29 November 2018, 15:00 GMT

FX COMPASS

Note: There will be no FX Compass in December. The next edition will be published in late January 2019.

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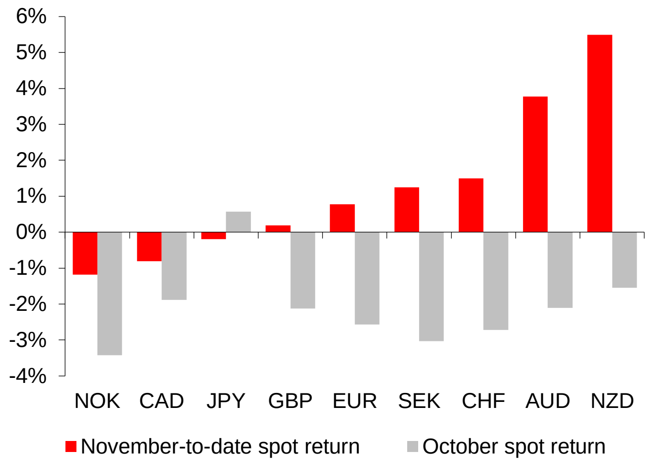
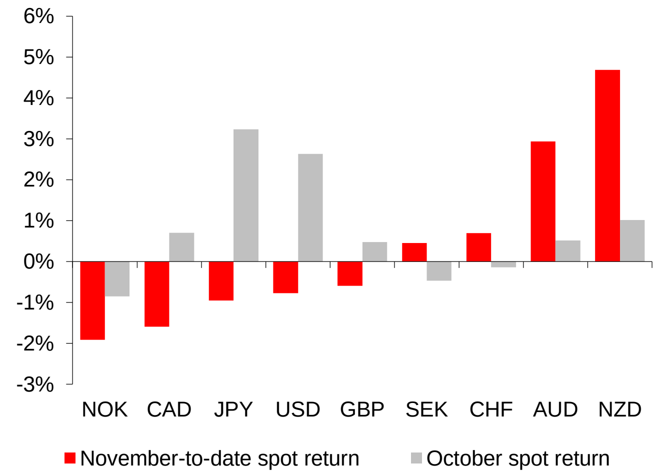
FX Spot Returns

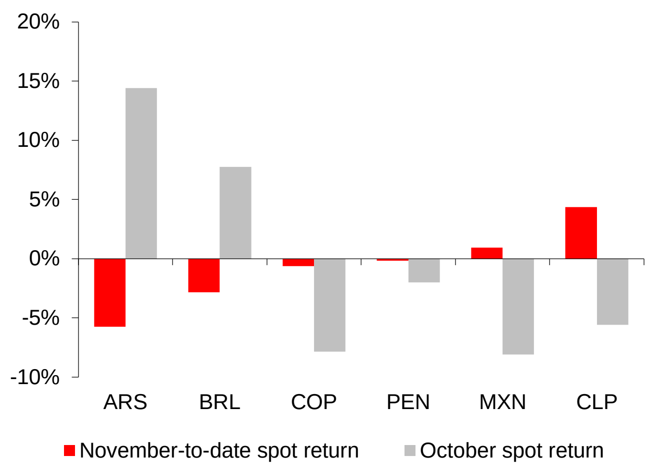
G10 spot returns vs. USD



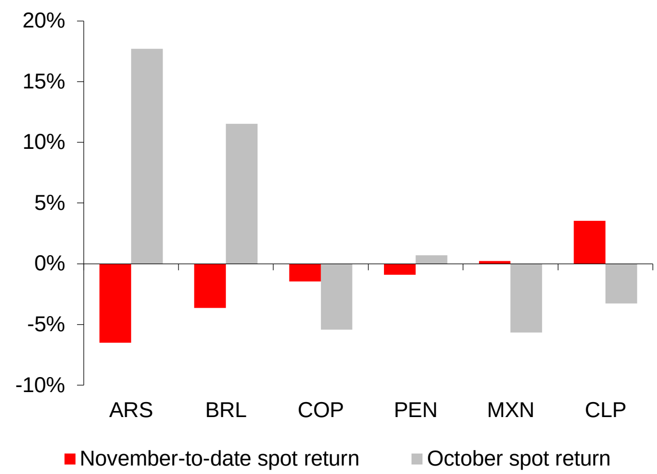
G10 spot returns vs. EUR



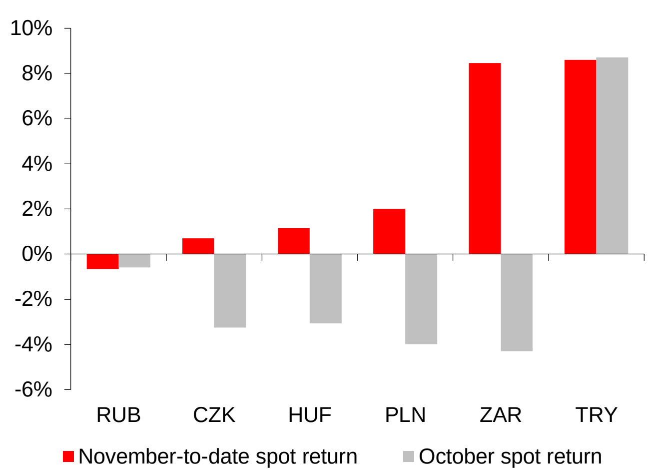
LatAm spot returns vs. USD



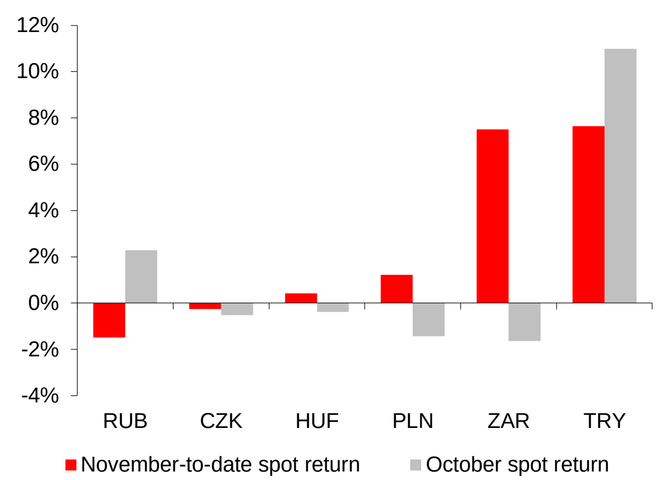
LatAm spot returns vs. EUR



CEEMA vs. USD



CEEMA vs. EUR



Source: Bloomberg, Santander. Note: Data current as at 29 November 2018 at 13:40 GMT

FX Forecasts

G10 FX Forecasts

	Q1-19	Q2-19	Q3-19	Q4-19	Q1-20	Q2-20
EUR-USD	1.20	1.22	1.23	1.24	1.25	1.27
GBP-USD	1.32	1.33	1.35	1.36	1.37	1.37
GBP-EUR	1.10	1.09	1.10	1.10	1.10	1.08
EUR-GBP	0.91	0.92	0.91	0.91	0.91	0.93
USD-JPY	118	120	118	116	114	112
EUR-JPY	142	146	145	144	143	142
USD-CNY	6.80	6.70	6.70	6.70	6.65	6.50
EUR-CHF	1.18	1.19	1.20	1.20	1.21	1.23
USD-CHF	0.98	0.98	0.98	0.97	0.97	0.97
EUR-SEK	10.2	10.0	9.8	9.6	9.5	9.5
EUR-NOK	9.1	9.0	8.8	8.7	8.6	8.6
USD-CAD	1.22	1.20	1.20	1.19	1.18	1.18
AUD-USD	0.73	0.74	0.75	0.76	0.77	0.78
NZD-USD	0.68	0.68	0.69	0.70	0.71	0.72

LatAm FX Forecasts

	Q1-19	Q2-19	Q3-19	Q4-19	Q1-20	Q2-20
USD-BRL	3.80	3.80	3.95	4.00	4.00	4.00
USD-MXN	19.6	19.6	19.8	19.5	19.8	20.0
USD-CLP	680	690	700	690	687	680
USD-COP	3300	3250	3350	3400	3400	3300
USD-ARS	39.0	42.4	47.5	50.3	52.1	54.0
USD-PEN	3.44	3.49	3.53	3.57	3.57	3.6
EUR-BRL	4.56	4.64	4.86	4.96	5.00	5.08
EUR-MXN	23.5	23.9	24.4	24.2	24.8	25.4
EUR-CLP	816	842	861	856	859	864
EUR-COP	3960	3965	4121	4216	4250	4191
EUR-ARS	47	52	58	62	65	69
EUR-PEN	4	4	4	4	4	5

CEE FX Forecasts

	Q1-19	Q2-19	Q3-19	Q4-19	Q1-20	Q2-20
EUR-PLN	4.28	4.29	4.30	4.32	4.25	4.25
EUR-CZK	25.8	25.9	26.1	26.2	26.2	25.2
EUR-HUF	320	325	325	325	325	322
USD-RUB	69	70	67	67	67	67
EUR-RUB	83	85	82	83	84	85

Sources: Santander

G10 FX: Main Themes

Currency	3M view	12M view	Main Themes
USD	⇨	↘	• The USD has been strong in 2018; this may spill over, but will not last throughout 2019, in our view. The Fed's hiking cycle may be coming to an end as the economy faces 'headwinds' in 2019.
EUR	⇨	↗	• Low risk appetite has weighed on the EUR. However, Eurozone fundamentals remain solid and, with inflation above target, does the economy still need a deposit rate at -0.4%?
GBP	⇨	⇨	• Sterling remains vulnerable, given subdued growth, political/Brexit uncertainty and general USD strength, as well as less chance of near-term rate hikes.
JPY	↘	↓	• Low risk appetite has boosted demand for the yen. However, when/if the uncertainties fade, the market will be faced with a yen-negative scenario of a BoJ likely to keep policy very loose for a long time.
CNY	⇨	⇨	• US-China trade tensions and slower Chinese growth remain a risk, as might a loosening of fiscal and monetary policy, but scope for big losses may have diminished as policymakers appear keen to prevent further CNY weakness.
CHF	↘	↘	• The CHF has been influenced by risk appetite. The SNB still views the CHF as 'highly valued' and, despite firmer economic data, should maintain a very loose policy into 2019 and remain willing to intervene.
CAD	↗	↗	• The CAD should appreciate amid expectations that the BoC will continue to hike rates. The economic outlook remains robust, as US-Canada trade tensions have lessened, and inflation is above target
AUD	⇨	↗	• Australian monetary policy is likely to continue taking a back seat, leaving the USD's moves and global trade concerns to guide the AUD. Interest rate differentials point to limited upside for AUD/USD in the months ahead.
NZD	⇨	⇨	• A dovish RBNZ and global trade concerns are likely to constrain the NZD in the coming months. Further weakness should be limited, though, as speculators already hold a large net-short NZD position.
SEK	⇨	↗	• The prospect of a rate hike in the coming months is positive for the SEK. However, global trade concerns are negative for the currency, and it may struggle to achieve significant gains until a new government is formed.
NOK	↗	↗	• Weaker oil prices have weighed on the NOK in Q4-18, but an upbeat economy, elevated inflation, and a central bank that expects to hike rates again in Q1-19 should all support the NOK in 2019.

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

Source: Santander

G10 FX Overview

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We favour a **softer USD** in 2019. The currency has gained across the board in 2018 and whilst a still strong economy should support sentiment, slowing momentum going into 2020 and the expected end of the Fed rate hike cycle as other central banks start to tighten policy should make the USD less popular.

Consequently we think the **EUR will strengthen** next year. The Eurozone economy is expected to underperform the US, although this gap should narrow as the year advances. 2019 should see a switch-over in the relative direction of ECB-Fed policies, with the former adopting a more hawkish stance and the latter drawing its rate hike cycle to an end.

Sterling remains vulnerable to Brexit uncertainty over the coming weeks/months. In addition, we expect the UK economy to underperform its peers and the BoE to keep rates on hold in 2019, both factors that should cap the pound's upside potential.

We still **expect the yen to weaken** in 2019. Global risk appetite could pick up if US-Chinese trade tensions ease. Meanwhile, Japan's growth and inflation outlook continues to point to the BoJ running a looser monetary policy than its peers.

The renminbi is likely to remain vulnerable in 2019; however, we do **not expect another major CNY depreciation** of . Whereas the direction of USD/CNY in 2018 was largely determined by the US dollar, its 2019 direction may rest more on domestic factors and how policymakers deal with slower Chinese growth.

We **expect the Swiss franc to weaken gradually, but persistently**, against the EUR in 2019. In our opinion, the Swiss National Bank will maintain its loose monetary policy throughout the year, and will not consider altering its stance before the ECB hikes rates.

Conversely, **our view on the SEK is positive**. Solid macro data, together with the prospect of the beginning of a tightening cycle should underpin the SEK in 2019.

We also **hold an upbeat view on the NOK** in 2019. A relatively firm economy, elevated inflation, and a central bank planning to hike rates again in Q1-19 should all support the NOK in 2019. However, lower oil prices remain a risk.

The oil price also poses a downside risk to the CAD. However, we are still bullish the currency in 2019. As with other currencies, the combination of a robust economy, less trade uncertainty and probable Bank of Canada rate hikes **should favour a stronger loonie.**

However, we are **neutral on the AUD in the H1-19**, turning more bullish in H2-19. The domestic economy is improving, but inflation is still too low to prompt the RBA to hike rates.

We are **also neutral the NZD**. Domestic data have picked up, but below-target CPI is putting no pressure on the RBNZ to hike rates. Indeed, the Bank does not expect to raise rates until 2020.

USD – What goes up

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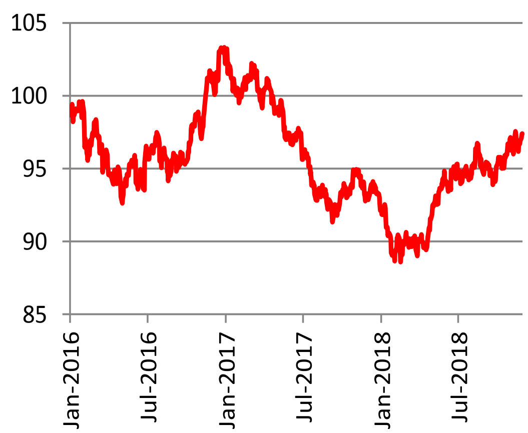
We favour a softer USD in 2019. The currency has gained across the board in 2018 and whilst a still strong economy should support sentiment, slowing momentum going into 2020 and the expected end of the Fed rate hike cycle as other central banks start to tighten policy should make the USD less popular.

The USD has had a strong 2018, and a soft patch in Q1-18 was quickly reversed. Year-to-date, the currency has posted gains against all of its developed market peers. However, this advance merely reversed the losses that the dollar posted in 2017. Indeed, the USD index is currently trading at the levels shown at the end of 2016. So will the dollar forge further ahead in 2019 or, as with 2018, merely reverse the previous year's move? Whilst recent USD strength could spill over into Q1-19, overall, next year we favour a softer dollar.

Chart 1: USD index since 2016

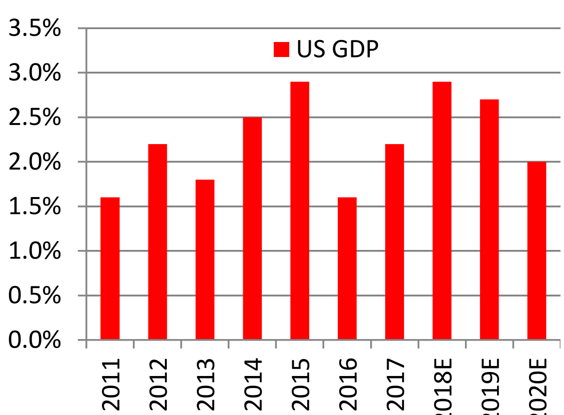


Source: Bloomberg, Santander

Admittedly, the US economy continues to outperform its peers. We expect the US to grow by 2.9% in 2018 and 2.7% in 2019, notably above the expected Eurozone growth of 1.9% in both years. Such a growth dividend should prevent significant USD weakness, but should be priced in. However, we also expect that growth gap to narrow in 2020, with US growth at 2.1% and the Eurozone at 2%, a dynamic that should weigh on the dollar.

Furthermore, the boost given to the USD by US monetary policy could start to peter out. We expect the Fed to hike rates in December 2018 and twice in H1-19. This will take the Fed funds target to the 3% level that many consider a 'neutral' rate. However, recent Fed rhetoric, including from Chair Powell, has hinted at a more cautious stance, which, even if it does not prevent rate hikes, may hamper the USD's ability to appreciate as a result.

Chart 2: US GDP growth to remain firm, but facing 'headwinds'



Source: Bloomberg, Santander

The Fed Chair, and other members of the FOMC, have highlighted headwinds that the US economic advance may face in 2019: 1) slower global demand; 2) the lagged effect of past rate hikes; 3) fading fiscal stimulus; and 4) rising debt.

