Latam Economic Update

- **Argentina: Quarantine tightened and extended to July 17 in greater Buenos Aires; "final" government debt offer this week; economic activity expected to dive sharply in April**
- **Colombia: Medium-term Fiscal Framework released; owing to COVID-19 outbreak, fiscal consolidation will need reforms equivalent to 2 ppts of GDP**
- **Mexico: April's economic activity indicator and May's trade balance foreshadow a bad Q2-2020 amid the lockdown**

ARGENTINA: QUARANTINE TIGHTENED AND EXTENDED TO JULY 17 IN GREATER BUENOS AIRES; "FINAL" GOVERNMENT DEBT OFFER THIS WEEK; ECONOMIC ACTIVITY EXPECTED TO DIVE SHARPLY IN APRIL

Note: Our Argentina 'Latam Daily' coverage will resume on July 6 following the Canada Day and US Independence Day holidays.

The Buenos Aires-focused quarantine, which was due to expire on Sunday, June 28, has been tightened and extended to July 17 in response to a recent spike in COVID-19 cases that has seen numbers rise by 5x since late-May. From today, public transport in BsAs and around 30 surrounding towns will be limited to workers in some 20 professions deemed essential; to make use of the public transportation system, these workers will need to renew or obtain a travel permit. From July 1 to 17, some recently-opened businesses will be re-shuttered. In retail, only shops connected to safety, health, and food will be allowed to stay open. Factories that produce for export and those that, for technical reasons, find it hard to halt production will be allowed to continue operations; public employees will be exempted from the re-tightening in measures.

***Clarin* reports that the government is presenting to creditors what Pres. Fernandez is calling a "final" set of offer terms that were developed late on Saturday, June 28.** The new plan is reported to maintain the government's existing proposal for a 50% NPV reduction on the USD 65 bn of external-law bonds currently in default, but is said to feature revised coupon structures and grace periods. A response from bondholders is expected by midweek. *Ambito* contends that there is new optimism amongst negotiators that a deal will be reached, which is reflected in more coordinated communication between the two sides as they exchange bargaining points. Minds are also likely to be focused on the USD 566 mn maturity due Tuesday on NY-law discount bonds which, when missed, will open up a new front in Argentina's debt problems. The grace period on this maturity ends July 30 and the government is clearly hoping to reach agreement on a debt exchange before that point given that it has extended its offer period to July 24.

The April edition of the monthly EMAE economic index comes out at 15:00 ET today and we expect it to contract by -13.2% m/m s.a. and -15.4% y/y n.s.a. April was the first full month of the lockdown, which began March 20. No consensus expectations have been generated for the print, but our projections are consistent with the -15% y/y decline we have forecast for the whole of Q2

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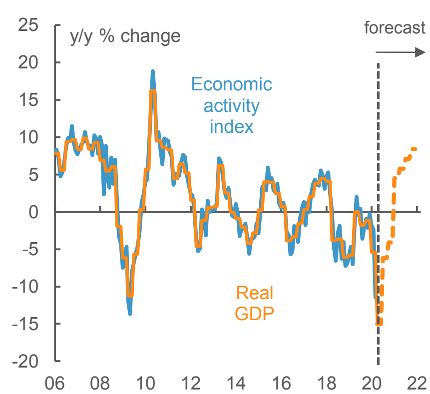
Chart 1

Argentina: Real GDP Tracking Deep Dive in Q2-2020



Sources: Scotiabank Economics, INDEC.

(chart 1). For the quarter, consensus has gradually come into line with our forecast, falling from the -11.4% y/y Bloomberg published in May to the -13.2% y/y currently posted on the terminal.

