The LatAm FX Strategist

Don't get carried away

25 January 2024

GEM FI & FX Strategy
LatAm

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Summary of FX views

With almost every major LatAm central bank easing monetary policy, the question is how far they could go. Absent any global shocks, our view is that LatAm central banks have significant space to cut, posing downside risks on FX as support from carry may fade.

ARS (bearish*): The new government is implementing a decisive stabilization plan, which may need additional FX depreciation. We see USD/ARS at 2,200 by 2024-end.

BRL (bullish*): We expect BRL to outperform the rest of LatAm FX, as we expect economic trends to favor Brazil in 2024. We see USD/BRL at 4.75 by 2024-end.

CLP (neutral*): Lower policy risks and potentially higher rates may provide support but risks of FX reserve accumulation limit upside. We see USD/CLP at 900 by end-2024.

COP (bearish*): We expect COP to underperform LatAm FX, as macro fundamentals and crowded positioning remove support. We see USD/COP at 4,100 by 2024-end.

MXN (bearish*): We have strong conviction MXN will weaken in 2024 amid Banxico's easing cycle, weak growth, and political noise. We see USD/MXN at 18.50 by 2024-end.

PEN (neutral*): A deep easing cycle should weigh on the currency, but a rebound in GDP growth may provide support. We see USD/PEN at 3.76 by 2024-end.

UYU (bearish*): Strong FDI and exports should keep improving external accounts. Yet, unattractive valuation and policy risks may weigh. We see USD/UYU at 41 by 2024-end.

CACs: We are bearish CRC amid the continuing easing cycle and bullish DOP on the back of strong growth. We see USD/CRC at 564 and USD/COP at 60 by 2024-end.

Exhibit 1: BofA quarter-end FX forecasts
We are bearish ARS, bullish BRL, neutral CLP, bearish COP, bearish MXN, neutral PEN

		Forecasts			
Currency	**View/bias**	**1Q '24**	**2Q '24**	**3Q '24**	**4Q '24**
USD/ARS (official)	bearish*	1100	1500	1670	2200
USD/ARS (blue chip)	--	1595	2025	2088	2640
USD/BRL	bullish*	4.90	4.88	4.80	4.75
USD/CLP	neutral*	920	910	905	900
USD/COP	bearish*	4,000	4,050	4,075	4,100
USD/CRC	bearish*	526	538	551	564
USD/DOP	bullish*	58.8	59.0	59.3	60.0
USD/MXN	bearish*	17.8	17.9	18.3	18.5
USD/PEN	neutral*	3.75	3.76	3.76	3.76
USD/UYU	bearish*	40.5	40.6	40.9	41.0

Source: BofA Global Research

BofA GLOBAL RESEARCH

*Note: bullish/neutral/bearish labels are relative to 1-quarter-ahead forward contracts.

Timestamp: 25 January 2024 10:28PM EST

Argentina

FX Views and forecasts

View: bearish*

The new government of President Javier Milei is implementing a decisive stabilization plan that includes a large fiscal adjustment, a strong devaluation, an IMF staff-level agreement to obtain a USD 4.7bn loan disbursement, and a set of pro-growth structural reforms. We expect official FX depreciation to accelerate in February and the FX gap to gradually narrow. We see USD/ARS at 2,200 by 2024-end.

Key macro developments: The government is seeking to stabilize the economy. On the fiscal front, it announced a balanced budget target implying a 5% of GDP fiscal adjustment in 2024. Out of the total, 3pp will be carried out via expenditure cuts and 2pp via revenue measures. Early consumption indicators hint to a deep recession in 1Q24, but a better harvest should support revenue in 2Q24.

The government devalued the currency, increasing the USD/ARS rate by 120% in December, which combined with Argentina's persistent capital controls allowed a strong accumulation of FX reserves of around USD 3.5bn. This initially allowed a sharp drop in the parallel FX gap to 12%, though a slow ARS depreciation of 2% has put pressure, bringing the gap back to 60%. In our view, BCRA will have to accelerate depreciation in February. Inflation was 25.5% mom in December, the highest since February 1991. While it remains a challenge, the jump is partly a one-off relative price correction following FX devaluation and de-regulation. We expect inflation to stand at 200% in 2024, down from 211% in 2023.

The government also reached an IMF staff-level agreement allowing access to a USD 4.7bn disbursement, committing to a USD 10bn FX reserve accumulation target by 2024-end and to eliminating the multiple FX regime.

Valuation: Overvalued by 63% according to our medium-term Compass BEER model. Overvalued by 4.2% according to our long-term Compass FX model.

Positioning: Market short (-14). Hedge funds short (-40), real money long (+12).

Risks to our view: A slower-than-expected depreciation or fiscal adjustment; social unrest.

Upcoming risk events: Structural reform debate (ongoing); approval of IMF staff-level agreement by the IMF board (1Q24).

Corporate hedging: We recommend hedging given risk of faster depreciation pace due to imbalances.

Exhibit 2: USD/ARS forecasts vs forwards

We forecast USD/ARS at 1500 by 2Q '24

	current	chg		
Spot	822	+6		
	Forecast		Forward	
Period	current	chg	current	chg
1Q 2024	1,100	-98	961	-21
2Q 2024	1,500	-73	1317	+3
3Q 2024	1,670	-256	1625	+34
4Q 2024	2,200	-130	1889	+1

Source: BofA Global Research, Bloomberg

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Exhibit 3: USD/ARS blue chip forecasts

We forecast USD/ARS at 2025 by 2Q '24

	current	chg
Spot	1316	+155
	Forecast	
Period	current	chg
1Q 2024	1,595	-79
2Q 2024	2,025	+43
3Q 2024	2,088	-189
4Q 2024	2,640	+145

Source: BofA Global Research, Bloomberg

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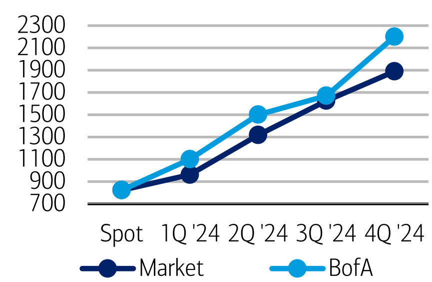
Exhibit 4: USD/ARS forecasts vs forwards

We are bearish vs. forwards for 2Q '24



Source: BofA Global Research, Bloomberg

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Brazil

FX Views and forecasts

View: bullish*

We expect BRL to outperform the rest of LatAm FX, as we expect economic trends to favor Brazil in 2024. BRL will continue to be supported by an attractive real interest rate differential, a reduction in fiscal risks amid a primary balance reduction, continued trade surpluses, attractive valuation, and relatively neutral positioning. We see USD/BRL at 4.75 by 2024-end.

Key macro developments: BCB kept easing rates in December, cutting the policy rate by 50bp to 11.75%. Guidance remained unchanged as minutes highlighted preference to keep the current pace of easing over the next two meetings. Moreover, inflation was 4.6% yoy in December, ending the year within the tolerance range (3.25% +/- 1.5pp) after two years of missed inflation targets. We believe inflation will continue its downward trend, reaching 3.7% yoy by 2024-end. The supportive headline and underlying inflation dynamics support our call for 50bp cuts and one final cut of 25bp in July. We see the Selic rate at 9.50% in 2024-end.

We continue to expect economic activity to slow in 2024, but to remain relatively resilient. We forecast GDP growth at 2.2% in 2024, well-above the 1.6% consensus. Domestic consumption continues to weaken amid the delayed effects of tight monetary policy. However, we believe that the Brazilian oil sector may continue to support GDP growth in coming years (see The oil frontier shines bright with promise). An oil boom is positive for growth, trade, fiscal and the BRL. Last year, the oil and derivatives trade balance surplus reached a record 1.3% of GDP. Moreover, there is still untapped potential in reserves' exploration, suggesting room for further growth. All in, we forecast it will peak in 2029 at 2.3% of GDP. The positive impact to net exports and the boost to investments has the potential to improve GDP growth by up to 3% in the next five years.

