# Latam Economic Update

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## ARGENTINA: WAITING FOR A COUNTER OFFER ON DEBT RESTRUCTURING

**In an interview published on May 12, Pres. Alberto Fernandez warned that Argentina will not modify its debt restructuring offer until the government sees some kind of counter offer from its creditors.** Spokespeople for some bondholders indicated that they expect to put forward something concrete soon, even as the President contended that all the government has received so far is "silence". This, of course, elides over the specific critiques provided last week by major bondholder groups in a webinar.

**Speculation has centred on what kind of recovery value from a debt exchange would be required to bring the two sides together.** With Argentina's offer providing somewhere around 32 to 35 cents on the dollar and creditors looking for something closer to 54 cents on the dollar, the two sides remain far apart.

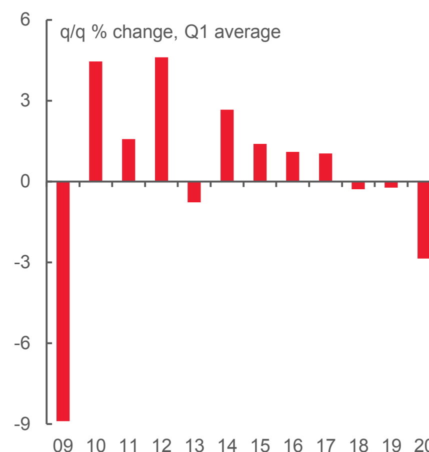
**Meanwhile, IMF MD Kristalina Giorgieva reaffirmed the Fund's finding that Argentina's debt is not sustainable.**

**—Brett House**

## BRAZIL: BCB MINUTES HIGHLIGHT HUGE DEGREE OF UNCERTAINTY

**The BCB published its minutes for the May 5–6 COPOM meeting, on Tuesday May 12.** The unanimous decision seemed to be fairly homogeneous in terms of the evaluation of the macro environment and risks. The Committee anticipated a "final adjustment" for its upcoming meeting that would be "no larger than" the 75 bps delivered on May 6. The Committee was chiefly concerned with the significant capital outflows we are seeing from emerging markets, even compared to other crises. The Committee agreed that the brunt of the economic decline will be in Q2, but also highlighted that—barring a medical break-through—we are likely to see a relatively slow rebound. Still, the Committee seemed to think that by Q3 the trend in growth will improve. We generally tend to agree with this growth profile.

Chart 1



Sources: Scotiabank Economics, INEGI.

**Our sense is the two main points of debate within the Copom concerned:** (1) the size of the output gap, as the pandemic shock could drive an increase in precautionary savings, thus reducing aggregate demand; and (2) the lower bound of Brazilian rates, with some on the Committee arguing that risk premiums likely imply a higher floor for the Selic than we see in developed markets, while the counter argument was that cutting rates will continue to support the economy. This last point was among the factors that supported a gradual approach to further policy adjustments and this argument is one of the key reasons why we see the door being left open for further moves after the Copom's "final cut" at its next meeting.

**The minutes highlighted a much larger than usual degree of uncertainty around the BCB's baseline scenario.** In particular, the Committee pointed out that a materialization of fiscal risks could force a move toward higher interest rates as investors demand greater risk premiums. Our base case is that the near-term growth outlook will continue to deteriorate—which is why we see the Committee delivering another rate cut after the upcoming June 17 meeting: we have a 75 bps cut followed by a further 25 bps move in our forecasts, but this could also be delivered as 2 x 50 bps cuts. Nevertheless, we expect the eroding fiscal situation, the drop in the BRL, and pass-through inflation effects will allow the BCB to keep the Selic at historic lows for only a short period of time before it's forced to reverse itself.

**—Eduardo Suárez**

## CHILE: IMF MD ENDORSES USD 24 BN FCL; BCCH FINANCIAL STABILITY REPORT HIGHLIGHTS CHALLENGES AHEAD; SANTIAGO LOCKDOWN INTENSIFIED

### I. IMF MD endorses request for an FCL arrangement

**The IMF's Executive Board met on May 12 in an informal session to discuss the Central Bank of Chile's (BCCh) request for a two-year arrangement under the Flexible Credit Line (FCL) for an amount of USD 23.8 bn, 10x the Chilean IMF quota, and equivalent to 8% of GDP.** These resources would complement the BCCh's FX reserves and increase its immediate access to international liquidity by more than 60%. The IMF's head, Kristalina Georgieva, intends to recommend the request for approval by the Board.

