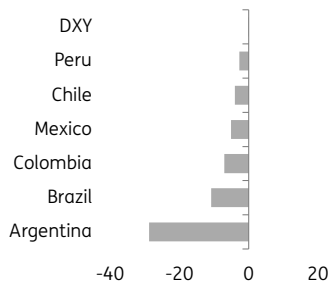


27 August 2019

# LATAM FX Talking

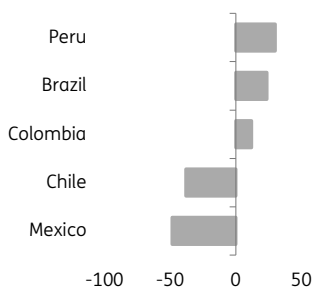
## Playing defensive

FX monthly change (%)



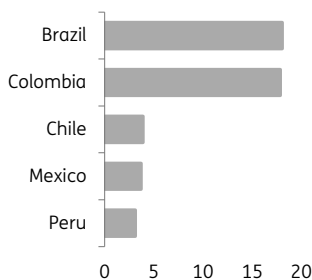
Source: Bloomberg, ING

5yr local rate monthly change (bp)



Source: Bloomberg, ING

5yr CDS monthly change (bp)



Source: Bloomberg, ING

The external risk environment has deteriorated over the past month, with rising trade-related risk aversion. And with limited prospects for a fast resolution to US-China trade disputes, the near-term environment for EM assets should remain testy, and, specifically in LATAM, the rising risk of a credit event in Argentina could also have some negative impact. With risk aversion staying elevated, we expect investors to continue to favour currencies that are likely to be less sensitive to external drivers, or that have strong domestic drivers to offset external headwinds. Defensive positioning should continue to benefit, in relative terms, the MXN, and the PEN.

The BRL has been the big underperformer in the region over the past month, excluding Argentina. This is somewhat surprising, considering the favourable evolution of the fiscal agenda and the fast drop in the sovereign's risk premium. The spread on Brazil's 5-year CDS is trading at a 5-year low, the best-performer in the region YTD, while the BRL was the worst performer in the same period.

Even though we remain especially bullish on the BRL in the longer-term, the currency's short-term prospect remains weighed down by stronger-than-expected FX outflows. These outflows have been triggered by debt liability management operations by local corporates, which are borrowing locally at record-low levels of interest rates, and using the proceeds to pre-pay debt abroad. Given their nature, these outflows are long-term positive for the currency, but they have been disruptive in the nearer term and, according to the central bank, they are likely to be long-lasting, as suggested by favourable prospects for an additional 100bp cut in the policy rate, to 5%. For the BRL to outperform, those outflows must be offset by inflows, but those should only rise when activity data strengthen materially, which may happen only gradually.

Argentina is, meanwhile, once again undergoing episodes of extreme volatility, as the risk of a credit event has resurfaced following the surprising electoral result of the recent presidential primaries. The primaries revealed that opposition candidate Alberto Fernandez is highly likely to become Argentina's next president. And given Fernandez's unorthodox economic policy credentials, the ARS has sold off massively, while the government's ability to roll over maturing debt amortizations has been severely hampered. A debt default is not inevitable, but it would likely require a considerable policy tightening that seems, arguably, unrealistic to expect from Fernandez.

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

|     | USD/BRL |   | USD/MXN |   | USD/CLP |   |
|-----|---------|---|---------|---|---------|---|
| 1M  | 4.15    | ↑ | 20.15   | ↑ | 730.00  | ↑ |
| 3M  | 4.00    | ↓ | 20.00   | ↓ | 725.00  | ↑ |
| 6M  | 3.85    | ↓ | 19.50   | ↓ | 700.00  | ↓ |
| 12M | 3.75    | ↓ | 19.50   | ↓ | 680.00  | ↓ |

|     | USD/ARS |   | USD/COP |   | USD/PEN |   |
|-----|---------|---|---------|---|---------|---|
| 1M  | 57.00   | ↓ | 3500.00 | ↑ | 3.39    | ↑ |
| 3M  | 70.00   | ↑ | 3500.00 | ↑ | 3.37    | ↓ |
| 6M  | 72.00   | ↓ | 3250.00 | ↓ | 3.33    | ↓ |
| 12M | 80.00   | ↓ | 3150.00 | ↓ | 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