Valuation: Undervalued by 0.5% according to our medium-term Compass BEER model. Overvalued by 6.4% according to our long-term Compass FX model.

Positioning: Market long (+5). Hedge funds short (-45), real money long (+27).

Risks to our view: Fiscal slippage or faster monetary policy easing in Brazil.

Upcoming risk events: BCB meeting (Jan 31, Mar 20).

Corporate hedging: We recommend taking advantage of BRL rallies to hedge.

Rates: Lower/steeper. We expect BCB to continue cutting rates at 50bp pace.

Exhibit 5: USD/BRL forecasts vs forwards
We forecast USD/BRL at 4.88 by 2Q '24

	current	chg		
Spot	4.93	+0.1		
	Forecast		**Forward**	
Period	**current**	**chg**	**current**	**chg**
1Q 2024	4.90	-0.10	4.97	+0.07
2Q 2024	4.88	-0.07	5.01	+0.07
3Q 2024	4.80	-0.05	5.06	+0.07
4Q 2024	4.75	-	5.11	+0.07

Source: BofA Global Research, Bloomberg

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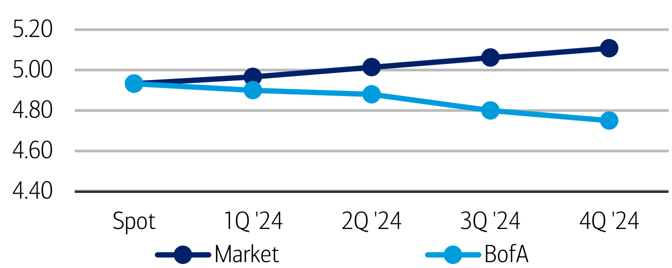
Exhibit 6: USD/BRL forecasts vs forwards
We are bullish with respect to forwards for 2Q '24



Source: BofA Global Research, Bloomberg

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Cross currency basis

Exhibit 7: Cupom cambial contracts

Cupom cambial rates are -76bp on average over the past 3m

Contract	Last	1w chg	3m chg	1y chg	Min	Last vs 1y Avg	Max	1y Avg	1w vol	3m vol	3m z-score	1y z-score
Jan25	599	2	-63	20	517		682	614	18	65	-0.7	-0.4
Jan26	546	3	-79	8	475		652	570	19	66	-0.6	-0.6
Jan27	524	3	-85	2	466		637	551	19	67	-0.6	-0.7

Source: BofA Global Research, Bloomberg

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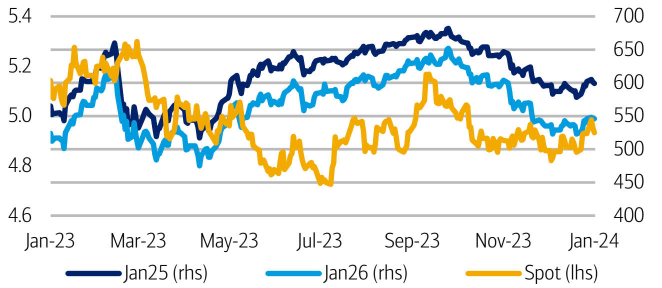
Exhibit 8: Short-term Cupom Cambial rates vs USD/BRL spot

Short-term Cupom Cambial rates stands at 549bp



Source: BofA Global Research, Bloomberg

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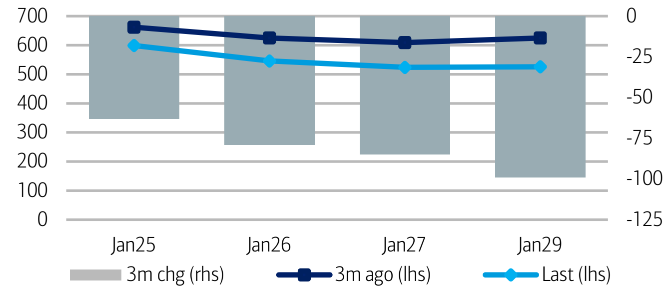
Exhibit 9: Term structure of Cupom Cambial rates

Cupom cambial is -82bp on average over the past 3m



Source: BofA Global Research, Bloomberg

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Volatility surface: USD/BRL

Exhibit 10: USD/BRL current implied volatilities

3-month ATM implied volatility is at 11.72

	10Δ Put	25Δ Put	ATM	25Δ Call	10Δ Call
1m	9.98	10.12	10.76	11.87	13.21
3m	10.90	11.03	11.72	12.98	14.53
6m	11.73	11.83	12.54	13.88	15.58
1y	12.68	12.80	13.56	15.00	16.88

Source: BofA Global Research

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Exhibit 11: USD/BRL 3m z-scores of implied volatilities

3-month z-score of 3-month ATM implied volatility is -2.56

	10Δ Put	25Δ Put	ATM	25Δ Call	10Δ Call
1m	- 2.2	- 2.2	- 2.2	- 2.2	- 2.2
3m	- 2.5	- 2.5	- 2.6	- 2.5	- 2.5
6m	- 2.3	- 2.5	- 2.7	- 2.7	- 2.7
1y	- 1.1	- 1.5	- 2.0	- 2.3	- 2.4

Source: BofA Global Research

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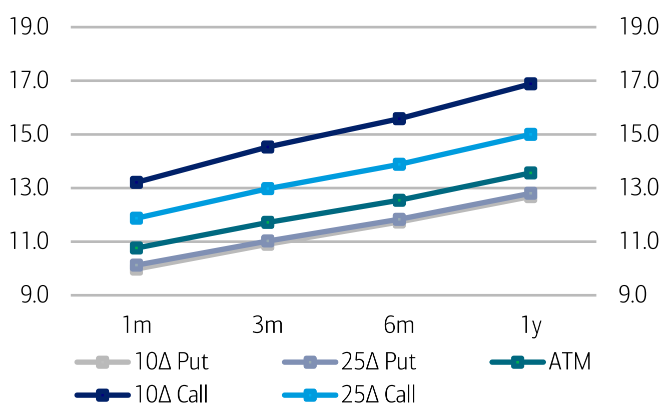
Exhibit 12: Implied volatility term structure

ATM implied volatility term structure is upward sloping



Source: BofA Global Research, Bloomberg

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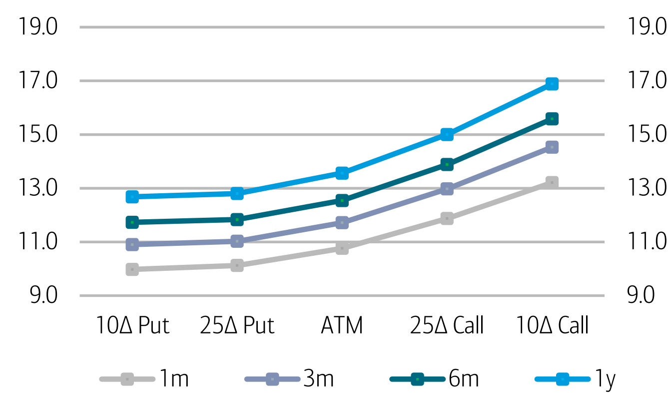
Exhibit 13: Implied volatility smiles

Implied volatility smiles are somewhat skewed



Source: BofA Global Research, Bloomberg

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Chile

FX Views and forecasts

View: neutral*

We remain neutral on the Chilean peso. Policy risks have declined substantially and a potential repricing in Chilean rates towards a slower easing cycle may provide some support to CLP. However, risks of a restart of BCCh's FX reserve accumulation program limit upside in CLP. We see USD/CLP at 900 by end-2024.

