THE WEEKLY **LATAM** ECONOMIC MONITOR

OCTOBER 9, 2017
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Inflation has bottomed in Brazil, but the picture will remain benign, allowing the BCB to ease further.

Chile's inflation plunged in September, due to one-off factors, the BCCh's stance won't change.

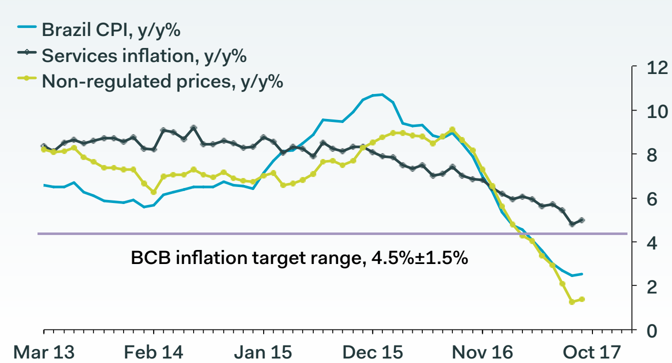
Inflation in Colombia surprises to the downside, allowing BanRep to bring forward rate cuts.

Inflation Surprises in September, but Will Central Banks Care?

Recent inflation numbers across LatAm have surprised, in both directions. On the upside, **Brazil's** IPCA index rose 0.2% month-to-month in September, above the market consensus forecast of 0.1%. But the trend remains favorable, as a result of the soft economic recovery and a sharp correction in agricultural prices this year.

The details of the September report were comforting, despite the modest headline overshoot. Higher fuel prices lifted the transportation component, while food prices—which have been the main driver of the downward trend in inflation—fell 0.4% month-to-month, the fifth consecutive drop. Housing prices, including utilities, dipped by 0.1%, due mainly to falling energy tariffs.

INFLATION HAS BOTTOMED IN BRAZIL, BUT NO WORRIES HERE



Inflation has now bottomed at 2.5%, the lowest rate since early 1999. The average of the core measures eased to 3.7% from 3.8% and the inflation diffusion index, which is the proportion of prices increasing in the month, rose just marginally. Still, we think that inflation likely will begin to rise *gradually* in October, and should reach 3.1% in December. Wholesale agricultural prices have plunged 20% since they peaked in June 2016, but we think food prices will start to edge marginally in Q4.

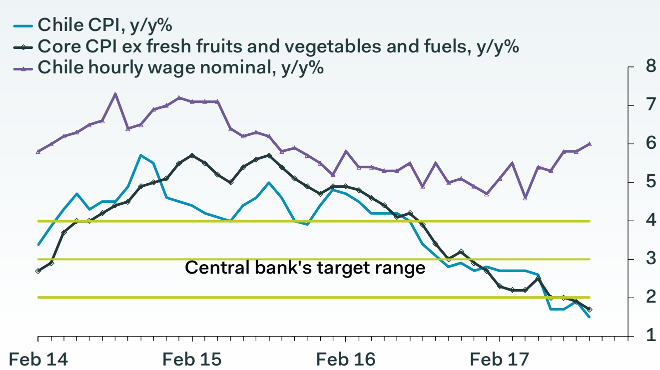
September's IPCA report adds a marginal upward bias to our year-end forecast, but the key story here is that underlying inflation pressure will remain under control for the foreseeable future, despite the likely headline uptick. Moreover, the BRL has behaved relatively well in recent weeks as political risk is now under control, at least for a while. President Michel Temer has managed to avoid serious entanglements from corruption charges, and this should strengthen the administration's position in Congress, increasing the chance that social security reform passes. The combination of tame inflation and an improved political environment means that the BCB will be able to continue cutting interest rates.

The BRL has benefited too from the improving economy and political stability, moving in a relatively narrow range, centered on 3.15 per USD, in recent months. The prospect of privatisations and rising M&A activity has boosted capital inflows, supporting the currency. At the same time, the BCB's easing is drawing portfolio flows into the bond market, adding further support to the currency, which tends to strengthen when short rates are falling. Finally, the balance of payments has improved significantly in the last year too, and we expect the environment over the next few months to remain constructive for the BRL.

Elsewhere in the region, the inflation picture in **Chile** remains favourable, but the speed of the recent *decline* will worry some BCCh board members. The headline CPI index fell 0.2% month-to-month last month—the first-ever September decline—well below market expectations and enough to push the year-over-year rate down to 1.5% from 1.9% in August. This is the lowest rate level since 2013.