These issues do appear to be real threats. The IMF recently cut its forecast for world trade growth in 2019 to 4%, from 4.5%. The US budget deficit is currently around 3.8%, with the Trump tax cuts for consumers expected to fade in 2019. Further, the budget deficit is keeping upside pressure on US debt. The US debt-to-GDP ratio is, at 82%, below the Eurozone's 86%, but the US rate has been rising in recent years, as the Eurozone's has declined.

The risk for USD bears from these factors is that, at least in the early part of 2019, the market decides to spin them primarily as global threats, undermining risk appetite and fuelling safe-haven demand for the USD. For example, the trade tensions between the US and China, as well as Mexico and Canada, were viewed as USD-positive.

In a similar way, if the Fed rhetoric does become increasingly concerned about the 'headwinds' the economy faces, a USD-loving market may merely assume that these fears will encompass other G10 economies and prevent their central banks from tightening policy, keeping the USD elevated, if only by default.

EUR – My turn

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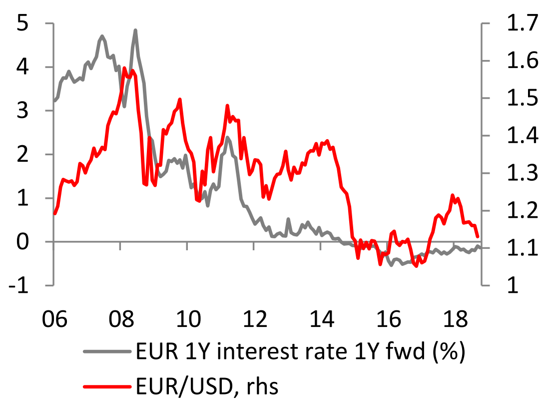
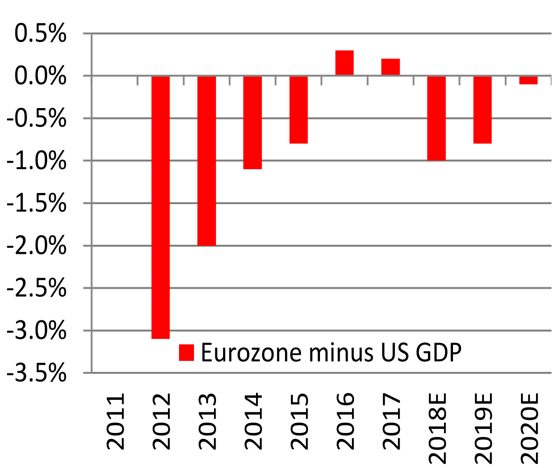
Chart 3: A less accommodative ECB policy should imply a firmer EUR



Source: Bloomberg, Santander

Chart 4: Eurozone's economic underperformance versus the US is set to narrow



Source: Bloomberg, Santander

We favour a firmer EUR in 2019. Admittedly, near-term downside risks will remain. The Eurozone economy is expected to underperform the US, although this gap should narrow as the year advances. Low oil prices could also keep European CPI below target and European political risks never seem that far away. However, 2019 should see a switch-over in the relative direction of ECB-Fed policies, with the former adopting a more hawkish stance and the latter drawing its rate hike cycle to an end.

We highlighted in the USD section that 2018 has been a good year for the US currency, reversing the losses made in 2017. For the EUR it has been the opposite. The Single Currency has, overall, struggled in 2018, only posting gains against the SEK, compared to the across-the-board gains that it recorded in 2017.

This simple analysis suggests that big moves in big currencies, whether over a month, quarter or year, might reflect over-buying/selling and could be subject to reversal. Second, it is difficult for the market to be bullish both the EUR and the USD for any extended period of time. If one falters, the other should gain.

In broad fundamental terms, the EUR may remain vulnerable in early 2019. Business surveys are slipping and German Q3-18 GDP contracted 0.2% QoQ. However, the decline in sentiment has been seen in many economies. The IMF recently cut its forecast for world output growth in 2019, by 0.2pp, to 3.7%. In addition, the drop in German GDP can be partly explained by one-off events.

Hence, whilst the US economy should continue to outperform the Eurozone in 2019, that growth differential should ease as 2020 looms. We expect US growth of 2.1% in 2020, just above the Eurozone's 2%. This is compared to the 2.9% US growth that is forecast for this year, against 1.9% in the Eurozone.

As the US-Eurozone growth gap narrows, so should the policy gap. The Fed is expected to hike rates in December 2019 and then twice more in H1-19, but then stop. Meanwhile, the ECB has confirmed that it will finish its asset purchase programme at the end of 2018, with the bank expected to start a rate tightening cycle from H2-19 onwards, just after the Fed end theirs. We also note that President Draghi will leave his post as head of the ECB in November. Whilst his replacement is currently unknown, many commentators expect it to be a Northern European hawk, a move that should increase pressure on rates and the EUR.

The big unknown factor in 2019 is risk, and where it might lead the FX market. In 2018 the mix of global (trade tensions between the US and China) and Eurozone risks (politics and worries over Italian fiscal plans) has tended to be viewed as unambiguously positive for the USD and JPY, and negative for the EUR.

In this regard, any sniff of low risk appetite in H1-19 should also weigh on the EUR. Brexit uncertainty should be EUR/USD negative, but EUR/GBP positive. However, globally, in line with the US-Mexico-Canada agreement on trade, a similar 'market-friendly' deal may be struck by China and the US. Further, the FX market might, once again, view US fiscal policy and rising debt as a US risk, weighing on the USD and parking its concerns about Eurozone politics as its focus drifts towards the attractions of a more hawkish ECB.

GBP – Uncertainty everywhere you look

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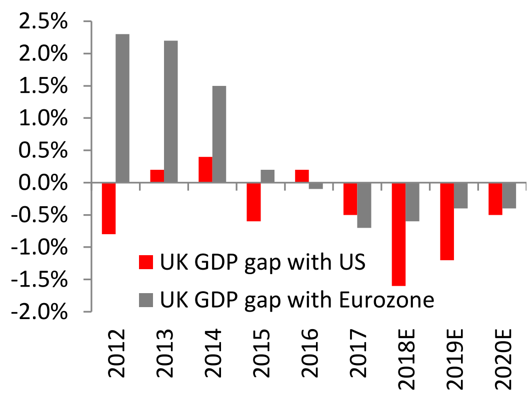
Sterling remains vulnerable to Brexit uncertainty over the coming weeks/months. In addition, we expect the UK economy to underperform its peers and the BoE to keep rates on hold in 2019, both factors that should cap the pound's upside potential.

The Brexit situation remains very unclear, and, as a result, the near-term outlook for the pound is also still very uncertain. The UK parliament will vote on the UK-EU withdrawal agreement (WA) on 11 December. The first scenario is that the agreement is accepted by parliament, implying that the UK will leave the EU on 30 March 2019 and enter a transition period, where not much will change. We still expect this to be viewed positively, in the short term, by the FX market, with the pound rising and sterling volatility falling.

The potentially 'smooth' Brexit that this might imply would probably boost expectations that the BoE will be able to hike rates in 2019. Further, business investment, which has been weak in 2019, may improve, implying a better near-term outlook for both GDP and the GBP. We still believe that this scenario could allow for a 3-4% jump in GBP/USD.

Chart 5: UK growth should continue to underperform the US and the Eurozone, but by less

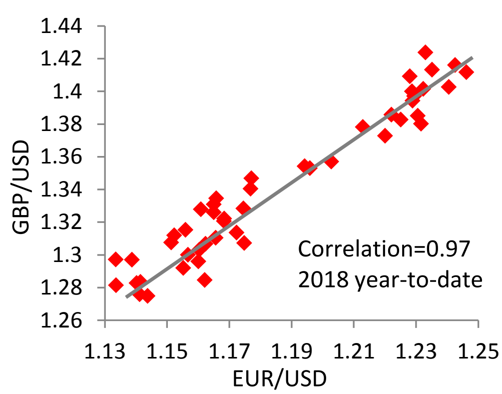


Source: Bloomberg, Santander

However, medium-term uncertainty regarding UK-EU relations will persist. Plus, whatever new trade deal is agreed between the UK and EU, it is unlikely to involve the same level of market access that the UK currently has. Hence, to account for this, the GBP may have to be permanently weaker than it was pre-referendum to provide the UK economy with competitive help. Further, domestic political uncertainty will not disappear, with the prime minister vulnerable if she has had to rely on opposition support to pass the deal, and these factors should cap any upside move in sterling.

The second scenario is that parliament rejects the 'WA'. It is very unclear what this might imply, although it should mean a weaker GBP. We recall that GBP/USD lost around 15% in the two weeks after the EU referendum in June 2016. We do not believe that the reaction to a 'WA' rejection will be quite as large, and focus on a 7% drop. However, as always, the knee-jerk reaction would probably see GBP/USD overshooting, before stabilising.

Chart 6: Brexit remains the pounds headline focus, but a softer USD in 2019 could help GBP/USD, if EUR/USD edges higher too



Source: Bloomberg, Santander

The UK government has indicated that it has no plan B if the 'WA' is rejected. However, lawmakers have suggested that there is no majority in parliament for a 'no-deal' Brexit, which should imply some support for the pound. Some parliamentarians are apparently discussing EFTA membership as a compromise ('Norway +'), while others want a second referendum, a general election, or to try and renegotiate the 'WA' with the EU.

Either way, the outlook for the pound in 2019 appears to be split between some political/economic uncertainty in scenario one and a lot of uncertainty in scenario two. Hence, despite the fact that sterling is very weak, beyond a knee-jerk rebound if the 'WA' is agreed, the pound may still struggle in 2019.

Further, even assuming a 'smooth' Brexit, economists only forecast growth of around 1.5% over the next couple of years, slower than both Eurozone and US growth. Hence, again, even under a 'smooth' Brexit, we think that slower growth and lower inflation will encourage the BoE to keep rates on hold until 2020.

JPY – Still a policy play

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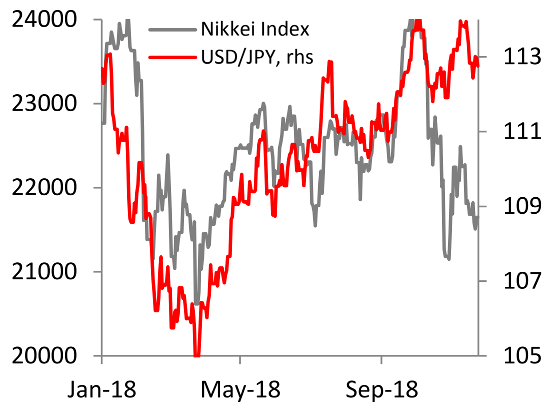
We still expect the yen to weaken in 2019. Global risk appetite could pick up if US-Chinese trade tensions ease, reducing demand for the yen as a safe-haven currency. Meanwhile, Japan's growth and inflation outlook continues to point to the BoJ running a looser monetary policy than its peers, although expectations that the Fed may call time on its hiking cycle in 2019 may contain USD/JPY gains.

The big picture facing the yen in 2018, which should continue into 2019, was that of an economy underperforming in GDP terms, with low inflation and an ultra-loose monetary policy, which targeted ten-year yields around 0%. Such mood music should have been yen-negative, but it wasn't. So far in 2018, the yen has been the second best performing developed market currency, beaten by the US dollar, but posting gains against its other peers.

The reason for the surprisingly strong yen, in our opinion, has been global risk appetite, or rather the lack thereof. Global trade tensions, political uncertainties and faltering equity markets have encouraged investors to seek sanctuary in the JPY and USD.

If low risk appetite remains a feature in 2019, the yen may be stronger than we expect. However, signs that a possibly 'successful' outcome to US-China trade tensions may come in Q1-19 should limit the yen's strength. In addition, we note that, given the drop in equities (a proxy for risk) since early October, USD/JPY looks on the expensive side.

Chart 7: Yen looks cheap given risk/equities, or is it the USD that is too expensive?

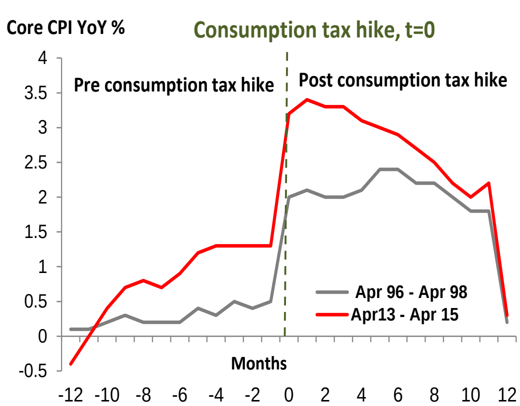


Source: Bloomberg, Santander

This apparent divergence between risk and the yen could be viewed as pointing to upside pressure on the currency, but may also be attributed to Japan's loose monetary policy keeping the yen under pressure. Hence, we reiterate our view that as long as Japan's monetary policy stays loose, the JPY should remain soft in 2019. However, if the Fed does adopt a more dovish approach in H1-19, that weakness may play out as much through the non-USD G10 currencies as through the US dollar.

In H2-18 the market has, intermittently, become fixated on the BoJ exiting its loose policy. However, the fundamental backdrop implies little need for policymakers to rush toward 'normalisation'. The bank remains cautious on growth and expects GDP to rise by 1.4% in fiscal year 2018-19, slipping to 0.8% in FY19 and FY20. In addition, inflation is not expected to hit its 2% target until 2020.

Chart 8: Consumption tax hike coming in October, but will higher inflation follow?



Source: Bloomberg, Santander

BoJ Governor Kuroda still sees the risks skewed to the downside for both the economy and prices and indicates that extremely low rates will be kept for an extended period. He has signalled that the next move will be up, tweaking policy, such as allowing 10Y yields to move as high as 0.2% and altering the timing and size of asset purchases should not be interpreted as a form of hiking/tapering.

The government looks set to go ahead with an increase in consumption tax in October, to 10% from 8%. Past tax hikes in 1997 and 2014 have risked weighing on growth. Thus, even as the government offers fiscal support, the BoJ may be reluctant to alter policy before seeing the consequences of the tax change for activity and CPI. Indeed, following past increases in the consumption tax, headline CPI has spiked higher, only to tumble back during the following months.

CNY – Stability may be key in 2019

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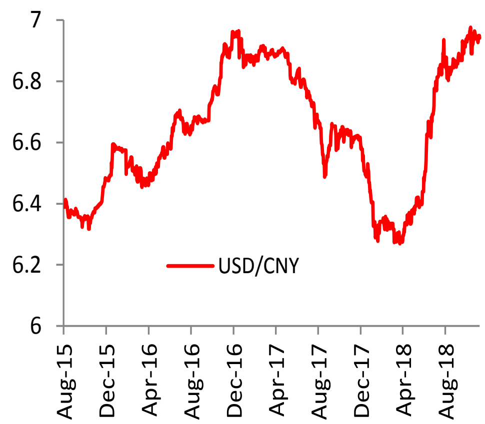
The renminbi is likely to remain vulnerable in 2019; however, we do not expect another major appreciation of USD/CNY. Whereas the direction of USD/CNY in 2018 was largely determined by the US dollar, its 2019 direction may rest more on domestic factors and how policymakers deal with slower Chinese growth.

The CNY's weakness against the USD attracted much attention in 2018. The market's focus on risk and trade tensions kept the spotlight on the CNY. However, year-to-date the Chinese currency has weakened 4.3% against the USD. This implies a lower rate of depreciation than most G10 currencies, bar the NZD and JPY.

Chart 9: CNY has depreciated against the USD in 2018…



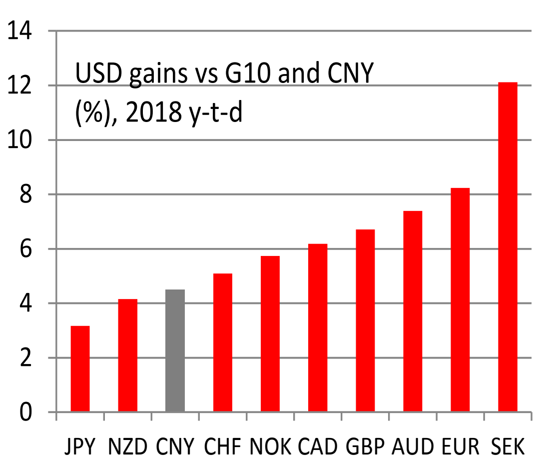
Source: Bloomberg, Santander

Hence, whether or not USD/CNY will continue to strengthen in 2019 will depend to a large extent on whether the USD continues to appreciate across the board. We suspect that it will not. The US economy will remain robust in 2019, but we expect growth to slow in 2020. Further, recent Fed rhetoric has hinted that its rate hike cycle could end sooner than many had expected. We expect the Fed to hike in December, March'19 and June'19, and then stop.

So, if a stronger USD cannot be relied upon to pull USD/CNY higher, might a weaker CNY do that job instead? Concerns over trade tensions between the US and China may fade if the two countries can reach some type of agreement, as the US did with Mexico and Canada, but the risk is that Chinese growth will slow anyway in 2019, and threaten to take the CNY with it.

