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LATAM Market Update

- **Chile: Two (useful) comments on the Central Bank minutes**
- **Colombia: Coincident indicators lost steam in December-2018; Capital imports bode well for 2019 investment**

CONTACTS

Eduardo Suárez, VP, Latin America Economics
52.55.9179.5174 (Mexico)
Scotiabank Economics
eduardo.suarez@scotiabank.com

Guillermo Arbe
511.211.6052 (Peru)
Scotiabank Peru
guillermo.arbe@scotiabank.com.pe

Mario Correa
52.55.5123.2683 (Mexico)
Scotiabank Mexico
mcorrea@scotiacb.com.mx

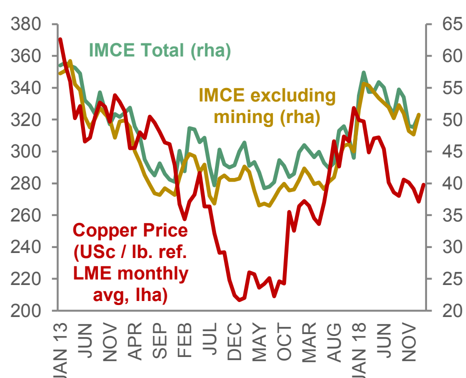
Sergio Olarte
57.1.745.6300 (Colombia)
Scotiabank Colombia
sergio.olarte@co.scotiabank.com

Benjamin Sierra
56.2.2619.4974 (Chile)
Scotiabank Chile
benjamin.sierra@scotiabank.cl

CHILE: TWO (USEFUL) COMMENTS ON THE CENTRAL BANK MINUTES

Yesterday, the Central Bank released minutes of the last Monetary Policy Meeting (January 30th). The comments contained in it summed up a bigger doubt about foreign conditions ant their effects on the domestic economy. That would be the reason the Board decided to go deeper to figure out what is really happening with foreign conditions and its effective risks for the domestic economy. At the end of the day, the finest explanation for the rate hike (25bp to 3%) was that market was expecting it and keeping the MPR in that meeting would have had a second (not "secondary" one...) effect: “it could also signal a change in the baseline scenario or in the need to continue with the normalization of the MPR without having any information that could justify this.”

Copper Price & Business Confidence



Sources: Scotiabank Economics, ICARE, Reuters Eikon.

It seems remarkable the sentence that “On the domestic front, there was agreement that, for the moment, the information at hand gave no obvious signs that the evolution of the external scenario was permeating the local economy”, which seems consistent with giving them a longer time to analyze the international scenario (actually, up to the next Monetary Policy Report (April 1st) but with (we hope) practical effects in the closest Monetary Policy Meeting (March 29th). A couple of features of the Chilean economy (size and openness) backs a strong correlation between the business confidence level and terms of trade, being the latter highly determined by the copper price. The attached chart (that takes the IMCE, the Monthly Business Confidence Index by its Spanish acronym, the most important in Chile) shows more than simple hints of correlation between copper price and business confidence, though sometimes there are domestic factors that can also have some effects (as can be seen in 2014, for example). In that sense, a sentence in the minutes yesterday: “On the domestic front, there was agreement that, for the moment, the information at hand gave no obvious signs that the evolution of the external scenario was permeating the local economy.” would seem to be a little misleading. However, the question is how deep the business confidence is conditioning the local decisions. All that, of course, putting aside some disappointing caused by the delay in critical reforms (to accelerate growth, investment and hiring), which do not depend on the foreign conditions.

On other matter, as it is well known, central banks have never trusted too much in stock markets to make their decisions (and they are probably right to do so, since factors behind stock markets are more complex and beyond than a set of models of macroeconomic variables), but they usually (and rightly) use them as side information. However, noteworthy its reference to the domestic stock market this time, saying that “The stock market (IPSA) had increased in every sector, owing partly to the improvement in global stock markets following the reorientation of the monetary policy statement in developed countries, but also influenced by a recovery in the Brazilian economic outlook.”

