

## Latam Economic Update

- **Argentina:** Debt talks face another extension
- **Chile:** Economy slumps -14.1% y/y in April, worst monthly decline since 1999
- **Colombia:** Central bank cuts 50 bps as expected amidst a negative jobs report and weak trade data
- **Mexico:** April's growth in non-bank private sector deposits and borrowing held strong

### ARGENTINA: DEBT TALKS FACE ANOTHER EXTENSION

Argentina is likely to announce a further extension of its current June 2 deadline on its efforts to restructure USD 65 bn in foreign-law bonds following submission of a joint proposal by two creditor groups last week and the government's release of a revision to its own offer terms. Reports from Buenos Aires point to a possible extension of at least 10 days following an [interview](#) on Sunday, May 31 by Economy Minister Guzman. Min. Guzman reiterated the government's "flexibility" on terms, but cautioned there was still "quite a long way to go" before an agreement is likely to be reached on a deal that Argentina believes would be compatible with its economic constraints. Min. Guzman also advised that a return to an IMF lending program following agreement on the debt exchange would be subject to broad consultations with civil society on a possible structural adjustment program.

—Brett House

### CHILE: ECONOMY SLUMPS -14.1% Y/Y IN APRIL, WORST MONTHLY DECLINE SINCE 1999

The contraction of the economy in April was widely expected, but with a wide variation in expectations given that it was the first full month with the impact of COVID-19 reflected in its data. The Economic Expectations Survey (EEE) presented a big dispersion in forecasts, ranging from a maximum contraction of -12% y/y to a minimum of -4.8% y/y, a span rarely seen in private expectations for monthly GDP. Still, reality exceeded even these forecasts.

In the event, the economy plummeted -14.1% y/y in data for April released June 1, with a seasonally-adjusted drop of -8.7% m/m, double what was anticipated by the consensus median. This leaves our projection for a drop of -4.5% y/y in 2020 GDP much better positioned compared to the consensus in the last EEE that showed a median contraction of GDP of -2.7% y/y, with the most pessimistic forecast anticipating -4.3% y/y.

For context, Chile has not seen a monthly economic contraction on this scale since the Asian crisis in the late-1990s. In April 1999, monthly GDP fell by -4.8% y/y, the most significant slowdown we have seen since the inception of the monthly series—until this year. April's contraction has brought real economic activity back to levels we last experienced in May 2013.

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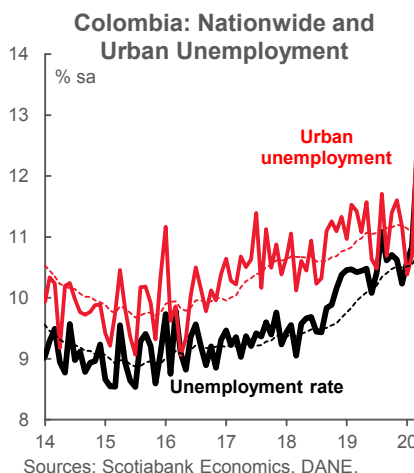
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Chart 1



The economy is on track to show a contraction of between -13% y/y and -16% y/y in May, which means a seasonally-adjusted month-on-month drop significantly less than that observed in April. The fourth month of the year has shown the worst of the macroeconomic effects of COVID-19 and the sanitary measures to contain its spread.

April's data will be extensively reviewed by the central bank in the next national accounts release since the numbers were clearly constructed with only partial information given the restrictions on citizen mobility and isolation. This will marginally affect forecasts for 2020 GDP.

For the coming months, we expect some recovery in the level of activity, as containment measures begin to relax, but this is unlikely to be reflected in activity before July. However, the year-on-year comparison would show negative growth rates throughout the rest of the year, except for October and November, where the comparison is more favorable due to the social unrest in those months in 2019.

Despite our expectation of some recovery in the second half of 2020 and into 2021, we expect output gaps to persist for the next two years. In this context, there is little doubt that we will see new measures by the BCCh to ensure the continued flow of credit. We are also likely to see a new fiscal package to mitigate the collapse in economic activity and its impact on employment.

