Latam Weekly: Weathering the Storm

FORECAST UPDATES

- Our forecasts feature two major updates this week. First, in Brazil: following the collapse in PMIs and the BCB's 75 bps cut to the Selic this past week, we now expect the easing cycle to terminate at 2.00% (down from 3.00%) before FX pass-through and lower potential growth force the Copom to reverse course in 2021. Second, Peru's growth outlook has soured despite the authorities' extensive policy support: we now expect a contraction of -9.0% y/y in 2020 (previously -2.3% y/y) followed by a 7.0% y/y rebound in 2021 (previously 4.5% y/y).

ECONOMIC OVERVIEW

- Latam now finds itself in the eye of the COVID-19 storm. We break down how the region's policymakers and economies are adjusting as the pandemic unfolds.

MARKETS REPORT

- Sovereign yield curves across Latam have steepened throughout the COVID-19 crisis as short-end rates have come down with monetary easing while longer-term rates have moved up on the liquidation of risk assets. We look at the prospects for curves to flatten as monetary policy expectations stabilize and appetite for duration improves.

COUNTRY UPDATES

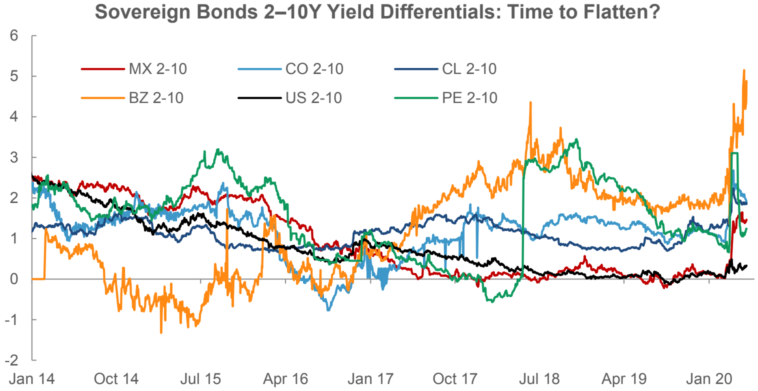
- Concise analysis of recent developments and guides to the week ahead in our Latam-6: Argentina, Brazil, Chile, Colombia, Mexico, and Peru.

MARKET EVENTS & INDICATORS

- Risk calendar with selected highlights for the period May 9–May 15 across our six major Latam economies.

Chart of the Week

Sovereign Bonds 2–10Y Yield Differentials: Time to Flatten?



Sources: Scotiabank Economics, Bloomberg.

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Forecast Updates: May 9

	2019	2020				2021						
Argentina	**Q4**	**Q1e**	**Q2f**	**Q3f**	**Q4f**	**Q1f**	**Q2f**	**Q3f**	**Q4f**	**2019**	**2020f**	**2021f**
Real GDP (y/y % change)	-1.1	-2.3	-12.4	-4.9	-3.3	0.3	3.1	5.9	7.5	-2.2	-5.6	4.2
CPI (y/y %, eop)	53.8	48.4	49.0	46.8	45.7	51.1	50.4	48.9	46.8	53.8	45.7	46.8
Unemployment rate (%, avg)	8.9	10.9	11.3	11.0	10.8	10.6	10.2	9.9	9.8	9.8	11.0	10.1
Central bank policy rate (%, eop)	55.00	38.00	37.00	36.00	36.00	36.00	37.00	38.00	40.00	55.00	36.00	40.00
Foreign exchange (USDARS, eop)	59.9	64.4	73.4	79.1	83.1	86.2	87.5	89.2	93.1	59.9	83.1	93.1

	2019	2020				2021						
Brazil	**Q4**	**Q1e**	**Q2f**	**Q3f**	**Q4f**	**Q1f**	**Q2f**	**Q3f**	**Q4f**	**2019**	**2020f**	**2021f**
Real GDP (y/y % change)	1.7	0.2	-9.3	-4.3	-0.3	1.1	4.2	3.1	1.7	1.1	-3.4	2.5
CPI (y/y %, eop)	3.8	3.3	4.2	5.2	6.3	7.1	7.9	7.6	7.1	4.3	6.3	7.1
Unemployment rate (%, avg)	11.3	11.8	12.7	12.8	12.6	13.2	13.6	13.6	13.4	11.9	12.5	13.5
Central bank policy rate (%, eop)	6.50	3.75	2.25	2.00	2.00	3.00	4.00	4.75	5.75	4.50	2.00	5.75
Foreign exchange (USDBRL, eop)	4.02	5.25	5.71	5.11	4.78	4.81	4.69	4.58	4.42	4.02	4.78	4.42

	2019	2020				2021						
Chile	**Q4**	**Q1e**	**Q2f**	**Q3f**	**Q4f**	**Q1f**	**Q2f**	**Q3f**	**Q4f**	**2019**	**2020f**	**2021f**
Real GDP (y/y % change)	-2.1	-0.6	-6.6	-2.6	1.3	0.9	6.6	2.1	2.2	1.1	-2.1	2.9
CPI (y/y %, eop)	3.0	3.7	2.9	3.1	2.8	2.5	2.9	3.3	3.0	3.0	2.8	3.0
Unemployment rate (%, avg)	7.0	7.8	9.0	8.5	8.0	7.8	7.8	7.8	7.5	7.2	8.3	7.7
Central bank policy rate (%, eop)	1.75	0.50	0.50	0.50	0.50	1.00	1.25	1.50	1.50	1.75	0.50	1.50
Foreign exchange (USDCLP, eop)	753	860	820	800	790	780	760	740	720	753	790	720

	2019	2020				2021						
Colombia	**Q4**	**Q1e**	**Q2f**	**Q3f**	**Q4f**	**Q1f**	**Q2f**	**Q3f**	**Q4f**	**2019**	**2020f**	**2021f**
Real GDP (y/y % change)	3.4	3.2	-8.4	-4.4	0.4	-1.0	9.8	4.3	1.4	3.3	-2.3	3.6
CPI (y/y %, eop)	3.2	3.9	3.3	3.1	3.2	3.0	3.2	3.1	3.1	3.8	3.2	3.1
Unemployment rate (%, avg)	10.4	12.6	20.9	20.5	17.8	14.8	13.1	12.6	12.1	11.2	18.0	13.2
Central bank policy rate (%, eop)	4.25	3.75	2.50	2.50	2.50	2.50	2.75	3.25	3.50	4.25	2.50	3.50
Foreign exchange (USDCOP, eop)	3,287	4,065	3,950	3,851	3,654	3,473	3,465	3,458	3,450	3,287	3,654	3,450

	2019	2020				2021						
Mexico	**Q4**	**Q1e**	**Q2f**	**Q3f**	**Q4f**	**Q1f**	**Q2f**	**Q3f**	**Q4f**	**2019**	**2020f**	**2021f**
Real GDP (y/y % change)	-0.5	-3.4	-15.1	-10.3	-4.7	-1.0	3.4	1.5	0.9	-0.1	-8.4	1.1
CPI (y/y %, eop)	2.8	3.2	2.2	2.8	2.6	2.8	3.9	3.9	3.8	2.8	2.6	3.8
Unemployment rate (%, avg)	3.4	3.7	6.7	7.7	7.1	6.3	6.0	6.5	5.8	3.5	6.1	6.3
Central bank policy rate (%, eop)	7.25	6.50	5.50	5.00	5.00	5.00	5.00	5.00	5.00	7.25	5.00	5.00
Foreign exchange (USDMXN, eop)	18.93	21.97	24.25	24.03	24.24	24.29	24.07	24.02	24.15	18.93	24.24	24.15

	2019	2020				2021						
Peru	**Q4**	**Q1e**	**Q2f**	**Q3f**	**Q4f**	**Q1f**	**Q2f**	**Q3f**	**Q4f**	**2019**	**2020f**	**2021f**
Real GDP (y/y % change)	1.8	-6.0	-23.3	-5.8	-1.1	3.4	19.8	4.0	3.5	2.2	-9.0	7.0
CPI (y/y %, eop)	1,9	1.8	1.6	1.3	1.1	1.2	1.3	1.8	2.2	1.9	1.1	2.2
Unemployment rate (%, avg)	6.1	…	…	…	…	…	…	…	…	6.6	12.0	10.0
Central bank policy rate (%, eop)	2.25	1.25	0.25	0.25	0.25	0.75	1.00	1.25	1.50	2.25	0.25	1.50
Foreign exchange (USDPEN, eop)	3.31	3.43	3.49	3.47	3.45	3.42	3.43	3.39	3.40	3.31	3.45	3.40

	2019	2020				2021						
United States	**Q4**	**Q1e**	**Q2f**	**Q3f**	**Q4f**	**Q1f**	**Q2f**	**Q3f**	**Q4f**	**2019**	**2020f**	**2021f**
Real GDP (y/y % change)	2.3	-0.4	-12.4	-7.7	-4.7	-0.4	14.4	9.2	6.0	2.3	-6.3	7.0
CPI (y/y %, eop)	2.0	2.1	0.8	0.1	-0.3	0.7	1.4	2.1	2.8	2.0	-0.3	2.8
Unemployment rate (%, avg)	3.5	3.8	10.3	11.5	11.6	10.8	9.4	8.1	6.9	3.7	9.3	8.8
Central bank policy rate (%, eop)	1.75	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	1.75	0.25	0.25
Foreign exchange (EURUSD, eop)	1.12	1.08	1.09	1.10	1.12	1.13	1.14	1.15	1.16	1.12	1.12	1.16

Source: Scotiabank Economics.
Red indicates changes in forecasts since last report.

Forecast Updates: March—May Revisions

	March 25		May 9	
	2020f	2021f	2020f	2021f
Argentina*				
Real GDP (annual % change)	-2.4	1.7	-5.6	4.2
CPI (y/y %, eop)	66.0	42.0	45.7	46.8
Unemployment rate (%, avg)	...	...	11.0	10.1
Central bank policy rate (%, eop)	42.00	38.00	36.00	40.00
Argentine peso (USDARS, eop)	82.0	76.0	83.1	93.1
Brazil				
Real GDP (annual % change)	-3.0	1.5	-3.4	2.5
CPI (y/y %, eop)	7.3	8.2	6.3	7.1
Unemployment rate (%, avg)	...	...	12.5	13.5
Central bank policy rate (%, eop)	4.75	8.25	2.00	5.75
Brazilian real (USDBRL, eop)	4.84	4.49	4.78	4.42
Chile				
Real GDP (annual % change)	-2.1	2.9	-2.1	2.9
CPI (y/y %, eop)	3.0	3.0	2.8	3.0
Unemployment rate (%, avg)	...	...	8.3	7.7
Central bank policy rate (%, eop)	0.50	2.00	0.50	1.50
Chilean peso (USDCLP, eop)	790	720	790	720
Colombia				
Real GDP (annual % change)	1.2	2.8	-2.3	3.6
CPI (y/y %, eop)	2.9	3.0	3.2	3.1
Unemployment rate (%, avg)	...	...	18.0	13.2
Central bank policy rate (%, eop)	3.50	4.25	2.50	3.50
Colombian peso (USDCOP, eop)	3,654	3,450	3,654	3,450
Mexico				
Real GDP (annual % change)	-5.8	1.8	-8.4	1.1
CPI (y/y %, eop)	4.4	4.1	2.6	3.8
Unemployment rate (%, avg)	...	...	6.1	6.3
Central bank policy rate (%, eop)	6.00	6.00	5.00	5.00
Mexican peso (USDMXN, eop)	22.84	22.74	24.24	24.15
Peru				
Real GDP (annual % change)	0.3	3.5	-9.0	7.0
CPI (y/y %, eop)	1.4	2.0	1.1	2.2
Unemployment rate (%, avg)	...	...	12.0	10.0
Central bank policy rate (%, eop)	1.00	1.75	0.25	1.50
Peruvian sol (USDPEN, eop)	3.45	3.40	3.45	3.40

Source: Scotiabank Economics.
* Initiated coverage March 22, 2020.
Red indicates changes in forecasts since last report.

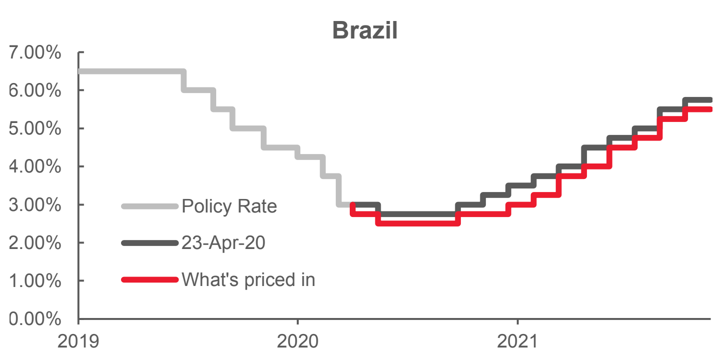
Forecast Updates: Central Bank Policy Rates and Outlook

Latam Central Banks: Policy Rates and Outlook

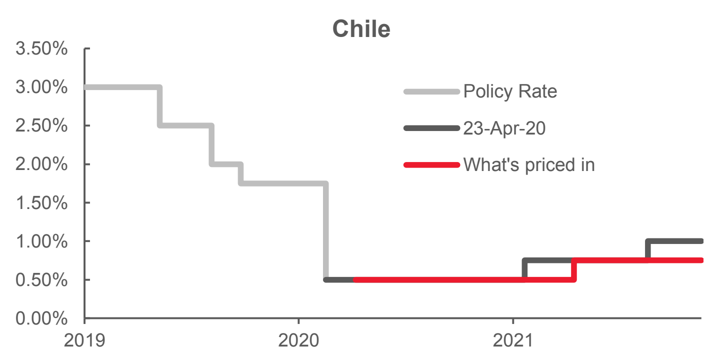
	Current	Next Scheduled Meeting Date	Market	BNS	Market Pricing 12 mos	24 mos	BNS Forecast End-2020	End-2021	BNS guidance for next monetary policy meeting
Argentina, BCRA, TPM, n.a.	38.00%	n.a.	n.a.	37.00%	n.a.	n.a.	36.00%	40.00%	The BCRA's last move on March 5 delivered its sixth rate cut in 2020, but economic activity indicators since then still point to a deepening slowdown. We expect the BCRA to cut again in the coming weeks.
Brazil, BCB, Selic	3.00%	Jun-17	2.70%	2.25%	3.61%	5.91%	2.00%	5.75%	The BCB has left the door open to a 75 bps cut in the Selic at its next meeting; we think economic softness will prompt another 25 bps cut to follow.
Chile, BCCh, TPM	0.50%	Jun-16	0.50%	0.50%	0.65%	0.91%	0.50%	1.50%	The BCCh mantained the MPR at 0.5%, its technical minimum, in its May 6 meeting. The bias of its press release was toward intensifying monetary impulse and supporting financial stability with unconventional instruments, if required.
Colombia, BanRep, TII	3.25%	Jun-26	2.68%	2.75%	2.49%	2.88%	2.50%	3.50%	BanRep will continue providing liquidity to the local and FX markets. May's meeting was not scheduled to be a monetary-policy rate decision meeting, but in his April 30 press conference Gov. Echavarria indicated that the meeting would be live.
Mexico, Banxico, TO	6.00%	May-14	5.06%	5.50%	4.06%	4.36%	5.00%	5.00%	Banco de Mexico is implementing the additional measures to provide liquidity and promote an orderly functioning of financial markets that it announced at its April 21 emergency meeting. Another 50 bps cut is expected by the next meeting, while the probability of more cuts is increasing.
Peru, BCRP, TIR	0.25%	Jun-11	n.a.	0.25%	n.a.	n.a.	0.25%	1.50%	The BCRP maintained its policy rate at 0.25%, as expected, at its May 7 meeting. The BCRP stated, in its policy release, that monetary policy will be expansionary for a long time, lending credence to our expectations that the 0.25% rate will persist throughout 2020. The release also stressed that BCRP would continue to provide liquidity through repos, swaps, and lending facilities for as long as is needed.

