

Latam Economic Update

- **Chile: Monthly GDP for May falls to a historical 15.3% y/y; Minutes of the last monetary policy meeting—on the brink of a new cut in the benchmark rate?**
- **Colombia: Employment losses stabilize in May; BanRep cuts policy rate by 25 bps to new historical low**
- **Mexico: Analysts keep lowering expectations for 2020, financial activity moderates, informality increased and revenues plunged in May, yet remittances rose**
- **Peru: The lockdown and quarantine have ended...almost!**

CHILE: MONTHLY GDP FOR MAY FALLS TO A HISTORICAL 15.3% Y/Y

June would show a similar contraction

In Chile, the year-over-year contraction for monthly GDP in May reached **15.3% (Economists Survey: -15.5% y/y)**. It is expected this decline would be followed by a similar one in June, after the fall of 14.1% y/y in April. This drop in activity during the fifth month of the year would be compatible with the “optimistic” end of the Central Bank’s 2020 GDP growth range (-5.5 / -7.5%). Indeed, although we still have a long way to go through the year, the reading that the CB should make is that the base scenario is marginally skewed towards the positive side. This would imply that any additional monetary stimulus, whether it is conventional (a cut in the MPR to 0.25%) or unconventional (buy Treasury bonds, macro/micro prudential measures), should be carried out without great haste. The fall of 2020 GDP would be for now more directed to be in the range of 5% to 6% after this figure, but this is certainly conditional on having relaxation in the measures to restrict mobility this July (Scotia^f GDP 2020: -6.0%).

Non-mining activity contracted 3.7% m/m (seasonally adjusted), considerably less than what was seen in April, reaching a year-over-year contraction of 17%. Much of the negative effect was generated after the initial stoppage of the economy, leaving little room for further deterioration in the coming months. For this reason, despite the new quarantine measures applied in June, the speed of the economy should be less negative and less volatile than that registered until May.

On the other hand, mining activity remained without major distortions in its production, as revealed by the 1.2% YoY growth in May. Given the special nature that the law grants to mining production, even under quarantine measures, a large part of the mining sites continued to operate without major restrictions in May. During June, this could have worsened since the new quarantines applied in the northern districts of the country, where there is a greater presence of mining sites, were effectively accompanied by restrictions on the services associated with mining operations, forcing a slowdown in production.

For June, our preliminary estimate is for a monthly GDP contraction around 15% y/y, explained by the renewal of quarantine measures and their

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extension to new communes in the country. This record would have a seasonally adjusted drop close to 1% m/m, meaning that the economy would already be close to the lowest point of this economic cycle.

To the extent that the Government responds in a timely manner to the evident slowdown in infections and improvement in the free-capacity of the health system that we are observing, and that we anticipate would continue improving the next few days, we could see strong seasonally-adjusted accelerations this second semester. While they would still keep us down in year-on-year terms, they would mean that the economy is entering a strong recovery phase that asset prices are likely to reflect. The main concern in this regard would arise if the Government and the Opposition do not reach agreements in the face of clear signs of slowdowns in infections, which could generate excessive "conservatism", postponing the return to normality of highly financially stressed activities. If this happens, the damage in the labour market would increase as would the effect on GDP.

—Jorge Selaive & Waldo Riveras

CHILE: MINUTES OF THE LAST MONETARY POLICY MEETING—ON THE BRINK OF A NEW CUT IN THE BENCHMARK RATE?

The June 16 meeting increased unconventional monetary stimulus measures. It was agreed to open a second stage of the Conditional Credit Facility, which includes an amount of US\$ 16 billion and a term of eight months. Second, it was agreed to implement a special asset purchase program, for an amount of up to US\$ 8 billion, within the next six months. The Congress would be a few days away from approving the purchase of sovereign bonds by the Central Bank (Quantitative Easing: QE).

One aspect that was not discussed at the last monetary policy meeting is to introduce an additional cut in the MPR, bringing it to 0.25%. Today, the Deposit Facility available to banks has US\$ 15 billion compared to an average US\$ 2.5 billion in normal times. Though a cut in the benchmark rate that leaves the interest rate of the Deposit Facility at 0%, the CB would encourage banks to increase their loans. We consider that this measure would not be taken before carrying out the QE that Congress would approve, and only if commercial credit fails to achieve nominal growth of 20.7% YoY (15% as of May); The CB defined this expansion of commercial credit as necessary to support firms during the pandemic.

