21 February 2019, 14:30 GMT

FX COMPASS

G10		
Main Themes		**4**
FX Overview		**5**
USD	**Why am I here?**	**6**
EUR	**Pressures remain**	**7**
GBP	**An uncertain fog**	**8**
JPY	**Finally sliding?**	**9**
CNY	**Support where it is needed**	**10**
CHF	**Heading in the wrong direction**	**11**
CAD	**Still room to hike**	**12**
AUD	**Holding the channel**	**13**
NZD	**Carry trade deterioration to limit NZD**	**14**
SEK	**A bad start to the year**	**15**
NOK	**Getting ready for a rate hike**	**16**
LatAm		
Main Themes		**17**
BRL	**Entering the political noise period**	**18**
MXN	**2H risks could mean peso closing 2019 at 20.5**	**19**
CLP	**Still too early to expect a sustained rally**	**20**
COP	**Range-bound**	**21**
ARS	**A shorter than expected monetary easing precludes a downward FX path**	**22**
PEN	**Contained appreciation**	**23**
CEE		
Main Themes		**24**
PLN	**Near crucial level**	**25**
CZK	**Boosted by data**	**26**
HUF	**Rating upgrade**	**26**
RUB	**VAT-flation**	**27**

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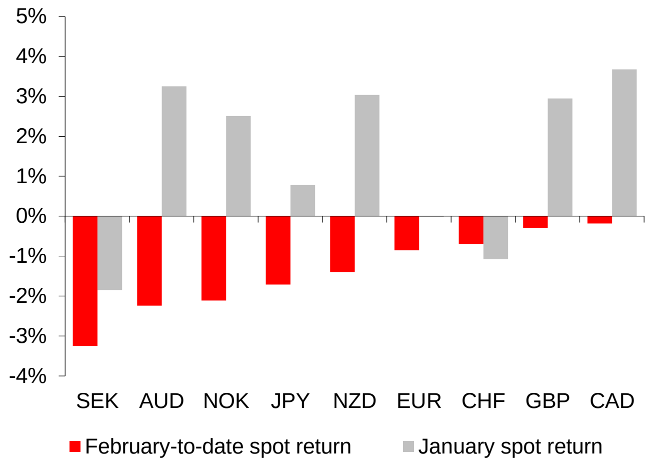
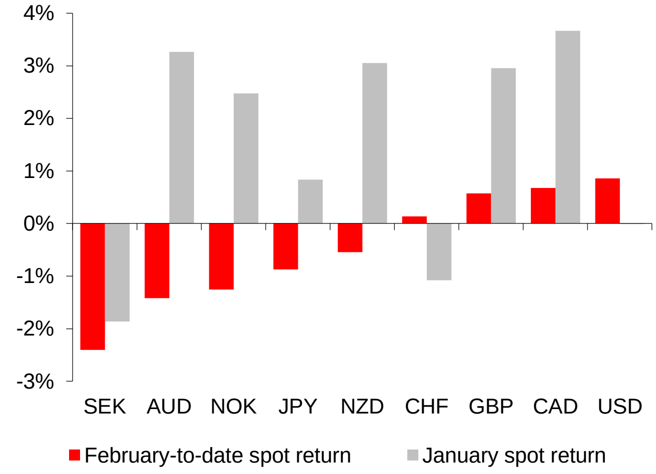
FX Spot Returns

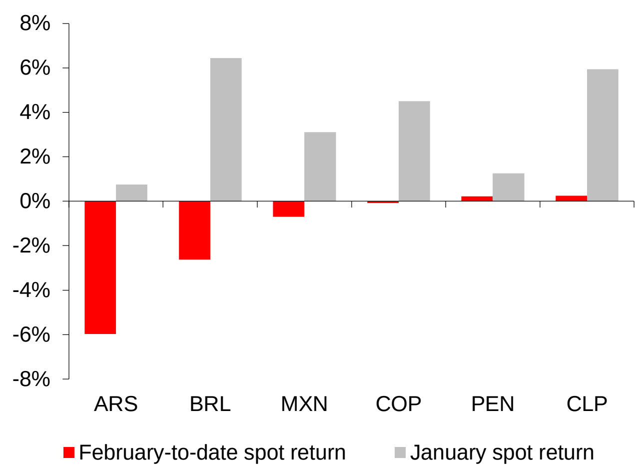
G10 spot returns vs. USD



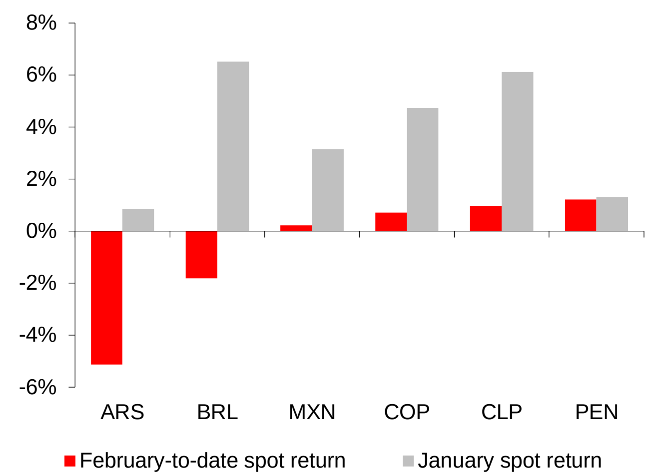
G10 spot returns vs. EUR



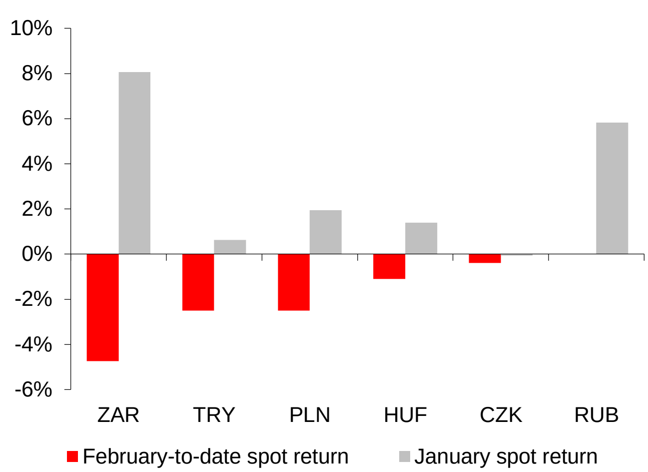
LatAm spot returns vs. USD



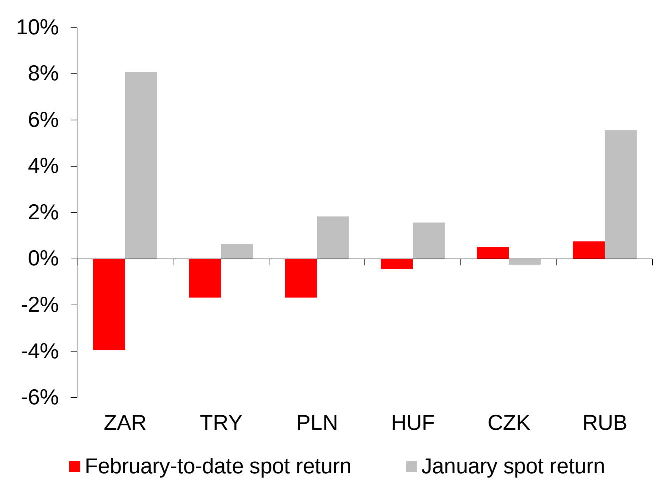
LatAm spot returns vs. EUR



CEEMA vs. USD



CEEMA vs. EUR



Source: Bloomberg, Santander. Note: Data current as at 21 February 2019 at 13:00 GMT

FX Forecasts

G10 FX Forecasts

	Q1-19	Q2-19	Q3-19	Q4-19	Q1-20	Q2-20
EUR-USD	1.17	1.19	1.20	1.21	1.23	1.25
GBP-USD	1.32	1.33	1.35	1.36	1.37	1.37
GBP-EUR	1.13	1.12	1.13	1.12	1.11	1.10
EUR-GBP	0.89	0.89	0.89	0.89	0.90	0.91
USD-JPY	114	118	119	119	116	115
EUR-JPY	133	140	143	144	143	144
USD-CNY	6.80	6.70	6.70	6.70	6.65	6.50
EUR-CHF	1.16	1.18	1.20	1.20	1.21	1.23
USD-CHF	0.99	0.99	1.00	0.99	0.98	0.98
EUR-SEK	10.2	10.0	9.8	9.6	9.5	9.5
EUR-NOK	9.7	9.6	9.6	9.5	9.4	9.3
USD-CAD	1.28	1.25	1.24	1.20	1.20	1.20
AUD-USD	0.73	0.74	0.75	0.76	0.77	0.78
NZD-USD	0.68	0.68	0.69	0.70	0.71	0.72

LatAm FX Forecasts

	Q1-19	Q2-19	Q3-19	Q4-19	Q1-20	Q2-20
USD-BRL	3.70	3.75	3.90	4.00	4.10	4.20
USD-MXN	19.3	19.6	20.3	20.5	20.5	20.7
USD-CLP	670	665	675	660	655	650
USD-COP	3165	3200	3250	3300	3250	3300
USD-ARS	39	42	44	47	48	50
USD-PEN	3.34	3.35	3.36	3.37	3.37	3.40
EUR-BRL	4.33	4.46	4.68	4.84	5.04	5.25
EUR-MXN	22.6	23.3	24.4	24.8	25.2	25.9
EUR-CLP	784	791	810	799	806	813
EUR-COP	3703	3808	3900	3993	3998	4125
EUR-ARS	46	50	53	57	60	62
EUR-PEN	3.9	4.0	4.0	4.1	4.1	4.3

CEE FX Forecasts

	Q1-19	Q2-19	Q3-19	Q4-19	Q1-20	Q2-20
EUR-PLN	4.34	4.33	4.35	4.30	4.30	4.30
EUR-CZK	25.9	26.2	26.3	26.4	26.2	25.2
EUR-HUF	320	325	325	325	325	322
USD-RUB	66	67	67	67	67	67
EUR-RUB	77	80	80	81	82	84

Sources: Santander

G10 FX: Main Themes

Currency	3M view	12M view	Main Themes
USD	⇨	↘	• The USD was strong in 2018, and this may spill over in to Q1-19, but is unlikely to last throughout the year. The Fed's hiking cycle may be coming to an end as the economy faces 'headwinds' in 2019.
EUR	⇨	↗	• Low risk appetite has weighed on the EUR. Slower economic growth has also not helped the currency. But we still expect the ECB to hike rates this year, which should provide support.
GBP	⇨	⇨	• Sterling remains vulnerable, given subdued growth, 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 the uncertainties fade, the market will be faced with a yen-negative scenario of a BoJ likely to keep policy very loose for a long time.
CNY	⇨	⇨	• US-China trade tensions and slower Chinese growth remain a risk, as might a loosening of fiscal and monetary policy, but scope for big losses may have diminished as policymakers appear keen to prevent further CNY weakness.
CHF	↘	↘	• The CHF should gradually weaken. The SNB still views the CHF as 'highly valued' and, despite robust economic data, should maintain a very loose policy into 2019 and remain willing to intervene.
CAD	↗	↗	• We still expect the CAD to appreciate as the BoC should continue to hike rates, albeit more slowly, and a more stable oil price should also help CAD sentiment.
AUD	⇨	↗	• Global risk sentiment, with a focus on the US and China, is likely to guide the AUD. Australian monetary policy looks set to continue taking a back seat, with the RBA unlikely to hike rates before 2020.
NZD	⇨	⇨	• A softer housing market and below-target inflation are likely to keep the RBNZ cash rate on hold throughout 2019. A deteriorating carry trade is likely to limit NZD/USD, with gains looking to be reliant on a weaker USD.
SEK	⇨	↗	• Domestic data have weighed heavily on the SEK in early 2019. The Riksbank continues to advocate a rate hike in H2-19, which should be SEK supportive, but this would depend on firm CPIF data.
NOK	↗	↗	• A March rate hike, with the prospect of another in H2-19, should offer the NOK scope for near-term gains. However, the oil price is set to remain the main NOK driver in the coming months.

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

Source: Santander

G10 FX Overview

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The US dollar has remained firm, with a dovish Fed not enough to undermine USD sentiment. US economic data has stayed robust, supporting the currency, helped by weak data in other countries. However, we believe that the risk backdrop is less dollar positive and we still expect that the outlook for US interest rates should have more of an adverse effect on the currency.

The euro has remained vulnerable over the last month. The 'patient' Fed and the expectation of fewer additional US rate hikes, given that we still expect the ECB to tighten its policy later in the year, still justify an upward profile for EUR/USD. However, the ECB's recent pessimistic rhetoric and downward revisions to the Eurozone growth outlook have encouraged the market to maintain a bearish bias, for now.

The pound is likely to remain vulnerable to political uncertainty surrounding Brexit. The 'next step' in the Brexit process should become clearer over the coming weeks, providing sterling with a directional pull, although in which direction is still unclear. However, a dovish stance from the BoE indicates that slower UK economic growth looks set to keep UK rates on hold and the UK pound under pressure.

We retain a negative view on the yen. The BoJ's monetary policy should remain very loose throughout 2019. Further, the decline in risk appetite effect which supported the yen in 2018, appears to be having less of an impact in Q1-19. We also continue to believe that the CHF will weaken in the months ahead as the SNB maintains very loose monetary policy as inflation is forecast to remain low and there are risks that slower Eurozone/global growth has an adverse impact on Swiss activity.

The renminbi has some scope to strengthen against the USD during 2019, in our view. However, the move is likely to be driven more by USD weakness, helped by a patient Fed, tugging USD/CNY lower. The pair's decline should be gradual though, as ongoing US-China trade tensions and concerns over Chinese growth temper CNY strength.

The CAD has performed strongly in 2019, even as a reinvigorated US dollar has kept USD/CAD above 1.30. A pick-up in the oil price has supported the Loonie, even as the near-term economic outlook has been downgraded. The Bank of Canada is unlikely to hike rates in H1-19, but we still expect CAD-friendly interest rate increases in H2-19.

We remain positive on the AUD in 2019, but weaker domestic data and a more dovish central bank could limit the currency in the near term. We still forecast the pair at 0.73 in Q1-19, but any break above this level will likely be dependent on more upbeat international risk sentiment, and a weaker USD. Significant NZD/USD are also likely dependant on a weaker USD, as the RBNZ still does not foresee a rate hike until 2021. With the NZD carry trade in decline, there is little reason domestically for the NZD to strengthen. Both the AUD and NZD will be particularly alert to the US-China trade discussions.

We are positive on the SEK over 2019 as a whole, but are cautious on the currency in the short term, with the Eurozone economy coming under pressure and Swedish data disappointing in early 2019. The Riksbank still advocates hiking rates in H2-19, but such a hike is largely dependent on where inflation sits in a few months' time.

We remain upbeat on the NOK in 2019. We expect the Norges Bank to hike rates in March, and then again in H2-19. With many other developed market central banks stepping back from tightening policy, this should help the NOK to strengthen this year.

USD – Why am I here?

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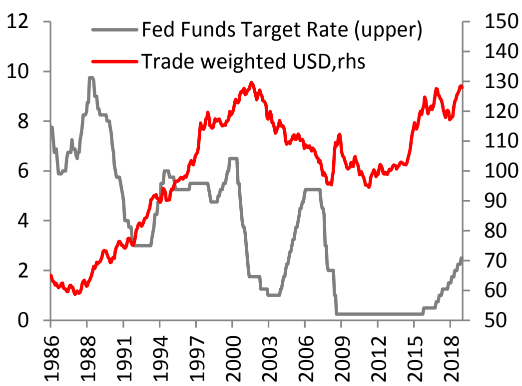
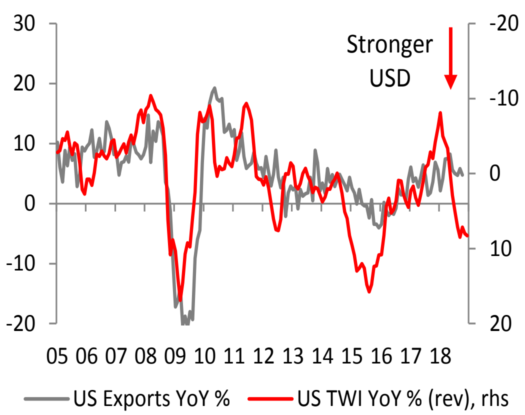
Chart 1: A patient Fed should imply a softer USD…



Source: Bloomberg, Santander

Chart 2: …and protectionist rhetoric shouldn't equal a strong USD



Source: Bloomberg, Santander

The US dollar has remained firm. A dovish Fed has not been enough to undermine USD sentiment. US economic data has stayed robust, supporting the currency, helped by weak data in other countries. However, we believe that the risk backdrop is less dollar positive and we still expect that the outlook for US interest rates should have more of an adverse effect on the currency.

