

Latin Weekly Observatory

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Economic Analysis

South America

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Markets
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Inflation is still not taking off, but central banks are starting to restrict liquidity

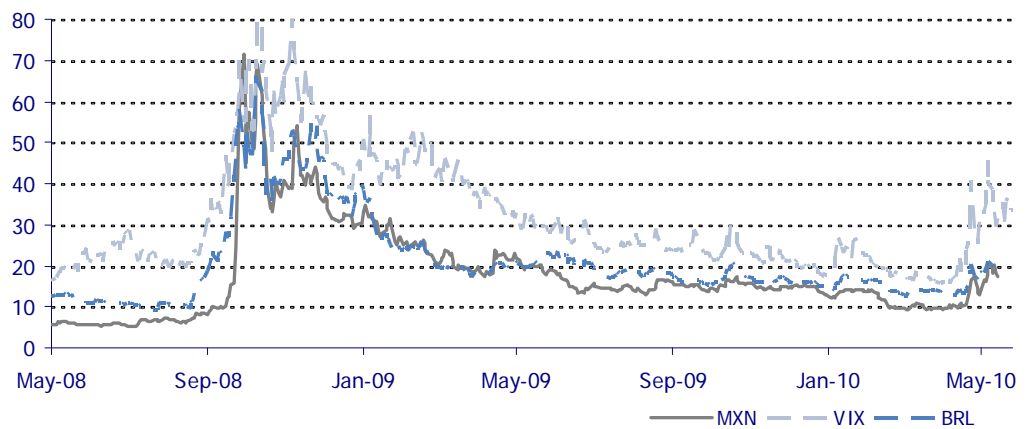
In a week when almost all countries in the region reported their inflation rates, it became clear that it still rather subdued, at least in countries with inflation targets. In fact, Colombia and Mexico reported inflation figures below expectations. However, the central banks of Brazil and Peru raised interest rates to dampen a potentially-dangerous pace of domestic demand growth. Chile's activity figures also point in that direction and the Central Bank should hike rates next week.

High volatility on the markets of the region ends on a positive note

The markets were in step with global trends, with a lot of volatility, but ending on a positive note supported by improvements in commodity prices and news economic activity better than expectative. Currencies tend to rise and equity markets are also following an upward course.

Chart 1

VIX vs. BRL and MXN Implied Volatility (1M)



Source: Bloomberg and BBVA Research

Highlights

Bearish supply-side shocks put a brake on inflation.

Surprising upward activity reports in Chile.

The Central Bank began operations in the band-based system with foreign currency bonds in Venezuela.

Peru: Central Bank raises its official rate by 25 BP, in-line with expectations

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The region's monetary policy and economic activity lead to a favourable outcome for Fixed-income markets

The week saw renewed flows from high-risk instruments towards the fixed income market as a result of: (1) monetary policy movements' in-line with expectations both in Brazil and Peru, and (2) expectation-beating economic activity data, which moderated risk premiums. The week ahead is expected to bring consolidation of fixed-income markets at current levels, as a consequence of reports on recovery. In particular, Chile's monetary policy decision (analysts forecast a 25 BP increase, while the swap curve predicts a likely MPR increase of 50 BP), and this could bolster expectations of hikes defying previous expectations, a situation replicating that of other countries in the region (e.g. Brazil and Peru). Finally, markets will pay attention to the Minutes of the COPOM meeting on Brazil, and the Monetary Policy Report (MPR) in Chile because this will provide more clues on the potential direction of the respective funding rates.

