20 September 2018, 12:55 BST

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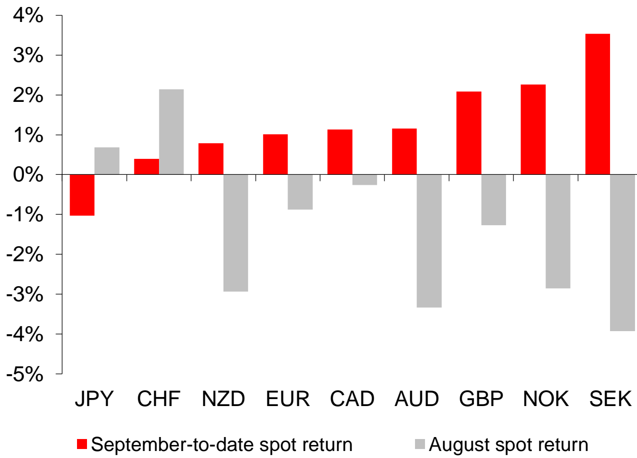
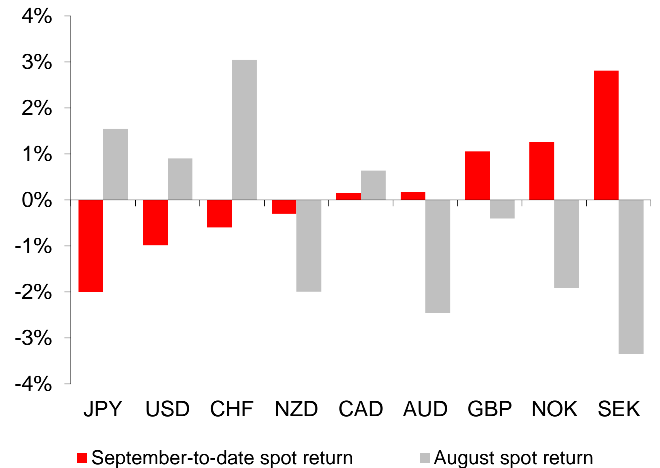
Santander Corporate & Investment Banking

FX Spot Returns

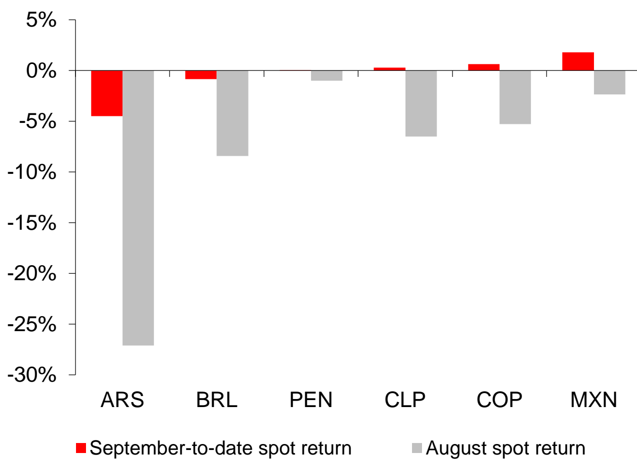
G10 spot returns vs. USD



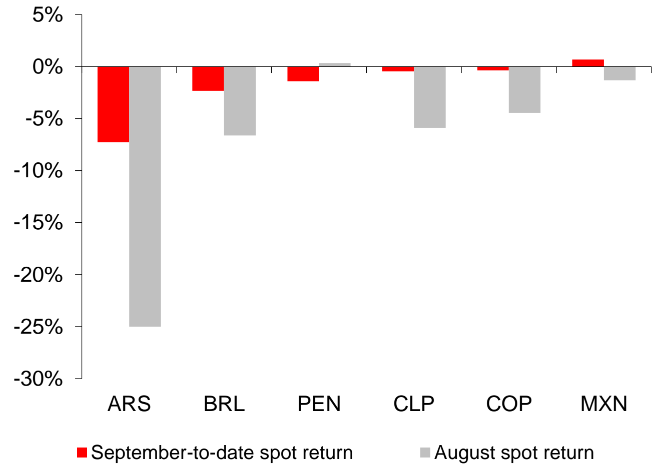
G10 spot returns vs. EUR



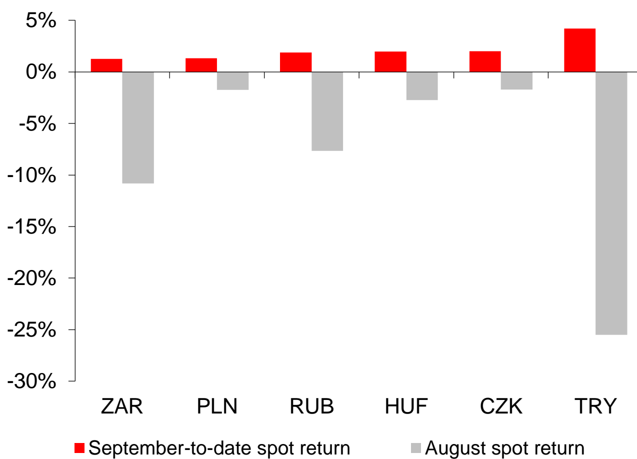
LatAm spot returns vs. USD



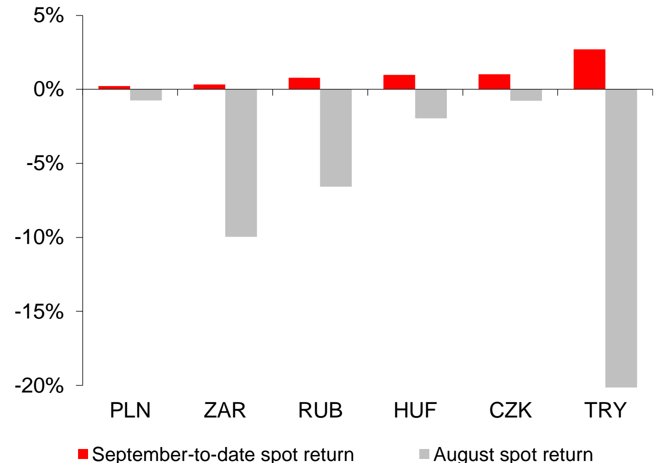
LatAm spot returns vs. EUR



CEEMA vs. USD



CEEMA vs. EUR



Source: Bloomberg, Santander. Note: Data current as at 20 September 2018 at 12:00 BST

FX Forecasts

G10 FX Forecasts

	Q4-18	Q1-19	Q2-19	Q3-19	Q4-19	Q1-20
EUR-USD	1.21	1.23	1.24	1.25	1.26	1.27
GBP-USD	1.32	1.32	1.33	1.35	1.36	1.37
GBP-EUR	1.09	1.07	1.07	1.08	1.08	1.08
EUR-GBP	0.92	0.93	0.93	0.93	0.93	0.93
USD-JPY	118	120	120	120	118	117
EUR-JPY	143	148	149	150	149	149
USD-CNY	6.70	6.80	6.70	6.70	6.70	6.65
EUR-CHF	1.20	1.22	1.23	1.24	1.24	1.25
USD-CHF	0.99	0.99	0.99	0.99	0.98	0.98
EUR-SEK	9.9	9.7	9.5	9.3	9.2	9.2
EUR-NOK	9.3	9.1	9.0	8.8	8.7	8.6
USD-CAD	1.22	1.22	1.20	1.20	1.19	1.18
AUD-USD	0.77	0.79	0.80	0.79	0.78	0.77
NZD-USD	0.69	0.71	0.72	0.73	0.74	0.73

LatAm FX Forecasts

	Q4-18	Q1-19	Q2-19	Q3-19	Q4-19	Q1-20
USD-BRL	3.50	3.52	3.55	3.57	3.57	3.57
USD-MXN	18.9	18.6	18.5	18.8	18.8	19.0
USD-CLP	680	680	680	685	685	685
USD-COP	3000	2950	2900	2850	2950	3000
USD-ARS	41.0	43.4	45.8	48.5	51.3	53.1
EUR-BRL	4.24	4.33	4.40	4.46	4.50	4.53
EUR-MXN	22.9	22.9	22.9	23.5	23.7	24.1
EUR-CLP	823	836	843	856	863	870
EUR-COP	3630	3629	3596	3563	3717	3810
EUR-ARS	50	53	57	61	65	67

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	25.6	25.5	25.5	25.7	25.8	25.8
EUR-HUF	325	320	325	325	325	325
USD-RUB	70	69	67	67	67	67
EUR-RUB	85	85	83	84	84	85

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	Bearish	Bearish	Low risk appetite has boosted demand for the yen. However, when/if such uncertainty disperses, 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, but scope for further losses may have diminished as policymakers appear to be anxious to prevent further destabilising yuan weakness.
CHF	Mildly Bearish	Mildly Bearish	The CHF has been boosted by low 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 given the robust economy and expectations that the BoC will hike rates in October. However, NAFTA concerns will remain a near-term risk.
SEK	Neutral	Mildly Bullish	The prospect of a rate hike in the coming months is positive for the SEK. However, global trade concerns remain a SEK negative, while the currency is likely to struggle until a new government is formed.
NOK	Mildly Bullish	Mildly Bullish	The NOK should be supported in the coming months by a strong economy, elevated inflation, upbeat oil prices, and a central bank that expects to hike rates again in Q1-19.
AUD	Mildly Bullish	Neutral	Australian monetary policy is likely to continue taking a back seat in Q4-18, leaving the USD's moves and global trade concerns to guide the AUD, although domestic politics are also likely to limit the currency.
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 close to an all-time high net-short NZD position.

Bullish | Mildly Bullish | Neutral | Mildly Bearish | Bearish

Source: Santander

G10 FX Overview

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The USD remains strong. A mixture of strong economic data, higher interest rates and low risk appetite has continued to support the dollar. However, the USD index has not been able to retest its August high, which might suggest that this USD positive good news is viewed as already priced in. Hence, we still suspect that the currency may be vulnerable to market repositioning.

We remain upbeat about the EUR over the coming months and into 2019. The currency is still under pressure against the USD, as low risk appetite continues to favour USD strength, but a robust economic outlook for the Euro zone and a more confident sounding ECB, should provide support.

We still feel that the pound is vulnerable to UK political/Brexit uncertainty. The economic data has improved, but the growth outlook remains subdued and we think that the BoE will keep rates unchanged over the coming months. Sterling is also susceptible to the swings in USD sentiment, but with the market already very short GBP/USD, positioning may offer some support in the month ahead.

We continue to expect the Yen to weaken. Admittedly, low risk appetite, whether due to trade tensions or emerging market jitters, can be expected to imply that safe-haven demand for the currency, will keep it elevated. But, beyond the current focus on risk, the expectation that the BoJ will continue to run a very loose monetary policy, even after its peers have hiked rates, should imply a steadily weaker yen.

The August high in USD/CNY around 6.95 should continue to offer resistance against even more USD strength. Admittedly, trade tensions between the US and China are likely to remain a risk, and will probably continue to be viewed as USD/CNY positive. However, the sell-off in the CNY since April may have priced in some of these trade risks.

We are still negative on the CHF, but for the foreseeable future the currency is likely to remain propped up by a combination of low risk appetite (boosting demand for the franc as a safe-haven) and improving Swiss economic data, which questions the need for the SNB to maintain such a loose monetary policy.

Trade tension between the US and Canada is likely to continue to constrain the currency against the USD. But fundamental factors remain generally CAD positive, with the economy performing well, inflation is above target and the BoC likely to hike rates in October.

We are positive the SEK over the coming year, and see it as too weak at its current level, given the upbeat GDP and CPI data. However, we are neutral the currency in the short term, as significant

We are long-tern SEK bulls, but risks remain for the in the near term, with a lack of clarity on when (and how) a new government will be formed, and whether the Riksbank will manage a rate hike in 2018. The NOK should be supported by monetary policy, with the Norges bank hiking rates in September, and likely to hike again in Q1-19.

We are more upbeat the AUD than the NZD, although both have fallen heavily in 2018, and have scope to recover, in our view. CPI data remain below target and rates are almost certain to be unchanged in either Australia or New Zealand until late 2019, although NZD upside may be more limited until the RBNZ rules out a rate hike. Global risk sentiment, and the USD, have dominated both AUD/USD and NZD/USD direction in recent months, and will likely continue to do so for the remainder of the year.

USD – Priced in?

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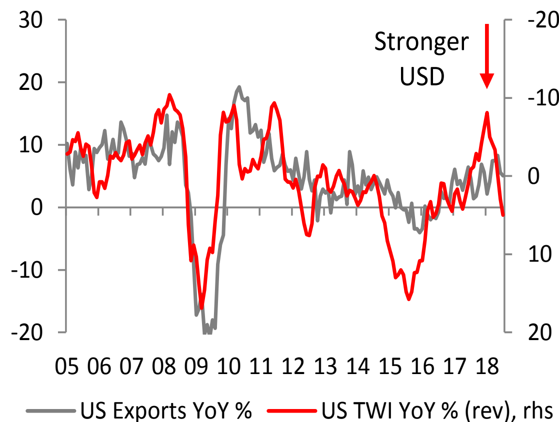
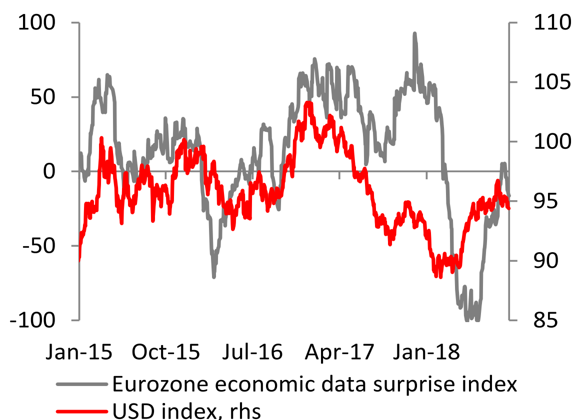
Chart 1: Reiterating again, a protectionist administration, concerned about a burgeoning trade deficit, should not want to see the USD strengthen



Source: Bloomberg, Santander

Chart 2: US data has been firm, but may need to be even better to pull the USD higher



Source: Bloomberg, Santander

The USD remains strong. A mixture of strong economic data, higher interest rates and low risk appetite has continued to support the dollar. However, the USD index has not been able to re-test its August high, which might suggest that this USD positive good news is viewed as already priced in. Hence, we still suspect that the currency may be vulnerable to market repositioning over the coming months and into 2019.

