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FX COMPASS

Stuart Bennett
Head G-10 FX Strategy
stuart.bennett@santanderCIB.co.uk
Banco Santander, S.A. London Branch
(+44) 33114 80134

Michael Flisher
G-10 FX Strategy
michael.flisher@santanderCIB.co.uk
Banco Santander, S.A. London Branch
(+44) 33114 80232

Jankiel Santos
Economist – Brazil
jankiel.santos@santander.com.br
Banco Santander Brazil S.A.
(+55) 11 3012 5726

Guillermo Aboumrad
Economist – Mexico
gjaboumrad@santander.com.mx
Banco Santander Mexico, S.A.
(+52) 55 5257 8170

Juan Pablo Cabrera
Chief Rates & FX Strategist, Chile
jcabrera@santander.cl
Banco Santander Chile S.A.
(+56) 22 320 3778

Juan Miguel Arranz
Chief Rates & FX Strategist, Argentina
jarranz@santanderrio.com.ar
Banco Santander Río S.A.
(+54) 11 4341 1065

Mike Moran
Latin America Rates & FX Strategist
mike.moran@santander.us
Santander Investment Securities, Inc
(+1) 212 350 3500

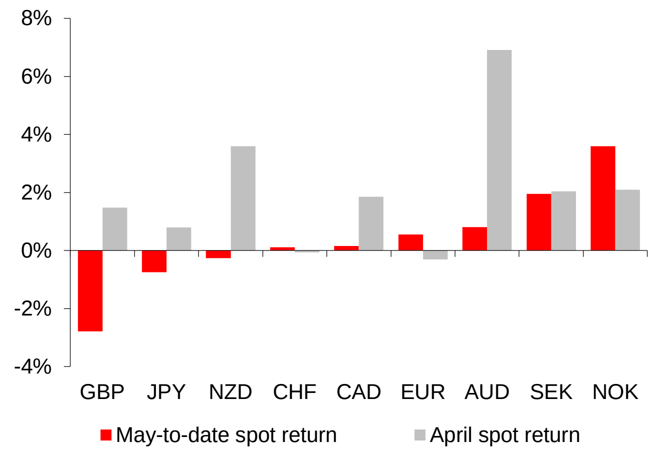
Marcin Sulewski, CFA
CEE Economist
marcin.sulewski@santander.pl
Santander Bank Polska S.A.
(+48) 22 534 1884

Wojciech Mazurkiewicz
CEE Economist
wojciech.mazurkiewicz@santander.pl
Santander Bank Polska S.A.
(+48) 22 534 1886

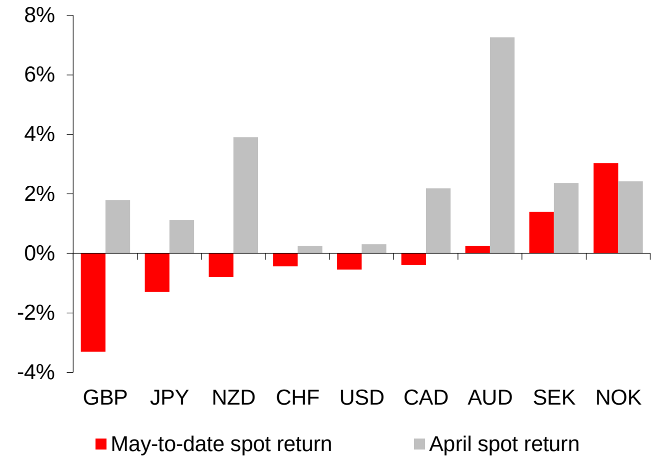
Santander Interest Rate & FX Strategy in Bloomberg: SRFS <GO>

FX Spot Returns

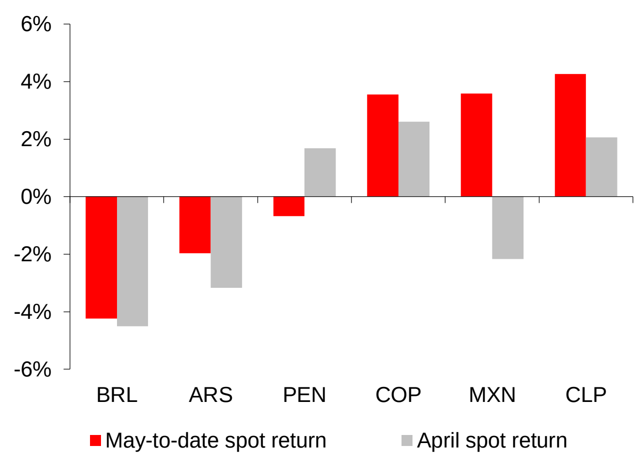
G10 spot returns vs. USD



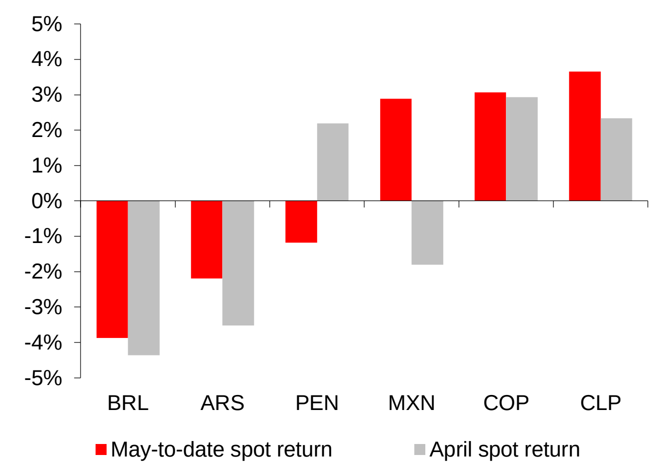
G10 spot returns vs. EUR



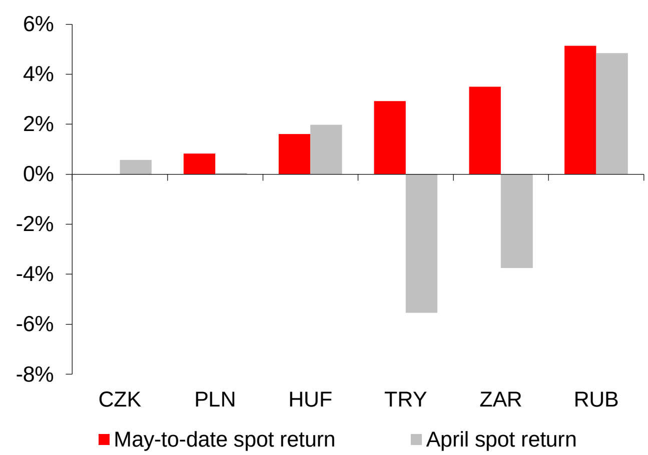
LatAm spot returns vs. USD



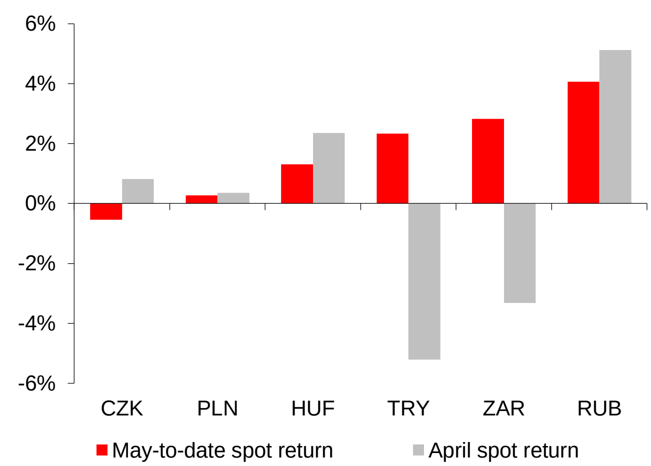
LatAm spot returns vs. EUR



CEEMA vs. USD



CEEMA vs. EUR



Source: Bloomberg, Santander. Note: Data current as at 21-May-2020 at 12:30 BST

FX Forecasts

G10 FX Forecasts	Q2-20	Q3-20	Q4-20	Q1-21	Q2-21	Q3-21
EUR-USD	1.09	1.12	1.14	1.14	1.15	1.16
GBP-USD	1.17	1.24	1.30	1.33	1.35	1.35
GBP-EUR	1.07	1.11	1.14	1.17	1.17	1.16
EUR-GBP	0.93	0.90	0.88	0.86	0.85	0.86
USD-JPY	112	113	114	114	115	118
EUR-JPY	122	127	130	130	132	137
USD-CNY	7.20	7.00	6.85	6.75	6.70	6.65
EUR-CHF	1.05	1.11	1.12	1.13	1.15	1.15
USD-CHF	0.96	0.99	0.98	0.99	1.00	0.99
EUR-SEK	10.9	10.8	10.5	10.4	10.3	10.2
EUR-NOK	11.3	11.1	10.7	10.4	10.2	10.1
USD-CAD	1.38	1.36	1.33	1.32	1.30	1.30
AUD-USD	0.62	0.64	0.65	0.67	0.68	0.70
NZD-USD	0.60	0.63	0.64	0.66	0.67	0.67

LatAm FX Forecasts	Q2-20	Q3-20	Q4-20	Q1-21	Q2-21	Q3-21
USD-BRL	5.90	6.00	5.80	5.80	5.70	5.60
USD-MXN	24.0	23.6	22.9	23.0	23.1	22.4
USD-CLP	825	810	800	790	780	770
USD-COP	3700	3750	3600	3500	3500	3400
USD-ARS	71	79	87	96	107	118
USD-PEN	3.4	3.5	3.4	3.5	3.6	3.6
EUR-BRL	6.43	6.72	6.61	6.61	6.56	6.50
EUR-MXN	26.2	26.4	26.1	26.2	26.6	26.0
EUR-CLP	899	907	912	901	897	893
EUR-COP	4033	4200	4104	3990	4025	3944
EUR-ARS	78	88	99	110	123	137
EUR-PEN	3.7	3.9	3.9	4.0	4.1	4.1

CEE FX Forecasts	Q2-20	Q3-20	Q4-20	Q1-21	Q2-21	Q3-21
EUR-PLN	4.70	4.70	4.60	4.55	4.50	4.48
EUR-CZK	28.0	27.0	25.7	24.8	24.8	24.5
EUR-HUF	360	370	372	375	380	385
USD-RUB	79	85	90	93	96	100
EUR-RUB	86	95	103	106	110	116

Sources: Santander

G10 FX: Main Themes

Currency	3M view	12M view	Main Themes
USD	⇨	↘	• The USD remains firm, but off of its March high as risk and equities have improved. A further decline will depend on how quickly the spread of Covid-19 is contained and the speed that economies are opened up.
EUR	⇨	↗	• EUR/USD has remained range-bound (1.08-1.10) since the start of April. The ECB has boosted stimulus and fiscal policy should also help activity, amid the gradual opening-up of European economies.
GBP	⇨	↗	• Sterling has reversed much of its recent excessive decline, but the GBP remains vulnerable to softer risk appetite and the apparent lack of progress in UK-EU trade talks. Plus, we expect more QE from the BoE.
JPY	↘	↘	• The yen remains driven by risk, but USD/JPY has tended to move sideways. Japan entered recession in Q1-20, with further weakness forecast for Q2-20, but a better H2-20 should signal a weaker yen.
CNY	↘	↗	• The economy has shown signs of returning to normal but remains at risk from the global slowdown and renewed US-China tensions. Given this, the CNY has been relatively stable, and looks to the PBoC to provide more stimulus.
CHF	⇨	↘	• The SNB now views the CHF as very highly valued, and with CPI slowing, may act to contain any renewed franc strength. However, a weaker CHF should also require a pick-up in risk appetite and a firmer EUR.
CAD	⇨	↗	• An oil price recovery has helped the CAD, but the currency still lags some of its commodity peers. Cheap oil and the Covid effect will weigh on the currency, with the new BoC governor not ruling out negative rates.
AUD	↘	↗	• The AUD has stalled in May after April's outperformance. We see short-term risks to the downside, with AUD upside still reliant on a more upbeat global risk backdrop.
NZD	⇨	↗	• The NZD has been held back in May by the RBNZ almost doubling the size of its QE programme. The Bank also opened the door to further rate cuts, which should continue to restrict the NZD in the near term.
SEK	⇨	↗	• The SEK fell in March as the Covid-19 crisis went global, but has almost fully unwound that move already. Given the high-risk, low-growth backdrop though, we expect the SEK to now struggle in the near term.
NOK	⇨	↗	• The NOK fell to new all-time lows against both USD and EUR in March, as oil prices plummeted. With oil prices recovering in May, the NOK has firmed, but additional gains remain reliant on oil.

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

Source: Santander

G10 FX Overview

Stuart Bennett
stuart.bennett@santanderCIB.co.uk
(+44) 33114 80134

Michael Flisher
michael.flisher@santanderCIB.co.uk
(+44) 33114 80232

The USD's performance has been mixed so far in May, but overall the currency remains firm, albeit with the USD index still notably below both April and March highs. Amid a weak economic outlook US yields have fallen, but the Fed's reluctance to move toward negative rates could offer support. However, we still favour a softer USD in H2-20, assuming economic risks diminish and risk appetite improves.

We remain positive on the EUR into H2-20 and see EUR/USD moving to 1.14 by the end of the year. The Eurozone economy is expected to shrink significantly in 2020, but the combination of fiscal and monetary stimulus should now be viewed as supportive for the currency. Further, gradual steps to open up some European economies could be euro positive.

Sterling has not had a good May. At the time of writing, the pound is the worst performing G10 currency month-to-date. In the short term, we expect the GBP to remain vulnerable. The UK economy is expected to contract in 2020, but in line with other economies, while some focus on the scope for negative UK rates might hamper the pound, although the FX market is also focussed on whether there will be progress on the UK-EU trade talks.

We continue to expect the yen to weaken over the coming months. Given the currency's perceived status as a safe-haven asset, it has been supported by low global risk appetite associated with Covid-19. But assuming these pressures ease in H2-20, the yen should soften.

The CNY has remained comparatively stable during the last month, with USD/CNY hovering around 7.10. The Chinese economy has shown signs of 'getting back to normal', but the PBoC is expected to continue providing stimulus as China faces a global slowdown and the potential threat of souring US-China relations.

The SNB continues to view the CHF as 'highly valued' and has conceded that it has been intervening heavily to weaken the CHF. This action has not succeeded in pulling EUR/CHF higher, and we believe it will still require a pick-up in risk appetite, if the spread of Covid-19 slows, and a firmer EUR to weaken the CHF.

We continue to favour a stronger CAD, even if it remains vulnerable to any dip in risk appetite, and the economy is expected to have contracted significantly in H1-20. But ongoing fiscal and monetary policy stimulus should support activity in H2-20 and if it continues, the oil price continue to rise, this should also help CAD.

We are cautious on both the AUD and NZD in the near term. Both currencies had a strong April, but gains have been more limited in May. We see the risks to the downside in June, as the market rebound starts to look overdone. Indeed, with domestic data set to weaken, and global growth, risk sentiment, and commodity prices to remain subdued, these risk currencies may find further gains more difficult.

After a sharp fall in March, as the Covid-19 crisis went global, the SEK rebounded strongly in April and May. But the currency may have gained too quickly, as EUR/SEK is now unchanged year-to-date, despite risk sentiment remaining well below its pre-Covid-19 highs.

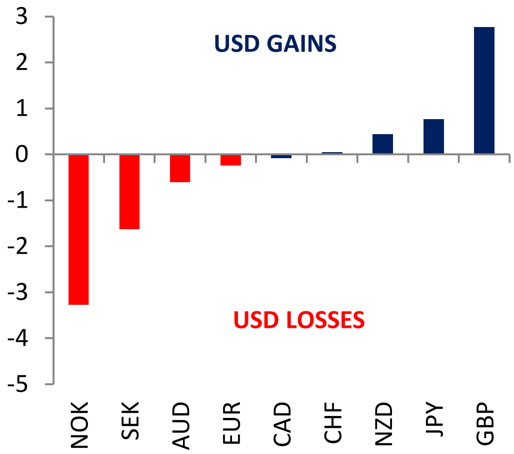
The Norges Bank cut rates to zero in May, but the NOK has gained on the firmer oil price May. Addition oil price gains should help the NOK to continue to strengthen over the coming months.

USD – Don't be negative

Stuart Bennett
stuart.bennett@santanderCIB.co.uk
(+44) 33114 80134

The USD's performance has been a little more mixed so far in May, but overall the currency remains firm, albeit with the USD index still notably below both April and March highs. Amid a weak economic outlook US yields have fallen, but the Fed's reluctance to move toward negative rates could offer support. However, we still favour a softer USD in H2-20, assuming economic risks diminish and risk appetite improves.

Chart 1: USD's carry-adjusted performance since month-to-date (%)



Source: Bloomberg, Santander As at 11:00BST on 21 May 2020

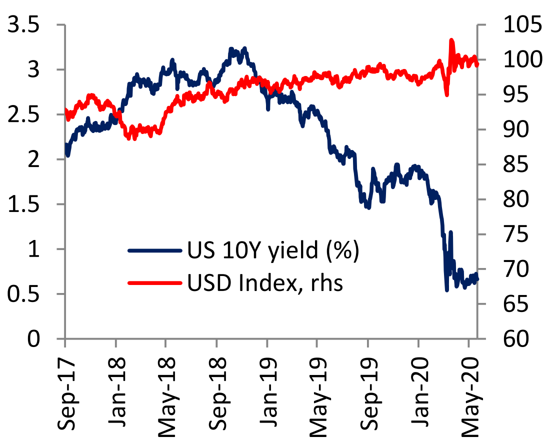
The USD index hit a high at 103 in March as risk appetite plummeted amid concern over the spread and impact of Covid-19 and the associated drop in equities. As markets calmed down, the USD fell, but has tended to remain firm, as risk appetite is still under pressure.

