Scotiabank™

GLOBAL ECONOMICS
| LATAM WEEKLY

April 11, 2020

Latam Weekly: Fiscal to the Fore

FORECAST UPDATES

- **The growth forecasts for Argentina, Colombia, and Mexico all see further markdowns this week owing to a combination of domestic and international developments. Central banks in Brazil, Mexico, and Peru are projected to take rates lower for longer.**

ECONOMIC OVERVIEW

- **Governments across Latam are launching and extending substantial fiscal programs to complement the monetary loosening they have undertaken to cushion the economic impact of public-health measures to stem the COVID-19 pandemic. We look at the economic implications of these fiscal packages across the Latam-6.**

MARKETS REPORT

- **Given the widely differing amount of fiscal space across the Latam-6, their tax and spending measures to counter COVID-19 imply differentiated implications for their currencies and local fixed-income markets. We take stock of what lies ahead for these asset classes.**

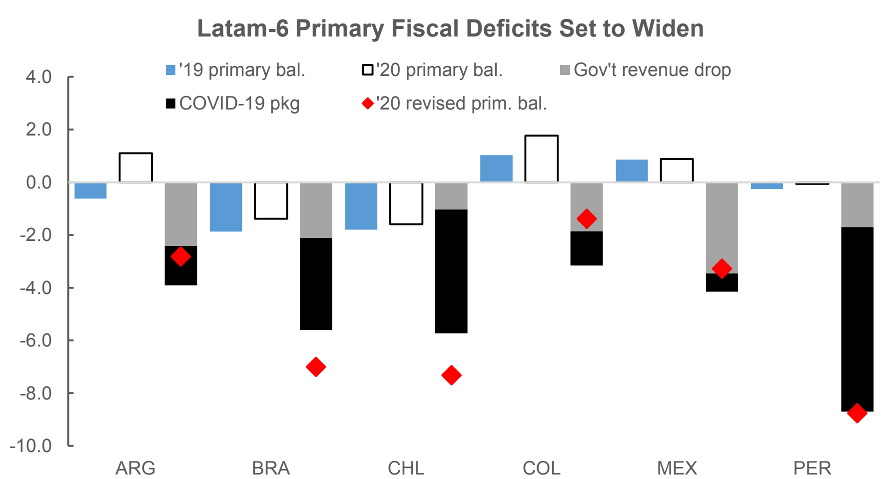
COUNTRY UPDATES

- **Succinct analysis of recent developments and guides to the week ahead in Argentina, Brazil, Chile, Colombia, Mexico, and Peru.**

MARKET EVENTS & INDICATORS

- **Risk calendars with selected highlights for the period April 11–17 across Latam's major economies.**

Chart of the Week



Sources: Scotiabank Economics, IMF.

CONTACTS

Brett House, VP & Deputy Chief Economist
416.863.7463
Scotiabank Economics
brett.house@scotiabank.com

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

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THIS WEEK'S CONTRIBUTORS:

Jorge Selaive, Chief Economist
56.2.2939.1092 (Chile)
jorge.selaive@scotiabank.cl

Carlos Muñoz, Senior Economist
56.2.2619.6848 (Chile)
carlos.munoz@scotiabank.cl

Sergio Olarte, Senior Economist
57.1.745.6300 (Colombia)
sergio.olarte@co.scotiabank.com

Jackeline Piraján, Economist
57.1.745.6300 (Colombia)
jackeline.pirajan@co.scotiabank.com

Mario Correa, Economic Research Director
52.55.5123.2683 (Mexico)
mcorrea@scotiacb.com.mx

Guillermo Arbe, Head of Economic Research
511.211.6052 (Peru)
guillermo.arbe@scotiabank.com.pe

Tania Escobedo Jacob, Associate Director
212.225.6256 (New York)
tania.escobedojacob@scotiabank.com

Raffi Ghazarian, Senior Research Analyst
416.866.4211
Scotiabank Economics
raffi.ghazarian@scotiabank.com

Forecast Updates: April 11

	2019	2020				2021						
Argentina	**Q4**	**Q1f**	**Q2f**	**Q3f**	**Q4f**	**Q1f**	**Q2f**	**Q3f**	**Q4f**	**2019**	**2020f**	**2021f**
Real GDP (y/y % change)	-1.1	-0.9	-12.0	-4.1	-1.7	0.9	2.0	3.2	2.9	-2.2	-4.9	2.3
CPI (y/y %, eop)	53.8	47.2	49.0	46.8	45.7	48.9	46.8	44.7	42.6	53.8	45.7	42.6
Unemployment rate (%, avg)	8.9	10.9	11.1	10.8	10.6	10.5	10.1	9.9	9.8	9.8	10.9	10.1
Central bank policy rate (%, eop)	55.00	38.00	37.00	36.00	35.00	35.00	35.00	37.00	40.00	55.00	35.00	40.00
Foreign exchange (USDARS, eop)	59.9	63.5	71.2	77.9	82.0	85.0	86.8	88.1	90.5	59.9	82.0	76.0

	2019	2020				2021						
Brazil	**Q4**	**Q1f**	**Q2f**	**Q3f**	**Q4f**	**Q1f**	**Q2f**	**Q3f**	**Q4f**	**2019**	**2020f**	**2021f**
Real GDP (y/y % change)	1.7	0.8	-9.3	-4.3	-0.3	1.1	4.2	3.1	1.7	1.1	-3.3	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	11.6	12.7	12.8	12.6	13.2	13.6	13.6	13.4	11.9	12.4	13.5
Central bank policy rate (%, eop)	6.50	3.75	3.00	3.00	3.00	4.00	4.75	5.50	6.00	4.50	3.00	6.00
Foreign exchange (USDBRL, eop)	4.02	5.25	4.97	4.72	4.84	4.93	4.64	4.52	4.42	4.02	4.84	4.42

	2019	2020				2021						
Chile	**Q4**	**Q1f**	**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	3.8	3.3	3.2	3.0	2.5	2.9	3.3	3.0	3.0	3.0	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**	**Q1f**	**Q2f**	**Q3f**	**Q4f**	**Q1f**	**Q2f**	**Q3f**	**Q4f**	**2019**	**2020f**	**2021f**
Real GDP (y/y % change)	3.4	3.6	-3.0	0.0	1.8	2.9	4.9	3.8	3.0	3.3	0.6	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	13.3	17.0	15.0	12.0	10.8	9.3	10.0	10.4	11.2	14.3	10.1
Central bank policy rate (%, eop)	4.25	3.75	3.25	3.25	3.25	3.25	3.75	4.25	4.25	4.25	3.25	4.25
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**	**Q1f**	**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	3.2	3.8	3.6	3.8	3.7	3.8	3.7	2.8	3.6	3.7
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	5.50	5.50	5.00	5.00	5.00	5.00	7.25	5.50	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**	**Q1f**	**Q2f**	**Q3f**	**Q4f**	**Q1f**	**Q2f**	**Q3f**	**Q4f**	**2019**	**2020f**	**2021f**
Real GDP (y/y % change)	1.8	-4.5	-7.0	0.7	1.3	6.7	9.6	1.0	1.6	2.2	-2.3	4.5
CPI (y/y %, eop)	1,9	1.9	1.8	1.7	1.4	1.5	1.4	1.8	2.0	1.9	1.4	2.0
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	0.25	0.50	0.75	1.00	2.25	0.25	1.00
Foreign exchange (USDPEN, eop)	3.31	3.57	3.56	3.47	3.45	3.42	3.43	3.39	3.40	3.31	3.45	3.40

	2019	2020				2021						
United States	**Q4**	**Q1f**	**Q2f**	**Q3f**	**Q4f**	**Q1f**	**Q2f**	**Q3f**	**Q4f**	**2019**	**2020f**	**2021f**
Real GDP (y/y % change)	2.3	1.0	-5.2	-2.6	-1.3	0.5	7.5	5.0	3.9	2.3	-2.0	4.1
CPI (y/y %, eop)	2.0	2.1	0.8	0.6	0.8	1.7	2.4	2.6	2.8	2.0	0.8	2.8
Unemployment rate (%, avg)	3.5	3.9	5.1	6.2	6.7	6.7	6.4	6.1	5.6	3.7	5.5	6.2
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.

Forecast Updates: March—April Revisions

	March 6		April 11	
	2020f	2021f	2020f	2021f
Argentina*				
Real GDP (annual % change)	...	...	-4.9	2.3
CPI (y/y %, eop)	...	...	45.7	42.6
Unemployment rate (%, avg)	...	...	10.9	10.1
Central bank policy rate (%, eop)	...	...	35.00	40.00
Argentine peso (USDARS, eop)	...	...	82.0	76.0
Brazil				
Real GDP (annual % change)	1.8	2.1	-3.3	2.5
CPI (y/y %, eop)	4.2	4.1	6.3	7.1
Unemployment rate (%, avg)	...	...	12.4	13.5
Central bank policy rate (%, eop)	3.50	5.25	3.00	6.00
Brazilian real (USDBRL, eop)	4.37	4.11	4.84	4.42
Chile				
Real GDP (annual % change)	1.4	2.5	-2.1	2.9
CPI (y/y %, eop)	3.0	3.0	3.0	3.0
Unemployment rate (%, avg)	...	...	8.3	7.7
Central bank policy rate (%, eop)	1.00	2.00	0.50	1.50
Chilean peso (USDCLP, eop)	740	700	790	720
Colombia				
Real GDP (annual % change)	3.6	3.6	0.6	3.6
CPI (y/y %, eop)	3.3	3.1	3.2	3.1
Unemployment rate (%, avg)	...	...	14.3	10.1
Central bank policy rate (%, eop)	4.50	4.75	3.25	4.25
Colombian peso (USDCOP, eop)	3,250	3,180	3,654	3,450
Mexico				
Real GDP (annual % change)	0.6	1.6	-8.4	1.1
CPI (y/y %, eop)	3.8	3.7	3.6	3.7
Unemployment rate (%, avg)	...	...	6.1	6.3
Central bank policy rate (%, eop)	6.25	6.25	5.50	5.00
Mexican peso (USDMXN, eop)	20.78	21.86	24.24	24.15
Peru				
Real GDP (annual % change)	3.0	3.5	-2.3	4.5
CPI (y/y %, eop)	1.8	2.1	1.4	2.0
Unemployment rate (%, avg)	...	...	12.0	10.0
Central bank policy rate (%, eop)	2.00	2.25	0.25	1.00
Peruvian sol (USDPEN, eop)	3.40	3.35	3.45	3.40

Source: Scotiabank Economics.
* Initiated coverage March 22, 2020.

Forecast Updates: Central Bank Policy Rates and Outlook

Latam Central Banks: Policy Rates and Outlook

		Next Scheduled Meeting			Market Pricing		BNS Forecast		
	Current	Date	Market	BNS	12 mos	24 mos	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.	35.00%	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 April.
Brazil, BCB, Selic	3.75%	May-06	3.73%	3.25%	3.78%	6.57%	3.00%	6.00%	The apparent absence of FX-induced pass-through inflation provides the BCB with room to pursue a deeper easing cycle.
Chile, BCCh, TPM	0.50%	May-06	0.47%	0.50%	0.94%	1.59%	0.50%	1.50%	The BCCh MPC indicated at its March 31 meeting that 0.5% is the policy rates' technical lower bound, and that it would remain here for an extended period.
Colombia, BanRep, TII	3.75%	Apr-30	3.74%	3.50%	3.70%	4.29%	3.25%	4.25%	BanRep will continue cutting rates due to the downside risks on economic activity and contained risk on the inflation side.
Mexico, Banxico, TO	6.50%	May-14	6.41%	6.00%	5.09%	5.68%	5.50%	5.00%	Recent rapid deterioration of economic outlook, coupled with more tamed inflation, will open space for more cuts on the reference interest rate.
Peru, BCRP, TIR	0.25%	Apr-16*	n.a.	0.25%	n.a.	n.a.	0.25%	1.00%	In a surprise, off-calendar move on the evening of Thursday, April 9, the central bank cut its reference rate by 100 bps to 0.25%, twice the 50 bps cut we had been expecting at the bank’s scheduled meeting on Thursday, April 16. The BCRP has never before lowered its policy rate by 200 bps in less than a month, and 0.25% is the lowest rate it has ever reached. The speed and depth of the BCRP’s moves are together a clear sign of just how concerned the monetary authorities are about the developing contraction in economic activity. * The scheduled April 16 meeting may be cancelled or become perfunctory owing to Thursday's surprise cut.

Sources: Scotiabank Economics, Bloomberg.

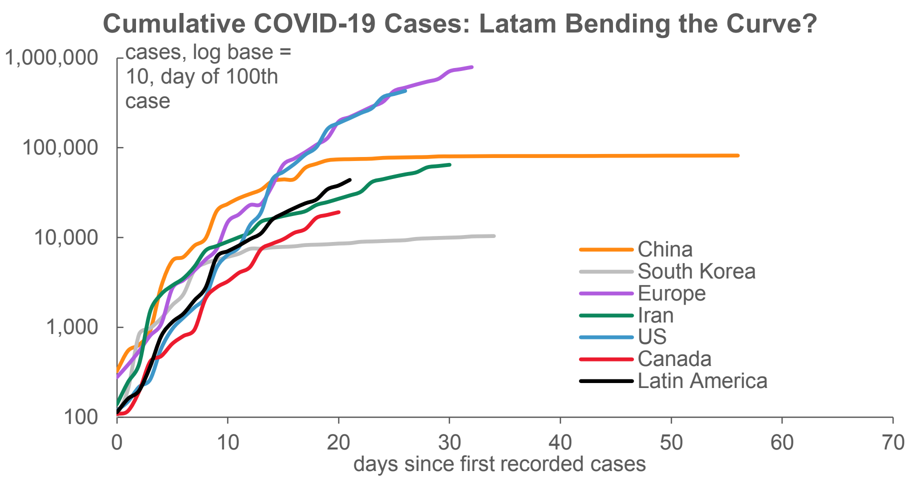
Economic Overview: A Whole Lotta Fiscal Goin' On

- **The Latam-6 continued to see substantial increases in identified COVID-19 cases over the past week, with a particularly marked jump in numbers in Peru. The region as a whole may be bending the curve faster than Europe or the US, but given Brazil and Mexico's delayed shutdowns, the numbers likely reflect low testing rates as much as effective efforts to stem infections.**
- **As in past weeks, we continued to see substantial new fiscal and monetary policy measures announced throughout the Latam-6, with an unprecedented cut in the main policy rate in Peru.**
- **In view of the past week's developments, we updated our Latam-6 macroeconomics forecasts yet again, in anticipation of a global update next week by Scotiabank Economics. Argentina's, Colombia's, and Mexico's 2020 downturns are expected to be deeper than previously forecast, while central banks in Brazil, Mexico, and Peru are projected to take rates lower for longer.**
- **Significant fiscal packages in most of the Latam-6 will substantially raise deficits and debt burdens across the Latam-6, with Chile, Colombia, and Peru relatively well positioned to absorb these shocks.**

COVID-19: EXPONTENTIAL COUNTRY GROWTH, REGIONAL FLATTENING?