The market's focus remains on trade tensions between the US and China. The US trade deficit widened to $72.2bn in July, a 12% YoY increase. President Trump announced in September that a tariff of 10% would be imposed on a further $200bn of Chinese imports. Plus, the tariff may rise to 25% if a trade deal is not reached between the two by the end of 2018.

China indicated that it would retaliate, sending risk appetite lower, amid concern about the impact trade conflict will have on equities and global growth. The FX market had appeared to be 'getting used to' protectionist rhetoric, and not always viewing it as USD positive, although the extra tariffs did support the USD.

However, the combination of a wider trade deficit and worries about US debt and its budget deficit, may imply that the dollar is more vulnerable than the market is presently willing to admit. Further, we would reiterate that a protectionist US administration should be unwilling to allow the USD to persistently rise and eat away at competitiveness. Indeed, further gains should be capped by speculation that the President may highlight his unhappiness about the dollar's strength and/or the market re-focuses on the risk of US intervention to soften the currency.

Aside from these concerns, the fundamental backdrop is likely to remain dollar friendly over the coming months. U.S. real GDP is expected to grow 2.9% in 2018, outperforming its peers. Overall, economic data remains firm, with headline CPI at 2.7% YoY in August, unemployment at 3.9%, with ISM and other confidence indicators highlighting good sentiment.

The main risk to the USD from the data is that the currency's recent strength has priced in all the good economic news. Indeed, the US economic surprise indices are broadly flat, suggesting that, on the whole, the market is not being fed the better-than-expected data that might be required to encourage further USD buying.

A similar point can be made about US interest rates. The headline level and differential with its peers continue to offer support for USD/G10 pairs. Given that the Fed is expected to hike later this month, again in December and then twice more in 2019, interest rates should prevent any significant weakness in the currency.

However, with those hikes expected and with the ECB starting to sound more confident about Europe's outlook, the focus over the coming months may shift toward the scope for tighter monetary policy in other countries. In addition, slower global growth, due to trade tensions, may undermine expectations of more US rate hikes, as might the prospect of an inversion of the US yield curve and the fear that signals about the chances of slower US growth looking ahead.

EUR – A less pessimistic ECB

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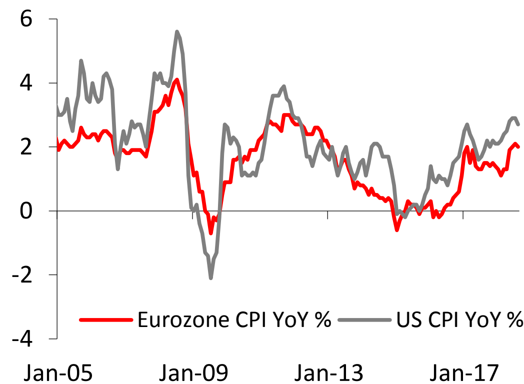
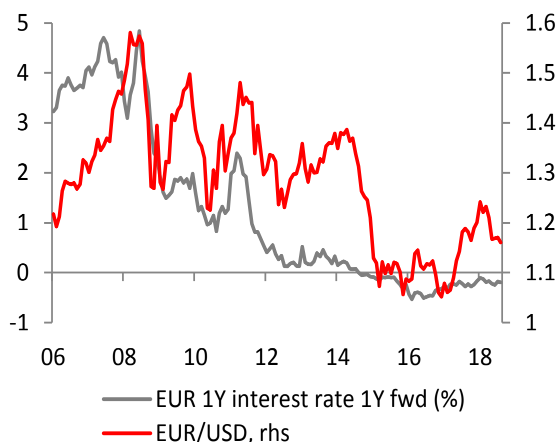
Chart 3: A firm growth outlook and solid inflation seems to be boosting ECB confidence



Source: Bloomberg, Santander

Chart 4: Expectations for a sooner than expected ECB rate hike may have to emerge to allow the EUR to hold on to any future gains



Source: Bloomberg, Santander

We remain upbeat about the EUR over the coming months and into 2019. The currency is still under pressure against the USD, as low risk appetite continues to favour USD strength, but a robust economic outlook for the Euro zone and a more confident sounding ECB, should provide support.

The ECB kept its monetary policy unchanged following the September meeting. However, despite a small downward revision to its GDP forecasts (growth is now expected to be 2% this year and 1.8% in 2019), the Bank's general tone was more upbeat.

The Bank believes that recent data confirm that the economy can look forward to 'ongoing broad based growth'. In addition, it still believes that the risks surrounding the GDP outlook are 'broadly balanced'. The optimistic stance from Draghi et al. took the market somewhat by surprise, given that it had become used to the ECB tending to talk up risks, which would in turn weigh on the EUR.

Further, the Bank's upbeat rhetoric extended to the inflation outlook. The final August CPI data confirmed headline inflation at 2% YoY, with the core rate at 1% YoY. In addition, the ECB kept its forecast for headline inflation unchanged, continuing to estimate CPI at 1.7% in each year through to 2020. Admittedly, the core CPI forecast was cut to 1.5% YoY in 2019 and 1.8% in 2020, but any negative impact on the EUR from this revision was blunted by Draghi's expectation that inflation will increase.

The ECB President highlighted the ongoing acceleration of wages as a reason behind the Bank's confidence that inflation will remain elevated. Moreover, he added that significantly stronger core inflation can be expected.

The Bank also repeated that its asset purchase programme will end by the end of the year, something that we think should be viewed as EUR positive. However, whilst it also reaffirmed that interest rates are unlikely to be hiked before September 2019, the combination of Euro zone GDP growth above 2%, inflation above target and solid economic confidence does not, at face value, indicate an economy that requires its main interest rate to remain at -0.4% for another year.

Hence, if the ECB remains confident about the outlook, the FX market could start to price in an earlier hike in ECB rates. Thus, perhaps, over the coming months, the market may choose to reposition toward the EUR as it focuses on an ECB on the precipice of starting a rate hike cycle and a Fed, whose hiking cycle should be drawing to a close.

The low risk appetite environment should continue to weigh on the EUR. Trade tensions and the impact on global growth are still viewed as USD positive. Although, we reiterate that we do not believe that a protectionist US administration will want the USD to strengthen too much from its current level.

However, on the plus side, EUR specific risk may be abating. The market concern over the Italian budget should come to a head by the end of the month. Comments from the finance minister suggest that Italy will stick to European budget rules, implying a narrower deficit. Hence, Italian yields have declined, with the associated improvement in sentiment helping the EUR.

GBP – A ticking clock

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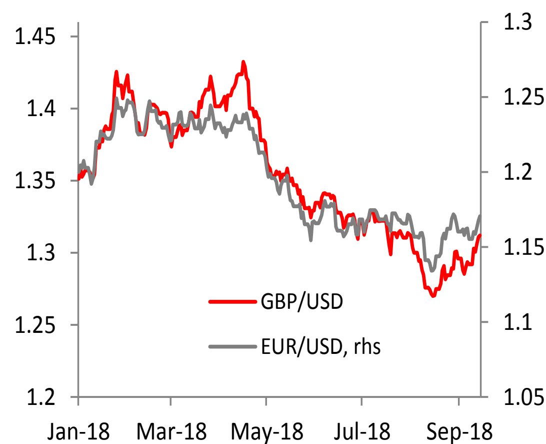
We still feel that the pound is vulnerable to UK political/Brexit uncertainty. The economic data has improved, but the growth outlook remains subdued and we think that the BoE will keep rates unchanged over the coming months. Sterling is also susceptible to the swings in USD sentiment, but with the market already very short GBP/USD, positioning may offer some support in the month ahead.

In order of importance we see five main factors driving the pound over the coming months; 1) Brexit, 2) USD, 3) risk appetite, 4) UK data and 5) BoE. First, the negotiations over the UK's withdrawal from the EU should be coming to some form of conclusion by November. As we highlighted in "GBP and the Brexit countdown – What's in the box?", we think a 'no-deal' Brexit could cause a 7% drop in GBP/USD, with smaller losses posted against the EUR.

However, the FX market still seems to be positioned for a 'deal' outcome. Even though we think this will boost Sterling, we envisage a gain of only around 3.5% against both the USD and EUR. With the UK governing Conservative Party scheduled to hold its conference at the end of September, clearer progress on a deal may not become apparent until the first couple of weeks of October.

Chart 5: Sterling remains vulnerable to Brexit risks, but a softer USD and better data may help…

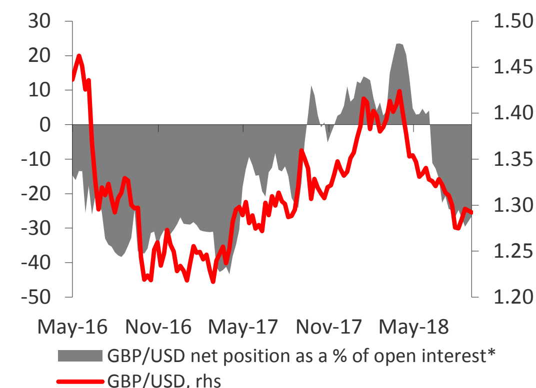


Source: Bloomberg, Santander

The market's view on the USD and risk appetite will also remain very important to Sterling. A strong US economy, the prospect of more Fed rate hikes, as well as safe haven dollar demand, amid emerging market and trade tension concerns, will stay important. Despite the pound's Brexit focus, USD movements explain much of the changes in GBP/USD in 2018. For example, the correlation between EUR/USD and GBP/USD year-to-date is 0.97.

That said, the pound should find some support from market positioning. In our opinion, the pound is already very weak, holding on to much of its post referendum decline. Further, speculators are still holding a considerable net short GBP/USD position. This implies less scope, even if there is the desire, to bet further against the pound, and therefore may offer some support over the coming weeks.

Chart 6: … plus with the market still very short GBP/USD there may be less scope to bet further against the pound



*Open interest = total short and long contracts
Source: CFTC, Bloomberg, Santander

Meanwhile, UK economic data has been a bit more pound supportive. Inflation jumped to 2.7% YoY in August, the labour market remains tight and GBP growth was faster than expected in July. Hence, the BoE now expects growth of 0.5% QoQ in Q3-18, compared to the previous estimate of 0.4%.

Despite the better economic outlook, the BoE kept rates in hold in September, and we continue to expect unchanged interest rates during the months ahead. Although, BoE Governor Carney is reported to have warned the UK government that a 'no-deal' Brexit might lead to higher interest rates in an effort to deal with the expected higher inflation if the pound weakens and tariffs are implemented.

The FX market is sceptical that the Governor will hike rates on a 'no-deal', particularly if it implies a hit to confidence and growth. Anyway, the importance of rate differentials to GBP/G10 crosses has faded recently as the focus has switched to Brexit and/or the USD. Hence, with the pound still vulnerable we would still recommend selling sterling into rallies.

JPY – Risk versus rates

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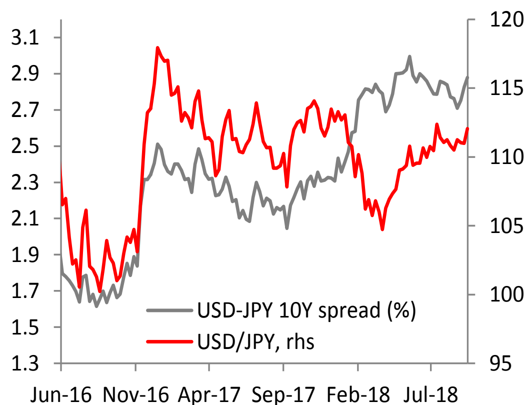
We continue to expect the Yen to weaken. Admittedly, low risk appetite, whether due to trade tensions or emerging market jitters, can be expected to imply that safe-haven demand for the currency, will keep it elevated. But, beyond the current focus on risk, the expectation that the BoJ will continue to run a very loose monetary policy, even after its peers have hiked rates, should imply a steadily weaker yen.

The yen tends to be viewed as a safe-haven currency. Hence, it is unsurprising that the JPY has gained as the market has worried about the impact of US-China trade tensions, and Turkey/Argentina inspired emerging market worries. If these tensions continue, or intensify, the yen should remain firm.

Another bellwether for risk, equity markets, performed poorly in early 2018, which in turn has supported yen demand. Indeed, year-to-date, USD/JPY has moved in line with the Nikkei index (correlation of 0.75 based on weekly data). Hence, the pick-up in Japanese stocks since early September provides some justification for the rebound in USD/JPY to +112 levels.

Further, we can view the US-China trade tension as a double-edged sword for the yen. On the one-hand, by boosting risk aversion, it has strengthened the yen in the short-term. However, if the aforementioned tensions do impact global, and Japanese, growth, it is likely to imply, in the longer-term, a very loose monetary policy, which should be yen negative.

Chart 7: A persistently loose BoJ monetary policy should imply a higher USD/JPY…

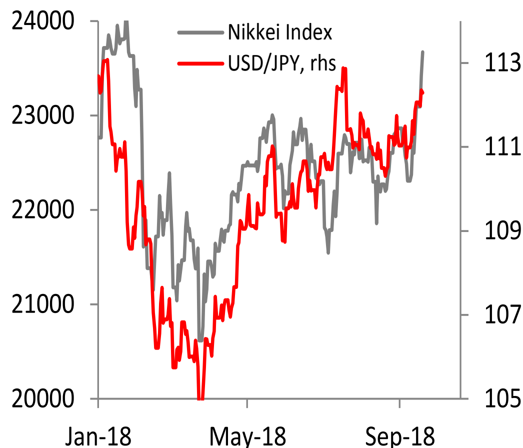


Source: Bloomberg, Santander

The BoJ kept its monetary policy unchanged following its meeting in September. Its asset purchase programme remained untouched, as did the deposit rate, which remains at -0.1%. In addition, the Bank continues to target 10-year yields 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.

