Latam Economic Update

- **Argentina: Q1-2020 GDP contracts and unemployment rises in line with expectations**
- **Brazil: BCB Copom *Minutes* leave door open for further cuts, data dependence in the cards**

ARGENTINA: Q1-2020 GDP CONTRACTS AND UNEMPLOYMENT RISES IN LINE WITH EXPECTATIONS

Real GDP growth in Q1 came in dead-on our and consensus expectations, with a -4.8% q/q and -5.4% y/y contraction, consistent with recent readings on the monthly EMAE index of economic activity.

- **On the supply side,** 12 of 16 sectors experienced declines from a year ago, led by fishing (-30.4% y/y), construction (-20.8% y/y), and hospitality (-10.2% y/y). The 3.8% y/y growth in utilities provided only a modest offset.
- **On the demand side,** investment fell the hardest (-18.3% y/y), which reflected both the uncertain economic outlook and the inconsistent macroeconomic framework. Private consumption (-6.6% y/y) and exports (-4.7% y/y) also provided drags on growth. Government declined by only -0.7% y/y as the authorities boosted spending to compensate for the imposition of the lockdown on March 20.
- **The unemployment rate rose from 8.9% in Q4-2019 to 10.4% in Q1-2020, close to our forecast of 10.9%.** This was broadly consistent with the first quarter's contraction in economic activity.

We continue to expect the Argentine economy to contract by about -15% y/y in Q2-2020 and to record a nearly -8% y/y contraction for 2020 as a whole. Even with our forecast of a 6.5% y/y rebound in 2022, real economic activity would remain at around 2010's levels until 2023 (chart 1), which would mark a new lost decade for Argentina.

—Brett House

BRAZIL: BCB COPOM MINUTES LEAVE DOOR OPEN FOR FURTHER CUTS, DATA DEPENDENCE IN THE CARDS

On Tuesday, June 23, the BCB released the *Minutes* of its June 16–17 Copom meeting, where a unanimous decision was made to cut rates by -75 bps. The *Minutes* reinforced our view that the Board will deliver another -50 bps of easing, but we'd still like to see two more data points before we fully reaffirm our call.

The *Minutes* highlighted the Board's concerns over the depth and likely length of the current recession as its top short-term worry. In the time since the Copom met, the pandemic in Brazil has gotten much worse. Inflation is posed in the *Minutes* as a 2021 concern, principally related to FX pass-through and fiscal pressures, which are unlikely to re-assert themselves until late-2020.

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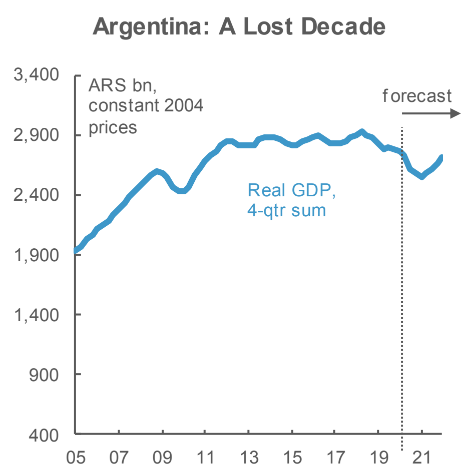
Chart 1



Sources: Scotiabank Economics, Bloomberg.

The main short-term argument against further cuts relates to worries about de-anchoring local markets by cutting yields too much, but the reaction of Brazilian asset prices since the June 16–17 Copom meeting's -75 bps cut should somewhat alleviate these concerns. Monetary policy acts with a lag, but at this juncture, any boost of confidence that the BCB can provide would be a plus.

Still, as noted above, there remain two issues we want to monitor over the coming weeks to get higher conviction on our call for another -50 bps in cuts:

1. **The evolution of DI rates over the next couple of weeks and whether the steepening of the last week intensifies**—which would play into the BCB's fear that the floor for rates provided by Brazil's higher country risk premium has been reached. The past week has seen short-end rates fall -75 bps for 1-mo. DIs, but we've seen 4-yrs-plus rates rise 10–20 bps. The moderate rises in longer-end rates we've seen so far should not forestall further cuts, but an acceleration of longer-tenor rate increases could; and

2. **We would also like to see the next round of PMIs. which would give us a glimpse of activity for June.** We expect a small bounce, which should not undermine the need for more cuts, but a major rise could be a factor inhibiting further rate reductions by the BCB.

For now, we will stick with our call for another -50 bps of easing, but it depends on these data.

It's worth noting that at least one former BCB Governor, Gustavo Franco, has discussed the possibility that the BCB could join the ranks of central banks that are experimenting with negative yields. We're not ready to go that far, but we do think that the end of the easing cycle is somewhat of a moving target at this stage. Our sense is that the BCB would be better served by being in data-dependent mode, rather than tying itself down with forward guidance. In a sense, this is the kind of environment where we think it's wiser for EM central banks to provide only conditional guidance due to the huge amount of uncertainty that exists.

—Eduardo Suárez