24 January 2019, 15:15 GMT

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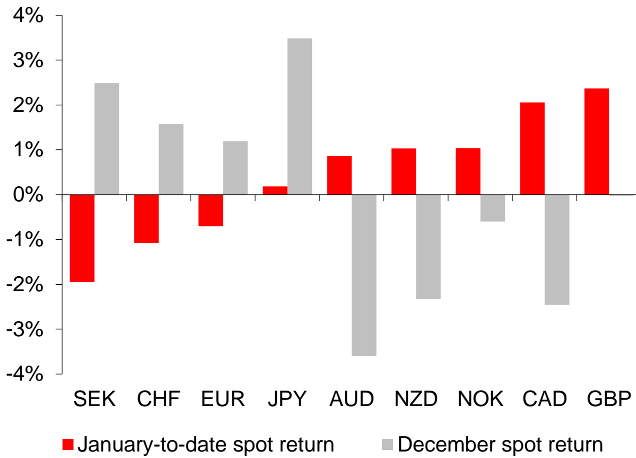
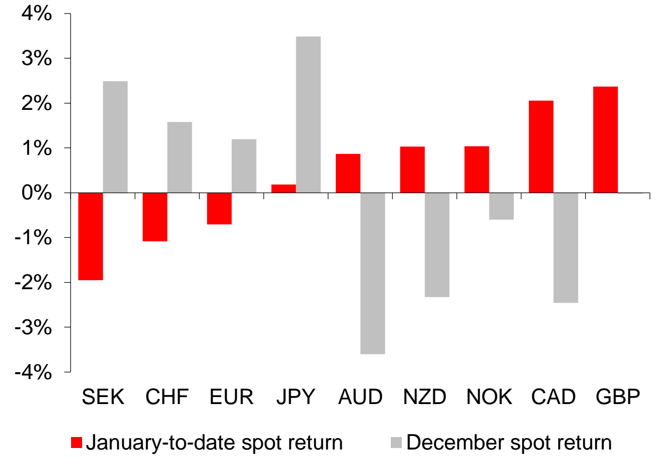
FX Spot Returns

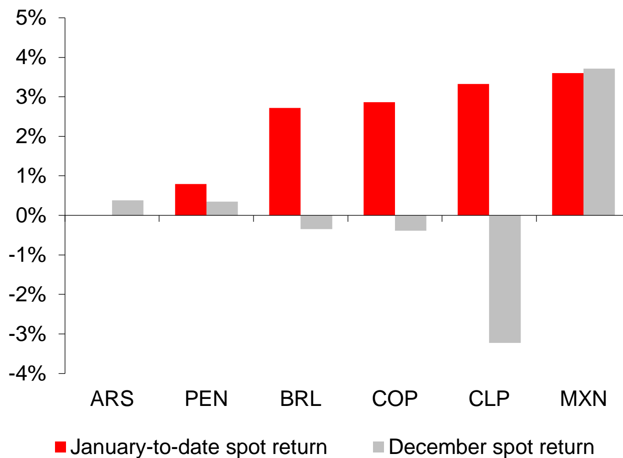
G10 spot returns vs. USD



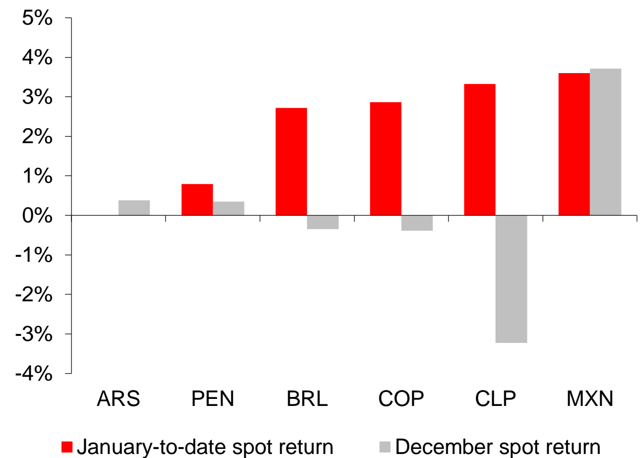
G10 spot returns vs. EUR



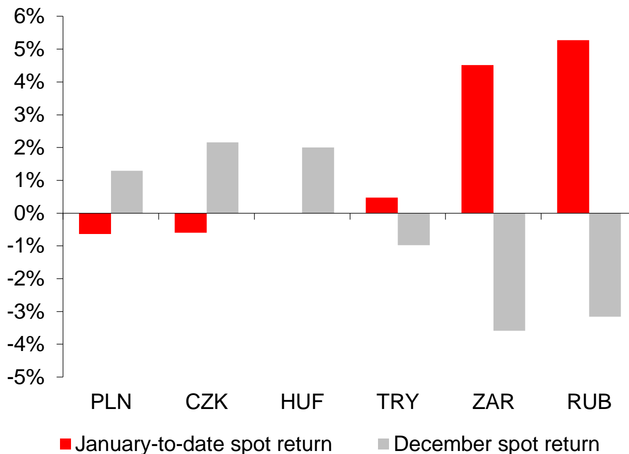
LatAm spot returns vs. USD



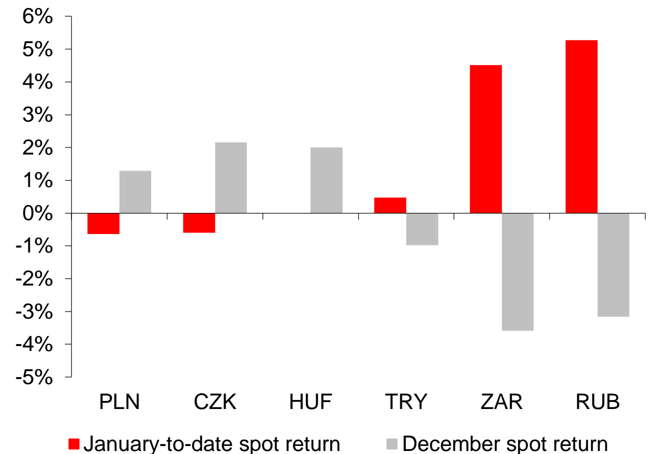
LatAm spot returns vs. EUR



CEEMA vs. USD



CEEMA vs. EUR



Source: Bloomberg, Santander. Note: Data current as at 24 January 2019 at 14:40 GMT

FX Forecasts

G10 FX Forecasts

	Q1-19	Q2-19	Q3-19	Q4-19	Q1-20	Q2-20
EUR-USD	1.17	1.19	1.20	1.21	1.23	1.25
GBP-USD	1.32	1.33	1.35	1.36	1.37	1.37
GBP-EUR	1.13	1.12	1.13	1.12	1.11	1.10
EUR-GBP	0.89	0.89	0.89	0.89	0.90	0.91
USD-JPY	114	118	119	119	116	115
EUR-JPY	133	140	143	144	143	144
USD-CNY	6.80	6.70	6.70	6.70	6.65	6.50
EUR-CHF	1.16	1.18	1.20	1.20	1.21	1.23
USD-CHF	0.99	0.99	1.00	0.99	0.98	0.98
EUR-SEK	10.2	10.0	9.8	9.6	9.5	9.5
EUR-NOK	9.7	9.6	9.6	9.5	9.4	9.3
USD-CAD	1.28	1.25	1.24	1.20	1.20	1.20
AUD-USD	0.73	0.74	0.75	0.76	0.77	0.78
NZD-USD	0.68	0.68	0.69	0.70	0.71	0.72

LatAm FX Forecasts

	Q1-19	Q2-19	Q3-19	Q4-19	Q1-20	Q2-20
USD-BRL	3.70	3.75	3.85	4.00	4.10	4.20
USD-MXN	19.4	19.7	20.4	21.0	21.2	21.4
USD-CLP	680	665	675	660	660	660
USD-COP	3300	3250	3350	3400	3400	3300
USD-ARS	40	42	45	47	49	50
USD-PEN	3.44	3.49	3.53	3.57	3.57	3.60
EUR-BRL	4.33	4.46	4.62	4.84	5.04	5.25
EUR-MXN	22.7	23.4	24.5	25.4	26.1	26.8
EUR-CLP	796	791	810	799	812	825
EUR-COP	3861	3868	4020	4114	4182	4125
EUR-ARS	47	50	53	57	60	63
EUR-PEN	4.0	4.2	4.2	4.3	4.4	4.5

CEE FX Forecasts

	Q1-19	Q2-19	Q3-19	Q4-19	Q1-20	Q2-20
EUR-PLN	4.34	4.33	4.35	4.30	4.30	4.30
EUR-CZK	25.8	25.9	26.1	26.2	26.2	25.2
EUR-HUF	320	325	325	325	325	322
USD-RUB	66	67	67	67	67	67
EUR-RUB	77	80	80	81	82	84

Sources: Santander

G10 FX: Main Themes

Currency	3M view	12M view	Main Themes
USD	→	↘	• The USD was strong in 2018, and this may spill over in to Q1-19, but is unlikely to last throughout the year. The Fed's hiking cycle may be coming to an end as the economy faces 'headwinds' in 2019.
EUR	→	↗	• Low risk appetite has weighed on the EUR. However, Eurozone fundamentals remain solid and, with despite below target inflation, does the economy still need a deposit rate at -0.4%?
GBP	→	→	• Sterling remains vulnerable, given subdued growth, political/Brexit uncertainty and general USD strength, as well as less chance of near-term rate hikes.
JPY	↘	↓	• Low risk appetite has boosted demand for the yen. However, when/if the uncertainties fade, the market will be faced with a yen-negative scenario of a BoJ likely to keep policy very loose for a long time.
CNY	→	→	• US-China trade tensions and slower Chinese growth remain a risk, as might a loosening of fiscal and monetary policy, but scope for big losses may have diminished as policymakers appear keen to prevent further CNY weakness.
CHF	↘	↘	• We now expect a firmer CHF in the near term, but the SNB still views the CHF as 'highly valued' and, despite robust economic data, should maintain a very loose policy into 2019 and remain willing to intervene.
CAD	↗	↗	• We have revised our forecast lower, but still expect the CAD to appreciate as the BoC should continue to hike rates, albeit more slowly. A more stable oil price should also help CAD sentiment.
AUD	→	↗	• Global risk sentiment, with a focus on the US and China, is likely to guide the AUD. Australian monetary policy is likely to continue taking a back seat, with the RBA unlikely to hike rates before 2020.
NZD	→	→	• A softer housing market and below-target inflation are likely to keep the RBNZ cash rate on hold throughout 2019. As such, any NZD/USD gains should be reliant on a pick-up in global risk sentiment and a weaker USD.
SEK	→	↗	• A stable government and a December rate hike are supportive for the SEK, but we do not expect another hike until H2-19, leaving risk sentiment and global trade concerns restricting SEK upside in early 2019.
NOK	↗	↗	• Weaker oil prices pulled the NOK lower in Q4-18, but an upbeat economy, elevated inflation, and a central bank that expects to hike rates again in Q1-19 should all support the NOK in 2019.

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

Source: Santander

G10 FX Overview

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The USD remains firm, but is still off of its December 2018 high. The US economy remains robust, although sentiment survey data have weakened. The partial government shutdown is not helping that sentiment and some of the wind has been taken out of the dollar's sails by a more 'dovish' sounding Fed. However, the market maintains a positive dollar bias, perhaps due to habit, but helped by global growth concerns and 'cautious' central banks across developed markets.

We have revised our near-term EUR forecasts lower. The USD has remained firmer than we expected at the start of 2019. Whilst the outlook for a less loose ECB monetary policy, as the Fed errs on the patient side, should still give a lift to EUR/USD this year, the effect of this is likely to be smaller and later, especially with ECB President Draghi again opting for a pessimistic message in January, warning of downside risks to growth and CPI. Hence we now expect EUR/USD to end Q1-19 at 1.17, rather than 1.20.

Sterling's outlook remains uncertain amid the ongoing Brexit process. However, with the pound still looking weak, given the sell-off since the EU referendum in June 2016, it may require 'new' FX-negative information for the pound to weaken much further. The FX market appears to be crystallising its Brexit focus on a few possible next steps: i) no deal; ii) a negotiated deal and transition period; iii) a second referendum; iv) a general election; and/or v) an extension of the Article 50 procedure. Market movements still suggest to us that the no-deal outcome is seen as the most negative for sterling. We suspect that the FX market would view the other possible outcomes ii) to v) as pound supportive, at least in the short term.

We retain a very negative view on the yen. Lower global risk appetite continues to boost the currency via demand for it as a safe haven, but both Japan's policy stance and fundamental backdrop continue to signal that the JPY should weaken.

We have cut our EUR/CHF forecasts, in line with our downward revision of the EUR in H1-19 and the persistently firm CHF. However, we still expect the CHF to weaken in 2019, and with inflation still low, the SNB is likely to stand firm against allowing further CHF strength.

We still expect the renminbi to weaken during 2019, but suspect that it may prove more stable over the coming month, given that the recent USD-driven decline in USD/CNY may have been excessive, and contrary to both Chinese economic data and policy.

We have revised our USD/CAD profile higher (1.28 in Q1-19, rather than 1.22) given the risk posed by a slower growth outlook, cheaper oil price and a more 'dovish' Bank of Canada. While the Norges Bank remains upbeat, the c.40% drop in oil prices in Q4-18 have also prompted us to lift our EUR/NOK forecasts to 9.7 in Q1-19 (from 9.1).

A rate hike and formation of a government are positives for the SEK, but with global growth expectations and risk sentiment dipping in recent months, the SEK may struggle in the early part of 2019.

We are cautiously positive on the AUD for 2019 as a whole, but expect limited gains in the first half of this year, as global risk sentiment, domestic politics and house price declines could all keep the RBA on the side-lines for another year. With the RBNZ planning to keep rates on hold in both 2019 and 2020, the NZD is also likely to struggle to appreciate in 2019.

USD – Still the most appealing

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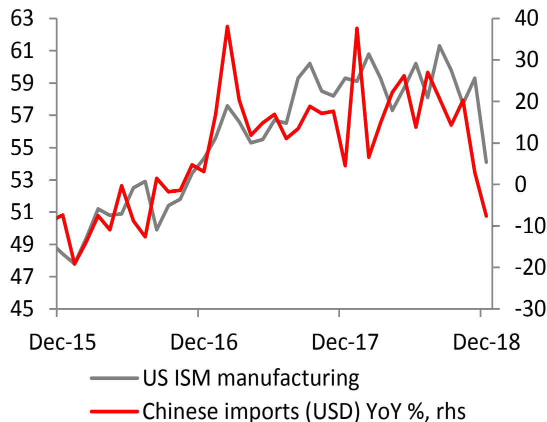
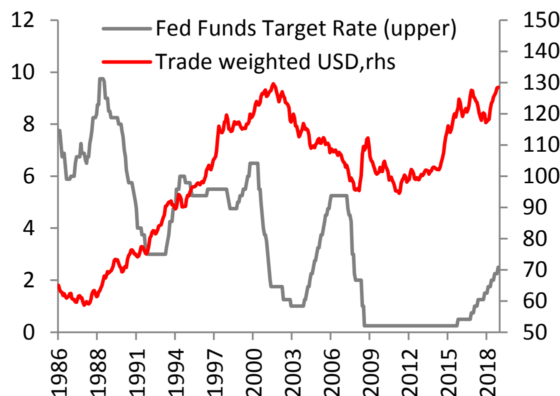
Chart 1: US business sentiment faltering on shutdown/China?



