

## LATAM Market Update

- **Chile: Worst year-on-year contraction since subprime crisis and historic fall in month-over-month activity**
- **Mexico: Central Bank Survey of Expectations foresees a stagnant economy for 2019**
- **Peru: Inflation comfortably low; Initial indicators for October GDP are mildly positive; The new Keiko**

### CHILE: WORST YEAR-ON-YEAR CONTRACTION SINCE SUBPRIME CRISIS AND HISTORIC FALL IN MONTH-OVER-MONTH ACTIVITY

Significant fall of 4% y/y in non-mining activity during October—2 years are lost in 2 weeks.

October is the first month that partially includes the effects of the October 18<sup>th</sup> that paralyzed the activity in various sectors. Economic activity in October contracted 3.4% y/y, a fall not seen since the financial crisis of 2008. Adjusting for calendar effects, non-mining activity fell 6.1% m/m, the biggest drop since there is a record for the indicator (year 1996). This implies a significant loss in the level of activity (seasonally adjusted), going back to mid-2017 levels. That is, the economy would have lost 2 years of growth in just 2 weeks.

Anticipating this record was particularly challenging given that until the beginning of the protests the economy had shown a significant recovery from the previous month as reported by daily transaction data. The magnitude of the damage and effects on productive activities and services was evident later, a magnitude hard to estimate. The market expected a contraction of 0.5% y/y, similar to our projection. On the other hand, mining continues with very low growth, with a virtually zero contribution to GDP, which would not improve until the new sites begin to operate at a greater capacity.

The negative incidence of the productive semi-paralysis will be seen more clearly in November, and we anticipate a markedly negative inter-annual and seasonally adjusted record, with an annual fall not very different from that seen in October of between 2% and 4% y/y. Depending on how much dynamism the economy has recovered in November, we estimate that GDP growth for 2019 would be in the range 0.5-1.5% y/y worse than the floor of the range initially estimated by us between 1.5% and 1.8%, and below the last Survey of Economic Expectations that considered 1.9%.

### FX intervention and monetary policy

For the Central Bank, this record entails a significant opening of output gaps, but at the same time, the recent exchange intervention seems to require some support from monetary policy to ensure its short-term success. This balance is highly complex. On the fiscal side, a 4.5% increase in government expenditure has already been announced, but something else could be announced soon.

### CONTACTS

**Eduardo Suárez, VP, Latin America Economics**  
52.55.9179.5174 (Mexico)  
Scotiabank Economics  
[eduardo.suarez@scotiabank.com](mailto:eduardo.suarez@scotiabank.com)

**Guillermo Arbe**  
511.211.6052 (Peru)  
Scotiabank Peru  
[guillermo.arbe@scotiabank.com.pe](mailto:guillermo.arbe@scotiabank.com.pe)

**Mario Correa**  
52.55.5123.2683 (Mexico)  
Scotiabank Mexico  
[mcorrea@scotiabank.com.mx](mailto:mcorrea@scotiabank.com.mx)

**Sergio Olarte**  
57.1.745.6300 (Colombia)  
Scotiabank Colombia  
[sergio.olarte@co.scotiabank.com](mailto:sergio.olarte@co.scotiabank.com)

**Jorge Selaive**  
56.2.2939.1092 (Chile)  
Scotiabank Chile  
[jorge.selaive@scotiabank.cl](mailto:jorge.selaive@scotiabank.cl)

However, the magnitude of the economic damage and contraction seems to be initially unsuspected. Consequently, support from all macroeconomic policies (fiscal and monetary) is essential during the coming months. Thus, although there is a risk that the CB does not stimulate the economy sufficiently in the short term, given certain depreciative fears and to ensure the greatest possible success of the intervention, it seems to us that there is little room to anticipate a different scenario from that of lowering the monetary policy rate. We anticipate that the swap market will move in that direction in the short term.

We expect that for the Monetary Policy Report (IPoM) the CB will adjust the GDP growth for 2019 towards something around 1.0% while in 2020 its projection range to 1.5%-2.5%, centered around the current median of the polls. However, these surveys did not have this short-term crash that will affect the beginning of 2020.

We believe that part of the Central Bank Board will privilege the relevant output gap and vote for a 25 bp. cut which will not be of consensus within the Board. The President of the Central Bank will have to keep his somewhat less stimulating speech delivered last Friday and we expect he will vote for maintaining the rate with a dovish bias. This stance would be followed by another Board member who has been characterized by his somewhat less stimulating view in the recent cycle. The rest of the Board, more likely to favour the output gap, would opt for an immediate cut of 25 bp. which is for now our baseline scenario.

