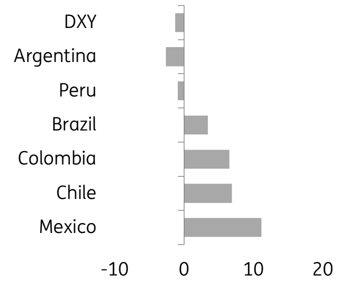
26 May 2020

# LATAM FX Talking

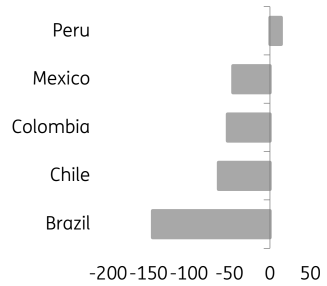
## Incipient recovery in risk appetite brings relief

**FX monthly change (%)**



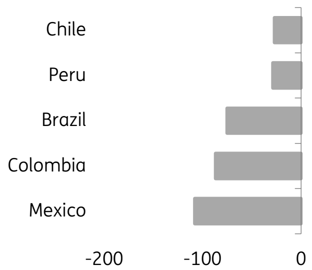

Source: Bloomberg, ING

**5yr local rate monthly change (bp)**




Source: Bloomberg, ING

**5yr CDS monthly change (bp)**




Source: Bloomberg, ING

**The incipient improvement in risk appetite seen in recent weeks led to considerable gains for most LATAM currencies in recent weeks, resulting in levels not seen since early March. The Brazilian BRL continues to stand out for its relatively poor performance, but recent sessions suggest that an inflection point may have been reached, and that more favourable FX dynamics may take hold from now on. The standout outperformer was, meanwhile, the Mexican peso, which continues to benefit from the currency's persistent yield-advantage.**

Given the elevated uncertainties regarding the health crisis and the still unstable global risk appetite, it may be too soon to tell, but it seems that LATAM's worst-performing currency (the BRL) may have found a bottom. This reflects, to a large extent, the greater certainty provided recently by Brazil's central bank. Recent statements by Brazilian officials suggest greater resolve to support FX markets by limiting additional rate cuts. The dramatic reduction in Brazil's reference rate that has taken place since the approval of the social security reform last year was, arguably, the chief responsible for the BRL's underperformance for almost one year now.

Despite the constructive market environment seen in recent weeks, the economic outlook for LATAM economies looks grim, as the Covid-19 health crisis remains unabated despite the strict social-distancing procedures that have been implemented since March.

The growing economic pain resulting from the collapse in economic activity, together with widespread labour informality throughout the region, suggest that extending social-distancing measures should become increasingly difficult. This suggests that "lockdowns" may be lifted even though there's limited evidence of "curve flattening" throughout the region. As a result, the toll represented by the Covid-19 outbreak should remain hard to assess and could take longer to abate.

These uncertainties suggest that it's going to be hard to be optimistic about in region's outlook. A particular source of concern is likely to be the fiscal toll represented by the deep recession and the greater spending needed to fight the pandemic, and each country's ability to keep fiscal accounts in a sustainable trajectory. Brazil should remain an especially important source of concern here, but we also worry about the potential deterioration 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 | ↓ | 22.00 | ↓ | 800.00 | ↓ |
| 3M | 5.10 | ↓ | 21.50 | ↓ | 780.00 | ↓ |
| 6M | 4.85 | ↓ | 22.10 | ↓ | 770.00 | ↓ |
| 12M | 4.70 | ↓ | 23.00 | ↓ | 770.00 | ↓ |
| | **USD/ARS** | | **USD/COP** | | **USD/PEN** | |
| 1M | 70.00 | ↓ | 3700.00 | ↓ | 3.40 | ↓ |
| 3M | 74.00 | ↓ | 3640.00 | ↓ | 3.38 | ↓ |
| 6M | 80.00 | ↓ | 3570.00 | ↓ | 3.35 | ↓ |
| 12M | 95.00 | ↓ | 3400.00 | ↓ | 3.30 | ↓ |