Source: Bloomberg, Santander

Chart 2: Fed preparing to end its hiking cycle, USD preparing to give back gains?



Source: Bloomberg, Santander

The USD remains firm, but is still off of its December 2018 high. The US economy remains robust, although sentiment survey data have weakened. The partial government shutdown is not helping that sentiment and some of the wind has been taken out of the dollar's sails by a more 'dovish' sounding Fed. However, the market maintains a positive dollar bias, perhaps due to habit, but helped by global growth concerns and 'cautious' central banks across developed markets.

The FX market's sentiment remains positive with regard to the US dollar. Admittedly, the USD index remains off of its late 2018 high, as the market has priced in less chance of further Fed rate hikes, but the currency is still surprisingly strong, despite some US negative news, with the USD still getting a leg up from the fact that other G10 currencies remain largely unappealing.

The US economy remains robust, although the partial government shutdown has meant that not all US economic data has been released. That said, the consensus still looks for strong GDP growth of 2.5% in 2019, albeit down from 2.9% in 2018, and slowing to 1.9% in 2020. However, some cracks in the USD-positive economic backdrop do appear to be forming.

First, the partial government shutdown is now the longest on record. Although conventional wisdom says that its impact on activity will be small, it is still likely to have an adverse effect, perhaps cutting Q1-19 GDP by 0.3pp. Second, trade tensions with China and/or the shutdown do appear to be having a negative effect on sentiment. The University of Michigan sentiment index dropped from 98.3 to 90.7 in January, the lowest reading since October 2016. Further, the ISM manufacturing index has tumbled over the last few months, echoing the decline in Chinese import growth.

Some slowing in US growth, however, was expected, especially as the impact of past tax cuts starts to fade. In addition, the prospect of a rising US budget deficit and debt-to-GDP ratio has, for now, been ignored, with USD bulls able to point to slower growth elsewhere in developed markets as a reason to maintain long USD positions into Q1-19.

The main change from the end of last year, and the reason for the slightly softer USD, has been the change in the Fed outlook. Following the FOMC's decision to increase the upper Fed Funds target rate 25bp to 2.5% on 19 December, the Fed's rhetoric has become far more dovish. Many FOMC members have indicated an inclination for a more patient approach to rate hikes.

The market has thus priced out the prospect of at least two more rate hikes in 2019, and, at the time of writing, sees only a c.20% chance of one 25bp hike in H2-19. This repricing pulled the USD lower over the last month, and implies that one of the key factors behind the USD's strength in 2018 will not be repeated in 2019.

However, as with the impact of GDP on the USD, the currency continues to find support from the reaction of other G10 economies/policymakers, as the Fed's new-found caution is being echoed by other central banks such as the ECB and BoC, which should allow most USD pairs to be firmer in Q1-19 than we previously expected.

EUR – Struggling again

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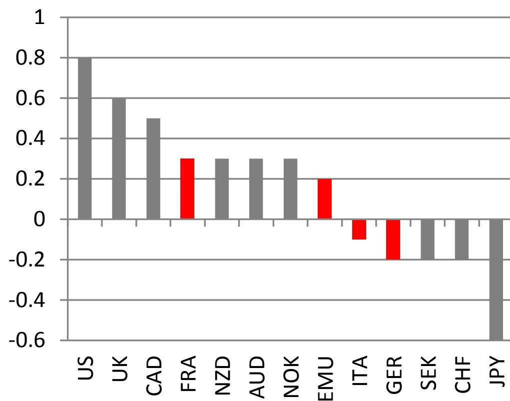
We have revised our near-term EUR forecasts lower. The USD has remained firmer than we expected at the start of 2019. Whilst the outlook for a less loose ECB monetary policy, as the Fed errs on the patient side, should still give a lift to EUR/USD this year, the effect of this is likely to be smaller and later. Hence we now expect EUR/USD to end Q1-19 at 1.17, rather than 1.20, but believe the pair should move toward 1.21 by the end of the year, compared to 1.24 previously.

Chart 3: Developed market Q3-18 QoQ % GDP growth



Source: Bloomberg, Santander

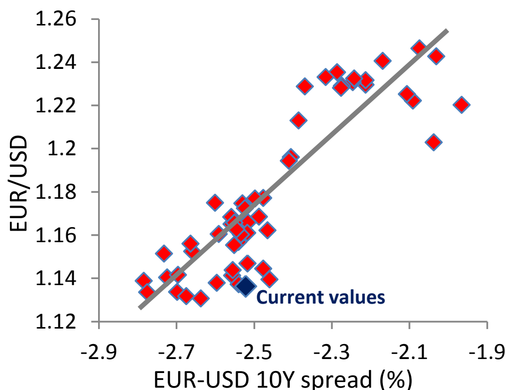
The ECB kept its monetary policy unchanged at the January meeting. However, President Draghi again opted for a pessimistic message, warning of downside risks to growth and CPI. Consequently, ECB rhetoric is countering a similarly cautious stance by the Fed, and preventing EUR/USD from benefiting from the market's move, to all but price out further US rate hikes.

Indeed, the movement in relative yields helps explain the slump in EUR/USD since early January. The EU-US 10Y spread has dipped since the start of the year, dragging EUR/USD lower. However, looking at the relationship between the two over the last year, we note that the spread and pair showed a large degree of correlation, 0.9, and even after the recent dip, the data for the last 12 months suggest that by this measure alone EUR/USD is undervalued, with a fairer value closer to 1.1650.

In addition, the recent fundamental backdrop favours a softer EUR profile. The Eurozone's economic data have tended to be weak and have surprised to the downside, whilst the US figures have been a touch firmer, although we note that the US government shutdown has meant that some US data have not been released.

A key focus for EUR bears has been weak Q3-18 GDP data, particularly the German figures, which showed that economy contracting 0.2% QoQ. Whether the EUR can gradually push higher in 2019 may depend a lot on whether the slowdown in Germany and the Eurozone, which only grew 0.2% QoQ, is a temporary phenomenon due to one-off factors.

Chart 4: Patient Fed, cautious ECB, but EUR/USD still looks soft given EU-US 10Y spread over the last year



Source: Bloomberg, Santander

We think this could be the case, and expect the Eurozone to grow 1.9% in 2019. We believe that fundamentals are robust and, since trade tensions may fade, we could see some acceleration in activity later in 2019. That said, with inflation dipping, the expected ECB rate hike this year may now be more likely to happen towards the end of the year.

Given that we still do not believe that the current economic backdrop requires the ECB to maintain policy at 'crisis' levels, the EUR should find it easier to drift higher through the year. However, another constraint on the currency may prove to be the market's unwillingness to jettison, or even question, its USD optimism.

As the Fed adopts a more cautious approach, one of the main catalysts behind the USD's gains in 2018 has been removed. Furthermore, despite a robust economy, some US business surveys are declining. In addition, US politics appears uncertain, the government is still in partial shutdown, and the fiscal deficit and US debt are expected to rise. The FX market would need little convincing to sell the EUR when faced with these factors, but the reverse is not true, and the market's love affair with the USD looks set to continue for a little longer than we had expected.

GBP – Nothing's changed

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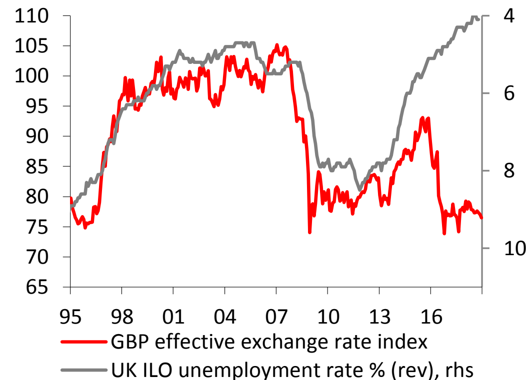
Chart 5: The pound may already have priced in real economic weakness



Source: Bloomberg, Santander

Chart 6: UK economic data still surprising to the downside, but to a lesser extent

Source: Citi, Bloomberg, Santander

Sterling's outlook remains uncertain amid the ongoing Brexit process. However, with the pound still looking weak, given the sell-off since the EU referendum in June 2016, it may require 'new' FX-negative information for the pound to weaken much further.

The FX market appears to be crystallising its Brexit focus on a few possible next steps: i) no deal; ii) a negotiated deal and transition period; iii) a second referendum; iv) a general election; and/or v) an extension of the Article 50 procedure.

Market movements over the past few months still suggest to us that the no-deal outcome is seen as the most negative for sterling. The risk of a sharp economic shock to the UK would likely prompt a knee-jerk sell-off of c.7% for the GBP versus the USD and EUR.

Indeed, the IMF recently renewed its warning about the risks to the UK if it leaves without a deal. That said, given the difficulty in forecasting anything related to the UK at the moment, it left its 2019 UK GDP estimate unchanged at 1.5%.

Our UK economist also believes that growth this year will be 1.5%. We also reiterate our view that, given the weakness in the pound since 2016, it could be argued that the cheap GBP has already priced in some of the potential difficulties that a no-deal implies, which might eventually provide some support for the currency.

We suspect that the FX market would view the other possible outcomes ii) to v) as pound supportive, at least in the short term. A negotiated deal and the transition period would provide businesses with some near-term certainty, even if the longer term relationship between the UK and EU remained unclear. This might be enough to spur business investment, which has been weak since early 2018. However, even in this scenario we still would not expect a GBP-friendly rate hike by the BoE.

Political commentators, and some politicians, seem convinced that an extension of Article 50 will be required. Recent market movements suggest that this too would be viewed as sterling positive. Admittedly, by itself an extension might not make the end result of Brexit any clearer, but were the government/parliament to prefer an extension to leaving without a deal at the end of March, the market would probably view this as evidence that policymakers do not want a no-deal outcome and the pound would rise as that option is 'effectively' taken off the table.

If the UK parliament cannot agree on the way forward for Brexit, the prospect of another referendum may loom. The knee-jerk response to this should also be GBP positive. Opinion polls still show the Leave/Remain split as evenly balanced, but the chance of remaining in the EU, and therefore also ending the prospect of a no-deal should allow for cautious gains by the pound, with its level thereafter largely determined by opinion polls.

Finally, the prospect of a general election has gained a little more traction lately. An election would not resolve the Brexit choices but a clear victory for either Conservative or Labour might make a solution politically easier to agree on. That said, the FX market may be wary of the possible changes to fiscal policy that a new government might imply, which even if it means a solution to Brexit, might be the 'new' information required to encourage the pound to weaken further.

JPY – Low CPI should not equal a strong yen

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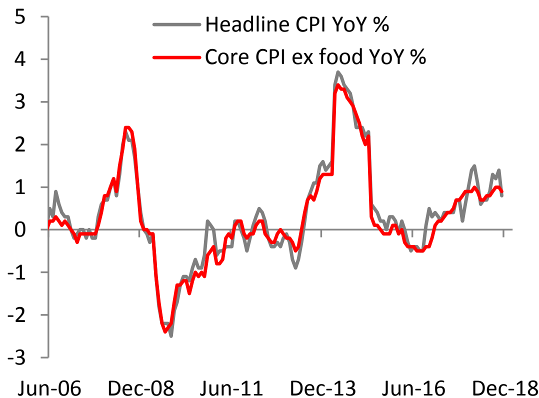
We retain a very negative view on the yen. Lower global risk appetite continues to boost the currency via demand for it as a safe haven. This appears likely to remain the case in the short term, but both Japan's policy stance and fundamental backdrop continue to signal that the JPY should weaken.

Global risk appetite has been under pressure for several months, focussing on US-China trade tensions, risks to world GDP growth and lower equity markets. These concerns have boosted demand for currencies that are perceived to offer greater safety, in this case the USD and JPY. Thus the yen has tended to strengthen over the last few months against its developed market peers, outperforming the USD recently as the dollar slipped amid signs that the Fed might slow or stop further US rate hikes.

Such global concerns are unlikely to disappear in the short term. We recall that the IMF recently revised down its estimate for world GDP growth in 2019, to 3.5% from 3.9%. However, BoJ Governor Kuroda has suggested that US-Chinese trade friction is likely heading towards resolution. Further, the pick-up in equity markets in January, reversing much of December's drop, hints at a calmer backdrop and less upside pressure on the yen.

Chart 7: Japanese CPI is low, and expected to head lower, keeping policy loose…

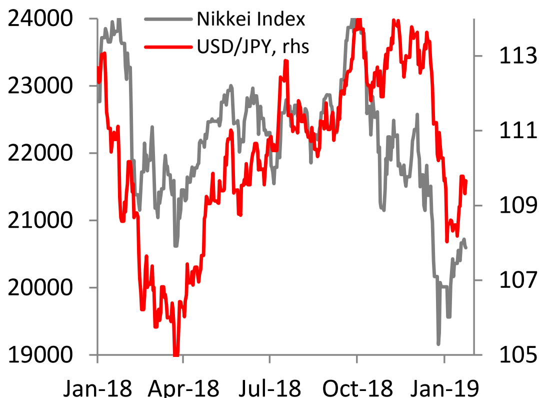


Source: Bloomberg, Santander

Japan's policy and fundamental backdrop also favour a weaker yen. On 23 January, the BoJ, as expected, kept its monetary policy unchanged, i.e. its benchmark rate at -0.1% and its 10Y yield target at around zero. It also kept the guideline on asset purchases at JPY80trn.

The Bank reiterated that it intends to keep both short-end and long-end rates at 'extremely' low levels for an extended period. Hence,, as we still expect the ECB to edge, albeit grudgingly, towards a rate hike, and that US rates are 'relatively' high and could yet be hiked further, the spread between US and EU yields compared to Japan's should imply a sharp weakening of the yen.

Chart 8: …even as global risk pressures continue to boost the yen



Source: Bloomberg, Santander

In the tug of war for the yen, between risk and policy, risk's dominance should eventually give way to the BoJ's stance. The JPY may remain elevated for a while longer, but the combination of sluggish Japanese growth, low inflation and a stubbornly loose monetary policy should turn the tide against the yen.

