Latam Economic Update

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ARGENTINA: DEBT OFFER DEADLINE EXTENDED AS IMF DELIVERS NEW DSA

The Economy Ministry confirmed on Monday, June 1, that it would extend the deadline on its debt offer to June 12 at 17:00 EDT in order to allow further time to negotiate with bondholders on the terms of the possible debt exchange. The authorities revised offer terms, released at end-May, would be subject to further modification.

At the request of the authorities, the IMF released on June 1 an update of its debt sustainability analysis (DSA) and found that "the Argentine authorities' revised debt restructuring proposal would be consistent with restoring debt sustainability with high probability"—the bar for any new lending arrangement with the IMF. The IMF staff cautioned, however, that "there is only limited scope to increase payments to private creditors and still meet the debt and debt service thresholds," that would be consistent with sustainability.

Martin Guzman, the Economy Minister and government lead on the debt negotiations, indicated in a statement, also on Monday, June 1, that they are working on "final amendments to the offer", but that "the remaining margin is small" to make any changes that would be consistent with the restoration of debt sustainability. Min. Guzman further clarified that once the offer is amended the deadline with the US SEC would be extended again to permit additional negotiations on finalizing a deal.

—Brett House

COLOMBIA: MAY 29 BANREP MINUTES POINT TO MORE GRADUALISM; Q1-2020 CURRENT ACCOUNT DEFICIT NARROWED A BIT

I. May 29 BanRep minutes showed Board still inclined toward gradualism

On Monday June 1, BanRep released the minutes of the May 29 meeting where the Board cut the monetary policy rate by 50 bps to 2.75% in a divided decision with two members opting for a 25 bps cut.

The minutes provided some interesting information about the Board's inclination toward gradualism in the easing cycle. In fact, according to the text, the Board expects the economy to start a gradual recovery in May-2020,

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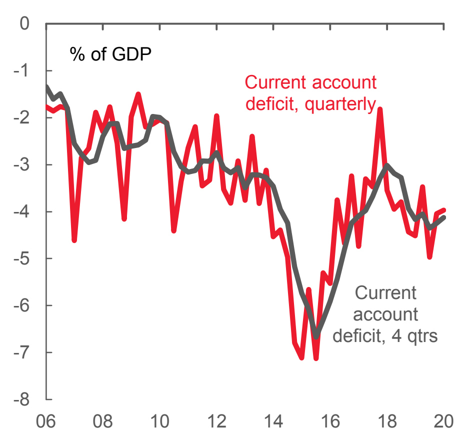
Chart 1

Colombia: Current Account Deficit



Sources: Scotiabank Economics, BanRep.

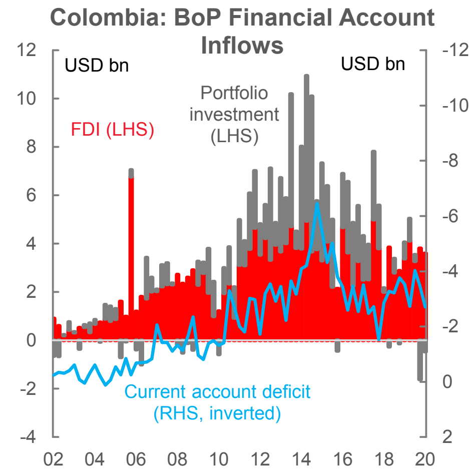
according to recent talks between Board members and businesspeople in the country. Additionally, inflation, although it has slowed in recent months, it is still in the upper half of the target range and inflation expectations are closer to the 3% target. Therefore, Board members prefer gradualism in any further easing.

Finally, and the most interesting part of the minutes, the two members of the Board that voted for a milder cut of 25 bps argued that in terms of financial stability, it would be better to diminish the speed of the easing cycle. They said that they would prefer not to run out of policy bullets in case they need them later on in the year.

We still think that BanRep will continue its easing cycle in June, but at a slower pace, and cut by 25 bps to 2.50% and enter a much more data-dependent mode.

II. Colombia: The current account deficit narrowed in Q1-2020 as automatic stabilizers saved the day

Chart 2



Sources: Scotiabank Economics, BanRep.

