March 15, 2019

LATAM Market Update

- **Peru: The Central Bank puts a short-term floor in the FX market**
- **Colombia: Coincident indicators continue pointing to a gradual recovery in economic activity**

PERU: THE CENTRAL BANK PUTS A SHORT-TERM FLOOR IN THE FX MARKET

On Wednesday, the Central Bank surprisingly bought a token US$26m in the FX spot market at S/ 3.284. This was unexpected, as it was the first time the Central Bank bought or sold currency in the market since January 2018. Although the amount purchased was small, it acted as a strong signal to the market regarding the CB's intention, in effect establishing a floor in the market. The question, however, is will the CB intend to hold this floor over the next two weeks, when export companies will need to sell USD significantly to pay the yearly income tax, during the height of the tax season. Normally, the PEN strengthens temporarily in this period. Given Wednesday's intervention, the CB seems to be giving the signal that it would not allow for this temporary dip this time. This could be due to the fact that the PEN has strengthened so strongly so far this year, from 3.37 at the turn of the year, to 3.29.

The new Del Solar cabinet held its first cabinet meeting on Wednesday, providing an initial insight as to the government's priorities. According to press reports, the issues discussed included: integrity and the fight against corruption; poverty; the fight against anemia; water and sanitation; growth of the economy and economic development; as well as improving productivity, reducing informality, and better policy execution. The new cabinet would also seek a better relationship with Congress, and with regional and local governments.

COLOMBIA: COINCIDENT INDICATORS CONTINUE POINTING TO A GRADUAL RECOVERY IN ECONOMIC ACTIVITY

DANE released January-2018 manufacturing and retail sales (RS) data. RS figure continues to show an annual expansion that came in at 3% y/y, although below market expectations. Manufacturing came in at 3% y/y, a bit above market expectations and returned to the gradual recovery seen last year.

January coincident indicators are in line with the gradual economic recovery (especially domestic demand) for our base line scenario, and led us to think that the deterioration in January employment data is mainly due to the lagging response of labor to the economic cycles and a measurement issue of the supply shock from Venezuelans' immigration. Positive manufacturing data also is in line with recent capital and raw material imports strong expansions. Additionally, expansionary monetary policy rate (MPR), a relatively stable and depreciated exchange rate, lower headline and core inflation, contribute to recovery in economic activity. January coincident indicators data, in our opinion, do not change authorities' or market base line scenario. Therefore, we think the government will keep 2019 GDP growth forecast at 3.6% and BanRep will continue on the sidelines, at least for 1H19 waiting for more data to confirm that the output gap is closing up.

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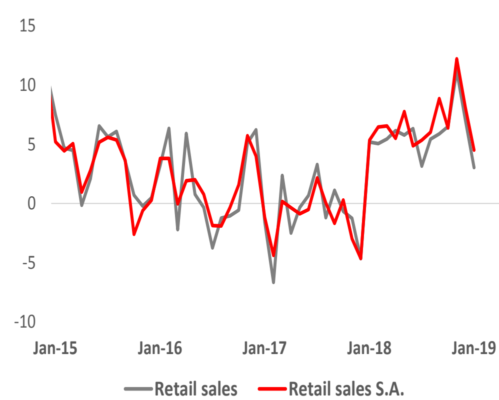
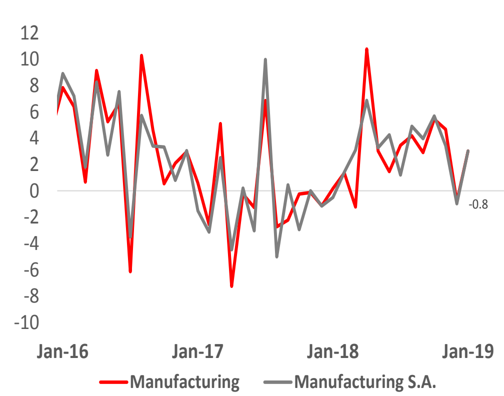
Retail Sales
(Y/Y, %)
Source: DANE, Scotiabank



Manufacturing
(y/y, %)
Source: DANE, Scotiabank)



Retail sales expansion was especially on the back of foodstuff sales that grew 7% y/y and added 1.6pp to headline annual expansion. Telecommunications added 0.5pp to total RS expansion. On the negative side, vehicle sales dropped 4.1% y/y and subtracted 0.5pp from headline expansion. We think the fall in vehicle sales was mainly on the back of lower car sales after the last two months' expansions of more than 25% y/y during Bogotá's Car fair last quarter of 2018.

On the manufacturing side, it is worth noting that DANE updated the index base to 2018 to make it more comparable with the new GDP calculations. Having said that, the historical series did not change much and continue showing a mild recovery since last year. In January, 26 out of 39 sub-sectors showed positive annual variation. The sub-sectors that expanded the most were beverages that grew 8.5% and added 1.0pp to headline annual expansion, paper fabrication added 0.5pp to total annual increase in manufacturing, and plastic added 0.4pp to the headline y/y expansion.

All in, January coincident indicators showed that domestic demand continue pointing north, and showed that last month's fall in manufacturing was an outlier in manufacturing's gradual recovery. RS showed still-strong behavior. We expect a gradual recovery in economic activity to continue in the coming months. In terms of monetary policy, we do not expect that today's results will affect the base case scenario for BanRep, therefore we are of the view that the board's unanimous decision will keep the MPR at 4.25% in March meeting (March 22).