February 26, 2019

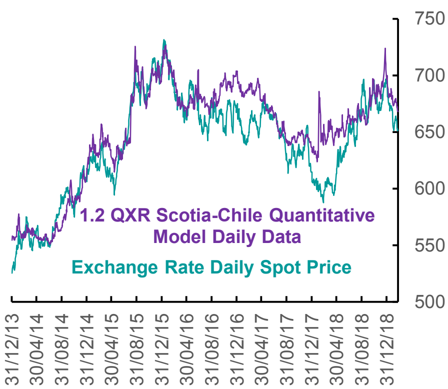
LATAM Market Update

- **Chile: A warming up week—A good analysis toolbox at hand**
- **Mexico: GDP slows in the fourth quarter; Pemex oil production shrank to its lowest level in 30 years**
- **Peru: CB is biased towards raising rates in the future, but in no hurry to do so**

CHILE: A WARMING UP WEEK—A GOOD ANALYSIS TOOLBOX AT HAND

Is the copper rally as positive as it could be considered? If we are referring to a real rally (not just a transitory rebound) of course it can change the profile of some variables. Beyond the exchange rate plunge (whose more notable and immediate spinoff effect is a marginal additional pressure on inflation expectation), in order to have a significant effect on business confidence, as we explained in our February 15th note, it should last two or three months at least (much better if longer and if it goes higher than 3 USD/lb). However, we will likely see a limited improvement in the coming report (February). About the exchange rate, though the gap vs. our quantitative model remains (one of whose determinants is copper price), recent downtrend is the same in both cases. However, volatility coming from abroad seems unlikely to be in a terminal condition. On the contrary, extremely "liquid" facts like the USA-China trade talks will likely remain so in coming weeks. Accordingly, effects on the domestic assets, being the exchange rate the first buffer, but also that of stock market will likely stay high.

Chile Exchange: Quantitative Approach



Sources: Scotiabank Economics, Reuters Eikon.

Yesterday, the Central Bank released data up to the first fortnight of February. According to which seemed to be more likely due to the adjustment process related with the MPR we mentioned in the past, money growth expansion continued losing steam at a very limited pace. On the opposite, banking loans described an also limited recovery but in the opposite direction, which was also expected considering the previous trend of the economic growth and the lag, as we explained a week ago.

Other (unfortunately) not surprising dataflow came from foreign trade. Exports deepened their contraction, and comparison bases can hardly be blamed for it. Though some recovery is expected in coming data coming from copper prices, however, agricultural and manufacturing products also contracted. About the latter, the worst part came from forestry products (expected) and that would continue in the very short term. Accordingly, next data should show a mix of trends, which would be finally positive (if copper prices hold up, of course).

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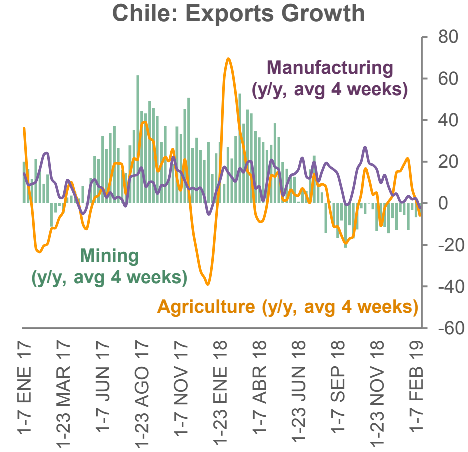
Chile: Exports Growth

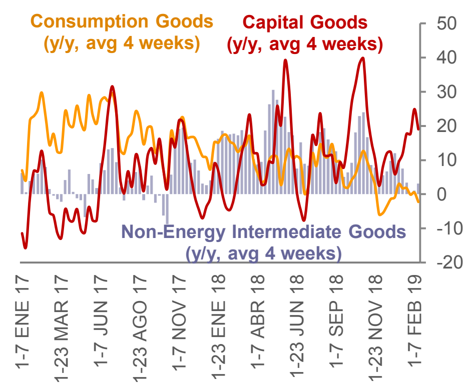


Sources: Scotiabank Economics, Central Bank of Chile (BCCh).

