



# FOCUS | Latin America

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# MARKETS 360™

Strategy & Economics

EM ECONOMICS

## 2021 Latam roadmap: It's all about politics and fiscal

### KEY MESSAGES

Politics and fiscal balance are likely to be the common themes for Latam countries this year.

**In Brazil**, we expect unwinding of the Covid-19 relief measures to result in economic and political challenges, as a vaccine is not yet widely available. The country's 2022 general elections could cause volatility towards year-end.

**Mexico** will hold midterm elections in June. The outcome is expected to favour President AMLO, opening the room for fiscal reforms.

**Argentina** could reach a deal with the IMF during the first half of the year, while midterm elections will be in the spotlight in the second half of the year.

**Colombia** needs a tax reform that increases fiscal revenues to avoid a ratings downgrade. The government will likely hold a debate on this in H1.

**Chile** will hold an election in April to decide on the members of the constitutional assembly, which could reassure markets. However, the presidential election in H2 could confirm a shift to the left.

**Elections will be a common theme across Latam nations.** Politics is challenging to follow, and is sometimes difficult to understand. However, the political decisions can potentially influence markets.

**During the year, Latam countries will see a slew of elections.** Mexico and Argentina will hold midterm elections that could affect the balance of power in Congress. Meanwhile, Chile will hold general elections (presidential and legislative). It will also continue to discuss the new constitution.

**Brazil and Colombia will be the only exception.** However, the 2022 general elections will be of relevance for both countries in the second half of this year due to election deadlines and the likely headlines generated by possible candidates.

**While politics is expected to take the centre stage this year, fiscal measures will need to be discussed.** With the exception of Mexico, the Covid-19 pandemic has made the fiscal accounts of Latam economies more fragile. We expect all countries to discuss spending cuts and/or measures to increase revenues. Fiscal adjustments and a busy political calendar can be an unpleasant combination.

For a broader EM roadmap please see: [EM 2021 Key Events: A roadmap to recovery](#), published on 4 January.

Table 1: Real GDP growth (% change)

	2020 <sup>(1)</sup>	2021 <sup>(1)</sup>	2022 <sup>(1)</sup>
<b>Latin America</b>	<b>-7.2</b>	<b>3.6</b>	<b>2.7</b>
Argentina	-11.0	5.0	2.0
Brazil	-4.5	3.0	3.0
Chile	-6.0	5.0	2.5
Colombia	-7.5	5.0	3.0
Mexico	-9.5	3.0	2.3

Sources: BNP Paribas (1)BNPP forecast

Table 2: Fiscal balance (% change)

	2020 <sup>(1)</sup>	2021 <sup>(1)</sup>	2022 <sup>(1)</sup>
<b>Latin America</b>	<b>-10.6</b>	<b>-5.6</b>	<b>-4.9</b>
Argentina	-9.2	-6.1	-4.5
Brazil	-17.3	-7.0	-6.7
Chile	-9.0	-5.5	-4.5
Colombia	-9.0	-7.0	-3.5
Mexico	-2.9	-3.0	-3.1

Sources: BNP Paribas (1)BNPP forecast



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Please refer to MAR disclosures and important information at the end of this report.

# Brazil: Politics likely to be in the spotlight

**Covid-19 vaccine likely to remain an issue for several months.** Brazil's government took a long time to announce the national Covid-19 vaccination programme. In the meantime, the number of infections has increased substantially. São Paulo appears to be ahead in the vaccine game, having developed one in collaboration with a Chinese company. However, the vaccine is still awaiting approval of the Brazilian health agency.

**Even after the approval, easy availability of the vaccine will take time.** Under such a scenario, we expect companies and households to remain conservative, spending and investing less than otherwise during the first half of 2021. We project GDP for the full year to grow only 3.0%, with a soft to negative H1.

**In parallel, the Congress will hold elections for speakers of the Houses.** The elections are scheduled to take place in the first week of February with potential impact for markets. The elected speakers will hold office for two years. We expect uncertainty on how the new speakers will handle the reform agenda, as well as the bills that could deteriorate the fiscal balance, to remain.