The Chinese economy grew 6.9% in 2017 and is expected to grow 6.6% in 2018, slipping to 6.2% in 2019 and 6% in 2020. Recent data has been on the soft side, with October PMIs down, showing an unsurprising drop in export sentiment. Plus, manufacturing growth is at its lowest for two years.

Chart 10: …but that depreciation has been less than most developed market currencies



Source: Bloomberg, Santander. As of 28 November 2018

How policymakers choose to respond to slower growth is likely to determine the direction of travel for the CNY in 2019. First, in terms of fiscal policy, Chinese leaders have already signalled that further stimulus measures are likely. Already in 2018, there have been changes to personal taxation and import tariffs, to help consumption, as well as planned increased in infrastructure.

Further, 2018 has also seen changes to monetary policy, including four reductions in banks' reserve requirement ratios and support. The expectation of more support has dragged 10-year yields lower and in early November, China's one-year yield slipped below the US's for the first time, removing the CNY's carry advantage and implying downside pressure on the CNY. More RRR cuts are possible, but policymakers remain wary as regards too much easing, amid fears that it will increase the 'wrong type' of debt and boost financial risks. The one-year lending rate has stood at 4.35% since October 2015. That said, the focus on deleveraging may be usurped by growth fears. Plus, the broadest measure of new credit slumped in October, suggesting that a lack of available funds may also now be a threat to the economy.

However, we still do not believe that China will directly use a weaker CNY to counter either trade problems or slow growth. In its Q3-18 Monetary Policy Report, the PBoC highlighted a tougher management stance on the CNY, indicating that FX stability may be desired, but a stable CNY as the USD softens would still imply downward pressure on USD/CNY.

CHF – Stay loose

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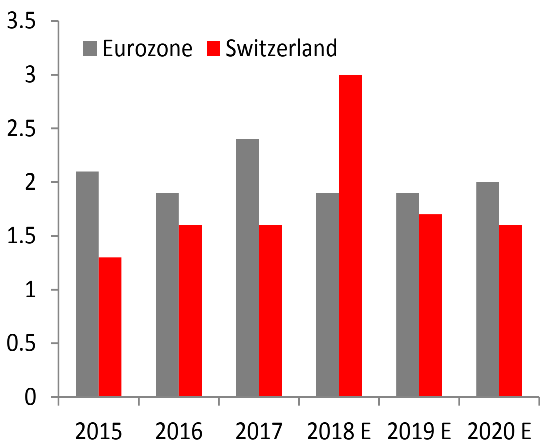
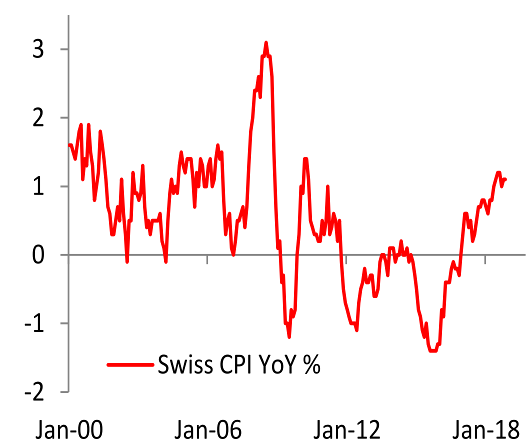
Chart 11: Annual Eurozone GDP growth versus Switzerland GDP growth (%)



Source: Bloomberg, Santander

Chart 12: Swiss inflation is heading higher, but the pace is expected to be slow



Source: Bloomberg, Santander

We expect the Swiss franc to weaken gradually, but persistently, against the EUR in 2019. In our opinion, the Swiss National Bank will maintain its loose monetary policy throughout the year, and will not consider altering its stance before the ECB hikes rates. The economy has fared very well in 2018, but growth is expected to slow in 2019, and inflation remains low. Furthermore, Eurozone risks that may have supported a safe-haven bid for the CHF may diminish in 2019.

The SNB's monetary policy should remain loose and CHF-negative. The deposit rate is -0.75%, the lowest benchmark rate among developed markets. We think the SNB will keep it at this level throughout the year.

As other central banks adopt a less dovish stance, the FX market is likely to view the SNB's policy as vulnerable to change. However, we suspect that the bank will prefer to hold the policy line, for fear that even a hint that Swiss policy could become less accommodative could result in a disproportionate rise in the Swiss franc.

Moreover, we do not expect the SNB to make any changes to interest rates before the ECB does. We look for a stronger EUR in 2019, helped by the prospect of ECB rate hikes, which in turn should help keep EUR/CHF elevated and provide the SNB with a little more room for manoeuvre on policy in early 2020. Consequently, we expect SNB rhetoric to continue labelling the CHF as highly valued, with the bank reserving the right to intervene, and the policy risk focussing more on the EUR side if the ECB maintains its dovish rhetoric, even as Eurozone growth and inflation perk up.

Given that the bank still views the CHF as strong, some market participants have questioned the success of the policy. However, note that when the SNB abandoned its 1.20 EUR/CHF floor in January 2015 and cut the depo rate to -0.75%, the cross dropped below parity. Even allowing for its decline from around 1.20 levels in April, the CHF has lost around 15% against the EUR since January 2015.

However, whilst policy has remained CHF-negative, the economy had been positive for the currency in 2018. However, Q3-18 GDP data surprised to the downside, the economy contracted 0.2% QoQ! That said, the SNB expects the economy to grow above potential in 2018, at 2.5-3%, although the consensus expects activity to slow in 2019 and 2020, with economic growth at 1.7% and 1.6%, respectively. Further, the outlook for inflation remains subdued, with the bank expecting CPI at 0.9% this year, 0.8% in 2019 and 1.2% in 2020. Indeed, headline inflation is not expected to reach 2% until half-way through 2021.

Eurozone risks will remain a threat to EUR/CHF in 2019. These include political risk, like the recent focus on the Italian budget, or the future relationship between Switzerland and the EU, and whether the bilateral agreements between the two can be replaced with a framework agreement, as the EU wants. However, the CHF should be less vulnerable to global risks, boosting the currency via a safe-haven bid. Those flows, helped by the unattractiveness of low Swiss interest rates, have tended to head towards the yen.

CAD – A potential outperformer

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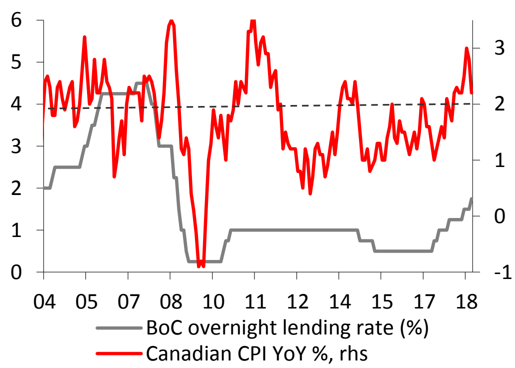
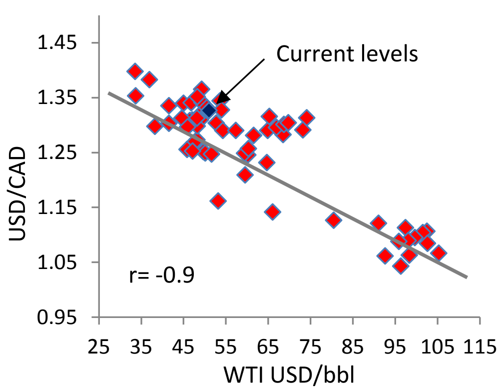
Chart 13: Solid Canadian fundamentals and above-target inflation signal that more CAD-friendly rate hikes are on the cards for 2019



Source: Bloomberg, Santander

Chart 14: USD/CAD versus oil: the long-term relationship (five years) suggests that the CAD is still too cheap



Source: Bloomberg, Santander

As we head towards 2019, we retain a bullish view on the CAD. The combination of a robust Canadian economy, less trade uncertainty and probable Bank of Canada rate hikes should favour a stronger loonie.

The Bank of Canada's monetary policy should be a positive factor for the CAD in 2019. The BoC has hiked rates three times in 2018, pulling the overnight rate to 1.75%. At its October meeting, it adopted a more hawkish approach, signalling that rates would need to move back to a neutral level. The neutral level for the Canadian benchmark rate is assumed to be 2.5-3.5%.

The BoC also dropped the reference to gradual changes, so whilst the pace of hikes is not pre-ordained, we suspect that at least three rate hikes are possible in 2019, with the first in January to correspond with the BoC's next monetary policy report and possible revisions to its economic forecasts.

The pace of rate hikes will also be data-dependent, but we currently see little in the Canadian economic outlook to prevent the BoC from running a less accommodative policy. The USMCA trade deal, the NAFTA replacement, has eliminated much of the uncertainty that has dogged Canada for most of 2018. Indeed, recent surveys have indicated that firms intend to increase investment.

Consequently, the economy is still expected to post solid growth over the next couple of years, growing by 2.1% in 2018 and 2019, before slowing to 1.7% in 2020. However, US growth is also expected to dip in 2020, which implies that the CAD may still be able to hold up against the USD even if it fades against other G10 currencies. Such growth rates, increasing capacity constraints and low unemployment should keep inflation firm. The headline CPI rate in October was above the 2% target and unchanged at 2.2%. The core measures are also hovering around 2%. Headline inflation is expected to be at or above 2% through to 2020.

The main risks, in our opinion, currently facing the CAD focus on the US dollar and oil. First, there is a risk that the USD remains strong. If the US economy continues to accelerate and the Fed adopts a more hawkish stance, USD/CAD would probably appreciate even if the BoC also hikes. However, in this scenario, the CAD might still appreciate against other currencies. The second risk, paradoxically, is that the USD weakens. If the USD dips because the US economy softens, given the strong economic links with Canada, it could pull the CAD down with it. However, in this scenario we would still expect the CAD to outperform the USD.

The third risk is the oil price. Since the beginning of October, the WTI oil price has fallen almost 30%. The correlation between USD/CAD and WTI has been inconsistent over the last year, but since the start of last month has reasserted itself, with the pair back to moving in line with oil. This suggests that, at least in the short term, the CAD is unlikely to post a recovery without a further pick-up in oil. However, if we widen the CAD-oil analysis out towards five years (see chart), it can be seen that whilst the correlation remains strong, the CAD still looks a little oversold given the current WTI level.

AUD – Restrained by global trade uncertainty

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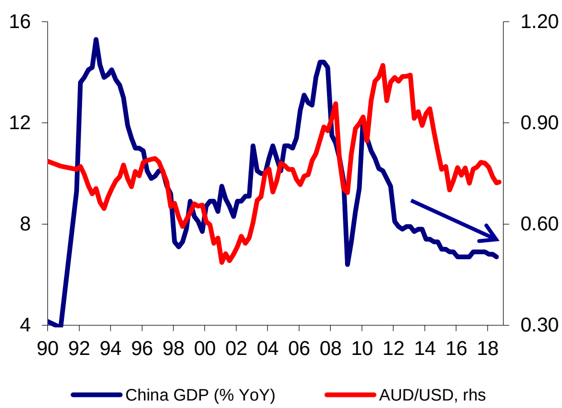
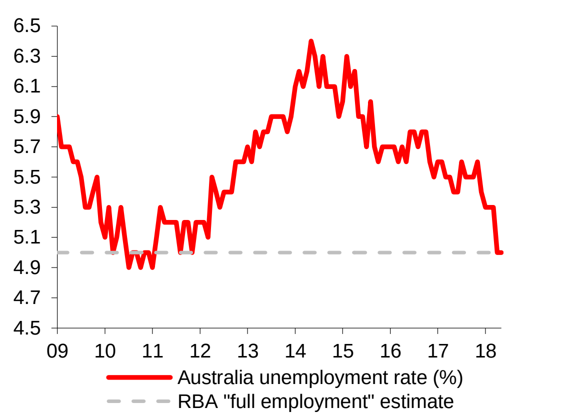
Chart 15: Weaker Chinese growth would be a negative for Australian trade and the AUD



Source: Bloomberg, Santander

Chart 16: Unemployment dropped to the RBA's estimated "full employment" rate in October



Source: Bloomberg, Santander

We hold a neutral stance on the AUD in the coming months, but are upbeat on the currency in H2-19. The domestic economy is improving, but inflation is still too low to prompt the RBA to hike rates. Internationally, things are less certain, with US-China trade fears weighing on risk sentiment, and thus also on the AUD. We see global trade as a key risk for the AUD in 2019. We forecast AUD/USD holding close to 0.73 heading into Q1-19, before rising gradually to 0.76 in Q4-19.

The Australian economy is performing well. Annual GDP rose by 3.4% in Q2-18, its highest level in over five years. The RBA now expects growth to average 3.5% in 2019. Meanwhile, the unemployment rate fell to 5% in October, six months earlier than the RBA had expected. This is now in line with the RBA's full employment estimate, with any further decline likely to pull wages higher. The latest hourly wage growth, for Q3-18, while still relatively low, is now at a three-year high of 2.4% YoY.

Australia's CPI still lingers at the very bottom end of the RBA's 2-3% target range. Until inflation pressures rise, there is little need for the Bank to abandon its neutral stance. In November, the Bank kept rates unchanged, at 1.5%, for a record 25th consecutive meeting. While mortgage rates remain low, the RBA already considers credit conditions to be tighter than they have been for some time. Hence, we believe that the Bank is unlikely to hike rates until at least late 2019.

Australian monetary policy will therefore probably continue to take a back seat in H1-19, meaning that the USD, and global trade concerns, are most likely to guide the AUD in early 2019. We still expect the FOMC to hike rates by 25bp at its December, March and June meetings. With no change from the RBA on the cards, interest rate differentials still point to limited scope for significant AUD/USD gains in the months ahead.

The largest risks to the AUD, in our view, stem from China, global trade and risk sentiment. China's 2018 GDP growth is expected to slip to 6.6% (Bloomberg consensus). This would be its slowest full-year growth since 1990 (Chart 15), likely negatively impacting iron ore prices, and the AUD.

Trade fears, particularly given the US-China tariffs, have partially been responsible for the AUD's underperformance for much of 2018. Over the next few days (30 Nov and 1 Dec), the G20 meeting takes place in Argentina. The AUD, in particular, is likely to be alert to this event, and specifically to any comments from presidents Donald Trump and Xi Jinping, as they are scheduled to discuss the future US-China trade relationship.

One recent positive for global trade stems from New Zealand, Canada and Australia joining Mexico, Japan and Singapore in ratifying the 11-nation Trans-Pacific Partnership (TPP11) free trade agreement in October. This deal is due to come into force on 30 December 2018. Upon confirmation of the deal, Australia's prime minister, Scott Morrison, said that "The TPP-11 is one of the most comprehensive and ambitious trade agreements in Australia's recent history. It will help support Australian businesses to grow and see annual benefits of up to AUD15.6bn to our national economy by 2030".

NZD – A waiting game

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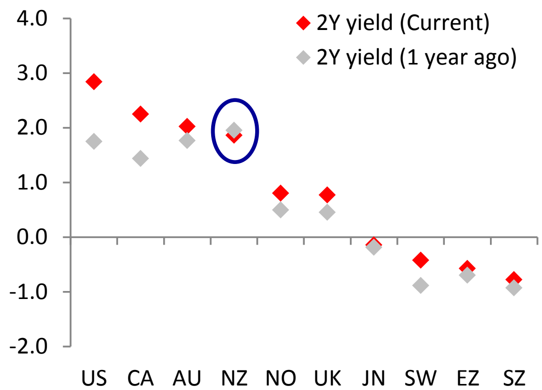
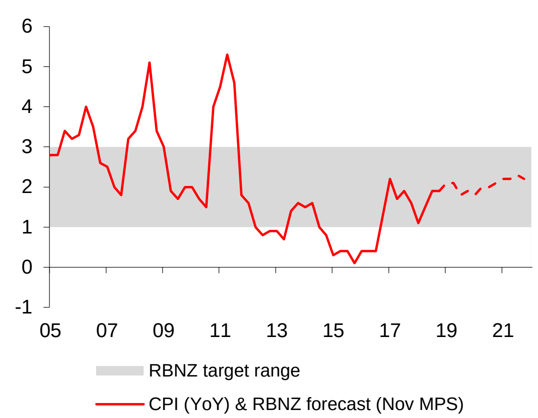
Chart 17: New Zealand is the only developed market country to see short-term yields fall over the past year



Source: Bloomberg, Santander

Chart 18: With the RBNZ expecting headline CPI to barely break above 2% for at least a couple of years, it is also forecasting no rate hike until 2020



Source: Bloomberg, Santander

We are neutral the NZD over the coming months. Global trade concerns are likely to remain a drag on the NZD in the short term, but with speculators already holding a large net-short NZD position, there should be little scope for them to sell the currency much further. Domestic data have picked up, but below-target CPI is putting no pressure on the RBNZ to hike rates. Indeed, the Bank does not expect to raise rates until 2020. This should leave interest rate differentials limiting the NZD as other banks continue to hike. We see NZD/USD holding close to 0.68 in Q1-19, before recording limited gains over the coming year, reaching 0.70 in Q4-19.

