23 May 2019, 15:00 BST

FX COMPASS

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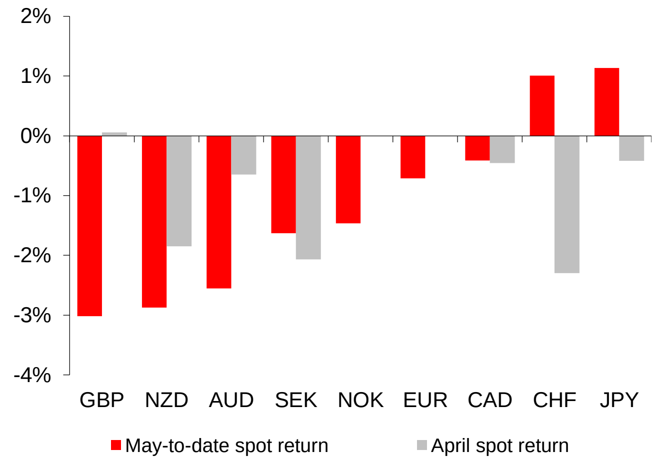
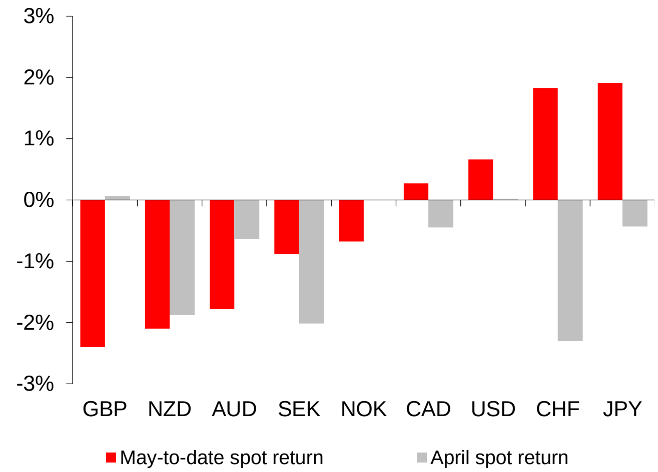
FX Spot Returns

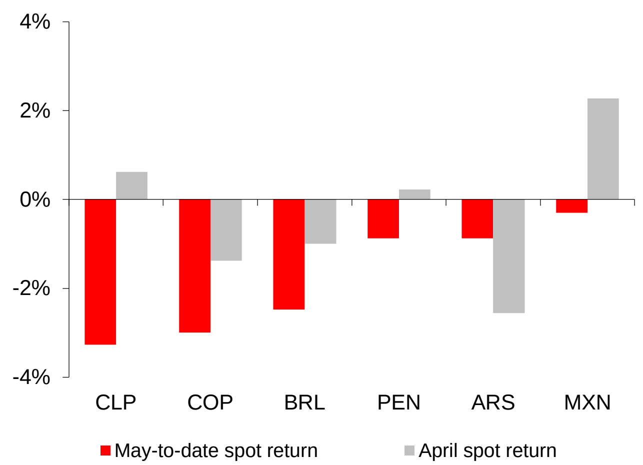
G10 spot returns vs. USD



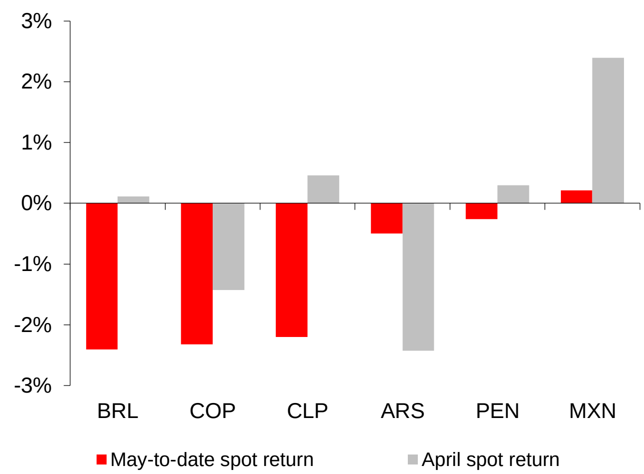
G10 spot returns vs. EUR



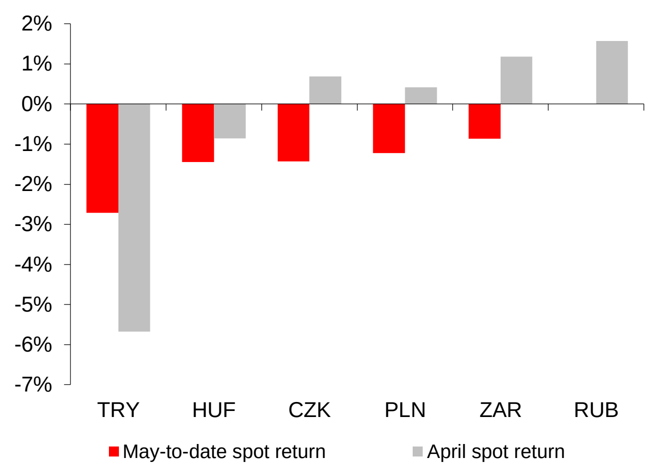
LatAm spot returns vs. USD



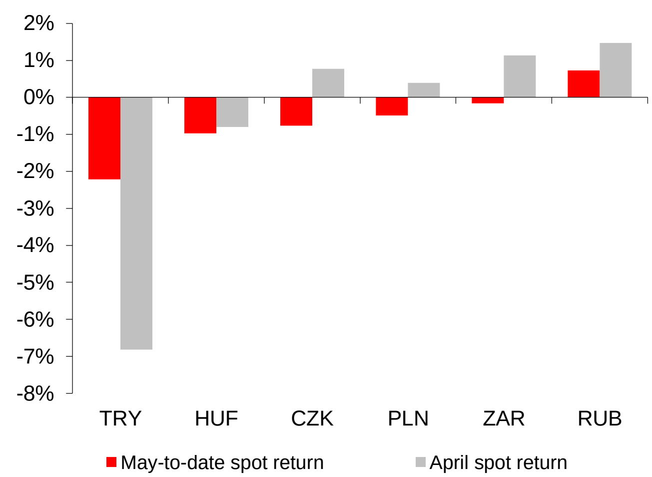
LatAm spot returns vs. EUR



CEEMA vs. USD



CEEMA vs. EUR



Source: Bloomberg, Santander. Note: Data current as at 23 May 2019 at 14:00 BST

FX Forecasts

G10 FX Forecasts

	Q2-19	Q3-19	Q4-19	Q1-20	Q2-20	Q3-20
EUR-USD	1.13	1.14	1.17	1.18	1.20	1.21
GBP-USD	1.33	1.35	1.36	1.37	1.37	1.37
GBP-EUR	1.18	1.18	1.16	1.16	1.14	1.13
EUR-GBP	0.85	0.84	0.86	0.86	0.88	0.88
USD-JPY	112	115	119	116	115	115
EUR-JPY	127	131	139	137	138	139
USD-CNY	6.70	6.70	6.70	6.65	6.50	6.50
EUR-CHF	1.15	1.18	1.20	1.21	1.23	1.24
USD-CHF	1.02	1.04	1.03	1.03	1.03	1.02
EUR-SEK	10.7	10.6	10.4	10.3	10.3	10.2
EUR-NOK	9.6	9.6	9.5	9.4	9.3	9.3
USD-CAD	1.33	1.31	1.29	1.28	1.27	1.25
AUD-USD	0.69	0.68	0.70	0.70	0.71	0.72
NZD-USD	0.65	0.65	0.67	0.68	0.68	0.69

LatAm FX Forecasts

	Q2-19	Q3-19	Q4-19	Q1-20	Q2-20	Q3-20
USD-BRL	3.90	3.95	4.00	4.10	4.20	4.30
USD-MXN	19.3	20.3	20.5	20.5	20.7	20.9
USD-CLP	680	670	660	650	670	660
USD-COP	3200	3250	3300	3250	3300	3250
USD-ARS	46.0	48.9	52.0	53.9	55.9	57.9
USD-PEN	3.35	3.36	3.37	3.37	3.40	3.37
EUR-BRL	4.41	4.50	4.68	4.84	5.04	5.20
EUR-MXN	21.8	23.1	24.0	24.2	24.8	25.3
EUR-CLP	768	764	772	767	804	799
EUR-COP	3616	3705	3861	3835	3960	3933
EUR-ARS	52	56	61	64	67	70
EUR-PEN	3.8	3.8	3.9	4.0	4.1	4.1

CEE FX Forecasts

	Q2-19	Q3-19	Q4-19	Q1-20	Q2-20	Q3-20
EUR-PLN	4.33	4.35	4.30	4.28	4.24	4.20
EUR-CZK	25.8	25.8	25.6	25.4	25.2	24.9
EUR-HUF	322	325	325	320	322	315
USD-RUB	65	67	67	67	67	64
EUR-RUB	73	76	78	79	80	77

Sources: Santander

G10 FX: Main Themes

Currency	3M view	12M view	Main Themes
USD	⇨	↘	• The USD remains firm, but should top out over the coming months. The factors that drove the USD higher in 2018 - US growth, high interest rates and risk - are still present, but a dovish Fed should curtail further gains.
EUR	⇨	↗	• The ECB adopted a more dovish stance at its March meeting. Both growth and inflation forecasts have been revised lower, but the negative impact on EUR/USD may be countered by a more dovish US outlook.
GBP	⇨	⇨	• Sterling remains vulnerable, given Brexit uncertainty. Economic data have surprised to the upside, but we still see little chance of near-term rate hikes. The pound should continue to be driven by politics.
JPY	↘	↓	• Low risk appetite has boosted demand for the yen. However, when/if the uncertainties fade, the market will be faced with a yen-negative scenario of a BoJ likely to keep policy very loose for a long time.
CNY	↘	⇨	• US-China trade tensions remain a risk, but an improvement in Chinese economic data appears to have reduced the chances of further stimulus measures and scope for bigger CNY losses.
CHF	↘	↘	• The CHF should gradually weaken: the SNB still views the CHF as 'highly valued' and, despite firm economic data, should maintain a very loose policy into 2020 and remain willing to intervene.
CAD	⇨	↗	• We still see scope for the CAD to appreciate. Higher oil prices should offer some support and Canadian yields remain relatively high. However, less hawkish BoC comments imply downward revisions to our CAD view.
AUD	⇨	⇨	• Global risk sentiment, with a focus on the US and China, has pulled the AUD lower. Further trade uncertainty, together with an imminent RBA rate cut, should continue to limit the AUD in the month ahead.
NZD	⇨	⇨	• The RBNZ cut rates in May, and could do so again as soon as August. Looser monetary policy, and elevated global trade fears, are likely to continue to restrict the NZD over the summer.
SEK	⇨	↗	• Domestic data have deteriorated in 2019 and while CPIF is back at 2%, the Riksbank is looking increasingly unlikely to hike rates again in 2019. With global trade fears elevated, a SEK recovery is unlikely just yet.
NOK	↗	↗	• With the economy performing relatively well, oil prices recovering from their early 2019 lows, and the Norges Bank now in the middle of a hiking cycle, the NOK should manage to strengthen over the coming months.

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

Source: Santander

G10 FX Overview

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The USD has remained strong over the last month. The combination of a robust US economy and strong employment growth continues to provide fundamental support. The negative impact of a more 'cautious' Fed, and a rising probability of US rate cuts this year has, for now, failed to dent the dollar, as other developed market central banks have also erred on the dovish side with regard to policy.

The EUR has remained under pressure against its 'main' G10 peers over the last month, as low risk appetite has supported demand for the yen and USD. A subdued economic outlook and dovish ECB continue to weigh on the currency, but should be priced in. However, even the gradual gains that we expect the EUR to see over the coming months will depend on a pick-up in risk appetite and/or the unwinding of the market's significant long USD positions.

The pound is set to remain constrained by UK political uncertainty in the coming months. We continue to feel that the pound is 'too cheap', but until the political fog clears, there will be little incentive for the market to sustainably bid sterling higher. Hence, despite some positive economic data, GBP risks still seem skewed to the downside.

We continue to believe that the yen is too weak. The prospect of very loose monetary policy from the BoJ, as it fails to achieve its inflation target, should have more of a negative effect on the currency. But, the yen is likely to continue to be driven by risk appetite over the coming month and, if the market remains worried about US-China trade tensions, soft equity markets should helping the yen remain firm.

The renminbi has weakened again amid escalating trade tensions between the US and China and declining risk appetite. USD/CNY has marched back towards the 7 level, but Chinese policymakers should remain reluctant to see it go any higher.

We continue to believe that the Swiss franc should be weaker than it is. However, very loose monetary policy has not proved sufficient to sustainably pull this currency lower. Thus, EUR/CHF should remain within a broad 1.12-16 range that has been in place since mid-August.

We still favour a firmer CAD in the medium term. However, while the currency has continued to perform well against most of its G10 peers over the past couple of months, it has underperformed the USD and JPY. We expect both trends to continue in the months ahead.

An escalation in US-China trade tensions have weighted on both the AUD and NZD in recent months. Monetary policy has also been a negative, with the RBNZ cutting rates by 25bp in May, and the RBA suggesting it could cut rates as soon as June. Both currencies have already weakened significantly in recent months, but a further escalation in global trade tensions and/or further rate cuts by the RBA and RBNZ could yet pull these currencies lower this summer.

The SEK is by far the weakest G10 currency year-to-date, hurt by global trade concerns, weaker domestic data, and a central bank that looks likely to struggle to hike rates this year. These are likely to continue to limit the currency over the coming month.

We are still positive on the NOK. The central bank has hiked rates twice since September, and has indicated that another rise in June is likely. This goes against the grain of general developed market monetary policy, which has been growing increasingly cautious over the past six months, and so should be NOK supportive.

USD – And the winner is?

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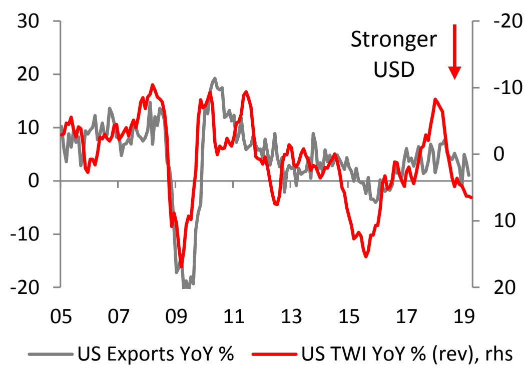
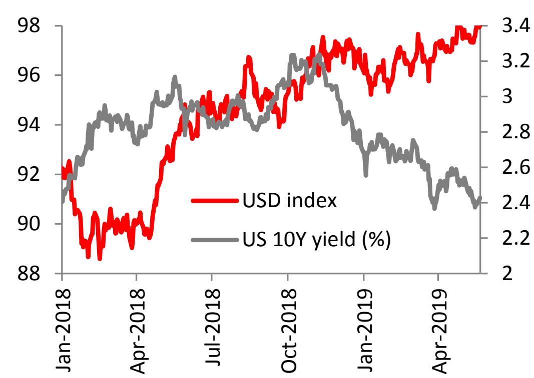
Chart 1: USD and US export growth



Source: JPM, Bloomberg, Santander

Chart 2: USD remarkably firm, even as US yields fall and Fed rate cut expectations increase



Source: Bloomberg, Santander

The USD has remained strong over the last month. The combination of a robust US economy and strong employment growth continues to provide fundamental support. The negative impact of a more 'cautious' Fed, and a rising probability of US rate cuts this year has, for now, failed to dent the dollar, as other developed market central banks have also erred on the dovish side with regard to policy.

The USD remains solid in 2019. Sound fundamentals and high US interest rates have fuelled demand for the greenback. However, year-to-date, in carry-adjusted terms, it is the CAD that has beaten its neighbour as the best performing G10 currency. Further, over the last month the yen has outperformed the USD.

The strength of both the yen and the USD indicate that the perception of global risks continues to drive the market. Both the dollar and yen are viewed as 'safe-haven' currencies, which tend to be demanded at times of low risk appetite. Hence, concerns over the ongoing US-China tensions have been feeding USD demand.

