CAPITAL ECONOMICS

LATIN AMERICA ECONOMICS WEEKLY

Bolivia's FX crunch, Argentina's debt shenanigans

Bolivia walking into a crisis

Bolivia's balance of payments problems entered a more acute phase this week. Commercial banks stopped providing FX to residents, forcing the central bank to do so itself. And there was some doubt (now resolved) whether the government made a coupon payment on a dollar bond due last Monday.

The crisis has its roots in a range of factors including an overvalued de facto pegged exchange rate, a worsening current account position, and a pick-up in capital outflows. The central bank has run down FX reserves, which fell from (a low) $6.5bn before the pandemic to (a paltry) $3.5bn on 8th February in order to support the currency. Data haven't been published since then, but it seems fair to assume that reserves are lower now. And dollar borrowing costs have surged amid the recent banking turmoil.

A sovereign default doesn't look imminent – large dollar debt payments come due only in 2026. But the balance of payments situation looks unsustainable. So what happens next? The orthodox response would be to go to the IMF, let the currency depreciate and tighten fiscal policy. That would improve Bolivia's balance sheet (making debt repayments easier) and set the ground for stronger growth in the future. But it would come at a near term cost of weaker growth and higher inflation. And it's unlikely that policymakers will go down this route. A read of the IMF's latest Article IV report underscores that the Fund and policymakers don't see eye to eye on a whole range of issues from the exchange rate to subsidies.

That alternative option, which would include more of the same policy mix, but probably also capital controls, multiple exchange rates and a drip feed of funding from bilateral allies (perhaps China). But as the experience from Argentina shows, such policies – even with an IMF deal in place – still lead to recession, high inflation and don't resolve the strains in the balance of payments…

Argentina's debt swap

A decree issued by Argentina's government this week forcing public entities to sell their sovereign dollar bonds is yet another desperate attempt to support the peso and ease pressure on FX reserves.

Public entities with holdings of *local-law* sovereign dollar bonds ("Bonares") will need to sell these on the domestic market and use 70% of the proceeds to buy peso-denominated "dual" bonds (i.e. bonds liked to inflation or the rate of devaluation of the peso). Entities holding *foreign-law* sovereign dollar bonds ("Bonos Globales") will have to hand these back the Treasury in exchange for dual peso bonds.

These measures appear to have two key aims. The first is to help the government meet its financing needs ahead of the election; financing has become much harder recently, forcing a return to deficit monetisation in March. The second is a reduction of outstanding sovereign dollar debt, which should ease some of the pressure on Argentina's FX reserves.

But these measures merely give the government some temporary breathing space and fail to address the fundamental issue that the peso is too strong. They are also likely to create problems down the line – the fact that the peso bonds are indexed may make the next administration more reluctant to carry out the necessary devaluation because it will worsen Argentina's public debt dynamics.

A big unknown in all of this is what it means for the next IMF loan tranche (the IMF's Board is due to sign off on the fourth review in the coming days). The Fund said it was currently assessing the debt swap, but there's a growing risk that its patience with Argentina wears thin and it stops its disbursements, paving the way for yet another sovereign default.

The week ahead

Central banks in Mexico and Colombia are likely to raise interest rates at their policy meetings next week. (See *Data Previews*.)

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Data Previews

Mexico Interest Rate Announcement (Mar.)

Thu. 30th Mar.

Forecasts	Time (BST/ET)	Previous	Consensus	Capital Economics
Policy Rate (%)	20.00/15.00	11.00	11.25	11.25

Strong services inflation to push Banxico into a 25bp hike

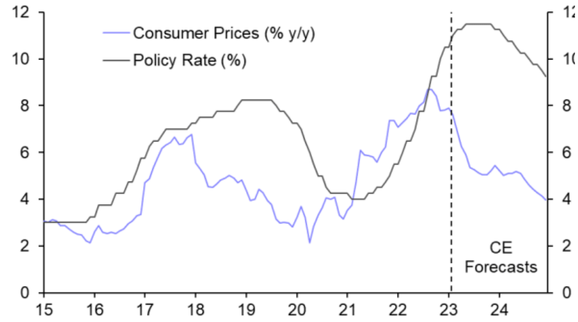
We expect Mexico's central bank to deliver a 25bp interest rate hike, to 11.25 %, on Thursday.

Banxico raised interest rates by a larger-than-expected 50bp at its last meeting in January as a "slower-than-anticipated decrease in food merchandise inflation and a rebound in that of services [inflation]" spooked the Board.

The global banking sector turmoil and the sharp slowdown in GDP growth at the end of 2022 will give officials food for thought. But even though March's mid-month inflation data showed a drop in the headline rate to 7.1% y/y, the further rise in services inflation will have heightened fears about the persistence of inflation. Coupled with more timely activity figures painting a resilient picture, a 25bp rate hike (to 11.25%) seems nailed on.

