

Contributors

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Latam Charts: Return of the Real Balance Effect

- **Protests in Peru this week highlight the dynamic between rapidly rising prices and the importance of controlling inflation. While the protests in Lima were triggered by rising fuel costs, steep increases in food prices could foment social discontent going forward.**
- **Russia’s invasion of Ukraine has already led to higher world prices for cereal grains and other key agricultural products. The expanding sanctions regime and the threat of counter sanctions creates the potential for further hikes in food prices.**
- **Price pressures stemming from these supply-side shocks highlight the impact of inflation on households’ purchasing power, both in terms of real income and desired real balances of financial assets. In this respect, the return of the real balance effect is likely to reinforce the need for independent, inflation-targeting central banks.**

Social protests in Peru incited by rising fuel prices naturally raise questions as to how the situation will evolve in coming days and whether the unrest seen on the streets of Lima might spread elsewhere in the Latam region. But the protests also focus attention on what economists refer to as the real balance effect and what it implies for economic performance over the medium term. In fact, you can expect to read a lot more about this effect in coming weeks as inflation erodes households’ real purchasing power.

As the Russian invasion of Ukraine enters its second month, attention increasingly focuses on the mounting evidence of war crimes perpetrated on Ukraine civilians. The moral outrage that the atrocities has justifiably generated will inevitably lead to additional sanctions, some of which have already been announced. And those sanctions will, in turn, inevitably animate promises of retaliation by Russia, including, ominously, the spectre of restricting exports of wheat and other cereals as well as edible oil crops. It would be folly to discount such threats.

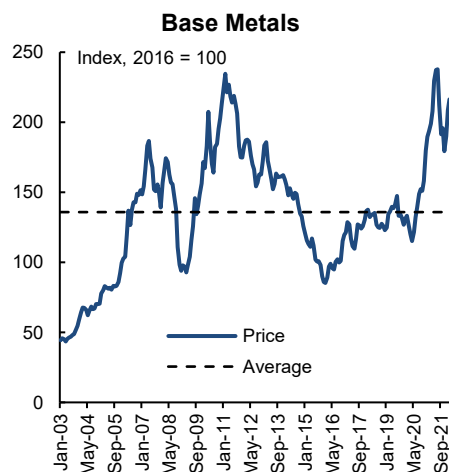
As shown in the chart panel below, global commodity prices had been trending up even before the Russian invasion. The realization of geopolitical risks has pushed these prices higher. And as has been argued in the past, the terms of trade effects of these developments are unlikely to be the same across all Latam countries. Moreover, the distributional consequences within a particular country could be significant. Employment and wages in mining may rise with higher base metal prices, for example, but increases in fuel energy costs and the price of foodstuffs could affect those not in the mining sector. A report by the Food and Agricultural Organization (FAO) of the UN released April 8 drives that point home. The FAO note that world food prices spiked in March to their highest level ever.

The use of foodstuffs as a strategic weapon, the deployment of which would disproportionately harm the world’s poor, could have potentially large impacts on household consumption and exacerbate the tensions that this week led to protests on the streets of Lima. As noted above, one reason for those impacts is that higher prices reduce the real value of households’ holdings of liquid financial assets.

This effect is separate from the erosion of real income (a flow variable), which obviously cannot be dismissed. In theory, if all prices are rising at the same rate, workers could demand higher wages to keep pace with the increase in the price level, such that real wages are unaffected by inflation so the economic effects are transitory. Though, in practice, getting those higher wages often entails costly strikes and an increase in labour militancy. This is because the price of a firm’s output may not be rising at the same rate as the cost of households’ consumption baskets so that granting wage increases implies lower profits.

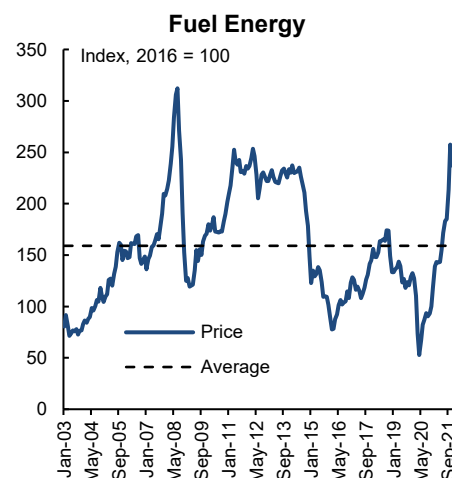
Panel 1: Commodity Prices

Chart 1



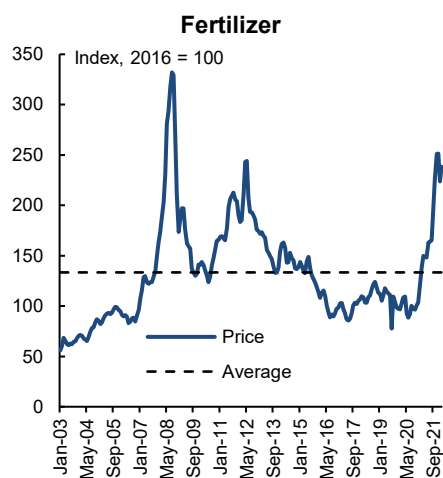
Sources: Scotiabank Economics, IMF.

Chart 2



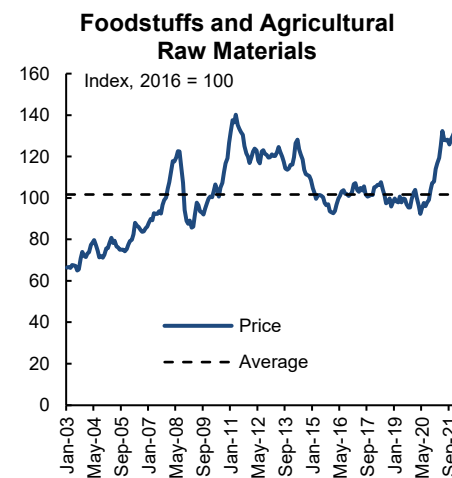
Sources: Scotiabank Economics, IMF.

Chart 3



Sources: Scotiabank Economics, IMF.

Chart 4



Sources: Scotiabank Economics, IMF.

In contrast, the real balance effect affects a stock variable with impacts that persist through time. These inter-temporal effects are typically explained in terms of a desired level of real balances of liquid assets that households wish to hold. With real balances defined by liquid assets divided (or “deflated”) by the price level, an inflation shock that raises the price level reduces actual real balances below the “desired” level. This shortfall in actual real balances relative to the desired level triggers an adjustment process that unfolds over time, one that requires a modification to planned consumption. In short, it requires that consumption be reduced relative to income until such time as equilibrium real balances are restored. That squeezing of consumption implies that, other things equal, aggregate demand is lower than would otherwise be the case, with clear implications for growth.

For central banks intent on delivering on their price stability commitments, this adjustment process is a double-edged sword. On the one hand, it contributes to the goal of disinflation. In the simplest possible model, if the central bank doesn’t accommodate the inflation shock, the decrease in consumption associated with the real balance effect will help dissipate price pressures, facilitating a timely and orderly return of inflation to target. On the other hand, uncertainty with respect to the mechanics of the real balance effect—the size of households’ “desired” real balances, the speed at which households aim to restore real balances, etc.—increases the risk of miscalculation in the calibration of monetary policy.

Unfortunately, the risk of miscalculation may be especially pronounced in the current circumstances. This is because the current inflation is, if not *sui generis*, unlike any episode in the past three-quarters of a century. The global pandemic has resulted in a series of

April 8, 2022

severe supply-chain disruptions, to which Russia's invasion of Ukraine has added. And because supply-side shocks differ from aggregate demand shocks in both raising prices and reducing output, central banks attempting to engineer a soft landing (reducing growth to bring down inflation while avoiding a recession) have less margin for error. Central banks acting too aggressively could tip the economy into recession, leading to higher unemployment and possibly fomenting social discontent; acting too slowly, however, or setting policy that is insufficiently restrictive, risks an acceleration of inflation as inflation expectations become unmoored.

