Latam Daily: More Easing from Mexico's Banxico and Colombia's BanRep

- **Argentina: Despite relatively optimistic consumers, solid August trade surplus reflects still-weak economy**
- **Brazil: BCB revises 2020 growth forecast higher, provides additional colour on expected rate path**
- **Colombia: We anticipate another -25 bps cut today from the BanRep**
- **Mexico: Despite rising inflation, Banxico cuts -25 bps and likely ends easing cycle**

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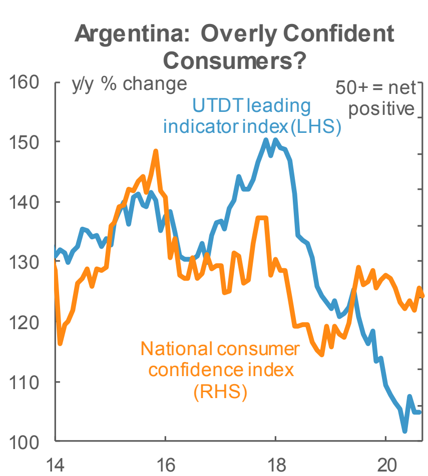
ARGENTINA: DESPITE RELATIVELY OPTIMISTIC CONSUMERS, SOLID AUGUST TRADE SURPLUS REFLECTS STILL-WEAK ECONOMY

In the September UTDT national consumer confidence index (CCI) reading, Argentine consumers maintained what is now three years of a pessimistic outlook (i.e., below 50), but they continue to look relatively positive compared with the UTDT's more comprehensive composite leading indicator (chart 1). The CCI edged down from 41.31 in August to 40.31 in September as lockdown measures were extended into October. We would expect further softening in consumer sentiment in the months ahead.

In August data released by INDEC on Thursday, September 24, Argentina notched up a monthly trade surplus just above USD 1.4 bn for a third month in a row (chart 2). The overall balance was slightly more positive than expected by consensus and the 12-month rolling balance rose for a fifth month in a row to USD 19.2 bn (chart 3). Weak imports on the back of soft economic activity continue to dominate gradually increasing exports.

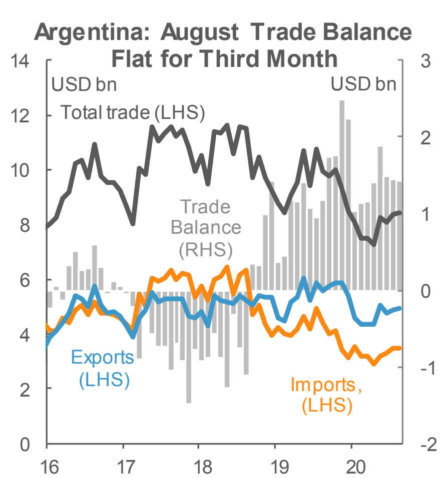
—Brett House

Chart 1



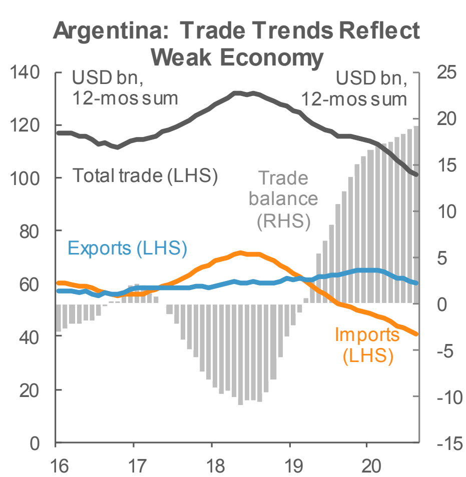
Sources: Scotiabank Economics, INDEC, UTDT.

Chart 2



Sources: Scotiabank Economics, Bloomberg.

Chart 3



Sources: Scotiabank Economics, Bloomberg.

BRAZIL: BCB REVISES 2020 GROWTH FORECAST HIGHER, PROVIDES ADDITIONAL COLOUR ON EXPECTED RATE PATH

On Thursday, September 24, the BCB released its quarterly *Inflation Report*. The tone of the report, and the evaluation of risks to both growth and inflation, seem consistent with the minutes from the September 16 Copom meeting that were released the previous day; hence we don't see the report as "view altering". However, there were still some sections of the report that merit comment. First, the BCB had already suggested growth was rebounding more strongly than expected, which has now been translated into a revision of its 2020 real GDP growth forecast from -6.4% y/y to -5.0% y/y. More importantly, we got a little more info on how the Copom expects its Selic rate path to look going forward (table 1). Essentially, the BCB signaled that it expects inflation to be below target until the end of 2021.

