

LATAM Market Update

- **Colombia: Tax Reform 2.0 was approved by Congress, earlier than expected thanks to important political alliances**
- **Mexico: Banco de México cuts benchmark rate by 25 basis points to 7.25%**
- **Peru: Keiko announces a pause from political activity, but what does that mean? Cement consumption weakish in November**

COLOMBIA: TAX REFORM 2.0 WAS APPROVED BY CONGRESS, EARLIER THAN EXPECTED THANKS TO IMPORTANT POLITICAL ALLIANCES

This morning, Congress approved the tax reform 2.0, Senate approved the text on Wednesday and the House resume the vote on Thursday night, concluding the total approval on Friday morning, earlier than the Government had anticipated and reinforcing alliances with key parties: Cambio Radical and Partido de la U.

This fiscal reform was the second version of last year's "Ley de Financiamiento" which The Constitutional Court declared unconstitutional due to a procedural failure. Although the new text kept the same spirit of Ley de Financiamiento, which means that reduction on corporate taxes to 30% by 2022 holds, tax credit to capital VAT tax imports holds, withholding tax reduction to 5% (from 14% in 2017) holds, formality boost to small companies with reduction in corporate taxes holds, and a program to strengthen tax collector institution to fight evasion. The new reform incorporated some new articles and subtracted others that, in our opinion, were needed to negotiate with protests leaders and to get the support of parties in Congress to pass the law. The net marginal cost for the government of the amendments in the tax law is preliminarily calculated at around COP3.4tr or 0.3pp of GDP per year. The main changes in the new tax reform are:

- 1) New tax reform added an article saying that by 2021 the government will return all VAT tax paid by the 20% most vulnerable population. This return will be bi-monthly and, according to the tax collector entity (DIAN), will cost COP2.2tr or 0.2pp of GDP. This article was in government's party agenda last year and is in line with some of the protests leaders' agenda (although was entirely the Government's idea).
- 2) Another amendment is that every year Colombia will have three days without VAT tax in some products (especially products that lower-income population consume). This measure will cost COP0.3bn (US\$100bn approx.), and although it is not technical in our opinion, a populist measure as this one can help negotiations with protesters.
- 3) Retirees that earn minimum wage as pension will beneficiate from a reduction in health contributions. Currently health contributions are 12%, the new legislation will reduce this contribution to 8% in 2020, and 4% in 2022. According to DIAN this reduction in health tariffs for low income retirees will cost COP1tr or a bit less than 0.1pp of GDP.

CONTACTS

Eduardo Suárez, VP, Latin America Economics
52.55.9179.5174 (Mexico)
Scotiabank Economics
eduardo.suarez@scotiabank.com

Guillermo Arbe
511.211.6052 (Peru)
Scotiabank Peru
guillermo.arbe@scotiabank.com.pe

Mario Correa
52.55.5123.2683 (Mexico)
Scotiabank Mexico
mcorrea@scotiabank.com.mx

Sergio Olarte
57.1.745.6300 (Colombia)
Scotiabank Colombia
sergio.olarte@co.scotiabank.com

Jorge Selaive
56.2.2939.1092 (Chile)
Scotiabank Chile
jorge.selaive@scotiabank.cl

- 4) Incentives to the first job: Companies that hire people that never have worked formally before and younger than 29 years old will benefit from a tax credit in the corporate tax as of all labour costs of these employees. There is no clarity how much it will cost the government. Having said that, it is one of the most essential articles to negotiate with the leaders of the protests.
- 5) Financial institutions will have a surcharge of 4% in 2020 and 3% in 2021 and 2022 in the corporate tax. Although minister Carrasquilla did not agree with this “temporary” surcharge, it was part of the negotiations with some parties on Congress to support tax reform.
- 6) Government subtracted from the text the additional tax to high value homes sales (2% of the sell for homes above COP900mn or ~US\$260k). We think this change was a demand from Cambio Radical party. We do not think this change will have a significant fiscal effect. This year, the government collected only COP60bn (~US\$17bn) due to this tax.

The Ministry of Finance emphasized that the net revenue of the Tax Reform will be around COP13.5tn (1.3 % of GDP). And, although the new amendments mean a higher fiscal expenditure for 0.3pp of GDP per year, in our opinion, it is credit positive for Colombia in the short run due to two main reasons. I) it maintains the status quo and ensures that the pro-market environment continues, and II) implicitly made the government look for coalitions in Congress and increase the likelihood of next year's presidential agenda to be supported. We think the last reason is the most important since the weak relationship between government and congress has been the constant in Duque's administration, which makes much difficult governability. In fact, the surprisingly early approval demonstrated that the Government created valuable alliances with key parties like Cambio Radical and Partido de la U, which jointly represent 29% in the Senate and 33% in the House.

