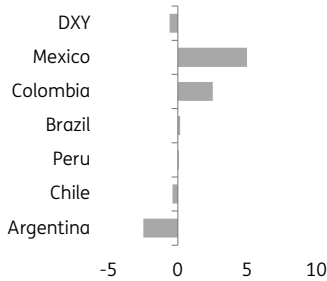


4 September 2020

LATAM FX Talking

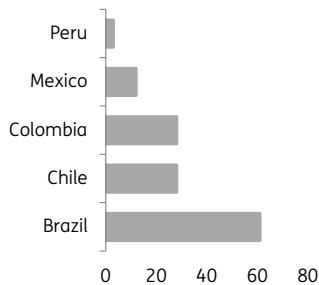
FX gains amid tentative rise in risk appetite

FX monthly change (%)



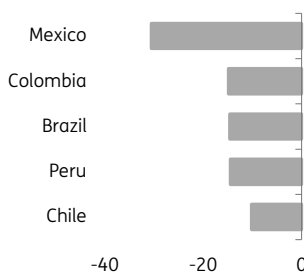
Source: Bloomberg, ING

5yr local rate monthly change (bp)



Source: Bloomberg, ING

5yr CDS monthly change (bp)



Source: Bloomberg, ING

LATAM currencies had mostly failed to benefit from the USD weakening that intensified in July but, judging by the more constructive trends seen in the currencies most affected by the March sell-off, ie, the MXN, the COP and the BRL, risk appetite for the more vulnerable LATAM assets appears to be gradually returning.

This more constructive environment for LATAM FX would be justified as a catch-up to the sharp USD correction seen in recent months, the ongoing uptrend in commodity prices, growing evidence that the Covid-19 spread is subsiding throughout the region and, lastly, evidence that economic activity is recovering a bit faster than previously expected, notably in Brazil and Chile.

Scope for additional appreciation in local assets is still substantial in some places that have been especially affected by selloff, notably Brazil, but LATAM's post-Covid macro outlook looks remarkably challenging.

The region will suffer a deep GDP contraction and a massive deterioration in fiscal metrics, demanding from local governments credible post-pandemic economic recovery plans that also manage to return fiscal accounts to a long-term sustainable path. As seen in Brazil in recent weeks, political pressure to keep fiscal spending elevated beyond 2020 may generate frequent episodes of market volatility, as governments decide how to balance fiscal responsibility and the need to support domestic demand.

With practically no scope left to stimulate demand through rate cuts, apart from Mexico where the policy rate remains close to "neutral" territory, pressure to stretch fiscal stimulus or delay the inevitable fiscal correction should be intense throughout the region, often resulting in the appearance of fiscal populism and market noise. In fact, the recession and the fiscal deterioration should weigh heavily on the outlook for credit-ratings throughout the region, with the threat of loss in investment grade affecting many corporate and sovereign credits in the region, notably in Mexico and Colombia.

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

	USD/BRL	USD/MXN	USD/CLP
1M	5.25 ↓	21.50 ↓	768.00 ↓
3M	5.20 ↓	21.70 ↑	760.00 ↓
6M	5.05 ↓	22.00 ↑	760.00 ↓
12M	4.80 ↓	22.40 ↑	740.00 ↓

	USD/ARS	USD/COP	USD/PEN
1M	76.00 ↑	3650.00 ↓	3.53 ↓
3M	80.00 ↑	3600.00 ↓	3.52 ↓
6M	87.00 ↑	3620.00 ↓	3.50 ↓
12M	100.00 ↑	3720.00 ↑	3.46 ↓

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

Source: Bloomberg, ING ↓

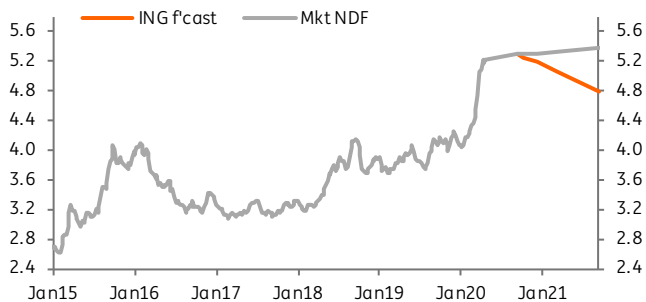
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USD/BRL

