12 July 2019

LATAM FX Talking

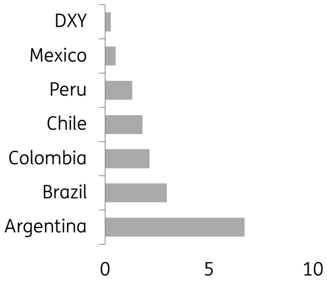
The Brazil vs Mexico divergence gains steam

The external risk environment has turned slightly more benign over the past month with US-China trade tensions stabilizing and market relief provided by expected rate cuts in the US and Europe. Having said that, risk of deterioration in the risk environment remains elevated, and, just like in the past month, we expect the market environment to continue to be more favourable for currencies that are likely to be less sensitive to external drivers, or that have a strong domestic driver to offset external headwinds. In that case, the Brazilian BRL continues to stand out, even though we have recently moderated our appreciation trajectory for the *Real*, while rising idiosyncratic risks faced by the Mexican economy have increased the risk of a more persistent weakening bias for the MXN.

In the case of Brazil, the much-anticipated approval of the pension reform should reduce uncertainties related to the sustainability of the fiscal accounts and prompt an improvement in the outlook for economic activity and for local assets in general. But market reaction to the approval of the pension reform by the Brazilian Congress has been relatively muted this week, suggesting that much of the approval had already been incorporated into asset prices. Moreover, implementation of a relatively frontloaded monetary easing cycle, by as much as 150bp, starting with a 50bp cut on July 31, suggests that the BRL may lag other local assets.

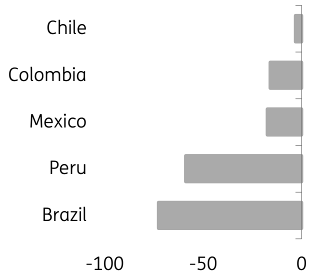
The outlook for the Mexican peso has become cloudier, with lingering external trade uncertainties and, especially, the deterioration in the outlook for economic activity, as illustrated by the worrying contraction in industrial activity seen today, and the rising risk of credit rating downgrades, for PEMEX and the sovereign. Due to these uncertainties Banxico remains cautious about changing policy guidance, but a deeper divide appears to have emerged inside the board, as suggested by the monetary policy minutes released this week, and the bank appears now more inclined to follow the US Fed and cut the policy rate slightly. Having said that, intense policy focus on maintaining FX stability suggests that high rates should continue to act as the chief FX anchor in the nearer term.

FX monthly change (%)



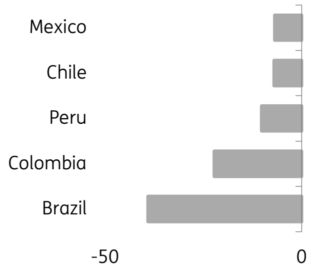
Source: Bloomberg, ING

5yr local rate monthly change (bp)



Source: Bloomberg, ING

5yr CDS monthly change (bp)



Source: Bloomberg, ING

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

	USD/BRL		USD/MXN		USD/CLP	
1M	3.60	↓	19.20	↑	685.00	↑
3M	3.60	↓	19.50	↑	695.00	↑
6M	3.70	↓	19.40	↓	680.00	↓
12M	3.70	↓	19.50	↓	670.00	↓
	USD/ARS		**USD/COP**		**USD/PEN**	
1M	42.00	↓	3200.00	↑	3.28	→
3M	42.50	↓	3200.00	↓	3.30	↑
6M	45.00	↓	3150.00	↓	3.31	→
12M	49.50	↓	3100.00	↓	3.31	↓

>/=/< 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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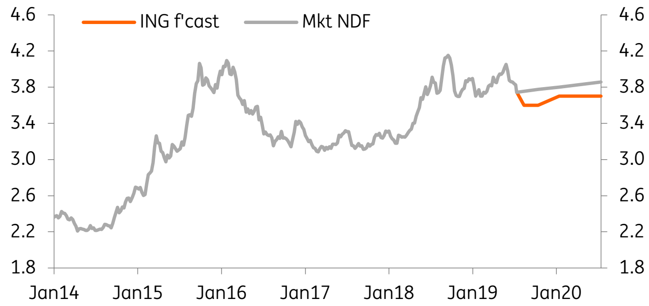
USD/BRL

