Latam Economic Update

- **Argentina: Echoes of 2005's incomplete debt exchange**
- **Brazil: May retail sales bounce better than expected**
- **Chile: Inflation stood at -0.1% m/m and 2.6% y/y in June**
- **Mexico: Auto sector recovers in June due to the May re-opening of the industry**

ARGENTINA: ECHOES OF 2005'S INCOMPLETE DEBT EXCHANGE

Following the release on Sunday of the authorities' fourth proposal to restructure its USD 65 bn of foreign-law bonds in default, it has become progressively clearer that Argentina's government may be content to move ahead with a partial exchange that leaves out some bondholders—much as it did in 2005. The 2005 exchange saw participation with respect to about three-quarters of the value of affected bonds at the cost of years of legal wrangling by holdout creditors. The exchange was re-opened in 2010, and about two-thirds of remaining untreated debt was tendered to the exchange, leaving unresolved about 7% of total debt that had been eligible for the 2005 exchange. As is well known, this led to years of legal battles that were resolved only in 2016–17 with the issue of the so-called "Macri bonds" to finance payment to the remaining holdouts.

In its SEC filing earlier this week, the Argentine government spelled out the minimum participation thresholds that would allow it to proceed with the proposed debt exchange even if a substantial bloc of creditors still balk at the government's latest terms. The filing indicates that the exchange will go ahead if at least 66.6% of the USD 65 bn total is tendered. The exchange could also go ahead on lower thresholds on subsets of the relevant bonds: specifically, the offer would proceed if either (1) at least 60% of at least one series of the 2005 exchange bonds and 2016 Macri bonds is tendered; or (2) if more than 50% of both of the 2005 exchange bonds and the 2016 Macri bonds, respectively, are tendered. These conditions should allow some debt to be swapped even if the Ad Hoc Bondholder Group, which represents some 35% of the value of relevant bonds in default and has not endorsed the deal, eventually holds out.

The implications of a partial exchange then depend on how Argentina handles payments owing on bonds not tendered in the swap. If the government decides to keep payments on these bonds suspended after the swap closes, we could find ourselves in a repeat of Argentina's post-2005 financial purgatory. In interviews Monday and Tuesday, Economy Minister Guzman repeated that the fourth set of proposed terms is the government's final offer and that it is "considering the possibility of not resolving all of the debt, but resolving a large amount." As noted previously, the offer period now closes on August 4 with an expectation that the swap will be completed on September 4.

—Brett House

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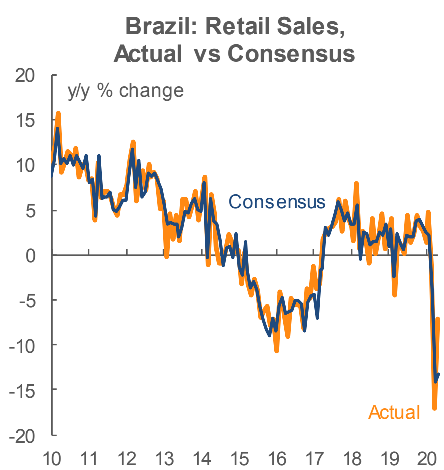
Chart 1



Sources: Scotiabank Economics, Bloomberg.

BRAZIL: MAY RETAIL SALES BOUNCE BETTER THAN EXPECTED

Brazilian retail sales growth rebounded much more strongly than anticipated by consensus in May, printing at -7.2% y/y versus analysts' expectation of -13.1% y/y (chart 1). The two strongest components were consistent with what intuition would suggest in a pandemic-restricted economy: food and beverages sales growth actually printed in positive territory, coming in at 9.4% y/y, while medical-related spending contracted only marginally at -2.6% y/y (table 1). Consistent with the retail Armageddon we have witnessed in many countries, sales of clothing and shoes plunged -62.5% y/y in May.

Table 1

Brazil: Retail Sales, y/y %	April 2020	May 2020
Total retail sales	**-17.1**	**-7.2**
Fuel	-25.3	-21.5
Food, beverages, tobacco	4.7	9.4
Clothes & shoes	-80.8	-62.5
Furniture/home electronics	-35.7	-7.1
Healthcare & pharmaceuticals	-9.8	-2.6
Books & magazines	-70.3	-67.1
Office & communication equipment	-45.6	-38.2
Personal & household items	-45.2	-18.9

Sources: Scotiabank Economics, Bloomberg.

We expect a stronger print for retail sales in June, but overall we anticipate that the rest of 2020 will be a bumpy ride. Lockdowns seem likely to be stop-and-go events.

—Eduardo Suárez

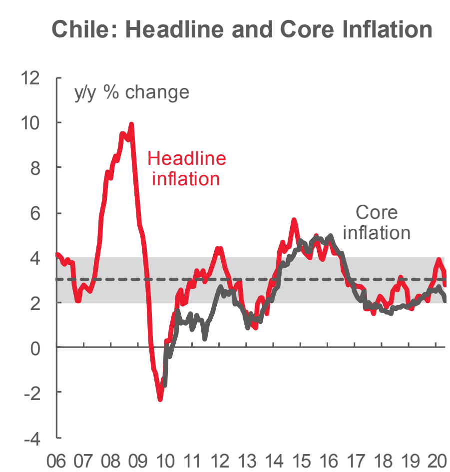
CHILE: INFLATION STOOD AT -0.1% M/M AND 2.6% Y/Y IN JUNE

June headline inflation came in at -0.1% m/m, which put annual inflation at 2.6% y/y (chart 2). This print was in line with expectations expressed in forwards, but was slightly below our and the Bloomberg consensus forecasts of zero month-on-month variation.

