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FX COMPASS

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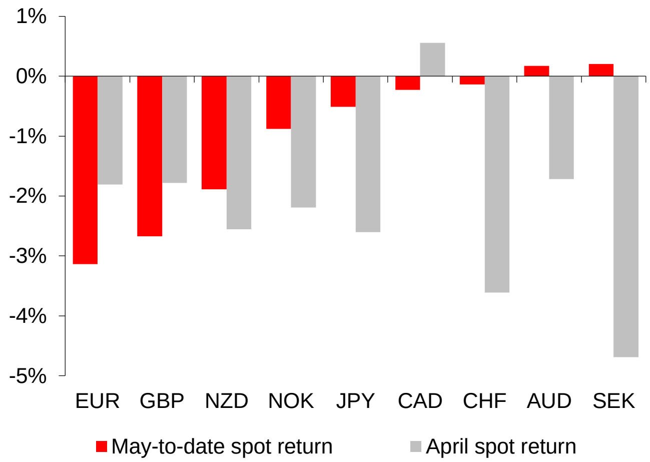
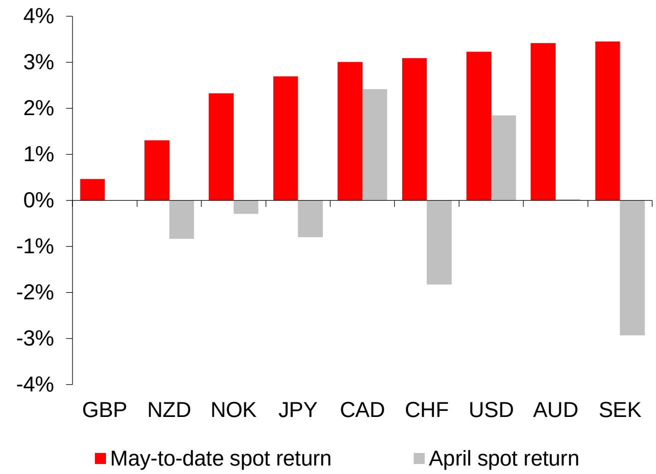
Santander Interest Rate & FX Strategy in Bloomberg: SRFS <GO>

FX Spot Returns

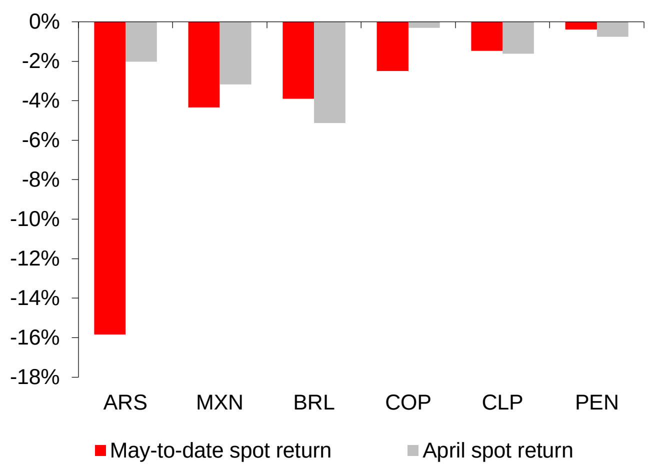
G10 spot returns vs. USD



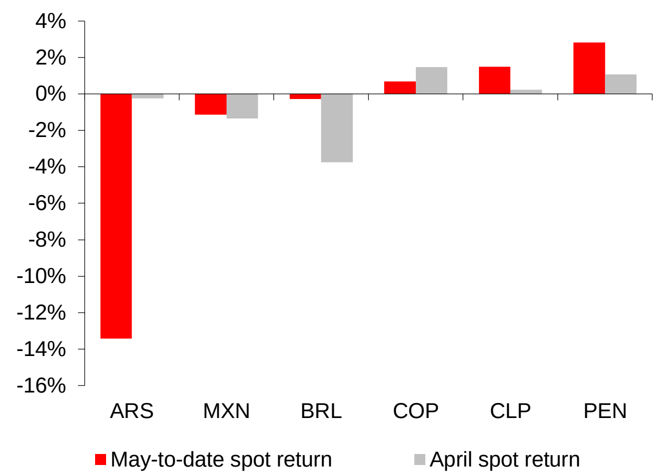
G10 spot returns vs. EUR



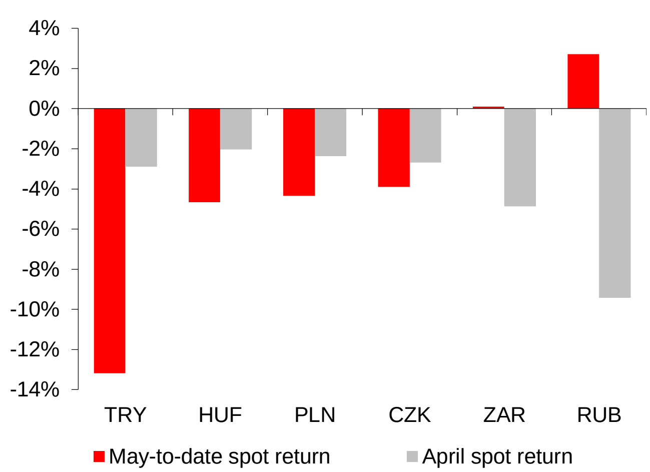
LatAm spot returns vs. USD



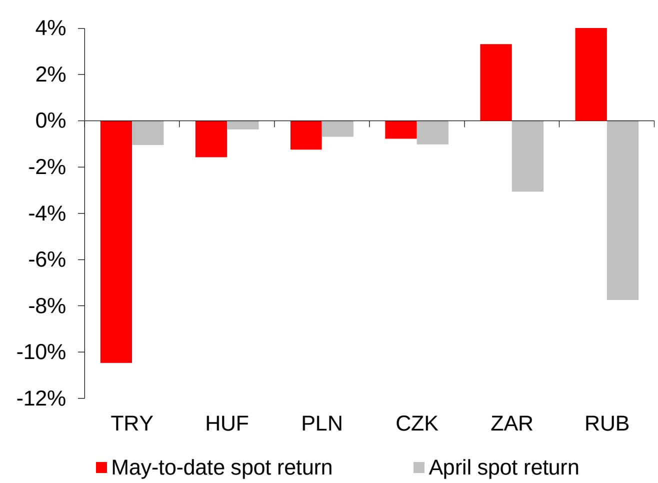
LatAm spot returns vs. EUR



CEEMA vs. USD



CEEMA vs. EUR



Source: Bloomberg, Santander. Note: Data current as at 24 May 2018 at 11:45 BST

FX Forecasts

G10 FX Forecasts

	Q2 18	Q3 18	Q4 18	Q1 19	Q2 19	Q3 19
EUR-USD	1.22	1.24	1.26	1.24	1.26	1.28
GBP-USD	1.36	1.34	1.32	1.32	1.33	1.35
GBP-EUR	1.11	1.08	1.05	1.06	1.06	1.05
EUR-GBP	0.90	0.93	0.95	0.94	0.95	0.95
USD-JPY	116	117	118	120	122	120
EUR-JPY	142	145	149	149	154	154
USD-CNY	6.60	6.65	6.70	6.80	6.70	6.70
EUR-CHF	1.17	1.18	1.20	1.22	1.23	1.24
USD-CHF	0.96	0.95	0.95	1.00	0.99	0.98
EUR-SEK	10.0	9.9	9.6	9.5	9.5	9.3
EUR-NOK	9.5	9.4	9.3	9.1	9.0	8.8
USD-CAD	1.24	1.24	1.22	1.22	1.20	1.20
AUD-USD	0.76	0.76	0.77	0.79	0.80	0.79
NZD-USD	0.70	0.71	0.72	0.74	0.76	0.75

LatAm FX Forecasts

	Q2 18	Q3 18	Q4 18	Q1 19	Q2 19	Q3 19
USD-BRL	3.65	3.75	3.50	3.52	3.55	3.57
USD-MXN	20.0	18.4	18.2	18.3	18.5	18.6
USD-CLP	630	625	625	620	625	630
USD-COP	2840	2820	2800	2780	2750	2720
USD-ARS	24.6	25.8	27.0	28.1	29.2	30.3
EUR-BRL	4.45	4.65	4.41	4.36	4.47	4.57
EUR-MXN	24.4	22.8	22.9	22.7	23.3	23.8
EUR-CLP	769	775	788	769	788	806
EUR-COP	3465	3497	3528	3447	3465	3482
EUR-ARS	30.0	32.0	34.0	34.8	36.7	38.8

CEE FX Forecasts

	Q2 18	Q3 18	Q4 18	Q1 19	Q2 19	Q3 19
EUR-PLN	4.22	4.25	4.20	4.26	4.25	4.24
EUR-CZK	25.6	25.5	25.4	25.3	25.2	25.1
EUR-HUF	313	314	312	313	313	311
USD-RUB	60	67	65	66	62	62
EUR-RUB	73	83	82	82	78	79

Sources: Santander, Bank Zachodni Wbk

G10 FX: Main Themes

Currency	3M view	12M view	Main Themes
USD	⇨	⇨	• The USD has been stronger since mid-April. Political/trade issues seem less of a risk. The outlook for USD-positive rate hikes and robust US growth should keep the USD firm
EUR	↗	↗	• EUR has weakened amid renewed political risks. But, we are still positive on the Eurozone activity, and still expect the ECB to call time on its loose monetary policy, which should now support the EUR
GBP	↘	⇨	• 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	↓	↓	• 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, risks remain to the downside
CNY	↘	↘	• We expect CNY to soften in 2018 as policymakers continue to focus on controlling financial risks. Further, USD/CNY should garner support from more US rate hikes in 2018
CHF	↘	↘	• The CHF remains “high”, and 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	↗	↗	• The CAD has scope to strengthen as long as NAFTA talks are ‘successful’. A firmer oil price should help, and we still expect that the BoC will hike rates in 2018, perhaps as soon as July
SEK	↗	↗	• The SEK is still too weak in our view. 350 years after its founding, the Riksbank continues to worry about price stability, despite CPIF being close to target and solid GDP growth
NOK	⇨	↗	• Domestic data have picked up, but the secondary effects of any global trade war are risks to the NOK. CPI data are now above target, supporting the case for a NOK-positive rate hike “after the summer”
AUD	⇨	⇨	• With the RBA likely on hold until 2019, we are relatively neutral the AUD over the summer months. However, slowing Chinese GDP and a potential global trade war are both downside risks for the currency
NZD	⇨	↗	• Weak CPI data and a dovish RBNZ have weighed on the NZD in Q2-18. A firmer USD and lower NZ yields are NZD/USD negatives, but dairy prices are robust and the new government budget should be NZD supportive

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

Source: Santander.

G10 FX Overview

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The USD has strengthened a lot over the last month. The currency looks to have recoupled with fundamentals and monetary policy/interest rate spreads. The perceived boost to risk appetite, focusing on North Korea and US trade tension with China, has also helped. But after strong gains, the currency may now find it harder to move even higher in the short term.

The EUR has been under pressure . We suspect that it may be drifting into oversold territory and retain our forecast profile that envisages gradual gains in H2-18 and 2019. The re-emergence of political risk, focusing on Italy, has hit EUR sentiment, as has a revitalised USD. But, we are positive on Eurozone growth, and still expect the ECB to call time on its loose monetary policy from Q4-18.

Sterling has performed poorly since mid-April. Overall, we still see some downside pressure in GBP/USD and maintain our year end forecast for GBP/USD at 1.32. Since April, the market has woken up to UK economic data underperformance, the BoE's MPC kept rates unchanged at its May meeting and Brexit concerns have also weighed.

We are still negative on the Yen. The currency could still find some support from periods of low risk appetite, but the combination of disappointing GDP data and slower inflation should guarantee that the BoJ retains a Yen negative ultra-loose monetary policy well into 2019.

Our outlook continues to look for a stronger USD/CNY during the remainder of 2018. A stronger dollar should pull the pair higher, helped by higher US interest rates, although Chinese-US trade now appears to pose less of a risk to the CNY and the Chinese economy. However, even if trade tensions re-emerge, we still view any swift and significant depreciation of the CNY unlikely, given its potential political risks.

The negative CHF stance has been retained. EUR/CHF has weakened recently, dropping below 1.2000 as the EUR has softened. The correlation suggests that the cross again strongly depends on EUR moves to provide its direction. Hence, the SNB Vice-Chair Zurbruegg warned that the CHF is still "highly valued" and whilst demand for the CHF has weakened, the situation is fragile and could change quickly.

We are positive about the CAD, although that outlook does depend on a 'friendly' outcome to the NAFTA re-negotiations. We still expect the BoC to hike rates by the end of July, as economic growth and inflation remain firm. Further, the recent rise in the oil price should also be CAD supportive.

We remain positive the SEK and marginally bullish the NOK in 2018. Admittedly, further SEK upside in the short-term might be more limited given the significant gains in recent weeks. Concerns over inflation reduce the likelihood of a SEK-positive rate hike in 2018 and put the focus on the next few inflation prints. But, for the NOK an improving domestic economy, firm oil price, and upbeat Norges Bank helping the cross slip to 9.3 by year end.

AUD/USD has weakened over the past month, led by a drop in iron ore and coal prices and a much firmer USD. But, we stick with a neutral view on the AUD. Domestic data have been relatively mixed, but, with inflation still below target and the RBA in no rush to hike rates. We are no longer negative the NZD. The recent decline in NZD is largely due to the general USD strength, but weaker CPI data, and a more dovish RBNZ Governor, have also prompted an NZD sell off.

USD – Back to 2017

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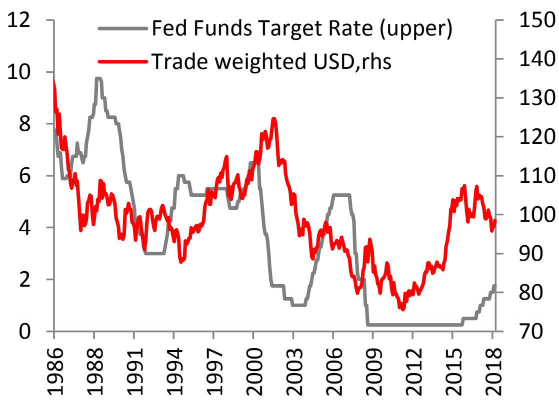
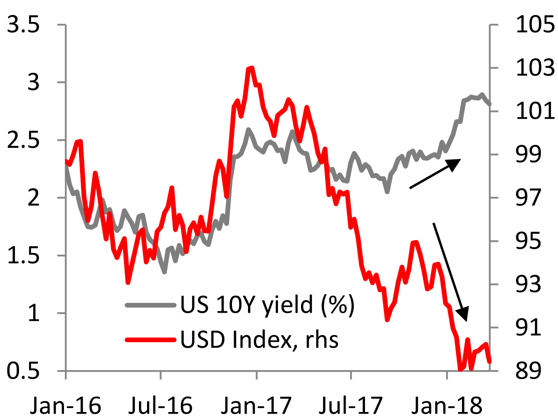
Chart 1: Fed Funds and the trade weighted USD



Source: Bloomberg, Santander

Chart 2: The USD sell off from late 2017 to mid-April, indicated a divergence from some traditional fundamental FX drivers



Source: Bloomberg, Santander

The USD has strengthened a lot over the last month. The currency looks to have recoupled with fundamentals and monetary policy/interest rate spreads. The perceived boost to risk appetite, focusing on North Korea and US trade tension with China, has also helped. But after strong gains, the currency may now find it harder to move even higher in the short term.

