Scotiabank

GLOBAL ECONOMICS

LATAM DAILY

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Latam Daily: Mexican Inflation Misses Expectations; BCRP to Hold (Again)

- **Mexico: February inflation comes in below forecasts**
- **Peru: BCRP would maintain its reference rate in pause mode, given signs that inflation is stabilizing**

Limited overnight developments and little of note in the US day ahead leaves markets trading aimlessly while we await tomorrow's key US nonfarm payrolls print. US equity futures are off about 0.3%, marginally weighed by Biden's tax plans which are, however, highly unlikely to succeed with the House under Republican control. More details are due later today when the Administration reveals its full plans. From a data standpoint, markets will only have US jobless claims and Challenger jobs cuts (both relatively secondary releases) to monitor.

Crude oil is a touch firmer, while iron ore and copper trade mixed (up 0.5% and down 0.3%, respectively). European yields gapped higher in line with the move in US hours with a steepening bias also reflected in USTs—where 2s are down 4bps but holding above 5%, while 10s are only down 1bp. The USD is broadly lower, seemingly amid the market calm, with the JPY leading on a 0.8% gain (nearing 136) on some possible profit taking in the dollar as well as preparations for tomorrow's BoJ announcement—Kuroda's last, which should nevertheless see no change.

The MXN marked a new high in the cycle this morning (just below 17.90). However, its outperformance among the majors overnight has been trimmed (to a 0.3% gain) by a softer-than-expected February inflation reading published this morning (see below), which reduces the odds of another half-point increase by Banxico in late-month. The bank's guidance on their intention to reduce the pace of adjustments also remains an important claim against betting fully on a 50bps increase. Note that Dep Gov Borja highlighted yesterday the importance of a strong MXN on price pressures via imports though not necessarily in other areas. The lukewarm backing of the peso's strength had limited impact on the currency in spot markets.

In Latam, we're looking ahead to the BCRP's decision (see below) at 18ET where a rate pause is widely expected in line with guidance from policymakers and the last two inflation readings coming in below expectations.

In a mostly unexpected result, Chile's lower house rejected yesterday the government's tax reform proposal as support for the bill fell five votes short of the 78 votes required in favour. The government may still present the initiative in the Senate, but as things stand the current text is bound to fail unless important changes are made. Our economists in Chile believe it likely that the government will choose to split the reform bill into separate issues that face better prospects while entering into negotiations on more contentious matters.

—Juan Manuel Herrera

MEXICO: FEBRUARY INFLATION COMES IN BELOW FORECASTS

Mexico's February inflation missed economist expectations in data published this morning, at 7.62%, below the previous reading of 7.91% y/y. Of note, core inflation also came in lower than expected, at 8.29% vs 8.35% expected and slowing from the January pace of 8.45% y/y; still, it remains above the headline gauge. Slowing y/y increases in fresh food and energy helped ease the pressure on headline inflation, but services price gains accelerated to 5.55% y/y, a marginal new high in the current cycle (5.51% in January). The m/m gains of 0.56% and 0.61% m/m in headline and core inflation missed (vs median estimates of 0.62% and 0.66%, respectively) as the H2-Feb data came in significantly softer than expected; core CPI, for instance, only rose 0.16% vs 0.26% projected and in contrast to the H1-Feb gain of 0.35%. A strong deceleration in processed foods ad beverages (from 1.25% to 0.68%) stands in contrast to an acceleration in services prices (though here education posted a seasonally-large increase that reflects prior inflation).

Last week, in its *Quarterly Inflation Report*, Banxico's board mentioned that price indexation to high inflation could be one of the reasons that explain core inflation stickiness (see education). Aside from that, our guess is that uncertainty regarding the full impact of pensions and minimum wage reforms has firms waiting to see how much they can adjust their prices downwards. Adding more fuel to the fire, Powell's hawkish remarks in Congress led markets to believe that Banxico's terminal rate could be closer to 11.75% (in line with our expectation).

As of now, we still want to believe Banxico's latest guidance that they intend to "reduce the pace of upward adjustments" and we expect 25bps for the decision in March. Today's print reduces the odds that the bank chooses to go ahead with a 50bps hike, though incoming data (e.g. the March 23 H1-Mar inflation release) as well as the outlook for the Fed remain key influences on the bank's decision.

—Luisa Valle

PERU: BCRP WILL KEEP ITS REFERENCE RATE PAUSE GIVEN SIGNS THAT INFLATION IS STABILIZING

We expect that the BCRP will leave its reference rate unchanged at 7.75% at its meeting on Thursday, March 9, in line with the Bloomberg consensus. Julio Velarde, the head of the BCRP, recently stated that "a 7.75% level or very close to this is enough to control inflation without causing a recession". Inflation stabilized in February, marking two months below market expectations. The BCRP, like us, projects a clear decline in inflation beginning in March, which will prompt the bank to likely continue with an unchanged reference rate at the 7.75% level established in February.

The February statement showed greater concern about economic weakness caused by social unrest, reflected in roadblocks which affected supply chains—mainly in the south of the country—and perishable foods prices. The intensity of this problem is currently lower, but it is set to impact the performance of the economy in Q1-2023. Velarde said that January GDP would fall -1.4% y/y and that the central bank will revise its 2023 GDP forecast in the next Inflation Report (probably March 17). Back in December, the BCRP penciled in a 2.9% GDP forecast for 2023.

March inflation will be pressured higher due to seasonal factors (education) and by the impact of the avian flu on poultry prices, though we expect a decline in year-on-year terms. In February, inflation accumulated 21 months outside the target range, matching the previous record episode. Inflation expectations twelve months ahead returned to the level reached in December 2022, from 4.6% in January to 4.3% in February according to the latest BCRP survey—still staying well above the target range (between 1% and 3%). The BCRP modified its view on inflation by end-2023, noting that it could be slightly greater than 3% (3.1%) and pointing towards 2.4% by end-2024. Our inflation forecast is unchanged at 5.00% for year-end.

—Mario Guerrero