

Latam Economic Update

- **Argentina:** COVID-19 case numbers worsen
- **Brazil:** Q2-2020 GDP—manufacturing and transportation particularly bleak
- **Chile:** BCCh held key policy rate at 0.5% “technical minimum”; July activity confirmed recovery
- **Colombia:** BanRep *Minutes*; Current account deficit narrowed as income account outflows contracted due to COVID-19 impact on economic activity
- **Mexico:** Expectations remain negative; remittances rose to new record levels in July; President gave his 2nd government report
- **Peru:** Inflation back on track to decline by year-end; early GDP growth indicators for July point to an improvement over June

ARGENTINA: COVID-19 CASE NUMBERS WORSEN

In Johns Hopkins data released yesterday, Argentina’s COVID-19 case numbers moved above those in Chile for the first time and now are the 10th largest in global comparisons. Some 417k positive cases have now been identified in Argentina, just above the 411k in Chile, which has a population half the size of Argentina’s. Argentine case numbers have risen 10% over the past week despite the continuation of over five months of relatively strict lockdown measures in most of the country.

—Brett House

BRAZIL: Q2-2020 GDP—MANUFACTURING AND TRANSPORTATION PARTICULARLY BLEAK

Brazil’s **Q2 GDP** growth data, released on Tuesday, September 1, printed at **-11.4% y/y** (chart 1), between a consensus expectation of **-10.7% y/y** and our call for **-12.6% y/y**. After yesterday’s print, we will likely revise our forecasts for the next two years to a somewhat flatter path. The GDP data included a sectoral breakdown of the Brazilian economy’s Q2 performance, where on the supply side, industry and services were particularly weak (table 1). Manufacturing (-20.0% y/y) and transportation (-20.8% y/y) led declines, but retail services (-14.1% y/y) and construction (-11.0% y/y) also contributed to the quarter’s drop. On the positive side, agriculture expanded 1.2% y/y, while within secondary activities mining grew by 6.8% y/y and amongst tertiary activities financial services grew 3.6% y/y.

Overall, the composition of supply-side growth in Q2 was broadly consistent with what should be expected in a pandemic disrupted economy—although the resilience in the mining industry was a surprise to us. Recent data imply that we’ll see an important further improvement in Q3, with the pace of contraction being reduced by about half on a y/y basis.

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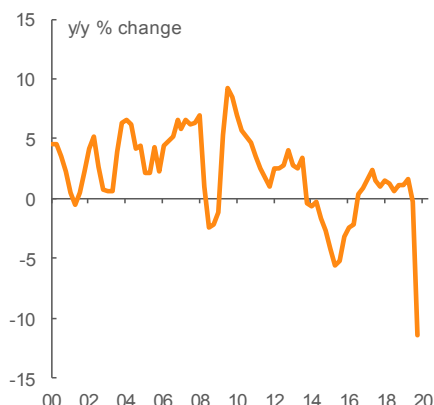
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Chart 1

Brazil: Gross Domestic Product



Sources: Scotiabank Economics, IBGE.

Looking at Q2 GDP from the demand side, investment, which accounts for about a sixth of demand-side GDP, saw the steepest drop at -15.2% y/y (table 1, again), while private consumption also had a very weak quarter at -13.5% y/y. Government consumption fared a little better at -8.6% y/y, but still saw a sharp contraction and provided a drag on growth. Our main concern on the demand side is that investment continues to fall as a share of Brazilian GDP, which is likely undermining potential growth. The trend of falling investment is not just COVID-19 induced, but rather a multi-year phenomenon that, at this point, implies that potential growth is now around 2%—at best.

Table 1

Brazil: Selected GDP component performance in Q2-2020

Supply	y/y % change	Demand	y/y % change
Agriculture	1.2	Investment	-15.2
Industry	-12.7	Private consumption	-13.5
Services	-11.2	Gov't consumption	-8.6

Sources: Scotiabank Economics, IBGE.

