17 January 2020

# LATAM FX Talking

## The mighty MXN

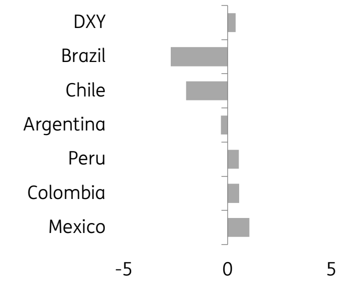
**The USD has once again become the chief driver for most currencies in LATAM and should remain a primary catalyst for the region's FX outlook. The effective de-escalation of trade-war concerns suggests a constructive environment for global growth and market-friendly conditions for EM FX, but so long as USD strength persists and domestic growth stories remain lackluster, investor focus should prioritize currencies offering material carry. This, we believe, helps explain the outstanding relative performance of the Mexican *peso* in LATAM.**

The MXN has been the clear standout performer across LATAM FX in January. Despite the gradual deterioration in Mexico's macro fundamentals, as evidenced by the ongoing recession and the risk of credit rating downgrades, the *peso*'s outstanding carry should continue to act as an effective FX anchor in the nearer term. But, unsurprisingly, Mexico also stands out in the region as the country with the largest potential for rate cuts this year and next, while the cumulative impact of the macro deterioration should continue to hamper the currency's longer-term outlook.

The BRL's performance in recent weeks represents, meanwhile, the biggest frustration across LATAM FX. To a large extent, it reflects a combination of optimistic expectations created around bullish prospects depicted in most "2020 outlook" analyses published at the end of the year and real frustration with the latest batch of activity data (for November). Having said that, much is not well-understood about the causes for the massive amounts of FX outflows seen in recent months in Brazil. To a large extent, outflows have been a result of sweeping changes in the local economy as it adjusts to record-low local interest rates. It's unclear how long this transition will last and, more to the point, how persistent these outflows will be. In any case, we believe a more supportive BRL environment should emerge gradually throughout the year, but it depends on the eventual confirmation that the monetary easing cycle has been concluded (with no additional rate cut in February) and, more importantly, stronger evidence that an activity recovery is firmly under way.

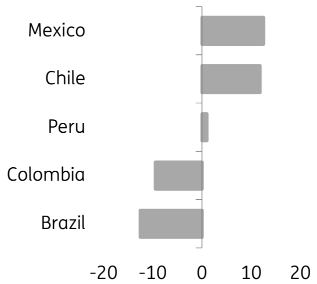
The Colombian COP and the Chilean CLP have largely traded in line with the BRL, with the USD acting as the main catalyst while domestic drivers, and commodity prices, have played secondary roles.

**FX monthly change (%)**



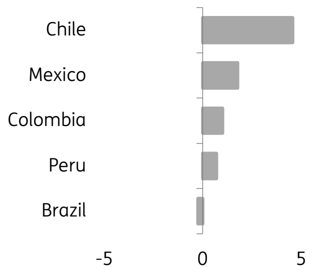

Source: Bloomberg, ING

**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 | 4.15 | ↑ | 18.80 | → | 770.00 | ↓ |
| 3M | 4.10 | → | 19.00 | ↑ | 760.00 | ↓ |
| 6M | 4.00 | ↓ | 19.10 | ↓ | 740.00 | ↓ |
| 12M | 3.90 | ↓ | 19.70 | → | 730.00 | ↓ |
| | **USD/ARS** | | **USD/COP** | | **USD/PEN** | |
| 1M | 60.00 | ↓ | 3300.00 | ↓ | 3.32 | → |
| 3M | 60.00 | ↓ | 3280.00 | ↓ | 3.33 | → |
| 6M | 65.00 | ↓ | 3250.00 | ↓ | 3.34 | → |
| 12M | 74.00 | ↓ | 3200.00 | ↓ | 3.33 | ↓ |

>/=/< 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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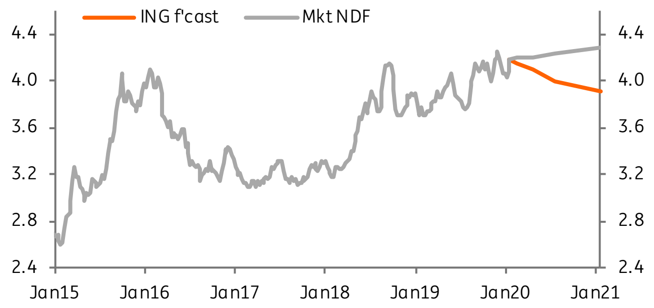
# USD/BRL