**The Congress still needs to vote on the 2021 budgetary law.** As in the past, 2021 begins with the Congress yet to approve a proper budget. During this period, the government is only allowed to spend a small portion of the expected budget per month. In the past, this translated into fiscal tightening.

In addition, the 2021 budget suggests the elimination of the fiscal support that was in place in 2020. While this could be positive for debt sustainability, the fiscal adjustment of almost 8% of GDP starting in January could hurt growth, particularly during the first half of the year. We expect 2021 primary balance to be -3.00% of GDP, and gross debt to remain around 90% of GDP.

**We do not expect any relevant reform to be approved in 2021.** With the 2022 presidential election approaching, the likelihood of the government approving unpopular, but needed measures diminishes. While we expect the tax reform to be discussed, we see a very slim chance for it to be approved. The Emergency bill, which could bring fiscal relief, may be approved, but could probably be diluted. Finally, the federative pact and administrative reform have no clear calendar and are unlikely to move much further.

**The government has released an ambitious concession and privatization plan for 2021.** The government plans to offer 115 assets for concessions or privatization. These include the auction of 22 airports on 7 April and the auction of the 5G network during the second half of the year. In addition, the government may privatize Eletrobras and Correios, which we see as unlikely.

**With regard to monetary policy, we expect the central bank to start normalizing rates closer to the end of the year.** The Selic rate is now at 2.0% and we see the central bank moving its focus from 2021 inflation to 2022 and even 2023. As this happens, the BCB may decide to be less

Table 3: Key dates for Brazil

Date	Event
January	Covid-19 vaccine distribution likely to begin in Brazil
1 February	Congress to elect speakers of the lower and upper houses
March	The central bank may move the relevant horizon for monetary policy to 2022
March	Congress to vote on the 2021 budgetary law
7 April	Auction of 22 airports
15 April	Government has to deliver the Budgetary Guidelines Law (LDO) to Congress
June	National Monetary Committee may announce the inflation target for 2023
End-Q2	5G telecom auction
H1	Lower house to vote on the independence of the central bank
H1	Some form of emergency fiscal reform may be approved
August	The central bank may include a comment about 2023 inflation into its minutes
31 August	The government delivers the Annual Budgetary Law (LOA) to Congress
September	We expect BCB to hike rates for the first time by 50bp
September	Possible candidates for the 2022 presidential election need to be affiliated to a party
December	Limit on banks to unwind the second part of their over-hedging operations
Q4	Privatization of Eletrobras and Correios (tentative)
H2	Tax reform to advance in the Lower House
H2	Ports and roads concessions

Source: BNP Paribas

expansionary. We see the Selic rate at 3.50% at end-2021 and at 5.0% at end-2022.

**The 2022 presidential election may start making news in 2021.** Although the presidential election will be held only in the second half of 2022, parties and likely candidates are expected to be in the news from H2 2021. The law states that all political candidates need to be affiliated to a party for at least one year before the election, meaning September 2021. We, therefore, expect to see candidates being more outspoken about Brazil's main problems.

# Mexico: Elections and reforms hinder recovery path

Table 4: Key dates for Mexico

Date	Event
1 February	Congress resumes discussion on Banxico's bill and outsourcing reform
11 February	Banxico's monetary policy decision
February	PEMEX Q4 2020 report
3 March	Banxico Q4 2020 report
25 March	Banxico's monetary policy decision
1 April	Finance Ministry presents its 2022 preliminary outlook
4 April	Beginning of electoral campaigns
April	Banxico delivers surplus to the Finance Ministry
30 April	Congress ends ordinary period
April	PEMEX Q1 2021 report
13 May	Banxico's monetary policy decision
2 June	Banxico Q1 2021 report
6 June	Midterm elections
24 June	Banxico's monetary policy decision
July	PEMEX Q2 2021 report
1 August	Congress begins ordinary period
12 August	Banxico's monetary policy decision
31 August	Banxico Q2 2021 report
8 September	2022 Budget and potential reforms
30 September	Banxico's monetary policy meeting
October	PEMEX Q3 2021 report
11 November	Banxico's monetary policy meeting
November	IMF reviews Mexico's flexible credit line
1 December	Banxico Q3 2021 report
15 December	Congress ends ordinary period
16 December	Banxico's monetary policy meeting
31 December	Banxico Governor Alejandro Diaz de León's tenure ends
December	Setting of minimum salary for 2022

Source: BNP Paribas

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**The Congress faces a busy agenda after recess:** Two key reforms that were postponed last year will now be taken up for discussion in February. These include modification to Banxico's rules on buying US dollars and a ban on private sector outsourcing. Under the first bill, Banxico will have to buy US dollars from local banks if they cannot find another bank to purchase the dollars.

