Latam Economic Update

- **Central banks: Tipped toward the doves**
- **Chile: July inflation came in at 0.1% m/m (2.5% y/y), above market expectations despite an increase in items with null variations owing to INE imputations**
- **Mexico: July headline inflation was in line with expectations, but still higher than previous months**
- **Peru: Congress moves towards allowing a new wave of pension fund withdrawals; trade balance strongly returns to positive territory in June**

See the August 8 edition of our Latam Weekly for our comprehensive preview and analysis of the next two weeks (Aug. 8–21) in macroeconomic developments in Argentina, Brazil, Chile, Colombia, Mexico, and Peru. Note: Our Argentina coverage in the Latam Daily will return on August 17 following staff vacations.

CENTRAL BANKS: TIPPED TOWARD THE DOVES

- **Mexico.** Banxico's Governing Board meets on Thursday, August 13 and our team in CDMX expects it to bring forward a -25 bps cut to a terminal rate of 4.75% to end this easing cycle, but there is a decent possibility that the Board could deliver on some calls for a -50 bps move. Regardless of the size of the cut delivered, all eyes will be on the statement for fresh insight on how the Board is balancing sticky inflation against a deepening contraction in economic activity.
- **Peru.** The BCRP's Monetary Policy Committee (MPC) meets on Thursday, August 13 and is expected to hold its headline policy rate at 0.25%, an all-time low, just as it did at its last meeting on July 9. The MPC has been clear that any additional easing needed would be delivered through enhanced liquidity and credit measures.
- **Brazil.** The *Minutes* from the Wednesday, August 5 Copom meeting will be published by the BCB on Tuesday, August 11. The *Minutes* may shed some light on the Copom's thinking about how much room remains for further policy easing.

—Brett House

CHILE: JULY INFLATION CAME IN AT 0.1% M/M (2.5% Y/Y), ABOVE MARKET EXPECTATIONS DESPITE AN INCREASE IN ITEMS WITH NULL VARIATIONS OWING TO INE IMPUTATIONS

Inflation data for July, released on Friday, August 7, came in at 0.1% m/m, above expectations embodied in inflation forwards (0% m/m), which gives support to our view that inflation, while declining in year-on-year terms, could be somewhat higher than expected by the market the rest of the year. We maintain our forecast of annual inflation of 2.2% y/y at end-2020, above what is expected by the market (1.6% y/y).

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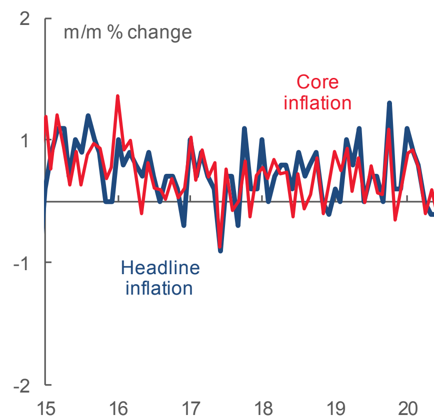
Chart 1



Sources: Scotiabank Economics, INE.

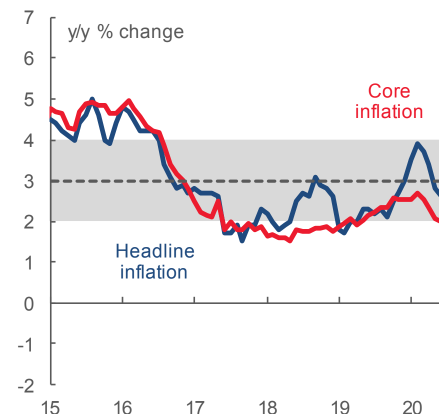
July core inflation stood at 0.1% m/m (chart 1) and 1.8% y/y (chart 2), with the goods component increasing 0.4% m/m (2.4% y/y) and services decreasing -0.1% m/m (1.4% y/y). Thus, inflation for the month was due to the rise in the prices of goods and new increases in food (somewhat higher than their seasonality), partially offset by the persistent drops in services and fuels prices.

The second half of 2020 should begin to show some inflationary pressures from fuels as well as stronger demand for consumer goods caused by the injection of liquidity from AFPs. The exchange rate should play a minor role in counteracting inflationary pressures. However, the National Institute of Statistics' (INE) data collection process could add volatility to the monthly numbers as they are not likely to be homogeneous with respect to the part of the CPI basket that currently reflects null imputations rather than actual prices.

For August, our preliminary projection anticipates headline inflation between 0% m/m and 0.1% m/m. August should feature a smaller negative contribution from gasoline (the last month of this cycle) and should continue to reflect inflationary pressure on goods prices, with greater intensity in the second part of the month because of spending fuelled by the withdrawal of funds from the AFPs.

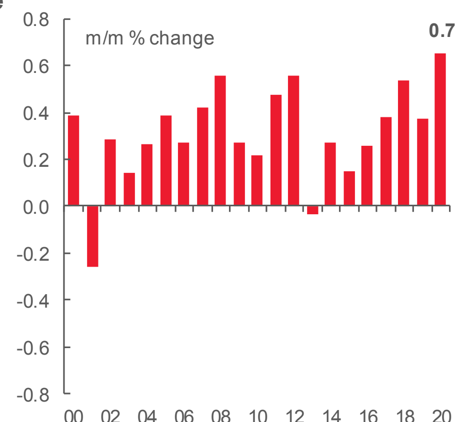
—Jorge Selaive

Chart 2



Sources: Scotiabank Economics, INE.

Chart 3



Sources: Scotiabank Economics, INEGI.