The US dollar has had a good February. The currency has gained against all of its peers. The USD index has moved back toward its 2018 high. Hence, the market's love affair with the USD seems to have resumed, after January's flirtation with a weaker dollar when the Fed adopted a more cautious approach to US rate hikes.

This creates a dilemma for analysts like us, who believe that the USD has been overbought. The dollar's resilience over the past few weeks raises the question of what is required to weaken it? Recall that in 2018 the USD was driven higher by three main factors 1) US interest rate hikes, 2) US economic outperformance, and 3) low global risk appetite. These factors remain present, but are less dominant, and yet the currency remains close to last year's highs.

The Fed's patient approach to future US rate hikes, should, in our opinion, have had a more negative effect on the USD than it has. On the one hand it might imply no more US rate hikes, which, even with US rates remaining above its peers, would rob the market of a reason to bid the USD even higher. Or, it might merely mean a bigger delay to the next US rate hike, still USD positive, but this would give an opportunity for other central banks to 'catch-up' with the Fed. In particular, we feel that the BoC and ECB should hike rates this year, boosting the CAD and EUR, whilst GBP, CHF and JPY should remain under pressure against the USD as their central banks are expected to keep policy unchanged.

However, the US's economic performance remains a USD positive. US economic data has tended to surprise to the upside in February, explaining some of the USD performance. However, USD/G10 pairs have been helped by deteriorating economic data in other markets. In particular, the EU Commission's downward revision for Eurozone growth in 2019 to 1.3% from 1.9%, weighed on EUR/USD. That said, we still expect US growth to slow in 2019 and again in 2020, again undermining one of the catalysts for the USD's 2018 gains.

Finally, low risk appetite in 2018, whether due to geo-political tension, US trade tensions with Mexico, Canada, EU or China, fuelled demand for the USD as a perceived safe haven against these uncertainties. We still believe that pulling the USD higher as a response to US protectionist rhetoric appeared counter intuitive. A stronger currency should be the last thing that a US administration concerned about the US trade deficit would sanction. However, both the USD and JPY gained as the market positioned away from the EU and emerging market assets.

US-China trade talks continue, and may come to a head in the weeks ahead. If the outcome is deemed positive, reducing risks to global growth, risk appetite should improve and the USD should weaken. Plus, the correlation between EM equities (a proxy for risk) and the USD index is -0.92 since the start of 2018, but despite the pick-up in EM equities in 2019, the USD has diverged, suggesting either equities are too strong, or the USD is.

EUR – Pressures remain

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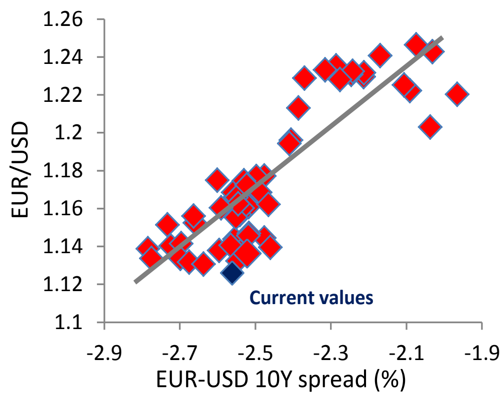
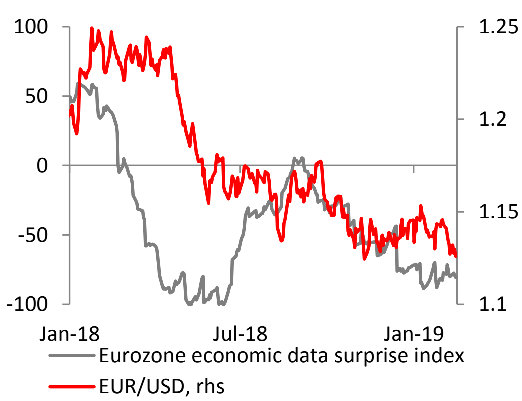
Chart 3: EUR/USD still looks a little cheap given EU-US spreads since the start of 2018



Source: Bloomberg, Santander . As at 15 February 2019

Chart 4: A softer Eurozone economic outlook has kept the EUR under pressure



Source: Citi, Bloomberg, Santander

The euro has remained vulnerable over the last month. The 'patient' Fed and the expectation of fewer additional US rate hikes, given that we still expect the ECB to tighten its policy later in the year, still justify an upward profile for EUR/USD. However, the ECB's recent pessimistic rhetoric and downward revisions to the Eurozone growth outlook have encouraged the market to maintain a bearish bias, for now.

The trade-off between the Fed and ECB's monetary policy, and its impact on relative yields and the EUR, has not, at least yet, panned out as we expected. The FOMC's adoption of a 'patient'/dovish stance with regard to the need for further US rate hikes should have been a bigger positive for the euro. However, the negative effect this implies for the USD has been more than outweighed by another dose of ECB pessimism, warning about economic risks to the Eurozone outlook.

In mid-January, President Draghi warned that the Eurozone was facing a slowdown, which could be longer than expected, but that the region is not forecast to fall into recession. Eurozone economic data has tended to surprise to the downside since September 2018, probably reflected in EUR/USD weakness over the same period. Consequently, we might be able to get away with arguing that a softer economy is already in the price.

However, the EU Commission's recent notable downward revisions to its Eurozone GDP forecast have kept euro sentiment under pressure. The Commission cut its 2019 GDP forecast to 1.3%, from 1.9%, with the 2020 estimate reduced to 1.6% from 1.7%.

Despite the revisions we still expect the ECB to hike rates in H2-19, even if that only implies a less negative deposit rate. Consequently, we still expect a cross-over in Fed-ECB policy, with the former ending its tightening cycle as the latter begins. This outlook for policy continues to favour a gradual uptrend for our EUR/USD forecast.

Moreover, looking at the current EUR-USD 10Y spread, it still seems to us that the pair is on the cheap side. The correlation between EUR/USD and the spread since the start of 2018, has been 0.87, with that relationship suggesting that a fairer value for EUR/USD currently would be closer to 1.1700.

The 'cheap' euro might also be explained by low global risk appetite. Concerns over global growth and US-China trade tensions have tended to fuel demand for the USD as a perceived safe haven, which has then pulled EUR/USD lower. Whilst global risks are unlikely to disappear, the US-China trade talks may reach some sort of conclusion during March. If that outcome is deemed market friendly, these USD safety-seeking flows could unwind quickly, allowing EUR/USD to edge toward the 1.1700 level.

Admittedly, European specific political risks remain, ahead of EU elections in May and Brexit. In terms of Brexit, we reiterate that a no-deal Brexit on 29 March would likely weigh on EUR/USD, but we would still envisage the EUR outperforming sterling. Given current levels, we estimate a 'no-deal' could pull EUR/USD as low as 1.1100 in the short-term, but EUR/GBP could rebound back to 0.91, forcing sterling to take a hit against the dollar.

GBP – An uncertain fog

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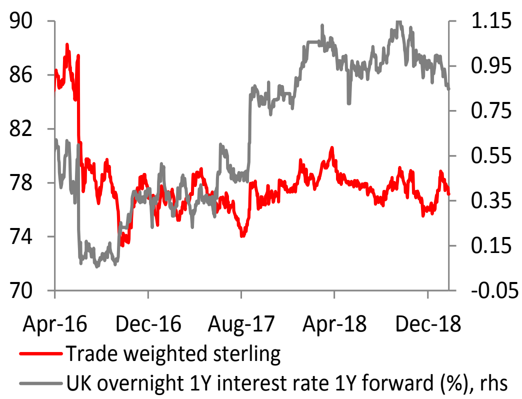
The pound should remain vulnerable to political uncertainty surrounding Brexit. The 'next step' in the Brexit process should become clearer over the coming weeks, which should provide sterling with a directional pull, although in which direction is still unclear. However, a dovish stance from the BoE indicates that slower UK economic growth looks set to keep UK rates on hold and the UK pound under pressure.

The BoE kept policy unchanged in February amid the 'fog of Brexit'. However, it signalled that if uncertainty persists it will not have to hike rates as much as previously assumed. In addition, its 2019 UK GDP forecast was revised down to 1.2% from 1.7%. Consequently, going forward, both the UK economic and interest rate outlook should offer less support for sterling.

Chart 5: Slower rate hikes, imply no support for the pound

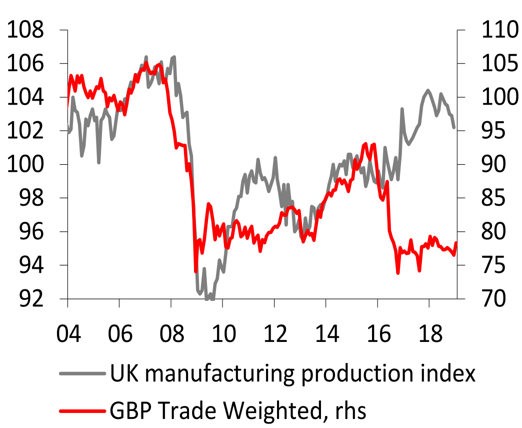


Source: Bloomberg, Santander

However, the main driver of sterling over the coming month will continue to be UK political uncertainty and the Brexit process. We retain the view that the sell-off in the pound since the EU referendum in June 2016 implies that the currency is historically very weak, and looks cheap when compared to fundamentals, such as unemployment and production. This might provide the pound with some support going forward, but much will depend on how the Brexit process pans out over the coming weeks.

The UK parliament looks set to have a 'meaningful' vote on the PM's withdrawal agreement from the EU on 27 February. We focus on three potential outcomes of the Brexit process that could occur. First, the withdrawal agreement (WA) is voted through. Second, the UK leaves the EU with 'no-deal'. Third, the Article 50 process is extended beyond 29 March.

Chart 6: Economic risks rising, but have they already been priced in?



Source: Bloomberg, Santander

If parliament agrees to the WA. The pound should strengthen in the short-term by c. 3.5%. The deal and the transition period would provide businesses with some near-term certainty. This might encourage business investment, which contracted again in Q4-18, the fourth consecutive contraction. However, the longer-term relationship between the UK and EU will remain unclear, which suggests to us that any pound gains could unwind if it becomes apparent that the difficulties experienced getting agreement on the WA imply similar problems in forging a new relationship between the UK and EU.

A 'no-deal' Brexit still appears to us to be the most sterling unfriendly outcome in the short term. The risk of a sharp economic shock to the UK would likely prompt a knee-jerk sell-off of c.7% for the GBP versus the USD and EUR. Given that the pound is already very weak, we would argue that a lot of the potential soft economic news should effectively be priced in, but the risk of fresh disruption would imply further weakness for the pound.

We think the pound will also strengthen if parliament decides to extend the A50 process, (c.2-3%), but how sustained any rise might be could depend on the reason for, and length of that extension. If the extension implies that the UK has effectively ruled out a 'no-deal' Brexit than the pound should rally, but without clarity on the direction the UK will be going with regard to Brexit these gains could similarly reverse quickly. In addition, a short extension, of say 3 months, may not be sufficient to convince the market that parliament can sort out these issues within that time frame.

JPY – Finally sliding?

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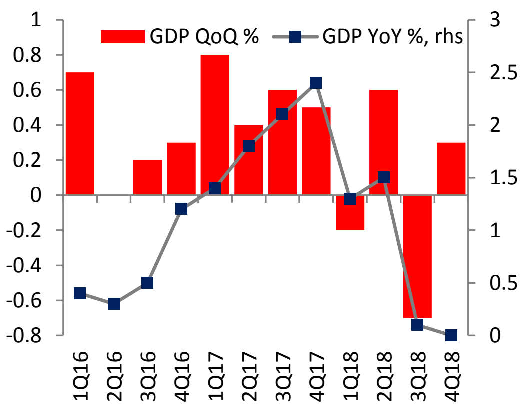
We retain a negative view on the yen. The BoJ's monetary policy should remain very loose throughout 2019. Further, the decline in risk appetite effect which supported the yen in 2018, appears to be having less of an impact in Q1-19.

Global risk appetite remains soft as the market frets about growth concerns and US-China trade tensions. The yen is viewed as a safe-haven asset, with demand boosted when risk appetite is low. Hence, despite a more mixed performance in Q1-19, the yen remains on the strong side, and still much firmer than the lows posted in Q4-18.

Chart 7: Japanese GDP picked up in Q4-18, but the outlook remains yen negative…



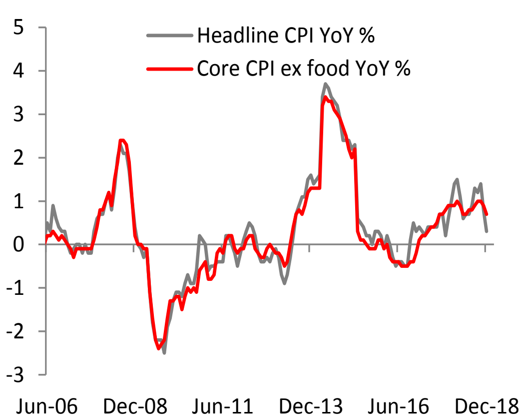
Source: Bloomberg, Santander

Low risk appetite could keep the yen firmer than Japanese fundamentals and policy would suggest to us that it should be. However, if the US and China reach some sort of market friendly trade agreement over the coming weeks, the demand for the yen could fall off quickly. Indeed, the pick-up in equities since the start of the year, echoed in a softer yen, highlights the impact that good trade news might have on the JPY.

Moreover, even if the US and China do not reach an agreement on their trade spat, we feel that the issue should be viewed as more ambiguous for the yen. Certainly, on one hand, a US-China trade conflict boosts global risk, reduces demand for risky assets and supports the yen. However, on the other hand, weaker Chinese growth has a direct negative impact on the Japanese economy, which, intuitively, should be viewed as yen negative. Trade data for January showed that Japanese export growth contracted 8.4% YoY, the biggest YoY fall since Q4-16. Further, exports to China, Japan's most important trading partner, contracted 17% YoY, to its lowest level in three years.

Whilst, US-China tensions and growth worries could imply two sided yen risk, the BoJ's loose policy should, in our opinion, signal clear downside JPY risk. In January, the bank kept policy unchanged. The benchmark rate remained at -0.1% and its 10Y yield target at around zero. The guideline for asset purchases remained at JPY80trn.

Chart 8: …as does the soft CPI outlook



Source: Bloomberg, Santander

The BoJ Governor Kuroda recently reiterated his intention to stick with the current policy, implying that interest rates across the curve will remain very low for a long period. This should imply downside pressure on the yen, even if the Fed halts its tightening cycle and the ECB only slowly moves toward a rate hike by the end of the year. Downside pressure for the yen from low interest rates may also come from its impact on the financial sector, as Kuroda conceded that the side effects of the policy on banks needed to be watched.

The Japanese economy did rebound in Q4-18, posting growth of 0.3% QoQ, following -0.7% QoQ in Q3-18 and the bank still envisages a 'moderate' recovery. It expects growth to be 0.9% in the fiscal year 2019 (the year ending in March 2020) and 1% for FY20.

However, the Bank's main problem is inflation. The core CPI forecast was cut to 0.9% from 1.4% in FY19, excluding the effect of this October's scheduled sales tax hike, and to 1.4% from 1.5% in FY20. The 2% inflation target remains some way off.

Whilst, the Bank has little room to add to its monetary stimulus, the inflation outlook suggests to us that there is little chance that the current policy will be 'exited' in 2019 and that a mixture of this loose policy and improving risk appetite will eventually convince more market participants that the yen is overvalued.

CNY – Support where it is needed

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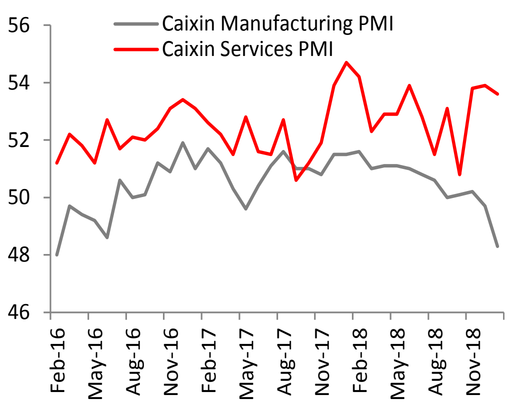
We continue to believe that the renminbi has some scope to strengthen against the USD during 2019. However, the move is likely to be driven more by USD weakness, helped by a patient Fed, tugging USD/CNY lower. Although, the pair's decline should be gradual as ongoing US-China trade tensions and concerns over China's economic outlook should temper CNY strength.

