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Latam Daily: Weaker Activity in Chile Signals Recession; Peru's Surprising Inflation

- **Chile: GDP expanded 6.8% y/y in February; non-mining activity drops 0.8% m/m, signaling a soft-landing**
- **Peru: Inflation surprises in March, the highest in 28 years**

CHILE: GDP EXPANDED 6.8% Y/Y IN FEBRUARY; NON-MINING ACTIVITY DROPS 0.8% M/M, SIGNALING A SOFT-LANDING

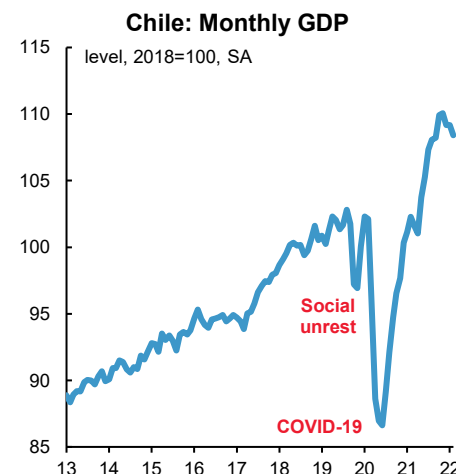
Weaker activity means benchmark rate unlikely to go above 7.5%. Possible technical recession on eve of constitutional referendum.

On Friday, April 1, the central bank (BCCh) released its proxy for monthly GDP growth (IMACEC) for February, which increased 6.8% y/y well below market consensus and Scotiabank's expectations (8%). The main surprise for our short-term scenario comes from services, which fell 1.2% m/m after expanding 2.3% m/m in January (charts 1 and 2). This sector should improve in March, as mobility restrictions introduced in response to increased COVID-19 cases were in place in February. The relaxation of these restrictions should partially offset a negative trend in activity. Meanwhile, seasonally adjusted monthly data suggest a slight slowdown is in process in the rest of the sectors.

A technical recession in Q2-2022 is probable, confirming BCCh's caution. In our view, the central bank is unlikely to raise the benchmark rate above 7.5% in this tightening cycle and we reiterate our call for an increase of 25 basis points at the next monetary policy meeting, provided the CPI for March does not exceed 1.1% m/m. A moderate technical recession is part of our baseline scenario and the just released February data could lead to a seasonally adjusted contraction in Q1-2022. This contraction is likely to be followed by another (seasonally adjusted) marginal decline in Q2-2022, marking a technical recession after the June IMACEC is released on August 1.

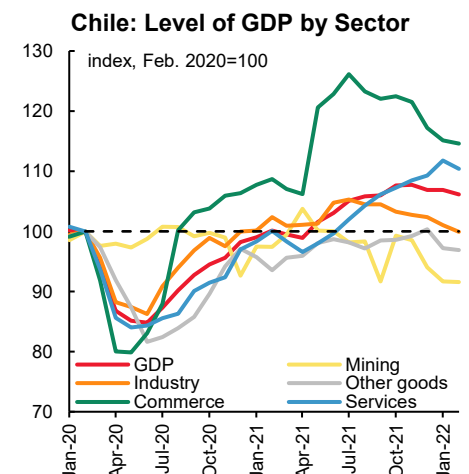
With the plebiscite to ratify the constitution pending, the economy could thus be in a technical recession that might affect the decision of undecided voters. The Constituent Convention is scheduled to deliver the proposal for a new Constitution to President Boric on July 5, while a technical recession could be called less than one month later. (This would be the first technical recession since March 2017 in the last part of the government of President Michelle Bachelet, as Chile did not have a technical recession during the social unrest or the worst of the pandemic.)

Chart 1



Sources: Scotiabank Economics, BCCh.

Chart 2



Sources: Scotiabank Economics, BCCh.

The non-mining IMACEC dropped a moderate 0.8% m/m (after +0.8% m/m in January), mainly influenced by the decline in services (-1.2% m/m). We believe that the contraction in services is largely explained by a break in services associated with investment. Other sectors declined modestly on a m/m basis, particularly commerce and construction.

Public spending did not contribute to investment growth, which likewise affected investment-related services. Public spending in February grew 3.6% y/y owing to higher health spending (vaccines). However, capital spending (public investment) contracted by a significant 3.9% y/y, which could have influenced the fall in services more linked to investment. Looking ahead, the fiscal budget incorporates a significant increase in public investment for 2022, so this component should begin to support investment in the coming months.

