22 June 2018, 10:50 BST

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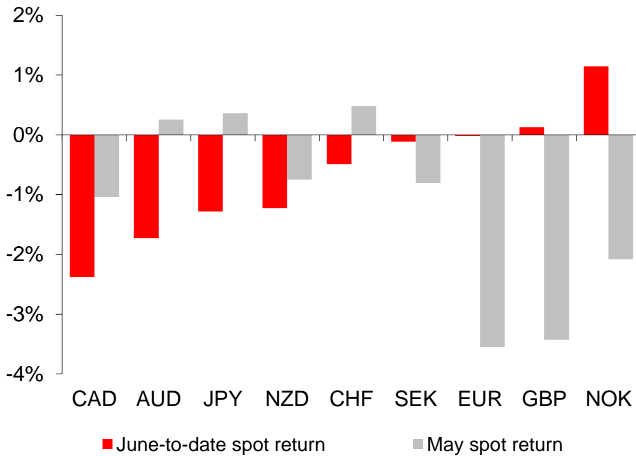
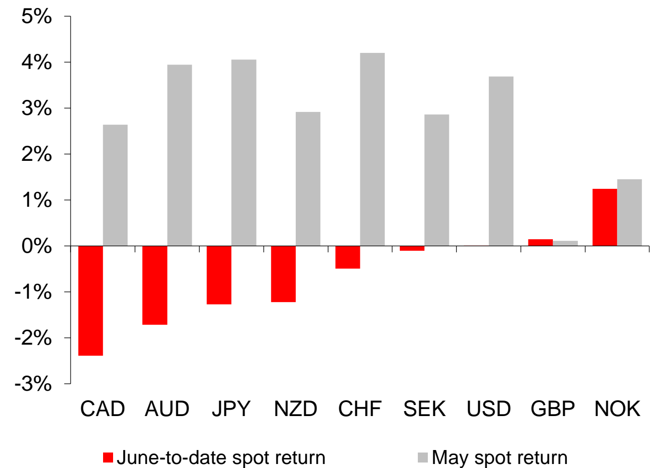
FX Spot Returns

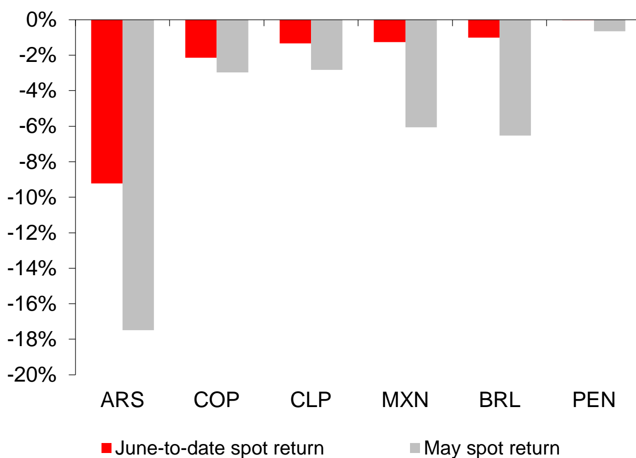
G10 spot returns vs. USD



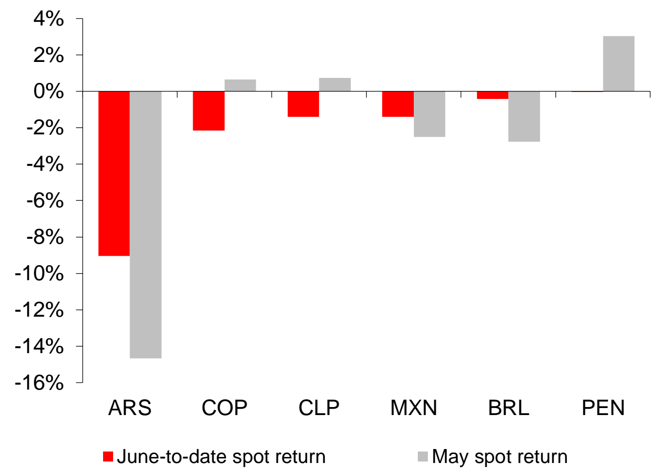
G10 spot returns vs. EUR



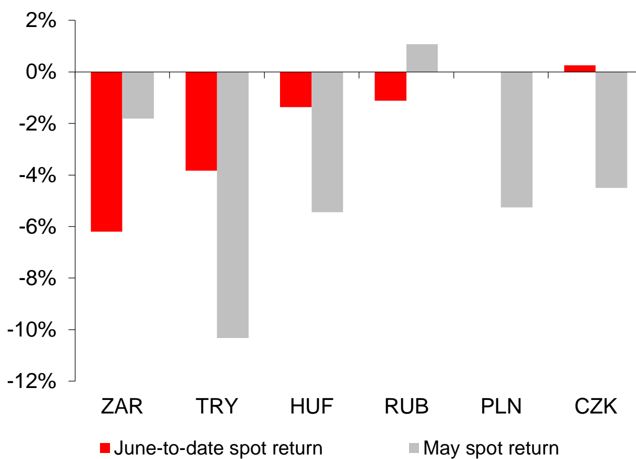
LatAm spot returns vs. USD



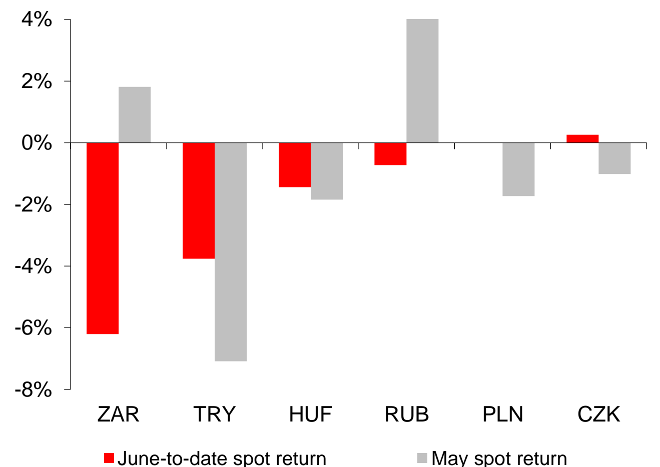
LatAm spot returns vs. EUR



CEEMA vs. USD



CEEMA vs. EUR



Source: Bloomberg, Santander. Note: Data current as at 22 June 2018 at 10:15 BST

FX Forecasts

G10 FX Forecasts

	Q3 18	Q4 18	Q1 19	Q2 19	Q3 19	Q4 19
EUR-USD	1.19	1.21	1.23	1.24	1.25	1.26
GBP-USD	1.32	1.32	1.32	1.33	1.35	1.36
GBP-EUR	1.11	1.09	1.07	1.07	1.08	1.08
EUR-GBP	0.90	0.92	0.93	0.93	0.93	0.93
USD-JPY	117	118	120	120	120	118
EUR-JPY	139	143	148	149	150	149
USD-CNY	6.65	6.70	6.80	6.70	6.70	6.70
EUR-CHF	1.18	1.20	1.22	1.23	1.24	1.24
USD-CHF	0.99	0.99	0.99	0.99	0.99	0.98
EUR-SEK	9.9	9.6	9.5	9.5	9.3	9.2
EUR-NOK	9.4	9.3	9.1	9.0	8.8	8.7
USD-CAD	1.24	1.22	1.22	1.20	1.20	1.19
AUD-USD	0.76	0.77	0.79	0.80	0.79	0.78
NZD-USD	0.71	0.72	0.74	0.76	0.75	0.75

LatAm FX Forecasts

	Q3 18	Q4 18	Q1 19	Q2 19	Q3 19	Q4 19
USD-BRL	3.80	3.50	3.52	3.55	3.57	3.57
USD-MXN	20.2	18.9	18.6	18.5	18.8	18.8
USD-CLP	635	635	630	630	630	630
USD-COP	2820	2800	2780	2750	2720	2750
USD-ARS	28.4	29.0	30.5	32.1	33.7	35.4
EUR-BRL	4.52	4.24	4.33	4.40	4.46	4.50
EUR-MXN	24.0	22.9	22.9	22.9	23.5	23.7
EUR-CLP	756	768	775	781	788	794
EUR-COP	3356	3388	3419	3410	3400	3465
EUR-ARS	34	35	38	40	42	45

CEE FX Forecasts

	Q3 18	Q4 18	Q1 19	Q2 19	Q3 19	Q4 19
EUR-PLN	4.28	4.20	4.26	4.25	4.24	4.22
EUR-CZK	25.5	25.4	25.3	25.2	25.1	25.0
EUR-HUF	327	325	323	320	318	317
USD-RUB	67	67	66	64	62	62
EUR-RUB	80	81	81	79	78	78

Sources: Santander, Bank Zachodni Wbk

G10 FX: Main Themes

Currency	3M view	12M view	Main Themes
USD	Mildly Bullish	Neutral	• The USD has been stronger since mid-April. Political/trade issues seem less of a risk. The outlook for more USD-positive rate hikes and robust US growth should keep the USD firm against most of its peers
EUR	Neutral	Mildly Bullish	• The ECB was viewed as adopting a dovish stance in June. The collapse of EUR/USD has forced a cut to our forecast, but we feel that the weakness was overdone. We are still positive on the Euro zone activity
GBP	Neutral	Neutral	• Sterling has weakened and may remain under pressure, given slower GDP, CPI and political/Brexit uncertainty, as well as the market pricing out near-term rate hikes and general USD strength
JPY	Bearish	Bearish	• Risk remains a key driver of the yen. More stable equity markets point to less ‘safe-haven’ demand for the JPY. With the BoJ maintaining its 0% JGB 10Y target, yen risks remain to the downside
CNY	Mildly Bearish	Mildly Bearish	• We expect CNY to soften in 2018 as policymakers continue to focus on controlling financial risks. Furthermore, the USD/CNY should garner support from more US rate hikes in 2018 and US-China trade tensions
CHF	Mildly Bearish	Mildly Bearish	• The CHF remains high, even though a weaker EUR has pulled EUR/CHF lower and back from the 1.2000 floor level. The SNB estimates low CPI over the coming year, so policy should remain loose and CHF-negative
CAD	Mildly Bullish	Mildly Bullish	• The CAD has the ability to strengthen as long as NAFTA talks are successful. The economy and CPI remain robust, and we still expect that the BoC will hike rates in 2018, perhaps as soon as July
SEK	Mildly Bullish	Mildly Bullish	• Global trade concerns and Swedish politics have weighed on the SEK in June. But strong growth and above-target inflation should encourage a more upbeat Riksbank and for the SEK to gain from such a weak level
NOK	Neutral	Mildly Bullish	• The Norges Bank continues to advocate a NOK-positive rate hike “after summer 2018”. However, weaker CPI data in May and solid NOK gains in June, could prompt patience from the Bank and slower NOK gains ahead
AUD	Neutral	Neutral	• Global trade risks and commodity price weakness are AUD negatives in the short term. The RBA is firmly on hold and so AUD neutral. After a sharp drop in June, we see further AUD weakness as less likely
NZD	Neutral	Mildly Bullish	• New Zealand’s economy remains relatively strong, but weaker GDP and inflation data in Q1-18 should keep the RBNZ firmly on hold for the duration of 2018. The USD continues to lead the NZD/USD

Bullish   Mildly Bullish   Neutral   Mildly Bearish   Bearish

Source: Santander

G10 FX Overview

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The USD remains firm. A robust economy, rising inflation and interest rate hikes are providing support and should continue to favour a firm currency. However, trade tensions and an adverse impact on global trade could be viewed as a USD negative factors. Plus, we wonder if a protectionist US administration would be prepared to allow the dollar to appreciate further.

We have revised our EUR/USD forecasts lower but remain positive over the forecast horizon (see page 3). We feel that the EUR weakened too much following the June ECB meeting, and, although more US rate hikes in 2018 imply USD support, we suspect that these should now be priced in. We question whether a protectionist US administration will allow EUR/USD to sink further. In addition, we remain upbeat about the Euro zone economic outlook in 2019.

It has been a tough month for the pound, which has underperformed all of its developed market peers, except the CAD. In the process, our year-end GBP/USD forecast of 1.32 has already been reached. We still believe that the pound got oversold in the months following the EU referendum and feel that a lot has already been priced in, which might provide some support. But ongoing Brexit uncertainty, a strong USD, disappointing UK data and a stable BoE imply gains may be difficult to generate.

We are still negative on the yen. The Bank of Japan is keeping its loose monetary policy. The economy is going through a soft patch, and inflation is slowing. Further, a firmer USD is helping to keep USD/JPY elevated. The main risk to our forecasts is ‘risk’ itself and the threat that this encourages buying of the yen.

We continue to expect USD/CNY to strengthen in 2018. Trade tensions between the US and China once again appear to threaten activity and the CNY. Plus, higher US interest rates should continue to provide support.

EUR/CHF has remained under pressure over the last month, with the CHF remaining relatively firm. Nevertheless, we are still negative on the CHF and expect the SNB to keep its monetary policy steady until 4Q19 at the earliest.

Trade tensions with the US are a threat to Canadian sentiment and activity, as is a softer oil price. But current data and CPI remain robust, and rhetoric from the BoC suggests that the rates may be hiked this year, perhaps as soon as July. Hence, we are still positive on the CAD.

We continue to see the Riksbank as too cautious on Monetary Policy, and believe the market is under-pricing the risk of a late-2018 rate hike, especially if inflation rises further above-target. Hence, while short-term risks remain, we remain positive the SEK in H2-18. Meanwhile, with the Norges Bank now suggesting a rate hike is most likely to come in September, the NOK should remain supported in the second half of this year.

We are relatively neutral both the AUD and NZD in H2-18, although both currencies have come under pressure from global trade risks and commodity price in recent weeks. With neither the RBA or RBNZ likely to change rates this year, the is likely to continue to lead both pairs in the coming months.

USD – Staying Strong

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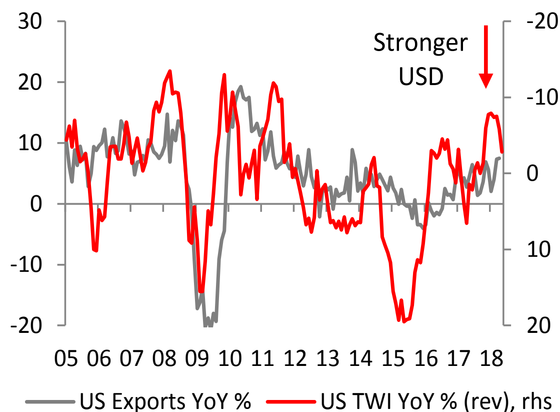
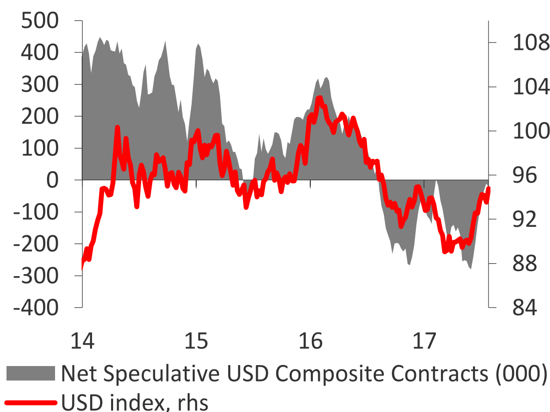
Chart 1: Nothing to worry about yet, but a strong USD does not fit well alongside protectionist policies



Source: Bloomberg, Santander

Chart 2: USD has scope to reposition in either direction, but does a protectionist administration want a strong USD?