Sources: Scotiabank Economics, Bloomberg.

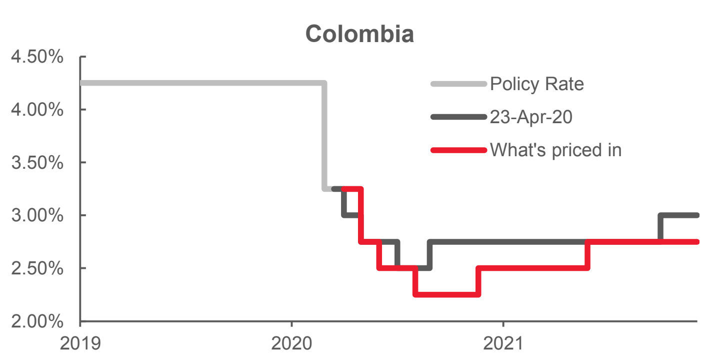
What's Priced In



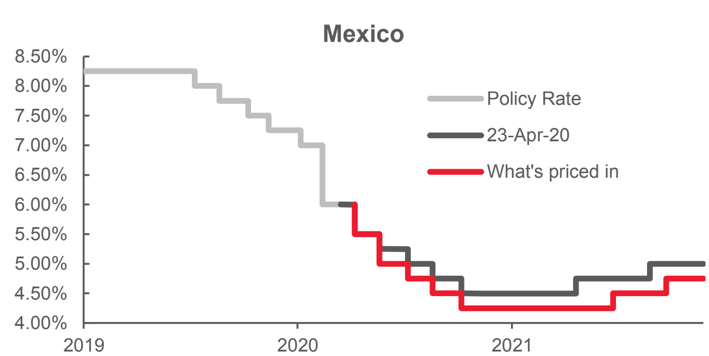
Source: Scotiabank GBM.



Source: Scotiabank GBM.



Source: Scotiabank GBM.



Source: Scotiabank GBM.

Economic Overview: In the Eye of the Tempest

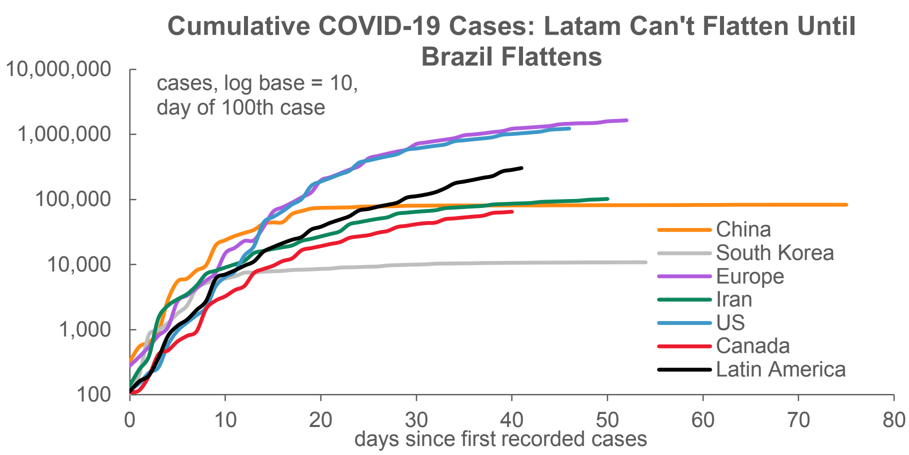
- **The Latam COVID-19 curve's slope hasn't altered in six weeks and is unlikely to flatten so long as numbers in Brazil continue to surge.**
- **Our assessment of the economic impact of pandemic control measures is worsening and we now expect a -9% y/y contraction in Peru's economy in 2020.**
- **Across the region, monetary authorities are easing policy rates even more than we previously anticipated and are complementing low rates with unconventional measures as QE comes to Latam.**

COVID-19: FLATTENING ELUSIVE WHEN BRAZIL IS STEEPENING

Latam just recorded its sixth week in a row where its new COVID-19 case numbers have steadily increased (chart 1) and its incidence curve has persistently failed to flatten (chart 2) even as curves elsewhere have seen their slopes start to come down. For the Latam region as a whole, numbers continue to double roughly every 10 days. Latam now accounts for 8.3% of global cases, up from 2.4% on April 8. Brazil now ranks 8th in the world in terms of total numbers, up from 10th last week, while Peru sits at 13th, Mexico at 18th, Chile at 23rd.

Brazil's accelerating case count makes it particularly difficult for Latam's curve to flatten (chart 3). Per capita numbers continue to rise steeply in Peru, Chile, and Brazil, despite the stark contrast in their policymakers' approaches to confronting the pandemic (chart 4). Whereas Brazil's national response remains conflicted, and much of the leadership in dealing with COVID-19 has fallen to state and local governments, Peru acted quickly and decisively to bring in one of the most comprehensive lockdowns in the world and complemented it with immediate compensatory monetary easing, credit instruments, and fiscal spending on a scale that compares favourably with most industrialized countries. The novel coronavirus' arrival in US President Trump's White House and the second wave hitting Singapore implies that even comprehensive measures can be porous to ongoing contagion.

Chart 2



Sources: Scotiabank Economics, Johns Hopkins University.

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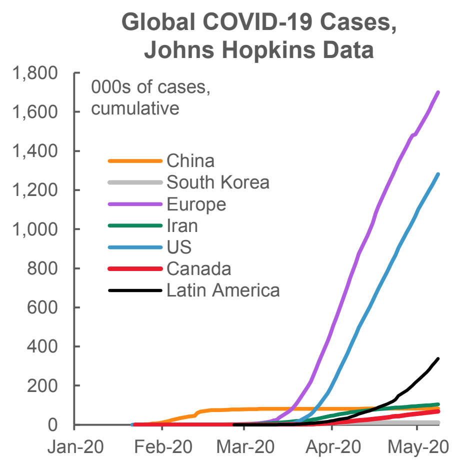
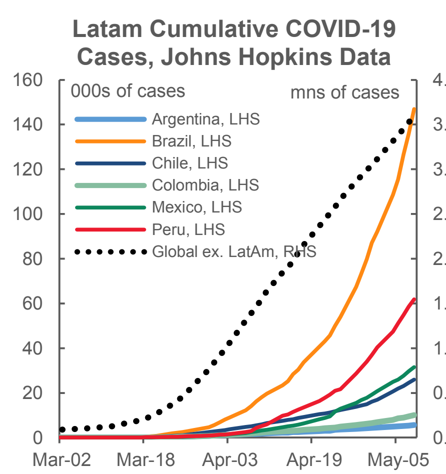
Chart 1



Sources: Scotiabank Economics, Johns Hopkins University.

Chart 3



Sources: Scotiabank Economics, Johns Hopkins University.

THE WORST ISN'T QUITE OVER

The economic implications of the COVID-19 pandemic in Latam continue to deepen as the pandemic intensifies in the region. Previous editions of the *Latam Weekly* have explored how forecasts have been marked down by the crisis, assessed the monetary and fiscal space available to Latam's public authorities to support domestic economic activity, and the extent to which they're availing themselves of this space and going beyond it. While last week we had a sense that our outlook may be stabilizing, developments continue to move beyond the outer envelope of what we've previously anticipated.

Our forecasts have deteriorated substantially in Peru, where this past week the Economy Minister admitted that the country's lockdown had not yet produced its expected results. At the same time, economic activity has suffered despite a suite of spending and credit measures that amount more than 12% GDP. This week's Country Update on Peru (see p. 18) details analysis by our team in Lima on the depth of the downturn. Up until March 25 we had expected Peru to eke out 0.6% y/y growth in 2020. In April, we moved our forecast to a contraction of -2.3% y/y in 2020, but we now foresee a -9.0% y/y drop (chart 5); this revision is balanced off by a stronger rebound in 2021, albeit from a lower base, at -7.0% y/y compared with our previous forecast for growth in 2021 of -4.5% y/y.

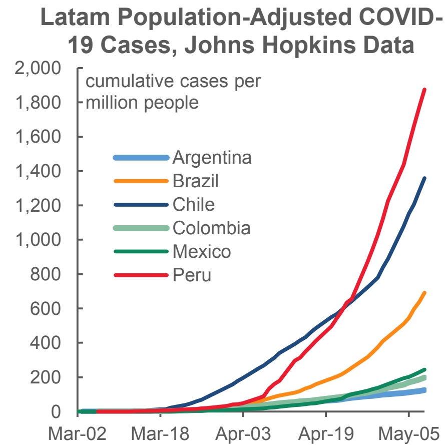
MORE MONETARY POLICY EASING COMING

This past week saw monetary policy in Latam move into a new realm with historic lows in policy rates set to be matched with a widening range of unconventional policy measures, including asset purchases. In Brazil, the BCB's Copom cut the Selic, the principal policy rate, to 3.00%, a record low (chart 6) and left the door open to a further "final" cut at its next meeting. The next cut could be as large as the 75 bps reduction the Committee delivered at its meeting on May 6. With headline inflation at 2.40% y/y in April, the real Selic rate remains narrowly in positive territory only because inflation slowed from 3.30% y/y in March. Our Brazil economist projects inflation to pick up by end-2020 as FX pass-through effects and idled businesses cut the potential rate of growth.

With policy rates falling even further than we previously expected (chart 7) and the inflation outlook unlikely to moderate much more (chart 8), Brazil's real policy rate joins those in Chile and Peru in strongly negative territory based on expected inflation one year out (chart 9). The minutes from the May 6 Copom meeting will be published on Tuesday, and will likely reiterate the dovish tone of this past week's rate decision. We now forecast Brazil's Selic to hit a 2.00% terminal rate before monetary policy reverses itself next year (chart 7, again). Colombia is likely to join the negative real-rate club in the coming weeks, based on our forecasts and the BanRep's indications that further, gradual policy rate cuts lie ahead.

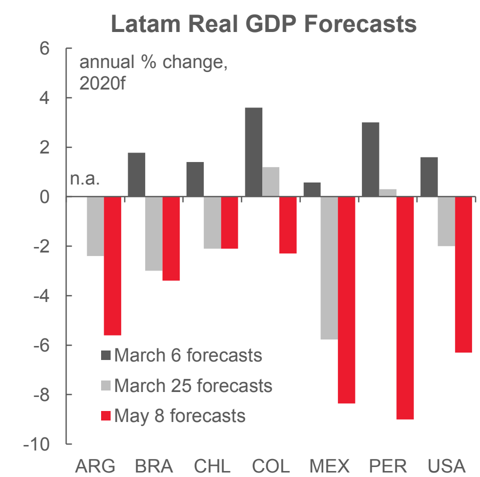
Mexico's Banxico meets on Thursday, 14 May, and our team in Mexico City expects the monetary policy committee to deliver another 50 bps cut to 5.50%, with the nontrivial possibility of an even bigger move. The stabilization of the MXN in recent weeks—up 1.7% over the last month and 3.9% over the last week—gives Banxico a bit of additional room to maneuver. We expect the easing cycle to end at 5.00% in a subsequent meeting, but the market is pricing a further drop to nearly 4.00%.

Chart 4



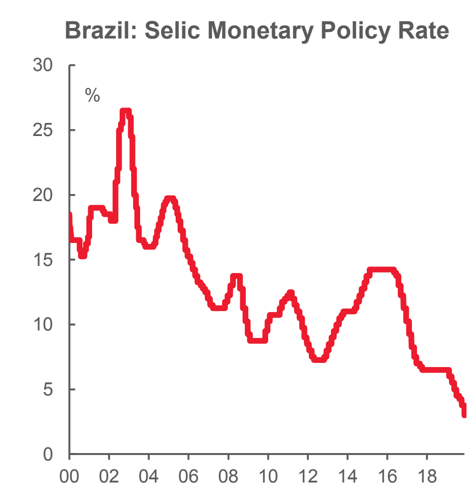
Sources: Scotiabank Economics, Johns Hopkins University, United Nations.

Chart 5



Source: Scotiabank Economics.

Chart 6



Sources: Scotiabank Economics.

NEW TERRITORY FOR NEGATIVE RATES AND FLOATING EXCHANGE RATES

Negative rates at these levels don't have much recent precedent in emerging markets and they speak to the great extent to which policy makers in Latam are moving decisively to ease monetary policy regardless of whether traditional indicators imply that they have the space to do so. The region's currencies have been allowed to float to a greater extent than in the past and act as shock absorbers in the face of large capital outflows. That said, those economies with the strongest fundamentals going into the crisis—and those with the most decisive policy responses to the pandemic--have seen some of the smaller hits to their exchange rates: YTD, the PEN is down only 2.9%, while the CLP has lost 9% and COP about 15%; in contrast, the MXN is down 20% and the BRL is off nearly 30%, both YTD. Markets are rewarding effective policy making.