We would continue to argue that the last thing the US wants to see, given its focus on the US trade deficit and US competitiveness, is a stronger dollar, but in the current environment the market's knee-jerk response to rising global risks remains to buy the dollar.

That said, at one stage during the month, after China retaliated against extra US duties on Chinese goods by increasing their tariffs on the US, the market did seem to focus a little more on the impact on US GDP from these trade tensions.

However, with the US economy still forecast to outperform its peers, in particular the Eurozone, fundamentals remain dollar supportive. In particular, we saw another good employment report for April, which showed non-farm payrolls rising 263k and unemployment dropping to 3.6%.

Despite positive economic data, the Fed remains cautious/dovish. Indeed, the Fed's Williams stated towards the end of May that policymakers had changed their view on how low unemployment can go before pulling up inflation.

Hence, the market still sees little prospect of further USD-positive rate hikes, which boosted the dollar in 2018. At the start of the year the market saw about a 15% chance of a Fed cut in 2019; as of 23 May that had increased to 73%. Despite this, the USD index was stronger on 23 May than it had been at the start of the year.

We expected that such a change in rate cut expectations would have had more of a negative impact on the dollar. However, that negative effect has been neutered by other central banks also adopting a more dovish stance. This renewed race to the bottom, focussing on growth risks and fuelling a low-risk environment, has helped keep the USD strong.

But with the market still very long the dollar, we still highlight the risk that an unwinding of those long USD positions could weigh on the currency in H2-19. If US-Chinese tensions ease, demand for dollar safety should fall. Alternatively, the market could, in our opinion, merely adequately price in the expected slower growth in 2020 or the increased likelihood of a US rate cut this year, to justify a weaker dollar.

EUR – The more things change…

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The EUR has remained under pressure against its 'main' G10 peers over the last month, as low risk appetite has supported demand for the yen and USD. A subdued economic outlook and dovish ECB continue to weigh on the currency, but should be priced in. However, even the gradual gains that we expect the EUR to see over the coming months will depend on a pick-up in risk appetite and/or the unwinding of the market's significant long USD positions.

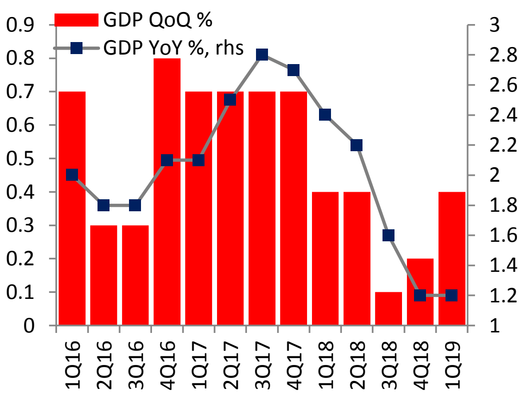
The euro remains the least popular of the big 3 currencies (USD, JPY and EUR). The market remains concerned about US-China trade tensions, which have fuelled demand for the yen as a safe haven, pulling EUR/JPY lower since mid-April. Meanwhile, a bearish outlook for Eurozone growth in 2019, with the economy still lagging the US's, has kept EUR/USD under pressure, leading it to trade below 1.12 throughout most of May.

As such, we have revised our EUR/USD forecast profile lower, but still favour a firmer EUR into the end of this year and the start of 2020. We now expect EUR/USD at 1.17 at the end of 2019 vs. 1.19 previously and 1.20 at the end of H2-20, down from 1.22.

Concerns about global trade and its impact on risk appetite should persist. However, despite its recent decline, the equity market remains well above its Q4-18 lows, which should provide more EUR support. Further, a suitable 'solution' to US-China trade talks over the coming weeks could help the euro. Plus, the US's move to defer a decision on imposing auto tariffs on the EU and Japan for six months should have had a more positive effect on the currency.

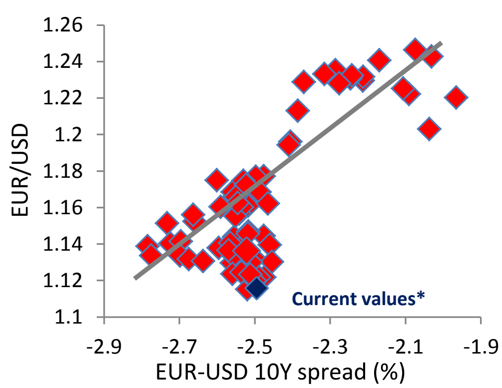
In addition, we continue to suggest that EUR/USD has priced in too much by way of Eurozone specific risk. The results of the EU elections on 23-26 May will be watched for any sign of rising domestic political risks. However, using the spread between Italian and German 10Y yields as a proxy for Eurozone risk, we would argue that EUR/USD is actually a little on the cheap side.

Chart 3: EUR struggling despite GDP showing some signs of improvement



Source: Bloomberg, Santander

Chart 4: EUR/USD and EU-US 10Y spread, weekly data, since the start of 2018



Source: Bloomberg, Santander *As at 17 May 2019

The Eurozone growth outlook remains a EUR negative. The ECB expects the economy to grow by just 1.1% in 2019, underperforming the US. However, with the US expected to slow in 2020, this 'growth gap' should become less of a USD positive as we move into H2-19.

The ECB's dovish stance continues to act as a brake on any EUR gains, and counter the more patient/dovish approach adopted by the Fed since the turn of the year. Whilst high US yields continue to support the dollar, we argue that since the start of 2018, the EU-US 10Y differential still suggests that EUR/USD is on the cheap side, and should be trading closer to 1.16.

In this regard, over the coming weeks, key to our view will be the ECB meeting on 6 June. Draghi could double down on his warning of downside risks, dragging the EUR lower. However, in recent comments he has sounded a little more upbeat, suggesting that wage growth would help the Bank hit its inflation target, albeit slowly.

Further, the June meeting should provide more information about the pricing of TLTRO-III. If it is not priced attractively, less of the funding from previous operations might be rolled, implying a reduction in excess liquidity. Less liquidity could be viewed as 'tighter' monetary conditions and EUR positive. Nevertheless, we think that a 'back door' tightening may merely add further pressure on the economy and be EUR negative.

GBP – Uncertainty still rules UK

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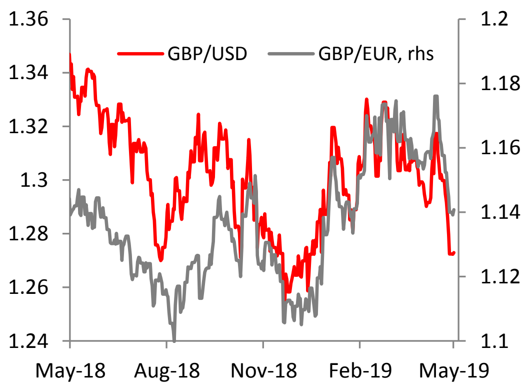
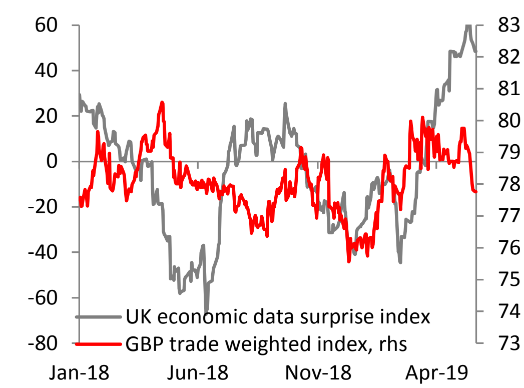
Chart 5: Downside sterling pressure intensified in May, but the pound remains above its Q4-18 lows



Source: Bloomberg, Santander

Chart 6: Upside data surprises have not helped the pound amid ongoing political uncertainty



Source: Citi, Bloomberg, Santander

The pound is set to remain constrained by UK political uncertainty in the coming months. We continue to feel that the pound is 'too cheap', but until the political fog clears, there will be little incentive for the market to sustainably bid sterling higher. Hence, despite some positive economic data, GBP risks still seem skewed to the downside.

The pound has become a 'political' currency, by which we mean it is the domestic political drama which now seems to exert the most influence on it, rather than economic data and monetary policy. Indeed, the ongoing uncertainty surrounding UK politics/Brexit has pulled GBP/USD back below 1.2700 in May.

The Brexit process appears unlikely to provide the FX market with the certainty, or even clarity, that it would like, as the cross-party talks between the governing Conservative party and opposition Labour party have collapsed.

Prime Minister May has indicated that she will ask parliament to vote on her withdrawal agreement bill (WAB) again, in the week beginning 3 June. After this, the PM has stated that she will set out a timetable for her resignation. Hence, the pound's focus has already drifted towards who will replace her as PM.

In terms of the expected change in PM over the coming months, we think the impact on the pound could be negative in the short run, but might be more positive in the medium term.

Opinion polls suggest that Conservative party members tend to be pro-Brexit and not worried by the risk of a 'no deal'. In the short term, to appeal to them, candidates to lead the Conservative party may adopt a similar view. We still feel that the FX market is worried by the potential economic effect of a 'no-deal' Brexit and, if this appears more likely, the pound could weaken.

However, in the medium term, a new PM might feel less pressure to abide by Mrs May's 'red lines'. This might imply a slightly more flexible stance regarding Brexit options and getting a deal done, which, in our opinion, the pound would respond positively to.

If it were not for this uncertain political outlook, we feel that the pound would be stronger, but would still face global economic headwinds. Further, whilst UK economic data have continued to exceed expectations, with unemployment at a new low, even here the Brexit effect muddies the water for the pound.

Much of the improvement in Q1-19 GDP growth to 0.5% QoQ has been explained by stockpiling, as firms prepared for the first Brexit deadline at the end of March. This positive effect may now go into reverse, weighing on the data and the currency.

Elsewhere, the rhetoric from the BoE has sounded a little more positive for the pound, with policymakers hinting that the market is underestimating the scope for future rate hikes. But in reality, the timing and pace of interest rate changes will depend largely on which way the Brexit process leads.

Consequently, all roads lead to Brexit, but the market is not clear yet where Brexit will lead. Speculative positioning data show that fast money accounts are broadly neutral in terms of GBP/USD, indicating plenty of scope for them to pull the pair in either direction. We still think that the risks are skewed to the downside.

JPY – The risk of lingering strength

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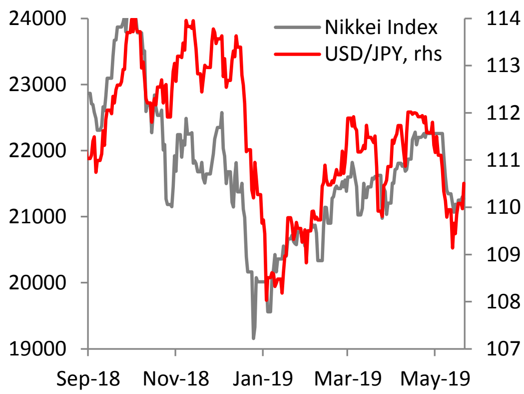
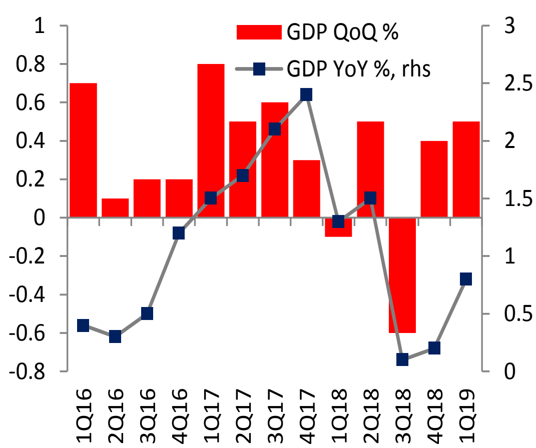
Chart 7: JPY continues to be driven by global risk factors and equities



Source: Bloomberg, Santander

Chart 8: Japanese GDP growth looked good in Q1-19, but the details were less impressive



Source: Bloomberg, Santander

We continue to believe that the yen is too weak. The prospect of the BoJ keeping its monetary policy very loose, as it fails to achieve its inflation target, even into 2021, should have more of a negative effect on the currency. However, the yen is likely to continue to be driven by risk appetite over the coming month and, if the market remains worried about US-China trade tensions, equity markets are likely to stay soft, helping the yen to remain firm.

The FX market perceives the JPY as a safe-haven currency, i.e. when risk appetite is low, investors tend to seek the safety of the yen, boosting its value. Hence, it should not be that surprising that the yen has been the best performing developed market currency over the last couple of months as investors have fretted over the impact of US-Chinese trade tensions on global growth.

The changes in risk appetite over the past six months are reflected in both the direction of the yen as well as equity markets. Hence, at the end of 2018, when risk appetite dropped and equity markets fell, USD/JPY declined amid demand for the yen.

This move reversed during the first four months of 2019 as, despite the focus remaining on trade concerns, equity markets calmed down and rallied. As a result, the yen weakened. However, fresh worries during May sent stocks and USD/JPY lower again.

Given this link between equities and the yen, if risk appetite, and equities, do not pick up, the yen is likely to remain on the firm side. Indeed, we would argue that the pick-up in USD/JPY from 109 from mid-May could be explained by the small rise in equities, suggesting that the May sell-off may have bottomed out.

Meanwhile, the economic outlook, in our opinion, is still yen negative. Admittedly, Q1-19 GDP data did surprise significantly to the upside. The economy grew 0.5% QoQ versus 0.4% QoQ in Q4-18. The market had expected that the economy would contract 0.1% QoQ at the start of 2019.

However, the breakdown of the data was far less positive. The trio of consumer spending, investment and exports all fell on the quarter, down -0.1% QoQ, -0.1% QoQ and -2.4% QoQ, respectively. The overall GDP figure was flattered by an even bigger decline in import growth, -4.6% QoQ, which meant that net exports made a positive contribution to GDP.

A combination of fiscal stimulus and consumers bringing forward purchases ahead of the October sales tax hike should help activity in Q2 and Q3, but that tax rise risks growth tailing off at the end of the year. Given the GDP outlook, and that inflation remains stubbornly low, the BoJ is expected to keep its monetary policy very accommodative, and therefore yen negative. The benchmark deposit rate should remain at -0.1%, with the Bank's target for 10Y yields sticking at approximately 0%.

Indeed, at its April meeting, the BoJ forecast CPI at 1.6% in the fiscal year 2021. This indicates that inflation is expected to remain below target through to 2022, giving the Bank little reason to run tighter policy. Rather, in May, Governor Kuroda indicated that not only would low rates remain in place, but that he might consider even more easing, if price momentum is lost.

CNY – Slipping in May

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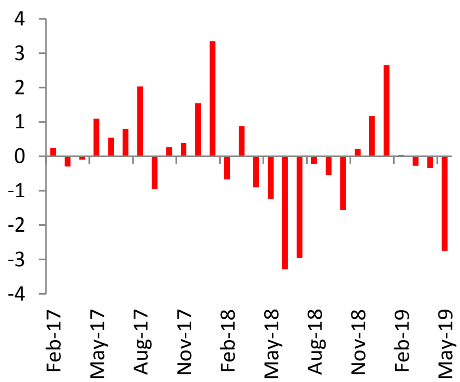
Chart 9: CNY monthly percentage change versus the USD



Source: Bloomberg, Santander

Chart 10: Chinese export growth slipping as trade tensions mount

Source: Bloomberg, Santander

The renminbi has weakened again amid escalating trade tensions between the US and China and declining risk appetite. USD/CNY has marched back towards the 7 level, but Chinese policymakers should remain reluctant to see it go any higher. Further, the pair's recent rally would be very vulnerable to a swift reversal if the rhetoric between China and the US calmed down in the coming weeks.

The CNY has weakened back towards the level that it recorded at the end of 2018. Trade concerns pulled the pair higher at the end of last year, but negotiations between the US and China in Q1-19 soothed market fears. Hence, USD/CNY was able to fall back towards the 6.7 level, where it has tended to remain since February.

