Latam Economic Update

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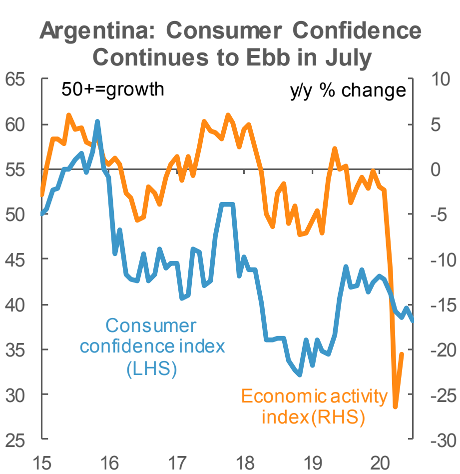
ARGENTINA: ECONOMY TURNING A CORNER, BUT STILL IN ROUGH SHAPE

Argentina's economy turned a corner in May with a 10% m/m lift in its monthly GDP proxy from April's bottom, but other indicators out this week continue to sketch the outlines of an economy deep into a third year of recession. July's **consumer confidence index**, published Thursday, July 23, retreated deeper into contractionary territory (i.e., below 50) following the re-intensification of quarantine measures in Buenos Aires, with a decline from June's 39.47 to 38.18 (chart 1).

The national government's primary budget deficit, released on Wednesday, July 22, continued to widen from ARS 251 bn in May to ARS 254 bn in June on slumping revenue and increased spending, though the pace by which the deficit grew slowed somewhat (chart 2). **Retail sales** for May, published July 23, reflected the lockdowns that continued on households in Buenos Aires that month, with supermarket sales up 5.1% y/y in May versus 0.3% y/y in April, but shopping centres, which were shuttered in late-March and remained nearly entirely closed in May, saw sales down -95.6% y/y, essentially unchanged from the -98.3% drop in April (chart 3).

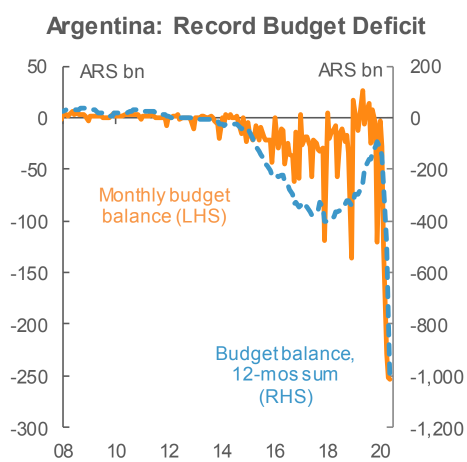
—Brett House

Chart 1



Sources: Scotiabank Economics, INDEC.

Chart 2



Sources: Scotiabank Economics, Ministerio de Hacienda.

Chart 3

Sources: Scotiabank Economics, Bloomberg.

CONTACTS

Brett House, VP & Deputy Chief Economist
416.863.7463
Scotiabank Economics
brett.house@scotiabank.com

Guillermo Arbe
51.1.211.6052 (Peru)
Scotiabank Peru
guillermo.arbe@scotiabank.com.pe

Mario Correa
52.55.5123.2683 (Mexico)
Scotiabank Mexico
mcorrea@scotiacb.com.mx

Sergio Olarte
57.1.745.6300 (Colombia)
Scotiabank Colombia
sergio.olarte@co.scotiabank.com

Jorge Selaive
56.2.2939.1092 (Chile)
Scotiabank Chile
jorge.selaive@scotiabank.cl

TODAY'S CONTRIBUTORS:

Carlos Muñoz
56.2.2619.6848 (Chile)
Scotiabank Chile
carlos.munoz@scotiabank.cl

Waldo Riveras
56.2.2619.5465 (Chile)
Scotiabank Chile
waldo.riveras@scotiabank.cl

Miguel Saldaña
52.55.5123.0000 Ext. 36760 (Mexico)
Scotiabank Mexico
msaldanab@scotiabank.com.mx

CHILE: ESTIMATING THE ECONOMIC IMPACT OF PENSION WITHDRAWALS

I. Preliminary estimates—effect on GDP of pension fund withdrawals

In our preliminary estimates, we anticipate that the withdrawal of pension monies from the AFPs will provide a positive, material impact on activity through a strong impulse to commerce. There are several transmission channels that must be considered in making this estimate.

