January 15, 2021

Latam Daily: Peru's BCRP Holds; Chile Fiscal Package Coming; Argentina Inflation Up

- **Argentina: Inflation accelerated in December**
- **Chile: A new fiscal package sooner rather than later**
- **Peru: As expected, the BCRP holds at 0.25%**

ARGENTINA: INFLATION ACCELERATED IN DECEMBER

In data released from INDEC later in the day on Thursday, January 14, inflation picked up from 3.2% m/m sa in November to 4.0% m/m sa, which was dead on a very late update to the Bloomberg consensus. We had long forecast a 3.6% m/m rise in the month, with upside risk owing to the BCRA's monetization of fiscal deficits through October; the rapid expansion of the monetary base; and pass-through effects from ARS depreciation. Core inflation's 4.9% m/m sa print reflected these underlying pressures (chart 1).

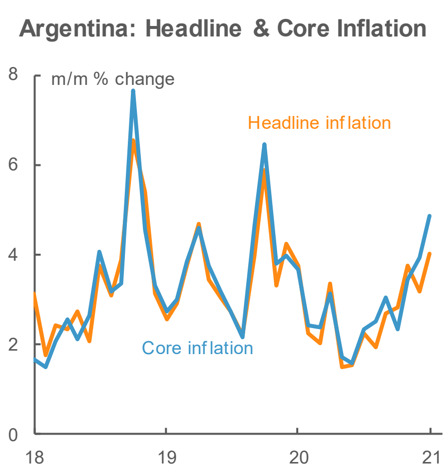
Argentine inflation would be even higher were it not for price controls. While goods prices were up 3.9% m/m sa and services prices rose 4.0% m/m sa, regulated prices rose by only 2.6% m/m (chart 2).

The print brought year-on-year inflation up from 35.8% y/y in November to 36.1% y/y in December, just above our forecast of 35.9% y/y. Core inflation rose from November's 37.8% y/y to 39.4% y/y in December (chart 3).

The decline in headline inflation from 53.83% y/y in December 2019 to 36.10% y/y at end-2020 is an artefact of level effects and price controls that mask the acceleration in sequential monthly inflation during the latter half of 2020. While monthly inflation averaged 2.15% m/m sa in H1-2020, it accelerated to a mean of 3.07% m/m sa in H2-2020. The rise in inflation would have been even greater were it not for the decline in administered price inflation from 16.9% y/y in December 2019 to 14.8% y/y at end-2020.

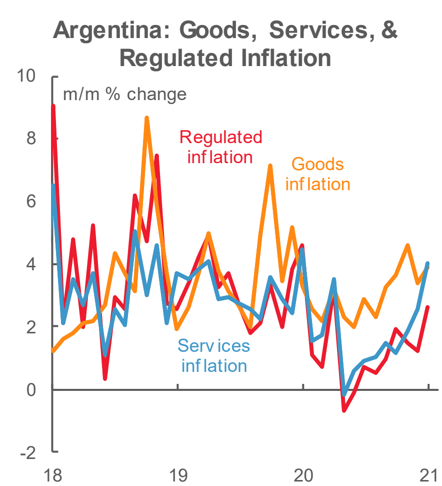
—Brett House

Chart 1



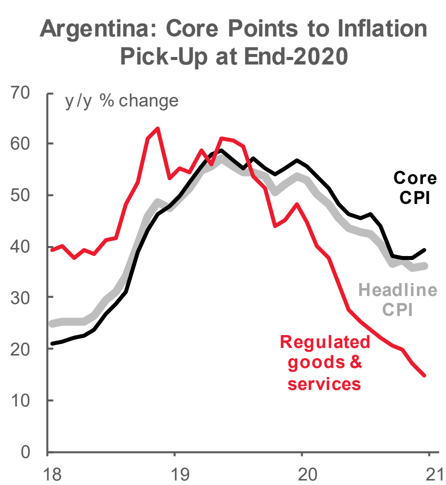
Sources: Scotiabank Economics, INDEC.

Chart 2



Sources: Scotiabank Economics, INDEC.

Chart 3



Sources: Scotiabank Economics, INDEC.

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CHILE: A NEW FISCAL PACKAGE SOONER RATHER THAN LATER

New COVID-19 cases have increased significantly and we expect the government to bring forward additional containment measures with accompanying fiscal support. Although the authorities have not yet called it a second wave, substantial signs of stress are clearly observable in the health system. Restrictions on mobility have intensified in recent weeks. In this context, a new fiscal package to support families is likely to be announced in March.

