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GLOBAL ECONOMICS

LATAM DAILY

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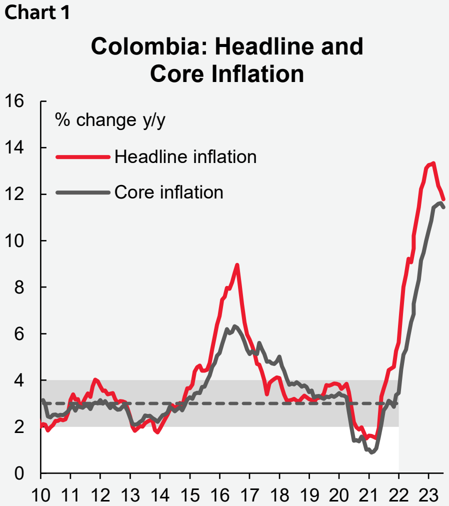
Chart 1



Sources: Scotiabank Economics, DANE.

Latam Daily: Colombian Inflation for July Above Expectations; BCRP Decision Preview

- **Colombia: Annual headline inflation decreased less than expected but core inflation went down for the first time since October 2021**
- **Peru: Focus on the BCRP statement, future rate cut would be on the horizon**

COLOMBIA: ANNUAL HEADLINE INFLATION DECREASED LESS THAN EXPECTED BUT CORE INFLATION WENT DOWN FOR THE FIRST TIME SINCE OCTOBER 2021

Colombia's pace of monthly CPI inflation was 0.50% m/m in July, according to DANE data released on Tuesday, August 8th. The result was well above analyst expectations in the BanRep survey (0.30% m/m) and above Scotiabank Economics' projection of 0.37% m/m. The upside surprise came mainly from food inflation, which in July was positive by 0.22% m/m, probably reflecting the effect of the interruption in regular operation amid landslides in relevant roads. Lodging & utilities and transportation remain the main upside driver of inflation, especially due to increases in rent fees, which reflect indexation effects and gasoline prices.

Year-on-year headline inflation decreased for the fourth month, from 12.13 % in June to 11.78% in July (chart 1), the lowest since September 2022. However, headline inflation decreased less than expected. Core inflation showed its first reduction since October 2021; ex-food inflation decreased from 11.62% to 11.44%, while ex-food and regulated inflation was 10.22% y/y, also decreasing from the previous register of 10.51% y/y, especially due to a moderation in tradable goods inflation. Either way, both headline and core inflation remain well above BanRep's target (3%). The previous dynamic affirms our expectation that BanRep won't consider rate cuts in September. Our official call is to start rate cuts in October; however, the start of the easing cycle could be delayed if inflation fails to show further improvement. Our current projection shows that Colombia could have single-digit inflation only by the end of the year (November), which is still a very high number versus the central bank target (3%) and represents a risk for inflation inertia due to indexation effects for 2024.

Regulated prices, especially gasoline and eventually diesel prices, El Niño weather phenomenon, and minimum wage negotiation remain the main risk factors that could prevent BanRep from starting the easing cycle. On the other side, the economic activity deceleration and FX appreciation could favour lower inflation. That said, the data-dependent approach that BanRep is taking is expected to continue, and only a scenario of further reduction of inflation and inflation expectations could trigger the easing cycle.

Today's surprises demonstrate that inflation reduction is still fragile, and there is still a significant uncertainty ahead that moderates recent bets about a rate cut coming in September.

Looking at July's numbers in detail, food inflation was the only group that showed monthly contractions (charts 2 and 3).

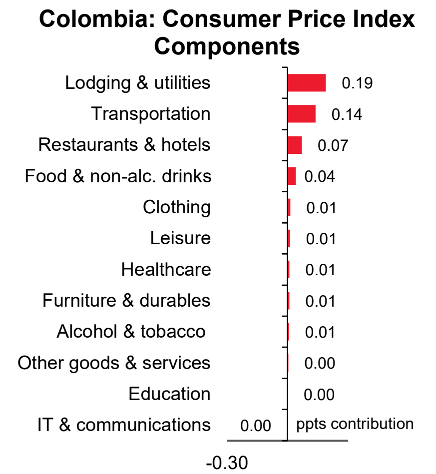
The highlights are:

- The lodging and utility group was the main contributor to the upside to monthly inflation. The group posted a +0.62% m/m and +19 bps contribution. Rent fees continued increasing, however, at a slower pace than last month (+0.53% m/m in July vs. 0.61% m/m in June), showing that indexation effects are moderating their impact as the year passes, although they are still present. Utility fees were increased by 0.91% m/m; gas fees decreased by 0.91% m/m. However, it was offset by increases in utility fees (+0.51% m/m) and water (+2.41% m/m).

