

Latam Economic Update

- **Argentina:** Government improves debt offer as economy continues to slide
- **Brazil:** PMIs for June show improvement, but imply the economy remained in contraction at the end of Q2
- **Colombia:** Exports still at the lowest level since 2016; fall in June inflation prompts us to expect another -25 bps cut from the BanRep in July
- **Peru:** Mining investment and output down sharply in May; inflation expectations slip unremarkably

ARGENTINA: GOVERNMENT IMPROVES DEBT OFFER AS ECONOMY CONTINUES TO SLIDE

The government [released](#) late on July 5 a new and meaningfully improved set of offer terms for the restructuring of the USD 65 bn of sovereign foreign-law bonds still in default. The new proposal addresses most of the outstanding issues outlined publicly by creditors and we believe it should lead to a deal in the coming weeks.

The main changes include a commitment on the payment of accrued interest via a bond that would mature in 2030, as well as revised terms that envisage smaller principal haircuts, higher coupons, and shorter maturities on debt resulting from the exchange. The new terms envisage that interest payments on step-up coupons would begin in September 2021 versus 2023 in previous offers; the new terms also foresee amortizations beginning from March 2025.

One big surprise is the authorities' concession that would allow holders of bonds from the 2005 exchange to maintain terms from those contracts that make them relatively hard to restructure. Amongst other things, the new proposal would allow creditors holding the 2005 bonds to maintain their collective action clauses and *pari passu* provisions rather than move to model language from ICMA agreed in 2014 that was included in the 2016 "Macri" bonds.

The offer period has been extended further to August 4. This raises the spectre of additional missed payments due in late-July that would need to be capitalized and rolled into the exchange.

Meanwhile, last week's indicators implied that Argentina's economy saw an even rougher Q2 than we and consensus have anticipated. The April EMAE index contracted by -17.5% m/m compared with our call for -13.2% m/m; this translated into a -26.4% y/y retreat (chart 1), which puts Q2 on track for a contraction of well beyond -20% y/y, which would imply our forecast for 2020 would need to be moved from our current -7.9% y/y to a contraction deeper than -9% y/y, assuming some greater proportionate rebound in the latter part of the year, driven in part by a debt deal.

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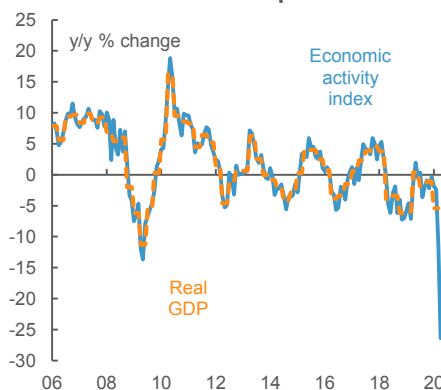
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Chart 1

Argentina: April EMAE Index Points to Worse than Expected Q2



Sources: Scotiabank Economics, INDEC.

—Brett House

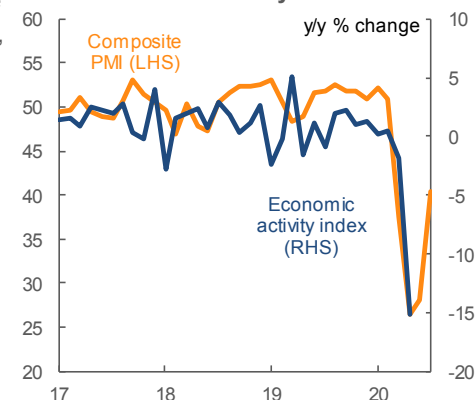
BRAZIL: PMIs FOR JUNE SHOW IMPROVEMENT, BUT IMPLY THE ECONOMY REMAINED IN CONTRACTION AT THE END OF Q2

Consistent with mobility data and the Markit Manufacturing PMI (released July 1), the Services PMI (out July 3) rose in June to 35.9, up from 27.6 in May (chart 2). Green shoots of recovery remain in place, but our sense is that the recovery will continue to follow a stop-and-go pattern, weighed down not only by pandemic-induced disruptions, but also by domestic political uncertainty. The Markit Composite PMI for June consequently saw an important bounce to 40.5, up from 28.1 in May, but remains materially below “expansionary territory” (i.e., above 50), which implies that—despite the important recovery we’ve seen in economic activity at the end of Q2—the economy remained in recession. Next week we plan to publish a broader update to our Brazilian forecasts.

