ANDBANK RESEARCH

Global Economics &
Markets

Alex Fusté
Chief Economist

alex.fuste@andbank.com

+376 881 248

Working paper - 44

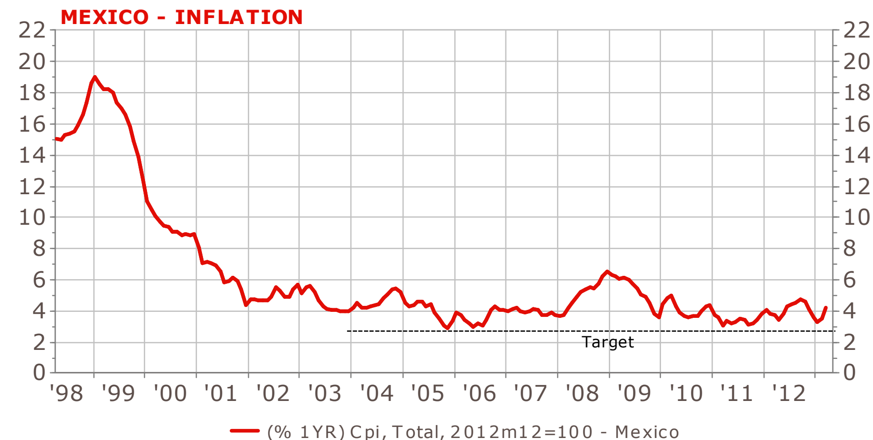
Latam – Monetary policy gets very interesting.
Outlook for Rates, Bonds & Forex

ANDBANK
Private Bankers

April, 2013

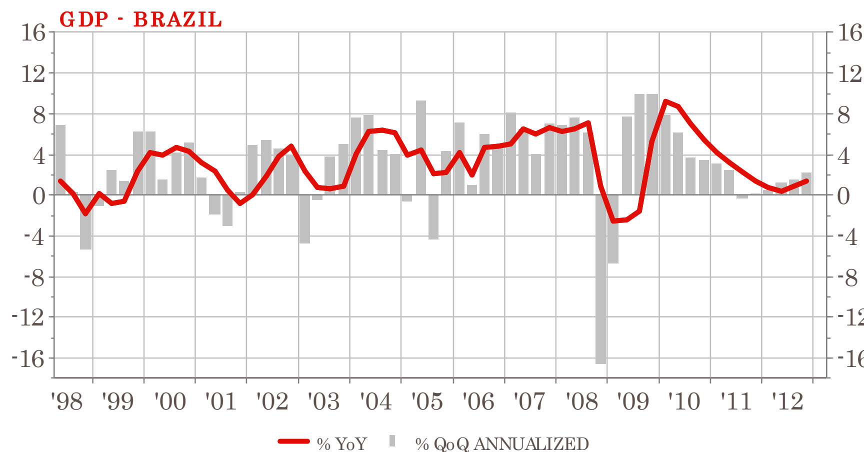
Mexico. Surprise rate cut likely a one-off but ...

