

ECONOMICS: LATIN AMERICA PERSPECTIVES

LATIN AMERICA: THE MANY FLAVORS OF MONETARY POLICY

+ Fernando J. Losada, Senior Economist—Latin America Research, fernando.losada@abglobal.com

One thing Latin American countries will have in common this year is subpar growth. That means regional central banks will probably keep monetary policy loose even as they monitor exchange-rate developments. But all monetary policies aren't alike, and we expect a rich variety of possible policy rate moves in 2015.

Slow Growth on the Horizon

Latin American economies have a tough year ahead of them. The drop in commodity prices has reduced national incomes, put pressure on fiscal accounts and discouraged investment. We expect the region's gross domestic product (GDP) to expand by no more than 1% this year on a weighted-average basis—a pace similar to that seen in 2014. Worse yet, risks to this forecast are weighted to the downside. Brazil's contraction could be even worse than expected if water and electricity shortages occur.

According to our calculations, Latin America's potential growth rate is at least twice as high as our forecast. That adds up to a negative output gap—even when taking into consideration the lower rate of trend growth caused by lower raw materials prices. In most countries, this should result in soft demand and limited pressure on prices. (Argentina and Venezuela are exceptions—both are facing high inflation.)

This should keep core inflation rates in the region in check. In fact, even headline inflation, which includes energy and food costs, should be modest, thanks to lower

domestic gasoline prices. Weak demand dynamics around the region should also limit the pass-through from currency depreciation to domestic prices. This backdrop suggests that regional central banks are likely to maintain a fairly accommodative stance, at least until the US Federal Reserve launches its own tightening exercise.

Latin American central banks aren't the only ones embracing monetary accommodation. So far this year, 18 central banks across the globe have relaxed their monetary policies either by lowering reference rates or by introducing quantitative easing in response to subdued growth (*Display 1*). These moves also provide additional room for maneuver once the Fed lifts interest rates, although the minutes from the Fed's last monetary policy meeting suggest that may not happen until the second half of the year.

Brazil: The Regional Outlier

In Latin America, however, some differences have started to appear among countries. Brazil is the clear outlier. Monetary policy there has run counter to the regional norm this year. The start of a new presidential term and the arrival of a more

Display 1 Monetary Accommodation Galore

Central Banks That Have Relaxed Monetary Conditions So Far in 2015

Albania	Pakistan
Australia	Peru
Canada	Romania
China	Russia
Denmark	Singapore
Egypt	Sweden
European Central Bank	Switzerland
India	Turkey
Indonesia	Uzbekistan

As of February 18, 2015
Source: Bloomberg

orthodox economic team have resulted in tighter fiscal and monetary policies despite lackluster economic activity. This policy restraint is needed to rein in inflation and prevent further deterioration of Brazil's public debt ratios. The central bank resumed hiking rates just after the presidential election in October and has since pushed up policy rates by 125 basis points (*Display 2, next page*).

We think this tighter policy will lead to a decline in inflation rates, especially since Brazil's GDP is likely to contract this year. Therefore, we cannot rule out the possibili-

ty that the central bank will start to reduce rates toward the end of 2015.

Mexico Starts to Talk Tough

Mexico's central bank, meanwhile, has started to strike a more hawkish note in its communications. Since surprising the market with a rate cut last June, Banco de Mexico (Banxico) has remained neutral, maintaining its target funding rate at 3%. And while economic indicators have shown only a mild recovery over recent quarters and sharply lower inflation, recent messages from policymakers have been on the hawkish side. We think this is an attempt to reassure the market that lax monetary policy won't compromise overall financial stability.

But we shouldn't forget that annual inflation is now virtually in line with the medium-term target. That means recent Mexican peso depreciation hasn't resulted in sharply higher prices. We think Banxico will wait for the Fed to move first before adjusting interest rates, and we assign a low probability to its deciding to act first.

Dovish Bias in Andean Countries

Colombia and Peru have been severely affected by the drop in commodity

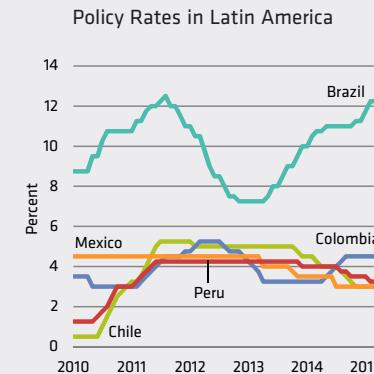
prices—for oil in the former, for metals and mining in the latter. In Colombia, GDP growth is expected to slow by roughly 2% this year. While the central bank would in principle have room to reduce its reference rate, recent statements by bank officials suggest they are satisfied with the endogenous relaxation of financial conditions caused by recent currency depreciation. We still think, though, that the central bank has a slight dovish bias and could cut rates if economic activity slows further.

