



LATIN AMERICA ECONOMICS WEEKLY

Easing inflation, Chile shifts right, Mexico's super-peso

Some relief on the inflation front

The past week or so has brought some positive news on the inflation front. Data from [Brazil](#) earlier today showed that the headline rate fell to a 30-month low in April. This followed data releases that showed falls in inflation in [Mexico](#) and Chile. And even in Colombia – one of the few countries in the region where inflation had still been on an upward trajectory – price pressures are finally easing.

A closer look at the breakdown shows that these falls were – once again – driven in large part by declines in food and energy inflation. That said, there was (finally) some good news on the core inflation front too. While core inflation in Colombia is still strengthening, the April data suggest that underlying price pressures elsewhere in the region are now easing more markedly. Indeed, services inflation in Mexico (a key focus of Banxico) dropped to a four-month low last month. Similarly, having been steady for four months, the Chilean central bank's preferred core inflation measure fell in April.

The broad-based decline in inflation means that a final hike at Banxico's meeting next week is no longer looking like the certainty that it once was (although we still expect a hike – see *Data Preview*). Meanwhile, attention elsewhere in the region has started to shift towards when central banks will start *cutting* interest rates. We think that, with inflation now on a clear downward trajectory, central banks in Peru and Chile will be the first to kick off their easing cycles around the middle of the year, with Brazil, Mexico and Colombia set to join in late Q3/Q4. That said, with inflation likely to prove more persistent than most anticipate, interest rates may not be lowered as much as the consensus is expecting

Chile's conservatives in the driver's seat

The strong showing for conservatives in last Sunday's vote for Chile's new Constitutional Council has caused fears of a more radical overhaul of the

country's constitution to ease. The far-right Republican party of former presidential candidate José Antonio Kast and the centre-right "Chile Seguro" list secured 33 of the 51 seats, giving them the necessary majority to pass articles. Meanwhile, the left-wing "Unidad para Chile" coalition, which is close to President Boric, merely secured 17 seats, falling short of seats needed to veto proposals. The outcome has raised the chances of a more moderate and market-friendly charter, which, unsurprisingly, went down well in Chilean financial markets.

That said, there's a risk that the strong performance of Kast's far-right party tilts the new charter too far right for the liking of many Chileans who took to the streets in 2019 clamouring for change. That could increase the likelihood of a renewed rejection in December's exit plebiscite, and, in turn, cause political uncertainty to intensify once again.

Mexican peso going from strength-to-strength

The Mexican peso continues to defy gravity, strengthening to a multi-year high of 17.6/\$ this week. The driver of the recent rally appears to have been strong US data. Indeed, the peso jumped after the [employment report](#) last Friday and, in a similar vein, strengthened against the greenback after Wednesday's [US CPI data](#), which appear to be consistent with a "higher for longer" interest rate scenario in the US – and expectations that Banxico will match the Fed. If optimism about the US economy is underpinning the peso's rally, we think its high valuation leaves the peso vulnerable to a sharp sell-off given our view that [the US will fall into recession](#) soon. So we are sticking with our [forecast](#) for the peso to weaken to 20/\$ by the end of the year.

The week ahead

Colombia's and Chile's GDP probably rose in Q1 and, in what is likely to be an extremely close call, we expect Mexico's central bank to deliver a final 25bp interest rate hike.



Data Previews

Colombia GDP (Q1)

Mon. 15th May

| Forecasts | Time (BST/ET) | Previous | Consensus | Capital Economics |
|-------------------|---------------|-------------|-------------|-------------------|
| GDP % q/q (% y/y) | 17.00/12.00 | +0.7 (+2.9) | +0.9 (+3.6) | +0.9 (+3.5) |

Set for a slowdown

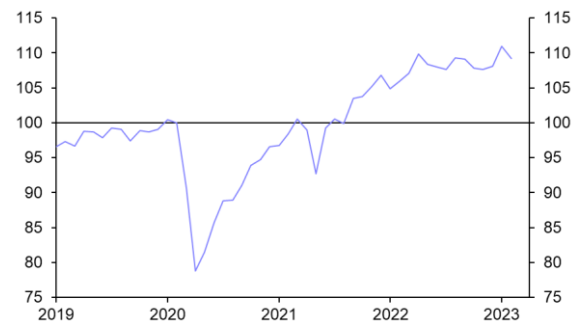
We think that data out on Monday will show that Colombia’s GDP rose by 0.9% q/q in Q1.

