Scotiabank

GLOBAL ECONOMICS

LATAM DAILY

January 6, 2023

Contributors

Juan Manuel Herrera
Senior Economist/Strategist
Scotiabank GBM
+44.207.826.5654
juanmanuel.herrera@scotiabank.com

Guillermo Arbe, Head Economist, Peru
+51.1.211.6052 (Peru)
guillermo.arbe@scotiabank.com.pe

Sergio Olarte, Head Economist, Colombia
+57.1.745.6300 Ext. 9166 (Colombia)
sergio.olarte@scotiabankcolpatria.com

Jorge Selaive, Head Economist, Chile
+56.2.2619.5435 (Chile)
jorge.selaive@scotiabank.cl

Eduardo Suárez, VP, Latin America Economics
+52.55.9179.5174 (Mexico)
esuarezm@scotiabank.com.mx

TODAY'S CONTRIBUTORS:

María (Tatiana) Mejía, Economist
+57.1.745.6300 (Colombia)
Maria1.Mejia@scotiabankcolpatria.com

Jackeline Piraján, Senior Economist
+57.1.745.6300 Ext. 9400 (Colombia)
jackeline.pirajan@scotiabankcolpatria.com

Latam Daily: Chilean Inflation Slows, but Slightly Beats

- **Colombia: Inflation upside surprise increases the odds of a 100 bps hike**

There were limited developments overnight to drive market sentiment, which is weak to neutral (more so reflected in currency markets), as we await US nonfarm payrolls data at 8.30ET. Reports of China easing restrictions on lending by property developers had limited spill-overs into cautious global trading; commodities are mixed as base metals trade stronger against minor losses in crude oil.

The USD is stronger across the board and most notably versus the JPY which marginally reached its weakest level since Dec 20 overnight. Eurozone inflation data (with core CPI exceeding estimates) having no notable impact on global yields. The MXN is unchanged while **the CLP is down 0.3% in early dealing after this morning's minor inflation beat** (see below).

Yesterday, **Banxico's meeting minutes reflected a relatively more neutral bias than expected, leading our Mexico team to lean towards a 25bps call** for the bank's February meeting (see **Latam Flash**). Mexico's Finance Ministry has finally chosen a replacement for dove Gerardo Esquivel, with **Omar Mejia selected to join the five-member board** after acting as an adviser to it since 2019. Mejia's professional background suggests that he will not be a controversial pick for the board and will approach rates-setting with a solid fundamental monetary policy approach. His nomination now requires the Senate's seal of approval before he can join Banxico's board for its February meeting.

Chilean inflation released this morning beat economist estimates while slowing to its lowest monthly rate since February. The 0.3% m/m increase was above ours and the median economist's projection of a 0.2% gain in headline CPI, with a 0.2ppts beat in year-on-year inflation vs consensus, coming in at 12.8% y/y (we had projected 12.7%).

Excluding volatile items, prices in Chile rose 0.3% representing the smallest monthly gain since late-2021 aside from October's 0.1% increase. This also marked a notable decline from November's increase of 0.9%. Seasonality aside, **price gains in Chile have clearly slowed on a month-on-month basis** despite y/y inflation holding around 13%. A rough (own) seasonal adjustment shows that m/m CPI ex volatile items inflation has decelerated from 1% in May (3-mth moving avg) to 'only' 0.5% in December.

Today's data are roughly in line with economists' and traders' expectations in the central bank's surveys, so **the print should not materially impact the outlook for the BCCh's meeting in late-January**. Now, whether the bank decides to hold rates unchanged and tee up an April cut or whether it decides to cut this month remains to be seen and may depend on the evolution of macroeconomic data published in coming weeks. **Our Santiago team's bias is for a minor reduction in the bank's policy rate.**

Note that **Boric's government announced yesterday a USD2bn social aid package** for 2023, including a doubling of annual cash transfers to poor and middle class families among other measures. The country's Finance Minister Marcel indicated that this spending will come from the country's 2023 expenditure budget as well as with measure that will be unveiled next week; he also claimed that the support will have no inflationary impact (which remains to be seen).

—Juan Manuel Herrera

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COLOMBIA: INFLATION UPSIDE SURPRISE INCREASES THE ODDS OF A 100 BPS HIKE AT JANUARY'S BANREP MEETING.

Colombia's pace of monthly CPI inflation was 1.26% m/m in December, according to DANE data released yesterday. The result was well above the BanRep survey (0.82% m/m) and Scotiabank Economics' projection of 0.84% m/m. The main contributor to monthly inflation was food and restaurants & hotels, which increased by 2.66% m/m and 2.51% m/m, respectively, contributing 0.52ppts and 0.26ppts headline inflation.

Year-on-year inflation increased from 12.53% in November to 13.12% in December, reaching its highest figure since March 1999. Core inflation increased from 9.48% to 9.99% (chart 1). In the same vein, inflation ex-food and regulated prices increased from 8.70% to 9.51%, showing that despite the main contributor to the inflation being food, some demand forces have also pressured core prices higher.

The inflation surprise has changed our expectations for BanRep's policy rate. The odds of a 100bps hike in January BanRep's meeting is now elevated. There is still a chance that inflation will reach a ceiling in Q1-23, mainly due to a historically-high statistical base level. **If inflation steadies in January and February, Banrep may be allowed to consider a pause at the March meeting** to wait and see the effects of the hiking cycle on the economy. However, we expect Banrep to continue with a data-dependent approach in January's statement.

Looking at December's numbers in detail, all the twelve aggregated components of the CPI basket contributed to higher inflation (charts 2 and 3), and the food group was again the main contributor.

