LATIN AMERICA ECONOMICS WEEKLY

Ecuador's 'mutual death', external imbalances easing

Ecuador: Political risks in the spotlight

Ecuador's political crisis escalated this week after President Guillermo Lasso invoked the "mutual death" clause, dissolving the National Assembly to dodge an imminent impeachment vote. This move triggers fresh presidential and legislative elections (which are likely to take place in August). In the interim period, Lasso will be able to rule by decree. The situation remains in flux, but, at this stage, we would highlight three key points.

First, the likelihood of Ecuador shifting left again following two years of right-wing leadership is high. It is still uncertain if Lasso will run again but, if he did, his low approval ratings suggest that his chances of re-election are slim. Instead, it's likely that the left-wing 'correístas' capitalise on the anti-incumbency sentiment, as was the case in municipal elections in February. Unsurprisingly, investors were spooked by the prospects of a renewed shift to the left, which resulted in a sharp sell-off in Ecuador's sovereign dollar bonds – spreads widened by c.170bp this week, more than in any EM barring Turkey.

Second, the fiscal picture is likely to deteriorate. In the near-term, Lasso might be tempted to loosen fiscal policy to shore up waning support. Indeed, he already issued a decree to cut taxes immediately after activating the mutual death clause. And, if the opposition wins, fiscal policy is unlikely to be kept tight enough to prevent the debt trajectory from starting to rise again. This would presumably keep Ecuador locked out of international capital markets.

This brings us to the third point, which is that debt risks are likely to intensify over the course of this decade. While the central bank's FX reserves should cover external obligations over the next couple of years, rollover risks are likely to intensify from 2026 when repayments on international bonds ramp up. A(nother) sovereign default appears to be on the cards in the second half of this decade.

Diverging adjustment process in Chile & Colombia

At face value, GDP data from Chile and Colombia released this week paint a positive picture, with growth in both countries picking up in Q1, especially in Colombia. But the headline figures masked signs of weakness under the surface. In both countries, government consumption was a key driver of growth last quarter. In contrast, fixed investment contracted. And private consumption fell in Chile and slowed in Colombia. Weakening domestic demand was reflected in a plunge in imports in both countries, which is good news for external positions. After all, strong post-pandemic recoveries had led to a build-up of macroeconomic imbalances, most notably rapidly widening current account deficits.

But while adjustment processes in both countries are in full swing, Chile and Colombia find themselves at different stages. In Chile, domestic demand has fallen back below its pre-pandemic trend, which helped to flip the current account position (on a seasonally adjusted basis) back into a surplus in Q1.

In contrast, domestic demand in Colombia is still some way above its pre-Covid trend. We only get current account data for Q1 in early June, but it's likely that, despite narrowing, Colombia's current account deficit remained wide last quarter. With Colombia's economy adjusting more slowly, it's perhaps not surprising that inflationary pressures there remain very strong. Indeed, while the headline rate fell in April to 12.8% y/y, the core rate continued to rise to 10.6% y/y. Against this backdrop, we think that, while the central bank's tightening cycle has come to an end, interest rates will be kept at their current level (13.25%) until at least late Q3, which is a more hawkish view than most other analysts hold.

The week ahead

Mid-month inflation figures from Brazil and Mexico should show that inflation was broadly unchanged in the former and fell in the latter in the first half of May.

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Economic Diary & Forecasts

Upcoming Events and Data Releases

Date	Country	Release/Indicator/Event	Time (BST)	Time (EDT)	Previous*	Median*	CE Forecasts*
Mon 22nd	Arg	Budget Balance (Apr.)	-	-	-257.9bn	-	-
Tue 23rd	Arg	Economic Activity (Mar.)	20.00	15.00	0.0%(+0.2%)	-	-
	Per	GDP (Q1)	-	-	(+1.7%)	(-0.2%)	-
Wed 24th	Mex	Bi-Weekly CPI (15th May)	13.00	08.00	+0.2%(+6.3%)	-0.2%(+6.1%)	-0.2%(+5.9%)
Thu 25th	Mex	Trade Balance (Apr.)	13.00	08.00	+$1.2bn	-	-
	Brz	IPCA-15 Inflation (May)	13.00	08.00	+0.6%(+4.2%)	+0.6(+4.2%)	+0.6(+4.3%)
	Mex	Current Account (Q1)	16.00	11.00	+$4.6bn	-	-
Fri 26th	Mex	Economic Activity (Mar.)	13.00	08.00	+0.1%(+3.8%)	(+3.0%)	-
	Mex	GDP (Q1, Final Est.)	13.00	08.00	+1.1(+3.9%)	+1.0%(+3.8%)	-
	Col	MPC Meeting	-	-	-	-	-
Selected future data releases and events:							
29th May	Brz	Current Account (Apr.)	12.30	07.30	+$0.3bn	-	-
	Chl	MPC Meeting Minutes	13.30	08.30	-	-	-
30th May	Chl	Unemployment Rate (Apr.)	14.00	09.00	8.8%	-	-
31st May	Brz	Nominal Budget Balance (Apr., BRL)	12.30	07.30	-79.5bn	-	-
	Brz	Primary Budget Balance (Apr., BRL)	12.30	07.30	-14.2bn	-	-
	Brz	Unemployment Rate (Apr.)	13.00	08.00	8.8%	-	-
	Chl	Industrial Production (Apr.)	14.00	09.00	(-5.9%)	-	-
	Chl	Retail Sales (Apr.)	14.00	09.00	(-8.4%)	-	-
	Col	Unemployment Rate (Apr.)	16.00	11.00	10.0%	-	-
	Dom	Interest Rate Announcement	-	-	8.50%	-	-
1st Jun	Brz	GDP (Q1)	13.00	08.00	-0.2%(-2.1%)	-	-
	Chl	Economic Activity (Apr.)	13.30	08.30	-0.1%(-2.1%)	-	-
	Brz	S&P Global Manufacturing PMI (May)	14.00	09.00	44.3	-	-
	Mex	S&P Global Manufacturing PMI (May)	16.00	11.00	51.1	-	-
	Per	CPI (May)	16.00	11.00	(+8.0%)	-	-
	Mex	MPC Meeting Minutes	-	-	-	-	-
	Brz	Trade Balance (May)	19.00	14.00	$8.2bn	-	-
	Mex	IMEF Manufacturing Index (May)	19.00	14.00	50.6	-	-
	Mex	IMEF Non-Manufacturing Index (May)	19.00	14.00	52.2	-	-
	Col	Current Account Balance (Q1)	-	-	-$5.0	-	-
	Brz	Industrial Production (Apr.)	13.00	18.00	+1.1%(+0.9%)	-	-
Also expected during this period:							
29th – 2nd	Pan	GDP (Q4)	-	-	(+9.5%)	-	-