NZD/USD has had a difficult 2018, with USD strength over the summer months dragging the pair lower, from a 0.72-74 range back in Q1-18, to below 0.65 in October. The pair has since rebounded to a high of 0.6884 in mid-November, but this move was largely USD-driven. Further gains in NZD/USD are likely to be dependent on additional USD weakness as we see little reason to be too positive on the NZD just yet.

The domestic economy has been improving, in our view. Certainly, employment data comfortably beat both the market's and central bank's forecasts in Q3-18, with the unemployment rate falling to 3.9%, a 10-year low, and below the government's 4% "full employment" target.

However, while annual GDP growth rose to 2.8% in Q2-18, this is still well below the 3-5% range of 2014-2016. Likewise, although headline CPI rose sharply to 1.9% YoY in Q3-18, only once during the past seven years has it touched above the 2% midpoint of its 1-3% target range.

Consequently, it should perhaps not be a huge surprise that the RBNZ repeated at its November meeting that "we expect to keep the overnight cash rate at its current level through 2019 and into 2020." While this statement is very clear, it is by no means a commitment to the future, as the Bank also says that "there are both upside and downside risks to our growth and inflation projections" and that "as always, the timing and direction of any future rate move remains data dependent".

As well as being data dependent, future rate decisions are also likely to be influenced by other members of the RBNZ. Until now, the RBNZ rate decision has been made solely by the RBNZ's governor. However, the government plans to amend the Reserve Bank Act, which would see the RBNZ monetary policy decisions being made by a committee of internal and external members in 2019.

Given these expected changes, RBNZ Governor Orr invited the Secretary to the Treasury, Gabriel Makhlouf, to attend the Bank's monetary policy decision meeting as an observer in November, to help ensure a smooth transition to a new monetary policy framework, when this change happens.

Meanwhile, with the market set to have a long wait for the RBNZ to change the cash rate, any further decline in short-term rates in New Zealand (Chart 17), when yields elsewhere are on the rise, is likely to cap the NZD going into 2019.

SEK – Calm, but uncharted waters

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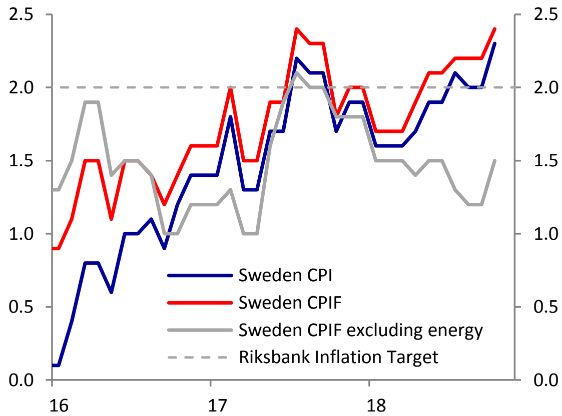
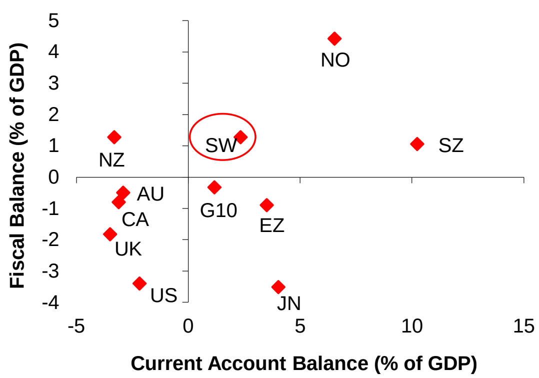
Chart 19: Headline and core inflation continue to move higher, with CPIF excluding energy even ticking up to 1.5% YoY in October



Source: Bloomberg, Santander

Chart 20: Political uncertainty remains, but any SEK fears should be limited by Sweden's dual fiscal and current account surplus



Source: Bloomberg, Santander

We are positive on the SEK over the coming year. Solid macro data, together with the prospect of the beginning of a tightening cycle should underpin the SEK in 2019. However, for the remainder of 2018, and perhaps the start of 2019, there are key risks for the SEK, primarily owing to the current political uncertainty, with a new government still not formed since the 9 September election, but also due to the fact that we do not expect the Riksbank to hike rates in December, despite the Bank reiterating that this is an option. We continue to forecast EUR/SEK at 10.2 in Q1-19 and 9.6 in Q4-19.

The SEK is the weakest developed market currency so far in 2018, having weakened almost 13% against the USD and 5% against the EUR. Most of this decline came at the start of the year though, with the SEK moving mostly sideways in H2-18.

The Swedish economy contracted 0.2% QoQ in Q3-18, this may have been due to temporary factors. So , Q3's slowdown could prove temporary, further, inflation continues to rise, with both the headline and core rates sitting comfortably above the Riksbank's 2% target in recent months, and even CPIF excluding energy rising in October (Chart 19).

The Riksbank continues to suggest that it could raise rates in either December or February but we still believe that a 2018 hike is very unlikely. We are not even fully convinced that the Bank will lift rates in February, although we certainly consider the latter date as the more likely of the two.

An unchanged rate decision from the Riksbank on 20 December has the potential to limit the SEK in late 2018, but domestic politics could also constrain the currency. As we have highlighted before, Sweden has strong and stable finances, with both a fiscal and current account surplus (Chart 20). As such, the political uncertainty has not caused as much disturbance as it might in another country.

However, the current impasse has already taken the country into uncharted waters. It is already Sweden's longest post-election period without a government, and snap elections are looking increasingly likely. Indeed, the Centre Party leader, Annie Lööf, abandoned her attempts to form a government last week. This follows similar failures to form a government from the leaders of the Moderate and Social Democrat parties.

Only the former went to a vote in parliament, but Kristersson's proposal to form a minority government with the Christian Democrats, supported by Sweden Democrats, was voted down (195-154), as the Centre and Liberals refused to accept a government that relied on the Sweden Democrats. This was the first time a candidate for prime minister was rejected by the Riskdag since the abolition of the bicameral legislature in 1971.

After four failed votes, snap elections must be held. Hence, the speaker of parliament, Andreas Norlen, is trying to force the next vote, and says that he will formally nominate the Social Democrats' leader (and ex-prime minister), Stefan Lofven, on 3 December, for a potential vote in the following days.

NOK – It all comes down to oil

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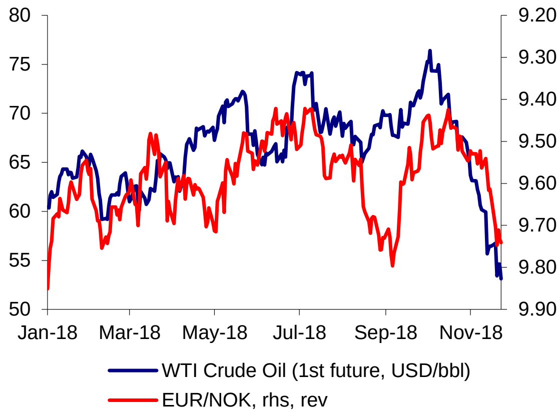
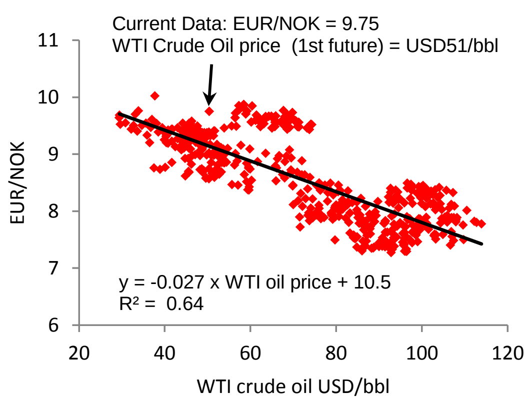
Chart 21: EUR/NOK has risen quickly on the back of a sharp oil price decline in Q4-18…



Source: Bloomberg, Santander

Chart 22: …although historical data still suggest the cross is too high given the current oil price



Source: Bloomberg, Santander.
Note: Data as at 26-Nov

We are positive on the NOK in 2019. A relatively solid economy, elevated inflation, and a central bank planning to hike rates again in Q1-19 should all support the NOK in 2019. However, a sharp decline in the oil price in Q4-18 (-30% from peak to trough) has weighed heavily on the NOK, pushing EUR/NOK briefly above 9.75. The NOK is now too weak, in our view, but this move has nevertheless forced us to revise our 2019 forecasts higher. We now see EUR/NOK dropping to just 9.5 in Q1-19 and 9.1 in Q4-19.

The NOK is the weakest developed market currency so far in Q4-18, depreciating by almost 5% against the USD. The second worst performer is the CAD, which is down by around 3% against the USD over the same period. Most of the weakness in both these currencies comes down to oil.

The petroleum sector accounts for around half of Norway's exports. As such, it is unsurprising that the c.30% drop in WTI oil prices over the quarter (from USD75bbl to USD50bbl this week) has weighed quite heavily on the NOK (Chart 21).

Oil is likely to continue being an important driver of the NOK, both in the coming weeks and throughout 2019. However, even if the oil price were to stay at around USD50/bbl, when we regress the oil price with EUR/NOK using weekly data over the past ten years, our model suggests that EUR/NOK is too high, and should instead be closer to 9.1.

However, the worst may now be over for the oil price decline. Indeed, the market is now turning its attention to the 6 December OPEC meeting, which could be crucial for oil price direction in 2019 as some OPEC members, including the UAE's OPEC Governor Ahmed al-Kaabi, have hinted at lower oil production. Russia's resistance to a cut may mean that this position could prove to be more 'forward guidance' than official policy, but even this could help support the oil price at its current level.

Domestic data have been mixed in recent months. GDP growth rose to 0.6% in Q3-18, but the mainland rate fell to 0.3%, hurt by low production in the power and agricultural sectors after the summer drought. The unemployment rate has been rising, but so too have wage pressures. Confidence data have been falling but Norway's trade balance reached its highest surplus in over four years in October (on a non-seasonally adjusted basis). Even inflation numbers have been a little mixed recently, disappointing in October, but with both the annual headline and core rates remaining relatively upbeat, at 3.1% and 1.6%, respectively.

Above-target inflation allowed Norway's central bank to raise rates for the first time in seven years in September, with the Bank signalling another rate hike to come in Q1-19. We do not expect the Norges Bank to lift rates until March and while the Bank has not explicitly ruled out a December hike, the recent oil price drop suggests that the Bank is more likely to be patient. As such, while we now see EUR/NOK as overbought, the market may need to wait until late Q1-19 for more explicit justification to buy the NOK.

LatAm FX: Main Themes

Currency	3M view	12M view	Main Themes
BRL	⇨	↘	• The likelihood of the approval of the pension reform will be the main driver for Brazilian assets going into 2019, in our view. • In the short term, with the summer holidays approaching in Brazil, domestic news flow should take a backseat to global market developments as the key driver of currency movements. • Low inflation should allow for loose monetary policy throughout 2019, contributing to low potential carry gains.
MXN	⇨	↗	• The Mexican peso has caught up with its EM peers and remained stable due to Banxico's 25bp hike on 15 November. • The market seems to be starting to price in the possibility of a further deterioration in the federal government's and/or Pemex's finances. • The incoming administration's economic team has set a target of a primary surplus of 1.0% for 2019, yet questions about its feasibility persist. Further MXN depreciation, on the back of fiscal concerns, could prompt a Banxico response at the 20 December meeting.
CLP	↘	⇨	• The CLP will remain dependent on the external environment, particularly trade tensions and copper prices. • The risk scenario is a permanent decline in copper, with effects on business confidence, investment, and eventually growth. • In the medium term, if copper prices normalise, the CLP should remain weak vs. the USD but relatively strong vs. EM peers, given Chile's lack of fundamental imbalances in the economy.
COP	↘	↘	• The impact of the slump in oil prices on the COP has been somewhat contained, but its risk profile has deteriorated, with lower oil prices putting pressure on fiscal accounts, growth and the current account balance. • We have increased our COP forecasts to reflect the new oil scenario and now expect the currency to return to 3400 vs. the USD in 2019. • 6 December will be a key market mover for the COP. If the members of OPEC agree to cut back production to counter the current supply glut, it could alleviate some of the pressures on the COP and the Colombian economy.
ARS	⇨	↘	• The new foreign exchange policy has proved very successful in curbing FX trends that seemed to be spinning out of control at the end of 3Q18. • Between 1 October and 23 November the local currency appreciated 11% vs. the USD. But the greenback unexpectedly jumped 6.7% in two sessions following Thanksgiving on Thursday 22 November. • We believe that the dollar spike of the last few days is unlikely to be sustained looking forward and foresee USDARS at around 38 by eoy.
PEN	⇨	↘	• Year-to-date, the Peruvian sol has been the best performer in the region and one of the best performers among EMs. • The PEN's better performance than its regional peers, such as the CLP, can be partly attributed to the increase in Peru's mining production, particularly copper, in the past couple of years. • We believe that the Peruvian sol's orderly depreciation will continue, reaching 3.4 vs. the USD in the short term as external risks continue to build, with the potential escalation of the trade war between the US and China being the main risk.

⬆ Bullish ↗ Mildly Bullish ⇨ Neutral ↘ Mildly Bearish ⬇ Bearish

Source: Santander.

BRL – Waiting for the flows (don't hold your breath)

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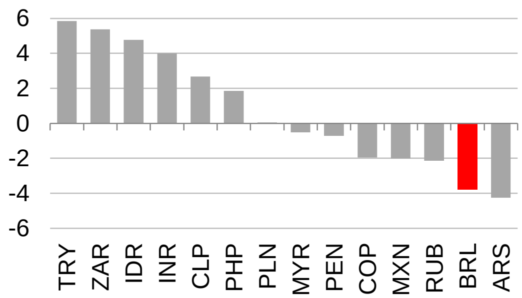
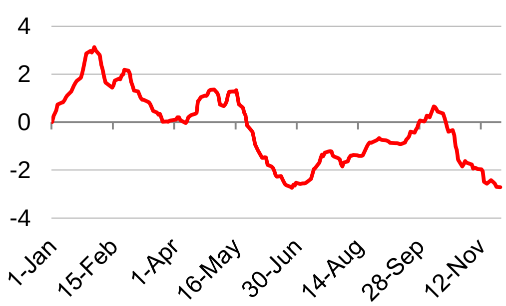
Chart 23: Currency spot returns vs. USD, % (29 Oct. – 28 Nov.)



Source: Santander, Bloomberg

Chart 24: Net YTD flows to Brazil's stock exchange (USD billion)



Source: Santander, Bloomberg

Following a strong run in October, the BRL has been among the worst performers in the EM currency universe since Jair Bolsonaro's triumph in the 27 October election run-off (notably, other high yield currencies such as the TRY, ZAR, IDR, and INR strengthened against the USD in that period). Apparently, the appointment of a market-friendly economic team was not enough to convince foreign portfolio investors to add to BRL-denominated assets, which also decreases the risk appetite of local investors that added risk ahead of the elections. There is little recent data on fixed income flows, but on the equity side, according to data from the São Paulo stock exchange (Bovespa), net foreign outflows in November already add up to more than USD 1 billion.

We highlighted in October's FX Compass that the BRL's move during that month was too fast, too strong: with the currency close to its fair value and record-low short-term interest rates leading to low potential carry gains relative to other EM currencies, we adopted a relatively bearish view on the currency in the medium term. Nevertheless, we were surprised by how fast the relief rally related to the results of the presidential election evaporated. The first leg of the 'honeymoon' phase (see our report *Brazil Post Elections: Honeymoon and Marriage*, 25 October 2018) seems to be already over, and a new wave of optimism will now depend, in our view, on concrete advances in the fiscal consolidation agenda, especially pension reform.

The next few months should bring little news on that front: Bolsonaro's proposal may be made public (in our view, it would be preferable for the incoming government to use Temer's reform as a starting point, as this would save them precious months of discussion in the Lower House and allow for a faster decisive floor vote in 2019), but the newly elected Congress only starts its activities in February and little can be done before the long Carnival holiday in early March. Therefore, the BRL's performance in the short term should be more dependent on global market gyrations.

Another development worth watching will be the stance of the newly appointed central bank governor, Roberto Campos Neto, on the bank's FX intervention policy and international reserves. His confirmation hearing in the Senate is still not scheduled, although it should happen before year-end. The central bank still holds a considerable amount of FX swaps auctioned mostly in May/June, and a change in the rollover policy has the potential to change the short-term dynamics of the currency. Campos Neto will probably soon be invited by the press to share his opinion on the level of international reserves, which incoming finance minister Paulo Guedes has already claimed to be excessive. STUART

On the monetary policy side, we still think that the Selic rate will stay at 6.5% throughout 2019 and 2020, so relative carry gains should continue to be defined by the rates of funding currencies and other competitors for this kind of flow.