This money will be added to the international reserve. Banxico has opposed the reform, saying it puts its autonomy at risk. The lower house has said it is open to making changes to the bill, but we cannot rule out its approval. Meanwhile, the reform to ban private sector outsourcing will likely impact export-oriented manufacturers in the electronics and automobile sectors. It will also hurt the competitiveness of the agricultural sector, as around 70% of the companies in the sector rely on outsourcing.

**Midterm elections to be held in June:** Early surveys suggest that President AMLO's party (MORENA) will keep control of the Congress. It will likely be a polarized election since there is no strong party that can oppose AMLO. We do not expect the June election to change the broader political landscape. AMLO is likely to reaffirm his position, improving the prospects of reforms during the second half of his term.

**A cherry on the 2022 Budget.** We expect fiscal reforms to be part of the 2022 economic package to be announced in September. The reforms will need to tackle two key areas for fiscal sustainability: i) insufficient income tax collection; and ii) high government expenditure – pension liabilities, debt cost, and transfers to states. The government is looking to raise revenues by 2% of GDP. Given the high rate of informality, a likely rise in income taxes has a limited potential to increase income revenues.

## Our key views for Mexico:

- I. We expect GDP growth of 3.0% in 2021. In our view, Mexico's recovery will be uneven, with the industrial and services sectors showing imbalance. While growth in the industrial sector could lead to recovery, driven by higher external demand, the services sector is likely to face a more challenging recovery, mainly due to the absence of fiscal spending and investment weakness.
- II. We see headline inflation at 3.50% at the end of next year and the core component to be 3.6%. This year, the negative output gap is likely to act as a buffer for potential risks such as USDMXN shocks, or the effect of a higher minimum wage.
- III. We think Banxico will remain on hold at 4.25% through 2021. Our call is based on three key assumptions: i) inflation converging towards target within the horizon of monetary policy effectiveness; ii) deep negative output gap narrowing gradually in the next two years; and iii) a long period of low rates in developing markets.

# Argentina: Politics to take center stage, but IMF talks first

Table 5: Key dates for Argentina

Date	Event
January - February	Discussions with the IMF for a new programme expected to continue
February - March	Start of wage discussions with key labour unions
1 March	The President inaugurates the period of ordinary sessions in Congress
March	Pension adjustment
Late Q1 – early Q2	Tentative target date for the end of negotiations with the IMF
April	Start of talks with the Paris Club to postpone debt payments that are due
June	Pension adjustment Deadline for pre-candidates and political alliances to be announced
8 August	National primaries
September	Pension adjustment
15 September	Deadline for the 2021 budget bill to be sent to Congress
24 October	Midterm elections
30 November	Ordinary sessions end in Congress
December	Pension adjustment
10 December	Elected legislators and senators assume office in Congress

Source: BNP Paribas

**Politics to come under the spotlight, but IMF negotiations will be first:** Ongoing discussions with the International Monetary Fund for a new programme to secure financing for large upcoming maturities will continue to attract attention in early 2021 (Figure 1). While Argentina has requested an Extended Fund Facility (EFF) from the IMF, we do not think the authorities will be willing to commit to the Fund's aggressive reform agenda.