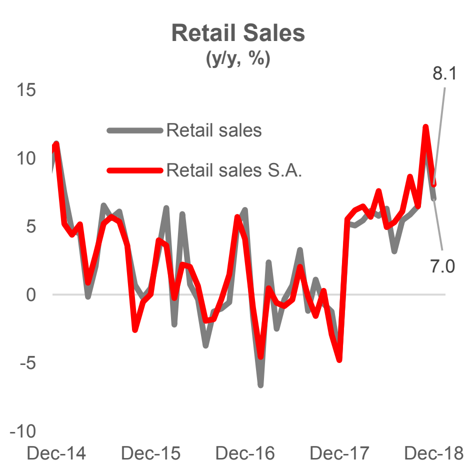
It unveils a right focus that sets the record straight (both, the market recent behavior and their own job). This is a small open economy, but it has an even smaller and more open stock market. Domestic conditions are just one of the factors determining the local stock prices performance. About this, let's say two things that can help in strategic views: first, in Chile the effects of the stock market on the economy seem to be limited (or, if some, not well identified yet), and second, the performance of the stock market in Chile is not so closely related with the Monetary Policy either, as in other countries, except when extreme level are reached (and, even in those circumstances, not always) or in very specific sectors. there are much more factors.

COLOMBIA: COINCIDENT INDICATORS LOST STEAM IN DECEMBER-2018; CAPITAL IMPORTS BODE WELL FOR 2019 INVESTMENT

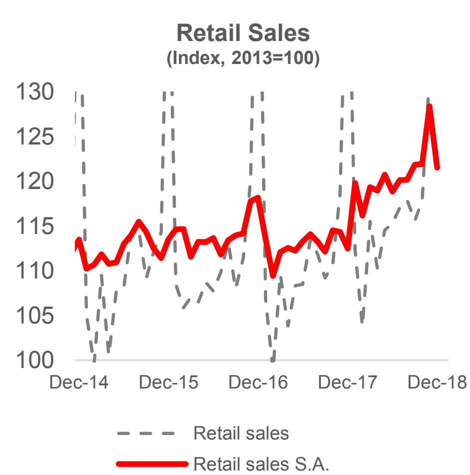
Dane released December-2018 manufacturing and retail sales (RS) data. RS figure continue showing annual strong expansions and came in at 7% y/y, although showed deceleration with respect to last month. Manufacturing dropped -0.8% y/y, well below market expectations.

December coincident indicators continue showing that gradual economic recovery (especially domestic demand) continues, although manufacturing disappointed in December, capital and raw material imports recent strong expansions let us to think that manufacturing will return to its gradual recovery. Additionally, expansionary monetary policy rate (MPR), relatively stable and depreciated exchange rate, lower headline and core inflation, contribute to economic activity recovery. Having said that, the economy is still running below potential and negative output gap. Therefore, we think that, since inflation and inflation expectations are controlled, COP has shown stability and international rates will remain low for longer, we think BanRep will continue on the expansionary side at least during 1H19.

Retail sales expansion was especially on the back of vehicle sales that grew 25% y/y and added 2.7pp to headline annual expansion. Vehicle sales was, still, positively affected by a Bogotá fair that boosted, temporary, car sales in the last two months of last year. Having said that, RS have a north trend and we expect this trend to continue in the coming months, although at a more sustainable rate.



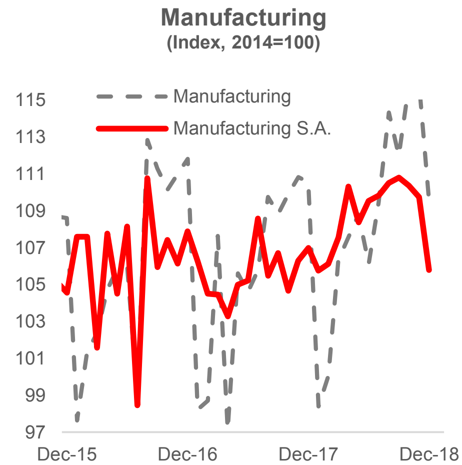
Sources: DANE, Scotiabank.



Sources: DANE, Scotiabank.

On the manufacturing side, it is worth to note that only 19 out of 39 sub-sectors showed positive annual variation. The sub-sectors that dropped the most to December manufacturing were oil refining that fell 7.6% and subtracted 1.6pp to clothing annual contraction and that dropped by 12.1% y/y and subtracted 0.6pp to headline.

Sources: DANE, Scotiabank.

