Scotiabank

GLOBAL ECONOMICS

LATAM DAILY

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Latam Daily: Chile CPI and US/Canadian Jobs; Peru Hold Surprise, Colombia and Mexico CPI Recap

- **Peru: BCRP surprises with unchanged rate and reserve requirement reduction**
- **Colombia: Inflation decreased less than expected in February to 7.74%, however it reached the lowest level since January 2022**
- **Mexico: Inflation came in below expectations in February owing to a slower pace in non-core items**

The post-Powell rates rally kept going in thin overnight trading, bolstered by cuts acceptance by ECB officials in morning speeches while G10 markets await the release of US and Canadian jobs data. In his second appearance in Capitol Hill this week, Powell said yesterday that they are "not far from" the required confidence to relax policy. This shouldn't be taken as the Fed readying a March, or even a May, cut but maybe rates markets are back to their optimism with cuts on the horizon as Fed and ECB officials tee them up. On the opposite end of things, the BoJ is reportedly leaning towards a hike at its March meeting.

USTs are bull flattening marginally after a 5bps or so intraday bull steepening yesterday that EGBs and gilts are continuing today. The rally in EGBs is chipping away at the EUR's surprising jump yesterday that reached the mid-1.09s, to now lag all majors with a small 0.2% drop. In the opposite direction, the JPY is up 0.7% on BoJ hike reports to trade in the 147 zone/ The MXN is slightly bid, holding around the 16.85/90 zone. European bourses and US equity futures are little changed after small rebounds in Asia. Crude oil is flat, iron ore is down about 1.5% and copper is up 0.3%.

Chile closes the Latam CPI data run this week, with February figures due at 6ET. The January 3.8% y/y increase greatly exceeded the economist median forecast of 3.5%, but the introduction of a new CPI basket sharply skewed the results higher. For our economists, the 3.2% y/y constant-basket inflation reading for January is the better representation of prices growth in the country. We project a 0.3% m/m rise, that is above the median's 0.2% rise, as a weaker CLP pressures local prices higher. Amid stronger than expected economic data, markets have shifted towards pricing in a 75bps cut from a previously thought 100bps reduction that remains our team's call.

—Juan Manuel Herrera

PERU: BCRP SURPRISES WITH UNCHANGED RATE AND RESERVE REQUIREMENTS REDUCTION

The board of the Central Bank of Peru (BCRP) opted for a surprising combination of its monetary tools at its meeting on Thursday, March 7th. On the one hand, it left its key interest rate unchanged, at 6.25%, when the market consensus and we expected it to continue with the interest rate cut. On the other hand, it made use of an old instrument: it reduced the reserve requirement, from 6.00% to 5.50%, to complement the monetary flexibility that began in September 2023. It had not used this instrument for almost two years, when in May 2022 it raised the reserve requirement from 5.75% to 6.00% (chart 1).

The statement is not explicit in the reason for the decision, although there are interesting points to consider. The first has to do with the increase in monthly inflation in February (+0.56% headline, and +0.51% core) which was enough for year-on-year inflation in both metrics to leave the target range (3.3% headline, 3,1 core). However, the BCRP estimates that these increases are transitory, which are explained by supply factors, and forecast that interannual inflation will continue its downtrend in the projection horizon and be within the target range (between 1% to 3%) in the coming months. To this last point, comparison base effects are favourable in March (which compares with an inflation of 1.25% m/m March 2023 vs 0.75% 20-year average) and April (which compares with an inflation of 0.56% m/m April 2023 vs 0.22% average 20 years). These elements would mean that the BCRP would resume the cycle of rate cuts soon.

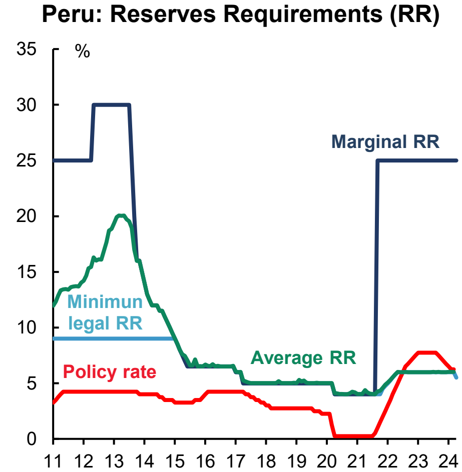
A second element is inflation expectations, which remained relatively stable at 2.65%, after four months of consecutive declines, although within the target range (between 1% and 3%). By maintaining the reference rate at 6.25%, the real interest rate remained between 3.6% and 3.7% for the fifth consecutive month, still far from the 2.0% considered a neutral level, reflecting a still contractionary stance (chart 2).