MXN – Banxico will keep on looking after the MXN

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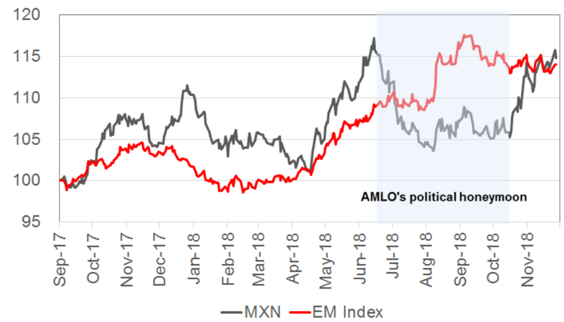
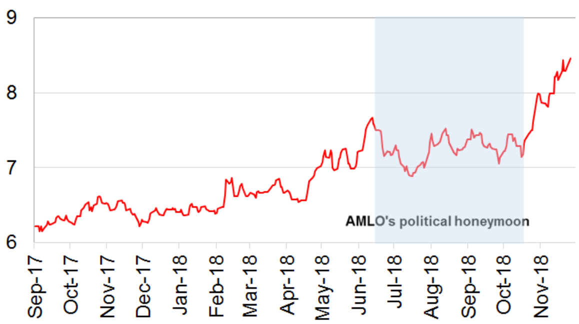
Chart 26: MXN vs. JPMorgan Emerging Market Currency Index Sep, 2017=100.



Source: Santander, Bloomberg

Chart 27: Pemex bond yield (%)



Source: Santander, Bloomberg

The Mexican peso has caught up with its EM peers and remained steady for some weeks now. A few weeks before the presidential elections, the MXN started to appreciate, diverging from the depreciating EM currencies, mainly in response to a stronger USD. At the time, AMLO was enjoying his political honeymoon with a market pleased by his conciliatory speech after winning the elections, his moderate stance on energy reform and private sector investments, his commitment to central bank autonomy (as he appointed the highly qualified and independent Jonathan Heath to the board), and his pledge of fiscal prudence.

This honeymoon was also sweetened by progress in the trade negotiations with the US, as uncertainty surrounding a potential US withdrawal from NAFTA diminished with the agreement on the USMCA, thereby further strengthening the MXN. However, the honeymoon began to come to an end as the market grew uneasy when the administration put the fate of the Mexico City Airport in the hands of a public referendum and then cancelled the Texcoco project (the latter action prompted Fitch to put Mexico on negative watch). As a result, the MXN's performance came back into line with its EM peers (see chart 26), with the currency now moving in the opposite direction to the USD. Nevertheless, the MXN has remained stable due to Banxico's 25bp hike on 15 November.

Thus, we could argue that the market is starting to price in the possibility of a further deterioration in the federal government's and/or Pemex's finances. The nominal yield curve spread between 2y and 10y now stands at 50bp, whereas on 16 October it was only 18bp. In the same period, the Pemex '47 bond yield in USD jumped from 7.16% to 8.34%. Mexico's 5-year CDS is now trading like a BBB- at 162, slightly higher than Russia at 159 and Colombia at 147, both countries rated BBB- by S&P.

Given the perception of fiscal deterioration, we expect further MXN depreciation to prompt a Banxico response at the 20 December meeting. We do not yet believe that a hike is likely—especially considering the hawkish tone of the last communiqué, Banxico's warnings about a prudent fiscal budget, and the fact that the November decision to hike the policy rate by 25bp was not unanimous (indeed, one member voted for a hike of +50bp.)

The incoming administration's economic team has set a target of a primary surplus of 1.0% for 2019. Nevertheless, proposals for new social programmes and new infrastructure projects have raised doubts about the likelihood of finding savings to accommodate such plans. In addition, credit rating agencies have warned of a credit downgrade for Pemex if it changes its business model to refining gasoline and reporting in MXN, instead of exporting more oil and reporting in USD, when 87% of its USD100bn worth of debt is mostly denominated in USD. According to the incoming government, the next budget may include MXN100bn to start building a new refinery and revamping the current six refineries.

CLP – More turns ahead on the roller coaster

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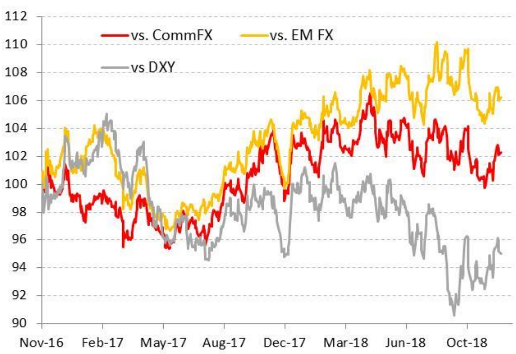
In the last few weeks, the USDCLP rate has been on a roller coaster ride, crossing the 690 threshold twice, but easing significantly in following sessions, hitting lows below 670. This replicated the volatile, but range-bound, performance of copper prices (between US$2.67/lb and US$2.81/lb), and dollar indexes (vs. DM and EM). In general, we continue to detect signs of a "funding currency" effect in the CLP, as the peso has tended to react more intensely to negative news.

On the local growth front, September's IMACEC came in at 2.3% y/y, a weak reading vs. previous months. This was due to a decline in mining output, a negative calendar effect, and a certain slowdown compared with 2Q18, although it is difficult to isolate these effects. October data should provide clarity on the state of the real economy, as the calendar effect should be reverted – we expect IMACEC to come out above 4% y/y, thus mitigating growth concerns. In any case, global risks continue to drive growth sentiment lower: projected 2019 GDP growth has fallen 30bp to 3.5%, as per the BCCH survey.

Regarding inflation, October's CPI came out slightly on the upside, at +0.4% m/m, +2.9% y/y. The breakdown was mixed, with gasoline and food prices exerting upward pressures, while electricity tariffs worked in the opposite direction. That said, core inflation remains low (at 2.1% y/y), and the FX pass-through to local prices continues to be mild, at least vs. historical standards. For the coming months, the abrupt decline of global oil prices will translate into lower gasoline prices in Chile, up to 10% vs. October, which is likely to produce low headline inflation prints in November and December, and keep y/y measures below 3% in 1Q19.

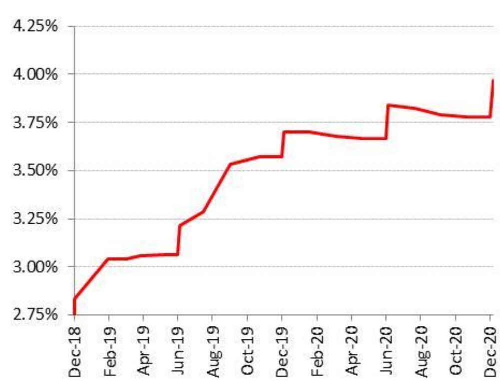
Chart 28: CLP vs. selected benchmarks



Base 100=Nov 2016. Higher values mean CLP appreciation and vice versa. Source: Bloomberg, Santander.

Local rates, in turn, moved lower, reflecting recent global trends. Now the market discounts a 3.75% BCCh rate for end-2019, vs. 4.10% one month ago, while 10yr Cámara swaps have rallied 30bp to 4.25%, a three-month low. Next week will be key for monetary policy, given the 4 December rate meeting and the IPoM release the following day. The market discounts a 60% chance of no move, but we would not be surprised to see a 25bp hike to 3% and a general dovish tone, suggesting that a pause is coming in the next few meetings. The BCCh would thus put real rates back into zero territory, while maintaining them well in expansionary zone (neutral is estimated at around 4.25%) and guaranteeing a gradual path thereafter.

Chart 29: BCCh rates – Market implied path



Source: Santander

All in all, we maintain our call that the key CLP drivers in the coming months will be external: the USD and copper prices. We expect a volatile context: the USD may lose some ground if Fed messages turn more dovish, but concerns about global growth may easily drag copper prices lower, with ambiguous effects on the peso. Mild rate hikes in Chile should not change the general CLP direction, in our view. Net net, we maintain the idea of an upward drift in the USDCLP, unless the scenario of soft landing in the US and a resilient China becomes more likely. Extrapolating the trend in fair values since early this year, we obtain 680-685 for end-December.

COP – New oil scenario

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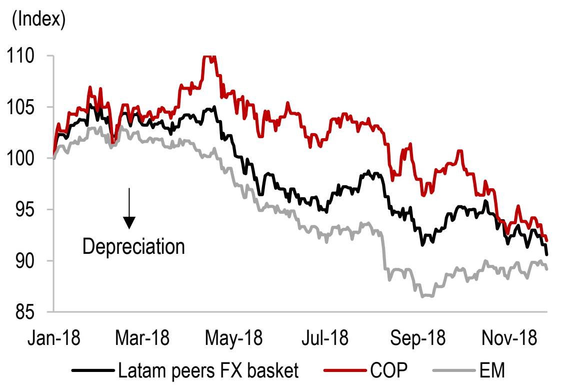
Since our last FX Compass (published 25 October), the COP's outlook has deteriorated, with oil prices plunging to their lowest levels since October 2017. The price of Brent has fallen 22% in the past month, from a high of $77/bbl to levels below $60/bbl. Despite the sharp correction in oil prices, the COP has mainly fluctuated within a tight range of 3150-3200, but started to evidence pressures recently, with the currency again depreciating and moving towards the USDCOP 3300 level, which we estimate to be its current fair value. While the impact of oil prices seems to have been moderate so far, in retrospect, the COP has been slowly catching up to its EM and LatAm peers throughout the year, prior to the decline in oil prices, with this last move aligning the COP with these peers.

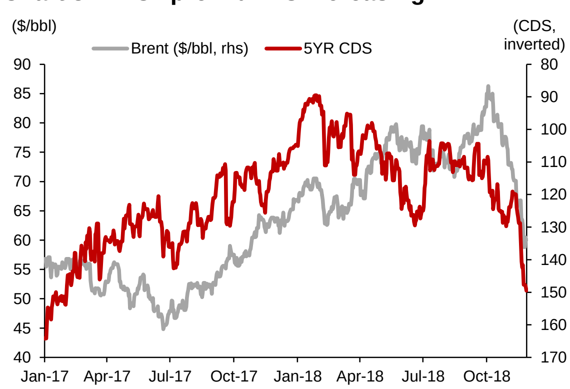
Chart 30: COP catching up with peers*



*Note: BRL, CLP, MXN, PEN; equally weighted.
Source: Santander, Bloomberg

In general, however, the currency's risk profile has deteriorated and we do not rule out further depreciation. In the short term we are entering a month of low liquidity, while lower oil prices have clouded the optimistic macroeconomic outlook, putting pressure on fiscal accounts, growth and the current account balance. In terms of fiscal accounts, the budget for 2019 estimates oil at a price of $65/bbl, above the current level. This, in addition to the lack of political coordination to pass the financing law are again raising concerns regarding the government's ability to continue with fiscal consolidation in the medium term. In tandem, country risk is starting to increase, with 5-year CDS rising by 21bp in the past month, albeit still below the 326 peak reported back in 2016 when the Brent oil price plummeted below $30/bbl. Needless to say, the OPEC meeting on 6 December will be a key market mover for the COP. If the members of OPEC agree to cut back production to counter the current supply glut, it could alleviate some of the pressures on the COP and the Colombian economy, with oil prices possibly recovering in the second half of next year.

Chart 31: Risk premium is increasing



Source: Santander, Bloomberg

Previously, we had expected a slow decline in the COP in 2019, but given the recent slump in oil prices, we have revised our COP forecasts upwards. In addition to lower oil prices, external risks are building as a result of tighter financial conditions and trade war tensions, and we thus consider that the COP will return to 3400 vs. the USD in 2019, a record high not seen since 2016.

In terms of monetary policy, we consider that the government's decision to continue to exempt basic basket items from VAT has notably decreased inflationary risks. However, other important risks to the upside remain, including the possible effects of *El Niño*, a significant increase in the minimum wage and further FX depreciation. Given this, we stick to our forecast that the central bank will start its hiking cycle in March 2019. Nevertheless, BanRep remains highly vigilant with respect to inflation expectations, and if there are important revisions in January, we would not rule out the possibility of a first hike in that month, as the market is pricing in.

ARS – The dollar is heading for the lower bound of the NIZ

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The new foreign exchange policy launched in early October has proved very successful in curbing FX trends that seemed to be spinning out of control at the end of 3Q18. After depreciating 33% between August and September, the peso's free fall has apparently been checked.

From 1October to 23 November the local currency appreciated 11%, letting market players relax their peso bets while they started to rethink their strategies, supported by a more stable financial environment.

The approval of the second phase of the IMF agreement, consisting of disbursements of funds that are no longer precautionary and more than 88% of the US$56.3bn total financial package to be disbursed in the next ten months, has undoubtedly been a key support for the recent FX performance.

In turn, the floating monetary policy rate, as set in the daily Leliq auction conducted by the central bank, has consistently moved downwards since early October, reaching 61.2 % on Monday 26 October from a peak of 73.5% on 8 October.

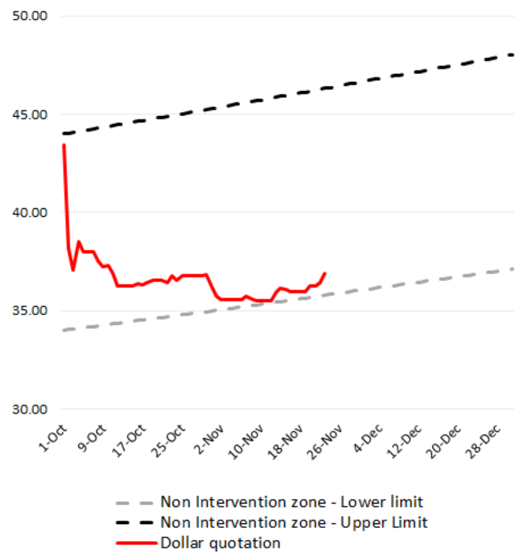
However, the greenback unexpectedly jumped 6.7% in the two sessions following Thanksgiving on 22 November. We see no clear reasons for the dollar spike of the last few days: our traders have not detected any significant trade outflows and in fact retailers have sold dollars to the bank's branches –in net terms- in the last two sessions as they have done since mid-October. Similarly, import customers, who buy dollars to purchase overseas goods or services, have not changed their extremely cautious behaviour of the last two months.

Some pundits and analysts argue that the monetary policy rate has dropped too fast while others believe that the 15% appreciation of the local currency in real terms recorded since late September might explain some portfolio changes from pesos to dollars, an unlikely hypothesis, in our view, which cannot be supported by the flows recorded by Santander.

Based on all the above, we believe that there are no clear arguments to support the view that the dollar spike of the last few days is likely to continue going forward.

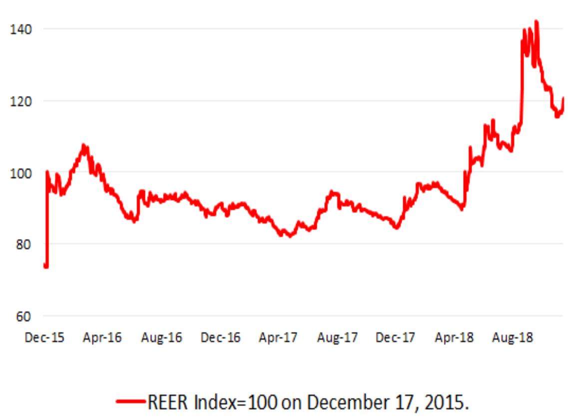
Furthermore, based on the assumption that the government will maintain monetary base growth at zero in the months to come, we ratify our view that the dollar quotation is likely to continue to move around the lower bound of the non-intervention zone. We expect a dollar price of around ARS38 by year-end, below the USD/ARS 39 officially projected by Santander Río economists.

Chart 32: No FX purchases or sales within a wide "non-intervention zone



Source: Central Bank and Santander.