However, the renminbi's steady period was brought to an abrupt end in May as US-Chinese trade tensions increased. First, the US declared that it was extending tariffs on Chinese imports. The Chinese then retaliated by announcing extra tariffs on US goods. Plus, the US announced that the Chinese telecom company Huawei would face restrictions on its access to US market.

As a result, USD/CNY has moved back towards the psychologically and politically important 7 level. The CNY's decline over the month has been the biggest since June and July 2018.

The ratcheting up of trade tensions weighs on the CNY by reducing risk appetite and boosting safe-haven demand for the US dollar. However, it also affects renminbi sentiment via its potential impact on Chinese activity.

Recent data have been on the soft side. The April PMIs stayed above 50 but did edge lower, with new export orders contracting, while China's trade surplus dipped to USD13.84bn in April versus USD32.42bn in March, with export growth at -2.7% YoY vs. +13.8% YoY in March. Admittedly, CPI rose in April to 2.5% YoY vs. 2.3% and PPI to 0.9% vs. 0.4%. But credit growth slowed in line with weaker bank lending, and industrial production, retail sales and fixed assets investment were all below expectations.

Given the risks to growth, the market is once again asking whether Chinese policymakers will allow the CNY to weaken further to help the economy. We continue to believe that they will remain reluctant to use the currency as a tool in any trade dispute. First, as in 2015, there is concern that a depreciating currency may spark large capital/investment outflows. Second, such a move would probably be seen as provocative by the US, eliciting a response from them. Third, it would undermine the established goal of liberalising the FX market and making China more 'market friendly'.

That said, the economic risks suggest that policymakers will continue, and perhaps intensify, economic stimulus measures. Recently, the PBoC cut the reserve requirements for rural commercial lenders, in another effort to make investment funding available for smaller and medium-sized firms.

Further easing and another reduction in the general reserve requirement rates look likely as the preferred response to slower growth, rather than weakening the currency. Indeed, given the concern about a weaker currency sparking capital outflows, policymakers may intervene to stop the CNY weakening further.

CHF – Follow the leader, but which one?

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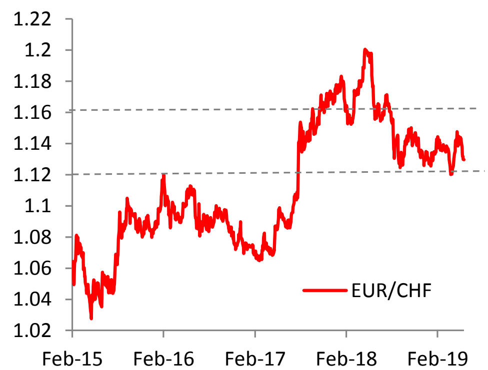
Chart 11: EUR/CHF sticking within a 1.12-1.16 range



Source: Bloomberg, Santander

We continue to believe that the Swiss franc should be weaker than it is. However, very loose monetary policy has not proved sufficient to sustainably pull the currency lower. Thus, EUR/CHF should remain within a broad 1.12-16 range that has been in place since mid-August.

The CHF weakened during April, against both the EUR and USD, but these losses have reversed in May. In our opinion, it remains notable that over the past few months EUR/CHF appears to have been driven more by changes in USD/CHF rather than EUR/USD.

Usually, we view EUR/USD as a key driver of EUR/CHF, e.g. when the EUR weakened amid Eurozone risk or ECB dovishness, it would pull EUR/CHF lower with it. The closer link to USD/CHF in 2019 is perhaps a mixed blessing for policymakers.

On the one hand, it could imply that EUR/CHF is now less vulnerable to EMU risk and any further ECB easing. On the other hand, it implies it is at risk from any USD sell-off. Note that we think the long USD trade is somewhat full and vulnerable to repositioning.

It also suggests that the SNB remains a ‘price taker’ as far as the CHF is concerned, with its ultra-loose policy unable to weaken the currency. We recall that the Swiss depo rate is -0.75% and the Bank retains the right to intervene to weaken the currency. However, with Swiss inflation low, at 0.7% YoY in April, and business indicators, KOF and PMI, dipping, the SNB’s policy should remain very loose and CHF negative throughout 2019 and 2020.

CAD – Still looking for medium-term gains

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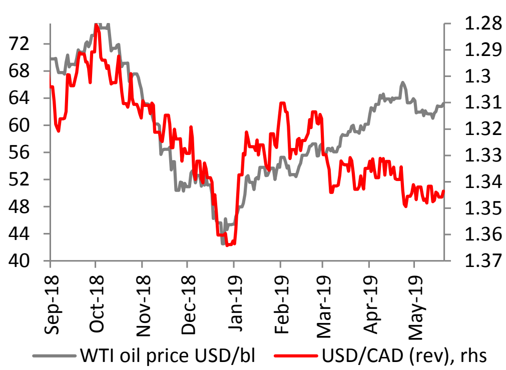
Chart 12: CAD has done well against its peers, but USD/CAD still appears disconnected from oil



Source: Bloomberg, Santander

We still favour a firmer CAD in the medium term. Indeed, over the last month the currency has continued to perform well against most of its G10 peers, albeit slightly weaker against the USD and notably weaker against the yen, which has been boosted by low risk appetite. As such, the outlook for the CAD is split between struggling against the USD and yen, and probably gains against other developed market currencies.

Focussing on USD/CAD, the upside bias for this pair, i.e. a softer CAD, looks likely to persist, given the market’s dovish view about the BoC and the low correlation between the CAD and higher oil prices in 2019.

First, we recall that in April the BoC kept interest rates on hold at 1.75%. But its tone was dovish: it cut its forecast for 2019 GDP growth to 1.2% from 1.7%, dropped the reference to a need for higher interest rates and also revised down its estimate of the neutral range for the policy rate, to 2.25%-3.25%, from 2.5%-3.5%.

However, subsequent comments from Governor Poloz suggest that more hikes will be needed. Plus, whilst GDP data was as soft as expected in February, there were signs of an export pick-up and wage and jobs growth were much stronger than forecast in April. Hence, we still see room for a more ‘hawkish’ rhetoric to support the CAD later in the year.

Second, the higher oil price in 2019 has not supported the CAD to the degree that we would have thought. We estimate that given the current oil price, USD/CAD should be trading closer to 1.31, rather than 1.35.

AUD – How low can it go?

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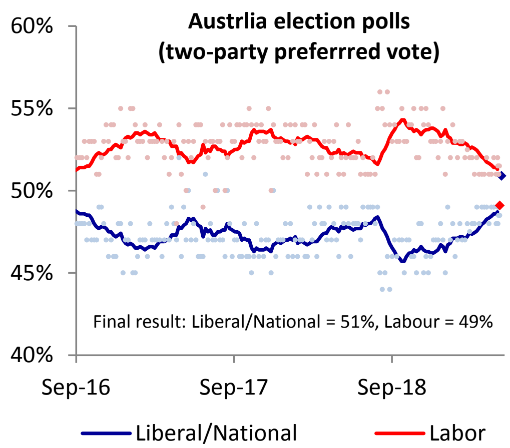
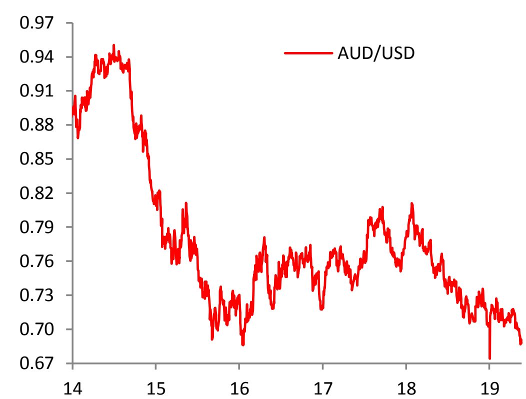
Chart 13: Labour have led the polls ever since the 2016 election, but voters opted to stick with the Liberal-National incumbent for another 3 years



Source: Wikipedia, Santander

Chart 14: AUD/USD fell to a four-month low in May, but without January 2019's "flash crash", it would have reached a three-year low



Source: Bloomberg, Santander

We are cautious on the AUD in the short term, but feel that the speed and extent of the recent decline, as well as the large net short speculative positioning, should limit the scope for a further significant decline. However, a deteriorating global trade backdrop, weaker domestic data, and the likelihood of an imminent RBA rate cut, all point to a soft AUD in the month ahead. We have lowered our AUD/USD forecasts on account of the above developments, and now see the pair at 0.69 in Q2-19 (0.74 previously), and 0.70 by year-end (0.76 previously).

On Saturday, 18 May, Australia's general election took place. As we discussed in our publication on 13 May, the opposition Labour party had been expected to win, as it had been leading opinion polls since the 2016 election (Chart 15). However, voters opted to stick with the incumbent Liberal-National coalition for another three years. The party's 51% of the vote was even enough to obtain a majority, preventing a sixth different prime minister in six years, and boosting the AUD.

The AUD gains did not last long, though. Indeed, while the RBA kept rates on hold in early May, the currency fell as Governor Lowe highlighted earlier this week that the Bank has an easing bias, and could cut rates at its June meeting. The market is already fully pricing in such a decision.

The governor appears particularly concerned about employment data, suggesting that there is still spare capacity in the economy and that a further improvement in the labour market was likely to be needed for inflation to be consistent with the Bank's target. While there was a stronger than expected 28k net increase in jobs in April, the monthly employment index turned negative for the first time since January 2016 and the unemployment rate rose to 5.2%.

These figures suggest that the RBA has not yet achieved either its employment or inflation mandate (headline CPI fell to just 1.3% in March, well below the Bank's 2-3% target range). Hence, even though we do not see much scope for the AUD to go even lower, an imminent rate cut from the RBA is likely to restrict the AUD over the summer.

Aside from domestic issues, the international backdrop has also been AUD negative, with the currency hurt by a deterioration in US-China trade talks in early May, which prompted both countries to raise tariffs on imports from the other.

AUD/USD has fallen to below 0.69 in late May, its first time below this level since the 3 January "flash crash". In fact, were it not for the sudden 3.5% drop that day, AUD/USD would be at a three-year low this week (Chart 16).

Further AUD weakness should not yet be ruled out, with softer data, rate cuts, and trade concerns all possible drags on the currency. However, the market is already very negative on the AUD. Indeed, at 64k contracts, the speculative net short AUD position it at its highest level since November last year. This is not far from the all-time net short position of 77k contracts, set in March 2015, and implies only limited scope for the speculative market to actively to sell the currency further.

NZD – A rate cut or rate cuts?

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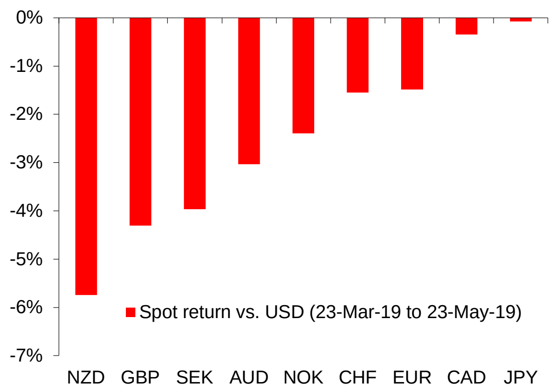
We are also cautious on the NZD in the short term. Poorer global trade sentiment and a RBNZ rate cut in May have hurt the currency, with NZD/USD down over 6% in the past two months. Given this sharp decline, there may be less scope for further NZD losses. However, a further escalation in trade tensions between the US and China and additional rate cuts by the RBNZ are still key risks for the NZD in the weeks and months ahead. Given the above, we have lowered our NZD/USD forecasts, and now see the pair at 0.65 in Q2-19 (0.68 previously) and 0.67 in Q3-19 (0.69 previously).

Chart 15: The NZD is the worst performing developed market currency over the past two months



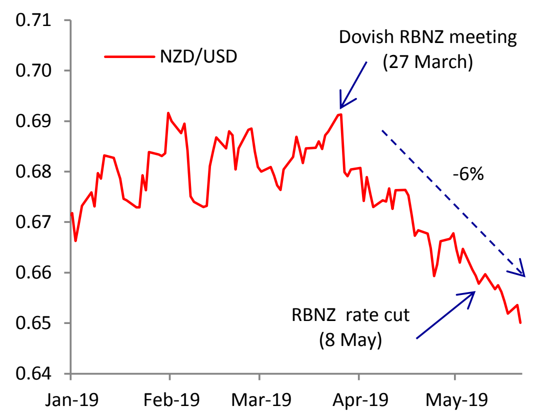
Source: Bloomberg, Santander

The NZD has come under significant pressure over the past two months, weakening by more than any other developed market currency (Chart 15). Indeed, while NZD/USD touched above 0.69 in late March, the pair has since fallen by over 6%, to below 0.65 (Chart 16). There are two key factors behind this move: the more dovish RBNZ, and the drop in risk sentiment, caused by a deterioration in US-China trade discussions.

The NZD downtrend began with the RBNZ meeting on 27 March. The Bank had previously taken a very cautious stance, suggesting that a rate hike was unlikely until 2021. However, at this meeting, RBNZ Governor Orr opened the door to a rate cut, suggesting that below-target inflation and slowing global economic growth could force the Bank to loosen policy.

In April, and as discussed in [RBNZ: A very uncertain first vote by committee], the RBNZ set up a seven-person Monetary Policy Committee, making it the last developed market central bank to shift to group decision-making on monetary policy, rather than just the governor previously.

Chart 16: A more dovish RBNZ and global trade fears have weighed on the NZD in recent months



Source: Bloomberg, Santander

The Committee's first decision was to cut rates by 25bp, to 1.50%. After the decision, Deputy RBNZ Governor Bascand suggested that New Zealand's economy needs to grow at around 3% a year for the central bank to meet its inflation and employment goals.

Annual growth fell to 2.3% in Q4-18, its lowest level in five years but the RBNZ foresees Q1-19 GDP (19 June) slipping even further, to 2.2%. A negative surprise here would certainly add pressure to cut rates again, but a one-off cut seems unlikely, in our view, as its impact on the economy is likely to be minimal. As such, we see a good chance of a further rate cut coming as soon as August.

Global trade concerns (US-China in particular) have not helped the NZD. On Friday 10 May, the US lifted tariffs on USD200bn of imports from China to 25%, from 10%. In response, China raised tariffs on USD60bn of imports from the US to between 5% and 25%.

With US President Trump since suggesting that China has one month to reach a trade deal, or else face tariffs on the remaining c.USD325bn of exports to the US, this trade uncertainty is unlikely to go away in the short term, even if the market still believes a deal will eventually be made.

Hence, while further NZD depreciation should now be more difficult given such a sharp decline already, these risks should continue to constrain the NZD in the short term.

SEK – Internationally constrained

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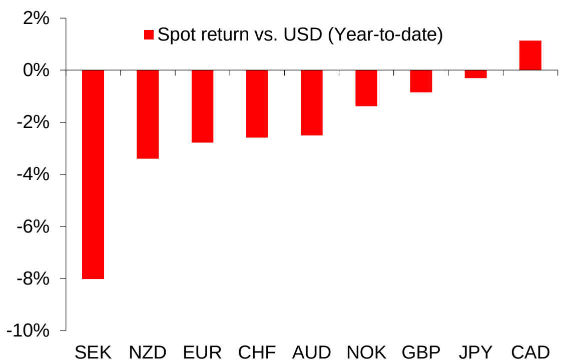
We are still wary of the SEK in the coming months. The likelihood of a rate hike from the Riksbank this year is looking increasingly remote as while domestic data are still reasonable, they are softer than they were six months ago. Global trade tensions have weighed significantly on many 'risk currencies' over the past month, including the SEK. We have raised our EUR/SEK forecasts, and now see the cross at 10.4 by year-end (10.1 before).

