

## LATAM Market Update

- **Peru's fiscal situation continues outperforming expectations in July**
- **Chile: A convenient quick overview to the base Chilean assets**
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EM was under pressure again last Friday, with the BRL being the underperformer this time (-0.9%). Outside the real, the losses in the LATAM FX space were limited to -0.6% (for CLP), or less. The poor performance of the real was based on the growing uncertainty over the upcoming presidential elections hitting sentiment. Our base case is that in the October 2018 election, it increasingly looks like we will either see an anti-establishment (anti-reforms) candidate win, or we will see a reformist, but without a mandate to carry out the reforms. In Mexico, Banxico released meeting minutes which seemed to show the board is balancing its stance. The board continues to monitor inflation risks closely, but also seems increasingly worried about the growth outlook.

### PERU'S FISCAL SITUATION CONTINUES OUTPERFORMING EXPECTATIONS IN JULY

Peru's rolling 12-month fiscal deficit of 2.2% to July came in at a two and half year low. In comparison, at this time last year, the deficit stood at 2.6%. As a result, and given strong tax revenue growth, up 17.6% YTD, the deficit is likely to end 2018 well below the 3.1% at which it ended 2017. Income tax revenue has come in very strong, up 21.3% in the YTD, thanks to a very strong income tax payment season in April–May. The deficit typically declines in the first half of each year due to this seasonal IR inflow, and then rises for the remainder of the year. We expect the same in 2018, especially as government spending is also high, and rising, up 9.3% in the year-to-July and accelerating to 17.0%, YoY, in July (in comparison, revenue rose 17.7% in July). However, with domestic VAT revenue rising nicely and consistently (12.4% in the year to date and 12.9% in July), the increase in the fiscal deficit should remain contained. This strengthening fiscal picture puts at rest, at least for the time being, concerns that predominated at the beginning of the year that the fiscal situation would deteriorate materially over the next two years. The risk, of course, is that the recent decline in metal prices, if it persists, will impact the fiscal outlook. This is more of a risk for 2019 than for 2018.

### CHILE: A CONVENIENT QUICK OVERVIEW TO THE BASE CHILEAN ASSETS

For the current week, almost the only relevant information will be the national accounts report for Q2 (as you can see, not very fresh stuff) to be released by the Central Bank a couple of hours after this comment. However, there is some important information in it to be analyzed, which will be commented on in tomorrow's report. (Although it is not usually a chunk of data able to move the markets in the very short term, it may condition our forecast revisions). With such a sparsely populated economic agenda, in our perspective, most of the week will be dominated by the volatile international markets, so it's a good time to check where we stand.

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Copper price is the most serious risk for the domestic economy. Despite the fact that the Chilean economy has strength enough to cope with almost any short-term turbulence, copper weakness has a negative effect on business expectations, which can trim investment perspectives and economic growth. It will depend on whether price weakness persists. Of course, the immediate reaction is revealed by the depreciation of the CLP (USDCLP). The breach between our quantitative model and the spot value disappeared. It is a symptom that CLP has been pressed to the extreme. Even though an exclusively technical analysis shows the exchange rate has momentum enough to reach 680 USDCLP, in the very short term that seems to be just volatility.

