Scotiabank.

GLOBAL ECONOMICS

LATAM DAILY

March 2, 2022

Latam Daily: Colombia's Current Account Widens; Peru's Inflation Problem

- **Colombia: Current account deficit increases to widest level since 2015**
- **Peru: February inflation remains above 6%**

COLOMBIA: CURRENT ACCOUNT DEFICIT INCREASES TO WIDEST LEVEL SINCE 2015

On Tuesday, March 1, the central bank (BanRep) released Q4-2021 current account data showing a quarterly deficit of USD 6.14 bn, equivalent to 7.0% of GDP (chart 1), the largest deficit since Q3-2015. For 2021, the current account deficit stood at USD 17.83 bn (5.7% of GDP), more than double the previous year's deficit of USD 8.62 bn (3.4% of GDP). The trade balance widened significantly in 2021 owing to the combined effects of production and higher international prices. For example, in terms of exports, the reduction in oil and coal production partially offset the positive impact from better commodities prices. Meanwhile, imports increased more than exports as domestic demand recovered and input prices rose. In this respect, despite higher commodity prices, Colombia is facing an offsetting effect in the terms of the trade due to higher import prices.

Financing was better balanced between FDI and portfolio investments in 2021, though FDI was 32% lower than in 2019 (pre-pandemic), while capital inflows remained extraordinarily high as a result of public sector debt issues. We expect the external deficit to narrow in 2022, but it will remain wider than in 2019 as the economic recovery continues to draw in imports. On the financing side, we expect higher FDI flows in H2-2022 and reduced capital inflows as government borrowing in international markets is scaled back.

In 2022, the deficit will remain as the economic recovery fuels import demand, while exports fight headwinds from mining production that is still below pre-pandemic levels despite higher prices. All in all, the current account deficit is having a fundamental impact on the currency, which from the flows perspective would impede the FX to reach again pre -pandemic levels.

Additional information by lines in the balance of payments.

- **Current account: In Q4-2021 the current account deficit stood at USD 6.14 bn.** While the trade deficit accounted for most of the current account deficit, income account outflows added to the deficit (chart 2). Inflows from transfers (mainly

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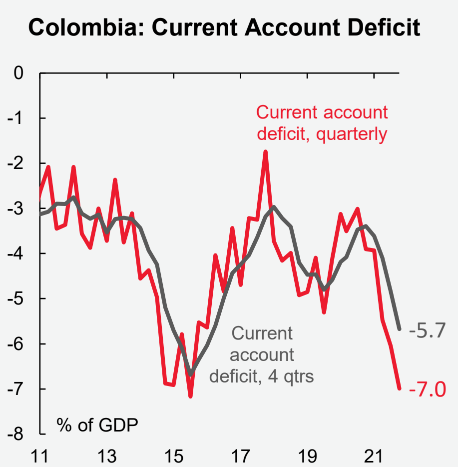
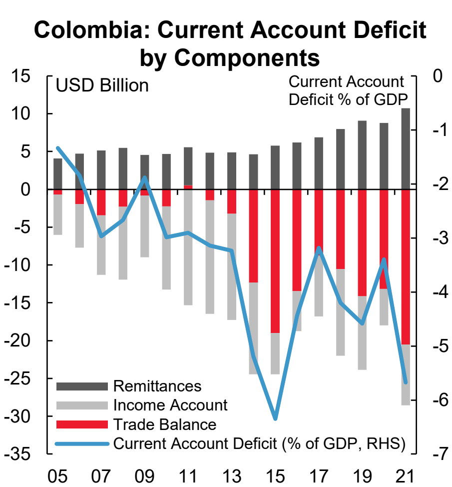
Chart 1



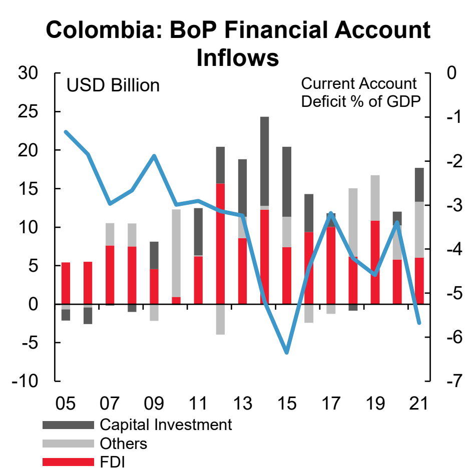
Sources: Scotiabank Economics, BanRep.

Chart 2



Sources: Scotiabank Economics, BanRep.

Chart 3



Sources: Scotiabank Economics, BanRep.

remittances), partially offset the former two effects. In 2021 deficit reached USD 17,83 bn in nominal terms, 20% above the pre-pandemic level (2019) and the widest since 2015 (USD 18.7 bn).

- **Trade balance: The deficit in goods trade accounted for 68% of the total deficit, the widest since at least 2000, reflecting high imports (USD 56.72 bn) which approached the record high level of 2014 (USD 61.54 bn).** In contrast, on average, exports surpassed pre-pandemic levels only by 5%, despite the strong rebound of 63% y/y in oil prices.
- **Income account: Net outflows stood at USD 8.05 bn, increasing by 66.5% y/y, as profits rebounded across Colombia's main economic sectors, especially those sectors with high FDI, such as oil and mining and financial services.**
- **Current transfers stood at USD 10.72 bn (+22% y/y), the highest level since 2000 according to BanRep statistics.** Net remittances inflows explained most of the account and showed the effect of direct pandemic support in host countries. In 2022, we expect this number to stabilize, or even drop, as pandemic support programs are wound down.