About domestic demand, which imports suggest continued being the same: weakness of consumption not an actual news (cars and smartphones, are the most negative among relevant components, that is, durable goods) and its slowdown should remain for some months. In intermediate goods, a tepid recovery is confirmed, aligned with the uptrend expected for some activities (recall we are talking about a limited uptick and the stocking process usually starts before). Finally also aligned with the cycle, capital goods imports (machinery) eased a tad, but continued growing around 20%, though it must be said that comparing bases are helping in that case.

The current week will be one of relevant figures, being the most important those to be released on Thursday: manufacturing and mining activity in January. For the former the market is expecting an annual growth of 0.3%, which would mean a limited slowdown (0.8% in December) Besides, we will know about the labour market in the mobile quarter that finished that month, where the seasonal effect should press on the unemployment rate (in Q4 2018 it decreased to 6.7%), but even so the market is expecting an increase to 6.8%. In any case, conclusions from these data should be taken carefully.

Chile: Imports Growth



Sources: Scotiabank Economics, Central Bank of Chile (BCCh).

MEXICO: GDP SLOWS IN THE FOURTH QUARTER; PEMEX OIL PRODUCTION SHRANK TO ITS LOWEST LEVEL IN 30 YEARS

Mexico's economy grew 1.7% in the fourth quarter, this was less than what was previously estimated (1.8%). In its annual measure, GDP slowed from 2.1% in 2017 to 2.0% in 2018. Fourth quarter growth decreased from 0.6 in the preceding quarter to 0.2% in seasonally-adjusted terms; this was originated by a strong decrease in its industrial component, from 0.2% to -1.2%, it's lowest performance since 2015-4Q, this could have been driven by the marked volatility produced in Mexican financial markets during the last quarter, much of it triggered by the announcement in late October that the US$13 billion New Mexico City Airport was canceled; and a modest recovery of its agricultural components (from 1.4% to 2.2%) and commercial components (from 0.6% to 0.7%).

Petróleos Mexicanos (Pemex) produced a daily average of 1.6 million barrels per day in January 2019, its lowest level for a month in over 30 years, with an annual decrease of 15% compared to the same month of 2018. Compared to December, Pemex reduced oil production by 5.1%. In 2014, when the Energy Reform was approved, the government's expectation was to maintain the decline during the first two years so that, with investments, Pemex could reach 2019 with a production of at least 2.6 million barrels per day. Nowadays, with the Program for Strengthening Petroleos Mexicanos and the National Hydrocarbon Production Plan, president Andrés Manuel aims to produce 2.4 million barrels per day by 2024.

PERU: CB IS BIASED TOWARDS RAISING RATES IN THE FUTURE, BUT IN NO HURRY TO DO SO

Julio Velarde, President of the Central Bank, stated that "it would be a good signal to withdraw monetary stimulus, but this would not be feasible in the short term". Velarde made this statement at a press conference held in London. His statement is in line with our perception of CB policy, namely, that, with the real reference rate, currently around 0.5%, well below the neutral rate of 1.75%, the CB is biased towards raising rates in the future, and yet, with inflation (2.2%) comfortably near the mid-point of the inflation target range (2.0%), and no signs of overheating in the economy, the CB feels there is no hurry to do so. The CB policy rate has been held stable at 2.75% for nearly a year, now, and will conceivably remain stable for the next six months, in our view. We're still leaning towards the possibility of at least one 25bps increase in 2019, but this would still mean a bullish monetary policy, in line with Velarde's statement.

Velarde also stated that he expected GDP growth of 4% in 2019, and inflation of around 2.0%. This is not new, and is in line with our forecasts of 4.0% GDP growth, and 2.5% inflation rate.

The truckers strike was lifted, after seven days, yesterday. The government would have agreed to lowering diesel prices, promoting a bill in Congress on fuel tax reimbursements, and initiating conversations (a "working group") to discuss pending issues.