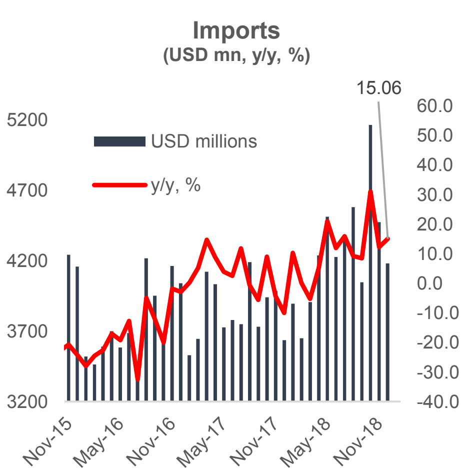


Sources: DANE, Scotiabank.

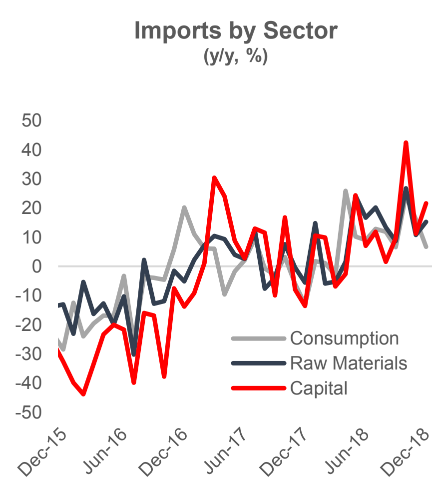
All in, December coincident indicators showed that domestic demand continue pointing north, although lost some steam and showed that we do not expect a strong rebound in domestic demand. RS showed still strong behavior on the back of a temporary boost from the vehicle sales. We expect gradual economic activity recovery to continue in the coming months. On monetary policy, we do not expect that yesterday's results affect the base case scenario for BanRep, therefore we keep thinking that the board in an unanimous decision will keep the MPR in 4.25% in March meeting (March 22nd).

Yesterday, DANE released December imports. It came in at 15.1% y/y or US$4.2b and continued showing strong behavior. Capital imports grew 21.7% y/y due to industrial and transportation imports. The strong numbers that capital imports have shown in 2018 are consistent with investment recovery in second half of 2018 and bode well for 2019 investment. Additionally, Raw materials imports are also growing above 10% y/y, which let us to think that domestic demand recovery continues. The import data do not change our GDP forecast for 2018 of 2.6% y/y and is in line with our 3.4% y/y for 2019.

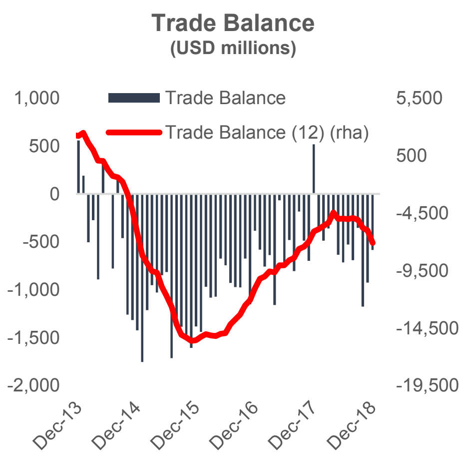
Finally, 2018 trade balance showed a deficit of US$-7.1bn (US$-586mn in December), which is in line with the current account deficit (CAD) of -3.3pp of GDP in 2018, although with bias to higher CAD.



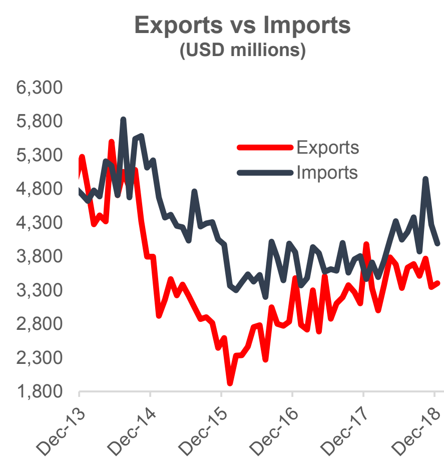
Sources: DANE, Scotiabank.



Sources: DANE, Scotiabank.



Sources: DANE, Scotiabank.



Sources: DANE, Scotiabank.