Chart 17: The SEK is by far the worst performing G10 currency year-to-date



Source: Bloomberg, Santander

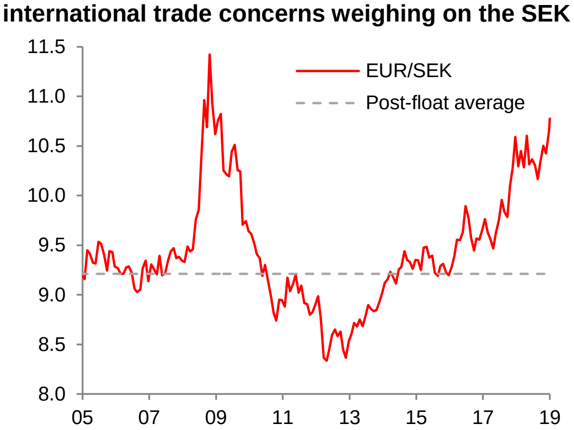
The SEK has continued its bad start to the year. It is the worst performing G10 currency by far, down 8% against the USD year-to-date (Chart 17). It even neared a 10-year low against the EUR in May, with EUR/SEK touching above 10.85.

Domestic data have not helped the currency, as while Sweden's figures are still relatively upbeat, most are softer than six months ago. Industrial production, household consumption, and both the manufacturing and services PMIs have disappointed in recent weeks.

Inflation did rise in April, with CPIF (CPI with fixed interest rate) returning to the Riksbank's 2% target. However, while this was a welcome increase after three prior declines, it was still below the Bank's 2.1% forecast, and is unlikely to be enough to prompt a more hawkish Riksbank just yet.

The Riksbank managed its first 25bp rate hike in seven years in Q4-18, but rates are still extremely low, at -0.25%. The Bank wants rates to return to more normal levels, but in April pushed back plans for a further increase, suggesting that it would hike rates again "towards the end of the year or at the beginning of next year". The SEK weakened on this, as previously it had implied that a hike would come this year.

Chart 18: EUR/SEK touched an almost 10-year high in May, with a more cautious Riksbank and international trade concerns weighing on the SEK



Source: Bloomberg, Santander

The Bank continues to advocate an expansionary monetary policy to support inflation. While Governor Ingves did note that he can live with a rate hike in H2-19, this should not be taken as anything more than a "maybe" as he also suggested that data will need to justify another rate increase.

In that regard, the Bank will be keeping an eye on the Q1-19 GDP data, released on 29 May. The Q4-18 figure impressed at 1.2% QoQ / 2.4% YoY, but with industrial production numbers for March falling to almost a three-year low, expectations for the next release are now skewed towards a softer print.

In our view, the international backdrop is currently of greater importance to the SEK than the domestic situation. Indeed, slightly softer data and a more cautious central bank seem to be the norm in developed markets over the past six months.

Consequently, as the currency of a small internationally dependent nation, the SEK has taken a big hit from international trade fears led by the escalation in US-China tariffs. While the SEK is very weak already, it is difficult to see the currency outperforming until the international trade situation settles down. Hence, while we do not expect additional SEK weakness, it may struggle to record significant gains until global risk sentiment picks up.

NOK – Going against the grain

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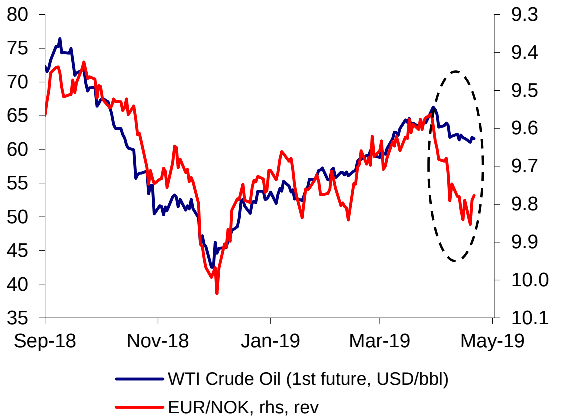
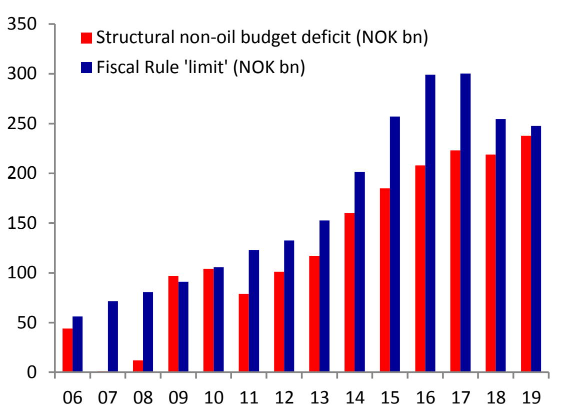
Chart 19: Oil prices have dipped in May, but even so, the NOK decline looks to have been excessive



Source: Bloomberg, Santander

Chart 20: With Norway's oil wealth continuing to rise, it has boosted spending further (i.e. structural non-oil budget deficit)



Source: Norway Finance Ministry, Bloomberg, Santander. Note: Norway's fiscal rule 'limit' was reduced to 3% of the value of the Global Pension Fund from 2018 (4% previously)

We are still positive on the NOK. The central bank has hiked rates twice since September, and has indicated that another rise in June is likely. This goes against the grain of general developed market monetary policy, which has been growing increasingly cautious over the past six months. The NOK has weakened too much over the past couple of months, in our view. We still see EUR/NOK dropping to 9.5 by Q4-19.

The Norges Bank kept rates on hold on 9 May, but said it would "most likely raise rates in June". A June rate hike would mean three rate hikes in just nine months, and therefore should be positive for the currency.

The first hike of the cycle came before the other developed market central banks shifted to a more cautious stance, so may have gone relatively unnoticed. The second hike came after the FOMC had shifted to a neutral and then a dovish view, signalling an end to quantitative tightening, so should have grabbed some headlines. However, the prospect of a third hike, only three months after the last, and just nine months after the first this cycle, highlights just how much the Norges Bank is going against the dovish grain set by the other developed market central banks, where none have hiked rates this year and the RBNZ has even cut rates.

The irony, though, is that despite the hawkish rhetoric and action by the Norges Bank, which is likely to hike rates by another 75bp over the next year, as it seeks to lift the policy rate towards the Bank's 2% estimate of its neutral rate, the NOK has barely strengthened. In fact, it has weakened notably over the past couple of months.

Oil prices have dipped during this time, and given the importance of oil to the Norwegian economy, this does suggest that the NOK should weaken, but not by as much as the recent move (Chart 19). In a similar fashion to the SEK, AUD and NZD, the NOK has taken a hit from increased global trade fears, as the US-China trade confrontation has escalated. Consequently, the NOK is likely to remain vulnerable to global risk aversion over the coming months.

However, fundamentals justify a stronger NOK, in our view. Norway's economy benefits from a fiscal stimulus from its oil earnings. The government's global pension fund made a record 9.1% gain in Q1-19 (Chart 20), and this clearly helps the already enviable government finances.

The government revised its budget on Tuesday 14 May, proposing to increase spending to NOK238bn (USD27bn) of its oil revenue in 2019, up from the initial NOK231bn estimate in October. Although this stimulus is due to lower spending last year, the Finance Ministry suggests it will provide a boost of some 0.5% to GDP.

Hence, this stimulus, together with above-target inflation (headline CPI is currently at 2.9%), suggests that the Norges Bank could continue its tightening cycle in June. The market may still be overlooking both factors currently, but when global trade fears subside, there should be scope for NOK gains.

LatAm FX: Main Themes

Currency	3M view	12M view	Main Themes
BRL	↗	→	• Increasing antagonism between the executive and members of Congress has raised concerns about the final shape that the pension reform will take. • General frustration with the pace of economic growth has resurrected debates about the likelihood of further monetary easing this year. • Similar to its policy under the previous central bank governor, the current monetary authority has intervened to correct distortions in the FX market.
MXN	→	↘	• Banxico's Board of Governors decided to hold the policy rate unchanged, at 8.25%, on 16 May, but maintained the previous communiqué's restrictive tone. • The number one risk to the inflation outlook, according to the 16 May communiqué, is the MXN/USD exchange rate potentially coming under pressure owing to external or domestic factors. • In essence, the policy rate has worked as insurance against any deterioration of the outlook, with an eye on a stable MXN.
CLP	↗	→	• The importance of the external environment will remain a recurring theme for USDCLP, with copper the best reflection of China-US trade tensions. • Risk factors centre on a pronounced global slowdown and copper prices suffering at the margin, both directly impacting local activity. • In the medium term, the convergence of the US economy towards potential and a pick-up in emerging markets' growth would constitute the ideal scenario for the CLP.
COP	↗	→	• In the past month, the COP has turned from being one of the best performing currencies in the EM and LatAm spectrum to one of the worst. • The COP's weakness stands out, not only because it has underperformed its EM peers, but mainly because oil prices remain relatively high. • While external factors have played an important role in the COP's recent weakness, the domestic macroeconomic scenario may also be turning into an important source of pressure, especially with a wider deficit on external accounts.
ARS	→	↘	• The peso's devaluation slowed to 1.7% m/m in May, halving the monthly loss registered in April. • The central bank's 29 April announcement of sporadic intervention through the sale of US dollars clearly helped FX performance. • We expect the FX market's volatility to remain low going forward, as in May, despite the uncertainty around the outcome of the 27 October presidential elections.
PEN	→	↘	• The PEN has performed relatively well against its LatAm and EM peers over the last month, despite its recent depreciation and unusually high volatility. • The external environment will likely be in the driver's seat, with copper prices and the US dollar being the main influences, while the central bank will likely continue to intervene at times of high volatility. • The central bank's board seems comfortable with its holding stance, and with the slow start for the economy in the first quarter, we consider that the board will now remain on hold until 4Q19.

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

Source: Santander.

BRL – Talk is (not) cheap

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Despite having witnessed a significant decline in his level of popular support since his presidential term began – which would suggest limited room to engage in quarrels – President Bolsonaro has maintained a relatively antagonistic posture towards his former colleagues in the Congress. This approach has led to increasing tension in their relationship, which has spilled over to market participants' confidence in the government's ability to succeed in getting a decent pension reform bill through the Congress.

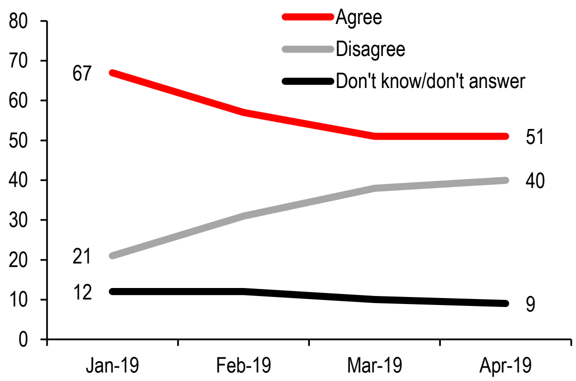
As a result, we have experienced a correction lately in Brazilian financial assets' prices, with the FX rate having breached the psychological threshold of USDBRL4.00 – which seemed to be the ceiling of the relatively tight range of BRL3.65-4.00 versus the USD that had prevailed since late October 2018. The move in asset prices attracted the attention of the Brazilian central bank, which apparently deemed it incompatible with the country's economic fundamentals, thus leading the monetary authority to intervene in the currency market through FX credit lines.

In our view, the choice of this approach reflected the BCB's perception that a shortage of greenbacks in the domestic market was not behind the weakening of the BRL and that the correction in asset prices could cause unnecessary damage to the domestic economy. That is exactly the same approach that former BCB boards pursued on previous occasions, which confirmed our view presented in the last FX Compass: that there has been no significant change in the modus operandi from Goldfajn's governorship to Campos Neto's captaincy. This prudence with respect to the FX market has also prevailed in the conduct of monetary policy lately. However, frustration regarding the vigour of economic activity has resurrected debate as to whether the BCB is excessively wary in the present situation – especially as core inflation gauges have continued to run at quite comfortable levels of late.

Amid uncertainties on the political front, we think that further monetary easing moves would lead the BRL to weaken versus the USD. However, the BCB board has already made clear that it does not plan to make any change in the base interest rate for now – particularly in the absence of concrete signs of progress related to structural reforms on the fiscal front (i.e. pension reform).

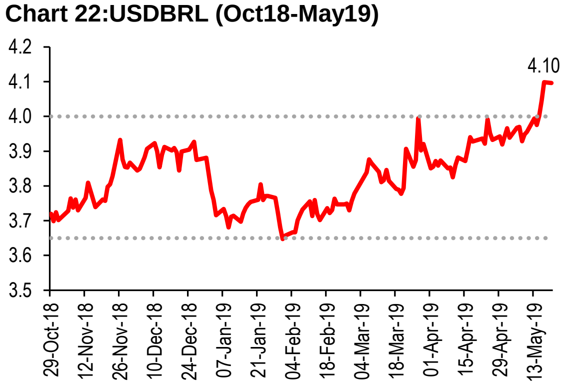
Fortunately, the political climate has seemingly improved of late, albeit gradually, as members of Congress have shown a greater willingness to move forward with fiscal reforms, while President Bolsonaro has softened his criticism of his erstwhile colleagues. This shift in attitudes, in tandem with the perception that the BCB would intervene in extreme situations and that it is not in a hurry to cut the Selic target rate, should favour the BRL in the short term.

Chart 21: Assessment of president Bolsonaro's conduct in the Brazilian presidency



Source: IBOPE

Chart 22:USDBRL (Oct18-May19)



Source: Santander, Bloomberg

MXN – Banxico maintains its restrictive tone

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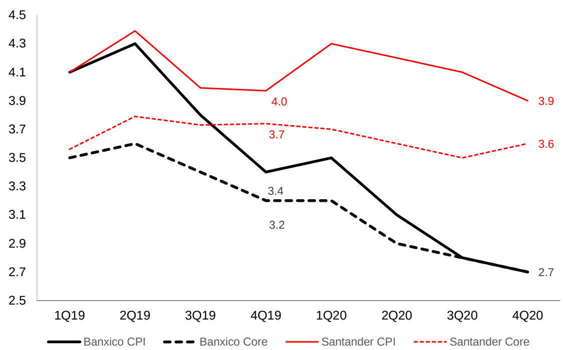
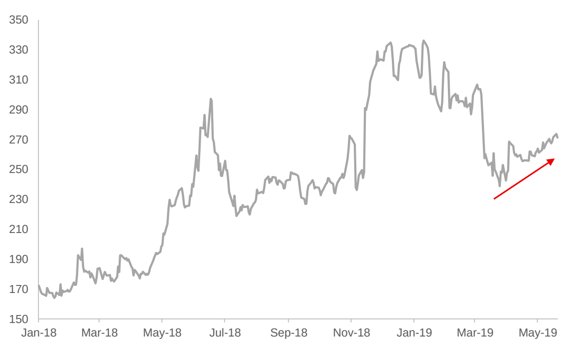
Chart 23: CPI inflation forecasts (y/y %)



Source: Santander, Banxico

Chart 24: Pemex CDS USD SR 5Y.



Source: Santander, Bloomberg

Banxico's Board of Governors decided to hold the policy rate unchanged, at 8.25%, on 16 May but maintained the previous communiqué's restrictive tone. If anything, inflation and the balance of risks to inflation have deteriorated from the last meeting on 28 March. According to Banxico's Monetary Policy Decision Making (as described on p.24 of the 4Q inflation report presentation), the first step in evaluating the required monetary policy stance is to compare inflation developments with inflation forecasts. Banxico's 2Q19 inflation projections call for average headline inflation of 4.3%, with core inflation at 3.6%. With only data for the month of April available, and our own price monitoring for the first half of May, we see that both measures might end the quarter above Banxico's expectations for the quarter, at 4.4% and 3.8%, respectively. In this latest meeting, Banxico said that inflation was on track to meet its projection, but it most likely will have to revise its forecasts in the following meetings. The second step was to look at the balance of risks to inflation.

The number one risk to the inflation outlook, according to the 16 May communiqué, was the MXN/USD exchange rate potentially coming under pressure owing to external or domestic factors. Although the MXN has not deteriorated since the last monetary policy meeting, one could argue that this lack of deterioration can be attributed to the high policy rate compared to other emerging markets and, in real terms, compared to historical data. However, external and domestic factors have deteriorated. As such, one could also argue that this deterioration is an argument for not cutting the policy rate but rather leaving it at the current level. In particular, the 16 May communiqué said: "Looking ahead, risks persist which might have a significant effect on the performance of financial assets in Mexico. In particular, uncertainty regarding the external environment might lead to portfolio adjustments, and investors remain alert to domestic issues such as the credit perspectives for Pemex and for the economy in general". Judging by its credit default swap, Pemex risk as perceived by the market has started to rise since the last meeting.