>/=/< 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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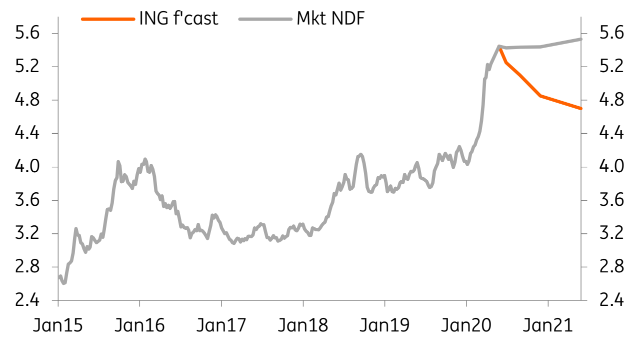
# USD/BRL

**Less dovish monetary signalling brings respite for the BRL**

**Current spot: 5.45**




Source: Bloomberg, ING

- The BRL appears to have finally found a bottom after CB officials emphasized the limits for additional rate cuts, while stressing their concern that further rate cuts could destabilise FX markets.
- Officials also renewed their resolve to intervene in FX markets. But, in our view, the firmer indication that the rate-cutting cycle is nearly over, with room for only one additional 75bp cut, to 2.25%, is the crucial factor helping limit additional FX weakness.
- Investors and monetary authorities also worry about a persistent damage to Brazil's fiscal outlook. Political noise and initiatives to support a permanent increase in fiscal spending are key sources of concern, that should help keep fiscal risks elevated in 2H20.

| | | | | |
|---|---|---|---|---|
| **ING forecasts** (NDF) | **1M** 5.25 (5.43) | **3M** 5.10 (5.43) | **6M** 4.85 (5.44) | **12M** 4.70 (5.53) |

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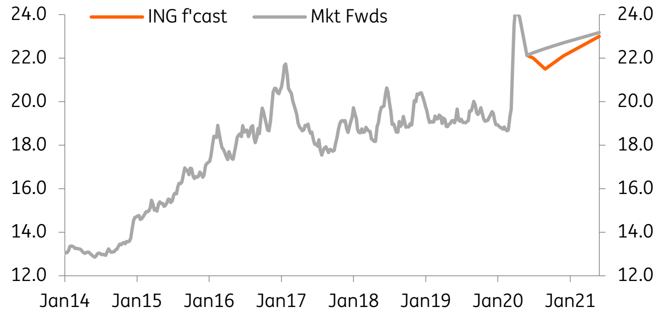
# USD/MXN

**MXN to remain supported by its yield-advantage**

**Current spot: 22.14**




Source: Bloomberg, ING

- Mexico's CB has shown greater willingness to support economic activity through rate cuts. But dovish developments elsewhere suggest that the MXN's yield advantage may continue to benefit the currency, in relation to its LATAM peers, in the nearer term.
- We expect Banxico to cut its refence rate to 4.0% by August, after three additional 50bp cuts during "emergency" and regularly-scheduled meetings.
- Credit rating agencies have downgraded Mexico recently, with the collapse in oil prices likely acting as a chief catalyst. Further downgrades are possible, but Mexico still retains a credit-rating advantage relative to regional peers like Brazil and Colombia.

| | | | | |
|---|---|---|---|---|
| **ING forecasts** (mkt fwd) | **1M** 22.00 (22.25) | **3M** 21.50 (22.44) | **6M** 22.10 (22.71) | **12M** 23.00 (23.18) |

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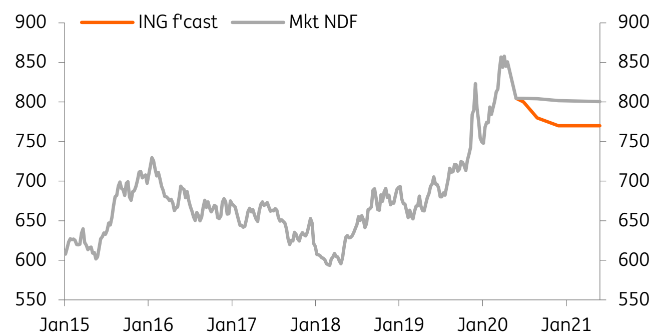
# USD/CLP