We still think, though, that interest rates will remain on hold in Q4, as the economy is recovering at a relatively healthy pace and September's CPI undershoot was driven by one-off factors. Food prices fell 0.6% month-to-month, but this was mainly driven by huge, temporary, discounts in soft drinks prices. And housing/utilities prices fell 0.4%, thanks to a one-off fall in regulated electricity tariffs. Other key components, excluding transportation, were little changed; a jump in petrol prices pushed up the transport component by 0.6%. The core index—ex-food and energy—was unchanged month-to-month in August, with the annual rate steady at 1.8 %.

NO NEED TO CUT FURTHER AS THE ECONOMY IS REBOUNDING



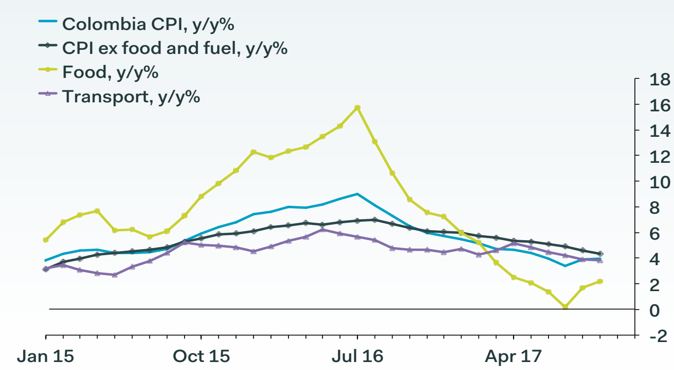
Overall, then, we aren't worried that inflation will fall too far. The headline is now well below the BCCh's 2-to-4% target range, boosting real wages and supporting the nascent recovery. The September report will increase speculation over further rate cuts, but we think that the majority of the BCCh board will take into account the temporary nature of the September's undershoot, and will leave rates on hold in the foreseeable future. That said, the door is open for an additional rate cut before the year-end if inflation doesn't pick up.

Finally, in **Colombia**, inflation also undershot the consensus in September. The CPI index was unchanged month-to-month, well below expectations for a 0.2% increase. The year-over-year rate rose marginally to 4.0% from 3.9%—the first increase in a year—reaching the top of BanRep's 2-to-4% target range. The modest upward pressure in September came from housing/utilities and tuition fees, partially offset by falling food and recreation prices. Other key components rose only marginally, suggesting that overall pressures remain under control.

Food prices fell 0.4% last month, the fourth consecutive decline. The underlying trend in this key component is still falling and it remains the key driver of the overall downward trend in inflation. Excluding food prices, September's core CPI rose just 0.2% month-to-month, pushing the year-on-year rate down to 4.7%, from 4.8% in August.

Overall, inflation still looks tame. We expect the headline rate to edge marginally up to 4.1% in October and November, but it should end the year marginally below 4.0%. Inflation then will continue falling gradually, thanks to a renewed favourable base effect. This will make monetary loosening a bit easier. We had been expecting further easing in Q1, but we now believe that BanRep has room to cut rates by at least 25bp in Q4. The economy is struggling and most of BanRep's board members will accept that the modest uptick in Q4 will prove temporary.

UNDERLYING PRESSURES REMAIN UNDER CONTROL



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THIS WEEK IN BRIEF

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

Monday, October 9

• D: Mexico Consumer Price Index (9)/8:00 Local

The CPI should increase **0.4%** month-to-month, pushing the year-over-year rate down to **6.5%**, from 6.7% in August. Inflation will fall consistently in Q4 and Q1, opening the door for rate cuts. **Consensus: 6.5%.**

Tuesday, October 10

• Chile Trade Balance (9)/8:30 Local

We expect an unadjusted **USD700M** surplus in September, up from USD213M a year ago. **Consensus USD400M.**

Wednesday, October 11

• D: Brazil Retail Sales (8)/9:00 Local

We expect retail sales to rise 0.6% month-to-month in August, pushing the year-over-year rate up to **5.4%** from 3.1% in July. Broad retail sales likely will increase by 1.3% month-to-month, due mainly to strong auto sales. The year-over-year rate likely will rise to 9.5% from 5.7% in July. The recovery is sound. **Consensus: 4.4%.**

Thursday, October 12

• D: Mexico Industrial Production (8)/8:00 Local

Industrial production likely fell 0.4% month-to-month, pushing the year-over-year rate up to **-0.5%** in August, from -1.6% in July. But we expect manufacturing production to increase 3.5% year-over-year, up from 2.2% in July. Mining is the key drag. **Consensus: -0.6%.**

