April 18, 2020

Latam Weekly: How Low Can Policy Rates Go?

FORECAST UPDATES

- **Our Latam Weekly arrives in tandem with Scotiabank Economics' first comprehensive update to its global forecasts since March 25. Significant markdowns in the outlook for the G10 economies and China cascade into the outlook for Latam.**

ECONOMIC OVERVIEW

- **Rate cuts by the Fed and other developed market central banks have given cover for Latam's monetary authorities to ease fiscal and monetary conditions to an unprecedented degree. With inflation relatively low and policymakers prioritizing efforts to sustain domestic activity, we look at how much further they could move.**

MARKETS REPORT

- **Commodity-exporting emerging markets are being hit by the twin forces of domestic shutdowns and sharply reduced prices for their major exports. We look at how these twin forces are landing in differentiated ways across Latam.**

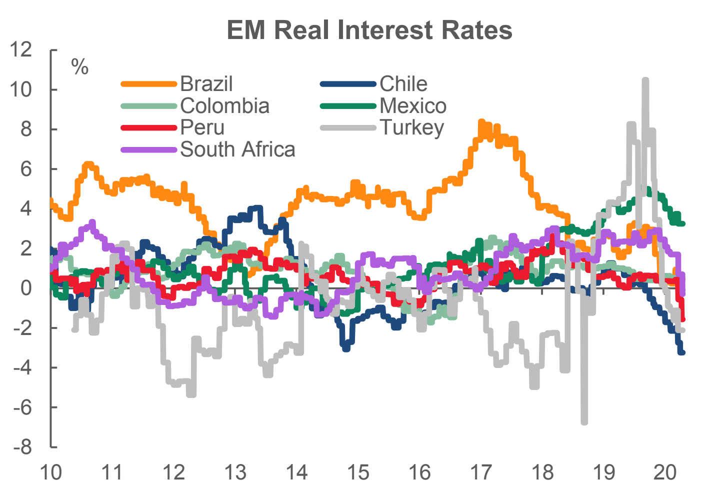
COUNTRY UPDATES

- **Succinct analysis of recent developments and guides to the week ahead in our Latam-6: Argentina, Brazil, Chile, Colombia, Mexico, and Peru.**

MARKET EVENTS & INDICATORS

- **Risk calendars with selected highlights for the period April 18–24 across Latam's major economies.**

Chart of the Week



Sources: Scotiabank Economics, Haver Analytics.

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Forecast Updates: April 17

Argentina	2019 Q4	2020 Q1e	2020 Q2f	2020 Q3f	2020 Q4f	2021 Q1f	2021 Q2f	2021 Q3f	2021 Q4f	2019	2020f	2021f
Real GDP (y/y % change)	-1.1	-0.9	-12.4	-4.9	-3.3	0.3	3.1	5.9	7.5	-2.2	-5.6	4.2
CPI (y/y %, eop)	53.8	47.2	49.0	46.8	45.7	51.1	50.4	48.9	46.8	53.8	45.7	46.8
Unemployment rate (%, avg)	8.9	10.9	11.3	11.0	10.8	10.6	10.2	9.9	9.8	9.8	11.0	10.1
Central bank policy rate (%, eop)	55.00	38.00	37.00	36.00	36.00	36.00	37.00	38.00	40.00	55.00	36.00	40.00
Foreign exchange (USDARS, eop)	59.9	64.4	73.4	79.1	83.1	86.2	87.5	89.2	93.1	59.9	83.1	93.1

Brazil	2019 Q4	2020 Q1e	2020 Q2f	2020 Q3f	2020 Q4f	2021 Q1f	2021 Q2f	2021 Q3f	2021 Q4f	2019	2020f	2021f
Real GDP (y/y % change)	1.7	0.8	-9.3	-4.3	-0.3	1.1	4.2	3.1	1.7	1.1	-3.3	2.5
CPI (y/y %, eop)	3.8	3.3	4.2	5.2	6.3	7.1	7.9	7.6	7.1	4.3	6.3	7.1
Unemployment rate (%, avg)	11.3	11.6	12.7	12.8	12.6	13.2	13.6	13.6	13.4	11.9	12.4	13.5
Central bank policy rate (%, eop)	6.50	3.75	3.00	3.00	3.00	4.00	4.75	5.50	6.00	4.50	3.00	6.00
Foreign exchange (USDBRL, eop)	4.02	5.25	4.97	4.72	4.84	4.93	4.64	4.52	4.42	4.02	4.84	4.42

Chile	2019 Q4	2020 Q1e	2020 Q2f	2020 Q3f	2020 Q4f	2021 Q1f	2021 Q2f	2021 Q3f	2021 Q4f	2019	2020f	2021f
Real GDP (y/y % change)	-2.1	-0.6	-6.6	-2.6	1.3	0.9	6.6	2.1	2.2	1.1	-2.1	2.9
CPI (y/y %, eop)	3.0	3.7	2.9	3.1	2.8	2.5	2.9	3.3	3.0	3.0	2.8	3.0
Unemployment rate (%, avg)	7.0	7.8	9.0	8.5	8.0	7.8	7.8	7.8	7.5	7.2	8.3	7.7
Central bank policy rate (%, eop)	1.75	0.50	0.50	0.50	0.50	1.00	1.25	1.50	1.50	1.75	0.50	1.50
Foreign exchange (USDCLP, eop)	753	860	820	800	790	780	760	740	720	753	790	720

Colombia	2019 Q4	2020 Q1e	2020 Q2f	2020 Q3f	2020 Q4f	2021 Q1f	2021 Q2f	2021 Q3f	2021 Q4f	2019	2020f	2021f
Real GDP (y/y % change)	3.4	3.6	-3.0	0.0	1.8	2.9	4.9	3.8	3.0	3.3	0.6	3.6
CPI (y/y %, eop)	3.2	3.9	3.3	3.1	3.2	3.0	3.2	3.1	3.1	3.8	3.2	3.1
Unemployment rate (%, avg)	10.4	13.3	17.0	15.0	12.0	10.8	9.3	10.0	10.4	11.2	14.3	10.1
Central bank policy rate (%, eop)	4.25	3.75	3.25	3.25	3.25	3.25	3.75	4.25	4.25	4.25	3.25	4.25
Foreign exchange (USDCOP, eop)	3,287	4,065	3,950	3,851	3,654	3,473	3,465	3,458	3,450	3,287	3,654	3,450

Mexico	2019 Q4	2020 Q1e	2020 Q2f	2020 Q3f	2020 Q4f	2021 Q1f	2021 Q2f	2021 Q3f	2021 Q4f	2019	2020f	2021f
Real GDP (y/y % change)	-0.5	-3.4	-15.1	-10.3	-4.7	-1.0	3.4	1.5	0.9	-0.1	-8.4	1.1
CPI (y/y %, eop)	2.8	3.3	3.2	3.8	3.6	3.8	3.7	3.8	3.7	2.8	3.6	3.7
Unemployment rate (%, avg)	3.4	3.7	6.7	7.7	7.1	6.3	6.0	6.5	5.8	3.5	6.1	6.3
Central bank policy rate (%, eop)	7.25	6.50	5.50	5.50	5.50	5.00	5.00	5.00	5.00	7.25	5.50	5.00
Foreign exchange (USDMXN, eop)	18.93	21.97	24.25	24.03	24.24	24.29	24.07	24.02	24.15	18.93	24.24	24.15

Peru	2019 Q4	2020 Q1e	2020 Q2f	2020 Q3f	2020 Q4f	2021 Q1f	2021 Q2f	2021 Q3f	2021 Q4f	2019	2020f	2021f
Real GDP (y/y % change)	1.8	-4.5	-7.0	0.7	1.3	6.7	9.6	1.0	1.6	2.2	-2.3	4.5
CPI (y/y %, eop)	1,9	1.8	1.6	1.3	1.1	1.2	1.3	1.8	2.2	1.9	1.1	2.2
Unemployment rate (%, avg)	6.1	…	…	…	…	…	…	…	…	6.6	12.0	10.0
Central bank policy rate (%, eop)	2.25	1.25	0.25	0.25	0.25	0.75	1.00	1.25	1.50	2.25	0.25	1.50
Foreign exchange (USDPEN, eop)	3.31	3.43	3.49	3.47	3.45	3.42	3.43	3.39	3.40	3.31	3.45	3.40

United States	2019 Q4	2020 Q1e	2020 Q2f	2020 Q3f	2020 Q4f	2021 Q1f	2021 Q2f	2021 Q3f	2021 Q4f	2019	2020f	2021f
Real GDP (y/y % change)	2.3	-0.4	-12.4	-7.7	-4.7	-0.4	14.4	9.2	6.0	2.3	-6.3	7.0
CPI (y/y %, eop)	2.0	2.1	0.8	0.1	-0.3	0.7	1.4	2.1	2.8	2.0	-0.3	2.8
Unemployment rate (%, avg)	3.5	3.8	10.3	11.5	11.6	10.8	9.4	8.1	6.9	3.7	9.3	8.8
Central bank policy rate (%, eop)	1.75	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	1.75	0.25	0.25
Foreign exchange (EURUSD, eop)	1.12	1.08	1.09	1.10	1.12	1.13	1.14	1.15	1.16	1.12	1.12	1.16

Source: Scotiabank Economics.

Forecast Updates: March—April Revisions

	March 6		March 25		April 17	
	2020f	2021f	2020f	2021f	2020f	2021f
Argentina*						
Real GDP (annual % change)	...	...	-2.4	1.7	-5.6	4.2
CPI (y/y %, eop)	...	...	66.0	42.0	45.7	46.8
Unemployment rate (%, avg)	...	...	...	...	11.0	10.1
Central bank policy rate (%, eop)	...	...	42.00	38.00	36.00	40.00
Argentine peso (USDARS, eop)	...	...	82.0	76.0	83.1	93.1
Brazil						
Real GDP (annual % change)	1.8	2.1	-3.0	1.5	-3.3	2.5
CPI (y/y %, eop)	4.2	4.1	7.3	8.2	6.3	7.1
Unemployment rate (%, avg)	...	...	...	...	12.4	13.5
Central bank policy rate (%, eop)	3.50	5.25	4.75	8.25	3.00	6.00
Brazilian real (USDBRL, eop)	4.37	4.11	4.84	4.49	4.84	4.42
Chile						
Real GDP (annual % change)	1.4	2.5	-2.1	2.9	-2.1	2.9
CPI (y/y %, eop)	3.0	3.0	3.0	3.0	2.8	3.0
Unemployment rate (%, avg)	...	...	...	...	8.3	7.7
Central bank policy rate (%, eop)	1.00	2.00	0.50	2.00	0.50	1.50
Chilean peso (USDCLP, eop)	740	700	790	720	790	720
Colombia						
Real GDP (annual % change)	3.6	3.6	1.2	2.8	0.6	3.6
CPI (y/y %, eop)	3.3	3.1	2.9	3.0	3.2	3.1
Unemployment rate (%, avg)	...	...	...	...	14.3	10.1
Central bank policy rate (%, eop)	4.50	4.75	3.50	4.25	3.25	4.25
Colombian peso (USDCOP, eop)	3,250	3,180	3,654	3,450	3,654	3,450
Mexico						
Real GDP (annual % change)	0.6	1.6	-5.8	1.8	-8.4	1.1
CPI (y/y %, eop)	3.8	3.7	4.4	4.1	3.6	3.7
Unemployment rate (%, avg)	...	...	...	...	6.1	6.3
Central bank policy rate (%, eop)	6.25	6.25	6.00	6.00	5.50	5.00
Mexican peso (USDMXN, eop)	20.78	21.86	22.84	22.74	24.24	24.15
Peru						
Real GDP (annual % change)	3.0	3.5	0.3	3.5	-2.3	4.5
CPI (y/y %, eop)	1.8	2.1	1.4	2.0	1.1	2.2
Unemployment rate (%, avg)	...	...	...	...	12.0	10.0
Central bank policy rate (%, eop)	2.00	2.25	1.00	1.75	0.25	1.50
Peruvian sol (USDPEN, eop)	3.40	3.35	3.45	3.40	3.45	3.40

Source: Scotiabank Economics.
* Initiated coverage March 22, 2020.

Forecast Updates: Central Bank Policy Rates and Outlook

Latam Central Banks: Policy Rates and Outlook

		Next Scheduled Meeting			Market Pricing		BNS Forecast		
	Current	Date	Market	BNS	12 mos	24 mos	End-2020	End-2021	BNS guidance for next monetary policy meeting
Argentina, BCRA, TPM, n.a.	38.00%	n.a.	n.a.	37.00%	n.a.	n.a.	36.00%	40.00%	The BCRA's last move on March 5 delivered its sixth rate cut in 2020, but economic activity indicators since then still point to a deepening slowdown. We expect the BCRA to cut again in April.
Brazil, BCB, Selic	3.75%	May-06	3.53%	3.25%	3.66%	5.84%	3.00%	6.00%	The apparent absence of FX-induced pass-through inflation provides the BCB with room to pursue a deeper easing cycle.
Chile, BCCh, TPM	0.50%	May-06	0.51%	0.50%	0.78%	1.20%	0.50%	1.50%	The BCCh MPC indicated at its March 31 meeting that 0.5% is the policy rates' technical lower bound, and that it would remain here for an extended period.
Colombia, BanRep, TII	3.75%	Apr-30	2.79%	3.25%	2.89%	3.95%	3.25%	4.25%	BanRep will cut the policy rate 3.25% owing to downside risks on economic activity and contained risk on the inflation side.
Mexico, Banxico, TO	6.50%	May-14	6.09%	6.00%	4.77%	5.23%	5.50%	5.00%	Recent rapid deterioration of economic outlook, coupled with more tamed inflation, will open space for more cuts on the reference interest rate.
Peru, BCRP, TIR	0.25%	May-07	n.a.	0.25%	n.a.	n.a.	0.25%	1.00%	In a surprise, off-calendar move on the evening of Thursday, April 9, the central bank cut its reference rate by 100 bps to 0.25%, twice the 50 bps cut we had been expecting at the bank's scheduled meeting on Thursday, April 16. The BCRP has never before lowered its policy rate by 200 bps in less than a month, and 0.25% is the lowest rate it has ever reached. The speed and depth of the BCRP's moves are together a clear sign of just how concerned the monetary authorities are about the developing contraction in economic activity.

