Scotiabank

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Latam Daily: Mexico's Weak GDP Expectations; Peru's Upside Inflation Surprise

- **Mexico: GDP expectations remain weak as inflation rises in Banxico's April Survey**
- **Peru: April inflation surprised on the upside, exceeding market consensus and Scotiabank's estimate**

MEXICO: GDP EXPECTATIONS REMAIN WEAK AS INFLATION RISES IN BANXICO'S APRIL SURVEY

I. GDP expectations remain weak

Banxico's April Survey of Expectations confirmed expectations of higher inflation and weaker growth in 2022 and 2023 (table 1). Expected growth for 2022 moderated from 1.76% to 1.73% y/y, while the consensus for 2023 fell from 2.08% to 2.02% y/y. Revisions to expected inflation were more significant, rising from 5.86% to 6.67% y/y for 2022 and from 3.96% to 4.18% y/y in 2023. Expectations of core inflation also increased, from 5.56% to 6.09% y/y for 2022, and from 3.96% to 3.99% y/y for 2023. More analysts anticipate further interest rate hikes, with a median policy rate of 8.25% for end-2022, up from 8.00%, with the rate staying at that level through the end of next year. Despite recent exchange rate appreciation, analysts expect a slight depreciation, from USDMXN 21.20 to USDMXN 21.31 for 2022, with no change for 2023 at USDMXN 21.67. Meanwhile, the percentage of analysts who consider that now is a good time to invest remained practically unchanged at 8%, while 59% think it's a bad time, and 32% said they were unsure. Finally, analysts assess inflationary pressures (16% of responses), domestic political uncertainty (11%); public insecurity problems (11%); weakness in the domestic market (8%); and higher input and raw materials prices (8%) as the leading factors hindering growth in the next six months.

II. GDP flash estimate for Q1-2022 shows an uneven recovery

The flash estimate for Q1-2022 GDP released by INEGI on Friday, April 29 met market expectations at 1.6% y/y, up from 1.1% y/y in Q4-2021 (chart 1). Primary activities increased 2.1%, secondary activities 2.8%, and tertiary activities 0.6%. On a quarterly basis, GDP grew 0.9% q/q (0.0% previously, 1.1% expected), with primary activities falling -

Chart 1

Sources: Scotiabank Economics, INEGI.

Table 1: Mexico—Banxico Survey, Main Results

Variable	Year	Mar.	Apr.	Change
GDP	2022	1.76	1.73	-0.03
(Real annual % change)	2023	2.08	2.02	-0.06
Headline inflation	2022	5.86	6.67	0.81
(Annual % rate, Dec.-Dec.)	2023	3.98	4.18	0.20
Core inflation	2022	5.56	6.09	0.53
(Annual % rate, Dec.-Dec.)	2023	3.96	3.99	0.03
Formal job creation	2022	469	502	33
(000s of IMSS insured workers)	2023	446	441	-5
Public deficit	2022	3.31	3.36	0.05
(% of GDP)	2023	3.28	3.30	0.02
Trade balance	2022	-12.21	-12.56	-0.35
(USD bn)	2023	-12.74	-14.00	-1.26
Foreign direct investment	2022	29.18	29.38	0.20
(USD bn)	2023	29.77	29.85	0.08
Exchange rate	2022	21.20	21.31	0.11
(USDMXN, Dec.)	2023	21.63	21.67	0.04
Policy rate	2022	8.09	8.36	0.27
(%, end of period)	2023	8.12	8.35	0.23

Sources: Scotiabank Economics, Banxico.

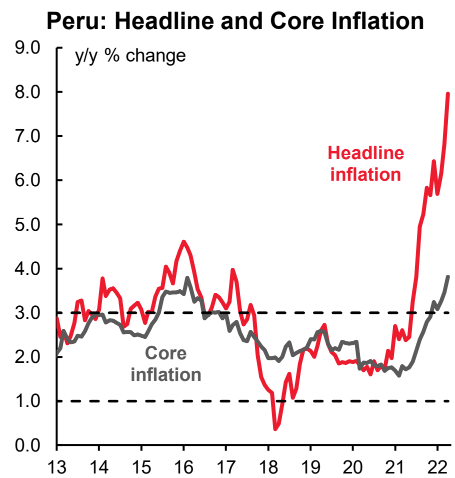
1.9%, which was more than offset by secondary and tertiary activities, both of which accelerated by 1.1%, respectively. These preliminary results show the uneven recovery across sectors, which remain below pre-pandemic levels. Looking ahead, we expect the war in Ukraine and inflationary pressures will continue to affect economic activity, exacerbating the trend weak investment, which started to fall in 2018 and has stagnated below pre-pandemic levels.

