Latam Economic Update

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ARGENTINA: DEBT TALKS FOCUSED ON POSSIBLE CONTINGENT SWEETENERS

Reports from Buenos Aires indicate that the Ad Hoc Bondholder Group and Exchange Bondholder Group, the two largest informal creditor collectives involved in Argentina's debt talks, made another counter offer over the weekend that would imply NPV losses of up to 46% on the USD 65 bn of external law bonds that have been in default in since May 22. These terms would still not meet the objective of a 50% NPV reduction contained in the most recent proposal from the government, but it hints at further convergence toward a deal.

Negotiations to bridge the gap appear to be focused on a possible continent sweetener. The creditors' proposal would feature a GDP-linked warrant tied to IMF data in order to avoid a repeat of problems with the politicization of INDEC's inflation and real GDP data following the 2005 debt exchange. The government proposal also featured a warrant linked to agricultural exports, which some argue can be monitored more transparently than a broad macro aggregate such as GDP.

Economy Minister Guzman indicated in an interview that he is "confident" that a deal can be reached this week.

—Brett House

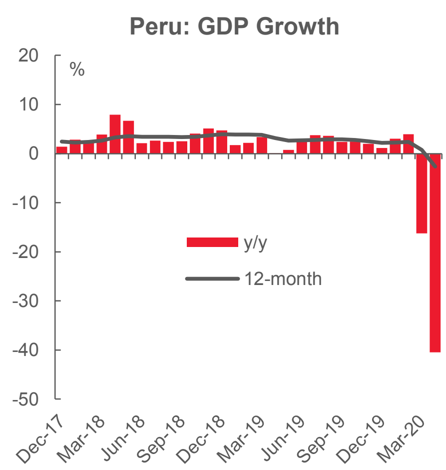
COLOMBIA: EXPECTATIONS SOFTEN AND FISCAL RULE SUSPENDED

I. June BanRep survey sees macro expectations soften

According to June BanRep's survey of macroeconomic expectations, analysts expect inflation to fall to 2.25% y/y in December 2020, 65 bps lower than last month. Inflation expectations (IE) for longer tenors also fell. In fact, the 1Y tenor stood at 2.88% y/y (previously 2.94% y/y), and the 2Y at 3.2% y/y. Inflation expectations have fallen recently due to the downward surprise on prices in May.

June's monthly inflation, on average, is expected to come in at -0.07% (our expectation +0.07% m/m), which would bring annual inflation to 2.51% y/y, 34 bps lower than May's y/y inflation reading. It is worth noting that, in June, utility prices would contribute negatively to headline inflation. For the longer term, we believe that the economic downturn is a negative pressure for core prices, but once government programs (i.e., temporary tax reductions and subsides) end in August, headline CPI will see upward pressures due to price normalizations in these areas.

Chart 1



Sources: Scotiabank Economics, INEI.

USDCOP forecasts for 2020-end stood at 3,703 (-89 pesos). For December 2021, respondents think (on average) that the COP will end at 3,587. We believe that EM FX volatility will continue. Having said that, our FX models point to an equilibrium level around 3,600–3,700.

BanRep's repo rate is expected to close 2020 around 2.25%, according to the median of the respondents, 50 bps lower than the current level. The first hike of 25 bps is expected by July-2021 and the monetary policy rate is expected to hit 3.0% by the end of 2021. For June's meeting, analysts' consensus points to a rate cut of 25 bps.

II. Fiscal Rule was suspended for 2020 and 2021

On Monday June 15, Fiscal Rule Committee decided to apply article 11 of the fiscal rule law and suspend the rule for 2020 and 2021 due to the COVID-19 / oil-price shock. The idea behind this decision was to give more flexibility to the government in a very uncertain environment. Initially, the Committee allowed the government to increase the fiscal deficit to -6.1% of GDP from the -2.2% of GDP targeted at the beginning of the year. The former increment was due to a roughly 2.5 ppts of GDP higher expenditure on social programs and lower tax collections due to the recession. However, this social expenditure has not been sufficient under the current economic downturn, which is the main reason to suspend the fiscal rule for this year and 2021. Therefore, we think we can expect a major announcement on further countercyclical expenditure in the coming days, and of course, a higher fiscal deficit.

In the communiqué, the Committee said that it took the decision to apply article 11, but with some conditions: (1) after 2021, the fiscal rule must be restored; and (2) in the 2020 Medium-Term Fiscal Framework, which will be released by the end of June, the government must be explicit on the specifics by which long-run sustainability will be ensured beyond 2021. In fact, the Committee advised the government to pass a tax reform to increase tax collections and to revise in detail the expenditure side in order to ensure medium-term debt sustainability. Finally, the fiscal rule committee will exercise the functions of an independent oversight board to monitor fiscal accounts while the fiscal rule is not active.

We think that further financing for the deficit (at least a portion of it) could come from the IMF's FCL (USD 10.8 bn or around 3.5 ppts of GDP), although we cannot discount the possibility of a bit more domestic TES issuance, especially the long expected 30-year bond.

Bottom line: we think further counter-cyclical measure will be announced in the coming days to help economic activity recover. Additionally, to calm international rating agencies and financial markets, the Medium-Term Fiscal Framework must have a very clear message about how the government will ensure debt sustainability. In fact, we expect a fiscal reform (on both sides—taxes and expenditures) next year. Another way to pacify concerns is to take advantage of the FCL with the IMF, which we see, now, as an option to finance the higher 2020 deficit.