The new fiscal package of the government will be known in coming days, though USD 3.5 bn focused on small companies and households most affected by the rise in consumer inflation has already been announced. This package would be financed with freely available resources (without further debt issuance), and would have an impact on activity in the second half of the year.

—Jorge Selaive, Anibal Alarcón, & Waldo Riveras

PERU: INFLATION SURPRISES IN MARCH, THE HIGHEST IN 28 YEARS

Inflation surprised to the upside in March, reaching 1.48% m/m, the highest m/m rate in 28 years for the month of March (since March 1994 when it reached 2.32%), exceeding the estimate by the market consensus (0.92% according to a Bloomberg survey) and our own forecast of 1.2%. Year-on-year inflation accelerated from 6.2% y/y to 6.8% y/y (chart 3), in line with what was observed in the rest of the region. March marks the tenth month in a row that inflation exceeded the upper limit of the central bank’s target range (between 1% and 3%) and price pressures show no signs of converging towards the target. The March result will exert pressure on the central bank, which we expect will continue to raise its reference rate in April.

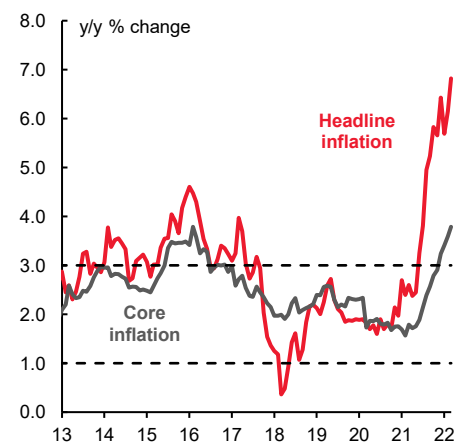
Price pressures were broadly based in March. Of the 586 products that make up the new consumer basket (base 2021), 457 (78%) rose, 69 (12%) fell, and 60 (10%) remained unchanged (table 1). Core inflation went from 3.6% y/y in February to 3.8% y/y in March, above the upper limit of the target range (3%) for the fourth consecutive month. Wholesale inflation, linked to production costs, went from 11.4% in February to 11.6% in March. Cost pressures, such as port freight, energy and agricultural commodity prices, were exacerbated in March owing to the Russia-Ukraine conflict, which will drive inflation higher in the future. The USDPEN exchange rate, which depreciated 3.6% in February on a year-on-year basis, appreciated 1.8% in March, limiting the rise in the prices of imported products.

For April, we expect inflation above to 7% y/y, driven by a low base of comparison since inflation in April 2021 was negative (-0.10% m/m) and by the pressures of higher commodity prices, such as oil, grains and fertilizers, on local prices.

In our *Latam Weekly* of March 18, 2022, we revised our inflation forecast from 4.2% to 6.4% for 2022, as a first approximation of the likely impact of the Russia-Ukraine war on the price of oil and cereals. We see inflation at least as high as that posted in 2021. However, we will adjust our forecast as we have greater clarity on the duration of the effects of the conflict on commodity prices and supply chains.

Chart 3

Peru: Headline and Core Inflation



Sources: Scotiabank Economics, BCRP.

Table 1: Peru—Lima CPI Basket—March 2022

Groups of consumption	Base 2021	% m/m	% y/y
1. Food and non-alcoholic beverages	22.97	3.41	11.1
2. Alcoholic beverages, tobacco, drugs	1.61	0.37	1.1
3. Apparel and footwear	4.20	0.17	0.8
4. Housing, water, electricity, gas and others	10.55	0.06	10.9
5. Furniture and home maintenance	5.11	0.27	3.5
6. Health	3.48	0.08	1.5
7. Transport	12.40	1.89	8.8
8. Communications	4.77	0.11	0.6
9. Recreation and culture	3.96	1.02	6.9
10. Education	8.61	2.84	2.8
11. Restaurants & hotels	15.89	0.73	6.4
12. Other goods and services	6.47	0.39	3.1
Total CPI	100.00	1.48	6.8

*Adjusted base to 12 from 8 groups of consumption.

Sources: Scotiabank Economics, INEI.

April 4, 2022

Over the past eight months, the central bank raised its benchmark rate by 375 basis points to 4.0% and increased reserve requirements three times. With inflation accelerating, we expect this hawkish stance on inflation control to continue. We believe that further increases in the key policy rate are necessary to bring inflation expectations (3.75% over 12 months according to the BCRP February survey) to the target range, so we expect a 50 bps hike at their meeting on Thursday, April 7.

—Mario Guerrero

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