Source: CFTC, Bloomberg, Santander

The USD remains firm. A robust economy, rising inflation and interest rate hikes are providing support and should continue to favour a firm currency. However, trade tension risk and an adverse impact on global trade could be viewed as a USD negative factors. Plus, we wonder if a protectionist US administration would be prepared to allow the dollar to appreciate further.

The Fed's monetary policy should remain a USD support. As expected, US rates were increased in June, with the Fed funds target range increasing 25bp to 1.75-2.00%. Also, Fed Chair Jerome Powell adopted a more hawkish tone. He was upbeat on the economy, stating that activity was rising at a solid rate.

Indeed, the Fed revised upwards its near-term economic forecasts. It now expects GDP growth of 2.8% this year, up from 2.7%, and then 2.4% in 2019 and 2% in 2020. Unemployment is expected to reach 3.6% in 2018, compared with the previous estimate of 3.8% and slip again in 2019 and 2020 to 3.5%. Further, both headline and core PCE inflation estimates have been increased, to 2.1% and 1.9% respectively for 2018, with both measures at 2.1% during the following two years. Powell added that 'further gradual' rate hikes would be consistent with sustained expansion of activity and CPI near the symmetric 2% target. Consequently, the Fed's dot charts, which provide a guide to FOMC member views on the appropriate interest rate level, were revised upwards by 25bp for both 2018 and 2019.

The dot chart revision now suggests that the Fed is likely to hike rates two more times in 2018, with three hikes coming in 2019. This is a slightly more bullish outlook for rates than has been priced in, and this suggests that monetary policy divergence can keep the USD supported against currencies whose central banks we think are unlikely to hike rates in the near-term, such as JPY, CHF, GBP and NZD. However, by extension, that should imply USD losses versus the EUR and CAD, whose central banks are adopting a less accommodative stance.

Although the fundamental outlook is positive, rising trade tensions present a risk to activity that continues to impact FX sentiment. Traditionally, the USD is perceived as a safe-haven trade, sought after at times of economic or geo-political risk. But, this time around, the dollar had tended to be sold as risk appetite has faded. There appear to be several reasons for the turnaround in the relationship between the USD and risk: 1) the current risk is more USD centric, namely President Trump's trade policy; 2) protectionism should undermine global growth, with a high performer like the US perhaps more at risk; and 3) similarly, slower growth could imply less need to hike rates, with the USD more at risk from a pricing out of US rate hikes.

The USD could spend the summer in a tug of war between these potentially conflicting factors. A focus on rates should imply a strong USD, even if not across the board, whereas trade tensions risk dollar weakness. And, given that speculative position data show that 'fast money accounts' are broadly neutral on the USD, after being very negative in mid-April, there appears to be ample room for the USD to be pulled in either direction. But, for now, we suspect fundamentals and interest rates will win the day and keep the dollar firm over the coming months.

EUR – Too Pessimistic?

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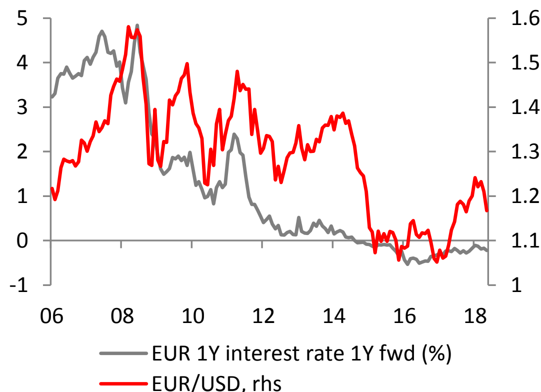
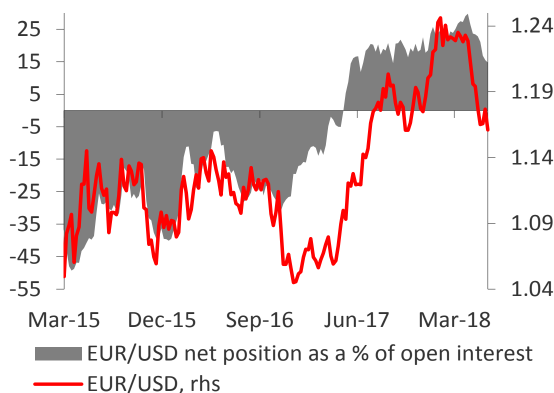
Chart 3: Confirmation that the ECB will exit its crisis-led monetary policy has not led to the EUR boost that we expected



Source: Bloomberg, Santander

Chart 4: Speculators remain net long EUR/USD for now



*Open interest = total long and short contracts

Source: CTFC, Bloomberg, Santander

We have revised our EUR/USD forecasts lower but remain positive over the forecast horizon (see page 3). We feel that the EUR weakened too much following the June ECB meeting, and, although more US rate hikes in 2018 imply USD support, we suspect that these should now be priced in. We question whether a protectionist US administration will allow EUR/USD to sink further. In addition, we remain upbeat about the Euro zone economic outlook in 2019.

The EUR weakened significantly following the June ECB meeting. As expected, the bank signalled that it would taper its asset purchases in 4Q18 to EUR15bn a month from EUR30bn, ending the purchases completely at the end of the year. In line with many analysts, the ECB staff forecasts included a downward revision of 2018 GDP to 2.1% from 2.4% but an upward revision to the 2018 CPI forecast to 1.7% YoY from 1.4%. However, the bank did suggest that interest rates would remain at the current level 'at least through the summer of 2019', which was slightly longer than the consensus expected.

We had expected that the announcement of the end of QE would be EUR positive, as reducing the supply of something normally boosts its price. But the mix of the growth revision and interest rates lower for longer was the catalyst for a big drop in the EUR. Whilst this drop in spot implies a need for a technical correction to our forecast profile, there are factors that suggest the market may have overreacted to the ECB and that without further EUR negative news, the currency may be able to claw back some of this decline, albeit gradually.

First, timing may have worked against the EUR. The market may have gone into the Fed and ECB meetings expecting a dovish hike from the Fed and a hawkish hold from the ECB. But the Fed was more hawkish and the ECB more cautious. This may have meant that the market needed to reposition quickly against the EUR.

Second, we feel that the president of the ECB, Mario Draghi, did not clarify exactly what 'through the summer' meant, implying enough wriggle room to bring a rate hike forward. So again, the market may have overreacted in the short term. Third, whether a rate hike can be brought forward will depend on the data. The 2018 GDP revisions were notable, but as our economists highlight, it has to be placed in the context of disappointing 1Q18 data. Growth was softer than expected at the start of the year, affected by transitory factors that are now over.

Indeed, we argued in the past that the EUR looked expensive in 1Q18, given that Euro zone economic data was surprising to the downside. But we still expect robust Euro zone growth in 2018, which after the EUR sell-off implies more scope for better than feared data to support the EUR. Plus, after the CPI revision, albeit thanks to oil, the ECB suggested that inflation is likely to remain around its current level, 1.9% YoY, for the remainder of the year.

Finally, whilst trade tensions risk undermining global demand, their impact on currencies appears increasingly ambiguous. At the start of the year, US warnings about tariffs were viewed as USD negative. But now with USD bulls in control, they may fuel a 'safe-haven' buying of the USD. Either way, we would question whether a protectionist US administration will sit quietly by and allow EUR/USD to plummet, potentially causing harm to US exporters.

GBP – Summer Frights

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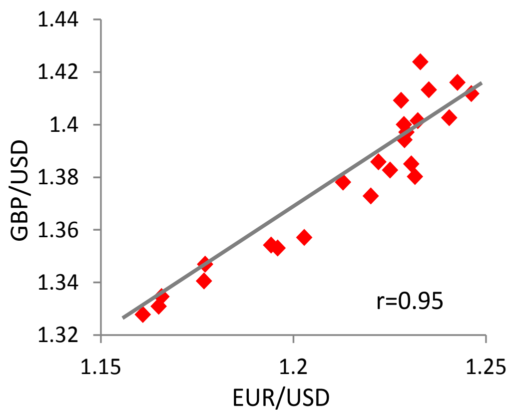
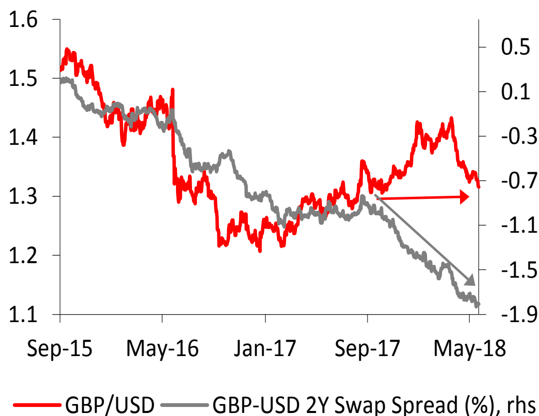
Chart 5: What matters for GBP/USD and EUR so far in 2018? Italy, ECB, Brexit, MPC, or simply the USD?



Source: Bloomberg, Santander. Note: Weekly data

Chart 6: Further interest rate divergence between the GBP and USD may merely imply Cable hanging around its recent levels



Source: Bloomberg, Santander

It has been a tough month for the pound. In the process, our year-end GBP/USD forecast of 1.32 was reached. We still believe that the pound got oversold in the months following the EU referendum and feel that a lot has already been priced in, which might provide some support. But ongoing Brexit uncertainty, a strong USD, disappointing UK data and a stable BoE imply gains may be difficult to generate.

Focussing on the movement in GBP/USD and EUR/GBP still highlights that, despite UK specific factors, much of the movement in Cable can be explained by the movement in the USD. For example, since the start of the year, the correlation between EUR/GBP and the trade weighted EUR has been 0.3, whilst the correlation between USD/GBP and the USD trade weighted has been 0.95.

Admittedly, the pound has also performed poorly against the yen, as 'safe-haven' flows have helped the JPY. Meanwhile, EUR/GBP has proved relatively stable as a 'dovish' ECB has weighed on the EUR and both GBP/USD and EUR/USD have weakened amid dollar strength. So, with the USD remaining a key driver, Cable may only rally over the coming month if the USD declines.

At present, a USD decline looks unlikely. The market has, for now, jettisoned its concern about the US budget deficit and debt, with trade tensions now viewed as USD positive. Furthermore, whilst FOMC rate hikes did little to support the dollar in 1Q18, more Fed hikes, albeit already priced in, are helping the greenback.

However, whilst the USD momentum remains key, the pound is receiving little help by way of UK-specific factors, a situation that is likely to continue over the summer. First, we expect economic underperformance to prevent any swift rebound in the pound. We expect UK GDP growth of 1.2% in 2018, compared to 2.8% in the US and 2.3% in the Euro zone.

The 1Q18 GDP data was weaker than expected, with growth at 0.1% QoQ. The BoE blamed poor weather for the data and expects a quick recovery in 2Q18. But weak manufacturing output in April (-1.4% MoM) casts some doubt on the pace of any second quarter recovery.

The BoE kept its policy on hold in June. but the vote split was 6:3, compared to 7:2 at the last meeting. The market viewed the meeting as leaving the door open to an August rate hike, and the Pound rallied. Inflation was unchanged at 2.4% YoY in May, and even though we expect it to rise to 2.6% YoY in June, we still do not expect the BoE to hike rates until 2020, which implies that the pound may be vulnerable to a reduction in rate hike expectations.

Further, Brexit uncertainty looks set to weigh on sterling sentiment. The EU Summit on June 28-29 looks unlikely to reach much of a conclusion on a future EU-UK relationship. Hence, we expect the focus to drift to the October summit.

Given these uncertainties, both political and fundamental, speculators may become increasingly willing to position against the pound. The IMM non-commercial GBP/USD position is currently broadly neutral, implying ample scope to open short GBP positions.

JPY – Risk in the Short Term but Easing in the Long Term

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We are still negative on the yen. The Bank of Japan is keeping its loose monetary policy. The economy is going through a soft patch, and inflation is slowing. Further, a firmer USD is helping to keep USD/JPY elevated. The main risk to our forecasts is 'risk' itself and the threat that this encourages buying of the yen.

The BoJ made no change to its monetary policy at its June meeting. The key points are that the overnight rate remains at -0.1%, and the target for 10Y yields is still around 0%. Such a loose monetary policy should be yen negative by default, but given that some other G10 central banks are hiking rates or moving toward a less accommodative policy, the divergence between monetary policy stances should imply even greater downside pressure on the JPY.

Admittedly, the BoJ did reduce its purchase of bonds for the first time since February at the end of May and then again at in mid-June. But, as before, we do not interpret this as the BoJ looking to unwind its policy. Instead, with global yields slipping, the bank may merely not have needed to purchase as much, in order to maintain its key aim of keeping that 10Y yield close to zero.

Overall, the bank continues to expect a moderate recovery for the economy, despite the 0.2% QoQ contraction in GDP that was recorded in 1Q18. This was the first drop in GDP since the end of 2015. However, the bank downgraded its assessment of CPI. The headline rate tumbled back to 0.6% YoY from 1.1%, and the core rate, excluding fresh food and energy, slipped to 0.4% from 0.5%. Further, Tokyo CPI data for May suggest that weak price pressures remain.

BoJ Governor Haruhiko Kuroda stated that it is appropriate to continue the current 'powerful monetary easing'. And he reiterated the pledge to continue with stimulus until the 2% CPI target is reached. Indeed, we think it may require a period of above-target CPI to ensure that inflationary expectations are sufficient engrained before exiting the stimulus.

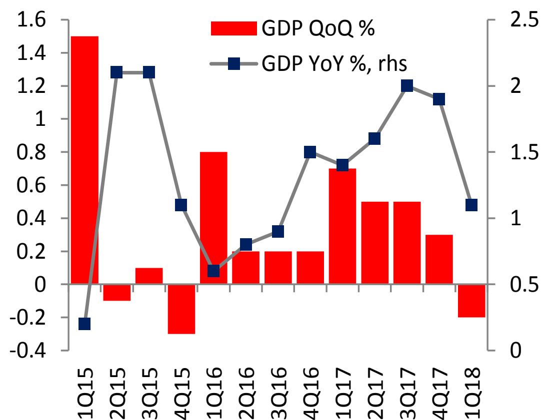
He stated that he will communicate appropriately at the right time about any exit from the policy. We think this remains some way off, and any hint at an exit, no matter how gradual, would likely be misinterpreted by the market, which would probably push the yen higher and, thereby add to any downside pressure on inflation.