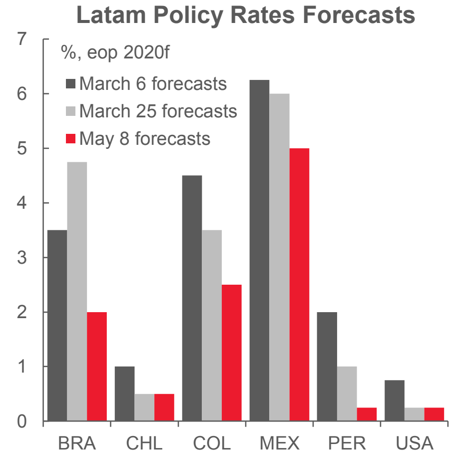
UNCONVENTIONAL MONETARY POLICY MEASURES EXPANDING

Negative real policy rates in Latam are being complemented by the spread of complementary central bank measures to ensure domestic credit markets function smoothly, including through new lending facilities and even asset purchases. Having hit the effective lower bounds on their policy rates, the central banks in both Peru and Chile are moving on additional measures. In Peru, the BCRP is already using stepped up repo operations to inject additional liquidity into the system, while assisting the government with a guaranteed lending facility for businesses. In the statement on its May 7 policy decision, the BCRP also indicated that it is looking at the creation of a lending program for the AFP private pension funds to help them avoid selling assets to fund withdrawals under temporary emergency rules that give Peruvians expanded access to their retirement funds. Similarly, Chile's BCCh, in its May 6 policy statement, reiterated its concern about the health of SMEs and may create a financing program for them. Similarly, Mexico's Banxico has begun to implement the broad set of measures it announced at its emergency April 21 meeting, which included enhancement of its liquidity facilities, an expanded range of collateral and counterparties, and a targeted financing facility for SMEs.

Speculation has stepped up that quantitative easing (QE) could become as ubiquitous in emerging markets as it has increasingly become in industrialized countries. On May 6, Brazil's Congress passed legislation that will allow the BCB to purchase nearly BRL 1 tn in corporate debt. This complements its re-initiation in March of repo operations on sovereign paper for the first time since 2008, and credit measures for SMEs launched in April. On May 7, Brazil's Congress also approved a legislation that will allow the BCB to buy government bonds in the primary market.

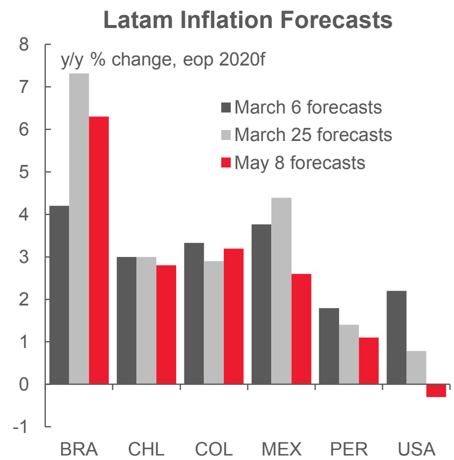
Similar changes may be coming in both Chile and Colombia, where there is speculation that their central banks could soon be empowered to effect QE. Colombia's BanRep already engages in secondary-market purchase of its government's sovereign paper and holds about 5% of the government's total issuance, according to BanRep and IIF data, but without an explicit objective of yield-curve control. Of course, Argentina's BRCA has actively monetized fiscal deficits since the country again became shut out of credit markets in recent months. In the rest of the emerging world, central banks in Turkey and South Africa have also recently initiated small steps to purchase their sovereign's bonds.

Chart 7



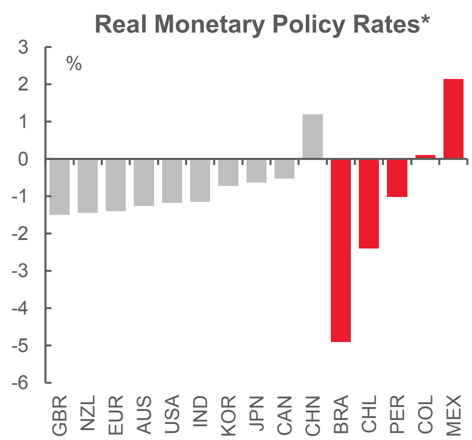
Argentina: 36%.
Source: Scotiabank Economics.

Chart 8



Argentina: 45.7%.
Source: Scotiabank Economics.

Chart 9



* Real monetary policy rate = current policy rate - BNS expected inflation, end-Q2-2021, % y/y.
Sources: Scotiabank Economics, Bloomberg.

POLICYMAKERS ADJUST LOCKDOWNS

As the eye of the COVID-19 storm settles into Latam, policy makers have adjusted their re-opening plans, but are now faced in some cases with decisions on whether and how to extend them even further.

- **Argentina.** The national quarantine was extended on April 26 to May 10. Targeted re-openings in rural areas have remained limited.
- **Brazil.** As COVID-19 cases surge, the new Health Minister indicated on May 7 that stricter lockdowns may be needed in hot-spot regions even as Economy Minister Guedes warned of a "total collapse" in the economy if controls aren't loosened. Dismissed ex-Minister Mandetta had earlier said that the toughest months of the pandemic would be in May and June.
- **Chile.** A broad roadmap for re-opening has been discussed, but details, deferred until now, may emerge this week. Small retail operations and services have begun re-opening in smaller cities and regions.
- **Colombia.** The third extension of the quarantine runs until May 25, with some "intelligent opening" from May 11. A second state of economic emergency was declared on May 6 and will run for 30 days, which gives special powers to the President to rule by decree.
- **Mexico.** Adjustments to national and local lockdown plans could be announced this week.
- **Peru.** On May 8, the government extended the state of emergency another two weeks, until May 24. Owing to economic pressures, the government did not alter its schedule for a four-month phased re-opening of the economy, starting in May. Phase 1, in which certain mining, construction, e-commerce, and other activities will be able to renew operations, continues.

As we noted in our April 25 ***Latam Weekly***, pressure will remain intense to accelerate re-openings if new signs emerge that the pandemic is being brought under control owing to the large informal sector in many Latam economies that is only partially touched by government support measures.

USEFUL REFERENCES

In addition to Scotiabank Economics' global economic research, all of which is available on our firm-wide website, our teams of economic researchers based in Latin America also publish in Spanish and English with in-depth coverage of their local markets. Their reports are available online at the sites noted below and you can also subscribe to ensure their reports land in your inbox hot off the virtual presses.

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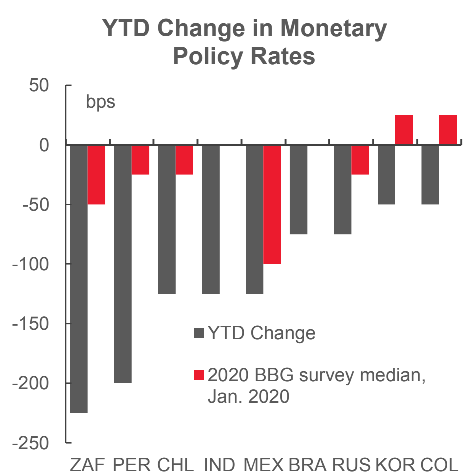
Markets Report: Is It Time For the Curves to Flatten?

- **Sovereign curves in Latam have steepened significantly throughout the COVID-19 crisis. The short end has gone down on aggressive monetary policy easing while the longer end has ended up higher than where we started the year on the broad liquidation of risk assets we have seen since March.**
- **As the economies start to re-open, we think monetary policy expectations will stabilize, shrinking the potential for gains in the short-end and leading to more appetite for duration in Latam.**
- **Contained inflation expectations—despite the sharp depreciation of Latam currencies—and the stabilization of country risk reflected in lower CDS spreads will likely take some pressure off longer maturities.**
- **In terms of positioning, the massive outflows we have seen since the start of the pandemic show that markets may already hold little exposure to EM risk, leaving space to add some risk.**
- **There may be relatively better value in Colombian and Mexican assets, but Chile and Peru merit more caution as their better fundamentals appear to be reflected already in pricing. For now, pricing on Brazilian assets is even trickier to assess, even with prospects of the central bank stepping in to buy government debt.**

WEEK IN REVIEW

It was a mixed bag for EM FX this past week (table 1). High beta currencies (MXN, ZAR) were the best performers with global equities, including in Latam (table 2), mostly higher throughout the week as investors looked at the re-opening plans of major economies with a hopeful eye. MXN got an additional impulse from the good performance in the oil market, which also benefited COP. BRL was the clear underperformer this past week, with USDBRL reaching an all-time high of 5.8757 on May 7. The move was driven by a more dovish central bank that signaled that real rates, when calculated on current inflation rates, might soon be in negative territory (n.b., they are already negative based on both the BBG consensus and the BNS expectation for inflation a year out); ongoing political disagreements that could see Pres. Bolsonaro veto a provision that excludes some public sector workers from having their salaries frozen in 2021, potentially complicating his relationship with congress; and a pandemic that is spreading in Brazil without signs of slowing.

Chart 1



Sources: Scotiabank Economics, Bloomberg.

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Latam Macro Strategy
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Table 1

Latam FX Performance: May 8, 2020

	Year-to-date	1-month	1-week
ARS	-11.0%	-3.1%	-0.7%
BRL	-29.8%	-10.6%	-4.3%
CLP	-9.0%	2.6%	1.0%
COP	-15.6%	0.2%	1.8%
MXN	-20.0%	1.7%	3.9%
PEN	-2.8%	-1.0%	-0.9%

Sources: Scotiabank Economics, Bloomberg.

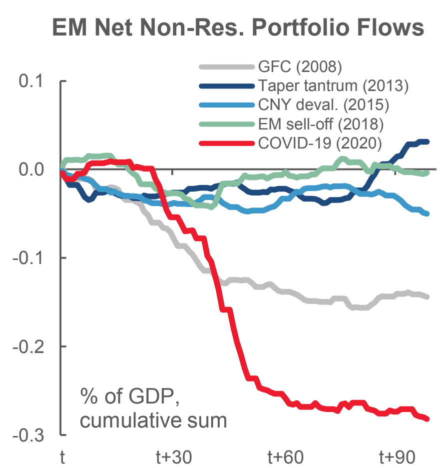
Table 2

Latam Equity Market Performance (local currency): May 8, 2020

	Year-to-date	1-month	1-week
Argentina	-13.2%	29.1%	10.5%
Brazil	-30.6%	3.3%	-0.3%
Chile	-18.2%	-0.1%	-4.0%
Colombia	-33.2%	-6.5%	-2.8%
Mexico	-13.6%	8.8%	3.2%
Peru	-24.9%	10.8%	4.3%

Sources: Scotiabank Economics, Bloomberg.

Chart 2



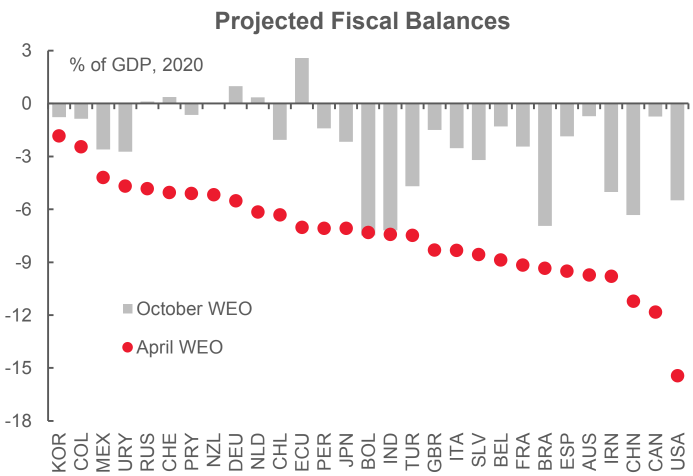
Sources: Scotiabank Economics, IIF, IMF.

COVID-19 STEEPENING IN SOVEREIGN YIELD CURVES

Sovereign curves in Latam have steepened significantly throughout the COVID-19 crisis. The short end has gone down on aggressive monetary policy easing while the longer end is higher than where we started the year on the broad liquidation of risk assets we have seen since March.

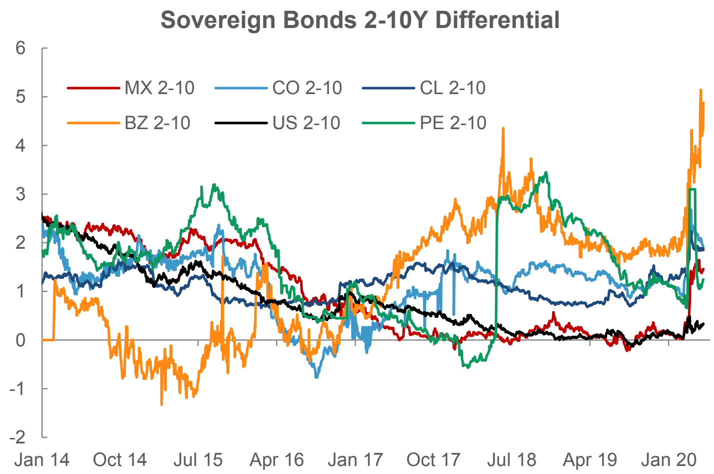
The short-end has gone down sharply on the abrupt and sizeable cuts to the monetary policy rates in the region (chart 1). Central banks, in EM in general and in Latin America in particular, have surprised some investors that were expecting that the magnitude of rate cuts would be limited by sharp FX depreciations and the potential spillovers to the inflation prints. As the global turmoil spiraled, however, the “fear of floating” was shelved and central banks let their currencies absorb the economic and financial shocks of the pandemic and the collapse in oil prices.

Chart 3



Sources: Scotiabank Economics, IMF.

Chart 4



Sources: Scotiabank Economics, Bloomberg.

Meanwhile, longer-dated sovereign bonds in EM were sold as investors took shelter in safe havens and liquidated risk positions to get ahold of cash. Financial distress in March 2020 led to historical outflows from EM, which even surpassed those seen in the Global Financial Crisis, according to data from the IIF (chart 2).

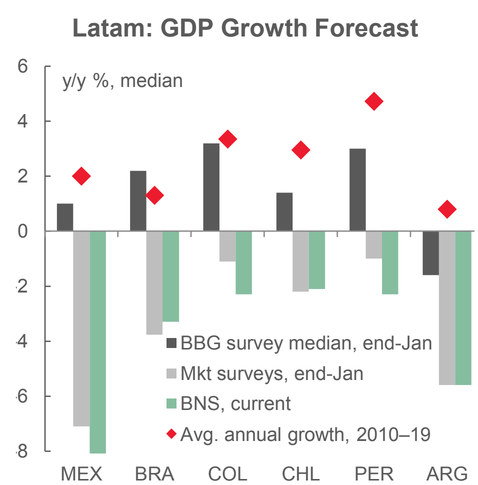
Adding to the pressures in the longer end of the sovereign curves, the deep economic contraction expected as a result of the lockdowns prompted aggressive fiscal responses that will deteriorate government balances and increase credit-risk (chart 3, projected deficits). The damage in some countries like Chile and Peru is expected to be limited to the next couple of years, but could become a longer-term problem for countries with tighter starting points like Brazil, Mexico, and Colombia (see ***Latam Weekly***, April 11, 2020).

