LATAM Macro Update

Thursday, April 7, 2016

Eduardo Suarez
Co-Head LATAM Strategy
52 55 9179 5174
Eduardo.Suarez@scotiabank.com

Scotiabank LATAM Macro update – Mexican inflation – nothing here, move on

Highlights:

2016 so far does not look like a great year for FX-macro-trading…. its turning out to be one of those "risk-on, risk-off" years.

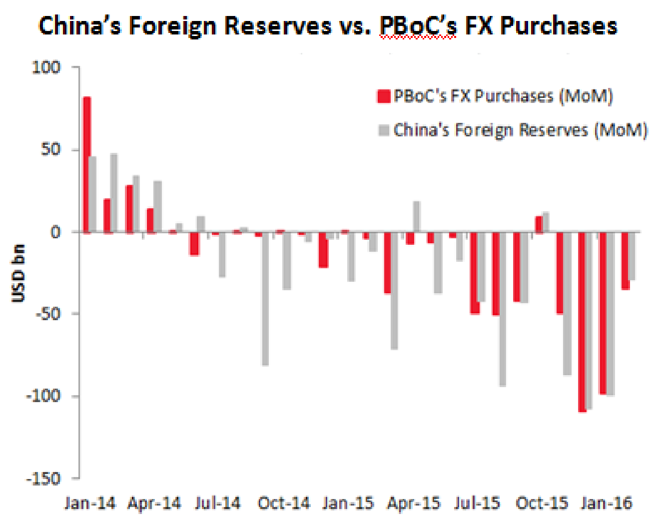
Mexican inflation remains somewhat of a "non-event", putting monetary policy drivers squarely focused on market stability.

Market highlights:

We continue to think that for FX markets, this is going to be a Mr Miyagui year ("Risk-on, Risk-off" – with a "don't ask why" after it). We've already seen 3 fairly solid turns in market direction, without arguably having any real change in major macro-fundamentals. Today, the tone is decidedly unhappy, with most LATAM FX down -0.5% to -1.6% (BRL is having a particularly bad day), while oil is also suffering, with WTI down -1.8%.

Some interesting comments on China from our local strategist:

"China's official and Caixin PMI both surprised the market on the upside. We expect the nation's macro data for March to improve along with robust money and credit supply, although we doubt the sustainability of the recovery over the medium term. China's foreign reserves for March are likely to beat market expectations and rise somewhat from a month earlier on the back of a relatively steady CNY and a strengthening EUR in March. It will bolster risk-appetite and benefit EM and commodity currencies in our view."



Source: Bloomberg and Scotiabank FX Strategy

"The temporary recovery could be attributed to China's efforts stabilizing its slowing economy. Wutongshu (梧桐树) Investment Platform, a fund owned by the SAFE that is China's FX regulator, is now among the top 10 shareholders in four Chinese banks. Last year, it injected USD 6.5bn, USD

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48bn and USD 45bn respectively to the Silk Road Fund, China Development Bank and Export-Import Bank of China to enhance their capital, according to local financial media Caixin. In addition, the planned CNY 1tn bad loans-to-equity swap scheme is aimed at reducing corporates' debt burden and cleaning up mounting bad loans on the balance sheet of the nation's banks."

Suggested readings:

"Understanding the slowdown in capital flows to emerging markets" IMF (April 2016)
"HSBC chief says China pessimism overstated" J. Hughes – FT (April 7, 2016)
"Rousseff report adds to impeachment pressure" J. Leahy – FT (April 7, 2016)
"The Panama papers embarrass China's leaders" The Economist (April 7, 2016)
"The rise of German isolationism" M. Fratscher - Project Syndicate (April 6, 2016)

Does "the Donald", become "the President"?, or at least "the Candidate"? – some of our favourite US campaign articles

"Can you get Trump to 1,237?" A. Boycoffee – FiveThirtyEight (April 4, 2015)
"How the rest of the delegate race could unfold" G. Aisch, J. Katz, R. Lai – New York Times (April 6, 2016)
"US politics is closing the door on free trade" P. Stephens – FT (April 7, 2016)
"Anti-trade America" K. Rogoff – Project Syndicate (April 7, 2016)
"GE CEO: Bernie Sanders says we're 'destroying the moral fiber' of America. He's wrong" J. R. Inmelt - The Washington Post (April 6, 2016) *** **Extraordinary Read** ***