The post-reform adjustment

Current spot: 3.74



Source: Bloomberg, ING

- The much-anticipated approval of the pension reform should reduce fiscal uncertainties and prompt an improvement in the outlook for economic activity and for local assets in general.
- BRL prospects have also improved, but a rally should be limited by rate cuts. The SELIC rate could drop by as much as 150bp, starting with a 50bp cut on July 31. Lower rates reduce the BRL's carry and stimulate the use of the USDBRL as a hedge to external risks for overweight positions in other local assets (FI/equities).
- The lower cost of BRL-financing has also reduced the inflow of USDs in Brazil this year. And this could intensify post-reform and help limit the BRL rally to levels closer to 3.6, instead of 3.4.

ING forecasts (NDF)	**1M** 3.60 (3.76)	**3M** 3.60 (3.78)	**6M** 3.70 (3.80)	**12M** 3.70 (3.86)

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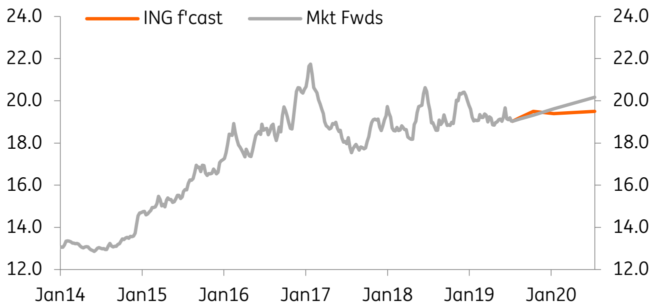
USD/MXN

Attractive carry partly offsets heightened uncertainties

Current spot: 19.03



Source: Bloomberg, ING

- Episodes of high volatility driven by external and domestic factors marked the MXN's performance over the past couple of months, resulting in a significant underperformance.
- These included the tariff threat by President Trump and, more recently, the abrupt resignation of Finance Minister Carlos Urzua, who cited economic policy disagreements, and raised questions about the outlook for Mexico's macro and credit metrics.
- Monetary policy caution indicates that high rates should remain a chief FX anchor, but poor GDP growth, with the risk of recession rising recently, and the possibility of sooner-than-expected credit rating downgrades (especially for PEMEX) hamper the MXN's outlook.

ING forecasts (mkt fwd)	**1M** 19.20 (19.13)	**3M** 19.50 (19.32)	**6M** 19.40 (19.62)	**12M** 19.50 (20.17)

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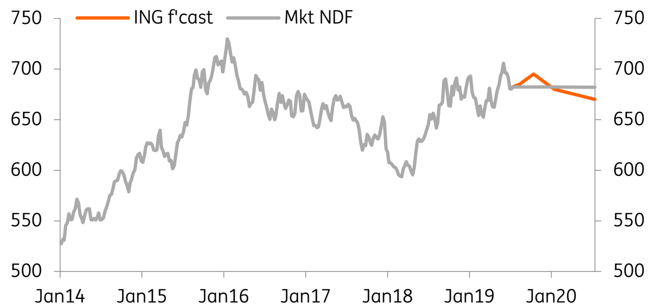
USD/CLP

Trade war concerns continue to drive the CLP outlook

Current spot: 682.35



Source: Bloomberg, ING

- As a small open economy, with an export basket heavily skewed towards copper, the CLP has traded with an underperformance bias in recent months, consistent with the weaker copper prices seen as a result of lingering trade-war concerns.
- A lack of progress in the US-China trade-war impasse in the coming months should extend that weakening bias.
- While external drivers dominate, local macro trends have also become less supportive for the CLP. Subdued inflation and softer economic activity indicators, dragged by mining, pushed BCCh to surprise the market with a large 50bp cut, reversing the hikes seen over the past year. And additional cuts are likely.

