Scotiabank

GLOBAL ECONOMICS

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Latam Daily: Colombia Previews Monetary Policy; Mexico August Trade Recap

- **Colombia's Monetary Policy Preview: The debate about the speed of the easing cycle**
- **Mexico: The trade balance for August reported a deficit of -$4,868.01 mn, due to a decrease in imports of capital and consumer goods**

COLOMBIA'S MONETARY POLICY PREVIEW: THE DEBATE ABOUT THE SPEED OF THE EASING CYCLE

On Monday, September 30th, BanRep will hold its sixth monetary policy meeting of 2024. The main debate will be around whether there is room to accelerate the easing cycle. Macro data gives space to the central bank to consider a higher cut. However, uncertainty around fiscal issues and the volatility in local markets could prevent some board members from encouraging more aggressive easing. At Scotiabank Colpatria, we expect a cut from 75bps to 10%. However, we expect a divided vote as some board members have expressed the need to remain cautious in order not to compromise the inflation trajectory to the target range and to maintain a predictable future interest rate path. That said, September's meeting will be a debate between macroeconomic arguments and uncertainty around local financial markets due to fiscal concerns. Either way, we think the central bank faces a key moment in which the speed of the easing cycle will be critical to define the next step of the economic cycle.

The central bank has maintained the pace of rate cuts at 50bps since March's meeting, and in July's meeting, the majority of the board considered that accelerating the easing cycle to a pace of 75bps cut wasn't sustainable, arguing that services' inflation remained sticky while fiscal risk maintains the country risk premium relatively high. It is worth noting that by July's meeting, inflation had been stagnant for two consecutive months (May and June), generating uncertainty and caution for BanRep's board. Ahead of September's meeting, macroeconomic indicators have evolved in a way that provides space to accelerate the easing cycle; inflation has been below expectations, decreasing more than 100bps since June's reading, economic activity is still showing stagnation in key sectors, the labour market is weakening, while on the international side, the Fed's kick-off of the easing cycle provides relief for central banks around the world.

Having said that, the only caveat to consider is the noise around the fiscal situation in Colombia because it recently triggered a more moderate appetite for COLTES and is part of the explanation of the FX depreciation. Some board members could consider that fiscal risk maintains the necessity to have a higher real rate. Still, from our perspective, as economic activity is already operating in a negative output gap, the risk of taking longer to reduce the real monetary policy rate could be reflected in weaker economic activity in the future. At the same time, in the case of inflation, we perceive risks under control as the inertia will be enough to take back the inflation to the target range in H2-2024.

Key points to consider ahead of September's BanRep meeting:

- **Inflation resumed the downward path.** In August, inflation fell to 6.12% y/y, which implies a reduction of more than 700 basis points from its peak of 13.3% reached in May 2023. Core inflation (excluding food) has also made significant progress, reaching 6.78% y/y in August, and goods inflation has remained below the target range for four consecutive months, while services inflation, despite remaining at high levels, is now on a more consistent downward path.
- **Weather events are a risk for inflation as the lack of rain is seen as one of the main risks to energy supply and food.** Energy rationing and the use of thermoelectric

plants have been some measures to deal with these climatic effects, however, these strategies to supply energy to the country pose a risk to the prices of public services and food. In our opinion, this risk could be material but potentially offset by the inertia of a lower indexation of prices in 2025.

- **Economic activity expanded 3.7% y/y in July, exceeding expectations, but showing uneven performance across sectors.** Some sectors have maintained significant growth so far this year, such as agriculture, public administration, and entertainment and recreation activities; however, labour-intensive sectors such as manufacturing, commerce, and construction would need additional stimulus to recover. The economic recovery plan proposed by the government could take longer than expected and may not even materialize in the short term, which makes us think that in 2024 and 2025, the country will maintain growth below its potential and, in this scenario, maintaining high levels for the real rate could be dangerous.
- **International financial conditions eased after the Fed's cut.** In July, expectations about the start of monetary policy easing in the US were uncertain, and the board framed this variable as one of the main concerns of the macroeconomic environment. However, the materialization of a first rate cut in the US and expectations that suggest additional cuts may contribute to greater confidence in BanRep to accelerate the pace of the easing cycle.
- **A final point to consider is that in August, BanRep decided to reduce the ratio of reserve requirements (RRR) by 1%,** and it brings a debate about if this action was a compensatory action to avoid accelerating the easing cycle, however, from our perspective it is not, as the RRR pointed to a decision to expand the liquidity permanently, which is aiming to make BanRep is less volatile in their intervention in COLTES market, but is not a substitute of the use of the traditional rate instrument.
- **Fiscal noise**. The debate around the government's budget in 2025 has triggered some concerns as the lack of consensus with congress has no precedent. In our opinion, the MoF will be pragmatic and will adjust spending to make it compatible with compliance with fiscal rules. However, shocking communication around the budget negotiation and the fiscal reform brings volatility to domestic markets, and it could prevent the central bank from a unanimous vote to accelerate the easing cycle.

—Jackeline Piraján & Daniela Silva

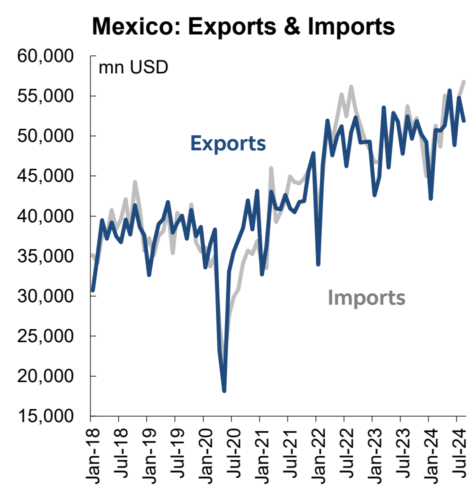
MEXICO: THE TRADE BALANCE FOR AUGUST REPORTED A DEFICIT OF -$4,868.01 MN, DUE TO A DECREASE IN IMPORTS OF CAPITAL AND CONSUMER GOODS

In August, the trade balance reported a deficit of -$4,868.01 million dollars (mn), compared to the previous deficit of -$71.99 mn. The year-to-date deficit is -$10,437.58 million, and in the last twelve months it is -$7,479.60 million. Imports increased by 5.7% y/y (13.3% previously), highlighting capital goods, which showed a slower pace of -2.6% (8.7% previously), consumer goods, which decreased by -1.3% (16.5% previously), and intermediate goods, which grew by 8.2% (13.3% previously). On the other hand, oil imports showed a significant annual drop of -26.0%, marking eighteen consecutive months of decreases.

Given these data, it is likely that the decrease in capital imports may indicate lower business confidence in the future, in addition, the drop in consumer goods indicates a reduction in domestic demand, in line with lower economic activity since last year.

Exports fell -1.0% (14.7% previously). Manufacturing exports slowed to 0.6% (15.9% previously), with automotive exports declining -3.3% (7.2% previously). This drop may reflect a decrease in external demand for Mexican products, although we expect the automotive sector to continue growing given the important trade relationship with Mexico, the United States and Canada.

Chart 1



Sources: Scotiabank Economics, INEGI.

—Brian Pérez & Miguel Saldaña