LATIN AMERICA ECONOMICS WEEKLY

Brazil's debt upgrade, Argentina-IMF, easing cycles

Fitch gives Haddad a gift

The upgrade by Fitch to Brazil's long-term foreign currency sovereign debt rating this week, from BB- to BB, provides another sign that fiscal concerns in the country are easing.

Fitch justified the move on the better-than-anticipated economic outlook, progress with the new fiscal framework and expectations of further reforms. There's certainly something to this. The budget, debt and growth figures have beaten expectations recently. And, as we've noted before, the new fiscal framework would, if implemented in full, help to stabilise the public debt-to-GDP ratio.

We also got a few more details this week of how the government plans to raise revenues to narrow the budget deficit and comply with the new framework. Reports from *Valor* suggest that it will raise revenues from measures including taxes on offshore funds and reduction in payments from tax disputes. Full details will be in the 2024 budget (known as PLOA), to be submitted to congress by the end of August.

One point that stands out, though, is that the government has a lot of legislative work to do in order to raise sufficient revenues. Our central forecast continues to assume that the government's plans will have to be watered down and it won't be able to stop the debt ratio from rising.

As a consequence, despite the upgrade from Fitch, it's hard to see Brazil regaining its coveted investment grade status (which was lost in 2015) any time soon. (It's currently two notches below.) When Brazil previously won investment grade status, in 2008, the public debt ratio was much lower and had been falling for many years. That was helped by fiscal discipline – including large primary budget surpluses – the commodity price boom and rapid growth. The same conditions are unlikely to fall into place now.

More help for Argentina

The news just out, that the IMF has agreed to front-load disbursements to Argentina, totalling $7.5bn (pending Executive Board approval in the second half of August), should help to tide the economy over until the election. It looks like the Fund is demanding additional austerity and higher interest rates as part of this financing. But it's still not clear that the overvalued exchange rate is being tackled. As we set out in a note earlier this week, a weaker peso is a key ingredient if Argentina is to get out of its current economic crisis.

The good news is that the leading presidential candidates seem increasingly aware of what needs to be done. (For more on the main candidates' plans see *here*.) That was reinforced by a webinar hosted by the Wilson Center this week, in which Diana Mondin, Senior Economic Adviser to far-right libertarian Argentine presidential candidate Javier Milei, shed more light on his economic proposals.

In particular, she highlighted the need for a unified exchange rate, deregulation to attract private investment, privatisations and harsh austerity (although it's unclear how that would be reconciled with her call for higher government spending on infrastructure). Mondin's comments on China also suggest that a Milei administration would take a more restrained stance towards Beijing than the current government (which has been drawing on a swap line with the PBOC to repay the IMF).

The week ahead

The Latin American monetary easing cycle will step up a gear over the next week. Although Colombia's central bank will leave rates on hold (Monday), policymakers in Chile (later today) and Brazil (Wednesday) will *cut* rates. (See *Data Previews* and sign up for our EM drop-in here.) Elsewhere, we think Mexico's Q2 GDP data will show a slowdown.

William Jackson, Chief Emerging Markets Economist, william.jackson@capitaleconomics.com
Hibah Khan, Research Assistant, hibah.khan@capitaleconomics.com

Data Previews

Mexico GDP (Q2)

Mon. 31st Jul.

Forecasts	Time (BST/ET)	Previous	Consensus	Capital Economics
GDP % q/q (% y/y)	13.00/08.00	+1.0(+3.7)	+0.6(+3.2)	+0.5(+2.8)

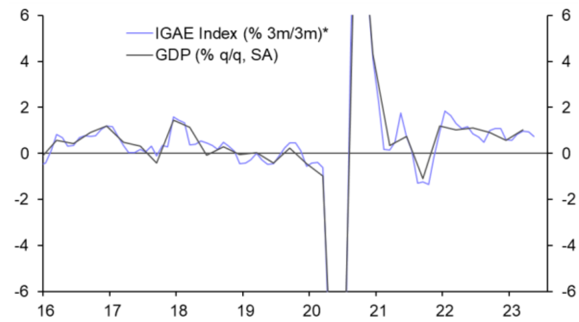
Economy lost steam in Q2

We expect that data due on Monday will show that Mexico's GDP growth slowed to 0.5% q/q in Q2 and it is likely to stay sluggish in the coming quarters.

