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FX

LATAM FX Talking: The mighty MXN

The USD should remain a primary catalyst for the region's FX outlook. As long as USD strength persists and domestic growth stories remain lackluster, investor focus should prioritize currencies offering material carry. This, we believe, helps explain the outstanding relative performance of the Mexican *peso* in LATAM



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Executive summary

The MXN has been the clear standout performer across LATAM FX in January. Despite the gradual deterioration in Mexico's macro fundamentals, as evidenced by the ongoing recession and the risk of credit rating downgrades, the peso's outstanding carry should continue to act as an effective FX anchor in the nearer term. But, unsurprisingly, Mexico also stands out in the region as the country with the largest potential for rate cuts this year and next, while the cumulative impact of the macro deterioration should continue to hamper the currency's longer-term outlook.

The BRL's performance in recent weeks represents, meanwhile, the biggest frustration across LATAM FX. To a large extent, it reflects a combination of optimistic expectations created around bullish prospects depicted in most "2020 outlook" analyses published at the end of the year and real frustration with the latest batch of activity data (for November). Having said that, much is not well-understood about the causes for the massive amounts of FX outflows seen in recent months in Brazil. To a large extent, outflows have been a result of sweeping changes in the local economy as it adjusts to

record-low local interest rates. It's unclear how long this transition will last and, more to the point, how persistent these outflows will be. In any case, we believe a more supportive BRL environment should emerge gradually throughout the year, but it depends on the eventual confirmation that the monetary easing cycle has been concluded (with no additional rate cut in February) and, more importantly, stronger evidence that an activity recovery is firmly under way.

The Colombian COP and the Chilean CLP have largely traded in line with the BRL, with the USD acting as the main catalyst while domestic drivers, and commodity prices, have played secondary roles.

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