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FX Compass

Contents

Stuart Bennett
Head G-10 FX Strategy
stuart.bennett@santanderCIB.co.uk
Banco Santander, S.A. London Branch
(+44) 33114 80134

Michael Flisher
G-10 FX Strategy
michael.flisher@santanderCIB.co.uk
Banco Santander, S.A. London Branch
(+44) 33114 80232

Jankiel Santos
Economist – Brazil
jankiel.santos@santander.com.br
Banco Santander Brazil S.A.
(+55) 11 3012 5726

Guillermo Aboumrad
Economist – Mexico
gjaboumrad@santander.com.mx
Banco Santander Mexico, S.A.
(+52) 55 5257 8170

Juan Pablo Cabrera
Chief Rates & FX Strategist, Chile
jcabrera@santander.cl
Banco Santander Chile S.A.
(+56) 22 320 3778

Juan Miguel Arranz
Chief Rates & FX Strategist, Argentina
jarranz@santanderrio.com.ar
Banco Santander Río S.A.
(+54) 11 4341 1065

Mike Moran
Latin America Rates & FX Strategist
mike.moran@santander.us
Santander Investment Securities, Inc
(+1) 212 350 3500

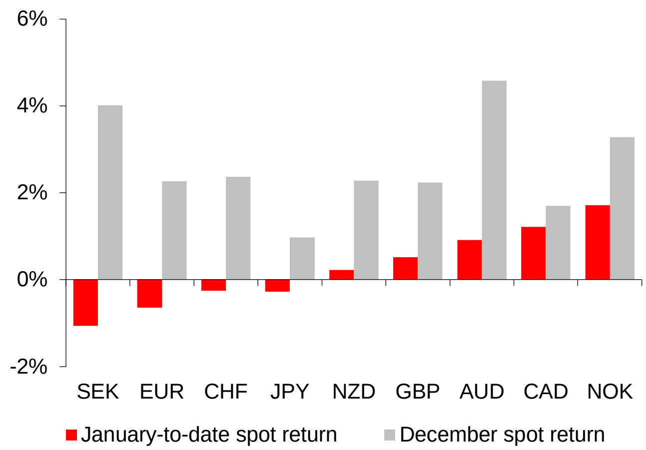
Marcin Sulewski, CFA
CEE Economist
marcin.sulewski@santander.pl
Santander Bank Polska S.A.
(+48) 22 534 1884

Wojciech Mazurkiewicz
CEE Economist
wojciech.mazurkiewicz@santander.pl
Santander Bank Polska S.A.
(+48) 22 534 1886

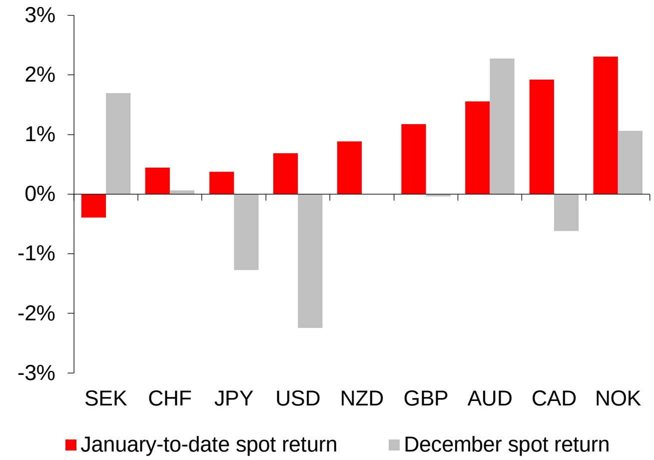
Santander Interest Rate & FX Strategy in Bloomberg: SRFS <GO>

FX Spot Returns

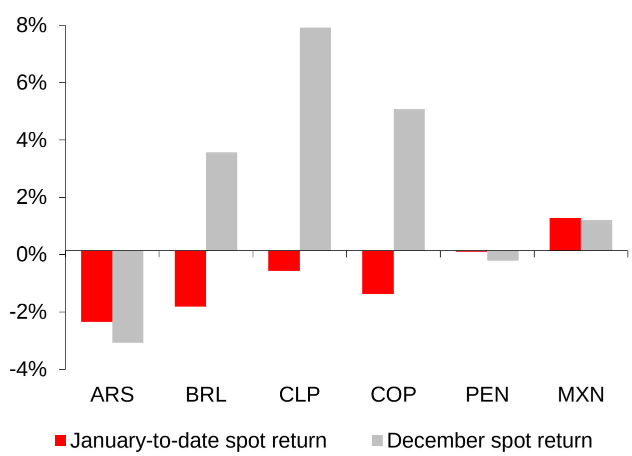
G10 spot returns vs. USD



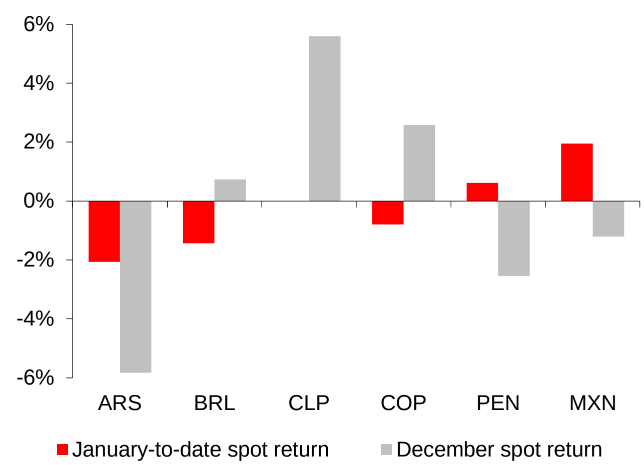
G10 spot returns vs. EUR



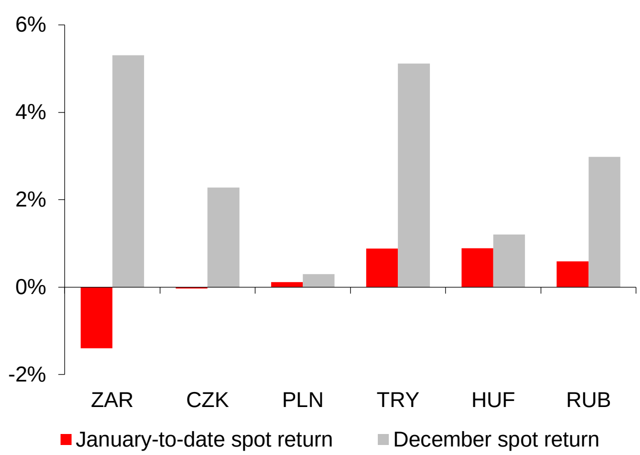
LatAm spot returns vs. USD



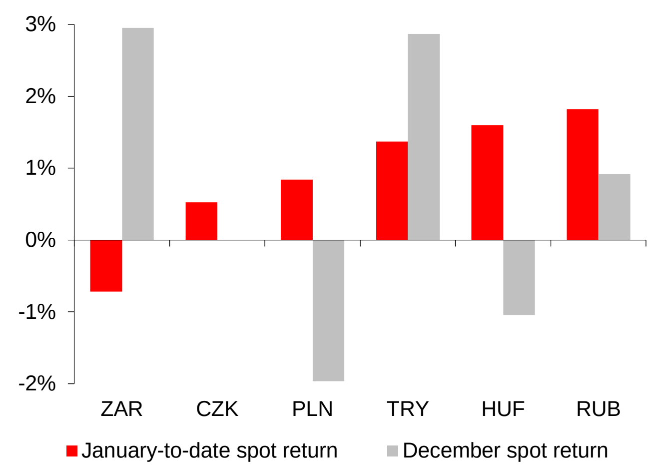
LatAm spot returns vs. EUR



CEEMA vs. USD



CEEMA vs. EUR



Source: Bloomberg, Santander. Note: Data current as at 21-January-2021 at 14:30 GMT

FX Forecasts

G10 FX Forecasts

	Q1-21	Q2-21	Q3-21	Q4-21	Q1-22	Q2-22
EUR-USD	1.21	1.21	1.21	1.22	1.22	1.20
GBP-USD	1.35	1.38	1.37	1.36	1.35	1.35
GBP-EUR	1.12	1.14	1.13	1.11	1.11	1.13
EUR-GBP	0.90	0.88	0.88	0.90	0.90	0.89
USD-JPY	104	106	107	108	110	110
EUR-JPY	126	128	129	132	134	132
USD-CNY	6.50	6.50	6.65	6.65	6.70	6.70
EUR-CHF	1.08	1.08	1.10	1.11	1.12	1.12
USD-CHF	0.89	0.89	0.91	0.91	0.92	0.93
EUR-SEK	10.1	10.0	9.9	9.8	9.6	9.5
EUR-NOK	10.5	10.4	10.2	10.0	9.9	9.8
USD-CAD	1.28	1.27	1.26	1.27	1.28	1.30
AUD-USD	0.74	0.75	0.76	0.77	0.77	0.78
NZD-USD	0.71	0.71	0.72	0.73	0.74	0.75

LatAm FX Forecasts

	Q1-21	Q2-21	Q3-21	Q4-21	Q1-22	Q2-22
USD-BRL	5.25	5.15	4.90	4.60	4.50	4.50
USD-MXN	19.8	20.0	20.5	21.0	21.2	21.5
USD-CLP	735	740	750	760	765	765
USD-COP	3350	3500	3650	3400	3650	3850
USD-ARS	93	104	115	128	136	146
USD-PEN	3.65	3.55	3.50	3.40	3.35	3.40
EUR-BRL	6.35	6.23	5.93	5.61	5.49	5.40
EUR-MXN	24.0	24.2	24.8	25.6	25.9	25.8
EUR-CLP	889	895	908	927	933	918
EUR-COP	4054	4235	4417	4148	4453	4620
EUR-ARS	113	126	139	156	166	175
EUR-PEN	4.42	4.30	4.24	4.15	4.09	4.08

CEE FX Forecasts

	Q1-21	Q2-21	Q3-21	Q4-21	Q1-22	Q2-22
EUR-PLN	4.50	4.40	4.30	4.30	4.30	4.30
EUR-CZK	26.4	26.3	26.1	25.8	25.6	25.3
EUR-HUF	355	367	369	370	371	372
USD-RUB	77	78	79	81	83	85
EUR-RUB	93	94	96	99	101	102

Sources: Santander

G10 FX: Main Themes

Currency	3M view	12M view	Main Themes
USD	⇨	↘	• The USD has made a steady start to 2021. The prospect of more US stimulus should keep risk assets bid and the USD under pressure. But, after the big sell-off in 2020, the USD could be more stable for a while.
EUR	⇨	↗	• We remain positive on the euro and still favour gradual gains versus the USD in the months ahead. Risk appetite should remain firm but a vulnerable economy and low Eurozone interest rates may weigh.
GBP	⇨	↗	• Sterling has been helped by the EU-UK trade agreement. Another national lockdown will weigh on the economy in Q1-21, but if global risk appetite remains firm, the pound should hold on to most of its recent gains.
JPY	⇨	↘	• The yen is firm against the USD and soft against other currencies. This should remain the position for a while, but widening GDP and inflation differentials in H2-21 may allow the market to be more yen-negative.
CNY	⇨	↗	• The economy continues to recover in 2020, China grew by 2.3% despite the pandemic. The PBoC is expected to reduce monetary stimulus slowly but high Chinese yields should continue to support the CNY.
CHF	⇨	↘	• The SNB still views the CHF as very highly valued, and with CPI negative, will try to limit further franc strength. However, being labelled an FX manipulator by the US may limit its room for manoeuvre.
CAD	⇨	⇨	• A softer USD has pulled USD/CAD lower. Economic data is improving, but the recovery is set to be gradual, with interest rates on hold and the CAD now likely to move sideways if oil does not rise further.
AUD	↘	⇨	• A global economic recovery should be AUD-supportive, but after significant gains, it may be a case of buy the rumour, sell the fact for AUD/USD. Australia's deteriorating relationship with China is still a risk for the AUD.
NZD	⇨	↗	• A vaccine-led global economic rebound should be NZD-supportive. But significant recent gains, a two-year high net-long speculative position, and the pricing out of any RBNZ rate cuts should limit near-term gains.
SEK	⇨	↗	• Despite a strong performance in 2020, any further rise in risk sentiment and global trade should boost the SEK again in 2021. However, after such strong gains, the SEK may struggle to climb even further in early 2021.
NOK	⇨	↗	• The NOK's direction will again depend on the evolution of the Covid-19 pandemic and oil prices this year. However, the currency is likely to benefit in H2-21 as the prospect of a first rate hike from the Norges Bank nears.

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

Source: Santander

G10 FX Overview

Stuart Bennett
stuart.bennett@santanderCIB.co.uk
(+44) 33114 80134

Michael Flisher
michael.flisher@santanderCIB.co.uk
(+44) 33114 80232

We expect the USD to be more stable over the coming month. The FX market has started 2021 still driven by its stance on risk appetite. The small pick-up in the USD is in line with New Year nervousness on the part of the market amid rising Covid-19 infections, lockdown restrictions and slightly softer equity markets. Hence the FX market remains unwilling to differentiate positive US factors as specifically USD-positive and has continued with a simplistic trading strategy of selling the dollar when the risk/economic outlook appears bright and buying when jitters reappear.

The euro has made a soft start to 2021. Concerns over a double-dip recession, the pace of the vaccine rollout within the EU and some internal political uncertainty have weighed on the currency. But the prospect of further US stimulus and expectations that the global economy will improve in 2021 should prevent further euro weakness, even if the currency merely moves sideways over the coming months.

The pound has started 2021 positively, holding on to the gains made in Q4-20. The market was relieved that the EU and UK agreed a trade deal at the end of last year. However, GBP/USD’s performance continues to owe much to global risk factors and a soft USD. Another UK-wide lockdown will cut Q1-21’s activity, but if the BoE does not ease policy further and the UK’s roll-out of the Covid-19 vaccine continues apace, sentiment towards sterling should remain robust.

The yen has remained under pressure against many of its developed market peers but has stayed firm against the USD. This does not look likely to change in H1-21. Hence, we have revised down our USD/JPY forecasts to account for this (104 in Q2-21 and 108 in Q4-21)

The renminbi has remained strong. The currency continues to be supported by China’s economic outperformance and high yields and the hope that a new US administration will reduce US-Chinese tensions. These factors should keep the currency firm, but a more stable USD suggest that the decline in USD/CNY should slow, or even stop.

The Swiss National Bank continues to see the CHF as highly valued and has maintained its pledge to intervene to weaken it, despite being labelled an FX manipulator by the US Treasury. EUR/CHF has kept to a tight range since mid-November, with the cross averaging 1.08 despite a firmer euro as the franc has strengthened against a weak USD.

We are neutral on the CAD, at least against the USD. The combination of a weak USD and firm oil has pulled USD/CAD below 1.3000. But with Canadian monetary policy set to remain loose throughout 2021 and the oil price not forecast to rise further, USD/CAD could find itself treading water for extended periods and vulnerable to a pick-up in USD sentiment.

A global economic recovery should be supportive for risk currencies in 2021, but AUD/USD and NZD/USD have had a very strong 9-months. Indeed, both pairs have now unwound not just their Q1-20 Covid-led decline, but also their 2018/19 US-China trade war-led decline. Hence, the optimism of a global recovery is already largely in the price, in our view, thereby skewing near-term risks to the downside.

Despite a very good year for the SEK in 2020, the prospect of a vaccine-led global growth recovery should further boost the SEK in 2021, even if additional gains near-term may be limited. We are also positive the NOK but note the currency’s dependence on the evolution of the Covid-19 pandemic and oil prices for direction. The prospect of a first rate hike should be NOK supportive in late 2021.

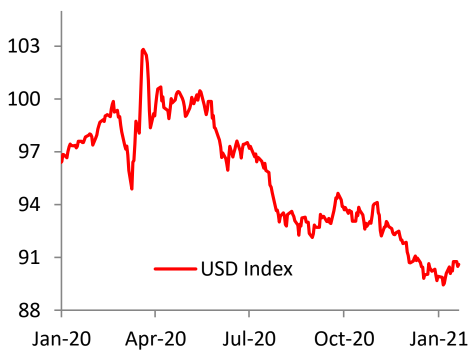
USD – Pausing for breath?

Stuart Bennett
stuart.bennett@santanderCIB.co.uk
(+44) 33114 80134

We expect the USD to be more stable over the coming month. The FX market has started 2021 still driven by its stance on risk appetite. The small pick-up in the USD is in line with New Year nervousness on the part of the market amid rising Covid-19 infections, lockdown restrictions and slightly softer equity markets. Hence the FX market remains unwilling to differentiate positive US factors as specifically USD-positive and has continued with a simplistic trading strategy of selling the dollar when the risk/economic outlook appears bright and buying when jitters reappear.

The perkier dollar at the start of the year may also imply that much of the current 'risk factors' have now been adequately priced into the currency. And after selling the USD aggressively in 2020, the market is now pausing for thought. However, this pause may not signal an imminent rebound in the currency. Despite the dip in risk appetite at the start of the year, the prospect of the Biden administration pushing ahead with further stimulus and the vaccine roll-out should keep risk appetite firm, which should keep the USD under pressure, but we believe there are factors which could help it escape another big sell-off in 2021.

