More cuts in the MPR? Not for the time being

Despite the negative manufacturing prints, we do not see scope for further cuts in the MPR in the short term

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Following the release of manufacturing production for April (-7.5% YoY) which anticipates an IMACEC (monthly economic activity indicator) close to zero (BBVAe: 0.25/0.75% YoY), and with a fairly modest inflation figure about to be released (BBVAe CPI May 0% MoM), voices have again been raised seeking further cuts in the MPR. After holding fast to our view of cuts when the MPR was at 3.5%, we do not rule out further adjustments, but for this to happen will require more discouraging figures, not just as regards activity but also in the labour market, and particularly regarding inflation to force the hand of the monetary authority.

Consequently, we do not recommend betting on further cuts for now. We see both the June monetary policy report and the Board of the central bank vigorously defending a baseline scenario with the MPR ending up at 2.5%. We expect this report to incorporate an adjustment to projected GDP for the year to the 1% to 1.75% range, holding expected inflation slightly below 3% and relying on surveys for the working assumption for the MPR. Not until August might we see adjustments to the MPR if further deterioration in macroeconomic conditions sets in.

What is more, there is a new piece of information from the labour market which contributes towards tempering the more expansive view of monetary policy in the short term, since the deterioration of the labour market seems to be stabilising. Destruction of salaried jobs has come to a halt, and there are even anecdotal reports of job creation. The authorities would not read this figure as a worsening of the labour market, beyond the usual seasonality.

Finally, following strong growth in public spending (7.8% in 1Q17), in April we start to see some moderation, to meet the expansion envisaged in the Budget Act. Public spending grew by 1.5% YoY, so it will contribute little to the figure for aggregate activity of April, but beyond the monthly volatility, we estimate that the central bank will consider that government expenditure falls within the baseline scenario it had in March and which will be implied in the June monetary policy report.

The manufacturing figure for April is admittedly significant news for market rates. Relatively generalised strong contraction at sub-sector level, which could even have been worse were it not for the support of a sector closely linked to natural resources. This alone already puts a cap on April's IMACEC. We expect retail sales to figure among the bad news as well (BBVAe 1.0%; consensus 3.0% YoY) and we already know that public spending slowed sharply in April. **Thus April's IMACEC is unlikely to be compatible with the March monetary policy report's baseline scenario, but probably will be compatible with that of the June report which will revise the growth forecast for 2017 to between 1% and 1.75%**, with growth closer to 1% YoY expected for 2Q17 (the March report forecast between 1.5% and 2.0% YoY for 2Q17).

In terms of prices, the CPI for May has little of an inflationary nature, hence our projection of 0% MoM, which would mark a new but not last retreat in annual inflation (2.4%). This will certainly put pressure on the central bank, although we believe it will cover this in the presentation of the monetary policy report. For June, it is possible to anticipate a positive figure influenced by seasonal factors and the marginally positive effect of petrol (gasoline) prices. However, it is difficult to see significant inflation on the horizon unless the peso depreciates further, which looks unlikely, mainly because of the dollar's weakness internationally. For now, we continue to expect the peso to strengthen further against the dollar during the rest of the year. Such depreciation would require a continuation of fiscal consolidation and a view of at least prolonged monetary stimulus on the part of the central bank, together with some recovery in inflation in the US giving the Federal Reserve grounds for moving ahead with conviction in the process of interest rate adjustment.

The rate of deterioration of the labour market has eased. The unemployment rate in the three months to the end of April was 6.7%, in line with expectations (+0.3 pp YoY). In twelve months, 109,000 jobs were created (1.4% YoY), the majority of them (52,000) in the manufacturing sector, which according to the INE (national statics institute) is due to the increase in the number of self-employed in the bakery sector, despite the poor activity figures for that sector. Once again the bulk of these jobs were in independent categories (employers and self employed), which together contributed 124,000 jobs.

Salaried jobs for their part have stabilised somewhat, with 18,000 jobs created (0.3%), leaving behind the declines of recent months, at least for now. In terms of economic sectors, the major part of salaried job creation was in the public sector (public administration and education), which is offset by year-on-year declines in salaried employment in construction and financial services.

As regards regions, we continue to see great disparity between the north and the extreme south of the country. In the north, the 9.1% unemployment rate in Antofagasta stands out, clearly reflecting the effects of the adjustment in mining activity, while in the south La Araucanía is he la region with the highest unemployment (8.4%), contrasting with the extremely low unemployment rates observed in the extreme south. **In short, these figures should not cause the central bank additional worries as regards forthcoming decisions on monetary policy.**

Public spending grew by just 1.5% YoY in April and will contribute much less than in previous months to growth in aggregate demand. The rate of growth was reduced through both current spending and public investment. Public investment was almost flat relative to the same month of last year (actually down by 0.1% YoY), and current spending, after growing strongly by 15.8% YoY in March, grew by just 1.8% YoY in April. In this way cumulative growth in public spending moderated to 6.2% YoY, showing that in the rest of the year reaching growth of close to 4% is feasible. Progress in budget execution in April 2017 is still slightly higher than that seen in the previous year (30.4% compared with 29.2%), reflecting the concentration of spending in 1Q17, but also showing that there is still room for greater growth in the first part of the year and a slowdown towards year-end, as we saw in 2016. Total revenues in April, the month in which income tax is due, showed growth of 24% YoY, with substantially better results in the payment of taxes on income both in private sector mining and among taxpayers in general.

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