Mexico's economy made a solid start to 2023, with GDP rising by 1.0% q/q. But the latest activity figures suggest the economy lost some steam in Q2. The IGAE activity index, which has a close relationship with the GDP figures, grew by 0.7% 3m/3m in May. (See Chart 2.) We suspect that the economy lost more momentum in June and so have pencilled in GDP growth of 0.5% q/q over Q2 as a whole. The IGAE suggests that agriculture remained a drag on the economy, whilst services slowed and industry grew at a snail's pace.

Looking ahead, we expect the a recession in the US – which still seems more likely than not in the coming quarters – combined with tight fiscal and monetary policy at home to weigh on growth in Mexico over the rest of 2023 and into next year.

Chart 2: GDP & IGAE Activity Index



Sources: Refinitiv, Capital Economics

Colombia Interest Rate Announcement (Jul.)

Mon. 31st Jul.

Forecasts	Time (BST/ET)	Previous	Consensus	Capital Economics
Policy Rate (%)	19.00/14.00	13.25	13.25	13.25

Rates on hold, loosening only likely in Q4

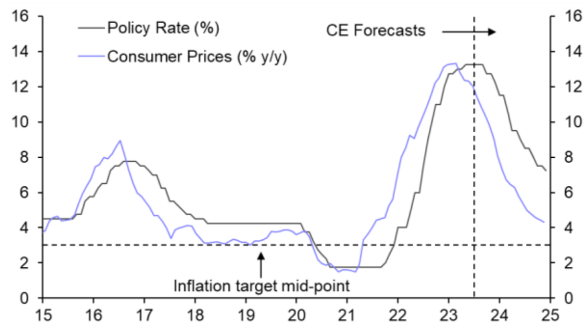
We think that Colombia's central bank (BanRep) will leave interest rates on hold at 13.25% when it meets next Monday.

BanRep halted its tightening cycle at its last meeting in June and the latest developments suggest that it is unlikely to be restarted. Inflation fell for a third consecutive month, to 12.1% y/y, in June and should continue to decline over the coming months. Meanwhile, the Colombian peso has appreciated beyond 4000/$ this month, taking its year-to-date gains against the greenback to over 20%.

That said, we doubt that interest rate cuts are imminent. After all, price pressures remain strong, with both headline and core inflation still well above the central bank's 3±1% inflation target. And the latest activity data provided few signs that the economy is coming off the boil.

Against this backdrop, we expect BanRep to keep its policy rate at 13.25% until Q4. (See Chart 3.) And once the central bank does start cutting rates, we think that easing will proceed more gradually than most anticipate. Our forecast is for the policy rate to be lowered to 12.25% by the end of this year.

Chart 3: Colombia Consumer Prices & Policy Rate



Sources: Refinitiv, Capital Economics

Brazil Interest Rate Announcement (Aug.)

Wed. 2nd Aug.

Forecasts	Time (BST/ET)	Previous	Consensus	Capital Economics
Policy Rate (%)	23.00/18.00	13.75	13.50	13.50

A cautious start to the easing cycle

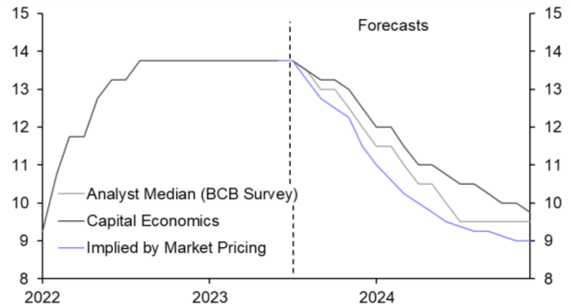
Brazil's central bank will kick off its easing cycle, but is unlikely to do so with a bang. We've pencilled in a 25bp reduction to 13.50%.

The minutes to the previous meeting in August made clear that policymakers think an easing cycle can begin at the upcoming meeting. Since those minutes were published, the incoming data won't have changed any minds. Inflation has, if anything, been slightly weaker than anticipated, coming in at just 3.2% y/y in the first half of this month.