The USD has reversed all of its 2018 decline, with the USD index back at levels recorded in December 2017. We had suggested that the USD had been over sold since late 2017, as the market adopted far too negative a stance on it. An easing of this pessimism has helped the Greenback, but it has also been supported by specific factors affecting its most traded peers.

For example, the EUR has weakened amid renewed uncertainty about Eurozone/Italian politics. The Yen has weakened as risk appetite has improved and the market seems to have finally absorbed warnings from Japanese policymakers that there is no intention to end Japan's ultra-loose monetary policy any time soon. And, the Pound has tumbled as the BoE decided not to hike interest rates in May and Brexit concerns have re-emerged.

In addition, recently the dollar has also been bolstered by the apparent easing of trade tensions between the US and China. The market had been concerned that the implementation of US tariffs on China and other countries would spark retaliation and reduce global demand. Recall that the US wanted China to cut its trade surplus with the US by USD200bn by 2020.

Admittedly, some commentators are sceptical whether this trade truce will last. They suggest that the US reversal on these issues is due to lobbying to protect US exports to China and an effort to ensure that North Korean talks are not derailed by trade friction between the US and China. Hence, protectionism may become a USD negative issue again, but for now, at the very least, a 'trade war' appears to have been delayed.

However, the other FX issue here, is the USD's response to risk. Traditionally, the USD is viewed as a safe haven, but over the last year or so, low risk appetite has tended to prompt USD weakness with the market preferring the EUR and JPY. Thus, as US-China trade tensions have eased, the USD has strengthened, but it can be argued that the rise in risk appetite this implies, plus a more stable backdrop for global demand, should imply less need for the perceived safety of the USD.

We suspect that a large chunk of the dollar's recent rise is merely a correction to overselling late last year. The short USD trade may simply have been finally swamped by positive USD factors that had been present from late 2017 but were ignored. For example, the USD was sold aggressively even as the US economy was forecast to outperform in 2018, as the Fed hiked rates and interest rate spreads moved in the USD's favour.

Hence, in our opinion, the recent USD rally has merely corrected the misplaced USD selling. Momentum may propel the dollar even higher in the short-term, but we favour a more stable outlook, with a better global backdrop allowing other central banks, to end their loose monetary policies, and concern about the impact on US debt from tax changes to reassert itself.

EUR – Looking for support

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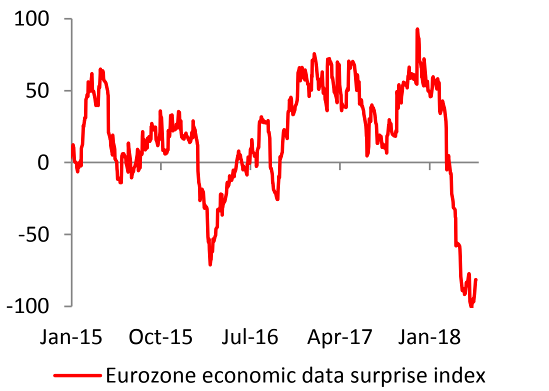
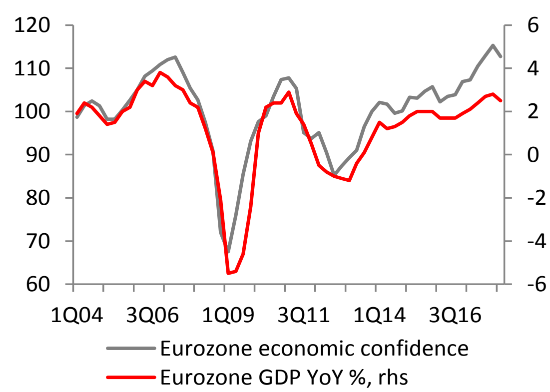
Chart 3: EUR on the back-foot as FX market finally acknowledges downside data surprises…



Source: Citi, Bloomberg, Santander

Chart 4: …but despite this, as well as a dip in economic sentiment, overall activity remains firm



Source: Bloomberg, Santander

The EUR has been under pressure over the last month. But we suspect that it may be drifting into oversold territory and retain our forecast profile that envisages gradual gains in EUR/USD into 2019. The re-emergence of political risk, focusing on Italy, has hit EUR sentiment, as has a revitalised USD. However, we are still positive on the Eurozone activity, and still expect the ECB to call time on its loose monetary policy from Q4-18, which should underpin the EUR.

Recall that the Italian general election was held on 4 March. The outcome was inconclusive, with no government formed. At the time, this uncertainty did not worry the FX market, perhaps because that might have implied a re-think of the negative USD stance that was dominant up to mid-April.

However, the formation of a new populist government, between the 5 star movement and the League has panicked markets. The Italian 10Y yield rose from 1.75% at the start of May, to 2.3%, with Italian equities losing 5% in May. The rhetoric from 5 Star/League has indicated a watering down of their market unfriendly negative stance on the EUR, but with the market more USD positive, Italian politics has become a stick with which, for now, to beat the EUR.

How long this will last is difficult to quantify, but we suspect that the currency may have drifted into oversold territory. Admittedly, speculators remain very long EUR/USD, despite reducing their positions over the last month, and this may imply further downside risks if this position is unwound further. But, assuming that the new Italian government at least brings some short-term stability, the EUR may find it easier to find some support over the coming month.

The Eurozone Q1-18 GDP data was weaker than expected. The economy grew 0.4% QoQ, but ECB President Draghi explained away the disappointing data as due to temporary factors. Further, the figure followed three quarters where growth was an impressive 0.7%. Certainly, economic data as a whole have tended to surprise to the downside in 2018, a factor that we highlighted in the last FX Compass as a reason that the EUR had been overbought.

But, whilst business confidence has slipped in recent months, overall, sentiment remains close to all-time highs and we still forecast robust Eurozone growth of 2.4% in 2018 and 2.2% in 2019. However, the EUR's gains in the early months of 2018, implied, in our opinion, that this good economic news had been priced in, with momentum and USD weakness then carrying EUR/USD into overbought territory, which has now reversed.

Similar to the Q1-18 GDP data, recent CPI figures have also surprised to the downside. In particular, core inflation slipped to 0.7% YoY in April, with headline inflation at 1.2% YoY. The decline should be temporary, although we still forecast headline CPI ending the year at a below-target 1.5% YoY. Hence, we still expect the ECB to stick to its plan to end its asset purchases in September, taper them in Q4-18 and raise interest rates at the end of H1-19. Given the market's current negative stance on Eurozone fundamentals and the EUR, as long as the bank clearly reiterates this intention over the coming months, ECB policy should, at the very least, be able to offer the currency some support.

GBP – Taking a hit

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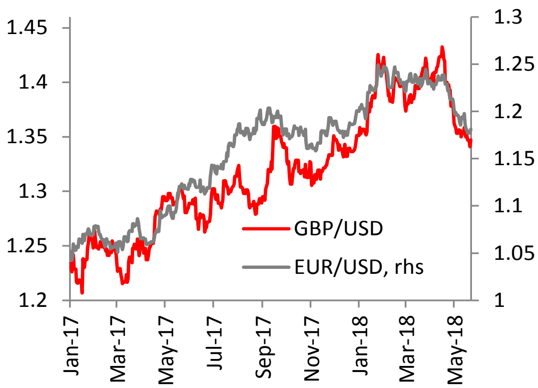
Sterling has performed poorly since mid-April. Overall, we still see some downside pressure in GBP/USD and maintain our year end forecast for GBP/USD at 1.32. Since April, the market has woken up to UK economic data underperformance, the BoE's MPC kept rates unchanged at its May meeting, Brexit concerns have also weighed and the USD has strengthened across the board.

The Pound's performance between early March and 17 April was impressive. Over that period Sterling was the best-performing developed market currency. GBP/USD hit a high of 1.4377 on 17 April, returning to levels last seen at the time of the EU referendum in June 2016. But this advance, has more than reversed since mid-April, with GBP/USD down 6% to sub 1.35 levels, with Sterling the worst performer over that period.

Chart 5: GBP/USD is still primarily a dollar story



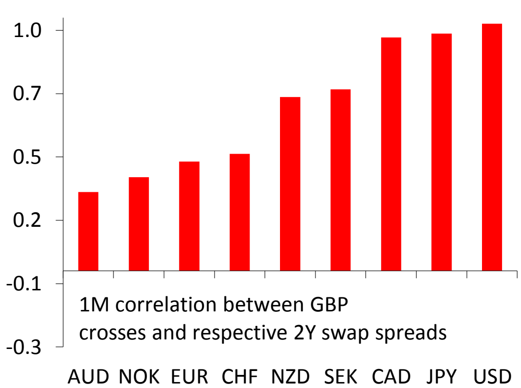
Source: Bloomberg, Santander

Whilst UK-specific factors have added to the Pound's woes, a key ingredient in GBP/USD's decline has been the recovery in the USD, whilst Sterling has been more stable against the EUR. One risk is that a market that was too negative about the USD for several months, may now be over compensating for that error by being too positive and pulling GBP/USD lower too quickly. However, beyond the USD effect there are Sterling factors that should imply further Cable weakness and risks in 2018.

The UK economic outlook remains vulnerable. Overall, UK economic data have continued to surprise to the downside. The Q1-18 GDP data were much weaker than expected, with growth at 0.1% QoQ. Admittedly, the BoE blamed poor weather and expects a quick recovery in Q2. However, the Office for National Statistics seemed to take the opposite stance, downplaying the weather's role and seeing a real threat to activity.

On the plus side, the labour market remains strong, with unemployment at 4.2% and core average earnings rising by 2.9% in March. However, headline CPI has declined since reaching 3.1% YoY in November. We expect it to fall to the 2% target by the end of the year.

Chart 6: GBP correlation with spreads. If MPC defers hike, Sterling should tumble.



Source: Bloomberg, Santander

The BoE kept interest rates unchanged in May. The market had priced in a rate hike, after hawkish MPC rhetoric since February, but a change of tune by Carney from mid-April (helping start the Pound sell-off) made it clear that the Bank was unlikely to hike.

The MPC's optimistic belief that Q1's GDP disappointment will be short-lived, together with Carney's reiteration that rates are likely to go up in the next year, means that the market is pricing around a 50% chance of a rate hike at the August MPC. But, we believe that the BoE will keep policy unchanged through 2018 and 2019.

Given that GBP/G10 crosses are currently notably correlated with their respective rate spreads at both the short and long end of the curve, a reduction in rate hike expectations should encourage a further re-positioning. Indeed, the IMM non-commercial position data show that the net long GBP/USD position, which peaked in mid-April (as Cable reached its 2018 high) has now been completely unwound.

Finally, with Sterling sentiment more vulnerable, Brexit concerns may now pull the Pound lower. The market may become more negative if sufficient progress on talks between the UK and EU is not apparent at the EU Summit in Sofia on 28-29 June.

JPY – Downside pressures should remain

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We are still negative on the Yen. The currency could still find some support from periods of low risk appetite, but the combination of disappointing GDP data and slower inflation should guarantee that the BoJ retains a Yen negative ultra-loose monetary policy well into 2019.

Risk appetite is likely to remain an important driver of the JPY over the coming month. In Q2-18 the market appears to have become a little more relaxed about the effect of US protectionism and events involving North Korea on risk appetite. This has been reflected in the Yen's performance. In Q1-18, when the market was more concerned about these issues, the safe-haven JPY gained over 5% against the USD. So far in Q2-18, this has been reversed, with the Yen losing around 5% against the USD.

The Q2 performance can also be evidenced by a more stable equity market, itself a proxy for risk. We have argued in the past that USD/JPY appears undervalued (i.e. the Yen too expensive) given the relative strength of equities. However, much of the divergence between the pair and stocks appears due to the market overselling the USD in 2017, a move which now partly appears to be getting corrected.

The correlation between USD/JPY and the Nikkei between Jan-11 and Jan-17 was an expectedly strong 0.96. But, in 2017, that plummeted to 0.27. So far in 2018, the relationship has reasserted itself, with the correlation rising back to 0.86. Hence, as long as stocks remain firm, there is less chance of the Yen strengthening.

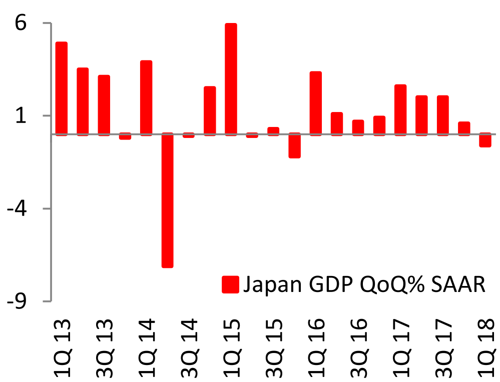
The economic data is beginning to look a little more Yen negative. The Q1-18 GDP data surprised to the downside, as growth contracted by 0.2% QoQ and Q4-17 data were revised lower, to just +0.1% QoQ from +0.4%. Policy makers and most economists blamed temporary factors for the downturn and still assume that activity will pick up in the remainder of the year.

But, the data represented the first contraction in activity for over two years, and, with concerns about global demand remaining, the pick-up in Japanese activity may prove more sluggish than previously expected. On the plus side, surprisingly strong earnings data for March may signal support for private consumption. Cash earnings rose 2.1% YoY in March, which was the biggest rise since 2003, helped by a 30% jump in bonuses, although basic pay still increased a respectable 1.3% YoY.

However, more strong earnings data will be needed to have a sustainable positive effect on inflation. The headline CPI rate dropped to 0.7% YoY in April, from 1.1%. In mid-May, Governor Kuroda warned that uncertainty surrounding the inflation outlook remained and that the 2% target remained a distant one.

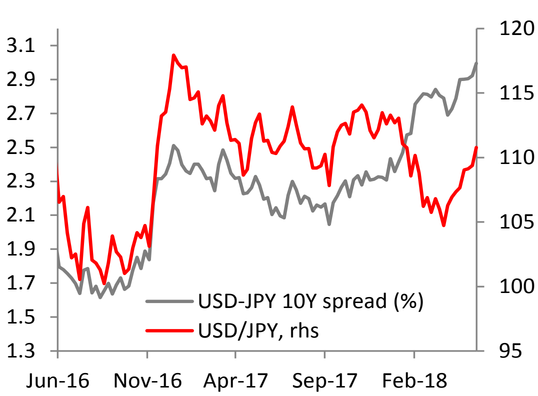
Given this, it is very unlikely that the BoJ will exit its loose monetary policy any time soon. Indeed, Kuroda highlighted that it should not even think about changing its policy of targeting the 10Y JGB yield at around 0%, even though he admitted that the target would not be kept no matter what. Hence, with US yields above 3% and Japanese yields anchored around zero, upside pressure on USD/JPY should continue. USD/JPY has been moving in line with US-JPY 10Y spreads since mid-February.

Chart 7: Japan's moderate recovery?