—Brett House

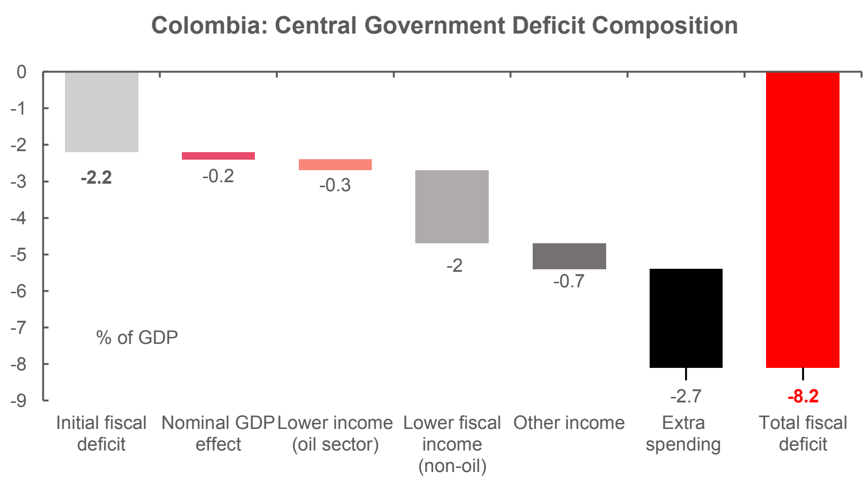
COLOMBIA: MEDIUM-TERM FISCAL FRAMEWORK RELEASED; OWING TO COVID-19 OUTBREAK, FISCAL CONSOLIDATION WILL NEED REFORMS EQUIVALENT TO 2 PPTS OF GDP

Following the suspension of the Fiscal Rule for 2020 and 2021, the Medium-Term Fiscal Framework 2020 (MTFF), has become the most relevant economic-policy publication since it provides the clearest insights on the government's thinking about the country's economic and fiscal results. It also gives a general perspective on the most important factors influencing the main fiscal goals and their sustainability over the next 10 years.

The main message from the MTFF, released on Friday, June 26, was that indebtedness will increase significantly this year, but the government will try to pass a fiscal reform once the pandemic is behind us to return the public accounts to a sustainable fiscal path. This message should give Colombia some time before international rating agencies move to downgrade Colombia further. Additionally, we expect no significant reaction from markets in response to the MTFF's publication.

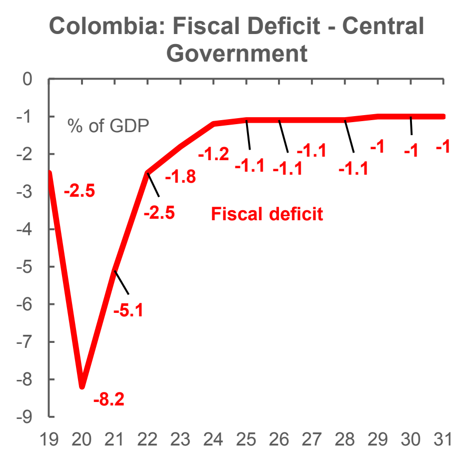
The COVID-19 outbreak and oil prices shock have led to a sudden increase in the need for social programs to boost the economy at the same time that tax collection has contracted due to the recession. Combined, these developments will increase public debt significantly in 2020. The IMF has emphasized that Colombia, like other Latin-American countries, should undertake substantial reforms to adjust its debt to more sustainable levels and the MTFF is the first step toward fiscal consolidation.

Chart 2



Sources: Scotiabank Economics, Ministerio de Hacienda y Crédito Público.

Chart 3



Sources: Scotiabank Economics, Ministerio de Hacienda y Crédito Público.

Key readings from the MTFF

I. Macro fundamentals and fiscal targets

- **Colombian GDP is expected to contract by -5.5% y/y in 2020 and the recovery would be at a 6.6% y/y pace in 2021, which we think is particularly optimistic and gives us a downward bias.** In the ensuing years, GDP would converge to a potential equilibrium of 3.3% y/y, gradually closing the negative output gap until 2028.
- The fiscal deficit target would be -8.2% of GDP in 2020, which is much higher than the -2.2% deficit projected pre-COVID-19. The higher deficit is a result, mainly, of 2.7 ppts of GDP in extra expending and contraction of 2.7 ppts of GDP in fiscal revenues due to lower economic activity (chart 2).

