LATIN AMERICA ECONOMICS WEEKLY

Andes adjusting, tight job markets in Brazil & Mexico

Colombia: baby steps towards sustainable growth

Data out this week suggest that Colombia's economy has started to undergo an adjustment process, albeit a gradual one.

In an *Update* last week, we explained how Colombia's unsustainably strong recovery had led to an accumulation of external imbalances, in particular a worryingly large current account deficit.

Data released yesterday by Colombia's central bank showed that things are (slowly) moving in the right direction. The current account deficit narrowed to 5.8% of GDP in Q1 (on a four-quarter-sum basis), from 6.2% in Q4. On a seasonally-adjusted basis, we estimate that the deficit narrowed to 4% of GDP. The fact that the improvement in the current account position was driven by a narrowing in the trade deficit due to a fall in imports echoes the message from breakdown of the Q1 GDP data, which painted a picture of weakening domestic demand.

Labour market data released this week provided further tentative signs that Colombia's economy is adjusting. The unemployment rate rose to a seven-month high of 10.6% on our seasonally adjusted measure, suggesting that labour market conditions are starting to loosen. That said, this process in Colombia is still in its infancy and we think it has a lot further to run given the country's large macroeconomic imbalances. This feeds into our below-consensus growth forecast of just 0.8% over 2023 as a whole.

Diverging labour market conditions

Meanwhile, Chile, the other country in the region that had overheated following the pandemic, is further ahead on the rebalancing path. Output has returned to its pre-pandemic trend, the current account balance has flipped back into a surplus on a seasonally adjusted basis and, although the unemployment rate edged down to 8.7% in April, it remains well above its pre-pandemic average. One consequence is that we think the conditions are in place for Chile's central bank to start cutting interest rates next month.

While labour markets in the Andes are loosening, those in the region's two largest economies remain very tight. Indeed, Brazil's unemployment rate fell to 8.5% in April, the second consecutive month the rate came in below consensus expectations. This is supporting rapid wage growth – wages are rising at 8% y/y in real terms. While this will support household incomes, and by extension private consumption, it means that Copom is unlikely to shift towards rate cuts anytime soon.

In a similar vein, labour market data from Mexico showed that the unemployment rate remained at a multi-decade low of 2.8% in April, keeping wage growth in double digits. We've been warning for a while about wage pressures feeding through to broader inflationary pressures in Mexico. And the minutes to the central bank's May meeting (at which the tightening cycle was brought to a close) showed that policymakers have come round to our view. The Board appeared concerned that "core inflation shows persistence", which they attributed, at least in part, to the tight labour market.

Against this backdrop, the minutes made clear that, although the tightening cycle had ended, it was "necessary to maintain the reference rate at its current level for an extended period". This supports our view that the policy rate will be kept at its current level of 11.25% until Q4. And once policymakers do start lowering interest rates we think they will do so more gradually than most other analysts are expecting.

The week ahead

The raft of inflation data from across the region is likely to show that inflation fell in May. Otherwise, Peru's central bank is likely to keep unchanged at next week's meeting.

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Data Previews

Brazil Consumer Prices (May)

Wed. 7th Jun.

Forecasts	Time (BST/ET)	Previous	Consensus	Capital Economics
% m/m (% y/y)	13.00/08.00	+0.6(+4.2)	-	+0.1(+3.8)

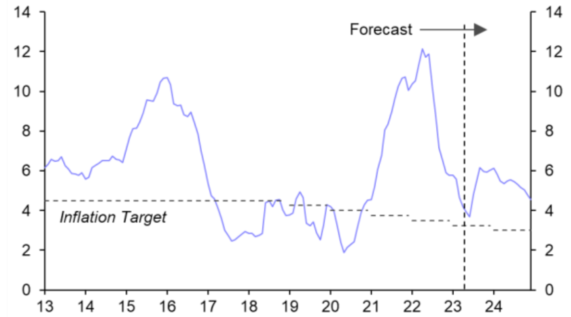
Further falls, but Copom won't be swayed

We think that data out on Wednesday will show that inflation fell to a multi-year low of 3.9% in May, but we doubt that this will prompt Copom to lay the groundwork for an easing cycle when it meets later this month.