The BoJ does still expect a 'moderate' recovery for the economy. It revised slightly higher its GDP forecasts for fiscal year (FY) 2019, the year ending March 2020, to 0.9% from 0.8%, and for FY20 to 1% from 0.8%. Nevertheless, these growth forecast still imply underperformance against the US and Eurozone.

However, the Bank's main problem is inflation. The core CPI forecast was cut to 0.9% from 1.4% in FY19, excluding the effect of this October's scheduled sales tax hike, and to 1.4% from 1.5% in FY20. Further, these estimates exclude expected reductions in telephone and education costs, which imply even lower CPI.

Thus, with still sluggish wage growth, the BoJ remains some way off its 2% inflation target. The Bank has little ammunition left in terms of monetary stimulus and will thus have to rely on highlighting its current loose stance, verbally pushing back on the yen, or merely hope that other banks' less accommodating stance will eventually convince the market that the yen is on the expensive side.

CNY – Not weak anymore

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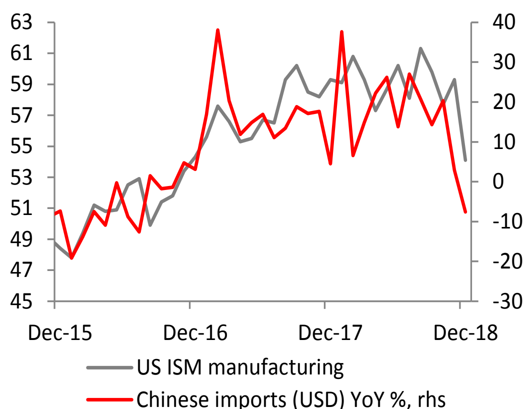
Chart 9: Chinese growth continues to ease

Source: Bloomberg, Santander

Chart 10: China's economic issues spilling over



Source: Bloomberg, Santander

We still expect the renminbi to weaken during 2019, but suspect that it may prove more stable over the coming month, given that the recent decline in USD/CNY may have been excessive, driven by the US dollar and contrary to the direction implied by both Chinese economic data and policy.

The renminbi has appreciated notably since the end of October 2018. At that point USD/CNY was testing the 7 level, but by 14 January it had tumbled to 6.7326, a decline of 3%. In the week ended 18 January, the CNY strengthened by over 2% against the USD, representing the biggest weekly advance since 2005.

However, it might be wrong to view the renminbi appreciation since late October as simply a CNY success story. The CNY did outperform many currencies over that period, but a large chunk of its gains versus the USD was due to a generally weaker dollar.

Indeed, the renminbi's gains came even as Chinese economic data deteriorated. The economy grew 6.6% in 2018, the slowest rate for 28 years. China's manufacturing PMI dropped below the 50 level in December, CPI slowed to 1.9% YoY, from 2.2%, and factory price inflation plummeted to 0.9% YoY, from 2.7% YoY. The latter should put further pressure on industrial profits, which contracted 1.8% YoY in November.

Trade tensions with the US are still a concern, despite additional meetings being held between the two countries. However, whilst at the end of 2018 the FX market viewed such concerns as USD positive, now they are more ambiguous. The economic impact of these trade tensions can be seen not only in the soft sentiment data of the PMI, but in hard trade figures. The Chinese trade surplus in December actually increased to USD57bn from USD42bn, the largest it has been since January 2016. However, the focus was on the collapse in export and import growth, which were -4.4% YoY and -7.6% YoY.

The data raises concerns about China's GDP outlook, which should remain negative for the CNY, but it also highlights worries about global growth. Intermittently, these fears may prompt safe-haven demand for the USD, supporting USD/CNY. However, weak Chinese imports and trade tensions appear to be having an adverse effect on US business sentiment, which also might help explain some of the pair's softness in recent months.

Given the concerns over Chinese growth, policymakers remain committed to providing support for the economy. The approach seems to focus on targeted measures to increase liquidity and reduce bank lending costs, whilst containing financial risks. At the end of December the PBoC created a 'targeted' version of the Medium Term Lending Facility, at a lower interest rate. This was followed in early January by another cut in banks' reserve requirement ratio, with a further cut likely. In addition, the sale of perpetual bonds is being encouraged to provide a capital buffer as more bad loans have to be moved onto banks' balance sheets.

These and past measures are having some success, interest rates have weakened and December's credit data surprised to the upside. However, a reduction in official interest rates is considered unlikely, but the scope of easing already in place should imply a slower pace of USD/CNY depreciation over the coming month.

CHF – Too perky for its own good

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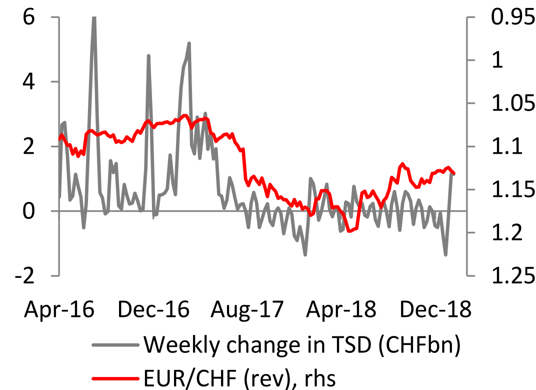
We have cut our EUR/CHF forecasts, in line with our downward revision of the EUR in H1-19 and the persistently firm CHF. We expect EUR/CHF at 1.16 by the end of Q1-19, versus 1.18. However, the direction of our forecast is unchanged, and we still expect the CHF to weaken in 2019, ending the year at 1.20, albeit from a stronger start. Plus, with inflation still low, the SNB is likely to stand firm against allowing further CHF strength.

Chart 11: The recent change in Swiss total sight deposits may signal that the SNB is losing patience with the strong CHF



Source: Bloomberg, Santander

The SNB's policy should remain loose and a CHF negative. The Bank should continue to label the CHF as highly valued, maintain the right to intervene and keep the deposit rate at -0.75%. Indeed, the recent rise in Swiss total sight deposits suggests that the SNB may have been trying to weaken the CHF. We do not expect the Bank to move toward 'normalising' policy before the ECB starts to hike rates, particularly as recent dovish comments from ECB President Draghi risk keeping EUR/CHF pinned around 1.12-13.

The inflation outlook should allow the Bank to remain cautious. The government has revised its CPI forecasts lower, and expects CPI at 0.5% in 2019, compared to 0.8% previously, rising to 0.7% in 2020. Subdued global risk appetite may have fuelled some demand for the traditional CHF safe haven in recent months, but sentiment has also been supported by a robust Swiss economy that seems to have shrugged off the impact of a strong franc. Output is expected to have grown 2.6% in 2018, but global growth risks are forecast to alter the outlook, with the government looking at 1.5% growth in 2019, revised down from 2%, and 1.7% in 2020.

CAD – Keeping low, for now

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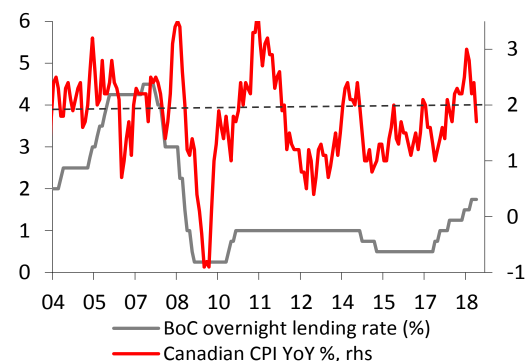
We remain positive on the CAD, but have revised our USD/CAD profile higher. We now expect USD/CAD to end Q1-19 at 1.28 rather than 1.22, and to end the year at 1.19. The change in forecasts reflects the risk posed by a slower growth outlook, cheaper oil price and a more 'dovish' Bank of Canada.

Chart 12: BoC joins the ranks of cautious policymakers, CAD weakens as the chance of H1-19 rate hikes diminishes



Source: Bloomberg, Santander

Despite the revisions, we note that the CAD has had a good start to 2019 and, at the time of writing, is one of the best performing G10 currencies year-to-date. The Canadian dollar has been helped by a softer USD since mid-December, as the market has moved to reduce the chances of further Fed rate hikes, and by the rebound in the oil price. However, with oil still on the cheap side, the currency is likely to remain weaker than we previously expected. The correlation between USD/CAD and the oil price has been a massive -0.93 since the start of October.

In addition, the support for the CAD that we expected to come from near-term BoC rate hikes now appears more unlikely. At its January meeting, the BoC left the benchmark overnight interest rate at 1.75%. It revised down its estimate for 2019 growth to 1.7% and expects inflation to be lower in the near term. The revisions and rhetoric make a rate hike much less likely at the next meeting.

However, helped by the USMCA trade deal and its impact on investment and sentiment, the BoC estimate for 2020 growth was lifted to 2.1%. Plus, capacity constraints still imply inflation moving back to the 2% YoY target by end-2019. Hence, the BoC still sees the need to hike rates toward the neutral range (2.5-3.5%) over time, which should still imply a lower USD/CAD in 2019.

AUD – A tough start to 2019?

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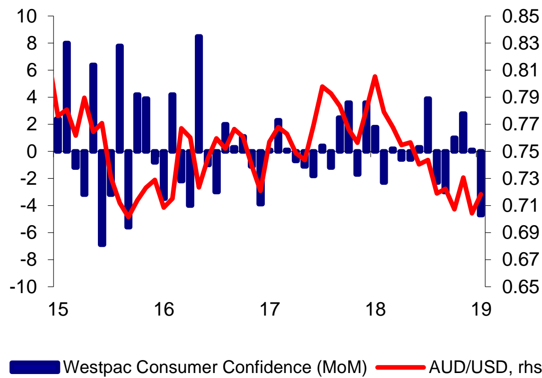
We are cautiously positive on the AUD for 2019 as a whole, but expect limited gains in the first half of this year, as global risk sentiment, domestic politics and house price declines could all keep the RBA on the side-lines for another year. We still foresee AUD/USD rising to 0.73 in Q1-19 and 0.76 in Q4-19, but these forecasts are perhaps more a function of our negative USD view than a particularly upbeat AUD one.

Global risk sentiment has fallen heavily in recent months. Fears are particular linked to the US, where economic data have started to disappoint, the government has experienced its longest ever shutdown, and the FOMC has turned significantly more cautious in a short space of time.

The potential for additional US-China tariffs is also not helping sentiment, and neither are fears of a slowdown in China, after its slowest annual growth in 28 years in 2018 (at 6.6% YoY).

As two of Australia's largest trading partners, responsible for c.40% of its two-way trade, concerns over the health of the US and Chinese economies are unlikely to help AUD sentiment.

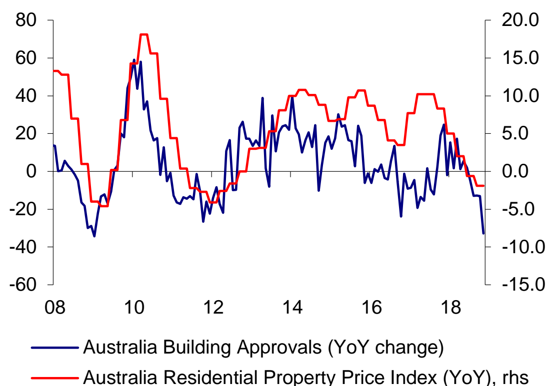
Chart 13: Australian consumer confidence fell sharply in January



Source: Bloomberg, Santander

Westpac consumer confidence for January fell by 4.7% month-on-month (Chart 13), its largest monthly decline since 2015. Other domestic data have not done a lot to help the AUD recently either, with most important releases surprising to the downside in the past few months. Indeed, Australia's Q3-18 GDP growth fell to just 0.3% QoQ, from a robust 0.9% the prior quarter. Annual growth slipped to 2.8%. Meanwhile, the manufacturing index fell into contraction territory in December, while building approvals saw their largest YoY decline in over a decade in November (Chart 14).

Chart 14: Building approvals and house prices have fallen sharply in Australia in recent months



Source: Bloomberg, Santander

The housing market could be one of the more important domestic concerns for the RBA this year. The slowdown in house prices in Sydney in particular is likely to be a worry for the central bank, with prices now over 11% below their 2017 peak, and expected to continue falling this year.

Household spending is expected to remain weak this year, and inflation, while currently within the Bank's 2-3% target range, is unlikely to rise significantly enough to force the RBA into hiking rates. This will certainly be the case for H1-19, we believe, but probably also in H2-19. In fact, while the RBA has kept its cash rate unchanged, at 1.5%, for a record 26 consecutive meetings, the market is now pricing a 30% chance of a rate cut in 2019.

We do not expect the RBA to hike rates until 2020, but given deteriorating economic conditions, and various Australian banks raising rates on a range of fixed-interest rate products, the Bank could yet be forced to at least consider cutting this year.

Political risk could also limit the AUD in H1-19. In August 2018, Malcolm Turnbull become the latest of a series of Australian prime ministers to be ousted before completing a full term (see AUD – Another one bites the dust, published 24 August 2018). Treasurer Scott Morrison was his replacement, but with new elections due to take place by 18 May this year, and with opposition Labour leader, Bill Shorten, constantly ahead in the opinion polls (on a two-party preferred basis), political uncertainty could also be a drain on the AUD in early 2019.

NZD – Macroprudential loosening

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Our NZD forecasts are unchanged. We continue to see the currency struggling to appreciate in 2019, with concerns over global growth and risk sentiment in particular, as well as the persistent below-target CPI likely to keep the RBNZ on hold all year. We forecast NZD/USD sitting relatively still during H1-19, at around 0.68, before rising gradually in the latter part of the year, helped by a softer USD, to around 0.70 in Q4-19.

The NZD has struggled for direction a little over the past couple of months, moving higher and lower as the global risk backdrop improves and deteriorates, following equities and the USD, rather than domestic factors. We expect this to remain the case in early 2019, with the NZD moving mainly on international issues and risk sentiment, as we see little on the domestic front to drive the currency, especially with the next GDP and CPI data not released until March and April, respectively.

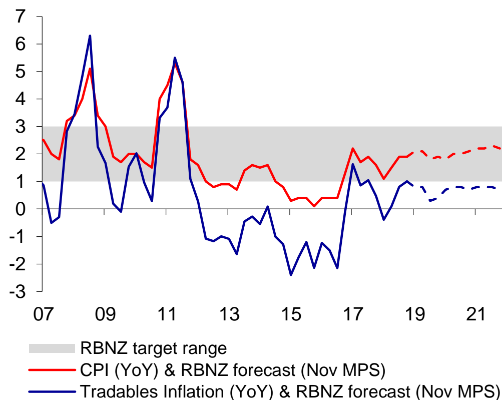
In November, the RBNZ again highlighted that it does not expect to change rates in either 2019 or 2020. It continues to keep the option of a rate cut on the table, and some economists are now forecasting this as the most likely option in 2019. We continue to expect the RBNZ to keep rates on hold, at 1.75%, throughout 2019, but would note that the overnight index swaps market is now pricing in a 30% chance of a rate cut in H1-19.

