May 4, 2021

Latam Daily: Growth Outlook Brightens Across the Pacific Alliance Economies

- **Chile: March's modest contraction showed economy adapting to quarantine; we reaffirm our 7.5% y/y 2021 growth forecast**
- **Colombia: BanRep minutes on split vote as staff unveil improved macro outlook; new finance minister to guide fiscal reforms**
- **Mexico: Banxico survey sees higher growth and inflation in 2021; record remittances in March**
- **Peru: April inflation; poll gap narrows; strong March leading indicators; revised MEF outlook; approval of pension withdrawals advances**

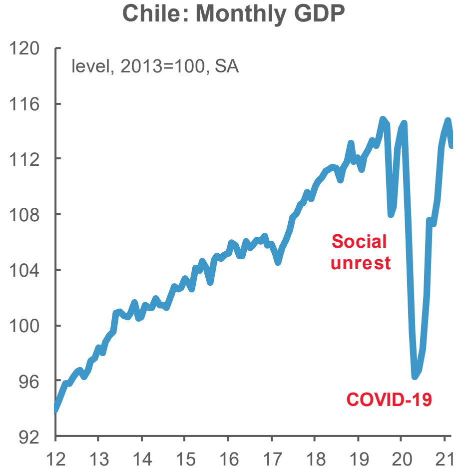
CHILE: MARCH'S MODEST CONTRACTION SHOWED ECONOMY ADAPTING TO QUARANTINE; WE REAFFIRM OUR 7.5% Y/Y 2021 GROWTH FORECAST

On Monday, May 3, monthly economic activity data for March were released and showed an expansion of 6.4% y/y (chart 1), which exceeded expectations by a wide mark. The BCCh's *Economic Expectations Survey* consensus was 1.6% y/y, while the Bloomberg market consensus was 4.5% y/y.

In seasonally-adjusted sequential terms, economic activity fell by -1.6% m/m sa, a smaller retreat than had been expected during a month in which quarantines were re-imposed throughout the whole country. The performance reflected a certain adaptation of the economy to public-health restrictions. The real test of these adjustments will come in April, when the greatest share of the country was subject to mobility limits. Services were hit hardest by quarantine measures imposed at the end of March (chart 2) and led the -2.0% m/m sa drop in non-mining GDP (chart 3).

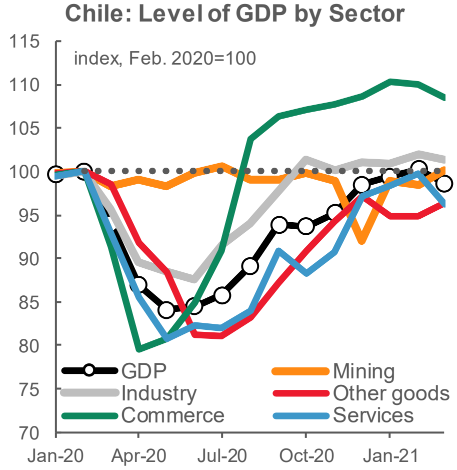
March's economic activity numbers lead us to reaffirm our annual real GDP growth projection of 7.5% y/y in 2021, well above the consensus projection of 6.0% y/y. Our outlook rests on solid economic activity numbers at the

Chart 1



Sources: Scotiabank Economics, BCCh.

Chart 2



Sources: Scotiabank Economics, BCCh.

