

Fixed Income & Economics Daily

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FX & RATES STRATEGY RESEARCH

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STRATEGY

- **Brazil: COPOM surprises with a dovish statement**
- **Mexico: 1H March CPI preview**
- **Peru: Kuczynski resigns the presidency**

ECONOMICS

- **Argentina: GDP Expanded 2.9% in 2017**
- **Brazil: BCB Signals New Rate Cut in May**
- **Poland: Retail Sales Supported by February Freeze**
- **Poland: Companies' Margins Did Not Succumb to Rising Labor Costs**

BRAZIL: Copom surprises with a dovish statement

- Yesterday, the Central Bank of Brazil decided to cut the reference interest rate by 25bps, to 6.50%, in line with expectations.
- However, the statement was more dovish than expected as Copom considered "additional moderate monetary easing as appropriate" for the next meeting, opening the door for an additional cut in April.
- Supporting this view, the MPC noted that the evolution of inflation has been better than expected, and that it now expects lower inflation for both 2018 and 2019, to 3.8% and 4.1%, from 4.2% for each year.
- For the meetings after June, the BCB stated that, without significant changes in the balance of risks and the base scenario, interrupting the easing cycle would be adequate.
- With this in mind, our economists have revised their monetary policy forecast, and now expect the Central Bank to cut the interest rate by 25bps in April, to 6.25% and to hold the policy rate at least until 2H19.
- We expect the market to react to the news, expecting a steeper curve and higher inflation breakeven.

MEXICO: 1H March CPI Preview

- Today, the Statistical Institute (INEGI) will publish the CPI figure for the first half of March. Our local economists expect headline inflation to increase 0.29% (0.25% consensus) during the period, reducing the annual inflation figure to 5.17% from 5.23% in 2H February.
- They estimate that annual core inflation increased 0.27% in the first half of March, taking the annual reading down to 4.18% from 4.23%. Overall, they see energy prices and seasonal increases in services (airfare and vacation packages) as the main drivers.

- Currently, the market has reduced the expected chances of an additional hike. The TIE curve is now pricing only 15bps of total hikes, 9bps in April and 6bps in May. If inflation surprises to the downside we could see further correction in the curve.

PERU: Kuczynski resigns the presidency

- Yesterday, in a national address, PPK announced his official resignation of the presidency. His letter of resignation was sent to Congress and will be addressed in today's session.
- The president's resignation comes one day before the second impeachment vote was scheduled to take place, and after his opponents released videos that showed key allies attempting to buy the support of lawmakers against his impeachment.
- In the speech, PPK assured that there will be an orderly transition. The Constitution states that his first Vice President, Alberto Vizcarra (current ambassador of Peru to Canada) should take office and be appointed President to finish PPK's original mandate until 2021.
- The speaker of Congress would be required to call for general elections if both the first and second Vice Presidents decline the position. This scenario seems unlikely at this stage, as we expect Mr. Vizcarra to be sworn in as President in the coming days.
- All in, the news is positive, as it removes the uncertainty that had persisted for more than four months. While Vizcarra may enjoy a more favorable political environment, we do not rule out additional political noise in the coming months as the Odebrecht probe continues.
- Markets reacted positively to the news, with the PEN strengthening 0.4%. We recommend buying spot and selling one month points in order to invest in PEN at higher rates.