The RBNZ continues to suggest that "the timing and direction of any future overnight cash rate move remains data dependent". Given that recent data have not been overly positive, a substantial improvement is likely to be needed for the Bank to think about hiking rates again. Indeed, the Q3-18 GDP print, released in late December, slowed to just 0.3% QoQ, its lowest level since 2012, and half the pace forecast by the market. The annual rate also slipped to almost a five-year low, at 2.6%.

The latest RBNZ forecasts still imply GDP at above 3% both in 2019 and 2020, but even though employment and wage growth remain upbeat, the Bank may need to revise its growth forecasts down slightly in its 13 February monetary policy statement. Further, unless there is a solid rebound in the next GDP numbers (released at the end of March), the RBNZ is likely to remain cautious on inflation data in early 2019. Indeed, headline CPI has already been struggling to break above the mid-point of the RBNZ's 1-3% inflation target in recent years, managing to do so only once since 2011 (Chart 19). Data for Q4-18, released earlier this week, showed headline CPI sitting once again below this target, 1.9% YoY.

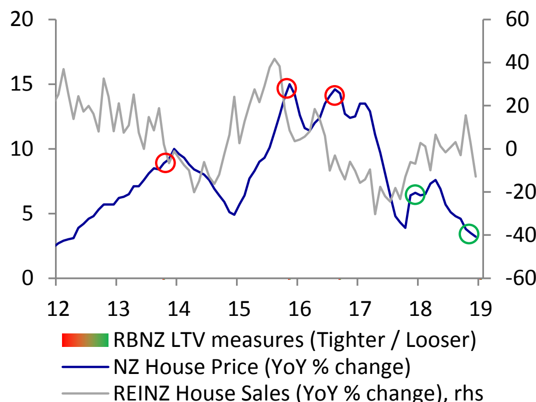
While we currently do not expect the RBNZ to cut rates from their present 1.75% all-time-low, there are other forms of easing that can help boost the economy, and inflation. Indeed, in recent years, the RBNZ has been relatively effective, in our view, at using macroprudential policies, such as lending restrictions, to constrain house price growth and ensure financial stability. In late 2013, 2015 and 2016, the Bank tightened lending restrictions, such as loan-to-value ratios, to limit house price growth. At the start of 2018, the RBNZ loosened these lending restrictions, to boost demand, sentiment and the economy. With house price growth slowing to a 6-year low, and home sales falling by 10% YoY in December, the Bank decided to loosen these restrictions again this month (Chart 20).

Chart 15: Annual CPI has touched above 2% only once since 2011, but tradables inflation is expected to turn positive in H2-19



Source: RBNZ, Bloomberg, Santander

Chart 16: After tightening loan-to-value measures to limit house price growth, the RBNZ is now loosening them to boost demand



Source: RBNZ, Bloomberg, Santander

SEK – A first rate hike and a new prime minister

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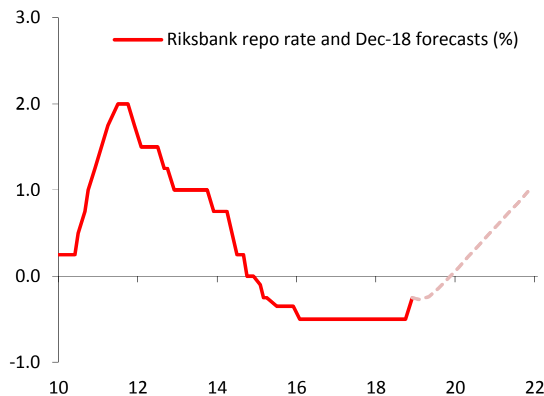
We are positive on the SEK for 2019 as a whole, but are neutral the currency in the early stages of the year. A first rate hike from the Riksbank in seven years in December was SEK positive, but we do not foresee another hike until H2-19. Likewise, while it is good for political stability that a new government was voted in last week, four months after the general election, this alone is not enough to boost the SEK materially, especially when global growth expectations and risk sentiment have dipped in recent months. We continue to forecast EUR/SEK holding close to 10.2 in Q1-19.

Chart 17: The Riksbank hiked rates in December for the first time in seven years, although the next hike is unlikely to come before H2-19



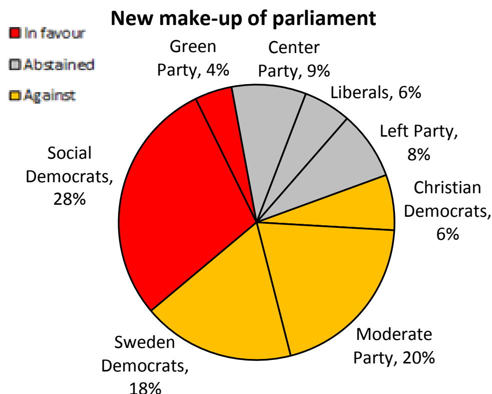
Source: Riksbank, Bloomberg, Santander

The Riksbank hiked rates by 25bp in December. This was the Bank's first hike since late 2011, and its first change in rates, in either direction, since early 2016 (Chart 17). Given the weaker data in the weeks ahead of the decision, and the fact that other central banks turned more dovish in Q4-18, we had expected a hike to come in February, rather than December. Consequently, rather than expecting zero hikes in 2018 and two in 2019, we now simply interpret the first of these hikes occurring one meeting earlier than we had anticipated.

Indeed, the December rate hike does not mean an aggressive tightening cycle will take place this year. In fact, the Riksbank does not expect to hike rates again until H2-19. It then only estimates two further hikes each in 2020 and 2021, implying only a very gradual tightening in monetary policy.

The recent data certainly do not seem to be placing any pressure on the central bank to go any quicker. Quarterly GDP growth contracted by 0.2% in Q3-18, Sweden's first negative print since 2013. The Q4-18 growth data are not released until the end of February, but the weaker economic performance of Germany, Sweden's largest trading partner, does not bode well for this next Swedish GDP print, which is now expected to record annual growth of just over 1.5% for the next couple of quarters, according to the Bloomberg consensus.

Chart 18: Sweden's parliament voted in a new PM, at the third attempt, in January, but even with Centre and Liberal support, the Social Democrat-Green coalition lacks a majority



Source: Statistics Sweden, Santander

Over the coming months, inflation data will also be closely watched. Annual CPIF rose to 2.2% in December, but if growth is weak, then this is likely to soften slightly, especially given the late 2018 oil price drop. However, if CPIF excluding energy edges higher (currently at 1.5%), this should support a gradual Riksbank tightening, and would therefore be SEK positive.

There was a breakthrough in the Swedish election process in mid-January. Four months after September's inconclusive election, and at its third attempt, the Swedish parliament voted in favour of a new coalition government. As discussed in Swedish politics: Third time lucky for a new Prime Minister, published on 18 January, the new administration will be led by the Social Democrat leader, and ex-prime minister, Stefan Löfven, in a coalition with the Green party (Chart 18). It will also receive parliamentary support from the Centre and Liberal parties.

We see it as a SEK positive that the Swedish political situation begins 2019 on a more settled footing, especially as plans for substantial tax reform should boost the economy. However, only time will tell if this new-found calm can be maintained. Meanwhile, the SEK remains at risk from global trade fears, a dip in risk sentiment, and slower growth in the Eurozone.

NOK – Where oil goes, the NOK follows

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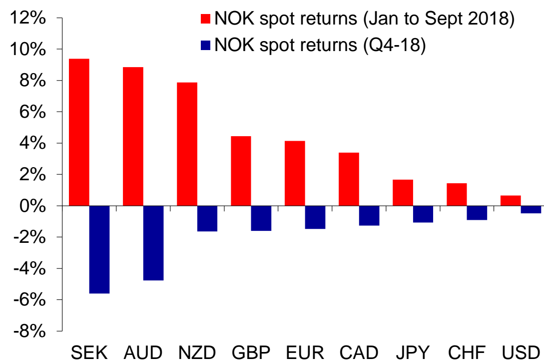
We are upbeat on the NOK in 2019. Domestic data and tighter monetary policy should be positive for the NOK this year, as should the prospects of a more stable government. However, the main NOK driver is oil, and where oil goes the NOK follows. Indeed, with oil suffering a c.40% drop in Q4-18, the NOK took a big hit. Unless oil prices return to their 2018 highs, EUR/NOK now looks far less likely to test last year's 9.4 lows in 2019. Hence, with WTI crude still sitting c.30% below its 2018 highs, at around USD53/bbl, we have lifted our EUR/NOK forecast profile notably higher, and now see the cross dropping to 9.7 in Q1-19 (9.1 previously) and to 9.5 by year-end (8.7 previously).

The NOK has begun 2019 on the front foot, just like it did in 2018. In fact, between the start of January 2018 and the end of September 2018, with oil prices rising by 25%, the NOK was the best performing G10 currency, recording gains even against the USD (Chart 19).

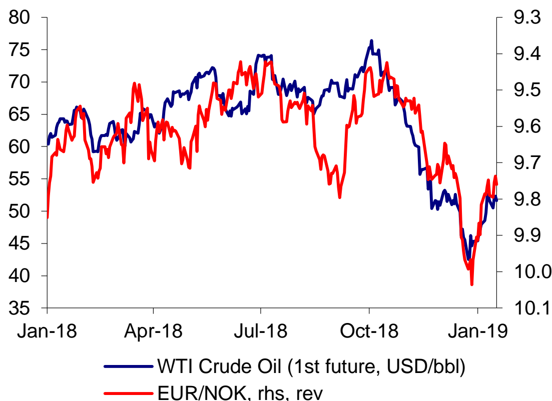
Chart 19: The NOK went from the best G10 performer from Jan-Sep 2018, to the worst performer in Q4-18



Source: Bloomberg, Santander

However, this outperformance came to a sudden end in Q4-18, with the NOK weakening across the board, and EUR/NOK touching above 10.0, as WTI crude oil prices fell by around 40% (Chart 20). The solid start to 2019 for the NOK appears to be largely due to the rebound in oil prices. Indeed, where oil goes, the NOK seems to follow, with WTI crude prices and EUR/NOK sharing a correlation of 0.96 over the past three months.

Chart 20: Oil prices have been the main NOK driver in recent months



Source: Bloomberg, Santander

OPEC's meeting in early December resulted in the cartel, together with Russia, agreeing an oil production cut of some 1.2mn bbl/day from its October 2018 levels for the first six months of 2019. However, we find it difficult to interpret this as a positive for oil prices, as together, OPEC's and Russia's oil output increased by almost 1.3mn bbl/day between the start of January and the end of October, negating the effect of this cut.

Furthermore, global oil production (led by sharp increases in US oil production), rose from 95.6mn bbl/day to 99.1mn bbl/day over the same period. Hence, even after this cut, all else being equal, global oil production would still be some 2.3mn bbl/day greater than at the start of 2018.

Given this backdrop for oil in 2019, along with weaker global sentiment and growth expectations, oil looks likely to struggle to return to its 2018 highs (around USD75/bbl). As such, without a significant rebound in oil prices, EUR/NOK now looks far less likely to retest its 9.4 2018 lows this year.

Norway's domestic data are upbeat though, and thus NOK supportive. Indeed, the unemployment rate is low, industrial production numbers high, and the country's trade balance is rising once again. Norway's manufacturing PMI is also still very firm, despite a recent deterioration in this number for most other developed markets. In addition, CPI data are above target, with the headline rate holding at 3.5% YoY in December, and the core rate remaining above 2% for a second consecutive month.

Earlier this month, Norway's coalition government, led by the Conservatives, but also comprising the Progress and Liberal parties, added the Christian Democrats to its ranks, to regain Norway's first centre-right majority in three decades. The deal includes plans to cut taxes, which, on balance, should be supportive of both growth and the NOK.

LatAm FX: Main Themes

Currency	3M view	12M view	Main Themes
BRL	Neutral	Mildly Bearish	• Expectations on the pension reform have been the main driver for Brazilian assets. • We expect interest rate differentials (Brazil vs. US and Brazil vs. other EM countries) to stay at historically low levels, keeping the BRL as a relatively cheap funding currency. • Portfolio flows should be decisive in the short term, as foreign investors still seem reluctant to join the recent rally.
MXN	Neutral	Mildly Bearish	• Banxico's policy rate of 8.25% is much higher than in most EM. • Banxico is becoming less tolerant as regards continuing to push forward the date on which it expects to achieve its inflation goal of 3.0%. • If, by the second half of the year, the Mexican economy has decelerated, the two new doves should start exerting more influence in Board discussions.
CLP	Neutral	Neutral	• The CLP is likely to remain dependent on the external scenario, with a special focus on trade tensions and copper prices. • The risk scenario is a permanent decline in copper, with effects on business confidence, investment, and eventually growth. • In the medium term, the US vs. China growth differential should be key for the peso, which should appreciate if that variable were to narrow.
COP	Mildly Bearish	Mildly Bearish	• The recent recovery in oil prices and the softer USD, in addition to seasonal tax inflows, have supported the currency in the first month of the year. • However, we consider that the risks remain to the upside, due to lower global growth, US-China trade talk uncertainty, as well as tighter financing conditions, plus an expected higher current account deficit in 2019. • In the short term, we expect an upward correction of the COP once the seasonal tax inflows end, towards the COP3192/ USD level. .
ARS	Bullish	Neutral	• The central bank has stepped up its daily purchases of hard currency this year. • The FX intervention strategy undoubtedly reflects signs of peso appreciation. • We remain very positive on the stabilisation of the FX market.
PEN	Neutral	Mildly Bearish	• The PEN recovered some ground in the first month of the year, aided by a small rebound in metal prices and a weaker US dollar. • However, risks remain biased to the downside, given the uncertainty on the external front, as China and the US continue their trade talks. • The MPC could start its hiking cycle in March if growth reaches potential and the output gap closes.

Bullish | Mildly Bullish | Neutral | Mildly Bearish | Bearish

Source: Santander.

BRL – Contained strengthening

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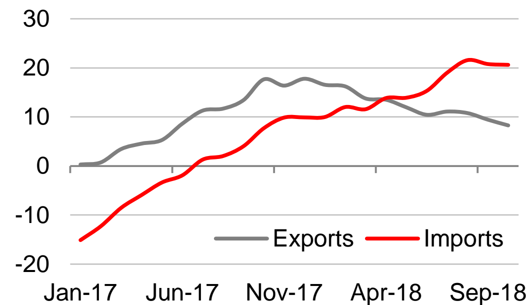
Although the BRL has strengthened since our last update (on 29 November), its relative performance has lagged the strong rally in other BRL-denominated markets (such as equities and sovereign bonds). In other words, in a period when the Ibovespa rose around 11% and five-year rates tightened about 70bp, we would usually expect a stronger currency. In our view, the four factors that may be behind such movement will continue to influence the currency this year, eventually leading to further weakness by year-end (we expect the BRL/USD to stand at 4.0 at the close of 2019).