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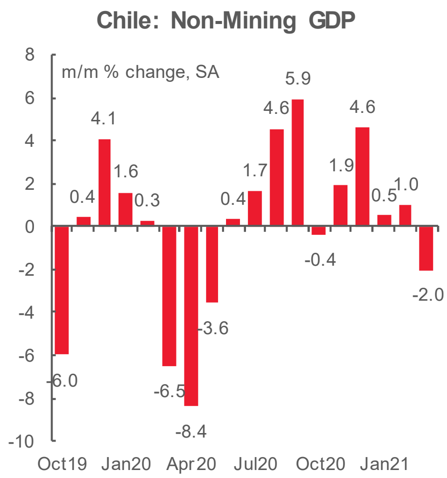
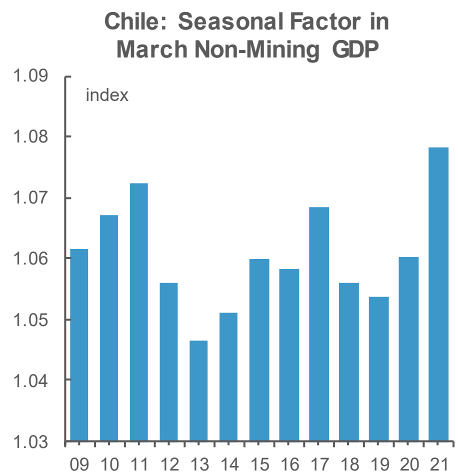
Chart 3



Sources: Scotiabank Economics, BCCh.

Chart 4



Sources: Scotiabank Economics, BCCh.

beginning of the year, a vaccination process that will allow greater mobility in the second half of 2021, a wide portfolio of public and private investment projects, and a new boost to private consumption stemming from the just-approved third round of withdrawals from pension funds. Additionally, the seasonal factor played an important role in the March data and surprised private-sector expectations (chart 4). Part of the seasonal factor's rise to a new high was driven by the additional business day in March 2021, which implies that the year-on-year comparison may be a better gauge of the economy's performance in the month.

For April, we anticipate an expansion of between 5% and 10% y/y in monthly economic activity, reflecting the first instance in which the annual comparison is with a full month of lockdown in 2020. Although the economy once again found itself under strict quarantine measures during April 2021, the level effects from April 2020 are very favourable. In this context, we preliminarily estimate a sequential retreat of between -5% m/m sa and -8% m/m sa in April that we consider compatible with annual growth in the high single-digit range.

—Jorge Selaive, Carlos Muñoz, & Waldo Riveras

COLOMBIA: BANREP MINUTES ON SPLIT VOTE AS STAFF UNVEIL IMPROVED MACRO OUTLOOK; NEW FINANCE MINISTER TO GUIDE FISCAL REFORMS

I. BanRep's minutes underscored broad stability in macro conditions amidst ongoing uncertainty; the staff improved its macro outlook

On Monday, May 3, the central bank released the minutes from its Board's most recent monetary-policy meeting on Friday, April 30, where Directors decided to maintain the benchmark rate at 1.75% in a split 6 to 1 vote. From the minutes, we would highlight that:

- Board members underscored their vigilance regarding the further development of the pandemic and its impact on economic activity. Despite positive numbers on growth at the end of 2020 and in Q1-2021, some risks could arise owing to new waves of contagion;
- Most members emphasized that increasing risk aversion and moderately lower credit demand could be associated with the deterioration of the fiscal situation. They also cautioned that the Board's space to maintain countercyclical monetary policy could be constrained by a negative conclusion to the ongoing fiscal talks. Note that the BanRep Board meeting ended on Friday, prior to the Duque Government's decision on the weekend to withdraw and revise its proposals for fiscal adjustment; and
- The Board member who voted for a -25 bps rate cut emphasized that the rate of growth of credit to the private sector is below its long-run trend; consequently, the member argued that the current policy rate could be lower to incentivize borrowing and investment.

The minutes of the April 30 BanRep Board meeting reinforced the impression that the Bank's policymakers remain in wait-and-see mode given the importance of the fiscal-reform package for the balance of risks. Although uncertainty remains high, further negative developments on the fiscal front or positive surprises to growth and/or inflation could lead the Board to skew more hawkishly.

The BanRep staff also released their April *Monetary Policy Report* in which they laid out an improved macroeconomic outlook. The forecast for real GDP growth in 2021 and 2022 has been shifted to 6.0% y/y and 3.0% y/y, respectively, compared with the previous forecasts of 4.5% y/y and 3.5% y/y. Inflation is expected to trend higher, ending 2021 at 3.1% y/y and 2022 at 2.8% y/y, versus the staff's previous forecasts of 2.33% y/y and 2.70% y/y, respectively. The staff's outlook assumes no significant new outbreaks of COVID-19 cases that would prompt strong lockdowns and subsequent dents to economic activity. The staff indicated that their baseline scenario is compatible with a path for monetary-policy rates that would be above the average expected trajectory in the market consensus, which, according to the Banrep's last survey, sees the Board on hold til January 2022. If a new, material COVID-19 negative shock were to emerge, the staff's framework would see the path for rates skewed to the downside of current market consensus.

