

LATAM Market Update

- **Chile:** Monthly GDP in July expanded 3.2% y/y, affected once again by supply shocks
- **Colombia:** August CPI inflation stood at 0.09% m/m, food inflation eased, while still muted exchange rate pass-through
- **Peru:** Congress puts Vizcarra in check; Central Bank turns mildly upbeat on growth

CHILE: MONTHLY GDP IN JULY EXPANDED 3.2% Y/Y, AFFECTED ONCE AGAIN BY SUPPLY SHOCKS

The damage of the teachers' strike persists, but other sectors recover—more accounting than economic effect. Economic activity in July (IMACEC) expanded 3.2% y/y (consensus 3.3%) showing a positive but insufficient non-mining dynamism, and responding to the null reversal of supply shocks that affected personal services and other supply sectors. Non-mining activity grew 3.4% y/y, with a positive impact from manufacturing, business services and trade, but with personal services absent, the sector with the highest weighting in GDP (Graph 1).

What happened with personal services? This sector of the economy includes health and educational services, where the main contribution comes from those provided on account of public expenditure. The Teachers' strike that ended on July 23rd means that the hours lost by students are not counted as part of the GDP, according to National Accounts methodology, despite the fact that the Treasury has disbursed the money for the corresponding education expenditure. We expected some positive reversal after such strike significantly affected last June's growth. The reversal is clearly less than we estimated. In fact, this sector had to have an inter-annual expansion around 4%, but we estimate that a modest and almost insignificant 0.7% y/y expansion (Graph 2). This would have taken half a percentage point of growth from monthly GDP, that is, we would have had an expansion close to 3.7% y/y in July. However, this should not be read as a true slowdown in activity, as it responds rather to a methodological-accounting aspect of the measurement of GDP, in a context where tax money continues to be disbursed and support private spending.

Regarding business services, the mention of its positive contribution in the growth of the month stands out. Since this item is linked to the recovery of investment, we are facing a confirmation of the good dynamism of investment at the beginning of the second semester. Hence, we maintain our estimate that total investment would grow 7% y/y this second half, reaching an annual expansion of 5.5% for 2019, which is above the estimate by the Central Bank in its September Monetary Policy Report (4.0%).

For August, we estimate an expansion of activity between 3.25% and 3.75% y/y. This month will have to deal with one less business day, but with positive mining contribution and some additional recovery coming from personal services, while we will see a contraction of the manufacturing industry (Graph 3).

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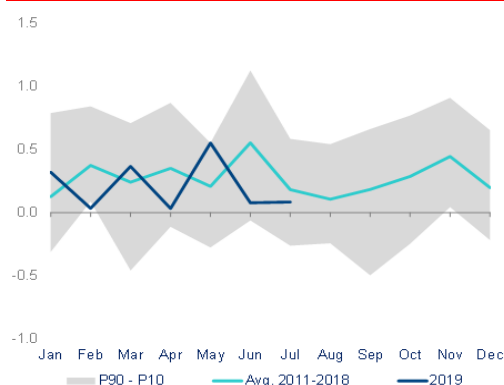
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The expansion of 1.1% y/y of the mining sector in July was higher than that indicated by the National Statistics Institute, while electricity generation continues to recover, signaling greater extraction and processing of ore in August (Graph 4). In this context, due to lower comparison bases and greater production, we anticipate a mining expansion between 4% and 6% y/y.

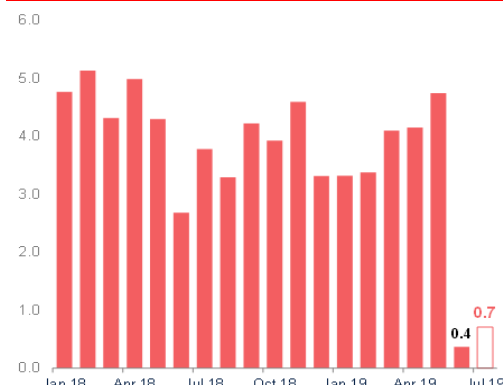
Public spending would continue to contribute to non-mining activity, an aspect that is reaffirmed with the expansion of fiscal spending in July (8% y/y in real terms). The growth of the public disbursement in the second semester will exceed 5% y/y (real growth), giving resilience to the growth of public wage employment and scheduled public investment.

This expansion represents a negative surprise in our GDP growth projection of 2.9% for 2019, so we adjust this projection downward pending the August growth figure. In any case, the Central Bank growth scenario seems much more likely after the recent monthly GDP growth.

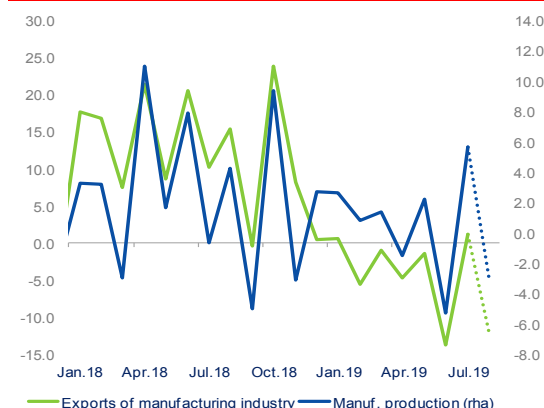
Since the CB most likely already had this figure before the release of the Monetary Policy Report, we do not consider that it affects its view of the monetary policy expressed in that report. Consequently, we are still waiting for a new cut of the TPM of 25 bp. at the October or December meeting.

