Latam Daily: April Data Weak in Colombia; S&P Affirms Mexico's BBB Rating

- **Colombia: April manufacturing and retail indicators suppressed by COVID-19 lockdowns, but suspension of protests bodes well for the future**
- **Mexico: S&P affirms the country's long-term sovereign rating, but maintains negative outlook**

COLOMBIA: APRIL MANUFACTURING AND RETAIL INDICATORS SUPPRESSED BY COVID-19 LOCKDOWNS, BUT SUSPENSION OF PROTESTS BODES WELL FOR THE FUTURE

Manufacturing production and retail sales data for April published by the Colombian National Statistical Department, DANE, June 15 were suppressed by lockdowns in major cities but showed substantial y/y gains compared to April 2020, when lockdowns were more stringent.

Manufacturing production fell -1.0% m/m sa in April (chart 1) as lockdowns to slow the third wave of COVID-19 were implemented in Bogota, Antioquia, the north coast, and other regions. Fuel oil, steel and iron, and coffee production were hardest hit.

On a year-over-year basis, April manufacturing data showed an expansion of 63.7% y/y, above the Bloomberg market consensus of 61.5% y/y and Scotiabank's 59.4% y/y estimate. Base effects account for this rise, as the economy was under a more severe lockdown in April 2020. In contrast, manufacturing expanded by only 5.2% compared with the pre-pandemic (April 2019) level.

Base effects account for the fact that output in all sectors expanded in April on a year-over-year basis, with construction-related mining products (808%), clothing (745%), beverages (170%); and oil refining (68%) posting the highest increases. Together these four sectors jointly accounted for about half of the overall yearly gain.

Antioquia, Cundinamarca, and Bogota led these gains and contributed 90% of Colombia's year-on-year growth in manufacturing. However, Bogota contracted (-4.1%) compared to April 2019.

Total retail sales, ex-vehicles, fell by -6.5% m/m sa in April (chart 2), owing to lockdowns implemented in some of Colombia's major cities, as all retail sales groups fell. In fact, it was the worst monthly contraction since the pandemic began.

On a year-over-year basis, retail activity increased by 75% y/y in April, posting a mild negative surprise as compared to the Bloomberg survey consensus (77.5% y/y), and below our expected 77% y/y. Base effects also affected this figure, as retail sales were flat (-0.1%) compared with pre-pandemic levels (April 2019).

Large increases were registered vehicles for household use (2,012% y/y), spare parts for cars (575% y/y) and fuel sales (105% y/y). Compared to April

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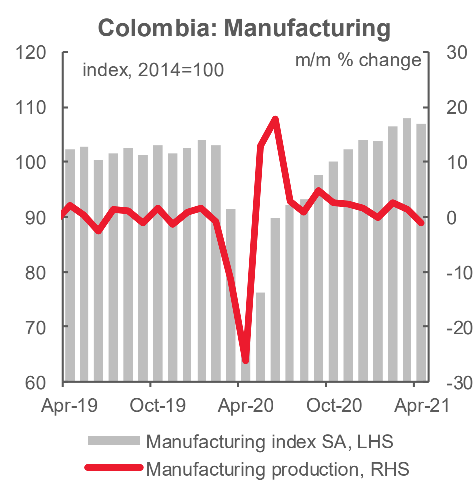
Chart 1



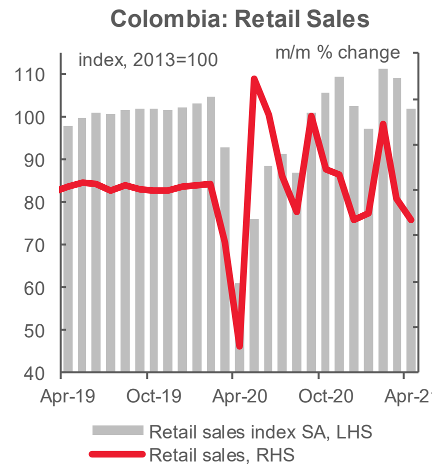
Sources: Scotiabank Economics, DANE.

