May 1, 2020

Latam Economic Update

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ARGENTINA: EXPLOSIVE WAGE GROWTH TRACKS INFLATION

February data, released on April 30, show that Argentine wage growth is tracking inflation as the country returns to monetizing deficits and the development of a wide gap between its official exchange rate and the blue-chip swap rate. Wages grew 3.9% m/m in February, down from the 6.0% m/m gain in January. Compared with a year ago, however, wages are up 46.6% y/y, a bit faster than the 44.9% y/y growth recorded in January. With production constrained by the COVID-19 lockdowns, fiscal stimulus ramping up, the ARS depreciating on the back of debt-default concerns, and inflation set to remain above 45% y/y in 2020, at even these astronomical rates of wage growth Argentines are set to tread water in terms of real earnings in 2020.

—Brett House

Chart 1

Sources: Scotiabank Economics, Bloomberg.

CHILE: SECTORAL DATA POINT TO A -4% Y/Y CONTRACTION IN MARCH; UNEMPLOYMENT RATE HEADING TO DOUBLE DIGITS, BUT DATA SKEWED

I. Sectoral data point to a -4% y/y contraction in March

We anticipate a -4% y/y contraction in monthly GDP for March, which will be released on Monday, May 4. Sectoral-level data that printed on April 30 confirmed a semi-paralysis in production, low demand, and a household focus on basic supplies in the retail numbers. Manufacturing showed a contraction of -1.2% m/m, but a small increase of 0.6% y/y. We were positively surprised by this given that we expected a significant year-over-year contraction. However, much of the surprise is explained by an unusual increase in methane production that contributed 2.2 ppts to growth and a rise in other pharmaceutical product production that could be related to government demand as a result of the COVID-19 crisis. The rest of the sectors showed significant contractions that reflected a collapse in demand: the National Bureau of Statistics (NBS) highlighted clothing, food, and furniture, among others.

Growth in mining activity slowed slightly in March, in line with our expectations. In annual terms, mining production grew by 2.3% y/y, which meant it did not exert a drag on total activity. Copper mining and processing expanded a modest 1.4% y/y, due to lower ore grades and higher maintenance costs. Statistical base effects implied that we should have seen even stronger y/y gains. We do not expect favourable surprises in production during the first half of the year owing to the health crisis and existing production strategies.

Retail trade contracted by 14.9% y/y in March, in line with our projections. Supermarket sales expanded 7.1% y/y, somewhat less than implied by our high-frequency transaction data. Looking forward to April, we see strong contractions in all segments except supermarkets. We expect the recent recovery in department-store sales to ebb as transaction data imply some marginal substitution by e-commerce.

All in all, the sectoral data appear to confirm our estimate that overall economic activity contracted by -4% y/y in March.

II. Labour market data will be skewed by the "absent employed"

The unemployment rate increased from 7.8% to 8.2% in March, close to our estimate and the Bloomberg survey consensus (8.4%). Both we and the market anticipated a further worsening of the labour market following the COVID-19 outbreak. Figures for the coming months will continue to show an increase in unemployment, as companies adjust to the new economic situation. The increase in the unemployment rate was due to the low rate of employment creation, which grew by only 0.7% y/y (previous month: 1.7% y/y) while the labour force expanded 1.8% y/y. About 120 thousand jobs were lost in the quarter ended in March, deepening the drop in the rolling quarter we observed last month.

By employment category, self-employment saw the destruction of nearly 65k jobs. Private and public employment numbers have yet to reveal the real impact of COVID-19, which could worsen in the coming months. One factor that will mitigate declines in salaried employment will be the recently passed new "Employment Protection" bill as it allows formal workers to maintain their contractual bond with their place of employment, which will mitigate job-loss numbers.

At the sectoral level, service activities continued to show the highest annual job creation growth through March, especially in professional activities that are linked to investment. However, we did see the beginning of COVID-19 effects, especially in the retail sector, which reduced its independent job creation. Finally, manufacturing continued to deepen its trend of job destruction.

