Scotiabank™

GLOBAL ECONOMICS

LATAM DAILY

December 6, 2022

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Latam Daily: Chile's BCCh to Hold, Focus on Guidance

- **Chile: BCCh to hold, guidance is key**
- **Colombia: Inflation beats, at 23-yr high; exports weaken**
- **Peru: Higher inflation forecast; Castillo-Congress clash continues**

The Asian and European sessions were quiet amid thin developments aside from a well-expected 25bps hike from the RBA and Beijing following other Chinese cities in relaxing testing requirements. The USD has swung from solid gains prior to London trading to sitting broadly weaker ahead of the North American open as Treasury yields falter and lift cash equities and futures; oil is ~1% weaker while copper is ~0.5% stronger and iron ore is practically unchanged.

The Latam highlight today will the BCCh's decision this afternoon where an unchanged policy rate is a given and the focus will be on guidance. Our Santiago team projects that the bank will reduce rates by a full percentage point (or more) in January, see ***Latam Weekly*** for a preview of today's decision. Nominal wages growth for October (10.9% y/y NSA and 0.5% m/m SA in data released this morning) as well as still high inflation (that we expect will considerably slow in coming months) continue to be a headache for the bank in its goal to reach the 3% inflation target. Chile's INE will also publish CPI data for November tomorrow.

In Brazil, a Senate committee will begin debate today on the incoming government's to-be-diluted transition bill that seeks to exclude social spending funds from the country's fiscal cap. The BCB's Copom two-day meeting begins today ahead of an announcement tomorrow where the bank will more than likely leave its levers unchanged while perhaps warning that additional fiscal spending or looser state-lending could guide a higher-for-longer Selic rate (or even additional rate increases).

—Juan Manuel Herrera

COLOMBIA: INFLATION BEATS, AT 23-YR HIGH; EXPORTS WEAKEN

Inflation surprises to the upside, rising above expectations to a fresh 23-year high

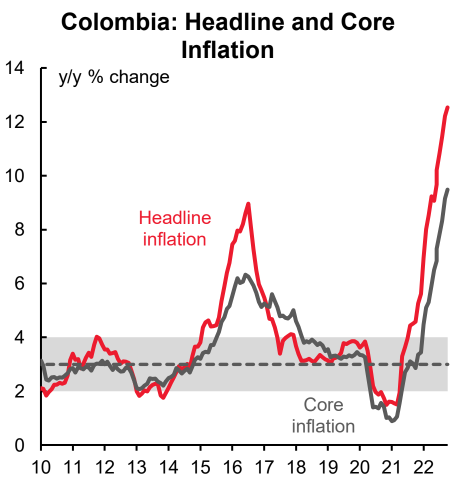
Colombia's pace of monthly CPI inflation was 0.77% m/m in November, according to DANE data released on Monday, December 5. The result was well above the BanRep survey (0.54% m/m) and one tenth of a ppt above Scotiabank Economics' projection (0.67% m/m).

Year-on-year inflation stood at 12.53%, up from 12.22% in October, and reaching its highest figure since March 1999 (chart 1). **Colombia is the only PAC country that hasn't yet seen a peak in inflation during the current cycle.**

Core inflation rose again, to 9.48% y/y from 9.16%, and ex-food and regulated goods inflation accelerated to 8.82% y/y from 8.48%. Core price gains are accelerating at a faster pace than food inflation, reflecting in our opinion the **impact of FX depreciation** as tradable inflation increased from 11.82% to 12.26%. Additionally, it also reflects a robust **performance of the domestic economy**.

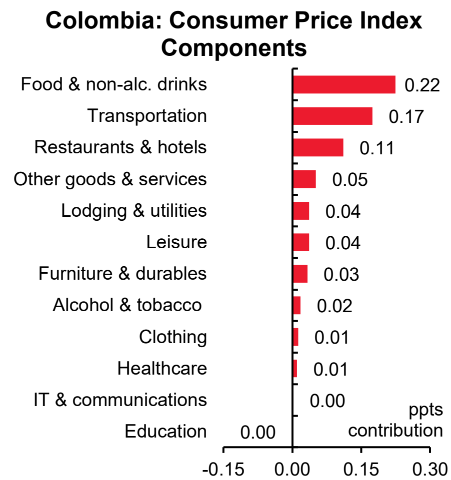
November's CPI results continue to dash BanRep's hope of an earlier peak in inflation. Upside risks to inflation in 2023 are increasing as the minimum wage negotiations (which started about a week ago) will call for a higher adjustment. Inflation expectations deviating further from target in the medium term would again place inflation worries among BanRep's top concerns.

Chart 1



Sources: Scotiabank Economics, DANE.

Chart 2



Sources: Scotiabank Economics, DANE.

