April 9, 2021

Latam Daily: BCRP Held; Banxico Minutes Imply Narrow Path for Further Easing

- **Chile: March CPI stood at 0.4% m/m, 2.9% y/y**
- **Colombia: Consumer confidence kept improving in March**
- **Mexico: Very narrow path to further easing; March inflation above Banxico target band; auto industry rebounded in March**
- **Peru: The BCRP held at 0.25%; mining investment in February was unencouraging**

CHILE: MARCH CPI STOOD AT 0.4% M/M, 2.9% Y/Y

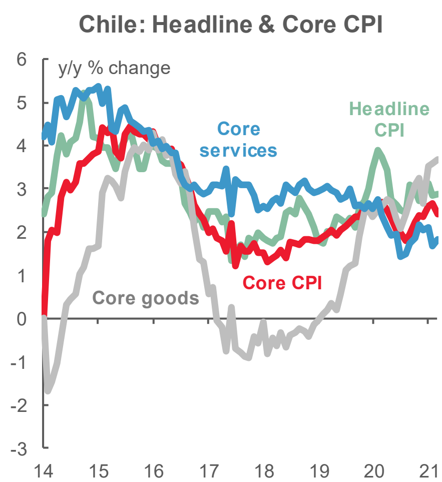
March CPI data calmed inflationary concerns, at least for now. The risk of too-subdued inflation is expected to emerge toward the second half of 2021.

March inflation stood at 0.4% m/m, in line with our forecast, although the market had anticipated a higher print (i.e., 0.5% m/m in the forwards). With this, annual inflation reached 2.9% y/y and remained influenced by higher prices for goods that offset the relatively low 2% y/y increase recorded for services (chart 1).

Still, monthly inflation in March was largely explained by an incipient rise in services prices, including seasonal increases in education services prices, together with somewhat smaller declines in interurban transport services. Along with services, the rise in fuels stands out, due to the higher international prices of oil and its derivatives, which have continued to be transferred internally through the MEPCO mechanism with weekly increases in all fuels (chart 2).

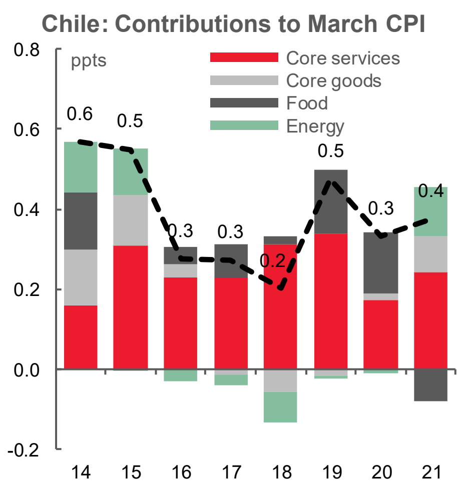
Regarding price imputations, the INE reports that in the March inflation print the methods applied in previous months were maintained; that is, they assumed null price variations for items such as air transport services, tourist packages, and other recreational services. The recently imposed new sanitary measures have forced delays in plans to resume the collection of prices for these items, which were expected to start reporting actual numbers in April.

Chart 1



Sources: Scotiabank Economics, INE.

Chart 2



Sources: Scotiabank Economics, INE.

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For April, we preliminarily project a CPI variation of 0.3% m/m, with a new positive incidence from gasoline. From May onward, we could begin to see zero contribution from fuels to overall inflation. The recent measures to restrict the consumption of certain goods considered non-essential will also make it possible to reduce somewhat the pressure on distribution chains and facilitate a replenishment of inventories in these products, which could somewhat mitigate pressure on prices.

For now, we are still expecting monthly inflation prints to come in around historical averages during the first few months of 2021, but we see risks that inflation will subside abruptly in the second part of the year. In terms of monetary policy, we maintain our view that the first hike in the monetary-policy rate should be expected to occur at the January 2022 meeting.

—Jorge Selaive, Carlos Muñoz, & Waldo Riveras

COLOMBIA: CONSUMER CONFIDENCE KEPT IMPROVING IN MARCH

March's Consumer Confidence Index (CCI) data, contained in a Fedesarrollo release on Thursday, April 8, stood at -11.4 ppts, an improvement of 3.2 ppts from February's level of -14.6 ppts. This brought the index closer to pre-pandemic levels (Feb 2020: -11.2 ppts, chart 3). Positive developments in consumers' sentiment continued even though in some regions COVID-19 contagion increased and regional leaders implemented some new restrictions. Expectations about the future remained at solid levels, and in March, current conditions improved too.

