ANDRES ABADIA,SENIOR ECONOMIST

Inflation in Peru remains close to the upper level of the target range, due to rising food prices...

...Activity improved marginally in December, still hampered by the weak mining and fishing sectors.

Accelerating inflation will prevent Colombia's central bank cutting interest rates on Friday.

Economic Activity Likely to Improve in Peru this Year, Gradually

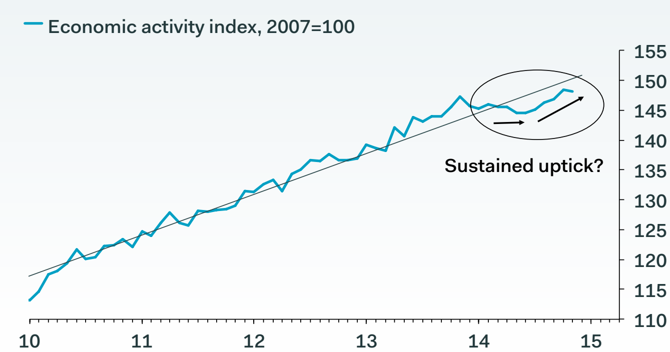
Peru's central bank, BCRP, left rates unchanged last week, at 3.25%, a four-year low. Above-target inflation and currency volatility prevented the Board from cutting rates. Inflation has slowed marginally in recent months, thanks to lower fuel prices, but the upward pressures on food prices are still strong, keeping annual CPI above the target range. *This, though, has not stopped dovish comments from policymakers in recent weeks.* Ongoing economic weakness, mostly due to the drop in copper prices, has given bank officials the justification to maintain their monetary policy bias towards additional stimulus. *The board has highlighted below-potential growth, and reiterated that inflation expectations remain within the target range.*

Nevertheless, we believe that the BCRP will not be able to cut further over the coming months, thanks to the weakness of the PEN against the USD. The PEN hit a five-year low against the USD after January's unexpected easing. A further rate cut now would trigger further currency depreciation and spark upward inflation pressures. In addition, U.S. monetary policy tightening, which we expect to start in June, will further constrain the BCRP. ***Over the coming months, we expect the currency to continue depreciating.*** The PEN will likely weaken to levels close to 3.15 per USD by the end of this year, close to the lowest since March 2009, from 3.08 at present, as the bulk of the adjustment to new global monetary conditions takes place. The BCRP will continue to intervene in the currency market in order to stem expectations of further losses.

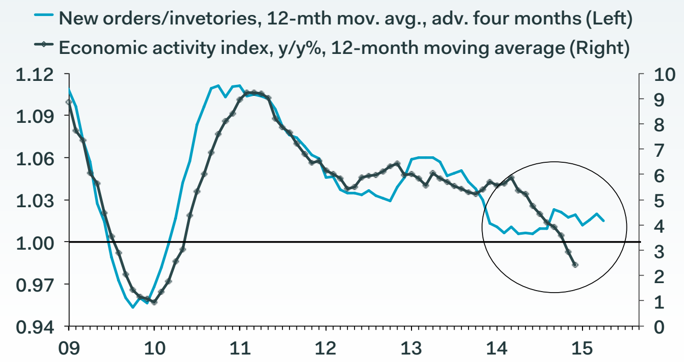
Meanwhile, we expect the economy to regain momentum, due to loose fiscal policy, still-accommodative monetary policy, higher copper production and infrastructure projects set for this year. Copper prices have risen 6% from their recent lows, an encouraging sign, but not yet definitive evidence of a new uptrend or even a real bottom.

The latest monthly GDP data, reported on Monday, suggest that growth has started to improve. The economic activity index in December rose 0.5% year-over-year, up from 0.3% in November. *The non-primary sectors—financial services, retail and construction—continued to grow in December and were the largest contributors to growth for the year, but their rates of expansion were well below the double-digit rates seen in previous years.* Manufacturing output fell by 3.3% in 2014, depressed by mining and fishing-related activities. In December alone, manufacturing dropped by 12.4% year-over-year, similar to the contraction seen in November.

