Scotiabank™

GLOBAL ECONOMICS

LATAM DAILY

March 2, 2023

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Latam Daily: Weaker Copper and Market Mood to Challenge Latam Assets Today

- **Chile: GDP to contract less than consensus and Central Bank forecasts in 2023**
- **Colombia: The current account deficit in 2022 reached its highest level since 2015; The main source of financing comes from FDI**
- **Peru: Inflation stabilizes, BCRP to extend key rate pause at 7.75%**

Yesterday's upbeat mood in the currency space on the back of strong Chinese data has been partly unwound with broad gains in the USD in overnight trading, while US equity futures record a 0.5% decline on the day. Higher US yields—10s above 4%—amid a high-for-longer stance from the Fed are weighing on markets ahead of a relatively quiet day ahead in the Americas. The Latam calendar presents limited risks while the release of US jobless claims may only briefly catch the market's eye.

Despite the risk-off feel to markets, crude oil is catching a bid with some lingering China demand optimism, up 0.8% at writing, against unchanged iron ore and weaker copper (down 2%+) which may act as a headwind for the CLP (down 0.3% in early trading) which gained 2% yesterday—supported by the commodities backdrop and a stronger than expected economic activity print—as well as the PEN.

Mexico's unemployment rate climbed to 3.0% in January, from 2.76% in December, according to non-seasonally-adjusted data published this morning by INEGI. The reading came in below the economist median projection that saw a 3.10% jobless rate to start out the year. Overall, the country's labour market remains strong, as the unemployment rate sat at 3.71% in January 2022.

Still, the most likely move by Banxico at its late-March decision will likely be a 25bps hike after the surprise 50bps hike last month. Yesterday, the balance of the bank's quarterly inflation report (seeing weaker growth than previously) as well as comments from Gov Rodriguez noting that the next hike could be of a smaller magnitude suggest this will be the case; Dep Gov Espinosa also noted that the bank would not want to surprise markets again. On that last note, markets are tilted towards a 25bps hike so if a 50bps hike is coming, we should get guidance from policymakers. The MXN nevertheless rallied in line with the risk-positive tone and news around Tesla plants in Nuevo Leon and possibly Hidalgo (batteries)—an idea floated by AMLO to the automaker's Musk. The MXN is unchanged on the day and resisting the broad pro-USD mood, for the most part, as it remains very near the 18 pesos per USD mark, trading at a five-year-high.

Brazil's economy contracted 0.2% q/q in Q4-22 in data released a few minutes ago, with a y/y pace of 1.9% with the latter missing the median forecast of 2.2% amid negative revisions. The quarterly contraction was driven by a steep deceleration in consumer spending (1% to 0.3%) as well as a contraction in investment (-1.1% from +2.6%). Markets have checked their expectations for BCB policy as inflation seemingly regains a clearer downward path (according to mid-month IPCA data) while, yesterday, Fin Min Haddad applied some pressure on the BCB to reduce rates on the back of the government's plan to phase out tax breaks on fuel over four months.

—Juan Manuel Herrera

March 2, 2023

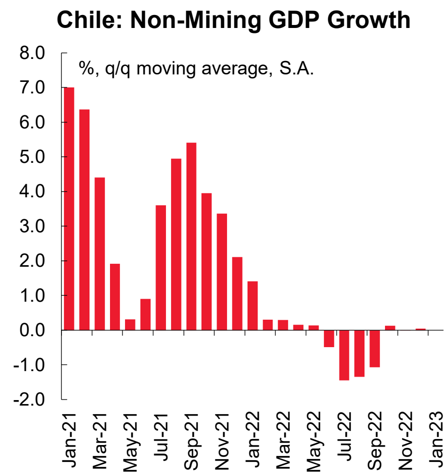
CHILE: GDP TO CONTRACT LESS THAN CONSENSUS AND CENTRAL BANK FORECASTS IN 2023

January GDP grew by 0.4% y/y, in line with our forecasts, supporting an upward revision of GDP growth in 2023 to -0.8%.

