Latam Daily: Chile's BCCh Holds; More Signs of Slowing Recoveries Across Region

- **Argentina: August capacity utilization rates close to pre-pandemic levels, continuing decade-long slide**
- **Brazil: Economic rebound lost a little steam in August**
- **Chile: Fitch downgrade; BCCh holds, as expected**
- **Colombia: Recovery stagnated in August as regional restrictions strengthened**
- **Peru: August GDP growth still below expectations**

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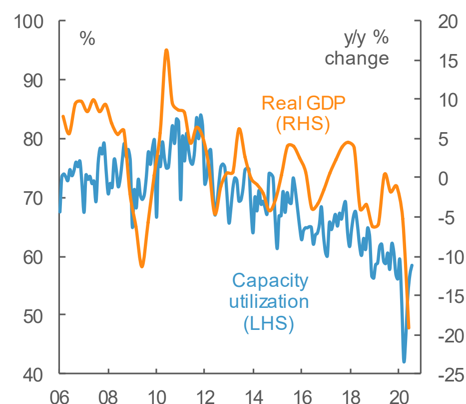
ARGENTINA: AUGUST CAPACITY UTILIZATION RATES CLOSE TO PRE-PANDEMIC LEVELS, CONTINUING DECADE-LONG SLIDE

According to data released by INDEC on Thursday, October 15, Argentina's industrial capacity utilization rate rose from 56.8% in July to 58.4% in August. The August numbers continued the country's recovery from the low of 42.0% in April, which was reached during the country's most extensive COVID-19-related shutdowns. The print was still down from August 2019's 60.5% capacity utilization rate, but it put Argentina's declining industrial sector back on its pre-pandemic trend (chart 1).

The August industrial capacity utilization numbers are broadly consistent with our broader forecast of an improvement of real GDP from a nadir of -19.1% y/y in Q2-2020 to -10.4% y/y in Q3-2020 (see the October 4 *Latam Weekly*). The industrial sector carries a weight of 18.9% in Argentina's monthly economic activity indicator and real GDP calculations.

—Brett House

Chart 1



Sources: Scotiabank Economics, INDEC.

BRAZIL: ECONOMIC REBOUND LOST A LITTLE STEAM IN AUGUST

Economic activity data for August, out from the BCB on Thursday, October 15, slowed from a revised 3.71% m/m in July to 1.06% m/m, well below the 1.70% m/m consensus. Nevertheless, the annual comparison improved a touch, from -4.30% y/y in July to -3.92% y/y in August (chart 2). We had expected a stronger print, in part because, up to August, the recovery should have been supported by the more aggressive version of the government's household support package. As this aid begins to be unwound, its withdrawal should start gradually weighing on activity from September onward.

Similar to what we saw in last week's inflation print, the details behind the headline growth numbers remain all over the place. Some indicators of domestic demand, such as retail sales, have been coming in much stronger than investment-related items. However, it's encouraging that for September, both manufacturing and service sector PMIs were in positive territory: manufacturing was at an extraordinarily strong 64.7, while services lagged at 50.4. The weaker services-sector performance is consistent with a country still struggling with social distancing and which remains hard hit by the pandemic: based on data from

Johns Hopkins University, Brazil and Mexico account for close to 20% of global COVID-19-related fatalities. Overall, Brazil's economy is recovering, but its restoration still looks quite dependent on public-sector stimulus.

—Eduardo Suárez

CHILE: FITCH DOWNGRADE; BCCH HOLDS, AS EXPECTED

I. Fitch downgrades Chile's ratings to A- and revises outlook to stable

As we have been anticipating in our reports and in calls with investors, on Thursday, October 15, Fitch downgraded Chile's Long-Term (LT) Foreign-Currency Issuer Default Rating (IDR) to "A-" from "A" and revised its Outlook to "Stable" from "Negative". Fitch has also lowered Chile's LT Local Currency IDR to "A-" from "A+" and revised its Outlook to "Stable" from "Negative".