We think the central bank will start the easing cycle cautiously. A minority of Copom members appear to think it's premature to start cutting rates, and the BCB's minutes also talked of small scale cuts ('parsimonious' in their words). This is also how they started the 2016 easing cycle, with small cuts followed by larger moves. A 50bp cut is in play (and, indeed, largely priced into markets), but we think a 25bp move is the most likely option.

And given continued strength of wage growth and core inflation, we think the easing cycle will proceed a little more slowly than most currently anticipate. (See Chart 4.)

Chart 4: Brazil Selic Interest Rate (%)



Sources: BCB, Bloomberg, Capital Economics

Economic Diary & Forecasts

Upcoming Events and Data Releases

Date	Country	Release/Indicator/Event	Time (BST)	Time (EDT)	Previous*	Median*	CE Forecasts*
Mon 31st	Brz	Nominal Budget Balance (Jun., BRL)	12.30	07.30	-119.2bn	-	-
	Brz	Primary Budget Balance (Jun., BRL)	12.30	07.30	-50.2bn	-	-
	Mex	GDP (Q2, q/q(y/y))	13.00	08.00	+1.0%(+3.7%)	+0.6%(+3.2%)	+0.5%(+2.8%)
	Chl	Industrial Production (Jun.)	14.00	09.00	(-4.5%)	(-4.9%)	-
	Chl	Retail Sales (Jun.)	14.00	09.00	(-10.5%)	(-10.0%)	-
	Col	Unemployment Rate (Jun.)	16.00	11.00	10.50%	-	-
	Col	Interest Rate Announcement	19.00	14.00	13.25%	13.25%	13.25%
Tue 1st	Brz	Industrial Production (Jun.)	13.00	08.00	+0.3%(+1.9%)	-	-
	Chl	Economic Activity (Jun.)	13.30	08.30	-0.5%(-2.0%)	-	-
	Brz	S&P Global Manufacturing PMI (Jul.)	14.00	09.00	46.6	-	-
	Mex	S&P Global Manufacturing PMI (Jul.)	16.00	11.00	50.9	-	-
	Per	CPI (Jul.)	16.00	11.00	-0.2%(+6.5%)	-	0.6%(+6.1%)
	Brz	Trade Balance (Jul.)	19.00	14.00	+$10.6bn	-	-
	Mex	IMEF Manufacturing Index (Jul.)	19.00	14.00	50.9	-	-
	Mex	IMEF Non-Manufacturing Index (Jul.)	19.00	14.00	51.5	-	-
Wed 2nd	Brz	Interest Rate Announcement	22.30	17.30	13.75%	13.50%	13.50%
Thu 3rd	Brz	S&P Global Services PMI (Jul.)	14.00	09.00	53.3	-	-
	Uru	CPI (Jul.)	18.00	13.00	-0.5%(+6.0%)	-	0.6%(+5.8%)
	Col	Central Bank Meeting Minutes	23.00	18.00	-	-	-
Fri 4th	Ecu	CPI (Jul.)	15.00	10.00	+0.4%(+1.7%)	-	+0.0%(+1.6%)
Selected future data releases and events:							
Mon 7th	Col	Trade Balance (Jul.)	13.30	08.30	+$1.6bn	-	-
Tue 8th	Brz	Central Bank Meeting Minutes	12.00	07.00	-	-	-
	Chl	CPI (Jul.)	13.00	08.00	-0.2%(+7.6%)	-	-
	C.Rc	CPI (Jul.)	-	-	-0.2%(-1.0%)	-	-
	Col	CPI (Jul.)	00.00	19.00	+0.3%(+12.1%)	-	-
Wed 9th	Brz	Retail Sales (Jun.)	13.00	08.00	-1.0%(-1.0%)	-	-
	Mex	CPI (Jul.)	13.00	08.00	+0.1%(+5.0%)	-	-
	Arg	Industrial Production (Jun.)	20.00	15.00	(+1.1%)	-	-
Thu 10th	Mex	Interest Rate Announcement	20.00	15.00	11.25%	-	-
	Per	Interest Rate Announcement	00.00	19.00	7.75%	-	-
Fri 11th	Brz	IPCA Inflation (Jul.)	13.00	08.00	-0.1%(+3.2%)	-	-
	Mex	Industrial Production (Jun.)	13.00	08.00	+1.0%(+3.9%)	-	-
	Brz	Economic Activity Index (Jun.)	13.00	08.00	-2.0%(+2.2%)	-	-