Getting policy right in such circumstances is clearly a difficult challenge, one that is complicated by the legacy of the pandemic. In this respect, current price pressures may, to some degree at least, reflect the adjustment effect of real balances being above "desired" levels. It is possible, for example, that actual real balances are above desired levels owing to the extraordinary fiscal response unleashed by the pandemic, specifically assistance measures designed to insulate households from job losses. Combined with a strong labour market that reduces the probability of future unemployment, consumption spending on goods (as opposed to services) could thus be a manifestation of households adjusting real balances back down to pre-pandemic levels. And because of supply chain disruptions, this spending falls on highly-inelastic supply. It is little wonder then that prices have risen.

Needless to say, this excess real balances effect need not apply to all households in all countries, though that seems to be the inference from a recent [Federal Reserve Bank of San Francisco note with respect to the US](#). It certainly doesn't apply to Latam households living at or below the poverty line. Such "hand-to-mouth" consumers effectively spend all that they earn. As a result, higher inflation that is not matched by increases in incomes pushes them further into poverty. Growing social discontent is a possible outcome. The plight of such households underscores the need for governments in the region to respond quickly and appropriately to the erosion of real purchasing power with targeted fiscal measures. In Chile, the government recently [announced assistance](#) to shield the most vulnerable from the effects of higher inflation. Meanwhile, in Peru, on April 7th, Congress approved legislation exempting a number of key staples from the 18% sales, including chicken, eggs, milk, meat, wheat, pasta and sugar. Our team in Lima expects the legislation to be signed into law with little delay.

For the avoidance of doubt, the need to protect the most vulnerable from the effects of inflation does not militate for "activist" monetary policy. In the past, governments may have responded by expanding the money supply in an attempt to quell economic discontent. However well-intentioned such efforts may have been, they ultimately ended in higher inflation and even greater economic dislocation.

For countries in the Latam region, the adoption of inflation-targeting regimes by independent central banks created an effective guard rail against such policy mistakes. The return of the real balance effect is likely to demonstrate the wisdom of that decision.

Key Economic Charts

Chart 1

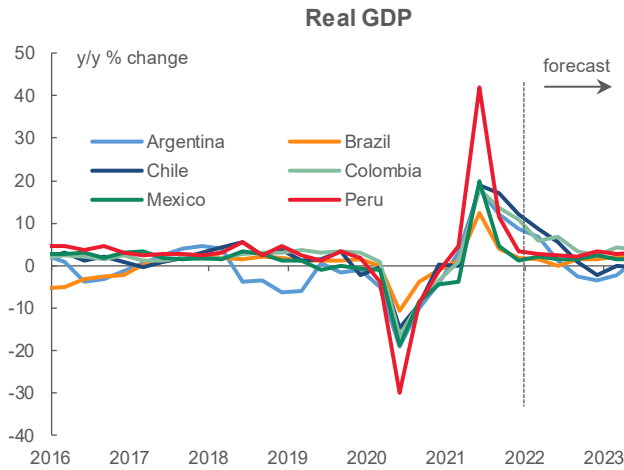


Chart 2

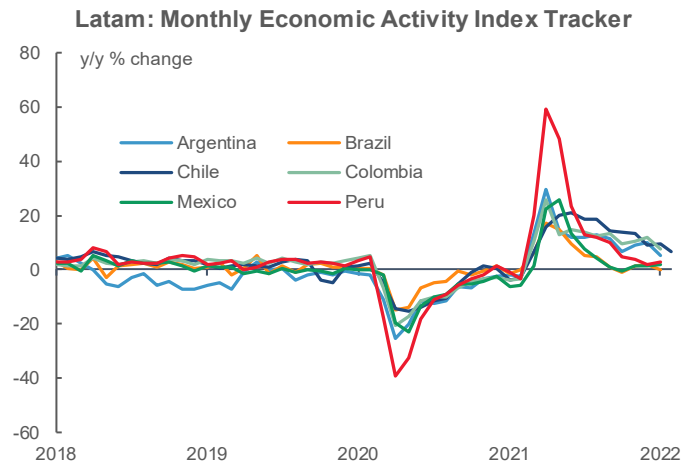


Chart 3

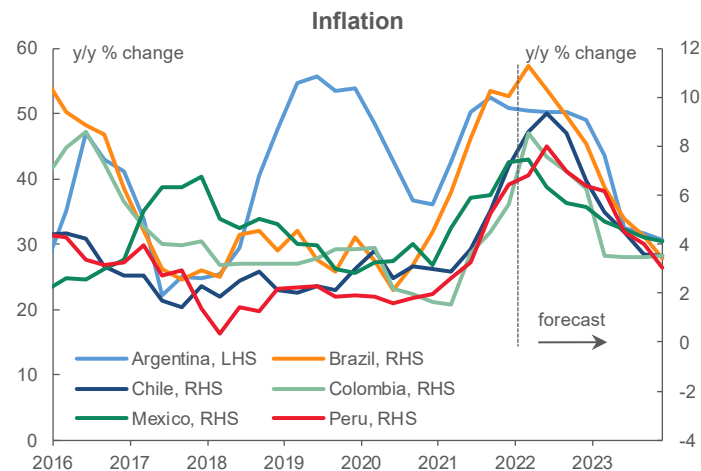


Chart 4



Chart 5

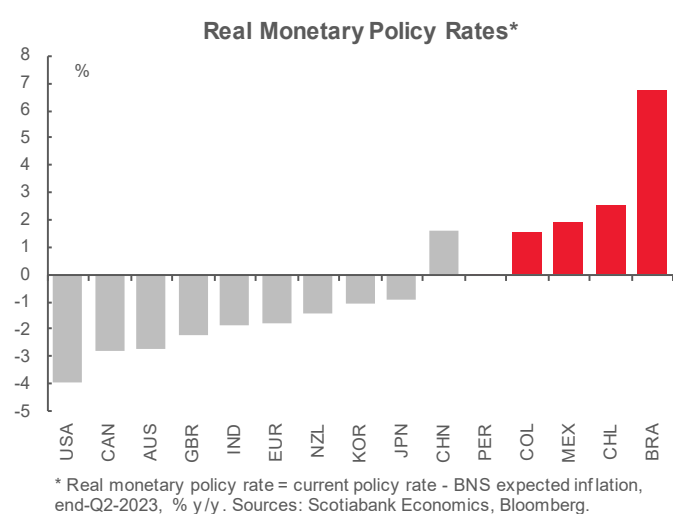
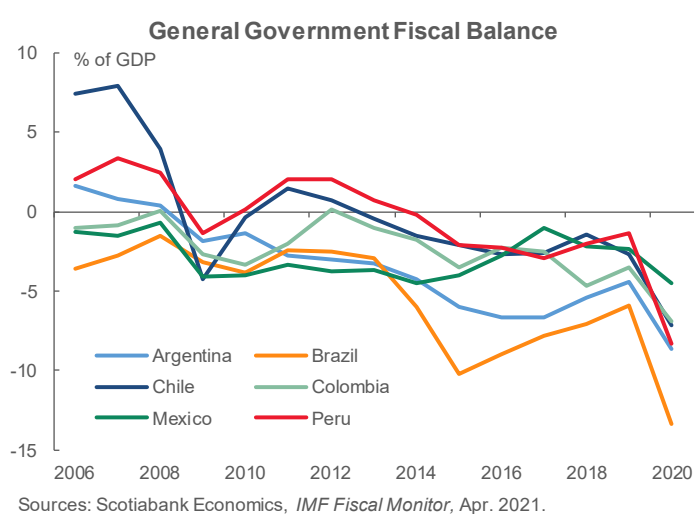
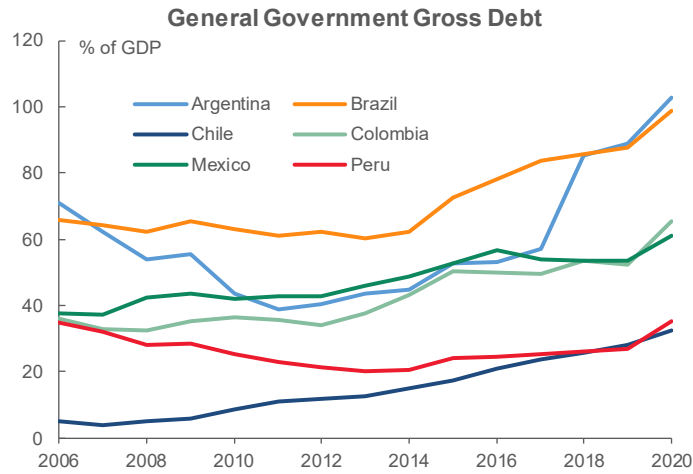