—Eduardo Suárez

CHILE: BCCh HELD KEY POLICY RATE AT 0.5% “TECHNICAL MINIMUM”; JULY ACTIVITY CONFIRMED RECOVERY

I. Central Bank diagnoses stabilization in activity, but still relevant risks in the labour market

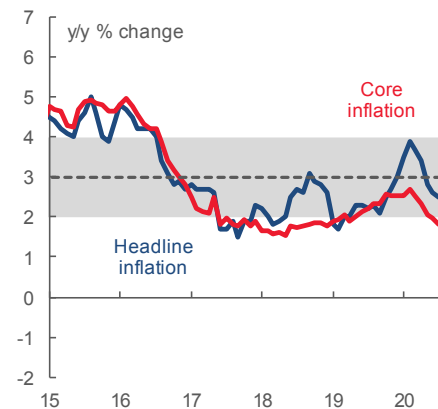
In its monetary policy decision on Tuesday, September 1, the BCCh’s Board unanimously voted to hold its benchmark rate unchanged at 0.5%, but signalled that it is open to adapt monetary stimulus measures, if necessary. The Board observed that the economy stabilized after GDP growth in June and July came in better than anticipated in the BCCh’s baseline scenario. Still, the Board remained concerned about the sharp deterioration in all of the labour market’s dimensions (i.e., employment and wages). Regarding credit flows, the Board was relatively satisfied with the counter-cyclical expansion of commercial credit, but also noted the persistent slowdown in consumer credit growth. It was striking that no reference was made to the recent slowdown in commercial loan growth, a process that began with some force in July.

In line with the confidence expressed regarding the economic recovery and lower disinflationary pressures (chart 2), the Board indicated that the BCCh’s benchmark rate would remain at its technical minimum “for a large part” of its monetary-policy horizon. This implies that the central bank has encountered positive surprises in economic activity and short-term inflation with the beginning of the gradual process of re-opening the economy. Such observations would augur against increasing monetary stimulus at this point, but given the risks present in the labour market, it cannot be ruled out that additional easing could become necessary in the coming months. Further stimulus could be delivered either by keeping the main policy rate at 0.5% for a longer time or by reducing the stated “technical minimum” or floor on the rate to 0.25%. Given the content and tenor of the Board’s [statement](#), it appears that the Board does not have a settled view on the matter and would now prefer to remove the question of a new technical minimum from the current discussion of monetary policy—despite the BCCh itself having raised the issue at its [June monetary policy meeting](#).

The statement anticipated a new [Monetary Policy Report](#), due for publication today, that should present some improvements in the BCCh’s macroeconomic forecasts, in line with yesterday’s July monthly GDP proxy (see below). We are likely to see the forecast contraction in 2020 GDP pared toward a range of 5% y/y and -6% y/y, with a slight increase in inflation for the rest of the year owing to the impact on consumption of the withdrawal of funds from individual retirement accounts in the AFP system.

Chart 2

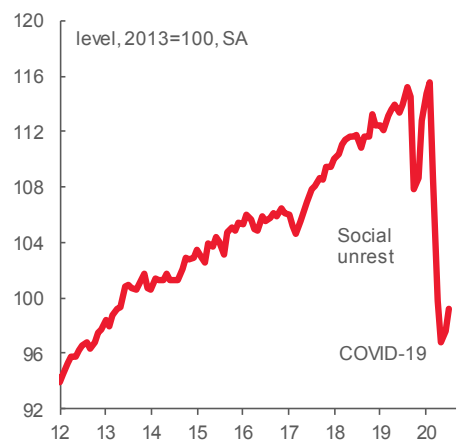
Chile: Headline and Core Inflation



Sources: Scotiabank Economics, INE.

Chart 3

Chile: Monthly GDP



Sources: Scotiabank Economics, IBGE.