Our view is that in the next Monetary Policy Report, the CB will reestimate critical parameters. The neutral monetary policy rate will be cut from 4% to the range 2.5-3% and the potential GDP from 3-3.5% to the range 2.5-3%. Along with these changes that will give support to the current forward guidance, we anticipate that the CB might also adjust the effective lower bound of the MPR depending on the expansion of commercial loans in August.

—Jorge Selaive

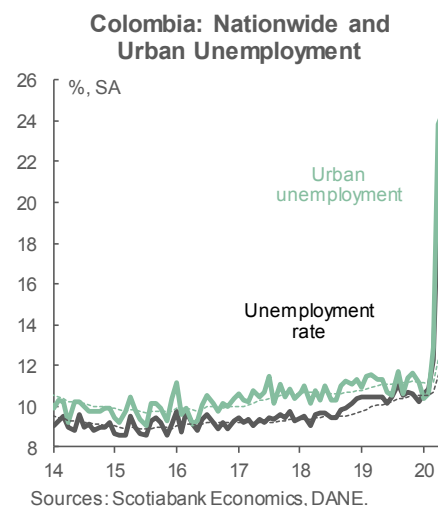
COLOMBIA: EMPLOYMENT LOSSES STABILIZE IN MAY; BANREP CUTS POLICY RATE BY 25 BPS TO NEW HISTORICAL LOW

The unemployment rate stood at 21.4% in May. Pace of employment deterioration fell significantly

On Tuesday, June 30th, DANE reported that in May the labour force contracted by 4.9 million people compared with May 2019, which showed that employment losses stabilized after the huge contraction in April of more than 5 million people. Nationwide unemployment came in at 21.4% (May 2019 was 10.5%), while urban employment (13 cities) came in at 24.5% (May 2019 11.2%). The labour force participation rate increased compared to April on the back of inactive population that returned to the labour market. The seasonally adjusted nationwide unemployment rate showed a deterioration to 21.2% in May versus 19.9% in April 2020 and rose to 24.6% versus 23.8% in April 2020 for the urban print. (chart 1)

It is worth noting that the process of reopening the economy began in May, which allowed some industry groups, construction, and the wholesale sector to resume activities, showing that April was the most affected month and that in the forthcoming months, the economy will be in a gradual recovery. Deterioration in May employment was concentrated in commerce (-910K), manufacturing (-716K), and public administration (-687K). The most significant decline was in urban areas (-2,427k y/y), especially in activities related to retail

Chart 1



(-540k y/y), public administration (-443k y/y), and manufacturing (-379k y/y). (chart 2)

In May's labor market report some "green shoots" started to arise, the first one is that employment loss almost stopped; now we are seeing a re-accommodation effect in which some people classified as inactive in April came back to the labor market, which made the unemployment rate increase, but we think that the worst has passed. Additionally, working hours increased due to the reopening process.

However, the labour market continued to show different dynamics in the formal and informal sectors. It appears that the formal sector has seen the most significant impact. The last three months' average net job numbers contracted -17.9% y/y, of which the destruction of informal employment (-15.5% y/y on average) was lower than the decline in waged employment (-20.0% y/y on average).

The labour market remained the biggest concern for policymakers; however, May's report showed that new job losses stopped, and although the unemployment rate deteriorated again, the worst has passed. Employment recovery should continue with the reopening process; however, the formal sector will take longer to recover.

BanRep cut policy rate by 25 bps in a divided decision. Data-dependent approach has begun

On Tuesday, June 30th, BanRep cut its policy rate by 25 bps to 2.50%, the new lowest nominal rate ever. The decision was not unanimous: five members voted for a conservative cut of 25 bps and two for 50 bps. The communiqué was rather neutral, although it showed, in our opinion, that the board has entered in a very data-dependent approach, recognizing that the uncertainty is high and that spare capacity has significantly increased, while the labor market's deterioration has been substantial.