Key macro developments: Inflation resumed its downward trend in December, after an upward surprise in November. In fact, headline inflation at 3.9% yoy was below the 4% upper bound of the target range for the first time since June 2021. In our view, inflation should continue to gradually converge to target. We forecast 3.3% inflation in 2024-end.

With inflation getting closer to target, we believe the central bank will continue to ease monetary policy. BCCh cut rates by 75bp in December, to 8.25%, faster than the 50bp in October. This in our view, was largely due to declining inflation and lower core rates volatility. We think that the central bank will cut rates down to 5.25% by December 2024, though we expect less cuts than priced by the market.

Meanwhile, activity has showed some signs of recovery last quarter, though it remains below potential. We expect GDP to rebound 2.2% in 2024, from -0.1% in 2023, on the back of expansionary fiscal and monetary policy. While construction may remain a drag, lower policy uncertainty may be positive. On this front, Chile rejected a new constitution in December. In our view, a new constitutional debate is unlikely until at least 2026, though some uncertainty may linger in the medium term as social demands persist and structural reforms (pensions, investment, tax) are discussed in Congress.

Fiscal deficit was 2.9% of GDP in November, adding upside risks to the 2024 budgeted deficit of 1.9% of GDP. Moreover, the MoF issued USD 1.7bn in dollar bonds as part of its 2024 funding strategy, tapped USD 800mn from its sovereign wealth funds, and announced it would carry out up to USD 3bn in dollar spot sales by March.

Valuation: Undervalued by 8% according to our medium-term Compass BEER model. Overvalued by 17.2% according to our long-term Compass FX model.

Positioning: Market is long (+15). Hedge funds are long (+29), real money long (+0.4).

Risks to our view: BCCh accumulating FX reserves; weak copper prices.

Upcoming risk events: BCCh meeting (Jan 31, Apr 2); tax & pension reform (ongoing).

Corporate hedging: We recommend taking advantage of CLP rallies to hedge.

Rates: Higher/flatter. We expect BCCh to cut less than market pricing.

Exhibit 14: USD/CLP forecasts vs forwards
We forecast USD/CLP at 910 by 2Q '24

	current	chg		
Spot	910	+1.0		
	Forecast		Forward	
Period	current	chg	current	chg
1Q 2024	920	+20.0	914	+0.7
2Q 2024	910	+30.0	916	+0.5
3Q 2024	905	+35.0	918	+0.3
4Q 2024	900	+25.0	918	+0.5

Source: BofA Global Research, Bloomberg

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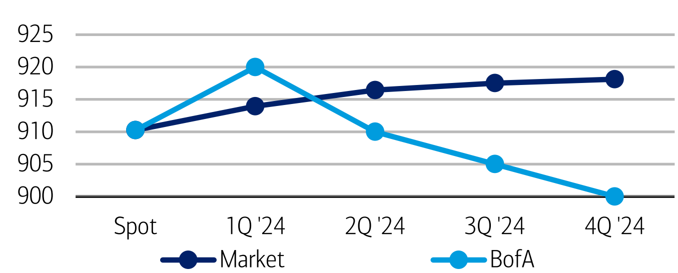
Exhibit 15: USD/CLP forecasts vs forwards
We are neutral with respect to forwards for 2Q '24



Source: BofA Global Research, Bloomberg

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Cross currency basis

Exhibit 16: CAMARA vs SOFR basis swaps

CAMARA basis swap rates are -54bp on average over the past 3m

Contract	Last	1w chg	3m chg	1y chg	Min	Last vs 1y Avg	Max	1y Avg	1w vol	3m vol	3m z-score	1y z-score
1y	-26	-39	-82	-121	-26		167	68	17	60	-2.9	-1.8
2y	7	-16	-66	-99	7		148	67	10	35	-1.6	-1.5
5y	6	-7	-37	-66	-6		72	29	9	30	-0.6	-1.1
10y	17	-10	-32	-46	3		64	32	8	29	-0.5	-1.0

Source: BofA Global Research, Bloomberg

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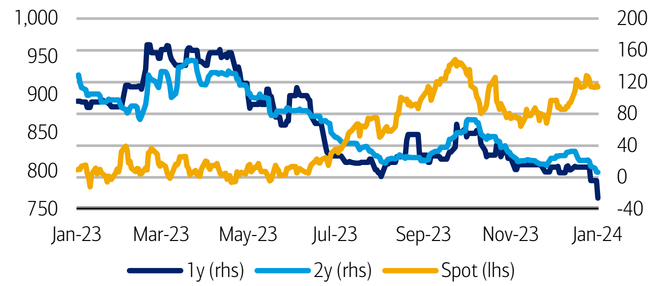
Exhibit 17: CAMARA basis swaps vs USD/CLP spot

CAMARA basis swaps stand around 1bp

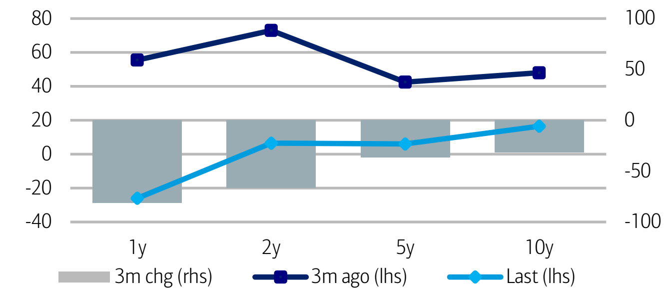


Source: BofA Global Research, Bloomberg

BofA GLOBAL RESEARCH

Exhibit 18: Term structure of CAMARA basis swaps

CAMARA basis swaps are -54bp on average over the past 3m



Source: BofA Global Research, Bloomberg

BofA GLOBAL RESEARCH

Volatility surface: USD/CLP

Exhibit 19: USD/CLP current implied volatilities

3-month ATM implied volatility is at 14.52

	10Δ Put	25Δ Put	ATM	25Δ Call	10Δ Call
1m	14.32	14.26	14.84	16.13	17.81
3m	13.83	13.81	14.52	16.00	17.92
6m	13.70	13.69	14.45	16.03	18.12
1y	14.03	13.95	14.70	16.35	18.60

Source: BofA Global Research

BofA GLOBAL RESEARCH

Exhibit 20: USD/CLP 3m z-scores of implied volatilities

3-month z-score of 3-month ATM implied volatility is -2.11

	10Δ Put	25Δ Put	ATM	25Δ Call	10Δ Call
1m	- 1.3	- 1.4	- 1.7	- 1.9	- 2.0
3m	- 1.8	- 1.9	- 2.1	- 2.3	- 2.4
6m	- 1.9	- 1.9	- 2.1	- 2.2	- 2.3
1y	- 1.1	- 1.2	- 1.4	- 1.6	- 1.7

Source: BofA Global Research

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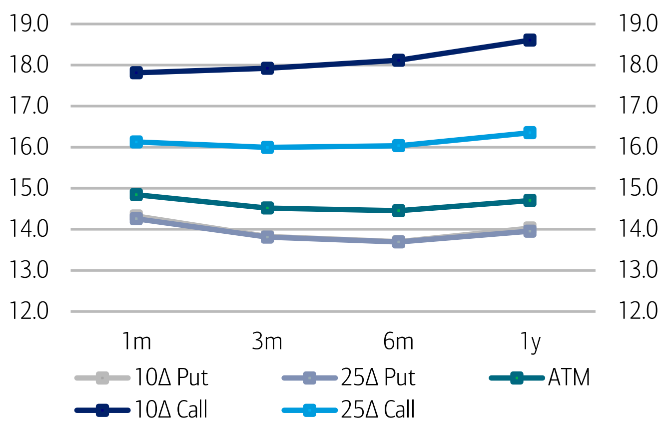
Exhibit 21: Implied volatility term structure

