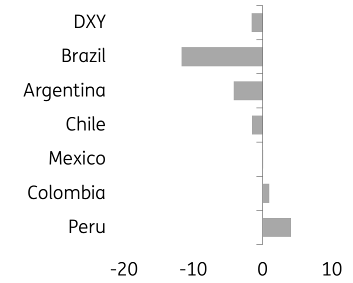
24 April 2020

LATAM FX Talking

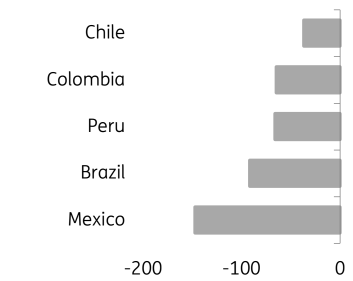
An extended rout, exacerbated by local drivers

FX monthly change (%)



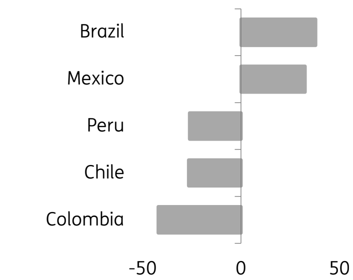
Source: Bloomberg, ING

5yr local rate monthly change (bp)



Source: Bloomberg, ING

5yr CDS monthly change (bp)



Source: Bloomberg, ING

The fallout from the global coronavirus outbreak should be exacerbated by idiosyncratic problems in several LATAM countries. From the incipient political crisis in Brazil, following the resignation of the popular Justice Minister Sergio Moro, to the persistent credit-rating downgrades seen in Mexico and the potential sovereign default in Argentina, the three largest economies in the region appear to be facing considerable challenges that should exacerbate volatility and extend a weakening bias for local assets.

The political crisis in Brazil took us, and most investors, by surprise and it is still too soon to gauge its implications. Moro's resignation should reduce President Bolsonaro's political capital and investors are, naturally, likely to worry about the risks to the economic agenda. The near-term outlook for fiscal accounts, following the fiscal relief packages approved by Congress, is a particular source of concern. The risk is that Congress, or Bolsonaro, decide to abandon the fiscally-conservative tenets advocated by Economy Ministry Paulo Guedes, resulting in his departure from the administration. Such an event would be especially negative for local assets and could ultimately threaten the sustainability of Bolsonaro's own administration.

In Mexico, the fast-deteriorating economic outlook, illustrated by the decision by three major rating agencies to downgrade the sovereign, pushed the central bank to conduct another emergency meeting. This was the second off-schedule meeting in one month, that resulted in another 50bp rate cut. The central bank's more assertive stance contrasts with the resistance by the federal government to provide fiscal relief to private sector corporations. Considering prospects of a 7-8% GDP contraction in 2020, rating agencies have maintained the negative outlook and, so, further downgrades are possible. But a sub-investment grade rating is still unlikely in the nearer-term.

Elsewhere in the region, Andean economies stand out for their superior capacity to provide stimulus, as seen especially in Chile and Peru, which should help pave the way for a faster post-crisis recovery. An outperforming bias for these currencies could also emerge amid more solid prospects for the eventual normalisation of commodity prices and global demand.

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

	USD/BRL		USD/MXN		USD/CLP	
1M	5.80	↑	26.00	↑	860.00	↑
3M	5.50	↓	26.50	↑	840.00	↓
6M	4.90	↓	24.50	↓	800.00	↓
12M	4.50	↓	23.00	↓	770.00	↓
	USD/ARS		**USD/COP**		**USD/PEN**	
1M	68.50	↓	4000.00	↓	3.38	→
3M	72.00	↓	3850.00	↓	3.38	→
6M	77.00	↓	3600.00	↓	3.35	↓
12M	90.00	↓	3400.00	↓	3.30	↓

>/=/< 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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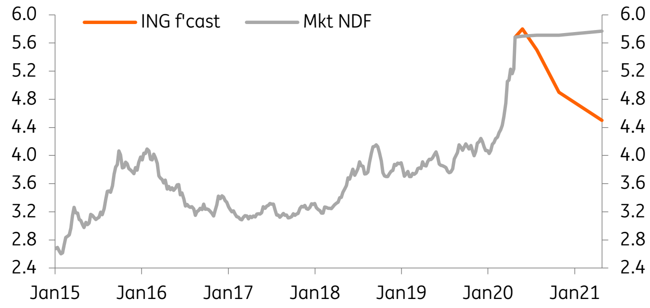
USD/BRL

