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LATAM FX Talking: Monetary policy needle turns more dovish

Much like the US and the EU, monetary policy in LATAM has also incorporated a dovish bias over the past few months. Economic activity has disappointed in both Brazil and Mexico, while inflation has surprised consistently to the downside, particularly in Mexico, and throughout the Andes, paving the way for a reassessment of current monetary policy guidance



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Executive summary

For **Chile**, this should translate into a delayed rate-normalisation cycle, with BCCh likely losing appetite for a faster rate-hiking cycle, after the two hikes already implemented, amid growing concerns over the strength of the global economy. We also expect the Colombian and Peruvian central banks to extend the current neutral guidance for longer than initially expected, even though economic activity has shown stronger resilience in both places.

Mexico is, however, in our opinion, where the policy guidance has greater room to manoeuvre. With inflation converging convincingly to the targeted range in the coming

months, Banxico should overcome its primary barrier for a dovish monetary policy shift. With the policy rate deep inside the contractionary territory, and economic activity decelerating, as investment contracts, the case for policy easing should strengthen. Overall, we expect a deeper cycle than currently expected, with a first 25 basis point cut possibly as early as June 27, and no later than 3Q, which should reduce MXN support towards yearend.

In **Brazil**, policymaking is mostly on hold, waiting for Congress to conclude its debate of the all-important social security reform. Even though inflation and economic cycle considerations could in principle accommodate an additional monetary easing, uncertainty vis-à-vis the reform should prevent BACEN from acting until the reform is approved, which we expect to take place sometime in 3Q. A sharp BRL rally following that approval could be an important catalyst for rate cuts.

Argentina is, again, a case apart, with monetary tightening being used to stabilise local assets amid heightened volatility driven by external events and the lingering deterioration of local macro fundamentals, with higher than expected inflation and disappointing growth, adding to investor concerns over the outcome of the October Presidential election.

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