Brazil’s 90-day suspension of its financial transaction tax (IOF) was extended to October 2 from the initial expiry date of July 3, according to a [decree](#) published on July 2. The suspension was initially instituted on April 1 to support financial-sector liquidity during the COVID-19 crisis. The extension of the measure is an acknowledgement that stress remains in Brazil’s financial system, as is the case elsewhere in the region.

Chart 2

Brazil: Composite PMI vs Economic Activity



Sources: Scotiabank Economics, Bloomberg.

Chart 3

—Eduardo Suárez

Colombia: Total Exports

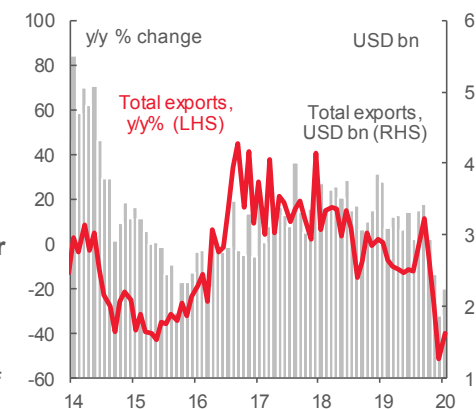
COLOMBIA: EXPORTS STILL AT THE LOWEST LEVEL SINCE 2016; FALL IN JUNE INFLATION PROMPTS US TO EXPECT ANOTHER -25 BPS CUT FROM THE BANREP IN JULY

I. Exports still at the lowest level since 2016

May’s monthly exports hit USD 2.37 bn, according to DANE’s July 3 release, a contraction of -40.3% y/y, which kept Colombia’s exports at their lowest level in four years (chart 3). Mining-related exports contracted by -56.7% y/y due to a significant decline in oil exports (-61.1% y/y) and coal exports (-48.8% y/y). Agricultural exports contracted by -11.7% y/y while manufacturing exports fell -38.4% y/y. May’s export results reflect weakness in demand from foreign business partners and also the negative effect of the strong fall in commodity prices.

Traditional exports contracted by -52.6% y/y in May (chart 4). Coal exports’ aforementioned -48.84% y/y contraction was due to price deteriorations and production declines (-21.11% y/y). Although oil exports in May almost doubled April’s figure, they continued at the lowest levels since 2009 (USD 566 mn). Oil currently represents 25% of total exports compared with 40% of total exports in 2019. The decline in oil-related exports was due to the deterioration in international prices since the volume of oil exports was almost unchanged (-0.8% y/y); in July, we expect reduced volumes to start to weigh on oil exports. Coffee exports declined by -1.25% y/y on lower volumes (-18.51% y/y), which offset favourable effects from international prices.

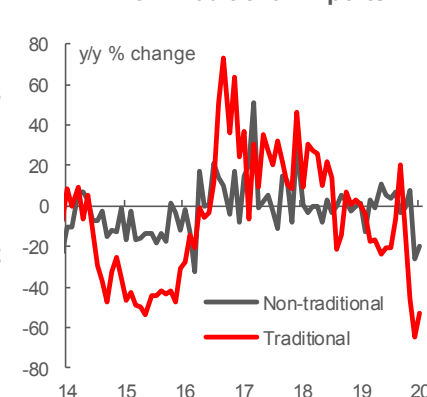
Non-traditional exports were USD 1.13 bn in May, a contraction of -19.8% y/y (chart 4, again). The decrease in agricultural exports was driven by bananas (-35.4% y/y) and flowers (-19.5% y/y). The manufacturing contraction was explained by machinery and equipment (-61.9% y/y) and chemical products (-27.8% y/y).



Sources: Scotiabank Economics, DANE.