Chart 6



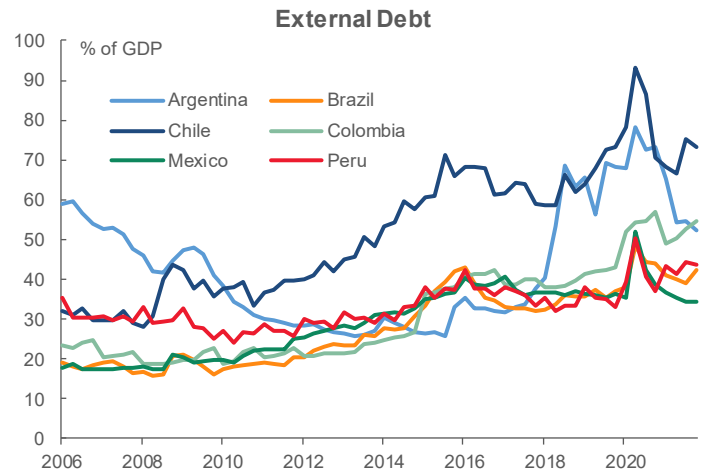
Key Economic Charts

Chart 7



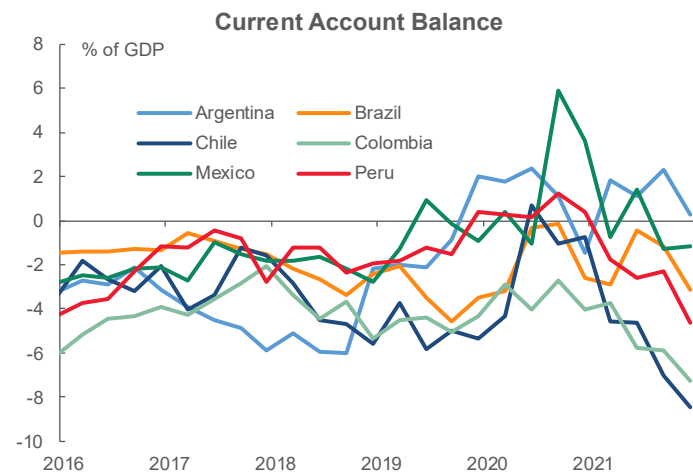
Sources: Scotiabank Economics, IMF Fiscal Monitor, Apr. 2021.

Chart 8



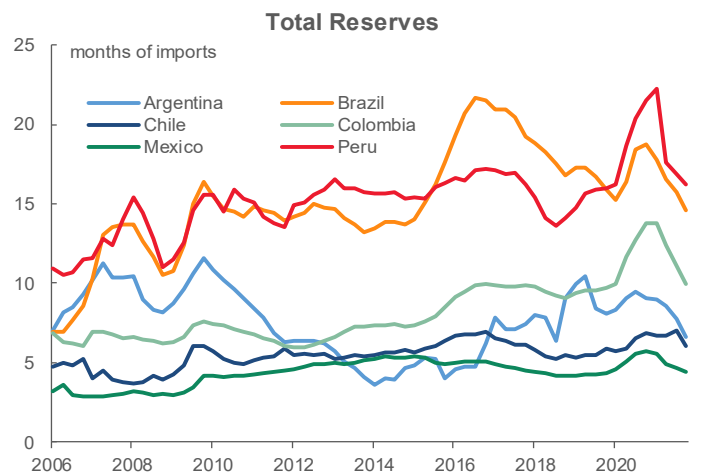
Sources: Scotiabank Economics, Haver Analytics.

Chart 9



Sources: Scotiabank Economics, Haver Analytics.

Chart 10

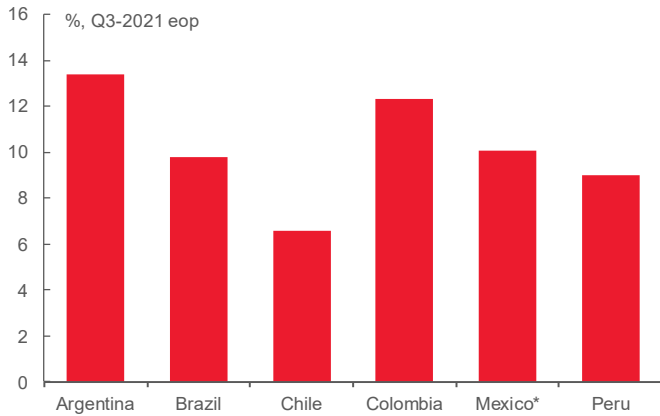


Sources: Scotiabank Economics, Haver Analytics.

Key Market Charts

Chart 1

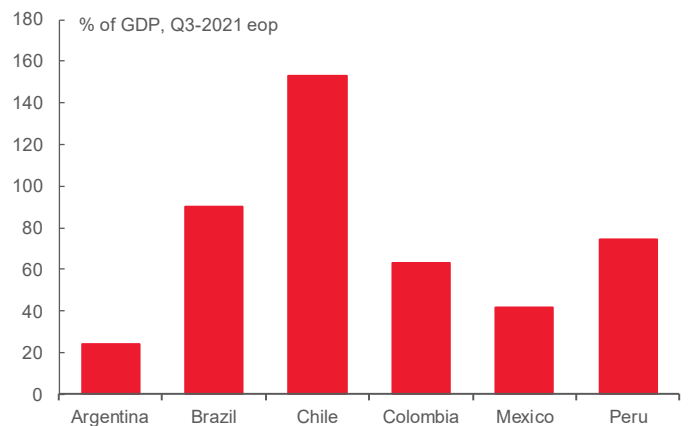
Bank Capital to Assets Ratio



* Data to Q1-2021.
Sources: Scotiabank Economics, IMF.

Chart 2

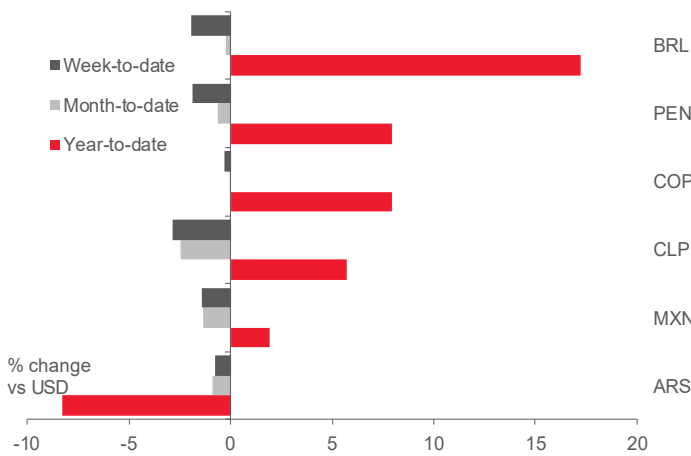
Domestic Credit to Private Nonfinancial Sector



Sources: Scotiabank Economics, BIS, Haver Analytics.

Chart 3

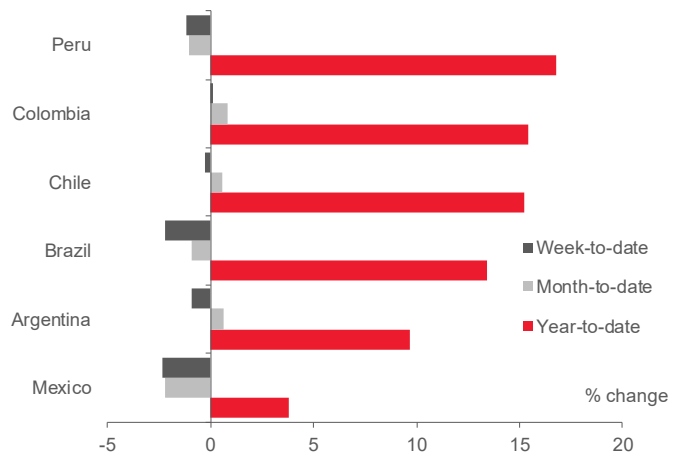
Latam Currencies Performance



Sources: Scotiabank Economics, Bloomberg.

