Latam Economic Update

- **Argentina: Foreign-law bond restructuring set to move forward**
- **Chile: Sectoral data confirmed recovery in July; monthly GDP (IMACEC) growth should be around 2.5% m/m, -11.8% y/y**
- **Colombia: BanRep delivers expected -25 bps cut, didn't close door to further easing; July exports improve, while local government lockdowns slowed employment recovery**
- **Mexico: Credit growth slows while the federal deficit grows**

ARGENTINA: FOREIGN-LAW BOND RESTRUCTURING SET TO MOVE FORWARD

Argentina's Ministry of Economy announced on Monday, August 31, that creditors had granted it wide support to move forward on its proposed restructuring of about USD 65 bn of foreign-law debt. Holders of 93.55% of the outstanding value of external-law bonds eligible for the government's proposed exchange had indicated their consent for the swap by the Friday, August 28, deadline. The authorities' moves to trigger collective action clauses bring the participation rate to 99.01%—a marked contrast with the infamous 2005 exchange that saw nearly a quarter of the total value of eligible debt remain untreated when bondholders rejected the operation's proposed terms. New bonds resulting from the current exchange should begin to trade after the planned Friday, September 4, settlement date.

The debt exchange is a necessary, but not sufficient, condition for rebuilding Argentina's economic and financial stability and sustainability. At about 55 cents on the dollar, the debt restructuring is set to deliver about USD 38 bn in debt relief over the next decade, according to Economy Minister Guzman, below our own estimates. Combined with another possible USD 20 bn in relief from the treatment of domestic-law debt later this month, the total USD 58 bn in savings comes in near the low end of the USD 50 to 85 bn in cash-flow relief needs identified in the IMF's March debt-sustainability analysis (DSA). Since then, macroeconomic indicators and government finances have come in substantially weaker than anticipated in the DSA, as we detailed in our latest *Latam Weekly*. This is likely to make the start of negotiations on a new borrowing program with the IMF to close Argentina's financing gaps even more challenging than it was already set to be.

—Brett House

CHILE: SECTORAL DATA CONFIRMED RECOVERY IN JULY; MONTHLY GDP (IMACEC) GROWTH SHOULD BE AROUND 2.5% M/M, -11.8% Y/Y

A spate of July data out on Monday, August 31, confirmed the economy's nascent recovery on a number of fronts (chart 1) and pointed to growth in the monthly IMACEC GDP proxy, which prints at 08:30 ET today, of around 2.5% m/m or -11.8% y/y. Retail sales contracted -17.4% y/y, somewhat better

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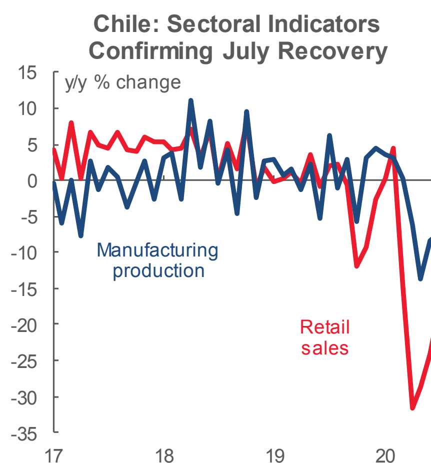
Chart 1



Sources: Scotiabank Economics, Bloomberg.

than our forecast of -20% y/y, a clear rebound thanks to public fiscal support and the withdrawal of funds from the AFP pension accounts. Supermarket sales increased 2.2% m/m seasonally adjusted. On the other hand, manufacturing contracted -7.2% y/y, much better than consensus and our forecast (-10.5% y/y). The main positive impact came from machinery and equipment that increased 22.1% y/y, as a result of higher sales in the mining sector. Finally, mining production continued to see gains with an increase of 1.2% y/y in July.

