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GLOBAL ECONOMICS

LATAM DAILY

March 10, 2023

Latam Daily: BCRP Holds as Expected; Weak Markets Ahead of US Jobs

- **Peru: BCRP keeps policy rate unchanged for second consecutive month**

Equity markets traded on the back foot following yesterday's rout in US stocks amid cracks appearing on the 'fringes' of the country's banking sector (crypto and start-ups-related), with major spillovers seeming unlikely. SPX futures are tracking a 0.2% decline after the 1.9% selloff on Thursday. Crude oil is down about 0.8%, while iron ore and copper again move in opposite directions (up and down ~1% respectively).

Despite the clear risk-off mood in equities, currencies are in relatively decent shape against the USD, which is trading mixed—generally losing ground against 'safer' European FX while high-beta currencies somewhat underperform. The MXN depreciated to its weakest point since mid-Feb overnight, just past the mid-18s zone, but is now among the best majors, higher 0.5%—though still ~2% off yesterday's intraday high. The MXN's relationship with US yields (reflecting the perception of linked Fed-Banxico monetary policy) yesterday acted as a negative driver for the currency while the COP, CLP, and PEN simultaneously strengthened. Note also that Mexican inflation missed forecasts yesterday (see ***Latam Daily***), troubling calls for a repeat 50bps hike from Banxico at month-end.

Global markets are laser-focused on the 8.30ET release of US employment data, where economists are calling a sizable decline in the number of jobs created after a blockbuster increase in January. A lot hinges on today's data as recent strength in US economic figures prompted Fed officials, notably Chmn Powell earlier this week, to talk up the possibility of moving back to a 50bps hike later this month. As alluded to above, a strong jobs print is liable to support the MXN while weighing on the country's debt markets on higher odds of a Banxico half-point hike.

In the Latam region, we await the BCRP's presser at 12ET on yesterday's rate hold (see below), while we keep an eye out on political developments in Colombia with Congress President Barreras saying yesterday that there are "more agreements than disagreements" on Petro's health reform proposal.

Brazilian CPI published this morning slightly beat economists' expectations, with a decline to 5.60% from 5.77% (vs the consensus median at 5.53%); prices rose by 0.84% m/m from 0.53% in January and above an estimated 0.78% pace. The BCB looks still in hold mode, but calls are rising for the start of the cutting cycle, seen at roughly toss-up odds in May but a 25bps cut is fully priced in for June amid economic weakness—and real rates are becoming more and more restrictive. Today's minor beat is unlikely to alter this view significantly.

—Juan Manuel Herrera

PERU: BCRP KEEPS POLICY RATE UNCHANGED FOR SECOND CONSECUTIVE MONTH

The board of Peru's central bank (BCRP) kept its key interest rate at 7.75% on Thursday, in line with the market consensus and with our forecast, confirming the pause stance for the second consecutive month after 18 months of increases. Although in its statement the BCRP kept its options open to changes in any direction in the future—specifying that this decision does not necessarily imply the end of the interest rate hike cycle—we believe that 7.75% is likely the terminal rate. Recently, the BCRP's head of the Board, Julio Velarde, pointed out that the level of 7.75% or very close to it is enough to control inflation without causing a recession.