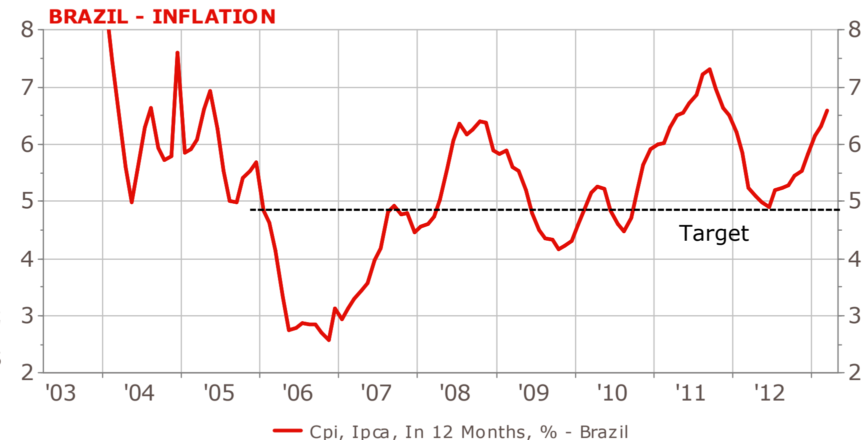
- ***Monetary policy:*** Mexican policymakers decided to cut rates by 50 bp in March, and this caught most investors by surprise. As early as November the market was pricing in interest rate hikes since inflation persisted above the upper bound of the central bank's 2%-4% target range.
- ***Outlook for Activity:*** While the economy slowed towards the end of last year, according to IGAE index GDP growth accelerated to 3,2% y/y (from 1,4% in December). Recent data suggest that activity is likely to pick up over the coming months. Our sense is **that the outlook for Mexico remains amongst the brightest in the region.** We estimate GDP growth could be fixed above 3,5% in 2013. Government has continued to press ahead with its ambitious reform agenda. A bill to break up monopolistic media & telecommunications firms was passed the lower house of congress. Banking and energy reforms has also been mooted.
- ***Outlook for Rates, Bonds, Fx…:*** Inflation remains well above 4% (central target is 3%), and due to the mentioned pick up in activity prices may even edge up over the next 3-6 months. By all this, we believe that the decision to lower rates was likely a one-off and that interests will remain on hold at 4% for a prolonged period. However, depending on the influence that BoJ's actions could have on MXN (recently the peso has appreciated considerably), additional cuts can not be ruled out. Despite recent cut, current differentials are in our view **positive for bonds and fx**. We see the peso well supported at current levels with potential for breaking the US$12 level toward the 11,50 area (currently is at 12,2). The prospect of a relatively strong growth over the coming quarters has made Mexico a hit with investors.



Brazil. Preparing the ground for a very light tightening

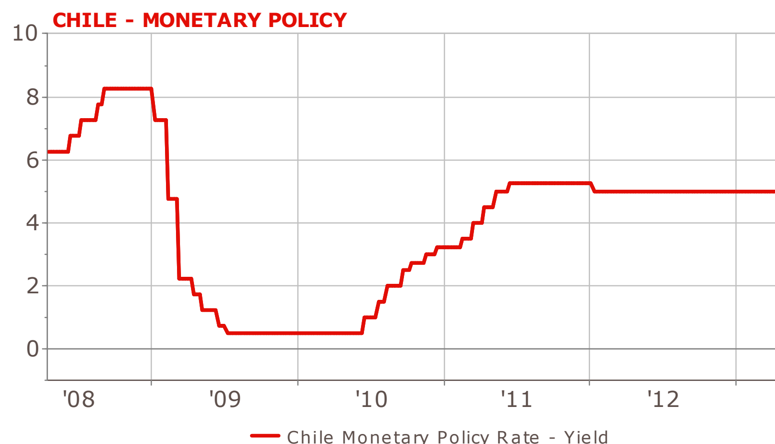
- ***Monetary policy:*** BCB decided to keep rates on hold at 7,25%, but policymakers removed a key line from their wording that referred to their commitment to keep rates on hold for a prolonged period.
- ***Outlook for Activity:*** Brazil recovery will continue over the course of the year, although we consider that growth will remain lackluster by standards of the past decade. 2012 GDP was 0,9% (a meagre return on the huge amount of stimulus pumped into the economy). In 1Q13 growth has been 0,8% q/q. This is an annualized rate of **3,25%. Similar to the pace we expect for the entire year** (around 3%)
- ***Outlook for Rates, Bonds, Fx …:*** The key concern is rising inflation (HIPCA is now at 6,3% y/y. Well above the central BCB's target of 4,5%). This will put pressure on policymakers to raise rates. We expect monetary policy to be mildly tightened (by 25 bp in the next COPOM meeting) to put SELIC at 7,5%. However, our sense is that **an aggressive tightening is unlikely** for three reasons. 1st Three-quarters of the rise in HIPCA has been driven by food prices (a factor more linked to global commodities dynamics and clearly outside the direct influence of BCB). 2nd Implied inflation in the spread between nominal and inflation linked bonds points to a 5,5% inflation for the next 2 years (above the BCB's central target but within the target range). 3rd.Continued weakness of the economic growth. **Our outlook for bonds and fx (1,98) is not as positive as for Mexico. We keep a neutral bias on these two assets.**



