Scotiabank

GLOBAL ECONOMICS

LATAM DAILY

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Latam Daily: A Latam Omnibus: Updates from Chile, Colombia, Mexico, and Peru

- **Chile: Monthly GDP for June points to first-half growth of 6.4%; expected debt issuance less than previously announced**
- **Colombia: One year after reopening, employment gains hit a ceiling while labour market inactivity remains high**
- **Mexico: Flash estimates of Q2 GDP shows growth accelerating, while Banxico survey reveals higher expected inflation, lower growth**
- **Peru: Month-on-month inflation rises in July, but year-on-year inflation may have peaked in June; President Castillo's speech**

CHILE: MONTHLY GDP FOR JUNE POINTS TO FIRST-HALF GROWTH OF 6.4%; EXPECTED DEBT ISSUANCE LESS THAN PREVIOUSLY ANNOUNCED

I. GDP would have grown 6.4% y/y in the first half

Non-mining GDP in technical recession, as consumption slows slightly. On Monday, August 1, the central bank (BCCh) released the monthly GDP growth for June, which grew 3.7% y/y (-0.2% m/m), in line with market expectations. With this, the second quarter would have grown 5.7% y/y (+0.3% q/q).

Industry grew (+0.6% m/m), putting an end to two months of seasonally adjusted declines (chart 1). Likewise, construction grew 0.8% m/m, a positive performance that could accelerate in the coming months thanks to a greater pace of execution of public investment projects, mainly in the housing sector.

Non-mining activity fell into its first technical recession since the social unrest (Q4-2019). However, this recession is not necessarily a source of concern, since convergence towards sustainable GDP growth rates is necessary to accompany the process of disinflation. That said, we believe that it may constitute a political warning signal, raising concerns among the most informed voters with respect to economic performance ahead of the September referendum.

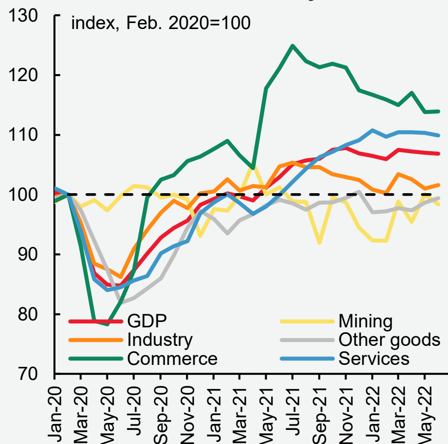
Taking all the above into account, we reaffirm our GDP growth projection of 2.1% for 2022. We expect the BCCh to make a 75 bps hike in the September meeting, raising the benchmark rate to 10.5%. We further anticipate GDP will decline in the second half of 2022 given the clear loss of dynamism in the labour market and confidence indicators in negative territory. Annual inflation is likely to approach 14% in Q3, justifying additional increases in the reference rate, which should be withdrawn shortly, conditional on price stability in the last two months of 2022.

II. MoF announces 2022 expected debt issuances of USD 15 bn, less than previously announced (USD 20 bn)

On Friday, July 29, the Ministry of Finance (MoF) reported revised financing estimates for this year showing that it will issue bonds for a maximum amount equivalent to approximately USD 15 bn in 2022, an amount lower than initially indicated in the issuance program at the beginning of the year (USD 20 bn). For Q3-2022, the issuance calendar contemplates a total of approximately USD 1 bn. It should also be recalled that the latest Public Finance Report estimated that the level of sovereign debt-to-GDP ratio would reach 38% in 2022.

—Jorge Selaive, Anibal Alarcón, & Waldo Riveras

Chart 1



Sources: Scotiabank Economics, BCCh.

COLOMBIA: ONE YEAR AFTER REOPENING, EMPLOYMENT GAINS HIT A CEILING WHILE LABOUR MARKET INACTIVITY REMAINS HIGH

Employment data for June, released on July 29, show that one year after the start of reopening services-related activities with a better performance in job creation, which mostly benefited the female population. However, inactivity remains around 18% above pre-pandemic levels, which is a source of concern for the medium term.

The national unemployment rate stood at 11.3% in June, while the urban unemployment rate (main 13 cities) was 11.7% (chart 2). Both indicators are lower than the June 2021 levels of 14.6% and 16.2%, respectively. In seasonally adjusted terms, however, the nationwide unemployment rate increased from 10.5% to 11.7%, while the urban rate rose from 11.3% to 11.7%. These developments point to increasing challenges to job creation. As a result, while the participation rate is increasing at a moderate pace, the labour market has had difficulties absorbing new people. In fact, in monthly terms, employment contracted by 259 thousand jobs compared to the previous month (chart 3), while the inactive population reduced by 140 thousand.