ATM implied volatility term structure is flat



Source: BofA Global Research, Bloomberg

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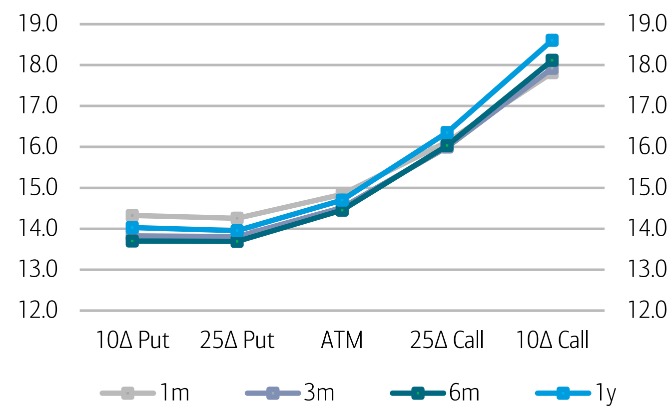
Exhibit 22: Implied volatility smiles

Implied volatility smiles are somewhat skewed



Source: BofA Global Research, Bloomberg

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Colombia

FX Views and forecasts

View: bearish*

We expect COP to underperform LatAm FX, as we expect macro fundamentals and crowded positioning to weigh on COP. We expect BanRep to cut rates more than other central banks and market pricing, which should reduce COP's favorable carry. Weak growth should also weigh on COP. We see USD/COP at 4,100 by 2024-end.

Key macro developments: Despite some green shoots in November, economic activity seems weaker than we thought. In fact, we recently revised our 2024 GDP growth forecast down to 1.9%, from 2.1% previously. Still, we believe growth could improve over the course of the year on the back of higher real wages, looser monetary policy, lower uncertainty associated to economic reforms, and external demand from Venezuela.

The economy's soft patch is spurring a response from policymakers. Specifically, the tradeoff between growth and inflation that BanRep is facing has become more challenging, as economic weakness has concentrated in interest-rate-sensitive sectors. As a result, BanRep began easing rates in December with a 25bp cut despite inflation and inflation expectations running well above target. We expect BanRep will likely continue cutting at the current pace in its January and March meetings, as it remains cautious about still-high inflation. We then believe BanRep will be more confident to switch to 50bp in April, reaching a terminal policy rate of 6% by October 2025.

While S&P revised Colombia's outlook to negative on the back of growth concerns, our view on Colombia's fiscal remains constructive. We expect the government's 2024 financing plan to be conservative. We see a more benign public debt trajectory – below the 55% of GDP anchor of the fiscal rule – and a smaller fiscal deficit relative to the target. Meanwhile, a new tax reform proposal is emerging, with the government pitching the idea of cutting corporate taxes and increasing taxes on high-income households.

Valuation: Overvalued by 11% according to our medium-term Compass BEER model. Overvalued by 7.3% according to our long-term Compass FX model.

Positioning: Market long (+0.6). Hedge funds long (+36), real money short (-34).

Risks to our view: Hawkish turn in BanRep; higher oil prices.

Upcoming risk events: BanRep meeting (Jan 31); MoF financing plan (Feb); reforms debate (1H24).

Corporate hedging: We recommend hedging amid bearish outlook for COP.

Rates: Lower/steeper. We expect BanRep to cut more than market pricing.

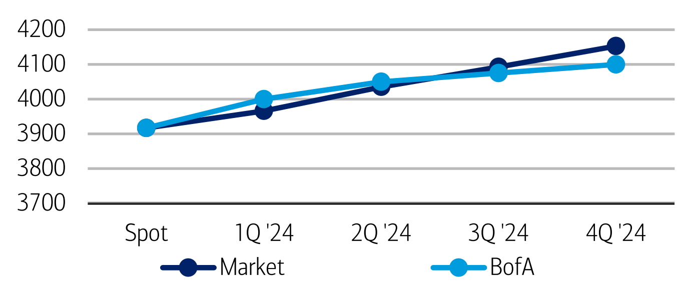
Exhibit 23: USD/COP forecasts vs forwards
We forecast USD/COP at 4050 by 2Q '24

	current	chg		
Spot	3,917	+5		
	Forecast		**Forward**	
Period	**current**	**chg**	**current**	**chg**
1Q 2024	4,000	-80	3966	-2
2Q 2024	4,050	-100	4035	-3
3Q 2024	4,075	-25	4093	-6
4Q 2024	4,100	+150	4153	-7

Source: BofA Global Research, Bloomberg

BofA GLOBAL RESEARCH

Exhibit 24: USD/COP forecasts vs forwards
We are bearish with respect to forwards for 2Q '24



Source: BofA Global Research, Bloomberg

BofA GLOBAL RESEARCH

Cross currency basis

Exhibit 25: IBR vs SOFR basis swaps

IBR basis swap rates are +39bp on average over the past 3m

Contract	Last	1w chg	3m chg	1y chg	Min	Last vs 1y Avg	Max	1y Avg	1w vol	3m vol	3m z-score	1y z-score
1y	-96	4	105	-51	-285		-13	-120	19	67	1.4	0.4
2y	-126	0	50	-45	-280		-41	-129	18	63	1.0	0.1
5y	-144	-4	26	-41	-200		-96	-139	13	48	1.1	-0.2
10y	-129	1	-24	-27	-135		-75	-104	8	30	-0.9	-1.6

Source: BofA Global Research, Bloomberg

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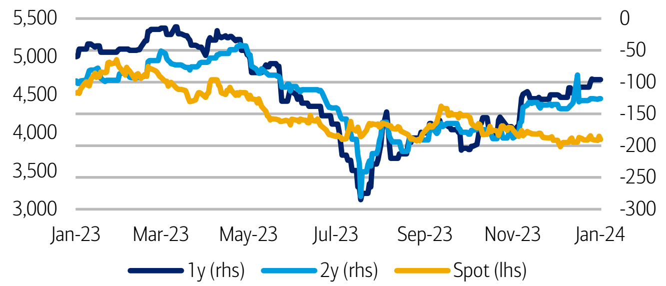
Exhibit 26: IBR basis swaps vs USD/COP spot

IBR basis swaps stand around -124bp

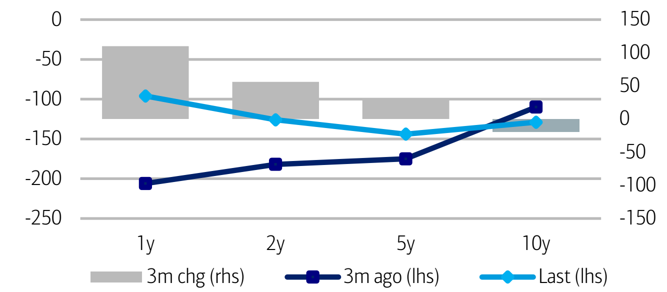


Source: BofA Global Research, Bloomberg

BofA GLOBAL RESEARCH

Exhibit 27: Term structure of IBR basis swaps

IBR basis swaps are +45bp on average over the past 3m



Source: BofA Global Research, Bloomberg

BofA GLOBAL RESEARCH

Volatility surface: USD/COP

Exhibit 28: USD/COP current implied volatilities

3-month ATM implied volatility is at 15.72

	10Δ Put	25Δ Put	ATM	25Δ Call	10Δ Call
1m	15.54	15.45	16.11	17.55	19.46
3m	15.26	15.06	15.72	17.31	19.48
6m	15.46	15.23	15.90	17.55	19.85
1y	16.10	15.77	16.40	18.17	20.73