The downgrade reflects the weakening of Chile's public finances in the wake of secular pressures to increase social spending in the aftermath of wide-scale protests during October and November 2019—pressures that have been compounded by the economic downturn precipitated by the COVID-19 pandemic. Fitch forecasts that the government debt burden should continue to increase over the medium term given Chile's lower trend growth prospects and difficulties in consolidating its fiscal accounts amid a heavy political calendar and social pressures (chart 3).

The stable outlook reflects Fitch's view that Chile's lower trend growth prospects, eroding fiscal balance sheet, and political/social risks are fully captured in the revised rating. The economy remains supported by a credible macroeconomic policy framework and a still-low government debt burden compared with "A-range" peers.

Fitch's fiscal forecasts are broadly in line with our own. Fitch forecasts a central government fiscal deficit of 8.5% of GDP in 2020 (Scotiabank: 8.2% of GDP) and 5.1% of GDP in 2021 (Scotiabank: 5% of GDP), up from 1.7% in 2018 and 2.8% of GDP in 2019. The government intends to set up a commission to study reductions in tax exemptions in conjunction with a review by the IMF and OECD. These efforts could yield additional fiscal savings, if implemented, under the next administration, which will take office in 2022.

The possible re-writing of the constitution and a series of elections over the next two years pose uncertainties that could dampen prospects for recoveries in investment and economic activity, and add to pressures for higher social spending, as detailed in our October 4 *Latam Weekly*. A public referendum will be held on Oct. 25 on re-writing the country's constitution. The process of constitutional revision (provided the "yes" vote prevails) would last two years, after which a final public referendum would be held in mid-2022. Presidential and congressional elections are scheduled for November 2021, further increasing political uncertainties and possibly postponing structural fiscal adjustments.

Chile's ratings are supported by a credible policy framework centered on an inflation-targeting regime, flexible exchange rate, and relatively strong sovereign balance sheet, with the government debt/GDP ratio well below those of its peers. These strengths are balanced by per-capita income levels that are projected to remain low relative to peers, a high degree of commodity dependence, and weaker external leverage and liquidity metrics. However, Chile's flexible policy framework serves as an effective buffer to terms of trade and financing shocks.

All in all, Fitch now has the lowest credit rating for Chile, with an "A-" (chart 4).

Chart 2

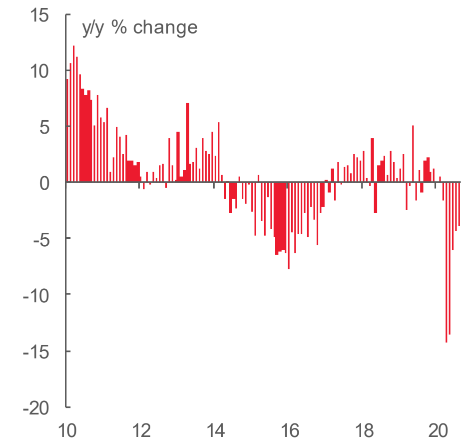


Chart 3

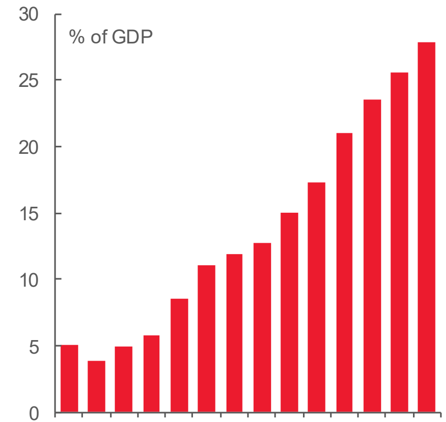
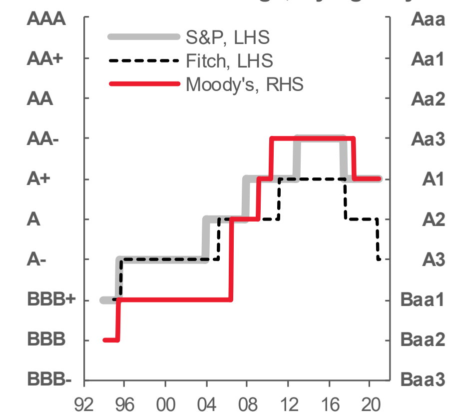


