

Fixed Income & Economics Daily

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FX & RATES STRATEGY RESEARCH

Diana Ayala

212-407-0979

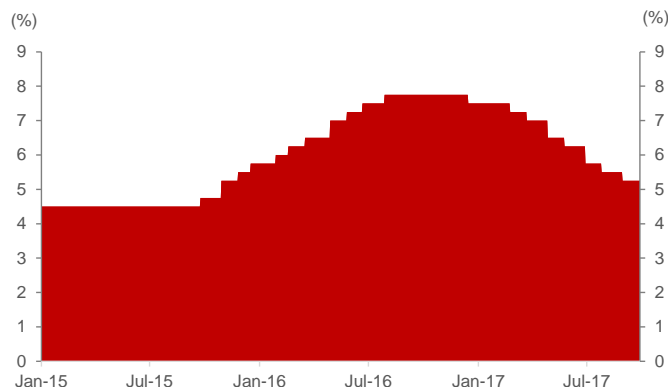
diana.ayala@santander.us

• COLOMBIA: BanRep On Hold in September

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- The Central Bank of Colombia (BanRep) kept the reference rate on hold at 5.25%, in line with our view and the consensus expectation.
- The decision was split, as expected, with 5 members voting to keep the rate on hold and 2 members voting for an additional 25-bp cut.
- The MPC acknowledge the risks of lower economic activity than expected; however, they stated that there is still uncertainty regarding the pace that inflation will converge to the 3% target and noted that core inflation and inflation expectations remain above 3%.
- The board has not closed the door for further cuts to give the economy an additional impulse. However, as Minister Cardenas noted in the press conference, the majority of members need more evidence that inflation will converge to the target before deciding to move the interest rate into expansionary territory.
- According to the latest central bank survey, analysts expect the board to provide further easing in December of this year, when headline annual inflation starts to decrease. We consider that BanRep will remain on hold the rest of the year and could cut the interest as early as 1Q18.
- In the press conference, Governor Echeverria commented that positive inflation readings in the first months of next year could warrant additional cuts, reinforcing our view. Yet, we acknowledge the risk that better-than-expected inflationary dynamics in the coming months could push the decision to cut earlier.
- Finally, in addition to inflation dynamics and the output gap, the board stated that it will also pay close attention to the current account deficit in determining monetary policy in the next meetings.

BanRep On Hold at 5.25%



Source: Bloomberg, BanRep.

IMPORTANT DISCLOSURES/CERTIFICATIONS ARE ATTACHED.

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ECONOMICS

Brazil Macro Compass

Lower Interest Rates Driving Credit Expansion

Maurício Molan* and Team
mmolan@santander.com.br
5511-3012-5724

What's New?

Contrary to some preconceived notions (e.g., credit channels do not work properly in Brazil, reductions in the benchmark interest rate do not affect lending rates to individuals and companies, and a resumption in borrowing to consume is a long way off due to excessively indebted families) the latest Central Bank data show that the average lending rate to individuals fell 6.6 pp over the 12 months up to August. In that same period, outstanding loans increased 3.1% (in 2016 this indicator stayed practically flat).

It is important to highlight that changes in the base rate tend to be amplified in lending rates, but with an estimated 6-month lag. Therefore, we expect lending rates to continue their steep decline over the next few months.

On the fiscal side, the central government reported a better-than-consensus primary deficit in August (BRL9.6 billion, versus an expected BRL15.6 billion). The 12-month primary deficit stands at 2.6% of GDP. We expect the government to meet this year's fiscal target (a BRL159 billion deficit), though that could depend upon "extraordinary revenue" from privatizations and concessions — on that note, the past week also brought good news, with successful auctions of hydropower plants and oil exploration areas.

Unemployment ticked down for the fourth straight month in August, at 12.5%. Although the job market recovery is moderate, along with the aforementioned credit expansion, it should contribute to a recovery in consumption (we expect household consumption to grow 2.9% in 2018).

Upcoming Releases

September CPI inflation data will be released on Friday. We expect monthly inflation at 0.14% and year-end 12-month inflation at 3.2%. Other relevant data in the week relate to economic activity: auto production and sales figures should, in our view, corroborate our estimates for 30% and 10% growth, respectively, for 2017 (full year). August industrial production will be known on Tuesday; we expect flat (seasonally adjusted) production MoM, with a corresponding 4.5% growth YoY.

Political Agenda

The deadline for changes in the electoral law to be applied for the 2018 elections is October 7. Therefore, the Senate needs to agree with the full constitutional amendment proposal approved in the Lower House; otherwise, there will not be time for a new discussion and voting. The Lower House approved the end of coalitions in proportional elections (to be applied from 2020 elections onward) and the introduction of a national vote threshold for parties to have access to public funds. Each party needs to reach that threshold individually; the alternative of "party federations" was vetoed. Additionally, representatives will be allowed to change parties during the six months leading up to the voting date.

