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GLOBAL ECONOMICS

LATAM DAILY

May 16, 2022

Latam Daily: Colombia's Indicators and Expectations; Mexico's Industrial Production

- **Colombia: Monthly indicators point to strength, as inflation expectations jump**
- **Mexico: Industrial production rises in March**

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COLOMBIA: MONTHLY INDICATORS POINT TO STRENGTH, AS INFLATION EXPECTATIONS JUMP

I. Economic activity in March shows positive surprises, raising expectations of solid growth

On Friday, May 13, the Statistical Agency of Colombia (DANE) published its monthly survey of economic activity for March showing that both manufacturing output and retail sales posted stronger-than-expected expansions. DANE also published confidence figures revealing that companies remain optimistic but perceptions of their future profits have been affected by the inflationary environment. Retail sales in March posted extraordinary results explained mainly by the VAT holiday, which suggests that consumption levels continue to follow a favourable trend. However, prospects for job creation remain murky, though they are improving at a slow pace. Owing to the impressive data, we have a strong upside bias on our GDP growth forecast for 2022, which we will be revising in the coming days.

Manufacturing production

Manufacturing output increased 12.3% y/y (above the market consensus of 8.2% y/y) in March, with a month-over-month expansion of 2.5% m/m (chart 1), resulting in first quarter growth of 12.5% that provides a positive signal of Q1-2022 GDP. Manufacturing was again led by sectors of the economy related to increased mobility, which largely involves industries related to in-person activities, such as mass events and the consolidation of the return to face-to-face attendance of all activities. Job creation showed no surprises, with employment growing 4.6% y/y.

On a y/y basis, the best performing sectors were beverages (+13. 8% y/y), clothing (29.8% y/y) and paper and paperboard related products (+23.7% y/y), which contributed 3.7 ppts (30% of total expansion). These sectors reflect the positive contribution of mobility and the return to normality of all activities. Sectors that subtracted from the overall performance include coffee threshing (-21.5%), the manufacturing of parts and pieces for vehicles (-14.4%), vehicle manufacturing (-13.1%), and oil refining and fuels (-6.1%) owing to international logistics problems and high input costs.

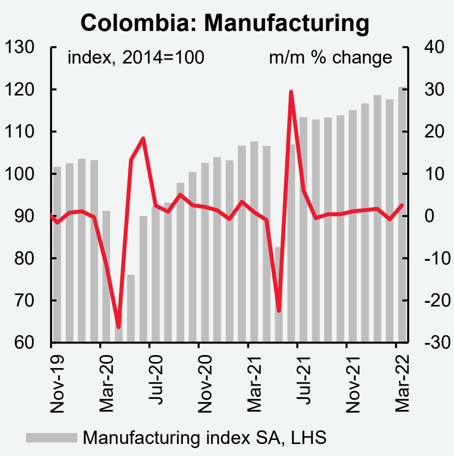
Employment growth was subdued, increasing by 0.4% on a m/m basis, but nevertheless rose 4.6% y/y. It is worth noting that the demand for labour continues to lag in March. In fact, for every three new jobs, two were temporary positions, reflecting the high uncertainty faced by companies regarding the strong increases in production costs that are reflected in the final prices for consumers.

Retail

Retail sales showed an increase of 12% y/y in March, well above the Bloomberg survey result of 4.5% y/y (chart 2), while retail employment increased 2.2% y/y. On a seasonally adjusted basis, retail sales (excluding other vehicles) expanded 7.5% m/m, influenced by VAT holiday.

Compared to March 2021, the expansion of retail sales was driven by the VAT holiday and is mainly explained by sales of technology products and household

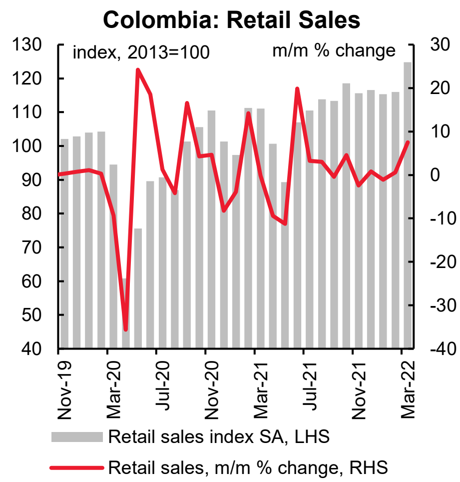
Chart 1



Sources: Scotiabank Economics, DANE.

appliances (+58.9% y/y), video equipment (66.5% y/y), footwear (39.4%y/y), and clothing (31.1% y/y) which contributed approximately 5.3 ppts to total expansion. Sales of the products above reflected the easing of mobility restrictions and the re-opening of the economy. While the demand for food (-2.5% y/y), cleaning products (-2.5% y/y) and vehicles and motorcycles (-0.2% y/y) declined, reflecting the erosion of households' purchasing power from high prices. At the commercial level, electronic transactions increased and accounted for 4.8% of total transactions.

