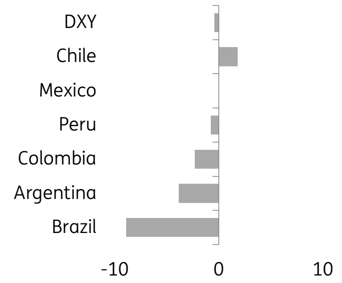
11 January 2021

LATAM FX Talking

FX gains lose steam as correction takes hold

FX monthly change (%)



Source: Refinitiv, ING

After ending 2020 with a firmly bullish momentum, LATAM FX markets are correcting, largely in reaction to rising US Treasury yields and the stronger USD. We don't expect this trend to last. In that case, we see greater scope for outperformance in Brazilian and Colombian assets, while Mexican assets remain attractive but seem nearer fair value, in our view.

Despite improved prospects for additional fiscal stimulus measures in the US, soft activity data, weighed down by the still-rising Covid-19 spread, should prevent any near-term change in the US Fed's policy guidance, which should help re-ignite the USD-weakness trend.

The vaccine-fuelled global recovery should, meanwhile, help revive risk appetite and benefit EM assets in general. This suggests that, despite lingering concerns, notably the fiscal weakness seen throughout LATAM, we consider that attractive valuations, higher commodity prices and a faster recovery, as the region avoids additional lockdowns, bode well for a constructive 2021 for local assets in LATAM.

Fiscal concerns are likely to remain elevated in the region throughout 2021, following the sharp deterioration suffered during the pandemic. Fiscal concerns are highest in Brazil, and much more modest in Mexico. But this difficulty in normalizing fiscal spending post-pandemic, and to bolster fiscal frameworks to return fiscal trajectories to a sustainable path, is playing out in most countries in the region.

Appetite for local assets may also hinge on post-pandemic growth-trajectories, with noted upside for Brazil and Colombia. A constructive outlook for commodity prices should also benefit Andean FX in general, but political risk is high in Chile and Peru.

Lastly, monetary policy could turn into another important catalyst for relative FX performance. Here the focus will be on Brazil and Mexico, with the bias pointing towards a sooner-than-previously-expected rate-hiking cycle in Brazil and a deeper-than-expected rate-cutting cycle in Mexico. Monetary policy has been, arguably, the most important domestic driver for the strength of the Mexican peso versus the Brazilian real in recent quarters. And as the policy rate rises in Brazil while falling in Mexico, the balance-of-risks should become more supportive of the BRL, in relation to the MXN.

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

	USD/BRL		USD/MXN		USD/CLP	
1M	5.30	↓	19.75	↓	705.00	↓
3M	5.10	↓	19.60	↓	685.00	↓
6M	4.90	↓	19.70	↓	695.00	↓
12M	4.90	↓	20.00	↓	700.00	↓
	USD/ARS		**USD/COP**		**USD/PEN**	
1M	88.00	↑	3460.00	↓	3.60	→
3M	91.70	↓	3420.00	↓	3.62	↑
6M	101.00	↓	3370.00	↓	3.60	↓
12M	123.00	↓	3350.00	↓	3.58	↓

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

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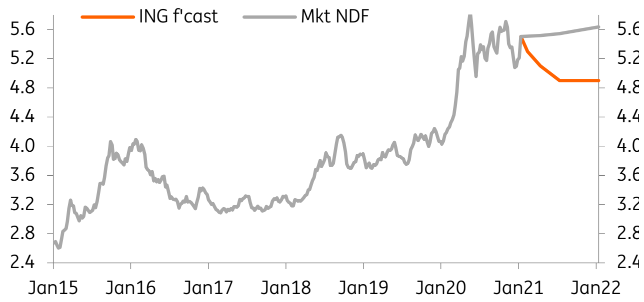
USD/BRL

Improved outlook for FX flows adds support to the BRL

Current spot: 5.50



Source:

- Fiscal concerns remain elevated amid political uncertainty related to the February election of Congressional leaders.
- Covid-19 cases have increased but robust domestic activity data along with stronger risk appetite for EM assets, and a weaker USD, bode well for local market assets in the coming months.
- Brazil's fiscal challenges suggest however that fiscal risk is unlikely to vanish, with local markets marked by high volatility exacerbated by the low benchmark rate, which should remain unchanged at 2% for longer than the market expects. Having said that, we now expect a very gradual rate-normalization process to start before mid-year, bringing some support to the BRL.