Chart 4

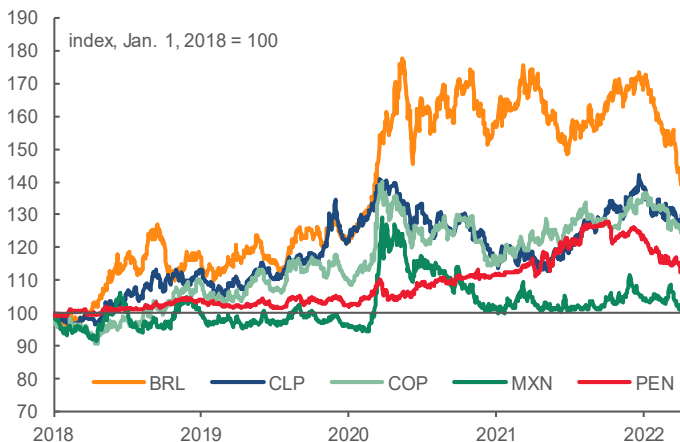
Latam Equities Performance



Sources: Scotiabank Economics, Bloomberg.

Chart 5

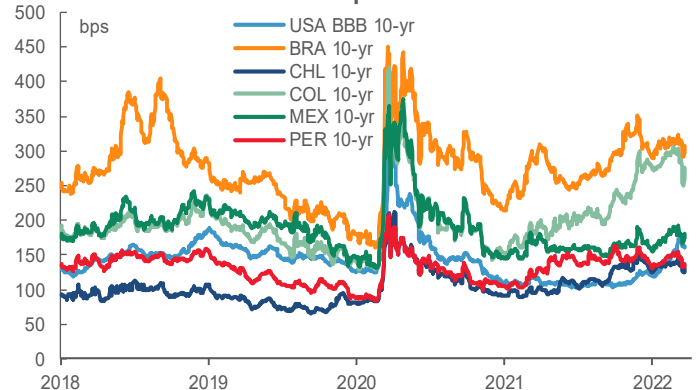
USD vs Latam Currencies



Sources: Scotiabank Economics, Bloomberg.

Chart 6

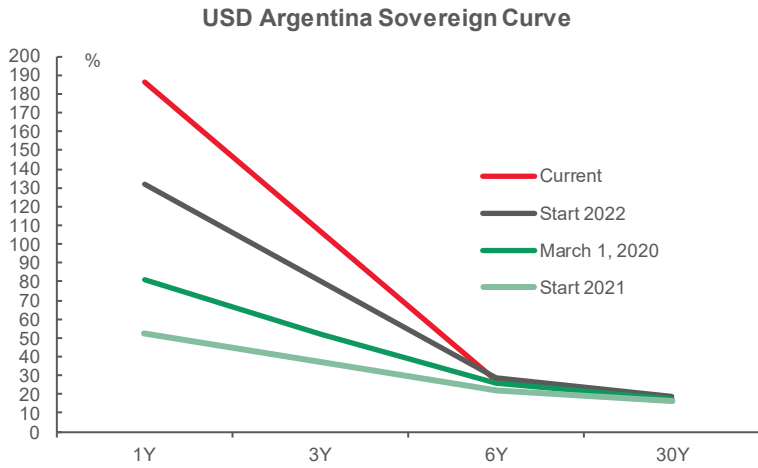
10-yr CDS Spreads: Latam Sovereigns & US BBB Corporates vs US*



*Sovereigns vs US swaps; BBB corporates vs 10-yr USTs.
Sources: Scotiabank Economics, Bloomberg.

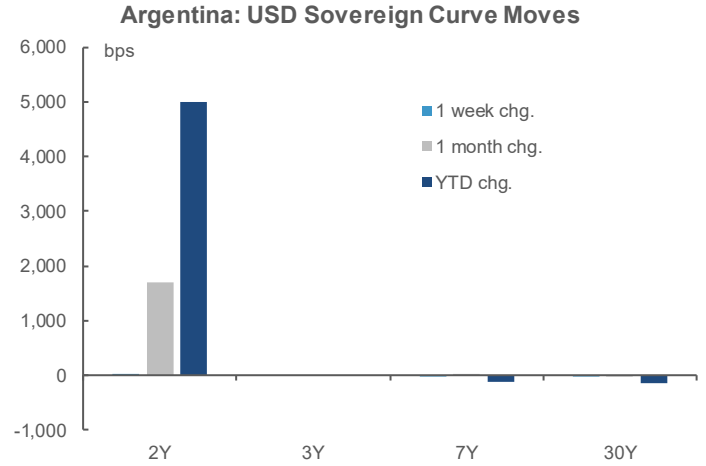
Yield Curves

Chart 1



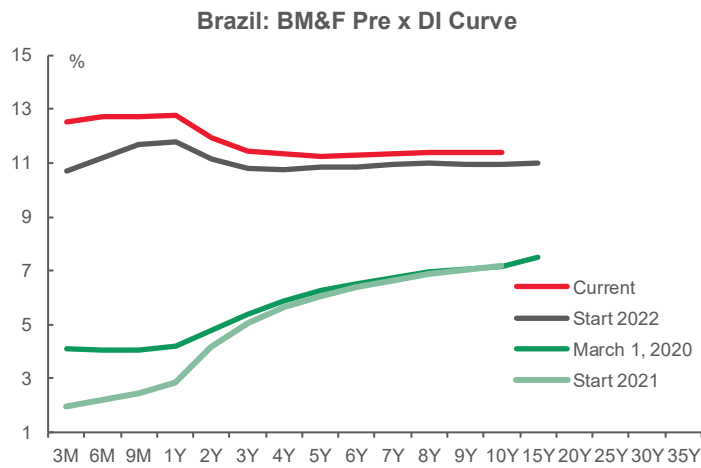
Sources: Scotiabank Economics, Bloomberg.

Chart 2



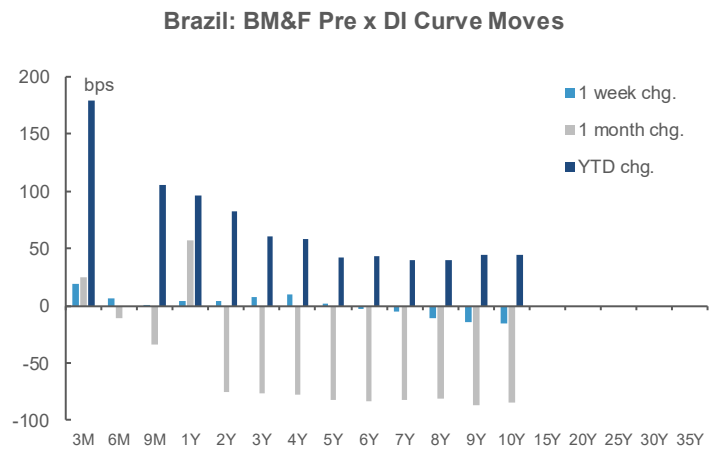
Sources: Scotiabank Economics, Bloomberg.

Chart 3



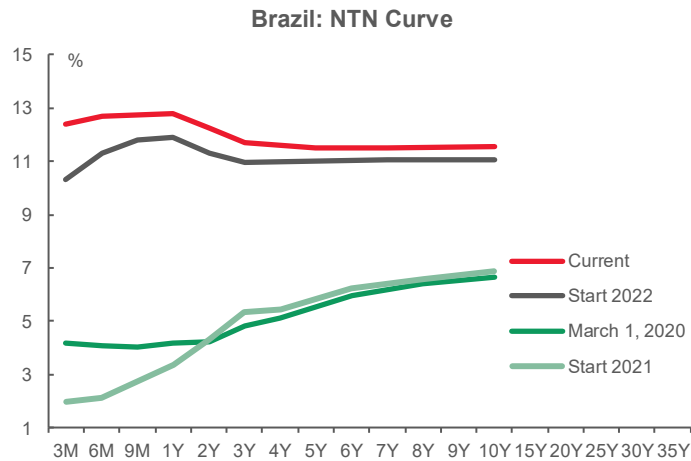
Sources: Scotiabank Economics, Bloomberg.