The third element is new. It is the first time in almost two years that the BCRP uses the reserve requirement. Unlike the movement of interest rates, whose transmission channel takes time to have an impact on the economy, the reduction of reserve requirements involves injecting liquidity immediately. This would reflect that the BCRP seeks to make monetary conditions more flexible more quickly, which, although they showed a more visible recovery since December, had posted very low interannual growth paces in terms of currency, liquidity, and loan expansion. In the past, a 50bps cut to the reserve requirement has been linked to an equivalent 25bps movement in the interest rate. The lowest point of the reserve requirement has been 4.00% between April 2020 and October 2021—during the pandemic. However, it shows us that although there would be room for further reductions, the room is limited as it would be approaching the level of operating reserve requirements.

Finally, the BCRP maintained its wording regarding the international context, although a factor that has produced recent financial volatility has been the change in expectations regarding a slower pace of interest rate cuts by the Federal Reserve. It hasn't been an explicit reason in the statement, but it could have played a role.

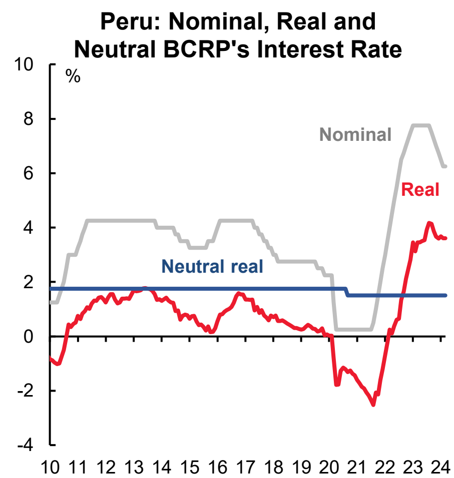
—Mario Guerrero

Chart 1



Sources: Scotiabank Economics, BCRP.

Chart 2



Sources: Scotiabank Economics, BCRP.

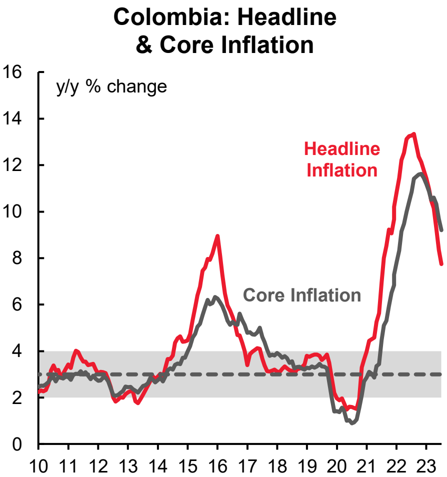
COLOMBIA: INFLATION DECREASED LESS THAN EXPECTED IN FEBRUARY TO 7.74%, BUT IT REACHED ITS LOWEST LEVEL SINCE JANUARY 2022

Monthly CPI inflation in Colombia stood at 1.09 % m/m in February, according to DANE data released on Thursday, March 7th. The result was above economists' expectations of 1.0% m/m, according to BanRep's survey, and above Scotiabank Colpatria's expectation of 0.96% m/m. Annual headline inflation continued slowing down from 8.35% to 7.74%, the lowest level since January 2022 (chart 3). Core inflation (Ex-food) decreased from 9.69% y/y in January 2024 to 9.20% y/y in February, while inflation excluding food and energy went down by 55bps to 7.26% y/y.

During February, the main contributors to headline inflation were education, housing and utilities, which accounted for 60% of monthly inflation. In the case of education, it is usual behaviour for February; however, inflation was slightly above the observed one year ago (8.74% m/m in 2024 vs. 8.61% m/m in 2023); in any case, it didn't contribute to a significant acceleration in headline inflation. In the case of the housing group, rent fees are higher compared to the same month in 2023 (0.89% m/m vs 0.69% m/m). We think rent fees high inflation is not only due to indexation effects, but also due to a supply vs demand issue derived of the significant slowdown in building construction. The main surprise came from utility fees, which increased 1.58% m/m, amid substantial increases in water and gas, especially for some regions; it could be associated with the dry season due to the "El Niño" phenomenon.