Latin America continues to register a relatively small share of global identified cases of COVID-19. All of Latin America accounts for about 8% of the world's population, but the region currently contributes only a 3.3% share to global COVID-19 numbers, but this is up from 2.4% a week ago (chart 1). Brazil continues to see clearly exponential growth in cases numbers, with Peru joining it as testing has stepped up (chart 2). Even with the delays in quarantines, shutdowns, and testing in some parts of the region, Latam's cumulative case

Chart 3

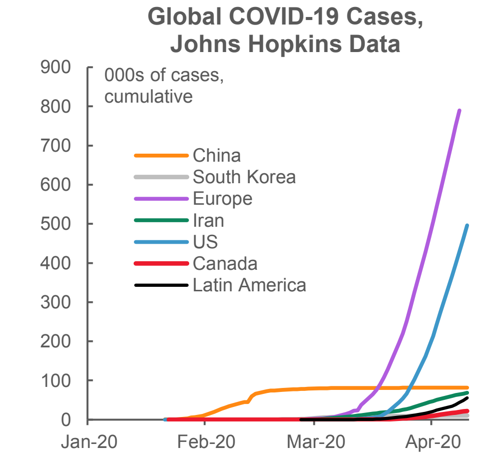


Sources: Scotiabank Economics, Johns Hopkins University.

CONTACTS

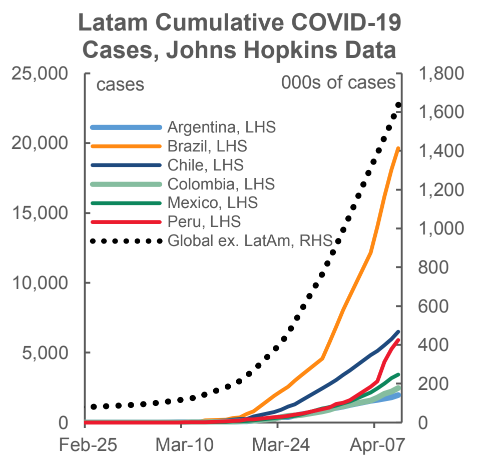
Brett House, VP & Deputy Chief Economist
416.863.7463
Scotiabank Economics
brett.house@scotiabank.com

Chart 1



Sources: Scotiabank Economics, Johns Hopkins University.

Chart 2



Sources: Scotiabank Economics, Johns Hopkins University.

numbers are trending better than Europe's or the United States' data at a comparable stage in local contagion (chart 3). This may be testament to the extensive physical isolation measures that have been enacted in most of the region's countries, but continued vigilance will be necessary as more extensive testing could well produce a worsening in this trend.

The Latam-6's governmental authorities extended and intensified quarantine and other public-health measures in several countries over the past week. Peru moved on April 8 to extend its state of emergency to April 26; Argentina's government moved on Friday, April 10 to extend its nationwide lockdown to the same date. In Colombia, the mandatory quarantine has been renewed from April 14 to April 27. Brazil's state governors and city mayors maintain stricter public-health measures than Brasilia has dictated; these are unlikely to be relaxed in the coming weeks. Chile is the one exception where restrictions have been eased in some cities, but remain fully in place in Santiago, where they are expected to be extended beyond their April 12 expiration.

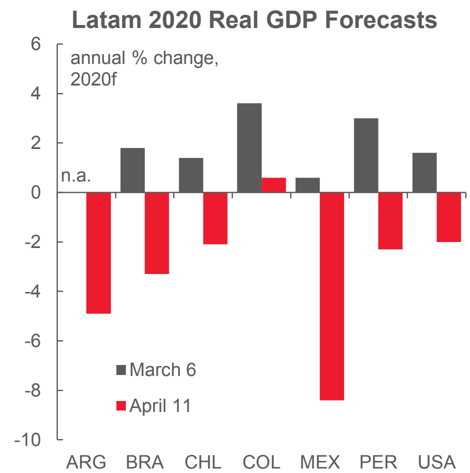
ECONOMIC POLICY AND FORECAST CHANGES

Policy makers continued to complement stringent measures to stop the spread of COVID-19 with remarkable moves on the economic policy front, led by Peru's BCRP, which slashed its principal monetary policy rate in a precedent-setting fashion. The central bank in Lima cut an additional 100 bps on the evening of Thursday, April 9, a week ahead of its scheduled April 16 meeting and on a public holiday, underscoring the authorities' concerns about weakening fundamentals. The move takes the BCRP's policy rate to a record low of 0.25% after 200 bps of cuts in a single month—a first. On the fiscal side, Chile's government announced a new fund amounting to USD 2 bn to help vulnerable and informal workers. The national government also committed to the creation of a line of state-guaranteed financing of up to USD 24 bn for firms.

Despite moves across the region to ease monetary policy and implement fiscal measures to compensate for the economic impact of efforts to control the COVID-19 pandemic, our Latam outlook has massively softened since the global implications of the COVID-19 pandemic began to crystalize (Forecast Updates tables, pp. 2 and 3). We map the evolution of our macroeconomic forecasts over last five weeks in charts 4–6 using Scotiabank Economics' March 6 global *Forecast Tables* as our reference benchmark since that set of projections marked the inflection point where the emerging novel coronavirus epidemic began to dominate our outlook. Since March 6, our expectations for global growth in 2020 have collapsed from 2.7% y/y to roughly no expansion in the year, the worst calendar-year worldwide performance since the -0.3% observed in 2009. Emerging markets as a whole are broadly expected to see an economic contraction in 2020, their first in the post-war era.

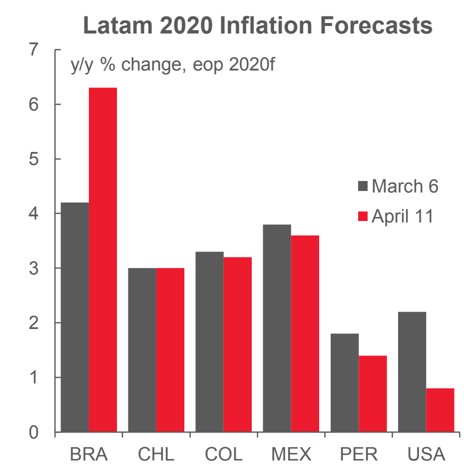
The regional outlook for the Latam-6 has seen similar markdowns, with some strong national distinctions. Across the Latam-6, the average real GDP growth rate forecast for 2020 sat at around 2% y/y on March 6; since then, the average has dropped steeply to a contraction of about -3% y/y (chart 4). Aside from Argentina, which is entering its third consecutive year of recession, none of the Latam-6 were expected to experience an average annual contraction in 2020, though Mexico was right on the edge. Now, all of the region's major economies are expected to see

Chart 4



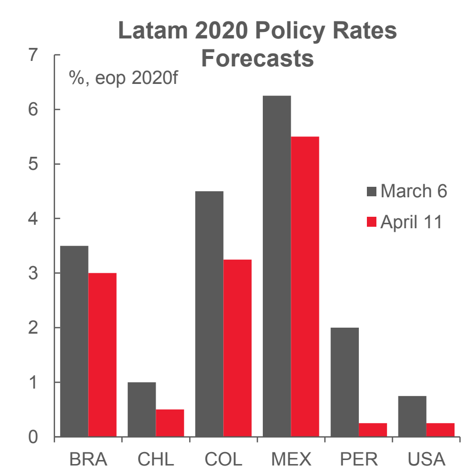
Source: Scotiabank Economics.

Chart 5



Argentina: 46%.
Source: Scotiabank Economics.

Chart 6



Argentina: 35%.Source: Scotiabank Economics.

profound recessions in 2020, with the exception of Colombia, where our country team flags (see Country Updates section) that risks remain tilted heavily to the downside as the country embarks on an extension of its quarantine measures.

In contrast, our Latam-6 inflation forecasts haven't changed much since early-March (chart 5). Our inflation forecasts have been shaved only marginally in most cases owing to an expectation that large exchange-rate depreciations will produce some inflationary pass-through to local prices. In Brazil's case, the distinct absence of much pass-through despite a 21% YTD depreciation in the BRL continues to surprise, but our Brazil economist expects prices on imported goods to jump later this year.

Moves by developed-market central banks, led by the Fed, to cut policy rates to their effective lower bounds have provided room for their Latam-6 monetary peers to follow them—and we expect some of them to go even further (chart 6). Chile's BCCh and Peru's BCRP have already hit their effective or 'technical' lower bounds for their monetary policy rates, but we expect Brazil's BCB, Colombia's BanRep, and Mexico's Banxico to continue lowering their policy rates to support domestic economic activity. In Brazil and Colombia, we expect policy rates to come down more than markets have yet priced in—an additional 75 bps lower in Brazil's case and an extra 50 bps lower for Colombia. Our team in Mexico City expects Banxico's target overnight rate to come down to 5.0%, as does the markets, but our forecasts anticipate a more gradual set of cuts stretching into 2021. In contrast, the market expects Banxico to hit 5.0% a year from now before moving to tightening late next year.

SUBSTANTIAL FISCAL PACKAGES, BIG CHANGES IN FISCAL METRICS

The response by Latam's economic policy-makers to the COVID-19 pandemic and ensuing shutdowns has been exceptional in many respects, but the new monetary and fiscal support for the region's domestic economies has been striking for its speed, scale, and scope across all of the Latam-6, with the exception of Mexico. In the midst of an

Table 1

Announced COVID-19 fiscal policy measures across the Latam-6

	% GDP	Approx. nominal	Key elements and caveats
Argentina	1.5%	ARS 350 bn	ARS 350 bn (1.5% GDP) in direct transfers and tax relief to households. Another ARS 100 bn may be dedicated to infrastructure and housing finance. Additional AR 343 bn in credit facilities through state banks do not affect the primary balance.
Brazil	3.5%	BRL 240 bn	Measures worth about 3.5% GDP in focused direct income support, accelerated pension payments, and tax deferrals, but some elements are reallocations from existing 2020 budget. Another roughly BRL 170 bn (2.5% GDP) in BNDES and other public-bank credit facilities outside fiscal balance. Congressional leaders have mooted a "war-time budget" of an overall total of up to BRL 500 bn (7.3% GDP).
Chile	4.7%	USD 13.75 bn	Package includes healthcare spending, enhanced unemployment benefits, tax deferrals, and accelerated payment of public contracts. USD 500 mn of the total package will be used to increase the capitalization of Banco del Estado to raise its lending capacity by USD 4.4 bn. On April 8 the government announced an additional USD 24 bn in credit lines for vulnerable firms that will not affect the primary balance. It also added a new USD 2 bn fund to the overall fiscal package that will support informal and other vulnerable workers.
Colombia	1.3%	COP 14.8 tn	Targeted tax deferrals and accelerated rebates, extra health and social spending, enhanced transfers to vulnerable groups, and suspension of selected import tariffs.
Mexico	0.7%	MXN 180 bn	Congress approved the creation of a Health Emergency Fund of up to MXN 180 bn pesos. Other measures, including accelerated pension payments and procurement, would be within the existing budget.
Peru	7.0%	PEN 48 bn	Approximately 5.5% GDP in new spending, 1.5% GDP in tax measures. Additional 4.7% GDP in credit facilities do not have budgetary impact.

Sources: Scotiabank Economics, IMF, National country authorities.
See: https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19#B

Table 2

Bigger primary deficits ahead in 2020

	IMF Oct. WEO primary balance, % GDP 2019	IMF Oct. WEO primary balance, % GDP 2020	Reduced tax revenue from lower growth, % GDP	Announced COVID-19 fiscal package, % GDP	Implied change in 2020 primary balance, % GDP	Revised 2020 primary balance, % GDP
Argentina	-0.6	1.1	-2.4	-1.5	-3.9	-2.8
Brazil	-1.9	-1.4	-2.1	-3.5	-5.6	-7.0
Chile	-1.8	-1.6	-1.0	-4.7	-5.7	-7.3
Colombia	1.0	1.8	-1.9	-1.3	-3.2	-1.4
Mexico	0.9	0.9	-3.5	-0.7	-4.2	-3.3
Peru	-0.3	-0.1	-1.7	-7.0	-8.7	-8.8

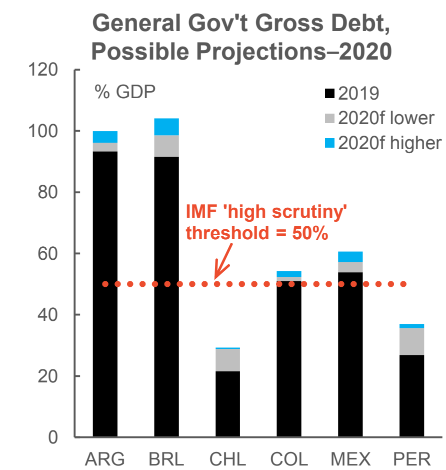
Sources: Scotialbank Economics, IMF, Fricke and Sussmuth (2011).

unparalleled pullback in foreign capital from emerging markets as a whole, which has induced some back-ups in yields and rapid FX depreciations, Latam governments have, in the main, moved decisively to offset the sudden stop in export demand and local economic activity with quick monetary easing, strategic tax relief, targeted spending measures, and new credit facilities (table 1).