Looking at March's details, as laid out in chart 3:

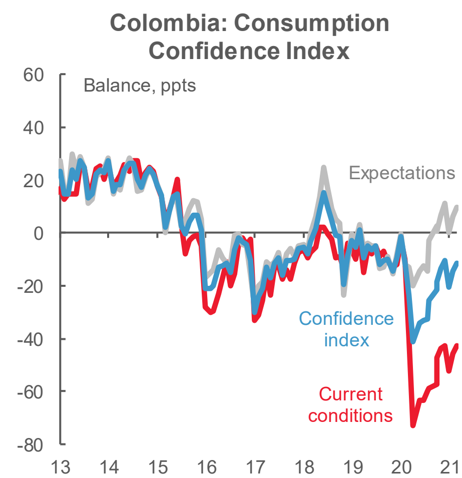
- **The Current Conditions Index increased to -42.8 ppts versus February's -45.8 ppts.** However, consumers remained pessimistic about current households' conditions; and
- **The Expectations Index rebounded to 9.6 ppts, an increase of 3.4 ppts from February's figure.** This gain was led by a better net assessment of the country's future situation from 1.5 ppts in February to 8.0 ppts in March. Expectations are at favourable levels, comparable to those observed in 2018 when the economy was in a positive recovery phase.

Despite these overall gains, Colombian consumers' willingness to buy durable goods remained soft, with only a slight jump from -58.2 ppts in February to -52.0 ppts in March (chart 4). Previous dynamics would be explained by the lags in the employment recovery and reductions in households' income; we expect this sentiment to improve gradually as lockdowns intensity decrease.

At the regional level, consumer confidence numbers improved in four out of the five major cities surveyed, with Medellin leading the gains. On the other hand, Bogota and Cali were the cities with the worst results. In Cali, consumer confidence deteriorated as restrictions to contain the pandemic spread were especially hard. Consumers' willingness to buy houses rose by 5.8 ppts on better sentiment in Medellin (42.5 ppts) and Barranquilla (24.8 ppts).

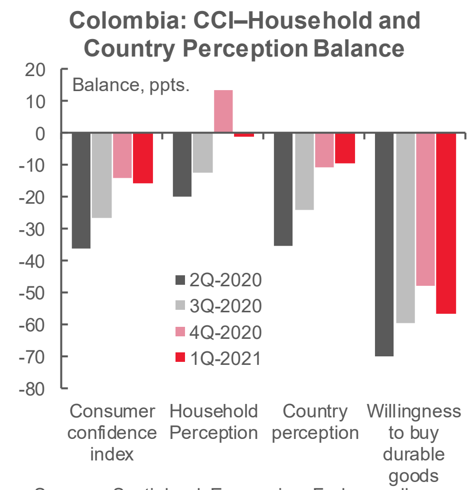
By socio-economic levels, March's indices painted a positive picture for middle- and high-income earners' confidence, which improved by 5.7 ppts and 6.9 ppts, respectively. In contrast, the overall index for low-income populations remained stable at -15.4 ppts.

Chart 3



Sources: Scotiabank Economics, Fedesarrollo.

Chart 4



Sources: Scotiabank Economics, Fedesarrollo.

To sum up, March's consumer confidence data affirmed that households remained optimistic about the future, but cautious about the current situation, which kept weak their willingness to buy durable goods. It is positive news that confidence keeps rising despite the new public-health restrictions in some cities: this signals that the new restrictions are more targeted and that the populace is better placed to accommodate them. We expect confidence to keep improving, but at a slower pace amidst still challenging labour-market dynamics.

—Sergio Olarte & Jackeline Piraján

MEXICO: VERY NARROW PATH TO FURTHER EASING; MARCH INFLATION ABOVE BANXICO TARGET BAND; AUTO INDUSTRY REBOUNDED IN MARCH

I. Banxico's minutes—data-dependent dovishness leaves very narrow path to further easing

Banxico published the minutes from its March 25 meeting, where the Board unanimously left rates on hold as rising US rates and market volatility, alongside spikes in both core and headline inflation, pushed a more cautious stance. The pause served two purposes: on one hand, the Board saw the pause as an opportunity to evaluate the impact of rising US rates on emerging markets (Ems) and capital flows; on the other hand, it also served to send a signal that, faced with higher financial uncertainty, Banxico will manage its policies prudently. Our sense is that at least two Board members see the path to additional easing as having narrowed. Policy going forward is in data-dependent mode.

