LatAm Macro Update October 28, 2021

The Consumer in 2022: Retail Therapy

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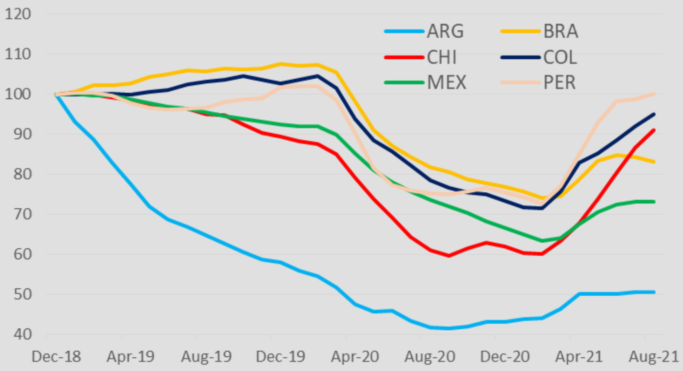
Overall: Consumers in Latin America appear ready to enter 2022 on a much better note than last year, in emotional as well as economic terms. The vaccine rollout took the pandemic off center-stage, and now the key economic challenge for the region is converting the natural rebound of 2021 into sustained growth in 2022 and beyond.

The labor market seems to be a crucial element for consumption dynamics next year. As fiscal aid transfers and one-off income "boosters" (such as pension fund withdrawals) will naturally fade, consumer spending will hinge more on normal labor incomes than in 2021. As seen practically worldwide, job creation continues to lag well behind GDP growth, reflecting both supply and demand factors in the labor market. The sooner employment catches up with overall production, the better the outlook for private consumption will end up being.

Vehicle sales in Latin America – Last 12M avg, base 100=2018



In units. Sources: local business associations, Bloomberg, Santander.

In **Mexico**, consumption growth looks fairly "organic": as fiscal transfers were small during the pandemic, its recovery now seems to be slow but self-sustained. In **Brazil,** the phasing-out of fiscal paychecks is needed to keep macro conditions in check, so consumption will grow but won't soar. **Colombia** presents a similar story, but political conditions here will only allow for a very gradual adjustment process in aid transfers.

Fiscal stimulus was also important in **Argentina** this year, but with no credible plan to reduce inflation, any improvement will be short-lived. **Peru** and especially **Chile** face the problem of a "too strong" consumption rebound in 2021, fueled by pension withdrawals, which by definition are not sustainable.

What is clear is that consumption in LatAm will have to grow thanks to a better-functioning labor market, rising productivity, an upsurge in private investment or a combination of them. In order words, "inflationary" solutions in 2022 appear much less viable, as prices are already under large pressure and more of this may oblige central banks to hike rates faster and put the whole recovery process in jeopardy.

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Brazil: Focus Shifts to Services as Welfare Transfers Normalize

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- **While overall private consumption could grow modestly in 2022 (around 1%), the composition of growth could also change significantly, with services being much more dynamic.**
- **The labor market could continue to normalize, and the "expanded real wage bill" (also including fiscal aid transfers) could resume growing in 2022.**
- **We assume that welfare transfers will fall to BRL61 billion in 2022, only a fifth of that in 2020 and -33% vs this year.**

Consumption trends in the final stages of the pandemic

As the sanitary crisis is gradually overcome, we expect a "normalization" of household consumption toward pre-pandemic patterns over the next few quarters, with a shift in spending to services as the economy reopens. Overall private consumption is growing but mostly in personal services, as this sector (which is still working well below capacity) continues to reopen steadily, although full-normalization will probably come in 2022.

After the healthy figures posted in 2Q21, following the reopening and the emergency aid paychecks, we expect a softening in retail sales growth in 2H21. We foresee the impact of inflation eating into household income, supply-chain problems and a shift of spending into services. We expect durable goods to suffer the greatest hit, while non-durable goods (mainly those considered as essentials) should likely be resilient, mainly considering the recovery of informal employment, which may recompose the income of workers (with a higher propensity to consume).

The consumption drivers for 2022

We estimate that in 2020 the "expanded" real wage bill (i.e., the sum of workers' salaries, pension contributions, and federal transfers) grew 3.7% annually, mainly based on the massive fiscal stimulus (with BRL293 billion, or more than 8%/GDP, in the emergency aid program).

In 2021, we estimate a drop of 5.7%, even considering the welfare program's transfers of ~BRL90 billion during the year. Leaving aside fiscal transfers, we estimate that the expanded real wage bill would have grown 3.3% this year

We forecast that employment will reach pre-pandemic levels only in mid-2022, and that the normalization in both jobs and the labor force participation should be strictly linked to the urban mobility levels. Real wages should have a modest growth, around 0.5%, as the people returning to the job market are experiencing lower wages.

