23 August 2018, 12:45 BST

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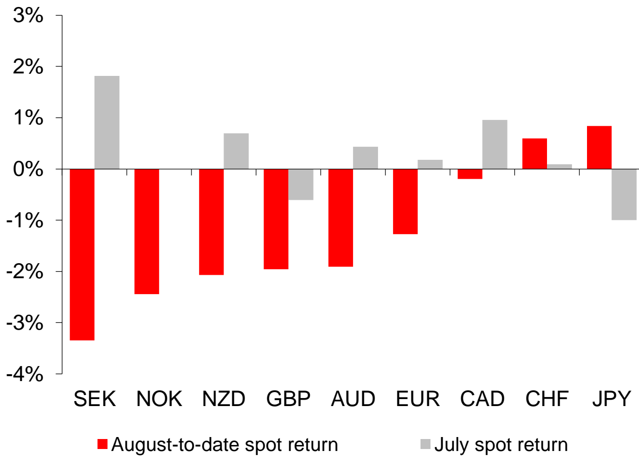
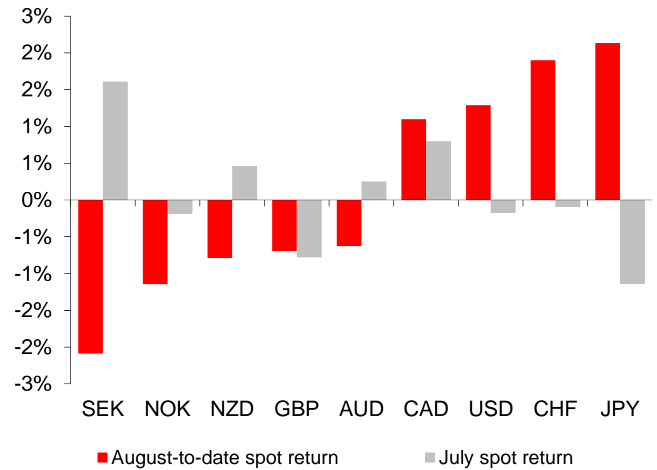
Santander Corporate & Investment Banking

FX Spot Returns

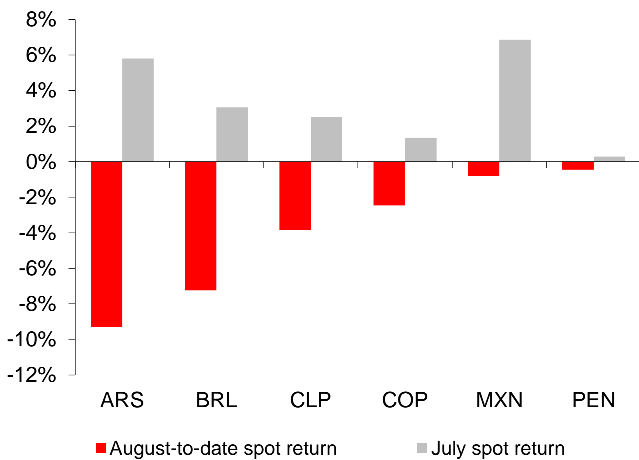
G10 spot returns vs. USD



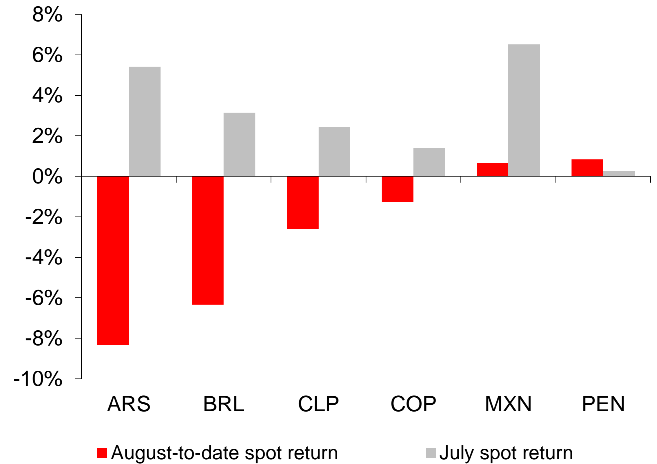
G10 spot returns vs. EUR



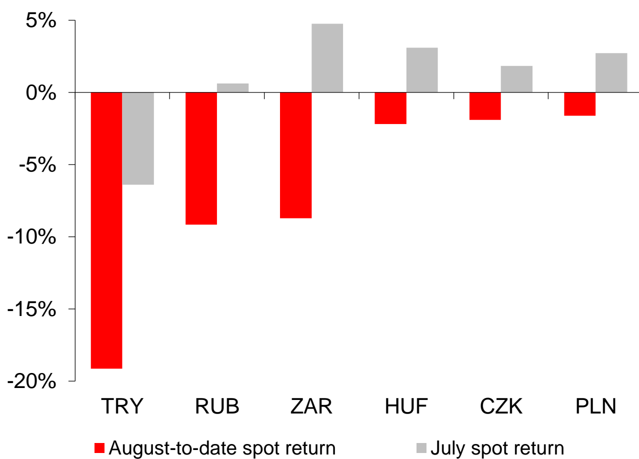
LatAm spot returns vs. USD



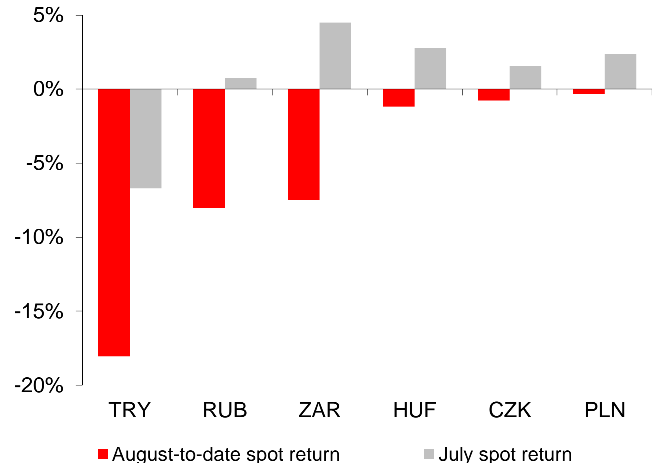
LatAm spot returns vs. EUR



CEEMA vs. USD



CEEMA vs. EUR



Source: Bloomberg, Santander. Note: Data current as at 23 August 2018 at 10:00 BST

FX Forecasts

G10 FX Forecasts

	Q3-18	Q4-18	Q1-19	Q2-19	Q3-19	Q4-19
EUR-USD	1.19	1.21	1.23	1.24	1.25	1.26
GBP-USD	1.32	1.32	1.32	1.33	1.35	1.36
GBP-EUR	1.11	1.09	1.07	1.07	1.08	1.08
EUR-GBP	0.90	0.92	0.93	0.93	0.93	0.93
USD-JPY	114	118	120	120	120	118
EUR-JPY	136	143	148	149	150	149
USD-CNY	6.65	6.70	6.80	6.70	6.70	6.70
EUR-CHF	1.15	1.2	1.22	1.23	1.24	1.24
USD-CHF	0.97	0.99	0.99	0.99	0.99	0.98
EUR-SEK	10.2	9.9	9.7	9.5	9.3	9.2
EUR-NOK	9.4	9.3	9.1	9.0	8.8	8.7
USD-CAD	1.24	1.22	1.22	1.20	1.20	1.19
AUD-USD	0.76	0.77	0.79	0.80	0.79	0.78
NZD-USD	0.68	0.69	0.71	0.72	0.73	0.74

LatAm FX Forecasts

	Q3-18	Q4-18	Q1-19	Q2-19	Q3-19	Q4-19
USD-BRL	3.80	3.50	3.52	3.55	3.55	3.55
USD-MXN	19.3	18.9	18.6	18.5	18.5	18.5
USD-CLP	658	640	650	660	650	640
USD-COP	2820	2800	2780	2750	2720	2750
USD-ARS	29.9	32.0	33.4	34.9	36.5	38.1
EUR-BRL	4.52	4.24	4.33	4.40	4.44	4.47
EUR-MXN	23.0	22.9	22.9	22.9	23.1	23.3
EUR-CLP	783	774	800	818	813	806
EUR-COP	3356	3388	3419	3410	3400	3465
EUR-ARS	36	39	41	43	46	48

CEE FX Forecasts

	Q3-18	Q4-18	Q1-19	Q2-19	Q3-19	Q4-19
EUR-PLN	4.28	4.25	4.28	4.29	4.30	4.32
EUR-CZK	25.7	25.6	25.5	25.5	25.7	25.8
EUR-HUF	325	325	320	325	325	325
USD-RUB	69	70	69	67	67	67
EUR-RUB	82	85	85	83	84	84

Sources: Santander, Bank Zachodni Wbk

G10 FX: Main Themes

Currency	3M view	12M view	Main Themes
USD	⇨	↘	• The USD has been stronger since mid-April. The outlook for more rate hikes and robust US growth should keep the USD firm, but may have been priced in. Plus, trade tensions may become viewed as USD negative.
EUR	⇨	↗	• Low risk appetite has weighed on the EUR. However, Eurozone fundamentals remain solid and, with inflation above target, does the economy still need a deposit rate at -0.4% for another year?
GBP	⇨	⇨	• Sterling has weakened and may remain under pressure, given slower GDP, CPI, political/Brexit uncertainty and general USD strength, as well as less chance of near-term rate hikes.
JPY	↓	↓	• Low risk appetite has boosted demand for the yen. However, when/if such uncertainty disperses, the market will be faced with a yen negative scenario of a BoJ likely to keep policy very loose for a long time.
CNY	⇨	⇨	• As expected, the CNY has softened in 2018, surpassing our year-end forecast. Scope for further losses may have diminished as policymakers appear anxious to prevent the yuan from being viewed as a one-way bet.
CHF	↘	↘	• The CHF has been boosted by low risk appetite. The SNB still views the CHF as 'highly valued' and, despite firmer economic data and CPI, should maintain a very loose policy into 2019 and remain willing to intervene.
CAD	↗	↗	• The CAD should appreciate given the robust economy and expectations that the BoC will hike rates in October. However, NAFTA concerns and, to a lesser extent, a softer oil price will remain near-term risks.
SEK	⇨	↗	• The prospect of a December rate hike is positive for the SEK. However, global trade concerns remain a SEK negative, while the currency is likely to struggle ahead of the Swedish general election, on 9 September.
NOK	↗	↗	• Global trade risks are negative for a net exporter such as Norway. However, the economy remains relatively upbeat, inflation is above target, and the prospect of a rate hike in September should support the NOK.
AUD	⇨	⇨	• Australian monetary policy is likely to continue taking a back seat in H2-18, leaving the USD's moves and global trade concerns to guide the AUD. In the short term, domestic politics are also likely to limit the currency.
NZD	⇨	⇨	• A dovish RBNZ and global trade concerns are likely to constrain the NZD in H2-18. Further weakness should be limited, though, as speculators already hold an all-time high net-short NZD position.

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

Source: Santander

G10 FX Overview

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The USD remains firm amid a mixture of low risk appetite and positive fundamentals. However, after rising 10% since the start of 2018, is the USD index too strong? Fed rate hikes may now be priced into the USD, with the risk that trade tensions weigh on US activity going forward and the administration becomes more vocal in complaining about a strong dollar.

The EUR has been under pressure for most of Q3-18, as low risk appetite has tended to favour a safe-haven bid for the USD and JPY. This pressure does not appear likely to end in the very short term, but with the market very long the USD, having seemingly priced in good US economic news and more Fed rate hikes, there remains scope for the EUR to recover, if the risk backdrop stabilises and the focus shifts to the robust Eurozone outlook.

The pound looks likely to remain under pressure. The BoE hiked rates in August, but doesn't seem in a rush to tighten again soon. The UK's economic data seem to have improved slightly, but global trade concerns and the threat of a 'no-deal' Brexit remain a risk.

We are still negative on the yen. The BoJ is sticking to a loose policy, which should keep pressure on the JPY as other central banks adopt less accommodative stances. However, a sustained improvement in Japan's economic data, and in particular labour earnings, could slow the yen's losses in the longer term. Meanwhile, low risk appetite, will continue to provide support for the JPY, as it is viewed as a safe haven.

There now appears less scope for more CNY weakness. The recent gains in USD/CNY implied that the pair broke above our forecast for the end of this year. For now, the market may continue to view Sino-US trade tensions as USD positive, but the PBoC does not want to use the CNY to counter tariff pressure, and policymakers have taken actions to make it harder for the market to short the yuan.

We are still negative on the CHF. However, in the near term the Swiss franc is expected to stay firm against the EUR as long as risk appetite remains low. We remain positive on the CAD. Canada's economic data has rallied over the past month. Given this, and that CPI, at 2.5% YoY, remains well above the BoC's 2% target, the bank is likely to hike rates in October

We are upbeat on the SEK in the medium term, with the prospect of a December rate hike being positive for the currency. But notable risks to the downside remain over the coming weeks. Global trade concerns continue to restrain the SEK, but the main risk stems from the Swedish general election, on 9 September.

Our optimistic view on the NOK remains. The currency has come under pressure in Q3-18, due to global trade concerns. However, as the economy remains robust and the Norges Bank is set to begin a tightening cycle in September, we see the NOK as oversold.

Our AUD view is now neutral for H2-18. Australian monetary policy is likely to continue taking a back seat in H2-18, leaving the USD's moves and global trade concerns to guide the AUD.

We are no longer mildly bullish the NZD and now hold a neutral view for the remainder of the year. The NZD fell particularly sharply after the RBNZ shifted to a more dovish stance in August, highlighting that a rate hike was firmly off the table and that the chances of a rate cut had increased.

USD – Strength coming to an end?