- The second most significant contributor to headline inflation was the transportation group, showing a 1.07% m/m figure and a contribution of 0.14 ppts to overall inflation. Gasoline prices (+4.84% m/m) contributed 14 bps in the monthly inflation due to the 600 pesos increase. We expect the government to continue increasing gasoline prices at a 600 pesos pace until the end of the year; however, by this time, the big question is if the government will decide to increase diesel prices, which is a material risk to the upside due to the potential secondary effects on other key items in the CPI basket.
- The transportation group continued showing an interesting dynamic derived from the FX appreciation and weaker demand: vehicle inflation was -0.19% m/m, the first monthly contraction since January 2019. The vehicle sector is showing the effect of a lower demand since new car sales have contracted more than 40% y/y, and a trend of sellers trying to renew inventories at a lower FX level.
- Foodstuff inflation surprised to the upside, showing a 0.22% m/m inflation. Price reductions are leveling off in many items; in fact, in July, 25 out of the 59 references in the basket reported a m/m reduction, however this time, that reduction was offset by significant increases in fruits (+4.96% m/m), chicken (+0.47%) and meat (+0.50% m/m). It is relevant to note that inflation has eased, mostly explained by food inflation. However, today's results prove that those prices are very volatile, and the cumulative progress observed in recent months could face sudden challenges. In the short/medium term, the main challenge is the El Niño weather phenomenon. However, we estimate that the potential upside impact on food prices could start to be reflected in H1-2024 if this phenomenon proves to be intense.
- Inflation by main groups: out of the 188 CPI items, 53 posted negative m/m inflation (~28% of the total basket). Goods inflation decreased from 14.26% m/m to 12.84% m/m, signaling that tradable goods are starting to contribute to lower inflation. Services inflation increased from 9.04% y/y to 9.19% y/y as a result of still material indexation effects in labour-intensive sectors.

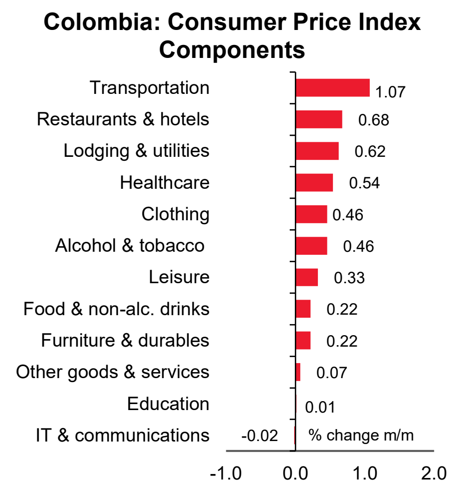
—Sergio Olarte, Jackeline Piraján & Santiago Moreno

Chart 2



Sources: Scotiabank Economics, DANE.

Chart 3



Sources: Scotiabank Economics, DANE.

PERU: FOCUS ON THE BCRP STATEMENT, FUTURE RATE CUT WOULD BE ON THE HORIZON

We expect the BCRP to leave its key rate unchanged at 7.75% at its meeting this Thursday, August 10th, in line with the market consensus according to a Bloomberg survey. However, this time we are not so convinced of it. We see economic reasons for the BCRP to start the rate cut cycle, although the absence of signals makes it difficult to predict the timing, so a 25bp cut would not be entirely surprising.

Regardless of the decision to move interest rates, the focus will be on the signals issued by the statement, since forward guidance has so far not shed any light on the future trajectory expected. We hope that the BCRP's statement contains explicit concern about economic weakness, considering that the MoF recently reduced its economic growth forecast for this year from 2.5% to 1.5%, and the market consensus from 1.8% to 1.3%, according to a BCRP survey. This could be interpreted as a sign that the BCRP would be open to a possible advance in the cycle of interest rate cuts. The BCRP's growth forecast is 2.2% and would be revised in its September inflation report. That is probably the right time to start the rate cut cycle.

Based on the signals in the BCRP's statement, we will evaluate changes to our baseline scenario. Our forecast assumes the start of the interest rate cut cycle during Q4-2023, but we see reasons for the BCRP to bring it forward, despite the risks posed by the proximity of the El Niño phenomenon and the recent increase in oil prices. We see that it has room to add cuts of 25bps, without altering the stance of monetary policy. Year-on-year inflation continued to decline in July, in line with official estimates, core inflation accumulated four months close to its historical average, and 12-month inflation expectations continued to decline. Although the direction of these metrics contributes to a scenario of the beginning of the rate cut cycle, the levels are still far from the target range (between 1% and 3%).

The decision does not seem so simple and the BCRP would evaluate it with caution. The Latam context favours it, after Chile and Brazil have already started their respective cut cycles, although this does not necessarily condition the BCRP. Although the economic weakness is a factor to consider, the BCRP will prioritize the performance of inflation—which so far in August would contribute to a further slowdown—as well as the future risks on prices derived from the increasing probabilities of an El Niño phenomenon.

—Mario Guerrero