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Week Ahead in Latin America

Argentina - Managing Scarcity (Again)

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This week we go back to Argentina, a country that is, again, managing scarcity. Amid falling popularity rates, the administration's political capital has weakened after the currency run and the IMF bailout. And the challenges ahead are multiple, including delivering on ambitious fiscal consolidation objectives without much help from economic growth, which is set to remain subdued for some time. The outlook also remains dependent on some key external factors.

What's new?

In **Brazil**, growth data came better than expected for industrial production (-10.9% m-o-m vs -13.2% expected) and retail sales (-0.6% m-o-m vs -0.8% expected) highlighting that hard data was not as bad as confidence indicators pointed to. This leaves us confident in our above consensus 1.7% GDP growth call for 2018. After winning the July 1 election by a landslide, comments by **Mexico's** president-elect and his advisors have reassured Mexico watchers by suggesting continuity in many important aspects of the country's investment narrative, including pledges to maintain a prudent approach to fiscal policy and to respect the central bank's independence. In **Argentina**, the Central Bank kept rates unchanged and announced a new monetary policy framework which includes monthly meetings with committee members voting on rate decisions and a monitoring of monetary aggregates. Most high frequency data are starting to point south, from industrial production to car sales, including a major slowdown in construction. In **Colombia**, BanRep also kept rates unchanged in light of rising concerns over international financial conditions amid a favorable growth and inflation backdrop - June inflation was in line with expectations and remains well behaved. Higher frequency activity continues to point to an ongoing recovery of the economy, with retail sales and manufactory production expanding at solid rates. **Chile's** economy keeps running hot as indicated by strong May data, including an above-consensus IMACEC and rising June confidence indicators; despite this above-trend growth performance, price pressures remain well behaved with June's inflation – both core and headline – coming in lower than expected.

What's next?

In **Brazil**, all eyes will be in the upcoming inflation print, which will be the first one with some payback after the truckers' strike supply shock. We believe by August we should have a deflationary sequential print and falling yearly readings for the reminder of the year. Aside from the formal employment report for June, no relevant data indicators from **Mexico**, so the focus is likely to remain on the next administration, particularly on further signs of policy priorities and direction, announcements of potential cabinet members and the result from the first meeting with US officials. In **Argentina**, all eyes are likely to be on the June inflation report, which will likely portray the highest headline inflation this year, around the 3.5% m-o-m handle. **Peru** will release the GDP report for May – we expect another solid gain, following welcome signs of acceleration in the past couple of months; and keep an eye on politics after allegations of irregularities in the judiciary surfaced this week, which led the executive to pledge to push for comprehensive judicial reform.

Saludos,

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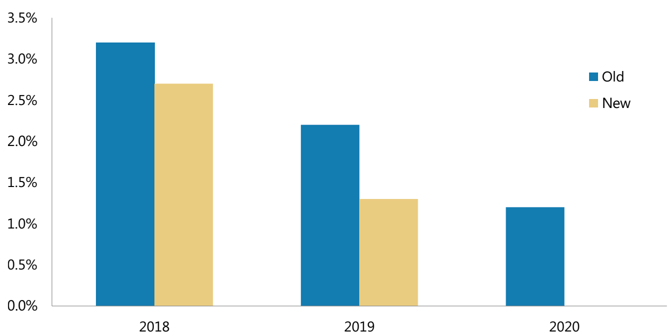
Argentina: Managing Scarcity (Again) by Fernando Sedano

Managing scarcity is back on the front burner. We wrote about managing scarcity back in late 2015, when there were doubts about the new administration's plan to dismantle capital restrictions and take the country out of a long-standing default that impeded Argentina's ability to tap into international financial markets to cover large fiscal deficits (see "Latin America: Stuck in the Adjustment II", in *Week Ahead in Latin America*, September 11, 2015). Since then, with an abundance of financing for EM in general and for Argentina's virtuous return to markets, the scarcity concept moved to the back burner for some time, before reemerging when global liquidity conditions turned and led the country´s currency to lose some 37% of its value since mid April. With a relatively weaker political and social support nowadays, the government has to accelerate fiscal consolidation to comply with the performance metrics of the IMF program at a time when the combination of a severe drought, the uncertainty and price pressures brought about by the currency run, and the ongoing high interest rates are starting to take a toll on economic activity. In light of the October 2019 presidential election, the delicate balancing act for the administration going forward is how to reduce fiscal imbalances amid more challenging global economic conditions while avoiding a deep and long-lasting recession that would complicate the political outlook further.