BRL weakens on lower rates, and rising fiscal concerns



Source: Bloomberg, ING

Current spot: 5.63

- FX intervention should continue to provide FX liquidity, but the BRL could reach new lows as the central bank embarks on a deeper rate-cutting cycle, even as fiscal risks remain elevated.
- CB officials have confirmed that the outlook for economic activity has deteriorated in recent weeks, while inflation dynamics have improved. Local markets now price a deeper easing cycle than previously expected, but the CB's ability to cut rates should also now depend on the evolution of the recent political crisis.
- Monetary authorities still worry about a persistent damage to Brazil's fiscal outlook. Initiatives to support states and to boost public infrastructure investment are two key sources of concern.

ING forecasts (NDF)	**1M** 5.80 (5.64)	**3M** 5.50 (5.66)	**6M** 4.90 (5.65)	**12M** 4.50 (5.71)

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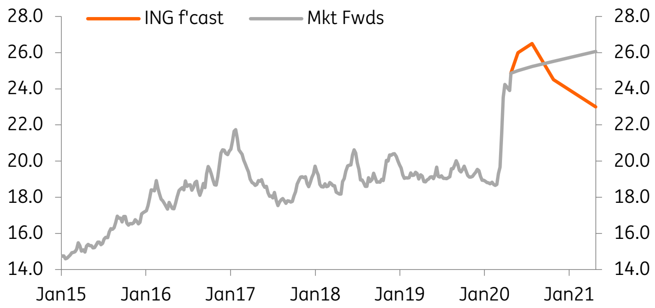
USD/MXN

MXN outlook hampered by recession and deeper rate cuts



Source: Bloomberg, ING

Current spot: 24.85

- The MXN may also see new lows as the CB signals greater willingness to support economic activity through rate cuts. This contrasts the CB's previous emphasis on financial stability, and a concern over FX outflows, that typically resulted in a relatively more hawkish guidance for the policy rate.
- This new emphasis should weaken the MXN's key anchor, its yield advantage, resulting in more outflows and lasting MXN weakness.
- Credit rating agencies have downgraded Mexico over the past month, with the collapse in oil prices likely acting as a chief catalyst. Further downgrades are possible, but a sub-investment grade rating is unlikely in the nearer-term.

ING forecasts (mkt fwd)	**1M** 26.00 (24.98)	**3M** 26.50 (25.21)	**6M** 24.50 (25.50)	**12M** 23.00 (26.04)

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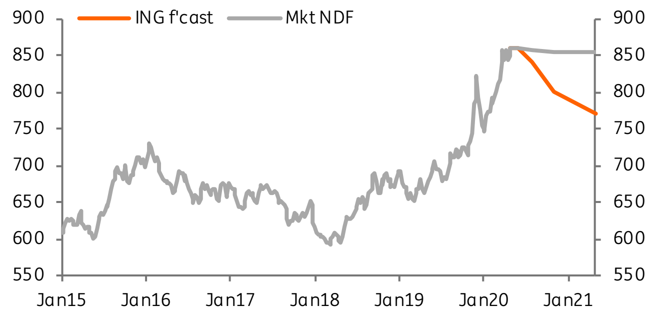
USD/CLP

Aggressive stimulus program could facilitate recovery



Source: Bloomberg, ING

Current spot: 860.41

- Chile's aggressive policy reaction to the economic crisis should help pave the way for a faster post-crisis recovery.
- The government announced a 6%-of-GDP fiscal package and the CB lowered the policy rate by 125bp to its "technical minimum" of 0.5%. An evolving battery of liquidity provisions to normalize and facilitate bank lending and ensure monetary policy transmission should also help ease financial conditions.
- As usual, copper prices should remain a key FX driver and with the metal price now off its recent lows, an outperforming bias for the CLP could emerge amid more solid prospects for the eventual normalisation of global demand.

