

Report | 27 August 2019

FX ARGENTINA BRAZIL

LATAM FX Talking: Playing defensive

The external risk environment has deteriorated over the past month, with rising trade-related risk aversion. The near-term environment for EM assets should remain testy, and, specifically in LATAM, the rising risk of a credit event in Argentina could also have some negative impact. Defensive positioning should continue to benefit the MXN and the PEN



Source: Shutterstock

Executive summary

The BRL has been the big underperformer in the region over the past month, excluding Argentina. This is somewhat surprising, considering the favourable evolution of the fiscal agenda and the fast drop in the sovereign's risk premium. The spread on Brazil's 5-year CDS is trading at a 5-year low, the best-performer in the region YTD, while the BRL was the worst performer in the same period.

Even though we remain especially bullish on the BRL in the longer-term, the currency's short-term prospect remains weighed down by stronger-than-expected FX outflows. These outflows have been triggered by debt liability management operations by local corporates, which are borrowing locally at record-low levels of interest rates, and using the proceeds to pre-pay debt abroad. Given their nature, these outflows are long-term positive for the currency, but they have been disruptive in the nearer term and, according to the central bank, they are likely to be long-lasting, as suggested by favourable prospects for an additional 100bp cut in the policy rate, to 5%. For the BRL to outperform, those outflows must be offset by inflows, but those should only rise when

activity data strengthen materially, which may happen only gradually.

Argentina is, meanwhile, once again undergoing episodes of extreme volatility, as the risk of a credit event has resurfaced following the surprising electoral result of the recent presidential primaries. The primaries revealed that opposition candidate Alberto Fernandez is highly likely to become Argentina's next president. And given Fernandez's unorthodox economic policy credentials, the ARS has sold off massively, while the government's ability to roll over maturing debt amortizations has been severely hampered. A debt default is not inevitable, but it would likely require a considerable policy tightening that seems, arguably, unrealistic to expect from Fernandez.

Author

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.