14 June 2019

LATAM FX Talking

Looking for strong domestic drivers

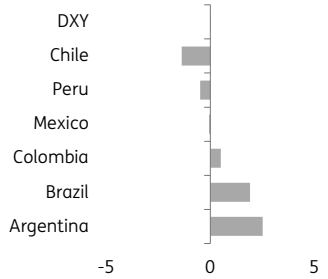
The external risk environment could stay unfavourable, with the US-China trade impasse looking to persist and potentially worsen before a compromise solution is arrived at, possibly early next year. Rate cuts in the US, and possibly in Europe, could bring some relief but, overall, the market environment should continue to be more favourable for currencies that are likely to be less sensitive to external drivers, or that have a strong domestic driver to offset external headwinds. In that case, the Brazilian BRL stands out, on the back of expected passage of landmark social security reform as early as mid-July, while the commodity exporters in the Andes, notably Chile's CLP, should continue to underperform.

In the case of **Brazil**, all eyes will be on Congress, where the amended version of the social security reform is expected to be approved by the Special Committee by the end of the month. This would pave the way for the all-important first-round vote by the entire Lower House to take place by mid-July. Should the reform get approved, the BRL could experience the largest appreciation in the region over the next 3 months, possibly reaching the 3.3-3.4 range. The FX rally would, meanwhile, be a chief catalyst for the central bank to implement a relatively frontloaded monetary easing cycle. Among other things, this should help limit the BRL rally and eventually help the currency to stability around equilibrium in the 3.6-3.7 range.

The outlook for the **Mexican peso** has become cloudier, with the renewal of external trade uncertainties and the faster-than-expected ratings downgrades. The latter could eventually trigger PEMEX-related financial instability, amid forced-selling, if the company is downgraded to "junk". Those uncertainties should extend Banxico's caution and delay a dovish shift for monetary policy, with high rates acting as the chief FX anchor.

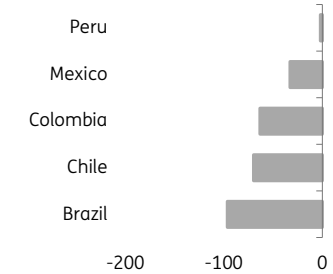
In **Argentina**, investors reacted well to the running-mate choices made by both President Mauricio Macri and Cristina Kirchner, which appeared designed to polarize the campaign while, at the same time, bridge the gap between the two candidates, and take the oxygen out of the candidacy of Roberto Lavagna. The August 10 primaries will be the big event here, which should provide important clues about who will win the October race.

FX monthly change (%)



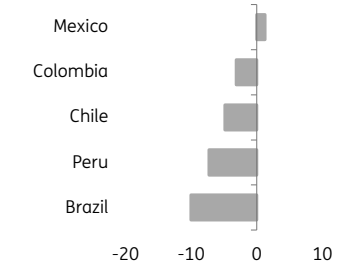
Source: Bloomberg, ING

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	3.70	↓	19.20	→	697.00	→
3M	3.40	↓	19.50	↑	705.00	↑
6M	3.60	↓	19.40	↓	700.00	↑
12M	3.70	↓	19.50	↓	670.00	↓

	USD/ARS		USD/COP		USD/PEN	
1M	44.00	↓	3280.00	↑	3.34	↑
3M	45.50	↓	3300.00	↑	3.34	→
6M	47.00	↓	3280.00	↓	3.35	↓
12M	50.50	↓	3200.00	↓	3.31	↓

↑/→/↓ 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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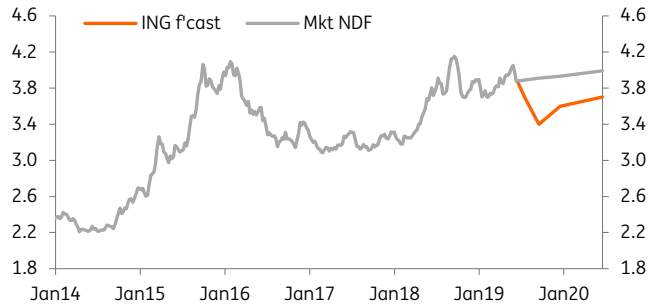
USD/BRL

Crunch time for the social security reform

Current spot: 3.88



Source: Bloomberg, ING

- The social security reform debate is reaching its final stage in Lower House, with the first-round vote by the entire House possibly taking place within the next month, before July 15.
- The political momentum has improved, with support for the reform broadening, but pressure by special-interest groups keeps the risk of erosion in the projected savings from the reform high.
- Thanks to the improved political momentum, the BRL has outperformed recently, but uncertainty about the reform's approval should keep volatility high. Underweight investor positioning suggests that decisive progress in the reform's approval could trigger an overshooting, towards 3.30-3.40.

