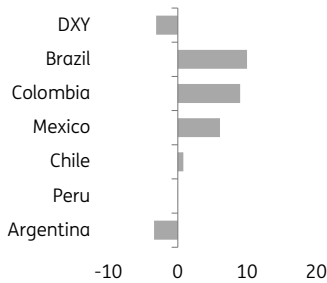


4 December 2020

# LATAM FX Talking

## FX gains as risk appetite solidifies

FX monthly change (%)



Source: Refinitiv, ING

**LATAM FX markets have turned decidedly bullish in the final weeks of the year. Despite lingering concerns, notably the fiscal weakness seen throughout the region, attractive valuations and favourable prospects for higher commodity prices and a faster recovery, as the region avoids additional Covid-19 disruptions, bodes well for a constructive 2021.**

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, including in Chile, Peru and Colombia.

The 2021 outlook 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.

Overall, in this more benign environment from EM FX in general, and a weaker USD, we see greater scope for outperformance in Brazilian and Colombian assets. Mexican assets remain attractive, in our view, but the rally seen in recent months have brought local assets closer to fair value, in our view.

In particular, the COP and the BRL stand out in the region as the currencies with the strongest potential for appreciation in 2021. Even though the potential for appreciation appears largest in the BRL, the COP may offer the best risk-reward proposition.

Brazil's fiscal outlook is much more challenging and less certain than Colombia's, while we also see greater upside for Colombia's oil-driven terms-of-trade than for Brazil's more diversified export basket.

From a political risk point of view, Colombia also stands out as a safer alternative in LATAM, when considering the tumultuous 2021 electoral cycle projected for Peru and Chile, along with mid-term elections in Mexico and a very active Brazilian Congress that's likely to keep headline risk elevated.

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

	USD/BRL				USD/MXN	
1M	5.20	→	19.80	↓	750.00	↓
3M	5.15	↓	19.80	↓	750.00	↓
6M	5.10	↓	19.70	↓	750.00	↓
12M	5.00	↓	20.00	↓	760.00	↑
	USD/ARS				USD/COP	
1M	84.00	↓	3500.00	↓	3.60	→
3M	89.50	↓	3450.00	↓	3.62	↑
6M	99.00	↓	3400.00	↓	3.60	→
12M	125.00	↓	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

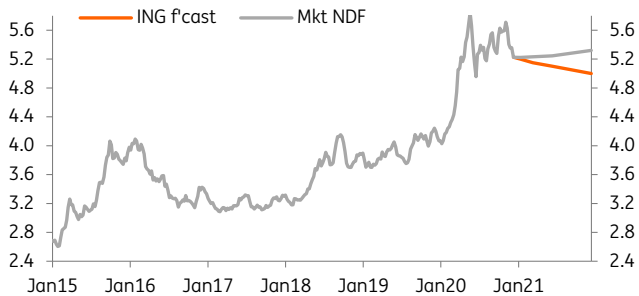
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## USD/BRL

### Some relief on the fiscal front

**Current spot: 5.17**



Source: Refinitiv, ING forecast

- Fiscal concerns remain elevated but prospects for a more constructive outlook have emerged as the government and Congress appear committed to tighten fiscal accounts in 2021.
- Robust domestic activity data along with stronger risk appetite for EM assets, and a weaker USD, also bode well for local market assets in the coming weeks.
- Brazil's challenging fiscal dynamics suggest however that fiscal uncertainties are unlikely to vanish, with local markets marked by high volatility exacerbated by the low benchmark rate. In fact, despite the temporary spike in inflation, we expect the policy rate to remain unchanged at 2% for longer than the market expects.

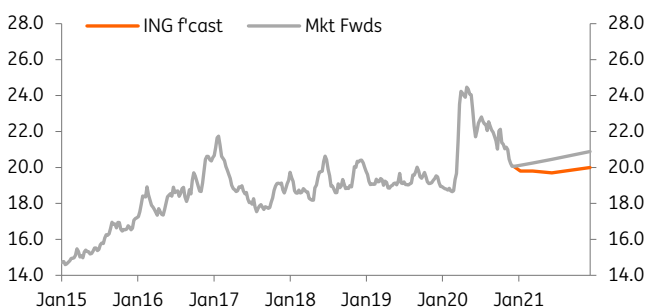
<b>ING forecasts (NDF)</b>	<b>1M 5.20 (5.22)</b>	<b>3M 5.15 (5.23)</b>	<b>6M 5.10 (5.25)</b>	<b>12M 5.00 (5.32)</b>
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## USD/MXN

### Yield-advantage helps offset policy mistakes

**Current spot: 19.84**



Source: Refinitiv, ING forecast

- The Mexican administration's chosen economic policy strategy, marked by a relatively hawkish fiscal and monetary policy stances, continues to help boost appetite for some local assets.
- The unusually modest policy stimulus is not without risks, as it should deepen the recession and likely harm Mexico's long-term trajectory. But, in the shorter-term, it should continue to be seen by investors as a safer path, when compared to regional peers.
- Even though FX and FI valuations are getting rich, when compared to some regional peers, Mexico should remain attractive and seen as the safer choice to boost LATAM/EM exposure in the context of a weakening USD and low global rates

<b>ING forecasts (mkt fwd)</b>	<b>1M 19.80 (20.13)</b>	<b>3M 19.80 (20.25)</b>	<b>6M 19.70 (20.45)</b>	<b>12M 20.00 (20.89)</b>
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## USD/CLP

### Copper upside limited by persistent domestic crisis

**Current spot: 749.3**



Source: Refinitiv, ING forecast

- The CLP was the best-performing currency YTD in LATAM and, if past correlations hold, the currency could strengthen further 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, suggest that a lasting negative reassessment of the country's macro prospects is possible during 2021.

