Latam Daily: BCRP Decision, First Brazil Polls

Scotiabank

GLOBAL ECONOMICS

LATAM DAILY

October 6, 2022

- **Chile: Fiscal consolidation would allow a lower-than-expected increase in public debt by 2023**
- **Colombia: Inflation surprised to the upside again and reached the highest since March 1999**
- **Peru: BCRP to hike 25bps, nears end of hiking cycle**

Risk sentiment soured in London hours after steady trading overnight as markets continue to digest the OPEC+ cut announcement while they try to convince themselves that a Fed pivot is coming (we don't think it is).

The oil cartel—in defiance of the White House's wishes—announced yesterday a 2mbpd reduction to its output goal which should translate into a net ~1mbpd net cut in supply given current underproduction relative to baseline levels. The pact has been extended to December 2023 with the group also now meeting only once every six months after the next meeting in December of this year—which should reduce meeting-related volatility but also highly reduce the odds of an OPEC+ pivot and thus keep prices elevated.

The main event in the Latam region will be the BCRP's decision where our economists in Lima anticipate a 25bps hike as the bank nears the end of its tightening cycle (see Peru section below).

Mexico reported weaker than expected gross fixed investment this morning, coming in at 2.1% y/y in July, lower than all of the forecasts submitted to Bloomberg with a median estimate of 3.8%, dragged by a decline in construction activity (on account of a steep decline in residential construction). **Analysts surveyed in the latest bi-weekly CitiBanamex survey lifted their Banxico end-2022 policy rate forecast to 10.50% from 10.00% with a 75bps move expected at the November meeting.** GDP projections were left unchanged for 2022 and 2023 at 2.00% and 1.20%, respectively. The MXN is practically unchanged around the 20 pesos per USD level in line with the mixed dollar mood.

In Brazil, Lula garnered a 51% voting intention share against Bolsonaro's 43% in the first noteworthy poll published since the first-round election on Sunday. The IPEC poll published yesterday also showed that 92% of those surveyed know with complete certainty who they will vote for, leaving little room for Bolsonaro to make up the gap to Lula. On the other hand, if the results of the first-round taught us anything, it's that polls in Brazil should be taken with a grain of salt, and 'hidden' Bolsonaro voters could come out in droves on election day to take the incumbent over the line**. A PoderData poll published this morning showed a much narrower race where, considering only valid votes, Lula leads Bolsonaro by 52% to 48%.**

In Colombia, president Petro lashed against BanRep in a series of tweets yesterday, noting that "the rise in interest rates goes against economic growth and employment for the Colombian people." The bank responded via Twitter as well, explaining the reasoning behind last week's 100bps hike which includes upward trending inflation expectations and stronger-than-expected growth in the country. Yesterday's stronger-than-expected inflation print (see details in Colombia section below) has put BanRep in an uncomfortable position of managing decelerating growth against still very elevated inflation. **After the Russian ruble, the Colombian peso was the worst performing currency among the expanded major currencies group yesterday** with a 1.8% decline—a ways off the 0.8% depreciation in the Chilean peso which was the next weakest currency in the region.

—Juan Manuel Herrera

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CHILE: FISCAL CONSOLIDATION WOULD ALLOW A LOWER-THAN-EXPECTED INCREASE IN PUBLIC DEBT BY 2023

The Ministry of Finance (MoF) published on Wednesday its quarterly Public Finance quarterly report for Q3-2022. For 2022, the fiscal and macroeconomic scenario improved compared to the June projections. The fiscal balance is expected to end the year in surplus, both in effective and structural terms (+1.6% and +0.9% of GDP, respectively), with public debt falling to 36% of GDP (36.3% in 2021), favoured by the reduction in bonds issuance announced a few months ago (see our ***Latam Daily***). A key change from the previous report is an upward revision to GDP growth for 2022, from 1.6% in June to 2.2%, similar to the 2.1% we have been projecting for a few months at Scotiabank Economics.