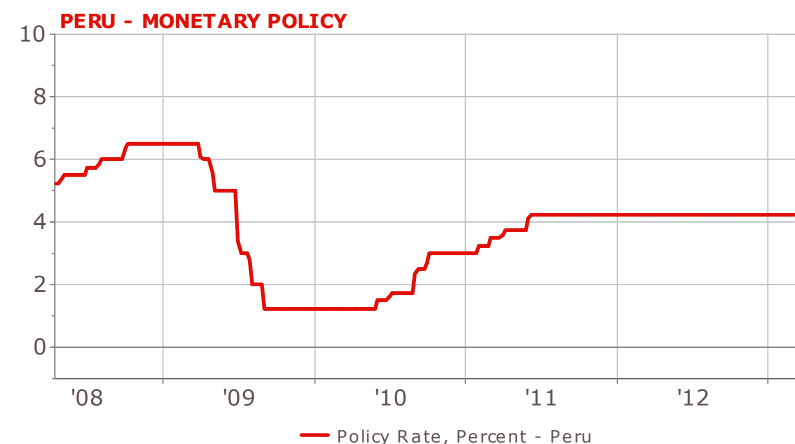


Chile & Peru. Facing a familiar set of challenges

- ***Monetary policy:*** Policymakers in Chile & Peru have kept rates unchanged for more than one year. These economies are still faced with the prospect of an overheated domestic economy. This would usually point to a monetary tightening, however things are not so simple, since a rate hike would ensure rapid capital inflows that could cause an excessive exchange rate appreciation that could lead to a large build up of leverage. We foresee monetary policy to remain stable once again in April in both economies.
- ***Outlook for Activity:*** **Peru** has started the year on a very strong footing. January's INEI (economic indicator) accelerated to a 6,2% y/y helped by a rebound in construction. Consumer facing sectors have continued to hold up relatively well. By contrast, export dependent industries are struggling to gain momentum. **In Chile**, the economy had a solid end to 2012 (5,7% y/y in Q4) helped by buoyant consumer spending and a pick up in mine production. Industry, however remains far weaker. We keep our view for a solid growth in both economies during 2013, although slightly lower than that seen in 2012. Our projections are 4,5% for Chile and 5,5% for Peru.
- ***Outlook for Rates, Bonds, Fx …:*** **In both places we expect rates to remain on hold** at 5% and 4,25% respectively for at least another 6 months. Any change in monetary policy will take place toward the end of the year and will probably **come in the form of a rate hike** as a macro-prudential measure. Relative high rates will keep investor's interest in **both bonds and forex, for which we still have a positive outlook** (460 for CLP and 2,50 for PEN)**.**



