Scotiabank.

GLOBAL ECONOMICS

LATAM INSIGHTS

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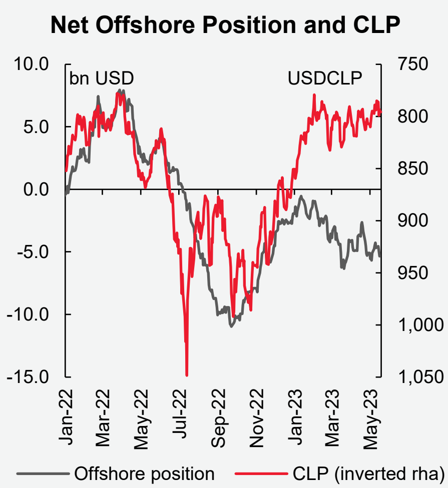
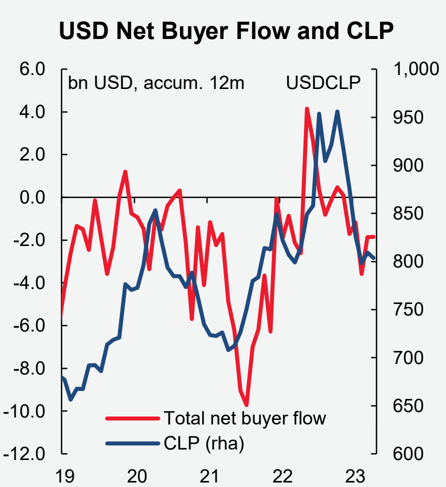
Chart 1



Sources: Scotiabank Economics, BCCh.

Chart 2



Sources: Scotiabank Economics, BCCh.

Chile—Who Buys and Who Sells? Decoding the FX Spot Market

- **Residents shift from net buyers to net sellers of USD, led by firms and mutual funds**

The relevant multilateral nominal appreciation of the Chilean peso (CLP), stronger since last September's plebiscite, can be understood as an adjustment of expectations that does not necessarily have to coincide with a relevant flow of US dollar sales in the spot/ forward market. The change in expectations can move the demand for US dollars without an aggressive shift in flows. In this Latam Insights, we try to see which spot flows—broken down by agent type—have accompanied this change in expectations.

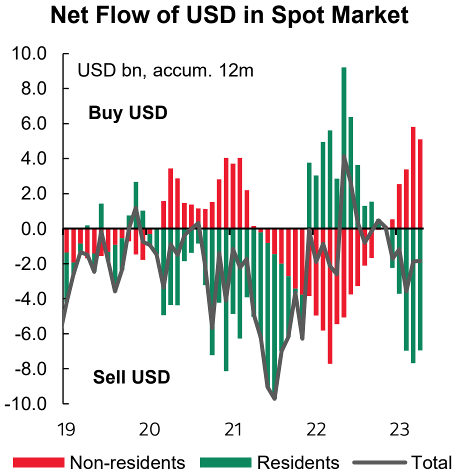
The adjustment in expectations could be explained by lower political uncertainty and/or a lower probability of aggressive structural reforms. The outcome regarding the makeup of the new constitutional council would also support arguments in favour of political moderation, although for several political analysts it raises the need for agreements to achieve the approval of the constitutional draft on December 17. On the whole, what seems quite clear is that, despite the announcement of a reduction of FX forward sales by the Central Bank (BCCh), the null sale of US dollars in the spot market by the Treasury during May, and declines in copper prices, the CLP has continued to show strength in relation to comparable currencies (not exempt from high volatility).

We have analyzed the dollar purchase and sale flows in the spot FX market for various resident and non-resident agents. It is worth noting that in the derivatives/non-deliverable forward (NDF) area, we had relevant movements by non-residents, but not coincident with the appreciation of the CLP (chart 1). Indeed, foreigners reduced their positions in favour of CLP by nearly USD 4 bn from the beginning of the year to the second half of May, while the currency has appreciated against the US dollar and in multilateral terms by 7.5% in the same period.