Hence, Japanese interest rates look set to remain low for longer. This should maintain a bias for yen weakness, with a soft currency potentially helping to pull CPI higher. Hence, the recent rate hike by the Fed, with more likely before the end of the year, should favour USD/JPY upside. The US-Japan 10Y spread is currently 2.9%. But assuming Japanese yields stick close to zero, this should rise to around 3.25% by the end of this year and 3.65% by the end of 1H19.

The outstanding threat to any yen negative stance, remains global risk appetite. The yen's status as a perceived safe haven implies that it should strengthen at times of high perceived risk, as happened earlier in 2018. Hence, a jittery FX market could still focus on trade tensions, etc., as a reason to intermittently buy the yen.

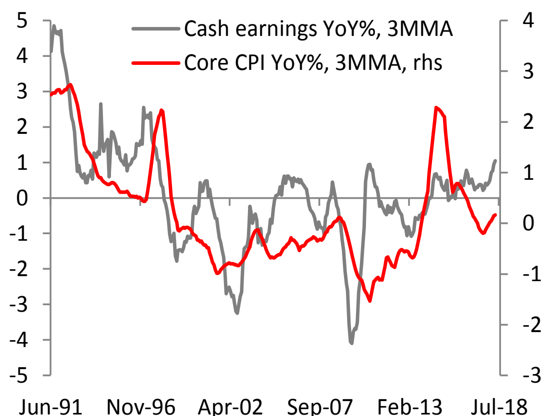
However, whilst we have raised doubts in the past of the efficacy of using speculative positioning as a guide to spot yen moves, it is at least worth highlighting that this part of the market has unwound its short yen position over the last few months and now holds a broadly neutral position in USD/JPY.

Chart 7: Japan's economy contracted in 1Q18



Source: Bloomberg, Santander

Chart 8: BoJ policy is likely to remain loose and yen negative, as long as inflation and wage growth struggles



Source: Bloomberg, Santander

CNY – Under Pressure

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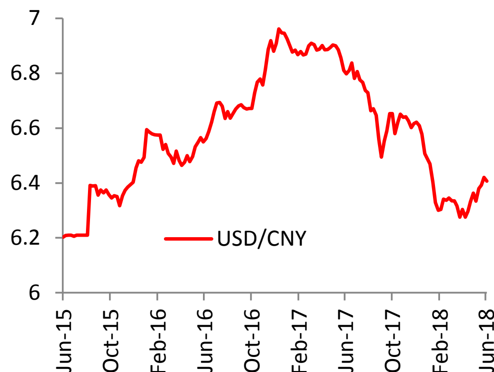
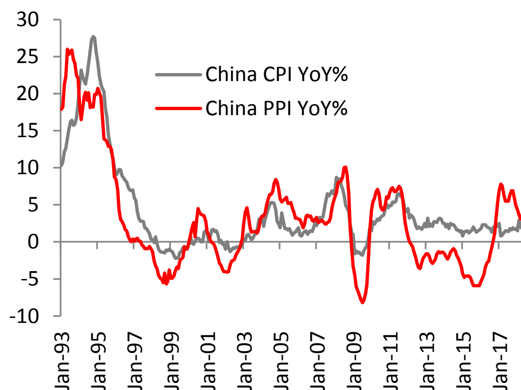
Chart 9: USD/CNY – giving a little back



Source: Bloomberg, Santander

Chart 10: China CPI and PPI



Source: Bloomberg, Santander

We continue to expect USD/CNY to strengthen in 2018. Trade tensions between the US and China once again appear to threaten activity and the CNY. Plus, higher US interest rates should continue to provide support.

The main focus is again on trade relations between the US and China. The US slapped tariffs of 25% on USD50bn of Chinese imports. The Chinese retaliated, which has prompted President Trump to consider tariffs on an extra USD200bn of Chinese goods, with more threatened if China again retaliates. Hence, with an apparent trade war looming, the IMF's head warned that the outlook for the global economy is 'growing darker by the day'.

Overall, China's trade surplus did shrink in May. However, the trade surplus with the US increased. The Ministry of Commerce has strongly criticised the threat of further tariffs, and China is expected to take measures to counter them. We had expected that these would not include allowing the CNY to weaken, to support exporters, but given the hardening of attitudes on both sides, authorities may be more inclined to allow CNY depreciation.

Downside CNY pressure is also stemming from activity data. Both retail sales and industrial production were weaker than expected in May. Spending grew 8.5% YoY, compared to 9.6% forecast and April's 9.4%. Production rose 6.8% YoY, compared to the 7% estimate. Further, whilst higher oil prices pulled PPI to 4.1% YoY from 3.4%, consumer inflation remained low and stable at 1.8% YoY. With inflation low, the PBoC is under no pressure to hike benchmark rates.

Indeed, the market was somewhat surprised that the Chinese rates were not automatically increased after June's Fed rate hike, in order to keep the US-China spread stable. The PBoC's reluctance to blindly follow the Fed could be explained by a few factors. First, policymakers are relaxed about the USD/CNY at its current level, or higher, and are less worried about destabilising outflows. Second, the slowdown in activity, highlighted above, together with trade concerns, implies a greater tolerance of a weaker CNY.

Also, seasonal liquidity requirements imply little room for manoeuvre to hike rates. Note, liquidity needs are expected to increase over the coming months, amid tax bills, the repayment of inter-bank debts and MLF loans to the PBoC. Consequently, to support liquidity, the PBoC could cut bank's reserve requirement ratio from 16%. The last cut to the RRR was on April 28.

Any move to bolster short-term liquidity should, however, not be viewed as policymakers rowing back on efforts to cut overall debt and reduce financial risks. Indeed, the broadest measure of new credit, aggregate financing, was much lower than expected in May. The May figure showed aggregate financing at CNY760bn, compared to the forecast CNY1.3trn and 1.565trn in April.

However, whilst seeking to contain the expansion of risk debt and credit, officials are trying to encourage the flow of credit to smaller banks and firms. Hence, the PBoC recently expanded the list of suitable collateral to access its lending facility to allow smaller firms better access to credit.

CHF – ECB Narrows Room for SNB to Manoeuvre

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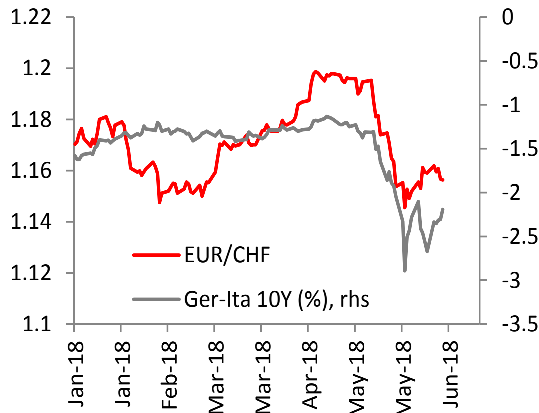
Chart 11: EUR/CHF pinned down by Europe risks and the ECB



Source: Bloomberg, Santander

We are still negative on the CHF. But, even though the EUR/CHF has remained under pressure over the last month, the CHF has remained relatively firm. But the driving factors behind the crosses relative weakness remain EUR-focused: 1) political concerns over the new Italian government, and associated widening of the German-Italian 10Y spread; and 2) the EUR decline following the June ECB meeting. Hence, the SNB is falling back into the role of price taker and not maker as far as the EUR/CHF is concerned.

The SNB still views the CHF as 'highly' valued, but it has limited ability to influence the currency. Its benchmark rate, at -0.75%, remains the lowest in the developed market. Further, it remains willing to intervene to counter CHF strength. Despite this, the EUR/CHF remains below the 1.2000 floor that the bank set the cross at between September 2011 and January 2015.

On the plus side, economic data continues to show a solid performance by the economy, with currency appreciation having less of an adverse effect on activity. The SNB is expecting growth of about 2% in 2018. Inflation remains low but is rising, and headline CPI moved back to 1% YoY in May.

The mixture of a subdued EUR and supportive Swiss fundamentals, as well as the Swiss current account surplus at 9% of GDP, may imply that the SNB will find it harder to massage the CHF lower over the coming months. However, the 'high' CHF together with expectations that the ECB is now unlikely to hike rates until the summer of 2019, should imply that the SNB will keep its monetary policy steady until 4Q19 at the earliest.

CAD – Slipping on Oil and Trade

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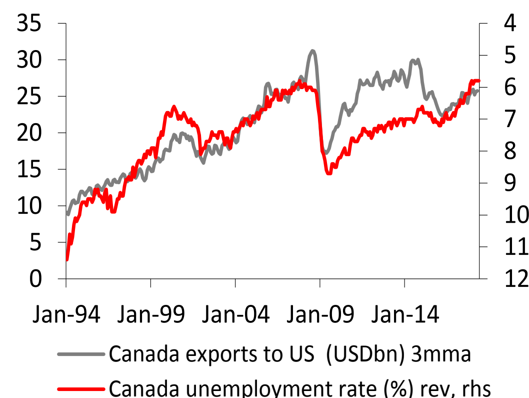
Chart 12: Trade tensions will remain a threat to the CAD, but support can still flow from a BoC rate hike



Source: Bloomberg, Santander

We are still positive on the CAD. Trade tensions with the US are a threat to sentiment and activity, as is a softer oil price. But current data and CPI remain robust, and rhetoric from the BoC suggests that the rates may be hiked this year, perhaps as soon as July.

Around 75% of Canadian exports go to the US. Therefore, unsurprisingly, any focus on trade tensions with the US has a significant negative effect on the CAD. Our forecast for a stronger CAD over the coming quarters explicitly implies an 'acceptable' outcome for the NAFTA renegotiation for Canada.

The BoC will try to account for the uncertainty surrounding trade relationships and its impact on sentiment. In its July Monetary Policy Report, it will give a more precise estimate as to the impact tariffs might have on activity and prices. We can only imagine that the net effect will not be a positive for Canada, despite recent strong data, and the bank, in April, revising up its full-year growth forecasts for 2018 and 2019, to 2.1% and 2%, from 1.8% and 1.7%, respectively. Hence, this could provide an excuse for the BoC to delay the rate hike that we expect to come on July 11. Note that the market is still pricing in an 80% chance of a July hike.

However, recent comments from BoC Governor Stephen Poloz, suggest to us that the hike is still on, helped by the bank noting the threat to Canada's financial system from high consumer debt and the fact that house prices are easing. Hence, despite soft oil prices, we feel that USD/CAD has been overbought at levels above 1.31.

SEK – Facing trade and political risks

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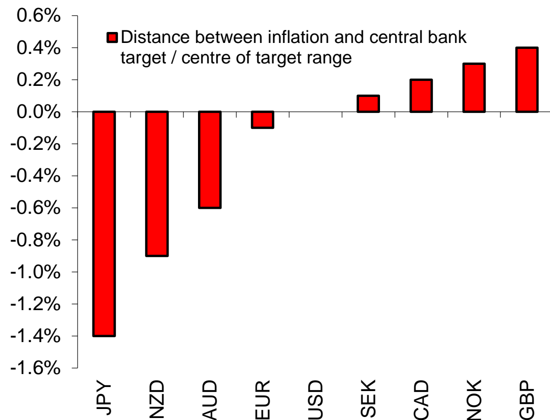
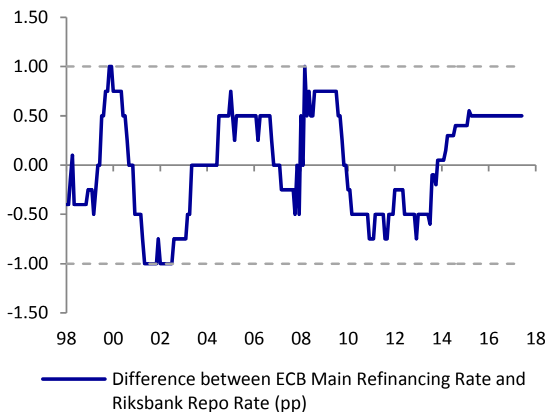
Chart 13: Despite the dovish rhetoric by the Riksbank, inflation is above target



Source: Bloomberg, Santander

Chart 14: Swedish monetary policy tends not to stray too far from the ECB stance



Source: Bloomberg, Santander

We remain positive on the SEK in 2018. We continue to see the Riksbank as too cautious on Monetary Policy, and believe the market is under-pricing the risk of a late-2018 rate hike, especially if inflation rises further above-target. Short-term risks remain, with global trade concerns and Swedish politics, ahead of the 9 September election, potentially restricting the currency. But, while these factors may limit short-term SEK gains, the currency is already very weak and so we still foresee EUR/SEK dropping to 9.9 in Q3-18 and 9.6 by year-end.

The Swedish central bank was busy celebrating its 350th birthday in May, but there was no rate decision, with the Executive Board last deciding on monetary policy in April. The six-person committee next decide on rates on 3 July, but any change from the Riksbank is highly unlikely just yet, with the bank retaining a very cautious tone of late, persistently highlighting the risks, especially over low inflation.

However, inflation is not low in Sweden. Indeed, the May CPIF data, the Bank's target measure, came in at 2.1%, above its 2% YoY target. Inflation data are currently at, or above, target, in the US, UK, Canada and Norway. The first three have already begun hiking rates, while the fourth expects to do so "after summer 2018". We would argue that the Riksbank should also be more actively discussing when to begin tightening policy.

Deputy Governor Olhsson voted for a 25bp rate hike at both meetings so far in 2018. However, the rest of the six person executive committee have been more cautious, voting to bring forward reinvestments of maturities for government bonds in February 2018, and to keep rates on hold, in April 2018.

With inflation data rising in May, and the ECB announcing in June that it will taper and finish its QE programme by the end of the year, there is scope for the Riksbank to be more upbeat. Chart 14 shows that monetary policy in the Eurozone and Sweden tends to move in step with each other. But, if the ECB does not plan to hike rates until H2-18, there is clearly still no rush for the Riksbank to act just yet.

Nevertheless, we see the market as excessively negative on the SEK, because the Riksbank is excessively dovish. A further pick-up in inflation data should ease the central banks fears and allow more positive rhetoric to support the SEK. Although, there are a couple of other risks that may limit the SEK heading into H2-18.

Global trade concerns are again making the newspaper headlines in recent weeks, with US-China trade tariffs, and their secondary impact on third parties, alarming various European exporting countries, including Sweden.

A further risk for the SEK stems from internal politics, ahead of the 9 September election. Coalition governments are not abnormal in Sweden, but the rise of the Sweden Democrats during the past two elections has the potential to weigh on the SEK. The latest polls show this party tied in second, but their recent calls for a referendum on the country's EU membership has weighing on the SEK since mid-June.