Source: Bloomberg, Santander

Chart 8: BoJ remains committed to targeting JGB yields around 0%, which should imply a stronger USD/JPY



Source: Bloomberg, Santander

CNY – A slow descent

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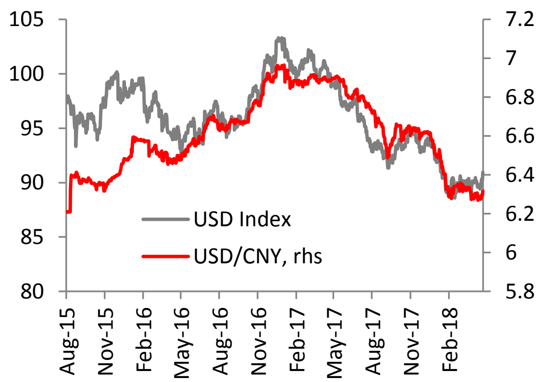
We still expect USD/CNY to strengthen in 2018. A stronger dollar should pull the pair higher, helped by higher US interest rates, although Chinese-US trade now appears to pose less of a risk to the CNY and the Chinese economy. However, even if trade tensions re-emerge, we still view any swift and significant depreciation of the CNY unlikely, given its potential political risks.

The CNY has weakened since mid-April. The rise in USD/CNY is primarily due to general dollar strength. However, the increase in the daily USD/CNY fixing levels may suggest that a softer CNY is viewed as a useful cushion against concern over exports, given recent and softer Chinese activity.

Chart 9: CNY and the USD



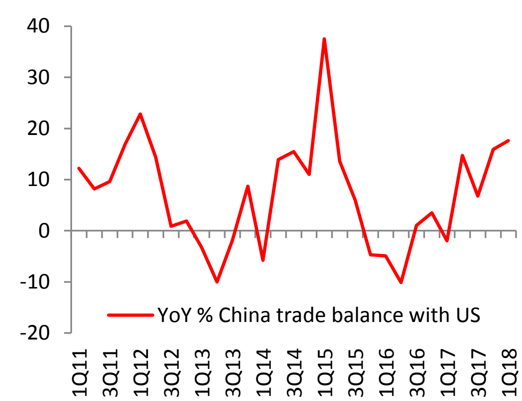
Source: Bloomberg, Santander

Either way, it appears that the 2018 low around 6.24, which implied a return to the levels recorded in August 2015, before the CNY was devalued, should now offer very strong support. The trade tensions between China and the US seem to have eased recently, as both parties have adopted a more conciliatory tone. But a more US protectionist stance is likely to remain a lingering threat for the CNY over the forecast horizon.

The Chinese current account actually recorded a deficit in Q1-18, for the first time in 17 years. However, this was explained away as due to seasonal factors. April trade data showed another surplus, with exports to the US up 9.6% YoY and accounting for 18% of total exports. Admittedly, the April PMIs did suggest slower export orders going forward. This may signal a dilemma for China's policymakers: on the one hand they need to placate US demands for a smaller trade surplus; and, on the other, they are trying to contain any adverse effect on activity from slower export growth.

Despite these pressures, economic data is holding up, and still tending to surprise to the upside. The economy grew by 6.8% YoY in Q1-18, and the market consensus expects it to grow by 6.5% in 2018 vs 6.9% in 2017. However, industrial profit figures showed that the growth rate in March was just 3% YoY, the slowest since 2016. Slower factory inflation and holidays may explain the decline, but the risk that trade issues and the effort to reduce debt could still negatively affect activity suggest policymakers could be more willing to support the economy.

Chart 10: Chinese trade with the US



Source: Bloomberg, Santander

The problem for Chinese policymakers is that if that support is seen to focus on allowing the CNY to weaken to help exports, it will be criticized by the US. That said, upside USD/CNY risks should continue to dominate, due to US factors, in particular the solid US economy and the expected Fed rate hikes, with the next one forecast for June. Otherwise, support is likely to continue to focus on supporting liquidity, even if in the short term this contradicts China's efforts to reduce its overall debt burden, and, by extension, financial risks.

For example, aggregate financing, the broadest measure of new credit, increased by CNY1.56trn in April, a larger increase than expected. New loans were also higher than forecast. In addition, the one-month Libor rate remains low, at around 3.8%, with a steeper yield curve suggesting to analysts that the central bank is tolerating looser liquidity. Moreover, recall that the PBoC reduced the reserve requirement ratio by 1% for some banks on 28 April.

CHF – Still highly valued

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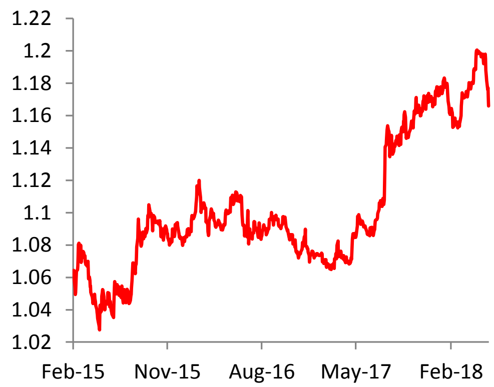
Chart 11: EUR/CHF



Source: Bloomberg, Santander

We are still negative on the CHF. Admittedly, EUR/CHF has weakened recently, dropping below 1.2000 as the EUR has weakened across the board. The correlation suggests that the cross still strongly depends on EUR moves to provide its direction. Hence, the SNB Vice-Chair Zurbruegg warned that the CHF is still "highly valued" and whilst demand for the CHF has weakened, the situation is fragile and could change quickly.

Hence, we expect the SNB to stick with its loose monetary policy (the deposit rate stands at -0.75%) well into 2019, and also maintain its willingness to intervene, if necessary, to counter CHF strength. The economic backdrop remains upbeat, with the SNB expecting growth of 2% in 2018 after 1% in 2017. Inflation remains low, but is rising. However, positive Swiss fundamentals are not necessarily CHF positive as growth remains supported by a better Eurozone/global outlook, which has the net effect of tending to pull the EUR and other currencies higher against the CHF.

Elsewhere, keep an eye on the Vollgeld 'Sovereign Money' referendum on 10 June. The vote focuses on preventing commercial banks from creating money through lending. If the 'yes' side is successful, it would imply a significant change to Swiss finance and increase CHF uncertainty. The knee-jerk response to a Yes vote should be negative, given the risks to banking. Also the SNB has warned this would prevent it using intervention to weaken the CHF. Opinion polls suggest that the motion will not be carried, and, even if it is, will take time to be implemented. Either way, there might be some extra CHF volatility around the time of the vote.

CAD – Upside potential lingers

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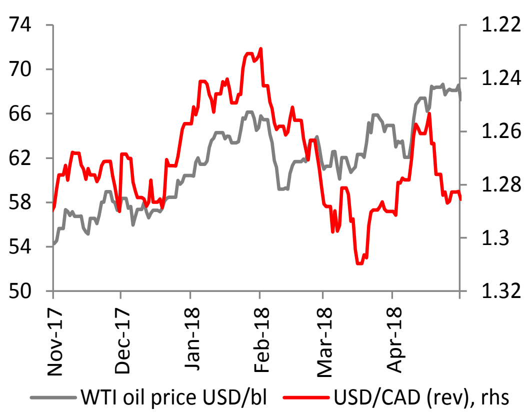
Chart 12: A brighter trade outlook, possible rate hike and oil prices favour a firmer CAD



Source: Bloomberg, Santander

We are still positive about the CAD, although that outlook does depend on a 'friendly' outcome to the NAFTA re-negotiations. In addition, we still expect the BoC to hike rates by the end of July, as economic growth and inflation remain firm. Further, the recent rise in the oil price should also be CAD supportive.

It is essential for our CAD positive view, that NAFTA talks conclude 'successfully'. If they do, the boost this should give to sentiment, should still allow the BoC to hike rates later this year, probably as soon as its July meeting. The BoC maintained a robust outlook for the Canadian economy in its April Monetary Policy Report, but a lot of this still depends on a benign global backdrop. The Bank revised up its full-year growth forecasts for 2018 and 2019, to 2.1% and 2%, from 1.8% and 1.7%, respectively.

Admittedly, very weak home sales in April, the worse for 5 years, may spark concern that the market cannot yet handle a rate hike, on top of new restrictive mortgage lending criteria. But, with headline CPI staying above the 2% target in April, there remains scope for rates to rise from the current 1.25%.

In addition, elements of US foreign policy remain a double-edged sword for the CAD. The US withdrawal from the Iran nuclear agreement could increase global risks and effect global demand, but it has also boosted the oil price. The correlation between the CAD and oil has weakened over the last year or so, but if WTI pushed further above USD70/bbl, it should at least limit downside pressure on the currency.

SEK – The world's oldest central bank turns 350

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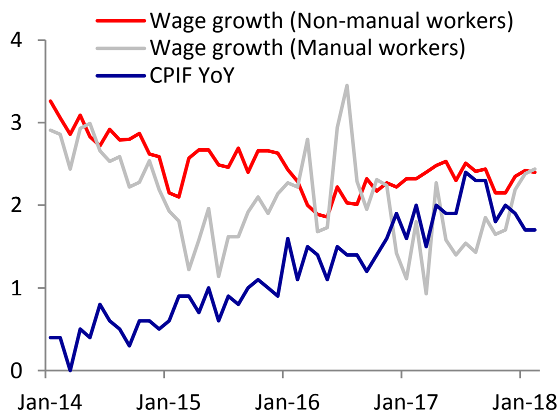
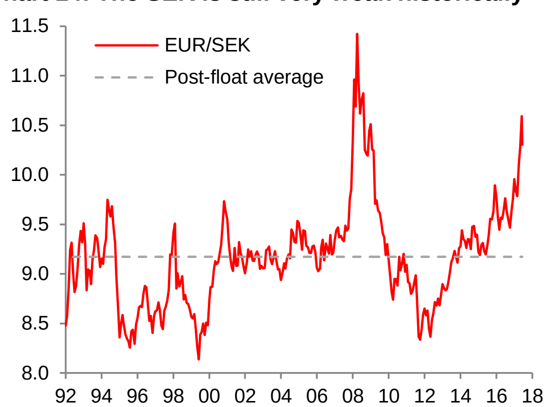
Chart 13: While CPIF data are only just below target, the Riksbank is concerned that wage growth and inflation expectations are too low



Source: Bloomberg, Santander

Chart 14: The SEK is still very weak historically



Source: Bloomberg, Santander

We remain positive the SEK in 2018, but acknowledge that further SEK upside in the short-term might be more limited given the significant gains in recent weeks. The Riksbank turns 350 this month, but, just as it did when it was founded, it continues to worry about price stability. Concerns over inflation reduce the likelihood of a SEK-positive rate hike in 2018 and put the focus on the next few inflation prints. We continue to forecast EUR/SEK dropping to 9.6 by year end.

In 1656, Sweden's first bank, Stockholms Banco, was founded. After a few years, cheap foreign imports of copper forced the Crown to increase the size of copper coins to maintain their value relative to silver. These newer heavier coins were cumbersome to carry, so the bank issued banknotes, and guaranteed them with coins on demand. While initially a success, a rapid increase in the number of banknotes led to the notes losing value, and the public becoming suspicious and demanding to redeem their banknotes for coins. As the Bank had issued too many notes in relation to the value of copper coins deposited, it went bankrupt.

While a failure, there was demand for such a Bank, and hence, with the nobles, the clergy and the burghers as principals, the Riksens Ständers Bank (the Riksbank) was born in 1668. Right from the start, one of Bank's tasks was to maintain price stability. Between 1668 and 1897, the law included a clause on price stability, saying the Riksbank was to "maintain the domestic coinage at its right and fair value".

The Riksbank, the world's oldest central bank, turns 350 on Friday, 25 May. The Bank continues to worry about price stability, with its mandate developing into an inflation target, which changed earlier this year, to keep annual CPIF inflation around 2%.

While the Bank has done a relatively good job of maintaining this target over the past 12 months (Chart 13), it has grown wary of risks of below-target inflation. The Executive Board of the Bank was again notably dovish at its meeting in late April. The Bank's cautious stance on rates now questions the likelihood of a rate hike at all in 2018.

Indeed, while Deputy Governor Ohlsson thinks a September rate hike is still possible, the other members of the board are less optimistic, as they do not want to risk what the Bank has achieved in respect to helping inflation rise towards its target. This suggests that a Q4-18, or even 2019, hike is more likely.

We still consider the SEK as excessively weak given that CPIF data are close to target and GDP growth was above 3% in Q4-18. In fact, despite the c.4% drop since its May high, it is still very high historically (Chart 14). However, the Executive Board have moved the goalposts to an extent on its target, noting that underlying inflation, inflation expectations and wage pressures are not yet high enough for a rate hike.

Hence, the Bank, and the market, are set to focus on the data, with key dates in the coming weeks including the release of the Q1-18 GDP data (30 May), CPI data for May (14 June) and the next Riksbank meeting (3 July).

NOK – Trade risks

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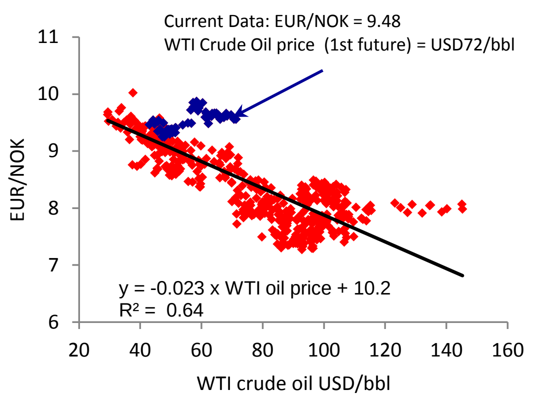
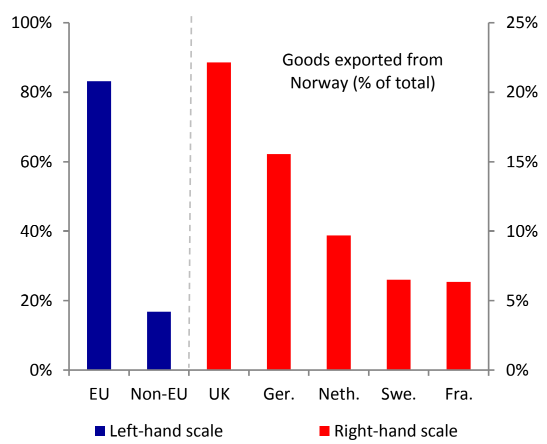
Chart 15: EUR/NOK is still ignoring oil data



Source: Bloomberg, Santander. Data as at 22 May 2018

Chart 16: While Norway trades predominately with the EU, the government is worried about the secondary effects of trade tariffs



Source: Statistics Norway, Santander. Note: Data for 2017

We remain marginally bullish the NOK in 2018, but are relatively neutral the currency for the remainder of H1-18, with EUR/NOK close to our 9.5 Q2-18 forecast. We continue to foresee an improving domestic economy, firm oil price, and upbeat Norges Bank helping the cross slip to 9.3 by year end.

Domestic data in Norway have been relatively upbeat over the past month. Retail sales and PMI data were strong, beating expectations, the unemployment rate declined once again and headline CPI data rose to 2.4%. In addition, a pick-up in exports helped the quarterly mainland GDP print beat estimates, with the Q4-18 data also revised higher, to 0.7% QoQ. Petroleum activities also saw a 1% gain in Q1-18, but the NOK has failed to reflect this improvement, with the currency little changed in recent months and EUR/NOK holding predominately in a 9.5-9.7 range since early January.

In fact, for a country so reliant on its petroleum exports, it is surprising that the oil price, historically such a strong indicator for the NOK, has been going in the opposite direction to the currency. EUR/NOK and WTI crude (1st future) prices have shared a strong correlation of -0.80 over the past 10 years (See red dots in Chart 15). However, over the past year EUR/NOK has diverged from its longer-term relationship with oil (See blue dots in Chart 15), with the NOK weakening, despite oil prices rallying by almost 70%.