As reported by the NBS, since the end of March and while the health crisis lasts, the employment survey is being carried out by telephone and the web. Due to this, the response or "achievement" rate decreased significantly in March and hit only 54.2%, despite only two weeks of mobility restrictions. As a result, the representativeness of the survey could continue to decrease in the coming months. The NBS provided an appendix to the data that tries to give technical support and credibility to its employment statistics. However, the health crisis and its logistical impact on the sampling process, together with the strong adjustment in employment concentrated in just a few weeks, only lead us to infer that the actual unemployment rate in March was likely significantly higher than the official NBS published rate. We expect the official unemployment rate to move into double digits as the southern hemisphere's winter advances.

The next month of labour market data will be affected by the "Employment Protection" bill that entered into force from April and will result in large numbers of "absent employed". This law allows employers to keep the employment contract alive for individuals by paying only their related social security contributions. Formal workers retained under this provision are classified as "absentee employed" and are not registered as unemployed under the NBS survey. This will partially mitigate the increase in the number of unemployed that we will see in the official data as a result of the health crisis, but only for salaried workers, since independent workers do not have the option of being "absent employed".

Summing up, we need to look cautiously at the official employment figures given the COVID-19-related mobility restrictions, the new reality of remote work, and policies to support employment. In the coming months, we will probably see a greater deterioration in the data for self-employed workers and a relatively smaller proportionate decline in numbers for salaried workers; but, in any case, the labour market will be weakened, with employed workers receiving significantly lower incomes.

—Jorge Selaive & Waldo Riveras

COLOMBIA: MARCH EXPORTS AND EMPLOYMENT DECLINED; BANREP CUT RATES BY 50 BPS TO 3.25% AND ANNOUNCED NEW LIQUIDITY MEASURES AT ITS APRIL 30 MEETING

I. Exports slumped in March

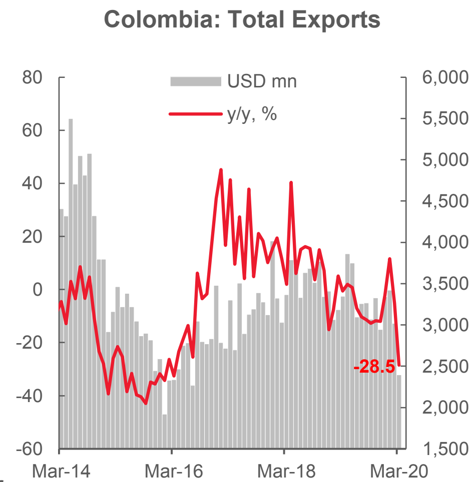
Colombia's monthly exports for March were USD 2.39 bn in the April 30 release, which is a contraction of -28.5% y/y (chart 2). Mining-related exports contracted by -52.0% y/y due to a significant decline in coal (-30.6% y/y) and oil exports (-60% y/y). Agricultural exports grew by 2.1% y/y while manufacturing exports expanded 1.3% y/y.

Traditional exports contracted by -48.2% y/y in March; coal exports contracted by -30.6% y/y due to price deterioration, which offset the increase of 6.5% y/y in metric tons. The -60% y/y contraction in oil-related exports took them to their lowest level since 2009 (USD 582.5 mn), which represented 24% of total exports (n.b., they were 40% of total exports in 2019). The decline in oil-related exports was due to the deterioration in international prices and lower volumes (-10% y/y). Coffee exports declined by -12.48% y/y, on the back of lower volumes, which offset favourable effects from international prices.

Non-traditional exports were USD 1.28 bn, an increase of 7.4% y/y. The expansion of agricultural exports was driven by cattle exports (+618.9% y/y) as Colombia was declared free of foot and mouth disease in February. However, the main contribution to non-traditional exports was from non-monetary gold exports.