Overall, the sectoral data had a positive tone, as was the case in June, especially considering that, for most of the month of July, Chile was in quarantine. The July numbers point to solid gains in economy as a whole. We anticipate monthly GDP growth, proxied by the IMACEC index, of -11.8% y/y in July which, based on our nowcast model, should translate into a sequential gain of 2.5% m/m seasonally adjusted (compared with 0.8% m/m in June).

—Jorge Selaive

COLOMBIA: BANREP DELIVERS EXPECTED -25 BPS CUT, DIDN'T CLOSE DOOR TO FURTHER EASING; JULY EXPORTS IMPROVE, WHILE LOCAL GOVERNMENT LOCKDOWNS SLOWED EMPLOYMENT RECOVERY

I. BanRep cuts -25 bps in unanimous vote; door open to further easing

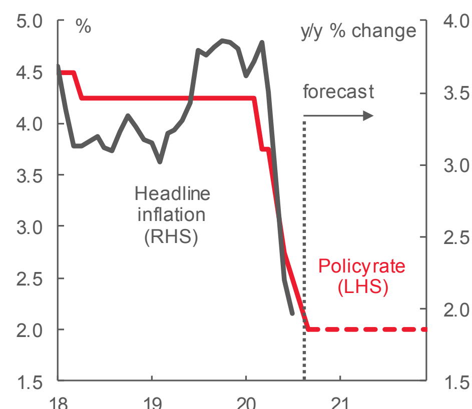
On Monday August 31, BanRep unanimously decided to cut the policy rate by -25 bps to 2.00%, which matched market expectations. The communiqué was rather factual and did not offer much forward-looking information about the monetary policy stance for the near future—but nor did it close the door on further easing. Our current forecast anticipates a long hold at 2.00% from here onward (chart 2), but now with a material risk of one more cut in September.

In the communiqué, the Board of the central bank emphasized that recent macroeconomic indicators confirmed the need for Monday's rate cut. Domestic demand weakness, a further deterioration in the labour market, and a reduction in household incomes, which, joined with low inflation (chart 3), motivated yesterday's -25 bps cut.

Unanimity within the Board leads us to think that BanRep did not close the door on further cuts, although Governor Echavarría, during the press conference, said that the BanRep staff views 2.00% as the terminal rate for this easing cycle. He also noted that the staff anticipates that the policy rate will stay at 2.00% even longer than current market expectations. It is worth noting that in a previous press conference, Gov. Echavarría said that a split decision pointed to a change in the speed of interest rate cuts; however, at this meeting, he explained that unanimity didn't imply that the Board's approach couldn't change, which confirms that the central bank's guidance remains cautious. Additionally, Echavarría noted that in previous meetings it was easier to agree to cut the monetary policy rate, but now a decision is not so straightforward since the monetary policy rate is at its lowest level since 1991 and further space to cut is limited.

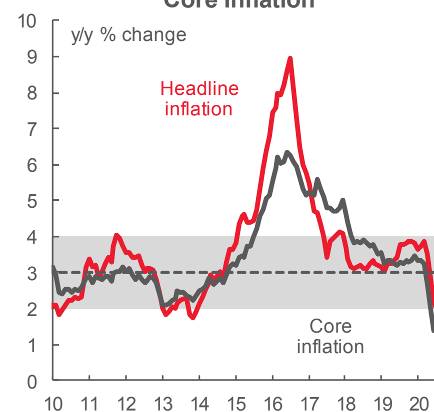
On the data side, Governor Echavarría stressed that uncertainty is still the name of the game, which drove the BanRep to soften the usual balance of risks approach and present only forecast ranges. Still, he said that the central bank staff's expectations see inflation below 2% this year with a gradual convergence to 3% next

Chart 2



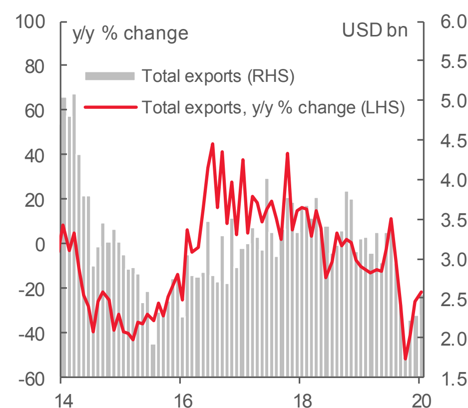
Sources: Scotiabank Economics, BanRep, DANE.

