THE WEEKLY **LATAM** ECONOMIC MONITOR

APRIL 8, 2019
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An uninspiring start to the year for the Chilean economy, due mainly to falling mining activity...

...Leading indicators point to a steady, though sub-par, recovery if external woes dissipate, as we expect.

Inflation in Peru edged higher in March, but the trend still tells the story of tame pressures in the near term.

Andean Economies Hoping for a U.S.-China Trade Deal Soon

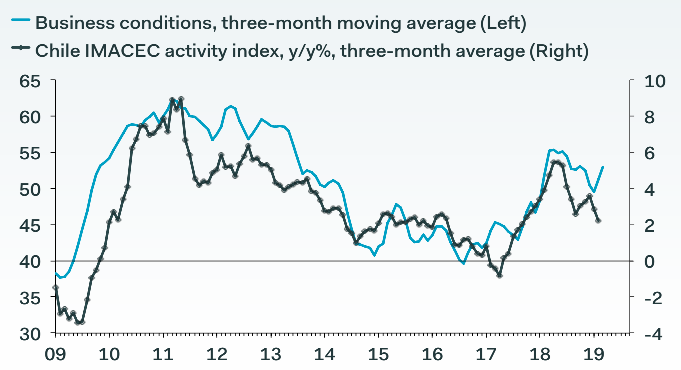
Fears of a Chinese hard landing have roiled financial and commodity markets this past year and have constrained the economic recovery of major raw material exporters in LatAm. A shock to China's industrial sector has a negative effect on global industrial activity, but the links are magnified in LatAm by the powerful effect on commodity prices. This drag, however, likely will fade as policy easing stabilizes Chinese industrial output growth. *Last week PMI data in China seem to be reducing the near-term downside tail risks and providing some support to LatAm markets, particularly in the Andes.*

If we are right, these developments will have a positive effect on LatAm, but it will take some time to work thorough. We reckon that external trade activity will be better over the second half of the year and 2020. A U.S.-China trade agreement would help enormously; recent news on this front is pointing in the right direction. More immediately, however, the Q1 external sector data in some LatAm economies will remain sluggish, serving as a reminder of the importance of Chinese industry to commodity sectors.

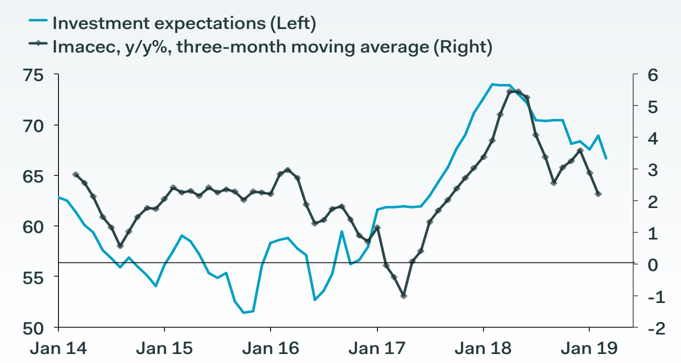
Chile's economic activity index—IMACEC—released on Friday, rose a poor 1.4% year-over-year in February, the weakest pace since June 2017, down from an already-subpar 2.1% increase in January. Non-mining activity—particularly in services—is rising, up 3.0% in February, slightly down from 3.2% in January. But output in the mining sector plunged 7.8% year-over-year in February, down from -4.0% in January, the fastest contraction since the Escondida mine strike in 2017.

Recent data continue to show the economy in a consistently disappointing state, despite some signs of improvement in the high frequency indicators a couple of months ago. The economy was hit in early Q1 by temporary shocks, including adverse weather conditions in the north of the country and workers' strikes that hurt mining production. Some demand-related sectors have also lost momentum, excluding those segments linked to capex. The weakness of the labour market, falling consumer and business

A SUBPAR START TO THE YEAR FOR THE CHILEAN ECONOMY...



...BUT LEADING INDICATORS ARE POINTING TO BETTER DAYS AHEAD



confidence and the effect of earlier-than-needed interest rate hikes in October and January have added to the recent economic pain. Moreover, public spending fell in early Q1 in year-over-year terms for the first time since September.

The weakness of the recovery in Q1 is creating an unfavourable base effect, and has pushed us to cut our real GDP growth forecast for this year to 3.0% from 3.4%. Everything points to year-over-year GDP growth hovering around 2½% in the first half of the year. But we still expect economic growth to improve over the second half, towards 3½%. The downtrend in firms' investment plans appears to have bottomed, and confidence indicators in key sectors have edged higher in recent months. On the bright side, if the recent recovery in copper becomes a sustained trend, as we expect, and the expectations of stronger commodity prices—driven by a resurgence of U.S. and Chinese growth—materialize, we could see a faster recovery of investment in the mining sector. This would jumpstart the rest of the economy.