ING forecasts (NDF)	**1M** 3.70 (3.89)	**3M** 3.40 (3.91)	**6M** 3.60 (3.93)	**12M** 3.70 (3.99)

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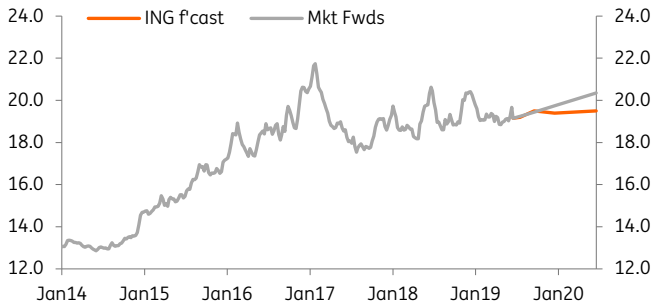
USD/MXN

External headwinds intensify

Current spot: 19.15



Source: Bloomberg, ING

- Despite intensifying headwinds over the past month, the MXN remains a standout outperformer YTD. Future prospects have deteriorated however, with the renewal of external trade uncertainties and the faster-than-expected ratings downgrades.
- Those uncertainties should extend Banxico's caution and delay a dovish shift for monetary policy, with high rates acting as the chief FX anchor.
- Recent developments deepened concerns about Mexico's economic growth outlook, and the risk of PEMEX-related financial instability has increased, amid potential forced-selling triggered by a possible classification as "junk" by rating agencies.

ING forecasts (mkt fwd)	**1M** 19.20 (19.24)	**3M** 19.50 (19.44)	**6M** 19.40 (19.75)	**12M** 19.50 (20.35)

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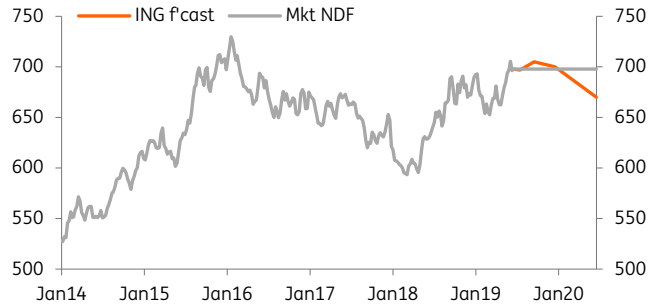
USD/CLP

Trade war concerns continue to drive CLP outlook

Current spot: 697.73



Source: Bloomberg, ING

- As a small open economy, with an export basket heavily skewed towards copper, the CLP has traded with a persistent weakening bias in recent months, consistent with the sell-off in copper prices seen as a result of lingering trade-war concerns.
- Lack of progress in the US-China trade-war impasse in the coming months should extend that weakening bias.
- While external drivers dominate, local macro trends have also become less supportive for the CLP. Inflation remains subdued while economic activity indicators have softened, dragged by mining, which pushed BCCh to surprise the market with a large 50bp cut, reversing the hikes seen over the past year.

ING forecasts (NDF)	**1M** 697.00 (698)	**3M** 705.00 (698)	**6M** 700.00 (698)	**12M** 670.00 (698)

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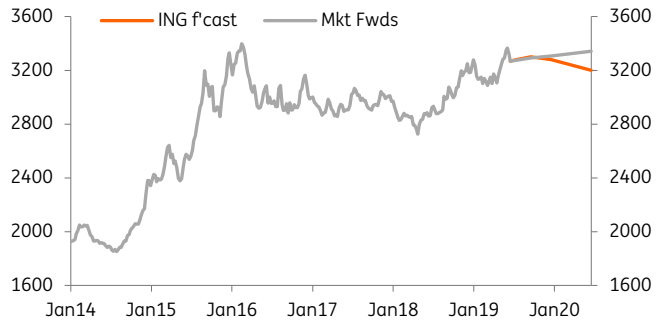
USD/COP