The government has at least two ways to finance this spending that is likely to amount to about USD 2 bn (0.8% of GDP).

- **On the one hand, the government could call on the committee of experts to review the long-term copper price (LTCP) benchmark for the fiscal rule.** The last revision of the LTCP occurred in August 2020, when the spot price of copper was around USD 2.8/lb. At that time, the committee determined an LTCP of USD 2.88/lb. The price of copper has increased significantly—and surprisingly—since that date, reaching USD 3.6/lb most recently. Consequently, knowing the strong co-movement between the spot price and the LTCP determined by the committee of experts, it is very likely that we should see an increase in the LTCP. If the LTCP were to be lifted to, say, USD 3.2/lb, it would open space for an additional USD 1.6 bn of government spending.

- **Alternatively, the government has about USD 5 bn available in liquid treasury assets with an important part of them in USD.** These resources could be used in a completely discretionary way. If the government chooses this alternative to finance a new fiscal package, it would certainly exert some minor, but significant, appreciative pressure on the peso.

—Jorge Selaive

PERU: AS EXPECTED, THE BCRP HOLDS AT 0.25%

In line with market expectations, the BCRP kept its reference rate unchanged at 0.25% for a ninth consecutive time at its monetary-policy meeting on Thursday, January 14 (chart 4). However, it signalled that it is looking to reduce long-term rates. It reinforced its strongly expansionary stance by activating interest-rate swaps for long-term loans in an effort to bring about lower yields, particularly for mortgage loans.

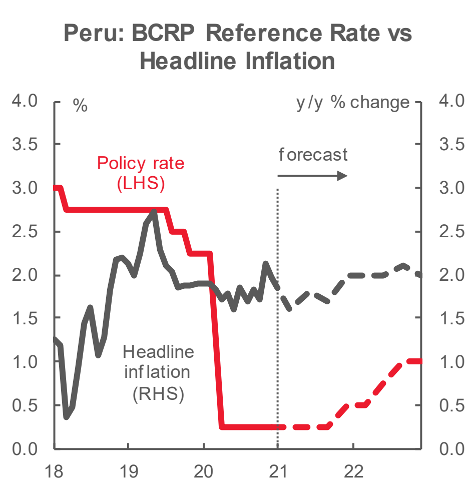
In its policy statement, the BCRP noted that inflation should stay within its target band over the next two years despite the past year's massive growth in the monetary base (chart 5). Inflation is expected to remain close to the 2% y/y midpoint of the target range during the early months of 2021, but it could fall toward 1.5% y/y in the lower part of the range at year-end due to an expectation that economic activity would remain below potential. In contrast, full-year 2021 inflation expectations are at 1.9% y/y, similar to our forecast of 2% y/y (chart 4, again).

In the short term, the BCRP warned that business expectations had moderated in December after some rebound during previous months. For 2021, the BCRP expects an economic recovery of 11.5% y/y higher than the 11.0% y/y projected in September, and more optimistic than our 8.7% y/y forecast.

Regarding the FX market, the BCRP sold USD 177 mn in the spot market and its derivatives offers outstanding were expanded to USD 65 mn in January, highlighting the longer-term tenors in the exchange swaps, i.e., from 3 months to 6 months, due to the limited appeal of short-term hedging. The PEN has appreciated by 0.2% YTD. The FX market is still marked by a record deficit of USD 3.4 bn in the cash position of the banking system. This keeps the exchange rate under pressure and prevents it from reflecting fundamentals.

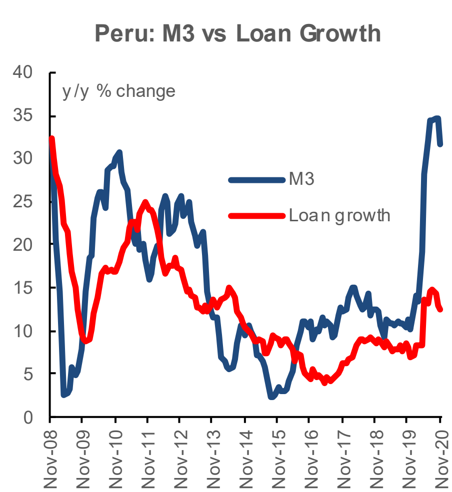
—Mario Guerrero

Chart 4



Sources: Scotiabank Economics, BCRP, INEI.

Chart 5



Sources: Scotiabank Economics, BCRP.