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Latam Daily: Colombian Inflation Beat Tees Up BanRep 100bps Repeat

- **Colombia: The current account deficit deteriorated further during Q3-2022 amid higher domestic demand**

The risk mood in markets is modestly positive to start the week as multiple tier-1 Chinese cities relax restrictions as the country looks more and more on track to exit zero-COVID-19 policy in H1-2023. Crude oil prices are decently stronger, shrugging off unchanged OPEC+ output plans, in line with gains in iron ore prices while other metals are little changed.

Equity markets outside of Asia-Pacific are nevertheless mixed and in relatively narrow ranges, with a more risk-on feel seen in the relatively broad weakness in the USD though the greenback has traded better over the past few hours. The MXN and JPY are underperforming, likely driven by higher US yields, and higher energy prices and possible profit-taking in the case of the yen.

It's a busy week ahead in the region in spite of holidays on Thursday in Chile, Colombia, and Peru (also on Friday) with central bank decisions and inflation data on tap.

Tomorrow, the BCCh is expected to leave its policy rate unchanged and perhaps open the door to rate cuts as soon as its January meeting (as is our expectation). Chilean Inflation data due the following day will play an important role in refining forecasts.

In Peru, the BCRP will roll out a (possibly) final 25bps hike on Wednesday, on the same day as the impeachment trial and vote against President Castillo in Congress, with odds pointing to the opposition again falling short of the required two-thirds majority to boot the head of state.

H2-Nov inflation data out of Brazil and Mexico, as well as the BCB's policy decision, where a rate hold is expected, round out the regional calendar this week.

Colombian CPI Beats, Supporting Hawkish BanRep

Colombian November inflation solidly beat economists' forecasts in data released this morning, teeing up another large BanRep hike next week. Headline prices increased 12.53% y/y and 0.77% m/m versus median estimates of 12.35% and 0.61% (and our forecasts of 12.42% and 0.67%) owing to large increases in food prices (4.7ppts contribution to headline). Core prices also recorded a solid gain, however, rising 9.48% y/y and 0.60% m/m.

The data support our team's call for a 100bps hike by the central bank next week—as is widely expected—while adding to bets that another sizable (though smaller) hike is coming at its first meeting of 2023.

We're monitoring ongoing negotiations on next year's minimum wage which, based on today's print plus a 1.24% productivity increase for 2022, would see a ~13.80% increase on the basis of today's data (pending December's release).

Lula Tees Up Haddad; Social Spending Exclusion and BCB Decision

Brazil's Lula reportedly told allies last week that Haddad will head the country's Finance Ministry. As had become apparent in recent days, the former Sao Paulo mayor and minister of education will take over from Guedes, a scenario that markets have seemingly braced for while we await more details on his plans for the country's finances and spending. The president-to-be noted on Friday that he will not announce his cabinet until Dec 12.

On Wednesday, Brazil's Congress will vote on the transition's constitutional amendment regarding the exclusion of social funds from the country's fiscal cap. Reports surfaced last week that Lula's team is willing to lower its demands to a BRL140-150bn spending waiver to gather the required two-thirds votes share, from aspirations of nearly BRL200bn (of which BRL175bn would be put towards the BRL600 per month Bolsa Familia payments). The 'watered-down' amendment would be in line with expectations, so market reaction should be limited.

—Juan Manuel Herrera

COLOMBIA: THE CURRENT ACCOUNT DEFICIT DETERIORATED FURTHER DURING Q3-2022 AMID HIGHER DOMESTIC DEMAND

On Thursday, December 1, the central bank (BanRep) released Q3-2022 current account data showing a quarterly deficit of USD6.17bn, equivalent to 7.2% of GDP (chart 1), which is 1.5ppts higher than last quarter and remains close to the highest level observed since 2014. In Q3-2022, although exports continue to be boosted by showed higher commodity prices, and also better services related to tourism, they decelerated significantly on a y/y basis, while imports continued with positive dynamics, especially for goods imports; remittances, again, helped to reduce the external deficit, while income account outflows weighed against further correction. In the YTD, the deficit was USD16.45bn—equivalent to 6.4% of GDP.

On the financing side, FDI net inflows in Q3-2022 stood at USD3.3bn, as international credit contributed USD3.2bn and portfolio investment was USD0.64bn. That said, although FDI is still the main source of total financing, debt issuance, especially from the private sector, gained participation. On the other side, capital inflows (USD0.6bn) moderated from the previous quarter's figure (USD1.4bn), as a result of a lower offshore appetite for local debt during the third quarter.

All in all, the current account deficit showed some signs of deterioration, which is in line with strong domestic demand that grew 9.8% y/y in real terms and 22.6% y/y in nominal terms, due to still very strong private consumption but also a strong recovery in investment in machinery and equipment, and construction. Domestic demand has pressured imports higher that are not being 'net out' by higher terms of trade, since export quantities are still behind pre-pandemic levels. Therefore, structural pressures on the FX continued up to September 2022.