Chart 33: A competitive real multilateral exchange rate - REER- would stabilise at around 120



Source: BCRA and Santander

PEN – Following the trend

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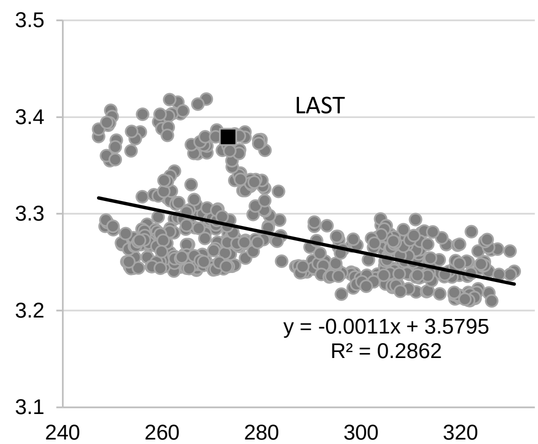
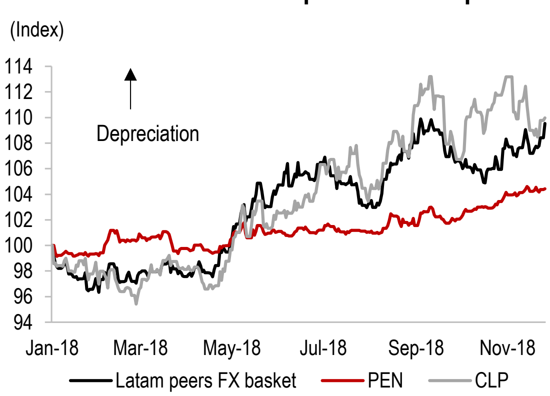
Chart 34: USDPEN vs. copper prices ($/lb)*



*Dec'16-Nov'18 Source: Santander, Bloomberg

Chart 35:PEN moderate depreciation vs. peers



Source: Santander, Bloomberg

Year-to-date, the Peruvian sol has been the best performer in the region and one of the best performers in the EM space. USD/PEN has depreciated moderately throughout the year, by 4.4% YTD, below the EM index depreciation of 10%. One of the main drivers of the PEN's depreciation has been lower international metal prices. The price of copper and gold, which are among Peru's top exports, have decreased by 17% and 8%, respectively, YTD. Gold exports account for 17% of total exports and are the second largest metal export after copper, which accounts for close to 30%. Despite this, the PEN's adjustment has been notably more moderate than the CLP in Chile (the other important copper exporter in the region), which has depreciated by 10% during the year. This better performance can be partially attributed to Peru's increase in copper production in the past couple of years, making it the world's second largest exporter in 2017, surpassing Chile's production levels.

Additionally, the central bank has intervened in the market during the year, mainly via FX swaps. The swap stock as of 21 November was close to US$1.4bn. However, the central bank's intervention has been somewhat contained, and while it has helped to moderate volatility, it has allowed the currency to maintain its trend.

We believe that the Peruvian sol's orderly depreciation will continue, reaching 3.4 vs. the USD in the short term as external risks continue to rise. We consider that the largest risk for the currency continues to be the potential escalation of the trade war between the US and China, as this could continue to put pressure on commodity prices, particularly metal prices, and China remains Peru's main trading partner, with 30% of Peruvian exports going to this market.

Still, the potential impact of external shocks could be somewhat contained in comparison to that felt by Peru's peers as it is less vulnerable thanks in part to the country's comfortable level of reserves (close to 30% of GDP, the largest in the region under this measure) that covers four times Peru's external short-term liabilities. Moreover, the current account deficit remains one of the lowest in the region despite the recent revisions due to the decline in metal prices (the central bank revised the 2018 current account deficit estimate up to 1.6% from 1.2%).

Finally, Peru's growth profile remains positive, with the consensus expecting the economy to expand by 3.8% in 2018 and reach its potential growth of 4.0% in 2019. Solid consumption and higher mining investment commitments for the coming years are the main driver, but private investment in general is picking up and compensating somewhat for the lack of public expenditure. In terms of monetary policy, we expect the central bank to deliver its first hike in 1Q19, as headline inflation is the way to reaching the 2% inflation target by end-2018 and the output gap is forecast to close in 1Q19.

CEE FX: Main Themes

Currency	3M view	12M view	Main Themes
PLN	⇨	⇨	• We maintain our view that the zloty might post gains in the last month of the year on the back of still robust Polish economic data and better global market sentiment. The room for a subsequent lower EUR/PLN seems limited, as more signs of an economic slowdown could appear.
CZK	⇨	↘	• The Czech koruna has underperformed its CEE peers due to such internal issues as hawkish rhetoric from the central bank and protests against the government. We think the koruna could gain slightly until the end of 2018E.
HUF	↗	↘	• We maintain our short-term forecast for EUR/HUF, which is likely suffering due to the geopolitical tension and deceleration of the Euro zone economy. At the end of 1Q19E, we expect a rebound of the HUF, mainly as a result of the central bank's decision to phase out unconventional monetary policy measures by the end of 2018.
RUB	↘	⇨	• We see room for the RUB to depreciate by the end of 1Q19, due to lower oil and energy commodities prices and the risk of the US imposing new sanctions on Russia. The RUB could also suffer as a result of lower global growth prospects.

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

Source: Santander Bank Polska S.A.

PLN – Dependent on external factors

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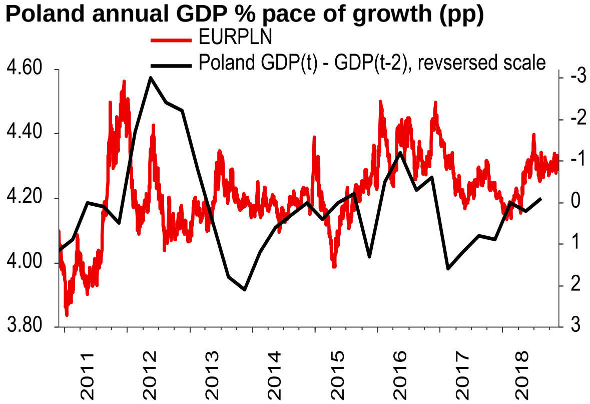
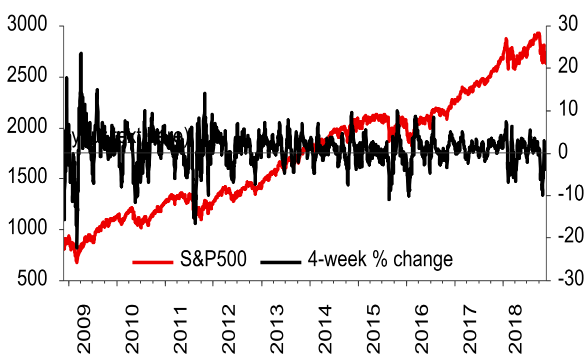
Chart 36: EUR/PLN and two-quarter change in Poland annual GDP % pace of growth (pp)



Source: Thomson Reuters Datastream, Santander Bank Polska

Chart 37: S&P500 and its 4-week % change



Source: Thomson Reuters Datastream, Santander Bank Polska

EUR/PLN remained within the 4.26-4.34 horizontal trend it has been in since August. We maintain our view that the zloty could see gains in the last month of the year on the back of still robust Polish economic data and better global market sentiment. The room for a subsequent lower EUR/PLN seems limited as more signs of an economic slowdown could appear.

Poland's flash 3Q GDP surprised on the upside, growing 5.1% y/y. The headline figure remained above 5% for the fifth time in a row, the best streak since the 2006-08 economic boom. The Stats Office is due to release details at the end of the month, but we believe consumption continued to be the main growth driver, while the contribution of net exports was negative or neutral.

We expect to see a deceleration in Poland's GDP growth in the coming quarters, mainly owing to a weakening trend in international trade. However, economic activity looks set to remain robust until the end of 2018E, as the October monthly output and sales data surprised significantly on the upside.

Recall that, in September, the European Commission (EC) decided to take the Polish government's judiciary reforms to the Court of Justice of the EU (CJEU). The EC has asked the Court to use an expedited procedure and has requested provisional measures.

The Polish government recently prepared an amendment to the bill in question, which should be in line with the CJEU's request, so we do not expect any political pressure on the zloty in the coming months.

The last few weeks have seen a sharp drop in US stock indexes and, in our view, the pace of the sell-off is overdone. The four-week % change in the S&P500 has only been lower during periods of serious turbulence (which does not seem to be the case now) and has always been followed by a stabilization or a gradual recovery in stock prices.

US economic activity data still look solid, which could encourage investors to take advantage of the recent sell-off to purchase shares. Higher risk appetite could, in turn, work in favour of the Polish currency.

The seasonal pattern could also be zloty-positive. According to Bloomberg, in the last 12 years EUR/PLN has only risen three times in December; the last time was in 2014.

The risk factor for our lower EUR/PLN scenario would be another round of market concerns about liquidity at some of the small Polish banks and the media talking about the central bank governor's resignation.

In November, top central bank and government officials said the situation was under control, but they are ready to act if needed, and this has calmed investors. However, any resurfacing of this issue could generate negative pressure for the zloty, like it did in mid-November.

CZK – GDP to show direction

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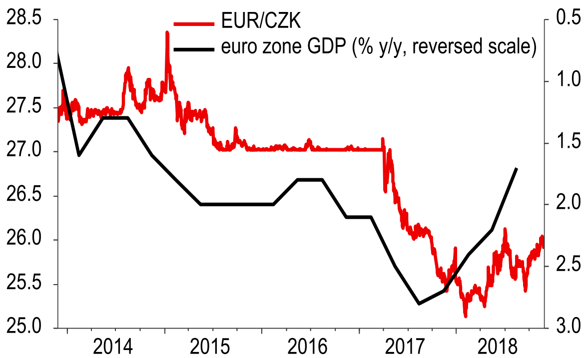
Chart 38: EUR/CZK and euro zone GDP growth



Source: Thomson Reuters Datastream, Santander Bank Polska

The Czech koruna has underperformed its CEE peers since the last FX Compass. The main reasons for this were internal issues, such as not very hawkish rhetoric by the central bank and protests against the government.

In November, the Czech central bank (CNB) hiked rates by 25bp, putting the main rate at 1.75%. The bank governor said that the next hike could take place in January with the timing largely depending on the EUR/CZK rate. We think the koruna could gain slightly until the end of 2018E making a December hike unlikely. The rate increase in 1Q19E might be the last one before a longer pause as there are initial signs of an economic slowdown.

According to the flash estimate, Czech GDP growth decelerated surprisingly in 3Q to 2.3% from 2.4% while the market expected an acceleration to 2.6%. In September, retail sales contracted 2.2% y/y, the worst performance since mid-2013, while industrial output fell 0.9% y/y, putting it in negative territory for the second time this year. At the same time, inflation seems to have stabilized at slightly above 2% y/y after it jumped to 2.6% in June from 1.7% in March.

In late-November, the Czech government survived a no-confidence vote after the opposition demanded PM Babis' resignation. Recall that the Czech PM is accused of a subsidy fraud. The fact that the long delay in establishing a new government after the 2016 elections had no clear impact on the koruna suggests there should be no long-lasting impact from political scene on the Czech currency this time around.

HUF – Hit by Eurozone

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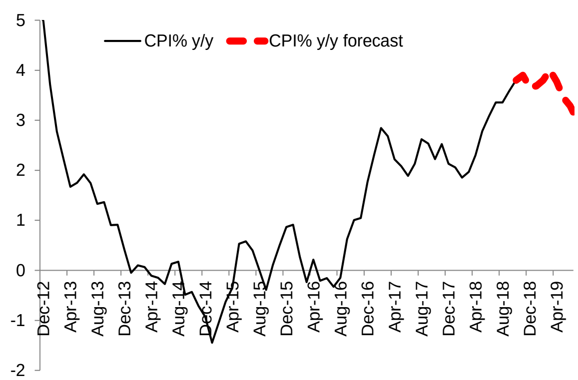
Chart 39: Hungary CPI



Source: Reuters, Santander Bank Polska.

EUR/HUF fell in early November to 321.70 from 324.50, and oscillated in the 321.30-322.80 range for most of the month. The HUF appreciation was a consequence of the better global market mood and positive surprises in macro data. According to the flash reading, 3Q18 GDP rose faster than expected (4.8% y/y vs 4.4% y/y in 2Q18). Wages and PMI also beat expectations (in October the Manufacturing PMI was at 57.3 vs 53.8 in September). Industrial production and retail sales data were below the market consensus (mainly due to seasonal effects) but they did not affect HUF noticeably. At the end of November, EUR/HUF jumped to 324.30, in reaction to increasing tension between Russia and Ukraine.

In the next four to five weeks, we anticipate EUR/HUF staying at around 325 due to the high geopolitical tension in the region (Ukraine-Russia conflict) and expected poor macro data from the rest of Europe. We believe that problems for the automotive sector (which accounts for c17% of Hungarian exports) will translate into poor results for Hungarian industry in general. The expected scale of the forint depreciation is likely to be relatively small, thanks to the central bank's decision to phase out part of the unconventional monetary policy measures by the end of 2018. This scenario should be supported by inflation data (the October reading was 3.8% y/y vs a 3.6% y/y market forecast). According to our forecasts, the November CPI could reach 3.9% y/y.

RUB – Geopolitics again

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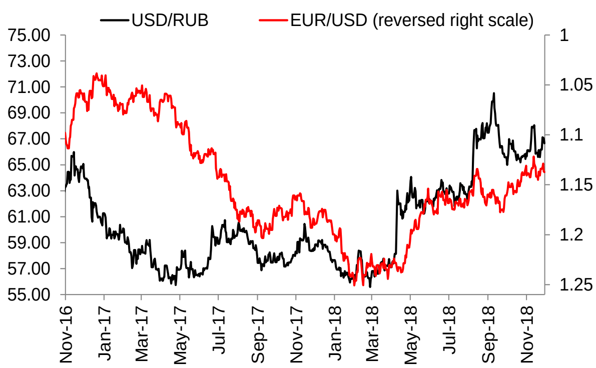
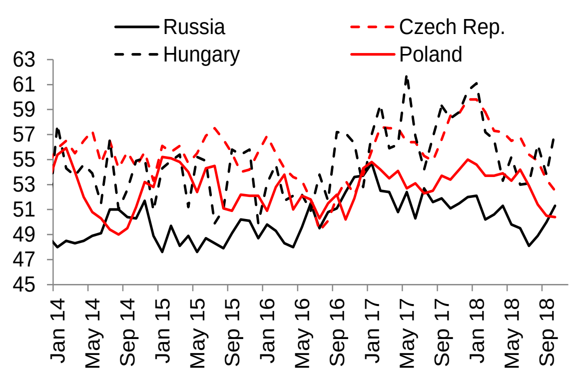
Chart 40: USD/RUB and EUR/USD



Source: Reuters, Santander Bank Polska.

Chart 41: Manufacturing PMI



Source: Reuters, Santander Bank Polska.

Over the last four to five weeks, we observed two waves of RUB depreciation. In the first ten days of November, the ruble was pressured by the slump in oil prices and the strengthening of the USD. This pushed USD/RUB up to 68.15 – the highest level since September. An additional factor which negatively affected the RUB was a remark of the chief of the central bank research department, Alexander Morozov, who said that the September interest rate hike could have been a one-off event.

The second wave of depreciation came at the end of November, as a reaction to the information that Russian naval forces had seized three Ukrainian vessels close to the Kerch Strait. As a consequence the USD/RUB rose to 67.15.

We believe that in the next few weeks USD/RUB may climb to 70 as a reaction to tension in the Black Sea. We think that the increasing risk of the US imposing new sanctions on Russia could negatively affect the RUB at the end of 2018. Taking a longer-term perspective, we expect the RUB to stay weak because of the mixed macro data we foresee.

The latest data showed some rebound in the leading indicators (in October the Manufacturing PMI rose to 51.3 from 50.0, while the Services PMI increased to 56.9 from 54.7). However, at the same time, we saw weaker-than-expected CPI data (3.5% y/y in October vs 3.6% y/y market forecast and 3.4% y/y for September) and GDP growth, which showed a deceleration (in 3Q18 GDP rose by 1.3% y/y vs 1.9% in 2Q18). Wages rose a bit less than expected, as did real retail sales (+1.9% y/y in October vs 2.2% y/y the previous month). In October only industrial production (3.7% y/y vs 2.2% in September) and real disposable income (1.4% r/r vs -1.5% y/y in September) surprised on the positive side, even though the real wages dynamics decreased.

In the October post-meeting information, the central bank suggested it may consider further rates hikes, while in mid-November, Alexander Morozov, head of the Russian central bank's research department, said that the September hike may have been a one-off. We are concerned that ambiguous information from the central bank could weaken investors' faith in interest rate hikes, despite the expected growth in inflation. According to our forecasts, inflation in Russia could reach 4.0% at the end of the year and 5%-5.5% y/y in mid-2019E (as a consequence of VAT rate increases announced by the government).

This scenario will be supported by still deteriorating Euro zone data, which, along with decreasing oil and energy prices, may erase market expectations of further interest rate hikes. This, together with geopolitical tension, could hit the ruble again at the end of 1Q19.