NOK – Supported by prospects of September hike

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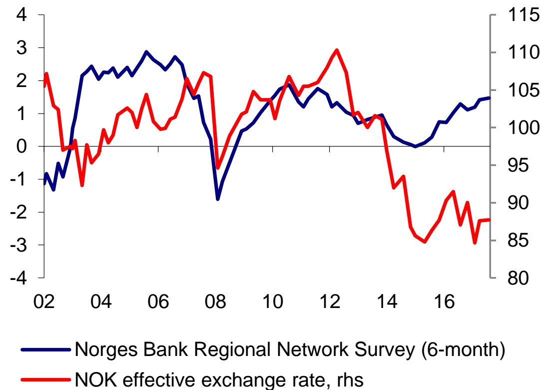
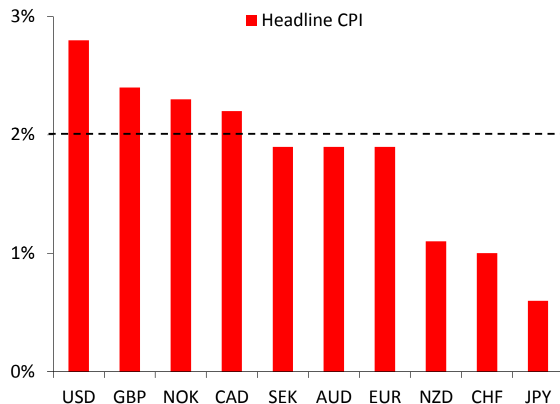
Chart 15: Norway's output expectations have risen to their highest level since September 2012



Source: Bloomberg, Santander

Chart 16: The Fed, BoC and BoE have all begun hiking rates. With CPI at a similar level in Norway, the Norges Bank should be the next to start



Source: Bloomberg, Santander

We are neutral on the NOK in Q3-18. A solid performance from the currency year-to-date saw EUR/NOK touch below 9.4 in mid-June. With the Norges Bank now suggesting a rate hike is most likely to come in September, the NOK should remain supported in the second half of this year. We still forecast EUR/NOK dropping to 9.3 by year end with the weaker CPI data in May, and the sharp NOK rise in recent weeks, implying that any additional decline in EUR/NOK over the short term may now be more limited.

Domestic data have been relatively upbeat in recent months. GDP grew by 0.6% QoQ in Q1-18, following a small contraction in Q4-17. When removing petroleum from this statistic, mainland growth also grew by 0.6% in Q1-18, its fifth consecutive quarterly increase greater than 0.5%.

The Norges Bank's latest quarterly Regional Network Survey (May) was also upbeat, and showed output expectations have risen to their highest level since September 2012 (Chart 15), supported by increasing activity in the oil sector and continued growth in public sector demand.

Norway's trade balance is also strong once again, having recovered from a negative blip in late 2017. Meanwhile, consumer confidence and the manufacturing PMI both remain at elevated levels, while the unemployment rate gradually continues to extend its three-year low.

The main data disappointment over the past month came from industrial production, with next to no growth recorded year-to-date, and weaker CPI data in May. Indeed, while inflation again came in above the Norges Bank's 2% target, it fell to 2.3% YoY. Further, the underlying rate, on which the Central Bank also places a lot of focus, fell to 1.2%, a six-month low.

A rebound in the June release (10 July) should keep the Bank on course to hike rates in September, as it advocated at its June meeting. Indeed, with the FOMC, BoC and BoE all hiking rates in 2017, of the G10 currency countries, the Norges Bank is probably The next one out the blocks. But a further decline in inflation could yet be enough to delay such thinking, and weigh on the NOK.

The NOK has performed well this year though, especially in recent weeks, with the NOK effective exchange rate climbing to an eight-month high in June. Following the market reaction to the 14 June ECB meeting, EUR/NOK even dropped below 9.4. We remain NOK positive in the long term, but we see limited scope for a significant further gains in the short term. Hence, we have closed out our long term sell EUR/NOK market recommendation, although would look to re-enter this short EUR/NOK position on a return above 9.55.

In the short term the NOK focus will be on i) the June CPI data, where any further decline could weigh on the NOK, and ii) the OPEC meeting in Vienna (22 June). The relationship between oil and the NOK has weakened in recent years, but if a boost in oil output is confirmed, then any negative impact this has on the oil price would likely be a net negative for the NOK.

AUD – A likely looser in any trade war

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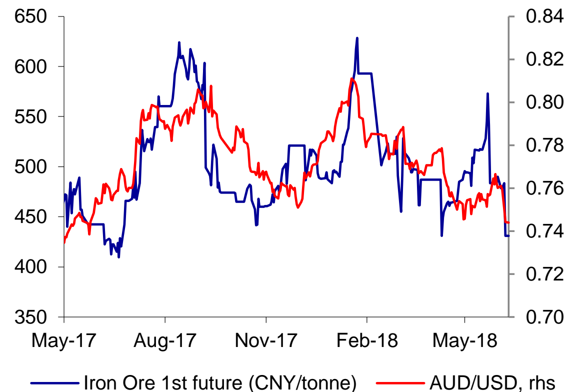
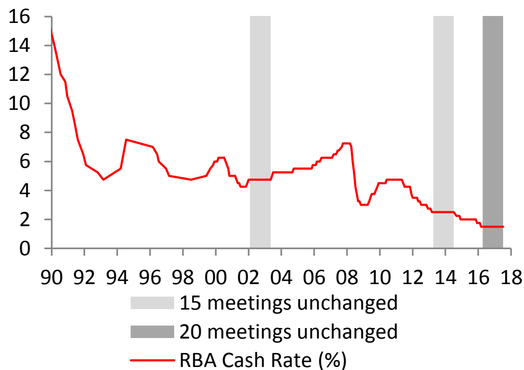
Chart 17: AUD/USD has followed iron ore prices lower in June



Source: Bloomberg, Santander

Chart 18: Following 20 meetings with unchanged rates, we expect the RBA to keep rates on hold throughout 2018



Source: Bloomberg, Santander

We are neutral the AUD for H2-18 as a whole, but would highlight that global trade risks and commodity price weakness have weighed on the currency in recent weeks. A firmer USD has also weighed on the AUD/USD, with the pair dropping to a one-year low in late June, at below 0.7350. While trade risks, commodity prices, and USD strength may continue to hamper AUD/USD in the short-term, we continue to forecast the pair returning to 0.76 in Q3-18 and 0.77 in Q4-18.

June has been a disappointing month for the AUD, with AUD/USD falling to a 12-month low, at below 0.7350. USD strength was largely responsible for this move though, with the USD up against all the major currencies month-to-date.

AUD-negative factors also played a part in this move, with the currency down month-do-date against all the other developed market currencies, with the exception of the CAD.

Global trade fears have risen again, with the US announcing a further USD50bn of tariffs on China in mid-June, and then almost immediately announcing an additional USD100bn of tariffs in response to China's retaliation. The AUD is a likely loser in any trade war, in our view. To begin with, Australia's commodity exports are a major contributor to domestic growth and employment and so any reduction in trade would be bad for the AUD. Indeed, AUD/USD has followed the decline in iron ore prices over the past month (Chart 17).

In addition, China is by far Australia's largest trading partner, with two-way trade greater than that with its four next largest trading partners (Japan, the US, South Korea and India). Hence, if a US-China trade war impacts the Chinese economy adversely, it will likely also have a secondary impact on Australia, through Australia-China trade. While an important risk to consider, Australia's trade balance remains positive for now, while Chinese growth is still relative upbeat. This should limit the scope for significant further AUD weakness.

One location where Australian trade has potential to improve, is in Europe, with Australia-EU trade negotiations set to begin in Brussels in July. Trade Minister Steve Ciobo, hopes that these negotiations will secure better access to the EU for Australian agricultural products, with beef, sheep meat, sugar, cheese and rice all currently "significantly constrained" by EU tariffs.

The free trade agreement between Canada and the EU managed to eliminate 98% of the tariffs between the two economies, and so an Australia-EU trade deal could be a big positive for Australian exports and the AUD. However, such a scenario is unlikely any time soon, as the Canada-EU free trade agreement took about eight years to agree, and only actually began, on a provisional basis, in September 2017.

The RBA kept rates on hold once again in June, a 20th consecutive meeting. We expect rates to stay unchanged throughout 2018 which suggests limited monetary policy related direction for the AUD over the coming months. Growth data impressed in Q1-18, with a strong 1% QoQ figure recorded, but the main data focus in the month ahead, should be the Q2-18 CPI print (released 25 July).

NZD – A hostage to the USD?

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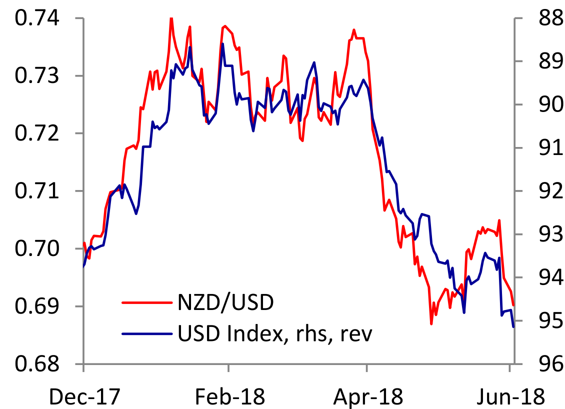
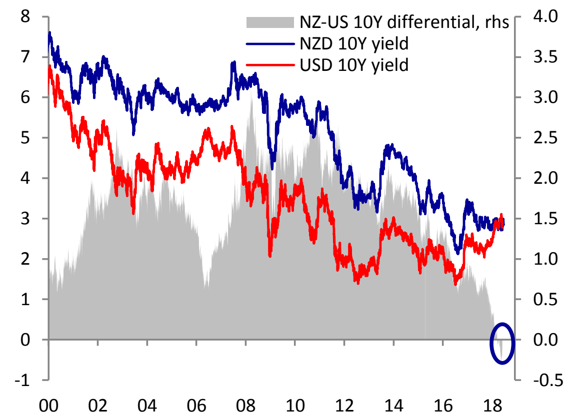
Chart 19: The USD continues to play a key role in guiding NZD/USD



Source: Bloomberg, Santander

Chart 20: The USD yield advantage over the NZD is set to increase in H2-18



Source: Bloomberg, Santander

With NZD/USD looking set to end the first half of the year close to our 0.70 Q2-18 forecast, we remain neutral on the NZD in the short term. New Zealand's economy remains relatively strong, but with GDP and inflation data both slipping in Q1-18, the RBNZ is likely to keep monetary policy unchanged for the duration of 2018. We continue to forecast NZD/USD at 0.71 in Q3-18 and 0.72 in Q4-18, but expect the pair to undershoot these levels in the short term.

The NZD has strengthened over the past month. However, this move does not show in NZD/USD, as even greater USD gains have caused the pair to drop back towards 0.69, from June highs, at above 0.7050. The USD move has not just dominated the NZD/USD throughout 2018, but also the movement for most other USD-pairs.

With the market focus switching between a tightening of monetary policy by the Fed, and the risks of a trade war, as the US and China announce more and more tariffs on each other's imports, NZD/USD is likely to remain a hostage to the USD over the coming months.

Compared to most other developed market economies, New Zealand's domestic economy is strong, with annual GDP growth holding above 3% during the past four years. While the annual GDP print dipped to just 2.7% in Q1-18, it remains upbeat. Of greater concern to the RBNZ, therefore, may be the latest CPI data, which dropped to just 1.1% in Q1-18, weighed down by low food and import price inflation.

A rebound is expected in Q2-18. As such, the next CPI release, on 16 July, could be an important driver for the NZD in the month ahead. A rebound should calm some central bank nerves, but another weak CPI print would reaffirm that the RBNZ will not be hiking rates for a long time to come, and therefore, restrain the NZD outlook for H2-18.

The RBNZ kept rates on hold in May, a tenth consecutive meeting with rates unchanged, at 1.75%. This was Governor Orr's first meeting as head of the Bank, and he left the market in no doubt that the Bank expects to keep the Official Cash Rate at this expansionary level for a considerable period of time. Indeed, the futures market is now only pricing in around a 10% chance of a rate hike at all during 2018.

The RBNZ remains positive on the economy, with the Bank expecting spending and investment, by households, businesses and the government, to support economic growth and employment. The unemployment rate continues to improve, falling to a nine-year low in the first quarter, but wage growth again disappointed.

The RBNZ next meet on 27 June. However, as Governor Orr highlighted in May, time and events will tell if the next move in rates is up or down. Hence, a greater focus should remain on inflation for now. With the RBNZ firmly on hold, and the Fed set to hike rates another two times in 2018, the yield advantage increasingly favours the USD, and should limit scope for NZD/USD gains in the second half of the year.

LatAm FX: Main Themes

Currency	3M view	12M view	Main Themes
BRL	Bearish	Neutral	• We maintain our year-end forecasts for the BRL/USD exchange rate and the Selic rate at 3.50 and 6.5%, respectively. • We believe the most likely scenario is that additional swaps will be consistent with a coverage ratio somewhere between the historical average (16%) and the 2015 level (25%) – BCB has to auction an additional USD 7 - 56bn in FX swaps, with Brazil remaining a net creditor in USD. • We estimate the total impact on 2018 GDP growth to be around 0.7pp (direct impact + indirect impact through confidence channel). Due to that we revised down our 2018 GDP growth forecast to 2% from 3.2%.
MXN	Mildly Bearish	Mildly Bullish	• The combination of higher real rates thanks to Banxico's ahead-of-the-shock strategy and ample liquidity are key factors for MXN to weather a complicated external EM backdrop. • Risk premia in the FX space look well advanced judging by the wider spreads versus US bonds. Also, the balance of supply-demand of USD within Mexico is better than in most EM countries. • Election outcome is the near-term stress test for MXN but Mexico has good buffers in place. Technical position has also improved. NAFTA remains the bigger structural risk.
CLP	Neutral	Neutral	• The CLP will remain dependent on the external scenario, still biased towards a stronger currency vs. commodity peers as fundamentals remain strong. • The risk scenario continues to be a further EM slowdown, which would hit copper prices that on the margin remain supportive of local activity at current levels. • In the medium term, the "honeymoon" period for the CLP looks to be over. The USDCLP should start to hover, with limited alpha, near our FV metrics, which currently stand above US$640.
COP	Neutral	Mildly Bullish	• We expect high oil prices to remain supportive of the COP. • Higher U.S. yields and a stronger USD imply pressure on the COP. • We remain constructive on Colombia's macroeconomic outlook, as we consider that Ivan Duque, the newly elected president, will continue with orthodox macroeconomic policies in the country.
ARS	Mildly Bearish	Mildly Bearish	• The 47% cut off rate for 27days shorter Lebac is reflecting Central Bank decision to stabilize the local currency at any cost, after the 46% jump in the dollar price recorded in 2018. • As per the IMF agreement, the possibility to stabilize the peso has been limited to the use of the monetary tools because the Central Bank restriction to intervene in the FX markets. • The Real Multilateral Exchange Rate Index reached the highest level during the Macri's era. • We believe the government decision to stabilize the currency has reasonably possibilities to succeed now, because the real exchange rate looks in line with the current account medium term deficit goal set in the IMF Letter of Intent.