The external deficit remains one of the most significant vulnerabilities for the Colombian economy, which supports another 100bps rate hike by BanRep at next week's meeting to try to slow private consumption but also to ensure that external inflows continue helping to finance the high current account deficit. **Governor Villar has emphasized that a larger external deficit increases the vulnerability of Colombia to international shocks.**

Chart 1

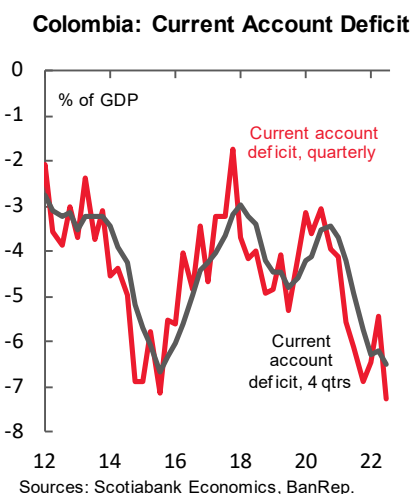


Chart 2

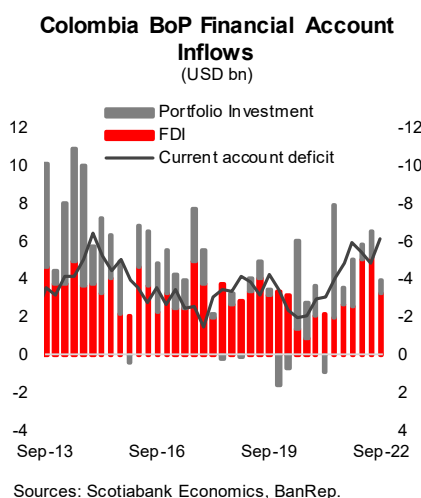
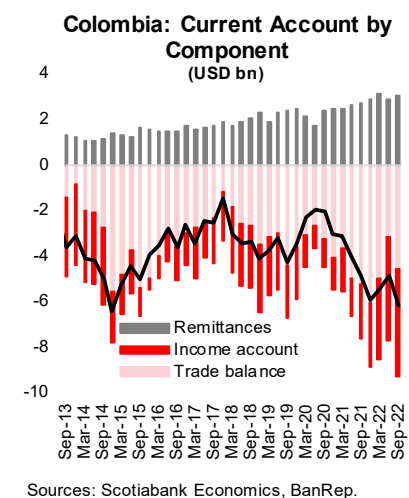


Chart 3



December 5, 2022

For all of FY 2022, we think the external deficit will end up higher than our current forecast of around 5% of GDP. However, for 2023, amid much lower domestic demand growth, we think current account deficit will correct a bit and come in around 4% of GDP. All in all, the current account deficit will continue to exert a fundamental influence on the COP, which would impede the FX to appreciate further, and volatility should remain high.

Additional details by lines in the balance of payments:

- Current account: In Q3-2022 the current account deficit stood at USD6.17bn. This time the income account contributed the most to the total deficit, showing USD4.7bn in outflows due to higher payments to companies with FDI in the mining-related sector (chart 2). Inflows from transfers (mainly remittances), partially offset the former two effects, reaching USD3.1bn. **It is worth noting that remittances showed a new historical high with inflows of USD3.42bn.**
- Trade balance: Exports contracted by 1.7% q/q showing that the boost of still high commodity prices did not offset the lower exported volumes despite a good performance of services and non-traditional exports. On the imports side, Colombia's purchases expanded by 4.7% q/q, reflecting higher capital goods and raw material imports for the industrial sector.
- Income account: Net outflows stood at USD4.72bn, similar to Q2's USD4.6bn. In the YTD, net outflows were USD12.9bn as a result of profits rebounding across Colombia's main economic sectors, particularly those sectors with high FDI, such as oil and mining, financial services, commerce-related activities, and transport and communications.
- Net current transfer inflows stood at USD3.1bn, increasing by 6.3% from the previous quarter. In the YTD, net current transfers were USD9.2bn, increasing by 17.2% y/y. Note that remittances continued showing new historical high levels (USD10.2bn in the YTD), an explanation of why despite the employment is not as strong, households' consumptions remain high.

Financing side:

- Net FDI inflows were USD3.1bn in Q3-2022, and USD10.3bn in the YTD (chart 3). According to BanRep's report, 41% of total FDI was allocated to the financial sector, 34% to the oil and mining sector, and 11% to transport and communications. Roughly 47% of FDI was on new capital investments, while 38% represented reinvestment and 13% debt to parent companies.

It will be important to see how the FDI behaves in coming quarters, especially in the mining sector after 57% of the tax reform's new tax collection will come from this sector. For now, we expect the FDI to continue to gain ground, showing that economic activity is backed by long-term investment.

- Net portfolio investments totaled inflows of USD644mn. Total inflows were USD626bn, lower than the previous quarter's USD1.6bn. In the YTD, total inflows totaled USD3.5bn, below where they were one year ago, at USD6.7bn, mostly explained by a more moderate appetite in the fixed income market but also due to a reduction of offshore in the equity market.

—Sergio Olarte, María (Tatiana) Mejía & Jackeline Piraján

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