On the liquidity side, BanRep announced:

- It will indefinitely maintain credit-backed repo operations, lifting the previous ceiling of COP 6.3 trillion.
- Additionally, the Central Bank announced Repos auctions backed by 1Y and 9months public debt every two weeks. The first auction will be held on July 2nd and will continue until no longer necessary.
- BanRep also announced that NDF auctions will continue to renew expired NDFs. Finally, BanRep ended the FX-Swap auctions program because they are no longer being used.

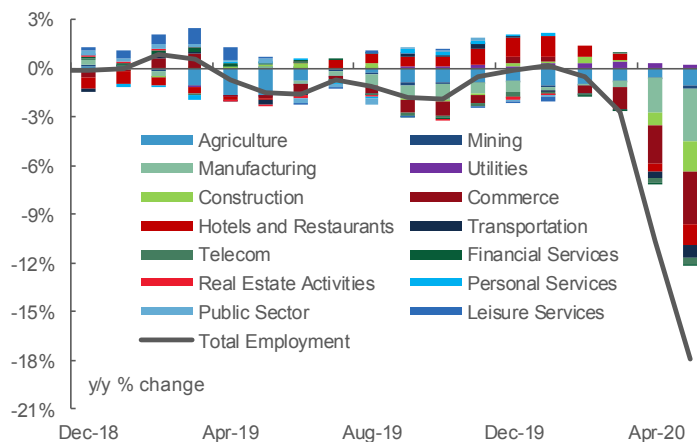
In the press conference, Governor Echavarría emphasized that the nature of the current crisis is different, making it difficult to assess the permanent effects on the economy. Additionally, he mentioned that the real neutral rate is at around 1.4%, making the monetary policy's current stance expansive. Echavarría also said that the worst has passed, and the economy will start a recovery phase in 3Q20, which is the main message that makes us think that the base case scenario for BanRep is such that the easing cycle is over. Of course, if economic data show further weakness, the board will deliver further cuts.

In our opinion, the press conference emphasized that a data-dependent point of view has started, and further cuts would depend on the magnitude of negative surprises in the macroeconomic recovery. A divided decision could probably point out that the easing cycle ended or will end sooner rather than later. We maintain our call of rate stability in July's meeting if economic data shows that gradual recovery was started in April.

—Sergio Olarte & Jackeline Piraján

Chart 2

Colombia: Employment Growth—Contributions by Sector



Sources: Scotiabank Economics, DANE.

MEXICO: ANALYSTS KEEP LOWERING EXPECTATIONS FOR 2020, FINANCIAL ACTIVITY MODERATES, INFORMALITY INCREASED AND REVENUES PLUNGED IN MAY, YET REMITTANCES ROSE

Expectations for 2020 kept softening according to Central Bank Survey

Banco de México's Survey of Expectations, released on Wednesday, July 1, showed that analysts keep lowering expectations for 2020, while they expected a stronger upturn in 2021.

- The average forecast for GDP dropped from -8.2 y/y to -9.0% y/y in 2020, while forecasts for 2021 rose from 2.5% y/y to 2.8% y/y.
- The projected rise in headline inflation average rose from 3.04% to 3.31% at the end of 2020, and from 3.46% to 3.55% at the end of 2021. Similarly, the average forecast for core inflation rose from 3.44% to 3.50% at the end of 2020 and remained in 3.42% at the end of 2021.
- Projections for MXN improved, as the average forecast moved from USDMXN from 23.30 to 22.788 at the end of 2020, and from 23.00 to 22.78 at the end of 2021.
- The median of responses for target policy rate remain at 4.50% at the end of 2020 and 2021.

Financial activity moderates

The data published by Banco de Mexico on June 30 reflects that financial activity moderated its dynamism as in May. Total commercial bank financing to the private sector slowed its growth rate, from 8.6% y/y in April to 5.2% y/y in May, with the biggest drop being in consumer spending. Likewise, the total current portfolio grew 5.3% y/y from 8.8% y/y previously. The portfolios that continue to push commercial bank credit are those related to enterprises and housing, while consumer-oriented credit accentuated its decline. The greater dynamism that financial activity presented in previous months hardly implied a change in trend, but rather was interpreted as a reaction of the different economic agents to a highly unusual and uncertain environment.

