LATIN AMERICA ECONOMICS WEEKLY

Brazil's fiscal rule inches closer, Chile's bank risks

Brazil's fiscal framework gets strong support

The approval of Brazil's fiscal framework in the lower house this week with a large majority suggests that there's a bit more political will to stabilise the public finances than we'd previously anticipated.

The new framework (see here for details) was approved with a majority of 372 to 108 this week. As we've argued before, if the framework is complied with in full, the debt-to-GDP ratio should top out at just under 80%. The big uncertainty is whether the government can raise the revenues needed to make the rule work. We have been sceptical on this front, but the scale of the vote in favour suggests that there might be more political appetite than we had anticipated. The bill now moves to the Senate, where it appears that approval will be a formality.

These fiscal developments, as well as the surprise decline in inflation in the first half of May, have led to a shift down in markets' interest rate expectations. Notably, the central bank started easing cycles shortly after the lower house approved previous fiscal reforms – the spending cap in 2016 and pension reform in 2019.

Nonetheless, there are some important differences between those episodes and now. For one thing, the run-up to the introduction of the spending cap was accompanied by a marked decline in Brazil's country risk premium; that hasn't happened recently. What's more, core inflation was lower before the start of previous easing cycles, at c. 6-6.5% in 2016 and 2.5% in 2019, compared with closer to 8% now. The upshot is that, while there's a risk of an earlier start to the easing cycle than we currently forecast (in Q4), policymakers at the central bank are likely to tread very cautiously.

Chile's central bank: better safe than sorry

Chile's central bank activated its counter-cyclical capital buffer earlier this week – a move that raises capital requirements for banks by 0.5% of their risk-weighted assets for a year. Policymakers emphasised that this was a precautionary measure, which is aimed at ensuring that banks' buffers are sufficient to withstand with a rise in non-performing loans (NPLs).

As we noted in an *Update* last month, there are pockets of risks in the consumer sector, where the NPL ratio has risen sharply. But Chile's banking sector already appeared to be well placed to deal with these. The ratio of regulatory capital relative to banks' risk-weighted assets stands well above the minimum under Basel III and our analysis suggests that most major Chilean banks could endure a relatively large loan loss rate before their CET1 capital would fall below the regulatory minimum.

Even so, higher capital requirements are likely to result in tighter credit conditions. To the extent that this causes growth to slow, that might shift the risks towards slightly looser monetary policy than we're currently anticipating. The fall in short-term swap rates after the central bank's announcement suggests that investors are already thinking this way. This makes us more confident in our view that Chile's central bank will be the first among the large economies in Latin America to cut interest rates – we expect the first move to come in July.

In case you missed it

Colombia has come up regularly in recent discussion with clients, in particular why the macroeconomic situation there looks more fragile than in much of the rest of the region. We looked at the root of the problem – the country's strong post-pandemic recovery and excessively loose policy – and the accompanying risks in an *Update* this week.

The week ahead

Q1 GDP figures from Brazil are likely to show that the economy rebounded last quarter. Otherwise, we'll be discussing the outlook for EM equities, monetary policy and near-shoring in our monthly EM Drop-in. Sign up here.

Kimberley Sperrfechter, Latin America Economist, kimberley.sperrfechter@capitaleconomics.com

Data Previews

Brazil GDP (Q1)

Thu. 1st Jun.

Forecasts	Time (BST/ET)	Previous	Consensus	Capital Economics
GDP % q/q (% y/y)	13.00/08.00	-0.2 (+1.9)	1.1(+2.7)	+0.4 (+1.5)

Rebounding, but temporarily

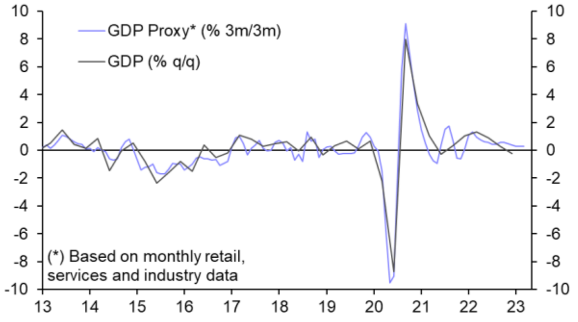
We think that data out on Thursday will show that Brazil's economy expanded by 0.4% q/q in Q1, but we expect growth to soften over the rest of the year.

The economy made a weak start to the year, but activity figures for February and March showed signs of improvement. The agricultural sector appears to have fared well. Meanwhile, the monthly hard data suggest that industry eked out positive growth and services expanded robustly. Retail spending was the one weak spot.

Our own proxy for GDP, which has had a reasonable relationship with the official figures, points to an expansion of around 0.4% q/q. (See Chart 1.) Surveys for early Q2 suggest that the economy continued to perform well in recent months. But we don't think this bright period will last. Brazil's terms of trade are likely to worsen, while the impact of high interest rates will exert an increasingly heavy toll on domestic demand.

We expect GDP to expand by just 1% both this year and next, which puts us a little below the consensus.