We see four factors as key to the outlook for USD/CNY; 1) general USD strength, 2) US-China trade negotiations, 3) concerns over China's economy, and 4) Chinese efforts to support the economy. First, USD strength. The slide in USD/CNY between November 2018 and the end of January 2019, and the rise in the pair during February, can be largely explained by the general USD movement, rather than CNY-specific factors. Despite renewed USD strength in February, we continue to expect that the dollar will weaken in 2019, helped by a 'dovish' Fed, and this should imply a softer USD/CNY.

Chart 9: Chinese PMIs highlighting growth concerns…

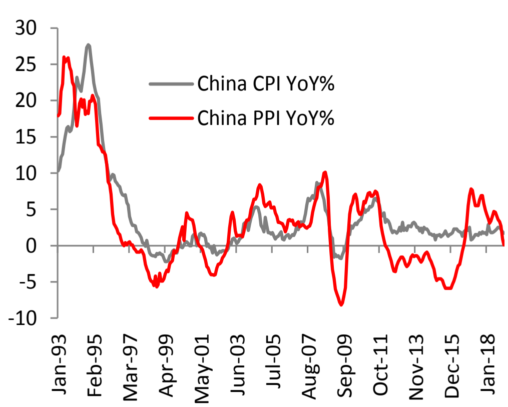


Source: Bloomberg, Santander

US-China trade tensions look set to continue as a key driver of CNY sentiment in the short term. USD/CNY levels are likely to depend on the latest rumours about how well, or poorly, the trade negotiations are going. Recall that 1 March is a deadline to achieve substantial progress on resolving the dispute. If this is not met, President Trump has promised to increase tariffs on some Chinese imports to the US. In general, when the headlines suggest t the talks are progressing well, risk appetite gets a boost and the USD slips, as demand for it as a possible safe haven declines, and USD/CNY falls.

There has been speculation in February that the president was considering extending that 1 March deadline by up to 60 days. Such an extension effect on USD/CNY appears ambiguous. It implies that the two sides are finding it difficult to reach agreement, which should be USD/CNY positive, but it could also delay the imposition of extra tariffs, which, should favour a weaker USD/CNY.

Chart 10: …as are inflationary indicators



Source: Bloomberg, Santander

Given concerns about China's economic outlook, escaping further tariffs may be crucial both to activity and the CNY. Recall, the economy grew 6.6% in 2018, the slowest rate for 28 years. Further, both Caixin PMI surveys were weaker than expected in January. The manufacturing index dropped to 48.3, the lowest since February 2016, amid a deteriorating outlook for exports.

Admittedly, January trade data did show a pick-up exports, up 9.1% YoY, after contracting 4.4% YoY in December. But import growth contracted again, albeit at a slower rate, -1.5% YoY, compared with -7.6% YoY. However, some commentators suspect that the data may have been helped by front loading orders ahead of the New Year holiday. If correct, February's data could show fresh weakness. In addition, the CPI dipped to 1.7% YoY in January, from 1.9% and factory price inflation plummeted to 0.1% YoY, from 0.9% in December. This is the slowest rate since September 2016 and is expected to put additional pressure on firms' profits.

Given these growth concerns, policymakers remain committed to providing support for the economy, focusing on targeted measures to increase liquidity and reduce bank lending costs, whilst containing financial risks. Another reduction in banks' reserve requirement ratio is possible over the coming months. Such 'easing' measures could be viewed as CNY negative, but might by seen as currency positive if they are successful in shoring up both activity and sentiment.

CHF – Heading in the wrong direction

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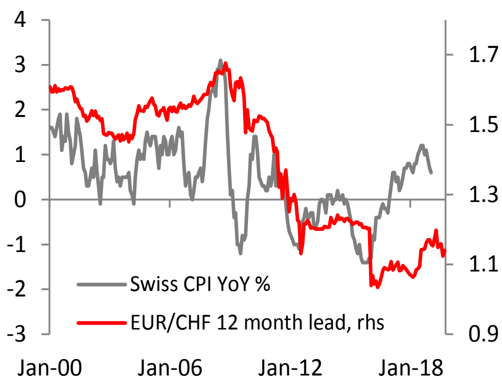
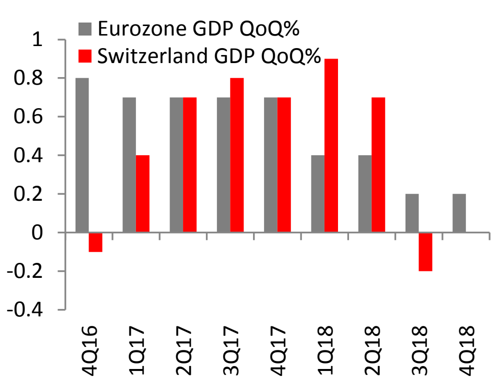
Chart 11: Swiss inflation slipping again, keeping the SNB on its toes



Source: Bloomberg, Santander

Chart 12: Softer Eurozone growth may spill over to Switzerland



Source: Bloomberg, Santander

We continue to believe that the CHF should weaken during the months ahead. The Swiss National Bank is expected to maintain its very loose monetary policy as inflation is forecast to remain low and there are risks that slower Eurozone/global growth has an adverse impact on Swiss activity.

The SNB monetary policy should remain a CHF-negative factor. The deposit rate is -0.75% and the bank maintains the right to intervene in the FX market to weaken a 'high' CHF. President Jordan recently reaffirmed that the current policy was the right one and that it will be continued for some time.

Admittedly, the 'high' CHF still does not appear to be having too much of an adverse effect on domestic activity. Growth did contract 0.2% QoQ in Q3-18, but the SNB believes that the economy remained robust in Q4 and at the start of 2019. That said, even if the Swiss economy can live with a firm CHF, a weaker currency appears necessary to lift inflation. The bank revised down its 2019 CPI forecast to 0.5% from 0.8% and its 2020 estimate to 1% from 1.2%. Indeed, CPI is not expected to reach 2% through to Q3-21.

Last month, we highlighted the increase in Swiss total sight deposits, viewed as a proxy for intervention, as an indicator that the Bank may have been trying to push against CHF strength at the start of the year. Similarly, Swiss foreign currency reserves increased by more than expected in January, moving to CHF741.5bn from CHF728.7bn in December. The rise could be explained by valuation changes, but could signal that policymakers may be willing to act if EUR/CHF falls back toward the low 1.12 levels, where it was at the start of January.

We reiterate that we do not expect this SNB policy to be changed until H2-19, and not before the ECB increases Eurozone interest rates. Hence, the policy spread between the CHF and EUR should remain in the EUR's favour. This has not so far been sufficient to significantly weaken the CHF, but we feel it should become more of a dominant factor in H2-19, when we expect the ECB to slowly edge toward increasing Eurozone interest rates.

However, this highlights the dilemma facing the SNB, as it remains a 'price taker' as far as EUR/CHF is concerned. The bank's actions may be sufficient to prevent EUR/CHF from dropping below 1.12, but are unable to prompt the more significant CHF weakening that we think the SNB would like to see. The policy remains vulnerable to Eurozone risks and/or a dovish ECB pulling the EUR down and, by default, taking EUR/CHF with it.

Traditionally the CHF has been viewed as a safe haven currency, with demand for the franc boosted when global risks are high. However, very low Swiss interest rates have dented the CHF's status. That said, EUR/CHF does tend to move in relation to changes in risk appetite, but via the effect on the EUR, rather than the CHF. Looking at EM equities as a gauge for global risk appetite, we saw that EUR/CHF sill tends to move with risk. In the past we might have explained this as the market shunning the CHF when EM stocks are high and risks are low, as the need for the safety of the franc is less. However, now it seems that as the market feels more confident on risks, EM/risk assets rise, the USD tends to fall, EUR/USD rises, pulling EUR/CHF up.

CAD – Still room to hike

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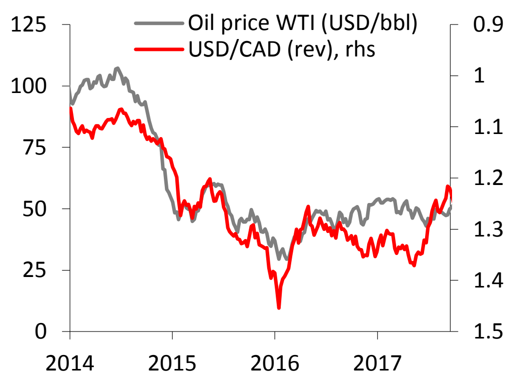
We remain positive on the CAD. The currency has performed strongly in 2019, even as a reinvigorated US dollar has kept USD/CAD above 1.30. A pick-up in the oil price has supported the Loonie, even as the near-term economic outlook has been downgraded. The Bank of Canada is unlikely to hike rates in H1-19, but we still expect CAD-friendly interest rate increases in the second half of the year.

Year-to-date, the CAD has been the best performing developed market currency. The outperformance has come despite a soft near-term economic outlook and a 'dovish' BoC. However, key to the CAD's 2019 performance has been a pick-up in the oil price since the start of the year.

Chart 13: Oil price rebounding off of its recent lows has helped the CAD



Source: Bloomberg, Santander

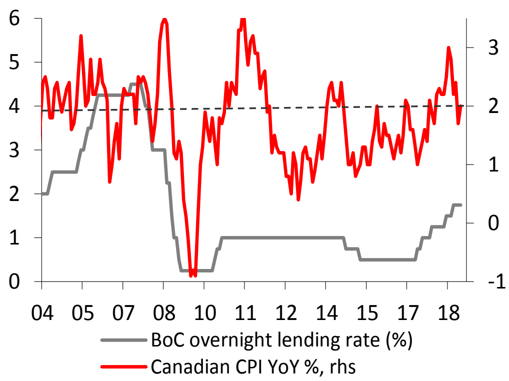
Recall that the WTI price dropped from a high at USD76.90/bbl at the start of October 2018, to a low at USD42.36/bbl at the end of last year. However, oil perked up in 2019 as the OPEC agreement to cut 1.2mn a barrels a day from the market during the first half of the year kicked in.

The correlation between WTI and USD/CAD over the past six months has been -0.9, with the currency obediently following the oil price. Hence, the pair dropped to 1.31 at the start of February, before reversing some of this move as the oil price has slipped in February, back below USD55/bbl.

However, the Bloomberg consensus oil price forecast envisages WTI rising above USD58/bbl in Q2-19, reaching USD63/bbl by the end of the year, which should support CAD sentiment.

Canada's employment report for January painted a rosy picture of the labour market. Net employment increased by 66.8k, with private sector jobs growing at the fastest rate since the md 1970s. However, the unemployment rate rose to 5.8% and wage growth remains subdued at 1.8% YoY, providing support for the BoC view that there is still slack in the labour market.

Chart 14: With inflation expected to hover around 2% target, BoC rate hikes should merely have been delayed



Source: Bloomberg, Santander

Moreover, the near-term economic outlook remains weak. Aside, from the jobs report, other data have been far less CAD friendly. Retail sales growth contracted 0.1% MoM in November, helping overall GDP also to contract 0.1% MoM.

Indeed, the BoC recently slashed its forecast for Q4-18 GDP to 1.3% QoQ in annualised terms, from 2.3%. In addition, it expects growth of just 0.8% QoQ annualised, in Q1-19.

Hence, the growth outlook suggests that the BoC will not hike rates in H1-19. However, the bank still forecasts the economy should move back to potential rates, considered by the BoC to be 1.4-2.2% for 2019 , from Q2-19 on.

Given this, and the forecast for CPI to remain around the 2% target, through to 2020, we still expect that the bank will hike rates in the second half of the year, taking the cash rate, currently at 1.75%, closer to the 'neutral range' of 2.5%-3.5%, and providing support for the currency.

AUD – Holding the channel

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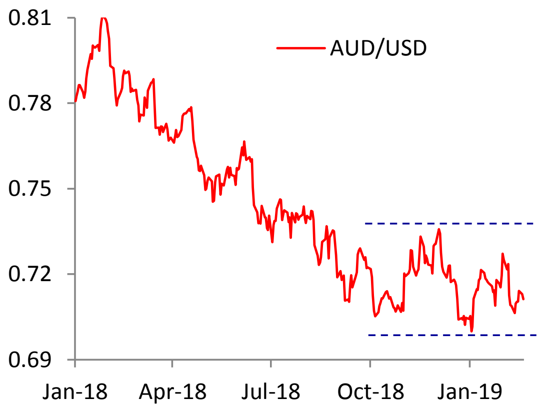
We remain positive on the AUD in 2019 and still forecast AUD/USD rising to 0.76 in Q4-19. However, weaker domestic data and a more dovish central bank could limit the currency in the near term. We still forecast the pair at 0.73 in Q1-19, but any break above this level will likely be dependent on more upbeat international risk sentiment, and a weaker USD.

The AUD has been one of the better performing developed market currencies in early 2019, lagging the CAD, GBP and NZD in terms of year-to-date gains, but outperforming others as a pick-up in global risk sentiment has allowed the commodity currencies to outperform. However, AUD/USD has held in a 0.70-74 channel over the past six months (Chart 15).

Chart 15: AUD/USD has moved sideways in recent months, holding in a 0.70-74 channel



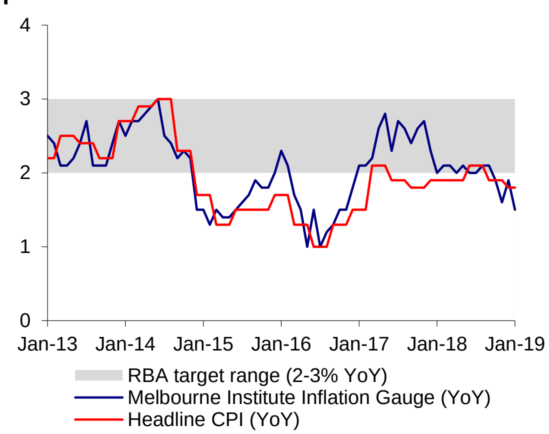
Source: Bloomberg, Santander

Domestic data have done little to support the AUD, with most releases disappointing in early 2019. Manufacturing figures picked up a little in January, but the services index dropped to a four-year low, while retail sales fell heavily. Headline CPI also slipped to 1.8% YoY in Q4-18 (Chart 16), still below the RBA's 2-3% inflation target, and the Melbourne Institute's monthly inflation gauge dipped to 1.5% in January, a two-year low.

With data putting no pressure on the RBA to consider hiking rates just yet, the Australian central bank did not surprise by keeping rates on hold in February, at 1.5%. We continue to expect the RBA to keep rates at this level throughout 2019, extending its record unchanged run to 37 meetings by year-end.

However, there are growing calls for a rate cut. At the end of November, the money markets were pricing in a 75% chance of a rate hike in 2019. Now, they see over a 1 in 2 chance of a rate cut this calendar year. Various economists are now even forecasting the RBA cash rate dropping to 1.00% by year-end.

Chart 16: With inflation below target, there is little pressure on the RBA to consider a 2019 rate hike



Source: Bloomberg, Santander

One reason to consider loosening monetary policy is the increase in funding rates for commercial banks (the last of the "Big Four" Australian banks, National Australia Bank, lifted its standard variable mortgage rates by 12bp on 31 January). This increase is akin to a small tightening in monetary policy for the Australian economy. With building approvals and property prices falling in recent months, there is an argument for the RBA to consider countering this move by cutting rates, in order to avert a housing-led slowdown across the Australian economy.

RBA Governor Lowe took a more dovish stance in February. The Bank slashing both its growth and inflation forecasts, while Lowe reiterated that the board did not see a strong case for a near-term rates change. He also highlighted that the rates outlook is now more balanced, with the next change in rates not necessarily a hike. This weighed on the AUD.

International factors are likely to be even more important for the AUD going forward. Upbeat sentiment on US-China trade had been supporting the AUD, but reports that the Chinese port of Dalian has banned imports of Australian coal indefinitely have pulled the AUD lower. Dalian only takes about 2% of Australia's coal exports, but there have been signs of concern recently over China's relationship with both Australia and New Zealand, since both rejected Chinese telecommunications giant Huawei Technologies for their 5G networks on security concerns.