In the last year, three sectors accounted for half of the y/y increase of 1.95 million employment: leisure-related activities (+508 thousand), manufacturing (+269 thousand), and restaurants and hotels (+210 thousand). Only one sector showed a contraction in employment compared to a year ago, professional activities (-83 thousand), which is related to domestic services.

In the same vein, in the last year, women have benefited the most as services-related sectors rebounded but also because of the return to in-person classes in schools. In May, for every 5 men who entered the workforce, 6 women did so, as gender gaps closed. The female unemployment rate now stands at 14.01%, 4.9 ppts above the male unemployment rate of 9.2%. This represents a reduction in the gap observed a year ago of 5.7 ppts, when the female unemployment rate stood at 18% compared to 12.3% of men.

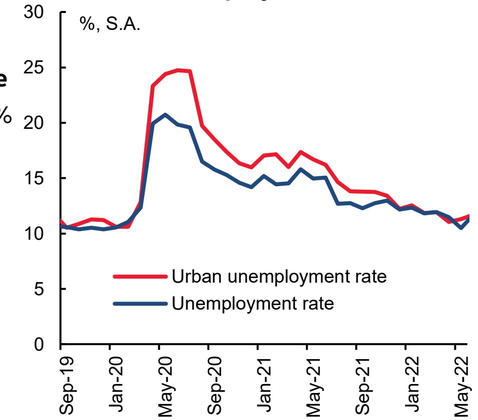
DANE also released an enhanced statistic for informality that now covers all of the country. Informal jobs accounted for 58% of national employment, down from the June 2021 level of 60.1%. The new measure reflects the effect of including rural areas, which are intensive in activities related to agriculture and has an informality rate of 85.4%.

The most worrying scenario in the labour market is the still high level of the rate of inactivity, which stands at 17.5% (or roughly two million people) above the pre-pandemic level and is mainly concentrated in urban areas. In the press conference, DANE highlighted that inactivity is concentrated in the population that previously worked in informal activities for businesses in which employment is lagging owing to the economic conditions.

Summing up, the labour market has shown strong progress in the last year as the economy reopened. Services-related sectors have led the job gains, especially for the female population. However, at the margin, we are beginning to see difficulties to further job creation as, on a seasonally adjusted basis, employment contracted. Additionally, inactivity remains well above pre-pandemic levels. For now, labour market dynamics are compatible with a gradual moderation of the economic activity in the forthcoming months.

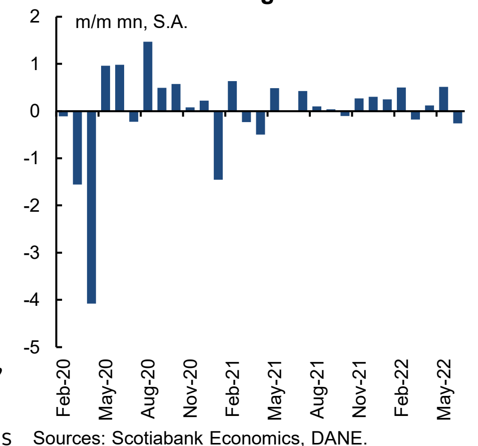
—Sergio Olarte, Maria (Tatiana) Mejía & Jackeline Piraján

Chart 2



Sources: Scotiabank Economics, DANE.

Chart 3



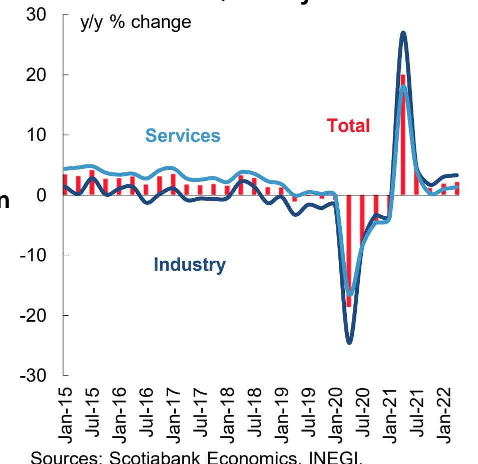
Sources: Scotiabank Economics, DANE.