However, since the start of April, the USD has tended to find support around the 99 level. Given that risk appetite remains a key driver of the FX market, it should require positive news on the spread of Covid-19, and signs that economic expectations are picking up, to pull the dollar sustainably lower over the coming months.

Hence, despite the outlook for a global economic contraction, such good news may push equities higher and eat away at the USD's appeal. In this regard, we see the 3000 level in the S&P 500 as an important technical/psychological level, where moves above could be the trigger for a weaker USD.

But the renewal of US-Chinese tensions over the past few weeks may muddy the outlook for risk appetite. After phase 1 of the US-China trade agreement was signed at the start of the year, the FX market was able to take a more relaxed approach with regard to the two countries. But Covid-19 has led to a deterioration of relations and, hence, even if the spread and effect of the disease lessens, a continuation of belligerent rhetoric from both sides ahead of the US elections in November could curtail any increase in risk appetite.

Chart 2: The Fed has reiterated its reluctance to make the Fed Funds Target negative, but its risk rather than yields that continue to hold sway over the FX market



Source: Bloomberg, Santander

The US economic outlook remains under pressure. The IMF sees the US shrinking 5.9% this year vs. +2.3% in 2019. Forecasts for other G10 countries are similar, but suggest that unlike in 2018-19 the USD may not get much of a lift from the US's GDP outperformance.

However, we note that the US did make a better, or rather less bad, start to the year. Q1-20 GDP data contracted 1.2% QoQ, compared to the Eurozone's 3.8% QoQ contraction and the UK's -2% QoQ. Japan contracted by only 0.9% QoQ, but after shrinking in Q4-19, this implies that Japan is already in a technical recession.

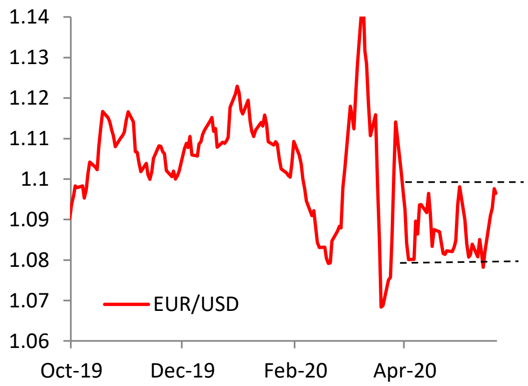
The weak economic outlook has already forced the unleashing of considerable monetary and fiscal stimulus. The Fed has adopted open-ended QE and cut the Fed Funds target range to 0.0%-0.25%. The April FOMC minutes highlighted, unsurprisingly, that the Fed sees Covid-19 posing a severe threat to the economy in the near term that may lead to considerable downside risks to the economic outlook.

But the Fed has reiterated that it is unlikely that the Fed Funds rate will turn negative. The reluctance to make further cuts could provide some USD support. However, yield differentials are exerting less influence on USD pairs at the moment. Indeed, despite the big drop in US yields since March, the 10Y is still above most of its peers, with the exception of Australia. But if risk appetite does improve, the outlook for US rates staying at very low levels still suggests that the USD will not benefit from the significant carry advantage it had pre Covid-19.

EUR – Looking ahead

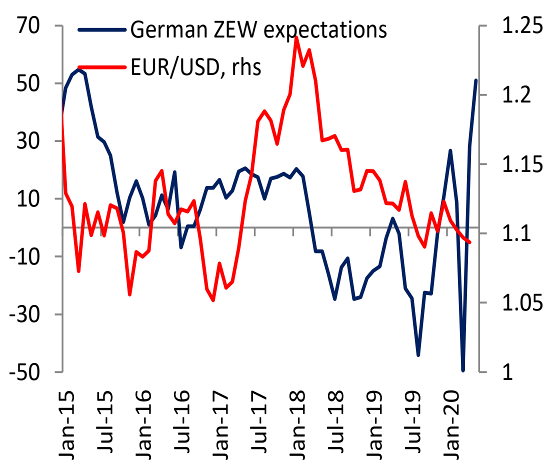
Stuart Bennett
stuart.bennett@santanderCIB.co.uk
(+44) 33114 80134

Chart 3: EUR/USD continues to hold around a 1.08-1.10 range…



Source: Bloomberg, Santander

Chart 4: …but things can only get better for both the economy and the euro



Source: Bloomberg, Santander

We remain positive on the EUR into H2-20 and see EUR/USD moving to 1.14 by the end of the year. The Eurozone economy is expected to shrink significantly in 2020, but the combination of fiscal and monetary stimulus should now be viewed as supportive for the currency. Further, gradual steps to open up some European economies could be euro positive.

EUR/USD has continued to trade in a broad 1.0800-1.1000 range, which has held since the start of April. The pair has tended to find support at levels close to or below 1.08, but has been unable to sustainably break above resistance around 1.1000. These levels look likely to persist over the coming weeks.

Indeed, despite the movement in risk appetite over the past couple of months, the euro's performance has been on a par with that of the USD, JPY and CHF, which despite the FX market's often negative stance on the euro is why we still feel it can be labelled a secondary safe haven.

This status may be key to supporting the euro in H2-20. On the one hand, if risks diminish, demand for the USD should weaken more strongly and EUR/USD should edge higher. Alternatively, if uncertainty persists, the euro may still be able to hold up against many of its G10 peers, supported by its status as a 'big' currency that offers some safety.

As expected, the ECB kept rates unchanged in April, but provided additional support measures. It also stated that QE/the Pandemic Emergency Purchase Programme could be increased and continue for as long as required. However, the euro dipped after the German Constitutional Court's 5 May ruling on the ECB's QE programme.

The court has given the ECB three months to show that its policy objectives were not disproportionate to the economic and fiscal policy effects of the programme. The ruling refers to the Public Sector Purchase Programme, running since 2015, and not the recent Pandemic Emergency Purchase Programme.

The FX market seemed to view the ruling as further undermining medium-term European co-ordination. And even though nothing would change for three months and the ECB should be able to justify the policy, it has worried the market about its ability to provide further stimulus if required in the short term.

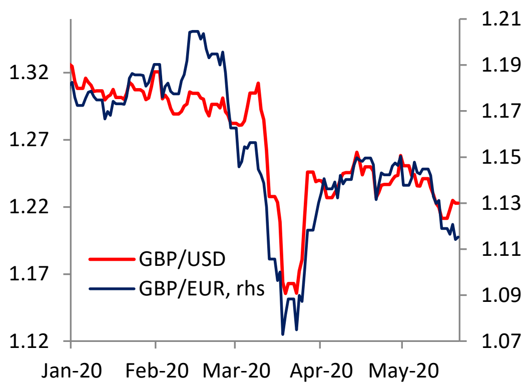
However, the euro, like other markets, is probably looking for fiscal, rather than monetary policy, to play a bigger role in the economic recovery. The Eurogroup has been criticised for its apparent lack of co-ordination in this issue, but on 18 May Germany and France announced a EUR500bn European Recovery Programme. This would allow the EU Commission to borrow on behalf countries and distribute the funds as grants.

Such support will be needed, in our view. The Q1-20 GDP contraction was confirmed at 3.8% QoQ. And ECB President Lagarde suggested the economy might contract between 5% and 12% this year. But sentiment surveys continue to show signs of bottoming out. The preliminary PMIs for May showed that both manufacturing and services remain weak, but are up from April. The German ZEW index revealed another improvement in expectations, to +51 in May compared to +28.2 in April and -49.5 for March.

GBP – More focus on EU trade talks

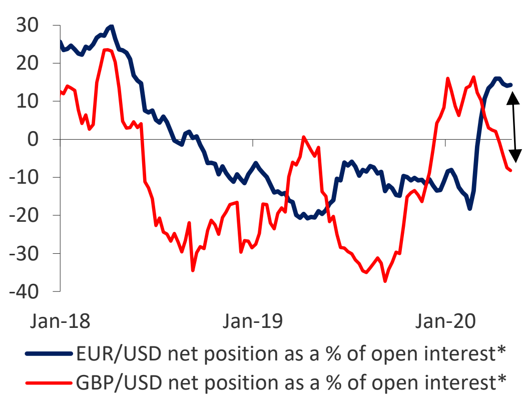
Stuart Bennett
stuart.bennett@santanderCIB.co.uk
(+44) 33114 80134

Chart 5: Sterling has struggled so far in May, after rebounding from the March low



Source: Bloomberg, Santander

Chart 6: Speculators have started to favour a softer GBP/USD, but EUR/USD positioning has remained firm



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

Sterling has not had a good May. At the time of writing, the pound is the worst performing G10 currency month-to-date. In the short term, we expect the GBP to remain vulnerable. The UK economy is expected to contract in 2020, but in line with other economies, while some focus on the scope for negative UK rates might hamper the pound, although the FX market is also focussed on whether there will be progress on the UK-EU trade talks.

The UK economy contracted 2% QoQ in Q1-20. However, the data was not as bad as expected and was better than the Eurozone's 3.8% QoQ contraction. A bigger decline is expected in Q2-20, but given lockdown restrictions, this should not be a surprise to the FX market. Indeed, of greater import to sterling over the coming month will be whether sentiment surveys show confidence that activity will pick up in H2-20.

However, with many other European countries further along than the UK in re-opening their economies, even a pick-up in domestic sentiment may not be enough to support the pound against either the USD or EUR.

In addition, given the weak economy, we continue to expect further stimulus measures from the BoE. The next BoE policy announcement will be on 18 June. We look for the Bank's QE programme to be increased by GBP100bn. We do not expect Governor Bailey to cut the benchmark rate from its current 0.1%, but recent comments from him clearly highlight that negative UK rates have not been ruled out. If rates do go negative, we would also see this as negative for sterling.

The pound also looks vulnerable to the developments in EU-UK trade talks. The latest discussions ended with little apparent agreement. The UK government recently published its post-Brexit tariff regime, but with the UK and EU seemingly far apart on many issues, if not remedied, the lack of progress could become a drag on both sterling and the euro by the end of June.

We recall that the Brexit transition period finishes at the end of this year, at which time the hope is that a trade agreement will be in place between the UK and EU. Obviously, the Covid-19 backdrop has hampered progress. A one-off extension to that transition period of up to two years, which would allow more time for negotiations, has to be agreed by both sides by the start of July.

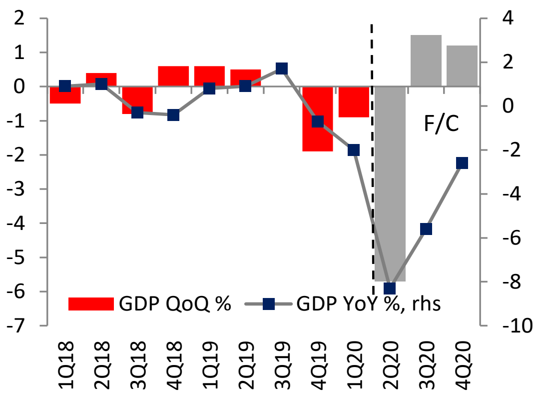
The UK government has been adamant it will not ask for an extension. Given the current lack of agreement on trade and with the clock ticking, the market has become more concerned that the UK might leave the EU with no formal trade agreement in place. In light of the economic hit that both are taking from Covid-19, this should not only weigh further on their economies, but also their currencies. However, given the relative size of both counterparts, we still tend to believe that the FX market will view this as more GBP negative in the short term, with the euro outperforming the pound, but underperforming the US dollar.

This view may be finding some support via the position that speculators are taking in terms of both currencies. The IMM commitment of traders' data show that speculators have maintained a significant net long EUR/USD position, i.e. they are not betting on a big euro sell-off. However, they have recently turned slightly net short GBP/USD, suggesting that the pound is expected to weaken.

JPY – Japan enters recession, but yen stays firm

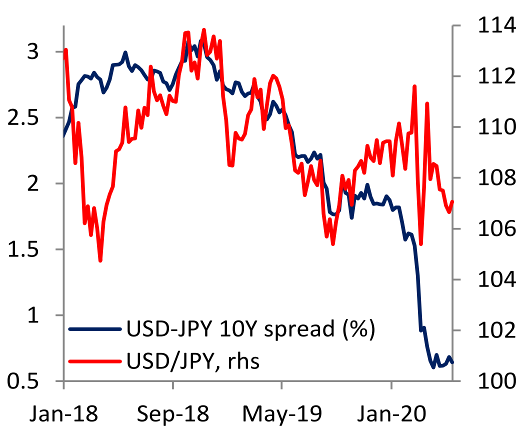
Stuart Bennett
stuart.bennett@santanderCIB.co.uk
(+44) 33114 80134

Chart 7: Japan entered a technical recession in Q1-20. A further decline is expected in Q2-20, but an improvement in activity is forecast for H2-20



Source: Bloomberg, Santander

Chart 8: Yield differentials may, for now, not be a good guide for USD/JPY and other USD/G10 pairs



Source: Bloomberg, Santander

We continue to expect the yen to weaken over the coming months. Given the currency's perceived status as a safe-haven asset, it has been supported by low global risk appetite associated with Covid-19. But assuming these pressures ease in H2-20, the yen should soften. Japan is already in recession, which should be a yen negative. However, loose BoJ policy is having less effect as other central banks have adopted very accommodative polices amid the pandemic.

The shifts in risk appetite continue to be an important influence on the yen. Year-to-date, the yen is the best performing G10 currency, albeit broadly on a par with the USD. Indeed, the focus on risk/equities and the global slowdown may explain why these two big safe-haven currencies have tended to move in line with each other.

Indeed, risk appetite has, for now at least, surpassed interest rate differentials and yield spreads as a key short-term driver for most USD/G10 pairs. In fact, given the collapse in US yields over the last couple of months, if USD/JPY were trading solely on the US-Japan 10Y spread, it might be closer to 102. However, the USD would also be much lower against all of its G10 peers.

Given this reduction in importance of rates/yields and the adoption of very loose monetary policy by other central banks, the BoJ's already loose policy has less scope to exert much of a negative effect on the yen. Hence, the Bank's decision on 28 April to keep the policy rate at -0.1%, but pledge to buy unlimited bonds to keep JGBs at 0% and scrap the previous JPY80trn annual target for bond purchases, had little impact on the currency. Given that the Bank has not even reached the JPY80trn target, the pledge of unlimited bond buying was more symbolic. More relevant perhaps was the enhanced support for corporate financing, extra CP and corporate bond buying.

The BoJ surprised by bringing forward its next meeting to 22 May. The market is not expecting any major policy changes at this time. However, Kuroda has not ruled out further rate cuts. We do not think this is likely, but it would be yen negative. The next BoJ policy meeting was not due until 16 June. Hence, given the pressures on business, the Bank may have felt it necessary to be seen as proactive, bringing forward the meeting to provide details of additional lending facilities announced in April, which broadly involve the BoJ incentivising/paying banks to ensure they lend to business.

The catalyst for bringing forward the BoJ meeting may have been the Q1-20 GDP report. The data showed that the economy dropped into a technical recession. The economy contracted 0.9% QoQ in Q1, after the sales tax/natural disaster-induced 1.9% QoQ contraction in Q4-19. Admittedly, the Q1 figure was slightly better than expected, but given the state of emergency and lockdown restrictions, an even weaker figure is expected for Q2-20.

The BoJ updated its forecasts in April. It now expects real GDP for fiscal year 2020 to be in a -5%- to -3% range compared to + 0.8-1.1% before, but to pick up to +2.8% to 3.9% in FY21 from +1% to 1.3%. Weaker growth and the collapse in oil prices has increased deflationary risk and made it even more important for policymakers to at least try to push back against yen strength. CPI ex fresh food is forecast at -0.7% to -0.3% in FY20, then flat to 0.7% in FY21. Again, the underlying assumption the Bank makes is that the Covid-19 effect will wane in H2-20. But uncertainties remain.

CNY – Focus on the People's National Congress

Stuart Bennett
stuart.bennett@santanderCIB.co.uk
(+44) 33114 80134

The CNY has remained comparatively stable during the last month, with USD/CNY hovering around 7.10. The Chinese economy has shown signs of 'getting back to normal', but the PBoC is expected to continue providing stimulus as China faces a global slowdown and the potential threat of souring US-China relations.

Chinese economic data have continued to show signs of improving. The PBoC estimated that IP was back at normal levels at the end of April: industrial production grew by more than expected in the month, by 3.9% YoY after -1.1% YoY in March.

Other data have been less positive: retail sales growth remained weak in April, but at -7.5% YoY was at least not as bad as figures for the end of Q1-20. Similarly, investment showed a contraction of 10% YoY in April but was up on the previous months.

However, even as the Chinese economy gets back on track, it risks being dragged down again by the weaker global outlook. The Caixin manufacturing PMI for April dropped back below 50 and whilst the official PMI was 50.8, it was still down from March's 52 and reflected weakness in new export orders as the rest of the world slips into recession.

In its April World Economic Outlook, the IMF forecast that the Chinese economy would grow by 1.2% this year, compared to 6.1% in 2019, but may rebound, growing by 9.2% in 2021. As such, even as some data improve, or deteriorate more slowly, the PBoC is expected to add to its stimulus measures already announced. The slowdown in CPI to 3.3% YoY in April from 4.3% YoY should also make further rate cuts easier.

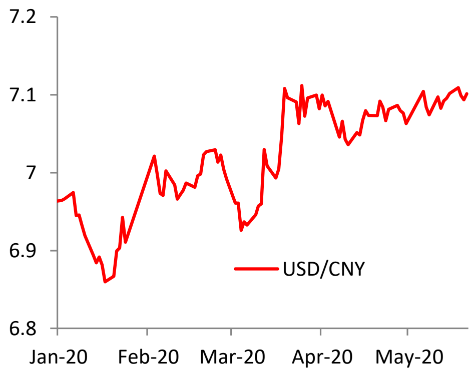
Indeed, in mid-May the PBoC explicitly said it would resort to "more powerful policies to counter unprecedented economic challenges from the pandemic". However, it did not give details and a few days later surprised the market by not reducing its one-year medium-term lending rate from 2.95%.