—Jorge Selaive, Carlos Muñoz & Waldo Riveras

## **MEXICO: CENTRAL BANK SURVEY OF EXPECTATIONS FORESEES A STAGNANT ECONOMY FOR 2019**

Bank of Mexico published the results of its November survey of expectations where analysts in the economic private sector foresee a stagnant economy at the end of 2019. The average growth forecast for Mexico's GDP in 2019 was revised downwards for the 14<sup>th</sup> consecutive time, now at 0.04% from 0.26%. By 2020, the expected growth was also revised downwards, to 1.08% from 1.14%. Regarding general inflation, expectations at the end of 2019 decrease from 2.96% to 2.92%, yet increase from 3.43 to 3.45 for 2020. As for monetary policy, most of respondents expect a target rate of 7.25% and 6.50% at the end of 2019 and 2020, respectively. Lastly, projections for the exchange rate at the end of 2019 and 2020 continue to exhibit slightly better results, where the exchange rate is expected at 19.59 pesos per dollar (ppd) at the end of 2019, below the expected rate in October of 19.72 ppd. For 2020, expected exchange rate was revised downwards to 20.09 from 20.17 pesos per dollar.

In October, fiscal revenues weakened further by 0.3% y/y, as a result of lower oil and tax revenues. On the other hand, lower than approved net public spending partially compensated the drop in revenues. From January to October 2019, the fiscal balance exhibited a deficit of 154.1 billion pesos, below the approved 334 billion. Yet, the primary balance presented a surplus of 296.5 billion, equivalent to 1.2% of GDP, which is more than both the programmed 191.4 billion, and the 156.2 billion pesos, reported during January-October 2018. With these results, the balance sheet is yet consistent with a primary surplus target of 1.0% of GDP in 2019. Thus, lower public spending and the use of public savings to compensate for lower revenues support accomplishment of the fiscal target, yet increases budgetary pressures and reduces options for maneuver of the fiscal policy.

—Miguel Saldaña

## **PERU: INFLATION COMFORTABLY LOW; INITIAL INDICATORS FOR OCTOBER GDP ARE MILDLY POSITIVE; THE NEW KEIKO**

Inflation in the 12 months to November came in at 1.9% (0.11% for the month of November). This was expected, and broadly in line with our forecast of 2.0% inflation for the full year, although inflation may come in just under our forecast. Inflation has been quite stable at around 1.9% for the past three months. We see no real inflationary pressures going forward, although we are entering a period in which rains intensify, and this sometimes drives inflation up temporarily. So, what will the Central Bank do with the reference rate next month? We're not sure. The CB is not giving clear signals. On the one hand, there is little room for rate cuts before the real rate enters into negative territory, which is something we would think the CB would try to avoid. On the other hand, however, the CB may very well decide to take what little room there is right away, to amplify the impact of last week's rate cut. And, it has arguments: the economy is underperforming CB expectations (although the CB will be looking close at the October-November growth numbers to see by how much), public sector investment is weak (this is a variable the CB stated in the past that it would look at), and, with much of the business community under siege due to involvement in campaign financing, if not,

in some cases, outright corruption, the investment environment could certainly do with some monetary encouragement, even if the impact is only symbolic. We see the balance tipping in favour of not lowering rates, due to precedent: the CB doesn't normally like to lower rates two months in a row (see graph, especially for the 2017 period), unless severely pressed, which does not seem to be the case now.

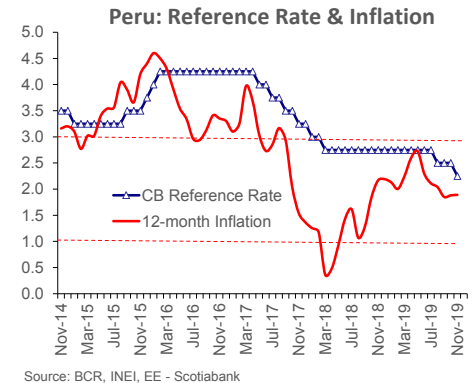
### October sectorial GDP growth figures have started to be released

Cement construction rose 6.1%, y/y, a sign that construction growth continues healthy and a leading driver of the economy. Resource sectors performed relatively well, for once. Agriculture rose a healthy 4.9%. Mining actually showed positive, albeit low, growth, 0.1%, although this was skewed by iron ore, up 92% on capacity expansion, while the output of the more important metals fell, copper by 1.0%, and gold by 14%.

Oil & gas rose 3.9%. Fishing was a bit of a disappointment, down 0.7%, although the new fishing campaign hadn't begun in earnest yet. All in all, the figures, which are partial and do not include the key retail, manufacturing and services sectors, are pointing to moderate growth of +2.5% in October, in line with our full-year forecast of 2.3% GDP growth.