Chart 1: USD index since the start of 2020

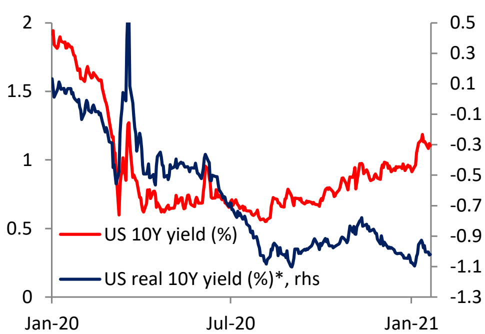


Source: Bloomberg, Santander

The USD is broadly back to early 2018 levels, before the 2018-19 USD bull run started. Indeed, whilst it took two years for the USD index to rise from sub-90 levels to a high at 103, it only took 9 months for those gains to be reversed. The speed of the decline is not a guarantee against further weakness, but with the USD 'relatively' cheap, the market may have less appetite to chase it lower, particularly if US-positive factors start to be viewed as USD-positive.

So even if risk appetite remains firm, the risk trade may become more nuanced if economic data shows the US economy, normally viewed as more flexible and dynamic than its peers, picking up faster. The prospect of the Biden administration pushing ahead with additional stimulus measures and the Covid-19 vaccine roll-out should boost economic sentiment in 2021, particularly later in the year as the benefits are felt.

Chart 2: Nominal US yields offer the USD some support, but real yields point to a steady or weaker dollar



Source: Bloomberg, Santander *Using 10Y breakeven rates

The question is whether economic recovery will be viewed solely as globally risk-positive and USD-negative or US-positive. The direction the market jumps on this may depend on the impact on US yields. In nominal terms, yields have been rising since early August and reached a recent high at 1.14% in January. But, overall, the yield remains historically low and insufficient to boost the USD given the market's focus on risk.

In addition, the USD-positive nature of rising nominal yields did not fit with the H1-20 consensus trade to sell the USD. Hence, focus moves to real US yields, using 10Y breakeven rates to calculate. The real yield is more in line with the USD index's performance, and with FOMC members willing to accept above-target inflation, negative real yields may keep the USD heavy. But the change in yield differential with the Eurozone, whether real or nominal, does suggest that the USD may have been oversold against the euro in Q4-20 (see EUR section).

The nominee for next US Treasury Secretary and ex-FOMC Chair Janet Yellen stated her support for further stimulus and added that the US is not seeking a weaker USD to gain an economic advantage and that the USD's value should be determined by the market. This was interpreted as suggesting that the new administration will not adopt the 'strong dollar' policy stance. However, the adoption of this verbal policy has not in the past prevented the currency from moving in either direction or is viewed as largely symbolic, although it has some relevance in encouraging participants to hold the world's main reserve currency.

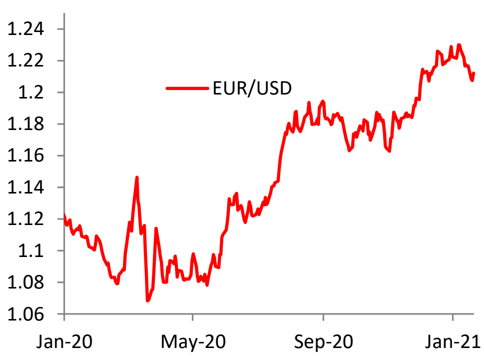
EUR – Slipping into 2021

Stuart Bennett
stuart.bennett@santanderCIB.co.uk
(+44) 33114 80134

The euro has made a soft start to 2021. Concerns over a double-dip recession, the pace of the vaccine rollout within the EU and some internal political uncertainty have weighed on the currency. But the prospect of further US stimulus and expectations that the global economy will improve in 2021 should prevent further euro weakness, even if the currency merely moves sideways over the coming months.

The euro has been one of the worst performing developed market currencies since mid-December, only marginally outperforming the NZD and SEK. EUR/USD reached a high at 1.2349, its highest since 20 April 2018, before slipping back. In our opinion, there are a few factors that may explain the euro's New Year dip and whilst the currency should remain firm, those factors could now be viewed as likely to prevent significant appreciation over the next few months.

Chart 3: EUR/USD since January 2020



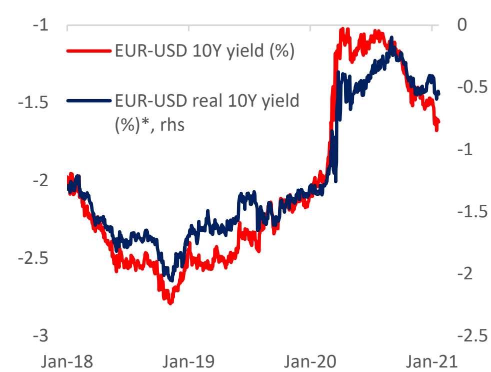
Source: Bloomberg, Santander

First, the long risk and short USD positioning that dominated Q4-20 may have run out of steam. The market sold the US dollar aggressively and by default bought EUR/USD. The move higher in EUR/USD was swift and in the new year the market may be pausing for reflection to decide if there is sufficient justification to pull the pair higher. Either way, EUR/USD gains have lost some momentum.

Second, in Q4-20 another dose of US stimulus had been viewed as positive for global risk and therefore a USD negative. However, the market could change its interpretation of stimulus and the new US administration and instead see US stimulus leading to a better US economic outlook as more USD-positive and less euro-friendly.

Third, concern over a double-dip Eurozone recession could compare unfavourably with a stimulus-driven US recovery, with higher US yields potentially acting as a brake on EUR/USD gains. As we noted in the USD section, US yields have been rising since August but remain historically low and therefore have been unable to provide the type of carry support that the USD received against the euro in 2018-19.

Chart 4: Both nominal and real EUR-USD 10Y spreads have moved against the euro



Source: Bloomberg, Santander

Fourth, the spread between EUR and US 10Y yields has also tended to move in the USD's favour for several months. But the FX market has ignored this and in Q4-20 continued to bid EUR/USD higher even when nominal spreads suggested the pair was being overbought amid firm risk appetite. Indeed, the story is not that different if we look at real yield spreads, adjusting the yields using 10Y breakeven rates.

From Q2-20, as risk appetite improved and the FX market responded to the Fed taking US rates near zero, EUR/USD followed that real 10Y yield spread higher. But as spreads widened in Q4-20 against the euro, EUR/USD still appreciated. Indeed, the 'dip' in EUR/USD at the start of 2021 can be explained by the decline in the yield spread in January.

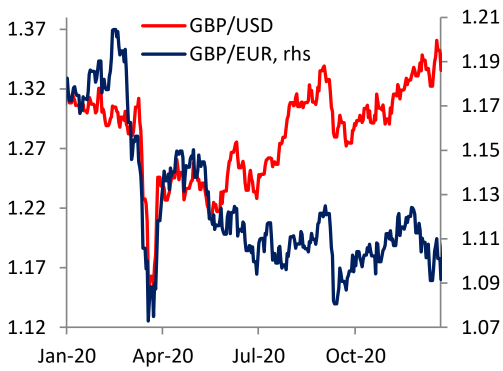
Fifth, the IMM commitment of traders' report showed the biggest rise in net-long EUR/USD positions for over a month in the week ended 12 January. Whilst this is euro positive, it also means that the overall net long position continues to look very stretched, which suggests to us less room for fast money accounts to easily and significantly bet in favour of the euro in the coming months.

Sixth, at its January meeting, the ECB reiterated short-term risks due to Covid-19, although vaccine roll-out will help confidence. Lagarde indicated that underlying price pressures remain subdued and the ECB is monitoring FX rates closely. December CPI showed headline inflation at 0.3% YoY, well below the target of close to but below 2% YoY.

GBP – Still focussed on risk

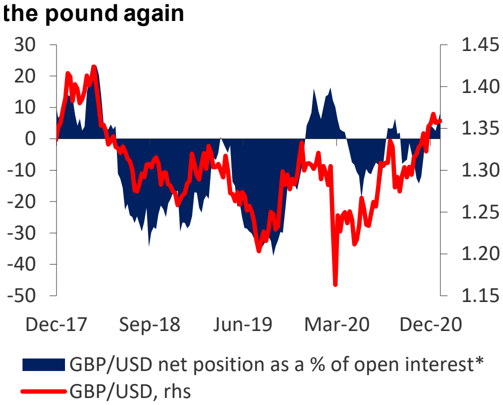
Stuart Bennett
stuart.bennett@santanderCIB.co.uk
(+44) 33114 80134

Chart 5: Sterling since the start of 2020



Source: Bloomberg, Santander

Chart 6: Speculators are starting to favour the pound again



Source: CFTC, Bloomberg, Santander *OI=Total long and short contracts

The pound has started 2021 positively, holding on to the gains made in Q4-20. The market was relieved that the EU and UK agreed a trade deal at the end of last year. However, GBP/USD's performance continues to owe much to global risk factors and a soft USD. Another UK-wide lockdown will cut Q1-21's activity, but if the BoE does not ease policy further and the UK's roll-out of the Covid-19 vaccine continues apace, sentiment towards sterling should remain robust.

The FX market was relieved that the Brexit trade deal was agreed before the end of 2020. However, it did not give the pound a massive boost. This suggests that 1) the spot market assumed a deal was the likely outcome; 2) the focus had shifted to global risk/the USD/the consequences of Covid-19; 3) the deal agreed was akin to the 'hard Brexit', no single market and customs union membership which GBP/USD at c.1.35 had already priced in. We recall that GBP/USD was at c.1.50 at the start of 2016; and 4) it just covers manufacturing, implying ongoing uncertainty surrounding trade in services.

The risk surrounding a trade deal may also have been asymmetric, with the pound likely to weaken on no-deal, but taking an agreement more in its stride. Hence, even though sterling has had a robust start to 2021, it is still moving in line with the risk/commodity currencies (AUD, NZD, NOK, CAD and SEK), suggesting that global risk and the USD remain key drivers.

However, the Brexit trade deal did have more of a notable impact on sterling volatility. The options market seemed more cautious and nervous about a deal being reached. Hence GBP/USDV1M was over 14 in mid-December, but fell below 8 in mid-January. Despite the decline, volatility remains above EUR/USDV1M, at 6.25, which again may hint at some lingering post-Brexit anxiety within the FX market.

The near-term focus should remain on global risk, the USD and the economic impact of Covid-19. The decline in November's GDP was less than expected: the economy contracted 2.5% MoM. We expect growth of 0.6% QoQ in Q4-20, but for activity to shrink 3.7% QoQ in Q1-21.

Weak UK growth will not be GBP-positive, but given that other developed economies are also expected to post slower growth, the pound should be able to shrug off some of its impact. Further, the UK is currently outperforming its peers in terms of the vaccine roll-out, which may be viewed as a gauge of how quickly economies will be able to recover, and therefore should continue to be supportive for sterling sentiment. BoE Chief Economist Haldane suggested that the economy could recover 'at a rate of knots' in H2-21.

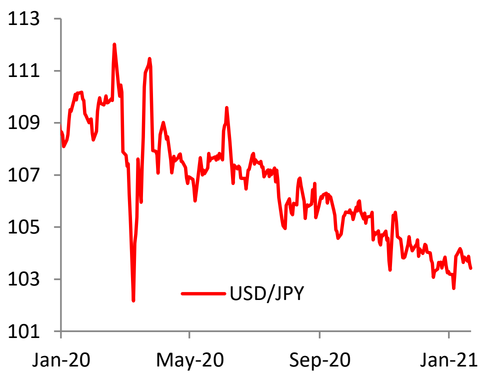
Admittedly risks remain, but the prospect of recovery should allow the BoE to avoid negative rates, again a stance that should be supportive for the pound. UK 10Y yields have picked up at the start of the year, but US yields also increased. Hence, GBP/USD continues to look expensive given nominal 10Y spreads. However, if inflation is taken account of, the real UK-EU yield spread, although still negative, does provide a further explanation for the pound's recent gains.

Finally, the IMM commitment of traders' report also provides some explanation for GBP/USD's resilience. The speculative net-long position rose to c.13k contracts in the week ended 12 January. This was the highest it has been since March 2020. That said, the position is still not very large - the all-time high is 98k contracts - which continues to highlight ample scope for fast money account to bet in favour of the pound if they want to.

JPY – A tale of two currencies, one weak and one firm

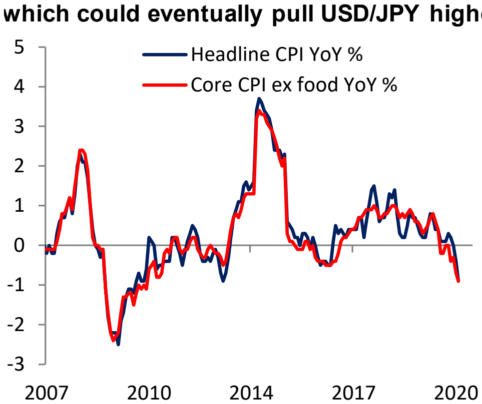
Stuart Bennett
stuart.bennett@santanderCIB.co.uk
(+44) 33114 80134

Chart 7: USD/JPY since the start of 2020



Source: Bloomberg, Santander

Chart 8: Inflation is forecast to remain low, which could eventually pull USD/JPY higher



Source: Bloomberg, Santander

The yen has remained under pressure against many of its developed market peers but has stayed firm against the USD. This does not look likely to change in H1-21. Hence, we have revised down our USD/JPY forecasts to account for this (H1-21 104 versus 110 previously and H2-21 108 versus 112).

We continue to highlight that a focus on USD/JPY, although understandable, can provide a misleading picture of the yen's general performance during the past year. The yen gained significantly against the USD in 2020 as US rates were cut close to zero and the USD was sold, given its status as safe-haven currency, amid a pick-up in risk appetite. Hence, US dollar weakness pulled USD/JPY lower.

However, the yen is also perceived as a safe-haven currency. Hence since the start of Q4-20, the yen has been the worst performing G10 currency, except for the USD. Consequently, for USD/JPY to rise in the near term, it may require one of several factors: 1) a decline in risk appetite, boosting USD demand; 2) a stronger US dollar if the market began to view US-positive factors, e.g. stimulus, as primarily USD-positive; or 3) a weaker yen caused perhaps by a unique decline in Japan's economic outlook or looser monetary policy.

On the first point, the consensus seems to be that the prospect of more US stimulus and the Covid-19 vaccine will simply encourage the market buy risk assets, which will weigh on the USD. Admittedly, the US dollar and USD/JPY have been a little more stable at the start of the year, which may signal that the USD/JPY sell-off is at or close to its bottom, but does not mean that the pair will find it easy to reverse this decline in H1-21.

The second point may become more relevant in H2-21. The stimulus and vaccine support for the US economy could start to show up clearly in US economic data. Given the view that the US economy is more 'flexible' than its peers, any differentiation in activity data and signs that the US is outperforming could start to be seen as USD-positive rather than exclusively risk-positive.

The third factor seems least likely at the moment. At its January meeting, the BoJ kept its policy unchanged, with the depo rate at 0.1% and the JGB target at around zero. It still expects the economy to improve, but slowly. The fiscal year 2020 GDP forecast was cut to -5.6% from -5.5%, but the FY21 estimate revised up to 3.9% from 3.6%. It extended its loans schemes to help businesses access credit for another year.

Like the SNB, the BoJ's policy dilemma focuses on low inflation. The December CPI rate is expected to drop below -1% YoY. Some of this disinflationary pressure is due to temporary factors, but the Bank still only forecasts core CPI of -0.5% YoY in FY20 and 0.5% YoY in FY21. Hence, inflation differentials could have more of an impact on yen sentiment in H2-21 and 2022. If Japanese price pressures remain low as other countries' rise amid the end of lockdown measures, this could be viewed as yen-negative even if the BoJ does not ease monetary policy further.

Indeed, the March BoJ meeting will include a review of its monetary policy. There has been speculation that the Bank may adopt a wider JGB trading range. Governor Kuroda also stated that the role of negative rates is included in the review. Allowing the 10Y yield to fluctuate in a wider range, or possibly making any change to the policy framework that is not clearly further easing would, in our opinion, risk further USD/JPY weakness.

CNY – Boosted by positive economic growth in 2020

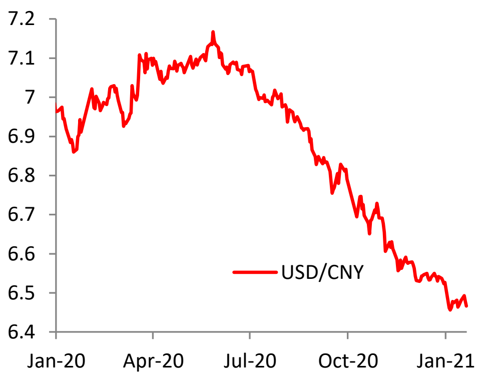
Stuart Bennett
stuart.bennett@santanderCIB.co.uk
(+44) 33114 80134

The renminbi has remained strong. The currency continues to be supported by China's economic outperformance and high yields and the hope that a new US administration will reduce US-Chinese tensions. These factors should keep the currency firm, but a more stable US dollar at the start of 2021 suggest that the decline in USD/CNY should slow, or even stop.

The renminbi continued its advance against the USD at the very start of 2021. USD/CNY hit a low at 6.43 compared to the 2020 high at 7.1777 set on 27 May 2020. Indeed, in 2020 the yuan gained around 7% versus the USD in spot terms. This was the biggest advance amongst Asian currencies, but behind EUR/USD's 9% rise. The 2020 sell-off was primarily driven by USD weakness; a firmer dollar at the start of 2021 has pulled USD/CNY off that 6.43 low.