In Q1-2020, the current account deficit stood at USD 2.7 bn, equivalent to 3.7% of GDP and below the 4.5% of GDP of Q1-2019 (USD 3.5 bn, chart 1). Financing of the current account deficit continued to be healthy: net FDI inflows amounted to USD 3.6 bn, while portfolio capital flows contracted by USD 453 mn. In the coming quarters, we expect the contraction in domestic demand to cut imports, which should keep the current account deficit in check despite a concurrent, significant deterioration in exports.

The current account deficit narrowed by USD 817 mn to USD 2.7 bn due to lower income account outflows (USD 677 mn, down by -26% y/y) and higher remittances (USD 308 mn, up 17% y/y). Meanwhile, the trade deficit widened by USD 157 mn to USD 2.08 bn. Exports contracted by -9.2% to USD 9.3 bn due to lower oil and manufacturing exports, while imports contracted proportionately less (-6.9% y/y) to USD 11.4 bn. It is worth noting that imports contracted on the back of lower capital goods (-5.7% y/y) and transport imports (-25.6% y/y). On the services balance, exports contracted by -7.5% y/y and imports by -4.1% y/y mainly because of travel restrictions due to COVID-19.

On the financing side, FDI continued to be the primary source of current account deficit financing (chart 2). In Q1-2020, FDI inflows stood at USD 3.6 bn (up 6% y/y and equivalent to 5.0% of GDP), while portfolio investment outflows came in at USD 453 mn (0.6% of GDP). FDI's composition showed that 30.7% was in the oil and mining sectors, 30.7% in the electricity sector, 13.8% in the financial system, 9.2% in the manufacturing industry, and 38% in other areas. The behaviour of portfolio flows in Q1-2020 reflected public external debt issuance (USD 532 mn) that was offset by outflows from COLTES of USD 822 mn and local equity markets of USD 163 mn.

The current account results for Q1-2020 showed that some automatic stabilizers are starting to work. In fact, the current account deficit narrowed despite an increase in the trade deficit, owing to lower income account outflows. In the forthcoming months, the reduction in exports and remittances is likely to be a challenge for the current account deficit. However, lower-income account outflows and stronger contractions in imports should offset these adverse effects. On the financing side, despite the good behaviour of FDI in Q1, we don't expect this to continue in the forthcoming quarters. Instead, external public indebtedness through multilateral borrowing or debt issuance will be the main source of financing. In fact, Colombia just issued USD 2.5 bn of new debt, which could guarantee financing for one additional quarter of the current account deficit.

Finally, despite the expected narrowing in the current account deficit in 2020, we project it will widen again in 2021. Colombia's economic recoveries typically feature increased capital-good imports, which are usually financed through higher FDI.

—Sergio Olarte & Jackeline Piraján

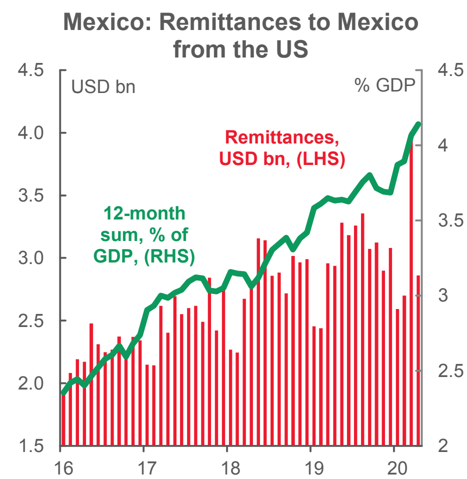
MEXICO: ANALYSTS' EXPECTATIONS LOWERED FOR 2020; REMITTANCES FALL IN APRIL, BUT PUBLIC FINANCES HOLD UP

I. Central bank Survey of Expectations foresees lower GDP forecast for 2020

Banco de México's Survey of Expectations, released on Monday, June 1, showed that analysts in the private sector have kept lowering their expectations for 2020.

- **The average projections for GDP growth** dropped from -7.3% y/y to -8.2% y/y in 2020; as for 2021, GDP expectations were kept at 2.5% y/y.
- **The average forecast for headline and core inflation** rose from 2.83% to 3.04% and from 3.32% to 3.44% at the end of 2020, respectively. With this, headline and core inflation expectations for end-2021 came down slightly from 3.51% to 3.46% and from 3.43% to 3.42%, respectively.
- **The outlook for the MXN was little changed.** Projections moved from USDMXN 23.36 to 23.30 for end-2020 and from USDMXN 23.03 to 23.00 for end-2021.
- **Lastly, most respondents expect a target policy rate of 4.50% at the end of 2020 and 2021**, contrary to 5.00% expected in the previous survey.