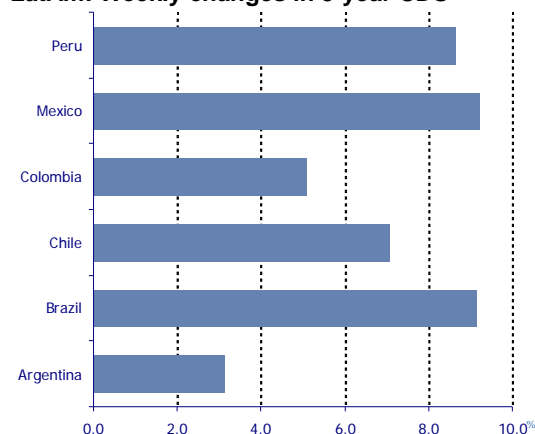
Foreign exchange shows greater differentiation in the region

The past week was distinguished by several events relating to domestic markets: in Argentina, the Central Bank (BCRA) decided that companies and individuals who purchase more than \$250,000 per year must submit evidence of their assets, while monthly purchases exceeding \$20,000 should be developed via a bank transaction. The measure involves greater tax control, rather than an increase of controls on capitals (the existing purchase limits remain unchanged). However, the surprise measures temporarily impacted foreign exchange markets.

In Brazil, the 75 BP increase of the SELIC rate, together with expectations regarding the issue of state debt on the Bovespa, could promote a positive bias for the Real. Markets will therefore keep a close eye on the dollar-buying levels of the Central Bank (to be published on Wednesday 16). In Peru, the monetary tightening cycle was in-line with market expectations, and we do not expect large scale movements over the coming days. Following a positive week for most currencies in the region, we expect further consolidation at levels slightly below resistance levels, based on a reduction of risk premiums, a fact evidenced by the decline in implied volatility of most exchanges. If there are no surprises, we do not expect a significant reaction of CLP and MXN to monetary policy decisions ahead. COP will continue with relative strength in the face of the expectation of favorable cyclic data (e.g. industrial production and retail sales). If the economic recovery environment is supported by the series of data released this week in the U.S. and Europe, we could see a shift in currencies to levels of USDMXN 12.65, USDBRL 1.78, USDCLP 530, and USDCOP 1.919. In the case of USDPEN, we maintain stability expectations in the region of 2.84-2.85.

Chart 2

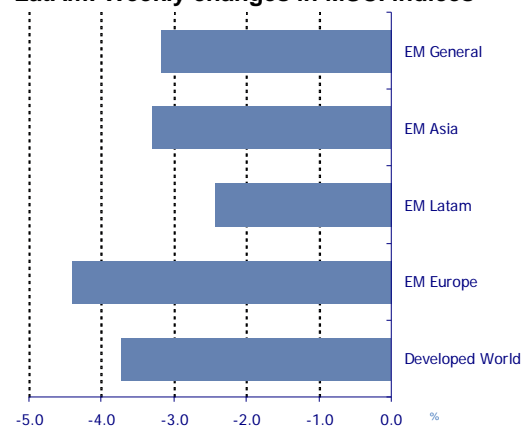
LatAm: Weekly changes in 5-year CDS



Source: Bloomberg and BBVA Research

Chart 3

LatAm: Weekly changes in MSCI indices



Source: Bloomberg and BBVA Research

Highlights

Bearish supply-side shocks put a brake on inflation.

In May, surprising downward inflation figures were reported in Mexico (-0.6%) and Colombia (0.1%), inflation slowed in-line with expectations in Brazil (0.4%) and Venezuela (2.6%), while Chilean figures remained stable, in-line with expectations (0.4%). Lower or stabilizing food prices played an important role in several countries.

Surprising upward activity reports in Chile

IMACEC grew 4.6% (y/y) in April, well above market expectations. Meanwhile, the change in the seasonally-adjusted series was 8.2%, mom. Growth was driven by the trade and services sectors, and a recovery of industry after the fall reported in March. We can thus see that demand is still the driving force behind growth and that effects of the earthquake will be temporary and less significant than expected.

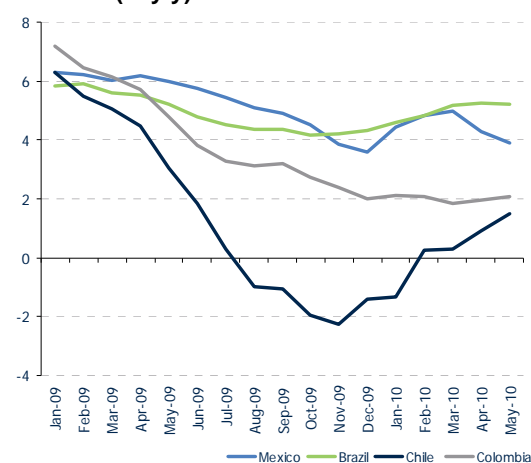
The Central Bank began operations in the band-based system with foreign currency bonds in Venezuela.

