Latam Economic Update

- **Brazil: Economic activity likely hit bottom in April**
- **Chile: Central bank will be able to buy sovereign bonds, but it will have to wait at least two weeks**
- **Colombia: Economic activity contracted by -20.06% y/y in April**

BRAZIL: ECONOMIC ACTIVITY LIKELY HIT BOTTOM IN APRIL

On Thursday June 18, the BCB released its GDP proxy for April (the IBC-Br), showing a -15.1% y/y decline, a contraction roughly twice as large as the previous sharpest drop on record. The data point was not much of a surprise given that we already had most of the other major activity indicators for the month, and hence consensus only missed the print by 20 bps. Barring a big unexpected development, such as the pandemic getting even worse than the current moment—and resulting in a more severe lockdown, which would mean a sharp change in policy by President Bolsonaro—we expect April to be the low point of the cycle.

However, we also expect the rebound from here to be very gradual. The IBC-Br doesn't give us a breakdown by sectors, but based on other data points we have so far, we expect the start of the rebound will have both the services and manufacturing sectors printing slightly better data in May than they did in April.

—Eduardo Suárez

CHILE: CENTRAL BANK WILL BE ABLE TO BUY SOVEREIGN BONDS, BUT IT WILL HAVE TO WAIT AT LEAST TWO WEEKS

The government announced on Thursday, June 18 a constitutional and legal reform that is intended to empower Chile's central bank so that, in exceptional circumstances, it can buy and sell sovereign bonds in the secondary market. We anticipated this in a previous *Latam Daily*.

These modifications will allow the BCCh's framework of tools to be expanded in order to deal with extraordinary situations in which the normal operation of the payment system could be at risk. This could include the case of a worsening of the health emergency and the economic impacts that COVID-19 is causing.

The purchase and sale of sovereign debt in the secondary market is an option that has long been available to the central banks of advanced economies for the fulfillment of their mandates. Chile's BCCh is now set to join their ranks.

The proposed reform of the constitution will modify its article 109 and contemplates necessary safeguards so that this new tool is used responsibly, without compromising the central bank's autonomy. First, transactions in sovereign debt by the BCCh would be limited to exceptional circumstances in which the protection of the normal operations of internal and

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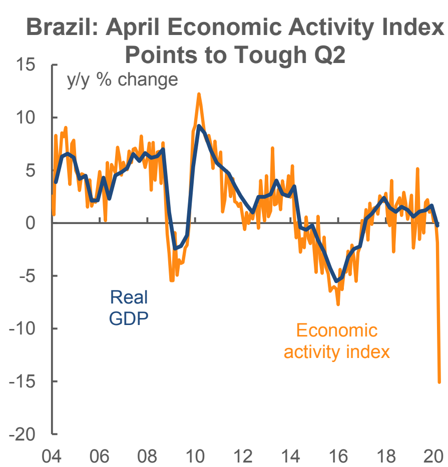
Chart 1



Sources: Scotiabank Economics, IBGE.

external payments requires them; and second, such transactions would need to be made on the open secondary market to prevent the monetization of fiscal deficits.

The government can already count on the support of the political opposition, which views this change very favourably. The two-thirds majority required to pass the amendment is more or less guaranteed.

Regarding timing, the government's legislative and bureaucratic processes imply that the central bank would not have authorization to begin transactions for at least two weeks. The announcement of this measure, which was implicit in the BCCh's communications this past week, has already had an effect on the yield curve.

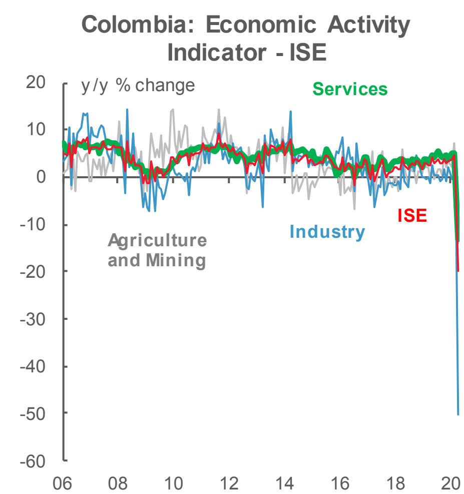
—Carlos Muñoz

COLOMBIA: ECONOMIC ACTIVITY CONTRACTED BY -20.06% Y/Y IN APRIL

On Thursday June 18, DANE released the monthly Economic Activity Indicator (ISE), which is a proxy for GDP. In April, ISE contracted by -20.06% y/y (chart 2), which was the worst result in the history of the indicator (2006). It is worth noting that April was the most restrictive month of the quarantine period, and it was reflected in all macroeconomic indicators. The poorest performing sectors were the industry-related activities, which contracted by -50.12% y/y; primary activities such as agriculture and mining sector fell -13.75% y/y, while services-related activities fell -13.3% y/y.

April's result is in line with our forecast of a -10.6% y/y contraction in Q2-2020 since we estimate that only 66% of the economy was active during this month. Although the year-on-year deceleration in economic activity will continue, it will be at a slower pace since, in May, an additional 8% of the economy re-opened. Additionally, by the end of June, around 81% of the economy will be back in action. If the re-opening process continues, the Colombian economy could contract by -5.0% y/y in 2020. In terms of monetary policy, the monthly economic activity results skew the risk balance toward further rate cuts. However, May's leading indicators are providing positive recovery signals, which support gradualism from the BanRep. We expect a 25 bps reduction at the June 30 meeting.

Chart 2



Sources: Scotiabank Economics, DANE.

—Sergio Olarte & Jackeline Piraján