Our 2022 projections

For our "expanded" real wage bill measure, we forecast a 3.4% growth in 2022. In our baseline scenario, we consider a welfare program of BRL61 billion. As per our models, the elasticity of real wages to fiscal transfers is approximately 10 bps of growth for every BRL5 billion of fiscal transfers. Following the sharp credit impulse seen during the pandemic, we expect a clear deceleration in consumer loans (in real terms), but even so we still project domestic credit conditions to contribute positively to consumption next year, even in real terms.

We expect household consumption (as per GDP figures) to grow modestly in 2022, around 1%, mainly in services (which should growth more than 20% in 2022 after falling almost 40% in 2020). We do not expect retail sales (mostly goods) to be particularly dynamic but forecast these to also grow next year (0.7% as per our estimate) mainly thanks to the increase in the "expanded" real wage bill and still abundant consumer credit.

We forecast average unemployment rate at 13.7% in 2022, gradually converging to long-term, natural levels (around 13%) by the end of next year.

"President Bolsonaro asked an additional layer of benefits in a way in which nobody receives less than BRL 400 (US$70 per month per family, under the Auxilio Brasil *social program). Our political system will decide to what extent the program is extended, a possibility would be asking Congress an extraordinary waiver to the spending cap for BRL 30 billion. The government must keep its commitment to fiscal responsibility, and we will continue to fight for reforms (…) We want to be a popular, not a populist government."*

Paulo Guedes, Finance Minister of Brazil

GDP/Unemployment (2021-22)

GDP Forecasts: "Bread for Today…

… hunger for tomorrow", goes a famous saying in Spanish, referring to short-term gains at the expense of longer-term losses. This is what our GDP forecasts are saying: the 2021 average for the region increased for the fifth consecutive month, to 7.1%. This implies that the 2020 GDP loss would be fully recovered in only one year. However, 2022 forecasts have fallen for the second month in a row, to 2.4% (-10 bps), suggesting that there are still significant challenges to consolidate the recovery next year.

2022 GDP levels: Winners and losers

Combining actual GDP numbers and our estimates, we find that Chile (6%) and Colombia (5%) will register the better performance in the entire 2019-22 period, while Mexico (0%) and Argentina (-1%) will stand at the other extreme. The average for the region would be a decent 2% net gain in 3 years.

Unemployment, the lagged variable

Our unemployment rate forecasts remain virtually unchanged in the last four months, confirming the notion that the GDP recovery is mainly based on labor productivity, not on job creation. We estimate average LatAm unemployment at 9.4% in 2021, and 8.9% in 2022.

Selected macro estimates & forecasts (2021-22)

		ARG	BRA	CHI	COL	MEX	PER
GDP	**2020**	-9.9%	-4.1%	-5.8%	-6.8%	-8.5%	-11.1%
(annual chg)	**2021E**	+7.6%	+4.9%	+11.0%	+8.9%	+6.2%	+11.5%
	2022F	+2.2%	+1.5%	+1.5%	+3.6%	+3.0%	+3.8%
Unemployment	**2020**	11.0%	13.2%	10.3%	15.6%	3.8%	13.8%
(% of labor force, eop)	**2021E**	10.1%	13.8%	8.4%	14.0%	3.7%	10.0%
	2022F	9.0%	13.7%	8.0%	12.0%	3.6%	8.5%
Retail sales	**2020**	n/a	-1.4%	-4.0%	-7.6%	-9.4%	-9.1%
(annual avg chg)	**2021E**	n/a	+4.0%	+28.0%	+9.2%	+9.0%	+19.5%
	2022F	n/a	+0.7%	-1.0%	+5.5%	+4.5%	+7.0%
Nominal wages	**2020**	+36%	+2.9%	+4.0%	-1.3%	+5.5%	-1.1%
(annual chg, eop)	**2021E**	+53%	+7.7%	+6.5%	+9.0%	+5.2%	+6.8%
	2022F	+50%	+5.5%	+5.0%	+5.5%	+5.5%	+3.5%

Source: National statistics offices, central banks, Santander.