WE LOOK FOR FURTHER ACCELERATION ON A SEQUENTIAL BASIS

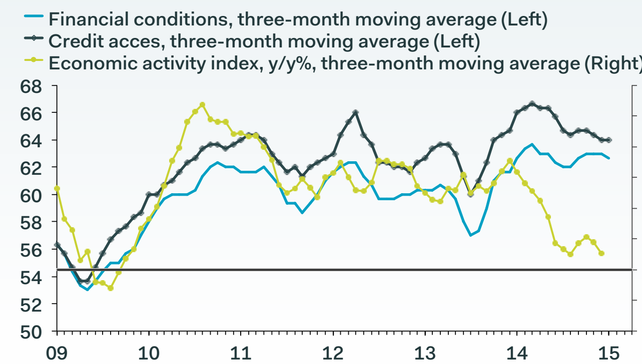


LEADING INDICATORS POINT TO A BETTER OUTLOOK SOON



remained flat, highlighting the divergence between the tradable goods sectors and the services/financial economy. The 75bp reduction the intervention rate since June has had little impact on financial indicators, suggesting that a further rate cut would have a marginal impact on sentiment. *Accordingly, we expect that the BCRP will maintain its wait-and-see approach over the coming quarters, leaving its benchmark rate on hold at 3.25%, despite the recent slowdown in economic activity.*

FINANCIAL LEADING INDICATORS HAVE REMAINED STRONG



In the primary sectors—the main area of disappointment last year—fishing activity has dropped again, with a 66% plunge in December. This follows a 28% collapse in 2014, due to El Niño. Mining output fell 5% in December, down from a modest gain in November and a 2.1% fall for the year as a whole. Peru's economy expanded by 2.4% in 2014, down from 5.4% in 2013. *Last year's growth rate is due to be confirmed next week when the BCRP releases its full GDP data. Details aside, though, Peru's growth is still high compared to its regional peers.*

The recent economic slowdown is concentrated in the tradable goods sector, while other activities have maintained healthy rates of growth, and key leading economic indexes point to recovery. ***Businesses's economic expectations bottomed last year and have move sideways since then, despite the weakness in the primary sector.*** In addition, survey-based leading indicators related to financial markets, as shown in our next chart, have

EXPECTATIONS HAVE REMAINED STEADY DESPITE WEAK ACTIVITY

Elsewhere in Latam, **Colombia's** central bank will hold its monetary policy meeting on Friday. We expect Banrep to leave rates at 4.5%; accelerating inflation will prevent policymakers from easing. The headline inflation rate has jumped from less than 2% year-over-year during the first months of 2013 to nearly 4% in recent months.

In **Mexico**, Banxico releases its Quarterly Inflation Report today, which will offer some clues about the immediate future of monetary policy, and on Friday the statistical office—INEGI—will report its GDP figures for the fourth quarter last year. We look for growth of 2.6% year-over-year. As a consequence, the economy likely expanded by 2.0% in 2014 as a whole, up from 1.1% in 2013. Activity should improve in the fourth quarter on the back of better data in the industrial and services sector.

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THIS WEEK IN BRIEF

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

Monday, February 16

• **Peru Unemployment Rate (1)/No specific time**
The three-month average unemployment rate increased to **6.4%** in January, the highest since March, from 5.6% in December, reflecting slower economic growth, especially in primary activities, in recent months.

• **Peru Economic Activity Index (12)/No specific time**
Economic activity edged up to **0.5%** year-over-year in December, from 0.3% in November. Reduced mining output and smaller fishing catches have contributed to the decline.