There is perhaps a reluctance to make policy changes ahead of the National People's Congress, which begins on 22 May. The Congress is expected to include details on the budget and economic outlook, with the market looking for a further increase in infrastructure spending.

In addition, the recent rise in credit indicators suggests that past rate cuts and measures have been working, and policymakers may be cautious to add to them too quickly. Aggregate financing rose by CNY3.09trn in April, although this was less than the record increase of CNY5.15trn in March. Further, new yuan loans climbed by CNY1.7trn in April.

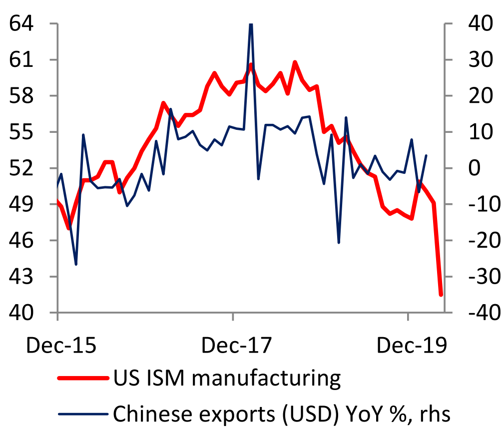
However, of concern will be the rise in US-China tensions during May. Earlier in the month, risk appetite received a boost from reports that the two trade negotiating teams were back in contact. Nevertheless, recently the rhetoric of the governments has turned more belligerent amid the spread of Covid-19. This raises the prospect that even if the economy does show signs of stabilising early in H2-20, the tensions associated with the US-China trade conflict in 2018-19 may return, undermining market sentiment and perhaps placing the CNY under more downside pressure.

Chart 9: USD/CNY so far in 2020



Source: Bloomberg, Santander

Chart 10: Chinese activity is expected to be constrained by the global slowdown



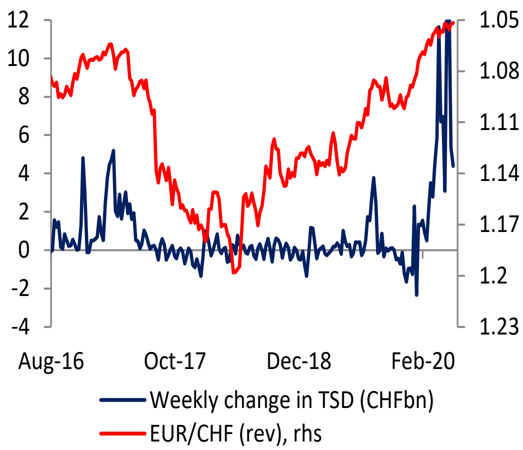
Source: Bloomberg, Santander

CHF – "Substantially active" FX intervention

Stuart Bennett
stuart.bennett@santanderCIB.co.uk
(+44) 33114 80134

The Swiss franc has remained strong. The SNB continues to view the currency as 'highly valued' and has conceded that it has been intervening heavily to weaken the CHF. However, this action has not succeeded in pulling EUR/CHF higher, but may have helped prevent the cross dropping below 1.05. As such, we believe it will still require a pick-up in risk appetite, if the spread of Covid-19 slows, and a firmer EUR to weaken the CHF.

Chart 11: SNB ramping up interventions as total sight deposits (intervention proxy) continue to show large weekly rises



Source: Bloomberg, Santander

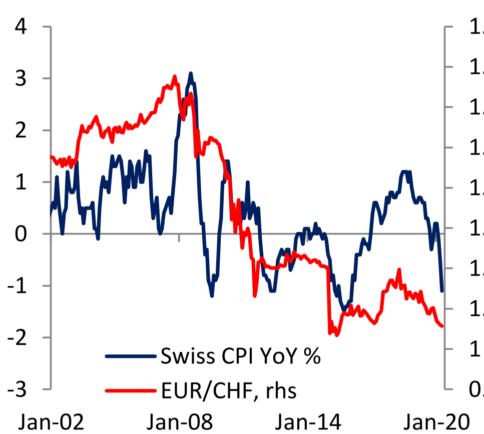
The Swiss franc is traditionally viewed as a safe-haven currency by the FX market and therefore will tend to rise when risk appetite is low and uncertainty is high. Hence, there has been little surprise that the franc has strengthened in 2020 amid concern over the spread of Covid-19.

However, we still tend to view the CHF's relationship with risk appetite as somewhat asymmetric. The currency is often quick to strengthen on any reduction in risk appetite, but slower to reverse these gains when risk shows signs of stabilising. Hence, EUR/CHF weakened in Q1-20 as equity markets collapsed but did not really pick up when stocks started to improve.

This 'stickiness' may be blamed in part on the euro. It is difficult for EUR/CHF to rally if the euro and EUR/USD remain on the soft side. Hence, as EUR/USD spent most of Q2-20 at the low end of a 1.08-10 range, EUR/CHF has been unable to piggyback a stronger euro.

Indeed, even as global risk appetite measures have tended to improve, e.g. equities and oil, the Swiss franc has remained constrained by Eurozone risk factors. The market is still concerned about the Eurozone's apparent lack of co-ordination in responding to Covid-19. Further, the German Constitutional Court's recent statement was viewed as raising doubts over the sustainability of the ECB's QE programme.

Chart 12: Headline inflation moves even lower in April (-1.1% YoY)



Source: Bloomberg, Santander

Hence, some of the franc's recent strength has had more to do with euro weakness. EUR/CHF will thus probably require EUR/USD to break clearly above 1.1000 if the cross is also to sustainably move clear of 1.05.Given that Swiss policymakers still seem to be prisoners of swings in EUR/USD, recent FX intervention may be framed not as designed to seriously weaken the franc, but to prevent/slow its rise against the euro. In essence, buying some time until hopefully the euro strengthens.

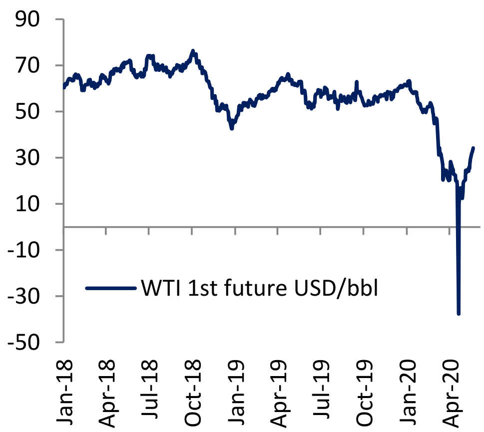
SNB President Jordan recently conceded that the SNB had ramped up interventions. He added that interest rates could be cut further, but given that the policy rate is already -0.75%, we do not think such a move is likely or will have much effect. Hence, Jordan commented that "we're concentrating on FX interventions to limit pressure on the franc".

Prior to the pandemic, Swiss business had shown signs of learning to live with the strong franc. But the additional downside pressures on activity may have increased the impact of a strong franc. The State Secretariat for Economic Affairs (SECO) now expects the Swiss economy to contract significantly more in 2020, by 6.7%. However, under the assumption that the pandemic does not intensify again, the economy is expected to grow 5.6% in 2021, up from 3.3%. Meanwhile, headline inflation dropped to -1.1% YoY in April compared to -0.5% YoY in March.

CAD – Oil pick-up helps the Loonie

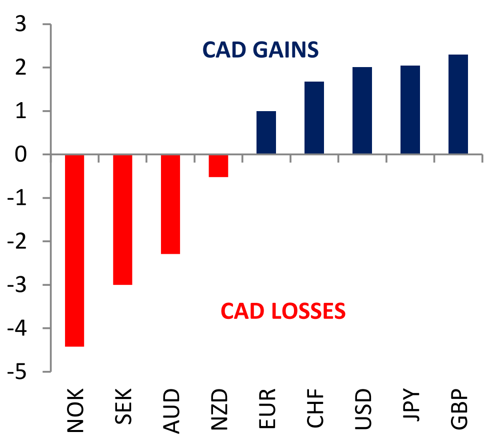
Stuart Bennett
stuart.bennett@santanderCIB.co.uk
(+44) 33114 80134

Chart 13: The CAD has been helped by the recovery in oil prices over the last month. But other oil/commodity currencies have gained more



Source: Bloomberg, Santander

Chart 14: CAD carry-adjusted performance since 21 April (%), as WTI started to pick up after hitting its record low



Source: Bloomberg, Santander As at 11.00BST 21 May 2020

We continue to favour a stronger CAD. The loonie will remain vulnerable to any dip in risk appetite, and the economy is expected to have contracted significantly in H1-20. But ongoing fiscal and monetary policy stimulus should support activity in H2-20 and if it continues, the recovery in the oil price over the last month should also help the currency.

The turnaround in the oil price since 20 April has provided clear support for the CAD. We recall that the WTI 1st future crashed to a low at USD-40.32/bbl on 20 April. The negative oil price, amid concern over limits on storing oil, was short-lived, with WTI steadily improving to a high at USD34/bbl on 21 May.

As we have highlighted before, the correlation between USD/CAD and WTI has not, over recent years, been as strong as intuitively one might have expected. But in 2020, if we treat that negative oil price as a rogue outlier, the relationship between the two has been much stronger, with the correlation at -0.96 year-to-date.

The link between CAD and oil raises several issues. First, our analysis suggests that USD/CAD is currently fairly valued based on WTI alone. Second, any further CAD gains will probably require a higher oil price. Note that the Bloomberg consensus expects WTI at USD44/bbl in Q1-21. But even though the CAD has picked up in line with the higher oil price, it has still, since 20 April, underperformed other oil currencies, such as the NOK, RUB, MXN, and COP.

Hence, a higher oil price should support the CAD versus the USD, but could still see it lag other commodity currencies. Further, although the higher oil price is a welcome recovery over the last month, headline WTI remains at a low level, and still indicates that the economy and the CAD are at risk from the double whammy of lower activity directly as a result of Covid-19, exacerbated by the indirect effect on Canada via the energy sector.

The Bank of Canada, at its April meeting, estimated activity under two scenarios, first assuming a short lockdown and secondly a lengthier one. The estimates focussed on a 1-3% contraction in Q1-20 and perhaps 15-30% lower in Q2-20 than in Q4-19. Further, the IMF in its April World Economic Outlook forecast Canada to contract 6.2% in 2020, but growth of 4.2% in 2021.

The IMF estimates are not that different, and in some cases better, than for other developed economies, which again suggests to us that if the economy can escape another drop in the oil price, the CAD should hold up well over the coming month.

The BoC has already cut its main rate to 0.25% and introduced a bond purchase programme designed to ease strains in financial markets. The programme focused on buying government debt and short-term corporate debt, but was later widened to include municipal bonds.

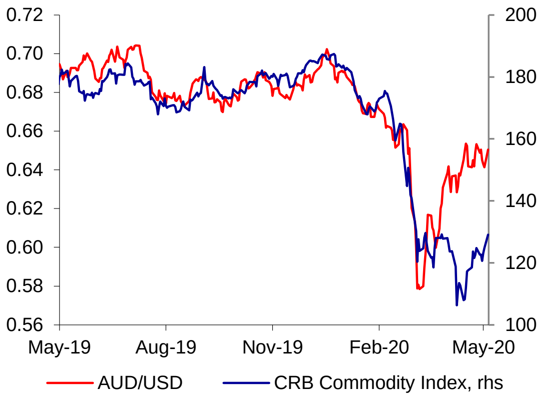
The next BoC meeting is on 3 June, under the new governor, Tiff Macklem. He was Deputy Governor from 2010-14, but has been working outside of the Bank since 2014. In early May, he indicated that he was comfortable with the policy rate's 0.25% effective lower bound. But he declined to comment on the direction of interest rates, and noted that negative interest rates are amongst the Bank's tools.

AUD – Outdoing commodities

Michael Flisher
michael.flisher@santanderCIB.co.uk
(+44) 33114 80232

We are cautious on the AUD in the near term. While the currency had a strong April, this uptrend has slowed in May, and we see the risks remaining to the downside in June. The RBA is unlikely to announce any further policy easing in the near term, as it has comfortably been achieving its 0.25% 3Y yield target, but domestic data are set to weaken, while global growth, risk sentiment, and commodity prices remain subdued. We continue to expect AUD/USD to end the quarter closer to 0.62 than at present, before gradually rising to 0.65 during H2-20.

Chart 15: April's AUD/USD rebound has fizzled out in May, with the pair looking too strong given subdued commodity prices



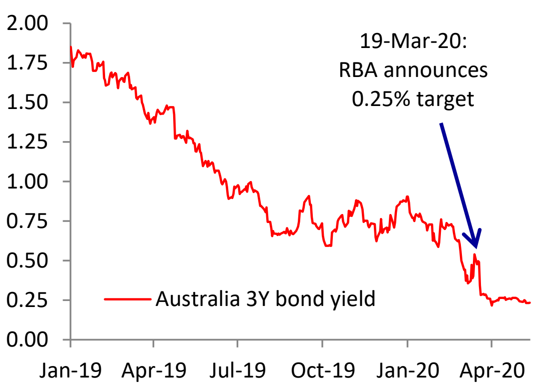
Source: Bloomberg, Santander

March was a bad month for all "risk" or "commodity" currencies, but in April many of these currencies managed to post a strong rebound. In the AUD's case, the currency outperformed all of its G10 peers, and even gained 7% against the USD. It was a rebound, not a reversal though, as this uptrend has lacked impetus to lift the currency even higher in May, with AUD/USD now sitting just above the 0.65 mark at which it began the month.

The RBA kept rates unchanged in May, at 0.25%. The Bank is unlikely to loosen monetary policy further in the short term, in our view, as the cash rate is already at a historic low, and Governor Lowe believes the costs of negative rates exceed the benefits. Also, the RBA does not need to step up its QE programme, as it has comfortably been reaching its 0.25% 3Y yield target since it was announced in late March (Chart 16).

However, the RBA Board did commit to doing what it can to support jobs, incomes and businesses during this difficult period, while pledging not to increase the cash rate target until: i) progress is being made towards full employment; and ii) it is confident inflation will be sustainably within its 2-3% target band.

Chart 16: With the RBA comfortably maintaining its 0.25% 3Y-yield target, there is little need for the Bank to increase QE



Source: Bloomberg, Santander

Ironically, headline inflation reached a five-year high in Q1-20, rising to 2.2% (from 1.8%). The Bank's various core measures also rose, although they were still below 2%. However, one quarter in the Bank's 2-3% target band is not enough, especially given that the Covid-19 crisis and the lockdown measures are likely to prompt a sharp decline in inflation in Q2-20.

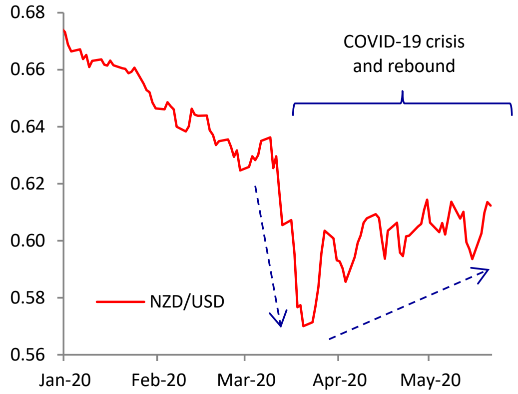
Meanwhile, a record 594k jobs were lost in April (c.5% of the labour force). While the unemployment rate only rose to 6.2% (from 5.2%), it would have almost certainly climbed to a 20+ year high had it not been for the participation rate dropping to a 16-year low, at 63.5% (from 66.0% in March). With jobs data also likely to get worse before they get better, even if the RBA does not actually loosen policy further, it is all but certain to maintain a very expansive monetary policy for the foreseeable future.

On 12 May, China imposed an import ban on four Australian abattoirs. On 18 May, it announced anti-dumping duties on Australian barley for five years (just a week after it approved the import of barley from the US as part of the phase one trade deal). Australia's Finance Minister suggested that both issues are isolated incidents with its largest trading partner, despite speculation that they could be linked to the Australian prime minister calling for an independent inquiry into the source of the Covid-19 outbreak. But, media reports already suggest Australian wine, seafood, fruit and dairy may be next on the list. Any further tariffs would be an issue of increasing concern for Australian trade and the AUD, and are thus a focus in the months ahead.

NZD – Restrained by RBNZ's "least regrets" approach

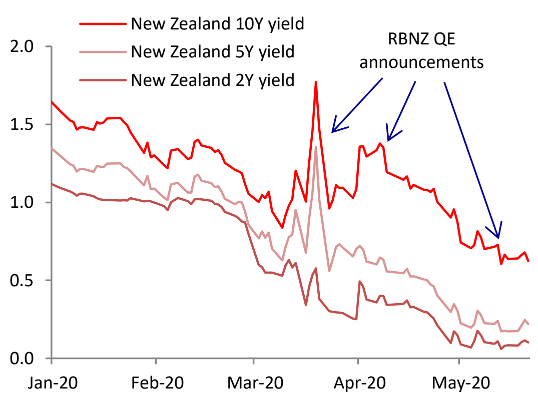
Michael Flisher
michael.flisher@santanderCIB.co.uk
(+44) 33114 80232

Chart 17: NZD/USD has struggled in May, and we expect the pair to continue to struggle to record gains over the coming weeks



Source: Bloomberg, Santander

Chart 18: The RBNZ's QE measures have so far succeeded in sending bond yields lower



Source: Bloomberg, Santander. Note: RBNZ announced i) Large Scale Asset Purchase programme (LSAP) of NZD30bn on 22-Mar-2020; ii) NZD3bn Local Government Funding Agency (LGFA) purchases on 7-Apr-2020; and iii) further LSAP increase of up to NZD27bn on 13-May-2020.