Mexico: Consumers' Mood Improves with the Labor Market

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- **Consumer spending continues to recover "organically", thanks to the recovery in mobility and the labor market, without particular support from government transfers to households.**
- **Job creation at c.600k and a real wage increase of almost 1% should be key drivers of consumer spending next year.**
- **We expect private consumption to grow by 3% in 2022 and fully recover to the pre-pandemic levels in 2023.**

Consumption trends in the final stages of the pandemic

Consumer spending grew 8.9% in January-July 2021 vs. a year ago, after a fall of 10.5% in 2020. At the end of July, the level of consumer spending is 2.6% below the average level of December 2019-February 2020, before the pandemic. We estimate consumption growth at 6.1% in 2021, supported by rising employment and remittances (at US$33 billion in January-August 2021, or +25% YoY), amid a gradual reopening of activities.

At the end of September 2021, practically all formal private jobs (as per social security records) had recovered, while the INEGI reports that total employment (formal and informal) was 1.1% below February 2020.

INEGI reports that retail sales grew 9.4% YoY in January-August 2021, vs. a decline of 9.4% in 2020. However, August's level is still 2.2% below the last 3-month average prior to the pandemic. But some industries are now selling better than in early 2020: self-service stores, health supplies, and online sales. However, department stores, clothing and footwear and automobiles continue to lag. We estimate retail sales growth of around 9% in 2021.

The consumption drivers for 2022

Consumption of durable goods increased 33.4% annually in 1H21 (vs a 20.8% drop in 2020), non-durable goods increased 10.0% annually (-6.1% in 2020) and spending on services 2.0% (-14.4% in 2020).

Consumer spending was not directly affected by government programs in 2020-21: these focused on health and social expenditures, but no tax cuts, subsidies or other transfers were implemented to support household incomes.

We estimate consumption growth to continue to be supported by job creation in 2022, a moderate recovery in real wages, the availability of credit, and the comeback of service sectors that are still lagging. Banxico estimates a 3% GDP growth next year (coinciding with our estimate and the consensus figure) and the creation of 500-700k formal private jobs. In turn, in 2022 private wages could grow by 5.5% (+5.2% in 2021), above the estimated inflation of 4.6%, implying a real increase of close to 1% (vs. practically zero this year).

Our 2022 projections

Regarding domestic credit, mortgage rates have been stable before and during the pandemic, and we expect these conditions to prevail in 2021, although they are now much higher than the Banxico policy rate. Back in 2019, the average mortgage rate for a 15-year loan was 13.2% (approximately 500 bps above the Banxico rate). So far this year it fell 12.7%, but the spread over the Banxico rate is almost 900 bps, mainly due to strong demand.

During 2018-2019, private consumption represented 67.4%/GDP but fell to 66%/GDP in 2020. We estimate consumption growth at 6.1%/GDP in 2021 and 3.0%/GDP in 2022, with 2023 as the year when pre-pandemic levels will be fully reached.

We believe that the vaccine roll out will advance well into 2022, which would translate into further reopening, and increasing capacity and mobility. Against this backdrop, we estimate retail sales growth of around 4.5% in 2022.

"Most of (Banxico) board members coincided that consumption continues to recover, although there was a decline in June (…), mostly boosted by the positive performance of remittances and wage bills. Another member noted that indicators of retail sales suggest that consumer spending is performing well. But others noted some weakness in consumer confidence (…) and stagnant spending via banking cards."

Minutes of the September's rate meeting of Mexico's Central Bank.

Inflation, FX & Interest Rates (2021-22)

No halt in inflation expectations' uptrend

Global as well as domestic forces continue to push inflation upward in most LatAm countries. In contrast to DM countries, local markets are not so sure about the "transitoriness" of this uptrend, and are discounting higher inflation for both 2021 and 2022

Central banks get no cold feet

Except for Colombia, we revised all our year-end reference rate forecasts upwards. The inflation outlook is leaving central banks no choice and will continue to hike rates in a significant manner, as the de-anchoring of short-term expectations are affecting long-term interest rates.

More optimism in LatAm currencies

The relatively stable global USD of the past few weeks plus decisive central bank action in terms of policy rates have improved FX sentiment across the region. Except for Chile, our year-end forecasts for 2021 and 2022 remained fairly stable vs our previous edition.

Foreign Exchange and Interest Rate Estimates, 2021-22

	FX Rate, Current (Oct 28, 2021)	FX Rate, Dec 2021E	FX rate, Dec 2022E	Last CPI print (y/y)	2021 CPI forecast (year-end)	2022 CPI forecast (year-end)	MonPol rate, Current	MonPol rate, Dec 2021E	MonPol rate, Dec 2022E
ARGENTINA	99.7	104.0	155.0	52.5%	50%	49%	38.0%	38.0%	42.0%
BRAZIL	5.61	5.35	5.55	10.3%	9.2%	5.0%	6.25%	9.25%	10.50%
CHILE	805.5	820	830	5.3%	6.0%	4.1%	2.75%	3.50%	5.00%
COLOMBIA	3,757	3,900	3,950	4.5%	5.2%	3.8%	2.00%	2.75%	4.00%
MEXICO	20.28	20.5	21.5	6.1%	6.6%	4.0%	4.75%	5.25%	6.00%
PERU	3.97	4.05	4.05	5.2%	5.4%	3.3%	1.50%	2.00%	3.50%

Source: Santander.