Overall, the impact on the external current account should be moderate: we would expect the deterioration in mining exports to be offset by a reduction in outflows on the income account. All in all, our expectation is for a current account deficit of 4.1% GDP in 2020. Financing this wider external imbalance will be an issue to monitor.

Chart 2

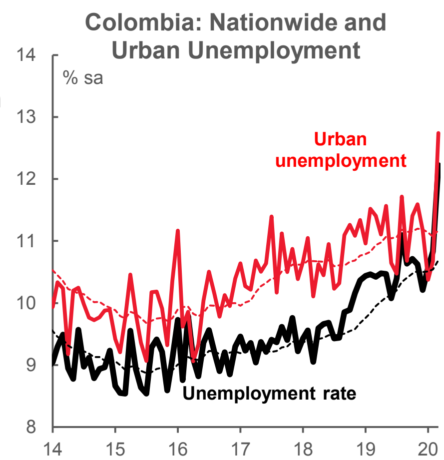


Sources: Scotiabank Economics, DANE.

II. DANE reported a historic decline in employment in March

DANE released March's unemployment statistics on April 30, which showed the first effects of the COVID-19 shock. Even though the mandatory quarantine only affected the last week of March, employment losses were the highest in at least a decade. However, since people who lost their jobs can't look for new positions owing to the lockdown, they are now considered inactive. This diminished the labour force participation rate and moderated the increase in the unemployment rate in the month, while still building pressures that will likely manifest in future monthly figures.

Chart 3



Sources: Scotiabank Economics, DANE.

Nationwide unemployment came in at 12.6% (March 2019 was 10.8%), while urban unemployment (13 cities) came in at 13.4% (March 2019, 12.0%) (chart 3). Labour force participation decreased to 59.2% (March 2019, 63.2%) for the nationwide print and fell to 60.9% for the urban data. The seasonally-adjusted unemployment rate showed a deterioration, to 12.2% versus 10.8% in February 2020 at the nationwide level, and increased to 12.7% versus 10.8% in February 2020 for the urban print. If people who lost their jobs and are considered inactive today start looking again for a job, the labour participation rate will increase and the unemployment rate could shoot up to 20% in the coming months.

The March labour market report reflected the sudden interruption in the economic recovery caused by the COVID-19 lockdown. In fact, it showed that the impact of COVID-19 in the labour market was even worse than initially expected, since employment decreased by 1.5 million y/y, nine times the change in 2019. The most significant deterioration was in urban areas (-952k y/y), especially in activities related to leisure and entertainment services (-512k y/y), manufacturing (-403k y/y), and retail (-329k y/y). In the press conference, DANE's Director, Juan Daniel Oviedo, highlighted that working hours had been reduced and that job losses disproportionately affected women.

Additionally, the labour market continued to show different dynamics between the formal and informal sectors. In Q1-2020, net job numbers contracted -2.7% y/y, of which the destruction of informal employment (-4.1% y/y on average) was twice the decline in waged employment (-1.6% y/y on average).

Although the unemployment rate in March didn't show a strong deterioration, job losses were significant. The jobs data point to discrepancies between indicators of formal-sector unemployment and the country's real social needs, which could put additional pressure on the government's finances over the coming months.

III. BanRep cut rates by 50 bps to 3.25% and announced new liquidity measures at its April 30 meeting

By a unanimous decision at its April 30 meeting, BanRep's board cut its main policy rate by 50 bps to 3.25%, an all-time low. It also announced new measures to provide additional liquidity to the financial system. BanRep will:

- Add Financiera de Desarrollo Nacional (FDN) and securitization companies as placement agents for open market operations;
- Make the operation of the Transitional Liquidity Support facility more flexible. In the press conference, the BanRep chief of staff, Hernando Vargas, explained that this flexibility would include lower haircuts for margin calls, among other things;
- Add new NDF auctions of up to USD 1 bn;
- Renew NDFs that expire before May 30; and
- Continue FX swap auctions of up to USD 400 mn.