G10 FX: IMM Speculative Positioning

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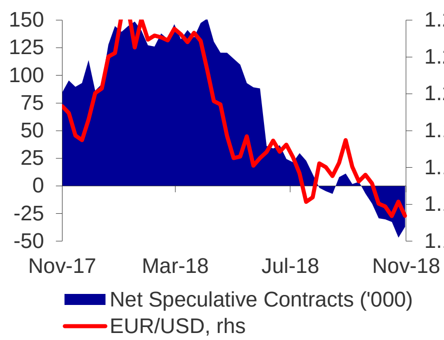
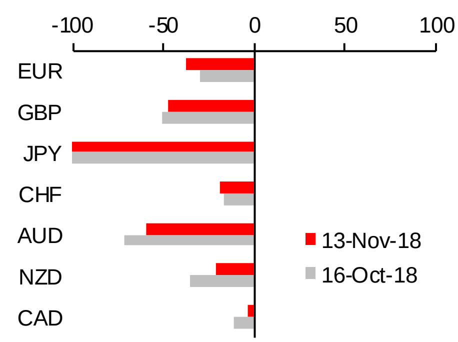
IMM commitment of traders report: EUR/USD position



- **Speculators remain very net long the USD.** Indeed, in the four weeks ended 13 November, the net long USD composite speculative position rose to its highest levels in almost two years.
- **The net EUR position turned negative in October,** having been positive for most of 2018. This position has turned even more negative in November, at 37k contracts in the week ended 13 November, as the market focus on the Italian budget has weighed on EUR sentiment.
- **Speculators are still very net short the GBP.** An unwinding of this position looks unlikely until there is more certainty on Brexit.
- **The net short AUD and NZD positions narrowed in November.** Both positions have deteriorated notably since April, following an inverse move in the USD and the USD positioning, whose turnaround began in April. The 12k and 15k improvements in the AUD and NZD speculative positions over the past four weeks are minimal, but could suggest the lows have now been reached.
- **Speculators have now turned net short the CAD.** Indeed, with oil prices dropping by c30% over the past two months, the CAD has already taken a big hit, and unless oil prices recover, the net short CAD position could increase further in the weeks ahead.

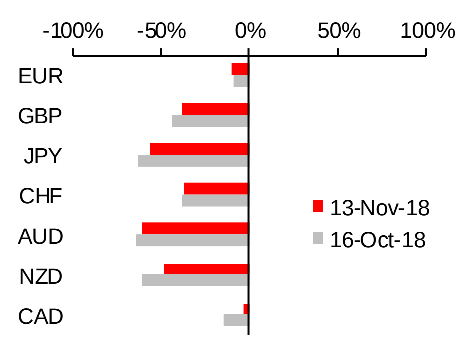
Net Speculative Contracts ('000s)*

	13-Nov-18	16-Oct-18	4w chg	YtD chg
USD***	281.2	246.2	35.0	278.5
EUR	-37.0	-29.3	-7.7	-129.2
GBP	-47.1	-50.4	3.2	-59.8
JPY	-102.3	-100.6	-1.7	13.8
CHF	-18.6	-16.5	-2.1	-4.7
AUD	-59.8	-71.5	11.7	-46.1
NZD	-20.9	-35.4	14.5	-3.3
CAD	-2.8	-11.0	8.2	-20.1



Net Speculative Contracts as % of Open Interest**

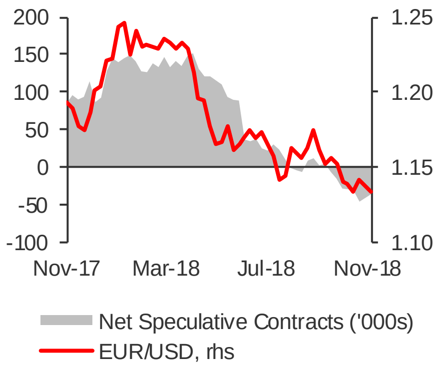
	13-Nov-18	16-Oct-18	4w chg	YtD chg
USD***	26%	23%	3%	26%
EUR	-10%	-9%	-1%	-39%
GBP	-38%	-44%	6%	-47%
JPY	-56%	-63%	7%	1%
CHF	-37%	-38%	1%	-19%
AUD	-61%	-64%	3%	-46%
NZD	-48%	-61%	13%	-16%
CAD	-4%	-15%	11%	-29%



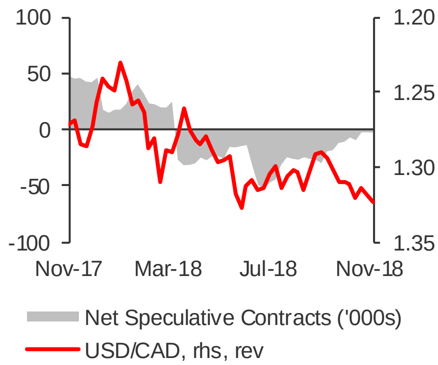
Sources: CFTC, Bloomberg, Santander. Note: *Net Speculative Contracts = Long non-commercial traders contracts minus short non-commercial traders contracts, **Open Interest = The total number of outstanding long and short futures contracts, ***USD composite index = USD composite index uses AUD, CAD, CHF,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

G10 FX: IMM Speculative Positioning

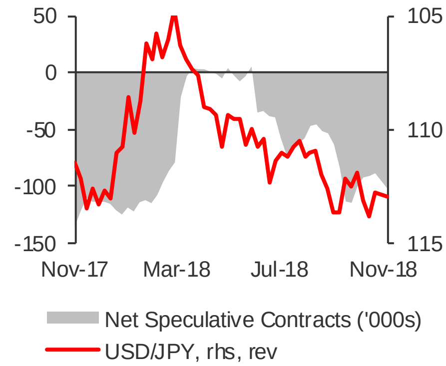
EUR/USD



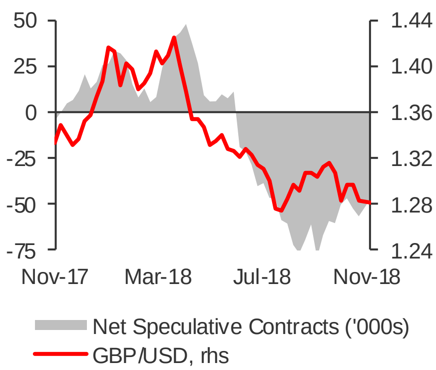
USD/CAD



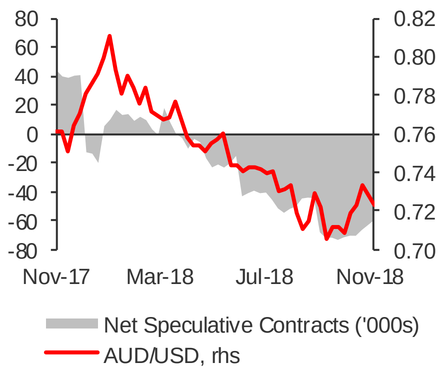
USD/JPY



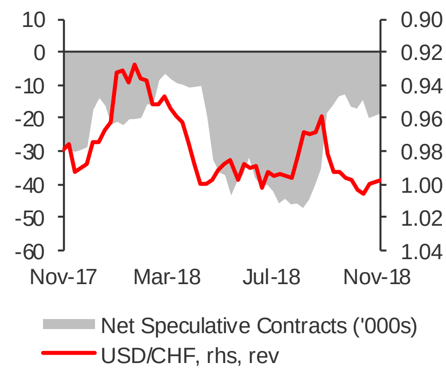
GBP/USD



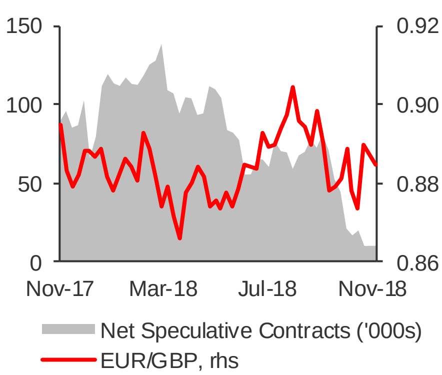
AUD/USD



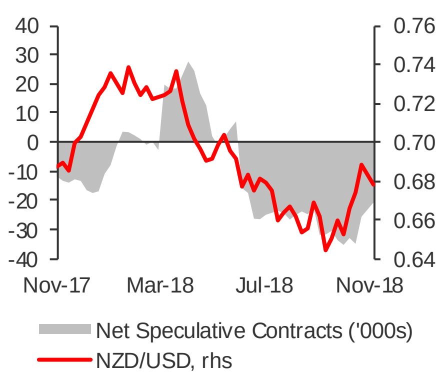
USD/CHF



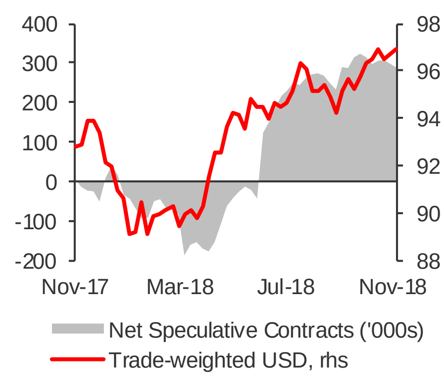
EUR/GBP



NZD/USD



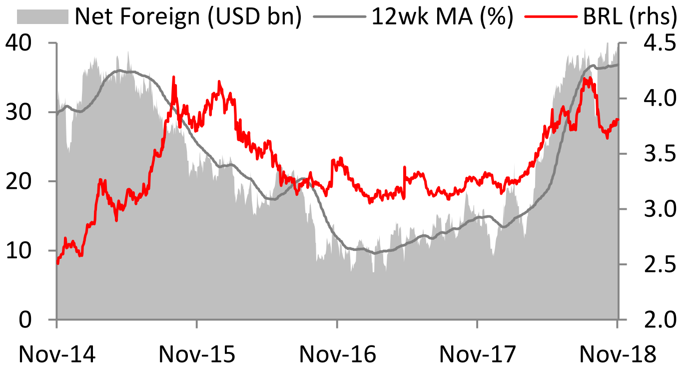
USD minus MXN



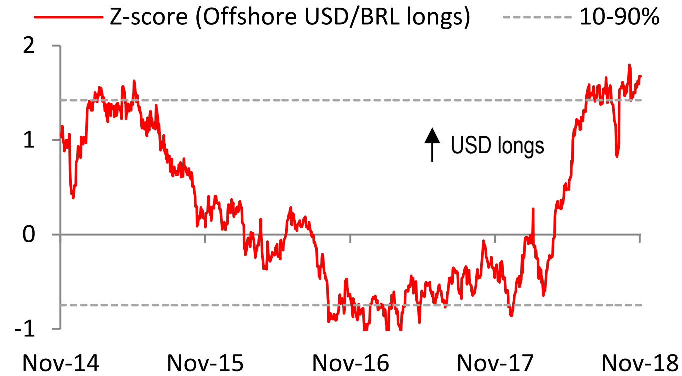
Sources: CFTC, Bloomberg and Santander. Note: IMM commitment of traders report

Latin America FX: Positioning indexes (Z-scores)

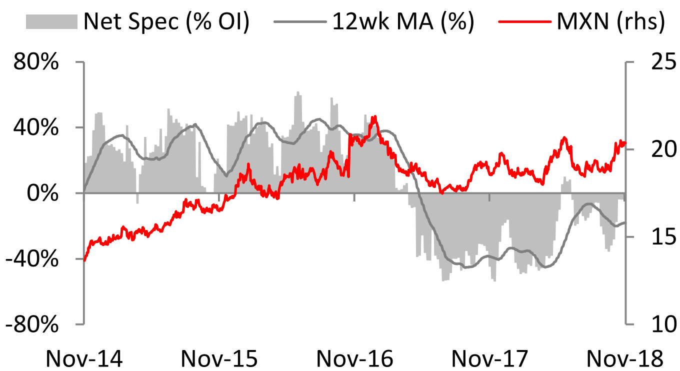
USD/BRL



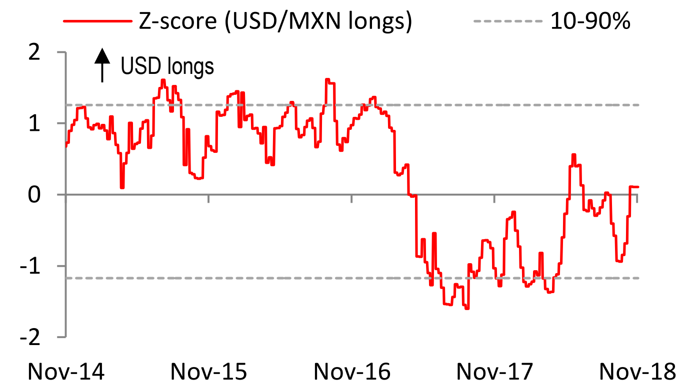
Z-score USD/BRL



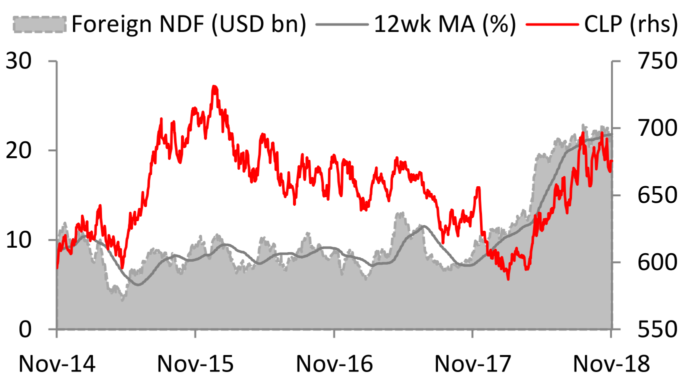
USD/MXN



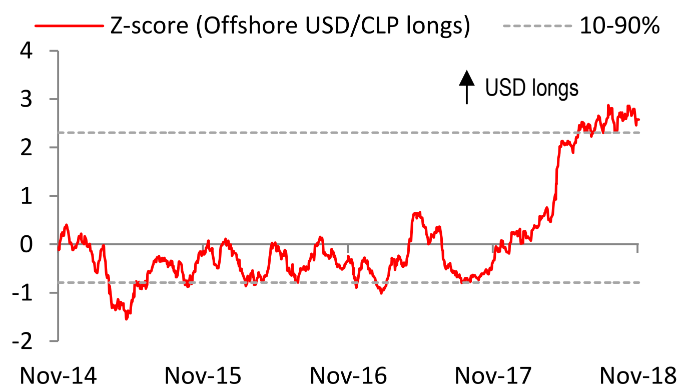
Z-score USD/MXN



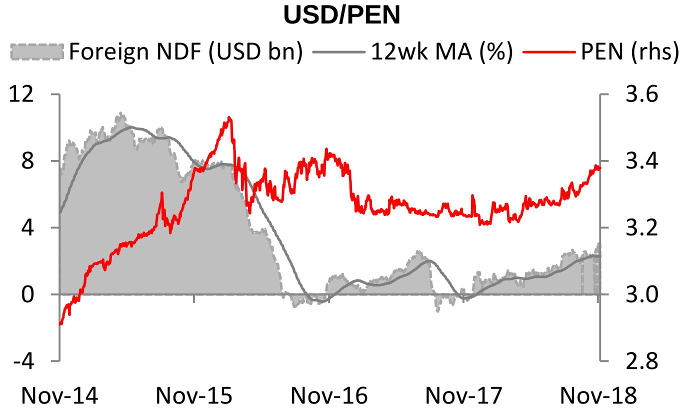
USD/CLP



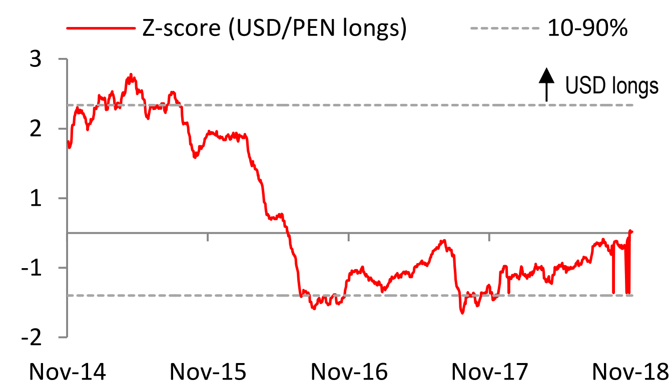
Z-score USD/CLP



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	1Q19	2Q19	3Q19	4Q19
ECB Depo	-0.40	-0.40	-0.40	-0.20	0.00
3m	-0.75	-0.53	-0.40	-0.20	0.00
2y	-0.59	-0.25	-0.05	0.20	0.40
5y	-0.25	0.25	0.50	0.75	0.90
10y	0.33	0.90	1.15	1.35	1.55
30y	1.00	1.40	1.60	1.80	1.95

Swap rate forecasts

Euro	Current	1Q19	2Q19	3Q19	4Q19
ECB Depo	-0.40	-0.40	-0.40	-0.20	0.00
3m	-0.32	-0.27	-0.17	-0.01	0.22
2y	-0.15	0.15	0.30	0.50	0.70
5y	0.29	0.70	0.90	1.10	1.25
10y	0.89	1.40	1.60	1.75	1.90
30y	1.47	1.80	1.95	2.10	2.20

US Interest Rate Forecasts

Government Bond yield Forecasts

US	Current	1Q19	2Q19	3Q19	4Q19
FOMC *	2.25	2.75	3.00	3.00	3.00
3m	2.37	2.65	2.90	3.00	3.10
2y	2.79	3.25	3.40	3.50	3.60
5y	2.83	3.45	3.60	3.65	3.70
10y	3.02	3.45	3.60	3.70	3.80
30y	3.31	3.50	3.55	3.60	3.65

