25 October 2018, 15:00 BST

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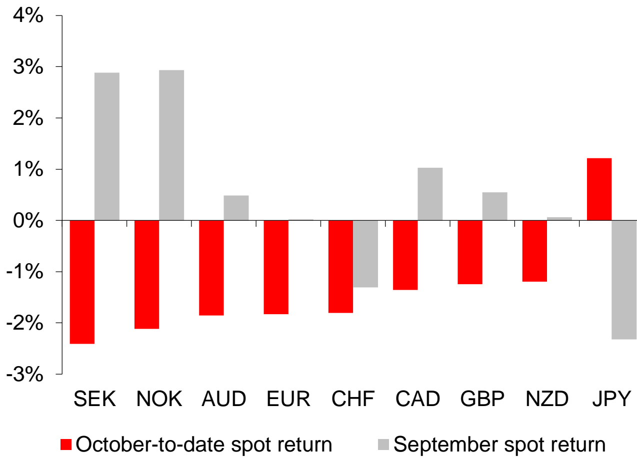
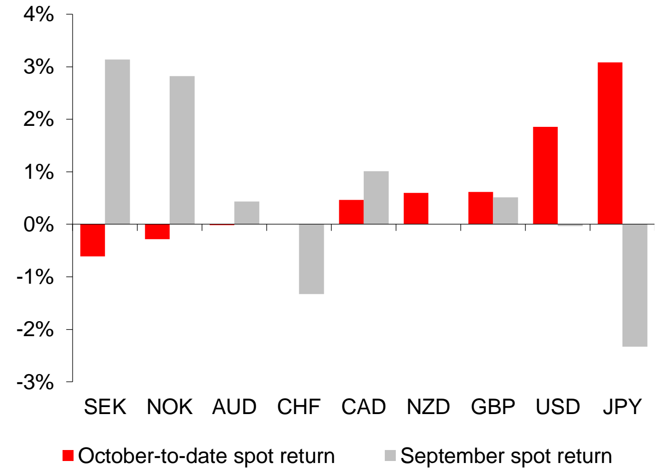
FX Spot Returns

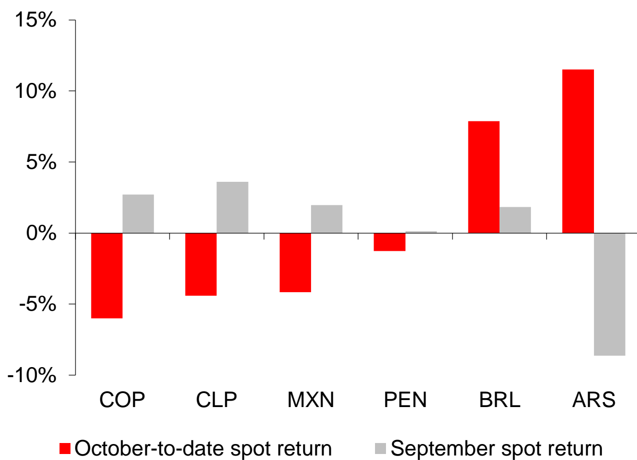
G10 spot returns vs. USD



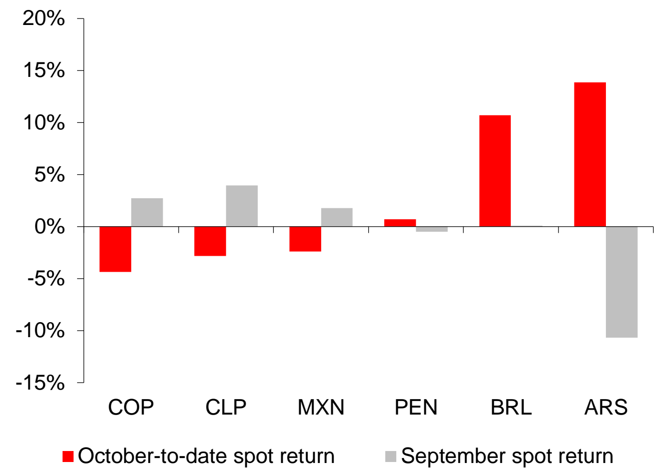
G10 spot returns vs. EUR



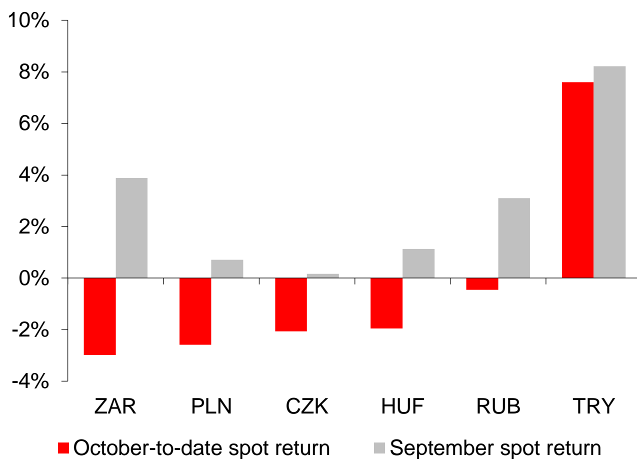
LatAm spot returns vs. USD



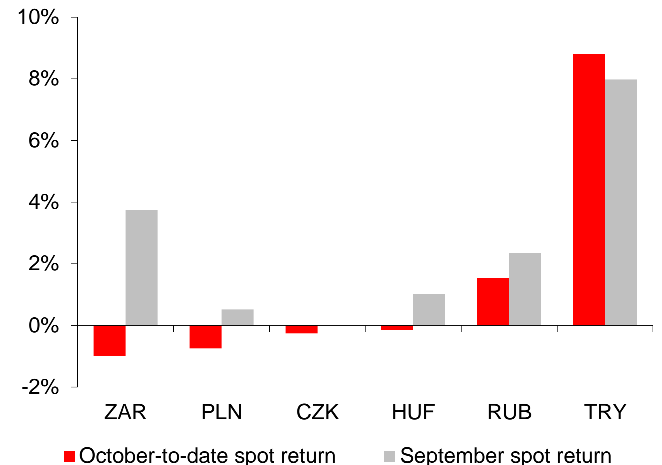
LatAm spot returns vs. EUR



CEEMA vs. USD



CEEMA vs. EUR



Source: Bloomberg, Santander. Note: Data current as at 25 October 2018 at 14:30 BST

FX Forecasts

G10 FX Forecasts

	Q4-18	Q1-19	Q2-19	Q3-19	Q4-19	Q1-20
EUR-USD	1.17	1.20	1.22	1.23	1.24	1.25
GBP-USD	1.32	1.32	1.33	1.35	1.36	1.37
GBP-EUR	1.13	1.10	1.09	1.10	1.10	1.10
EUR-GBP	0.89	0.91	0.92	0.91	0.91	0.91
USD-JPY	116	118	120	118	116	114
EUR-JPY	136	142	146	145	144	143
USD-CNY	6.80	6.80	6.70	6.70	6.70	6.65
EUR-CHF	1.16	1.18	1.19	1.20	1.20	1.21
USD-CHF	0.99	0.98	0.98	0.98	0.97	0.97
EUR-SEK	10.3	10.2	10.0	9.8	9.6	9.5
EUR-NOK	9.3	9.1	9.0	8.8	8.7	8.6
USD-CAD	1.25	1.22	1.20	1.20	1.19	1.18
AUD-USD	0.73	0.73	0.74	0.75	0.76	0.77
NZD-USD	0.67	0.68	0.68	0.69	0.70	0.71

LatAm FX Forecasts

	Q4-18	Q1-19	Q2-19	Q3-19	Q4-19	Q1-20
USD-BRL	3.50	3.50	3.75	3.85	4.00	4.00
USD-MXN	18.9	18.6	18.5	18.8	18.8	19.0
USD-CLP	680	690	700	690	687	680
USD-COP	3000	3100	3000	3150	3200	3250
USD-ARS	41.0	43.4	45.8	48.5	51.3	53.1
EUR-BRL	4.10	4.20	4.58	4.74	4.96	5.00
EUR-MXN	22.1	22.3	22.6	23.1	23.3	23.8
EUR-CLP	796	828	854	849	852	850
EUR-COP	3510	3720	3660	3875	3968	4063
EUR-ARS	48	52	56	60	64	66

CEE FX Forecasts

	Q4-18	Q1-19	Q2-19	Q3-19	Q4-19	Q1-20
EUR-PLN	4.25	4.28	4.29	4.30	4.32	4.25
EUR-CZK	25.9	25.8	25.9	26.1	26.2	26.2
EUR-HUF	325	320	325	325	325	325
USD-RUB	68	69	67	67	67	67
EUR-RUB	80	83	82	82	83	84

Sources: Santander

G10 FX: Main Themes

Currency	3M view	12M view	Main Themes
USD	Neutral	Mildly Bearish	• The USD has been stronger since mid-April. The outlook for more rate hikes and robust US growth should keep the USD firm, but may have been priced in. Plus, trade tensions may become viewed as USD-negative.
EUR	Neutral	Mildly Bullish	• 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% for another year?
GBP	Neutral	Neutral	• Sterling remains vulnerable, given subdued growth, political/Brexit uncertainty and general USD strength, as well as less chance of near-term rate hikes.
JPY	Mildly Bearish	Bearish	• 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	Neutral	Neutral	• US-China trade tensions remain a yuan 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 destabilising yuan weakness.
CHF	Mildly Bearish	Mildly Bearish	• 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	Mildly Bullish	Mildly Bullish	• 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	Neutral	Neutral	• 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	Neutral	Neutral	• A dovish RBNZ and global trade concerns are likely to constrain the NZD in Q4-18. Further weakness should be limited, though, as speculators already hold an all-time high net-short NZD position.
SEK	Neutral	Mildly Bullish	• 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	Mildly Bullish	Mildly Bullish	• A strong economy, elevated inflation, upbeat oil prices, and a central bank that expects to hike rates again in Q1-19 should all support the NOK heading into 2019.

Bullish   Mildly Bullish   Neutral   Mildly Bearish   Bearish

Source: Santander

G10 FX Overview

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The USD appears set to remain on the front foot. US data is robust, the Fed is likely to raise rates again before the end of the year, and lower global risk appetite continues to fuel a dollar safe haven bid. However, the result of the US mid-term elections, the US administration's criticism of rate hikes, worries about the rising US deficit and debt, as well as concerns that an even stronger dollar risks softening both the growth and inflation outlooks could contain upside pressure on the currency.

The EUR has been under pressure for much of October, and there is little indication that this pressure will reverse over the coming weeks. A strong US dollar continues to weigh on EUR/USD, as it does on the other USD/G10 pairs, while worries about Italy's budget and soft Eurozone economic sentiment has recently added to the EUR's woes.

Sterling should remain vulnerable to Brexit uncertainty over the coming month. 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.

Periods of low global risk appetite, may continue to intermittently support the CHF as a safe haven. However, concerns about the future EU-Swiss relationship may be more of a franc risk. This, together with the SNB's loose monetary policy, should favour a weaker franc.

In our opinion, the SEK still appears too weak. However, low risk appetite, a cautious Riksbank, as well as domestic political uncertainty may keep the currency under pressure during the next few weeks.

Meanwhile, a strong economy, elevated inflation, oil prices, and a central bank that expects to hike rates again in Q1-19 should support the NOK.

Our view is that the yen remains too strong. However, low Japanese interest rates have not led to a weaker yen, as the currency has been boosted by low global risk appetite and equities spurring demand for the yen as a safe haven.

The CNY remains vulnerable to a combination of a strong USD, a slowing Chinese economy and the likelihood that this will involve a continuation of fiscal and monetary policy loosening. However, the PBoC has reiterated that it will not use the CNY as a tool in any trade war, a stance that should imply less scope for further notable CNY weakness.

We think the AUD/USD has been oversold in the short term, but concede the longer-term outlook is becoming less supportive. Global trade concerns have weighed on the AUD. Plus, the RBA is unlikely to hike rates until Q4-19, implying that rate spreads will also work against the AUD.

A dovish RBNZ and global trade concerns are likely to keep the NZD weak. However, further losses may be limited, given the currencies already big sell-off and that the market is already very short the NZD.

The Bank of Canada hiked rates at its October meeting and we expect that it will continue to increase interest rates through 2019, which should strengthen the CAD. The economic outlook remains robust, as US-Canada trade tensions have lessened, and inflation is expected to be around target through to 2020.

USD – Steadily advancing again

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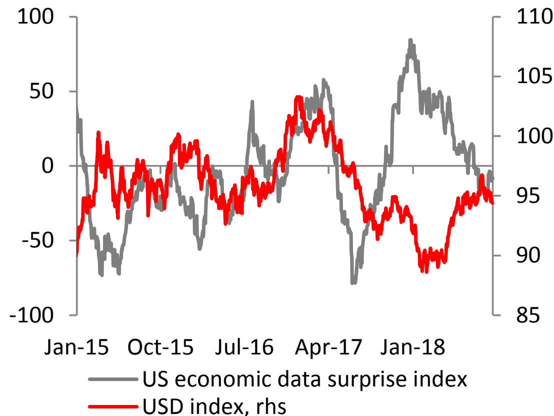
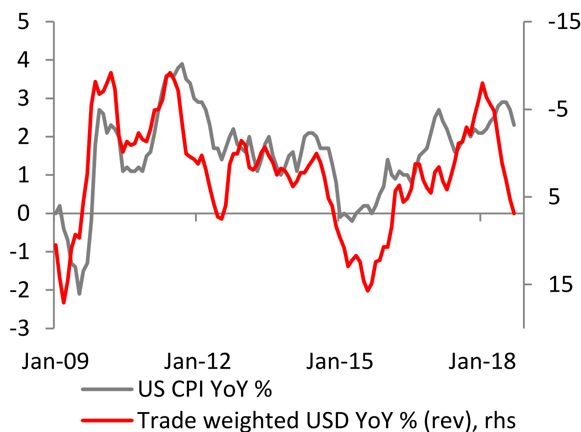
Chart 1: USD strength may now be in line with the US economy's strong performance



Source: Citi, Bloomberg, Santander

Chart 2: More USD strength could pull inflation lower and question the need for more US rate hikes



Source: Bloomberg, Santander

The USD appears set to remain on the front foot. US data is robust, the Fed is likely to raise rates again before the end of the year, and lower global risk appetite continues to fuel the dollar as a safe haven. However, the result of the US mid-term elections, the US administration's criticism of rate hikes, worries about the rising US deficit and debt, as well as concerns that an even stronger dollar risks softening both the growth and inflation outlooks should contain upside pressure on the currency.