Chart 3



Sources: Scotiabank Economics, DANE.

Chart 4



Sources: Scotiabank Economics, DANE.

year. On economic activity, he did not say much: he noted only that re-opening strategies are the key driver of the recovery, and that low rates will help to boost this rebound in 2021.

All in all, today BanRep's meeting did not surprise the market and delivered the -25 bps cut that was expected. However, the unanimity of the decision left the door open for further easing. We think August inflation data (out on September 5) and high-frequency data on economic activity will be critical for September's monetary policy decision. For now, we maintain our call that yesterday's cut was the last move of the year. However, the Board's unanimity tilts risks toward one more cut in September.

II. July exports contracted by -21.7% y/y, but kept improving from April's levels

According to DANE's release on Monday, August 31, July's monthly exports stood at USD 2.55 bn (-21.7% y/y, chart 4). Although July's data showed the highest monthly export numbers since the pandemic began, they continue at their lowest levels in four years. The contraction was smaller than in June, especially on the back of better agricultural exports. Mining-related exports contracted by -38.6% y/y due to a significant decline in oil exports (-62.3% y/y) and coal (-34.1% y/y). Agricultural exports expanded by 16.5% y/y while manufacturing exports fell -21.4% y/y.

July's export results still reflect weakness in demand from trade partners and the negative effect of the sharp fall in commodity prices. Traditional exports contracted by -38.9% y/y (chart 5), slightly improving from the previous month's figure. Coffee exports expanded by 33.3% y/y due to better volumes and better international prices. Oil-related exports still represented only 25% of total exports compared with 40% of total exports in 2019. Having said that, oil provided a drag on total exports since oil shipments continued at their lowest values since 2009 (USD 632 mn). International prices and weaker global demand continued to weigh on both oil export volumes and prices. Coal exports fell -34.05% y/y due to lower prices and lower volumes (-6.58% y/y). Non-traditional exports were USD 1.32 bn in July, an expansion of 3.7% y/y (chart 5, again). Agricultural exports such as palm oil (up 22.2% y/y) and bananas (14.8% y/y), as well as gold (118.0% y/y) led the increases; meanwhile, on the negative side, manufacturing exports' contraction (-21.4% y/y) was explained by machinery and equipment (-38.7% y/y) and chemical products (-13.2% y/y).

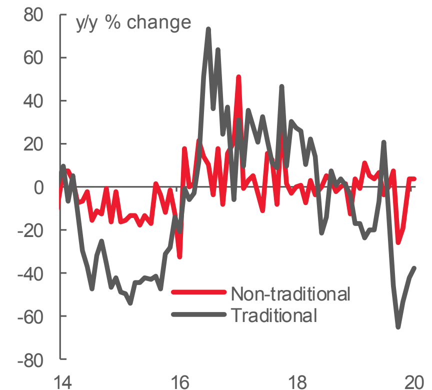
July's exports numbers showed an improvement compared to previous months' data. The world's economic re-opening process and oil price stability could further firm up export values in the coming months. The impact on the current account should be moderate due to simultaneous moves in exports and imports resulting from automatic stabilizers.

Today, September 1, the central bank releases the Q2 balance of payments. We expect a current account deficit below 4% GDP, while on the financing side, we expect government debt issuance to cover the current account deficit and mitigate the anticipated reduction in FDI.