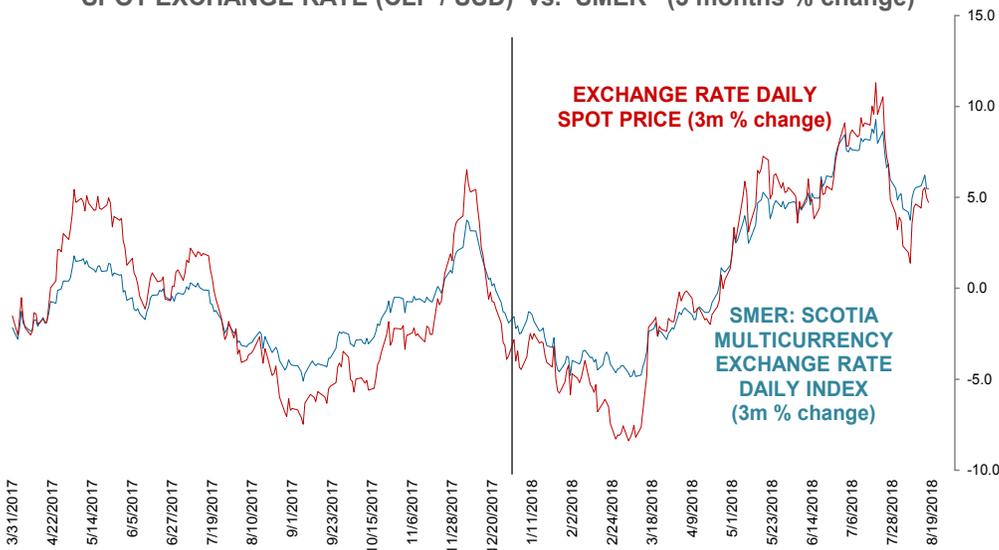
### CHILE EXCHANGE RATE: QUANTITATIVE APPROACH



Sources: Scotiabank Economics; Reuters Eikon

About the inflation induced by the exchange rate, our model (SMER) suggests it is not negligible, but is much less than the pressure we saw by mid-July. Accordingly, market expectation inflation for the current year has not changed recently (2.9%). The same can be said for 2019, for which expectations are centered at 3%. Needless to say that 24 months inflation expectations (basic for the Monetary Policy), remain well anchored to 3%.

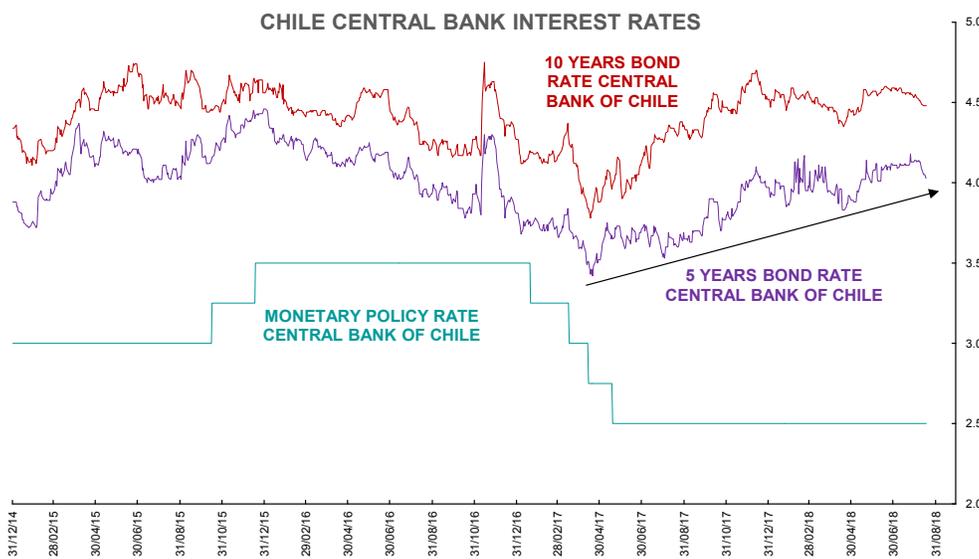
### SPOT EXCHANGE RATE (CLP / USD) vs. SMER (3 months % change)



TECHNICAL NOTE: Calculated considering energy and consumption goods imported from several countries that represent relevant proportion on total.

Sources: Scotiabank Economics, Reuters Eikon

With the majority of forecasters expecting the Central Bank to stay on the sidelines up to December 4th, short-term interest rates should remain relatively stable (with typical liquidity stress in some seasonally foreseeable dates), so the short part of the yield curve is not expected to change much. About the longest portion, it must be said that recent data and international events have put some pressure on yields, but still within the mild uptrend we forecast for H2. That view is not expected to change: since most of the international volatility is captured by the exchange rate, the effect of foreign volatility on long-term yields has been pretty limited. Long-term interest rates are determined by a mix between inflation expectations and the forecasted trend for the economy in following 12 to 24 months. The last is expected to continue improving, unless the international turmoil were much worse (a permanent negative perspective for copper price), which is not our base case. The chart shows the MPR determined by the Central Bank and the interest rates of 5 and 10 years bonds issued by the Central Bank (but the rate is freely determined by the market), which are the most important benchmarks for long-term rates.