Hence, a weaker US dollar might not be relied upon to pull down USD/CNY, but other domestic factors that supported the renminbi in 2020 remain in place. Chinese yields remain high and broadly CNY supportive. However, the 10Y yield is back around 3.18%, compared to the 2020 high set in November at 3.372%. Hence, the spread to US 10Y yields has narrowed to around 208bp from November's peak at 251bp as US yields have moved higher.

Chart 9: USD/CNY since the start of 2020



Source: Bloomberg, Santander

In addition, reflected in the high Chinese yields, China's economic recovery has continued. The economy grew faster than expected at the end of 2020. The GDP data for Q4-20 showed growth at 6.5% YoY compared to 4.9% YoY in Q3-20. Hence, the economy grew by a better-than-expected 2.3% in 2020, compared to the consensus forecast for the US economy to shrink 3.5% in 2020 and the Eurozone to contract 7.3% YoY. China is also expected to outperform the US and Europe in 2021.

Moreover, the recovery is being led by both export and domestic demand. The PMI indices did slip at the end of 2020 but remain above 50, indicating that manufacturing and services are expanding. Exports rose 18.1% YoY in December, with import demand climbing 6.5% YoY. The trade surplus for 2020 was $535bn, a 27% rise from 2017. Exports to the US rose 34.5% YoY in 2020, with imports up 47.7% YoY, taking the surplus to $317bn, a 7% rise on 2019.

Chart 10: Chinese growth improved at the end of 2020, allowing full-year growth at 2.3%

Source: Bloomberg, Santander

Inflationary pressures also rose at the end of last year. Headline CPI was 0.2% YoY in December, up from -0.5% YoY. But the increase may have been caused by weather disruption and efforts by the government to clamp down on an increase in Covid-19 infections. Hence, despite the stronger economy, slow inflation should still allow the PBoC to retain its current accommodative monetary policy.

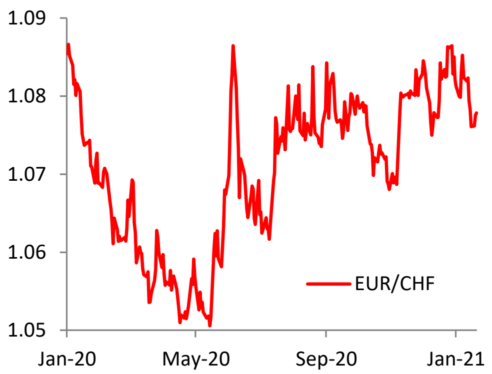
Towards the end of last year, PBoC rhetoric appeared to be pushing back against speculation that a strong recovery would allow for a less accommodative monetary stance. In December, the Bank stated that the main priority was stability and not to make a sharp turn. Hence the market was surprised in mid-January when the Bank offered CNY500bn in medium-term loans, which implied the first withdrawal of cash from the financial system since July. However, a significant tightening of policy is not expected and liquidity will be boosted ahead of the Lunar New Year holiday in mid-February. January's move may indicate that with economic recovery on course, policymakers may be shifting their focus back to dealing with potential financial risks caused by high debt levels.

CHF – FX manipulation or monetary policy?

Stuart Bennett
stuart.bennett@santanderCIB.co.uk
(+44) 33114 80134

The Swiss National Bank continues to see the CHF as highly valued and has maintained its pledge to intervene to weaken it, despite being labelled an FX manipulator by the US Treasury. However, EUR/CHF has kept to a tight range since mid-November, with the cross averaging a rate close to 1.08 despite a firmer euro as the franc has strengthened against a weak USD. Policymakers expect growth to rebound in 2021 but inflation to remain very low for longer. However, with policy rates very negative, scope for further action to boost prices and weaken the currency could prove difficult.

Chart 11: EUR/CHF since the start of 2020 – off of its lows, but still 'highly valued'?



Source: Bloomberg, Santander

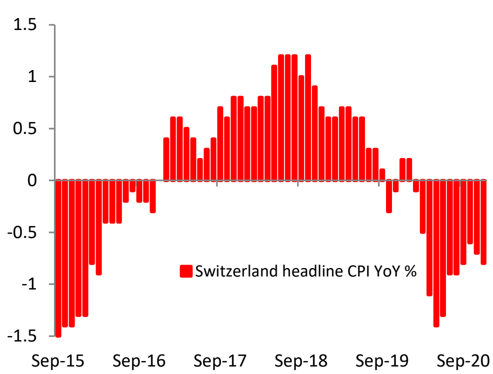
The weak US dollar contributed to pulling USD/CHF to a low of 0.8758 at the start of 2021, its lowest since January 2015. The franc's weakness against the USD, despite both currencies being viewed as safe havens, has meant that EUR/CHF has not benefited from the stronger EUR/USD over the past few months, with EUR/CHF anchored around the 1.08 average level since mid-November.

The SNB kept its policy unchanged at the 17 December meeting. The deposit rate was kept at -0.75%, where it has been since January 2015. President Jordan reiterated that the Bank views the CHF as 'highly valued'. And, a day after being labelled an FX manipulator by the US Treasury, Jordan stated that the announcement has no impact on its policy.

Indeed, the SNB strengthened its language, stating that it "remains willing to intervene <u>more strongly</u> in the FX market". In our opinion, it was necessary for the SNB to push back against US criticism of its intervention as otherwise the FX market would likely have pushed the franc higher to test the Bank's resolve to maintain its policy.

Further, the SNB reiterated that that its intervention was not designed to manipulate FX rates but instead to ensure the effectiveness of its monetary policy and therefore price stability.

Chart 12: Inflation remains negative as the CHF remains firm



Source: Bloomberg, Santander

Given the arrival of a new US administration, the pressure on the Swiss about intervention may ease. But with the Eurozone economy looking like suffering a double-dip recession, with growing concern over the spread of Covid-19 infections and economic restrictions as well as the speed of the vaccine roll-out, the euro could be vulnerable over the coming weeks.

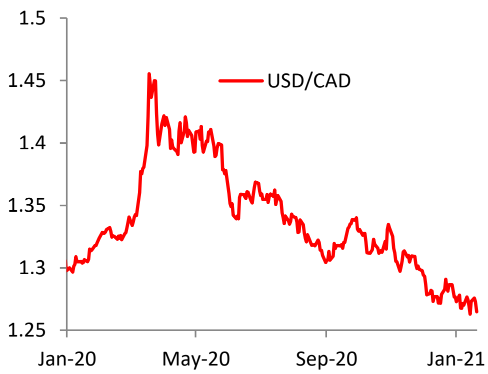
However, with the depo rate at -0.75%, the SNB's balance sheet at 140% of GDP and FX reserves at a record high in November 2020, it remains questionable what the SNB can do to unilaterally weaken the CHF, at least against the euro. Admittedly, quarterly data did show that the Bank spent CHF11bn in Q3-20 on intervention, bringing the total for the first nine months of 2020 to CHF100bn. But weekly data for total Swiss sight deposits, considered an indicator for intervention, have recorded little change for several weeks, hinting that even before the US announcement, the Bank may have not been aggressively pushing back against CHF strength.

The SNB's forecasts continue to highlight why it has a low pain threshold to further CHF strength. It expects the economy to have contracted around 3% in 2020 and to grow 2.5-3.0% in 2021. But it sees CPI staying low at 0% in 2021, 0.2% in 2022 and only 0.5% in Q3-23. Such low inflation forecasts might normally trigger further policy easing; the fact that they have not may highlight the sparseness of the Bank's policy options.

CAD – Further gains need a higher oil price

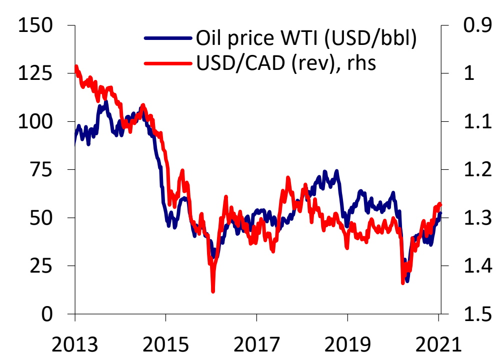
Stuart Bennett
stuart.bennett@santanderCIB.co.uk
(+44) 33114 80134

Chart 13: USD/CAD since the start of 2020



Source: Bloomberg, Santander

Chart 14: If the oil price remains steady, the CAD may find it hard to generate further gains even as the BoC sounds more optimistic



Source: Bloomberg, Santander

We are reasonably neutral on the CAD, at least against the USD. The combination of a weak US dollar and firm oil has pulled USD/CAD below 1.3000. But with Canadian monetary policy set to remain loose throughout 2021 and the oil price not forecast to rise further, USD/CAD could find itself treading water for extended periods and vulnerable to a pick-up in USD sentiment.

The CAD's focus tends to primarily be on USD/CAD. As such, the currency has continued to perform well, not just over the last month, but since the start of Q4-20. However, a lot of the decline in USD/CAD has been driven by USD weakness rather than the CAD.

Either way, the pair reached a low at 1.2625 at the start of January, its lowest level since 26 April 2018. The CAD has also remained bid against the other safe havens (JPY, CHF and to a lesser extent the euro) as risk appetite has remained high. That said, the CAD is often the underperformer within the risk/commodity group of G10 currencies (NOK, SEK, AUD, NZD and now GBP).

We expect USD/CAD to be more stable over the coming months. First, the BoC remains committed to an unchanged monetary policy. Second, the oil price is not expected to post further big gains. Third, further US stimulus should keep risk appetite elevated but this may no longer be viewed as a USD negative.

The Bank of Canada kept its monetary policy unchanged at its January meeting. The Bank did feel able to revise its economic forecasts slightly higher, helped by a faster than expected roll-out of the Covid-19 vaccine. It now expects growth at 4% in 2021, 4.8% in 2022 and 2.5% in 2023, but inflation is not expected to return sustainably to its 2% target until 2023, which still implies no change to rates anytime soon. In addition, Governor Macklem warned that whilst the rise in the CAD was primarily caused by the soft USD, it does pose some risks to the outlook.

Hence, changes in policy rates and yields are not expected to influence USD/CAD much. Indeed, the pair has decoupled from both the nominal and real USD-CAD 10Y spread since the start of Q4-20, with the pair much cheaper than the spreads alone would suggest. It may need a significant move higher in US 10Y yields, with Canadian yields not following, for spreads to be a driver of USD/CAD again. Further, US stimulus may eventually encourage the market to bet on such a move, but it does not look likely in H1-20.

Aside from the soft USD and strong risk appetite, the CAD has also been supported by a firmer oil price. The Brent oil price reached USD57.42/bbl, rallying after OPEC+ as a whole agreed to keep oil output steady rather than bring more oil to the market. Further support came from Saudi Arabia's decision to make a unilateral cut of one million bbl/day to its oil production in February and March.

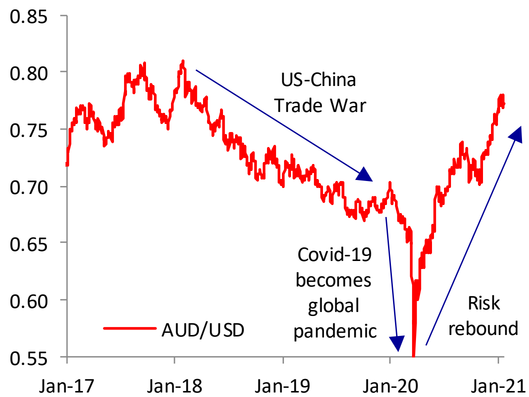
Based on Brent alone, and using a year's worth of data, we would suggest that USD/CAD is slightly on the cheap side and should be closer to 1.3000 rather than the current 1.2650. If the USD stabilises, it may require a higher oil price to pull the CAD higher or even keep it around its current levels. However, despite the vaccine roll-out holding out hope of rising demand in H2-21, the Bloomberg consensus oil forecast is bearish and expects Brent at USD54/bbl in Q4-20. This may be high enough to prevent the CAD significantly weakening but not enough to ensure gains from current levels.

AUD – Trading like it's 2017

Michael Flisher
michael.flisher@santanderCIB.co.uk
(+44) 33114 80232

We are neutral on the AUD in 2021. A global economic recovery should be supportive for risk currencies, but we believe this is already in the price for AUD/USD, thereby skewing near-term risks to the downside. Australia's deteriorating relationship with China is again a risk for the AUD in 2021, while the RBA is likely to keep monetary policy very loose. We still see AUD/USD dipping to 0.74 in Q1-21, before returning to 0.77 by year-end.

Chart 15: After a tough Q1-20, AUD/USD has performed well, unwinding both its Covid-19 and US-China trade war-led declines



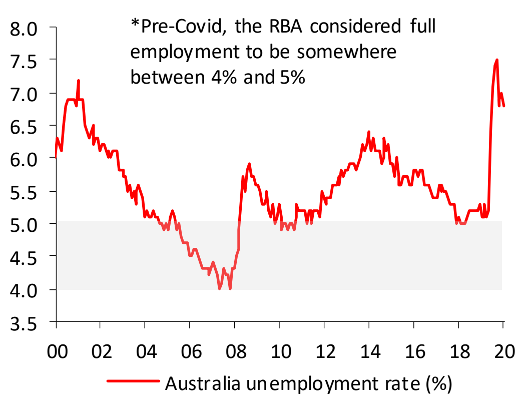
Source: Bloomberg, Santander

Like the other risk currencies, the AUD started 2020 on the back foot, with AUD/USD dropping by 13% in the first quarter, and even touching below 0.55 briefly (an 18-year low) as Covid-19 became a global pandemic. The AUD's rebound was quick though, with a 13% rise in the second quarter taking the pair back to the 0.70 level at which it began the year.

The AUD rose another 13% against the USD in the second half of the year, and while the pair had already unwound all of its Covid-led decline in Q2-20, it then unwound all of its 2018/19 US-China trade war fall in H2-20 (Chart 15).

Hence, while a global recovery in 2021 should be positive for a risk currency like the AUD, with AUD/USD having already unwound the declines of the past couple of years mainly on the hope and expectation of a global recovery, it may now be a case of buy the rumour and sell the fact for AUD/USD, with a global recovery merely justifying the move already seen. However, we accept that if the market keeps on selling the USD with conviction, this is an upside risk to AUD/USD.

Chart 16: With RBA decisions now based on actual inflation and employment data (rather than forecasts) these numbers will be closely watched in 2021



Source: Bloomberg, Santander

Australia has managed to avoid the high number of Covid-19 cases seen in many other developed market countries, with the c.30k cases equivalent to 0.1% of the population. Hence, while there have been various intense local lockdowns, the disruption has generally been less than in many other developed markets.

This has tended to help domestic data, although these have been mixed. PMI readings are strong, but the unemployment rate is elevated (Chart 16), while the firm 3.3% GDP rebound in Q3-20 followed quarterly contractions of 0.3% and 7.0%, respectively, as Australia fell into recession for the first time in 29 years.

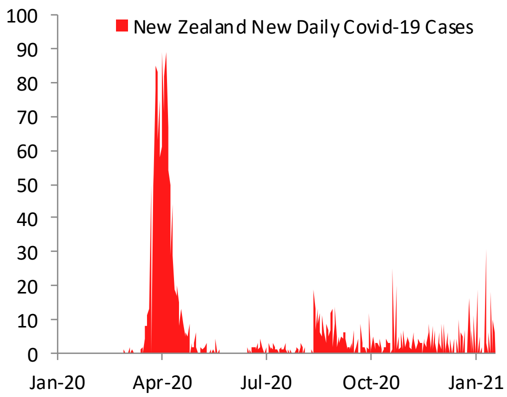
Hence, the RBA is likely to retain a very loose policy throughout 2021 and even suggests that the cash rate will not rise for "at least another three years". The Bank says it has "an open mind" on more QE, but any extension will depend on jobs, what other central banks are doing, and how financial markets are functioning. We would highlight, however, that since October, the Bank makes policy decisions based on actual inflation and employment, and not forecasts. Hence, these data should be even more closely watched for signs of RBA policy direction.

One persistent risk for Australia is the country's deteriorating relationship with its largest trading partner, China. Over the past year, China has imposed significant bans and tariffs on Australian beef, barley, and more recently wine, while Australia has blocked the sale of various domestic companies to Chinese buyers. We see this as just a risk for now, rather than a real weight on the economy or the AUD, but it is an area to pay attention to over the coming year, as tensions can quickly escalate.

NZD – Rebound looking done

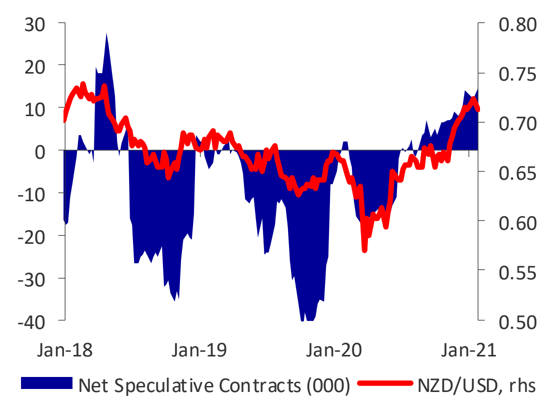
Michael Flisher
michael.flisher@santanderCIB.co.uk
(+44) 33114 80232

Chart 17: New Zealand's total Covid-19 count still sits just above 2000, while the new daily cases are extraordinarily low compared to developed market peers



Source: Bloomberg, Johns Hopkins, Santander

Chart 18: The net-long NZD/USD speculative position has reached its highest since May 2018



Source: CFTC, Bloomberg, Santander

We are marginally positive on the NZD for 2021 as a vaccine-led global economic rebound should be supportive for risk currencies. However, until this improvement is more imminent and tangible, we are cautious on the NZD, as it has gained significantly already in recent months, the net-long speculative NZD position is already at a two-year high, and an RBNZ rate cut has already been priced out while a rate hike is still a long way off. We continue for foresee NZD/USD holding close to 0.71 in Q1-21, before rising to 0.73 in Q4-21.

