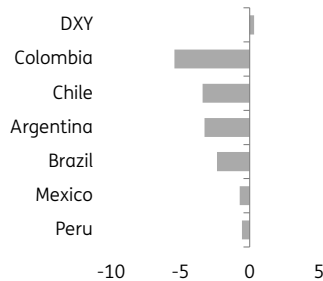


10 May 2019

LATAM FX Talking

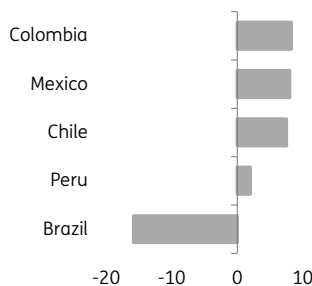
May forecast update

FX monthly change (%)



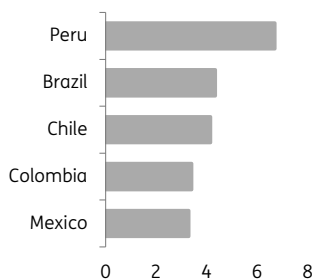
Source: Bloomberg, ING

5yr local rate monthly change (bp)



Source: Bloomberg, ING

5yr CDS monthly change (bp)



Source: Bloomberg, ING

Heightened risk aversion and the stronger USD resulted in a persistent weakening bias to LATAM FX in recent weeks. An eventual resolution of the US-China trade-war impasse could add material upside to local currencies, particularly the COP, which touched multi-year lows recently despite the supportive oil price environment, and appeared to be particularly affected by the perceived rise in risk aversion.

But other risks may lurk for EM assets. Apart from a more persistent-than-expected USD strength, a spike in political risk in **Argentina**, should Cristina Kirchner announce her presidential candidacy in the coming weeks and consolidates a solid lead over President Macri in opinion polls, or in Turkey, with the repeat of the Istanbul election, could affect investor sentiment towards EM assets in general.

In the case of **Brazil**, domestic drivers should continue to dominate, and the BRL could experience the largest appreciation in the region over the next 3-6 months. Investors will continue to focus on the fate of the social security reform. The reform is now in its second-stage Lower House approval process, at the Special Committee. Approval in this committee is expected for next month, but investors will be watching for the amount of changes lawmakers will make to the government's proposal, which could reduce materially the proposed savings from the reform.

Given the government's tentative command of a Congressional majority, the reform's approval process is unlikely to be smooth, with uncertainty about reform passage exacerbating local asset volatility and creating a weakening bias in the nearer term. The BRL may continue to trend closer to 4.0, before the proposal is finally approved by the Lower House. Our base-case scenario is that the reform will be approved around August, when the currency could experience a considerable, but temporary rally towards 3.4.

Apart from the **COP** and the **CLP**, which, as commodity currencies could benefit the most from a resolution of the US-China trade-war, the **Mexican peso** also stands to gain from a reduction in risk aversion. The return of a more favourable environment towards EM assets could push the USDMXN below 19 once again, supported in large part by the highly attractive carry.

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

	USD/BRL		USD/MXN		USD/CLP	
1M	4.00	↑	19.00	↓	682.00	↓
3M	3.70	↓	18.80	↓	675.00	↓
6M	3.40	↓	19.00	↓	668.00	↓
12M	3.70	↓	19.50	↓	660.00	↓
	USD/ARS		USD/COP		USD/PEN	
1M	46.20	↓	3250.00	↓	3.31	↓
3M	48.80	↓	3250.00	↓	3.29	↓
6M	50.00	↓	3150.00	↓	3.30	↓
12M	54.80	↓	3100.00	↓	3.27	↓