Chart 2



Sources: Scotiabank Economics, DANE.

Looking ahead to the second half of 2022, we expect some deceleration in consumption to a more sustainable rate from still-high consumption, but see a downside risk coming from inflation.

Services & Hotels

In March 2022 all service activities expanded, the most robust growth being in the film and television related industry (+231.9% y/y). In terms of employment, only one out of 18 activities had lower employment than the pre-pandemic period, editing activity (-2.8% y/y), while employment growth was concentrated especially in IT-related activities.

The lodging revenues segment showed an increment of 68.3% y/y and employment increased by 27.2% y/y in March. Hotel occupancy reached 53.8%, above the pre-pandemic level of 48.1%. Business travel continued to recover, accounting for 19.6% of total occupancy—above pre-pandemic levels—and is mainly explained by business conventions.

Dane, also published data on civil works for the first quarter, which registered an increase of 1.8% y/y in nominal terms. The largest contribution came from the construction of mines and industrial plants, while the construction of pipelines for the transport of gas and wiring lagged far behind. Despite the y/y expansion of civil works, the q/q comparison of the indicator shows a contraction of 10.9%, which point to a still weak construction expansion for Q1-2022.

Despite activity indicators showing a positive surprise in March amid as the economy adjusts the "new normal," confidence surveys show that companies are cautious about the future owing to the impact of inflation on their margins and lower levels of demand. Given that, the recovery in employment could continue to lag. Even so, we estimate in the base case scenario that the economy will continue on its current path and we have a strong upside bias to our growth forecast, which we will be revising in the coming days. That said, risks could become tilted to the downside if distribution channels bottlenecks continue, and inflation further destroys the purchasing power households' disposable income.

II. BanRep survey shows Inflation expectations two years ahead above target range; the terminal monetary policy rate is expected at 8.25%

On Friday, May 13, the central bank, BanRep, published its monthly survey of economic expectations showing that inflation expectations for end-2022 increased by 139 bps after the strong upside surprise on April inflation (table 1). In the same vein, end-2023 expectations of 4.69% revealed a further divergence from the inflation target ceiling, which point to long-lasting effects of recent price shocks (chart 3). At Scotiabank Economics, we expect May inflation will come in close to the market consensus (0.84% m/m), with some possibility of stabilization in the H2-2021.

Table 1: Colombia—Headline Inflation Expectations

	Average	Change vs previous survey, bps
May-2022, m/m % change	0.82	6
Dec-2022, y/y % change	8.42	139
1-yr ahead, y/y % change	5.23	60
Dec-2023, y/y % change	4.69	50
2-yr ahead, y/y % change	4.04	27

Sources: Scotiabank Economics, BanRep.

Given these results, 100 bps increases are expected in June and July, with the end of the cycle tightening at 8.25% (+75 bps compared to the previous survey) lasting until March 2023 (chart 4). At Scotiabank Economics a 100 bps hike is expected in the next couple of meetings and the terminal rate is expected at 8%. Uncertainty regarding inflation remains high, however, which could lead to a higher terminal rate, one that lasts longer than initially expected.

- **Short-term inflation expectation.** For May consensus is 0.82% m/m, which places annual inflation at 9.05% year-on-year (from 9.23% in April). The dispersion of the survey remains high, with a minimum expectation of 0.30% m/m and a maximum of +1.12% m/m. Scotiabank

Economics expects monthly inflation for May to be +0.84% m/m and 9.06% y/y, monthly inflation will continue strongly lead by food inflation and tradeable goods.