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LATAM ECONOMICS

ARGENTINA

ECONOMICS

GDP Expanded 2.9% in 2017

Rodrigo Park*, Martin Mansur*, Cristian Cancela*

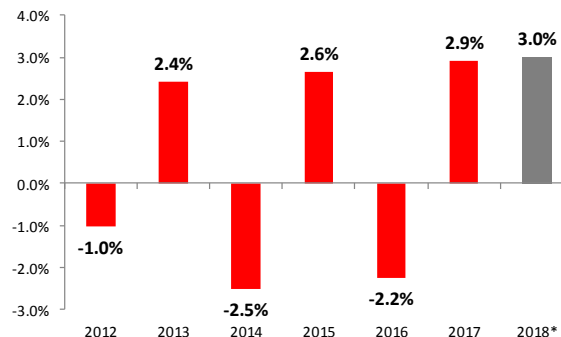
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GDP grew 2.9% y/y in 2017, confirming that the GDP warrant payment will not be triggered (recall that the threshold to trigger the payment is 3% annual growth). Growth was driven by investment expenditures, which rose 11.3% y/y. Private consumption expanded 3.6% y/y due to real payroll growth, while public expenditures increased 2% annually. The external sector contributed negatively to the GDP performance, with imports increasing 14.7% y/y while exports grew only 0.4% y/y. The sectors with strongest expansion were fishing (+14.3% y/y), construction (+10.4% y/y), financial services (+5.1% y/y) and agriculture (+3.9% y/y).

We forecast 2018 GDP expansion of 3% y/y, with investment expenditures up 11% and private consumption up 2.8%. Nevertheless, the latest downward revisions to agricultural production forecasts due to the drought could result in future downward revisions to our current GDP estimates.

Beginning of sustainable GDP growth trend



*Santander estimate. GDP annual growth. Sources: Indec and Santander.

Elsewhere, the trade deficit reached USD903 million in February, larger than the deficit observed in February 2017 (USD217 million). On the external sales front, exports increased 10.1% y/y, driven by primary goods exports (13.8% y/y) and industrial exports (+9.1% y/y). Imports increased 26.3% y/y, expanding across the board: capital goods supplies (+39.8% y/y), intermediate goods (+35.4% y/y), energy (+30.8% y/y), cars (+25.1% y/y), consumption goods (+23.3% y/y) and capital goods (7.3% y/y).

We estimate a trade balance deficit of USD12.7 bn in 2018 (above the USD8.5 bn in 2017) due to high import demand in a context of GDP growth and private investments needs, while we expect exports to be mixed: primary goods affected by drought with industrial export growth propped up by the recovery in Brazilian demand.



BRAZIL

ECONOMICS

BCB Signals New Rate Cut in May

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The Central Bank of Brazil (BCB) cut the benchmark overnight rate (Selic) to 6.5% (from 6.75%), signaling in the statement, in our view, that another 25-bps cut is likely to be delivered in the next monetary policy meeting, on May 16. In its forward guidance expressed in the statement, the BCB stated that “for the next meeting, the committee sees additional moderate monetary easing as appropriate.”

This looser stance can be explained by downward revisions in the BCB’s central forecasts for 2018 and 2019 inflation, to 3.8% and 4.1%, respectively (from 4.2% previously for both years). These projections follow a “more benign than expected” evolution of the committee’s base scenario, with lower-than-expected headline and core inflation readings. This has led the BCB to identify its main concern as undershooting the midpoint of the inflation target for a prolonged period, as 2019 market expectations have recently begun to fall below that level (4.25%).

For the meetings after June, the BCB stated that, without significant changes in the balance of risks and the base scenario, interrupting the easing cycle would be adequate.

With that in mind, we are changing our 2018 year-end Selic rate forecast to 6.25% per year. We believe that the Central Bank will be able to hold the policy rate at that level until 2H19, when a narrowing output gap is likely to create inflationary pressures strong enough to trigger a new hiking cycle. We maintain our 2019 year-end Selic rate forecast at 8.50%.



CEE ECONOMICS

POLAND

ECONOMICS

Retail Sales Supported by February Freeze

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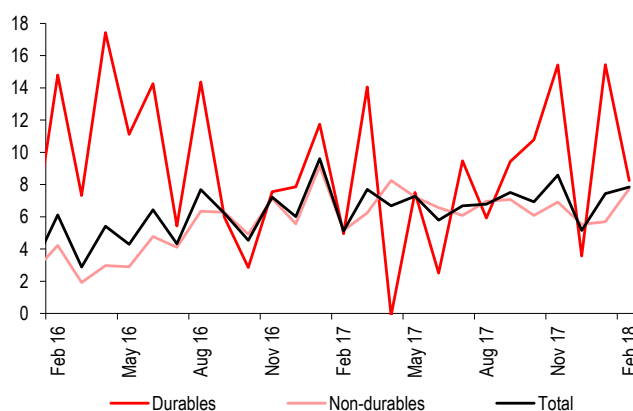
Retail sales in constant prices rose in February by 7.7% y/y, unchanged versus January, in line with market consensus and slightly above our forecast of 7.4% y/y.

