LATAM Market Update

- **Chile: October's CPI responds to the depreciation of the peso as we expected**
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CHILE: OCTOBER'S CPI RESPONDS TO THE DEPRECIATION OF THE PESO AS WE EXPECTED

Inflation of services reaches 2.6% annually. Even so, the CB would cut 50 bp in December if there are no depreciative surprises.

Annual inflation reaches 2.5% and approaches our revised target of 2.8% for December. With a print above forward prices and surveys, October's CPI advances 0.81% m/m, very close to our 0.74% m/m projection. This monthly CPI was more complex to project than usual given the greater difficulties in anticipating the methodological adjustments that the NBS (National Bureau of Statistics, INE in Spanish) could make after the disturbances. The adjustments ranged from freezing prices since October 18th to making isolated surveys in some establishments.

The total CPI diffusion was marginally above its historical average for the month, with 57.4% of the products showing a positive variation. The diffusion of core services was in the high part of its historical range (55%), showing persistence with respect to its September registration, which was the maximum for that month. Finally, diffusion of core goods had a print around its historical average for October (53.6%), increasing considerably compared to last month.

Core CPI increased 0.6% m/m (2.6% y/y), with a sharp increase in goods (0.9% m/m, reaching an annual variation of 2.5%), which evidences strong CLP pass-through this last part of the year. The CPI for core services, meanwhile, increased 0.5% m/m, reaching an annual variation of 2.6%, a print somewhat lower than what was seen in recent months

At the product level, it is worth noting the strong increase in beef meat, which increased 4.8% m/m, after a sharp fall in September. This is a result of less room to reduce margins by retailers. Likewise, the tourist package increased by more than 10% in October, influenced by a higher exchange rate and a structural change in its price trend, which this year has risen considerably, accumulating an increase of 43% in the last six months.

This print should surprise the Central Bank given its last baseline scenario where it projected a 2.5% Core CPI in December, in circumstances that it already stands at 2.6%. Likewise, core services (2.63% y/y) would be showing a relevant recovery in the margin both in diffusion and at the total level. This set of

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information leads to some caution before proceeding particularly dovish in the face of the abrupt opening of capacity gaps and the obvious cut in activity for the last quarter of 2019 and 2020 that will have to be made in the December Report. However, we are inclined to forecast a 50 bp cut in the December meeting that would leave the rate at 1.25%. Subsequently, we anticipate a new cut of 25 bp at the beginning of 2020.

Why cut "beyond" the usual 25 bp. in December? Because what defines inflation convergence in the first place is not past inflation but expected inflation, especially when it is possible to rule out second order effects given the total inflationary level in all of its components even below the target of 3%. Likewise, more relevant for the inflationary convergence is the cancellation of part of the usual CLP pass-through given the freezing of several products/items in the basket. This 50 bp cut would be conditional on the fact that during the days prior to the monetary policy meeting the exchange rate is not subject to depreciative speculative pressures higher than those seen in recent times (mass capital outflow, aggressive institutional residents exit, between others). If an exchange rate stress event occurs, we anticipate the CB would opt for a more modest 25 bp cut, avoiding feeding any unwanted financial effects on the exchange rate that would increase the cost of exchange coverage, affecting the on-shore spread in dollars over libor. For now, our baseline scenario considers a 50 bp cut at the December meeting.

For November's CPI we have to reverse the increases observed in electricity rates and multimodal transport (Metro). Incorporating seasonal effects that have been marginally exacerbated, as well as a reduction in sale offers by retailers, along with the effect of the CPI of 0.8% on indexed items (rent, financial services, among others), we expect November's CPI between 0% and 0.1% m/m, which represents a slight upward adjustment compared to our previous projection centered at 0% m/m for the eleventh month.