The mid-month IPCA-15 reading, which showed a fall in the headline rate to 4.1% y/y, pointed to a broad easing of price pressures. And based on weekly CPI figures, it looks like the headline rate fell further over the month as a whole, to 3.9%. That would be well within the central bank's inflation tolerance range for this year of 3.25±1.5%.

But the central bank will be paying more attention to core inflation, which probably remained too high for its liking, as well as the strength of the labour market. (See main article.) These factors are likely to push headline inflation back up in Q3 once some favourable base effects affecting food and energy unwind. (See Chart 1.) As a result, we still expect hawkish noises from the central bank when it meets later this month and we don't expect an interest rate cut until the November meeting.

Chart 1: Brazil Consumer Prices (% y/y)



Sources: Refinitiv, Capital Economics

Mexico Consumer Prices (May)

Thu. 8th Jun.

Forecasts	Time (BST/ET)	Previous	Consensus	Capital Economics
% m/m (% y/y)	13.00/08.00	0.0(+6.3)	-	-0.1(+6.0)

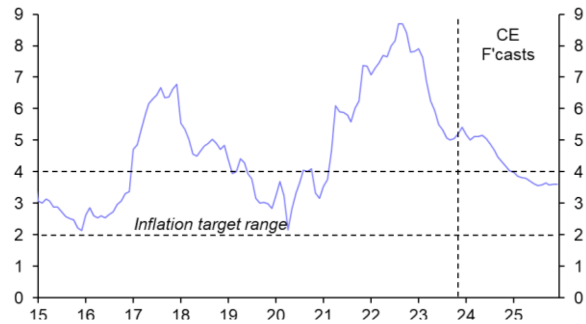
Inflation falling, but rate cuts unlikely until late-2023

We think that data out on Thursday will show that inflation in Mexico fell to 6.0% y/y in May. While Banxico has ended its tightening cycle, a strong labour market and rapid wage growth means that rate cuts are unlikely until the very end of this year.

Headline inflation has dropped back from a peak of 8.7% y/y in September to 6.3% y/y in April. And it fell further to 6.0% y/y in the first half of May. That largely reflected weaker core goods inflation as well as a further decline in non-core inflation due to a continued easing of energy price pressures. But core services inflation, a key focus of Banxico recently, was unchanged at 5.4% y/y.

We expect the full month inflation figures to come in line with the mid-month data. And while headline inflation should continue to ease over the coming months, it is likely to be a bumpy path and rapid wage growth means that services inflation in particular will be slow to fall. We don't expect inflation to return to within Banxico's 2-4% target range until late-2024. (See Chart 2.) The upshot is that rate cuts are unlikely until Q4 at the earliest.

Chart 1: Mexico 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*
Mon 5th	**Brz**	S&P Global Services PMI (May)	14.00	09.00	54.5	-	-
	Uru	CPI (May)	18.00	13.00	+0.8%(+7.6%)	-	+0.4%(+7.6%)
Tue 6th	**Ecu**	CPI (May)	15.00	11.00	+0.2%(+2.5%)	-	+0.1%(+2.0%)
Wed 7th	**Brz**	IPCA Inflation (May)	13.00	08.00	+0.6%(+4.2%)	-	+0.1%(+3.8%)
	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%)	-	+0.3%(+1.2%)
Thu 8th	**Col**	CPI (May)	00.00	19.00†	+0.8%(+12.8%)	+0.7%(+12.7%)	+0.7%(+12.7%)
	Chl	CPI (May)	13.00	08.00	+0.3%(+9.9%)	+0.3%(+8.9%)	+0.3%(+8.9%)
	Mex	CPI (May)	13.00	08.00	0.0%(+6.3%)	-	-0.1%(+6.0%)
	Arg	Industrial Production (Apr.)	20.00	15.00	(+3.1%)	-	-
Fri 9th	**Per**	Interest Rate Announcement	00.00	19.00†	7.75%	7.75%	7.75%
	Mex	Industrial Production (Apr.)	13.00	08.00	-0.9%(+1.6%)	-	-
	Mex	Wage Growth (May)	-	-	(+9.3%)	-	-
Also expected during this period:							
29th – 2nd	**Pan**	GDP (Q4)	-	-	(+9.5%)	-	-
Selected future data releases and events:							
14th Jun	**Brz**	Retail Sales (Apr.)	13.00	08.00	+0.8%(+3.2%)	-	-
	Arg	CPI (May)	20.00	15.00	+8.4%(+108.8%)	-	-
	C.Rc	Interest Rate Announcement	-	-	7.50%	-	-
15th Jun	**Brz**	Services Output (Apr.)	13.00	08.00	+0.9%(+6.3%)	-	-
	Per	Unemployment Rate (May)	16.00	11.00	7.1%	-	-
	Per	Economic Activity (Apr.)	16.00	11.00	(+0.2%)	-	-
	Col	Industrial Production (Apr.)	16.00	11.00	(-0.4%)	-	-
	Col	Retail Sales (Apr.)	16.00	11.00	(-7.1%)	-	-
	Pan	CPI (May)	-	-	(+0.2%)	-	-
	Uru	GDP (Q1)	-	-	(-0.1%)	-	-
16th Jun	**Brz**	Economic Activity (Apr.)	13.00	08.00	-0.2%(+5.5%)	-	-