Sources: Scotiabank Economics, Bloomberg.

Economic Overview: Tapping Policy Space

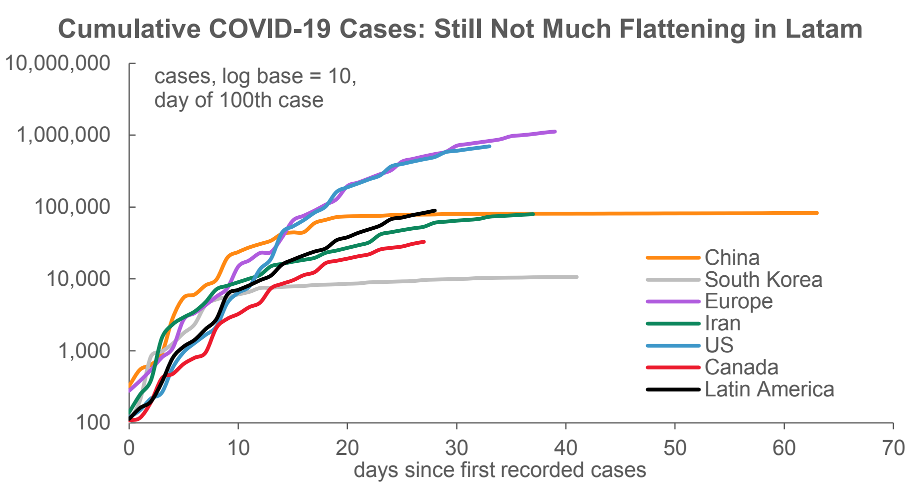
- **Widely divergent approaches to the COVID-19 pandemic across Latam have led to a third week in a row in which identified cases have doubled in the region despite what are still some significant gaps in testing in a few countries.**
- **Incoming data prompted Scotiabank Economics to revise and update its global forecasts on April 17, with a significant cut in global growth and cascading effects into the outlook for the Latam-6.**
- **In contrast with past crises, the Latam-6 are tapping their available fiscal and monetary space, and in cases going well beyond usual assessments of policy room. We look at how much further they could go.**

COVID-19: RISING OFFICIAL NUMBERS STILL UNDERSTATE THE SPREAD

Identified COVID-19 cases in Latin America continued to mount across the region during the past week, with the total case load nearing 90k—surpassing China's official numbers for the first time (chart 1). Latin America's share of total global cases continues to edge up, rising from 2.4% a fortnight ago to 3.8% as of Friday, April 17. Global cases have meanwhile crossed the two-million mark.

Growth in case numbers appears to be exploding with particular force in Brazil and Peru (chart 2), but for widely divergent reasons. In Brazil, despite the best efforts of state governors, the Presidency continues to resist concerted possible measures to stem the contagion. On Thursday, April 16, Brazilian Pres. Bolsonaro fired Heath Minister Mandetta after repeated clashes on how to handle the COVID-19 pandemic: Mandetta advocated sheltering in place, while Bolsonaro called for Brazil to stay open for business. The firing came as local experts warned that the health system is at risk of being overwhelmed and that the number of [actual infections is 12-times larger] than official numbers indicate. In contrast, the authorities in Lima have imposed the most stringent state of emergency in the region and stepped up testing substantially, which has added to the rise in Peru's official numbers.

Chart 3



Sources: Scotiabank Economics, Johns Hopkins University.

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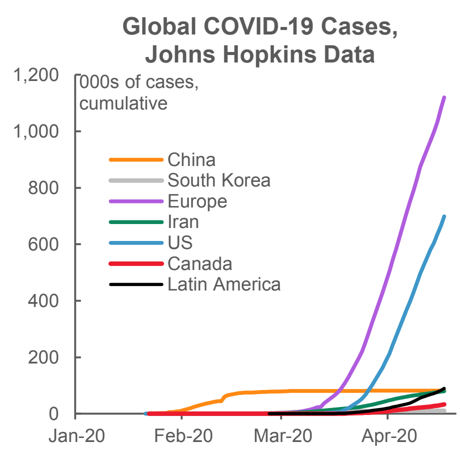
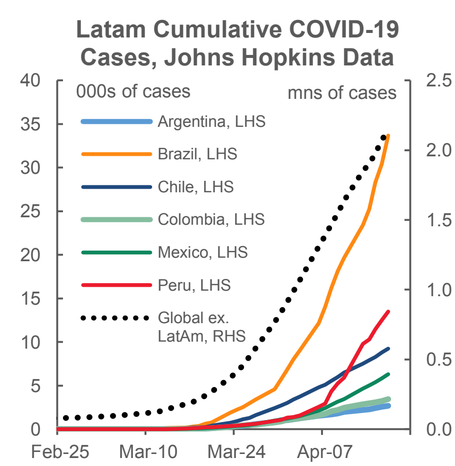
Chart 1



Sources: Scotiabank Economics, Johns Hopkins University.

Chart 2



Sources: Scotiabank Economics, Johns Hopkins University.

Official COVID-19 data are likely vastly understated in other parts of the region as well. The relatively modest numbers recorded in Mexico, where measures to confront the pandemic have been somewhat more constrained and delayed relative to those in regional peers, look particularly incredible given the size of the country's tourism industry.

CURVE FLATTENING IS ELSEWHERE

While the COVID-19 wave may be cresting in Europe and parts of the US, there is no clear indication yet that the curve is flattening in Latam (chart 3). In fact, the region's total case load has consistently doubled every week for the last three weeks and this pace is not showing any signs yet of slowing down.

With few signs of a meaningful improvement in the pandemic in Latam, existing public health measures remained largely unchanged across the region this week, but there were some indications that "quarantine fatigue" is setting in. On April 16, Mexico's President Lopez Obrador said that he expects to relax quarantine recommendations for cities that have not been affected by COVID-19, at least in the official numbers, as of May 17, with the rest of the country following on June 1. In Chile, the Health Ministry lifted its quarantine in five cities, including Santiago's financial district, but added three more municipalities to the controls. Downtown Santiago remains in lockdown, but new COVID-19 cases have declined in the Metropolitan Region.

UPDATING FORECASTS TO GLOBAL DEVASTATION

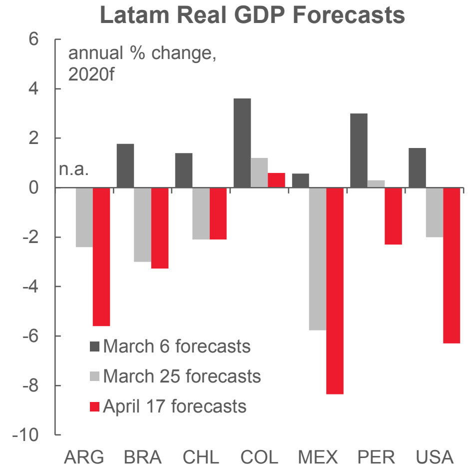
On Friday, April 17, Scotiabank Economics brought forth its first comprehensive update to its global forecasts since March 25, with significant markdowns in the outlook for the G10 economies and China. Global economic growth in 2020 has been revised downward from a flat 0% y/y to a massive -2.8% contraction, far worse than the -0.3% observed in 2009 and on track to be the worst calendar-year pullback in economic activity since the Great Depression. The US is expected to see a -6.3% y/y cut in real GDP in 2020, while Chinese growth is forecast at 1.6% y/y, its worst year since the Cultural Revolution. Most major economies are expected to see record quarterly downturns in Q2-2020, with growth collapsing by 30–50% in annualized terms.

Our forecast revisions and updates echo the downbeat tone of the IMF's April *World Economic Outlook* that came out this past week and dubbed the crisis the "Great Lockdown". The IMF similarly sees a -3% contraction for the global economy in 2020, with a -5.2% decline in Latin America.

In most major markets, Scotiabank Economics' forecasts anticipate a gradual, phased relaxation of quarantine and physical distancing measures going into the second half of 2020, with a rebound in growth beginning to take hold in Q4-2020. A full resumption in economic activity requires more than a simple relaxation of restrictions and re-opening business: it will require that people feel safe to return to public spaces. In most places, a combination of near-zero new COVID-19 cases, an effective treatment regime, and a vaccine will be needed for people to venture out *en masse*.

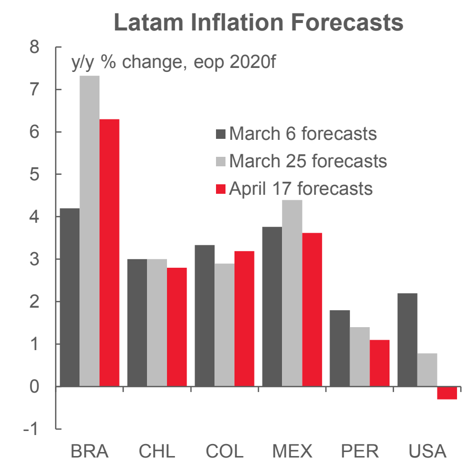
Both Scotiabank Economics and the IMF forecast a V-shaped path for growth rates, but something closer to an L-shaped recovery in levels of economic activity. Across the world, growth rates in 2021 are forecast to hit eye-popping paces by building on 2020's weak base, but in many economies our projections imply that overall economic activity will not return to the levels seen at end-2019 until early-2020.

Chart 4



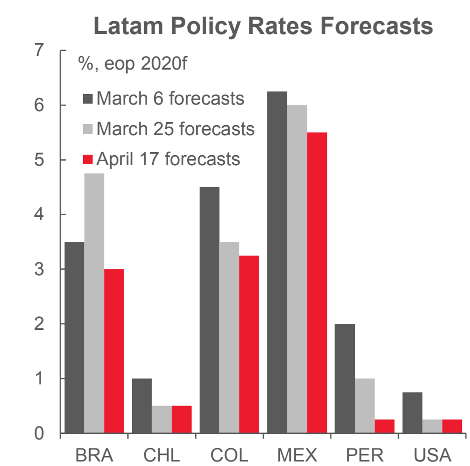
Source: Scotiabank Economics.

Chart 5



Argentina: 45.7%.
Source: Scotiabank Economics.

Chart 6



Argentina: 36%.
Source: Scotiabank Economics.

Since early-March, we have been progressively revising our Latam-6 forecasts to reflect global developments and domestic events inside the region, and we update them again here in our Forecast Tables (pp. 2–4). Because of our progressive revisions, the changes in this week's projections are limited compared with the numbers we published in our April 11 *Latam Weekly*. In contrast, if we set our current projections against Scotiabank Economics' global forecasts issued on March 6 and March 25 (charts 4–6), one sees the same big markdowns highlighted in our global tables and by the IMF.

Growth prospects have been slashed across the Latam-6. In Argentina, a much deeper third year of recession will complicate negotiations on its sovereign debt restructuring, and in Mexico, a generalized slowdown in activity last year has been transformed into a deep rout in 2020. Brazil, Chile, and Peru are expected to contract more moderately this year, but Peru has seen the second largest swing in its growth outlook (5.3 ppts compared with Mexico's 8.4 ppts), from an expansion of 3.0% to a contraction of -2.3%. This explains, in part, the swift and comprehensive response to the pandemic by Peru's authorities. Our team in Bogota still expects Colombia to narrowly eke out an economic expansion in 2020, but risks to this outlook are clearly heavily tipped to the downside.

LEGAL RULES ON USING FISCAL SPACE

In response to our forecasts in our last *Weekly* of widening primary fiscal deficits and debt burdens in 2020 across the Latam-6, several clients inquired about possible policy or legal impediments to further fiscal stimulus in these countries: the short answer is that few meaningful fiscal rules or debt limits will stand in the way of government efforts to sustain these economies through COVID-19 lockdowns. As table 1 lays out, Peru is the only one of the Latam-6 countries that has a defined debt limit, but it has been suspended for 2020 and 2021. Fiscal rules exist to govern spending in all six countries, but they are unlikely to bind government action. Peru's cabinet, which is acting in a legislative capacity delegated to it by Congress to avoid large

Table 1

Latam-6 fiscal rules and debt limits

	Fiscal rules	Debt limits
Argentina	2000 financial responsibility legislation has been suspended in *de facto* terms since 2009.	No debt limit.
Brazil	2016 constitutional amendment established a 20-year spending rule. From the 2016 base, primary spending could increase by 7.2% in 2017 and thereafter by the rate of the preceding year's June IPCA inflation.	2000-era financial responsibility legislation established debt ceilings for state and municipal governments, subject to Senate approval. Excesses have to be eliminated within one year. No debt limit for the central government was ever established, despite provisions for one in the legislation.
Chile	2001 balanced-budget rule governs growth in the structural balance based on an estimate for potential growth and copper prices. Escape clause for downturns and the use of counter-cyclical measures was invoked in 2009 following the GFC.	No debt limit
Colombia	2012 fiscal rule defines permitted central government deficit based on (1) structural deficit; (2) output gap; and (3) deviation of Brent from its equilibrium.	No debt limit
Mexico	2006 balanced-budget rule covers the federal public sector (i.e., central gov't, social security, Pemex, CFE), but Pemex investment was carved out in 2009. Escape clause allows deficits in the event of oil-price downturns and other exceptional circumstances. The clause was used in 2020, 2011, and 2012.	No debt limit
Peru	Fiscal responsibility and transparency law implies deficit limits of -2.0% GDP in 2020; -1.8% GDP in 2021; -1.6% GDP in 2022; -1.3% GDP in 2023; and -1.0% GDP in 2024; suspended by government for 2020 and 2021.	Fiscal responsibility and transparency law sets debt limit at 30% GDP; suspended by government for 2020 and 2021.

