Mexican Peso Outlook Is Bleak With or Without Trump

By George Lei, Bloomberg First Word

The peso may look historically very cheap, but weak fundamentals will probably prevent much appreciation, regardless of who wins the U.S. election.

The embattled currency hit a three-week low Nov. 1 after a poll showed Republican candidate Donald Trump narrowly ahead a week before the vote. A Trump victory could further bruise the peso, but Hillary Clinton wouldn’t do much to reverse 26 percent undervaluation of the real effective exchange rate compared to the 20-year average.

The combination of lower oil prices, falling domestic crude production, tepid economic growth and a rising debt-to-GDP ratio are key challenges Mexico must address, even if a status quo in U.S. trade relations is preserved. Oil and related revenues contribute to about one third of Mexico’s budget and output is at a 32-year low.

Economic growth is forecast at 2.07 percent in 2016 and 2.26 percent in 2017, according to a Nov. 1 central bank survey. This is lower than potential GDP growth, generally considered at or slightly below 3 percent.

To make matters worse, Central Bank’s Deputy Governor Manuel Sanchez said Oct. 21 that the GDP outlook has downside risks and that the government must urgently improve its budget stance amid widespread perceptions of fiscal fragility.

Given this pressure, it seems unlikely that the peso will strengthen beyond 18.40, the 200-day moving average. Since Sept. 2014, the currency has rarely advanced beyond the 200-day moving average, and quickly weakened again every time it tested that.

Recent election-related trading supports the view. When Hillary’s victory seemed most likely, the peso reached a high of 18.46 on Oct 19.

An intraday swing of more than 2 percent on Oct. 28 — after the FBI re-opened a probe into Clinton’s emails — and a 1.6 percent drop on Nov. 1 after polls showed Trump’s support rising suggest the peso would probably slide below 20 for the first time ever if Trump wins.

NOTE: George Lei is an FX strategist who writes for Bloomberg. The observations he makes are his own and are not intended as investment advice.

Peso Has Not Been So Undervalued in at Least 20 Years

Source: BIS

Source: Bloomberg

LatAm currencies had four of the five biggest rallies in October among the 31 most traded currencies in the world tracked by Bloomberg. The Mexican peso, the best performing major currency, gained 2.76 percent.
Is Colombia’s Peso About to Break Free: High, Low, Best Cases

By Christine Jenkins, Bloomberg News

Currency analysts can’t seem to agree on the outlook for Colombia’s peso.

Standard Chartered strategist Nick Verdi, the top forecaster of the Andean country’s tender in the third quarter, sees the peso weakening toward 3,200 per dollar by year-end, before rebounding to 2,900 in 2017. But to Nomura’s Mario Castro, Colombia’s currency will soon start slumping towards a level of about 3,500, which it will reach next year.

The divergent projections underscore how volatile oil prices, attempts to fix Colombia’s worsening finances and its failed peace plan have made it harder to predict the peso’s future.

The currency has weakened 6.5 percent in the past six months, the most in Latin America after the Mexican peso. The government’s failure to gain popular support for a peace deal with FARC rebels in an Oct. 2 plebiscite has fueled concern President Juan Manuel Santos may struggle to push through key tax reforms to help rein in a budget deficit.

Oil, which accounts for 40 percent of Colombia’s exports, also dropped to a one-month low on Nov. 1. “Next year, higher oil prices should help, and some of the current-account difficulties that Colombia currently has will start to ease a little bit,” Verdi said.

Colombia’s external deficit has narrowed faster than forecast amid slowing growth, and the central bank said at its October policy meeting that it was reducing its projection for the 2016 current account gap to 4.7 percent of gross domestic product, from an earlier forecast of 5.3 percent.

Nomura’s Castro, who has one of the weakest peso forecasts, said he’s concerned about the political and fiscal challenges facing the country.

“There’s a lot of uncertainty about what’s happening with the tax reform after the “no” vote won the plebiscite, and everyone is pretty nervous about what can happen,” he said.

