Scotiabank

GLOBAL ECONOMICS

LATAM DAILY

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Latam Daily: BCRP and Banxico Cut Rates, Colombian Inflation Undershoots

- **Colombia: Inflation returned to a downtrend in July, undershooting expectations and reaching its lowest level since December 2021**
- **Mexico: Banxico cuts amid rising inflation and increased volatility; July inflation**
- **Peru: BCRP puts its reference rate on par with Fed's**

COLOMBIA: INFLATION RETURNED TO A DOWNTREND IN JULY, UNDERSHOOTING EXPECTATIONS AND REACHING ITS LOWEST LEVEL SINCE DECEMBER 2021

Colombia's monthly CPI inflation stood at 0.20% in July, according to data released on Thursday, August 8th. The result was below analysts' expectations of 0.28% m/m, according to the BanRep survey, and also below Scotiabank Colpatria's expectation of 0.26% m/m. Inflation resumed its downward trend after having remained stagnant for two months, with annual headline inflation falling from 7.18% to 6.86%, reaching the lowest level since December 2021 (chart 1). Core inflation (ex-food) fell to 7.24% y/y from 7.64% y/y in June, while inflation excluding food and regulated prices fell by 20bps from the previous month to 5.81% y/y, the lowest level since April 2022. The decline in inflation is expected to continue for the remainder of the year, reaching 5.65% y/y, and entering the target range in the 2nd quarter of 2025.

The results were better than anticipated, reinforcing our expectation that BanRep can accelerate the pace of the easing cycle at its September meeting (September 30th). We expect a 75bps cut to 10%. However, the materialization of the scenario will depend on the rate of decline in inflation in August, which will be announced on September 6th. In addition, the BanRep board will know in advance the Fed's rate decision (September 18th), which will be a key factor for the decision, considering the arguments of the previous meetings in which uncertainty about international financial conditions has been consolidated as one of the main risks to accelerate the pace of cuts.

In July, lodging and utilities accounted for 70% of monthly inflation (charts 2 and 3). Monthly inflation in the lodging and utilities group was 0.45% m/m, contributing 14bps. Rental rates rose less than in June with a variation of 0.47%, which means that the indexation effects would gradually fade away. As for utilities, water and gas rates increased the most, while electricity helped to offset this with a variation of -0.57% m/m. The second contributor to overall inflation was the food group but with a lower variation than the previous month. Products such as fresh fruits, eggs, and poultry meat continue to show a reduction in their prices, while some tubers, sweets, and chocolate continue to have an acceleration in their prices. Food could maintain a moderate performance, thanks to the fact that the risks associated with a strong La Niña phenomenon have been dissipating. Service inflation managed to fall at a faster pace in July.

Although service inflation has been stubborn, in July it fell by 20bps to 7.69% y/y, reflecting a lower indexation, however still well above the central bank's target. The results support the gradual convergence to the target as the upward indexation effects vanish. Meanwhile, inflation related to goods decreased from 1.43% to 1.20% annually, completing three months below the target range, a behaviour that could continue if domestic demand remains weak.

Other highlights:

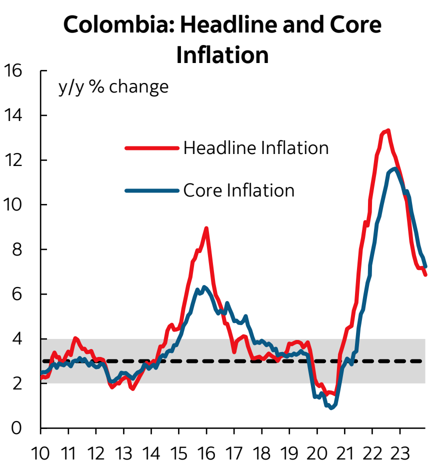
- **The lodging and utilities group was again the main contributor to overall inflation.** Rental rates were slightly lower than the previous month, going from a variation of 0.48% in June to 0.47% in May, and lower than the 0.53% m/m in July 2023, reflecting a lower indexation effect. Similarly, utility inflation was lower than in June

(0.83% m/m), registering a variation of 0.50%, in which water and gas services were the ones that contributed the most, while electricity offset the result by registering negative monthly variations in seventeen cities out of the twenty-three cities studied. Utilities inflation is expected to continue to decline in August, however, it could show an increase in September, due to a low statistical base (-0.18% m/m last year). However, it is expected to be a transitory increase since the statistical bases for the last quarter of 2023 are high and will give room for inflation to continue to decline.