Exhibit 1: Argentina: Primary Fiscal Deficit Target

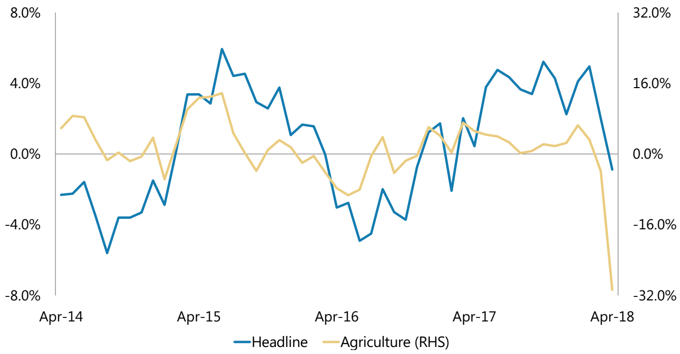


Source: Finance Ministry

With market sentiment towards EM shifting, the gradual approach to macro consolidation is set to accelerate (see Exhibit 1). While tapping into IMF funding allows the government to keep some of its gradualist approach, the government has to deliver on tighter fiscal goals calling for primary deficits of 2.7% of GDP this year and 1.3% in 2019, before reaching a balanced primary budget by 2020. While there are other performance metrics Argentina has to deliver, we believe this fiscal consolidation path is the most important conditionality attached to the IMF funding program.

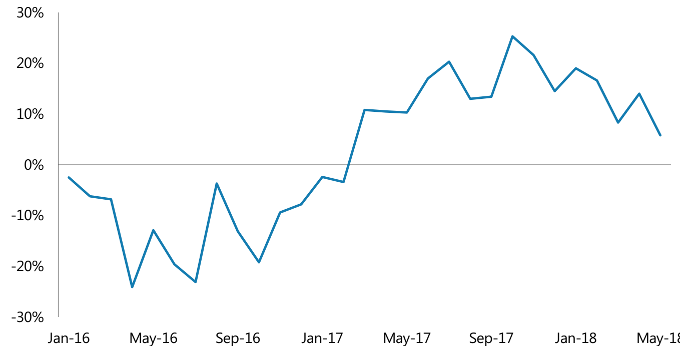
The challenge is that a recession is in the making given three key factors. First, a severe drought that led to a roughly 40% decline in soybean output and a 20% contraction in corn production are starting to show in high frequency macro data. The monthly GDP proxy shows that agricultural production is down some 30% y-o-y in April and the monthly manufacturing index is down 1.2% y-o-y in May dragged by declining food production, which in turn is a result of double-digit contractions in soy-based food manufacturers (see Exhibit 2). Second, the sizable currency depreciation and its pass-through effects as well as the policy response – including an aggressive hike in interest rates and the IMF reach-out – has negatively impacted sentiment and purchasing power, which in turn are starting to take a toll on consumer spending, particularly on durable goods. Car sales plunged 17.5% y-o-y in June while construction activity – an engine of growth and job creation – is slowing down considerably (see Exhibit 3). Third, the coming fiscal consolidation also entails a substantial decline in government spending. Considering that increasing tax rates and strong economic growth are hard to imagine at this point, going from a 3.9% of GDP primary deficit in 2017 to the 1.3% target in 2019 entails some 2.5ppt of GDP of lower government spending in just 24 months.

Exhibit 2: Argentina: EMAE Headline & Agriculture (% change y-o-y)



Source: INDEC

Exhibit 3: Argentina: Construction Activity (% change y-o-y)



Source: INDEC

And the recession is concomitant with higher inflation. It is worth highlighting that we now expect inflation at 27.9% this year and 19.2% in 2019 (previously 24.8% and 18.5%, respectively), in light of our weaker FX forecasts (see "USD Revision: Higher for Longer", June 21, 2018) and our firm´s higher oil price forecasts which could translate into pressures on gasoline and energy prices for consumers in Argentina (see "All Hands on Deck' for Those with Spare Capacity", July 2, 2018).

Despite the challenging backdrop, we think the administration will deliver on fiscal targets. Given the strong budget performance seen so far this year, we think the 2.7% of GDP primary fiscal deficit target set for 2018 may be over-delivered, even if by a small margin. We also think that a combination of spending cuts should help the government approach a primary fiscal deficit of roughly 1.5% of GDP next year, which should be in compliance with the IMF program (there is a 0.2% of GDP buffer on social spending). It seems that trimming operational expenditures, reducing the subsidy bill by continuing the adjustment of utility prices for consumers and as a result of lower needs to import gas amid stronger local production, and reducing capital spending can do the job, although this will surely take a toll on activity. It is important to monitor in the coming weeks the discussions around the 2019 budget – whether the government secures enough support in Congress to translate austerity plans into law. In the event the opposition does not support the tighter budget, then the government could use the 2018 budget next year, which would also allow them to deliver spending cuts as it is not inflation adjusted.

So, how can Argentina deliver on fiscal consolidation while avoiding a deep and long-lasting recession? That is exactly the delicate balancing act the authorities face in coming months (see "Argentina: Balancing the Adjustment", in *Week Ahead in Latin America*, June 8, 2018). After all, a deep and protracted recession does not bode well with the administration´s electoral ambitions next year and will raise questions among Argentina watchers about policy continuity. We think the authorities could put a floor to the economic downturn by letting private sector wages adjust to the most recent inflation dynamics and forecasts, in an attempt to give the consumer some breathing room. The government may also limit painful spending cuts by transferring to the City of Buenos Aires and the Province of Buenos Aires part of the federal subsidy bill on electricity, water, and transportation targeting dwellers in those jurisdictions, a request apparently made by several provincial governors across the country. If the currency appreciation seen in recent days persists, cutting rates from the current crisis management levels could also limit the depth and scope of the recession, but that is a risky move that could raise the volatility in the FX market.

