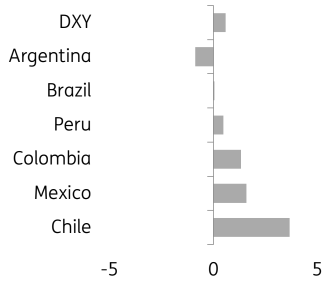
8 February 2019

LATAM FX Talking

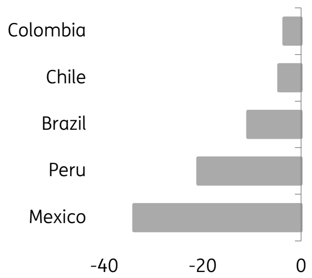
February forecast update

FX monthly change (%)



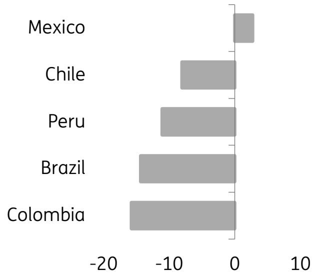
Source: Bloomberg, ING

5yr local rate monthly change (bp)



Source: Bloomberg, ING

5yr CDS monthly change (bp)



Source: Bloomberg, ING

Improved risk appetite has resulted in an appreciating bias for LATAM assets over the past couple of months, but that momentum appears to be waning now, with valuations in some assets looking somewhat less attractive (eg, **CLP**). Even though a truce in "trade-war" concerns and a less hawkish US Fed would be supportive of investor sentiment towards EM assets, some local assets may struggle to appreciate substantially from current levels.

Argentinean assets are perhaps the highlight in the region, still offering attractive valuations and significant potential to benefit from a relatively benign external environment. In fact, Argentina appears to have again become the destination of choice for foreign investors with appetite for risk. High volatility means that the currency frequently fluctuates between best and worst in the region, but the high carry should keep investor interest in the nearer term. We still expect ARS assets to suffer from the political uncertainty generated by the upcoming Presidential election, but election-related risk premium should be incorporated into prices closer to May-June. Until then, external drivers should play a bigger role and likely lend an appreciating bias for local asset prices.

The "glass half-full" perspective is likely to prevail for the **Mexican peso** as well. In this case, the attractive carry and the solid macro fundamentals should compensate for policy uncertainties ranging from the highly uncertain and systemically important outlook for PEMEX and the outlook for monetary policy under the new administration.

Regarding the **Brazilian real**, we remain highly sceptical that the social security reform will follow a smooth approval process in Congress. Our concerns were exacerbated in recent days, with the confirmation that the Lower House will not allow the reform to be fast-tracked, skipping some of the procedural steps that the reform advanced by the previous administration had already gone through. The Bolsonaro administration was able to elect allies to preside in both legislative chambers, but the effective size of its support-base remains unclear. Overall, we expect uncertainty about reform passage to create episodes of volatility in the coming months, leading the BRL to test levels closer to 4.0, before the proposal is finally approved by the Lower House. Congressional leaders are indicating that the reform may be approved by mid-2Q, but our base-case scenario is for a later-than-expected approval, possibly in early 3Q.

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

	USD/BRL		USD/MXN		USD/CLP	
1M	3.80	↑	19.00	↓	655.00	↓
3M	4.00	↑	18.90	↓	665.00	↑
6M	3.40	↓	18.60	↓	660.00	↑
12M	3.70	↓	19.40	↓	640.00	↓
	USD/ARS		**USD/COP**		**USD/PEN**	
1M	38.30	↓	3110.00	↓	3.33	↑
3M	39.60	↓	3100.00	↓	3.32	↓
6M	42.90	↓	3040.00	↓	3.30	↓
12M	46.90	↓	2970.00	↓	3.30	↓

>/=/< 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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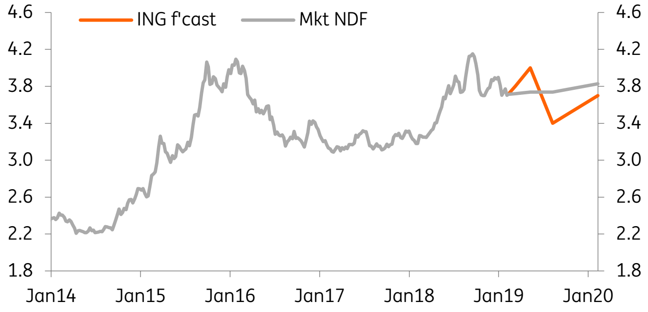
USD/BRL