- **Food inflation showed a more moderate variation.** The effects of the El Niño phenomenon seem to have disappeared, while the risks associated with La Niña have been dissipating, contributing to a better performance in the prices of agricultural goods such as some fresh fruits. In July, food inflation was 0.21% m/m, being the second group to contribute to general inflation with 4bps, also registering a slight reduction in annual inflation from 5.27% to 5.26%. Potatoes (+8.92% m/m), onions (+11.6% m/m), and chocolate (+6.04% m/m) were the foods that increased their price the most in July, while fresh fruit (-2.78% m/m) and bananas (-3.41% m/m) were the ones that led the reduction.

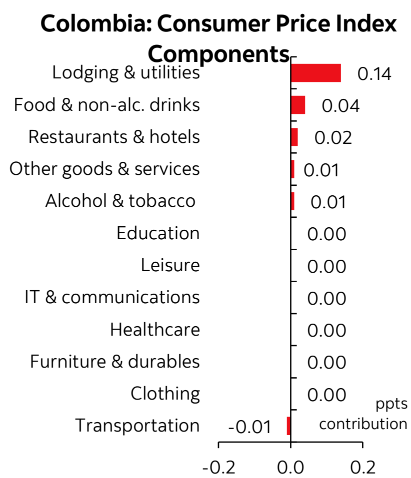
- **Only five out of the twelve groups contributed positively to inflation.** Lodging and utilities, food, restaurants and hotels, alcoholic beverages, and the group of miscellaneous goods and services were those that contributed to inflation, while transportation was the only group to present a negative contribution -1bps (charts 2 and 3 again). Inflationary pressures have been concentrated in some specific groups, while others have shown moderate variations. From now on, the increase in tolls would not imply a greater contribution, the increase in diesel prices would also have a smaller impact, which would allow general inflation to maintain a downward path. Service inflation is expected to converge more gradually, but overall, the results could support an acceleration in the easing cycle starting in September.

Chart 1



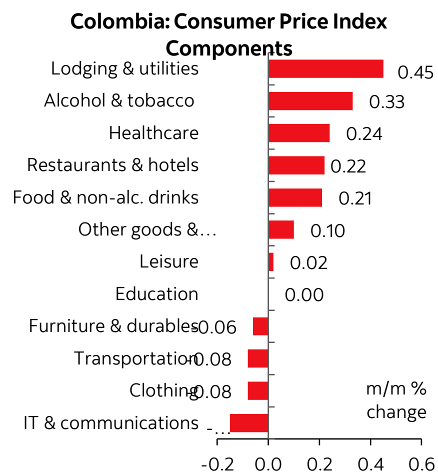
Sources: Scotiabank Economics, DANE.

Chart 2



Sources: Scotiabank Economics, DANE.

Chart 3



Sources: Scotiabank Economics, DANE.

—Sergio Olarte & Daniela Silva

MEXICO: BANXICO CUTS AMID RISING INFLATION AND INCREASED VOLATILITY

In a split vote, Banxico's governing board opted for a 25 basis point cut in the target rate to 10.75%. Governor Rodriguez, with Deputy Governors Borja and Mejia voted for the cut, while Deputy Governors Espinosa and Heath voted for an unchanged rate. At the same time, the board revised upward its expectations for headline inflation again, expecting it to converge to 3.0% by the end of 2025. The core inflation forecast was marginally lowered for the current quarter, while the rest of forecast horizons remained unchanged (table 1).

The statement noted that the board "considered the nature of the shocks that have affected the non-core component and the projection that their effects on headline inflation will dissipate over the next quarters." In addition, the tone of the statement showed a dovish bias, repeating that "looking ahead, the board foresees that the inflationary environment may allow for discussing reference rate adjustments." It also mentioned that it will consider global shocks will continue fading, and weakness in economic activity (chart 4).