ING forecasts (NDF)	**1M** 5.30 (5.51)	**3M** 5.10 (5.52)	**6M** 4.90 (5.54)	**12M** 4.90 (5.64)

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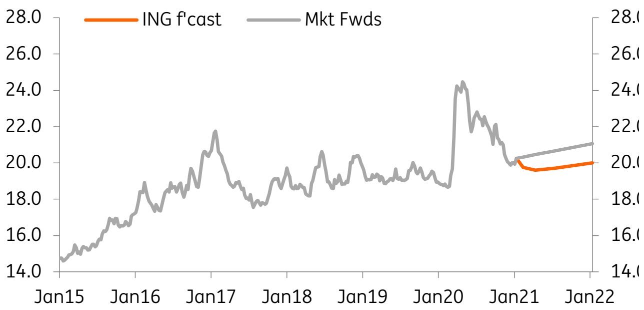
USD/MXN

Yield-advantage continues to help offset policy mistakes

Current spot: 20.25



Source:

- The MXN should continue to benefit from its yield-advantage relative to LATAM majors, and be regarded as a safer choice to boost EM exposure in the context of a weakening USD and low global rates, but the dire outlook for economic activity suggests that an under-performing bias should gradually emerge.
- That bias would intensify if the monetary policy guidance turns markedly dovish, which could happen once monetary policy board composition turns from the 3 vs. 2 hawkish split seen in December into a 3 vs. 2 dovish split as of next month.
- In that case, we suspect Banxico could cut the policy rate by as much as 100bp in the coming months.

ING forecasts (mkt fwd)	**1M** 19.75 (20.33)	**3M** 19.60 (20.45)	**6M** 19.70 (20.66)	**12M** 20.00 (21.06)

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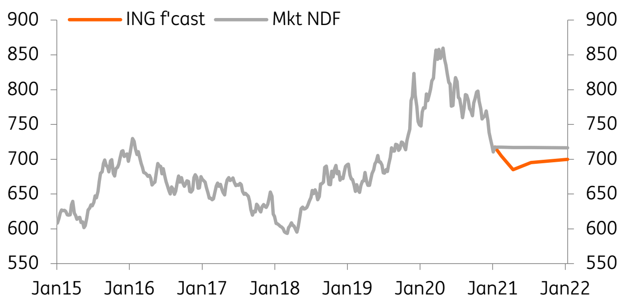
USD/CLP

Copper upside limited by elevated domestic uncertainties

Current spot: 719.64



Source:

- The CLP was the best-performing currency in 2020 in LATAM and, if past correlations hold, the currency could strengthen some more on the back of elevated copper prices in 2021.
- Signs of a faster recovery are also emerging, amid Chile's assertive policy stimulus and pension fund withdrawals. But the heavy electoral calendar and latent social risks call for caution and, in our view, other commodity exporters offer greater upside.
- The election of a constitutional convention to rewrite the country's constitution is set for April and general elections in November, suggesting that a lasting negative reassessment of the country's macro prospects is possible during 2021.

ING forecasts (NDF)	**1M** 705.00 (719.39)	**3M** 685.00 (719.06)	**6M** 695.00 (718.86)	**12M** 700.00 (718.61)

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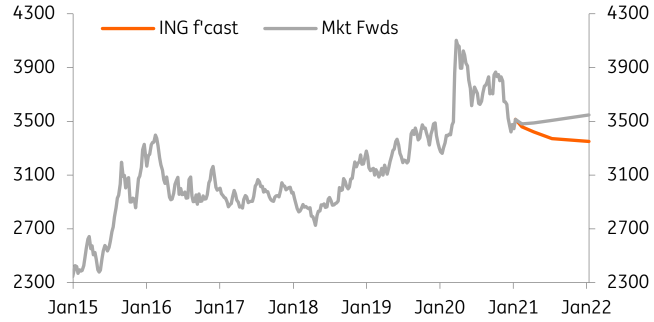
USD/COP