The US economy continues to outperform its peers. US growth was 3.3% QoQ annualised in Q3-18, slower than the 4.2% posted in Q2. We expect the US to grow 2.8% in 2018 and 2.7% in 2019, notably above the expected Eurozone growth of 2.3% and 2.2%, respectively. Consequently, such a growth dividend, at a time when markets are concerned about downside risks to global growth, continues to support the dollar.

However, US data are no longer providing the persistent upside surprises that they were earlier in the year. But neither are the data from other developed market economies, which may have blunted the US effect on the dollar. In addition, the relationship between economic data surprises and the USD again highlights the dollar's largely unjustifiably poor performance in Q1-18. At the start of the year US data were outperforming forecasts, but the USD was struggling. Given this, we could argue that the strong dollar performance since Q2 has been helped by the currency catching up with the lead set by the strong economy.

The strength of the economy and inflation allowed the Fed to hike rates again at its September meeting. The minutes of that meeting indicate that more rate hikes are likely. We expect another increase in December, and two more in 2019. Further rate hikes should be expected and are already priced into the USD, but suggestions by some members of the FOMC that rates need to rise further have also kept the dollar firm.

However, the minutes also reflected some concern as to the threat posed to activity by a strong dollar. The USD index is currently around 2.5% higher than it was at the time of September FOMC. Hence, policymakers' concern over the strong USD may also slow its advance, as might the US administration's criticism of the FOMC policy of hiking rates. President Trump recently called the Fed his "biggest threat" and blamed it for stock market sell-offs during the past month.

Low global risk appetite, evidenced by weak equities, and trade tensions, continue to favour the USD as a safe-haven currency. The US mid-term elections on 6 November will be a focus for the USD, but their effect on the dollar seems ambiguous. If the Republicans lose control of Congress, would that be viewed as USD-positive, or would it encourage the government to move forward with more populist policies, including tax cuts to win back support ahead of the 2020 presidential election?

Hence, US risks, particularly focussed on the budget, may become more of a USD-negative factor over the coming months. Moody's recently warned that without offsetting policies, the debt burden will continue to rise, resulting in an overall weaker fiscal profile for the US.

EUR – Fiscal conflict woes

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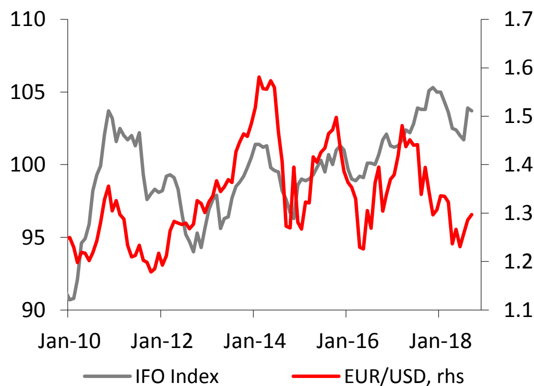
The EUR has been under pressure for much of October, and there is little indication that this pressure will reverse over the coming weeks. A strong US dollar continues to weigh on EUR/USD, as it does on the other USD/G10 pairs, and soft Eurozone economic sentiment has recently added to the EUR's woes.

We still favour EUR gains over the forecast horizon, but have lowered our forecast to reflect the current drop in spot, which looks likely to be sustained over the coming weeks.

Chart 3: Softer Eurozone data may be weighing on the EUR, but the robust outlook remains positive for the currency



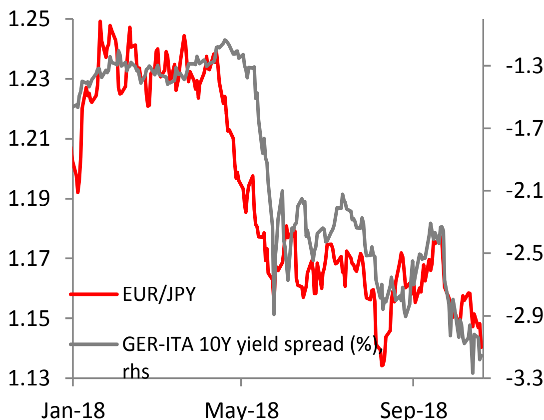
Source: Bloomberg, Santander

We note that it has been the yen, and not the USD, that has performed best against the EUR in October. The JPY's gains provide a clear signal as to why the EUR has been weak, namely low risk appetite. EUR/JPY has been pulled lower by worries about global growth, weaker equities, but in particular concerns about Italian politics and fiscal policy and their impact on Europe.

We recall that the Italian government adopted a budget deficit target of 2.4% of GDP over the next three years. This is above the 0.8% targeted by the previous administration, and will imply that the Italian debt to GDP ratio, currently at 135% of GDP, edges up over the next few years. The EU has rejected the budget and given the Italian government until mid-November to put forward a new one. However, the Italians have indicated they will not alter their plans. Hence, the fiscal conflict between Italy and Europe is set to continue and keep the EUR vulnerable into November.

As the budget tension has mounted, the Italian ten-year yield has risen, reaching a high of 3.68% on 18 October. The spread between this and the German ten-year yield has been used recently as a gauge of Italian/Eurozone risk. In October the spread reached its widest level since Q1-13. The correlation between the German-Italy ten-year spread and EUR/USD has been 0.91 so far in 2018. At the moment, the spread suggests that EUR/USD is accurately valued at around 1.1400. It may require an even wider yield to pull the EUR lower. Given that it is already at a multi-year high, this may be difficult to generate or sustain, but the uncertainty surrounding the Italian budget over the next few weeks should keep the EUR hovering around its current levels.

Chart 4: EUR weakened as EUR-specific risk increased; it may be unable to strengthen until/unless this risk pressure abates



Source: Bloomberg, Santander

The recent underperformance of some Eurozone economic data has also weighed on the currency. However, we suspect that without the backdrop of Italy, the data may not have been sufficiently weak to undermine the currency by itself. Economic sentiment has slipped during the last few months, but the PMIs and IFO, although softer, still point to growth in both the manufacturing and services sector. Meanwhile, consumer confidence, IP and trade data have all surprised to the upside.

Indeed, we still expect robust economic growth in the Eurozone, and forecast 2.3% growth this year and 2.2% in 2019. The ECB kept its policy unchanged at its October meeting, but with growth firm, headline inflation above target and Draghi reiterating that the acceleration of wages implies that the bank is confident that inflation will remain elevated, the ECB remains on course to remove its monetary policy accommodation and hike rates in 2019, which together with an assumption that current risk factors will fade, should still allow the EUR to gradually and sustainably strengthen.

GBP – The final countdown?

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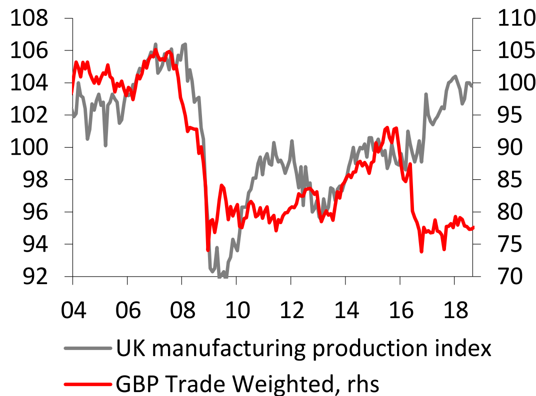
Sterling should remain vulnerable to Brexit uncertainty over the coming month. In addition, we expect the UK economy to underperform its peers and the BoE to keep rates on hold in 2019, both factors that should cap the pound's upside potential.

If an EU withdrawal agreement is not reached, and whether this can be achieved should become clearer over the next month, the pound is likely to weaken significantly. GBP/USD lost around 15% in the two weeks after the referendum. We do not believe that the reaction to a 'no-deal' Brexit 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 5: Sterling remains cheap, given UK fundamentals, which prevents a further big sell-off



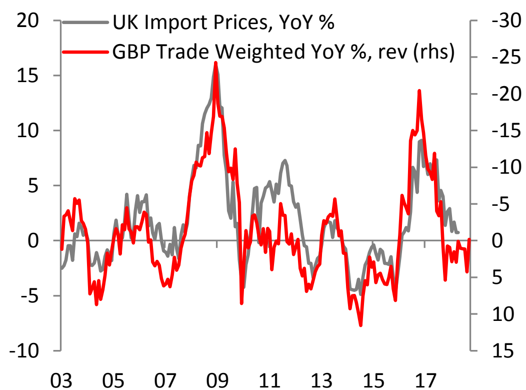
Source: Bloomberg, Santander

Further, several factors could support the pound, or at least limit its fall, in the event of a 'no-deal'. First, sterling is already cheap, around 12% down from its pre-referendum level and weaker than fundamentals suggest it should be. Second, many market participants are already short sterling, which may limit the market's ability to bet further against the pound. Third, we think the USD may be too strong, and a softer dollar would support GBP/USD.

If a withdrawal agreement is reached, we expect this to boost GBP/USD by 3-4%, although, again, the market will probably over-react in the short term and pull the pair up by more. But, whilst the market may be relieved by an agreement, uncertainty will remain, which should prevent the pound from appreciating further. First, UK political uncertainty will persist, i.e. will parliament approve the deal? Second, even if it is approved, trade negotiations may also imply currency-negative uncertainty.

Plus, in the medium term, 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.

Chart 6: Another drop in the pound would put upside pressure on prices



Source: Bloomberg, Santander

Brexit issues will also have an impact on UK growth, inflation and interest rates, which in turn will feed into the FX market. Even if a 'deal' is agreed, we do not expect UK growth to exceed 1.5% either this year or in 2019. Further, we suspect that headline CPI will fall below the BoE's 2% YoY target in 2019. Hence, contrary to market expectations, we do not expect the Bank to hike rates until 2020. This should keep GBP/USD under pressure. If a deal is not struck, we believe that growth in 2019 will be weaker than forecast, and, even though inflation will be higher (due to tariffs and the impact of a cheaper pound), the Bank is still not expected to hike rates, given the possible negative impact on sentiment.

The EUR/GBP outlook will depend on Brexit, but may also be driven by movements in the USD, concerns about Italian risk and ECB rate hikes. In a no-deal scenario, we expect the EUR to be negatively affected, but less so than the pound, so EUR/USD should weaken, but EUR/GBP should strengthen. Hence, this would imply upside risks to our forecast, which is for EUR/GBP to hover around or above 0.90 over the next year or so.

If a withdrawal agreement is negotiated, we think this will tend to be EUR/GBP negative in the short term as the pound benefits from a relief rally, but that this could fade as ongoing uncertainty, a better Eurozone outlook and ECB rate hikes help the cross.

JPY – Torn between risk and yields

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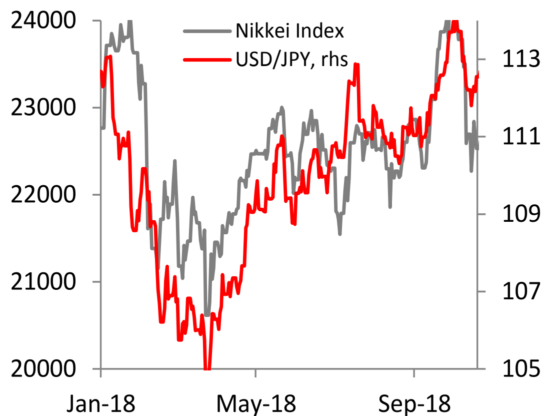
We continue to favour a weaker yen. The BoJ's monetary policy should remain very loose and yen-negative. The Japanese economy is recovering moderately, but both inflation and wage growth are still soft. However, low Japanese interest rates have not led to a weaker yen, as the currency has been boosted by low global risk appetite and equities spurring demand for the yen as a safe haven.

The BoJ kept its monetary policy unchanged following its meeting in September. Its asset purchase programme remained untouched, as did the deposit rate, which still stands at -0.1%. In addition, the Bank continues to target 10-year yields of around 0%. The Bank had injected a little more flexibility into its yield target following the BoJ meeting in July, which could allow for the 10-year yield to rise to 0.2% before the Bank might step in to try and lower it.

Chart 7: The yen is being helped by low risk appetite and equities…



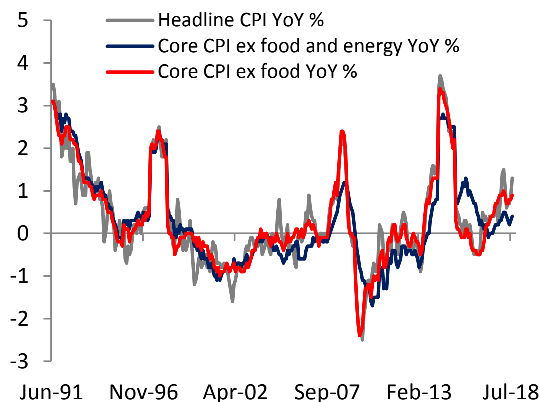
Source: Bloomberg, Santander

Despite this increased flexibility, the 10Y yield has not tested the 0.20% level, and has remained in a 0.14-0.16% range for most of the last month. The US 10Y yield also slipped from its October high above 3.23%, but the gap between the two remains wide and should, in our opinion, have implied more upside pressure on USD/JPY.

During the last three quarters of 2017 the correlation between USD/JPY and the US-Japan 10Y spread was +0.9. However, year-to-date 2018, that correlation has crashed to 0.15. To put this change into perspective, if the 2017 link between yields and USD/JPY had persistently continued in 2018, USD/JPY would be trading around 119 currently.

Admittedly, the correlation has picked up again over the last few months, but the poor overall relationship for 2018 seems to be down to the unusually weak USD in Q1-18, when the dollar declined even as US rates were rising, and low risk appetite boosted the yen.

Chart 8: … but low inflation, low interest rates and low yields are providing a balance



Source: Bloomberg, Santander

Low risk appetite looks set to remain supportive for the yen over the coming weeks. Whether the focus is on US-China trade tensions, Italian/Eurozone budgetary risks or emerging markets, the yen has tended to be the safe-haven currency of choice in 2018.

Therefore, whilst the relationship between the US-Japan 10Y spread and USD/JPY has been weak for much of 2018, the link between the currency and equities (a proxy for global risk) has remained strong.

