Scotiabank.

GLOBAL ECONOMICS

LATAM DAILY

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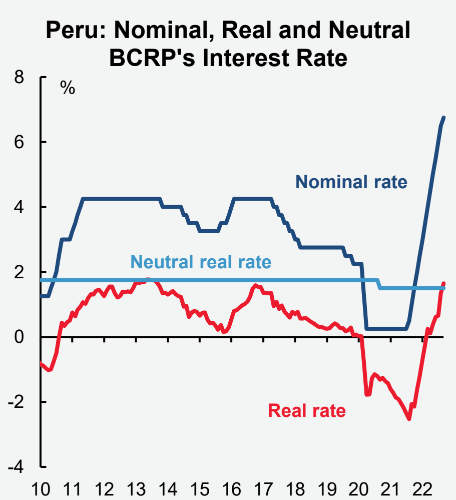
Chart 1



Sources: Scotiabank Economics, BCRP.

Latam Daily: Peru's Rate Hike; Inflation in Chile and Mexico; Colombia's Confidence

- **Peru: BCRP reduces pace of rate hike, rises 25 bps**
- **Chile: Inflation of 14.1% y/y likely marks peak of this inflation cycle**
- **Colombia: Consumer confidence improved in August**
- **Mexico: Core inflation jumps above 8% in August**

PERU: BCRP REDUCES PACE OF RATE HIKE, RISES 25 BPS

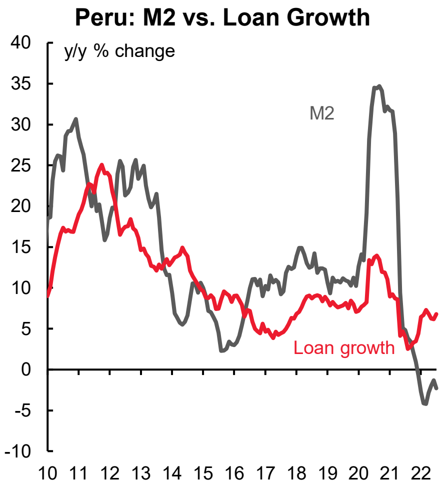
The Board of Peru's central bank (BCRP) raised its key interest rate by 25 bps to 6.75% on Thursday, September 8, in line with the three-month interest rate swap market (6.75%), but below the market consensus, which printed to 7.00% (Bloomberg). The decision to raise its rate by 25 bps and not by 50 bps, as on the previous 12 occasions, signals that we are nearing the end of the interest rate hike cycle, though not as soon as we expected (see ***Latam Flash***, August 12, 2022). The key will continue to be the speed at which inflation expectations moderate. The wording of the statement is similar to previous statements, which suggests that although the data is in the expected direction, it is not yet convincing. We assume that the central bank will wait for clear evidence of easing of price pressures, so it is pre-emptively opting for additional interest rate hikes. This is deduced from wording that indicates "the Board reaffirms its commitment to adopt the necessary actions to ensure the return of inflation to the target range in the forecast horizon". This leads us to assess our key reference rate forecast.

The data reflects that inflation peaked in June (8.8% y/y) and is decelerating. Headline inflation continued to slow down, as it fell from 8.7% y/y in July to 8.4% y/y in August, while core inflation fell from 5.44% y/y in July to 5.39% y/y in August. Increases in other price indices also slowed, showing a more generalized process of disinflation. Something similar was observed in 25 of the 26 largest cities in the country. The 12-month inflation expectations also fell, going from 5.16% in July to 5.10% in August. These data would explain the change in the pace of interest rate increases; however, we believe that more convincing evidence of the slowdown in inflation is needed for the central bank to hit pause in the current tightening cycle. With this result, the real interest rate rises from 1.34% to 1.65%, standing above 1.50% for the first time since December 2016, a level considered neutral (chart 1).

The BCRP kept the forward guidance used in previous statements, which leaves open the possibility of new hikes, depending on how the determinants of inflation evolve. We consider it likely that further precautionary interest rate hikes will be closer to 25 bps, and we see a return to 50 bps hikes as less likely. Like us, the central bank projects a downward trend in year-on-year inflation, maintaining its expectation of a return to the target range during the second half of 2023, reflecting the moderation of international food and energy price effects, as well as the lowering inflation expectations. However, the global price environment remains uncertain, so the central bank may continue to make further adjustments. To reflect this precautionary stance of the BCRP, we are evaluating a forecast adjustment, raising our current key interest rate forecast of 6.50%, possibly to a level close to 7.00% at the year-end.