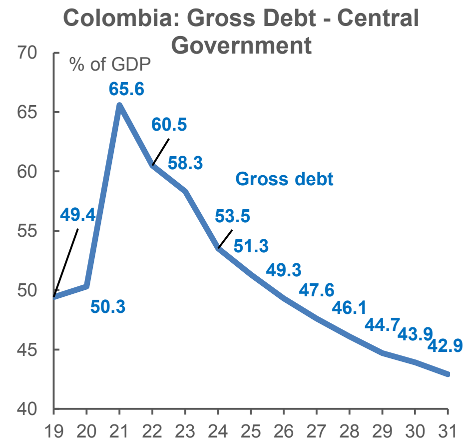
- **For 2021, the fiscal deficit target is -5.1% of GDP, which is a result of lower fiscal income due to the lagged effect of the pandemic's shock and assumes no extra expending related to the crisis (chart 3).**

- **The 2020 and 2021 targets can change if fiscal income and expenditures evolve with the pandemic.** Any change in fiscal targets must be approved by the Independent Committee Fiscal composed of the Fiscal Rule Committee's members.

- **After 2021, the fiscal deficit will be defined according to the Fiscal Rule's parameters.** To ensure rule compliance in the medium-term, the Ministry of Finance has announced that it will try to pass a fiscal reform that will raise 2 ppts of GDP.

- **Details on fiscal reform were not discussed in the MTFF, but there was a strong message from the MoF on the need to increase fiscal income and reduce some expenditures.** Having said that, the discussion about fiscal reform will take place when the pandemic has been overcome and government can quantify the permanent effects of COVID-19.

Chart 4



Sources: Scotiabank Economics, Ministerio de Hacienda y Crédito Público.

- **The gross debt-to-GDP ratio will increase to 65.6% in 2020 (chart 4).** Starting in 2022, a convergence to lower levels through primary surpluses is expected.

- **At the press conference, the MoF ruled out debt defaults or direct loans with the central bank.**

- **The MoF emphasized that the high uncertainty around the macroeconomic outlook implies that the MTFF's base case scenario could change easily.** In our opinion, the GDP recovery projected in 2021 appears optimistic, and the expected adjustment of the fiscal deficit in 2022 needs an early discussion on tax reform.

II. Funding

- **In 2020, total sources of financing are expected to amount to COP 130.5 tn (table 1), up by COP 55.6 tn from January's Financial Plan for the year.**

Table 1

Colombia: Fiscal Financing—Sources and Uses, 2020

	MTFF, June 2020	Financing Law, January 2020		MTFF, June 2020	Financing Law, January 2020
Sources, COP tn	**130.5**	**74.8**	**Uses, COP tn**	**130.5**	**74.8**
Disbursements to the government	**109.6**	**45.0**	**Fiscal deficit**	**83.4**	**24.9**
Foreign sources (USD 16.1 bn)	**59.1**	**10.1**	Local interests	22.9	23.4
Bonds		4.7	External interests (USD 2.4 bn)	9.4	8.6
Multilateral and other		5.4			
Local sources	**50.5**	**35.0**	**Amortizations**	**10.8**	**13.2**
TES		**34.9**	External (USD 1.8 bn)	6.5	6.0
Auctions		24.5	Local	4.3	7.2
Public entities		5.0	**Debt service obligations**	**12.6**	**15.7**
Payment of obligations		5.4			
Other		**0.0**			
Other sources	**0.1**	**9**	**Floating debt**	**1.5**	
Initial balance	**20.8**	**20.8**	**Final balance**	**22.1**	**21.0**
Local currency		14.0	Local currency		14.7
USD		6.8	USD		6.3

Sources: Scotiabank Economics, Ministry of Finance Colombia.

