Latam Economic Update

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ARGENTINA: DESPITE HICCUP IN DEBT NEGOTIATIONS, THE TWO SIDES DON'T APPEAR FAR APART

As more details emerge about this week's "hiccup" in Argentina's efforts to restructure its USD 65 bn of external-law bonds that are in default, it's becoming clearer that the authorities' proposal and their creditors' demands are not so far apart that a deal is unlikely to be concluded. Media reports indicate that the three creditor groups that united on Monday to reject the government's latest offer are seeking terms that would provide them with 57 cents on each dollar of their existing claims in NPV terms compared with the roughly 54 cents that we estimate would be delivered by the authorities' July 5 proposal, assuming a 10% exit yield. If the two sides were to meet halfway between their positions, it would require Argentina to pay an additional USD 180–240 mn per year, or about 0.05% of GDP, over and above the debt-service flows implied by the government's current offer terms. Media reports also note that the creditors have dropped their demands that any new bonds issued in the proposed debt swap carry elements of the 2005 exchange bonds' indenture.

Although Pres. Fernandez and Economy Minister Guzman have indicated that they cannot improve on their current offer, 0.05% of GDP annually would be good value to avoid a repeat of the 2005 exchange and the ensuing years of legal wrangling. As we've previously noted, we expect the authorities to return to their earlier proposal of a contingent claim based on agricultural export revenues, GDP, or some other proxy for payment capacity in order to close the remaining gap between the two sides.

—Brett House

BRAZIL: FISCAL REFORM—ONLY A FIRST STEP

Brazil's tax system is among the most cumbersome in the world: the country is ranked 184th globally by the World Bank Group in terms of tax system efficiency, with an average company spending 1,500 person hours on tax payments. Brazil's fiscal framework also imposes one of the greatest tax burdens on its economy amongst emerging markets: by IMF estimates, government revenues are equivalent to 30% of GDP. Cutting tax rates would be difficult, however, given that the general government is expected to post a deficit this year equal to 9% of GDP. Hence, tax reform should be about increasing efficiency.

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On Tuesday July 21, Brazil's Ministry of Finance presented the first step in its fiscal reform proposal, which seeks to merge the PIS and COFINS taxes. The PIS (Program of Social Integration) tax is earmarked for financing the unemployment insurance system, while the COFINS (Contribution for Financing Social Security) tax is dedicated to financing social security. The two taxes function as sales taxes and have some similarities to VAT taxes. The COFINS rate is currently 7.6% (3% for companies that calculate taxes on forecast methods), and the PIS has a rate of 1.65% (0.65% for companies that use forecast methods for tax payment). While rates are lower under forecast methods, the application of the taxes shifts from being non-cumulative to cumulative. Neither tax is charged on exports. The merged tax would be called the Contribution on Goods and Services (CBS) and have a rate of 12%.

Once Congress resumes regular sessions, the next stages of the tax reform are expected to be presented, including the introduction of an electronic payments tax. Other proposals expected to be presented later include cuts to corporate taxes and the introduction of taxes on dividends, which are currently tax-exempt.

The proposals raised so far on fiscal reform are steps in the right direction, but fall far short of what is needed to solve Brazil's fiscal woes.

—Eduardo Suárez

CHILE: BILL TO ALLOW THE WITHDRAWAL OF PENSION FUND ADVANCES IN THE SENATE

Following a vote on Monday in the Senate's Constitutional Committee, Tuesday saw the Committee debate 15 observations or proposed amendments to the draft bill that would allow withdrawals from the AFP pension funds. A vote on the bill by the full Senate is expected today, Wednesday, July 22.

The main elements of the bill endorsed last week by the Chamber of Deputies have been maintained. Most importantly, the bill would allow individuals to have the option to withdraw 10% of their funds, only once and without restriction by income level, with a minimum withdrawal of around USD 1,250 and a maximum of around USD 5,400. If 10% of an individual's funds amounts to less than USD 1,250, they would be able to withdraw up to that amount; where the individual's total AFP account does not exceed 35 UF (about USD 1,300), they would be able to withdraw all of their pension savings.

Three other major features of the proposed legislation are worth noting. The current draft of the bill keeps non-taxable status for any income withdrawn and it is affirmed that this provision would not be incompatible with other state benefits or policies implemented by the government to face the current public health crisis. Likewise, delivery of funds withdrawn would be made through two installments: 50% of funds withdrawn would be disbursed a maximum of 10 business days after a request has been made to an AFP and the other half would be expected to follow within 30 business days after the first transfer. Yesterday also saw the endorsement of access to the proposed withdrawal option for current retirees.

The Senate's Constitutional Committee also moved to reinstate to the draft bill a proposal to create a Collective Solidarity Fund. The Fund's objective would be "to finance, under the criteria of progressivity, pension supplements resulting from the amounts withdrawn" through contributions from employers and the State. The proposal to create the Fund was previously rejected by the Chamber of Deputies, Congress' Lower House.

According to the pension fund regulator, around USD 20 bn could be withdrawn from the AFPs if the "10% bill" is approved. It is likely that the AFPs will sell their most liquid assets, including sovereign bonds and assets invested overseas, to meet withdrawal demands. We anticipate that the AFPs will not sell proportionately as many corporate bonds and Chilean stocks. It is important to recall, also, that there is a bill currently under discussion by Congress that would allow the central bank to purchase Chilean sovereign bonds in the secondary market. This initiative, which is likely to be approved, would alleviate some of the burdens that the AFPs could face in complying with withdrawal requests and would mitigate the creation of distortions in the long end of the sovereign yield curve. In addition, we expect the BCCh and the financial markets regulator to issue some norms in order to minimize any impact on interest rates and on financial markets in general.

—Carlos Muñoz

PERU: CONGRESS TO RECEIVE NEW CABINET ON AUGUST 4; FISHING SEASON ENDS STRONGLY; CEMENT DEMAND RISES IN JUNE

The new cabinet, led by Pedro Cateriano, reached an agreement with Congress to present its governing plan on August 4. The government had been hoping to get this legal requirement out of the way before the annual President’s Address on July 28. The cabinet’s policy presentation is typically a defining moment in its relations with Congress, although Cateriano has already been meeting with the opposition party to pave the way for a better relationship.

A spokesperson from Peru’s fishing sector stated on Monday, July 20, that the fishing season had concluded and that the full 2.4 tonne quota had been met. The quota was 15% higher this year than in 2019, but fishing GDP growth during June–July will be much higher than implied by the quota due to shifts in the fishing season that compensate for a weaker than warranted May.

Just-released data show that cement demand rose 128% m/m in June. Even though demand in June was still 26% lower than a year earlier, the increase from May to June points to a nice recovery. June coincided with only Phase 2 in the recovery plan, so further growth is expected. A similar increase of approximately 300 mt in July, when Phase 3 began, would put cement demand about 10% below pre-COVID levels.

—Guillermo Arbe