Higher informality in May and still-low rate participation as lockdown remained

On June 30, INEGI released the results for the second Telephone Survey of Occupations and Employment, bringing some light into the impact of the crisis as regular face-to-face interviews remained suspended as the lockdown measures. In May, labour market participation remained stable at 47.4%, from 47.5% a month before, but still below pre-lockdown level of 59.8% in March. With this, the unemployment rate fell from 4.7% to 4.2%. However, reflecting the lack of government benefits to households during the lockdown, informality rate rose from 47.7% to 51.8%, and underemployment rate rose from 25.4% to 29.9% (vs. 7.2% in the same month of 2019 reported in the ENOE Survey with face-to-face interviews, therefore strictly non comparable with this data). Regarding the occupational status of employed population, workers moved from subordinated and paid jobs (from 74.9% to 72.3%) and employers status (from 5.3% to 4.5%), to self-employed (from 17.5% to 19.0%) and unpaid jobs (from 1.9% to 4.2%). In conclusion, despite the fall in unemployment rate, labour force dynamics suggest a deteriorated outlook owing to widespread suspension of activities.

Public finances registered a higher deficit than scheduled in the January–May owing to plunging revenues

For the January–May period, public finances registered a MXN 148.2 bn deficit, above the 142.9 scheduled for the same period owing to the collapse of revenues, despite efforts to reduce public expenditures in the same amount.

- Total revenues accounted for MXN 2.196 tn in the first five months of 2020, below the MXN 2.316 scheduled for the same period. In May, total revenues plummeted 23.1% y/y in real terms, as oil revenues decreased -65.3% and tax revenues fell -14.6% y/y.
- Net expenditures totalled MXN 2.371 tn, below the MXN 2.459 tn programmed, yielding a -5.2% y/y decrease in real terms. Highlights include a 9.0% y/y decrease (MXN 256.7 bn) in current expenditures in May, a sharp contrast to the 52.0% y/y (MXN 78.7 bn) increase in capital expenditures.

Remittances rose in May unexpectedly, but this is probably just a seasonal effect

Remittances recorded an unexpected sum in May, despite the deteriorated labor market in US. In May, data released on June 1, suggest a positive effect of the “Mother’s Day” in remittances since they recorded an 18.1% m/m increase and a 3.0% y/y increase at USD 3,379 bn, despite conditions in the US. However, we remain with our outlook of significant declines for the next months.

—Paulina Villanueva & Miguel Saldaña

PERU: THE LOCKDOWN AND QUARANTINE HAVE ENDED...ALMOST!

Starting yesterday, July 1, the quarantine in Peru has ended... almost. Seven of Peru’s 24 provinces will continue under full quarantine. In the remaining 17 provinces—including Lima—children under 14 years of age, people over 60, and those with health conditions will continue under quarantine, at least in principle, as compliance will, in practice, apparently depend on each household. The curfew was also rolled forward from 10pm to 9pm in most of the country, and restrictions lifted on Sundays.

Restaurants and malls will be allowed to open, although at 40% capacity. Phase 3 (July) of the unlocking process allows over 96% of GDP to open up, according to the government. This is up from 91% in Phase 2 (June). Thus, nearly all activities are now open. Opening up domestic flights has yet to be announced, but is being contemplated for July, at some point. As expected, the government has been accelerating its unlocking plans. There is little left for Phase 4 (August). Overall, the only segments of the economy still not open include education and most of entertainment.

The government also announced new funds. These include a PEN 500 mn business support fund (FAE - Fondo de Apoyo Empresarial) earmarked to help tourism companies to leverage financial system loans. A similar fund is being prepared for agriculture companies. The government also announced a subsidy for public transportation. The government wishes to avoid the costs the new social distancing protocols being passed on to passengers. The government has also established a PEN 800 mn subsidy for household electricity consumption during the lockdown. Finally, the finance Minister María Alva announced that the government expects to increase public investment by 1% in 2020. This is ambitious, given the sharp decline during the lockdown. The goal is all the more doubtful given that much of the burden will be on regional governments, which the government expects will increase investment by 32% y/y in 2H20 (9% for full-year 2020).

In yet more signs of political tension, President Vizcarra criticized Congress for removing corruption as a legal impediment to running for elected office, and for demanding that cabinet ministers appear repeatedly for political questioning. Six members of cabinet are currently being required to answer to Congress.

—Guillermo Arbe

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