The upside risks mentioned in the document were: persistence of core inflation; further exchange rate depreciation; higher cost pressures; climate shocks; and escalation of geopolitical conflicts. On the downside, the governing board mentioned the following risks: lower than anticipated economic activity; a lower pass-through of some cost pressures; and that the effect of the exchange rate depreciation will be

Table 1: Mexico - Banxico Inflation Forecasts Update	23Q3	23Q4	24Q1	24Q2	24Q3	24Q4	25Q1	25Q2	25Q3	25Q4	26Q4	26Q5
Headline Inflation Aug. 2024 Forecast	4.6%	4.4%	4.6%	4.8%	5.2%	4.4%	3.7%	3.3%	3.1%	3.0%	3.0%	3.0%
Headline Inflation Jun. 2024 Forecast	4.6%	4.4%	4.6%	4.7%	4.5%	4.0%	3.5%	3.3%	3.1%	3.0%	3.0%	3.0%
Difference, Aug.-Jun.	0.0%	0.0%	0.0%	-0.1%	-0.7%	-0.4%	-0.2%	0.0%	0.0%	0.0%	0.0%	0.0%
Core Inflation Aug. 2024 Forecast	6.2%	5.3%	4.7%	4.2%	4.0%	3.9%	3.6%	3.3%	3.1%	3.0%	3.0%	3.0%
Core Inflation Jun. 2024 Forecast	6.2%	5.3%	4.7%	4.2%	4.1%	3.9%	3.6%	3.3%	3.1%	3.0%	3.0%	3.0%
Difference, Aug.-Jun.	0.0%	0.0%	0.0%	0.0%	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

Sources: Scotiabank Economics, Banxico.

lower than anticipated. In this regard, we highlight that, according to the July inflation data published earlier the same day, headline inflation exceeded expectations by 5.57% y/y (vs. 5.51% consensus), due to higher increases in agricultural prices. However, the services component, which has not broken the 5.0% barrier, edged up again to 5.22%, with increases in its three subcomponents (housing, education, and other services), with no clear signs of changes in their behaviour.

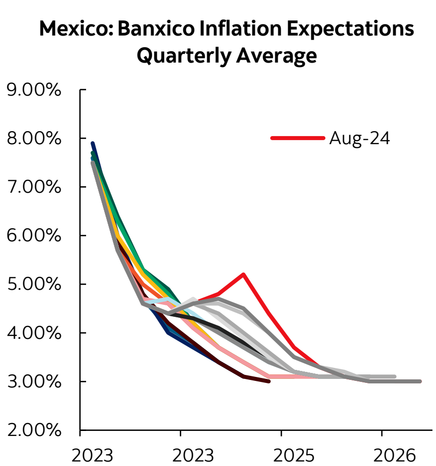
In our view, we believe the outlook faces a higher degree of uncertainty, both from international factors, such as the Bank of Japan's rate hike, recession fears in the US, along with its upcoming elections and increased tensions in the Middle East, as well as from local factors, such as the development of constitutional reforms, next year's fiscal balance, climate impacts, and insecurity issues, which could offset the effect of lower economic activity on inflation. Despite this, we believe that the governing board could continue with a dovish bias, allowing for at least one more cut during the year (chart 5). It appears that the board considers that the rate level has no impact on supply shocks to non-core inflation, so further rate cuts are still on the table. However, in our view, the dovish guidance from some members contrast with the continued upward revision of inflation forecasts and headline inflation beating expectations. Keeping a dovish message amid continued increases in forecasts could bring some doubts about Banxico's commitment and its ability to meet the price stability.

After the decision, the peso USDMXN strengthened, trading as high as $18.87, reacting to a more dovish than expected statement, after being pressured by volatility in international markets in recent weeks. The TIIE curve has been observed consistently downward in all its nodes since the last meeting, owing to the expectation of lower rates, as well as the implied rates curve, which discounts another cut in its 3-month node (chart 6).