In Peru, the central bank has been steadily reducing its reference rate for more than a year—it's down 100 basis points since November 2013. Peru's currency, like Colombia's, has weakened, and the central bank has relaxed financing conditions further by lowering mandatory reserve requirements.

However, there's still a significant gap between actual and potential growth. This is why we think policymakers in Peru also have a slight dovish bias and could reduce rates further.

Finally, Chile's central bank has adopted a neutral stance, but only after engineering

Display 2
Brazil Is the Outlier



Through February 18, 2015
Source: Bloomberg and Haver Analytics

an aggressive easing cycle that has shaved 225 basis points off the policy rate since the start of 2012. Growth has decelerated, but the central bank now appears willing to wait for the monetary transmission mechanism to work in full. For the time being, we don't expect any changes to the reference rate.■

The information contained herein reflects the views of AllianceBernstein L.P. or its affiliates and sources it believes are reliable as of the date of this publication. AllianceBernstein L.P. makes no representations or warranties concerning the accuracy of any data. There is no guarantee that any projection, forecast or opinion in this material will be realized. Past performance does not guarantee future results. The views expressed herein may change at any time after the date of this publication. This document is for informational purposes only and does not constitute investment advice. AllianceBernstein L.P. does not provide tax, legal or accounting advice. It does not take an investor's personal investment objectives or financial situation into account; investors should discuss their individual circumstances with appropriate professionals before making any decisions. This information should not be construed as sales or marketing material or an offer or solicitation for the purchase or sale of any financial instrument, product or service sponsored by AllianceBernstein or its affiliates.

Note to Canadian Readers: AllianceBernstein provides its investment management services in Canada through its affiliates Sanford C. Bernstein & Co., LLC and AllianceBernstein Canada, Inc.

Note to European Readers: European readers should note that this document has been issued by AllianceBernstein Limited, which is authorised and regulated in the UK by the Financial Conduct Authority. The registered office of the firm is: 50 Berkeley Street, London W1J 8HA.

Note to Australian Readers: This document has been issued by AllianceBernstein Australia Limited (ABN 53 095 022 718 and AFSL 230698). Information in this document is only intended for persons that qualify as "wholesale clients," as defined in the Corporations Act 2001 (Cth of Australia), and should not be construed as advice.

Note to New Zealand Readers: This document has been issued by AllianceBernstein New Zealand Limited (AK 980088, FSP17141). Information in this document is only intended for persons who qualify as "wholesale clients," as defined by the Financial Advisers Act 2008 (New Zealand), and should not be construed as advice.

Note to Readers in Vietnam, the Philippines, Brunei, Thailand, Indonesia, China, Taiwan and India: This document is provided solely for the informational purposes of institutional investors and is not investment advice, nor is it intended to be an offer or solicitation, and does not pertain to the specific investment objectives, financial situation or particular needs of any person to whom it is sent. This document is not an advertisement and is not intended for public use or additional distribution. AllianceBernstein is not licensed to, and does not purport to, conduct any business or offer any services in any of the above countries.

Note to Readers in Malaysia: Nothing in this document should be construed as an invitation or offer to subscribe to or purchase any securities, nor is it an offering of fund management services, advice, analysis or a report concerning securities. AllianceBernstein is not licensed to, and does not purport to, conduct any business or offer any services in Malaysia. Without prejudice to the generality of the foregoing, AllianceBernstein does not hold a capital markets services license under the Capital Markets & Services Act 2007 of Malaysia, and does not, nor does it purport to, deal in securities, trade in futures contracts, manage funds, offer corporate finance or investment advice, or provide financial planning services in Malaysia.

Note to Singapore Readers: This document has been issued by AllianceBernstein (Singapore) Ltd. ("ABSIL", Company Registration No. 199703364C). ABSIL is a holder of a Capital Markets Services Licence issued by the Monetary Authority of Singapore to conduct regulated activity in fund management and dealing in securities. AllianceBernstein (Luxembourg) S.à r.l. is the management company of the portfolio and has appointed ABSIL as its agent for service of process and as its Singapore representative.

Note to Taiwan Readers: AllianceBernstein L.P. does not provide investment advice or portfolio-management services or deal in securities in Taiwan. The products/services illustrated here may not be available to Taiwan residents. Before proceeding with your investment decision, please consult your investment advisor.

Note to Hong Kong Readers: This document is issued in Hong Kong by AllianceBernstein Hong Kong Limited (聯博香港有限公司), a licensed entity regulated by the Hong Kong Securities and Futures Commission. This document has not been reviewed by the Hong Kong Securities and Futures Commission.