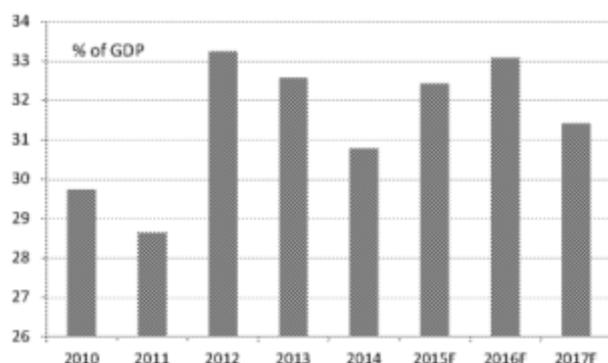


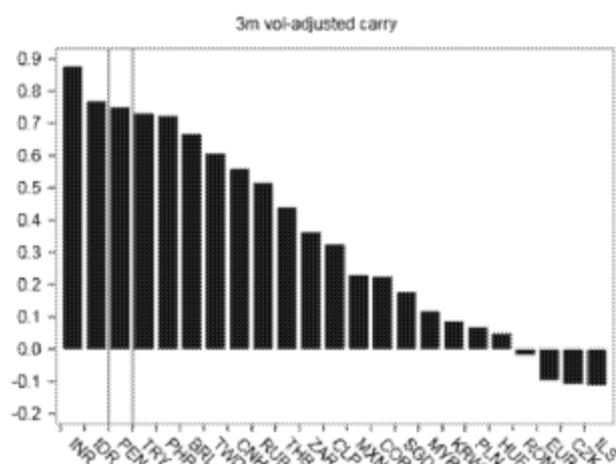


Peru's Reserve to GDP ratio



Source: Deutsche Bank, Bloomberg Finance LP

PEN scores well on the vol-adjusted carry metric



Source: Deutsche Bank, Bloomberg Finance LP

In contrast to MXN, COP has been relatively resilient in recent weeks after being the worst performer in the region in 2015. Although COP, CDS and TES continue to trade very closely to oil, the change in BanRep's intervention rule (the trigger to sell 1M USD calls/COP puts moved from 7% to 5% above the 20d MA) led to a considerable rally in COP in the last days of 2015. Since then, the currency has been slowly weakening in line with the sell-off in oil, a trend we believe will continue in 2016 even if "risk on" sentiment eventually resumes. This is predicated on three arguments: a more dovish BanRep in terms of monetary policy (despite the overshooting in inflation), further deterioration on the CA (imports stickiness) and an increase in risk-premium due to fiscal woes. From the RV perspective the undervaluation of MXN/COP vs. the current levels of oil is clear, and in relative terms COP has greater exposure than MXN to further crude weakness (a major risk factor for 2016).

Copper block and intervention willingness: Long PEN/CLP (target 230 stop 205 ref:212)

Falling copper prices and a flight to dollar deposits fueled by rising depreciation expectations led the PEN to slip 12% vs. USD in 2015. Interventions in the spot market (USD7.3bn in net sales) and through FX swaps (USD8bn outstanding) have assuaged pressures and as a result PEN depreciation was not as extensive as that of other commodity exporters in the region. With foreign reserves still amounting to 32% of GDP (13% net of banks' reserve requirements), the BCRP has enough firepower to absorb additional external shocks. Further, given the relatively high inflation pass-through and the dollarization of the economy we believe that this trend of relative outperformance vs. other regional commodity exporters will persist in 2016.

Therefore, PEN should remain highly managed and strengthen relative to regional peers in 2016. CLP is in our view a natural candidate to fund PEN longs despite the light positioning, valuation and better fundamentals. The explicit BCCh stance regarding FX intervention, a relatively flat rates curve, progressively lower inflation pass-through, low foreign participation in local markets and the advanced stage of the country's external adjustment all support the case for a free-floating CLP (much needed for a small open economy like Chile). Further, the PEN/CLP cross significantly reduces exposure to copper, though is not entirely copper-neutral.

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