The correlation between the Nikkei index and USD/JPY has been 0.74 year-to-date. Indeed, we estimate that, based on equities/risk alone, the currency pair is overvalued, with a fairer value closer to 108. Hence, it is possible that low Japanese yields and the wide US-Japan 10Y gap is having an effect on the yen by preventing it from appreciating in line with low global risk appetite.

Hence, the yen appears torn between risk issues and yield issues, with the two perhaps having more of a balancing effect than is appreciated. At the moment the risk factors are in focus, but with the Japanese economy still expected to post only a moderate recovery, inflation still low and growth in cash earning slowing to 0.9% YoY in August, the BoJ's policy should remain loose in 2019 and if/when risk appetite improves, should still imply a weaker yen.

CNY – No manipulation to see here

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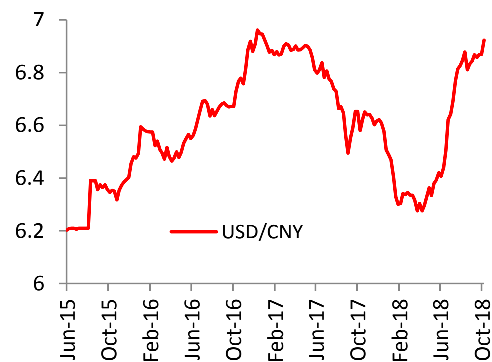
Chart 9: Chinese policy seeking to support growth

Source: Bloomberg, Santander

Chart 10: USD/CNY heading back up



Source: Bloomberg, Santander

The CNY remains vulnerable to a combination of a strong USD, a slowing Chinese economy and the likelihood that this will involve a continuation of fiscal and monetary policy loosening. However, the PBoC has reiterated that it will not use the CNY as a tool in any trade war with the US. Such a stance may not prevent USD/CNY hovering at higher levels than we previously expected, but should suggest a reluctance on the part of Chinese policymakers to allow USD/CNY to break the psychologically, and maybe politically, important 7 level.

The focus remains on the trade tensions between the US and China, and their impact on the Chinese economy and the renminbi. However, despite rhetoric from the US administration warning other countries not to competitively devalue their currencies, the US Treasury Department did not declare China a currency manipulator in its recent report on the FX policies of its trading partners. The decision was not a surprise. The US Treasury has three criteria to decide whether a country is manipulating the currency: 1) it must have a big trade surplus with the US, of at least $20bn; 2) a current account surplus of at least 3% of GDP; and 3) it needs to have persistently intervened to buy its currency over a 12-month period. China has only met the first criterion.

The CNY weakened on that announcement as some market participants viewed it as giving a green light for the PBoC to allow the renminbi to weaken to counter trade concerns' negative impact on growth. We still believe that Chinese policymakers will be reluctant to allow the CNY to weaken aggressively for several reasons. First, they have persistently stated that the currency will not be used as a tool in a trade war. Second, notable additional CNY weakness might merely prompt US retaliation. Third, runaway depreciation might spark a major outflow of funds and destabilise policy.

However, that is not to say that USD/CNY will not remain firm and even edge higher and above seven in the short term. But the catalyst for such a move may simply be a standard policy divergence between the US and China. We expect the Fed to hike rates three more times in this cycle, but the Fed's rhetoric is erring toward the hawkish side, with the market considering that more hikes may be forthcoming.

Further, this comes as China's economic outlook appears to be pointing to a slowdown. China's GDP growth dipped to 6.5% YoY in Q3-18. The decline was driven by manufacturing output, which grew 5.3% YoY compared to 6% YoY in Q2. Industrial production slipped to 5.8% YoY in September, the slowest rate since October 2015. However, the trade surplus was much bigger than expected in September ($31.7bn), including the highest-ever trade surplus with the US. Exports grew 14.5% YoY, perhaps as firms front-loaded sales to escape tariffs, and imports grew 14.3% YoY.

Given the risks to growth, policymakers' response has tended to focus on stimulating activity across the board, rather than on the CNY. To help shore up liquidity, the PBoC cut banks' reserve requirement ratio. In addition, infrastructure spending has been increased. In late October, President Xi expressed his unwavering support for the private sector and, after a recent increase in income tax thresholds, a plan for tax cuts was announced.

CHF – Shifting risks

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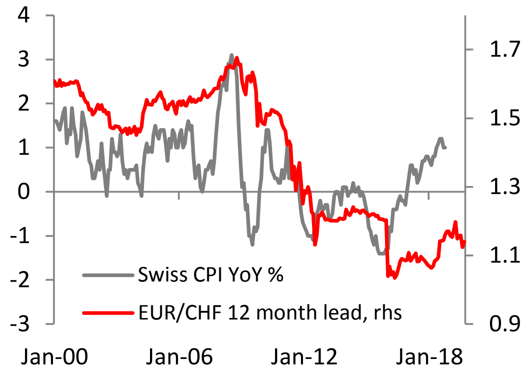
We remain negative on the CHF. Periods of low global risk appetite, and worries about Italy's budget, may continue to intermittently support the currency as a safe haven. However, concerns about the future EU-Swiss relationship may be more of a franc risk. In addition, even though the Swiss economy is holding up well, the combination of the SNB sticking to its loose monetary policy as the ECB adopts a less accommodative stance should pull EUR/CHF upward.

Chart 11: Swiss inflation is higher, but a sluggish outlook should keep the SNB on hold



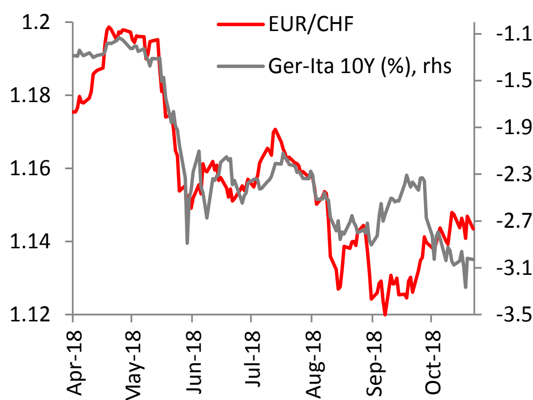
Source: Bloomberg, Santander

The FX market's appetite for risks remains a relevant factor for the franc, although the focus of these risks may be changing, and could start to favour a weaker CHF. Overall, lower global risk appetite due to trade tensions and lower global growth has primarily boosted demand for the yen and dollar as safe havens, although the franc has also found some support from these factors.

The focus on Eurozone risk, in the form of Italian politics and its budget, has tended to be unambiguously positive for the CHF. However, the Italian-inspired drop in EUR/USD at the end of September did not spill over into EUR/CHF and drag that cross lower, as the market has become more concerned about future EU-Swiss relations.

The EU and Switzerland's relationship is underpinned by around 120 bilateral agreements. The two have been negotiating for quite a while to simplify these within a single framework agreement, within one treaty. The talks have not been progressing too well, and broke down over the summer amid concern among Swiss unions that the agreement would undermine workers' conditions.

Chart 12: EUR/CHF firmer, despite focus on Italian/EUR risk



Source: Bloomberg, Santander

The EU has warned that the negotiations cannot continue forever, and there is some hope that they may reach a head over the coming weeks. A failure to agree would raise doubts over Switzerland's scope of access to the Single Market. In addition, given the importance of finance to Switzerland, much attention has centred on the risk that a failure to agree a way forward might prevent EU participants from accessing Swiss equity exchanges in 2019.

Aside from such Swiss-specific risk, we still envisage the monetary policy trade-off between the ECB and SNB as likely to be EUR/CHF positive. The ECB is in the process of ending its asset purchase programme, and has signalled that rates could be hiked by the end of next summer. However, with Eurozone CPI above target and Eurozone growth holding up, the market may start to expect rates to be increased sooner.

Meanwhile, we do not expect the SNB to be in any rush to alter its policy. The bank should keep its deposit rate at -0.75% at least until the end of 2019, allowing the ECB to do the heavy lifting and pull EUR/CHF higher. Consequently, the SNB still views the franc as 'highly valued', considers that conditions in the FX market are 'still fragile' and remains willing to intervene.

Admittedly, the economy continues to hold up rather well. Indeed, the SNB revised up its GDP forecast in September, and now expects growth of between 2.5% and 3% for the current year. However, the inflation outlook remains weak, with the bank expecting CPI at 0.9% this year, 0.8% in 2019 and 1.2% in 2020.

CAD – Back to neutrality

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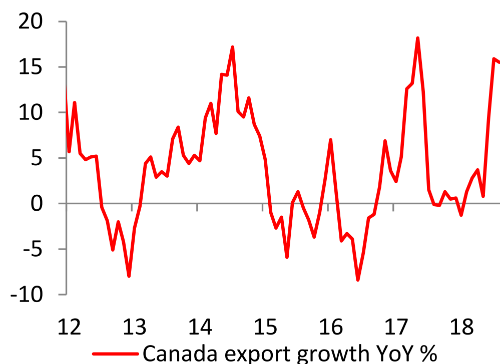
We remain positive on the CAD. The Bank of Canada hiked rates at its October meeting and we expect it to continue increasing interest rates through 2019. The economic outlook remains robust and inflation is expected to be around target through to 2020. In addition, the settling of trade tensions between the US and Canada should support the currency.

The BoC increased its overnight rate by 25bp to 1.75% in October. The change was expected, but the Bank adopted a more hawkish stance than many market participants had anticipated. It signalled that rates would need to rise to the 'neutral' level, 2.5%-3.5%, and whilst the pace is not pre-ordained, and remains data-dependent, it dropped the reference to gradual changes.

We expect that the Bank will continue to hike rates through 2019, with the next move likely in January. The Bank's signal that interest rates need to move back to 'neutral' implies at least three more increases. The prospect of a sustained and persistent tightening of monetary policy should support the CAD across the board, and even against the USD, despite our expectations that the Fed will hike US interest rates in December and then twice more in 2019.

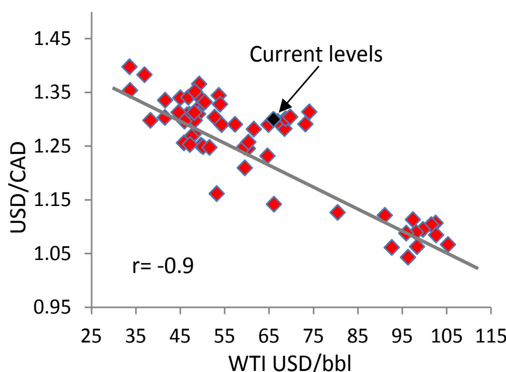
Chart 13: Canada's economic and export outlook already appeared robust. Going forward, the USMCA trade agreement should support both, and the CAD, further



Source: Bloomberg, Santander

The BoC's Monetary Policy Report painted a picture of a robust economy. The Bank expect the Canadian economy to grow by 2.1% in 2018 and 2019, and 1.9% in 2020. Its forecast for Q3-18 GDP was revised up to 1.8% QoQ annualised, from 1.5%. Canadian CPI in September was significantly lower than expected, at 2.2% YoY versus 2.8% YoY in August, but this remains above target, with the core measures also hovering around 2%. In addition, the bank had warned that the summer spike in CPI was expected to reverse, but continues to forecast inflation at its 2% target through to 2020.

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



Source: Bloomberg, Santander

The recent BoC autumn business outlook showed that companies were expecting to increase investment. Importantly, that survey was conducted between August and September, i.e. before the US, Canada and Mexico agreed a replacement for NAFTA, in the form of the USMCA. The settling of trade tensions between the US and Canada is expected to provide an additional boost for investment in exports.

The risks that might prevent further CAD-friendly rate hikes appear to focus on: 1) global risk factors, i.e. a negative effect on activity from events such as US-China trade tensions, 2) the impact of rate hikes on Canadian households; and 3) a weaker oil price.

However, the Bank again highlighted signs of housing market stabilisation, suggesting that consumers can deal with further rate hikes. It indicated that credit growth has slowed and that the share of new mortgages with high loan-to-income ratios has fallen. Plus, the ratio of household debt to income has levelled off and is forecast to 'edge down'.

The oil price has weakened in October, with WTI at $66/bbl. Cheaper oil is intuitively a CAD negative, but the correlation between oil and CAD has been very weak recently. However, the longer-term, 5-year, correlation between WTI and USD/CAD is -0.9. This 'more normal' relationship indicates that even after oil's decline the CAD is cheap and USD/CAD should be closer to 1.23.

AUD – Weighed down by yield differentials

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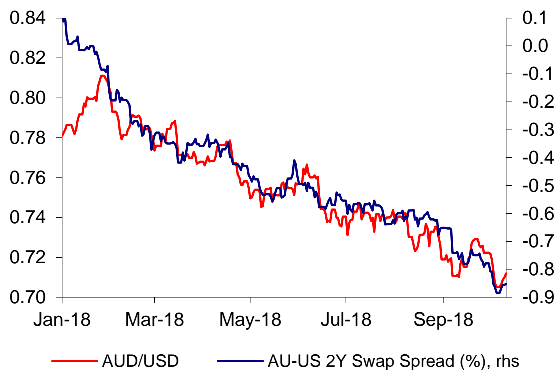
We continue to see AUD/USD as oversold in the short term, but would note that the longer-term outlook is becoming far less supportive for the AUD. Global trade concerns have simultaneously boosted the USD and weighed on the AUD. Further, with the market pricing in several more Fed rate hikes over the next year, and no RBA hikes until at least Q4-19, interest rates differentials have pulled AUD/USD lower in 2018. Given the deterioration in the AUD/USD outlook, we have reduced our forecasts, and now see the pair at 0.73 in Q4-18 (0.77 previously), and 0.76 in Q4-19 (0.78 previously).

In January 2018, AUD/USD spent a couple of weeks above 0.80. Since then, however, the pair has been on a downward trend, ending Q1-18 at 0.77, Q2-18 at 0.74, and Q3-18 at 0.72. The peak-to-low decline in AUD/USD reached 13% earlier in October, with the pair touching a low of 0.7041.

Various factors are responsible for this decline, but the simplest explanation is the deterioration in expectations for Australian monetary policy, relative to that in the US (Chart 15).

