Latam Daily: Colombia Preview to Friday's MPR Decision, Economic Survey; Peru GDP

- **Colombia: Preview to central bank's MPR decision on Friday; BanRep's survey of expectations and economic activity**
- **Peru: GDP growth begins to lose steam in October**

COLOMBIA: PREVIEW TO CENTRAL BANK'S MPR DECISION ON FRIDAY; BANREP'S SURVEY OF EXPECTATIONS AND ECONOMIC ACTIVITY

I. Monetary policy meeting preview: clear inflation upside pressures will maintain BanRep on the hawkish side

Tomorrow (Friday, December 17), the central bank, BanRep, will hold its regular monetary policy meeting. The majority of analysts expect the Board to increase the policy rate by 50 bps to 3.00%, which is aligned with our own projection. At its last meeting (October 29), BanRep surprised the market with a 50 bps hike, mainly on a more constructive view about the economic growth, however, the decision was in a split vote (2 voting for + 25 bps versus 5 voting for +50 bps). Since then, macro data has affirmed a strong economic recovery, in fact, in Q3-2021 the economy stood 2.6% above pre-COVID-19 levels, and some market players now expect the economy to grow above 10% in 2021.

As we discuss in the following sections, recent data on inflation landed above the consensus, with y/y headline inflation now more than 1% above the ceiling of the target range (2%–4%). Additionally, the recent announcement of a 10.07% increment to the minimum wage will put additional pressures on inflation into 2022. Our base case scenario is still a 50 bps hike in Friday's meeting, however, a split decision including a vote(s) for a 75 bps hike is not discarded. Looking ahead, in 2022 inflation developments would determine if the terminal rate in the hiking cycle would surpass the neutral rate.

Key points to have in mind ahead of Friday's BanRep vote:

- **Even while this meeting will not be accompanied by an official update of the *Monetary Policy Report*, the central bank would have a new expected path of inflation and economic growth.** In fact, in recent, minimum wage negotiations tabled by the central bank said that they upgraded inflation expectations to close around 5.3% in 2021, while in 2022 it would be above 3.6%. It would be relevant to know the assessment of the central bank regarding the risk associated with the minimum salary increase of 10.07%.

- **Recent economic data pointed to a stronger than expected recovery, meanwhile, the country is maintaining broad normality, even allowing massive events at full capacity, observing vaccination requirements for attendees.** Additionally, household consumption received a boost from the VAT holidays in October, November, and December, which would continue leading to a stronger close of 2022.

CONTACTS

Adriana Vega
613.564.5204
Scotiabank Economics
adriana.vega@scotiabank.com

Guillermo Arbe
+51.1.211.6052 (Peru)
Scotiabank Peru
guillermo.arbe@scotiabank.com.pe

Sergio Olarte
+57.1.745.6300 Ext. 9166 (Colombia)
Scotiabank Colombia
sergio.olarte@scotiabankcolpatria.com

Jorge Selaive
+56.2.2619.5435 (Chile)
Scotiabank Chile
jorge.selaive@scotiabank.cl

Eduardo Suárez
+52.55.9179.5174 (Mexico)
Scotiabank Mexico
esuarezm@scotiabank.com.mx

TODAY'S CONTRIBUTORS:

Jackeline Piraján
+57.1.745.6300 Ext. 9400 (Colombia)
Scotiabank Colombia
jackeline.pirajan@scotiabankcolpatria.com

- **Inflation stood at 5.26% in November, while core inflation measures increased, in the case of inflation ex-food the increase was of 50 bps to 3.36%, while in the case of inflation ex-food and regulated prices, the inflation was 2.54% (+52 bps).** Higher input prices and FX depreciation among other internal factors related to the reopening are leading to higher inflation. One additional risk would come from the minimum wage increase. Our current forecast for December 2022 of 4% assumes a minimum wage increase of 6.5%–7%, however, given that around 20% of the CPI basket is affected by past inflation and 10% responds to the minimum wage, we think that a 10.07% increase in the minimum wage makes highly probable that inflation would also surpass the target range by the end of 2022 since the impact would increase headline inflation by ~30 bps from the current forecast. Previous risks would motivate a higher terminal rate of the hiking cycle in 2022.

- **The balance of payments showed a high current account deficit.** YTD up to September, the deficit reached USD 12.6 bn, equivalent to 5.5% of GDP. In an environment of tight international financing conditions due to the potential early hiking cycle from the Federal Reserve, would also motivate a hawkish call by some members.