Financing side:

- **Net FDI inflows were USD 6.04 bn in 2021, up 4.1% y/y but still 44.3% below the 2019 (pre-pandemic) level (chart 3).** FDI inflows totalled USD 9.40 bn (3% of GDP) in 2021, 32.8% lower than pre-pandemic levels, while FDI outflows (USD 3.36 bn) were 6.6% higher than in 2019. According to BanRep's report, 60% of total FDI was allocated to the financial sector (25%), oil and mining sector (19%), and manufacturing (15%). Roughly one-third of FDI was on new capital investments, while 40.2% represented reinvestment. We expect FDI to continue to recover in 2021, with a surge in H2-2022, as the electoral process is likely to weigh negatively on investor sentiment through the first half of the year.
- **Net portfolio investments were USD 4.41 bn.** Total inflows of USD 8.39 bn (2.7% of GDP) represent the external debt issues (USD 6.44 bn) and net purchases of local debt by offshore agents (USD 3.12 bn).
- **In 2021, the government received international credit of USD 6.67 bn, which is the result of transactions with multilaterals.** However, the public sector reduced liabilities by USD 2.33 bn.
- **In 2021 the central bank received Special Drawing Rights (SDR) of USD 2.79 bn from the International Monetary Fund, which led to a transitory increase in international reserves.** The central bank subsequently sold the equivalent in international reserves to the government, which counts as a credit on the financing side.
- **In 2022, we expect multilateral financing to be less significant than in 2021.** In fact, the recent Financing Plan 2022 showed a reduction in indebtedness targets from USD 10.5 bn to USD 6.2 bn.

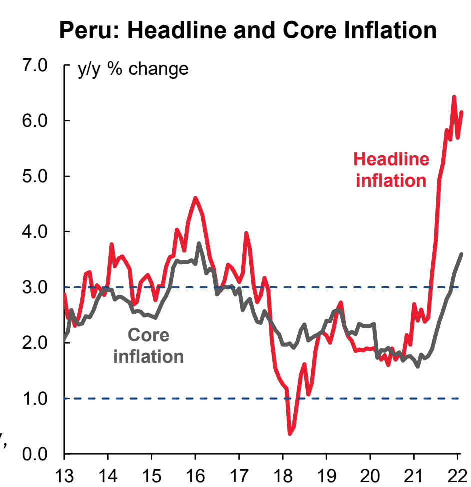
—Sergio Olarte & Jackeline Piraján

PERU: FEBRUARY INFLATION REMAINS ABOVE 6%

While Peru's inflation was 0.31% m/m in February, the lowest rate for the month of February since 2018 (+0.49%), year-on-year inflation increased after taking a break in January, going from 5.7% y/y to 6.2% y/y. This outcome is slightly above the Bloomberg consensus (6.1%), but below Scotiabank's forecast (6.4%). February marks the ninth consecutive month that inflation exceeded the upper limit of the central bank's target range (between 1% and 3%), and with price pressures showing no signs of converging towards the target, the February outcome will put pressure on the central bank to continue raising its reference rate in March (chart 4).

Price pressures were broadly based in February. Of the 586 products that make up the new consumption basket (base 2021), 390 (67%) rose, 116 (20%) fell, and 80 (13%) remained unchanged (table 1). Core inflation increased from 3.4% y/y in January to 3.6% y/y in February, above the upper limit of the target range (3%) for the third consecutive month. Wholesale inflation, linked to production costs, fell from 12.1% in January to 11.4% in February, due to a high comparison base. It is likely that, owing to this factor, the annual rate of wholesale inflation will approach 10% in March. Some cost pressures, such as port freight and

Chart 4



Sources: Scotiabank Economics, BCRP.

the FX rate, have eased, but other costs, such as soft commodity prices and oil prices, continue to rise, which will push inflation higher in the future. The PEN depreciation continued to moderate, falling from 5.7% in January to 3.6% in February, helping to limit the rise in imported products prices.

For March, we expect inflation to remain around 6% y/y. Price pressures are likely to come from the seasonal increase in prices linked to education, which will trigger a higher rise than last year as face-to-face classes resume with the relaxation of restrictions made possible by the decrease in COVID-19 cases, and the impact of higher oil prices on the international market. The upward pressure will be limited, however, by the high comparison base, since inflation in March 2021 was 0.84%.

Table 1: Peru—Lima CPI Basket—February 2022

Groups of consumption	Base 2021	% m/m	% y/y
1. Food and non-alcoholic beverages	22.97	0.19	9.2
2. Alcoholic beverages, tobbaco, drugs	1.61	0.29	1.0
3. Apparel and footwear	4.20	0.08	0.6
4. Housing, water, electricity, gas and others	10.55	0.17	11.5
5. Furniture and home maintenance	5.11	0.30	3.3
6. Health	3.48	0.08	1.7
7. Transport	12.40	0.30	7.6
8. Communications	4.77	0.49	0.3
9. Recreation and culture	3.96	1.12	6.7
10. Education	8.61	0.00	1.9
11. Restaurants & hotels	15.89	0.61	5.8
12. Other goods and services	6.47	0.33	2.8
Total CPI	**100.00**	**0.31**	**6.2**

*Adjusted base to 12 from 8 groups of consumption
Sources: Scotiabank Economics, INEI.

Our inflation forecast remains at 4.2% for 2022, although it has an upward bias attributable to the impact of the Russia-Ukraine conflict on the price of oil and grains. Our assumption is that the market reaction is cautious but manageable. We will need some more time to see if this risk materializes and leads us to review our forecast.

Over the past seven months, the central bank hiked its benchmark rate by 325 basis points to 3.50% and raised reserve requirements three times, showing a hawkish stance on controlling inflation since early 2022. We believe that further increases in the policy rate will be necessary to return inflation expectations (3.7% over 12 months according to the BCRP's January survey) to the target range, so we expect a 50 bps hike at its meeting on Thursday, March 10.

—Mario Guerrero