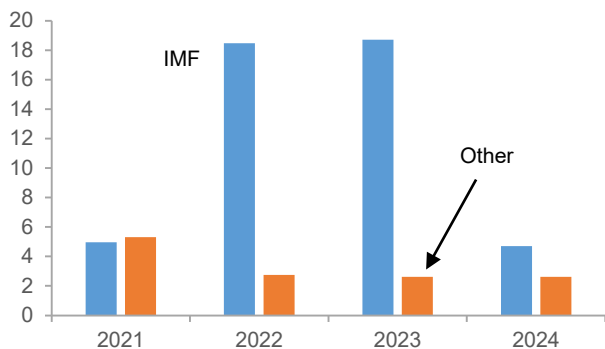
Minister of Economy Guzman has repeatedly said that he expects to reach an agreement by late Q1 or early Q2. Although there are no large payments due to the Fund until September, when an amortization totaling USD1.8bn is due, the current low level of international reserves calls for reaching an agreement sooner rather than later.

Whether the new programme will include net new disbursements is unclear. The inclusion of new funds could be a catalyst for improving expectations, given the current low level of international reserves and the widening gap between the BCRA's assets and liabilities (Figure 2). The government's objective of avoiding increases in FX exposure could be an obstacle, though.

As we approach the second half of the year, the midterm elections will come under the spotlight. Elections will be held in October for half of the lower chamber and one-third of the Senate. The provinces that will elect Senators this year are Catamarca, Chubut, Cordoba, Corrientes, La Pampa, Mendoza, Santa Fe, and Tucuman.

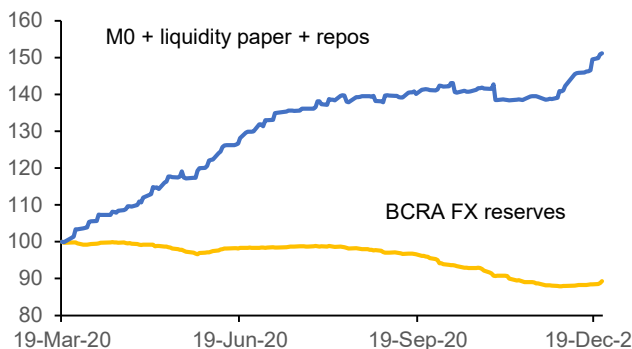
While the primaries are required to take place on 8 August, there is some degree of uncertainty as provincial governors have proposed suspending them due to the pandemic. The proposal has been rejected by the opposition, which prefers to allow parties to organize primaries based on individual needs. President Fernandez has not said whether he supports the suspension and the initiative has not been included for discussion in the extraordinary session of Congress. Although no official election calendar has yet been unveiled, pre-candidates as well as political alliances have to be formally announced by June.

Fig. 1: Total hard-currency debt service due (USDbn)



Sources: Finance Secretary, Macrobond, BNP Paribas.

Fig. 2: BCRA FX reserves and monetary liabilities (March 19 = 100)



Sources: BCRA, Macrobond, BNP Paribas.

Florencia Vazquez, Economist | BNP Paribas Sucursal Buenos Aires

# Colombia: Fiscal challenges, political constraints

**Focus will be on tax reform in H1 2021:** The Ministry of Finance has indicated that Colombia needs a tax reform that increases revenues by 2% of GDP to meet the fiscal rule, which has been suspended until 2022, and ensure debt sustainability in the medium term. Colombia has a long track record of approving tax reforms, but these are often watered down in Congress.

Moreover, as the government's proposal will likely include unpopular measures, such as the removal of VAT exemptions, the debate could give rise to the resurgence of social tensions.

**A hard context for structural reforms:** President Duque does not enjoy a solid position in Congress and acknowledges that the current social and economic scenario is not the most appropriate to discuss structural reforms. In fact, there are diverging views within the administration. The President initially stated that he would not pursue tax reforms during the pandemic. He later recognized the need to address the fiscal front. Finance Minister Alberto Carrasquilla seems to have a more ambitious agenda – he has added pension and labour reforms to the pipeline.

With legislative and presidential elections scheduled for March and May 2022, respectively, the government will probably aim to hold contentious Congress debates in H1 2021.

**Colombia's investment grade at peril:** We expect the government to pass the reform, but we think that it will raise revenues below its 2% of GDP target. Despite falling short of expectations, our base case scenario is that Colombia will maintain its investment grade rating. In our view, strong policy fundamentals will weigh more on the decision than the difference in revenue enhancing measures.

