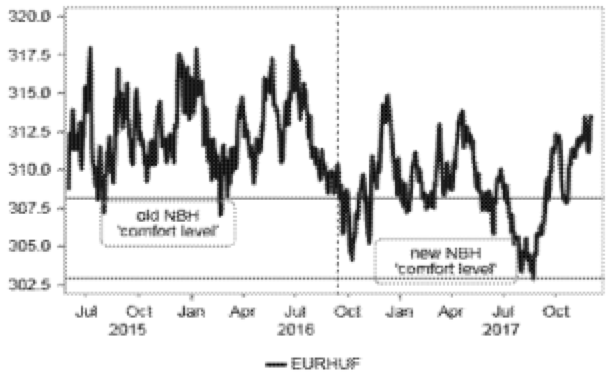
HUF appreciation in line with fundamentals and valuation. PLN, on the other hand, is at the strong end of the recent range. However, we believe that tensions with the EU – the main barrier to PLN appreciation – seem to be softening, opening up more room for appreciation in line with fundamentals and valuation; positioning is also still light in historical terms.

NBH: Comfortable with stronger HUF than in the past



Source: Deutsche Bank, Macrobond

CLP: The Chilean peso's depreciation on the aftermath of the first round of the Presidential election has pushed the CLP to level that is an attractive entry point to enter long CLP position. There is uncertainty regarding the election's second round, but Chile's economy seems poised for rebound regardless. We expect frontloaded output growth of around 3.5% during 2018 due to base effects related to last year's mining strike and improving terms of trade and a rebound of investments especially into the mining sector. We expect the BCCh to begin a hiking cycle in Q3 '18 which will marginally increase the CLP's carry. Finally, domestic investors' limited capacity to absorb new debt issued by the government is likely to steepen the CLP curve. Then, we expect the recently achieved "euroclearability" of local gov't bonds to attract debt inflows of yield-seeking foreign investors. The main risk to this view is an unexpected slowdown of China and lower metal prices.

PEN: Mining of metals accounts for 12% of Peru's private investment, 60% of exports, and 10% of GDP. The investment cycle in metals is at a turning point after falling since 2015. Higher copper and zinc prices and the operation at full capacity of mines in Peru suggest new investment flows are on their way: the gov't expects investments of around USD 11.3bn to be executed out of Peru's USD 51.1bn investment project backlog in mining. The government's efforts to minimize social conflicts and regulatory issues pose upside risks both to investment and current account projections. The BCRP has forcefully prevented the PEN from appreciating but as the economy grows, gaps shrink, and XCCY converge to zero we expect USD purchases to ease. Just like in the case of the CLP, the PEN's main risk is an unexpected China-born shock.

3) The wild cards: MXN, TRY, and ZAR

Within EM FX there are a handful of currencies that could potentially appreciate or depreciate significantly depending on the resolution of very specific and significant idiosyncratic (and mostly political) risks with potential outcomes that are almost binary in terms of their FX impact. The three wild cards within EM FX are the MXN, TRY, and ZAR.

MXN: The future of the MXN hinges not on one but two sources of political uncertainty that are very significant in terms of their potential impact on the MXN and on the Mexican economy as a whole: the 2018 Presidential elections and the future of the NAFTA renegotiations. The base case scenario is for negotiations to be temporarily suspended sometime during Q1 '18 until Mexico's new government and Congress take over. Also during Q1 '18 we expect the Presidential campaign in Mexico to gather momentum. We believe that NAFTA will be ratified and the Presidential election noise will dissipate later in the year, but the MXN is subject to bouts of depreciation through 1H18. We favour being initially short MXN as we see potential for a significant depreciation of the peso throughout the first half of the year. However as Q3 '18 begins, NAFTA renegotiations could resume and the new government might want to reassure markets by tightening fiscal spending. MXN would retrace then.

ZAR: Within our sample, the more undervalued currencies are also – unsurprisingly – those that rank low in defensive metrics and happen to be exposed to domestic risks. Among the cheap and 'riskier' currencies, we favour ZAR longs for several reasons: 1) The rand is one of the cheapest currencies in the world on our fundamental valuation metrics (first chart below). 2) We believe there is a significant likelihood of a market-positive outcome at the December ANC election, i.e. a victory for Cyril Ramaphosa. This would spur a sizable rand rally as market sentiment around South Africa improved; there is also potential for an improvement in business confidence and in the investment climate. 3) South Africa's trade balance has flipped from a deep deficit to a record-high surplus, which has helped compress the current account deficit (second chart below).

However, given the risks around the ANC election, the February budget and the next Moody's rating announcement, we prefer expressing our view via long-dated (6m+) limited loss options structures (e.g. 6m USD/ZAR digital puts). We expect ZAR appreciation to be skewed towards the first part of the year, in the post-ANC election period.