II. July GDP proxy confirms recovery, but expected slope for 2021 remains moderate

Monthly GDP data for July, which were released ahead of the BCCh rate decision on Tuesday, September 1, once again showed signs of recovery in non-mining activity with 1.8% m/m seasonally-adjusted growth, a second straight month of expansion (charts 3 and 4). Compared with last year, aggregate economic activity was still down -10.7% y/y, but this was better than anticipated by market consensus (-12.0% y/y) and implied that our relatively strong forecast recovery scenario is beginning to be confirmed. Most notably, this has occurred in a context where quarantine measures were still strict, so for August we anticipate a year-on-year contraction in the single digits with an “impressive” seasonally adjusted monthly expansion between 6% m/m and 8% m/m. This would reflect not only the gradual lifting of mobility restrictions, but also to the short-term shock from the spending of monies withdrawn from AFP individual retirement accounts.

The seasonal adjustment was particularly large in July, similar to what we saw in June. This may be related to volatility in certain activities, especially educational services reported by the Ministry of Education to the central bank. As a result of the relatively large seasonal factor in July, the month-on-month adjusted growth rate was accompanied a lower-than-expected year-on-year contraction.

The mining sector continued to show moderate but sustained growth in July, which highlighted the reduction in COVID-19-related restrictions on the industry, but also the higher grade of ore recorded in some private sector operations. Despite these gains, the impact of the sector on total GDP is still practically nil compared to the strong year-on-year contractions that the non-mining side of the economy still shows.

Our baseline scenario contemplates a 2020 GDP contraction of no deeper than -6% y/y, which recent data have supported, while for 2021 we project an expansion of around 4.5% y/y. The slope of Chile’s recovery continues to be conditional on the health of the global economy, with a particular emphasis on China. Chile’s rebound is also subject to political uncertainty related to next October’s constitutional referendum. Overall, we expect that Chilean GDP will not return to pre-pandemic levels until the second half of 2022.

—Jorge Selaive & Carlos Muñoz

COLOMBIA: BANREP MINUTES; CURRENT ACCOUNT DEFICIT NARROWED AS INCOME ACCOUNT OUTFLOWS CONTRACTED DUE TO COVID-19 IMPACT ON ECONOMIC ACTIVITY

I. BanRep Minutes from Monday’s meeting

The BanRep published the [Minutes](#) of its Monday, August 31 monetary policy meeting where it cut its headline policy rate by -25 bps to 2.00% in an unanimous decision. The *Minutes* echoed the Board’s decision [statement](#), which did not close the door on possible further easing. The text was very factual, much like the communiqué and the press conference. The Board stressed that Q2-2020 GDP was the lowest in recent history, but the labour market showed some signs of recovery in June.

The Board did note that inflation expectations for next year show some uncertainty. They stressed that analysts’ consensus is such that inflation will converge

Chart 4



Chart 5

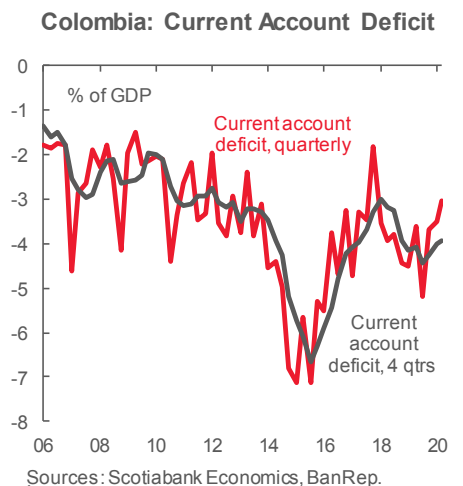
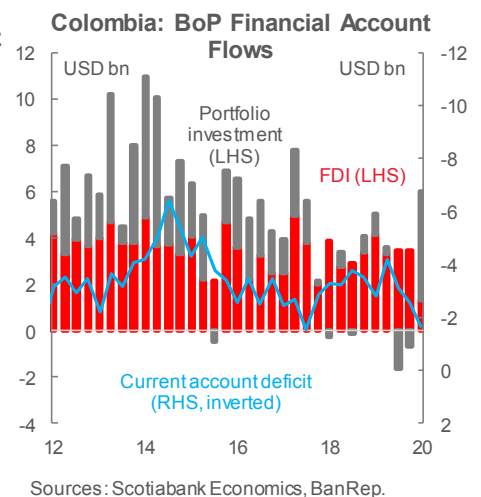


Chart 6



to 3% next year, while market break-evens still show inflation below the target range (2 to 4%) through August 2022. According to the *Minutes*, the monetary policy easing cycle has been partially transmitted to the rest of the rates in economy, especially to short-run rates and commercial loans, while liquidity conditions are good domestically and internationally.