Sources: Scotiabank Economics, IMF, National country authorities.

gatherings, has already suspended its fiscal rule; Colombia's government is also in the process of seeking an exemption from its fiscal responsibility committee. Escape clauses in Chile and Mexico are easily invoked for the exceptional circumstances of low commodity prices and the globally-synchronized drop in economic activity. Brazil's rule does not cover social-security spending, which consumes upward of 40% of the budget. Finally, Argentina's government has simply ignored its fiscal responsibility law since 2009.

MONETARY POLICY RATES CAN GO LOWER

A rapid-fire set of efforts to ease monetary policy across the Latam-6 has taken policy rates down deeply and quickly—but we believe some of the Latam-6 still have further to go. Peru's and Chile's real policy rates are already quite deeply into negative territory for two open-economy emerging markets, and neither is likely to cut rates again (chart 7). But we anticipate further cuts by Colombia's BanRep and Mexico's Banxico at their next meetings (Central Banks table, p. 4). Both central banks may feel some caution owing to recent ratings actions, but like all EM monetary authorities, their DM peers have given them a great deal of space to go further now that real policy rates are strongly negative across the G10 complex (chart 8). With muted inflation and only moderate fiscal action so far by the government in Brasilia, we also expect Brazil's BCB to lower the Selic again and take its real policy rate to zero.

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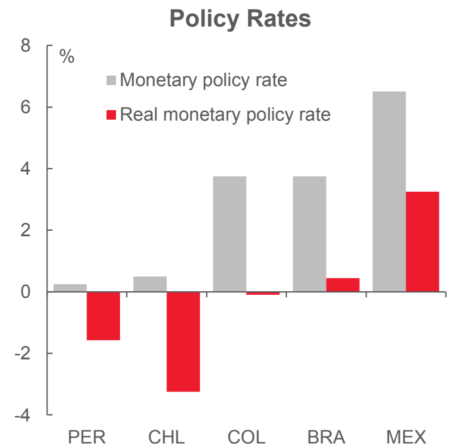
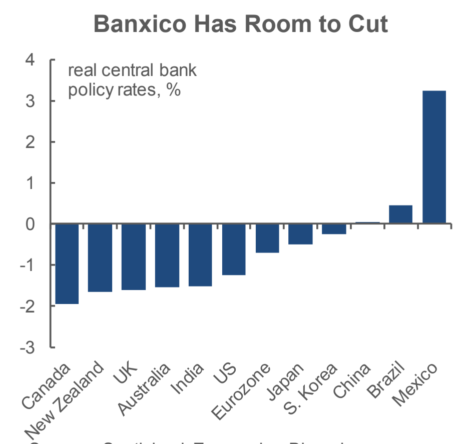
Chart 7



Argentina: MPR = 38.0%; Real MPR = -10.4%.
Sources: Scotiabank Economics, Haver Analytics.

Chart 8



Sources: Scotiabank Economics, Bloomberg.

Markets Report: Commodity FX Provides Shock Absorbers

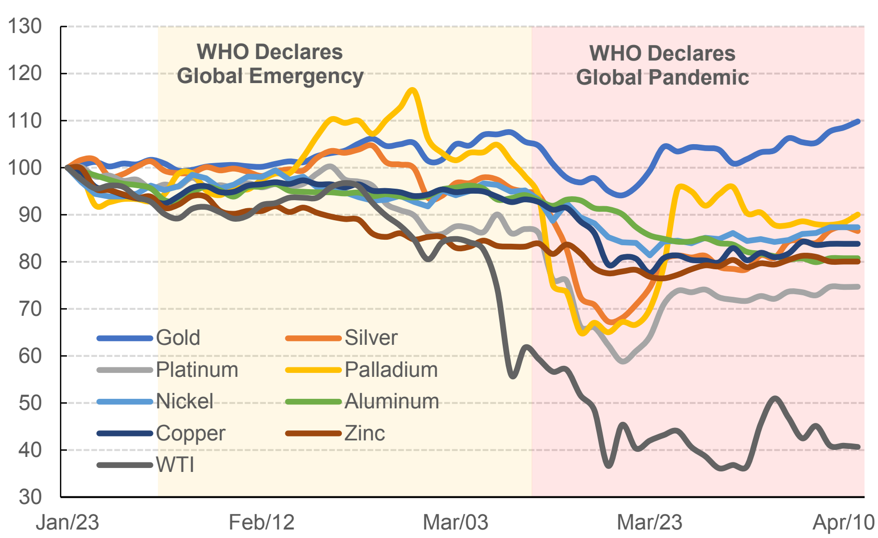
- **Latam's commodity currencies have been on the front line of the COVID-19-induced volatility in EM FX, with differentiated impacts depending on their dominant commodity exports, openness, and their main trading partners.**
- **If oil prices stabilize, we anticipate some appreciation potential for MXN and COP, while relative macro strength in Chile and Peru is mainly already priced into CLP and PEN.**

REGIONAL ONE-TWO PUNCH

Many emerging markets (EMs), including those in Latin America, are being hit by both a sudden stop in domestic activity owing to COVID-19-related lockdowns and a drop in prices for their major commodity exports as global growth slumps (chart 1). EM currencies are absorbing much of the big moves in international commodities prices (table 1) as EM governments and central banks have gotten over—or, at least, have hit pause on—their past "fears of floating" their exchange rates. In the past, Calvo and Reinhart (2000, 2016) showed that many countries have tended to try to manage the value of their currencies even when they have been viewed as overseeing freely floating exchange-rate regimes. This time may be different.

In the face of the COVID-19 crisis, EM countries seem to be more fully embracing floating exchange rates as external shock absorbers for their domestic economies. It's clear that it would be futile to lean against the swiftest and largest capital outflows that EMs have experienced at any point in the last 20 years (chart 2). Moreover, with the entire world in a synchronized downturn, interest-rate cuts by developed-market (DM) central banks have given EM authorities some space to prioritize efforts to sustain domestic economic activity by easing monetary and fiscal policies.

Chart 1



Scotiabank Commodity (Metals) Strategy, Bloomberg and WHO.

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Table 1
Latam FX Performance: April 17, 2020

	Year-to-date	1-month	1-week
ARS	-9.1%	-2.2%	-1.1%
BRL	-23.1%	-0.6%	-2.4%
CLP	-11.8%	0.0%	-1.8%
COP	-16.6%	3.2%	-2.6%
MXN	-20.1%	-0.1%	-1.6%
PEN	-2.8%	0.7%	-1.1%

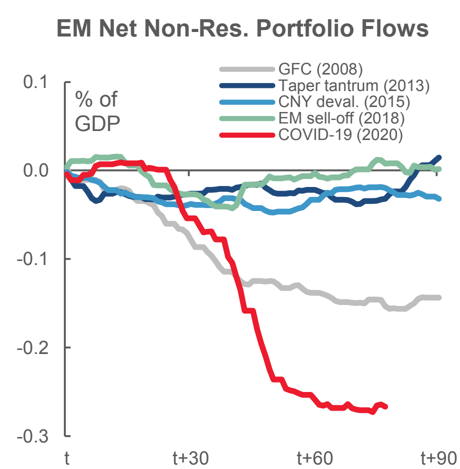
Sources: Scotiabank Economics, Bloomberg.

Table 2
Latam Equity Market Performance (local currency): April 17, 2020

	Year-to-date	1-month	1-week
Argentina	-28.3%	22.6%	6.7%
Brazil	-31.7%	8.2%	1.7%
Chile	-18.2%	9.5%	-0.1%
Colombia	-28.3%	6.1%	0.4%
Mexico	-20.2%	0.5%	0.5%
Peru	-29.4%	0.2%	4.2%

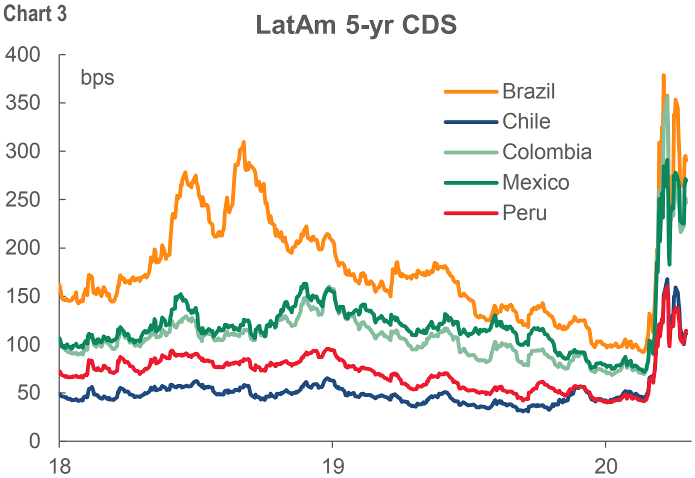
Sources: Scotiabank Economics, Bloomberg.

Chart 2



Sources: Scotiabank Economics, IIF, IMF.

Chart 3



Sources: Scotiabank Economics., Bloomberg

Table 3

Openness: goods & services trade, % of GDP

	Exports	Imports	Total Trade
USA	11.7	14.5	26.2
China	18.4	17.3	35.7
Latam-6 average	23.2	23.0	46.2
Argentina	17.6	14.7	32.2
Brazil	14.1	13.8	27.9
Chile	28.1	28.4	56.4
Colombia	16.2	19.9	36.1
Mexico	39.1	39.1	78.2
Peru	24.0	22.5	46.5

Sources: Scotiabank Economics, Haver Analytics.

Latam's commodity currencies have been on the front line of the COVID-19-induced volatility in EM FX. In part, this reflects the fact that the MXN is amongst the most heavily traded and liquid of EM currencies. Mexico and Brazil also have some of the deepest equity and credit markets in the EM space, and both have seen substantial drawdowns (table 2 and chart 3).

THE BLOW FROM THE OIL-PRICE WAR

The moves in the MXN also reflect the relatively high degree to which Mexico's economy is integrated with the rest of the world. On the traditional measure of openness—total imports and exports of goods and services as a share of GDP—Mexico is by far the most outward oriented of the Latam-6: in relative terms, trade is much more important to Mexico's economy than the Latam-6 average. Mexico is also far more open on this metric than the US or China (table 3). Looking at goods exports alone, Mexico's goods exports also account for the highest share of national GDP in the region, about half again as large as the share of goods exports in the GDP of Peru and Chile, the next in line (table 4).

Oil exports, however, have progressively lost significance in Mexico's external commerce as Pemex, the state oil company, has faltered. As recently as 2011 oil exports accounted for 4.8% of GDP and 16.2% of total goods exports, but by 2019 these shares had fallen to 2.1% and 5.6%, respectively.

Colombia provides an important comparison to Mexico as the other major oil exporter amongst the Latam-6. In contrast with Mexico, Colombia is a relatively closed economy (table 3, again), but oil dominates its goods exports, at about 40% of total merchandise sales abroad. Oil exports account for about 5% of total GDP in Colombia, more than twice oil's contribution to Mexico's GDP (table 4, again). Altogether, in terms of the COP's performance, Colombia's relatively lower degree of openness appears to offset its greater dependence on oil exports compared with Mexico.

DOCTOR COPPER'S OUTLOOK A BIT MORE SANGUINE

Goods exports account for just shy of a quarter of GDP in Chile and Peru and copper dominates goods exports from both countries (table 4, again). Global copper prices are down "only" about 15% YTD, much less than the 70% decline in oil prices.

Table 4

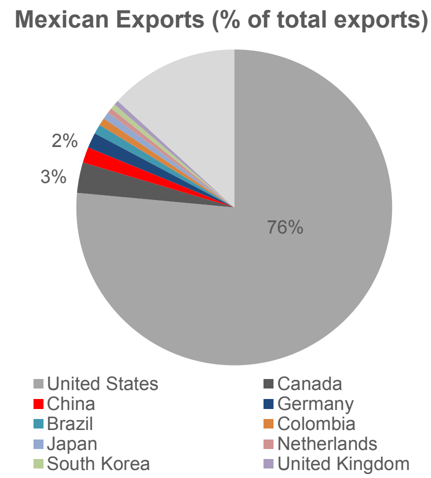
Latam-6: commodities in exports & fiscal revenue

	2019
Argentina	
Total goods exports, % of GDP	14.5
Oil exports, % of GDP	0.3
Oil exports, % of total goods exports	2.2
Brazil	
Total goods exports, % of GDP	12.0
Oil exports, % of GDP	1.3
Oil exports, % of total goods exports	10.7
Chile	
Total goods exports, % of GDP	23.7
Copper exports, % of GDP	11.4
Copper exports, % of total goods exports	48.0
Copper gov't revenues, % of total revenues	6.2
Colombia	
Total goods exports, % of GDP	12.2
Oil exports, % of GDP	4.9
Oil exports, % of total goods exports	40.4
Oil gov't revenues, % of total revenues	9.3
Mexico	
Total goods exports, % of GDP	36.9
Oil exports, % of GDP	2.1
Oil exports, % of total goods exports	5.6
Oil gov't revenues, % of total revenues	17.7
Peru	
Total goods exports, % of GDP	23.9
Copper exports, % of GDP	6.0
Copper exports, % of total goods exports	29.1
Copper gov't revenues, % of total revenues	8.1

Sources: Scotiabank Economics, Haver Analytics.

