ING

Economic & Financial Analysis

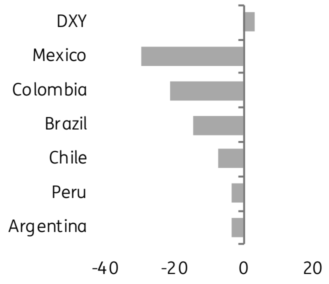
FX

20 March 2020

LATAM FX Talking

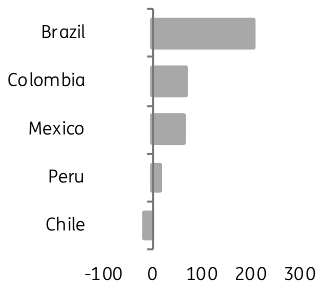
Crowded trades suffer in rush to the exit

FX monthly change (%)



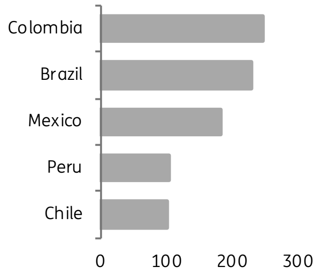
Source: Bloomberg, ING

5yr local rate monthly change (bp)



Source: Bloomberg, ING

5yr CDS monthly change (bp)



Source: Bloomberg, ING

The flight-to-quality that roiled financial markets has led to a reversal-of-fortunes type of scenario for LATAM FX, with the Mexican peso weakening the most after leading EM FX performance for several quarters. The popularity of the trade, together with the "perfect storm" scenario resulting from the rout in oil prices and the fact that Mexico is likely to be among the most affected in LATAM from the economic disruption caused by the coronavirus outbreak.

This reflects Mexico's more globally-integrated manufacturing supply-chain, the larger share of tourism in its GDP and the fact that Mexico's energy industry plays a larger role in its macro outlook. Mexico is now more vulnerable to a downgrade from its investment-grade status, which could trigger material disruption in local financial markets.

Other credits that we consider in greater danger of credit-rating downgrades are Chile and Colombia, but downgrades there seem less imminent or far less disruptive as, in principle, both would remain investment grade credits. In Brazil, its CB appears well-prepared to deploy its ample intervention potential to ensure the liquidity of FX markets. Even though there's limited scope for fiscal stimulus, the "public calamity" declaration was an effective way to ensure that temporary fiscal relief does not translate into permanent fiscal damage, as the underlying fiscal regime remains unaltered.

Ultimately, much should depend on the ability of local economies to prevent the ongoing liquidity crunch faced by households and corporates to turn into solvency issues. But not every country has the capacity to deploy resources effectively while ensuring that the necessary short-term fiscal weakening does not translate into permanent damage to its long-term fiscal outlook.

Given that much of the recent FX dynamics is being driven by risk aversion and portfolio reallocation, forecasting should remain an especially perilous exercise in the near term, with the prevalence of excessively wide trading ranges. FX intervention has been effective at limiting liquidity constraints in some markets, but it's not enough to reverse the trend. Once risk aversion stabilizes, the aggressive rate cuts by the US Fed could also eventually translate into a weaker USD, bringing some support to EM FX at a later stage.

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

	USD/BRL		USD/MXN		USD/CLP	
1M	5.30	↑	25.00	↑	880.00	↑
3M	5.00	→	23.50	↓	850.00	↑
6M	4.50	↓	23.00	↓	800.00	↓
12M	4.10	↓	21.50	↓	770.00	↓
	USD/ARS		**USD/COP**		**USD/PEN**	
1M	65.00	↓	4200.00	↑	3.58	↑
3M	68.00	↓	3850.00	↑	3.54	↓
6M	75.00	↓	3600.00	↓	3.50	↓
12M	90.00	↓	3400.00	↓	3.45	↓

>/=/< 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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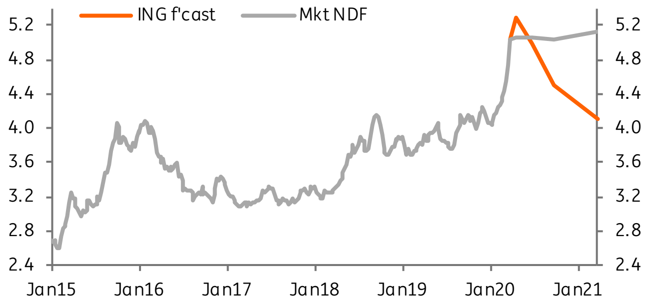
USD/BRL