For 2023, the MoF anticipates a 0.5% contraction in GDP (vs -0.1% in the June projection) consistent with less effective revenues than expected in June's Report. Thus, the effective fiscal balance would deteriorate slightly compared to the June projection, to -2.7% of GDP. On the flip side, more structural revenues are expected, which would make it possible to outperform the fiscal commitment of a structural deficit of 2.6% of GDP in 2023. In this sense, MoF projects a 2.1% structural deficit, which is consistent with an expansion of 4.2% in fiscal expenditures next year. In this scenario, public debt would increase to 38.7% of GDP, less than that anticipated in the June projection (40.4%). The latter contemplates bond issuance at USD17 bn (USD 15 bn in 2022).

Over the long run, the government's fiscal commitment sees a convergence to a structural fiscal deficit of 0.3% of GDP by 2026 (consistent with an effective fiscal deficit of 0.2% of GDP), considering a prudent level of gross public debt of 45% of GDP. The MoF also projected a positive fiscal slack until 2027.

—Aníbal Alarcón

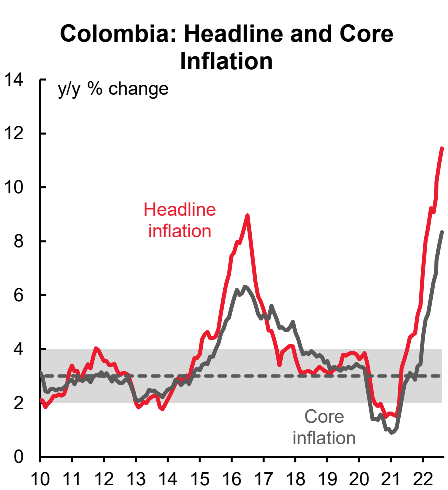
COLOMBIA: INFLATION SURPRISED TO THE UPSIDE AGAIN AND REACHED ITS HIGHEST SINCE MARCH 1999

Monthly CPI inflation in Colombia came in at 0.93% m/m in September 2022, according to DANE data published on Wednesday. **The result was well above the BanRep survey (0.71% m/m) and above the Scotiabank Economics projection (0.68% m/m**). Monthly inflation was 5.2 times the average inflation observed in September since 2016. **Annual headline inflation stood at 11.44% y/y, increasing from the 10.84% of the previous month, the highest since March 1999** (chart 1).

Core inflation rose again, from 7.83% y/y to 8.33% y/y and ex-food and regulated goods inflation stood at 7.49% y/y (compared to the previous 6.89%). Even though in August, food inflation was the main contributor, core metrics showed that there are still other sources of upward pressure, such as rental fees, some services, and tradable goods.

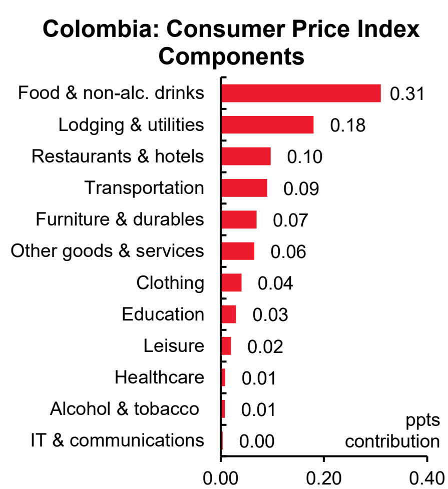
The September CPI figure, in our opinion, was a new strong surprise not only for the market but also for BanRep, as in September's press conference the Finance Minister and Governor Villar expressed confidence that forthcoming inflation data would moderate. It is possible that inflation will continue oscillating at high levels until year-end, which will again trigger strong indexation forces before 2023 as the minimum wage negotiations kick off.

Chart 1



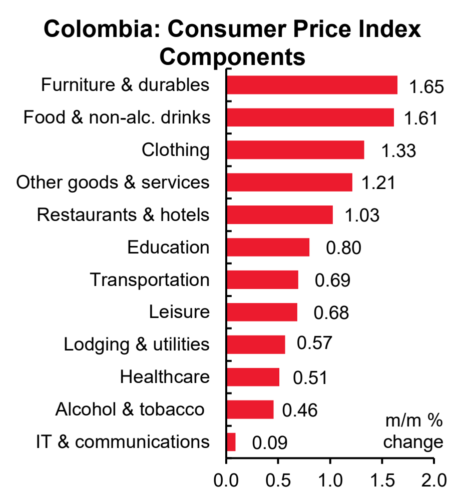
Sources: Scotiabank Economics, DANE.