**Record levels of FX outflows continue to prevail**

**Current spot: 4.18**




Source: Bloomberg, ING

- Persistent FX outflows triggered by, among other factors, record-low local interest rates, continued to drive BRL dynamics recently, extending its underperforming bias into the new year.
- The replacement of external debt with (cheap) local-currency alternatives is one of the chief drivers for these outflows, but portfolio outflows and the current account deficit have also risen, the latter thanks to the ongoing fall in the external trade surplus.
- A more supportive BRL environment depends on the eventual confirmation that the monetary easing cycle has been concluded (with no additional rate cut in February) and, more importantly, stronger evidence that an activity recovery is firmly under way.

| **ING forecasts** (NDF) | **1M** 4.15 (4.20) | **3M** 4.10 (4.20) | **6M** 4.00 (4.23) | **12M** 3.90 (4.28) |
|---|---|---|---|---|

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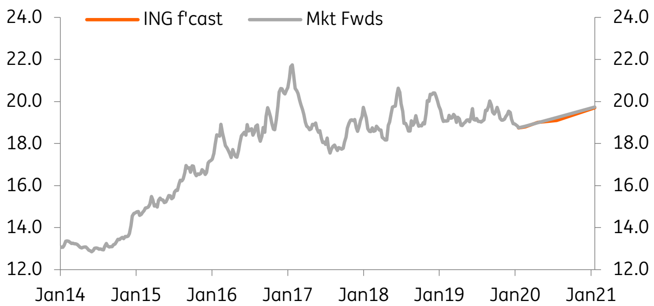
# USD/MXN

**Near-term resilience contrasts with long-term uncertainty**

**Current spot: 18.74**




Source: Bloomberg, ING

- The MXN has proven to be more resilient than its regional peers and that relative strength should continue in the very near term.
- The *peso*'s 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.
- Larger-than-expected rate cuts would be a catalyst for a weaker FX, but policy caution indicates that rates should remain high in the nearer term. Still, faltering fundamentals, as seen in the poor GDP growth and the possibility of credit rating downgrades, should continue to hamper the MXN's longer-term outlook.

| **ING forecasts** (mkt fwd) | **1M** 18.80 (18.83) | **3M** 19.00 (19.00) | **6M** 19.10 (19.24) | **12M** 19.70 (19.73) |
|---|---|---|---|---|

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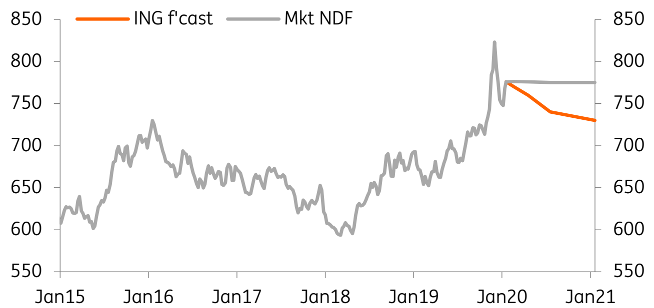
# USD/CLP

**The CLP's decoupling from copper prices persists**

**Current spot: 775.92**




Source: Bloomberg, ING

- As a small open economy, with an export basket heavily skewed towards copper, the CLP has historically followed a trajectory that closely matched copper price trends. That has changed since the socio-economic turmoil generated by the October protests.
- Since then, the sharp weakening in activity and fiscal metrics and, specially, the lingering uncertainties represented by the April constitutional referendum, have helped justify a weaker CLP path and a larger gap between copper and FX trends.
- FX intervention has helped narrow that gap, but it's unlikely to close it so soon thanks in part to lasting macro uncertainties, and despite the apparent normalization of local business conditions.

| **ING forecasts** (NDF) | **1M** 770.00 (776) | **3M** 760.00 (776) | **6M** 740.00 (775) | **12M** 730.00 (775) |
|---|---|---|---|---|

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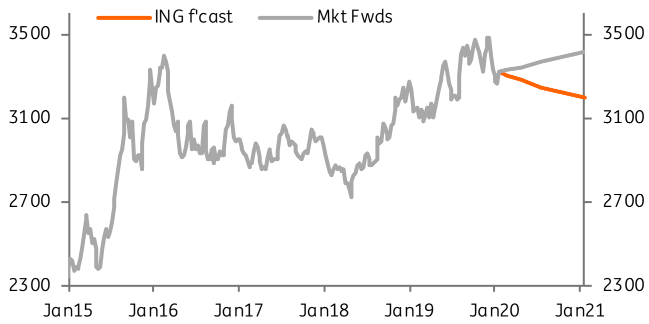
# USD/COP