Chart 4



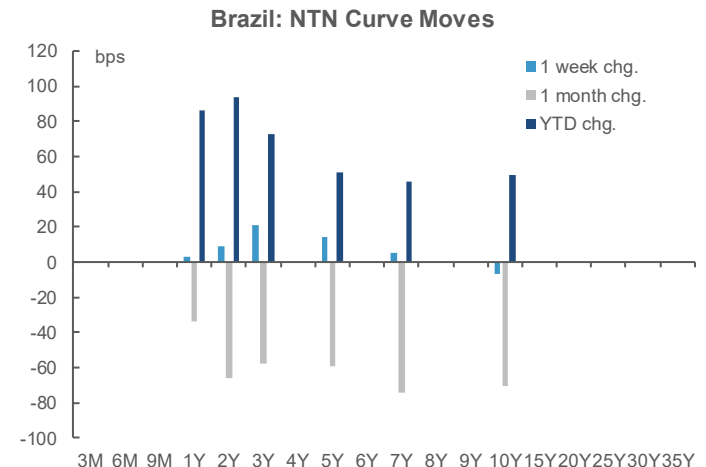
Sources: Scotiabank Economics, Bloomberg.

Chart 5



Sources: Scotiabank Economics, Bloomberg.

Chart 6

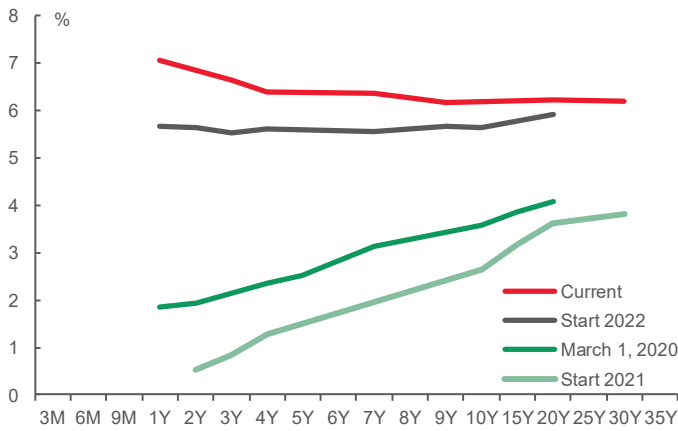


Sources: Scotiabank Economics, Bloomberg.

Yield Curves

Chart 7

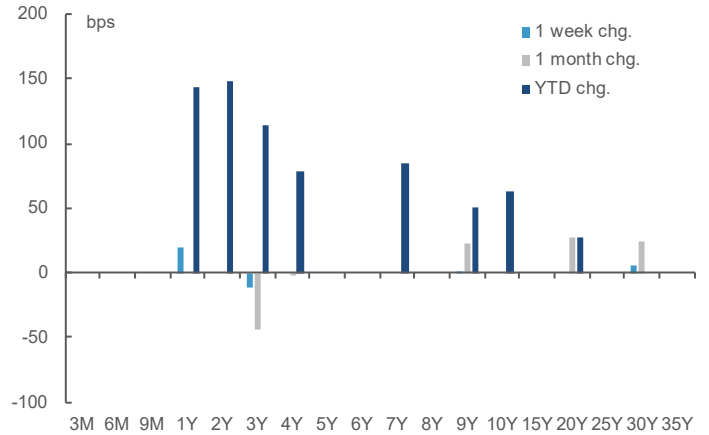
Chile: Sovereign Curve



Sources: Scotiabank Economics, Bloomberg.

Chart 8

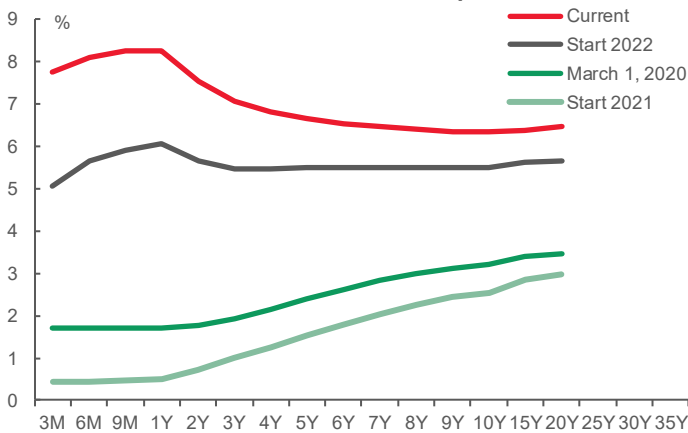
Chile: Sovereign Curve Moves



Sources: Scotiabank Economics, Bloomberg.

Chart 9

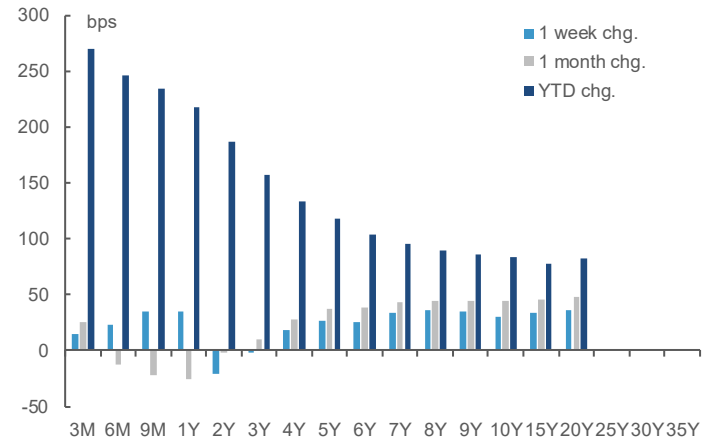
Chile: Fixed x Camara Swap Curve



Sources: Scotiabank Economics, Bloomberg.

Chart 10

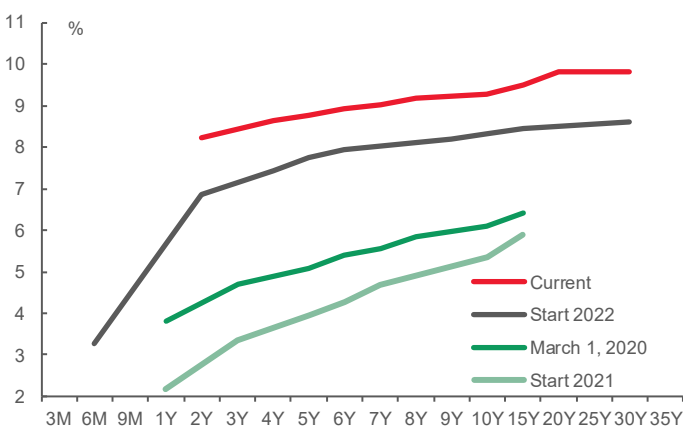
Chile: Fixed x Camara Swap Curve Moves



Sources: Scotiabank Economics, Bloomberg.

Chart 11

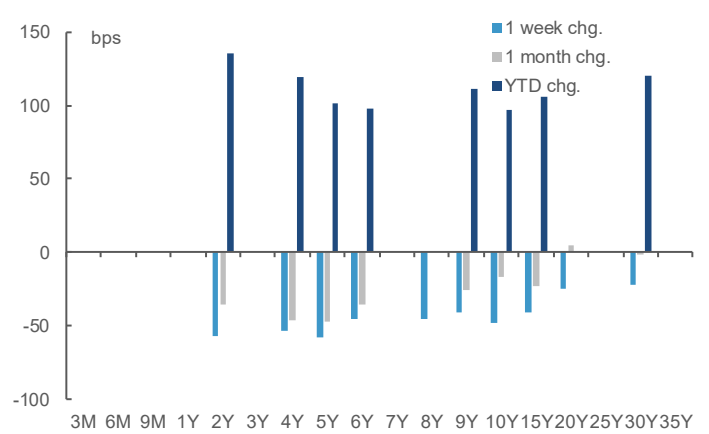
Colombia: Coltes Curve



Sources: Scotiabank Economics, Bloomberg.

Chart 12

Colombia: Coltes Curve Moves



Sources: Scotiabank Economics, Bloomberg.