Chart 1: Brazil GDP & CE GDP Proxy



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*
Mon 29th		**Brz**	Current Account (Apr.)	12.30	07.30	+$0.3bn	-	-
		Chl	MPC Meeting Minutes	13.30	08.30	-	-	-
Tue 30th		**Chl**	Unemployment Rate (Apr.)	14.00	09.00	8.8%	-	-
Wed 31st		**Brz**	Nominal Budget Balance (Apr., BRL)	12.30	07.30	-79.5bn	-	-
		Brz	Primary Budget Balance (Apr., BRL)	12.30	07.30	-14.2bn	-	-
		Brz	Unemployment Rate (Apr.)	13.00	08.00	8.8%	8.9%	-
		Chl	Industrial Production (Apr.)	14.00	09.00	(-5.9%)	-	-
		Chl	Retail Sales (Apr.)	14.00	09.00	(-8.4%)	-	-
		Col	Unemployment Rate (Apr.)	16.00	11.00	10.0%	-	-
		Dom	Interest Rate Announcement	-	-	8.50%	-	-
Thu 1st		**Brz**	GDP (Q1)	13.00	08.00	-0.2%(-2.1%)	+1.1%(+2.7%)	+0.4%(+1.5%)
		Chl	Economic Activity (Apr.)	13.30	08.30	-0.1%(-2.1%)	-	-
		Brz	S&P Global Manufacturing PMI (May)	14.00	09.00	44.3	-	-
		Mex	S&P Global Manufacturing PMI (May)	16.00	11.00	51.1	-	-
		Per	CPI (May)	16.00	11.00	(+8.0%)	+0.3%(+7.9%)	+0.3%(+7.9%)
		Mex	MPC Meeting Minutes	16.00	11.00	-	-	-
		Brz	Trade Balance (May)	19.00	14.00	+$8.2bn	+$9.1bn	-
		Mex	IMEF Manufacturing Index (May)	19.00	14.00	50.6	-	-
		Mex	IMEF Non-Manufacturing Index (May)	19.00	14.00	52.2	-	-
		Col	Current Account Balance (Q1)	-	-	-$5.0bn	-$5.1bn	-
Fri 2nd		**Brz**	Industrial Production (Apr.)	13.00	08.00	+1.1%(+0.9%)	-	-
Also expected during this period:								
29th – 2nd		**Pan**	GDP (Q4)	-	-	(+9.5%)	-	-
Selected future data releases and events:								
5th Jun		**Brz**	S&P Global Services PMI (May)	14.00	09.00	54.5	-	-
		Uru	CPI (May)	18.00	13.00	+0.8%(+7.6%)	-	-
6th Jun		**Ecu**	CPI (May)	15.00	11.00	+0.2%(+2.5%)	-	-
7th Jun		**Brz**	IPCA Inflation (May)	13.00	08.00	+0.6%(+4.2%)	-	-
		Chl	Trade Balance (May)	13.30	08.30	+$1.2bn	-	-
		Chl	Wage Growth (Apr.)	14.00	09.00	(+11.2%)	-	-
		C.Rc	CPI (May)	-	-	-0.3%(+2.4%)	-	-
8th Jun		**Col**	CPI (May)	00.00	19.00†	+0.8%(+12.8%)	-	-
		Chl	CPI (May)	13.00	08.00	+0.3%(+9.9%)	-	-
		Mex	CPI (May)	13.00	08.00	0.0%(+6.3%)	-	-
		Arg	Industrial Production (Apr.)	20.00	15.00	(+3.1%)	-	-
9th Jun		**Per**	Interest Rate Announcement	00.00	19.00†	7.75%	-	-
		Mex	Industrial Production (Apr.)	13.00	08.00	-0.9%(+1.6%)	-	-
		Mex	Wage Growth (May)	-	-	(+9.3%)	-	-

*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 (26th May)	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	11.25	Up 25bp (Mar. '23)	**Down 25bp (Q4 '23)**	**11.00**	**9.00**
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 (26h May)	Forecasts End 2023	Forecasts End 2024	Stock Market	Latest (26th May)	Forecasts End 2023	Forecasts End 2024
Brazil	BRL	5.01	**5.50**	**5.00**	Bovespa	111,606	**109,500**	**153,000**
Mexico	MXN	17.7	**20.0**	**21.0**	Bolsa	53,992	**52,600**	**62,100**
Argentina	ARS	236	**400**	**600**	Merval	341,669	**-**	**-**
Colombia	COP	4,462	**4,800**	**4,200**	IGBC	1,100	**970**	**1,290**
Chile	CLP	806	**850**	**775**	IPSA	5,629	**4,900**	**6,500**
Peru	PEN	3.67	**4.00**	**3.70**	S&P/BVL	21,222	**22,100**	**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**	**1.0**	8.3	9.3	**5.5**	**5.5**
Mexico	1.8	1.3	4.7	3.1	**2.3**	**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	**111.5**	**106.5**
Colombia	0.6	2.5	11.0	7.3	**0.8**	**1.5**	3.5	10.2	**11.8**	**5.8**
Chile	0.4	2.1	11.7	2.4	**0.5**	**2.5**	4.5	11.6	**8.3**	**4.8**
Peru	0.3	2.5	13.3	2.7	**2.5**	**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	**5.3**	**4.5**
Ecuador	0.1	1.6	4.2	2.9	**3.0**	**2.0**	0.1	3.5	**1.5**	**1.3**
Venezuela	-	-12.7	2.5	**15.5**	**6.5**	**5.0**	1,589	185	**320**	**65**
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	**3.5**	**2.3**	1.7	8.3	**2.3**	**3.3**
Uruguay	0.1	1.5	5.3	4.8	**1.3**	**2.5**	7.7	9.0	**7.5**	**8.0**
Latin America[2]	**6.7**	**1.0**	**7.0**	**3.7**	**1.1**	**1.2**	**6.2**	**8.7**	**6.2**	**4.9**

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