LATAM Market Update

- **Mexico: 2Q19 GDP downwardly revised as industrial production shrank and services sector weakened; 2Q19 Current account exhibited a surplus**
- **Peru: Second quarter figures released on Friday were mixed, with growth weakish, but macro balances healthy**

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MEXICO: 2Q19 GDP DOWNWARDLY REVISED AS INDUSTRIAL PRODUCTION SHRANK AND SERVICES SECTOR WEAKENED; 2Q19 CURRENT ACCOUNT EXHIBITED A SURPLUS

During 2Q19, Mexico's GDP was downwardly revised in comparison with the flash estimate, from -0.7% to -0.8 y/y (vs +1.2% y/y in 1Q19). Uncertainty, both in domestic and in external markets, has negatively weighted in market participants' sentiment, and it holds the unfavorable economic outlook. By components, services sector decelerated from 1.8% in 1Q19 to 0.0% y/y; industrial activity decreased at a faster pace, from -0.6% in 1Q19 to -3.0% y/y; and agriculture slowed down, from 5.7% in 1Q19 to 1.4% y/y. Meanwhile, seasonally adjusted 2Q19 GDP marginally rebound from -0.3% in 1Q19 to 0.0% q/q in 2Q19.

Additionally, June's Global Economic Indicator (IGAE) decreased by a third month in a row at a faster rate, from -0.4% in May to -0.9% y/y. The worse performance of the indicator highlights the higher-than-expected weakening of economic activity. By sectors, services decreased -0.1% y/y (vs. +1.0% y/y in May), industrial activity diminished by an eight consecutive month, now -2.9% y/y (vs -3.3% y/y in May); and agriculture accelerated to 2.5% y/y (vs. +0.5% y/y in May).

Mexico's current account in 2Q19 printed the first surplus in the last 10 years. The 2Q19 figure was 1.6% of GDP (USD $5.14 billion), a better result than the deficit observed during 2Q18 (1.1% of GDP) and 1Q19 (2.7% of GDP). The result was mainly due to an increase in non-oil goods' trade balance surplus and a reduction in the services trade balance deficit, partially offset by an increase in the primary income deficit. Furthermore, the capital account presented a deficit of US$2 million and the financial account net loans, or outflows, of US$983 million. Within the financial account, it was observed a net indebtedness of US$4 billion in foreign direct investment and US$1.6 billion in other investments; and net loans of US$3.7 billion in portfolio investments and US$387 million in financial derivatives.

PERU: SECOND QUARTER FIGURES RELEASED ON FRIDAY WERE MIXED, WITH GROWTH WEAKISH, BUT MACRO BALANCES HEALTHY

Major GDP growth indicators released on Friday showed a weak second quarter, as expected. GDP growth was 1.2%, y/y, for 2Q19. The figure itself was already known. In general, the second quarter was always expected to be weak, due to a high comparison base (5.5% GDP growth in 2Q18). Domestic demand, at 2.0%, was also somewhat weak, but also as expected (for similar reasons). The main surprise was private investment, which grew 5.1%. Mining investment growth of 17.4% was already known. However, we had been wondering whether non-mining investment would show any growth at all. The fact that it rose 3.5% was a bit of a relief. It was the first positive growth in four quarters. Note, however, that there is no assurance that this will continue going forward, as business confidence in 2Q had not yet suffered the impact of the renewal of the global trade war, and of the new domestic uncertainty due to social conflicts and the call for early elections.

Just as private investment outperformed expectations, private consumption underperformed, growing only 2.5%, well under the quarterly trend of the past two years, of over 3.2% growth. There is a bit of a caveat, however, due to high consumption associated with the World Cup in 2Q18. It'll be interesting to see if there is a similar positive effect due to the Lima Pan-American Games in 3Q2019.

While domestic demand was weakish, it was at least positive. Exports, on the other hand, fell 2.9% in volume. This was in line with a moderate decline in mining output, and a sharp decline in fishing, during the quarter. Both will normalize over time.

Based on 2Q results, the Ministry of Finance has sharply reduced its growth forecast for 2019 to 3.0% from 4.0%, and more mildly for 2020 to 4.0% from 4.2%. Their 2020 figure continues to look high to us, but 2019 is much more reasonable. We shall also be taking a closer look at our own forecasts (3.1% for 2019 and 3.7% for 2020), especially for 2020, although not so much due to second quarter results, which were not that different from our expectations, but, rather due to recent events, including the renewal of the global trade war, and a significant increase in domestic political uncertainty.

The Central Bank, CB, also released private sector formal employment figures. Growth for the quarter was 2.8%, well below trend of +4% throughout most of 2018-2019. However, on a monthly basis, at least June breaks with the downward trend, with 2.9% growth, up from 2.6% in May. The big change in the employment trend came in agriculture, where employment increased a paltry 1.9% in June, compared to 11.4% for the first half of 2019. Although it's still a bit early to be conclusive, this may be a sign that the boom in agro-industrial production is now starting to stabilize. On the more positive side, employment in construction rose a quite healthy 6.0% in June (2.5% in 1H19).

The CB released both fiscal accounts and external accounts for 2Q19. Most figures had already been released on a monthly basis. The country registered a 2.2% of GDP fiscal surplus in 2Q2019, y/y. Note, however, that fiscal accounts swing sharply from positive in the first half of the year, when income taxes are paid, to negative in the second half, when the central and local governments try to speed up spending before the end of the year. On a 12-month basis, fiscal accounts are trending at a 1.6% of GDP deficit, which is still very healthy. We expect the year to end with a 2% shortfall, although this will depend on if the government is able to improve its spending record, especially investment spending.

Finally, the government reported a 1.9% current account deficit in 2Q2019. We always hesitate when we provide current account figures, which register foreign company profits as an outflow, regardless of whether profits leave the country or are reinvested. Once we have the breakdown in information to correct for this, we expect the corrected current account deficit to be closer to nil. Note, however, that the trade surplus is shrinking, coming in at little over US$1bn in each of 1Q19 and 2Q19, compared to nearly twice as much in the better quarters of the recent past. An yet, reserves at the Central Bank continue rising. They closed 2Q at US$66bn, up over 10% on the year, and increasing to 29.4% of GDP, from 26.7%. This increase was largely due to a capital account of nearly US$8bn in the first half of 2019, and nearly US$5bn in 2Q alone.