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Insigneo Weekly Dispatch

Latam Central Banks: leading the way

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Latam Central Banks: leading the way

Last week, several central banks around the world held high-stakes meetings to determine the course of monetary policy in the future. Developed countries stole the spotlight by, in most cases, keeping their rates stable while signaling that rate cuts could occur relatively soon. Perhaps lost in the headlines, we want to turn our attention to the Latin American central banks and what their decoupling from advanced economies may mean for the investment world. As we discussed in our last weekly, the Fed stole the spotlight last week when it announced its monetary policy decision of keeping rates unchanged. Even if disinflation may have stalled and the job market remained strong, Chair Powell maintained a data dependent stance that needed additional confirmation before proceeding with a rate cut.

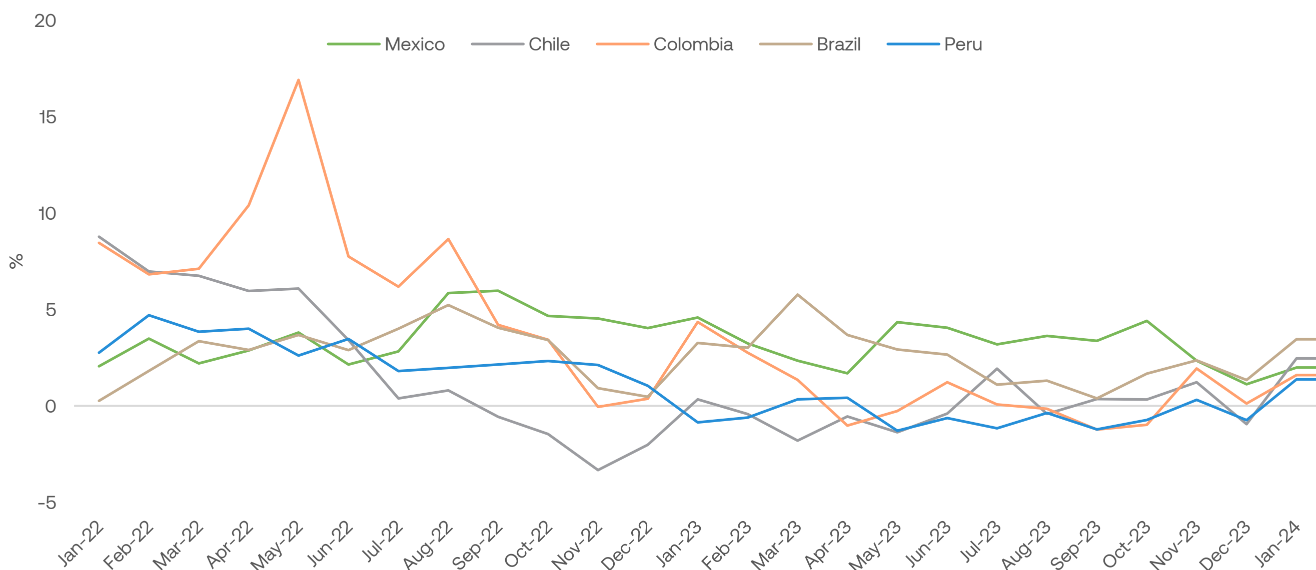
Meanwhile, the narrative took a different course in Latin America – it is no longer a matter of when Central Banks may start implementing an easier monetary policy but of what the terminal rate of this easing cycle may be for the different monetary authorities in the region. Just as was the case at the time of implementing a more aggressive monetary policy, Latin American Central Banks seem to have a head start versus other developed economies. Brazil was the trailblazer in the region after hiking the Selic rate for the first time in March 2021 and was closely followed by the other Central Banks in the region, all with the communal goal of bringing inflation back to target. Currently, it seems like Latin America will favor local fundamentals once more over the international scenario by, again, beginning its new monetary policy cycle ahead of the developed economies.

In terms of easing, Chile was the first country to cut its monetary policy rate, closely followed by Brazil and Peru, with Colombia and, lastly, Mexico following suit. However, something worth highlighting from the Latam monetary policy meetings from last week was the undertone of

caution expressed by most central banks. Even if most banks cut their monetary policy rates, they emphasized in their forward guidance that inflation convergence was starting to be visible on the horizon, and in some cases even performed upward revisions to what was a languid growth projection for 2024. Latin America is not immune from the uncertainty that still surrounds the global environment. Even if most post-meeting press releases did not make a specific mention of the Fed, it would be safe to say that Latin American central banks continue to hope for the Fed to achieve a soft landing, which would grant them an additional safety net for their easing cycle to continue.

