

## Latam Economic Update

- **Argentina:** Debt restructuring deadline looms on Friday, May 22
- **Colombia:** GDP below expectations in the first quarter; BanRep analysts' survey downgrades inflation expectations
- **Peru:** March's plunge in GDP by -16% y/y a mild positive

### ARGENTINA: DEBT RESTRUCTURING DEADLINE LOOMS ON FRIDAY, MAY 22

In a May 15 virtual meeting with the New York-based Council on Foreign Relations (CFR), Economy Minister Martin Guzman continued to express his interest in seeing a new “sustainable” counter offer from creditors to restructure about USD 65 bn of foreign-law bonds. Implied exit yield, coupon, and grace period all appear to remain the focus of negotiations, while Min. Guzman noted that there seemed to be little interest in possible GDP-linked warrants, which may reflect wariness of any instrument tied to government statistics.

Creditors are said to be demanding more fiscal adjustment from the Argentine authorities and have contended that the government’s growth assumptions are too weak. But, if anything, data so far in imply that the economy is on track to record a contraction much closer to the authorities’ -6.5% y/y forecast than to alternative projections (chart 1). We expect March’s economic activity index to show a further contraction from April that would be consistent with a nearly -6% y/y pullback in economic activity for 2020 as a whole.

The Province of Buenos Aires was cut to “selective default” by S&P on Friday, May 15, after it let a 10-day grace period lapse on May 14 on an outstanding USD 150 bn bond payment. The provincial government extended its restructuring offer on USD 7 bn of foreign-law bonds to May 26.

—Brett House

### COLOMBIA: GDP BELOW EXPECTATIONS IN THE FIRST QUARTER; BANREP ANALYSTS’ SURVEY DOWNGRADES INFLATION EXPECTATIONS

#### I. Colombian economy grew 1.1% y/y in Q1-2020, weaker than expected due to the early effects of COVID-19

On May 15, DANE released Q1-2020 GDP growth data. Real GDP growth in Q1 came in at 1.1% y/y, the weakest expansion since Q1-2017 and well below market consensus of 1.5% y/y. We had been expecting a much higher 3.2% y/y print until March’s coincident retail, manufacturing, and trade indicators came in on May 14, which pointed to Q1-2020 growth closer to 1.8%–2.1% y/y.

Although the mandatory quarantine affected mainly the last week of March, the economic costs were higher than expected. In spite of having expanded 4.2% y/y, on average, in the first two months of the year, March contracted by 4.9% y/y due to one week of quarantine. Domestic demand growth slowed to

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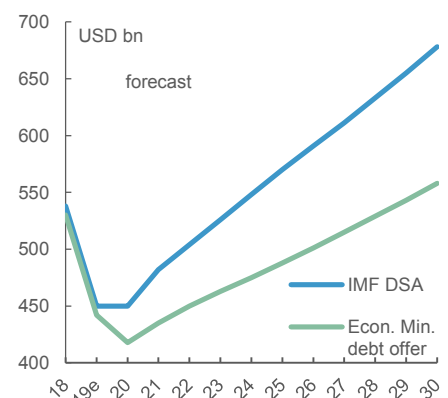
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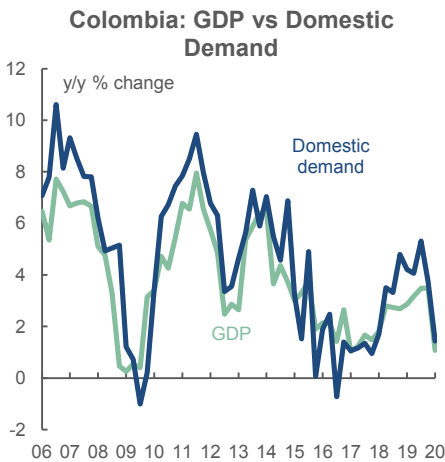
Chart 1

#### Argentina: Nominal GDP Forecasts



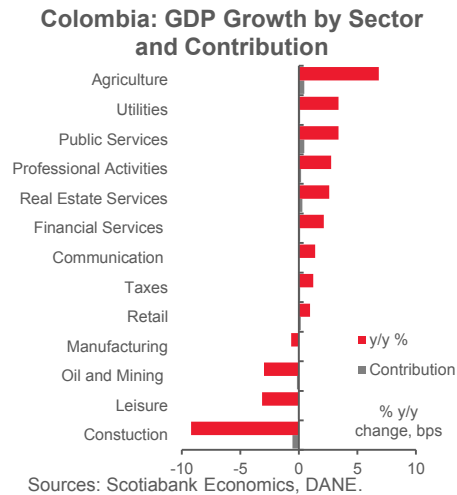
Sources: Scotiabank Economics, IMF, Argentina Economic Ministry.

