Latam Economic Update

- **Argentina: Markets shrug off default**
- **Brazil: Inflation retains downward trend, balance of payments confirmed the country is bleeding capital**
- **Mexico: Data released for Q1 reflect a deterioration in economic activity and foreign investment**
- **Peru: Congress explores motions to remove Central Bank board members**

ARGENTINA: MARKETS SHRUG OFF DEFAULT

Argentine bonds subject to a possible debt exchange gained in the first two sessions after the country slid into its ninth default on Saturday—in line with the rest of fixed-income markets that are discounting warnings of mounting debt distress in both developed and emerging markets (chart 1). Reports on bondholder discussions continue to indicate constructive engagement and the possibility of better terms from the Argentine authorities, but we do not yet have an indication on when a new offer would be announced ahead of the revised June 2 deadline. The prospect of pre-judgment interest at a 9% rate on the roughly USD 50 bn in bonds in default that were issued under New York law provides an incentive for Argentina's government to move quickly and avoid litigation.

—Brett House

BRAZIL: INFLATION RETAINS DOWNWARD TREND, BALANCE OF PAYMENTS CONFIRMED THE COUNTRY IS BLEEDING CAPITAL

The IBGE published on Tuesday IPCA-15 inflation for the first half of May, with an even weaker print than consensus expected. Bloomberg's economist survey anticipated 2.07% y/y, while the actual data came in at 1.96% y/y. Within the print, there was wide dispersion: on the downward side, we had household goods (-3.36% y/y) and transportation (-3.63% y/y), alongside clothing (-0.17%) which we could expect to have weak demand in the current lockdown. But it was also interesting to note that even communications (1.45% y/y) helped drive the decline in inflation—despite heavy reliance on telecoms in the current circumstances. On the flip side of that, the largest upwards pressures came from food & beverages (+6.39% y/y) and education (+5.04% y/y). We expect continued disinflation to manifest itself until later this year, but by the end of 2020, we expect mounting inflationary pressures to trigger backpedaling by the BCB.

Consistent with the tough current global environment, data released on Tuesday, May 26, showed that Brazil had a rough month in its external accounts, in April. The current account printed its largest monthly surplus since the data started being tracked in 1995, as the economy bled capital. FDI collapsed to USD 234 mn versus USD 5.1 bn in April 2019, and portfolio outflows

CONTACTS

Brett House, VP & Deputy Chief Economist
416.863.7463
Scotiabank Economics
brett.house@scotiabank.com

Guillermo Arbe
51.1.211.6052 (Peru)
Scotiabank Peru
guillermo.arbe@scotiabank.com.pe

Mario Correa
52.55.5123.2683 (Mexico)
Scotiabank Mexico
mcorrea@scotiacb.com.mx

Sergio Olarte
57.1.745.6300 (Colombia)
Scotiabank Colombia
sergio.olarte@co.scotiabank.com

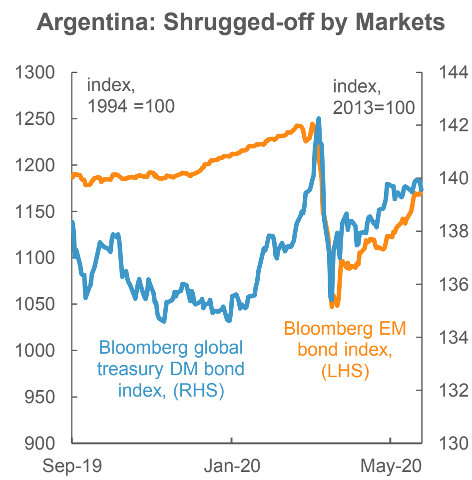
Jorge Selaive
56.2.2939.1092 (Chile)
Scotiabank Chile
jorge.selaive@scotiabank.cl

TODAY'S CONTRIBUTORS:

Eduardo Suárez
52.55.9179.5174 (Mexico)
Scotiabank Mexico
eduardo.suarez@scotiabank.com

Paulina Villanueva
52.55.5123.6450 Ext. 36450 (Mexico)
Scotiabank Mexico
pvillanuevac@scotiabank.com.mx

Chart 1



Sources: Scotiabank Economics, Bloomberg.

totaled USD 7.3 bn, with about 2/3 from public debt, and 1/3 from equities and investment funds. Overall, the combination of COVID-19-related uncertainty and increasingly complex politics led to a rough month for investment in Brazil. We anticipate that outflows likely peaked in April or early May, but it's telling that Brazilian asset prices have not managed to find their footing so far this month, even as a large share of other risk proxies have seen their prices stabilize.

