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Latam Daily: Colombia and Peru Macro; BCRP Recap

- **Peru: BCRP cuts rate for the fourth consecutive time, inflation under control**

Treasurys, currencies, equity futures, and crude oil all moved in relatively narrow ranges in Asia hours, getting a break from the sharp moves seen over the week with the parade of central bank decisions and key data, until rates caught a bid with the release of weaker-than-expected Eurozone PMIs. The PBoC injected a net CNY800bn against expectations that it would reduce funds under the 1-yr MLF, but the broad market barely blinked. G10 markets await the US PMIs and industrial production, Canadian housing starts, and a parade of central bank speakers.

USTs are slightly bull steepening compared to bull flattening EGBs (after a weak open in front-end to catch up to US). The USD is mixed as the EUR underperforms down 0.3% after the weak PMIs while high-beta FX outperform (NOK and AUD leading) likely reflecting the PBoC's move. However, the MXN is among the laggards, down 0.2% tou roughly trade only a touch better than pre-Banxico levels (see our report **here** on the hawkish hold). US equity futures are up 0.2/3%, ESX is up 0.8% while FTSE is down 0.3%. WTI/Brent and copper are 0.5% higher, but iron ore is flat.

In Latam, Colombia and Peru data at 10ET is the highlight. Banxico will also publish the results to its economists survey, but these will likely be stale as guidance or comments (and the November meeting minutes) ahead of the yesterday's decision, and thus before the survey, suggested that Banxico was eyeing a Q1 rate cut—it's now not as certain. AMLO will today inaugurate a leg of the Maya Train in Campeche, so there's a risk of political rhetoric coming out of the event.

From Colombia, we get November data for manufacturing/industrial production and retail sales, and the results of BanRep's economists survey, all this ahead of Monday's monthly economic activity release, all to help us narrow our view of what BanRep may do on the 19th. Compared to October, economists expect smaller but still large declines in manufacturing and retail activity—which would be their ninth and eighth consecutive months of negative y/y growth, respectively. We'll keep an eye on the reaction in markets to, or experts' opinions to, yesterday's submission of a bill to Congress by Petro's government for the creation of a state mining company.

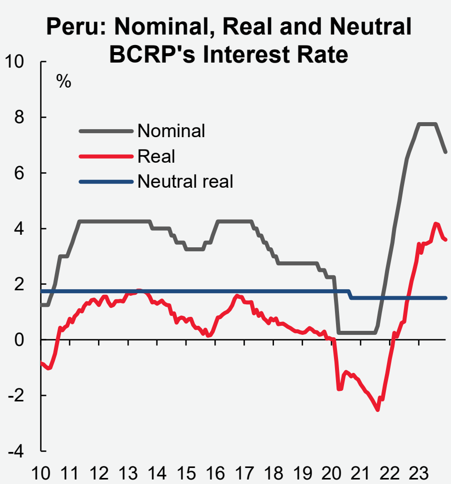
We estimate that October GDP data will show a 0.4% y/y contraction in output due to weakness in manufacturing and construction industries against a boost from the second fishing season of the year (the first one in May was cancelled). The median economist has a more negative view, expecting a 0.9% y/y drop. The (somewhat unreliable) unemployment rate is expected to hold at 6.6% for the capital region. No matter how you slice it, the Peruvian economy is in poor shape and more than supports the BCRP's decision to continue rate cuts, more so because of the positive evolution of inflation in the past few months (see our take on yesterday's decision below).

—Juan Manuel Herrera

PERU: BCRP CUTS RATE FOR THE FOURTH CONSECUTIVE TIME, INFLATION UNDER CONTROL

The board of Peru's Central Bank of Peru (BCRP) cut its key interest rate on Thursday, December 14th by 25bps, to 6.75%, in line with what was expected by market consensus, according to a survey by Bloomberg, and Scotiabank. In its statement, the BCRP once again emphasized that the rate cut "would not necessarily imply a cycle of successive cuts in the key rate," although the possibility of a pause on the horizon is increasingly less, due to more moderate signs of El Niño and because inflation is already under control according to the BCRP.