The central bank will continue to focus on providing enough liquidity to the financial system. During the press conference, Governor Echavarría emphasized that, in the current situation, cutting rates aggressively would not ensure a fast rebound in economic activity, and, for now, gradual cuts are preferred. Additionally, Governor Echavarría stated that May's meeting would become a monetary-policy rate decision meeting, which implies that the easing cycle is far from being over. It is worth noting that, for the time being, TES purchases are not planned to resume in May. Vargas explained that liquidity has improved and it is not necessary to continue intervening at this time.

On Monday, May 4, BanRep's staff will publish the quarterly *Monetary Policy Report* and the press conference will be on Wednesday, May 6.

—Sergio Olarte & Jackeline Piraján

MEXICO: Q1-2020 GDP FALLS TO ITS LOWEST LEVEL SINCE 2009 AS OULOOK DETERIORATES

According to data released on Thursday, April 30, Mexico's economy shrank in Q1-2020 by its fastest annual rate since Q1-2009. According to INEGI's preliminary estimate, Mexico's GDP fell for the fourth consecutive time on a yearly unadjusted basis, from -0.5% y/y in Q4-2019 to -1.6% y/y in Q1-2020 (versus 1.2% y/y in Q1-2019), beating more pessimistic market expectations (-2.0% y/y). This result was driven by a drop in the services sector, from 0.0% y/y to -0.9% y/y (versus +1.9% y/y in Q1-2019) and by an even larger contraction in industrial activity, from -2.1% y/y to -3.2% y/y (versus -0.5% y/y in Q1-2019), while growth in primary activities decelerated slightly, from 1.6% y/y to 1.5% y/y (versus 1.5% in Q1-2019).

On a seasonally adjusted basis, economic activity shrank -1.6% q/q, down from -0.1% q/q in Q4-2019, its sharpest quarterly contraction since Q1-2009, with growth in secondary and tertiary activities decreasing from -1.2% q/q to -1.4% q/q and from 0.2% y/y to -1.4% y/y, respectively, while agricultural sector growth rose, from -1.1% q/q to 0.5% q/q.

Even though GDP figures beat market expectations, the outlook for the Mexican economy remains unfavourable. Containment measures implemented by different countries to minimize the spread of COVID-19 are having a significant impact on global growth, including the US economy, where a recession scenario was confirmed earlier this week. This would not only have a negative impact on Mexico's industrial production and exports, but it would also slow down the transfer of remittances to the country, which would affect domestic consumption. Likewise, as the effects of local restrictions to limit the spread of the virus continue to materialize, the service sector will most likely be severely affected (especially retail, restaurants, hotels, transportation, as well as cultural and recreational activities), while already weak private consumption could deteriorate even further.

—Alejandro Stewens

PERU: CONGRESS APPROVES FURTHER WITHDRAWALS FROM PENSION FUNDS

Congress approved the legal withdrawal of funds from private pension funds. Anyone with an account in the private pension fund system (i.e., the Administradoras de Fondos de Pensions, or AFPs) will be able to withdraw 25% of their funds, up to a ceiling of PEN 12,900 per account (approximately USD 3,900). It isn't clear how much will actually be withdrawn, and projections differ, but a very rough estimate could be around USD 4 bn. Not all withdrawn funds will go to increasing demand: some will be used to bring down debt. Although withdrawals could represent around 10% of total funds under administration, the AFPs have largely anticipated the move, and have liquidity available. We do not expect a huge or lasting impact on the FX rate (AFPs have over 40% of resources offshore).

One intriguing aspect in all of this is that the government did not veto the bill, as was widely expected. On Wednesday, April 29, President Vizcarra had criticized the Congressional bill, and stated that the government would issue, by decree, its own withdrawal proposal of between PEN 3,000 and PEN 5,000 per account. This proposal would have made sense only if the government vetoed the Congressional bill. Why did it not do so? Perhaps because it realized that Congress had the votes to overcome the veto and preferred to avoid what could be perceived as a confrontation.

—Guillermo Arbe

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