In essence, the policy rate has acted as insurance against any deterioration of the outlook, with an eye on a stable MXN. Banxico is also worried about persistently high core inflation that could lead to increased resistance to reducing long-term inflation forecasts, even more so if core inflation breaks the 3.5-3.7% range. Moreover, additional upward risks to inflation, as listed in Banxico's last monetary policy communiqué, are deteriorating: international energy prices continue to rise; more nations are implementing protectionist and compensatory measures; Pemex targeted oil revenue is proving out of reach, thereby weakening public finances; and contractual wage revisions have grown more rapidly than productivity —private sector contractual wage revisions average 6.2% to date, with productivity gains close to zero. Banxico now sees wage increases as a possible explanation of persistently high core inflation.

CLP – China sneezes, the peso gets a cold

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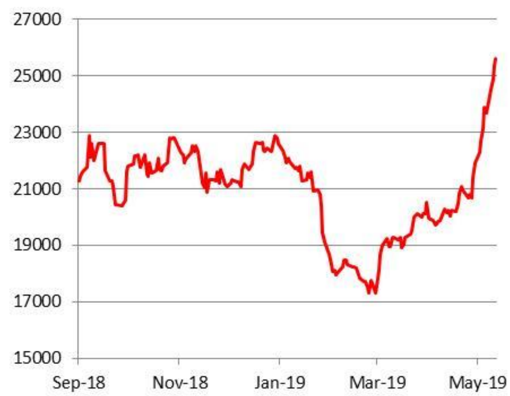
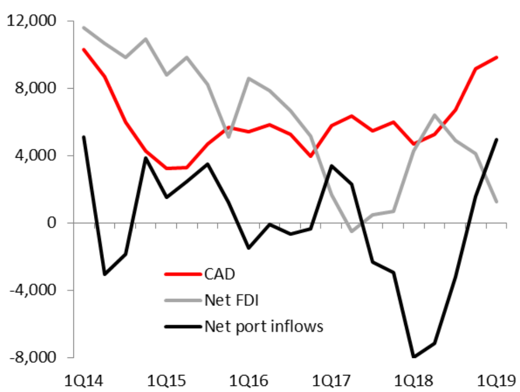
Chart 25: USDCLP: NDF offshore positioning



In US$ million. Source: Santander, Bloomberg

Chart 26: Selected BoP indicators – Last 4Q, US$mn



Source: Santander, BCCh

In the last few weeks, renewed global trade tensions have been a key driver for the CLP, highlighting once again the connection between China, copper, and the Chilean peso. Since 25 April, the offshore renminbi has sold off 3%, copper declined by 5% (near US$2.70/lb), and the USDCLP rate jumped 4% to almost 700 as this report goes to press. The CLP has underperformed in this context, with the EM FX index and typical commodity currencies losing 2%, mainly reflecting a very substantial increase in long USDCLP positions by offshore investors (+U$5bn in only four weeks).

On the local front, March IMACEC and April CPI added to the dovish sentiment also prevailing abroad. Regarding growth, IMACEC grew only 1.8% y/y in March and 1.6% in 1Q19, the slowest pace since mid-2017. This is in part due to specific problems in the mining sector, but non-mining activities have also softened in the last few months (+2.2% y/y in 1Q, vs. 3.7% in 4Q18). We expect to see a rebound in IMACEC data in 2H19, but the market is now projecting 2019 GDP at 3.2% (-40bp vs. December 2018), close to the bottom end of the BCCh projection range. Regarding inflation, April posted a level of 2.0% y/y, unchanged vs. previous readings. Core inflation was even lower (1.9% y/y), and the underlying factors appear relatively benign (salaries, output gap, the ongoing disconnection between FX and inflation), so we are likely to see CPI hovering around 2% for several months.

As for monetary policy, we expect a relatively quiet period in the coming months, as the BCCh should keep rates unchanged at 3% for somewhat longer. This was the message of the last MonPol report, and we do not see the inflation-growth balance shifting enough to justify any great change in that approach.

On the external front, recent BoP data showed another widening in the current account deficit (CAD), to US$1.0 billion in 1Q19 (vs. US$0.3 billion 1Q8) and US$9.8 billion in the last four quarters (or 3.3% of GDP, vs. 2.2% two quarters ago). This is the result of stagnant export revenue (non-mining exports failing to offset the weakness of copper prices) and sustained import growth (especially mining machinery and cars). On the financing side, Chile's position also looks a little more vulnerable now, as net FDI covered only 15% of the CAD, with net portfolio inflows (especially in bonds) gaining significant importance (50% of CAD). Access to external markets is far from a concern for Chilean issuers, but the CAD approaching 4% of GDP and tightening rate differentials with the US may become a source of weakness for the currency.

All in all, we continue to see the CLP highly correlated with external forces, i.e. copper and the global USD, and its trajectory ultimately depends on whether investors believe the US or China is the key engine of global growth. We maintain our range-bound strategy, assuming copper at US$2.65-3.00/lb, which for USDCLP should mean 650-690. If this call is correct, current market levels would represent reasonable selling USDCLP points, although in the era of Twitter-based news on the global trade conflict, one can never know.

COP – Feeling the pressure

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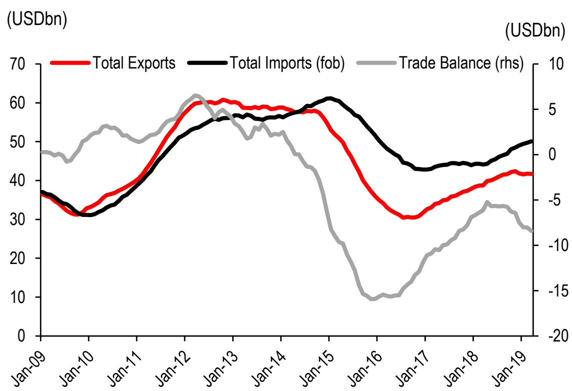
Since our last FX Compass (published on 25 April), the COP has turned from being one of the best performing currencies in the EM and LatAm spectrum, to one of the worst. Since our last publication, the COP has weakened constantly, depreciating 5.7% against the USD, surpassing the 3300 level and hitting the lowest levels since February 2016. In general, in the past month, EM currencies have lost ground against the dollar as a result of the risk-off mood arising from the escalation of trade tensions between the US and China. However, the COP's weakness stands out, not only because it has underperformed its EM peers, but mainly because oil prices remain relatively high, with Brent prices only falling 4.3% in the past month, but remaining above 70 dollars per barrel.

While external factors have played an important role in the COP's recent weakness, April's seasonal outflows likely added some pressure, while the domestic macroeconomic scenario may also be turning into an important source of pressure, as sovereign rating downgrades from Moody's and Fitch remain a possibility, the external balance has widened and the expectation of low interest rates for longer prevails, as the economic recovery fails to impress.

On the external front, a wider trade and current account deficit is fostering strong demand for dollars. The latest trade data indicate that imports are accelerating, in line with the economic recovery, while exports remain stable. As a result, the trade deficit is widening at a fast pace, suggesting that the figure will double by end-2019, which in turn will lead to a current account deficit of around 4.0% of GDP or above, the highest deficit registered since 2016.

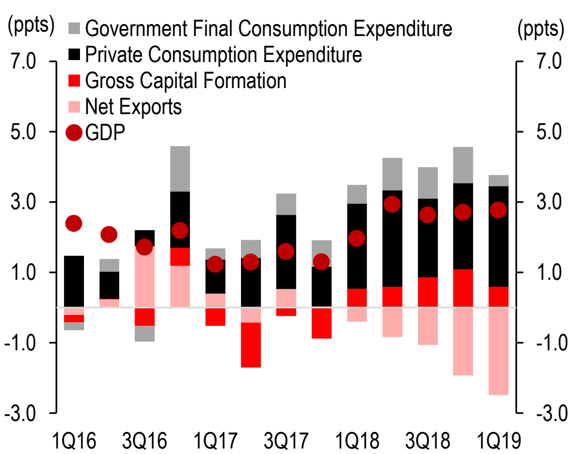
Chart 27: Widening trade deficit (12-month sum)



Source: DANE, Santander

In addition to the higher external deficit, BanRep is likely to remain on hold for longer, as 1Q19 GDP growth disappointed. Indeed, GDP grew 2.8% y/y, falling short of BanRep's estimate of 3.2% y/y. On the supply side, construction was the main negative surprise, as it contracted 5.6% y/y, subtracting 0.4ppts from annual GDP growth. On the demand side, the higher trade deficit was the main drag, offsetting still robust private consumption, while investment and public consumption also moderated.

Chart 28: GDP growth, demand side composition



Source: DANE, Santander

In the latest quarterly inflation report, the central bank governor, Mr Echavarria, reiterated the bank's growth forecast of 3.5% y/y for 2019 as they continue to expect a stronger recovery in investment. Yet, he recognised that the results were disappointing and there are still concerns about the pace of the recovery. This, in combination with a benign outlook for inflation in 2019, suggests that the board is likely to hold until December, when we think they will deliver their first hike as inflationary pressures are likely to increase.

In general, we consider that in the short term the COP may make up some ground as June's seasonality favours the currency, in addition to the new flows coming from Ecopetrol payments. Yet, in the second half of the year, we expect the COP to remain pressured and close to the 3300 level.

ARS – US dollar quote entering calmer waters

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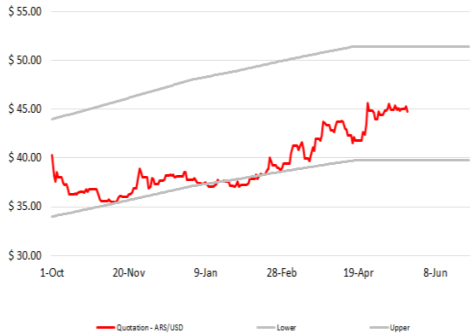
The peso's devaluation slowed to 1.7% m/m in May, halving the monthly loss registered in April. This respite from the devaluation trend, in a year in which the ARS has lost more than 15% of its value and inflation reached a 56% cyclical annual peak in April, constitutes the first positive response to draconian monetary and fiscal policies, with the growth in the monetary base equal to zero in the last eight months and the 2019 Treasury goal continuing to be a primary balance already achieved this year.

Chart 29: ARS/USD and NI zone



Source: Santander, Central Bank, Bloomberg

In addition, on 29 April the central bank announced two crucial measures highly awaited by the market: (i) its sporadic intervention through the sale of US dollars, even though the FX price would be quoting below the ARS51.488 ceiling of the non-intervention-zone; and (ii) an increase to US$250 million – 67% higher – in its daily FX interventions in any session when the US dollar quotation exceeds ARS51.488/USD.

Interestingly, according to central bank statistics, month-to-date the BCRA has not intervened in the spot market other than the US$60 million daily auction implemented on behalf of the Treasury. The derivative (ROFEX) market, in turn, may have recorded non-significant future selling from the central bank. The central bank's 7-day Leliq rate, in turn, currently assimilated to the monetary policy rate, has compressed 170 basis points in May, in tandem with a gradual easing of credit conditions.

Looking forward, we expect the FX market's volatility to remain low, as in May, despite the uncertainty about the outcome of the first round of the presidential elections on 27 October.

We foresee a shift towards a more moderate and pragmatic version of 'Kirchnerism', envisaged as a result of the 18 May announcement of Cristina Kirchner's candidacy as vice presidential running mate to Alberto Fernandez. In our view, this unexpected decision has important implications for the 2019 elections and for what a potential Fernandez-Kirchner presidency might entail. We believe Cristina Kirchner has finally realised the country's lack of sufficient resources to support the populist policies she would like to propose. Thus, if Alberto Fernandez became president instead of CFK, he would be obliged to follow cautious macroeconomic policies as Nestor Kirchner did at the beginning of his government in 2003. Thus, our base case scenario currently assumes moderate and reliable proposals from Alberto Fernandez in an eventual government led by CFK's "Unidad Ciudadana" coalition.

If our hypotheses prove correct, the Fernandez-Kirchner macroeconomic proposals made before October 2019 should further compress volatility for highly sensitive macroeconomic variables on top of the sound policy currently in place, benefiting President Macri's polling in the October presidential race and thus increasing the likelihood that the Cambiemos coalition will win a second term.

PEN – Low interest rates for longer

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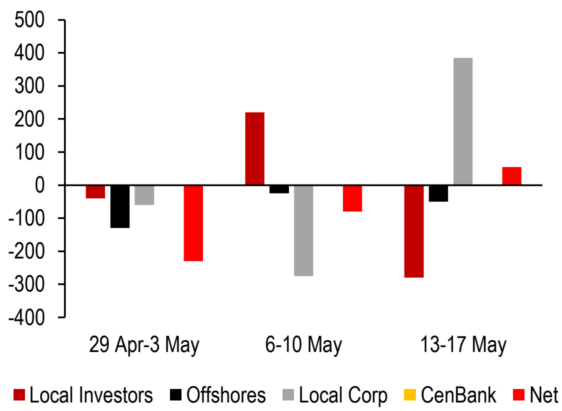
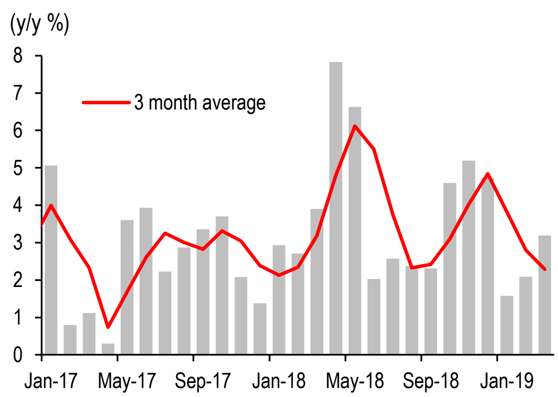
Chart 30: USDPEN FX flows (billions)



Source: Central Bank, Santander

Chart 31:Slow start to activity in 1Q19



Source: INEI, Santander,

Since our last publication on 25 April, the external environment has taken a turn for the worse, with renewed tensions between the US and China, as well as a further slowdown expected in the global economy, led by the developed economies. In this less benign scenario, metal prices have suffered, with copper declining 7.7% in the past three weeks. In line with this, the PEN has depreciated by 1.1% against the USD, exceeding 3.34, the PEN's lowest level since January this year, amid unusually high volatility. Yet the PEN has performed well versus its EM and LatAm peers, being one the best performing currencies YTD here.

During the past month, in addition to lower metal prices, the currency saw some pressures coming from demand for USD from offshore account and local corporations, while the central bank intervened for the first time this year on 21 May, via swaps ($300mn), limiting the PEN's depreciation. In general, we expect the currency to continue to be influenced by the external environment, but its adjustment should remained contained versus peers, as the central bank will likely continue to intervene at times of high volatility or strong depreciation. With these forces at work, the PEN will likely continue to float between 3.33 and 3.35.

On the local front, headline inflation jumped to 2.59% y/y in April from 2.25% y/y in March, reflecting mainly inflationary pressures from food & beverages, as a result of the seasonal effect from Easter week, as well as from transportation, due to higher gasoline prices. Core inflation (CPI ex-food and energy prices) also increased slightly to 2.59%, remaining above 2.0% for almost a year, suggesting that demand side pressures remain.

In terms of growth, economic activity improved, climbing 3.2% y/y in March, up from the 2.1% y/y and 1.6% y/y growth reported in February and January, respectively. With this, GDP growth for 1Q19 stood at 2.3% y/y, notably below the robust 4.8% y/y growth reported for 4Q18. The main drag was registered in primary activities, in particular mining and fishing. However, seasonally-adjusted series continue to point to a steady improvement in the economy.