At the time, commentators believed that this might be a step toward the Bank winding back on more of its loose policy stance. However, in our opinion, the rhetoric following the September meeting suggests that the BoJ is happy to maintain the status quo, in order to ensure that the yen does not strengthen too much, whilst keeping an eye on the consequences of its policy for the economy and banks.

Chart 8: …risk and equities allowing



Source: Bloomberg, Santander

Further, as the SNB recently suggested, with regard to the CHF, the BoJ may be happy to see other central banks move to a less accommodative stance, helping widen the spread between Japanese and G10 rates and therefore keep the yen under pressure into 2019.

Indeed, the economic outlook continues to provide some justification for the BoJ to continue to err on the cautious side. The bank still envisages only a moderate recovery in Japan. The Q2-18 GDP data was better than expected, growing 3% QoQ annualised, but growth is expected to fall back in Q3. Further, both wage growth and inflation remains sluggish, with headline rate around 1% YoY, compared to the 2% target. In fact it may require a period of above target inflation to convince policymakers that the CPI outlook will be able to deal with a tighter monetary policy, whether that stems from a deliberate removal of some accommodation, or the market pulling the yen higher amid low risk appetite.

CNY – Limited scope for more yuan gains

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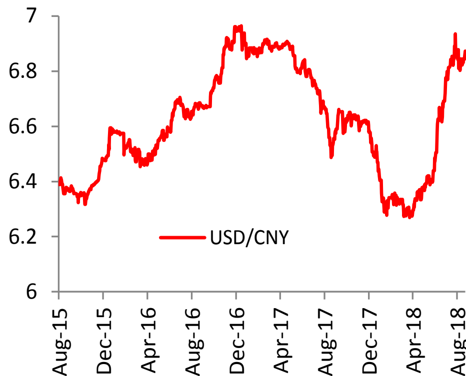
We continue to see less scope for yuan gains. The August high in USD/CNY around 6.95 should continue to offer resistance against even more USD strength. Admittedly, trade tensions between the US and China are likely to remain a risk, and will probably continue to be viewed as USD/CNY positive. However, the sell-off in the CNY since April may have priced in some of these trade risks. Further, Chinese policymakers remain eager to prevent further 'destabilising' yuan weakness.

Chart 9: USD/CNY may have peaked



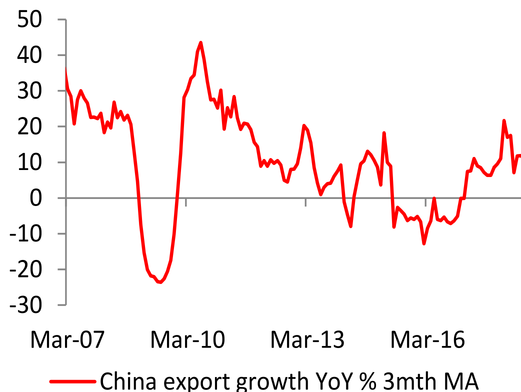
Source: Bloomberg, Santander

The combination of a generally strong USD, low risk appetite, emerging market woes, trade tensions and concerns about China's economic outlook has kept USD/CNY at elevated levels, with support at 6.80, over the last month. However, efforts to keep the pair away from testing the 7 level have been successful, with it failing to re-test the August high, which was just below 6.95.

The confrontation between the US and China over trade, remains a key issue. The US stated in September that it would impose a 10% tariff on a further $200bn worth of Chinese imports. China retaliated by applying tariffs to $60bn of US exports to China. The latter, once again, shows a willingness by China to retaliate on trade without falling back on currency manipulation.

These trade tensions should continue to dominate USD/CNY as, for now, the FX market views them as a USD positive. Hence, even if the long USD/CNY may be maxed out in terms of pricing in trade conflict, the rhetoric is preventing the USD, and USD/CNY weakening. Further, as US economic data remain firm, and even improve, the market has adopted the view that the US is winning these trade skirmishes. Thus, concern about the performance of the Chinese economy is also weighing on yuan sentiment.

Chart 10: Chinese export growth



Source: Bloomberg, Santander

Chinese economic data continue to suggest that economic momentum is slowing. The August CPI edged up to 2.3% YoY, whilst PPI slowed to 4.1% YoY, implying a potential squeeze on firms' margins. Indeed, industrial profits slowed, to a still impressive 16.2% YoY. On the plus side, both manufacturing and non-manufacturing PMIs strengthened in August. Further, whilst export growth slowed below 10% YoY in August, China's trade surplus, both globally and in particular with the US, remains large.

Consequently, Chinese policymakers are still walking a tightrope between their desire to reduce China's debt burden and leverage, whilst at the same time trying to ensure that enough liquidity is available to help growth, and counter trade worries, as well as containing yuan weakness, amid fear that an even weaker currency sparks destabilising capital outflows.

However, aggregate financing, the broadest measure of new credit growth, increased in August, as companies issued more debt. Meanwhile, bank loans slowed, suggesting a reluctance to lend and take on risk. Moreover, Chinese markets are facing another elevated period of liquidity needs. Funding costs tend to jump in September as banks hold back cash for regulatory/tax payment and some PBoC funding is also maturing. Plus, liquidity is also squeezed by officials encouraging the purchase of local government bonds, to shore up infrastructure spending. The dilemma, as earlier in the year, is to meet this liquidity need without weakening the yuan, and undoing the currency's recent stability.

CHF – Up, up and away?

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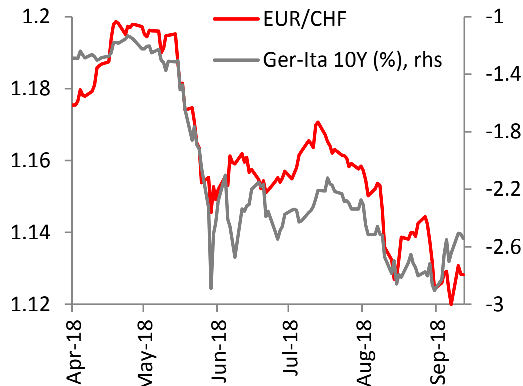
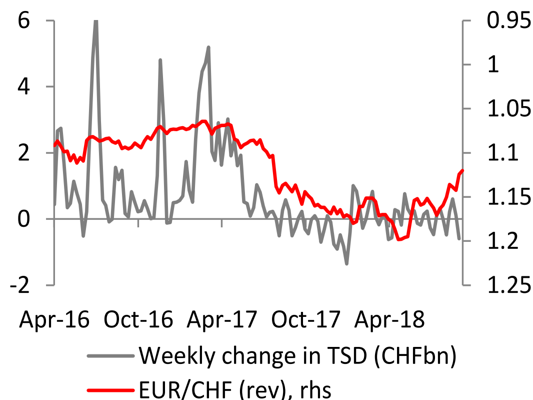
Chart 11: Risk, European or global, still appears to supporting the CHF



Source: Bloomberg, Santander

Chart 12: SNB is still willing to intervene, but maybe not yet?



Source: Bloomberg, Santander

We are still negative on the CHF, but for the foreseeable future the currency is likely to remain propped up by a combination of low risk appetite (boosting demand for the franc as a safe-haven) and improving Swiss economic data, which questions the need for the SNB to maintain such a loose monetary policy.

Global risk appetite has remained a key driver of the Swiss franc. At the start of the year the CHF, which is traditionally viewed as a safe-haven currency, was not benefiting from rising risk aversion amid concern over global trade and its impact on global growth.

Demand for the currency may have been contained by persistent warnings from the SNB that the franc was overvalued and that the Bank would intervene to prevent it strengthening further. In addition, the Bank's ultra-loose monetary policy (the depo rate is -0.75%) would also have made holding the currency unattractive.

However, as the year has progressed, and particularly over the last couple of months, safety-related demand has boosted the franc, sending EUR/CHF to a sub 1.12 low in September. The renewed focus on closer to home European risks, in particular Italy, appears to have been the catalyst pulling the franc higher.

In addition, safety lovers may also have felt less at ease in constantly focusing only on the USD and JPY as safe havens. Hence, as concerns shifted more widely to include emerging market currencies, market participants may have felt it necessary to diversify their safety assets. Given this, it is unsurprising that USD, JPY and CHF are three of the best performing currencies, year-to-date.

Despite the franc's appreciation we can find little clear indication that the SNB is intervening to weaken it. The data for Swiss total sight deposits (TSD), which we view as a proxy for intervention flows, has shown no sustained or significant weekly increases. The apparent lack of intervention may imply that the SNB suspects that given low global risk appetite any effort to weaken the franc might be doomed to failure. In essence, the SNB remains a price taker with regard to the CHF, relying on an improvement in risk and/or stronger EUR, to bring EUR/CHF higher.

The other dilemma facing the SNB is that the Swiss economy is picking up, providing support to the currency, and making some market participants question whether the Bank needs to run such a loose policy. The Swiss economy grew by a faster than expected 0.7% QoQ in Q2-18, Q1's data was revised up to 1% QoQ from 0.6%. In addition, the unemployment rate continues to hover around 2.5%, the manufacturing PMI increased again in August, industrial output grew by a better than expected 8.3% YoY in Q2.

Admittedly, exports dipped 1.4% in July, but so did imports. Hence, Switzerland still runs a healthy trade surplus and has a current account surplus of over 10% of GDP. Plus, inflation remained at 1.2% YoY in August, holding on to the uptrend since early 2016. Despite this we do not expect the SNB to weaken its stance. It still views the franc as 'highly valued, which recent moves will only exacerbate. Given this policy will remain a theoretical CHF negative and we don't expect the Bank to alter policy either before the ECB, or before EUR/CHF strengthens, which might imply no change until 2020.

CAD – Another hike expected in October

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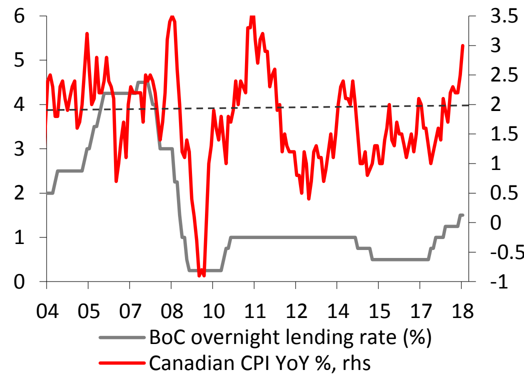
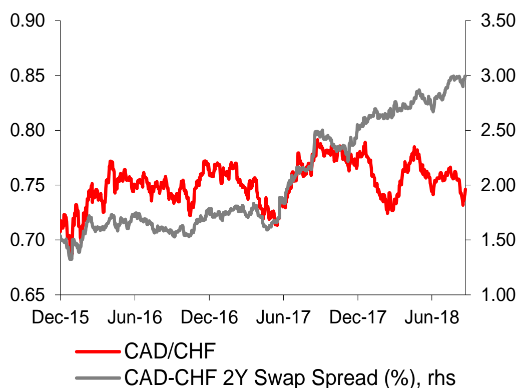
Chart 13: Canada CPI expected to slip from recent high, but above target inflation should keep the BoC on course to hike rates



Source: Bloomberg, Santander

Chart 14: An October rate hike should be CAD positive, although CAD/CHF has been held down by low risk appetite



Source: Bloomberg, Santander

We remain positive on the CAD. Admittedly, trade tension between the US and Canada is likely to continue to constrain the currency against the USD. But fundamental factors remain generally CAD positive. The economy is performing well, inflation is above target and the BoC looks likely to hike rates in October. In addition, a firm oil price should also be providing more support than it has been.

So far in H2-18, the CAD has been the second best performing developed market currency, only pipped to the title by the CHF. Hence, despite the market's concerns about the NAFTA re-negotiations and trade tensions in general, the Loonie has held up remarkably well, even against the USD.

Indeed, looking at the CAD's performance in 2018, it can be seen that the main period of weakness occurred in the first quarter of 2018. Thereafter, in Q2 and so far in Q3, the CAD's returns have been positive. The currency's underperformance in Q1 was due to worries over trade, but also to the Bank of Canada adopting a more cautious/dovish tone, after hiking rates in January.

Hence, the outlook for Canadian interest rates is an important driver for CAD sentiment versus all other developed market currencies. The BoC kept the overnight lending rate unchanged at 1.5%, following its September meeting. However, the Bank's rhetoric suggests, to us, that a rate hike remains likely at the next meeting on 24 October.

We viewed the BoC's September statement as cautiously upbeat. It noted that global and domestic data had been in line with expectations, with lower unemployment and wage gains helping consumption. The Q2-18 GDP data was 2.9% QoQ annualised, lower than consensus, but slightly above the BoC's forecast.

Further, whilst it warned that July's big jump in CPI to 3% YoY was likely to be temporary, inflation is still forecast to stay above the 2% target over the next couple of years. Plus, the Bank hinted at signs of housing market stabilization. We think that this is important as it implies that higher rates may not have too negative a spillover to demand and household debt. Indeed, the Bank noted that the household debt to income ratio was starting to edge lower.

Obviously the Bank highlighted the need to monitor NAFTA developments, and a deterioration in these talks would, in our opinion, be sufficient to delay a rate hike. Although, given the current focus on the trade risks, it may be telling that Deputy Governor Wilkins stated that the Bank had debated dropping the reference to a 'gradual approach' to rate hikes.

The 3 month correlation between CAD/G10 crosses and their respective 2 year interest rate differentials remains very positive. Hence, a rate hike should be CAD positive. The exception, with regard to the correlation, is CAD/CHF, as safe haven demand has allowed the CHF to outperform.

Moreover, our analysis suggests little of the CAD's performance since Q2-18 has been due to the higher oil price. The longer-term, 5 year, correlation between WTI and USD/CAD is -0.9, but over the last year this link has weakened. If trade tensions wane and the CAD is allowed to 'catch up' with recent oil price gains, we estimate that WTI at USD70/bbl implies a USD/CAD closer to 1.23.

