Latam Daily: Chile Election; Mexico Banxico Minutes and Q3 GDP Indicators

- **Chile: First-round election delivered new guardrails against ideological deterioration of fundamentals**
- **Mexico: Banxico meeting minutes; Q3 GDP estimate and September proxy reveal persistent supply chain pressures**

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CHILE: FIRST-ROUND ELECTION DELIVERED NEW GUARDRAILS AGAINST IDEOLOGICAL DETERIORATION OF FUNDAMENTALS

Chile's competitive Presidential election on Sunday (November 21) delivered a new composition of Congress, adding new guardrails around the need to reach consensus. The greatest takeaway we observe is that the election broadly voted in favor of the status quo. One interpretation by local observers is that the vote should be read as a push for social change, albeit with voters' endorsement to do so peacefully. Another interpretation is that we are facing a society that for the most part does not want change, preferring order, peace, low interest rates, access to a good level of consumption and better wages over ethical, inclusive, redistributive and environmental aspects. It will be the job of Congress and the future President to assess where the interests of the majority lie.

What will happen over the next four weeks of the campaign?

On the side of candidate Mr. Jose Antonio Kast (right), he is expected to modify his **economic program, incorporating a redistributive component and moderating the tone around economic growth as the main driver of public finances.** We should also see a softening on socially conservative issues, as well as a clearer critique of Chile's complex past from the 1970s and 1980s.

In the case of Mr. Gabriel Boric's (left) economic proposal, no relevant changes are in sight. Rather, we expect a recognition of the relevance of economic recovery and growth, and of the need to rein in violence and crime. Some of this has already been seen and will likely be accentuated.

The large share of votes for centrist candidates Franco Parisi and Marco Enríquez-Ominami (360k and 490k votes, respectively), are a significant voter pool. This is notable as both candidates, from non-traditional parties, secured considerably higher votes compared to their peers running for congress and regional assemblies. The motivations of their supporters lie somewhere between charisma and relatively market-friendly proposals. This gives them both a more credible ability to endorse a presidential candidate in the runoff, relative to the other first-round candidates and coalitions.

If there are no major errors with high media impact from either candidate, the presidential runoff election on December 19 will be defined by no more than 100k votes.

What to expect from the financial market in the coming months?

The result of the runoff will influence the behavior of interest rates, exchange rates and the stock market. But the indisputable balance in Congress

introduces caution in the actions of the Constituent Assembly and the new President. Unsurprisingly, Assembly leaders reacted immediately with statements of support and warning. It is clear that an exit referendum has different probabilities of obtaining approval depending on who the president is. All of the above carries impacts on economic and financial variables and, certainly, also in public finances. But to a large extent, guardrails are now in place for financial variables following the first-round election.

The remaining challenge for the macroeconomic scenario is the fourth withdrawal of pension funds (PF). Mr. Boric will most likely take ownership of this initiative, as it became clear that it brought gains to parliamentarians who supported previous PF withdrawals. It is not ruled out—if there is political pragmatism—that Mr. Kast bets on the same and ties the field. Therefore, we must work on the assumption that there is a high possibility of a new withdrawal of PF that, depending on the attached restrictions, could have limited impacts. A new withdrawal of PF will raise growth and inflation expectations for 2022 along with an expected adjustment in public spending that will occur under Mr. Boric or Mr. Kast during the first months of the new year. The Central Bank would have to respond accordingly by withdrawing the stimulus until early 2022, but with a different view of monetary policy during the second half of next year.

—Anibal Alarcón

MEXICO: BANXICO MEETING MINUTES; Q3 GDP ESTIMATE AND SEPTEMBER PROXY REVEAL PERSISTENT SUPPLY CHAIN PRESSURES

I. Central Bank Meeting minutes provide new insights into Banxico's board split

On Thursday (November 25), the Central Bank, Banxico, released minutes from its meeting held on November 11 when the Board voted to increase the policy rate by 25 bps to 5.00%. The minutes provide additional—and important—insights into the different views among the board members. While the tone is now more hawkish, arguments are strong for a 25bps hike at the December meeting.

The item most likely to draw attention was that one board member argued the economy likely needed a faster stimulus unwind, in support of a 50bps hike. However, the same member also argued that, in the current uncertain environment, an acceleration of the tightening pace could have undesired effects on financial markets. We tend to agree with this view.

We have argued for some time that Mexico's inflationary pressures now reach beyond simply supply-side factors. This is in part because output gaps in the Mexican economy have closed unevenly but faster in markets of lower elasticity goods. And also because producer prices pressures have now been strong for almost 1.5 years in the primary and secondary sectors, in addition to Mexican firms having faced 8 quarters of recession and stagnation. With this in mind, an acceleration would probably be seen as a signal of a faster sustained pace going forward, which may not be appropriate for the economy.

The other very interesting part of the debate is that Banxico is starting to discuss the publication of "dot-plots" for rate expectations of the board's members, alongside the CB's inflation forecasts, similar to what the Federal Reserve has done. As we have discussed in the past, we think one of the defining traits of Governor Diaz de Leon's tenure has been a strong push to make monetary policy communication more transparent. It will be interesting if this can be implemented in the Governor's last meeting, on December 16th, or if this debate continues into the term of the bank's new leadership.

Third quarter GDP data already confirmed a sequential contraction, and the economy continues to show very uneven rebound speeds. As we have said in the past, we are likely to revise our 2021 and 2022 inflation forecasts to the upside—but also 2021 and 2022 growth forecasts to the downside—in our next forecast update. With those two divergent paths, a gradual Banxico adjustment path is prudent. To some degree, we think one of the hurdles facing Banxico is that the board is very split, somewhat undermining the signaling power in regard to price containment commitment.

