4 October 2019

LATAM FX Talking

A benign interlude

Even though trade-related risk aversion remains a key driver for LATAM FX, the USD has become the chief catalyst for most currencies in the region. In particular, if this week's market reaction is any indication, the view that weaker US growth should prompt the US Fed to cut rates and avoid a recessionary trend suggests a weaker USD and FX appreciation across LATAM. We see more downside for the USD early next year than right now but, if this relatively benign market assessment continues, it would benefit LATAM currencies that are more sensitive to external drivers and risk aversion generally, such as the COP and the BRL, while resulting in a relative underperformance of currencies with stronger domestic anchors such as the MXN and the PEN.

The BRL has benefited in recent days from the USD weakness resulting in an outperformance after a long stretch of underperformance. 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. Low domestic rates have contributed to FX instability by incentivizing large-scale FX outflows, as corporates replace external funding with newly available low-cost local funding. As CB officials have highlighted, this should continue to exacerbate FX outflows and add a persistent near-term weakening bias for the BRL. And, for the currency to outperform, and consolidate below 4.0, those outflows must be offset by inflows, which should only rise when domestic activity data strengthen materially, which may happen only gradually.

In Mexico, high local rates should continue to play a critical role in the stabilization of the MXN. In fact, thanks to Banxico's policy strategy, the Mexican peso has been a consistent outperformer since Andres Manuel Lopez Obrador's election on 1 July 2018. Our expectation is for Banxico to continue to follow the US Fed's lead in the very near term. But the risk of a more frontloaded cycle has increased, amid the sharp growth deceleration, and this scenario should consolidate if the MXN remains stable.

Argentina's assets have been supported by assertive monetary policies but, should the 27 October presidential election confirm that Alberto Fernandez will be Argentina's next president, episodes of extreme volatility should resurface. Given Fernandez's unorthodox economic policy credentials, his ability to roll over debt amortizations should be further debilitated. A debt default is not inevitable, but it would likely require a considerable policy tightening (ie, stronger fiscal balances, high interest rates and a strong ARS) and that seems, arguably, unrealistic to expect from Fernandez.

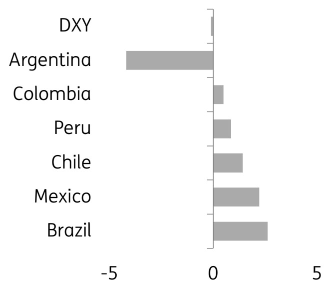
ING's 12-month currency view vis-à-vis forward/NDF market forecasts

	USD/BRL		USD/MXN		USD/CLP	
1M	4.10	↑	19.60	→	720.00	↑
3M	4.10	↑	19.70	↓	720.00	↑
6M	4.00	→	19.60	↓	700.00	↓
12M	3.90	↓	20.00	↓	680.00	↓
	USD/ARS		**USD/COP**		**USD/PEN**	
1M	60.00	↓	3480.00	↑	3.38	↑
3M	70.00	↓	3450.00	↓	3.38	→
6M	75.00	↓	3350.00	↓	3.34	↓
12M	82.00	↓	3300.00	↓	3.32	↓

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

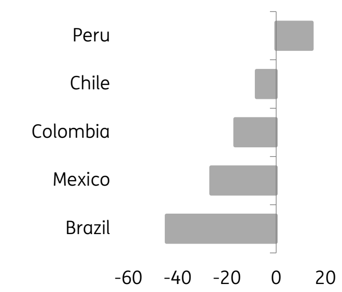
Source: Bloomberg, ING

FX monthly change (%)



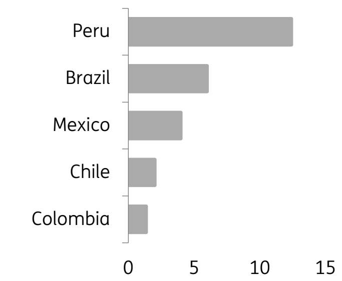
Source: Bloomberg, ING

5yr local rate monthly change (bp)



Source: Bloomberg, ING

5yr CDS monthly change (bp)