Mexican inflation – nothing here, move on:

Today's inflation report confirmed that inflation fears have been one of the phantom stories of the year – which we have been surprised by. We expected inflation to creep up to about 3.5% at some point this year, but inflation has been a surprising "non-story". Consensus looked for a 2.62% y/y today, and it came in very close – at 2.60%, but we think today's release has important reasons that should help allay Banxico's inflation concerns: 1) some of the big "base effects" that were expected to hit on the inflation front were Q1 events, such as telecoms price drops, and the first part of the energy price drops in 2015 – we haven't seen particularly strong inflation shocks so far in Q1, and 2) almost across the board, inflation remains "MIA" (Missing in action"). Only education – which always seems to have inflation in the 4% - 5% range, and fruit & vegetables have inflation prints above the target range, and the rest of the main components are within 50bps above the middle of the target.

With inflation muted, and growth likely to remain sluggish – even more so with the 1.6% of GDP of announced pre-emptive public spending cuts for 2017, we don't see any real domestic drivers why Banxico would need to hike rates again this year… or even to have hiked already. This continues to put focus squarely on domestic / FX market volatility. The concerning thing about current market moves, is that we seem to once again be seeing relatively strong pressure on EM, and the weakest currencies have been BRL, ZAR and MXN. We don't yet see a trigger for intervention, but if MXN continues to be singled out as an EM hedge, we could at some point see Banxico step in to sell USD again.

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We don't see any major evidence that FX-inflation pass-through is a major inflation threat so far

March Inflation (m/m %)	2016	2015	2014
Core:	0.36%	0.26%	0.21%
Merchandise	0.34%	0.15%	0.18%
Food	0.33%	0.00%	0.11%
Other	0.35%	0.26%	0.24%
Services	0.37%	0.36%	0.24%
Housing	0.24%	0.17%	0.18%
Education	0.01%	0.05%	0.02%
Other	**0.63%**	0.65%	0.37%
Non-Core	-0.49%	0.85%	0.46%
Agricultural	-1.00%	0.74%	0.71%
Fruit & Veg.	-2.84%	2.32%	0.42%
Animal origin	0.18%	-0.05%	0.89%
Energy & Administered	-0.16%	0.92%	0.31%
Energy	-0.28%	1.29%	0.56%
& Administered	0.06%	0.21%	-0.15%

Source: INEGI, ScotiaFIC Strategy.

Outside of education – which is always above 4%, and fruit and vegetables, inflation looks contained

March Inflation (y/y %)	2016	2015	2014
Core:	2.76%	2.45%	2.89%
Merchandise	3.23%	2.60%	2.88%
Food	3.20%	2.98%	4.58%
Other	3.25%	2.28%	1.52%
Services	2.37%	2.32%	2.90%
Housing	2.16%	2.08%	2.24%
Education	**4.13%**	4.40%	4.39%
Other	2.06%	1.95%	3.17%
Non-Core	2.12%	5.29%	6.54%
Agricultural	6.21%	8.34%	1.49%
Fruit & Veg.	**20.87%**	-0.66%	-2.81%
Animal origin	-1.26%	13.59%	4.14%
Energy & Administered	-0.37%	3.52%	9.73%
Energy	-2.19%	4.01%	9.83%
& Administered	3.13%	2.59%	9.55%

Source: INEGI, ScotiaFIC Strategy.

Data hits:

	Country	Actual	Consensus	Previous
Consumer credit	US		$14.9b	$10.5b
CPI	Mexico	2.60%	2.62%	2.87%
FGV IGP-DI inflation	Brazil	11.07%	11.09%	11.93%
Trade balance	Chile	$610m	$575m	$5697m
Nominal wages	Chile		5.4%	5.8%

CONTACTS GLOBAL FX STRATEGY

THE MAJORS & PRIMARY CURRENCIES

Shaun Osborne	Chief Currency Strategist		shaun.osborne@scotiabank.com
Eric Theoret, CFA, CMT	Currency Strategist	416 -863 -7030	eric.theoret@scotiabank.com

LATAM

Eduardo Suarez	Co-Head LATAM FIC Strategy	(52 55) 91 79 51 74	eduardo.suarez@scotiabank.com

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