Finally, in terms of monetary policy, in the latest communiqué, we consider that the central bank retained its hawkish bias, with the board differentiating the primary sector from the rest of activities. Indeed, the board acknowledged that the economy ex-primary sector remains dynamic, and continues to believe that the output gap for these activities is narrowing. In general, we consider that the economy will pick up in the coming quarters, as local public investment normalises. However, given the weakness of the first quarter, we anticipate a delay in the closing of the economy's output gap, and thus we believe that the central bank will try to hold the monetary policy rate on hold for longer to continue to provide support to the economy. Thus, we now expect the central bank to deliver its first hike in 4Q19 instead of 3Q19 and bring the interest rate up to 3.00% by end-2019.

CEE FX: Main Themes

Currency	3M view	12M view	Main Themes
PLN	↘	↗	• We leave our forecasts unchanged and still expect EUR/PLN to stay above 4.30 in the coming months, before starting to gain when signs of an economic revival in the European economy become more apparent. Also, we think that trade tensions would need to calm down in order to allow the zloty to make sustainable gains.
CZK	⇨	↗	• In late May, EUR/CZK is trading slightly below our 2Q target where it rose after a dovish rate hike and lower-than-expected Czech inflation. We expect the exchange rate to stay in the 25.5-25.8 range in the short term, while we see a risk of a weaker koruna in 2H19 due to trade tensions. For now, we keep our forecasts unchanged.
HUF	⇨	⇨	• We maintain our forecast for EUR/HUF and expect it to stay close to the current high level in the coming quarters, owing to the trade war escalation and expected lower export activity in the EU. In our opinion, this could negatively affect the Hungarian economy, which is closely tied to EU exports and this, in turn, would prevent the forint from appreciating.
RUB	⇨	↘	• We maintain our forecast of USD/RUB gradually climbing to 67, in the face of an expected deterioration of the global market mood and persistent tensions in US-Russia relations. Moreover, we believe the ruble will be weakened by the decrease in inflationary pressure that is expected in 2H19 and by the still low level of economic activity. This implies that the market should continue the process of shifting from discounting increases in rates to discounting a cut in rates, which might weaken the ruble.

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

Source: Santander Bank Polska S.A.

PLN – Following the pattern

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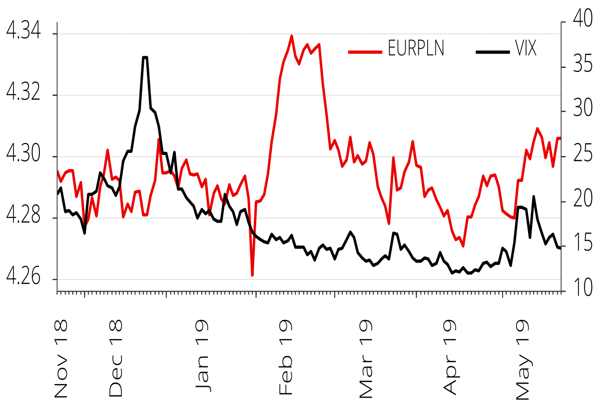
Chart 32. EUR/PLN and VIX



Source: Thomson Reuters Datastream, Santander Bank Polska

In the recent weeks, we have not seen any major changes in the Polish FX market, with EUR/PLN holding the "May pattern" described last month as higher risk aversion weighs on the zloty. We leave our forecasts unchanged and still expect EUR/PLN to stay above 4.30 in the coming months, before starting to gain when signs of an economic revival in the European economy become more apparent. Also, it seems that the current trade tensions would need to calm down in order to allow the zloty to make sustainable gains.

European Parliament elections will take place in the final weekend of May. We do not expect the results to have much impact on the zloty. Should the ruling PiS win (as the recent polls show), this would most likely maintain the status quo in Polish politics after the autumn parliamentary elections. The fact that people in large cities participate in the EP elections more than those in smaller cities (where PiS usually has more support) might lead to a victory for the coalition of opposition parties.

As expected, the Monetary Policy Council (MPC) kept interest rates unchanged. The recent CPI rise (to 2.2% y/y in April from 1.7% y/y) came as a surprise, but the MPC downplayed it and said it was not enough to change their views. The central bank governor did not rule out the possibility that the CPI may exceed 3.5% at the end of this year but said he expected it would subsequently decline. We are still quite a long way from a point when a serious discussion about monetary tightening could start. It is possible in 1H20 at the earliest, in our view, assuming the CPI exceeds 3% and economic growth does not decelerate sharply. In the short term, the MPC's soft approach towards rising inflation may work against a stronger zloty.

According to the flash estimate, Poland's GDP growth reached 4.6% y/y in 1Q19 vs 4.9% y/y in 4Q18. The seasonally-adjusted 1.4% q/q growth should be viewed as a strong result, confirming that the Polish economy is quite resilient to the global economic slowdown. The breakdown will be revealed on May 31, but we suspect that strong domestic demand played an important role and net exports most likely made a positive contribution to growth as well. We expect the Polish economy to continue on a gradual slowdown (to c4.1% on average in 2019E) as the impact of the negative external environment (slowdown in EU, US-China trade war) will be partly offset by robust consumption and investments.

In mid-May, the General Ombudsman at the European Court of Justice (ECJ) issued a favourable opinion for Polish FX mortgage borrowers about how the exchange rate for monthly instalments was calculated. The ombudsman said that, when this process is considered illegal, the mortgage could be converted into a PLN loan at the market FX rate when the initial deal was signed. The ECJ is expected to give a verdict in up to six months, which would not be binding for the Polish courts. However, the final verdict is likely to be in line with the initial opinion and so the CHF-loans issue could re-emerge and generate uncertainty about the future of the Polish banking sector.

CZK – New risk factor

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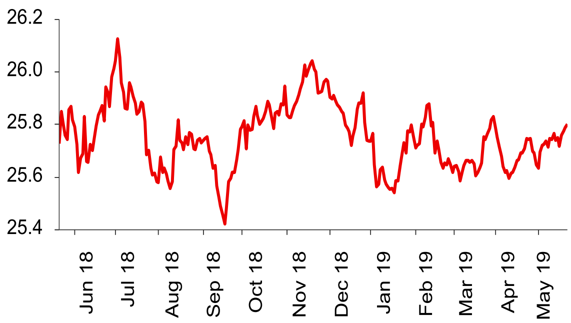
Chart 33. EUR/CZK



Source: Thomson Reuters Datastream, Santander Bank Polska

In late May, EUR/CZK is trading slightly below our 2Q target where it rose after the dovish rate hike and lower-than-expected Czech inflation. We expect the exchange rate to stay in the 25.5-25.8 range in the short term but see a risk of the koruna weakening in 2H19 due to the trade wars. For now, we keep our forecasts unchanged.

President Trump has recently said he could impose tariffs on European car exports. In late May, he postponed the decision by 180 days but this case could be important for the Czech economic outlook. According to data for 2017, cars and vehicle parts constitute c20% of Czech exports, with Germany the main destination (30% of the total). Opening another front in the trade war could generate an upside risk to our 3Q and 4Q EUR/CZK targets.

In 1Q19, Czech GDP growth slowed to 2.5% y/y from 2.6% y/y in 4Q19 and vs 5.2% y/y at the economic cycle's peak in 3Q17. We do not yet have the detailed breakdown. In April, Czech inflation slowed to 2.8% y/y vs 3% in March (the highest reading since late 2012).

In early May, the Czech central bank (CNB) hiked interest rates by 25bp, taking the main rate to 2%. Governor Rusnok said that rates should now be stable and the next move could be in any direction. We thought the rate hike would be delivered in June. Nevertheless, we now think rates will stay on hold at least until the end of the year.

HUF – Weakest for a year

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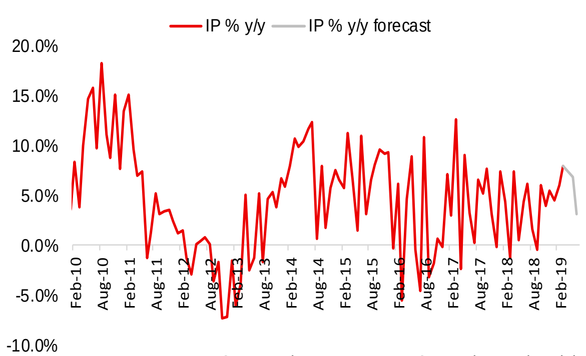
Chart 34. Hungarian industrial production (% y/y)



Source: ThomsonReuters, Santander Bank Polska

We maintain our forecast for EUR/HUF and expect it to stay high in the coming quarters, owing to the trade war escalation and expected lower export activity in the EU. In our opinion, this could negatively affect the Hungarian economy, which is strongly tied to EU exports, and this could prevent the forint from appreciating.

In May EUR/HUF was rising, fuelled by mounting tension in the Sino-US and US-EU trade negotiations. Moreover, the forint was negatively affected by information about weak factory orders in Germany and disappointing domestic retail sales data. Market players ignored positive surprises in GDP growth (5.3% y/y vs. 4.9% y/y consensus) and PMI releases (54.9 vs. 51.5 pct.) as well as March industrial production data (8.0% y/y vs. 6.0% y/y). As a consequence, EUR/HUF climbed from 320.60 to 326.80, its highest since mid-2018.

We expect EUR/HUF's rise to pause in June as much of the negative impact of the trade wars looks to have already been priced in and the market may focus on the macro data. We forecast April industrial output rose by 7.3% y/y vs. 8.0% y/y in March and the May PMI is likely to stay high. This should be supported by temporarily higher activity in the auto sector.

Taking a year-end view, we see EUR/HUF remaining high because of a likely slowdown in industry, especially in the export-driven sectors. The room for further forint depreciation is likely to be limited by still high inflation and the fact that the market does not believe the March depo rate hike by the Hungarian central bank was just a one-off adjustment. Moreover the forint will be supported by expectations of strong domestic demand.

RUB – Under global stress

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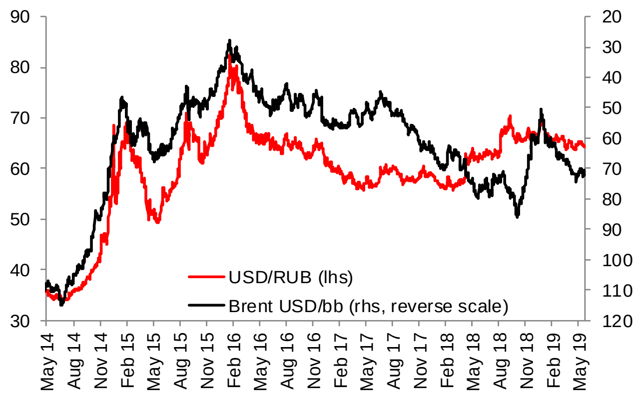
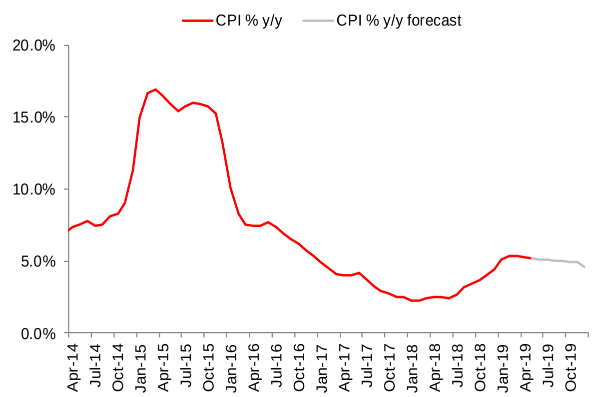
Chart 35. USD/RUB and Brent oil price



Source: Santander Bank Polska, Thmoson Reuters

Chart 36. Russia CPI (% y/y)



Source: ThomsonReuters, Santander Bank Polska

We maintain our forecast of USD/RUB gradually climbing to 67 in the face of a likely deterioration in the global market mood and persistent tensions in US-Russia relations. Moreover we believe that the ruble will be weakened by the decrease in inflationary pressure that we expect in 2H19 and the still low level of economic activity. This implies that the market should continue to shift from discounting rate increases to discounting rate cuts, which could weaken the ruble.

The ruble has declined in the last month. Initially this was a negative reaction to lower oil prices and the escalation in geopolitical tension and it recovered late May. This rebound was partly due to the rise in oil prices and partly to a better mood in global financial markets. As a result, by mid-month USD/RUB had climbed to 65.40 (from 64.70 at the end of April) and it stood at 64.40 in late May.

Recently-released weaker macro data (1Q19 GDP rose by 0.5% y/y vs. a market consensus of 1.2% y/y), and a weakening of the inflation surge generated by VAT increases at the beginning of the year, should negatively affect the ruble in the short term. We believe that slower economic activity (partly as a reaction to the VAT increases, according to the central bank), combined with the above-mentioned factors, will gradually translate into the market discounting steeper rate cuts in 2H19 and will push the USD/RUB up. In the short term, the ruble could be hurt by contamination of Russian oil delivered to Europe via the Druzhba pipeline, which is likely to translate into lower export income.

On a year-end perspective, we still see some threat from the weakening of the Asian economy (hit by new US tariffs on Chinese exports), which is likely to translate into lower demand for the industrial commodities exported by Russia. However the scale of this could be limited, as the US's restrictive measures against Iran could curb Iranian competition in the commodity market.

As a result, we expect a further increase of USD/RUB to close to 67 at year-end, with the currency staying at that level until mid-2020.

G10 FX: IMM Speculative Positioning

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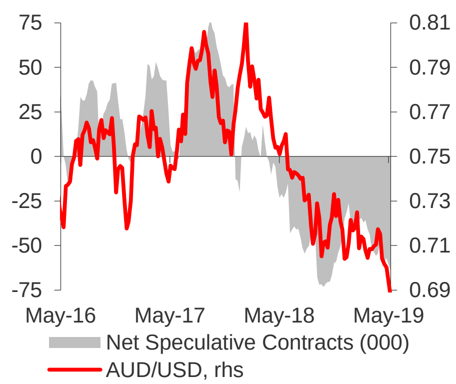
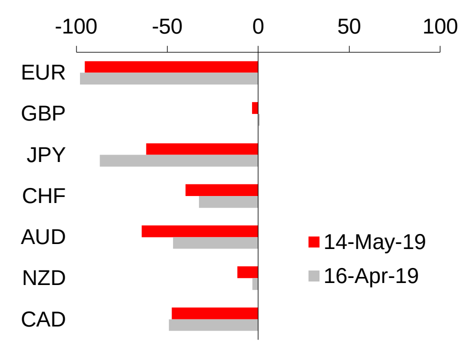
IMM commitment of traders report: AUD/USD position



- **Speculators have turned more cautious on the NZD.** The net short NZD position was relatively neutral a month ago, but has turned notably net short on a more dovish RBNZ. The Bank cut rates to a new all-time low in early May, and the prospect of a further cut is likely to keep this position net short. In the week ended 14 May, the net short NZD position was 11k contracts.
- **The net short AUD position has also risen,** with the market increasingly assuming the RBA will follow the RBNZ in cutting rates. The Bank even suggested this week that a cut could come as soon as the June meeting. The net short AUD position is now at 64k contracts. This is not far from 2018's 73k high, or 2015's all-time high, at 77k contracts.
- **Speculators have reduced their net short EUR position slightly,** but at 95k contracts, they remain very cautious on the EUR, with low growth and limited prospect of tighter monetary policy offering EUR bulls little to work with.
- **The net GBP position remains neutral,** with little change on the Brexit front in recent weeks requiring no alteration in stance.

