Scotiabank

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Latam Daily: Peru and Colombia Macro; Chile Central Bank Preview

- **Chile: We expect a 25bps cut at the October 17 BCCh meeting, but accompanied by a message of caution**

Sliding oil prices on the Washington Post reporting yesterday that Israel has agreed to not hit Iranian oil or nuclear facilities has driven a strong bull flattening in the global rates complex in overnight trading. EGBs are bid 4–6bps across the curve with German debt underperforming a touch, while gilts are behind by a couple of bps in the front end versus continental peers after a slightly stronger than expected jobs report—but still gaining 2–5bps at all tenors. USTs are reopening after the holidays with a pronounced bull flattening (2s -1bp, 30s -6bps), with few items on the G10 calendar due to shape global debt prices until remarks by the Fed's Daly and Kugler in late/post-London hours; the impact of Canadian CPI at 8.30ET will likely be limited to local markets.

The 'less risky' war backdrop is not obviously reflected in risk barometers, however, as the USD sits mixed against the major currencies, where yields-sensitive FX like the JPY and CHF outperform, gaining on the USD, while commodity currencies like the AUD and NOK lag with small losses. The MXN is the worst performing major on the day, shedding 0.5% to move back into the mid-19s area where it traded prior to Friday's US jobs report. European stock indices are losing about 0.5% in the main Eurozone and UK aggregates, while SPX futures trade slightly weaker after solid 0.8% in cash markets yesterday. Likewise, iron ore and copper are down 1.5–2%.

WTI oil is an additional 5% lower this morning, trading just below the $70/bbl mark for the first time since early-October, adding to a late-Monday 3% loss on the Washington Post reporting that "Israeli Prime Minister Benjamin Netanyahu told the Biden administration he is willing to strike Iranian military targets rather than oil or nuclear facilities." Kan News also reported this morning that PM Netanyahu and MinDef Gallant have agreed to the intensity and timing of Israel's retaliation—pending cabinet approval. Headlines on what this retaliation may be and/or when will likely see sharp moves in markets.

We get a bunch of data out of Colombia and Peru at 11ET, and little else in the region. Colombia's DANE will release industrial/manufacturing production and retail sales data for August that is expected to show a y/y contraction in industrial output of close to 2% (after a surprisingly strong July for manufacturing) in contrast to an acceleration in retail sales from 1.6% to the mid-2s that would represent the best y/y print for the sector since late-2022. The data will help us refine forecasts for Friday's monthly economic activity print. As for Peru, our team in Lima previewed today's GDP and unemployment data in yesterday's **Latam Daily**, expecting a strong 3.7% y/y rise in output (vs 3.4% median) based on already published electricity, government spending, and imports figures.

—Juan Manuel Herrera

CHILE: WE EXPECT A 25BPS CUT AT THE OCTOBER 17 BCCH MEETING, BUT ACCOMPANIED BY A MESSAGE OF CAUTION

- **The market may assign a lower probability to a new policy rate cut in December**

We expect a further 25bps cut in the monetary policy rate by the central bank (BCCh) on October 17th. However, two sources of risk lead us to expect a more cautious message in the statement that could be interpreted as an eventual pause in the December meeting.

On the one hand, there are less benign external conditions stemming from geopolitical risks and inflation in the US in an economy that has not yet shown clear signs of a

decrease in excess demand. Indeed, the rise in oil prices together with a possible escalation of the war situation in the Middle East are elements that advise caution. Proper risk management suggests waiting before continuing successive rate cuts. Although freight rates costs have come down from the levels observed in the September meeting, which were a source of concern for the BCCh at the time, we cannot rule out that a worsening of the geopolitical situation could lead to further increases. On the external front, US inflation is not good news for the Fed as seasonally adjusted annualized inflation accelerated from 3.4% in August to 3.8% in September. The US economy appears to remain in excess demand, with an output gap above 1% of potential GDP and, in the best-case scenario, the Fed will cut only 25bps. While that is part of the BCCh's baseline scenario (a further 25bps cut), the balance of risks would be pointing towards assessing eventual pauses by the Fed which would also suggest a similar move by the BCCh.