• Mexico Banxico Minutes /9:00 Local

After leaving its benchmark rate unchanged at 7.00% in late September, we expect Banxico to suggest that rate cuts are not on the near-term agenda. Policymakers will continue to say that future policy action will depend on the Fed, and the MXN's performance. They also will highlight that they remain vigilant, emphasising their cautious approach. Our core view is that rates will be on hold in Q4 and Q1, as NAFTA-related risks are still relatively high. But falling inflation, the end of NAFTA negotiations and weak economic performance will allow Banxico to start easing in Q2. The presidential election next year is a risk, though.

• Argentina Consumer Prices (9)/16:00 Local

The index should rise **1.1%** month-to-month in September. Pressures are finally easing. **Consensus: 1.3%.**

• Peru Overnight Rate Target /18:00 Local

The BCRP likely will cut its main interest rate by 25bp to **3.25%**, as inflation dipped in September and likely will again in October, and growth was relatively sluggish at the start of Q3. But this likely will be the end of the easing cycle as the PEN likely will come under temporary pressure in Q4 as the Fed raises rates. **Consensus: 3.50 %.**

Friday, October 13

• Colombia BanRep Minutes /13:00 Local

After leaving its benchmark rate unchanged at 5.25% in late September, we expect the minutes to show BanRep's Board is deeply divided, but inflation fears will overshadow the sluggish pace of the economic recovery, for now. We expect interest rates to fall early next year.

PANTHEON'S LATAM FINANCIAL CONDITIONS DASHBOARD

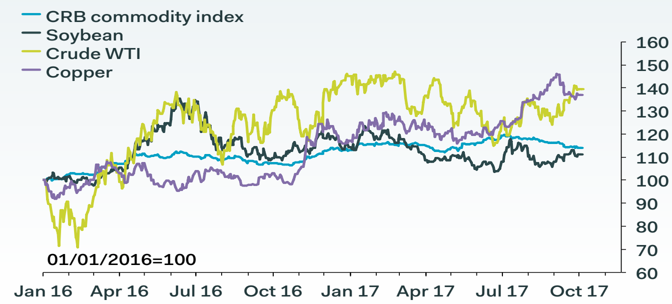
	Currency			Benchmark Stock index		
	Value	Week, %	YTD, %	Value	Week, %	YTD, %
Argentina	17.44	-0.7	-9.0	26,798	2.8	58.4
Brazil	3.16	0.2	3.2	76,055	2.4	26.3
Chile	632.6	1.0	6.0	5,486	2.7	32.1
Colombia	2,940	-0.1	2.1	11,120	0.2	10.0
Mexico	18.53	-1.5	11.9	50,303	-0.1	10.2
Peru	3.27	-0.1	2.7	19,479	5.1	25.1
Venezuela	9,995	1.6	-0.1	551,876	12.7	1,640.6

INDEX EMBIG SPREAD LATAM HISTORY

PANTHEON'S ECONOMIC FORECASTS

	Real GDP, y/y%		Inflation, Avg.		Interest rate, Q4	
	2017	2018	2017	2018	2017	2018
Argentina	2.7	2.8	26.0	15.0	25.0	15.0
Brazil	0.8	2.6	3.5	3.8	7.00	6.00
Chile	1.4	2.5	2.3	2.6	2.50	3.00
Colombia	1.8	2.6	4.3	3.4	5.00	4.50
Mexico	2.2	2.4	6.0	3.9	7.00	6.00
Peru	2.5	3.4	3.0	2.4	3.25	3.75
Venezuela	-4.5	-3.0	600	500	--	--

COMMODITY PRICES (JANUARY 1, 2016 = 100)



PANTHEON'S FINANCIAL FORECASTS

	Currency			Benchmark Stock index		
	Q4F	Q1F	Q2F	Q3F	Q4F	Q1F
Argentina	16.8	17.9	18.2	25,900	26,200	27,600
Brazil	3.00	3.10	3.05	75,800	76,400	77,300
Chile	650	655	660	4,250	4,620	4,700
Colombia	2,990	2,950	3,100	1,500	1,850	1,940
Mexico	17.90	18.10	18.00	49,300	51,300	52,500
Peru	3.24	3.18	3.25	17,500	18,600	18,400
Venezuela	12.0	12.0	12.0	--	--	--