Chart 15: As US bonds extend their yield advantage over Australian bonds, so too the USD strengthens against the AUD

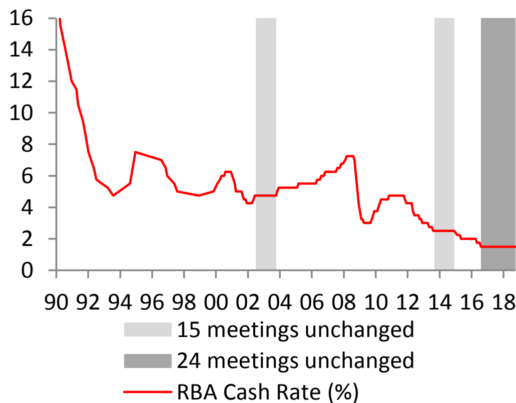


Source: Bloomberg, Santander

Australian interest rates have had a yield advantage over US rates for most of the 21st century. However, in early 2018, the US Fed Funds rate overtook the RBA's cash rate, with this advantage moving further in the favour of the USD over the course of 2018, as the Fed hiked rates again in Q2 and Q3.

We expect the Fed to hike rates three times over the next three quarters. Over the same period, we expect the RBA to keep rates at 1.5%, with the central bank extending its record run of 24 meetings on hold significantly further. The US 10Y bond is now yielding about 50bp above the Australian 10Y, with this divergence following that of the 2Y swap spread in the chart. The outlook for AU-US rates over the next year makes it difficult to argue for a significantly stronger AUD/USD, hence our decision to lower our 2019 forecasts for the pair.

Chart 16: The RBA is set to keep rates on hold



Source: Bloomberg, Santander

There are many reasons for this deterioration in the AU-US interest rate differentials. Clearly, the strong US economy and hawkish Fed have boosted the USD, while the neutral RBA has grown increasingly wary of negative impacts on global trade from the US-China trade tariffs, and the secondary effect this could have on the Australian economy.

Indeed, in the RBA's semi-annual financial stability report, released in mid-October, the Bank highlighted that while global growth is still positive, the downside risks have increased due to the rise in protectionism. These views echo the recent comments from the IMF Managing Director Christine Lagarde, who said that trade wars risk hurting global growth and innocent bystanders.

A by-election took place in Wentworth, New South Wales, this past weekend to fill the seat left by ex-prime minister Malcolm Turnbull, who was ousted as head of the Liberal party in August (see Another one bites the dust, published 24 August). The Liberal party, which has held this seat for the past 90 years, lost it to an independent candidate, and with it, lost its one-seat majority in the House of Representatives. This is clearly not helpful for the government, although the next federal election does take place in 2019 anyway.

NZD – Up or down (but probably neither for now)

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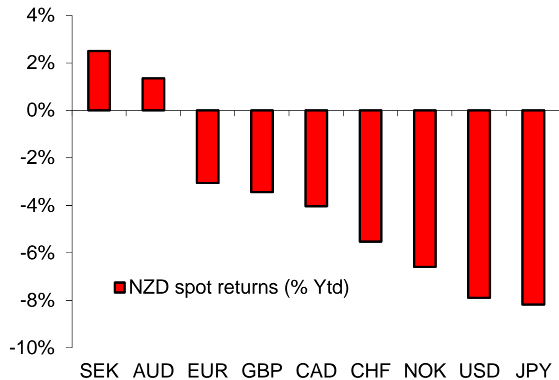
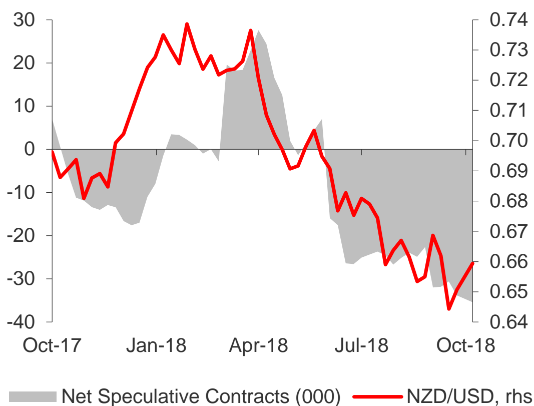
Chart 17: The NZD outlook may not look great, but the currency has already weakened notably in 2018



Source: Bloomberg, Santander

Chart 18: Speculators took their net short NZD position to another all-time high in October



Source: CFTC, Bloomberg, Santander

We are still neutral the NZD, both in late 2018 and early 2019. The NZD has underperformed this year, and is already down 8% against the USD (Chart 17). USD gains and concerns over global trade have weighed on the pair but unless the USD begins to weaken, or global trade concerns dissipate, we see little reason to be too upbeat on the NZD for the remainder of the year.

That said, given its decline, further NZD weakness in Q4-18 now looks less likely, in our view, especially with the speculative short NZD position already at an all-time high. But the currency is also unlikely to receive any support from monetary policy in the short term, with the RBNZ still suggesting that rates could go up or down.

Neither looks especially likely any time soon, in our view, but another full year of unchanged rates limits the scope for even longer term NZD gains. Hence, we have reduced our NZD/USD forecasts and now see the pair at 0.67 in Q4-18 (0.69 previously) and 0.70 in Q4-19 (0.74 previously).

Domestic factors have improved in recent weeks though. Q2-18 GDP growth rose to 2.8% YoY, rising back towards the 3% the RBNZ considers its potential long-term growth level. In addition, Q3-18 CPI climbed to 1.9% YoY, comfortably beating both the market's (1.5%) and central bank's (1.4%) forecast. This is still at the lower end of the Bank's 1-3% inflation target, but certainly looks more promising that the past couple of quarters.

These figures should allow the RBNZ to relax a little, potentially offering the NZD some support. But significant RBNZ-led gains look unlikely for the time being, given that the Bank is still suggesting that rates could go up or down.

We believe that neither are likely any time soon, but with the RBNZ continuing to forecast no rate hikes until Q3-20, the currency is likely to struggle for support heading into 2019, as central banks elsewhere begin/continue to hike rates. Like the AUD/USD (see AUD page), the NZ-US yield advantage has disappeared in 2018, which in turn has weighed notably on NZD/USD.

A further move in favour of the USD could potentially pull NZD/USD even lower. Indeed, according to the latest Bank of International Settlements FX turnover data, the NZD is only used in 2% of global spot trades, whereas the USD is used in 88% of trades. Consequently, any significant USD move is likely to have a disproportionate impact on NZD/USD, and so the pair could yet fall further on the USD, even if domestic NZD factors do not warrant such a move.

However, with the speculative net short NZD position setting a new all-time high in October, at 35.41k contracts (Chart 18), we doubt speculators will want to add significantly to this short position. In fact, a slightly less downbeat speculative position could be enough to offer the NZD some support in the months ahead.

SEK – Waiting for a rate hike and a government

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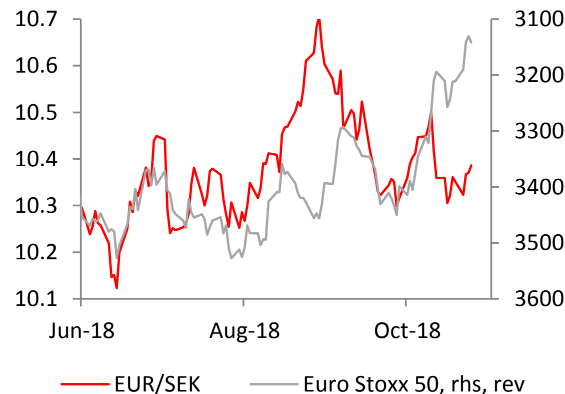
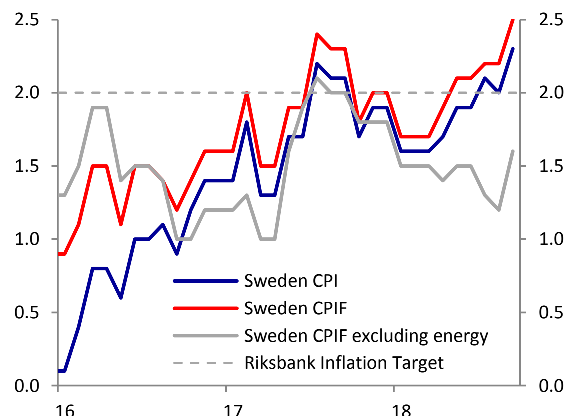
Chart 19: EUR/SEK has tended to follow risk/equities, but fell on the back of strong CPI data in mid-October



Source: Bloomberg, Santander

Chart 20: Swedish inflation rose in September, with a sharp pick-up in CPIF in particular boosting expectations of a rate hike



Source: Bloomberg, Santander

We still consider the SEK too weak, and expect the currency to strengthen in 2019. However, European risk sentiment, a very cautious and patient Riksbank, as well as domestic political uncertainty, may all continue to limit the SEK over the next couple of months. Given this, we have raised our EUR/SEK forecasts, and now see the cross at 10.3 in Q4-18 (9.9 previously) and 9.6 in Q4-19 (9.2 previously).

The SEK has broadly followed equities/risk sentiment in recent months (Chart 19). However, the cross seems to have diverged from the Euro Stoxx 50 over the past week, with the SEK strengthening on the strong September CPI data.

Both the CPI and CPIF numbers beat expectations, rising to 2.3% YoY and 2.5% YoY, respectively. With energy prices lifting both these measures in recent months, the Riksbank has focused more on CPIF excluding energy (Chart 20). This saw a particularly notable increase, to 1.6% YoY (1.2% previously), boosting the prospects of a rate hike.

At yesterday's meeting (24-Oct), the Riksbank continued to suggest that it expects to hike rates in "December or February". We see a hike at either meeting as possible, with GDP and CPI data already supporting the case for tighter monetary policy. However, we still see a February rate hike as the more likely of the two. Much will depend on the next two months' CPI data, as well as the Q3-18 GDP numbers. However, new data aside, the Riksbank has tended to be too optimistic in forecasting monetary policy tightening in recent years, and has a history of disappointing the market (see Riksbank and Norges Bank to show patience in October, of 18 October).

Aside from the question of when the Riksbank will finally hike rates, another key matter is when Sweden will have a new government. This political uncertainty is neither good for the outlook for interest rates nor for the SEK. The timeline below shows that we are already in uncharted political territory.

- 9-Sept: Inconclusive general election
- 25-Sept: Parliament returns (speaker elected)
- 26-Sept: PM Lofven loses vote of no confidence (204-142)
- 2-Oct: Moderate party tasked to form new government
- 14-Oct: Moderate party unable to form new government
- 16-Oct: Social Democrats tasked to form new government

If no government is formed after four attempts, the country will hold new elections within three months. Sweden has never previously needed more than one attempt to form a government, so we are already in uncharted waters. In spite of this uncertainty, the SEK has performed relatively well given that: i) it is focussing more on the prospect of a rate hike; ii) Sweden has solid finances with both a fiscal and current account surplus. However, the SEK could come under pressure if new elections are needed, or parliament is unable to pass the 2019 budget, which is due to be presented to parliament by 15 November, and voted upon in December.

NOK – Some patience, and then further gains

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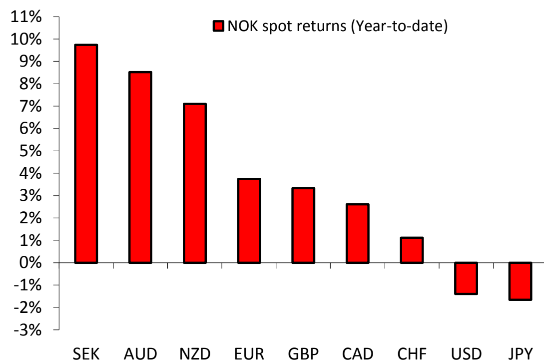
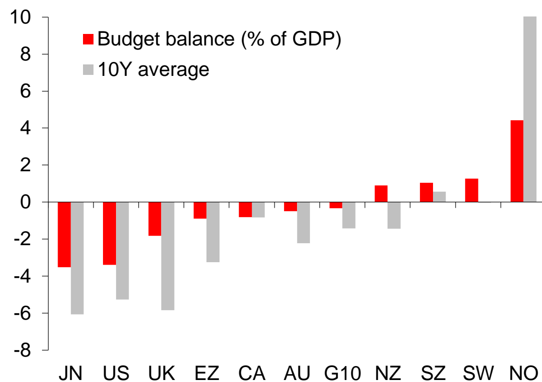
Chart 21: After a strong year so far, the NOK might struggle to add significantly to its 2018 gains in November, but we still see scope for further upside heading into 2019



Source: Bloomberg, Santander.

Chart 22: Norway's budget balance has fallen as a % of GDP in recent years, but remains in surplus



Source: Bloomberg, Santander

We still hold an upbeat view on the NOK, but it is already one of the strongest developed market currencies so far in 2018 (Chart 21). Furthermore, we do not expect the Norges Bank to hike rates again until March. Hence, with EUR/NOK falling sharply over the past couple of months, the cross may need to wait until early next year to test last summer's 9.22 lows. With the next rate hike potentially still five months off, we see EUR/NOK holding mostly in a 9.3-9.5 range for the remainder of 2018, although we continue to see the cross heading into 2019 towards the lower end of this range.

This morning (Thursday, 25 October) the Norges Bank kept rates on hold, at 0.75%. This decision was no great surprise to the market, not least because just five weeks ago the Bank hiked rates for the first time since 2011, but also because there was no press conference, no new forecasts, and the Bank had previously stated that it expected to next hike rates in Q1-19.

The Norges Bank's Executive Board has also made it clear that if the economy evolves as it expects, it will only hike rates gradually. This significantly reduces the probability of a rate hike in December, in our view, even though the bank has not completely ruled out such a possibility.

Now that the central bank has begun its tightening cycle, the upcoming data will be closely watched for signs of when the Bank will hike next. In the coming weeks the focus will be on the CPI data (9 Nov) and GDP numbers (14 Nov).

September CPI came in unchanged, at 3.4% YoY (headline) and 1.9% YoY (core), despite expectations of a decline. The Norges Bank expects both inflation numbers to come in lower in Q4-18, and so any further increase in October would keep pressure on it to hike rates sooner rather than later.

However, GDP data disappointed in both July and August. Hence, even assuming strong growth for the month of September, Q3-18 GDP is unlikely to impress, with quarterly growth (including the petroleum sector) at risk of turning negative for the first time since 2016.