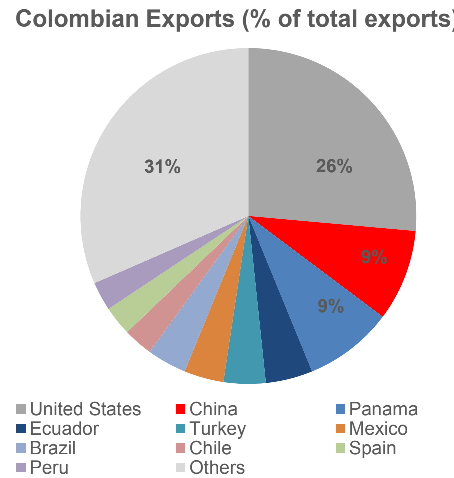
Dominant commodity exports partially determine the extent to which the Latam-6 economies are relatively more exposed to the US versus China (charts 4 through 7). Copper demand binds the Chilean and Peruvian economies relatively more closely to Chinese growth than is the case for Mexico and Colombia, though all four Pacific Alliance countries have free-trade agreements with the US. China's lead experience with COVID-19 and relatively early moves to reactivate its shuttered economy may be giving the CLP and PEN some breathing space relative to their Latam-6 peers, though this effect is not sufficient to provide a shield to the BRL despite Brazil sending 28% of its exports to China.

Chart 4



Sources: Scotiabank Economics, World's Top Exports.

Chart 5



Sources: Scotiabank Economics, World's Top Exports.

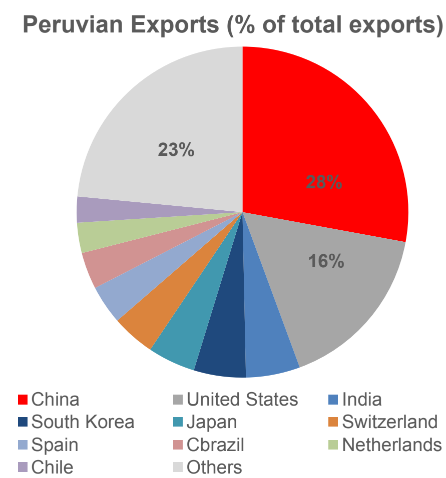
MORE PAIN NOW AND AHEAD

The ties of the Mexican and Colombian external and fiscal sectors to oil have led to a cascade of downgrades, especially for Mexico, which is also burdened with a battered state oil company. In the last three weeks, S&P has joined Fitch in placing Colombia at the lowest investment-grade rating; all major agencies have downgraded Mexico's sovereign rating with Fitch placing it on the brink of speculative grade and Moody's finally delivering the feared downgrade of Pemex to junk on Friday, April 17.

Chart 6

Sources: Scotiabank Economics, World's Top Exports.

Chart 7



Sources: Scotiabank Economics, World's Top Exports.

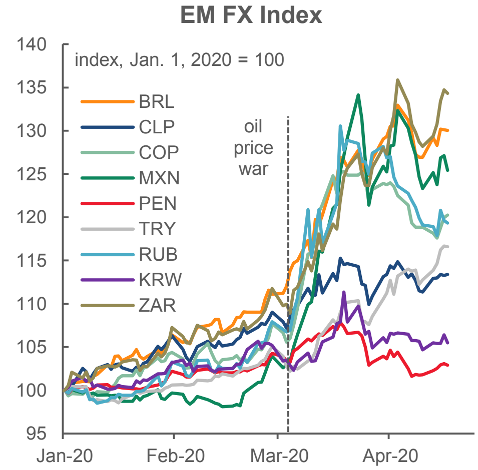
Pemex will remain a relatively heavy ongoing burden weighing on Mexico's credit risk. Even at last year's oil prices, the company was too capital constrained to invest in renewal. With this year's price war, its challenges are even greater. This dynamic might explain why MXN has behaved like currencies in countries with a much more delicate fiscal situation such as Brazil and South Africa.

At this point, both the MXN and COP have already incorporated an awful lot of bad news (chart 8) and our trading desks report that positioning in both is already fairly short. The COP has reversed some of its YTD losses, aided by the BanRep and Ministry of Finance that have been engaged at the margins in the NDF and spot markets, respectively. This mirrors some of the recent experience of other petro-currencies, such as the RUB, that have seen similar support from their authorities—which may be a sign that the "fear of floating" has, indeed, simply been on pause. The MXN, however, continues to lag, despite oil's relatively smaller role in Mexican total economic activity and fiscal revenues than in Colombia and Russia. Hence, MXN likely has relatively more space to appreciate if oil supply and prices stabilize, though this appears unlikely before late-2020.

Our commodity analysts are expecting H1-2020 to be the most difficult period for oil prices and the complicated recovery beyond. Recent agreements on possible supply cuts will go a long way toward re-balancing the market later in the year, but inventories will continue to build before we see some actual reduction in drilling activity and daily production. Dynamics in storage operations point to "dangerously" full levels of inventories at Cushing by mid-May (above 80%), with full storage capacities being hit in 14 to 15 weeks (chart 9), which would push oil prices sharply lower from current levels. In short, the situation for EM petro-currencies may well get worse before it gets better: levels in the low USD 10s for Brent and WTI should not be ruled out. From there, Scotiabank's oil analysts and economics forecasts expect a recovery to USD 29/bbl for WTI by year-end and around USD 40 /bbl in 2021 (chart 10).

For Mexico, however, a very dramatic scenario for oil prices is already at least partially incorporated in expectations. The gap between the Mexican mix and the WTI/Brent references has widened during the COVID-19 turmoil and the Mexican barrel is already close to the USD 10/bbl mark, shrinking the potential for further downside ahead (chart 11). This has led to a somewhat lower correlation of MXN to oil in recent days and a relatively higher correlation with "risk appetite" (chart 12).

Chart 8



Sources: Scotiabank Economics, Bloomberg.

WITH THE WORST PRICED IN, SOME LATAM COMMODITY FX MAY HAVE MACRO VALUE

While the Scotiabank Economics forecast (Forecast Tables, pp. 2–3) anticipates USDMXN remaining around 24 over the projection horizon, Scotiabank's strategy team sees probabilities biased towards lower levels of USDMXN in the coming months, though the magnitude of the rallies will not be extreme. Levels of USDMXN at 21.00 seem possible in a recovery phase towards the end of the year. This would represent a roughly 15% advance from current levels, thereby unwinding about half of the losses we have seen year to date. In a very positive scenario, where global growth proves more resilient than expected and risk appetite recovers quickly, we could see the pair trending to and stabilizing around the USDMXN 20 mark. This would still be well off the pre-crisis highs in the USDMXN 18s range owing to the likely damage in the coming months to the economy and to fiscal balances.

The strategy team's optimistic view for MXN is driven by the expectation that, although the fundamentals of the Mexican economy will be worse off after the crisis, prices are already accounting for an aggressive mix of "worst case scenarios" (i.e., longer epidemic, extremely sharp recession,

Chart 9

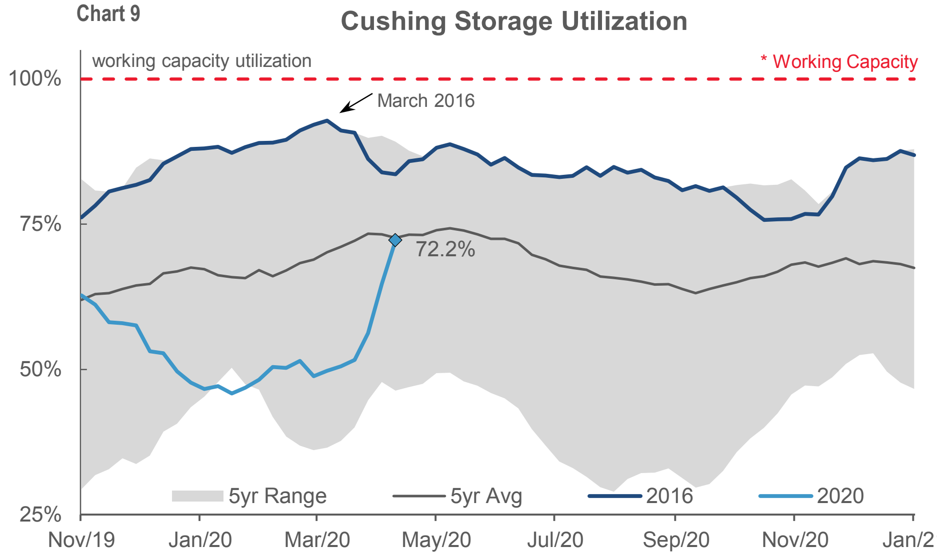
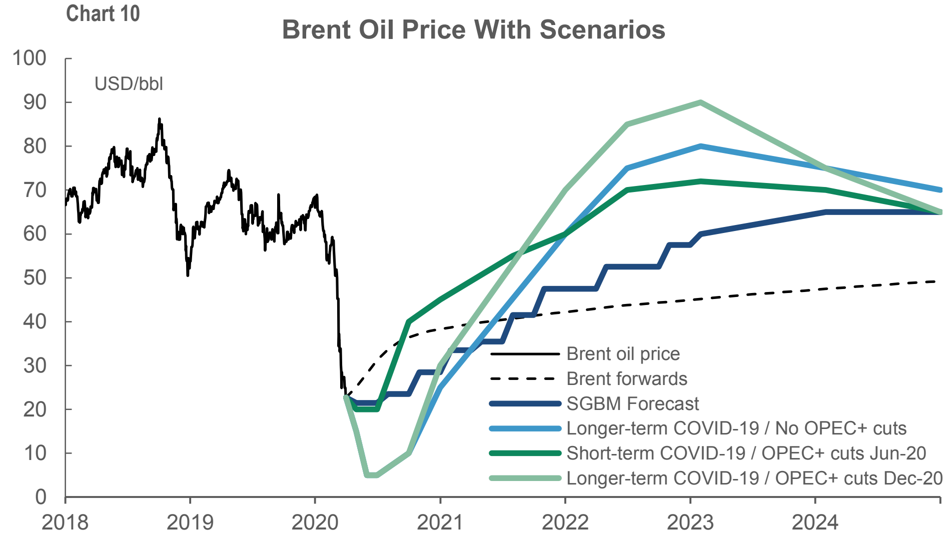


Chart 10



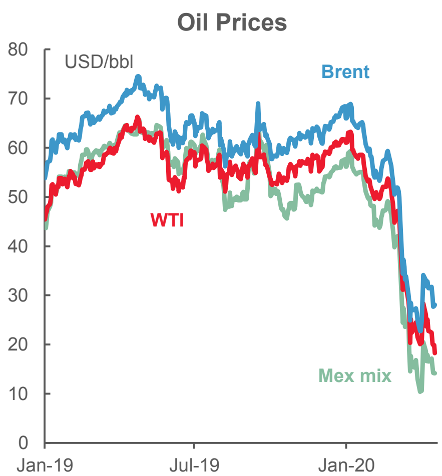
Sources: Scotiabank GBM, Bloomberg.

L-shaped recovery and fast fiscal deterioration). In the aftermath of the crisis, the massive injections of cash that central banks have deployed globally will likely prompt a new hunt for yield; Mexican assets and the MXN are likely to benefit.

For the COP, an eventual recovery of oil prices will release some pressure from the fiscal and current accounts, lower country risk in Colombia and push the currency higher in the medium term (see Forecast Tables, again). The persistence of an ample current account deficit and the negative consequences of the pandemic, however, will likely put a lid on any major COP rally for the foreseeable future. Valuation models point to USDCOP levels of 3,800–3,600 if oil consolidates above 30 USD/bbl. In a better scenario for global growth and risk appetite, COP could rise to a 3,600–3,400 range, still weaker than pre-crisis levels.

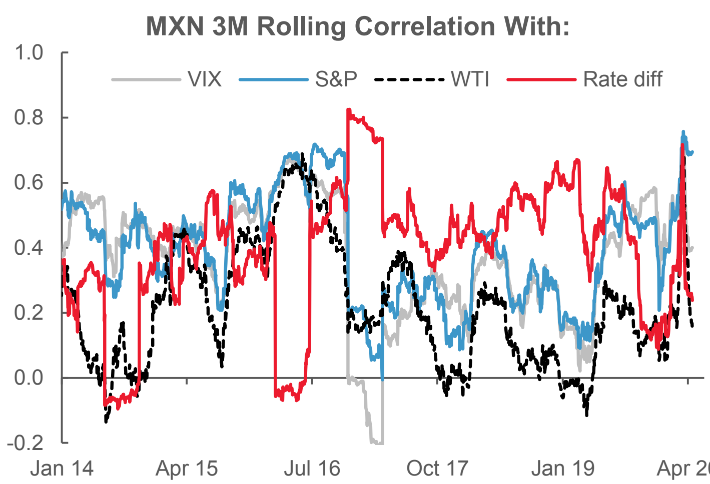
CLP and PEN have been more stable than their Latam-6 peers throughout the crisis (Chart 13), and Scotiabank Economics' forecasts point to some mild appreciation ahead. Markets have already priced in Chile and Peru's relatively strong macro fundamentals and the shallower sell-off in copper versus oil. There are some upside risks that will come from the liquidation of USD savings that fiscal authorities will use to finance additional spending, but some of this is also already reflected in positioning, in our view. Looking further forward, upside in CLP and PEN is further capped by the impact of aggressive central bank policy-rate cuts that may limit future carry strategies and push the carry trade to other currencies that have seen less aggressive monetary easing (chart 14).

Chart 11



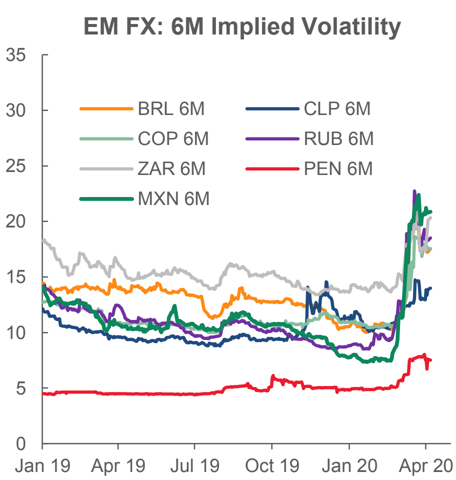
Sources: Scotiabank Economics, Bloomberg.