Chart 21: 12-month external trade, y/y change (%)

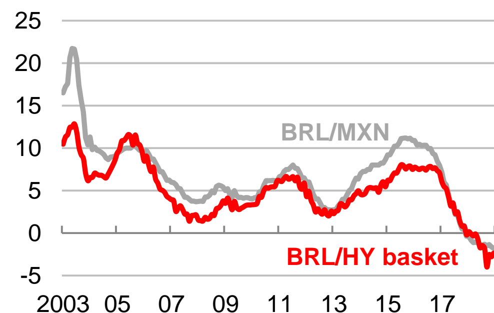


Source: Brazil Central Bank, Santander.

Deteriorating current account. We expect the current account deficit to widen by 1pp of GDP this year, to 1.6% of GDP, on the back of strong growth in merchandise imports (+12% y/y, on top of +20% y/y in 2018). That translates into around USD18bn in extra external financing needs. Although foreign direct investment inflows should remain strong (we forecast USD82bn this year), Brazil's external vulnerability should continue to increase as the economy gradually leaves the bottom of the cycle of domestic consumption and leverage.

Interest rate differentials. In our view, Brazil should continue to lag the global cycle of tightening rates, as core inflation is still significantly lower than the inflation target midpoint (3.0% versus 4.25%) and it has not shown signs of bottoming yet – which, combined with a wide albeit slowly narrowing output gap, should allow the central bank to keep its policy rate at the historically low level (6.5%) until 1Q20. This should keep hedging currency mismatches between BRL and hard currencies relatively cheap and correspondingly low expected returns to carry (which may also increase the use of BRL as a funding currency for bets on other higher-yielding EM currencies).

Chart 22: Overnight interest rate differentials, %



HY basket includes Mexico, India, Indonesia, South Africa, Turkey, and Colombia. Sources: Santander, Bloomberg

Portfolio flows. Inflows into Brazilian equities and bonds since the elections have been disappointing, which is consistent with the notion that local investors have been leading the rally in such assets and with the currency's relatively poorer performance. Foreign investors apparently continue to be relatively sceptical about the possibility of a rapid approval of the pension reform in Congress, or are still waiting for more concrete signs of the new government's commitment to fiscal responsibility to add to their portfolios. In any case, the next month may bring more information about the government's coordination with Congress, but a breakthrough is unlikely, in our view.

EM risk appetite. We believe 2019 will be another challenging year for EM, with the continuous reduction in G3 central bank balance sheets compounding idiosyncratic domestic risks. BRL will probably continue to be a "high beta" currency, under considerable influence of external factors.

In the very short term, the elections for the leadership of the two houses of Congress is the key event to be watched – it will be an important data point on the alignment (or lack thereof) between the government and lawmakers.

MXN – Tight monetary policy behind stronger peso for now

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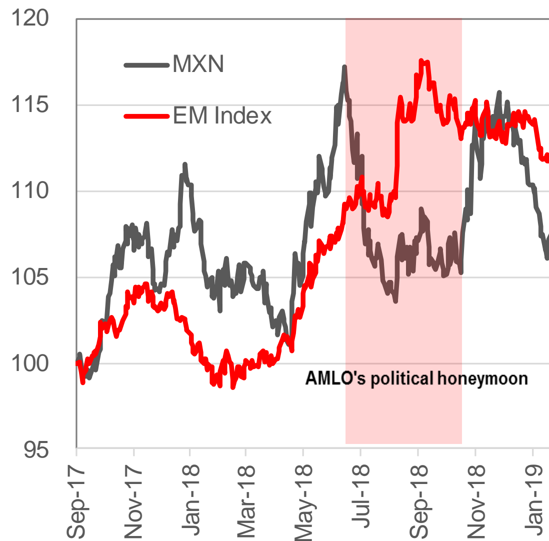
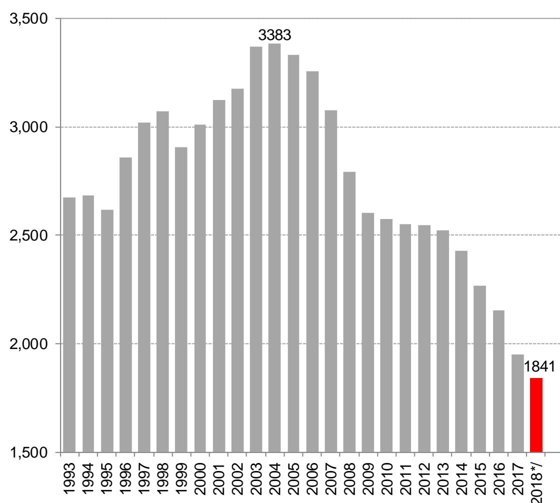
Chart 23: MXN vs. JPMorgan Emerging Market Currency Index Sept. 2017=100



Source: Santander, JP Morgan and Bloomberg

Chart 24: Oil production (thousands of barrels per day)



Source: PEMEX and Santander. *2018 = Jan-Nov.

On 15 December last year, the federal government presented a 2019 fiscal budget in line with what the markets were expecting: a primary surplus of 1.0% of GDP. Although many questions remain unanswered, which the market should get to grips with at least partially as we move through 2019, the primary surplus was enough for now to give the benefit of the doubt to the new government. The Mexican peso thus appreciated from 20.3 to below 19.0 vs. the USD from mid-December to mid-January. The MXN appreciated more than other emerging market currencies over the period and, in our view, this responds to the high policy rate of the central bank. Banxico's policy rate of 8.25% is much higher than Brazil's and Colombia's (6.50% and 4.25%, respectively), and higher than Russia's and South Africa's (7.75% and 6.75%, respectively), and all of these countries have a lower credit rating than Mexico. This difference seems unlikely to change, significantly, however, in light of the hawkish tone of Banxico's latest minutes and its bias towards additional hikes in 2019. In our view, Banxico is becoming less tolerant of pushing forward the date to when its inflation goal of 3.0% is expected to be achieved.

According to the minutes of the 12 December 2018 monetary policy meeting, the Board is concerned about the fact that inflation expectations have deteriorated and core inflation has shown substantial resistance towards moving to the 3% target. Also, the Board believes that GDP growth could slow as investment has been flat for the last three years. On the other hand, the minimum wage increase for 2019 could have a 40bp impact on inflation. More importantly, they are concerned about Pemex's new business model, falling oil production and a possible rating downgrade for Pemex.]. Finally, they did not rubber stamp the 1% of GDP primary surplus as they see issues with the management and structural vulnerability of medium-term public finances.

In our view, Banxico could hike again in 1H19 following the Fed, which should provide additional support to the MXN at least during that period. Two new members will join the Board for the next meeting on 7 February, leading to a less uniform composition, with the two new members foreseeably bringing more dovish arguments to the discussion. If the deceleration of the Mexican economy becomes more evident by 2H19, the two new doves could gain more influence over Board discussions and the market could start pricing cuts with more conviction, potentially leading to a depreciation of the MXN. By 2H19 , the market should pay more attention to the evolution of the 2019 budget, which could possibly show that Pemex has failed to achieve its production target, tax collection was lower than expected on less growth and that there is not much space in the 2020 budget to accommodate the full cost of the social programmes. It could also become more evident that USMCA approval in the US Congress is not moving forward as expected, and that global growth is weakening. All arguments in favour of a much weaker MXN and a steeper yield curve pricing Banxico's cuts in the short term and more credit risk in the long term.

CLP – A more range-bound outlook

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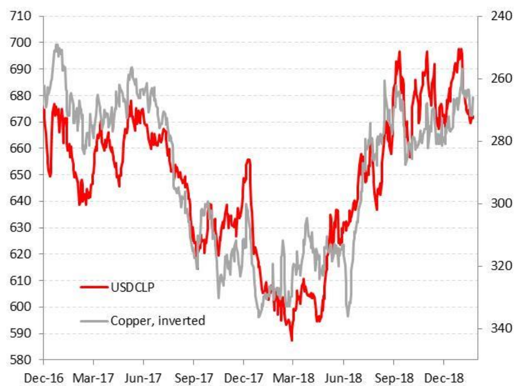
As seen in many other global risk assets, the CLP recovered in January what it had lost in December. The peso depreciated almost 3.5% in the last month of 2018, even crossing the critical 700 level on 3 January, but has posted a similar rally since the turn of the year. Short-term CLP correlations have been higher with EM peers and commodity currencies, and lower with copper prices and DM currencies, which in general remain weak vs. their end-November levels.

On the local growth front, IMACEC averaged 3.6% y/y in October and November, better than the 2.8% y/y recorded in 3Q18, in part due to a positive calendar effect. Assuming a 3.5% reading for December, 2018 GDP growth would close at 4.0%, the fastest pace in five years. That said, growth at the margin in the non-mining sector, a more precise indicator of underlying trends, has fallen to 2% annualised in recent months. This is rather softer than the 3.75% projected by the BCCh, and the 3.6% analysts' consensus for this year.

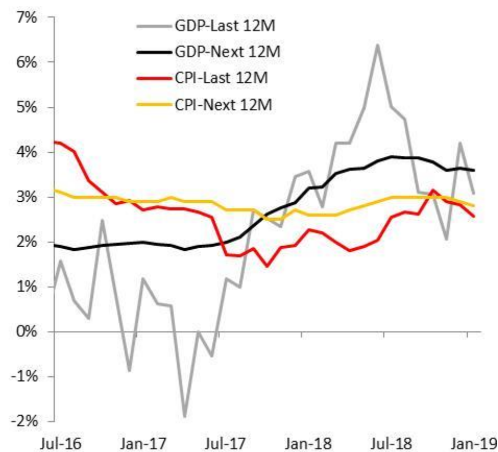
Chart 25: USDCLP vs. copper price



Copper prices=USD cents per pound Source: Santander, Bloomberg

Regarding inflation, December's CPI closed the year at a low 2.6% y/y, thanks to lower gasoline prices and very mild pressures elsewhere. Although the CLP remains relatively weak, pass-through to consumer prices is proving to be very limited, in part due to structural changes in the retail sector. For January, we estimate a decline to 2.3% y/y, but mainly driven by non-core items such as energy and food prices. The IPSAE core measure would hit 2.5% y/y, a still low level but the highest in 18 months. In any case, inflation should remain very contained in 1H19, with chances of a gradual pick-up in the second half but below the 3% threshold.

Chart 26: Growth and inflation – Actual and 12-month ahead expectations.



Source: INE, BCCH, Santander

Local rates, in turn, moved in line with the swings of global markets, showing a big rally in December and a sharp correction in January. However, short-term rates remain tight: the market discounts just over two 25bp hikes in 2019, with the first one coming in March (or before) and the second by July/September. However, the BCCh has so far stuck to the view that rates should converge to neutral by mid-2020 (around 4.25%), much faster than the market is expecting. Our call lies in the middle, with rates likely hitting 3.50% by year-end, and the BCCh gradually adopting a more dovish approach in the next two monetary policy reports (due out in March and June), a combination that should prove relatively neutral for the currency.

All in all, our impression is that the upward drift in the USDCLP rate observed over the last year has ended (or is at least very near its end), and that a more range-bound story is likely to prevail in 2019. However, this range would be wide and market swings would remain very erratic, with global investors hopping on and off the hard- and soft-landing scenarios for the US economy. Local factors would continue to play a secondary role, and only a stubbornly hawkish BCCh would generate an upward trend in the CLP, which in our view is unlikely. Our preferred range is 660-695 for the next few months, which in the copper space is more or less consistent with a range of USD2.55-2.90/lb.

COP – Temporary recovery

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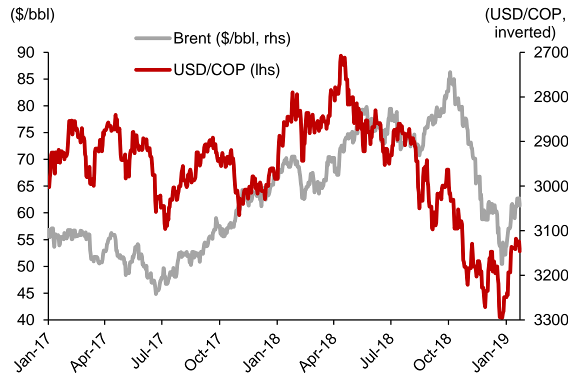
Since our last FX Compass (published 29 November), the COP had strengthened 2.9% and has appreciated 3.2% YTD, becoming the second best performing EM currency in 2019. The positive COP performance can be explained by the rebound in oil prices, as Brent has increased 14% YTD, moving back to prices above $60/bbl. Moreover, the US dollar has provided some relief for EM currencies as the DXY index has decreased 1.1% since 29 November and 0.4% YTD. Finally, adding to the external factors, in January and part of February there are seasonal tax inflows domestically that support the COP at the beginning of the year.

Chart 27: :Oil's recent pick-up supports COP

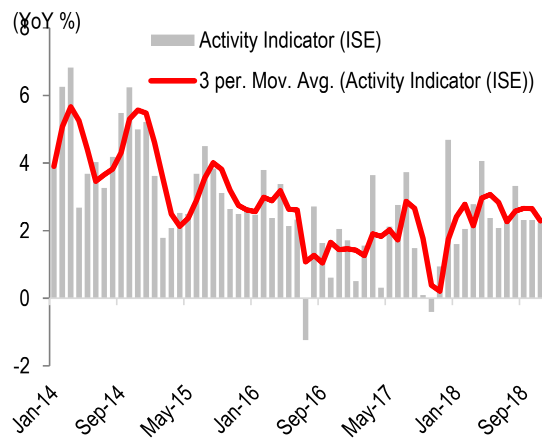


Source: Santander, Bloomberg

Despite the currency's recent positive performance, we consider that the risks remain to the upside, with China's economy showing further signs of deceleration, US-China trade talk uncertainty and tighter international financial conditions, and the Federal Reserve still expected to raise rates further this year. Moreover, despite the recent increase in oil prices, Colombia's current account deficit is expected to widen this year, as the trade deficit seems set to increase on declining exports due to less favourable oil prices and accelerating imports as a result of the economic recovery. We consider that the current account deficit could widen 3ppts of GDP to 3.6% (% GDP) in 2019, slightly deteriorating Colombia's external position.