MEXICO: FLASH ESTIMATES OF Q2 GDP SHOWS GROWTH ACCELERATING, WHILE BANXICO SURVEY REVEALS HIGHER EXPECTED INFLATION, LOWER GROWTH

I. GDP Q2-2022 flash figures beat expectations, as services and industry accelerated on a yearly basis

According to INEGI, the flash estimate of Q2 2022 GDP shows growth accelerating from 1.8% y/y to 2.1% y/y nsa (chart 4), well above the 1.5% consensus. Services soared 1.3% y/y from

Chart 4



Sources: Scotiabank Economics, INEGI.

0.9% y/y previously. Industry increased from 3.1% y/y to 3.3% y/y, though primary activities moderated from 1.9% y/y to 1.5% y/y. Thus, in the first half of the year, GDP recorded a cumulative growth of 2.0%. In its seasonally adjusted quarterly comparison, GDP maintained a growth rate of 1.0% q/q (0.9% q/q consensus). Industry moderated to 0.9% q/q from 1.2% q/q, while services eased from 1.3% q/q to 1.0% q/q. In contrast, primary activities rebounded from -0.9% q/q to 0.9% q/q.

Looking to the monthly data released earlier last week, the growth proxy (IGAE) accelerated in May, from 1.3% y/y to 2.1% y/y, which like the flash estimates was also above the 1.7% consensus. Services edged up to 1.4% y/y, driven by retail (7.7%) and wholesale trade (9.9%), as higher vaccination rates have reduced risk despite new recent contagion waves. Manufactures, which are highly dependent on exports, increased 6.2% y/y. However, construction associated with investment decreased -0.1% y/y, suggesting that prevailing domestic uncertainty could still be affecting investment-related sectors, and the long-term outlook.

Given these results, we continue to expect moderate growth for the remainder of the year as global supply chains disruptions are alleviated and consumption preferences shift to services. By 2023, the expected US slowdown and tighter monetary policy could impinge domestic economic activity, leading to lower growth, though our outlook remains positive for 2022 and 2023. In addition, domestic uncertainty, a complicated relationship between public and private sector, which has led recently to the implementation of consultations by its trading partners under the **USMCA** agreements, and stagnant investment remain the main risks to long-term growth.

II. Banxico survey reveals higher expected inflation with lower expected 2023 GDP

According to the Banxico Survey of Private Sector Analysts for July, inflation expectations for 2022 have been raised higher. The average inflation forecast for end-2022 soared from 7.45% to 7.83%, while projections for 2023 rose to 4.58%, up from 4.50% (table 1). Expected core inflation at year-end increased to 7.07% from 6.93%, and from 4.24% to 4.35% for 2023.

Table 1: Mexico—Banxico Survey, Main Results

Variable	Year	Jun.	Jul.	Change
GDP	2022	1.77	1.78	0.01
(Real annual % change)	2023	1.74	1.51	-0.23
Headline inflation	2022	7.45	7.83	0.38
(Annual % rate, Dec.-Dec.)	2023	4.50	4.58	0.08
Core inflation	2022	6.93	7.07	0.14
(Annual % rate, Dec.-Dec.)	2023	4.24	4.35	0.11
Formal job creation	2022	542	564	22
(000s of IMSS insured workers)	2023	443	434	-9
Public deficit	2022	3.38	3.37	-0.01
(% of GDP)	2023	3.33	3.36	0.03
Trade balance	2022	-14.34	-15.28	-0.94
(USD bn)	2023	-15.73	-15.84	-0.10
Foreign direct investment	2022	31.22	31.09	-0.13
(USD bn)	2023	30.89	30.71	-0.18
Exchange rate	2022	20.73	20.80	0.07
(USDMXN, Dec.)	2023	21.30	21.27	-0.03
Policy rate	2022	9.47	9.61	0.14
(%, end of period)	2023	9.02	9.13	0.11

Sources: Scotiabank Economics, Banxico.

In contrast, growth forecasts remained largely unchanged for this year, although they underwent a significant downward revision for 2023; analysts now foresee 2022 growth of 1.78% (compared to 1.77% previously), and 1.51% for 2023 (1.74% previously). These expectations likely reflect the risks of a slower pace of activity owing to lower US growth and the increase in interest rates. The main factors that could hinder further growth considered by analysts were those related to governance issues (39%) and inflation (21%). In terms of perception, the percentage of participants who believe that the business climate will worsen in the next six months rose to 49% (24% previously), while 41% consider it will remain the same (62% previously), and a minority considers it will improve (11% compared to 14% previously). At Scotiabank, we expect GDP growth of 1.7% and 1.5% for 202 and 2023, respectively, reflecting stagnant investment and a complicated relationship between the public and private sectors as the main downside risks in the long-term outlook.