Bullish | Mildly Bullish | Neutral | Mildly Bearish | Bearish

Source: Santander.

BRL – How Far Can the BCB Go With Swaps?

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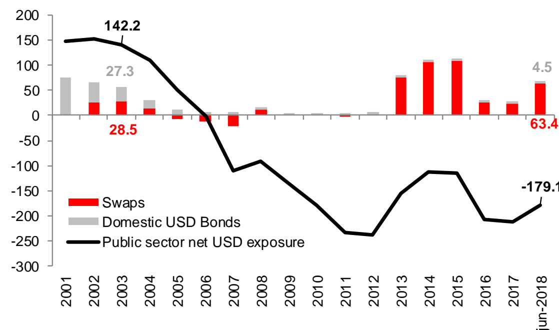
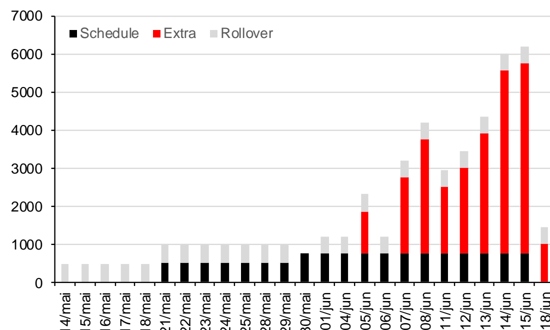
Chart 21: Public Sector Net Foreign Currency Exposure



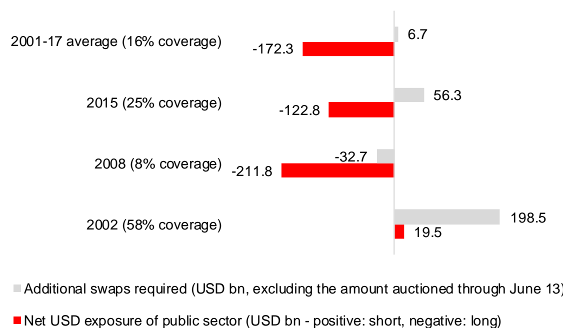
Sources: BCB and Santander estimate.

Chart 22: Daily Swaps Auctions



Source: BCB.

Chart 23: Simulation of Public Sector Net Foreign Currency Exposure



Sources: BCB and Santander estimate.

In the second half of May, volatility of Brazilian assets surged, the BRL depreciated, and the yield curve steepened, triggered by the truck drivers' strike. This unrest led markets to lower expectations of an economic recovery and reprice the electoral scenario, as the BRL's behavior decoupled from EM currencies: the USD/BRL peaked at BRL3.97/USD and a 250-bp hike was priced in the from June to December local curve during the first week of June. Consequently, the BCB has been intervening by selling FX swaps since mid-May and has intensified its intervention since beginning of June.

What is the limit and goal of the BCB's swap policy? The BCB has ample ammunition to calm markets and contain BRL weakening: specifically, USD380 billion in international reserves, and, in theory, no limit to FX swaps outstanding. We see the only constraint to FX swaps as fiscal; i.e., what value does the government place on reducing net-long foreign currency exposure to control FX market volatility.

June 18 to date, the CB's swap exposure stands at USD63.4 billion, and the public sector remains a net creditor, at USD179 billion — international reserves of USD380 billion, excluding (i) external sovereign debt of USD133 billion; (ii) local USD-linked bonds of USD4.6 billion; and (iii) the outstanding notional of FX swaps. This position acts as an important countercyclical fiscal cushion: a 10% BRL depreciation would increase the Brazilian government's assets (hence decreasing net debt) by roughly BRL66 billion, or around 1% of GDP, while during the turbulent election cycle in 2002, Brazil's net foreign currency exposure was USD152 billion short, and a 10% BRL weakening would add BRL54 billion, or 3.6% of GDP to net debt.

On the side of demand, a look at past crises offers a useful guide as to the extent the private sector hedged its external, foreign-currency-denominated liabilities. According to the Central Bank's latest balance-of-payments data (April 2018), Brazilian companies owe around USD496 billion (25% of GDP) in foreign currency. In 2002, the outstanding USD exposure of public domestic debt (swaps plus USD-linked bonds) climbed to 58% of outstanding private sector external liabilities denominated in foreign currency; in 2015 the outstanding USD exposure of public domestic debt reached 25% after an extensive swap program. Currently, the outstanding USD exposure of public domestic debt corresponds to about 13% of outstanding private sector external liabilities denominated in foreign currency.

We believe the most likely scenario is that additional swaps will be consistent with a coverage ratio somewhere between the historical average (16%) and the 2015 level (25%), for two reasons. First, fundamentals are stronger than in 2002, and therefore less likely to drive a similar level of investor concern as seen in that period. Second, should market turbulence ever reach those levels, we believe the BCB would prefer to allow the currency to depreciate, even if accompanied by severe volatility, rather than allow a shift to net debtor status in USD, resulting in deteriorating debt dynamics.

MXN – Anti-shock rule and liquidity are your friends

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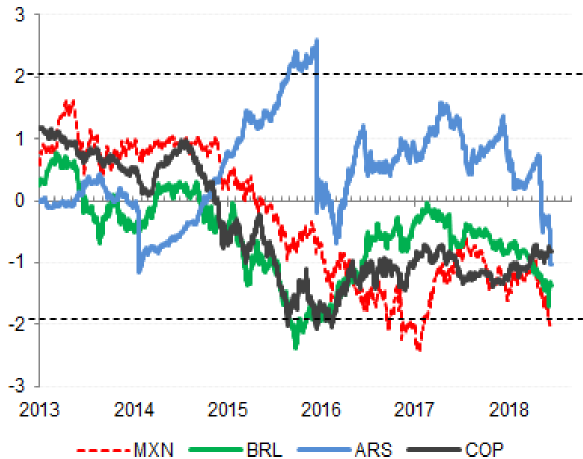
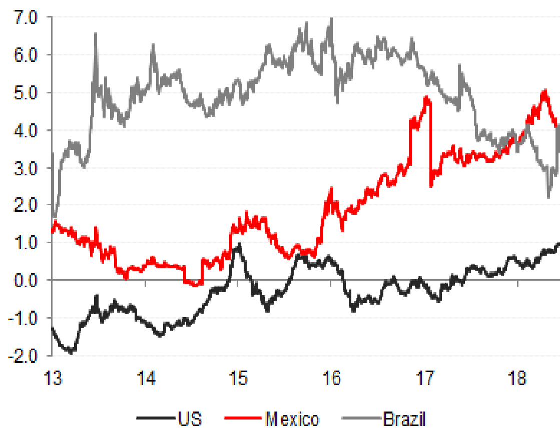
Chart 24: FX performance in real terms, Mexican peso looks cheap



Z-score values using REER since 2010.
Source: Santander, Bloomberg

Chart 25: Real rates



Ex ante using 2yr swaps and discounted using market inflation expectations.
Source: Santander, Bloomberg

Most EM currencies have come under further selling pressure since our last FX Compass edition. The typical panic reaction leading to heavy outflows over the last few weeks confirms a combination of factors at play. First, the search for yield was still in full swing during most of 2017 and Q1-18, suggesting that the market was complacent about Fed tightening. Second, amid a rotation from quantitative easing into quantitative tightening, developed economies exhibited well matured but less synchronized expansion (witness the sizable differentiation between USD and Europe activity data), which fueled USD strength. Third, escalating trade tensions between the US and China increasingly imply a potential for global growth deceleration, and not that far away. Against this backdrop, investors are likely to remain cautious on risky assets despite attractive yields, in our view.

However, investors are differentiating between countries that are running big imbalances in their current account and fiscal deficits; those where the pace of deterioration in fundamentals may be more rapid; and those where policymakers have been ahead of both local and external shocks. Using this three-layer comparison, we rank the Mexican peso as having a decent risk-reward compared to other EM currencies. We judge that the level of risk premium associated with both NAFTA and the upcoming July 1 elections is relatively well advanced. Clearly, MXN could weaken further if the worst case develops, particularly if the US withdraws from NAFTA, but this currency is in better shape than other EM currencies, in our view.

Regarding the elections stress test, a measure of the level of political risk priced in is the interest rate spread versus US. Using the 2yr benchmark, this gap stands at 520 bps, but it has narrowed versus its previous worst level at 570 bps in late 2017 and is well above 400 bps around the time of the 2013 taper tantrum. Behind this lies Banxico's ahead-of-the-shock policy strategy, also in sharp contrast to other EM central banks. A flat yield curve also reflects a “no-exodus” response from foreign investors, who own nearly two thirds of Mexico bonds. Indeed, using the 2yr market reference, real rates have increased to 3.85% after Banxico's new hike to 7.75% this week from near zero when the Fed started to hike in late 2015. Holding liquidity is the name of the game when general risk-off market moves are dominant, and the Mexican peso has plenty of liquidity. This is another reason to expect MXN to weather the storm in better shape than its peers. Moreover, MXN's technical position has improved, while hedging risk looks widespread, thus suggesting a better supply-demand balance of USD within this EM play.

Post-election we recommend keeping these catalysts on the radar: the transition team's policy priorities, mainly the strategy to renegotiate NAFTA (macro discipline), 2019 budget (fiscal consolidation), Pemex oil auctions (energy reform), Banxico board member selection (monetary policy), the decision to complete the Mexico City airport, and cabinet appointments before the December 1 inauguration.

CLP – Going with the External Flow

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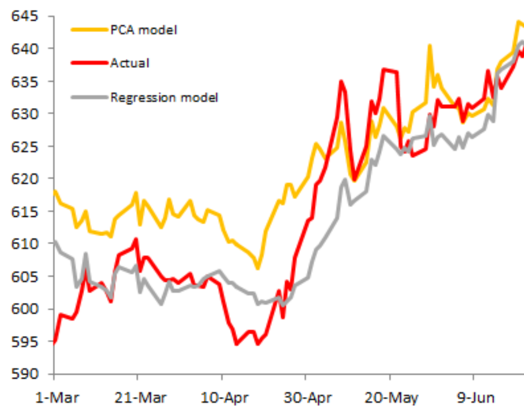
Since May, and closely resembling the global USD trend, the CLP has once again been losing out, as the strain of the current external environment continues to be absorbed by global currencies. Additionally, and still embedded in a volatile and upward-trending USD, at this time of writing the USDCLP continues to test new 2018 highs near 640. During the week, the USDCLP reached a 2018 peak of 643, which implied a monthly 1.7% depreciation of the CLP, with copper losing 0.8% (currently at US$3.06) over the same time frame.

Chart 26: USDCLP Fair Value Metrics

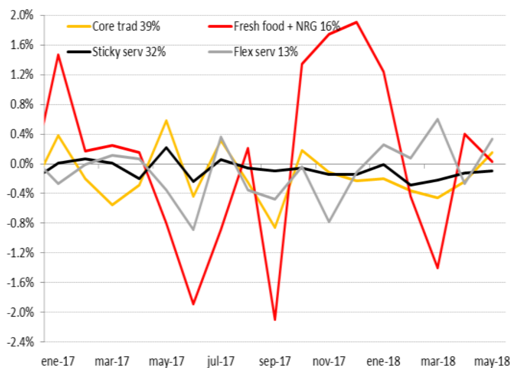


Source: Santander, Bloomberg

On growth, May's IMACEC index came out at a respectable 5.9% y/y, in line with market consensus and consolidating the hypothesis of sustained activity recovery. This reading alone almost ensures an average Q2 2018 IMACEC above 4.0%, and as a result we have revised our year-end GDP forecast to 3.7% y/y. While it is only natural that the extraordinary growth pace in the mining sector will wane in the second half, given that the impact of the Escondida strike is limited to the first half of the year, we continue to project a consolidation of the non-mining sector, with readings that should stabilize around 3.0% y/y for the remainder of the year. Regarding inflation, May CPI was in line with market expectations, as the headline reading rose to 2.0% y/y on higher energy prices and specific USD-denominated components (e.g., tourist packages).

That said, divergence between headline and core inflation readings (the later lagging by 40 bps) is starting to creep up, a trend that we expect consolidates in the coming months, as the impact of local activity on core inflation remains elusive. While the more volatile items (e.g., fresh foodstuffs and energy items) should keep headline inflation on the rise, the only true inflationary pressure we detect in core inflation is in "flexible services", driven by second-round effects of oil prices and USDCLP, with the recovery of other components (e.g., sticky services") still soft.

Chart 27: Shocks to CPI components



Source: Santander, INE

Regarding monetary policy, June's BCCh meeting and subsequent release of the IPoM reaffirm the board's stance that rates will remain expansive. The convergence of inflation towards the 3% level remains the primary concern, along with consolidation of the current economic recovery. Overall, the bias remains neutral, but BCCh made it clear that its monetary policy projections are more in line with the trader survey forecast of a single 25-bps hike in December 2018 (as opposed to the market's pricing in two hikes this year, starting in October), and only a further 75 bps 24 months ahead (3.50% vs. the current market implied 4.25%).

Net-net, the short-term outlook for the CLP remains dependent on the ability of EM to weather external challenges. If current political and financial conditions generate enough pressure to further suppress EM growth, while inflation aggressively picks up due to weaker currencies, it would further disrupt the CLP. Given current volatility and our fair value estimates that push towards 645, it would seem reasonable to believe that the USDCLP may fluctuate somewhere between 635-650 over the coming weeks.

COP – The Outperformer

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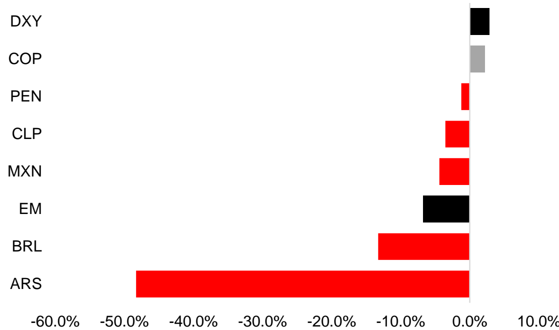
Since our last *FX Compass* (published on May 24) the COP has depreciated 2.5%, following the recent strengthening of the USD (DXY +1.5%) and the more hawkish statement from the FOMC in June, where it suggested that it would increase interest rates four times this year, instead of three, as previously envisioned. The COP's recent weakening came despite an increase in oil prices, with Brent prices moving up by 4.4% in the past three weeks.

Year to date, however, the COP continues to be the best-performing currency on the EM and LatAm spectrum. In effect, YTD the COP has appreciated 2.0%, while EM currencies have lost 6.7% against the USD and the USD has improved 2.3%, according to the DXY index.

We consider that the COP's overperformance so far reflects in part the country's improving macroeconomic outlook, with growth recovering, inflation under control and near the target, a narrowing current account deficit, and moderate but ongoing fiscal consolidation. Moreover, we consider that market expectations of continuing orthodox macroeconomic policies under the new government also may have had a positive impact on its performance.