Colombia was a regional outperformer last year, with the economy expanding by 7.5% over 2022 as a whole. The economy made a decent start to the 2023 too. The monthly activity index rose by 2.7% m/m in January. But it looks like the economy has lost momentum since then. The index contracted by 1.5% m/m in February on the back of a plunge in services activity. (See Chart 1.) And soft data, such as the consumer confidence indicator, suggest that activity remained weak in March.

The strength of the January data mean that growth over Q1 as a whole was probably fairly strong, at around 0.9% q/q. However, the economy headed

into Q2 with weak momentum and we think high inflation and tight monetary policy will weigh on growth in the coming quarters. We expect growth this year to come in at a below-consensus 0.8%.

Chart 1: Colombia Official Economic Activity Index (ISE, SA, Feb. 2020 = 100)



Sources: Refinitiv, Capital Economics

Chile GDP (Q1)

Thu. 18th May

| Forecasts | Time (BST/ET) | Previous | Consensus | Capital Economics |
|-------------------|---------------|-------------|-----------|-------------------|
| GDP % q/q (% y/y) | 13.30/08.30 | +0.1 (-2.3) | - | +0.9 (-0.5) |

Decent start to the year, but weak momentum going into Q2

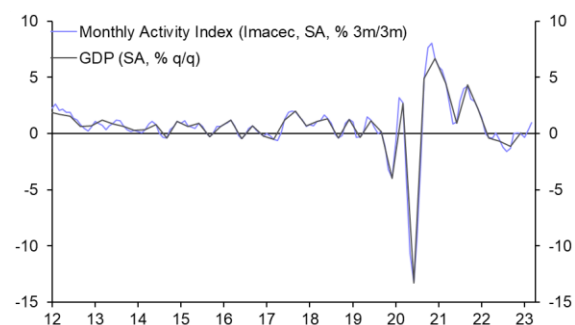
We expect data due out next Thursday to show that Chile’s economy expanded by 0.9% q/q in Q1.

Having struggled for most of 2022 – the economy contracted in three of the four quarters – there were signs that Chile’s economy recovered towards the end of last year, with output rising by 0.1% q/q in Q4.

The economy made a surprisingly strong start to Q1 – the monthly activity index (Imacec), which has a decent relationship with GDP, rose by 1.7% m/m in January. But the more recent data have been disappointing, with the Imacec index contracting in both February and March. Given the strong start to the year, on a 3m/3m basis this points to growth of 0.9% q/q over Q1 as a whole. (See Chart 2.)

That rebound in Q1 will prove to be a one-off. With tight monetary policy continuing to take its toll, we expect weaker growth over the coming quarters and that Chile’s economy will contract by 0.3% over 2023 as a whole.

Chart 2: Chile Imacec & GDP



Sources: Refinitiv, BCCh, Capital Economics



Mexico Interest Rate Announcement (May)

Thu. 18th May

| Forecasts | Time (BST/ET) | Previous | Consensus | Capital Economics |
|-----------------|---------------|----------|-----------|-------------------|
| Policy Rate (%) | 20.00/15.00 | 11.25 | 11.25 | 11.50 |

Close call, but strong labour market points to final 25bp hike

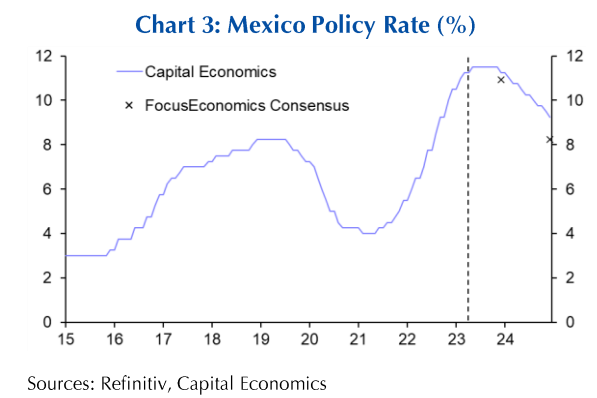
In what is likely to be an extremely close call, we think that Mexico’s central bank (Banxico) will opt for a final 25bp interest rate hike, to 11.50%, at Thursday’s Board meeting.

The statement accompanying the [last Board meeting](#) in March, at which rates were raised by 25bp, made clear that this month’s decision was going to be touch and go. And the economic data in recent weeks will certainly have given policymakers food for thought. While provisional [GDP figures](#) showed robust growth of 1.1% q/q in Q1, the monthly [industrial production](#) figures suggest that the economy was losing momentum at the end of the quarter. Meanwhile, [inflation](#) dropped sharply in April, to 6.3% y/y, amid a broad-based easing of price pressures. The peso has also continued to rally and is now up by more than 10% against the dollar year-to-date.