*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 (28th Jul.)	Last Change	Next Change	Forecasts End 2023	Forecasts End 2024
Brazil	Selic Target	13.75	Up 50bp (Aug. '22)	**Down 25bp (Aug. '23)**	**12.50**	**9.75**
Mexico	Overnight Rate	11.25	Up 25bp (Mar. '23)	**Down 25bp (Q4 '23)**	**11.00**	**9.00**
Colombia	Intervention Rate	13.25	Up 25bp (Apr. '23)	**Down 50bp (Q4. '23)**	**12.25**	**7.25**
Chile	Overnight Rate	11.25	Up 50bp (Oct. '22)	**Down 50bp (Jul. '23)**	**9.25**	**5.25**
Peru	Reference Rate	7.75	Up 25bp (Jan. '23)	**Down 25bp (Sep. '23)**	**6.75**	**5.00**

Sources: Refinitiv, Capital Economics

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

	Currency	Latest (28th Jul.)	Forecasts End 2023	Forecasts End 2024	Stock Market	Latest (28th Jul.)	Forecasts End 2023	Forecasts End 2024
Brazil	BRL	4.72	**5.25**	**5.00**	Bovespa	120,144	**111,750**	**149,500**
Mexico	MXN	16.6	**20.0**	**21.0**	Bolsa	54,927	**44,600**	**59,300**
Argentina	ARS	274	**400**	**600**	Merval	458,331	**-**	**-**
Colombia	COP	3,919	**4,500**	**4,200**	IGBC	1,167	**910**	**1,210**
Chile	CLP	825	**825**	**775**	IPSA	6,357	**5,100**	**7,000**
Peru	PEN	3.59	**4.00**	**3.70**	S&P/BVL	23,156	**19,300**	**25,650**

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	**2.3**	**0.8**	**1.5**	9.3	**4.8**	**5.0**	**4.0**
Mexico	1.8	1.3	3.0	**2.5**	**1.3**	**2.0**	7.9	**5.5**	**4.3**	**3.5**
Argentina	0.7	-0.7	5.2	**-2.8**	**-1.3**	**2.5**	72.4	**115.0**	**134.5**	**103.5**
Colombia	0.6	2.5	7.3	**1.0**	**1.5**	**2.5**	10.2	**11.5**	**5.5**	**3.8**
Chile	0.4	2.1	2.4	**0.3**	**2.5**	**2.8**	11.6	**7.5**	**3.8**	**3.5**
Peru	0.3	2.5	2.7	**1.5**	**2.3**	**2.5**	7.9	**6.8**	**4.5**	**3.3**
Dom. Rep.	0.2	4.1	4.9	**3.8**	**5.0**	**5.0**	8.8	**5.0**	**4.3**	**4.0**
Ecuador	0.1	1.6	2.9	**2.5**	**2.0**	**2.5**	3.5	**1.8**	**1.3**	**1.8**
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	**1.5**	**1.3**	**1.3**
Costa Rica	0.1	2.8	4.3	**3.5**	**2.5**	**2.5**	8.3	**1.5**	**2.5**	**2.8**
Uruguay	0.1	1.5	4.9	**1.5**	**2.5**	**2.3**	9.1	**6.5**	**7.3**	**6.8**
Latin America[2]	**6.7**	**1.0**	**3.7**	**1.6**	**1.1**	**2.1**	**8.7**	**5.8**	**4.5**	**3.7**

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

Disclaimer: While every effort has been made to ensure that the data quoted and used for the research behind this document is reliable, there is no guarantee that it is correct, and Capital Economics Limited and its subsidiaries can accept no liability whatsoever in respect of any errors or omissions. This document is a piece of economic research and is not intended to constitute investment advice, nor to solicit dealing in securities or investments.

Distribution: Subscribers are free to make copies of our publications for their own use, and for the use of members of the subscribing team at their business location. No other form of copying or distribution of our publications is permitted without our explicit permission. This includes but is not limited to internal distribution to non-subscribing employees or teams.

TORONTO NEW YORK LONDON SINGAPORE

Email **sales@capitaleconomics.com** Visit **www.capitaleconomics.com**