The government last month submitted a tax bill to Congress, seeking to curb the widening fiscal deficit and shore up Colombia’s investment grade credit rating. It is unclear whether Santos’ defeat in the peace vote will lead some allies in Congress to desert him, which could lead to a watered-down tax bill that raises too little revenue to allow Colombia to retain its BBB credit rating.

Meanwhile, Gordian Kemen, a strategist at Morgan Stanley, said he’s “neutral” on the Colombian currency as the country’s high-yielding bonds continue to lure investors even while the nation struggles to fix its fiscal problems.

“Goldman is a lot more bullish on the peso than its bank peers. In an Oct. 26 report, strategist Kamakshya Trivedi said he sees the peso strengthening to 2,700 per dollar in twelve months. At the same time, investors shouldn’t expect a “smooth ride” to the target given the fragile commodity price recovery and uncertainty over the government’s ability to enact the tax reforms, he said. Trivedi said he sees similarities with the rand in South Africa, where inflation has peaked and the current account deficit is also narrowing.
The emerging market carry trade is back in the Colombia peso/dollar cross. Even with a brutal sell-off that meant it was the worst-performing EM currency in October, the peso is still on track to post its best year on a total return basis against the dollar since 2012. The sell-off was prompted by Colombian voters rejecting the FARC peace deal on Oct. 2. The currency could end the year as only one of six EM currencies to post double-digit total returns versus the dollar. The others are the Brazilian real, Russian ruble, South African rand, Chilean peso and Indonesian rupiah.

One of the Colombian peso’s attractions is higher interest rates. One-month implied peso interest rates have risen almost 64 percent this year to Oct. 31, the most in LatAm. Rates were 109 percent higher at the end of June, but have declined since then, indicating that the peso’s winning streak may be coming to an end.

Other reasons that have traditionally been associated with a stronger peso have had less impact this year. Much has been made of its correlation with oil, and yet, year-to-date, oil prices have been relatively flat. Portfolio flows, meanwhile, were negative in the six months to the end of June at $3.2 billion.
Mexican Peso Volatility Jumps as U.S. Vote Nears, BRL No Longer Most Volatile

By Carlos Torres and Kevin Kelly, Bloomberg Data

Mexico’s currency became the most volatile in LatAm this year as investors shorted it to hedge against a Donald Trump win in the U.S. presidential election. Real volatility plunged after Brazilian President Michel Temer took office pledging to improve the fiscal outlook.

MXN Became Most Volatile LatAm Currency

Mexican peso one-month implied volatility rose to the highest in the region this year in the run-up to the U.S. presidential election. It shot up about 12 percent from Oct. 28 to Oct. 31 on news the FBI was re-opening an investigation of Hillary Clinton, increasing the odds of a Donald Trump victory.

Brazil’s Volatility Fell After Temer Took Over

The Brazilian real — traditionally the most volatile currency in the region — saw its one-month implied volatility plunge after former President Dilma Rousseff was impeached and replaced by Michel Temer. Real volatility is now lower than in Mexico, Argentina and Colombia. That said, volatility has jumped since Oct. 24 as the odds of a U.S. rate hike increased.

Peace Defeat Didn’t Boost COP Volatility

One-month volatility on the Colombian peso fell to 17.32 percent on Oct. 31 from 18.47 percent a year earlier. Volatility dropped even after President Juan Manuel Santos’s peace plan was defeated on Oct. 2, raising concerns that he may lack political support to pass a tax reform to shore up fiscal accounts.

Sol Volatility Fell With PPK’s Election

The election in June of market-friendly President Pedro Pablo Kuczynski reduced sol one-month volatility, which touched a seven year-high in May. The sol has the lowest volatility among the major currencies in the region.
Q&A

PDVSA Bondholders May Be Left With Nothing, Says Gramercy's Koenigsberger

Robert Koenigsberger, CIO, Gramercy Funds Management

Venezuela may have incentive to turn PDVSA into a defunct company and leave bondholders with nothing.

Brazil may now have value, says Koenigsberger, who oversees $6 billion in assets.

Interviewed by Ben Bartenstein, Bloomberg News, on Oct. 31. Comments have been edited and condensed for clarity.