Chart 4



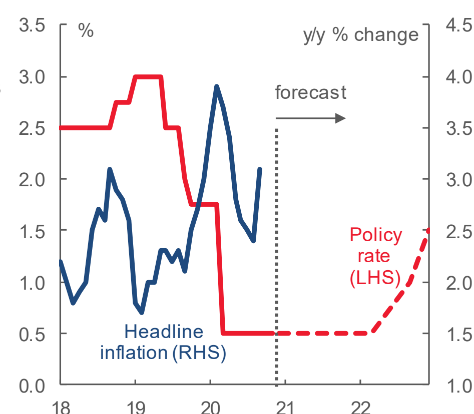
Fitch's rating is now located two notches below those of Moody's and S&P. Consequently, we anticipate that these other two agencies could each cut their ratings by one notch, restoring the margin they had with Fitch from 2017 (chart 4, again).

—Carlos Muñoz

II. BCCh again held at the "technical minimum" of 0.5%, as expected

Following its usual two days of meetings, the BCCh Board announced at 17:00 ET on Thursday, October 15 that it had unanimously decided to keep its benchmark monetary policy rate at its "technical minimum" of 0.5%, in line with our expectations and the market consensus. The Board's forward guidance remained unchanged from its September 1 meeting, with an indication that it would keep its policy rate at its technical minimum "for a large part" of its forecast horizon. We maintain our view that the Board shall begin to lift the policy rate from Q2-2022 (chart 5).

Chart 5



Sources: Scotiabank Economics, BCCh, INE.

The tone of the Board's communications was somewhat dovish. The Board's statement implied that the central bank has begun to have less conviction in a homogenous and sustained recovery as growth tends toward the lower end of the forecast range in the last *Monetary Policy Report*. Looking ahead, we anticipate declines in short-term nominal market rates and some slight depreciation pressure on the CLP additional to that which is already being provided by uncertainty surrounding the upcoming referendum.

In this context, we expect the central bank to evaluate options to increase monetary stimulus at its next monetary policy meeting on December 7 given the recent slowdown in credit growth and less dynamism in economic activity than was anticipated in the BCCh's base scenario. The Board is likely to look through the recent temporary boost to consumption and prices underpinned by one-off withdrawals from pension accounts.

Additional monetary stimulus would now generate greater impact than when the economy was partially closed. Monetary policy must continue to support the recovery, and in order to do this, it may be necessary to increase stimulus measures compared to that delivered during the worst of the pandemic, given the greater dynamism that an increase in stimulus would generate in an economy with fewer restrictions on mobility. Now that we now have close to 90% of the economy re-opened there is a greater need for access to credit. Although fiscal policy has been an essential measure in the face of the abrupt drop in income for families and companies, monetary policy—including unconventional measures—will remain at least as crucial or become even more important in the months ahead.

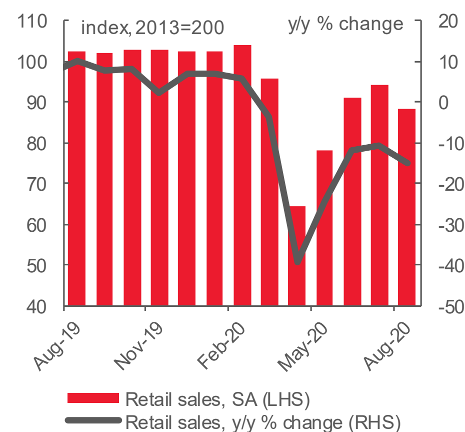
In its assessment of the current environment, the Board noted that there has been an increase in long-term interest rates, a fall in the stock market, and a depreciation of the peso. Still, nothing was said about their causes or their implications.

In its review of the external scenario, the Board recognized a moderation in the speed of economic recovery, especially in developed and Latin American economies, which also points to the possibility of weaker external impulse compared to that in its base scenario. In the emerging world, the strength shown by activity and demand indicators in China has stood out, which has allowed the price of copper to remain around USD 3/lb. Finally, the Board highlighted the delicate health and economic situation in Latin America, while noting the heterogeneity in the responses in health and economic matters between countries.

