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GLOBAL ECONOMICS

LATAM DAILY

January 25, 2022

Latam Daily: Mexican Inflation Persists; Peru's BCRP Raises Reserve Requirements

- **Mexico: Core-inflation continues upward trend, raising concerns of persistent inflation pressures**
- **Peru: BCRP raises banking reserve requirements again**

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MEXICO: CORE-INFLATION CONTINUES UPWARD TREND, RAISING CONCERNS OF PERSISTENT INFLATION PRESSURES

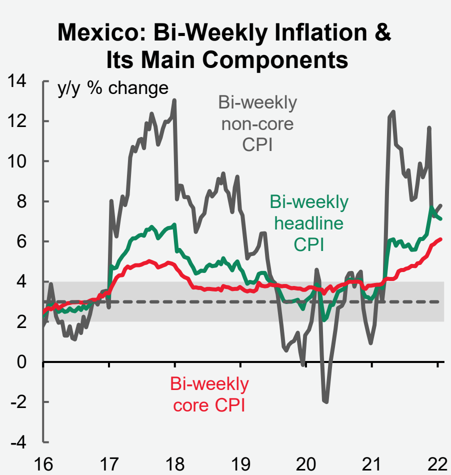
According to INEGI, inflation for the first half of January came in at 7.13% y/y, consistent with market expectations (7.12% y/y), and 13 bps below last month's level. Core inflation measured on a year-over-year basis continues its upward trend, rising 6.11% in the first two weeks of January versus 6.00% the previous month (chart 1). Goods prices increased 7.78% y/y (+25 bps) while services decreased marginally to 4.24% y/y (-5 bps) (chart 2). Lower energy prices, which increased by 7.83% (versus 10.53% the previous month), were enough to push non-core inflation 93 bps lower to 10.21% (chart 3). The omicron variant has affected the supply of labour in the services and goods sectors, with adverse effects on logistics. Meanwhile, demand for certain services remained subdued as the infection rate increased (with several states having raised their alert levels this weekend).

On a bi-weekly sequential basis, general inflation reached 0.39% 2w/2w up from 0.01% 2w/2w in the second half of December, in line with consensus (0.38% 2w/2w). Core inflation increased to 0.34% from 0.20% over this period, mainly owing to 0.62% rise in goods prices, while services remained practically unchanged at 0.02%. Non-core item rose 0.53% in early January from -0.54% in December, pushed up by higher energy prices and government tariffs as well as agricultural prices (which increased 0.55% as compared to a decline of -0.98% in December).

For Banxico's meeting on the 10th of February, the Board will have more information as the monthly inflation data will be published the previous day. We expect a divided decision, with greater likelihood for a 25 bps increase. However, attention will be focused on the message regarding core-inflation and the new Governor's (Rodriguez Ceja) monetary stance. We forecast a terminal rate of 6.75%, though this is subject to inflation dynamics in the following months and the stance that the board takes.

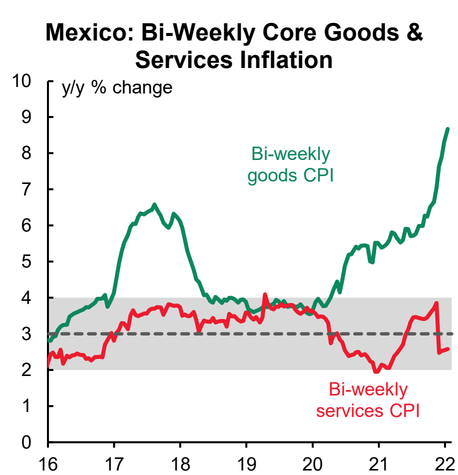
—Luisa Valle

Chart 1



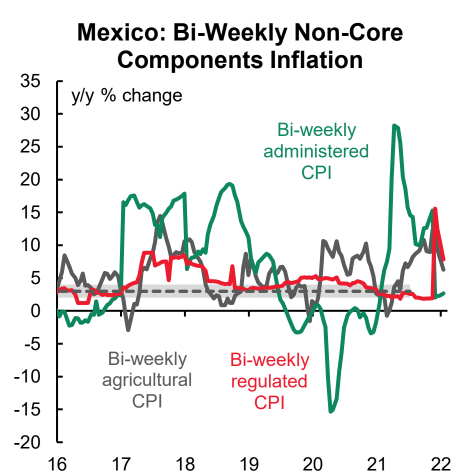
Sources: Scotiabank Economics, INEGI.

Chart 2



Sources: Scotiabank Economics, INEGI.

Chart 3



Sources: Scotiabank Economics, INEGI.

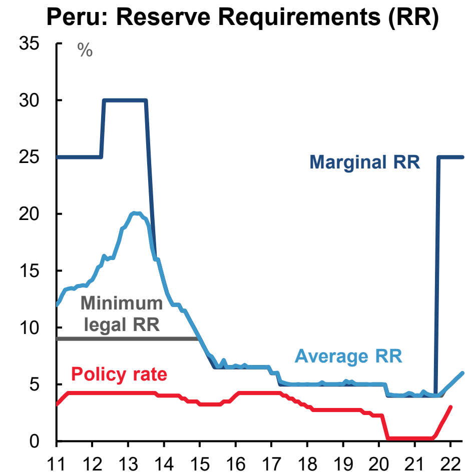
PERU: BCRP RAISES BANKING RESERVE REQUIREMENTS AGAIN

On January 21, the BCRP announced that it would be raising bank reserve requirements for the third time in the last five months, as we expected. The BCRP has been complementing policy rate hikes with staggered increases in reserve requirements since it began the progressive withdrawal of the monetary stimulus. Higher reserve requirements allow it to strengthen monetary control, because unlike the increase in the reference rate, which has a role of guiding monetary policy, reserve requirements have an immediate effect on the liquidity of the financial system.

The measure confirms that the BCRP is willing to use all its tools in a context of persistent global inflationary pressures. Tighter reserve requirements are also consistent with a stronger stance on inflation, as hinted at in its January statement.

On this occasion, the BCRP announced the staggered increase in the minimum legal reserve requirement, similar to its October 2021 announcement, going from the current 5.0% to 5.25% in February, to 5.50% in March, 5.75% in April and 6.00% in May 2022, a level that corresponds to March (chart 4).

Chart 4



Sources: Scotiabank Economics, BCRP.

Subsequent increases in reserve requirements are likely to be based on the data and, in particular, the evolution of inflation expectations. These measures will also be accompanied by increases in the policy rate in February and March, of 50 bps in each case, according to our forecast. Our policy rate forecast at 4.00% by Q1-2022 and 4.50% by the year-end.

Finally, the BCRP also modified the remuneration for foreign currency reserve requirements, substituting the reference to the Libor rate for the 1-month Term Secured Overnight Financing Rate (SOFR). This adjustment is consistent with the imminent demise of Libor and the expected start of the rate hike cycle by the Federal Reserve. This measure will take effect from February.

—Mario Guerrero