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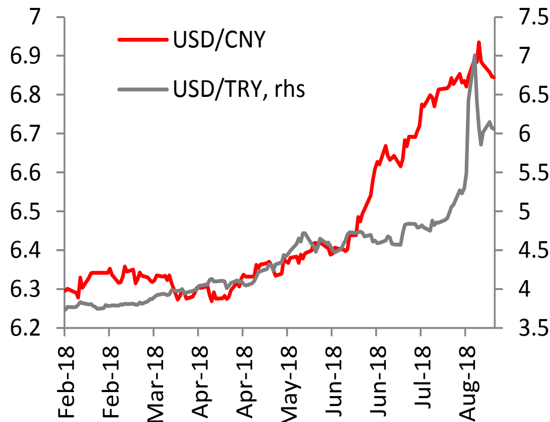
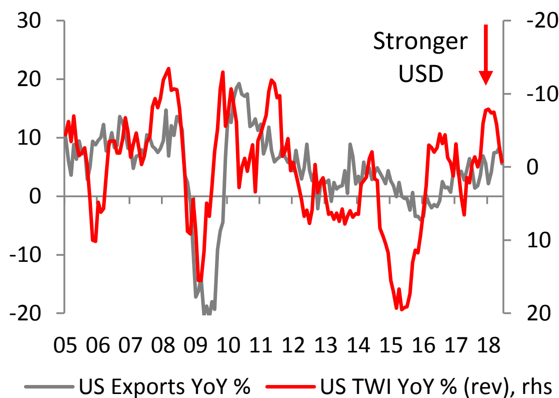
Chart 1: Risk factors and US protectionism have provided support for the USD…



Source: Bloomberg, Santander

Chart 2: …but we need to reiterate that protectionism does not sit well with a strong USD



Source: Bloomberg, Santander

The USD remains firm amid a mixture of low risk appetite and positive fundamentals. However, after rising 10% since the start of 2018, is the USD index too strong? In technical terms, the answer is probably no. The 10% rise in 2018 is large, but still smaller than the 12% increase posted in H2-16 and the 25.6% jump in H2-14. Plus, it could be argued that 2018's gains still represent only a 50% retracement of 2017's losses.

Whilst risk has been the main driver of the USD recently, it is the fundamental backdrop that acts as a sustainable support. The US economy grew 4.1% YoY in Q2 and is expected to outperform its developed market peers in 2018 and 2019. Unemployment fell to 3.9% in July, and economic confidence remains high. Consequently, inflation has risen to 2.9% YoY in July, which we still suspect should be enough to allow the FOMC to hike rates four times more, twice in H2-18 and twice in H1-19.

Interest rates thus remain a USD support. With the exception of the BoC and Norges Bank, other developed market central banks should keep policy on hold well into 2019, with the RBA and RBNZ recently using much more dovish rhetoric. Nevertheless, the USD's weakness in 2017 occurred despite interest rate differentials being in its favour. Hence, the market can ignore the influence of rates on FX when it suits. Further, it might be argued over the coming months that the US tightening cycle is nearing its end, which could encourage some market participants to re-position toward currencies, such as the EUR, whose central banks look set to push up rates in 2019.

However, risk has been the main USD driver. Concerns about the impact of trade tensions with China and the situation with Turkey have undermined risk appetite and boosted demand for the USD as a safe haven. The trade spat between China and the US may prove to have a more lasting effect on the market than the recent focus on Turkey/EM, but both highlight the vulnerability of global sentiment and growth.

The resumption of talks between the US and China is a positive sign, but perhaps not enough to significantly dent the USD. However, if, as the IMF has warned, trade policies undermine global growth, this may have an impact on US sentiment, which could eventually influence Fed rhetoric and make the market question whether all of those extra rate hikes will be forthcoming.

We still highlight the paradox of a market that pulled the USD higher due to US protectionism. A stronger currency should be the last thing that a protectionist would want. In late July and August, President Trump complained about the disadvantage to the US of a strong currency and rate hikes. This increased speculation that the US might intervene to weaken the dollar. We do not think this is likely, particularly given G20 communiqués, which argue against devaluing a currency for competitive reasons. However, given that the US has already walked away from other international agreements, would another matter?

Further, the New York Times reported on 16 August that the US will seek to pressure China to strengthen the CNY. A higher USD/CNY has been the flagbearer for general dollar strength, so if this is ended, it could pull the dollar down against the board.

EUR – Vulnerable to risk

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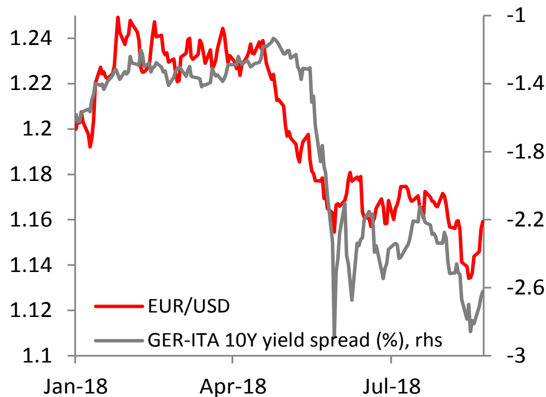
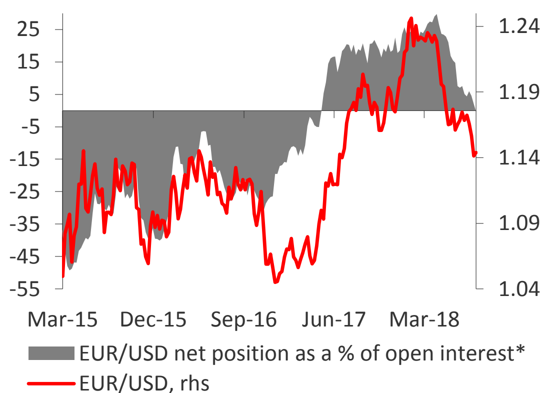
Chart 3: Global and Eurozone risk is weighing on the EUR again



Source: Bloomberg, Santander

Chart 4: Speculators have now unwound their net long EUR/USD position, but overall are still very long the USD



*Open interest = total short + long contracts

Source: CFTC, Bloomberg, Santander

The EUR has been under pressure for most of Q3-18, as low risk appetite has tended to favour a safe-haven bid for the USD and JPY. This pressure does not appear likely to end in the very short term, but with the market very long the USD, having seemingly priced in good US economic news and more Fed rate hikes, there remains scope for the EUR to recover, if the risk backdrop stabilises and the focus shifts to the robust Eurozone outlook.

The deterioration in risk appetite, which has weighed on EUR/USD, has focussed on two factors. First, trade tensions, primarily between the US and China. Second, concerns about Turkey and its spill-over to other emerging markets. In addition, the EUR has been rattled by worries about Italy's budget plans.

The Turkish panic, the TRY sell-off, and the spill-over to other emerging markets boosted the USD. The knee-jerk reaction has subsided as Turkish policymakers acted to stabilise the currency, but these risks are likely to linger over the coming month. Similarly, intermittent worries about the Italian government's spending plans will be pounced upon as a reason to keep the EUR low.

Hence, the German-Italian 10Y spread (a proxy for EUR risk) has widened. Since the start of 2018, there has been a strong correlation (r=0.89) between EUR/USD and the Bund-BTP spread. The spread hit a low at -2.85% on 15 August, not far off the 2018 low of -2.89%, posted in May when the market was worried about the formation of the new, more 'populist' Italian government.

In terms of worries about trade , the EUR has been undermined by concerns about global trade tensions' impact on world growth. However, focussing on bilateral trade between the US and the EU, the news has been less EUR negative. At the end of July, the EU and US agreed to suspend fresh tariffs and negotiate on trade.

Unfortunately, fears that a Sino-US trade war might undermine global growth have tended to push the USD higher and drag the EUR down. The FX market still views a protectionist US stance as USD positive. We would continue to highlight that the last thing protectionist policymakers want is for their currency to strengthen, and still believe that if the EUR/USD continues to weaken, the US may become less willing to allow their currency to appreciate, making exporters less competitive.

Further, we still feel that the USD is more vulnerable to a protectionist-inspired global slowdown. The US economy remains strong and inflation is high. Indeed, more Fed rate hikes are already priced in. Hence, slower growth/market uncertainty may encourage the market to price out some of those hikes, thereby supporting EUR/USD. Consequently, we still believe that the market is too pessimistic about EUR/USD and too long the USD.

Admittedly, downside growth pressure would also weigh on the ECB. However, with the Bank sticking to its very cautious stance of no rate hikes until after the summer of 2019, there is less scope for it to become even more dovish. Moreover, if global trade tensions ease over the coming months, the market may start to question the bank's cautious stance. The combination of Eurozone GDP growth above 2%, inflation above target and solid economic confidence does not, at face value, indicate an economy that requires its main interest rate to remain at -0.4% for another year.

GBP – What's in the box?

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The pound looks likely to remain under pressure. The BoE hiked rates in August, but does not appear in much of a rush to tighten policy again soon. The UK's economic data seem to have improved slightly, but global trade concerns and the threat of a 'no-deal' Brexit remain a risk. In addition, Turkish/emerging market worries have boosted demand for the USD (and JPY), keeping GBP/USD under pressure.

The BoE hiked its benchmark rate 25bp to 0.75% at its August meeting. If its economic forecasts prove correct, further 'gradual' rate hikes are likely. As the bank expected, GDP growth improved in Q2-18, with the economy growing 0.4% QoQ, after 0.2% in Q1. In addition, overall, UK economic figures have started to surprise to the upside again.

However, the economy's response to 'Brexit' will determine the accuracy of the BoE's forecasts and that will not even start to become clearer until Q2-19. Furthermore, whilst inflation did edge higher in July, to 2.5% YoY, we expect CPI to decline into 2019, and end 2018 at below the BoE's target. Hence, we think that even the gradual rate hikes (an increase every 9-12 months) may prove too hawkish, and expect no change in policy until 2020.

Thus, even though we believe the pound is cheap at its current levels, the mix of declining CPI, a loose monetary policy and risk factors imply only intermittent upside pressure on sterling, which may be viewed as a selling opportunity.

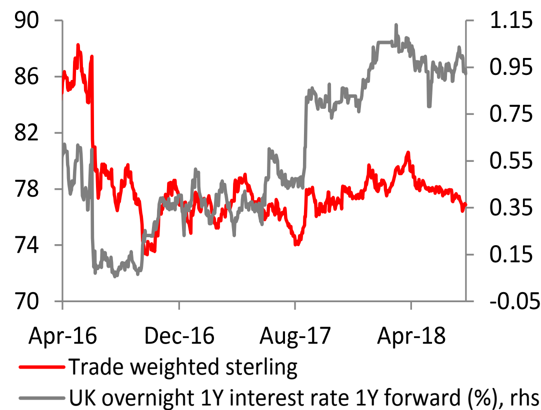
For instance, GBP/USD weakened as the USD was bought as global risk appetite slumped, as a result of worries about global trade and fears about the spill-over effect to other markets from events affecting Turkey. Admittedly, the knee-jerk panic that prompted the FX market to seek the sanctuary of the US dollar could abate, and allow GBP/USD to revisit 1.32 levels, but bigger gains are unlikely as Brexit uncertainty persists.

Indeed, the risk appears to have grown that the UK may not reach a deal with the EU on a withdrawal agreement by late October. Liam Fox, the international trade secretary, warned that the odds of the UK leaving the EU without a deal were "60-40". Further, the governor of the Bank of England cautioned that the risk of the UK leaving the EU without a deal was "uncomfortably high".

We suspect that the consensus view is still that the politicians will reach some sort of agreement. Hence, failure to do so would imply a GBP negative shock, which could replicate the type of move that was seen after the EU referendum in June 2016. Then, GBP/USD weakened sharply and was around 15% cheaper two weeks after the vote. If replicated on a 'no-deal' outcome, this would imply cable sinking below 1.10.

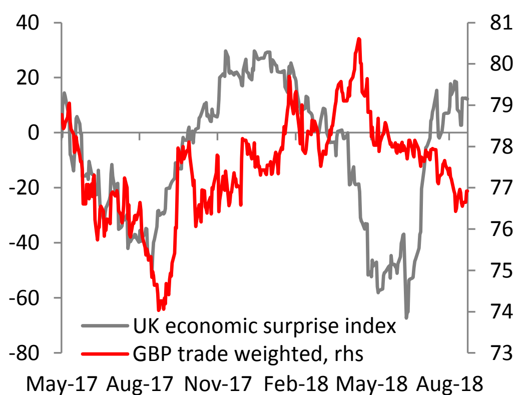
Such a sharp move may be less likely now, given that the pound is already cheap and may have priced in some of this risk. Plus, a 'no-deal' outcome might become clearer before October and have a staggered impact on the pound. However, the positive impact on the pound from a 'deal' outcome may not be symmetrical to 'no-deal'. The pound would likely rise, but with much uncertainty surrounding future trade arrangements between the UK and EU, the market may be reluctant to pull it significantly higher.

Chart 5: Sterling remains weak, despite BoE rate hikes…



Source: Bloomberg, Santander

Chart 6: …and an improvement in UK economic data



Source: Citi, Bloomberg, Santander

JPY – Still a risky bid

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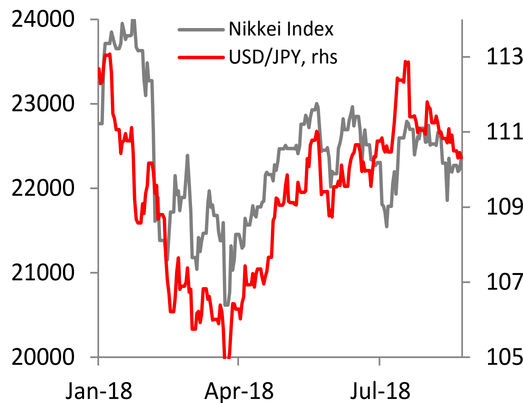
We are still negative on the yen. The BoJ is sticking to a loose monetary policy, which should put pressure on the JPY as other central banks adopt less accommodative stances. However, a sustained improvement in Japan's economic data, and in particular labour earnings, could slow the yen's losses in the longer term. Meanwhile, low risk appetite, due to both emerging market concerns, focussing on Turkey, and ongoing global trade tensions, will continue to provide support for the JPY, as it is viewed as a safe haven.

Chart 7: Risk/equities has been driving the yen



Source: Bloomberg, Santander

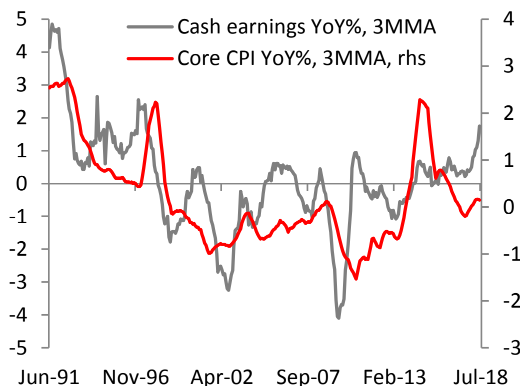
Risk appetite is likely to remain the main driver of the yen over the coming weeks. Global risk appetite has weakened, amid market concern about the impact of US protectionism on global growth. In addition, the recent concerns about Turkey and its spill-over effect on emerging markets in general have increased risk aversion.