Ready to deploy all the available tools **Current spot: 5.04**



Source: Bloomberg, ING

- The Brazilian CB is prepared to deploy all its tools to ease FX liquidity constraints, including FX swaps, spot and FX-repo lines, and views its discretion to announce intervention as an asset.
- This heavy battery of intervention has been effective to improve the overall performance of the BRL, relative to its EM peers, but extremely wide trading ranges should prevail in the nearer term.
- Liquidity constraints should continue to exacerbate volatility but Brazil's superior ability to provide liquidity through intervention and idiosyncratic factors such as reduced demand for FX hedge to offset long positions local portfolios (after their sharp loss in value) suggest a relatively improved BRL environment.

ING forecasts (NDF)	1M 5.30 (5.05)	3M 5.00 (5.06)	6M 4.50 (5.04)	12M 4.10 (5.13)

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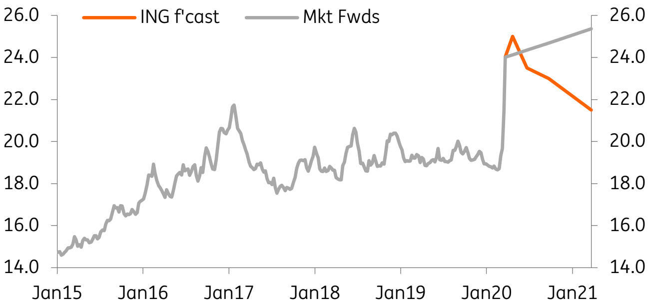
USD/MXN

A "perfect storm" scenario becomes reality **Current spot: 24.01**



Source: Bloomberg, ING

- The MXN's reign as the "best-performing" currency across EM came into a hard crash in recent weeks as the peso's previous carry-induced popularity helped exacerbate the sell-off amid the sharp flight-to-quality that took hold of global financial markets.
- The shift was also aggravated by Mexico's own vulnerability to oil prices, the reduced capacity (relative to its size) to intervene to ease liquidity problems, and the fact that Mexico's economy may be among the most affected in LATAM, from the ongoing crisis.
- The risk of more permanent damage to Mexico's long-term outlook (and its credit rating) also rose sharply and suggest a more difficult recovery and extended market volatility.

ING forecasts (mkt fwd)	1M 25.00 (24.13)	3M 23.50 (24.35)	6M 23.00 (24.68)	12M 21.50 (25.36)

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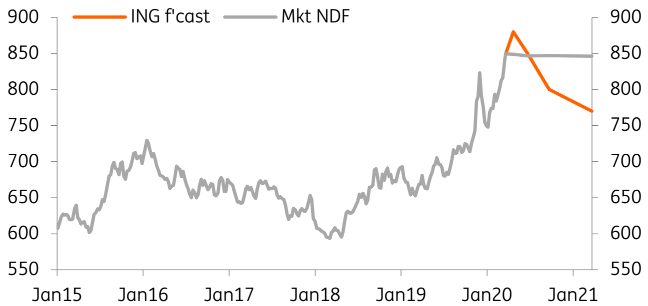
USD/CLP

The most aggressive stimulus program in the region **Current spot: 849.53**



Source: Bloomberg, ING

- The Chilean government has stood out as the most aggressive in the region in announcing both monetary and, especially, fiscal stimuli to mitigate the economic impact of the crisis.
- The CB set the policy rate at 1%, after a 75bp emergency-meeting rate cut, announced credit-enhancing initiatives to support local banks, and extended its FX intervention program while the government announced a 5%-of-GDP fiscal package.
- The CLP's performance has improved, in relative terms, but this reflects in earlier underperformance. As it stands, judging by current copper price levels and risk appetite, the currency looks fairly-priced and should perform largely in line with its EM peers.