Chart 3

Sources: Scotiabank Economics, DANE.

With this in mind, our forecast for the December meeting is now tilted towards a 100bps hike, and a potential pause will likely be delayed until an inflation peak is confirmed which may not happen until Q1-2023.

Looking at November's numbers in detail, eleven of the twelve components of the CPI basket contributed to higher inflation (charts 2 and 3), and the food group was again the main contributor.

The highlights are:

- **Food inflation was again elevated with prices growth at 1.50% m/m**, resulting in a contribution of 0.22ppts to overall inflation. In November, potatoes led the gains (+19.52% m/m); the end of the harvesting season and a harsher rain season are leading to higher prices. The other main contributors in the category were rice (+3.55% m/m), tomatoes (+5.12% m/m), and eggs (+2.05% m/m). All reflecting higher input prices, but also the effect of a weaker COP.
- **The second biggest contributor to headline inflation** (+0.14ppts) **was the transport group** (+2.66% m/m). Within this group, the main contribution came from vehicles (+2.37% m/m), with its strongest monthly expansion this year that not only reflects higher international costs but also the depreciation of the COP. Airfares also increased significantly (8.82% m/m) showing still strong domestic demand (and the anticipation of December season gasoline prices) and contributing 0.04ppts to inflation.
- **Restaurant and hotels was the third main contributor** to November's inflation (rising 1.18% m/m and contributing 0.12ppts). This sub item is highly correlated with food prices, regulated items, such as gas that increased by 1.99% m/m, and labour costs.
- **Goods inflation increased from 13% to 13.93% y/y** reflecting the effect of higher international prices and the weaker currency. Services prices increased but at a slower pace of 6.87% y/y from 6.62% y/y. The asymmetric response of goods and services prices could reflect the difference between supply and demand sources of inflation. It is notable that regulated prices decelerated to 11.95% y/y from 12.04% y/y last month, due to a decline in electricity prices after tough negotiations between government and energy distributors.

To conclude, November CPI data show that inflation should still be the main concern for BanRep. Ahead of 2023 not only indexation effects but also significant FX depreciation will keep inflation expectations away from the target range. Ahead of the December 16 monetary policy meeting our new base case scenario is a 100bps hike to 12%. Calls for a rate hike pause will have to wait for a peak in inflation which according to our projection will not come until Q1-2023. It is also relevant to highlight that **continued large hikes are needed to restore confidence in financial markets to prevent recent risk premium shocks reflected in Colombian assets to become embedded**.

Exports expanded by 10.9%, showing weaker contribution from mining-sector products

DANE released exports data on Monday December 5, showing that **monthly exports stood at USD4.21bn in October** (+10.9% y/y, chart 4), **down from September's USD4.78bn**. In y/y terms, traditional exports (related to mining and coffee) showed a lower contribution to the overall expansion, as **oil export volumes fell in October**. **Non-traditional exports** decelerated, growing by 5.3% y/y (USD1.67bn), **down from the highest levels observed in May 2022**.

- **Traditional exports increased by 14.9% y/y in October** (chart 5), showing a deceleration compared to the previous month. Coffee exports fell 2% y/y, explained by a decrease in the volume exported (-24.1%). **Oil contracted 7% y/y, the weakest behaviour since February 2021**, amid an 11% y/y contraction in volumes, while ferronickel sales showed a 12.4% y/y expansion, along with higher volumes. Coal export volumes also contracted versus the previous month (-21.1%).

- **Non-traditional exports increased by 5.3% y/y to USD1.67bn, an expansion well below that of recent months**. Manufacturing exports were the largest contributor to non-traditional exports, increasing by 7.3% y/y. In the case of agricultural products (+0.7% y/y), the main contribution came from livestock exports (+66.5% y/y), while palm oil contraction of -50.7% y/y was the biggest.

Exports in October showed a strong deceleration. Traditional exports contracted specifically due to the lower volume of coffee, oil and coal exports, while ferronickel shows a positive evolution. **October exports results bode poorly for the Q4-2022 current account deficit that may remain above 6%.**

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

PERU: HIGHER INFLATION FORECAST; CASTILLO-CONGRESS CLASH CONTINUES

We have updated our inflation forecast

It is an opportune time to formalize the upward bias to **our inflation forecast, from 7.7% to 8.2% for this year, and from 4.0% to 4.5% for 2023** (chart 6). This reflects that we see inflation decelerating, although at a slower pace than initially projected since the slowdown that we had expected in H2-2022 was not as pronounced as foreseen. **We expect inflation to remain above the ceiling of the target range (1-3%) of the central bank throughout 2023**.