Table 1
Brazil: BCB Inflation Expectations Under Different FX & Selic Scenarios, %

	Expected inflation: rates & BRL unchanged	Expected inflation: "Focus Survey FX & Selic consensus assumptions"	BCB Target
Q3-2020	2.90	2.90	4.00
Q4-2020	2.10	2.10	4.00
Q1-2021	2.40	2.30	3.75
Q2-2021	3.30	3.20	3.75
Q3-2021	2.80	2.60	3.75
Q4-2021	3.00	2.60	3.75
Q1-2022	3.40	2.80	3.50
Q2-2022	3.80	3.20	3.50
Q3-2022	3.90	3.20	3.50
Q4-2022	3.80	3.10	3.50
Q1-2023	4.10	3.20	3.25
Q2-2023	4.30	3.20	3.25
Q3-2023	4.50	3.20	3.25
Q4-2023	4.60	3.30	3.25

Sources: Scotiabank Economics, BCB, IBGE.

- **If the Copom leaves the Selic unchanged until the end of 2023,** it will hit its inflation target in 2022, but it will then overshoot from the second half of 2022 onward.

- **Alternatively, if the BCB follows the expectations of the consensus in the most recent *Focus Survey***, it will undershoot its target in 2022, but be "on target" in 2023.

We have a more hawkish path for the Selic in our more recent *Latam Weekly* than consensus at the end of 2021 (i.e., we forecast 4.25% versus 2.50% consensus in the *Focus Survey*), mainly owing to our expectation that the tightening cycle will kick off about six months earlier than consensus. The foundation for this view is that once the economy gets back on track, which we expect next year, we believe that the BCB will have to tighten earlier than anticipated by analysts surveyed in order to contain inflationary pressures and to provide financial stability. The main risk we see to our view is rooted in the possible unwinding of fiscal stimulus at the start of 2021, alongside the possibility of a re-introduction of shut-downs in major economies, which would hit the Brazilian economy hard. We're holding out on any revisions to our view for the moment and will monitor developments in the pandemic's evolution.

—Eduardo Suárez

COLOMBIA: WE ANTICIPATE ANOTHER -25 BPS CUT TODAY FROM THE BANREP

Today, Friday, September 25, BanRep will hold its regularly scheduled Board meeting and we, along with consensus, expect it to bring in a final -25 bps cut. In the last meeting, the Board cut the policy rate by -25 bps to 2.00% in a unanimous vote. In the post-meeting press conference, Governor Echavarria left the door open for further cuts amid weakening inflation and persistent uncertainty on economic activity. However, he also said that the space for further cuts has shrunk and that the central bank would remain in a data-dependent stance. For this meeting, analysts are divided in their calls between for a hold and a final -25 bps cut to 1.75%. We think BanRep will deliver this final cut today on the back of August's lower inflation.

After the last meeting on August 31, that month's inflation reading surprised on the downside, dampened by a significant drop in education prices (which are inside the set of core numbers) that more than offset increases in regulated prices. Additionally, economic activity indicators for July continued to show a gradual recovery, although at a slowing pace owing to Bogota's and Medellin's enhanced mobility restrictions. Economic activity should pick up from September due to the national government's move to a new, more comprehensive re-opening plan (see our comment in the *Latam Daily* for Sept 24) and lower the space for further easing from the BanRep.

We think BanRep will cut the policy rate once more today by -25 bps to 1.75% for three main reasons:

1) **Headline inflation is below the target range, and core inflation is closer to 1% y/y than 2% y/y,** which should reassure the BanRep's Board and Staff that further easing is merited;

2) **The Board's unanimous vote for a -25 bps hold at the August meeting implied that it would not be ready to move to a hold today.** This united stance could be broken in today's meeting; and

3) **There is political and market support for further easing:** the market has already priced in this final cut.

Having said all of this, since we expect stable inflation for the rest of the year and consolidation in economic activity to keep the BanRep Board on hold from this point onward to Q3-2021.

