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Latin America: the beginning of the recovery?

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Latin America Economic Outlook – Fourth quarter 2014 | Madrid, 13 November 2014

Key takeaways

1. **The world economy is still growing, albeit slowly.** Global growth will increase from 3.2% in 2014 to 3.7% in 2015. Commodity prices will fall in the short term because of increased supply, but should recover somewhat in the medium term.

2. **Increased tensions in international financial markets were also felt on LatAm exchanges.** Volatility in LatAm markets is very likely here to stay. The rise in the Fed's interest rates will not be offset by the greater monetary easing in Europe.

3. **LatAm will grow 0.9% in 2014 and 1.8% in 2015. The second quarter marked the lowest point of the slowdown**. The Pacific Alliance will grow by 2.8% and 3.8% in 2014 and 2015, well above the regional average.

4. **Weak growth has biased monetary policies in LatAm towards a looser stance, except in Brazil.** We can expect interest rate hikes in 2015, on the back of the recovery and the rise in the Federal Reserve's rates.

5. **Exchange rates will continue to depreciate in 2015**, in a context of lower commodity prices and a rise in interest rates by the Fed.

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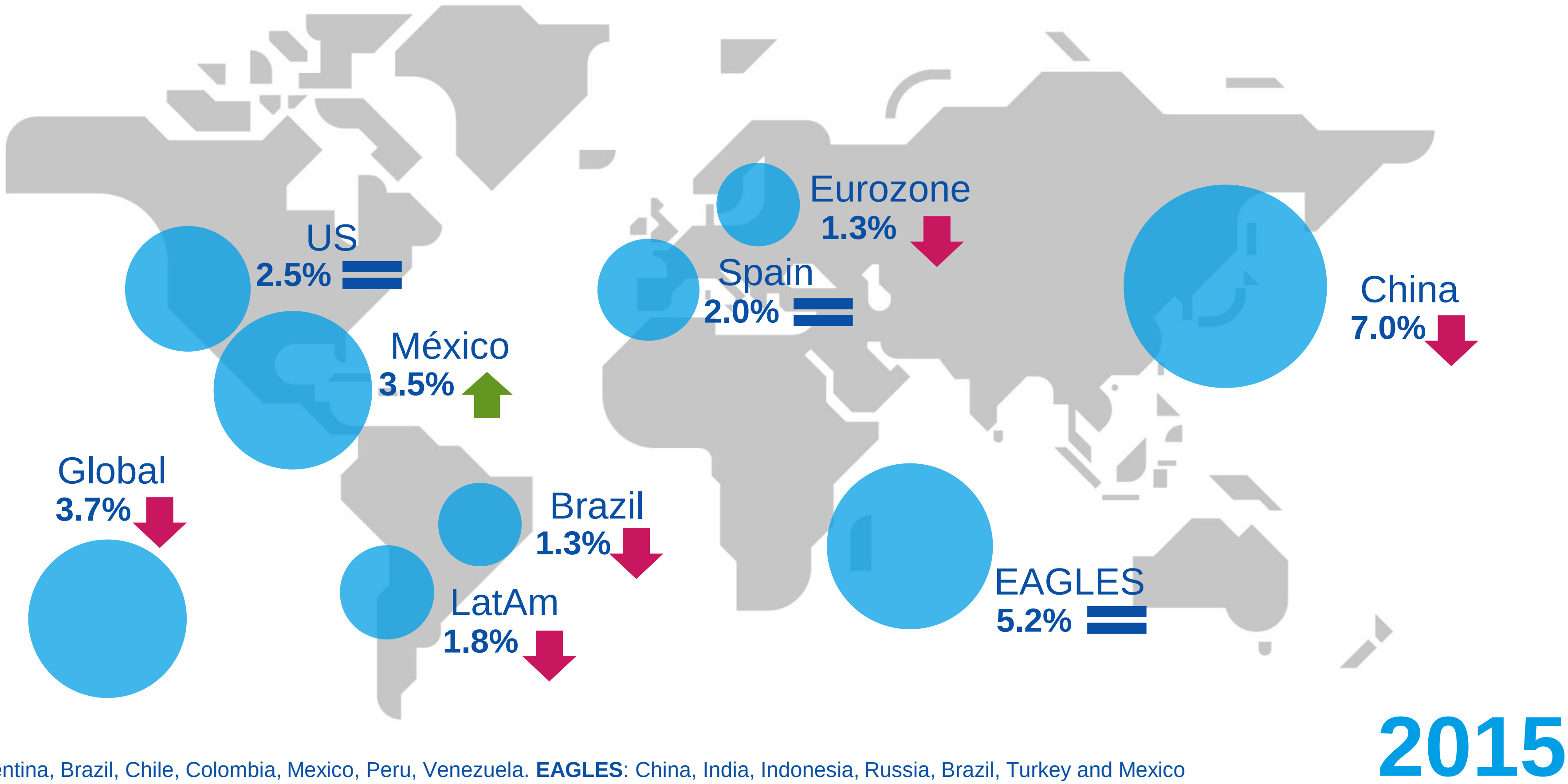
In the last year we have revised our growth forecasts downwards in some areas