Argentina: A Breather for Consumers in 2H21… Will it Last?

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- **Private consumption has been lagging vs. GDP in the last stages of the pandemic, but an array of government measures in 2H21 are likely to lift consumer spending until year-end.**
- **Medium term, elevated inflation is probably the biggest enemy for consumers. In our view, an IMF deal in 2022 is necessary in order to anchor expectations and sustain real wage growth.**
- **Assuming an IMF deal in 1Q22, we see private consumption growing modestly next year, but also a brighter outlook for the following years.**

Consumption trends in the final stages of the pandemic

Year to date, private consumption has recovered at a slower pace than GDP: as of 1Q21, it was 5.7% below pre-pandemic (4Q19), while overall activity was -3.3%. However, in 3Q21 dynamics should be more favorable for consumers. With mid-term elections dominating the political landscape, fiscal aid via transfers to households, added to large wage rises, a stable official FX rate, frozen utilities rates, price controls, and soft loans, will all be contributing factors to reinvigorate private consumption in the short term.

Against this backdrop, non-durable goods sales have accelerated recently. Supermarket sales (INDEC) grew 4.5% YoY in real terms (the fastest rate since May 2020), while retail sales grew 15.7% YoY (CAME). Regarding durable goods (such as automobiles), there are supply-chain bottlenecks that are limiting sales growth. The global microchip shortage has had an impact on several industries, and imported cars are falling in short supply due to tight FX controls. According to the business association numbers, new car registrations grew 23% YoY in the year to September, but actually declined 9.5% YoY in the last month.

The consumption drivers for 2022

Fiscal transfers to households have decreased sharply this year to 1.2%/GDP vs 2020's 2.6%, mainly due to the reduction in the 2020 COVID-related package. However, after the negative results for the ruling coalition of primary Congress elections in September, fiscal spending is expected to increase by 0.5%/GDP in 4Q21, mainly via transfers to the low class. Regarding real wages, they began to improve since April after the 40%-45% annual rise permitted by the government. As of July, real wages grew 2.5% YoY, the fastest rate since February 2020.

As seen in many other countries, private sector jobs are recovering slowly: in July it surpassed the pre-pandemic level by only 0.5%. In our view, the macro picture is still unclear so as to encourage formal job creation. Regarding real wages, they are still 20% below those of 2017, suggesting that the room to grow is ample in case demand and productivity get momentum.

Our 2022 projections

Inflation continues to be a problem for Argentine consumers. In order to anchor future price expectations, the country needs a credible fiscal plan, ideally with the IMF support, so these negotiations will be crucial for the overall economy in 2022. Next year's budget bill proposes a mild fiscal deficit reduction from 4%/GDP this year to 3.3%. In our base-case scenario, an IMF deal is reached before March 2022, as almost US$4 bn in payments mature in 1Q22. The resulting economic program should clarify the medium term outlook, but will also bring an adjustment in utility rates and the revamp of FX markets, with potential negative effects on consumers' purchasing power. Also, local interest rates may also increase as an IMF-backed, new FX strategy will likely require it. However, this should not be an extra negative for consumers, as rates' normalization will probably be gradual.

We expect private consumption to grow 1.8% next year, with GDP growing 2.2%. For payrolls, we expect the number of jobs (especially formal) to grow faster than real salaries, in a context of still elevated inflation in 2022 (near 50%). As a result, unemployment will continue to fall gradually, to 9% from 10.1% in 2021.

"Regarding consumption, there is still US$23 billion, or 9% of GDP, of excess liquidity in checking accounts, sight deposits, cash, ready to be spent. Does this mean an overheated economy? (…) More than overheating, what we see is that current consumption dynamics cannot be sustained without exerting significant pressure on inflation. "

Mario Marcel, President of Central Bank of Chile

Annex: Interest rates in real terms

In the last few weeks, the process of monetary adjustment continued apace across the region.

In **Brazil**, Selic rate hikes already total 425 bps from the 2% historical low of 1Q21. The market expects 300 bps more before year-end, up to 9.25%.

