CAPITAL ECONOMICS

LATIN AMERICA ECONOMICS UPDATE

Strong wage growth to temper falls in inflation and rates

- **The tightening of labour markets across Latin America in the past year or so has fuelled rapid wage growth in many economies and wage growth is likely to remain uncomfortably high for a while yet. Against this backdrop, even as central banks kick off their easing cycles over the coming months, we think that they will lower interest rates more cautiously than most currently anticipate.**
- Labour market conditions in most Latin American economies have tightened over the past year or so, with unemployment rates falling almost across the board. (See Chart 1.) The fall has been sharpest in Brazil, where we estimate that the unemployment rate is now at its lowest rate since 2015. Similarly, unemployment has fallen sharply in Colombia (although it remains slightly above its pre-pandemic average) while in Mexico, the unemployment rate remained at a multi-decade low in April.
- **Tight labour markets have pushed up wage growth sharply.** Annual wage growth across the region's major economies is running in double digits, and is well above its pre-pandemic average. (See Chart 2.) Admittedly, in seasonally adjusted m/m terms – which gives a better sense of the latest developments – there are signs that wage pressures have passed their peak. But even so, wages are still rising rapidly.
- **What's more, Chile's experience suggests that, even once labour markets loosen, wage pressures may remain strong.** Indeed, despite the unemployment rate falling by more than 1%-pt since last June, wage growth in Chile has remained stable at around 11% y/y (see Chart 3), suggesting that the backdrop of high inflation is prompting workers to still push for large wage increases.
- With GDP growth across the region set to slow, labour market conditions are likely to loosen. This, alongside further falls in headline inflation, means that wage growth should ease over the coming quarters. That said, we expect wage growth to slow only gradually, which will keep core price pressures elevated. **This is unlikely to prevent central banks from shifting towards monetary easing over the next couple of quarters. But strong core inflation means that we expect policymakers to tread more cautiously than most anticipate when lowering interest rates.** (For more, see our latest *Latin America Outlook*.)

Chart 1: Unemployment Rate (%-pt Difference Between Latest & Q1 2022)

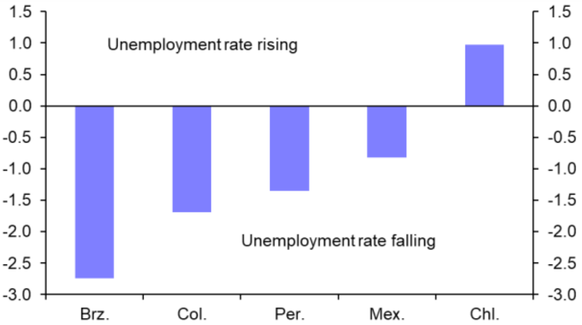


Chart 2: Nominal Wages (% y/y)

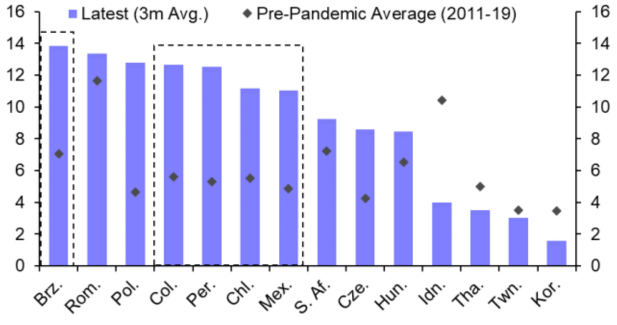


Chart 3: Chile Unemployment Rate and Wage Growth

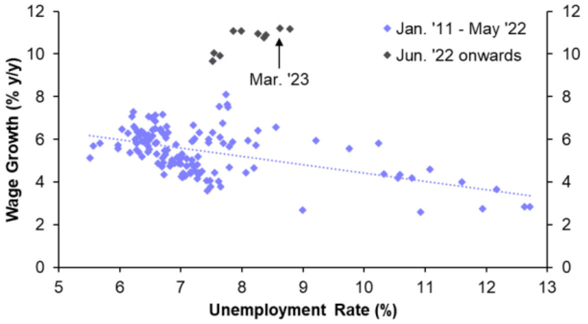
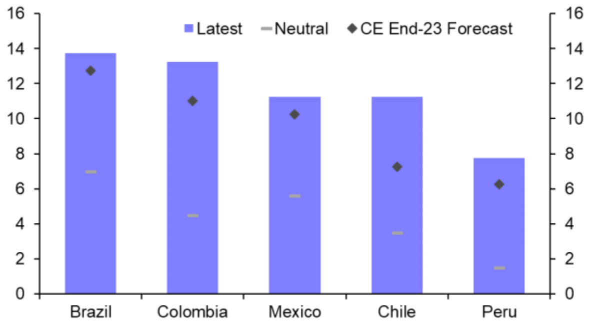


Chart 4: Policy Rates (%)



Sources: Refinitv, Capital Economics

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