Fiscal uncertainties and low local rates intensify volatility

Current spot: 5.30



Source: Bloomberg, ING

- The BRL continues to stand out for its outsized volatility, perhaps the largest in EM. The currency has also been weighed down by lingering post-pandemic fiscal uncertainties and the central bank's aggressive rate-cutting stance.
- The CB confirmed that there's now minimal scope for more rate cuts (from 2.0%), and an additional rate cut appears less likely now, but the bank appears more willing than others to test that lower bound, even at the cost of greater FX volatility.
- The tide would turn in favour of the BRL amid continued evidence of a faster economic recovery and legislative action that confirms a long-term commitment to a sustainable fiscal trajectory.

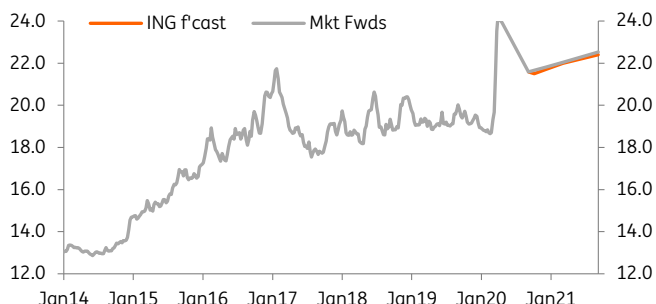
ING forecasts (NDF)	1M 5.25 (5.30)	3M 5.20 (5.31)	6M 5.05 (5.32)	12M 4.80 (5.37)
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USD/MXN

Yield-advantage helps offset policy mistakes

Current spot: 21.59



Source: Bloomberg, ING

- The MXN performed relatively well in recent weeks, catching-up with the weaker USD and benefiting from the supportive carry.
- But Mexico's post-pandemic macro outlook is especially worrying. Its GDP is likely to face one of the deepest slumps in LATAM this year, likely above 10%, but the country has opted for modest countercyclical initiatives, exacerbating the risk of greater permanent damage to the economy and a delayed recovery.
- The administration's frequent disputes with the private sector also continues to undermine investor confidence and call into question whether the MXN's persistent yield advantage would suffice to ensure a supportive MXN environment for too long.

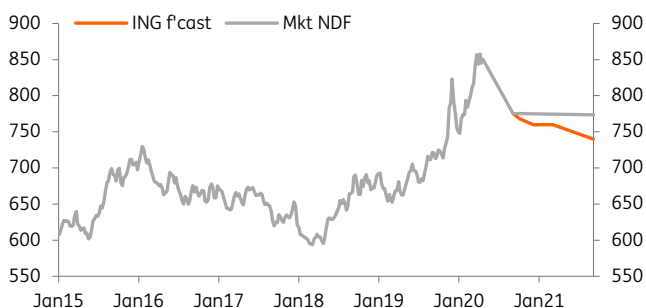
ING forecasts (mkt fwd)	1M 21.50 (21.66)	3M 21.70 (21.82)	6M 22.00 (22.04)	12M 22.40 (22.53)
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USD/CLP

Copper upside limited by the severe domestic crisis

Current spot: 775.08



Source: Bloomberg, ING

- The CLP has been among the best-performing currencies in LATAM in recent months, largely thanks to the sustained rally in copper prices. In fact, if past correlations hold, current price levels for the metal suggests that the currency should strengthen further.
- High copper prices are partly offset by unsupportive domestic drivers, however. The severe Covid-19 crisis and latent political and social risks suggest that the likelihood of a more lasting negative reassessment of the country's macro prospects is likely.
- Chile's assertive policy stimulus bodes well for a faster recovery, as seen in recent data, but the CB's appetite for material stimulus through QE could also add downside for the currency.