Given that the yen is traditionally viewed as a safe-haven investment, which tends to be bought at times of low risk appetite, it is no surprise that the currency has performed strongly over the last month. That said, its performance against the dollar has been more muted, as the USD has also strengthened amid safe-haven demand for the dollar.

For example, there tends to be a strong correlation between USD/JPY and the Nikkei index, using equities as a proxy for risk. As such, when risk appetite is low and stocks weaken, USD/JPY tends to decline. Year-to-date this relationship has held up, with the correlation between the two at 0.8.

Beyond the noise generated by the yen-positive risk issues, we still feel that the BoJ's policy stance remains a yen-negative factor. In the run-up to the July BoJ meeting, the yen strengthened on speculation that the bank might edge away from its ultra-loose policy.

Chart 8: Labour earnings are growing, but pay relies too much on bonuses for policymakers to confidently believe it is sustainable and will pull CPI higher



Source: Bloomberg, Santander

However, in the end the bank made little change. The deposit rate was kept at -0.1%, with 10Y yields still targeted to be kept close to 0%. It did suggest more flexibility in tolerating higher yields, which may imply a willingness to allow the JGB to test 0.15% levels before the bank intervenes, but is not, in our opinion, sufficient enough a change to alter the yen-monetary policy trade-off over the coming months. Indeed, the current US-Japan 10Y rate spread suggests to us that better value for USD/JPY based on this is currently 116.

In addition, the necessity for the BoJ to make further tweaks to its policy does not appear urgent. The bank cut its inflation forecasts for the current fiscal year, as well as FY19 and FY20, and reiterated its intention to keep rates low for an extended period of time. That said, GDP growth in Q2-18 was better than expected at 0.5% QoQ, versus -0.2% in Q1. However, consumption data look to have been flattered by a dip in the price deflator, while soft machine orders, weak IP data for June, as well as trade concerns, imply that growth risks remain.

On the plus side, labour earnings rocketed 3.6% YoY in June, but the strength was primarily due to a rise in discretionary bonuses, and did not have a positive impact on household spending, which fell 1.2% YoY. Hence, with core CPI at just 0.8% YoY in June, it may require a large and sustained rise in non-bonus labour earnings to convince the BoJ that upside pressure on CPI can be maintained. That still appears many months off and, in our opinion, only then will the bank be willing to alter its policy again and allow the yen to strengthen.

CNY – Stopping herd behaviour

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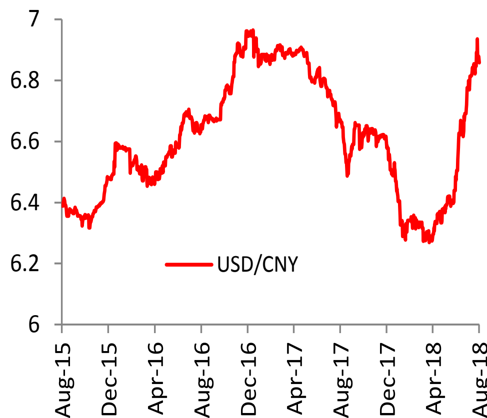
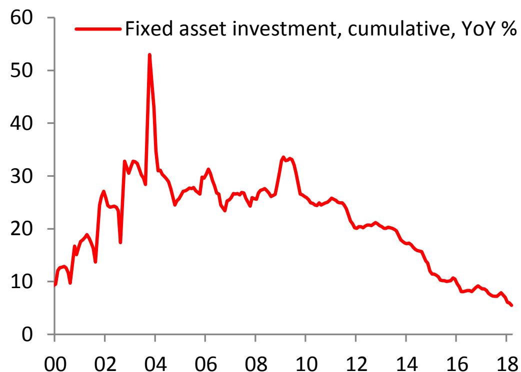
Chart 9: USD/CNY may have peaked



Source: Bloomberg, Santander

Chart 10: Signs of Chinese slowdown starting to mount



Source: Bloomberg, Santander

In our opinion, there is now less scope for further CNY weakness. The recent gains in USD/CNY already imply that the pair has broken above our forecast for the end of this year. For now, the market may continue to view Sino-US trade tensions as USD positive, but the PBoC does not want to use the CNY to counter tariff pressure, and policymakers have taken actions to make it harder for the market to short the yuan.

The yuan has continued to weaken over the last month. The week up to 11 August marked the CNY's 9th weekly decline, the longest stretch since modern policy started in 1994. Concerns over US-Chinese trade tensions have continued, but jitters about Turkey/emerging markets have also weighed on risk appetite and boosted the USD. However, whilst the weaker yuan versus the USD does counter some of the adverse effect on China from US tariffs, the PBoC reaffirmed in its monetary policy report that it will not use the yuan as a tool to cope with trade tensions, and will not conduct any 'strong' economic stimulus.

Indeed, over the last month Chinese policymakers have made efforts to slow the yuan's decline: 1) The PBoC announced it would impose a reserve requirement of 20% on some FX forwards, increasing the cost to short the CNY. A similar tool was used to stabilise the currency in the aftermath of the 2015 devaluation; 2) it was also reported that banks were warned not to adopt 'herd' behaviour, and chase downside yuan momentum; and 3) amid reports that China was restricting banks' ability to lend yuan offshore, forward points for the offshore yuan surged, making a negative stance on the yuan more expensive.

The above suggests that policymakers do not want the USD/CNY to break the 7 level, and hence the August high of 6.934 may represent a peak. Indeed, a weaker yuan may create several problems: 1) The US may see a weak CNY as 'unfair'. The NY Times reported on 16 August that it is likely to put pressure on China to lift the yuan; 2) Chinese equity markets are weak, losing 18% since the start of the year, and further yuan weakness may encourage capital outflows; 3) capital outflows would put pressure on policymakers and run the risk of destabilising the economy and diverting their attention from trying to reduce China's debt burden.

Further, recent Chinese data have indicated that activity may be slowing. Fixed asset investment grew by only 5.5% YoY in the seven months to July, the slowest pace for 20 years. Industrial production undershot forecasts in July, as did retail sales. Signs that the economy is losing momentum may imply that the PBoC will want to cut banks' reserve requirement ratio again over the coming months. Given that such a move would be viewed by the market as a currency-negative easing, policymakers may be anxious for the yuan to strengthen now, and give them some wriggle room against future weakness if policy needs to be altered to help the economy.

Hence, the effective policy stance may have shifted slightly to stabilising depreciation risk from staying neutral as it frets about capital outflows. Thus, changes are in the pipeline to try and shore up China's appeal to investors, with the announcement that China would revise its investment rules to broaden access for foreign funds and allow more types of investment by them.

CHF – Rising on risk

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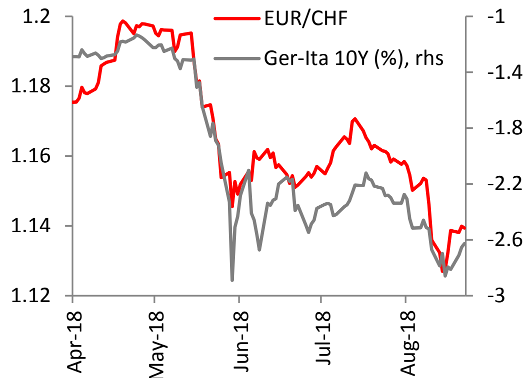
Chart 11: Lower (European) risk appetite has dragged EUR/CHF lower



Source: Bloomberg, Santander

We are still negative on the CHF. However, in the near term the Swiss franc is expected to stay firm against the EUR as long as risk appetite remains low. EUR/CHF dropped below 1.13 in August, the lowest level since July 2017, as concerns about Turkey/emerging markets, as well as jitters about Italian budget plans, boosted demand for the CHF as a safe haven.

Before then, low risk appetite was driven by trade tensions between the US and China, and had tended to be played out via a rising yen. However, with the focus switching to European concerns, the EUR weakened, taking EUR/CHF with it. Indeed, the correlation between the German-Italian 10Y spread (a proxy for EUR risk) and EUR/CHF has been 0.94 since the start of Q2-18, when the market became concerned about Italian politics again.

Hence, much of the EUR/CHF decline is due to the EUR and it may thus require a general pick-up in the single currency to pull the cross higher. If this is not forthcoming, the SNB will likely be willing to act on the pledge to intervene in the FX market when needed to weaken the CHF. The weekly data on total sight deposits may give some clues as to how active the bank might be.

However, the renewed strength of the CHF should ensure that, despite a steady improvement in economic data and CPI, the bank will likely stick to its view that the CHF is 'highly valued', and maintain its very loose monetary policy and the deposit rate at -0.75% well into 2019.

CAD – Looking for gains

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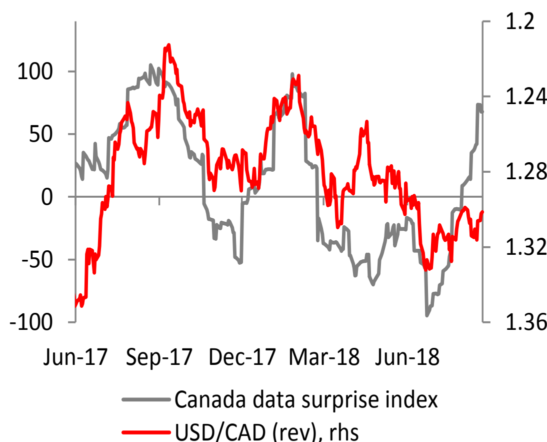
Chart 12: Strong economic data and the prospect of higher interest rates should support the CAD, despite NAFTA risks



Source: Citi, Bloomberg, Santander

We remain positive on the CAD. Canada's economic data surprise index has rallied over the past month as economic figures have been better than expected. Another decline in unemployment, to 5.8% in July, has supported consumer spending. Overall GDP growth was 0.5% MoM for May, compared to the 0.3% forecast and 0.1% in April. Given this, and that CPI, at 2.5% YoY, remains well above the BoC's 2% target, the bank is likely to hike rates again in October.

Uncertainty about the NAFTA negotiations and trade tensions remain a downside risk for the CAD, with Mexico apparently closer to reaching a deal with the US. However, has some 'bad' NAFTA news already been priced into USD/CAD?

The apparent deterioration in talks between the US and Canada has not prevented the CAD from posting solid gains against its developed market peers: indeed, so far in Q3-18 the CAD has been the best-performing G10 currency.

Another downside risk is the oil price. The WTI oil price has dropped from almost USD75/bbl at the start of July to c.USD66/bbl currently. However, this has been largely ignored by the currency, suggesting that the near-term correlation between oil and the CAD has weakened.

Nevertheless, looking at data for the last five years, we still see a strong link between the two (r=-0.9), and this longer-term relationship continues to suggest that USD/CAD is overvalued in relation to oil and should be trading closer to 1.23.

SEK – Restrained by election risks and 'Swexit' fears

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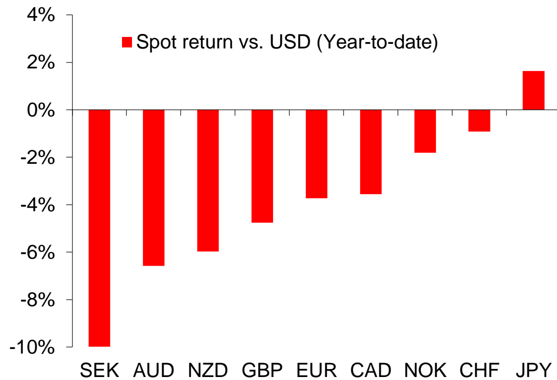
We are upbeat on the SEK in the medium term, with the prospect of a December rate hike being positive for the currency. But notable risks to the downside remain over the coming weeks. Global trade concerns continue to restrain the SEK, but the main risk stems from the Swedish general election, on 9 September. Of particular concern to the market is the rapid rise of the nationalist Sweden Democrats, which support a 'Swexit' referendum on Sweden's EU membership. We continue to forecast EUR/SEK declining to 10.2 in Q3-18 and 9.9 by year-end, but SEK gains are unlikely until election risks subside.

Chart 13: The SEK is by far the worst performing developed market currency this year



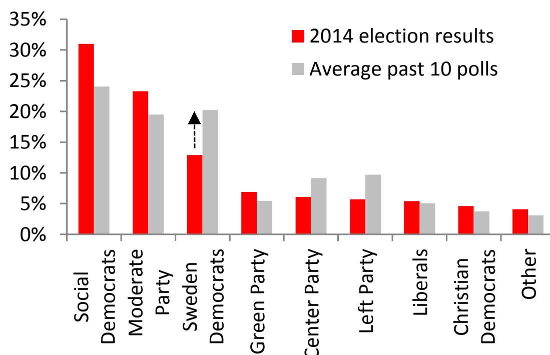
Source: Bloomberg, Santander

The SEK has taken a big hit this year. It is by far the worst performing G10 currency, weighed down by global trade concerns and risk aversion, as well as by fears that US tariffs could potentially have a negative impact on the Swedish automotive industry. The SEK is down by 10% against the USD year-to-date, significantly more than the next worst performing developed market currency, the AUD (Chart 13).

Global trade concerns are likely to continue to limit the SEK, but election risks are also set to hold the currency back in the coming weeks. The Swedish general election takes place on Sunday, 9 September. Polls suggest the traditionally dominant Social Democratic party could be challenged (Chart 14).

Of particular concern to the market is the rapid rise of the nationalist Sweden Democrats, which only entered the Swedish parliament for the first time in 2010. In August, leader Jimmie Åkesson reiterated his party's support for a 'Swexit' referendum on Sweden's EU membership. While we see very little chance of a 'Swexit' occurring, the mere mention of it is likely to be enough to constrain the SEK for now.