Petroleum prices have dipped from their early October highs, but remain elevated. Earlier this month, the government highlighted that "the cyclical downturn that followed the fall in oil prices four years ago has come to an end, and the economy is in a cyclical upturn,"

Data over the coming quarters should help clarify whether this is true, but the firmer oil prices should at the very least be helping government finances. The Norwegian government, which runs a non-oil structural deficit to use its oil wealth to help fund its welfare state, presented a relatively neutral budget for the 2019 fiscal year. It proposed spending just NOK231bn (USD28bn) of its oil income (slightly above the NOK226.7bn for this year). This would amount to around 2.7% of the USD1trn wealth fund, below the 3% rule. Although Norway's budget surplus is no longer as large as it once was, the country's finances are still in far better shape than those of most other developed markets (Chart 22), which should continue to support the NOK.

LatAm FX: Main Themes

Currency	3M view	12M view	Main Themes
BRL	Bullish	Mildly Bearish	• The dilution of election risk has been the main driver of the BRL, in our view. Markets are attributing a relatively high probability to a scenario of extended fiscal consolidation into 2019. • Unwinding of FX hedges and portfolio flows may, in the short term, extend the ongoing rally. • Past the elections, cabinet composition (including the central bank) and articulation to pass reforms in Congress should be the main themes.
MXN	Neutral	Neutral	• The emerging market outlook and the international price of oil have turned more favourable. • Fitch and Moody's recently expressed concerns about the finances of Pemex and the market is worried about the location of the Mexico City Airport. • Regardless of the improved external scenario, politics is taking centre stage and is likely to define the direction of the exchange rate.
CLP	Mildly Bearish	Neutral	• The CLP will remain dependent on the external scenario, with special focus on trade tensions and copper prices. • The risk scenario is a permanent decline in copper, with effects on business confidence, investment, and eventually growth. • In the medium term, 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	Neutral	Neutral	• COP performance risks are tilting upward as the external environment remains uncertain and with the recent decline in oil prices. • BanRep's reserve build-up programme may cap any possible appreciation. • The macroeconomic outlook remains solid, with ongoing recovery, low and stable inflation and narrowing of the current account deficit.
ARS	Bullish	Bullish	• The peso has appreciated around 12% since a new monetary and FX policy was launched in early October. • Part of the US$13.4 billion IMF lending to be withdrawn before year-end will be converted into pesos by the Treasury, as several government financial obligations are local currency-denominated. • Thus, an additional US dollar supply of around US$150 million daily should generate additional downward pressure in a market where average daily volumes are no more than US$450 million daily. • We believe the time is approaching, in the months to come, to be long in local currency peso instruments and enjoy returns on inflation linked or floating Badlar fixed income instruments.

Bullish   Mildly Bullish   Neutral   Mildly Bearish   Bearish

Source: Santander.

BRL – Relief, for now

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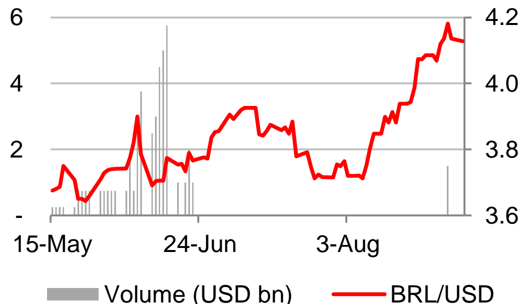
A relief rally for Brazilian assets came earlier than we were expecting, mostly due, in our view, to presidential polls pointing to a comfortable lead in favour of the candidate perceived as willing to continue the country's fiscal consolidation process. Since first round voting on 7 October, the BRL has been among the top performers within the EM universe, following the bullish trend in CDS spreads, local rates, and equities. The sharp movements suggest, in our view, that market positioning in Brazil was quite light and that investors are now running to cover short/underweight positions or add to bullish trades in anticipation of the continuation of those new trends.

Chart 23: FX swap auctioned volumes*

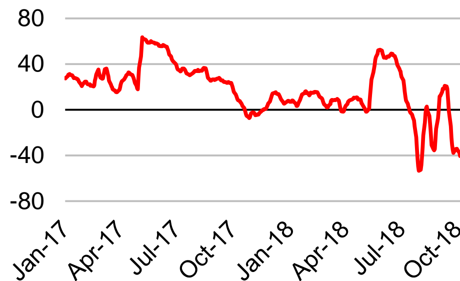


*BRL/USD (rhs) Source: Brazil Central Bank, Bloomberg

Although we believe that the combination of momentum and still favourable positioning (the central bank has yet to start unwinding the FX swaps it offered to the market this year — primarily between May and June — at an estimated average starting exchange rate of BRL 3.76/USD) may extend the BRL rally for a few months after the presidential elections (the run-off is scheduled for 28 October), we see several hurdles to be cleared for us to become comfortable with the hypothesis of a new prolonged bull market.

In our view, the recent BRL/USD move was too fast and too strong. In terms of valuation (here gauged by the deviation from the long-term average real effective exchange rate), the exchange rate moved from an undervaluation of around 25% (with BRL/USD at 4.13 on 19 September, when we closed the September issue of this FX Compass) to close to fair value after the first round of the elections (with BRL/USD at 3.70). We reach a similar conclusion when we look at the sovereign CDS market, which is usually highly correlated with the BRL. According to our modelling (see our 9 October report, Risk Premium – Apples and Oranges), the idiosyncratic (i.e. not linked to any external variable) component of Brazil's country risk is now negligible, suggesting low risk associated with the execution of reforms and the macroeconomic policy of the new government, in our view. At 210bp, Brazil's 5-year CDS is trading inside the BB-curve and in line with BB credits (such as South Africa), which, in our view, suggests the relatively optimistic assessment that the country's split rating is more likely to be solved with an upgrade by Fitch and S&P Global than with a downgrade by Moody's (which has been keeping Brazil as Ba2).

Chart 24: 5-year CDS, Brazil minus Russia, Turkey, South Africa average (bp)



5-day moving average. Source: Santander, Bloomberg

For that scenario to materialise, in our view, the newly elected government will have to start doing the groundwork for passing a major pension reform early next year. That would include defining the terms of the proposal to be presented to Congress, form an effective coalition in both houses and prioritise the economic agenda among several other demands from society. The legislative year only starts next February; the next president will have until then to strengthen the current wave of market confidence. While we wait for more concrete signals on that, we maintain a relatively bearish view on the currency in the medium term.

MXN – AMLO's politics in the spotlight

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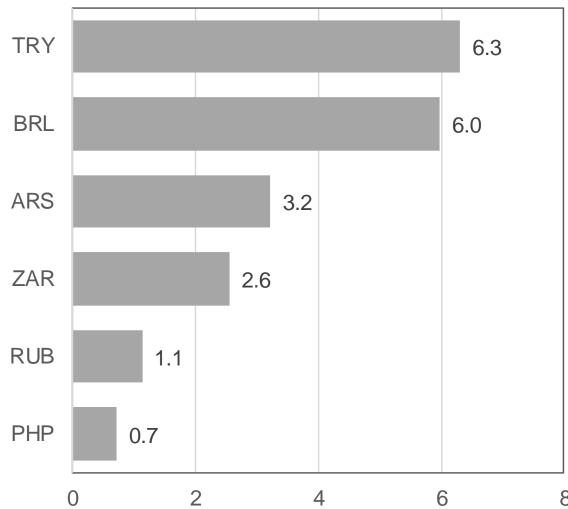
The minutes of the 4 October Banxico monetary policy meeting underscore the Board's significant worries about the external scenario. Most members warn that increased US economic dynamism could exert pressure on US inflation. So, an environment of higher external interest rates and USD appreciation is expected, which would lead to greater tightening of financial conditions that will particularly affect emerging markets. The Board also discussed the possibility of international crude oil prices continuing their upward trend, thus pressuring domestic inflation.

However, what stands out is that from 3 October to date, both the emerging market outlook and the international price of oil have turned more favourable. Major emerging market currencies that depreciated steeply are on an appreciation trend, particularly the Turkish lira, the Brazilian real, the Argentinian peso, and the South African rand. Also, the price of WTI oil has dropped from 2018's peak of US$76.41/barrel to ~US$69.00/barrel.

The Board took a wait-and-see attitude with respect to not hiking, based on no evidence of second-round effects on core inflation aided by an improved outlook for USMCA; we believe the Board could also adopt a similar stance in the following meetings if the 2019 budget is prudent and credible. The majority of members highlighted that core inflation has evolved, in general, as anticipated, and is expected to continue decreasing, which is primarily why there has been no change in the policy rate (at 7.75%). In the minutes, there are several mentions of fiscal policy and the need to complement efforts on the monetary policy side with a prudent 2019 budget.

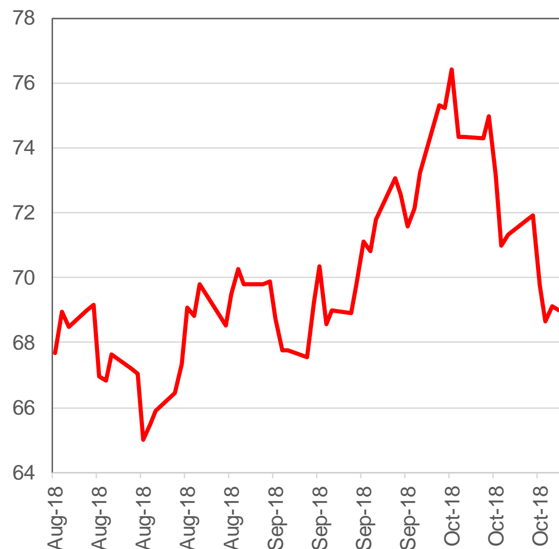
There is uncertainty about the fiscal management of the incoming administration, according to one member. Another member expressed the need to know in detail the next administration's public policies, concerns that are now shared by the market. In our view, if the AMLO administration delivers a prudent and credible 2019 budget as promised, Banxico could maintain the policy rate unchanged; otherwise, a hike in December is more likely. Fitch and Moody's recently expressed concerns about the finances of Pemex, adding to market jitters about the next administration's handling of the budget. Also, the market is starting to get worried about the decision on the location of the Mexico City Airport based on a public consultation. In sum, regardless of the improved external scenario, politics is taking centre stage and is likely to define the direction of the exchange rate, in our view.

Chart 25: EM FX performance 2018 (3 oct - 22 oct 2018



Source: Santander, Bloomberg

Chart 26: NY WTI (US$/ barrel)



Source: Santander, Bloomberg

CLP – Rate hikes to mitigate funding currency effect

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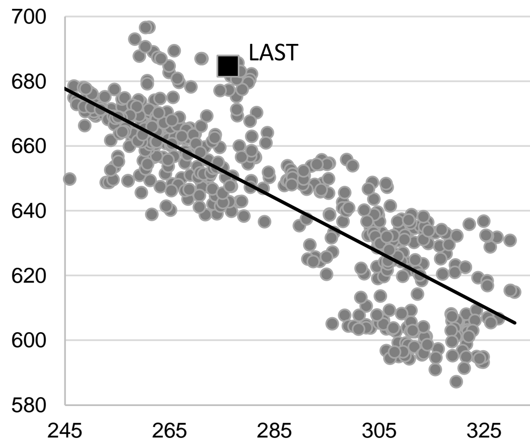
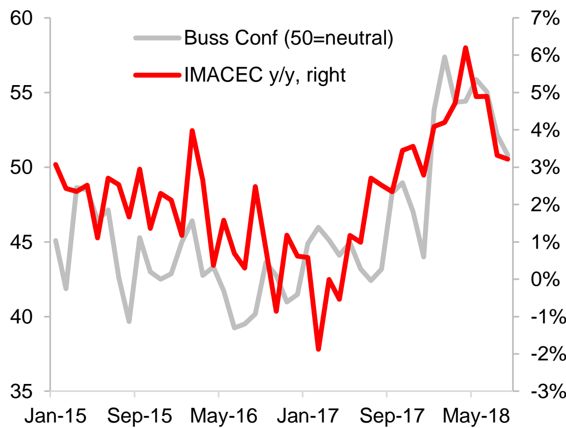
Chart 27: USDCLP vs. copper prices ($/lb)*



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

Chart 28: GDP growth and business confidence



Source: Icare, BCCh, Santander

In the last few weeks, the USDCLP rate has hovered around 656-684, in another month of relatively high volatility. This coincided with a more range-bound global USD story, including relatively stable copper prices of around US$2.75/lb. In general, the CLP traded weak vs. peers: the last two times the FX rate spiked in Chile (early September to almost 700, and early October to 685), the currency was overly hard hit considering historical parameters. Even adjusted for copper prices and global USD levels, our models indicate that the CLP slide was 15-20 pesos over-extended, which in our view was triggered by fast-money offshore investors expressing a negative EM FX call via relatively cheap short positions in CLP: forward rates trade inside the spot rate up to the 1yr tenor due to very tight interest rate differentials with the US.

On the local growth front, August's IMACEC was 3.2% y/y, near market consensus. Now the 3Q18 reading is likely to be close to 3% y/y, which implies a deceleration vs. 2Q18's 5.3%. This would be mainly due to the mining sector (where output is expected to contract on a y/y basis), and a likely poor September print, reflecting fewer working days. The BCCh analysts' survey maintained expected 2018 growth at 4.0% but cut 2019's by 10bp to 3.7%, probably because of negative risks from the global economy.

Regarding inflation, September's CPI surprised on the downside again, at +0.3% m/m (3.1% y/y). Although gasoline prices remained on the upside, food inflation was lower than what is normal for this month (the National Holiday week normally makes foodstuffs much dearer), while the FX pass-through is being milder than suggested by historical data. For the coming months, we expect y/y inflation to hover around current levels, but it should pick up further along 2019, as the weaker CLP should eventually affect core tradable goods such as apparel, cars, electronics, etc.

In the last rate meeting, the BCCh board decided to hike rates by 25bp to 2.75%, vs. a split market consensus (50% of analysts expected no change this month). Although recent data indicate a softening in growth and a mild uptrend in core inflation, the BCCh maintained its view that the output gap is narrowing, and rates need to be normalised. The Board mentioned that rates should converge to neutral in 2020 (i.e. to 4.00%-4.25%), suggesting that a rate hiking cycle of at least 100bp will take place in the next few quarters.

All in all, we expect FX trends in Chile to continue hinging on external factors, despite the coming hikes in policy rates. In our view, higher local rates would make sharp USDCLP spikes less frequent, as investors' should have less incentive to use the CLP as funding currency. Nonetheless, we do not believe this will be enough to fully offset the global USD uptrend stemming from the strong US economy. Net net, we expect the USDCLP rate to continue moving upwards, but in a more stable and moderate manner: extrapolating the trend in fair values since early this year, we obtain 680-685 for end-November.