To some extent, the size of countries' fiscal COVID-19 packages has been linked to the severity of their shutdowns and their available fiscal space, but in some cases, Latam policy makers have moved to preserve domestic economic activity even where deficits and debt levels were already high. Chile and Peru were relatively swift to take comprehensive public-health measures to stem the spread of the novel coronavirus and both followed up with comparatively large compensatory suites of spending and tax relief. Both countries came into 2020 with room to act: they were carrying low debt burdens (chart 7) and, in the case of Peru, a small primary deficit (table 2). Chile's response to its social unrest in 2019 left its primary deficit uncharacteristically large, but its low general government debt-GDP ratio, large sovereign wealth funds, and moderate external current account deficit position it to finance higher spending. In contrast, Brazil has brought forward a sizable fiscal package worth 3.5% GDP despite having no fiscal breathing room: it has the region's largest primary deficit and the highest debt burden. Even Argentina, which is in selective default and has no access to capital markets, has launched fiscal measures worth 1.5% GDP to counter the effects of its quarantine.

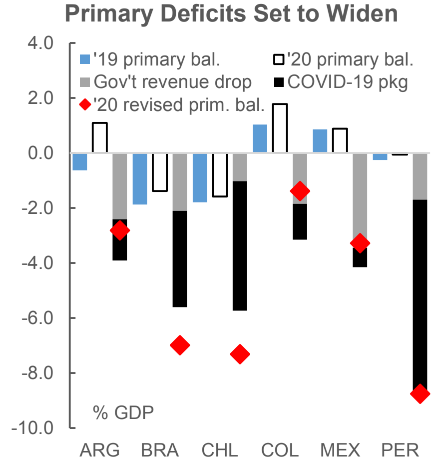
Regardless of the size and shape of the fiscal packages they have announced, implemented, or are still contemplating, all of the Latam-6 are set to encounter large deteriorations in their primary fiscal balances in 2020 (table 2, again). First, lower growth will put a major dent in government revenues. Using average elasticities on personal, corporate, and value-added taxes calculated by Fricke and Sussmuth (2011), the Latam-6 would expect to see tax revenue fall by between 1% of GDP in Chile and a striking 3.5% GDP equivalent in Mexico. Combined with the COVID-19-related new measures outlined in table 2, primary fiscal deficits would be expected to grow by at least 3.2 ppts of GDP in Colombia and up to 8.7 ppts of GDP in Peru. Peru is set to see its primary deficit reach nearly 9% of GDP before we take stock of further revenue hits from low commodity prices (chart 8). We should caution that these are likely lower-bound estimates of how much the region's primary fiscal deficits will widen as they do not incorporate projections of the extent to which automatic stabilizers on the spending side will also kick in as growth falls.

Chart 7



Sources: Scotiabank Economics, IMF.

Chart 8



Sources: Scotiabank Economics, IMF.

Despite these rapid moves to wider fiscal deficits, debt sustainability concerns should not arise immediately for any of these countries aside from, obviously, Argentina. Chile and Peru retain substantial room to add to their existing COVID-19 fiscal responses (chart 7), and recent policy announcements imply that they could do so without sending their general government debt levels to particularly high ratios even if they choose to capitalize interest payments coming due this year to add to their immediate spending power (i.e., consistent with the higher forecasts for 2020 debt-GDP ratios in chart 7). Colombia and Mexico are both likely to see in 2020 their respective general government debt-GDP ratio pass the 50% threshold that invites "high scrutiny" for countries with market access under the IMF's debt sustainability framework, but this is more of a bureaucratic milestone than a signal of looming debt distress. Colombia could finance any further shortfalls domestically out of state funds, Mexico has access to deep credit markets, both countries have decent stocks of FX reserves, and both are buttressed by recourse to Flexible Credit Line (FCL) arrangements with the IMF. In the case of Brazil, its existing debt load is already high and it would likely have to seek much of any additional financing domestically, which in part accounts for the back-up in rates our forecasts anticipate in 2021.

Financing issues are discussed further in the Markets Report section.

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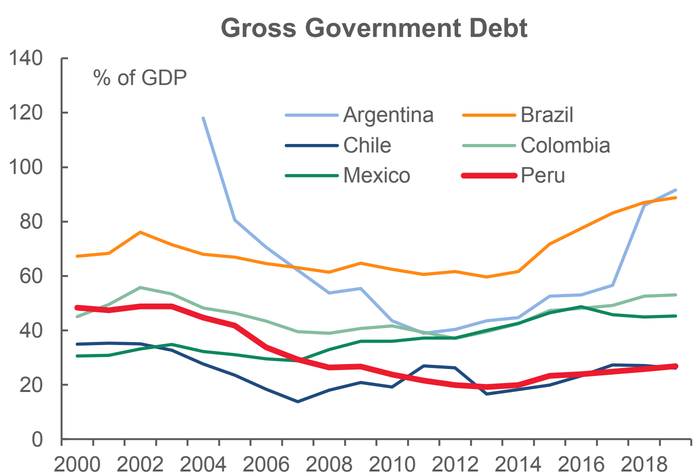
Markets Report: Financing Bold Fiscal Plans

- **As pressure on emerging markets paused somewhat this past week, we turn to the market implications of the Latam-6's COVID-19 fiscal packages for their bond markets and currencies.**
- **USD bond issuance in Peru and Chile may mitigate pressure on the domestic sovereign curves and ensuing flows could be a net positive for their currencies.**
- **Fiscal packages in Mexico and Colombia might be "market neutral", but confidence in the long-term sustainability of their debt will likely drive performance going forward.**
- **Brazil is likely to remain under pressure on several fronts and will probably have to expand its fiscal package and issue more than is currently anticipated.**
- **Argentina's fiscal package is likely to be accommodated in its sovereign debt restructuring.**

EMERGING MARKETS FIRM UP, ECHOING G10 DEVELOPMENTS

Mirroring some of the stabilization in G10 markets, this past week some swaths of emerging-market risk assets, including Latam FX and equity markets, found some respite from the COVID-19 maelstrom and saw some mild firming in prices after weeks of sell-offs. The Latam-6 currencies saw some mild gains (table 1) against the greenback as USD stress continued to ease and safe-haven flows abated somewhat on hopes that parts of Europe and North America may be seeing the start of a flattening in their new COVID-19 incidences curve at the same time as China brings shutdown areas gradually back into activity. Latam equities also caught a bid driven by broad global macro developments, as the domestic near-term outlook generally dimmed across the Latam-6.

Chart 1



Sources: Scotiabank Economics, National Ministries of Finance.

CONTACTS

Brett House, VP & Deputy Chief Economist
416.863.7463
Scotiabank Economics
brett.house@scotiabank.com

Tania Escobedo Jacob, Associate Director
212.225.6256 (New York)
Latam Macro Strategy
tania.escobedojacob@scotiabank.com

Table 1

Latam FX Performance: April 9, 2020

	Year-to-date	1-month	1-week
ARS	-8.1%	-1.2%	-0.4%
BRL	-21.2%	1.9%	4.7%
CLP	-10.3%	1.7%	3.0%
COP	-14.3%	6.0%	5.0%
MXN	-19.7%	0.5%	6.2%
PEN	-1.7%	1.8%	2.6%

Sources: Scotiabank Economics, Bloomberg.

Table 2

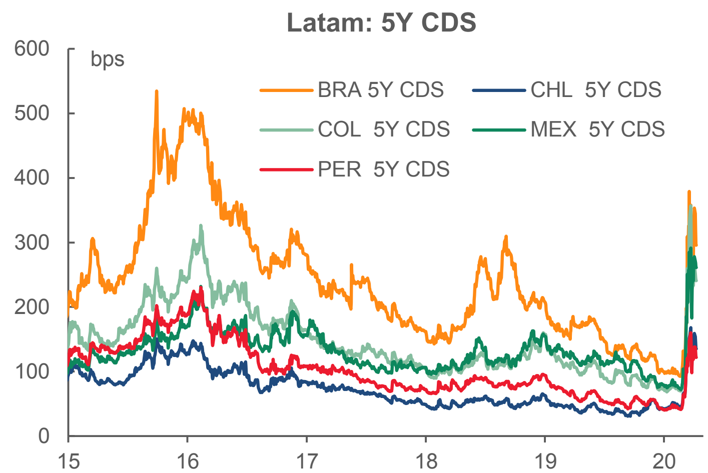
Latam Equity Market Performance (local currency): April 9, 2020

	Year-to-date	1-month	1-week
Argentina	-32.8%	14.9%	10.6%
Brazil	-32.8%	6.4%	7.5%
Chile	-18.2%	9.6%	7.4%
Colombia	-28.6%	5.6%	11.7%
Mexico	-20.6%	0.0%	2.6%
Peru	-32.2%	-3.8%	0.9%

Sources: Scotiabank Economics, Bloomberg.

FISCAL PACKAGES HAVE TO BE FINANCED

Chart 2



Sources: Scotiabank Economics, Bloomberg.

Across the Pacific Alliance countries, government responses to the pandemic have been broadly proportional to their starting points in terms of fiscal space. Peru and Chile have initiated fiscal and new credit measures that amount to about 12% and 4.7% of GDP, respectively, starting from low debt-GDP ratios (chart 1). Mexico and Colombia on the other hand, are starting from tighter positions that have to accommodate both responses to the economic shock of the pandemic and also the collapse in oil prices and the resulting hit to the government income. Mexico is further burdened with a battered state oil company that was already in poor shape. The downgrades we have seen in the sovereign ratings of these two economies are a confirmation of the complicated situation they are navigating, and CDS have responded accordingly (chart 2).

The fiscal stimulus in the Latam region will impact markets through additional debt issuance, the depletion of government savings that will imply FX transactions and, in some cases, assistance from the multilateral institutions will further shape developments. Throughout this section, we analyze the different implications of these actions in markets on and risk premiums embedded in Latam assets.

PERU: MULTIPLE FINANCING SOURCES

The total amount of the fiscal package in Peru is the biggest in the region at around PEN 90 bn (12% GDP), with about PEN 48 bn (7% GDP) dedicated to fiscal measures and the rest to credit facilities, guarantees, and pension withdrawals. There will be two phases to the overall package: a containment stage and a reactivation stage.

From the total amount, around PEN 15 bn (about 2.5% GDP) will be spent immediately on improvements in the health system as well as direct transfers, subsidies and other plans to alleviate the immediate damage to the economy. Tax measures will provide another 1.5% GDP of support. Loans and guarantees to the corporate sector amounting to about PEN 30 bn (more than 4% GDP) will also be deployed, and for individuals, some early access to pension funds will be facilitated.

In the next phase where the economy is reactivated, the government expects to spend about PEN 30 bn more. The remaining resources could be deployed later this year, or possibly early next year, but there has not yet been a clear indication on this.

Depending on the details and timing, the measures could raise the fiscal deficit to between 6% and 9% in 2020 and keep it over 3% in 2021.

As for sources of financing, we think that the government will tap part of the USD 5.8 bn Fiscal Stabilization Fund. The next step would be the IMF, where Peru is said to be seeking a USD 18 bn arrangement; the government also has more immediate contingent lines of credit available totaling USD 2.3 bn.

We believe the country would still need to issue sovereign bonds to cover key elements of its package. Congress has approved a debt ceiling of PEN 11.4 bn (about USD 3.3 bn) and this could constrain borrowing unless it is extended through presidential decree. The MEF and the Central Bank have signaled that Peru is preparing an external issuance to help underwrite its unprecedented stimulus package. This would be a good way to avoid putting pressure on the local curve and it should get a good response in international markets.

The Peruvian Congress has approved the government's bill that allows pensioners to withdraw up to 25% of the balance in their pension accounts up to PEN 12,900. The law will now go to the Executive, which has 15 days to accept or make observations; President Vizcarra will likely propose amendments, given that he has expressed his opposition to the bill.

In terms of the sale of assets, we think that the degree of liquidity in the Soberano market is at very low levels currently and that government bonds will not be the first instrument that the AFPs will sell in order to get cash. Also, the heavy impact such sales would have on nominal rates is undesirable for the financial system and the government. Hence, our view is that pension funds would prefer to sell part of their foreign-assets exposure, owing to the deeper markets and greater ease to liquidate these assets. Hence, any eventual sale of government debt and its effect on the curve would not be as dramatic as what could be inferred from the headlines on the government's COVID-19 response. Pension funds have 22% of their AUM in Soberanos (PEN 33 bn) and they are concentrated in the 2028s to 2040s tenors. The inflow of foreign currency that would hit the market would be PEN positive in our view, but part of it seems to be already priced in, with PEN outperforming peers after the congressional vote.

As a caveat, we would say such a move would not be market friendly and some pressure on the Peruvian curve and FX is likely if it is seen as a sign of conflict between the legislative and executive branches that increases political risk.

CHILE: BIASED TOWARD FOREIGN ISSUANCE

The USD 13.75 bn stimulus announced in parts by the Chilean government includes the USD 5.5 bn package already announced late in 2019 to soothe the effects of last year's social protests. Hence, the new money in the package is around USD 8 bn of which up to USD 1.4 bn corresponds to emergency funds and USD 2 bn for vulnerable and informal workers. Tax relief such as the suspension of the corporate tax payments and deferral of VAT payments will be automatically reversed through 2021 (USD 3.2 bn).