In the discussion of the external environment there was some uncertainty over the impact of US monetary policy in EMs and Mexico, not only centered around a potential start of the Fed's next hiking cycle (which the FOMC sees in 2023, but which markets are now pricing for 2022), but also around dynamics of non-conventional policy tweaks. There was also uncertainty surrounding capital flows, not only those driven by a move toward higher UST yields, but also those that reflect a reallocation within EM driven by the looming inclusion of Chinese public debt in additional benchmarks.

On the domestic economy side, Banxico's Board noted the deceleration that we have seen in the first two months of the year, but described it as driven by transitory factors, mainly the new round of shutdowns in response to COVID-19 pandemic's latest wave. However, the Board noted that the main driver of the economy's recovery continues to be externally driven, while domestic consumption and investment remain weak. On the labour front, the Board highlighted the recent weakening in the labour market's recovery, with growth in some indicators not only slowing, but deteriorating in their most recent prints. Overall, the balance of risks to growth according to some of the Board (likely two members) remains tilted to the downside.

On the inflation front, although the Board anticipated the near term rise in inflation, which is to an important degree driven by base effects (although core merchandise price pressures are also present), it still sees inflation converging to the 3% y/y target by Q2-2022. The main risk seen by the majority of the Board appears to be MXN depreciation, although there is a fairly serious number of additional risks that the Board identifies. Our own view on the inflation front is a little less benign than the Board's, with four key items playing a part in our higher inflation call:

- **Cost pressures for producers.** Over the last couple of years, minimum wages have increased close to 40%. To these producer pressures we need to add some legislation running through Congress that could tighten further their margin squeeze: the outsourcing bill, which would strongly limit the use of this type of labour, which currently accounts for about 20% of the formal market; the pension reform would gradually increase employer contributions from 5.15% to 13.875% over eight years; and the power-related bills which could put upward pressure on business-sector electricity costs—and also trigger under-investment that could increase the risk of blackouts (another cost pressure). PPI is already running materially above CPI, and producer price pressures look likely to rise;

- **Indexation concerns.** As we noted above, the past couple of years have seen minimum wages increase by almost 40%. However, going forward, the government's new policy is that minimum wage increases will always be higher than inflation, which could introduce indexation risks to Mexico's inflation dynamics. Though these are widespread in South American economies, they have heretofore been modest in Mexico;

- **A more dovish bias in the Board could raise inflation risks.** The past couple of years have seen three of the five members of Banxico's Board change. Although the strength of the Board, at least from a technical perspective, has not suffered, we have seen a shift in the bias of one of the more hawkish central banks in Latam to a more dovish tilt. In the past, Banxico built a reputation as a central bank that consistently erred on the side of anchoring inflation expectations, which in turn, likely stabilized inflation by reducing uncertainty around temporary inflation spikes. Now that the Board has shifted a more balanced view between growth and inflation, inflation risks have likely risen; and

- **Services inflation.** At the end of 2020, parts of the services sector related to entertainment and tourism were operating close to 40% capacity, making them among the hardest-hit sectors in the economy. With vaccination efforts putting light at the end of the pandemic tunnel, a big jump in demand for their services is now looming more closely. Like the current bout of base-effect driven annual headline inflation, annual services inflation is set to have an unfavourable base as we approach end-2021, but we could also see inflationary pressures come from a big jump in demand in the midst of capacity constraints.

Although Banxico is in a data-dependent mood and exhibited a somewhat dovish bias in its latest minutes, we believe the window for cutting rates further is squeezed in between inflation shocks. Without risk of indexation kicking in (with new wage policies), it would be easier for Banxico to look-though these shocks as they are somewhat base-effect driven. However the risks of price contamination make looking through these shocks harder. If markets remain volatile or the MXN stays under pressure during this window to ease, this portal could shut completely. Banxico's capacity to cut further could also be complicated by progress in other EM central banks with their own tightening cycles. Such moves could limit Banxico's ability to cut due to capital flow risks in a world of diverging monetary conditions. We stick to our view of 1 more -25 bps cut in Q3, but see an increasingly narrow path for its materializing.

