December 18, 2020

# Latam Daily: Banxico Held, Copom Minutes & IR Updated Outlook; Argentine Green Shoots

***This is our last Scotiabank Economics Latam Daily for 2020; our first edition in the new year will be published on Monday, January 11 and shall include a risk calendar for the ensuing two weeks ahead of our next Latam Charts Weekly on January 13 followed by our Latam Weekly on January 23. We wish you safe and happy holidays!***

- **Argentina: Fresh signs of sustained recovery**
- **Brazil: Copom minutes and *Inflation Report* provided BCB's updated outlook as 2020 ends**
- **Mexico: Banxico held at 4.25%; *Survey* expectations improved; 2021 minimum wage increase coming**

## ARGENTINA: FRESH SIGNS OF SUSTAINED RECOVERY

**A trio of prints in the second half of this week pointed to some additional green shoots in Argentina's ongoing recovery.**

- **INDEC released Argentina's stale, but detailed, Q3 GDP numbers on Wednesday, December 16, and they came in a bit better than anticipated by the monthly economic activity proxy.** While the monthly numbers had been tracking -10.8% y/y in Q3 and the Bloomberg consensus anticipated -10.7%, the actual quarterly contraction came in at -10.2% y/y, a solid bounce from Q2's -19.1% y/y (chart 1). The drag in Q2 from both private consumption and investment abated, but so too did the upside from exports owing to both seasonal effects and some holdback by producers anticipating a devaluation in the ARS (chart 2).
- **On Wednesday, December 16, we also got October's industrial capacity utilization rate, which rose from 60.8% in September to 61.8% (chart 3).**

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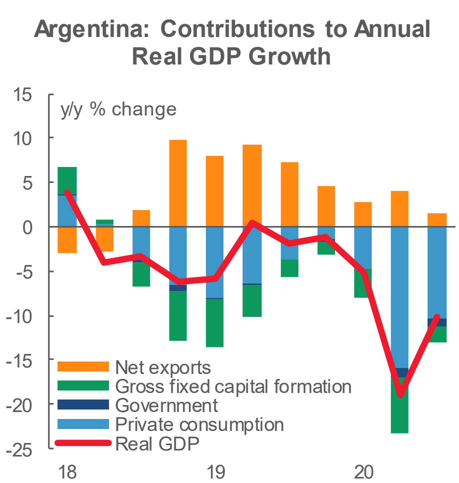
Chart 1

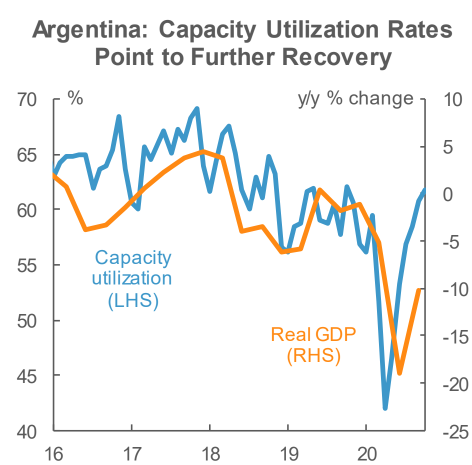

Sources: Scotiabank Economics, INDEC.

Chart 2




Sources: Scotiabank Economics, INDEC.

Chart 3




Sources: Scotiabank Economics, INDEC.

While this was above February's pre-pandemic 59.4% rate, capacity utilization is seasonal and this October's level was still below October 2019's 62.1%. Nevertheless, the continued increase in industrial capacity utilization points to a further rise in economic activity in Q4 as capacity utilization tends to lag in downturns and lead in upturns.

- **On Thursday, December 17, INDEC followed up with Q3's jobs numbers, wherein the unemployment rate pulled back a bit from 13.1% in Q2 to 11.7% (chart 4).** We had expected Q3's growth rebound to drive the unemployment rate down a bit further to 10.4%, but more people returned to the active labour force in the midst of the extended lockdown than we had expected, with a higher share of them accepting underemployed situations.

**—Brett House**

Chart 4

Sources: Scotiabank Economics, INDEC.

## BRAZIL: COPOM MINUTES AND *INFLATION REPORT* PROVIDED BCB'S UPDATED OUTLOOK AS 2020 ENDS

**So far, 2020 has been a tough year for most organizations, including the BCB, which introduced forward guidance to its toolkit to try to flatten the local yield curve and anchor its monetary stimulus, but it did not get enough cooperation from Brazil's fiscal authorities to achieve the central bank's intended results.** Accordingly, the Brazilian yield curve has mostly steepened since forward guidance was introduced at the BCB's August 5, 2020, monetary-policy meeting. The country's gross-general-government-debt-to-GDP ratio has hit 100% and roughly one quarter of the stock of debt will need to be rolled over in 2021. Related questions about fiscal sustainability were among the major concerns for the Copom in 2020 and will likely play a role in preventing very accommodative monetary policy settings from remaining in place for longer. Real rates have been hovering south of -200 bps, but this is unlikely to be allowed to persist for much longer.