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

Source: Bloomberg, ING

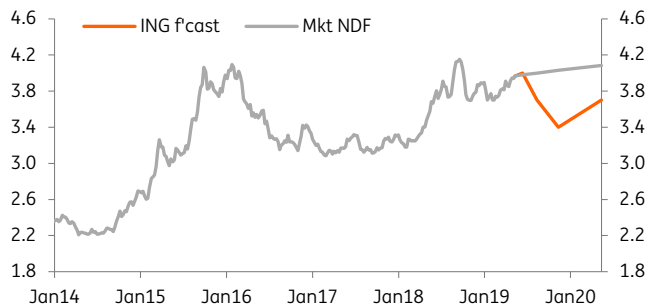
Gustavo Rangel

Chief LATAM Economist
New York +1 646 424 6464
gustavo.rangel@ing.com

USD/BRL

Social security reform debate advances in Congress

Current spot: 3.97



Source: Bloomberg, ING

- The social security reform debate is advancing in Congress, but the Bolsonaro administration has yet to consolidate the firm support of a solid Congressional majority. As a result, uncertainty regarding the reform's final approval should remain high.
- The opposition is not large enough to block the reform, but the government must negotiate lawmakers' support to offset entrenched resistance by powerful special-interest groups.
- The BRL has underperformed recently and uncertainty about the reform's approval should keep a high-volatility underperforming bias in place. But we still expect the reform to be approved in 3Q, triggering a temporary BRL rally, towards the 3.3-3.4 range.

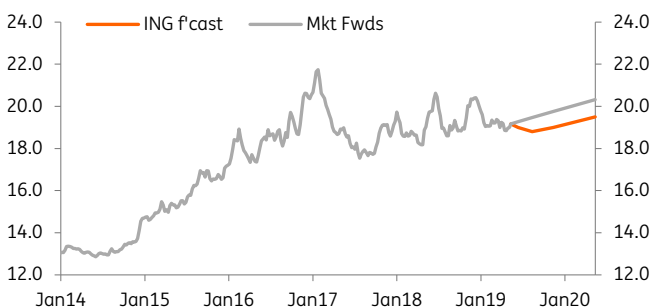
ING forecasts (NDF)	1M 4.00 (3.98)	3M 3.70 (4.00)	6M 3.40 (4.03)	12M 3.70 (4.08)
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Gustavo Rangel, New York +1 646 424 6464

USD/MXN

Attractive carry to extend the MXN's outperformance

Current spot: 19.17



Source: Bloomberg, ING

- The Mexican peso has been the standout outperformer in the region, and among the best performers across EM this year. Even though we expect Banxico to shift to a dovish monetary policy stance in the coming months, the mix of attractive rates and still-solid macro fundamentals suggests continued outperformance.
- Despite lingering policy uncertainties and growing concerns about Mexico's economic growth outlook, we believe that the risk of a big rupture in market credibility in issues like fiscal prudence, PEMEX and CB independence should take longer to emerge.
- That risk is rising though, as disappointment with economic activity should raise the risk of policy mistakes.

ING forecasts (mkt fwd)	1M 19.00 (19.28)	3M 18.80 (19.47)	6M 19.00 (19.76)	12M 19.50 (20.31)
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USD/CLP

Trade war concerns to drive CLP outlook

Current spot: 686.41



Source: Bloomberg, ING

- The CLP traded with a weakening bias in the past month, consistent with the USD rally that affected most EM FX and, especially, the selloff in copper, amid lingering trade-war worries.
- Constructive Chinese data and a favourable resolution to the US-China trade-war impasse could pave the way for significant CLP appreciation.
- Near-term CLP prospects are closely linked to external drivers, while local macro trends have become more FX neutral. Inflation remains subdued while economic activity indicators have softened, dragged by mining, which should, in practice, delay BCC's next rate hike towards next year.

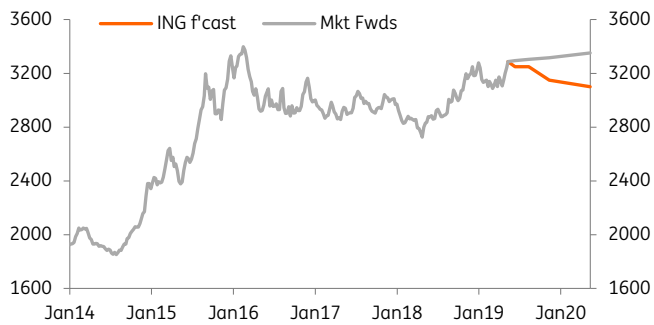
ING forecasts (NDF)	1M 682.00 (686)	3M 675.00 (686)	6M 668.00 (687)	12M 660.00 (687)
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USD/COP