—Jorge Selaive

COLOMBIA: RECOVERY STAGNATED IN AUGUST AS REGIONAL RESTRICTIONS STRENGTHENED

Chart 6



Sources: Scotiabank Economics, DANE.

On Thursday, October 15, DANE released real retail sales and real manufacturing production data for August; both indicators implied that the economic recovery stagnated due to the extension of regional governments' pandemic restrictions,

which were broadly similar to those implemented in July. Real retail sales were down by -17.1% y/y (chart 6), worse than the -10.8 % y/y expected, while real manufacturing production was down by -10.3% y/y (chart 7), poorer than consensus expectations of -7.3% y/y. Contrary to the employment data in August, activity indicators surprised us negatively which implies that the recovery is relatively concentrated in primary activities and informal sectors such as agriculture. On the other hand, given that September saw the start of the government's "new normal" re-opening scheme, we expect better numbers ahead, although they are likely to remain in negative territory compared with last year.

On the retail sales side, the indicator contracted -6.2% m/m sa, which is attributed to the aftermath of the VAT holiday in July, which was not repeated in August. By sectors, gasoline (-21.4% y/y), other vehicles (-40.5% y/y), vehicles for domestic use (-33.4% y/y), and clothing (-45.7% y/y) accounted for 85% of the month's undershoot compared with last year. These contractions were directly related to mobility restrictions and weaker demand related to the main cities' lockdown measures. Additionally, employment contracted -5.2% y/y, especially in the clothing sector, which is the sector hardest hit by the weaker demand. In September, we expect a strong rebound in retail activity as gasoline demand was almost at pre-pandemic levels and commercial activities were not restricted, especially in Bogota.

On the manufacturing side, August production was down by -10.3% y/y, while manufacturing sales were off by -9.0% y/y, which pointed to reductions in inventories in the month. It is worth noting that 35 out of 39 sub-sectors were down in year-on-year terms in August. Three sectors accounted for 40% of the annual contraction: beverages (-16.8% y/y), clothing manufacturing (-30.9% y/y), and oil refining (-14.0% y/y). August is usually a month of huge regional festivals and events. However, given the pandemic restrictions, these festivals were canceled and this hit beverage production hard. On the employment side, clothing and shoe manufacturing saw the biggest declines due to weaker demand in these sub-sectors. Green shoots appeared, however, in vehicle manufacturing, which trimmed its annual contraction to -29.9% y/y from -49.1% y/y in July.

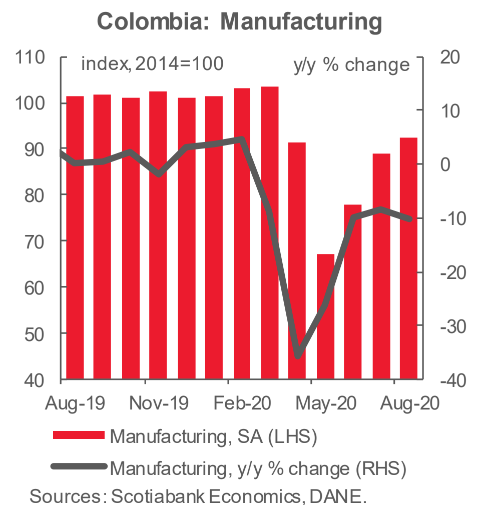
Although the national government allowed more than 90% of the economy to operate in August, local lockdown measures were strengthened in Bogota and Antioquia, which weighed on the economic recovery. These two regions contributed 56% of the retail sales contraction and 50% of the manufacturing downturn, which was worse than in July.

Again, to reiterate, we expect that economic activity improved further in September as Colombia started its new re-opening scheme and mobility indicators rose, gasoline demand strengthened (chart 8), and energy demand continued its upward trend (chart 9). However, in the ensuing months, re-opening is likely to begin encountering diminishing marginal returns, consistent with our baseline forecast of a -7.5% y/y contraction in real GDP during 2020.

In light of all of this, we still think that BanRep will keep its monetary policy rate unchanged at 1.75% at the October 30 meeting. Inflation has started to rise and economic activity indicators should improve with September re-openings.