Regarding monetary policy, the median responses with respect to year-end interest rates remained unchanged at 9.50% for 2022, and 9.00% for 2023. In this regard, in the Citibanamex Expectations Survey, all participants anticipate a 75 basis points hike at the next monetary policy meeting that will take place on August 11, taking the policy rate to 8.50%. We maintain our outlook of 50 basis point increases in the subsequent meetings of the year (September 29, November 10 and December 15), to end the year at 10.00%.

—Miguel Saldaña

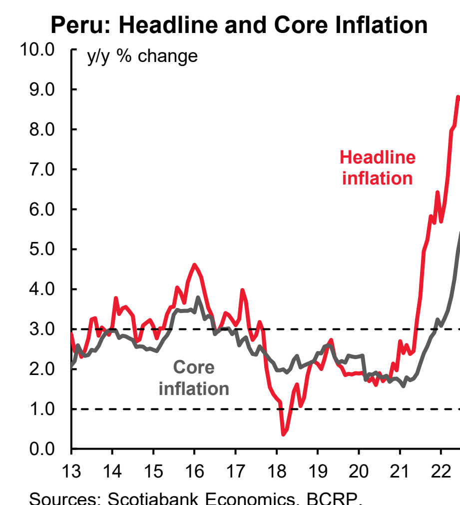
PERU: MONTH-ON-MONTH INFLATION RISES IN JULY, BUT YEAR-ON-YEAR INFLATION MAY HAVE PEAKED IN JUNE; PRESIDENT CASTILLO'S SPEECH

I. Inflation higher than expected in July but appears to have peaked in June

Inflation was 0.94% m/m in July, above our forecast and the Bloomberg market consensus (0.7%). This is the second-highest m/m inflation for the month of July in the last 25 years, though still less than that in July 2021 (1.01%).

Despite the high m/m rate, year-on-year inflation slowed for the first time in seven months, dropping marginally from 8.8% y/y to 8.7% y/y (chart 5), following 14 consecutive months in which inflation exceeded the upper limit of 3% of the inflation target and approaching the previous prolonged period in which it remained outside the range (16 months, between March 2015 and June 2016). From 2000 to now, the longest period with inflation above 3% was 21 months (between October 2007 and June 2009).

Chart 5



Sources: Scotiabank Economics, BCRP.

July's inflation mainly reflected increases in prices for transportation services and food prices. Of the 586 products that make up the consumer basket (base 2021), 428 (73%) rose, 77 (13%) fell, and 81 (14%) remained unchanged (table 2). Core inflation continued to rise, up from 4.9% y/y in June to 5.4% y/y in July, well above the upper limit of the target range (3%) for the eighth consecutive month, without yet showing signs of a change in trend.

Going forward, we expect the slowdown in inflation to continue, albeit at a slow pace. The downtrend in inflation is supported by the effect of a greater statistical base since inflation began to rise in July 2021 (around 1%) and remained high thereafter. The second reason we anticipate lower inflation is the already visible reversal in the prices of the soft commodities (grains), port costs and fertilizers. However, the pace of decline is likely to be slow. Pressures on costs intensified again in July, with a rise of 1.96% m/m in wholesale inflation, according to the INEI, explained in part by the average depreciation of 4.1% of the USDPEN FX, after two months of appreciation.

Table 2: Peru—Lima CPI Basket—July 2022

Groups of consumption	Base 2021	% m/m	% y/y
1. Food and non-alcoholic beverages	22.97	1.56	13.5
2. Alcoholic beverages, tobacco, drugs	1.61	0.21	2.0
3. Apparel and footwear	4.20	0.18	1.4
4. Housing, water, electricity, gas and others	10.55	0.45	9.1
5. Furniture and home maintenance	5.11	0.26	4.2
6. Health	3.48	0.59	3.3
7. Transport	12.40	2.49	14.9
8. Communications	4.77	0.09	1.5
9. Recreation and culture	3.96	0.12	7.6
10. Education	8.61	0.01	3.1
11. Restaurants & hotels	15.89	0.79	9.4
12. Other goods and services	6.47	0.48	5.3
Total CPI	**100.00**	**0.94**	**8.7**

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

In our *Latam Weekly* of July 15, 2022, we revised our inflation forecast for 2022 upwards from 6.4% to 7.4% and kept it for 2023 at 4.0%. Our view is that while we have seen the peak of inflation the pace of slowdown is likely to be slow. For August, we expect lower m/m inflation than in July, due to the visible correction in local fuel prices and seasonal factors.