COP underperformance amid higher oil prices

Current spot: 3286.90



Source: Bloomberg, ING

- Perhaps exacerbated by portfolio outflows and the less attractive carry, the COP has become especially sensitive to global risk appetite and the USD rally generally.
- The currency's considerable underperformance contrasts with the rally in oil prices seen in recent months, which has sharply reduced the correlation between the two assets and created some scope for a catch-up appreciation in the COP once a more favourable environment for EM currencies emerges.
- Domestic drivers are closer to COP-neutral, if a bit more constructive. GDP growth still appears on track to expand near its potential this year while on-target inflation suggests an extended period of neutral monetary policy guidance.

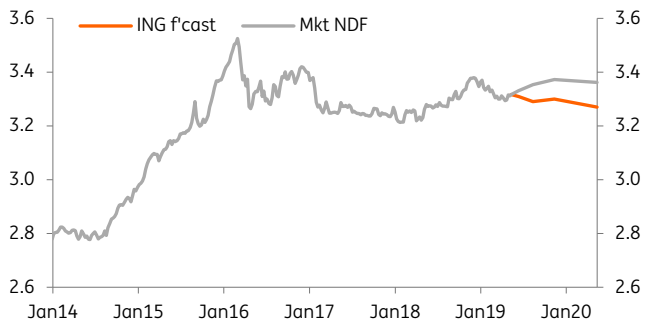
ING forecasts (NDF)	1M 3250.00 (3293)	3M 3250.00 (3303)	6M 3150.00 (3316)	12M 3100.00 (3351)
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USD/PEN

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, outperforming amid the widespread sell-off. As a result, the PEN was effectively the least affected by the USD move and the risk aversion that affected its peers in the region.
- Eventual positive developments on the US-China trade-war front would add support to the currency, with the USDPEN once again consolidating below 3.30. But the slowdown in economic activity seen in 1Q and the potential for BCRP's FX intervention would likely limit any sustained rally.
- Peru's BCRP should extend the current neutral bias for the policy rate (2.75%) longer than we initially thought amid moderate economic activity and on-target inflation.

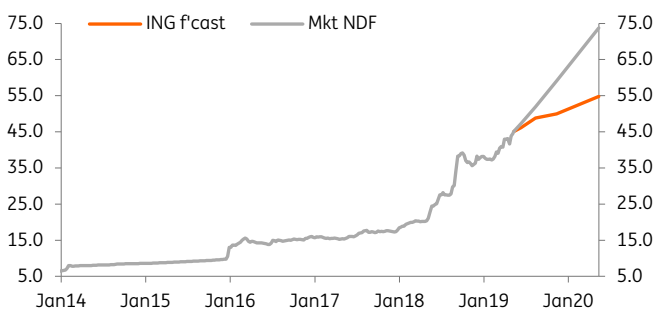
ING forecasts (NDF)	1M 3.31 (3.33)	3M 3.29 (3.35)	6M 3.30 (3.37)	12M 3.27 (3.36)
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USD/ARS

All eyes on Cristina

Current spot: 45.08



Source: Bloomberg, ING

- Argentina's macro vulnerabilities, higher-than-expected inflation and prospects for the return of heterodox policies following the October election should limit the effectiveness of the policy reaction adopted by the Macri administration. The 11 August primaries are the chief near-term catalyst for asset prices.
- A more aggressive FX intervention program coupled with sharp monetary policy tightening should help support local assets but any additional evidence that Cristina Kirchner would win in the October election should trigger further local market turbulence.
- Despite high rates, local assets should remain vulnerable to political risk, which could manifest in the form of a shift away from ARS bank deposits towards hard currency and actual goods.

ING forecasts (NDF)	1M 46.20 (47.33)	3M 48.80 (51.93)	6M 50.00 (59.10)	12M 54.80 (73.78)
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