COP – BanRep accumulating FX reserves

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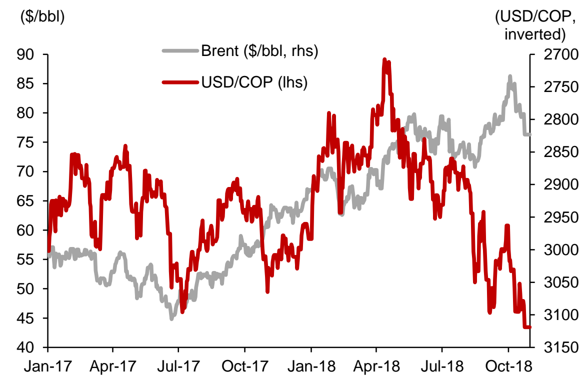
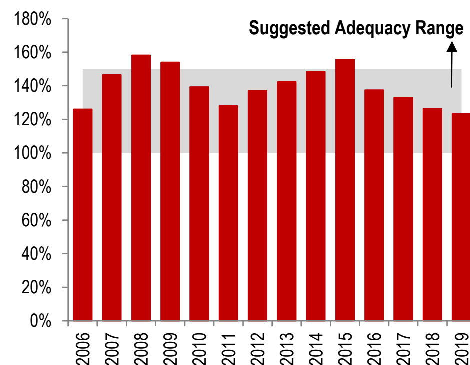
Chart 29: Oil prices have declined but remain high



Source: Santander, Bloomberg

Chart 30: FX reserves as % ARA metric



Note: ARA Metric is a weighted average of export revenue (5%) broad money (5%), short-term debt (30%) and other liabilities (15%). Sources: IMF and Santander

Since our last FX Compass (published 20 September) external pressures have eased after a period of intensity, providing some relief to EM asset prices, with EM FX increasing 0.6%. During this period, however, the COP depreciated 3.8%, underperforming its EM and LatAm peers and reaching levels above COP3100/USD, which were last recorded in November 2016. Part of the COP's underperformance has been due to lower oil prices, with Brent prices decreasing 2.7% in the last month from US$78/bbl to US$76/bbl. However, the COP's underperformance was more evident at the beginning of this month, when oil prices rallied, with Brent reaching US$86/bbl — the highest level this year and since October 2014, and yet, the COP remained above the COP3000/USD levels.

Part of the COP's underperformance could be explained by the central bank's FX reserves accumulation programme. Following its monetary policy decision of 24 September, when the MPC maintained the rate at 4.25% as expected, BanRep surprised the market by announcing a programme to accumulate international reserves through put options as a preventive measure in case its flexible credit line (FCL) with the IMF of around US$11.5 billion is reduced in 2020. The options can only be exercised when the official exchange rate (TRM) is below the average of the previous 20 working days.

The first auction was held on 1 October and offered US$400 million. As of the time of writing, US$300,000 of the US$400 million put options have been exercised. BanRep used this system previously in 2008; yet, the last time BanRep bought USD was in 2014 through direct auctions, accumulating US$4 billion. If we look at FX reserves as a percentage of the IMF's ARA metric, we notice that reserves remain within the range of adequacy. However, since 2015 this buffer has been declining. Moreover, we expect the current account to widen in 2019, as we expect imports to accelerate faster in line with the recovery. At the same time, we note that portfolio inflows have been decelerating at a faster pace than the increase in FDI. According to BanRep, the FX accumulation programme may last two years, and although there is no specific target and it does not aim to fully cover the FCL, we consider that the accumulation of US$4 billion could lead to a more adequate level.

Although the programme is designed so that the central bank does not exacerbate pressures in the FX market, it seemed that it had an impact on market expectations, as the programme would likely cap any possible appreciation. However, there is flexibility in the programme, as BanRep stated that the amount of put options would be defined on a monthly basis. Thus on 1 November, we will learn if BanRep has decided to continue with the mechanism or make a pause.

In the short term our view on COP is neutral, as COP risks remain to the upside, due to the uncertainty in the external environment and tighter international financial conditions. We believe, however, that oil prices remain supportive and continue to stress the positive macroeconomic outlook.

ARS – We foresee the dollar around the bottom of the FX band in November and December

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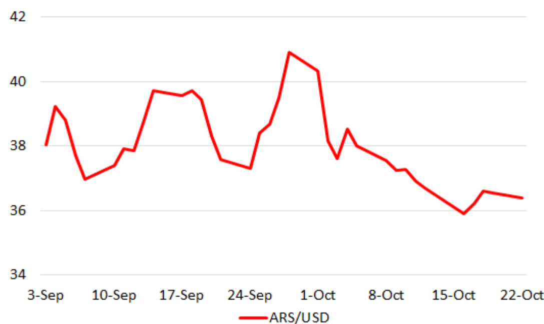
The peso has appreciated around 12% since a new monetary and FX policy was launched in early October. The core of the plan was to freeze money supply growth until June 2019, in an effort to bring down an inflation rate that has accumulated 32% YTD. On the FX front, a floating FX rate within the "non-intervention zone" (NIZ) was established. The NIZ was set in the range of ARS34-44 per USD. The band is updated by the monetary authority on a daily basis at a 3% monthly pace until December 2018.

Chart 31: ARS/USD daily quote



Source: Santander, Bloomberg

Referring to the FX policy, when the US dollar quotation is either above or below the NIZ, the CB has established that for prices above the NIZ, the CB will sell international reserves and reduce the monetary base by an amount of up to US$150 million daily. Conversely, in the event of excessive FX appreciation, with the quote falling below the NIZ, the central bank may decide to purchase hard currency and determine whether or not to increase the monetary base.

The IMF Board of Directors is scheduled to discuss the new financial package on Friday, 26 October. Should the approval of the new loan materialise, US$13.4 billion will be disbursed to Argentina before year-end. Treasury Minister Dujovne has suggested that part of the IMF lending to be withdrawn before year-end will be converted into pesos in the Siopel market, because some government financial needs are local currency-denominated obligations.

Based on Minister Dujovne's statement, the market is anxiously awaiting the dollar auction mechanism to be announced for the sale of around US$6.7 billion Treasury proceeds.

In addition, the US dollar quotation, at ARS36.3947/USD on Monday, 22 October, has been on a downward trend throughout the month, now approaching the lower bound of the non-intervention zone (see Chart 31).

Thus, an additional US dollar supply from IMF lending of around US$150 million daily should exert further downward pressure on a market where average daily volumes are around US$450 million daily.

Central bank governor Guido Sandleris has said that if the peso falls below the lower limit, the CB "might" buy US dollars to prevent it from strengthening further, while the use of exchange rate "sterilisation" — selling peso-denominated debt to prevent an expansion of the money supply — also "depends on what will happen". However, we believe that under the baseline scenario, the BCRA will finally buy US dollars in the weeks to come, while peso proceeds will be partially sterilised.

Based on the above, we believe the time is approaching to be long in local currency peso instruments and enjoy the returns on inflation linked or floating Badlar fixed income paper.

CEE FX: Main Themes

Currency	3M view	12M view	Main Themes
PLN	↗	→	• The zloty has been moving sideways vs the euro for the last few weeks despite higher volatility on the equity and bond markets and important internal events. We stick to our view that there is some room for the zloty to gain until the end of the year.
CZK	↘	↘	• During the last few weeks, the Czech koruna underperformed its CEE peers mainly owing to the internal factors. In our view, the list of Czech-positive factors has shortened and so we decided to lift our EUR/CZK profile and reduce the number of expected rate hikes.
HUF	→	↘	• We maintain our short-term forecast for EUR/HUF. We are still concerned that car industry problems with passing the new WLTP emission standards may negatively affect Hungarian exports.
RUB	↘	↘	• We have changed our short-term view and pushed our USD/RUB forecasts down from 70 to 68, mainly due to the better outlook for US-Russia relations and a lower risk of the US imposing new sanctions on Russia.

Bullish Mildly Bullish → Neutral Mildly Bearish Bearish

Source: Santander Bank Polska S.A.

PLN – Waiting for a trigger

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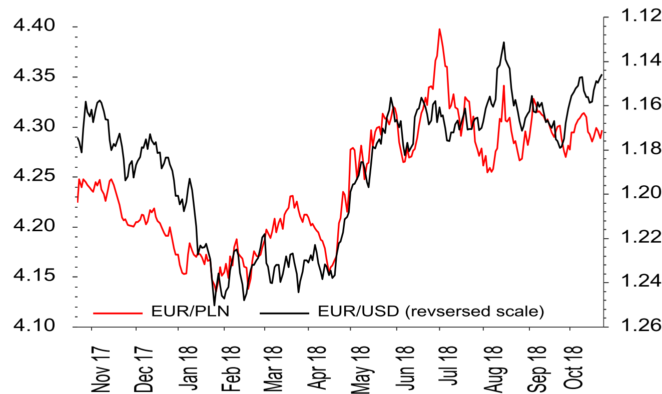
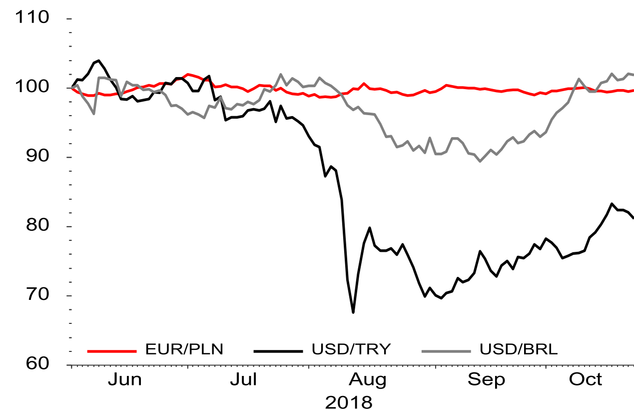
Chart 32: EUR/PLN and EUR/USD



Source: Thomson Reuters Datastream, Santander Bank Polska

Chart 33: PLN, TRY, BRL (June 1 = 100)



Source: Thomson Reuters Datastream, Santander Bank Polska

The zloty has been moving sideways vs the euro for the last few weeks, despite higher volatility on the equity and bond markets and important internal events (rating upgrade, local government elections, the next stage of the conflict with the EU).

We stick to our view that there is some room for the zloty to gain until the end of the year. Polish factors should continue to be at least neutral for the zloty and a EUR/PLN decline in the months to come should be driven by the situation in the global markets.

We perceive the deterioration of global market sentiment in late September/early October as temporary. There are several risk factors on the horizon (Italy, Brazil, Brexit) but, for now, we do not expect them to materialize in such a way that risk aversion remains higher for longer. At the same time, the ECB and Fed maintain their generally positive view of economic growth and the recent US data were pretty good.

The correlation between EUR/PLN and EUR/USD seems to be still having a material impact on the zloty. Thus, the EUR/USD's rise should allow the Polish currency to appreciate in the months to come.

We think that Polish bonds might look attractive after the noticeable rise in yields in the last few weeks. Should non-residents use this opportunity, the zloty may benefit.

At the time of writing, the October high-low spread was the lowest monthly range since November 1996 (according to Reuters data). However, implied volatilities are trading above levels seen in April and so we do not assume that the current low trading range is an omen that a bigger move could take place soon.

In September, the European Commission (EC) decided to take the Polish government's judiciary reforms to the Court of Justice of the EU (CJEU) on the basis that they were counter to EU law. The EC has asked the Court to use an expedited procedure and requested provisional measures. The CJEU approved the EC's motion and suspended implementation of the Polish act in the Supreme Court. Poland's top officials said the government will comply with the CJEU decision. For the time being we do not expect this issue to generate any serious pressure on the zloty. There could be a negative impact if the Court's ruling is not in favour of the government but a verdict is likely to be several months away.

In October, S&P surprised the markets by raising Poland's long-term rating in foreign currency from BBB+ to A- with a stable outlook. In January 2016, the agency unexpectedly downgraded Poland, highlighting the weakening of the independence of key institutions. In April this year, it changed the rating outlook to positive. October's upgrade was explained by the balanced economic growth, improved fiscal situation and better competitiveness of the Polish economy.

CZK – Rate outlook-driven

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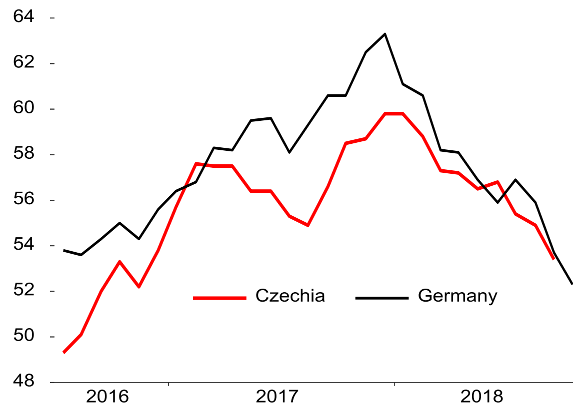
During the last few weeks, the Czech koruna underperformed its CEE peers, mainly owing to the internal factors. In our view, the list of Czech-positive factors got shorter and so we decided to lift our EUR/CZK profile and reduce the number of expected rate hikes (see table on page 3).

Last month we said we thought comments suggesting that monetary policy normalisation could proceed faster were the only thing that could support the koruna, as the next rate hikes were already priced in. We expected some profit taking after the currency appreciation and indeed EUR/CZK has risen noticeably since then. The main trigger was the signal from the Czech central bank.

In line with expectations, in late September the Czech central bank (CNB) hiked rates by 25bp, taking its main rate to 1.50%. CNB governor Jiri Rusnok said that one more rate hike cannot be excluded and could take place later this year or in early 2019. Before the decision, the market had been pricing in three hikes, with two of them to be delivered in 2019 so the bank governor comment might have sounded dovish.

This reserved opinion was followed by the below-consensus Czech August retail sales, industrial output and October PMI for manufacturing. Flash October Euro zone PMIs did not look encouraging and are a poor omen for the Czech economy.