Chart 4

Colombia: Traditional vs Non-Traditional Exports



Sources: Scotiabank Economics, DANE.

Overall, May's numbers showed an improvement in export dynamics compared to April's data. The reopening process and the recovery in oil prices could stabilize export values in the coming months. The impact on the external current account should, however, be moderate. The deterioration in mining exports would be offset by a reduction in outflows on the income account, but weaker economic activity would significantly contract imports. All in all, our expectation is for a current account deficit of 4.1% of GDP in 2020 compared with 4.3% in 2019. On the financing side, we think new external government debt issuance worth USD 16 bn should cover the current account deficit and mitigate Colombia's dependence on FDI.

II. Inflation in June contracted by -0.38% m/m; the annual figure is the lowest since 2013; we now expect another -25 bps cut from the BanRep in July

Monthly CPI inflation contracted by -0.38% m/m in June, according to DANE's data published on July 4, which was below market expectations (-0.09% m/m, according to the BanRep survey) and our projection of +0.07% m/m. The June inflation print represented the strongest contraction in the headline rate in nearly ten years (chart 5). Government aid on utility fees and a VAT holiday led the abatement in price pressures (chart 6).

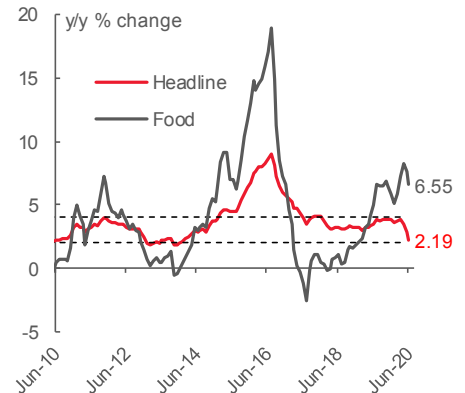
Foodstuffs prices fell -0.11% m/m (chart 7) and rents, although still rising, showed negative demand pressures that decelerated the pace of their gains. The annual inflation rate decreased by 66 bps to 2.19% y/y, the lowest level since 2013 (chart 5, again).

The lodging and utilities group had the most negative contribution to headline inflation in June at -17 bps, which accounted for 45% of the monthly contraction (chart 6, again). Regional governments continued giving subsidies to water and power fees. These subsidies alone subtracted -15 bps from total inflation. Some subsidies were increased in July and this aid will continue for the rest of 2020. Having said that, we expect this effect to reverse in 2021.

Clothing and shoes (-2.06% m/m, chart 7, again) dampened inflation by -8 bps (chart 6, again); the huge contraction was due to the VAT holiday on June 19, but other sub-items, such as entertainment, didn't reflect the same price contraction despite the VAT benefit. Additionally, the IT and communications group, which contributed negatively in the past two months, had neutral inflation in June; if a temporary tax holiday on low-cost cell-phone plans is not extended, it would be a source of new price pressures in August. Transport group prices fell again (-0.53% m/m), contributing -7 bps to monthly inflation. The picture of June's low inflation rate was completed by foodstuffs inflation (-0.11% m/m), fruits (-5.93% m/m), and eggs (-0.02% m/m) where price contractions were partially offset by increases in chicken prices, which are showing pass-through effects from the FX depreciation and higher demand. However, the majority of food prices were relatively stable and could remain low for the rest of the year.

Chart 5

Colombia: Headline CPI vs Foodstuffs



Sources: Scotiabank Economics, DANE.

Chart 6

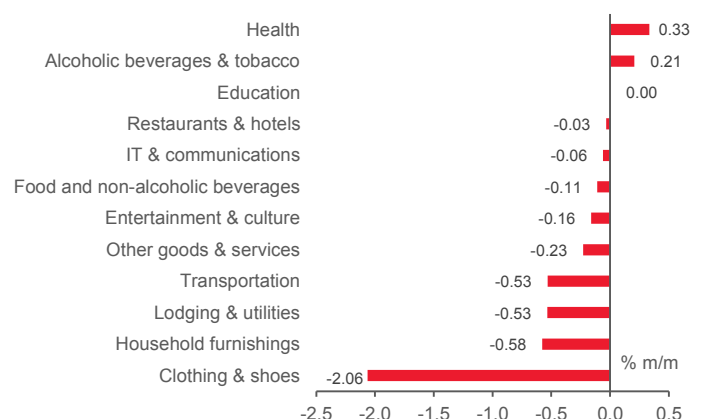
Colombia: CPI Contributions



Sources: Scotiabank Economics, DANE.

