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LATIN AMERICA: DIVERGENCE IN MONETARY POLICY

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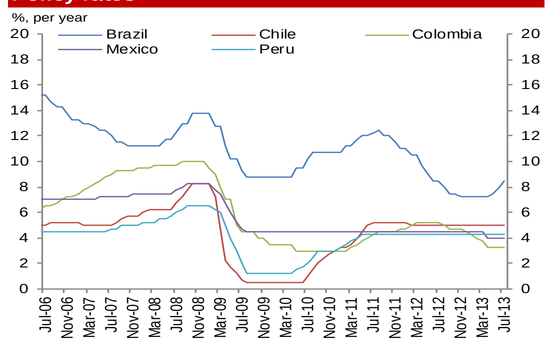
Maintaining policy flexibility is key

- This week was a busy one for several Latin American countries' Central Banks. The Central Banks of Brazil, Chile, Mexico, and Peru held policy meetings, and the Central Bank of Colombia released the minutes from its June meeting.
- Only Brazil is tightening monetary conditions via increases of the policy rate. Persistent inflation is forcing rate hikes—which are needed—but limiting monetary policy flexibility.
- The Central Banks of Chile, Colombia, Mexico and Peru are on hold, with inflation within respective target ranges. Chile has shifted to an easing bias, while Peru may ease reserve requirements. Colombia is in a wait-and-see mode, and Mexico is likely to stay on hold.
- Going forward, this ability to carry out flexible monetary policy (via use of the policy rate and macroprudential tools) is a key advantage during times of global market uncertainty.

Policy rates



Source: Central Banks; BTMU Economic Research.

Results of this week's monetary policy decisions and minutes

Brazil — COPOM continues tightening at unchanged pace (Wednesday, July 10th)

- High inflation is forcing the Central Bank to raise interest rates. The Brazilian Central Bank's Monetary Policy Committee (COPOM) raised the policy interest rate (SELIC) by 50bp to 8.50% per year. COPOM has now increased the SELIC by a combined 125bp since commencing the tightening cycle in April.
- The language in the accompanying statement suggests that monetary tightening is still underway. We expect another 50bp hike to the SELIC in August and a final 50bp increase in October. This would raise the SELIC to 9.5%. Yet, we note that there are uncertainties in the outlook, given weak growth and FX depreciation pressures. It will be very informative to our outlook to assess the BCB's evaluation of economic growth and FX in the forthcoming minutes.

Chile — On hold, and considering future rate cuts (Thursday, July 11th)

- The Central Bank of Chile (BCCH) kept the policy rate on hold at 5.0% per year, while shifting from a neutral bias to an easing bias. It cited more restrictive global financial conditions. It also cited concerns regarding Europe's recession and China's slower growth, along with lower commodity prices and appreciation of USD. Regarding the domestic economy, the BCCH cited the gradual deceleration of economic activity and domestic demand, which is concentrated in investment. Inflation is within the target. Yet, it was also noted that consumption remains dynamic and labor market conditions are tight.
- The BCCH stated that the current trends may require adjustment to the policy rate. We are of the view that the BCCH may begin to ease the policy rate by 25bp as soon as August or September. However, BCCH is still not in a hurry to ease policy and such a move will be dependent on incoming data.

Peru — On hold. If needed, future easing will first focus on adjustment to macroprudential tools (Thursday, July 11th)

- As expected, the Central Bank of Peru (BCRP) maintained the policy rate at 4.25% per year. The accompanying statement stated that inflation is within the target, in the context where domestic economic activity remains near its potential and there is uncertainty in global financial markets.
- It was also indicated that, if deemed necessary, adjustments could be made to banks' reserve requirements to support an orderly evolution of credit. This signals that any forthcoming easing of monetary policy would likely first come through adjustments to macroprudential tools rather than the policy rate.

Mexico — On hold (Friday, July 12th)

- The Central Bank of Mexico (Banxico) maintained the policy rate unchanged at 4.0% per year. This was expected. Banxico's last move was a one-off rate cut of 50bp in March and, since then, it has wanted to keep policy flexibility. Banxico is attentive to the growth outlook and the policy stance relative to the US.
- In the accompanying statement, it cited slower domestic economic activity from weaker external demand and lower fiscal spending. The output gap has turned negative; however, Banxico is still expecting growth acceleration in 2H13. We continue to be of the view that Banxico will also be considering its monetary policy stance relative to advanced economies, especially the US. With the expectation that the Federal Reserve may begin to taper QE measures sooner versus later—and a weakened MXN—Banxico has less reason to ease and may be more inclined to hold at 4.0% for the rest of the year.

Colombia — Release of minutes indicates comfort with wait-and-see mode (Friday, July 12th)

- The minutes from the Central Bank of Colombia (Banrep)'s June meeting, in which the policy rate was kept at 3.25%, signal that monetary policy will remain in a wait-and-see mode. Banrep—which eased by a combined 150bp from November 2012-March 2013—maintains an optimistic growth outlook for 2H13.

Latin America: Inflation, inflation targets, and policy rates
at July 12th 2013

Central Bank	Consumer price inflation (12-m %change) Jan-13	Feb-13	Mar-13	Apr-13	May-13	Jun-13	Inflation target	Policy rate	Last move	Policy stance
Brazil	6.15	6.31	6.59	6.49	6.50	6.70	4.5% (+/- 2%)	8.50	(+) 50bp in July '13	Tightening
Chile	1.58	1.30	1.53	1.00	0.90	1.90	3.0% (+/-1%)	5.00	(-) 25bp in Jan '12	On hold
Colombia	2.00	1.83	1.91	2.02	2.00	2.16	3.0% (+/-1%)	3.25	(-) 50bp in Mar '13	On hold
Mexico	3.25	3.55	4.25	4.65	4.63	4.09	3.0% (+/-1%)	4.00	(-) 50bp in Mar '13	On hold
Peru	2.87	2.45	2.59	2.31	2.46	2.77	2.0% (+/-1%)	4.25	(+) 25bp in May '11	On hold

Source: Central Banks; BTMU Economic Research.

For historical data and commentary following BTMU's Economic News Releases, see our website at: https://reports.us.bk.mufg.jp/portal/site.

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