On the other hand, there are the GDP and inflation figures, together with the derivative for domestic demand of a fiscal budget that would expand close to 4% in real terms by 2025. In terms of economic activity based on August GDP, the reading is not negative as it seemed to be read by the market as it reaffirms GDP growth of 2.5% for 2024 but with a slight upward bias (Scotia: 2.7%). Seasonal effects tended to normalize in August, which is evident when comparing the y/y GDP growth figure with its seasonally adjusted counterpart. The seasonally adjusted annual growth was 2.8%, similar to that of July, which positively surprised expectations. Moreover, the August GDP also revealed a rather negative transitory impact of supply factors (Escondida strike, rains in the Metropolitan Region and suspension of classes in schools). This will be evident in the September GDP, which will be around 1.5% y/y, marking a relevant difference with respect to the base scenario of the BCCh, which confirms a Q3-2024 GDP growth of around 2.5% y/y (IPoM: 2.1% y/y). In terms of activity, we should have a somewhat more reassuring reading from the Board in the statement, which would allow eventual pauses in a path towards the neutral policy rate.

Regarding inflation, the September CPI reveals that "everything is in line with expectations", and although annual inflation could be somewhat below the 4.5% projected in the BCCh's baseline scenario, this would not be guaranteed given the recent depreciation of the CLP, the rise in international fuels prices and the increase in electricity tariffs in October, which could eventually generate second round effects given that it accumulates with the previous increase in tariffs observed in the middle of the year. In Q3-2024, annual inflation was below the IPoM forecast (4.3% vs. 4.4% projected), as well as at the headline level (3.6% vs. 3.7% projected). At Scotiabank we believe that the economy has little room for second round effects, but from the BCCh's perspective, with adequate risk management in a context of a real policy rate around 0%, it would be advisable to raise a message of caution.

The new element to assess in the December IPoM is the expansion of public spending in 2025 in conjunction with the spending cut in this last quarter of 2024. The BCCh's reading for the October meeting will not consider the quantitative impact on domestic demand as we must wait for the last quarter's IPoM, but the biases appear to be clearly bullish given the 3.8% real expansion in public spending in 2025 that we estimate at least 1.4 ppts above that contemplated in the base scenario of the September IPoM (Q2 Public Finance Report, input for the September IPoM: 2.4% spending growth for 2025). While this expansion has a relevant incidence of public investment, biasing upward the total investment growth projection for 2025 (at Scotiabank we project total investment expansion between 5% and 8% in 2025), it also has an upward bias of current spending over the domestic demand growth projection of the BCCh. Specifically, the IPoM notes that based on a real expansion of fiscal spending of around 4% for 2024, "a downward trajectory for the real growth of this variable continues to be anticipated for the coming years" (page 31 of the September IPoM). Considering that spending will grow 3.5% this year and an expansion of 3.8% as proposed in the 2025 budget, this "downward" trajectory assumed in the IPoM would not be fulfilled.

All of the above scenarios occur in the midst of a new CLP depreciation that, we estimate, would be placing the spot RER at the high end of the range consistent with its fundamentals (estimated spot RER: 104) and in a direction opposite to that expected in the BCCh's baseline scenario. Recall that the central bank envisaged a (slight) appreciation of the peso in the policy horizon according to the September IPoM.

Risks to take the policy rate through the upper part of the corridor could be materializing. According to the risk analysis conducted in the IPoM, a scenario with greater inflationary pressures, due, among other reasons, to greater domestic demand driven by the dynamism of mining investment, would imply placing the rate in the upper part of the corridor. That is, an eventual maintenance of the policy rate in December. Additionally, one of the sensitivity scenarios contemplated in the IPoM that would take the rate outside the limits of the corridor considers precisely a "recrudescence of the different geopolitical conflicts in progress". Both events, which we believe would be materializing, would support some caution with a monetary policy path somewhat more consistent with a maintenance of the benchmark rate at the December meeting.

With this set of information, we expect that the BCCh will make a 25bps cut at the meeting to take place this month, but that it will accompany this decision with a conservative and cautious bias that would have an upward impact on market rates. We expect that the market reading will lead to put in check a further rate cut in December, even though it could materialize in the event of a rapid easing of the geopolitical situation, an appreciation of the CLP and moderate inflationary records in October and November.

—Aníbal Alarcón

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