NZD – Carry trade deterioration to limit NZD

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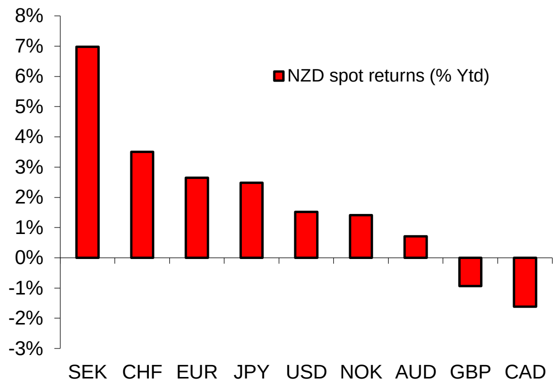
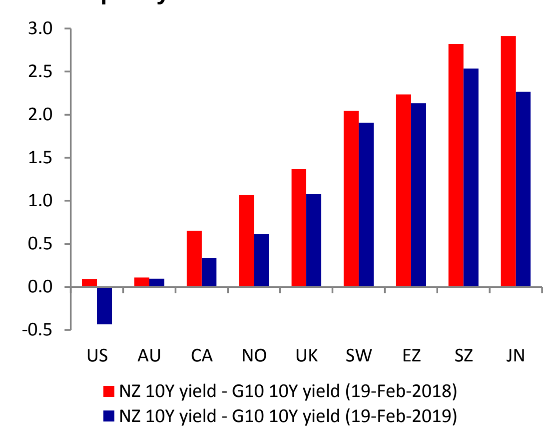
Chart 17: The NZD has performed well in early 2019



Source: Bloomberg, Santander. Note: Data correct as at 21 February, 10:00 GMT

Chart 18: The NZD yield advantage over the other developed market currencies has deteriorated over the past year



Source: Bloomberg, Santander

We are neutral the NZD in early 2019. The RBNZ may have been more upbeat than both we, and the market, had expected earlier this month, but the Bank still does not foresee a rate hike until 2021. With the NZD carry trade in decline, there is little reason domestically for the NZD to strengthen. Internationally, NZD/USD will be particularly alert to the US-China trade discussions, as well as the general USD strength. We forecast little change in NZD/USD during H1-19, and see the pair holding close to its current 0.68 level.

The NZD rallied on the RBNZ rate decision in mid-February after RBNZ Governor Orr suggested that the odds of a rate cut had not increased. The RBNZ kept rates on hold, at 1.75%, as expected, but the Bank's rhetoric was more positive than we, and the market, had expected.

The RBNZ did highlight both domestic and international risks, and lowered its growth, inflation and rates forecasts. However, the NZD benefitted as Governor Orr emphasised that the Bank is likely to hold rates still for a long time, rather than cut them.

The situation actually warrants a wait-and-see approach, in our view. Indeed, there is little the central bank of a small open economy, like New Zealand, can do to combat global uncertainty stemming from slower growth, trade fears, and Brexit, other than remain vigilant and mindful of the risks.

The US-China trade discussions, and potential future tariffs, are a particular focus. Together, these two countries make up around one-third of New Zealand's two-way trade. New Zealand's prime minister, Jacinda Ardern, highlighted in early February that "the worry for us is that further reductions in Chinese exports could cause a material slowdown in its economy, with adverse effects for New Zealand exporters".

The RBNZ has made good use of macroprudential policies in recent years, such as using loan-to-value bank lending to ensure house price stability and reduce the chances of boom-bust cycles. Now, the RBNZ is planning to increase commercial bank capital ratios, in order to further protect the economy from bank failures, by making them more resilient to economic shocks in any future crisis.

As discussed in RBNZ inertia adds to deterioration in NZD carry trade, published 11 February, the Bank is proposing to almost double the required amount of high quality capital that banks will have to hold. This is akin to a tightening of monetary policy conditions, and another reason for the RBNZ to keep the cash rate loose and to signal that hikes are unlikely anytime soon.

Long-term yields have fallen throughout the developed market over the past year as rate hike expectations have declined, but nowhere more so than in New Zealand. With New Zealand's 10Y yield falling to an all-time low in early February (at 2.08%), the NZD now has a yield disadvantage against the USD (Chart 18) and could find itself in a similar position versus the AUD, CAD, and even the NOK, by the end of this year. We expect this declining carry trade to limit the NZD.

SEK – A bad start to the year

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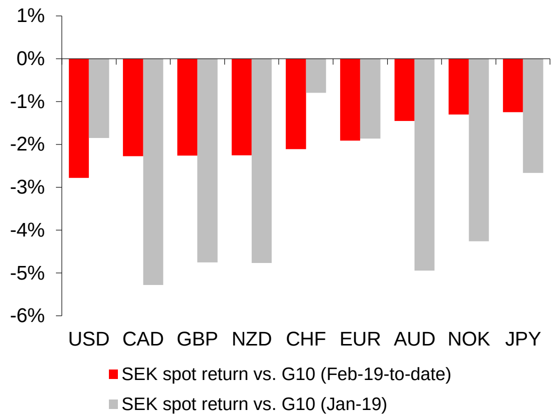
We are positive on the SEK over 2019 as a whole, but are cautious on the currency in the short term, with the Eurozone economy coming under pressure and Swedish data disappointing in early 2019. The Riksbank still advocates hiking rates in H2-19, ending its four-plus year experiment of negative rates. But such a hike is largely dependent on where inflation sits in a few months' time. We continue to see EUR/SEK close to 10.20 in Q1-19 and 9.60 by year-end.

Chart 19: After a bad January, the SEK has again performed poorly so far in February



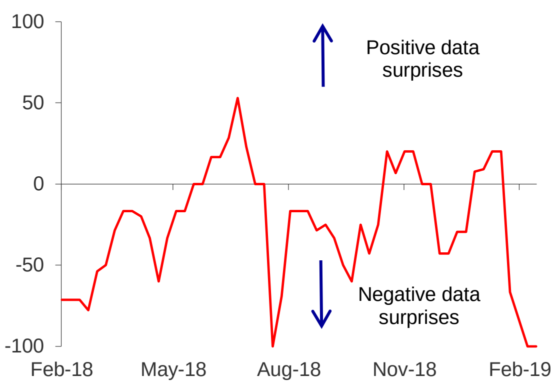
Source: Bloomberg, Santander

The SEK is the biggest underperformer among the developed market currencies in early 2019. The currency was the worst performing G10 currency in January and is again bottom of the pack month-to-date in February, down over 3% against the USD (February's outperformer) over the same period (Chart 19).

International growth fears are certainly not supportive of small open economies like Sweden. With Eurozone growth forecasts revised lower, US-China trade fears still present, more caution from the Fed and Brexit day just round the corner, global risk sentiment has hurt risk currencies like the SEK.

The SEK decline over the past two months has an even closer relationship with domestic data. Indeed, almost all Sweden's data releases have surprised to the downside (Chart 20). Any data surprise is likely to be quickly acted upon by the market, with persistent downward surprises causing the market to continually sell the SEK.

Chart 20: Swedish data have disappointed heavily to the downside in early 2019



Source: Bloomberg, Santander

The Swedish manufacturing and services PMIs were already on a downtrend in 2018, but have continued to deteriorate in early 2019, in line with the weaker Eurozone PMIs. The same can be said for Sweden's consumer and manufacturing confidence, which are at multi-year lows. Household lending has started to decline more quickly, household consumption is now at a decade low and retail sales just recorded their largest annual drop in eight years. The unemployment rate is the exception, falling to 6% in January, although this is still above its 2018 low.

Having hiked rates by 25bp in December (its first hike since 2011), the Riksbank was not expected to tighten policy again in February. It did not. It was more upbeat than the market was expecting, and did not seem too concerned about the economy. However, it is conscious that international conditions have deteriorated and that it needs to tread warily in monetary policy. The Bank continues to advocate a rate hike in H2-19, followed by two more increases in 2020.

However, it announced that it would not extend its mandate for FX market intervention (introduced in January 2016 initially, and extended several times since). This does not change policy as such, and is more a signal of moving to more "normal" times, where such policy is less likely to be needed.

One reason why the Riksbank sounded relatively calm was likely the above-target inflation. However, with CPIF falling to just 2% in January, a further decline would worry the Riksbank. The deteriorating data have rightly weighed on the SEK in recent weeks and Q4-18 GDP will be closely watched for signs of a recession on 28 February. For now, the Riksbank is set to wait and see where inflation sits in a few months' time.

NOK – Getting ready for a rate hike

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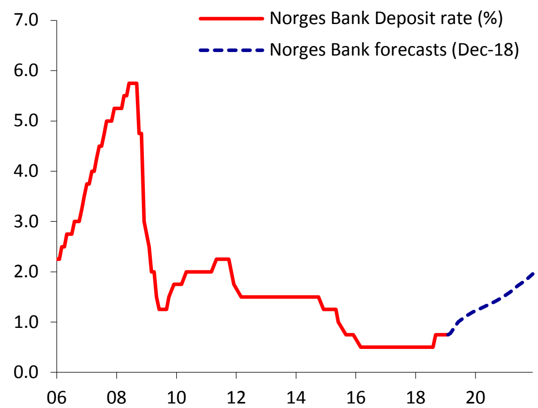
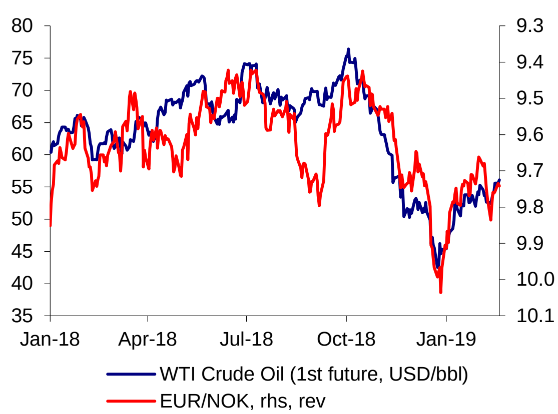
Chart 21: The Norges bank looks set to hike rates again in March…



Source: Bloomberg, Santander

Chart 22: …although oil prices are set to remain the biggest NOK-driver in the coming months



Source: Bloomberg, Santander

We remain upbeat on the NOK in 2019. The Norges Bank will likely hike rates in March, and then again in H2-19, at a time when many other developed market central banks have stepped back from tightening policy, which should help the NOK to strengthen this year. Domestic data have been a little mixed in recent weeks, but the main focus for the NOK is still oil. With WTI crude rising to a 3-month high this week, the NOK has strengthened. We expect a firmer NOK to pull EUR/NOK down to 9.7 in Q1-19 and 9.5 by year-end.

The NOK has been a middle-of-the-range performer so far in 2019, underperforming the other commodity currencies (CAD, NZD and AUD) but outperforming most of its European peers (SEK, CHF and EUR). Meanwhile, the NOK is little changed since the start of the year against both the USD and the JPY.

The petroleum sector makes up around half of Norway's goods exports, and is responsible, either directly or indirectly, for employing over 10% of the population. As such, it is not surprising that fluctuations in the oil price play a very important role in guiding its domestic currency.

WTI crude prices rose by c.20% in January, with the NOK rallying throughout the month. While the oil price is quite flat month-to-date, the NOK has continued to follow the commodity, falling with softer oil prices in early February and then rising with firmer oil over the past couple of weeks.

Crude oil and EUR/NOK have shared a strong correlation of -0.83 year-to-date, and the NOK is likely to continue to follow oil in the coming months, with any further recovery in oil prices likely to mean a stronger NOK.

Another potential reason for a stronger NOK is the Norges Bank. The Bank hiked rates in September 2018, its first rate hike in seven years. While it has since kept rates on hold, at 0.75% (in October, December and January), Governor Olson continues to advocate another 25bp increase on 21 March. Such a move is largely expected, but would nevertheless represent the first rate hike from a developed market economy in 2019.

The Norges Bank's latest forecasts imply a further rate hike in H2-19, and another three over the following two years. Perhaps with the exception of the Bank of Canada, the Norges Bank appears alone in expecting two rates hikes this year, and this should provide the NOK with a favourable platform to strengthen in the coming months.

The Norges Bank's main concerns (slowdown in international trade and prospects of a hard Brexit) are shared by all developed market central banks. Another topic of concern is the historically high levels of household debt. The Norwegian government has already announced new temporary regulations to limit the growth of high-interest consumer loans, and has suggested it could do more. Nevertheless, the Norges Bank will not want to hike rates too quickly, through fear of putting financial stability at risk.

LatAm FX: Main Themes

Currency	3M view	12M view	Main Themes
BRL	⇨	↘	• We expect market volatility to increase with the end of the “honeymoon” period for the new government and the debates in Congress about the pension reform proposal. • BRL is likely to continue to underperform other Brazilian assets, as it will probably continue to be perceived as a cheap hedge for local portfolios. • It will be important to observe the approach of the new central bank governor to FX intervention.
MXN	⇨	↘	• Banxico considers the possibility that the peso will come under pressure as the main risk for inflation. • By the middle of this year, it could become obvious that reaching the budgeted oil revenue for full year 2019 will be a real challenge. • Medium-term concerns remain, so we continue to believe it is too early for the market to price in cuts in 2019.
CLP	⇨	⇨	• The CLP will remain dependent on the external environment, with a special focus on trade tensions and copper prices. • The risk scenario is a permanent decline in copper, with effects on business confidence, investment, and eventually growth. • In the medium term, the US vs. China growth differential should be key for the peso, which should appreciate in case of a downward adjustment in that variable.
COP	⇨	↘	• Higher oil prices and the recent improvement in the external environment have led to a moderate appreciation of the COP. • Given the more benign external environment that is likely to prevail in the early part of this year, we expect the COP to post a more moderate depreciation throughout 2019, but we expect the currency to come under pressure in 2H19 and end at 3300 COP/USD at year-end. • We consider that BanRep will remain on hold for longer, as a result of the improvement in the external environment and the better inflation outlook this year. Thus, we see BanRep starting to hike in June, rather than in March, as previously anticipated.
ARS	↑	↘	• The uninterrupted compression of the Leliq returns suddenly reversed. The dollar quote has returned to the non-intervention zone (NIZ). • Based on FX flows, we anticipate further excess dollars that must be purchased by the central bank. • If the central bank continues capping the daily dollar purchases at US$75 million, we favour long local currency positions built every time the dollar quote is above the lower FX band.
PEN	⇨	↘	• PEN continued to recover some ground in February, aided by stronger metal prices and a less adverse external scenario. • However, PEN has underperformed when compared to other copper exporters’ currencies, mainly due to strong USD demand from locals, which could fall off in the coming months. • Risks remain biased to the downside, yet given PEN’s contained appreciation, we consider that the adjustment to lower commodity prices will be more moderate than we previously anticipated and thus we have revised our FX forecast to reflect more moderate depreciation in 2019.

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

Source: Santander.

BRL – Entering the political noise period

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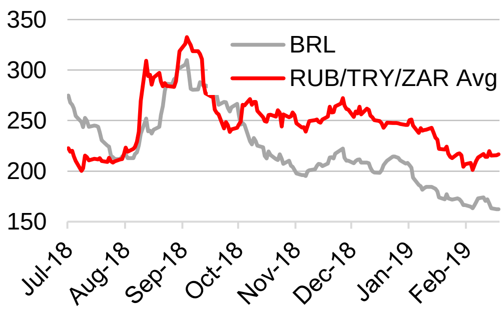
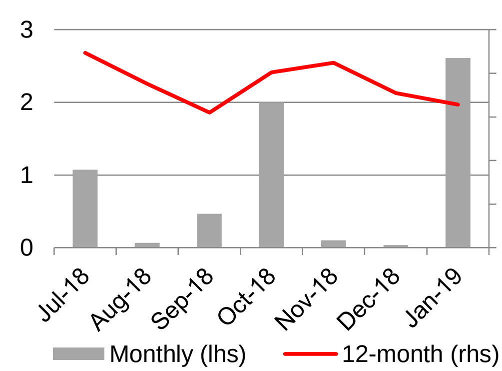
BRL has been trading in a tight range, with relatively low volatility, but arguably still in a strengthening trend versus the USD. Like other Brazilian assets, it has benefited from what we have been calling the "honeymoon period" of the newly elected government, during which the pro-market plans of a strong finance minister are still mostly unchecked by the legislative branch. As NPV data suggests, local hedge funds have been quite successful in building portfolios to profit from that wave of optimism: Anbima's IHFA, an index that tracks the *multimercados* industry, is up around 2% year-to-date.

Chart 23: Five-year CDS spreads (bp)



Source: Santander, Bloomberg

Chart 24: Brazil hedge fund returns (%)



Source: Anbima (IHFA index), Bloomberg

The end of the Carnival holiday (5 March), in our view, will mark the beginning of a period of increased political noise, with the resumption of legislative activities and discussions about the government's pension reform proposal, scheduled to be submitted to Congress in the next few weeks. The reform is key to the FX market for several reasons. First, as suggested by some surveys, current prices already embed a fairly high probability of a good outcome of the reform process (for example, in a panel of our Latin American Conference in January, 66% of respondents expected the reform to be approved by the end of this year). Second, without the reform, market participants would likely resume questioning Brazil's fiscal solvency, which could lead to portfolio outflows and currency depreciation (not to mention bearish speculative positions). Third, the country's fiscal consolidation process still depends on a series of other reforms, whose associated probability will likely be reassessed according to the legislative vote on the pension reform.