We retain a neutral stance on the NZD in the short term. The NZD has recovered from its March lows, but the currency has been held back in May by the RBNZ almost doubling the size of its QE programme and opening the door to further rate cuts. Also, in spite of New Zealand gradually exiting its lockdown, the NZD is not helped by the high expectation of weak domestic data ahead. We continue to see NZD/USD ending Q2 at 0.60, and Q4 at 0.64.

Following a sharp decline in March, the NZD managed a reasonable rebound in April (Chart 17), but the currency has struggled to add to these gains in May.

On 11 May, New Zealand's prime minister, Jacinda Ardern, announced that the nation would start a phased relaxation of restrictions, moving to a level 2 lockdown from 14 May. Retailers, cafes, restaurants, cinemas and gyms were allowed to reopen, with domestic travel resuming. On 18 May, schools then began to reopen, with bars opening their doors from today. Groups will be limited to 10 people and social distancing rules will remain in place, but this would still show New Zealand reopening its economy ahead of many other developed markets.

However, even assuming that New Zealand has successfully contained the spread of the Covid-19 virus locally, reduced world activity implies lower demand for many of New Zealand's exports, and so the economy is set to struggle. Indeed, the RBNZ estimates suggest that a level 2 lockdown would still restrict New Zealand's economy to running at c.90% capacity.

Further, the global economic disruption caused by the Covid-19 pandemic is expected to persist and lead to lower economic growth, employment, and inflation, in New Zealand and abroad.

Ironically, headline inflation actually rose to 2.5% YoY in Q1-20, while the unemployment rate edged only marginally higher, to 4.2% (from 4.0%), but both these figures are set to deteriorate notably in Q2-20, even with the economy opening back up.

Indeed, the RBNZ does not expect to reach its CPI or employment targets for some time. The Bank is now forecasting a contraction in GDP growth of 2.4% QoQ in Q1-20, and 21.8% in Q2-20.

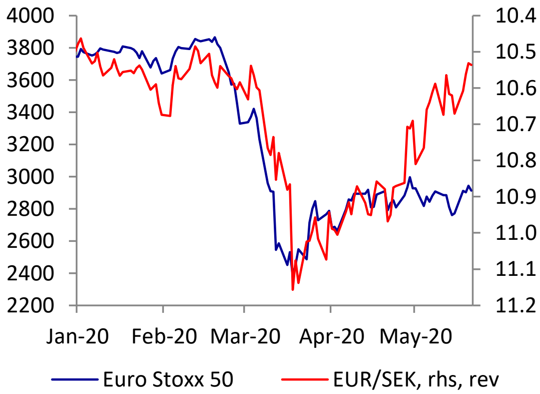
Given such weak growth forecasts, it is unsurprising that the RBNZ significantly expanded its Large Scale Asset Purchase (LSAP) programme potential to NZD60bn in May (a cap, not a target), up from the previous NZD33bn limit, with inflation-indexed government bonds now also included, to help improve market function and policy effectiveness. The Bank also suggested, once again, that it would prefer to act too soon rather than too late, in what it called a "least regrets" approach.

Hence, with the RBNZ saying that further rate cuts from the current 0.25% are possible, with negative rates even an option in the future (when financial institutions are operationally ready), the market should remain cautious to the RBNZ possibility joining the ZIRP (zero interest rate policy) or even NIRP (negative interest rate policy) clubs in the future. Such cuts might not come soon, but even the possibility of negative rates should still limit the NZD in the near term.

SEK – Overdoing the rebound?

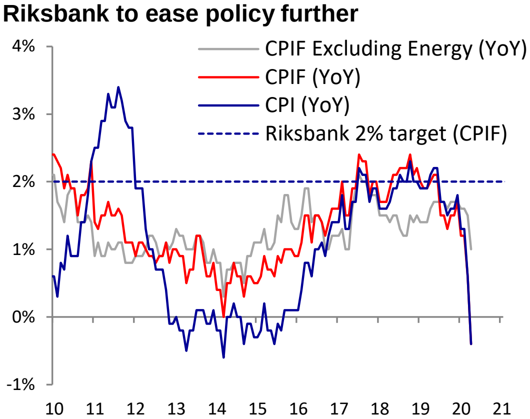
Michael Flisher
michael.flisher@santanderCIB.co.uk
(+44) 33114 80232

Chart 19: After a sharp jump in early March, EUR/SEK has already unwound this move



Source: Bloomberg, Santander

Chart 20: Sweden's inflation data turned negative in April, keeping pressure on the Riksbank to ease policy further



Source: Bloomberg, Santander

We are cautious on the SEK in the near term. After a sharp fall in March, as the Covid-19 crisis went global, the SEK rebounded strongly in April and May. EUR/SEK has fallen a little too quickly in our view, as the cross is now unchanged year-to-date (at 10.5), and yet risk sentiment is not back to where it was before the Covid-19 pandemic. Plus, with annual inflation data turning negative in Sweden in April, there is still pressure on the Riksbank to do more, perhaps even to revisit negative rates. We continue to forecast the cross at 10.5 in Q4.

March was a dire month for the SEK. The Covid-19 crisis weighed heavily on risk sentiment, and even though Sweden might be somewhat protected domestically by taking far less restrictive countermeasures, fears of a collapse in global trade and growth weighed heavily on the small Nordic nation's trade-reliant currency. On 19 March, in a week that saw half a dozen developed market central banks cut rates, and various asset purchase programmes announced or increased, EUR/SEK peaked at just above 11.40, its highest level since 2009.

In the two months since reaching this decade-long high, EUR/SEK has fully unwound this move (Chart 19), and is unchanged year-to-date, at 10.5. The SEK recovery has been faster than we had anticipated, as despite a rebound in risk sentiment, economic confidence measures have collapsed, while equity markets have not returned to their prior levels.

Indeed, Sweden's economic tendency survey sank to 58.6 in April (from 92.4), an all-time low (values below 90 signal a much weaker economy than normal). The manufacturing (36.7) and services (39.0) PMIs also fell sharply in April, each dropping to their lowest levels since 2009, and certainly well below the 50 mark which implies neither expansion nor contraction. Meanwhile, equity markets throughout the world have lifted off their March lows, but are still nowhere near their prior highs.

With the Covid-19 crisis still the markets' prime concern, global risk sentiment is set to remain subdued, and growth expectations, both domestic and international, to remain gloomy. There is likely to be a hefty contraction in Sweden in 2020, with government forecasts seeing annual GDP falling by between 4% and 10%, while Riksbank forecasts predict a larger contraction of between 7% and 10%.

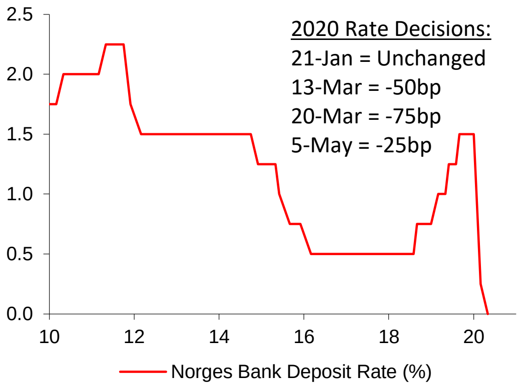
At its meeting on 28 April, the Riksbank kept the repo rate unchanged, at 0%. However, it had already increased its asset purchase programme by up to SEK300bn in March. The Bank continues to say that all of its tools are at its disposal, including negative rates. But unless there is a big drop in risk sentiment, we still consider a return to negative rates unlikely. We see scope for the Riksbank to expand its QE programme at some point, though, but the next scheduled meeting is not until July.

Until then, we struggle to see the SEK continuing its recent pace of gains for the remainder of Q2-20. A burst of optimism and firmer equity markets would undoubtedly offer the SEK some support. However, without it, we expect the currency to give back some of its April/May rebound over the coming weeks.

NOK – The latest to go ZIRP

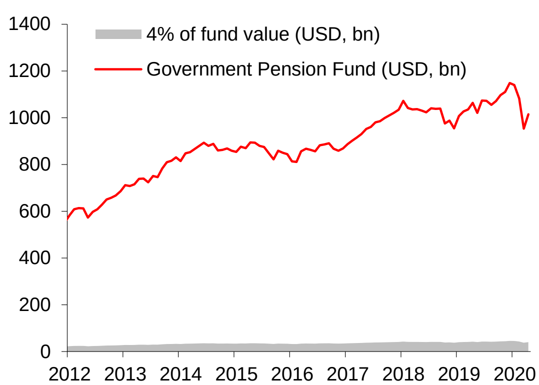
Michael Flisher
michael.flisher@santanderCIB.co.uk
(+44) 33114 80232

Chart 21: The Norges Bank cut rates to 0% in May, a new all-time low



Source: Bloomberg, Santander

Chart 22: Even after a bad Q1-20 for Norway's sovereign wealth fund, 4% of USD1trn is a useful support for the economy and the NOK



Source: Bloomberg, Santander

The Norges Bank surprised the market by cutting rates to 0% in early May. Meanwhile, the Norwegian economy contracted in Q1-20, and despite gradually exiting lockdown measures, a recession is all but certain in Q2-20. Despite this, the NOK has made a strong start to May. But additional gains are likely reliant on a further pick-up in oil prices. We retain a positive view on the NOK for 2020 as a whole, and continue to forecast EUR/NOK dropping to 10.7 in Q4.

The Norges Bank surprised the market on 7 May, when it cut rates by 25bp. This was the Bank's third consecutive rate cut, taking this year's total rate reduction to 150bp. It also took the deposit rate to a new all-time low, at 0%, making it the latest central bank to join the ZIRP (zero interest rate policy) club.

There is now no scope left in terms of "normal" rates cuts. The Bank could take the deposit rate into negative territory, but Governor Olsen has played down the likelihood of such a move, saying "we do not envisage making further policy rate cuts", and that the Bank "has used the room for manoeuvre that we had".

We do not expect the Norges Bank to go down either the route of negative rates or asset purchases. However, the Bank admitted quite explicitly in May that it has been intervening in the FX market. FX intervention therefore remains a tool for the Bank to use, if necessary, but the unlikelihood of significant further action in the near term should now be NOK supportive.

Oil prices have recovered somewhat in early May, with WTI crude up 75% month-to-date, at USD34/bbl. At the end of April, Norway joined international efforts by OPEC, and others, to curb oil supply, announcing that it would cut its output by 250k bbl/day in June (from a reference point of 1.86 million bbl/day) and by 134k bbl/day in H2-20. This is the country's first coordinated output cut since 2002.

The combination of lower oil output and significantly lower oil prices is certainly not ideal for Norway's economy. Indeed, the oil price is still some way below the USD50-60/bbl range which Norges Bank Governor Olsen suggested was "fine for Norway".

As such, it is unsurprising that Norway's economy contracted in Q1-20, with the mainland print coming in at -2.1% QoQ, and the overall economy (including the petroleum sector) falling by a much larger 5.5% QoQ. Given that Norway's lockdown only began on 12 March, a double-digit contraction, and therefore recession, is highly likely in Q2-20. Indeed, the government now expects the mainland economy to contract by 4% this year.

Nevertheless, we expect to see a strong rebound in H2-20, helped by significant monetary stimulus, plus fiscal stimulus. In early May, the government announced plans to spend a record NOK420bn (USD41bn) of its oil wealth on weathering the Covid-19 storm. This money will come from the country's sovereign wealth fund, with this year's "structural oil-corrected deficit" to represent just over 4% of the fund's value, well above the country's 3% fiscal rule for normal times. Together with the economy now gradually exiting the lockdown, these stimuli should help support the NOK in the coming months.

LatAm FX: Main Themes

Currency	3M view	12M view	Main Themes
BRL	↘	⇨	• Amid the Covid-19 pandemic, political noise continued to blur the Brazilian fiscal policy horizon and raised doubts about long-term debt sustainability. • Recent updates of activity indicators hinted at a stronger-than-expected contraction that should result in increased pressure for fiscal stimulus, in our view. • As market participants' inflation expectations recede, the Brazilian monetary authority has brought the base interest rate to new historical lows.
MXN	↗	⇨	• We expect a slow return to the new normal to translate into increased demand for oil and oil derivatives. • A healthy rebound in oil prices is supporting oil-exporting economy currencies like the MXN. • When we think of Banxico's monetary policy in relative terms: we see it as being more prudent than other central banks, both in terms of the speed and the magnitude of the cuts.
CLP	↓	↗	• The main driver will continue to be global USD gyrations (including copper) linked to the virus spread. • On a relative basis, the CLP looks somewhat expensive. The local risk component looks very tight compared the peak of social unrest. • As the global economy normalises in 2H20, the CLP should gain some ground vs. the USD, assuming that good fundamentals pave the way for a decent rebound in local activity.
COP	↗	↑	• The short-term bias is turning more positive on the recovery in oil prices and an improved risk backdrop. • The flattening local yield curve is attracting foreign interest, especially with other regional yields declining. • Colombia's twin deficits remain an obstacle to a stronger COP rebound.
ARS	⇨	↓	• Local savers are not taking any chances as fears for the country's ninth sovereign default grow. • With less than $10bn of liquid central bank reserves, the monetary authority could face reduced freedom to continue supporting a relatively slow crawling peg policy, in a country with 45% annual inflation and lacking voluntary capital market financing. • The implicit dollar rate known as the blue chip arbitrage or CCL has moved at a faster speed that the official FX rate in the last two months. • Thus, a side effect of an eventual default would be further FX volatility.
PEN	⇨	↘	• By virtue of a modest depreciation vs. the USD, the PEN's REER has risen over 5% since the Covid-19 outbreak, a seven-year high. • Exchange rate stability remains the priority, and Peru's FX reserves are sufficiently stocked to allow the BCRP to continue smoothing operations. • Peru's open economy, capital investment dependence and terms of trade, coupled with a less flexible currency adjustment, suggest that the recovery arc may be shallower than its peers, in our view.

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

Source: Santander.

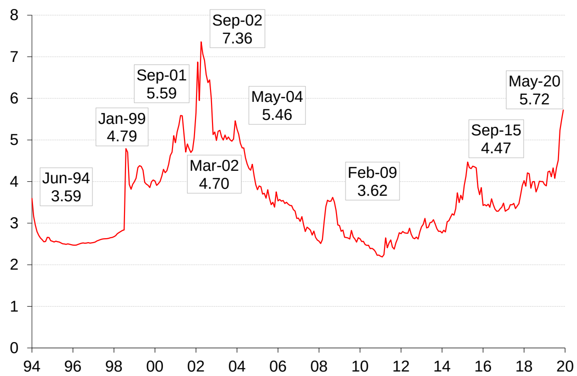
BRL – Despite a little help from our friends

Jankiel Santos
jankiel.santos@santander.com.br
(+55) 11 3012 5726

Recently, the BRL has weakened to levels that, in real terms, are only just stronger than those seen on the eve of the presidential election in Oct/02. Back then, market participants had doubts about Brazil's fiscal prospects, as its gross public debt had jumped to 81.0% of GDP in Sep/02 from 67.3% of GDP in Dec/01. On top of that, approximately 29% of its domestic public bonded debt was USD-linked (c.USD169.1bn), while international reserves amounted to USD38.4bn. The Brazilian 5-year CDS spread was hovering around 4,000bp in those days.

Since then, the country has made progress on several fronts, as the participation of USD-linked instruments in its domestic public bonded debt has fallen below 1% (~0.6% or USD4.5bn in Mar/20) and the level of international reserves is nine times greater than in 2002 (USD343.3bn), which translates into a 5-year CDS spread more than ten times lower than then (around 350bp now). Why then has the BRL weakened so substantially lately?

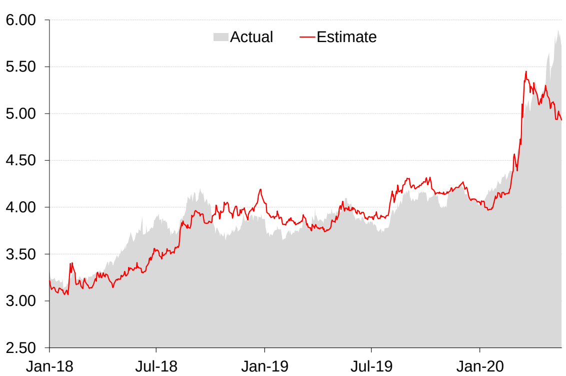
Chart 23: USD/BRL, inflation adjusted



Source: Santander, Bloomberg

While we think that international factors have played a role in the move observed during 2020 on the heels of the economic impact of the health crisis on the global economy, we also highlight that the behaviour of external variables since mid-April should have brought some relief to the Brazilian FX rate of late, in our opinion. Commodity prices have improved c.4% since 21 April—when the actual FX rate and estimates started diverging recently—whereas global risk aversion (as measured by the level of the VIX index) has receded significantly (to 29.3% from 45.4% in the same period) and a basket of emerging market currencies has strengthened some 1.3% since then. According to these changes, our simulations indicate that the Brazilian FX rate should otherwise be trading close to USD/BRL4.95 instead of USD/BRL5.70, if only considering international influences.

Chart 24:USD/BRL - External influences vs. domestic factors



Source: Santander, Bloomberg

However, domestic drivers have prevailed in the dynamics of the Brazilian FX market, in our view. Noise on the political front stemming from changes in the federal cabinet and from the unsteady relationship between the executive and legislative branches has hindered discussions about the outlook for structural reforms post-crisis, keeping market participants wary of the trajectory for public debt once the Covid-19 crisis has passed. As the debt-to-GDP ratio is expected to exceed the level seen in 2002 (we forecast it to reach 94.2% by the end of this year) and the country shows difficulties in generating primary fiscal surpluses as it did in the past (around 3.4% of GDP between 2002 and 2008 and 2.3% between 2009 and 2013), the reform agenda has gained greater importance and it should continue to weigh on the Brazilian FX rate, unless external factors give the country (unlikely) extra help. We hope that the reform agenda once again becomes a priority.