The market for buying and selling foreign currency sovereign bonds regulated by the Central Bank (BCV), opened trading with a band system with maximum and minimum caps for implied exchange rates of 4.3 BsF/USD and 5.3 BsF/USD. On the first two days, the amounts traded were very low, at USD 5.0 MM and USD 10.9 MM, respectively, due to strong bureaucratic constraints to access this market. The implied exchange rate of transactions developed showed a tendency towards the band's upper limit, averaging 5.3 BsF/USD. An influx of demand is expected over the coming weeks.

Peru: Central Bank raises its official rate by 25 BP, in-line with expectations

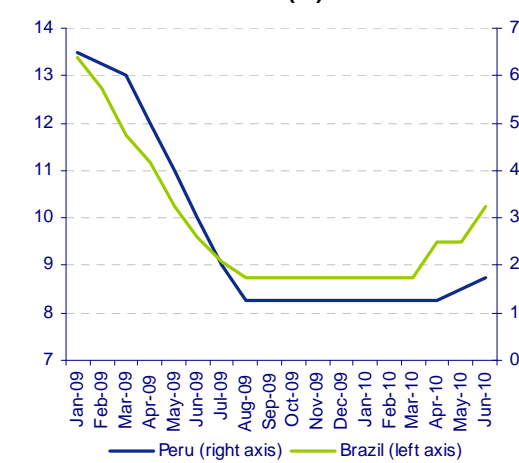
The BCRP raised its official rate to 1.75%, in-line with expectations, in response to strong growth in internal demand.

Chart 4
Inflation. (% y/y)



Source: National Sources

Chart 5
Official interest rates (%)



Source: BBVA Research

Calendar: indicators

Argentina	Date	Period	Forecast	Consensus	Previous	Comment
Consumer Confidence	17-Jun	Jun			48.61	
Industrial Production (y/y) nsa	18-Jun	May			10.2%	We expect confirmation of strong growth of domestic demand
GDP Q	18-Jun	1Q			2.6%	
Current Account - (USD)	18-Jun	1Q			\$1584M	
Brazil	Date	Period	Forecast	Consensus	Previous	Comment
CAGED Creation formal employment	14-18 Jun	May			305,068	
COPOM Mon. Policy Meeting Minutes	17-Jun					Minutes COPOM might give signs on the future course of the monetary policy
FGV inflation IGD-10 (m/m)	16-Jun	Jun			1.11%	
Retail Sales (m/m)	16-Jun	Apr		-1.1%	1.6%	
CPI FIPE - weekly	17-Jun	15-Jun			0.08%	
Tax revenue	17-Jun	May			70906M	
Colombia	Date	Period	Forecast	Consensus	Previous	Comment
Trade Balance	16-Jun	Apr			\$98.7	The information should show that the recovery takes force
Industrial Production (y/y)	18-Jun	Apr			6.4%	
Retail Sales (y/y)	18-Jun	Apr			9.3%	
Mexico	Date	Period	Forecast	Consensus	Previous	Comment
Vehicles production (AMIA)	14-Jun	May			170,277	
Retail Sales (INEGI)	18-Jun	Apr		5.7%	2.3%	
Peru	Date	Period	Forecast	Consensus	Previous	Comment
GDP Q (y/y) nsa.	15-Jun	Apr	8.7%		8.8%	Growth remains strong and above potential
Unemployment	15-Jun	May			9.0%	
Venezuela	Date	Period	Forecast	Consensus	Previous	Comment
Lending (m/m)	16-18 Jun	May			3.1%	

Calendar: events

Chile: Monetary Policy Rate (June, June 15)

Forecast: 0.75%

Consensus: 0.75%

Previous: 0.5%

We forecast a rise of 25 BP, with the rate reaching 0.75%. However, we do not rule out a rise of 50 BP.