Given the unpopularity of a reform that intends to introduce a minimum retirement age, along with fragmentation in the Congress, we expect the reform process to be relatively lengthy (in our view, the reform will not be ready for a floor vote before the Congress's mid-year recess) and not free of attrition, hence leading to swings in investors' perceptions about the outcome. In the coming months, we expect an increase in volatility and some BRL weakening, as concerns about underlying fundamentals (low interest rate differentials, deteriorating trade balance, and little support from the external environment), as we have been describing, should start to prevail, in our view. In addition, local investors will probably continue to take advantage of the "cheap" carry costs to use BRL short positions as a partial hedge to their equity and bond portfolios.

A final factor to be taken into account for the next month: in the next few weeks Roberto Campos Neto is scheduled to replace Ilan Goldfajn as central bank governor. That may or may not bring changes in how the monetary authority approaches intervention in the FX market and how it will deal with the outstanding short USD position on FX swaps (currently at USD68.9 billion). Campos Neto has not given any statement or interview ahead of his confirmation by the Senate; markets will be hearing from him for the first time when the radio silence is broken.

MXN – 2H risks could mean peso closing 2019 at 20.5

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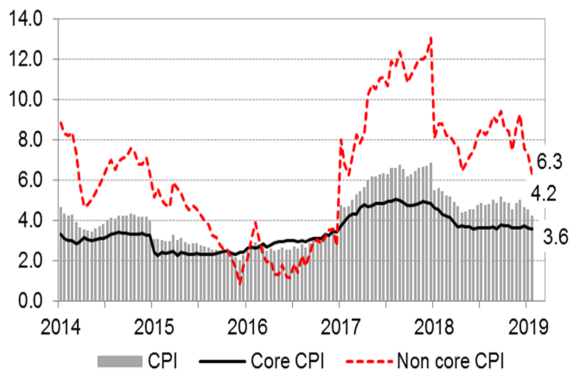
Chart 25: Consumer prices (annual % var.)



Source: Santander, Bloomberg

Chart 26: Consumer price forecasts(y/y %)

Source: Santander, Banxico

The central bank of Mexico considers the possibility that the peso will come under pressure as the main risk for inflation, according to the most recent monetary policy communiqué. Such depreciation could reflect external or domestic factors. The central bank reiterated that the economy could require adjustments to the real exchange rate. The main external factor, in our view, is whether the US dollar keeps appreciating against the rest of the global currencies as it has done in February and in particular against emerging market currencies. Among internal factors, we cite weak GDP growth and medium-term risks to public finance and to Pemex's new business model. In this context, we expect Banxico to keep monetary policy tight for the remainder of the year, supporting the peso at least in the short term.

By the middle of this year, it could become obvious that reaching the budgeted oil revenue for full year 2019 will be a real challenge. Also, higher tax revenue, which is dependent on a significant reduction in tax evasion and a GDP growth rate of 2.0%, could prove difficult to achieve. By the third quarter of this year, the discussion of the fiscal 2020 budget will be on the front burner, when the full cost of the government's proposed social programs will have to be accommodated against the backdrop of a weak economy.

AMLO promised a binding referendum in mid-2021 on his continuation as president for the remainder of his six-year term, coinciding with 13 gubernatorial elections and elections for the entire lower house. Thus, we believe he will be pushing his economic team to fulfil his campaign promises for better economic results, putting fiscal restraint at risk. By then, we should know if private investment is still in a wait-and-see mode, as it has been for the last three years on jitters about NAFTA renegotiation and the new administration's policies. It could also become evident that USMCA approval in the US Congress is not moving forward as expected and that global growth is weakening further. All of these factors would lead to a much weaker MXN and a steeper yield curve, we believe.

Our interpretation of the language of Banxico's latest communiqué is that with inflation on track and the economy weakening, these factors were enough to soften the hawkish tone somewhat but did not in any way create room for a discussion about cuts. The communiqué underscored the Board's concern about the persistence of core inflation and about the possibility that it could increase the resistance of long-term inflation expectations to move towards the 3% goal. The positive surprise for January inflation is mostly explained by non-core inflation, and for Banxico, the slightly positive result in core inflation was not enough to call it a trend change, a view we share.

Medium-term concerns remain, so we continue to believe it is too early for the market to price cuts in 2019. We maintain our view that the first cuts will come in 2020.

CLP – Still too early to expect a sustained rally

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In the last few weeks, the CLP has performed well in global FX markets, gaining almost 2% vs. the USD and other relevant benchmarks, such as DXY, EM FX indexes, and commodity currencies. Part of this was due to copper prices, which have jumped 7% since late January, breaking through US$2.80/lb for the first time in two months. But there was also a local factor: relatively large inflows to the local bond market, reflecting the general EM mood and the boost provided by Chile's rising weightings in global bond indexes (such as GBI).

On the local growth front, IMACEC closed 4Q18 at 3.3% y/y, 4.0% for the entire year. December's print was a little disappointing, with the actual 2.6% y/y falling 60bp short of consensus. Likewise, underlying trends remain soft: non-mining sector growth was only 1.6% annualised in the last six months, in part due to a notable slowdown in durables consumption. The BCCh survey consensus on 2019 GDP has already fallen 30bp to 3.5% in the last five months, and may decline further if our sub-3% estimates for IMACEC in January-February materialise.

Regarding inflation, January CPI brought important news: the new CPI basket indicates that inflation was much lower than believed in recent quarters. As per the new series (base-year 2018), CPI inflation was 1.8% y/y in January, vs. the 2.2% resulting from the old series (base-year 2013), mainly due to the new methodology applied to telecommunications, as well as to tourism services. Inflation expectations plummeted accordingly, with the forward market now discounting 2.3% y/y in June and 2.4% in December, well below the 3% target, reflecting soft underlying pressures but also uncertainty regarding the future dynamics of the new series.

At its 30 January meeting, the BCCh hiked rates by 25bp to 3%, but introduced a softer tone for the future course of monetary policy. So far this cycle, the BCCh has hiked rates every other meeting, but we think the pace in upcoming months could be even slower (one hike every three meetings, or a full interruption of the cycle). For the next IPoM report (due out in late March), we expect the confirmation of a more dovish stance, stemming from lower 2019 projections in terms of growth as well as inflation. In such a context, monetary policy should not provide a big boost to the currency.

All in all, the global USD story and copper gyrations should continue to be the key drivers of the peso. Despite the good CLP performance in recent weeks, we still have a hard time seeing a sustained downward drift in the USDCLP rate: the US economy may be softening at the margin, but the same is true for the main economic blocs and Chile. In this context, we maintain our view of a range-bound story to prevail in 2019: this range would be wide and market swings would continue to be erratic, with global investors hopping on and off the hard- and soft-landing scenarios for the US economy. Our preferred range for USDCLP is 660-690 for the next few months, which in the copper space is more or less consistent with a range of US$2.60-2

Chart 27: Multilateral exchange rate

Base Feb 2019=658.30 (actual USDCLP rate average).
Source: BCCH, Santander

Chart 28: CPI inflation (new 2018 basket)

Source: INE, BCCH, Santander

COP – Range-bound

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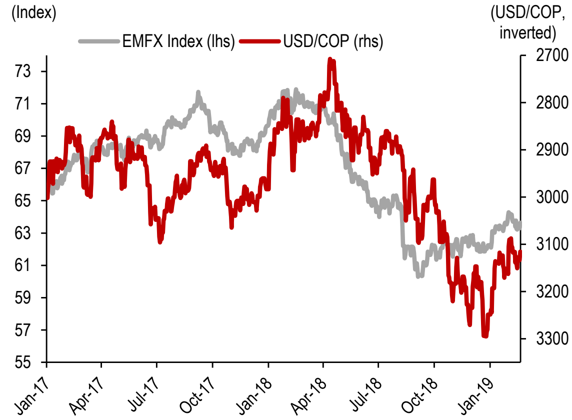
Since our last *FX Compass* (published on 24 January), the COP has appreciated marginally (1.7%) and remains one of the best performing currencies among the LatAm and EM currencies so far this year. Part of the COP's strengthening can be explained by higher oil prices, with the Brent oil price jumping 9% to $66/bbl. In addition, in contrast to the previous month, the external environment seems more benign, giving EM markets in general a break with a more dovish Fed and optimism about the ongoing trade talks between the US and China.

In this scenario, in February we have seen the COP fluctuating mainly in a range between 3100 and 3150 COP/USD, slightly below our fair value estimate of around 3165 COP/USD. We consider that, given the relative improvement in the external scenario, the COP will remain close to the current range in the short term, but we expect it will eventually see some pressures to the upside in 2H19 due to some possible strengthening of the US dollar, as the growth differential between the US and other advanced economies increases and as the Fed possibly resumes its tightening cycle in June. Thus, while we still expect the COP to depreciate, given the contained pressures seen year to date, we now expect a more moderate depreciation throughout the year. Stronger upside pressure likely will not come until 2H, and we now see the COP depreciating to 3300 COP/USD by year-end from 3400 COP/USD previously forecast.

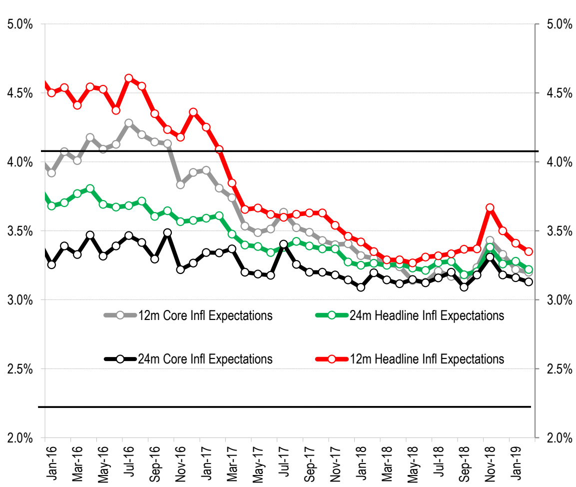
Chart 29: COP strengthens along with peers



Source: Santander, Bloomberg

In terms of monetary policy, we have also revised our call, as we now see the MPC delaying the start of hiking to June from March and expect the cycle to extend to 1Q20, as we still expect BanRep to increase the interest rate by 100bp, bringing the rate up back to neutral, with a 25bp increase in each quarter. In their latest communiqué, on 31 January, the board decided unanimously to keep the interest rate on hold at 4.25%, but in general they had a more positive view on growth, as they expect investment to rebound and see the economy growing 3.5% in 2019, giving some hints of hawkishness.

Chart 30: Improving inflation expectations



Source: Santander, BanRep

We believe that the board will remain on hold for a little longer, as inflationary risks have moderated significantly, with mild pressures from El Niño and increases in food prices offset by food prices' lower weight under the new methodology implemented in January. As a result, inflation expectations for end-2019 fell to 3.4% from 3.5%, and we have revised downward our inflation forecast to 3.2% from 3.6%. In addition to the more benign inflation outlook, in the minutes the board noted an improvement in the external scenario and listed it as one of the factors they considered in their decision to hold. Deputy Director Carolina Soto mentioned in an interview that the Fed's new stance gave BanRep a break, and thus we consider that the board will be unlikely to change the interest rate during the Fed's pause.

ARS – A shorter than expected monetary easing precludes a downward FX path

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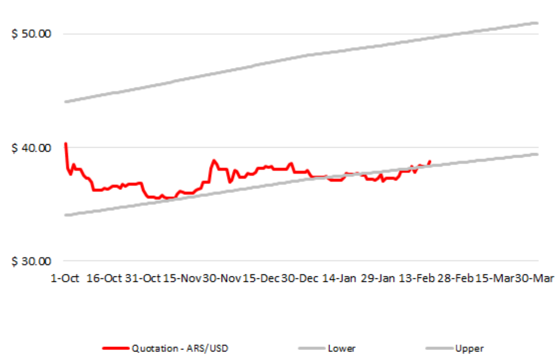
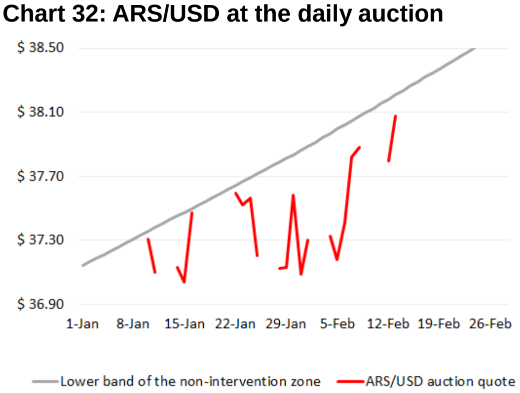
Chart 31: Non-Intervention zone and daily ARS/USD quote



Source: BCRA and Santander

Chart 32: ARS/USD at the daily auction



Source: BCRA and Santander

The uninterrupted compression of Leliq returns has suddenly reversed. After the Leliq rate fell more than 15% from early January, central bank authorities validated an increase of 38bp in the Leliq rate in the last two sessions, in order to exceed February's monetary base goal of ARS1.38tn by around 3%.

Meanwhile, the dollar quote returned to the non-intervention zone (NIZ) at the beginning of the week of 11 February, after remaining below the lower band of the NIZ since 10 January.

The falling dollar quote recorded in mid-January allowed the central bank authorities to purchase approximately US$1.0bn in FX reserves through 13 February.

On Thursday 14 February, January monthly CPI of 2.9% was released, above the 2.5% consensus forecast. Taken together with high frequency indicators that suggest that February CPI could be even higher than 3% – well above the 2.6% market consensus – this might be inducing the central bank to exceed the 2.1% February limit of the zero monetary base growth recorded in the first half of this month.

In this scenario, the floater ARGPOM sovereign bond should benefit *vis à vis* fixed rate instruments, while inflation linkers should continue being perceived as juice, especially among local investors, in an environment in which the inflation rate will take more time to abate.

The hefty agricultural export flows derived from the record crop of 52 million tons of soybeans and 47 million tons of corn, coupled with languishing demand from importers of goods and services and dollar purchases to be saved by locals as well, anticipate further excess dollar flows that, sooner rather than later, are likely to be purchased by the central bank when the quote finally breaks through the lower band of the non-intervention zone.

In a context in which the central bank continues capping daily dollar purchases at US$75 million, we favour long local currency positions built every time the dollar quote is above the lower FX band. Such a position should be reversed at any time the central bank acquires dollars.

Interestingly, the average dollar quotation of central bank purchases increased by a meagre 0.8% monthly between January and February, well below the 2% monthly devaluation set by the BCRA's lower and upper bands.

In our view, the limited amounts of dollars set by the central bank – i.e.US$50 million cap in January and US$75 million limit since February – ensure that the monetary authority will continue buying dollars with a less than 2% monthly adjustment in the weeks to come.

PEN – Contained appreciation

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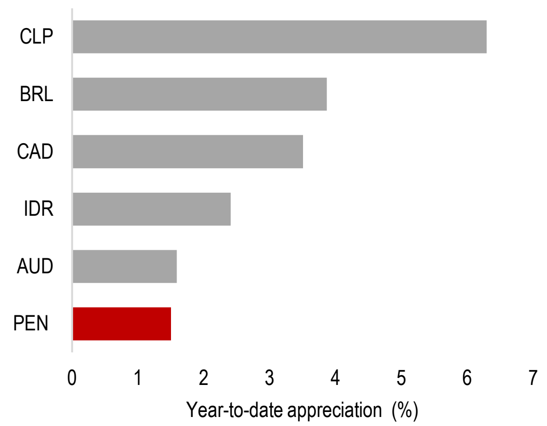
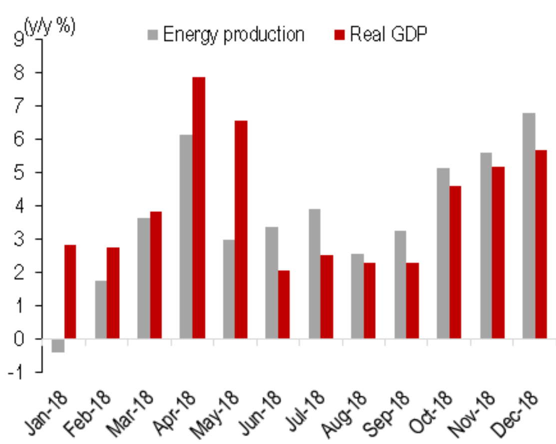
Chart 33: PEN underperforming peers



Source: Santander, Bloomberg

Chart 34: Activity growing at potential



Source: Santander, COES, central bank

Since our last publication, the PEN has come under certain pressure in February but ended up appreciating again, strengthening 0.6% since the second week of the month. The stronger FX was driven in part by the recent jump in copper prices, which have increased 5.1% since 14 February, and broke though the US$2.90 level for the first time since July last year. Additionally, the PEN has been supported by tax-related inflows, which typically are registered between 14 Feb and 22 Feb. Finally, we consider that a less adverse external environment, with a more dovish Fed and optimism regarding the trade talks between the US and China, has provided some relief to EM FX, including the PEN. Given the recovery in the PEN, the central bank has remained on the side-lines and has not intervened in the FX market in 2019.

