March 5, 2019

LATAM Market Update

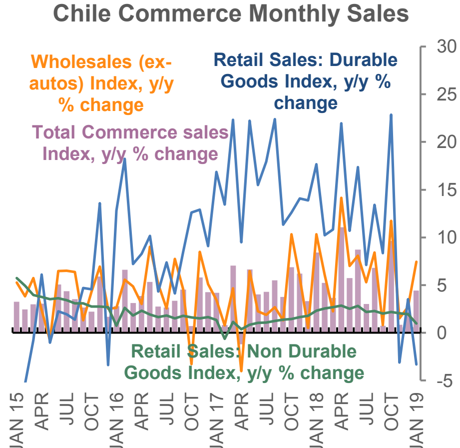
- **Chile: Retail sector still weak (Jan) but business confidence is improving (Feb)… Cyclically consistent with the start of the year**
- **Colombia: 2018 current account deficit deteriorated further; FDI was the main financing source**
- **Mexico: Banxico's survey of private sector expectations exhibited lower estimates for both 2019 GDP and 2019 headline inflation; S&P downgrades outlook for Mexico's sovereign rating and Pemex**
- **Peru: Public sector investment appears to decline more than expected in February**

CHILE: RETAIL SECTOR STILL WEAK (JAN) BUT BUSINESS CONFIDENCE IS IMPROVING (FEB)… CYCLICALLY CONSISTENT WITH START OF THE YEAR

The commerce data released yesterday showed the sector expanded 4.4%, but critically driven by the wholesale sector (4.4% y/y), while retail sector did not expand. The retail sector excluding car sales expanded 0.4%, which also mirrors a severe contraction (-3.3%) in durable goods and a limited expansion of non-durable sales (1%). Recall that annual growth of retail sector had experienced some recovery in December (1.6%), which was decisively helped by a low comparison base (December 2017), but the original 2.8% y/y growth of the total sector index that month was revised down to 2.2%. Weak performance of retail sector will remain and likely the accumulation of inventories sectors will continue for some months, though at a slower rate. Considering this chunk of data, our team now estimates the monthly economic activity index (IMACEC by its acronym in Spanish, to be released today by the Central Bank) could reach 2% y/y. Recall that the market, after knowing the industrial data last week, was forecasting in a range between 2% and 3%, but rather centered at 2.6%. Our team forecast is made of -4.8% in mining sector and 2.7% in non-mining sector.

For the second time in a row, the report of the IMCE (Monthly Business Confidence Index, compiled by ICARE) inched up, I think closely related with recovery of terms of trade in the previous weeks, as said in mid-February in the note that linked a part of the confidence to copper prices (terms of trade in a wider definition). As that was likely the main reason, mining sector recovered much

Chile Commerce Monthly Sales



Sources: Scotiabank, Instituto Nacional de Estadísticas (INE).

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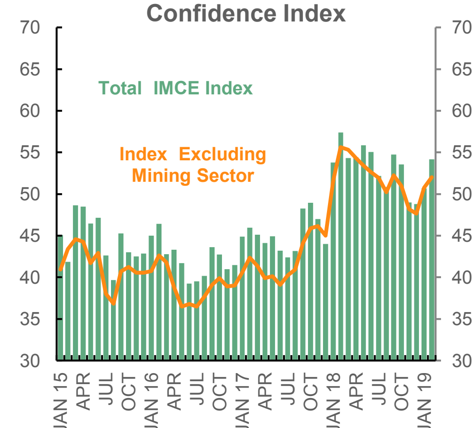
Chile IMCE: Monthly Business Confidence Index



Sources: Scotiabank, ICARE, UAI, BCCh.

faster, but even excluding it, there is a widespread improvement which is expected to deepen in the coming months. More qualitatively, confirming the improvement is more related with external factors than with specific domestic conditions, the report says that inventories continued at a higher-than-wanted level, cost pressures fell, but even so their appreciation remained optimistic about both the own business and the Chilean economy. That guaranties a slow rhythm in H1 (as expected), but with a still upbeat view of the future which should mean some acceleration in H2. We have to repeat that is very common in previous cyclical recoveries of the Chilean economy.

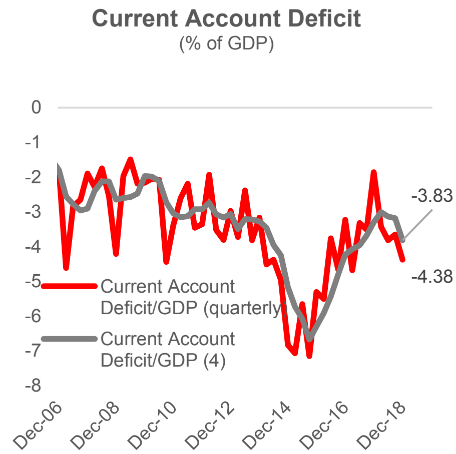
COLOMBIA: 2018 CURRENT ACCOUNT DEFICIT DETERIORATED FURTHER; FDI WAS THE MAIN FINANCING SOURCE

2018 current account deficit increased to 3.8% of GDP (US$12.6bn), from 3.3% of GDP in 2017. For 2019 BanRep staff think the current account will deteriorate further to 4.1% of GDP. Although its financing continued being healthy (FDI was US$11bn), external vulnerability continue being one of the main concerns for the Colombian economy.