Source: Scotiabank Economics; DataMart

Finally, according to our quantitative model, the alleviation of factors pressing on the domestic stock market (represented by the IPSA index) has stopped its fall and started a mild recovery. Although, in the very short term, technical analysis confirms that Chilean equities continue under pressure and we are still relatively far from being out of the woods (the complete quarter is seasonally very volatile, among other reasons), it is notable that positive factors dominate over negative, though by a limited margin. That provides a glimmer of hope.



Sources: Scotiabank Economics; Reuters Eikon

## WHAT'S NEXT FOR THE NEW MEXICO CITY AIRPORT?

President-elect AMLO, and proposed Infrastructure Minister Jimenez Espriu held a conference to discuss the incoming administration's plans for the new Mexico City Airport. As we already knew, the options on the first branch of the tree are to cancel or continue with the project. If the project is cancelled, the AMLO administration would seek to expand the air force base in Santa Lucia, to share the passenger load alongside the existing airport. If the project continues, our sense is the alternatives would be to continue with the project as it is, or concession it – which would give AMLO a way out of his pledge to not devote public resources to the project. Based on the incoming administration's own assessment of the risks in cancelling the project, it sounded like cancellation is not really their preferred action. These "costs" include:

- The project is already 1/3 of the way built.
- The project's funding is mostly already in place.
- With the private funding already in place, it's likely that cancelling the project would drive a strong negative reaction from markets.
- Cancelling would mean giving up the capacity to increase the city's passenger capacity from just over 30mn at the moment, to almost 70mn. This implies large costs to the tourism industry, which is both a relevant employer, and a tier-1 ingredient in the balance of payments.

In addition, the incoming administration highlighted disadvantages of the proposed alternative of a "complementary airport" at the Santa Lucia air force base:

- Questions about the "aeronautical viability" of the current CDMX airport and Santa Lucia operating jointly. The airport safety agency MITRE argues that the two airports (which would be around 40KM away from each other) cannot operate jointly, unless traffic were cut substantially – thus leading to total capacity materially below the potential of the first leg of the project currently under construction (the current project can be expanded to around 130mn of passenger capacity).
- The cost of moving the country's main air force base: Santa Lucia is currently the main hub for the Mexican air force. If the base becomes an alternate airport, a new location would need to be found for the air force, and facilities to house and provide services for 7,500 soldiers and 3,000 families would need to be built.
- Logistical hurdles & inconvenience for airlines and passengers: For airlines, having two airports—which are a long distance away from each other – involves very important costs in logistics, which would also affect passengers who would potentially face a long commute between the two airports to make connections.

Based on the disadvantages of cancelling the project that the incoming government spoke of, and the disadvantages that joint operations with Santa Lucia entail, we assume that the base case is the airport project will continue. The key question is whether it would be concessioned or not. The incoming administration did not rule out concessioning the project. However, as my colleague Joe Kogan highlighted, there are financial/legal hurdles to the concession of the project—related to the conditions in the airport bonds. However, our sense is there is a growing consensus that this will be the way forward, and there are potential ways around the hurdles.

Going forward, some key dates, according to the incoming government are:

- A review of the project by a third group of engineers could take 6 months (from now).
- Presentation of "expert opinion" should be ready by September 5<sup>th</sup>.
- A referendum on the airport (which will be binding) is planned for the end of October.
- Airport project should be ready (if it proceeds) by 2022 H2.

**MONDAY, AUGUST 20<sup>TH</sup> DATA PIPELINE**

Country	Indicator	Actual	Consensus	Previous
Brazil	Formal job creation (Aug 20–24)		19608	-661
	CNI industrial confidence			50.2
Chile	Current account			-\$269m
	GDP		5.2%	4.2%

**RECOMMENDED READINGS:**

[“The dangers of illiberal liberalism”](#) The Economist (August 17, 2018)

[“Putin overplays his hand”](#) C. Hill – Project Syndicate (August 17, 2018)

[“Crumbling infrastructure is a worldwide problem”](#) The Economist (August 17, 2018)

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