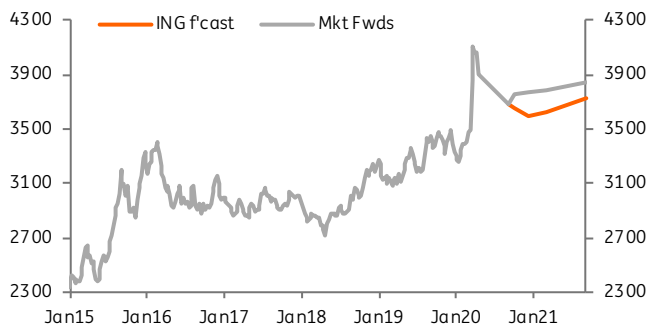
ING forecasts (NDF)	1M 615.00 (634)	3M 620.00 (634)	6M 620.00 (635)	12M 600.00 (638)
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USD/COP

Risk of credit rating downgrades calls for caution

Current spot: 3685.61



Source: Bloomberg, ING

- The COP performed relatively well in recent weeks, but we remain worried about the lasting post-pandemic fiscal damage, and Colombia's precarious "investment grade" status amid continued elevated risk of rating downgrades. Overall, risk of FX outflows should persist until long-term fiscal dynamics are re-anchored.
- The possibility of additional rate cuts, from 2.0% now, is also unsupportive for the COP, but current monetary policy guidance is closer to neutral, suggesting a higher bar for additional cuts.
- The recovery in crude prices, a crucial near-term FX driver, helps reduce fiscal risks but, considering lingering risks to the macro outlook, we see little scope for lasting COP outperformance.

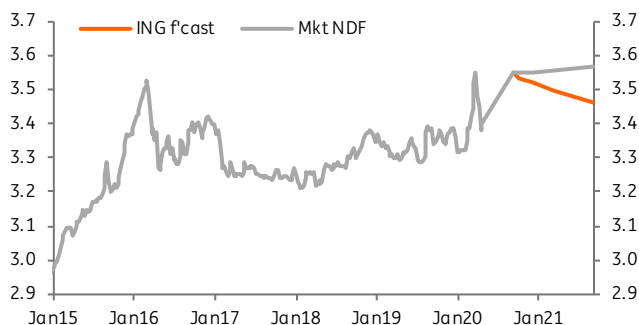
ING forecasts (NDF)	1M 3650 (3751.26)	3M 3600 (3768.01)	6M 3620 (3790.40)	12M 3720 (3838.75)
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USD/PEN

Aggressive stimulus is unable to prevent a deep recession

Current spot: 3.55



Source: Bloomberg, ING

- Like Chile, Peru is suffering one of the most severe consequences of the Covid-19 outbreak in LATAM. This, together with controversial initiatives advancing in Congress and lingering political instability, add important macroeconomic headwinds for local assets.
- Peru's superior ability to deploy economic policy stimulus, including large fiscal outlays and the lowest policy rate in LATAM, should help alleviate the impact of the crisis, but having had the worst contraction in the region so far, it's hard to be optimistic.
- Large FX reserves suggest, however, that Peru should be able to continue to heavily manage its FX dynamics, and shield the PEN from the wider fluctuations that typically affect its EM peers.

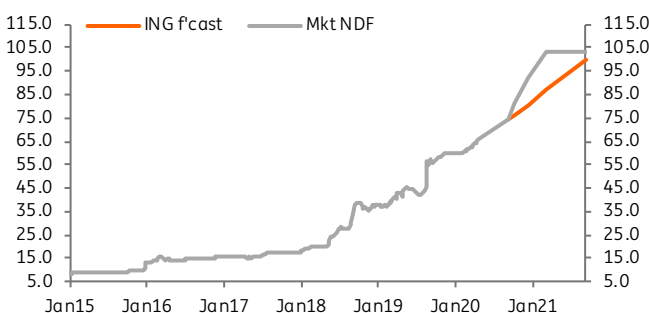
ING forecasts (NDF)	1M 3.53 (3.55)	3M 3.52 (3.55)	6M 3.50 (3.56)	12M 3.46 (3.57)
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USD/ARS

Optimism as debt-renegotiation concludes successfully

Current spot: 74.38



Source: Bloomberg, ING

- The successful conclusion of the negotiations with external bondholders has allowed Argentina to avoid a hard default and start re-negotiating with the IMF.
- Having said that, restoring Argentina's macroeconomic outlook towards a sustainable trajectory will be a difficult undertaking, requiring the adoption of a credible policy plan, with the IMF's imprimatur, to revive investor sentiment towards the country.
- The rising fiscal toll and the monetisation of fiscal accounts amplified inflation risks and helped widen the premium between the official and the non-official FX rate, which remains a crucial barometer for domestic policy credibility, to more than 70% now.

ING forecasts (NDF)	1M 76.00 (81.35)	3M 80.00 (92.20)	6M 87.00 (103.50)	12M 100.00 (103.21)
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