ING forecasts (NDF)	**1M** 685.00 (682)	**3M** 695.00 (682)	**6M** 680.00 (682)	**12M** 670.00 (682)

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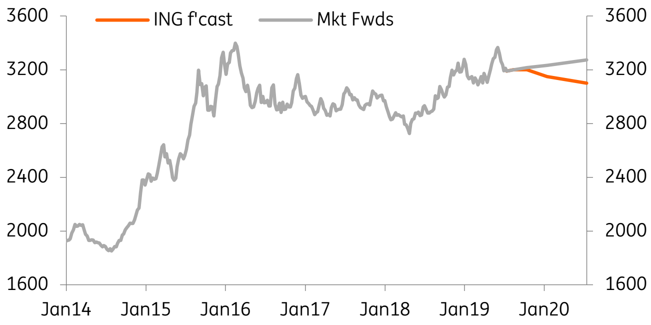
USD/COP

Balance of risks seem more balanced for the COP now

Current spot: 3190.42



Source: Bloomberg, ING

- The COP continues to be especially sensitive to external shocks and USD fluctuations generally. And even though its correlation with oil prices has become less stable, the recent rise in oil prices seems to have contributed to the COP's recent outperformance.
- The ongoing widening of the current account deficit has become more of a concern, but that is partly offset by domestic drivers, which are more constructive than its peers in the region.
- Robust near-potential GDP growth prints together with muted inflation help justify a neutral monetary policy guidance. However, weak labour market data and the dovish FOMC have increased the risk of rate cuts in the coming quarters.

ING forecasts (NDF)	**1M** 3200.00 (3198)	**3M** 3200.00 (3215)	**6M** 3150.00 (3233)	**12M** 3100.00 (3272)

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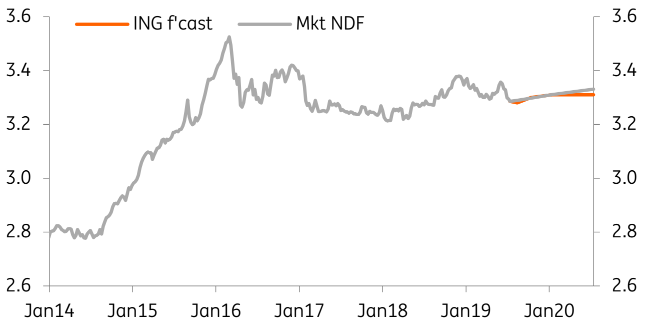
USD/PEN

Solid macro trends help offset trade-war concerns

Current spot: 3.29



Source: Bloomberg, ING

- As usual, the PEN traded with the lowest volatility in the region, appreciating slightly over the past month. Even though Peru is a small open economy heavily reliant on commodity exports, the currency remains the least affected by gyrations in the USD and the trade-war concerns that affected its EM peers.
- Eventual positive developments on the US-China trade-war front would add support to the currency, but the potential for BCRP's FX intervention would likely limit any major rally in the PEN.
- Peru's BCRP has just adopted a dovish bias for the policy rate (2.75%) citing downside risks for inflation and the moderation in economic activity. With this month's shift, BCRP is now broadly in line with its Andean peers.

ING forecasts (NDF)	**1M** 3.28 (3.29)	**3M** 3.30 (3.30)	**6M** 3.31 (3.31)	**12M** 3.31 (3.33)

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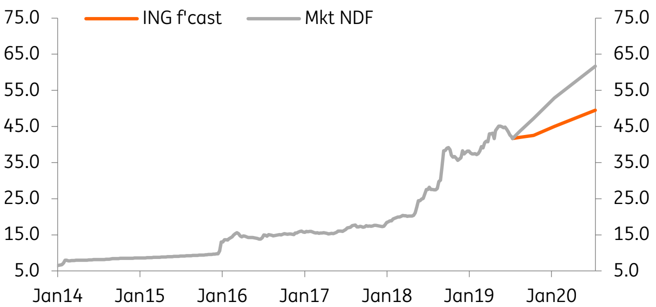
USD/ARS

Improved economic trends helped reduce political risk

Current spot: 41.68



Source: Bloomberg, ING

- The favourable external environment triggered by the dovish shift signalled by developed-market central banks have helped extend the outperformance of the ARS seen over the past couple of months.
- The stronger peso, lower inflation pressures, and signs of stability in economic activity have also helped generate a virtuous cycle as improved economic trends help boost prospects for the re-election of Mauricio Macri in the October presidential election.
- High interest rates should also help support local assets but any evidence that the Kirchnerist ticket would win in the October election should weigh on asset prices. The August 11 primaries are the chief near-term catalyst for local assets.

ING forecasts (NDF)	**1M** 42.00 (43.67)	**3M** 42.50 (47.26)	**6M** 45.00 (52.92)	**12M** 49.50 (61.69)

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