Taking all the above into account, we maintain our expectation that BanRep would continue its hiking cycle with a 50 bps movement this week, raising the rate to 3%. However, a hawkish signal ahead of future meetings would arise if we have at least one vote for a 75 bps hike. The minimum wage increase is an upside risk for 2022 inflation and would lead to a higher terminal monetary policy rate from our current estimate of 5%. That said, January's meeting will be relevant as the staff will launch a new *Monetary Policy Report* in which we expect a more robust assessment of current developments. In January it would be relevant to monitor if the terminal rate of the hiking cycle would need to be higher than the neutral rate. For now, we affirm our expectation of policy rate closing 2021 at 3.0% and 2022 at 5% but with upside risks.

II. BanRep economic survey reaffirms expectation of 50 bps rate hike on Friday; higher rate expectations for 2022

On Wednesday, December 15, Colombia's central bank, BanRep, published its monthly survey of economic expectations. Inflation expectations (IE) for end-2021 increased by 49 bps amid persistent pressures on food prices and more moderate effects of the VAT holiday. A higher closing inflation by the end of this year will trigger higher indexations effects for 2022. Additionally, the minimum wage increase of 10.07%, announced last Tuesday, is an upside risk that was not yet captured in the survey, which had closed the previous day. As for monetary policy, expectations for Friday's Board meeting (December 17) point to a 50 bps hike, consistent with our own call at Scotiabank Economics. Looking ahead into 2022, rate hikes expectations have increased.

Table 1

Colombia: Headline Inflation Expectations

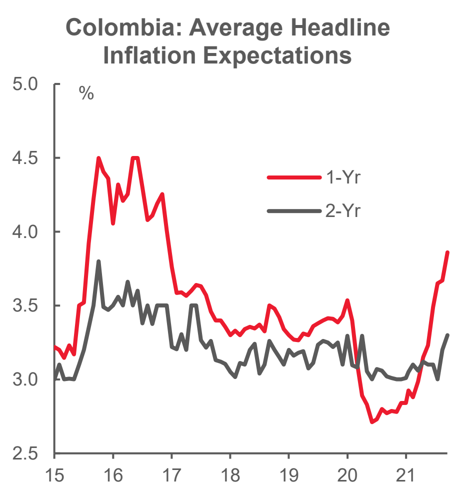
	Average	Change vs Previous Survey, bps
Dec-2021, m/m % change	0.45	…
Dec-2021, y/y % change	5.33	48
1-Yr ahead, y/y % change	3.91	26
2-Yr ahead, y/y % change	3.29	6

Sources: Scotiabank Economics, BanRep.

- **Short-term inflation.** For December is 0.45% m/m, which places annual inflation at 5.33% year-on-year (from 5.26% in November). That said, the dispersion of the survey remained significantly high with a minimum expectation of 0.04% m/m and a maximum of +0.86% m/m. Scotiabank Economics expects monthly inflation for December to be +0.54% m/m and 5.43% y/y, under continued pressure of food prices and diluted effects of the VAT holiday.

- **Medium-term inflation.** Inflation expectations rose to 5.33% y/y for December 2021, 48 basis points above last month's survey (table 1). Current higher inflation is showing more long-lasting effects, with end-2022 inflation hovering around the ceiling of the central's bank target range (2%–4%). IE for 1-year ahead stood at 3.91% y/y (above last month's reading of 3.65% y/y); and the 2-year forward was slightly above the target range of 3.29% y/y, which underscores that expectations remained anchored for the monetary policy horizon (chart 1). Scotiabank Economics expects CPI inflation to close 2021 at 5.4% y/y and end 2022 at around 4.00% y/y, amid indexation effects. It is worth noting that the potential indirect effects of the 10.07% increase in the minimum wage tilted to the upside of our current inflation expectation for 2022.

Chart 1



Sources: Scotiabank Economics, BanRep.

- **Regarding core inflation, expectations presented an upward bias.** The one-year expectation is 3.51% (above the previous survey's 3.27%), while in the two-year horizon the expectation remained within range, increased only 1 basis point to 3.01%, still in line with the central bank target.

- **Policy rate.** On average, the consensus expects one more 50 bps rate hike this year in the policy rate, to take place later this week, to close at 3.0% in 2021 (from the current 2.5%). Scotiabank Economics' forecast is in line with the consensus, however, a split vote showing a more hawkish bias is not discarded. For 2022, the consensus also expects a policy rate of 4.75% by the end of the year, an increase compared to the previous survey (4.50%) (chart 2). Scotiabank Economics' forecast is for a terminal rate of 5.0% for December 2022, assuming a path of 50 basis points hikes until the March meeting and then increases of 25 bps. However, given current developments regarding the minimum wage, the terminal rate would be higher.