We continue to see the NOK as oversold and believe robust oil prices will eventually provide support for the currency. Indeed, while the NOK remains weak historically, Norway has been benefiting from the recovery in oil prices. In mid-May, the government suggested that for 2018, it would reduce the amount of oil wealth that it uses to fill its structural non-oil deficit. The government expects to withdraw just NOK21bn from its Sovereign Wealth Fund to plug this deficit, down from an estimated NOK72bn in its first budget in October 2017.

A notable risk to the NOK currently is trade. Indeed, Norway is a small, open economy, reliant on its trading partners. In mid-May, Prime Minister Solberg warned that Norway was increasingly worried about being caught in the crossfire of a US-European trade war. Its EEA membership puts it inside the single market but outside the EU customs union, leaving it potentially exposed to external trade battles. Indeed, Norway has not received the temporary exemption from US tariffs on steel and aluminium that the EU has. As most of Norway's exports go to the EU, Solberg highlighted that her main concern was the secondary effects of tariffs (increased tensions on trade, new types of tariff barriers etc.).

The development of these potential trade risks will certainly be a focus for the NOK in the coming weeks. Assuming that these risks do not escalate though, the May CPI data (11 June) and the Norges Bank meeting (21 June) should lead the currency. So long as Governor Olsen continues to suggest that the Bank will hike rates "after the summer", it should keep the NOK supported, and ensure EUR/NOK does not stray far from 9.5.

AUD – Steady as she goes

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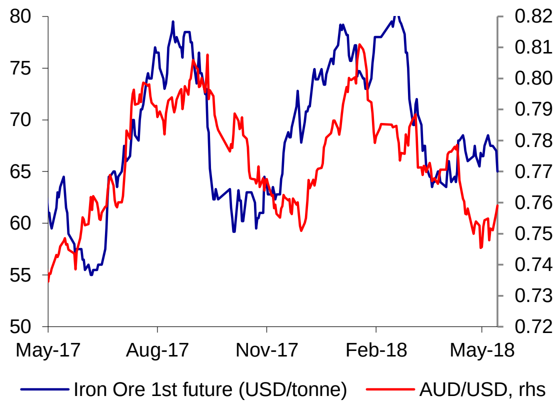
We are still neutral the AUD. AUD/USD has weakened over the past month, led by a drop in iron ore and coal prices and a much firmer USD. Domestic data have been relatively mixed, but, with inflation still below target and the RBA in no rush to hike rates, we continue to foresee AUD/USD holding close to 0.76 in Q2-18 and Q3-18.

Chart 17: The decline in iron ore prices has weighed on the AUD in recent months

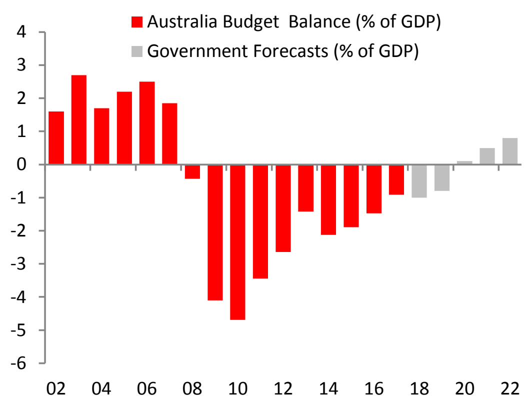


Source: Bloomberg, Santander

AUD/USD has had a tough few months, weakening to an 11-month low in early May, at below 0.7450. As has been the case with most USD pairs between mid-April and mid-May, a strong USD has been guiding AUD/USD lower. But, the AUD was already falling before this USD move, with weaker iron ore prices weighing on the currency throughout Q1-18. However, improved sentiment over US-China trade in recent days has helped support iron ore prices, and could offer the AUD some short-term support, having managed a small rebound in AUD/USD in late-May.

The Australian government released its 2018/19 budget in early May. It now expects to reach a surplus in fiscal year 2019/20, a year earlier than forecast previously (Chart 18). An improving fiscal balance should ensure that S&P follows Fitch ratings, which earlier this month affirmed Australia's 'AAA' rating. Australia remains one of only nine countries to retain a 'AAA-rating' from all three of the main rating agencies.

Chart 18: The Australian government is expecting to return a fiscal surplus in fiscal year 2019/20



Source: Australia Treasury, Bloomberg, Santander

The government's other forecasts are also relatively upbeat. It upgraded nominal GDP estimates to 4.25% for this financial year (3.5% previously) and now sees the pace of wage growth at 3.25% in FY2020 and 3.5% in FY2021 (2.1% currently).

However, there are plenty of suggestions that these forecasts are overly upbeat, and that it might not be a coincidence that such a positive outlook is occurring in the year before the Federal elections. Indeed, GDP growth has failed to reach even 3.5% in the past five years. Further, wage growth in other developed market economies has not risen as much as hoped, despite very low jobless rates and the erosion of spare capacity.

In fact, in the RBA's Statement on Monetary Policy at the start of May, the Bank noted that the unemployment rate is little changed since mid-2017 (in fact, after rising to 5.6% in May, it is completely unchanged since May 2017). The Bank says this implies that there is still spare capacity in the labour market, with the unemployment rate around 0.5pp above conventional estimates of full employment. Hence, wage growth is unlikely to rise too quickly until this spare capacity is eroded away.

With the unemployment rate little changed, GDP well below 3%, and CPI still below the RBA's 2-3% target range, there is no significant pressure on the RBA to hike rates any time soon, even if it has already indicated that the next direction is likely to be up. As such, we see limited impetus to pull the AUD significantly higher in the short term and we remain neutral the currency over the summer months.

However, while the RBA is unlikely to hike in 2018, we expect it to raise rates before the RBNZ and still see more scope for a relative repricing down of the NZ vs AU expectations, and hence remain constructive AUD/NZD.

NZD – Losing its yield

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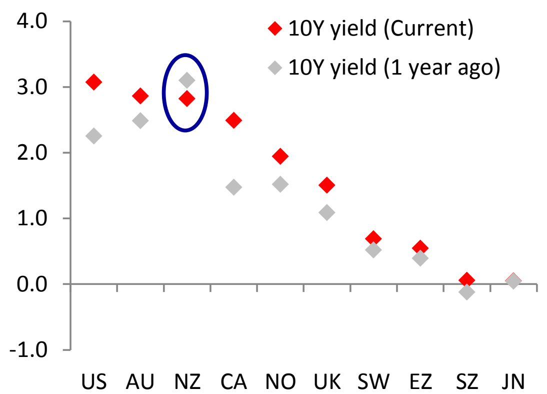
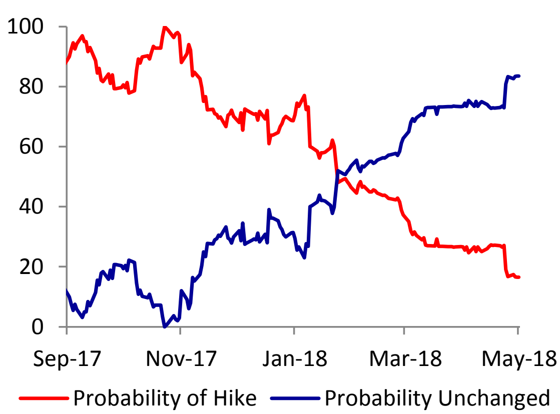
Chart 19: Developed market yields have mostly risen over past year, but not in New Zealand



Source: Bloomberg, Santander

Chart 20: The market had all but priced in a 2018 rate hike by Q4-17, but the chances of such a move have declined ever since



Source: Bloomberg, Santander. Note: Data shows probability of each rate outcome for 8 November 2018 RBNZ meeting using interpolated overnight index swaps. Probability of a cut is priced as 0%.

We are neutral the NZD in the short term. Indeed, with NZD/USD declining by around 6.5% since its 0.74 April high, to its 0.68 May low, we are no longer negative the currency. This decline is largely due to the general USD strength over the past month. However, weaker CPI data, and a more dovish RBNZ Governor, have also prompted NZD weakness. The next inflation print will be key for the NZD, but the Q2-18 data are not released until July. Hence, we continue to see NZD/USD ending Q2-18 at 0.70.

After a quiet few months, the USD rallied between late April and early May, weighing heavily on all the other developed market currencies. NZD/USD flirted with the 0.74-level throughout Q1-18, but has fallen to a 2018 low in May, at below 0.70, led by the firmer USD. With the FOMC expected to continue tightening monetary policy, the USD should remain a negative for the pair. However, it was not just USD strength that prompted this move.

With annual headline CPI data for Q1-18 dropping to 1.1%, the very bottom of the RBNZ's 1-3% target range, the NZD weakened. The market was understandably unsure of the exact stance Governor Orr would take at the 9 May RBNZ meeting, given that it was his first as head of the RBNZ as well as the Bank's first with the new dual mandate targeting both CPI and unemployment (see RBNZ: New Governor, New mandate, No rate change, published 3 May). But the rhetoric of the new governor was more dovish than many had been expecting. While he highlighted there is "no rush to move rates in either direction", he said a rate cut was a "valid possibility".

The new governor seemed content with the NZD level, but was clear that monetary policy needs to be expansionary for some time to lift inflation. The Bank's forecasts show headline CPI remaining below 2% until Q4-20. Governor Orr also said that he wants core inflation to pick up before raising rates. Using the RBNZ's own "sectoral factor model", core inflation stood at 1.5% in Q1-18, not high enough to warrant a rate hike.

Market pricing implied a 2018 rate hike by the RBNZ was all but guaranteed 12 months ago, but this pricing now attributes only a 20% chance of a hike this year. The deteriorating prospect of a 2018 rate hike can be seen in New Zealand's bond yields, which have fallen over the past 12 months at both the short- and long-end of the curve.

This contrasts sharply with other developed markets, where improving sentiment, growth and central bank rhetoric have raised the prospect of higher rates (Chart 19). Further, while New Zealand's 10Y debt has been the highest yielding among the G10 currency economies for most of the past 18 years, it lost its top spot to the US in mid-March, and also dropped below the AU 10Y in early May.

The NZD remains at risk from lower domestic yields, but the currency has probably fallen enough for now. Indeed, domestic data generally remain good, dairy prices remain relatively robust, and the government's budget, released in May, should be NZD supportive, as it not only increased spending, but also forecast a higher budget surplus over the next few years.

LatAm FX: Main Themes

Currency	3M view	12M view	Main Themes
BRL	↓	→	• We revised upward our forecast for the Selic rate to 6.50% p.a. for year-end 2018. • Our baseline scenario for BRL at 3.5 per US dollar at year-end 2018 assumes 10-yr treasury yields not far from 3%. • We see BRL under depreciation pressure in the short term. BRL stabilization and, maybe, some strengthening depend on stabilization of global markets and the reduction of domestic risks.
MXN	→	↗	• The level of stress across local asset prices looks stretched, with local bond yields trading near their highest levels of the past year, and thus the risk-reward asymmetry has improved. • MXN remains highly sensitive to a NAFTA deal, which in turn faces time constraints. We remain bullish on NAFTA and see a very low probability of termination. • Pre-election volatility is likely to increase in the final laps of the race. AMLO continues to be the front-runner with a comfortable double-digit lead, but undecided voters at 25% make the outcome uncertain.
CLP	→	→	• We expect the CLP to follow the general USD trend, with a positive bias vs EM peers, thanks to its more solid fundamentals. • Conditioned to global USD gyrations, copper should be a positive driver for the CLP, based on the idea of a strong global economy, fading trade tensions, and good medium-term prospects for the red metal. • Medium term, the “honeymoon” period of the new government should phase out, which is CLP negative.
COP	→	↗	• We expect high oil prices to become supportive of a stronger COP. • Higher U.S. yields and a stronger USD imply pressure on the COP. • Presidential elections to be held on May 27; polls suggest center-right candidate Ivan Duque will progress to the second round and will face leftist candidate Gustavo Petro in the run-off.
ARS	↘	→	• Traders and analysts are discussing alternatives to the recent FX strategy launched by the Central Bank. Some clues in favour of abandonment of the ARS25/USD cap can be seen in the persistence of EM volatility. • By contrast, incoming financing from the IMF might tempt the economic authorities to keep the cap at the current level, until the moment an agreement with the Washington based creditor is signed.

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

Source: Santander.

BRL – The end of an easing era

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We recently raised our forecast for the Selic rate to 6.50% p.a. for year-end 2018, but we are maintaining our forecast at 7.5% for the Selic rate at year-end 2019. At its most recent meeting, the monetary authority highlighted the more challenging global scenario and, specifically, the change in the normalization of interest rates in some advanced economies. In its post-decision statement, it signaled it would maintain the policy rate at 6.5% p.a. at its upcoming meetings.

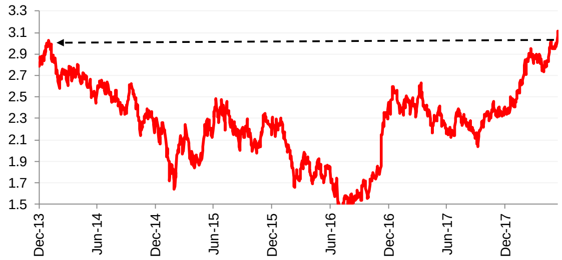
We maintain our call that the Central Bank will be able to continue an easing stance for a longer period. However, it is worth noting that the length of the stimulative monetary policy will depend on BRL behaviour, among other fundamentals. In the last Copom decision, its baseline scenario forecast inflation running at 4% in both 2018 and 2019, assuming the BRL at 3.60 per US dollar and the Selic rate at 6.5% p.a., which, in our opinion, implies international markets stabilizing around current levels (i.e., the US yield curve stabilizing at the current level).

Our forecast for BRL at year-end 2018 has been 3.5 per US dollar since last year, based on the assumption of a stronger US dollar in international markets, and coupled with higher risk aversion and risk premiums.

Our econometric estimates continue to indicate that BRL behaviour is most determined by global financial conditions. The most important factors defining BRL variations are the prices of commodities (CRB); the value of the USD against major currencies measured by the DXY; global risk aversion (VIX); and interest rate differentials (DI 1-yr minus Fed Fund 1-yr). The correlation between the CRB Index and BRL is negative, which means an upward trend in the CRB tends to indicate an appreciation in BRL, while the correlation between the DXY Index and BRL is positive, so an upward trend in the DXY tends to indicate a depreciation in BRL. The relationship between the VIX Index and the BRL is positive; and finally, the relationship between the interest rate differential and BRL is negative, so a decrease in the interest rate differential will produce a depreciation in BRL.

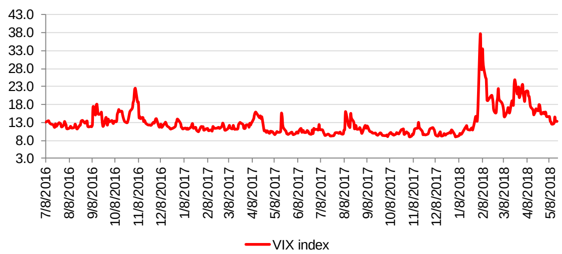
We have highlighted that the historical reduction of carry trade (interest rate differential) would imply a depreciation trend for the BRL. In addition, expectations regarding global monetary policy, and more specifically US policy, have changed, producing a significant adjustment in global currency realignment, where the emerging countries' currencies are more impacted given that they are high beta. That said, we should expect BRL to remain volatile as long as international markets remain volatile. **Our baseline scenario for BRL at 3.5 per US dollar at year-end 2018 assumes 10-yr treasury yields not far from 3%. In our view, the current BRL level above 3.5 is a response to international market volatility, the uncertainties surrounding the upcoming elections, and the risk premium in the event of a continued postponement of fiscal reforms. Therefore, we may see BRL under pressure in the short term. We foresee BRL strengthening toward year-end with global market stabilization and the reduction of domestic risks.**

Chart 21: US 10-yr Treasury Bond Yield



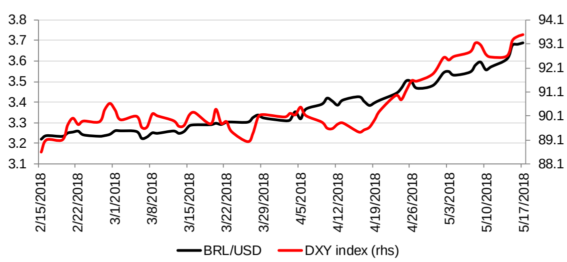
Sources: Santander, Bloomberg.