Highlights:

- **Foodstuffs inflation was again elevated**, showing a 2.66% m/m figure, resulting in a **contribution of 0.52 ppts to overall inflation**. The atypically strong rain season is impacting the productivity of the agricultural sector in many products. In December, the price gain was led by potatoes (+17.32% m/m), tomatoes (+27.90% m/m) and bananas (+13.27% m/m), milk (+3.85% m/m), and rice (+4.18% m/m). These are domestically produced goods, and prices reflect the effects of more moderate crops due to the high costs of inputs and the weather effects.

- **The second most significant contributor to headline inflation (+0.26 ppts) was the restaurant and hotels group** (+2.51% m/m). Restaurants' inflation usually reflects the passing of input costs (food) but also demonstrates the effect of still robust domestic demand in the context of the most important holiday in Colombia. In the case of hotels, the inflation was 4.60% m/m, almost double what was observed one year ago.

- **The third main contributor was the transport group** (+1.22% m/m and contribution of 0.16ppts). The transport group is not only reflecting the effect of the holiday season, it still also shows the FX passthrough and higher international costs in items such as vehicles which in the last three months had increased above the 2% m/m monthly, which is not usual. Gasoline prices contributed 0.6ppts as expected due to the monthly increase of COP 200 per gallon, but in 2023 gasoline prices will increase by twice as much since the government established increases of COP 400 per gallon in January.

- **In December, again, we observed an asymmetric response between goods and services inflation. Goods inflation is increasing at a more accelerated pace than services inflation, which highlights the contrast in supply and demand sources of inflation**. Goods inflation rose from 13.93% to 15.04% y/y (accelerating by 1.11 ppts) while Services prices increased but at a slower pace of 0.54 ppts from 6.87% y/y to 7.41% y/y.

- Note that regulated prices decelerated again to 11.77% y/y from the previous 11.95% y/y last month due to lower electricity prices after the agreement between the government and energy distributors.

- Inflation for the low-income population closed in 2023 at 14.92% y/y, well above the country average of 13.12% y/y. Since the increase in the minimum wage was 16%, the population would start to discuss that this increase was not enough, increasing the pressure on the Government. For now, we expect the Government to deliver some enhanced social programs in the budget addition in February, in which the Government will reveal how they will use the additional income from the tax reform.

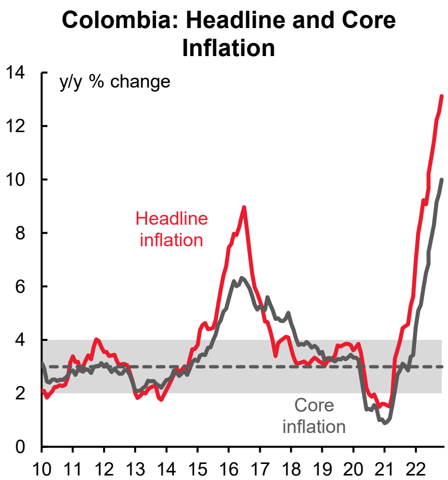
December's CPI data has placed additional pressure on BanRep to continue with its hiking cycle. Our base case scenario is biased towards a 100 bps hike in light of this big inflation upside surprise.

The main challenge for inflation in 2023 concerns indexation to the minimum wage increase (16%) in some labor-intensive services. And indexation in some items, such as rental fees, to December's inflation of 13.12%. However, in Q1-2023, we still see the possibility of inflation reaching a ceiling and starting to decrease moderately due to historically high statistical base effects. **In any case we do not see headline inflation going below double-digits before September 2023.**

Average inflation in 2023 would be above 10%, making it hard for Banrep to discuss a cut. **That said, we expect BanRep to hike to 13% in January, and in March, the possibility of a pause will be alive if headline inflation stabilizes.** However, a cut discussion will come until the inflation reaches a single digit which would be in Q4-2023.

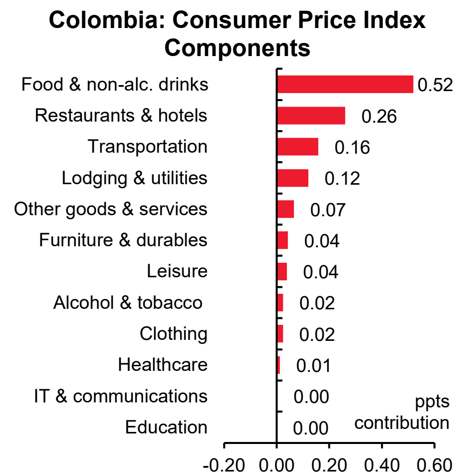
—Sergio Olarte, María (Tatiana) Mejía & Jackeline Piraján

Chart 1



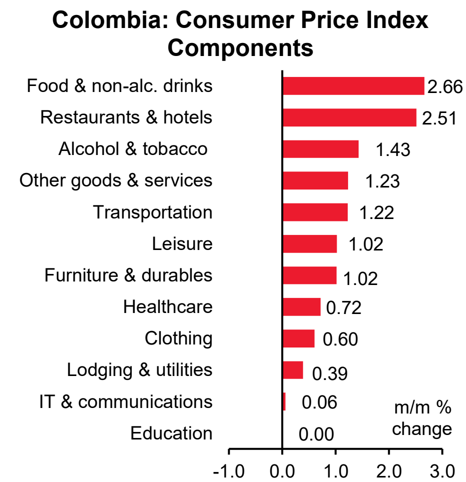
Sources: Scotiabank Economics, DANE.

Chart 2



Sources: Scotiabank Economics, DANE.

Chart 3



Sources: Scotiabank Economics, DANE.