Chart 12



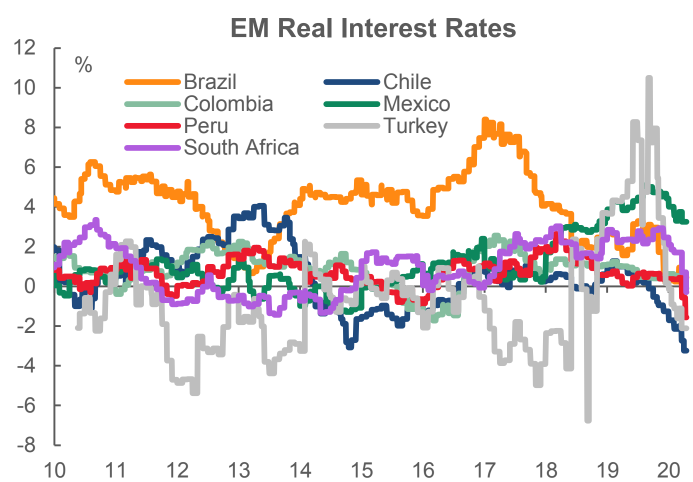
Sources: Scotiabank Economics, Bloomberg.

Chart 13



Sources: Scotiabank Economics, Bloomberg.

Chart 14



Sources: Scotiabank Economics, Haver Analytics.

Country Updates

Argentina—Memories of the Early-2000s

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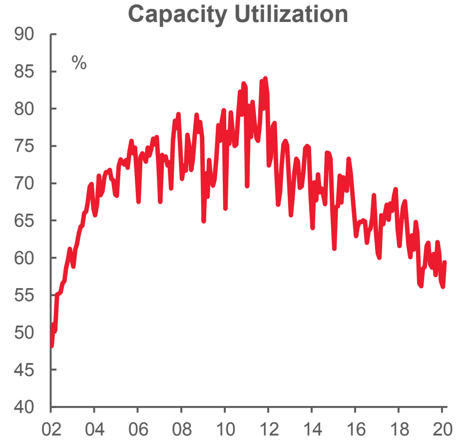
March inflation provided the only major new macro data this week, with a 3.3% m/m increase, faster than the 2.5% m/m we anticipated and up from February's 2.00%. Seasonal increases in food prices and educational fees drove much of the pick-up. Level effects brought the y/y rate down from 50.30% in February to 48.4% in March. These effects will continue to bring down the pace of y/y inflation to around 47% by end-2020 even if a combination of rapidly expanding base money and ARS depreciation ensure m/m price inflation averages 3.5% over the remainder of 2020.

Argentina: Industrial Capacity Utilization



Sources: Scotiabank Economics, INDEC.

Argentina's INDEC released industrial capacity utilization data for February that showed an increase from 56.1% in January to 59.4% (chart). These data are typically seasonal, with February exhibiting a regular rise from the holidays in January. Still, this was indeed a slight improvement over February 2019's 58.5%, but was right on the 59.4% average for all of 2019. Petroleum refining saw the highest utilization rates at an average of 80.1%, while Argentina's industrial decline remained most pronounced in the auto industry (37.5%) and metal manufacturing (39.8%). The capacity utilization rate hasn't been in this range since 2003, a remarkable summing up of the last three years of recession—and far off the high of 84.1% hit in November 2011.

Early in the week, the Argentine government renewed its tease that a restructuring offer to bondholders would be forthcoming imminently. President Fernandez promised that the government would avoid restructuring ARS-denominated debt as a hat-tip to investors who had stuck with the Argentine currency. But, he cautioned that the COVID-19 pandemic and its macroeconomic impact would affect the terms the government would be prepared to offer. As we outlined in our April 11 *Latam Weekly*, Argentina's government is already on track to see a primary fiscal deficit of at least -2.8% GDP in 2020, well beyond the -1.1 to -1.5% GDP range anticipated in the Ministry of Economy's *Guidelines for Debt Sustainability* and the -1.6% GDP expected in the "feasible macroeconomic scenario" outlined in the IMF's *March 2020 debt-sustainability analysis*. Pres. Fernandez emphasized that sustaining domestic economic activity would take precedence over containing deficits and adjusting for debt sustainability.

Thursday evening, April 16, the Fernandez Government finally presented its debt restructuring proposal for about USD 70 bn of foreign debt. The offer's key features include: a three-year grace period, a 62% cut in interest payments, and a 5% haircut on principal, all of which implies a 30% recovery value, similar to the pain inflicted on bondholders following the 2001 default. All told, the offer would reduce future interest payments by USD 37.9 bn and cut principal by USD 3.6 bn. Further details are due to be delivered by Minister of Economy Guzman; investors will then have 20 days to respond to the offer. The next major milestone in Argentina's debt-service calendar arrives on April 22, when about USD 500 mn of interest falls due on foreign-law bonds covered by the proposal. All in, principal and interest due on external debt over the remainder of the year totals USD 3.5 bn.

Next week sees a few macroeconomic data prints that, while normally of secondary importance, will be amongst our first concrete signs of the impact of the quarantine. On Wednesday, March trade data will likely show declines in both imports and exports, with mixed prospects for the trade balance, while the March UTDT leading indicator, also released on Wednesday, and April's consumer confidence numbers that follow on Thursday, will add additional colour on the bleeding edge of the COVID-19 downturn.

Brazil—Forecasts on Growth Sour

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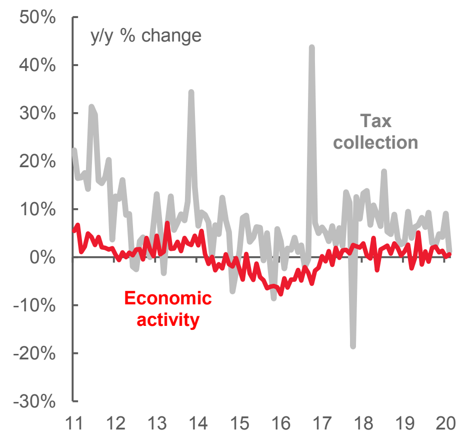
While the Bloomberg consensus has Brazil contracting only -1.5% y/y in 2020, we look for -3.3% y/y. Our more-bearish-than-consensus forecast now looks a bit optimistic compared to the new forecasts from the IMF's WEO, where they look for -5.3% y/y in 2020. To a large degree, whether the risks to our forecast are tilted to the downside will depend on the strength of the post-crisis bounce, which will be partly determined by business confidence—one data point to gauge these risks will be next week's print of CNI Industrial Confidence for April (April 23rd).

Economic Activity & Tax Collection



Sources: Scotiabank Economics, Bloomberg.

Tuesday, we got economic activity data for February. The data at first glance seemed relatively strong, printing +0.35% m/m versus consensus +0.20% m/m, but after revisions it showed a weaker-than-previously-expected first two months of 2020. January's data were revised down from +0.24% m/m to -0.01% m/m, meaning a softer base for sequential calculations. On an annual basis, February economic activity came in at +0.60% y/y versus consensus +0.70% y/y. The weakness in January–February was likely, at least to a degree, an imported shock. China was the first economy to be hit hard by COVID-19, and although it receives only 2.5% of Brazil's merchandise exports, it is a major driver for commodity prices, which represent 45% of Brazilian merchandise exports. The weakness in commodity prices intensified in March, but was already present in January–February.

This coming week we should get tax collection data for March (April 20–27). We expect a sharp drop (somewhere around -5% y/y), but not yet a terrible one. The hit to tax collection should worsen as we go deeper into Q2, and both employment and activity decline. Before the coronavirus shock, Brazil was already expected to post a broad fiscal deficit of nearly 7% of GDP. Gross public debt was expected to climb from 92% of GDP to 94% (IMF pre-crisis estimates). However, with our weaker-than-consensus growth target, we think gross public debt will likely close 2020 closer to 98% of GDP.

Outside of fiscal data, we would argue the most important indicator of the week ahead will be February formal job creation (for release April 16–25). We normally see employment data as somewhat of a lagged indicator, but in this case, it will show us how solid the job market was pre-COVID-19. This is important as it will give us another indication of business confidence—as well as household incomes—and with it how rapid a rebound we could expect post-crisis (with downside risks as firms' resilience will be tested by the size of the COVID-19 shock, so even strong confidence may not be enough).

Chile—Fiscal and Monetary Measures Reflect a Worsening Economic Climate

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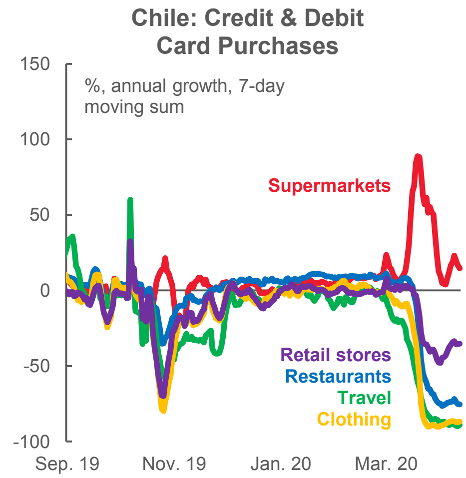
Monetary. On April 8, the Chilean Central Bank announced new measures: the extension of its liquidity line for banks; the expansion of collateral (including corporate bonds as eligible collateral for all liquidity operations offered by the CB); the extension of the FX sales program until Jan 9, 2021; the transitory modification of the monetary reserve rules, expanding the reserve requirement for commercial banks; and finally, the temporary adjustment of liquidity requirements for banks, suspending compliance with the requirements for mismatches of terms (30 and 90 days) and making it easier to regulate and comply with the short-term liquidity limit. On April 15, the Central Bank announced it will increase the limits for Pension Fund Administrators to invest in alternative assets.

Fiscal & Regulatory. On April 8, the Government announced a new USD 2 bn fund to support informal and independent workers, and a plan for up to USD 3 bn to increase the state guarantee used in loans for SMEs (*Fogape*). All in all, the total fiscal package now accounts for 6.7% of GDP.

Health. Health Ministry lifts quarantine in five municipalities, including the financial district, but adds three more. Santiago downtown remains in lockdown. New COVID-19 cases decline in the Metropolitan Region.



Source: Scotiabank Economics.

This past week, authorities have continued announcing new measures to contain the backlash caused by COVID-19. On Sunday, April 12, President Pinera provided details about the loans for SMEs with state guarantee. Among the highlights, he noted that the credits will be for 3 months of sales under normal conditions, with a rate of the current monetary policy rate + 3% and a 6-month grace period. The bill to capitalize *Fogape* (SMEs guarantee fund) is currently under discussion in Congress. On Tuesday, April 14, the IMF released its WEO report, in which they predict the Chilean economy will contract 4.5% this year, more than the 1.5%–2.5% contraction range expected by the central bank and Scotiabank's projection of -2.1%. After the release of the CPI on April 8, forwards have moved downward for year-end inflation, and expect low prints for the coming months, a view to which we subscribe. High-frequency data for April show a certain stabilization in supermarket sales, while retail, restaurants, travel and clothing have stopped declining. Requests for loans and demand for liquid assets by companies rebounded strongly in early April, due to the greater flow of commercial credit supported by the new monetary and fiscal measures. Indicators of electricity generation, emergency health care, exports, and imports, reveal that April's activity could be even worse than what we have seen in March, reflecting the real magnitude of the shock generated by COVID-19.

The BCCh's *Minutes* from its March 31 monetary policy committee meeting were in line with the meeting's statement and the outlook expressed in the last *Monetary Policy Report.* The *Minutes* confirmed that the unanimous decision to cut the policy rate to its technical minimum was based on an assessment that the economic situation has deteriorated drastically, prompting the need for greater stimulus through lower rates and less conventional measures.

For next week, we are expecting more announcements regarding the quarantine measures imposed in several cities across the country. As some municipalities are seeing an easing in total lockdown, others are gradually experiencing stricter measures. Regarding economic data, we will see if credit and debit card purchases remain stable through the second half of April. We reiterate that monthly GDP for March would contract around or below 4% y/y, while in April activity could fall between 8 and 10% y/y. COVID-19 cases in Chile maintain a high contagion rate compared with other countries, but show a stabilization in the margin. For April CPI, we are expecting 0% m/m, as fuels are decreasing and the NBS is having some difficulties in gathering price data. For year-end we anticipate an annual inflation slightly below 3.0%

Colombia—Gearing up a Larger Fiscal Response to COVID-19

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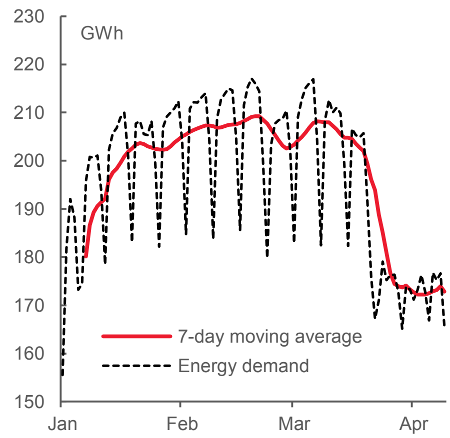
The Colombian government is paving the way to ask for a significant incremental increase of public debt to fight COVID-19 and the oil-price shock. This week, Minister Carrasquilla has been very vocal on the need to increase fiscal expenditure and loan guarantees for the lower-income population and for SMEs, and also stated that 2020 tax collection will be much lower (by around 1% of GDP initially) on the back of the slump in oil prices and much weaker economic activity, since Carrasquilla expects a contraction of no less than -1.5% in 2020. Fiscal rule Committee met on Thursday April 16, and although we do not yet know the final conclusions, we anticipate that—due to a widening negative output gap (of at least 1 ppt of GDP more) and lower-than-expected oil prices—the Committee will allow the fiscal deficit to be increased to at least 4.9% of GDP, as requested by the Finance Minister, from the previous target of 2.2% of GDP.