These financing needs are to be met by a combination of additional debt issuance for USD 4 bn, budget reallocation, and legal deferral of mandated contributions to funds. According to the Ministry of Finance, budget reallocations may be larger considering the difficulties of executing several aspects of the National Budget during the emergency.

The allocation between new USD debt and CLP debt has not been decided yet, but we think the Ministry of Finance (MoF) will be biased toward issuing abroad. Local debt would be a bit cheaper for the government, but it would also be inconsistent with the purchasing programs that are being implemented and liquidity might be an issue in these market conditions. Issuing abroad, on the other hand, would avoid pressure on local rates and encounter better levels of liquidity at spreads that are still attractive for the MoF.

On the FX side, we estimate that the spot USD liquidation from the MoF in 2020 could total about USD 16 bn, which we think will be a net positive for the CLP in the coming months. The MoF recently decided to adjust the mechanism by which it sells dollars in the local foreign exchange market, starting in April of this year (USD 500 mn/week to start, but with more details to come; see here). This is the mechanism through which we will see these new flows reaching the market.

The original budget for 2020 considered a 9.8% real increase in government spending, relative to 2019. With the new measures, the government expenditure in 2020 will likely be 16% above 2019 in real terms. The fiscal deficit for 2020 was previously estimated at 4.4% GDP and will probably adjust to 7%–8%, depending on the impact of the crisis on GDP.

MEXICO: ONLY THE BEGINNING

The government's limited fiscal action will, in principle, not require issuing more debt, reallocating expenditure, or tapping the credit line the government has with the IMF (about USD 60 bn). The government's commitment to fiscal discipline is maintained as the administration "does the impossible" to keep the debt/GDP ratio stable. Resources to give stimulus to the economy will come from the use of savings in the FEIP (about MXN 160 bn) and all the resources in the state trusts (about MXN 100 bn). Other savings will come from new cuts in wages and the elimination of bonuses in the public sector. None of these actions imply FX transactions or increased supply in the fixed income space so there will likely be little direct market impact.

We think the bulk of the market response in Mexico will come in the form of a reassessment of risk premiums embedded in the sovereign and quasi-sovereign curves, as well as the MXN. What we have seen so far is a violent re-pricing and position adjustment from a very crowded "long-Mexico" trade at the beginning of the year. The appealing carry-profile of Mexican bonds had the curve extremely flat and MXN outperforming peers up until March; the liquidation of EM assets and move into safer instruments that came with the recent financial turmoil has cleared the positioning significantly and risk premiums have inflated again. Nevertheless, the recent spike in EM-wide vol has significantly reduced the attractiveness of any remaining relative pick-up in Mexican debt (charts 3 through 6).

But it is difficult to assess at this point if the handling of the crisis in Mexico will have a long-lasting effect on investors' confidence that will keep Mexican assets deteriorating further. So far, the government response has been received with skepticism by the industrial sector and economic analysts locally, who claim that the lack of direct support to industries affected by the pandemic will result in an explosion of unemployment and an economic downturn that will put the country's investment-grade credit rating at risk. Still, uncertainty on the magnitude and duration of the economic damage is very high and will remain so until more hard data is available and the pandemic reaches an inflection point, globally.

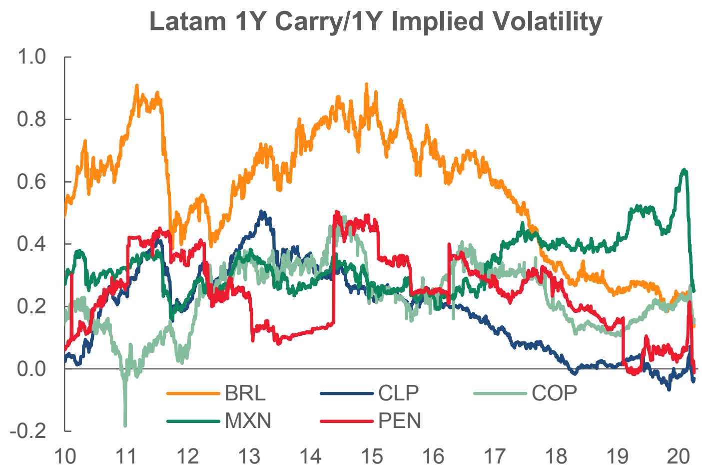
We think rate differentials will remain wide, favouring Mexico versus peers that have slashed rates more aggressively. Mexico also remains relatively stable in the context of comparable economies that are either on the brink of speculative grade like Colombia or just cut to junk like South Africa. Whether investors will see value in Mexican assets at current prices will depend to a great extent on the data and any potential adjustment of government responses to COVID-19. We think the final equilibrium will be somewhere in the middle between current pricing—which might be too pessimistic—and pre-crisis prices, after we account for the damage done to the economy from COVID-19-related shutdowns and the fiscal impact of compensatory measures.

COLOMBIA: CONSTRAINED BY RATINGS

Colombia has announced a relatively tentative response to the economic shock that amounts to COP 14.8 tn (1.3% GDP) and is intended to be fully financed by savings held in different state funds. Some extra resources might come from an increase in taxes to high-income individuals, but this idea is still preliminary. There is no more debt issuance in the government's plans so far; on the contrary, the government cut the 2020 debt auction plan by COP 1.5 tn (USD 368 bn) to COP 23 tn, of which COP 6.3 tn has already been auctioned.

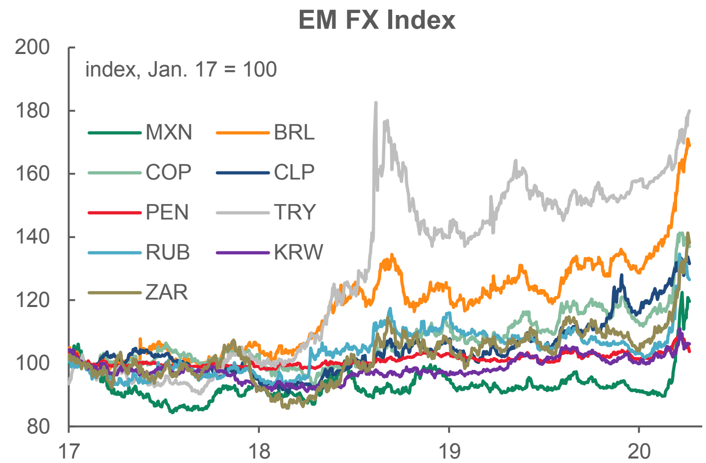
There are reasons for being cautious. In the aftermath of the epidemic, Fitch cut Colombia's sovereign credit rating to BBB- with negative outlook. With this move, Fitch joined S&P in placing Colombia only one notch above speculative grade with negative outlook. The driver of the move is quite predictable, namely, the deterioration of the fiscal metrics due to a combination of shocks from lower oil prices and measures to contain the COVID-19 outbreak. The discussion has taken a

Chart 3



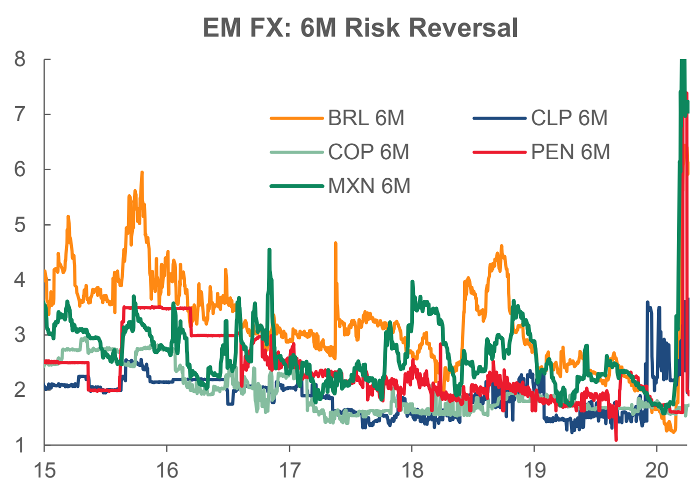
Sources: Scotiabank Economics, Bloomberg.

Chart 4



Sources: Scotiabank Economics, Bloomberg.

Chart 5

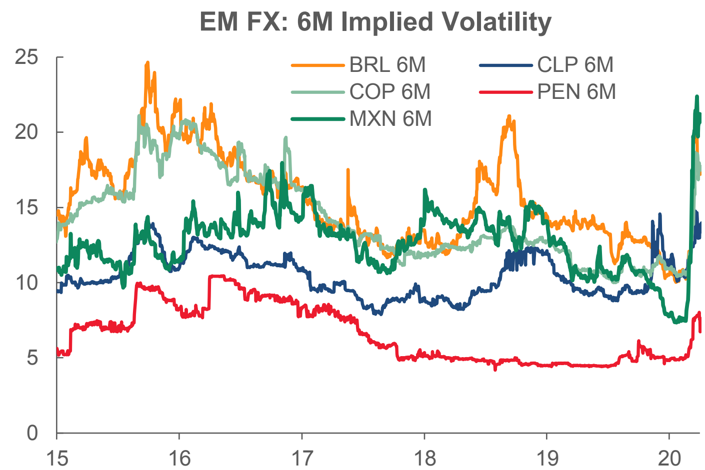


Sources: Scotiabank Economics, Bloomberg.

step further with Fitch adding that "the predictability and credibility of medium-term fiscal policy has deteriorated relative to 'BBB' peers" which looks like a direct criticism of achieving compliance with the fiscal rule only through extraordinary revenues and a concern about the difficulties in raising more structural sources of tax revenues. Growth projections from Fitch also look grim, with an expected contraction of 0.5% in 2020, which is much worse than the +0.3% expected by our economics team in Bogota.

Although in principle the fiscal plan will not have any direct impact on the fixed-income space, COP might benefit from USD flows that the Ministry of Finance will exchange in the market. The mechanism of these transactions is unclear, but sales of USD with this purpose in mind might already be hitting the market, which could potentially explain the recent stability of COP and account for the NDF sales made by the central bank.

Chart 6



Sources: Scotiabank Economics, Bloomberg.

Looking ahead, we think that the government will realize that the proposed assistance is insufficient and will probably look for additional resources from the multilateral organizations, where debt is usually cheaper. The current arrangement under the Flexible Credit Line with the IMF expires in May 2020, but the government has already expressed its interest to renew it. The amount approved in 2018 was about USD 11 bn. We think the government could either tap that line or, more likely, look for additional resources with the IaDB or the World Bank. The FCL is meant to be used to address problems with the BoP, which is not the current issue.

The longer-term impact on Colombian assets will depend on the delicate balance between keeping sustainable debt ratios and avoiding economic asphyxia to a point that the damage to GDP will have an even worse effect on long-term fiscal sustainability. We think Colombia is starting from a better position in terms of economic performance than its peers in Latam and that a lot of bad news is already priced in. For now, this leaves valuations of Colombian assets at attractive levels.

BRAZIL: TIGHT FISCAL SPACE

In Brazil, the government might have the least fiscal space in the region, with one of the highest debt-GDP ratios amongst the Latam-6 (on par with Argentina's) and mandatory spending eating more than 90% of allocated resources. Moreover, the BRL has also been the worst performing of the Latam-6 currencies this year, depreciating in line with the TRY and ZAR, as all three countries' reliance on credit-driven growth has put their currencies under pressure from markets.

Before the crisis, efforts were focused on reducing deficits, but the current situation has put these goals on hold and now the nominal total deficit could even be north of -10% GDP in 2020 with the risk of extending the trend in 2021. The fiscal response so far (around BRL 240 bn or 3.5% GDP) implies, according to the Treasury calculations, a primary deficit of -6% GDP with an upside bias if growth deteriorates further (pre-crisis, primary deficit was expected between -1.4% and -2.5% GDP). The median of market expectations for the debt-GDP ratio could see up to 10 ppts added this year over 2019. Adding to the complications, the disagreement between the executive and legislative powers and between federal and local governments on how to respond to the health crisis might create a much more adverse climate for dialogue in the future that might get in the way of much-needed reforms.

From the fiscal stimulus that has been announced, only a part would be funded with "new money": these are mostly measures that frontload social assistance payments, defer company taxes, and make it easier for people to access workers' severance funds. The objective is to keep expenditures below the spending cap and maintain some degree of fiscal caution but as with most countries following this line, markets think it will be insufficient and that sooner, rather than later, the fiscal response will have to be escalated.

If that is the case, there are very few places from which to take resources. Lower spending might be of little help as the space for further cost cuts is dismal. Privatizations are expected to be put on hold given market conditions, and additional taxes would be politically challenging in the middle of a recession. That leaves us with savings and debt. The Speaker of the lower house of Congress, Rodrigo Maia, has proposed the use of BRL 300 bn–BRL 400 bn in emergency funds to create a "war budget" that would not be subject to ordinary fiscal rules, but the bill is still being discussed. Issuing more debt will likely be necessary, but Congress would have to clear the way for it.

All in all, we think that the mix of measures presented so far will be insufficient to contain the pandemic and its economic fallout. The challenging environment in which to pursue long-term reforms might keep the curve steep and the BRL under pressure in the coming months.

ARGENTINA: HARDBALL IS COMING

The Argentine government's COVID-19 response features about 3% GDP in fiscal measures and new credit. It includes ARS 350 bn (about 1.5% GDP) in direct payments and tax relief to households and companies affected by public-health-related shutdowns. This is complemented by another ARS 343 bn in financing from state banks: ARS 320 bn in concessional 180-day bridge financing from the BCRA, the central bank, and ARS 23 bn in loans for essential sectors and teleworking equipment. Another ARS 100 bn may be dedicated to public works projects, through a mix of spending and loans.