In the short term we see some adjustment to the upside when the seasonal inflows end and expect the COP to rise closer to the 50-day moving average of 3192 vs. the USD. Finally, any further appreciation due to a weaker USD or higher oil prices should continue to be capped to some extent by the central bank's international reserve accumulation programme.

Chart 28: Moderate recovery



Source: Santander, DANE

In terms of rates, BanRep will hold its first meeting of the year on 31 January, where we expect it to hold rates for the eighth consecutive month. In its December communiqué, the MPC maintained its dovish/neutral tone as it continues to focus on the weakness of the economy and the uncertainty of the recovery, while it remains optimistic on inflation. We consider that March will be a key month for monetary policy, as by then we should know the impact, if any, of El Niño on inflation, as well as the 4Q18 GDP numbers. The inflationary risks from El Niño persist as Ideam (Hydrology, Meteorology and Environmental Studies Institute) issued a red warning to 22 districts due to the extreme weather conditions. We consider that if El Niño creates important inflationary pressures, BanRep could deliver its first hike in March. However, if the effects are milder than we currently expect (adding around 40bp to inflation), the board could decide to hold until 2H19, given that the latest monthly economic activity report continues to point to a moderate recovery. Indeed, November's activity growth disappointed, as it increased only 2.2% y/y despite the solid results reported in the retail and secondary sector. With this result, monthly economic activity suggests that GDP may have expanded below BanRep's forecast of 2.6%.

ARS – CB FX purchases have triggered a virtuous circle

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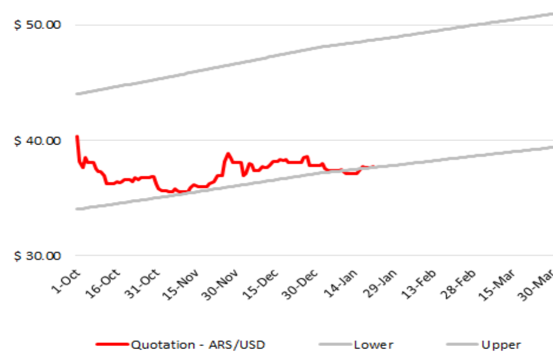
Chart 29: Non-intervention FX zone and dollar price ARS/USD



Source: BCRA and Santander.

The central bank has stepped up its daily purchases of hard currency this year, which totalled USD240mn as of 22 January. Interestingly, the negative differential between the dollar price at each auction has mostly increased in accordance with the quotation set by the lower bound of the non-intervention zone.

Such growing separation suggests a deepening FX market, in our view. Santander Río flows have also been positively impacted this year by dollar proceeds coming from wheat export sales and some short-term capital inflows.

The central bank's FX intervention strategy began on 10 January as a result of the peso showing clear signs of appreciation. For the time being, the central bank's action is subject to a USD50mn daily cap in unsterilised FX purchases. The monetary authorities thus seek to avoid excessive deviation from the target of zero growth in the monetary base, as set out in the IMF agreement.

Bear in mind that the USD700mn monthly target has been capped at 2% of the monetary base, while the non-intervention corridor is also adjusted by 2% monthly.

Central bank officials have pointed out that a proper calibration of unsterilised FX purchases is the top priority, in order to ensure that the monetary policy stance remains conducive to a rapid reduction of inflation and inflation expectations.

In this context, local press reports discussing the possibility of a rapid reduction in banks' reserve requirement ratios aimed at increasing credit supply and reducing interest rates rather than purchasing FX reserves seem to have been ignored by central bank authorities, at least during the first quarter of the year.

We remain very positive on the stabilisation of the FX market in the weeks to come. We expect the ARS to continue fluctuating around the bottom of the band set by the central bank, breaking below the lower bound in most sessions, as a result of export proceeds 25% higher than last year, low import purchases and some still cautious capital inflows.

PEN – Relief rally

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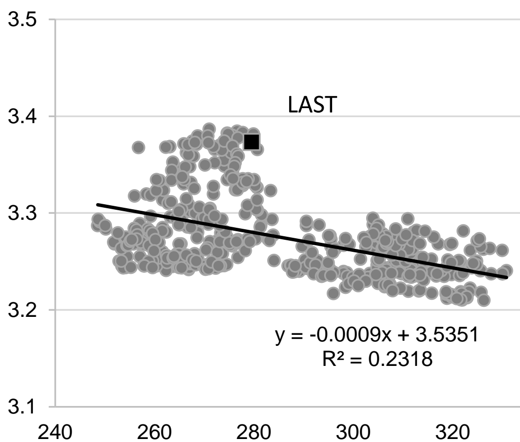
Since our last FX Compass (published 29 November), the PEN has recovered some ground, appreciating 1.39% since that date and PEN/USD falling to around 3.34 in January after breaking through the 3.38 level in November, for the first time since January 2017. The relief rally was explained in part by the moderate increase in metal prices, with copper rising 1.1% in the first month of 2019, in addition to the weakening of the US dollar which provided some relief to EM currencies, including the PEN. Furthermore, so far this month, offshore inflows have offset the outflows registered by local corporates, providing additional support to the currency. Given the recovery in the PEN, the central bank has remained on the side-lines and has not intervened in the FX market in January.

Despite the recent rally, we consider that the risks remain biased to the downside, due to the high degree of uncertainty on the external front as US-China trade talks continue. Additionally, lower growth in China may continue to put pressure on metal commodities, while tighter international financing conditions could strengthen the US dollar. We consider that the PEN will continue to follow the trend set by the external environment, but in a risk-off scenario we expect the PEN to perform better than its peers given Peru's positive macroeconomic outlook, with solid growth and contained external vulnerability.

As mentioned before, Peru's economic outlook remains positive in 2019. Economic activity expanded by 5.3% y/y in November, beating consensus expectations and confirming that the economy had picked up after disappointing growth of 2.3% y/y in 3Q18. All in all, leading indicators suggest that the economy grew at its potential level in 2018 at 4.0% y/y, a pace that we expect to be maintained in 2019. We consider that private consumption will continue to improve this year, supported by a steady increase in consumer credit as well as a recovery in formal employment. At the same time, we believe that private investment will remain an important source of growth, as there are strong investment commitments in the pipeline in both the mining and non-mining sectors for this year.

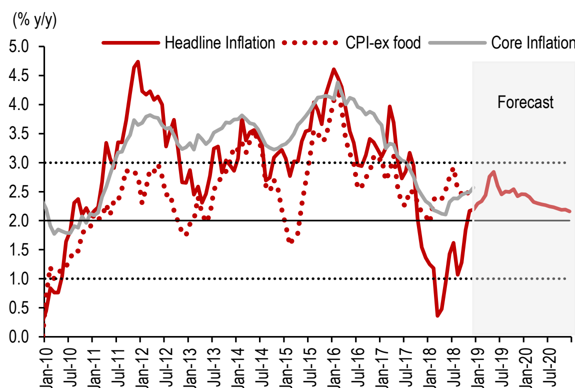
Inflation remains under control. CPI ended 2018 at 2.2% y/y, slightly above the 2% target. In 2019, we expect inflation to increase to 2.5%, above the target but remaining within the target band. This rise would be due to higher food prices and some pressures coming from the demand side. In this scenario of strong growth and increasing inflation, we expect the central bank to deliver its first hike in March. At its January meeting, the MPC continued to consider it appropriate to maintain an expansionary policy stance as long as inflation expectations remain anchored and economic activity remains below potential. We estimate that the output gap will close in the first half of the year, and thus believe that the central bank will have to adjust the reference rate accordingly.

Chart 30: USDPEN vs. copper prices ($/lb)*



*Jan-17-Jan-19. Source: Santander, Bloomberg

Chart 31: CPI expected to remain above target



Source: Santander, Central Bank

CEE FX: Main Themes

Currency	3M view	12M view	Main Themes
PLN			• EUR/PLN remained within the 4.26-4.34 horizontal trend it has been in since August. We expect the zloty to depreciate vs the euro in the first part of 2019E, with a gradual recovery of the Polish currency later in the year. As a result, we have revised our EUR/PLN forecasts up.
CZK			• We think the weaker growth in the euro zone will finally take its toll on the open Czech economy and that the hard data will start to converge with the sentiment indices. A scenario of slower economic growth leads us to leave the EUR/CZK upside profile unchanged.
HUF			• We expect EUR/HUF to stay flat in the short term, owing to the central bank's suggestion to withdraw the nonstandard monetary policy measures. At the end of 2Q19E, we expect EUR/HUF to rebound, mainly as a result of the expected further deterioration of Hungarian macro data.
RUB			• We have changed our USD/RUB forecast for 1Q19 to 66 from 69, mainly due to higher inflation (result of VAT increases). On a longer horizon, higher oil prices and prospects for decreases in the tension in US-Russia relations could help to keep USD/RUB stable.

Bullish Mildly Bullish Neutral Mildly Bearish Bearish

Source: Santander Bank Polska S.A.

PLN – Waiting for a trigger

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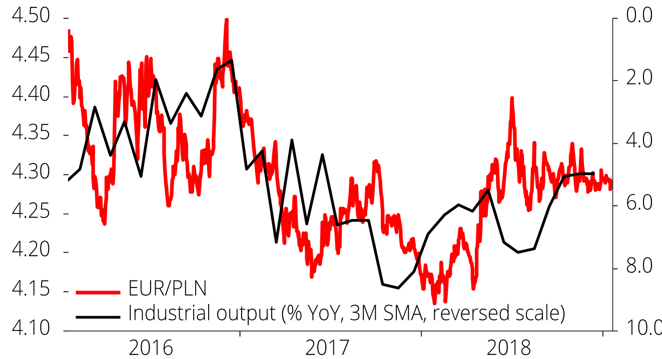
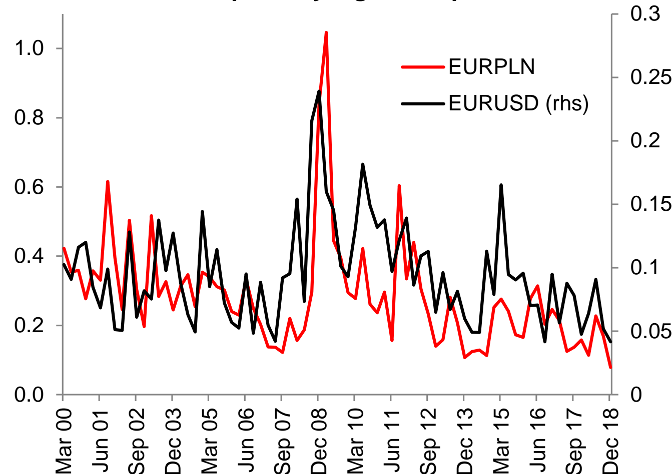
Chart 32: EUR/PLN and Polish industrial output (moving average, % y/y)



Source: Thomson Reuters Datastream, Santander Bank Polska

Chart 33: Nominal quarterly high-low spreads



Source: Reuters, Santander Bank Polska

EUR/PLN remained within the 4.26-4.34 horizontal trend it has been in since August. We expect the zloty to depreciate vs the euro in the first part of 2019E, with a gradual recovery of the Polish currency later in the year. As a result, we have revised our EUR/PLN forecasts up.

The first months of 2019 could bring some zloty depreciation, as the hard data should finally provide evidence that the economic slowdown in Poland is actually happening. We view the December industrial output (+2.8% y/y vs 4.7% y/y in November), retail sales (4.7% y/y vs 8.2% y/y previously, in real terms) and manufacturing PMI (47.6pt, its lowest since April 2013 and the second month in a row below 50pts) as the first signs that 5% GDP growth will not hold in 2019E. The zloty is a cyclical currency, and the decelerating economic growth should at least limit the scope for appreciation.

Since August, EUR/PLN has been moving in a very narrow range, and the 4Q18 high-low spread was the lowest quarterly range since 2Q93, according to Reuters data. Low volatility, measured as the quarterly high-low spread, has also been recorded in CEE and developed market exchange rates and bond yields. Only stock markets and LatAm currencies seem to maintaining a "proper" volatility.

Periods of a very low volatility are often followed by sharp jumps in price. Recall that rises in volatility are usually a negative phenomenon for EM currencies, and this makes us cautious when assessing the chances of a significant appreciation in the zloty in the short term.

After the December Fed rate hike, the upper-end of the Fed Funds rate is already 100bp above Poland's main refi rate. The Polish MPC has recently adopted even more dovish rhetoric, suggesting that rates could stay unchanged until 2022.

We think EUR/PLN could rebound towards the upper end of the above-mentioned range amid concerns surrounding global growth, the slowdown in Poland, the dovish rhetoric of the MPC and a jump in market volatility.

Later in the year, the zloty could start to benefit from the rising EUR/USD, a pause in the Fed's rate hike cycle and market pricing for an improvement in the situation in emerging markets after a turbulent 2018. However, the pace of EUR/PLN decline may be slow amid a lack of interest rate hikes in Poland this year, the continuation of an economic slowdown and market uncertainty ahead of the general election slated for the autumn.

CZK – Slower growth may weigh on koruna

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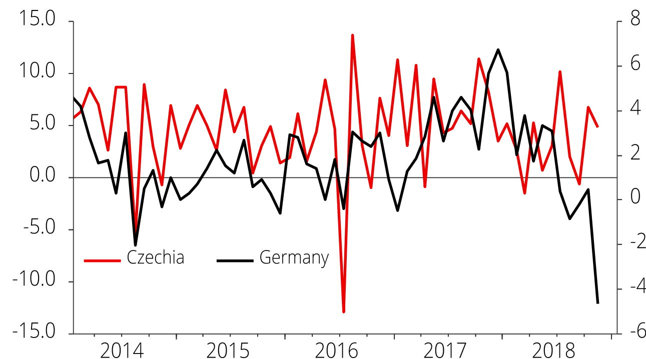
Chart 34: Czech and German industrial output (% y/y)



Source: Thomson Reuters Datastream, Santander Bank Polska

In November we wrote that the koruna could see gains in December, and EUR/CZK finished the year even a touch below our 25.9 target thanks to market expectations of a December rate hike from 1.75% to 2% (which, as we expected, was not delivered in the end).

After the last central bankers' meeting in 2018, the head of the Czech National Bank (CNB), Jiri Rusnok, said that most of the council said there was no rush for hike rates and that it was advisable to wait for more data and updated forecasts. In mid-January, Rusnok said that there could be fewer rate increases in 2019 than in 2018, adding that it is uncertain how many will take place this year after five 25bp hikes in 2018.

The Czech and German manufacturing PMIs are heading in the same direction, but we still do not see that kind of convergence in the hard data yet. Czech central bankers cite uncertainty regarding global economic growth as the reason for a delay in the next rate hikes, particularly when the annual CPI pulled back to the 2% target from 2.9% in late 2017 and 2.6% in mid-2018.

