LATAM Market Update

- **Brazil: FinMin reportedly asks rating agencies to delay decisions until February**
- **Chile: Everybody expecting more certainty**
- **Mexico: How do investors we spoke to see Banxico's decision from yesterday?; Private analysts apparently more confident than Banxico**

LATAM is opening broadly flat, outside of BRL, where the real is getting a strong bounce (+0.8%), basically reversing the losses it saw when news emerged that "pension reform" is now at best a 2018 story for its first vote in the lower house. A similar trend reversal took place in MXN, which basically lost all the gains it got on the back of Banxico's surprising hawkishness in yesterday's statement. In Peru, the sol is opening about -0.5% weaker, with the political situation we discussed in yesterday's daily adding some unexpected uncertainty to what was seen as the safe-haven of LATAM in 2018. On the rates front, Mexican swamps are about 15bps – 25bps wider than they were at the close of December 13th, with markets pricing in another hike given the hawkish tone Banxico expressed in its latest statement. An important piece of the Mexican monetary policy puzzle will be who gets picked to complete the currently 80% staffed board.

BRAZIL: FINMIN REPORTEDLY ASKS RATING AGENCIES TO DELAY DECISIONS UNTIL FEBRUARY

With Brazil's pension reform now a 2018 story at best, it's likely that Brazil's government fears it could suffer an additional bout of credit ratings downgrades as we head into yearned. Accordingly, there are reports that Meirelles approached the rating agencies to request a delay on any credit rating action until after February 19th, when a new date could be set to vote on the pension bill. However, there are also reports that the government is considering further watering down the bill (which is currently only about 50% as ambitious as it began), in order to secure a positive vote.

CHILE: EVERYBODY EXPECTING MORE CERTAINTY

The BCCh kept the MPR at 2.50% last night (its regular December meeting) as per market expectation (around 98%). The wordiness of the neutral bias (neutral bias but underscoring that risk of a slower-than-expected convergence of inflation to 3% is still there and could prompt a more expansive monetary policy –more cuts) was changed, but it was not pretty clear the direction of it. However, the paragraph devoted to the domestic economic conditions is more dovish, no doubt. The first sentence, referred to total inflation and core indices, has a whiff of that. Moreover, its explicit reference to a labour market with strong self-employment and weak salaried employment points in the same direction. Though I was not expecting a turn to that way, it must be conceded that specific trend indicators in

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some sectors were showing a weaker recovery lately, while the recent upturn in risk of generic domestic assets (stock market, currency, etc.), though partially reverted in the current week, might be taking a toll on real investment (at least in inventories).

Anyway, the statement should be understood as one of wait-and-see, but more intense than other times. Why? Because additional to the natural risk of the inflationary convergence, the economy has to deal with some risk coming from the political world. So, next few days (or weeks, depending of the ability of the new elected President and its coalition to articulate a new political scenario) will be critical. If risk aversion persists, MPR cuts would become more likely. The finger in the trigger, but expecting something that can avoid to have to pull of it. Notwithstanding, our base case continues the same, but with just 60% of probability: the MPR will be kept at the current level (2.5%) up to mid-year, when a higher (and more certain) velocity of growth and a business expectation index well into the optimistic zone would allow a normal inflationary convergence, all of which will create conditions to be more prone to start a moderate hiking period.

This morning the Central Bank showed some data up to the first week of December. On the positive side, it can be said that exports and imports, money (M1) and banking loans kept their previous trends, which in any case are positive, and even accelerated a tad. This improvement, though very marginal, cannot be attributed to weaker bases. On the negative side, capital goods imports contracted (in our estimation, -1.6%) for the first time since last May. Though this is not the first sign of that, due to the high volatility of some components it seems very early to be very concluding, but we have to keep it as a warning sign for investment, which, meanwhile, fits well with the current juncture.

The domestic exchange rate (USDCLP) plunged in the last days, recording the deepest fall in one year. There were some powerful determining factors pointing in that direction: copper price pick-up (though its downtrend has not reverted yet), a weaker USD in foreign markets, some relief from the intense risk aversion that faced domestic assets due to next Sunday's election and an evident oversold condition. As we thought it was going to be the case in these days, volatility will remain high, likely up to year-end. However, there are no powerful reasons to expect a closing level meaningfully different to the current 12 days average, which is not very different of our original estimation. For other important Chilean assets, like stock market indices and Central Bank's or Treasury's bonds (their performances are almost the same), volatility outlook is likely going to be very similar in coming weeks. In following paragraph we depict the most likely scenarios for these prices related with political risk, but are far from being concluding.

The run-off of the presidential election will take place on Sunday. At or before 7:30 pm we expect to have a very descriptive result (earlier than on November 19th because this election in much more simple), probably considering more than 20% of total voters, that in Chile usually is almost definitive. As said, the result is expected to be very tight (a difference of no more than 3pp), though a critical factor will be the definitive number of voters (it has been very hard to pre-survey that). If Mr. Guillier were the winner, we should see a rebound of risk aversion, but not bigger than what we saw in the markets at the peak, a few hours before to the TV debate. If Mr. Piñera gets the majority, the opposite reaction is very likely to take place, but also in a limited extent. As said, so far the latter result seems just a smidgen more likely than the former, but it is an extremely close call, and a bet that is even riskier after the embarrassment of surveyors in the first round (not to mention what we witnessed last year in Colombia , the UK and the US).

MEXICO: HOW DO INVESTORS WE SPOKE TO SEE BANXICO'S DECISION FROM YESTERDAY?

We think the +25bps hike was expected and most investors we spoke to think it was prudent, but three parts of the statement were more controversial in calls with investors we've had since the announcement: 1) leaving the link between Mexican and US monetary policy is puzzling to most investors we have spoken to. Banxico is seen as among the most credible and strong central banks in all the emerging world, and investors are puzzled over why Banxico would see itself as having no independence relative to the Fed, while the rest of LATAM clearly does (most are cutting) 2) a discussion of hiking +50bps, just as inflation is broadly and widely expected to fall early in 2018 (base effects become quite favorable in the next couple of months) is puzzling to most we spoke with. If inflation is expected to fall rapidly, and Banxico to start easing in the not too distant future (most expect 18H2), many argue that given the policy transmission lag, its likely overkill to take too aggressive a stance at this point. Starting another aggressive hiking spree at this time, will likely leave Banxico tugging both ends of the same rope in a few months. On the other side, Banxico's mandate is to combat inflation, so the hike and a cautious tone on inflation were seen as "expected and justified" by most observers we spoke with. We'd say the bottom line, is the broad majority of investors we spoke with don't disagree with the hike, but most think parts of the statement were "puzzling".

PRIVATE ANALYSTS APPARENTLY MORE CONFIDENT THAN BANXICO

According to central bank's survey on private economic expectations analysts see inflation relatively optimistic compared to Banxico's hawkish tone on its latest press release. Mexico CB poll median anticipate annual inflation for 2017 closing at 6.56% (6.49% prev. poll) while converging next year to 3.96%. Yesterday's rate hike communication warned about actual inflation (6.63% in Nov.) suggesting a higher probability of new rate increases during 2018. Exchange rate expectations remain a bit volatile but below 19 pesos per USD perhaps responding to domestic political uncertainty and awaiting for a new NAFTA Round table. GDP forecast seen stable at 2.11% this year and 2.24% on 2018.

— Luis Armando Jaramillo Mosqueira

RECOMMENDED READINGS:

"America's long-running economic expansion" The Economist (December 16, 2017)

"In the name of democracy, Venezuela bans the opposition" The Economist (December 16, 2017)