On Wednesday, March 1, the central bank (BCCh) released monthly GDP data for January, showing a 0.4% y/y expansion, similar to our projection (0.5%) but well above what was anticipated in the Economic Expectations Survey (-1.5%) and Bloomberg (-0.1%).

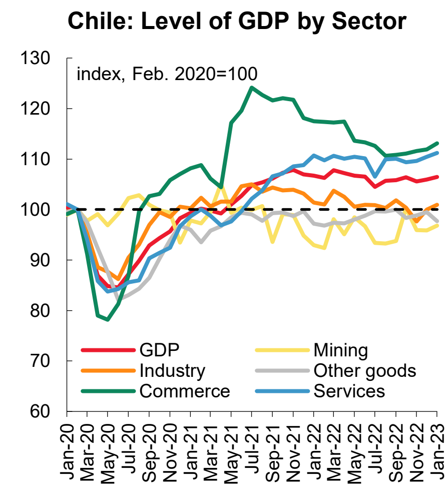
With this, we revise upwards our 2023 GDP projection from -1.7% to -0.8%. The correction is in response to a series of factors: (1) Better start of the year with a positive handover effect; (2) Greater than expected labour market resilience; (3) Improvement in terms of trade explained by a significant increase in the price of copper; (4) Fast execution of public spending since late 2022 that would have continued in early 2023; (5) A political scenario that would lead to a moderation in the structural reforms under negotiation and a constitutional process (constitutional council) where we anticipate a political balance of forces similar to the one observed in the current Senate.

Chart 1



Sources: Scotiabank Economics, BCCh.

Chart 2



Sources: Scotiabank Economics, BCCh.

As we expected, trade fell year-on-year due to the lower level of household liquidity. However, the sector has been resilient thanks to a more dynamic labour market and the contribution of the Universal Guaranteed Pension, all of which have provided support to trade. At the same time, services grew again in monthly terms, this time thanks to personal services, which we believe is due to the boost provided by the acceleration of public spending and its positive impact on the health sector. With this, the Imacec registered its first positive year-on-year growth rate since August 2022.

Negative year-on-year prints will be observed again in the second and third quarters. January's figure reinforces a positive economic performance for the first quarter, which would show an expansion in year-on-year terms even with incoming marginal seasonally adjusted declines. From April onwards, the year-on-year growth rate could return to negative territory, which could extend into the third quarter.

Compared to the previous month, the Imacec grew 0.5% thanks to the positive contribution of almost all sectors. While we expected growth in mining, industry and goods production, commerce and services again surprised positively with a greater resilience than expected, growing at the margin. Thanks to this, the level of non-mining GDP has remained stable in recent months, providing support to the economy and ratifying the positive momentum of the trade and services sectors (charts 1 and 2).

—Aníbal Alarcón

COLOMBIA: THE CURRENT ACCOUNT DEFICIT IN 2022 REACHED ITS HIGHEST LEVEL SINCE 2015; THE MAIN SOURCE OF FINANCING COMES FROM FDI

On Wednesday, March 1, the central bank (BanRep) released 2022 current account data. The current account deficit in Q4-2022 stood at USD4.99bn (6.1% of GDP), below that observed in Q3-2022 (USD6.91bn and 7.0% of GDP). The reduction in the current account deficit vs the Q3 followed from a lower trade deficit amid weaker exports, which is compatible with the hypothesis of economic slowdown (chart 3). For the yea as a whole, the current account deficit stood at USD21.45bn; in nominal terms, it was the highest nominal deficit since 2014, when Colombia suffered from the commodities prices shock, and aligned with BanRep's estimation. As a share of GDP, the current account deficit in 2022 represented 6.2% of GDP, the highest since 2015 as a share of GDP. In 2022, FDI inflows increased by 81.7%, becoming the main source of financing (65% of the total current account deficit).