—Eduardo Suárez

II. Inflation surpassed Banxico target range in March, as expected

Inflation data for March, released by INEGI on Thursday, April 8, came in at 4.67% y/y, well above Banxico's target-range ceiling of 4% y/y (chart 5). This rise in inflation was partly expected by both market participants and Banxico, as energy-related base effects, as well as a deterioration in core inflation, were long positioned to lead to higher headline inflation.

On a sequential basis, monthly headline inflation (0.83% m/m) came in slightly above consensus (0.80% m/m), up from the 0.63% m/m we saw in February. On the other hand, core inflation had a monthly variation of 0.54% m/m, in line with 0.51% m/m average forecast of the Citi Survey. This time, both merchandise and services grew more sharply than in the previous reading. Merchandise prices accelerated their pace to 0.60% m/m from 0.52% m/m in February; services prices rose 0.47% m/m, from the 0.25% m/m reported in February.

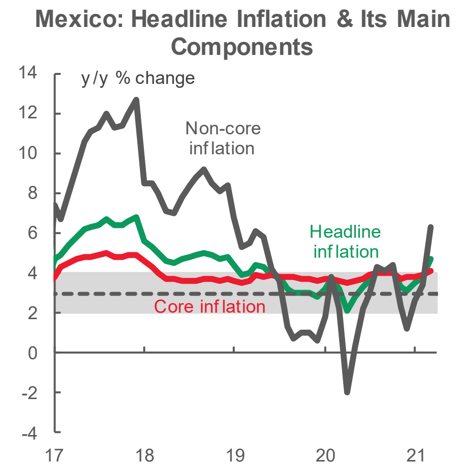
Non-core inflation rose 1.69% m/m, stronger than the 1.36% m/m in February and the -1.06% m/m recorded a year earlier. The significant increase was mainly driven by disruptions observed in energy markets. The increase in energy prices was 2.75% m/m, which followed a very high 3.47% m/m in February; meanwhile agricultural prices rose 1.27% m/m (versus -0.22% m/m previously).

In its annual comparison, the National Consumer Price Index accelerated to 4.67% versus 3.76% previously and 3.25% a year earlier. The core component came in at 4.12% y/y from 3.87% y/y previously (chart 6). The merchandise subcomponent accelerated from 5.54% y/y to 5.79% y/y. Meanwhile, the services subcomponent accelerated again, this time from 2.06% y/y in February to 2.30% y/y currently.

The non-core component climbed from 3.43% y/y in February to 6.31% y/y as energy prices accelerated by 14.55% y/y from 6.83% y/y in the previous month—reaching their highest pace of gains since October 2018, when the rate of increase was 17.10% y/y (chart 7). Food product price growth softened to 0.64% y/y from 0.66% previously.

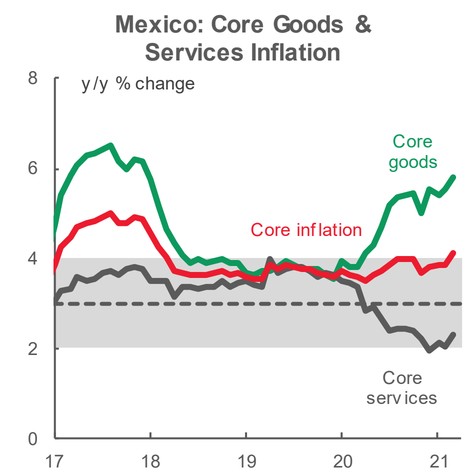
This increase in annual inflation for the months of March and April has been widely expected, mainly owing to the base effects stemming from the reduction in energy prices from the previous year. We anticipate that by Q3-2021 these effects could begin to dissipate. Given Banxico's data-dependent stance, we expect

Chart 5



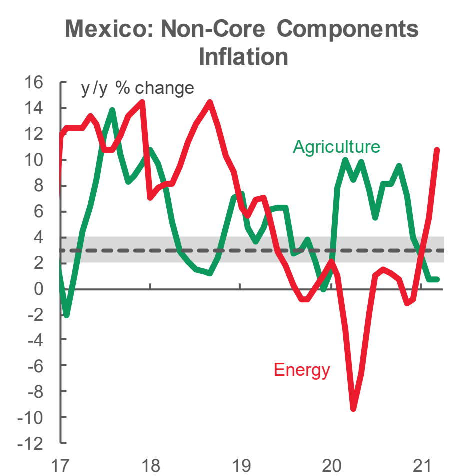
Sources: Scotiabank Economics, INEGI.