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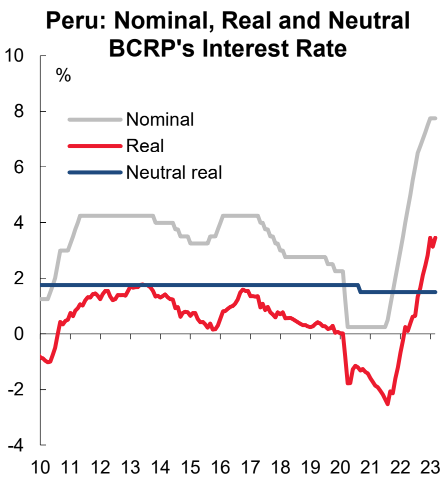
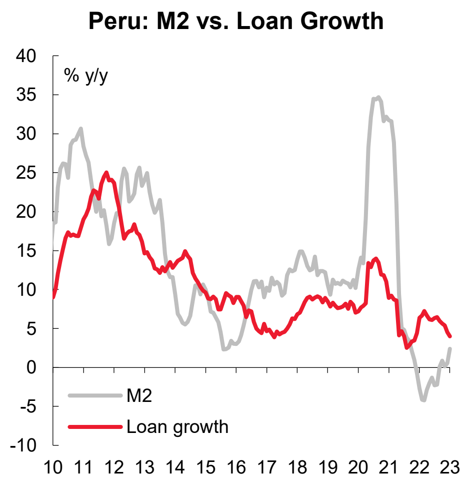
Chart 1



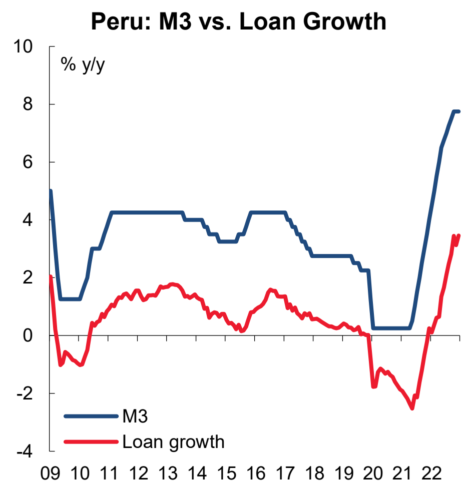
Sources: Scotiabank Economics, BCRP.

Chart 2



Sources: Scotiabank Economics, BCRP.

Chart 3



Sources: Scotiabank Economics, BCRP.

The statement kept its concerns about the macroeconomic effects of social unrest. This had its highest impact in January, so the BCRP estimated that GDP fell -1.4% that month. The intensity of the protests moderated in February and continued to reduce in March, which was reflected in an improvement in indicators and expectations about the economy in February—though these remain in pessimistic territory. The impact of social unrest on the economy has been material. Velarde recently indicated that they would probably revise their GDP growth forecast for this year (after it was lowered from 3.1% to 2.9% in December) in their Inflation Report this month.

In February, year-on-year inflation accumulated 21 months outside the target range, matching the previous record. Inflation stabilized in February and marked a second consecutive month of coming in below what the market expected. The BCRP, like us, expects a visible drop in inflation starting in March. Although the statement maintains the expectation of a return to the target range in Q4-2023, Velarde suggested that inflation could be slightly above 3%, and forecasted inflation of 2.4% for 2024. Our inflation forecast remains at 5.00% by end-2023.

In the scenario that the terminal rate has already been reached, our focus is on how long it can stay at this level. Twelve-month inflation expectations are key. In February, these returned to the previous level, going from 4.6% to 4.3%, still well above the target range (between 1% and 3%). March inflation is expected to be seasonally high (due to short-term and seasonal factors, such as education), but well below March 2022 inflation (1.48% m/m), so we see the possibility that year-on-year inflation will fall from 8.6% to below 8%.

The decision to hold the policy rate could also have considered that the monetary policy stance is already tight enough to deepen economic weakness. The real interest rate rose from 3.13% to 3.46% (chart 1), above its neutral level (1.50%) for the seventh consecutive month. Liquidity growth in soles (M2, chart 2) accelerated from 0.5% to 2.4% in January, remaining in positive territory for the fifth consecutive month, while, on the contrary, credit expansion slowed down for fifth consecutive month, going from 4.5% in December to 4.0% in January (chart 3). The BCRP statement indicated that prospects for global economic activity have shown a slight improvement, although global risk remains due to restrictive monetary policy in advanced economies, the impact of inflation on consumption (purchasing power), and ongoing global conflicts.

—Mario Guerrero