At this point, we think most of the weakness will be seen in the April-October 2018 GDP numbers. Indeed, we expect a technical recession in 2Q2018 and 3Q2018, before a likely solid wheat harvest (November-December) coupled with a limited boost to infrastructure investment would lift activity at the margin in 4Q2018. The bulk of next year´s growth is heavily dependent on strong soybean and corn harvests in 2Q2019 under normal weather conditions, which should strengthen economic activity and boost exports. In an election year, we also expect infrastructure investment to contribute to growth beginning in early 2019. Also, the sizable currency correction should help net exports contribute to growth next year as import growth weakens and exports rise.

Our growth forecasts (0.8% in 2018 and +1.8% in 2019) are also dependent on external factors. Global economic conditions matter, especially growth in China and Brazil and the outlook for agricultural-related commodity prices. In fact, Brazil´s elections later this year and the ensuing economic policy mix are key unknown external factors shaping Argentina´s growth profile next year, especially in the manufacturing sector. As proven in recent weeks, a risk-off scenario that prolongs FX volatility could make the recession last longer than desired.

Bottom Line

Argentina´s fiscal consolidation objectives are realistic, but those imply a relatively high sacrifice in terms of growth. While there could be measures to limit the depth and scope of the recession, growth should remain subdued for some time and will also depend on key external factors at play in coming months. We think the Argentine authorities will have to deliver on the IMF-program performance metrics while managing scarcity, which comes in the form of limited political and social capital and potential headwinds from abroad.

O Que Aconteceu? / ¿Qué Pasó?

Recent Economic Releases (Jun 29 - Jul 12)

Argentina

7-Day Repo Rate (Jul 10 - Jul 24)
Actual: 40.00% ; Consensus: 40.00%

Central bank stayed on hold and announced changes: interest rate policy to be complemented with liquidity-management tools; monthly policy meetings from now on; and Monetary Policy Committee moves from being an advisory group to one that makes decisions, with voting results to be made public.

Industrial Production (May)
Actual: -1.2% y-o-y; Consensus: -2.0% y-o-y

Worst reading in 13 months with weakness spreading: only half of sectors posted positive growth; important food industry mixed (-1.9% y-o-y, +0.3% YTD) while other key sectors such as the auto industry, basic metals and metal-mechanics are all losing steam versus performance seen so far this year.

Construction Activity (May)
Actual: 5.8% y-o-y; Consensus: n/a

Activity in sector posted softest pace of annual growth in 15 months; asphalt consumption – linked to public works – grew only 5.8% y-o-y (+29.3% YTD) while cement shrank 4.4% y-o-y (+9.5% YTD). Future prospects discouraging: building permits were down 22.6% y-o-y (-6.6% YTD).

ADEFA - Vehicle Production (June)
Actual: -13.4% y-o-y; Consensus: n/a

Strikes locally and in Brazil disrupted production in month which only counted 17 workdays. Exports maintained momentum (+16.2% y-o-y) while domestic sales to dealers collapsed 31% y-o-y. Going forward, expect downtrend in sales to continue given higher rates while exports can benefit from weaker FX.

Tax Revenues (June)
Actual: Ar$ 298.9 billion; Consensus: Ar$ 307.1 billion

Surprisingly solid performance given widespread slowdown of the economy: overall receipts were up 31.9% y-o-y – slightly above inflation – with main drivers the domestic income tax (+45.8%) , domestic VAT (+46.9%) and external-related taxes (+51.8%). Expect weakness ahead as economy weakens further.

Brazil

FGV - Business Confidence (June)
Actual: 98.5; Consensus: n/a

Business confidence decreased to the lowest level so far this year, dragged by current conditions, in response to the supply chain disruption triggered by the truck drivers' strike in late May. The good news is that future conditions reached the highest level since May 2013.

Industrial Production (May)
Actual: -6.6% y-o-y; Consensus: -9.4% y-o-y

Although above consensus, industrial production fell by 10.9% m-o-m, dragged by the truck driver's strike in May. The main negative contributions came from capital (-6.6%) and consumer goods (-11.9%). For the following months, we expect a rebound effect in June as occurred in Colombia in 2016.

PMI - Manufacturing (June)
Actual: 49.8; Consensus: n/a

For the first time since March 2017, PMI Manufacturing is below the 50 threshold indicating a contraction of the manufacturing sector. The truck drivers' strike impacted industry, as fewer orders were received and the supply chain was interrupted.

PMI - Services (June)
Actual: 47.0; Consensus: n/a

Reflecting the downside effects of the truckers' strike, PMI Services fell at the fastest pace since November 2017 to 47 (from 49.5 in May). The downturn was also linked to weaker demand and market uncertainty. The offsetting news is that service providers forecast higher output in the next 12 months.

Retail Sales (May)
Actual: 2.7% y-o-y; Consensus: 2.6% y-o-y

Retail sales contracted by 0.6% m-o-m in May, dragged by almost all categories. The main negative contributions were Fuel & Lubricants (-6.1%), apparels (-3.2%) and Office Equipment (-4.2%). On the opposite side, supermarket sales were up by 0.6%. Moreover, broad retail sales decreased by 4.9%.