Q: What's your view on Venezuela?
A: People are missing the forest through the trees. This country has a very difficult political path in front of it as well as a financial path. We've probably put together one of the most detailed balance of payments models out there, and we can't convince ourselves the model works through 2017. Venezuela's running out of reserves — that's just a fact.

Q: Do you see a potential credit event coinciding with a change in regime?
A: Often the thought is default equals change of regime. However, we're concerned that the Chavistas have held power through extraordinary and undemocratic means, so they're not necessarily synonymous.

Q: What are investors underestimating in Venezuela?
A: We're certainly concerned about the difference between PDVSA and Venezuela. There's a scenario where PDVSA doesn't get paid as much as Venezuela. Most sovereigns haven't had to do a bankruptcy filing in the U.S., but PDVSA might have to. Venezuela's goal is to continue producing oil and they could produce and export oil without PDVSA. Venezuela's military has set up an oil services company. PDVSA doesn't own assets. It's just granted monopoly powers on production. If it enters bankruptcy, will the Venezuela government still grant it licenses and grants or might they auction them off? I could imagine a scenario where they don't care much about unsecured holders of a defunct oil company.

Q: What do you find most exciting about LatAm?
A: There are two asymmetries that coexist: An asymmetry of the long side (dislocated distressed, defaulted distressed, capital solutions) that exists not just because of change in credit metrics but change in technicals. And two, banks are no longer making loans that they used to make. One of our themes is dipping into that asymmetry. I also find the ability to buy portfolio insurance fascinating.

Q: Why?
A: That cost has never been so cheap when you measure that from typical five-year CD low-beta LatAms. Most portfolios you can protect at 150 basis points or less. With this construct, buy long and overlay CDS hedge you can create portfolios that are expected to have high return, but to do so in a fashion that's uncorrelated and tail-risk aware. The current net opportunity set is as exciting as any I've seen in my career.

Q: What's the biggest change you've noticed in the past year or two?
A: The notion of capital solutions — filling a vacuum of institutions that have left the region. There's this notion that you can either buy liquid bonds or private debt. We remain suspect of how liquid the liquid bonds really are. We're pretty certain you don't get paid for the lack of liquidity that exists. We've spent a lot of time transforming our strategy from liquid to longer-lock capital solutions.

Q: Where do you see the greatest value in Argentina today?
A: I still think you see spread compression so I like having some duration — 46s feel a bit overbought compared to 36s. I like 2036 on the curve.

Q: Do you own GDP warrants?
A: The expected return isn't as compelling. There's a lot of volatility, and I'd rather see where that settles.

Q: Could we see warrants in Venezuela?
A: Eventually on the other side of a default or regime change you will see warrants. I think they'll be oil warrants like Mexico.

Q: Why have you become more active in Brazil?
A: Historically, we're a non-BRIC shop. Three years ago we were looking at an overcrowded market. I joked that I'd go to JFK at 11 p.m. and the Brazil flight used to be full and Argentina was empty. Now it's the opposite. If you didn't get burnt in Brazil before, you might want to take a fresh look now. It looks like Carwash is mostly behind it. We're open to adding opportunistically in Brazil. Odebrecht is a great example of something that had been affected by Carwash and the sovereign crisis, and it will be a big benefactor as things get better.

Q: What's been your biggest move in the past quarter?
A: We've had a big reduction in Venezuela as it rallied into the swap. We're opportunistically entering Brazil and taking a bifurcated private approach to Argentina.

At a Glance

How often you visit LatAm: Every 4 to 6 weeks
What you never travel without: Bloomberg Anywhere on my ipad.
Book: Next 100 Years by George Friedman
Movie: Forrest Gump
Hobby: Tennis, Golf and Fishing
Alternative career: Strategic Consulting
All Eyes on Mexican Credit, Rates and Equity

By Eduardo Thomson, Aline Oyamada, Michelle Davis and Ben Bartenstein, Bloomberg News

A Hillary Clinton victory would provide an immediate, but short lived, boost to Mexican sovereigns, quasi-sovereigns and higher quality corporates, according to Invesco’s Jason Trujillo. The initial gain would be tempered as investors look back into Mexico’s fundamentals, which are deteriorating, he says. If Donald Trump wins, airport operators with assets that benefit from tourism, such as Asur and GAP, would benefit as the peso weakens, says Wasatch Advisors’ Andrey Kutuzov.

