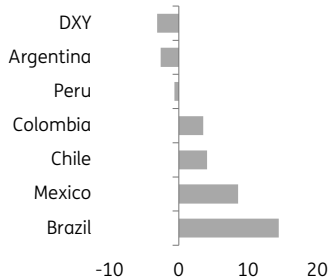


12 June 2020

LATAM FX Talking

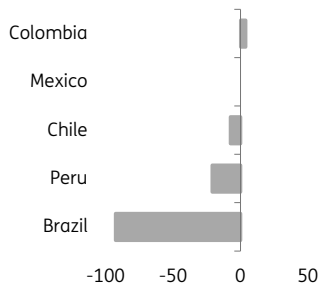
Rally likely has a bit further to go

FX monthly change (%)



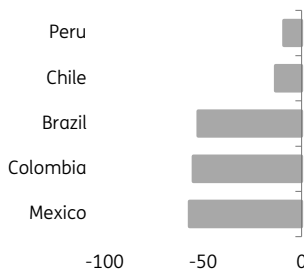
Source: Bloomberg, ING

5yr local rate monthly change (bp)



Source: Bloomberg, ING

5yr CDS monthly change (bp)



Source: Bloomberg, ING

The impressive rally seen in recent weeks showed signs of strain after the widespread profit-taking seen this week. The correction may prove to be temporary, however, if signs of a recovery in economic activity consolidate and Covid-19 health indicators remain under control, as the reopening in business activities gains momentum. Our bias is for risk appetite to remain mildly constructive, helping extend the rally in LATAM FX a bit further, even though the bulk of the appreciation is likely behind us now.

Some currencies are now much closer to what we consider their fair values. Overall, we consider the Brazilian *real* and the Colombian *peso* to have the greatest potential to outperform in the shorter term.

Domestic FX drivers are likely to turn more positive in Brazil as well, if next week's monetary policy meeting concludes, as we expect, with a firm indication that the rate-cutting cycle is over. Our view is that the policy rate will drop by 75bp on June 17, to 2.25%, and stay at that level in the foreseeable future. Any additional effort to implement monetary stimulus should be done through alternative credit-boosting initiatives, like the ones already being deployed by BACEN, along with a greater focus on the shape of the yield curve, which remains exceedingly steep.

The Mexican peso should, meanwhile, continue to benefit from its yield advantage in the shorter term. But, going forward, the Mexican central bank is the one with the greatest scope to cut the policy rate in LATAM. And our bias is for the central bank, faced with the grim economic reality created by the ongoing health crisis, to surprise on the dovish side in the coming months, by cutting its reference rate every month by 50bp until the policy rate reaches 4%.

We are more circumspect about our medium-term outlook for Brazil and for LATAM in general. The impact of the deep recession and of the Covid-related fiscal relief over sovereign debt dynamics is likely to be considerable. As a result, a strong fiscal-tightening bias is necessary to return fiscal trends to a sustainable trajectory in 2021, which may create political friction later in the year. Eventually, this could result in negative credit-rating action for several sovereigns in the region.

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

	USD/BRL		USD/MXN		USD/CLP	
1M	4.85	↓	21.80	↓	765.00	↓
3M	4.60	↓	21.40	↓	745.00	↓
6M	4.50	↓	22.00	↓	750.00	↓
12M	4.60	↓	22.50	↓	770.00	↓
	USD/ARS		USD/COP		USD/PEN	
1M	71.40	↓	3600.00	↓	3.43	↓
3M	76.00	↓	3500.00	↓	3.39	↓
6M	82.00	↓	3450.00	↓	3.36	↓
12M	97.00	↓	3400.00	↓	3.35	↓

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

Source: Bloomberg, ING

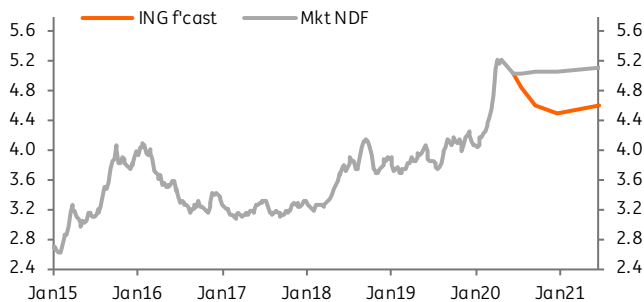
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USD/BRL