**The quota that Chile maintains with the IMF amounts to USD 2.4 bn.** Due to Chile's precautionary treatment of the FCL (i.e., it will not be immediately drawn), the annual cost of the credit line is limited to the commitment fee, which is provisionally estimated at 0.4% a year.

**To date, only three countries—Colombia, Mexico, and Poland—have applied for and received approval for an arrangement under the FCL, with all three receiving their authorization in 2009, the first year of the FCL.** All three have treated their FCL as precautionary: none of them has needed to draw on their arrangements. Only Mexico and Colombia have continued to renew their FCL arrangements; Poland allowed it to lapse in 2017. Colombia made its most recent renewal almost two weeks ago on May 1. Less than a week ago, Peru submitted to the IMF a request for a two-year FCL arrangement amounting to approximately USD 11 bn. This amount is equivalent to that of Colombia's FCL, although it represents about 6x Peru's quota with the IMF, whereas Colombia's arrangement is nearly 4x its quota. Formal approval by the IMF's Executive Board of Peru's request is still pending.

**The FCL is broadly envisaged as a precautionary facility that would not be drawn on immediately following approval and would be used to bolster FX reserves in the event of a severe shock, such as the current pandemic.** The facility is not intended to finance public spending and is provided only to countries with strong policy frameworks and track records. No conditionalities are imposed after approval.

**Access to the FCL is part of the strategy of the BCCh to strengthen its instruments in case the adverse economic conditions arising from the health crisis become more pronounced or prolonged.** The mere existence of additional mechanisms to protect the Chilean economy against external shocks should help to relax financial conditions.

**Financial markets will view this request as having a high probability of being approved, given Chile's fundamental strengths and the endorsement provided yesterday by the IMF's Managing Director.** The CLP saw some lift owing to the signalling effects of the announcement.

### II. BCCh *Financial Stability Report*: a challenging scenario for firms, households and banks

**The BCCh's new *Financial Stability Report* (FSR), published May 13, projects that the effects of the lockdown's restrictions on activity and the drop in incomes that follows will be reflected in a deterioration in the financial position of companies, which could limit their ability to service their debts.** As of the first quarter of 2020, total company debt reached 131% of GDP, which represents an increase compared to the previous FSR and is largely explained by the depreciation of the peso against the dollar since the share of FX-denominated private debt in Chile is amongst the highest in the region. A fraction of larger firms will need additional financing to supplement their cash flows. These firms have an important role in job creation, they have numerous business relationships with smaller firms, and their debt has a sizable presence within bank portfolios.

**Regarding the situation of households, the FSR points out that the recent deterioration of the labour market occurs in a context where the total debt of households in Q1-2020 exceeded 50% of GDP.** The average bank debtor faced a 23% financial burden on income (FBI, calculated as the ratio of debt service to personal disposable income). For its part, the fraction of vulnerable debtors, who have an FBI of over 40%, remains at 30%. In this context, economic measures in response to the health emergency that directly benefit households make an important contribution toward avoiding episodes of non-payment. In particular, the postponement of the payments on real estate and on basic services accounts, the flexibility to reprogram and extend credits in installments, and the employment protection program stand out for their critical roles in preventing household delinquencies.

**Credit allocation presents great challenges in the current economic scenario, where banks will face increases in credit risk with less capital slack.** A significant contraction in activity will likely cause a deterioration in the financial indicators of banks, due to an increase in delinquencies. The expected slowdown is similar to that considered within the stress scenarios usually used to establish bank resiliency, so we have some sense of the expected magnitude of late payments.

**The developing reduction in excess capital buffers and the intensive use of guarantees as a credit risk mitigator imply, going forward, relatively lower capacity by banks to face further deterioration in the current situation.** Going forward, the loss-mitigation measures that are being implemented will be fundamental to ensure that banks can continue to provide adequate flows of new credit.