As a result, the spreads between the long and short end of the sovereign curves in Latin America are at multi-year highs (chart 4).

IS IT TIME FOR THE CURVES TO FLATTEN?

On the fundamental side, the evolution of risk appetite will depend on growth (chart 5). Hopes are being put on the re-opening of the global economy, but the path to normalization will likely be long and difficult. The return of flows to EM assets will be slow and potentially hampered by the lack of liquidity that still prevails in regional markets.

Chart 5



Source: Scotiabank Economics, Bloomberg, central banks.

Investors may still be overpricing some risks. After discounting very negative scenarios, we think that a pickup in global activity—even if mild—and the stabilization we are expecting in oil prices should lead to a rebound in EM assets in the coming months. Meanwhile, positioning is clean and we think a slightly positive momentum is starting to build.

FUNDAMENTALS

As economies start to re-open, we think monetary policy expectations will stabilize, shrinking the potential for gains in the short-end and leading to more appetite for duration in Latam. Monetary policy rates have probably reached their cycle lows in Chile and Peru and we expect them to stay on hold for the rest of the year, in line with market pricing. In Brazil, the space for further easing is uncertain, especially on the back of political turbulence that might get in the way of the reform agenda. With the central bank delivering a surprising 75 bps cut and telegraphing a "final" cut of the same magnitude, we think prices will stabilize around discounting a roughly 2% terminal rate. Mexico and Colombia, on the other hand, have more space to keep cutting rates, and markets will probably take expectations for the terminal rate a bit lower than the current 4.5% and 2.5%, respectively, implied in the swap rates. But we think the adjustments will be much milder than what we have seen since March (see What's Priced In on p. 4)

Emerging-market inflation expectations remain broadly contained despite the sharp depreciation of Latam currencies (chart 6) and CDS spreads have stabilized and are on a downward trend (see Key Market Charts section). The exception is Brazil, which is dealing with more idiosyncratic issues.

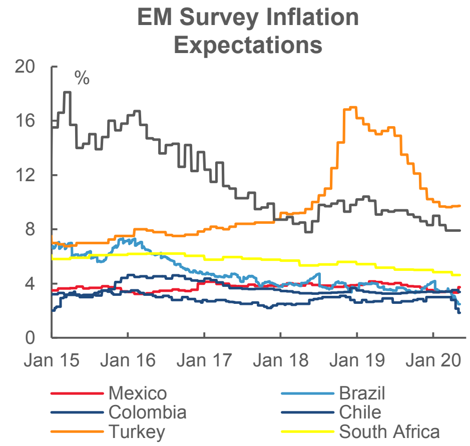
Central banks might deploy bond-purchase programs. Discussions about sovereign bond purchases could lead to lower rates in the longer end. In Brazil, the lower house of Congress approved a bill that granted power to the central bank to purchase government and private bonds in the secondary market; in Chile, Congress is discussing the same sort of move, while the BCCh has also alluded to a possible resort to unconventional measures. Still, for all the talk of central-bank asset purchases in the EM space, very little has happened so far.

POSITIONING/MOMENTUM

Risk appetite seems to have bottomed out and the panic phase seems to be over. IIF numbers showed that capital outflows from EM economies moderated in April. Debt flows to EM were positive (USD 15.1 bn) while equity indices still saw outflows (USD 6.3 bn) once one excludes China. In all, April data represents a significant improvement from the record USD 83.2 bn outflow seen in March. The recovery is concentrated in EM Asia, probably because the pandemic cycle is in an advanced stage there and the economies are closer to a normalization phase, but we have seen some pick-up in interest towards the Latam region as well (chart 7).

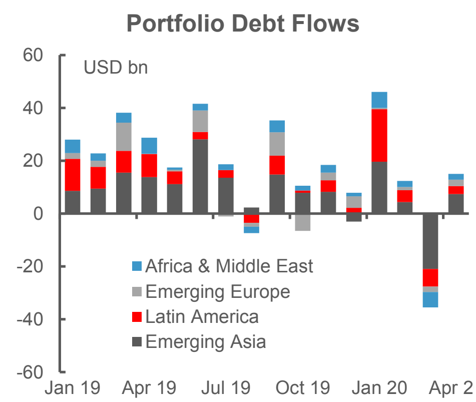
The massive capital outflows EM has seen since the start of the pandemic show that markets cut their exposure to EM-risk significantly and that very negative scenarios are incorporated in their positions. As countries start to unwind their lockdown measures, investors might be willing to add some risk, noting that the pile of liquid assets that markets will have available in the aftermath of COVID-19 will be bigger than what markets saw after the 2008 crisis (chart 8). For now, at least in the

Chart 6



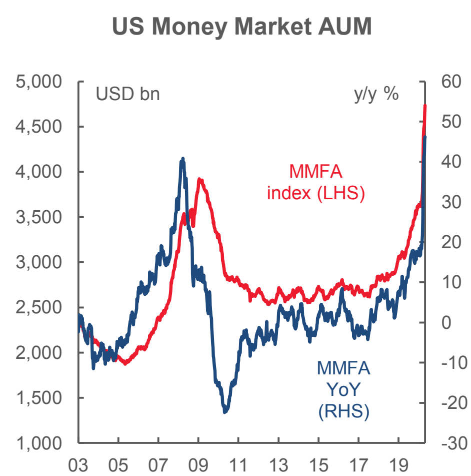
Sources: Scotiabank Economics, Bloomberg.

Chart 7



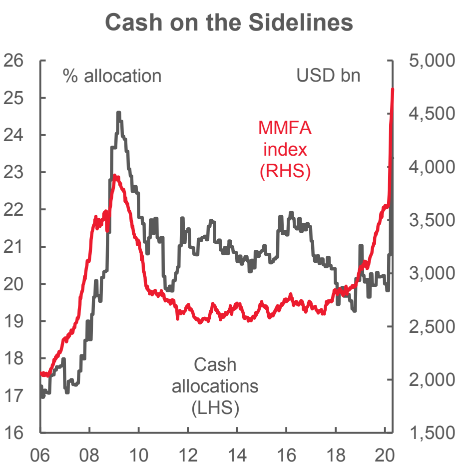
Sources: Scotiabank Economics, National Sources, Bloomberg, IIF.

Chart 8



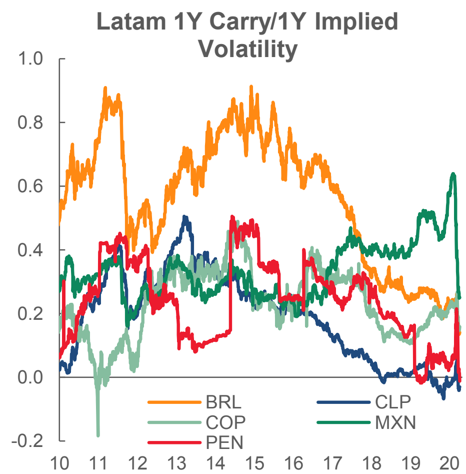
Sources: Scotiabank Economics, Bloomberg.

Chart 9



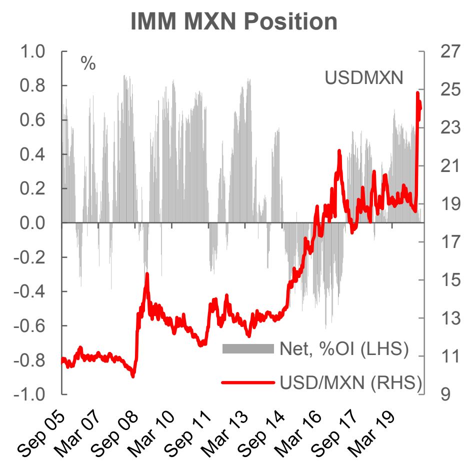
Sources: Scotiabank Economics, Bloomberg.

Chart 10



Sources: Scotiabank Economics,Bloomberg.

Chart 11



Sources: Scotiabank Economics, Bloomberg.

US, cash allocations remain at 24% of assets, which is also the highest level since 2008 (chart 9). Eventually, we think this ample available liquidity will look for ways to yield returns, benefiting Latam assets in the process (chart 10).

There is good participation in the primary market issuances in Latam. Peru, Mexico and Chile have returned to international capital markets issuing sovereign debt in USD and EUR with high levels of demand from a variety of accounts. Peru issued at sub-3% yields and 6x oversubscribed. Chile issued a 30Y in USD at 2.45% with a demand of 5.7x the amount allocated, and Mexico allotted a surprising amount of USD 6 bn, with bid to cover of 5 times. The participation of dedicated EM funds would be expected but anecdotal evidence points to interest from crossover accounts with broader alternatives of investment, which is also a good sign. Interest in the secondary and local markets is not remarkable yet but it could follow the wave of primary issuance in hard currencies.

Signs of an inflection point are also appearing in the derivatives market. According to IMM data, after 13 consecutive weeks of declines in the net longs in MXN—the only EM currency in the ranking—investors added some long positioning in the last week of April (chart 11).

CURVES TO FLATTEN, BUT NOT IN TANDEM

All in all, we expect risk appetite to return gradually and think the shape of the curves in Colombia and Mexico imply good entry points and carry from the 5-year node onward as long-term yields come down. In both countries, although the macroeconomic fundamentals will worsen with the crisis, we think prices are already accounting for an aggressive mix of “worst case scenarios”, particularly in Mexico (i.e., longer pandemic, extremely sharp recession, L-shaped recovery and rapid fiscal deterioration). An eventual recovery of oil prices will also release some pressure from the fiscal and current accounts, lowering country risk. Also, in both countries, the likelihood of issuance in addition to what is already in the calendar is low, as their governments have committed to maintaining debt at current levels.

Chile and Peru may merit more caution. We think markets have already priced in Chile and Peru’s relatively strong macro fundamentals and the shallower sell-off in copper versus oil. Also, one needs to keep in mind the impact of aggressive central bank policy rate cuts that may limit future inflows for carry strategies. In Peru, the recent law that allows the withdrawal of up to 25% of AFP funds has made noise among international investors and, even though we do not think it will lead to the liquidation of a significant volume of Soberanos, we acknowledge that it is not a market-friendly development. Additionally, the MEF might still have some domestic issuance pending in the long-end that could create distortions in that part of the curve. Lastly, PEN has been outperforming its peers on the back of heavy central bank intervention and it offers little in terms of valuation.

Finally, in Brazil, even with the currently steep curve, the challenging environment to pursue long-term reforms amid a recession and increasing spending might keep the 2–10Y differential wide and the BRL under pressure in the coming

months. We note that the BCB might start to purchase government bonds to prevent a more painful steeping of the yield curve, but if uncertainty around long-term fiscal sustainability remains this high, we see reasons to be cautious.

Well-contained inflation expectations across the region and the economic fall-out from lockdowns imply, in the view of our economists in the region, that monetary easing will be maintained at least until the end of the year. Clearly, in the aftermath of the economic shock, central banks will have to start normalizing monetary policy rates. But further yield-curve flattening driven by the short end of curves appears to be a story for 2021: we do not think that talk of hikes will start to make the rounds in the market for the foreseeable future.

A CAVEAT

One risk is that the US stock market is already pricing a very rosy picture that, according to our analysts, leaves almost no room for disappointment. If we do see another wave of losses in the equity sector, the risk-off mood could get in the way of any recovery for other risk assets. A pause or an orderly consolidation phase would be more constructive and is still the base case scenario for our equity analysts. Of course, there is also the risk of a completely disorderly re-opening of the economies and second waves of the pandemic that would bring the world economy back to a standstill.

Country Updates

Argentina—Judgment Day

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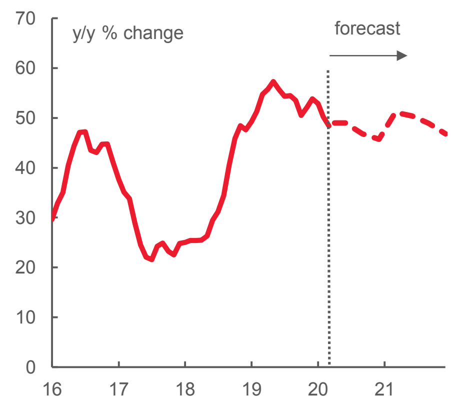
May 8 marked the government's deadline for an agreement with bondholders on restructuring some USD 65 bn of external debt and it was missed, with the President announcing on May 9 that the offer would remain open through May 11. Nevertheless, talks are likely to continue in an effort to avoid a disorderly default when the grace period on missed coupon payments on some dollar bonds expires on May 22. In a webinar on Wednesday, May 6, Argentina's Minister of Economy Martin Guzman indicated a new willingness to be flexible with creditors and said that the government remains open to any ideas that help restore the nation's debt sustainability. As Min. Guzman noted on Monday, May 4, "A lot can change in the course of a week."

Argentina: Inflation Set to Remain Stubbornly High



Sources: Scotiabank Economics, INDEC.

Three major possible points of negotiation emerged this week: (1) the length of the government's proposed three-year grace period; (2) the structure of the proposed step-up coupon on bonds emerging from an exchange; and (3) the development of a contingent sweetener, similar to the GDP warrants that featured in the 2005 exchange. The 2005 warrants hit problems owing to the politicization of data produced by INDEC, the national statistical agency. As a result, any move to add similar instruments to a new debt treatment would likely see them linked to internationally-produced data from a multilateral source, such as the World Bank or IMF.

Min. Guzman contended that, despite the pushback from three major bondholder groups, some creditors endorse the government's restructuring offer. Nearly 140 prominent economists also issued a letter on Wednesday, May 6, that endorsed the government's proposed terms. Min. Guzman said that the government intends to reform the country's tax structure to stimulate greater savings over the medium term. He also noted that discussions with the IMF on a new adjustment program and lending arrangement are on a "positive path". Next steps were set to be announced on May 9 according to government indications.

In macro data, Argentina showed signs this past week of a deepening slide into its third year of recession. Construction and industrial production, which together account for about a quarter of GDP, posted massive declines in March, with -46.8% y/y and -16.8% y/y respective contractions. Vehicle production closed entirely in April owing to the lockdown, with sales down -73.6% y/y and exports off -88.4% y/y. Tax revenue fell for a third straight month, with a -9% m/m drop in April.

Real GDP growth in Q1 now looks more like -2.3% y/y than the -0.9% y/y we previously forecast. This implies that on the current track, growth for the year could come in at closer to -5.9% y/y than the -5.6% y/y we forecast, but we will continue to monitor developments prior to moving our outlook for the rest of 2020.