Colombia and Mexico: Central Bank Committee (June, June 18)

Consensus: 3.00 and 4.50%, resp. Previous 3.00 and 4.50%, resp.

Next Friday June 18 Colombia and Mexico will hold monetary policy meetings to establish the level of benchmark rates. In both cases the forecast is that central governments will maintain the current rate at 3% in the case of Colombia, and at 4.5% in the case of Mexico.

Calendar: holidays

There will be no holidays in Latin America next week.

Table 1

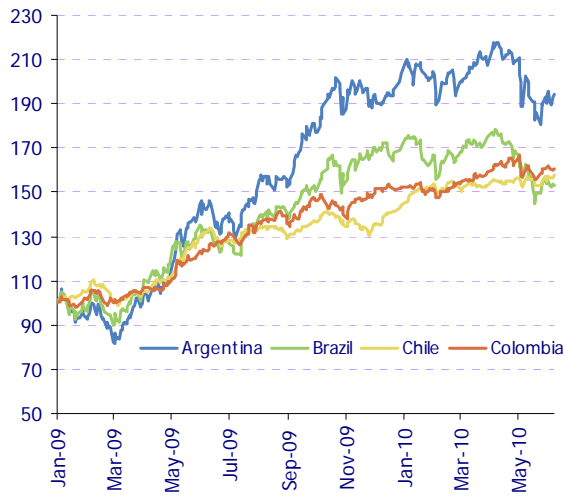
Market data

		Close	Weekly change	Monthly change	Annual change	
Interest rates (changes in bps)	US	3-month Libor rate	0.54	0	10	-9
		2-yr yield	0.74	2	-8	-52
		10-yr yield	3.25	5	-28	-54
	EMU	3-month Euribor rate	0.72	1	4	-55
		2-yr yield	0.47	-1	-14	-122
		10-yr yield	2.57	-1	-37	-106
Exchange rates (changes in %)	Europe	Dollar-Euro	1.208	0.5	-4.0	-13.9
		Pound-Euro	0.83	0.3	-3.0	-2.2
		Swiss Franc-Euro	1.39	-0.4	-0.8	-8.0
	America	Argentina (peso-dollar)	3.92	-0.1	0.6	4.1
		Brazil (real-dollar)	1.81	-2.0	2.1	-5.6
		Colombia (peso-dollar)	1926	-2.0	-1.7	-4.5
		Chile (peso-dollar)	538	-0.3	1.5	-4.3
		Mexico (peso-dollar)	12.69	-1.6	2.7	-5.4
		Peru (Nuevo sol-dollar)	2.84	-0.1	0.3	-4.4
	Asia	Japan (Yen-Dollar)	91.62	-0.2	-1.3	-6.8
		Korea (KRW-Dollar)	1247.35	1.9	10.3	-0.7
		Australia (AUD-Dollar)	0.848	2.6	-5.7	4.3
Comm. (chg %)	Brent oil (\$/b)	74.8	3.7	-6.7	5.4	
	Gold (\$/ounce)	1226.9	0.6	-0.5	30.6	
	Base metals	473.7	0.9	-3.7	16.1	
Stock markets (changes in %)	Euro	Ibex 35	9559	7.1	-4.2	-1.6
		EuroStoxx 50	2642	3.4	-4.4	5.3
		USA (S&P 500)	1082	1.6	-6.5	14.4
	America	Argentina (Merval)	2260	3.6	-0.9	36.6
		Brazil (Bovespa)	62964	2.1	-2.8	17.6
		Colombia (IGBC)	12301	0.6	-0.4	27.2
		Chile (IGPA)	18374	1.8	1.6	18.9
		Mexico (CPI)	32149	3.7	-0.6	26.3
		Peru (General Lima)	14197	2.7	-8.3	2.6
		Venezuela (IBC)	64321	1.6	3.9	48.3
	Asia	Nikkei225	9705	-2.0	-8.6	-4.2
		HSI	19872	0.5	-2.7	5.2
Credit (changes in bps)	Ind.	Itraxx Main	133	6	35	26
		Itraxx Xover	604	14	142	-76
	Sovereign risk	CDS Germany	39	-10	-6	4
		CDS Portugal	290	-62	91	213
		CDS Spain	206	-51	54	110
		CDS USA	38	-3	0	---
		CDS Emerging	286	-8	49	-91
		CDS Argentina	1110	-62	214	-754
		CDS Brazil	141	-5	20	-28
		CDS Colombia	162	-7	17	-45
		CDS Chile	103	-2	15	-21
		CDS Mexico	139	-6	20	-69
		CDS Peru	139	-7	20	-43