Chart 2



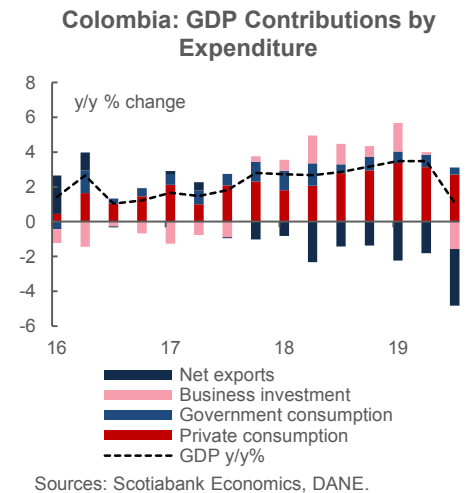
Sources: Scotiabank Economics, DANE.

Chart 3



Sources: Scotiabank Economics, DANE.

Chart 4



Sources: Scotiabank Economics, DANE.

1.4% y/y (chart 2) owing to lower investment, especially in building investment (-16.5% y/y); in contrast, private consumption growth remained relatively solid, particularly due to perishable goods consumption that grew 13.2% y/y. From the supply-side point of view, the construction, mining, and leisure sectors contributed -0.9 pts to total growth (chart 3).

The first quarter results showed that even one week of impaired activity can weigh significantly on economic activity, which now skews risks on our 2020 GDP forecast to the downside given the evident sensitivity of the economy to a few days of shutdown. Since the result also came in below BanRep expectations, we think cuts in the monetary policy rate will likely continue.

Domestic demand grew at its slowest pace in two years (1.4% y/y) due to weaker business investment (-6.7% y/y), which offset consumption growth (3.7% y/y, chart 4). Private consumption remained relatively strong (3.8% y/y), while government consumption growth slowed down (3.2% y/y) as a result of 2020 being the start of a new cycle of regional governments: public investment is typically slower in this initial stage of incoming administrations. Business investment weakened mainly in housing activities (-16.5% y/y).

Net exports contributed negatively to the y/y expansion in Q1-2020 because the contraction in imports at -2.5% y/y was smaller than the contraction in exports of -6.1% y/y. It is worth noting that exports fell on the back of weaker mining shipments. We expect imports to contract even more due to the demand shock on durable goods. Having said that, the current account deficit in 2020 is on track to hit 4.1% of GDP due to the offsetting effects on the income account and imports.

Bottom line: the Q1-2020 GDP figures showed that the lockdown hurt economic activity even more than expected despite the fact that the COVID-19 restrictions started just 15 days before the quarter ended. As expected, services-related activities were the most affected. Having said that, progressive re-opening of the economy will first benefit the goods-related side of the economy. Questions arise on the demand side, since deterioration in employment and consumer sentiment could continue interrupting the regular cycle of the economy.

The current scenario increases the possibility of further monetary policy rate cuts in 2020; for the May 29 meeting, we expect a 50 bps rate cut.

## II. Medium-term inflation expectations fell, more rate cuts are expected

- According to BanRep's May survey of macroeconomic expectations released on May 15, analysts now expect inflation at 2.89% y/y for December 2020 (table 1), 54 bps lower than last month. Inflation expectations (IE) for longer tenors also fell. In fact, expectations for the 1Y tenor stood at 2.94% (previously: 3.38%), and for the 2Y at 3.15%

(previously: 3.27%). Inflation expectations remained anchored, but are lower than the previous survey result. Lower than expected inflation results in April contributed, in our opinion, to IE being downgraded by analysts. Additionally, downside risk in economic growth and the recent BanRep inflation report that showed a range between 1% and 3% for December 2020 headline inflation also helped to push IE down.

- May's monthly inflation, on average, is expected at 0.13% m/m (our expectation is 0.09% m/m), which would bring annual inflation to 3.32% y/y, 19 bps lower than April's y/y figure.** Foodstuffs will likely drive headline price increases since core inflation is expected at 0.05% m/m. It is worth noting that in May, utility prices will likely contribute negatively to overall inflation and prices of services that were closed in April will likely reflect weaker activity. Over the longer term, the economic downturn will tend to impose negative pressures on prices.
- USDCOP forecasts for end-2020 stood at 3,792.67 per USD (up 16 pesos).** For December 2021, respondents think (on average) that the COP will end up at 3,611.27. We believe that risk-off sentiment will likely maintain the USDCOP exchange rate at current or higher levels; however, if there is some news of activity normalization, an equilibrium level could be around 3,600–3,700.
- BanRep's repo rate is expected to close 2020 around 2.5%, according to the median of the respondents, 75 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 reach 3.0% by the end of 2021. For May's meeting, analysts' consensus points to a rate cut of 25 bps. However, we think that some analysts responded to the survey without expecting that May's meeting would become a policy-rate decision meeting. **We expect a 50 bps cut.**

Date	Average	Change versus previous survey, bps
May-2020 m/m	0.13%	...
Dec-2020 y/y	2.89%	-54
May-2021 y/y	2.94%	...
Dec-2021 y/y	3.02%	-24
May-2022 y/y	3.15%	...