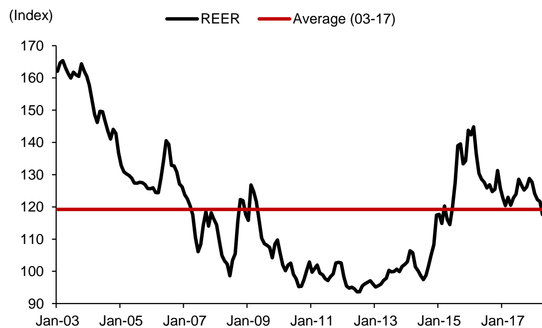
Chart 28: COP has outperformed its peers in 2018*



Note : * Y-t-d as of June 18
Source: Bloomberg, Santander.

In line with expectations, on June 17 Ivan Duque was elected president for the 2018-2022 term, with 54% of the votes, in the second runoff of the presidential election. Moving forward, markets will be paying close attention to the new government's fiscal policy as well as Duque's pick for the Ministry of Finance. Ivan Duque campaigned in favour of lower corporate taxes, a policy that could be inconsistent with the fiscal consolidation task that his government will have to fulfil. In effect, although the Fiscal Rule Committee revised down the fiscal targets for the coming years, the 0.7-pts adjustment in the fiscal deficit for 2019 remains ambitious, leaving no room for lower tax rates, in our view.

Chart 29: REER in line with the 15-year average



Note: REER: Weights defined by total trade; CPI deflated
Source: Bloomberg, Banco de la Republica, Santander.

Although the COP has outperformed its peers, the real effective exchange rate is in line with the 15-year average, suggesting that the COP was fairly valued at around 2850 USD/COP. Looking ahead, however, we do not rule out the possibility that the COP could start to move more in line with peers and lose some ground, mainly driven by negative external factors that could continue to reinforce the risk-off mood in emerging markets: namely, trade war escalation and the continuing of monetary policy normalization in the US.

Moreover, OPEC's production decision, expected to come at its meeting on Friday, June 22 in Vienna, should be key for the COP's future performance. Persistent high oil prices could continue to be an important buffer for the COP in the more challenging external environment. As of this writing, Brent prices have increased 4.4% during the month, boosted recently by the report that OPEC members may consider a small increase in oil production (300,000 to 600,000 barrels a day) over the next few months. This amount differs from the 1.5 million barrels per day increase proposed by Russia.

ARS – All CB weapons focus on stabilizing the currency

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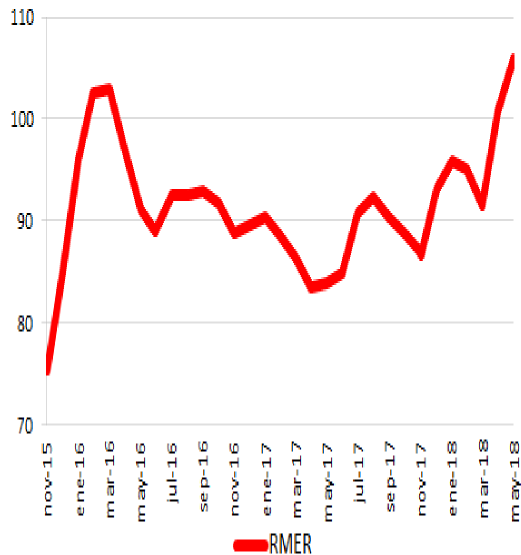
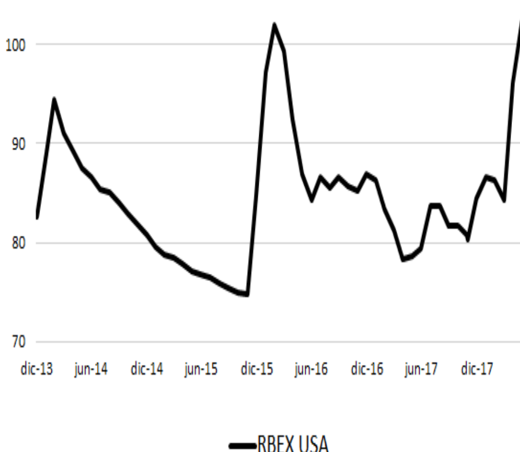
Chart 30: Real Multilateral Exchange Rate - Index=100 in December17, 2015



Source: Central Bank and Santander.

Chart 31: Real Bilateral Exchange Rate with the USA- Index=100, December 17, 2015.



Source: Central Bank and Santander

The 47% cut off rate for 27days shorter Lebac recorded on Tuesday 19 auction - more than 1.000bps jump when compared with April - is reflecting Central Bank decision to stabilize the local currency at any cost, after the 46% jump in the dollar price recorded in 2018.

Bear in mind that the US$50bn loan approved by the IMF this week, implied the government restriction to intervene in the FX market, not only using cash dollar reserves but betting on the Future and NDF markets too, as set in the Letter of Intent signed by Ministry Dujovne.

As per the new agreement, the possibility to stabilize the peso has been mostly limited to the use of the monetary tools in the short term and obviously, to the fulfilment of contractive quarterly fiscal goals in the medium term.

While banks' reserve requirements were recently increased by 5% of all peso deposits in June and July, Lebac's cut off rates have been significantly adjusted upward, well above the 40% monetary policy rate, the reference rate of the market currently under reviewed by Governor Caputo's board of Directors.

The Real Multilateral Exchange Rate Index reached 106 avg. in June, the highest level during the Macri's era. The ARS28/ USD nominal level coincided with the 2014 real average quotation, a year in which the current account deficit was equivalent to 3.5% of GDP.

Interestingly in June 12 Letter of Intent, the government signal that under the baseline scenario defined in the agreement, the 2020 current account deficit should shrink to 3.6% in two years from now.

Such coincidence may have determined Luis Caputo to declare to newspaper La Nacion on Wednesday, that the government feels comfortable with the current dollar quotation and that the most important goal right now is to stabilize the currency. If the peso stabilizes, we should see a rapid reduction in interest rates, likely since August.

Bear in mind that the 20% jump in the dollar quote recorded in May has implied wholesale price index increases of around 8%, reflecting the possibility of a dangerous price dislocation if further devaluation materializes.

Net/net: We believe the government decision to stabilize the country at any monetary cost has a more reasonably possibility to succeed now, because the real exchange rate looks in line with the current account medium term deficit goal set in the IMF Letter of Intent. In any case, it is absolutely imperative that EM currency weaknesses recede in the weeks to come. Otherwise a new bout of peso depreciation will be unavoidable.

CEE FX: Main Themes

Currency	3M view	12M view	Main Themes
PLN	Mildly Bullish	Mildly Bullish	• We think recent zloty depreciation could be utilized to enter the Polish market amid positive fundamentals. However, much will depend on global market sentiment, which appears to have been the main driver for the zloty in recent weeks. We have revised our 3Q target up and see an upside risk to our 4Q18 forecast.
CZK	Mildly Bullish	Mildly Bullish	• In recent weeks, EUR/CZK stayed around 25.75. The outlook for more rate hikes amid robust economic growth should be the main factor supporting the koruna in the months to come, provided that economic growth in Europe does not decelerate sharply. The political situation should be no more than neutral.
HUF	Mildly Bearish	Mildly Bullish	• We changed our EUR/HUF forecasts to 323-327 in the short-term and 317-320 in the longer term as a consequence of the potentially negative impact of Trump's trade tariffs on Hungarian exports because of expected slower Euro zone economy activity.
RUB	Mildly Bearish	Mildly Bullish	• We change our short-term view for the ruble and revise the USD/RUB forecast up due to the current and expected adverse impact on the emerging market currencies of tension associated with the change of global trade regime.

Bullish Mildly Bullish Neutral Mildly Bearish Bearish

Source: Bank Zachodni WBK.

PLN – Weak despite supportive fundamentals

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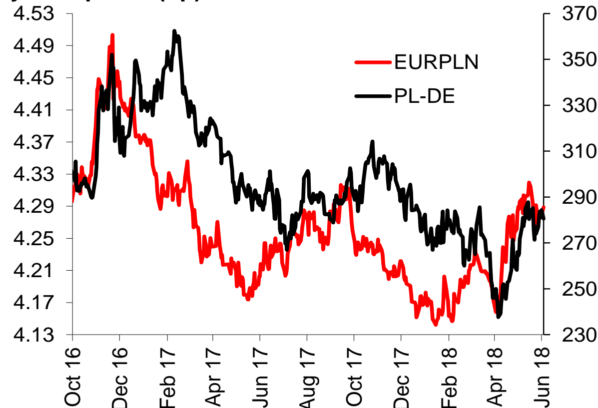
In recent weeks, the zloty got hit versus main currencies amid the sharp appreciation of the US dollar fuelled by the political situation in Europe. Concerns about the impact of trade wars on global economic growth and the state of fiscal policy in Italy under the new government pushed EUR/PLN to 4.34, its new 2018 peak.

Since mid-April, when the market's mood started to deteriorate and EUR/PLN's upside move began, the zloty is the sixth weakest among its emerging market peers. Within this time frame, however, we saw some pretty encouraging news flow from Poland; 1Q18 headline GDP surprised to the upside; the CPI rebounded and is expected to rise to 2% in the months ahead; and the state budget continued its outstanding performance (surplus in April for the first time since data is available, that is since 1995).

Chart 32: EUR/PLN and Poland-German 10Y bond yield spread (bp)



Source: Reuters, Bank Zachodni WBK.

We regard the Polish bonds as pretty attractive with the PL-DE 10Y bond yield spread having approached c300bp in late May, its highest for nearly a year. The foreign investors' demand for the domestic debt could be among the factors supporting the zloty.

However, much will depend on global market sentiment, which appears to have been the main driver for the zloty in recent weeks. Waves of risk aversion triggered by trade tariffs imposed by the US and China curbed demand for risky assets. We stick to our scenario that EUR/PLN could stay above 4.25 during the summer and ease slightly at the year end. However, because of the recent intensification of the trade wars and discouraging Euro zone data, we have revised our 3Q target up and see an upside risk to our 4Q18 forecast.

1Q18 GDP grew 5.2% YoY, slightly above a flash estimate at 5.1%. As regards the growth breakdown, it is somewhat disappointing, as it appears that the surge in inventories was the only source of the positive surprise in GDP growth in the first quarter, adding as much as 1.9pp. Remaining components disappointed. The pace of growth for exports and imports decelerated sharply and net exports deducted 1.2pp from the headline GDP figure. Private consumption growth decelerated to 4.8% YoY from 5.0% YoY in 4Q17, despite the accelerating growth of household income and record high consumer confidence. It is possible that the surprisingly high growth of inventories in 1Q18 is the result of difficulties with proper data classification by the statistical office. The next revisions may show again that part of inventories growth will be re-allocated to the other categories, for example, to investments. This has happened in the past.

Summing up, GDP growth at 5.2% YoY or 1.6% q/q after seasonal adjustment is a very good result and places Poland again at the top of the fastest-growing EU economies. We expect a gradual slowdown in the quarters to come and that total 2018 growth should be only marginally below the 4.6% seen in 2017.

CZK – Hikes are getting closer

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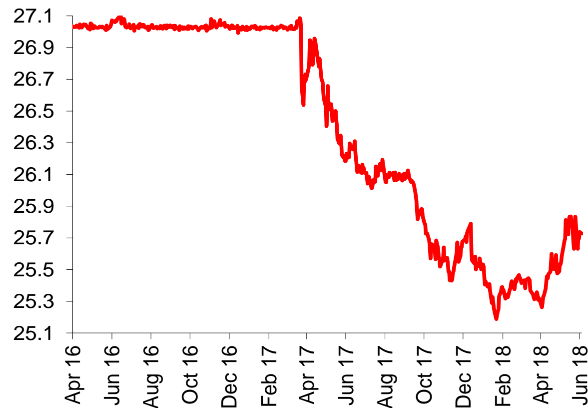
Chart 33: EUR/CZK



Source: Reuters, Bank Zachodni WBK.

In recent weeks EUR/CZK stayed around 25.75. The koruna performed better than the zloty and forint thanks to hawkish comments by Czech central bankers amid the release of data showing higher-than-expected inflation.

In May, the Czech CPI accelerated to 2.2% YoY from 1.9% YoY which spurred comments by central bankers indicating that the next rate hike could be delivered earlier than in late 2018. Also, the koruna is appreciating more slowly than the central bank expected, making more room for monetary policy normalization. The outlook for more rate hikes amid robust economic growth should be the main factor supporting the koruna in the months to come, provided that economic growth in Europe does not decelerate sharply.

Over the course of the past month, there has been some progress in government formation. The ANO party, which won elections in October 2017, is to form a coalition with the Social Democrats. However, this would still be a minority government that would rely on the support of communists during the confidence vote. Overall, the government does not look to have solid support within parliament. And, in our view, even if such support is finally established, this should not have much of a positive impact on the koruna.

HUF – Weakest for years

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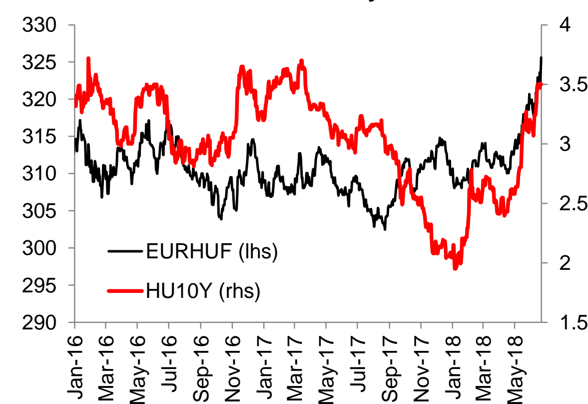
Chart 34: EUR/HUF and HU10Y yields



Source: Reuters, Bank Zachodni WBK.

In the last four weeks, we observed the continuation of EUR/HUF rise owing to rising tension in the trade war between the US, China, the EU and Russia. As a result, the exchange rate rose to c324 from c319, following the jump in Hungarian 10Y bond yields. The forint depreciated, ignoring the dovish rhetoric of ECB and weaker-than-expected Hungarian macro numbers. The Hungarian currency managed to recover slightly only after the central bank (MNB) suggested limiting the horizon of maintaining loose monetary conditions to five to eight quarters. At the previous conference, the MNB had declared it would maintain loose monetary conditions for an extended period.

In the next three to four weeks we expect EUR/HUF to remain high, due to the tensions in global trade relations. Moreover, we think that the close international trade integration of Hungarian economy with Euro zone economy will weigh on the forint. We think that expected Euro zone slowdown (suggested by the falling leading indicators) will affect the Hungarian economy in the next months. Therefore, we forecast that EUR/HUF will remain at the current level or slightly higher in the coming weeks. Taking a longer perspective, we expect EUR/HUF to ease to 317-320 thanks to the change of the MNB's stance, which suggested limiting the horizon to maintain loose monetary conditions.