Source: Bloomberg, ING

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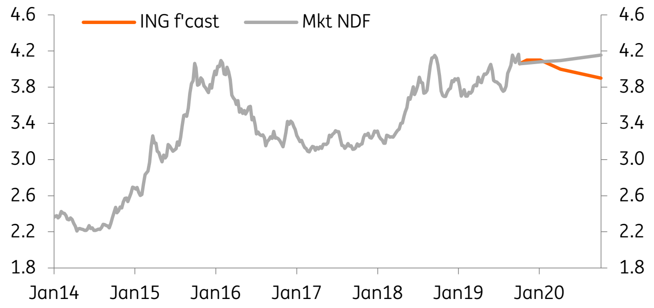
USD/BRL

FX outflows amid rate cuts continue to prevail

Current spot: 4.06



Source: Bloomberg, ING

- Favourable prospects for continued policy rate cuts should contribute to extend the underperforming bias for the Real, amid persistent FX outflows triggered by the replacement of external debt with (cheap) local-currency alternatives.
- These debt-management operations are long-term BRL-positive, but outflows should prevent a rally below 4.0 in the nearer term.
- Large outflows pushed the central bank to change its FX intervention scheme, to improve the liquidity of the spot FX market, but the new scheme is not meant to alter the FX level. Outflows may also prompt the CB to pause the easing cycle, after the next 50bp rate cut (to 5.0%), to assess the full FX impact of the decision.

ING forecasts (NDF)	**1M** 4.10 (4.07)	**3M** 4.10 (4.08)	**6M** 4.00 (4.10)	**12M** 3.90 (4.16)

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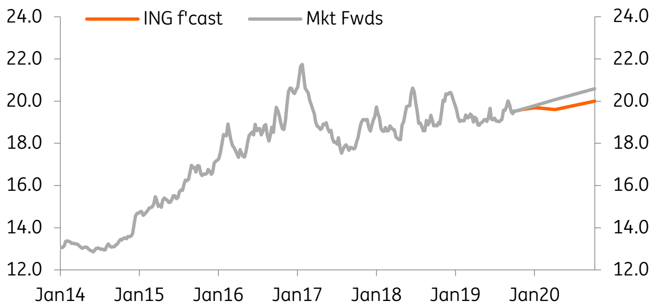
USD/MXN

Near-term resilience contrasts with long-term uncertainty

Current spot: 19.53



Source: Bloomberg, ING

- The MXN has proven to be more resilient than its regional peers and that resilience should continue in the nearer term.
- The relative outperformance reflects primarily the very attractive carry, with high rates acting as an effective FX anchor, and the fact that Banxico remains especially vigilant about FX stability, when compared to the other central banks in the region.
- Faster-than-expected rate cuts would be a catalyst for a weaker FX but CB policy caution indicates that high rates should persist. Still, 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.

ING forecasts (mkt fwd)	**1M** 19.60 (19.62)	**3M** 19.70 (19.80)	**6M** 19.60 (20.08)	**12M** 20.00 (20.59)

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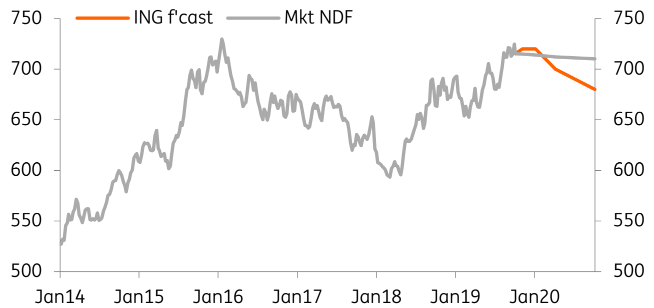
USD/CLP

Copper price trends continue to drive the CLP outlook

Current spot: 715.29



Source: Bloomberg, ING

- 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/China 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. Low inflation and broad-based moderation in economic activity indicators paved the way for BCCh to implement two large 50bp rate cuts, to 2.0%, and policy guidance signals an additional 50bp in cuts, to a low 1.5%.