Banxico in **Mexico** is also hiking rates but more slowly: 75 bps since June, to 4.75%. But the yield curve discounts another 100 bps until December.

In the Andean region, interest rates are also on the rise, but adjusted by inflation expectations they remain relatively low, vs. the rest of the region but also their own pre-pandemic levels.

Chile's BCCh already hiked 225 bps since July, with the curve pricing in an extra dose of 100 bps, to 3.75%, before year-end. **Peru**'s adjustments started from very low levels: +125 bp to 1.50% and 50 bps more is likely in the coming months.

Colombia's BanRep has been a laggard here: hikes just started in September, by 25 bps to only 2%. But the process will continue, with the market discounting 75 bps more until December.

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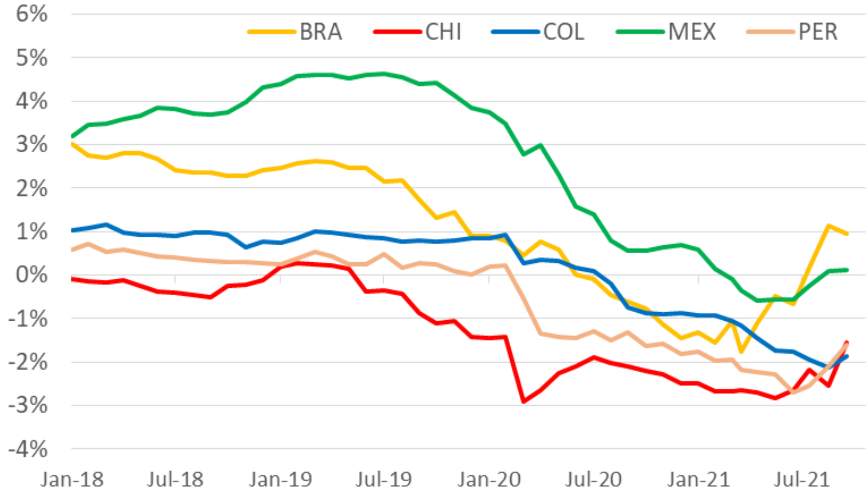
Central Bank reference rates net of 1y ahead inflation expectations



Sources: Central banks, Santander.

Chile: The Soft-Landing Challenge

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- **2021 will likely be an excellent year for private consumption and the retail sector: consumer spending to recover from COVID-related loss of 2020 and much more.**
- **But all that glitters is not gold: this boom is based on unsustainable factors: AFP withdrawals and massive aid paychecks.**
- **In 2022, we expect a 2% contraction in private consumption, but this would be a sign of economic health, not weakness: it reflects the notion that pension fund withdrawals will stop next year.**

Consumption trends in the final stages of the pandemic

2021 will likely be an excellent year for private consumption, not only recovering what was lost in 2020 during the pandemic but also growing significantly vs. the more normal 2019 levels. As a GDP component, we estimate 2021 private consumption to grow by 19% vs. 2020 and 10% vs. 2019. In terms of retail sales (in volumes), 2021 levels could be 28% higher than 2020's and 23% vs 2019's, as per our projections.

The flip side of this is its sustainability. First, the reopening has been a key driver behind the rebound this year, but will not be repeated in 2022. Second, the labor market comeback has been slow vs. overall production, so we cannot argue that labor incomes are leading the ongoing consumption boom.

Total jobs and worked hours in August were still 8-9% below February 2020 (a loss of 700k jobs). Unemployment now stands at 8.5% of the labor force, slightly above the 7.5% of February 2020, but mainly thanks to the 1 million persons that abandoned the labor market since the pandemic. Wages, in turn, are now waking up (+6.4% YoY in August) and should remain strong as long as labor market participation continues restrained by the pandemic fallout.

The consumption drivers for 2022

The major factor behind the consumption boom is an extraordinary one: the cash transfer for approximately US$70 billion (or 22%/GDP) consumers received in the form of pension fund withdrawals (August and December 2020 the first two, March 2021 the third one) and universal IFE paychecks (from June to December 2021). This is being gradually spent over time with a significant impact on overall consumer spending. We estimate that excess cash and checking deposits in Chile is still equivalent to 16%/GDP, so its consequences should continue to be felt well into 2022.

Durable goods consumption fell by c.40% with the pandemic but soared thereafter and are now 30% higher than 3Q19 levels, before the social riots. Non-durable consumption, by definition, did not suffer so much with COVID, but since the extension of IFE paychecks they started to grow fast, now reaching levels also 30% above 3Q19. Low inventories in the retail sector, shortages in many products and rising inflation are clear indicators that these demand levels will be difficult to sustain along all 2022.

