



Additionally, after the Central Bank of Mexico suspended the "stabilization" mechanism, we would not be surprised if a new "reserve accumulation" rule is installed if the speed of appreciation increases. While any potential negative effects in the currency will likely be short lived (barring any disappointment in the reform agenda) we have recommended tactically taking profits in our long held short USD/MXN recommendation <sup>2</sup> (closing: 11.96, entry: 12.68). Investors willing to position for residual upside could benefit from still reduced volatility by entering some bullish options strategies (either 1x2 USD/MXN put spreads or knock-outs).

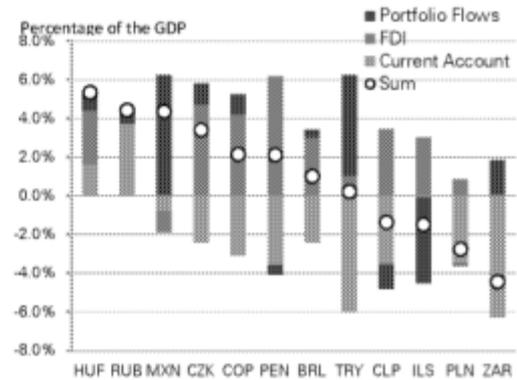
Andean currencies may suffer relatively more from weakening fundamentals, but we think that the downside may be limited.

In particular, we do not see much upside potential in the CLP, but the combination of elevated yield and relatively low volatility makes it an attractive carry proposition for those willing to position for the global recovery. Nevertheless, as fundamentals gradually weaken, the risk of intervention is also fading away. The recent correction in commodity prices, especially copper, has driven the CLP away from intervention levels (perceived to be around 460), to the extent that some statements by CB president Vergara vouching for a weaker currency took the market by surprise. Depending on its persistence, this novel shock to the terms of trade could worsen an already complicated current account balance. Additionally, economic activity seems to be entering the long awaited deceleration path. In our view, the carry trade on EUR/CLP is an attractive alternative to position for loose monetary policies at the core (current: 618, entry: 616, target: 602, stop: 626).

In Colombia, policymakers under-delivered in terms of FX market intervention after signaling that the currency was unacceptably expensive. Nevertheless, some noise remains due to proposed changes in pension funds' minimum return calculation.<sup>3</sup> While it is difficult to determine the potential impact of this measure (early calculations point to a range of 1bn to 5bn of USD demand), this should not have an important direct short-run impact in the COP (beyond market anticipation). With the currency trading around away from the perceived 1800 intervention threshold, we have recommended taking profits in long USD/COP

(closing:1830, entry:1819) and waiting for some potential retracement to re-enter.

Figure 3: Capital flows help to cover growing current account deficits



Source: Deutsche Bank

The PEN finally suffered a meaningful correction on the back of some news regarding the potential acquisition of a stake in a private oil company by a public one and weakening external accounts. But after briefly touching 2.65, the currency recovered to the 2.60 level. Barring any external surprises, and taking into consideration the new boost to global liquidity, PEN should remain relatively anchored on the back of strong FDI flows but the change in CB intervention is evidently beginning to have the desired effect of increasing the volatility of the currency. Considering the almost non-existent carry, we recommend remaining neutral on USD/PEN.

All in all, the tide is beginning to change in LatAm FX. While some currencies still offer some attractive carry (BRL or even CLP) and other have some (medium-term) upside potential (MXN), gradually weakening fundamentals could increase the relevance of differentiation.

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<sup>2</sup> See *Emerging Market Monthly: Flow Motion*, May 10 2013.

<sup>3</sup> The draft by the Superintendent of Pension Funds suggests it could induce pension funds to follow a minimum share of foreign assets, which is slightly above current portfolios' allocation.