—Jorge Selaive, Carlos Muñoz & Waldo Riveras

MEXICO: DOMESTIC CONSUMPTION UNDERPERFORMED, UNDERCUTTING THE ECONOMIC OUTLOOK

In August, domestic private consumption figures exhibited poor results, mainly because its n.s.a. annual expansion printed its worst pace in more than 6 years, averaging its weakest increase in a decade during the first eight months of 2019. Therefore, private consumption's outlook seems to hold a negative bias. Even though the strong remittances, the slight recovery of consumer credit and the favourable dynamism of wages are expected to continue to support demand for goods and services, the prevailing domestic uncertainty continues fostering prudence among consumers.

Furthermore, August's domestic private consumption index, n.s.a., shrunk 0.5% y/y in real terms (vs. +2.2% in July 2019 and +2.5% in August 2018), while the average growth during the first eight months was only 0.9% y/y. Within the n.s.a. index, domestic consumption of goods and services moderated its pace, declining from 1.2% to 0.0% y/y in real terms (vs. +2.3% in August 2018), and imported goods figures plunged, from 11.4% to -4.3% y/y in real terms (vs. +4.4% a year earlier).

—Daniel Mendoza

PERU: THE CENTRAL BANK SURPRISES BY LOWERING ITS REFERENCE RATE TO 2.25%

In a surprise move, at least in terms of timing, Peru's Central Bank lowered its reference rate 25 bps, to 2.25% on Thursday. We had been expecting the Central Bank to lower its rate one more time, but our expectation was for December, or even January, rather than in November. The Central Bank's decision has us wondering what is next. Although the Central Bank President, Julio Velarde, had signaled earlier this week that he had a concern, saying that September's GDP growth would come in between 2.5% and 3.0%, whereas he had expected something "much" higher, this was a single comment that contrasted with a number of previous comments about how the economy had turned the corner and how lowering the reference rate was ineffectual in stimulating investment when uncertainty is high.

In the accompanying statement, the CB stressed that it had a downward bias on its 2% inflation forecast (yearly inflation came in at 1.9% in October), and that the 0.11% monthly inflation for October would have been negative, if not for one-off factors, such as a one-time increase in water and light. The CB stated that this suggests "the possibility of lower than expected domestic demand growth". This, and a decline in inflation expectations, seem to be the only motivation for its decision, as other things mentioned in the statement do not seem to support the decision, including expectations that government investment will improve, GDP growth is closing the gap with potential GDP growth, and global growth risks have softened.

So, what is the Central Bank telling us? One, is that they are more worried about growth than we thought. Of course, they had been a bit optimistic compared to us, with a 2.7% GDP forecast for 2019, to our 2.3%, and 3.8% for 2020, to our 3.0%. Two, is that inflation is lower than they expected, given them more room to lower rates, especially if inflation expectations continue adapting downward. To a certain extent, then, the Central Bank seems to be seeing things differently than we had previously thought and to how they had signaled in the past.

Are they also suggesting that uncertainty, domestic (political) and global, has eased enough that lowering rates may have a greater impact? Not necessarily. The CB also does not seem to have lowered its rate as a signal for the economy, as few investors were demanding, or hoping for, Central Bank action. The decision would seem to have been more of an insurance move. However this may be, the Central Bank does appear to be giving the message that growth is not improving enough, in timing or magnitude, for their taste.

Given that the Central Bank's move was a surprise, we need to reevaluate their intentions going forward, before we can ratify our position that the CB would discontinue lowering rates at 2.25%. It is no longer clear to us that further cuts are off the table.

José Luis Sardón, one of the seven members of the Constitutional Court, suggested that, based on precedent, it could take the Court until July 2020 to reach a decision. Sardón also stated that, largely due to this delay, the sentence the Court will give "will be inconsequential", as it will have been overtaken by events. Sardón has ratified what many political analysts have already concluded, that regardless of whether the closure of Congress was legal or not, to reinstate the closed Congress would not be feasible in practice.

In an equally charged political statement, a person close to Keiko Fujimori stated to the prosecuting attorney in her case, that Keiko knew that Odebrecht had been contributing to her 2011 presidential campaign. Furthermore, Keiko would have given instructions to find "false contributors" (stand-ins to disguise the real, business, contributors), during the 2016 campaign. This is likely to be a strong statement against Keiko Fujimori in her corruption lawsuit.