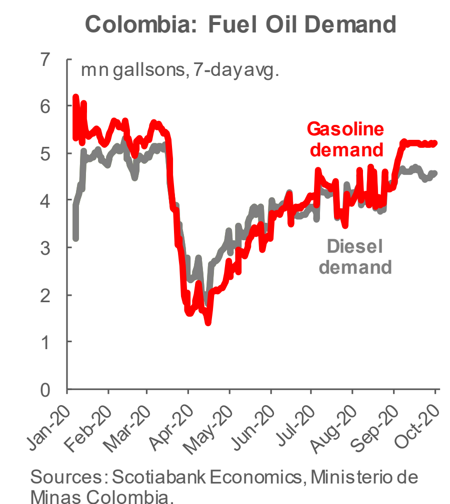
—Sergio Olarte & Jackeline Piraján

Chart 7



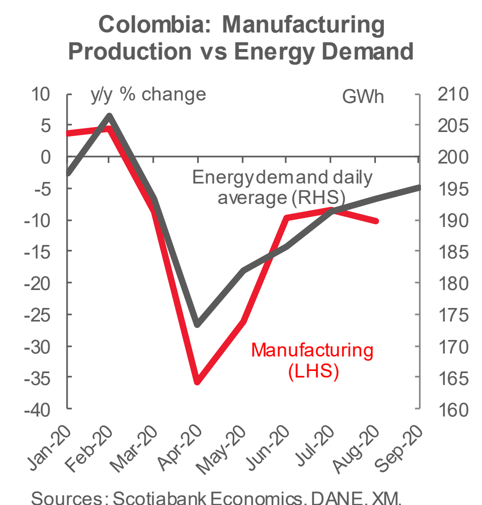
Sources: Scotiabank Economics, DANE.

Chart 8



Sources: Scotiabank Economics, Ministerio de Minas Colombia.

Chart 9



Sources: Scotiabank Economics, DANE, XM.

PERU: AUGUST GDP GROWTH STILL BELOW EXPECTATIONS

August GDP growth came in at -9.8% y/y, according to figures released on Thursday, October 15 by the National Statistics Institute, just a hair below consensus, which stood at -10.1% y/y. The breakdown of the figures mixed good and bad.

At first sight, the result was weakish, as it barely missed becoming another monthly double-digit decline, and was up only 2.4% in m/m terms. Interestingly though, August's numbers were very different from previous months in that the sectors linked to domestic demand outperformed export sectors (table 1). The major disappointments were mining and agriculture, both with sharp decreases. Mining especially was weak, down -11.2% y/y and also declining -1.0% m/m. We had been aware that mining in August and September had been affected by a shortage of workers as many were being treated for COVID-19 at a couple of major mines, but the magnitude of the impact was surprising. As for agriculture, the sector has been underperforming for some time now, so what initially seemed like a temporary phenomenon is starting to look increasingly more long-term. That said, if the situations for mining and agriculture both prove to be temporary, and if one excludes both sectors, then GDP would have been off by less than -8% y/y in August. September should still see a spillover effect in mining, but it is our understanding that the sector will have normalized by October.

Table 1

GDP Growth, August 2020	y/y % change	m/m % change
GDP	**-9.8**	**2.4**
Agriculture	-6.6	1.9
Fishing	-6.5	-27.0
Mining, oil & gas	-11.2	-1.0
Manufacturing	-12.1	-3.0
Electricity	-2.7	2.1
Construction	-6.5	13.7
Commerce	-8.1	4.1
Transportation	-27.9	3.1
Hospitality	-60.9	35.6
Telecom	5.1	0.3
Financial services	19.7	3.0
Defense & public sector	3.9	n.a.

Sources: Scotiabank Economics, INEI.

All other sectors were in line with expectations, or better—most particularly, those sectors linked to domestic demand, from construction and electricity, to commerce and essential services such as telecom and financial services. All in all, there were very few sectors in October that still showed double-digit declines, and nearly all sectors continued rising in m/m terms.

—Guillermo Arbe

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