ING forecasts (NDF)	1M 880.00 (849)	3M 850.00 (847)	6M 800.00 (847)	12M 770.00 (846)

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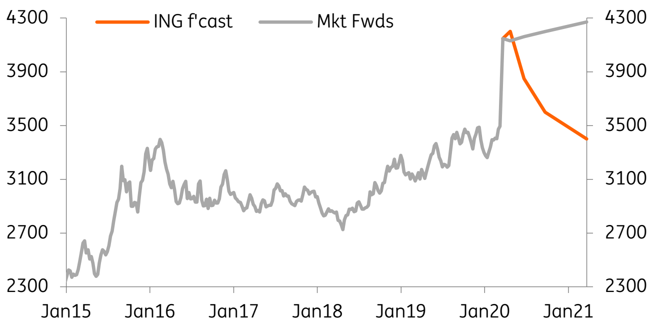
USD/COP

Facing twin-shocks from a stronger starting point **Current spot: 4070.90**



Source: Bloomberg, ING

- The sharp COP sell-off is justified by the twin shocks represented by the economic crisis and the collapse oil prices. For now, the CB has intervened in FX markets but refrained from cutting rates.
- The good GDP growth seen until recently and lingering worries about Colombia's wide current account deficit, reduces the urgency to stimulate the economy, allowing the bank to focus on financial market stability, but there's scope for rate cuts later.
- The declaration of economic emergency allows for temporary fiscal relief without permanent fiscal damage, but Colombia's oil-sensitive fiscal outlook has weakened, and future action may be needed to avoid a downgrade in its credit-rating.

ING forecasts (NDF)	**1M** 4200.00 (4071)	**3M** 3850.00 (3612)	**6M** 3600.00 (4134)	**12M** 3400.00 (4283)

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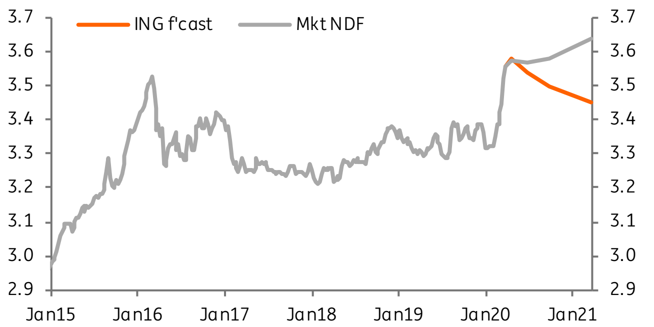
USD/PEN

Solid macro trends help offset global risk worries **Current spot: 3.56**



Source: Bloomberg, ING

- The PEN also reached fresh all-time lows recently, but it continues to trade with less volatility, as usual, and to outperform its commodity exporter peers.
- 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.
- In an emergency meeting, Peru's BCRP cut the policy rate by 100bp to 1.25% and signalled that it could do more to help offset economic impact of the lockdown. Solid fiscal accounts also imply some room for fiscal stimulus, without long-term damage

ING forecasts (NDF)	**1M** 3.58 (3.57)	**3M** 3.54 (3.57)	**6M** 3.50 (3.58)	**12M** 3.45 (3.64)

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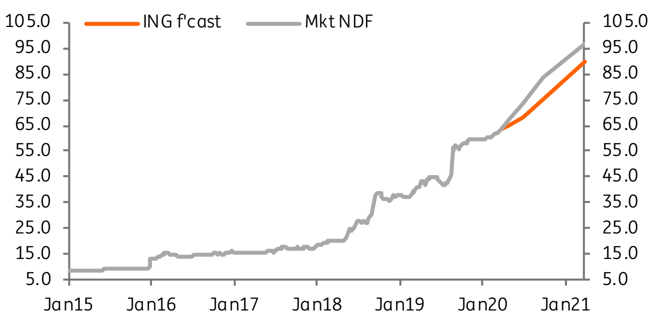
USD/ARS

Debt negotiations on hold, risk of default rises **Current spot: 63.75**



Source: Bloomberg, ING

- The administration continues to struggle to finance itself, while poor initial macro conditions suggest that the risk of an even deeper recession than the one seen in the past couple of years.
- Local bonds should continue to be swapped/reprofiled while the delay caused by the virus outbreak suggests that a solution to the external debt-renegotiation process is unlikely before May, when higher maturity levels could heighten noise and uncertainties, weighing further on local market stability.
- FX will continue to be managed with a mix of stringent controls and intervention, ensuring some stability for the official FX rate, and a significant real appreciation relative to its regional peers, even as its premium relative to the non-official rate rises.

ING forecasts (NDF)	**1M** 65.00 (67.42)	**3M** 68.00 (73.85)	**6M** 75.00 (83.32)	**12M** 90.00 (96.49)

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