MXN – Prudent monetary policy & oil price rebound support

Guillermo Aboumrad
gjaboumrad@santander.com.mx
(+52) 55 5257 8170

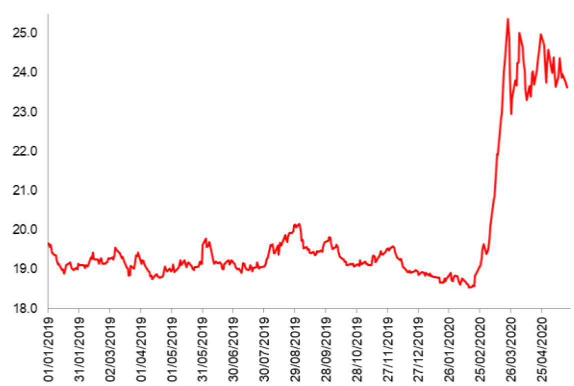
We expect the slow return to the new normal to translate into increased demand for oil and oil derivatives. If one were to add the fulfilment of the commitments to cut supply, we would see a healthy rebound in oil prices, supporting oil exporting economy currencies like the MXN. We further note Banxico's prudent monetary policy, which makes the MXN even more appealing, in our view. We believe that the slow deterioration of public finances and potentially higher risk premia in Mexico led conservative Banxico board members to lean toward a more restrictive monetary policy to compensate investors for the increasing risk premia and to avoid capital outflows before the pandemic hit the world economy. We further believe that the current board of Banxico could become more conservative now that the economic growth outlook has dimmed, Pemex's situation has become more challenging with the recent collapse in oil prices, and the risk of losing sovereign investment grade in two years' time is much higher.

When we think about Banxico's monetary policy in relative terms, we see it as having been more prudent than other central banks, both in terms of the speed and the magnitude of the cuts. But certainly in absolute terms, we see the board as now willing to do more than before the pandemic. In our opinion, a necessary condition for a healthy recovery after the pandemic is over is orderly behaviour of financial markets and the expansion of banking credit; to that end, a lower policy rate certainly contributes. In our view, the latter was the central point that united the board in a unanimous vote in the last two decisions to cut the policy rate by 50bp at each meeting and should be the same point that is likely to lead it to continue cutting the policy rate to a similar degree at the two upcoming scheduled meetings (25 June and 13 August), foreseeably taking the policy rate this year to a low of 4.50%, and to 4.0% next year.

Discussions among board members with respect to the impact of lowering the policy rate on economic activity and whether closing the spread between its policy rate and that of the Fed could risk further depreciation of MXN remain a hot topic. Most members agree that monetary policy alone will not be able to solve the problems wrought by the pandemic and that more fiscal measures are warranted. But where there seems to be most agreement is on the central bank doing as much as possible in its area of influence, which is the financial system and credit conditions, and certainly there a lower policy rate can contribute (together with the liquidity measures that accompanied the penultimate monetary policy decision on 21 April).

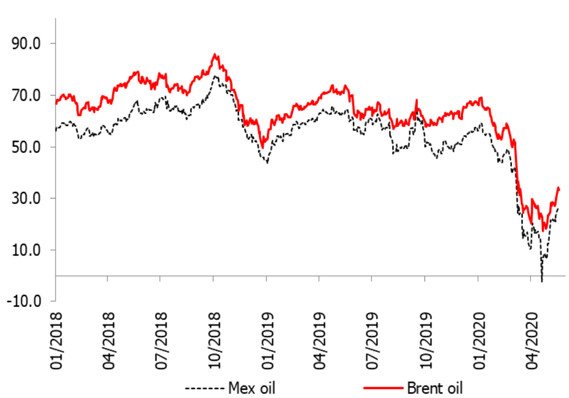
Still, most members point to the importance of Banxico showing prudence, which is why we see cuts at a pace of no more than 50bp at a time.

Chart 25: Exchange rate (MXN$/USD)



Source: Santander, Bloomberg

Chart 26: Oil prices (USD/bbl)

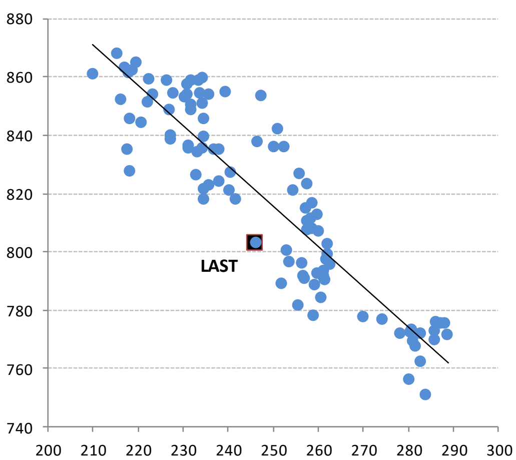


Source: Santander, Bloomberg

CLP – Strength, all of a sudden

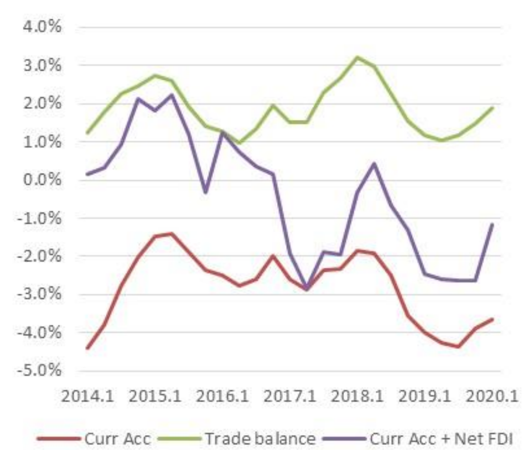
Juan Pablo Cabrera
jcabrera@santander.cl
(+56) 22 320 3778

Chart 27: Copper prices vs. USDCLP



Copper prices in US$ cents per pound.
Source: Santander.

Chart 28: BoP indicators (% of GDP)



Last 4 quarter basis. Source: Central Bank, Santander.

Since our last monthly report, conditions in the local FX market have changed significantly. The CLP has rallied by almost 7% vs. the USD, now trading at c.800 for the first time in three months. Copper prices, EM and commodity currencies have generally risen (+3%-6% approx.), but even in this favourable context the CLP rally looks impressive.

Our fair value estimates, based on "normal correlations" with external assets, indicate that around 60% of the recent rally is due to idiosyncratic, not global, factors. In terms of flows, local pension funds have been fairly neutral in the spot market, and the Treasury continues selling USD (US$90mn daily on average, from the sovereign wealth fund). Despite the lack of carry, offshores in general have a positive CLP view vs. EM peers, based on the reasonable management of the Covid-19 crisis, Chile's sizeable fiscal and external cushions, and the resilience of copper vs. other commodities (namely oil).

On the virus front, the spread in Chile has been speeding up in recent weeks, obliging the government to tighten lockdowns and restrictions, with the subsequent impact on the economy. March's IMACEC stood at -3.1% y/y, and the 2Q20 collapse will likely reach double digits. The BCCh's 2020 GDP projection of -2% now looks old, and our sense here is that the output contraction may hover around 6% this year, but this will depend largely on the local virus dynamics.

Regarding measures, the BCCh kept rates at 0.5% in May but promised to expand monetary stimulus further if the economic crisis continues to deepen. The Bank is already providing liquidity via purchases of local bonds (banks' and BCCh's), and a facility to foster credit to the private sector (FCIC), but the BCCh is likely to start buying longer-term sovereign bonds before year-end, if Congress lifts the legal restrictions that exist today. Two weeks ago, the IMF announced that Chile had secured a contingent FCL for US$23bn to gross up FX reserves in case of need (today at US$36bn, i.e. a relatively low 13% of GDP). On top of the several previous measures, the Treasury launched emergency household income of US$325 per month for low-income families for 3 months. Fiscal deficit estimates now exceed 8% of GDP, suggesting that the room for further fiscal stimulus is running out.

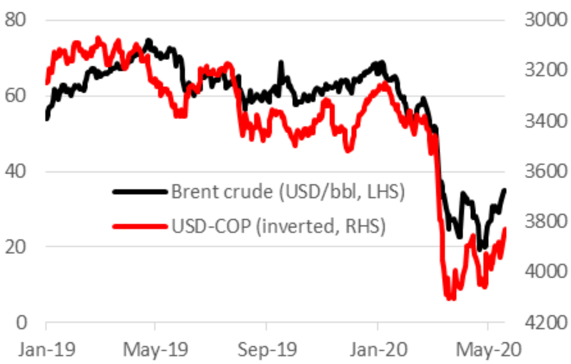
All that said, we now find the USDCLP rate vulnerable to the upside, on two factors: 1) global risk assets are probably rallying excessively; and 2) the local risk premium inside the FX rate is probably too tight. Regarding the former, there are few arguments we can add with conviction, but on the latter, we estimate that the USDCLP rate could easily increase 20-25 pesos in case of faltering newsflow and not so favourable technicals. For instance, copper prices at US$2.45/lb are consistent with an 820-825 rate, which implies a 30 peso premium vs. our externally-driven fair value estimate. In other words, we see the USDCLP rate going up in the short term, and if it falls further, that would likely be the result of a global USD sell-off, not a CLP rally.

COP – A crude proxy

Mike Moran
mike.moran@santander.us
(+1) 212 350 3500

We believe that the increasingly stable risk backdrop and tentative signs of a bottoming in global oil prices provide a more constructive short-term outlook for the COP. Colombia finds itself among the region's higher yielders for now, and in the context of low or negative yields in global debt markets, relatively attractive in addition to the weaker REER since March. The COP trades as an oil proxy, benefiting from any further positive developments in the global demand narrative. But there are vulnerabilities that lurk beneath. Colombia's fiscal and current account deficits cannot be entirely ignored. Even if they take a backseat for the time being, they could re-emerge as more prominent risks should risk aversion return.

Chart 29: Oil correlations are reengaging for COP

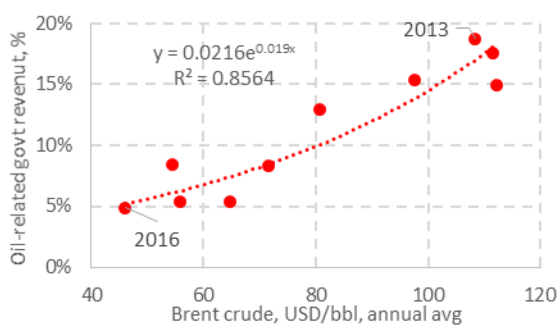


Source: Santander, Bloomberg

Meanwhile, Banrep has "only" delivered two 50bp cuts in policy rates in March and May. Now at 3.25%, this makes Colombia a relative high-yielder in regional terms. However, the policy stance is probably not accommodative enough either in nominal or real terms given the deceleration in the economy. The first quarter's 2.4% q/q GDP contraction was worse than expected, and Q2 data is likely to be worse. Banrep announced this month that the remainder of 2020's policy meetings will be rate-setting meetings (previously only 8 of the 12 scheduled meetings were), clearing the way for 50bp in policy rate cuts at each of the next two decisions on 29 May and 26 June, in our view.

Colombia's fiscal dynamics remain a key risk. The government's initial 2.7% of GDP fiscal response package is modest relative to others in the region and pressure for additional fiscal support is unlikely to dissipate. Funding for the first fiscal package (through the Emergency Mitigation Fund, or FOME) comes from fiscal savings, multilateral loans and the upcoming issuance of "solidarity bonds" (raised from local banks) and earmarked for the first wave of direct transfers to healthcare, households and payroll subsidies.

Chart 30: Lower baseline oil pressures revenues



Source: Santander, Bloomberg

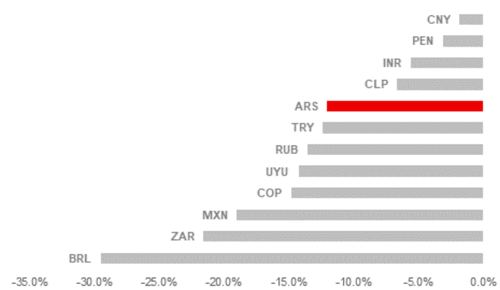
A government guarantee fund to backstop SMEs loans could also cost up to 1-1.5% of GDP. Given the uncertain backdrop, Colombia's Fiscal Rule Advisory Committee has twice revised higher the permissible fiscal deficit for 2020, the latest on 4 May, to 6.1% of GDP, as weaker growth and associated variables justify greater countercyclical measures. This may not be a hard cap. If economic conditions deteriorate even further, a temporary breach in the fiscal rule is possible but would require remedial policy proposals to be drawn up in coming years.

The revenue side of the fiscal equation is also fluid. With government 2020 GDP forecasts being slashed, now to -5.5% from the previous -1% to -2%, Finance Minister Carrasquilla has warned that tax revenue could fall as much as 10%, ~1.5% of GDP. Oil-related revenue has been in decline since the highs of almost 20% of total tax income in 2012-13 but remains a sizeable portion, at ~10% last year. This should keep the COP's sensitivity to global crude prices high despite weaker domestic output. All the more reason why tax reform remains a top priority urged by ratings agencies.

ARS – Default fears put pressure on FX markets

Juan Arranz
jarranz@santanderrio.com.ar
(+54) 11 4341 1065

Chart 31: EM devaluations YTD (%)



Source: Santander, Bloomberg

Chart 32: A fair REER by historical standards

Source: Santander, Bloomberg

Local savers are not taking any chances as fears for the country's ninth sovereign default grow. Market players worry that a default could bring even greater exchange rate volatility, especially if negotiations between the government and its creditors break down. With less than $10bn of liquid central bank reserves, the monetary authority could face reduced freedom to continue supporting a relatively slow crawling peg policy, in a country with 45% annual inflation and lacking voluntary capital market financing. Also, an EM environment of rapid devaluations triggered by capital outflows resulting from fears caused by the Covid-19 pandemic turmoil should be added to the domestic restrictions already mentioned.

Since the government's lockdown on 20 March, the central bank has intervened, selling USD400mn in the FX market. The monetary authority's intervention was aimed at supporting the official FX quote. Interestingly, the second quarter is a period of the year in which oilseed agricultural exports have a positive seasonal pattern. Imports, in turn, should move downward, in our view, as the lockdown imposed by the coronavirus has significantly compressed economic activity. Thus, we believe that the expected CB move should be purchasing hard currency rather than selling dollars.

The central bank's intervention in a shallow FX market might be reflecting some export sales postponements and/or anticipated import purchases triggered by expectations of an eventual acceleration of the current crawling peg's path.

The implicit dollar rate derived from the ratio between the price of a single financial asset in both pesos and dollars - known in the jargon as the blue chip arbitrage or CCL - has moved at a faster speed that the official FX rate in the last two months. The gap between the official and the implicit dollar rate is currently approaching 80%, practically doubling the 40% historical average.

Although the real effective multilateral exchange rate indicates a fair FX value when compared with its historical time series, some analysts and pundits note that the use of the domestic CPI as the deflator of the nominal exchange rate might be a misguided tool, taking into account that more than 50% of the items included in the consumer basket of goods and services in the index are either frozen, as in the case of public utility rates, transportation fares or rentals, or there are no transactions at all during the quarantine, in segments such as tourism, restaurants, entertainments and some others.

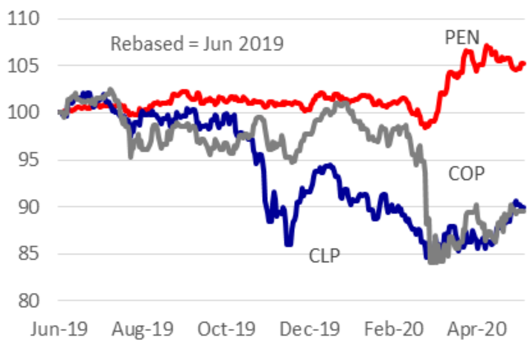
If, as some analysts suggest, the real effective exchange rate were adjusted by the 60% annual expansion in government spending to April vis-à-vis the 45% annual inflation rate, it would imply a less competitive local currency.

As such, a side effect of an eventual default would be further FX volatility. In order to avoid such a situation, further capital controls and import restrictions should not be ruled out, in our view, if such an undesirable scenario finally materialises.

PEN – It's all relative

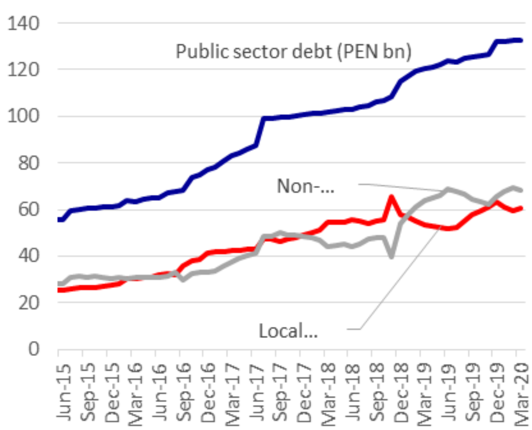
Mike Moran
mike.moran@santander.us
(+1) 212 350 3500

Chart 33: Strength by standing still



Source: Santander, BIS

Chart 34: Foreign participation remains stable



Source: Santander, BCRP

The PEN has traded on the back foot for much of May, though we note the price action is more orderly, with daily standard deviations continuing to decline from March's highs. That said, the PEN stands out as a relative outperformer year-to-date (both nominally and in real terms) by virtue of other regional currencies' weakness. Banco Central de Reserva del Peru (BCRP), the central bank, remains active in managing the current currency range, though any perceived thresholds remain largely lines in the sand for the time being. Offshore hedging activity is dynamic and remains a key short-term factor, as BCRP focuses on balancing liquidity needs and minimising disruptions. For now, currency stability is the name of the game, and we view the recent ranges (PEN3.35-3.46/USD) as soft, if informal, targets while policymakers grapple with stabilising the economy.