Overall, we expect Argentina's primary fiscal deficit to go to about -3% GDP in 2020 from what had been an expected surplus. This would consist of (1) the 1.5% GDP in new spending and tax relief in response to COVID-19 just outlined; (2) another 2% GDP in revenue reductions owing to the substantial contraction in GDP we forecast this year; and (3) additional spending under existing and possible new programs worth about 0.5 to 1.0% GDP.

With the country in selective default and signalling from the Ministry of Economy in its new *Guidelines on Debt Sustainability* that it intends to take an aggressive line with existing creditors, markets are effectively closed to Argentina. Its authorities will be forced to rely on financing from the IMF, World Bank, and IaDB to help fill some of the fiscal gap, with the rest of the deficit covered by monetization. This expectation drives our forecasts of higher-than-consensus inflation during 2020–21 and a sharp depreciation in the ARS over the next two years.

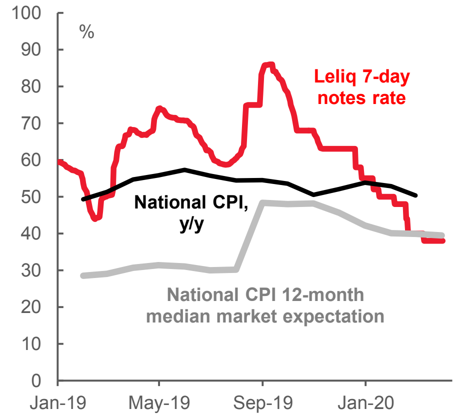
Country Updates

Argentina—The Decline Continues

Brett House, VP & Deputy Chief Economist
416.863.7463
brett.house@scotiabank.com

The Argentine government continued to ratchet up tension with its creditors regarding its imminent debt restructuring by making the first major move to put its March 31 *Guidelines for Debt Sustainability* into practice. Late on Sunday, March 5, the Ministry of Economy announced that it would delay until end-2020 about USD 10 bn in both principal and interest payments on hard-currency bonds issued under local Argentine law. Maturing bonds will be rolled over into new debt instruments at the government's discretion and in line with terms it eventually proposes to external creditors to ensure future sustainability under Argentina's forthcoming sovereign debt restructuring. The move prompted S&P to downgrade the sovereign's FX rating from CCC- to "selective default", which brought S&P in line with earlier moves by Fitch and Moody's.

Argentina: Monetary Policy Rate & Inflation



Sources: Scotiabank Economics, Bloomberg

Meanwhile, the Argentine economy continued to stumble into its third year of recession, with ongoing contractions on several fronts that are set to be made more severe by the public-health response to COVID-19. March government tax revenue was the lowest in five months, which reflected the imposition of the national quarantine in the second half of the month. Similarly, March auto sales to dealers were down -43.9% y/y while exports fell -33.9% y/y, reflecting weak demand from Brazil. Total auto production in Q1-2020 remained at lows last seen in 2003 as the industry's decline rolls on. The vehicle sector reflects trouble in the broader industrial sector, which recorded a -0.8% y/y drop in output in February after a -0.1% y/y fall in January, with declines in 10 of 16 sub-sectors. Similarly, construction activity fell by -22.1% y/y in February, accelerating its decline from a contraction of -13.5% y/y in January. This revisited the sector's rate of decline at its last nadir in mid-2016; prior drops of this magnitude haven't been seen since 2003.

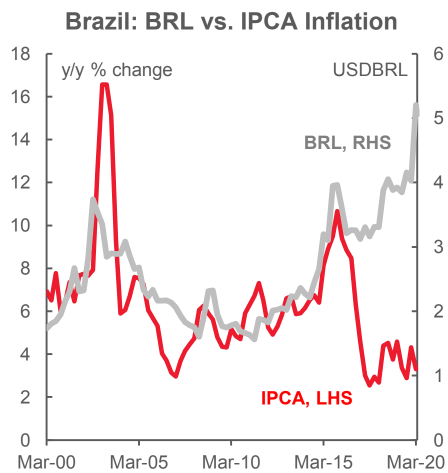
The BCRA's March *Survey of Market Expectations* reflected the worsening prospects for the Argentine economy with the average growth forecast for 2020 falling from a contraction of -1.2% y/y in the February *Survey* to -4.3% y/y now. End-2020 inflation remained pegged at 40.0% y/y, while end-2021 inflation expectations came up from 30.5% y/y to 33.0% y/y. Core inflation is now expected to hit 43.0% y/y at end-2020.

Looking to the week ahead, March inflation is the only major print, and we expect it to come in at 2.5% m/m, an acceleration from February's 2.00% m/m; level effects imply that the y/y rate would nevertheless fall from 50.30% in February to 47.1% in March.

Brazil—FX Pass-Through Inflation Missing in Action

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

February's Brazilian retail sales came in at a surprisingly strong +4.7% y/y pace (consensus +2.3% y/y), while inflation surprised to the downside in March, printing at +3.30% y/y (market expected +3.36% y/y). With this dip, IPCA inflation is now below the bottom end of the BCB's target range, giving the central bank room for more aggressive stimulus—leading us to alter our SELIC rate call, which we discuss below. Some of Brazil's February data held up better than we anticipated, but the scant March data we have so far has been weaker than we expected. Particularly worrying was the super-soft services PMI which came in at 34.5 (down from 50.4 in February). Overall, Q1 seems likely to be a bit stronger than we had expected, but we are revising our GDP call to show a more marked drop in mid-2020. The sharpest hit for the Brazilian economy is likely to be in Q2, but we still see quite a weak Q3, as the economy will continue to suffer from the hangover of the COVID-19 lockdown, even if it's not enforced by the federal government: some States are being more aggressive in lockdowns, and people are self-isolating. The Brazilian government's fiscal stimulus announced to date is reasonably strong at about 3.5% of GDP—but mostly comes from budget re-allocations. It aims to support consumption by providing income to informal workers, bringing forward some pension payments to retirees, and adding other measures to support workers. In addition, the plan does include some business support, primarily through loans totaling 2.5% of GDP in public bank lending for companies' working capital. All told it's a decent program, but we don't expect it to have nearly the same impact on the economy as the more aggressive programs in Chile and Peru .



Sources: Scotiabank Economics, Bloomberg.

Our biggest positive surprise in Brazil has so far been the fact that FX-inflation pass-through has gone missing in action. The country's traditional pass-through has been 20–30%. But as the chart shows, in the current cycle we've yet to see any meaningful upswing in prices despite the sharp drop in the real. We acknowledge that measures such as tightening the BCB's target band, and lowering the target itself, have added credibility to the central bank. At same time, the reduction in the SELIC-TJLP spread has helped reduce credit market segmentation and has, thus, strengthened monetary policy transmission. All of these factors may be helping to anchor inflation. But despite this, we're still surprised at the absence of inflationary pressures in the face of a very weak BRL. We expect that the weak BRL will eventually push inflation higher, particularly given how loose monetary policy settings are set to get: we expect real policy rates to go into negative territory. But this is likely to be a concern for a time after the coronavirus crisis has passed. Accordingly, we've increased the extent of the easing cycle we look for (with a low of 3.0% in the SELIC) and have pushed back our expected start of tightening to Q1-2021.

For next week, we have a shallow indicator pipeline in Brazil, with the two main indicators being the economic activity index for February—where we and consensus look for 0.3% m/m—and formal job creation, also for February.

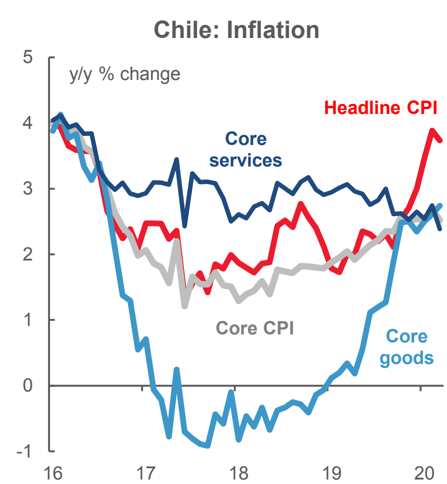
Chile—Data Confirm March Weakness

Jorge Selaive, Chief Economist
56.2.2939.1092 (Chile)
jorge.selaive@scotiabank.cl

Carlos Muñoz, Senior Economist
56.2.2619.6848 (Chile)
carlos.munoz@scotiabank.cl

Fiscal and regulatory: On April 8, the Government announced a new fiscal package, with a focus on independent workers and new measures to ease the flow of credit for firms. The package creates a new fund of USD 2 bn to help vulnerable workers and commits to the creation of a line of state-guaranteed financing for up to USD 24 bn for firms.

Health: The Health Ministry has suspended the strict lockdown in several communities in the Metropolitan Region, but it remains in some others, including Santiago downtown. Curfew from 10pm to 5am is still in place across the country.



Sources: Scotiabank Economics, NBS.

This past week, we learned that trade figures from March maintained their weakness, despite some stabilization in the last two weeks of the month. Exports of goods decreased -5.6% y/y, due mainly to the -10.3% y/y decrease in industrial shipments—especially salmon and cellulose—and an important contraction in copper exports (-7.6% y/y). In addition, vehicle sales came out this week, showing a contraction of 36.5% y/y in March, representing the biggest fall since records were made available, and the eighth monthly decline in a row. On April 8, the CPI print for March was released, showing inflation of 0.3% m/m. This print was influenced by the increase in prices for educational services and bread, which led to an overall annual increase of 3.7% y/y. Finally, the government announced its new fiscal package, with an important focus on independent workers and firms in danger of bankruptcy while strict quarantine measures are still in place in several cities across the nation.

In the coming week, on Thursday, April 16, the BCCh will release the minutes from its March 31 monetary-policy meeting. We expect to see in more detail the points of view of the board members regarding the different policy options that were available at that time, given that all the background analysis and projections were already published in the *Monetary Policy Report*. We will also receive the first external figures for April, which would show the sharp decline in activity due to the semi-paralysis following implementation of the quarantine measures. We will also be looking more closely at credit loans data for the first week of April, which should show the initial effects of the COVID-19 crisis on the financial sector.

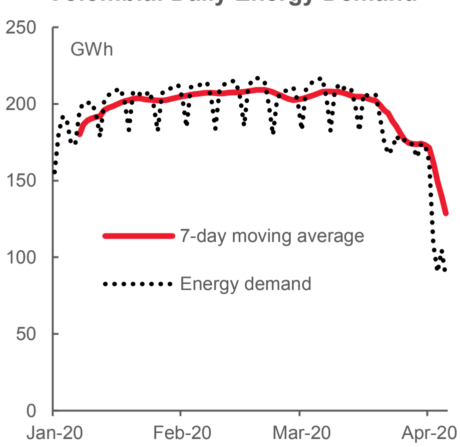
Colombia—Outlook Revised Downward

Sergio Olarte, Senior Economist
57.1.745.6300 (Colombia)
sergio.olarte@co.scotiabank.com

Jackeline Piraján, Economist
57.1.745.6300 (Colombia)
jackeline.pirajan@co.scotiabank.com

President Duque announced that mandatory quarantine has been extended for two more weeks to April 27 (it had been scheduled to end on April 14). He mentioned that although Colombia's COVID-19 curve has not been explosive, so far, isolation continues to be the best way to flatten the curve, reduce the number of deaths, and open up the economy sooner. In the meantime, nearly half of the economic activity is highly affected due to the lockdown that, in the base case scenario, will be in effect for five weeks. President Duque is considering—depending on the COVID-19 developments—opening up the economy in a gradual process. He called this a move to an "intelligent quarantine", in which the elderly population will continue in lockdown (up to May 31), the education system will continue with virtual classrooms (up to May 31), and distancing measures will continue, while parts of the economy will be re-opened. The informal sector in Colombia accounts for almost half of the urban labor force, which is what is driving the government to try to re-open the economy partially as soon as possible: keeping economic activity on hold could create high social disruption that worsens the crisis.

Colombia: Daily Energy Demand



Sources: Scotiabank Economics, XM.

We revised down, again, 2020 GDP growth in our base-case scenario from 1.2% y/y to 0.6% on the back of indications of lower private consumption (see chart) stemming from the higher unemployment rate we expect in Q2-2020, which could rise to 17%, especially in the informal part of the economy. Domestic demand is expected to fall by -0.4% y/y owing to a sharp -3.2% fall in investment, with no growth in private consumption. Growth will also see a drag from lower exports, especially non-traditional exports and coal. That said, we still think that a gradual recovery will start in Q3-2020. Our main assumption is that the government will decide to proceed with the intelligent quarantine: subsidies to households and efforts to keep the economic engine partially running will, we think, save the economy from recession.

Colombia: GDP base-case forecast, decomposition

% change, y/y	2019	2020	2021
GDP	**3.3**	**0.6**	**3.6**
Domestic demand	**4.5**	**-0.4**	**3.5**
Total consumption	4.6	0.3	3.7
Private consumption	4.6	0.0	3.5
Government consumptio	4.2	1.9	4.6
Investment	4.2	-3.2	2.8
Exports	3.2	-1.0	2.3
Imports	9.3	-5.0	2.1

Source: Scotiabank Economics Colombia.

Nevertheless, we acknowledge that risks remain biased to the downside, particularly if the total quarantine continues for much longer. If total isolation continues, domestic demand could fall by more than 5% y/y in the second and third quarters with a small rebound in the last quarter of 2020. This would imply a recession and a drop of -1.7% y/y or more for GDP in 2020. Domestic demand would fall by -2.3% y/y, mainly due to private consumption growth also falling by some -2.3% y/y under a much deeper and longer-lasting COVID-19 shock.

