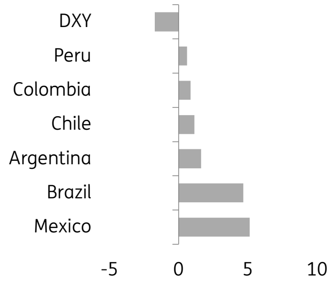
11 January 2019

LATAM FX Talking

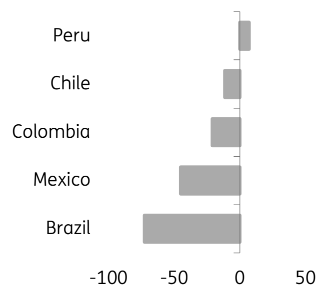
January forecast update

FX monthly change (%)



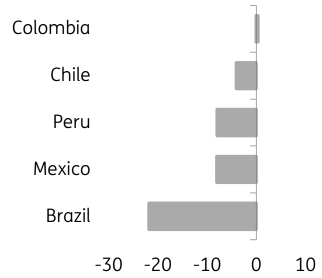
Source: Bloomberg, ING

5yr local rate monthly change (bp)



Source: Bloomberg, ING

5yr CDS monthly change (bp)



Source: Bloomberg, ING

Over the past month, LATAM FX experienced a substantive correction on the back of improved risk appetite, but domestic drivers also played an important role, particularly in Brazil and Mexico. For the BRL and the MXN, a more extended period of improved risk appetite, along with a benign domestic political news cycle, could push these currencies into what we would consider "overshooting" territory.

Mexico should continue to benefit from the highly attractive carry, amid signs that the Lopez Obrador administration is now settling into a more conservative policymaking stage, after having solidified some key controversial "political victories" in recent months. Even though we believe the MXN should be trading above 19, there's now a greater risk that the currency could overshoot towards 18.5.

In Brazil, all eyes should be on the new Congress, which will be inaugurated in February and is expected to initiate immediately the debate on the social security reform to be proposed by the Bolsonaro administration in the next month. Predicting the near-term BRL path should continue to be quite difficult, however, as any signs of political difficulties in garnering enough votes in Congress is bound to trigger volatility, while the currency's performance following the reform's vote remains clearly binary.

Elsewhere in the region, the evolution of trade-war concerns and its impact on China and commodity prices should play a crucial role, with the March 1 deadline for new US tariffs looming on the horizon. Depressed commodity prices led to a massive FX weakness across the Andes, with Colombia's COP and Chile's CLP consistently posting the worst performance in the region for several months. Having corrected so much, there appears to be particularly large room for recovery in this segment, conditional on favourable developments on the commodity's front.

Investor sentiment has also improved towards Argentina, where the central bank started a small-scale FX intervention program, buying USDs as the ARS strengthened beyond its non-intervention zone. Price action indicates that implementation of the stringent monetary program introduced last year has been successful, which should gradually create a path for authorities to ease monetary conditions in the coming months.

ING's 12-month currency view vis-à-vis forward/NDF market forecasts

	USD/BRL		USD/MXN		USD/CLP	
1M	3.75	>	18.80	<	675.00	>
3M	3.85	>	18.60	<	680.00	>
6M	3.40	<	18.80	<	660.00	<
12M	3.70	<	19.40	<	640.00	<
	USD/ARS		**USD/COP**		**USD/PEN**	
1M	37.80	<	3110.00	<	3.35	>
3M	39.60	<	3100.00	<	3.34	=
6M	42.40	<	3040.00	<	3.34	<
12M	46.60	<	2970.00	<	3.32	<

>/=/< indicates our forecast for the currency pair is above/in line with/below the corresponding market forward or NDF outright

Source: Bloomberg, ING

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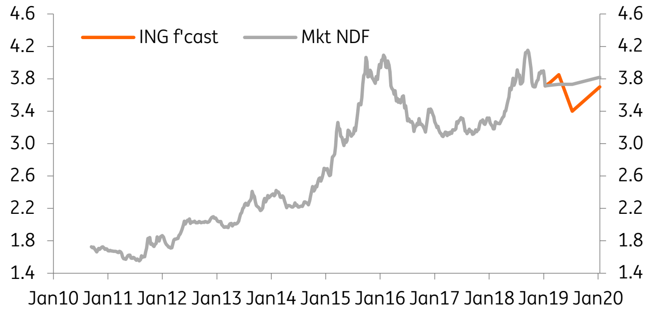
USD/BRL

All eyes on the social security reform

Current spot: 3.71



Source: Bloomberg, ING

- In the coming weeks, the Bolsonaro administration should unveil its social security reform proposal, helping narrow investor attention on the likelihood of its passage in the new Congress, which will be inaugurated early in February.
- Confirmation that Bolsonaro will opt to approve the proposal already under debate in Congress, with amendments, would be well received. Another important positive catalyst would be the re-election of Rodrigo Maia as Lower House President.
- Uncertainty about reform passage is bound to create episodes of volatility in the coming weeks, but we still expect the reform to be approved. The sooner the reform is voted on, the higher its likelihood of success, and the bigger the payoff in terms of activity recovery in 2019. Its eventual passage should trigger a temporary overshooting in the BRL, towards the 3.3-3.5 range, relative to fair-value in the 3.6-3.7 range. Failure to approve the reform would, meanwhile, trigger a sell-off towards 4.0.