The twin deficit, especially the structurally-high current account deficit, is the weakest fundamental for the Colombian economy. However, it is an endemic issue for Colombia since a wide deficit is compatible with strong economic growth. That said, the 2022 current account results are consistent with a 7.5% pace of GDP growth which demanded higher imports, especially of raw materials and capital goods. It is also worth noting that although the current account deficit was high, its financing came from a more healthy source: the FDI. For 2023, the central bank projects the current account deficit to narrow to USD13.60bn, equivalent to 3.9% of GDP, reflecting the economic slowdown with lower import dynamics, but still with enough financing from 'healthy' sources.

That said, as the current account deficit would narrow, from the real flows perspective, we don't expect it to imply a strong appreciation for COP. Instead, fundamental models point out that current levels are compatible with medium-term equilibrium in which the USDCOP reflects macroeconomic forces but adequately includes an idiosyncratic risk premium in prices.

Current account:

- In Q4-2022, the current account deficit stood at USD4.98bn (6.1% of GDP, chart 3 again). The deficit was lower than the Q3-2022 current account deficit since the economic activity slowdown was reflected in lower imports and, in turn, a lower trade deficit.

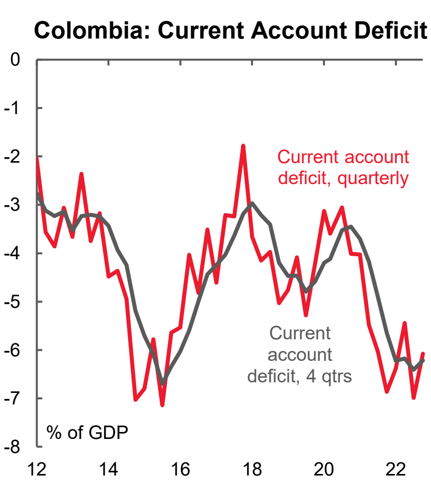
  In absolute terms, the main source of current account deficit by the end of the year were net outflows in the income account (USD4.34bn) due to payments to companies with FDI (chart 4) in the mining-related sector, financial-related activities and special services. A second effect that contributed to the current account deficit was the trade deficit (USD3.87bn). However, this deficit fell by 15% vs the previous quarter.

  Inflows from transfers (mainly remittances), partially offset the former two effects, reaching USD3.23bn. Remittances again showed a new historical high with inflows of USD2.55bn in Q4-2022. In fact, remittance inflows in 2022 were equivalent to 2.7% of GDP, representing around 50% of total oil exports in the same period.

Trade balance:

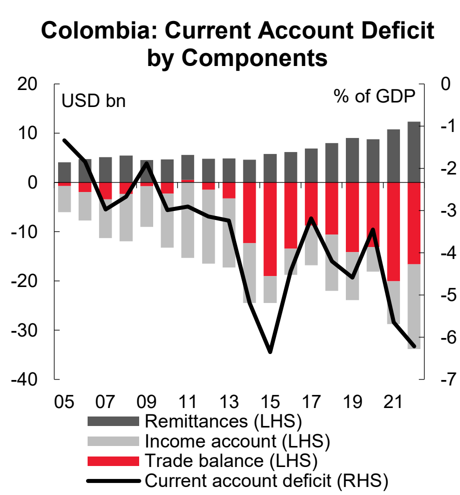
- In Q4-2022, exports contracted by 10.4% q/q showing that the positive price effect in commodities is vanishing, and it did not net off the lower commodity quantities exported, despite good behavior of services and non-traditional exports. On the import side, Colombia's purchases contracted by 11.24% q/q, reflecting the weakening in the economic activity.
- For 2022, the trade deficit was USD11.82bn, USD2.17bn lower than registered in 2021. Exports of goods but also, of services contributed to observing lower trade deficits. The trade deficit in services was 21.3% lower vs 2021, strongly explained by the rebound of touristic services amid unrestricted mobility with international destinies. In the case of the trade balance for goods, the constructive context of commodities prices, translated in a 10.8% improvement in terms of trade, also contributed to a lower trade deficit vs 2021.
- Income account: Net outflows stood at USD17.21bn in 2022; in the last quarter of 2022, they stood at USD4.34bn, decreasing 6.6% vs the previous quarter. Net income account outflows in 2022 were 97% (USD8.49bn) higher vs 2021. Around 65% of outflows were due to earnings payments to foreign companies with FDI in Colombia, especially in industries related to mining (USD4.25bn), oil (USD1.59bn), and financial services (USD 474 million).