National Unemployment Rate (May)
Actual: 12.7%; Consensus: 12.6%

Once seasonally adjusted, unemployment rate fell to 12.2% from last month's 12.3%, showing that the economy continues to recover, though at a slower pace than anticipated. This movement's engine was informal jobs, which grew 5.7% y-o-y. Real wages growth remained close to stability.

Trade Balance (June)
Actual: $5.9 billion; Consensus: $6.6 billion

Although below consensus, the second best number for June since the start of the data series; the trade balance remains at high levels, pushed by orange juice, soybeans and mining. On the other hand, meat exports were negatively impacted by the truck drivers' strike (-42% y-o-y).

IPCA (June)
Actual: 1.26% m-o-m; Consensus: 1.28% m-o-m

Consumer prices are up by 4.4% in June (from 2.9% in May). The main highlights were the items impacted by the truck drivers' strike, such as food inflation and gasoline prices. In contrast, services inflation decreased in June to 3.1%. In August, we expect inflation to decrease to 4.2%

IGP-DI - FGV (June)
Actual: 1.48% m-o-m; Consensus: 1.57% m-o-m

IGP-DI decelerated to 1.48% m-o-m (from 1.64% in May), still impacted by the truck drivers' strike, but there are signs that they are fading. The main driver continues to be food inflation, such as meat and milk. Fuel prices are showing a payback from the strike and are back in the deflationary camp.

CPI - FIPE (Final) (June)
Actual: 1.01% m-o-m; Consensus: 1.14% m-o-m

Consumer prices in Sao Paulo accelerated from last month's 0.19% m-o-m. The items which suffered from the truckers' strike escalated the most, such as gasoline (4.32%) and food (3.14%), especially milk and meat. Moreover, electricity tariff hikes made energy prices rise by 1.99%.

Primary Budget Balance (May)
Actual: -R$8.2 billion; Consensus: -R$12.2 billion

Fiscal results registered the best month of May since 2011 due to the upside in the states & municipalities and the SOEs. The 12-month deficit narrowed to 1.4% of GDP (from -1.8% in May). However, gross debt kept its upward trend and reached 77% of GDP.

Chile

IMACEC (May)
Actual: 4.9% y-o-y; Consensus: 4.0% y-o-y

New month, same strong growth story: economic activity posted a solid 0.7% sequential gain, rising for the fifth time in the past half year and leaving the pace of expansion so far in 2018 at an above-trend 4.3% annualized. Non-mining activity outperforming, up 4.6% annualized in January-May.

Unemployment Rate (May)
Actual: 7.0%; Consensus: 6.9%

Seasonally adjusted jobless rate declined slightly to 6.7%, moving further below the multi-year peak of 7.0% seen in March. Details mixed, however, showing annual pace of hiring stable at a modest 2.1%; quality of hiring disappointing as self-employed and public-sector workers led employment gains.

Manufacturing Output (May)
Actual: 1.8% y-o-y; Consensus: 2.0% y-o-y

While May's result came in on the soft side – output declined -0.5% sequentially – the recovery in factory output remains on track running at a pace nearing 5.0% annualized in January-May. The ongoing uptrend is consistent with upbeat sentiment indicators: the manufacturing PMI has been above 50 since February.

Mining Output (May)
Actual: 6.4% y-o-y; Consensus: n/a

Strong pace of annual growth still benefiting from easy comparison base – production at the *La Escondida* was still ramping up after a strike in the first quarter of 2017. Seasonally adjusted output has been fairly stable all year at elevated levels, running just -5% below the two-year high reached in August 2017.

Retail Sales - INE (May)
Actual: 3.0% y-o-y; Consensus: 4.0% y-o-y

Not much new: amid improving confidence, consumers keep spending at a moderate pace with real sales up 4.1% in the January-May period compared to 2017. Durable goods, and new car sales (up 25.9%) in particular, remain the bright spot.

Business Confidence - IMCE (June)
Actual: 55.1; Consensus: n/a

Uptrend carries on: seasonally adjusted index edged up further reaching 55.9 points, a high since mid-2013. All sectors but construction – whose 20-point rebound over the past year was the strongest – posted gains at the margin; recent run of gains still driven by improving expectations component.

Consumer Confidence (June)
Actual: 52.7; Consensus: n/a

Sentiment keeps moving in the right direction up to seasonally-adjusted high (53.1 points) since early 2014, staying above the 50 threshold for fourth straight month. Participants quite upbeat about the year-ahead economic outlook and durable goods purchases – both above 60 points – with positive implications for spending.

Trade Balance (June)
Actual: $483 million; Consensus: $650 million

Surplus in first half reached $5.5 billion, nearly doubling from same period in 2017 ($3.1 billion) on strong mining-led growth in exports (up 21.6%). Imports also rose at a solid pace (15.4%) – mirroring the positive trend in domestic demand – including stronger capital goods purchases (9.7%).