Chart 2



Sources: Scotiabank Economics, DANE.

Chart 3



Sources: Scotiabank Economics, DANE.

We expect the debate between still high inflation and weaker economic activity to intensify at the October BanRep decision, showing the possibility of a new split vote between 50bps and 100bps. For now, our call remains a 50bps hike, as concerns about economic deceleration intensify. However, this will need to be confirmed by incoming economic activity indicators. The terminal rate, for now, is expected at 10.50% as our base case scenario points to a moderation in economic activity by end-2022, which would trigger a "wait and see" approach from BanRep.

Looking at September's numbers in detail, all 12 components of the CPI index contributed to higher inflation (charts 2 and 3), and again, the food group was again the main contributor.

The highlights are:

- Foodstuffs inflation was again high, this time at 1.65% m/m, implying a contribution of 031ppts to total inflation. In September, fresh fruits (+6.08% m/m), rice (+2.18% m/m), and eggs (+2.59% m/m) were the main contributors. However, it is worth noting that only 5 of the 59 food categories saw a reduction in prices, which means that upside pressures are present in most of the food basket, with the majority reflecting pressures from higher international input costs.
- The second main contribution (+0.18ppts) came from the housing and utilities group (+0.57% m/m). In this group, utility rates reflect the effect of higher indexation, electricity (+2.09% m/m), and gas (+3.36% m/m), where exchange rate depreciation also plays a role. In the same vein, rental fees increased more than usual (+0.24% m/m) and are also contributing to inflation.
- Other relevant items contributing to inflation are restaurants & hotels (+1.03% m/m), reflecting the higher cost of food but also the strong domestic and foreign demand for touristic services.
- Exchange rate depreciation and bottlenecks in international logistics channels are also reflected in Colombia's inflation. Vehicle prices (+1.82% m/m) were a significant contributor to the increase in CPI. Health care and cleaning products are reflecting higher production costs amid increases in international input prices.
- In forthcoming months, the expected increase in gasoline prices will contribute to inflationary pressures, however, the main impact is expected to be seen in 2023.

As for annual inflation in the main categories, goods inflation increased from 10.56% y/y to 11.57% y/y reflecting the effect of international bottlenecks and high input prices, while services increased at a slower pace but went from 5.48% y/y to 5.93% y/y, a strong acceleration that reflects that demand remains strong. Regulated price inflation rose 0.60ppts to 7.49% y/y.

All in all, September inflation again surprised to the upside, this time not only driven by higher food inflation. Our official scenario is for a hike of 50bps on October 28 at BanRep's meeting to reach a rate of 10.50%, which would be the terminal rate of the current hiking cycle. After September's CPI result, we maintain our call, though this is highly dependent on incoming economic activity data. If economic data continue to show strong activity, the bias would tilt towards another 100bps hike, otherwise expectations for a final 50bps hike will be reinforced.

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

PERU: BCRP TO HIKE 25BPS, NEARS END OF HIKING CYCLE

We expect the BCRP to raise its reference rate by 25bps to 7.00% at today's meeting. Although inflation has already shown signs of slowing down, the pace of deceleration is still not convincing, and the central bank will seek to ensure that inflation returns to the target range.

We believe that we are nearing the end of the BCRP interest rate hike cycle, so today's could be one of the last adjustments of this phase of the cycle. The real interest rate (1.65%) is already around the neutral rate (1.50%). However, the 12-month inflation expectations do not yet show a clear pullback, going from a record of 5 .35% in July to 5.10% according to the August BCRP survey.

Our inflation forecast was revised from 7.4% to 7.7% for 2022 and remains at 4.0% for 2023. We believe that the pace of disinflation will be slow going forward. The BCRP also raised its inflation forecast from 6.4% to 7.8% for this year and from 2.5% to 3.0% for 2023. **The BCRP sees a risk that this episode of inflation could exceed the previous record duration (21 months, to date there are 16).**

—Mario Guerrero