Our 2022 projections

As the starting point is to a great extent artificially high, we foresee a 2% contraction in private consumption next year, based on the notion that AFP withdrawals will stop and IFE paychecks will be significantly reduced (we expect a 10%-20% reduction in overall fiscal spending). Nonetheless, in this scenario consumer spending would remain elevated: it would imply an average 2.5% annual growth in the 2019-22 period, just as if the pandemic would have never existed.

Regarding other drivers, we see the BCCH hiking interest rates up to 5% by mid-2022 to rein in inflation, and this should increase savings and cap consumption growth. In turn, the labor market would continue to heal, but this wouldn't offset the decline in one-off transfers. We pencil in a 6% increase in total jobs (+500k) but not a massive decline in unemployment (to 8% by end-2022), just the absorption of persons gradually coming back to work.

Overall, the key challenge for the next administration will likely be promoting the reduction of current macro imbalances without unleashing a too abrupt adjustment in its first year of its term: surgical hands will be needed.

"We have a clear challenge: economic growth is not enough today, the real challenge is employment. 80% of the jobs lost during the pandemic have been recovered but we still need to regenerate 1.3 million jobs, mostly for women and the young."

José Manuel Restrepo, Minister of Finance of Colombia.

Annex: Unemployment in the region

The first thing worth noting regarding unemployment metrics in Latin America is that national definitions across countries differ notably.

In **Brazil** and **Colombia**, the long-term average rate for unemployment stands between 9-10% of the labor force; In **Argentina** it hovers around 8%, while **Chile** and **Peru** are used to oscillate around 7%. **Mexico** is the country with the most lax definitions, as the most traditional unemployment metric averages 4%.

This is why we adjusted national unemployment rates by its pre-pandemic, 2011-2019 average levels. This way we can see that the heaviest, Covid-related hits on labor markets were seen in Colombia and Peru, where recorded joblessness jumped almost 10 points vs previous, "normal" levels,

In **Mexico**, the impact on unemployment indicators was very mild, mainly as a result of methodology issues (quarantined people was considered out of the labor force).

Elsewhere, the pattern was similar: joblessness increased by 5-6% of the labor force during the worst of the pandemic, and although there was a steady reversal in 2021, pre-pandemic levels were not yet reached.

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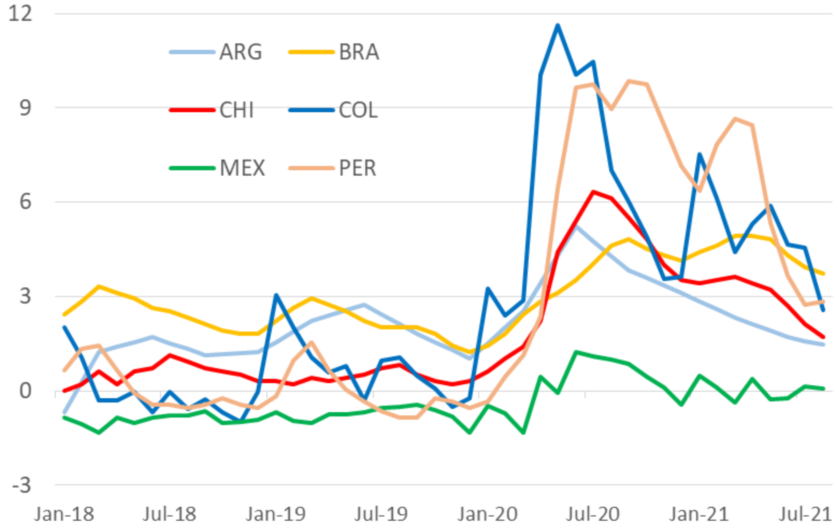
Unemployment rate – Gap vs 2011-19 average, in %



Sources: National statistics offices, Bloomberg, Santander.
Note: Quarterly data in Argentina, Lima city area in Peru.

Colombia: Edging Back to Normality

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- **One of the key pillars of Colombia's GDP rebound was private consumption: growth in 1H21 was +12% YoY and +6% vs 1H19.**
- **The healing labor market, low interest rates and the gradual phasing-out of government transfers all pave the way for a sustained recovery of consumer spending next year.**
- **We project private consumption to expand by 3.5% in 2022, with retail sales running c. 9% annually.**

Consumption trends in the final stages of the pandemic

Colombia's private consumption recovery provides the strong underpinning for a remarkable rebound in top-line growth in 2021 that we estimate could rise to 8.9%. 1H21 consumption growth (real terms) rose 12.4% YoY benefiting from low base effects from 2020, but still registered a 5.9% increase over 1H19. With capital formation and export sectors yet to recover to H1-2019 levels, private consumption accounted for 73%/GDP in 1H21, versus 69.5% for FY 2019.