The NZD is in a relatively favourable position as risk currencies should benefit from a vaccine-led global rebound in 2021, while aside from border restrictions, New Zealand's domestic economy is not being hampered by the strict lockdown measures that have been extended and intensified throughout Europe in early 2021.

Indeed, while there was a relatively intense and immediate lockdown shortly after Covid-19 became a global pandemic in early 2020, continued lockdown measures in 2021 are not considered necessary in New Zealand, as the country's total number of Covid-19 cases sits at a couple of thousand, while new daily cases are mostly limited to single figures (Chart 17).

On the one hand, this means the domestic economy is now operating far more normally than elsewhere in the developed world. On the other, it implies that when much of the global economy does manage to rebound in 2021, New Zealand will likely have less scope for gains as it has already rebounded.

Indeed, while New Zealand fell into recession in H1-20 (with 1.2% and 11.0% QoQ contractions, respectively, in Q1 and Q2), the economy rebounded 14% QoQ in Q3-20. This means that unlike almost all its developed market peers, New Zealand's economy is already back above its pre-Covid pandemic peak.

But, with the rebound looking done, further gains may prove harder to come by, especially with the RBNZ forecasting small 0.3% and 0.2% contractions in Q4-20 and Q1-21. Hence, despite the absence of any significant domestic lockdown measures, the "V-shaped" recovery may yet turn into a "double-dip" recession.

We expect the RBNZ to keep rates on hold, at 0.25%, in 2021. However, because of the obvious uncertainty arising from the Covid-19 pandemic, the Bank has not yet taken negative rates off the table. In any case, subdued inflation and the recent rise in the unemployment rate ensure that monetary policy will need to remain stimulatory for a long time, with the Bank prepared to provide additional support if necessary.

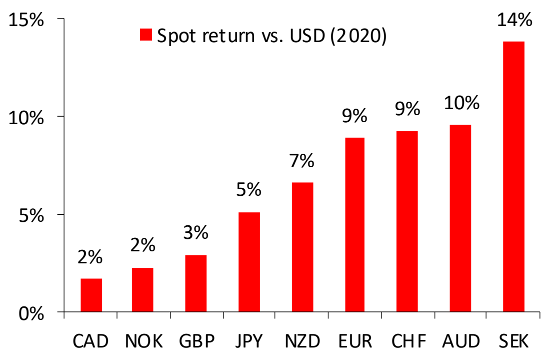
NZD/USD fell 12% in Q1-20, but the pair has risen 30% since, reaching a two-year high at almost 0.73 in early January. This does not just take the pair above its pre-Covid level of early 2020, but also back up to its pre-US/China trade war level of early 2018. With the currency's rebound looking largely done, any further notable NZD/USD gains may now rely on an even softer USD.

Understandably, speculators turned more positive on the NZD in late 2020. As such, the current net long NZD position (14.7k contracts) is its highest since May 2018 (Chart 18). While this position is still some way below its July 2017 high (36k contracts), it should imply more limited scope for NZD gains.

SEK – It was a very good year

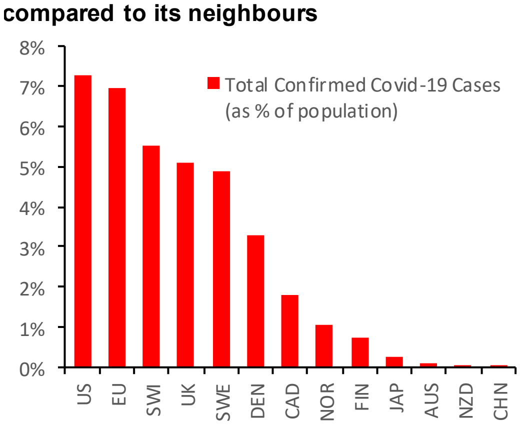
Michael Flisher
michael.flisher@santanderCIB.co.uk
(+44) 33114 80232

Chart 19: The SEK was the G10 currency outperformer in 2020



Source: Bloomberg, Santander

Chart 20: Sweden's hands-off approach to Covid appears to be coming to an end, amid legislative changes and a high case count compared to its neighbours



Source: Bloomberg, Johns Hopkins, Santander

We are positive on the SEK in 2021. Despite a very good year for the SEK in 2020, the prospect of a vaccine-led global growth recovery should boost global trade, and therefore continue to support currencies of trading economies like Sweden's. However, after falling sharply in Q4-20, EUR/SEK may struggle for significant further downside in early 2021, so we continue to forecast the cross ending Q1-21 close to its current 10.10, before dropping to 9.8 by year-end.

The SEK was the G10 currency outperformer in 2020 (Chart 19), gaining 14% in spot terms against the USD over the year, and almost 5% against the EUR. The currency has started 2021 on the back foot, as the G10 currency underperformer, but we foresee another strong year ahead for the currency, with the global economy set to rebound from the Covid-19 pandemic.

Such a rebound is unlikely to be immediate, however, as Covid-19 cases continue to rise throughout the world. In Sweden, the government's hands-off approach increasingly appears to have failed. Indeed, new daily cases in Sweden are among the highest they have been since the start of the pandemic, and the total count of just over 500k is far higher than its Nordic neighbours, and equates to almost 5% of Sweden's population (Chart 20).

In 2020, Sweden avoided a national lockdown and relied mostly on voluntary measures to fight the pandemic. In part, this was because the government lacked the legal framework to do more. However, it passed an emergency lockdown law in early 2021, which implies that firmer measures may be coming sooner or later, especially if cases continue to rise.

Before this spike in infections, and higher risk of new restrictions, the Swedish government revised its 2020 growth expectations up slightly, expecting only a 2.9% contraction (-4.6% previously). However, its growth forecast was revised lower to 3.0% for 2021 (from 4.1%) and 3.7% for 2022 (from 3.8%).

After squeezing in a rate hike in December 2019, the Riksbank kept the repo rate unchanged throughout 2020, at 0%. However, the Bank did expand its QE programme in April, July, and again in November, lifting the current programme to SEK700bn, and extending it until the end of 2021.

The Riksbank expects economic activity to decline in the near term, with the labour market deteriorating further and GDP contracting in both Q4-20 and Q1-21, with growth not recovering to pre-crisis levels until the end of the year.

Further, the Bank does not expect to reach its 2% CPIF target until 2023, which implies that the repo rate will remain stuck at 0% once again for the whole of 2021, as we continue to see a very high bar to returning to negative rates.

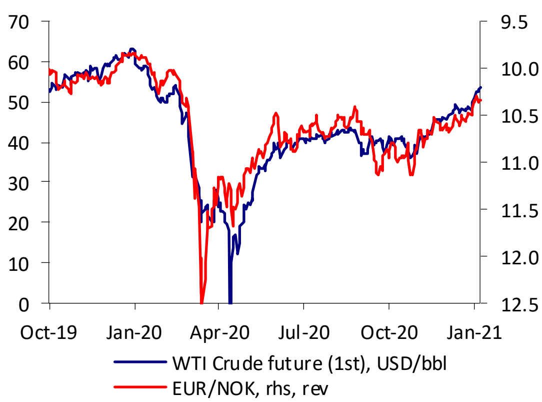
In January, the Riksbank announced its transition to fully self-financed FX reserves. Currently, the Bank's reserves are partly financed through government borrowing (SEK178bn). The Bank will replace this borrowing by purchasing around SEK5bn of foreign currency per month between February 2021 and December 2023. While this change does not impact monetary policy, it did have a negative impact on the currency.

NOK – Still following oil prices

Michael Flisher
michael.flisher@santanderCIB.co.uk
(+44) 33114 80232

We are positive on the NOK this year but would highlight the currency's dependence on the evolution of the Covid-19 pandemic and oil prices for direction over the coming months. Towards year-end, the NOK is also likely to pay more attention to the Norges Bank, as the prospect of a first rate hike nears. We continue to see EUR/NOK dropping to 10.0 in Q4-21.

Chart 21: The NOK is set to follow oil prices closely again in 2021



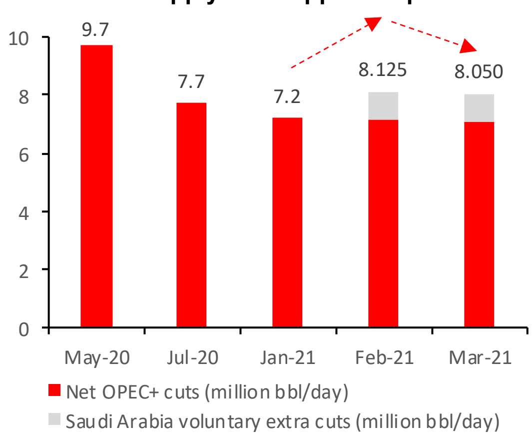
Source: Bloomberg, Santander

The NOK has begun 2021 on the front foot, leading all its G10 peers as it follows oil prices higher (Chart 21), as WTI crude reached over USD53/bbl for the first time since last February. Part of this rise is down to reduced supply. Indeed, since OPEC+ agreed to cut its oil output by 9.7mn bbl/day from May 2020, the market has been speculating on when these output cuts would be unwound further.

After reducing these cuts in July 2020, and January 2021, the group agreed to unwind an additional 0.75mn bbl/day in February and a further 0.75mn bbl/day in March (Chart 22). However, with OPEC's largest oil producer, Saudi Arabia, then announcing a 1mn bbl/day voluntary reduction in output in both February and March, oil supply is actually set to fall next month, thus supporting oil prices and the NOK.

Oil prices have likely also benefitted from the generally more positive news for risk sentiment over the past month, with the result of the US election now being settled, the hardest Brexit being avoided, and the rollout of Covid-19 vaccines gradually increasing throughout the world. However, the Covid-19 pandemic is still a huge source of uncertainty.

Chart 22: Saudi Arabia's voluntary output cuts should limit supply and support oil prices



Source: Bloomberg, Santander

Indeed, new daily Covid-19 cases in Norway, while still low as a proportion of the population, have reached record highs in January, while the number of global cases has now passed 95 million, with 500-750k new cases being announced every day.

Until these numbers drop drastically, economic conditions cannot normalise, and this should ensure the need for highly expansive monetary policy over the coming months.

Indeed, the Norges Bank kept the deposit rate on hold in January, at 0%, and suggested that rates would remain at this level for some time. However, while there was no monetary policy report released (thus no new forecasts), the Bank already surprised the market in December, bringing forward its forecasts for a rate hike to H1-22 (from late 2022), making it the most upbeat of the developed market central banks. The Bank's stance and forecasts will likely be increasingly watched as the year progresses, and a first rate hike becomes more imminent late this year, and early next year.

Norway's economy performed better than most developed market peers in 2020 but GDP contracted again in November and is still below its pre-Covid level. While December's manufacturing PMI was practically unchanged at 51.9 (slight expansion), the latest retail sales and industrial production data recorded month-on-month gains in December, while CPI also rose, with the headline rate climbing to 1.4% YoY (from 0.7%) and the underlying rate reaching 3.0% (from 2.9%).

LatAm FX: Main Themes

Currency	3M view	12M view	Main Themes
BRL	↗	↑	• Uncertainties regarding the influence of the second wave of Covid-19 on economic activity and the conduct of fiscal policy have intensified lately. • Additionally, the change in speakership in Congress has blurred the horizon for the resumption of discussions about the reform agenda. • Lastly, the recent uptick in inflation indices has led market participants to bring forward their expectations for interest rate hikes in Brazil in 2021.
MXN	↗	↘	• A second wave of lockdowns is affecting the world economy and Mexico is no exception. • The market seems bullish on the MXN on the prospects for continued fiscal austerity and a strong fiscal package in the US that could spill over to Mexico. • The more dovish members of the Banxico board in Mexico may hold the key to releasing pressure on MXN by re-engaging in cuts.
CLP	→	↘	• The external backdrop is improving for Chile, with a sustained rally in copper prices and a weakening global USD. • However, local factors would tend to depreciate the currency, especially by mid-2021, at the peak of the constitutional convention debates. • Local and global forces will likely tend to go in opposite directions, so we have a kind of range-bound view, in a very wide range.
COP	→	↘	• The latest lockdown measures following the post-holiday spike in Covid cases overshadow the improved macro conditions in recent months. • We still view the COP as moderately undervalued vs. historical levels and peers, but maintain a neutral short-term view as we monitor quarantine measures. • Fiscal and credit downgrade risks remain key headwinds in 2021, which provide resistance to a stronger retracement back to pre-Covid 19 levels.
ARS	→	→	• Booming commodity prices as seen recently represent a novel performance in 2H20. Soybean and corn prices have jumped 44% and 33% since August, reaching a cyclical peak not seen since 2013. • Improving commodity prices, reinforced by tighter capital controls, have allowed CB dollar purchases to rise above USD900mn since December. • Both events have been the main reason for a significant change in expectations regarding the lower probability of a discrete rise in the official quote taking place this year.
PEN	→	↑	• Local corporate USD demand remains strong, a key pillar of support for USD/PEN of late. • Campaigning ahead of April's election is expected to intensify in the coming months, with newcomer Forsyth still holding a strong lead; but the undecided vote remains the plurality. • There are constructive aspects of the macro outlook; however, it will be difficult for these to take leadership until the political outlook clears up.

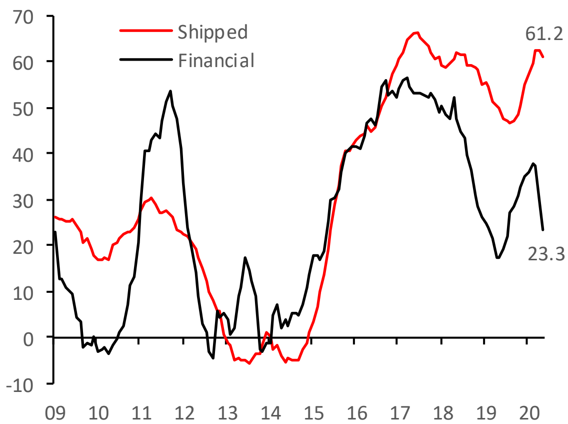
↑ Bullish ↗ Mildly Bullish → Neutral ↘ Mildly Bearish ↓ Bearish

Source: Santander.

BRL – What are they waiting for?

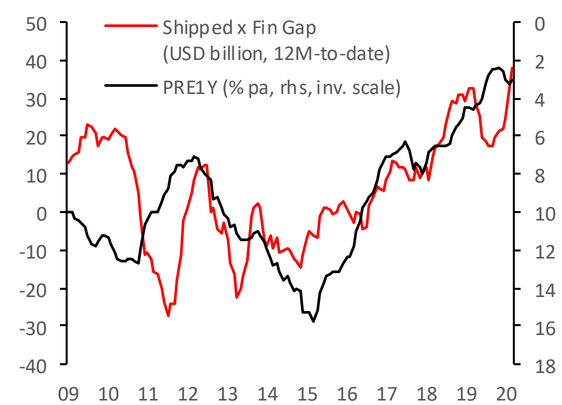
Jankiel Santos
jankiel.santos@santander.com.br
(+55) 11 3012 5726

Chart 23: Trade balance - Shipped goods versus financial flows (USD billion, 12M-to-date)



Source: Brazilian Central Bank, SECEX, Santander

Chart 24: Gap between shipped goods and financial flows versus 1y interest rate



Source: ANBIMA, Brazilian Central Bank, SECEX, Santander

A new year has begun, but the BRL's trajectory has continued to follow an old story, with its moves registering a much more volatile pattern than other emerging currencies and diverging from what would be expected based on the usual drivers (e.g. balance of payments). Were it just for these influences, we believe the USD/BRL pair should be far south of the 5.00 level. Nonetheless, USD/BRL continues to run north of this threshold. We think that lawmakers' failure to approve a budget for the federal administration in 2021 has contributed to this divergence, as it kept market participants wary of the fiscal trajectory that public debt will follow in the coming years, as well as the lack of coordination between public administrations to deal with the pandemic, which blurred prospects for the trend that the Brazilian economy will follow. Not even overcoming the so-called "over-hedge issue" was able to bring substantial respite to the Brazilian FX market, in our opinion.

On top of favourable global circumstances and sound fundamentals regarding Brazil's external sector data, we are increasingly of the view that the solution to the current divergence between the BRL and its usual determinants lies in solving Brazilian idiosyncratic questions, especially those related to fiscal matters.

In the meantime, we would expect the improvement observed in the trade balance to turn into stronger cash inflows, thus making room for some strengthening of the BRL. However, another discrepancy has risen here. Although the trade balance ex-oil platform deals (which are accounting adjustments related to tax issues) registered a USD61.2bn surplus in 2020, the net commercial FX flow was USD23.3bn (positive). This nearly USD38bn gap between the balance of shipped goods and net cash commercial-related flows is the largest in 12 years, and suggests that exporters are preferring to leave most of their money abroad rather than repatriating it to Brazil. Why?

It is hard to answer that question, mainly as transactions in Brazil are compulsorily settled in BRL, which means that exporters need cash to pay for their current expenditures in the country—something that should force them to bring their money in. However, looking at the behaviour of this gap between shipped goods and their cash flows and comparing it to the trajectory of the one-year forward interest rate (PRE1Y), we find an inverse correlation between them. It is true that, in moments of scarcity of funding (such as in 1H20) or high uncertainty (such as in the aftermath of the 2008 crisis), this relationship ceased to prevail, but in "normal" times it seems to hold properly. Given our expectation of (i) clearer signals regarding compliance with the current fiscal framework, which would help to reduce fears regarding the public-debt trend, and (ii) a gradual economic recovery, which should lead to the normalisation of monetary policy, the ensuing increase in the PRE1Y level should encourage Brazilian exporters to bring in their money, thus also helping the BRL to strengthen.