Chart 22: VIX Index



Sources: Santander, Bloomberg.

Chart 23: DXY Index versus BRL/USD



Sources: Santander, Bloomberg.

MXN – Risk-reward asymmetry has improved

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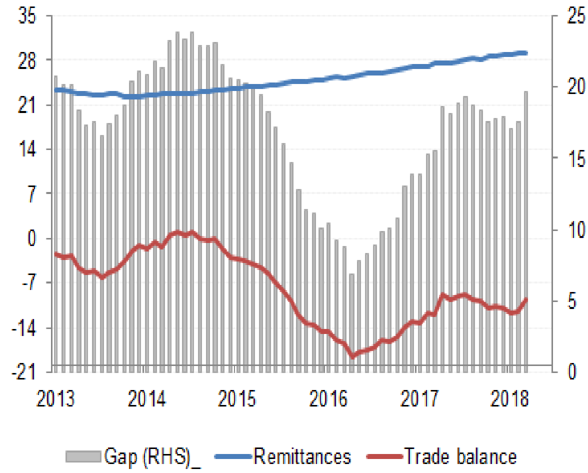
The deterioration in financial conditions across the emerging world since our last FX Compass a month ago has been noteworthy and has pushed market participants into recalculation mode while questioning the soundness of fundamentals. In the case of Mexico, all assets have performed poorly, but the extent of the recent correction is more extreme in the case of local bonds. Indeed, 30yr yields are approaching the 8% handle featuring a lot of contamination from MXN weakness. In general, we judge that the negative news from both external (repricing in USD and higher US yields) and idiosyncratic drivers (NAFTA resolution and the July 1 election) has already been priced in unless another unexpected negative story unfolds. Notably and despite this unfavourable combo, capital inflows (from both the real and financial side) have shown a gradual but constant improvement over the last 6-8 months. Indeed, the gap between remittances and the trade balance has improved to near MXN20bn (12-month sum, top chart). Meanwhile, holdings of MBonos positions by foreign investors surpassed MXN200bn (cumulative since the US presidential election in November 2016).

Moreover, since the aforementioned drivers have been running in parallel and also have a circular impact, a clear breakdown of the overall negative toll is complicated. Still, a first conclusion is that the asymmetry of the risk-reward for the Mexican peso has improved, and the attractiveness of the carry (high real rates ex-ante now at 3.4%) will have a stronger influence ahead. Additionally, the recent market correction has allowed some cleaning-up of market positioning as captured by net long MXN contracts(IMM non-commercial stock), which were slashed almost by half to 35% of the all-time peak. Forward points are quite high, but the level of the fear factor in the market (risk reversals) is actually quite low.

Is NAFTA a more systemic risk for Mexico than the election? That is another interesting debate. Judging by the price action, MXN and NAFTA news has been more highly correlated than MXN and political risk. A NAFTA 2.0 deal must happen soon in order for the US Congress to approve it, and the most contentious items (tough standards for content in autos, sunset clause, and trade resolution scheme) hold the keys to unlock the current impasse. MXN could see additional stress if NAFTA goes into limbo or talks are postponed until next year, given its political implications (new Mexican president and Senate and new US Congress will define it); however, this is not as negative as some people believe, since we expect NAFTA 1.0 to prevail.

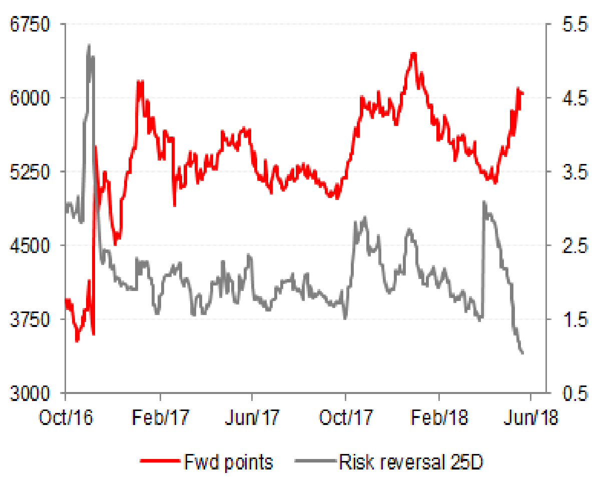
MXN performance relative to selected EM peers and liquidity/volatility conditions are what Banxico will stand for in the market. Additional support to MXN, including discrete FX intervention or new hikes, has low probability, in our view, in the context of broad USD appreciation. So, unless a new systemic event unfolds, we believe Banxico will remain on the sidelines and MXN should stabilise around 19.75 short term.

Chart 24: Real (activity) inflows have firmed



Sources: Santander, Bloomberg.

Chart 25: MXN hedging cost up, fear factor down



Sources: Santander, Bloomberg

CLP – Still Digesting New Global USD Conditions

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Since mid-April, the CLP has been steadily depreciating vs. the USD, following the general trend seen in FX markets as of late. In a context of high volatility, the USDCLP rate scratched the 640 level earlier this month, but at the closing of this report, the market is hovering below the 630 mark. During this global USD rally, the peso tended to be among the worst performing currencies, posting a 7% loss in the three weeks to May 18, vs. the 4-6% declines seen in other key DM and EM pairs, even though copper prices held on reasonably well (around US$3.05/lb). Most of the CLP slide was triggered by foreign investors, with local corporates and pension funds first on the sidelines, and mildly following the trend thereafter.

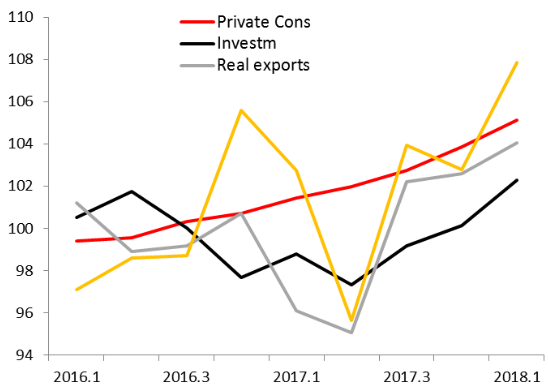
On the growth front, the March IMACEC index came out at 4.6% y/y, in line with consensus, pushing the 1Q18 GDP reading to a solid 4.2% y/y, the fastest pace in five years. Although the non-mining sector is expanding at a more modest 3.1% y/y, the laggard industries of the last few years (construction, machinery & equipment, non-mining exports) are showing signs of steady improvements. Market sentiment on growth should remain positive for some time longer, as 2Q18 GDP is likely to be above 4% y/y (also pushed by a positive base-year effect). That said, there seems to be some room for disappointment in 2H18, as growth rates should decline to 3% y/y or less, closing the year around 3.5%, per our estimates.

Regarding inflation, April CPI surprised on the upside (+1.9% y/y, vs. consensus at 1.7%), but mainly on specific items, such as energy and transportation. This surprise, plus the CLP slide of the last few weeks and the consistent increase in global fuel prices, led to an upward adjustment in inflation expectations. As per the inflation forwards market, 2018 CPI inflation is now discounted at 2.8% y/y, +30 bps vs a month ago.

Regarding monetary policy, May's BCCh meeting reaffirmed previous guidelines: rates will remain unchanged until inflation shows clear signs of convergence toward the 3% target, and this is likely to happen in early 2019, in our view. The minutes of this meeting were neutral but supported the view that the BCCh will not embark on preemptive rate hikes to keep FX or financial conditions under control. The rates market is now discounting 40 bps of hikes in 2018 and 110 bps in 2019, to 4%, which, in our view, is excessive, especially for this year. This path seems to be consistent with a large and persistent CLP depreciation in coming months, which is not our most likely macro scenario.

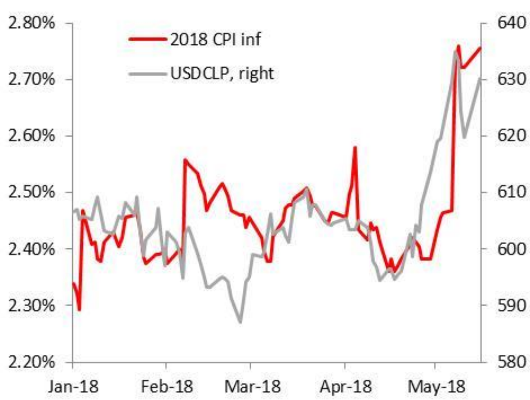
Net/net, the short-term CLP outlook will continue to hinge mostly on global USD gyrations. Keeping that in mind, based on copper prices and other fair-value metrics, we believe that the recent change in global USD conditions, as of today, justifies a jump in the USDCLP rate of 20-25 pesos, to 625-630, which may become a new pivot level (vs. the former 605). We maintain our call that the local component should remain neutral or CLP positive, given Chile's good fundamentals in the EM universe. 620-645 seems to be a reasonable fluctuation range for USDCLP in upcoming weeks.

Chart 26: GDP components, s.a. levels



Source: Santander, Bloomberg

Chart 27: 2018 CPI inflation as per inflation forwards market



Source: Santander, Bloomberg

COP – Presidential Elections Ahead

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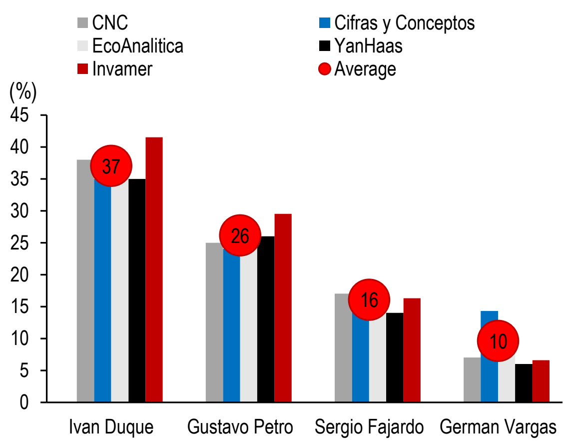
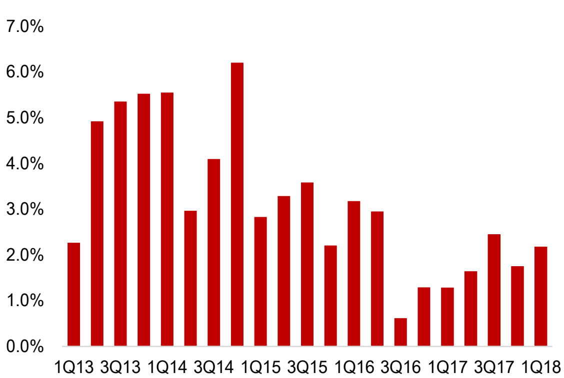
Chart 28: Polls point to a run-off between Duque and Petro



Source: CNC, Cifras y Conceptos, EcoAnalitica, YanHaas, Invamer, Santander, Bloomberg

Chart 29: GDP growth improves in 1Q18



Source: DANE, Santander, Bloomberg

Since our last FX Compass (published April 27), the COP has depreciated 2.1% following the recent strengthening of the USD, which, as measured by the DXY index, appreciated 2.4% in the last three weeks. Despite this recent depreciation, the COP remains the best-performing currency in LatAm and EM markets as the continuing rise of oil prices remains supportive. In effect, since our last publication, the price of Brent oil has increased 5.8%, reaching $79/bbl as of this writing, as the geopolitical risks in the Middle East remain and as U.S. authorities announced further sanctions on Venezuela.

Moving forward, we expect oil prices to remain at high levels in the short term as geopolitical tensions in the Middle East are likely to continue. While high oil prices are supportive of stronger COP, we recognize that COP's trend is highly conditional on the performance of the USD,

In addition to external factors, the presidential elections, to be held on Sunday May 27, should be a key driver in the short term. The most recent polls from May 17-19 continue to show Ivan Duque, center-right candidate, in the lead with around 37% of vote intentions. Polling in second place is Gustavo Petro, the leftist candidate, with 26% support. Compared to the polls from April, support for center-left candidate Sergio Fajardo and center-right candidate German Vargas Lleras has improved, but they remain in distant third and fourth places, respectively. Polls suggest that Duque will not gain the support necessary (50% +1 vote) to win in the first round and would face Petro in a run-off on June 17.

As discussed in our report *Colombia Economics: Presidential Elections Are Near* (May 17), polls in Colombia have failed to accurately predict the outcome of recent elections and we would not rule out the possibility of surprises. One potential surprise could be that two center-right candidates progress to the second round, as suggested by a recent study from Cifras y Conceptos, where its probabilistic model that accounts for not only poll results but also the results of the legislative election, held on March 11, suggests that Duque will face Vargas Lleras instead of Petro in the second round.

Both polls and polymetric studies suggest that a center-right candidate would become the new president, implying the continuation of orthodox macroeconomic policies in Colombia, in our view.

In terms of growth, 1Q18 GDP results confirm that the economy continues to recover, albeit at a slow pace. Real GDP expanded 2.2% in 1Q18, up from the 1.8% y/y reported for 4Q18. Sequentially, the economy expanded 0.7% q/q (s.a.), up from the +0.5% q/q (s.a.) in 4Q17. On the demand side, consumption continues to be the main driver, expanding 1.4% q/q (s.a.). In contrast, investment continues to pressure the economy, contracting 4.8% q/q (s.a.). In all, we view these results as in line with our GDP forecast of 2.5% y/y in 2018.

ARS – How long will the Central Bank be offeringUSD5bn at ARS25/USD in Siopel screens?

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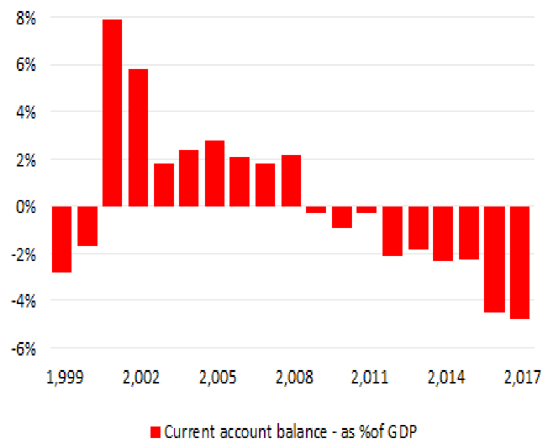
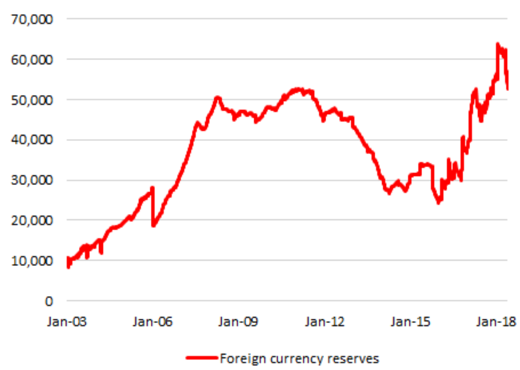
Chart 30: Current account balance - as % of GDP



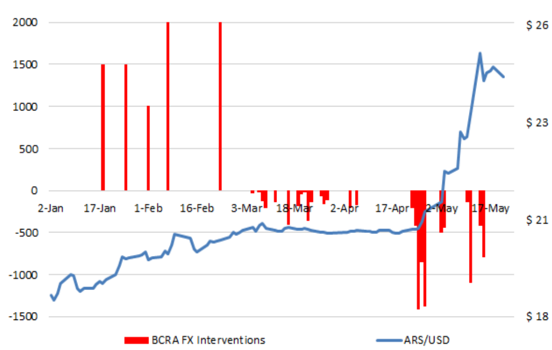
Sources: Central Bank and Santander.