Source: BofA Global Research

BofA GLOBAL RESEARCH

Exhibit 29: USD/COP 3m z-scores of implied volatilities

3-month z-score of 3-month ATM implied volatility is -2.59

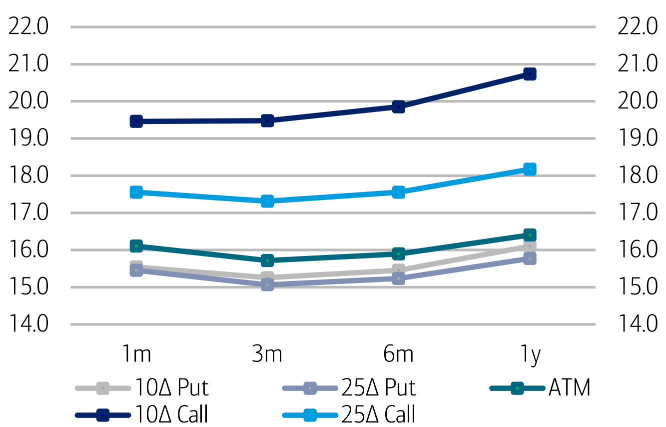
	10Δ Put	25Δ Put	ATM	25Δ Call	10Δ Call
1m	- 1.1	- 1.2	- 1.4	- 1.5	- 1.6
3m	- 2.3	- 2.5	- 2.6	- 2.7	- 2.7
6m	- 2.6	- 2.8	- 2.8	- 2.8	- 2.8
1y	- 2.3	- 2.4	- 2.5	- 2.5	- 2.5

Source: BofA Global Research

BofA GLOBAL RESEARCH

Exhibit 30: Implied volatility term structure

ATM implied volatility term structure is flat



Source: BofA Global Research, Bloomberg

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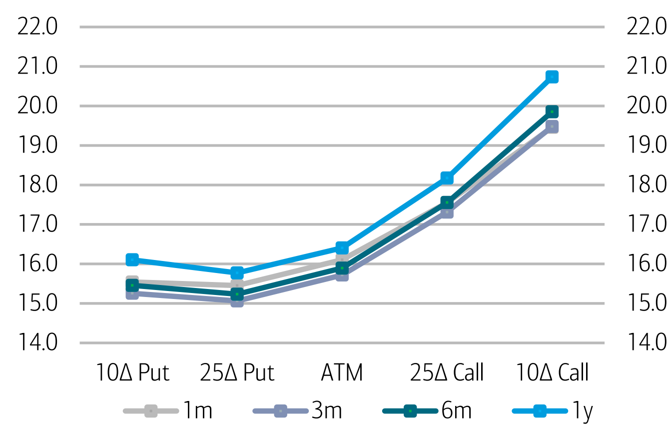
Exhibit 31: Implied volatility smiles

Implied volatility smiles are somewhat skewed



Source: BofA Global Research, Bloomberg

BofA GLOBAL RESEARCH

Mexico

FX Views and forecasts

View: bearish*

We have strong conviction MXN will weaken in 2024, after a long run of remarkable resilience. Our view is mainly supported on Banxico's easing cycle, but weaker growth in Mexico and the US, slowing remittances, potential fiscal concerns, and a noisy political backdrop will not help the peso. We see USD/MXN at 18.50 by 2024-end.

Key macro developments: Economic activity remains strong, though it is showing some signs of deceleration. Monthly GDP and remittances surprised to the downside in November. In our view, 1H24 will be characterized by resilient growth amid a large fiscal impulse, but we should expect a sharp deceleration in 2H24 on the back of slower growth in the US and a cut in government expenditure. We expect GDP growth to decelerate to 2.0% in 2024 and 1.0% in 2025 (see Top 5 (macro) questions for 2024).

Inflation moved up in end-2023, driven by the non-core print. Services inflation remains high and sticky, driven by an overheated economy and a tight labor market. In 2024, we see upward pressures to inflation: high fiscal spending via pensions and investment, the 20% minimum wage hike, and a 4.2% hike in the excise tax. We also see risks for cost-push shocks at the global level (see Global rate cuts lost at (Red) Sea?). These factors, along with above-target inflation expectations and monetary easing, should result in above-target inflation in 2024 and 2025. We see inflation at 4.7% yoy by end-2024.

While core inflation remains high and activity strong, Banxico has signaled it may start cutting in 1Q24. Thus, we expect Banxico to begin the easing cycle with non-consecutive 25bp cuts in March and June, though the risk is for a later start. We see Banxico raising the pace to 50bp in 2H, as the economy decelerates, reaching a 9.25% rate by end-2024.

Finally, general elections in June should increase volatility. Historically MXN weakens in the 3 months prior to Mexican presidential elections. We think there will be a larger focus on the congressional race this year, as it could determine the extent to which deep policy changes and fiscal consolidation could be implemented by the next government.

Valuation: Overvalued by 12% according to our medium-term Compass BEER model. Overvalued by 5.3% according to our long-term Compass FX model.

Positioning: Market long (+2.5). Hedge funds short (-50), real money long (+6).

Risks to our view: Hawkish turn in Banxico; resilient growth in Mexico and the US.

Upcoming risk events: Banxico meeting (Feb 8, Mar 21); presidential campaigns (Mar 1); general election (Jun 2).

Corporate hedging: We recommend hedging amid bearish outlook for MXN.

Rates: Lower/steeper. We expect Banxico to cut more than market pricing.

Exhibit 32: USD/MXN forecasts vs forwards

We forecast USD/MXN at 17.9 by 2Q '24

	current	chg		
Spot	17.23	+0.36		
	Forecast		Forward	
Period	current	chg	current	chg
1Q 2024	17.80	-	17.42	+0.34
2Q 2024	17.90	-	17.68	+0.34
3Q 2024	18.25	-0.05	17.94	+0.34
4Q 2024	18.50	-	18.20	+0.35

Source: BofA Global Research, Bloomberg

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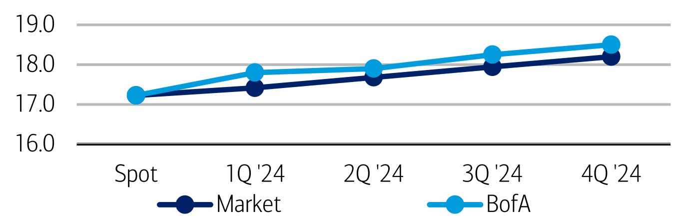
Exhibit 33: USD/MXN forecasts vs forwards

We are bearish with respect to forwards for 2Q '24



Source: BofA Global Research, Bloomberg

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Cross currency basis

Exhibit 34: 28d TIIE vs SOFR basis swaps

TIIE basis swap rates are +8bp on average over the past 3m

Contract	Last	1w chg	3m chg	1y chg	Min	Last vs 1y Avg	Max	1y Avg	1w vol	3m vol	3m z-score	1y z-score
1y	14	-4	15	37	-73		23	-27	8	30	0.7	1.4
2y	14	-2	14	29	-55		19	-20	6	23	1.1	1.6
5y	13	-2	2	11	-35		33	-4	7	24	1.0	1.0
10y	15	-1	2	21	-38		33	-4	7	25	1.2	1.1

Source: BofA Global Research, Bloomberg

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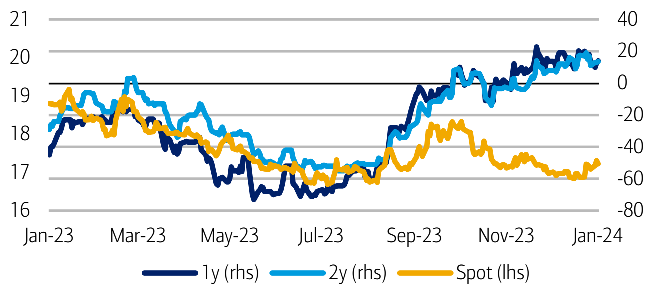
Exhibit 35: TIIE basis swaps vs USD/MXN spot

