July 13, 2020

Latam Economic Update

- **Argentina: June inflation expected to hold at 1.5% m/m**
- **Mexico: May Industrial production shrank more than consensus expected**
- **Peru: May trade and fiscal accounts were as bleak as expected given the lockdown, but not worse**

ARGENTINA: JUNE INFLATION EXPECTED TO HOLD AT 1.5% M/M

June inflation numbers come out on Wednesday, July 15, and we expect the headline rate to hold at 1.5% m/m owing to capital controls that are propping up the official value of the ARS, domestic price controls on utilities, official monitoring of thousands of prices to discourage increases, and the recessionary effects of the lockdown. A monthly print at this rate implies that annual inflation will fall to between 41% and 42% y/y in June owing to base effects from last year, which would be the lowest annual rate since Q3-2018.

We expect the four factors holding the official price index down to persist through the end of the year. This would bring annual inflation down to a temporary low at 25.7% y/y by December 2020, its softest rate since April 2018, before heading back up in 2021.

—Brett House

MEXICO: MAY INDUSTRIAL PRODUCTION SHRANK MORE THAN CONSENSUS EXPECTED

Figures published on July 10 for May industrial production showed the biggest single-month decline since records have been available (from 1993), going from -29.3% y/y in April to -30.7% y/y, versus -3.1% y/y in May 2019. For a second month in a row, the fall in IP surpassed by a wide margin the drop anticipated by the consensus (-25.6% y/y).

- **The May results were driven by a more pronounced fall in manufacturing,** from -35.4% y/y to -37.1% y/y (versus 0.7% y/y in May 2019), which made for eight consecutive months with manufacturing growth in negative territory (chart 1). A slightly lesser, yet still significant, plunge in construction, which went from -37.9% y/y to -36.3% y/y (versus -9.6% y/y in May 2019), also contributed. Smaller pullbacks were recorded in utilities, from -3.4% y/y to -13.1% y/y (versus 3.6% y/y in May 2019), and mining, from -3.9% y/y to -5.9% y/y (versus -8.9% in May 2019).
- **In the January–May period,** industrial production averaged a monthly decline of -13.7% y/y (versus -1.4% y/y for the same stretch in 2019), its weakest pace for a similar period since records have existed (chart 2).
- **Within manufacturing, which accounted for 54.9% of total industry as of Q1-2020,** all of its sub-components observed annual declines. Eight out of 21 sub-sectors saw record contractions: food, wood, paper, chemical, plastics

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Chart 1

Source: Scotiabank Economics, INEGI.

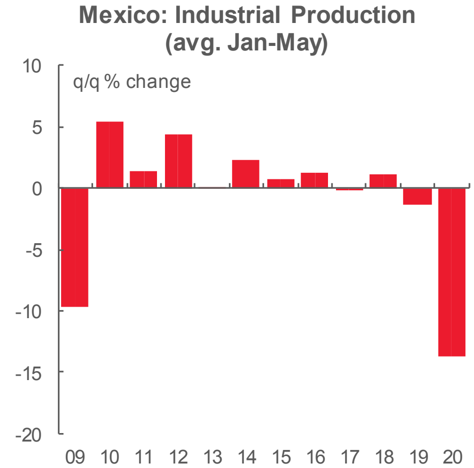
and rubber, metal products, machinery and equipment, and electrical generation equipment.

- **Similarly, the annual decrease in construction was driven by an exceptional drop in its three sub-components.**
- **In mining,** the sector's dynamics were explained mainly by a reduction in oil extraction after the entry into force of the cuts in production agreed during April's OPEC meeting.

In sum, despite the reopening of some sectors in mid-May, industrial production fell further from the sharp annual drop that it saw in April and produced a new, record decline in May. Even though some components of the previously released May trade data already pointed to an unfavourable outlook for industrial activity, the May IP print revealed a much larger contraction than expected, which could motivate further downward revisions to 2020's prospects for economic growth.