—Eduardo Suárez

MEXICO: DATA RELEASED FOR Q1 REFLECT A DETERIORATION IN ECONOMIC ACTIVITY AND FOREIGN INVESTMENT

I. Revised GDP figures showed economic activity contracted less than expected in the first quarter

On May 26, the National System of Statistical and Geographical Information (INEGI, by its acronym in Spanish) released revised Q1-2020 GDP growth data that showed a slightly smaller contraction in the quarter's economic activity. Real GDP growth in Q1 came in at -1.4% y/y, a slightly better result than the previously estimated -1.6% y/y. A breakdown of INEGI's first quarter data showed that the industrial sector declined for the sixth consecutive quarter, contracting further from -2.1% y/y in Q4-2019 to -2.9%y/y in Q1-2020. Services shrank from -0.2% y/y in Q4-2019 to -0.7% y/y in Q1-2020. In contrast, agriculture grew, up from -0.3% y/y in Q4-2019 to 1.4% y/y in Q1-2020.

INEGI's publication highlighted revisions to previous quarters, which led GDP to average an annual growth rate of -0.3% in 2019 versus the -0.1% previously estimated. Economic weakness prior to the pandemic was even more pronounced than previously thought.

Also on May 26, INEGI released the March IGAE economic activity index which posted a sharp drop at the end of Q1-2020, affected by the suspension of non-essential activities in order to mitigate the dispersion and transmission of COVID-19 in Mexico. The IGAE recorded a -1.3% m/m sa drop, which was the worst performance since January 2009. In real annual terms, IGAE fell to -2.3% y/y, the lowest level in more than a decade. Economic activity was already showing weakness in the first two months of the year and, after the COVID-19 health crisis, the deterioration increased considerably. The print corroborates the quarterly GDP slowdown and points to a weak hand-off into Q2.

II. Data released on May 25 by Banxico showed a strong deterioration in the financial account

As we reported yesterday, Mexico's current account deficit in Q1-2020 of USD 0.98 bn marked an improvement from a year ago. Looking at the details, which were released later on May 25, the current account's major components saw gains from 2019, but these simply offset a weaker financial account. Notably, transfers recorded a surplus of USD 9.1 bn, which was higher than the USD 7.7 bn in Q1-2019. Remittances were up: at USD 9.3 bn, net remittance inflows showed annual growth of 18.4% y/y as Mexicans abroad raced to send money home ahead of the lockdown. However, a fall in remittance inflows is expected in the coming months due to the drop in economic activity and employment in the US.

In contrast, in an environment of high international uncertainty, the financial account recorded a surplus of USD 7.8 bn in Q1-2020, down from a surplus of USD 14.8 bn a year earlier. The strong deterioration in the financial account reflected the broader pullback of international capital from emerging markets in the midst of the COVID-19 pandemic. Net foreign direct investment fell to USD 9.1 bn in Q1-2020 compared to USD 11.3 bn in Q1-2019, which represented an annual contraction of 20.1% y/y. Lastly, portfolio investment showed a considerable weakening, registering new net inflows of only USD 1.3 bn in Q1-2020, compared to USD 8.5 bn in Q1-2019.

—Paulina Villanueva

PERU: CONGRESS EXPLORES MOTIONS TO REMOVE CENTRAL BANK BOARD MEMBERS

A motion to remove three of the seven members of the BCRP Board of Directors was introduced in Congress on Tuesday, May 26. The three Board members are Elmer Cuba, Rafael Rey, and José Chlimper. There was a second, similar, motion, that excludes Cuba. The main argument was that their designations do not comply with a constitutional norm governing ethics in state functions. All three are linked to Fuerza Popular (FP), the political party led by Keiko Fujimori. They were appointed in 2016 by a Congress dominated by Fuerza Popular. Rey is a political analyst close to the FP; Chlimper has been a prominent member of FP and worked with Cuba in preparing FP's governing plan. Cuba is a prestigious economist who participated in preparing FP's governing plan as an independent outsider. Of the three, Cuba has the most experience and expertise to back his appointment as a Board member. The motion suggested lack of compliance with experience and ethics standards required to be a Board member. José Chlimper, in particular, is involved in an investigation in money laundering over campaign financing funds.

It's too soon to tell whether the motion will proceed within Congress. If the three members were to be removed, they would need to be replaced on an interim basis until the next round of Board members designations, in August 2021. Their removal would be more a political act than anything else, and should not affect BCRP policy, whose Board is dominated by members, led by Julio Velarde, that have strong economic credentials, and is backed up by the institutional strength of the Bank itself. However, it is never a good thing when politics affects a central bank.

The Cabinet, headed by Vicente Zeballos, will be in Congress tomorrow, May 28, for the habitual vote of confidence which every new cabinet must receive. This vote is much overdo, but there was some confusion in this regard, due to the chronology of the new Cabinet coming into office and the new Congress being elected. The Congressional Constitutional Committee approved a novel structure in which there would be two votes of confidence. One would involve a vote of confidence over the norms put in place during the interregnum in which there was no Congress, and a second vote on the current government policies. This must still be voted on by the Congressional floor, however.

—Guillermo Arbe