The dynamics of headline inflation continue to be dominated by the most volatile products, with increases in food prices and drops in fuel costs, while core inflation remains fairly stable—all of which is still conditioned on the ongoing difficulties in collecting prices and imputing missing prices during the pandemic. Core inflation decreased -0.1% m/m (2% y/y) in June, with a change of -0.3% m/m in goods (2.1% y/y) and 0% m/m in services (1.9% y/y). Within goods, the drop in the price of pharmaceutical products stands out. For some services, the way in which the National Institute of Statistics (INE) estimates prices remains surprising given that the temporary absence of personnel in buildings and condos should lead to imputations using the carry-over method (i.e., zero change), rather than price reductions, as the INE appears to be showing.

Within food, which contributed positive 0.06 ppts to monthly inflation in June, the rise in meats stands out, especially chicken (up 0.04 ppts) and beef (up 0.02 ppts), as well as eggs (gaining 0.01 ppts). Regarding fuels, gasoline continues to subtract around -0.07 ppts from monthly inflation, repeating negative contributions from the last three months that reflected declines in international prices. Even with the sustained rise in the price of oil in recent weeks, we should continue to see declines in domestic fuel prices until at least July with, increases thereafter. Furthermore, given seasonalities and the price adjustment that is applied every year in September, we would anyway begin to see increases in gasoline prices from September, a phenomenon that does not seem to be captured in market expectations for inflation.

Chart 2



Sources: Scotiabank Economics, INE.

The diffusion index for the total CPI basket remains within its historical range at 46.2%, which is slightly below its June average for the years 2013–19. On the one hand, the diffusion index for core goods continues to be high at 47.8%, influenced by pressures on food prices and the lagging effects of exchange rate depreciation. On the other hand, the diffusion index of core services stands at 31.3%, which is below its historical range for June and reflects weak demand and soft labour markets.

The share of prices in the CPI basked that have been imputed rather than collected continues to decrease from a peak of 42.6% in April to 26.9% in June. Despite the intensification in quarantine measures at the national level in June, the INE was able to capture a greater share of actual price data. For some items such as air transport and tourist packages, a zero monthly change continues to be assigned given the INE's inability to collect representative prices. The difficulties anticipating the INE's imputation rate will continue to tip the market toward working under a highly disinflationary scenario for the rest of the year. However, we should point out that to the extent that data collection is fully resumed, which is highly conditional on quarantine measures, we could see significant increases in the volatility of the CPI, especially since the process will not be contemporaneously homogeneous for all of the imputed items in the basket.

June's inflation print did not surprise the market and we do not anticipate any ongoing effects from it on interest rates or exchange rates. The release was also broadly in line with the BCCh's baseline scenario.

The proposal under discussion by Congress to allow the withdrawal of funds from pension funds has much more worrisome implications for eventual actions by the central bank. The proposal could have effects on the exchange rate and interest rates if it were to be implemented in the manner provided for in the Chamber of Deputies' bill.

—Jorge Selaive

MEXICO: AUTO SECTOR RECOVERS IN JUNE DUE TO THE MAY RE-OPENING OF THE INDUSTRY

The Mexican automotive industry exhibited an improvement in June according to data from the national statistics agency released on June 7.

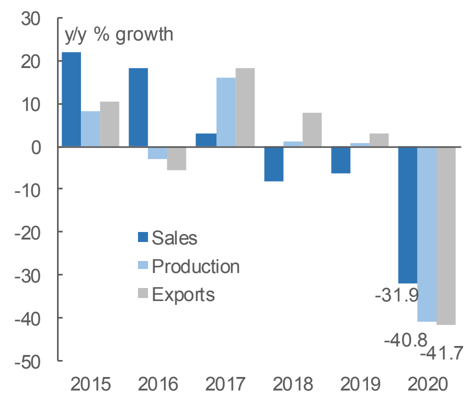
- **Internal sales of new cars slightly improved from an annual drop of -59.% y/y in May to a -41.1% y/y contraction in June (chart 3).** This implies that during the January–June 2020 period new car sales were down by -31.9% y/y compared with the same period a year ago.
- **Auto production growth in real annual terms recovered from -93.8% y/y in May to -29.2% y/y June.** Over the first six months of the year, auto production was down -40.8% y/y compared with the same period of 2019.
- **Finally, the contraction in automobile exports moderated from -95.1%y/y in May to -38.8%y/y June,** with exports down by -41.7% y/y in the first half of 2020 compared with the first six months of 2019.

Although disruptions derived from containment measures to mitigate the spread of COVID-19 are still being observed in the auto sector, the June data also reveal a recovery that followed the reopening of the industry from mid-May.

—Paulina Villanueva

Chart 3

Mexico: Auto Industry, Cumulative Figures January–June



Sources: Scotiabank Economics, INEGI.