Chart 14: Election uncertainty has weighed on the SEK, especially as the far-right pro-'Swexit' Sweden Democrats have risen in the polls



Source: pollofpolls.eu, Bloomberg, Santander

The domestic backdrop still looks pretty good, and should support the SEK further ahead. Indeed, the preliminary GDP estimate for Q2-18 came in at a very robust 1% QoQ, double market expectations. Headline inflation is also still elevated, with both the CPIF and CPI rates above 2% once again in July.

However, while the Riksbank has suggested it could hike rates in December, this will be reliant not only on firm GDP and headline CPI data, but also on core inflation. The Bank has persistently cited CPIF excluding energy as a key focus. This slid to 1.3% YoY in July, and will likely need to edge up over the coming months if the Bank is to hike rates this year.

We expect to see another clear vote in favour of no change on 6 September. While there is a chance of a 3:3 tie in October, in such a scenario the governor's vote would trump the rest, likely resulting in no change. Hence, a rate hike before December currently looks unlikely, with the SEK continuing to face short-term pain until a rate hike is closer, and election risks have passed.

However, even a December rate hike would see the Riksbank lift-off not just before the ECB, but also before the SNB, BoJ, RBA and RBNZ (the Norges Bank is likely to hike rates in September). Hence, the beginning of a tightening cycle, however slow, would justify SEK gains, in our view.

NOK – And then there were four (?)

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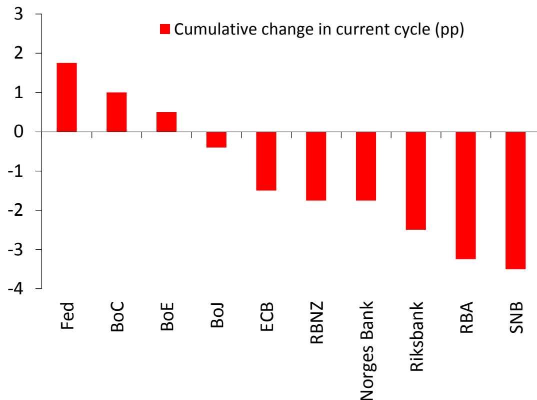
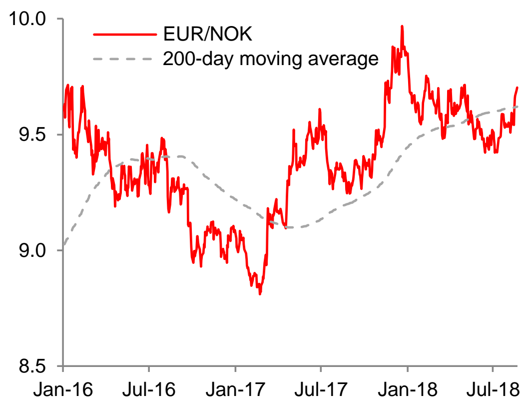
Chart 15: The Norges Bank is preparing to join the FOMC, BoC and BoE in starting a hiking cycle



Source: Bloomberg, Santander

Chart 16: Despite global trade concerns, a firm oil price and Norges Bank rate hike should boost the NOK



Source: Bloomberg, Santander

We remain optimistic on the NOK for the remainder of 2018. The currency has come under pressure so far this quarter, hurt primarily by global trade concerns, as Norway is a large net exporter. However, the economy remains relatively upbeat and inflation is above target. With oil prices firm, and the Norges Bank set to begin a tightening cycle in September, we see the NOK as oversold and consider it to be just a matter of time until it starts to strengthen. We still see EUR/NOK dropping to 9.4 in Q3-18 and 9.3 by year-end and therefore retain our 19 July sell EUR/NOK recommendation.

The NOK has not performed too badly in 2018, but the currency has been sold quite firmly in both July and August, as global trade fears have weighed on risk currencies. The fact that Norway is, and has long been, a net exporter, does not help the NOK at a time when trade wars and protectionism have quickly escalated, punishing currencies of net exporters.

Ironically, Norway is actually a net importer from the US. But any drop in global trade would still likely hurt Norwegian exports, and so trade fears will probably remain a constant negative for the NOK, given the increasingly uncertain global trade backdrop.

The Norges Bank is likely to keep an eye on trade, but at the Bank's August meeting, the executive board reiterated that the outlook and balance of risks suggested that the key policy rate would probably be raised on 20 September 2018.

The Norges Bank last hiked rates in May 2011, but it was quickly forced to unwind them once again, as headline inflation fell towards zero. Headline CPI is now no longer a problem, having risen to 3% YoY in July, comfortably above the Bank's 2% target. The Bank also considers the core rate, which is much lower, at 1.4%. But this also rose in July, climbing to a joint 12-month high. Further, the bank expects it to increase gradually over the coming quarters.

Growth data also appear to support a rate hike, with the Q2-18 mainland GDP print rising to 0.5% QoQ. Hence, 30 months after cutting its deposit rate to an all-time-low, at 0.5%, the Norges Bank now looks set to hike rates.

Governor Olsen insists that he would prefer to hike rates together with a press conference and the release of the Bank's updated forecasts. Hence, it should now take a sizable drop in the August inflation data (released on 10 September) or some notable and unforeseen event to prevent a hike by the Bank.

The prospect of a rate hike should be boosting the NOK, but, together with the SEK, it is actually the worst performing developed market currency over the past month, with global trade risks and a strong USD driving the FX market. The Norges Bank has even suggested that the weak currency is now actually becoming an argument for a slightly higher rate hike path. Hence, while global trade concerns may continue to weigh on the NOK in the coming weeks, as soon as these die down, a tightening path should boost the NOK.

AUD – Down on domestic politics and the USD

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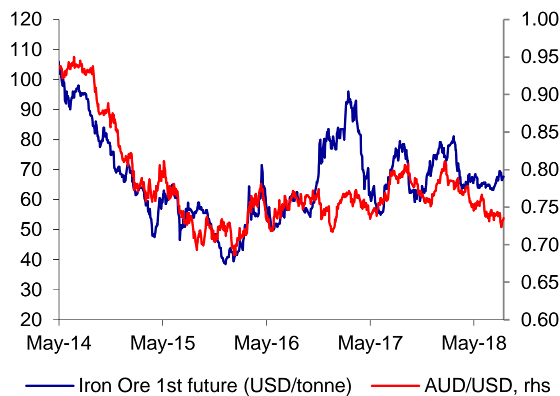
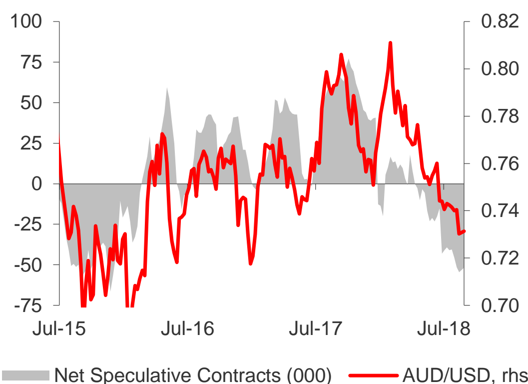
Chart 17: Iron ore prices have picked up over the summer, but these can occasionally deviate from the AUD direction over the short term



Source: Bloomberg, Santander

Chart 18: Speculators have gradually increased their net short AUD/USD position, which has helped pull the currency pair lower



Source: CFTC, Bloomberg, Santander

We remain neutral the AUD in H2-18. AUD/USD fell to 0.72 briefly in August, a 19-month low, but this was more due to USD strength than anything else, as the AUD trade-weighted index is little changed over the past six months. Australian monetary policy is likely to continue taking a back seat in H2-18, leaving the USD's moves and global trade concerns to guide the AUD. We continue to see AUD/USD close to 0.76 in Q3-18 and 0.77 for year-end.

Domestic political uncertainty has not helped the AUD of late. Prime Minister Turnbull survived a leadership challenge from the right wing of his Liberal party earlier this week, but after various ministerial resignations, another vote is possible. At best, the incumbent is likely struggle to achieve any meaningful policy change in the run-up to the 2019 Australian federal elections (due to be held before 18 May 2019).

Evidence of this was perhaps also underlined this week, with the prime minister dropping plans to cut corporate taxes after they were rejected by the senate.

Australian monetary policy continues to do little to offer the AUD direction. The RBA kept rates on hold, at 1.50%, for a record 22nd consecutive meeting in August, and the Bank continues to argue that there is no strong case to hike rates in the near term.

We do not expect the Bank to lift rates until late 2019, which suggests that the AUD could be relatively immune to the RBA meetings for the remainder of 2018. However, Governor Lowe has indicated his concern about the shift in global trade policies and its potential impact on the Australian economy.

Certainly, the increasing worries over global tariffs and protectionism have weighed on risk currencies, including the AUD. AUD/USD is down about 2% month-to-date, and by more than 6% year-to-date, underperforming all other developed market currencies bar the SEK. Global risk sentiment is likely to continue to impact the AUD in the coming months, especially through the AUD/USD.

Despite the AUD's weakness, the Australian economy still seems to be in good health. Inflation sits at the lower end of the RBA's 2-3% target range, while the economy is already in its 27th year of recession-free growth. GDP growth is expected to dip to 0.6% QoQ / 2.7% YoY in Q2-18, when released on 5 September, but the RBA continues to forecast annual growth above 3% both this year and next.

Although the latest employment report disappointed in July, with the month-on-month change in employment negative for just the second time since 2016, the unemployment rate continues its downward trend.

Iron ore prices have picked up in both July and August, with the DCE iron ore future peaking above CNY500/tonne in mid-August. Beijing is cracking down on pollution, which should help support iron ore prices. However, as Chart 17 shows, when there is a divergence between iron ore prices and AUD/USD, it is often the former that ends up heading in reverse.

NZD – A dovish shift

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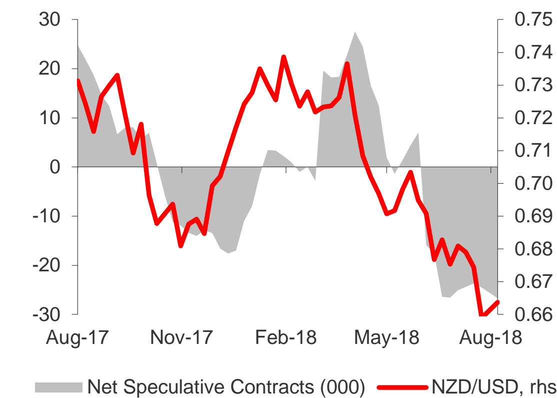
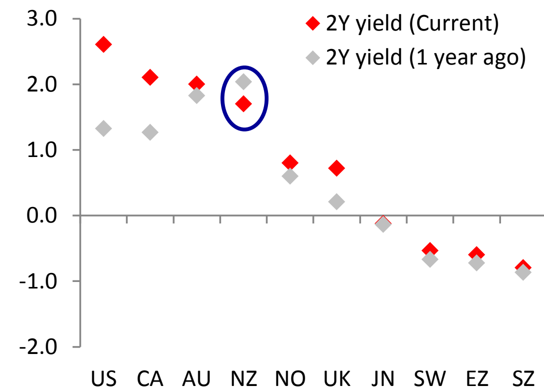
Chart 19: With the speculative net short NZD position at an all-time high, there should be less scope for speculators to sell the currency further



Source: CFTC, Bloomberg, Santander

Chart 20: Upbeat growth prospects and monetary policy have pulled most countries' yields higher over the past year, but not in New Zealand



Source: Bloomberg, Santander

We are no longer mildly bullish the NZD and now hold a neutral view for the remainder of the year. Market sentiment has weighed on risk currencies in general this summer, but the NZD fell particularly sharply after the RBNZ shifted to a more dovish stance in August, highlighting that a rate hike was firmly off the table and that the chances of a rate cut had increased. With the Bank pushing its forecasts for a rate hike back by a year, to Q4-20, we have cut our NZD/USD forecasts. We now see the pair at 0.68 by year-end (0.72 previously).

Emerging market risks, particularly in Turkey and China, and general concerns over global trade, have continued to weigh on risk sentiment. The USD has benefitted from this increase in risk aversion while the NZD has come under intense pressure, with NZD/USD falling below 0.66 in mid-August.

This was not just a two-year low for the pair, but at the time represented a 7% year-to-date drop. NZD/USD has recovered a little since, helped by USD weakness and a pick-up in retail sales data, but if the US maintains its confrontational attitude to trade, the USD is likely to stay strong, and this alone is going to hamper the outlook for NZD/USD.

Domestically, there does not appear to be much support for the NZD either. New Zealand's trade deficit hit a nine-year high in June, as fuel imports increased and dairy export volumes and prices fell again. Building permits also continued to slide in June, while business confidence slipped to a 10-year low.

The big negative for the NZD weakness over the past month though, and now a significant constraint on the currency going forward, was the RBNZ. The Bank kept its cash rate on hold in August, at 1.75%, but it pushed back its already cautious forecast for a Q3-19 rate hike by a whole year, to Q3-20.

The NZD and domestic bond yields fell after this dovish shift from the RBNZ made it clear that a rate hike was now off the table and that a rate cut would be needed if growth slows further below potential. Annual GDP slowed to 2.7% in Q1-18, and the RBNZ forecasts growth of just 2.3% in Q2-18 and 2.5% in Q3-18, below the Bank's potential growth rate estimate of around 3%. Hence, the release of the Q2-18 GDP data, on 19 September, could play an important role in determining how dovish the RBNZ's stance is likely to be at its next meeting, on 26 September.

Inflation rose in Q2-18, with the headline print reaching 1.5% YoY (1.1% previously). Higher oil prices, a proposed 3-4 cent national fuel excise tax increase, along with the 11.5 cent rise that was rolled out in Auckland on 1 July, should help boost headline CPI. However, the bank is keeping a close eye on core inflation and suggests this would need to be above 2% in order to hike rates.

Global trade concerns, together with another two years of unchanged rates in New Zealand are understandably NZD negative. Speculators now hold their largest ever net short NZD position (Chart 19). While we see little reason to buy the currency given this backdrop, there should now also be less scope for this portion of the market to sell the NZD even further.