BanRep staff are expected to discuss the *Monetary Policy Report* further in their usual press conference on Wednesday, May 5. Although the staff presentation will provide some more details on the improved outlook, uncertainty remains high and, in our view, the confidence intervals around the staff's forecasts are likely large. For now, we re-affirm our expectation of a 25 bps hike by September, followed by two more rate increases to close the year with the key policy rate at 2.50%.

II. New Minister of Finance; next steps on fiscal reform outlined

On Monday, May 3, President Duque named José Manuel Restrepo to replace Albero Carrasquillas as Minister of Finance. Restrepo had until recently been the Minister for Trade and Industry. He is an economist and holds a PhD from the University of Bath in the UK. As head of the Trade Ministry, Restrepo has been an effective good negotiator and has decent relations with Congress: he should be able to find consensus with major stakeholders on fiscal reform.

On Monday afternoon, President Duque convened a meeting with the main political parties and invited the Opposition to work on a proposal for fiscal adjustment. If a new bill is drafted and submitted to Congress soon (i.e., by the end of the current week or during the next week), we think the deadline of approval before June-end would still be obtainable.

Tensions in the country remain elevated and new protests are planned for Wednesday, May 5, to maintain pressure on the authorities.

—Sergio Olarte & Jackeline Piraján

MEXICO: BANXICO SURVEY SEES HIGHER GROWTH AND INFLATION IN 2021; RECORD REMITTANCES IN MARCH

I. Banxico Economists' Survey anticipates stronger growth and higher inflation for 2021

Consensus forecasts in Banxico's April *Survey of Economists*, released on Monday, May 3, improved for a sixth consecutive month. The average real GDP growth rate projected for 2021 was 4.76% y/y, up from the 4.53% y/y recorded in the previous survey. Scotiabank Economics continues to expect a 4.9% y/y gain in 2021. The drivers of stronger growth remain the recently approved US stimulus package and stronger demand in H2-2021 owing to the impact of vaccinations. Over the next few months, better headline annual numbers on Mexico's economic recovery will principally reflect base effects and external factors, rather than improvements in the local economy. Domestic Mexican investment has continued to underperform, and with weak investment comes soft job creation, which further dampens domestic demand. Anaemic domestic demand remains the main reason Mexico's economic recovery continues to lag the rebounds underway in the country's Latam peers.

Other highlights in the *Survey* included:

- Headline inflation forecasts for the end of 2021 moved up from 4.17% y/y to 4.58% y/y, further above the 4% upper bound of Banxico's target range; Scotiabank Economics forecasts 4.3% y/y at end-2021. Core inflation also rose, but remained at a slower pace, going up from 3.68% y/y to 3.80% y/y, which implies that the most volatile parts of the consumer basket are seeing relatively bigger price gains;

- Regarding monetary policy, most analysts foresaw no changes in the overnight target rate until Q3-2022. The median of responses stood at 4.00% for the end of 2021, while it moved up from 4.00% to 4.35% for end-2022. Scotiabank Economics' forecasts see the benchmark Banxico policy rate moving to 5.0% by end-2022;
- The outlook for the peso at end-2021 strengthened from USDMXN 20.66 in the March survey to USDMXN 20.50. For 2022, the outlook for the peso also improved, moving from USDMXN 21.06 to USDMXN 20.95;
- Formal job creation expectations saw some modest improvements, but remained weak for both 2021 and 2022. Projections for annual job creation rose from 394k to 435k in 2021, which still represents only slightly above half the annual average for the period between 2009 and the COVID-19 crisis. Forecasts for formal job creation in 2022 were little changed, with a tiny move from 385k to 384k; and
- On the main risks to growth, analysts' concerns remained dominated by governance (44%), weak domestic economic conditions (40% of analysts), and public finances (7%).