Chart 31: Foreign currency reserves – US$ million



Sources: Central Bank and Santander.

Chart 32: CB 2018 FX interventions



Sources: BCRA and Santander.

Traders and analysts are discussing alternatives to the recent FX strategy launched by the Central Bank (BCA). Bear in mind that the current account deficit is approaching the equivalent of 5% of GDP, and the IMF will likely favour the reversal of a multi-year widening trend through a more competitive multilateral real exchange rate - REER -.

Some clues in favour of abandonment the ARS25/USD cap can be seen in the persistence of EM volatility, with the JP Morgan EM FX Index reflecting 2.1% depreciation since April 30, while the USD – as reflected by the Bloomberg dollar index – has appreciated around 1.9% in the last 30 days.

Both trends make it difficult for the BCA to maintain a cap on the USD quote for a long period of time. After a more than 30% nominal depreciation of the peso YTD, the country has an annual inflation rate above 25% and still rising.

On the domestic side, incoming financing from the IMF might tempt the economic authorities to keep the cap at the current level, until the moment an agreement is signed. Unfortunately, the Standby arrangement is unlikely to be signed soon; our more likely scenario assumes that at least another four weeks of negotiations will be necessary prior to finalization of the agreement.

Year to May 16, the Central Bank's net FX intervention was US$1.8bn, derived from US$8.0bn purchases from the Treasury made in January and February, which were more than offset by US$10.1bn Central Bank sales made between March 6 and May 16.

If international volatility does not recede and further foreign exchange reserves are spent through new interventions, we can expect the Central Bank to change its strategy, lifting both the ARS25/USD fix USD ceiling and the US$5.0bn daily offered, while keeping its commitment to sell USD in the FX market to smooth abrupt quotation variations.

Central Bank foreign exchange reserves were at US$54.4bn on May 17, according to the BCRA web page, or only 1% lower than on December 29.

Such an amount includes the US$2.7bn proceeds from the Treasury's issuance of ARGTES23 and ARGTES26 collected on Thursday 17 May and the outflows made by Banco Nación USD sales on 17 and 18 May, presumably on behalf of the Treasury.

Net/net: Should global volatility affecting EMs persist, we expect the abandonment of the current US dollar ceiling at ARS25/USD as well as the disappearance of the Central Bank US$5bn daily offer. Alternatively, the Central Bank intervention in the market might persist until a final agreement with the IMF is confirmed. The high volatility affecting EMs, the still wide current account deficit in the balance of payments and limited FX reserves, lead us to this conclusion.

CEE FX: Main Themes

Currency	3M view	12M view	Main Themes
PLN	⇨	⇨	• We think the zloty might recover a bit in the short run, provided that the dollar appreciation pauses on the global market, as the economic headlines in Poland are still pretty good. We see some upside risk to our 2Q forecast, but think the exchange rate could ease slightly below 4.30 in the weeks to come.
CZK	⇨	↗	• Volatility that has emerged on the EM market has also had some adverse impact on the koruna. GDP data also generated some pressure on the currency. • EUR/CZK has been moving pretty in line with our expectations and so we leave our forecast unchanged. However, after the recent macro data we see some upside risk to the expected exchange rate path.
HUF	↗	↗	• We expect a slight forint appreciation in the next month, mainly thanks to the anticipated improvement of Hungarian macro data and partly due to the relaxation of geopolitical tension.
RUB	↘	⇨	• In the next month, we expect a slight and temporary strengthening of RUB against USD owing to higher oil prices and expected stronger readings for industrial production, exports, and the PMI indexes for May and June. Thus, we revise our 2Q18 target to 60 from 65.

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

Source: Bank Zachodni WBK.

PLN – Time to recover

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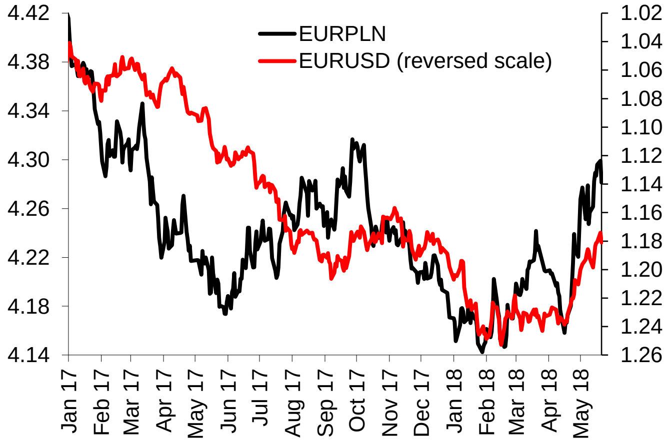
Chart 33: EUR/PLN and EUR/USD



Source: Reuters, Bank Zachodni WBK.

Last month, we titled this section "Only a temporary appreciation" referring to the March/April zloty gains and this proved pretty accurate, as the following weeks saw a sharp rise of EUR/PLN to 4.31 from c4.20. The zloty was pressured by the dollar's appreciation amid thin liquidity on the Polish market at the end of April/beginning of May.

We think the zloty might recover a bit in the short run, as the economic headlines in Poland are still pretty good, and provided that the dollar appreciation pauses on the global market. Still, we see some upside risk to our 2Q forecast (4.22) but think the exchange rate could ease to slightly below 4.30 in the weeks to come.

The zloty depreciated more than many of its EM peers during the general currency sell-off in early May, which might have been due to the lower liquidity on the Polish market and the fact that the zloty gained so much in 2017 and now may be more sensitive to any spikes in global market volatility.

GDP growth held close to 5% at the beginning of the year (5.1% in 1Q18, according to the flash estimate), but we expect the economy to decelerate in the quarters to come (to 4.5% in 2Q and 4.3% on average this year). Recall, that the zloty is a cyclical currency and slowing growth is likely to limit the room for a lower EUR/PLN later in the year. However, the deceleration should not be sharp and the upcoming data should remain quite decent. Moreover, with 4.3% GDP growth this year, we estimate, Poland is likely to be one of the EU's top performers with a balanced current account and good fiscal metrics. These factors should limit the room for the zloty depreciation and the currency might recover somewhat in the weeks to come. Recent European data did not look too encouraging and any signals that this is not having a negative impact on Polish economic activity (yet?) might be positively received by investors.

April's CPI rose by 1.6% y/y, in line with the flash reading, up from 1.3% y/y in March. In our view, inflation will continue to climb and may temporarily surpass 2.0% in mid-2018, but will retreat below this level at the end of the year. With CPI below the official target (2.5% y/y), the Monetary Policy Council should feel comfortable and, in our view, will not change rates until the end of 2019. At the same time, the ECB and the Fed should be on track for monetary policy normalization, which could also make it more difficult for the Polish currency to appreciate.

CZK – Poor data weigh

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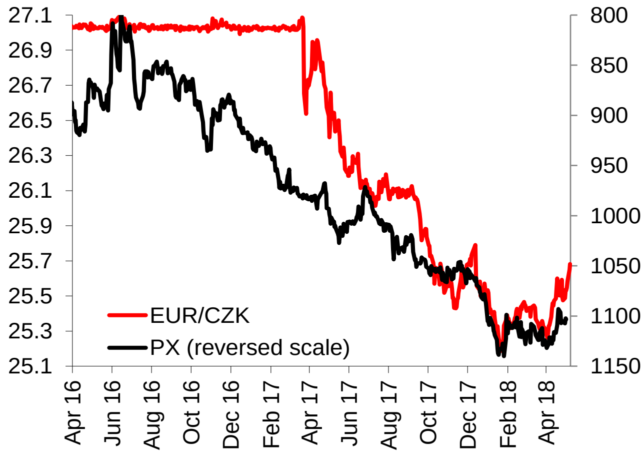
Chart 34: EUR/CZK and PX Prague stock index



Source: Reuters, Bank Zachodni WBK.

Volatility that has emerged on the EM market has also had some adverse impact on the koruna, pushing EUR/CZK temporarily up to c25.82. Some pressure on the Czech currency also came from GDP data.

EUR/CZK has been moving pretty closely in line with our expectations and so we are keeping our forecast unchanged. However, after the recent macro data, we see some upside risk to the expected exchange rate path.

The first estimate of 1Q GDP showed a deceleration to 4.5% y/y from 5.5% y/y in 4Q17, below the consensus of 4.7% y/y. Also, April industrial output disappointed with the annual figure at -1.1%, its lowest since mid-2016, and the manufacturing PMI fell for the third month in a row. According to Czech central bankers, one more 25bp rate increase is still on the agenda later this year, but if upcoming data are also weak, the market may start delaying its expectations of a hike, limiting the room for the koruna to strengthen.

Czechia has taken a small step towards establishing a government after the October 2017 parliamentary elections. The ANO party and the Social Democrats (SD) signed an initial agreement that still has to be approved by the SD's lawmakers. Results may be known in mid-June, but even if the coalition is formed, this will be only a minority government with 93 votes in 200-seat parliament, thus requiring support from other parties to pass bills. In our view, progress in constituting a government is rather unlikely to provide much of a positive boost for koruna.

HUF – Pressured by geopolitics

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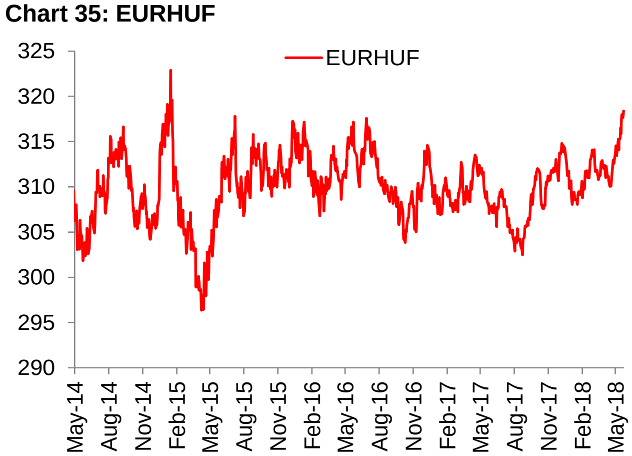
Chart 35: EURHUF



Source: Reuters, Bank Zachodni WBK.

We expect a slight forint appreciation in the coming month, mainly thanks to the anticipated improvement of Hungarian macro data and partly to the relaxation of geopolitical tension.

During the last four weeks, EUR/HUF has been rising, together with the other CEE currencies. The HUF weakening was driven by higher geopolitical tensions (the trade war between China and the US, the US sanctions on Iran) and their potential impact on EU countries. Unlike at the turn of the year, there were no positive surprises in the macro data. Figures published were mixed: on the one hand, we saw an improvement in the trade balance, retail sales and GDP; but on the other hand, the PMI and manufacturing data were surprisingly weak. As a result, EUR/HUF rose to 317.90, from 312.50 month ago.

Looking ahead, we expect a slight reversal and a decline of EUR/HUF next month, supported by better macro data. We expect a clear improvement in manufacturing (benefiting from seasonal factors) and no further strong declines in PMI. As a result, we expect EUR/HUF to return to levels close to 313-314. The central banks' stated intention to maintain interest rates at the current level and continue its accommodative monetary policy, also using non-standard tools, should have no effect on the market.

RUB – Oil to the rescue

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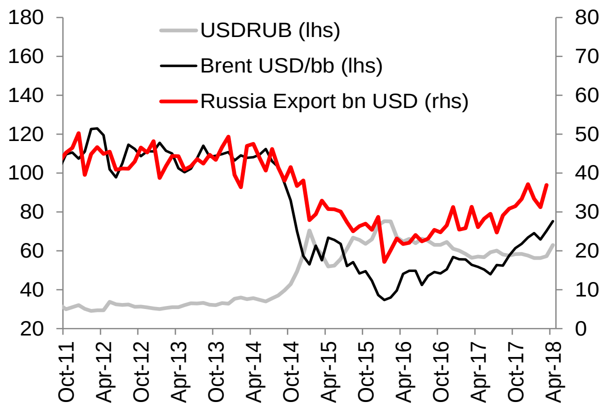
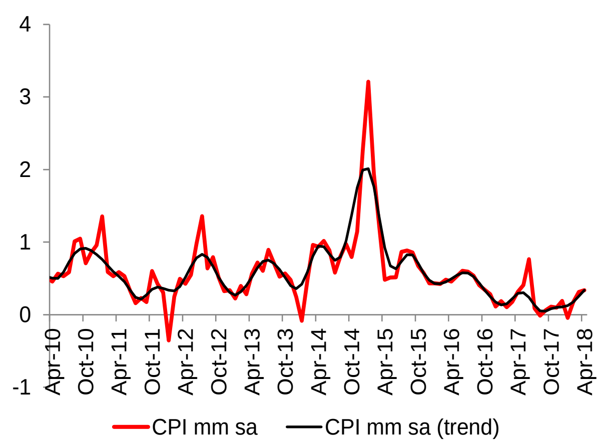
Chart 36:Oil prices, export and USD/RUB



Source: Reuters, Bank Zachodni WBK.

Chart 37: Russia CPI (% m/m)



Source: Reuters, Bank Zachodni WBK.

In the next month, we expect a slight and temporary strengthening of RUB against USD, owing to the expected higher readings of industrial production, exports, and the PMI index for May and June, and higher crude prices. Thus, we revise our 2Q target to 60 from 65 (see Forecast Table on page 3).

After the sharp sell-off at the end of April, USD/RUB has jumped to 63.90, its highest since November 2016. The ruble strengthened in May, driven by better import and export data (and a trade surplus). Also the April inflation numbers – the third consecutive reading to show a rise – have pushed FRAs up, which supported the Russian currency. The strengthening of the ruble was only temporarily interrupted by another rise in geopolitical tensions resulting from the US sanctions imposed on Iran. By the end of May USD/RUB had returned to the levels of late April.

We believe that the recent sharp weakening of the ruble against the US dollar (above 65 RUB per USD) was prompted in part by US sanctions on Russian aluminum companies and US and Chinese moves in their on-going trade dispute. The risk of further sanctions may pressure the Russian currency for another two to four quarters, in our view.

Still, we see a possibility of USD/RUB dropping temporarily below 60 on the back of better macro data, helped by higher oil prices. Since the end of March, the Brent price rose by cUSD10, to nearly USD80/bbl, which should quickly translate into an increase in the USD value of Russian exports. Furthermore, we believe that the weaker ruble will lead to a better sentiment in Russian industry, which should be reflected in higher PMIs. Additionally, the ruble may receive a temporary boost from the June football World Cup, expected to have a short-term positive effect on the Russian economy.

