



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 riskweighted 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.

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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.







Economic Diary & Forecasts

Upcoming Events and Data Releases

Mon 29 th	Date	Country	Release/Indicator/Event	Time (BST)	Time (EDT)	Previous*	Median*	CE Forecasts*
Tue 30%	Mon 29 th	♦ Brz	Current Account (Apr.)	12.30	07.30	+\$0.3bn	-	-
Wed 31st Sept		L Chl	MPC Meeting Minutes	13.30	08.30	-	-	-
Brz Primary Budget Balance (Apr., BRL) 12.30 07.30 -14.2bn - - - S 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 (-5.9%) - - Col Unemployment Rate (Apr.) 14.00 09.00 (-8.4%) - - Col Unemployment Rate (Apr.) 16.00 11.00 10.0% - - Dom Interest Rate Announcement - - 8.50% - - Dom Interest Rate Announcement - - 8.50% - - Dom Interest Rate Announcement - - 8.50% - - Dom Interest Rate Announcement - - 8.50% - - Dom SP Z SP Clobal Manufacturing PMI (May) 14.00 09.00 44.3 - - Mex SP Clobal Manufacturing PMI (May) 16.00 11.00 51.1 - - Per CPI (May) 16.00 11.00 51.1 - - - Mex MPC Meeting Minutes 16.00 11.00 51.1 - - - Mex MPC Meeting Minutes 16.00 11.00 50.6 - - - Mex MREF Manufacturing Index (May) 19.00 14.00 50.6 - - - Mex MEEF Non-Manufacturing Index (May) 19.00 14.00 50.6 - - Fri 2 nd	Tue 30 th	L Chl	Unemployment Rate (Apr.)	14.00	09.00	8.8%	-	-
Series Brz Unemployment Rate (Apr.) 13.00 08.00 8.8% 8.9% -	Wed 31st	Brz	Nominal Budget Balance (Apr., BRL)	12.30	07.30	-79 . 5bn	-	-
Chl Industrial Production (Apr.) 14.00 09.00 (.5.9%) 		Brz	Primary Budget Balance (Apr., BRL)	12.30	07.30	-14.2bn	-	-
Chl Retail Sales (Apr.)		Brz	Unemployment Rate (Apr.)	13.00	08.00	8.8%	8.9%	-
Col Unemployment Rate (Apr.) 16.00 11.00 10.0% - -		Chl	Industrial Production (Apr.)	14.00	09.00	(-5.9%)	-	-
Thu 1 ⁸		Chl	Retail Sales (Apr.)	14.00	09.00	(-8.4%)	-	-
Thu 1 st		Col	Unemployment Rate (Apr.)	16.00	11.00	10.0%	-	-
Chl Economic Activity (Apr.) Brz S&P Global Manufacturing PMI (May) Mex S&P Global Manufacturing PMI (May) Per CPI (May) Mex MPC Meeting Minutes Brz Trade Balance (May) Mex IMEF Manufacturing Index (May) Mex IMEF Mon-Manufacturing Index (May) Pro Col Current Account Balance (Q1) Brz Industrial Production (Apr.) Selected future data releases and events: S'' Jun Brz S&P Global Services PMI (May) Brz IPCA Inflation (May) Brz IPCA Inflation (May) Brz IPCA Inflation (May) Brz Industrial Production (Apr.) Brz IPCA Inflation (May) Col Cli Trade Balance (May) Brz IPCA Inflation (May) Col Cli Trade Balance (May) Brz IPCA Inflation (May) Col Cli Trade Balance (May) Brz IPCA Inflation (May) Col CPI (May)		Don Don	Interest Rate Announcement	-	-	8.50%	-	-
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Mex S&P Global Manufacturing PMI (May) 16.00 11.00 51.1 - - Per Per CPI (May) 16.00 11.00 (+8.0%) +0.3%(+7.9		Chl	Economic Activity (Apr.)	13.30	08.30	-0.1%(-2.1%)	-	-
Per CPI (May) 16.00 11.00 (+8.0%) +0.3%(+7.9%) +0.3		Brz	S&P Global Manufacturing PMI (May)	14.00	09.00	44.3	-	-