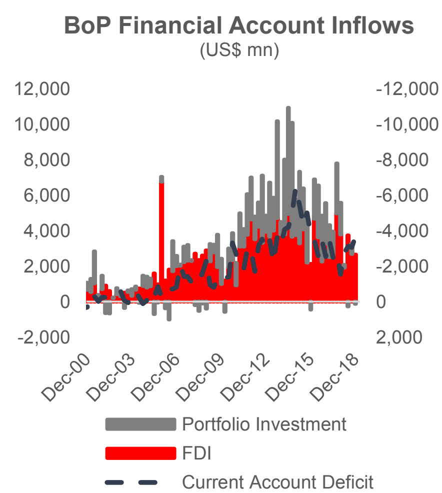
Trade balance (good and services) came in at US$9.1bn, US$637mn higher than 2017 due to imports expansion of 11.1% that more than compensated the increment of 11.7% of exports (favoured by higher value of oil exports). Imports significant expansion was mainly on the back of capital and raw materials imports.

On the financing account, it is worth to note that FDI continued being the most important source of current account deficit financing (US$11bn). 2018 FDI was 37% in oil and mining sector, 18% in financial system, 14% in communication, 12% manufacturing, and 11.3% in other sectors. Portfolio investment last year was not significant (only US$349mn). Finally in 2018 gross foreign indebtedness was US$8.8bn, on which public sector account for US$3bn and private sector US$5.8bn.

On monetary policy, current account deficit deterioration is difficult. If Banrep decides to hike rates earlier to stop raising demand for imports it also can produce appreciation through the financial channel and fueled, at the same time, what they want to stop. On the contrary, if BanRep decides to continue its base line plan, and keep MPR at 4.25% for longer, arguing that current account deterioration is due to higher capital imports which will be good for 2019 investment and potential GDP, can fuel external vulnerability concerns triggering COP depreciation and a possible Colombian downgrade, ending up affecting GDP which was what they wanted to boost in the first place. In the end, although widen current account deficit concerns BanRep, it is not clear how central bank will play this part. History says that BanRep weights more real channel than financial channel, which means that BanRep is historically more hawkish and prefers to stop the raising domestic demand.



Sources: BanRep, Scotiabank.



Sources: BanRep, Scotiabank.

MEXICO: BANXICO'S SURVEY OF PRIVATE SECTOR EXPECTATIONS EXHIBITED LOWER ESTIMATES FOR BOTH 2019 GDP AND 2019 HEADLINE INFLATION; S&P DOWNGRADES OUTLOOK FOR MEXICO'S SOVEREIGN RATING AND PEMEX

The projections of the main macro-financial variables forecast a positive performance, but those regarding the economic activity deteriorated. The average growth forecast for Mexico's GDP in 2019 was cut back for the 5th consecutive month, now to 1.64% from 1.80%. Meanwhile, the average growth expected for 2020 remained stable at 1.91%.

S&P Global Ratings revised its outlook on Mexico's long-term sovereign rating and Pemex from stable to negative. This downgrade reflects lower growth expectations and a persistent deterioration of the company's business and financial risk profiles that has compromised the recovery of its upstream and downstream activities, respectively. The country's sovereign rating remained at 'BBB +', but the rating agency stated that there is a one-third chance of a downgrade within the next 18 months. The outlook reflects the risk that a recent shift in government policy to reduce private-sector involvement in the energy sector, along with other developments that have led to a decline in investor confidence, could contribute to higher contingent liabilities for the sovereign and lower GDP growth prospects. The resulting weakening of the sovereign's financial profile could lead to a downgrade. The negative outlook on PEMEX mirrors that on the sovereign and reflects Standard & Poor's view that the close relationship between the company and the sovereign will remain unchanged over the next couple of years.

PERU: PUBLIC SECTOR INVESTMENT APPEARS TO DECLINE MORE THAN EXPECTED IN FEBRUARY

According to estimates by non-official (media) sources, public investment would have declined a significant 29%, y/y, in February. Official figures may differ, but the direction and greater magnitude should prove correct. There are two reasons for this. The first, and more important, as it will last longer, is the that newly elected local and regional authorities took office in January, and, given high rotation and weak institutionality, this typically is cause for a pause in investment. The second is this February's y/y figure was against a particularly high base comparison in February 2018, when government investment rose 56%. So far, investment seems to be underperforming this year. However, government investment is generally more volatile in the first quarter of each year, and it would be best to wait for a couple more months of data to see how trends stabilize before revising our full-year view.