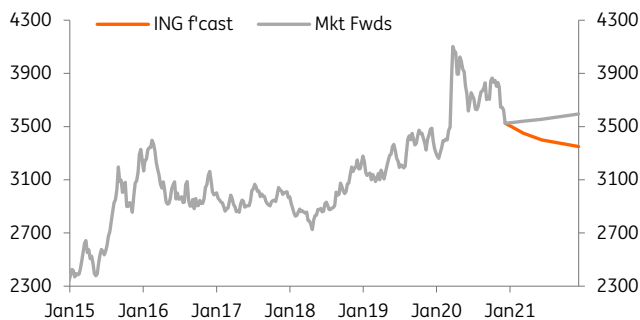
<b>ING forecasts (NDF)</b>	<b>1M 750 (755.03)</b>	<b>3M 750 (754.47)</b>	<b>6M 750 (753.95)</b>	<b>12M 750 (753.27)</b>
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## USD/COP

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

Current spot: 3456



Source: Refinitiv, ING forecast

<b>ING forecasts (NDF)</b>	<b>1M 3500 (3530)</b>	<b>3M 3450 (3540)</b>	<b>6M 3400 (3555)</b>	<b>12M 3350 (3595)</b>
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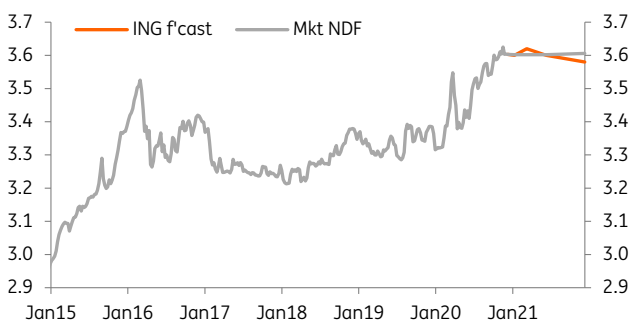
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- We remain worried about the lasting post-pandemic fiscal damage Colombia will face, and the need to approve legislation to re-anchor fiscal accounts and its “investment grade” status.
- The increase and partial withdrawal of the IMF’s FCL was well-received and helped reduce fiscal funding risks while improving global risk appetite and an attractive valuation suggest greater scope for COP outperformance in 2021.
- Relative to its Andean neighbours, the COP offers a higher benchmark rate, reduced political noise and a larger potential for appreciation if oil prices follow the appreciation trajectory our commodity analysts expect for 2021.

## USD/PEN

Lingering political crisis requires caution

Current spot: 3.59



Source: Refinitiv, ING forecast

<b>ING forecasts (NDF)</b>	<b>1M 3.60 (3.60)</b>	<b>3M 3.62 (3.60)</b>	<b>6M 3.60 (3.60)</b>	<b>12M 3.58 (3.61)</b>
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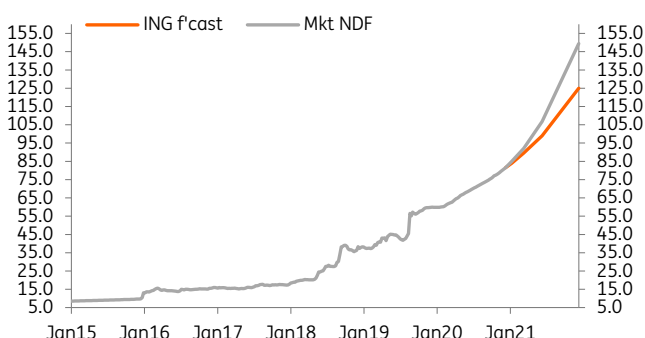
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- Peru has arguably suffered the most severe consequences of the Covid-19 outbreak in LATAM. This, together with the tremendous political instability seen in recent months, add important macroeconomic headwinds for local assets.
- The election of a 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.

## USD/ARS

Negotiations with the IMF continue in uncertain path

Current spot: 81.6.



Source: Refinitiv, ING forecast

<b>ING forecasts (NDF)</b>	<b>1M 84.00 (85.07)</b>	<b>3M 89.50 (92.07)</b>	<b>6M 99.00 (106.77)</b>	<b>12M 125.00 (149.44)</b>
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- The Argentinean government has announced some monetary and fiscal policy tightening initiatives that have been well-received by investors.
- Those initiatives have had limited success in mitigating FX pressures, amid continued concerns over dwindling FX reserves and political disputes within the government’s political base. There remains strong resistance to fiscal austerity measures that would likely be included in any IMF-sponsored program.
- Going forward, we expect the ARS to follow CPI dynamics more closely, as the government continues to resist bigger FX corrections for fear of exacerbating inflation dynamics.

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