- Part of the injection of resources to households from pension withdrawals is likely to be consumed in tradable goods and another part in non-tradable goods, including both durable and non-durable goods.
- Some of this will also lead to a decrease in inventories and an increase in imports.
- Additionally, another part of the withdrawals will be consumed in services; however, given the ongoing isolation and quarantine measures, the short-term impact on services should be small, although it could intensify once the reopening of the economy begins.
- A further part of the liquidity injection will be used to pre-pay debts, which we must also look at with caution given that significant deleveraging of households has already occurred and, additionally, we have seen quite significant postponements of debt-service payments under facilities provided by the bank and the regulator.
- Finally, it is also expected that a share of pension account holders with higher incomes will choose to save part of the resources they withdraw, mindful of the tax benefits that this strategy would provide.

Table 1

Chile: Effect on GDP of Withdrawal of Pension Funds (Estimates)

Net Injection on Consumption	Impact on GDP (percentage points)*
USD 15 bn	4.5 ppts to 5.3 ppts
USD 10 bn	3.0 ppts to 3.5 ppts
USD 5 bn	1.5 ppts to 1.8 ppts

Sources: Scotiabank Economics.
(*) The direct effects on consumption, stocks and imports are considered. The different levels of net injection can be used linearly, discounting other transmission channels.

The financial effects of the withdrawal of funds may also affect real variables. An appreciation of the Chilean peso or increases in interest rates is likely to affect real variables in different ways. For now, our exercise does not incorporate any relevant financial effects as we expect that the AFPs will make divestments of liquid assets and at the same time, various authorities (i.e., the central bank, financial markets regulators, and Superintendency of Pensions) will take compensatory measures.

In the fiscal dimension, the government has projected that pension withdrawals will generate a cost of around USD 6 bn for the pubic accounts, mainly through the pension system's "solidarity pillar". Withdrawals increase the chances that more Chileans may not have enough funds to finance mandated minimum pension payments, with the government left to cover the gaps. But given that a significant part of withdrawn pension resources will go to private consumption, VAT collections should be favourably impacted, which would partially offset the aforementioned fiscal cost in the short term.

Our estimates are preliminary and are oriented to see the direct impact on GDP of possible pension withdrawals while discounting for now the indirect effects on stocks, imports, and debt pre-payments. Using a product input-matrix and also various elasticities from the economic literature, our estimates point to relevant effects that we hope will be considered by the central bank in its next *Monetary Policy Report*, either as part of its base scenario or in a box that puts an upward bias on its projections, as these estimates certainly imply significant positive effects on short-term GDP growth. The medium- and long-term effects will need to be analyzed later.

Table 1 shows the net impact of various money injections while controlling for the transmission channels mentioned above. Our central scenario corresponds to a USD 10 bn net injection to consumption, but given uncertainty regarding the final use of resources, we also look at larger and smaller possibilities. If the injection from pension withdrawals, net of the pre-payment of debts and savings, is USD 10 bn, the impact on GDP is between 3 and 3.5%. That is, if the economy were already expected to contract by -7% in 2020, by incorporating this net injection during the remainder of the year, the economy would be expected to end up with a contraction closer to -4%.

These estimates are preliminary because we must wait for the final details of the legislation, and also analyze the behaviour of people during the withdrawal of funds and their subsequent spending profiles. Such a strong net injection of liquidity would have first order effects on the trade sector and indirect effects on banking, by decreasing to some extent the degree of personal leverage, and on VAT tax collections, among others things.

II. Withdrawal of pension funds is a reality

President Piñera will enact the bill to withdraw pension funds. During the next week, the law will be published in the *Official Gazette* and, immediately thereafter, the AFPs will have to begin the process of handing over the funds to the account holders who request them.

The pension fund regulator has already provided the AFPs with rules to govern the delivery of funds. Once requested by the account holder, the AFPs will have 10 days to deposit a maximum of USD 2,800 in a bank account indicated in the withdrawal request. The remainder would be deposited after 30 days.