**Accordingly, in the last Copom minutes of 2020 regarding the Committee's December 9 meeting, members provided guidance on their plans for the elimination of its forward guidance.** In particular, the BCB stated that "*since the adoption of the forward guidance, inflation expectations reversed their declining trend relative to the target for the relevant horizon. Additionally, over the coming months, the 2021 calendar year should become less relevant than the 2022 calendar year, for which projections and expected inflation are around the target"*. We viewed the minutes as signaling that the BCB's forward guidance is likely to be unwound around the end of Q1-2021.

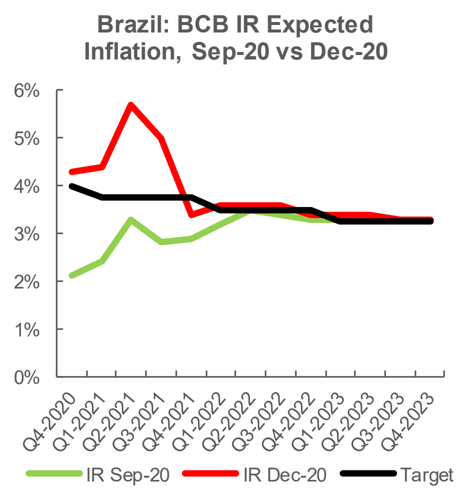
**DI rates are pricing 475 bps of hikes over the next two years and while our own forecasts in the December 13 *Latam Weekly* fall 50 bps short of that target, the tightening cycle we expect is more front-loaded.** The BCB has not signaled any relevant disagreement with the market's views, which imply real rates of around 3.5% two years from now—inside the IMF's estimate of a 3.00% to 4.00% neutral range. Given our expectations for Brazilian growth, we think the economy should get back to potential at some point between late-2022 and early-2023.

**The BCB's *Inflation Report* (*IR*) made material revisions to its baseline inflation scenario from the previous release in September and its new projections are consistent with a much more aggressive interest-rate hiking cycle, such as the path that is already reflected in DI rate prices.** Consistent with the Copom's minutes, the BCB's *IR* stressed a high degree of two-sided uncertainty on inflation that stems from a lack of clarity on fiscal policy. On one hand, the unwinding of economic stimulus adds a layer of volatility to the growth outlook, while on the other hand, a paucity of information on the country's coming fiscal consolidation creates doubts over what the country's risk premium should be going forward.

**One additional item highlighted in the BCB's *IR* was a finding that, since the central bank introduced forward guidance, near-term inflation expectations in the BCB's surveys have risen materially (chart 5).**

**—Eduardo Suárez**

Chart 5



Sources: Scotiabank Economics, BCB.

## MEXICO: BANXICO HELD AT 4.25%; *SURVEY* EXPECTATIONS IMPROVED; 2021 MINIMUM WAGE INCREASE COMING

### I. Banxico's target rate maintained at 4.25%, as expected

**In the last monetary policy meeting of 2020, the Banco de Mexico's Board maintained the target rate unchanged at 4.25%, as expected by most analysts and ourselves (chart 6); however, two of the five Board members voted for a rate cut of -25 bps to 4.00%.** The statement noted that inflation expectations for 2020 had been reduced, owing to the recent downturn in headline CPI (chart 7), but that medium- and long-term expectations remained stable at levels above the 3.0% y/y target. The Board noted that: "*Considering the aforementioned forecasts for inflation, the uncertainty that surrounds them, as well as the necessity of consolidating a downward path for headline and core inflation toward the 3% y/y target, with all members present the Banco de Mexico's Governing Board decided by a majority to maintain the target for the overnight interbank interest rate at 4.25%,"* with a reference to the balance of risks for inflation being uncertain.

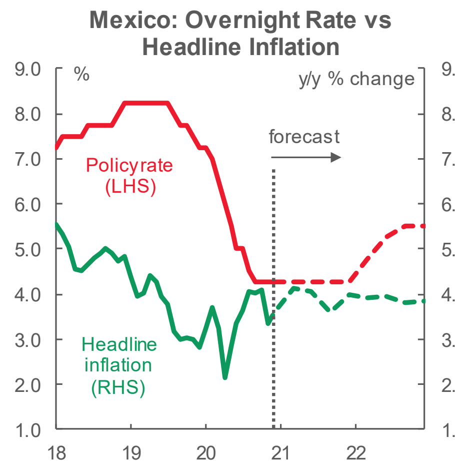
**The minutes of yesterday's meeting will be published on January 7, 2021, and the next monetary policy decision is scheduled for February 11 of next year.** Recall that this was the last meeting of one of the relatively hawkish members of the Board, Javier Guzmán Calafell, who will hand his seat to Galia Borja following her recent nomination by the President. Ms Borja does not appear to have a clear bias regarding Banxico's monetary stance; however, it is broadly expected that she won't be as hawkish as her predecessor.