Looking to the week ahead, we expect the April inflation print on Thursday, May 14, to show a slight acceleration in price increases, up from 3.3% m/m in March to 3.5% m/m in April. With wages growing at nearly 4% m/m in their last reading for February and the ARS blue-chip swap rate implying an unofficial exchange rate around USDARS 120, nearly twice the official rate of USDARS 66.2, inflation is set to remain above 3% m/m for much of 2020. Nevertheless, some strong base effects imply that the headline year-on-year number will remain unchanged from March at around 48.4% y/y in April.

Brazil—As Macro Indicators Collapse, the BCB Turns on Its Dovish Jets

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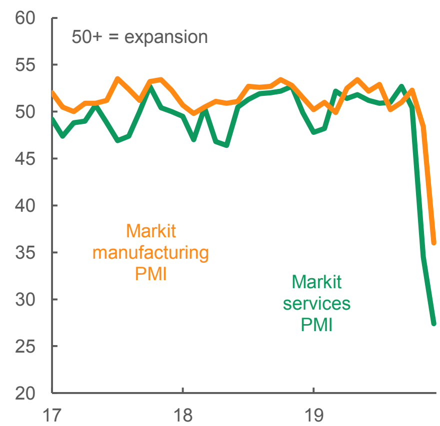
The biggest news of the past week was the BCB's decision to cut the Selic rate by 75bps, as opposed to the 50bps that most economists (including us) expected. The surprisingly large cut further undermined the BRL, and pushed USDBRL to a new all-time high of 5.86. This made the real easily the worst-performing EM currency so far in May, substantially underperforming the TRY. In its statement, the BCB highlighted a challenging environment for EM in which capital outflows are materially larger than in other recent episodes of volatility. The Copom pointed out that the macro outlook for Brazil on both growth and inflation has two-sided risks with unusually high variances. The downside growth risks are mainly centred around rising precautionary savings further dampening demand while, on the other hand, a further deterioration of the fiscal stance could trigger an increase in risk premia and imply a higher-than-anticipated inflation path. The BCB signaled that it is likely to provide further stimulus in order to deal with the anticipated demand shock. However, it also warned that the duration of its stimulus could be shortened by a deterioration in the fiscal stance that triggers the need for higher rates through a rising risk premia channel.

Major Collapse in Brazilian PMIs



Sources: Scotiabank Economics, IHS Markit.

Based on the Copom's statement, we are revising our Selic rate call as we have already reached our previously forecast floor: we now expect another 75bps of easing at the next meeting and one further cut to follow. Despite the fact that the Copom signalled that the next move would be its "final" cut, the huge collapse in Brazilian PMIs over the past week, which eclipsed any previous drop in the indicators' short history, leads us to forecast another 25 bps reduction in the Selic to end the easing cycle at 2.00%. We anticipate that the BCB will be forced to reverse course in 2021, in line with our above-consensus inflation forecast, which is underpinned by an expectation that FX pass-through and a reduction in overall growth potential will put upward pressure on prices later this year.

Also feeding into our Selic call, May 8 saw IPCA inflation for April come in at -0.31% m/m, stronger deflation than the survey anticipated and down from 0.07% m/m in March. In year-on-year terms, inflation fell from 3.30% y/y in March to 2.40% in April.

For the coming week, we again have some tier-1 indicators printing, led by retail sales for March (released May 13), where we look for a further deceleration from 4.7% y/y in February, to -0.7% y/y. We may also get monthly economic activity for March, in which we look for a -0.7% y/y decline.

Chile—A Second Big Shock in Under A Year

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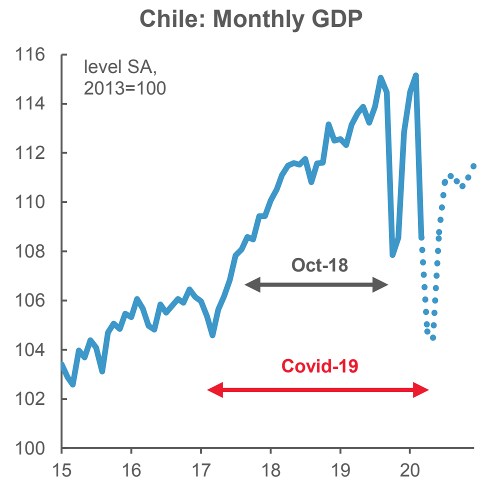
On Monday, May 4, monthly GDP data was released, recording a fall of -3.5% y/y in March. The forced isolation measures decreed by the government began in mid-March, making this month the first one to show the economic impact of COVID-19. The impact in activity has been significant, and it represents the second big shock in the Chilean economy in less than a year, after the social outbreak that started on October 18, 2019 (O-18). As expected, the sectors most affected were education, transportation, and restaurants and hotels. Our base scenario contemplates a drop in 2020 GDP of -2.1%, which we are holding firm for now. The March indicator of monthly activity and our base scenario for the rest of the year would leave us with a GDP level at end-2020 similar to that at the beginning of 2018. Our high-frequency indicators imply that purchases with credit and debit cards continue to decrease year-on-year, but have been more stable in recent days. Growth in supermarket purchases has moderated, while other items continue to be hit hard, especially purchases in restaurants, travel, clothing and retail stores. On Wednesday, May 6, the BCCh (central bank) met and kept the monetary policy rate unchanged at 0.5%, its technical minimum. The bias of its press release pointed toward intensifying monetary stimulus and support for financial stability with unconventional instruments, if required, in a context where inflation is not a short- or medium-term problem for the BCCh.



Sources: Scotiabank Economics, Central Bank.

On May 8, we received the CPI data for April, and, as we expected, it printed a null variation of 0% in m/m terms. The decline we've seen in fuels and transport services prices was partially offset by increases in some goods prices. Year-on-year inflation came in at 3.4%, down from 3.7% y/y in March. Looking to the year end, we maintain our projection of an annual inflation rate of 2.8% y/y. Regarding April economic activity, which comes on June 1, high-frequency indicators imply a steep decline, and we project a monthly GDP contraction of around -7% y/y after a -3.5% y/y contraction in March.

In the coming week we will also receive more information regarding the re-opening of the economy. The government has already announced a broad program for safe re-opening, but the details are unknown for now. We have, however, seen the re-opening of small retail and services providers in cities with no lockdown. The BCCh highlighted a marked concern for SMEs in its May 6 meeting statement, which could mark a possible new support measure in that direction in the near future if this concern persists.

Colombia—Assessing the Policy Response to COVID-19

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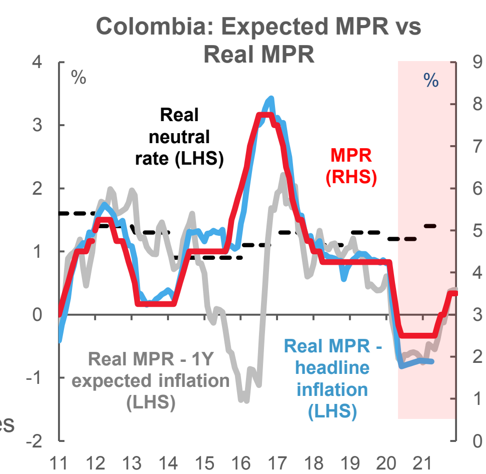
The rapid Colombian public health response to the COVID-19 pandemic has helped keep the virus under control. Additionally, President Duque has preferred to open up the economy very gradually to try to avoid a new health crisis. Therefore, the quarantine was extended for a third time up to May 25, although President Duque also announced that from May 11, some additional sectors will be allowed to open under what he has called "intelligent opening".



Shaded area = forecasts.
Sources: Scotiabank Economics, BanRep.

In terms of economic policy, the Colombian authorities have so far shown, on the contrary, a more conventional and gradual approach. In terms of fiscal measures, the Colombian government's initial social package is modest compared to peers, as we explained in last week´s *Latam Weekly*. At the same time, monetary policy has moved on a rather gradual easing cycle (in the past two months the policy rate has only been cut by 100 bps), although the liquidity measures initiated have been similar to those of peers or even greater.

The question that arises is: why has the BanRep acted in such slow motion? Since the official adoption of the inflation-targeting framework, BanRep has always been rather obsessive with keeping inflation within the target range under a flexible exchange rate framework, and so far it has worked out. As a result, under conditions of uncertainty, the central bank in Colombia always prefers to err on the side of being hawkish. On May 4, the BanRep released its *Monetary Policy Report,* which reflects considerable uncertainty about COVID-19 and oil price shocks. In fact, BanRep's staff argued that the duration and depth of the shocks, along with the speed of recovery, depend on a wide range of unforeseeable conditions, reinforcing its bias toward gradualism in monetary policy measures.

The central bank's staff proposed wide forecast ranges for variables such as economic growth, inflation, and the current account deficit. However, the long-term equilibrium parameters, such as potential GDP and the neutral real interest rate, were not calibrated, making it even more difficult to know the new equilibrium to which monetary policy will be compared, which is essential to assess how expansionary the prevailing policy rate is.

A calculation of the real interest rate shows that the policy rate in Colombia is expansionary and slightly negative in real terms; however, if inflation expectations are such that current levels of 3.6–3.8% are expected to drop, the policy rate could turn positive and less expansionary as early as June. Therefore, we think that if the BanRep wishes to keep the real policy rate at current levels, the central bank will continue easing at the same pace and will cut its policy rate another 50 bps to 2.75%, which would be a record low. Moreover, we expect that in June, after BanRep gains a bit more certainty in terms of actual economic activity and can run some modelling on potential output, it will cut another 25 bps to 2.5% to keep the real policy rate at levels close to -1%.

On the data side, April monthly inflation stood at 0.16% m/m (3.51% y/y, 35 bps lower than in March), below market expectations. Most of the constituent prices were unchanged, but foodstuff inflation continued making positive contributions due to price increases on staple foods. However, what is causing headline inflation to decline are governmental aid programs on utilities fees and reduction of the VAT on communications, which are temporary measures and their disinflationary effects could reverse as soon as the emergency ends. On the other side, the aid programs' reversal would be offset by a weaker demand for services and durable goods that, for now, are not reporting price changes.

Next week, DANE will release Q1-2020 GDP growth, which should still be positive (we expect 3.2% y/y), since—in January, February, and part of March—economic activity was consolidating a recovery cycle. Retail sales in February were the strongest in history and March results should have continued to be healthy; on the other hand, manufacturing could have contracted in March by around 8% y/y due to the sudden interruption in activities by the quarantine.

Mexico—Taking Stock of the Depth of Disruption

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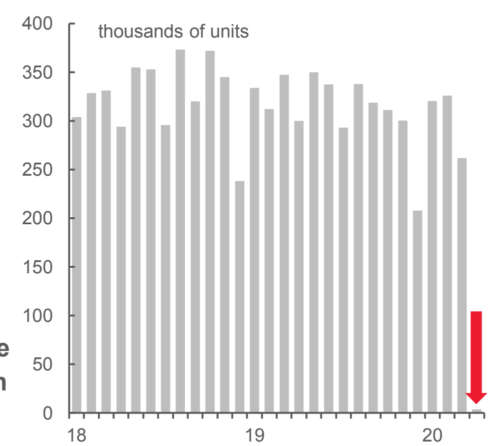
The first relevant indicators of the economic activity in the month of April presented a dramatic reading, providing a glimpse of the depth of the disruption produced by COVID-19-related health and safety measures. Domestic auto sales plummeted -64.5% y/y and production basically halted, falling -98.8% y/y; similarly, exports fell -90.2% y/y.

Mexico: Vehicle Production



Sources: Scotiabank Economics, INEGI.

On the other hand, remittances from abroad surged 36% y/y in March, reaching a record high of USD 4.0 bn. It is likely that Mexicans in the US sent more money to their families in anticipation of harder times ahead since jobs and opportunities will likely be scarcer after the pandemic ends.

We also received the results of the survey conducted during April by Banco de Mexico among private sector economists, which posted significant changes in its 2020 forecasts as analysts started to take stock of the magnitude of the impact from COVID-19. The average GDP forecast for 2020 was revised to -7.27% y/y from -3.99% y/y in March, while formal job creation was revised to -693k from -174k; inflation was adjusted to 2.83% from 3.75%; the USDMXN exchange-rate forecast was increased to USDMXN 23.36 from USDMXN 22.27; and the monetary reference interest rate for year's end was lowered to 4.82% from 5.60%.

Inflation nose-dived in April, posting a -1.01% monthly reading while reaching a y/y rate of 2.15%. Huge drops in energy costs and some fruits and vegetable prices were responsible for this unusual result. Investment kept falling sharply in February, posting a -8.6% real y/y rate, with its two main components falling: -8.1% real y/y on construction and -9.5% real y/y on machinery and equipment. Private domestic consumption also showed accentuated weakness in February, growing only 0.5% y/y in real terms, with a contrasting result in durable goods purchases, where domestic goods grew by 4.1% y/y, while purchases of imported goods contracted 8.3% y/y.

For the week ahead we will have the industrial activity figures for the month of March and the next monetary policy decision of Banco de Mexico. We are expecting a new cut of 50 bps to the reference interest rate and perhaps some guidance on Banxico's forecast for GDP, which could be a new addition to the bulletin. With inflation tamed and dramatic numbers reflecting falling economic activity, a bigger cut in the reference rate is not far-fetched. Attention will also be focused on the evolution of COVID-19 and the possible timing for the reopening of economic activities.

Peru—Divergence Between Supply and Demand

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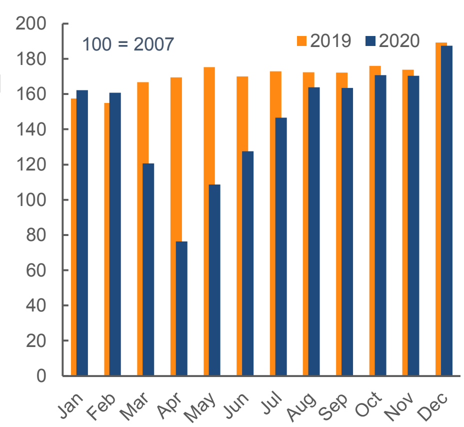
Peru's economy is facing a bit of a divergence between the supply side, dominated by the lockdown, and the demand side, with the advantages of the stimulus measures. On the supply side, the current government schedule to re-open the economy implies a -14% y/y contraction in GDP in 2020 (broadly summarized in the graph). At the same time, the government and the central bank (BCRP) continue to mobilize a prodigious quantity of resources to support demand. Given the stimulus programs, the demand side equation points closer to a -9% y/y GDP contraction; that is, business will confront a contraction in demand on the order of -9% y/y, but re-opening timing and protocols may not enable them to produce as much.