TIIE basis swaps stand around 14bp



Source: BofA Global Research, Bloomberg

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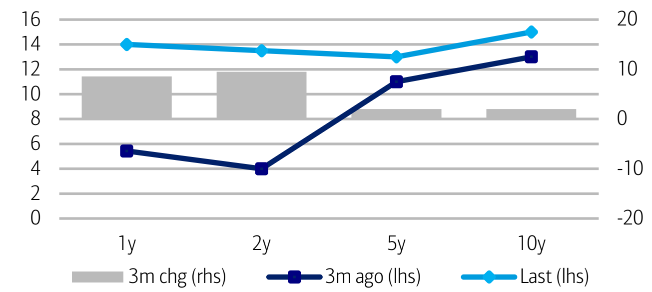
Exhibit 36: Term structure of TIIE basis swaps

TIIE basis swaps are +6bp on average over the past 3m



Source: BofA Global Research, Bloomberg

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Volatility surface: USD/MXN

Exhibit 37: USD/MXN current implied volatilities

3-month ATM implied volatility is at 11.23

	10Δ Put	25Δ Put	ATM	25Δ Call	10Δ Call
1m	9.43	9.89	11.04	12.82	14.92
3m	9.57	10.03	11.23	13.16	15.50
6m	10.53	10.94	12.15	14.13	16.61
1y	11.43	11.72	12.88	14.91	17.51

Source: BofA Global Research

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Exhibit 38: USD/MXN 3m z-scores of implied volatilities

3-month z-score of 3-month ATM implied volatility is -1.19

	10Δ Put	25Δ Put	ATM	25Δ Call	10Δ Call
1m	- 0.9	- 0.9	- 0.8	- 0.7	- 0.6
3m	- 1.4	- 1.3	- 1.2	- 1.0	- 0.9
6m	- 1.4	- 1.2	- 1.0	- 0.8	- 0.7
1y	- 1.5	- 1.2	- 0.9	- 0.8	- 0.8

Source: BofA Global Research

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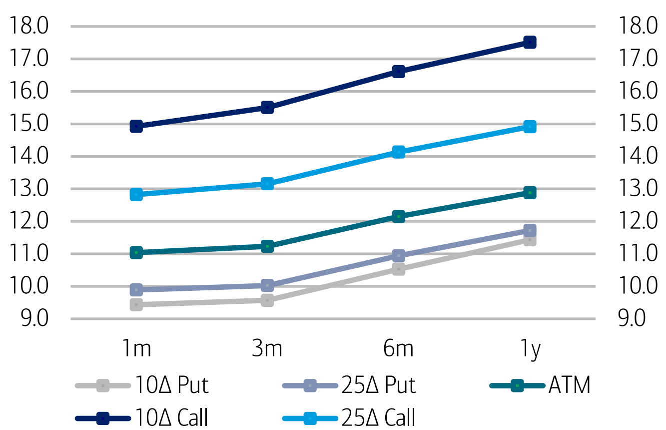
Exhibit 39: Implied volatility term structure

ATM implied volatility term structure is upward sloping



Source: BofA Global Research, Bloomberg

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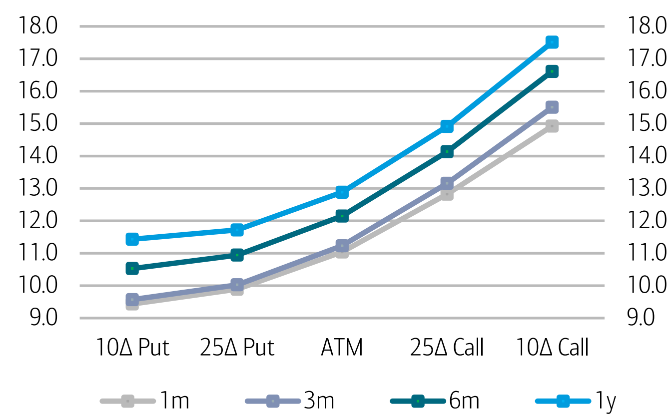
Exhibit 40: Implied volatility smiles

Implied volatility smiles are somewhat skewed



Source: BofA Global Research, Bloomberg

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Peru

FX Views and forecasts

View: neutral*

We have a neutral bias on PEN. A deep easing cycle that brings the interest rate differential into negative territory should weigh on the currency, but a rebound in GDP growth may provide support. Materialization of additional pension fund withdrawals may warrant risk premium, but lower likelihood of credit downgrades reduces risks. We see USD/PEN at 3.76 by 2024-end.

Key macro developments: Inflation continues to decline in Peru. Falling food prices, PEN appreciation and subdued economic activity have been exerting downward pressure on inflation. Moreover, the government commission studying El Niño has substantially reduced its estimated probability of a strong shock happening in Peru during 1Q24, which should be positive for both inflation and economic activity.

We have conviction that the drop in inflation, milder El Niño, depressed activity, and more benign external conditions provide space for the central bank to continue cutting rates. In our view, BCRP will likely cut 25bp in every meeting until it reaches 4%. Such a rate would imply a mildly expansionary stance, with a real ex-ante rate of about 1.5%, below the 2% neutral. Our path implies that, starting in August and for several months, Peru will have a negative interest rate differential against the Fed. This could put pressure on PEN.

Given the lower interest rates, the government stimulus plan, a rebound of agriculture and fishing, as well as new infrastructure, we expect GDP growth to accelerate in 2024 to 2.6% from -0.5% in 2023. On the fiscal front, we expect mild underperformance in the short-term, but we believe it will be insufficient to trigger credit rating downgrades amid Peru's still low debt-to-GDP ratio.

Valuation: Overvalued by 8% according to our medium-term Compass BEER model. Undervalued by 2.6% according to our long-term Compass FX model.

Positioning: Market short (-7). Hedge funds short (-42), real money long (+28).

Risks to our view: Hawkish BCRP; approval of pension fund withdrawals; credit rating downgrades.

Upcoming risk events: BCRP meeting (Feb 8, Mar 7); pension fund withdrawal discussion (1Q24).

Corporate hedging: We recommend hedging amid a deep BCRP easing cycle.

Rates: Lower/steeper. We expect BCRP to cut more than market pricing.

Exhibit 41: USD/PEN forecasts vs forwards
We forecast USD/PEN at 3.76 by 2Q '24

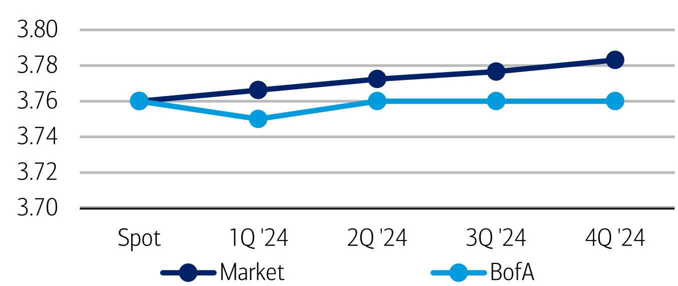
	current	chg
Spot	3.76	+0.06

	Forecast		Forward	
Period	**current**	**chg**	**current**	**chg**
1Q 2024	3.75	-0.03	3.77	+0.06
2Q 2024	3.76	-0.01	3.77	+0.06
3Q 2024	3.76	-	3.78	+0.06
4Q 2024	3.76	+0.01	3.78	+0.06

Source: BofA Global Research, Bloomberg

BofA GLOBAL RESEARCH

Exhibit 42: USD/PEN forecasts vs forwards
We are neutral with respect to forwards for 2Q '24



Source: BofA Global Research, Bloomberg

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Uruguay

FX Views and forecasts

View: bearish*

UYU has appreciated amid favorable external dynamics, sovereign rating upgrades and a resilient macro. Strong FDI inflows of about 5% of GDP and a push to exports on the back of a weather normalization and a new pulp mill should continue improving external accounts. However, unattractive valuation and a few policy risks may put pressure on UYU. We see USD/UYU at 41.0 by 2024-end.

Key macro developments: Inflation declined to 5.1% in 2023, from 8.3% in 2022, but is off the recent 3.9% low. Core inflation stands at 4.5% yoy, below the center of the target range (3-6%). We forecast inflation at 5.3% this year. BCU cut rates 25bp to 9% in December (accumulating 325bp cuts in 2023). We forecast BCU will cut rates further to 8% rate by end 2024 amid the disinflation trend.