MEXICO: JULY INFLATION EXCEEDS ESTIMATES

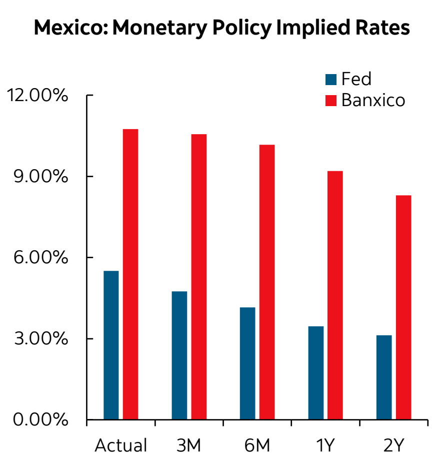
In July, headline inflation surged to 5.57% y/y from 4.98% (vs. 5.51% consensus in the Citibanamex Survey), see chart 7, adding five consecutive months of upward prints, while core inflation moderated to 4.05% from 4.13% (vs. 4.02% consensus) see chart 8, adding eighteen consecutive months of a downward trend. Within the core component, merchandise decelerated 3.09% (3.28% previously), while services rose to 5.22% (5.03% previously), with its three subcomponents above their 2010–2024 average, and increasing in July: housing (3.96%), education (6.36%), and other services (6.01%). On the other hand, non-core inflation presented a strong increase of 10.36% (7.67% previously) see chart 9, highlighting agricultural products, which rose 13.72% (10.36% previously), mainly due to fruits and vegetables (+23.55%), affected by weather phenomena and problems in the local supply chain.

Chart 4



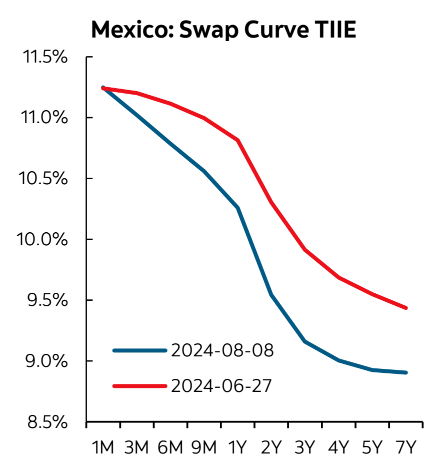
Sources: Scotiabank Economics, Banxico.

Chart 5



Sources: Scotiabank Economics, Bloomberg.

Chart 6



Sources: Scotiabank Economics, Bloomberg.

Chart 7

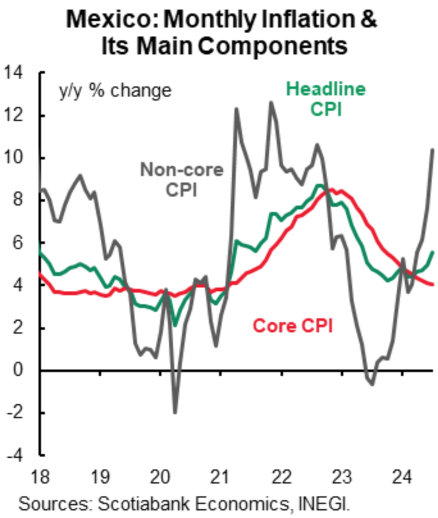


Chart 8

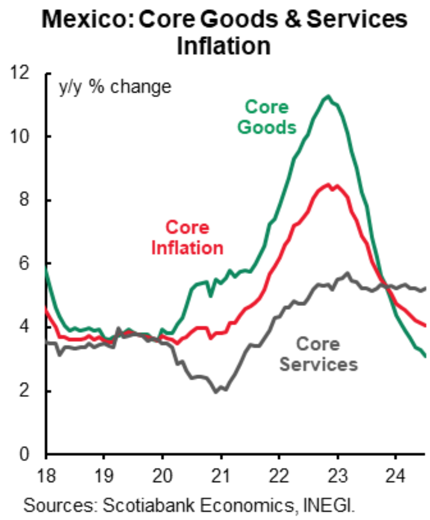
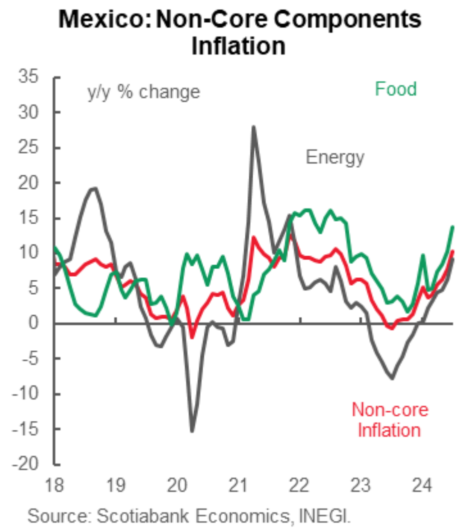