II. Record for remittances in March

According to data released by Banco de México on Monday, May 3, remittances in March hit their highest flows ever for a single month (USD 4.152 bn, chart 5) and for the first quarter of any year (USD 10.623 bn). The average size of the transfers (USD 370) was the largest since 2008 and the number of transfers (11.2 mn) was also an all-time record for any month. US fiscal stimulus, further progress in the US vaccination effort, economic gains, and the ongoing recovery in the US labour market should together sustain a steady flow of remittances into Mexico throughout the remainder of 2021.

—Miguel Saldaña

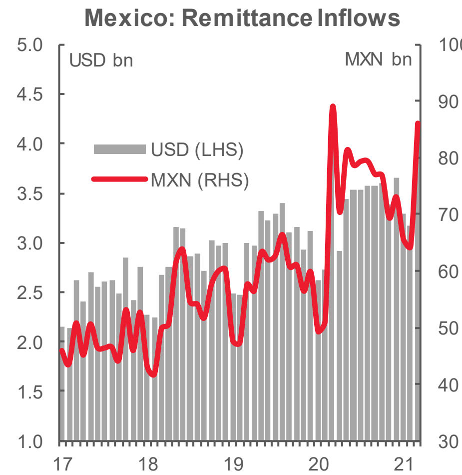
PERU: APRIL INFLATION; POLL GAP NARROWS; STRONG MARCH LEADING INDICATORS; REVISED MEF OUTLOOK; APPROVAL OF PENSION WITHDRAWALS ADVANCES

I. Lima inflation saw a negative print in April, but remains biased to rise

Lima inflation surprised on the downside in April, with a decline of -0.10% m/m sa, below both the Bloomberg consensus of 0.15% m/m and our own forecast of 0.05% m/m, again stemming from the volatility of non-core prices (chart 6). Headline inflation fell from 2.6% y/y in March to 2.4% y/y in April and remained above the 2% y/y target and the BCRP's expectation of 2.1% y/y. Core inflation fell slightly, from 1.79 y/y in March to 1.72% y/y in April and remains below the 2% y/y target for headline inflation (chart 6, again).

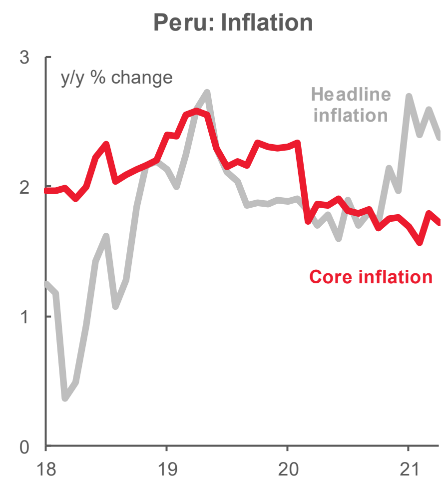
Our forecast of 2.6% y/y for end-2021 remains firm, although with an upward bias owing to possible continued pressure on the sol. The gradual depreciation from around USDPEN 3.62 at the beginning of 2021 to USDPEN 3.84 last week could add some inflationary impulse via pass-through effects. Slack is expected to persist in the Peruvian economy well into 2022. As a result, there is little immediate rationale for the BCRP Board to change its monetary-policy stance even though level effects are expected to push headline inflation close to 3.0% y/y in the coming months (chart 7).

Chart 5



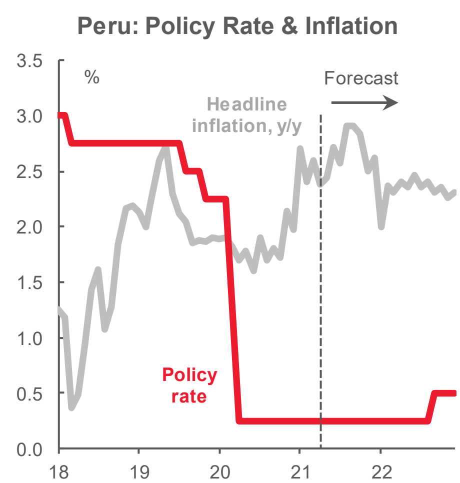
Sources: Scotiabank Economics, INEGI.

