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## Theme #12: Tequila sunset – buy USD/MXN, buy BRL/CLP

The last few weeks of 2017 were uncharacteristically eventful in LatAm FX as the region's largest economies experience a tumultuous year-end due to a events ranging from monetary policy surprises to impeachment votes. We expect LatAm FX to continue to be driven mostly by idiosyncratic stories as our growth, inflation, and monetary policy forecasts vary substantially across countries and Presidential elections are scheduled to take place in Brazil and Mexico.

### Mexico: short MXN despite a more hawkish Banxico

The central bank surprised markets by hiking its policy rate 25bp in its December meeting despite Mexico's negative output gap and a relatively benign future scenario for inflation. The tone of the meetings' minutes was noticeably more hawkish than that of previous months. And while Banxico officially does not have a target for the currency the price action of the MXN and the Exchange Commission's decision to increase the amount of their DNDF-based intervention lead us to believe that the weak MXN might have triggered Banxico's decision. Yet we think a more hawkish Banxico is unlikely to prevent the USD/MXN from rallying. Noise regarding NAFTA has been muted over the past few weeks but is likely to pick up when negotiations resume in Montreal on January 23rd. While political representatives did not attend the fifth round to de-escalate tensions at the negotiating table they will all attend the Canadian round. Also, domestic political noise is also likely to be MXN-negative as Andrés Manuel López Obrador's chances of becoming President are likely to rise: Margarita Zavala has gathered the required number of signatures to run as an independent. In short, while a higher interest rate and a more activist central bank might limit the extent of an MXN weakening we still like being long USD/MXN as over the next few months the cross could reach 19.8 and even 20 before Banxico or the Exchange Commission intervene decisively enough to bring the cross below 20.

### BRL likely to remain stable until Carnaval: Long BRU/CLP

Last year ended in Brazil without Government being able to get Congress to go along a reform to social security. Amendments to the State-funded pension system are crucial to ensure the medium-term sustainability of Brazil's fiscal accounts. In fact, once it became clear that a social security reform vote would have to wait until 2018, the noise associated to a likely downgrade of Brazil's sovereign credit rating picked up considerably especially after several local media outlets reported Finance Minister Meirelles had held conference calls with rating agencies. While the government denied Meirelles had discussed any possible downgrades the concern regarding Brazil's government accounts are only likely to increase going forward. Brazil's Presidential elections later in the year are likely to make a social security reform even less likely. And as economic growth picks up and capital imports rise the current account deficit is likely to widen. Yet while the BRL is likely to weaken later in the year, we think the triggers for a repricing of the Real only become likely in March once the Brazilian summer is over and political activity in Congress resumes in earnest. Until then, we recommend being long BRL/CLP (target 195) to take advantage of Brazil's still elevated carry. We favor CLP funding as the recent appreciation of the peso after the Presidential election not only leaves limited room for a further rally but also increases the pressure on the BCCh to reduce the interest rate.

*Sebastian Brown, New York*