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GLOBAL ECONOMICS

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Latam Daily: Quiet End to Week; Mexican Inflation and BCRP Decision Recap

- **Mexico: Headline inflation sub 6%, cuts must wait a while amid high core**
- **Peru: BCRP holds key rate for 5th consecutive time and changes view regarding inflation returning to target range by year-end**

We're heading into the weekend with only some second-tier Mexican data left for release, a BCRP presser, and global markets having little in the calendar to trade on aside from Canadian employment data at 8.30ET. It was a quiet Asia session, handing over generally narrow ranges in currency, rates, commodity, and equity futures markets to European traders that just couldn't let the trading calm continue. Still, even the moves in Europe dealing are modest.

The USD is caught in 0.1/2% gains and losses against all major FX, with the clear exception of two: the top performing NOK on stronger than expected inflation, and the worst performing JPY that extended overnight weakness on dovish BoJ leaks. The MXN is flat but on track for another weekly gain (15 out of 23 weeks so far in 2023). US yields are about 3/4bps higher across the curve, SPX futures are showing a 0.2% drop, WTI is about 0.4% firmer (recovering a decent chunk of yesterday's losses on Iran-US nuclear deal rumours), iron ore is 2% higher, and copper is little changed.

Mexico releases April industrial production data at 8ET, with the median economist expecting a 1.3% y/y increase after a 1.6% gain in March, but the data will be of no consequence for Mexican rates markets that are likely content with where they sit after yesterday's inflation data (see below). For those following 'nearshoring' developments, or merely the encouraging outlook for Mexico's manufacturing sector, a key Japanese automaker announced yesterday that it will invest an extra USD330mn in its plant in the state of Guanajuato.

It will be headlines and flows that drive markets today. At 13ET, the BCRP has its post-decision press conference where we'll be looking for colour on why they've changed the language around expectations for where inflation will sit at year-end (see below). Colombia's Pres Petro is in Cuba today for peace talks with the ELN, but this is unlikely to influence local rates and currency markets that have benefitted from weakening social reform prospects and the recent lower than forecast inflation print. On a related note, we point you to our Santiago team's Chile inflation flash **here**.

—Juan Manuel Herrera

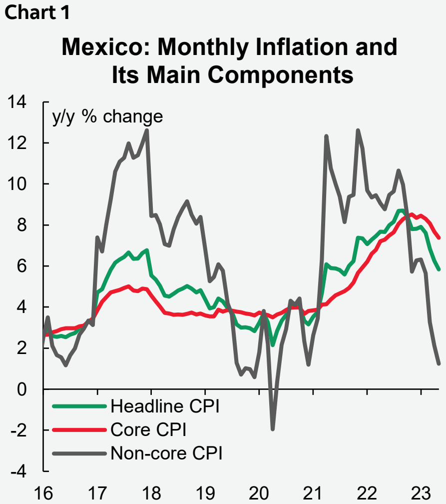
MEXICO: HEADLINE INFLATION SUB 6%, CUTS MUST WAIT A WHILE AMID HIGH CORE

In March, inflation eased slightly more than expected to 5.84% y/y from 6.25% previously (vs 5.90% consensus), reaching its lowest point since August 2022. Core inflation also slowed to 7.37% from 7.67%, practically in line with the median seeing 7.38%.

Services inflation slightly moderated to 5.43% (5.46% prior), owing to a slowing in non-housing/education services prices (7.01% vs 7.10%). Core goods inflation also slowed, to 9.04% (9.54% prior). Non-core maintains a downtrend going from 2.12% to 1.24% y/y, with agriculture moderating to 4.95% (6.13% prior) and energy dropping to -1.83% (-1.08% prior).

In its monthly comparison, headline inflation fell to -0.22% m/m from -0.02% previously (-0.16% consensus), and core inflation went to 0.32% m/m from 0.39% previously (0.33% consensus). Lastly, non-core inflation fell to -1.88% m/m from -1.25% (charts 1 and 2).

Chart 1

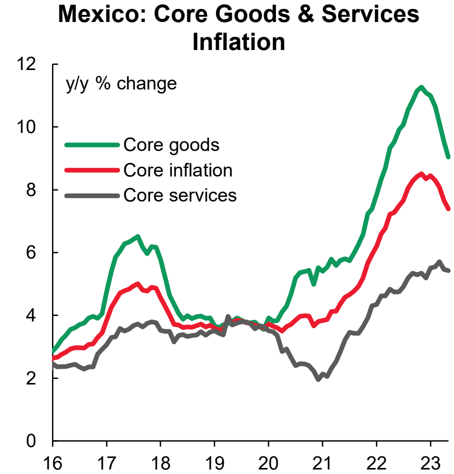


Sources: Scotiabank Economics, INEGI.

After this print, we expect inflation to continue its downtrend, although will remain elevated by the end of the year (exceeding Banxico's target by 3ppts), with core inflation also remaining above the headline trend. On monetary policy implications, analysts expect the first rate cut to be in December of this year according to the latest Citibanamex Survey. Also, analysts project inflation at 5.01% y/y at the end of 2023, and 4.02% at the end of 2024, in contrast to Banxico's forecasts, that see inflation converging to the 3.0% target by Q4-24.