Analysis of US dollar buying and selling flows in the spot FX market helps to understand the CLP's resilience in a context of an unwind in NDF positions by non-residents and copper price declines from year-ago levels. We detected:

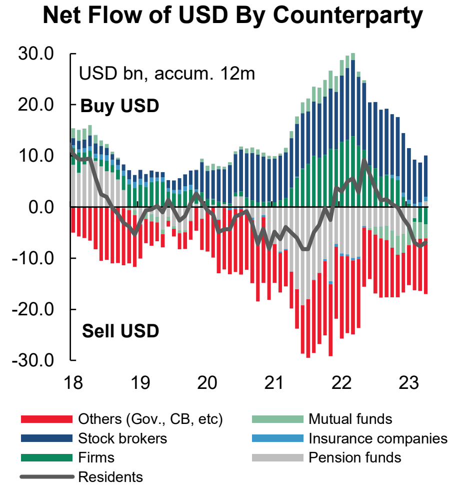
- As expected, net purchases flows in the FX spot market co-move significantly with the exchange rate (chart 2).
- Before the third withdrawal of pension funds—in May 2021—residents were net sellers of USD (appreciation pressure on the CLP), with net sales at their highest level in the first half of 2021. After the third withdrawal, residents shifted sharply to net buyers of USD, a situation that continues until the third quarter of 2022 (chart 3).
- However, not all residents were net buyers after the third pension fund withdrawal (chart 4). In particular, firms and stock brokers—as tasked by clients—were net buyers. In contrast, pension funds (PFs) were net sellers of US dollars in the FX spot market due to the repatriation of capital required to pay for PF withdrawals.
- In line with this, and as expected given the announcements of USD sales by the Treasury, the government has shown relatively persistent USD sales flows in the last two years.
- In a marked and, for now, persistent manner throughout 2023, residents have shifted from USD buyers to net sellers since Q4-22, coinciding with CLP resilience (chart 3 again). Analysis at counterparty level would show that USD selling by residents observed since late-2022 is led by mutual funds and firms (chart 4 again). Mutual fund sales are likely due to the adjustment of their clients' portfolios towards CLP and Unidad de Fomento denominated funds, while for companies, it would be as part of the unwind of usual hedges, dividend distributions, among others.

Chart 3



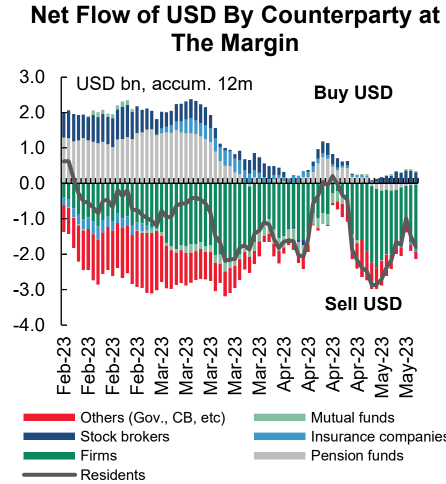
Sources: Scotiabank Economics, BCCh.

Chart 4



Sources: Scotiabank Economics, BCCh.

Chart 5



Sources: Scotiabank Economics, BCCh.

- For their part, stock brokers—by client requests—have been net buyers since social unrest picked up, which has eased during the early months of 2023 and especially during May (chart 4 again and chart 5). Spot USD buying by stock brokers could be symptomatic of a more structural monetary denomination adjustment process in the wealth of high net worth residents, since, although USD buying has declined, it has not been reversed—at the margin. In other words, they are still buying USD, but at a significantly slower pace. We continue to see no flow of sales by stock brokers, which would be a symptom of asset repatriation by individuals.
- In the first two months of 2023, Pension Funds (PF) started to buy US dollars in the spot market, contrary to firms, mutual funds and the government (chart 5 again). However, since the end of March, these agents have been less active in the FX spot market, probably explained by the higher volatility of foreign assets, which has led to a lower appetite of the PF contributors towards risk funds more exposed to foreign currencies.
- In a clear and relevant way, companies in the real sector started USD sales in the spot market at the end of 2022 that have since continued (firms, in chart 5 again), and stand as one of the factors that have supported the CLP's resilience.