On the data side, DANE has released March inflation, the first hard data which includes initial effects of the COVID-19 shock on the Colombia economy. Headline inflation came in above market expectations, especially on the back of much higher foodstuffs prices (perishable goods) and some utility bills that depend on the behaviour of the exchange rate. Monthly inflation stood at 0.57% (Bloomberg market consensus had been 0.42% m/m), while the annual inflation rate increased by 14 bps to 3.86% y/y. We think food prices will turn back the next month since the central government is implementing price controls on key products, especially food. The good news is that March core inflation measures fell a bit and remained close to BanRep's target, which makes us think that, although March inflation may trigger some upward adjustments of short-run inflation expectations, longer-term expectations should remain anchored. Therefore, our base-case scenario continues to be such that BanRep will cut the MPR by 25 bps at the April meeting due to increasing downside risk on economic activity. Inflation would be expected to remain above 3.5% in the upcoming months. However, weaker demand in other sectors would lead to a moderation in the medium term.

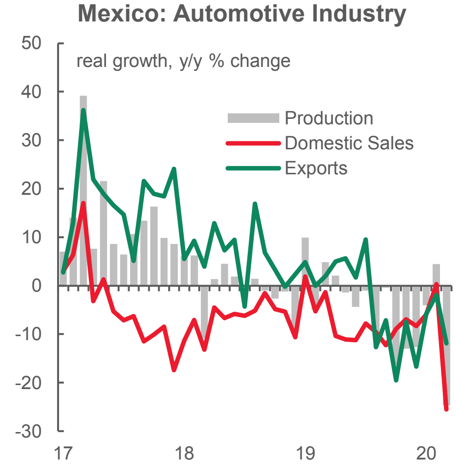
Next week, DANE will release February's coincident indicators, retail sales, and industrial production. Retail sales should continue strong with y/y growth above 6%. On the other side, manufacturing data should benefit from one additional business day from the leap year, which usually accounts for an extra 3 ppts of m/m growth.

Mexico—Business Mounts Its Own Crisis Response

Mario Correa, Economic Research Director
52.55.5123.2683 (Mexico)
mcorrea@scotiacb.com.mx

The Mexican government's plan to cope with the COVID-19 crisis has failed to convince a number of the major business leaders in the country that it is currently enough to stop the slide in the Mexican economy. The three salient components of the government's plan are: (1) the government plans to create two million jobs over the next nine months (details on this are still forthcoming); (2) the government plans to provide businesses with MXN 25 bn in loans to cope with the crisis (i.e., 1 million loans of MXN 25,000 each for SMEs); and (3) the President also said the energy sector investment program will finally be released. Mexico's main business chamber, the CCE, has announced that the private sector would work together to form an alternative proposal to the government's fiscal plan by bringing together the public and private sectors in cooperation to reduce the crisis' damage to the economy.

Mexico: Automotive Industry



Sources: Scotiabank Economics, INEGI.

In terms of the impact of COVID-19, the Labor Ministry announced that the crisis has already cost 347,000 jobs (more than the total created in 2019), while auto sales and output both contracted 25% y/y in March. In addition, industrial production for February posted a -1.9% y/y contraction, showing the impact of global supply chain disruptions even before the self-imposed lockdown hit the Mexican economy. The auto industry has been particularly affected (see chart). In terms of private consumption, we saw a +0.2% y/y expansion in January, while investment contracted -8.8% y/y in the same month. The positive news for last week was inflation cooling down a little in March to 3.25% y/y due to a significant decline in gasoline prices.

The rapid deterioration in Mexico's macroeconomic and investment environment, the limited response so far from federal government, and the gathering economic disruption from isolation measures have prompted us to

markdown our forecasts again (see forecast tables, pp. 2–4). The contraction in 2020 has been deepened from -5.8% y/y to -8.4% y/y, while Banxico's terminal policy rate has been brought down from 6.00% to 5.00%.

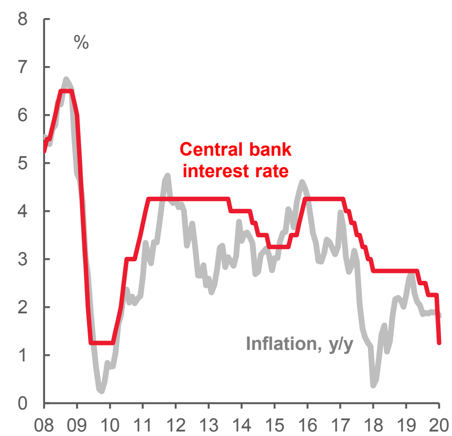
For the week ahead, there are no relevant indicators to be released in Mexico, so the attention will be concentrated on the government's response to the emergency. Next Tuesday, the government is expected to release the mechanics of how the above-mentioned loans to support SMEs' working capital and liquidity will work. As pressure mounts in the coming weeks, there could be some other unscheduled events, such as a possible cut to the reference rate by Banco de Mexico or a new downgrade on the sovereign or Pemex's ratings. It is worth noting that PEMEX is just one notch above junk on Moody's scale, which, if cut, would make Moody's the second agency to reduce the company to sub-investment grade.

Peru—Unprecedented Moves by the Central Bank (BCRP)

Guillermo Arbe, Head of Economic Research
511.211.6052 (Peru)
guillermo.arbe@scotiabank.com.pe

In a surprise, off-calendar move on the evening of Thursday, April 9, the central bank cut its reference rate by 100 bps to 0.25%, twice the 50 bps cut we had been expecting at the bank's scheduled meeting on Thursday, April 16. The BCRP has never before lowered its policy rate by 200 bps in less than a month, and 0.25% is the lowest rate it has ever reached. The speed and depth of the BCRP's moves are together a clear sign of just how concerned the monetary authorities are about the developing contraction in economic activity.

Peru: Inflation & Reference Rate



Sources: Scotiabank Peru, BCRP.

One of the economic measures that is working well is the supply of liquidity by the BCRP. Much of this is being channeled to businesses through the reprogramming of loans, and new loans to tide businesses over during the state of emergency with liquidity to manage payrolls and pay suppliers.

President Vizcarra has announced that the state of emergency would be extended two more weeks, until April 26. This is a relative surprise, as Vizcarra had repeatedly said that the state of emergency would be lifted partially beginning on Monday, April 13. The change may reflect the fact that the COVID-19 curve is taking longer to flatten than had been expected, and that insufficient testing is obscuring the real level of contagion.

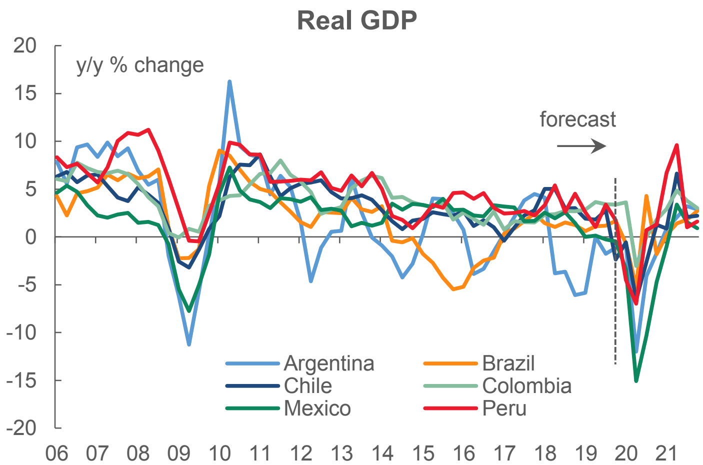
February GDP is scheduled to be published on April 16, although the central bank delayed for a couple of days reports that were due to appear last week. We expect GDP growth of 2.5% y/y. More recent figures have been predictably weak. Electricity demand was down 29% y/y during the first week of April. In March, light vehicle sales (mainly automobiles) fell 40% y/y, the greatest decline ever. Government investment was down 26% y/y in March, an indicator of how strongly the state of emergency is affecting even the government's spending capability.

The government finally approved the much awaited program to provide guarantees on PEN 30 bn to finance working capital for, mainly, small businesses. Guarantees would be for 80% of loans of up PEN 10 mn, and 98% on loans of up to PEN 30,000. The remaining 2% to 20% of risk would need to be taken on by banks awarding the loan. The Minister of Finance also stated that it is preparing a debt issuance to finance part of this year's increased deficit. The government also intends to tap the multilateral institutions for support.

Congress voted in favor of a proposal to allow people to withdraw as much as 25% of their pension funds, up to a maximum of PEN 12,900 (just under USD 4,000), to support their basic needs during the emergency. The Executive has two weeks to either veto or sign the proposal. We expect it to either veto the bill or negotiate a watered-down version.

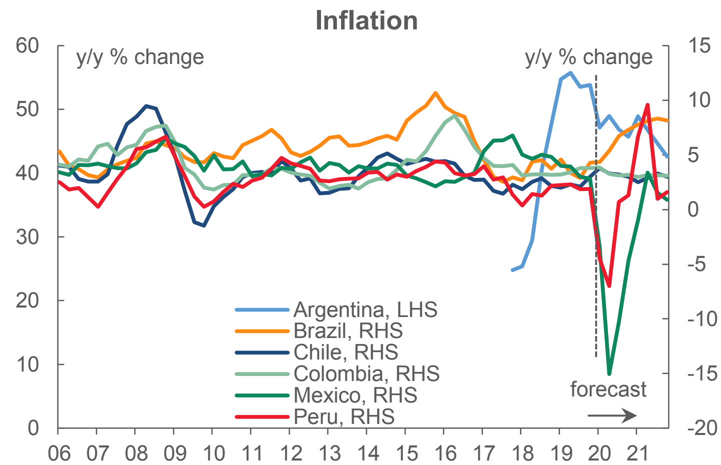
Key Economic Charts

Chart 1



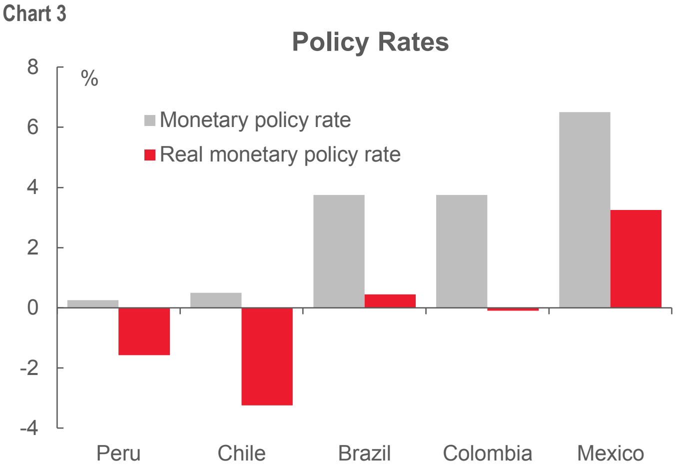
Sources: Scotiabank Economics, Haver Analytics.

Chart 2



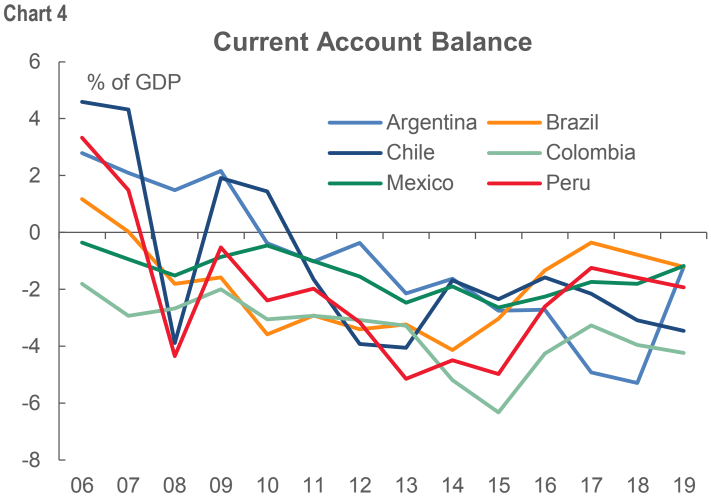
Sources: Scotiabank Economics, Haver Analytics.

Chart 3



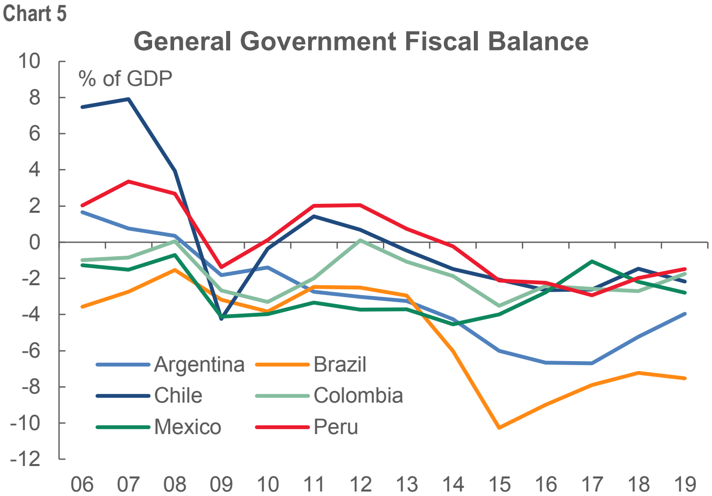
Argentina: MPR = 38.0%; Real MPR = -12.3%.
Sources: Scotiabank Economics, Haver Analytics.

Chart 4



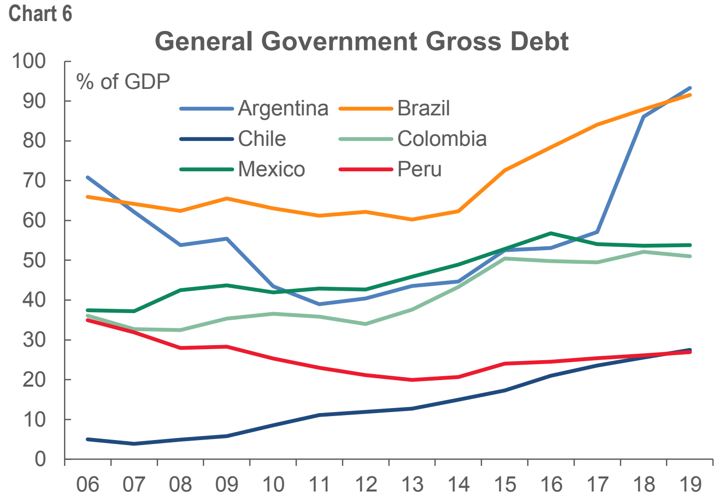
Sources: Scotiabank Economics, IMF.

