14 February 2020

LATAM FX Talking

The mighty MXN endures

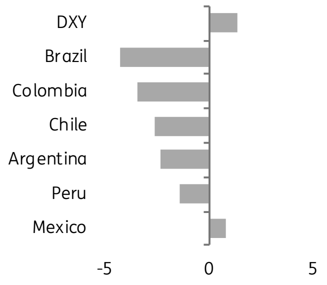
The past month was, once again, a very good month for the MXN, which was the top performer across EM. The currency's high carry continues to prove to be a very effective anchor but there are other factors that help justify this outperformance. In our view, the MXN also stands out for not being a commodity currency at a time that its regional peers are facing strong headwinds resulting from the after effects of the coronavirus outbreak in China, and its impact over Chinese demand and commodity prices. Mexico's fast-improving external trade balance, which is a result of a mix of depressed domestic demand and a slight improvement in terms of trade, is also supportive of the currency.

Much like over the past month, the other currencies in the region should continue to react to risk-aversion trends resulting from market reaction to the evolution of the coronavirus outbreak and its impact over commodity prices and the USD. The eventual de-escalation of this threat would help consolidate a more constructive environment for global growth, and potentially a bigger catch-up rally from the currencies that have sold off the most more recently, notably the BRL and the COP, when compared to the more muted reaction seen in the CLP and the PEN, which have followed a lower volatility path.

Taking a longer-term perspective, we believe the scope for the MXN to outperform should be constrained by the fact that Mexico's rate differential with the rest of the region and with the US stands to drop throughout 2020-21. In addition, Mexico's lower growth outlook, relative to its peers, suggests that the ongoing macro deterioration should continue, extending the risk of credit-rating downgrades and hampering the currency's longer-term outlook.

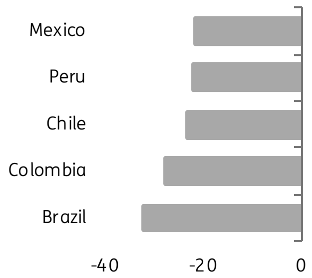
The BRL's recent underperformance continues to stand out and generate scepticism about Brazil's outlook. To a large extent, the currency's performance remains not well-understood and appears less to do with Brazil's macro outlook than the fact that it continues to reflect the sweeping changes in local financial markets resulting from the transition to a new low-rate environment. It's unclear how long this transition will last but for the BRL to trade on a stronger footing, at a minimum, we should have stronger evidence that an activity recovery is firmly under way.

FX monthly change (%)



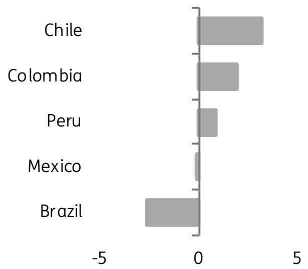
Source: Bloomberg, ING

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	4.30	→	18.80	↑	785.00	↓
3M	4.22	↓	18.90	→	772.00	↓
6M	4.05	↓	19.20	↑	755.00	↓
12M	3.90	↓	19.80	↑	730.00	↓
	USD/ARS		**USD/COP**		**USD/PEN**	
1M	61.50	↓	3400.00	↑	3.38	→
3M	63.00	↓	3380.00	↓	3.37	↓
6M	67.00	↓	3280.00	↓	3.35	↓
12M	77.00	↓	3200.00	↓	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

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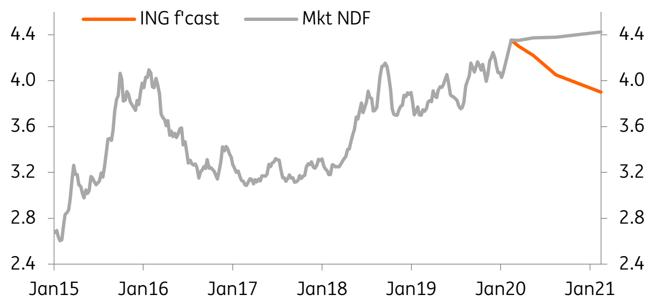
USD/BRL

Central bank caution helps limit the BRL's weakening bias **Current spot: 4.33**



Source: Bloomberg, ING

- The BRL continued to underperform in recent weeks amid persistent FX outflows triggered by, among other factors, record-low local interest rates. The central bank cut the policy rate again at its latest meeting, to 4.25%, but signalled that the cycle is over for now, which should help limit the BRL's underperforming bias.
- Stronger evidence that an activity recovery is firmly under way is crucial to support the BRL going forward. Recent data has been mixed, and the risk of coronavirus-led export disruptions added some downside for 1Q data, potentially delaying the recovery.
- A recovery is necessary to facilitate a faster fiscal consolidation and, consequently, faster credit-rating upgrades.