Sources: Scotiabank Economics, BanRep.

**BanRep's survey showed that inflation expectations remained anchored near the 3% middle of the 2–4% target range.**

However, downside risks are increasing since economic activity is weakening. May's CPI inflation will likely continue being weak since foodstuffs inflation has moderated in recent weekly reports and utility fees will likely keep falling. The balance of risks tilts to a more negative perspective for growth and upside pressures on inflation are low for now, which is why we expect a larger-than-consensus cut at the BanRep's May 26 meeting.

—Sergio Olarte & Jackeline Piraján

## PERU: MARCH'S PLUNGE IN GDP BY -16% Y/Y A MILD POSITIVE

**Figures released on Friday, May 15, showed that GDP plunged by -16.3% y/y in March and this is good news!** We were expecting a -25% y/y decline and the government had signaled around -20% y/y. One thing which may be happening is that government programs could be filtering into the economy and helping, at the margins, to blunt the impact of efforts to control COVID-19. In any event, this is a historic moment, as this was the first monthly contraction since 2009, bringing to an end what was quite possibly the longest period of consecutive growth in Peru's history. GDP fell -3.4% q/q in Q1-2020 versus our expectation of -6% q/q.

**The first quarter figure is not very informative, in some ways, as it mixes two very different periods—before and after COVID-19—so we shall focus on the March data.** Given the large error range around all figures and projections, it would be very premature to change our forecast of -9% y/y GDP growth in full-year 2020 on the basis of last week's data. They are, nonetheless, telling of the magnitude of the impact of the lockdown during its first month. The March data imply that GDP growth in April may be closer to -30% y/y than to -40% y/y. Some things of interest in the March numbers: retail sales only fell -7% y/y, during the month, while public investment was on the other side of the spectrum, down -47% y/y.

**In other news, Finance Minister María Alva stated that the total package of measures to contain COVID-19 and uphold the economy now amounts to 14.4% of GDP.** In broad terms, over 5% of GDP corresponds to measures that require fiscal

outlays, nearly 8% corresponds to monetary resources, and the remainder comes from partial access to otherwise restricted private pension and unemployment funds. Note that these are authorized amounts: not all monetary resources will necessarily be used, nor access to private savings necessarily be completely tapped. Min. Alva also stated that if there were to be a second COVID-19 wave after the unlocking of the economy, the government would need to adopt a much more focused approach.

**Looking at the March GDP results by sector (table 2), there were only a few areas that benefited from the lockdown: telecoms, government services (mainly health), and financial services, for example.** Agriculture, which is not locked down, also grew modestly. All other sectors were hurt to some degree by the closure measures and their consequences. Industry and construction were, among the main economic sectors, perhaps, the two most affected.

Sector	March	Comments
Agrarian	2.0	One of the few positives, but still weak, especially agriculture (i.e., excluding livestock), which fell -0.3%.
Fishing	-21.4	Already known. Not relevant, as not part of a major fishing season. May–June will be key.
Mining	-23.1	Known. Reflects only partial lockdown. April will likely be worse. Should improve significantly starting in June.
Power & water	-11.9	Decline in power reflects lower industrial and mining demand. Battered, but continued household consumption. Signs of improvement showing in May.
Manufacturing	-35.2	This hurts. Industry has been particularly impacted. Consumption goods fell -30%, intermediate goods -38%, and capital goods -73%. No respite for April–May.
Construction	-46.3	Nearly totally shut since lockdown began. April will be even worse, as cement demand was nearly nil.
Commerce	-22.4	As expected. Lockdown is only partial. April likely to be worse, May perhaps a bit better, but will only begin to return to normal in June.
Transportation	-24.4	As expected. Partial lockdown.
Restaurants/hotels	-42.4	Full brunt of the lockdown. Expect April to be worse, and the impact to extend much longer than other sectors.
Telecom	3.4	Social media benefits from social distancing.
Financial services	4.0	Driven by demand for liquidity and government-sponsored funding programs.
Government	3.8	Greater COVID-19-related health services in particular. Shall likely continue henceforth.

Sources: Scotiabank Peru, INEI—Instituto Nacional de Estadística e Informática.

—Guillermo Arbe

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