2019, the best performing lines were vehicles (10.5%), computers for domestic use (33%), and cleaning products (34%). On the negative side, the most significant declines relative to pre-pandemic (April 2019) levels were concentrated in clothing (-3% y/y) and vehicles (-4.3% y/y), reflecting the lasting effects of the pandemic.

By region, Bogota led the gains with a 78% y/y increase in retail activity, but also registered the largest contraction compared to pre-pandemic 2019 levels (-6.1%).

Looking ahead, May data for manufacturing activity could be significantly weaker as some industries have experienced disruptions to their operations resulting from social unrest. According to DANE estimates from its electricity demand indicator, manufacturing activity in May could fall by almost 23% from pre-COVID-19 levels. May retail sales could also contract as the nationwide strike disrupts supply chains, increasing the inflation in some key items.

Chart 2



Sources: Scotiabank Economics, DANE.

Activity should pick up in June, however, as protests dissipate and production is restored. In this respect, on June 15 protest leaders announced they will suspend demonstrations, providing an impulse to economic activity. While the labour market remains a concern, since employment remains around 4% below pre-pandemic levels in manufacturing and 3.5% below in retail sales, employment should rise as economic reopening consolidates. Therefore, although economic activity in Q2-2021 will be weaker because of social unrest, we continue to expect 6% y/y GDP growth in 2021.

On this basis, we reaffirm our view that the central bank (BanRep) will begin moving toward hikes in September or October.

—Sergio Olarte & Jackeline Piraján

MEXICO: S&P AFFIRMS THE COUNTRY'S LONG-TERM SOVEREIGN RATING, BUT MAINTAINS NEGATIVE OUTLOOK

On Tuesday, June 15, S&P affirmed Mexico's long-term sovereign rating in foreign currency at BBB, one notch above non-investment grade (table 1), but maintained its' negative outlook.

S&P cited a strong external profile, including a flexible exchange rate and inflation targeting regime that supports the credibility and flexibility of its sound monetary policy. Net government debt is expected to remain stable at around 48% of GDP over the next two years, consistent with the BBB group.

Table 1

Mexico: LT sovereign credit rating profile

Agency	Rating	Outlook	Last revision	Real GDP, y/y change, 2021f
S&P	BBB	Negative	Dec 03, 2020	5.8%
Fitch	BBB-	Stable	May 17, 2021	5.0%
Moody's	Baa1	Negative	Apr 29, 2021	5.6%

Sources: Scotiabank Economics, S&P, Fitch, Moody's.

S&P expects that the conservative fiscal stance that has characterized the current administration will continue in the second part of its term, supporting macroeconomic and financial stability. Economic growth is expected to rebound to 5.8% y/y in 2021 (which is a little more optimistic than our 5.3% y/y expectation) driven by robust US demand, record remittances from workers abroad, which support consumption in the lower income segment, and a broad recovery in tourism, as vaccines become more widely available. S&P anticipates growth to slow over 2022–2024 to below 3.0% y/y owing to low public and private sector investment, the relatively low quality of education, and high levels of crime and judicial uncertainty. S&P's announcement also highlighted the recent mid-term elections, noting that with greater counterweights in the Chamber of Deputies the results are unlikely to lead to a material shift in macroeconomic policies.

Our take is that rating agencies will maintain Mexico's current ratings until the broad outlines of fiscal reforms scheduled for the second half of this year are clear. In our view, the need for fiscal reform is becoming increasingly urgent as a result of the rise in the public debt-to-GDP ratio caused by the economic crisis of 2020. Our estimates and projections suggest that, to anchor the trajectory of public debt, a fiscal adjustment equivalent to around three percentage points of GDP would be needed, of which one point would be necessary to capitalize Pemex. This adjustment could be achieved through cuts to spending that expand the primary surplus, and through an increase in public revenue from greater collection efficiency, a broadening of the tax base, the introduction of new taxes, or hikes in some existing taxes.

—Paulina Villanueva