Andbank, Central Bank of Chile *©FactSet Research Systems*

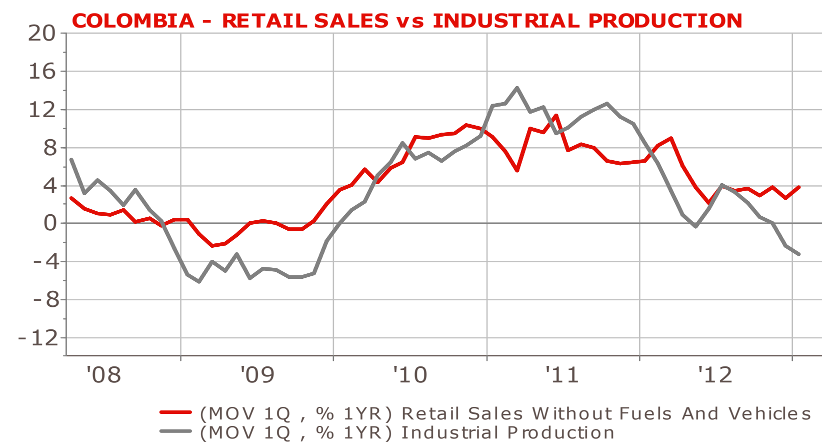


Andbank, Central Reserve Bank of Peru *©FactSet Research Systems*

Colombia. Strong Peso dragging on growth.

- ***Monetary policy:*** Monetary policy has remained accommodative during the second half of 2012 and continues being so in the first stages of 2013. Although consumer spending is likely to have been the key driver of growth, it is now running at a slower pace than previous years. Additionally, industry probably contracted by about 2% y/y in Q4 as strong peso probably hit competitiveness of local firms.
- ***Outlook for Activity:*** GDP in Colombia grew at a 2,5% pace y/y but the country is still struggling to overcome large imbalances. The economy needs to keep interest rates low for an extended period but also needs a substantial & sustained intervention in the currency market in order to rebalance economic growth. We foresee these two premises to be satisfied helping the country to accelerate pace from 2,5% in 2012 to 3,0% - 3,25% in 2013.
- ***Outlook for Rates, Bonds, Fx ...:*** With inflation below target, and the imbalances persisting, we expect policy makers to continue to loosen monetary policy keeping interest rates low for an extended period (positive for bonds). Our outlook for COP is not as bright as for MXN, CLP and PEN. We consider COP is already significantly overvalued and our view for monetary policy suggests that capital inflows could moderate in the medium term, preventing the currency from further gains. We are more inclined to believe that COP could continue with its recent depreciation and might breach the 1,840 level.

Andbank, Central Bank of Colombia ©FactSet Research Systems



Andbank, DANE ©FactSet Research Systems

Legal Disclaimer

All the sections in this publication have been prepared by the team of analysts from the financial institution.

The views expressed in this document are based on the assessment of public and private information. These reports contain evaluations of a technical and subjective nature on economic data and relevant social and political factors, from which the financial institution's analysts have extracted, evaluated and summarized the information they believe to be the most objective, subsequently agreeing upon and drawing up reasonable opinions on the issues analyzed herein.

The opinions and estimates in this document are based on the market events and conditions that took place before the publication of this document, and therefore cannot be determining factors in the evaluation of future events that take place after its publication.

The financial institution may hold views on financial instruments that differ completely or partially from the general market consensus. The market indices chosen have been selected following the exclusive criteria that the financial institution regards as most appropriate.

The financial institution cannot in any way guarantee that the predictions or events given in this document will take place, and expressly reminds readers that any past performances mentioned do not in any circumstances imply future returns; that the investments analyzed may not be suitable for all investors; that investments can fluctuate over time in terms of their share price and value; and that any changes that might occur to interest rates or currency exchange rates are other factors that may also make it unadvisable to follow the opinions expressed herein.

This document cannot be regarded, under any circumstances, as an offer or proposal to buy the financial products or instruments that may have been mentioned, and all the information herein is for guidance purposes and should not be regarded as the only relevant factor when it comes to making a decision to proceed with a specific investment.

This document does not, therefore, analyze any other determining factors for properly appraising the decision to make a specific investment, such as the risk profile of the investor, his/her knowledge, experience and financial situation, the duration or the higher or lower liquidity of the investment in question. Consequently, investors are responsible for seeking and obtaining the appropriate financial advice in order to assess the risks, costs and other characteristics of any investments they wish to make.

The financial institution cannot accept any responsibility for the accuracy or suitability of the evaluations or estimates of the models used in the valuations in this document, or any possible errors or omissions that may have been made when preparing this document.

The financial institution reserves the right to change the information in this document at any time, whether partially or in full.