The dovish tone of this week's Fed decision means that it is up in the air whether there will be an additional 25bp increase in rates in May. Regardless, inflation is likely to stay higher than most expect and as a result, a turn to loosening is unlikely until the end of this year. (See Chart 1.)

Chart 1: Mexico Consumer Prices & Policy Rate



Sources: Refinitiv, Capital Economics

Colombia Interest Rate Announcement (Mar.)

Thu. 30th Mar.

Forecasts	Time (BST/ET)	Previous	Consensus	Capital Economics
Policy Rate (%)	19.00/14.00	12.75	13.00	13.25

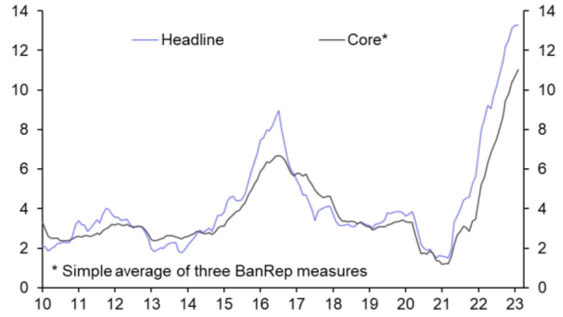
Tightening cycle to draw to a close

We expect Colombia's central bank (BanRep) to deliver a final 50bp interest rate hike, to 13.25%, at next Thursday's meeting.

Inflation dynamics in Colombia continue to provide plenty of cause for concern. While the headline rate stabilised at 13.3% y/y in February (see Chart 2), it is still well above the central bank's 3±1% inflation target. More worryingly, core inflation continued to strengthen last month and is now running at 11% y/y.

Meanwhile, timely activity data suggest that the economy is continuing to hold up reasonably well – the monthly activity index rose by 2.6% m/m, driven by strength in the services sector. Against this backdrop, we expect the central bank to deliver a final 50bp interest rate hike, to 13.25%, at next week's meeting. We think rates will be kept at this level until Q3 and, once the central bank does start easing policy, we think it will do so more cautiously than the consensus is expecting.

Chart 2: Colombia Consumer Prices (% y/y)



Sources: Refinitiv, Capital Economics

Economic Diary & Forecasts

Upcoming Events and Data Releases

Date	Country	Release/Indicator/Event	Time (BST)	Time (EDT)	Previous*	Median*	CE Forecasts*
27th Mar	**Mex**	Trade Balance (Feb.)	13.00	08.00	-$4.1bn	-	-
	Brz	Current Account (Feb.)	12.30	07.30	-$8.7bn	-$4.7bn	-
28th Mar	**Arg**	Current Account (Q4)	20.00	15.00	-$3.0bn	-	-
29th Mar	**Arg**	Economic Activity (Jan.)	20.00	15.00	-1.0%(-1.2%)	-	-
30th Mar	**Chl**	Unemployment Rate (Feb.)	13.00	08.00	8.0%	8.2%	-
	Brz	Industrial Production (Jan.)	13.00	08.00	0.0%(-1.3%)	-	-
	Col	Interest Rate Announcement	19.00	14.00	12.75%	13.00%	13.25%
	Mex	Interest Rate Announcement	20.00	15.00	11.00%	11.25%	11.25%
31st Mar	**Mex**	Unemployment Rate (Feb.)	13.00	08.00	3.0%	3.1%	-
	Chl	Industrial Production (Feb.)	13.00	08.00	(+0.5%)	-	-
	Chl	Retail Sales (Feb.)	13.00	08.00	(-10.4%)	(-10.0%)	-
	Brz	Unemployment Rate (Feb.)	13.00	08.00	-	-	-
	Brz	Budget Balance (Feb., BRL)	13.30	08.30	46.7bn	-	-
	Col	Unemployment Rate (Feb.)	16.00	11.00	13.7%	13.1%	-
	Arg	Wage Growth (Jan.)	20.00	15.00	(+5.3%)	-	-
Also expected during this period:							
8th – 13th	**Dom**	CPI (Feb.)	-	-	+0.6%(+7.3%)	-	-
Selected future data releases and events:							
3rd Apr	**Chl**	Economic Activity (Feb.)	13.30	08.30	+0.5%(+0.4%)	-	-
	Brz	S&P Manufacturing PMI (Mar.)	14.00	09.00	49.2	-	-
	Mex	S&P Manufacturing PMI (Mar.)	16.00	11.00	51.0	-	-
	Uru	CPI (Mar.)	18.00	13.00	+1.0%(+7.5%)	-	-
	Mex	IMEF Manufacturing (Mar.)	19.00	14.00	51.3	-	-
4th Apr	**Chl**	Interest Rate Announcement	23.00	18.00	11.25%	-	-
	Col	MPC Meeting Minutes Released	23.00	18.00	-	-	-
5th Apr	**Col**	CPI (Mar.)	12.00	07.00	+1.7%(+13.5%)	-	-
	Mex	CPI (Mar.)	13.00	08.00	+0.6%(+7.6%)	-	-
	Brz	S&P Services PMI (Mar.)	14.00	09.00	49.8	-	-
	Chl	Wage Growth (Feb.)	14.00	09.00	(+11.1%)	-	-
	Arg	Industrial Production (Feb.)	20.00	15.00	(+6.3%)	-	-
6th Apr	**Chl**	CPI (Mar.)	13.00	08.00	-0.1%(+11.9%)	-	-
	Ecu	CPI (Mar.)	15.00	10.00	0.0%(+2.9%)	-	-

