Scotiabank

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Latam Daily: Colombia's BanRep *MPR*; Peru's Fiscal Outlook Brightens as Growth Weakens

- **Colombia: Uncertainty regarding economic activity is key to hiking cycle**
- **Peru: Improving fiscal outlook with weaker growth; new political tensions**

COLOMBIA: UNCERTAINTY REGARDING ECONOMIC ACTIVITY IS KEY TO HIKING CYCLE

On Monday, May 2, the central bank staff released the *Monetary Policy Report* (*MPR*) updating their assessment of the current macroeconomic scenario and the near-term balance of risks. BanRep staff note that international price pressures have been more persistent than expected, especially input prices, which will push inflation above the central bank's inflation target range in 2022 and 2023. Despite these pressures, and better-than-expected economic activity, the staff project a policy rate below the market's consensus for end-2022 (currently 7.5%) and a rate that is slightly higher than the market's consensus for 2023 (5.9%).

Main highlights include:

- **Inflation is expected to close at 7.1% in 2022 and 4.8% in 2023.** International pressures on input prices and a low agricultural supply will keep inflation high in 2022, again triggering indexation effects ahead of 2023. Moreover, inflation risks are tilted to the upside as projections do not account for further international shocks and the expiration of some tax aids related to the health emergency.
- **BanRep staff anticipate GDP growth of 5% for 2022 (above the previous forecast of 4.7%) and a slower expansion in 2023 of 2.9%.** The central bank is anticipating strong growth in Q1-2022, followed by a deceleration over the rest of the year, especially in private consumption. Investment is expected to improve, however, though below pre-pandemic levels.
- **A scenario of stronger growth is compatible with a robust recovery in employment.** The unemployment rate is expected to average between 10% and 11.9% this year.
- **The 2022 current account deficit is estimated at 4.7% of GDP, falling from 5.7% in 2021, with the effects of higher commodity prices on exports and stronger economic activity the main contributors to this projection.** Nevertheless, the deficit would remain around USD 16.5 bn in nominal terms, which represents a drag on the currency.
- **Despite having a higher inflation projection than the market consensus, the staff expect a more moderate interest rate path in 2022 compared with the market expectation, signaling that the staff is calling for a lower terminal rate that prevails for a longer time.** In contrast, surveys of market expectations feature more volatility, with the policy rate reaching a higher rate level but with an earlier reversal. The staff's policy rate path is also consistent with a view that higher inflation is coming from supply and external factors that are difficult to tackle with the policy rate. In this respect, the staff may be trying to normalize the policy rate, control long-run inflation expectations, but also minimize the potential harm to the economic recovery.
- ***Monetary Policy Report* (press conference):** During the press conference on Wednesday, May 4, BanRep's Chief Economist, Hernando Vargas, said that supply shocks remain strong upside inflation risks that would weigh against economic growth in the future. He said that such shocks resulting in lower potential GDP would elicit higher monetary policy rates, though he didn't provide details of what kind of indicators would point to a lower potential GDP.

  Vargas also noted that international financial conditions are another source of uncertainty as they could motivate higher neutral rates given the current high fiscal and external deficits, and the persistent high fiscal and political uncertainty.

All in all the press conference revealed a high level of uncertainty, which points to a data-dependent approach to assessing the terminal rate of the current hiking cycle.

Additionally, on Tuesday, May 3, the central bank released the Minutes of its most recent monetary policy meeting held on Friday, April 29. The Board of Director's decision to increase the benchmark rate by 100 bps to 6.0% was taken in a split vote (four members voting for a 100 bps hike, with three members voting for 150 bps), with the Minutes revealing that concerns about the economic activity the main source of division among the Board. The hawks who voted for a 150 bps hike highlighted that inflation expectations keep increasing, making convergence to the target range more elusive. They also pointed out that consumption and credit growth are high, pointing to persistent demand pressures. On the other side, the doves who voted for a 100 bps hike said that the current pace is appropriate to achieve a gradual convergence of the inflation, while also helping to sustain economic activity.