Impressive rally exacerbated by underweight positioning

Current spot: 5.04



Source: Bloomberg, ING

- Firmer indication that the monetary easing cycle is nearly over, together with the broader rise in global risk appetite led the BRL to be the best-performing LATAM currency in the past month.
- The extent of the rally was impressive and may reflect the fact that investors had been vastly underweighted in their BRL holdings. This likely helped exacerbate the rally as investor appetite for riskier assets took hold but, for longer time periods, the BRL remains one of the worst-performing EM currencies.
- The rally may have a bit more to go, but we suspect it would be hard for the pair to breach the 4.5 barrier, while the deep recession should help keep fiscal risks elevated in 2H20.

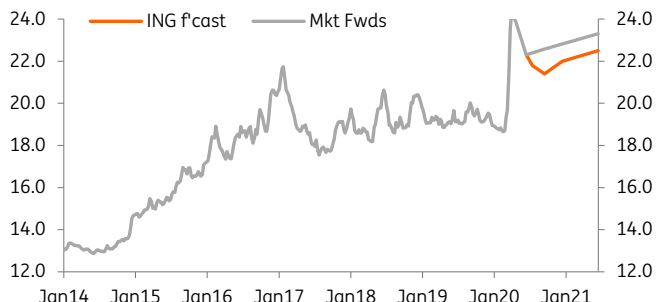
ING forecasts (NDF)	1M 4.85 (5.04)	3M 4.60 (5.05)	6M 4.50 (5.06)	12M 4.60 (5.10)
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USD/MXN

Short-term yield-advantage remains substantial

Current spot: 22.30



Source: Bloomberg, ING

- The MXN was also, for a while, recovering much of the loss seen in March but, we suspect, those gains should start to stall whenever the currency drops below 22. The eventual resumption of the risk-on sentiment could push the currency towards 21, but we consider fair value to be nearer 21.5.
- We expect Banxico to cut its reference rate to 4.0% by August. But, even then, the MXN should retain its yield advantage, in relation to its LATAM peers, in the nearer term.
- For longer horizons, we suspect the yield advantage should not suffice to ensure outperformance for the MXN, as the macro outlook is likely worse for Mexico than for its LATAM peers.

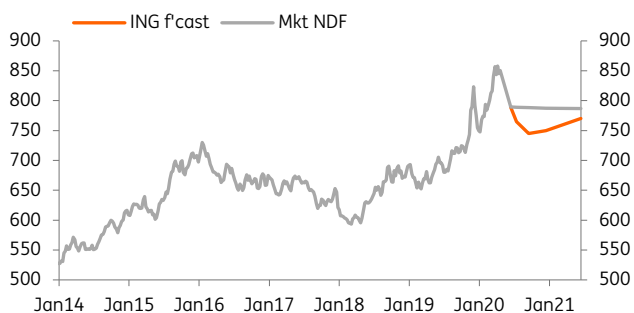
ING forecasts (mkt fwd)	1M 21.80 (22.39)	3M 21.40 (22.57)	6M 22.00 (22.82)	12M 22.50 (23.31)
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USD/CLP

CLP to remain buoyed by global recovery prospects

Current spot: 789.23



Source: Bloomberg, ING

- Chile stands out for its assertive policy stimulus measures, but latent political and social risks suggest that the likelihood of episodic volatility should remain high, especially considering the ongoing health crisis and the looming constitutional re-write.
- A 7%-of-GDP fiscal package was announced, and the central bank lowered the policy rate to its "technical minimum" of 0.5%. A broad range of liquidity provisions should help ease financial conditions while FX lines (IMF, Fed, PBoC) should help boost Chile's FX reserves.
- As usual, copper remains a key FX driver and the metal's recent price trajectory suggests that an outperforming bias for the CLP could persist, if firmer prospects for a global recovery consolidate.