GDP Index



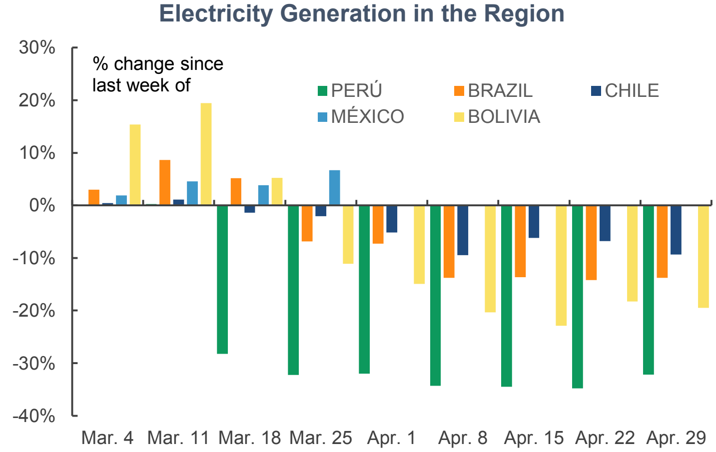
Sources: Scotiabank Economics.

Heightened uncertainty makes any growth forecast purely referential, and we are opting to use our demand scenario of a -9% y/y contraction as a sufficiently adequate base case. However, the risk that growth will be more like the supply scenario is high.

Regardless of the scenario, what is certain is that economic activity in H2-2020 will be much greater than in H1-2020 but, at the same time, well below H2-2019. In our base case, we expect H2-2020 GDP to be 18% higher than in H1-2020, but 3.4% lower than in H2-2019.

Peru's contraction is greater than that of peer countries because Peru's lockdown has been more drastic. Note, for example, the extent to which Peru's electricity demand has fallen much more than elsewhere.

Electricity Generation in the Region



Source: Scotiabank Economics, COES (Perú) CEN (Chile), NCDC (Bolivia), CENACE (México), ONS (Bra).

Forecasting remains a challenge, with so many elements of uncertainty still in play, including:

- On May 8, the government announced that it has extended the state of emergency another two weeks, until May 24. Note that the government has not altered the schedule for unlocking the economy. Phase 1—in which certain mining, construction, e-commerce, and other activities will be able to renew operations—continues;

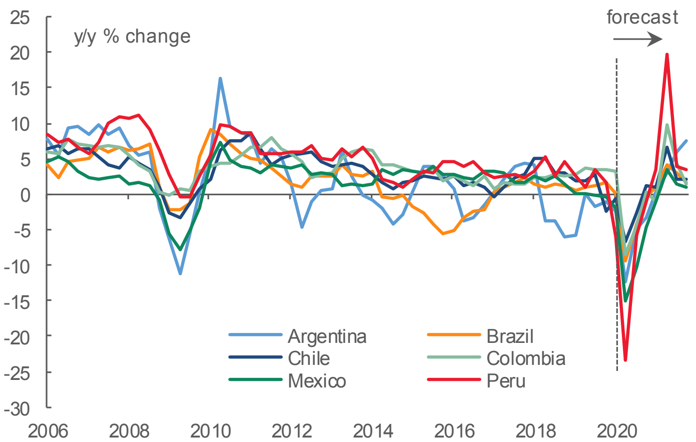
- Further plans to unlock the economy remain gradual and not totally defined. The schedule will continue to vary as things evolve;
- The government is under pressure from businesses and some parts of public opinion to unlock faster. At the same time, COVID-19 containment is not going as hoped, and aspects such as the ban on the use of personal vehicles and the nighttime curfew will hamper normalization;
- Before opening, businesses will need to implement rather involved health protocols which will slow the process even more;
- Stimulus resources will flow into demand at an unclear pace;
- The re-opening of the informal economy (about 15% of GDP) is unclear; and
- The extent of damage to payment and logistic chains is unclear.

In other economic news this week, April inflation came in at 0.1% m/m, and 1.7% y/y. Loans growth was a healthy 8.4% y/y, in March, as businesses demand liquidity. The BCRP has held repo auctions for nearly 80% of its PEN 30 bn REACTIVA program.

Key Economic Charts

Chart 1

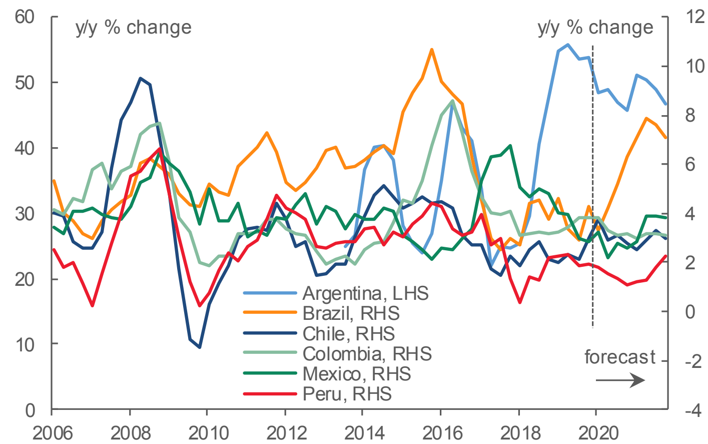
Real GDP



Sources: Scotiabank Economics, Haver Analytics.

Chart 2

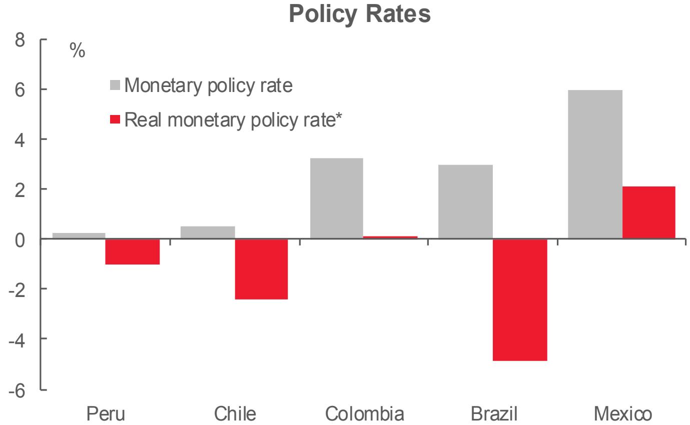
Inflation



Sources: Scotiabank Economics, Haver Analytics.

Chart 3

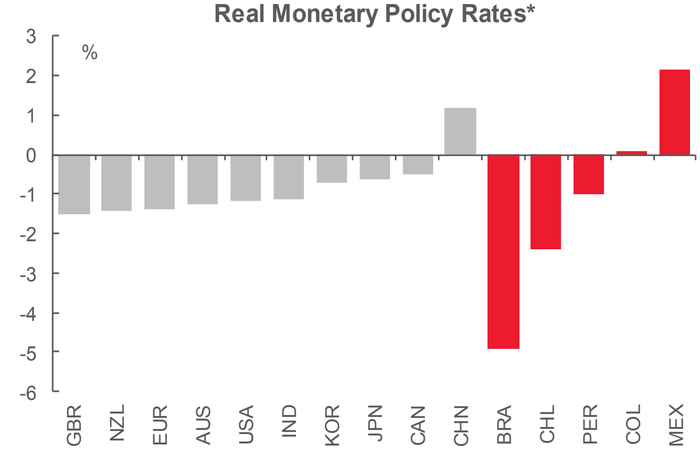
Policy Rates



* Real monetary policy rate = current policy rate - BNS expected inflation, end-Q2-2021, % y/y. Argentina: MPR = 38.0%; Real MPR = -12.4%.
Sources: Scotiabank Economics, Haver Analytics.

Chart 4

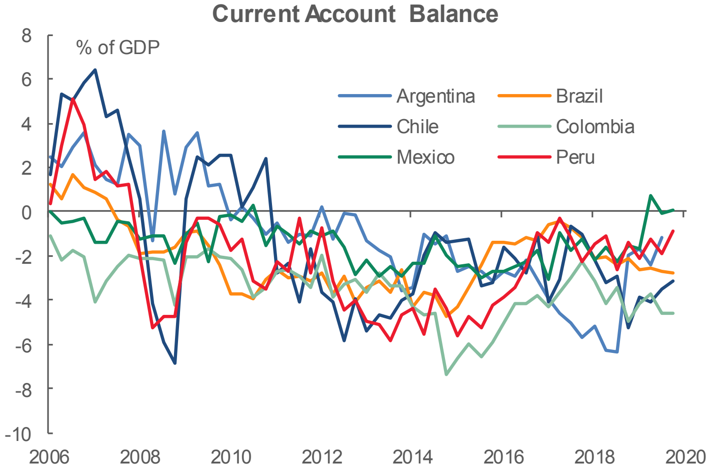
Real Monetary Policy Rates*



* Real monetary policy rate = current policy rate - BNS expected inflation, end-Q2-2021, % y/y. Sources: Scotiabank Economics, Bloomberg.

Chart 5

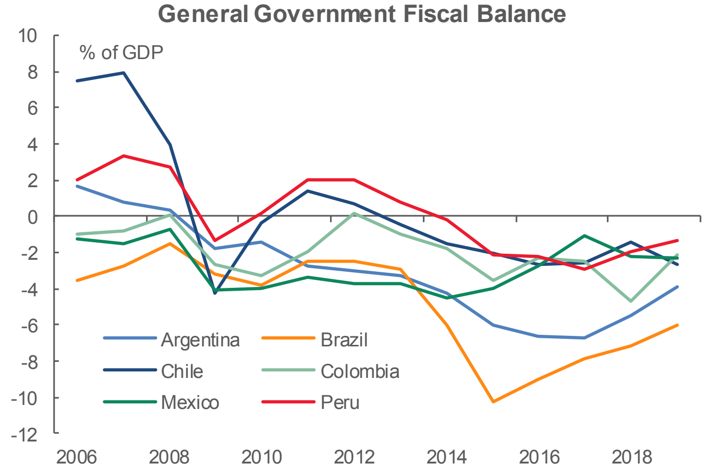
Current Account Balance



Sources: Scotiabank Economics, Haver Analytics.

Chart 6

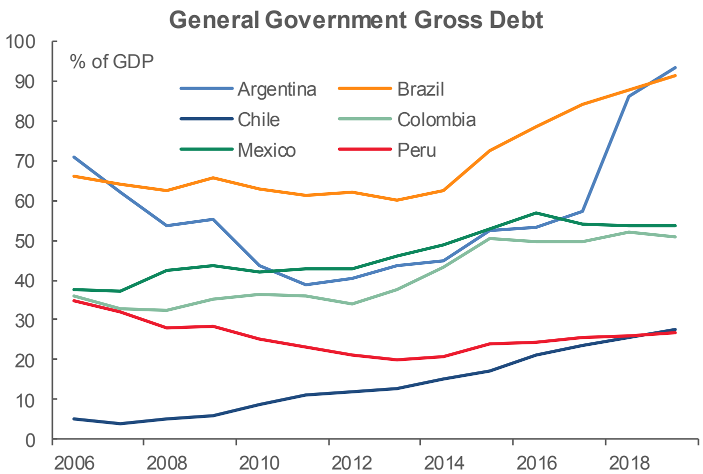
General Government Fiscal Balance



Sources: Scotiabank Economics, IMF.

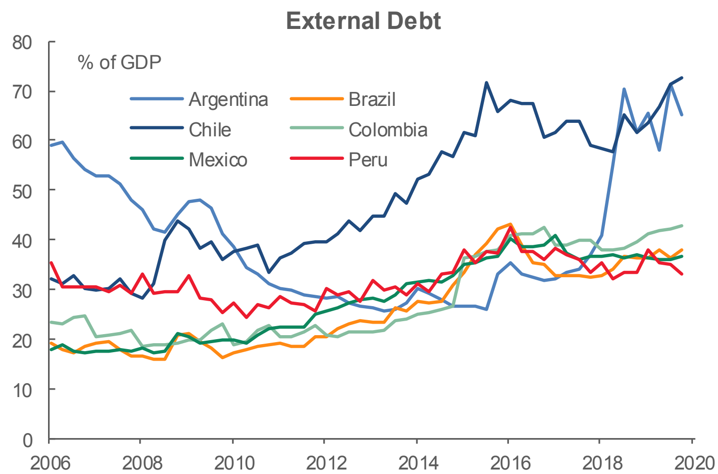
Key Economic Charts

Chart 7



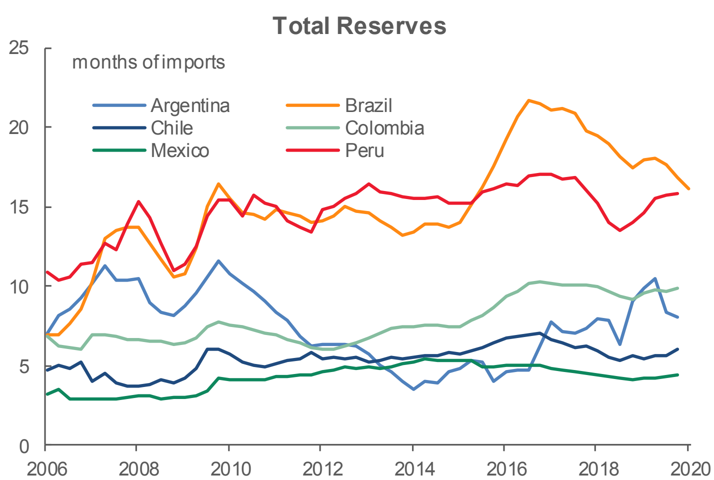
Sources: Scotiabank Economics, IMF.

Chart 8



Sources: Scotiabank Economics, Haver Analytics.

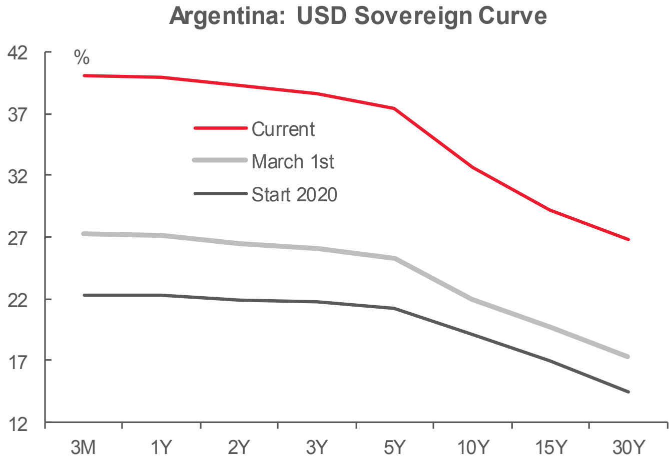
Chart 9



Sources: Scotiabank Economics, Haver Analytics.