Graph 1
Non-mining activity
(percentage, sa annual growth)


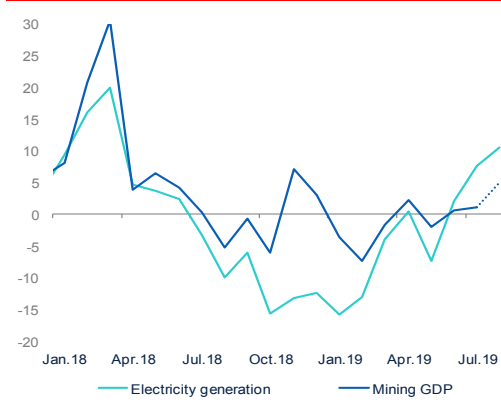
Sources: Central Bank, Scotiabank Economics.

Graph 2
Personal Services growth, estimated for July
(percentage, annual growth)


Sources: Central Bank, Scotiabank Economics.

Graph 3
Manufacturing and industrial exports: August would see another annual contraction
(percentage, annual growth)


Sources: Central Bank, INE, Scotiabank Economics.

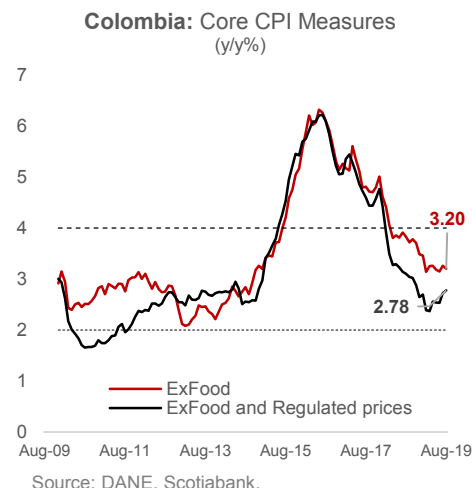
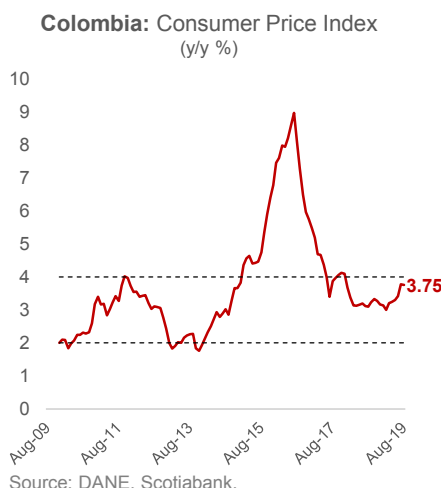
Graph 4
Mining activity and electricity generation: a recovery this second semester
(percentage, annual growth)


Sources: Coord. Eléctrico, Central Bank, Scotiabank Economics.

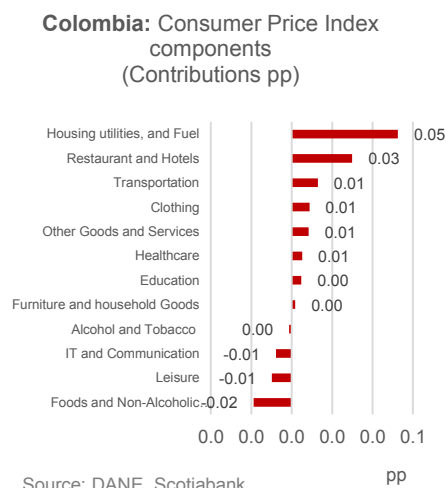
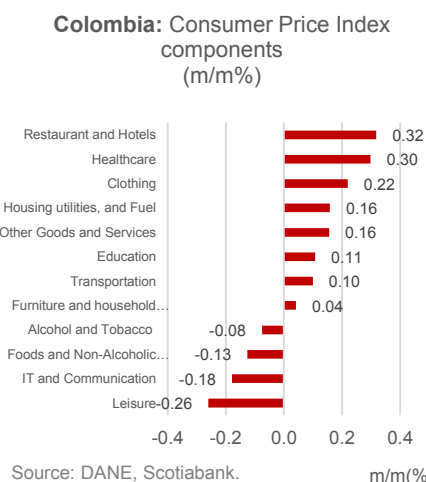
—Carlos Muñoz, Waldo Riveras & Jorge Selaive

COLOMBIA: AUGUST CPI INFLATION STOOD AT 0.09% M/M, FOOD INFLATION EASED, WHILE STILL MUTED EXCHANGE RATE PASS-THROUGH.

