

LATAM Market Update

- **Brazil: BCB announces start of BRL convertibility process, could be bumpy but positive**

The BCB on Wednesday spoke about the near term release (potentially next week) of a draft note on their plans to make the BRL convertible. They spoke about the country's FX laws being outdated, and a need to make it easier for foreigners to access the country more easily. Based on Mexico's experience, this could mean that within 2 years, the BRL could be a deliverable currency. For that to happen, we would need to see this as the first of several steps, that could include:

- Reducing restrictions on access for foreigners
- Joining CLS bank (Chile spoke about joining in the 1st Piñera administration, but the process stalled)
- Finally moving to full deliverability

During this process, we expect BRL volatility to rise. If this is done in conjunction to the previously mentioned plans to open Brazil's real economy to trade—potentially leaving Mercosur, or setting up agreements with other countries, this could be messy if the reforms (both micro and macro) fail to deliver. At this time, the Brazilian economy faces important competitiveness issues, and needs micro reforms to be able to stand head to head with the rest of the world without trade barriers. This issue could be compounded if the BRL strengthens due to capital inflows.

For MXN it could be both a boon and curse: 1) boon in the sense that if the full process for BRL deliverability runs its course, MXN stops being the sole proxy hedge in the hemisphere—potentially reducing its volatility. 2) curse in that Brazil becomes even more a competitor for capital flows. Near term, it's harder to see the Brazilian bond market being added to DM benchmarks due among other reasons, to credit ratings (fairly deep into junk). Again, this is an area where how positive this process becomes, depends on how much the Bolsonaro—and future administrations—deliver on reforms and adjustment.

This is a good step by the BCB—but they will need help from the administration and politics to fully benefit.

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