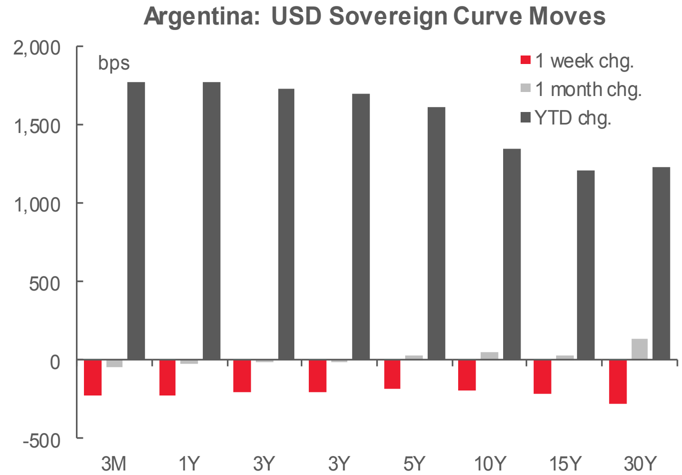
Key Market Charts

Chart 1



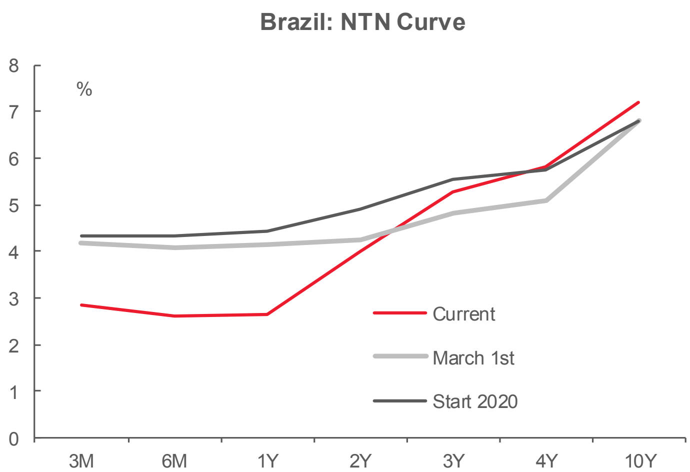
Sources: Scotiabank Economics, Bloomberg.

Chart 2



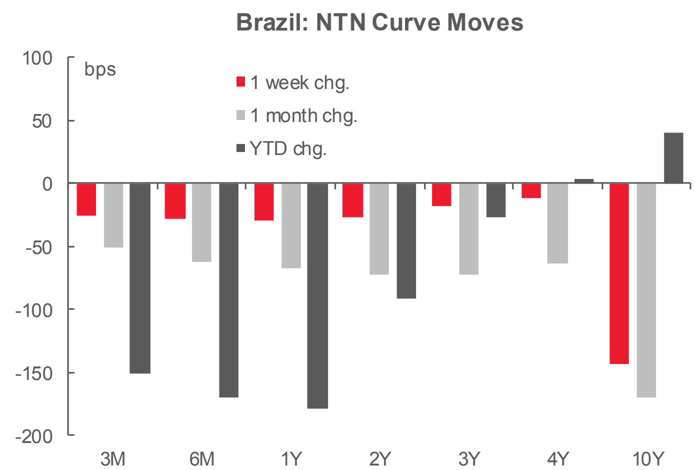
Sources: Scotiabank Economics, Bloomberg.

Chart 3



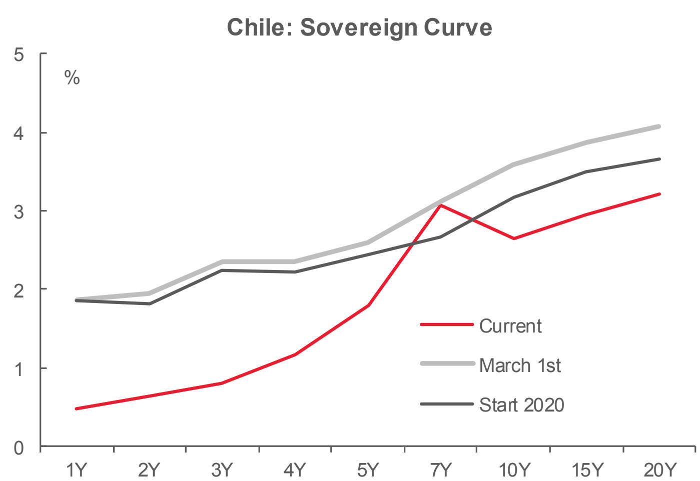
Sources: Scotiabank Economics, Bloomberg.

Chart 4



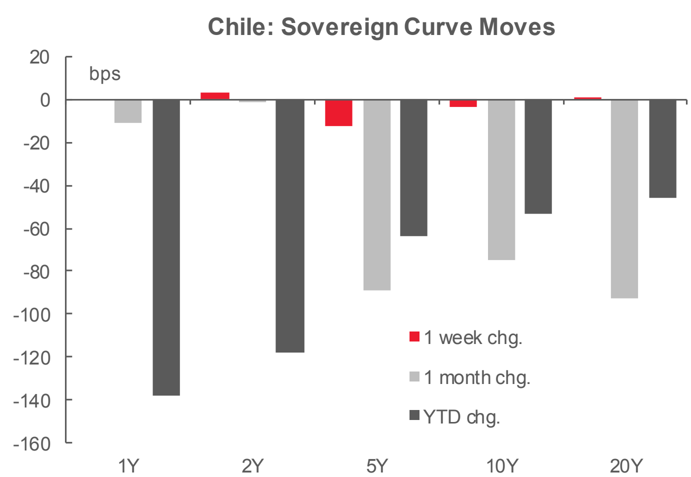
Sources: Scotiabank Economics, Bloomberg.

Chart 5



Sources: Scotiabank Economics, Bloomberg.

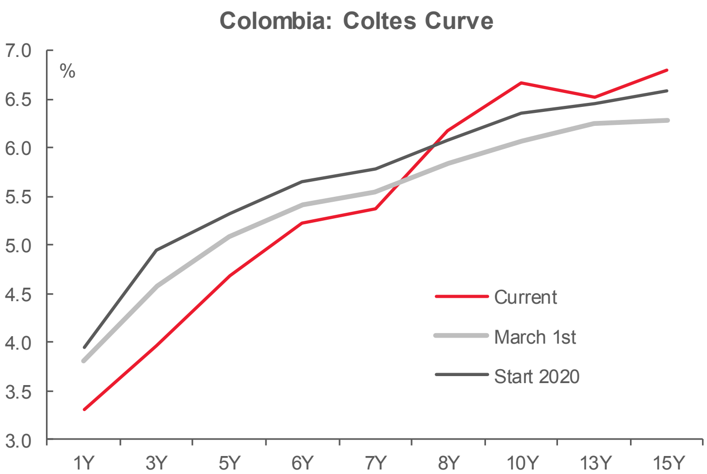
Chart 6



Sources: Scotiabank Economics, Bloomberg.

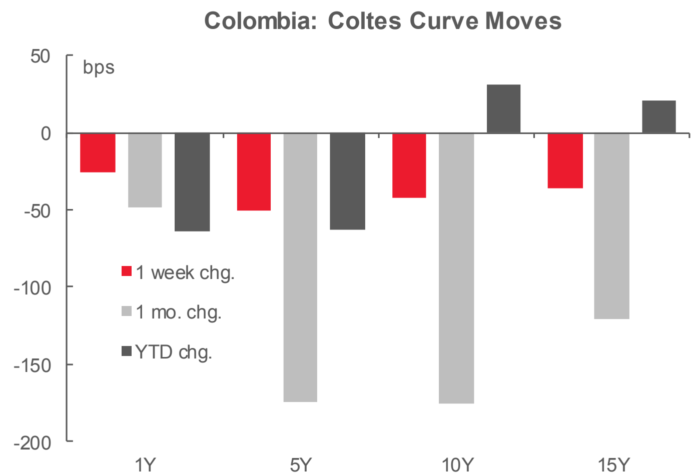
Key Market Charts

Chart 7



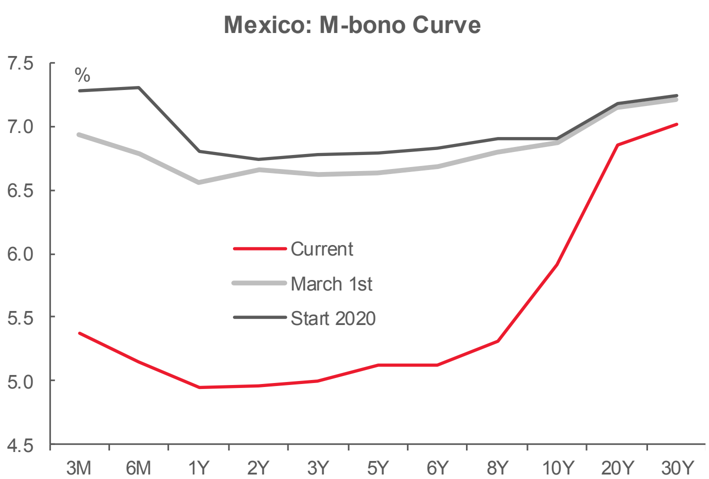
Sources: Scotiabank Economics, Bloomberg.

Chart 8



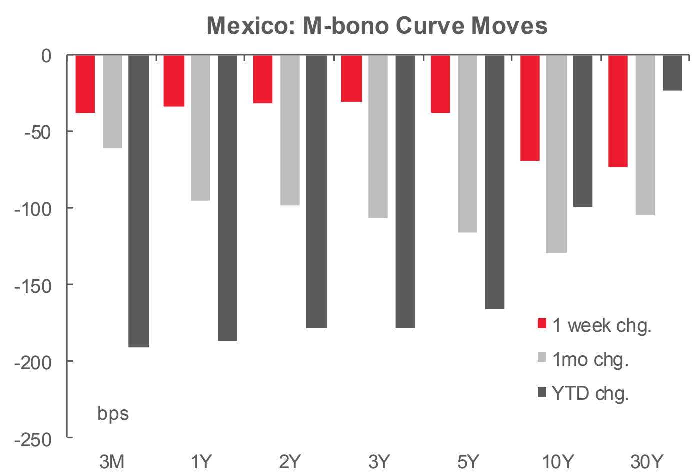
Sources: Scotiabank Economics, Bloomberg.

Chart 9



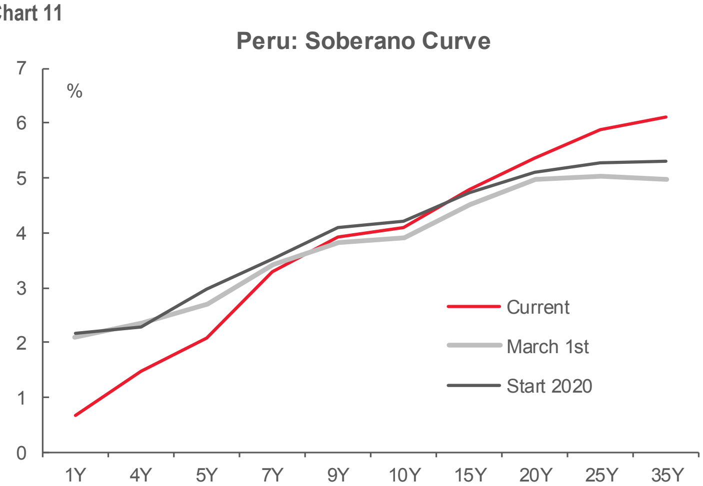
Sources: Scotiabank Economics, Bloomberg.

Chart 10



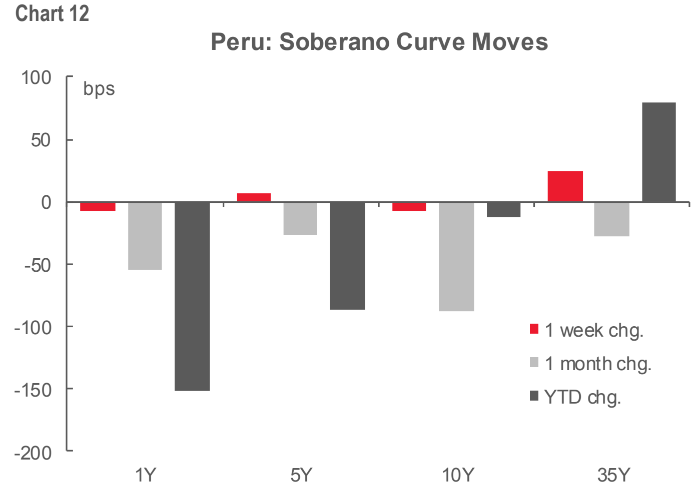
Sources: Scotiabank Economics, Bloomberg.

Chart 11



Sources: Scotiabank Economics, Bloomberg.

Chart 12



Sources: Scotiabank Economics, Bloomberg.

Key Market Charts

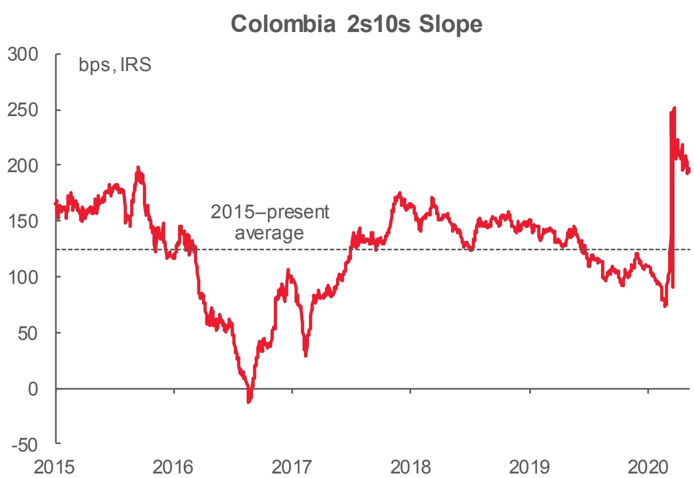
Chart 13

Sources: Scotiabank Economics., Bloomberg.

