A Monetary Policy Report without big surprises

Internationally, the CPI above expectations in the US shakes global markets

After increasing the monetary policy rate by 75 base points, this week the Central Bank presented the Monetary Policy Report (IPoM) for June, where it significantly adjusted upwards the inflation projections for this year (from 5.6% forecast in March up to 9.9% , in line with market estimates. This, in a context where the CPI for May once again showed an increase (1.2% m/m) that raised inflation to 11.5%.

In its report, the Council increased the growth range of local activity expected for 2022 (from 1%/2% to 1.5%/2.25%) and lowered it significantly for 2023 (from -0.25 %/0.75%, up to -1%/0%). These changes are explained by the resilience that consumption has shown so far —which has been sustained by the liquidity that households still maintain— which would continue to rise for longer and then contract in 2023. To this is added a more punished investment both this year and next due to tighter financial conditions, a high level of uncertainty and a weaker external sector as a result of less favorable external conditions.

According to the report's projections, the slowdown in activity from the second half of the year, together with a moderation in the prices of raw materials, would lead to a rapid convergence of inflation to the target already in the second half of 2023 (2.9% in December). This constitutes a significant discrepancy from the market view —and our own projections—, where a much more gradual convergence is expected (4.6% in December 2023, according to the Survey of Economic Expectations).

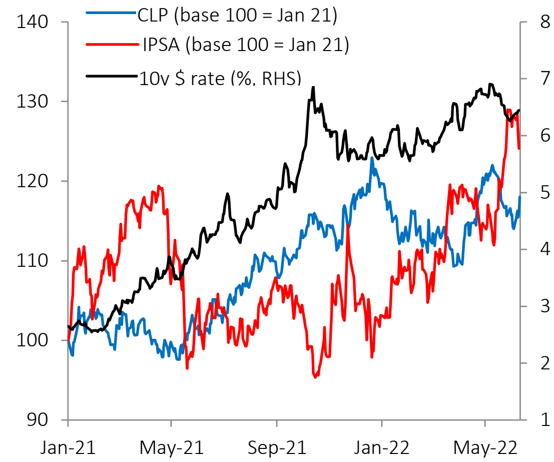
Given this scenario, the Central Bank once again modified its forward guidance for monetary policy, raising the midpoint of the MPR corridor by almost 200 bp compared to the March Report. According to the new trajectory, the Council foresees that the rate could climb an additional 50 bp in July, closing its cycle with the MPR at 9.5%. Then it could drop from the end of the year, although at a slow pace (it would close at 6% at the end of 2023). Although this is similar to what is contained in market prices, it appears contradictory with the dynamics for inflation forecast by the Council itself.

Market response

The higher interest rate scenario prompted an immediate response in the local currency. The exchange rate fell $6 to $822. However, a new strengthening of the global dollar, after the release of the US CPI for May, which surprised on the upside, and a fall in copper, led to reverse this fall. Thus, the parity closed the week around $840. Likewise, interest rates —particularly short-term ones— climbed 20 bp on average, adjusting to the ceiling of the rate corridor of the Report.

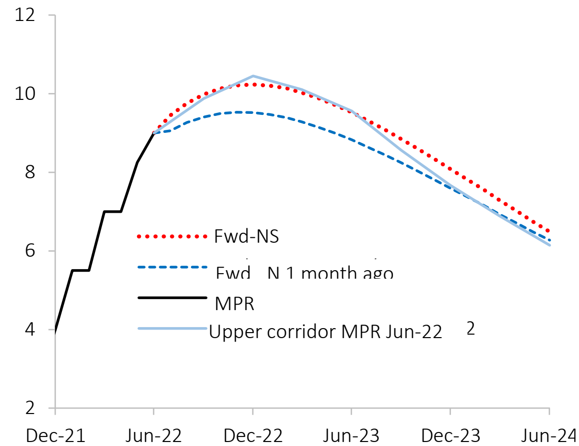
Long-term rates, which had been on a downward trend, in line with the slowdown in activity, rose 3 bp (BTP10: 6.4%), somewhat less than their external benchmarks. Real rates rose to a greater extent (BTU10: 2.1%), reflecting the scenario of inflationary convergence in the medium term.