Upside for a commodity-driven rally in the COP stands out

Current spot: 3514.5



Source:

- The COP's near-term outlook looks especially promising on the back of the combination of strong global risk appetite, an attractive valuation and rising oil prices.
- The pair could potentially move towards the 3400-3300 range should oil prices rise some more, but medium term dynamics remain clouded by the lasting post-pandemic fiscal damage Colombia will face, and the need to approve legislation to re-anchor fiscal accounts and its "investment grade" status.
- Relative to its Andean neighbours, the COP offers a higher benchmark rate, reduced political noise and a larger potential for appreciation if oil prices continue to rise.

ING forecasts (NDF)	**1M** 3460.00 (3480.9)	**3M** 3420.00 (3487.9)	**6M** 3370.00 (3507.5)	**12M** 3350.00 (3546.8)

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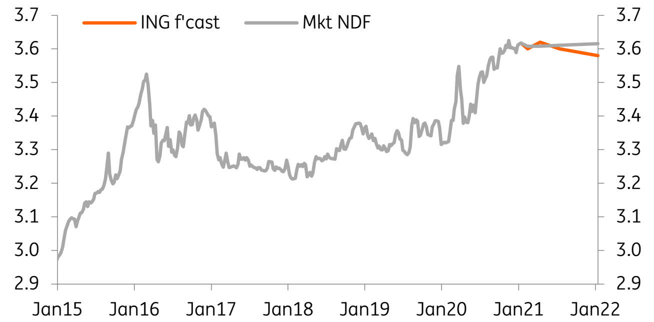
USD/PEN

Lingering political crisis requires caution

Current spot: 3.62



Source:

- Peru has arguably suffered the most severe consequences of the Covid-19 outbreak in LATAM. This, together with the tremendous political instability seen in recent months, add important macroeconomic headwinds for local assets.
- The election of a president with a working legislative majority in the April election is essential to end years of political dysfunction that have resulted in very unstable presidential mandates.
- BCRP's large FX reserves suggest that the country 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. But until political risks are mitigated, hopefully through the April election, local market upside should remain limited.

ING forecasts (NDF)	**1M** 3.60 (3.61)	**3M** 3.62 (3.61)	**6M** 3.60 (3.61)	**12M** 3.58 (3.62)

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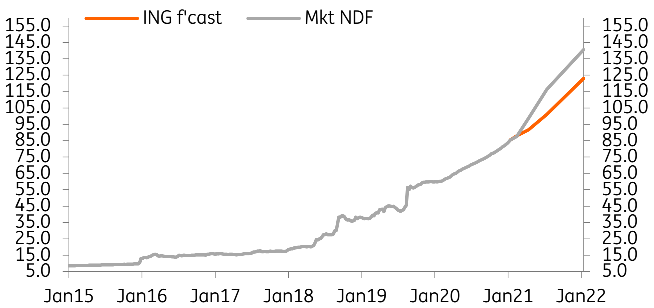
USD/ARS

Muddling through and hoping for an IMF deal

Current spot: 85.39



Source:

- BCRA's chief FX policy goals appear to be avoiding a one-off ARS devaluation, keeping the monthly FX depreciation trend in line with inflation, and lowering the gap between the official and the non-official FX rate. The hope is to muddle through until April, when external trade flows are expected to boost FX inflows.
- Until then, FX restrictions should prevail, to minimize outflows.
- After that, officials hope that an eventual deal with the IMF helps restore market confidence, boosting FX inflows. The timing and the long-terms sustainability of IMF negotiations remain uncertain, calling into question the government's strategy and keeping a depreciating bias on the ARS in place.

ING forecasts (NDF)	**1M** 88.00 (87.51)	**3M** 91.70 (98.77)	**6M** 101.00 (116.35)	**12M** 123.00 (140.58)

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