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Latam Daily: Brazilian-Election Gains Continue; BanRep Strikes a Cautious Note

- **Colombia: Cautious BanRep minutes; export growth eases**
- **Mexico: Analysts forecast higher inflation and interest rates in Banxico Survey**
- **Peru: Inflation interrupts its y/y decline in September, BCRP would raise key rate**

Latam assets saw strong gains yesterday, carried by the closer-than-expected first round election in Brazil on Sunday—that should deliver a more moderate Lula presidency (if victorious in late-October)—as well as a broad improvement in risk sentiment to start the month and quarter after global equities recovering from oversold conditions and the dollar correcting from overbought.

FX gains in the region are continuing today amid a mixed performance of the USD but with gains in commodity prices and solid gains in equity markets disproportionately benefitting the highly-risk/commodity sensitive nature of Latin American assets. The CLP and COP are notching solid gains today of about 1%, with the BRL up around 0.6% while the MXN lags (close to unchanged around the 20 pesos level).

The regional calendar is light after yesterday's BanRep minutes noted the Board's concern with weaker economic activity, while Banxico survey results showed participants revising their inflation and interest rate projections higher (see more below).

Peru's inflation data released over the weekend beat economists' expectations while still showing a third consecutive deceleration in month-on-month prices growth. Our Lima team nevertheless anticipates another 25bps hike at the BCRP's decision this week.

—Juan Manuel Herrera

COLOMBIA: CAUTIOUS BANREP MINUTES; EXPORT GROWTH EASES

I. BanRep minutes highlight that the deceleration in the hiking cycle was due to weaker economic activity

Last night, BanRep published the minutes to its September 29 monetary policy meeting that showed that all members considered it necessary to continue the hiking cycle as inflation and inflation expectations remain well above target and international financial conditions continue to tighten. **However, they conceded that an outlook of decelerating economic activity should have a higher weight in decision-making.**

In the minutes the Board affirmed the data-dependent approach, saying that to achieve the 3% inflation target additional rate hikes are necessary for further rate hikes.

Our take is that now the evolution of the economy is gaining relevance in the reaction function of the central bank. That said for now we affirm our expectations of a move of 50 bp on October 28, which probably would take us to a terminal rate at 10.50%. Additional hikes will depend on strong upside inflation surprises but also if the economy remains growing well above trend—this is not our base case scenario, for now.

Key points from the Board's minutes:

- The majority group supported the 100bps considering that inflation and inflation expectations remain high, and vulnerabilities related to the external sector are high. But also recognized that expectations for economic activity are moderating. That said, **they considered 100bps to be enough to send a message of commitment to the inflation target.**
- **The member who voted for a 50bps hike said that now the most relevant risk is economic growth since inflation is driven more by a supply shock.** Also, they emphasized that higher international rates impact the domestic economy. That said, this member considers that now higher rates impact economic growth more than inflation.

II. In August, non-traditional exports remained strong, while traditional exports eased amid weaker coal activity

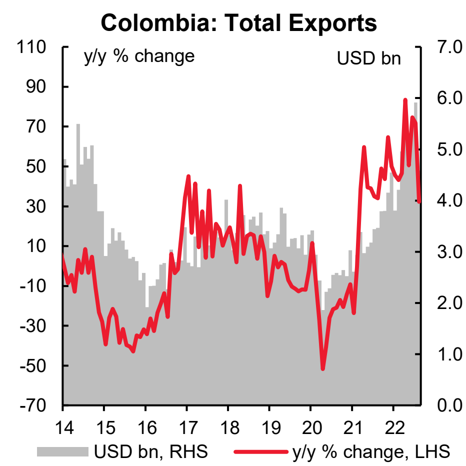
Monthly exports for August stood at USD4.58bn (+32.2% y/y, chart 1), falling from July's USD5.9bn total (non-seasonally adjusted) according to DANE data published on Monday. Traditional exports (related to mining and coffee) contributed to the year-on-year expansion but a lesser extent than in previous months due to significant decline in coal exports. Non-traditional exports grew by 11.3% y/y to USD1.78bn, remaining near the highest levels on record in May 2022 (USD1.92bn) and reflecting solid international demand.

- **Traditional exports increased by 50.1% y/y in August (chart 2), again reflecting the positive impact of international commodity prices and a lower statistical base effect.** However, coffee exports showed a fall of -2.15%y/y explained by lower production. Oil exports expanded 66.1% y/y, with an expansion of 15.77% y/y in metric tons, while coal sales showed a slower expansion of 47.1% y/y, with a lower contribution in exported volumes. In monthly terms, exports fell by 22.5%, which was mostly explained by a contraction in coal export volumes of 51.6% m/m, as maintenance at some mines impacted the sector's performance.
- **The value of non-traditional exports was USD1.77bn (11.3% y/y) in August, a stronger year-on-year expansion than in the previous month, and still close to historical highs.** Manufacturing exports saw the smallest gain among subsectors, at 13.1% y/y. Exports of machinery and transport equipment fell by 21.1% y/y, while those of chemical products contributed with an increase of 16.8% y/y. In the case of agricultural products (+7.6%y/y), the main contribution came from exports of bovine cattle (+197.7% y/y).