Chart 14

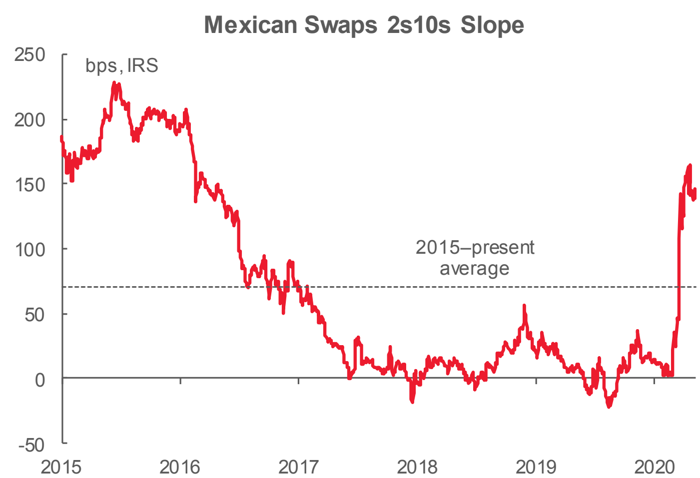
Sources: Scotiabank Economics., Bloomberg.

Chart 15



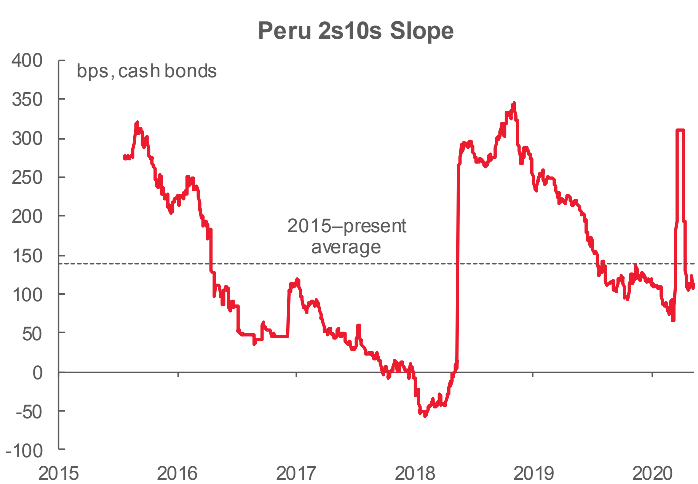
Sources: Scotiabank Economics., Bloomberg.

Chart 16



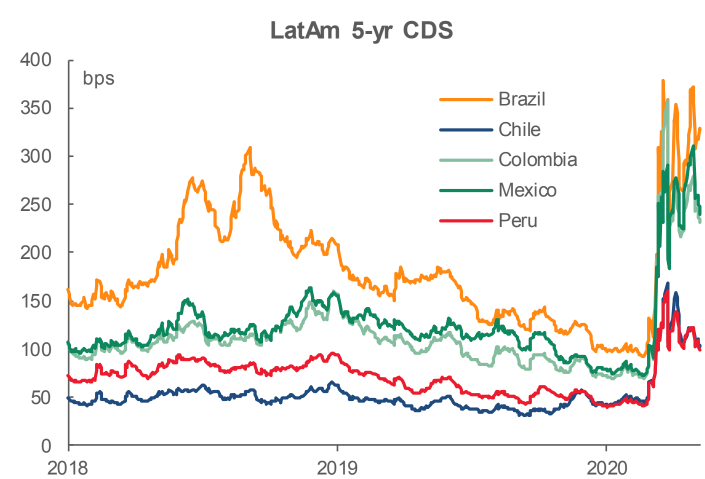
Sources: Scotiabank Economics., Bloomberg.

Chart 17



Sources: Scotiabank Economics., Bloomberg.

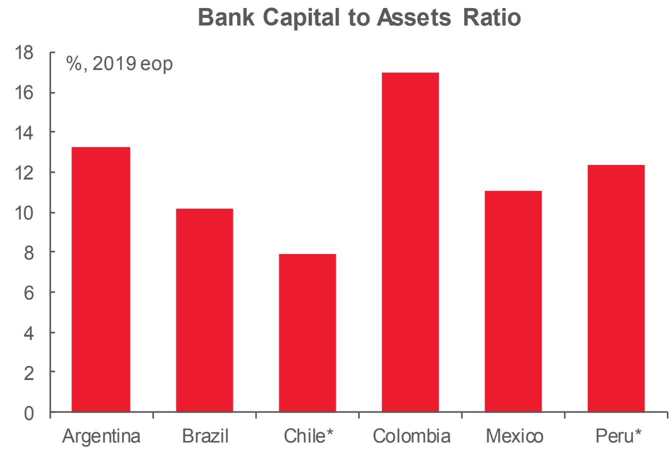
Chart 18



Sources: Scotiabank Economics., Bloomberg

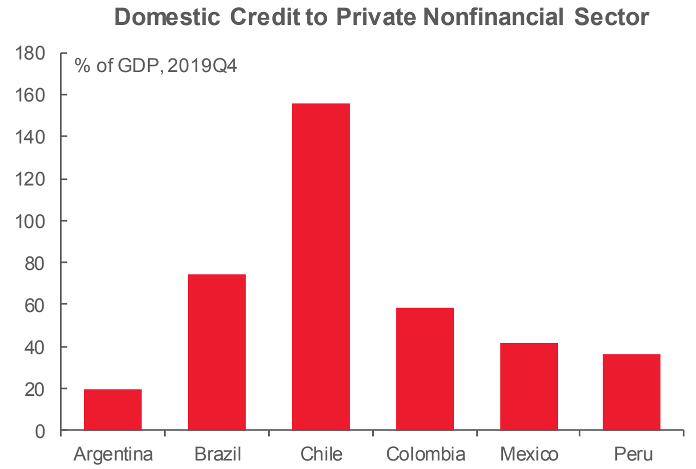
Key Market Charts

Chart 19



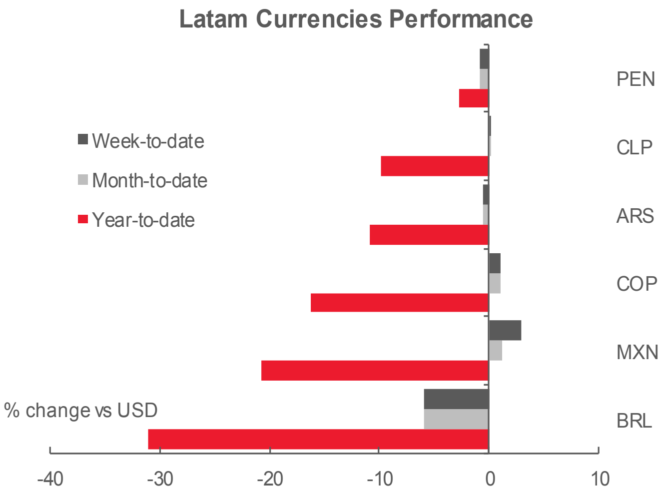
* Chile 19Q3; Peru 19Q2.
Sources: Scotiabank Economics, IMF.

Chart 20



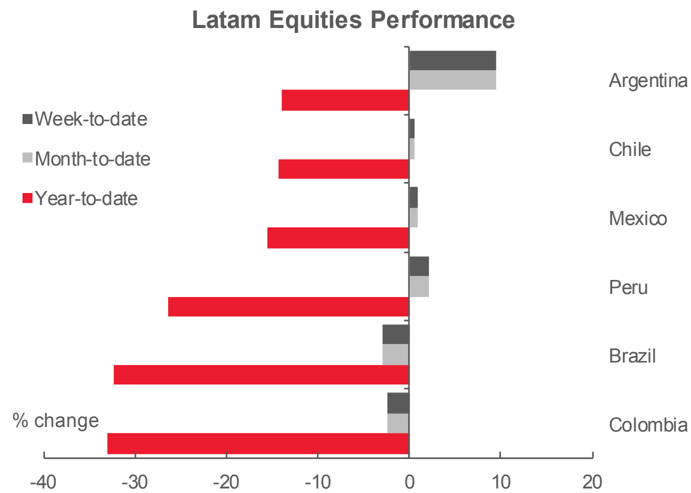
Sources: Scotiabank Economics, BIS, Haver Analytics.

Chart 21



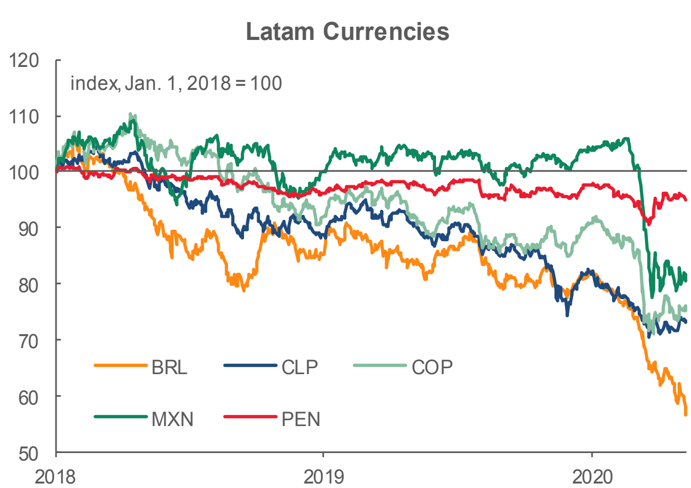
Sources: Scotiabank Economics, Bloomberg.

Chart 22



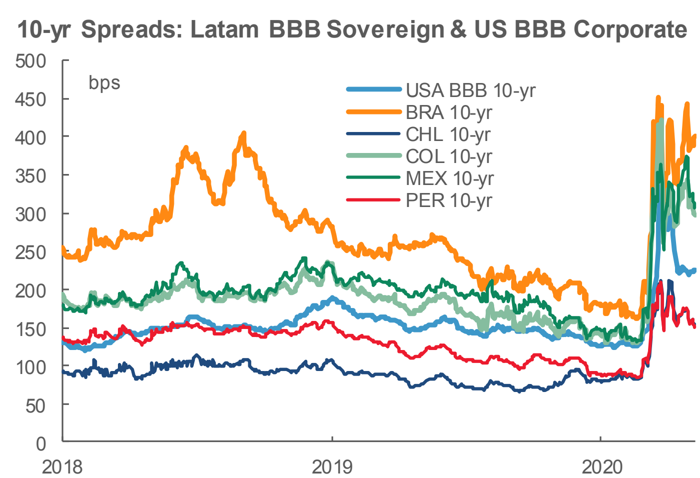
Sources: Scotiabank Economics, Bloomberg.

Chart 23



Sources: Scotiabank Economics, Bloomberg.

Chart 24



Sources: Scotiabank Economics, Bloomberg.

Market Events & Indicators for May 9–15

ARGENTINA

Date	Time	Event	Period	BNS	Consensus	Latest	BNS Comments
May 12-22		Budget Balance	Apr	--	--	-124728	
05-13	15:00	Capacity Utilization	Mar	--	--	59.4	
05-14	15:00	Greater Buenos Aires CPI (y/y)	Apr	--	--	46.9	
05-14	15:00	Greater Buenos Aires CPI (m/m)	Apr	--	--	3.6	
05-14	15:00	National CPI (m/m)	Apr	3.5	--	3.3	We expect m/m inflation to accelerate to 3.5% owing to strong wage growth and ARS depreciation. Level-effects would keep y/y inflation at 48.4%.
05-14	15:00	National CPI (y/y)	Apr	48.4	--	48.4	

BRAZIL

Date	Time	Event	Period	BNS	Consensus	Latest	BNS Comments
05-11	7:25	Central Bank Weekly Economists Survey					
05-11	14:00	Trade Balance Weekly	10-May	--	--	1744	
05-12	4:00	FIPE CPI - Weekly	07-May	--	--	-0.1	
05-12	7:00	Central Bank Meeting Minutes					We expect the *Minutes* to provide additional insight on the COPOM's forward guidance regarding the "finality" of its next rate move.
05-12	7:00	IGP-M Inflation 1st Preview	May	--	--	1.1	
05-12	8:00	IBGE Services Sector Volume (y/y)	Mar	--	--	0.7	
05-13	8:00	Retail Sales (m/m)	Mar	--	--	1.2	
05-13	8:00	Retail Sales (y/y)	Mar	-0.7	--	4.7	
05-13	8:00	Retail Sales Broad (m/m)	Mar	--	--	0.7	
05-13	8:00	Retail Sales Broad (y/y)	Mar	--	--	3.3	
May 13-14		Economic Activity (y/y)	Mar	--	--	0.6	
05-15	8:00	Economic Activity (m/m)	Mar	--	--	0.4	

CHILE

Date	Time	Event	Period	BNS	Consensus	Latest	BNS Comments
May 8-13		Vehicle Sales Total	Apr	--	--	19177	
05-12	7:30	Central Bank Economists Survey					

COLOMBIA

Date	Time	Event	Period	BNS	Consensus	Latest	BNS Comments
05-13	15:00	Civil Works Payments (y/y)	1Q	--	--	7.7	
05-14	11:00	Manufacturing Production (y/y)	Mar	-8.4	--	4.6	Manufacturing expected to contract because the lockdown affected 7 business days. Retail sales will remain strong due to households stocking up before the emergency.
05-14	11:00	Retail Sales (y/y)	Mar	10	--	13.2	
05-14	11:00	Imports CIF Total	Mar	--	--	3968	
05-14	11:00	Trade Balance	Mar	--	--	-755.5	
05-14	15:00	Industrial Production (y/y)	Mar	--	--	4.9	
05-15	12:00	GDP NSA (y/y)	1Q	3.2	--	3.4	Economic recovery consolidation would still be reflected in the 1Q GDP. Lockdown effects will come in 2Q.
05-15	12:00	GDP (q/q)	1Q	--	--	0.5	
05-15	15:00	Economic Activity NSA (y/y)	Mar	--	--	4.8	
05-15		Central Bank Economist Survey					

Forecasts at time of publication.
Sources: Scotiabank Economics, Bloomberg.

Market Events & Indicators for May 9–15

MEXICO

Date	Time	Event	Period	BNS	Consensus	Latest	BNS Comments
May 6-12		ANTAD Same-Store Sales (y/y)	Apr	--	--	1.1	
May 7-13		Formal Job Creation Total	Apr	-367	--	-130.6	
05-12	7:00	Industrial Production NSA (y/y)	Mar	-6.1	--	-1.9	
05-12	7:00	Manuf. Production NSA (y/y)	Mar	--	--	-1	
05-12	7:00	Industrial Production SA (m/m)	Mar	--	--	-0.6	
05-12	10:00	International Reserves Weekly	08-May	--	--	186128	
05-14	14:00	**Overnight Rate**	**14-May**	**5.50**	**5.50**	**6.00**	

PERU

Date	Time	Event	Period	BNS	Consensus	Latest	BNS Comments
May 11-13		Trade Balance	Mar	--	--	256	
05-15	1:00	Economic Activity (y/y)	Mar	-25	2.6	3.8	
05-15	1:00	Unemployment Rate	Apr	--	--	7.8	

Forecasts at time of publication.
Sources: Scotiabank Economics, Bloomberg.

Scotiabank Economics Latam Coverage