Fixed Income & Economics Daily

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FX & RATES STRATEGY RESEARCH

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STRATEGY

- **Brazil: Monetary policy rate preview**
- **Chile: Central bank remains on hold in March**

ECONOMICS

- **Argentina: Unemployment rate declined to 7.2% in 4Q17**
- **Mexico: We maintain our YE2018 FX estimate at MXN$18.20/USD, with adjustments in the monthly trajectory**

BRAZIL: Monetary policy rate preview

- Today, the Central Bank of Brazil will hold its second monetary meeting of the year. Our economists expect Copom to cut the interest rate by 25bps, in line with consensus, taking the interest rate down to 6.50% from 6.75%.
- Copom has been in data-dependent mode, and in the February minutes, the Committee stated that low and falling core inflation could open room for additional monetary easing. We believe recent inflation readings warrant this cut.
- Headline inflation surprised to the downside in the last three months, with February inflation coming in 25bps below the Central Bank's estimate. While food prices continue to put downward pressure on the headline, core inflation has also decelerated, falling 62bps year-to-date.
- Moving forward, our local economists believe that the Central Bank will change its focus from end-2018 inflation forecasts to 2019, where inflation is expected to converge to the target. Under this scenario, they expect COPOM to remain on hold for a long period of time, possibly until 2H19.

CHILE: Central bank remains on hold in March

- Yesterday afternoon, the Central Bank of Chile decided unanimously to keep the rate on hold at 2.50% for the ninth consecutive time, in line with expectations and our view.
- As expected, the board changed the tone to more neutral language, stating that the risks to inflation have moderated as a result of a better growth outlook.
- In terms of growth, the MPC noted that 2H17 GDP was better than expected. The board highlighted that non-mining activities in particular surprised to the upside, while investment picked up at the end of 2017 and consumption improved at the margin.
- On the inflation front, the Central Bank noted that inflation has been in line with their expectations, but recognized that inflation will be lower than previously estimated, driven by CLP appreciation.
- With this outlook of an improved growth environment and low inflation, we believe the MPC will opt to remain on hold for longer, and will not hike until 3Q18 or later.
- Today, the Central Bank will release the Quarterly Monetary Policy Report (IPOM), where we expect the Central Bank to raise its growth forecast.

LATAM ECONOMICS

ARGENTINA

ECONOMICS

Unemployment rate declined to 7.2% in 4Q17

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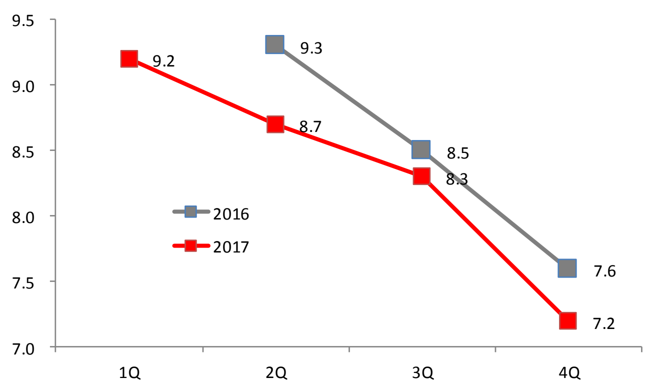
The unemployment rate reached 7.2% in 4Q17, below the 7.6% observed in the last quarter of 2016. Additionally, the employment rate stood at 43% (vs. 41.9% in 4Q16), while the activity rate reached 46.4% (above the 45.3% registered one year before). These latest numbers indicate that the unemployment rate decline is due to both the increase in employment and the decrease of the number of unemployed workers. Geographically, the unemployment rate decrease was observed in five out of the six polled regions, which indicates that employment growth is a regionally consolidated process.

For 2018, we estimate 2.3% annual job creation for registered workers, which will help maintain lower levels of unemployment compared to the historical data.

Unemployment rate decline linked to GDP expansion



Unemployment rate (%). Sources: Indec and Santander.

MEXICO

ECONOMICS

We maintain our YE2018 exchange rate estimate at MXN$18.20/USD, with adjustments in the monthly trajectory

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We maintain our estimate for the exchange rate at the end of 2018 at MXN$18.20/USD, with adjustments in the monthly trajectory. We see reduced pressure on the MXN peso as a result of the weakness of the dollar, improvement in the perception of NAFTA negotiations, and a reduction in the expected impact of U.S. fiscal reform on the MXN peso. As such, we expect the greatest pressure level for the MXN peso to occur between May and June towards MXN$20.20/USD, versus MXN$22/USD as previously estimated.

We estimate lower pressures for the MXN peso in the short term (first half of 2018) as a result of the following factors:

1. The U.S. dollar has weakened against most currencies, particularly against the main currencies of developed economies.

2. Despite upward expectations for Fed interest rates, improvements in the European economy, and the widening of the fiscal deficit and external accounts in the U.S., the dollar has weakened. Looking forward, we expect more stability.

3. There is a perception of lower risks related to the negotiation of the Free Trade Agreement with the United States and Canada. Although progress may be slower than expected, there is a perception of greater certainty that the United States will continue to negotiate.

4. While controversial U.S. proposals remain regarding NAFTA, there is strong support among U.S. economic and political groups to maintain the favored relationship with Canada and Mexico, improving the competitiveness of the region.

In the short term, we continue to warn about:

1. Risks of financial volatility associated with the country’s electoral process.

2. Upward pressure on U.S. Treasury bond interest rates due to the impact of fiscal reform on the budget deficit.

3. Episodes of volatility associated with the Fed’s monetary policy.

4. Significant uncertainty regarding the evolution of oil production in Mexico.

Therefore, we expect the greatest pressure level for the MXN peso to occur between May and June towards MXN$20.20/USD, instead of MXN$22/USD as previously forecast.

For the second half of 2018, we have a positive outlook for the exchange rate closing at MXN$18.2/USD based on the following factors:

1. We expect NAFTA negotiations to continue throughout 2018, with positive news developing in the second half of the year. After the negotiations, we believe the agreement will prevail, with benefits for the three economies.

2. We assume moderate but sustained growth in Mexico's economic activity, with growth in exports, services, remittances and foreign investment.

3. We expect a cautious monetary policy stance with the goal of coaxing inflation towards the target range.

4. We assume continuity of economic policies favoring the implementation of Structural Reforms, consolidation of Public Finances and the autonomy of the Central Bank.

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