That all being said, policymakers have placed increasing focus on the strength of the labour market and rapid wage growth at recent meetings. The unemployment rate remains very low at just

2.8% and the most timely wage data, which covers workers that make social security contributions, shows that salaries are rising at close to their fastest pace in 20 years. That, alongside the rate hike by the Fed earlier this month, means that policymakers will remain in a hawkish mood. We think the Board will opt for a 25bp hike on Thursday.

Even if we’re wrong, with [inflation unlikely to return to Banxico’s 2-4% target range until late-2024](#), interest rates are likely to remain higher than the consensus and markets anticipate over the next couple of years. (See Chart 3.)





Economic Diary & Forecasts

Upcoming Events and Data Releases

| Date | Country | Release/Indicator/Event | Time (BST) | Time (EDT) | Previous* | Median* | CE Forecasts* |
|--|--|--------------------------------------|------------|------------|--------------|--------------|---------------|
| Mon 15 th |  Per | Unemployment Rate (Apr.) | 16.00 | 11.00 | (+7.5%) | - | - |
| |  Per | Economic Activity (Mar.) | 16.00 | 11.00 | (-0.6%) | - | - |
| |  Col | Economic Activity (Mar.) | 17.00 | 12.00 | (+3.0%) | (+1.5%) | - |
| |  Col | GDP (Q1) | 17.00 | 12.00 | +0.7%(+2.9%) | +0.9%(+3.6%) | +0.9%(+3.5%) |
| |  Pan | CPI (Apr.) | - | - | +0.2% | - | - |
| Tue 16 th |  Brz | Services Volume (Mar.) | 13.00 | 08.00 | +1.1%(+5.4%) | - | - |
| |  Col | Trade Balance (Mar.) | 16.00 | 11.00 | -\$0.5bn | - | - |
| |  Uru | Interest Rate Announcement | - | - | 11.25% | - | 11.00% |
| Wed 17 th |  Brz | Retail Sales (Mar.) | 13.00 | 08.00 | -0.1%(-2.3%) | - | - |
| Thu 18 th |  Chl | GDP (Q1) | 13.30 | 08.30 | +0.1%(-2.3%) | - | +0.9%(-0.5%) |
| |  Mex | Interest Rate Announcement | 20.00 | 15.00 | 11.25% | 11.25% | 11.50% |
| Fri 19 th |  Mex | Retail Sales (Mar.) | 13.00 | 08.00 | -0.3%(+3.4%) | - | - |
| |  Brz | Economic Activity (Mar.) | 13.00 | 08.00 | +3.3%(+2.7%) | - | - |
| Also expected during this period: | | | | | | | |
| 8 th – 11 th |  Dom | CPI (Apr.) | - | - | -0.2%(+4.4%) | - | - |
| 8 th – 12 th |  Pan | GDP (Q4) | - | - | (+9.5%) | - | - |
| Selected future data releases and events: | | | | | | | |
| 22 nd May |  Arg | Budget Balance (Apr.) | - | - | -257.9bn | - | - |
| 23 rd May |  Arg | Economic Activity (Mar.) | 20.00 | 15.00 | 0.0%(+0.2%) | - | - |
| |  Per | GDP (Q1) | - | - | (+1.7%) | - | - |
| 24 th May |  Mex | Bi-Weekly CPI (15 th May) | 13.00 | 08.00 | +0.2%(+6.3%) | - | - |
| 25 th May |  Mex | Trade Balance (Apr.) | 13.00 | 08.00 | +\$1.2bn | - | - |
| |  Brz | IPCA-15 Inflation (May) | 13.00 | 08.00 | +0.6%(+4.2%) | - | - |
| |  Mex | Current Account (Q1) | 16.00 | 11.00 | +\$4.6bn | - | - |
| 26 th May |  Mex | Economic Activity (Mar.) | 13.00 | 08.00 | +0.1%(+3.8%) | - | - |
| |  Mex | GDP (Q1, Final Est.) | 13.00 | 08.00 | +1.1(+3.9%) | - | - |
| |  Col | MPC Meeting | - | - | - | - | - |