**For now, we maintain our projection of a hold at the Board's next monetary-policy meeting in February, but we caution that this is subject to a fundamental review of our forecasts in January.** Banxico's *Survey of Expectations* now finds that most analysts expect another -25 bps cut to 4.00% to be delivered by Q2-2021.

### II. Banxico *Survey of Expectations* shows slight improvement in growth outlook

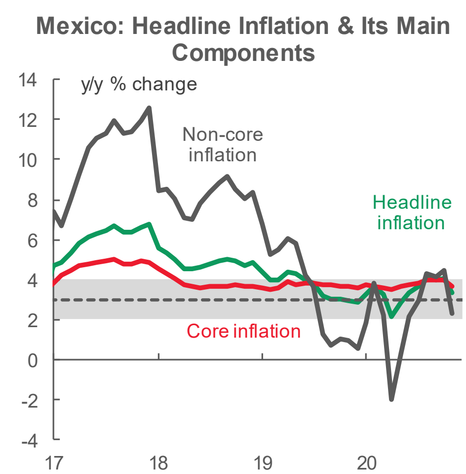
**On Thursday, December 17, Banco de Mexico published the results for December of its *Survey of Expectations* in anticipation of the year-end holidays.** For the fifth consecutive time, respondents anticipated, on average, a smaller contraction in 2020's GDP, moving from -9.10% y/y to a -8.99% drop. However, even though the outlook for 2020 has improved thanks to a stronger recovery than previously estimated—mainly driven by external demand—the *Survey*'s projected contraction would still be the steepest on record. However, the economic recovery forecast for 2021 also improved slightly from 3.29% y/y to 3.54% y/y, with a more positive bias.

Chart 6




Sources: Scotiabank Economics, Banxico, INEGI.

Chart 7




Sources: Scotiabank Economics, INEGI.

**Looking at the *Survey*'s details:**

- **Headline inflation expectations** for end-2020 declined further, to 3.38% y/y from the previous 3.63% y/y, influenced by the "El Buen Fin" sales which lasted longer and with greater price reductions than in previous years. For end-2021, headline inflation expectations also declined, from 3.61% y/y to 3.57% y/y. We emphasize that in both the medium- and longer-term outlooks, headline and core inflation prospects remain within the target range of monetary policy;

- **The exchange rate** projections for end-2020 and end-2021 appreciated with respect to the November *Survey*; analysts now expect the peso to close 2020 at USDMXN 20.12 and to end 2021 at USDMXN 20.65;

- Regarding **monetary policy**, for the fourth quarter of 2020 and the first quarter of 2021, most researchers anticipate an interbank funding rate unchanged from the current target of 4.25%, although a few expect it to be lower. From Q2-2021 to Q3-2022, analysts foresee the interbank funding rate at an average of 4.00%;

- **The labour market** outlook remained practically unchanged, with an anticipated loss of -835k jobs (versus -832k previously) by the end of the year, with a recovery of 367k jobs (versus 360k previously) in 2021;
- As for **the public deficit** as a percentage of the GDP, expectations changed only marginally for 2020, from 3.86% in November's *Survey* to 3.85% in December's update; in contrast, the average view of respondents increased from 3.38% to 3.41% for the end of 2021; and
- Lastly, 100% of the consulted analysts still viewed **the economy** as worse off than it was a year ago, which it literally still is. The main factors they cited that could hinder Mexico's economic growth during the next six months were: internal economic conditions (46%), governance (26%), and external conditions (15%).

## III. Ambitious minimum wage increase for 2021 resisted by business councils

**The National Commission on Minimum Wages (CONASAMI) agreed to increase the minimum daily wage for 2021 by 15% in nominal terms from MXN 123.22 (USD 6.16) to MXN 141.70 (USD 7.09), as had been proposed by the federal government.** The decision came in line with AMLO's objective of doubling the minimum wage by the end of his term in office in 2024: it follows on from nominal increases of 16% in 2019 and 20%, in 2020. This year, however, the increase was strongly resisted by Mexico's business councils in the context of the pandemic, little government fiscal support, and the risk that some 700k enterprises are on the brink of disappearing from the Mexican economy over the next three months.

**—Miguel Saldaña**

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