Latam Daily: Chile May Inflation Projection; Banxico Q1 *QIR*

- **Chile: Hikes in fuel prices should continue to pressure inflation in May**
- **Mexico: Banxico's Q1 *Inflation Report* laid out a more optimistic outlook for the economy**

CHILE: HIKES IN FUEL PRICES SHOULD CONTINUE TO PRESSURE INFLATION IN MAY

We forecast an increase of 0.2% m/m sa (3.6% y/y) in the May CPI print that is due to be released on Tuesday, June 8. Our forecast is below market expectations: the medians in the *Financial Traders Survey (FTS)* and the *Economic Expectations Survey (EES)* are both 0.3% m/m, while forwards are pricing 0.37% m/m. We expect monthly inflation to be led by new increases in the prices of gasoline (i.e., transport) and cigarettes (table 1).

May would be the thirteenth consecutive month with zero variation in the prices of air transport services, tourist packages, and other services with high degrees of social interaction, such as gyms, sports classes, and cultural shows, among others. The re-imposition of quarantines during March, which were maintained for much of May, made it impossible to resume data collection on the pricing of these items. However, with the lifting of restrictive measures at the end of May we expect that some of these items will see data collected on prices for the June CPI estimates.

Preliminarily, for June we forecast an increase of 0.2% m/m (3.9% y/y). Looking farther ahead, we expect inflation to decline to the central bank's 3.0% y/y target by December 2021 owing to slack in the labour market and the recent appreciation of the CLP.

Table 1
Chile: May inflation breakdown

Divisions	Contribution, ppts
Food and non-alcoholic beverages	-0.01
Alcoholic beverages and tobacco	0.04
Clothing and footwear	-0.02
Housing, water, electricity, gas, and others	-0.02
Household equipment and maintenance	0.00
Health	0.01
Transport	0.15
Communication	0.00
Recreation and culture	0.02
Education	0.00
Restaurants and hotels	0.01
Miscellaneous goods and services	0.02
CPI, m/m % change, sa	**0.20**
CPI, m/m % change, sa (rounded)	**0.2**

Sources: Scotiabank Economics, INE.

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As we noted several months ago, we continue to maintain our conservative stance regarding the evolution of inflation during the rest of the year. We project annual inflation at 3.0% y/y in December 2021, below market expectations. The inflationary pressures seen at the beginning of the year should diminish in the coming months as the weakness in labour markets comes to be reflected more broadly throughout the economy.

Amidst conflicting forces, we expect inflation to moderate in H2-2021. Although we expect some recovery in service-sector inflation, we also project some relaxation in pressures on the price of goods from September onwards, hand in hand with greater re-opening and looser restrictions on mobility. These offsetting effects between the expected recovery in service-sector inflation and the projected stabilization in goods-price inflation are set to be accompanied by repeated attempts by public policymakers to sustain household spending—moves that could have an impact on the price basket. At the same time, pass-through effects from the peso's recent appreciation should be transmitted to the economy with greater intensity as supply chains begin to improve. Though these cross-currents could cause some price volatility over the coming months, on balance, we expect inflation to come down in the latter half of 2021.

Our projected path for inflation in the remainder of 2021 sits below market expectations. The *FTS* prior to the May monetary policy meeting showed a slight increase in short-term inflation expectations, which was tied to the depreciation in the CLP that was also expected in the survey. In any case, medium-term inflation expectations remain anchored to the central bank's 3% y/y target.

—Carlos Muñoz & Anibal Alarcón

MEXICO: BANXICO'S Q1 *INFLATION REPORT* LAID OUT A MORE OPTIMISTIC OUTLOOK FOR THE ECONOMY

On Wednesday, June 2, Banxico presented its quarterly *Inflation Report* *(QIR)* for January–March 2021. As broadly expected, the central bank revised upwards its growth and inflation forecasts for 2021, but changes for 2022 were mixed.

On the growth front, the central scenario for 2021 is now at 6.0% y/y, above the 4.8% y/y of the previous report and Scotiabank Economics' forecast of 4.9% y/y. Once again, Banxico also offered a range around its growth outlook, where the lower bound foresees a 5.0% y/y expansion and the upper bound anticipates 7.0% y/y real GDP growth. For 2022, Banxico expects 3.0% y/y real growth, down from the 3.8% y/y forecast previously; the new base line has a 2.0% y/y lower bound and a 4.0% y/y upper bound. The upward revision for growth in 2021 came from the stronger than projected economic recovery in Q1-2021, expectations of vigorous external demand given the better outlook for the US economy in 2021, and a broader resumption of domestic activities thanks to the vaccination process in Mexico.

Regarding inflation, numbers were revised upward for each remaining quarter in 2021. Headline inflation for the end of 2021 is now expected to hit 4.8% y/y, well above the 3.6% y/y previously forecast by Banxico's staff. However, the central bank maintained its view that inflation will converge toward the 3.0% y/y target by Q2-2022, which underscored that the Board considers recent pressures as a transitory event mainly explained by base effects. In the same sense, core inflation forecasts were revised upward from 3.1% y/y to 3.9% y/y at end-2021, before coming down to 3.2% y/y at end-2022. Assuming a two-year policy horizon, and a 12–18 month transmission lag, tightening now would have its full impact on the economy by the time the central bank expects inflation to be back at target, which implies that the Board still sees room for patience with respect to hikes. With this in mind, we do not yet see evidence that Banxico is preparing to raise its policy rate, but its base scenario could change if inflation induced by weather and supply-side effects starts contaminating other components of the CPI basket.

Even with these forecast revisions, the balance of risks for both growth and inflation remained skewed to the upside.

- The main event that could push a further improvement in the **growth outlook for 2021** would be a stronger vaccination process in Mexico, while a better-than-expected rebound in the US economy could also further raise economic activity. On the downside, supply shortages, poor developments regarding the pandemic, and episodes of financial volatility were cited as the main negative risks for the economy.

- On the **inflation side,** higher energy prices, ongoing scarcity in food and other industrial inputs, and a strong rebound in demand for services as the economy continues to re-open were noted as the sources of upside risks to prices. The possibility of a wider-than-expected output gap remained the main risk on the downside.

With this new *QIR* in hand, we maintain our view that Banxico's Board shall hold its key policy rate at 4.00% through the rest of 2021 and implement a first rate hike in Q1-2022. The *QIR* reinforced the sense that the Board remains convinced that the recent spike in inflation is transitory and that increasing rates now would deliver a tightening in monetary conditions just when the Board expects inflation to come down.

—Miguel Saldaña