In the meantime, the recent new measures from the government (still to be formally enacted) can be summarized as follows:

- The government will finance three months of SME payrolls, for employees with salaries up to 5 times the minimum wage. Unofficial calculations say that these payrolls can be as much as COP 8 bn (~0.8ppt of GDP) for the three months.
- Employees and employers (in the SMEs) have the option to suspend monthly pension contributions for two months to both public and the private pension system. Although this measure is good for the real sector, pension funds are the main TES holder and the missing income from contributions for three months can hurt the yield curve in Colombia.

Colombia: Daily Energy Demand



Sources: Scotiabank Economics, XM.

- The Government will increase loan guarantee from FNG (Fondo Nacional de Garantías) to 80%–90% of loans from 50%.
- Higher Finagro (like BDC in Canada) credit lines for COP 1.2 tn (USD 300 mn) for SMEs and big companies.
- BanRep cut the reserve requirement from 11% to 8% over deposits in saving accounts, current accounts, and to 3.5% from 4.5% for the term deposits. Additionally, BanRep will resume permanent TES purchases by COP 2 tn; the purchases will be made during April.
- Government will compel banks to invest around COP 9 tn in public debt with one year maturity. The amount is equivalent to the increase in liquidity achieved by reducing the reserve requirements.
- Additionally, the private pension funds will transfer approximately COP 5 tn to the Colpensiones (state-owned pension fund). It will be through the transfer of savings of pensioners whose pension payments are equivalent to one minimum wage salary.

On the data side, February´s retail sales and manufacturing came in very strong, in line with an expectation of strong Q1-2020 domestic demand growth (above 3.2% y/y). In fact, retail sales grew 13.2% y/y, and manufacturing 4.6% y/y. Having said that, this positive behavior will only help the average 2020 GDP growth a bit since the Q2-2020economic activity will fall at least 3% y/y, and new soft data is pointing to even lower economic activity in April. Despite strong Q1-2020, we are seeing that our negative growth scenario is getting more likely, which implies a recession of about -1% for 2020, with a recovery of 3.6% in 2021.

Colombia: GDP scenarios, decomposition

	2019	2020 (base case)	2020 (worst case)
GDP	**3.3**	**0.6**	**-1.7**
Domestic Demand	**4.5**	**-0.4**	**-2.3**
Total Consumption	4.6	0.3	-1.7
Private Consumption	4.6	0.0	-2.3
Gov't Consumption	4.2	1.9	1.0
Investment	4.2	-3.2	-4.0
Exports	3.2	-1.0	-2.0
Imports	9.3	-5.0	-4.5

Source: Scotiabank Economics.

Finally, inflation expectations (IE) in April continue to show an anchored IE, which will help BanRep to continue easing the policy rate in April. We expect a 50 bps cut to bring the policy rate to a terminal 3.25%.

Mexico—The IMF Catches Up with A Dark Growth Outlook

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Last week, we revised our forecasts—now starring an -8.4% real GDP contraction in 2020—just three weeks after our previous updates. As we have mentioned in past reports, we live under extremely unusual and quickly changing circumstances that require faster response times from our forecasting work. It is worth noting that other institutions' forecasts have also been adjusting rapidly to the harsh reality produced by COVID-19. Even the IMF delivered a grim outlook for the global economy in its April *World Economic Outlook*, which included a -6.6% GDP contraction for Mexico in 2020.

COVID-19 Impact on 2020 GDP

	Severity				
Days	20%	30%	40%	50%	60%
30	-4.0	-4.9	-5.7	-6.5	-7.3
40	-4.6	-5.7	-6.8	-7.9	-9.0
50	-5.1	-6.5	-7.9	-9.2	-10.6
60	-5.7	-7.3	-9.0	-10.6	-12.3
70	-6.2	-8.2	-10.1	-12.0	-13.9
80	-6.8	-9.0	-11.2	-13.4	-15.6
90	-7.3	-9.8	-12.3	-14.7	-17.2

Source: Scotiabank Economics.

We also commented last week on some of the new information that led us to see the COVID-19-related shock as being considerably stronger than previously thought. These new data points include the most profound drop in domestic auto sales and production since 1995.

In addition to these emerging bits of economic information, our updated forecasts also reflect our efforts to calibrate better our projections of the economic disruption likely to be produced by COVID-19 isolation measures to a range of assumptions about their duration and intensity. We re-estimated GDP growth for the whole of 2020 depending on the number of days during which economic activity is disrupted and the severity of the disruption (i.e., the share of economic activity shut down). In all cases, we assume that by Q4 the economy returns to the pace of growth it showed before the pandemic took hold. The adjacent table shows the forecast results for different combinations of lockdown intensities and durations. For instance, if the disruption brings 50% of economic activity to a halt and this shutdown lasts for 50 days—which is a likely outcome according to current information—then GDP in 2020 would contract by -9.2%.

This week we received more bad news for Mexico from the credit-rating agencies. Fitch cut the sovereign rating from BBB to BBB-, with a 'stable' outlook, and late on Friday, Moody's followed with a well-anticipated decision to downgrade Mexico's long-term foreign-debt rating one notch from A3 to Baa1 with a 'negative' outlook. Moody's also cut Pemex's rating by two notches to Ba2, well into junk territory with a 'negative' outlook, fueling concerns about a potential sell-off in Pemex paper.

For the week ahead, we will have the inflation figures for April's first half, which will be a key variable for Banco de Mexico's next monetary policy decision, scheduled for May 14. There is, however, a good chance that Banco de Mexico will deliver a decision ahead of schedule once again, especially if inflation turns out negative, as it is likely to do under current circumstances. We are still waiting for the long-promised Investment Plan for the Energy Sector, which has been postponed again and again since last year. A stronger public policy response to the COVID-19 pandemic is still needed and awaited by many businesses and households, with the more difficult weeks of the contagion just ahead.

Peru—Peru Adjusts its Fiscal Rules to its New Fiscal Reality

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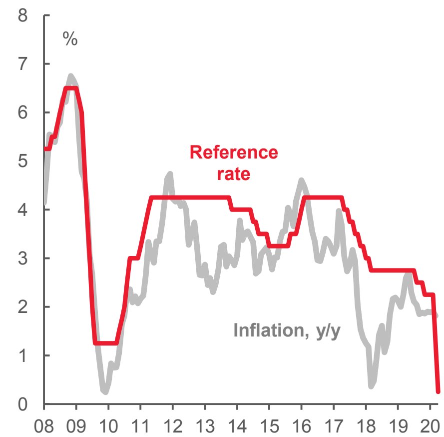
Now that it is clear that there will be a sharp contraction in the Peruvian economy, there is a shift in interest toward 'the morning after'. When will the emergency measures be lifted? What will be the fiscal burden we are left with? How will it be financed? The government has acknowledged that the peak of COVID-19 has not yet been reached, which puts the April 26 end date for the state of emergency into question. The government intention is to allow production to resume on an industry-by-industry basis starting in May, with most industries, but not necessarily all, up and running by June. Mining, agro-exports and construction are prime candidates to resume early.

In terms of fiscal burden, over the weekend the government used the exceptional legislative powers awarded by Congress to override the fiscal rule law—which called for a maximum 2% of GDP deficit in 2020 and 1.8% in 2021, and a 30% of GDP cap on fiscal debt. The new rule is that there is no rule. The limits were all eliminated for 2020–2021. The government is seeking to finance what may amount to an over 7% fiscal deficit in part by filing with the SEC as much as USD 4.7 bn in global bonds issuance with the SEC. This alone, if issued in full, could raise Peru's debt to nearly 30% of GDP. We expect the government to also seek multilateral credit lines, with which debt will certainly exceed the previous 30% ceiling.

The economy was performing nicely before COVID-19. February GDP growth came in at 3.8% y/y. This followed on 3.0% growth in January. Growth was fairly broad-based in February, with fishing up 19% y/y, manufacturing and construction up over 5% each, and mining growing 4.2%.

Peru: Inflation & Reference Rate



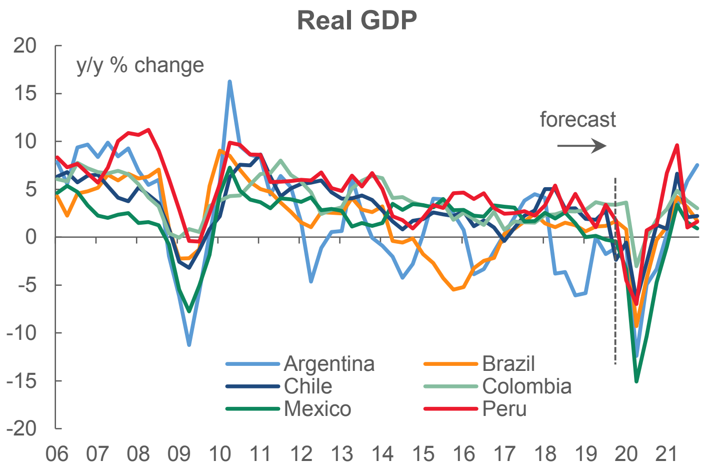
Sources: Scotiabank Economics, BCRP.

Now back to today's reality. In April, Google data show that trips to markets and cafés, etc., fell 90% in Lima in early April. Electricity demand is down nearly 30% in the first half of April. Peru's unemployment rate rose to 7.8% in March, from 7.1%, in February. Note, however, that there is a seasonal component involved, and unemployment was actually lower than March 2019 (8.2%). The more key underemployment rate rose to 36% from 34% the year before. This trend does not yet seem to reflect the emergency measures.

Finally, we are nudging lower our 2020 inflation forecast, from 1.4% to 1.1%, considering lower demand and lower oil prices.

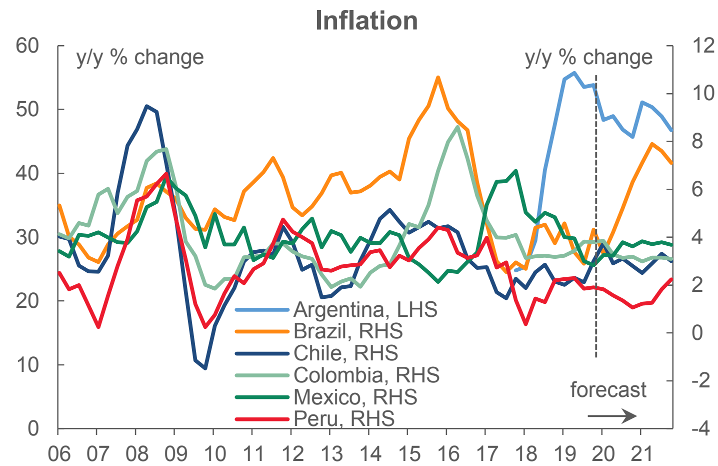
Key Economic Charts

Chart 1



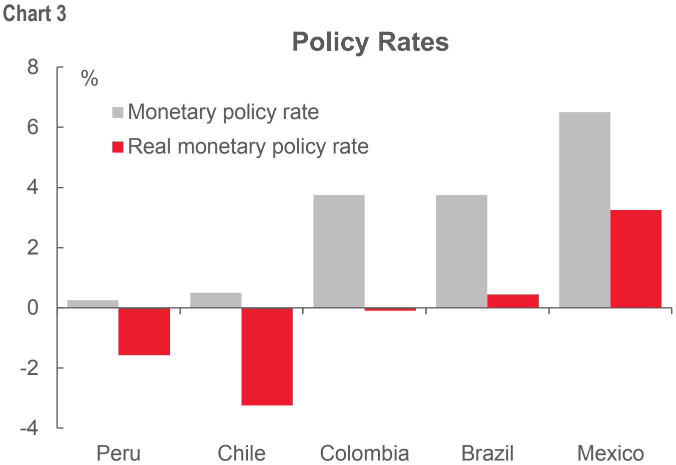
Sources: Scotiabank Economics, Haver Analytics.

Chart 2



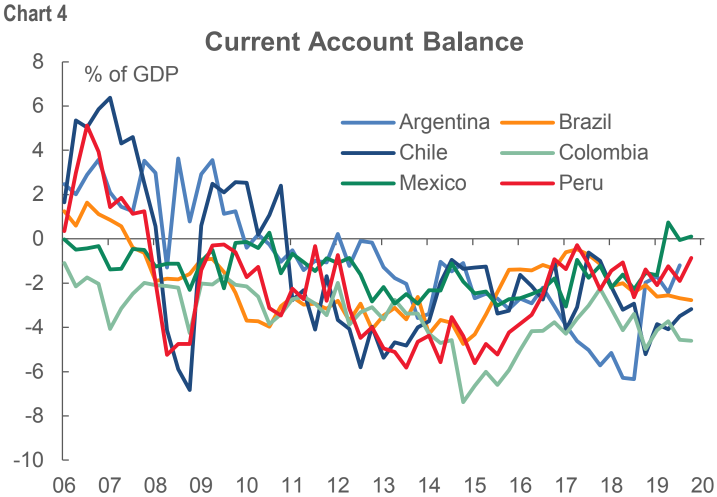
Sources: Scotiabank Economics, Haver Analytics.

