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GLOBAL ECONOMICS

LATAM DAILY

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Latam Daily: BCRP Surprise Hold and Banxico Minutes Recap

- **Mexico: Banxico's minutes point to continuing the cutting cycle; however, the Board of Governors acknowledge upside inflationary risks**
- **Peru: BRCP surprises with an unchanged reference rate**

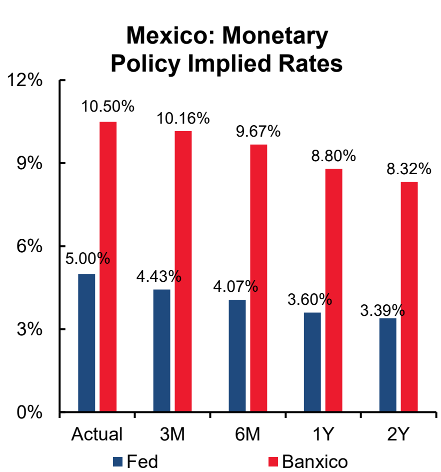
MEXICO: BANXICO'S MINUTES POINT TO CONTINUING THE CUTTING CYCLE; HOWEVER, THE BOARD OF GOVERNORS ACKNOWLEDGE UPSIDE INFLATIONARY RISKS

The minutes of the September 26th meeting provided details on the discussion regarding inflation and monetary policy within the Board of Governors, where a 4–1 vote revealed divided stances. In general, we highlight the arguments of the Board members who voted in favour of a 25 basis point cut, which reflects the weakness of economic activity and the observed slowdown in inflation. On the other hand, Deputy Governor Heath based his dissenting vote on the need for more time for the monetary stance to have the desired effect, especially in the services inflation component, as well as inflation expectations.

Regarding the Mexican economy, the minutes mentioned that economic activity is going through a period of weakness, with notable loss of dynamism since the last quarter of 2023. The slowdown in consumption and investment was also noted. In this regard, members expressed concern about short-term economic outlook, mentioning that economic weakness is likely to persist in the coming quarters; however, they do not anticipate a contraction in the economy so far. They also mentioned the widespread weakening in the manufacturing sector, with several subsectors recording negative annual drops. Meanwhile, manufacturing exports showed some recovery in July, mainly due to an improvement in orders to the United States, despite external demand showing sluggishness.

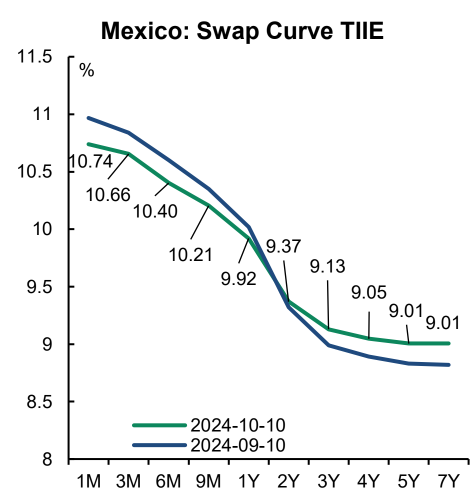
Regarding inflation, several members commented that increases in non-core components, mainly agricultural products, were expected to reverse as supply shocks dissipate. This expectation of edging back inflation likely motivated the interest rate cut during the August meeting, which surprised as it was delivered amid a surging in the inflation reading that exceeded expectations, as well as a short-term forecast upward revision. Similarly, several members highlighted that the inflation rebound observed in previous months was concentrated in fruits and vegetables, which did not lead to a generalized price increase. However, we believe that some members have concerns about the core inflation trend. On one hand, some of them noted that goods are below their

Chart 1



Sources: Scotiabank Economics, Bloomberg.

Chart 2



Sources: Scotiabank Economics, Bloomberg.

historical averages and that it is unlikely this component will continue to moderate. On the other hand, there was a consensus on recognizing the stickiness of services, although one member considered that wage pressures in services could be of lesser magnitude in the future. Finally, some Board members noted an increase in inflation expectations for the next four years, although long-term expectations remained unchanged.

In the monetary policy discussion, we found different opinions on the inflation outlook and policy direction. First, two Governing Board members believe that inflationary pressures are easing, which will allow interest rate adjustments to continue in upcoming meetings. One member even considered that “in the absence of new shocks, the magnitude of the cuts can begin to be discussed,” which we perceive as an invitation to discuss a 50 basis point cut in the near future. On the other hand, two more members believe there is room for additional adjustments, although these decisions will depend on the development of new data, as the risk balance remains biased to the upside and inflation expectations persist above the target. Finally, Deputy Governor Heath holds the most cautious stance, considering that greater certainty in disinflation progress is necessary before continuing with reference rate cuts.

Looking ahead, we maintain our call that the next cut by the Governing Board will be again 25 basis points at the November meeting. We believe recent climatic events will generate new pressures on agricultural prices, despite the recent slowdown in this non-core component. Additionally, we anticipate a possible increase in exchange rate volatility as the U.S. elections and the presentation of the 2025 fiscal package come closer, which could motivate a more cautious stance by Banxico’s Governing Board. Finally, given the inflation expectations of private sector analysts above the target, the Governing Board will continue to reinforce its commitment to the objective of price stability.

—Rodolfo Mitchell Cervera, Brian Pérez & Miguel Saldaña

PERU: BCRP SURPRISES WITH AN UNCHANGED REFERENCE RATE

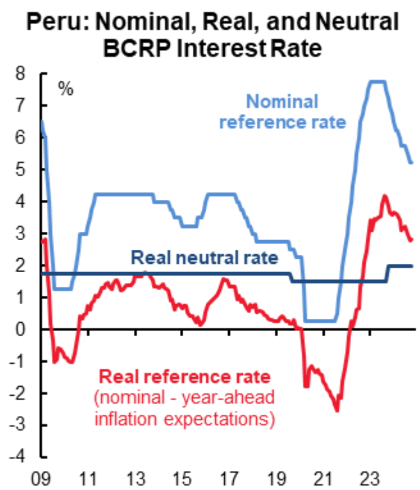
The board of the Central Bank of Peru (BCRP) kept the local rate unchanged at 5.25%, when market consensus (Bloomberg median) and our expectations saw a continuation of the 25bps interest rate cuts. We maintain our estimate of 5.00% by year-end.

The statement does not explicitly state the reason for the decision, although there are interesting points to consider.

The first relates to the decrease in monthly inflation in September (-0.28% headline, and 0.00% core). However, the BCRP estimates that headline inflation will increase during 4Q24, which is expected to be transitory due to a base effect. This should not be concerning, We were always expecting an increase in inflation due to low comparison level in October (headline inflation of -0.32% m/m in 2023 vs 0.13% 20-year average) and November (headline inflation of -0.16% m/m in 2023 vs 0.10% 20-year average).

A second element is core inflation. The BCRP highlighted in its statement that core inflation is above the midpoint (2%) of the target range, unlike in the previous statement, where it indicated that core inflation was within the target range (1%–3%). Rather than a reason for the pause, this could have been used as a justification for pause the rate cut cycle.

Chart 3



Sources: Scotiabank Economics, BCRP.

Finally, the BCRP toughened its wording regarding the international context. The statement suggests that an intensification of international conflicts could drive fuel prices higher. By keeping the reference rate at 5.25%, the spread with the Fed rate is now positive (+25 bps), and the real interest rate remains at 2.8%, approaching the 2.0% considered a neutral level. However, this still reflects a restrictive stance.

—Ricardo Avila