—Miguel Saldaña

PERU: APRIL INFLATION SURPRISED ON THE UPSIDE, EXCEEDING MARKET CONSENSUS AND SCOTIABANK'S ESTIMATE

In April, inflation again surprised on the upside, reaching 0.96% m/m, the highest m/m rate in 27 years for the month since 1995, when it reached 0.98%, exceeding the estimate by the market consensus (0.63% according to the Bloomberg survey) and our own forecast of 0.7%. Year-on-year inflation accelerated from 6.8% y/y to 8.0% y/y (chart 2). April marks the 11th 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 abating, April's result will continue to put pressure on the central bank, which we expect will continue to raise its benchmark rate in May.

Chart 2



Sources: Scotiabank Economics, BCRP.

Price pressures were broadly based in April. Of the 586 products that make up the consumer basket (base 2021), 453 (77%) rose, 67 (11%) fell, and 66 (11%) remained unchanged (table 2). Core inflation went from 3.5% y/y in March to 3.8% y/y in April, above the upper limit of the target range (3%) for the fifth consecutive month. Moreover, the increase in prices occurred despite the government's temporary reduction of the excise tax (ISC) on gasoline and its inclusion in the Fuel Price Stabilization Fund, though these measures were reflected in a reduction in the price of oil diesel (-8.1%) and vehicular liquefied petroleum gas (-2.2%).

Wholesale inflation, linked to production costs, jumped from 11.6% in March to 13.1% in April, the highest rate so far this year. The USDPEN exchange rate, which appreciated 1.8% y/y in March, depreciated 1.9% y/y in April, contributing to the rise in the prices of imported products.

Table 2: Peru—Lima CPI Basket—April 2022

Groups of consumption	Base 2021	% m/m	% y/y
1. Food and non-alcoholic beverages	22.97	2.47	15.1
2. Alcoholic beverages, tobacco, drugs	1.61	0.23	1.4
3. Apparel and footwear	4.20	0.16	0.9
4. Housing, water, electricity, gas and others	10.55	0.02	10.0
5. Furniture and home maintenance	5.11	0.27	3.6
6. Health	3.48	0.50	1.8
7. Transport	12.40	0.88	9.5
8. Communications	4.77	0.74	1.3
9. Recreation and culture	3.96	0.67	7.5
10. Education	8.61	0.04	2.9
11. Restaurants & hotels	15.89	0.80	7.1
12. Other goods and services	6.47	0.60	3.6
Total CPI	**100.00**	**0.96**	**8.0**

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

For May, we expect inflation between 8% y/y and 9% y/y, driven by a low base of comparison, given that May 2021 inflation was 0.27% m/m, and continuing high commodity prices for key products, such as oil, grains, and fertilizers. The government has announced a temporary reduction of the VAT for a set of products such as chicken, eggs, milk, meat, wheat, pasta, and sugar starting in May, although business associations question the effectiveness of this measure. The government also announced a 10% increase in the minimum monthly wage, from PEN 930 to PEN 1,025 (USD 267), to compensate for the loss of purchasing power from higher inflation, although the scope of this measure is also limited (covering just 12% of the formal labour market). The estimated fiscal cost of the measures is close to 0.3% GDP, the same as the average for comparable measures in Latin America, according to the IMF.

In our *Latam Weekly* of April 29, 2022, we revised our inflation forecast for 2023 from 3.0% to 4.0%, with the message that we see inflation as more persistent and therefore less likely to return to the target range next year. The central bank estimates that inflation will return to the target range by the second half of 2023, but its chairman, Julio Velarde, recently warned that there is a risk that inflation will persist in the longest period outside the target range. From 2000 until now, the longest period with inflation above 3% was 21 months (between October 2007 and June 2009). With April's result, there have now been 11 consecutive months in which inflation exceeded 3%.

For 2022, our inflation forecast of 6.4% maintains an upward bias given the April results and the analysis of the effects of the Russia-Ukraine conflict on the prices of raw materials and the problems in China over supply chains.

Over the past nine months, the central bank has raised its benchmark rate by 425 basis points to 4.50% and increased reserve requirements three times. We believe further increases in the policy rate are necessary to prevent further slippages in inflation expectations (4.39% over 12 months according to the BCRP March survey, the highest level since October 2008) away from the target range. **Accordingly, we expect a rise of 50 bps in its meeting on Thursday, May 12.**

—Mario Guerrero