#### What do we expect from the BCCh?

- A revision in their baseline scenario in the June *Monetary Policy Report* toward a contraction centered on -4.5% y/y for 2020 and a recovery for 2021 centered on 3.0% y/y.
- Revision of the long-term parameters (i.e., potential GDP and neutral MPR) downward in order to provide better forward guidance on future monetary stimulus. We expect the estimated nominal neutral monetary policy rate to be revised from 4% to around 2.5/3.0%.
- New unconventional measures that would range from an expansion of credit lines to banks to greater purchases of corporate bank bonds (i.e., an extension and increase of measures already in place) and new unconventional measures (both macro and micro prudential) to support the real estate sector and the flow of credit to SMEs and individuals.

#### What do we expect from the Ministry of Finance?

- A temporary extension and increase in all recently taken measures to ensure liquidity and financial relief for SMEs and families.
- A new social tax and pro-investment package, with a focus on public investment and public-private partnership to ensure a recovery by 2021. The new fiscal package would be equivalent to at least 1 ppt of GDP and not more than 4 ppts of GDP.
- Creation of a new commission to define a new fiscal rule that would lend more confidence to the fiscal sustainability of the government's measures.

—Jorge Selaive & Carlos Muñoz

### COLOMBIA: CENTRAL BANK CUTS 50 BPS AS EXPECTED AMIDST A NEGATIVE JOBS REPORT AND WEAK TRADE DATA

#### I. BanRep cut by 50 bps policy rate, but unanimity was broken by two hawkish members

On Friday May 29, BanRep cut by 50 bps its policy rate to 2.75%, the lowest nominal rate ever. The decision was not unanimous: two members voted for a more conservative cut of 25 bps. The communiqué was rather neutral, although the Board recognized that spare capacity has significantly increased, and the labour market's deterioration has been very large. Having said that, the Board also noted that inflation is in the upper half of the target range and inflation expectations—although they have been decreasing—are very close to 3%. When Governor Echavarría was asked about the possibility of deflation, he downplayed this scenario and said that market consensus continues to think that inflation will hover around the BanRep's target. The communiqué

also stressed that international and domestic markets have recently improved, and that liquidity has returned to local markets, in part due to the strong liquidity measures that BanRep has put into place.

In the press conference, Governor Echavarría said that the Board's talks with businesspeople led them to expect some recovery in the months to come, and especially an improvement in labour markets. April's nationwide unemployment rate hit 19.8%, the worst ever.

Gov. Echavarría also hinted at the source of the disagreement within the Board. He said that the two Board members that voted for a 25 bps cut thought that speed of the easing cycle should slow down since the nominal rate was already at a record low and the real interest rate is significantly negative. After a strong decline in economic activity in Q2-2020, a gradual recovery is expected to follow.

Finally, BanRep announced that it will renew existing contracts due in June under the existing NDF program, and will auction remaining unsold amounts under the NDF and swaps programs. It did not, however, announce new amounts for each program.

All in, May's BanRep 50 bps cut, although expected, showed that gradualism is still the name of the game within BanRep's Board and data will show them by how much further they will need to cut. The meeting's communications also showed that BanRep's Board expects an economic activity recovery in Q3-2020, which implies they will remain gradualist and data-dependent going forward. We still think that BanRep will cut the policy rate by another 25 bps at the June 30 meeting.

## II. DANE reported a historic and scary decline in employment in April

Also on Friday May 26, DANE released April's unemployment statistics, which showed the huge social impact of the COVID-19 shock. Around 25% of the employed population has lost jobs, with the working population contracting by 5.3 mn. Inactive people increased by 4.3 mn, which reduced the labour force participation rate to 51.8% from 62.2% in 2019. Nationwide unemployment came in at 19.8% (April 2019 was 10.3%), while urban unemployment (13 cities) came in at 23.5% (April 2019, 11.1%), both historic highs under the current statistical methodology. A more concerning calculation is that, if all people who lost their jobs in the past two months were to be included in the labour force, the unemployment rate would increase to around 38%. The seasonally-adjusted nationwide unemployment rate showed a deterioration to 19.9% in April versus 12.2% in March 2020, and rose to 23.5% versus 13.4% in March 2020 for the urban print (chart 1).