Higher frequency retail trade data have been volatile (with disruptions from COVID lockdowns and nationwide strikes in H1) but broadly trending higher. Retail trade rose 32.0% YoY in August while excluding vehicle sales, spending still rose 24.9% YoY. Low base effects will wash out more fully by year-end with monthly trends already showing signs of slowing momentum. The strength of spending has been broad-based including food, apparel and other household goods consistent with reopening themes. But the stand-out categories are vehicle and related components that represent almost 25% of consumer goods imports.

The consumption drivers for 2022

After sluggish momentum in 1H21, recent prints show tentative evidence of stronger job gains going into 2022. Urban unemployment rate trended down to 14.2% in August, down from 15.6% last December, though still somewhat above the 10.5% at the end of 2019. The (formal) employed population is still 1 million jobs short of end Decemebr-19 levels with trade, construction and retail/services leading the jobs rebound in 2011.

Public transfer spending targeting low-income/vulnerable households (expanded social programs, unemployment benefits and payroll subsidies) mitigated pressures on household balance-sheets (particularly those with higher propensities to consume) though, at a cost of less than 3%/GDP, is one of the smaller initiatives in the region. Many of these fiscal support programs will be extended through 2022 (budgeted in this year's fiscal reform bill that included the 'Ingreso Solidario' program, arguably the political sweetener to tax increases on higher income earners and corporates). A significant phasing out of social support programs may still be premature in 2022 given the extent of the jobs recovery and a looming election year.

Our 2022 projections

A (relatively) low interest rate environment coincides with a brisk expansion in consumer credit after a brief dip in Q2-Q3 2020. Consumer gross loans are currently growing 8.29% YoY (August) and 11.9% vs 2019, while mortgage loans have also risen 11.9% YoY. Consumer credit rates are drifting higher but remain at multi-year lows while we note that consumer loan demand has been less sensitive to rates in recent years.

The extraordinary factors behind the rebound in spending (low base effects, pent-up demand and a modest jobs recovery) suggest 2022 consumption growth is likely to normalize even with low-income fiscal support remaining in place. As a % of GDP, private consumption is likely to gravitate back below the long term average (below 70%) but could still grow around 3.5% YoY terms and retail sales growing 8-9% YoY.

The jobs recovery is likely to continue though we expect the pace to remain moderate. Post-COVID economic scarring may have caused structural employment changes that may take longer to recover from.

"When there's economic growth we get new jobs (…) Nobody likes inflation rising but as long as we have growth we will recover jobs, which is the most important thing (…) In the last 6 months 1 million jobs were created, there is a sustained employment growth at the national level."

Pedro Francke, Finance Minister of Peru

Annex: GDP Performance in LatAm

YoY growth metrics in the region continue to show uniform, positive results, but performance at the margin started to vary in the last few months.

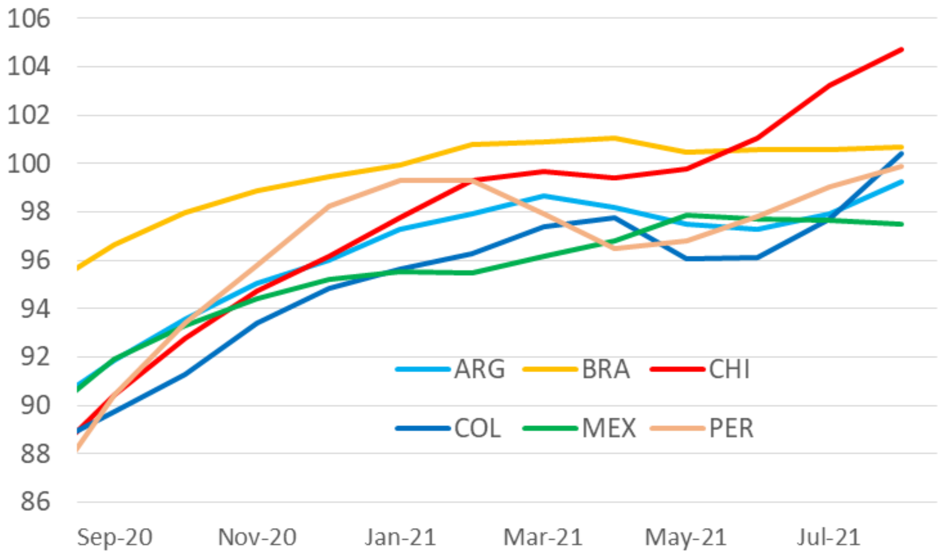
The most impressive comeback is **Chile**'s: back in 3Q20 activity was the lowest in LatAm compared with pre-COVID levels. However, pension fund withdrawals first, and fiscal paychecks amid a fast vaccination rollout after, triggered a consumption boom that allowed Chile to lead the regional pack now.