SEK – Waiting for more certainty

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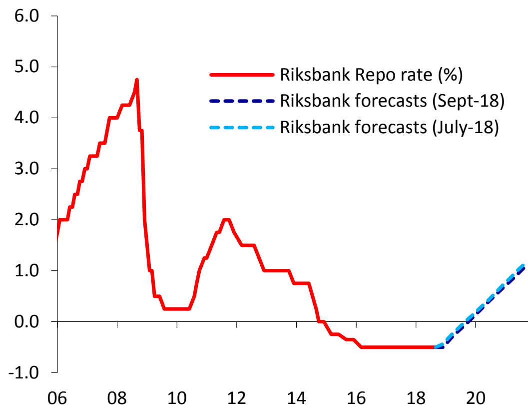
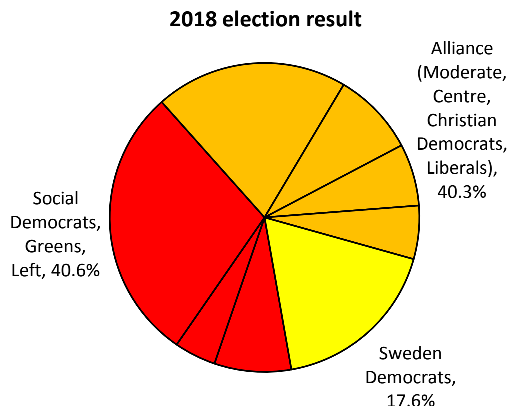
Chart 15: The Riksbank lowered its forecast profile in September, and now forecasts a full 25bp rate hike in either December or February



Source: Riksbank, Bloomberg, Santander

Chart 16: The Swedish election resulted in no clear winner, with the two main blocs tied at around 40% of the vote



Source: Swedish Election Authority, Santander. Note: Remaining 1.5% of the vote were invalid/blank or went to a party that received less than the 4% threshold needed to enter parliament.

We are positive the SEK over the coming year, and see it as too weak at its current level, given the upbeat GDP and CPI data. However, we are neutral the currency in the short term, as significant risks remain for the SEK, as the market awaits more certainty over when the Riksbank will hike rates, and when (and how) a new government will be formed. We continue to forecast EUR/SEK at 9.9 by year-end, but accept the risks are skewed to the upside if election uncertainty drags on and the Riksbank refrains from hiking rates until 2019.

The SEK has underperformed in 2018, with USD/SEK reaching a 20-month high in August, while EUR/SEK briefly touched above 10.7, its highest level since 2009. The SEK has strengthened a little in September, but continues to be the weakest developed market currency this year, down almost 8% against the USD, and 6% against the EUR.

The recent SEK gains have come despite uncertainty on when exactly the Riksbank will hike rates, and when (and how) a government will be formed after an inconclusive election.

At the Riksbank's last meeting, on 6 September, the bank suggested that it would hike rates by a full 25bp in either December or February. While this would still make the bank more upbeat than many of the other developed market central banks (bar the FOMC, BoC, BoE and Norges Bank), it had previously implied that it would hike rates in December.

Deputy Governor Ohlsson again voted for an immediate hike, and Deputy Governor Floden supported hiking rates by 25bp in October. However, the other four executive board members still appear concerned on inflation. Both CPI and CPIF data slipped in August (to 2.0% YoY and 2.2% YoY, respectively). The bank has focused on CPIF excluding energy in recent months. With this measure of inflation dropping for a third consecutive month (to just 1.2%), we see a rate hike before February as increasingly unlikely. While still SEK supportive, a February hike is far enough away to leave the SEK at risk from political uncertainty.

The Swedish general election took place on Sunday, 9 September. The final result showed no clear winner, with both the incumbent Social Democrat-led coalition and opposition Alliance-bloc receiving around 40% of the vote (Chart 16). Support for the Sweden Democrats grew once again, with the anti-immigration party receiving 17.6% of the vote.

The political deadlock was expected, and as such largely in the price, prompting little movement in the SEK. Further, Sweden has not had an outright majority since 1968, so the country is used to coalition and minority governments. Sweden's finances are also in good shape (it has a budget surplus of 1.3% of GDP and a current account surplus of 2.3% of GDP). As such, the market, and the SEK, is likely to remain quite relaxed, for now.

However, the opposition Alliance bloc has suggested it will try to oust incumbent Social Democrat Prime Minister Lofven, once the 2018/19 Swedish parliament (Rikstag) session has opened, on 24 September. While stable finances buy time, the longer political uncertainty weighs on confidence and domestic data, the more persistently it could remain a SEK negative.

NOK – And then there were four

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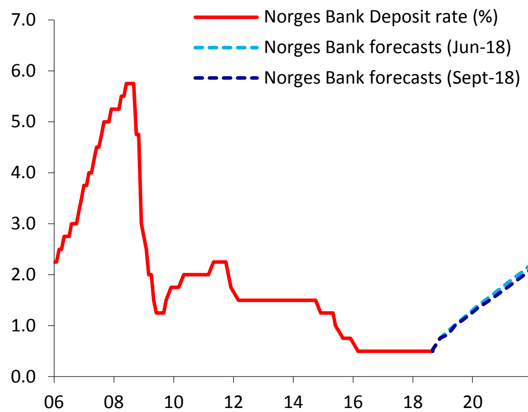
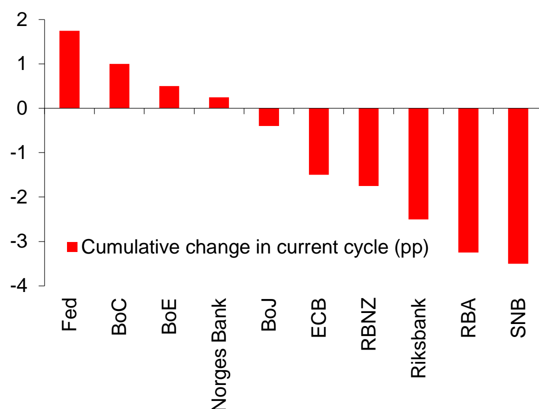
Chart 17: Today (20-Sept) the Norge Bank hiked rates for the first since 2011. But, it surprised by lowering its rate forecast profile slightly



Source: Norges Bank, Bloomberg, Santander

Chart 18: The Norges Bank is the fourth G10 currency central bank to being a tightening cycle



Source: Bloomberg, Santander

We are upbeat the NOK for the remainder of 2018 and into 2019. The Norwegian economy is performing well, inflation is elevated, oil prices are relatively upbeat, and the Norges Bank has now begun a tightening cycle, having hiked rates by 25bp this morning (20-Sept). After a summer decline, the NOK has recovered quite a bit, but we still see scope for further gains in the coming months. We continue to see EUR/NOK falling to 9.3 by year-end. Although the NOK momentum has stalled today, after the Norges bank lowering its interest rate forecast profile this morning.

The Norges Bank hiked rates by 25bp this morning (Thursday, 20 September), taking the deposit rate to 0.75%. This was the Bank's first rate hike since 2011, and the beginning of a tightening cycle, albeit a gradual one.

Governor Olsen has highlighted this move for a while, and so the market was prepared in advance, see Norges Bank prepares for liftoff, published 14 September. As such, the NOK had already strengthened in the run up to this meeting, with EUR/NOK falling to 9.50 ahead of the meeting, from above 9.80 just two weeks previously.

The Norges Bank has previously stated that while underlying inflation has been lower than the target, rising capacity utilisation implies an increase in price and wage inflation further out. The latest CPI data suggest that this is indeed the case. In August, headline CPI data rose to 3.4% YoY (a 20-month high, and well above the banks 2% target). Meanwhile, core CPI rose sharply, climbing to 1.9% (from 1.4%), an 18-month high.

However, despite the pick-up in inflation, and to the surprise of the market, the Norges Bank actually lowered its rate forecast profile (Chart 15), albeit only slightly. Indeed, the bank now sees the key policy rate at 1.22 in Q4-19 (1.26 previously) and 1.64 in Q4-20 (1.72 previously). These forecasts are lower than the market was expecting and show the Norges Bank as advocating only a gradual tightening of policy. The NOK reaction to this was to weaken, with EUR/NOK rising to 9.6 on the decision.

The Norges Bank expects to hike rates again in Q1-19. While some of the market may have been positioned for an earlier hike, we do not think this was ever likely. After two years of unchanged rates, there is no need to rush the first few hikes.

The FOMC, BoC and BoE have all tightened policy so far this year, making the Norges Bank the fourth G10 currency central bank to begin a tightening cycle. Following its meeting a couple of weeks ago, the Riksbank now looks less likely to hike rates in 2018. In addition, neither the ECB, RBA, RBNZ, BoJ or SNB are likely to start hiking rates until H2-19 at the earliest. Hence, while the market may be disappointed today, tighter monetary policy in Norway should support the NOK in the coming months, with firmer inflation, a still weaker than expected NOK, and improving outlook for investment all supporting the case for additional tightening from the Norges Bank, and further longer-term NOK gains.

AUD – Domestically in limbo

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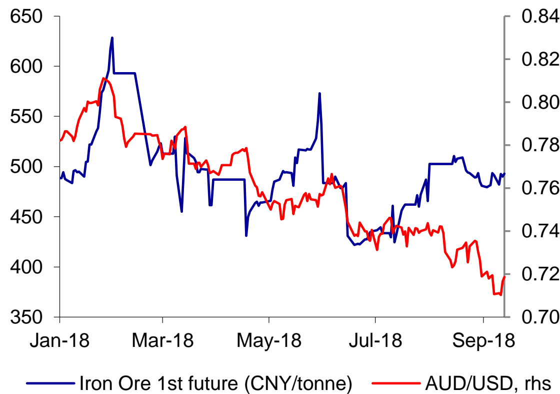
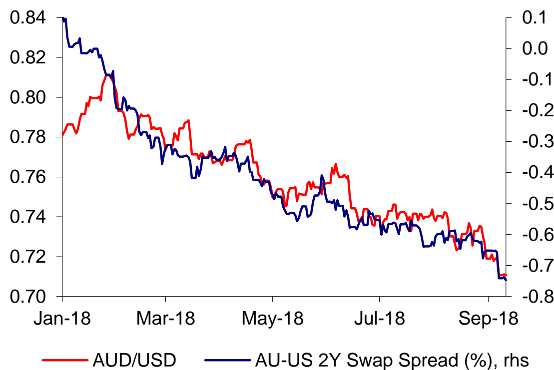
Chart 19: The AUD looks a little too weak given iron ore prices…



Source: Bloomberg, Santander

Chart 20: …although interest rate differentials suggest the AUD/USD depreciation is correct



Source: Bloomberg, Santander

We are mildly positive the AUD for the remainder of 2018. CPI data remain below target and rates are almost certain to be unchanged until 2019. Meanwhile, domestic politics are an AUD negative, with a change in government in August, and an election due in 2019. Global risk sentiment, and the USD, have dominated AUD/USD direction in recent months, and will likely continue to do so. However, GDP data have picked up, and the AUD has already fallen sharply in 2018. With the speculative AUD position already very net short, we see scope for some near-term upside, and continue to forecast AUD/USD at 0.77 by year-end.

Iron ore is Australia's largest export, and so movement in the iron ore price tends to have more than a minor impact on the Australian currency. For much of this year, that has been the case, but over the past couple of months AUD/USD appears too weak given the iron ore prices (Chart 19).

One potential reason for this is that global risk sentiment, and the USD strength, seem to be playing a greater part in leading the AUD than domestic factors. Global trade fears, for example, (especially between the US and China – Australia's largest trading partner), have had a positive impact on the USD, and a negative impact on the AUD, weighing on the pair. Global risk sentiment and trade headlines are likely to continue to have an important impact on the AUD/USD in the coming months.

Monetary policy has also played its part in encouraging AUD/USD lower. With the FOMC set to hike rates by 100bp over the coming 12 months, and the RBA likely to keep rates on hold during this time, the AU-US rate differentials have moved against the AUD (Chart 20). While the FOMC hikes should now be mostly in the price, the RBA is still a long way from offering the AUD any support from tighter policy. Even without action from the RBA, three of Australia's big four banks have lifted their variable mortgage rates over the past month, citing increasing funding costs. This should act to push an eventual RBA rate hike even further into 2019.

Domestic data have been mixed in Australia over the past month, with strong jobs data in August and firmer Q2-18 GDP data contrasted sharply by a first decline in buildings approvals data this year and the largest fall in capital expenditure in two years in the second quarter.

Prime Minister Turnbull survived a confidence vote in August, but was ousted as leader shortly after (24-Aug) with the majority of MPs voting for a change of leader, with treasurer Scott Morrison becoming the prime minister.

Political uncertainty is usually a negative for the domestic currency. Although, as we discussed in AUD – Another one bites the dust, published on 24 August, no Australian leader has managed to serve out a full term since John Howard's 11-years as prime minister ended in 2007, so in a way, a change now is nothing new for Australian politics. Even with the change in prime minister, there is limited time for Morrison to enact change, as the 2019 Australian general election area due to take place in 2019.

NZD – An EM currency in disguise?

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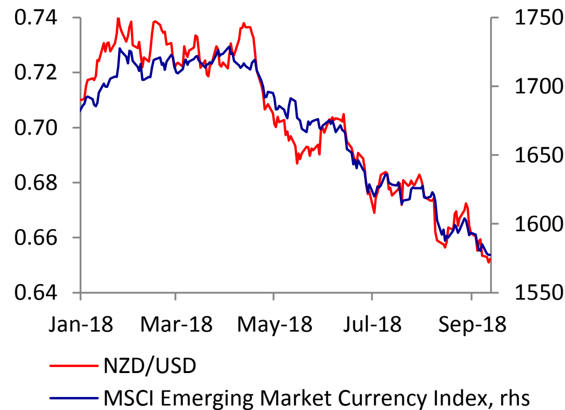
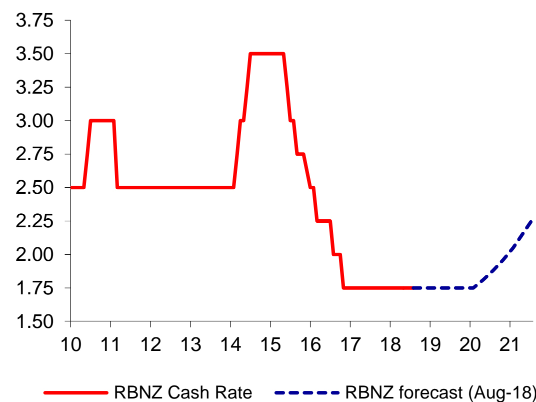
Chart 21: The NZD has performed is line with many emerging market currencies this year



Source: Bloomberg, Santander

Chart 22: The RBNZ does not expect to hike rates for another two years



Source: RBNZ, Bloomberg, Santander

We continue to hold a relatively neutral stance on the NZD. Weaker economic data, below target inflation and a dovish central bank suggest limited short-term support for the NZD, while global trade fears and a strong USD could see NZD/USD continue to struggle. However, with the NZD already weakening considerably in 2018, and the speculative net-short NZD position still close to its record high, there may be less desire to further sell the currency. We still see NZD/USD at 0.68 in Q4-18.