—Daniel Mendoza

Chart 2

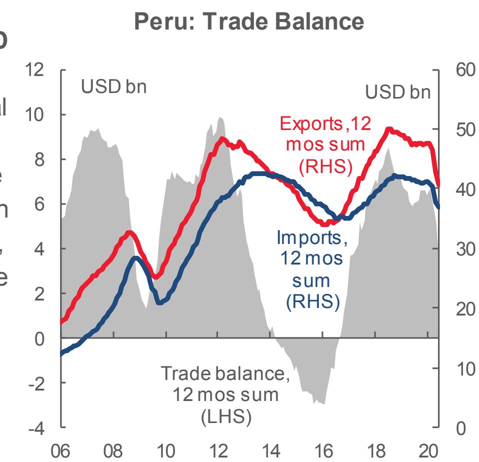


Source: Scotiabank Economics, INEGI.

PERU: MAY TRADE AND FISCAL ACCOUNTS WERE AS BLEAK AS EXPECTED GIVEN THE LOCKDOWN, BUT NOT WORSE

The trade balance for May, released on Friday, July 10, registered a very mild USD 229 mn deficit. The details were bleak, but May was in the midst of the lockdown period, so all economic variables from that time will look weak and divorced from normal conditions. Exports fell -47% y/y in May, led by mining exports, which were down -52% y/y. This is not surprising, given that mining production was down nearly -50% y/y in the month. More encouragingly, agro-industrial exports growth was nearly flat (-0.8% y/y), in line with our view that the sharper decline in April was due to supply-chain logistics (i.e., difficulties in obtaining packaging supplies) and that agro-industrial output itself was little impacted by the lockdown. Interestingly, the BCRP has begun releasing month-on-month growth figures. Exports in May were up 7.7% m/m from April; June should be even better.

Chart 3



Sources: Scotiabank Economics, Bloomberg.

Imports fell -38% y/y, in May. The decline in capital goods imports was particularly marked at -45% y/y as most investment projects were at least partially halted during May. The Quellaveco copper project was a significant exception. Consumer goods imports fell -31% y/y, which was not all that bad for a lockdown month. Consumer goods imports should recover more significantly with the unlocking of the economy. However, capital goods imports growth and oil imports growth (due to low prices) are likely to continue to be negative throughout the remainder of the year. Imports in May were -1.1% m/m lower than April.

Despite the temporary deficits during the April–May lockdown, the trade balance for the year-to-May continued to be a negligibly positive at USD 230 mn. With mining and agro-industrial exports normalizing, terms of trade increasingly moving in Peru's favour, and imports growth remaining rather low, the trade balance should turn decidedly more positive once again by July, and remain in the black for the foreseeable future. As it is, we maintain our forecast of a USD 6.6 bn trade surplus for full-year 2021.

The fiscal deficit in H1-2020 came in at PEN 11.2 bn. This represented a sharp turnaround from a PEN 9.8 bn surplus for the same period in 2019. Tax revenue was down -20.4% y/y in H1-2020, as Peru's main income tax season, March–May, fell in the middle of the lockdown. Income tax revenue fell -13% y/y in H1-2020, in part due to tax relief measures that allowed businesses and individuals to defer their tax payments. Some of this revenue will be seen later on in the year; however, sales tax revenue, down -19% y/y, will mostly not be recovered.

Meanwhile, government spending fell by only -1.3% y/y, in H1-2020. Government current spending rose 10% y/y, whereas public investment plunged -42% y/y. This is not surprising, but it is a disappointment that fiscal spending is not being mobilized adequately to counter the crisis. On the positive side, low government spending is keeping the overall fiscal deficit smaller than would otherwise be the case. In fact, the fiscal balance is trending more in line with a 5% of GDP fiscal deficit than with our forecast of 9%. There is, however, still time for the government to pick up its spending pace. We expect this to happen, although we continue to have doubts about the State's capacity to spend as fully as we would all like. Given this, although it's too early to change our 9% deficit, we are starting to see a greater downside risk to it.

—Guillermo Arbe