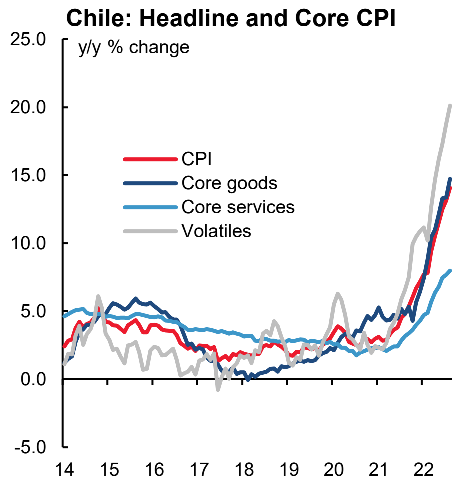
The BCRP statement maintains its pessimistic outlook for global and local economic activity, emphasizing the drop in global growth expectations for this year and next despite some improvements in recent months. It also notes that while several leading indicators and expectations for Peru's economy rebounded in August, most remain in pessimistic territory. On the quantitative side, the growth of the quantity of money (M2)

Chart 2



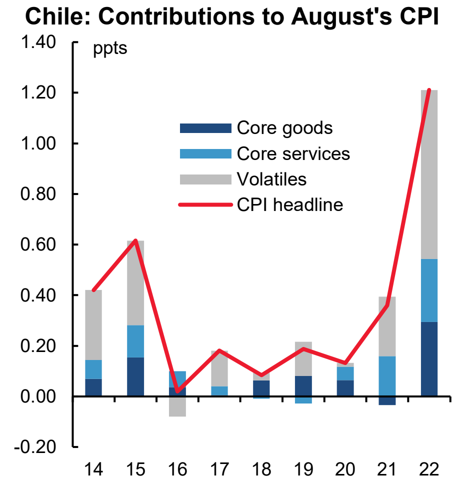
Sources: Scotiabank Economics, BCRP.

Chart 3



Sources: Scotiabank Economics, INE.

Chart 4



Sources: Scotiabank Economics, INE.

remained in negative territory (-2.3% y/y in July) for the eighth consecutive month, although maintaining a low intensity, which could reflect some comfort in the central bank with the current level of liquidity (chart 2). Loan growth accelerated in July, with a nominal rate above 6% y/y for the seventh consecutive month.

—Mario Guerrero

CHILE: INFLATION OF 14.1% Y/Y LIKELY MARKS THE PEAK IN THIS INFLATION CYCLE

CPI for August (1.2% m/m) above expectations and with broad diffusion. On Thursday, September 8, the statistical agency (INE) released CPI inflation for August, which rose 1.4% m/m (14.1% y/y) (charts 3 and 4), above market and our expectations. This inflationary surprise does not appear to be driven primarily by dynamic domestic demand. **In our view, August inflation largely reflects the recent depreciation of the Chilean peso (CLP), as well as the inertial effects of historically high inflation.**

Price increases across the basket of goods in the CPI, with nearly 70% of components recording higher prices in August, support this contention. The diffusion in volatile items rose to 76%, confirming that the surprise increase in headline inflation is explained by volatile goods and services.

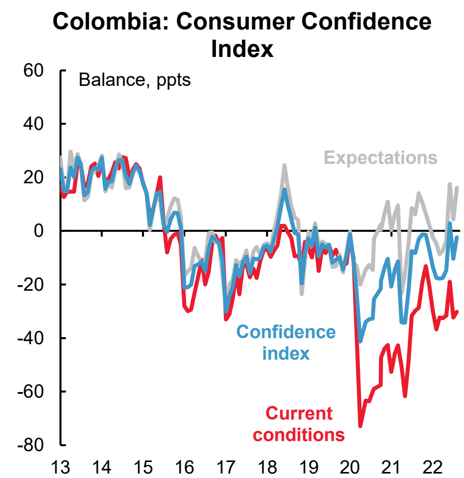
According to our projections, August's year-over-year inflation read out (14.1% y/y) is likely to mark the peak in this inflation cycle. For September, we anticipate a CPI inflation between 0.5 and 0.7% m/m, lower than expected by the market, which is explained by significant negative contributions of specific items tied to the CLP that will be affected by seasonal factors in September. **We project CPI inflation at 12.5% y/y for December 2022 and 3.7% y/y for December 2023.**