Social security reform faces reality check

Current spot: 3.71



Source: Bloomberg, ING

- The Bolsonaro administration is about to unveil its social security reform proposal. A relatively "ambitious" plan is expected, which should generate both cheers (from investors) and political resistance to such an unpopular legislation.
- The new administration was able to elect allies to preside in both legislative chambers, but the effective size of its support-base remains unclear. More importantly, confirmation that Congress will not allow the new reform proposal to be fast-tracked, delaying its approval by at least two months, has lent a weakening near-term bias for local assets.
- Uncertainty about the reform passage should create episodes of volatility in the coming months, but we still expect the reform to be approved. Its eventual passage should trigger a temporary overshooting in the BRL, towards the 3.3-3.4 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** 3.80 (3.72)	**3M** 4.00 (3.74)	**6M** 3.40 (3.74)	**12M** 3.70 (3.83)

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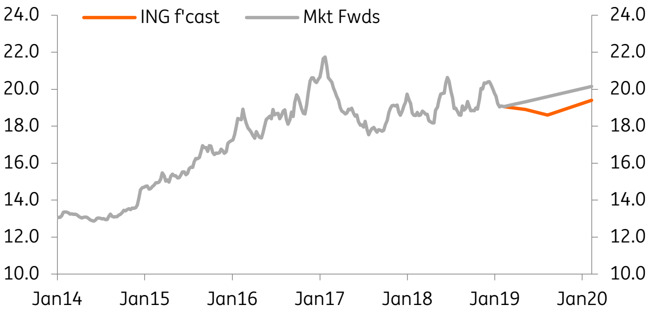
USD/MXN

A “glass half-full” perspective for the MXN

Current spot: 19.05



Source: Bloomberg, ING

- Despite lingering policy uncertainties, we believe 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.
- In particular, the risk of rupture in market credibility in issues like fiscal prudence, PEMEX and central bank independence should take longer to emerge. If Brazil's recent experience is any indication, that risk would intensify especially if economic activity disappoints, as pressure on the administration to find alternative means to boost economic growth would rise, increasing the risk of policy mistakes.
- For now, however, the mix of attractive rates, solid macro fundamentals and the relatively benign external environment suggests that a "glass half-full" perspective is likely to prevail, adding a benign near-term bias for local assets.

ING forecasts (mkt fwd)	**1M** 19.00 (19.14)	**3M** 18.90 (19.32)	**6M** 18.60 (19.59)	**12M** 19.40 (20.14)

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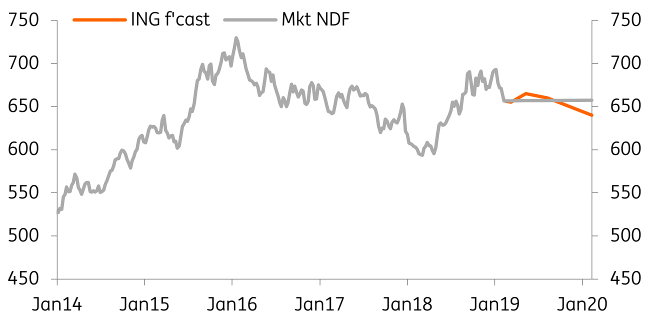
USD/CLP

A copper-fuelled rally, from worst to best

Current spot: 656.72



Source: Bloomberg, ING

- After standing out among the worst-performing currencies in LATAM in recent months, the recent rally in copper prices helped the CLP break out from its previous trading ranges, with the currency now trading considerably stronger than its moving averages.
- Hopes for a faster resolution of the US-China trade-war impasse would support the CLP but, at current levels, the currency already incorporates a fairly benign external outlook, and no longer appear attractive, in purely valuation terms.
- Near-term CLP prospects are closely linked to external drivers but solid local macro trends also indicate a supportive CLP outlook. The mining-led recovery has cooled down a bit, but growth dynamics continue solid, while BCCh remains on track to extend the only rate-hiking cycle in LATAM during 1H19.