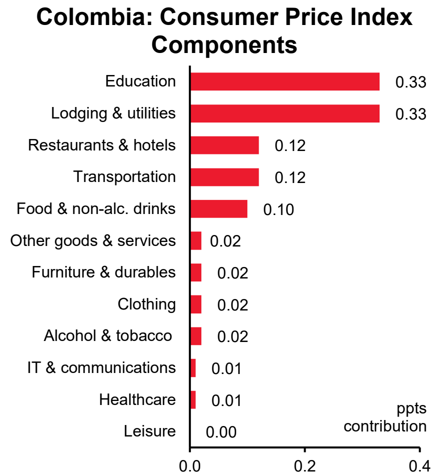
In the case of food inflation, prices continued increasing at a moderate pace on a monthly basis, contributing to the disinflation in the headline annual figure. It is worth noting that the "El Niño" phenomenon will only have an impact if it lasts longer than currently expected, and for now, climatic agencies are pointing to a weakening in the intensity. In fact, in y/y basis food inflation is already below 2% which has helped headline inflation to consolidate the convergence path to lower levels.

Chart 3



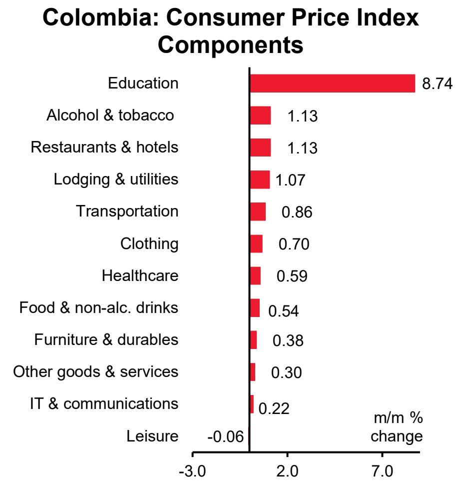
Sources: Scotiabank Economics, DANE.

Chart 4



Sources: Scotiabank Economics, DANE.

Chart 5



Sources: Scotiabank Economics, DANE.

On the core inflation side, the main disinflationary force is still coming from goods inflation, which reflects the impact of lower exchange and stable exchange rate levels and the domestic demand reduction, especially for durable and semidurable goods. Goods-related inflation went down to 4.32%, while in the case of services, it stood at 8.47%, showing the stickiness in some prices amid indexation.

Either way, inflation has come down by 154bps since December 2023, which, in any case, could support an acceleration in the easing cycle. However, we expect February's CPI data will not be enough for some members to accelerate the easing cycle to a 75bps rate cut. Instead, we think the final decision will be tilted towards a 50bps cut in a split vote.

In a reaction function type of analysis, BanRep could even cut by 100bps in February due to the highly contractionary policy rate in the context of a negative output gap; however, we think that the central bank's credibility will be a relevant topic in the decision making process for some board members who are still pointing towards a conservative stance, given that stickiness in prices could delay even more inflation convergence to the target.

If BanRep implements a 50bps cut, the real rate will stand at ~7.9% ex-ante and ~4% ex-post, which is significantly contractive vs the neutral rate estimate of 2.4%. In any case, the debate will be around the dilemma of having still high inflation due to the stickiness motivated by indexation effects, but on the other side, an economy operating below the potential GDP. That is why we think the split vote will be granted, in fact, the Finance Minister is calling for 100bps, while governor Villar maintains "cautious" calls.

Complementary highlights (chart 4 and chart 5):

- Education was, as expected, one of the main contributors to February's inflation (inflation of 8.74% m/m and contribution of 33bps). Unfortunately, the education group is showing that indexation effects maintain elevated services inflation. Education fees inflation was higher versus 2023, especially in primary and intermediate education. While other services around education, such as transport and clothing, are showing mixed behaviours. In the case of transport, gasoline prices are motivating higher increases versus 2023, while in the case of clothing, the effect was disinflationary.

- The lodging and utilities group contributed 33bps to headline inflation. Rent fees are increasing more than the observed one year ago despite the theoretically lower indexation base. This would suggest a housing supply shortage and a competition effect from new services or short rents that could compete with traditional living rents. This group remains challenging for core inflation to decrease. On the other side, utility fees also surprised us to the upside: water fees (+2.33% m/m) and gas (+2.66% m/m) contributed the most, while electricity fees only increased by 0.48% m/m. The effect of the "El Niño" phenomenon is still not clear, but we think that part of the water fee increases could be associated with that in some regions.

- Food inflation is on the sidelines. It is good news to see moderate inflation in food. Fruits inflation continues as the main upside contributor (+6.65% m/m), followed by vegetables (+3.82% m/m) and rice (+1.02% m/m), however those upside moves are partially offset by the reduction in plantains (-4.82% m/m), potatoes (-3.50% m/m) and eggs (-2.20% m/m). In the case of food, statistical base effects are contributing to the disinflationary effect, and we expect this to continue in March.

