

LATAM Market Update

- **Mexico's Central Bank Quarterly Report (2Q); Minutes of the monetary policy decision announced on August 15, 2019**
- **Peru: The Central Bank refrains from intervention as the PEN tests 3.40**

MEXICO'S CENTRAL BANK QUARTERLY REPORT (2Q); MINUTES OF THE MONETARY POLICY DECISION ANNOUNCED ON AUGUST 15, 2019

The Mexican economy faced a difficult environment in the second quarter of the year, due to both internal and external factors, which affected its dynamics. Economic growth remained stagnant, exhibiting results below expectations, due to the persistence of economic slack conditions. Regarding the performance of general inflation, although its annual average rose between the first and second quarters of the year (from 4.10% to 4.21%), its most recent result (3.29% in the first half of August) showed a downward trajectory. In this context, Banxico kept the benchmark interest rate stable at its meetings in May and June, but in August reduced it from 8.25% to 8.00%, due to general inflation being decreased according to its forecast; greater economic slack compared to what was expected, and the recent behaviour of external and internal performance yield curves. In this context and in line with recent data and as expected, Banxico reduced for the fifth consecutive time its estimated range for GDP growth in 2019 and that of 2020, now at a range between 0.2% and 0.7% from 0.8% to 1.8% prior for 2019 and a range between 1.2% and 2.5% from 1.7% to 2.7% in 2020 maintaining a risk balance to the downside. For the average annual general inflation in 2019-2020, Banxico reduced its forecast now expecting general inflation at 3.2% at the end of 2019, while next year the forecast remained unchanged at 3.0%.

In the fifth monetary policy meeting of the year all members of the Board noted that during the second quarter of 2019 the world economy decelerated, reflecting lower growth of the main advanced and emerging economies. In this sense, most members added that this deceleration had been widespread and greater than anticipated. Banco de México's Governing Board decided by majority to lower the target for the overnight interbank interest rate by 25 basis points to 8.00%, considering that under the current environment such level is consistent with the convergence of headline inflation to the central bank's target within the time frame in which monetary policy operates. In this occasion one member voted to maintain the target at 8.25% and with the minutes published today now we know that the member who voted to maintain was Deputy Governor Javier Eduardo Guzmán-Calafell. In his statement he reflected that in his judgment, the combined effect of several factors makes monetary policy easing inadequate. First, although headline inflation has decreased, its core component, which reflects inflationary pressures more accurately, has remained high for a long period and does not show signs of decreasing. Second, at the moment there is no information on fiscal policy for 2020, a fundamental input for monetary policy implementation. Third, lowering the policy rate implies surprising the markets, which creates the risk of an adverse reaction and of making the central bank's communication policy confusing.

The median projection expects the policy rate at the end of 2019 at 7.75% which implies one more rate cut. The next decision is scheduled for September 26th.

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PERU: THE CENTRAL BANK REFRAINS FROM INTERVENTION AS THE PEN TESTS 3.40

The PEN went just over 3.40 on Wednesday, the last day of official trading (Thursday and Friday are holidays). The interesting issue here is that the Central Bank did not intervene to put in a hard ceiling at 3.40. It is not totally clear what this means, as this level seems to have acted as a ceiling throughout most of the year. It could be that the CB simply does not seem to perceive sufficient demand for USD, and is willing to allow some movement around 3.40 as a soft ceiling. One wonders, though, if the CB might not be willing to let the PEN float up, at least in a mild and contained fashion, and only so long as the demand for USD in the FX market is linked to transactions or hedging of real assets, and not short-term speculation on the PEN weakening.

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