- **FX.** The USDCOP projections for the end of 2021 were located at 3,863 (84 pesos above the previous survey). By December 2022, respondents think, on average, that the peso will end the year at USDCOP 3,759 (+97 pesos above the previous survey). We believe that the USDCOP would appreciate by the end of the year to 3,760.

III. Activity indicators showed Colombia is consolidating robust economic activity levels

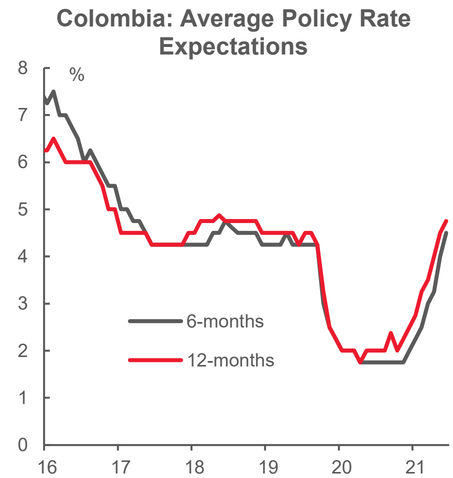
Also on Wednesday, December 15, Colombia's statistical agency (DANE) released its monthly economic surveys for October. Indicators showed positive balances, pointing to a strong end of the year in 2021. Retail sales jumped due to the effect of the VAT holiday while manufacturing production is now showing a recovery in the employment of the sector. In the same vein, the services sector strengthened its performance amid consolidation of "back to normal" mandates across the country. All in all, previous indicators affirm the expectation that the Colombian economy would grow at around or above 10% in 2021, which supports the expectation of the output gap closing faster, and indeed our expectation of a 50 bps rate hike on Friday, December 17. Employment dynamics, however, remain a source of concern.

Manufacturing Production

Manufacturing production increased by 10.1% y/y (below to market consensus +13.0%), while compared to the same pre-pandemic period (October 2019), the index grew by 7.2% (chart 3). On the employment side, the sector still shows a contraction of 1.7% versus pre-pandemic levels, especially concentrated in the clothing sector, however, we highlight that gaps in the employment side are closing, although at a more gradual pace as the "normality" consolidates. On the YTD basis, manufacturing grew by 16.4% y/y, with better gains in the employment side +2.3% versus Jan–October 2020. On a monthly basis, manufacturing expanded by 0.9% m/m (chart 3, again), as a result of higher production anticipating the strong demand for some products due to the VAT holidays in the last quarter of the year.

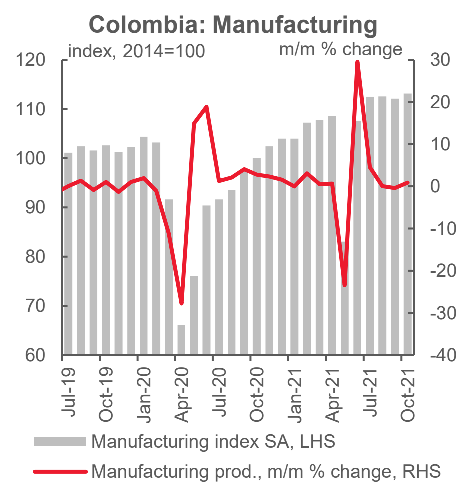
Compared to the pre-pandemic period, the sector's strongest gains came from chemical products (+25.3%), electronic devices (+38.0%); and paper-related industries (+20.4%). Lagging the recovery are vehicle body manufacturing (-32.2%) and sugar and threshing coffee (-19.4%). From the employment perspective, the main jobs contraction is reported in the clothing sector (-8.7%) and shoe manufacturing (-16.7%), both accounting for around 75% of total jobs contraction.

Chart 2



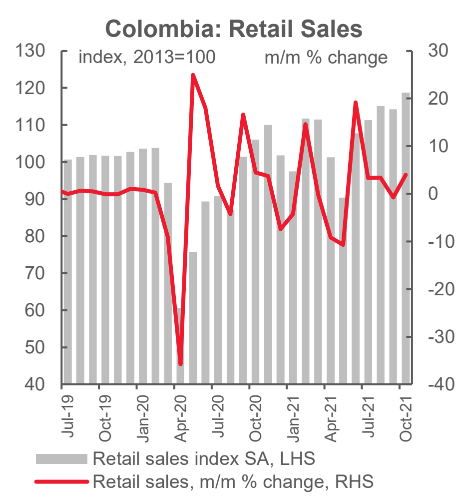
Sources: Scotiabank Economics, BanRep.

Chart 3



Sources: Scotiabank Economics, DANE.

Chart 4



Sources: Scotiabank Economics, DANE.