Chart 5



Sources: Scotiabank Economics, IMF.

Chart 6



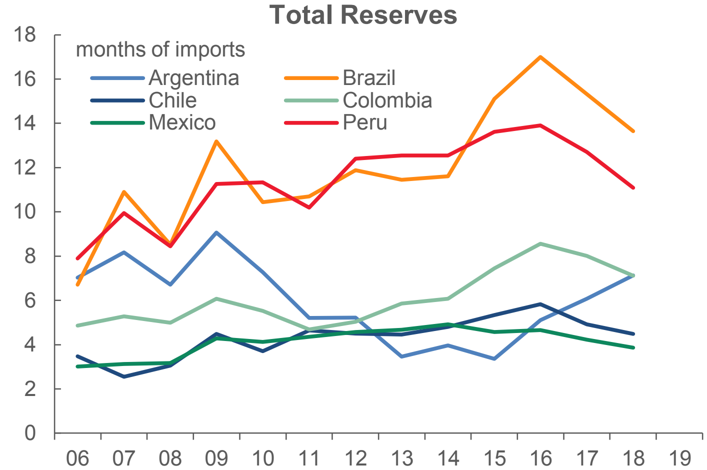
Sources: Scotiabank Economics, IMF.

Key Economic Charts

Chart 7

Sources: Scotiabank Economics, IIF.

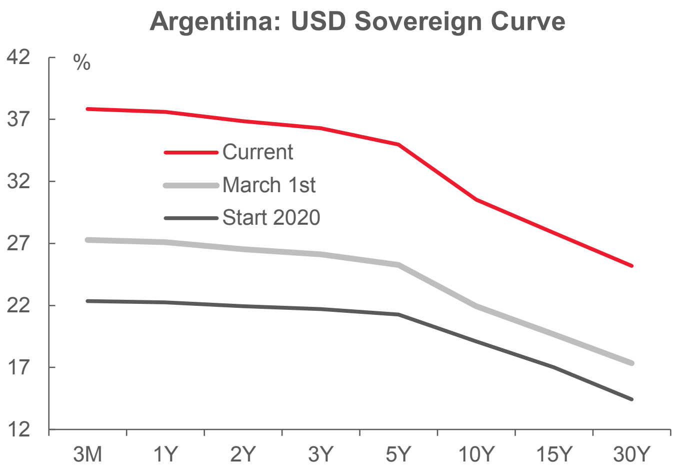
Chart 8



Sources: Scotiabank Economics, World Bank.

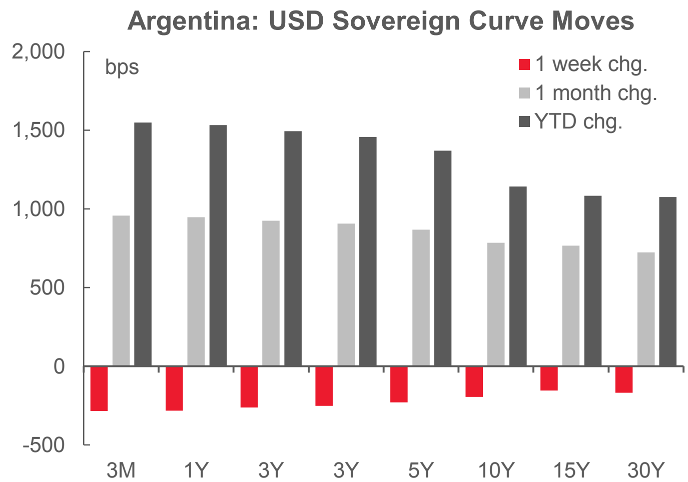
Key Market Charts

Chart 1



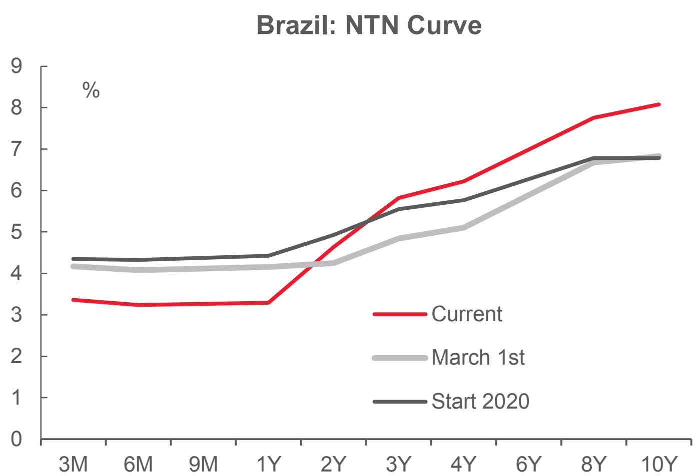
Sources: Scotiabank Economics, Bloomberg.

Chart 2



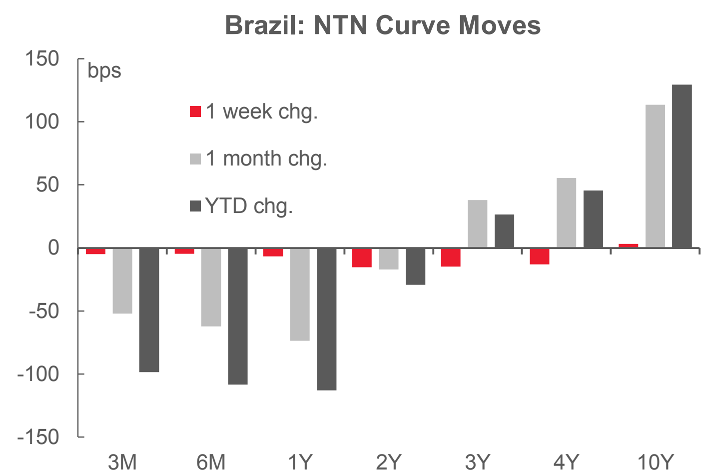
Sources: Scotiabank Economics, Bloomberg.

Chart 3



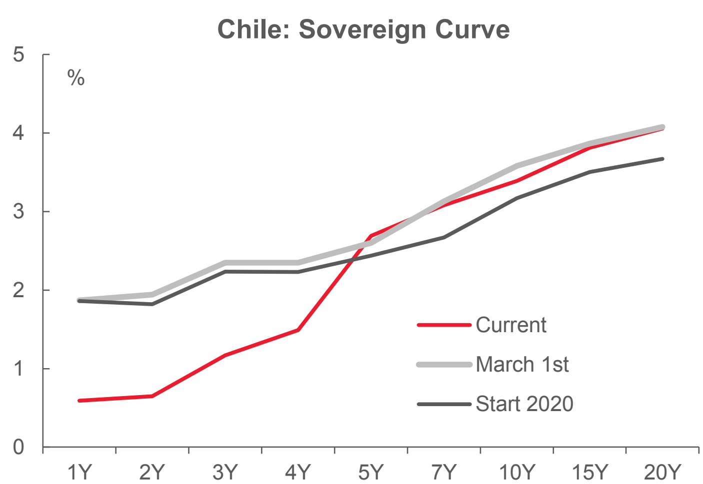
Sources: Scotiabank Economics, Bloomberg.

Chart 4



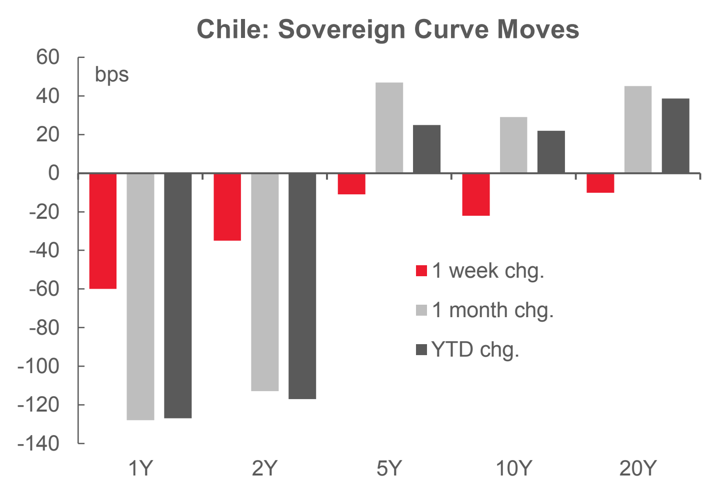
Sources: Scotiabank Economics, Bloomberg.

Chart 5



Sources: Scotiabank Economics, Bloomberg.

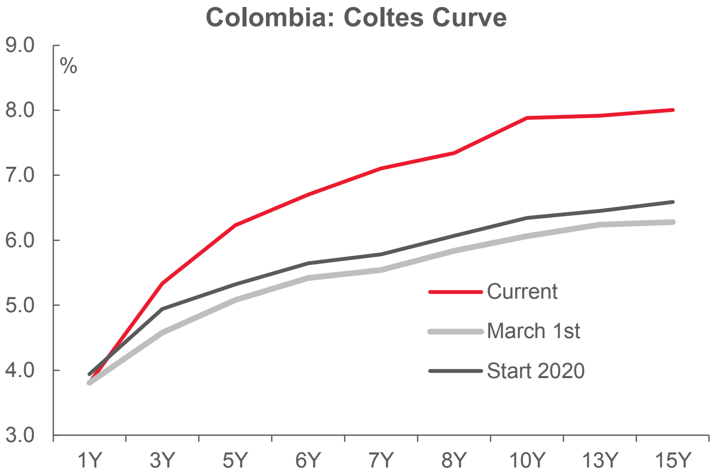
Chart 6



Sources: Scotiabank Economics, Bloomberg.

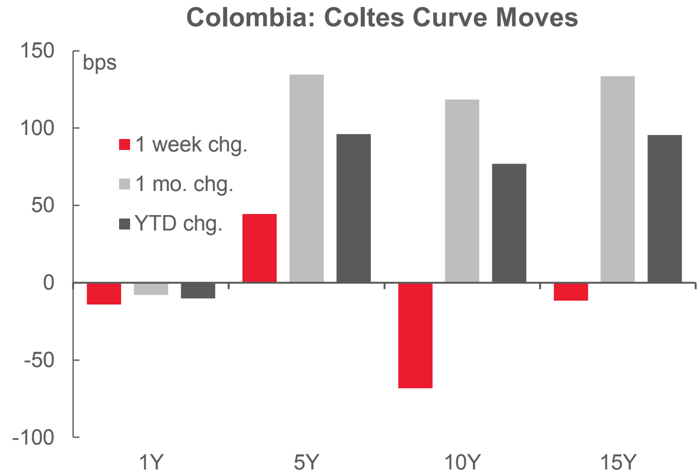
Key Market Charts

Chart 7



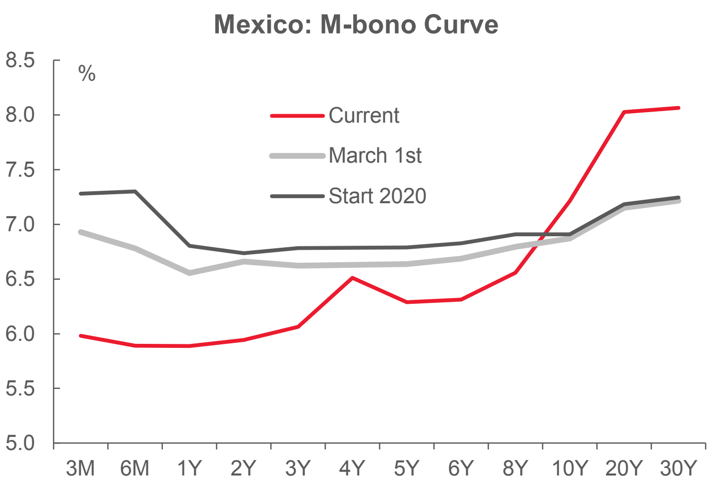
Sources: Scotiabank Economics, Bloomberg.

Chart 8



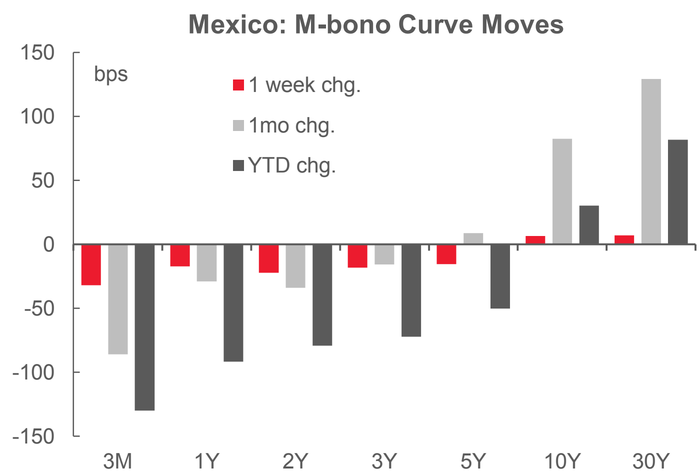
Sources: Scotiabank Economics, Bloomberg.