MEXICO: JULY HEADLINE INFLATION WAS IN LINE WITH EXPECTATIONS, BUT STILL HIGHER THAN PREVIOUS MONTHS

Headline inflation figures for July, released on August 8, were practically in line with those expected by the market consensus, but this still meant the monthly variation hit its fastest pace for the month of July since 2000 at 0.7% m/m (chart 3). In the main components, the increase in non-core prices stands out, which followed a sharp, expected increase in government-authorized rates, while core inflation was also in line with expectations.

Core inflation registered a monthly variation of 0.40%, also in line with that anticipated by the analysts' consensus (0.39% m/m), but higher than the 0.26% m/m printed in July 2019.

Non-core inflation accelerated to 1.48% m/m from 1.12% m/m in June 2020 (versus 0.74% m/m in July 2019), as a result of the increase in energy prices and rates authorized by the government (2.70% m/m). On the other hand, there was a decrease in the agriculture component of -0.03% m/m, from -2.09% m/m in June.

Thus, annual headline inflation accelerated for a fourth consecutive month, now from 3.33% y/y to 3.62% y/y (versus 3.78% y/y in July 2019). Both of its components increased: its core component from 3.71% y/y to 3.85% y/y (versus 3.82% y/y a year earlier), and the non-core from 2.16% y/y to 2.92% y/y (versus 3.64% y/y in July 2019).

It is worth noting that, owing to the COVID-19 pandemic, inflation readings may be subject to distortions since: (i) the methodology used to collect price data has changed; and (ii) changes in consumption patterns are not fully reflected in the price index (INPC), which features pre-pandemic fixed weights; among other issues.

Finally, Mexico's central bank last forecast anticipated that inflation would print, on average, 3.5% y/y during Q3-2020, but in our opinion, the actual number will be closer to the 4% upper bound of the central bank's tolerance range. We forecast 4.1% y/y in the latest *Latam Weekly* since core inflation remains sticky and oil prices continue to recover. Therefore, we foresee that, at the next meeting on August 13, Banxico will cut the benchmark rate at a slower pace (-25 bps) than previous meetings, though there is a chance that it could repeat its previous -50 bps move.

—Daniel Mendoza

PERU: CONGRESS MOVES TOWARDS ALLOWING A NEW WAVE OF PENSION FUND WITHDRAWALS; TRADE BALANCE STRONGLY RETURNS TO POSITIVE TERRITORY IN JUNE

On August 6, the congressional Consumer Defense Committee approved an initiative that would allow unemployed individuals full or partial access to their private pension fund accounts. The initiative's key details include (1) Those who have not been able to contribute to their funds in the past 12 months would be able to withdraw the totality of funds from their accounts. If they possess over PEN 10,000 (just under USD 3,500), the withdrawal would be in three parts over a 190-day period; if they possess under this amount, the withdrawal would be over a shorter period; and (2) Those individuals who have not been able to contribute during the State of Emergency period (which began on March 16) will be able to withdraw up to PEN 4,300 (approx. USD 1,200) over a 10-day period.

This initiative is different from the "25% law" law approved in April, which was universal, with open access to all, although with a PEN 12,900 cap. The current initiative is not universal, but limited to those participants who have not contributed recently, presumably due to the loss of employment. Those who have not lost their jobs cannot withdraw funds. Should the law be passed, this latter aspect will be key in keeping the private pension fund system functional.

The bill still needs to be approved on the Congressional floor. In the past, this Congress has acted rather swiftly, and is unlikely to delay too much this time around either. Given voting precedents in similar matters, it is more likely than not that the initiative will be passed by Congress. Note, however, that there is, perhaps, some room for the new Cabinet to negotiate. The April withdrawal law did not originally include a cap: the PEN 12,900 cap was put in after talks between the government and Congress.

The government fell short of challenging the 25% law in court. On this occasion, and assuming the bill is passed, the government's response is likely to depend on whether it is able to have the initiative watered down, and whether it considers the magnitude of the resources involved to be large enough to pose a risk to the system. If the initiative does become law in terms that the government finds worrisome, the government could veto the law. However, Congress would probably have enough votes to override his veto in a second vote. After that, the government would need to rely on the Courts.

The Banking Superintendent (SBS) which also regulates the AFP pension funds, has estimated that the new law would lead to withdrawals of up to PEN 20.7 bn, or 13.7% of AUM. This sounds fairly reasonable, although with some risk to the upside. Withdrawals due to the 25% law amounted to approximately PEN 25 bn (16.5% of the portfolio). The need for liquidity by the AFPs to meet demands for withdrawals would need not be too great an issue as the central bank put in place a swap line to provide AFPs with liquidity when the 25% withdrawal law was passed.

The BCRP released trade-balance figures for June on Sunday, August 9. Unsurprisingly, the trade balance turned positive, to the tune of a USD 434 mn surplus, after two consecutive months of deficit in April (USD 481 mn) and May (USD 224 mn). The trade surplus year-to-date is USD 810 mn, which seems like a far cry from our forecast of USD 5.3 bn for 2020, but June is only the tip of the iceberg for exports performance in the rest of the year.

- **Exports in June were nearly 36% m/m greater than in May.** Furthermore, the surplus in June occurred even though mining output was still only at about 80% to 85% of pre-COVID-19 levels. The trade surplus should increase in the coming months as mining output normalizes, the full impact of the fishing season is felt, and trade revenues reflect higher metals prices.

- **Imports, meanwhile, were only 2% m/m greater in June than in May.** This still seems weak, on the face of it, but the details are telling. Imports of consumption goods were up 13.9% m/m with respect to May, which indicates a moderately health increase in domestic demand, considering it was still only Phase 2 of the unlocking process. Capital goods rose 7% m/m. What held imports down was intermediate goods, including oil imports, which were down -7.3% m/m, more due to prices than to volumes.

—Guillermo Arbe

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