*m/m(y/y) unless otherwise stated; † = previous day
Sources: Bloomberg, Capital Economics

Main Economic & Market Forecasts

Table 1: Central Bank Policy Rates (%)

	Policy Rate	Latest (19th May)	Last Change	Next Change	Forecasts End 2023	Forecasts End 2024
Brazil	Selic Target	13.75	Up 50bp (Aug. '22)	**Down 50bp (Q4 '23)**	**12.75**	**10.00**
Mexico	Overnight Rate	11.25	Up 25bp (Mar. '23)	**Down 25bp (Q4 '23)**	**11.00**	**9.00**
Colombia	Intervention Rate	13.00	Up 25bp (Apr. '23)	**Down 50bp (Q3. '23)**	**11.50**	**7.50**
Chile	Overnight Rate	11.25	Up 50bp (Oct. '22)	**Down 50bp (Jul. '23)**	**8.50**	**5.75**
Peru	Reference Rate	7.75	Up 25bp (Jan. '23)	**Down 25bp (Jun. '23)**	**5.75**	**4.50**

Sources: Refinitiv, Capital Economics

Table 2: FX Rates vs. US Dollar & Equity Markets

	Currency	Latest (19th May)	Forecasts End 2023	Forecasts End 2024	Stock Market	Latest (19th May)	Forecasts End 2023	Forecasts End 2024
Brazil	BRL	4.99	**5.50**	**5.00**	Bovespa	110,672	**109,500**	**153,000**
Mexico	MXN	17.7	**20.0**	**21.0**	Bolsa	55,457	**52,600**	**62,100**
Argentina	ARS	233	**400**	**600**	Merval	332,477	**-**	**-**
Colombia	COP	4,525	**4,800**	**4,200**	IGBC	1,141	**970**	**1,290**
Chile	CLP	796	**850**	**775**	IPSA	5,636	**4,900**	**6,500**
Peru	PEN	3.69	**4.00**	**3.70**	S&P/BVL	21,571	**22,100**	**27,400**

Sources: Refinitiv, Capital Economics

Table 3: GDP & Consumer Prices (% y/y)

	Share of World[1]	GDP 2011-20 Ave.	GDP 2021	GDP 2022	GDP 2023	GDP 2024	Consumer Prices 2021	Consumer Prices 2022	Consumer Prices 2023	Consumer Prices 2024
Brazil	2.3	0.3	5.0	2.9	**1.0**	**1.0**	8.3	9.3	**5.5**	**5.5**
Mexico	1.8	1.3	4.7	3.1	**2.3**	**1.3**	5.7	7.9	**5.5**	**4.5**
Argentina	0.7	-0.7	10.4	5.2	**-2.8**	**-1.3**	48.4	72.4	**111.5**	**106.5**
Colombia	0.6	2.5	11.0	7.3	**0.8**	**1.8**	3.5	10.2	**11.8**	**5.8**
Chile	0.4	2.1	11.7	2.4	**-0.3**	**2.0**	4.5	11.6	**8.3**	**4.8**
Peru	0.3	2.5	13.3	2.7	**2.5**	**2.5**	4.0	7.9	**7.0**	**4.0**
Dom. Rep.	0.2	4.1	12.3	4.9	**3.8**	**5.0**	8.2	8.8	**5.3**	**4.5**
Ecuador	0.1	1.6	4.2	2.9	**3.0**	**2.0**	0.1	3.5	**2.0**	**1.3**
Venezuela	-	-12.7	2.5	**15.5**	**6.5**	**5.0**	1,589	185	**320**	**65**
Panama	0.1	3.5	15.3	**10.5**	**1.8**	**2.8**	1.6	2.8	**2.0**	**1.5**
Costa Rica	0.1	2.8	7.8	4.3	**3.5**	**2.3**	1.7	8.3	**2.3**	**3.3**
Uruguay	0.1	1.5	5.3	4.8	**1.3**	**2.5**	7.7	9.0	**7.5**	**8.0**
Latin America[2]	**6.7**	**1.0**	**7.0**	3.7	1.1	1.2	**6.2**	**8.7**	6.2	4.9

Sources: Refinitiv, Capital Economics. 1) % of GDP, 2021, PPP terms. 2) GDP Excl. Venezuela; Consumer Prices Excl. Argentina & Venezuela.