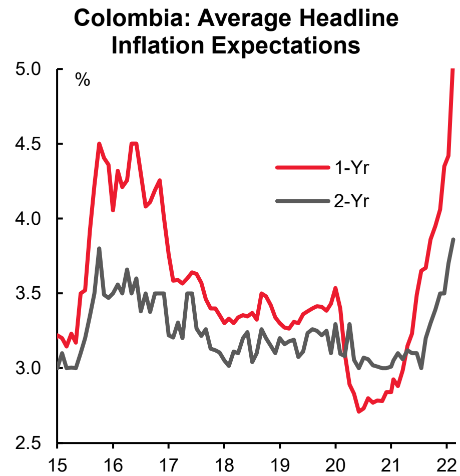
- **Medium-term inflation.** Inflation expectations rose to 8.42% y/y for December 2022, 139 basis points above last month's survey (table 1 again). High input prices remain the main risk for headline inflation. Inflation expectations one-year ahead stood at 5.23% y/y (above last month's reading of 4.63% y/y), while the two-year forward increased 27 bps to 4.04% y/y, showing that now all the inflation expectations are above BanRep's target range.

- **Policy rate.** On average, the consensus expects a 100 bps rate hike in June and July's meetings, which would leave the rate at 8% (from the current 6%); Scotiabank Economics also expects 100 bps hikes too in June and July. For 2022, the consensus expects a policy rate closing at 8.25%, an increase compared to the previous survey (7.5%). Scotiabank Economics' forecast for the terminal rate of 8% continues to incorporate an upside bias if inflation pressures persist.

- **FX.** The USDCOP projections for the end of 2022 were 3,852 (up from the previous 3,778). For 2023, respondents think, on average, that the peso will end the year at USDCOP 3,745, and in 2024 at 3,686.

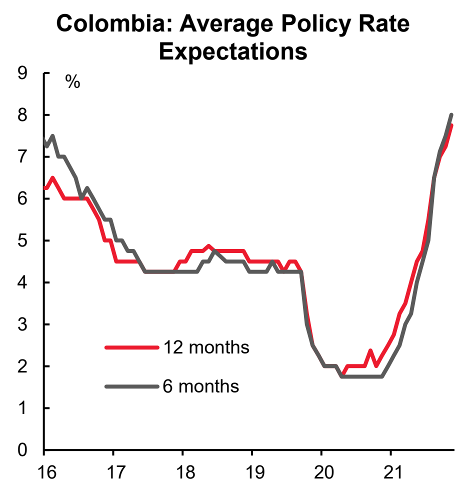
—Sergio Olarte, Maria (Tatiana) Mejía & Jackeline Piraján

Chart 3



Sources: Scotiabank Economics, BanRep.

Chart 4



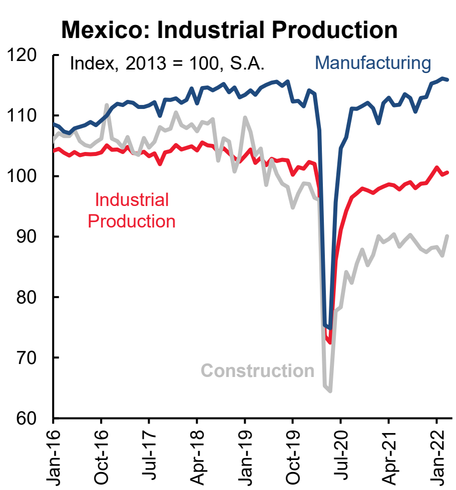
Sources: Scotiabank Economics, BanRep.

MEXICO: INDUSTRIAL PRODUCTION RISES IN MARCH

According to data released by INEGI on May12, industrial production increased in March from 2.4% y/y to 2.6% (chart 5), driven by an advance in construction which rebounded from -4.3% y/y to 3.0%. Looking to other sectors, mining attenuated its year-over-year decline from -3.1% y/y in February to -1.3% in March, utilities were up 2.8% y/y, and manufacturing moderated markedly from 8.9% y/y to 3.6% (chart 6). On a seasonally adjusted monthly basis, industrial activity rebounded from -1.2% m/m in February to 0.4% in March, as the recovery in construction (from -1.6% m/m to 3.7%) offset the decline in manufacturing (-0.2% m/m from 0.5%). Utilities rose 2.3% m/m, while mining fell -0.6%. Finally, from January to March industry showed a 3.1% year-to-date increase (chart 7). Looking ahead, although production is already above pre-pandemic levels, the recovery of its components has varied widely. Manufacturing, which led the recovery in H2-2020, now faces downside risks owing to disruptions in global value chains, while construction remains below pre-pandemic levels, affected by weak investment, and thus has a weak outlook in the medium term.

—Miguel Saldaña

Chart 5



Sources: Scotiabank Economics, INEGI.

Chart 6

Sources: Scotiabank Economics, INEGI.

Chart 7

Sources: Scotiabank Economics, INEGI.