We must note, however, that the PEN has underperformed relative to its fundamentals. Indeed, the PEN's 1.5% YTD appreciation has been more moderate than the recovery observed in key metal prices, such as copper, which have increased 11% since the beginning of this year. Similarly, the PEN has underperformed other metal exporters' currencies, including the CLP which has appreciated 6.3% YTD. The PEN's underperformance can be partially explained by the strong USD demand from local corporates registered since the end of last year. We consider that this demand may fall off in the coming months, allowing the currency to align itself more with external drivers.

Overall, we consider that the risks are to the downside, with still high uncertainty about the US and China talks, the Fed possibly resuming its tightening cycle and lower global growth. Yet, given the PEN's limited rally reported so far, we consider that in the case of a reversal in commodity price trends, and in particular metals, due to a continuing slowdown in China and global economic growth, the PEN's adjustment is likely be more moderate than we had previously anticipated, and thus we have revised our forecasts: we now expect the PEN to register a more moderate depreciation in 2019 and see the currency ending 2019 at 3.37 PEN/USD.

In terms of rates, as expected, the central bank kept the reference rate on hold at 2.75% in its February meeting, for the tenth consecutive month. While the MPC maintained a positive view on inflation, as in previous communiqués, the MPC used a more hawkish tone, stating for the first time that economic indicators point to a narrowing of the output gap, albeit gradual. Indeed, the monthly economic activity indicator suggests that the economy expanded by 4.0% y/y in 2018, reaching potential. Leading indicators suggest that the dynamism of the economy has continued in 2019, although the recent truck drivers' strike may lead to a temporary deceleration. Overall, the MPC maintained its forward guidance, and considers it prudent to keep rates on hold as long as the economy remains below potential. Given the positive news on growth, we expect the central bank to deliver its first hike in June.

CEE FX: Main Themes

Currency	3M view	12M view	Main Themes
PLN	→	→	• EUR/PLN broke the upper end of the 4.26-4.34 horizontal trend it has been in since August. Recent developments have been pretty much in line with our expectations, so we are leaving our EUR/PLN forecasts unchanged. Since volatility could rise further in the short term, we see a risk that EUR/PLN could stay above 4.34 for a while.
CZK	↘	↘	• In February, the Czech koruna benefited from domestic data, and EUR/CZK is now trading slightly below our 1Q target. A correlation analysis suggests that the exchange rate could now rebound.
HUF	↘	↘	• We expect EUR/HUF to rise slightly in the short term owing to the expected deterioration of macro figures. At the end of 2Q19E, we expect EUR/HUF to move up to 325 as a result of the next wave of weak economic data and a return of the central bank's rhetoric to a dovish tone.
RUB	→	→	• We maintain our USD/RUB forecast at 66 for 1Q19 and at 67 for the rest of the year. A stabilisation of USD/RUB is likely to be mainly the result of relaxing geopolitical tension and market expectations for further rate hikes.

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

Source: Santander Bank Polska S.A.

PLN – Near crucial level

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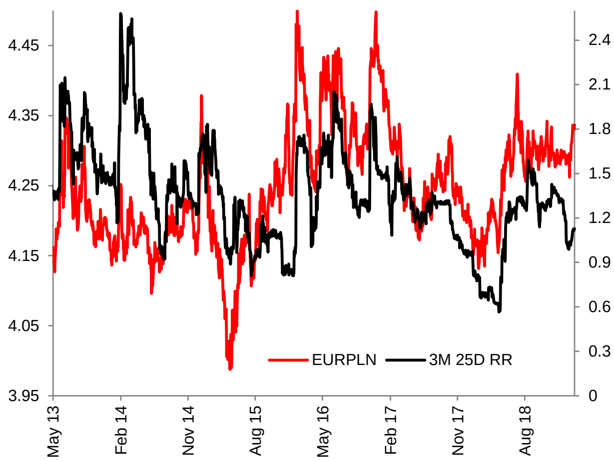
EUR/PLN broke the upper end of the 4.26-4.34 horizontal trend it has been in since August. The recent developments were pretty much in line with our expectations, so we are leaving our EUR/PLN forecasts unchanged. Since volatility could rise further in the short term, we see a risk that EUR/PLN could stay above 4.34 for a while.

Later in the year, an improvement in the situation of EM markets and a rise in EUR/USD could support the Polish currency. However, the pace of EUR/PLN decline may be slow amid a lack of interest rate hikes in Poland this year, a continuation of the economic slowdown and market uncertainty ahead of the general election slated for the autumn.

In January, we wrote that, in our view, the first months of 2019 could bring some zloty depreciation. In February, EUR/PLN reached its highest level since October as the zloty appreciated after the FOMC's dovish shift proved temporary and due to the dollar's appreciation. Since the end of 2018, the zloty has been the third weakest (after the Argentina peso and Romanian leu) major EM currency.

Chart 35: EUR/PLN and its 25 delta 3M risk reversal implied volatility



Source: Bloomberg, Santander Bank Polska

Following the gradual narrowing of the EUR/PLN trading range in recent months, we have finally seen signs of life in this market. The zloty's depreciation vs the euro was accompanied by a rise in implied volatilities. The 1M and 3M 25-delta Risk Reversals rebounded from their local lows, while ATM 1M implied volatility rose somewhat from its multi-month low level. For months now, we have been suggesting that a rise in volatility would weigh on the zloty, and there seems to be room for this to continue in the weeks to come.

The zloty is a cyclical currency, and the next bit of evidence that economic growth in Poland is cooling should prevent EUR/PLN from declining. 4Q18 GDP growth came in at 4.9% y/y, falling below the 5% mark for the first time since mid-2017. Seasonally adjusted growth reached 0.5% q/q, the lowest since 2Q16. We expect a further mild economic slowdown down the road, to 3.8% y/y on average in 2019E. At the same time, inflation remains subdued (0.9% y/y in January), creating a comfortable environment for the Polish central bank to keep its "wait-and-see" approach.

In autumn, general elections will be held in Poland, and before that lawmakers are expected to resume work on the "Swiss bill", the act that allows commercial bank clients to convert their FX mortgages to PLN with part of the cost being borne by the bank. Although there seems to be a consensus among lawmakers that the final shape of the bill should not threaten the stability of the banking sector, the risk of populist ideas re-emerging ahead of the election makes us cautious as regards the room for zloty appreciation – at least in the short term.

Poor data are still coming out of Europe. The equity market seems to be currently pricing in a scenario of economic revival, but the zloty has not been benefiting from the rebound in stock indexes. Regarding Brexit, our base-case scenario does not envisage a no-deal solution, so this event should not have a permanent negative impact on the zloty.

CZK – Boosted by data

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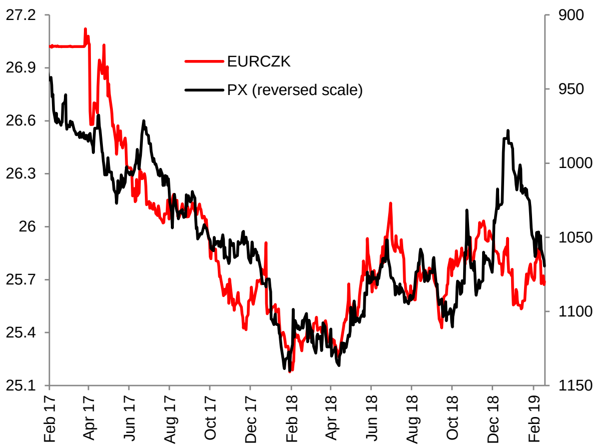
Chart 36: EUR/CZK and Prague stock exchange index



Source: Bloomberg, Santander Bank Polska

In February, the Czech koruna benefited from domestic data, and EUR/CZK is now trading slightly below our 1Q target. A correlation analysis suggests that the exchange rate could now rebound.

In early February, the Czech central bank left interest rates unchanged, but the data released in Czechia later in the month were pretty hawkish. According to the flash estimate, in 4Q18 the pace of GDP growth accelerated more than expected, to 2.9% y/y from 2.4% y/y in 3Q, but was still slower than the 5.2% peak registered in 3Q17. January CPI came in at 2.5% y/y vs 2.0% y/y in December, with the core elements being responsible for most of the upside surprise. The Czech central bank viewed this release as confirmation of strong inflation pressures persisting in the economy, and the market started to expect a rate hike at the next meeting on March 28.

The 20-day correlation between EUR/CZK and the Czech FX stock index reached its cyclical peak at +80% and has started to decline. At the same time, the analogous correlation between EUR/CZK and the Czech 10Y bond yield started to rise from its cyclical low of -80%. It seems that the equity market has (at least to a certain degree) already priced in the scenario of weaker growth in Europe and would finally need some solid data to hold onto gains. On the other hand, the recent hawkish signals from the Czech economy could trigger upside pressure on yields, which implies EUR/CZK could rise provided the correlation pattern holds.

HUF – Rating upgrade

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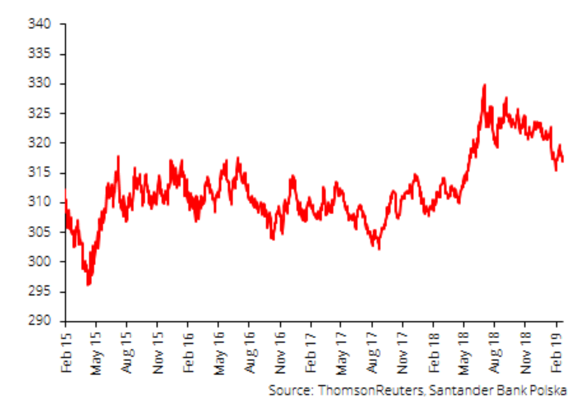
Chart 37: EUR/HUF



Source: Reuters, Santander Bank Polska.

EUR/HUF has declined over the last four-five weeks, supported by talk about monetary policy normalisation in Hungary. The Hungarian Central Bank pointed out again that the expected rise in core inflation will be a reason for monetary policy normalisation. Moreover, the forint was supported by strong macro data (wages, December's industrial production, January's PMI and 4Q18 GDP surprised on the positive side). Additionally, information about a rating upgrade to BBB from BBB- with a stable outlook by S&P pushed the EUR/HUF down. As a result, the exchange rate declined from 319.70, temporarily reaching 315.70.

Over the next four to five weeks, we anticipate EUR/HUF will rebound slightly, likely supported by a poor macro data release from Hungary (as we expect). In our opinion, in January Hungarian industrial production decelerated to 4.7% y/y (after 5.7% y/y in December). Under these circumstances, we think that not even further central bank remarks about monetary policy normalisation (in the face of an expected increase in core inflation) will not be able to stop the forint's weakening. Moreover, Eurozone economic data (Ifo, industrial production, new car registrations) and European monetary policymakers' gloomy comments on the economic outlook for the European Union could negatively affect the forint. As a result, we see EUR/HUF at 320 at the end of 1Q19E. Later in the year, we believe EURHUF will return to around 325 owing to the poor macro data out of Hungary.

RUB – VAT-flation

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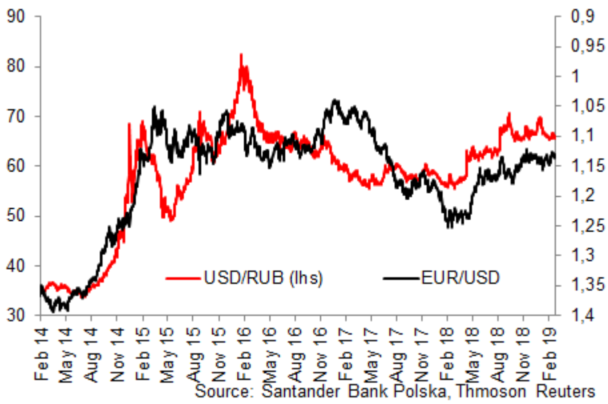
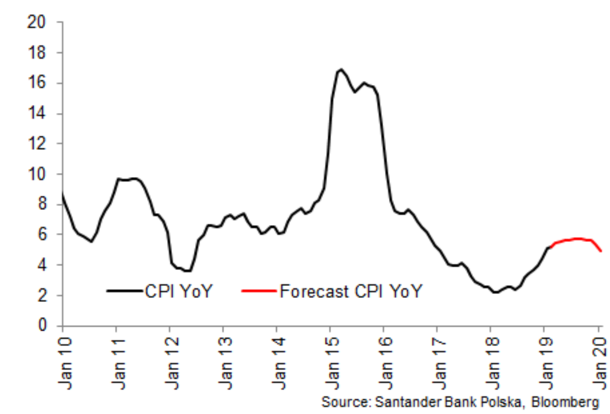
Chart 38: USD/RUB and EUR/USD (reversed scale)



Source: Reuters, Santander Bank Polska.

Chart 39: Russian CPI



Source: Reuters, Santander Bank Polska.

USD/RUB has been relatively stable over the past four to five weeks, except for a short while in mid-February, when it jumped to 67.20 from 65.50 in reaction to the drastic strengthening of the USD. USD/RUB was also pushed up by information about the possibility of new EU sanctions being imposed on Russia. However, the USD/RUB’s upward move was short-lived. A relatively strong ruble in recent weeks was the result of the lack of new information about rising tension in the Ukraine-Russia conflict and high oil prices. Moreover, the ruble was still under the influence of expected interest rate hikes (in reaction to an inflation spike on the back of a VAT rate hike), despite the central bank’s declaration that the current level of interest rates was enough to push inflation down below the upper band (4.0% y/y) in 2020. The incoming weak macro data out of Russia (industrial production, retail sales, wages, PMI, GDP) has not negatively affected the ruble.

Over the next four to five weeks, we expect USD/RUB to stabilise, as the upcoming data releases are unlikely to further raise market expectations on the scale of looming monetary policy tightening. FRA rates are currently pricing in the full scale of expected interest rate hikes by the central bank at 125bp over a 6-month horizon. In our opinion, the ruble should continue to be supported by high oil prices (we see Brent oil prices in a USD65-70/bbl range). In our opinion, as in recent months, the (expected) weak macro data should not impact the ruble.

For 2Q19E, we expect USD/RUB to increase to 67. We believe this will be the result of the gradual dissipation of inflationary pressures (generated by the VAT increase) and a milder-than-expected monetary policy response. We expect the CBR to raise interest rates twice (by 25bp each time), signalling the end of the cycle. We think the expected weaker data on the real economy and the fading of inflationary VAT pressures will discourage the central bank from applying further interest rate increases.

G10 FX: IMM Speculative Positioning

The CFTC suspended publication of the weekly IMM speculative positioning data during the US government shutdown. These reports are being published twice weekly to catch up, and, as discussed in [Market left to speculate on the speculative positioning data], published 4 February, will not be fully up-to-date until 8 March.

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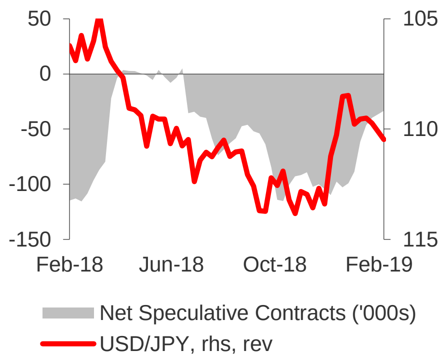
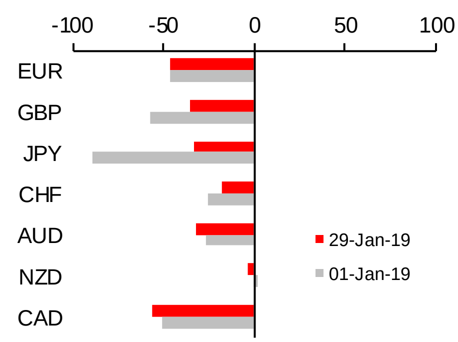
IMM commitment of traders report: USD/JPY position



- **Speculators turned more cautious on the USD in January,** reducing their net long USD composite position to 155k contracts in the week ended 29 January, from 282k contracts in the week ended 1 January. Surprisingly, though, the more cautious USD position did not benefit the single currency, with the net short EUR position seeing little change, at 47k contracts, and EUR/USD starting and finishing the month at 1.1450.
- **The net short JPY position fell in January,** with the most recent net short 33k contract position the least negative the JPY that speculators have been since June 2018.
- **The net short GBP position also shrank in January,** despite Brexit fast approaching, with speculators also the least negative they have been the pound since mid-2018.
- **Speculators turned more negative on the AUD, NZD and CAD in January.** Each of these positions worsened by some 5k contracts over the month, with the net short AUD and CAD positions falling to 32k and 56k contracts, respectively, while the small net long NZD position turned net short.