The NZD has continued to creep lower during the summer, with NZD/USD slipping to 0.65 in early September, its lowest level since February 2016. New Zealand specific factors (weak data, dovish central bank etc.) have not helped the NZD, but external factors are perhaps more responsible for this move.

Indeed, the NZD has been trading much like an emerging market currency this year, weakening on trade fears and global risk aversion. Given that China is New Zealand's largest trading partner, it makes sense that a trade war between the US and China, in particular, would be bad for New Zealand's economy, and also the NZD. Even so, the relationship between NZD/USD and the MSCI emerging market currency index has been incredibly strong in 2018, with the two sharing a correlation of 0.97 (Chart 21).

Safe-haven demand for the USD has weighed on the G10/USD pairs, including NZD/USD. If further risk aversion prompts additional USD gains, then NZD/USD would be exposed to further weakness. However, by the same logic, any improvement in global risk sentiment should weigh on the USD, alleviating some of the downwards pressure on NZD/USD.

While the US and China are set to reopen trade talks between the two countries, it is impossible to predict what Trump will do next in the global trade saga. However, we can look at how stretched the FX market is already.

The net long speculative USD composite position is just below a 20-month high. Meanwhile, the net short NZD/USD touched an all-time high in August, and remains at extreme levels. Hence, even if risk sentiment takes a turn for the worse, there should now be more limited scope for this segment of the market to sell NZD/USD aggressively further.

Domestic data have also weighed on the NZD recently, with manufacturing activity volumes falling by 1.2% in Q2-18, its largest quarterly decline in six years. Meanwhile, building permits saw its largest MoM decline in three years in July, while business confidence dropped to a 10-year low in August. GDP data for Q2-18 picked up though, rising to 1% QoQ, and should be a relief to the RBNZ, as Governor Orr said in August that the RBNZ would cut rates if growth slowed further below potential.

The Bank next meets on 26 September, and is almost certain to keep rates on hold, at 1.75%. It is also unlikely to change its stance significantly, having turned more dovish in August, pushing back its forecasts for a first rate hike to Q3-20. Hence, the domestic focus in the month ahead should be on the Q3-18 CPI data (15-Oct).

LatAm FX: Main Themes

Currency	3M view	12M view	Main Themes
BRL	⇨	⇨	• The presidential election is likely to remain the main market driver throughout October, with the run-off election scheduled for October 27. • Although BRL is apparently already in overshooting territory, the election outcome may lead to portfolio outflows that would probably add to the current weakness. • Conversely, if the market perceives that the next president will commit to prudent economic management and reforms, unwinding of FX hedges may lead to a sharp short-term strengthening
MXN	⇨	⇨	• The Mexican peso is still the currency with the highest return this year among EMs • The Mexican peso has benefited from high real interest rates and other favourable factors that we believe are already priced in • Unless Canada joins NAFTA 2.0, Banxico might have to follow the Fed in October to stabilize the MXN
CLP	↘	↗	• The CLP will remain dependent on the external environment, with the spotlight on trade tensions and copper prices. • The risk scenario remains a pass-through of higher trade war tensions to copper prices, which would affect business confidence, investment, and eventually growth. • In the medium term, and despite the apparent underperformance of the CLP over the last month, we adhere to the view that the peso should eventually regain its strength vs. EM peers, given the lack of fundamental imbalances in Chile’s economy.
COP	⇨	↗	• COP performance risks are tilting upward as the external environment has deteriorated on the back of the escalation of trade tensions. We have revised our forecasts to show this additional pressure and now see COP ending at 3000 USD/COP this year, up from our previous estimate of 2800 USD/COP. • Oil prices remain at high levels and are thus an important buffer for the COP in a risk-off event. • The macroeconomic outlook remains solid, with growth picking up, low and stable inflation and a narrowing of the current account deficit.
ARS	↓	⇨	• Although the Peso has remained volatile, the country risk - as measured by the JPMorgan’s EM Bond Index - has compressed significantly in the last week, while the Merval equity index has jumped more than 24% since its low on August 28. • The trigger for the positive reversal of both the bond and the equity asset trends is the incoming approval of a revisited IMF loan to Argentina. • Once a larger IMF loan is approved, the Peso should start to converge to a more stable ARS38/USD to ARS41/USD range.

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

Source: Santander.

BRL – Bracing for Impact

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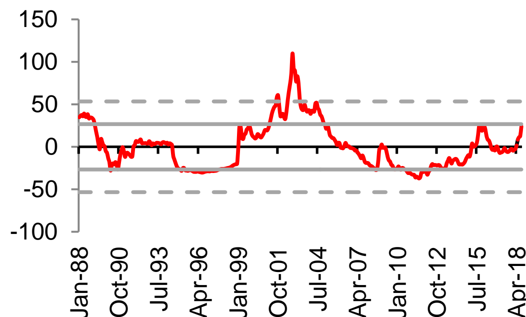
Considering that current market prices in Brazil likely reflect an aggregation of subjective views about the outcome of the October presidential election, we think the BRL is set for a landing after the run-off, scheduled for October 27. That aggregation, in our view, attributes a relatively large likelihood to the election of a non-reformist president, or, with a similar effect, continued uncertainty regarding the implementation of an agenda of fiscal consolidation from 2019 onward. The first-round voting, on October 7, will narrow down the possible scenarios, but whether the BRL's landing will be soft or hard will not become clear until the beginning of cabinet nominations and emergence of more details about each candidate's economic plans, in our view.

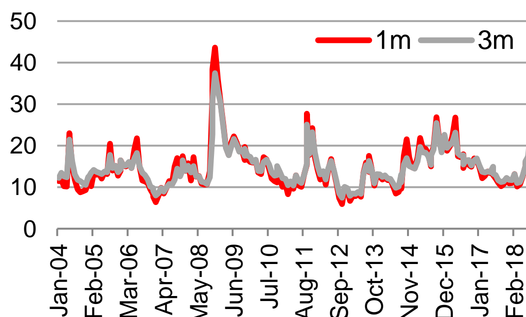
Chart 23: USD/BRL REER, Deviation from Long-Term Average (%)



Source: Brazil's Central Bank, Santander estimates

At 4.13/USD, BRL is less than 2% from a nominal all-time high (at the BCB daily fixing), a possibility we recognized in the August *FX Compass*. This level corresponds with a 24% deviation from the long-term real effective exchange rate average, close to one standard-deviation above it. Since 1988, the currency traded weaker than that level only between 2001 and 2004, during the Argentina default, the sharp spike just before the 2002 elections, and the following strong rally backed by the commodities boom. In other words, BRL looks cheap – especially taking into account Brazil's external position, which in the past 13 years has been better only under a much stronger currency. Nevertheless, that conclusion may change quickly if we relax the assumption that inflation will continue to stick to the target regime. A non-reformist government under tight fiscal constraints may opt for some degree of debt monetization, and it is hard to envision to which terminal level of inflation that process may lead.

Chart 24: BRL/USD ATM Volatility (%)



Source: Santander, Bloomberg

If this scenario of "financial repression" is ruled out after the elections, BRL may experience a relief rally, with the unwinding of FX hedges of BRL-denominated bonds and equities and a lower possibility of sizeable portfolio outflows (cross-border risk indicators, such as the difference between USD-denominated local and LIBOR rates, still show no signs of stress). However, BRL may continue in undervalued territory until the next government delivers more than talk on the reform agenda. Given Brazil's underlying fiscal fragility, BRL will probably continue to be a "high-beta" currency – still differentiated from countries facing imminent or ongoing currency/balance of payment crises, but with a low probability of long-term outperformance, in our view.

Our baseline scenario – the election of a president with indisputably reformist credentials and a rally taking the BRL back to 3.50/USD – now seems considerably less likely than a month ago. In another month we believe we will have more elements for a more solid reassessment, considering that the current conjunction of risks and associated probabilities bears watching, in our view.

MXN – The best performer this year on high interest rates

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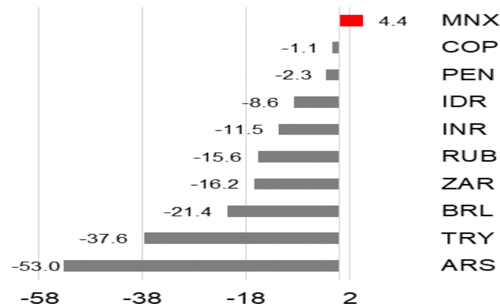
Chart 25: EM FX Performance 2018



Source: Santander, Bloomberg

Chart 26: 10Y Break-Even Inflation Mex (%)

Source: Santander, Bloomberg

Among the emerging markets, the Mexican peso is still the currency with the highest return this year (see Chart 25), albeit with considerable volatility, especially just before and after the presidential election in July. We highlight that while the MXN peaked on June 14 at 20.9, it has appreciated to below 19.0, while the average of EM currencies continued to depreciate, widening the gap between the MXN and the average. Even with the worsening outlook for the Turkish, Argentine, Brazilian, and South African currencies recently, the Mexican peso has proven its resilience.

In our view, the Mexican peso has benefited from high real interest rates, the expectation of decelerating inflation, better prospects for NAFTA, and a political honeymoon between incoming president AMLO and the market. We think that the most favourable of these factors could be already priced in, unless Canada joins a trilateral trade agreement with Mexico and the US, rescuing NAFTA 2.0. This could further strengthen MXN but not create a new trend, in our view.

We believe that Banxico over-hiked its policy rate prior to the presidential election, anticipating a possible negative outcome, so some could argue that with the positive electoral result, the current policy rate is too high. Before the elections, however, it was expected that inflation would end 2018 at 4.0%; now projections point to 4.5%. Mexico hiked rates while other EMs were cutting rates, but some EMs have already begun hiking, and in others anticipation of hikes is building, which is threatening Mexico's comparative advantage.

The release of the last Beige Book pointed towards a tight US labour market and the Fed continuing with gradual rate hikes. The reduction of global liquidity could keep EMs unattractive on a medium-term perspective, pressuring local currencies and leading Banxico to keep real rates high. AMLO's ambitious social and infrastructure spending plans are creating some doubts about medium-term fiscal sustainability, and the market is pricing that risk by widening the break-even inflation linkers (see Chart 26), underscoring our view that AMLO's political honeymoon with the market is already priced in.

In our view, Banxico, understanding the risks to EM currencies and the threat of higher global rates, could hike by 25 bps at its next meeting on October 4th, in line with market expectations. This action, in our view, would further stabilize the MXN in the short term. We think a positive NAFTA 2.0 would offset an eventually stronger US dollar.

CLP – Cheapness exaggerated… but direction looks right

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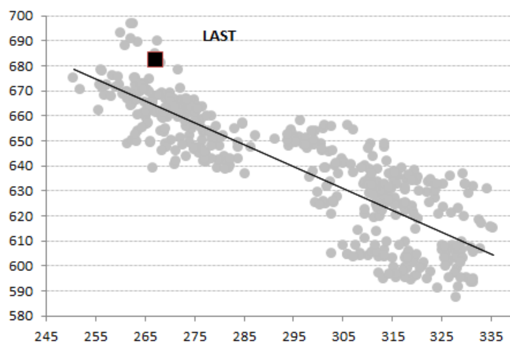
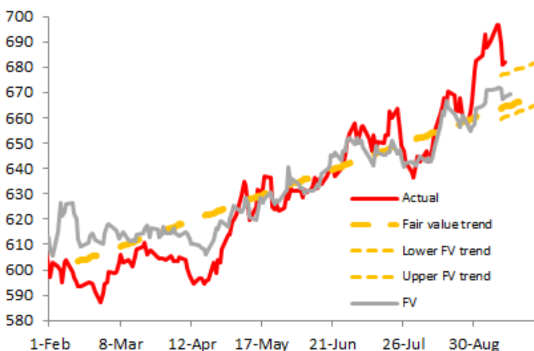
Chart 27: USDCLP vs. Copper prices*



*Nov'16-Sep'18 ; Source: Santander, Bloomberg

Chart 28: USDCLP vs. FV Metrics*



Since : Feb 2018 ; Source: Santander, Bloomberg

The CLP has continued to weaken since mid-August, losing 2.2%, with the USDCLP even breaching the 700 barrier last week. While the performance can be attributed to the contamination of deteriorating external conditions, evident when comparing the performance of our broad EM FX and commodity FX basket, which lost 1.2% and 0.4%, respectively, in the same time period, CLP underperformance intensified, with copper again the main culprit, falling by 3.5% and settling currently in the US$2.60-2.70/lb range.

Despite all the external negativity, local news flow was positive. Growth continues to hold up favorably, with July's IMACEC ending at a respectable 3.3% y/y, beating market consensus at 2.9% y/y. This in spite of preliminary activity releases (mining, manufacturing output, and retail sales) much weaker than expected, as services offset those apparent underperformances.