LatAm FX: Main Themes

Currency	3M view	12M view	Main Themes
BRL	⇨ (Neutral)	↗ (Mildly Bullish)	• Presidential polls and the external scenario are likely to be the main drivers for the BRL in the short run, in our view. • More specifically, the market is likely to assess the chances of reformist candidates through polls and react accordingly. The beginning of TV advertisements, on 31 August, is expected to shift the current picture of voting intentions. • Our scenario assumes a market-friendly candidate getting elected in October, which would, in our view, be a bullish catalyst in the medium term.
MXN	⇨ (Neutral)	↗ (Mildly Bullish)	• MXN has not been immune to the second leg of EM stress this year; however, it has managed to outperform other EM FX peers, supported by carry, resilient fundamentals, and light positioning. • NAFTA is a structural catalyst for MXN looking forward. A deal on the auto sector would be a breakthrough and bullish for MXN, but a final agreement would require some US flexibility on other contentious items. • We remain constructive on the currency over the longer term, as we believe the US will agree to NAFTA modernisation.
CLP	⇨ (Neutral)	↗ (Mildly Bullish)	• The CLP is likely to remain dependent on the external scenario, with a special focus on trade tensions and copper prices. • The risk is a permanent decline in copper prices, with effects on business confidence, investment, and eventually growth. • In the medium term, if copper prices normalise, the CLP should remain relatively strong vs. EM peers, given Chile's lack of fundamental imbalances in the economy.
COP	⇨ (Neutral)	↗ (Mildly Bullish)	• COP performance risks are tilting upwards as the external environment has deteriorated on the back of the turmoil in Turkey and the escalation of trade tensions. • Despite the recent fall in oil prices, they remain at high levels and are thus supportive for the COP. • The macroeconomic outlook remains solid, with growth picking up, low and stable inflation and narrowing of the current account deficit.
ARS	⇨ (Neutral)	⇨ (Neutral)	• The peso has suffered bearish blues since late April and might lose further ground, should a strong dollar continue reinvigorating. • The real effective exchange rate –REER- was back to the 112 index level by 17 August, close to the highest quotation recorded since early 2014. • The closure of an enlarged currency swap with China will provide the central bank authorities with further ammunition to finance portfolio changes in the months to come.

⇧ Bullish ↗ Mildly Bullish ⇨ Neutral ↘ Mildly Bearish ⇩ Bearish

Source: Santander.

BRL – Ahead of elections, September may be choppy

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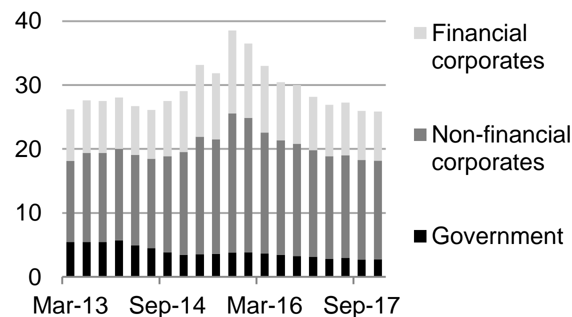
Given Brazil's current relatively strong external position (high level of reserves, low sovereign external debt, narrow current account deficit, abundant FDI flows), BRL's fluctuations in the short term should continue to be dictated mostly by global trends and expectations regarding the upcoming presidential elections, in our view.

Over the past month, BRL resumed weakening, following the USD trend against most of the emerging currencies. The currency traders' behaviour seems, to some extent, to be mirroring fundamentals: Brazil is clearly not perceived as a potential victim of a sudden stop in capital flows (thus BRL is not performing as poorly as TRY, ARS, and ZAR), but BRL continues to oscillate as a high-beta currency, embedding risks associated with the country's poor credit rating and future fiscal consolidation and monetary policy. Therefore, we believe it is unlikely that BRL will decouple should the USD continue in an uptrend, especially before we get more visibility on the possible outcome of the October elections.

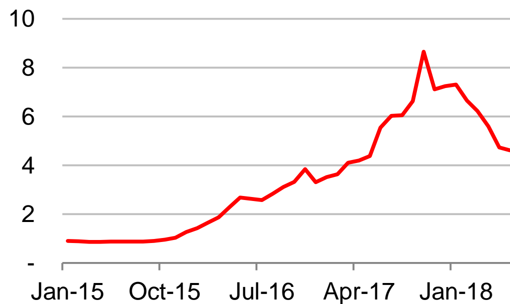
Chart 21: Brazil FX-linked debt (% of GDP)



Source: IIF, Santander

Such visibility is likely to increase throughout September. TV and radio advertisements for the elections start on 31 August, and polls should soon begin to capture the long-expected effects of the media on voting intentions. Our scenario presumes a reformist candidate winning (and keeping up the fiscal consolidation agenda left by the current government), in which case we believe BRL should strengthen towards our 3.50/USD year-end target. However, even assuming that there will be at least one market-friendly candidate in the run-off (which takes place on 27 October), there will be plenty of room for volatility: the field is likely to remain fragmented until close to the voting day, and doubts regarding the implementation of the reforms will probably persist under most of the plausible scenarios.

Chart 22: FDI/Current account deficit ratio (12-month rolling)



Source: Brazil Central Bank, Santander

With that in mind, we cannot rule out the possibility of the BRLUSD exchange rate overshooting (to a new all-time high) over the next couple of months, even if the external environment stabilises. If that happens, BRL will certainly look cheap based on real effective exchange rate metrics (at 3.95/USD, it is already around 15% weaker than the long-term average, according to our calculations), but it will not be, in our view, an obvious long. We think the attractiveness of Brazilian assets in the next few years will largely depend on a feasible plan to put the debt dynamics on a sustainable path, and that may simply not be achievable (without substantially accelerating inflation) under certain sets of economic policies.

We believe a bullish scenario will eventually emerge from the elections, with the next president enjoying the bonanza from a coming cyclical recovery and the good shape of the country's external accounts. In terms of strategy, however, our degree of confidence in that materialising makes waiting seem prudent, even knowing that it will probably imply a worse entry point. A responsible government will probably provide rewards for investors for more than a few months; an irresponsible one may cause long-term damage.

MXN – NAFTA auto deal is a breakthrough, but not enough

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NAFTA is a structural driver for the outlook of the Mexican economy, in our view, so the outcome of the continuing talks will exert strong influence on MXN. The timing of a make-or-break deal is quite sensitive too, given the current market context. Indeed, most risky assets across EM remain highly exposed to an unusually large number of heavyweight external drivers, including recent turmoil in Turkey (an economy similar in size to Mexico but with significantly more credit exposure among local banks); US-China trade tensions; Italy's fiscal sustainability; a potential no-deal outcome on Brexit; and USD's undisputed momentum. Following its roller coaster ride, the peso has managed to outperformed its EM peers with YTD gains of 3.6%, due to the following factors: (i) attractive carry, also evident in the wide spread of local bond yields vs. US Treasuries (520bp in the 2yr tenor); (ii) resilient fundamentals despite NAFTA uncertainty and closely tracking US growth momentum; and (iii) neutral positioning, with net MXN longs hovering around the neutral zero value since early July (using z-score).

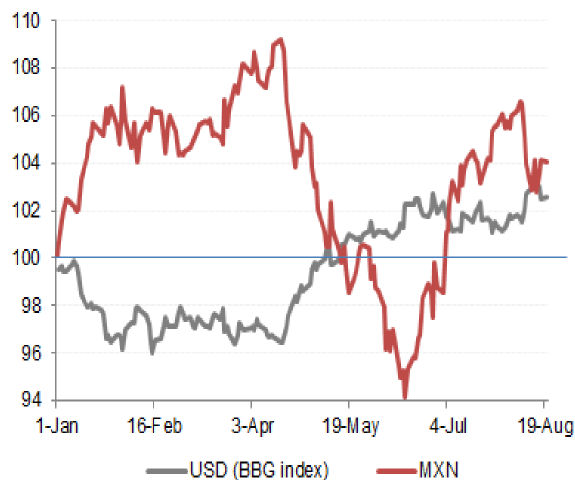
Chart 23: MXN asymmetry is back to the positive side, with EM risk premia and lower likelihood of NAFTA deal priced in

	Before US election	NAFTA bullish	Best YTD	Last
USDMXN spot	18.52	17.47	18.05	19.00
	Oct-2016	Jul-2017	Apr-2018	Aug-2018
Policy rate, real (ex-ante)[1]	1.2	**3.1**	3.5	**3.8**
Yield Curve (2s/10s, TIIE)[2]	72	11	11	10
Mexico-US yield (2yr)[2]	458	531	487	522
Brazil-Mexico spread (2yr)[2]	589	**179**	-28	**86**
MXN net longs (z-score)	-0.87	**1.34**	1.17	**0.04**
MXN volatility (1m)[1]	15.7	10.6	10.8	14.6
CDS 5yr [2]	142	110	105	119
Pemex CDS 5yr [2]	275	214	180	244

Notes: 1 refers to %, 2 refers to basis points

Source: Santander, Bloomberg

Chart 24: MXN has outperformed EM FX peers YTD, despite USD strength



Nominal index, 2 Jan 2018=100. USD is BBG dollar index.
Source: Santander, Bloomberg

Given MXN's ample capacity to reflect extrinsic market developments, the current spot level around 19 reflects heightened EM risk premia, and therefore MXN trades with positive asymmetry if a NAFTA "deal in principle" is reached. As the top table shows, MXN determinants have remained positive or improved to some extent compared to July of last year, right before NAFTA negotiations kicked off. In particular, Banxico's ahead-of-shock policy approach has pushed real policy rates (ex ante) to 3.8%, while bond yield spreads vs. regional peers have compressed, as in the case of Brazil, where election volatility is likely to increase ahead.

A year ago, the US trade representative's goals for NAFTA made clear President Trump's strategy to disincentivise new FDI in Mexico, mainly in the auto sector, in order to reduce the bilateral trade deficit. Following complex negotiations, anecdotal evidence suggests the two countries may have reached an agreement on autos, which is bullish for MXN and a step toward NAFTA modernisation. In our view, a deal on autos could mean Mexico likely agreed to US demands (raising total local content, higher regional content for aluminium and steel, and the provision to produce some percentage of cars in zones paying wages at US levels) – all of the above in exchange for more flexible US demands around the sunset clause and settlement of disputes.

A deal on autos would be in sharp contrast to US officials' push for a border tax of 35% on firms that run factories in Mexico, which sent MXN to historical lows (around 22) in early 2017. However, there is no indication that the US has changed its tough trade position. Here, political pressure from pro-NAFTA firms and members of Congress in the US could tip the balance, since Trump needs to secure congressional votes for NAFTA approval. While the political incentives to get a NAFTA deal may be stronger in Mexico, as it will allow president-elect AMLO to focus on his social agenda, US midterm elections could shift US incentives.

CLP – No breather for copper…or the peso

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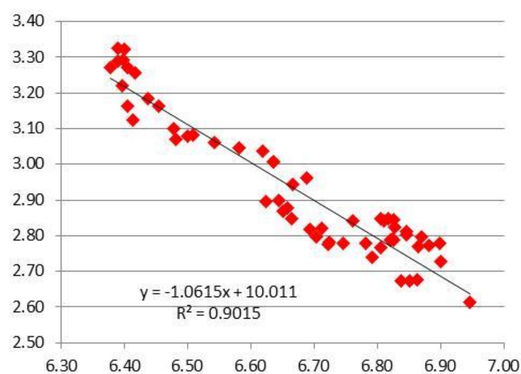
The CLP has had another month of weakness, losing 1.5% vs. the USD in the last four weeks. This was similar to losses seen in DXY currencies or the AUD, but compares positively to a broad EM FX index, and commodity FX peers (down 4-5%, in part due to the slump of the Turkish lira). Copper prices have also suffered since mid-July (-4%), reflecting global trade tensions and EM turmoil, now accumulating an 18% loss in the last two months.

On the local growth front, June's IMACEC was 4.9% y/y, a touch below expectations but nonetheless confirming the good pace of 1H18: 4.3% in 1Q, 5.3% in 2Q. Data on GDP components was also released this week, with investment and real exports expanding strongly above 7% y/y in 2Q18, while private consumption rose by a healthy 4.5% y/y. That said, the outlook for 2H18 is not so positive. On the one hand, there is a negative statistical effect, as year-ago levels will become much more demanding in upcoming quarters. On the other hand, the more adverse external backdrop should affect real exports, mining output and local consumption (as the weaker CLP makes imported durable goods more expensive). We maintain our 4% call on 2018 GDP growth, which means a 3.2% average in 2H18.

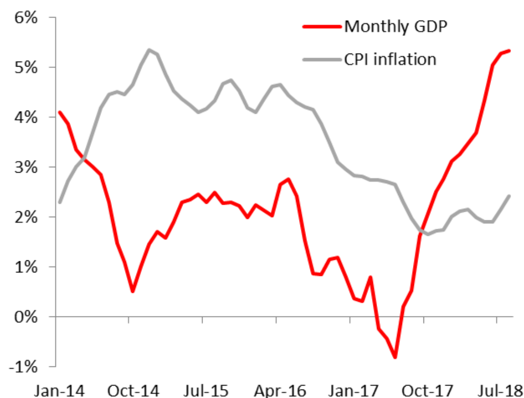
Chart 25: Copper prices vs. offshore yuan



June-August 2018.
Source: Bloomberg, Santander.

Regarding inflation, July's CPI came out at a relatively high 0.4% m/m, +2.7% y/y. The increase in recent months has been steady (from 2% in May), mainly as a result of higher gasoline prices, and the turnaround in the FX trend. Although growth has picked up notably, demand pressures are not so evident: at the same time, large immigration flows are keeping nominal salaries very disciplined. If the FX rate remains at 650 or above, inflation would continue to increase, at least 3% by December 2018 and 3.3% in March.

Chart 26: GDP growth and CPI inflation



Last 3 month average.
Source: BCCh, INE, Santander

In the last BCCh statement, the Board maintained rates at 2.50%, sending an ambiguous message. Although it seems to be in no rush to hike, it has also warned of possibly moving more intensely than expected if upcoming growth readings surprise on the upside. Consequently, we maintain our call of a 25bp rate hike in December, with three more to come next year, up to 3.50%.

Our sense is that today's new, more adverse external environment is consistent with an FX rate of 660-665. Medium-term copper fundamentals justify levels above US$2.80/lb, but if global trade frictions continue to dominate markets, supra-3.00 values will unlikely return. So we pencil in a modest copper price rebound for the upcoming months of ~5%. In turn, EM currencies may continue to weaken vs. the USD, reflecting vulnerabilities in large countries and the strong US economy. On the domestic front, the moment of rate hikes will come closer, and this may give some support to the peso. Rising inflation should add to the case for higher rates, but the expected deceleration in growth would suggest that the upcoming tightening cycle will not be very aggressive. Net/net, we see a short-term fluctuation range of 645-670 for the peso, but extremely conditioned by gyrations in global markets.