In the last twelve months, the central bank raised its benchmark rate by 575 basis points to 6.00% and raised reserve requirements three times. However, inflation expectations remain high (5.4% in 12 months according to the June BCRP survey, the highest level since this variable has been measured). Consequently, we believe that the BCRP will make an additional adjustment of 50 bps at its next meeting on Thursday, August 11, to bring the policy rate to 6.50%, a level at which we believe it will stop as long as it is confirmed that inflation peaked in June.

—Mario Guerrero

II. President Castillo July 28 address avoids contentious issues, and novelty

President Castillo began his second year in office on July 28 with a mandatory address to Congress. The address had generated expectations on two counts: first, how he would deal with the plethora of corruption allegations that have multiplied lately; second, what policies he would propose, or change, in his second year. He was significantly underwhelming on both counts.

President Castillo began his presentation putting the blame for political instability on the powers that be ("los grandes poderes") that "think they own the country". His answer to corruption charges was to deny any wrongdoing, stating that it was all a fabrication of a press that is intent on destabilizing the government. Survival by denial and deflection continues to appear to be the preferred course of action by the Castillo Regime.

Most of the remainder of his nearly two-hour (86 page) address was dedicated to recounting seemingly every single decision, act or measure taken by each Cabinet member. Very little was said regarding future policies, measures or direction. Rather, there was a tedious recounting of the normal activities at each ministry, which were presented as accomplishments.

All in all, however, this was not a leftist speech. Apart from blaming the right for 200 years of misrule, there was very little ideological content. For instance, the amount of time dedicated to the government's plans for Peru to be accepted into the OECD was much greater than the brief mention made on the Constitutional Assembly (President Castillo basically said that his government had tried to introduce the Constitutional Assembly, but that Congress had blocked it, and left things at that).

In terms of policy, then, there were no strong announcements, no changes in directions, but, rather, the feeling that the government will stay on the individual courses drawn up at each ministry.

President Castillo did focus on how well the economy was doing in an attempt to suggest that his government's performance was better than public opinion has given them credit for. What was lacking, in particular, was any mention of measures, or intentions even, to stimulate private investment, which is today the greatest drag on growth. Much of the address versed on increasing public spending, but, once again, more along the lines of business as usual, than anything novel or expansionary.

The general sentiment one gets from the address is that President Castillo is leaving governance to his Cabinet, without providing unifying criteria for Cabinet members to rally around. This would explain why the direction and quality of policy is not uniform within the government, but varies form one ministry to another, in accordance with the leadership at each individual ministry. A few ministries, notably the Ministry of Finance, have serious leadership and continuity, but others lack this.

Furthermore, the high rate of turnover in the Cabinet has contributed to uncertainty and instability in policy vision and execution. Although talk of imminent Cabinet changes have not been borne out, the precedent of over 50 Cabinet changes (out of eighteen members) in the first year of the Castillo Regime does not bode well for future stability. Unless, as may be the case, Castillo has finally found an adequate mix of Cabinet members that are more acceptable to Congress, and that either do their jobs without requiring President Castillo's input, or are somehow central in helping President Castillo in what he seems mostly dedicated to doing, which is to avoid impeachment and survive.

Although there were no major new announcements, President Castillo did seem to stress in his recount of accomplishments those measures that have a more populist ring to them. At least in the vein of soft populism. This lack of new announcements doesn't mean that new questionable measures will not emerge in the future. Rather, government decisions appear to be taken piecemeal, emerging spontaneously or circumstantially, rather than emanating from a clear and structured vision. This spontaneity is likely to continue.

But the economy is not the main liability, or even issue, that President Castillo faces as he begins his second year. It is corruption. President Castillo is now being investigated for five allegations of misconduct, including corruption. And the allegations just keep getting more detailed with each passing day. Thus, with an approval rating that has dropped to 19%–20%, depending on the polling firm, the real focus of President Castillo as he begins his second year is likely to continue to be survival. This is a weak government, that is basically being propped up by a Congress that is not interested in his removal.

—Guillermo Arbe

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