LATAM Market Update

- **Chile: Expansion of 2.7% in GDP during February, favored by leap-year; we were going well but then everything changed; March Monetary Policy Report: Adjusting expectations for 2020, but maybe too optimistic for 2021**
- **Colombia: Fitch downgrades Colombia's Rating to 'BBB-' and outlook remained negative**
- **Peru: Inflation stable in March; February growth indicators are positive, but stale**

CHILE: EXPANSION OF 2.7% IN GDP DURING FEBRUARY, FAVORED BY LEAP-YEAR; WE WERE GOING WELL BUT THEN EVERYTHING CHANGED

- **February does not capture COVID-19 ... but March will do so more clearly, revealing significant seasonally adjusted and year-over-year contraction**

Monthly GDP for February increased 2.7% y/y without significant differences compared to our projection, and favored by the additional business day due to the leap year. This record is the greatest expansion since the social outbreak, evidencing a certain normalization of activity, especially in manufacturing, and continued to be aided by the high strength of construction that was associated with the acceleration of public works projects and also those linked to the mining sector (chart 1). Non-mining activity increased 0.4% m m (sa), recovering to levels of months prior to the social outbreak, but without yet incorporating the impact of the restrictive measures adopted by the authorities to reduce the spread of COVID-19. Mining activity recorded strong growth increasing 10.4% y/y, driven by high copper production and a favorable base of comparison, after the heavy rains of February 2019 that paralyzed some production tasks.

For March, meanwhile, our expectations are pessimistic. We estimate that monthly GDP will contract around 4% y/y, due to the paralysis of activities in most of the country. According to our base scenario and due to the magnitude of the shock and its persistence, we would see the worst year-over-year growth records for monthly GDP in April and May, which would be around -8% y/y. The recovery would begin in June.

The spread of COVID-19 has led the authorities to take a series of measures to contain it, such as the temporary closure of commercial shops, curfews, health quarantines and social isolation, which has had strong implications for economic activity, especially in the service sector. This shock, added to the local uncertainty due to the constitutional reform, would leave activity depressed throughout the whole year, with an even worse trajectory than recent previous crisis events.

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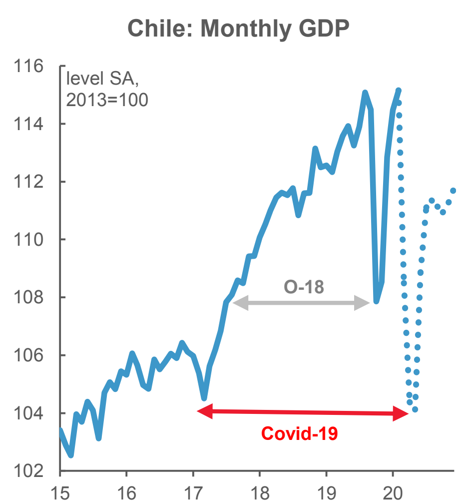
Chart 1



Sources: Central Bank, Scotiabank Economics.

Several high-frequency indicators at the supply and demand level show a strong impact of the restriction measures during the second half of March. Sales from trade sector, as well as external accounts and electricity generation reveal that the magnitude of the shock is even greater than what was seen after October 2019.

MARCH MONETARY POLICY REPORT: ADJUSTING EXPECTATIONS FOR 2020, BUT MAYBE TOO OPTIMISTIC FOR 2021

The base scenario of the last Monetary Policy Report published today by the Central Bank considers that the economy will suffer a significant contraction in the second quarter, but that it will begin to recover from the third quarter onwards. This projection assumes that businesses and households can effectively supplement their income with state support and finance the remaining gap by accessing credit at reasonable costs. With these assumptions, the Central Bank anticipates a contraction centered on 2.1% for 2020 GDP, in line with our estimate of -2.1%. However, the CB estimates an expansion centered on 4.3% for 2021 that we do not share. Although we will have a natural "rebound due to the base of comparison", the extended local political uncertainty makes us project a lower expansion, of 2.9% by 2021.