ING forecasts (NDF)	**1M** 4.30 (4.35)	**3M** 4.22 (4.37)	**6M** 4.05 (4.38)	**12M** 3.90 (4.42)

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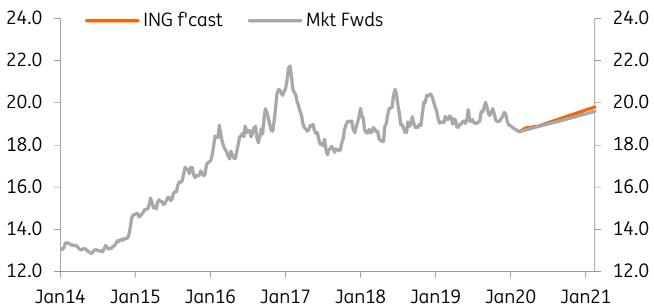
USD/MXN

Near-term resilience contrasts with long-term uncertainty **Current spot: 18.63**



Source: Bloomberg, ING

- The MXN continues to shine and show greater resilience than its regional peers, and that relative strength may continue.
- The peso's relative outperformance reflects primarily the highly attractive carry, with the highest rate among its regional peers acting as an effective FX anchor. Banxico's resistance to deploy a deeper rate-cutting cycle should continue to support the MXN.
- The peso's relative strength is also justified by the improvement in Mexico's external accounts in recent quarters, notably the sharp fall in the current account deficit. But the lingering recession and the risk of credit-rating downgrades continue to hamper the MXN's longer-term outlook.

ING forecasts (mkt fwd)	**1M** 18.80 (18.71)	**3M** 18.90 (18.87)	**6M** 19.20 (19.11)	**12M** 19.80 (19.60)

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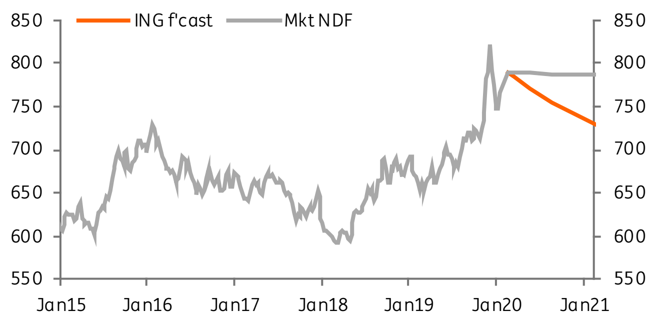
USD/CLP

End of China-led risk-off could help trigger catch-up rally **Current spot: 789.53**



Source: Bloomberg, ING

- The Chilean peso performed largely in line with its EM peers in recent weeks. This is relatively surprising given Chile's larger external trade dependence on China and the sharp drop in copper prices seen in the same period.
- The somewhat constructive FX dynamics may reflect the fact that the CLP was already trading at stressed levels, suggesting perhaps a more limited downside and, potentially, larger upside should coronavirus-related risks subside.
- The weakening in activity following the October protests were more subdued than initially feared, but the April constitutional referendum still justify a weaker CLP path in the nearer term.