CPI (June)
Actual: 0.1% m-o-m; Consensus: 0.2% m-o-m

Even though headline and core (-0.1% versus 0.0% expected) came in below consensus, annual rates moved up to 2.5% and 1.9%, respectively, reflecting a very low comparison base. Seasonally-adjusted sequential figures pointed to muted pressures in June, easing concerns sparked by May's spike to near 5% annualized.

Wages (Nominal) (May)
Actual: 3.2% y-o-y; Consensus: 3.2% y-o-y

Consistent with signs of slack in labor market conditions, salary adjustments remain in check translating into modest real wage gains averaging 1.1% in the past couple of months – a material deceleration from last year's 3.1% increase. Sector details show that moderation in wage hikes is broadly based.

Colombia

Monetary Policy Meeting
Actual: 4.25%; Consensus: 4.25%

Policymakers unanimously agreed to keep rates unchanged; statement sounded slightly more hawkish than the previous one given risks of a weaker-than-expected FX – linked to the ongoing EM volatility – and of a pickup on food prices. However, BanRep kept optionality by stressing that future guidance remains data-driven.

Monetary Policy Minutes
Actual: n/a; Consensus: n/a

Unanimous decision to keep rates on hold hinges on the notion that while the economic recovery is on track and inflation remains well behaved, uncertainty in international financial markets has increased, with potential negative impact to the country´s risk premia. Amid this backdrop, board members believe that monetary policy seems “adequate” for now.

Industrial Production (May)
Actual: 2.9% y-o-y; Consensus: 4.9% y-o-y

Below expectations, but showing widespread gains, with coffee production and the making of transport equipment leading the growth tables. Fabricated metal products, meat, seafood, beverage production, and plastics manufacturing were the main growth contributors in May.

Retail Sales (May)
Actual: 5.9% y-o-y; Consensus: 5.0% y-o-y

Above expectations, retail sales were lifted by computers and telecommunications as well as other household goods. The critical food sector also contributed to overall growth. Car sales were also up (+7.7% y-o-y) in May.

CPI (June)
Actual: 0.15% m-o-m; Consensus: 0.17% m-o-m

Slightly below expectations and remains hovering near the target range at 3.2% y-o-y (vs 3% target). Tradables as well as non-tradables items pushed inflation higher while food prices remain muted.

Mexico

Industrial Production (May)
Actual: 0.3% y-o-y; Consensus: 0.8% y-o-y

Disappointing: May's weak result (barely up 0.1% sequential) left output contracting at a -0.7% annualized pace so far in 2018, adding to evidence suggesting economy shifted into lower gear in second quarter. Solid export demand propping up manufacturing, but not enough to offset weakness elsewhere.

Fixed Investment (April)
Actual: 10.5% y-o-y; Consensus: 9.5% y-o-y

Seasonally adjusted investment down (-1.3% sequential) for second consecutive month with declines in both construction and machinery outlays. The ongoing downshift – which left investment off -1.7% from the February peak – confirms that part of the strength seen at the turn of year was linked to temporary factors.

Private Consumption (April)
Actual: 4.4% y-o-y; Consensus: n/a

Unlike narrower surveys – such as ANTAD retail sales (see below) – showing consumer spending is gradually recovering as the inflation shock subsides, the broader consumption indicator puts spending levels roughly flat so far this year caused mainly by a moderation in demand for services.

Retail Sales - ANTAD (Real) (June)
Actual: 6.3% y-o-y; Consensus: n/a

Encouraging result: sales reported by retail chamber ANTAD rose sequentially for the fourth consecutive month, bringing second-quarter growth to just over 4.0% annualized – while the pace remains moderate, it represents a material acceleration from the near flat performance of 2017.

Remittances (May)
Actual: 19.8% y-o-y; Consensus: 10.3% y-o-y

After hitting a record in April, remittances gained further ground in May to a seasonally adjusted US$33.0 billion annualized (2.8% of GDP). While the weaker peso may have incentivized workers to send some money home, fears over aggressive immigration policies may have also played a role in boosting transfers.

Bank Credit to the Private Sector (Real) (May)
Actual: 8.5% y-o-y; Consensus: n/a

Credit recovery gained further strength: May's sequential gain was strongest since late 2016, leaving April-May loan growth running at near 14% annualized (+10% in 1Q). Bulk of strength came from corporate loans – likely exaggerated by switch from external to domestic funding – while consumer segment was flat.

Manufacturing Index - IMEF (June)
Actual: 52.6; Consensus: 50.8

Sentiment bounced a bit, moving back to the average of the past year (52.4 points) which has been consistent with moderate growth. Still, the gap between manufacturers in Mexico and their more upbeat US counterparts – June's ISM rose to 60.2, second highest since 2004 – remains wide, likely reflecting election concerns.

Non-Manufacturing Index - IMEF (June)
Actual: 51.0; Consensus: 50.8

While still slightly above the 50 threshold, index is down for fourth straight month – led by declines in new orders (51.7 in June) and production (50.9) gauges – to a new 14-month low. Index's record in predicting services activity has been mixed, yet recent downshift mirrors softness in second-quarter hard data.