All in all, recent releases from the central bank point that uncertainty remains high. There is a consensus among the Board to continue increasing the Monetary Policy Rate, while the staff would start to call for a pause sooner than market expectations. We think that the hiking cycle will continue until inflation shows tangible signals of moderation. That said, we keep our projection of 100 bps hikes in the next couple of meetings to reach a terminal rate at 8%. For 2023, we expect rate cuts in the first quarter to close the year at 5.50%.

—Sergio Olarte, Maria Mejía, & Jackeline Piraján

PERU: IMPROVING FISCAL OUTLOOK WITH WEAKER GROWTH; NEW POLITICAL TENSIONS

I. The Ministry of Finance lowers growth forecast, but fiscal outlook improves

On May 3, the Ministry of Finance (MEF) published its annual forecast and policy guidance document, Marco Macroeconómico Multianual (MMM). According to the MMM, the MEF has reduced its growth forecast for 2022 from 4.8% to 3.6%, and for 2023 from 4.5% to 3.5% (table 1). While the previous MEF forecasts were unrealistic, the current forecasts are optimistic, but more attainable. They contrast with our own forecasts of 2.6% for 2022 and 2.8% for 2023.

Table 1: Peru—Ministry of Finance Forecast Changes 2022

	New	Previous
GDP Growth	**3.6%**	4.8%
Private Investment	**0.0%**	5.5%
Public Investment	**11.0%**	6.7%
Private Consumption	**3.3%**	4.4%
Fiscal Deficit (% of GDP)	**2.5%**	3.7%
Government Debt (% of GDP)	**34.7%**	36.6%
Trade Balance (USD bn)	**14.9**	16.7

Sources: Scotiabank Economics, MEF MMM.

In line with this more realistic view, the MEF also lowered its forecast for private investment to nil, from 5.5% (Scotiabank -2%). Interestingly, the MEF raised its forecast for public investment growth from 6.7% to 11%, underlying an intention to be more aggressive in providing fiscal stimulus to support GDP growth. We do hope they are successful, although this would require a sharp turnaround in the current trend. Based on monthly figures, we estimate that public investment fell approximately 13% y/y, in the first quarter. This performance puts even our modest forecast of 4.4% growth for the year at risk.

The MEF also cautiously improved its fiscal outlook, lowering its fiscal deficit forecast for 2022 to 2.5% of GDP, from 3.7% previously. This is reasonable and in line with the fiscal deficit (12-month rolling) of 1.7% of GDP to February. It also leaves room for the government to increase spending, as would appear to be its intention.

II. Congress to grill Cabinet members

Anibal Torres, the Head of the Cabinet, has been summoned, following a 73 to 41 congressional vote on May 3, to appear before Congress on May 12 to explain the reasons why the government ordered a lockdown and curfew in Lima on April 5. The procedure (interpelación) could lead to his removal. On April 5, opposition groups had organized protests against the government, leading to the lockdown decision by the government, which it justified based on alleged intelligence information indicating the intention of unknown groups to loot and destroy in the city.

The general feeling among opposition parties in Congress is that the government decision was uncalled for under the circumstances. The interpelación procedure also reflects a more general sense of distrust in Congress regarding the government and the Torres Cabinet. In fact, Minister Torres was not the only Cabinet member to be summoned by Congress. The Minister of the Interior, Alfonso Chávarry, of Labour, Betssy Chávez, and of Energy and Mining, Carlos Palacios, have also been summoned. Chávarry (Interior) will need to answer for a number of deaths that occurred in recent protests; Chávez (Labour) will be questioned on her role in allowing for an air traffic controllers strike during the crucial Easter holiday. Palacios (Energy & Mines) will need to respond to accusations of party cronyism at the Ministry under his control. Each Minister has been summoned at separate times in sessions to take place between May 11 and May 12.

—Guillermo Arbe