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 2 nd		Me>	S&P Global Manufacturing PMI (May)	16.00	11.00	51.1	-	-
Brz Trade Balance (May) 19.00 14.00 +\$8.2bn +\$9.1bn - Mex MEF Manufacturing Index (May) 19.00 14.00 50.6 - - Mex MEF Non-Manufacturing Index (May) 19.00 14.00 52.2 - - Col Current Account Balance (Q1) - - -\$5.0bn -\$5.1bn - Fri 2 ^{ndl}		Per	CPI (May)	16.00	11.00	(+8.0%)	+0.3%(+7.9%)	+0.3%(+7.9%
Mex MEF Manufacturing Index (May) 19.00 14.00 50.66 - - - Mex MEF Non-Manufacturing Index (May) 19.00 14.00 52.2 - - Col Current Account Balance (Q1) - - - - - - Brz Industrial Production (Apr.) 13.00 08.00 +1.1%(+0.9%) - - Also expected during this period: 29½n - 2½n² Pan GDP (Q4) - - (+9.5%) - - Selected future data releases and events: 5½n² Uru CPI (May) 14.00 09.00 54.5 - -		Me>	MPC Meeting Minutes	16.00	11.00	_	-	-
Mex MEF Non-Manufacturing Index (May) 19.00 14.00 52.2 - - - Col Current Account Balance (Q1) - - - - - 5.0bm - 5.1bm - Fri 2 nd		♦ Brz	Trade Balance (May)	19.00	14.00	+\$8.2bn	+\$9.1bn	_
Col Current Account Balance (Q1)		Mex	(IMEF Manufacturing Index (May)	19.00	14.00	50.6	_	_
Fri 2 nd		Mex	IMEF Non-Manufacturing Index (May)	19.00	14.00	52.2	_	_
Also expected during this period: 29th - 2nd		Col	Current Account Balance (Q1)	_	_	-\$5.0bn	-\$5.1bn	_
29th − 2nd	Fri 2 nd	→ Brz	Industrial Production (Apr.)	13.00	08.00	+1.1%(+0.9%)	-	-
Selected future data releases and events: 5th Jun Brz S&P Global Services PMI (May) 14.00 09.00 54.5 - - 5th Jun Brz S&P Global Services PMI (May) 18.00 13.00 +0.8%(+7.6%) - - 5th Jun Ecu CPI (May) 15.00 11.00 +0.2%(+2.5%) - - Chl Trade Balance (May) 13.00 08.00 +0.6%(+4.2%) - - Chl Wage Growth (Apr.) 14.00 09.00 (+11.2%) - - C.Rc CPI (May) - - -0.3%(+2.4%) - - Bth 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%) - - Parameters Restricted Rate Announcement 00.00 19.00† 7.75% -	Also expe	cted during t	his period:					
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*m/m(y/y) unless otherwise stated; † = previous day	*m/m(y/v) ı							





Main Economic & Market Forecasts

Table 1: Central Bank Policy Rates (%)

					Forecasts		
	Policy Rate	Latest Last Change (26 th May)		Next Change	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)	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	

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

	-	Latest	Forecasts		Stock	Latest	Forecasts	
	Currency	(26 ^h May)	End 2023	End 2024	Market	(26 th May)	End 2023	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	<i>77</i> 5	IPSA	5,629	4,900	6,500
Peru	PEN	3.67	4.00	3.70	S&P/BVL	21,222	22,100	27,400

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

	Share of	GDP				Consumer Prices				
	World ¹	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	2.3	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

 $\underline{ \text{Sources: Refinitiv, Capital Economics. 1) \% of GDP, 2021, PPP terms. 2) GDP Excl. Venezuela; Consumer Prices Excl. Argentina \& Venezuela.}$





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