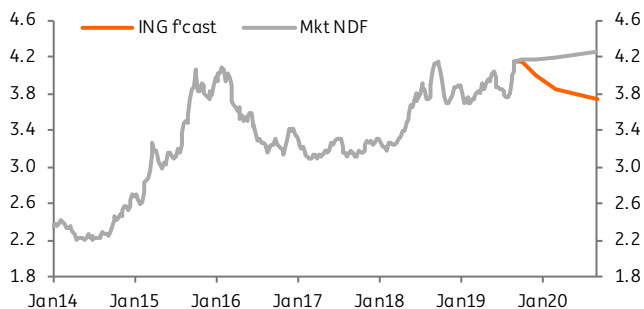
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## USD/BRL

### FX outflows exacerbate the BRL sell-off

**Current spot: 4.16**



Source:

- Domestic factors have exacerbated the BRL sell-off and resulted in a persistent underperforming bias for the Real as the positive shock represented by the fiscal agenda wasn't enough to offset persistent FX outflows triggered by record-low domestic rates.
- Outflows reflect the fact that local corporates are now borrowing locally at record-low levels to pay down external debt. Even though these debt management operations are long-term BRL-positive, outflows have been disruptive in the short-term.
- Large outflows pushed the CB to change its FX intervention scheme in an effort to improve the liquidity/functionality of the FX market, but the new scheme is not meant to alter the FX level.

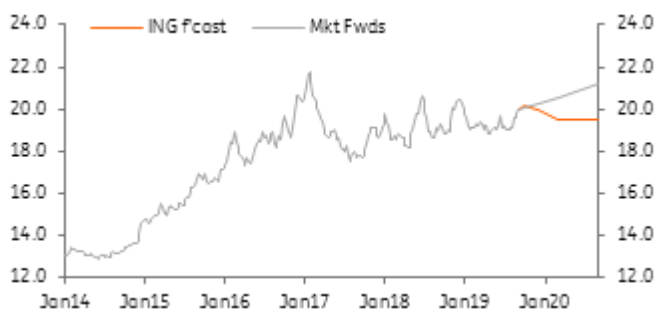
|                            |                       |                       |                       |                        |
|----------------------------|-----------------------|-----------------------|-----------------------|------------------------|
| <b>ING forecasts (NDF)</b> | <b>1M</b> 4.15 (4.18) | <b>3M</b> 4.00 (4.18) | <b>6M</b> 3.85 (4.20) | <b>12M</b> 3.75 (4.27) |
|----------------------------|-----------------------|-----------------------|-----------------------|------------------------|

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## USD/MXN

### High rates remain an effective near-term FX anchor

**Current spot: 19.97**



Source:

- The MXN continues to experience episodes of high volatility driven by external and domestic factors but the currency has proven to be more resilient than its regional peers.
- The relative outperformance reflects primarily the very attractive carry, with high rates functioning as a chief FX anchor, and the fact that Banxico remains one of the most vigilant central banks in the region, especially when it comes to FX stability.
- Monetary policy caution indicates that high rates should persist, but faltering fundamentals, as seen in poor GDP growth and the high likelihood of credit rating downgrades (especially for PEMEX) should continue to hamper the MXN's longer-term outlook.

|                                |                         |                         |                         |                          |
|--------------------------------|-------------------------|-------------------------|-------------------------|--------------------------|
| <b>ING forecasts (mkt fwd)</b> | <b>1M</b> 20.15 (20.08) | <b>3M</b> 20.00 (20.28) | <b>6M</b> 19.50 (20.58) | <b>12M</b> 19.50 (21.16) |
|--------------------------------|-------------------------|-------------------------|-------------------------|--------------------------|

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## USD/CLP

### Trade war concerns continue to drive the CLP outlook

**Current spot: 719.80**



Source:

- As a small open economy, with an export basket heavily skewed towards copper, the CLP has weakened in recent months, following a trajectory that closely matches copper price trends.
- As a result, the currency's near-term outlook remains closely tied to trade-war concerns, and global growth dynamics more generally, and their resulting impact on copper prices.
- 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 and manufacturing, paved the way for BCCCh to implement a large 50bp rate cut, and an additional 50bp cut to 2.0% is likely.