RUB – Little room for depreciation

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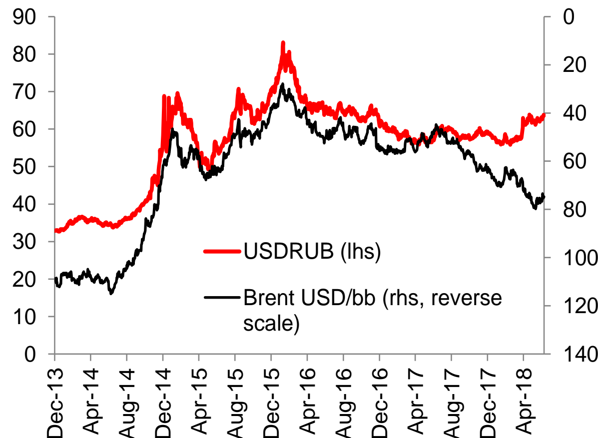
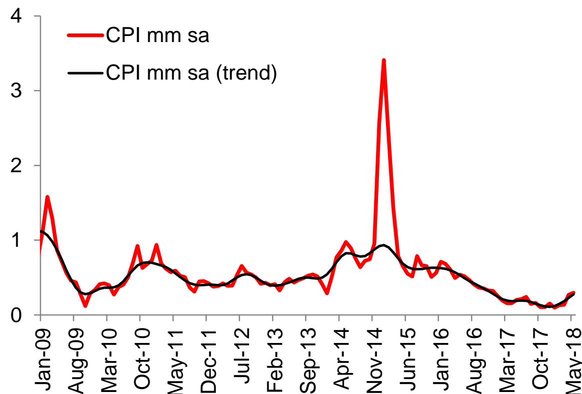
Chart 35: Oil prices, RUB



Source: Reuters, Bank Zachodni WBK.

Chart 36: Russia CPI m/m



Source: Reuters, Bank Zachodni WBK.

Over the last four weeks, USD/RUB oscillated in the 61-64.20 range. It is worth noting that rise above 63 in mid-June was a reaction to the information about new tariffs imposed by the US and responses from China, the EU and Russia. USD/RUB rose, despite the release of better-than-expected industrial production data (3.7% y/y vs. median forecasts 0.9% y/y) and the Central Bank of Russia's (CBR) press conference, where the it suggested slowing down the process of cutting rates. However, the scale of USD/RUB increase was substantially smaller than it was in April, when the US imposed sanctions against Russia (including a freeze on Russian companies' assets) – when USD/RUB jumped to c65 from c58.

In our opinion, in the next weeks, USD/RUB will be influenced by tensions connected with the '3T' issue (Trump's Trade Tariffs and international reactions). In recent days, the European Union extended sanctions against Russia until mid-June. At the same time, sanctions imposed in March are still in place. Moreover, we expect that trade tariffs to be imposed by Trump's administration will generate stress on the financial market. In our opinion, fears about international trade will negatively affect emerging market currencies.

However, we do not expect any sharp ruble depreciation. We think the Russian currency will be supported by decent macro data. Industrial production surprised on the positive side, while the content of the PMI report suggests that optimism among entrepreneurs about future demand is still high (despite the May PMI falling below 50pt). Except for the traditional supporter of the ruble – high oil prices – the Russian currency will probably benefit from information from the last CBR conference. In the last central bank communique, the bank said: "The balance of risks up to the end of 2019 has shifted towards pro-inflationary risks". This phrase was a consequence of the increase in the inflation pressure that the CBR expects, as a reaction to the planned VAT increase (effective since mid-2019).

Therefore, we believe that the central bank will slow the pace of rate cuts to the neutral level (6%-7%) so as to reach the planned level at the end of 2019. In our opinion, this will support the ruble in the short term and will prevent USD/RUB rising above 67. In the longer term (3-6 quarters), we anticipate the exchange rate falling gradually to 62. We believe that the expected USD/RUB downward shift will be supported by rising income from energy commodities. According to the CBR's estimates, these revenues should increase to USD425bn in 2018 from USD353bn in 2017, while imports should grow at a slower pace to USD259bn in 2018 from USD238bn in 2017.

G10 FX: IMM Speculative Positioning

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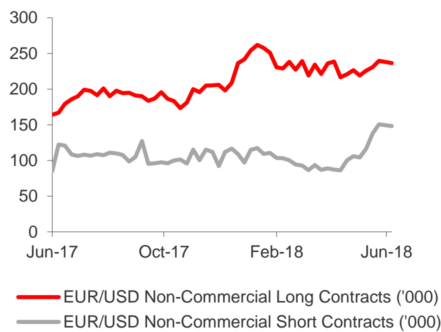
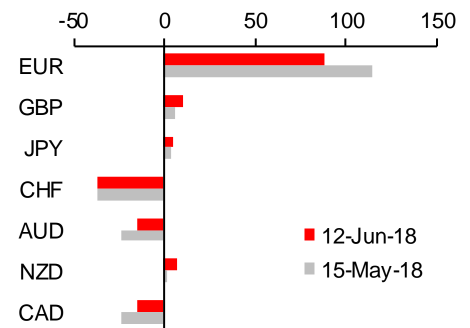
IMM commitment of traders report: EUR/USD position



- **The net long EUR position fell again** in the four weeks ended 12 June 2018. This position dropped to 88k contracts, which is the least bullish speculators have been on the EUR this year. While the total number of long EUR contracts has not changed significantly in 2018, the number of short EUR contracts has risen 50% in the past two months. This less upbeat speculative EUR view has aided the 6.5% decline in EUR/USD since its April high.
- **USD sentiment among speculators continues to improve.** While this net position has been negative throughout 2018 to date, it is now the least negative since the start of the year, at 22k contracts, with this improved USD view coinciding with the more bearish EUR sentiment.
- **Speculative positioning is little changed elsewhere.** The Speculators are marginally less net short the AUD and CAD, while their net long NZD and GBP positions have increased slightly, over the past four weeks. However, the recent changes in speculative positioning have been dominated by the EUR/USD move.

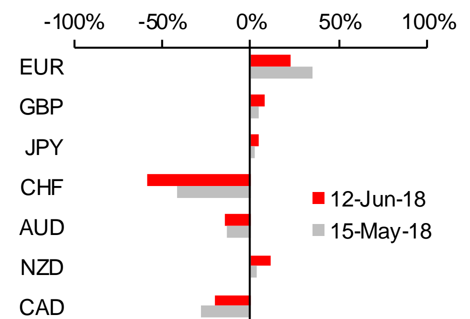
Net Speculative Contracts ('000s)*

	12-Jun-18	15-May-18	4w chg	YtD chg
USD***	-22.1	-96.0	73.9	-24.7
EUR	88.2	115.1	-26.9	-3.9
GBP	11.0	5.6	5.3	-1.7
JPY	5.1	3.7	1.4	121.1
CHF	-37.2	-36.4	-0.9	-23.3
AUD	-15.2	-23.1	7.9	-1.6
NZD	7.0	2.0	5.1	24.6
CAD	-15.0	-23.7	8.7	-32.3



Net Speculative Contracts as % of Open Interest**

	12-Jun-18	15-May-18	4w chg	YtD chg
USD***	-2%	-9%	7%	-2%
EUR	23%	36%	-13%	-5%
GBP	9%	5%	4%	0%
JPY	4%	3%	1%	61%
CHF	-59%	-41%	-17%	-41%
AUD	-14%	-14%	-1%	1%
NZD	11%	4%	8%	44%
CAD	-20%	-28%	8%	-46%



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

200 150 100 50 0 | 1.28 1.24 1.20 1.16 1.12 1.08
Jun-17 Oct-17 Feb-18 Jun-18
Net Speculative Contracts ('000s)
EUR/USD, rhs

USD/CAD

100 50 0 -50 -100 | 1.20 1.25 1.30 1.35 1.40
Jun-17 Oct-17 Feb-18 Jun-18
Net Speculative Contracts ('000s)
USD/CAD, rhs, rev

USD/JPY

50 0 -50 -100 -150 | 105 110 115
Jun-17 Oct-17 Feb-18 Jun-18
Net Speculative Contracts ('000s)
USD/JPY, rhs, rev

GBP/USD

60 30 0 -30 -60 | 1.48 1.44 1.40 1.36 1.32 1.28 1.24 1.20
Jun-17 Oct-17 Feb-18 Jun-18
Net Speculative Contracts ('000s)
GBP/USD, rhs

AUD/USD

80 60 40 20 0 -20 -40 | 0.82 0.80 0.78 0.76 0.74 0.72
Jun-17 Oct-17 Feb-18 Jun-18
Net Speculative Contracts ('000s)
AUD/USD, rhs

USD/CHF

10 0 -10 -20 -30 -40 -50 | 0.90 0.92 0.94 0.96 0.98 1.00 1.02 1.04
Jun-17 Oct-17 Feb-18 Jun-18
Net Speculative Contracts ('000s)
USD/CHF, rhs, rev

EUR/GBP

150 100 50 0 | 0.93 0.92 0.91 0.90 0.89 0.88 0.87 0.86 0.85 0.84
Jun-17 Oct-17 Feb-18 Jun-18
Net Speculative Contracts ('000s)
EUR/GBP, rhs

NZD/USD

40 30 20 10 0 -10 -20 | 0.76 0.74 0.72 0.70 0.68
Jun-17 Oct-17 Feb-18 Jun-18
Net Speculative Contracts ('000s)
NZD/USD, rhs

USD minus MXN

100 0 -100 -200 | 100 95 90 85
Jun-17 Oct-17 Feb-18 Jun-18
Net Speculative Contracts ('000s)
Trade-weighted USD, rhs

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

Latin America FX: Positioning indexes (Z-scores)

USD/BRL

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

40, 30, 20, 10, 0 | 4.5, 4.0, 3.5, 3.0, 2.5, 2.0

Jun-14 Jun-15 Jun-16 Jun-17 Jun-18

Z-score USD/BRL

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

USD longs

2, 1, 0, -1

Jun-14 Jun-15 Jun-16 Jun-17 Jun-18

USD/MXN

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

80%, 40%, 0%, -40%, -80% | 25, 20, 15, 10

Jun-14 Jun-15 Jun-16 Jun-17 Jun-18

Z-score USD/MXN

Z-score (USD/MXN longs) — 10-90%

USD longs

2, 1, 0, -1, -2

Jun-14 Jun-15 Jun-16 Jun-17 Jun-18

USD/CLP

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

30, 20, 10, 0 | 750, 650, 550, 450

Jun-14 Jun-15 Jun-16 Jun-17 Jun-18

Z-score USD/CLP

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

USD longs

4, 3, 2, 1, 0, -1, -2

Jun-14 Jun-15 Jun-16 Jun-17 Jun-18

USD/PEN

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

12, 8, 4, 0, -4 | 4.0, 3.5, 3.0, 2.5

Jun-14 Jun-15 Jun-16 Jun-17 Jun-18

Z-score USD/PEN

Z-score (USD/PEN longs) — 10-90%

USD longs

3, 2, 1, -1, -2

Jun-14 Jun-15 Jun-16 Jun-17 Jun-18

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

Euro Interest Rate Forecasts

Government Bond yield Forecasts

Germany	Current	3Q18	4Q18	1Q19	2Q19
ECB Depo	-0.40	-0.40	-0.40	-0.40	-0.40
3m	-0.61	-0.70	-0.60	-0.55	-0.35
2y	-0.67	-0.30	-0.15	-0.10	0.10
5y	-0.30	0.20	0.35	0.50	0.65
10y	0.34	0.80	0.95	1.15	1.30
30y	1.12	1.30	1.50	1.70	1.85

Swap rate forecasts

Euro	Current	3Q18	4Q18	1Q19	2Q19
ECB Depo	-0.40	-0.40	-0.40	-0.40	-0.40
3m	-0.32	-0.33	-0.33	-0.29	-0.18
2y	-0.17	0.10	0.20	0.25	0.40
5y	0.26	0.60	0.75	0.85	1.00
10y	0.89	1.20	1.35	1.50	1.65
30y	1.52	1.60	1.75	1.95	2.10

US Interest Rate Forecasts

Government Bond yield Forecasts

US	Current	3Q18	4Q18	1Q19	2Q19
FOMC *	2.00	2.25	2.25	2.50	2.75
3m	1.92	2.00	2.25	2.50	2.75
2y	2.55	2.70	2.85	3.10	3.35
5y	2.78	3.00	3.15	3.40	3.60
10y	2.91	3.10	3.25	3.45	3.65
30y	3.05	3.25	3.40	3.60	3.75

Swap rate forecasts

US	Current	3Q18	4Q18	1Q19	2Q19
FOMC *	2.00	2.25	2.25	2.50	2.75
3m	2.34	2.40	2.55	2.70	2.85
2y	2.82	2.85	2.90	3.10	3.35
5y	2.93	3.00	3.10	3.35	3.50
10y	2.97	3.05	3.15	3.35	3.55
30y	2.98	3.10	3.20	3.35	3.50

UK Interest Rate Forecasts

Government Bond yield Forecasts

UK	Current	3Q18	4Q18	1Q19	2Q19
MPC	0.50	0.50	0.50	0.50	0.50
3m	0.51	0.45	0.40	0.45	0.45
2y	0.73	0.40	0.50	0.50	0.55
5y	1.04	0.75	0.90	1.00	1.20
10y	1.28	1.20	1.40	1.60	1.80
30y	1.75	1.70	1.80	2.00	2.20

Swap rate forecasts

UK	Current	3Q18	4Q18	1Q19	2Q19
MPC	0.50	0.50	0.50	0.50	0.50
3m	0.64	0.65	0.55	0.55	0.55
2y	1.03	0.90	0.95	0.90	0.85
5y	1.30	1.10	1.20	1.25	1.40
10y	1.51	1.40	1.50	1.70	1.85
30y	1.63	1.30	1.45	1.80	1.90

G10 Central Bank Calendar

	Current Rate	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
FOMC (Upper)	2.00	Unch.	-	+25bp	-	Unch.	+25bp	-	1	26	-	8	19
ECB (Depo)	-0.40	Unch.	-	Unch.	Unch.	-	Unch.	26	-	13	25	-	13
BoE	0.50	-	Unch.	Unch.	-	Unch.	Unch.	-	2	13	-	8	20
BoJ	-0.10	Unch.	-	Unch.	Unch.	-	Unch.	31	-	19	31	-	20
SNB	-0.75	-	-	Unch.	-	-	Unch.	-	-	20	-	-	13
BoC	1.25	+25bp	-	Unch.	Unch.	Unch.	-	11	-	5	24	-	5
RBA	1.50	-	Unch.	Unch.	Unch.	Unch.	Unch.	3	7	4	2	6	4
RBNZ	1.75	-	Unch.	Unch.	-	Unch.	27	-	8	26	-	7	-
Norges Bank	0.50	Unch.	-	Unch.	-	Unch.	Unch.	-	16	20	25	-	13
Riksbank	-0.50	-	Unch.	-	Unch.	-	-	3	-	6	24	-	19