*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 (12 th May) | Last Change | Next Change | Forecasts | |
|----------------------------|----------------------------------|--------------------|-----------------------------|--------------|--------------|
| | | | | End 2023 | End 2024 |
| Brazil Selic Target | 13.75 | Up 50bp (Aug. '22) | Down 50bp (Q4 '23) | 12.75 | 10.00 |
| Mexico Overnight Rate | 11.25 | Up 25bp (Mar. '23) | Up 25bp (May. '23) | 11.25 | 9.25 |
| Colombia Intervention Rate | 13.00 | Up 25bp (Apr. '23) | Down 50bp (Q3. '23) | 11.50 | 7.50 |
| Chile Overnight Rate | 11.25 | Up 50bp (Oct. '22) | Down 50bp (Jul. '23) | 8.50 | 5.75 |
| Peru Reference Rate | 7.75 | Up 25bp (Jan. '23) | Down 25bp (Jun. '23) | 5.75 | 4.50 |

Sources: Refinitiv, Capital Economics

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

| Currency | Latest (12 th May) | Forecasts | | Stock Market | Latest (12 th May) | Forecasts | |
|---------------|----------------------------------|--------------|--------------|-----------------|----------------------------------|----------------|----------------|
| | | End 2023 | End 2024 | | | End 2023 | End 2024 |
| Brazil BRL | 4.93 | 5.50 | 5.00 | Bovespa | 108,535 | 108,250 | 151,250 |
| Mexico MXN | 17.6 | 20.0 | 21.0 | Bolsa | 54,853 | 52,600 | 62,100 |
| Argentina ARS | 229 | 400 | 600 | Merval | 316,965 | - | - |
| Colombia COP | 4,564 | 4,800 | 4,200 | IGBC | 1,150 | 970 | 1,290 |
| Chile CLP | 787 | 850 | 775 | IPSA | 5,596 | 4,900 | 6,500 |
| Peru PEN | 3.65 | 4.00 | 3.70 | S&P/BVL | 21,692 | 22,100 | 27,400 |

Sources: Refinitiv, Capital Economics

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

| | Share of World ¹ | GDP | | | | | Consumer Prices | | | |
|----------------------------------|--------------------------------|-----------------|------------|-------------|-------------|-------------|-----------------|------------|--------------|--------------|
| | | 2011-20 Ave. | 2021 | 2022 | 2023 | 2024 | 2021 | 2022 | 2023 | 2024 |
| Brazil | 2.3 | 0.3 | 5.0 | 2.9 | 1.0 | 1.0 | 8.3 | 9.3 | 5.5 | 5.5 |
| Mexico | 1.8 | 1.3 | 4.7 | 3.1 | 2.5 | 1.3 | 5.7 | 7.9 | 5.5 | 4.5 |
| Argentina | 0.7 | -0.7 | 10.4 | 5.2 | -2.8 | -1.3 | 48.4 | 72.4 | 107.0 | 105.0 |
| Colombia | 0.6 | 2.5 | 11.0 | 7.5 | 0.8 | 1.8 | 3.5 | 10.2 | 11.8 | 5.8 |
| Chile | 0.4 | 2.1 | 11.7 | 2.4 | -0.3 | 2.5 | 4.5 | 11.6 | 8.3 | 4.8 |
| Peru | 0.3 | 2.4 | 13.6 | 2.7 | 2.0 | 2.5 | 4.0 | 7.9 | 7.0 | 4.0 |
| Dom. Rep. | 0.2 | 4.1 | 12.3 | 4.9 | 3.8 | 5.0 | 8.2 | 8.8 | 5.8 | 4.8 |
| Ecuador | 0.1 | 1.6 | 4.2 | 2.9 | 3.0 | 2.0 | 0.1 | 3.5 | 2.0 | 1.3 |
| Venezuela | - | -12.7 | 2.5 | 15.5 | 6.5 | 5.0 | 1,589 | 170 | 110 | 60 |
| Panama | 0.1 | 3.5 | 15.3 | 10.5 | 1.8 | 2.8 | 1.6 | 2.8 | 2.0 | 1.5 |
| Costa Rica | 0.1 | 2.8 | 7.8 | 4.3 | 3.0 | 2.3 | 1.7 | 8.3 | 2.8 | 3.5 |
| Uruguay | 0.1 | 1.5 | 5.3 | 4.8 | 1.3 | 2.5 | 7.7 | 9.0 | 7.5 | 8.0 |
| Latin America² | 6.7 | 1.0 | 7.0 | 3.8 | 1.1 | 1.2 | 6.2 | 8.7 | 6.3 | 4.9 |

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



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