Chart 9



In its monthly comparison, headline inflation rose 1.05% m/m (0.38% previously, 0.99% consensus), its highest level for any July since at least 1996, core inflation rose 0.32% (0.22% previously, 0.29% consensus) and non-core inflation accelerated 3.29% (0.87% previously).

Despite these numbers, Banxico surprised with a 25 basis point cut, arguing that the recent surge in headline inflation is expected to cool in the coming months as it is driven by non-core items. However, the governing board revised up its inflation forecast, expecting now an average headline inflation at 4.4% y/y in the last quarter of 2024 and 3.9% in its core component. Private analysts' also revised up their expectations, anticipating now a 4.63% year-end headline inflation (vs 4.42% previously), and 3.96% in non-core inflation for 2024 (4.00% previously). Looking ahead, as pressures remain high, and volatile items drove headline inflation above expectations again in July, more upwards revisions could take place in the near term, despite the view of some members of Banxico's governing board, that consider the upsurge to be transitory.

—Brian Pérez & Miguel Saldaña

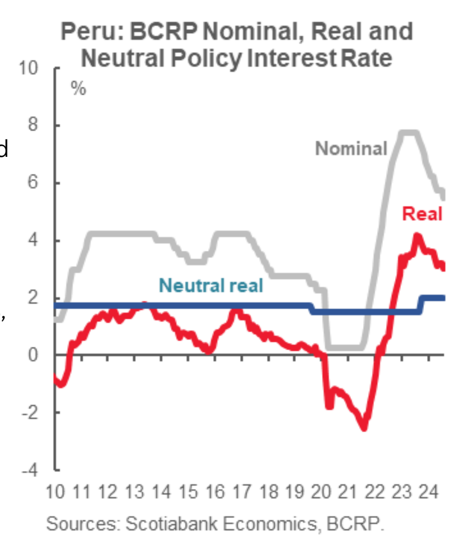
PERU: BCRP PUTS ITS REFERENCE RATE ON PAR WITH FED'S

The board of the Central Bank of Peru (BCRP) surprised and chose to cut its policy rate by 25bps, to 5.50%, contrary to the market consensus and our expectation of another pause. With this decision, the differential between the BCRP and the Fed reference rate disappears.

The 25bps cut was made despite the fact that the BCRP's statement indicated that core inflation is above the upper limit of the target range (3.0%) and continues to show a certain persistence associated with some service sectors (having stayed at this level for six consecutive months without showing clear signs of easing). In addition, the statement indicates that headline inflation in some economies has a slight persistence, however, it will continue to gradually decrease over the course of the year.

The BCRP probably based its decision on weak economic data for June. Mining GDP plunged 8.1%, y/y, agriculture GDP declined 3.1%, y/y and domestic demand indicators were also weak, with electricity output up a very marginal 0.06%, y/y, and cement demand down 5.5%, y/y. On the other hand, the first readings for August inflation are favourable and suggest that inflation will be below the midpoint of target range (2.0%). These factors would have been implicitly validated by the BCRP, being sufficient to resume the cycle of rate cuts.

Chart 10



By cutting the reference interest rate to 5.50%, the real interest rate was reduced from 3.2% to 3.0%, still far from the 2.0% considered a neutral level, marking twenty-four months in contractionary territory (chart 10). The forward guidance remained unchanged, stating that "if necessary, it will consider additional modifications to monetary policy." So far in 2024, monetary policy decisions have aligned with our vision, which is why we maintain our forecast of a rate of 5.00% by year-end.

—Ricardo Avila