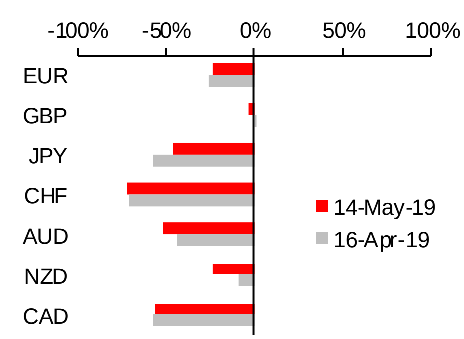
Net Speculative Contracts ('000s)*

	14-May-19	16-Apr-19	4w chg	YtD chg
USD***	175.1	160.0	15.1	172.4
EUR	-95.3	-98.0	2.7	-187.4
GBP	-3.3	0.9	-4.2	-16.0
JPY	-61.6	-87.1	25.5	54.5
CHF	-40.0	-32.6	-7.4	-26.1
AUD	-64.0	-46.9	-17.2	-50.4
NZD	-11.4	-3.2	-8.2	6.1
CAD	-47.6	-49.2	1.6	-64.9



Net Speculative Contracts as % of Open Interest**

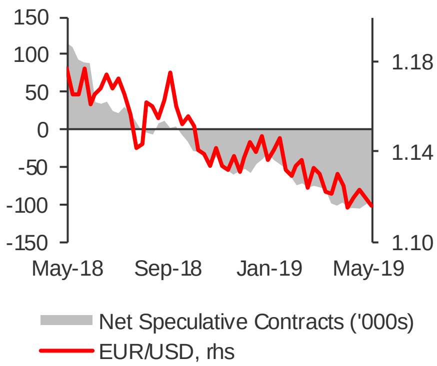
	14-May-19	16-Apr-19	4w chg	YtD chg
USD***	14%	14%	0%	14%
EUR	-24%	-25%	1%	-52%
GBP	-3%	1%	-4%	-12%
JPY	-46%	-58%	12%	11%
CHF	-72%	-71%	-1%	-54%
AUD	-52%	-44%	-8%	-37%
NZD	-23%	-9%	-14%	10%
CAD	-56%	-57%	1%	-82%



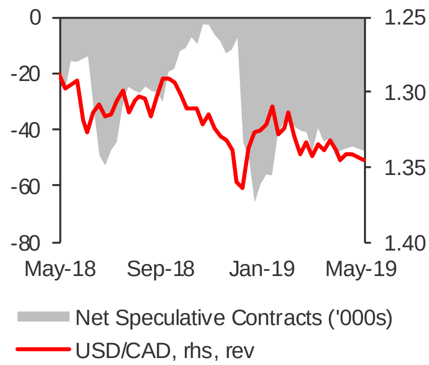
Sources: CFTC, Bloomberg, Santander. Note: *Net Speculative Contracts = Long non-commercial traders contracts minus short non-commercial traders contracts, **Open Interest = The total number of outstanding long and short futures contracts, ***USD composite index = USD composite index uses AUD, CAD, CHF,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

G10 FX: IMM Speculative Positioning

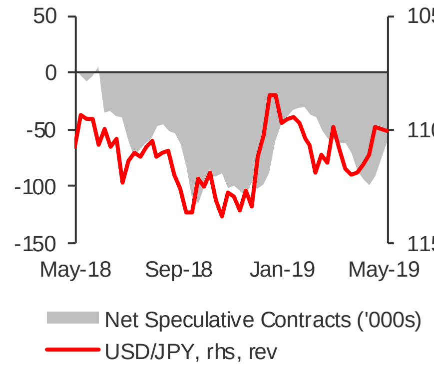
EUR/USD



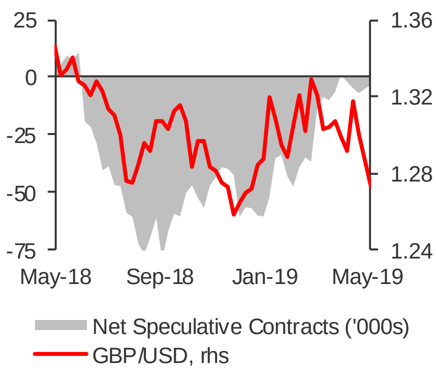
USD/CAD



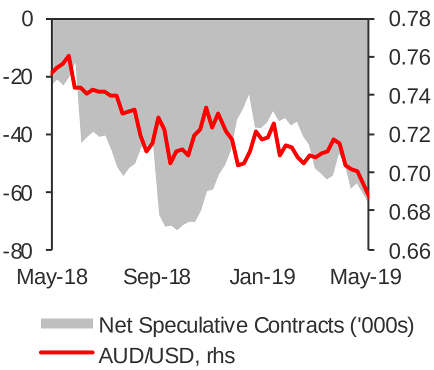
USD/JPY



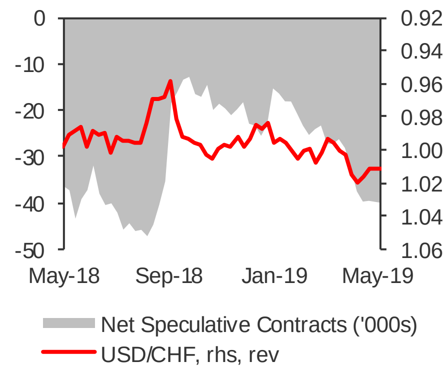
GBP/USD



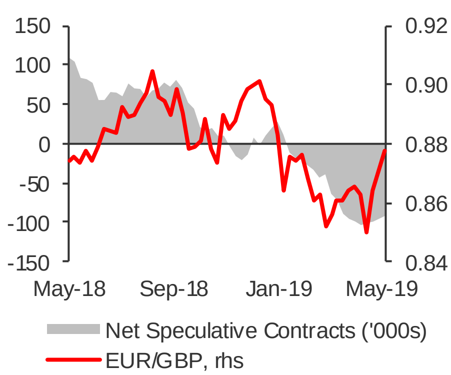
AUD/USD



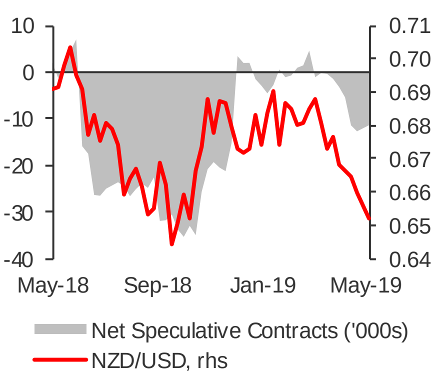
USD/CHF



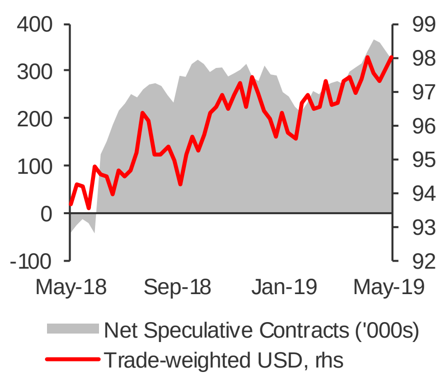
EUR/GBP



NZD/USD



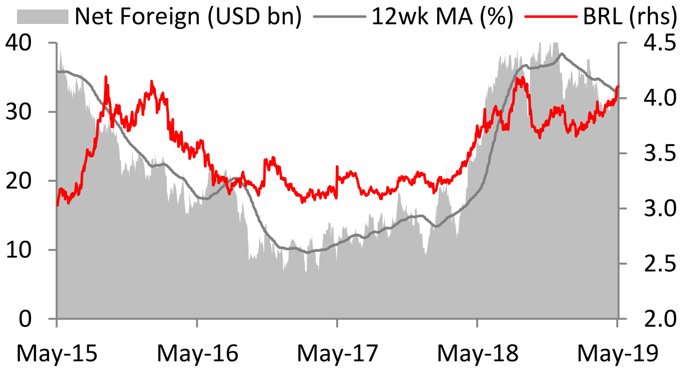
USD minus MXN



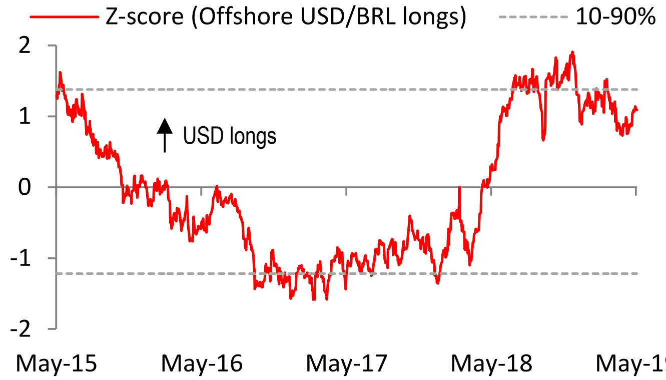
Sources: CFTC, Bloomberg and Santander. Note: IMM commitment of traders report

Latin America FX: Positioning indexes (Z-scores)

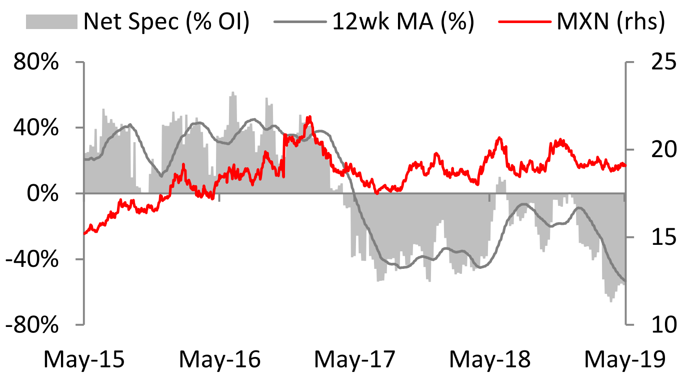
USD/BRL



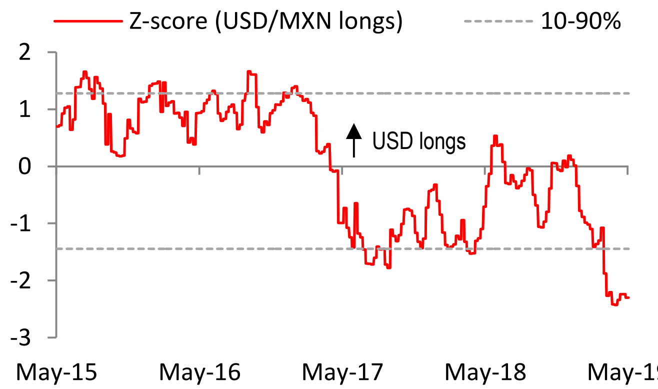
Z-score USD/BRL



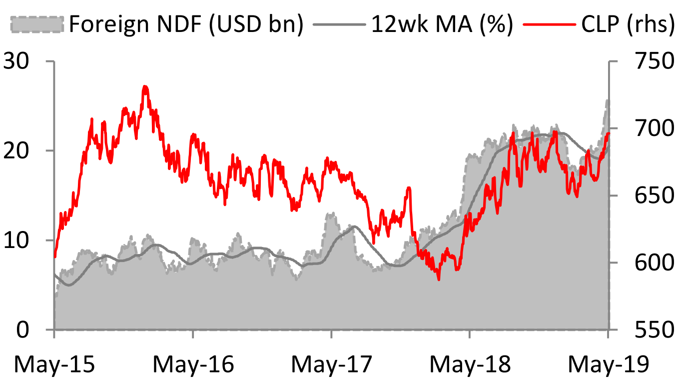
USD/MXN



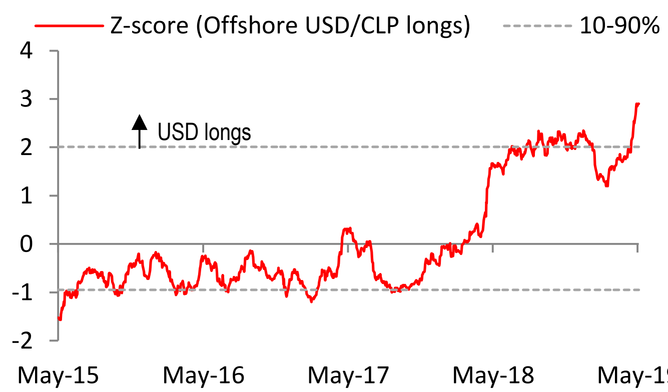
Z-score USD/MXN



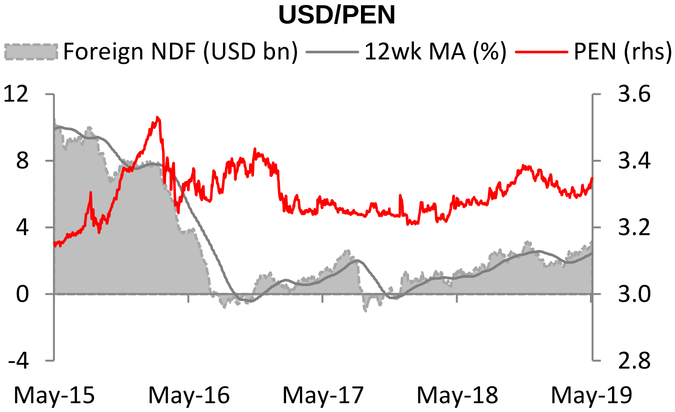
USD/CLP



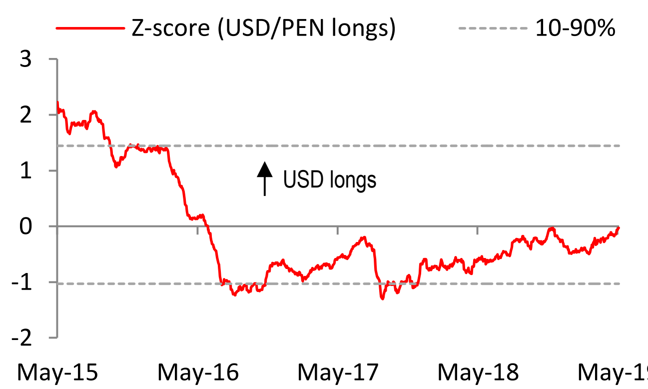
Z-score USD/CLP



USD/PEN



Z-score USD/PEN



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

Euro Interest Rate Forecasts

Government Bond yield Forecasts

Germany	Current	2Q19	3Q19	4Q19	1Q20
ECB Depo	-0.40	-0.40	-0.40	-0.40	-0.20
3m	-0.54	-0.55	-0.55	-0.55	-0.35
2y	-0.64	-0.45	-0.35	-0.25	-0.05
5y	-0.52	-0.35	-0.20	-0.10	0.10
10y	-0.11	0.10	0.25	0.40	0.55
30y	0.55	0.65	0.80	0.90	1.05

Swap rate forecasts

Euro	Current	2Q19	3Q19	4Q19	1Q20
ECB Depo	-0.40	-0.40	-0.40	-0.40	-0.20
3m	-0.31	-0.30	-0.30	-0.19	-0.09
2y	-0.25	-0.10	0.00	0.10	0.25
5y	-0.05	0.10	0.20	0.30	0.45
10y	0.42	0.60	0.70	0.80	0.95
30y	1.02	1.10	1.20	1.30	1.40

US Interest Rate Forecasts

Government Bond yield Forecasts

US	Current	2Q19	3Q19	4Q19	1Q20
FOMC *	2.50	2.50	2.50	2.50	2.50
3m	2.36	2.45	2.45	2.45	2.45
2y	2.19	2.40	2.50	2.60	2.60
5y	2.14	2.40	2.55	2.65	2.65
10y	2.35	2.55	2.65	2.75	2.80
30y	2.78	2.95	3.00	3.10	3.10

Swap rate forecasts

US	Current	2Q19	3Q19	4Q19	1Q20
FOMC *	2.50	2.50	2.50	2.50	2.50
3m	2.52	2.60	2.55	2.55	2.55
2y	2.24	2.50	2.60	2.75	2.75
5y	2.15	2.45	2.60	2.75	2.75
10y	2.30	2.50	2.65	2.80	2.85
30y	2.50	2.65	2.75	2.90	2.95

UK Interest Rate Forecasts

Government Bond yield Forecasts

UK	Current	2Q19	3Q19	4Q19	1Q20
MPC	0.75	0.75	0.75	0.75	0.75
3m	0.80	0.75	0.77	0.77	0.79
2y	0.67	0.70	0.75	0.80	0.90
5y	0.75	0.85	0.85	1.00	1.10
10y	0.99	1.10	1.10	1.20	1.25
30y	1.55	1.70	1.75	1.80	1.90

Swap rate forecasts

UK	Current	2Q19	3Q19	4Q19	1Q20
MPC	0.75	0.75	0.75	0.75	0.75
3m	0.80	0.85	0.85	0.85	0.87
2y	0.92	1.05	1.05	1.10	1.20
5y	1.03	1.20	1.15	1.25	1.35
10y	1.19	1.25	1.20	1.30	1.35
30y	1.34	1.45	1.45	1.50	1.60

G10 Central Bank Calendar

	Current Rate	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
FOMC (Upper)	2.50	Unch.	-	Unch.	-	Unch.	19	31	-	18	30	-	11
ECB (Depo)	-0.40	Unch.	-	Unch.	Unch.	-	6	25	-	12	24	-	12
BoE	0.75	-	Unch.	Unch.	-	Unch.	20	-	1	19	-	7	19
BoJ	-0.10	Unch.	-	Unch.	Unch.	-	20	30	-	19	31	-	19
SNB	-0.75	-	-	Unch.	-	-	13	-	-	19	-	-	12
BoC	1.75	Unch.	-	Unch.	Unch.	29	-	10	-	4	30	-	4
RBA	1.50	-	Unch.	Unch.	Unch.	Unch.	4	2	6	3	1	5	3
RBNZ	1.50	-	Unch.	Unch.	-	-25bp	26	-	7	25	-	13	-
Norges Bank	1.00	Unch.	-	+25bp	-	Unch.	20	-	15	19	24	-	19
Riksbank	-0.25	-	Unch.	-	Unch.	-	-	3	-	5	24	-	19

Source: Bloomberg, Santander. Note: Current levels as at 23-May-19. For meetings that have already taken place, decision identified as +/- in bp, or "unch" for no change. "-" denotes no meeting taking place that month *FOMC rate refers to upper bound rate. **The FOMC announced in March that is would phase out its Quantitative Tightening between May 2019 and September 2019.

