LATAM Market Update

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CHILE: DOVISH BIAS IS MAINTAINED, WITH SPECIAL FOCUS ON THE DOMESTIC SITUATION

The Central Bank cut the MPR by 25 bp, leaving it at 1.75%, in line with our expectations. Expansive bias is maintained and the need to evaluate additional monetary stimulus given the macro-financial implications of the domestic situation is introduced.

The Board notes that recent events have a negative effect on short-term economic activity. Scotiabank estimates that monthly GDP growth in October will be between 0 and 1% y/y under the assumption that the riots end this Friday. The reconstruction and the measures announced by the government could compensate (partially) for these effects, but certainly that does not seem to be the preliminary view of the Board, indicating in the bias of the communiqué that inflationary convergence could be affected "after the events of the last days".

Only in the next Monetary Policy Report (December 9th) will we have the quantitative evaluation of the CB in terms of growth and inflation and, consequently, the dynamics that the MPR will follow during the next quarters under its new baseline scenario. Given the local situation, we estimate that the Board will choose to cut the MPR once again, leaving it at 1.5%, as we noted in our outlook after recent events at the national level, while also maintaining an dovish bias conditional on the evolution of the domestic and external scenario. The December cut will not necessarily be the last cut of this cycle. In this last Monetary Policy Report of the year, we expect the CB to deliver a forecast of growth for 2020 centered at 2.75%. For 2019, we anticipate the CB will incorporate the lower activity/demand prints of the last quarter of the year, forecasting a GDP growth of 2.2%. We also expect an inflation forecast of 2.8% for this year and 2.6% for the next.

Undoubtedly, political instability and disturbances are considered by economic literature as harmful to economic expectations, business confidence, job creation, consumption and investment. Consequently, to the extent that they are of short duration, they tend to require greater monetary stimulus. To the extent that they are lasting, monetary policy begins to play a different role, containing possible capital outflows.

The Board notes that the external scenario has evolved in line with expectations, framed by a slowdown in activity and greater monetary stimulus in many of the economies. This indicates that the CB would be much more concerned with the evolution and impact of local events, although it still considers that the external scenario has not yet turned toward delivering particularly favorable financial and economic conditions.

—Jorge Selaive, Carlos Muñoz & Waldo Riveras

MEXICO: ECONOMIC ACTIVITY WEAKENS IN AUGUST; INFLATION IN LINE WITH BANXICO'S TARGET

Mexico's Monthly Indicator of Economic Activity (IGAE) contracted from 0.3% y/y in July to -0.9% y/y in August, standing below market expectations (+0.1% y/y) and last year's result (+1.8% y/y), with original figures. Furthermore, during the first eight months of the year, economic activity stagnated at 0.0% with respect to January-August of last year, being its lowest cumulative growth in a decade.

Within its components, the services sector fell from 1.1% y/y to -0.7% y/y (vs. +2.5% in August 2018), while the industrial component declined for the tenth consecutive time, now from -1.8% y/y to -1.3% y/y (vs. +0.3% y/y one year ago). On a seasonally adjusted basis, IGAE increased 0.1% m/m, following a -0.2% m/m decrease in the previous month.

IGAE's sluggish performance suggests a rather weak dynamism of the Mexican economy—which depicts the lingering economic and political uncertainty, due to both external and domestic factors—that may extend until the end of the year.

In the first half of October, headline inflation printed at 0.40% biweekly, slightly below market consensus (+0.43%). This outcome was mainly driven by the seasonal increase in electricity tariffs, due to the roll back of summer subsidies in some cities, which was partially offset by a decline in some agricultural commodities and low octane gasoline. In its annual comparison, inflation remained at 3.01% with respect to the previous fortnight (vs. 4.94% a year earlier), while its core component decelerated from 3.72% to 3.68% and non-core inflation increased from 0.84% to 0.99%.

These prints reinforce our view that the Central Bank will continue to cut interest rates at its next meeting in November. Although core inflation has remained persistent around 3.8%, recent headline inflation dynamics have been enough for lowering the overnight interest rate by 25bp in the past two meetings, in which two out of five members of the Board argued for a more aggressive easing.

—Alejandro Stewens

PERU: REGIONAL CEMENT SALES POINT TO GREATER PUBLIC INVESTMENT; SOCIAL PROTESTS: THE DIFFERENCE BETWEEN PERU AND CHILE

Cemento Pacasmayo cement sales were up 17.6%, y/y, in 3Q2019. We normally wouldn't report on a company more of regional than national importance, such as Pacasmayo, except that this time it is suggesting something that we've been waiting for, for a long time. Namely, that the government's post-Niño reconstruction efforts in the North may finally be taking off. This could be a good sign that public sector investment is starting to gain more importance. Our hope is that, little by little, public investment will (finally!) turn into the driver of growth that we've been waiting for since 2016. However, we need more confirmatory data from other sources, and for a longer period of time, before we begin to factor this into our forecasts.

Following the eruption of violent protests in neighbouring countries, we've been receiving a lot of questions on whether Peru will be next. The concern is understandable. After all, we're surrounded. Or at least it seems that way. Chile, Ecuador, Bolivia are all neighbouring countries that share similar traits in terms of skewed income distribution and paucity of basic State services. So, why shouldn't Peru be next?

Well, for one thing, skewed income distribution and paucity of State services are long-standing historical issues, that don't really help enough in explaining why protests have erupted now in neighbouring countries. Furthermore, although the reasons behind the depth of protests in Chile are not very clear, they are clear in Ecuador and Bolivia, and they are very local reasons that have little do with events in the other countries. It just doesn't look like contagion, once you look deeper. Seeking a common thread in something that might not be more than a timing coincidence might simply be a case of overanalyzing things.

Precedent also supports the view that there should be no contagion. At least in Peru's case. Protests in Chile in the relatively recent past (think of the student protests in 2011 and 2006, for example), had no repercussion in Peru. Nor have protests in other neighbouring country.

Additionally, the dynamics of protest are different in Peru. Social/political protests not only occur in Peru today, but are very frequent. Only, they are local or regional, rather than national, in scope, and they are almost always very focused on specific issues. This year we've seen turbulence and conflict around mining projects (Tía María) and operations (Las Bambas), around oil fields and the pipeline in the rainforest, and around issues such as highway tolls. Social demands are real and continual, but are more local in nature and more focused on particular issues.

Finally, political events and corruption scandals are overshadowing everything else, and are being dealt with through institutional means (more or less), with very little protests on the streets. The continual flow of corruption news and, the noise surrounding the closing of Congress, together with the proximity of two elections, Congress in January 2020, and Presidential/Congressional in 2021, have been absorbing, or at least distracting, society's political and social energies, and any attempt to stage protests would risk being buried beneath the dust of macro-political turbulence.

So, then, given these arguments, am I 100% sure that a large-scale Chile type situation will not occur in Peru? As likely as I believe it is, the answer is no, I'm not 100% sure. After all, no doubt that a couple months ago few, if any, analysts in Chile would have expected the protests that are occurring today.