Chart 3



Source: Scotiabank Economics, INEGI.

II. Remittances set back in April, after a record pre-lockdown increase

Remittances for April, released on Monday, June 1, reported an annual decrease of -2.6% y/y at USD 2.86 bn (chart 3), as expected. The number of remittance transfer operations summed up to USD 8.7 mn, representing an annual decrease of -4.7% y/y for the first time in three years. Despite the decline in USD terms, the purchasing power of these flows held up owing to a favourable exchange rate and lower inflation rates. We expect remittances to fall further in the coming months owing to the state of the labour market in the US.

III. Public finances registered a lower deficit than programmed for the January–April period

Despite pressure on government revenues from lower economic activity, public finances for the January–April period, released on Friday, May 29, recorded a MXN 73.9 bn deficit, well below the MXN 115.1 bn shortfall that had been programmed, as lower spending and efforts to combat tax evasion more than offset lower oil revenues.

- **Oil revenues** amounted to MXN 157.7 bn in the first four months of 2020, about half the MXN 302.5 bn budgeted. In April, oil revenues fell by -73.8% y/y in real terms due to lower oil prices.
- **Tax revenues** accounted for MXN 1.255 tn in the January–April period, as programmed; however, April saw a -15.3% y/y fall in tax revenues. This reflected a -26.3% y/y decrease in income tax due to lower activity, which was only partially offset by a 8.28% y/y increase in value-added tax as a result of efforts to combat tax evasion.
- **Net expenditures** summed to MXN 1.957 tn, lower than the MXN 2.004 tn in the budget. Higher federal expenditures were offset by lower spending by Pemex, the CFE (the public electricity utility), and other public companies and agencies.

—Miguel Saldaña

PERU: REACTIVA 2 LAUNCHED; HIGHER MAY INFLATION A MILD SURPRISE, PLUNGING APRIL GROWTH INDICATORS WERE NOT

Conditions for the second tranche of the REACTIVA government guaranteed loans program were released on Monday, June 1. The new program extends the ceiling for business loans from one month to three months of 2019 average monthly sales (or two months, if sales have not been registered with the tax agency; i.e., for informal businesses). The loan ceilings were doubled and tripled for loans under either the 95% or 98% government guaranteed loans, which is meant for small businesses. The ceiling for the 80% guarantee program, mainly geared to large businesses, remains the same. Businesses that obtained loans under the REACTIVA 1 program can participate in REACTIVA 2 to the extent that the new ceilings allow. Credit conditions were also made more flexible, with the intention of allowing greater access for informal businesses. The changes seek to expand the set beneficiaries to two million businesses, especially small businesses. However, it is not clear how much appetite banks will have for these resources, as there has been no change in the proportion of government guarantees, nor was the ceiling raised for loans to larger companies which already participated fully in REACTIVA 1. The new scheme is likely to benefit most the larger businesses within the small business universe.

Inflation did not slip to 1.6% y/y in May (from 1.7% y/y in April) as we had expected, but, rather increased to 1.8% y/y. Monthly inflation came in at 0.2% m/m, marginally different from the 0.05% m/m we expected. The actual change from April to May was minimal, from 1.72% y/y, to 1.78% y/y, but it was not in the direction we expected. The main difference with our expectations was in prices for medicine. Food prices also contributed to the rise in inflation to a lesser extent, mostly due to logistics and distribution difficulties during the quarantine.

On June 1, the National Statistics Institute also published a number of growth indicators for April. All were just as dire as feared. These indicators included:

- Mining, down -47% y/y. Broadly in line with our expectations of a -50% y/y decline;
- Oil & gas fell -13.4% y/y. The sector was deemed essential, and the decline was largely for market reasons;
- Fishing plunged -57.8% y/y. Thankfully, the figure is not really relevant, as the fishing season didn't begin until May;
- Exports fell -57% y/y, in April, which was more than expected. It would appear that it was a bad month for agro-industrial exports, which had held up well in March; and
- Imports declined -32% y/y. Imports of consumer goods, of intermediate goods, and of capital goods all declined between -30% and 33% y/y.

These indicators are in line with a GDP contraction of -35% y/y in April. This comes after -16% y/y in March. April will be the month with the greatest contraction for the year, as the lockdown was in full force for the entirety of the month.

—Guillermo Arbe