On inflation, August's CPI print coincided with market consensus at 0.2% m/m and 2.6% y/y. Core inflation in turn came out at 0.0% m/m and 1.9% y/y. Compared with previous months, annualized headline inflation conditions remain unchanged, despite the abrupt CLP depreciation witnessed over the last couple of months. Core tradable prices continue to hold up well, while all components uncorrelated with the FX cycle (around 20% of overall CPI, as per our estimates) posted a 2.2% y/y rise, stable and supportive of the notion that local factors remain well anchored, in line with the labor market, with a gradual convergence of core inflation to 3.0%.

Regarding monetary policy, we saw important developments. September coincided with the most anticipated Monetary Policy Report (IPoM) of the year, given the BCCh's need to state the end of the expansive cycle, and in the process shed some light on the pace of hikes looking into 2019. The BCCh's approach was surprisingly hawkish, starting with a 2018 GDP range pushed up to 4.0-4.5%, while 2019 projections were left unchanged at 3.25-4.25%. The latter indicates little concern from the BCCh on medium-term repercussions of EM turbulence and global trade concerns, as cutting 2019 GDP forecasts would have been a subtle indicator of concern looking ahead. BCCh also considers that after strong growth in 1H18, there is no more spare capacity in the overall economy, a sign to us that the decision to tighten has been made. Given these developments, it is now a question of whether the first hike will be in October or December, with upcoming September CPI a key input.

For USDCLP, despite positive local news flow, the FX continues to price in external vulnerability and could continue to do so in the short term. We still anticipate a strong USD, as positive news flow in the US economy should continue in the medium term. That said, our fair value metric continues to point towards excessive CLP underperformance, which could eventually adjust towards fundamentals, subject to improving regional conditions, with risk factors continuing to be political tensions in Brazil and trade war concerns creeping up once again in external markets.

COP – Back to the 3000 level

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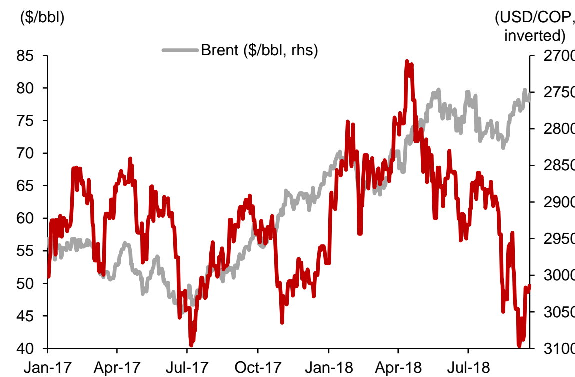
Since our last FX Compass (published on August 23) the risk-off environment exacerbated with EMFX losing ground and depreciating 2.8% by the first 10 days of September. During this period COP underperformed its peers as it depreciated 3.7%, reaching 3100 USD/COP during the intraday session, the weakest level since November 2016. Part of the temporary underperformance in the COP can be explained by estimated outflows of US$0.9 bn due to EMBI rebalance where Colombia's weight in the GBI-EM Global Diversified index decreased by 14 bps.

Since the second week of September pressures from the external environment moderated after Turkey and Russia's monetary policy adjustments, providing some relief to EMFX (+1.1%). During this period COP appreciated 2.4%, getting close to the 3000 USD/COP level. In addition to some improvement in the EM sentiment, COP's recent strength also reflects a moderate decline in USD (-0.7% measured by BBDXY) and an increase of 2.1% in Brent prices, which reached levels close to 80$/bbl. Year to date COP remains among the best performances among EM and Latam peers, although it hast lost around 1.0% since the end of last year.

Despite the recent relief in the external environment, we believe that the COP risks remain to the upside, as trade tensions between China and the U.S. continue to escalate and there is no clear end to a resolution, thus increasing the risk of lower global growth. Additionally, higher U.S. rates on the back of the U.S.'s normalization in monetary policy could continue to provide support for the USD, adding more pressure to EMFX overall. We are revising our forecasts to reflect this additional pressure, and now see COP ending at 3000 USD/COP this year, up from our previous estimate of 2800 USD/COP. We consider, however, that high oil prices will continue to serve as a buffer against a risk-off event, and we continue to stress the positive macroeconomic outlook with growth picking up, low and stable inflation and a narrowing of the current account deficit.

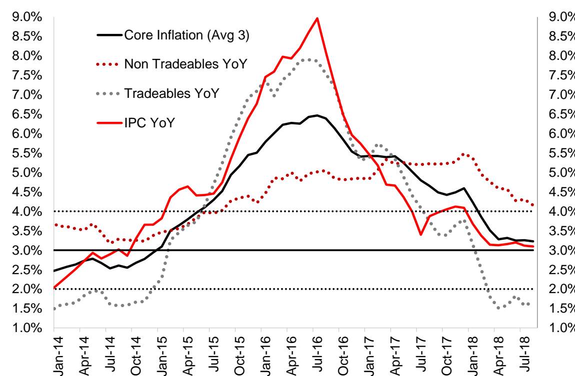
For 2019, the COP may gain some ground, as we expect the Central Bank to increase monetary policy interest rates by 100 bps and thus increase the spread against U.S. rates, which currently are at its lowest levels in the past decade, proving some additional support to the currency. In the short term, however, we expect BanRep to remain on hold until the end of this year, given that inflation remains close to the target. The recent depreciation has not created significant pressures on inflation. In fact, headline inflation decreased to 3.10% in August from 3.12% in July, moving close to the 3.0% target. In coming months, however, we expect inflation to jump back up slightly and to end the year at 3.3%, partially due to statistical base effects. In 2019, however risks to inflation are adding up, with weaker COP putting pressure on gasoline prices, the possible increase in the tax base and in minimum wage, and the risks associated with el Nino, which typically affects food inflation in the first months of the year.

Chart 29: High oil prices remain an important buffer



Source: Santander, Bloomberg

Chart 30: Inflation under control in the short-term



Source: Santander, DANE

ARS – Pros and cons affecting the long-awaited peso stability

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The Argentine peso has depreciated more than 50% in 2018 as a result of a US dollar increase of 113% this year.

Interestingly, although the peso remains volatile, moving in a downward trend, sovereign bonds and local equities have rallied in September.

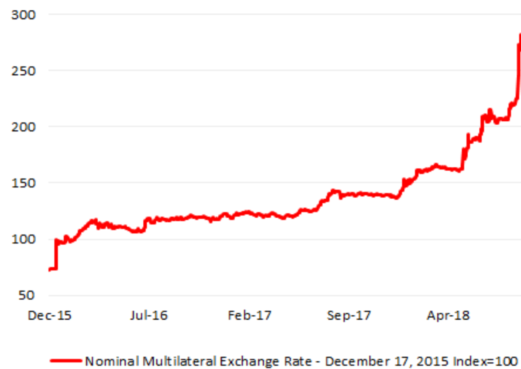
The country risk, as measured by the JPMorgan's EM Bond Index, has compressed by more than 120 basis points from an 800 bps cyclical peak, while the Merval equity index has jumped 24% since its low at August 28.

The trigger for the positive reversal of both the bond and the equity asset trends was the announcement of negotiations between the Argentine government and the IMF, through which both parties have been discussing mechanisms to increase the $50bn loan, coupled with faster and larger disbursements, to fully cover the sovereign's financial needs until the end of the Macri administration in December 2019.

Local economists estimate an inflation rate of more than 40% this year, while projecting that the economy will shrink by more than 2% in 2018.

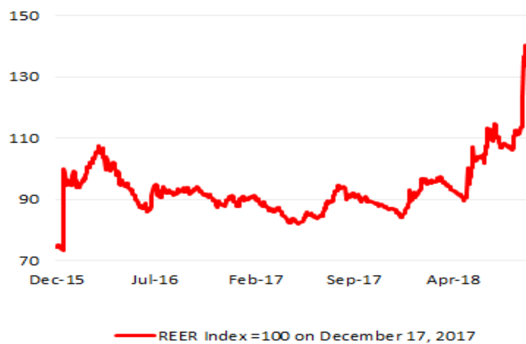
In order to attempt to forecast when the desired peso stability will materialize, we discuss below the pros and cons involved in reaching a more stable FX quotation.

Chart 31: The peso – one of the most depreciated EM currencies



Source: Santander, BCRA

Chart 32: A highly competitive real multilateral exchange rate -REER- has emerged



Source: Santander, Bloomberg

Pros

- The IMF board's approval of a revised IMF loan, which would include an increased amount and larger quarterly disbursements than the original program signed on June 20.
- The highly competitive real multilateral exchange rate – REER – which has reached a peak not seen since 2006.

Cons

- FX impact of further US dollar strength and/or FX contagion due to volatility of the Brazilian *real* associated with the first round of presidential elections on October 7.
- Uncertainty about whether the Argentine Congress will approve the 2019 budget bill, taking into account that the ruling party lacks a majority in either of the two houses of Congress.

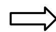
Based on the weight market participants give to the pros and cons in the coming weeks, the peso could converge to a more stable ARS38/USD to ARS41/USD range or not.

Our baseline scenario assumes that the peso's convergence to a narrow range, as described above, will finally materialize in the days to come.

However, we warn investors that in the last FX Compass we did not foresee any factors that could explain the 26% peso depreciation recorded in August.

CEE FX: Main Themes

Currency	3M view	12M view	Main Themes
PLN	↗	→	• After a positive July, August saw sentiment towards emerging markets deteriorate as the tensions between the US and Turkey intensified. However, the zloty did not depreciate much and we are leaving our EUR/PLN forecasts unchanged.
CZK	↘	→	• The Czech koruna was the best performing CEE currency in August as it was boosted by rate hike talk. We assume EUR/CZK could rise slightly by year-end amid profit-taking after the recent rally, as the market has already priced in the expected rate hikes.
HUF	→	→	• We maintain our short-term scenario of a forint appreciation, thanks to better sentiment towards CEE currencies. Over a longer term horizon, we still see a depreciation of the Hungarian forint as a reaction to the expected slight deceleration of Euro zone GDP growth in 2019E.
RUB	→	↗	• We think that the next interest rate hike in the US (expected at the end of September), as well as the still unstable global market situation, will interrupt the RUB's appreciation in the short term. At the beginning of the next year we expect USD/RUB to increase, thanks to the CBR interest rate hikes (fueled by inflation growing at more than 5% y/y in 2019E).

Bullish Mildly Bullish  Neutral Mildly Bearish Bearish

Source: Santander Bank Polska S.A.

PLN – Fairly stable

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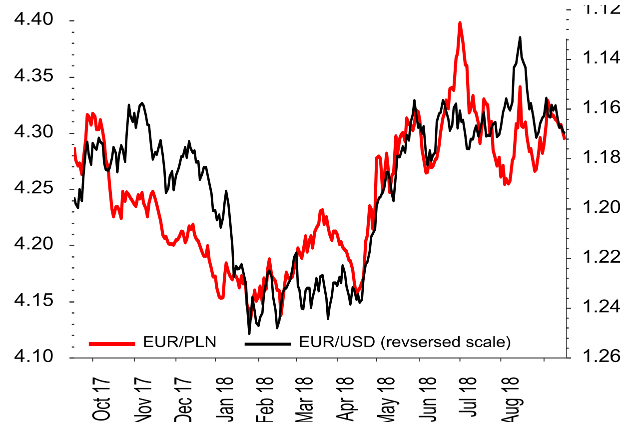
Chart 33: EUR/PLN and EUR/USD



Source: Thomson Reuters Datastream, Santander Bank Polska

After the positive July, August saw sentiment towards the emerging markets deteriorating as the tensions between the US and Turkey intensified. However, the zloty did not depreciate much and we are leaving our EUR/PLN forecasts unchanged.

Overall, the summer months have been pretty calm on the Polish FX market and we saw the zloty performing better than in the previous years during this statistically negative period. Last month, we suggested this could be the case, and the August rise of 0.79% was below the average increase of 1.4% in the previous 13 years. When compared to its EM peers, from early August until mid-September, the zloty was among currencies that suffered the smallest losses.

We think there is still a little room for the Polish currency to gain in the remainder of the year. The internal environment should be at least neutral (with domestic economic data showing only a gradual slowdown) while the external one could provide some support (mainly through higher EUR/USD). In the short term, however, the room for a lower EUR/PLN looks to be limited.

All the turmoil on emerging market currencies, plus the protectionist rhetoric, do not create an environment that could strengthen the zloty. The positive side to this is that much of this should already be priced-in. The zloty was quite resilient to the Turkish lira, Brazilian real and Argentina peso meltdown as well as to the sharp reaction of US Treasuries after the strong August NFP report.

Poland looks to be pretty resilient to any contagion of the crisis in Turkey, at least regarding the economic links. Turkey is not a top Polish trade partner, with mere 1.4% share in exports and 1.0% share in imports. Poland's major trade partners also do not have high exposure to Turkey, so indirect links are not so strong either. Polish FDI in Turkey amount to €271mn and Turkish FDI in Poland is €77mn, numbers that look totally insignificant (<0.1% of totals, based on data for 2016).

The market expects the FOMC to hike interest rates in September but since this scenario is already priced in, we do not expect the decision to pressure the zloty. At the same time, the ECB has just confirmed that bond purchases will cease later this year, which boosted the euro. In the base case scenario, we still expect EUR/USD to move higher in the months to come, which should generate downside pressure on EUR/PLN, should the correlation between these exchange rates hold.

CZK – Needs new positive factors

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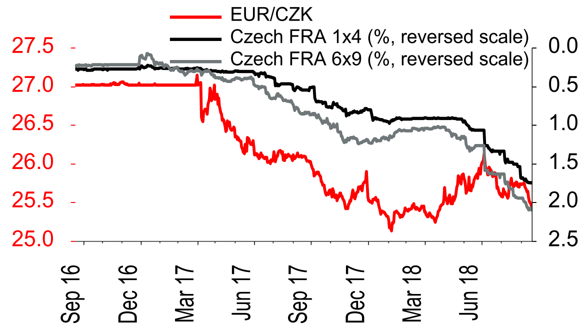
Chart 34: EUR/CZK and Czech FRA rates



Source: Thomson Reuters Datastream, Santander Bank Polska

The Czech koruna was the best performing CEE currency in August thanks to the boost from rate hike talk. We assume EUR/CZK could rise slightly by year-end amid profit taking after the recent rally as the market has already priced in the next rate hikes.