Jason Trujillo, EM analyst at Invesco, which manages about $1.5 billion of EM fixed income assets:
“To the extent polls show Trump’s chances improving, that weighs on Mexican credit and is an opportunity to add risk as we think the ultimate probability of a Trump victory is low. Should Clinton prevail, that would provide an immediate boost to Mexican corporate and sovereign credit. Mexican sovereign bonds are the most direct way to play that view, however, there is likely more upside in quasi-sovereign credits like CFE and Pemex in such a scenario. We would also expect higher quality Mexican corporates such as Liverpool, Alfa and Televisa [to do well]. However, we expect any such effect to be relatively short lived as investors return their focus to Mexico’s fundamental, which are deteriorating.” Interviewed Oct. 27

Andrey Kutuzov, associate portfolio manager at Wasatch, who oversees about $3 billion in small caps funds:
“There are some stocks that could benefit [from a Trump win]: Asur, which has the Cancun Airport as its main asset, is mainly a destination airport for American tourists. The other operator is GAP — it will benefit to a small degree because it benefits from a weak peso, which makes travel to Mexico more attractive. Airport operator OMA is the opposite. It would probably be a bigger beneficiary of a Clinton win. Their key asset is Monterrey Airport, which is the center of exports to the U.S.” Interviewed on Oct. 27

Gerardo Rodriguez, senior investment strategist at BlackRock’s EM group, who helps oversee $5.1 trillion in assets:
“We manage low volatility strategies so we try to avoid adding risk around these types of events. We think Mexico offers a lot of value on the interest rates front. We’ve been long inflation-linked bonds, bonds and dollar-denominated sovereign debt for a few months. We’ve been slightly overweight the peso now that it’s depreciated and because it looks attractive relative to other currencies from a valuation perspective. We’re a little underweight equities in Mexico. Valuations and the rate hiking cycle by Banxico have led to that view. Once the election’s over, there should naturally be a little less volatility. Our strategy could be affected by whatever the Fed does and depending on where the dollar and oil prices go.” Interviewed Oct. 27

Jim Craige, portfolio manager at Stone Harbor, who helps oversee about $40 billion in assets:
“Mexico is the peer play and the other one is Malaysia. The way to play Asia is in Malaysia because it’s about as good a proxy as you’re going to get. The peso is the biggest one in the Americas. If you do believe protectionism increases and Trump wins — not our view — the peso is the most efficient way to play it.” Interviewed Oct. 28

Alexis Hombrecher, portfolio manager, Whard Stewart UK, who helps manage $215 million in assets.
“A Clinton victory would bring short-term relief to the market. A Trump victory would see a short, sharp selloff and then a quick normalization. In Mexico and Canada, the pain would be much longer. In Brazil, if you have a risk-off moment you’d see general selling for a week to two weeks. I would expect Brazil to outperform Mexico in either case.” Interviewed Oct. 28

Ray Zucaro, chief investment officer, RVX Asset Management:
“We’ve been reducing Russia and increasing our Mexico exposure as a bet on a Clinton win. We are also buying Pemex bonds in pesos and in dollars. Polls indicate a Clinton win, so for sure we don’t see a lightening of sanctions for Russia. We’re also concerned about Russian valuations. In Mexico we’ve also been buying the 2026 bonds of Banco Nacional de Comercio Exterior. We think that the spreads of quasi-sovereigns versus the sovereigns are just too wide. If Trump were to win, Colombia would also be a concern because there could be less support from the U.S. government.” Interviewed Oct. 27

Jorge Unda, chief LatAm investment officer for BBVA, which manages about $38 billion:
“We’d been long the dollar for some time but started shedding the position as it reached extreme levels against the peso. Now, we’re long the peso and we’re hedging the position using FX options going into the election.” Interviewed Oct. 28
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