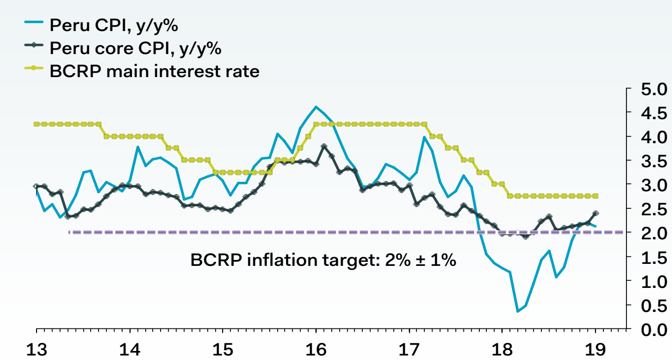
We also expect the reforms promoted by the government to be approved relatively soon, boosting business and investors' confidence and, therefore, accelerating capex in the second half of the year. *Overall, we don't see the weakness of the Q1 data as the start of a protracted downtrend.* That said, risks will continue to be tilted to the downside. Delaying or even failing to approve the tax reform is a potential risk to business sentiment. Also, some leading employment indicators are still reluctant to rebound and consumer confidence has appeared to be unresponsive in Q1. On the external front, meanwhile, threats seems to be diminishing, but they haven't disappeared.

Elsewhere in the Andes, consumer prices in **Peru** rose 0.7% month-to-month unadjusted in March, pushing the inflation rate up to 2.3% year-over-year, from 2.0% in February. This is the highest rate since September 2017, due to an unfavourable base effect, fading downside pressures from food prices, and higher tuition fees, which are normal at this time of year. But remains comfortably within the official tolerance target band of 1-to-3%. Core inflation, which excludes food, rose marginally in March from 2.4% in February. The underlying trend has been rising since the second half of last year but only modestly. *The trend is far from triggering an interest rate hike, for now.*

Inflation remains within policymakers' comfort zone and we see no immediate threat to the relatively benign picture. We expect headline and core inflation to hover around the current rate, ending the year at 2.7% and 2.5%, respectively. Supply risks likely will linger, but these pressures probably will be offset by limited FX pass-through and low financial volatility. Accordingly, we expect inflation expectations to remain broadly under control. Real rates, currently at 0.4%—deflated by 12-month inflation expectations—are well below their estimated neutral level, around 2.0%, suggesting that the policy rate is still accommodative. *As such, we expect the BCRP to deliver at least one 25bp hike over the second half of the year to maintain a tight interest rate differential with the US, given the partially dollarized nature of the Peruvian economy.*

The PEN likely will rebound gradually over the coming months, easing policymakers' concerns on this front. And even if there is an abrupt currency movement, the BCRP has enough policy tools and FX reserves to smooth any volatility. Our base case is that the PEN is likely to benefit from a potential increase in export receipts and direct investment inflows as a result of the improved outlook for metals, and this also applies to the CLP.

TAME INFLATION IN PERU MEANS RATES TO REMAIN ON HOLD IN Q2



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THIS WEEK IN BRIEF

Note: "**D**" prefix denotes Datanotes for these releases.

Monday, April 8

- **Chile Consumer Prices (3)/8:00 Local**

We look for the index to increase **0.4%** month-to-month in February. The year-over-year rate likely will edge higher to **2.0%**, from 1.8% in February. **Consensus: 1.9%.**

- **Chile Trade Balance (3)/8:30 Local**

We look for an unadjusted **USD0.6B** surplus in March, unchanged from a year ago. **Consensus: N/A.**

- **Mexico Gross Fixed Investment (1)/8:00 Local**

GFI likely fell **2.0%** year-over-year in January, up from -6.8% in December. Uncertainty about AMLO's policies has put capex under stress. **Consensus: -2.0%.**

Tuesday, April 9

- **D: Brazil Retail Sales (2)/9:00 Local**

We expect retail sales to fall **0.1%** month-to-month in February, pushing the year-over-year rate up to **2.5%**, from 1.9% in January. Consumption will be resilient in the first half, thanks to low inflation, low interest rates and the modest recovery in the labour market. **Consensus: 3.4%.**

- **D: Mexico Consumer Price Index (3)/8:00 Local**

We think consumer prices rose **0.4%** month-to-month unadjusted in March. Inflation likely edged higher to **4.0%** year-over-year, from 3.9% in February. Core inflation probably edged up to **3.6%**, from 3.5% in February. Slowing demand is putting a lid on inflation. **Consensus: 4.0%.**

Wednesday, April 10

- **D: Brazil IBGE Inflation IPCA (3)/9:00 Local**

The index likely rose **0.4%** month-to-month in March, driven by food prices. The year-over-year rate likely rose to **4.5%**, from 3.9% in February. **Consensus: 4.4%.**