ING forecasts (NDF)	**1M** 860.00 (860)	**3M** 840.00 (858)	**6M** 800.00 (855)	**12M** 770.00 (854)

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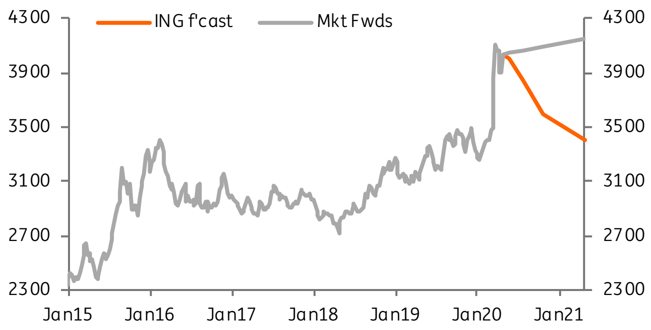
USD/COP

Facing twin-shocks from a stronger starting point

Current spot: 4037.18



Source: Bloomberg, ING

- The Colombian administration has also eased its economic policy stance over the past month, but that response is considerably tamer than the one seen in Chile and Peru.
- This reflects Colombia's mix of relatively stronger economic momentum and concern over lasting damage to fiscal accounts, especially given the recent negative action by credit-rating agencies, which was probably triggered by the fall in oil prices.
- The COP looks fairly priced, but the evolution of oil prices should remain a key FX driver. In addition, the CB's focus on liquidity provisions, rather than rate cuts, suggests that the relatively high policy rate (3.75%) could act as an FX stabilizer.

ING forecasts (NDF)	**1M** 4000.00 (4047)	**3M** 3850.00 (4064)	**6M** 3600.00 (4092.00)	**12M** 3400.00 (4143.00)

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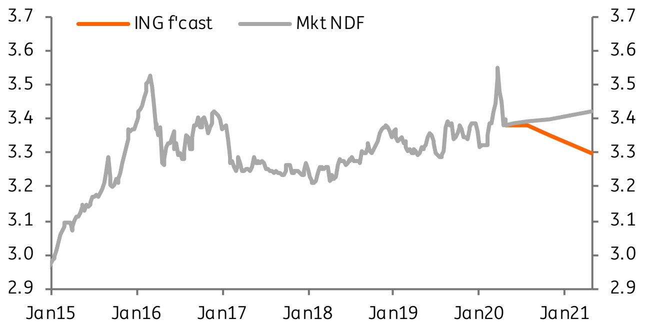
USD/PEN

Aggressive stimulus to limit the economic downside

Current spot: 3.38



Source: Bloomberg, ING

- The PEN stands out for its fast recovery from the fresh all-time lows reached one month ago.
- Even though Peru is a small open economy that is heavily reliant on commodity exports, the currency remains less affected by the fluctuations in risk appetite that affected its EM peers, which reflects Peru's more heavily-managed FX regime.
- Peru's superior ability to deploy economic policy stimulus to help offset economic impact of the crisis may also help explain the PEN's outperformance. So far, the government has announced the largest fiscal stimulus package in LATAM, estimated at 12% of GDP, along with the deepest rate cuts, with the policy rate now at its lower bound, at 0.25%.

ING forecasts (NDF)	**1M** 3.38 (3.38)	**3M** 3.38 (3.39)	**6M** 3.35 (3.40)	**12M** 3.30 (3.42)

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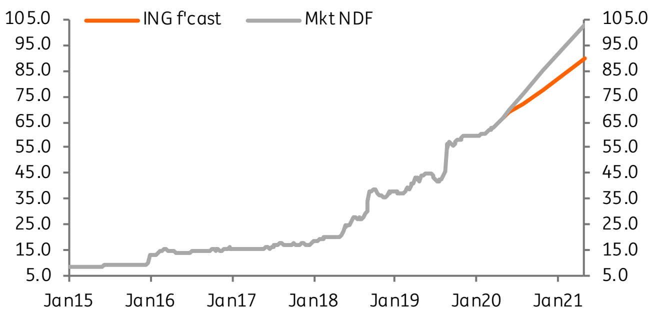
USD/ARS

External debt negotiations show limited progress

Current spot: 66.44



Source: Bloomberg, ING

- The Fernandez administration has finally presented its external debt exchange offer. The initial offer incorporates deep 60-70% NPV discounts and has been rejected by bondholders.
- Argentina also has opted to enter the grace period to delay servicing external bonds. The confrontation is generally expected to result in counter-offers and more intense negotiations but the ongoing economic crisis appears to have both added urgency and complicated the negotiating process.
- A compromise solution is still possible, but the clock is ticking and, if an understanding is not reached soon, Argentina could default. This would exacerbate local market instability and widen the large premium between the official and the non-official FX rates.

ING forecasts (NDF)	**1M** 68.50 (69.75)	**3M** 72.00 (75.65)	**6M** 77.00 (85.05)	**12M** 90.00 (102.92)

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