**COP is still marked by high sensitivity to external drivers**




Source: Bloomberg, ING

**Current spot: 3322.40**

- The COP continues to display heightened sensitivity to external shocks and USD fluctuations in general. The *peso*'s correlation with oil prices remains another important FX driver, even though that correlation has become far less stable in recent quarters.
- The COP's high-sensitivity likely reflects concerns over the widening of Colombia's current account deficit, which has become an increasingly persuasive argument against additional rate cuts. The large deficit typically places the COP among the most vulnerable EM currencies to risk aversion episodes.
- Robust near-potential GDP growth prints together with moderate inflation also help justify a neutral monetary policy guidance.

| **ING forecasts** (NDF) | **1M** 3300.00 (3330) | **3M** 3280.00 (3344) | **6M** 3250.00 (3368) | **12M** 3200.00 (3416) |
|---|---|---|---|---|

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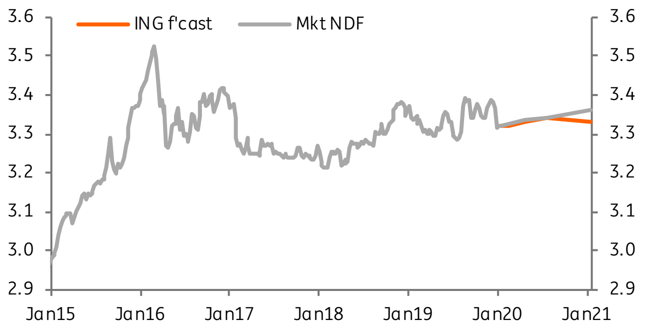
# USD/PEN

**Solid macro trends help offset enduring political tension**




Source: Bloomberg, ING

**Current spot: 3.32**

- The PEN continues to trade with the lowest volatility in the region. Even though Peru is a small open economy that is heavily reliant on commodity exports, the currency remains less affected by fluctuations in the USD and the trade-war/geopolitical concerns that affected its EM peers. Political turmoil, amid the dissolution of Congress and its new election set for later this month, has also had reduced impact over local assets so far.
- Positive developments on the US-China trade-war front has added support to the currency, but the threat of FX intervention and additional rate cuts would limit a rally in the PEN.
- Peru's BCRP cut the policy rate (2.25%) twice in 2019 amid slowing economic activity data and additional cuts are possible.

| **ING forecasts** (NDF) | **1M** 3.32 (3.33) | **3M** 3.33 (3.33) | **6M** 3.34 (3.34) | **12M** 3.33 (3.36) |
|---|---|---|---|---|

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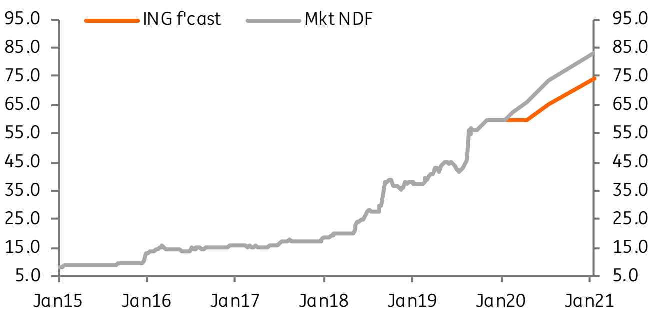
# USD/ARS

**Assertive policies suggest that FX stability is a priority**




Source: Bloomberg, ING

**Current spot: 59.98**

- The Fernandez administration has managed to limit FX volatility with a mix of stringent FX restrictions and heavy FX intervention.
- It's unclear how long FX stability will prevail, as much should depend on the outcome of the debt-restructuring process that Fernandez aims to conclude by March. A longer negotiation process, and the risk of a credit event in the coming quarters, also suggest that little visibility should prevail beyond the near term.
- Price freezes, FX controls and evidence of fiscal and monetary policy restraint should help ease inflation pressures in the nearer term. But the large gap between official and non-official FX rates is one evidence that permanent policy solutions are still lacking and appear conditional on the debt renegotiation process.

| **ING forecasts** (NDF) | **1M** 60.00 (62.26) | **3M** 60.00 (66.15) | **6M** 65.00 (73.35) | **12M** 74.00 (83.28) |
|---|---|---|---|---|

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