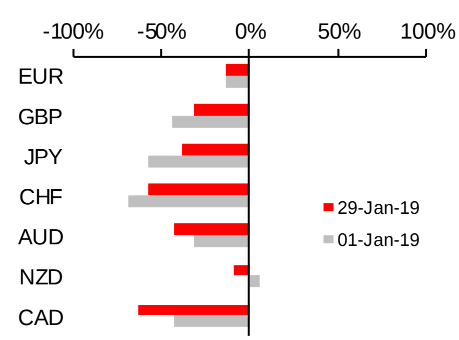
Net Speculative Contracts ('000s)*

	29-Jan-19	01-Jan-19	4w chg	YtD chg
USD***	155.0	282.9	-128.0	152.3
EUR	-46.5	-46.6	0.2	-138.6
GBP	-35.2	-56.9	21.7	-47.9
JPY	-33.3	-88.6	55.3	82.7
CHF	-18.1	-25.5	7.5	-4.2
AUD	-32.1	-26.3	-5.8	-18.5
NZD	-2.8	2.0	-4.8	14.8
CAD	-56.4	-50.6	-5.7	-73.7



Net Speculative Contracts as % of Open Interest**

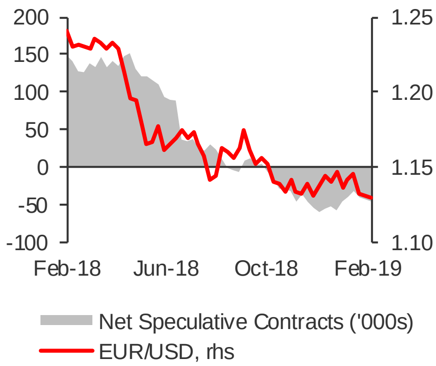
	29-Jan-19	01-Jan-19	4w chg	YtD chg
USD***	16%	27%	-11%	15%
EUR	-14%	-14%	0%	-42%
GBP	-31%	-44%	13%	-40%
JPY	-38%	-58%	19%	19%
CHF	-57%	-68%	11%	-39%
AUD	-43%	-32%	-11%	-28%
NZD	-9%	6%	-14%	24%
CAD	-63%	-42%	-21%	-89%



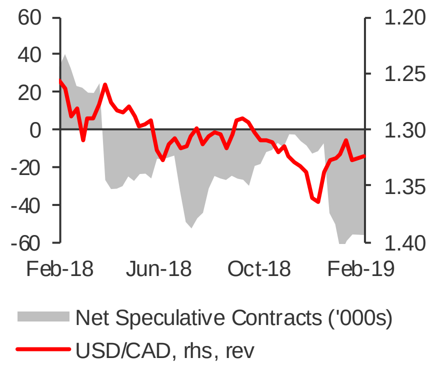
Sources: CFTC, Bloomberg, Santander. Note: *Net Speculative Contracts = Long non-commercial traders contracts minus short non-commercial traders contracts, **Open Interest = The total number of outstanding long and short futures contracts, ***USD composite index = USD composite index uses AUD, CAD, CHF,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

G10 FX: IMM Speculative Positioning

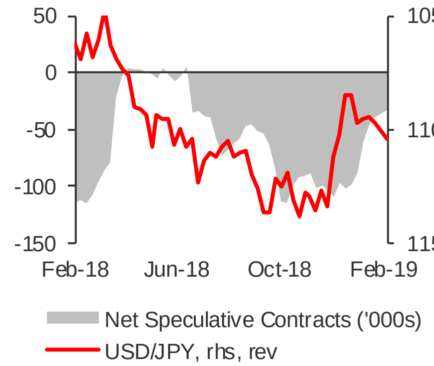
EUR/USD



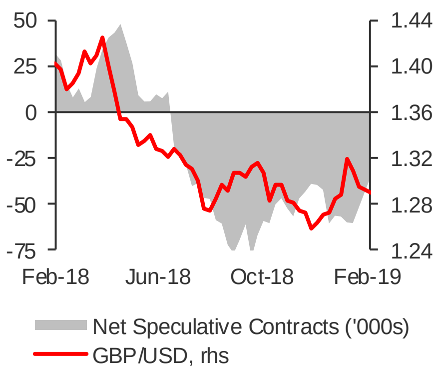
USD/CAD



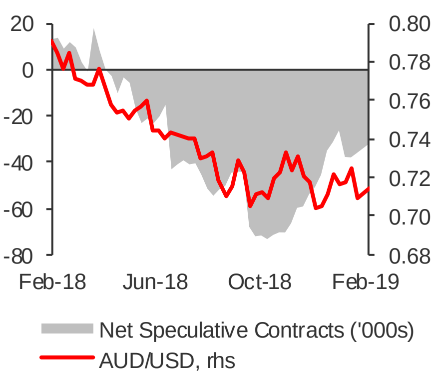
USD/JPY



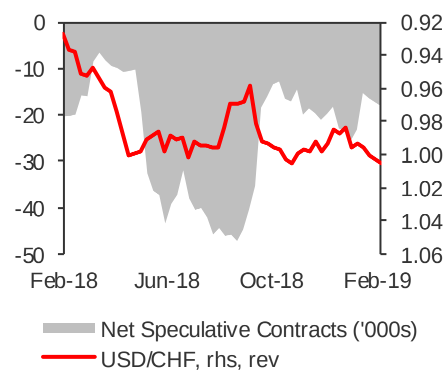
GBP/USD



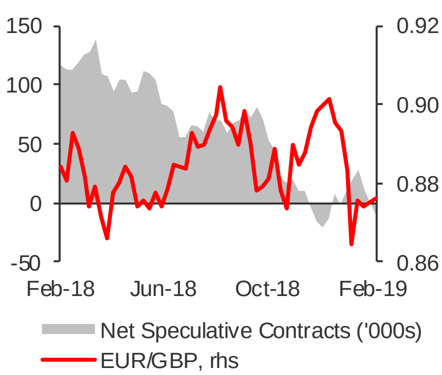
AUD/USD



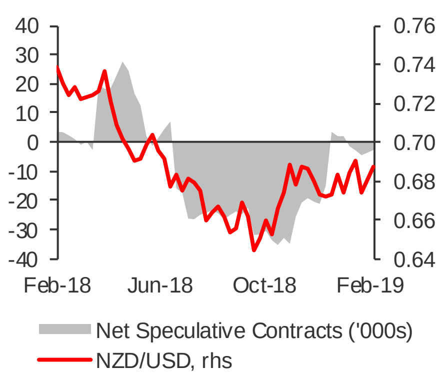
USD/CHF



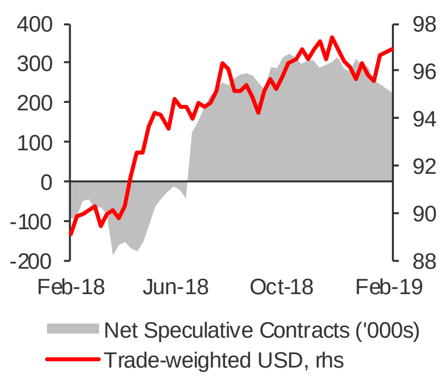
EUR/GBP



NZD/USD



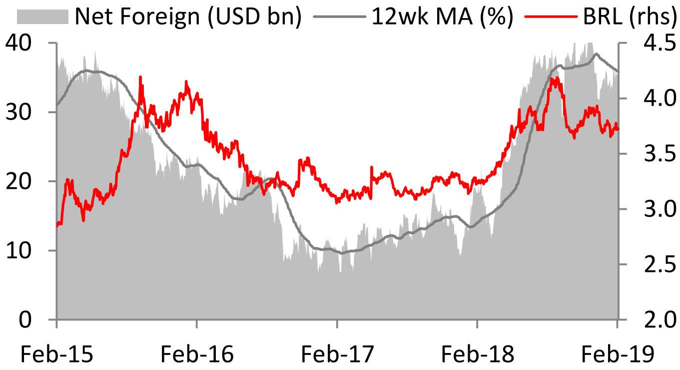
USD minus MXN



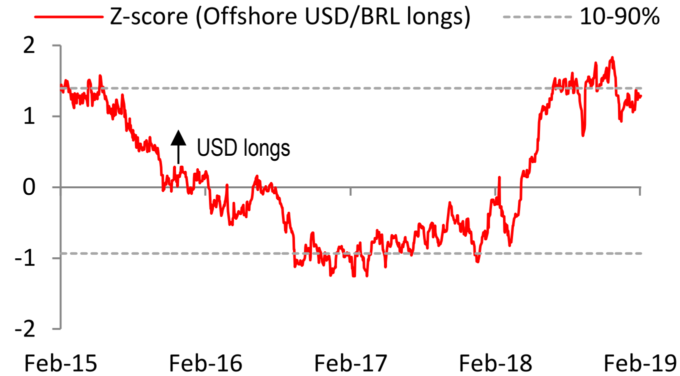
Sources: CFTC, Bloomberg and Santander. Note: IMM commitment of traders report. Data in tables and charts are for the week ended 29 January 2019 (the most recent data published by the CFTC, which is still being published with a delay following the US government shutdown)

Latin America FX: Positioning indexes (Z-scores)

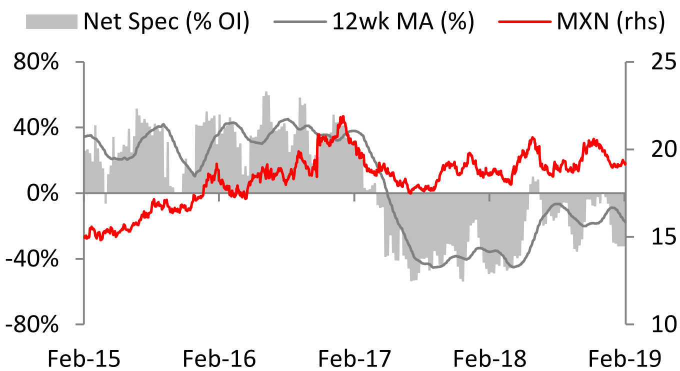
USD/BRL



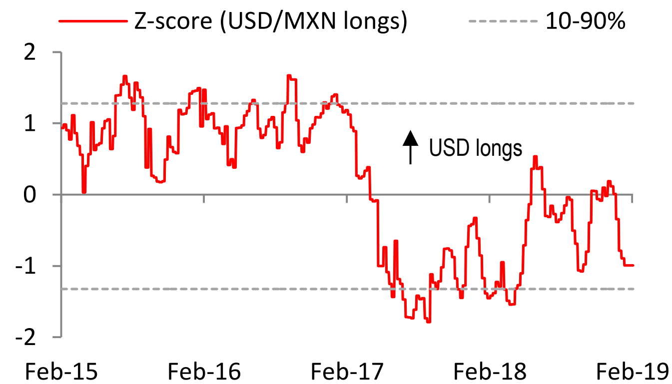
Z-score USD/BRL



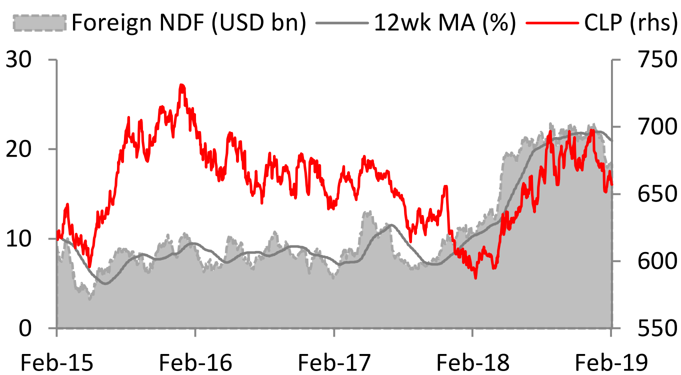
USD/MXN



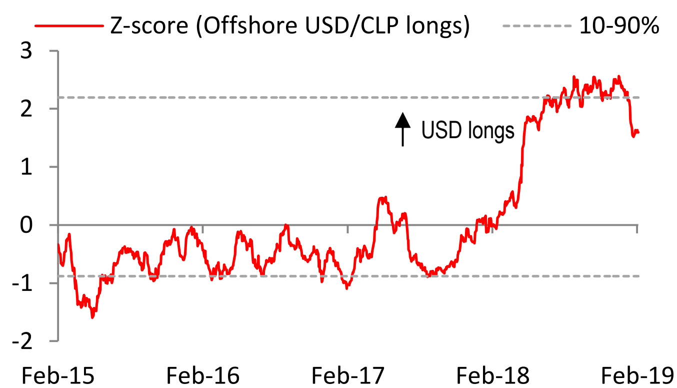
Z-score USD/MXN



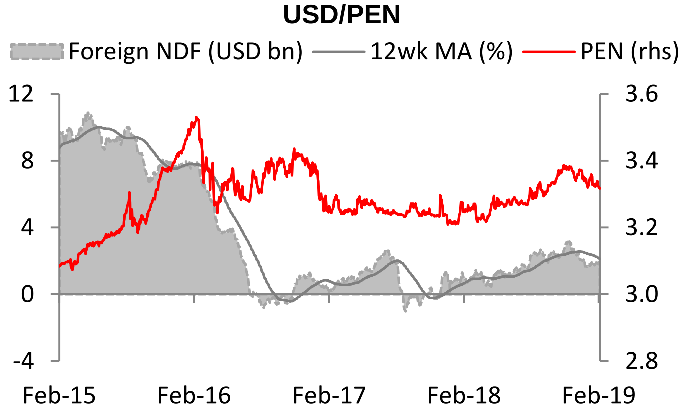
USD/CLP



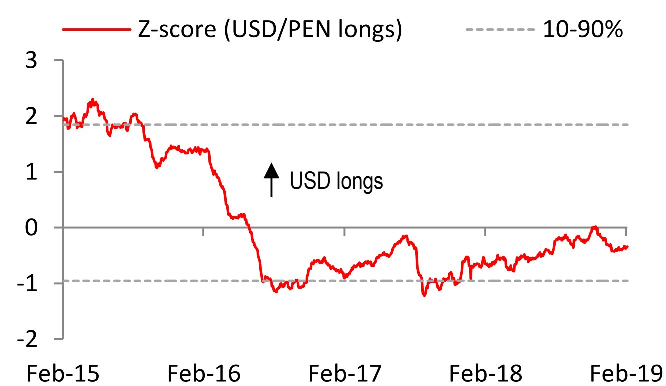
Z-score USD/CLP



USD/PEN



Z-score USD/PEN



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

Euro Interest Rate Forecasts

Government Bond yield Forecasts

Germany	Current	1Q19	2Q19	3Q19	4Q19
ECB Depo	-0.40	-0.40	-0.40	-0.40	-0.20
3m	-0.55	-0.55	-0.50	-0.45	-0.35
2y	-0.56	-0.50	-0.40	-0.15	0.00
5y	-0.35	-0.15	0.00	0.20	0.35
10y	0.11	0.35	0.45	0.65	0.80
30y	0.73	0.95	1.00	1.15	1.25

Swap rate forecasts

Euro	Current	1Q19	2Q19	3Q19	4Q19
ECB Depo	-0.40	-0.40	-0.40	-0.40	-0.20
3m	-0.31	-0.30	-0.23	-0.09	0.05
2y	-0.16	-0.10	0.00	0.20	0.35
5y	0.12	0.30	0.45	0.60	0.75
10y	0.64	0.85	0.95	1.10	1.25
30y	1.23	1.40	1.45	1.55	1.65

US Interest Rate Forecasts

Government Bond yield Forecasts

US	Current	1Q19	2Q19	3Q19	4Q19
FOMC *	2.50	2.50	2.50	2.75	2.75
3m	2.43	2.45	2.60	2.80	2.90
2y	2.51	2.55	2.75	3.00	3.10
5y	2.48	2.55	2.75	3.10	3.20
10y	2.66	2.75	3.00	3.15	3.25
30y	3.00	3.10	3.15	3.30	3.35

Swap rate forecasts

US	Current	1Q19	2Q19	3Q19	4Q19
FOMC *	2.50	2.50	2.50	2.75	2.75
3m	2.66	2.80	2.80	2.95	3.00
2y	2.62	2.70	2.90	3.15	3.25
5y	2.55	2.65	2.85	3.20	3.25
10y	2.68	2.80	3.05	3.20	3.25
30y	2.82	2.90	2.95	3.10	3.15

UK Interest Rate Forecasts

Government Bond yield Forecasts

UK	Current	1Q19	2Q19	3Q19	4Q19
MPC	0.75	0.75	0.75	0.75	0.75
3m	0.88	0.75	0.80	0.79	0.77
2y	0.76	0.75	0.85	0.90	0.90
5y	0.85	1.00	1.10	1.20	1.10
10y	1.19	1.35	1.50	1.70	1.60
30y	1.72	1.85	2.00	2.20	2.10

Swap rate forecasts

UK	Current	1Q19	2Q19	3Q19	4Q19
MPC	0.75	0.75	0.75	0.75	0.75
3m	0.86	0.90	0.90	0.87	0.85
2y	1.07	1.15	1.15	1.15	1.20
5y	1.22	1.35	1.40	1.45	1.45
10y	1.39	1.50	1.60	1.75	1.70
30y	1.53	1.65	1.75	1.95	1.80

G10 Central Bank Calendar

	Current Rate	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
FOMC (Upper)	2.50	-	Unch.	+25bp	-	Unch.	+25bp	Unch.	-	20	-	1	19
ECB (Depo)	-0.40	Unch.	-	Unch.	Unch.	-	Unch.	Unch.	-	7	10	-	6
BoE	0.75	-	+25bp	Unch.	-	Unch.	Unch.	-	Unch.	21	-	2	20
BoJ	-0.10	Unch.	-	Unch.	Unch.	-	Unch.	Unch.	-	15	25	-	20
SNB	-0.75	-	-	Unch.	-	-	Unch.	-	-	21	-	-	13
BoC	1.75	+25bp	-	Unch.	+25bp	-	Unch.	Unch.	-	6	24	29	-
RBA	1.50	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	-	Unch.	5	2	7	4
RBNZ	1.75	-	Unch.	Unch.	-	Unch.	-	-	Unch.	27	-	8	26
Norges Bank	0.75	-	Unch.	+25bp	Unch.	-	Unch.	Unch.	-	21	-	9	20
Riksbank	-0.25	Unch.	-	Unch.	Unch.	-	+25bp	-	Unch.	-	25	-	-

Source: Bloomberg, Santander. Note: Current levels as at 21-Feb-19. 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.