### III. Santiago lockdown intensified

**The government decreed on May 13 that the lockdown in the Santiago Metropolitan Region will be intensified for at least one week from May 15 at 10pm following a spike in positive COVID-19 test numbers.** Today saw 2,660 people identified as COVID-19 positive in the Region, the highest number since the pandemic began. The tightened lockdown covers 73% of the municipalities in the Region. All told, from Friday, night 42% of Chile's total population will be under a strict quarantine. Additionally, the age of older adults subject to mandatory quarantine in their home was lowered from 80 to 75 for the entire country.

**—Jorge Selaive & Carlos Muñoz**

## MEXICO: INDUSTRIAL PRODUCTION FELL IN MARCH, AS THE ECONOMY SUFFERED THE EFFECTS OF CONFINEMENT; SOME RE-OPENING TO BEGIN MAY 18

**Mexican industrial production, released on Tuesday, May 12, intensified its decline from -2.0% y/y in February to -5.0% y/y in March, its lowest rate since 2009, which marks 17 months in negative territory.** The contraction was led by a drop in manufacturing output, which was down -6.1% y/y in real terms, with the production of vehicles and auto parts falling -20.3% y/y and production of machinery and equipment down -13.7% y/y. Construction also reported a strong decline, going from -9.0% y/y in February to -7.5% y/y in March, while utilities output decreased from 1.5% y/y to -0.8% y/y, and mining slowed from 5.5% y/y to 1.3% y/y. With March data, industry averaged a contraction of -2.9% q/q in Q1-2020 (versus -0.2% q/q in the same period last year), which was its worst performance for a calendar-year first quarter since 2009 (chart 1).

**The Mexican authorities took measures to minimize the spread of COVID-19 in the second half of March: closing schools and stadiums; canceling public events; and recommending people stay at home and work remotely.** Some industries such as automotive assembly plants also closed in late-March because of disruptions in supply chains. The closures were extended in April to all industries and services deemed non-essential. Thus, we anticipate that the effect on industrial production of these closures will be significantly more severe in the second quarter of the year, as some data already released for April seem to confirm.

**Industrial numbers may begin to turn around in May since Economy Minister Graciela Marquez confirmed on May 13, that a phased re-opening of the economy will begin on Monday, May 18 even as COVID-19 death counts continue to climb.** Auto parts and assembly, construction, and mining have all been cleared to restart operations next week. The auto sector is under particular pressure to re-open in order to feed global supply chains that depend on Mexico.

**—Paulina Villanueva**

## PERU: BCRP—LOCKDOWN SHAVES 8 PPTS OFF GDP GROWTH; STIMULUS MEASURES WILL SPEED UP RECOVERY; 2020 INFLATION TO BE NIL

**BCRP president, Julio Velarde, stated on Monday May 11, that the lockdown had knocked 8 percentage points off of GDP for 2020.** The comment is revealing, as the central bank monitors GDP closely and does not talk lightly. The BCRP has not given new forecasts for 2020 GDP growth, however, so, on the face of it, Velarde's comment would suggest that, if the BCRP was previously forecasting 4% GDP growth for the year, the lockdown alone would lower the figure to -4% y/y. Considering that the economy is being unlocked very gradually, Velarde's statement is in line with our forecast of a contraction in GDP of between -9% y/y and -14% y/y in 2020. Velarde also stated that fiscal and monetary stimulus and recovery measures should allow the economy to be back on its feet by late-2021, and that inflation could be close to nil in 2020.

**The government has made it mandatory for all salaries and other labour payments to be made through a bank deposit.** The intention is to prevent workers from focusing on cash payments to avoid taxes and fees. However, to the extent that this is successfully adopted by formal and informal businesses, it is also a step towards greater digitalization, greater bank penetration, greater transparency, and lower informality.

**Carlos Gálvez, head of the association of mining companies (SNMPE, the Sociedad Nacional de Minería, Petróleo y Energía), stated on Monday that 80% of large mining operations should be back on stream during May and 100% by the end of June.**

**—Guillermo Arbe**

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