We estimate GDP growth declined to 1.1% in 2023 (from 4.9% in 2022), amid the drought and slower global growth including neighbors Argentina and Brazil. The severe drought in 2023 would have shaved more than 2% of GDP. We expect a 3.3% rebound in 2024 GDP amid weather normalization, pulp mill production (opened in June 2023 and could add about 1% of new exports annually) and FDI. This includes potential investments in renewable energy (a hydrogen plant and others).

Elections in October 2024 generate some noise, but the political system in Uruguay is perceived as moderated and less polarized than the region. The national union of workers (CGT) seeks a plebiscite to abolish the pension reform law (retirement age back to 60 years, eliminate AFAP pension administrators and minimum pension above minimum wage), but our base case is the reform will remain in place.

The pension reform increased the retirement age to 65 years and changed the calculation of pensions to improve the sustainability of the system (see A week to remember). The system remains mixed (pay-as-you-go component and individual capitalization). Structural progress led to rating upgrades last year (Fitch and S&P upgraded Uruguay one notch to BBB and BBB+ respectively in 2Q).

Risks to our view: Weak FDI; weak soybean harvest; higher election risks.

Upcoming risk events: BCU meeting (Feb 22, Apr 10); general election and pension reform referendum (Oct).

Corporate hedging: We recommend hedging amid possibility of a slight reversal of recent outperformance.

Rates: Lower/steeper. We expect further cuts from BCU.

Exhibit 43: USD/UYU forecasts vs forwards
We forecast USD/UYU at 40.6 by 2Q '24

	current	chg		
Spot	38.8	- 0.4		
	Forecast		**Forward**	
Period	**current**	**chg**	**current**	**chg**
1Q 2024	40.5	-0.1	39.06	-0.4
2Q 2024	40.6	+0.0	39.50	-0.5
3Q 2024	40.9	-	39.96	-0.5
4Q 2024	41.0	-0.0	40.41	-0.5

Source: BofA Global Research, Bloomberg

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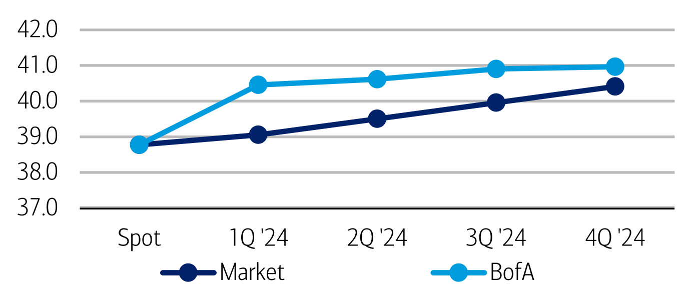
Exhibit 44: USD/UYU forecasts vs forwards
We are bearish with respect to forwards for 2Q '24



Source: BofA Global Research, Bloomberg

BofA GLOBAL RESEARCH

Central America & Caribbean

Costa Rica

View: bearish*

We expect CRC to depreciate in the medium term. The recent strength, in our view, is largely driven by booming exports, tourism and FDI, which along with market optimism is more than offsetting the narrowing interest rate differential. We think BCCR will likely continue cutting rates in coming months and induce a weakening of the Colon. We see CRC/USD at 564 by 2024-end.

Key macro developments: BCCR started the easing cycle back in March 2023 and has cut the monetary policy rate by 325bp, reaching 5.75% in January after a 25bp cut. We expect BCCR to continue cutting until reaching 5% in June. The central bank's cautious approach despite the -1.77% inflation in 2023 is consistent with a challenging global backdrop with high risks of geopolitically induced spikes in commodity or freight costs. We forecast inflation to pick up to 2.7% by 2024-end. We foresee a deceleration in economic activity relative to 2023, as GDP growth should stand at 3.8% in 2024.

Upcoming risk events: BCCR (Mar 21, Apr 25).

Corporate hedging: We recommend taking advantage of CRC rallies to hedge.

Dominican Republic

View: bullish*

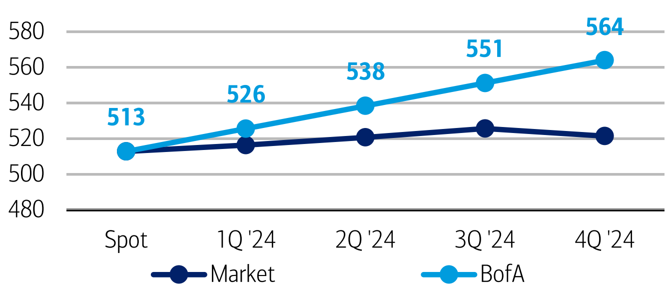
DOP depreciated late last year as monetary policy continued easing. While additional cuts may put some pressure on the currency, we expect DOP to remain relatively resilient amid strong growth and low policy risks. We see USD/DOP at 60.0 by 2024-end.

Key macro developments: After a disappointing year, DomRep might emerge as the growth star of LatAm in 2024. We foresee strong growth amid lower interest rates, a business-friendly presidential election, favorable terms of trade amid lower oil prices, and robust tourism. In our view, DomRep is set to grow 5.1% in 2024. On the fiscal front, the government announced an outperformance of the reformulated budget deficit of 3.2% of GDP approved in August amid improved tax collection and tighter expenditures, which put the fiscal deficit at 3.1% of GDP. For 2024, we expect deficit to continue declining to 2.9% of GDP. Despite the improvement, the debt ratio should deteriorate marginally amid FX depreciation.

Upcoming risk events: BCRD (Jan 31, Feb 29), pension reform (ongoing), general election (May 19).

Corporate hedging: We do not recommend hedging.

Exhibit 45: USD/CRC forecasts vs forwards
We are bearish with respect to forwards for 2Q '24



Source: BofA Global Research, Bloomberg

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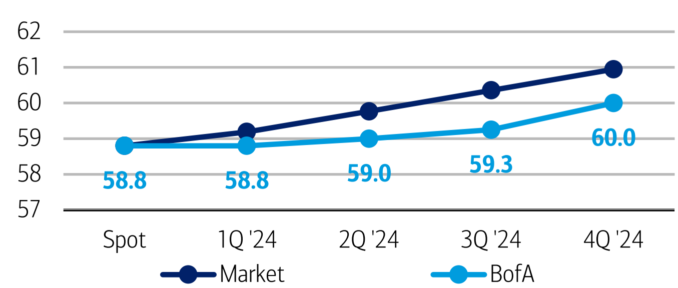
Exhibit 46: USD/DOP forecasts vs forwards
We are bullish with respect to forwards for 2Q '24



Source: BofA Global Research, Bloomberg

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FX models

Short term: Compass 30

Exhibit 47: Compass 30 signals for LatAm currencies
Signals: Neutral BRL, Neutral CLP, Neutral COP, Short MXN, Neutral PEN

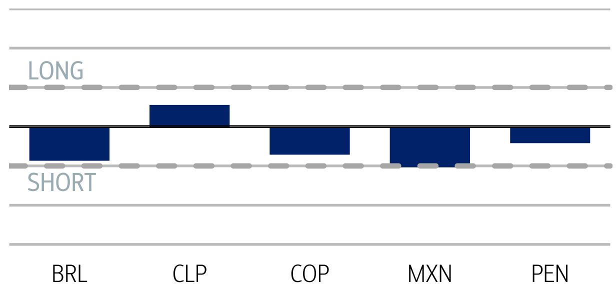
	Spot	Forecast	Forward	Exp Ret	Std Dev	Signal
BRL	4.93	5.00	4.94	-1.08	2.49	Neutral
CLP	909	901	912	1.17	4.21	Neutral
COP	3,941	4,017	3,968	-1.21	3.40	Neutral
MXN	17.21	17.52	17.30	-1.26	2.42	Short
PEN	3.77	3.78	3.77	-0.29	1.39	Neutral

Source: BofA Global Research. Signals as of 1/25/2024

BofA GLOBAL RESEARCH

Compass30 uses macroeconomic and financial variables to predict currency returns over the following 30 days. For more details about the model, see our Compass 30 Viewpoint.