Producer Confidence (June)
Actual: 48.66; Consensus: n/a

After a 7-point, yearlong improvement that pushed seasonally-adjusted confidence to a high in over two years by February (49.95), participants have turned more cautious over past four months. Most downside came from capex plans (37.48) and current economic conditions (44.77) likely reflecting election and NAFTA fears.

Consumer Confidence (June)
Actual: 89.8; Consensus: 88.7

Seasonally adjusted confidence up for third straight month (to 88.0 points), reversing the entire downturn seen in first quarter. The bulk of the gains came from participants' future perception of the economy – at 87.1, a high since late 2015 and up 11.2 points since December – coinciding with the downshift in inflation.

Leading Economic Indicator (May)
Actual: -0.12% m-o-m; Consensus: n/a

Consistent with several indicators – from industrial output to fixed investment and car sales – suggesting that the economy shifted into lower gear during the second quarter, the leading indicator continued drifting lower posting its fourth negative month in a row.

Contractual Wages (June)
Actual: 5.6% y-o-y; Consensus: n/a

Private sector wage adjustments which keep catching up to still elevated inflation, averaged 5.6% in the first half of the year, accelerating from 4.8% in same period in 2017. In real terms, real gains approached 0.7% in first half, contributing positively to consumers' incomes, in contrast to a decline of -0.7% a year ago.

Tax Revenues (Real) (May)
Actual: -2.1% y-o-y; Consensus: n/a

Fiscal accounts in good shape thanks to surprisingly strong revenues – both oil and taxes excluding fuel duties – which in first five months of the year topped budget estimates by almost 1.9% of GDP annualized, leaving primary surplus at M$132 billion through May – wider than the M$16 billion estimate.

CPI (June)
Actual: 0.39% m-o-m; Consensus: 0.33% m-o-m

Upside surprise – core as well up 0.23% (0.21% consensus) – pushing annual headline rate to 4.65% (4.51% in May), putting a halt to downtrend seen since January. Normalization in agricultural goods (-0.32%) not enough to offset pressure from energy (up 2.29%) particularly LNG (5.85%) and gasoline (1.45%).

Monetary Policy Minutes
Actual: n/a; Consensus: n/a

Minutes struck a more balanced tone compared to the hawkish June 21 statement; discussions did not contain a firm commitment to tighten policy further, but instead central bank will remain watchful of factors that led to June's quarter-point hike including fuel prices, the peso and inflation expectations.

Peru

Monetary Policy Meeting
Actual: 2.75%; Consensus: 2.75%

As expected, central bank on hold for fourth consecutive time. Guidance stayed neutral, emphasizing that it is "appropriate to keep an expansionary stance" until policymakers are sure that inflation convergence to target is happening in context of well-anchored expectations and growth near potential.

CPI (June)
Actual: 0.33% m-o-m; Consensus: 0.15% m-o-m

Well above expectations, June's upside surprise was caused by food & beverages (0.42%) and transportation (0.72%) groups. The 12-month trailing rate stood at 1.43% (0.93% in May), moving within the 1-3% tolerance band; core rate rose to 2.23%.

Source: Government data, Morgan Stanley Latam Economics

What's Next? – Upcoming Data Releases (Jul 13- Jul 20)

Friday, Jul 13

	MS Forecast/ Consensus	Last[2]
Mexico		
Formal Employment[1]	4.2% y-o-y	4.5% y-o-y
(June)	n/a	

Monday, Jul 16

	MS Forecast/ Consensus	Last[2]
Brazil		
GDP Proxy (IBC- Br) (May) (See Exhibit 4)	2.3% y-o-y n/a	3.7% y-o-y
IGP-10 - FGV (July)	n/a n/a	1.86% m-o-m
Peru		
GDP (May) (See Exhibit 5)	5.1% y-o-y n/a	7.8% y-o-y
Unemployment Rate (June)	n/a n/a	6.6%

Tuesday, Jul 17

	MS Forecast/ Consensus	Last[2]
Argentina		
National CPI (June) (See Exhibit 6)	n/a n/a	2.1% m-o-m
Colombia		
Consumer Confidence (June)	n/a n/a	8.9

Wednesday, July 18

	MS Forecast/ Consensus	Last[2]
Brazil		
IGP-M (Second Preview) (July)	n/a n/a	1.75% m-o-m
CPI - FIPE (Second Preview) (Jun 16 - Jul 15)	n/a n/a	0.63% m-o-m

Thursday, July 19

	MS Forecast/ Consensus	Last[2]
Colombia		
Trade Balance (May)	n/a n/a	-$325 million

Friday, July 20

	MS Forecast/ Consensus	Last[2]
Argentina		
Budget Balance (June)	n/a n/a	-Ar$ 7.8 billion
Brazil		
IPCA-15 (July) (See Exhibit 7)	0.78% m-o-m n/a	1.11% m-o-m

n/a = not available or not applicable

[1] Earliest possible release date

[2] *Last* denotes last published data by a non-Morgan Stanley source.