All in all, we think that the fiscal cost is manageable, and the big win was the surge of political alliances.

—Sergio Olarte & Jackeline Piraján

MEXICO: BANCO DE MEXICO CUTS BENCHMARK RATE BY 25 BASIS POINTS TO 7.25%

In its last monetary policy meeting of the year, Banco de México's Board of Governors decided to lower the overnight interbank rate by 25 basis points (bps) for the fourth consecutive time, to 7.25%, in line with market expectations. Once again, the decision wasn't unanimous since one member of the Board voted to cut the rate by 50 bps, to 7.00%.

According to Banxico's press release, the current environment continues to pose risks that could affect the country's macroeconomic conditions and the economy's price formation process. Thus, it is important to foster an environment of confidence and certainty for investment, and that public finances are consolidated in a sustainable way. Even though the latest information for Q4-2019 is limited, the weakness that economic activity has been showing in the last quarters is expected to persist, leading to a widening in the negative slack conditions with respect to those observed in the last quarter. However, the growth outlook is still in line with the latest Quarterly Report estimate. Additionally, Banxico mentions that headline inflation in November was 2.97% y/y, with its non-core component reaching 0.98% y/y and the core component remaining persistent, albeit decreasing slightly at 3.65% y/y. Thus, expectations for headline inflation for the end of 2019 could be below the forecasts of the July-September 2019 Quarterly Report. For 2020, core and headline inflation may reflect both a greater amount of slack in the economy and the cost-related pressures resulting from the recent minimum wage revisions, which could place them moderately above the levels anticipated in the last quarterly report.

The Central Bank stressed that it will maintain a prudent monetary policy stance and follow closely the potential exchange rate pass-through to prices; Mexico's relative monetary policy stance in an external environment that is still subject to risks; the behaviour of economic slack conditions; and on cost-related pressures in the economy.

The minutes from yesterday's monetary policy decision will be released on January 2nd of 2020, and the next decision is scheduled for February 13th.

—Alejandro Stewens

PERU: KEIKO ANNOUNCES A PAUSE FROM POLITICAL ACTIVITY, BUT WHAT DOES THAT MEAN? CEMENT CONSUMPTION WEAKISH IN NOVEMBER

Keiko Fujimori announced that she would “pause” in her political activities, to dedicate more time to her family. This was her first public appearance since being released from jail (where she was held on preventive detention, prior to her trial) at the end of November. Keiko did not give details regarding for how long she plans to pause in her political activities, nor on the scope of the pause. The fact that she made a public announcement suggests the pause will be longer than just the Christmas holidays, which was the main speculation prior to her announcement. It now seems that Keiko plans not to be involved in actively supporting and campaigning for Fuerza Popular candidates running for Congress in the January 26th elections. The interesting question, however, is what does she plan to do regarding the 2021 Presidential elections? Chances are, I believe, that she will be back by then. The other interesting question is what exactly is being “paused”? Will she take a rest from political activity entirely, or only from appearing in public, while continuing to manage party issues from behind the scenes? It is hard to envision Keiko removing herself from political activity altogether, after having had such a strong control for so long a time. Finally, what will happen to the power structure within Fuerza Popular in the meantime and upon her return? Keiko had already made statements suggesting that party members linked to her father, and that had been relegated in recent years, will begin having a greater role. And, in fact, this faction has been promoted, while those recent prominent leaders that had favoured a more aggressive stance, have been sidelined. But, even these decisions were hers. There still does not seem to be any evidence of her actually beginning to share power with her father, Alberto Fujimori, or brother Kenji Fujimori, and there is no other figure within the party that can compete with her in terms of leadership.

Cement consumption rose a weakish 2.1% in November. This is a leading indicator for construction growth, although it mostly reflects private sector construction. In October, cement consumption rose 6.7%, and yet construction GDP only increased 1.2%, due to a sharp decline in government investment. Government investment In November has been equally anemic. Thus, November’s low cement consumption growth reflects that private investment is not taking up much of the slack, which does not bode well for construction GDP in the month. All in all, initial indicators are pointing to a November being another month of rather disappointing GDP growth in the vicinity of 2%.

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