In mid-September, EUR/CZK fell to nearly 25.4 (its lowest since April), with the downward trend being driven by solid macro data that beat expectations. The robust economic performance was commented on by the Czech central bankers, with Governor Jiri Rusnok saying that next rate hike could take place in September. The main central bank rate now stands at 1.25% after the 25bp rate hike in August.

The Czech economy shows no signs of slowing, with monthly retail sales and industrial output data well above forecasts. However, German hard economic activity data have not looked good in recent weeks and this could finally start to take its toll on the export-oriented Czech economy.

Czech FRAs are now pricing in one 25bp rate hike to be announced this month and a second to be delivered by March. Thus, it seems that only comments suggesting the monetary policy normalisation could proceed faster may support the CZK.

HUF – Stronger, but probably only temporarily

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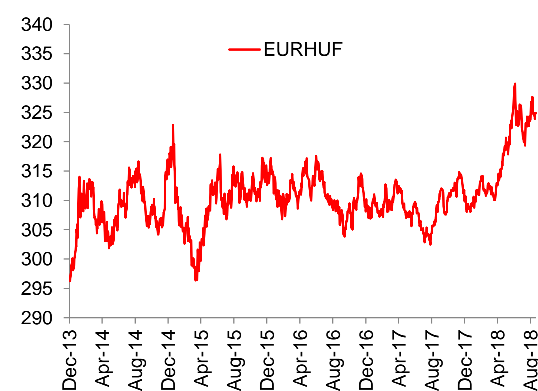
Chart 35: EUR/HUF



Source: Reuters, Santander Bank Polska.

In the second ten days of September the forint recovered after a strong sell-off at the end of August, fueled by weakening sentiment for EM currencies. The initial EUR/HUF fall was supported by improved sentiment towards CEE markets (as a reaction to the easing of tensions related to the trade war) and the positive surprise of projected Hungarian budget bill for 2019. Moreover, the forint was supported by Moody's comments that Hungary's tighter mortgage lending rules, introduced by the central bank, were credit positive for the country. As a consequence, at the end of the second ten days of September the EUR/HUF returned to the levels last seen before the late August sell-off (c323) and at the beginning of September EUR/HUF tried to reach 328.

In a 4-5 week perspective, we expect EUR/HUF to stabilise close to the current level or a little higher (323-324). We believe that the last central bank communique about gradual normalisation of ultra-loose monetary policy (the decision to end mortgage bond buying) is fully priced in to EUR/HUF. Similarly we think that positive impact of the last strong macro data (PMI, GDP) on EUR/HUF has already been exhausted.

Thus, in the coming weeks we expect some profit-taking on the last HUF gains. This scenario may be supported by expected weaker Euro zone and Hungarian PMI data (in our opinion the positive surprise of the August Hungary PMI reading was the one-off).

In the longer term, we maintain our scenario of a temporary HUF appreciation in 1Q19 (supported by stronger macro data) followed by a weakening at the end of the year in reaction to the expected slight deceleration in Euro zone growth.

RUB – Rate hikes support RUB

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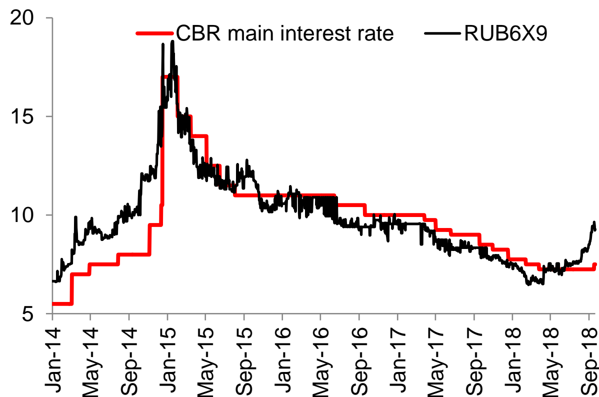
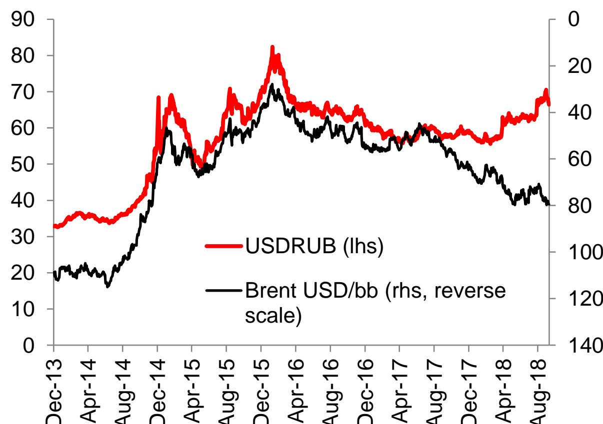
Chart 36: RUB FRA rates



Source: Reuters, Santander Bank Polska.

Chart 37: USD/RUB and oil prices



Source: Reuters, Santander Bank Polska.

Over the last month, we observed the USD/RUB rising. The ruble depreciation was fueled by the US and the UK calling for fresh sanctions against Russia. Furthermore, investors were nervously reacting to remarks of the Russian Central Bank (CBR) Governor Elvira Nabiullina about the possibility of interest rate hikes, while at the same time, Prime Minister Dmitry Medvedev called to cut interest rates. Moreover, data released for the industrial sector negatively affected the Russian currency.

In August, PMI manufacturing rose to 48.9pt from 48.1pt (against a 49.3pt market forecast). However, the PMI index stayed below the neutral level of 50pt for the fourth month in a row. Those figures negatively affected the ruble, despite the rise in oil prices.

In the first ten days of September, the ruble appreciated sharply, thanks to the 25bp interest rate hike to 7.50% and the central bank decision to suspend foreign currency buying. As a result, USD/RUB returned to the level of the end of August (66-67).

In the next four to five weeks, we expect USD/RUB to return to 68-69. In our opinion, the upcoming macro data may still show the deterioration of industry activity and some weakening of exports. Furthermore, we believe that the unstable situation in the global financial markets (where we anticipate further increases in yields and short-term rates, especially USD) may negatively affect the ruble, due to the high level of debt in USD of Russian companies.

The perspective of more interest rates hikes by the CBR may keep USD/RUB below 70. Currently, market players are pricing in a 150bp interest rate hike in the next six months. The communique accompanying the last interest rate hike said that the central bank could raise rates by more, anticipating an inflation increase in Russia (to c4.0% in December 2018 and to 5.0%-5.5% in 2019).

We believe that a scenario of higher inflation (besides the VAT rate increases planned for 2019) will be supported by a visible improvement in household real income dynamics as well as real wage growth. In July, real household income rose by 1.5% y/y, having entered positive territory at the beginning of 2018. These increases were accompanied by a solid rebound in retail sales (seen since mid-2017).

In the next three months, we expect USD/RUB to stabilise at 69-70. In the next 12 months, we anticipate a gradual strengthening of the Russian ruble as a reaction to interest rates hike by the CBR and an expected improvement in global financial market sentiment towards emerging market currencies.

G10 FX: IMM Speculative Positioning

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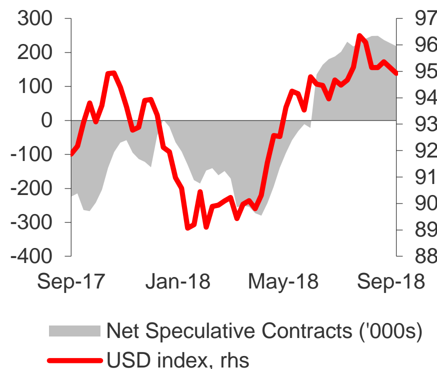
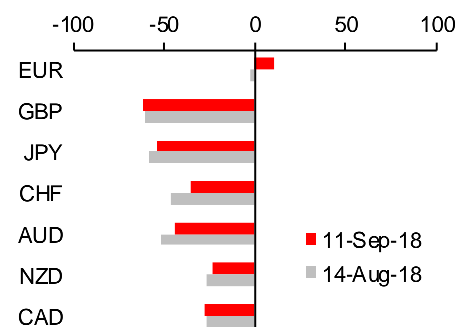
IMM commitment of traders report: USD composite position



- **The net long USD composite position has fallen slightly,** over the past four weeks, but speculators are still upbeat the USD, and remain net short most of the other developed market currencies against the USD, with the prospect of four rate hikes from the FOMC over the next twelve months keeping the USD firm.
- **The net long EUR position is the exception.** While speculators are net short the GBP, JPY, CHF, AUD, NZD and CAD, they held a small net long EUR position in the week ended 11 September. Although, this position reflects a neutral stance on the currency.
- **The net short CHF position has seen the largest move over the past month,** dropping to 35k contracts (from 46k contracts) as risk aversion has seen the CHF strengthen.
- **Speculators retain large net short AUD and NZD positions,** given risk aversion and a sell-off in risk currencies over the summer. However, these positions improved slightly in September, with the net short AUD and NZD positions falling to 44k and 23k contracts.
- **The net short GBP position is still substantial (61k contracts).** The risk of a no deal-Brexit pulled this position down to 77k contracts in late August, but an increase in expectations of a Brexit deal has since seen the position return to 61k contracts.

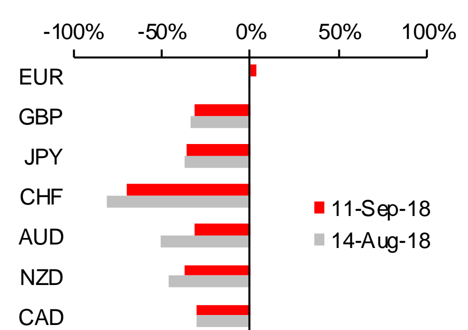
Net Speculative Contracts ('000s)*

	11-Sep-18	14-Aug-18	4w chg	YtD chg
USD***	218.6	240.3	-21.7	216.0
EUR	11.2	-1.8	13.0	-81.0
GBP	-61.2	-60.7	-0.4	-73.9
JPY	-53.9	-58.4	4.5	62.2
CHF	-35.4	-45.8	10.5	-21.4
AUD	-44.3	-51.8	7.5	-30.7
NZD	-22.6	-26.7	4.0	-5.1
CAD	-26.9	-26.2	-0.7	-44.3



Net Speculative Contracts as % of Open Interest**

	11-Sep-18	14-Aug-18	4w chg	YtD chg
USD***	18%	20%	-1%	18%
EUR	4%	0%	4%	-25%
GBP	-32%	-34%	2%	-41%
JPY	-36%	-37%	1%	21%
CHF	-70%	-81%	11%	-52%
AUD	-31%	-50%	19%	-16%
NZD	-37%	-46%	9%	-4%
CAD	-31%	-30%	-1%	-56%



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

Sep-14 Sep-15 Sep-16 Sep-17 Sep-18

Z-score USD/BRL

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

USD longs

2, 1, 0, -1

Sep-14 Sep-15 Sep-16 Sep-17 Sep-18

USD/MXN

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

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

Sep-14 Sep-15 Sep-16 Sep-17 Sep-18

Z-score USD/MXN

Z-score (USD/MXN longs) — 10-90%

USD longs

2, 1, 0, -1, -2

Sep-14 Sep-15 Sep-16 Sep-17 Sep-18

USD/CLP

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

30, 20, 10, 0 | 750, 700, 650, 600, 550

Sep-14 Sep-15 Sep-16 Sep-17 Sep-18

Z-score USD/CLP

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

USD longs

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

Sep-14 Sep-15 Sep-16 Sep-17 Sep-18

USD/PEN

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

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

Sep-14 Sep-15 Sep-16 Sep-17 Sep-18

Z-score USD/PEN

Z-score (USD/PEN longs) — 10-90%

USD longs

3, 2, 1, -1, -2

Sep-14 Sep-15 Sep-16 Sep-17 Sep-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	-0.59	-0.60	-0.55	-0.40	-0.20
2y	-0.53	-0.40	-0.20	0.00	0.20
5y	-0.10	0.05	0.30	0.55	0.75
10y	0.48	0.70	1.00	1.25	1.40
30y	1.14	1.35	1.55	1.70	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	-0.30	-0.28	-0.17	-0.01
2y	-0.13	0.00	0.15	0.30	0.50
5y	0.36	0.50	0.70	0.90	1.10
10y	0.98	1.15	1.40	1.60	1.75
30y	1.58	1.65	1.80	1.95	2.10

US Interest Rate Forecasts

Government Bond yield Forecasts

US	Current	4Q18	1Q19	2Q19	3Q19
FOMC *	2.00	2.50	2.75	3.00	3.00
3m	2.16	2.40	2.65	2.90	3.00
2y	2.80	3.05	3.25	3.40	3.50
5y	2.95	3.20	3.45	3.60	3.65
10y	3.07	3.25	3.45	3.60	3.70
30y	3.22	3.30	3.45	3.55	3.60

Swap rate forecasts

US	Current	4Q18	1Q19	2Q19	3Q19
FOMC *	2.00	2.50	2.75	3.00	3.00
3m	2.35	2.75	2.95	3.15	3.20
2y	2.98	3.25	3.40	3.50	3.55
5y	3.07	3.25	3.45	3.55	3.55
10y	3.13	3.20	3.40	3.50	3.60
30y	3.14	3.20	3.35	3.40	3.45

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	0.65	0.70	0.70
2y	0.84	0.65	0.50	0.55	0.60
5y	1.19	0.90	1.00	1.20	1.50
10y	1.60	1.35	1.50	1.60	1.60
30y	1.94	1.75	1.80	1.90	2.00

Swap rate forecasts

UK	Current	4Q18	1Q19	2Q19	3Q19
MPC	0.75	0.75	0.75	0.75	0.75
3m	0.80	0.80	0.80	0.80	0.80
2y	1.17	1.10	0.95	0.95	0.95
5y	1.46	1.25	1.30	1.45	1.70
10y	1.68	1.50	1.65	1.70	1.70
30y	1.77	1.60	1.60	1.70	1.70