Chart 3



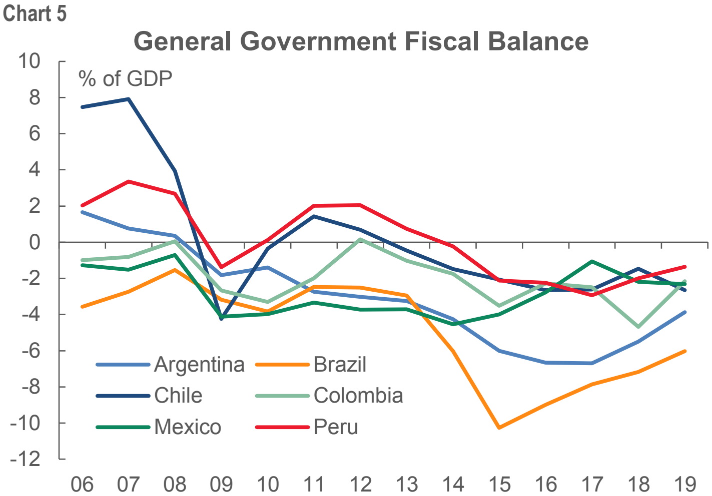
Argentina: MPR = 38.0%; Real MPR = -10.4%.
Sources: Scotiabank Economics, Haver Analytics.

Chart 4



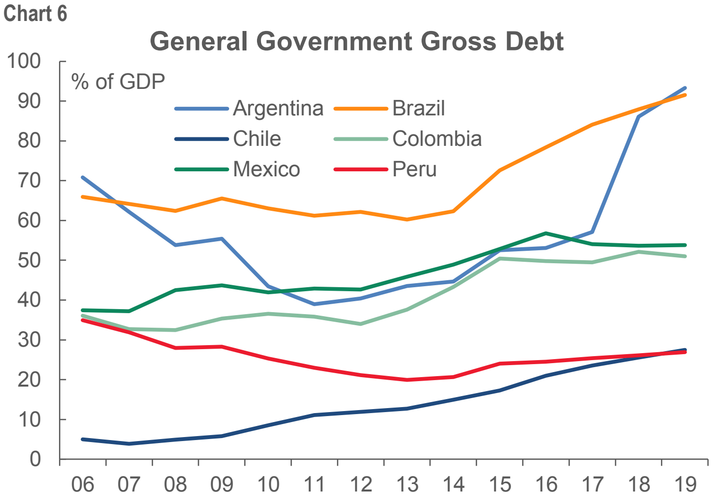
Sources: Scotiabank Economics, Haver Analytics.

Chart 5



Sources: Scotiabank Economics, IMF.

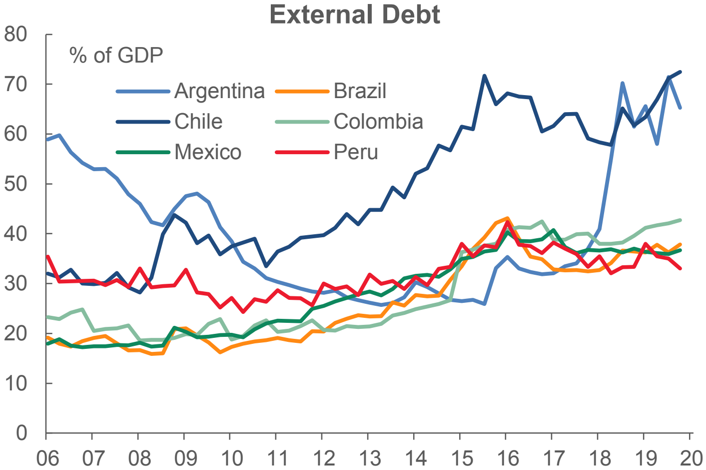
Chart 6



Sources: Scotiabank Economics, IMF.

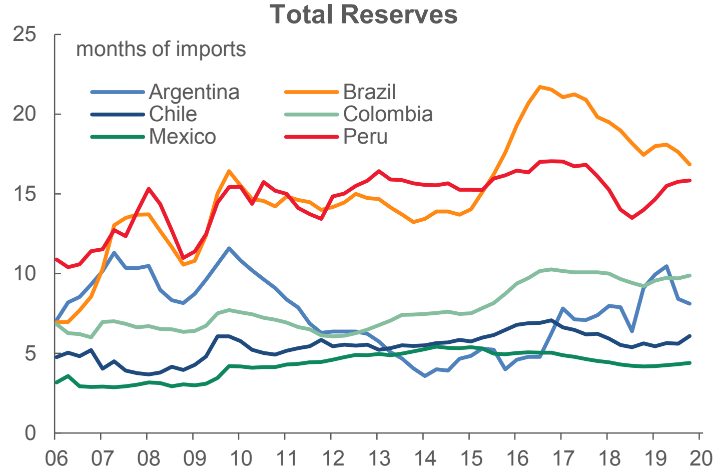
Key Economic Charts

Chart 7



Sources: Scotiabank Economics, Haver Analytics.

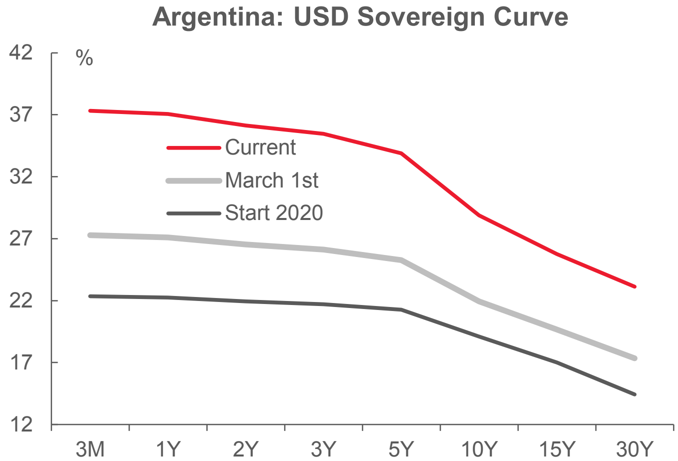
Chart 8



Sources: Scotiabank Economics, Haver Analytics.

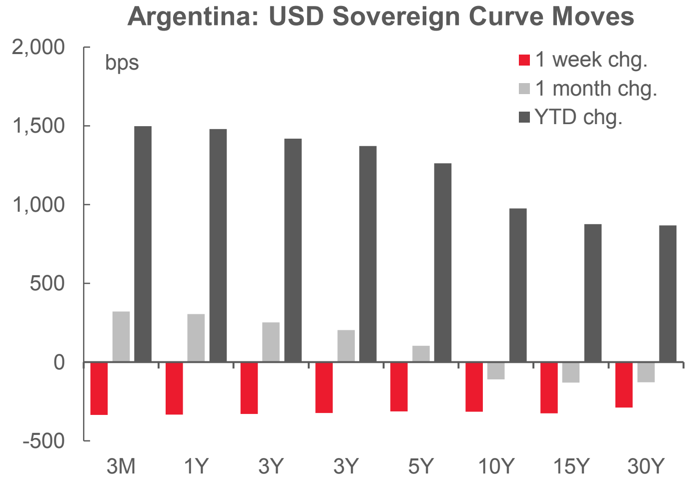
Key Market Charts

Chart 1



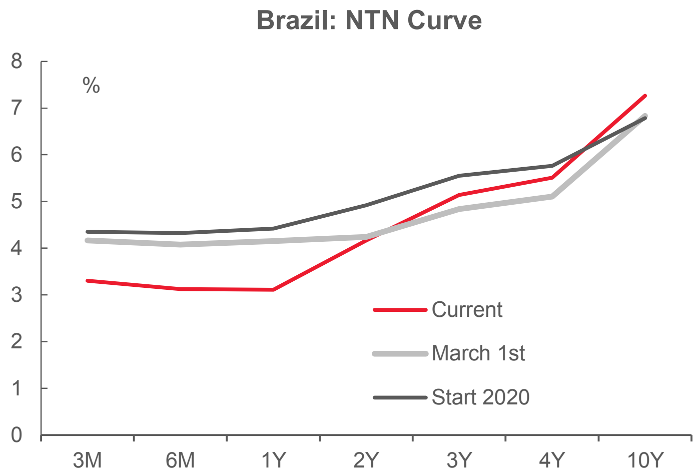
Sources: Scotiabank Economics, Bloomberg.

Chart 2



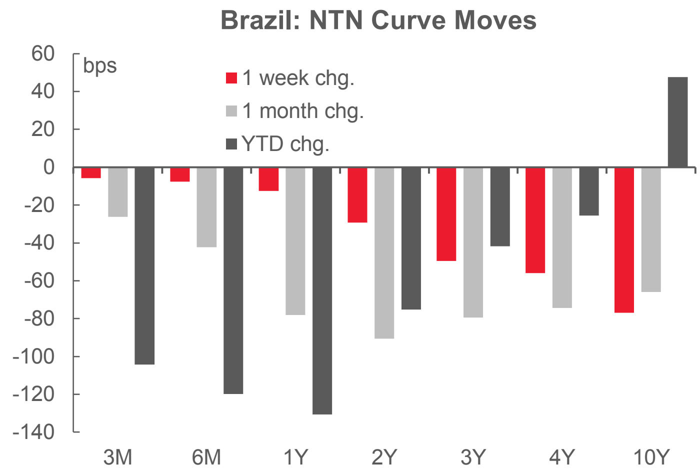
Sources: Scotiabank Economics, Bloomberg.

Chart 3



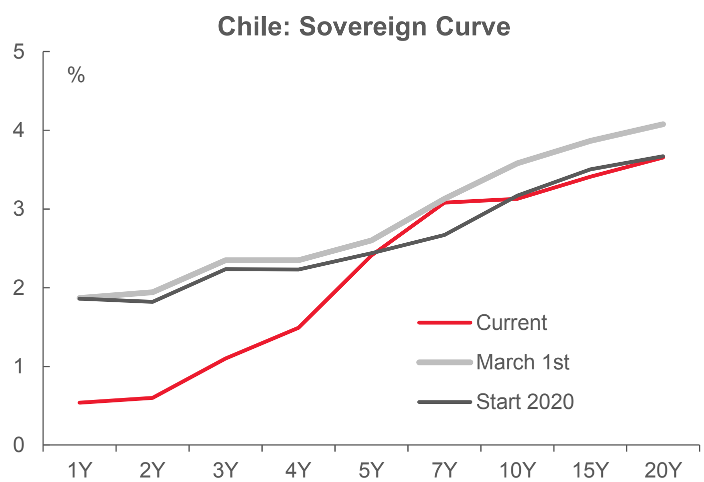
Sources: Scotiabank Economics, Bloomberg.

Chart 4



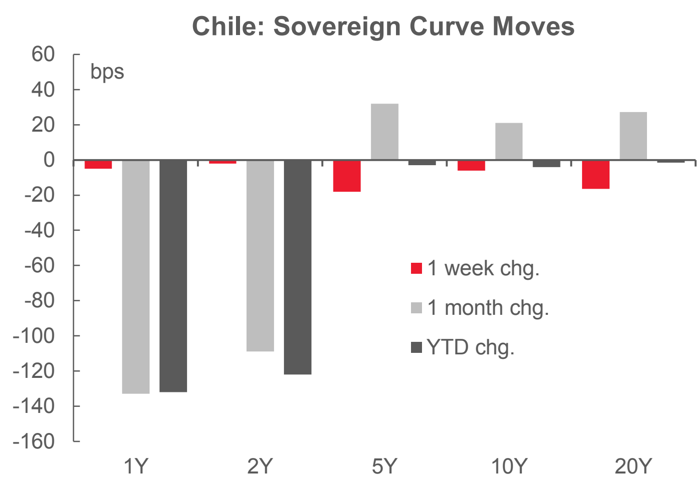
Sources: Scotiabank Economics, Bloomberg.

Chart 5



Sources: Scotiabank Economics, Bloomberg.

Chart 6

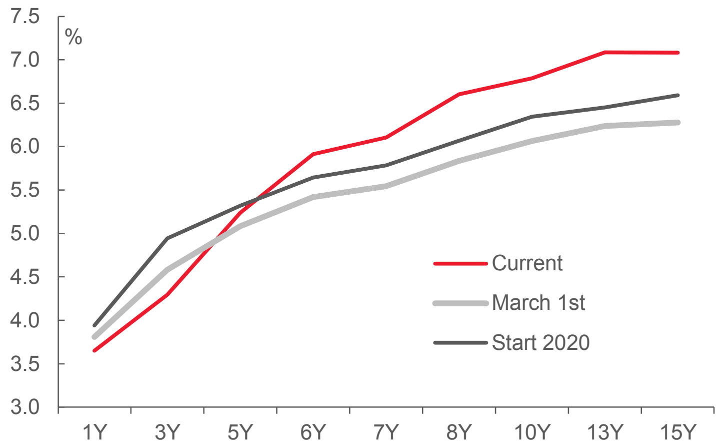


Sources: Scotiabank Economics, Bloomberg.

Key Market Charts

Chart 7

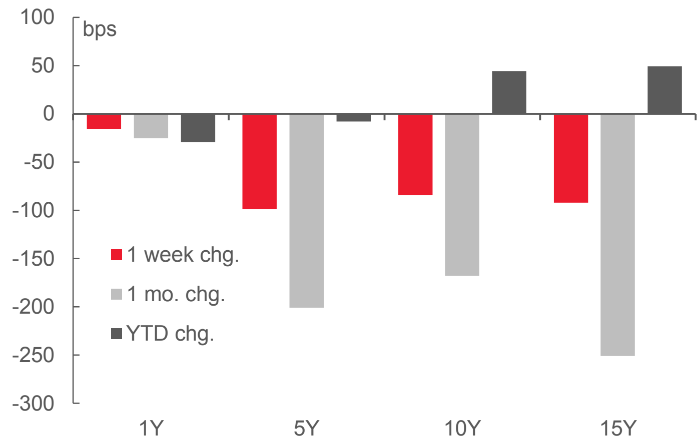
Colombia: Coltes Curve



Sources: Scotiabank Economics, Bloomberg.