ING forecasts (NDF)	**1M** 3.75 (3.72)	**3M** 3.85 (3.73)	**6M** 3.40 (3.73)	**12M** 3.70 (3.82)

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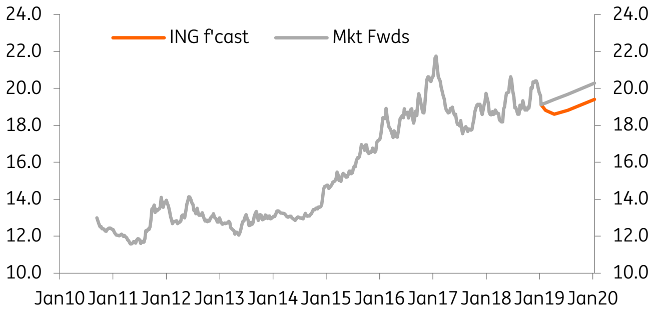
USD/MXN

Attractive carry adds support to the MXN

Current spot: 19.12



Source: Bloomberg, ING

- Having addressed investor concerns vis-à-vis the 2019 budget and the negotiations with the bondholders of the cancelled Mexico city airport project, local assets are likely to be particularly sensitive to external drivers in the coming weeks.
- High yielding local assets should benefit from a more dovish US monetary policy stance and renewed risk appetite amid falling trade-war concerns. Even though we consider its fair value to be closer to 19-19.5, the attractive carry could trigger a rally towards 18.5, amid benign external conditions.
- A pause by the US Fed should also help Banxico keep its policy rate (8.25%) unchanged in 1Q, possibly bringing its long tightening cycle to a decisive conclusion. Inflation remains uncomfortably high, but it is on track to continue to converge to the targeted range throughout the year. Unless FX volatility surges on the back of surprising market developments, the policy rate should remain unchanged in the foreseeable future.

ING forecasts (mkt fwd)	**1M** 18.80 (19.21)	**3M** 18.60 (19.39)	**6M** 18.80 (19.68)	**12M** 19.40 (20.27)

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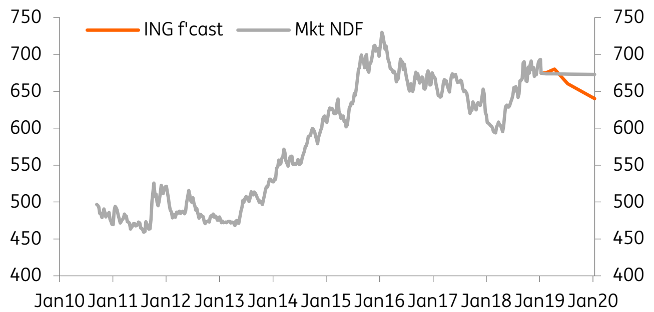
USD/CLP

Still trapped in the trade-war crossfire

Current spot: 674.27



Source: Bloomberg, ING

- The slump in copper continues to weigh down the Chilean peso, which remains among the worst-performing currencies in LATAM in recent months. A faster resolution of the trade-war impasse would, however, add significant upside to the currency, given the current depressed levels.
- In valuation terms, Andean currencies appear to have particular upside, relative to the BRL and MXN, which are already trading near fair value. But near-term prospects for the currency remain closely linked to these external drivers.
- Solid local macro trends also indicate a relatively benign outlook for the CLP. The sharp mining-led recovery has cooled down a bit, but 2018 GDP growth is still expected at close to 4%. Inflation is on-target but downside from fuel prices and more subdued activity data suggests a more gradual rate hiking path.

