

LATAM Market Update

- **Chile: Retail sales ostensibly decreased around 0.5% y/y in June; Central Bank holds rate at 2.50 percent but trade woes and domestic weakness strengthen call to cut**

We anticipate a decrease in retail sales (IVCM) of around 0.5% y/y in June. Our indicators, based on credit and debit card transaction data, point to a null expansion of retail sales (excluding cars) in June. However, supermarket sales are accelerating, and we forecast an expansion of around 3% y/y.

The main contributions to the deceleration in retail sales come from big stores, furniture and electronic and clothing, partly due to “Cyber Day” in May. On the other hand, car sales remained low, close to 2013 levels, decreasing 14.4% y/y in June. We forecast a fall between 5% and 10% in automobile sales this year (385k), with a slight positive growth in 2020.

Additionally, manufacturing purportedly shrank between 4-5% in June, in line with industrial exports. Mining production however, recovered positive growth rates, even after the strike in Codelco’s mine during the second half of the month. Overall, we forecast an expansion of economic activity (IMACEC) between 2-2.5% y/y in June.

However, this would be the last disappointing activity figure. July will show a significantly higher GDP growth, between 4-5% y/y, not only by a favourable basis of last year but also by a solid growth in core-activity sectors and a rebound in mining production. Only if GDP growth is below 4% y/y in July, it would be time to adjust downward the medium term GDP growth of our baseline scenario (3.2% GDP growth in 2019 and 2020).

Central Bank (CB) kept rates at 2.5 percent while signaling additional monetary stimulus as soon as September if its baseline scenario continues to be disappointing. The CB was expecting a GDP growth of 2.4% in 2Q19, but the economy will expand no more than 2.2% y/y. Additionally, core inflation in services was below its baseline scenario reflecting persistent or even widening output gap according to the Central Bank.

In the short-run, risks may come from domestic activity but also from an intensification of the trade war. The Board acknowledged the uncertainties related to the economy’s growth path due to global trade headwinds, but refrained from offering “explicit” guidance about an imminent rate cut before releasing the next Monetary Policy Report in September. Therefore, we consider that the quite low GDP growth in June (Scotiabank 2.0-2.5% y/y) and subdued inflation (Scotiabank 0.1-0.2% m/m) will open the door for justifying a cut of at least 25 bp. in September’s meeting.

The minority vote of one of the Board members reflects that the options evaluated were maintaining or cutting the monetary policy rate. As a result, the Board is no longer adopting a neutral bias. We consider the four members who voted to maintain the rate at 2.5 percent are as dovish as the dissident voter. In order to

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@scotiabank.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

avoid further market surprises after the unexpected 50 bp. cut in June's meeting, they just preferred to accumulate more information regarding the speed of growth and inflation, the Fed's decision, as well as releasing an exhaustive analysis in the Monetary Policy Report.

Calls from some analysts for the Central Bank to ease policy intensified after first-quarter GDP came in below expectations. The CB delivered a surprising cut of 50 bp. in June making reference to a pool of reasons related to the revision of structural parameters and minor negative surprises in core activity and inflation.

The CB implicitly recognized that there is large spare capacity in the economy and that a further improvement in the labour market—impacted by the immigrants' wave—is likely needed for inflation to be consistent with the target. We have to recall that the revision of the potential GDP has enlarged the output gap which is the favourite measure of the CB for diagnosing domestic inflation pressures.

We consider that the statement has an "implicit" easing bias with the CB sounding less confident about the economy after a run of disappointing data lately. The on-hold decision comes just 2 weeks before the Fed's meeting at the end of this month where the market is expecting another cut of 25 bp. We think the Fed's decision could be an additional trigger for the Central Bank to ease in September.

Our view: We still consider that the baseline scenario of the CB has a significant probability to be positively surprised during the second semester. Activity was impacted by supply shocks coming from Mining, Fishing & Agriculture during the first half of the year, but core activity has performed relatively well despite the challenging external scenario. In fact, we forecast GDP growth above 4% y/y during the 3Q19 thanks to the former resilience and favourable basis of comparison. On the other hand, inflation will continue a recovery process driven by the recent depreciation of the peso and some pressure coming from services. Nevertheless, our baseline scenario recognizes that the CB is on track to ease, introducing at least 25 bp. as implicit in surveys and swaps rates, with the next cut in September's meeting.

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