Chart 34: Czech and German Manufacturing PMIs (pt)



Source: Thomson Reuters Datastream, Santander Bank Polska

HUF – Hit by cars

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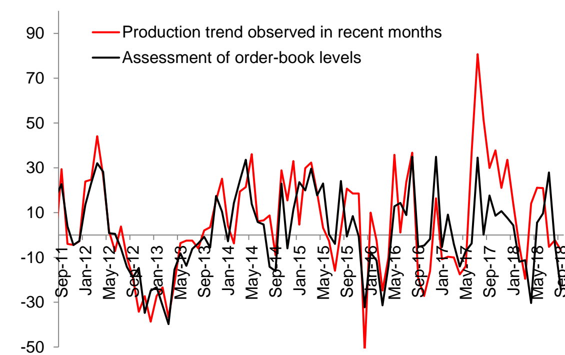
Over the last month EUR/HUF has declined. HUF appreciation was a result of the improvement in the mood on the global markets after the temporary sell-off at the end of the summer. Another positive influence on the HUF was the market digesting information that Hungary's central bank had tightened mortgage lending rules as well as confirmation by the MPC that the central bank is prepared for the gradual and cautious normalisation of monetary policy (possibly in the 2H19). As a result EUR/HUF slid to 322.50 from 324 at the end of September.

On a 4-5 week perspective, we expect EUR/HUF to increase slightly to 325. The MPC's intention to stop using non-standard measures the next year, signalled in the last MPC communique, should positively influence the forint in the longer horizon. However, in the short term, we believe that weaker macro data releases next month will affect the HUF. We anticipate a negative impact on industrial production from the automotive sector's WLTP problems, related to difficulties with passing the new emissions regulations. We also still see some negative impact on industry from cyclical factors and trade war-related fears. Furthermore, weaker industrial sector results will be translated into exports, which are closely connected with the automotive sector (cars and autoparts are c17% of Hungarian exports).

At the beginning of 2019 we expect EUR/HUF move to c320, mainly thanks to the expected rebound in the automotive sector. We think that, until then, the European cars should pass the WLTP tests, while intentions to buy a car in the next 12 months index in the EC survey remain stable and still at their highest level since the financial crisis in 2008.

Chart 35: ESI Survey



Source: Reuters, Santander Bank Polska.

RUB – A little more optimistic

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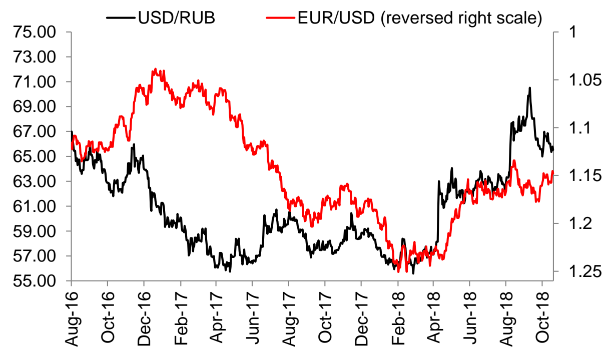
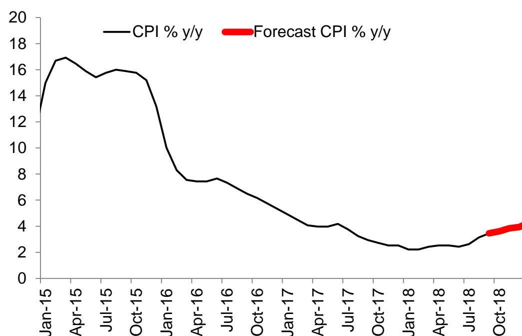
Chart 36: USD/RUB and EUR/USD



Source: Reuters, Santander Bank Polska.

Chart 37: Russia CPI % y/y



Source: Reuters, Santander Bank Polska.

USD/RUB has fallen over the last month. At the end of September the Russia ruble was supported by a diminishing of risk aversion towards emerging markets, after the market absorbed information (after a typical cycle of “buy the rumour, sell the news”) that the US government had started to apply tariffs on Chinese exports. In September and October RUB was supported by high oil prices (above US$80/bbl) and USD/RUB stabilised between 62.50 and 66.80 after the Russian currency’s depreciation in the second half of September.

Domestic data did not have a major impact on the RUB due to their mutually neutralising effect. PMI data were better than expected (the industry reading was 50 points vs an expected 49.4). Similarly, inflation (3.4% y/y vs 3.3% expected), wages (7.20% y/y, vs exp. 6.50% y/y) and unemployment (4.50% vs. exp. 4.70%) surprised on the positive side and supported the scenario of further interest rate increases. Industrial production and disposable income data surprised on the negative side.

In the next four or five weeks we expect USD/RUB to stay close to the current level, despite the still negative influence of lower oil prices. Our short-term scenario is supported by a faster rise in Russian inflation. We believe that the CPI will reach 4.0% y/y at the end of this year, while in 1Q2019 it will be hovering between 5.0% and 5.5%. The faster-than-expected inflation growth is still the one of the most important factors pushing expectations of interest rate increases. Currently investors priced-in c200bp of interest rate hikes over six months.

We expect USD/RUB to rise again by the end of the year, however, the upward move may be smaller than we formerly expected (to 70 RUB per USD). We still believe that the ruble will be negatively affect by expectations of rate hikes in the US. The ruble will probably also be impacted by the expected fall in oil prices (in reaction to the likely slowdown in global and European GDP growth). The scale of weakening of the ruble will probably be less than we previously expected due to the remarks of US National Security Advisor John Bolton, who said that Washington is not currently considering additional sanctions against Russia.

G10 FX: IMM Speculative Positioning

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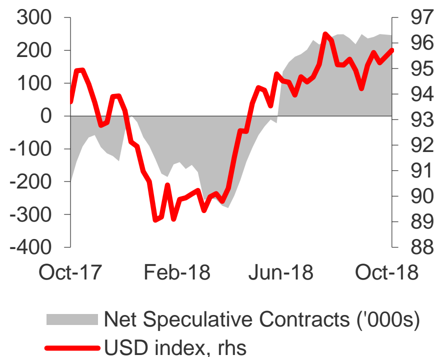
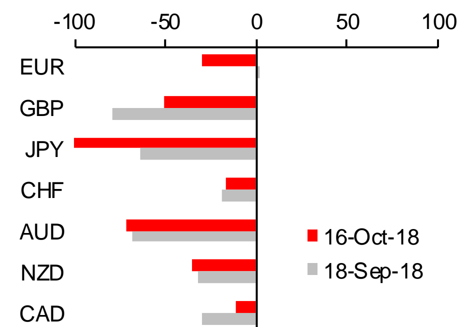
IMM commitment of traders report: EUR/USD position



- **Speculators now very upbeat on the USD and short the EUR.** The net long USD composite position is close to its highest level since early 2017. Meanwhile, the net EUR/USD position turned short in October, at 29k contracts. This position has deteriorated over the summer, weighing increasingly on the single currency.
- **AUD/USD and NZD/USD positioning have deteriorated.** The net short NZD/USD position reached an all-time high in the week ended 16 October, at 35k contracts. Meanwhile, the net short AUD/USD position is now over 70k contracts, just below its 76.85k all-time high, from early 2015.
- **Speculators are now less pessimistic on sterling.** Their net short GBP position has fallen from 80k contracts just four weeks ago, to 50k contracts in the latest data, as fears of a no-deal Brexit have diminished. Still, Brexit uncertainty is likely to continue to limit GBP's strength and keep speculators net short the currency.
- **The net CAD position has turned more neutral in October,** with the prospects of tighter monetary policy being CAD supportive.

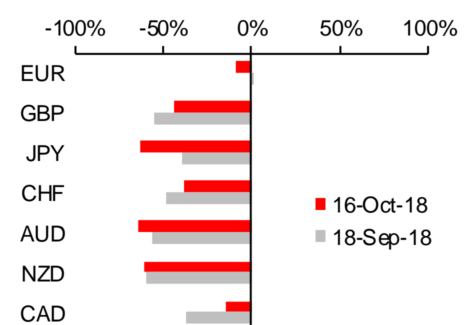
Net Speculative Contracts ('000s)*

	16-Oct-18	18-Sep-18	4w chg	YtD chg
USD***	246.2	249.4	-3.2	243.5
EUR	-29.3	1.7	-31.0	-121.5
GBP	-50.4	-79.3	28.9	-63.0
JPY	-100.6	-63.8	-36.9	15.5
CHF	-16.5	-18.4	1.9	-2.6
AUD	-71.5	-68.0	-3.5	-57.9
NZD	-35.4	-32.0	-3.4	-17.8
CAD	-11.0	-30.1	19.1	-28.4



Net Speculative Contracts as % of Open Interest**

	16-Oct-18	18-Sep-18	4w chg	YtD chg
USD***	23%	22%	1%	23%
EUR	-9%	1%	-10%	-38%
GBP	-44%	-55%	11%	-53%
JPY	-63%	-39%	-24%	-6%
CHF	-38%	-48%	10%	-20%
AUD	-64%	-56%	-8%	-49%
NZD	-61%	-59%	-2%	-29%
CAD	-15%	-37%	22%	-40%



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

Net Speculative Contracts ('000s)
EUR/USD, rhs

USD/CAD

Net Speculative Contracts ('000s)
USD/CAD, rhs, rev

USD/JPY

Net Speculative Contracts ('000s)
USD/JPY, rhs, rev

GBP/USD

Net Speculative Contracts ('000s)
GBP/USD, rhs

AUD/USD

Net Speculative Contracts ('000s)
AUD/USD, rhs

USD/CHF

Net Speculative Contracts ('000s)
USD/CHF, rhs, rev

EUR/GBP

Net Speculative Contracts ('000s)
EUR/GBP, rhs

NZD/USD

Net Speculative Contracts ('000s)
NZD/USD, rhs

USD minus MXN

Net Speculative Contracts ('000s)
Trade-weighted USD, rhs

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

Latin America FX: Positioning indexes (Z-scores)

USD/BRL

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

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

Oct-14 Oct-15 Oct-16 Oct-17 Oct-18

Z-score USD/BRL

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

USD longs

2 1 0 -1

Oct-14 Oct-15 Oct-16 Oct-17 Oct-18

USD/MXN

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

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

Oct-14 Oct-15 Oct-16 Oct-17 Oct-18

Z-score USD/MXN

Z-score (USD/MXN longs) — 10-90%

USD longs

2 1 0 -1 -2

Oct-14 Oct-15 Oct-16 Oct-17 Oct-18

USD/CLP

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

30 20 10 0 | 750 700 650 600 550

Oct-14 Oct-15 Oct-16 Oct-17 Oct-18

Z-score USD/CLP

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

USD longs

4 3 2 1 0 -1 -2

Oct-14 Oct-15 Oct-16 Oct-17 Oct-18

USD/PEN

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

12 8 4 0 -4 | 3.6 3.4 3.2 3.0 2.8

Oct-14 Oct-15 Oct-16 Oct-17 Oct-18

Z-score USD/PEN

Z-score (USD/PEN longs) — 10-90%

USD longs

3 2 1 -1 -2

Oct-14 Oct-15 Oct-16 Oct-17 Oct-18

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

Euro Interest Rate Forecasts

Government Bond yield Forecasts

Germany	Current	4Q18	1Q19	2Q19	3Q19
ECB Depo	-0.40	-0.40	-0.40	-0.40	-0.20
3m	-0.72	-0.58	-0.53	-0.40	-0.20
2y	-0.62	-0.40	-0.20	0.00	0.20
5y	-0.20	0.05	0.30	0.55	0.75
10y	0.39	0.65	1.00	1.25	1.40
30y	1.02	1.25	1.45	1.65	1.85

Swap rate forecasts

Euro	Current	4Q18	1Q19	2Q19	3Q19
ECB Depo	-0.40	-0.40	-0.40	-0.40	-0.20
3m	-0.32	-0.33	-0.27	-0.17	-0.01
2y	-0.12	0.00	0.15	0.30	0.50
5y	0.36	0.50	0.70	0.90	1.10
10y	0.96	1.15	1.40	1.60	1.75
30y	1.52	1.65	1.80	1.95	2.10

US Interest Rate Forecasts

Government Bond yield Forecasts

US	Current	4Q18	1Q19	2Q19	3Q19
FOMC *	2.25	2.50	2.75	3.00	3.00
3m	2.32	2.40	2.65	2.90	3.00
2y	2.84	3.05	3.25	3.40	3.50
5y	2.95	3.20	3.45	3.60	3.65
10y	3.11	3.25	3.45	3.60	3.70
30y	3.34	3.40	3.50	3.55	3.60

Swap rate forecasts

US	Current	4Q18	1Q19	2Q19	3Q19
FOMC *	2.25	2.50	2.75	3.00	3.00
3m	2.51	2.55	2.80	3.00	3.10
2y	3.05	3.20	3.35	3.45	3.50
5y	3.10	3.30	3.50	3.60	3.60
10y	3.18	3.30	3.45	3.55	3.65
30y	3.23	3.30	3.35	3.40	3.40

UK Interest Rate Forecasts

Government Bond yield Forecasts

UK	Current	4Q18	1Q19	2Q19	3Q19
MPC	0.75	0.75	0.75	0.75	0.75
3m	0.77	0.70	0.70	0.73	0.77
2y	0.75	0.90	1.00	1.00	1.10
5y	1.04	1.35	1.40	1.50	1.60
10y	1.45	1.70	2.00	2.10	2.10
30y	1.88	2.00	2.40	2.50	2.60

Swap rate forecasts

UK	Current	4Q18	1Q19	2Q19	3Q19
MPC	0.75	0.75	0.75	0.75	0.75
3m	0.81	0.80	0.80	0.80	0.80
2y	1.10	1.25	1.35	1.30	1.35
5y	1.36	1.65	1.65	1.70	1.80
10y	1.59	1.85	2.10	2.15	2.15
30y	1.71	1.80	2.20	2.25	2.30

G10 Central Bank Calendar

	Current Rate	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
FOMC (Upper)	2.25	Unch.	-	+25bp	-	Unch.	+25bp	-	Unch.	+25bp	-	8	19
ECB (Depo)	-0.40	Unch.	-	Unch.	Unch.	-	Unch.	Unch.	-	Unch.	Unch.	-	13
BoE	0.75	-	Unch.	Unch.	-	Unch.	Unch.	-	+25bp	Unch.	-	1	20
BoJ	-0.10	Unch.	-	Unch.	Unch.	-	Unch.	Unch.	-	Unch.	31	-	20
SNB	-0.75	-	-	Unch.	-	-	Unch.	-	-	Unch.	-	-	13
BoC	1.75	+25bp	-	Unch.	Unch.	Unch.	-	+25bp	-	Unch.	+25bp	-	5
RBA	1.50	-	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	6	4
RBNZ	1.75	-	Unch.	Unch.	-	Unch.	Unch.	-	Unch.	Unch.	-	7	-
Norges Bank	0.75	Unch.	-	Unch.	-	Unch.	Unch.	-	Unch.	+25bp	Unch.	-	13
Riksbank	-0.50	-	Unch.	-	Unch.	-	-	Unch.	-	Unch.	Unch.	-	20