*m/m(y/y) unless otherwise stated; † = previous day
Sources: Bloomberg, Capital Economics

Main Economic & Market Forecasts

Table 1: Central Bank Policy Rates (%)

	Policy Rate	Latest (24th Mar.)	Last Change	Next Change	Forecasts End 2023	Forecasts End 2024
Brazil	Selic Target	13.75	Up 50bp (Aug. '22)	**Down 50bp (Q4 '23)**	**12.75**	**10.00**
Mexico	Overnight Rate	11.00	Up 50bp (Feb. '22)	**Up 25bp (Mar. '23)**	**10.25**	**8.25**
Colombia	Intervention Rate	12.75	Up 75bp (Jan. '23)	**Up 50bp (Mar. '23)**	**11.00**	**7.25**
Chile	Overnight Rate	11.25	Up 50bp (Oct. '22)	**Down 50bp (May '23)**	**7.25**	**5.25**
Peru	Reference Rate	7.75	Up 25bp (Jan. '23)	**Down 25bp (Q3 '23)**	**6.50**	**5.00**

Sources: Refinitiv, Capital Economics

Table 2: FX Rates vs. US Dollar & Equity Markets

	Currency	Latest (24th Mar.)	Forecasts End 2023	Forecasts End 2024	Stock Market	Latest (24th Mar.)	Forecasts End 2023	Forecasts End 2024
Brazil	BRL	5.25	**5.25**	**5.00**	Bovespa	99,057	**109,250**	**126,000**
Mexico	MXN	18.5	**20.0**	**19.0**	Bolsa	52,628	**57,500**	**62,100**
Argentina	ARS	206	**300**	**375**	Merval	219,277	**-**	**-**
Colombia	COP	4,727	**4,400**	**4,400**	IGBC	1,092	**1,380**	**1,520**
Chile	CLP	811	**820**	**780**	IPSA	5,235	**5,950**	**6,500**
Peru	PEN	3.77	**3.80**	**3.70**	S&P/BVL	21,348	**25,100**	**27,400**

Sources: Refinitiv, Capital Economics

Table 3: GDP & Consumer Prices (% y/y)

	Share of World[1]	GDP 2011-20 Ave.	GDP 2021	GDP 2022	GDP 2023	GDP 2024	Consumer Prices 2021	Consumer Prices 2022	Consumer Prices 2023	Consumer Prices 2024
Brazil	2.3	0.3	5.0	**2.9**	**1.0**	**1.5**	8.3	**9.3**	**5.0**	**5.3**
Mexico	1.8	1.3	4.7	**3.0**	**1.0**	**1.8**	5.7	**8.0**	**5.5**	**4.0**
Argentina	0.7	-0.7	10.4	**5.5**	**0.8**	**1.0**	48.4	**72.5**	**93.0**	**83.5**
Colombia	0.6	2.5	11.0	7.5	**0.8**	**2.0**	3.5	**10.3**	**11.8**	**5.5**
Chile	0.4	2.1	11.7	**2.8**	**-1.3**	**2.3**	4.5	**11.8**	**8.0**	**4.8**
Peru	0.3	2.4	13.6	**2.5**	**2.3**	**2.3**	4.0	**8.0**	**6.5**	**3.8**
Dom. Rep.	0.2	4.1	12.3	**4.8**	**4.0**	**4.8**	8.2	**8.8**	**4.8**	**4.3**
Ecuador	0.1	1.6	4.2	**3.0**	**2.3**	**2.0**	0.1	**3.5**	**1.8**	**1.0**
Venezuela	-	-12.7	**5.0**	**10.0**	**7.5**	**5.0**	1,589	**170**	**110**	**60**
Panama	0.1	3.5	15.3	**7.8**	**2.5**	**4.5**	1.6	**2.8**	**0.3**	**0.5**
Costa Rica	0.1	2.8	7.8	**4.5**	**2.5**	**2.3**	1.7	**8.3**	**3.5**	**3.3**
Uruguay	0.1	1.5	4.4	**4.8**	**1.5**	**2.0**	7.7	**9.0**	**7.0**	**8.0**
Latin America[2]	**6.7**	**1.0**	**7.0**	**3.8**	**1.0**	**1.8**	**6.2**	**8.8**	**5.9**	**4.6**

Sources: Refinitiv, Capital Economics. 1) % of GDP, 2021, PPP terms. 2) GDP Excl. Venezuela; Consumer Prices Excl. Argentina & Venezuela.

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