Most of Banxico's board highlighted recent downward revisions to global growth, which is now confirmed to be taking place simultaneously in Mexico. In addition, the board discussed that, given the strong integration of the US-Mexico economies, inflation shocks in the northern partner have a relevant impact south of the Rio Grande. A point raised by one of the members during the board's discussion—which we think is highly relevant and agree with—is that as part of the inflation debate, and because of the length and breadth of the supply shocks, the nature of the shock has become much less relevant than how long we will live with it. In many ways this is key because, to the extent that economies continue to see demand rebound (Mexico printed 3 monthly trade deficits averaging US$3 bn this summer), producers will pass along the cost shock to suppliers if they see it as long lasting.

Overall, the tone of the minutes seems like the tone in the statement—we perceived it to be marginally more hawkish. Although we don't fully shut the door on an eventual shift towards a 50bps hiking pace, we think the arguments used against the 50bps hike by the board member who discussed that move are valid—and correct.

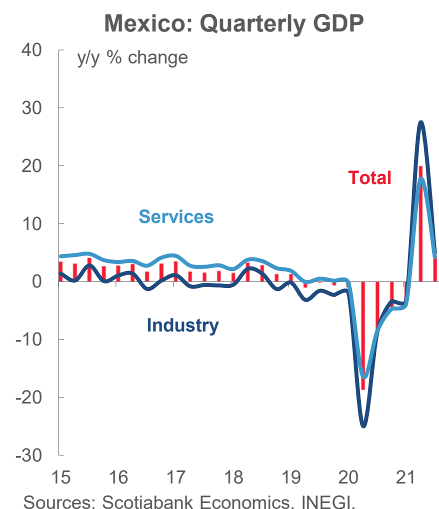
—Eduardo Suárez

II. GDP figures for Q3-2021 land below consensus amid persistent supply chain pressures and COVID-19 infections in July-August

According to statistical agency, INEGI, the final GDP estimate for Q3-2021 resulted in a broader quarterly decline of -0.4% sa q/q from -0.2% q/q in its flash estimate, below the -0.3% q/q consensus and the previous 1.2% q/q in Q2. The industrial sector moderated from 0.8% q/q to 0.3% q/q (0.7% q/q in the flash estimate), amid persistent supply chain disruptions particularly affecting manufacturing despite a bigger advance in construction. Services fell -0.9% q/q from 1.2% q/q previously and -0.6% q/q in the flash estimate, in line with the high number of COVID-19 infections during July and August, which fostered lower mobility during the period.

In its annual comparison, GDP moderated its increase from 19.9% y/y to 4.5% y/y nsa (vs. 4.7% y/y flash estimate) (chart 1), showing still some distortions by the low comparison base effect (see our Latam Daily on Q2's GDP final estimate here). Industry moderated to 5.0% y/y from 27.5% y/y, while services moderated from 17.7% y/y to 4.2% y/y, and the agricultural component slowed from 6.4% y/y to 0.3% y/y.

Chart 1

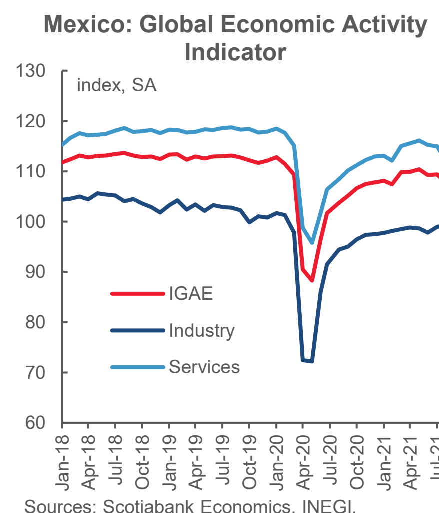


Sources: Scotiabank Economics, INEGI.

III. Monthly GDP proxy (IGAE) drops in September, with fourth drop in manufacturing since April

Also released on Thursday (November 25), was the monthly economic activity index (IGAE), which dropped -0.4% m/m sa from the previous -1.2% m/m, starting to show a downward trajectory since March (chart 2) as the index summed six drops since January 2021. The services components softened its fall, from -1.7% m/m to -0.3% m/m, adding up to four consecutive drops and seven YTD, despite the higher consumer confidence resulting from lower covid contagions. Industry fell -1.4% m/m from 0.0% m/m, where utilities (-1.1% m/m), construction (-1.4% m/m) and manufacturing (-1.3% m/m) fell, and only mining showed a modest increase (0.1% m/m). In particular, manufacturing showed its fourth drop since April, again affected by supply chain disruptions. Agricultural activities also fell, from 1.8% m/m to -1.1% m/m. In its annual comparison, economic activity moderated in September, from 4.3% y/y to 0.9% y/y. Services moderated from 3.8% y/y to 0.7% y/y, and industry moderated from 5.5% y/y to 1.6% y/y.

Chart 2



Sources: Scotiabank Economics, INEGI.

Looking ahead, services could see a modest recovery in the holiday season, while industry will continue to face pressures by disruptions in value chains. The recent behavior of inflation, combined with persistent uncertainty regarding COVID-19 contagion and economic policies represent the main downside risks to consumption and investment, with the latter presenting patent weakness. Thus, the recovery in the economy could decelerate and present a very modest pace in the last quarter of 2021. Consensus in the Citibanamex Survey expects a 5.9% GDP growth in 2021.

—Miguel Saldaña

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