MXN – Enjoying fiscal austerity in a benign global context

Guillermo Aboumrad
gjaboumrad@santander.com.mx
(+52) 55 5257 8170

Chart 25: Core CPI and components (YoY %)

Source: Santander, Bloomberg

Chart 26: Exchange rate (MXN$/USD)

Source: Santander, Bloomberg

A second wave of lockdowns is affecting the world economy and Mexico is no exception. Mexico City is back on red alert since the December holidays, suffocating some sectors of the economy which were starting to see the light, while hospital occupation is still high with Covid-19 cases on the rise. The vaccine roll-out has started slowly, and it could be several months before the majority of the population gets vaccinated. Even though it is a health crisis, and the solution should lie in that sector, many economic agents are feeling the pain and need support to recover; otherwise there could be permanent damage to potential GDP, in our view.

The government chose fiscal austerity over economic growth policies, contrary to the rest of the world. We could argue that while other countries did completely the opposite and eventually may be dealing with fiscal problems, the better policy mix should be a moderate one, away from either extreme. In the case of Mexico, we think that the negative growth story could potentially flare up in the foreseeable future if not addressed soon. The Mexican economy was already decelerating before the pandemic started, with lacklustre private investment whose outlook does not seem to have improved in recent months.

Nevertheless, for now the market seems bullish on the MXN on the prospects for continued fiscal austerity and a strong fiscal package in the US that could spill over to Mexico. The market has rewarded the government's austere policies with high demand and favourable conditions for recent placements of international debt, also benefiting the MXN. Also, there is a market view that an ambitious fiscal package proposed by the Biden administration will have positive spill-over impacts on the Mexican economy due to the close link between the two economies. In addition, the monetary policy rate is high compared to other emerging markets, thus attracting carry trade; and in general monetary conditions in Mexico are too tight for the size of the output gap, we believe.

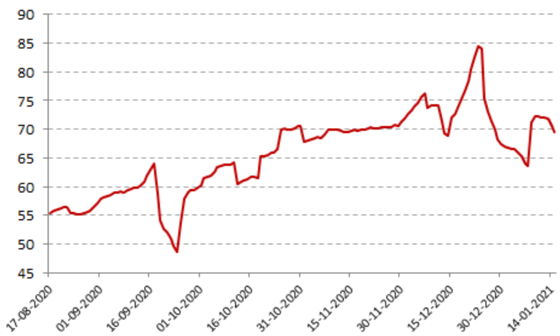
The more dovish members of the Banxico board in Mexico may hold the key to releasing pressure on the MXN by re-engaging in cuts. Mexico's current account surplus saw a large correction in 3Q last year to historic levels, most likely underscoring the big shock to aggregate demand together with the austere fiscal policy, which is also evidenced in very low service inflation at the core level (around 2.0%), while food inflation could be categorised as a temporary supply shock. Our base scenario calls for at least two more cuts of 25bp each, starting at the next monetary policy meeting on 11 February, taking the policy rate to 3.75%. We think that a lower policy rate in Mexico, the potential for other EMs to start normalising their policy rate, the uncertain outlook for the mid-term elections, the need to address Pemex's finances, and the negative growth story potentially affecting Mexico's credit rating might prove to be unsupportive for the MXN by the second half of this year, pressuring the currency to close 2021 at 21.0.

CLP – Increasingly idiosyncratic

Juan Pablo Cabrera
jcabrera@santander.cl
(+56) 22 320 3778

Since our last report in mid-November, the CLP has rallied significantly and outperformed EM and commodity FX peers. The USDCLP rate is now trading at 735-740 (-4% vs. 25 November), touching 693 on 6 January, an 18-month low. One key element has been copper prices, up 10% in the last two months, boosted by the persistent global risk-on mood and positive news from China. However, the typical CLP beta vs. copper is c. 0.85x, so the 30-cent jump in copper since end-November per se may justify a 25 peso gain, not the 75-80 rally seen until two weeks ago. Market evidence suggests that CLP gyrations are becoming increasingly idiosyncratic.

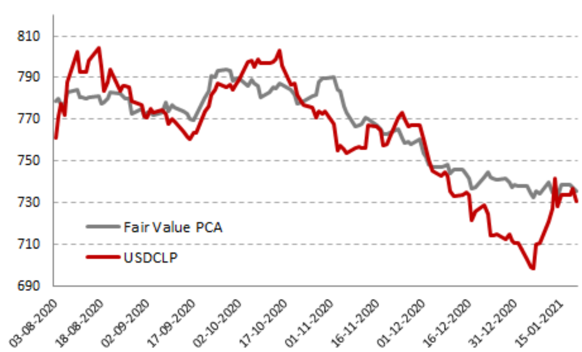
Chart 27: Google mobility index in Chile



7-day moving averages, national scope. 100=January 2020. Source: Santander, Google

After social riots in 4Q19 and the constitutional process started in 2020, we had continuous FX swings created by AFP's inter-fund migration (more erratic and intense as of late), two AFP withdrawals, a persistent USD sell flow from the Treasury, and since this week the BCCh buying US$40mn a day, in an intervention program aimed at replenishing FX reserves. The CLP began the year strongly, trading very expensive vs. our fair-value metrics, as the market positioned itself for a new wave of Treasury sales. But, unexpectedly, the BCCh announced that it will buy US$12bn in the next 15 months, not much for daily trading volumes (less than 5%), but relevant on an annual basis: it is equivalent to the impact of an average 25% increase in copper prices in 2021, and practically offsets the expected US$10bn Treasury sell flow this year. Against this backdrop, domestic news is now crucial to make reasonable CLP calls for the short/medium term.

Chart 28: USDCLP vs. fair-value metrics



Based on PCA model including 30 main global risk assets. Source: Santander, Bloomberg

Regarding the pandemic-mobility-activity triangle, the virus is also resurging in Chile, leading the authorities to restrict mobility in the last few weeks. As per the Google index (100=Jan 2020), mobility stands near 70 in January vs. a peak at 84 in December, falling back to October levels now. Access to vaccination will be broad in Chile but not necessarily fast, so we now assume that GDP levels in 1H21 will be high vs. the worst of the lockdowns but sequential q/q growth (s.a.) will remain modest. 2021 consensus GDP growth stands at +5% now, but we estimate the 2020 carry-over at 4.5%: i.e. blue numbers would reflect more a rebound from depressed levels than a dynamic economy at the margin. With so many growth uncertainties ahead (also considering the political context, with several key elections until December), we expect the BCCh to maintain a very dovish stance throughout 2021. We assume rates will remain unchanged until 2022 and the first "tapering" announcements will come after the main G10 central banks start to do so (whenever that means), even in a context of above-target inflation (probably at 3.5% y/y by June).

Net net, the USDCLP range should remain a function of opposing global and local forces, with the latter more on the weak CLP side after the BCCh's intervention. Based on the notion of a global USD sell-off close to its end, we pencil in 715-755 for the USDCLP in coming months, slightly more CLP-negative thereafter due to increasing political noise.

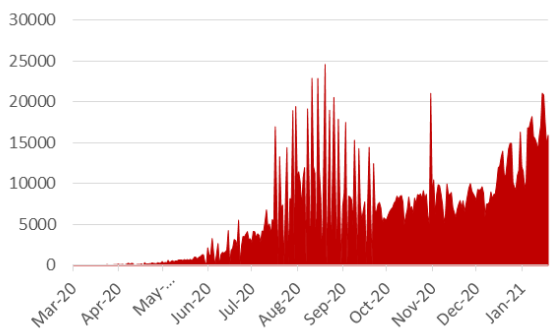
COP – Two steps forward, one step back

Mike Moran
mike.moran@santander.us
(+1) 212 350 3500

The COP ended 2020 on a strong footing, recouping almost all its losses against the USD since February, when the pair last traded below 3400. But the early year narrative turned sour as another sharp outbreak in coronavirus in key metro areas (Bogota, Medellin) has led to strict quarantines and nightly curfews being put back in place, as hospital ICU utilisation rates move alarmingly into the 90-95% range. While some easing in restrictions may come at the end of the month, a return to Q4 mobility settings may take longer (with Europe's experience a case in point). We remain neutral on the COP in the short term, awaiting stabilization in coronavirus conditions before expecting a retest of key support at 3400 by the end of Q1-21.

This is not the first time Colombia has been forced into selective lockdowns since the coronavirus outbreak. Bogota and Medellin, accounting for over a third of GDP, also imposed rolling restrictions in August for several weeks when new daily cases breached 10k for the first time. The recent spike, which many attribute to the holiday period, has stabilized near the 15k mark but is stretching hospital resources far more than in previous episodes.

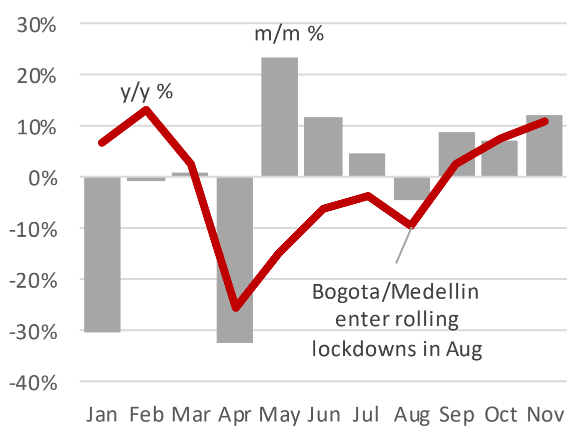
Chart 29: New daily cases spike post-holiday



Source: Santander, Bloomberg

The economic impact of August's temporary lockdown was modest. The dip in activity that month, particularly noticeable in retail trade data, was mostly made up for over the subsequent months, when the spending recovery showed strong momentum. Households and businesses are arguably better prepared for sudden lockdowns than before, so the disruptive impact of mobility restrictions is likely diminished compared with previous examples. But how long restrictions are left in place could still have an important bearing on the outlook for economic normalization and, potentially, policy responses too.

Chart 30: Core retail sales rebounded after August



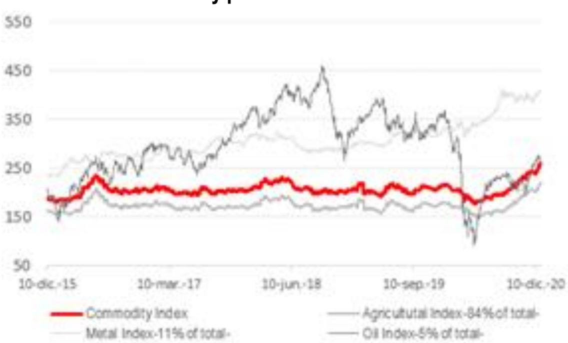
Source: Santander, DANE

The current lockdown comes at a delicate juncture for BanRep, the central bank. After (unanimously) signaling a shift to a neutral policy stance last October, December's policy meeting unexpectedly showed two members dissenting in favour of cutting policy rates again (the vote ended at 5-2 for leaving rates unchanged). The next policy meeting, on 29 January, takes on added significance in the context of the latest lockdowns. Our BanRep view coming into this year was for no change in policy rates through 2021 (despite markets pricing in modest tightening later in the year), recognizing that the economic recovery/reopening would not be smooth and that hysteresis may keep income and a domestic investment rebound sluggish while price pressures remain broadly subdued. But January's decision could now be much closer – with the markets pricing in roughly 50:50 for a cut. As we noted above, the multi-week lockdown in August was not too disruptive, perhaps giving BanRep the option to wait until the following policy-setting meeting (in March) to judge whether more monetary stimulus is needed. For now, we think the policy rate will be left unchanged in January. But clearly the balance of risks has deteriorated and reinforces the view that rate hikes in 2021 are still premature.

ARS – FX policy strengthens as commodity prices escalate

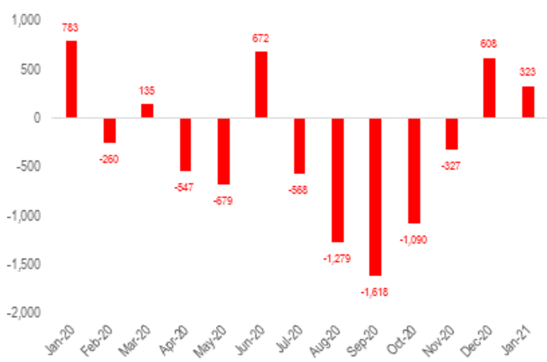
Juan Arranz
jarranz@santander.com.ar
(+54) 11 4341 1065

Chart 31: Commodity price evolution - 2001 index = 100



Source: Central bank and Santander

Chart 32: CB monthly dollar purchases - USD million



Source: Central bank and Santander

Booming commodity prices as seen recently represent a novel performance in 2H20. Bear in mind that agricultural and mining commodities account for half of Argentine exports. Soybean and corn prices have jumped 44% and 33% since August, reaching cyclical peaks not seen since 2013. Thus, the prices of agricultural commodities – which account for 84% of total export commodities – have increased by 27% since President Fernandez took office on 10 December 2019.

Improving commodity prices, reinforced by tighter capital controls, have allowed CB dollar purchases to rise above USD900mn since December. After five uninterrupted months of net sales to defend the crawling peg policy, a combination of tighter controls to prevent FX reserve leakage and higher settlements of exports as a result of rising commodity prices have allowed the monetary authority to gross up its hard currency reserves via direct purchases in the FX market.

Both events have been the main reason for a significant change in expectations regarding the lower probability of a discrete rise in the official quote taking place this year.

Improved terms of trade constitute an invaluable opportunity for the government in its strategy to arrive at the October mid-term elections without any real adjustment of the dollar quote. The authorities may even be tempted to allow the peso to appreciate in real terms, as a strong local currency implies higher real wages in an election year.

Better export earnings obliged market participants to revise up the estimated 2021 trade surplus by an equivalent of 1.5% of GDP, while tax revenues may benefit from a jump equivalent to 0.5% of GDP not included in the approved budget. All of the above are contingent upon a moderate drought in the months to come in a context in which the Southern American hemisphere is negatively affected by the La Niña Gulf Stream.

Thus, 2021 exports could increase by at least US$6bn, or 10% above the level reached last year. Furthermore, central bank FX intervention shows more than USD900mn in purchases since December. Fine-tuning of capital controls championed by Minister Guzman in October and November could also be responsible for such a result.

Gross FX reserves reached USD39.6bn by year-end, boosted by a USD1.2 bn increase in dollar deposits and USD0.6bn FX purchases made by the monetary authority in the last month of the year. For the months to come, the USD38.6bn cyclical minimum reserves reached in early December will not be backed.

Parking on USD MEP transactions was halved to one day, while CCL operations, generally used to move money in and out of the country, were reduced to NV100.000 maximum, on a weekly basis. The regulatory changes released in early January by the local Security and Exchange Commission reflect the government's intention to further tighten FX controls, keeping a rein on free dollar rate quotes.

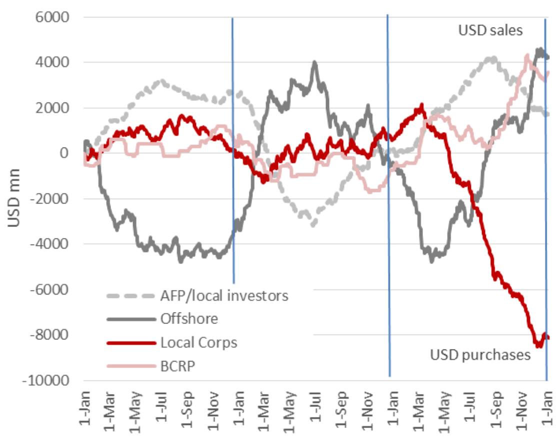
PEN – Failure to launch

Mike Moran
mike.moran@santander.us
(+1) 212 350 3500

Having failed to participate in the global EM FX rally at the tail end of last year, the PEN's lacklustre performance looks set to continue into 2021. The contrast between the performance in EM FX indices and USD/PEN is stark; the MSCI EM FX index rose 7.46% from Jul-Dec 2020 vs. the PEN weakening 2.21% over the same period. A common explanation is the embedded political risk premium from the upcoming presidential and congressional elections set for 11 April.

While this event risk is clearly important, it feels too convenient a 'catch-all' to explain PEN underperformance over the last six or so months. Certainly the political turmoil (Peru has had three presidents since last November) and populist policy experiments (the second private pensions withdrawal passed the legislature, and the program is currently underway) have given investors reason for pause; but Chile's similar pension changes and that country's fractured political backdrop did not prevent the CLP from outperforming LatAm currencies in H2-20 (though we do not overlook Chile's official USD sales as a key differentiating factor too).