Chart 9



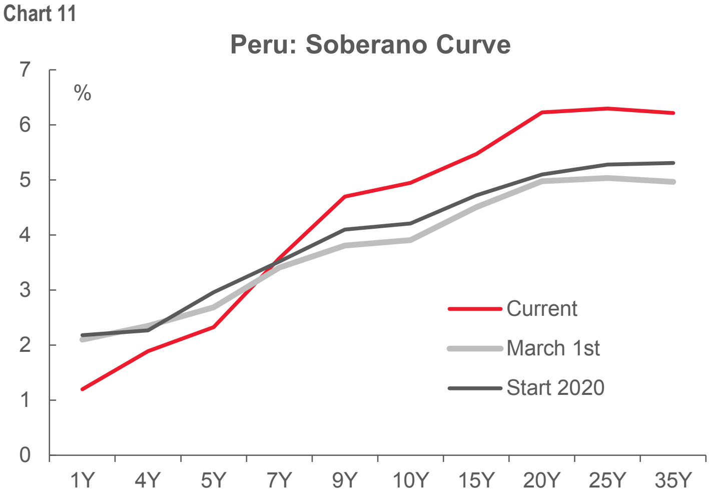
Sources: Scotiabank Economics, Bloomberg.

Chart 10



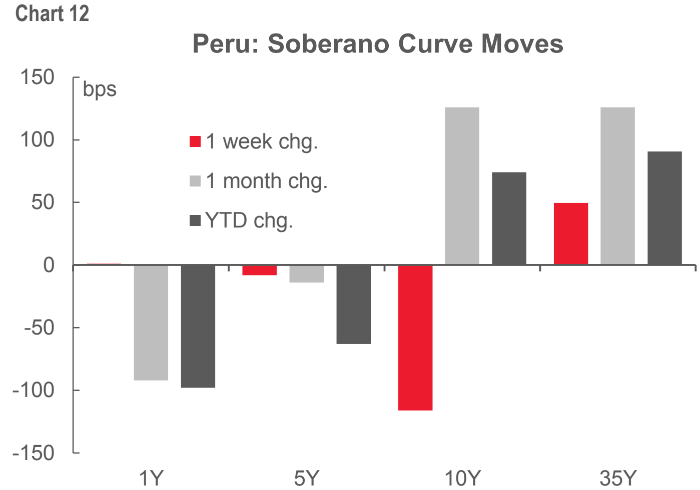
Sources: Scotiabank Economics, Bloomberg.

Chart 11



Sources: Scotiabank Economics, Bloomberg.

Chart 12



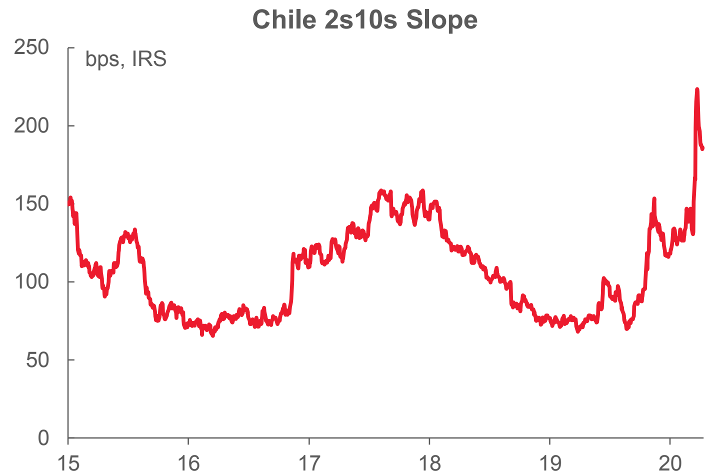
Sources: Scotiabank Economics, Bloomberg.

Key Market Charts

Chart 13

Sources: Scotiabank Economics., Bloomberg.

Chart 14

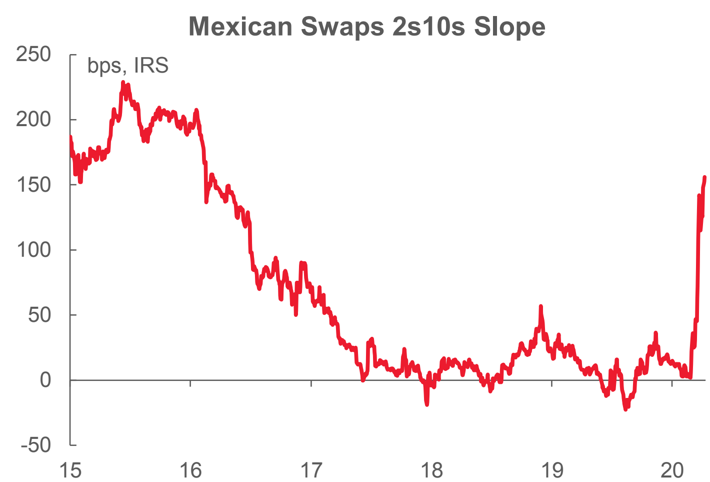


Sources: Scotiabank Economics., Bloomberg.

Chart 15

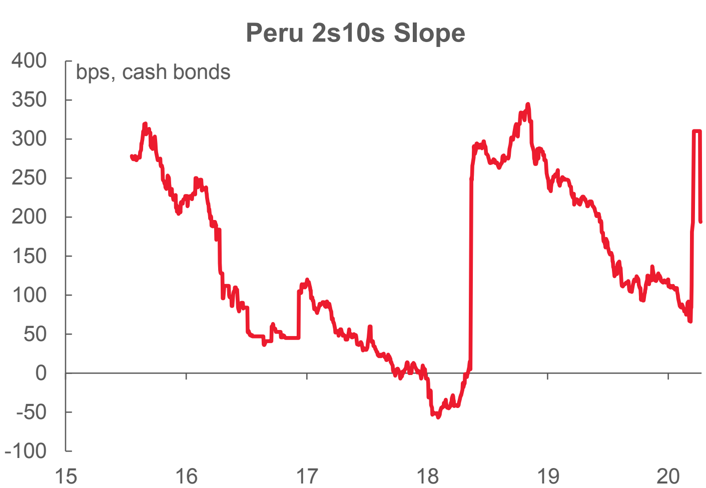
Sources: Scotiabank Economics., Bloomberg.

Chart 16



Sources: Scotiabank Economics., Bloomberg.

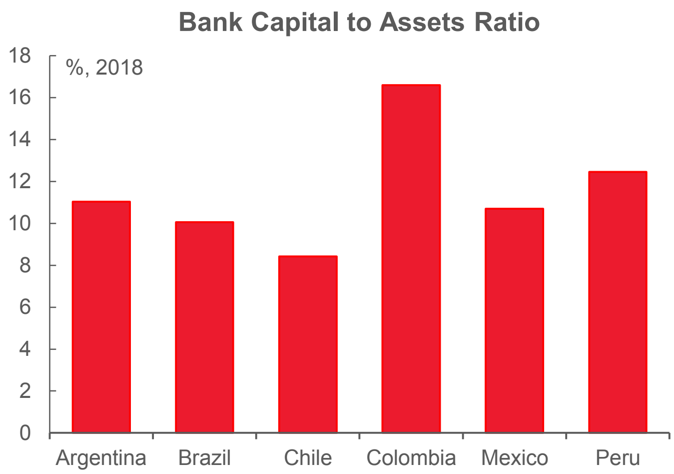
Chart 17



Sources: Scotiabank Economics., Bloomberg.

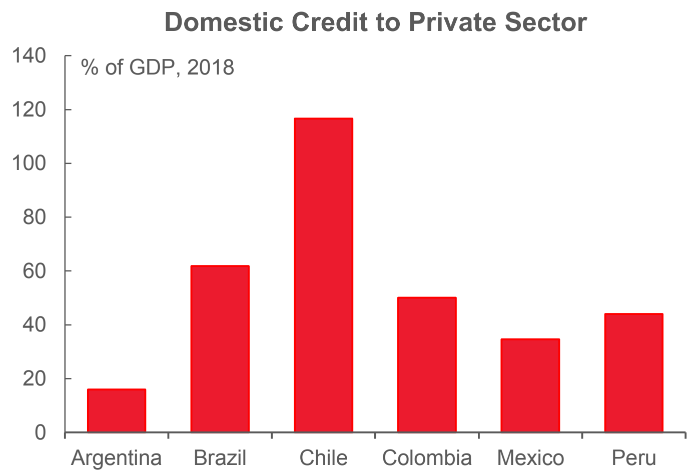
Key Market Charts

Chart 18



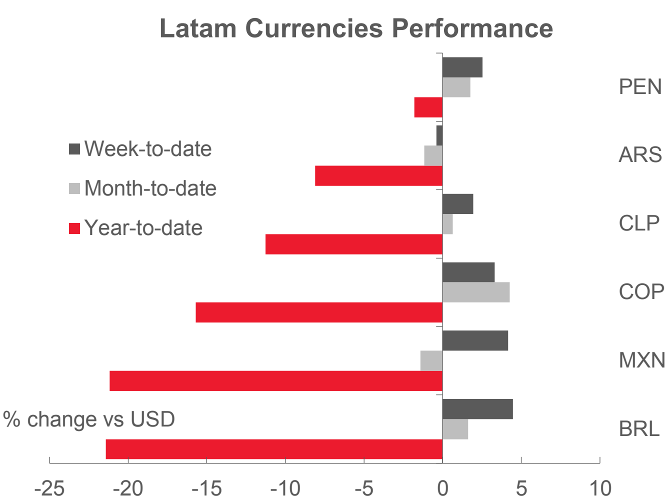
Sources: Scotiabank Economics, World Bank.

Chart 19



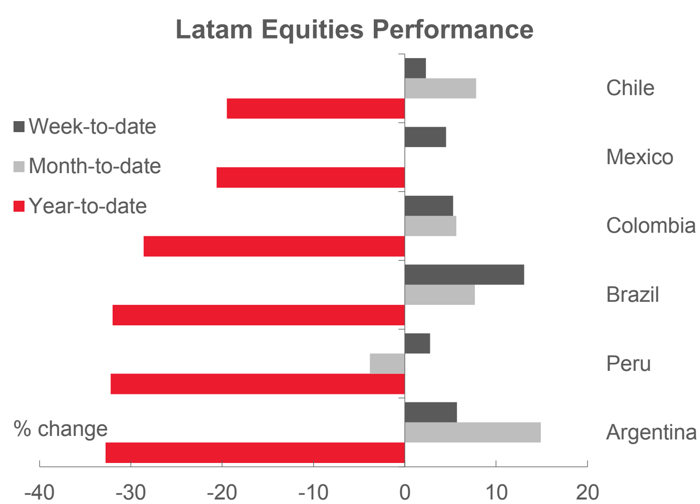
Sources: Scotiabank Economics, World Bank.

Chart 20



Sources: Scotiabank Economics, Bloomberg.

Chart 21



Sources: Scotiabank Economics, Bloomberg.

Market Events & Indicators for April 11–17

ARGENTINA

Date	Time	Indicator	Period	BNS	Consensus	Latest	BNS Comments
APR 13-22		Budget Balance (ARS mn)	Mar	--	--	-27497	
04/15	15:00	Greater Buenos Aires CPI (y/y)	Mar	--	--	48.6	
04/15	15:00	Greater Buenos Aires CPI (m/m)	Mar	--	--	1.8	
04/15	15:00	National CPI (m/m)	Mar	2.5	--	2.0	Inflation is expected to accelerate on FX effects and moves to expand.
04/15	15:00	National CPI (y/y)	Mar	47.1	--	50.3	Money supply, but level effects will bring the y/y rate down from February.
04/16	15:00	Capacity Utilization (%)	Feb	--	--	56.1	

BRAZIL

Date	Time	Indicator	Period	BNS	Consensus	Latest	BNS Comments
04/13	14:00	Trade Balance Weekly (USD mn)	12-Apr	--	--	882.0	
04/13		Economic Activity (y/y)	Feb	--	0.8	0.7	
04/14	8:00	Economic Activity (m/m)	Feb	--	0.3	0.2	
04/15	7:00	FGV Inflation IGP-10 (m/m)	Apr	--	--	0.6	
04/16	7:00	FGV CPI IPC-S (m/m)	15-Apr	--	--	0.4	
APR 16-25		Formal Job Creation Total	Feb	--	--	-307311	
04/17	7:00	IGP-M Inflation 2nd Preview (m/m)	Apr	--	--	1.0	

CHILE

Date	Time	Indicator	Period	BNS	Consensus	Latest	BNS Comments
04/16		Minutes of March 31 BCCh MPC mtg					More details on options considered by the MPC.

COLOMBIA

Date	Time	Indicator	Period	BNS	Consensus	Latest	BNS Comments
04/15	11:00	Manufacturing Production (y/y)	Feb	4.0	--	3.7	Industry data will be boosted due to one extra business day.
04/15	11:00	Retail Sales (y/y)	Feb	6.0	--	7.5	February retail sales should surprise upwards due to strong domestic demand at the start of the year.
04/15	15:00	Industrial Production (y/y)	Feb	--	--	1.9	
04/17	15:00	Economic Activity NSA (y/y)	Feb	--	--	3.5	

MEXICO

Date	Time	Indicator	Period	BNS	Consensus	Latest	BNS Comments
04/13		ANTAD Same-Store Sales (y/y)	Mar	--	--	7.5	
APR 13-15		Formal Job Creation Total (000s)	Mar	--	--	123.1	
04/14	10:00	International Reserves Weekly (USD mn)	08-Apr	--	--	185557	

PERU

Date	Time	Indicator	Period	BNS	Consensus	Latest	BNS Comments
APR 13-15		Trade Balance (USD mn)	Feb	--	--	143.6	The delay in publishing the data is unusual and may be COVID-19 related.
04/15	1:00	Economic Activity (y/y)	Feb	2.5	--	3.0	Last month before state of emergency was implemented.
04/15	1:00	Unemployment Rate (%)	Mar	--	--	7.1	
04/16	19:00	**Reference Rate (%)**	**16-Apr**	**0.25**	**--**	**0.25**	In a surprise, off-calendar move on the evening of Thursday, April 9, the central bank cut its reference rate by 100 bps to 0.25%, its lowest level ever. The speed and depth of the BCRP's moves are together a clear sign of just how concerned the monetary authorities are about the developing contraction in economic activity.

Scotiabank Economics Latam Coverage