Tuesday, February 17

• **Colombia Retail Sales (12)/16:00 Local**
We look for a **8.2%** year-over-year increase, after 8.4% in November. Consumer confidence and domestic demand have remained relatively upbeat. **Consensus: 9.9%.**

• **Colombia Industrial Production (12)/16:00 Local**
Industrial production should increase **0.1%** year-over-year, up from a 0.9% contraction in November, thanks largely to the auto sector, which will partially compensate for the ongoing weakness in the oil industry. In addition, the sharp fall in the COP over the last quarter should help to boost the recovery in the manufacturing sector. **Consensus: 0.1%.**

Wednesday, February 18

• **No significant data released.**

Thursday, February 19

• **Colombia Trade Balance (12)/16:00 Local**
Weak petroleum exports, oil-derivatives and coal will continue to erode the trade balance. We look for a **USD1.0B** deficit in December, up from USD1.3B in October. But the underlying trend is still negative. Agricultural products will be the only category with a positive performance in December. **Consensus: -USD1.2B.**

Friday, February 20

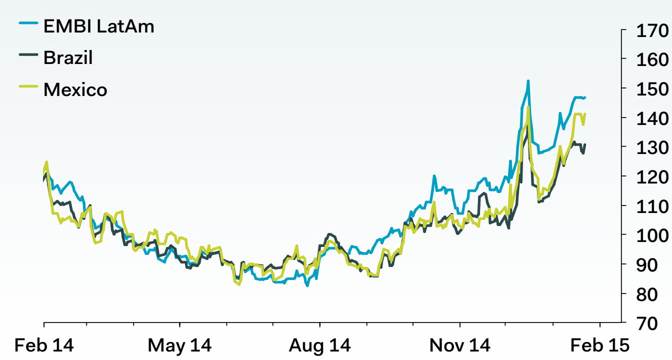
• **D: Mexico GDP (Q4)/8:00 Local**
We look for GDP growth of **2.6%** year-over-year in the fourth quarter. As a consequence, the economy likely expanded by **2.0%** in 2014, up from 1.1% in 2013. Activity should rise **0.7%** in the fourth quarter from 0.5% in Q3 on the back of improving data in the industrial and services sector. The monthly proxy for GDP should expand **0.4%** in line with the relatively weak industrial production data in December. Overall, the picture of a Mexican economy gaining further momentum, thanks to a solid manufacturing sector, will be reinforced by this report. **Consensus: 0.9%.**

• **Colombia Overnight Lending Rate /No specific time**
We expect Banrep to remain on hold at **4.5%**. Inflation is impeding any easing movement, despite the slowdown in economic activity. In January, consumer prices rose 0.6% month-to-month, up from 0.3% in December. In annual terms inflation climbed to 3.8%, up from 3.7% in December, the highest rate since November 2011. **Consensus: 4.5%.**

PANTHEON LATAM FINANCIAL CONDITIONS DASHBOARD

	Currency			Benchmark Stock index		
	Value	Week, %	YTD, %	Value	Week, %	YTD, %
Argentina	8.7	-0.3	-2.5	9,503	5.5	10.8
Brazil	2.83	-1.6	-6.0	50,558	3.6	1.1
Chile	618.6	1.3	-2.0	3,975	0.6	3.2
Colombia	2,387	-0.2	-0.4	10,625	-3.7	-8.7
Mexico	14.9	-0.2	-0.8	42,979	0.6	-0.4
Peru	3.07	-0.1	-3.1	13,778	1.8	-6.9
Venezuela	6,292	--	--	3,489	-3.5	-9.6

INDEX EMBI SPREAD LATAM HISTORY (01/01/2014=100)



PANTHEON'S ECONOMIC FORECAST

	Real GDP, y/y%		Inflation, Avg.		Interest rate, Q4	
	2014	2015	2014	2015	2014	2015
Argentina	-1.8	-1.5	25.0	23.0	--	--
Brazil	-0.1	-0.6	6.3	6.4	11.75	12.50
Chile	1.7	2.6	4.4	3.3	3.00	3.25
Colombia	4.8	3.7	2.9	3.2	4.50	4.50
Mexico	2.0	3.5	4.0	3.4	3.00	3.50
Peru	2.4	4.1	3.3	2.8	3.50	3.75
Venezuela	-3.5	-2.0	63.0	75.0	--	--

COMMODITY PRICES (PRICE INDEX, 01/01/2014=100)