Brazil/Mexico Interest Rate forecasts

Brazil	Current	1Q19	2Q19	3Q19	4Q19
SELIC	6.50	6.50	6.50	6.50	6.50
NTNF Jan' 25s	8.60	8.50	8.50	8.20	8.00
NTNF Jan.' 29s	8.97	8.80	8.80	8.50	8.30

Mexico	Current	1Q19	2Q19	3Q19	4Q19
Banxico fondeo	8.25	8.25	8.25	8.25	8.25
Mbono Jun. '21s	8.12	8.25	8.25	8.20	8.20
MBono Jun. '29s	8.14	8.50	8.60	8.60	8.60

Chile/Colombia Interest Rate Forecasts

Chile	Current	1Q19	2Q19	3Q19	4Q19
BCCh TPM	3.00	3.00	3.25	3.25	3.25
BCP 5Y	3.98	4.10	4.15	4.20	4.20
BCP 10Y	4.11	4.45	4.50	4.60	4.60

Colombia	Current	1Q19	2Q19	3Q19	4Q19
Banrep O/N	4.25	4.25	4.50	4.75	5.00
TES Jul '24s	5.99	6.25	6.35	6.64	6.64
TES Apr '28s	6.65	6.64	6.72	6.92	7.10

Argentina/Peru Interest Rate Forecasts

Argentina	Current	1Q19	2Q19	3Q19	4Q19
LELIQ 7-day	46.01	43.00	40.00	37.00	34.00

Peru	Current	1Q19	2Q19	3Q19	4Q19
BRCP Ref. Rate	2.75	2.75	3.00	3.25	3.50

LatAm Central Bank Calendar

	Current Rate	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Brazil	6.50	-	Unch.	Unch.	Unch.	-	Unch.	-	Unch.	20	-	8	19
Mexico	8.25	-	Unch.	-	Unch.	+25bp	+25bp	-	Unch.	28	-	16	27
Chile	3.00	Unch.	-	Unch.	+25bp	-	Unch.	+25bp	-	29	-	9	7
Colombia	4.25	Unch.	-	Unch.	Unch.	-	Unch.	Unch.	22	29	26	31	28
Argentina*	46.01	Unch.	+2000bp	+500bp	+305bp	-730bp	-1503bp	-5563bp	~	~	~	~	~
Peru	2.75	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	7	11	9	13

CEE Interest Rate Forecasts

Poland	Current	1Q19	2Q19	3Q19	4Q19
Reference Rate	1.50	1.50	1.50	1.50	1.50
2y	1.54	1.40	1.53	1.59	1.48
10y	2.82	2.65	2.85	3.00	2.75

CEE	Current	1Q19	2Q19	3Q19	4Q19
Hungary	0.90	0.90	0.90	0.90	0.90
Czech Republic	1.75	2.00	2.00	2.00	2.00
Russia	7.75	8.00	8.25	8.25	8.25

CEE Central Bank Calendar

	Current Rate	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Poland	1.50	Unch.	-	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	6	3	15	5
Czech Republic	1.75	-	+25bp	+25bp	-	+25bp	Unch.	-	Unch.	28	-	2	26
Hungary	0.90	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	26	26	30	28	25
Russia	7.75	Unch.	-	+25bp	Unch.	-	+25bp	-	Unch.	22	26	-	14

Source: Bloomberg, Santander. Note: Current levels as at 21-Feb-2019. For meetings that have already taken place, decision identified as +/- in bp, or "unch" for no change. "-" denotes no meeting taking place that month. *On 7 August 2018 = Argentina's monetary policy committee voted unanimously to change the key interest rate to 7-day Leliq rate, which the bank has been changing on a daily basis since the start of October (the decision was made fortnightly previously).

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

	3M	6M	9M
EUR/USD	**1.18**	**1.20**	**1.21**
vs.forward	4.2	5.3	6.2
vs.consensus forecast	2.9	3.2	2.3
GBP/USD	**1.33**	**1.34**	**1.36**
vs.forward	1.5	2.8	3.8
vs.consensus forecast	1.3	1.0	0.5
EUR/GBP	**0.89**	**0.89**	**0.89**
vs.forward	2.6	2.5	2.3
vs.consensus forecast	2.5	2.4	2.2
USD/JPY	**117**	**119**	**119**
vs.forward	5.4	7.2	7.5
vs.consensus forecast	6.1	7.9	9.7
EUR/JPY	**138**	**142**	**144**
vs.forward	9.8	12.9	14.2
vs.consensus forecast	10.4	11.8	12.2
EUR/CHF	**1.17**	**1.19**	**1.20**
vs.forward	3.4	5.1	5.7
vs.consensus forecast	2.9	3.8	4.3
USD/CHF	**0.99**	**1.00**	**0.99**
vs.forward	-0.8	-0.2	-0.5
vs.consensus forecast	0.2	0.7	0.5
EUR/SEK	**10.1**	**9.9**	**9.7**
vs.forward	-4.7	-6.6	-8.5
vs.consensus forecast	-1.8	-3.1	-3.7
EUR/NOK	**9.6**	**9.6**	**9.5**
vs.forward	-1.1	-1.5	-2.1
vs.consensus forecast	0.3	1.1	1.1
USD/CAD	**1.26**	**1.24**	**1.21**
vs.forward	-4.2	-5.5	-7.8
vs.consensus forecast	-4.5	-4.4	-5.9
AUD/USD	**0.74**	**0.75**	**0.76**
vs.forward	2.7	4.1	5.5
vs.consensus forecast	2.3	2.3	2.3
NZD/USD	**0.68**	**0.69**	**0.70**
vs.forward	-1.1	-0.1	1.3
vs.consensus forecast	0.0	1.0	2.5

	3M	6M	9M
USD/BRL	**3.73**	**3.82**	**3.95**
vs.forward	0.6	2.8	6.4
vs.consensus forecast	0.1	3.2	6.8
EUR/BRL	**4.42**	**4.57**	**4.77**
vs.forward	4.7	8.3	13.0
vs.consensus forecast	3.0	6.4	9.2
USD/MXN	**19.6**	**20.17**	**20.80**
vs.forward	2.2	5.1	8.4
vs.consensus forecast	1.8	4.2	7.3
EUR/MXN	**23.2**	**24.1**	**25.1**
vs.forward	6.4	10.8	15.2
vs.consensus forecast	4.8	7.5	9.7
USD/CLP	**670**	**672**	**665**
vs.forward	2.6	2.9	1.8
vs.consensus forecast	0.6	1.0	1.5
USD/COP	**3267**	**3317**	**3383**
vs.forward	5.0	6.6	8.7
vs.consensus forecast	5.2	7.0	10.9
USD/ARS	**41.3**	**43.7**	**46.2**
vs.forward	3.4	9.3	15.5
vs.consensus forecast	6.0	7.3	7.7
USD/PEN	**3.47**	**3.52**	**3.56**
vs.forward	4.7	6.0	7.2
vs.consensus forecast	4.3	6.2	7.8
EUR/PLN	**4.33**	**4.34**	**4.32**
vs.forward	0.0	0.2	-0.4
vs.consensus forecast	0.8	1.5	1.6
EUR/CZK	**26.1**	**26.3**	**26.4**
vs.forward	1.7	2.4	2.7
vs.consensus forecast	1.6	2.6	3.4
EUR/HUF	**323**	**325**	**325**
vs.forward	2.0	2.5	2.5
vs.consensus forecast	1.4	1.9	1.6
EUR/RUB	**79**	**80**	**81**
vs.forward	6.0	7.7	8.6
vs.consensus forecast	4.2	6.4	4.3

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	1.134	1.308	110.69	125.77	144.71	1.001	1.135	1.309
1M	1.136	1.310	110.46	125.52	144.65	0.998	1.135	1.307
2M	1.139	1.312	110.17	125.53	144.50	0.995	1.134	1.306
3M	1.142	1.314	109.88	125.55	144.35	0.992	1.134	1.304
6M	1.151	1.319	109.08	125.58	143.92	0.984	1.133	1.298
9M	1.160	1.325	108.28	125.61	143.45	0.975	1.131	1.292
12M	1.169	1.331	107.39	125.59	142.90	0.967	1.130	1.286

ATMf vol.

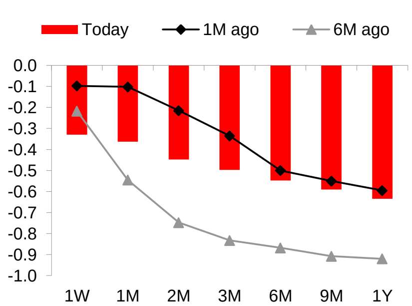
	EUR/USD	GBP/USD	USD/JPY	EUR/JPY	GBP/JPY	USD/CHF	EUR/CHF	GBP/CHF
1W	6.1%	11.9%	5.1%	6.3%	11.8%	5.4%	4.4%	11.1%
1M	6.3%	11.4%	5.8%	6.8%	11.9%	5.6%	4.4%	10.7%
2M	6.2%	11.9%	6.1%	7.0%	12.5%	5.7%	4.6%	11.1%
3M	6.4%	11.8%	6.5%	7.3%	12.5%	5.9%	4.7%	10.9%
6M	6.7%	11.3%	7.1%	7.9%	12.3%	6.3%	5.0%	10.4%
9M	6.9%	10.9%	7.4%	8.2%	12.1%	6.6%	5.2%	10.2%
12M	7.0%	10.6%	7.6%	8.5%	11.9%	6.8%	5.4%	10.0%

Implied/realized vol. ratio

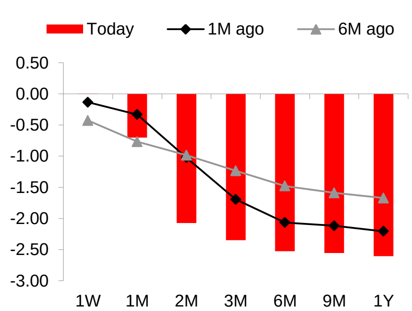
	EUR/USD	GBP/USD	USD/JPY	EUR/JPY	GBP/JPY	USD/CHF	EUR/CHF	GBP/CHF
1W	0.99	1.61	1.03	1.02	1.47	1.09	1.23	1.67
1M	1.10	1.51	1.13	1.16	1.42	1.01	0.95	1.45
2M	1.03	1.40	0.74	0.81	1.03	0.92	0.96	1.31
3M	0.99	1.35	0.88	0.90	1.12	0.97	1.00	1.32
6M	1.00	1.29	1.08	0.98	1.16	1.05	1.00	1.27
9M	1.00	1.31	1.15	0.98	1.21	1.10	0.99	1.32
12M	1.02	1.32	1.17	1.04	1.22	1.12	1.05	1.33

25-delta risk reversals

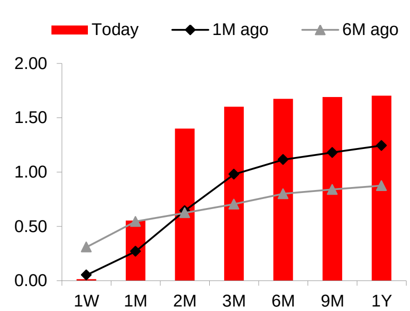
EUR/USD



GBP/USD



EUR/GBP



Sources: Bloomberg and Santander. As of 21-Feb-19

Latin America FX: Spot and forward rates

	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
Spot	39.7	3.71	653	3112	19.2	3.32
1M	40.8	3.74	653	3116	19.3	3.32
2M	42.2	3.75	653	3120	19.4	3.33
3M	43.5	3.75	653	3124	19.5	3.33
6M	47.4	3.78	653	3137	19.8	3.34
9M	50.5	3.81	653	3152	20.1	3.35
12M	53.6	3.84	654	3164	20.3	3.36

ATMf vol.

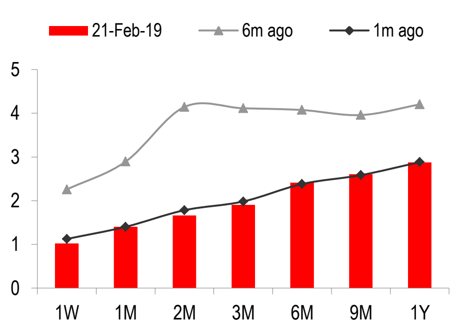
	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
1W	8.20	13.91	9.68	12.26	10.72	3.58
1M	10.00	13.62	9.38	11.72	11.29	3.72
2M	12.23	13.90	9.70	11.70	11.51	4.00
3M	13.90	13.91	9.95	11.80	11.92	4.19
6M	17.00	14.26	10.29	12.17	12.60	4.65
9M	18.83	14.31	10.64	12.44	12.98	5.01
12M	20.00	14.34	10.76	12.58	13.22	5.23

Implied/realized vol. ratio

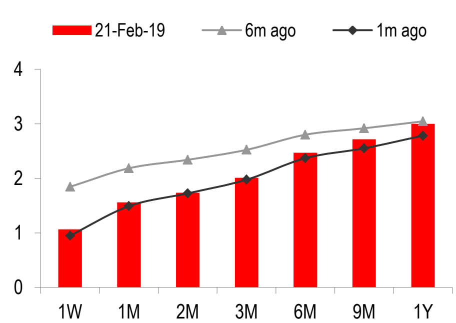
	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
1W	0.47	1.32	1.28	2.64	1.21	1.16
1M	0.69	1.14	1.03	1.52	1.23	0.93
2M	0.93	1.14	1.09	1.35	1.22	1.07
3M	0.93	1.04	1.06	1.28	1.12	1.17
6M	0.60	0.88	1.00	1.29	1.04	1.30
9M	0.72	0.88	1.04	1.29	1.01	1.39
12M	0.79	0.95	1.10	1.22	1.05	1.40

25-delta risk reversals

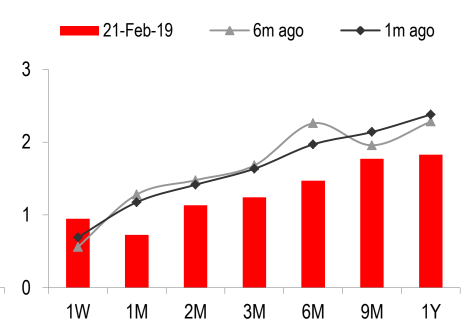
USD/BRL



USD/MXN



USD/CLP



Sources: Bloomberg and Santander. As of 21-Feb-19

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EXPLANATION OF THE RECOMMENDATION SYSTEM

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

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

DEFINITIONS

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

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