All in all, the August *Minutes* were only a description of events and did not provide any guidance on the near-term monetary policy strategy. We still think that BanRep is data dependent and August inflation and high frequency data will be key to the September decision; in other words the door is still open for one more -25bps cut this month, depending on data.

II. Current account data for Q2-2020

BanRep also released Q2-2020 current account data where the deficit stood at USD 1.7 bn, equivalent to 3.0% of GDP, the lowest level since 2017 (chart 5). Despite the considerable contraction in exports in the second quarter, some offsetting effects moderated the current account deficit. The main stabilizing effect came from a significant contraction in imports and lower income-account outflows. On the financing side, net capital inflows to public external debt contributed the most, while FDI contracted by 30% on a quarterly basis, but remained positive. The YTD current account deficit was USD 4.2 bn, equivalent to -3.3% of GDP—down from the comparable H1-2019 result (i.e., USD 6.4 bn, -4.1% of GDP)—indicating that automatic stabilizers related to the huge domestic demand contraction are mitigating external imbalances. We expect the current account deficit to continue narrowing in the second half of this year and to end 2020 smaller than -4% of GDP, in line with the historic domestic demand contraction.

Looking at the numbers in more detail, the current account deficit in the H1-2020 narrowed by USD 2.1 bn to USD 4.2 bn due to smaller income-account outflows (USD 4.9 bn, down by -48% y/y) and a smaller deficit in services trade (USD 1.8 bn, down -4.7% y/y). Meanwhile, the trade deficit widened by USD 169 mn to USD 5.3 bn. Exports contracted by -26.9% y/y to USD 19.4 bn due to lower oil and manufacturing exports, while imports contracted proportionately less (-22% y/y) to USD 24.7 bn. It is worth noting that the contraction in imports was fairly widespread across sub-sectors. In fact, capital goods contracted -14.9% y/y, transport equipment imports by -47.7% y/y, and consumption goods by -17.5% y/y. On the services balance, exports contracted by -35.1% y/y and imports by -26.5% y/y, mainly because of travel restrictions due to COVID-19. It is worth noting that the reduction in income account outflows was expected since the COVID-19 shock has reduced profits across all economic sectors, but especially in industries with substantial foreign investment such as mining, transport, and communication. In the coming quarters, lower income-account outflows should keep moderating the current account deficit.

On the financing side, capital inflows in the public sector, due to monetization of external debt, stood at USD 6.2 bn, while FDI inflows stood at USD 1.34 bn in Q2-2020. Additionally, international reserves increased by USD 2.6 bn. This being said, despite the fact that FDI inflows remained positive, they are no longer the main contributor to financing the current account deficit financing (chart 6) and we expect this trend to continue for the rest of 2020. In H1-2020, FDI inflows stood at USD 4.8 bn (down -36.4% y/y and equivalent to 3.7% of GDP), while portfolio investment came in at USD 4.1 bn (3.1% of GDP). Portfolio flows in H1-2020 reflected public external debt issuance (USD 4.9 bn) which was partially offset by outflows from COLTES of USD 563 mn and from local equity markets of USD 317 mn. Within the FDI flows, 32.7% was in the oil and mining sectors, 19.9% in the financial sector, 14.7% in the energy sector, 9.6% commerce and hotels, 6.3% in the manufacturing industry, and 16% in other areas.