Thursday, April 11

- **D: Mexico Industrial Production (2)/8:00 Local**

Industrial production likely rose **0.1%** month-to-month, pushing the year-over-year rate up to **0.2%** in February, from -0.9% in January. We expect the manufacturing sector to improve, once the trade war eases and the USMCA agreement is ratified. **Consensus: -0.5%.**

- **Peru Overnight Rate Target /18:00 Local**

The BCRP likely will keep its key interest rate on hold at **2.75%**. We think the Board will keep its neutral bias in Q2, as inflation remains under control. **Consensus: 2.75%.**

Friday, April 12

- **Colombia Retail Sales (2)/10:00 Local**

We look for a **5.3%** year-over-year increase, up from 3.0% in January. The COP's modest rebound in recent months, and improving retail confidence, suggest that the sector will do well. **Consensus: N/A.**

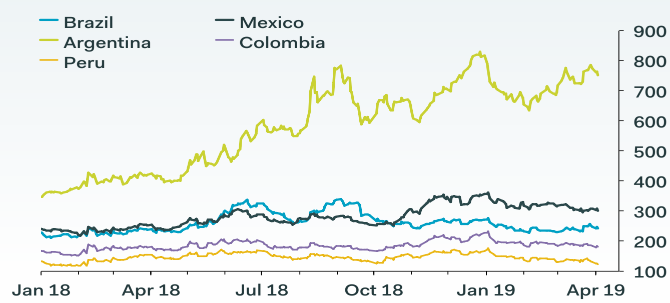
- **Colombia Industrial Production (2)/10:00 Local**

Industrial output likely rose **2.0%** year-over-year, slowing from 2.9% in January. Improving fundamentals and better external conditions will help the industrial sector. **Consensus: N/A.**

PANTHEON'S LATAM FINANCIAL CONDITIONS DASHBOARD

	Currency			Benchmark Stock index		
	Value	Week, %	YTD, %	Value	Week, %	YTD, %
Argentina	43.93	-1.4	-14.3	32,667	-0.7	7.8
Brazil	3.87	1.2	0.0	97,108	1.8	10.5
Chile	664.7	2.3	4.4	5,255	-0.1	2.9
Colombia	3,126	1.9	3.9	13,111	0.4	17.6
Mexico	19.07	1.9	3.0	44,990	3.9	8.0
Peru	3.29	0.7	2.2	21,368	1.3	10.4
Venezuela	--	--	--	8,834	3.1	450.3

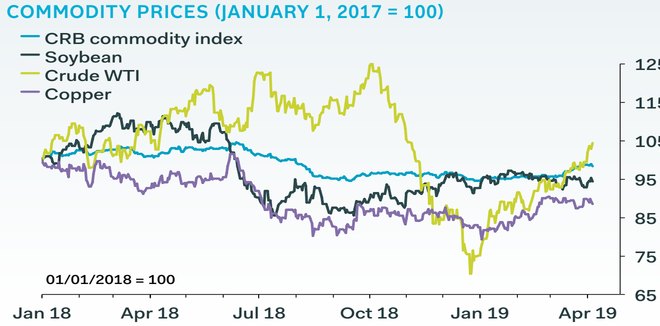
INDEX EMBIG SPREAD LATAM HISTORY



PANTHEON'S ECONOMIC FORECASTS

	Real GDP, y/y%		Inflation, Avg.		Interest rate, Q4	
	2018	2019	2018	2019	2018	2019
Argentina	-2.8	-1.2	33.8	36.0	59.25	32.00
Brazil	1.1	2.0	3.7	3.7	6.50	6.50
Chile	4.0	3.0	2.4	2.6	2.75	3.50
Colombia	2.7	3.0	3.2	3.1	4.25	4.75
Mexico	2.0	1.6	4.9	4.0	8.25	7.75
Peru	4.0	4.2	1.3	2.5	2.75	3.25
Venezuela	-17.0	-20.0	1.3M	25M	--	--

COMMODITY PRICES (JANUARY 1, 2017 = 100)



PANTHEON'S FINANCIAL FORECASTS

	Currency			Benchmark Stock index		
	Q2F	Q3F	Q4F	Q2F	Q3F	Q4F
Argentina	44.2	44.5	45.2	33,400	32,100	37,300
Brazil	3.75	3.45	3.67	98,100	101,500	103,200
Chile	674	667	648	5,240	5,380	5,460
Colombia	3,080	3,010	3,005	1,610	1,680	1,720
Mexico	19.2	19.4	19.3	43,500	44,300	45,600
Peru	3.25	3.23	3.24	21,200	22,500	23,800
Venezuela	--	--	--	--	--	