Scotiabank

GLOBAL ECONOMICS

LATAM DAILY

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Contributors

Juan Manuel Herrera
Senior Economist/Strategist
Scotiabank GBM
+44.207.826.5654
juanmanuel.herrera@scotiabank.com

Guillermo Arbe, Head Economist, Peru
+51.1.211.6052 (Peru)
guillermo.arbe@scotiabank.com.pe

Sergio Olarte, Head Economist, Colombia
+57.1.745.6300 Ext. 9166 (Colombia)
sergio.olarte@scotiabankcolpatria.com

Jorge Selaive, Head Economist, Chile
+56.2.2619.5435 (Chile)
jorge.selaive@scotiabank.cl

Eduardo Suárez, VP, Latin America Economics
+52.55.9179.5174 (Mexico)
esuarezm@scotiabank.com.mx

TODAY'S CONTRIBUTORS:

Mario Guerrero, Deputy Head Economist
+51.1.211.6000 Ext. 16557 (Peru)
mario.guerrero@scotiabank.com.pe

Latam Daily: Large Drop in Chilean Economic Activity

- **Peru: December inflation beats, increases hike odds for next week**

A sharp strengthening in the dollar in early-European trading is the most notable development in quiet, thin markets awaiting US jobs data on Friday. Outside of the strong pro-USD move, the risk mood in markets looks somewhat positive with equity cash and futures markets trading broadly higher while crude oil and metals prices are mixed. A strong decline in German inflation owing to a one-off gas bills subsidy in December is weighing on bund yields, though global bonds are generally well bid.

The MXN is resisting the dollar-positive mood, however, with its 0.3% loss a full percentage point lower than that seen in the EUR.

Chile's economy recorded a smaller-than-expected, though still large, decline in economic activity in November of 2.5% y/y (vs –2.8% consensus) according to data published this morning; mining activity rose 1.34% against a 0.96% drop in non-mining output. The fading impact of pension withdrawals coupled with highly-restrictive policy rates have clearly stunted the Chilean economy that will likely record a second consecutive quarterly contraction in Q4-22. On a month-over-month basis, activity declined by 0.8% after a 0.5% expansion in October (in very choppy data). **Chile's INE publishes December inflation data on Friday** that should maintain the downward trend from the August high, but the deceleration looks far from quick enough to see the BCCh reduce its policy rate at its late-January meeting. Note that only three of 57 traders polled in the latest BCCh survey expected a rate reduction this month.

The Latam day ahead is quiet with little on the calendar to drive sentiment in the region's assets. Watch comments from Brazilian policymakers as local assets trade on edge with Lula's team sounding a more fiscally loose policy than had perhaps been expected before his term began this year.

—Juan Manuel Herrera

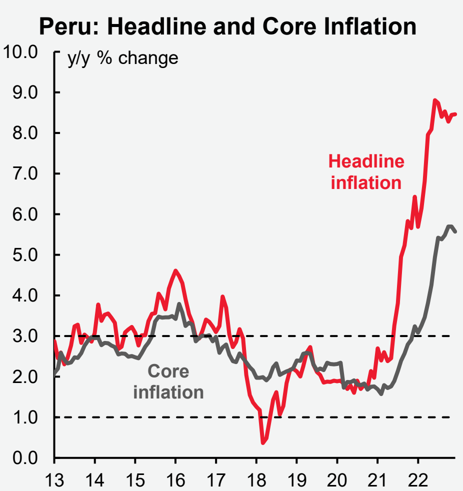
PERU: DECEMBER INFLATION BEATS, INCREASES HIKE ODDS FOR NEXT WEEK

Peruvian prices rose 0.79% m/m in December in data released over the weekend, above our forecast (0.52%) and the Bloomberg consensus (0.69%). Year-on-year inflation was practically unchanged, going from 8.45% y/y to 8.46% y/y (chart 1), and remaining well above the upper limit of 3% of the inflation target. This is the nineteenth consecutive month that inflation sits above the bank's target band, with more to come. The longest period with inflation above 3% was 21 months (between October 2007 and June 2009). **The BCRP sees the risk that this period of inflation above the 3% limit will be the longest in history** (since the 1-3% target band was established in 2007).

Inflation in December reflected the impact of social protests and roadblocks on food prices, mainly perishable foods such as tubers and vegetables (Table 1). Adverse weather conditions also had an impact (lack of rain in the producing areas) as well as the high cost of fertilizers. During 2022, of the 586 products that make up the consumer basket (base 2021), 534 increased (91%), 35 decreased (6%), and 17 remained unchanged (2.9%).

Core inflation fell from 5.70% y/y to 5.57% y/y, suggesting that core prices growth peaked in November. A number of cost indicators, such as wholesale prices, machinery and equipment prices, and construction material prices, continued to slow, thus maintaining the expectation of lower inflationary pressures (chart 1 again).

Chart 1



Sources: Scotiabank Economics, BCRP.

At the city level (considering the 26 most important cities, not only Lima), y/y inflation readings were balanced: accelerating in half of them and slowing in the other half. **Three cities continued to register an annual inflation rate above 10%.**

Looking ahead, although our baseline scenario assumes that the slowdown in inflation will continue, this pace is slower than expected. In our December 16 ***Latam Weekly***, we revised our inflation forecast from 7.7% to 8.2% at end-22 and from 4.0% to 4.5% at end-2023. Over the past sixteen months, the central bank has raised its benchmark rate by 725 basis points to 7.50% and raised reserve requirements three times. Twelve-month inflation expectations are softening, but still without conviction, while the BCRP raised its inflation forecast from 7.8% to 8.2% for 2022 and kept it at 3.0% for 2023.

Table 1: Peru—Lima CPI Basket—December 2022

Groups of consumption	Base 2021	% m/m	% y/y
1. Food and non-alcoholic beverages	22.97	1.73	15.2
2. Alcoholic beverages, tobacco, drugs	1.61	0.58	3.8
3. Apparel and footwear	4.20	0.30	2.5
4. Housing, water, electricity, gas and others	10.55	0.16	4.2
5. Furniture and home maintenance	5.11	0.22	3.5
6. Health	3.48	0.30	4.8
7. Transport	12.40	0.84	11.3
8. Communications	4.77	0.46	1.4
9. Recreation and culture	3.96	0.80	6.7
10. Education	8.61	0.00	3.9
11. Restaurants & hotels	15.89	0.76	9.5
12. Other goods and services	6.47	0.59	6.7
Total CPI	**100.00**	**0.79**	**8.5**

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

The real policy interest rate continues to rise and has already reached 2.82%, a level well above the neutral rate (1.50%), although low compared to other countries in the region. Like us, the central bank has signaled that it sees the end of the cycle of interest rate hikes near but does not rule out further hikes. Our baseline scenario shows that the BCRP has reached a terminal rate at 7.50%, but with an upside bias. **With stubbornly-high inflation, it is probable that the reference rate will rise 25bps to 7.75% at the BCRP's decision on Thursday, January 12.**

—Mario Guerrero