If the economic stagnation continues as a result of a greater contagion of the COVID-19, and the consequent collapse of health services, the local economy could face a deeper and more lasting recession, with significant effects on the well-being of the population. For this reason, the CB has adopted measures that go beyond the reductions in the MPR and are aimed at facilitating access to credit for individuals and companies.

We have no difference with the Central Bank's inflation projection around 3% for 2020 and marginally less than 3% for 2021. The risks that we see point towards an inflation markedly below 3% for 2021. The Central Bank reveals the TPM corridor in the base scenario, where it is subscribed that we should not initially expect rate increases until the beginning of 2021, an aspect that we agree with, since we do not expect the MPR to exceed 1.5% towards the end of that year.

—Carlos Muñoz

COLOMBIA: FITCH DOWNGRADES COLOMBIA'S RATING TO 'BBB-' AND OUTLOOK REMAINED NEGATIVE

Fitch double-hit Colombia's sovereign credit rating, reducing it by one notch to BBB- (one notch above investment grade) and keeping a negative outlook. Fitch argued that fiscal metrics are likely weakening due to a combination of shocks of lower oil prices and measures to contain the COVID-19 outbreak. Fitch considers that Colombia has low fiscal space to counteract economic shocks. On the other side, the negative outlook reflects the downside risk on economic growth and public finances, given the scale of the shock.

Colombia can lose the investment grade rating, according to Fitch, if fiscal consolidation is not achieved with a stabilization of government debt burden, a deterioration of growth prospects occurs, and sustained external imbalances continue.

Fitch emphasized that although Colombia's macroeconomic policy framework overall remains solid, the predictability and credibility of the medium-term fiscal policy have deteriorated, which is a direct critique on the compliance of the fiscal rule through extraordinary revenues and on the difficulties of raising more structural sources of tax revenues.

Fitch joined S&P giving Colombia the lowest notch in the investment-grade scale and increasing the risk of losing it, keeping a negative outlook. We believe that Fitch's assumptions about economic growth are challenging since they assume contraction of 0.5% GDP in 2020 and a widening of the current account deficit to 4.6% of GDP, which would lead to an increase in net external debt to 17% of GDP. It is worth noting that Colombia remains in investment grade. Moody's has a rating of Baa2 with outlook stable.

—Sergio Olarte & Jackeline Piraján

PERU: INFLATION STABLE IN MARCH; FEBRUARY GROWTH INDICATORS ARE POSITIVE, BUT STALE

COVID-19 cases jumped by 258 to 1,323. The curve is now starting to look a bit more exponential and less like a straight line. But, the curve is a very soft one.

Inflation was 0.65% for the month of March, taking the 12-month figure to 1.8%. Inflation has been stable and in a tight range of just under 2.0% since mid-2019. March inflation takes into account a mild increase in food and beverages, as people stocked up on supplies due to the State of Emergency. Inflation going forward should decline as domestic demand contracts, and lower global oil prices begin to feed through.

Fishing rose 19% in February, cement rose 4.0%, and electricity was 6.2% higher. Together, these figures suggest GDP growth of between 2.5% and 3.0%. The figures, of course, represent a situation pre-COVID-19, and are not very relevant any longer. Together with the 3.0% growth these figures support the idea that the economy had recovered close to 3% growth and was moving along nicely, prior to COVID-19.

The government, by Executive Decree, established that approximately three million people in the private pension fund system, and who have not had a job in the past six months, can access up to S/ 2,000. According to official estimates, this would boost the income in hands of low-income households by S/ 4.5bn. The downside is that the government felt it had to issue a decree, which suggests that it could not reach an agreement with Congress. Congress continues to discuss a much more questionable proposal to allow as much of 25% of funds to be withdrawn, although having been pre-empted by the government may affect the likelihood of it being approved.

—Guillermo Arbe