**Aggressive stimulus program could facilitate recovery**

**Current spot: 804.71**




Source: Bloomberg, ING

- Chile's assertive policy stimulus implies a faster recovery, 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 CB lowered the policy rate to its "technical minimum" of 0.5%. A broad range of liquidity provisions should help ease financial conditions while an IMF credit line should help boost sharply 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** 800.00 (805) | **3M** 780.00 (804) | **6M** 770.00 (802) | **12M** 770.00 (800) |

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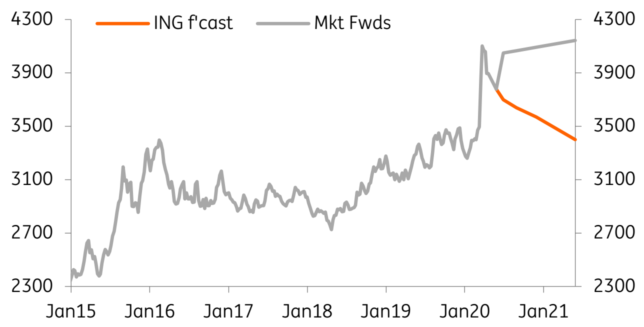
## USD/COP

### Recovery in oil prices offers important upside

**Current spot: 3778.46**




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 COP looks fairly priced, closely following the evolution of oil prices, which should remain the most important near-term FX driver. This adds a potential upside for the COP, if crude prices extend the recent trajectory, while Colombia's relatively higher reference rate (3.25%) could act as an FX stabilizer.

| ING forecasts (NDF) | 1M | 3M | 6M | 12M |
|---|---|---|---|---|
| | 3700.00 (4048.00) | 3640.00 (4065.00) | 3570.00 (4092.00) | 3400.00 (4143.00) |

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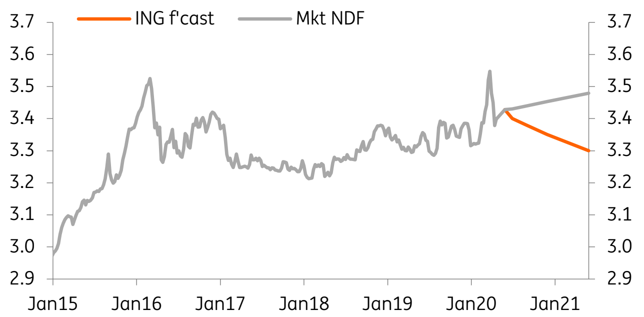
## USD/PEN

### Aggressive stimulus to limit the economic downside

**Current spot: 3.43**




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 if risk appetite continues to recover.
- 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 | 3M | 6M | 12M |
|---|---|---|---|---|
| | 3.40 (3.43) | 3.38 (3.44) | 3.35 (3.45) | 3.30 (3.48) |

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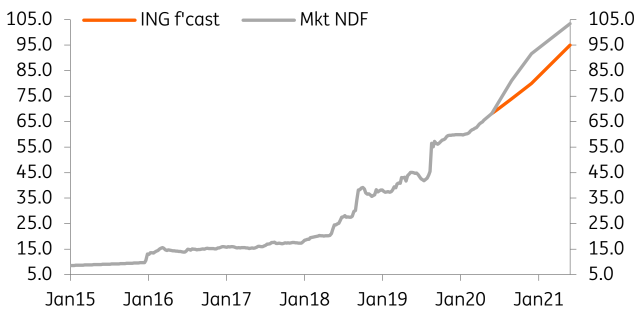
## USD/ARS

### Officially in default, but debt negotiations continue

**Current spot: 68.17**




Source: Bloomberg, ING

- The administration's external debt exchange offer was rejected by a large majority of external bondholders, as expected.
- The limited progress in the negotiations led Argentina to opt to cease servicing external bonds, moving closer to a default and extending the widening premium between the official and the non-official FX rate. The situation remains fluid however, as negotiations continue, and the default can still be "cured" if an agreement is reached in the coming weeks.
- In our view, 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 | 3M | 6M | 12M |
|---|---|---|---|---|
| | 70.00 (72.58) | 74.00 (81.12) | 80.00 (91.69) | 95.00 (103.42) |

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