Chart 3



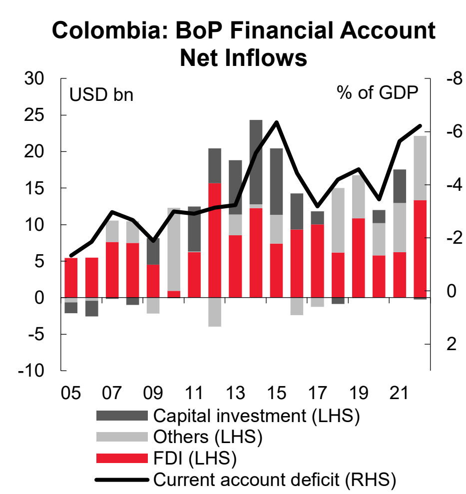
Sources: Scotiabank Economics, BanRep.

Chart 4



Sources: Scotiabank Economics, BanRep.

Chart 5



Sources: Scotiabank Economics, BanRep.

- Net current transfer inflows stood at USD3.23bn in Q4-2022, expanding by 3.95% q/q. In 2022, net current transfers totaled an inflow of USD12.34bn, increasing by 14.54% vs one year ago. In that account, remittances play an important role. According to BoP statistics, remittance inflows were USD9.43bn, increasing by 9.7% vs 2021. Remittances represent around 2.7% of GDP and 10.1% of the total current income of the balance of payments.

  In fact, one thesis in Scotiabank of why domestic consumption has been strongly resilient to inflation and higher rates is that remittances are at historically high levels, allowing low-income families to afford a decent living standard.

Financing side:

In the last quarter of 2022, the current account deficit financing came mainly from the FDI (chart 5), which totaled net inflows of USD3.29bn, increasing by 12.7% q/q, which is excellent news given the noise that brought the discussion for the fiscal reform for the business sector. On the negative side, the net portfolio investment was weaker than in the previous quarter. It is worth noting that in the last quarter of 2022, financial markets faced intense volatility that triggered strong domestic asset sales from offshore investors.

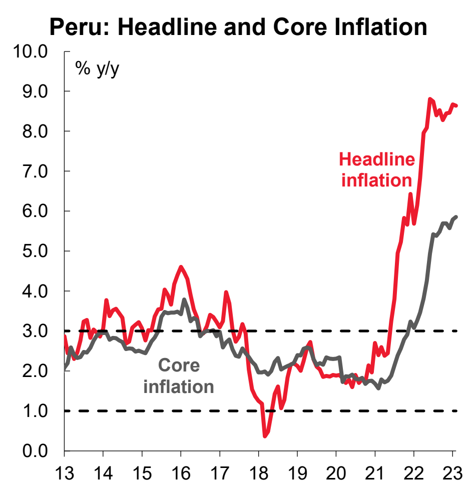
- Foreign direct investments: in 2022, FDI inflows stood at USD17.05bn (4.9% of GDP), increasing by 81.7% vs 2021. FDI was allocated 32% in financial services, 26% in oil and mining, 11% in transport and communication, 9% in manufacturing, 9% in commerce and hotels, 6% in electricity, and 7% in other sectors such as agriculture and construction.
- Capital Investments: net capital investments registered outflows of 265.5mn. Inflows fell by 65.5% vs 2021 (USD5.47bn lower), mainly on lower purchases of debt from foreign investors (-64.0% y/y).
- Other liabilities: in 2022, foreign currency liabilities increased by 37.71% vs 2021 to USD13.09bn. Private sector indebtedness (USD9.32bn) increased vs 2021, especially in the financial sector. In the public sector, indebtedness was lower compared with 2021 (USD3.77bn vs USD8.13bn in 2021).
- Regarding capital outflows from locals: in 2022, capital outflows were USD7.45bn, significantly higher than the USD923mn registered in 2021. The most significant amount of outflows was from the private sector (USD5.99bn), capital investments (USD2.74bn), and other assets (USD3.25bn). Outflows could be associated with a higher asset allocation in international assets from Pension Funds among other big portfolios such as Insurance companies' portfolios.