ING forecasts (NDF)	**1M** 785.00 (790)	**3M** 772.00 (789)	**6M** 755.00 (789)	**12M** 730.00 (789)

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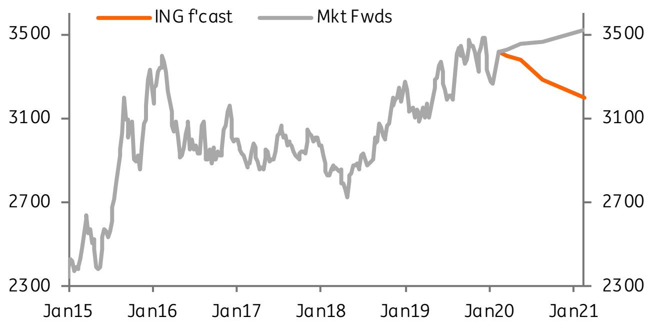
USD/COP

COP is still marked by high sensitivity to external drivers

Current spot: 3419.81



Source: Bloomberg, ING

- The COP underperformed in recent weeks as it continues to display high sensitivity to external shocks. But the currency was also weighed down by the sharp drop in oil prices. The eventual stabilization in risk sentiment suggests material upside but we are not especially bullish on the outlook for oil prices.
- The COP's high-sensitivity reflects concerns over Colombia's wide current account deficit, which has become a crucial argument against additional rate cuts. 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 moderate inflation also help justify a neutral monetary policy guidance.

ING forecasts (NDF)	**1M** 3400.00 (3426)	**3M** 3380.00 (3450)	**6M** 3280.00 (3463)	**12M** 3200.00 (3522)

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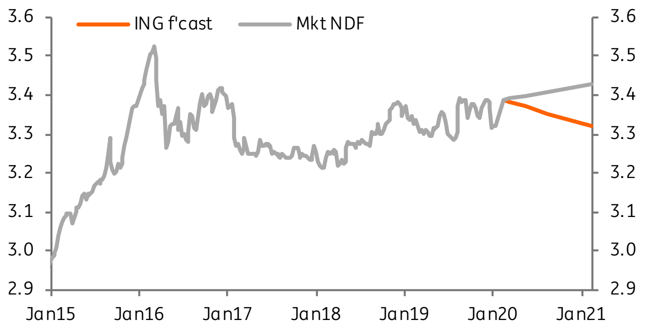
USD/PEN

Solid macro trends help offset global risk worries

Current spot: 3.39



Source: Bloomberg, ING

- The PEN also weakened on the back of coronavirus-related worries, but it continues to trade with low volatility, as usual, weakening much less than its commodity exporter peers.
- Even though Peru is a small open economy that is heavily reliant on commodity exports, the currency remains less affected by fluctuations in risk appetite that affected its EM peers, which reflects Peru's more heavily-managed FX regime.
- Recent Congressional elections resulted in a more fragmented legislature, which reduced the power of the opposition even though a stable government majority is still not ensured. 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** 3.38 (3.39)	**3M** 3.37 (3.40)	**6M** 3.35 (3.41)	**12M** 3.32 (3.43)

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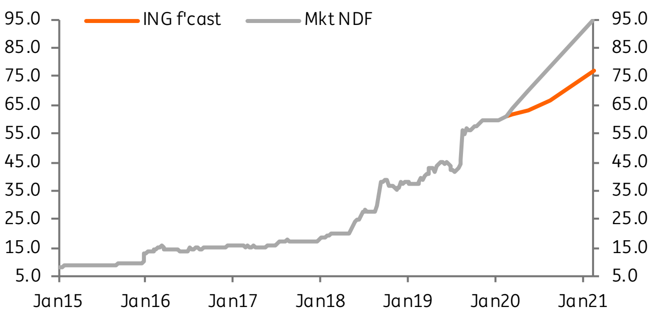
USD/ARS

Waiting for debt negotiations to begin

Current spot: 61.12



Source: Bloomberg, ING

- The Fernandez administration continues to struggle to finance itself, increasing the risk of a broader reprofiling of local bonds.
- The IMF mission arrives this week in Buenos Aires, which should help shed some light on the government's debt-renegotiation strategy. As illustrated by the failed effort by the BA Province to delay an amortization payment, heightened uncertainties should prevail as bondholders, the administration and the IMF convene. The administration continues to favour a quick resolution, to reduce the drag these uncertainties will impose on economic activity, but a March finish still looks too ambitious
- FX will continue to be managed with a mix of stringent controls and intervention, ensuring some stability for the official FX rate.

ING forecasts (NDF)	**1M** 61.50 (63.95)	**3M** 63.00 (70.00)	**6M** 67.00 (78.46)	**12M** 77.00 (95.25)

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