We anticipate that the maximum amount that could be withdrawn from the pension system would be approximately USD 20 bn and we outlined above some possible effects on GDP in the short-term. It is worth noting that the law has indicated that withdrawals could be made up to a year after the law has been promulgated. However, we believe that most of the funds will be withdrawn upfront in the coming months of 2020 given the stressed conditions in the labour market.

The financial impact on interest rates and the FX market would be mitigated by the central bank (BCCh), as it has already indicated in a recent statement (see here in Spanish), while the AFPs have noted that their divestment process will be focused on liquid assets and on those where there are relevant buyers. In this context, we see little or almost no impact on the local stock market, only mild appreciative pressure on the Chilean peso (CLP), and limited upward pressure on the yield curve, which would be mitigated by the BCCh. Recall that the BCCh still has room to buy bonds issued by itself, a unique facility amongst central banks, and bank bonds. The BCCh is also expected to be authorized in the coming weeks to buy sovereign bonds on the secondary market once a law under discussion in Congress is approved.

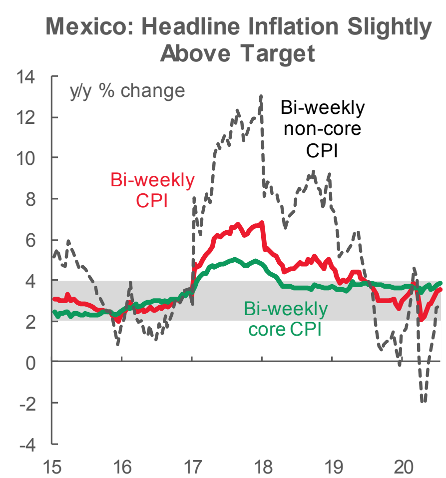
—Jorge Selaive, Carlos Muñoz, & Waldo Riveras

MEXICO: HEADLINE INFLATION HIGHER THAN EXPECTED IN JULY H1; TRANSPORT MINISTER RESIGNED CLAIMING DIFFERENCES WITH THE PRESIDENT

According to figures released by INEGI on Thursday, July 23, headline inflation came in at 0.36% 2w/2w in the first fortnight of July, its highest rate for a July H1 since 2012. Headline substantially surpassed the consensus of 0.29% 2w/2w projected in the Banxico *Survey of Specialists in Economics from the Private Sector*, and the 0.27% recorded a year ago. Core inflation came in at 0.25% 2w/2w, which also exceeded the 0.13% consensus and the 0.17% registered a year ago. Services prices rose 0.12% 2w/2w (versus 0.27% a year ago) and merchandise prices increased 0.36% (versus 0.07% in 2019). Non-core inflation moderated to 0.69% 2w/2w (versus 0.60% a year ago) owing to a setback in food prices of -0.26% 2w/2w (versus 1.15% a year ago), and an increase of 2.09% 2w/2w in energy items (versus 3.92% in H1 July 2019).

In annual terms, headline inflation retained its accelerating trend (chart 4), increasing from 3.50% y/y to 3.59% (versus 3.84% in the same period of 2019), with its core component rising from 3.76% y/y to 3.84% (versus 3.81% a year ago), and non-core inflation increasing from 2.69% y/y to 2.79% (versus 3.92% in the same fortnight of 2019).

Chart 4



Sources: Scotiabank Economics, INEGI.

Summing up, headline inflation surprised with a higher than expected rate, but these prints do not change our expectation of a -25 bps cut to the benchmark interest rate in the next Banco de México monetary policy meeting set for August 13.

Minister of Communications and Transportation Javier Jimenez Espriú has resigned owing to a dispute with the President about the recent decision to have the military manage ports rather than the transport ministry. The decision to hand sea and land ports to the navy and army was made last Friday, July 17, for "security reasons and to prevent the entry of drugs to Mexico", according to the President. Rumors of Jimenez's departure have circulated since last weekend. However, it wasn't until this Thursday, July 23, that the President announced Jimenez's resignation. Jorge Arganis Díaz Leal, former Vice Minister, has been announced as the new head of the Ministry.

—Miguel Saldaña