Yield Curves

Chart 13

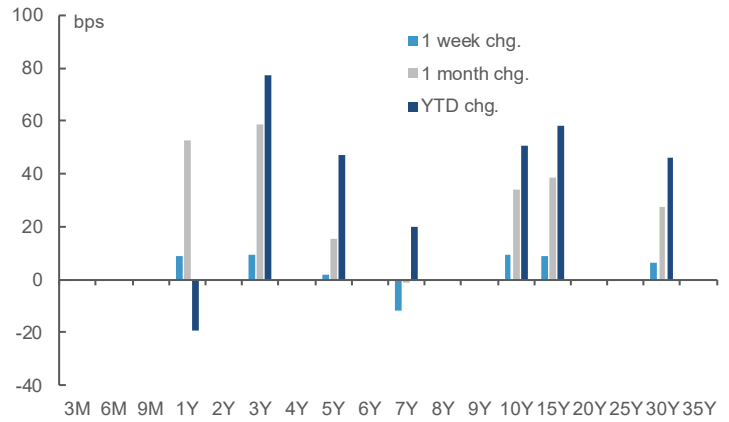
Colombia: UVR-Indexed Curve



Sources: Scotiabank Economics, Bloomberg.

Chart 14

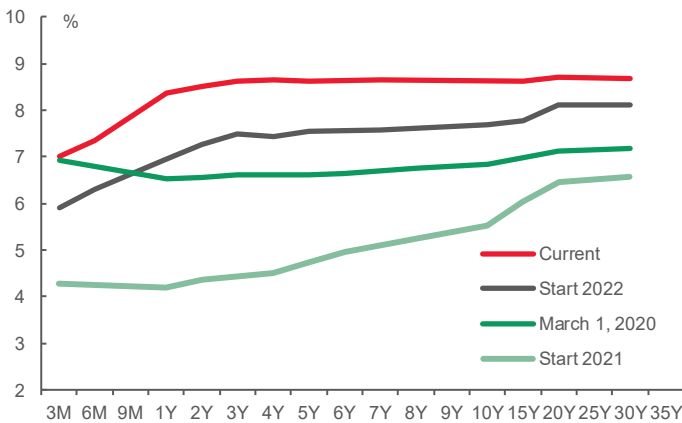
Colombia: UVR-Indexed Curve Moves



Sources: Scotiabank Economics, Bloomberg.

Chart 15

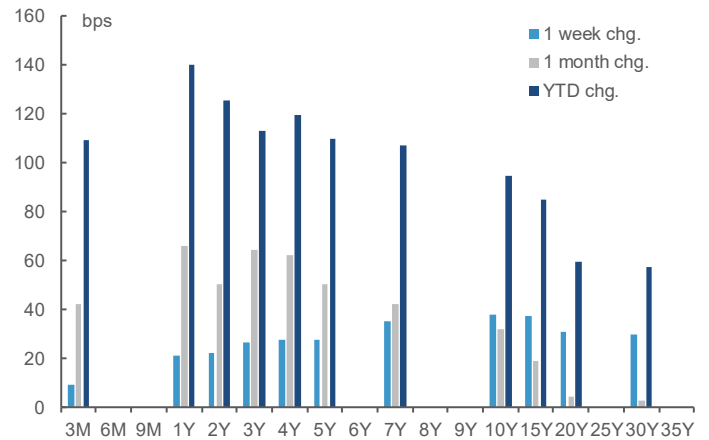
Mexico: M-Bono Curve



Sources: Scotiabank Economics, Bloomberg.

Chart 16

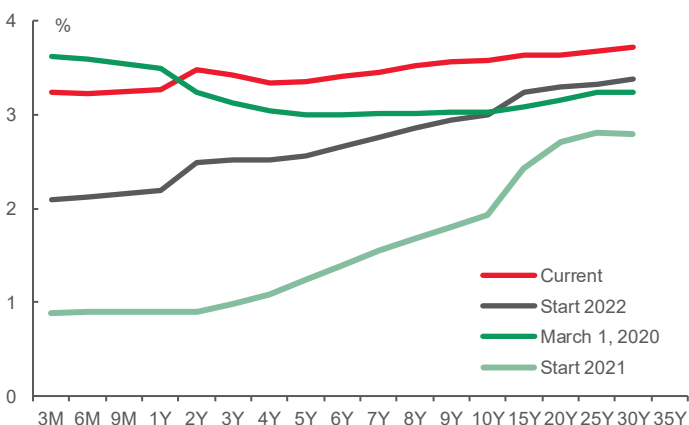
Mexico: M-Bono Curve Moves



Sources: Scotiabank Economics, Bloomberg.

Chart 17

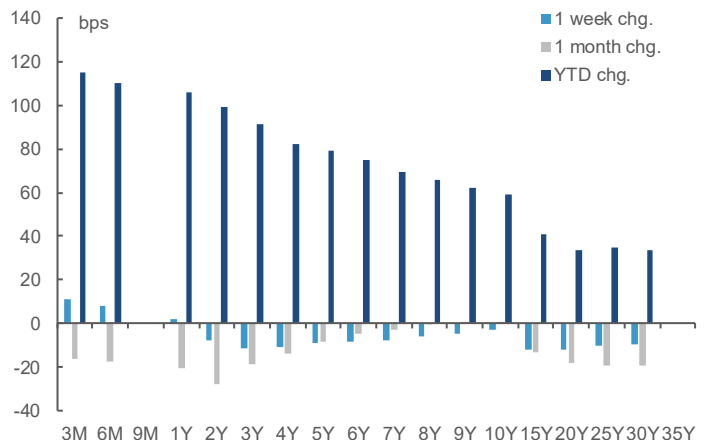
Mexico: Udibonos BVAL Yield Curve



Sources: Scotiabank Economics, Bloomberg.

Chart 18

Mexico: Udibono Curve Moves



Sources: Scotiabank Economics, Bloomberg.

Yield Curves

Chart 19

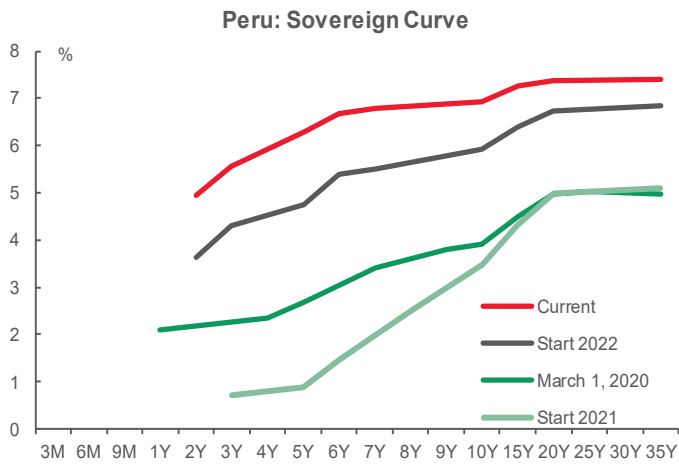
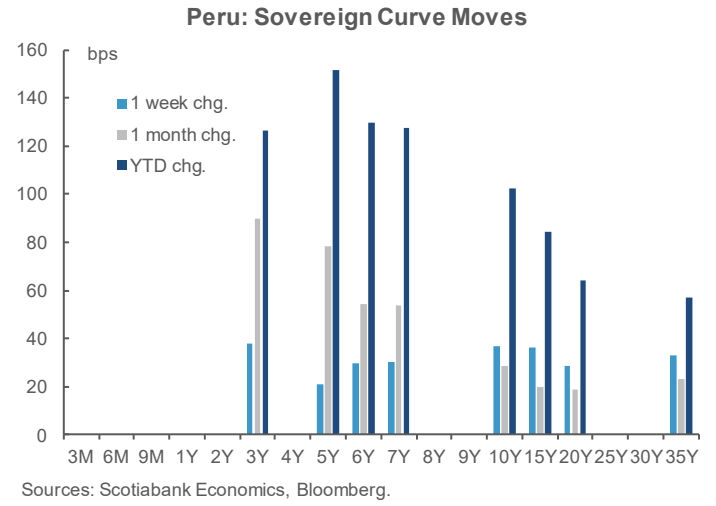
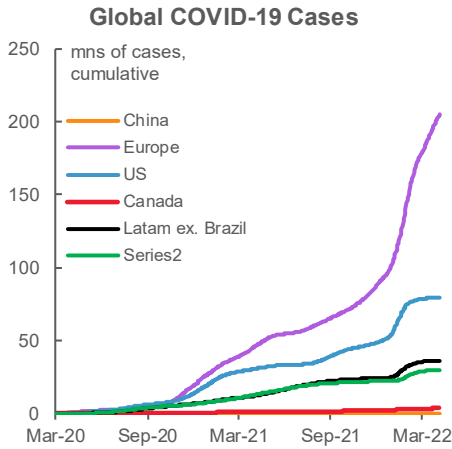