We think weaker growth in the euro zone will finally take its toll on the small open Czech economy and that hard data will start to converge with the sentiment indices (the process looks to have started in Poland). A scenario of slower economic growth leads us to leave our EUR/CZK forecast unchanged for 2019.

HUF – Monetary policy normalisation

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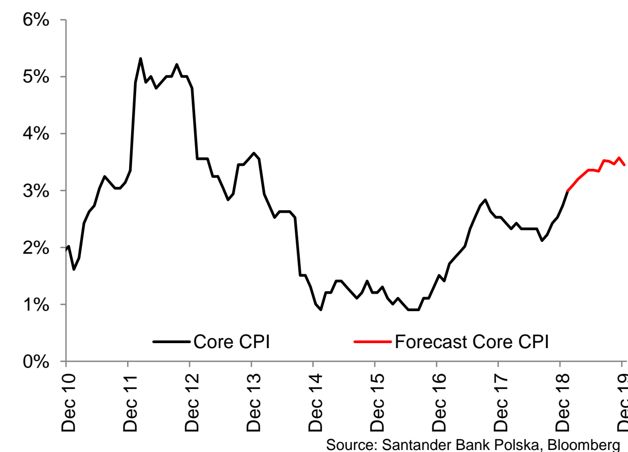
Chart 35: Hungary core CPI



Source: Reuters, Santander Bank Polska.

Over the last two months, EUR/HUF has decreased gradually (accelerating in 2H January). The forint's appreciation was largely driven by a change in Hungarian Central Bank (MNB) communication with the financial markets and, to a lesser extent, by an improvement in global moods. MNB started to suggest monetary policy normalization in response to the expected rise in core inflation. As a result, EURHUF slid to 317.70 at the end of January from 324.10 end-November.

Over the next four to five weeks, we anticipate EUR/HUF will stay between 316 and 318, owing to expectations of monetary policy normalization. Market expectations for policy normalization are likely to be supported by further speeches by MNB representatives. After the publication of the December minutes (at the beginning of January), the MNB's deputy governor reiterated that the rise in core inflation will be a strong argument for MNB to withdraw nonstandard monetary policy measures. In our opinion, the upcoming macro data will probably provide a ceiling for further forint appreciation. We expect a y/y decrease in industrial production to 2.4% in December (the second-lowest release in 2018) from 3.6% y/y in November. Moreover, we believe that further series of poor euro zone macro data (PMI, Ifo, industrial production) will hold back expectations for interest rate increases (despite the MNB, core inflation is expected to exceed 3.0% y/y at the beginning of this year and remain at that level throughout the year). Later in the year, we believe EURHUF will return to around 325 owing to the poor macro data from Hungary.

RUB – Inflation in the spotlight

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At the turn of December/January, we observed a rise in USD/RUB, fuelled by oil price decreases. News of abating tensions in US-Russia relations (the US president decided to withdraw US troops from Syria, and some Trump administration representatives suggested lifting sanctions on Rusal and other companies belonging to Russian oligarch Deripaska) did not prevent USD/RUB from rising. As a result, at the end of January USD/RUB wiped out the increases from the turn of the year (peak at 69.60) settling at around 66, which was supported, among other things, by oil price increases.

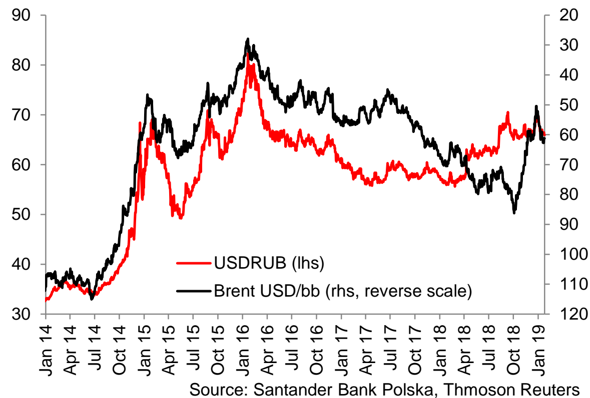
Over the next four to five weeks, we expect USD/RUB to stay around 65-66 (thus, we are retracting our USD/RUB growth forecast of 70 at the end of 1Q19). We believe Brent oil prices, at USD60/bbl, will help keep USD/RUB at a lower level. In the short term, real economy data releases should also keep USD/RUB at a lower level. In our opinion, if PMI-services indicators stay at a relatively high level (an average slightly below 55 points over the last six months), this should translate into higher wages and retail sales readings.

We expect USD/RUB to stay close to the current level at the end of 1Q19E. The key factor, which should keep USD/RUB at current levels over the next few quarters, will be increasing inflation (and, consequently, the strengthening of expectations for interest rate hikes – FRA6X9 currently stands at 9.0% vs the Bank of Russia key rate of 7.75%). The latest weekly CPI data suggests that the CPI for January should reach 4.5%-4.6% y/y, which is a consequence of the VAT increase (to 20% from 18%).

We expect the Russian CPI to rise further, to 5.0%-5.5% y/y over the coming months, supported by higher VAT rates and strong employee positions in the labour market (owing to a shrinking labour force). In our opinion, this will give rise to expectations of interest rate hikes by the Central Bank of Russia and, as a consequence, keep the USD/RUB close to current levels.

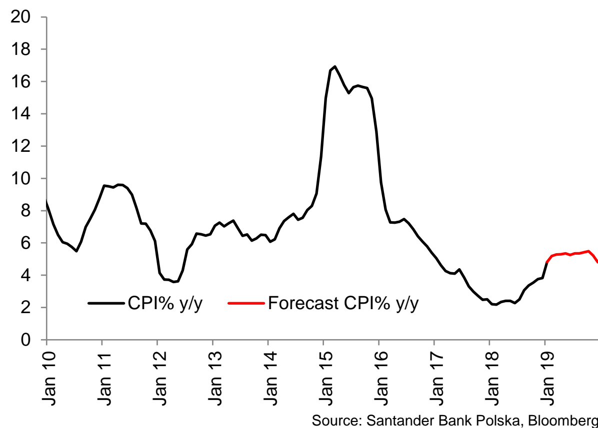
Furthermore, the US president's decision to withdraw US troops from Syria (which could be treated as a signal of playing down tensions in US-Russia relations) should provide additional support for the ruble. We believe that lifting the sanctions on Rusal (suggested by the Trump administration) could be the next positive factor for the ruble.

Chart 36: USD/RUB and oil prices



Source: Reuters, Santander Bank Polska.

Chart 37: Russian CPI



Source: Reuters, Santander Bank Polska.

G10 FX: IMM Speculative Positioning

****During the US federal government shutdown, the Commitments of Traders report is not being published. The most recent published data is from 18 December 2018 and we have used this data below.**

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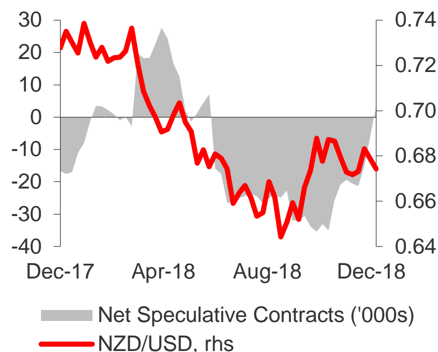
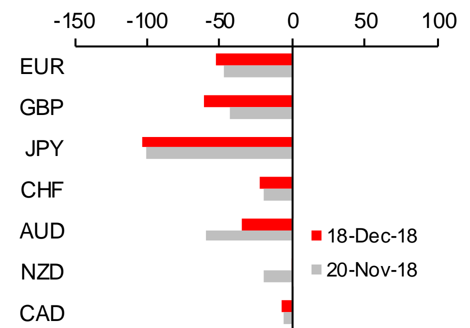
IMM commitment of traders report: NZD/USD position



- **Speculators retained a very large net long USD composite position in December.** Indeed, speculators have held a large net long USD composite position throughout H2-18. While we do not believe this position has much scope to continue increasing, speculators have been reticent to sell the USD throughout 2018.
- **The net short EUR position stood between 50k and 60k contracts during December**. While this is the most net short speculators have been the EUR since early 2017, it is also a massive shift since the start of 2018, with speculators holding a net long EUR position of almost 150k in mid-January.
- **The net NZD position turned long** in the week ended 18 December. This is the first time that speculators have held a net long NZD position during H2-18, but significant further increases in this NZD position are unlikely, in our view.
- **Speculators remained net short the GBP, JPY, CHF, AUD and CAD in December**, with the 24k improvement in the AUD position the largest 4-week change among these positions.

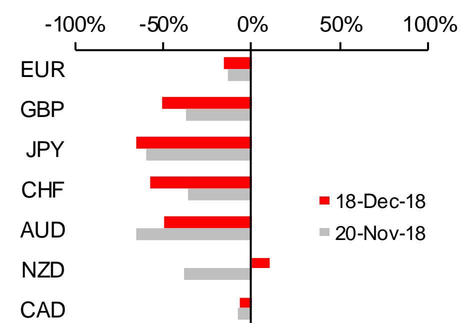
Net Speculative Contracts ('000s)*

	18-Dec-18	20-Nov-18	4w chg	YtD chg
USD***	279.4	281.1	-1.7	276.8
EUR	-53.1	-47.2	-5.9	-145.3
GBP	-60.7	-43.5	-17.2	-73.4
JPY	-102.8	-100.1	-2.7	13.3
CHF	-22.9	-19.6	-3.3	-9.0
AUD	-35.1	-59.2	24.1	-21.4
NZD	3.4	-19.3	22.8	21.0
CAD	-7.5	-6.3	-1.2	-24.8



Net Speculative Contracts as % of Open Interest**

	18-Dec-18	20-Nov-18	4w chg	YtD chg
USD***	28%	27%	2%	28%
EUR	-15%	-13%	-2%	-44%
GBP	-51%	-37%	-14%	-60%
JPY	-66%	-60%	-6%	-9%
CHF	-58%	-36%	-22%	-40%
AUD	-49%	-65%	16%	-34%
NZD	10%	-38%	48%	43%
CAD	-7%	-7%	1%	-32%



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)

Z-score USD/BRL

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

USD longs

USD/MXN

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

Z-score USD/MXN

Z-score (USD/MXN longs) ------ 10-90%

USD longs

USD/CLP

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

Z-score USD/CLP

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

USD longs

USD/PEN

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

Z-score USD/PEN

Z-score (USD/PEN longs) ------ 10-90%

USD longs

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

Euro Interest Rate Forecasts

Government Bond yield Forecasts

Germany	Current	1Q19	2Q19	3Q19	4Q19
ECB Depo	-0.40	-0.40	-0.40	-0.40	-0.20
3m	-0.54	-0.75	-0.65	-0.40	-0.25
2y	-0.58	-0.50	-0.35	-0.10	0.15
5y	-0.31	-0.15	0.05	0.35	0.55
10y	0.19	0.40	0.55	0.80	1.00
30y	0.80	1.00	1.15	1.35	1.50

Swap rate forecasts

Euro	Current	1Q19	2Q19	3Q19	4Q19
ECB Depo	-0.40	-0.40	-0.40	-0.40	-0.20
3m	-0.31	-0.33	-0.27	-0.17	-0.07
2y	-0.16	-0.05	0.05	0.30	0.50
5y	0.17	0.40	0.55	0.80	0.95
10y	0.74	1.00	1.10	1.60	1.45
30y	1.33	1.55	1.65	1.80	1.90

US Interest Rate Forecasts

Government Bond yield Forecasts

US	Current	1Q19	2Q19	3Q19	4Q19
FOMC *	2.50	2.75	3.00	3.00	3.00
3m	2.39	2.65	2.90	2.95	3.00
2y	2.56	3.00	3.15	3.20	3.25
5y	2.55	2.95	3.15	3.30	3.45
10y	2.71	3.00	3.20	3.35	3.50
30y	3.03	3.25	3.45	3.60	3.75

Swap rate forecasts

US	Current	1Q19	2Q19	3Q19	4Q19
FOMC *	2.50	2.75	3.00	3.00	3.00
3m	2.76	2.90	3.10	3.10	3.15
2y	2.71	3.20	3.35	3.35	3.40
5y	2.63	3.05	3.25	3.40	3.50
10y	2.75	3.05	3.25	3.40	3.50
30y	2.85	3.15	3.35	3.50	3.60

UK Interest Rate Forecasts

Government Bond yield Forecasts

UK	Current	1Q19	2Q19	3Q19	4Q19
MPC	0.75	0.75	0.75	0.75	0.75
3m	0.79	0.80	0.80	0.79	0.77
2y	0.78	0.75	0.90	0.80	0.80
5y	0.92	1.00	1.20	1.25	1.10
10y	1.27	1.40	1.70	1.80	1.60
30y	1.77	1.85	2.00	2.20	2.00

Swap rate forecasts

UK	Current	1Q19	2Q19	3Q19	4Q19
MPC	0.75	0.75	0.75	0.75	0.75
3m	0.93	0.90	0.90	0.87	0.85
2y	1.14	1.15	1.20	1.05	1.10
5y	1.30	1.35	1.45	1.55	1.45
10y	1.46	1.55	1.75	1.90	1.70
30y	1.60	1.65	1.75	1.95	1.70

G10 Central Bank Calendar

	Current Rate	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
FOMC (Upper)	2.50	-	Unch.	+25bp	-	Unch.	+25bp	30	-	20	-	1	19
ECB (Depo)	-0.40	Unch.	-	Unch.	Unch.	-	Unch.	Unch.	-	7	10	-	6
BoE	0.75	-	+25bp	Unch.	-	Unch.	Unch.	-	7	21	-	2	20
BoJ	-0.10	Unch.	-	Unch.	Unch.	-	Unch.	Unch.	-	15	25	-	20
SNB	-0.75	-	-	Unch.	-	-	Unch.	-	-	21	-	-	13
BoC	1.75	+25bp	-	Unch.	+25bp	-	Unch.	Unch.	-	6	24	29	-
RBA	1.50	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	-	5	5	2	7	4
RBNZ	1.75	-	Unch.	Unch.	-	Unch.	-	-	13	27	-	8	26
Norges Bank	0.75	-	Unch.	+25bp	Unch.	-	Unch.	Unch.	-	21	-	9	20
Riksbank	-0.25	Unch.	-	Unch.	Unch.	-	+25bp	-	13	-	25	-	-

Source: Bloomberg, Santander. Note: Current levels as at 24-Jan-19. For meetings that have already taken place, decision identified as +/- in bp, or "unch" for no change. "-" denotes no meeting taking place that month *FOMC rate refers to upper bound rate. **The ECB QE programme is set to drop to EUR15/month for Q4-18 and then stop.