Balance of risks is looking more favourable to the COP

Current spot: 3267.90



Source: Bloomberg, ING

- Perhaps exacerbated by portfolio outflows and the less attractive carry, the COP continues to be especially sensitive to global risk appetite and USD fluctuations generally.
- The currency's underperformance this year was also justified by the sell-off in oil prices seen recently, even though the COP's correlation with oil has fallen sharply in recent months.
- Domestic drivers are more constructive than its peers in the region, which should limit further underperformance. GDP growth is on track to expand near its potential this year while on-target inflation suggests an extended period of neutral monetary policy guidance. Improved growth is also supportive of fiscal accounts, with improved targets limiting downside risk to credit ratings.

ING forecasts (NDF)	**1M** 3280.00 (3275)	**3M** 3300.00 (3292)	**6M** 3280.00 (3305)	**12M** 3200.00 (3341)

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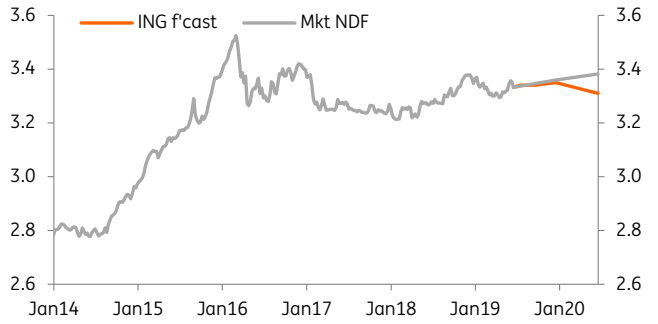
USD/PEN

Solid macro trends help offset trade-war concerns

Current spot: 3.33



Source: Bloomberg, ING

- As usual, the PEN traded with the lowest volatility in the region, trading near stability over the past month. Even though it's a small open economy heavily reliant on commodity exports, the currency remains the least affected by the USD move and the risk aversion that affected its peers in the region.
- Eventual positive developments on the US-China trade-war front would add support to the currency, with the USDPEN once again consolidating below 3.30. But the potential for BCRP's FX intervention would likely limit any sustained rally.
- Peru's BCRP should extend the current neutral bias for the policy rate (2.75%) for the foreseeable future amid moderate economic activity and on-target inflation.

ING forecasts (NDF)	**1M** 3.34 (3.34)	**3M** 3.34 (3.35)	**6M** 3.35 (3.36)	**12M** 3.31 (3.38)

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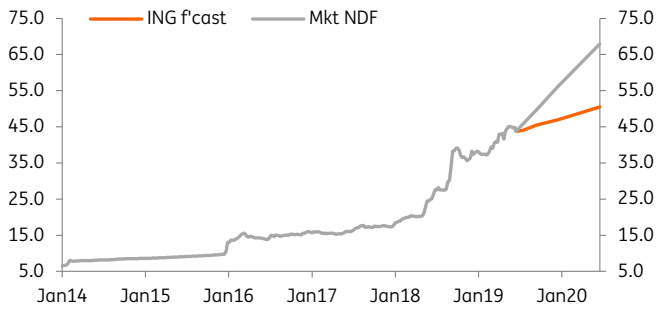
USD/ARS

Presidential race narrows

Current spot: 43.75



Source: Bloomberg, ING

- Investors have reacted well to the latest political developments, which showed both Cristina Kirchner and Mauricio Macri aligning themselves with centrist candidates, in an effort to broaden their support and polarise the race.
- FX intervention and high interest rates should help support local assets but any evidence that the Kirchnerist ticket would win in the October election should weigh on asset prices. The August 11 primaries are the chief near-term catalyst for local assets.
- Beyond that, given Argentina's macro vulnerabilities, prospects for policy changes following the October election should drive asset prices. Risk that locals shift their holdings away from ARS deposits (into hard currency/goods) should be monitored.

ING forecasts (NDF)	**1M** 44.00 (45.78)	**3M** 45.50 (49.92)	**6M** 47.00 (56.14)	**12M** 50.50 (67.94)

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