Chart 6



Sources: Scotiabank Economics, INEGI.

Chart 7



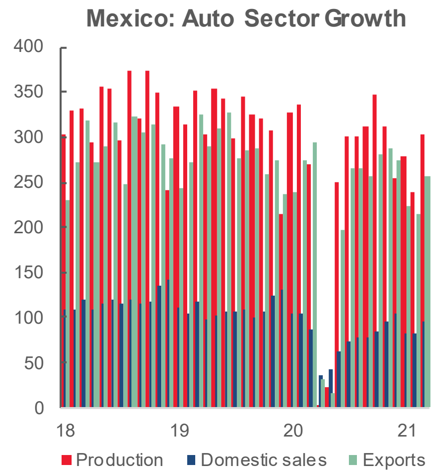
Sources: Scotiabank Economics, INEGI.

that if inflation were to actually decline by the third quarter, this would again open a window of opportunity for an additional -25 bps cut, which is our current view. However, as we mentioned above, financial market developments could also narrow this window.

III. Auto-industry growth rebounded in March due to base effects and better weather conditions

According to data released by INEGI on Thursday, April 8, the auto industry saw an improvement in activity during March despite the chip shortage that affected production (chart 8). Auto production growth rebounded from -28.0% y/y in February to -12.5% y/y in March (303.5k units) owing to base effects since pandemic-related closures started affecting the economy in March of 2020. However, cumulative production remained in negative territory at -12.0% y/y YTD in March, which represented 821.1k units. On a sequential basis, production growth rebounded from -14.3% m/m in February to 27.1% m/m in March: in February, the industry experienced technical stoppages from the power outrages driven by extreme weather conditions in the US. Though these weather conditions normalized in March, chip shortages continued to hinder potential production and many analyst expect this to continue at least until the second half of the year.

Chart 8



Sources: Scotiabank Economics, INEGI.

Exports softened their annual contraction from -21.8% y/y in February to -13.2% y/y in March, which corresponded to 256.1k exported units. Cumulative exports remained almost unchanged at -14.1% y/y YTD. On a monthly sequential basis, exports bounced back in March as weather conditions normalized in the US and the stimulus package materialized. We anticipate that exports should continue to rebound as production stabilizes and the fiscal stimulus packages in the US translate into increased consumption and demand for Mexican goods and services.

Finally, domestic sales bounced back from -21.1% y/y to 9.1% y/y (95.5k sales) owing to the base effect of the comparison with the same month in pandemic-affected 2020. Cumulative domestic sales eased their contraction from -21.8% y/y to -12.7% y/y YTD. However, in their sequential monthly comparison, sales accelerated from 1.4% m/m in February to 16.0% m/m in March. This was consistent with an improvement in pandemic-related risk assessments (i.e. the "traffic light system") for most of Mexico's states.

—Miguel Saldaña

PERU: THE BCRP HELD AT 0.25%; MINING INVESTMENT IN FEBRUARY WAS UNENCOURAGING

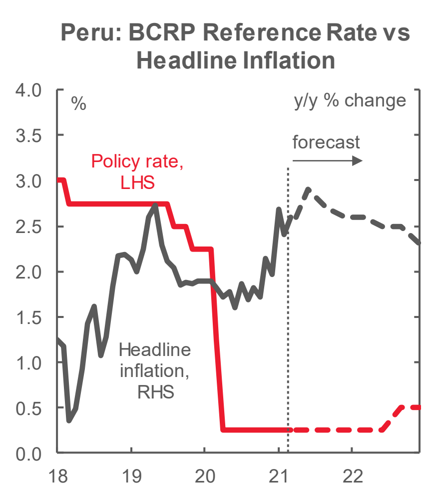
I. The BCRP held at 0.25% with no change in forward guidance

At its monthly meeting on Thursday, April 8, the Board of Peru's BCRP decided to keep its key interest rate unchanged at its current record low of 0.25% for a twelfth consecutive month, as widely expected by both Scotiabank Economics and market consensus. The BCRP's reference rate has been at 0.25% since April 9, 2020 at the onset of the pandemic.