Some transitional support for the ruble may also come from an increase in inflation and the resulting rise in market interest rates. At the beginning of the year, the Russian central bank saw the optimum rates at 6%-7% and cut interest rates to 7.25% in March. Until March, the markets were pricing-in further rate cuts to 6.50% this year. However, after the US sanctions were imposed, the FRA6X9 rates increased to about 7.30%-7.50% and have remained at this level since then, which suggests that investors do not believe there will be any more easing before the beginning of next year.

In our view, after 2Q18 the ruble may weaken again, due to geopolitical issues, but a more persistent USD/RUB drop should be possible in mid-2019, when better exports (supported by expensive oil) should outweigh negative geopolitical factors.

G10 FX: IMM Speculative Positioning

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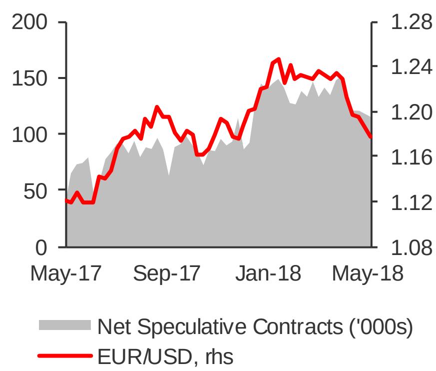
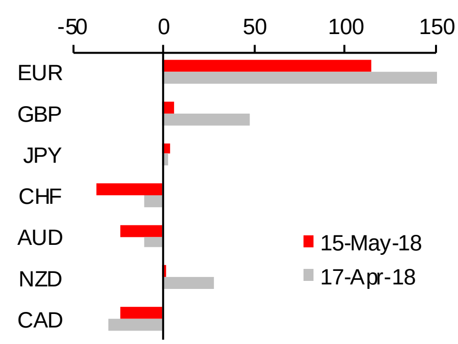
IMM commitment of traders report: EUR/USD position



- **Speculators have reduced their net long EUR stance,** with last month's all-time -high position, at 151.5k contracts, falling to a 2018-low, at 115k contracts, in the week ended 15 May. This move has contributed to a weaker EUR over the past month and a further unwinding of this still large net long position could yet weigh further on the single currency.
- **Net short USD composite position continues to unwind,** reaching -96k contracts in the latest data, from a five-year low, of -280k contracts just a month ago. There is still scope for this USD negative position to unwind further. But, given the large USD gains so far in Q2-18, any move may be more limited.
- **The improved USD view has weighed on the positions of the other currencies.** The spec market has increased its net short CHF and AUD positions, although its JPY position is largely unchanged and the CAD position is less negative.
- **The spec market has turned neutral GBP and NZD** with a lower likelihood of a BoE rate hike causing the net GBP position to drop from 48k contracts a month ago, to 6k contracts. A more dovish RBNZ also pushes the prospect of a rate hike further into 2019, with April's large net long NZD position now fully unwound.

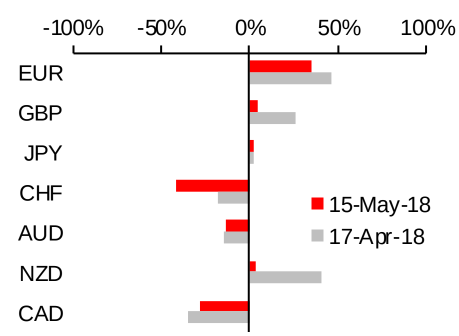
Net Speculative Contracts ('000s)*

	15-May-18	17-Apr-18	4w chg	YtD chg
USD***	-96.0	-280.2	184.2	-98.7
EUR	115.1	151.5	-36.4	23.0
GBP	5.6	47.7	-42.1	-7.1
JPY	3.7	2.6	1.1	119.8
CHF	-36.4	-10.5	-25.9	-22.5
AUD	-23.1	-10.2	-13.0	-9.5
NZD	2.0	27.6	-25.7	19.5
CAD	-23.7	-30.3	6.7	-41.0



Net Speculative Contracts as % of Open Interest**

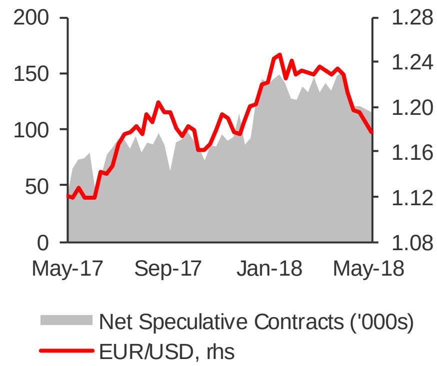
	15-May-18	17-Apr-18	4w chg	YtD chg
USD***	-9%	-26%	17%	-9%
EUR	36%	46%	-11%	7%
GBP	5%	27%	-22%	-4%
JPY	3%	3%	0%	60%
CHF	-41%	-17%	-24%	-24%
AUD	-14%	-15%	1%	1%
NZD	4%	41%	-38%	36%
CAD	-28%	-35%	7%	-54%



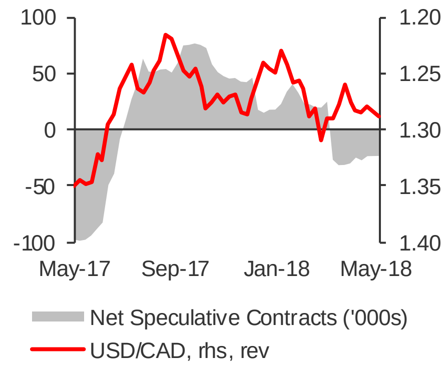
Sources: CFTC, Bloomberg, Santander. Note: *Net Speculative Contracts = Long non-commercial traders contracts minus short non-commercial traders contracts, **Open Interest = The total number of outstanding long and short futures contracts, ***USD composite index = USD composite index uses AUD, CAD, CHF,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

G10 FX: IMM Speculative Positioning

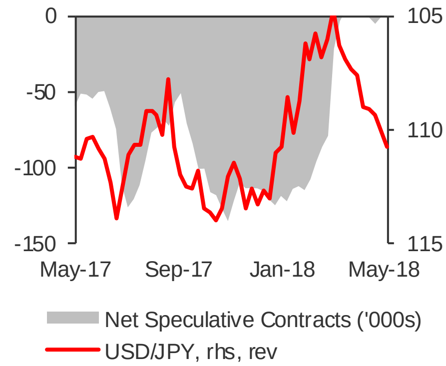
EUR/USD



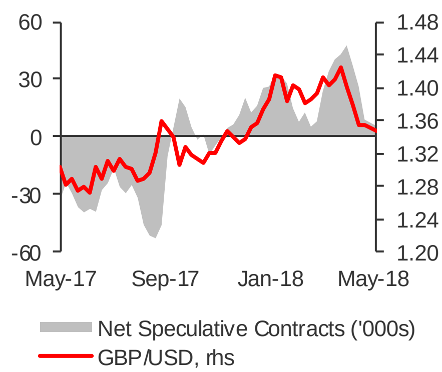
USD/CAD



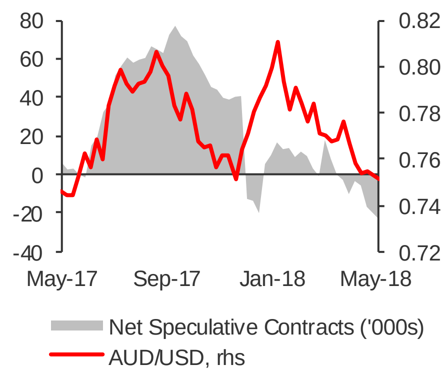
USD/JPY



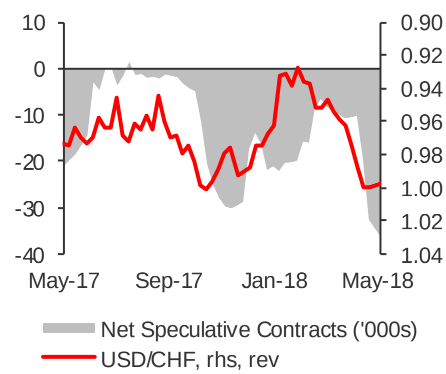
GBP/USD



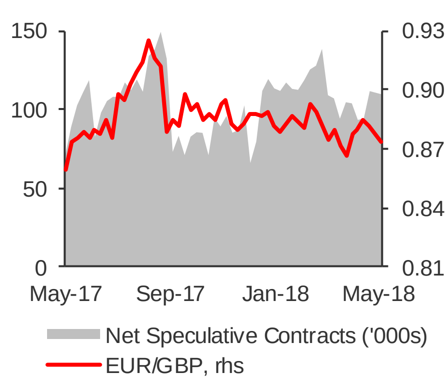
AUD/USD



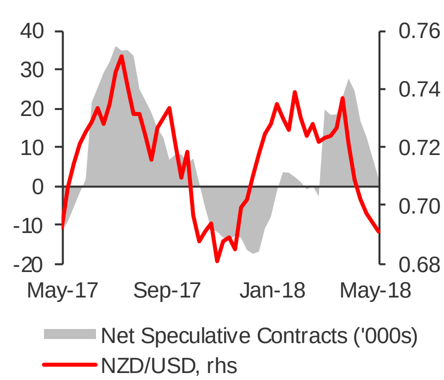
USD/CHF



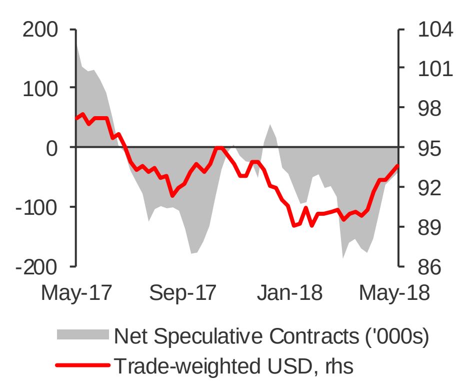
EUR/GBP



NZD/USD

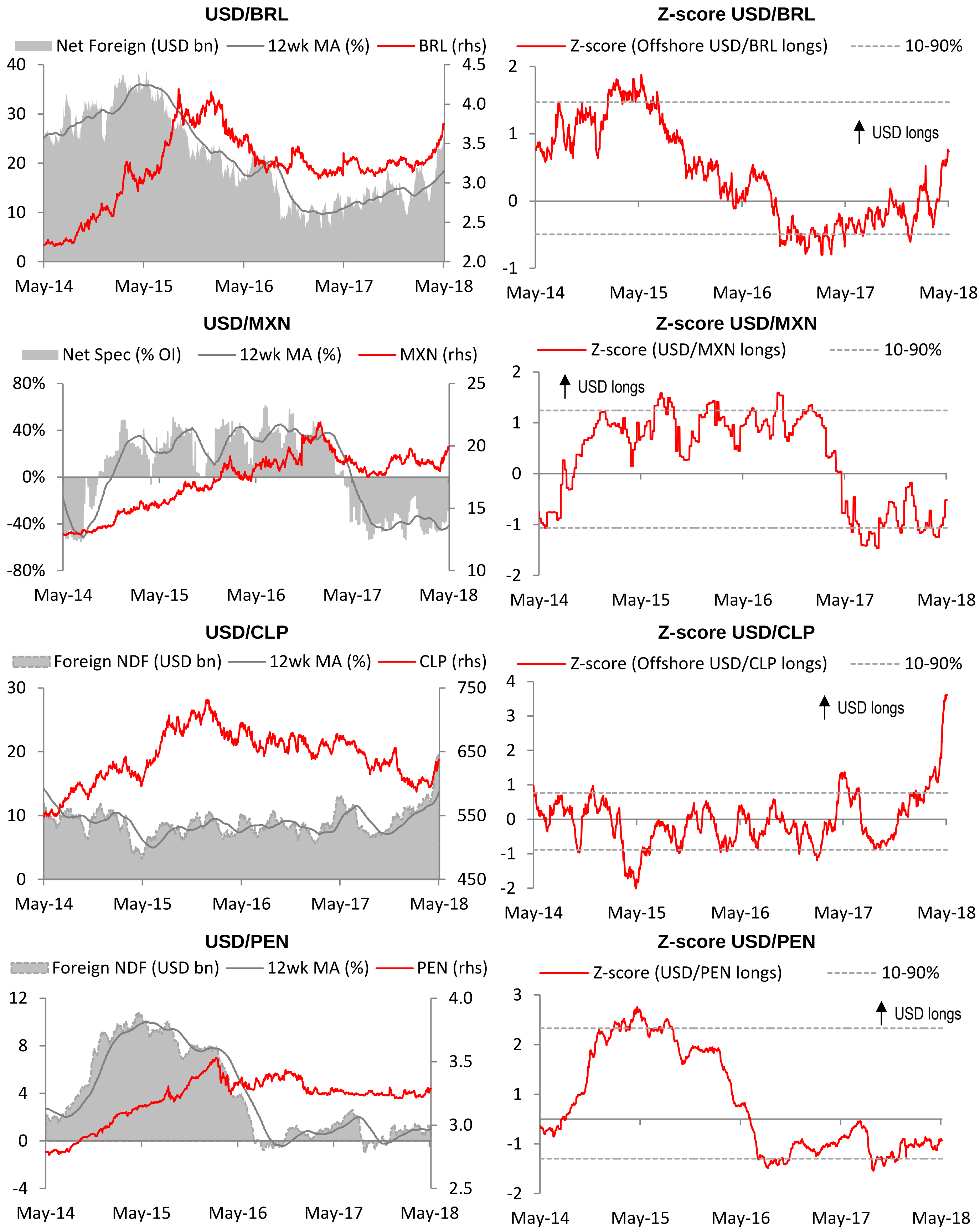


USD minus MXN



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

Latin America FX: Positioning indexes (Z-scores)



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

Euro Interest Rate Forecasts

Government Bond yield Forecasts

Germany	Current	2Q18	3Q18	4Q18	1Q19
ECB Depo	-0.40	-0.40	-0.40	-0.40	-0.40
3m	-0.59	-0.70	-0.70	-0.60	-0.55
2y	-0.57	-0.45	-0.30	-0.15	-0.10
5y	-0.12	0.05	0.25	0.35	0.50
10y	0.52	0.65	0.80	0.95	1.15
30y	1.23	1.30	1.40	1.50	1.70

Swap rate forecasts

Euro	Current	2Q18	3Q18	4Q18	1Q19
ECB Depo	-0.40	-0.40	-0.40	-0.40	-0.40
3m	-0.32	-0.33	-0.33	-0.33	-0.27
2y	-0.14	-0.05	0.10	0.20	0.25
5y	0.38	0.50	0.65	0.75	0.85
10y	1.01	1.10	1.20	1.35	1.50
30y	1.59	1.60	1.65	1.75	1.95

US Interest Rate Forecasts

Government Bond yield Forecasts

US	Current	2Q18	3Q18	4Q18	1Q19
FOMC *	1.75	2.00	2.00	2.25	2.50
3m	1.91	1.90	2.00	2.25	2.50
2y	2.52	2.55	2.70	2.85	3.10
5y	2.84	2.85	3.00	3.15	3.40
10y	3.01	3.00	3.10	3.25	3.45
30y	3.17	3.15	3.25	3.40	3.60

Swap rate forecasts

US	Current	2Q18	3Q18	4Q18	1Q19
FOMC *	1.75	2.00	2.00	2.25	2.50
3m	2.33	2.40	2.10	2.55	2.70
2y	2.76	2.55	2.60	2.85	3.10
5y	2.94	2.75	2.85	3.10	3.30
10y	3.04	2.85	2.90	3.15	3.35
30y	3.07	2.90	2.95	3.15	3.35