Exhibit 48: Compass 30 signals for LatAm currencies
Signals: Neutral BRL, Neutral CLP, Neutral COP, Short MXN, Neutral PEN



Source: BofA Global Research. Signals as of 1/25/2024

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Medium term: Compass BEER

Exhibit 49: Compass BEER valuations for LatAm currencies
The average misalignment in LatAm is 14.3% overvaluation

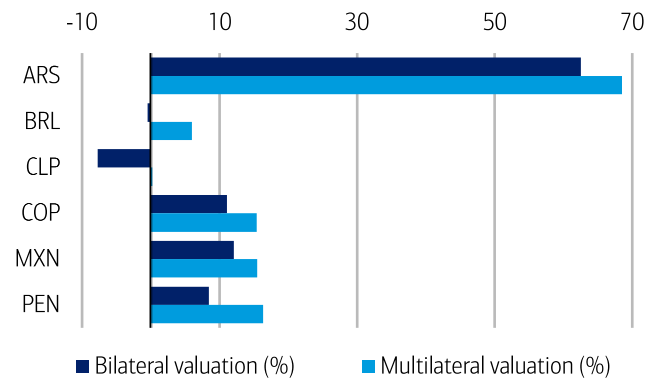
Currency	Spot	Fair value vs USD	Bilateral valuation (%)	Multilateral valuation (%)
ARS	822	1,537	62.5	68.5
BRL	4.93	4.91	-0.5	6.0
CLP	910	842	-7.7	0.2
COP	3,917	4,375	11.1	15.4
MXN	17.2	19.4	12.1	15.5
PEN	3.76	4.09	8.4	16.3

Source: BofA Global Research. Fair values as of 1/24/2024

BofA GLOBAL RESEARCH

Compass BEER is our medium-term valuation model for EM currencies. It estimates real exchange rate fair values based on macro fundamentals. For more information about the model, see our Compass BEER Viewpoint.

Exhibit 50: Compass BEER valuations for LatAm currencies
The average misalignment in LatAm is 14.3% overvaluation



Source: BofA Global Research. Fair values as of 1/24/2024

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Long term: Compass FX

Exhibit 51: Compass FX valuations for LatAm currencies
The average misalignment in LatAm is 6.3% overvaluation

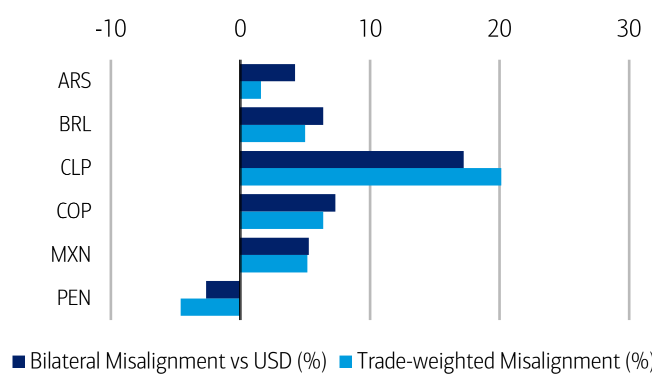
	Spot	Fair Value vs USD	Bilateral Misalignment vs USD (%)	Trade-weighted Misalignment (%)
ARS	819	855	4.2	1.6
BRL	4.93	5.27	6.4	5.0
CLP	911	1,101	17.2	20.1
COP	3,918	4,228	7.3	6.4
MXN	17.1	18.1	5.3	5.2
PEN	3.75	3.65	-2.6	-4.6

Source: BofA Global Research. Fair values as of 1/18/2024

BofA GLOBAL RESEARCH

Compass FX provides estimates of long-term equilibrium exchange rates for 22 emerging market currencies, both trade-weighted and bilateral (vs the USD and EUR). For more information about the model, see our Compass FX Viewpoint.

Exhibit 52: Compass FX valuations for LatAm currencies
The average misalignment in LatAm is 6.3% overvaluation



Source: BofA Global Research. Fair values as of 1/18/2024

BofA GLOBAL RESEARCH

Forecast details

Exhibit 53: BofA quarter-end FX forecasts
We are bearish ARS, bullish BRL, neutral CLP, bearish COP, bearish MXN, neutral PEN

	Forecasts							
Currency	**2024 Q1**	**2024 Q2**	**2024 Q3**	**2024 Q4**	**2025 Q1**	**2025 Q2**	**2025 Q3**	**2025 Q4**
USD/ARS (official)	1100	1500	1670	2200	2700	3200	3800	4500
USD/ARS (blue chip)	1595	2025	2088	2640	3105	3520	3990	4500
USD/BRL	4.90	4.88	4.80	4.75	4.78	4.82	4.90	5.00
USD/CLP	920	910	905	900	905	910	920	925
USD/COP	4,000	4,050	4,075	4,100	4,125	4,150	4,200	4,250
USD/CRC	526	538	551	564	566	568	569	571
USD/DOP	58.8	59.0	59.3	60.0	60.5	61.0	61.5	62.0
USD/MXN	17.8	17.9	18.3	18.5	18.7	18.9	19.1	19.5
USD/PEN	3.75	3.76	3.76	3.76	3.77	3.78	3.79	3.80
USD/UYU	40.5	40.6	40.9	41.0	41.5	41.7	42.0	42.1

Source: BofA Global Research

BofA GLOBAL RESEARCH

Exhibit 54: BofA LatAm FX forecasts vs Consensus
We are on average more bearish than Consensus in Q1 24

	2024 Q1			2025 Q1		
Currency	**BofA**	**Consensus**	**% Diff**	**BofA**	**Consensus**	**% Diff**
USD/ARS (official)	1100	1053	4.5%	2700	1620	66.7%
USD/BRL	4.90	4.95	-1.0%	4.78	4.97	-3.8%
USD/CLP	920	883	4.2%	905	866	4.6%
USD/COP	4,000	4,083	-2.0%	4,125	4,158	-0.8%
USD/CRC	526	533	-1.5%	566	545	3.9%
USD/DOP	58.8	58	1.3%	60.5	59	2.9%
USD/MXN	17.8	17.6	1.1%	18.7	18.3	2.5%
USD/PEN	3.75	3.79	-1.1%	3.77	3.76	0.3%
USD/UYU	40.5	39.7	1.8%	41.55	41.1	1.0%

Source: BofA Global Research, Consensus Economics

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List of acronyms:

- ARS: Argentinian peso
- Banxico: Central Bank of Mexico
- BanRep: Central Bank of Colombia
- BCB: Central Bank of Brazil
- BCCh: Central Bank of Chile
- BCCR: Central Bank of Costa Rica
- BCRA: Central Bank of Argentina
- BCRD: Central Bank of Dominican Republic
- BCRP: Central Bank of Peru
- BCU: Central Bank of Uruguay
- BRL: Brazilian real
- CAMARA: Chilean Average Chamber Index
- CLP: Chilean peso
- COP: Colombian peso
- CRC: Costa Rican colon
- DomRep: Dominican Republic
- DOP: Dominican peso
- EUR: Euro
- EM: Emerging market
- FDI: Foreign direct investment
- FX: Foreign exchange
- GDP: Gross domestic product
- IBR: Reference Banking Indicator
- IMF: International Monetary Fund
- LatAm: Latin America
- MXN: Mexican peso
- PEN: Peruvian sol
- SOFR: Secured Overnight Financing Rate
- TIIE: Interbank Equilibrium Interest Rate
- USD: US dollar
- UYU: Uruguayan peso
- yoy: Year over year

Analyst Certification

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