Exports in August generally showed a positive balance. The year-on-year expansion is moderating due to a normalization of statistical base effects and a lower contribution from coal exports. On the non-traditional side, we observed greater y/y expansion as the fall in exports of machinery and equipment was offset by exports of livestock. **We estimate that the current account deficit in 2022 will be around USD17bn, which is similar to 2021, although as a percentage of GDP the deficit would represent around 5% or less** amid the expected best economic activity. **Having a still high external deficit could limit the potential of the Colombian peso to appreciate strongly.**

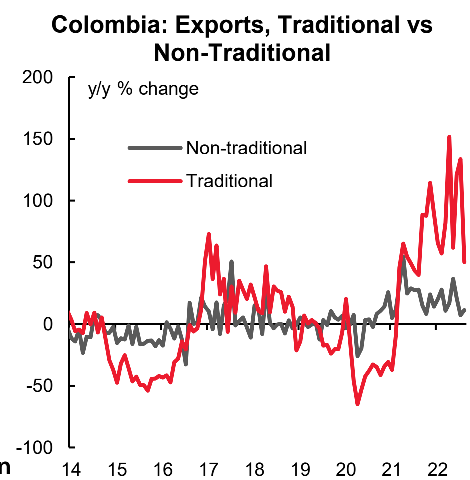
—Sergio Olarte, María (Tatiana) Mejía & Jackeline Piraján

Chart 1



Sources: Scotiabank Economics, DANE.

Chart 2



Sources: Scotiabank Economics, DANE.

MEXICO: ANALYSTS FORECAST HIGHER INFLATION AND INTEREST RATES IN BANXICO SURVEY

As we had expected, analysts revised their end-2022 inflation and interest rate forecasts higher in the latest Banxico survey, according to results published yesterday (table 1). Inflation expectations continue on the rise. Now, analysts expect headline inflation to end the year at 8.48% (8.15% previous), with core CPI climbing by 8.11% (7.61% previous). Despite the survey taking place prior to Banxico's decision last week (where it lifted its own inflation outlook and stuck to guidance), the median economist's projection for the bank's policy rate at year-end rose, from 9.75% to 10.25%. However, analysts may have joined our call for a 10.50% rate for end-2022 in the aftermath of Banxico's announcement. This shift may be evidenced in submissions to the Citibanamex survey due for release on Wednesday—this comes before September's inflation print, out on Friday.

The central bank has realized that elevated inflation will be difficult to control in the short and medium term, further pushing out the convergence to target. As shown in the monetary policy statement, Banxico's forecasts see the inflation target being reached at the end of 2024, which would extend the necessary period of high rates. We highlight that in the Banxico survey the most frequently-cited factors that could hinder economic growth are governance (32% of respondents), external conditions (20%), and inflation (18%). Regarding growth expectations, respondents project a GDP growth rate of 2.01% for 2022 (revised up from 1.93%), and a slowdown to 1.15% for 2023 (revised down from 1.31% in the previous survey).

—Miguel Saldaña & Brian Pérez

Table 1: Mexico—Banxico Survey, Main Results

Variable	Year	Aug.	Sep.	Change
GDP	2022	1.93	2.01	0.08
(Real annual % change)	2023	1.31	1.15	-0.16
Headline inflation	2022	8.15	8.48	0.33
(Annual % rate, Dec.-Dec.)	2023	4.62	4.81	0.19
Core inflation	2022	7.61	8.11	0.50
(Annual % rate, Dec.-Dec.)	2023	4.41	4.73	0.32
Formal job creation	2022	564	600	36
(000s of IMSS insured workers)	2023	419	340	-79
Public deficit	2022	3.38	3.31	-0.07
(% of GDP)	2023	3.34	3.64	0.30
Trade balance	2022	-16.90	-20.29	-3.39
(USD bn)	2023	-17.07	-18.92	-1.85
Foreign direct investment	2022	33.66	34.42	0.76
(USD bn)	2023	31.12	31.58	0.46
Exchange rate	2022	20.76	20.68	-0.08
(USDMXN, Dec.)	2023	21.19	21.23	0.04
Policy rate	2022	9.70	10.25	0.55
(%, end of period)	2023	9.17	9.75	0.58

Sources: Scotiabank Economics, Banxico.

