Latam Daily: Mexican Econ Activity and Brazil CPI Beat

Scotiabank

GLOBAL ECONOMICS

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- **Mexico: Headline inflation misses, core exceeds forecasts**

The relatively quiet Asian and European backdrop is giving markets in the Americas little to go on to start the day. As equity futures, commodities are broadly weaker, both in the energy and metals space, with continued pessimism over Chinese growth remaining a clear weight on the demand outlook for raw materials—more so as misplaced optimism on a possible relaxation of COVID-19 policies fades. In the FX space, amid a mixed USD mood, the MXN is marginally stronger, the BRL is weaker in choppy early trading while the CLP drifts slightly away from the 1,000 level thanks to a 0.5% gain on the day; today we will watch whether USDCOP breaches the 5,000 pesos point. **The Latam day ahead is quiet with little of note on tap.**

Economic activity grew 5.7% y/y and 1.0% m/m in Mexico in August, solidly exceeding the median forecasts submitted to Bloomberg in data published this morning. Mexico's economic acceleration in August followed a 0.42% expansion in July when aside from decent growth in manufacturing and services, (volatile) primary sector activity (agriculture) recovered slightly from a sharp contraction in June. This time around, primary output also jumped 3.6% m/m compared to flat industrial activity and a 1.2% m/m gain in services—where activity is just shy of the pre-COVID-19 peak.

Yesterday, Banxico's Deputy Governor Heath highlighted core inflation risks following the Monday morning data beat (see Mexico write-up below). Via Twitter, he noted that one-off declines in single items "does not begin to resolve the main inflation problem, which is broad-based and sustained increases in prices". His comments (hawkish, as usual) stand in contrast to those of dove Esquivel last week who suggested discussions should begin soon on decoupling from the Fed or ending the hiking cycle. Heath's comments as well as the core inflation beat helped the MXN hold its ground in the region on Monday, as its Latam peers lost significant ground to start the week—ranging from 0.35% in the PEN (weakening through 4.00) to 2.6% in the BRL (amid unease ahead of Sunday's runoff vote).

Brazilian inflation for the first half of October beat economists' expectations. Prices growth in Brazil slowed less than expected to 6.8% y/y from 7.96% in H1-Sep, placing marginal pressure on the BCB, though not sufficiently to see the bank sound anything other than neutral at tomorrow's decision. On the election front, while recent polls from other firms had shown a clearer narrowing of Lula's lead, Ipec poll results published yesterday showed an unchanged share of the vote for Lula and Bolsonaro (at 54% vs 46%). Brazilian markets were on edge on Monday after a former Bolsonaro ally was arrested on Sunday—not before a standoff with police—and an uptick in unrest is prompting caution ahead of the close-to-call runoff vote.

The BCRP's Chief Economist Armas said yesterday that they "have not identified that there is inflationary pressure due to demand" while noting that the real interest rate of 2.1% is in line with a slightly restrictive position, with the economy close to its potential. His comments confirm our view that the central bank is nearing the end of its hiking cycle with a final 25bps increase to 7.25% expected this quarter—and rate reductions not kicking in until late-2023. USDPEN closed above the 4.00 mark yesterday for the first time since the final trading day of 2021, and continued upwards pressure on the cross could see a firmer response from the central bank to rein in the exchange rate—all the while considering the PEN's relative performance in the region, however, with the COP and CLP recording steep losses so far this year.

—Juan Manuel Herrera

MEXICO: HEADLINE INFLATION MISSES, CORE EXCEEDS FORECASTS

In the first half of October, headline annual inflation decelerated more than expected (chart 1), from 8.64% to 8.53% y/y (8.62% Bloomberg consensus) owing to a moderation in non-core items. **However, core inflation edged up above consensus estimates**, from 8.29% to 8.39% (vs 8.32% expected), owing to an increase in merchandise inflation to 11.10%, and in services to 5.29% (chart 2). Non-core inflation decelerated from 9.70% to 8.95% (chart 3), as energy cooled from 5.68% to 3.70%, although agriculture and livestock rose from 14.87% to 15.09%. In its sequential bi-weekly comparison, headline inflation increased from 0.10% to 0.44% 2w/2w, below the 0.51% expected by analysts. **The core component also accelerated above consensus on a 2w/2w basis, from 0.15% to 0.42%** (vs. 0.35% expected), with merchandise inflation accelerating by 0.53%, and services by 0.30%. The non-core component rebounded to 0.48% from -0.04%, owing to an increase in energy from -0.11% to 1.30%, despite food contributing to the lower-than-expected print, as it dropped from 0.05% to -0.46%. Year-end forecasts continue on the rise, with analysts in the Citibanamex survey now forecasting inflation at 8.56% by year-end, and 5.11% by the end of 2023. **As for monetary policy, core prices trends increase the risk of further hikes, despite signs of cooling in non-core prices. We maintain our stance of a 10.50% rate by year-end, but with upside risks of a higher terminal rate in early-2023**. For 2023, we expect the policy rate to start declining only in the final quarter of the year, in line with consensus.

Chart 1

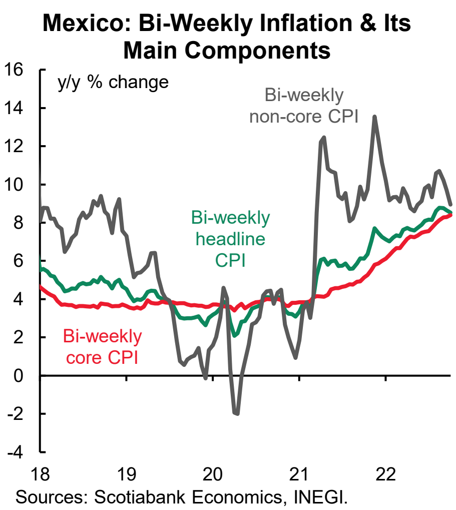


Chart 2

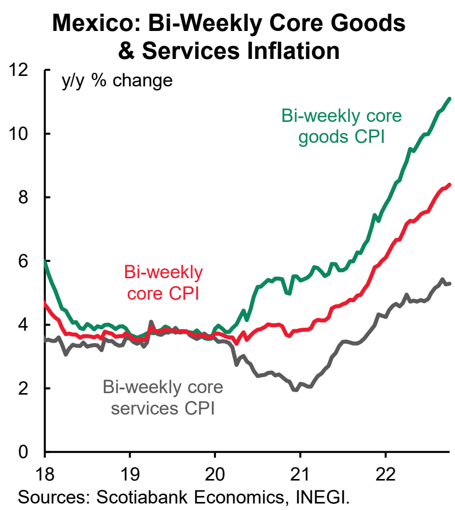
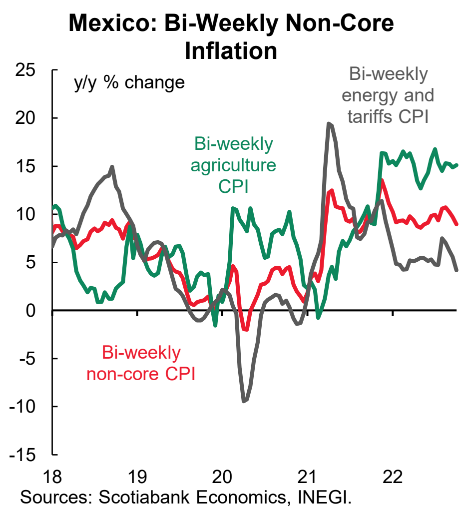


Chart 3



—Miguel Saldaña