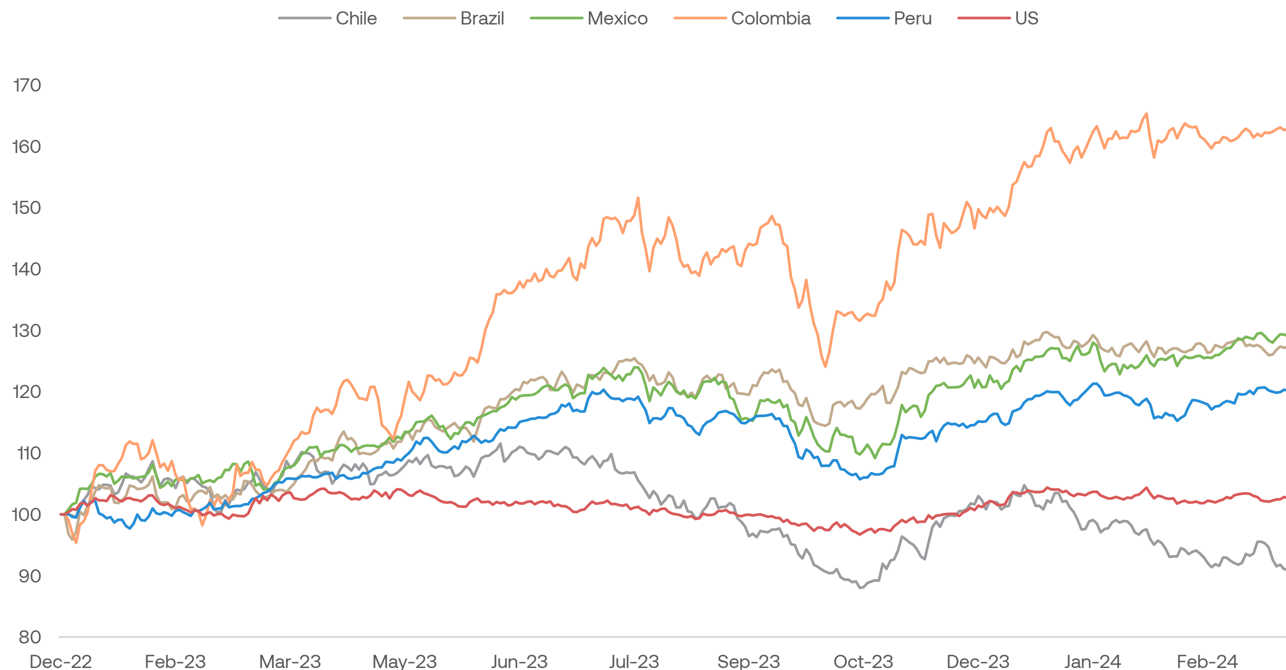
Still, we would be remiss if we did not highlight that Latin American central banks have several reasons to maintain their steady cutting rhythm, albeit at a more cautious pace than what was initially expected. Inflation has been relatively benign in the region – which in turn has led sovereign real rates back into positive territory across the various sovereign curves. Activity has remained resilient, and is even showing signs of a mild rebound in activity indexes for the last months of the first quarter as this graph demonstrates:

Activity indexes – Latin America



Source: Bloomberg. Data as of January 2024. Depicted are Mexico's IGAE, Chile's IMACEC, Colombia's ISE, Brazil's IBC - Br, and Peru's National Production Index

Furthermore, it is worth looking at the performance of the different fixed income indices, which also prove the point that the independence of the Latin American central banks has been beneficial for this asset class. When normalizing the Bloomberg Total Return Indices for each country and comparing them to the US fixed income market, it should be noted that, except Chile, Latin American fixed income has been a better alternative in terms of return.



Source: Bloomberg. Data as of March 27, 2024, where December 30, 2022 = 100. The graph includes all Bloomberg EM Local Currency Total Return Index Value Unhedged for the Latam countries in question, compared to the US Treasury Index.

It is worth considering that these indices are measured in USD, and the majority of Latam currencies —except the Chilean peso— appreciated in 2023, which also adds to the impressive returns depicted in the chart above. Some Central Banks also mentioned this FX appreciation, highlighting that the appreciation trend helps mitigate inflationary pressures and reduce external vulnerabilities. In sum, Latam central banks have been blazing the trail in terms of monetary policy easing amid favorable macroeconomic variables that have set the stage for rate cuts, and those independent efforts seem to be paying off. If they continue to exercise caution and do not get ahead of themselves in terms of easing too much, the region could continue to exemplify a prudent, favorable monetary policy implementation that favors both investors and the economy. ■

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