Source: Morgan Stanley Latam Economics estimates

On the Horizon

	AR	BR	CL	CO	MX	PE	VE	Region**
Real GDP growth (%)								
2015	2.7%	-3.8%	2.3%	3.1%	3.3%	3.3%	-6.2%	0.2%
2016	-2.2%	-3.6%	1.6%	2.0%	2.9%	3.9%	-16.5%	-0.4%
2017	2.9%	1.0%	1.6%	1.8%	2.0%	2.5%	-15.6%	1.7%
2018E	0.8%	1.7%	3.7%	2.5%	2.0%	3.3%	-15.8%	2.0%
2019E	1.8%	2.4%	3.3%	3.0%	2.3%	3.4%	-12.4%	2.5%
Inflation (year-end, %)								
2015	26.9%	10.7%	4.4%	6.8%	2.1%	4.4%	181%	9.1%
2016	39.3%	6.3%	2.7%	5.7%	3.4%	3.2%	482%	8.7%
2017	24.8%	2.9%	1.9%	4.1%	6.8%	1.4%	1829%	6.5%
2018E	**27.9%**	4.0%	2.6%	3.2%	4.0%	2.0%	857604%	6.4%
2019E	**19.2%**	4.4%	3.0%	3.3%	3.3%	2.6%	26266146%	5.5%
FX rate (year-end vs. US$)								
2015	12.94	3.90	707	3149	17.21	3.41	6.3	
2016	15.87	3.15	667	3001	20.73	3.35	n/a	
2017	18.60	3.31	615	2984	19.64	3.24	n/a	
2018E	28.00*	3.90*	630*	3000*	20.50*	3.26*	n/a	
2019E	31.00*	3.40*	555*	2740*	18.00*	3.15*	n/a	
Current account balance (% GDP)								
2015	-2.7%	-3.4%	-1.9%	-6.4%	-2.5%	-4.8%	n/a	-3.3%
2016	-2.7%	-1.3%	-1.4%	-4.4%	-2.1%	-2.7%	n/a	-2.0%
2017	-4.8%	-0.5%	-1.5%	-3.4%	-1.6%	-1.9%	n/a	-1.7%
2018E	-4.9%	-0.8%	-1.6%	-2.9%	-1.8%	-0.9%	n/a	-1.8%
2019E	-3.9%	-1.3%	-1.9%	-3.0%	-2.1%	-1.0%	n/a	-2.0%
Trade balance (US$ bn)								
2015	-3.0	19.7	3.5	-18.1	-14.7	-2.9	6.2	-9.4
2016E	2.0	47.7	5.4	-13.5	-13.1	1.9	6.6	36.9
2017	-8.5	67.0	7.9	-8.3	-10.9	6.5	21.0	74.7
2018E	-8.2	61.0	6.9	-3.8	-12.3	5.2	10.8	59.6
2019E	-6.3	52.0	3.7	-4.5	-18.6	4.0	14.9	45.2
Interest rate (year-end)								
2015	33.00%	14.25%	3.50%	5.75%	3.25%	3.75%	n/a	
2016	24.75%	13.75%	3.50%	7.50%	5.75%	4.25%	n/a	
2017	28.75%	7.00%	2.50%	4.75%	7.25%	3.25%	n/a	
2018E	31.00%	6.50%	2.50%	4.00%	7.50%	2.50%	n/a	
2019E	24.00%	7.50%	3.50%	4.50%	6.00%	3.50%	n/a	
International reserves (US$ bn)								
2015	25.6	356.5	38.6	46.7	176.7	61.5	16.4	722.0
2016	39.3	365.0	40.5	46.7	176.5	61.7	11.0	740.8
2017	55.1	374.0	39.0	47.6	172.8	65.0	9.5	762.9
2018E	62.6	375.0	38.0	48.0	170.0	65.0	9.3	767.9
2019E	68.0	375.0	38.0	48.1	170.0	65.0	9.1	773.2
Public sector balance (% GDP)								
2015	-5.2%	-10.4%	-2.2%	-3.1%	-3.4%	-2.1%	n/a	-6.3%
2016	-5.9%	-9.0%	-2.7%	-3.8%	-2.5%	-2.6%	n/a	-5.6%
2017	-6.1%	-7.8%	-2.8%	-3.6%	-1.1%	-3.1%	n/a	-4.7%
2018E	-5.1%	-7.5%	-2.1%	-3.1%	-2.0%	-3.6%	n/a	-4.7%
2019E	-4.4%	-6.9%	-1.9%	-2.6%	-2.2%	-3.3%	n/a	-4.4%

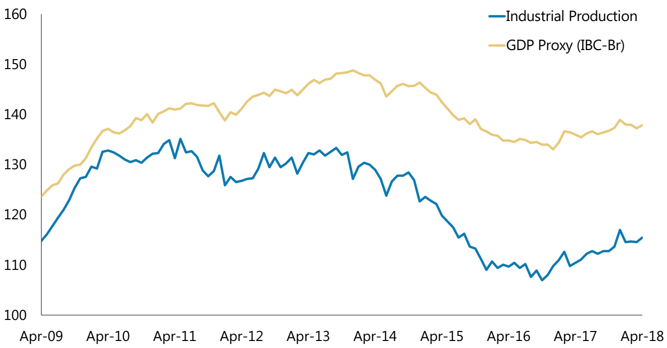
E = Morgan Stanley Forecast

Source: Morgan Stanley Research, *FX Strategy Team, Updated forecasts in bold, **Regional inflation and GDP figures exclude Venezuela