Chart 20



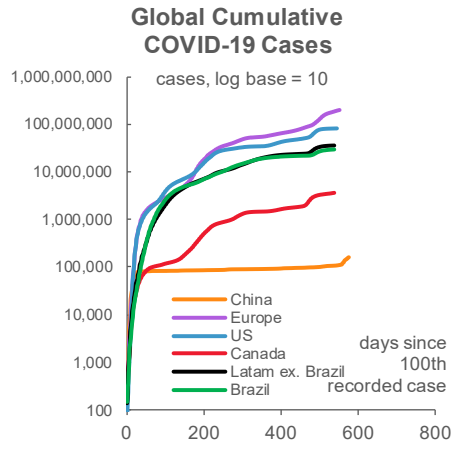
Key COVID-19 Charts

Chart 1



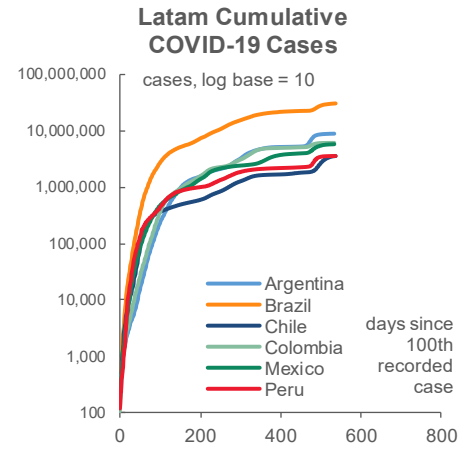
Sources: Scotiabank Economics, Johns Hopkins University, Oxford University.

Chart 2



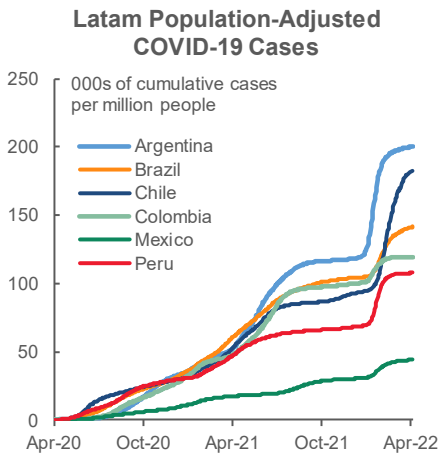
Sources: Scotiabank Economics, Johns Hopkins University.

Chart 3



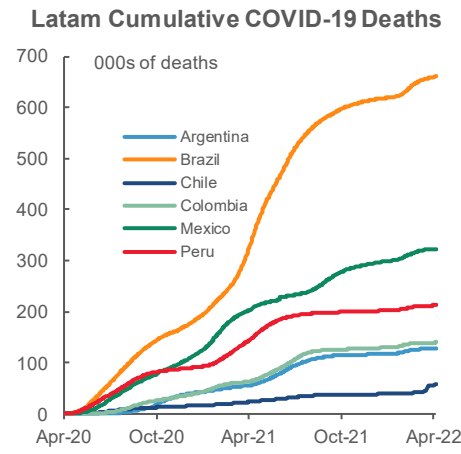
Sources: Scotiabank Economics, Johns Hopkins University.

Chart 4



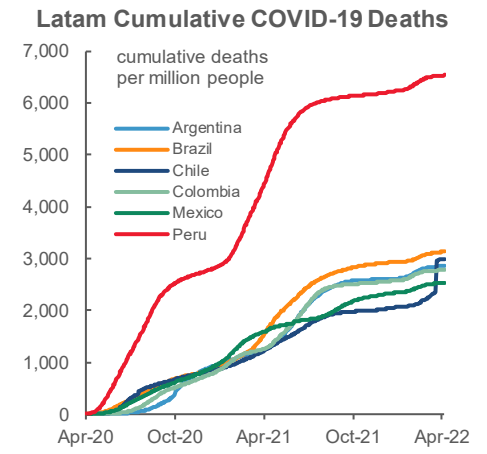
Sources: Scotiabank Economics, Johns Hopkins University, United Nations.

Chart 5



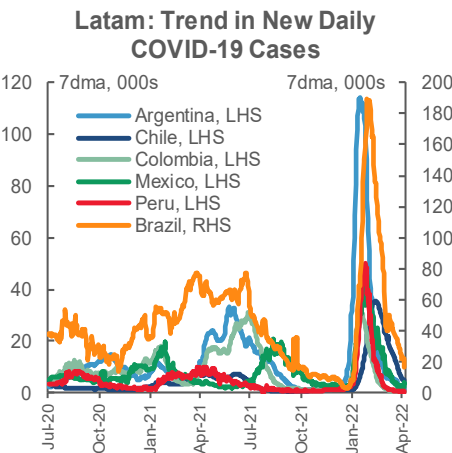
Sources: Scotiabank Economics, Johns Hopkins University.

Chart 6



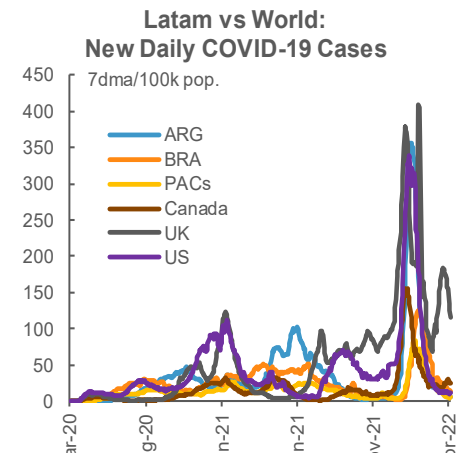
Sources: Scotiabank Economics, Johns Hopkins University.

Chart 7



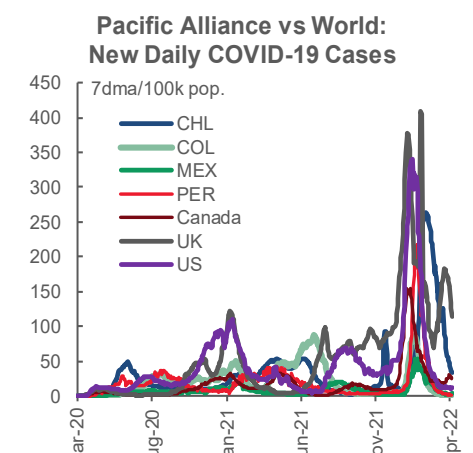
Sources: Scotiabank Economics, Johns Hopkins University.

Chart 8



Sources: Scotiabank Economics, JHU.

Chart 9



Sources: Scotiabank Economics, JHU.

Key COVID-19 Charts

Chart 10

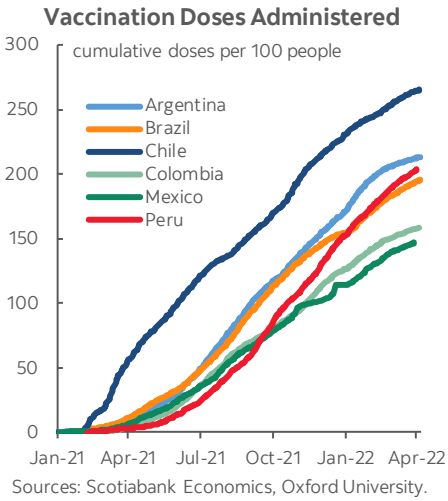


Chart 11

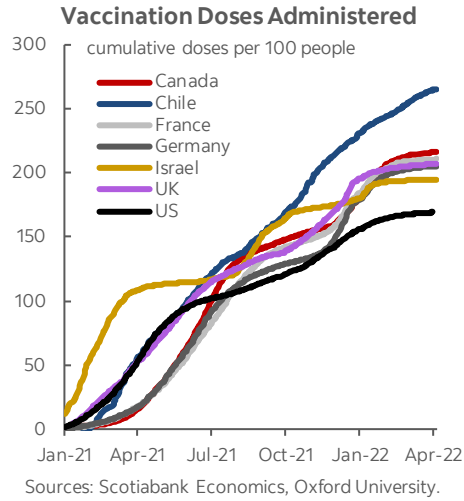
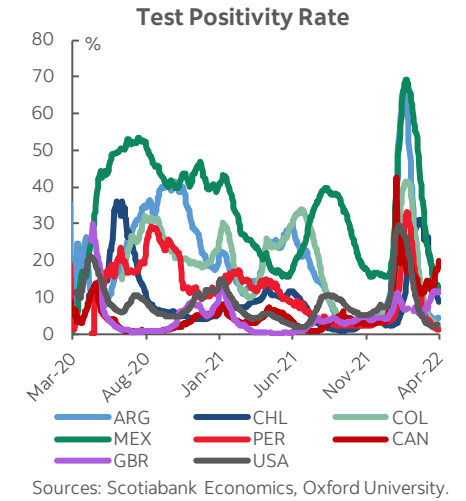