—Anibal Alarcón

COLOMBIA: CONSUMER CONFIDENCE IMPROVED IN AUGUST

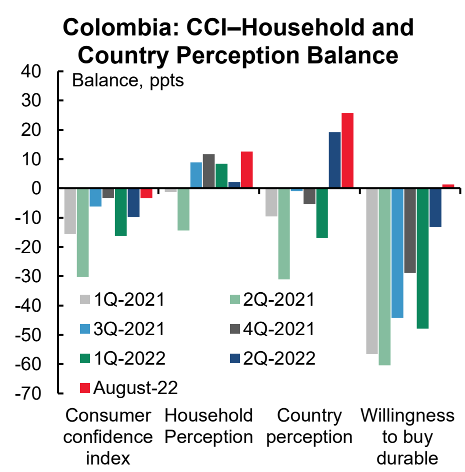
Colombia's Consumer Confidence Index (CCI) recorded in August stood at -2.4 ppts, showing a m/m increase of 8.0 ppts (chart 5). Improved consumer perceptions reflect a rise in the expectations component of future conditions, which increased from 4.3 ppts to 16.1 ppts. Current conditions slightly improved from -32.3 to -30.2 ppts.

Chart 5



Sources: Scotiabank Economics, Fedesarrollo.

Chart 6



Sources: Scotiabank Economics, Fedesarrollo.

The expectations index increased the most (chart 6). Consumers think that the conditions of their households will improve in the coming year along with the conditions of the country. The willingness to buy a house jumped 6.2 ppts compared to the previous month (rising from -35.3 ppts to -29.1) and the willingness to buy a vehicle registered a positive balance of 4.0 ppts compared to the previous month to -55.9 ppts. In contrast, the willingness to buy durable goods declined, possibly reflecting recent FX depreciation. While households' perception of the economic future registered a better balance compared to the previous month, recent government's announcements and the final draft of the tax reform could have important effects on private consumption in the coming months.

Looking at the details of the month of August:

- **The Current Conditions Index stood at -30.2 ppts, rising slightly from -32.3 ppts in July.** Households remain vigilant to still-high inflation and international volatility; while the deterioration of households' current situation has stabilized, it remains well below the historical average. The willingness to buy durable goods fell by 0.2 ppts compared to the previous month.
- **The Expectations Index improved to 16.1 ppts in August from 4.3 ppts in July (chart 5, again).** Household expectations about the future contributed the most to CCI improvement (from -10.7 ppts to 5.0 ppts). Similarly, the assessment of the country's economy also improved, at 13.4 ppts up from 4.9 ppts. Recent strong economic activity and a possible easing of political uncertainty are likely the main reasons for this improvement. Having said that, it will be important to continue monitoring the dynamics of consumption in the coming months, as inflation reached double digits and food prices continue to rise. In this context, the expectation that consumer credit growth will slow as interest rates continue increase make us to think that private consumption will decelerate in the coming months.
- **Consumer confidence increased in four of the five cities in the survey.** In Bogota, confidence rose from -10.1 ppts to -2.0, as well as in Medellin, confidence improved to -16.8 ppts from -20.7. In Barranquilla and Cali we see better performance. Bucaramanga was the only major city were confidence fell, from -6.2 to -6.6 ppts, and doubled by a lower willingness to buy housing.
- **Consumer confidence improved at all socioeconomic levels.** In high incomes, confidence rose from -37.9 to -26.1 ppts. Middle income households' perception improved from -12.7 ppts to -4.2, while low-income confidence moved into positive territory from -4.8 to 1.6 ppts. Labour market improvements and somewhat less political uncertainty account for these developments.

While consumer confidence in August showed that consumers have improved their expectations of the economic future, households continue to be affected by the effects of higher inflation and currency depreciation that have reduced their willingness to buy durable goods. Still, it's relevant to follow these metrics and see how inflation continues to behave. A more hawkish BanRep, meanwhile, would affect consumer credit and slow what is, in our opinion, too high a rate of private consumption growth. In fact, we have recently changed our expectation on September's monetary policy meeting and now expect a 150 bps hike, raising the monetary policy rate to 10.5%, and with a possible terminal rate at 11.5%, which would be held for longer. At the same time, we tilt our balance of risks upwards, as we see inflation trajectories in the short and medium term far from reaching the Target Range of BanRep.