Chart 1

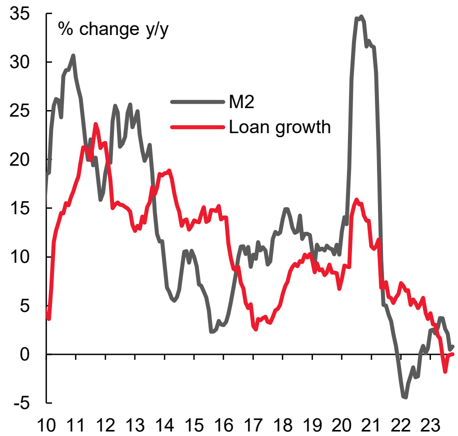


Sources: Scotiabank Economics, BCRP.

The BCRP statement confirmed the forecast that headline inflation will reach the target range within the next few months but added that core inflation will be within the target range starting this month. This message confirms what Governor Velarde previously stated regarding inflation being under control. Velarde went further by pointing out that he even sees it possible that the target range will be reached only in December, during the first quarter or towards April 2024. Velarde specified that "if there were an El Niño it would probably take us longer to reach the goal, but we would get there anyway". Although the statement repeated that since June a more marked downward trend in inflation has been observed, as some of the transitory effects due to supply restrictions dissipate, 30 months have already accumulated outside the target range (between 1% and 3%). Likewise, 12-month inflation expectations fell only slightly, from 3.3% to 3.2% in its last reading.

Chart 2

Peru: M2 vs. Loan Growth



Sources: Scotiabank Economics, BCRP.

We see it likely that the BCRP will reduce its inflation forecast of 3.8% for this year and maintain its forecast of 2.4% for next year in its next report, to be released on Friday, December 22nd.

Velarde pointed out that 2023 has not been a good year and that he hopes 2024 will be better. The BCRP warned that leading indicators and expectations about the economy showed mixed results in November, but the majority remained in the pessimistic range, and reiterated that "the shocks derived from social unrest and the El Niño event have had a greater impact on economic activity and domestic demand". The macroeconomic expectations survey reflects a new drop in the GDP growth forecast for this year from 0.2% to -0.1% on average, in line with our -0.2% GDP forecast. Expectations for 2024 GDP were stuck at 2.3% in the survey, in line with our forecast for 2024. Climate experts are lowering the odds of a Strong El Niño. Today the respective authority (ENFEN) publishes a new statement, where there will be a clearer vision of this event. If there is not a strong El Niño during the next year, there will be a significant recovery, Velarde noted. The first readings for December inflation suggest that it could drop from 3.6% to a range between 3.1% and 3.2%, below our current forecast of 3.6%. This new forecast is in line with what the authorities expected now. Food prices have been reversing the supply shocks of previous months, to which is added a lower impact of El Niño, whose temperature metrics fade during the latest readings. Likewise, the weakness of the economy would put pressure on a new decrease in core inflation, which would go from 3.1% to 2.9%, with which we agree with the BCRP, regarding the possibility of it returning to the target range after 24 months.

Our forecast remains under a moderate/strong El Niño scenario, the dominant probability until now, although we will evaluate a change of scenario if the reduction in the temperature anomalies that we have been observing until now is confirmed. The BCRP pointed out that the data indicate that the probability of a strong or very strong El Niño has fallen, so a lower economic impact is expected for 2024.

By cutting its policy rate to 6.75%, the real interest rate fell from 3.7% to 3.6% (chart 1), maintaining the restrictive stance of monetary policy, and still well above the neutral level (2.00%), accumulating 16 months in contractive territory. The monetary policy stance was maintained by reaffirming that, "if necessary, it will consider additional modifications to monetary policy". Our forecast for 2024 is for a cut of 200bps, to 4.75%, with a bias that the cut could be greater, if a more moderate impact of El Niño on inflation materializes.

Even though the cycle of interest rate cuts has already accumulated four months, monetary conditions continued to tighten until October, with a greater contraction of the currency (-6.7% y/y, in negative territory for 17 consecutive months) and liquidity (-1.0% y/y, in negative territory for the fourth consecutive month). Loans recorded a null variation for the second consecutive month, in line with the weakness of the economy and the still contractionary stance of monetary policy (chart 2).

—Mario Guerrero