The Lower House is also expected to vote on some amendments to the proposed tax amnesty program (Refis), approved on September 27. The bill extends the deadline to join the program until October 31 and provides a more generous haircut on due interest to debts up to BRL15 million.

Finally, lawyers for President Temer and two cabinet ministers are expected to initiate their defense against the criminal charges brought by the Office of the Chief Prosecutor to the Lower House. These lawyers will be allocated up to 10 sessions, though their defense may be concluded earlier if the same strategy used during the process related to earlier charges (presented in June) is repeated. In any case, the procedures leading to a final floor vote are expected to take most of October.



Recent Publications

- *Social Security Reform: Well Beyond the (Necessary) Fiscal Impact* (September 13, 2017)
- *Monetary Policy and the Last Crusade* (August 30, 2017)
- *Unusually Low Risk Aversion Triggers a More Bullish Scenario in the Short Term* (August 17, 2017)
- *Fiscal Policy: 2017-2020 Long Range Fiscal Targets* (August 16, 2017)

BRAZIL

ECONOMICS

Labor Market: Beginning a New Cycle

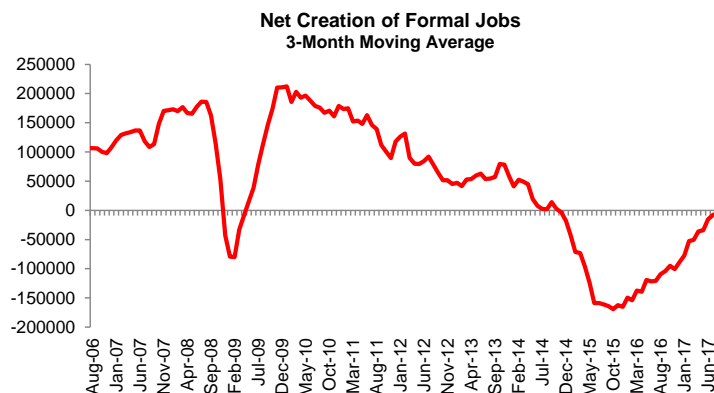
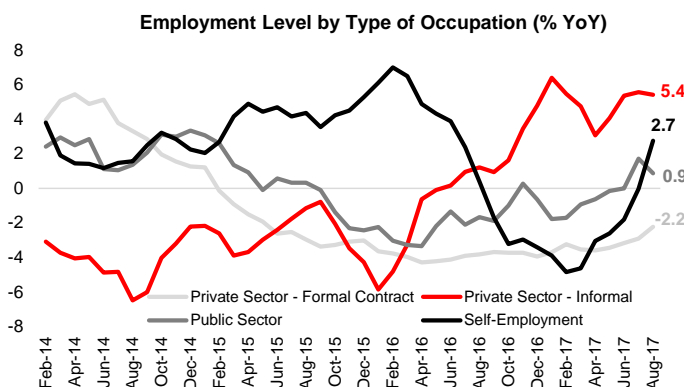
Tatiana Pinheiro*, **Adriana Dupita***, **Everton Gomes***, **Luciano Sobral***, **Rodolfo Margato***, **Mirella Hirakawa***

+5511-3012-5179

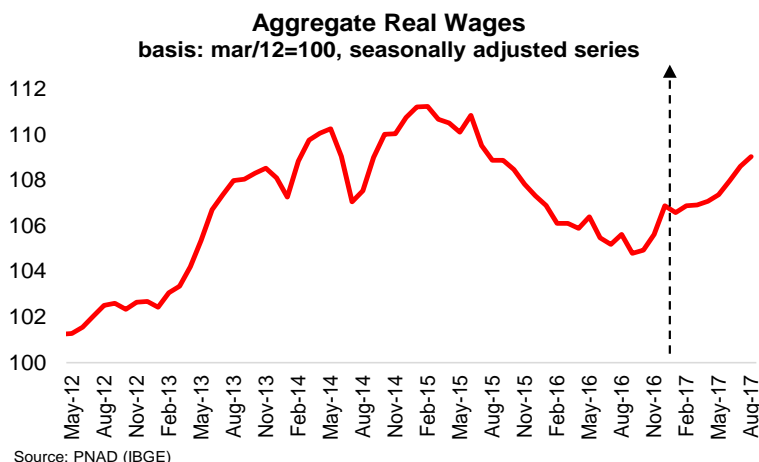
tatiana.pinheiro@santander.com.br

According to the National Household Sample Survey published last Friday, Brazil's unemployment rate decreased to 12.6% in August from 12.8% in July, exactly in-line with our forecast and slightly below market consensus (of 12.7%).