It is worth noting that April was the month most affected by the quarantine. Activity indicators for the month, such as fuel and energy demand, saw big declines; commensurately, the labour market showed a considerable employment contraction compared with a year ago. Twelve of thirteen economic sectors reduced their employment, especially commerce, manufacturing, and leisure, which accounted for half of the job destruction numbers. The most significant deterioration was in urban areas (-2,969k y/y), especially in activities related to retail (-645k y/y), manufacturing (-603k y/y), and leisure (-434k y/y, chart 2). At the press conference, DANE's Director, Juan Daniel Oviedo, highlighted that reductions in working hours and job losses disproportionately affected women.

Additionally, the labour market continued to show different dynamics between the formal and informal sectors. It appears that the formal sector has seen the biggest impact. The last three months' average, net job numbers contracted -10.6% y/y, of which the destruction of informal employment (-9.7% y/y on average) was lower than the decline in waged employment (-11.3% y/y on average, chart 3).

Chart 2

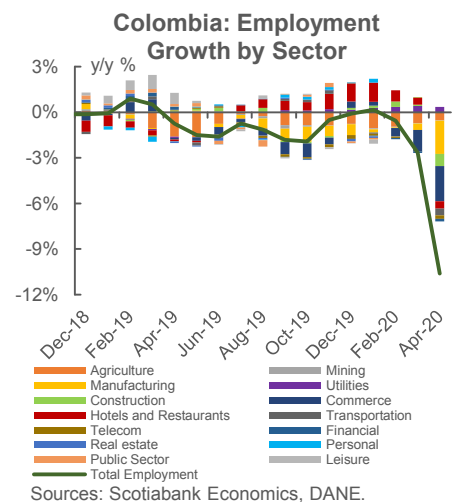
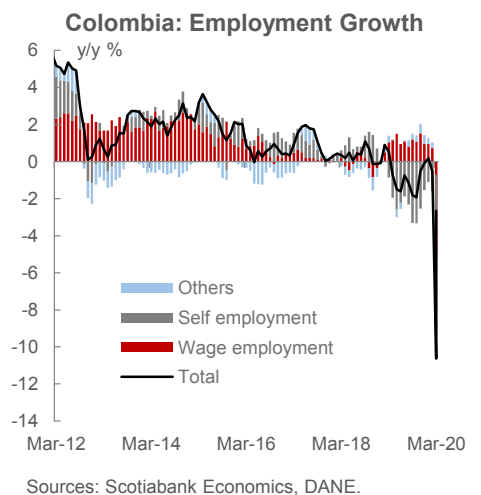


Chart 3



Although the unemployment rate in April shows a strong deterioration, job losses were significantly higher, which could put additional pressure on the government's finances over the coming months. Furthermore, labour market pressure highlight the necessity to speed up re-opening strategies under distancing protocols with the strengthening of the health system.

### III. Exports were the weakest in 14 years

Colombia's monthly exports for April, released by DANE on June 1, were USD 1.844 bn, which is a contraction of -52.3% y/y and the weakest level since January 2006 (chart 4). Mining-related exports contracted by -70.1% y/y due to a significant decline in oil exports (-78.6% y/y) and coal exports (-47.7% y/y). Agricultural exports contracted by -9.4% y/y while manufacturing exports fell -41.3% y/y.

Traditional exports contracted by -65.8% y/y in April (chart 5); coal exports contracted by -47.71% y/y due to price deterioration and production cuts (-38.32% y/y). The -78.6% y/y contraction in oil-related exports took them to their lowest level in thirteen years (USD 364 mn). Oil represented 20% of total exports in April; it was 40% of total exports in 2019 and more than 60% in 2013. The decline in oil-related exports was due to both the deterioration in international prices and lower volumes (-25.32% y/y). Coffee exports declined by -17.39% y/y, on the back of lower volumes (-29% y/y), which offset favourable effects from international prices.

Non-traditional exports were USD 974.9 mn, a contraction of -26.1% y/y (chart 5, again). The decrease in agricultural exports was driven by bananas and fruit (-40.1% y/y), coffee (-17% y/y), and tobacco (-62.7% y/y). The manufacturing contraction was explained by machinery and equipment (-61% y/y) and manufactured goods (-47.7% y/y).