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

MEXICO: CORE INFLATION JUMPS ABOVE 8% IN AUGUST

In August, headline inflation remained elevated at 8.70% y/y, up from 8.15% previously, and slightly above consensus of 8.68% (chart 7). Core inflation surged to 8.05% y/y from 7.65% previously (chart 8), highlighting increases in the merchandise component of 10.55% y/y (10.07% previously), and services of 5.19% (4.90% previously).

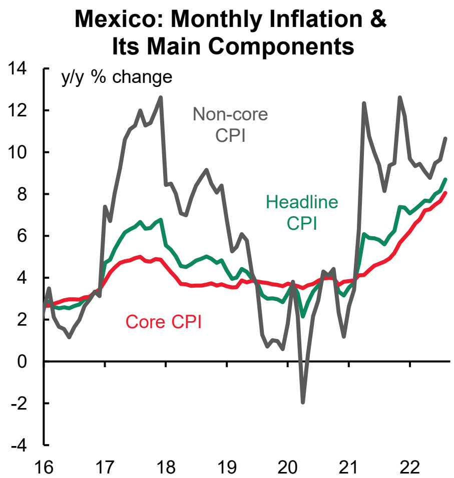
Non-core inflation also edged-up, from 9.65% to 10.65% y/y (chart 9), with energy and government tariffs rising to 7.25% y/y (4.76% previously), while food price inflation eased to 14.90% (16.05% previously). In its monthly sequential comparison, headline inflation decelerated to 0.70% m/m from 0.74% prior (compared to 0.87% consensus), its highest level for any August since 1998.

Core inflation rose to 0.80% m/m from 0.62% previously and above consensus at 0.76%, owing to a 1.14% m/m increase in merchandise (0.72% previously), while services moderated to 0.39% from 0.50%.

Finally, non-core items moderated to 0.39% from 1.09% m/m, with a deceleration in food from 1.64% to 0.98%, while energy and government tariffs dropped -0.11% from 0.63% in July.

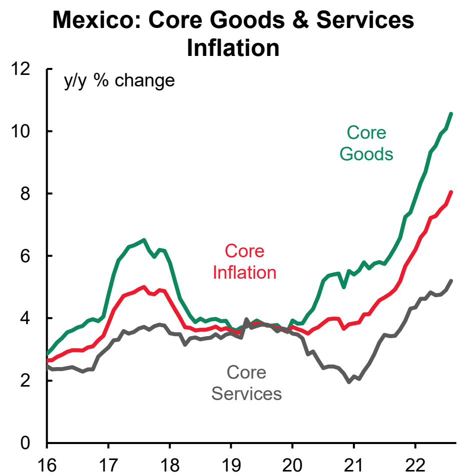
Year-end expectations were again revised up in the Citibanamex Survey to 8.24%. After the August reading, which again exceeded consensus, we expect further revisions in inflation forecasts, with prevailing uncertainty regarding the month of the peak in the trajectory.

Chart 7



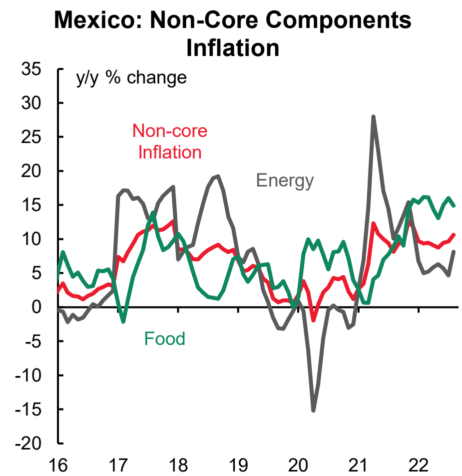
Sources: Scotiabank Economics, INEGI.

Chart 8



Sources: Scotiabank Economics, INEGI.

Chart 9



Sources: Scotiabank Economics, INEGI.

As for monetary policy implications, we maintain our call for an increase of 75 basis points to 9.25% at the September 29 monetary policy meeting. We now expect an interest rate of 10.25% at year-end, which would imply two additional 50 bps hikes at the November and December meetings, above the consensus median that anticipates a rate of 9.75%.

—Miguel Saldaña