Source: Bloomberg, Santander. Note: Current levels as at 25-Oct-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

Government Bond yield

Brazil	Current	4Q18	1Q19	2Q19	3Q19
SELIC	6.50	6.50	6.50	6.50	7.00
NTNF Jan' 19s	6.64	6.47	--	--	--
NTNF Jan.' 25s	9.96	9.50	9.25	9.00	8.50

Government Bond yield

Mexico	Current	4Q18	1Q19	2Q19	3Q19
Banxico fondeo	7.75	7.75	7.75	7.75	7.50
Mbono Jun. '21s	8.14	7.70	7.60	7.40	7.40
MBono Jun. '27s	8.25	7.75	7.75	7.50	7.50

Chile/Colombia Interest Rate Forecasts

Government Bond yield

Chile	Current	4Q18	1Q19	2Q19	3Q19
BCCh TPM	2.75	2.75	3.25	3.50	3.50
BCP 5Y	4.31	4.30	4.35	4.40	4.45
BCP 10Y	4.54	4.80	4.85	4.90	4.95

Government Bond yield

Colombia	Current	4Q18	1Q19	2Q19	3Q19
Banrep O/N	4.25	4.25	4.50	5.00	5.25
TES Jul '24s	6.46	6.70	6.80	6.90	6.97
TES Apr '28s	7.14	7.10	7.40	7.60	7.66

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.	31	-	12
Mexico	7.75	-	+25bp	-	Unch.	Unch.	+25bp	-	Unch.	-	Unch.	15	20
Chile	2.75	-	Unch.	Unch.	-	Unch.	Unch.	Unch.	-	Unch.	+25bp	-	4
Colombia	4.25	-25bp	-	Unch.	-25bp	-	Unch.	Unch.	-	Unch.	26	-	21
Argentina*	71.87	-150bp	Unch.	Unch.	+300bp	+975bp	Unch.	Unch.	+2000bp	+718bp	+469bp	~	~

CEE Interest Rate Forecasts

Poland

Poland	Current	4Q18	1Q19	2Q19	3Q19
Reference Rate	1.50	1.50	1.50	1.50	1.50
2y	1.53	1.58	1.57	1.56	1.55
10y	3.18	3.25	3.36	3.40	3.47

Hungary/Czech Republic/Russia Base Rates

CEE	Current	4Q18	1Q19	2Q19	3Q19
Hungary	0.90	0.90	0.90	0.90	0.90
Czech Republic	1.50	1.50	1.75	1.75	1.75
Russia	7.50	7.50	7.75	8.00	8.00

CEE Central Bank Calendar

	Current Rate	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Poland	1.50	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	-	Unch.	Unch.	7	5
Czech Republic	1.50	-	+25bp	Unch.	-	Unch.	+25bp	-	+25bp	+25bp	-	1	20
Hungary	0.90	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	20	18
Russia	7.50	-	-25bp	Unch.	Unch.	-	Unch.	Unch.	-	+25bp	26	-	14

Source: Bloomberg, Santander. Note: Current levels as at 25-Oct-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	5.0	6.8	7.6
vs.consensus forecast	3.4	3.4	2.5
GBP/USD	**1.32**	**1.33**	**1.35**
vs.forward	2.3	3.1	4.6
vs.consensus forecast	0.8	0.0	0.0
EUR/GBP	**0.91**	**0.92**	**0.91**
vs.forward	2.6	3.6	2.9
vs.consensus forecast	2.1	4.2	3.5
USD/JPY	**118**	**120**	**118**
vs.forward	5.0	6.8	5.0
vs.consensus forecast	5.4	7.1	7.3
EUR/JPY	**142**	**146**	**145**
vs.forward	10.3	14.0	13.0
vs.consensus forecast	8.9	11.8	9.1
EUR/CHF	**1.18**	**1.19**	**1.20**
vs.forward	3.4	4.3	5.2
vs.consensus forecast	3.5	3.5	3.4
USD/CHF	**0.98**	**0.98**	**0.98**
vs.forward	-1.5	-2.3	-2.3
vs.consensus forecast	-0.7	-0.5	-0.4
EUR/SEK	**10.2**	**10.0**	**9.8**
vs.forward	-1.9	-3.8	-5.7
vs.consensus forecast	-0.5	-1.5	-2.6
EUR/NOK	**9.1**	**9.0**	**8.8**
vs.forward	-4.2	-5.3	-7.4
vs.consensus forecast	-3.2	-3.2	-4.3
USD/CAD	**1.22**	**1.20**	**1.20**
vs.forward	-6.5	-8.1	-8.1
vs.consensus forecast	-5.4	-6.3	-4.8
AUD/USD	**0.73**	**0.74**	**0.75**
vs.forward	2.9	4.3	5.7
vs.consensus forecast	1.4	2.8	1.4
NZD/USD	**0.68**	**0.68**	**0.69**
vs.forward	4.1	4.1	5.6
vs.consensus forecast	4.6	3.0	3.0

	3M	6M	9M
USD/BRL	**3.50**	**3.75**	**3.85**
vs.forward	-5.9	0.9	3.5
vs.consensus forecast	-10.3	-2.8	0.8
EUR/BRL	**4.20**	**4.58**	**4.74**
vs.forward	-1.1	7.7	11.5
vs.consensus forecast	-7.2	0.4	3.3
USD/MXN	**18.6**	**18.50**	**18.80**
vs.forward	-4.8	-5.3	-3.7
vs.consensus forecast	-2.1	-2.6	0.3
EUR/MXN	**22.3**	**22.6**	**23.1**
vs.forward	0.0	1.1	3.6
vs.consensus forecast	1.3	0.7	2.8
USD/CLP	**690**	**700**	**690**
vs.forward	0.4	1.9	0.4
vs.consensus forecast	3.0	5.7	4.5
EUR/CLP	**828**	**854**	**849**
vs.forward	5.4	8.7	8.0
vs.consensus forecast	6.5	9.3	7.2
USD/COP	**3100**	**3000**	**3150**
vs.forward	-2.1	-5.2	-0.5
vs.consensus forecast	2.5	-0.3	4.3
USD/ARS	**43.4**	**45.8**	**48.5**
vs.forward	17.0	23.7	30.8
vs.consensus forecast	5.7	7.9	7.7
EUR/PLN	**4.28**	**4.29**	**4.30**
vs.forward	-0.7	-0.5	-0.2
vs.consensus forecast	-0.5	0.2	0.9
EUR/CZK	**25.8**	**25.9**	**26.1**
vs.forward	-0.1	0.3	1.1
vs.consensus forecast	0.8	2.0	3.6
EUR/HUF	**320**	**325**	**325**
vs.forward	-1.2	0.4	0.4
vs.consensus forecast	-1.5	0.0	0.8
EUR/RUB	**83**	**82**	**82**
vs.forward	10.3	8.9	9.8
vs.consensus forecast	7.3	6.8	6.9

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

G10 FX: Spot and forward rates

	EUR/USD	GBP/USD	USD/JPY	EUR/JPY	GBP/JPY	USD/CHF	EUR/CHF	GBP/CHF
Spot	1.140	1.290	112.34	128.05	144.90	0.998	1.138	1.288
1M	1.143	1.292	112.09	128.07	144.77	0.996	1.138	1.286
2M	1.146	1.294	111.84	128.11	144.67	0.993	1.137	1.284
3M	1.149	1.296	111.45	128.08	144.43	0.989	1.137	1.282
6M	1.158	1.302	110.59	128.12	143.98	0.980	1.136	1.276
9M	1.168	1.308	109.70	128.17	143.50	0.971	1.134	1.270
12M	1.179	1.315	108.78	128.20	143.00	0.962	1.133	1.264

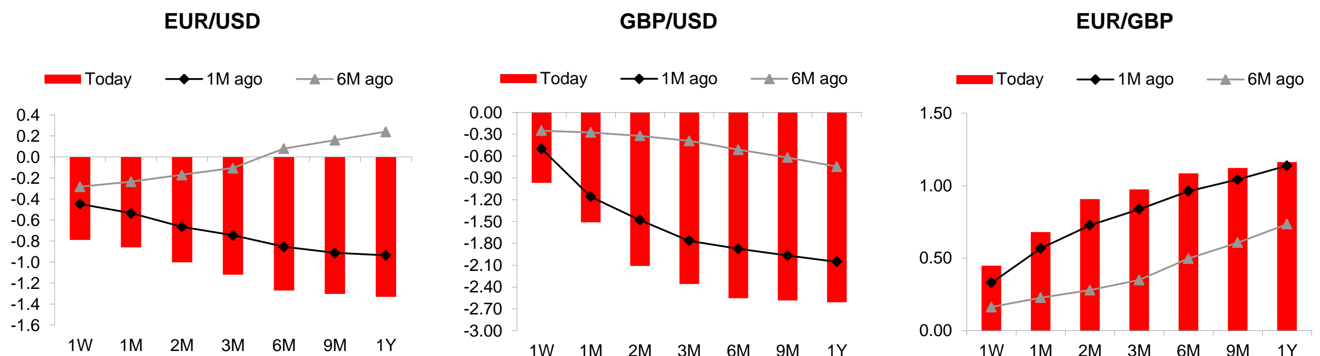
ATMf vol.

	EUR/USD	GBP/USD	USD/JPY	EUR/JPY	GBP/JPY	USD/CHF	EUR/CHF	GBP/CHF
1W	8.0%	9.4%	7.2%	10.3%	11.3%	6.2%	5.7%	8.6%
1M	7.3%	9.3%	7.1%	9.2%	10.6%	6.2%	5.6%	8.5%
2M	7.6%	10.1%	7.4%	9.3%	11.3%	6.5%	5.7%	9.1%
3M	7.6%	10.2%	7.5%	9.4%	11.4%	6.5%	5.7%	9.1%
6M	7.7%	10.1%	7.9%	9.7%	11.6%	7.0%	5.9%	9.2%
9M	7.7%	10.0%	8.2%	9.9%	11.6%	7.2%	6.1%	9.3%
12M	7.8%	9.9%	8.4%	10.0%	11.6%	7.3%	6.2%	9.4%

Implied/realized vol. ratio

	EUR/USD	GBP/USD	USD/JPY	EUR/JPY	GBP/JPY	USD/CHF	EUR/CHF	GBP/CHF
1W	1.23	1.36	1.24	1.20	1.24	1.14	0.96	1.24
1M	1.15	1.31	1.22	1.10	1.18	1.08	0.94	1.16
2M	1.16	1.26	1.35	1.14	1.19	1.14	1.01	1.17
3M	1.15	1.35	1.33	1.15	1.25	1.20	1.05	1.27
6M	1.08	1.33	1.32	1.15	1.29	1.18	1.06	1.31
9M	1.10	1.28	1.22	1.17	1.22	1.13	1.12	1.28
12M	1.12	1.28	1.24	1.25	1.27	1.12	1.15	1.27

25-delta risk reversals



Sources: Bloomberg and Santander. As of 25 October 2018

Latin America FX: Spot and forward rates

	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
Spot	37.04	3.73	689	3165	19.5	3.34
1M	38.37	3.74	688	3169	19.6	3.35
2M	39.87	3.75	688	3172	19.7	3.35
3M	41.64	3.76	688	3175	19.8	3.35
6M	45.45	3.78	687	3187	20.1	3.37
9M	49.97	3.82	688	3201	20.4	3.38
12M	54.03	3.86	687	3218	20.7	3.39

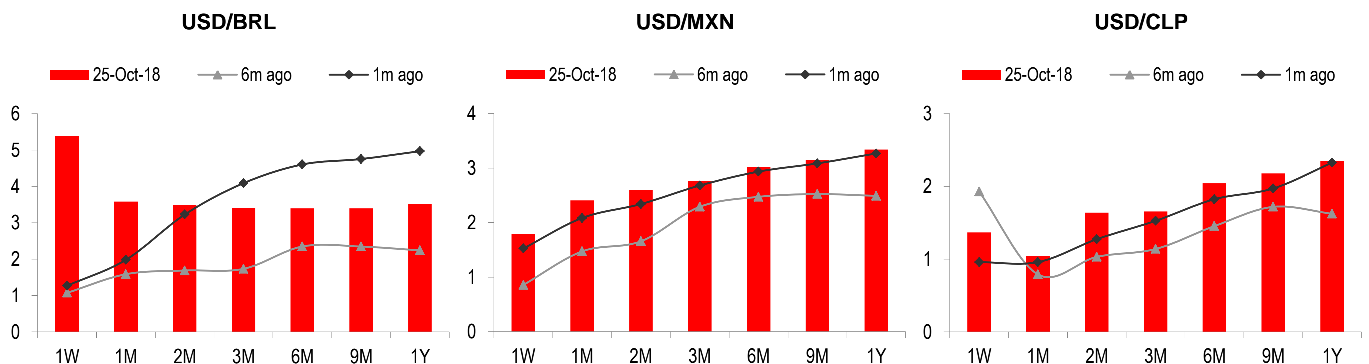
ATMf vol.

	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
1W	7.75	22.96	11.59	12.99	16.49	3.36
1M	17.34	17.00	12.34	12.70	14.06	3.51
2M	19.99	16.21	12.31	12.79	13.76	3.86
3M	22.27	15.74	12.24	12.87	13.53	4.01
6M	27.63	15.62	12.09	12.94	13.51	4.57
9M	30.02	15.57	11.93	13.05	13.57	5.10
12M	31.41	15.57	11.58	13.13	13.63	5.40

Implied/realized vol. ratio

	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
1W	0.68	1.83	1.42	1.29	1.37	1.74
1M	0.73	0.80	1.09	1.35	1.23	1.14
2M	0.46	0.81	1.06	1.25	1.14	0.98
3M	0.58	0.86	1.07	1.26	1.04	0.97
6M	0.82	0.90	1.10	1.15	0.98	1.12
9M	1.08	1.01	1.21	1.19	1.05	1.29
12M	1.27	1.07	1.20	1.24	1.10	1.36

25-delta risk reversals



Sources: Bloomberg and Santander. As of 25 October 2018

IMPORTANT DISCLOSURES

ANALYST CERTIFICATION:

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

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

EXPLANATION OF THE RECOMMENDATION SYSTEM

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

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

DEFINITIONS

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

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

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

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