However, if political or social tensions escalate to the point where the government fails to approve the reform, we would expect a downgrade on the back of a growing debt burden and sustained external imbalances. In our view, rating agencies will wait until H2 to see how the political debate unfolds before taking a decision.

**Monetary policy normalization debate to start only in Q4:** With inflation expectations anchored and a negative output gap, we think that the bar for a rate hike is unusually high. In turn, the recent announcement of new Covid-19 related mobility restrictions pose downside risks to our forecast. External and fiscal imbalances support a neutral stance from the central bank until the end of the year, in our view. However, further negative surprises in inflation could lead BanRep to a final rate cut of 25bp in Q1.

Table 6: Key dates for Colombia

Date	Event
January*	Monetary policy report
29 January	Monetary policy meeting
February	Likely release of the tax reform proposal
26 March*	Monetary policy meeting
April*	Monetary policy report
30 April*	Monetary policy meeting
25 June*	Monetary policy meeting
Q2	Tentative period for rating agencies review
Q2-Q3	Release of medium-term fiscal framework
July*	Monetary policy report
20-29 July	Release of 2022 fiscal budget
30 July*	Monetary policy meeting
24 September*	Monetary policy meeting
October*	Monetary policy report
29 October*	Monetary policy meeting
December	2022 minimum wage negotiation
17 December*	Monetary policy meeting
Q4	Tentative period for rating agencies review

\*Preliminary dates based on 2020 releases

Source: BNP Paribas

# Chile: Uncertain road to the new constitution

**The constitutional convention election may create further discontent, but it could reassure markets:** While the new constitutional assembly will be composed solely of directly elected citizens, we do not think this necessarily implies the emergence of new political groups. We believe the composition of the convention is likely to disappoint those who see the constitutional process as an opportunity to change the political status quo. Instead, the election could be well received by the markets. Polls suggest that under most scenarios, the ruling coalition would be able to win at least a third of the assembly seats. This, combined with the less radical factions from the left, would be enough to limit material changes to the policy framework.

**The government has little control over the policy agenda, yet some reforms could be debated:** Pension changes submitted by Piñera's administration in Q4 2019 have been stuck in Congress since March 2020. If the government is not able to approve the pension reform in Q1 2021, the chances of a bill approving a third withdrawal from savings at pension funds are likely to increase. In addition, the government has asked an independent advisory committee to work on recommendations for a structural change to the tax system. Higher public spending to address social demands will require a rise in taxes at some point, we think, even if the current administration does not have the political capital to transform these recommendations into a tax reform.

**The draft of the new constitution poses a difficult trade-off:** Following the April election, the constitutional convention will have between 9 and 12 months to draft the new Constitution. This will be written almost from scratch, increasing uncertainty over the final text. This risk is mitigated by the fact that a two-thirds majority will be required to approve each article, thus leading to a low probability of drastic changes. However, if this safeguard waters down the new Constitution, there is also a risk that unfulfilled expectations could trigger a return of social unrest and political instability.

**Presidential election may confirm a shift to the left:** With a weak ruling coalition and a fragmented opposition, the presidential election may need a second round. Under such a scenario, polls show that some left-leaning candidates seem well positioned to win. We expect pension reforms to be the main topic of the campaign, as there is popular pressure to overhaul the pension system. Regardless of the election outcome, we believe Chile is headed towards an economy where the state has a bigger role and public spending is higher.

Table 7: Key dates for Chile

Date	Event
27 January	Monetary policy meeting
11 February	Start of campaign for constitutional convention election
March	Start of sessions in Congress
30 March	Monetary policy meeting
31 March	Monetary policy report
11 April	Constitutional convention election
13 May	Monetary policy meeting
June	Advisory committee to present a proposal for tax reform
8 June	Monetary policy meeting
9 June	Monetary policy report
4 July	Presidential and legislative elections (primaries)
14 July	Monetary policy meeting
31 August	Monetary policy meeting
1 September	Monetary policy report
30 September	2022 fiscal budget
13 October	Monetary policy meeting
21 November	Presidential and legislative elections (first round)
14 December	Monetary policy meeting
15 December	Monetary policy report
19 December	Presidential election (second round)

Source: BNP Paribas

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