February saw a **slowdown in durable goods sales, especially cars** – to 6.9% y/y from 17.9% y/y in January. In our view, the weaker working-day effect is mostly to blame. This category is the most vulnerable to this effect and, in our view, this stems from the fact that it includes car purchases by companies, which are typically made during office hours.

The lower car growth rate was offset by higher growth of fuel sales, which accelerated to 8.8% y/y in February from 1.3% y/y in January. Fuel sales were boosted by a heavy freeze in late February. We track average temperatures in 10 locations across Poland, and in February, this measure was -3.4°C vs. +2.8°C in January, while the number of days with temperatures below -5°C was 8.5 vs. 0.2 in the previous month.

Retail sales data support our forecast of robust private consumption (up c5% y/y in 1Q18). **In the coming months we expect more positive retail sales prints, supported by high consumer confidence and a favorable labor market environment.** March data are likely to show some distortions due to the Sunday trade ban, but it is difficult to estimate the potential short-term impact from the new regulation on sales.

Retail sales: durables vs. non-durables (% y/y)



Source: Poland Central Statistics Office, BZ WBK.



POLAND

ECONOMICS

Companies' Margins Did Not Succumb to Rising Labor Costs

Grzegorz Ogonek*

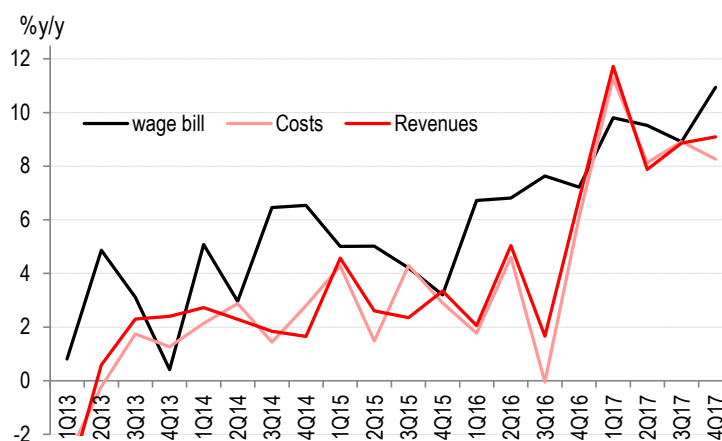
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Stats office data on non-financial corporate quarterly earnings showed revenues rising 9.1% y/y in 4Q17 while costs rose 8.3% y/y. The gross financial result was 29.5% higher y/y and the net result was 37.4% higher y/y. **The data confirm that the wage bill is rising rapidly, up 10.9% y/y in 4Q17** compared to +8.9% in 3Q and +9.5% in 2Q. Wages once again posted a relatively high contribution (1.6pp) to the overall y/y increase of costs, with the two biggest contributors being materials (3.9pp) and external services (1.9pp). **However, the strong growth of the wage bill did not undermine margins** – the 4Q-moving average profit margin rose to 4.4% in 4Q17 from 4.2% in 3Q17, reaching the highest level since 2012. Thus, companies may not yet be experiencing significant pressure from wage costs which could lead to higher prices of end products.

Based on financial results from the largest companies, we estimate **that investment rose 12.0% y/y in real terms in 4Q17, as compared to total growth of investment in the economy by 11.3% y/y**. This suggests that a recovery of investment occurred in the private sector as well.

Enterprise results



Source: Poland Central Statistics Office, BZ WBK.



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