- **External sources are forecast to provide USD 16.1 bn: USD 2.8 bn have already been done through external debt issuance and USD 4.1 bn in previously announced multilateral funding.** The remaining USD 9.2 bn has not yet been assigned to a specific source; however, external funding should be enough to finance the current account deficit, which is expected to hit 4.8% of GDP in 2020.

- **Local sources are expected to finance COP 50.5 tn, higher than the COP 33.5 tn scheduled in the original plan.** TES issuances would increase to COP 27.5 tn from the previously scheduled COP 24.5 tn. The increase includes the 30Y bond issuance. Other local financing would come through national savings—the Emergency Fund, FOME—and mandatory investments from banks in solidarity bonds.

- **In 2021, the deficit calculation includes around COP 12 tn in sales of assets, which has always been a strong assumption due to political concerns.**

All in all, the MTFF was constructed in a highly uncertain situation and will need to be accompanied by robust fiscal reforms. The MTFF's GDP contraction forecast for 2020 is smaller than the IMF expects and the recovery pace for 2021 looks challenging. Either way, substantial fiscal reforms will be needed to comply with the fiscal rule in 2020 and in years beyond. The government should have a golden opportunity to present reforms that try to change the fiscal budget on both the expenditure and the income sides. However, discussions on specifics should start sooner rather than later.

—Sergio Olarte & Jackeline Piraján

MEXICO: APRIL'S ECONOMIC ACTIVITY INDICATOR AND MAY'S TRADE BALANCE FORESHADOW A BAD Q2-2020 AMID THE LOCKDOWN

I. April's economic activity printed its strongest-ever monthly decline, but it was less than market consensus expected

Even though n.s.a. figures published on June 26 showed that economic activity, measured by the Global Economic Activity Indicator (IGAE), decreased for the fourth consecutive month in April and at the most pronounced rate that it has ever registered, the -19.9% y/y contraction was better than market consensus (-21.1% y/y).

- IGAE posted its sharpest decline on record, surpassing the -11.0% y/y drop of April 2009 and the -10.1% contraction of April, 1995 (chart 5).

- This drop originated in a record collapse of the industrial sector, which has now accumulated 14 monthly declines in a row, this time going from -4.9% y/y to -29.3% y/y, and a never seen before serial drop in services, from -1.5% y/y to -16.4% y/y. These falls more than offset the soft advance in the agricultural sector, which moderated from 9.3% y/y to 1.8% y/y.

- Meanwhile, s.a. IGAE also significantly deepened its monthly slowdown, going from -1.3% m/m to -17.3% m/m, as a result of the general decline of its three major components: industry deepened its fall from -3.3% m/m to -25.1% m/m, at the same as services slowed from -1.3% m/m to -14.4% m/m, and the agricultural sector deteriorated from 11.1% m/m to -6.4% m/m. On an annualized basis, the IGAE added 12 consecutive losses, this time accentuating its negative rate, from -2.6% to -19.7% y/y.

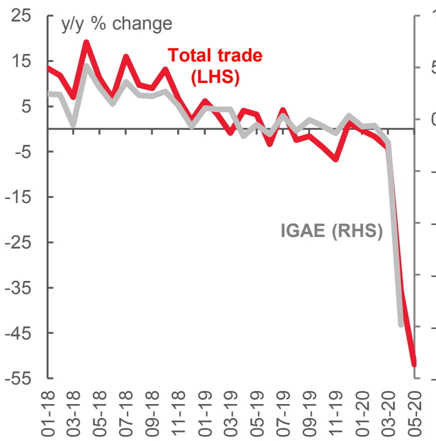
The weakness of the Mexican economy during Q1-2020 changed to a strong plunge at the beginning of Q2-2020, owing to the effects of the lockdown, which pretended to mitigate the dispersion of COVID-19. It is foreseeable that the economy will continue in negative territory in the coming months and at least until early-2021.

Chart 5

Sources: Scotiabank Economics, INEGI.