Chart 12



Market Events & Indicators for April 9–22

ARGENTINA

Date	Time	Event	Period	BNS	Consensus	Latest	BNS Comments
Apr-13	15:00	Greater Buenos Aires CPI (m/m)	Mar	3.5	--	4.6	Inflation has averaged 3.67% m/m over the last 6 mos, higher than even our above-consensus prior forecast. We've made our outlook more pessimistic, with an avg. 3.2% m/m for 2022.
Apr-13	15:00	Greater Buenos Aires CPI (y/y)	Mar	50.4	--	53.79	
Apr-13	15:00	National CPI (m/m)	Mar	--	5.8	4.7	
Apr-13	15:00	National CPI (y/y)	Mar	--	54	52.3	
Apr-19	15:00	Capacity Utilization (%)	Feb	--	--	57.9	
Apr-20	15:00	Exports Total (USD mn)	Mar	--	--	6443	
Apr-20	15:00	Imports Total (USD mn)	Mar	--	--	5634	
Apr-20	15:00	Trade Balance (USD mn)	Mar	--	--	809	
Apr-20		Budget Balance (ARS mn)	Mar	--	--	-76284	
Apr-20		UTDT Leading Indicator	Mar	--	--	2.52	
Apr-21	15:00	Economic Activity Index (m/m)	Feb	--	--	-0.5	
Apr-21	15:00	Economic Activity Index (y/y)	Feb	--	--	5.4	

BRAZIL

Date	Time	Event	Period	BNS	Consensus	Latest	BNS Comments
Apr-11	4:00	FIPE CPI - Weekly (%)	07-Apr	--	--	1.14	
Apr-11	7:25	Central Bank Weekly Economist Survey					
Apr-11	14:00	Trade Balance Weekly (USD mn)	10-Apr	--	--	2427.36	
Apr-12	8:00	IBGE Services Volume (m/m) SA	Feb	--	--	-0.1	
Apr-12	8:00	IBGE Services Volume (y/y) NSA	Feb	--	--	10.9	
Apr-13	8:00	Retail Sales Broad (m/m)	Feb	--	--	-0.31	
Apr-13	8:00	Retail Sales Broad (y/y)	Feb	--	--	-1.5	
Apr-13	8:00	Retail Sales (m/m)	Feb	--	--	0.8	
Apr-13	8:00	Retail Sales (y/y)	Feb	--	--	-1.9	
Apr-14	8:00	Economic Activity (m/m)	Feb	--	--	-0.99	
Apr-14	8:00	Economic Activity (y/y)	Feb	--	--	0.01	
Apr 11-14		Current Account Balance (USD mn)	Feb	--	-1500	-8145.9	
Apr 11-14		Foreign Direct Investment (USD mn)	Feb	--	10000	4709	
Apr 11-14		Net Debt % GDP	Feb	--	57	56.64	
Apr 11-14		Nominal Budget Balance (BRL bn)	Feb	--	-29.3	84.061	
Apr 11-14		Outstanding Loans (m/m)	Feb	--	0.5	0	
Apr 11-14		Personal Loan Default Rate (%)	Feb	--	--	4.61	
Apr 11-14		Primary Budget Balance (BRL bn)	Feb	--	-10	101.833	
Apr 11-14		Total Outstanding Loans (BRL bn)	Feb	--	4700	4670460	
Apr-18	7:00	FGV CPI IPC-S (%)	15-Apr	--	1.53	1.62	
Apr-18	7:00	FGV Inflation IGP-10 (m/m)	Apr	--	--	1.18	
Apr-18	7:25	Central Bank Weekly Economist Survey					
Apr-18	14:00	Trade Balance Weekly (USD mn)	17-Apr	--	--	2427.36	
Apr-19	4:00	FIPE CPI - Weekly (%)	15-Apr	--	--	1.14	
Apr 20-27		Tax Collections (BRL mn)	Mar	--	152150	148664	
Apr 22-29		Formal Job Creation Total	Mar	--	--	155178	

CHILE

Date	Time	Event	Period	BNS	Consensus	Latest	BNS Comments
Apr-12		Central Bank Economist Survey					We expect a downward revision in GDP growth for 2022, due to the recent adjustment in the Central Bank's forecast.
Apr 7-12		Vehicle Sales Total	Mar	--	--	41467	Rebound in car sales in March. Still strong sales of durable goods.
Apr-13		Central Bank Meeting Minutes					
Apr-18		Central Bank Traders Survey					
Apr-22	9:00	PPI (m/m)	Mar	--	--	2.5	

Forecasts at time of publication.

Sources: Scotiabank Economics, Bloomberg.

Market Events & Indicators for April 9–22

COLOMBIA

Date	Time Event	Period	BNS	Consensus	Latest	BNS Comments
Apr-11	Consumer Confidence Index	Mar	--	-19.6	-17.5	
Apr-13	11:00 Industrial Production (y/y)	Feb	--	--	10.33	
Apr-13	11:00 Manufacturing Production (y/y)	Feb	10.9	--	15.06	Economic activity could continue showing a recovery in industries
Apr-13	11:00 Retail Sales (y/y)	Feb	3.7	--	20.9	related to in-person activities, while on the consumption side, retail sales could post further moderation.
Apr-13	Central Bank Economist Survey					
Apr-18	12:00 Economic Activity NSA (y/y)	Feb	--	--	7.8	
Apr-21	11:00 Imports CIF Total (USD mn)	Feb	--	--	6050.58	
Apr-21	11:00 Trade Balance (USD mn)	Feb	--	--	-1704.9	

MEXICO

Date	Time Event	Period	BNS	Consensus	Latest	BNS Comments
Apr-11	7:00 Industrial Production NSA (y/y)	Feb	--	--	4.26	
Apr-11	7:00 Industrial Production SA (m/m)	Feb	--	--	1	
Apr-11	7:00 Manuf. Production NSA (y/y)	Feb	--	--	3.76	
Apr-12	10:00 International Reserves Weekly (USD mn)	08-Apr	--	--	200726	
Apr-12	13:00 Formal Job Creation Total	Mar	--	--	64.6	
Apr-12	ANTAD Same-Store Sales (y/y)	Mar	--	--	11.7	
Apr-19	10:00 International Reserves Weekly (USD mn)	13-Apr	--	--	200726	
Apr-20	Banamex Survey of Economists					
Apr-22	7:00 Bi-Weekly Core CPI (%)	15-Apr	--	--	0.4	
Apr-22	7:00 Bi-Weekly Core CPI (y/y)	15-Apr	--	--	6.88	
Apr-22	7:00 Bi-Weekly CPI (%)	15-Apr	--	--	0.59	
Apr-22	7:00 Bi-Weekly CPI (y/y)	15-Apr	--	--	7.62	

PERU

Date	Time Event	Period	BNS	Consensus	Latest	BNS Comments
Apr-18	Economic Activity (y/y)	Feb	4.8	--	2.86	Rebound expected from low comparison base in Feb. 2021 due to restrictions on Delta variant.
Apr-18	Lima Unemployment Rate (%)	Mar	8.2	--	8.9	Slow recovery of labour market.

Forecasts at time of publication.

Sources: Scotiabank Economics, Bloomberg.

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