ING forecasts (NDF)	**1M** 720.00 (715)	**3M** 720.00 (714)	**6M** 700.00 (712)	**12M** 680.00 (710)

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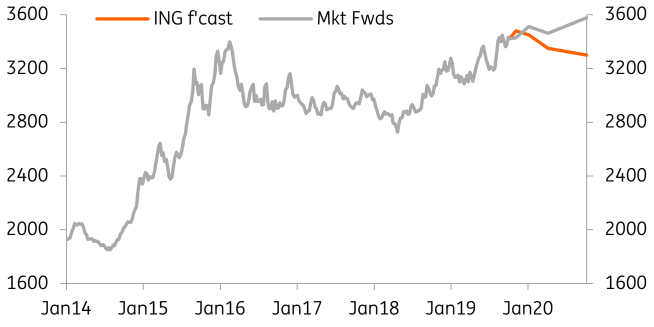
USD/COP

Heightened sensitivity to risk appetite keeps volatility high

Current spot: 3423.13



Source: Bloomberg, ING

- The COP continued to underperform over the past month, 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 considerably less stable.
- That sensitivity possibly reflects concerns over the widening of the current account deficit. The large deficit typically places the COP among the most vulnerable EM FX 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 suggest a small risk of rate cuts in the coming quarters.

ING forecasts (NDF)	**1M** 3480.00 (3428)	**3M** 3450.00 (3512)	**6M** 3350.00 (3462)	**12M** 3300.00 (3578)

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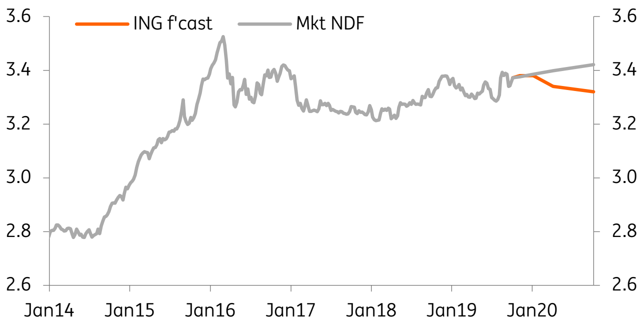
USD/PEN

Solid macro trends help offset political turmoil

Current spot: 3.37



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 less affected by gyrations in the USD and the trade-war concerns that affected its EM peers. Political turmoil, amid the Presidential call for early elections and the dissolution of Congress, has also had reduced impact over local assets so far.
- 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%) amid slowing economic activity data and an additional cut seems likely.

ING forecasts (NDF)	**1M** 3.38 (3.38)	**3M** 3.38 (3.39)	**6M** 3.34 (3.40)	**12M** 3.32 (3.42)

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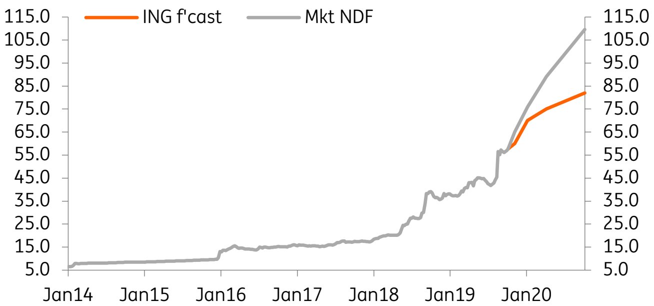
USD/ARS

Assertive policies help offset political uncertainties

Current spot: 57.68



Source: Bloomberg, ING

- The Macri administration has managed to limit FX volatility following the surprise electoral result with a mix of higher interest rates and heavy use of the central bank's FX reserves.
- FX stability is likely to be temporary however, as Alberto Fernandez is likely to become Argentina's next president in the October presidential election. This complicates the government's ability to rollover maturing debt amortizations, and increases the risk of a credit event at some point in the coming quarters.
- IMF negotiations have stalled, without the disbursement of the program's last tranche. This remains an important near-term catalyst, but news on this front should be delayed until after the election results are known.

ING forecasts (NDF)	**1M** 60.00 (65.05)	**3M** 70.00 (75.91)	**6M** 75.00 (89.16)	**12M** 82.00 (109.58)

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