Chart 33: Local corps reshaping FX dynamics

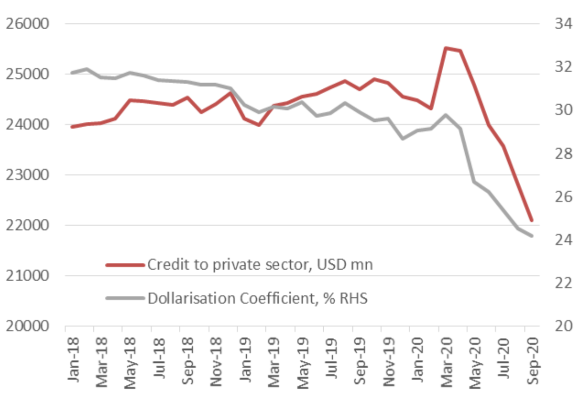


Source: Santander, BCRP

Our (estimated) FX flow tracking reveals several notable trends that may help account for PEN underperformance. The most anomalous observation has been the sharp increase in net USD purchases from Peru's local corporates. In recent years, members of this group are typically moderate net USD sellers over the course of a calendar year (see chart), usually leaving either offshore or local investor flows as the determining drivers for net flows at the aggregate level.

However, 2020 proved the exception as local corporates turned significant net USD buyers from the middle of last year. This cannot be entirely explained by trade flows – Peru's trade balance fell into deficit in Q2, but the subsequent rebound in exports outstripped import demand to register strong trade surpluses again through H2-20. Our working thesis is that exporters could be retaining a larger proportion of USD receipts than usual, as their access to PEN liquidity (through various government fiscal programs for their working capital needs) has been ample (and cheap).

Chart 34: Dollarisation declining



Source: Santander, BCRP

It is also plausible that local entities are taking this opportunity to deleverage/reduce USD liabilities, or at least swap into PEN liabilities. In support of this thesis, USD credit to the private sector (from banks) has steadily declined since last March (PEN credit has increased, see chart) with the 'dollarisation coefficient' also down over 5% points (to 24% in September). Monitoring these flow trends could be key to determining when (or if) these anomalies return to trend, and a signal for the PEN to play catch-up with its improved macro credentials. Early 2021 dynamics have not altered, in our view, suggesting that PEN underperformance could persist despite a positive EM backdrop.

CEE FX: Main Themes

Currency	3M view	12M view	Main Themes
PLN	⇨	↗	• The recent change in the Polish central bank's approach is the main reason behind an upward revision of the EUR/PLN path for 1H21E. In the second half of 2021E, when it should become obvious that there is no need to cut interest rates and/or keep the zloty at a weaker level, the Polish currency should finally start to benefit from the global and domestic economic recovery and weak dollar, in our view.
CZK	⇨	↗	• We think the koruna may make gains in 2021E, particularly in 2H21E, when we assume the vaccination process will be sufficiently advanced to allow the lifting of all or most of the restrictions and talks about a rate hike could start. In the short term, we see a risk of a weaker koruna, as volatility has recently fallen, and this is not a good omen for EM currencies.
HUF	⇨	↘	• EUR/HUF should test 355, the lower end of the upside trend channel. However, we assume this would just be a technical correction, and that is why we lower only our 1Q21 forecast to 355, leaving our forecasts for further out unchanged.
RUB	⇨	↘	• We lower our USD/RUB forecast for end-Q1 to 77.0 from 81.0 and also slightly lower our forecasts for further out to account for a period of range trading that we envisage in the short term as many factors impacting the rouble seem to offset each other temporarily.

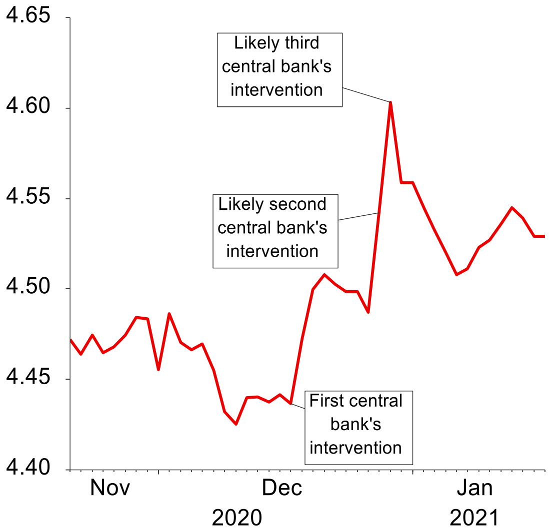
⬆ Bullish ↗ Mildly Bullish ⇨ Neutral ↘ Mildly Bearish ⬇ Bearish

Source: Santander Bank Polska S.A.

PLN – Weaker owing to central bank

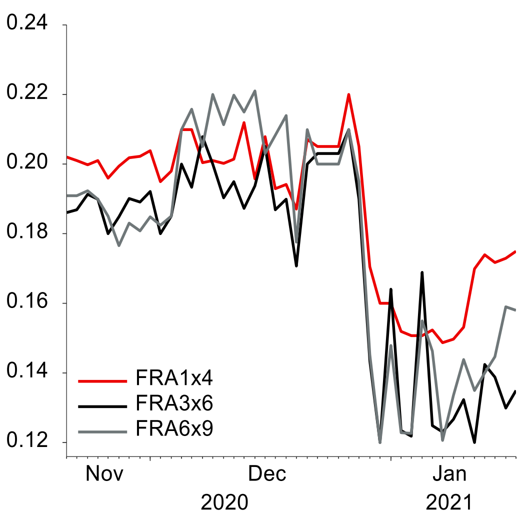
Marcin Sulewski, CFA
marcin.sulewski@santander.pl
(+48) 22 534 18 84

Chart 35: EUR/PLN



Source: Refinitiv Datastream, Santander Bank Polska

Chart 36: Rate cut talk affected the interest rate market



Source: Refinitiv Datastream, Santander Bank Polska

The recent change in the Polish central bank's approach (threat of FX interventions, suggestion of a possible rate cut) is the main reason behind an upward revision of the EUR/PLN path for 1H21. In the second half of 2021E, when it should become obvious that there is no need to cut interest rates and/or keep the zloty at a weaker level, the Polish currency should finally start to benefit from the global and domestic economic recovery and weak dollar, in our view.

Events that took place in late December 2020 made us more cautious on the zloty's likely performance in early 2021. In mid-December, and possibly in the final days of the year, the National Bank of Poland (NBP) intervened directly in the market to weaken the domestic currency: EUR/PLN jumped from 4.33 at mid-month to temporarily above 4.60 at year-end. Also, at the very end of the year, the NBP's Governor Glapiński and three other MPC members said they do not rule out further rate cuts should the zloty become too strong and/or the economic outlook deteriorate noticeably.

The video with Mr Glapiński answering journalists' questions in mid-January 2021 was not very helpful in understanding the rationale behind the intervention and assessing how determined the central bank might be to keep EUR/PLN above any particular level. Mr Glapiński said that the aim of the central bank's intervention was to smooth the exchange rate and prevent a precipitated appreciation of the zloty (he mentioned that a sharp depreciation is not desired either). He said that the regime for the Polish currency is still free-floating and distanced from suggestions that the NBP could introduce a floor for EUR/PLN, similar to EUR/CZK. Regarding rate cuts, the NBP governor admitted that there is "plenty of room" for them but said they would only take place if economic activity were to deteriorate sharply, which neither we nor the central bank expect to see.

Nevertheless, given the dovish message from the central bank and the bias clearly not supportive for the zloty, we think EUR/PLN should remain above 4.50 until around mid-year. Only then, when we expect to see the vaccination process more advanced than the early weeks would imply and a much bigger probability of a strong economic rebound in 2H21, could the zloty start to see some persistent gains.

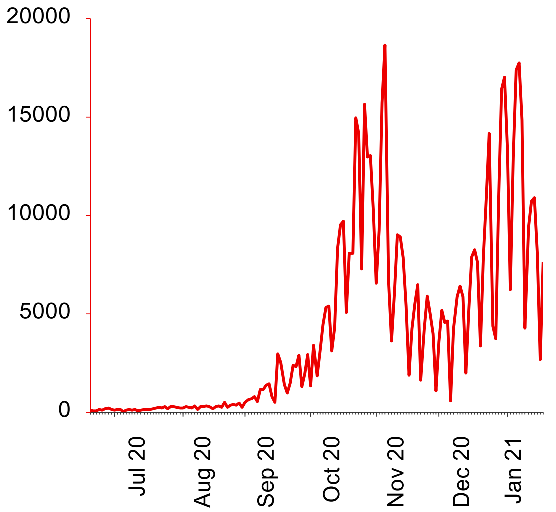
On the macro data front, in November Poland's current account balance reached +€1.7bn. The 12-month current account surplus improved to 3.4% of GDP from 3.3% in October. Taking the quarterly data, at the end of 3Q20, Poland's C/A surplus stood at 2.5% of GDP, equal to that of Russia and only lower than Thailand (+6.6%) and Malaysia (+3.1%) among the main EM countries. On the other hand, even after the Polish CPI fell to 2.4% y/y in December from 3% in November, the real interest rate (calculated as the spread between the main central bank rate and annual CPI) in Poland is still the second-lowest among the main EM countries: -2.3%, only behind Brazil's -2.5%.

The two risk factors we mentioned in November –the veto of the EU Recovery Fund and 2021-2017 budget, as well as a hard Brexit– did not materialize. Supportive news failed to trigger any noticeable reaction in risky assets, in line with our call that the positive scenario has already been priced in.

CZK – Decent data concluded 2020

Marcin Sulewski, CFA
marcin.sulewski@santander.pl
(+48) 22 534 18 84

Chart 37: New daily cases of Covid-19 in Czechia



Source: Refinitiv Datastream, Santander Bank Polska

Since late November, EUR/CZK has been trading above the 26.0 support. We think the koruna may gain in 2021, particularly in 2H21, when we assume the vaccination process will be sufficiently advanced to allow the lifting of all or most of the restrictions and rate hike talks might start. In the short-term, we see a risk of a weaker koruna as volatility has recently declined, and this is not a good omen for EM currencies.

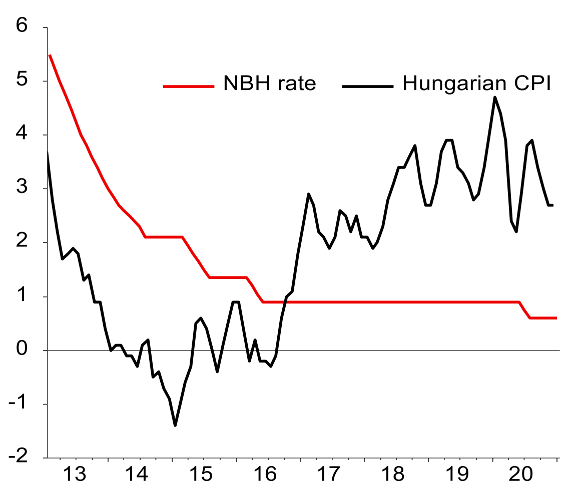
Over the past several weeks, encouraging data has been released in Czechia. For example, the manufacturing PMI rose from 51.9pts in October to 57.0pts in December, its highest since April 2018. The performance of industrial output was less robust, but the annual figure managed to remain in positive territory in October and November vs negative readings in the previous 14 months. Retail sales fell 7% y/y in November, but this was largely due to the persistent Covid-related restrictions (closures of some stores). The turn of the year brought a sharp, but temporary (for now), rise in the daily number of new Covid-19 cases. The Czech health minister said that roughly half of its 10.7mn citizens should be vaccinated by the end of summer, with the pace of vaccine deliveries being a key factor.

In December, the CPI fell to 2.3% y/y, its lowest in two years, vs 2.9% in October. The Czech central bank did not change its interest rates nor did it suggest any action would be needed in the coming months. In January, Vojtech Benda said that monetary policy normalization might be considered in 2H21.

HUF – Technical correction ahead

Wojciech Mazurkiewicz
wojciech.mazurkiewicz@santander.pl
(+48) 22 534 18 86

Chart 38: Hungarian CPI vs central bank main rate



Source: Refinitiv Datastream, Santander Bank Polska

EUR/HUF, after rising 9% in 2020, finished the year at 362.8 vs our forecast of 367.0, just a 1.2% miss. Currently, EUR/HUF is trying to decline below the upper band of the upside trend channel it established back in 2019. We think it will manage to do so and afterwards will test the lower band of the channel at 355. In our view, this would be just a technical correction, which is why we only lower our 1Q21 forecast to 355, leaving our forecasts for further out unchanged as the medium-to-long-term fundamentals remain unchanged and challenging (as the record fiscal deficit shows).

NBH (National Bank of Hungary) has not changed its rates, maintaining the 1-week deposit rate at 0.75%, above the base rate of 0.60%, to slow the forint depreciation. NBH recently expanded its corporate bond buying program (already used by 46 companies) by 53% to HUF1.15tn (~EUR3.2bn).

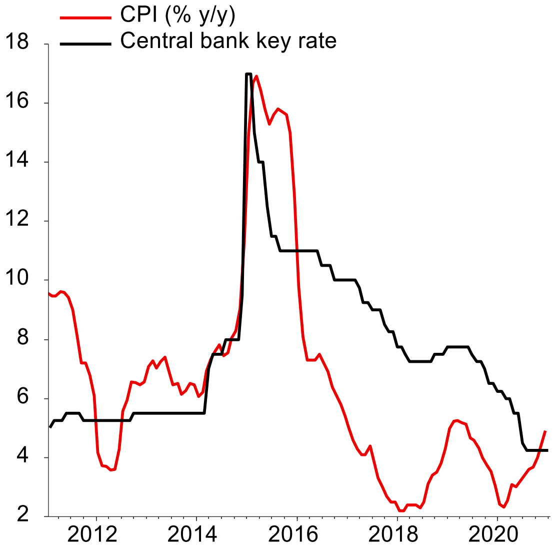
Headline inflation continues to decline (from c4% in the summer of 2020) to 2.7% y/y in December. The NBH's target is 3%, +/-1pp. Core CPI increased 0.1pp to 4.0%. In 1Q21 the NBH expects a higher CPI due to the excise tax hike and commodity base effects as well as higher CPI volatility due to the pandemic.

Manufacturing rebounded a bit; industrial production showed its first y/y% growth since the beginning of the pandemic (on cars and electronics). The Manufacturing PMI remains slightly above 50.

RUB – Horizontal range trading

Wojciech Mazurkiewicz
wojciech.mazurkiewicz@santander.pl
(+48) 22 534 18 86

Chart 39: Russian CPI and central bank rate



Source: Refinitiv Datastream, Santander Bank Polska

The USD/RUB finished 2020 at 74.2 (up 19% y/y), below our slightly overly bearish EoY forecast of 77.0.

We lower our USD/RUB forecast for end-Q1 to 77.0 from 81.0 and lower our forecasts for further out a bit to account for a period of range trading that we envisage in the short term as many factors impacting the rouble temporarily seem to offset each other.

Since our November FXC, the global market mood was positive, with the S&P500 up another 5% and the VIX stable. Oil rallied 16%, while dollar DXY edged down c2%. US 10Y yields moved up 23pb to 1.11%. Over the period the RUB basket declined just 1.2%.

The rouble basket has stabilized since December and is broadly trading within an 80.0-82.0 horizontal range, which we think is likely to continue in the short term. The fact that during the period the rouble basket approached from above the 200-day moving average thrice (early and mid-December as well as mid-January), without ever actually touching it, we read as a slightly bearish sign. In January the Russian central bank returned to FX purchases on the market.

Oil prices have recovered almost all of their losses from March 2020. At the latest OPEC+ meeting, Saudi Arabia promised to reduce the oil supply somewhat. As a result, the price of Brent moved towards $55/bbl. At these levels, most of the oil-positive news might already be priced in. Further significant oil price increases, which would be supportive for the rouble, would be possible under a relatively strong reflationary scenario, which is not our base case at the moment.

At its December 18 meeting (the next one is scheduled for February 12), the Central Bank of the Russian Federation (CBR) left rates unchanged at 4.25% for the third month in a row. The bank increased its full-year 2020 inflation forecasts noticeably from 3.9%-4.2% to 4.6%-4.9%. Now the CBR expects inflation to peak in February 2021. The CBR said that the tightening of the policy is possible only when an economy can handle it. Market participants expect headline inflation to accelerate to above 5% in 1Q21. Should this happen, it would automatically mean more negative real rates, which would undermine the rouble.

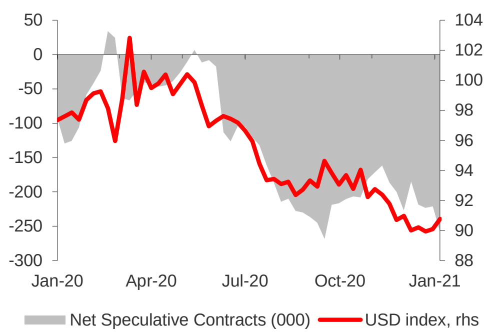
The manufacturing sector seems to be improving. Industrial production for November was much less negative at -3.6% y/y and is in an apparent recovery mode. The December manufacturing PMI rebounded to 49.7 from 46.3, beating market expectations by a significant margin (Services PMI remained subdued at 48.5 though). Producer prices continue to rise, with those of November at 2.5% y/y, up from 0.7% y/y a month ago.

All in all, a still weak USD, solid oil prices and a recovery in manufacturing should point to a stronger rouble going forward. The negative and decreasing real rates and the CBR's FX purchases work in the opposite direction. Time will show which side wins. For the next month, we envisage USD/RUB to trade within a horizontal range.