What's Next? – A Closer Look

Monday, July 16

Exhibit 4: Brazil: Real GDP and Industrial Production (Seasonally Adjusted, 2012=100)

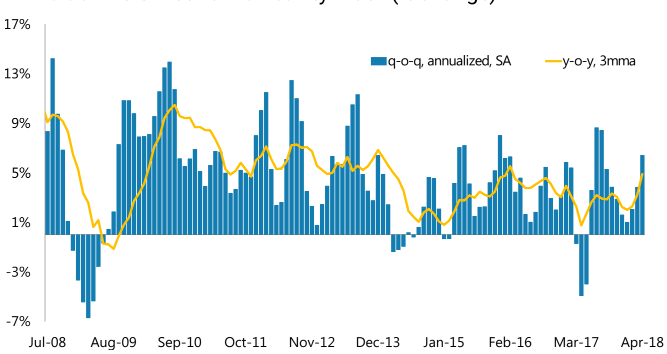


Source: IBGE, BCB, Morgan Stanley Latam Economics

Brazil's May GDP Proxy (IBC-Br)
Morgan Stanley Forecast: 2.3% y-o-y; Consensus: n/a

- We expect GDP Proxy to contract by 2.1% m-o-m, as signaled by coincident indicators, such as industrial production (-10.6%) and broad retail sales (-4.9%), on the back of the supply chain disruption caused by the truck drivers' strike.
- For the following months, June will likely benefit from a rebound effect from this month's substandard results as happened in Colombia in 2016. Nevertheless, long-term outcomes will depend on how the strike will further hit confidence and on election uncertainty, as in May we already had a marginal decrease.

Exhibit 5: Peru: Economic Activity Index (% change)



Source: INEI

Peru's May GDP
Morgan Stanley Forecast: 5.0% y-o-y; Consensus: n/a

- Peru's economy has been stuck in a low gear, but in recent months activity has been showing welcome signs of an acceleration boosted by strength in commodity-linked and other sectors as well (see "Peru: Defensive Growth," June 28, 2018).
- Preliminary indicators for May point to more of the same positive trend of the past couple of months: construction continues to improve, as indicated by stronger cement consumption, exports remain strong, credit to consumption is expanding as is government spending.

Tuesday, July 17

Exhibit 6: Argentina: Inflation (% change y-o-y)

Source: OJF,, Morgan Stanley Latam Economics,

Argentina's June National CPI

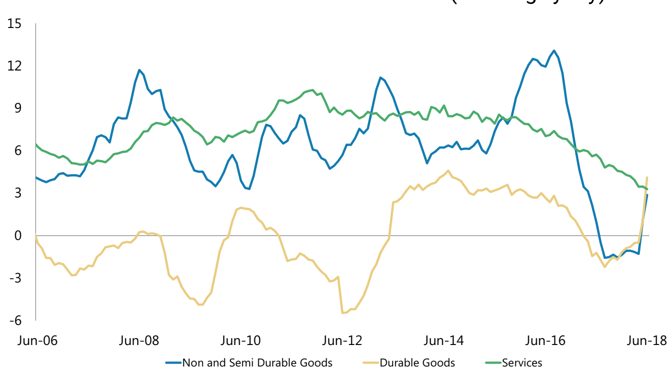
Morgan Stanley Forecast: n/a; Consensus: n/a

- June is poised to be the high mark for monthly inflation this year: FX depreciated 37% between April and June and thus local prices are likely to spike given the pass-through effect. Indeed, higher frequency data for inflation suggest a reading hovering around the 3.5% m-o-m handle.

- Despite this major speed bump, the disinflation process should resume ahead as long as FX stabilizes. The very tight monetary policy stance coupled with depressed demand and the ending of the central bank's financing of the fiscal deficit should allow Argentina to resume a disinflationary trend. Much rides, however, on the external backdrop as further FX depreciation could hamper the disinflation process.

Friday, July 20

Exhibit 7: Brazil: Goods and Services Inflation (% change y-o-y)



Source: IBGE

Brazil's July IPCA-15

Morgan Stanley Forecast: 0.78% m-o-m; Consensus: n/a

- We expect consumer prices up to mid-July to

  still show the impact of the truck drivers' strike from the end of May, especially on food inflation and fuel prices, due to supply chain disruptions, but this is already fading. Moreover, higher air fares and electricity tariffs in Sao Paulo, Porto Alegre and Curitiba should pressure headline inflation. The 12-month print should accelerate to 4.7% (from 3.7% in the previous month). However, in the upcoming months, we expect a mild deceleration in the yearly print close to 4.2% in August, when we should see a deflationary print, resulting from the payback from the truckers' strike.

- However, we do not expect this to be a source of concern that would prompt the central bank to start a hiking cycle, since structural inflation, such as services inflation and core inflation, should remain at low levels, close to 3%. And this should be reversed as supply chains normalize.

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