*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 (2nd Jun.)	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 (2nd Jun.)	Forecasts End 2023	Forecasts End 2024	Stock Market	Latest (2nd Jun.)	Forecasts End 2023	Forecasts End 2024
Brazil	BRL	4.96	**5.50**	**5.00**	Bovespa	112,643	**109,500**	**153,000**
Mexico	MXN	17.5	**20.0**	**21.0**	Bolsa	53,070	**52,600**	**62,100**
Argentina	ARS	241	**400**	**600**	Merval	357,422	**-**	**-**
Colombia	COP	4,350	**4,800**	**4,200**	IGBC	1,131	**970**	**1,290**
Chile	CLP	796	**850**	**775**	IPSA	5,578	**4,900**	**6,500**
Peru	PEN	3.69	**4.00**	**3.70**	S&P/BVL	21,653	**22,100**	**27,400**

Sources: Refinitiv, Capital Economics

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

	Share of World[1]	GDP 2011-20 Ave.	GDP 2022	GDP 2023	GDP 2024	GDP 2025	Consumer Prices 2022	Consumer Prices 2023	Consumer Prices 2024	Consumer Prices 2025
Brazil	2.3	0.3	2.9	**1.0**	**1.0**	**1.5**	9.3	**5.5**	**5.5**	**4.0**
Mexico	1.8	1.3	3.1	**2.3**	**1.3**	**2.0**	7.9	**5.5**	**4.5**	**3.8**
Argentina	0.7	-0.7	5.2	**-2.8**	**-1.3**	**2.5**	72.4	**111.5**	**106.5**	**82.5**
Colombia	0.6	2.5	7.3	**0.8**	**1.5**	**2.5**	10.2	**11.8**	**5.8**	**4.0**
Chile	0.4	2.1	2.4	**0.5**	**2.5**	**3.0**	11.6	**8.3**	**4.8**	**3.8**
Peru	0.3	2.5	2.7	**2.5**	**2.5**	**2.8**	7.9	**7.0**	**4.0**	**3.3**
Dom. Rep.	0.2	4.1	4.9	**3.8**	**5.0**	**5.0**	8.8	**5.3**	**4.5**	**4.0**
Ecuador	0.1	1.6	2.9	**3.0**	**2.0**	**2.5**	3.5	**1.5**	**1.3**	**1.5**
Venezuela	-	-12.7	**15.5**	**6.5**	**5.0**	**5.0**	185	**320**	**65**	**50**
Panama	0.1	3.5	**10.5**	**1.8**	**2.8**	**3.0**	2.8	**2.0**	**1.5**	**1.3**
Costa Rica	0.1	2.8	4.3	**3.5**	**2.3**	**2.5**	8.3	**2.3**	**3.3**	**3.0**
Uruguay	0.1	1.5	4.8	**1.3**	**2.5**	**2.5**	9.0	**7.5**	**8.0**	**7.3**
Latin America[2]	**6.7**	**1.0**	**3.7**	**1.1**	**1.2**	**2.1**	**8.7**	**6.2**	**4.9**	**3.8**

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

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