Chart 6

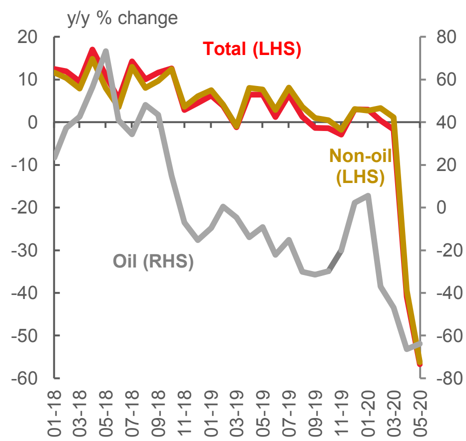
Mexico: Trade & Economic Activity



Sources: Scotiabank Economics, INEGI.

Chart 7

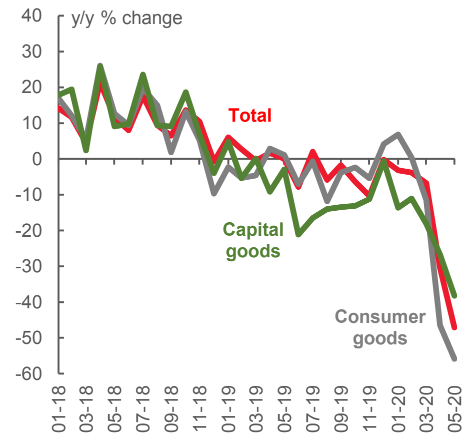
Mexico: Exports



Sources: Scotiabank Economics, INEGI.

Chart 8

Mexico: Imports



Sources: Scotiabank Economics, INEGI.

II. May foreign trade figures highlighted poorer economic activity during the lockdown as the trade deficit far outweighed market consensus

Trade data for May, that were released on June 26, revealed a much deeper collapse in both exports and imports, which slowed growth in Mexico's total trade with the rest of the world to its lowest pace since records have been available from 1994 (chart 6).

- May's trade deficit hit the USD 3,523 mn, which compares to a surplus of USD 957 mn in May 2019 and to a deficit of USD 385 mn expected by the market consensus.
- This result was driven by strong declines in both exports and imports. Export growth fell from -40.9% y/y in April to -56.7% y/y in May, versus 6.5% y/y in May 2019 (chart 7). Import growth fell from -30.5% y/y in April to -47.1% y/y (chart 8), compared with 0.1% y/y in May 2019. For both, it was their biggest drops since records began in 1994.
- Within exports, the notable decline of non-oil exports stood out, from -39.4% y/y in April to -56.3% y/y (also chart 7), in contrast with 7.7% y/y in May 2019. An even stronger decrease happened in manufacturing, from -41.9% y/y to -58.7% y/y (versus 8.0% y/y growth a year before). Auto exports fell by -90.1% y/y while manufacturing exports, excluding autos, contracted -41.4% y/y.
- On the other hand, within imports, capital goods marked 14 months of negative growth, accentuating their fall from -26.7% y/y in April to -38.3% y/y (compared with -3.0% y/y in May 2019); meanwhile, growth in intermediate goods imports slowed from April's -28.1% y/y to -46.6% y/y (versus a small gain of 0.3% y/y in May 2019), and consumer goods imports declined further, from -46.5% y/y to -55.8% y/y, compared with growth of 1.1% y/y in May 2019 (chart 8).
- Therefore, total trade (i.e., exports + imports) slowed significantly, from a -35.8% y/y decline in April to a large -52.0% y/y drop in May, in stark contrast to a 3.2% y/y expansion in May 2019.

Despite the monthly reactivation of industrial production in the US and the partial reopening of some sectors in Mexico from mid-May, foreign trade figures turned out worse than those in April. Thus, the commercial outlook continues to be subject to a high degree of uncertainty, albeit with a marked negative bias, and these figures point to a recovery that would be slower than expected.

—Daniel Mendoza