COP – Feeling external pressures

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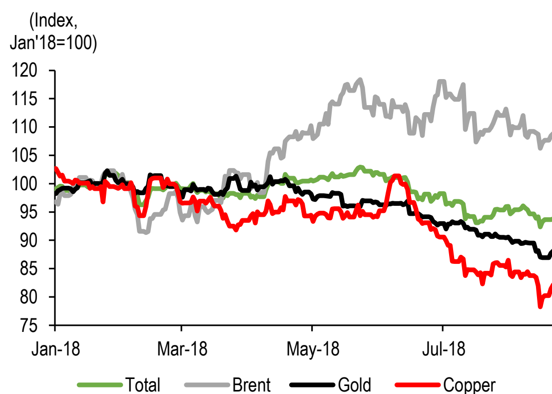
Since our last FX Compass (published on 26 July), the external environment has deteriorated notably, with Turkey's turmoil creating waves in the rest of the emerging markets and the escalation of the trade dispute between the US and China. Colombia has not been immune to this new risk-off episode, with the COP temporarily reaching levels above 3000 USD/COP for the first time this year and depreciating around 6% from bottom to peak.

In contrast to previous risk-off episodes, this time the COP depreciation was intensified by lower oil prices, which until recently, had been somewhat resilient to the escalation in trade war tensions throughout the year, especially if we compare it to other commodities such as cooper. Yet in the past month it seems that oil prices have started to reflect some of the concerns regarding global growth, with the Brent oil price reaching levels close to $70/bbl, the lowest level since April of this year.

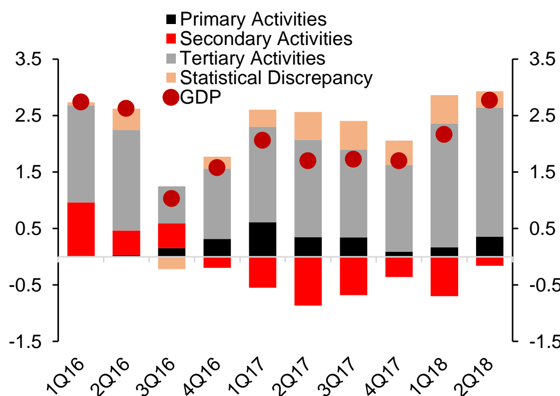
Chart 27: Oil prices reacted to trade tensions with a lag



Source: Santander, Bloomberg.

Year-to-date, the COP continues to be the second-best performer among LatAm and EM currencies, following the MXN (+4.12%), although the COP's spot returns have moved from positive to mildly negative (-0.14%). Moving forward, we expect oil prices to continue to support the COP and serve somewhat as a buffer to the negative external environment, as despite the recent decline in oil prices they remain at high levels. Moreover, the domestic macroeconomic outlook remains positive, with growth picking up, inflation under control and a narrowing current account deficit. We acknowledge, however, that the FX risk is to the upside, given the external pressures coming from trade tensions, Turkey's turmoil and higher US rates.

Chart 28: Growth surprises to the upside in 2Q18 (%)



Source: Santander, DANE.

On the domestic front, growth continues to bring positive news, with 2Q18 GDP surprising to the upside, expanding a solid 2.8% y/y, up from 2.2% y/y growth in 1Q18 and 1.8% y/y in 2017. Seasonally-adjusted figures showed that the economy expanded 0.6% q/q, slowing slightly from the 0.9% q/q expansion in 1Q18. All in all, despite the slowdown seen in the seasonally-adjusted series, the economy is performing better than expected and is likely to expand by 2.7% for the full year, in line with the central bank's official forecast.

In terms of monetary policy, BanRep presented its inflation report for 2Q18, holding the main forecasts for inflation and growth unchanged. On inflation, Governor Echavarria noted that food inflation has provided important relief to the headline and that their end-2018 forecast, at 3.3%, incorporates some upward pressures from food. On growth, they continue to highlight that despite the more dynamic economic growth, they expect the output gap to widen this year. Under this scenario, we expect BanRep to stay on hold until the end 2018 and to hike for the first time in March 2019. However, if food inflation continues to surprise to the downside, we acknowledge that there is a possibility that the MPC will hold for longer.

ARS – Currency swap with China will provide CB with more ammunition to intervene in the FX market

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Chart 29: CB Multilateral real effective exchange rate – REER – Index=100, 17 December 2015

Source: Central Bank and Santander.

Since late April, the ARS has suffered bearish blues and could lose further ground if the already robust USD continues to strengthen. While much attention has shifted to Turkey's woes in the last few weeks, concerns that the ARS and the domestic bond market will continue to be hurt by a strong USD persist. Despite the IMF's enormous US$50bn package, Argentina will remain reliant on capital inflows.

Central bank authorities have announced that negotiations are currently underway with the People's Bank of China to enlarge the currency swap signed by the Kirchner administration in 2014. The aim is for an additional US$4.0bn on top of the US$11bn already disbursed.

Local authorities are also requesting that Beijing officials extend the length on an enlarged package to a more than one-year tenor. If agreed upon, the swap with China would not be deducted from central bank gross reserves, thereby implying that the authorities will have more ammunition to eventually intervene in the FX market.

In a floating FX regime, central bank authorities avoid hard currency interventions to smooth USD quotations in order to face any external shock. Moreover, and according to the IMF's Letter of Intent, the change in the net international reserves floor was set at a US$5.5bn variation from 4 June 2018 to March 2019.

However, for well-defined portfolio changes (as is the case of the dismantling of the Lebac snowball, moving from ARS and USD), Governor Caputo has agreed with the IMF to sell USDs to provide liquidity to the market when investors are cashing out the maturing Lebacs, thus allowing portfolio switches from ARS to USD.

To that end, the central bank sold ~US$1.1bn between August 14 and 16 while USD volatility remained restricted within the ARS29-30 range.

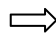
The real effective exchange rate (REER) was back to the 112 index level by 17 August, close to the highest quotation recorded since early 2014. In our view, such a USD quotation is sufficiently high and should remain at around this level in the weeks to come, assuming no further strength in the USD index quote.

Furthermore, the closure of an enlarged currency swap with China will provide the central bank authorities with further ammunition to finance portfolio changes in the last four primary auctions of Lebacs to be implemented from September to December.

Thus, *ceteris paribus* (i.e. no significant volatility in the BRL/USD rate in September, prior to the first round of presidential elections of 7 October), we believe the ARS quotation should remain relatively stable in the weeks to come.

CEE FX: Main Themes

Currency	3M view	12M view	Main Themes
PLN			• There has been little change in the Polish FX market in recent weeks: the zloty gained vs the euro, but this proved temporary. We are leaving our EUR/PLN forecasts unchanged and still expect the exchange rate to fall slightly by the end of the year and rise during the course of 2019E, on the back of slower economic growth.
CZK			• No new factors have appeared to change our EUR/CZK profile and we still expect the koruna to gain modestly in the remainder of the year, as economic growth remains decent and as the CNB hikes rates.
HUF			• We maintain our one-two quarter forecast of temporary forint appreciation thanks to the better market mood and new car industry investment in Hungary. Over a longer-term horizon, we still see a risk of depreciation as a reaction to the expected negative impact of trade tariffs on imports of EU cars to the US.
RUB			• We have raised our USD/RUB forecast and now expect the exchange rate to move up to 69-70 over a four-week perspective, driven by the tension between Russia and the US. In the longer term, we maintain our view that USD/RUB will hold near 67, once the impact of geopolitical tensions is neutralised.

Bullish Mildly Bullish  Neutral Mildly Bearish Bearish

Source: Bank Zachodni WBK.

PLN – On track

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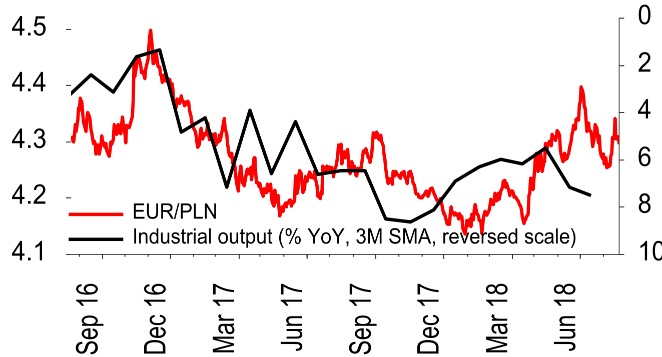
Chart 30: EUR/PLN and Polish industrial output



Source: Thomson Reuters Datastream, Bank Zachodni WBK

There has been little change in the Polish FX market in recent weeks: the zloty gained vs the euro, but this proved temporary. We are leaving our EUR/PLN forecasts unchanged and still expect the exchange rate to fall slightly by the end of the year and rise during the course of 2019E, on the back of slower economic growth.

So far, the pace of economic growth in Poland remains robust. According to the flash estimate, GDP growth in 2Q18 reached 5.1% YoY, only a notch below the first quarter's 5.2%. Seasonally-adjusted growth was 0.9% QoQ vs 1.6% in 1Q18. The breakdown of economic growth in 2Q has not yet been published.

Although 3Q started on a strong footing (according to July monthly output and retail sales data), we think that the pace of growth will decelerate slightly in 2H18E, with a slower expansion of investments and a slightly more negative contribution from net exports. Still, after a much better-than-expected performance in the first half, the average pace of GDP growth this year is likely to be even slightly above last year's 4.6%. Between now and the end of the year we expect the market to be impressed by still solid economic growth, which should be positive for the zloty.

Tension in Turkey has recently dominated much of the market's attention, putting the lira and other EM currencies under pressure. After the USD/TRY reached a new all-time high at above 7.0, Turkish officials have taken some action to stabilise the situation, which has helped to calm the emerging markets. The Turkish economy has shown signs of overheating for some time and the political conflict was a trigger for the recent sharp sell-off of Turkish assets. Attempts by Turkish officials to stabilise the financial markets provide hope that this issue should stop generating negative pressure on the other EM markets, at least in the short term. Still, the political conflict looks far from resolved and any rise in tension between the US and Turkey could again spur worries about contagion from the Turkish crisis.

August is statistically negative month for the zloty but at the time of writing the c0.8% rise of EUR/PLN so far this month is below the average increase in August of 1.4% for the last 13 years. EUR/PLN gained c3.8% in 2Q18, the biggest rise in this quarter since 2010 and, in our view, the zloty depreciation in 2Q was more than enough and we expect the August seasonal pattern to be weaker than in past years.

CZK – More rate hikes likely

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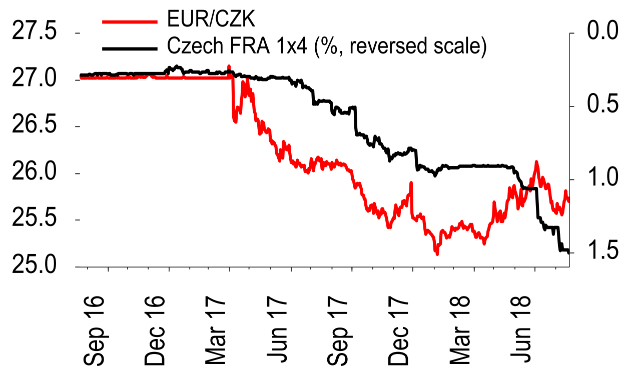
Chart 31: EUR/CZK and Czech FRA 1x4 rate



Source: Thomson Reuters Datastream, Bank Zachodni WBK

The Czech koruna proved to be the most resilient of the CEE currencies we cover to the turmoil triggered by the market's focus on Turkey, with EUR/CZK rising temporarily to 25.8 from 25.55.

Overall, there have been no new factors to make us change our EUR/CZK profile. We still expect the koruna to make modest gains in the rest of the year, as economic growth remains decent and as the Czech central bank (CNB) hikes rates.

In early August, the CNB raised interest rates by 25bp, taking the main refi rate to 1.25%. CNB head, Jiri Rusnok, pointed to strong inflationary pressure and koruna's slower appreciation as the reasons behind the hike. In his view, next hike was likely to be fairly soon. Since this decision, EUR/CZK has risen slightly and inflation has eased to 2.3% YoY in July from 2.6% YoY. Last month we suggested there could be a pause in rate hikes, but recent comments of the Czech central bankers show they might now be more determined to cool economic growth and control inflation. CNB Vice President Jaromir Hampl said he will vote for a hike in September and we think this could be the most likely scenario.

Czech GDP growth decelerated sharply in 2Q18 to 2.3% YoY from 4.2% in 1Q18, but mainly due to the strong base effect.

HUF – After the storm

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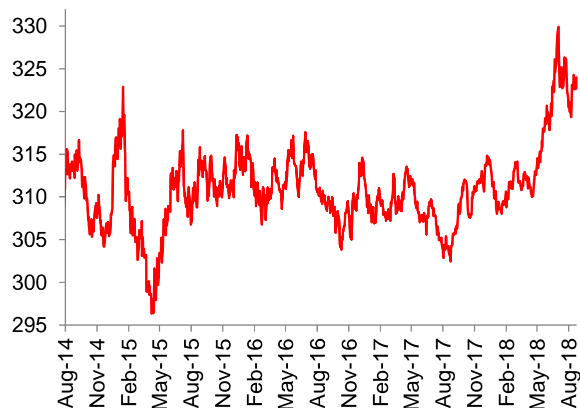
Chart 32: EUR/HUF



Source: Reuters, Bank Zachodni WBK.

In recent weeks the forint has stabilised in the range 321-324 after its recovery in July. This stabilisation was a result of the easing of trade tensions and a generally better mood in emerging markets. The crisis in Turkey had little impact: the forint lost less than 1.0% compared with its c3.0% drop in reaction to the trade war. The forint was supported by a solid domestic economic data, especially by strong wage growth and retail sales. The central bank's decision to leave interest rates at the current level and maintain extremely loose monetary conditions did not affect the EUR/HUF.