G10 FX: IMM Speculative Positioning

Michael Flisher
michael.flisher@santanderCIB.co.uk
(+44) 33114 80232

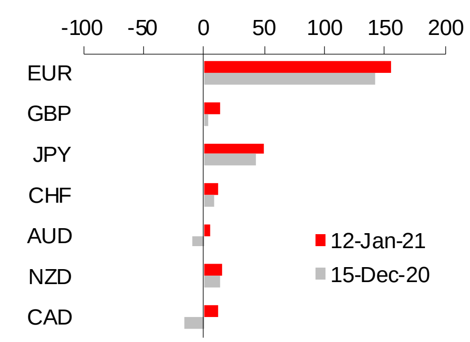
IMM commitment of traders report: USD composite position



- **Speculators have begun 2021 negative on the USD,** with the net short USD composite position at its largest since September and increasing by 73k contracts over the four weeks to 12 January 2021.
- **The speculative net-short CAD position has turned net long,** switching from -16k contracts four weeks ago to +12k contracts currently. While the USD/CAD spot position has barely changed over this period, oil prices have risen by over 10%.
- **AUD positioning has also switched from negative to positive.** This position is still largely neutral, but it has improved by 15k net contracts over the past four weeks, to 6k contracts currently.
- **Softer USD has boosted EUR and GBP positioning,** with the net long EUR position now at an elevated 156k contracts, while the net long GBP position has improved to a still relatively modest 13k contracts. The more downbeat USD view has also lifted speculators' net positive positioning on the JPY (51k), CHF (12k) and NZD (15k), with the latter at its highest since May 2018.

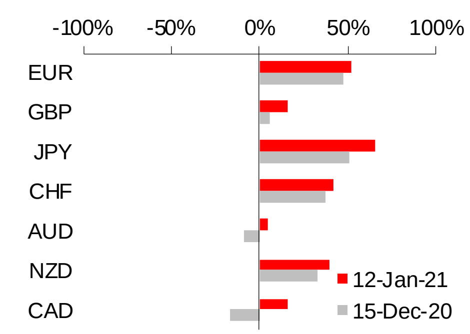
Net Speculative Contracts ('000s)*

	12-Jan-21	15-Dec-20	4w chg	YtD chg
USD***	-258.1	-185.1	-73.0	-232.3
EUR	155.9	141.8	14.1	230.2
GBP	12.9	4.1	8.9	0.5
JPY	50.5	44.0	6.6	75.8
CHF	12.0	9.3	2.7	17.7
AUD	5.5	-9.3	14.8	43.8
NZD	14.7	14.2	0.5	19.8
CAD	12.1	-15.7	27.8	0.2



Net Speculative Contracts as % of Open Interest**

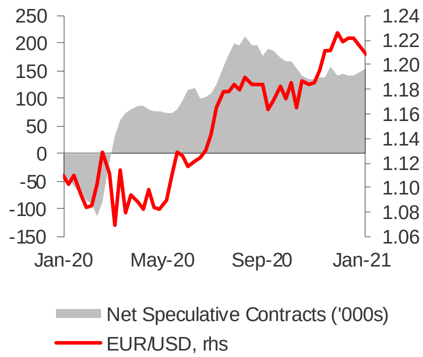
	12-Jan-21	15-Dec-20	4w chg	YtD chg
USD***	-31%	-22%	-9%	-29%
EUR	52%	48%	4%	70%
GBP	16%	6%	9%	5%
JPY	65%	51%	15%	88%
CHF	41%	37%	4%	58%
AUD	5%	-9%	14%	33%
NZD	39%	33%	6%	49%
CAD	16%	-16%	33%	6%



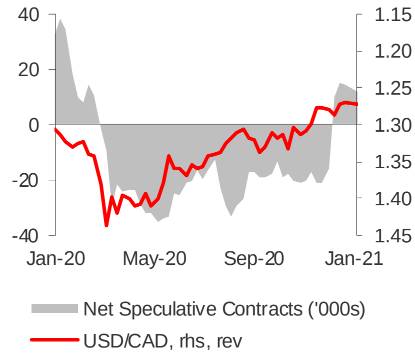
Sources: CFTC, Bloomberg, Santander. Note: *Net Speculative Contracts = Long non-commercial traders contracts minus short non-commercial traders contracts, **Open Interest = The total number of outstanding long and short futures contracts, ***USD composite index = USD composite index uses AUD, CAD, CHF,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

G10 FX: IMM Speculative Positioning

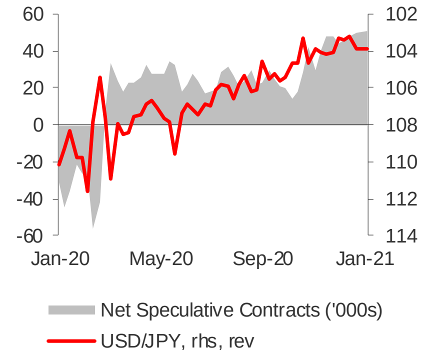
EUR/USD



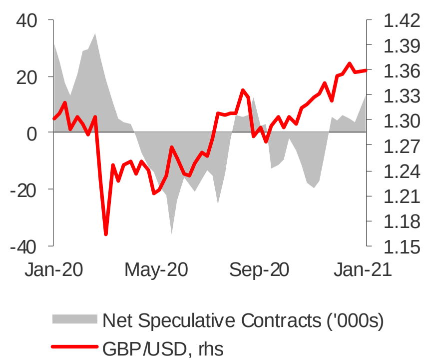
USD/CAD



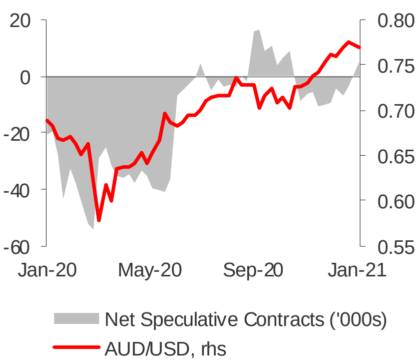
USD/JPY



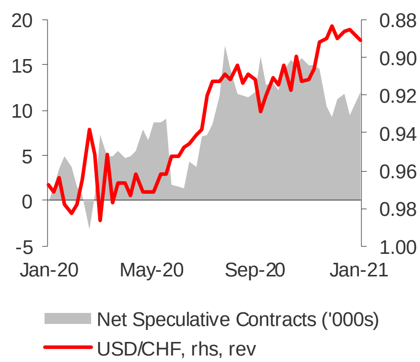
GBP/USD



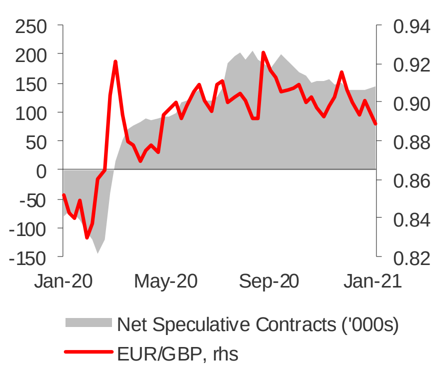
AUD/USD



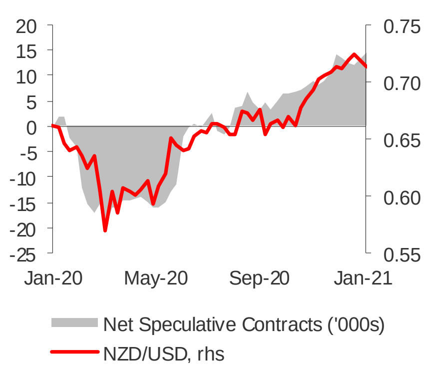
USD/CHF



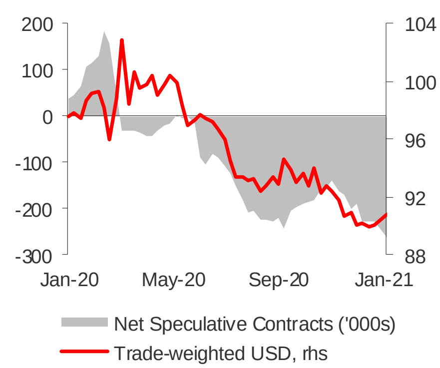
EUR/GBP



NZD/USD



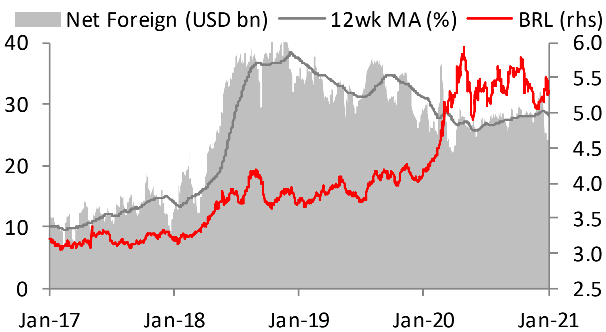
USD minus MXN



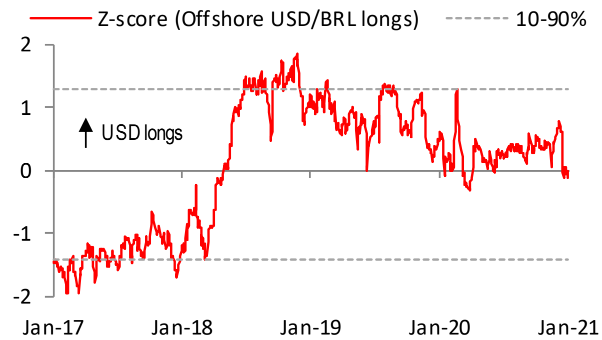
Sources: CFTC, Bloomberg and Santander. Note: IMM commitment of traders report

Latin America FX: Positioning indexes (Z-scores)

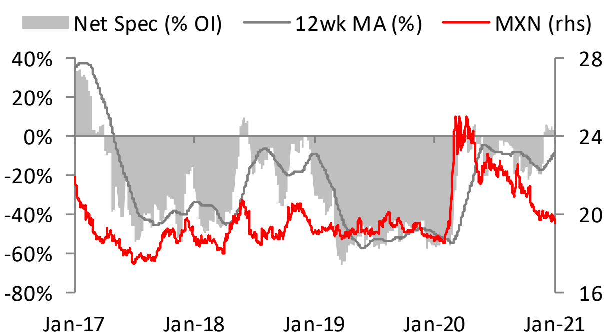
USD/BRL



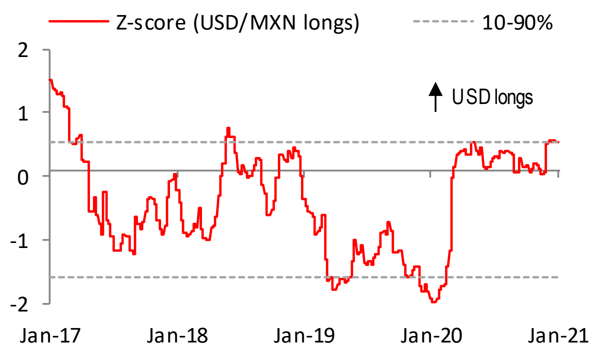
Z-score USD/BRL



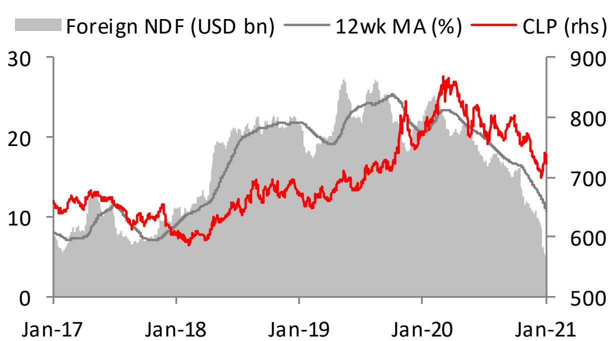
USD/MXN



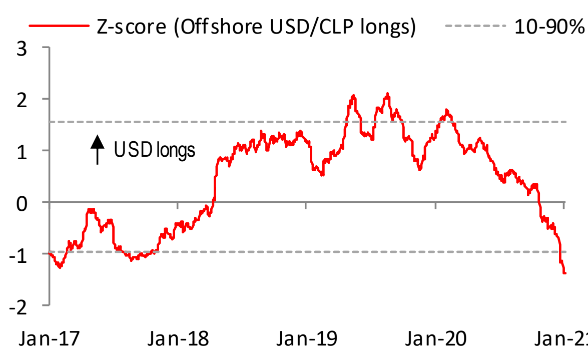
Z-score USD/MXN



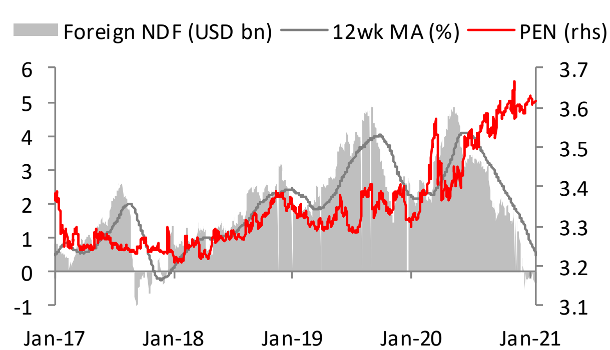
USD/CLP



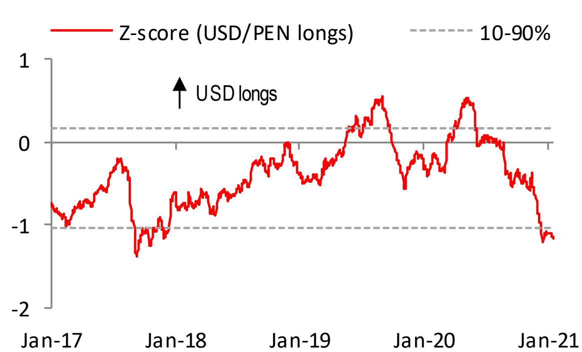
Z-score USD/CLP



USD/PEN



Z-score USD/PEN



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

Euro Interest Rate Forecasts

Government Bond yield Forecasts

Germany	Current	1Q21	2Q21	3Q21	4Q21
ECB Depo	-0.50	-0.50	-0.50	-0.50	-0.50
3m	-0.60	-0.70	-0.65	-0.60	-0.60
2y	-0.70	-0.70	-0.65	-0.60	-0.55
5y	-0.72	-0.70	-0.65	-0.55	-0.45
10y	-0.52	-0.55	-0.50	-0.40	-0.30
30y	-0.11	-0.15	-0.10	-0.05	0.00

Swap rate forecasts

Euro	Current	1Q21	2Q21	3Q21	4Q21
ECB Depo	-0.50	-0.50	-0.50	-0.50	-0.50
3m	-0.54	-0.55	-0.55	-0.55	-0.55
2y	-0.52	-0.50	-0.50	-0.50	-0.45
5y	-0.44	-0.40	-0.35	-0.25	-0.15
10y	-0.21	-0.20	-0.15	0.00	0.10
30y	0.07	0.00	0.10	0.20	0.25

US Interest Rate Forecasts

Government Bond yield Forecasts

US	Current	1Q21	2Q21	3Q21	4Q21
Fed Upper	0.25	0.25	0.25	0.25	0.25
3m	0.07	0.10	0.10	0.10	0.10
2y	0.13	0.20	0.25	0.30	0.30
5y	0.45	0.50	0.55	0.60	0.70
10y	1.09	1.10	1.25	1.35	1.50
30y	1.84	1.85	1.95	2.00	2.05

Swap rate forecasts

US	Current	1Q21	2Q21	3Q21	4Q21
Fed Upper	0.25	0.25	0.25	0.25	0.25
3m	0.22	0.25	0.25	0.20	0.30
2y	0.21	0.30	0.30	0.35	0.40
5y	0.53	0.55	0.60	0.65	0.75
10y	1.09	1.05	1.20	1.30	1.40
30y	1.58	1.50	1.60	1.70	1.75

UK Interest Rate Forecasts

Government Bond yield Forecasts

UK	Current	1Q21	2Q21	3Q21	4Q21
MPC	0.10	0.10	0.10	0.10	0.10
3m	0.01	-0.03	0.02	0.04	0.07
2y	-0.11	-0.10	-0.10	-0.05	0.05
5y	-0.02	-0.10	-0.10	0.00	0.10
10y	0.32	0.10	0.25	0.40	0.50
30y	0.90	0.60	0.75	0.85	0.95

Swap rate forecasts

UK	Current	1Q21	2Q21	3Q21	4Q21
MPC	0.10	0.10	0.10	0.10	0.10
3m	0.03	0.05	0.10	0.12	0.15
2y	0.10	-0.02	-0.05	-0.03	0.05
5y	0.28	0.00	-0.05	0.05	0.12
10y	0.52	0.10	0.20	0.30	0.38
30y	0.73	0.20	0.30	0.35	0.45

G10 Central Bank Calendar

	Current Rate	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
FOMC (Upper)	0.25	Unch.	-	Unch.	-	Unch.	Unch.	27	-	17	28	-	16
ECB (Depo)	-0.50	Unch.	-	Unch.	Unch.	-	Unch.*	Unch.	-	11	22	-	10
BoE	0.10	-	Unch.	Unch.	-	Unch.*	Unch.	-	4	18	-	6	24
BoJ	-0.10	Unch.	-	Unch.	Unch.	-	Unch.	Unch.	-	1	27	-	18
SNB	-0.75	-	-	Unch.	-	-	Unch.	-	-	25	-	-	17
BoC	0.25	Unch.	-	Unch.	Unch.	-	Unch.	Unch.	-	10	21	-	9
RBA	0.10	Unch.	Unch.	Unch.	Unch.	-15bp*	Unch.	-	2	2	6	4	1
RBNZ	0.25	-	Unch.*	Unch.	-	Unch.	-	-	24	-	14	26	-
Norges Bank	0.00	-	Unch.	Unch.	-	Unch.	Unch.	Unch.	-	18	-	6	17
Riksbank	0.00	Unch.	-	Unch.	-	Unch.*	-	-	10	-	27	-	-

Source: Bloomberg, Santander, Central Banks. Note: Data correct as at 21-January-2021. For meetings that have already taken place, rate decision identified as +/- in bp, or "unch" for no change. - Denotes no meeting taking place that month. ^ Indicates rate decision at emergency unscheduled meeting. * Indicates increase/extension of QE programme.