Like many economies, recent data is not for the faint hearted. March's YoY GDP contraction of -16.3% underscores the rough road ahead with lockdowns spurred by the Covid-19 pandemic impacting the back end of the month. While comparatively Peru reacted quickly in implementing quarantine measures, these steps are unlikely to prevent more ugly data points to come. April's activity figures should bring limited relief in this regard, as they capture a full month of quarantine-impacted activity.

With parts of Peru starting to reopen in May, data moving forward may reflect some stabilisation at the margin. Mining sector restrictions are easing though, with operations opening with partial crews to minimise infection risks. Thus, a return to full capacity will be gradual, even taking into account President Vizcarra's desire to open the economy by 10% per month (official government estimates put the economy operating at ~60-65% now). Moreover, Peru's dependence on capital investment to drive growth exposes the vulnerability of the recovery. We expect mining-related investments, particularly foreign, to likely be shelved or delayed until 2021, potentially putting Peru's growth on a weaker trajectory relative to the region.

We expect this trajectory to be influenced by several other structural considerations: the relative strength and inflexibility of the PEN suggest that the domestic economy may bear the brunt of the competitive adjustment going forward. Likewise, Peru's terms of trade have taken a dive since the beginning of the year, and while recent years have seen stronger trade surpluses, the quality of the recovery, in our view, will hinge not only on commodity prices, but also on Peru's biggest trading partners, China and the US. In this context, the recent escalation of US-Sino trade rhetoric deserves close monitoring.

Locally, we see the impact of new legislation that allows individuals to withdraw up to 25% of private pension holdings as another key risk event. Private pension funds (AFPs) hold some USD46bn in assets (locally and foreign), and the potential withdrawal of~USD10bn (admittedly the extreme scenario) could cause significant disruption as assets are liquidated to meet cash calls. To mitigate liquidity risks, the BCRP plans to offer three-month collateralised loans to AFPs to meet withdrawals, a number we think may be closer to USD5bn (over time) given the demography of AFP holders.

CEE FX: Main Themes

Currency	3M view	12M view	Main Themes
PLN	↘	⇨	• We maintain our negative view of the zloty's likely performance in the short term since the Polish currency did not benefit from the rise of global stock indexes and drop in volatility on the Polish FX market.
CZK	↘	↗	• We expect that the upper end of the 26.8-27.9 range could soon be broken. The recent negative circumstances – a larger-than-expected CNB rate cut and GDP y/y contraction in 1Q20 – support this view.
HUF	↘	↘	• We expect EURHUF to consolidate for a short while near 350.0, in line with the recent positive global mood in EM FX currencies, which is possibly related to a rebound in commodity prices. At the end of 2Q20 and in the longer term we expect HUF to resume weakening, due to worsening fundamentals.
RUB	↘	↘	• We are leaving our longer-term USDRUB forecasts unchanged for the time being. We are adjusting our shorter-term forecast lower, however, to accommodate the unanticipated oil-rally-based rouble strengthening. Even after lowering the forecast we remain bearish on the rouble.

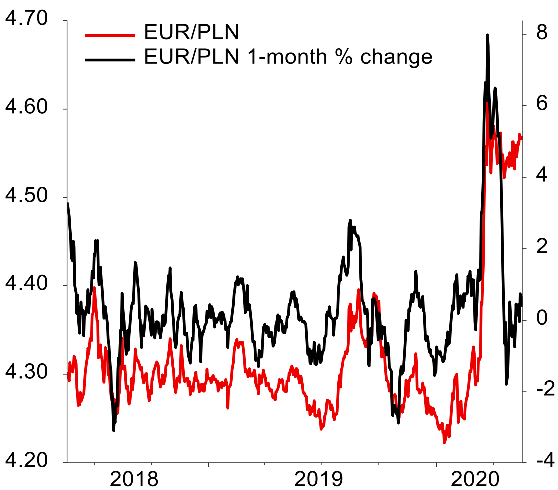
↑ Bullish ↗ Mildly Bullish ⇨ Neutral ↘ Mildly Bearish ↓ Bearish

Source: Santander Bank Polska S.A.

PLN – Still weak despite lower volatility

Marcin Sulewski, CFA
marcin.sulewski@santander.pl
(+48) 22 534 18 84

Chart 35. EUR/PLN and its 1-month % change



Source: Refinitiv Datastream, Santander Bank Polska

No meaningful changes happened in the EUR/PLN market during the last few weeks. The exchange rate remained within a 4.50-4.60 range and daily volatility eased. We maintain our negative view for the zloty's performance in the short term since the Polish currency did not benefit from the rise in global stock indexes and the drop in volatility in the Polish FX market.

Volatility on the Polish FX market has declined, along with the falling VIX. As shown in the chart, EUR/PLN's 1M realized volatility returned to the range in which it has been holding for the last two years (when EUR/PLN was trading around 4.30 for much of the time). However, unlike the pattern seen in the previous spikes, this time the subsequent drop in volatility was not accompanied by a zloty recovery. Actually, this observation is true for all four of the CEE currencies we cover and some LatAm and Asian EM peers as well. The zloty did not benefit from a noticeable rise in the major stock indexes and, in our view, this is a clear evidence there is still high uncertainty present in global markets.

If the sharp monetary and fiscal policy easing delivered by the central banks and states only managed to stabilize EM currencies, it seems that strong evidence that the global economy has passed the bottom of recession is needed to allow the zloty and its peers to pare coronavirus-related losses. We think this may take several months to become clear.

According to the flash estimate, Poland's GDP growth slowed to 1.9% y/y in 1Q20, from 3.2% y/y in 4Q. This was the weakest print since 3Q13. Seasonally-adjusted growth was -0.5% q/q and 1.6% y/y. It seems clear that Poland will be unable to avoid a technical recession (the last one was in 1H01) as the 2Q20 reading may come close to -12% q/q and below -10% y/y, we estimate. Overall, the data confirmed that a visible (but not as sharp as we expected) economic slowdown already took place in 1Q20. However, even a better-than-expected reading failed to support the zloty. We suspect that private consumption and services were the first to suffer from the epidemic. The full GDP data for 1Q20 will be released on May 29.

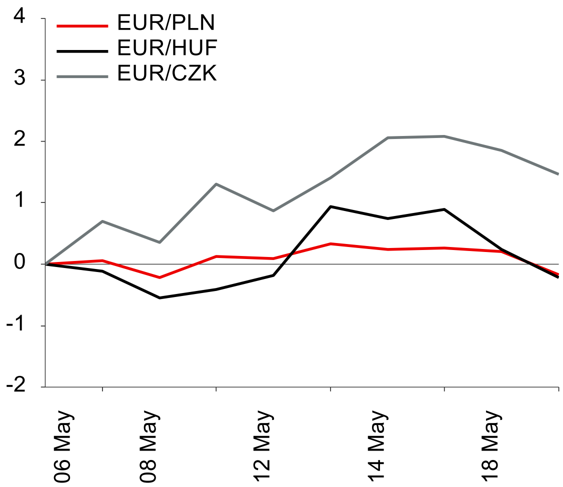
In mid-May Poland entered the third phase of easing of lockdown introduced to contain Covid-19. Deputy PM Jadwiga Emilewicz said that the government's target is to fully open the economy on July 1. For now, the total number of cases is Poland is growing and shows little signs of slowing. In our base case scenario we assume that in April Poland could have recorded the bottom of recession and economic activity should start to revive gradually.

Political tensions have recently eased after the ruling coalition agreed to postpone the presidential elections that were initially scheduled for May 10. There is no new date set, but late June is now considered the most likely. The polls show that incumbent president Andrzej Duda is still well ahead of his competitors.

CZK – Weaker than its CEE peers

Marcin Sulewski, CFA
marcin.sulewski@santander.pl
(+48) 22 534 18 84

Chart 36. Exchange rate % change since May 6



Source: Refinitiv Datastream, Santander Bank Polska

Last month we said there seemed to be no new internal factors to put extra pressure on the CZK. However, in the last few weeks we saw that the Czech central bank cut interest rates to the lowest level in the CEE region and that Czech GDP was the only one to fall in y/y terms in 1Q20 among its CEE peers.

As a result, the EUR/CZK rate has neared the upper end of the 26.8-27.9 range it has been holding in since mid-March. We already expected that the upper end could soon be broken and the recent negative circumstances allow us to maintain this view. Note that EUR/HUF and USD/RUB are trading near the lower ends of their consolidation ranges, while EUR/CZK is hovering near the upper end of its range.

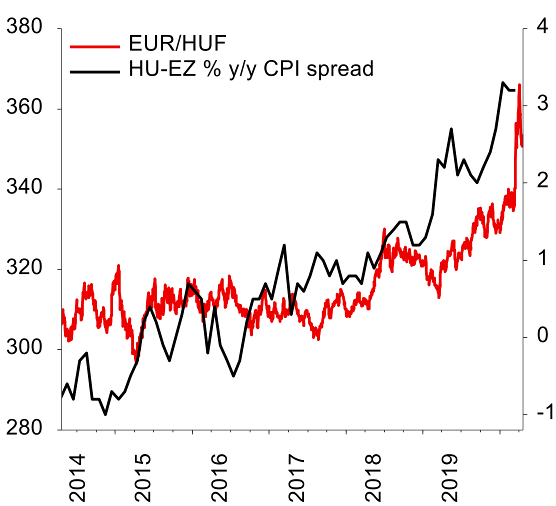
On May 7, the Czech central bank surprised the market when it cut its interest rate by 75bp to 0.25%. Governor Jiri Rusnok said that negative rates are not an obstacle for the bank's activity, adding to the dovish message send by the bank that day.

In mid-May, three of the four CEE countries we cover published flash 1Q20 GDP. Czechia recorded the biggest loss of y/y GDP growth vs. 4Q19 in percentage point terms: 4pp vs. 2.3pp for Hungary and 1.3pp for Poland. In the first three months of 2020, the Czech economy contracted 2.2% y/y, mainly owing to the drop in external demand and investments. As we explained in March, the Czech economy is heavily reliant on the auto sector. In March, car registrations in Czechia fell 36.3% y/y, the most since comparable data have been available (2005). April car registrations in the whole EU fell by 76.3%y/y.

HUF – New QE programme

Wojciech Mazurkiewicz
wojciech.mazurkiewicz@santander.pl
(+48) 22 534 18 86

Chart 37. EUR/HUF HU-EZ CPI spread



Source: Refinitiv Datastream, Santander Bank Polska

We expect EURHUF to consolidate in the short term near 350, thanks to the recent positive global mood in EM FX currencies, which is related to a rebound in commodity prices. We expect HUF to resume weakening due to worsening fundamentals. As a result, we leave all our forecasts unchanged.

Hungary was one of the very few countries where the April manufacturing PMI rebounded from the March reading (to 33.6 from 28.5), although it was still firmly in contraction territory. The April CPI declined to 2.4% y/y, from 3.9% y/y a month before, and was even lower than market expectations of 2.7%.

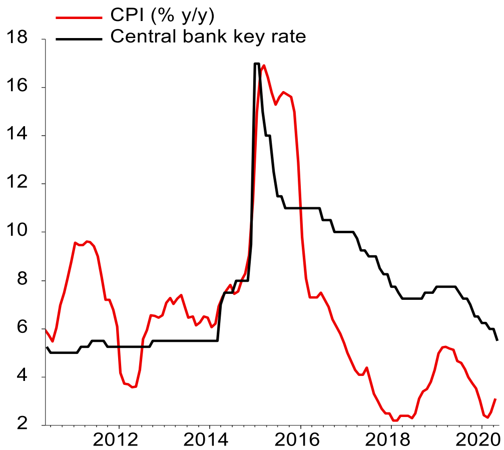
Preliminary 1Q GDP growth declined to +2.2% y/y (from +4.5% in 4Q19)– to the lowest level since 4Q16. The Bloomberg 2020 GDP growth consensus has dropped by a further 0.6pp in a month to -2.1% y/y currently. Both the CPI and GDP data indicate that the deflationary and contractionary effects of Covid-19 are significant and likely to remain in place for the time being.

At its April 28 meeting, the NBH left rates unchanged but launched a QE programme with the aim of flattening the yield curve. The QE programme is open-ended but due for review once it reaches HUF1.0trn. With the pace of purchases set at HUF100bn/week, this level is to be reached in 10 weeks. So far, the central bank has bought HUF134.0bn of bonds maturing in 2030, 2031 and 2038. Supply constraints mean it is likely to move towards shorter tenors soon. The 10Y HU-DE spread narrowed as a result to 233bp from 286bp.

RUB – Deteriorating growth outlook but oil rebound helps

Wojciech Mazurkiewicz
wojciech.mazurkiewicz@santander.pl
(+48) 22 534 18 86

Chart 38. Russian CPI and central bank key rate



Source: Refinitiv Datastream, Santander Bank Polska

Since our last FX Compass the USDRUB has fallen by almost 3.0%, to which the weaker US dollar contributed roughly 0.5pp (DXY down to 99.6 from 100.1) and the rouble basket 2.5pp (down to 75.4 from 77.1). The latter might have been the result of a 60% rebound in oil prices (Brent to USD34.5/bbl from USD21.6bbl), which we had not envisaged.

The weak growth environment is also a result of Russia having the second-highest number of confirmed Covid-19 cases globally (c300k), expectations of further rate cuts and rising inflation and inflation expectations, which all point to more challenging fundamentals in the future and lower real rates (even if only temporarily). All the above lead us to maintain our longer-term USDRUB forecasts for the time being. We are adjusting our shorter-term forecast lower, however, to accommodate the unanticipated oil-rally-based rouble strengthening. We now see 2Q20E at 79.0 and 3Q20 at 85.0. Even with our lower forecasts we remain bearish on rouble.

At its April 24 meeting, the Russian central bank delivered a 50bp cut, bringing rates to 5.50%. In the press conference Governor Elvira Nabiullina said the CBR expects a sharp fall in total demand and that the measures taken that far helped GDP growth by 2pp. She also made clear that gold reserves are sufficient to support both imports and short-term debt. The CBR announced the start of repo transactions, due to a need for longer-term liquidity and said that another rate cut in June is possible and could be as much as 100bp.

The central bank governor's early May press conference came not long after very weak April PMI readings (manufacturing down to 31.3 from 47.5 and services to 12.2 from 37.1 a month before). As for GDP growth in 2Q20, the CBR, after observing slower spending in the April 20-24 data on sectoral financial flows, expects it to shrink up to 8% y/y.

Regarding the inflation spike (3.1% y/y in April from 2.5% y/y just a month before) the CBR reckons it was affected by one-off factors. The risks of secondary effects associated with those factors are low, in the bank's opinion.

As far as oil prices are concerned, the CBR noted that not only Brent increased in price but also the Urals discount to Brent decreased from USD10-11 to USD3-4, taking the Urals price higher to USD24-25/bbl.

Market volatility calmed down and fixed income had a solid rally, which is no surprise given the delivered and expected rate cuts in the context of rapidly worsening growth expectations (Bloomberg 2020 GDP consensus growth dropped to -4.6% from -2.0% in April). The rally took place despite the seemingly stable share of foreigners in the OFZ market (around 31%, according to the CBR).

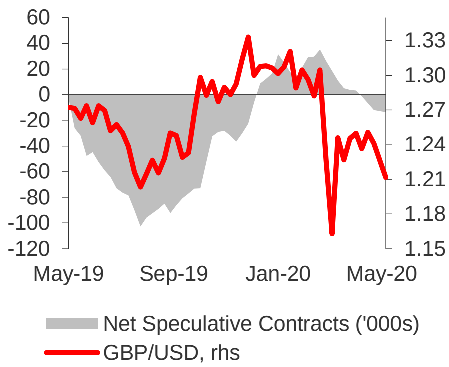
Local bonds rallied along the curve, with 2Y currently at 4.7% (-63bp) and 10Y at 5.5% (-60bp). Cross currency swaps declined even more, by around 75bp to 4.0% (2Y, 10Y).

FX options volatilities declined and the curve is now only slightly inverted, with 1M at 16.0% vs 1Y at 15.0%, while risk reversals declined to 3.7% and 4.4% for 1M and 1Y, respectively (both from 5.0% just a month ago).

G10 FX: IMM Speculative Positioning

Michael Flisher
michael.flisher@santanderCIB.co.uk
(+44) 33114 80232

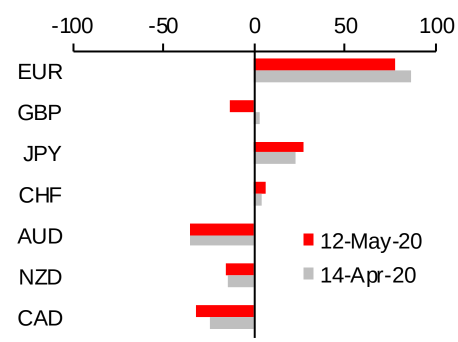
IMM commitment of traders report: GBP/USD position



- **Speculators turned net short GBP/USD in late April,** increasing this position in each of the past four weeks, to 13k contracts in the week ended 12 May. In the UK, a high Covid-19 count, confusion over the lockdown exit plan, and worries about a lack of progress on UK-EU Brexit talks have all likely prompted investors to cut GBP longs, but a more upbeat USD view has also weighed on GBP/USD positioning.
- **The net long EUR/USD position has fallen in recent weeks,** to 78k contracts currently, likewise due to the markets' more upbeat USD view, as well as a slight increase in EUR short contracts, which have again begun to climb gradually from their March lows.
- **The net short CAD position has deteriorated further.** Despite a gradual increase in the oil price, it remains low by historical standards, with the net short CAD position, at 32k contracts, now at its highest in almost a year.
- **Speculators have also become more bullish on the JPY,** with the net long JPY position rising to 27k contracts in early May.
- **The net AUD, NZD and CHF positions are all still neutral,** and relatively unchanged over the past four weeks.