DANE released August's CPI inflation. Monthly inflation stood at 0.09% while the annual inflation rate came in at 3.75%. The figure was below consensus (according to Bloomberg's survey 0.17%), and closer to our estimated 0.12% m/m. Foodstuff inflation was negative for the first time since Nov-2018 (-0.13% m/m) and subtracted 2 bps to headline inflation. Annual inflation remained close to BanRep's target range ceiling, although eased a bit from last month (3.79%). We expect inflation to hover around the current level for the rest of 2019 due to statistical base effects in food prices.



August CPI inflation was influenced by increases in housing group prices (+0.16% m/m), mainly rent fees (+0.22% m/m). Energy prices fell again (0.25% m/m), especially in the Caribbean coast, which continues to help the moderation in regulated prices. Worth noting, contrary to what we have seen in previous months, food prices contributed negatively with 2 bps to headline inflation on the back of perishable goods such as potatoes (-7.12% m/m), tomatoes (-8.87% m/m), bananas (-3.62% m/m) and onions (-5.33% m/m); those items more than offset the effect of price increases in fruits (+6.10% m/m) and rice (+2.17% m/m).



Regarding the exchange rate depreciation effect, DANE reported that items like airline tickets prices increased a bit due to the recent exchange rate depreciation. However, other tradable items such as vehicles and some foodstuff prices do not have adjusted prices up yet. We estimate that tradable inflation was 1.50% y/y and could increase moderately in the forthcoming months.

Core inflation measures continued under control, close to BanRep's objective (3%). Ex-food inflation came in at 3.20% y/y, while Ex-food and Regulated inflation was 2.78% y/y. It is worth noting that the negative effect from blockages of a major road linking Bogotá to the southeast was not mentioned in this press conference and is expected to be reopened in September which could be favourable for some prices, especially non-core.

Bottom line, August inflation came below market expectations, but we do not think it will affect short term inflation expectations because there is, still, some statistical base effect in the next couple of months that could keep y/y inflation at current levels. Core inflation continues close to the target (3%), which should keep BanRep's staff calm. Therefore we do not expect August's inflation to change BanRep's or markets' base case scenario of a steady policy rate for the rest of 2019. In our opinion, annual inflation at 3.75%, and recent exchange rate depreciation keep out of the table a discussion of a possible monetary policy easing for the time being. Instead, better economic growth and wider current account deficit could motive a rate hike discussion in 2020.

—Jackeline Pirajan & Sergio Olarte

PERU: CONGRESS PUTS VIZCARRA IN CHECK; CENTRAL BANK TURNS MILDLY UPBEAT ON GROWTH

On Wednesday a Congressional Committee, dominated by opposition groups Fuerza Popular (FP, Fujimori) and Apra, requested increased time and faculties to investigate possible corruption involving the Chinchero (Cusco airport) project and the Conirsa Consortium (led by Odebrecht and Graña y Montero). Both projects have links with Vizcarra, who proposed and defended an addenda for the Chinchero airport project as a cabinet member during the Kuczynski regime. Conirsa was involved in the Interocéánica Sur highway, and the Vizcarra family company CyM Vizcarra was one of its suppliers from 2006 to 2008. The Committee is also seeking to investigate whether Vizcarra's legally mandated yearly Address to the Nation, held on July 28, had received the full-cabinet approval as required by law. Finally, the Committee advised on its intention to investigate polling companies. Vizcarra has frequently pointed to poll results in defending his political reform measures. This sudden rush of investigations involving Vizcarra, including one that is fairly ludicrous (on popularity polls), is being taken as a frontal, and personal, counterattack on President Vizcarra for having called for early elections and for continuing to push for political reforms. The Committee's intention is so obvious, and its agenda is so hostile and personal, that it would have had a strong impact on the credibility of Congress, had Congress had any credibility left to lose. In our view, these actions lower the likelihood that early elections will be held. Although it is too early to determine the real intention of FP and Apra, these investigations do insert distraction, and, indeed, confusion, in the political arena, and give Congress an excuse to stall approval of early elections (and, possibly, of political reforms in general), while, at the same time, weakening the Vizcarra government enough so it cannot take counteraction. The risk is that, even though there probably is not an intention to actually take down the Vizcarra government, these actions could conceivably help unleash political events leading to such a result. President Vizcarra later called these actions "an attitude of intimidation", and said that they give further justification for early elections.

During a conference on Wednesday, Central Bank Head Julio Velarde stated that, in his view, monetary policy is not effective in periods of great uncertainty. He gave the example that, globally, interest rates are close to nil, or even negative in some countries, without stimulating investment. Velarde seemed to be suggesting that Peru's Central Bank might not continue lowering rates, as this would be ineffectual.

Velarde was relatively upbeat on the economy going forward, suggesting that the slowdown in growth was past. Velarde stated that non-resource GDP would have grown 3.2% in July, with consumption up 2.7%, and electricity 4.7%. This would add to 52% growth in fishing. Velarde did not state an aggregate GDP growth figure for July, but all this would add up to +3.0%. This is not very much different from what we are forecasting: 3.1% non-resource GDP growth, and 3.0% for the aggregate.

Velarde expressed some concern for growth going forward, due to declining growth expectations and lower business confidence. However, he balanced this with reports that business sales and orders are improving (slightly), and sales taxes for sales made in July (reported in August) came in very strong.

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