Brazil/Mexico Interest Rate forecasts

Brazil	Current	2Q19	3Q19	4Q19	1Q20
SELIC	6.50	6.50	6.50	6.50	6.50
NTNF Jan' 25s	8.44	8.45	8.30	8.00	8.00
NTNF Jan.' 29s	8.86	8.85	8.60	8.50	8.20

Mexico	Current	2Q19	3Q19	4Q19	1Q20
Banxico fondeo	8.25	8.25	8.25	8.25	8.00
Mbono Jun. '21s	7.94	8.10	8.20	8.20	8.00
MBono Jun. '29s	7.89	8.50	8.60	8.60	8.50

Chile/Colombia Interest Rate Forecasts

Chile	Current	2Q19	3Q19	4Q19	1Q20
BCCh TPM	3.00	3.00	3.00	3.00	3.00
BCP 5Y	3.49	3.65	3.65	3.70	3.75
BCP 10Y	4.00	4.05	4.05	4.10	4.15

Colombia	Current	2Q19	3Q19	4Q19	1Q20
Banrep O/N	4.25	4.25	4.25	4.50	4.75
TES Jul '24s	5.83	6.04	6.09	6.16	6.23
TES Apr '28s	6.53	6.65	6.77	6.91	7.05

Argentina/Peru Interest Rate Forecasts

Argentina	Current	2Q19	3Q19	4Q19	1Q20
LELIQ 7-day	70.99	67.00	58.75	48.50	43.75

Peru	Current	2Q19	3Q19	4Q19	1Q20
BRCP Ref. Rate	2.75	2.75	2.75	3.00	3.25

LatAm Central Bank Calendar

	Current Rate	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Brazil	6.50	-	Unch.	Unch.	-	Unch.	19	31	-	18	30	-	11
Mexico	8.25	-	Unch.	Unch.	-	Unch.	27	-	15	26	-	14	19
Chile	3.00	+25bp	-	Unch.	-	Unch.	7	18	-	3	23	-	6
Colombia	4.25	Unch.	-	Unch.	Unch.	-	21	26	-	27	31	-	20
Argentina*	70.99	-557bp	-356bp	+1803bp	+578bp	~	~	~	~	~	~	~	~
Peru	2.75	Unch.	Unch.	Unch.	Unch.	Unch.	14	13	10	14	12	8	13

CEE Interest Rate Forecasts

Poland	Current	2Q19	3Q19	4Q19	1Q20
Reference Rate	1.50	1.50	1.50	1.50	1.75
2y	1.73	1.65	1.65	1.70	1.85
10y	2.82	2.80	2.85	2.90	2.95

CEE	Current	2Q19	3Q19	4Q19	1Q20
Hungary	0.90	0.90	1.25	1.50	1.50
Czech Republic	2.00	2.00	2.00	2.00	2.00
Russia	7.75	7.75	7.75	7.75	7.75

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.	5	3	-	11	2	6	4
Czech Republic	2.00	-	Unch.	Unch.	-	+25bp	26	-	1	25	-	7	19
Hungary	0.90	Unch.	Unch.	Unch.	Unch.	28	25	23	27	24	22	19	17
Russia	7.75	-	Unch.	Unch.	Unch.	-	14	26	-	6	25	-	13

Source: Bloomberg, Santander. Note: Current levels as at 23-May-19. For meetings that have already taken place, decision identified as +/- in bp, or "unch" for no change. "-" denotes no meeting taking place that month. *On 7 August 2018 = Argentina's monetary policy committee voted unanimously to change the key interest rate to 7-day Leliq rate, which the bank has been changing on a daily basis since the start of October (the decision was made fortnightly previously).

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

	3M	6M	9M
EUR/USD	**1.14**	**1.16**	**1.18**
vs.forward	1.8	3.9	5.4
vs.consensus forecast	-0.3	0.0	0.6
GBP/USD	**1.34**	**1.36**	**1.37**
vs.forward	6.2	7.2	8.0
vs.consensus forecast	1.0	1.2	0.5
EUR/GBP	**0.85**	**0.86**	**0.86**
vs.forward	-4.1	-3.1	-2.5
vs.consensus forecast	-1.6	-0.6	1.3
USD/JPY	**114**	**118**	**117**
vs.forward	3.3	6.6	6.0
vs.consensus forecast	3.6	8.0	8.3
EUR/JPY	**130**	**136**	**138**
vs.forward	5.1	10.7	11.7
vs.consensus forecast	4.1	9.2	9.3
EUR/CHF	**1.17**	**1.19**	**1.21**
vs.forward	4.0	6.0	7.2
vs.consensus forecast	3.5	4.7	4.9
USD/CHF	**1.03**	**1.03**	**1.03**
vs.forward	2.1	2.1	1.8
vs.consensus forecast	1.9	2.9	3.6
EUR/SEK	**10.6**	**10.5**	**10.3**
vs.forward	-1.2	-2.8	-4.0
vs.consensus forecast	1.3	0.6	-0.2
EUR/NOK	**9.6**	**9.5**	**9.4**
vs.forward	-1.7	-2.3	-3.4
vs.consensus forecast	0.6	0.4	0.0
USD/CAD	**1.32**	**1.30**	**1.28**
vs.forward	-1.6	-3.1	-4.1
vs.consensus forecast	-0.3	-1.8	-2.0
AUD/USD	**0.68**	**0.69**	**0.70**
vs.forward	-0.7	0.7	1.7
vs.consensus forecast	-5.1	-5.0	-5.4
NZD/USD	**0.65**	**0.66**	**0.68**
vs.forward	0.0	2.0	4.1
vs.consensus forecast	-3.0	-1.0	-0.5

	3M	6M	9M
USD/BRL	**3.93**	**3.98**	**4.07**
vs.forward	-2.0	-0.8	1.3
vs.consensus forecast	3.5	4.8	7.9
EUR/BRL	**4.47**	**4.62**	**4.79**
vs.forward	-0.3	3.0	6.7
vs.consensus forecast	3.2	4.8	8.5
USD/MXN	**20.0**	**20.43**	**20.50**
vs.forward	5.4	7.8	8.2
vs.consensus forecast	3.2	4.8	5.7
EUR/MXN	**22.7**	**23.7**	**24.1**
vs.forward	7.2	12.0	14.0
vs.consensus forecast	2.9	4.8	6.3
USD/CLP	**673**	**663**	**653**
vs.forward	-3.2	-4.7	-6.1
vs.consensus forecast	1.3	-1.0	-2.0
USD/COP	**3233**	**3283**	**3267**
vs.forward	-3.0	-1.5	-2.0
vs.consensus forecast	2.6	5.2	5.4
USD/ARS	**48.0**	**51.0**	**53.3**
vs.forward	7.6	14.4	19.5
vs.consensus forecast	-0.1	3.1	8.7
USD/PEN	**3.36**	**3.37**	**3.37**
vs.forward	0.5	0.8	0.9
vs.consensus forecast	1.7	2.0	2.1
EUR/PLN	**4.34**	**4.32**	**4.29**
vs.forward	0.9	0.3	-0.4
vs.consensus forecast	1.0	0.4	-0.1
EUR/CZK	**25.8**	**25.7**	**25.5**
vs.forward	0.0	-0.5	-1.3
vs.consensus forecast	0.4	0.3	0.3
EUR/HUF	**324**	**325**	**322**
vs.forward	-0.8	-0.5	-1.5
vs.consensus forecast	0.9	1.4	0.5
EUR/RUB	**75**	**78**	**79**
vs.forward	5.1	8.4	9.9
vs.consensus forecast	1.0	2.4	2.7

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

G10 FX: Spot and forward rates

	EUR/USD	GBP/USD	USD/JPY	EUR/JPY	GBP/JPY	USD/CHF	EUR/CHF	GBP/CHF
Spot	1.114	1.264	110.04	123.25	139.65	1.009	1.123	1.275
1M	1.116	1.266	109.78	122.56	138.92	1.006	1.123	1.273
2M	1.119	1.268	109.50	122.57	138.79	1.003	1.123	1.271
3M	1.122	1.269	109.25	122.59	138.67	1.000	1.122	1.269
6M	1.131	1.275	108.47	122.64	138.28	0.992	1.121	1.264
9M	1.139	1.280	107.67	122.65	137.82	0.983	1.120	1.259
12M	1.147	1.284	106.99	122.69	137.41	0.976	1.119	1.253

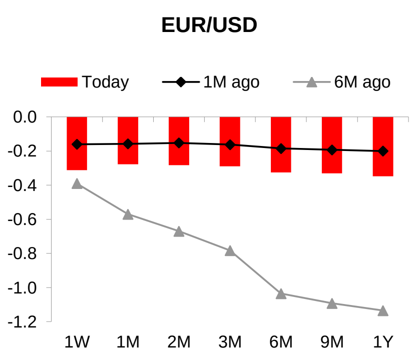
ATMf vol.

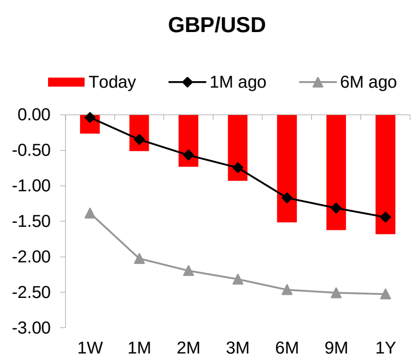
	EUR/USD	GBP/USD	USD/JPY	EUR/JPY	GBP/JPY	USD/CHF	EUR/CHF	GBP/CHF
1W	5.1%	7.5%	5.6%	6.9%	8.2%	4.8%	4.4%	6.9%
1M	5.0%	7.5%	5.9%	6.7%	8.5%	5.1%	4.4%	7.1%
2M	5.1%	7.6%	6.1%	6.9%	8.7%	5.2%	4.5%	7.2%
3M	5.2%	7.7%	6.2%	6.9%	8.7%	5.3%	4.5%	7.3%
6M	5.7%	8.6%	6.5%	7.2%	9.5%	5.7%	4.8%	8.1%
9M	6.0%	8.8%	6.7%	7.4%	9.6%	6.0%	4.9%	8.3%
12M	6.2%	9.0%	6.9%	7.6%	9.8%	6.2%	5.0%	8.5%

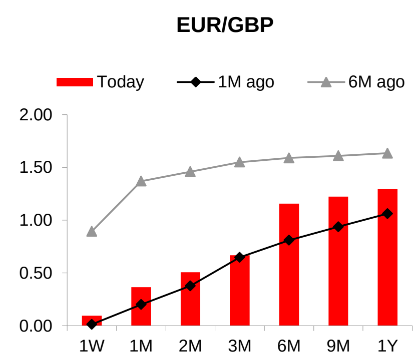
Implied/realized vol. ratio

	EUR/USD	GBP/USD	USD/JPY	EUR/JPY	GBP/JPY	USD/CHF	EUR/CHF	GBP/CHF
1W	1.29	0.99	1.27	1.20	0.94	1.17	1.21	0.97
1M	1.01	1.20	1.07	1.02	1.13	1.07	1.04	1.18
2M	1.11	1.06	1.24	1.13	1.09	1.20	1.16	1.03
3M	1.04	0.90	1.23	1.10	0.94	1.13	1.20	0.88
6M	0.99	1.00	1.03	1.00	0.92	1.05	1.11	0.99
9M	0.97	1.01	1.10	0.99	0.94	1.07	1.06	1.01
12M	0.96	1.08	1.12	0.97	0.99	1.09	1.02	1.08

25-delta risk reversals







Sources: Bloomberg and Santander. As of 23-May-19

Latin America FX: Spot and forward rates

	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
Spot	44.9	4.01	697	3336	19.1	3.34
1M	47.0	4.05	697	3341	19.2	3.35
2M	49.6	4.06	697	3346	19.3	3.35
3M	52.1	4.07	696	3351	19.4	3.36
6M	59.4	4.10	698	3367	19.7	3.37
9M	66.9	4.12	698	3383	19.9	3.38
12M	73.6	4.15	698	3403	20.2	3.39

ATMf vol.

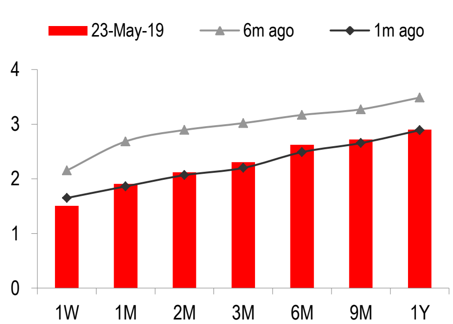
	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
1W	7.50	13.56	9.09	10.00	8.03	3.39
1M	10.00	13.54	9.09	10.01	8.76	3.60
2M	12.15	13.74	9.14	10.23	9.16	3.80
3M	13.75	13.75	9.13	10.34	9.42	3.98
6M	16.98	13.89	9.28	10.76	10.10	4.49
9M	18.85	13.86	9.46	11.11	10.53	4.92
12M	20.00	13.90	9.59	11.36	10.92	5.16

Implied/realized vol. ratio

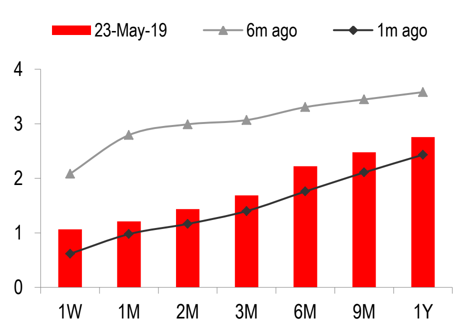
	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
1W	0.67	1.12	1.66	1.23	1.06	1.13
1M	0.49	1.12	1.07	1.03	0.92	0.85
2M	0.57	1.09	1.04	1.03	1.03	1.04
3M	0.66	1.05	1.06	1.11	1.06	1.15
6M	0.93	1.05	1.04	1.13	1.03	1.28
9M	0.73	0.92	0.98	1.16	0.95	1.40
12M	0.81	0.90	0.98	1.17	0.91	1.45

25-delta risk reversals

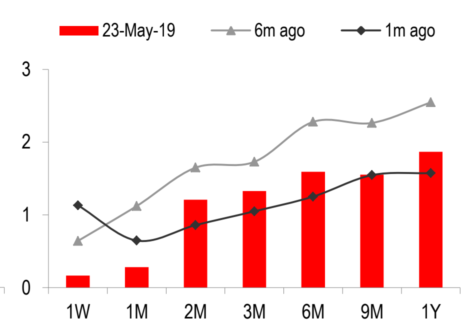
USD/BRL



USD/MXN



USD/CLP



Sources: Bloomberg and Santander. As of 23-May-19

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EXPLANATION OF THE RECOMMENDATION SYSTEM

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

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

DEFINITIONS

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

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

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