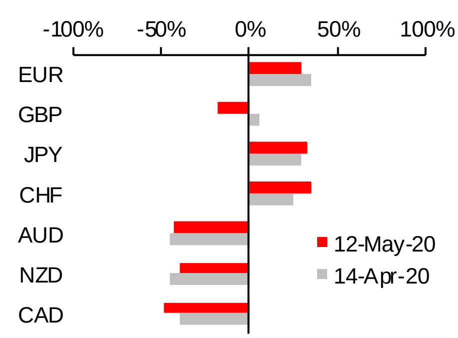
Net Speculative Contracts ('000s)*

	12-May-20	14-Apr-20	4w chg	YtD chg
USD***	-10.4	-46.6	36.2	15.4
EUR	78.1	86.6	-8.5	152.5
GBP	-13.7	3.2	-16.9	-26.1
JPY	27.9	22.6	5.3	53.2
CHF	6.6	4.7	2.0	12.4
AUD	-35.4	-35.6	0.1	2.9
NZD	-15.9	-14.6	-1.3	-10.8
CAD	-32.2	-23.8	-8.5	-44.2



Net Speculative Contracts as % of Open Interest**

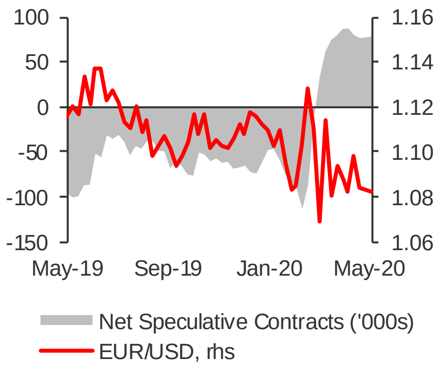
	12-May-20	14-Apr-20	4w chg	YtD chg
USD***	-2%	-7%	6%	1%
EUR	29%	36%	-6%	47%
GBP	-18%	6%	-23%	-28%
JPY	33%	29%	4%	55%
CHF	36%	25%	11%	52%
AUD	-43%	-45%	2%	-15%
NZD	-40%	-45%	5%	-30%
CAD	-49%	-40%	-9%	-59%



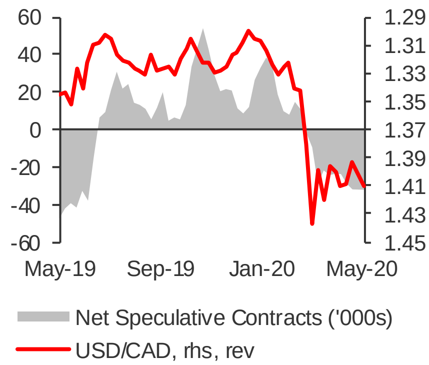
Sources: CFTC, Bloomberg, Santander. Note: *Net Speculative Contracts = Long non-commercial traders contracts minus short non-commercial traders contracts, **Open Interest = The total number of outstanding long and short futures contracts, ***USD composite index = USD composite index uses AUD, CAD, CHF,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

G10 FX: IMM Speculative Positioning

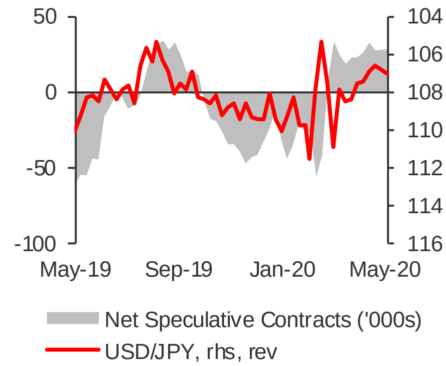
EUR/USD



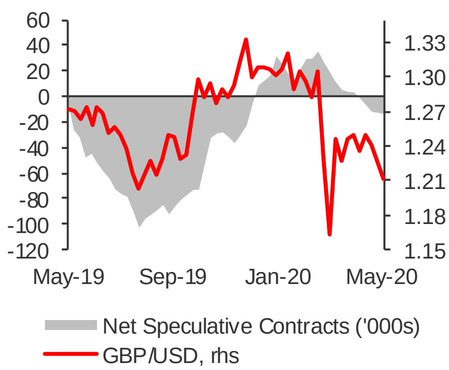
USD/CAD



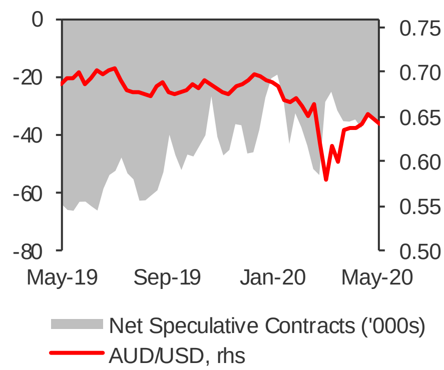
USD/JPY



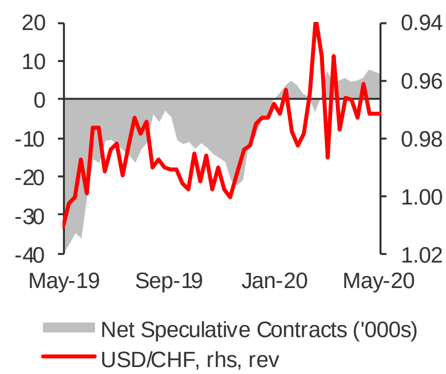
GBP/USD



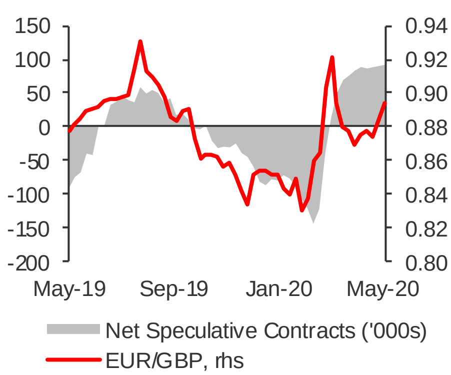
AUD/USD



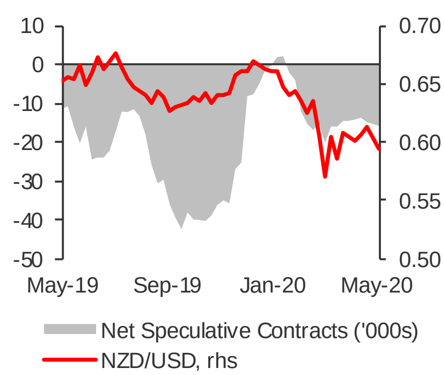
USD/CHF



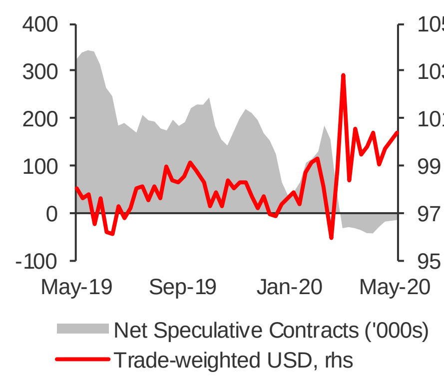
EUR/GBP



NZD/USD



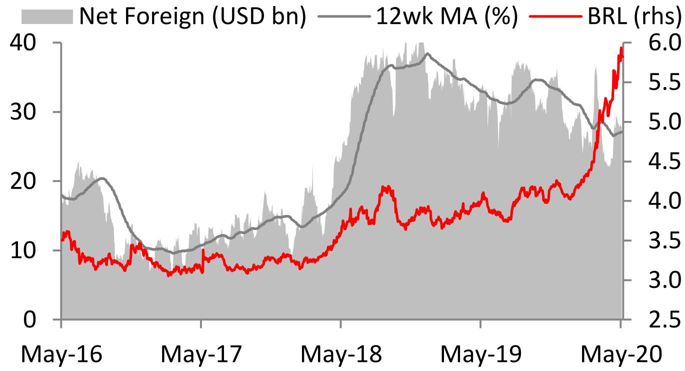
USD minus MXN



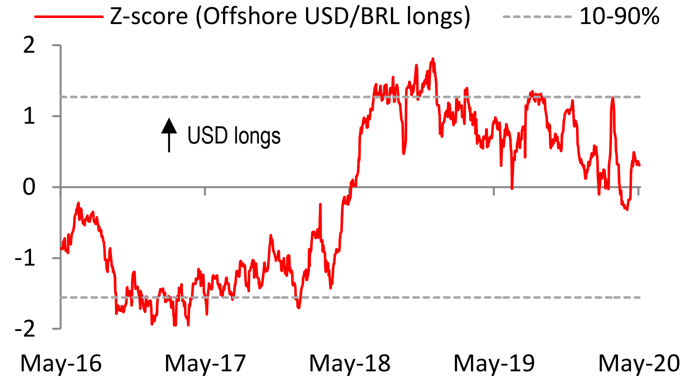
Sources: CFTC, Bloomberg and Santander. Note: IMM commitment of traders report

Latin America FX: Positioning indexes (Z-scores)

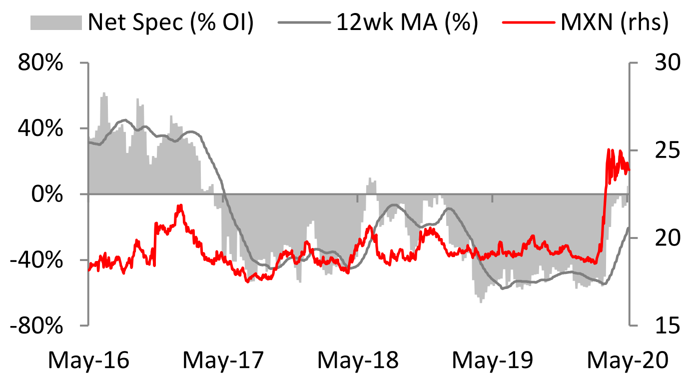
USD/BRL



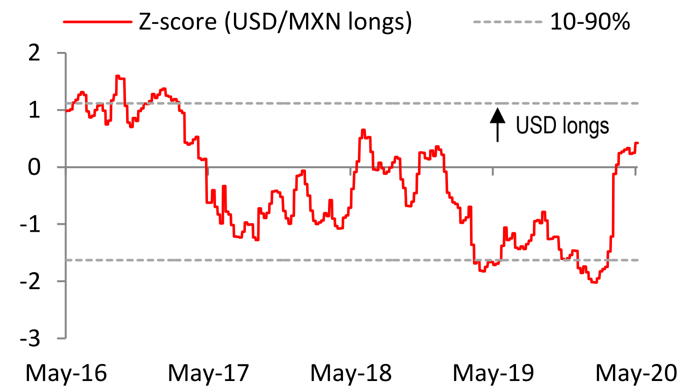
Z-score USD/BRL



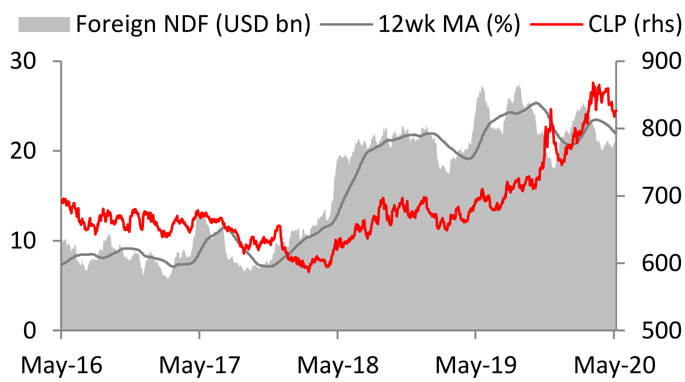
USD/MXN



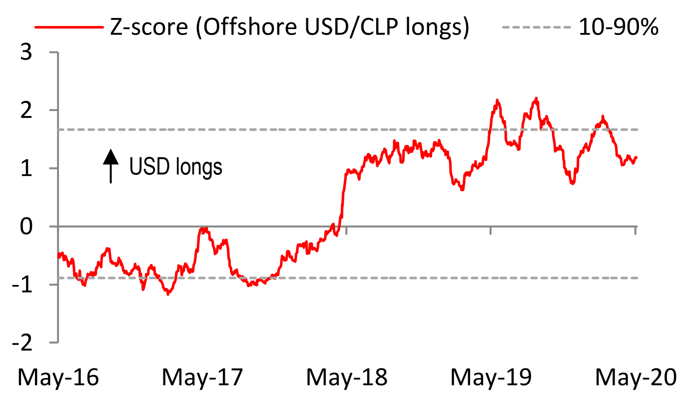
Z-score USD/MXN



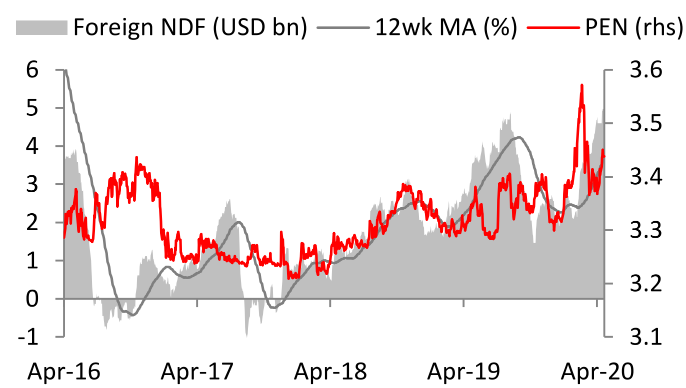
USD/CLP



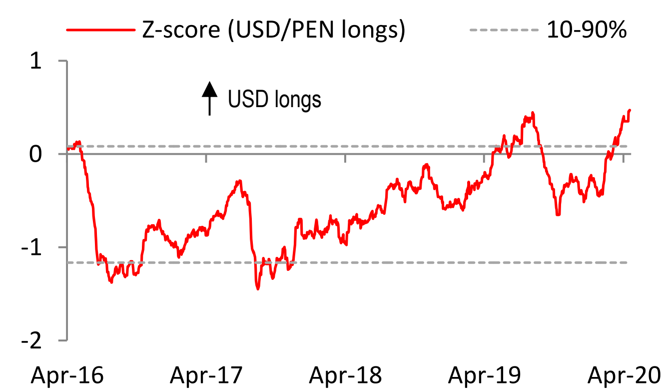
Z-score USD/CLP



USD/PEN



Z-score USD/PEN



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

Euro Interest Rate Forecasts

Government Bond yield Forecasts

Germany	Current	2Q20	3Q20	4Q20	1Q21
ECB Depo	-0.50	-0.50	-0.50	-0.50	-0.50
3m	-0.53	-0.65	-0.60	-0.55	-0.55
2y	-0.69	-0.60	-0.55	-0.50	-0.50
5y	-0.67	-0.50	-0.45	-0.40	-0.35
10y	-0.49	-0.35	-0.30	-0.25	-0.20
30y	-0.07	0.05	0.10	0.15	0.20

Swap rate forecasts

Euro	Current	2Q20	3Q20	4Q20	1Q21
ECB Depo	-0.50	-0.50	-0.50	-0.50	-0.50
3m	-0.28	-0.35	-0.35	-0.35	-0.35
2y	-0.29	-0.30	-0.30	-0.30	-0.30
5y	-0.27	-0.20	-0.20	-0.20	-0.15
10y	-0.14	0.00	0.00	0.00	0.05
30y	-0.04	0.20	0.20	0.25	0.30

US Interest Rate Forecasts

Government Bond yield Forecasts

US	Current	2Q20	3Q20	4Q20	1Q21
Fed Upper	0.25	0.25	0.25	0.25	0.25
3m	0.11	-0.05	0.01	0.01	0.01
2y	0.16	0.30	0.35	0.40	0.45
5y	0.33	0.50	0.50	0.55	0.60
10y	0.67	0.80	0.90	1.00	1.10
30y	1.39	1.40	1.45	1.50	1.55

Swap rate forecasts

US	Current	2Q20	3Q20	4Q20	1Q21
Fed Upper	0.25	0.25	0.25	0.25	0.25
3m	0.36	0.65	0.65	0.65	0.55
2y	0.25	0.30	0.30	0.40	0.45
5y	0.37	0.55	0.55	0.60	0.65
10y	0.66	0.75	0.75	0.75	0.85
30y	0.92	0.90	1.00	1.10	1.20

UK Interest Rate Forecasts

Government Bond yield Forecasts

UK	Current	2Q20	3Q20	4Q20	1Q21
MPC	0.10	0.10	0.10	0.10	0.10
3m	0.12	0.10	0.10	0.14	0.17
2y	-0.02	0.05	0.05	0.05	0.10
5y	0.05	0.10	0.15	0.20	0.20
10y	0.23	0.25	0.30	0.40	0.45
30y	0.62	0.70	0.75	0.80	0.90

Swap rate forecasts

UK	Current	2Q20	3Q20	4Q20	1Q21
MPC	0.10	0.10	0.10	0.10	0.10
3m	0.26	0.35	0.25	0.22	0.25
2y	0.28	0.40	0.40	0.40	0.40
5y	0.34	0.40	0.40	0.40	0.45
10y	0.45	0.55	0.55	0.60	0.65
30y	0.43	0.55	0.55	0.50	0.60

G10 Central Bank Calendar

	Current Rate	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep
FOMC (Upper)	0.25	-25bp	-	Unch.	Unch.	-	-150bp^	Unch.	-	10	29	-	16
ECB (Depo)	-0.50	Unch.	-	Unch.	Unch.	-	Unch.^	Unch.	-	4	16	-	10
BoE	0.10	-	Unch.	Unch.	Unch.	-	-65bp^	-	Unch.	18	-	6	17
BoJ	-0.10	Unch.	-	Unch.	Unch.	-	Unch.^	Unch.	-	16	22	-	17
SNB	-0.75	-	-	Unch.	-	-	Unch.	-	-	18	-	-	24
BoC	0.25	Unch.	-	Unch.	Unch.	-	-150bp	Unch.	-	3	15	-	9
RBA	0.25	-25bp	Unch.	Unch.	-	Unch.	-50bp^	Unch.	Unch.	2	7	4	1
RBNZ	0.25	-	Unch.	-	-	Unch.	-75bp	-	Unch.	24	-	12	23
Norges Bank	0.00	Unch.	-	Unch.	Unch.	-	-125bp	-	-25bp	18	-	20	24
Riksbank	0.00	Unch.	-	+25bp	-	Unch.	Unch.^	Unch.	-	-	1	-	22

Source: Bloomberg, Santander, Central Banks. Note: Data correct as at 21-May-2020. For meetings that have already taken place, rate decision identified as +/- in bp, or "unch" for no change. "-" denotes no meeting taking place that month. ^Indicates rate decision at emergency unscheduled meeting.