UK Interest Rate Forecasts

Government Bond yield Forecasts

UK	Current	2Q18	3Q18	4Q18	1Q19
MPC	0.50	0.50	0.50	0.50	0.50
3m	0.47	0.40	0.40	0.45	0.45
2y	0.79	0.65	0.40	0.50	0.55
5y	1.15	1.00	0.80	1.00	1.20
10y	1.45	1.60	1.40	1.60	1.70
30y	1.88	1.90	1.90	2.10	2.20

Swap rate forecasts

UK	Current	2Q18	3Q18	4Q18	1Q19
MPC	0.50	0.50	0.50	0.50	0.50
3m	0.62	0.60	0.55	0.55	0.55
2y	1.03	0.95	0.80	0.80	0.95
5y	1.38	1.25	1.15	1.30	1.50
10y	1.63	1.70	1.50	1.70	1.80
30y	1.73	1.70	1.60	1.70	1.80

G10 Central Bank Calendar

	Current Rate	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
FOMC (Upper)	1.75	Unch.	-	+25bp	-	Unch.	13	-	1	26	-	8	19
ECB (Depo)	-0.40	Unch.	-	Unch.	Unch.	-	14	26	-	13	25	-	13
BoE	0.50	-	Unch.	Unch.	-	Unch.	21	-	2	13	-	8	20
BoJ	-0.10	Unch.	-	Unch.	Unch.	-	15	31	-	19	31	-	20
SNB	-0.75	-	-	Unch.	-	-	21	-	-	20	-	-	13
BoC	1.25	+25bp	-	Unch.	Unch.	Unch.	-	11	-	5	24	-	5
RBA	1.50	-	Unch.	Unch.	Unch.	Unch.	5	3	7	4	2	6	4
RBNZ	1.75	-	Unch.	Unch.	-	Unch.	27	-	8	26	-	7	-
Norges Bank	0.50	Unch.	-	Unch.	-	Unch.	21	-	16	20	25	-	13
Riksbank	-0.50	-	Unch.	-	Unch.	-	-	3	-	6	24	-	19

Source: Bloomberg, Santander. Note: Current levels as at 24 May 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	2Q18	3Q18	4Q18	1Q19
SELIC	6.50	6.50	6.50	6.50	6.50
NTNF Jan' 19s	6.56	6.60	6.90	6.80	6.80
NTNF Jan.' 25s	10.26	10.50	11.00	10.50	10.50

Government Bond yield

Mexico	Current	2Q18	3Q18	4Q18	1Q19
Banxico fondeo	7.50	7.50	7.50	7.00	6.75
Mbono Jun. '21s	7.62	7.50	7.30	6.80	6.50
MBono Jun. '27s	7.64	7.60	7.40	7.20	6.80

Chile/Colombia Interest Rate Forecasts

Government Bond yield

Chile	Current	2Q18	3Q18	4Q18	1Q19
BCCh TPM	2.50	2.50	2.50	2.75	3.00
BCP 5Y	4.04	3.95	4.05	4.10	4.20
BCP 10Y	4.54	4.55	4.60	4.70	4.80

Government Bond yield

Colombia	Current	2Q18	3Q18	4Q18	1Q19
Banrep O/N	4.25	4.25	4.25	4.25	4.50
TES Jul '24s	6.11	6.01	5.98	6.06	6.18
TES Apr '28s	6.63	6.47	6.27	6.42	6.62

LatAm Central Bank Calendar

	Current Rate	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Brazil	6.50	-	-25bp	-25bp	-	Unch.	20	-	1	19	31	-	12
Mexico	7.50	-	+25bp	-	Unch.	Unch.	21	-	2	-	4	15	20
Chile	2.50	-	Unch.	Unch.	-	Unch.	13	24	-	4	18	-	4
Colombia	4.25	-25bp	-	Unch.	-25bp	-	29	27	-	28	26	-	21
Argentina	40.00	-150bp	Unch.	Unch.	+300bp	+975bp	*	*	*	*	*	*	*

CEE Interest Rate Forecasts

Poland

Poland	Current	2Q18	3Q18	4Q18	1Q19
Reference Rate	1.50	1.50	1.50	1.50	1.50
2y	1.58	1.50	1.50	1.50	1.56
10y	3.21	3.12	3.18	3.32	3.36

Hungary/Czech Republic/Russia Base Rates

CEE	Current	2Q18	3Q18	4Q18	1Q19
Hungary	0.90	0.90	0.90	0.90	0.90
Czech Republic	0.75	0.75	1.00	1.00	1.00
Russia	7.25	7.25	7.25	7.25	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.	6	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.	19	24	21	18	16	20	18
Russia	7.25	-	-25bp	Unch.	Unch.	-	15	27	-	14	26	-	14

Source: Santander, BZWBK. Note: Current levels as at 24 May 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	**1.23**	**1.25**	**1.25**
vs.forward	3.8	4.7	4.4
vs.consensus forecast	1.4	1.4	0.3
GBP/USD	**1.35**	**1.33**	**1.32**
vs.forward	0.5	-1.4	-2.8
vs.consensus forecast	-1.9	-4.1	-5.7
EUR/GBP	**0.91**	**0.94**	**0.95**
vs.forward	3.2	6.2	7.4
vs.consensus forecast	3.0	6.3	6.7
USD/JPY	**116**	**117**	**119**
vs.forward	6.1	7.0	8.2
vs.consensus forecast	6.7	7.6	9.9
EUR/JPY	**143**	**146**	**149**
vs.forward	10.8	13.6	15.5
vs.consensus forecast	8.1	10.8	11.4
EUR/CHF	**1.17**	**1.19**	**1.21**
vs.forward	0.9	2.2	4.0
vs.consensus forecast	-0.6	-0.3	0.6
USD/CHF	**0.96**	**0.95**	**0.97**
vs.forward	-2.7	-2.5	0.1
vs.consensus forecast	-2.4	-3.1	-1.4
EUR/SEK	**10.0**	**9.8**	**9.6**
vs.forward	-2.7	-4.3	-6.5
vs.consensus forecast	-2.7	-3.0	-4.1
EUR/NOK	**9.5**	**9.4**	**9.2**
vs.forward	-0.5	-1.9	-3.7
vs.consensus forecast	-0.4	-0.4	-0.7
USD/CAD	**1.24**	**1.23**	**1.22**
vs.forward	-3.3	-3.7	-4.6
vs.consensus forecast	-2.4	-2.1	-3.2
AUD/USD	**0.76**	**0.76**	**0.78**
vs.forward	0.4	0.8	2.4
vs.consensus forecast	0.0	-0.9	-0.4
NZD/USD	**0.70**	**0.71**	**0.73**
vs.forward	1.6	3.0	4.8
vs.consensus forecast	-0.9	0.5	2.3

	3M	6M	9M
USD/BRL	**3.68**	**3.67**	**3.51**
vs.forward	0.7	-0.5	-5.6
vs.consensus forecast	6.1	4.8	2.2
EUR/BRL	**4.52**	**4.57**	**4.40**
vs.forward	4.8	4.5	-1.1
vs.consensus forecast	7.6	6.2	2.5
USD/MXN	**19.5**	**18.33**	**18.23**
vs.forward	-2.4	-9.4	-11.2
vs.consensus forecast	1.5	-3.5	-2.0
EUR/MXN	**23.9**	**22.9**	**22.9**
vs.forward	1.2	-5.2	-7.3
vs.consensus forecast	2.9	-2.2	-1.8
USD/CLP	**628**	**625**	**623**
vs.forward	0.7	0.1	-0.1
vs.consensus forecast	1.9	2.0	1.7
EUR/CLP	**771**	**779**	**781**
vs.forward	5.7	6.9	7.1
vs.consensus forecast	3.3	3.4	2.0
USD/COP	**2833**	**2813**	**2793**
vs.forward	-1.5	-2.2	-2.9
vs.consensus forecast	-0.3	-1.2	-2.5
USD/ARS	**25.0**	**26.2**	**27.4**
vs.forward	-5.7	-7.6	-9.3
vs.consensus forecast	11.1	15.2	20.2
EUR/PLN	**4.23**	**4.23**	**4.22**
vs.forward	-2.0	-2.4	-3.3
vs.consensus forecast	0.2	0.8	0.7
EUR/CZK	**25.6**	**25.5**	**25.4**
vs.forward	-1.0	-1.4	-1.8
vs.consensus forecast	0.7	1.1	1.5
EUR/HUF	**313**	**313**	**312**
vs.forward	-1.7	-1.7	-2.0
vs.consensus forecast	0.1	0.1	-0.2
EUR/RUB	**76**	**83**	**82**
vs.forward	4.3	10.9	9.8
vs.consensus forecast	4.6	11.9	10.9

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	1.173	1.340	109.710	128.670	147.006	0.991	1.162	1.328
1M	1.175	1.342	109.498	128.701	146.919	0.988	1.162	1.326
2M	1.178	1.344	109.239	128.730	146.823	0.986	1.161	1.325
3M	1.181	1.346	109.017	128.759	146.721	0.983	1.161	1.323
6M	1.190	1.352	108.265	128.826	146.359	0.975	1.160	1.318
9M	1.200	1.358	107.409	128.860	145.904	0.966	1.159	1.312
12M	1.209	1.364	106.598	128.906	145.451	0.957	1.158	1.306

ATMf vol.

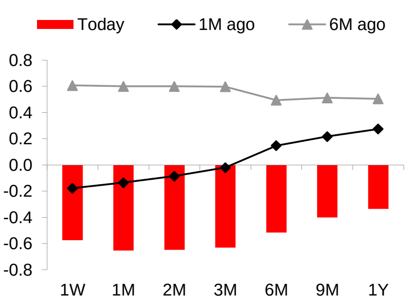
	EUR/USD	GBP/USD	USD/JPY	EUR/JPY	GBP/JPY	USD/CHF	EUR/CHF	GBP/CHF
1W	7.3%	7.1%	7.0%	8.8%	9.1%	6.0%	6.4%	6.5%
1M	7.4%	7.5%	7.1%	8.4%	9.1%	6.4%	6.0%	6.8%
2M	7.2%	7.5%	7.2%	8.4%	9.1%	6.5%	5.9%	6.9%
3M	7.1%	7.6%	7.4%	8.4%	9.2%	6.6%	5.8%	6.9%
6M	7.2%	7.9%	7.9%	8.6%	9.6%	7.0%	5.9%	7.3%
9M	7.2%	8.0%	8.1%	8.8%	9.8%	7.2%	5.9%	7.4%
12M	7.3%	8.1%	8.3%	8.9%	10.0%	7.3%	6.0%	7.6%

Implied/realized vol. ratio

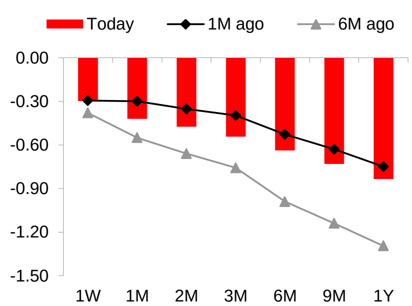
	EUR/USD	GBP/USD	USD/JPY	EUR/JPY	GBP/JPY	USD/CHF	EUR/CHF	GBP/CHF
1W	1.04	1.07	1.09	0.93	1.01	1.03	1.05	0.90
1M	0.97	0.94	1.21	1.13	1.08	1.05	1.27	1.00
2M	1.08	1.00	1.18	1.21	1.10	1.08	1.40	1.02
3M	1.06	1.03	1.09	1.10	1.03	1.05	1.30	1.02
6M	1.03	0.97	1.07	1.11	1.02	0.98	1.15	0.96
9M	1.04	1.00	1.09	1.15	1.04	0.99	1.10	0.94
12M	1.05	1.01	1.11	1.16	1.04	1.01	1.11	0.93

25-delta risk reversals

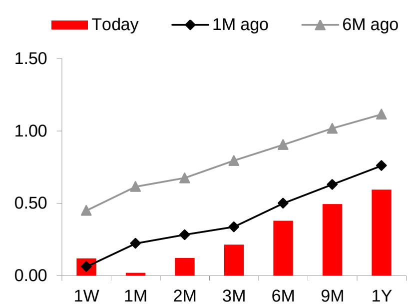
EUR/USD



GBP/USD



EUR/GBP



Sources: Bloomberg and Santander. As of 11.00 BST 24 May 2018

Latin America FX: Spot and forward rates

	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
Spot	24.48	3.63	624	2875	19.6	3.27
1M	25.14	3.64	622	2878	19.7	3.27
2M	25.79	3.65	624	2881	19.8	3.27
3M	26.43	3.66	624	2884	19.9	3.27
6M	28.24	3.68	624	2894	20.2	3.28
9M	29.78	3.71	625	2907	20.5	3.29
12M	31.30	3.74	626	2920	20.8	3.30

ATMf vol.

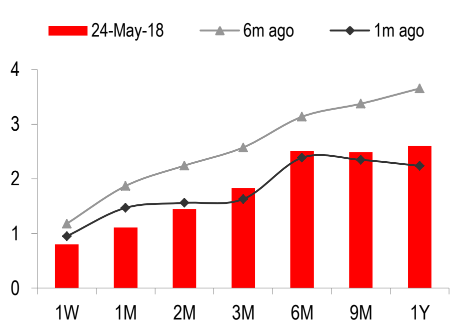
	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
1W	7.05	13.91	10.01	11.05	15.01	4.14
1M	14.08	13.44	10.11	10.89	14.02	3.79
2M	14.59	13.21	9.87	11.18	15.39	4.20
3M	14.92	13.35	9.72	11.29	14.47	4.50
6M	15.04	14.32	9.40	12.05	13.72	4.99
9M	17.28	13.92	9.28	12.30	13.54	5.39
12M	18.44	13.73	9.19	12.45	13.38	5.61

Implied/realized vol. ratio

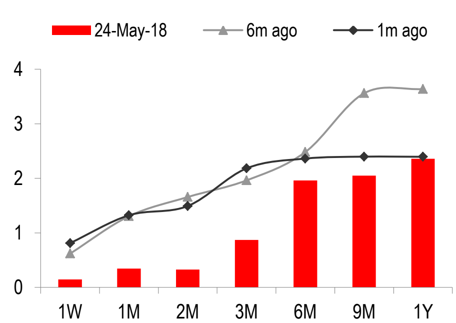
	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
1W	0.74	1.00	1.03	1.10	1.01	1.16
1M	0.35	1.02	0.92	0.70	0.94	0.72
2M	0.51	1.11	1.13	0.85	1.21	0.99
3M	0.64	1.20	1.20	0.96	1.23	1.11
6M	0.81	1.26	1.08	1.07	1.16	1.16
9M	1.09	1.30	1.11	1.23	1.20	1.41
12M	1.26	1.33	1.19	1.32	1.23	1.57

25-delta risk reversals

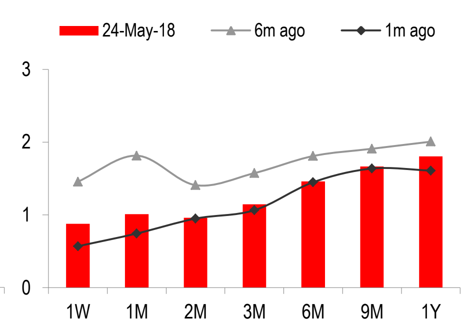
USD/BRL



USD/MXN



USD/CLP



Sources: Bloomberg and Santander. As of 11.20 BST 24 May 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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