III. July unemployment rate stabilized at high levels; employment recovery almost stopped due to regional lockdowns

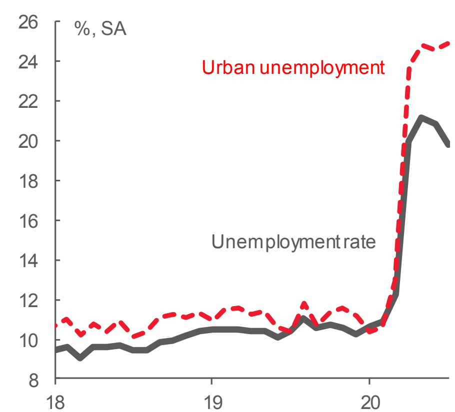
On Monday, August 31, DANE reported that in July, the nationwide unemployment rate came in at 20.8% (July 2019 was 10.7%), while urban employment (i.e., across 13 cities) came in at 24.7% (July 2019 was 24.7%). The

Chart 5



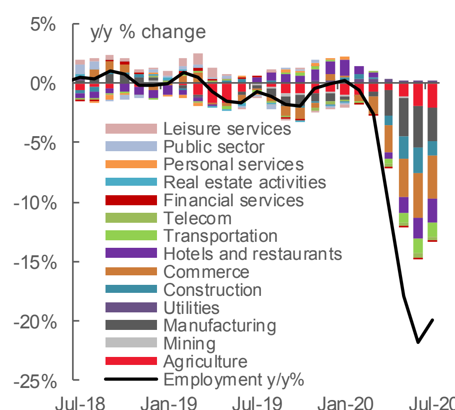
Sources: Scotiabank Economics, DANE.

Chart 6



Sources: Scotiabank Economics, DANE.

Chart 7



Sources: Scotiabank Economics, DANE.

seasonally adjusted series showed that the national unemployment rate improved to 19.8% in July versus 20.8% in June 2020, although it increased to 24.9% versus 24.6% in June 2020 for the urban print, which implies that regional lockdowns weighed against labour market recovery in the main cities (chart 6). We also expect some stagnation in job creation in August since local restrictions remained in place; however, labour-market recovery should continue in September as new activities such as commercial flights, hotels, and restaurants are allowed to open.

The re-opening process has led to some progress in employment, but recent lockdowns imperil these gains. In July, cities that imposed new restrictions have had the worst performance: in Bogota, the unemployment rate stood at 25.1%, above the national urban unemployment rate. In the national figure, the recovery trend almost stopped compared with June's results: the number of inactive people remained around 1.7 mn, while employment stalled at 18 mn people. Urban employment recovery should be weak in August since some major cities continued with lockdown measures. That said, in September, we expect better dynamics since the national government lifted generalized isolation measures and allowed further activities to open; the most important are those related to touristic services.

In July, the re-opening of the economy allowed around 90% of usual total activity to resume work, including the commercial or retail sector. That said, retail activities continued to face some restrictions to operate and remained the sector with the highest job losses (chart 7). On a y/y basis, the deterioration in employment is now concentrated in retail sales (-848k y/y), leisure activities (-690k y/y), hotels and restaurants (-636k y/y), and manufacturing (-504k y/y). The most significant decline was in urban areas (-2.4 mn y/y), especially in activities related to retail sales (-438k y/y), leisure (-384k y/y), and public administration (-357k y/y).

The labour market continued to show that urban areas were the most affected by the lockdown: they contributed 60% to total nationwide job losses. Job losses have also been concentrated in the formal sector. The last three months' average net job numbers contracted by -19.9% y/y, but the destruction of informal employment (-16.0% y/y) was proportionately smaller than the decline in waged employment (-23.0% y/y). As we mentioned in previous reports, we think that the employment recovery will be slower in the coming months and that informality could increase. Leisure-related activities should lead to job recovery in September, although the rebound is unlikely to be complete as the room to re-open is limited.

The labour market remains the biggest concern for policymakers, and for us, it constitutes the main risk for the economic recovery. In September, the "new normal" approach to re-opening should lead to further job recovery. However, its sustainability will depend on the pandemic's evolution. We expect the unemployment rate to hit 17.8% by end-2020, which is still high compared with any normal situation.