In the statement, the Board reiterated its forward guidance from previous months. It advised that the reference rate would remain low for an extended period and for so long as the pandemic's effects on inflation and its determinants persist. It repeated its commitment to using "diverse instruments" to support the monetary stimulus it is providing, should this prove necessary. The current policy mix seeks to strengthen long-term interest rate transmission mechanisms with a focus on mortgage rates.

Inflation in Q1-2021 has been above both the BCRP's 2% y/y target and expectations, but it remains in line with our forecast of 2.6% y/y for end-2021 (chart 9). After January saw a surprising 2.7% y/y print, headline inflation came down to 2.4% y/y in February before rising again to 2.6% y/y in March. The most recent price

Chart 9



Sources: Scotiabank Economics, BCRP, INEI.

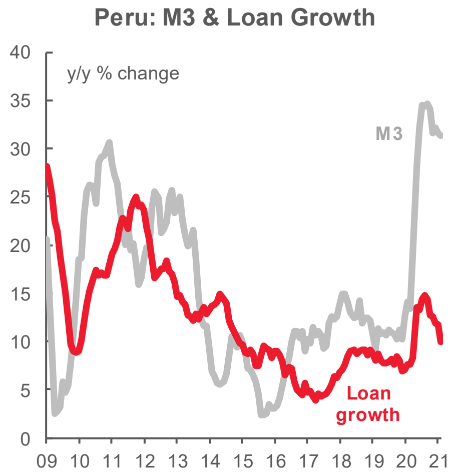
pressures have come from non-core and fuel prices. Core inflation still rose from 1.6% y/y in February to 1.8% y/y in March, but it remains below the 2% y/y target for headline inflation. In its March *Inflation Report*, the BCRP revised its inflation forecast for 2021 from 1.5% y/y to 2.0% y/y as the Bank's survey of inflation expectations moved from 1.7% y/y to 2.1% y/y for this year.

We see little immediate rationale for the Board to change its stance even though level effects are expected to push headline inflation close to 3.0% y/y in the coming months. Slack is expected to persist in the Peru's economy well into 2022.

Taking recent developments into account, we reconfirm our forecast that the BCRP Board will keep its reference rate on hold at 0.25% until Q3-2022 (chart 9, again). An eventual rate increase would be preceded by a gradual shift in the Board's forward guidance toward a less data-dependent line.

Monetary expansion, one of the most powerful in the region, reached its highest rate in Q3-2021, but is levelling off. It now shows a slight slowdown, both in terms of the growth of the money supply and in the moderating the pace of loan growth (chart 10).

Chart 10



Sources: Scotiabank Economics, BCRP.

The statement highlighted that business expectations continued to improve in March and entered optimistic territory. In the March *Inflation Report*, the BCRP also revised its growth forecast for 2021, as expected, but brought it down only from 11.5% y/y to 10.7% y/y, a still ambitious figure yet that is well above our 8.7% y/y projection.

Regarding the FX market, the BCRP has sold USD 108 mn in the spot market so far in April, despite the recent reversal of FX expectations, which has led the PEN to print its highest and fastest appreciation (i.e., 5% in four days) since 1992. The BCRP has accumulated sales in the spot market of USD 2.5 bn YTD, although its net FX position garnered an increase of USD 0.8 bn YTD.

The supply of derivatives decreased significantly (only USD 0.2 bn so far in April), after increasing by USD 4.4 bn in March. The imbalance in the spot FX market remained high in March, reaching a deficit of USD 3.1 bn. We expect this shortfall to be reduced over the time, as the supply of dollars and FX expectations normalize following the extended electoral season.