Chart 8

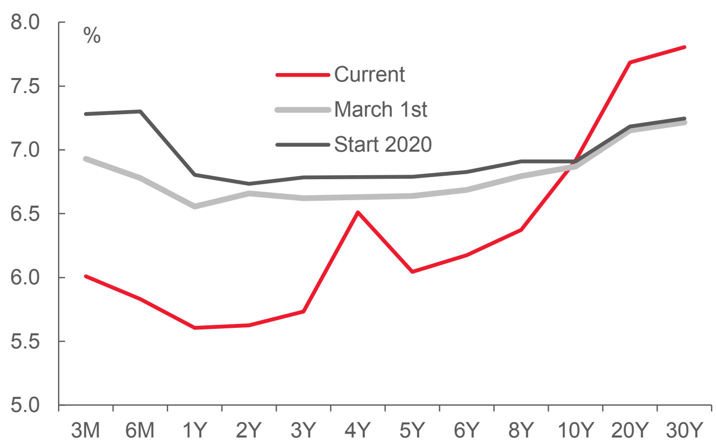
Colombia: Coltes Curve Moves



Sources: Scotiabank Economics, Bloomberg.

Chart 9

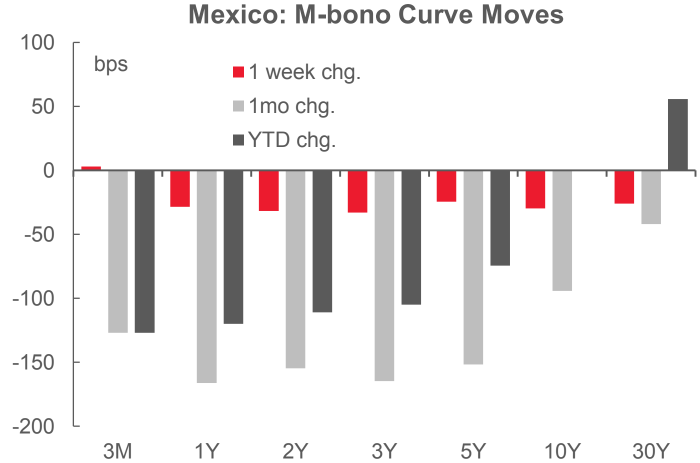
Mexico: M-bono Curve



Sources: Scotiabank Economics, Bloomberg.

Chart 10

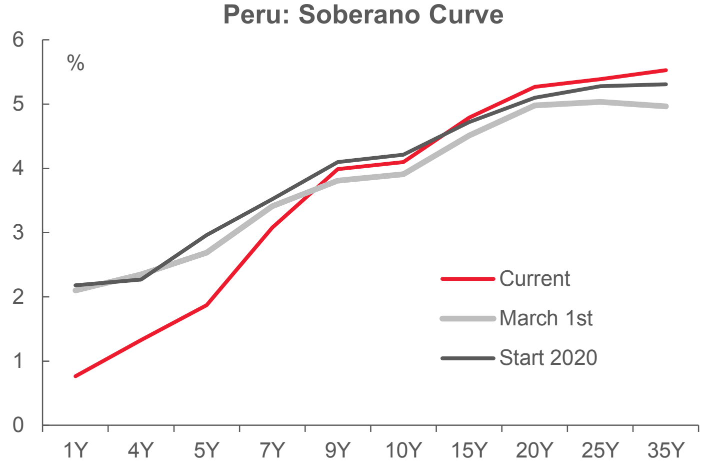
Mexico: M-bono Curve Moves



Sources: Scotiabank Economics, Bloomberg.

Chart 11

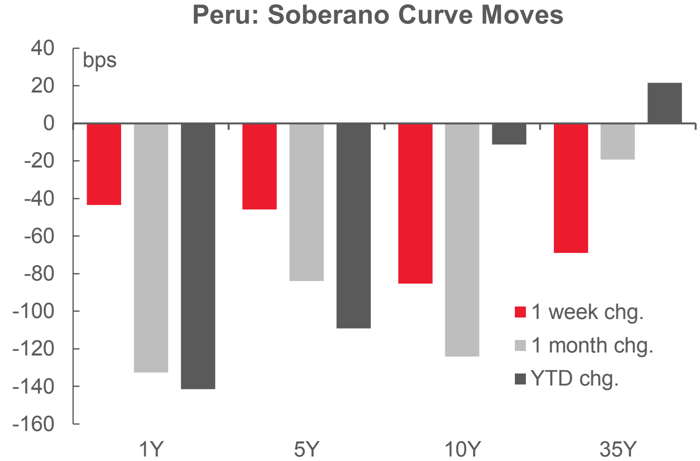
Peru: Soberano Curve



Sources: Scotiabank Economics, Bloomberg.

Chart 12

Peru: Soberano Curve Moves



Sources: Scotiabank Economics, Bloomberg.

Key Market Charts

Chart 13

Sources: Scotiabank Economics., Bloomberg.

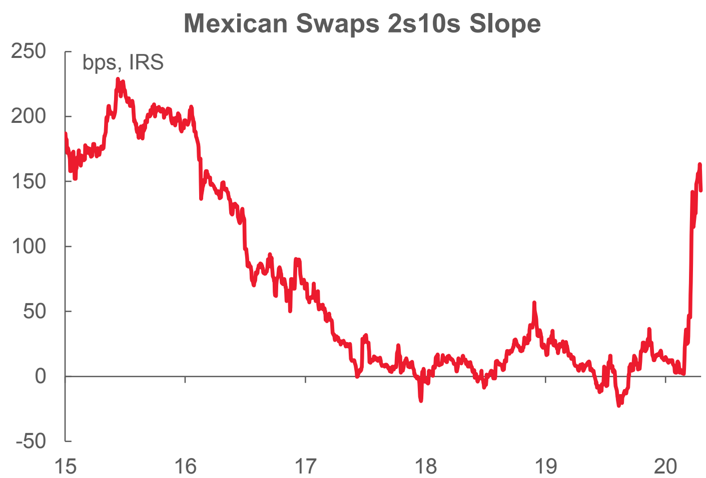
Chart 14

Sources: Scotiabank Economics., Bloomberg.

Chart 15

Sources: Scotiabank Economics., Bloomberg.

Chart 16



Sources: Scotiabank Economics., Bloomberg.

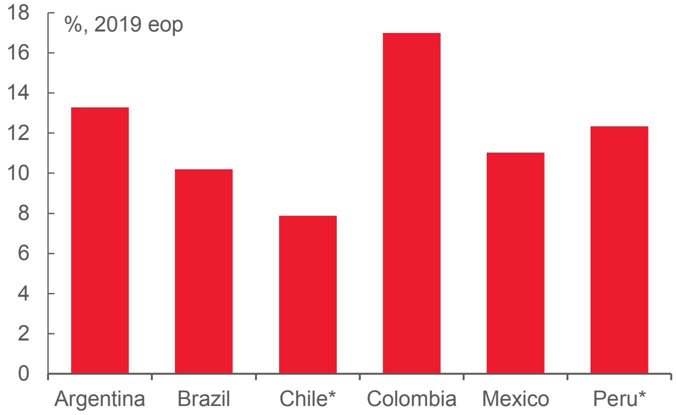
Chart 17

Sources: Scotiabank Economics., Bloomberg.

Key Market Charts

Chart 18

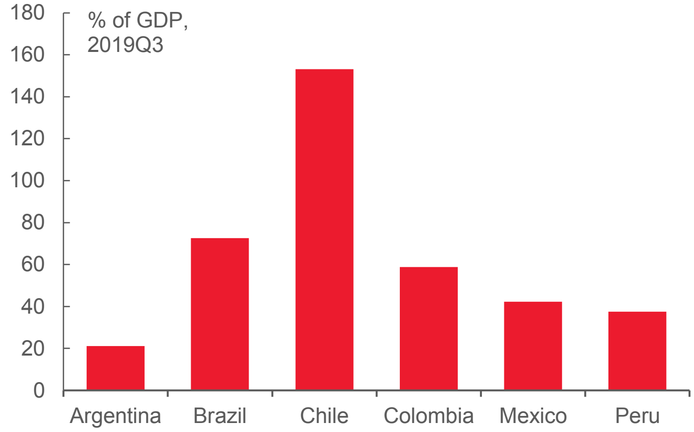
Bank Capital to Assets Ratio



* Chile 19Q3; Peru 19Q2.
Sources: Scotiabank Economics, IMF.

Chart 19

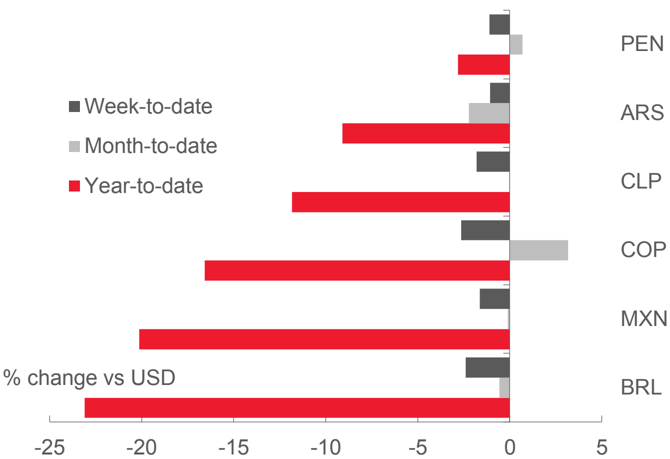
Domestic Credit to Private Nonfinancial Sector



Sources: Scotiabank Economics, BIS, Haver Analytics.

Chart 20

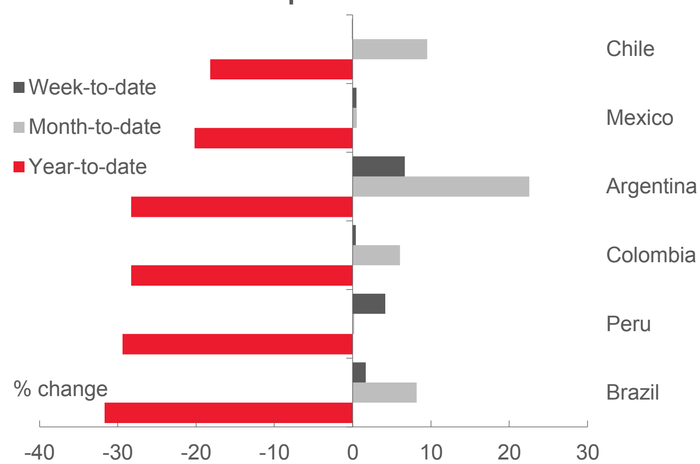
Latam Currencies Performance



Sources: Scotiabank Economics, Bloomberg.

Chart 21

Latam Equities Performance



Sources: Scotiabank Economics, Bloomberg.

Market Events & Indicators for April 18–24

ARGENTINA

Date	Time	Event	Period	BNS	Consensus	Latest	BNS Comments
APR 20-22		Budget Balance (ARS mn)	Mar	--	--	-27497.1	
04/22	15:00	Trade Balance (USD mn)	Mar	--	--	1129.0	Both imports and exports are likely to show declines with mixed prospects for the overall balance.
04/22	15:00	Imports Total (USD mn)	Mar	--	--	3195.0	
04/22	15:00	Exports Total (USD mn)	Mar	--	--	4324.0	
04/22		UTDT Leading Indicator (m/m)	Mar	--	--	-2.5	Nation-wide quarantine began March 19.
04/23	15:00	Supermarket Sales (y/y)	Feb	--	--	-1.6	
04/23	15:00	Shop Center Sales (y/y)	Feb	--	--	-1.9	
04/23		Consumer Confidence Index	Apr	--	--	41.2	

BRAZIL

Date	Time	Event	Period	BNS	Consensus	Latest	BNS Comments
04/20	14:00	Trade Balance Weekly (USD mn)	19-Apr	--	--	1714.9	
APR 20-25		Formal Job Creation Total	Feb	--	73881	-307311	
APR 20-27		Tax Collections (BRL mn)	Mar	--	110500	116430	
04/23		CNI Industrial Confidence	Apr	--	--	60.3	
04/24	8:30	Current Account Balance (USD mn)	Mar	--	-200.0	-3904.0	
04/24	8:30	Foreign Direct Investment (USD mn)	Mar	--	6600.0	5996.3	

CHILE

Date	Time	Event	Period	BNS	Consensus	Latest	BNS Comments
04/24	9:00	PPI (m/m)	Mar	--	--	-1.2	

COLOMBIA

Date	Time	Event	Period	BNS	Consensus	Latest	BNS Comments
04/21	11:00	Imports CIF Total	Feb	--	3951.0	4329.6	
04/21	11:00	Trade Balance	Feb	--	-750.0	-690.3	
04/22		Retail Confidence (USD mn)	Mar	--	--	28.3	
04/22		Industrial Confidence (USD mn)	Mar	--	--	9.8	

MEXICO

Date	Time	Event	Period	BNS	Consensus	Latest	BNS Comments
04/21	10:00	International Reserves Weekly (USD mn)	17-Apr	--	--	185618	
04/23	7:00	Retail Sales (m/m)	Feb	--	0.2	0.5	
04/23	7:00	Retail Sales (y/y)	Feb	-4.0	3.5	2.7	
04/23	7:00	Bi-Weekly CPI (w/w)	15-Apr	0.2	-0.7	-0.8	
04/23	7:00	Bi-Weekly Core CPI (w/w)	15-Apr	0.3	0.2	0.1	
04/23	7:00	Bi-Weekly CPI (y/y)	15-Apr	3.0	2.2	2.8	
04/24	7:00	Economic Activity IGAE (y/y)	Feb	1.7	-0.6	-0.8	
04/24	7:00	Economic Activity IGAE (m/m)	Feb	-0.7	-0.2	0.0	

PERU

Date	Time	Event	Period	BNS	Consensus	Latest	BNS Comments
		No scheduled events					

Scotiabank Economics Latam Coverage