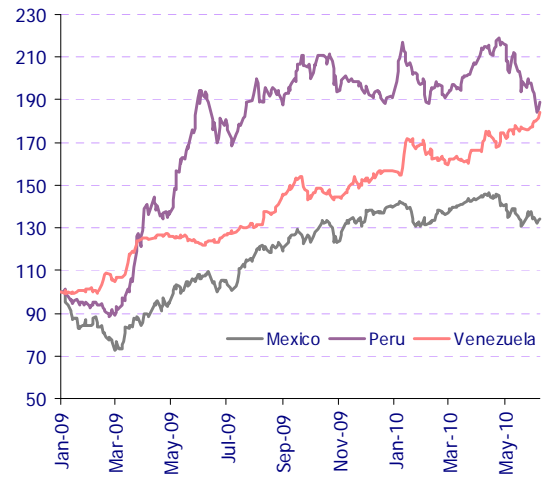
Sources: Bloomberg, Datastream and JP Morgan

Charts 6 & 7

Stock exchanges (base index Jan09=100)



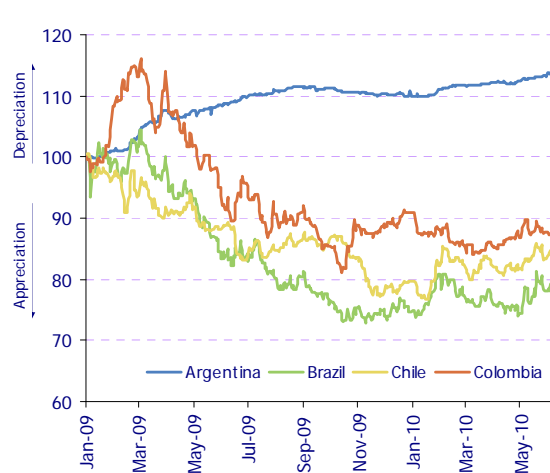
Source: Bloomberg



Source: Bloomberg

Charts 8 & 9

Exchange rates (base index Jan09=100)



Source: Bloomberg



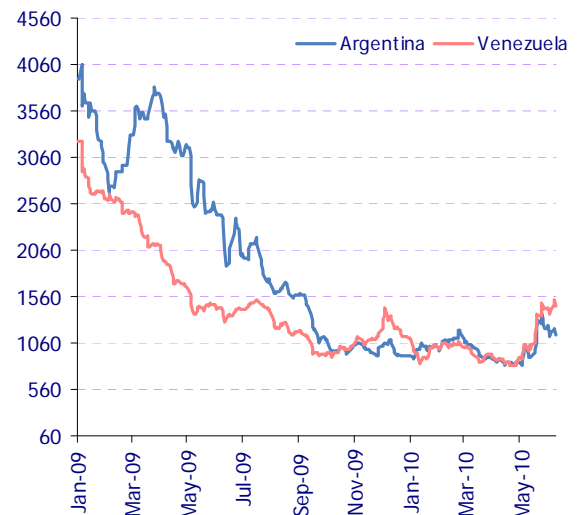
Source: Bloomberg

Charts 10 & 11

Credit Default Swaps (levels)



Source: Bloomberg



Source: Bloomberg

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