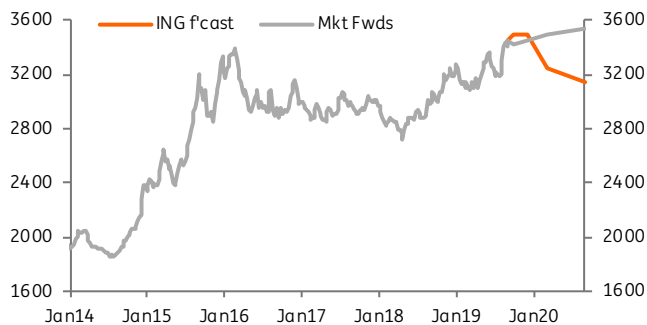
|                            |                        |                        |                        |                         |
|----------------------------|------------------------|------------------------|------------------------|-------------------------|
| <b>ING forecasts (NDF)</b> | <b>1M</b> 730.00 (720) | <b>3M</b> 725.00 (719) | <b>6M</b> 700.00 (717) | <b>12M</b> 680.00 (716) |
|----------------------------|------------------------|------------------------|------------------------|-------------------------|

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## USD/COP

Heightened sensitivity to risk appetite keeps volatility high

Current spot: 3445.16



Source:

- The COP also underperformed over the past month, nearly matching the BRL, as the currency continues to be highly sensitive to external shocks and USD fluctuations generally, while the Peso's correlation with oil prices has become less stable.
- That sensitivity possibly reflects the widening of the current account deficit, which typically places the COP among the most vulnerable EM currencies to risk aversion episodes.
- 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.

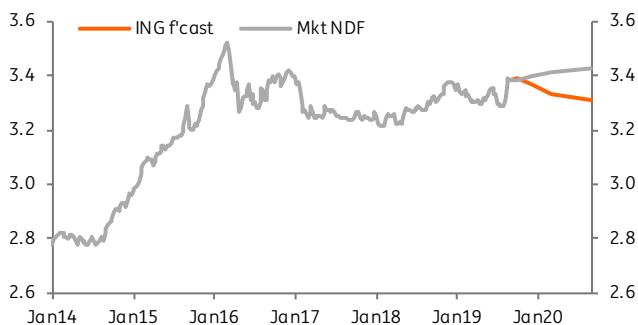
|                     |                   |                   |                   |                    |
|---------------------|-------------------|-------------------|-------------------|--------------------|
| ING forecasts (NDF) | 1M 3500.00 (3418) | 3M 3500.00 (3455) | 6M 3250.00 (3490) | 12M 3150.00 (3535) |
|---------------------|-------------------|-------------------|-------------------|--------------------|

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## USD/PEN

Solid macro trends help offset trade-war concerns

Current spot: 3.38



Source:

- As usual, the PEN traded with the lowest volatility in the region, depreciating slightly over the past month and outperforming all its regional peers. 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 cut the policy rate (2.5%) citing downside risks for inflation and, especially, the slowdown in economic activity. An additional cut is likely, despite the neutral guidance in place now.

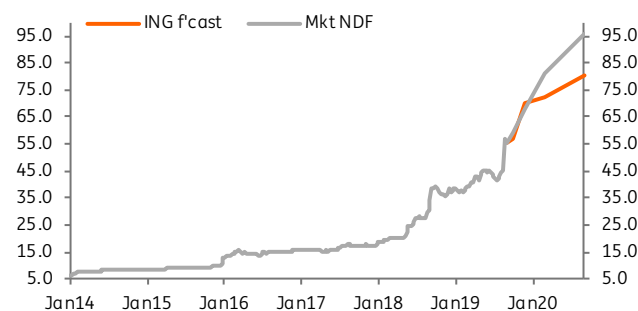
|                     |                |                |                |                 |
|---------------------|----------------|----------------|----------------|-----------------|
| ING forecasts (NDF) | 1M 3.39 (3.39) | 3M 3.37 (3.40) | 6M 3.33 (3.41) | 12M 3.31 (3.43) |
|---------------------|----------------|----------------|----------------|-----------------|

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## USD/ARS

Political uncertainties reach new highs

Current spot: 55.30



Source:

- The Macri administration managed to stabilize the ARS, following the sharp sell-off triggered by the surprise with the electoral primary results, with a mix of higher interest rates and FX intervention.
- FX stability is likely to be temporary however, as Alberto Fernandez is likely to become Argentina's next president, in the October presidential election, complicating the government's ability to rollover maturing debt amortizations, and increasing the risk of a credit event at some point in the coming quarters.
- Ongoing IMF negotiations represent another important near-term catalyst. But we expect no negative surprises on this front, with the Fund likely agreeing to release of the last loan tranche.

|                     |                  |                  |                  |                   |
|---------------------|------------------|------------------|------------------|-------------------|
| ING forecasts (NDF) | 1M 57.00 (59.15) | 3M 70.00 (67.80) | 6M 72.00 (81.00) | 12M 80.00 (96.07) |
|---------------------|------------------|------------------|------------------|-------------------|

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