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

PERU: INFLATION STABILIZES, BCRP TO EXTEND KEY RATE PAUSE AT 7.75%

Inflation in Lima reached 0.29% m/m in February data released on Wednesday, March 1, below our forecast (0.48%) and Bloomberg consensus (0.44%). Year-on-year inflation fell for the first time after three months of increases, going from 8.66% y/y to 8.65% y/y (chart 6), remaining below the peak posted in June 2022 (8.81% y/y). With inflation data for February, 21 months were accumulated in which inflation remained above the upper limit of 3% of the inflation target, matching the longest period with inflation above 3% (between October 2007 and June 2009), since the target band of 1–3% was established in 2007.

Chart 6



Sources: Scotiabank Economics, BCRP.

Although the social protests continued in February, their intensity was reduced. The number of interrupted roads fell from 74 in January to 50 in February on average, which was also reflected in the prices of perishable foods (fruits, vegetables, legumes, and tubers), which fell 1.9% after having risen 4.4% in January and 4.9% in December.

Inflation for February (table 1) reflected the impact of the bird flu in higher poultry prices, contributing 0.23 percentage points (ppts) to the inflation of the month according to the official data. The seasonal rise in education costs was also clear (which contributed 0.07ppts). These factors were offset by a decrease in electricity costs (-0.11ppts) and the lower prices of perishable foods (-0.10ppts). In February, of the 586 products that make up the consumer basket (base 2021), 385 increased (66%), 103 decreased (18%) and 98 remained unchanged (17%), a dynamic alike that of January. Core inflation went from 5.79% y/y to 5.86% y/y, reaching a new maximum and accumulating 15 months outside the target range. Various cost indicators, such as wholesale prices, increased from 7.7% y/y to 8.1% y/y, as did the prices of machinery and equipment, which went from 2.6% y/y to 5.4 % y/y and the prices of construction materials that went from 4.7% y/y to 5.0% y/y (chart 6 again). Inflation at the national level (not just Lima) rose from 8.9% y/y to 9.0% y/y, without exceeding the peak seen in June 2022 (9.3% y/y). Across the 26 largest cities, year-on-year inflation accelerated in 16 of them (62%). The number of cities that posted annual inflation above 10% remained at 9 (35% of the total).

Looking ahead, we expect inflation to break lower in March, mainly because of a high base of comparison (inflation for March 2022 was unusually high: 1.48% m/m), so it is likely to be close to 8%, or even below the figure. We maintain our inflation forecast of 5.0% at end-2023.

Table : Peru—Lima CPI Basket— February 2023

Groups of Consumption	Base 2021	% m/m	% y/y
1. Food and non-alcoholic beverages	22.97	0.60	16.3
2. Alcoholic beverages, tobacco, drugs	1.61	0.47	4.1
3. Apparel and footwear	4.20	0.26	2.9
4. Housing, water, electricity, gas and others	10.55	-1.03	3.3
5. Furniture and home maintenance	5.11	0.18	3.2
6. Health	3.48	0.15	5.1
7. Transport	12.40	0.26	11.5
8. Communications	4.77	0.00	1.4
9. Recreation and culture	3.96	0.29	5.7
10. Education	8.61	0.78	4.7
11. Restaurants & hotels	15.89	0.53	9.2
12. Other goods and services	6.47	0.43	6.9
Total CPI	**100.00**	**0.29**	**8.7**

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

February's inflation and our forecast for March increase the probability that the BCRP will continue its pause in the interest rate hiking cycle. Our current base scenario considers it has already reached its terminal rate at 7.75% and that it will remain at that level for most of the year.

—Mario Guerrero