Like us, the central bank projects a downward trend in year-on-year inflation. Recently, the central bank said that for inflation to return to the target range (between 1% and 3%) during the second half of 2023—as they had expected—it was necessary that food prices do not increase or that they decrease slightly and that energy prices also fail to increase, given the risk that this does not occur. This reflects the concern of the central bank for the future trajectory of inflation. Inflation picked up temporarily rising from 8.3% y/y in October to 8.4% y/y in November. **The BCRP hopes that the decline in inflation will be more visible between March and July 2023.**

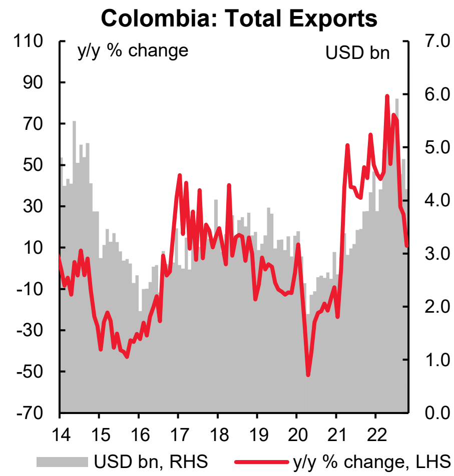
—Mario Guerrero

The Castillo-Congress conflict escalates

Congress will hold hearing on December 7 on the impeachment of President Castillo, in what will be the third attempt by lawmakers to remove the President. The hearing will be followed by a debate and a vote. **A successful motion requires 87 votes, but only 73 members of Congress backed the request to introduce the impeachment proposal**, so it's **unlikely that Castillo's detractors will come out on top**.

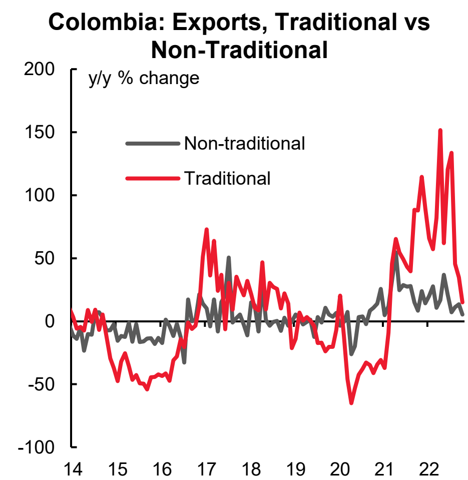
Having said that, given the government's threat of shutting down Congress, the likelihood of reaching the required votes is a bit higher than in the past.

Chart 4



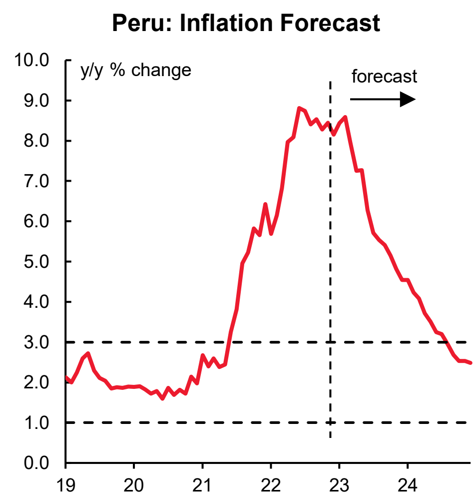
Sources: Scotiabank Economics, DANE.

Chart 5



Sources: Scotiabank Economics, DANE.

Chart 6



Sources: Scotiabank Economics, BCRP.

On Monday, December 5, the Congressional subcommittee of Constitutional Accusations exonerated Vice-President Dina Boluarte from charges of having acted anti-constitutionally when she remained as the president of a private club after having been sworn in as VP. The decision enables Dina Boluarte to become president, should President Castillo be impeached.

At the same time, **President Castillo appointed Wilson Barrantes as the new head of national intelligence. According to news reports, Barrantes would have links to the radical left**, including the leader of Peru Libre, Vladimir Cerrón. Another person close to Cerrón, Raúl Noblecilla, was appointed to a Vice-Minister position reporting to Cabinet Head Betssy Chávez. **These appointments may have been a concession to lock in Perú Libre's votes when the impeachment issue comes up**. Thus, President Castillo seemingly continues to appoint people of questionable background who may nevertheless be helpful in the survival of his government.

Meanwhile, the **Minister of Justice Félix Chero suggested in an interview that the Castillo Government would not step down automatically if Congress impeaches President Castillo**. They would first seek to block the decision legally, though it is unclear if there is a legal basis for such a delay. The Minister of Defense, Daniel Barragán, resigned on December 3. This was a surprising event and one wonders, given the timing, whether it has anything to do with the way the government is choosing to confront Congress. The name of his replacement will be crucial in determining whether or not President Castillo has designs on tampering institutionally with the army.

—Guillermo Arbe

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