

FOCUS ON LATIN AMERICA

Latin America is extremely well positioned to benefit from the (near) end of the Fed's tightening cycle.

Strategist viewpoint



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The (near) end of the Fed's monetary tightening cycle is an important catalyst for emerging markets, particularly in Latin America.

Positive and attractive real interest rates.

Currencies in Latin America are set to benefit from positive real rates, as shown in the following chart.



Improving growth prospects

The rise in commodity prices has served as a cushion for economic activity in a context of aggressive rate hikes, allowing Latin America to record growth of 4% in 2022. In 2023, growth is expected to slow to 1.6%, but decelerate less than expected in Q1. That said, inflation, especially core inflation, remains high, which favors vigilant positioning on policies from central banks. Dollar weakness and the China recovery (driven by consumption) are catalysts for higher commodity prices, which should benefit the region's producing and exporting countries.

Economic orthodoxy achieved

The overall region has strengthened its economic orthodoxy (the exception being Argentina). Central banks in the region are proving to be credible by pursuing inflation targeted monetary policies, limiting current account deficits and repositioning public debt in domestic currencies (vs USD). International reserves are also solid. Today, Latin America is well equipped to cope with external shocks.

Reduced political risk

Reduced political risk has served to improve investor sentiment, particularly in regard to Brazil, Colombia and Chile. Today, international investors are signaling they are more comfortable with political risks in these three countries compared to a few months ago.

Portfolio Manager viewpoint



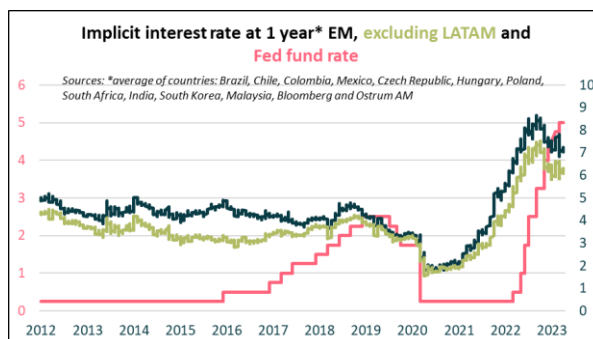
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In our opinion, local rates in Brazil and Mexico offer the most attractive investment opportunities considering the context of high real / nominal yields and upcoming rate cut cycles.

The end in rate hike cycle(s)

In Brazil, after raising key interest rates from 2% to 13.75% (March 2021 - September 2022), the central bank is expected to lower its rates as early as Q3 2023. In Mexico, after a 7.25% increase since June 2021, the monetary tightening cycle is coming to an end (terminal rate close to 11.50%) and rate cuts are expected from 2024. Rate hikes in Brazil & Mexico were the most aggressive in the EM universe, as shown in the chart below.



Disinflation is underway

In Brazil, headline inflation is below 5%, after peaking at 12% in June 2022. In Mexico, the process of disinflation is emerging with inflation falling below 7%, after a peak at 8.7% in September 2022. Brazilian and Mexican real rates are in positive territory and among the highest in emerging markets.

LATAM currencies have appreciated vs the USD

We expect the Mexican peso and the Brazilian real to benefit from positive real rates, investment flows (at a historical high level in Mexico), strong external accounts and the return of foreign investors to local debt markets. It is worth noting that foreign holdings of Brazilian and Mexican local bonds are at historically low levels.

Idiosyncratic risks are priced into local yield curves

In Brazil, we identify the main risk as uncertainty about the tax trajectory and the cap on spending. In Mexico, we identify no specific risks in the run-up to the 2024 presidential election.

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Additional notes

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