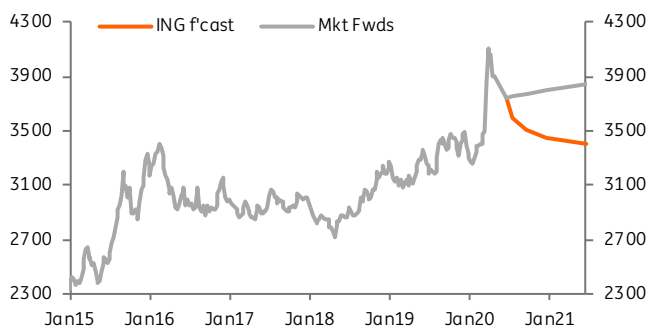
ING forecasts (NDF)	1M 765.00 (789)	3M 745.00 (788)	6M 750.00 (787)	12M 770.00 (787)
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USD/COP

Recovery in oil prices continues to offer important upside

Current spot: 3745.38



Source: Bloomberg, ING

- Colombia's economic policy reaction to the ongoing crisis has been considerably tamer than the one seen in Chile and Peru.
- This reflects Colombia's mix of relatively stronger economic momentum (pre-pandemic) and concern over lasting damage to fiscal accounts, especially considering the recent negative action by credit-rating agencies, likely driven by the fall in oil prices.
- The recovery in crude prices reduces fiscal risks, limiting the scope for negative credit-rating actions. But the COP looks fairly priced, especially after the recent profit-taking. Oil prices remain the most important near-term FX driver, but Colombia's relatively higher reference rate (2.75%) could act as a mild FX stabilizer.

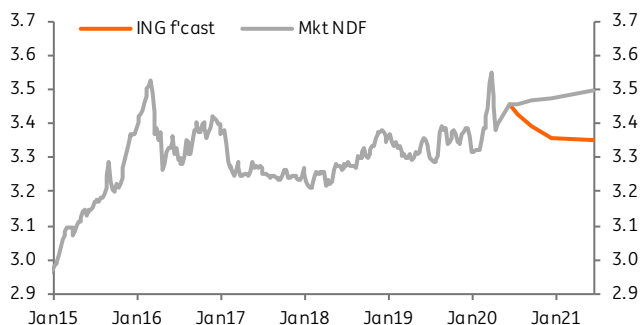
ING forecasts (NDF)	1M 3600.00 (3755.27)	3M 3500.00 (3774.26)	6M 3450.00 (3797.62)	12M 3400.00 (3841.25)
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USD/PEN

Aggressive stimulus to limit the economic downside

Current spot: 3.46



Source: Bloomberg, ING

- The PEN has underperformed its regional peers in recent weeks, but this reflects the fact that the currency never reached the lows seen elsewhere in the region, which suggests that the currency should underperform in times of rising risk appetite.
- Even though Peru is a small open economy that is heavily reliant on commodity exports, Peru's more heavily-managed FX regime shields its currency from the wider fluctuations in risk appetite that affected its EM peers.
- Peru's Covid-related health crisis remains especially lethal, but the country's superior ability to deploy economic policy stimulus, including the lowest reference rate in LATAM at 0.25%, should help alleviate the economic impact of the crisis.

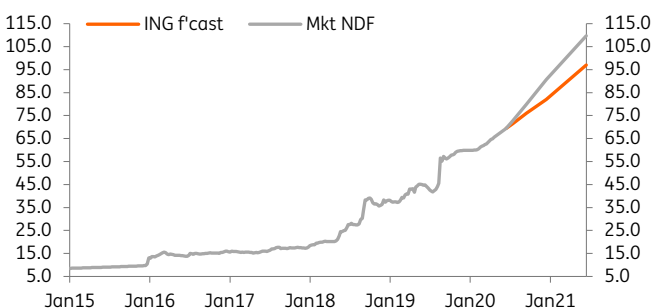
ING forecasts (NDF)	1M 3.43 (3.46)	3M 3.39 (3.47)	6M 3.36 (3.48)	12M 3.35 (3.50)
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USD/ARS

In default but still hopeful of a compromise solution

Current spot: 69.38



Source: Bloomberg, ING

- Argentina opted to cease servicing external bonds, but negotiations continue, and a compromise solution is still possible in the coming weeks, which would "cure" the default.
- Stringent FX controls have, meanwhile, helped limit the widening premium between the official and the non-official FX rate. But at about 60%, that premium remains exceedingly high, illustrating both Argentina's difficult predicament and the limits of the government's strategy.
- Overall, the ongoing economic crisis appears to have both added urgency and complicated the negotiating process. A compromise solution is still possible, but enormous uncertainty prevails, extending local market instability into the near future.

ING forecasts (NDF)	1M 71.40 (72.67)	3M 76.00 (79.98)	6M 82.00 (90.67)	12M 97.00 (109.72)
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