Swap rate forecasts

US	Current	1Q19	2Q19	3Q19	4Q19
FOMC *	2.25	2.75	3.00	3.00	3.00
3m	2.74	2.80	3.00	3.10	3.15
2y	2.97	3.35	3.45	3.50	3.60
5y	2.98	3.50	3.60	3.60	3.65
10y	3.06	3.45	3.55	3.65	3.70
30y	3.15	3.35	3.40	3.40	3.45

UK Interest Rate Forecasts

Government Bond yield Forecasts

UK	Current	1Q19	2Q19	3Q19	4Q19
MPC	0.75	0.75	0.75	0.75	0.75
3m	0.79	0.70	0.73	0.77	0.77
2y	0.74	1.00	1.00	1.10	1.10
5y	0.92	1.40	1.50	1.60	1.65
10y	1.34	2.00	2.10	2.10	2.20
30y	2.00	2.40	2.50	2.60	2.65

Swap rate forecasts

UK	Current	1Q19	2Q19	3Q19	4Q19
MPC	0.75	0.75	0.75	0.75	0.75
3m	0.90	0.80	0.83	0.85	0.85
2y	1.14	1.35	1.30	1.35	1.30
5y	1.33	1.65	1.70	1.80	1.75
10y	1.53	2.10	2.15	2.15	2.25
30y	1.76	2.20	2.25	2.30	2.35

G10 Central Bank Calendar

	Current Rate	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar
FOMC (Upper)	2.25	-	Unch.	+25bp	-	Unch.	+25bp	-	Unch.	19	30	-	20
ECB (Depo)	-0.40	Unch.	-	Unch.	Unch.	-	Unch.	Unch.	-	13	24	-	7
BoE	0.75	-	Unch.	Unch.	-	+25bp	Unch.	-	Unch.	20	-	7	21
BoJ	-0.10	Unch.	-	Unch.	Unch.	-	Unch.	Unch.	-	20	23	-	15
SNB	-0.75	-	-	Unch.	-	-	Unch.	-	-	13	-	-	21
BoC	1.75	Unch.	Unch.	-	+25bp	-	Unch.	+25bp	-	5	9	-	6
RBA	1.50	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	4	-	5	5
RBNZ	1.75	-	Unch.	Unch.	-	Unch.	Unch.	-	Unch.	-	-	13	27
Norges Bank	0.75	-	Unch.	Unch.	-	Unch.	+25bp	Unch.	-	13	24	-	21
Riksbank	-0.50	Unch.	-	-	Unch.	-	Unch.	Unch.	-	20	-	13	-

Source: Bloomberg, Santander. Note: Current levels as at 29-Nov-18. For meetings that have already taken place, decision identified as +/- in bp, or "unch" for no change. "-" denotes no meeting taking place that month *FOMC rate refers to upper bound rate. **The ECB QE programme is set to drop to EUR15/month for Q4-18 and then stop.

Brazil/Mexico Interest Rate forecasts

Brazil	Current	1Q19	2Q19	3Q19	4Q19
SELIC	6.50	6.50	6.50	6.50	6.50
NTNF Jan' 20s	6.98	6.80	6.70	6.60	6.50
NTNF Jan.' 25s	9.62	9.50	9.25	9.00	9.00

Mexico	Current	1Q19	2Q19	3Q19	4Q19
Banxico fondeo	8.00	8.00	8.00	8.00	8.00
Mbono Jun. '21s	8.76	8.70	8.60	8.60	8.40
MBono Jun. '27s	9.04	8.80	8.70	8.70	8.50

Chile/Colombia Interest Rate Forecasts

Chile	Current	1Q19	2Q19	3Q19	4Q19
BCCh TPM	2.75	2.75	3.25	3.50	3.50
BCP 5Y	4.27	4.15	4.20	4.25	4.30
BCP 10Y	4.41	4.60	4.65	4.70	4.75

Colombia	Current	1Q19	2Q19	3Q19	4Q19
Banrep O/N	4.25	4.50	5.00	5.00	5.25
TES Jul '24s	6.44	6.44	6.48	6.64	6.64
TES Apr '28s	7.09	7.50	7.61	7.79	7.84

Argentina/Peru Interest Rate Forecasts

Argentina	Current	1Q19	2Q19	3Q19	4Q19
LELIQ 7-day	61.25	55.00	48.00	40.00	35.00

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

LatAm Central Bank Calendar

	Current Rate	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Brazil	6.50	-	-25bp	-25bp	-	Unch.	Unch.	-	Unch.	Unch.	Unch.	-	12
Mexico	8.00	-	+25bp	-	Unch.	Unch.	+25bp	-	Unch.	-	Unch.	+25bp	20
Chile	2.75	-	Unch.	Unch.	-	Unch.	Unch.	Unch.	-	Unch.	+25bp	-	4
Colombia	4.25	-25bp	-	Unch.	-25bp	-	Unch.	Unch.	-	Unch.	Unch.	-	21
Argentina*	61.20	-150bp	Unch.	Unch.	+300bp	+975bp	Unch.	Unch.	+2000bp	+718bp	+305bp	-685bp	~
Peru	2.75	-	Unch.	-25bp	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	13

CEE Interest Rate Forecasts

Poland	Current	1Q19	2Q19	3Q19	4Q19
Reference Rate	1.50	1.50	1.50	1.50	1.75
2y	1.55	1.57	1.56	1.54	1.53
10y	3.13	3.20	3.18	3.12	3.10

CEE	Current	1Q19	2Q19	3Q19	4Q19
Hungary	0.90	0.90	0.90	0.90	0.90
Czech Republic	1.75	2.00	2.00	2.00	2.00
Russia	7.50	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.	Unch.	Unch.	-	Unch.	Unch.	Unch.	5
Czech Republic	1.75	-	+25bp	Unch.	-	Unch.	+25bp	-	+25bp	+25bp	-	+25bp	20
Hungary	0.90	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	18
Russia	7.50	-	-25bp	Unch.	Unch.	-	Unch.	Unch.	-	+25bp	Unch.	-	14

Source: Bloomberg, Santander. Note: Current levels as at 29-Nov-2018. For meetings that have already taken place, decision identified as +/- in bp, or "unch" for no change. "-" denotes no meeting taking place that month. *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	**1.20**	**1.22**	**1.23**
vs.forward	4.7	5.6	5.6
vs.consensus forecast	3.4	3.4	2.5
GBP/USD	**1.32**	**1.33**	**1.35**
vs.forward	2.9	3.2	4.3
vs.consensus forecast	0.8	0.0	0.0
EUR/GBP	**0.91**	**0.92**	**0.91**
vs.forward	1.8	2.3	1.3
vs.consensus forecast	3.3	4.2	3.5
USD/JPY	**118**	**120**	**118**
vs.forward	4.1	5.8	4.1
vs.consensus forecast	5.4	8.6	7.3
EUR/JPY	**142**	**146**	**145**
vs.forward	9.9	13.6	12.6
vs.consensus forecast	8.9	11.3	9.1
EUR/CHF	**1.18**	**1.19**	**1.20**
vs.forward	4.4	5.4	6.4
vs.consensus forecast	2.6	2.6	2.6
USD/CHF	**0.98**	**0.98**	**0.98**
vs.forward	-0.3	-0.2	0.7
vs.consensus forecast	-0.7	-1.5	-0.4
EUR/SEK	**10.2**	**10.0**	**9.8**
vs.forward	-1.0	-3.0	-5.0
vs.consensus forecast	0.7	-0.5	-0.6
EUR/NOK	**9.1**	**9.0**	**8.8**
vs.forward	-6.9	-8.2	-10.7
vs.consensus forecast	-3.0	-3.2	-4.3
USD/CAD	**1.22**	**1.20**	**1.20**
vs.forward	-8.1	-9.4	-9.3
vs.consensus forecast	-5.4	-6.3	-6.3
AUD/USD	**0.73**	**0.74**	**0.75**
vs.forward	-0.3	0.9	2.0
vs.consensus forecast	1.4	2.8	1.4
NZD/USD	**0.68**	**0.68**	**0.69**
vs.forward	-1.0	-1.2	0.1
vs.consensus forecast	3.0	4.6	4.5

	3M	6M	9M
USD/BRL	**3.80**	**3.80**	**3.95**
vs.forward	-2.3	-2.9	0.1
vs.consensus forecast	0.0	-1.3	4.5
EUR/BRL	**4.56**	**4.64**	**4.86**
vs.forward	2.3	2.5	5.7
vs.consensus forecast	3.4	2.0	7.1
USD/MXN	**19.6**	**19.60**	**19.80**
vs.forward	-4.4	-5.9	-6.4
vs.consensus forecast	1.8	1.3	4.0
EUR/MXN	**23.5**	**23.9**	**24.4**
vs.forward	0.1	-0.6	-1.1
vs.consensus forecast	5.3	4.7	6.6
USD/CLP	**680**	**690**	**700**
vs.forward	1.6	3.1	4.6
vs.consensus forecast	0.7	2.8	4.8
USD/COP	**3300**	**3250**	**3350**
vs.forward	0.9	-0.6	2.4
vs.consensus forecast	7.8	6.0	10.2
USD/ARS	**39.0**	**42.4**	**47.5**
vs.forward	-9.5	-10.6	-6.1
vs.consensus forecast	-1.3	2.7	11.7
USD/PEN	**3.44**	**3.49**	**3.53**
vs.forward	1.7	2.8	3.6
vs.consensus forecast	3.9	5.8	7.0
EUR/PLN	**4.28**	**4.29**	**4.30**
vs.forward	-0.9	-1.2	-1.5
vs.consensus forecast	-0.5	0.2	1.2
EUR/CZK	**25.8**	**25.9**	**26.1**
vs.forward	-0.7	-0.3	0.4
vs.consensus forecast	0.4	1.4	2.8
EUR/HUF	**320**	**325**	**325**
vs.forward	-1.0	0.5	0.5
vs.consensus forecast	-0.9	0.6	0.6
EUR/RUB	**83**	**85**	**82**
vs.forward	7.5	8.8	4.9
vs.consensus forecast	8.9	9.5	3.8

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	1.139	1.278	113.26	128.89	144.79	0.994	1.132	1.268
1M	1.142	1.280	112.90	128.96	144.48	0.991	1.132	1.267
2M	1.146	1.281	112.62	128.97	144.36	0.988	1.131	1.265
3M	1.148	1.283	112.37	129.00	144.24	0.985	1.131	1.265
6M	1.157	1.289	111.50	129.03	143.77	0.976	1.130	1.259
9M	1.167	1.295	110.59	129.05	143.27	0.967	1.129	1.253
12M	1.177	1.301	109.68	129.06	142.74	0.958	1.127	1.247

ATMf vol.

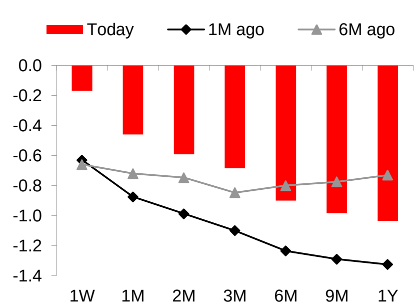
	EUR/USD	GBP/USD	USD/JPY	EUR/JPY	GBP/JPY	USD/CHF	EUR/CHF	GBP/CHF
1W	7.5%	10.9%	6.6%	8.1%	11.7%	6.6%	5.3%	9.7%
1M	7.0%	13.3%	6.6%	8.1%	14.0%	6.4%	5.4%	12.5%
2M	7.2%	13.0%	6.8%	8.4%	13.5%	6.5%	5.6%	11.8%
3M	7.2%	12.7%	7.0%	8.6%	13.2%	6.7%	5.7%	11.5%
6M	7.4%	11.7%	7.5%	9.0%	12.7%	6.9%	6.0%	10.7%
9M	7.6%	11.3%	7.8%	9.3%	12.7%	7.2%	6.1%	10.4%
12M	7.6%	11.0%	8.0%	9.5%	12.4%	7.3%	6.3%	10.3%

Implied/realized vol. ratio

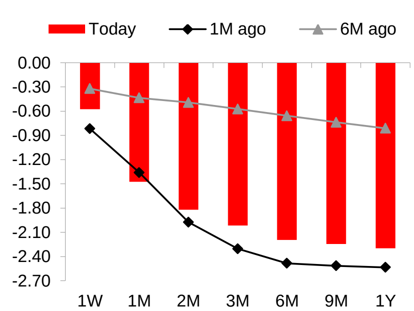
	EUR/USD	GBP/USD	USD/JPY	EUR/JPY	GBP/JPY	USD/CHF	EUR/CHF	GBP/CHF
1W	1.03	1.51	1.53	1.39	1.85	1.14	1.33	1.65
1M	0.91	1.23	1.18	1.11	1.29	0.98	1.25	1.33
2M	1.02	1.43	1.18	1.06	1.35	1.08	1.12	1.43
3M	1.03	1.42	1.25	1.07	1.32	1.12	1.09	1.40
6M	1.05	1.44	1.29	1.12	1.38	1.18	1.15	1.46
9M	1.08	1.44	1.27	1.14	1.38	1.19	1.18	1.44
12M	1.07	1.37	1.20	1.17	1.33	1.12	1.18	1.38

25-delta risk reversals

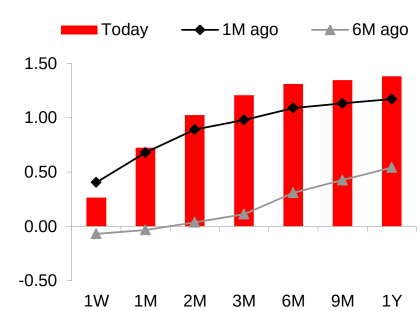
EUR/USD



GBP/USD



EUR/GBP



Sources: Bloomberg and Santander. As of 29-Nov-18

Latin America FX: Spot and forward rates

	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
Spot	38.40	3.87	667	3259	20.2	3.37
1M	39.99	3.85	668	3259	20.3	3.37
2M	41.46	3.86	668	3262	20.4	3.38
3M	42.86	3.87	668	3265	20.5	3.38
6M	46.77	3.89	667	3276	20.8	3.39
9M	50.26	3.92	667	3287	21.1	3.40
12M	54.58	3.96	666	3304	21.5	3.42

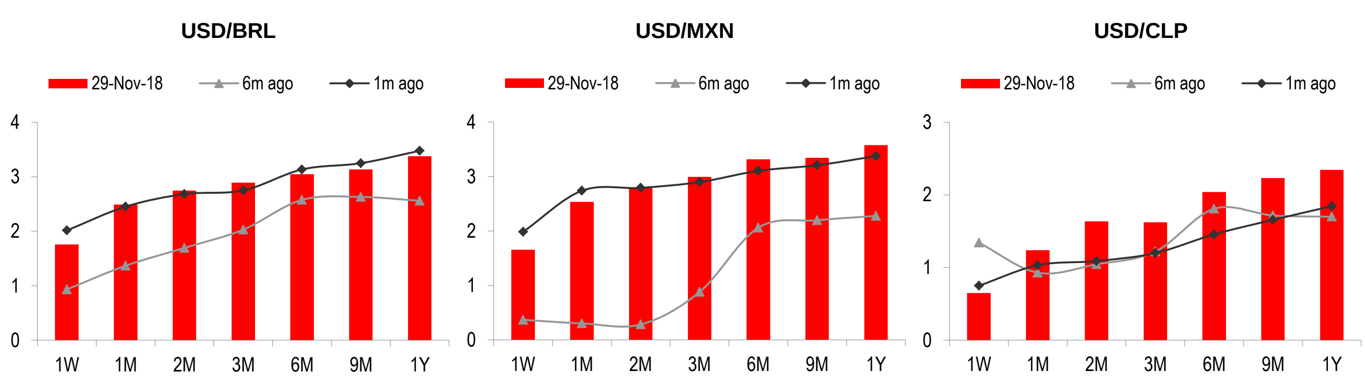
ATMf vol.

	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
1W	7.50	15.54	12.55	11.99	15.68	3.63
1M	10.00	14.43	12.58	12.50	14.67	3.59
2M	12.15	14.64	12.43	12.53	14.82	3.84
3M	13.65	14.69	12.43	12.53	14.76	4.08
6M	16.95	14.71	12.24	12.79	14.63	4.62
9M	18.83	14.81	11.96	12.93	14.55	5.03
12M	20.00	14.87	11.66	13.02	14.50	5.28

Implied/realized vol. ratio

	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
1W	0.39	1.14	1.29	1.40	1.43	2.75
1M	0.76	1.10	1.34	1.63	1.05	1.53
2M	0.77	0.81	1.18	1.40	1.09	1.44
3M	0.58	0.80	1.15	1.36	1.12	1.29
6M	0.55	0.85	1.14	1.31	1.06	1.29
9M	0.67	0.94	1.19	1.22	1.10	1.35
12M	0.80	1.01	1.21	1.23	1.12	1.32

25-delta risk reversals



Sources: Bloomberg and Santander. As of 29-Nov-18

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EXPLANATION OF THE RECOMMENDATION SYSTEM

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

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

DEFINITIONS

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

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