In short, August figures confirmed the gradual improvement in the Brazilian labor market. Based on seasonally adjusted data, the national unemployment rate showed the fourth decline in a row (it fell from 13.1% in April to 12.5% in August, according to our estimates). It is worth noting that the reduction in local unemployment has been mainly driven by the increase in the employed population, i.e., it is not associated with a mere labor force despondency (indeed, the labor force has been growing at a very significant rate). While for now most of the increase in employment is coming from "self-employment" and "private jobs without a formal contract", we reinforce our expectation that net creation of formal jobs will return to positive territory in the coming months (see the charts below), since the recovery of economic activity has been gaining momentum.

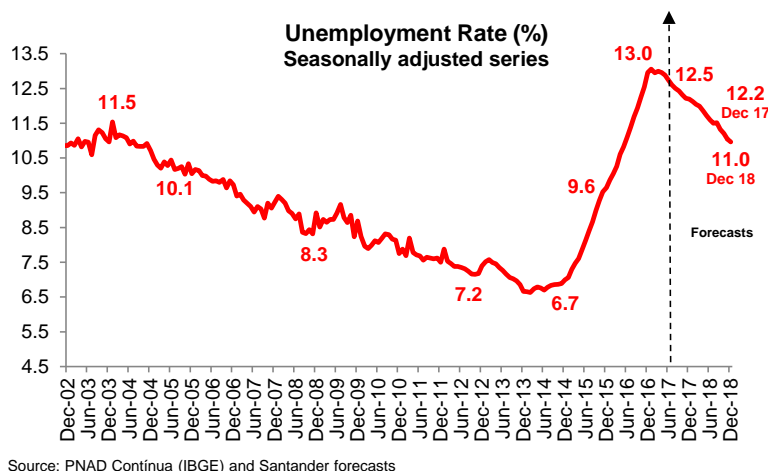


Furthermore, we highlight the important contribution to the economic recovery of the continued expansion in aggregate real wages (+2.0% from April to August); that, coupled with the massive interest rate cuts, should keep the household consumption as the main driving force behind the resumption of economic growth. In fact, as we have emphasized, **the higher disposable income (in view of the falling inflation) and lower income burden with debt service will likely be consolidated as the main explanatory factors for the resurgence of private consumption in Brazil.** (For more information, please see our report [“Understated Consumption Drivers, June 12, 2017”](#)).



Most of our projections for the Brazilian labor market this year have proven accurate – e.g., the unemployment rate has peaked in mid-year (at around 13%) and real wages have resumed growth. The more pessimistic views about these variables, such as the scenario of a jobless recovery, seems very improbable in light of recent statistics.

On the other hand, we believe that unemployment will remain relatively high (despite falling) in the coming years – we do not expect the indicator to reach single digit levels before mid-2019. Hence, demand-driven inflationary pressures are unlikely to emerge over that period, which means that interest rates should remain below neutral levels for a long period, in our view.





CONTACTS / IMPORTANT DISCLOSURES

Macro Research

Maciej Reluga*	Head Macro, Rates & FX Strategy – CEE	maciej.reluga@bzwbk.pl	48-22-534-1888
Sergio Galván*	Economist – Argentina	sgalvan@santanderrio.com.ar	54-11-4341-1728
Maurício Molan*	Economist – Brazil	mmolan@santander.com.br	5511-3012-5724
Juan Pablo Cabrera*	Economist – Chile	jcabrera@santander.cl	562-2320-3778
Diana Ayala	Economist - Colombia	diana.ayala@santander.us	212-350-0979
David Franco*	Economist – Mexico	dafranco@santander.com.mx	5255 5269-1932
Tatiana Pinheiro*	Economist – Peru	tatiana.pinheiro@santander.com.br	5511-3012-5179
Piotr Bielski*	Economist – Poland	piotr.bielski@bzwbk.pl	48-22-534-1888
Marcela Bensión*	Economist – Uruguay	mbension@santander.com.uy	5982-1747-5537

Fixed Income Research

Diana Ayala	Macro, Rates & FX Strategy – Latin America	diana.ayala@santander.us	212-407-0979
Juan Pablo Cabrera*	Chief Rates & FX Strategist – Chile	jcabrera@santander.cl	562-2320-3778
Aaron Holsberg	Head of Credit Research	aholsberg@santander.us	212-407-0978

Equity Research

Christian Audi	Head LatAm Equity Research	caudi@santander.us	212-350-3991
Andres Soto	Head, Andean	asoto@santander.us	212-407-0976
Walter Chiarvesio*	Head, Argentina	wchiarvesio@santanderrio.com.ar	5411-4341-1564
Valder Nogueira*	Head, Brazil	jvalder@santander.com.br	5511-3012-5747
Pedro Balcao Reis*	Head, Mexico	pbalcao@santander.com.mx	5255-5269-2264

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