Brazil/Mexico Interest Rate forecasts

Brazil	Current	2Q20	3Q20	4Q20	1Q21
SELIC	3.00	2.25	2.25	2.25	2.25
NTNF Jan' 25s	6.34	6.38	6.31	6.25	6.21
NTNF Jan.' 29s	7.70	7.83	7.65	7.48	7.31

Mexico	Current	2Q20	3Q20	4Q20	1Q21
Banxico fondeo	5.50	5.00	4.50	4.50	4.00
MBono Mar. '23s	5.14	5.15	5.00	4.90	5.10
MBono May. '29s	6.08	6.10	6.00	6.00	6.00

Chile/Colombia/Argentina/Peru Interest Rate Forecasts

Chile	Current	2Q20	3Q20	4Q20	1Q21
BCCh TPM	0.50	0.50	0.50	0.50	0.50
BCP 5Y	1.41	1.35	1.50	1.70	1.90
BCP 10Y	2.11	2.10	2.40	2.70	3.00

LatAm	Current	2Q20	3Q20	4Q20	1Q21
Colombia	3.25	2.25	2.25	2.25	2.25
Argentina	38.0	39.0	40.0	41.0	43.0
Peru	0.25	0.25	0.25	0.25	0.25

LatAm Central Bank Calendar

	Current Rate	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep
Brazil	3.00	-50bp	-	-50bp	-	-25bp	-50bp^	-	-75bp	17	-	5	16
Mexico	5.50	-	-25bp	-25bp	-	-25bp	-50bp^	-50bp^	-50bp	25	-	13	24
Chile	0.50	-25bp	-	Unch.	Unch.	-	-125bp^	-	Unch.	16	15	-	1
Colombia	3.25	Unch.	-	Unch.	Unch.	-	-50bp	-50bp	-	26	31	-	25
Argentina*	38.00	-1037bp	-500bp	-800bp	-500bp	-1000bp	-200bp	Unch.	~	~	~	~	~
Peru	0.25	Unch.	-25bp	Unch.	Unch.	Unch.	-100bp^	-100bp^	Unch.	11	9	13	10

CEE Interest Rate Forecasts

Poland	Current	2Q20	3Q20	4Q20	1Q21
Reference Rate	0.50	0.50	0.50	0.50	0.50
2y	0.53	0.60	0.60	0.64	0.67
10y	1.68	1.50	1.55	1.65	1.70

CEE	Current	2Q20	3Q20	4Q20	1Q21
Hungary	0.90	0.90	0.90	0.90	0.90
Czech Republic	0.25	0.25	0.25	0.25	0.25
Russia	5.50	5.00	5.00	5.00	5.00

CEE Central Bank Calendar

	Current Rate	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep
Poland	0.50	Unch.	Unch.	Unch.	Unch.	Unch.	-50bp^	-50bp	28	3	8	-	9
Czech Republic	0.25	-	Unch.	Unch.	-	+25bp	-125bp	-	-75bp	24	-	6	23
Hungary	0.90	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	26	23	21	25	22
Russia	5.50	-50bp	-	-25bp	-	-25bp	Unch.	-50bp	-	29	24	-	18

Source: Bloomberg, Santander, Central Banks. Note: Data correct as at 21-May-2020. For meetings that have already taken place, decision identified as +/- in bp, or "unch" for no change. "-" denotes no meeting taking place that month. ^Indicates rate decision at emergency unscheduled meeting

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

	3M	6M	9M
EUR/USD	**1.11**	**1.13**	**1.14**
vs.forward	0.9	3.1	3.7
vs.consensus forecast	1.8	3.0	1.8
GBP/USD	**1.22**	**1.28**	**1.32**
vs.forward	-0.5	4.7	7.9
vs.consensus forecast	-0.3	3.2	4.8
EUR/GBP	**0.91**	**0.89**	**0.86**
vs.forward	1.5	-1.5	-4.0
vs.consensus forecast	2.5	-0.5	-1.8
USD/JPY	**113**	**114**	**114**
vs.forward	4.6	5.5	5.8
vs.consensus forecast	5.3	6.2	6.0
EUR/JPY	**125**	**129**	**130**
vs.forward	5.5	8.7	9.7
vs.consensus forecast	7.3	9.6	10.1
EUR/CHF	**1.09**	**1.12**	**1.13**
vs.forward	2.7	5.2	6.1
vs.consensus forecast	2.8	5.3	4.3
USD/CHF	**0.98**	**0.99**	**0.99**
vs.forward	1.7	2.1	2.4
vs.consensus forecast	1.2	1.6	2.9
EUR/SEK	**10.8**	**10.6**	**10.4**
vs.forward	2.7	0.5	-1.1
vs.consensus forecast	0.3	-1.9	-2.5
EUR/NOK	**11.2**	**10.8**	**10.5**
vs.forward	2.3	-0.8	-3.8
vs.consensus forecast	-1.2	-2.8	-4.3
USD/CAD	**1.37**	**1.34**	**1.32**
vs.forward	-1.7	-3.7	-4.9
vs.consensus forecast	-3.1	-4.3	-4.1
AUD/USD	**0.63**	**0.65**	**0.66**
vs.forward	-3.7	-1.7	0.9
vs.consensus forecast	2.2	2.6	2.1
NZD/USD	**0.62**	**0.64**	**0.65**
vs.forward	1.2	3.9	6.6
vs.consensus forecast	5.1	6.1	7.1

	3M	6M	9M
USD/BRL	**5.97**	**5.87**	**5.80**
vs.forward	4.8	3.0	1.9
vs.consensus forecast	8.5	10.9	13.7
EUR/BRL	**6.62**	**6.65**	**6.61**
vs.forward	6.0	6.4	5.8
vs.consensus forecast	10.5	14.3	15.8
USD/MXN	**23.7**	**23.1**	**23.0**
vs.forward	2.4	-0.2	-0.9
vs.consensus forecast	-1.7	-0.5	-0.1
EUR/MXN	**26.3**	**26.2**	**26.2**
vs.forward	3.3	2.8	2.7
vs.consensus forecast	0.1	2.5	1.6
USD/CLP	**815**	**803**	**793**
vs.forward	1.5	0.0	-1.2
vs.consensus forecast	-3.8	-4.4	-5.0
EUR/CLP	**905**	**910**	**904**
vs.forward	2.6	3.3	2.6
vs.consensus forecast	-2.1	-1.5	-3.3
USD/ARS	**76**	**84**	**93**
vs.forward	12.4	23.8	36.9
vs.consensus forecast	8.0	12.2	15.0
EUR/ARS	**85**	**95**	**106**
vs.forward	13.6	27.8	42.1
vs.consensus forecast	10.0	15.6	17.0
EUR/PLN	**4.70**	**4.67**	**4.58**
vs.forward	3.7	3.0	1.1
vs.consensus forecast	2.8	2.8	1.9
EUR/CZK	**27.7**	**26.6**	**25.4**
vs.forward	1.5	-2.6	-6.9
vs.consensus forecast	1.9	-1.6	-4.2
EUR/HUF	**363**	**371**	**373**
vs.forward	4.2	6.3	7.0
vs.consensus forecast	2.6	4.9	5.1
EUR/RUB	**89**	**98**	**104**
vs.forward	14.5	25.5	33.3
vs.consensus forecast	10.0	20.9	30.0

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	1.099	1.223	107.74	118.45	131.75	0.966	1.062	1.181
1M	1.100	1.223	107.70	118.48	131.72	0.965	1.061	1.180
2M	1.101	1.223	107.65	118.49	131.67	0.964	1.061	1.179
3M	1.101	1.223	107.60	118.51	131.62	0.963	1.061	1.178
6M	1.104	1.224	107.42	118.56	131.45	0.960	1.060	1.175
9M	1.106	1.225	107.18	118.58	131.24	0.957	1.059	1.172
12M	1.109	1.225	106.99	118.60	131.05	0.954	1.058	1.169

ATMf vol.

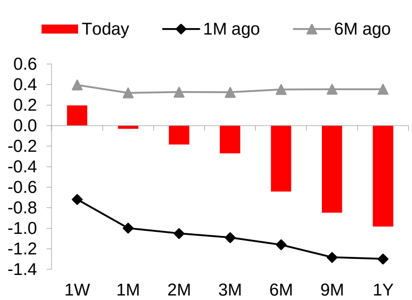
	EUR/USD	GBP/USD	USD/JPY	EUR/JPY	GBP/JPY	USD/CHF	EUR/CHF	GBP/CHF
1W	6.2%	8.7%	5.1%	7.0%	9.1%	6.1%	5.4%	7.7%
1M	6.6%	10.3%	5.7%	7.6%	10.5%	6.6%	5.6%	8.9%
2M	6.6%	10.4%	6.0%	7.8%	10.6%	6.6%	5.7%	9.0%
3M	6.6%	10.4%	6.3%	8.1%	10.7%	6.6%	5.7%	9.0%
6M	7.0%	10.7%	7.2%	8.8%	11.1%	7.0%	5.9%	9.3%
9M	7.0%	10.9%	7.2%	9.0%	11.2%	7.1%	6.1%	9.6%
12M	7.1%	10.9%	7.3%	9.2%	11.3%	7.1%	6.1%	9.6%

Implied/realized vol. ratio

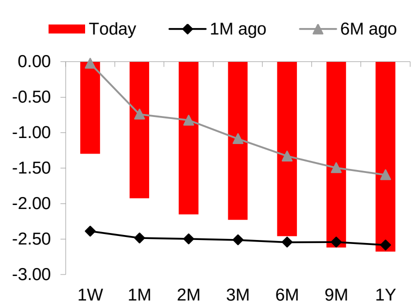
	EUR/USD	GBP/USD	USD/JPY	EUR/JPY	GBP/JPY	USD/CHF	EUR/CHF	GBP/CHF
1W	0.93	1.00	1.03	0.91	0.95	1.04	0.95	0.97
1M	0.86	1.05	0.96	0.88	1.02	0.91	1.40	1.11
2M	0.70	0.77	0.70	0.81	0.82	0.79	1.25	0.82
3M	0.59	0.67	0.49	0.65	0.63	0.60	0.99	0.65
6M	0.82	0.85	0.74	0.92	0.81	0.83	1.19	0.80
9M	0.93	0.94	0.84	1.03	0.88	0.92	1.22	0.87
12M	1.01	1.04	0.91	1.13	0.96	0.96	1.26	0.94

25-delta risk reversals

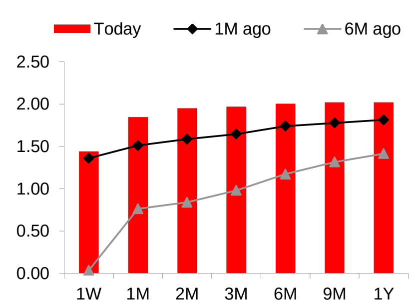
EUR/USD



GBP/USD



EUR/GBP



Sources: Bloomberg and Santander. As of 21-May-2020

Latin America FX: Spot and forward rates

	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
Spot	68.0	5.69	803	3815	23.2	3.40
1M	72.3	5.70	803	3825	23.3	3.41
2M	76.6	5.71	803	3834	23.4	3.41
3M	80.5	5.72	802	3845	23.5	3.41
6M	92.2	5.74	800	3867	23.8	3.43
9M	100.0	5.75	799	3891	24.0	3.44
12M	112.3	5.78	799	3921	24.3	3.45

ATMf vol.

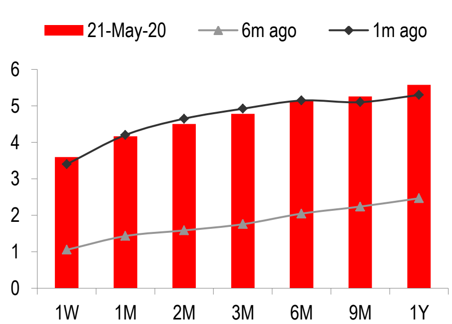
	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
1W	6.90	22.24	12.34	16.05	20.90	5.21
1M	9.68	22.49	12.10	15.98	19.29	7.26
2M	13.31	21.69	12.24	15.72	18.51	7.25
3M	15.07	20.90	12.31	15.26	17.88	7.19
6M	17.71	19.80	12.58	14.84	17.30	7.30
9M	19.13	18.87	12.55	14.30	16.58	7.31
12M	19.90	18.35	12.60	13.98	16.25	7.31

Implied/realized vol. ratio

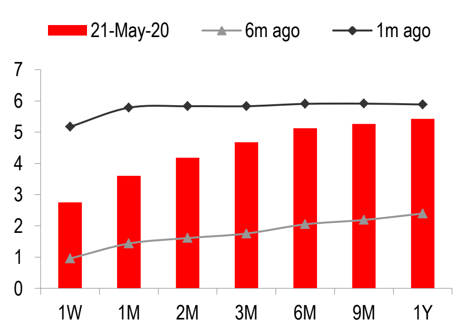
	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
1W	3.98	1.27	1.48	1.12	1.04	0.78
1M	3.26	0.96	1.24	1.20	0.91	1.05
2M	3.47	1.04	0.87	0.95	0.68	0.74
3M	4.15	0.85	0.73	0.58	0.53	0.75
6M	5.77	1.05	0.84	0.76	0.71	0.98
9M	1.23	1.13	0.86	0.84	0.82	1.09
12M	0.65	1.17	0.94	0.89	0.88	1.18

25-delta risk reversals

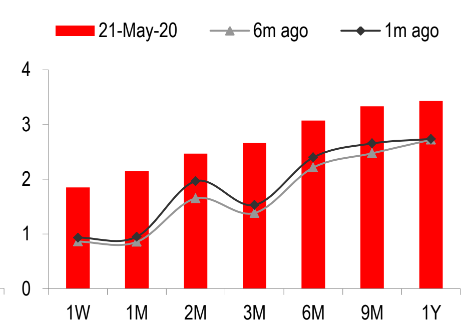
USD/BRL



USD/MXN



USD/CLP



Sources: Bloomberg and Santander. As of 21-May-2020

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EXPLANATION OF THE RECOMMENDATION SYSTEM

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

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

DEFINITIONS

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

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G10 Rates/FX Strategy			
Antonio Villarroya	Head of Macro and Strategy Research	antvillarroya@gruposantander.com	+34 91 257 2244
Stuart Bennett	**Head G10 FX Strategy**	**stuart.bennett@santanderCIB.co.uk**	**+44 33114 80134**
Michael Flisher	**G10 FX Strategist**	**michael.flisher@santanderCIB.co.uk**	**+44 33114 80232**
Antonio Espasa	Chief Economist	aespasa@gruposantander.com	+34 91 289 3313
Laura Velasco	Economics	laura.velasco@gruposantander.com	+34 91 175 2289
Beatriz Tejero	Economics	beatriz.tejero@gruposantander.com	+34 91 257 2410
Adam Dent	UK Rates Strategy	adam.dent@santanderCIB.co.uk	+44 20 7756 6223
José María Fernández	Rates Strategy	josemariafernandezl@gruposantander.com	+34 91 257 2244
Cormac O'Connell	Rates Strategy	cormac.oconnell@gruposantander.com	+34 91 257 2244
Latin America Research – Strategy			
Juan Pablo Cabrera	**Chief Rates & FX Strategist – Chile**	**jcabrera@santander.cl**	**+56 22 320 3778**
Juan Miguel Arranz	**Chief Rates & FX Strategist – Argentina**	**jarranz@santanderrio.com.ar**	**+54 11 4341 1065**
Mike Moran	**Rates & FX Strategy – Colombia & Peru**	**mike.moran@santander.us**	**+1 212 350 3500**
Latin America Research – Economics			
Sergio Galván	Economist – Argentina	sgalvan@santanderrio.com.ar	+54 11 4341 1728
Jankiel Santos	**Economist – Brazil**	**jankiel.santos@santander.com.br**	**+55 11 3012 5726**
Guillermo Aboumrad	**Economist – Mexico**	**gjaboumrad@santander.com.mx**	**+52 55 5257 8170**
Marcela Bensión	Economist – Uruguay	mbension@santander.com.uy	+59 82 1747 5537
Central and Eastern Europe			
Maciej Reluga	Head CEE Macro, Rates & FX Strategy	maciej.reluga@santander.pl	+48 22 534 1888
Piotr Bielski	CEE Economist	piotr.bielski@santander.pl	+48 22 534 1888
Marcin Sulewski	**CEE Economist**	**marcin.sulewski@santander.pl**	**+48 22 534 1884**
Wojciech Mazurkiewicz	**CEE Economist**	**wojciech.mazurkiewicz@santander.pl**	**+48 22 534 1886**

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Local Offices

Madrid Tel: 34-91-257-2035 Fax: 34-91-257-0252	**Lisbon** Tel: 351-21-389-3400 Fax: 351-21-387 0175	**London** Tel: 44-870-607-6000 Fax: 44-20-7332-6909	**Milan** Tel: 39-02-8542-09810 Fax: 39-02-8606-71648
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