—Sergio Olarte & Jackeline Piraján

MEXICO: CREDIT GROWTH SLOWS WHILE THE FEDERAL DEFICIT GROWS

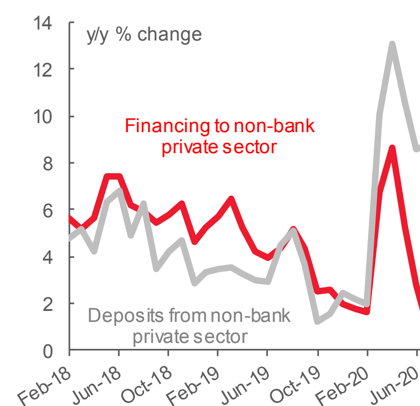
I. Credit growth slows in July

In July, financial sector data moderated its dynamism, owing to slower growth across business loans and mortgages for the fourth consecutive month, while consumption lending showed the deepest contraction in a decade.

Growth in total deposits from the non-bank private sector at the commercial banks regained some of its momentum, going from 8.6% y/y in June to 8.8% y/y in July (versus 4.5% y/y in July 2019, chart 8), as demand deposit accelerated from 12.6% y/y to 13.4% y/y (versus 1.9% y/y a year earlier). However, growth in time deposits moderated from 2.8% y/y to 2.0% y/y (versus 8.4% y/y in a similar month in 2019).

Growth in total commercial bank financing to the private sector slowed sharply, from 2.8% y/y in June to 0.8% y/y in July (versus 4.3% y/y a year earlier, chart 8 again), as direct financing also slowed down, from 2.7% y/y to 0.7% y/y (versus 4.3% y/y in July a year earlier).

Chart 8



Sources: Scotiabank Economics, Banxico.

- Growth in business financing was steadier, slowing from 5.7% y/y in June to 3.9% y/y in July (versus 4.4% y/y a year earlier).
- Mortgage lending remained comparatively stable, down slightly from 6.0% y/y growth in June to 5.7% y/y in July (versus 6.7% y/y a year earlier).
- Consumer financing deepened its contraction, from -6.0% y/y to -9.2% y/y (versus 2.1% y/y a year earlier), the steepest decline in a decade.

II. Federal deficit through July grew

For the January–July year to date, the public finances report released in the afternoon of Friday, August 28, registered a MXN -414.6 bn deficit for the first seven months of the year, larger than the MXN -387.3 bn budgeted for the period and greater than the MXN -153.1 bn deficit observed in the same seven months of 2019. With this, the primary balance saw a MXN -9.8 bn surplus, below the MXN 39.7 bn surplus in the program and well below the MXN 215.8 bn surplus observed in the same period of 2019.

- **Total revenues** accounted for MXN 2.998 tn in the first seven months of 2020, MXN 236.6 bn below program and a -4.7% y/y decrease. Oil revenues summed to MXN 30.2 bn in the January–July period, which represented a 39.2% y/y drop. Tax revenues amounted to MXN 2.004 tn, a decrease of -0.8% y/y, owing to a -3.7% y/y fall in value-added tax revenue and a 1.2% y/y increase in income tax revenue as part of the strategy of federal government to increase tax collection with a focus on large firms' contributions. However, in the month of July, revenues declined by -6.7% y/y, driven by a strong contraction of -19.5% y/y in the VAT and a slightly increase of 0.8% y/y in income taxes.
- **Net expenditures** summed to MXN 3.438 tn, below the MXN 3.622 tn scheduled, which still amounted to a 2.4% y/y increase YTD. Highlights included a 4.8% y/y increase in current expenditures, which totaled MXN 2,022.6 tn in the January–July period, and a 20.5% y/y increase in capital expenditures, that summed to MXN 456.3 bn over the same seven months.

—Miguel Saldaña

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