In the next few weeks, we expect EUR/HUF to stabilise in the current range (321-325) thanks to the easing of trade tensions and expectations that the imposition of new import taxes on European cars and automotive exports to the US will be more predictable. Moreover, we think that Hungary's pretty solid macro data will support the forint. Data out last month show that the Hungarian economy was relatively resistant to international trade shocks. In June industrial production rose by 3.1% y/y vs 3.8% y/y in May, but GDP expanded 4.6% y/y in 2Q18 (flash reading) compared with 4.4% y/y in 1Q18. This strength was mainly thanks to the fast growth of wages (11.2% y/y in June) and private consumption (retail sales rose 6.1% y/y in June, close to their 6.9% average for 1H18).

We believe that the expected negative impact of the planned US import taxes on European cars will be delayed, while the current improvement in the market's mood and announced car industry investment in Hungary (new BMW plant) should lead to a slight appreciation of the forint in the next two quarters.

RUB – Suffering from geopolitical tension

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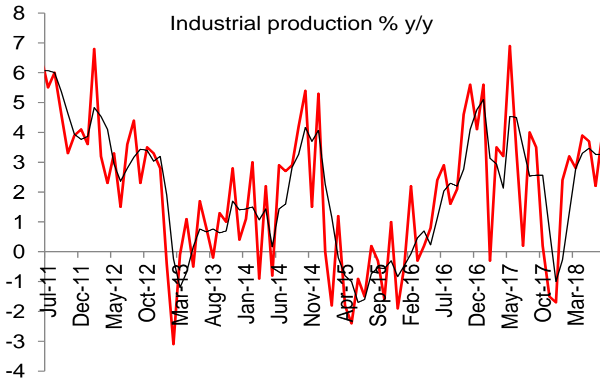
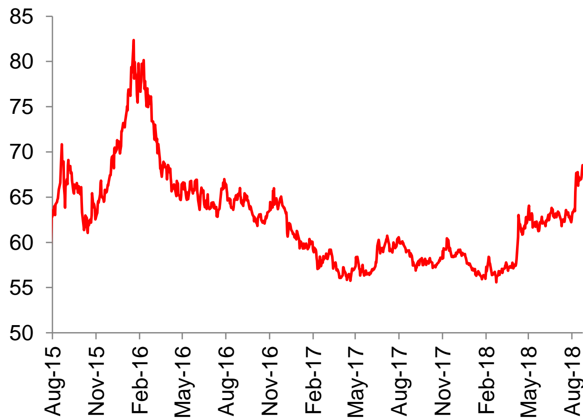
Chart 33: Russia industrial production% y/y and *3M MA*



Source: Reuters, Bank Zachodni WBK.

Chart 34: USD/RUB



Source: Reuters, Bank Zachodni WBK.

We have raised our USD/RUB forecast and now expect the exchange rate to move up to 69-70 over a four-week perspective, driven by the tension between Russia and the US. In the longer term, we maintain our view that USD/RUB will hold near 67, once the impact of geopolitical tensions is neutralised.

Over the last four weeks USD/RUB moved up to c68 from c62. The ruble depreciation was a reaction to tension between US and Russia, related to the US government agency report suggesting that Russian intelligence was involved in the chemical attack against the ex-Russian spy in the UK and proposals of imposing new sanctions on Russia. At the end of August, the ruble was negatively affected by the U.S. senators' proposal to impose new sanctions on Russia as a reaction to the report about Russian meddling in U.S. elections.

In the next four weeks, we see a risk of a further slight increase of USD/RUB to 69-70. We think that the US will try to impose new sanctions against Russia (as a reaction to Nordstream2 project continuation and accusations of election manipulation). However, we believe there is little reason to expect a big ruble depreciation after the August sell-off, which priced-in most of the negative effects of Russia-UK-US tensions.

We believe that over a longer horizon the room for a solid depreciation of the ruble is limited by the prospect of growing trade between Russia and the EU. We think that trade tension between the US, China and the EU will encourage Germany to seek to improve political relations with Russia. In our opinion, this could be interpreted by investors as increasing the chance of an easing of EU sanctions against Russia, which could support the ruble.

On the macro front, we still expect some data releases to negatively affect the ruble. Industrial production data surprised on the negative side (July industrial production rose by 3.9% y/y, vs. 2.2% in June, but slowed in seasonally adjusted terms) and the PMI data release (the July reading was 48.1 pct) was the third in row below 50 pct. Similarly, in July real retail sales rose by 2.5% y/y vs. 3.0% y/y the previous month. In our opinion, the ruble will be supported by inflation, which is still rising (more slowly than expected but systematically), having climbed from 2.3% y/y in June to 2.5% y/y in July and with a possible rise to 4.0% y/y at the end of the year. In our opinion, it means that central bank interest rates will remain at the current level (7.25%) for the next six quarters, which should support the ruble.

G10 FX: IMM Speculative Positioning

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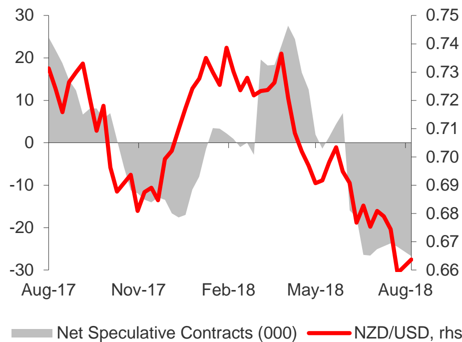
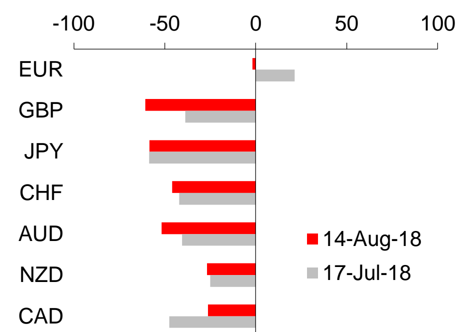
IMM commitment of traders report: NZD/USD position



- **Speculators have never been so short the NZD.** While they have held a large net-short NZD position throughout the summer, in the week ended 14 August 2018, this position rose to 26.69k contracts, an all-time high. NZD/USD has fallen on the back of an upbeat USD and downbeat NZD market view. However, with the speculative position now so net short, there should be less scope, and desire, from speculators to continue to sell the NZD.
- **The speculative market is no longer net long the EUR.** Speculators turned increasingly upbeat on the EUR during 2017, taking the net-long position to a record 151.48k contracts in April 2018. However, the speculative market has progressively unwound this position and is now neutral the single currency.
- **USD positioning continues to have a large impact** on the other developed market currencies. The net-long composite USD position is at its highest since January 2017, with the speculative market remaining net short the GBP, CHF, AUD, CAD and JPY.
- **Brexit concerns have lifted the net-short GBP position,** to 60.7k contracts, the most since May 2017. While now quite large, speculators are understandably cautious on the pound, and the current position is still a long way off its 108k March 2017 low.

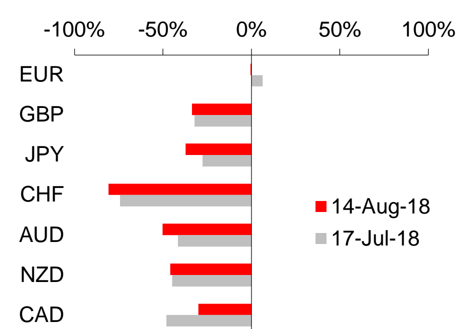
Net Speculative Contracts ('000s)*

	14-Aug-18	17-Jul-18	4w chg	YtD chg
USD***	240.3	202.1	38.2	237.7
EUR	-1.8	21.4	-23.2	-93.9
GBP	-60.7	-38.8	-22.0	-73.4
JPY	-58.4	-58.7	0.3	57.7
CHF	-45.8	-42.1	-3.7	-31.9
AUD	-51.8	-40.5	-11.3	-38.1
NZD	-26.7	-25.1	-1.6	-9.1
CAD	-26.2	-47.5	21.3	-43.5



Net Speculative Contracts as % of Open Interest**

	14-Aug-18	17-Jul-18	4w chg	YtD chg
USD***	20%	18%	1%	20%
EUR	0%	6%	-7%	-29%
GBP	-34%	-32%	-1%	-43%
JPY	-37%	-28%	-10%	20%
CHF	-81%	-74%	-7%	-63%
AUD	-50%	-42%	-9%	-35%
NZD	-46%	-45%	-1%	-13%
CAD	-30%	-48%	18%	-56%



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

G10 FX: IMM Speculative Positioning

EUR/USD

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

USD/CAD

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

USD/JPY

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

GBP/USD

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

AUD/USD

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

USD/CHF

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

EUR/GBP

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

NZD/USD

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

USD minus MXN

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

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

Latin America FX: Positioning indexes (Z-scores)

USD/BRL

Net Foreign (USD bn) — 12wk MA (%) — BRL (rhs)

Z-score USD/BRL

Z-score (Offshore USD/BRL longs) ------ 10-90%

↑ USD longs

USD/MXN

Net Spec (% OI) — 12wk MA (%) — MXN (rhs)

Z-score USD/MXN

Z-score (USD/MXN longs) ------ 10-90%

↑ USD longs

USD/CLP

Foreign NDF (USD bn) — 12wk MA (%) — CLP (rhs)

Z-score USD/CLP

Z-score (Offshore USD/CLP longs) ------ 10-90%

↑ USD longs

USD/PEN

Foreign NDF (USD bn) — 12wk MA (%) — PEN (rhs)

Z-score USD/PEN

Z-score (USD/PEN longs) ------ 10-90%

↑ USD longs

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

Euro Interest Rate Forecasts

Government Bond yield Forecasts

Germany	Current	3Q18	4Q18	1Q19	2Q19
ECB Depo	-0.40	-0.40	-0.40	-0.40	-0.40
3m	-0.59	-0.65	-0.60	-0.55	-0.40
2y	-0.60	-0.45	-0.30	-0.15	0.00
5y	-0.23	0.05	0.25	0.50	0.65
10y	0.34	0.55	0.75	1.00	1.25
30y	1.00	1.10	1.25	1.50	1.70

Swap rate forecasts

Euro	Current	3Q18	4Q18	1Q19	2Q19
ECB Depo	-0.40	-0.40	-0.40	-0.40	-0.40
3m	-0.32	-0.33	-0.33	-0.28	-0.17
2y	-0.15	0.00	0.10	0.20	0.30
5y	0.27	0.50	0.70	0.85	1.00
10y	0.87	1.00	1.15	1.35	1.60
30y	1.47	1.45	1.55	1.75	1.95

US Interest Rate Forecasts

Government Bond yield Forecasts

US	Current	3Q18	4Q18	1Q19	2Q19
FOMC *	2.00	2.25	2.50	2.75	3.00
3m	2.07	2.15	2.40	2.65	2.90
2y	2.60	2.80	3.05	3.25	3.40
5y	2.70	2.95	3.20	3.45	3.60
10y	2.82	3.05	3.25	3.45	3.60
30y	2.98	3.05	3.30	3.45	3.55

Swap rate forecasts

US	Current	3Q18	4Q18	1Q19	2Q19
FOMC *	2.00	2.25	2.50	2.75	3.00
3m	2.31	2.55	2.75	2.95	3.15
2y	2.79	3.05	3.25	3.40	3.50
5y	2.84	3.05	3.25	3.45	3.55
10y	2.89	3.05	3.20	3.40	3.50
30y	2.92	3.05	3.20	3.35	3.40

UK Interest Rate Forecasts

Government Bond yield Forecasts

Yields

UK	Current	3Q18	4Q18	1Q19	2Q19
MPC	0.75	0.75	0.75	0.75	0.75
2y	0.72	0.40	0.50	0.50	0.55
5y	1.01	0.75	0.90	1.00	1.20
10y	1.27	1.20	1.40	1.60	1.80
30y	1.75	1.70	1.80	2.00	2.20

Swap rate forecasts

Swaps

UK	Current	3Q18	4Q18	1Q19	2Q19
MPC	0.75	0.75	0.75	0.75	0.75
2y	1.09	0.70	0.95	0.95	0.95
5y	1.33	1.05	1.25	1.30	1.45
10y	1.53	1.40	1.60	1.70	1.90
30y	1.62	1.50	1.40	1.65	2.00

G10 Central Bank Calendar

	Current Rate	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
FOMC (Upper)	2.00	Unch.	-	+25bp	-	Unch.	+25bp	-	Unch.	26	-	8	19
ECB (Depo)	-0.40	Unch.	-	Unch.	Unch.	-	Unch.	Unch.	-	13	25	-	13
BoE	0.75	-	Unch.	Unch.	-	Unch.	Unch.	-	+25bp	13	-	8	20
BoJ	-0.10	Unch.	-	Unch.	Unch.	-	Unch.	Unch.	-	19	31	-	20
SNB	-0.75	-	-	Unch.	-	-	Unch.	-	-	20	-	-	13
BoC	1.50	+25bp	-	Unch.	Unch.	Unch.	-	+25bp	-	5	24	-	5
RBA	1.50	-	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	4	2	6	4
RBNZ	1.75	-	Unch.	Unch.	-	Unch.	Unch.	-	Unch.	26	-	7	-
Norges Bank	0.50	Unch.	-	Unch.	-	Unch.	Unch.	-	Unch.	20	25	-	13
Riksbank	-0.50	-	Unch.	-	Unch.	-	-	Unch.	-	6	24	-	19

Source: Bloomberg, Santander. Note: Current levels as at 23 August 2018. For meetings that have already taken place, decision identified as +/- in bp, or "unch" for no change. "-" denotes no meeting taking place that month *FOMC rate refers to upper bound rate. **The ECB QE programme is set to drop to EUR15/month for Q4-18 and then stop. *Note: Our UK rates forecasts (2y to 30y) are correct as at 27 July I&E publication

Brazil/Mexico Interest Rate forecasts

Government Bond yield

Brazil	Current	3Q18	4Q18	1Q19	2Q19
SELIC	6.50	6.50	6.50	6.50	6.50
NTNF Jan' 19s	6.77	6.55	6.50	–	–
NTNF Jan.' 25s	11.68	11.50	10.50	10.00	9.50

Government Bond yield

Mexico	Current	3Q18	4Q18	1Q19	2Q19
Banxico fondeo	7.75	8.00	8.00	8.00	7.50
Mbono Jun. '21s	7.76	8.10	8.00	7.70	7.30
MBono Jun. '27s	7.72	8.20	8.10	7.80	7.50