Shutdowns across the world affected the export data, however, the impact on the external current account should be moderate. Since the deterioration in mining exports would be offset by a reduction in outflows on the income account, and weaker economic activity would cut imports significantly. All in all, our expectation is for a current account deficit equivalent to 4.1% GDP in 2020. The financing of this wider external imbalance now will likely come from larger public-sector external financing.

—Sergio Olarte & Jackeline Piraján

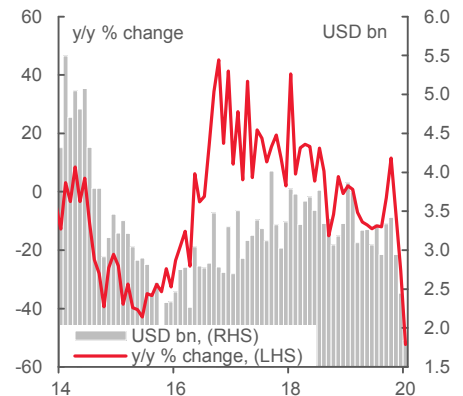
### MEXICO: APRIL'S GROWTH IN NON-BANK PRIVATE SECTOR DEPOSITS AND BORROWING HELD STRONG

April's growth in commercial banks' deposits from non-financial clients, published on Friday May 29, printed a further pick-up in real terms from March's 10.1% y/y to 13.1% y/y in April versus 3.3% y/y in April 2019 (chart 6). This result was mainly explained by a marked acceleration in demand deposits growth from 12.8% y/y to 16.4% y/y (versus -0.7% y/y in April 2019) and in term deposits growth from 6.2% y/y to 8.3% y/y (versus 9.6% y/y in April 2019).

Similarly, growth in total commercial bank financing to the non-bank private sector strongly accelerated from 6.7% y/y to 8.6% y/y in real terms (versus 5.3% y/y in April 2019), driven by an increase of direct financing from 6.7% y/y to 8.7% y/y (versus 5.2% y/y in April of 2019). A higher pace was observed in growth

Chart 4

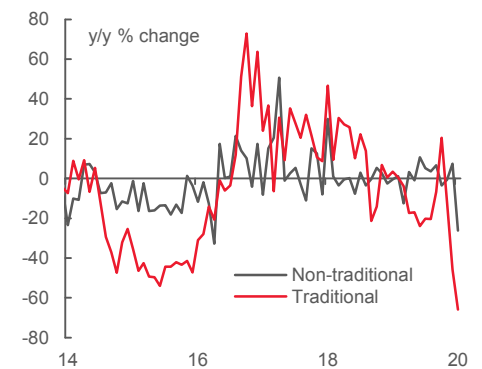
Colombia: Total Exports



Sources: Scotiabank Economics, DANE.

Chart 5

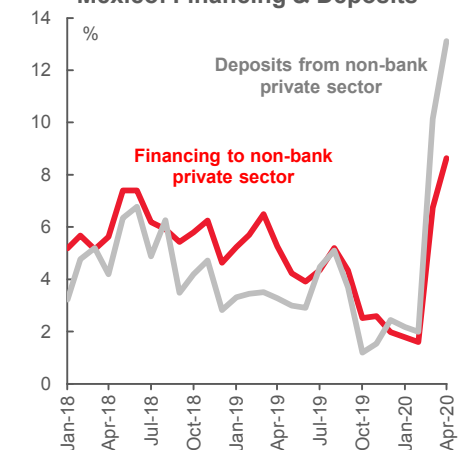
Colombia: Exports, Traditional vs Non-Traditional



Sources: Scotiabank Economics, DANE.

Chart 6

Mexico: Financing & Deposits



Sources: Scotiabank Economics, Banxico.

in financing to companies, up from 9.7% y/y to 13.3% y/y (versus 6.4% y/y in April 2019), as well as in mortgage financing, quickening from 6.9% y/y to 7.8% y/y (versus 5.5% y/y in April 2019), which more than offset the drop in consumer financing from 0.1% y/y to -1.6% y/y (versus 1.3% y/y in April 2019).

**The strong dynamism of financial activity that we observed in March was accentuated in April.** Both businesses and households are drawing on existing credit facilities and expanding their indebtedness to sail through these turbulent times.

—Daniel Mendoza

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