ING forecasts (NDF)	**1M** 675.00 (674)	**3M** 680.00 (674)	**6M** 660.00 (673)	**12M** 640.00 (673)

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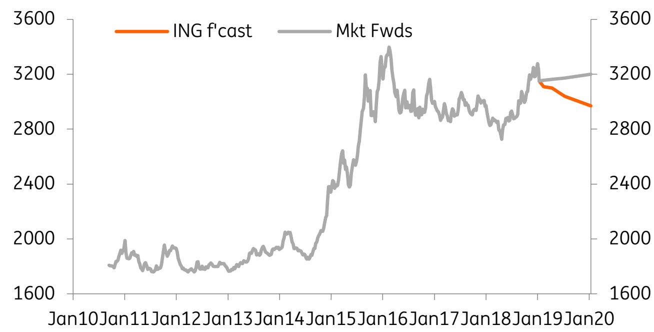
USD/COP

Underperformance is now consistent with external drivers

Current spot: 3151.85



Source: Bloomberg, ING

- Thanks in large part to the sharp correction in oil prices, the COP was the chief underperformer over the past six months in the region, closely in line with Argentina's ARS.
- Improved outlook for portfolio flows, with the approval of tax cuts on local financial holdings by foreigners, together with attractive levels (relative to local peers) suggest a stronger appreciation bias for the COP, if oil prices continue to recover.
- President Duque failed to persuade lawmakers to approve his ambitious tax reform but the more modest proposal approved should be enough to keep the fiscal rule intact in the nearer term. Evidence of political weakness by the new president, with the lack of a solid Congressional majority, suggests however that yearly battles with Congress may eventually erode investor sentiment, and keep the risk of credit ratings downgrades alive. Inflation is on-target and economic activity has improved, while monetary policy guidance should remain neutral in the foreseeable future.

ING forecasts (NDF)	**1M** 3110.00 (3156)	**3M** 3100.00 (3164)	**6M** 3040.00 (3172)	**12M** 2970.00 (3200)

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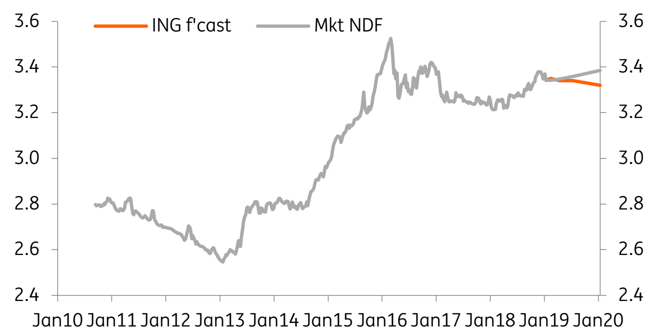
USD/PEN

Solid macro trends help offset trade-war concerns

Current spot: 3.34



Source: Bloomberg, ING

- As usual, the PEN traded with the lowest volatility in the region, underperforming amid the recent rally seen in local currencies.
- Trade-war concerns continue to cloud the outlook for metal prices, but above-trend economic growth, thanks to stronger investment and greater political stability, with President Vizcarra's stronger political capital and a more subdued opposition, should be supportive for the PEN.
- Peru's BCRP has kept the policy rate unchanged, at 2.75%, for almost one year now. Signs of moderation in economic activity and on-target inflation suggests that authorities should be in no rush to follow Chile and tighten monetary policy, extending the current "neutral" bias for longer than we initially thought.

ING forecasts (NDF)	**1M** 3.35 (3.34)	**3M** 3.34 (3.35)	**6M** 3.34 (3.36)	**12M** 3.32 (3.38)

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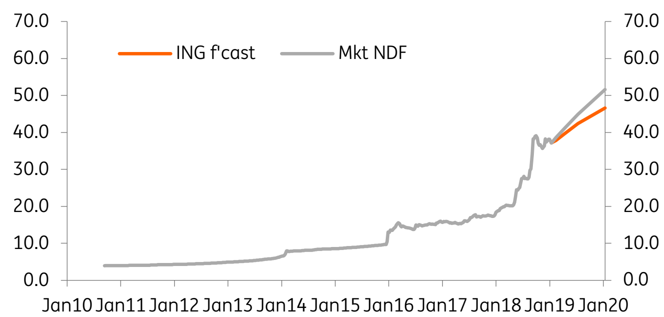
USD/ARS

A consolidated monetary program path

Current spot: 37.16



Source: Bloomberg, ING

- The firm commitment to a tight monetary policy and a tight fiscal program has finally helped stabilize the ARS, and lend more clarity to the currency's near-term path.
- Continued commitment to restrictive policies should support local assets in the coming months, with the ARS trending near the lower-bound of BCRA's FX non-intervention zone.
- As we get closer to mid-year, political uncertainty created by the October presidential elections could weaken local assets, especially if former President Cristina Kirchner remains a competitive Presidential contender. President Macri's popularity has recovered somewhat since reaching a bottom late last year, and could consolidate higher as signs of macro stability solidify. But, ultimately, the election outcome should determine the trajectory of the currency during 2H19.

ING forecasts (NDF)	**1M** 37.80 (38.61)	**3M** 39.60 (41.14)	**6M** 42.40 (44.93)	**12M** 46.60 (51.59)

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