—Miguel Saldaña & Brian Pérez

Chart 2



Sources: Scotiabank Economics, INEGI.

PERU: BCRP HOLDS KEY RATE FOR 5TH CONSECUTIVE TIME AND CHANGES VIEW REGARDING INFLATION RETURN TO TARGET RANGE BY YEAR END

The board of Peru's Central Bank (BCRP) kept its key interest rate unchanged at 7.75% this Thursday, in a decision widely expected by the market consensus and by us, for the fifth consecutive month. In its statement, it reiterated that it keeps its options open to changes in any direction in the future, specifying that this decision does not necessarily imply the end of the interest rate hiking cycle.

Year-on-year inflation fell slightly in May, in line with what was expected by the market, although it remains outside the target range for 24 months, a record sequence. Monthly inflation reached 0.32% m/m, more than double the May month average of the last 20 years (0.14%). So far, no visible drop in inflation has materialized, as we and the authorities expected. In May, more than 65% of the prices of the consumer basket posted increases, a proportion that has been maintained so far this year.

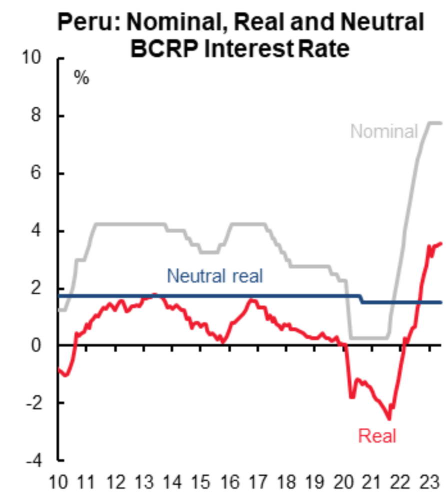
However, for June we expect a more visible decrease in inflation, with the possibility that the monthly data may even be below the June month average of the last 20 years (0.17%), since we see a significant correction in poultry prices, which would reflect the fading effects of the bird flu, to which would be added lower prices of local fuels. In its statement, the BCRP no longer mentioned the effects of the rains caused by Cyclone Yaku. With this, we believe that year-on-year inflation in June is likely to be below 7%. The BCRP expects food prices to drop for the remainder of the year, which would help lower inflation.

Although the advance guidance in the statement does not yet give clear signs of how long the policy rate will remain at its current level, the BCRP would be cautious in rushing to start easing policy after the government declared an emergency due to the imminent risk of the El Niño global phenomenon, which would bring uncertainty about prices, as has happened in the past. Twelve-month inflation expectations have fallen from 4.25% to 4.21%, a decrease still without conviction, remaining well above the target range (between 1% and 3%). 24-month inflation expectations were raised from 2.89% to 3.13%, reflecting that the consensus still sees that the return of inflation to the target range could take longer.

Recently, the BCRP governor pointed out that inflation will reach the target later than expected because inflation has been slowly declining. This view was reflected in a new wording in the BCRP's statement, noting that it now expects inflation to be close to the target range at the year-end, so the return to the target range in Q4-23 is no longer as explicit. This could lead one to think that the BCRP would keep its interest rate at the terminal level for longer.

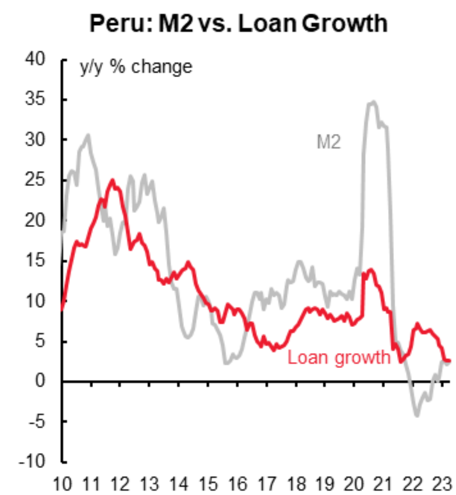
Other important inflation indicators show a clear downward trend. Wholesale inflation continues to fall and is now at 1.6%, the level it was at the 2020-end when the producer

Chart 3



Sources: Scotiabank Economics, BCRP.

Chart 4



Sources: Scotiabank Economics, BCRP.

prices index began to alert us that inflation would increase. It now tells us that headline inflation should start to come down. The PEN appreciation (close to 2% y/y) would also help curb inflation in the future. Our inflation forecast remains at 5.00% by end-2023. We also maintain our expectation that the BCRP will keep the reference rate at 7.75% through Q3-23, lower it to 7.25% in Q4, and continue easing until a level near 5.25% by end-2024. The real interest rate held steady at 3.5% (chart 3), staying above its neutral level (1.50%) for the tenth consecutive month. Liquidity growth in soles (M2, chart 4) recovered and went from 2.1% to 2.4% in April, remaining in positive territory for the eighth consecutive month, while credit expansion stabilized around 2.7% in April. Business expectations improved in May in relation to April but remain in a pessimistic zone. The economic indicators have not been recovering as expected. The BCRP statement also confirmed that the outlook for global economic activity points to moderation, although global risks remain due to restrictive monetary policy in advanced economies and ongoing global conflicts.

—Mario Guerrero