Source: Bloomberg, Santander. Note: Current levels as at 22 June 2018. For meetings that have already taken place, decision identified as +/- in bp, or "unch" for no change. "-" denotes no meeting taking place that month *FOMC rate refers to upper bound rate. **The ECB announced it would extended QE until September 2018 at EUR30/month

Brazil/Mexico Interest Rate forecasts

Government Bond yield

Brazil	Current	3Q18	4Q18	1Q19	2Q19
SELIC	6.50	6.50	6.50	6.50	6.50
NTNF Jan' 19s	7.05	7.10	6.90	6.80	6.80
NTNF Jan.' 25s	11.65	11.00	10.50	10.50	10.50

Government Bond yield

Mexico	Current	3Q18	4Q18	1Q19	2Q19
Banxico fondeo	7.75	7.75	7.25	6.75	6.75
Mbono Jun. '21s	7.83	7.50	7.30	6.80	6.60
MBono Jun. '27s	7.78	7.60	7.40	7.20	6.80

Chile/Colombia Interest Rate Forecasts

Government Bond yield

Chile	Current	3Q18	4Q18	1Q19	2Q19
BCCh TPM	2.50	2.50	2.75	3.00	3.25
BCP 5Y	4.09	4.10	4.20	4.30	4.40
BCP 10Y	4.58	4.60	4.70	4.80	4.80

Government Bond yield

Colombia	Current	3Q18	4Q18	1Q19	2Q19
Banrep O/N	4.25	4.25	4.25	4.50	5.00
TES Jul '24s	6.11	5.98	6.06	6.18	6.70
TES Apr '28s	6.63	6.27	6.42	6.62	7.35

LatAm Central Bank Calendar

	Current Rate	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Brazil	6.50	-	-25bp	-25bp	-	Unch.	Unch.	-	1	19	31	-	12
Mexico	7.75	-	+25bp	-	Unch.	Unch.	+25bp	-	2	-	4	15	20
Chile	2.50	-	Unch.	Unch.	-	Unch.	Unch.	24	-	4	18	-	4
Colombia	4.25	-25bp	-	Unch.	-25bp	-	29	27	-	28	26	-	21
Argentina	40.00	-150bp	Unch.	Unch.	+300bp	+975bp	Unch.	*	*	*	*	*	*

CEE Interest Rate Forecasts

Poland

Poland	Current	3Q18	4Q18	1Q19	2Q19
Reference Rate	1.50	1.50	1.50	1.50	1.50
2y	1.62	1.60	1.60	1.56	1.50
10y	3.15	3.18	3.32	3.36	3.40

Hungary/Czech Republic/Russia Base Rates

CEE	Current	3Q18	4Q18	1Q19	2Q19
Hungary	0.90	0.90	0.90	0.90	0.90
Czech Republic	0.75	1.00	1.00	1.25	1.25
Russia	7.25	7.25	7.25	7.00	7.00

CEE Central Bank Calendar

	Current Rate	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Poland	1.50	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	11	-	5	3	7	5
Czech Republic	0.75	-	+25bp	Unch.	-	Unch.	27	-	2	26	-	1	20
Hungary	0.90	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	24	21	18	16	20	18
Russia	7.25	-	-25bp	Unch.	Unch.	-	Unch.	27	-	14	26	-	14

Source: Santander, BZWBK. Note: Current levels as at 22 June 2018. For meetings that have already taken place, decision identified as +/- in bp, or "unch" for no change. "-" denotes no meeting taking place that month. *The Argentina Central Bank decides on monetary policy on a fortnightly basis.

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

	3M	6M	9M
EUR/USD	**1.19**	**1.21**	**1.23**
vs.forward	2.1	3.8	5.6
vs.consensus forecast	0.0	0.8	0.8
GBP/USD	**1.32**	**1.32**	**1.32**
vs.forward	-0.7	-0.7	-0.7
vs.consensus forecast	-1.5	-2.9	-4.3
EUR/GBP	**0.90**	**0.92**	**0.93**
vs.forward	2.9	4.6	6.3
vs.consensus forecast	2.4	4.2	5.9
USD/JPY	**117**	**118**	**120**
vs.forward	6.2	7.1	8.9
vs.consensus forecast	7.3	8.3	11.1
EUR/JPY	**139**	**143**	**148**
vs.forward	8.4	11.2	15.0
vs.consensus forecast	7.9	9.8	11.8
EUR/CHF	**1.18**	**1.20**	**1.22**
vs.forward	2.3	4.1	5.8
vs.consensus forecast	0.9	1.7	2.5
USD/CHF	**0.99**	**0.99**	**0.99**
vs.forward	0.2	0.2	0.2
vs.consensus forecast	0.2	0.2	2.3
EUR/SEK	**9.9**	**9.6**	**9.5**
vs.forward	-4.1	-7.0	-8.0
vs.consensus forecast	-2.0	-4.0	-4.0
EUR/NOK	**9.4**	**9.3**	**9.1**
vs.forward	-0.3	-1.4	-3.5
vs.consensus forecast	0.0	0.0	-1.3
USD/CAD	**1.24**	**1.22**	**1.22**
vs.forward	-6.7	-8.2	-8.2
vs.consensus forecast	-3.1	-4.7	-3.2
AUD/USD	**0.76**	**0.77**	**0.79**
vs.forward	2.4	3.8	6.5
vs.consensus forecast	0.0	0.0	1.3
NZD/USD	**0.71**	**0.72**	**0.74**
vs.forward	2.9	4.3	7.2
vs.consensus forecast	1.4	1.4	2.8

	3M	6M	9M
USD/BRL	**3.80**	**3.50**	**3.52**
vs.forward	0.8	-7.1	-6.6
vs.consensus forecast	2.7	-2.8	0.6
EUR/BRL	**4.52**	**4.24**	**4.33**
vs.forward	3.4	-3.2	-1.0
vs.consensus forecast	2.7	-2.0	1.4
USD/MXN	**20.2**	**18.90**	**18.60**
vs.forward	-0.5	-6.9	-8.4
vs.consensus forecast	3.1	-3.1	-4.2
EUR/MXN	**24.0**	**22.9**	**22.9**
vs.forward	1.6	-3.3	-3.3
vs.consensus forecast	3.1	-2.3	-3.4
USD/CLP	**635**	**635**	**630**
vs.forward	-0.8	-0.8	-1.6
vs.consensus forecast	0.6	1.4	2.4
EUR/CLP	**756**	**768**	**775**
vs.forward	1.6	3.3	4.1
vs.consensus forecast	0.6	2.3	3.3
USD/COP	**2820**	**2800**	**2780**
vs.forward	-4.5	-5.2	-5.9
vs.consensus forecast	-2.1	-2.8	-2.9
USD/ARS	**28.4**	**29.0**	**30.5**
vs.forward	3.1	5.4	10.8
vs.consensus forecast	14.4	14.6	17.4
EUR/PLN	**4.28**	**4.20**	**4.26**
vs.forward	-0.9	-2.7	-1.3
vs.consensus forecast	0.2	-1.2	0.9
EUR/CZK	**25.5**	**25.4**	**25.3**
vs.forward	-1.1	-1.5	-1.9
vs.consensus forecast	0.4	0.8	1.2
EUR/HUF	**327**	**325**	**323**
vs.forward	0.7	0.1	-0.5
vs.consensus forecast	3.8	3.0	2.5
EUR/RUB	**80**	**81**	**81**
vs.forward	8.3	10.1	10.2
vs.consensus forecast	9.0	10.8	10.0

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

G10 FX: Spot and forward rates

	EUR/USD	GBP/USD	USD/JPY	EUR/JPY	GBP/JPY	USD/CHF	EUR/CHF	GBP/CHF
Spot	1.166	1.329	110.18	128.41	146.38	0.990	1.153	1.315
1M	1.168	1.330	109.94	128.42	146.26	0.987	1.153	1.313
2M	1.171	1.332	109.70	128.45	146.14	0.984	1.152	1.311
3M	1.174	1.334	109.47	128.47	146.03	0.982	1.152	1.310
6M	1.182	1.340	108.71	128.52	145.62	0.973	1.151	1.304
9M	1.192	1.346	107.86	128.54	145.16	0.965	1.150	1.298
12M	1.202	1.352	107.01	128.59	144.69	0.956	1.148	1.292

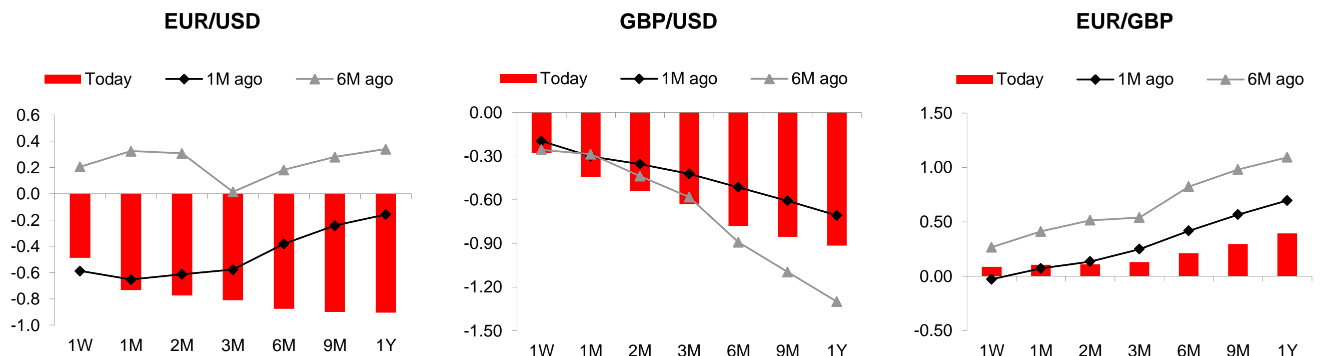
ATMf vol.

	EUR/USD	GBP/USD	USD/JPY	EUR/JPY	GBP/JPY	USD/CHF	EUR/CHF	GBP/CHF
1W	8.5%	7.9%	6.9%	9.9%	10.0%	6.6%	6.6%	7.1%
1M	7.5%	7.5%	6.9%	8.8%	9.5%	6.4%	5.9%	6.5%
2M	7.7%	7.8%	7.3%	9.1%	9.7%	6.7%	5.9%	6.8%
3M	7.6%	7.8%	7.4%	9.1%	9.8%	6.8%	5.9%	6.8%
6M	7.8%	8.1%	8.0%	9.4%	10.0%	7.3%	6.0%	7.2%
9M	7.8%	8.1%	8.2%	9.4%	10.0%	7.4%	6.0%	7.3%
12M	7.8%	8.1%	8.3%	9.5%	10.1%	7.5%	6.0%	7.4%

Implied/realized vol. ratio

	EUR/USD	GBP/USD	USD/JPY	EUR/JPY	GBP/JPY	USD/CHF	EUR/CHF	GBP/CHF
1W	1.11	1.05	1.02	1.07	1.04	1.07	1.23	1.01
1M	0.89	0.97	0.99	0.83	0.94	0.90	0.80	0.82
2M	0.96	1.00	1.13	1.00	1.06	1.02	0.97	0.92
3M	1.04	1.03	1.16	1.09	1.09	1.06	1.10	0.96
6M	1.06	1.01	1.09	1.10	1.05	1.02	1.08	0.98
9M	1.11	1.02	1.14	1.20	1.08	1.06	1.10	0.96
12M	1.09	1.05	1.12	1.20	1.08	1.03	1.04	0.93

25-delta risk reversals



Sources: Bloomberg and Santander. As of 22 June 2018

Latin America FX: Spot and forward rates

	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
Spot	27.51	3.77	640	2953	20.3	3.27
1M	28.41	3.78	640	2958	20.4	3.28
2M	29.06	3.79	640	2961	20.5	3.28
3M	30.17	3.80	640	2964	20.6	3.29
6M	32.31	3.83	640	2978	20.9	3.29
9M	34.36	3.86	640	2992	21.2	3.30
12M	36.11	3.89	640	3007	21.5	3.31

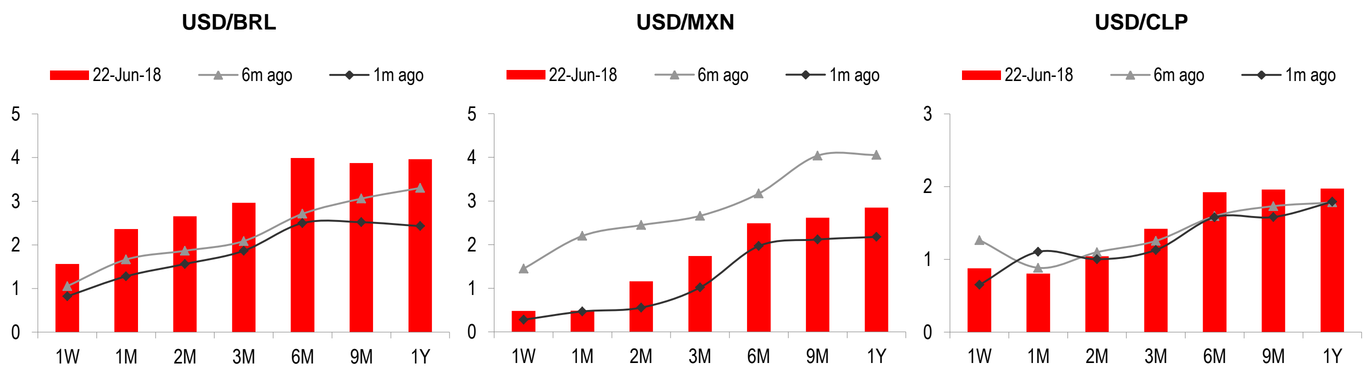
ATMf vol.

	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
1W	7.45	18.34	10.09	11.24	14.29	3.36
1M	8.00	16.22	9.85	11.61	16.34	3.32
2M	9.05	16.39	9.75	11.75	15.32	3.91
3M	9.80	16.46	9.66	11.81	14.87	4.22
6M	11.40	17.59	9.46	12.40	14.71	4.92
9M	12.40	16.93	9.15	12.52	14.62	5.24
12M	13.00	16.65	9.09	12.60	14.63	5.47

Implied/realized vol. ratio

	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
1W	0.48	1.22	1.21	1.08	1.02	1.34
1M	0.34	0.79	1.23	1.14	1.22	0.99
2M	0.28	0.95	0.99	0.88	1.08	0.89
3M	0.37	1.08	1.11	0.95	1.15	1.06
6M	0.55	1.34	1.15	1.06	1.19	1.29
9M	0.71	1.36	1.08	1.20	1.24	1.34
12M	0.81	1.44	1.14	1.30	1.31	1.53

25-delta risk reversals



Sources: Bloomberg and Santander. As of 22 June 2018

IMPORTANT DISCLOSURES

ANALYST CERTIFICATION:

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

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

EXPLANATION OF THE RECOMMENDATION SYSTEM

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

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

DEFINITIONS

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

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

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

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