Assets react to a higher inflation and rates scenario



Source: Bloomberg and Santander

Market adjusts expectations of MPR in line with higher rate corridor



Source: Bloomberg and Santander

US inflation surprise fuels volatility in global markets

At the close of this report, in the international arena, the market's attention was focused on the CPI data for May from the US, which was higher than expected (1% m/m vs. 0.7%) and led the annual measure up to 8.6% (8.3% expected), the highest since December 1981. For its part, the underlying measure also continued its upward trend (0.6% m/m vs 0.5% expected; 6% y/y vs. 5.9% expected), reinforcing concern about persistent inflation and encouraging the Fed to withdraw stimulus ahead of its meeting next week. The foregoing triggered the treasury bond yields of the main economies to show a strong upward trend in the week and rose more than 25 bp on average, with the T10 in the US exceeding 3% and at levels comparable to 2018 highs.

With this, a historical drop was added in the preliminary sentiment indicator of the U. of Michigan for June (50.2 vs. 58.1 expected), reaching its lowest value on record, comparable to the minimum reached in the middle of the recession of 1980. In the labor field, although the initial unemployment benefits in the US are still at low levels compared to history, in the last week they unfavorably surprised (229 thousand vs. 206 thousand expected).

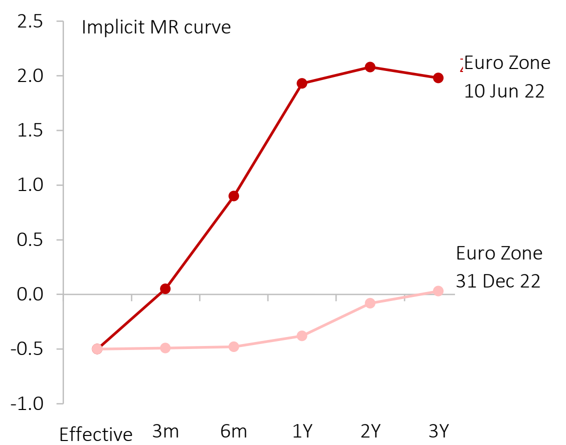
In this context, North American and European markets were coupled with decreases close to 5% compared to the previous week. The global dollar strengthened (DXY: +2%), volatility showed an increase (VIX: +4 points) and the prices of benchmark raw materials once again exhibited mixed behavior (copper: -4%; WTI oil: + 2%; agricultural: +2%).

Emerging markets were the exception, thanks to China, which advanced almost 4% amid the gradual lack of confinement in large cities, the rebound in the technology sector that was observed in the week and good foreign trade figures that surprised to the upside in May (exports: 166.9% vs. 8% expected; imports: 4.1% vs. 2.8% expected).

For its part, as had been anticipated, the European Central Bank (ECB) announced the start of its monetary normalization process starting next month, which would be the first rate hike in more than a decade. At its June meeting, the Board anticipated an increase of 25 bp in July, without ruling out a similar one in September, which could be of a larger amount subject to the evolution of inflation, which gave the hawkish bias perceived by the market.

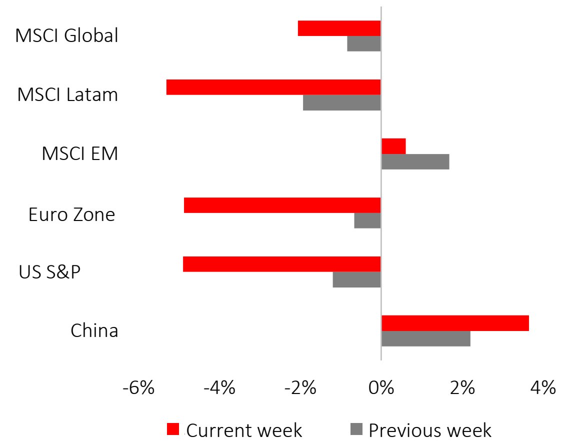
Along with this, they announced the completion of the Asset Purchase Program net purchases as of July 1. The foregoing occurs in the face of the recognition of the high and persistent inflation, and amid fears about the effects of the war on European activity, which led to lowering its growth forecasts (to 2.8% in 2022 and 2.1% in 2023) and those of inflation (6.8% in 2022 and 3.5% in 2023), compared to what was estimated in March.

The European Central Bank confirms the start of the monetary normalization process in July



Source: Bloomberg and Santander

The global exchanges closed the week with falls, with the exception of the Emerging Market block



Source: Bloomberg and Santander