It is worth noting that the manufacturing sector was allowed to fully operate earlier than other sectors, that said, we expect more moderate gains in the indicator over the coming months. On the other hand, if Colombia continues to allow normal economic activity, sectors such as clothing would lead to improved dynamics in the manufacturing sector and subsequently better employment recovery.

Retail Sales

Retail sales expanded by 14.2% y/y aligned with Bloomberg's survey; and, compared to pre-pandemic levels (September 2019), retail sales are now 17.8% higher (chart 4). On a YTD basis, retail sales increased by 19.4% relative to pre-pandemic (Jan–October 2019). Mobility and the return to in-person activities continued leading retail sales dynamics. However, on the employment side, there is a contraction of 5.1% versus pre-pandemic levels, worsening from the previous month mainly in clothing and non-specialized stores. On a monthly seasonally adjusted basis, retail sales (excluding other vehicles) expanded by 4.0% m/m. The VAT holiday led to strong demand for computers and telecom devices (+44.8% y/y) and clothing (+35.1% y/y). However retail sales of other vehicles (+39.7% y/y) and gasoline (+10.4% y/y) are still the main contributors for retail sales expansion.

—Sergio Olarte & Jackeline Piraján

PERU: GDP GROWTH BEGINS TO LOSE STEAM IN OCTOBER

Peru's GDP rose 4.6%, y/y, in October. This was below our expectations of 5.6% that were modified recently based on early indicators. However, there still seems to be some upside to our full-year forecast of 12.3% growth. The 12-month trailing growth trend to October is at 12.7%. GDP growth, up 1.6% versus October 2010, has now surpassed 2019 levels for the sixth consecutive month (chart 5).

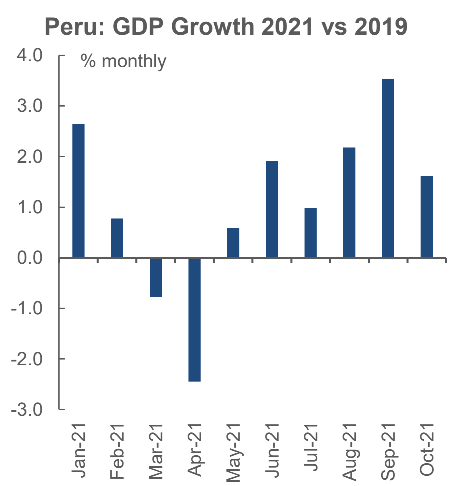
That is the good news. The bad news is that October's GDP fell by 1.2% in m/m terms. Although it may be a bit soon to make too much of this, we have a real concern that this may be a sign that politics have started to catch up with the economy and could possibly be affecting growth. This, especially considering that the disappointing m/m growth figures were across the board, encompassing nearly all sectors in October (table 2). The only exceptions were fishing (0.3%), which is volatile and non-relevant in October, hotels & restaurants (1.1%), which is still rebounding belatedly from the period of mobility restrictions, and commerce (0.4%) and telecom (0.1%) which showed very soft growth.

Agriculture fell 4.1% m/m, but that was off a strong September. Of greater significance, construction declined 4.8% m/m, and transportation fell 4.1% m/m. Ever since the lockdown ended in the third quarter of 2020, Construction had been leading in growth. This appears to be petering out. Private construction in real estate is levelling off, albeit not yet declining, whereas government investment projects slowed in October, a potentially worrying sign that political events, including a plethora of corruption investigations at regional governments, may be starting to disrupt public investment projects.

In more general terms, poor October GDP growth in m/m terms may be the first sign that economic growth is slowing in Peru. Or, it may be just a temporary pause. November–December GDP results will be crucial in determining which of the two alternatives are in play. However, it does not appear to be a coincidence that October was a pivot month in which fiscal and monetary stimulus started to be withdrawn. As a result, the economy is losing its main drivers of growth.

—Guillermo Arbe

Chart 5



Sources: Scotiabank Economics, BCRP.

Table 2
Peru: GDP Growth by Sector

%	October y/y	October m/m
Aggregate GDP	**4.6**	**-1.2**
Agriculture	5.2	-4.1
Fishing	-33.2	0.3
Mining & oil	1.4	-1.4
Manufacturing	0.9	-1.2
Electricity	3.3	-0.3
Construction	-3.1	-4.8
Commerce	5.1	0.4
Telecom	8.0	0.1
Transportation	13.3	-4.1
Business services	5.9	-0.6
Hotels & restaurants	62.1	1.1
Public administration	3.4	n/a
Financial services	-6.9	-4.0
Other services	8.5	n/a

Sources: Scotiabank Economics, INEI.