Chart 6



Sources: Scotiabank Economics, BCRP, INEI.

Chart 7



Sources: Scotiabank Economics, BCRP, INEI.

II. Gap narrows further between Castillo vs Fujimori

The latest Ipsos survey, released on Monday, May 3, revealed that the gap between Castillo and Fujimori has narrowed another 2 ppts, from 11% (April 16) to 9% (April 30). This survey showed Castillo with 43% of voter preferences (up 1 ppt) versus 34% (a gain of 3 ppts) for Fujimori. A full 10% of voters remain undecided and 13% plan to cast blank or invalidated ballots, a share that has not come down over successive polls. The polling data were collected prior to last Saturday's debate and the space between the candidates is likely to have narrowed further since Fujimori appeared to perform better in the exchange. Accordingly, Castillo seems disinclined to agree to another meeting.

In last Saturday's debate, Castillo emphasized some of his well-known proposals, such as revisions to the constitution and the nationalization of natural resources (gas, mining, fishing, etc.). He also outlined some additional initiatives, such as the purchase of debt from SMEs by the government's Banco de la Nación, a reduction in the pensionable age for vulnerable people from 65 to 60 years-old, and restrictions on imports to favour locally produced goods.

Fujimori also introduced some proposals that carry a populist bias. These included doubling the value of pensions for vulnerable people, distributing 40% of the tax revenues from companies that extract natural resources directly to people that live in the communities where they operate, and reducing the fuel tax.

III. Leading indicators imply Peru's economy performed strongly in March

Leading indicators linked to domestic demand, such as cement sales, electricity consumption, public investment, and imports imply that the economy performed strongly in March, even when compared with March 2019. Primary sectors, such as mining, posted an increase in activity of 20.4% y/y compared with March 2020, but the level of activity was still 7% lower than that observed in March 2019. Fishing activity registered an increase of 33% y/y; compared with March 2019 it was even up 9%.

IV. Revised MEF macro outlook features ambitious growth projections and greater use of public savings

In its revised projections for 2021–24 released on Friday, April 30, the Ministry of Finance (MEF) left unchanged its outlook for real GDP growth at 10% y/y for this year and 4.8% y/y for 2022, which for 2021 is optimistic compared to the market consensus (9.5% y/y) and our forecast (8.7% y/y). Most importantly, the MEF lowered its projections for the fiscal deficit and public debt in 2021. The official fiscal deficit forecast fell from 6.2% of GDP to 5.4% of GDP mainly due to lower public spending, which was reduced from 23.4% of GDP in the previous estimate to 22.9% of GDP. Obviously, both projections are sensitive to the forecast for real GDP growth. Public revenues were adjusted slightly downward (from 19.4% of GDP to 19.2% of GDP). The projected level of public debt fell 2.1 ppts, from 38.0% of GDP to 35.9% of GDP, explained mainly by less financing via sovereign (i.e., local) bonds, whose forecast balance outstanding at end-2021 went from 22.5% of GDP to 17.5% of GDP; this was partially offset by an increase in the projected stock of global bonds outstanding, which went from 8.7% of GDP to 11.7% of GDP and includes global bonds already issued during the first months of 2021. The revised numbers imply that the MEF anticipates greater use of public savings than it did previously.

V. Approval of third round of withdrawals of pension-fund assets advances

Congress' Economy Commission approved the third round of withdrawals of pension-fund assets. The measure would provide up to PEN 17,600 to all account holders; however, the Commission set aside the possibility to allow those over 40 years old to withdraw up to 100% of their assets. The package must be debated in a plenary session of Congress this Thursday, May 6. The government has not yet indicated whether it will support the initiative; if not, the bill could be sent to the Constitutional Court for evaluation.

—Mario Guerrero