LATAM Market Update

- **Mexican industrial production drops to lowest rate since 2009**
- **Peru: The Central Bank signals (we believe) a downward bias for its reference rate going forward**

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

Jorge Selaive
56.2.2939.1092 (Chile)
Scotiabank Chile
jorge.selaive@scotiabank.cl

MEXICAN INDUSTRIAL PRODUCTION DROPS TO LOWEST RATE SINCE 2009

Industrial production showed poor results in May, both in its annual variation with original figures and with its monthly seasonally adjusted comparison, standing significantly below market expectations with a big drop in construction activity and weaker mining, manufacturing and utilities output. These results confirm that the economy is weakening faster than anticipated, reaffirming our perspective towards a more negative economic environment and with lower growth perspectives.

In May, non-seasonally adjusted figures for industrial production continued, for the seventh consecutive month, in negative territory, amplifying its decline from -2.8% y/y in April to -3.3% in May, its weakest rate for a similar month since 2009, being significantly below market expectations (-1.3% y/y) and the level registered in May 2018 (0.2% y/y). Moreover, in the accumulated period from January to May, industrial activity averaged a variation of -1.6% ytd, also its worst advance for a similar period since 2009. This was mainly driven by a sharp decline in construction, which added four months of contractions, passing this time from -4.2% y/y to -9.8% (vs. 0.0% y/y a year earlier), its worst decline in 10 years, which more than offset the rebound in manufacturing, -0.4% y/y to 0.7% (vs. 2.7% y/y in May 2018), and generation of electricity, gas and water, from -2.0% Y/Y to 1.6% Y/Y (vs. -1.2% Y/Y in the same month of 2018). Meanwhile, mining remained in negative territory at -8.9% y/y from -9.0% in April (-6.5% y/y vs. a year earlier). Similarly, with seasonally adjusted figures industrial activity decreased -2.1% m/m accompanied by a deterioration in all of its four components.

PERU: THE CENTRAL BANK SIGNALS (WE BELIEVE) A DOWNWARD BIAS FOR ITS REFERENCE RATE GOING FORWARD

The Central Bank maintained its reference rate at 2.75%. However, the wording changes in its announcement clearly point, in our view, to a leaning towards lowering its rate in the future. This is in line with our change in outlook to lowering its reference rate from 2.75% to 2.50% in 1Q2020 (previously we expected stable reference rate with a downward bias). We notice three changes in the wording of the CB statement:

1. Past allusions to the trade war as a risk in terms of market volatility have disappeared, and been replaced by expectations of a more expansionary monetary policy globally as a risk for market volatility.
2. The announcement clearly states a downside risk to inflation due to the fact that domestic demand is underperforming expectations.
3. The announcement now states that it will be following new information on inflation and its determinants and will evaluate “adjustments in its position” regarding inflation.

All these changes in wording ratify the view we picked up at Friday's Central Bank quarterly Inflation Report conference, in the sense that the CB is now given serious consideration to lowering its reference rate, has not yet reached a determination in this regard, and will continue monitoring the economy, for perhaps another two quarters before deciding. In our view, the aspects that the Central Bank is monitoring (domestic demand, public sector investment, confidence levels, inflation itself) are likely to lead it to reduce its rate, albeit non-aggressively, not sooner than 4Q2019 and not later than 1Q2020.