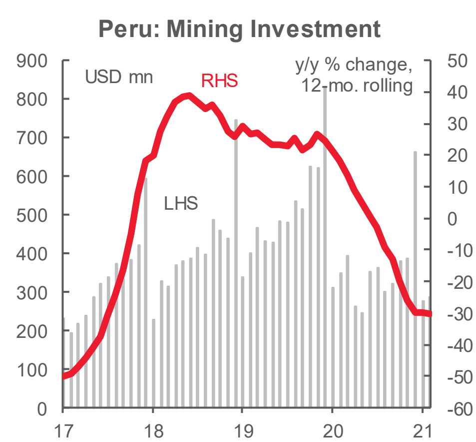
—Mario Guerrero

II. Mining investment weaker than expected in February

Mining investment was down -18.2% y/y in February, mildly lower than we expected. The trend is also poor, declining -15.5% y/y over the January-February period compared with the same two months in 2020. This is still, however, broadly in line with our forecast of 12% y/y growth in 2021. Although the trend is negative, it will start to turn around sharply in March, when the year-on-year figures will compare to a low 2020 lockdown-affected base. The -30% y/y decline in the 12-month rolling trend, which included the 2020 COVID-19-related restrictions, is indicative of the magnitude of the pandemic's impact (chart 11). If not for the lockdown, mining investment would be declining in 2021 compared with the year before. As it is, mining investment is likely to stay below 2019 levels. Part of the reason is that investment in the large Mina Justa and Toromocho projects is winding down. Meanwhile, investment at Quellaveco (Anglo American) continues to lead: Quellaveco is nearly 60% completed, but investment is not likely to conclude before the latter half of 2022 (table 1).

—Guillermo Arbe

Chart 11



Sources: Scotiabank Economics, Ministerio de Energía y Minas.

Table 1
Peru: Mining Investment

		February			January-February		
	Top 20 Investment Companies	**2020, USD**	**2021, USD**	**y/y % chg**	**2020, USD**	**2021, USD**	**y/y % chg**
1	Anglo American Quellaveco S.A.	81,663,821	84,884,395	3.9%	145,370,766	152,582,240	5.0%
2	Marcobre S.A.C.	44,236,243	30,091,448	-32.0%	89,336,289	63,395,623	-29.0%
3	Compañia Minera Antamina S.A.	18,061,654	26,604,487	47.3%	37,720,500	49,840,752	32.1%
4	Southern Peru Copper Corporation Sucursal Del Peru	15,644,973	18,968,438	21.2%	21,999,925	38,625,930	75.6%
5	Minera Chinalco Peru S.A.	39,287,033	17,224,163	-56.2%	78,684,639	33,676,359	-57.2%
6	Minera Las Bambas S.A.	21,588,634	11,867,694	-45.0%	32,722,571	20,436,005	-37.5%
7	Sociedad Minera Cerro Verde S.A.A.	15,363,215	10,680,184	-30.5%	46,012,101	18,526,875	-59.7%
8	Compañia Minera Poderosa S.A.	5,897,996	5,495,035	-6.8%	15,502,979	15,474,953	-0.2%
9	Minsur S.A.	1,951,318	2,867,187	46.9%	5,405,131	10,427,690	92.9%
10	Minera Yanacocha S.R.L.	8,465,218	5,248,413	-38.0%	12,150,260	8,863,399	-27.1%
11	Volcan Compañía Minera S.A.A.	6,070,859	4,776,578	-21.3%	14,146,812	8,736,122	-38.2%
12	Compañia Minera Ares S.A.C.	5,909,669	4,488,384	-24.1%	10,377,788	8,303,087	-20.0%
13	Nexa Resources El Porvenir S.A.C.	1,697,271	3,251,850	91.6%	2,937,313	6,635,137	125.9%
14	Hudbay Peru S.A.C.	4,156,211	3,425,682	-17.6%	6,654,039	6,143,319	-7.7%
15	Consorcio Minero Horizonte S.A.	2,764,694	2,954,966	6.9%	5,055,458	6,036,320	19.4%
16	Compañía De Minas Buenaventura S.A.A.	4,747,041	3,379,394	-28.8%	6,661,291	5,376,891	-19.3%
17	Sociedad Minera El Brocal S.A.A.	665,244	606,117	-8.9%	732,968	5,272,466	619.3%
18	Minera Shouxin Peru S.A.	-	948,403	+	-	5,065,528	+
19	Compañia Minera Chungar S.A.C.	2,912,465	2,480,002	-14.8%	5,065,568	4,545,983	-10.3%
20	Compañia Minera Kolpa S.A.	1,580,954	1,445,616	-8.6%	3,496,125	4,377,077	25.2%
	Total for top 20	282,664,513	241,688,436	-14.5%	540,032,523	472,341,756	-12.5%
	Other companies	66,117,466	43,584,971	-34.1%	120,193,851	85,315,001	-29.0%
	Grand Total	**348,781,979**	**285,273,407**	**-18.2%**	**660,226,374**	**557,656,757**	**-15.5%**

Sources: Scotiabank Economics, Ministerio de Energía y Minas.