### Politics: has Keiko changed?

Keiko's first statements after her release from prison are noteworthy. She has stated that she will seek "the union of her family". Apparently, she's not talking about being a better daughter or sister, but, rather, she's talking politics. The message appears to be that she will abandon the political strategy of aggressive opposition to the government for something much more conciliatory, and that she would shift the party's focus from a personal one that was centered on her, to a more family one that would include her father (and, if possible, brother Kenji), thereby bridging the gap that had ripped the party apart into the keikista and albertista factions. This would mean a greater sharing of power, but, more importantly, a sharp change in her entourage and the party's power structure. This has already begun, as many of the most radical members of Fuerza Popular were not given a berth to run for the January Congressional elections. To underline the change, Keiko has also suggested she would take a break from politics for a while, probably until after Christmas, to spend time with her family.



This report has been prepared by Scotiabank Economics as a resource for the clients of Scotiabank. Opinions, estimates and projections contained herein are our own as of the date hereof and are subject to change without notice. The information and opinions contained herein have been compiled or arrived at from sources believed reliable but no representation or warranty, express or implied, is made as to their accuracy or completeness. Neither Scotiabank nor any of its officers, directors, partners, employees or affiliates accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents.

These reports are provided to you for informational purposes only. This report is not, and is not constructed as, an offer to sell or solicitation of any offer to buy any financial instrument, nor shall this report be construed as an opinion as to whether you should enter into any swap or trading strategy involving a swap or any other transaction. The information contained in this report is not intended to be, and does not constitute, a recommendation of a swap or trading strategy involving a swap within the meaning of U.S. Commodity Futures Trading Commission Regulation 23.434 and Appendix A thereto. This material is not intended to be individually tailored to your needs or characteristics and should not be viewed as a "call to action" or suggestion that you enter into a swap or trading strategy involving a swap or any other transaction. Scotiabank may engage in transactions in a manner inconsistent with the views discussed this report and may have positions, or be in the process of acquiring or disposing of positions, referred to in this report.

Scotiabank, its affiliates and any of their respective officers, directors and employees may from time to time take positions in currencies, act as managers, co-managers or underwriters of a public offering or act as principals or agents, deal in, own or act as market makers or advisors, brokers or commercial and/or investment bankers in relation to securities or related derivatives. As a result of these actions, Scotiabank may receive remuneration. All Scotiabank products and services are subject to the terms of applicable agreements and local regulations. Officers, directors and employees of Scotiabank and its affiliates may serve as directors of corporations.

Any securities discussed in this report may not be suitable for all investors. Scotiabank recommends that investors independently evaluate any issuer and security discussed in this report, and consult with any advisors they deem necessary prior to making any investment.

**This report and all information, opinions and conclusions contained in it are protected by copyright. This information may not be reproduced without the prior express written consent of Scotiabank.**

™ Trademark of The Bank of Nova Scotia. Used under license, where applicable.

Scotiabank, together with "Global Banking and Markets", is a marketing name for the global corporate and investment banking and capital markets businesses of The Bank of Nova Scotia and certain of its affiliates in the countries where they operate, including, Scotiabanc Inc.; Citadel Hill Advisors L.L.C.; The Bank of Nova Scotia Trust Company of New York; Scotiabank Europe plc; Scotiabank (Ireland) Limited; Scotiabank Inverlat S.A., Institución de Banca Múltiple, Scotia Inverlat Casa de Bolsa S.A. de C.V., Scotia Inverlat Derivados S.A. de C.V. – all members of the Scotiabank group and authorized users of the Scotiabank mark. The Bank of Nova Scotia is incorporated in Canada with limited liability and is authorised and regulated by the Office of the Superintendent of Financial Institutions Canada. The Bank of Nova Scotia is authorised by the UK Prudential Regulation Authority and is subject to regulation by the UK Financial Conduct Authority and limited regulation by the UK Prudential Regulation Authority. Details about the extent of The Bank of Nova Scotia's regulation by the UK Prudential Regulation Authority are available from us on request. Scotiabank Europe plc is authorised by the UK Prudential Regulation Authority and regulated by the UK Financial Conduct Authority and the UK Prudential Regulation Authority.

Scotiabank Inverlat, S.A., Scotia Inverlat Casa de Bolsa, S.A. de C.V., and Scotia Derivados, S.A. de C.V., are each authorized and regulated by the Mexican financial authorities.

Not all products and services are offered in all jurisdictions. Services described are available in jurisdictions where permitted by law.