—Sergio Olarte & Jackeline Piraján

MEXICO: DESPITE RISING INFLATION, BANXICO CUTS -25 BPS AND LIKELY ENDS EASING CYCLE

I. Banxico cut rates by -25 bps, most likely ending its easing cycle

In line with market expectations, Banco de Mexico reduced the interest rate target by -25 bps to 4.25% in a unanimous vote on Thursday, August 24. Although the move was in line with consensus, analysts had expected a mix of votes in view of the risks to inflation, economic activity, and financial markets. This move is the eleventh consecutive time that Banxico has lowered its target rate, accumulating -400 bps of cuts since the beginning of this cycle; we believe this cut marks the end of the cycle and we expect an extended hold at 4.25% (chart 4). In a slightly shorter than usual statement, Banxico's Board emphasized a few key points:

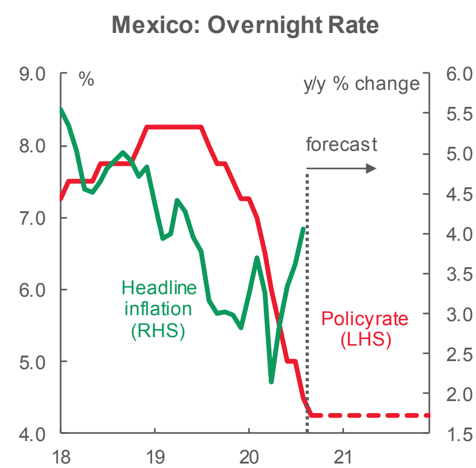
- **The balance of risks for inflation remains uncertain.** Regarding inflation's trajectory, the Board mentioned that the pace of price increases has surpassed short-term expectations. For the next 12 to 21 months, however, the Board anticipates that headline and core inflation will stand around 3%. Still, the following risks stand out: on the downside, (i) greater-than-expected pressure from the negative output gap, and (ii) lower global inflationary pressures; on the upside, (i) additional depreciation of the peso, as well as (ii) a high degree of stickiness in core inflation.

- **The balance of risks to growth is skewed downward.** The text points out that economic activity in Mexico began to recover after the deep contraction observed in April and May; however, the outlook for growth continues to look uncertain. Thus, the Board foresees ample slackness in the Mexican economy over the current horizon of monetary policy.

- **Global economic activity continues to recover, but the Board anticipates ongoing accommodative monetary policies from the central banks of advanced economies.** The Board indicated that the world economy and international financial markets are subject to various risks, including those associated with the pandemic, which will guide Banxico's policymaking peers.

Considering the upward trend that inflation has maintained over recent months (chart 5), we think the cycle of monetary easing has ended, or has come close to an end. Further easing would be contingent on inflation coming down closer to levels more consistent with the Banco de Mexico's targeting framework.

Chart 4



Sources: Scotiabank Economics, Banxico, INEGI.

Chart 5

Sources: Scotiabank Economics, INEGI.

II. Headline inflation above target for a second fortnight

Headline inflation in the first half of September, released on Thursday, September 24, came in at 4.10% y/y (chart 6), above the upper limit of inflation target rate established by Banxico (i.e., 3% with a band of +/- 100 bps). In sequential terms, it came in at 0.16% 2w/2w, a touch higher than the 0.10% 2w/2w market consensus, but a hair down from 0.17% 2w/2w at the end of August. Core inflation rose 0.17% 2w/2w compared with 0.18% 2w/2w in the second half of August, owing to growth in both goods and services prices. Non-core prices rose, with a particular impact from a rise in livestock products and fees authorized by the government.

- **Core inflation** was driven mainly by a rebound in services prices, which saw their inflation rate accelerate from 0.10% 2w/2w in the second half of August to 0.17% 2w/2w in the first half of September. The increase in the education sub-component stood out. Goods prices saw a fortnightly increase of 0.16% 2w/2w.
- **Non-core prices** rose 0.15% 2w/2w as the agricultural component sped up from 0.10% 2w/2w to 0.17% 2w/2w, mainly driven by livestock products. The sub-component of fees authorized by the government went from 0.11% 2w/2w at end-August to 0.30% 2w/2w, while the energy item softened its inflationary pace from 0.15% 2w/2w to 0.07% 2w/2w.

Chart 6

Sources: Scotiabank Economics, INEGI.

Thus, in an annual comparison of the consumer price index remained practically unchanged as it moved from 4.11% y/y at end-August to 4.10% y/y (versus 2.99% y/y a year earlier). The core component went from 4.01% y/y to 3.99% y/y (versus 3.78% y/y a year earlier) and the non-core component went from 4.42% y/y to 4.44% y/y (versus 0.57% y/y during the same period in 2019).

—Miguel Saldaña