Colombia and **Peru** are also recovering fast in the last few quarters: in the former, manufacturing and services lead the process on sustained reopening, while in the latter public and private consumption plus a swift rebound in construction are being key drivers.

Argentina has been in an activity plateau since 1Q21, but it's showing a good momentum recently, thanks to rising public spending and sudden reopening measures.

Brazil and **Mexico** have a common feature: sluggish growth at the margin. For Brazil it's not so serious, as the 2020 hit was relatively mild: it still runs second in the region. But in Mexico, pre-pandemic levels have not even been reached.

Monthly GDP indicators, s.a. levels, last 3M averages



Sources: Central banks, national statistics offices, Santander.
Base 100=1Q20. August 2021 is an estimate in Mexico.

Peru: Tailwinds Could Lose Momentum

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- **Private consumption is roughly back to 2019 levels, being a key force behind the overall GDP growth of 12% we expect for 2021.**
- **Pension fund withdrawals helped to boost consumer spending in 2020-21, but further rounds seem much less likely next year.**
- **We expect GDP growth in Peru to be more consumption-dependent in upcoming quarters, as political and regulatory uncertainty may continue limiting investment growth.**

Consumption trends in the final stages of the pandemic

Private consumption rebounded 14.0% in 1H21 compared with 1H20, with much of the outsized gains from a low 2020 base. Compared with same period in 2019, private consumption has recovered roughly back to similar levels. Given the relative importance and weight of consumer expenditures, the recovery in this sector is key in driving top-line growth potentially above 12% YoY in 2021. At the current pace, private consumption is accounting for 66.4% of GDP, 2 pp higher than in 2019 (64.5%).

Consumer spending patterns are normalizing after abrupt shifts in 2020. Consumer goods as a % of total imports fell below 12% at the depth of the pandemic but has since recovered back to its long-term averages of 19-20% in 2021. Non-durables demand has been the more resilient over the period and it has been consumer durables that have exhibited the strongest average yoy growth rates of 80% this year. Food demand as a consumer staple is also strong growing at an average 30% YoY rate, in part boosted by higher commodity prices too.

The consumption drivers for 2022

Public transfers directed at supporting vulnerable households remain in place (with some modifications), coupled with fresh initiatives (Yanapay Peru) of the new government. Also, several private pensions withdrawals (the last approved in May 2021) has resulted in the drawdown of an estimated PEN 66 bn (equivalent to 8.7%/GDP) in household savings that has been instrumental in driving the strong consumption recovery. Formal sector income growth is picking up since Q2 this year after a modest decline in 2020. However estimated informality rates (~73%) remain above pre-pandemic levels and may decline only slowly in coming quarters.

Formal job creation goes into 2022 with positive momentum after a slow start in 2021 when rolling COVID quarantines were still in place. Formal jobs growth could end 2021 recovering by 4.5% YoY, with private formal jobs expanding even faster at 6% YoY. However we are likely to see peak recovery rates (in YoY terms) in early 2022 as tailwinds could start to waver.

Our 2022 projections

Average (formal) income growth should continue to increase in 2022 as the employment recovery deepens. However, our 2021 formal income growth projection (6.8%) would be difficult to sustain in 2022: we pencil in a 3.5% rate. Real incomes was helped in part by low inflation in 2020 and early 2021, but this is no longer the case for 2022. The weaker real income recovery is likely to be less supportive for the broader consumption outlook.

The scope for another round of private pension withdrawals is much reduced in 2022, removing a key driver of consumption growth over the past 12 months. While the policy outlook is still susceptible to populist pressures, industry estimates suggest that the number of pension savings accounts with positive balances have fallen by over half, with the remainder belonging to households that are not economically vulnerable.

The outlook for private investment is also muddied by low business confidence in certain sectors and ongoing regulatory uncertainty. Large-scale projects typically have long lead times to execute, suggesting that even if current uncertainties abate, fresh private projects make be delayed beyond 2022. Private investment typically accounts for 16-17% of Peru's GDP and poses another headwind to top-line and consumption growth.

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