The current account results for Q2-2020 showed that automatic stabilizers are working. In fact, the current account deficit narrowed despite an increase in the trade deficit, owing to lower income account outflows. In the coming months, the reduction in exports and remittances is likely to be a challenge for the current account deficit. However, lower-income account outflows and stronger contractions in imports should offset these adverse effects. On the financing side, FDI was still positive in Q2, and we expect inflows to continue but at a moderate pace. New external public indebtedness through multilateral borrowing or debt issuance will likely be the primary source of financing. According to the government's Fiscal Framework, external financing sources for 2020 will amount to around USD 16 bn, which should be enough to cover entirely the current account expected for the year.

Finally, despite the expected narrowing in the current account deficit in 2020, we project it to widen again in 2021. Colombia's economic recoveries typically feature an increase in the external deficit via capital-good imports. However, these imports are usually financed through higher FDI.

—Sergio Olarte & Jackeline Piraján

MEXICO: EXPECTATIONS REMAIN NEGATIVE; REMITTANCES ROSE TO NEW RECORD LEVELS IN JULY; PRESIDENT GAVE HIS 2ND GOVERNMENT REPORT

I. Mexican outlook for 2020 worsened further in Banxico Survey of Expectations

According to Banco de Mexico's latest monthly Survey of Expectations, released on Tuesday, September 1, with information collected between August 24 and 28, for the first time this year, private sector economists' expectations point to a smaller contraction in GDP in 2020. However, the growth outlook for this year remains the most pessimistic view captured by Banxico's survey since data was first collected in 2001.

- **The average projection for the 2020 real GDP growth rate remains virtually unchanged, improving from -10.02% y/y to -9.97% y/y;** in the same direction, the average forecast for 2021 changed only slightly from 2.88% y/y to 3.01% y/y.
- **Average forecasts for headline and core inflation at end-2020 rose from 3.64% y/y to 3.82% and from 3.72% y/y to 3.82% y/y, respectively.** For end-2021, the average headline inflation forecast remained almost unchanged, ticking up slightly from 3.56% y/y to 3.60% y/y, but core inflation moved more substantially from 3.38% y/y to 3.50% y/y. Despite the predicted increases in inflation, forecasts remained within the target range for monetary policy.
- **The average USDMXN projection for end-2020 improved from 22.69 to 22.61;** for end-2021, the average exchange-rate projection weakened slightly from USDMXN 22.68 to 22.71.
- **As for monetary policy, from the third quarter of 2020 to the third quarter of 2022, the preponderance of analysts anticipate an interbank funding rate below the current target rate (4.50%).**

Finally, in the August survey, not a single strategist believed that it is a good time to invest. Some 83% of those surveyed felt that it is still a bad time to make investments and 17% were not sure. As for the evolution of the business climate for productive activities in the private sector, 49% of those surveyed estimate that conditions will remain poor over the next six months. Lastly, not a single analyst felt that the economy is better off than it was a year ago.

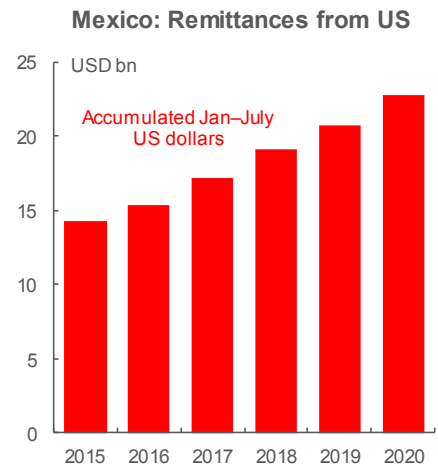
II. Remittances rose to new record levels in June

July remittances data, which were also released on Tuesday, September 1, printed new records for any month of July at USD 3.5 bn (chart 7) and for the first seven months of the year (since at least 1995) at USD 22.8 bn. These prints implied annual increases of 7.2% y/y and 10.0% y/y in each case. These record levels of remittances might somewhat compensate for Mexican households' reduced labour incomes. Remittances have remained high following their surge at the beginning of the pandemic-induced lockdowns. This may reflect the fact that in the months of May, June, and July 2020 there was a cumulative increase in the employment of Mexican immigrant workers in the United States. This moderate improvement has already led to an increase in the income levels of this group of Mexican workers and, to some extent, in the resources available for sending remittances to their families in Mexico.