Brazil/Mexico Interest Rate forecasts

Brazil	Current	1Q21	2Q21	3Q21	4Q21
SELIC	2.00	2.00	2.00	2.00	2.50
NTNF Jan' 25s	6.25	6.15	6.10	6.20	6.30
NTNF Jan.' 29s	7.35	7.10	7.00	7.00	7.00

Mexico	Current	1Q21	2Q21	3Q21	4Q21
Banxico fondeo	4.25	3.75	3.75	3.75	3.75
MBono Mar. '23s	4.21	4.30	4.40	4.50	4.70
MBono May. '31s	5.53	5.80	6.00	6.10	6.10

Chile/Colombia/Argentina/Peru Interest Rate Forecasts

Chile	Current	1Q21	2Q21	3Q21	4Q21
BCCh TPM	0.50	0.50	0.50	0.50	0.50
BCP 5Y	1.57	1.45	1.60	1.60	1.60
BCP 10Y	2.72	2.65	2.80	2.90	2.95

LatAm	Current	1Q21	2Q21	3Q21	4Q21
Colombia	1.75	1.75	1.75	1.75	1.75
Argentina	38.0	42.5	43.0	44.0	45.0
Peru	0.25	0.25	0.25	0.25	0.25

LatAm Central Bank Calendar

	Current Rate	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Brazil	2.00	-	-25bp	Unch.	-	-	Unch.	Unch.	-	17	-	5	16
Mexico	4.25	-	-50bp	-25bp	-	Unch.	Unch.	-	11	25	-	13	24
Chile	0.50	Unch.	-	Unch.	Unch.	-	Unch.	27	-	30	-	13	8
Colombia	1.75	-25bp	-	-25bp	Unch.	-	Unch.	29	-	26	30	-	28
Argentina	38.00	Unch.	Unch.	Unch.	-200bp	+200bp	Unch.	~	~	~	~	~	~
Peru	0.25	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	-	11				

CEE Interest Rate Forecasts

Poland	Current	1Q21	2Q21	3Q21	4Q21
Reference Rate	0.10	0.10	0.10	0.10	0.10
2y	0.01	0.10	0.10	0.10	0.10
10y	1.17	1.30	1.35	1.40	1.45

CEE	Current	1Q21	2Q21	3Q21	4Q21
Hungary	0.60	0.60	0.60	0.60	0.60
Czech Republic	0.25	0.25	0.25	0.25	0.25
Russia	4.25	4.25	4.25	4.25	4.25

CEE Central Bank Calendar

	Current Rate	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Poland	0.10	Unch.	-	Unch.	Unch.	Unch.	Unch.	Unch.	3	3	7	5	9
Czech Republic	0.25	-	Unch.	Unch.	-	Unch.	Unch.	-	4	24	-	6	23
Hungary	0.60	-15bp	Unch.	Unch.	Unch.	Unch.	Unch.	26	23	23	27	25	22
Russia	4.25	-25bp	-	Unch.	Unch.	-	Unch.	-	12	19	23	-	11

Source: Bloomberg, Santander, Central Banks. Note: Data correct as at 21-January-2021. For meetings that have already taken place, decision identified as +/- in bp, or "unch" for no change. - Denotes no meeting taking place that month. ^ Indicates rate decision at emergency unscheduled meeting. ~ Indicates rate set daily.

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

	3M	6M	9M
EUR/USD	**1.21**	**1.21**	**1.21**
vs.forward	-0.5	-0.5	-0.5
vs.consensus forecast	-0.8	-1.6	-2.4
GBP/USD	**1.35**	**1.38**	**1.37**
vs.forward	-1.7	0.5	-0.2
vs.consensus forecast	-0.7	0.7	-0.7
EUR/GBP	**0.90**	**0.88**	**0.88**
vs.forward	1.2	-1.0	-0.3
vs.consensus forecast	0.7	-1.5	-1.9
USD/JPY	**104**	**106**	**107**
vs.forward	0.4	2.4	3.3
vs.consensus forecast	1.0	2.9	3.9
EUR/JPY	**126**	**128**	**129**
vs.forward	-0.1	1.9	2.8
vs.consensus forecast	-0.1	2.2	1.9
EUR/CHF	**1.08**	**1.08**	**1.10**
vs.forward	0.3	0.3	2.2
vs.consensus forecast	-0.9	-0.9	0.0
USD/CHF	**0.89**	**0.89**	**0.91**
vs.forward	0.8	0.8	2.7
vs.consensus forecast	-0.8	1.4	3.3
EUR/SEK	**10.1**	**10.0**	**9.9**
vs.forward	0.2	-0.8	-1.7
vs.consensus forecast	0.0	-0.2	-1.0
EUR/NOK	**10.5**	**10.4**	**10.2**
vs.forward	2.5	1.6	-0.4
vs.consensus forecast	1.0	1.5	0.4
USD/CAD	**1.28**	**1.27**	**1.26**
vs.forward	1.4	0.7	-0.1
vs.consensus forecast	0.8	0.0	0.0
AUD/USD	**0.74**	**0.75**	**0.76**
vs.forward	-4.7	-3.5	-2.2
vs.consensus forecast	-2.6	-2.6	-2.6
NZD/USD	**0.71**	**0.71**	**0.72**
vs.forward	-1.5	-1.5	-0.1
vs.consensus forecast	0.0	-1.4	-1.4

	3M	6M	9M
USD/BRL	**5.25**	**5.15**	**4.90**
vs.forward	-2.1	-3.9	-8.6
vs.consensus forecast	1.0	1.0	-2.0
EUR/BRL	**6.35**	**6.23**	**5.93**
vs.forward	-2.5	-4.4	-9.0
vs.consensus forecast	0.1	-0.7	-4.4
USD/MXN	**19.8**	**20.0**	**20.5**
vs.forward	0.5	1.5	4.1
vs.consensus forecast	-1.0	1.3	3.8
EUR/MXN	**24.0**	**24.2**	**24.8**
vs.forward	0.0	1.0	3.6
vs.consensus forecast	-1.8	-0.4	1.3
USD/CLP	**735**	**740**	**750**
vs.forward	2.8	3.5	4.8
vs.consensus forecast	2.8	2.4	0.8
USD/COP	**3350**	**3500**	**3650**
vs.forward	-3.8	0.5	4.8
vs.consensus forecast	-1.5	0.0	4.3
USD/ARS	**93**	**104**	**115**
vs.forward	8.1	20.0	-
vs.consensus forecast	-0.3	0.7	3.5
USD/PEN	**3.7**	**3.6**	**3.5**
vs.forward	0.5	-2.3	-3.7
vs.consensus forecast	1.7	1.4	0.0
EUR/PLN	**4.50**	**4.40**	**4.30**
vs.forward	-0.7	-2.9	-5.2
vs.consensus forecast	0.9	-0.9	-2.3
EUR/CZK	**26.4**	**26.3**	**26.1**
vs.forward	1.2	0.8	0.0
vs.consensus forecast	1.0	1.2	1.2
EUR/HUF	**355**	**367**	**369**
vs.forward	-0.6	2.7	3.3
vs.consensus forecast	-0.8	3.4	4.7
EUR/RUB	**93**	**94**	**96**
vs.forward	4.0	5.3	6.7
vs.consensus forecast	5.9	9.7	14.6

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	1.214	1.372	103.40	125.49	141.87	0.887	1.077	1.217
1M	1.215	1.372	103.37	125.54	141.85	0.887	1.077	1.217
2M	1.215	1.373	103.34	125.58	141.83	0.886	1.076	1.216
3M	1.216	1.373	103.29	125.62	141.80	0.885	1.076	1.215
6M	1.219	1.373	103.18	125.72	141.70	0.883	1.076	1.212
9M	1.221	1.374	103.05	125.83	141.60	0.880	1.075	1.210
12M	1.224	1.375	102.88	125.92	141.50	0.878	1.074	1.207

ATMf vol.

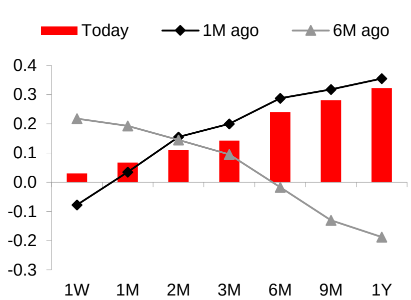
	EUR/USD	GBP/USD	USD/JPY	EUR/JPY	GBP/JPY	USD/CHF	EUR/CHF	GBP/CHF
1W	6.9%	8.1%	5.6%	5.9%	7.4%	6.4%	3.7%	7.5%
1M	6.1%	7.8%	5.4%	5.9%	7.6%	6.0%	3.9%	7.4%
2M	6.2%	7.9%	5.8%	6.1%	7.8%	6.0%	4.1%	7.4%
3M	6.2%	8.0%	5.9%	6.3%	8.0%	6.1%	4.2%	7.4%
6M	6.2%	8.1%	6.2%	6.5%	8.2%	6.2%	4.5%	7.4%
9M	6.2%	8.1%	6.4%	6.7%	8.4%	6.2%	4.7%	7.4%
12M	6.3%	8.1%	6.5%	6.8%	8.5%	6.3%	4.9%	7.4%

Implied/realized vol. ratio

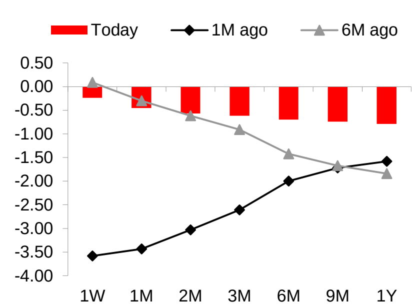
	EUR/USD	GBP/USD	USD/JPY	EUR/JPY	GBP/JPY	USD/CHF	EUR/CHF	GBP/CHF
1W	1.23	1.26	1.21	1.23	1.27	1.10	1.06	1.34
1M	0.98	0.95	1.15	1.14	1.09	0.93	1.00	0.97
2M	0.94	0.76	1.18	1.10	0.87	0.93	1.00	0.78
3M	0.93	0.79	1.08	1.02	0.87	0.93	1.01	0.80
6M	0.91	0.83	1.11	1.02	0.92	0.93	1.04	0.85
9M	0.88	0.85	1.15	0.95	0.90	0.95	1.02	0.86
12M	0.77	0.73	0.81	0.80	0.73	0.81	1.00	0.73

25-delta risk reversals

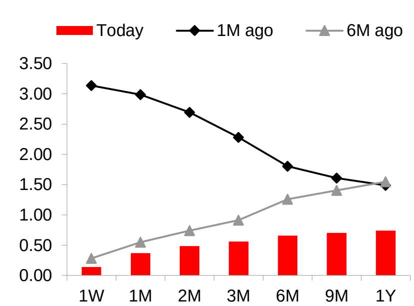
EUR/USD



GBP/USD



EUR/GBP



Sources: Bloomberg and Santander. As of 21-January-2021

Latin America FX: Spot and forward rates

	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
Spot	86.3	5.31	722	3466	19.6	3.62
1M	90.1	5.31	722	3470	19.6	3.61
2M	94.4	5.32	722	3474	19.7	3.61
3M	99.2	5.32	722	3477	19.8	3.62
6M	115.7	5.35	722	3493	20.0	3.62
9M	135.1	5.39	721	3510	20.2	3.62
12M	151.7	5.44	721	3529	20.4	3.62

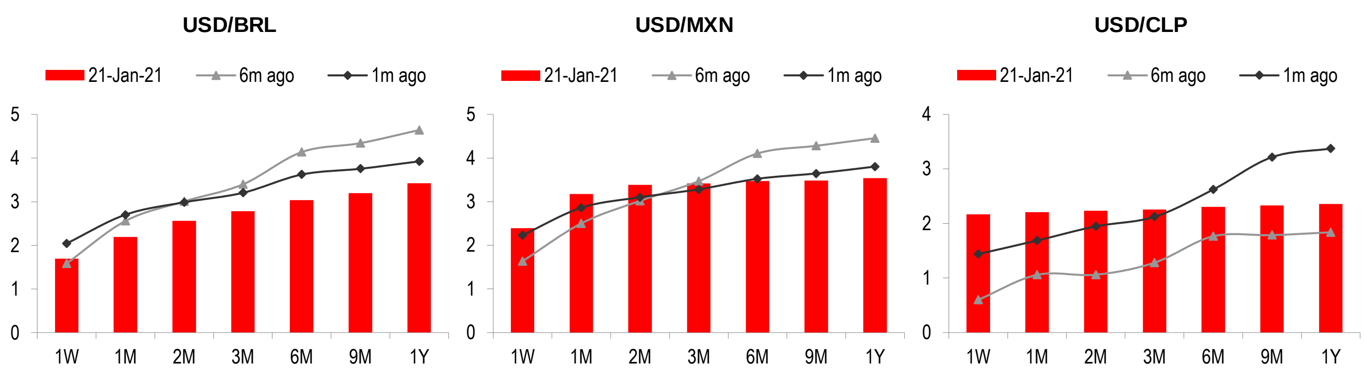
ATMf vol.

	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
1W	7.05	22.66	13.53	12.52	14.03	2.80
1M	9.78	20.98	13.36	13.19	14.06	3.00
2M	13.27	20.37	13.39	13.14	14.04	3.15
3M	15.01	19.67	13.26	13.21	13.85	3.20
6M	17.67	18.57	13.02	13.18	13.56	3.25
9M	19.04	17.83	13.01	13.20	13.28	3.30
12M	19.90	17.36	12.96	13.21	13.11	3.40

Implied/realized vol. ratio

	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
1W	2.26	1.52	1.26	1.49	1.36	1.64
1M	1.91	1.01	0.96	1.03	1.04	1.03
2M	3.02	1.02	1.04	1.06	1.06	0.94
3M	3.80	1.00	1.04	1.03	0.91	0.60
6M	4.07	0.99	1.08	1.08	0.92	0.60
9M	4.71	0.86	0.98	1.04	0.81	0.55
12M	5.10	0.82	0.89	0.78	0.62	0.49

25-delta risk reversals



Sources: Bloomberg and Santander. As of 21-January-2021

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EXPLANATION OF THE RECOMMENDATION SYSTEM

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

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

DEFINITIONS

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

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G10 Rates/FX Strategy			
Antonio Villarroya	Head of Macro and Strategy Research	antvillarroya@gruposantander.com	+34 91 257 2244
Stuart Bennett	**Head G10 FX Strategy**	**stuart.bennett@santanderCIB.co.uk**	**+44 33114 80134**
Michael Flisher	**G10 FX Strategist**	**michael.flisher@santanderCIB.co.uk**	**+44 33114 80232**
Antonio Espasa	Chief Economist	aespasa@gruposantander.com	+34 91 289 3313
Laura Velasco	Economics	laura.velasco@gruposantander.com	+34 91 175 2289
Beatriz Tejero	Economics	beatriz.tejero@gruposantander.com	+34 91 257 2410
Victoria Clarke	UK Economics	victoria.clarke@santandercib.co.uk	+44 77 0848 3219
Adam Dent	UK Rates Strategy	adam.dent@santanderCIB.co.uk	+44 20 7756 6223
José María Fernández	Rates Strategy	josemariafernandezl@gruposantander.com	+34 91 257 2244
Cormac O'Connell	Rates Strategy	cormac.oconnell@gruposantander.com	+34 91 257 2244
Jaime Costero	Rates Strategy	jaime.costero@gruposantander.com	+34 91 257 2244
Latin America Research – Strategy			
Juan Pablo Cabrera	**Chief Rates & FX Strategist – Chile**	**jcabrera@santander.cl**	**+56 22 320 3778**
Juan Miguel Arranz	**Chief Rates & FX Strategist – Argentina**	**jarranz@santanderrio.com.ar**	**+54 11 4341 1065**
Mike Moran	**Rates & FX Strategy – Colombia & Peru**	**mike.moran@santander.us**	**+1 212 350 3500**
Latin America Research – Economics			
Sergio Galván	Economist – Argentina	sgalvan@santanderrio.com.ar	+54 11 4341 1728
Jankiel Santos	**Economist – Brazil**	**jankiel.santos@santander.com.br**	**+55 11 3012 5726**
Guillermo Aboumrad	**Economist – Mexico**	**gjaboumrad@santander.com.mx**	**+52 55 5257 8170**
Marcela Bensión	Economist – Uruguay	mbension@santander.com.uy	+59 82 1747 5537
Central and Eastern Europe			
Maciej Reluga	Head CEE Macro, Rates & FX Strategy	maciej.reluga@santander.pl	+48 22 534 1888
Piotr Bielski	CEE Economist	piotr.bielski@santander.pl	+48 22 534 1888
Marcin Sulewski	**CEE Economist**	**marcin.sulewski@santander.pl**	**+48 22 534 1884**
Wojciech Mazurkiewicz	**CEE Economist**	**wojciech.mazurkiewicz@santander.pl**	**+48 22 534 1886**

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Local Offices

Madrid Tel: 34-91-257-2035 Fax: 34-91-257-0252	**Lisbon** Tel: 351-21-389-3400 Fax: 351-21-387 0175	**London** Tel: 44-870-607-6000 Fax: 44-20-7332-6909	**Milan** Tel: 39-02-8542-09810 Fax: 39-02-8606-71648
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