Brazil/Mexico Interest Rate forecasts

Brazil	Current	1Q19	2Q19	3Q19	4Q19
SELIC	6.50	6.50	6.50	6.50	6.50
NTNF Jan' 20s	6.54	6.50	6.50	6.50	6.50
NTNF Jan.' 25s	8.82	8.80	8.70	8.60	8.50

Mexico	Current	1Q19	2Q19	3Q19	4Q19
Banxico fondeo	8.25	8.50	8.50	8.50	8.50
Mbono Jun. '21s	8.32	8.60	8.70	8.80	8.80
MBono Jun. '27s	8.44	8.90	9.00	9.20	9.40

Chile/Colombia Interest Rate Forecasts

Chile	Current	1Q19	2Q19	3Q19	4Q19
BCCh TPM	2.75	3.00	3.25	3.25	3.25
BCP 5Y	4.10	4.20	4.35	4.30	4.25
BCP 10Y	4.26	4.60	4.70	4.65	4.60

Colombia	Current	1Q19	2Q19	3Q19	4Q19
Banrep O/N	4.25	4.50	4.75	5.00	5.25
TES Jul '24s	6.23	6.44	6.48	6.64	6.64
TES Apr '28s	6.84	7.01	7.23	7.31	7.41

Argentina/Peru Interest Rate Forecasts

Argentina	Current	1Q19	2Q19	3Q19	4Q19
LELIQ 7-day	56.87	51.80	43.20	38.50	29.85

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

LatAm Central Bank Calendar

	Current Rate	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Brazil	6.50	-	Unch.	Unch.	Unch.	-	Unch.	-	6	20	-	8	19
Mexico	8.25	-	Unch.	-	Unch.	+25bp	+25bp	-	7	28	-	16	27
Chile	2.75	Unch.	-	Unch.	+25bp	-	Unch.	30	-	29	-	9	7
Colombia	4.25	Unch.	-	Unch.	Unch.	-	Unch.	31	22	29	26	31	28
Argentina*	56.87	Unch.	+2000bp	+500bp	+305bp	-730bp	-1503bp	~	~	~	~	~	~
Peru	2.75	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	7	7	11	9	13

CEE Interest Rate Forecasts

Poland	Current	1Q19	2Q19	3Q19	4Q19
Reference Rate	1.50	1.50	1.50	1.50	1.50
2y	1.36	1.40	1.53	1.59	1.48
10y	2.81	2.85	2.95	3.10	2.85

CEE	Current	1Q19	2Q19	3Q19	4Q19
Hungary	0.90	0.90	0.90	0.90	0.90
Czech Republic	1.75	2.00	2.00	2.00	2.00
Russia	7.75	7.75	7.75	7.75	7.75

CEE Central Bank Calendar

	Current Rate	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Poland	1.50	Unch.	-	Unch.	Unch.	Unch.	Unch.	Unch.	6	6	3	15	5
Czech Republic	1.75	-	+25bp	+25bp	-	+25bp	Unch.	-	7	28	-	2	26
Hungary	0.90	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	29	26	26	30	28	25
Russia	7.75	Unch.	-	+25bp	Unch.	-	+25bp	-	8	22	26	-	14

Source: Bloomberg, Santander. Note: Current levels as at 24-Jan-2019. For meetings that have already taken place, decision identified as +/- in bp, or "unch" for no change. "-" denotes no meeting taking place that month. *On 7 August 2018 = Argentina's monetary policy committee voted unanimously to change the key interest rate to 7-day Leliq rate, which the bank has been changing on a daily basis since the start of October (the decision was made fortnightly previously).

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

	3M	6M	9M
EUR/USD	**1.18**	**1.19**	**1.20**
vs.forward	3.7	5.2	6.1
vs.consensus forecast	2.3	2.0	1.1
GBP/USD	**1.32**	**1.34**	**1.35**
vs.forward	1.5	2.5	3.8
vs.consensus forecast	1.8	1.3	1.0
EUR/GBP	**0.89**	**0.89**	**0.89**
vs.forward	2.2	2.6	2.2
vs.consensus forecast	1.0	1.5	1.0
USD/JPY	**115**	**118**	**119**
vs.forward	5.1	7.8	8.4
vs.consensus forecast	3.9	7.6	10.2
EUR/JPY	**136**	**141**	**143**
vs.forward	9.0	13.4	15.0
vs.consensus forecast	6.0	9.5	10.2
EUR/CHF	**1.17**	**1.19**	**1.20**
vs.forward	3.4	5.2	6.3
vs.consensus forecast	2.3	3.2	4.3
USD/CHF	**0.99**	**0.99**	**1.00**
vs.forward	-0.3	0.0	0.3
vs.consensus forecast	0.2	0.4	1.8
EUR/SEK	**10.1**	**9.9**	**9.7**
vs.forward	-1.5	-3.4	-5.4
vs.consensus forecast	-0.7	-1.5	-2.7
EUR/NOK	**9.7**	**9.6**	**9.6**
vs.forward	-0.5	-1.2	-1.5
vs.consensus forecast	1.2	1.1	1.2
USD/CAD	**1.27**	**1.25**	**1.23**
vs.forward	-4.9	-6.6	-8.1
vs.consensus forecast	-3.8	-4.1	-4.9
AUD/USD	**0.73**	**0.74**	**0.75**
vs.forward	3.4	4.8	6.2
vs.consensus forecast	1.9	1.8	1.8
NZD/USD	**0.68**	**0.68**	**0.69**
vs.forward	0.4	0.9	2.4
vs.consensus forecast	1.5	0.5	2.0

	3M	6M	9M
USD/BRL	**3.72**	**3.78**	**3.90**
vs.forward	-1.1	0.6	3.7
vs.consensus forecast	-2.2	0.4	4.0
EUR/BRL	**4.37**	**4.51**	**4.69**
vs.forward	2.2	5.5	9.6
vs.consensus forecast	0.1	2.4	5.2
USD/MXN	**19.5**	**19.93**	**20.60**
vs.forward	2.2	4.5	8.0
vs.consensus forecast	0.0	1.2	4.3
EUR/MXN	**22.9**	**23.8**	**24.8**
vs.forward	6.1	9.9	14.6
vs.consensus forecast	2.3	3.2	5.5
USD/CLP	**675**	**668**	**670**
vs.forward	0.3	-0.7	-0.4
vs.consensus forecast	0.0	0.0	1.1
USD/COP	**3283**	**3283**	**3367**
vs.forward	4.2	4.2	6.8
vs.consensus forecast	5.5	5.9	9.5
USD/ARS	**40.6**	**42.9**	**45.4**
vs.forward	8.0	14.3	20.8
vs.consensus forecast	2.1	2.3	2.0
USD/PEN	**3.46**	**3.50**	**3.54**
vs.forward	3.5	4.9	6.1
vs.consensus forecast	3.5	5.5	6.7
EUR/PLN	**4.34**	**4.34**	**4.33**
vs.forward	0.9	0.9	0.9
vs.consensus forecast	0.9	0.9	1.7
EUR/CZK	**25.8**	**26.0**	**26.1**
vs.forward	0.5	1.0	1.6
vs.consensus forecast	0.7	1.8	2.9
EUR/HUF	**322**	**325**	**325**
vs.forward	0.8	1.8	1.8
vs.consensus forecast	0.2	1.6	1.6
EUR/RUB	**78**	**80**	**81**
vs.forward	4.4	6.9	7.8
vs.consensus forecast	-0.1	3.2	1.8

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

G10 FX: Spot and forward rates

	EUR/USD	GBP/USD	USD/JPY	EUR/JPY	GBP/JPY	USD/CHF	EUR/CHF	GBP/CHF
Spot	1.134	1.302	109.72	124.51	143.07	0.995	1.128	1.296
1M	1.137	1.304	109.45	124.44	142.77	0.992	1.128	1.294
2M	1.140	1.306	109.21	124.46	142.65	0.990	1.128	1.293
3M	1.143	1.308	108.93	124.48	142.51	0.986	1.127	1.291
6M	1.152	1.314	108.08	124.49	142.02	0.978	1.126	1.285
9M	1.161	1.320	107.27	124.52	141.54	0.969	1.125	1.279
12M	1.170	1.325	106.37	124.51	140.97	0.960	1.124	1.272

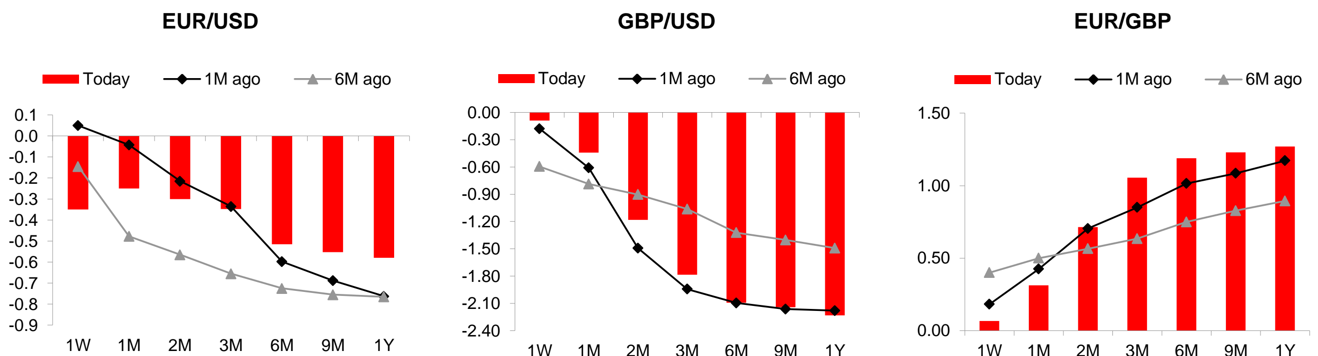
ATMf vol.

	EUR/USD	GBP/USD	USD/JPY	EUR/JPY	GBP/JPY	USD/CHF	EUR/CHF	GBP/CHF
1W	7.6%	12.0%	6.7%	7.5%	12.5%	6.3%	4.5%	10.9%
1M	6.5%	10.6%	6.6%	7.3%	11.6%	5.9%	4.5%	9.8%
2M	6.7%	10.7%	7.0%	7.8%	11.8%	6.2%	4.8%	9.8%
3M	6.7%	10.8%	7.1%	7.9%	11.9%	6.4%	5.0%	9.9%
6M	7.0%	10.7%	7.6%	8.4%	12.0%	6.7%	5.4%	10.0%
9M	7.2%	10.6%	7.9%	8.7%	12.0%	7.0%	5.7%	9.9%
12M	7.3%	10.5%	8.1%	8.9%	12.0%	7.2%	5.8%	9.9%

Implied/realized vol. ratio

	EUR/USD	GBP/USD	USD/JPY	EUR/JPY	GBP/JPY	USD/CHF	EUR/CHF	GBP/CHF
1W	1.93	1.89	1.31	1.30	1.59	1.75	1.23	1.78
1M	0.99	1.13	0.63	0.67	0.76	0.90	0.92	1.04
2M	0.98	1.18	0.84	0.86	0.96	0.98	1.00	1.16
3M	0.96	1.12	0.95	0.93	1.00	1.00	1.06	1.13
6M	1.02	1.24	1.14	0.99	1.13	1.13	1.06	1.25
9M	1.01	1.28	1.21	1.03	1.20	1.15	1.07	1.30
12M	1.02	1.26	1.17	1.05	1.19	1.11	1.09	1.28

25-delta risk reversals



Sources: Bloomberg and Santander. As of 24-Jan-19

Latin America FX: Spot and forward rates

	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
Spot	37.6	3.76	673	3156	19.1	3.34
1M	39.0	3.79	673	3160	19.1	3.34
2M	40.0	3.80	673	3164	19.2	3.35
3M	41.2	3.80	673	3168	19.3	3.35
6M	44.9	3.83	673	3181	19.6	3.36
9M	49.4	3.86	673	3194	19.9	3.38
12M	52.1	3.88	673	3207	20.2	3.39

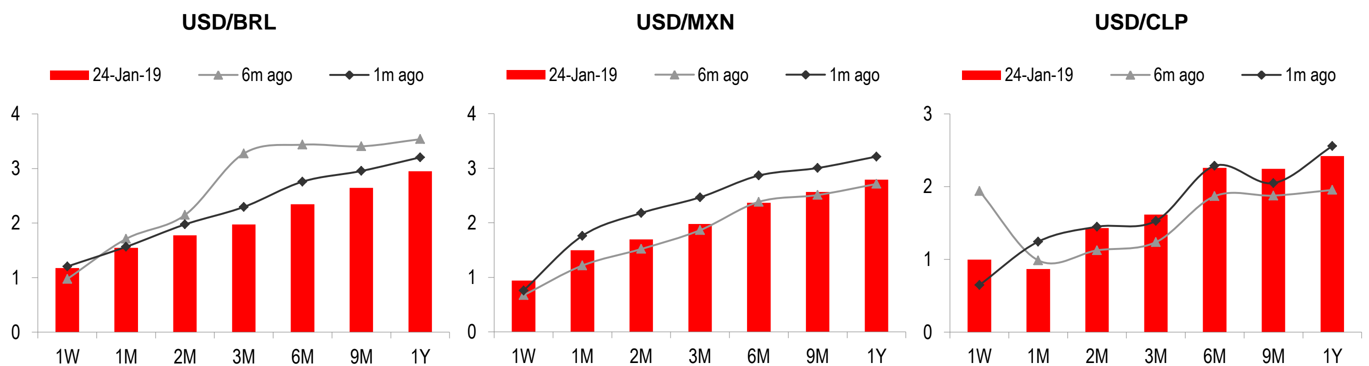
ATMf vol.

	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
1W	7.75	13.40	10.47	11.62	11.32	3.58
1M	10.00	13.41	10.43	11.78	11.61	3.68
2M	12.03	13.53	10.51	11.99	12.00	3.96
3M	13.75	13.64	10.56	12.16	12.29	4.16
6M	16.93	13.83	10.60	12.40	12.82	4.64
9M	18.78	13.98	10.89	12.63	13.14	5.00
12M	20.00	14.03	10.92	12.77	13.33	5.23

Implied/realized vol. ratio

	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
1W	1.20	1.25	1.98	3.31	1.31	1.36
1M	0.96	1.02	1.19	1.25	1.18	1.13
2M	0.88	0.97	1.13	1.25	1.07	1.18
3M	1.00	0.96	1.11	1.33	0.96	1.35
6M	0.57	0.84	1.00	1.27	0.99	1.27
9M	0.65	0.85	1.04	1.19	0.98	1.33
12M	0.80	0.93	1.12	1.20	1.03	1.38

25-delta risk reversals



Sources: Bloomberg and Santander. As of 24-Jan-19

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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