III. President Andres Manuel Lopez Obrador gave his second government report

President Andres Manuel Lopez Obrador gave his second government report on Tuesday, September 1, in which he mentioned different topics such as the fight against corruption, the progress of welfare programs, security achievements, and his handling of the economic fallout from the COVID-19 pandemic, arguing that the economy has fared better than some of its peers. In the speech, he emphasized the government's frugality, noting that luxuries have been eliminated and that resources saved are being dedicated to advancing the well-being of Mexicans. He also forecast that *"the worst is over and now we are recovering. Lost jobs are already recovering, production is slowly returning to normal, and we are already beginning to grow"*. According to his official calculations, fighting corruption and government austerity have together allowed his

Chart 7



Sources: Scotiabank Economics, Banxico.

administration to save close to MXN 560 bn (approx. USD 25.5 bn). Finally, he stated that “*We have faced the pandemic and we are going to get out of the economic crisis without taking on additional external debt and without allocating public money to immoral bailouts.*” **In short, we shouldn’t expect the government to launch a spending program to cushion the pandemic’s impact.**

—Paulina Villanueva

PERU: INFLATION BACK ON TRACK TO DECLINE BY YEAR-END; EARLY GDP GROWTH INDICATORS FOR JULY POINT TO AN IMPROVEMENT OVER JUNE

Monthly inflation was **-0.11% m/m** in August, which took yearly inflation down to **1.7% y/y** from **1.9% y/y** in July in data released on Tuesday, September 1. Inflation has resumed the downtrend that we were expecting, but which was briefly interrupted in July due to one-off factors. We continue to expect **1.1% y/y** inflation for full-year 2020. With the downtrend back on course, the BCRP should be comfortable keeping the reference rate at 0.25% for a considerable time in the future.

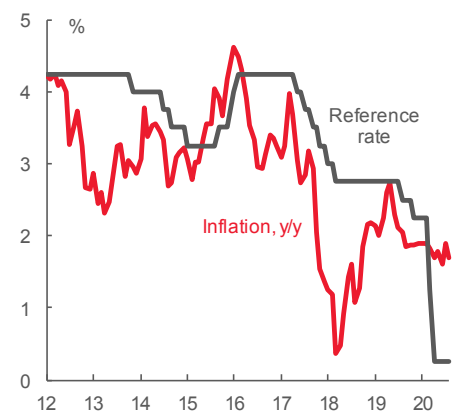
The National Statistics Institute has also published a number of early indicators for July GDP growth. The data are broadly in line with our expectations of a **-8% y/y** to **-10% y/y** GDP contraction in July, roughly half the **-18% y/y** GDP contraction in June. Outside of fishing, which is a special case, all data show declines that were half as large, or better, than in June. The data that were released include:

- **Fishing GDP rose 33.3% y/y, in July (compared with 48.1% y/y, in June).** This was as strong as expected, given how the fishing season has evolved. Some fishmeal processing will spill over into August, but June-July was pretty much the height of the fishing season.
- **Mining GDP fell -6.4% y/y, in July (-13.6% y/y, in June), non-materially worse than the -5% y/y we were expecting.**
- **Oil & gas activity was down -5.1% y/y, in July (-19.7% y/y in June).** The decline was only in oil production (-21% y/y), which continues to face social conflict in the rainforest. Meanwhile, gas output rose 0.4% y/y.
- **Cement consumption was down -5.4% y/y in July.** This is, actually, an impressive rebound from **-32.7% y/y, in June.**
- **Sales tax revenue fell -23.4% y/y, in July.** The decline was sharp, although much better than the **-51.1% y/y** contraction in June.

—Guillermo Arbe

Chart 8

Peru: Inflation and Reference Rate



Sources: Scotiabank Economics, BCRP.

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