G10 Central Bank Calendar

	Current Rate	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
FOMC (Upper)	2.00	Unch.	-	+25bp	-	Unch.	+25bp	-	Unch.	26	-	8	19
ECB (Depo)	-0.40	Unch.	-	Unch.	Unch.	-	Unch.	Unch.	-	Unch.	25	-	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	1.50	+25bp	-	Unch.	Unch.	Unch.	-	+25bp	-	Unch.	24	-	5
RBA	1.50	-	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	2	6	4
RBNZ	1.75	-	Unch.	Unch.	-	Unch.	Unch.	-	Unch.	26	-	7	-
Norges Bank	0.75	Unch.	-	Unch.	-	Unch.	Unch.	-	Unch.	+25bp	25	-	13
Riksbank	-0.50	-	Unch.	-	Unch.	-	-	Unch.	-	Unch.	24	-	19

Source: Bloomberg, Santander. Note: Current levels as at 20 September 2018. For meetings that have already taken place, decision identified as +/- in bp, or "unch" for no change. "-" denotes no meeting taking place that month *FOMC rate refers to upper bound rate. **The ECB 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	6.50
NTNF Jan' 19s	6.78	6.50	--	--	--
NTNF Jan.' 25s	11.76	11.50	11.00	10.50	10.50

Government Bond yield

Mexico	Current	4Q18	1Q19	2Q19	3Q19
Banxico fondeo	7.75	8.00	8.00	7.75	7.50
Mbono Jun. '21s	7.93	7.70	7.60	7.40	7.40
MBono Jun. '27s	7.93	7.75	7.75	7.50	7.50

Chile/Colombia Interest Rate Forecasts

Government Bond yield

Chile	Current	4Q18	1Q19	2Q19	3Q19
BCCh TPM	2.50	2.75	3.00	3.25	3.25
BCP 5Y	4.23	4.30	4.30	4.35	4.40
BCP 10Y	4.48	4.75	4.80	4.80	4.85

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	6.11	6.70	6.80	6.90	6.97
TES Apr '28s	6.91	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.	-	4	15	20
Chile	2.50	-	Unch.	Unch.	-	Unch.	Unch.	Unch.	-	Unch.	18	-	4
Colombia	4.25	-25bp	-	Unch.	-25bp	-	Unch.	Unch.	-	28	26	-	21
Argentina*	60.00	-150bp	Unch.	Unch.	+300bp	+975bp	Unch.	Unch.	+2000bp	Unch.	9	13	11

CEE Interest Rate Forecasts

Poland

Poland	Current	4Q18	1Q19	2Q19	3Q19
Reference Rate	1.50	1.50	1.50	1.50	1.50
2y	1.55	1.59	1.58	1.57	1.55
10y	3.22	3.30	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	1.25	1.75	2.00	2.00	2.00
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.	3	7	5
Czech Republic	1.25	-	+25bp	Unch.	-	Unch.	+25bp	-	+25bp	26	-	1	20
Hungary	0.90	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	16	20	18
Russia	7.50	-	-25bp	Unch.	Unch.	-	Unch.	Unch.	-	+25bp	26	-	14

Source: Bloomberg, Santander. Note: Current levels as at 20-Sept-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 = Argentina's monetary policy committee voted unanimously to change the key interest rate to 7-day Leliq rate.

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

	3M	6M	9M
EUR/USD	**1.23**	**1.24**	**1.25**
vs.forward	5.1	6.0	6.8
vs.consensus forecast	6.0	5.1	4.2
GBP/USD	**1.32**	**1.33**	**1.35**
vs.forward	0.1	0.9	2.4
vs.consensus forecast	1.5	0.8	0.7
EUR/GBP	**0.93**	**0.93**	**0.93**
vs.forward	4.9	5.0	4.3
vs.consensus forecast	4.7	4.8	5.2
USD/JPY	**120**	**120**	**120**
vs.forward	6.9	6.9	6.9
vs.consensus forecast	8.1	9.1	10.1
EUR/JPY	**148**	**149**	**150**
vs.forward	12.4	13.3	14.2
vs.consensus forecast	14.4	15.3	16.3
EUR/CHF	**1.22**	**1.23**	**1.24**
vs.forward	7.8	8.7	9.6
vs.consensus forecast	6.1	6.0	6.0
USD/CHF	**0.99**	**0.99**	**0.99**
vs.forward	2.5	2.6	2.6
vs.consensus forecast	0.2	1.2	1.2
EUR/SEK	**9.7**	**9.5**	**9.3**
vs.forward	-6.3	-8.3	-10.2
vs.consensus forecast	-5.8	-7.0	-7.5
EUR/NOK	**9.1**	**9.0**	**8.8**
vs.forward	-4.4	-5.5	-7.6
vs.consensus forecast	-3.7	-3.2	-4.9
USD/CAD	**1.22**	**1.20**	**1.20**
vs.forward	-5.5	-7.0	-7.0
vs.consensus forecast	-6.2	-6.3	-5.5
AUD/USD	**0.79**	**0.80**	**0.79**
vs.forward	8.7	10.0	8.7
vs.consensus forecast	8.2	9.6	6.8
NZD/USD	**0.71**	**0.72**	**0.73**
vs.forward	6.6	8.1	9.6
vs.consensus forecast	7.6	7.5	7.4

	3M	6M	9M
USD/BRL	**3.52**	**3.55**	**3.57**
vs.forward	-14.7	-14.0	-13.5
vs.consensus forecast	-10.7	-8.5	-8.0
EUR/BRL	**4.33**	**4.40**	**4.46**
vs.forward	-10.2	-8.7	-7.4
vs.consensus forecast	-5.3	-3.9	-4.2
USD/MXN	**18.6**	**18.50**	**18.80**
vs.forward	-0.7	-1.3	0.3
vs.consensus forecast	-2.1	-2.5	-0.5
EUR/MXN	**22.9**	**22.9**	**23.5**
vs.forward	4.4	4.6	7.2
vs.consensus forecast	3.8	2.4	3.6
USD/CLP	**680**	**680**	**685**
vs.forward	0.0	0.0	0.8
vs.consensus forecast	0.5	1.3	3.6
EUR/CLP	**836**	**843**	**856**
vs.forward	5.2	6.1	7.7
vs.consensus forecast	6.6	6.4	7.9
USD/COP	**2950**	**2900**	**2850**
vs.forward	-2.6	-4.3	-5.9
vs.consensus forecast	-2.2	-3.5	-5.0
USD/ARS	**43.4**	**45.8**	**48.5**
vs.forward	10.3	16.6	23.3
vs.consensus forecast	12.6	19.0	19.7
EUR/PLN	**4.28**	**4.29**	**4.30**
vs.forward	-0.3	0.0	0.2
vs.consensus forecast	-0.5	0.0	0.9
EUR/CZK	**25.5**	**25.5**	**25.7**
vs.forward	-0.2	-0.2	0.6
vs.consensus forecast	0.0	0.8	2.2
EUR/HUF	**320**	**325**	**325**
vs.forward	-1.1	0.4	0.4
vs.consensus forecast	-1.5	0.2	0.8
EUR/RUB	**85**	**83**	**84**
vs.forward	9.1	6.8	7.7
vs.consensus forecast	11.2	7.5	7.9

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	1.171	1.323	112.23	131.30	147.89	0.966	1.132	1.278
1M	1.174	1.324	111.98	131.49	148.31	0.963	1.131	1.276
2M	1.177	1.326	111.73	131.52	148.19	0.961	1.131	1.274
3M	1.180	1.328	111.48	131.54	148.05	0.958	1.130	1.273
6M	1.190	1.334	110.62	131.59	147.61	0.949	1.129	1.267
9M	1.199	1.341	109.75	131.66	147.13	0.941	1.128	1.261
12M	1.210	1.347	108.84	131.70	146.61	0.931	1.127	1.255

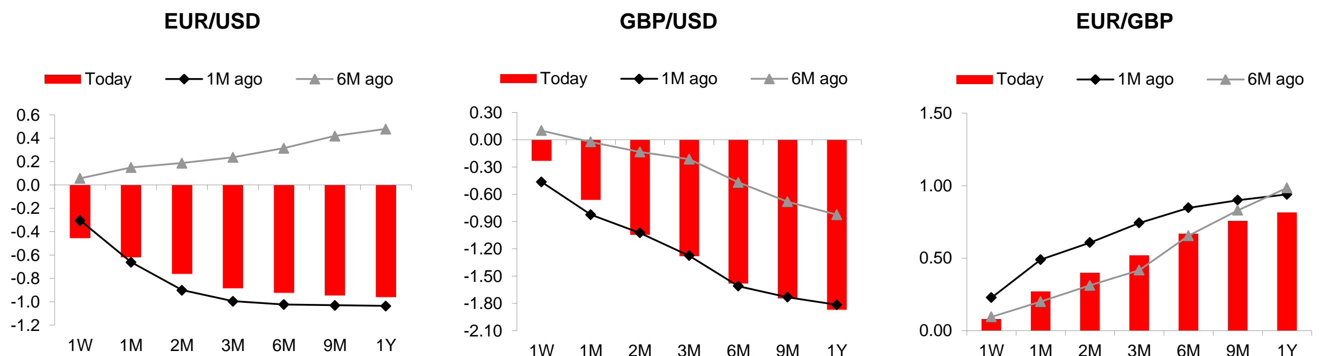
ATMf vol.

	EUR/USD	GBP/USD	USD/JPY	EUR/JPY	GBP/JPY	USD/CHF	EUR/CHF	GBP/CHF
1W	7.1%	9.1%	6.5%	7.6%	9.5%	6.2%	5.1%	7.4%
1M	6.5%	8.5%	6.3%	7.8%	9.6%	5.7%	5.0%	7.6%
2M	7.0%	9.1%	6.9%	8.4%	10.2%	6.1%	5.3%	8.1%
3M	7.2%	9.3%	7.2%	8.6%	10.5%	6.3%	5.4%	8.3%
6M	7.2%	9.3%	7.6%	8.9%	10.7%	6.5%	5.6%	8.5%
9M	7.3%	9.3%	7.9%	9.2%	10.9%	6.8%	5.8%	8.6%
12M	7.4%	9.3%	8.1%	9.3%	11.0%	7.0%	6.0%	8.8%

Implied/realized vol. ratio

	EUR/USD	GBP/USD	USD/JPY	EUR/JPY	GBP/JPY	USD/CHF	EUR/CHF	GBP/CHF
1W	1.02	1.25	1.22	0.92	1.11	1.14	1.06	1.15
1M	0.98	0.98	1.20	1.00	0.97	1.07	1.00	0.97
2M	1.05	1.20	1.23	1.03	1.13	1.19	1.06	1.19
3M	1.05	1.21	1.23	1.08	1.18	1.16	1.10	1.25
6M	1.02	1.23	1.24	1.09	1.20	1.10	1.08	1.24
9M	1.02	1.19	1.16	1.10	1.17	1.03	1.08	1.21
12M	1.07	1.20	1.18	1.18	1.20	1.05	1.12	1.19

25-delta risk reversals



Sources: Bloomberg and Santander. As of 20 September 2018

Latin America FX: Spot and forward rates

	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
Spot	39.31	4.13	680	3029	18.7	3.30
1M	40.56	4.14	679	3031	18.8	3.31
2M	42.00	4.15	679	3037	18.9	3.31
3M	43.56	4.16	679	3040	19.0	3.32
6M	47.98	4.20	679	3053	19.3	3.33
9M	52.36	4.24	679	3068	19.5	3.34
12M	54.90	4.29	679	3085	19.8	3.35

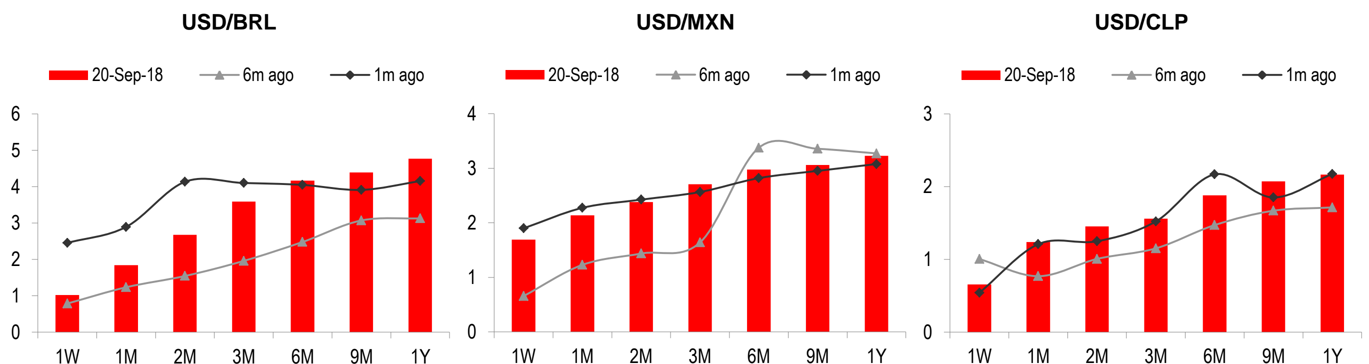
ATMf vol.

	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
1W	9.35	20.51	12.49	13.36	12.70	3.25
1M	10.00	25.39	12.48	13.36	12.23	3.66
2M	11.25	26.94	12.40	13.68	12.72	3.99
3M	12.15	24.02	12.32	13.57	12.87	4.26
6M	14.05	20.31	11.84	13.55	13.10	4.85
9M	15.23	19.01	11.56	13.54	13.33	5.31
12M	16.00	18.23	11.23	13.51	13.52	5.59

Implied/realized vol. ratio

	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
1W	1.20	1.38	2.51	1.91	1.07	1.12
1M	0.19	1.38	1.10	1.16	0.90	0.75
2M	0.27	1.67	1.08	1.30	0.91	0.88
3M	0.35	1.56	1.11	1.35	0.89	1.05
6M	0.45	1.32	1.17	1.18	0.96	1.20
9M	0.58	1.36	1.23	1.20	1.02	1.36
12M	0.70	1.38	1.21	1.30	1.09	1.41

25-delta risk reversals



Sources: Bloomberg and Santander. As of 20 September 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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