Chart 7

Colombia: CPI Components



Sources: Scotiabank Economics, DANE.

Tradable goods ex-food inflation decreased by -73 bps to 0.61% y/y, which implies that weaker demand could offset effects from FX depreciation. Non-tradable inflation stood at 2.13% y/y, while regulated inflation decreased by -183 bps to 0.78% y/y, which could be partially reversed when regional subsidies to utility fees expire.

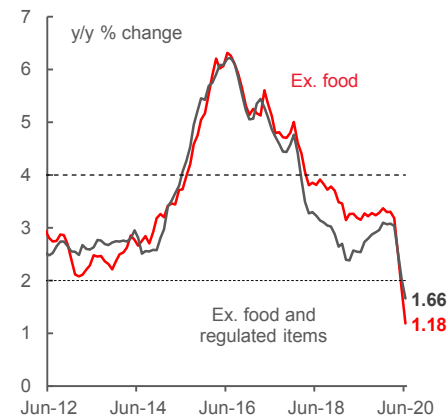
Core inflation measures fell again well below the central bank target range (chart 8). Ex-food inflation came in at 1.18% y/y (-66 bps from the previous month), while ex-food and regulated items inflation decreased by -37 bps to 1.66% y/y.

Altogether, CPI inflation is still distorted by the downward effect of government programs and subsidies, but this should dampen in the coming months. Although these effects should continue in July; a partial reversal is expected in August if the government lifts some subsidies. In 2021, we expect additional offsetting effects that would lead inflation to rise again to the BanRep's 3% target.

Either way, the June CPI results now skew our expectations on monetary policy toward another -25 bps cut to 2.25% at the July 31 BanRep meeting, with the central bank remaining data dependent thereafter. We had previously expected the central bank to hold at a terminal rate of 2.50% after its quarter-point cut at its June 30 meeting. Since the decline in CPI inflation is partially artificial and could potentially be reversed, we think that monetary policy would not overreact to June's inflation result. We will lay out our thinking in more depth in the *Latam Weekly* at the end of this week.

Chart 8

Colombia: Core CPI Measures



Sources: Scotiabank Economics, DANE.

—Sergio Olarte & Jackeline Piraján

PERU: MINING INVESTMENT AND OUTPUT DOWN SHARPLY IN MAY; INFLATION EXPECTATIONS SLIP UNREMARKABLY

Mining investment fell -43% y/y in May. This was expected, given the lockdown. Mining investment is down -24.5% y/y in the year to May, which is in line with our expectations of a -28% y/y decline for the full year. June will be a better, but still sub-par, month for mining investment, as projects take their time to get fully back on track. The important aspect to consider is that there has been no announcement of a major project being abandoned.

Metals output was down for pretty much all metals and mining companies in May. Copper production fell -41% y/y. Output at Antamina was halted during the month, whereas most other major companies continued producing to some extent. Zinc output fell even more, down -76% y/y. The difference is that copper operations are mainly open pit, which were allowed to operate in May, whereas zinc comes mostly from underground mines which were locked down. Gold output fell -65% y/y and silver was down a similar -66% y/y.

The BCRP released on July 3 the results of its most recent survey of expectations. Inflation expectations for the next twelve months declined a couple of notches to 1.4% y/y, which is not surprising: our own expectations are in this vicinity. Typically, the BCRP will use the survey's read of inflation expectations as the comparison base to establish its reference rate, decreasing or increasing the spread between the two depending on how expansionary or contractionary it wishes to be. In the current situation of a deep economic contraction, however, providing liquidity is paramount and, as a result, the BCRP is likely to hold the reference rate at 0.25% regardless of changes in inflation expectations.

—Guillermo Arbe

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