ING forecasts (NDF)	**1M** 655.00 (657)	**3M** 665.00 (657)	**6M** 660.00 (657)	**12M** 640.00 (657)

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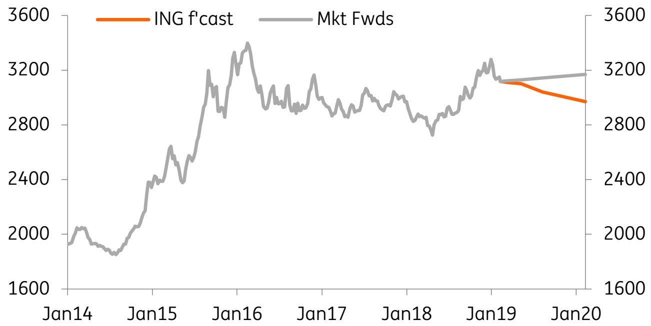
USD/COP

Following external drivers

Current spot: 3118.29



Source: Bloomberg, ING

- After underperforming for much of the past six months, thanks in large part to the sharp correction in oil prices, the COP has steadied now and appears closer to fair-value.
- Future performance appears chiefly dependent on oil price fluctuations, as domestic drivers should remain COP-neutral.
- 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 this year. Evidence of political weakness by the new president and the lack of a solid Congressional majority suggest, however, that yearly battles with Congress may eventually erode investor sentiment, and keep the risk of credit ratings downgrades alive. Macro trends have improved, with inflation on-target and economic activity accelerating, but monetary policy guidance should remain neutral in the foreseeable future.

ING forecasts (NDF)	**1M** 3110.00 (3121)	**3M** 3100.00 (3130)	**6M** 3040.00 (3143)	**12M** 2970.00 (3170)

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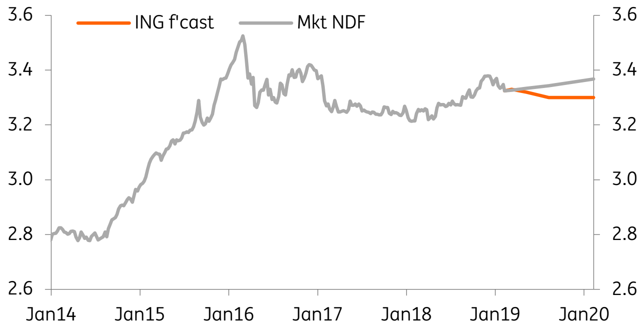
USD/PEN

Solid macro trends help offset trade-war concerns

Current spot: 3.32



Source: Bloomberg, ING

- As usual, the PEN traded with the lowest volatility in the region, trading mostly sideways over the past month.
- Trade-war concerns continue to cloud the outlook for metal prices, but solid 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 about 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** 3.33 (3.33)	**3M** 3.32 (3.33)	**6M** 3.30 (3.34)	**12M** 3.30 (3.37)

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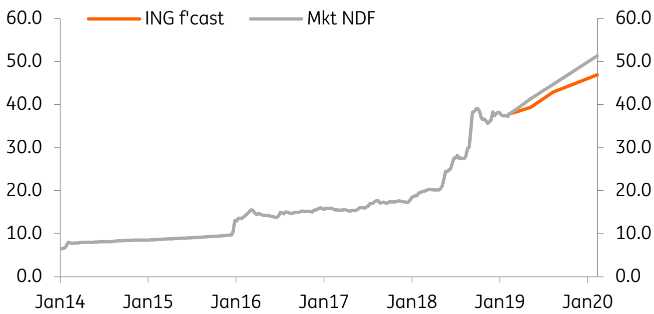
USD/ARS

ARS is appealing again, for investors with risk appetite

Current spot: 37.84



Source: Bloomberg, ING

- Improved global risk appetite, thanks in large part to the dovish shift by the US Fed, together with attractive levels and the high carry have triggered a significant improvement in investor appetite for Argentinean assets.
- The peso has appreciated beyond the central bank's non-intervention zone, pushing BCRA to increase its daily intervention to US$75m, up from US$50m, but the overall impact of the measure has been relatively muted, highlighting the improved investor sentiment towards local assets.
- We still expect local assets to suffer from the political uncertainty generated by the upcoming Presidential election, but election-elected risk premium should be incorporated into prices closer to May-June. Until then, external drivers should play a bigger role and potentially lend an appreciating bias for local asset prices.

ING forecasts (NDF)	**1M** 38.30 (38.84)	**3M** 39.40 (41.39)	**6M** 42.90 (44.65)	**12M** 46.90 (51.31)

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