PERU: ANNUAL INFLATION INTERRUPTS ITS Y/Y DECLINE IN SEPTEMBER, BCRP WOULD RAISE KEY RATE

Peruvian month-on-month inflation was 0.52% m/m in September in data published on Sunday slightly above our forecast (0.40%) and the Bloomberg consensus (0.45%), **but lower than 0.94% gain in August and decelerating for the third consecutive month**, while higher than that of September 2021 (0.40%).

Year-over-year inflation climbed slightly, from 8.4% y/y to 8.5% y/y, remaining above the 3% upper limit of the target for the sixteenth consecutive months matching the previous record during which it remained outside the target range (16 months, between March 2015 and June 2016). Since 2000, the longest period with inflation above 3% was 21 months (between October 2007 and June 2009). **The BCRP sees a risk that this episode of inflation could be record in duration.**

Table 2: Peru—Lima CPI Basket—September 2022

Groups of consumption	Base 2021	% m/m	% y/y
1. Food and non-alcoholic beverages	22.97	1.34	13.7
2. Alcoholic beverages, tobacco, drugs	1.61	0.22	2.2
3. Apparel and footwear	4.20	0.25	1.8
4. Housing, water, electricity, gas and others	10.55	0.56	8.8
5. Furniture and home maintenance	5.11	0.27	4.3
6. Health	3.48	0.52	4.3
7. Transport	12.40	-0.34	12.1
8. Communications	4.77	-0.06	1.3
9. Recreation and culture	3.96	0.09	6.1
10. Education	8.61	0.05	3.8
11. Restaurants & hotels	15.89	0.65	9.5
12. Other goods and services	6.47	0.53	6.0
Total CPI	**100.00**	**0.52**	**8.5**

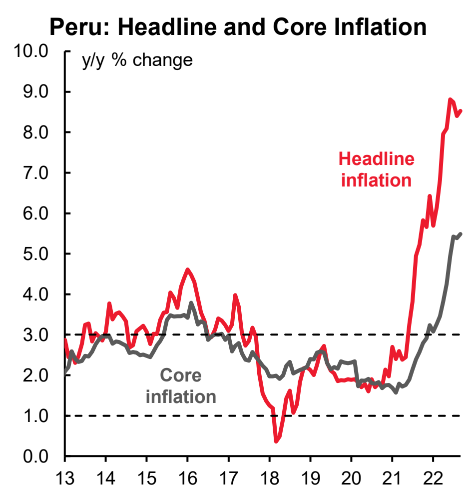
*Adjusted base to 12 from 8 groups of consumption.
Sources: Scotiabank Economics, INEI.

September's inflation print reflected increases in food prices, mainly tubers, but also showed a reduction in fuel and transportation prices (table 2). Of the 586 products that make up the consumption basket (base 2021), 391 rose (67%), 108 fell (18%), and 87 remained unchanged (15%). **Core inflation accelerated slightly, going from 5.38% in August to 5.49% y/y in September.** Other prices, such as wholesale prices, construction materials, and machinery and equipment continued to moderate. In addition, inflation fell in 21 of the 26 largest cities in the country, reducing the number of cities where inflation exceeds 10% from 8 to 4.

Looking ahead, we expect the slowdown in inflation to continue, albeit at a gradual pace. Cost pressures are easing, reflected in a decline from 10.3% to 9.2% in the year-on-year expansion of wholesale prices, the slowest pace since May 2021 (chart 3).

Our inflation forecast was revised from 7.4% to 7.7% for 2022 and remains at 4.0% for 2023, as published in the September 9, 2022 edition of *Latam Weekly*. We think that the pace of easing inflation will be slow going forward. This will be visible in October, since it is likely that monthly inflation will be around somewhat lower than that of a year ago (0.58%)—the statistical base would play in its favor again—considering that the average October inflation of the last 20 years has been 0.16%.

Chart 3



Sources: Scotiabank Economics, BCRP.

Over the past thirteen months, the central bank raised its reference rate by 650 basis points to 6.75% and raised reserve requirements three times. Twelve-month inflation expectations began to break lower in July, going from a record 5.35% to 5.10% according to the August BCRP survey. Descending, but without conviction. The BCRP raised its inflation forecast from 6.4% to 7.8% for this year, and from 2.5% to 3.0% for 2023, so it is likely that this adjustment will have some impact on the formation of expectations going forward. **The real interest rate (1.65%) is already around the neutral rate (1.50%), so we believe that we are close to the end of the BCRP interest rate hike cycle,** but it will first want to make sure that inflation has returned (or will return) to the target range. The key will continue to be the rate of decline in inflation expectations. Until then, **we expect the reference rate to rise 25bps to 7.00% at its meeting this Thursday, October 6.**

—Mario Guerrero