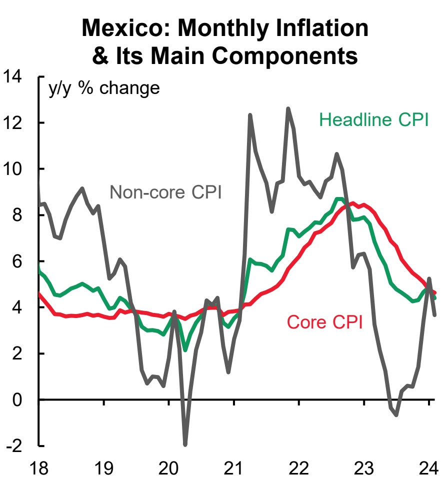
- The rest of the groups behaved very close to our expectations. Goods-related inflation decreased by 1.48 ppts to 4.32%, while services inflation fell by 16bps to 8.47%. In general, we could say that most of the groups are contributing to the disinflation, tradable goods, especially transport goods (vehicles) and other durable goods. In the case of services, the inflationary effect from rent fees is being offset by restaurants services, which is also demonstrating weak demand.

—Sergio Olarte & Jackeline Piraján

MEXICO: INFLATION CAME IN BELOW EXPECTATIONS IN FEBRUARY OWING TO A SLOWER PACE IN NON-CORE ITEMS

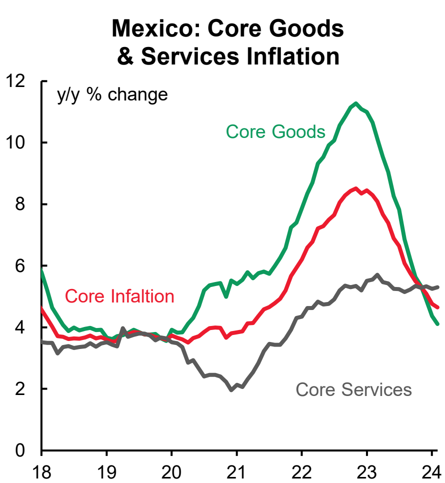
In February, inflation decelerated more than expected to 4.40% y/y from 4.88% previously (4.45% consensus). Core inflation came in slightly above consensus, as it moderated to 4.64% y/y from 4.76% previously (4.63% consensus), derived from a deceleration in merchandise to 4.11% (4.37% previously), services rose 5.30% (5.25% previously), remaining sticky, showing no clear sign of deceleration in the last nine months. Non-core inflation moderated its pace to 3.67% y/y from 5.24%. In its monthly comparison, headline inflation registered a lower increase of 0.09% m/m (0.89% previously, 0.14% consensus), core inflation rose 0.49% m/m (0.40% previously, 0.48% consensus), with a slower pace in merchandise. Finally, non-core inflation fell -1.20% m/m (2.37% previously, see chart 6). Headline inflation edged up since October to January owing to important increases in food non-core items. This month, headline inflation showed better than expected results as food slowed from 9.75% to 4.77%. However, risks remain biased to the upside, and stickiness in the core inflation is the main factor to keep in mind in the coming months, as services have stayed somewhat flat since the second part of 2023, and a higher demand could put pressure on core items in the short term (chart 7). Also, non-core items led the inflation pace but we do not rule out some volatility in the coming months, as any change in non-core items could change the trend of headline inflation (chart 8). In monetary policy implications, inflation prints for February reinforces the consensus for a rate cut this month, although we still think that the decision could be divided this time.

Chart 6



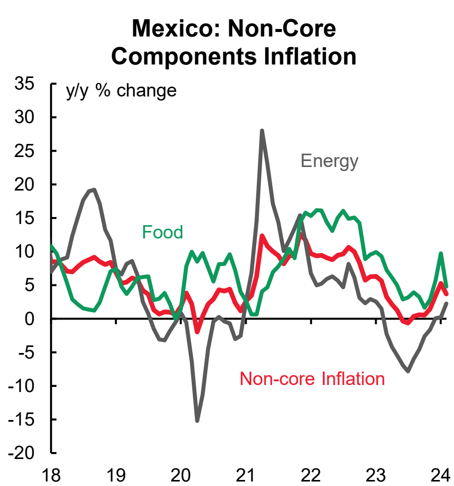
Sources: Scotiabank Economics, INEGI.

Chart 7



Sources: Scotiabank Economics, INEGI.

Chart 8



Sources: Scotiabank Economics, INEGI.

—Miguel Saldaña