—Sergio Olarte

PERU: SCARY APRIL GROWTH NUMBERS STIR THE GOVERNMENT TO GREATER EFFORTS

Somewhere the sun is shining, but there is little joy in Peru—as April's GDP and employment figures have come out. GDP fell -40.5% y/y in April, and -24% m/m, according to data released by the National Statistics Institute (INEI) on June 15 (chart 1). April, the only month of full lockdown, will, of course, be the worst month of the year in terms of growth, but, given the magnitude, it will still be a drag on the whole year. The -40.5% y/y contraction was within the (wide) margin of error of our -36% y/y growth forecast for April. The overall message is that the government intention to shut down the economy was only too successful in April.

Only two sectors showed positive growth (table 1). Agriculture rose a marginal 0.6% y/y. This was still lower than the 3%–4% that we would expect in normal times, proving that even agriculture, deemed an essential sector and, as such, not locked down *per se*, suffered indirectly from the lockdown anyway, through lower demand (e.g., from restaurants) and complications with distribution. The other sector that grew was government services, by 3.6% y/y. The figure shows that government emergency spending did take place, but perhaps not in the magnitude that the announced emergency spending program had suggested. Note, however, that the lack of normal government services during April would have countered emergency spending to some degree.

On the other end of the spectrum, hotels & restaurants fell -94.6% y/y. One might wonder who was able to open, except we do know that. The government used a number of hotels to quarantine passengers from incoming flights. Another sector which fell in the -90% y/y range was construction, as all non-essential (e.g., outside health and sanitation) projects were halted. Then came the sectors that saw contractions in the -60% y/y range. These were mostly linked to consumption, and included manufacturing (-65%), commerce (-65%) and transportation (-69%). Fishing (an offseason month) and mining did only marginally better.

The impact of the lockdown on employment was equally strong in April (chart 2), with the added concern that this might have longer-term repercussions on demand. Lima lost 2.3 mn jobs in the March–May period (the National Statistics Institute, INEI, provides employment data on a three-month rolling basis). This was an enormous -47.6% y/y decline. One wonders just how does an economy recover from something like this. As a result, the unemployment rate for Lima shot up to 13%, which makes our 12% unemployment forecast for the country this year look outdated.

President Vizcarra addressed the concern over the economy in a press conference on Monday. The tenor of his message has changed dramatically over time. Whereas a month ago he would talk mainly of what the government was doing to contain COVID-19, with little allusion to the economy, now it was the other way around. The great majority of the time was dedicated to the economy. Pres. Vizcarra made a number of very important announcements. The main news was that the government was launching the ARRANCA PERU stimulus program, focused on creating at least one million jobs in the second half of 2020. To the best of my understanding (the announcement was not always orderly), this would be a PEN 6.4 bn (USD1.9 bn) program. Investment in transportation will account for the bulk of the resources, at PEN 4 bn and 570,000 jobs. The program will also include: housing, 20,000 homes and 80,000 jobs; agriculture: irrigation and ditches, with over 76,000 jobs; and the PEN 700 mn Trabaja Perú temporary job program: which aspires to create 226,000 jobs. What is clear is that the government is focusing on jobs. However, programs to create one million jobs seems underwhelming compared to the 2.3 mn jobs lost over the past three months.

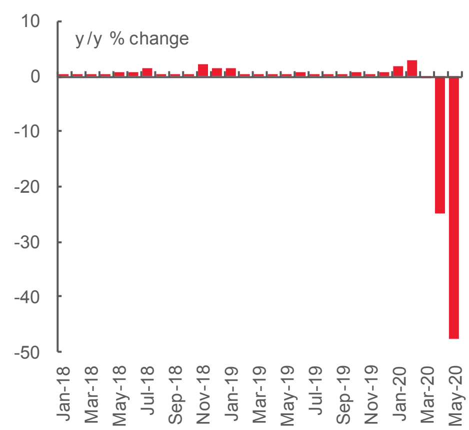
Table 1

Peru: April 2020 GDP	y/y % change
GDP	**-40.5**
Agriculture	0.6
Fishing	-57.8
Mining	-47.3
Manufacturing	-65.1
Resource processing	-83.3
Electricity	-25.6
Construction	-89.7
Commerce	-65.4
Transportation	-69.1
Hotels & restaurants	-94.6
Telecom	-1.6
Government	3.6

Sources: Scotiabank Economics, INEI.

Chart 2

Peru: Lima Employment Growth



Sources: Scotiabank Economics, INEI.

A second significant announcement was that the government had awarded the United Kingdom the tender to be the project manager of the PEN 7 bn El Niño reconstruction program for investment in hospitals, schools, riverbank reinforcement, and so forth. According to Pres. Vizcarra, PEN 1.5 bn would be invested in the second half of 2020, and the program will be completed over two years time. This may be the most convincing announcement of all. A similar program was very successful in building the infrastructure for the Pan-American Games.

Finally, the government announced that marketplaces and "centros comerciales" would be allowed to operate, presumably beginning on Thursday, June 18. With centros comerciales, the government seems to have in mind are the large flea-market style centers of retail goods, although the term may include modern formats such as malls. Certain of the retail conglomerates, such as the iconic Gamarra, were given the green light to begin operating Monday, although this is largely the government giving in to a fait accompli that it hasn't been able to control. Much of the informal and semi-formal part of the economy is simply starting to go out and work.

The new emphasis on the economy is in line with Finance Minister María Alva's statement to the press on Sunday that the government was seeking to keep the contraction in GDP for 2020 at no more than -8% y/y. We sincerely hope that she is successful.

—Guillermo Arbe