Chile/Colombia Interest Rate Forecasts

Government Bond yield

Chile	Current	3Q18	4Q18	1Q19	2Q19
BCCh TPM	2.50	2.50	2.75	3.00	3.25
BCP 5Y	3.98	4.10	4.15	4.25	4.35
BCP 10Y	4.43	4.75	4.80	4.85	4.95

Government Bond yield

Colombia	Current	3Q18	4Q18	1Q19	2Q19
Banrep O/N	4.25	4.25	4.25	4.50	5.00
TES Jul '24s	6.11	6.60	6.70	6.80	6.90
TES Apr '28s	6.81	7.20	7.30	7.40	7.60

LatAm Central Bank Calendar

	Current Rate	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Brazil	6.50	-	-25bp	-25bp	-	Unch.	Unch.	-	Unch.	19	31	-	12
Mexico	7.75	-	+25bp	-	Unch.	Unch.	+25bp	-	Unch.	-	4	15	20
Chile	2.50	-	Unch.	Unch.	-	Unch.	Unch.	Unch.	-	4	18	-	4
Colombia	4.25	-25bp	-	Unch.	-25bp	-	Unch.	Unch.	-	28	26	-	21
Argentina	40.00	-150bp	Unch.	Unch.	+300bp	+975bp	Unch.	Unch.	+50bp	11	9	13	11

CEE Interest Rate Forecasts

Poland

Poland	Current	3Q18	4Q18	1Q19	2Q19
Reference Rate	1.50	1.50	1.50	1.50	1.50
2y	1.60	1.60	1.60	1.60	1.60
10y	3.16	3.20	3.25	3.30	3.25

Hungary/Czech Republic/Russia Base Rates

CEE	Current	3Q18	4Q18	1Q19	2Q19
Hungary	0.90	0.90	0.90	0.90	0.90
Czech Republic	1.25	1.50	1.75	1.75	1.75
Russia	7.25	7.25	7.25	7.25	7.25

CEE Central Bank Calendar

	Current Rate	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Poland	1.50	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	-	5	3	7	5
Czech Republic	1.25	-	+25bp	Unch.	-	Unch.	+25bp	-	+25bp	26	-	1	20
Hungary	0.90	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	18	16	20	18
Russia	7.25	-	-25bp	Unch.	Unch.	-	Unch.	Unch.	-	14	26	-	14

Source: Santander, BZWBK. Note: Current levels as at 23 August 2018. For meetings that have already taken place, decision identified as +/- in bp, or "unch" for no change. "-" denotes no meeting taking place that month.

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

	3M	6M	9M
EUR/USD	**1.20**	**1.22**	**1.24**
vs.forward	4.1	5.9	7.0
vs.consensus forecast	2.8	2.8	2.2
GBP/USD	**1.32**	**1.32**	**1.33**
vs.forward	2.6	2.6	3.1
vs.consensus forecast	0.8	0.0	-1.7
EUR/GBP	**0.91**	**0.93**	**0.93**
vs.forward	1.5	3.2	3.8
vs.consensus forecast	2.4	4.1	4.7
USD/JPY	**117**	**119**	**120**
vs.forward	5.2	7.6	8.2
vs.consensus forecast	5.6	8.5	10.1
EUR/JPY	**140**	**146**	**148**
vs.forward	9.6	13.9	15.8
vs.consensus forecast	8.8	12.3	13.3
EUR/CHF	**1.18**	**1.21**	**1.23**
vs.forward	4.1	6.7	7.9
vs.consensus forecast	1.1	2.8	4.0
USD/CHF	**0.98**	**0.99**	**0.99**
vs.forward	-0.1	0.8	0.8
vs.consensus forecast	-1.7	0.2	1.2
EUR/SEK	**10.0**	**9.8**	**9.6**
vs.forward	-4.8	-7.1	-9.0
vs.consensus forecast	-2.0	-2.6	-3.3
EUR/NOK	**9.3**	**9.2**	**9.0**
vs.forward	-3.4	-5.1	-6.5
vs.consensus forecast	0.4	-0.4	-1.1
USD/CAD	**1.23**	**1.22**	**1.21**
vs.forward	-5.9	-6.4	-7.5
vs.consensus forecast	-4.9	-4.7	-4.2
AUD/USD	**0.77**	**0.78**	**0.80**
vs.forward	5.1	7.4	9.2
vs.consensus forecast	3.6	4.4	4.8
NZD/USD	**0.69**	**0.70**	**0.72**
vs.forward	2.9	5.4	7.4
vs.consensus forecast	2.5	5.0	5.4

	3M	6M	9M
USD/BRL	**3.60**	**3.51**	**3.54**
vs.forward	-11.0	-13.1	-12.5
vs.consensus forecast	-4.8	-3.7	-1.7
EUR/BRL	**4.33**	**4.30**	**4.38**
vs.forward	-7.6	-8.3	-6.6
vs.consensus forecast	-2.0	-1.0	0.5
USD/MXN	**19.0**	**18.70**	**18.53**
vs.forward	1.2	-0.5	-1.4
vs.consensus forecast	0.2	-0.3	-1.6
EUR/MXN	**22.9**	**22.9**	**22.9**
vs.forward	5.4	5.3	5.5
vs.consensus forecast	3.0	2.5	0.6
USD/CLP	**646**	**647**	**657**
vs.forward	-2.5	-2.4	-0.9
vs.consensus forecast	0.2	-0.1	1.4
EUR/CLP	**777**	**791**	**812**
vs.forward	1.1	2.9	5.6
vs.consensus forecast	3.0	2.7	3.7
USD/COP	**2807**	**2787**	**2760**
vs.forward	-5.2	-5.9	-6.8
vs.consensus forecast	-4.9	-5.0	-5.2
USD/ARS	**31.3**	**32.9**	**34.4**
vs.forward	3.5	8.9	13.8
vs.consensus forecast	5.5	9.8	12.7
EUR/PLN	**4.26**	**4.27**	**4.29**
vs.forward	-0.6	-0.3	0.0
vs.consensus forecast	-0.9	0.5	-0.1
EUR/CZK	**25.6**	**25.5**	**25.5**
vs.forward	-0.4	-0.8	-0.9
vs.consensus forecast	0.3	0.9	1.6
EUR/HUF	**325**	**322**	**323**
vs.forward	0.2	-0.8	-0.3
vs.consensus forecast	1.6	0.7	1.4
EUR/RUB	**84**	**85**	**84**
vs.forward	5.6	6.8	5.4
vs.consensus forecast	15.8	15.0	12.7

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	1.157	1.288	110.83	128.22	142.80	0.984	1.138	1.268
1M	1.159	1.290	110.61	128.21	142.64	0.982	1.138	1.266
2M	1.162	1.292	110.34	128.22	142.50	0.979	1.138	1.264
3M	1.165	1.293	110.12	128.26	142.39	0.976	1.137	1.263
6M	1.174	1.299	109.27	128.28	141.95	0.968	1.136	1.257
9M	1.183	1.305	108.47	128.33	141.52	0.959	1.135	1.252
12M	1.193	1.311	107.62	128.35	141.06	0.950	1.134	1.246

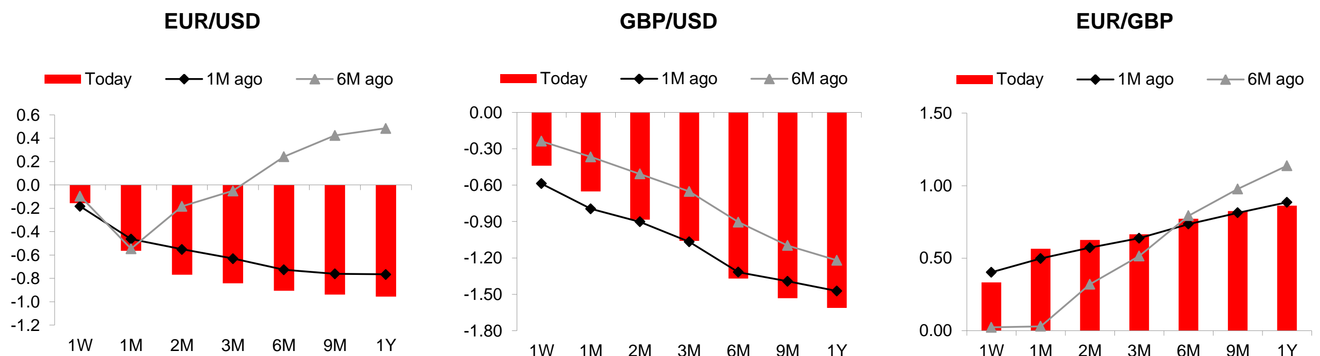
ATMf vol.

	EUR/USD	GBP/USD	USD/JPY	EUR/JPY	GBP/JPY	USD/CHF	EUR/CHF	GBP/CHF
1W	8.1%	7.7%	6.5%	8.2%	8.5%	6.5%	5.3%	6.4%
1M	7.5%	7.7%	6.7%	8.5%	9.1%	6.2%	5.3%	6.7%
2M	7.7%	8.3%	7.2%	8.7%	9.6%	6.5%	5.4%	7.3%
3M	7.7%	8.6%	7.5%	8.9%	9.9%	6.6%	5.5%	7.5%
6M	7.7%	8.9%	7.8%	9.1%	10.4%	6.8%	5.7%	8.0%
9M	7.7%	9.2%	8.1%	9.4%	10.8%	7.0%	5.9%	8.4%
12M	7.7%	9.3%	8.3%	9.6%	11.0%	7.2%	6.0%	8.6%

Implied/realized vol. ratio

	EUR/USD	GBP/USD	USD/JPY	EUR/JPY	GBP/JPY	USD/CHF	EUR/CHF	GBP/CHF
1W	1.15	1.33	1.19	1.04	1.17	1.28	1.01	1.19
1M	1.12	1.20	1.13	1.00	1.11	1.25	1.04	1.16
2M	1.12	1.19	1.19	1.11	1.19	1.18	1.12	1.24
3M	1.04	1.18	1.19	1.00	1.13	1.10	0.96	1.13
6M	1.09	1.23	1.19	1.10	1.18	1.11	1.10	1.19
9M	1.08	1.18	1.15	1.15	1.17	1.04	1.10	1.15
12M	1.10	1.19	1.15	1.21	1.19	1.04	1.09	1.13

25-delta risk reversals



Sources: Bloomberg and Santander. As of 23 August 2018

Latin America FX: Spot and forward rates

	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
Spot	30.24	4.04	663	2961	18.8	3.28
1M	31.12	4.05	662	2965	18.9	3.29
2M	32.12	4.07	663	2969	19.0	3.29
3M	33.00	4.07	662	2974	19.1	3.30
6M	35.72	4.11	662	2988	19.3	3.31
9M	38.10	4.14	662	3001	19.6	3.32
12M	40.40	4.19	663	3018	19.9	3.33

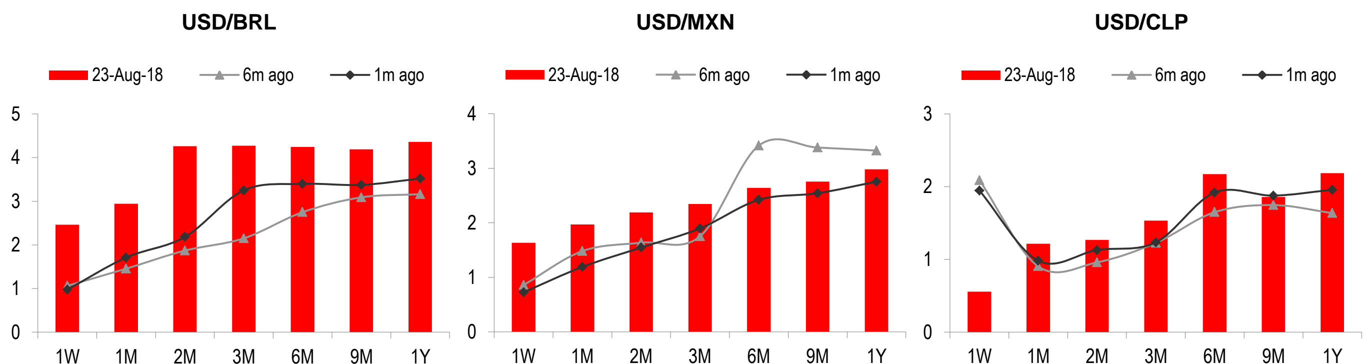
ATMf vol.

	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
1W	9.25	21.38	11.13	13.12	14.17	3.81
1M	10.00	21.35	10.90	13.22	13.71	3.67
2M	11.25	22.83	10.96	13.52	13.85	4.02
3M	12.15	22.36	10.98	13.48	13.94	4.30
6M	14.05	19.49	10.76	13.40	13.87	4.87
9M	15.23	18.47	10.68	13.51	13.93	5.32
12M	16.00	17.84	10.37	13.53	13.94	5.62

Implied/realized vol. ratio

	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
1W	0.82	1.52	0.89	1.76	0.89	0.79
1M	0.41	1.57	0.97	1.41	0.95	0.89
2M	0.56	1.68	0.99	1.47	0.93	1.14
3M	0.57	1.38	1.08	1.36	0.97	1.22
6M	0.62	1.39	1.15	1.22	1.06	1.28
9M	0.78	1.40	1.15	1.25	1.10	1.31
12M	0.92	1.44	1.16	1.35	1.15	1.50

25-delta risk reversals



Sources: Bloomberg and Santander. As of 23 August 2018

IMPORTANT DISCLOSURES

ANALYST CERTIFICATION:

The views expressed in this report accurately reflect the personal views of the undersigned analyst(s). In addition, the undersigned analyst(s) has not and will not receive any compensation for providing a specific recommendation or view in this report: Stuart Bennett, Michael Flisher, Juan Pablo Cabrera, Tatiana Pinheiro, Diana Ayala, Juan Arranz, David Franco, Marcin Sulewski, Konrad Soszynski

The analysts referenced in connection with the section for which he or she is responsible may have received or will receive compensation based upon, among other factors, the overall profitability of the Santander group, including profits derived from investment banking activities.

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.

We generally review our FX recommendations monthly, in our regular FX Compass publication, and when market events/moves so warrant.

Comprehensive disclosures for all G-10 Rates, Macro & FX Strategy/research produced by Banco Santander, S.A. can be found on our website.

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