COFACE BRIEF

03 APRIL 2020 – PATRICIA KRAUSE

CONFIDENTIAL

Latin America: COVID-19 has landed in a region with pre-existent illnesses

GDP forecast 2020: Argentina: - 4%; Brazil: -1.6%; Chile: -2%; Colombia: -0.5%, Ecuador: -3%, Mexico: -3.8% and Peru -0.2%
Coface Country Risk Assessment: Chile & Peru: A4 (reasonable), Brazil, Colombia and Mexico: B (fairly high), Argentina & Ecuador: C (high)

What

COVID-19 landed in Latin America relatively late. The first case was detected in Brazil on February 26 2020, when a 61-year old man tested positive after a trip to northern Italy. Since then, the virus has spread across the region. As of April 3 2020, taking into account the seven largest economies - Argentina, Brazil, Chile, Colombia, Ecuador, Mexico and Peru - the virus has already infected 19 563 people and has taken 582 lives. Most of the contagion was reported in Brazil (7910), followed by Chile (3404), Ecuador (3163), Mexico (1378), Peru (1414), Argentina (1133) and Colombia (1161). However, it is worth noting that these numbers are likely underestimated because of delays and lack of testing. Overall, COVID 19's arrival in Latin America has further deteriorated the already poor growth perspectives for 2020 **(Coface now expects the region´s GDP growth to fall at -2.1% this year, down from the estimate of +1% earlier this year).**

Why

Later contagion and favorable demographics could help smooth the COVID-19's spread across the region. Regarding the first argument, Latin American leaders count on a relatively longer period of global monitoring of the virus, which opens a window of opportunity to try flattening the curve of contagion. Concerning demographics, COVID-19 is known for usually having a higher severity among elderlies. **According to World Bank statistics, the population aged 65 and over represents on average 8% of Latin America´s total population. This figure is well below the rates observed in Europe & Central Asia (16%) and North America (16%). Nevertheless, the poor health system, the prevalence of an informal job market, high poverty rates and limited public resources may prevail.** As a reference, the ratio of hospital beds per 1000 inhabitants averages 2.2 in Latin America, thus considerably lower than in Europe & Central Asia (5.9), East Asia & Pacific (4.4) and North America (2.9). Additionally, the job market in the region is mostly informal, representing 53% of labor (against 25% in Europe & Central Asia and 18% in North America). The losses for workers of this group are normally greater, as they usually will not receive any income or benefit if they are in quarantine. Finally yet importantly, since the end of the commodity bonanza period (mostly after 2014), public debts in Latin American countries have considerably increased (assisted by abundant global liquidity). This means that their governments have limited space to launch large expansionary fiscal packages. **In addition to the aforementioned weakness, this year already started with large challenges ahead.** During the second half of 2019, several countries in Latin America faced large social upheavals (some other equally vulnerable countries have managed to avoid them). Although different triggers drove the protests, the affected countries share the same roots such as high inequality and poor growth rates. These factors will be further tested with the arrival of COVID-19 to the region and the current low popularity of governments.

Risks

Generally, for emerging economies like Latin America, an economic crisis has four major channels of contagion to activity: i) supply shock - disruptions triggered in China and that later reached other markets, as the virus spread worldwide; **ii) demand shock** - related to containment measures, **iii) lower commodity prices** - that cannot be underestimated in a region well-known for its vast commodity resources and **iv) the lack of USD denominated funding,** in a period where global risk aversion is on the rise. **Moreover, Coface's baseline scenario assumes that Latin America will reach the negative peak by the end of Q2 2020, followed by a gradual reopening in Q3 and Q4 2020 (albeit businesses and consumers will remain very cautious).** This means that fiscal, monetary, and financial market measures will be key in mitigating the social and economic impacts**.** Furthermore, although the first measure will raise governments´ fiscal deficits in already highly indebted countries, the action can be justified since it is a one-off increase in the event of calamity and because, in relative terms, the rest of the world should have the same behavior. Moreover, on the monetary side, there is not much room for interest rate cuts (notably in Brazil, Chile, Colombia and Peru). **Finally yet importantly, given the generally low popularity of governments in the region, depending on the manner and the swiftness of their reaction, there can be an opportunity or even a last chance to improve governance.** Overall, the degree of risk is not homogeneous and is summarized below in descending order.

- **Argentina and Ecuador** are the most at risk, since they hold high foreign debts versus very limited foreign exchange reserves. Regarding Argentina, President Fernandez has been praised by many for his efforts to fight the spread of COVID-19 in his country (being one of the first to declare quarantine). However, an agreement with private creditors has not yet been reached (the IMF has stressed the need for a major debt haircut). In Ecuador, the sharp drop in oil price represents an additional challenge. President Moreno's popularity is low and the indigenous confederation CONAIE, which led the protests in 2019, is asking to stop all foreign debt payments and use those funds to support the population during the COVID-19 crisis.
- In **Mexico,** COVID-19 hit an already moribund economy (GDP dropped by 0.1% in 2019), afflicted by the uncertainties brought by the controversial measures of the current government. Moreover, the 0.9% recession expected in the US will further affect its southern neighbour, particularly considering the expected sharp rise in the US unemployment rate (reducing remittances) and lower manufacturing activity. Moreover, President AMLO finally stopped downplaying COVID-19 and declared the country in a state of emergency on Monday 30 March (urging everyone in the private sector to halt all non-essential activities from March 30 and until April 30). However, fiscal measures are yet to be announced.
- With lower intensity, **Colombia** will also be affected by lower oil prices, which implies further pressure on its large twin deficits (fiscal and current account). Furthermore, although border crossings were closed temporarily, it is unlikely to entirely prevent influx of Venezuelan refugees (currently there are already 1.8 million Venezuelans in Colombia) since the border is more than 2,000km long. Finally, in **Brazil**, the COVID-19 crisis has caused political sparks. President Bolsonaro has refused to impose stronger mobility restrictions. Thus, state governors are now assuming this role. Despite this, mitigation measures have been announced, partially financed by budget reallocation, but also adding new fiscal expenditure (the government is now estimating that the primary deficit could reach 5% of GDP in 2020, from 0.9% in 2019). Resources will be allocated for health and for providing financial assistance to individuals and companies, to counter the negative effects of the pandemic on economic activity.
- **Chile and Peru**, small open economies, highly impacted by lower mineral prices, but with higher fiscal space. In Peru, the government counts on relatively higher popularity to take the required measures. Meanwhile, in Chile, President Piñera has tried to retrieve his popularity after the disruptive protests at the end of last year (albeit the constitution rewriting consultation scheduled for April 26 2020 had to be postponed). The likelihood of his success is not clear yet, but so far, he has announced fiscal stimulus amounting 4.7% of GDP.