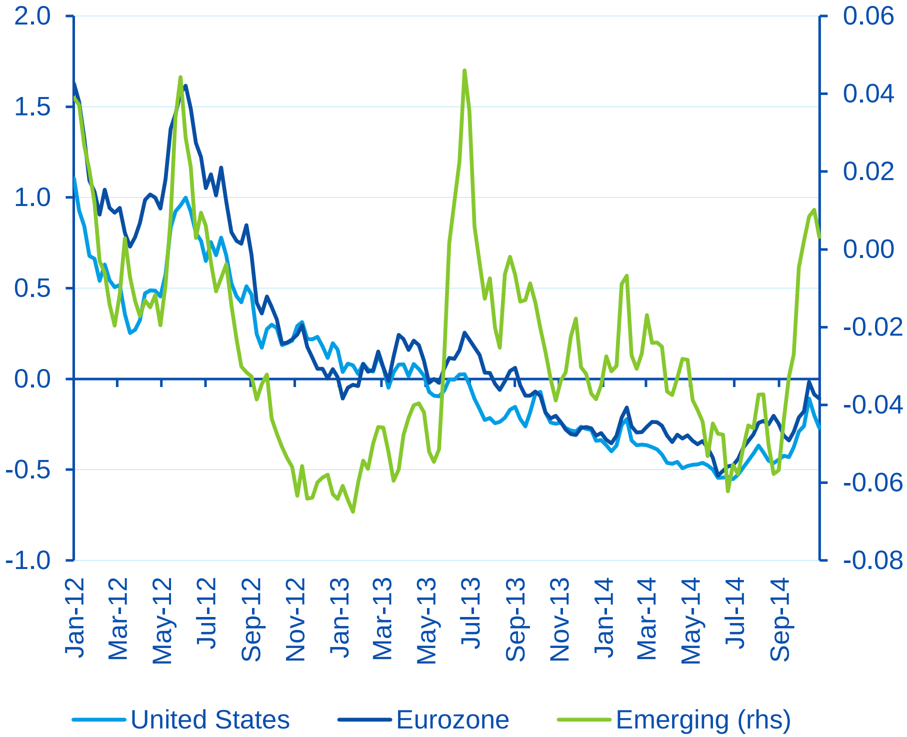


LatAm 7: Argentina, Brazil, Chile, Colombia, Mexico, Peru, Venezuela. **EAGLES**: China, India, Indonesia, Russia, Brazil, Turkey and Mexico

Source: BBVA Research

Slow growth in the world economy, but financial tension is rising too

BBVA index of financial tensions in developed and emerging countries Source: BBVA Research



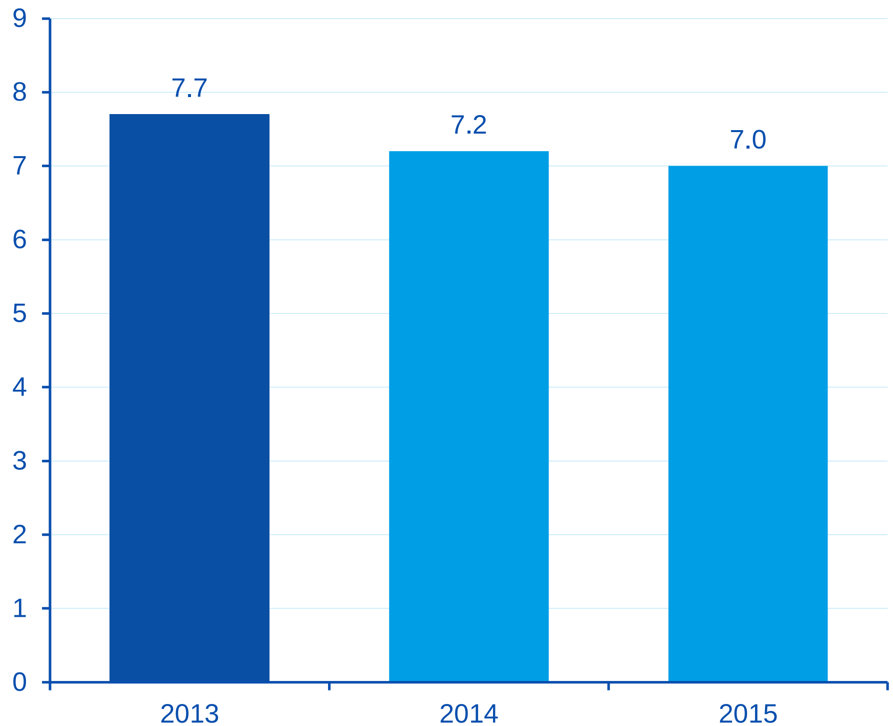
Improvement in world growth in 3Q, rising from 0.6% to 0.8%, but growth is still slow

Growth continues to be fragile. Financial tensions in developed economies increase, but more so in emerging markets

Financial tensions on the rise in a context of divergence between the monetary policies of the Fed and the ECB

China: continued support measures will allow growth of 7% in 2015

China: GDP growth (%)
Source: BBVA Research



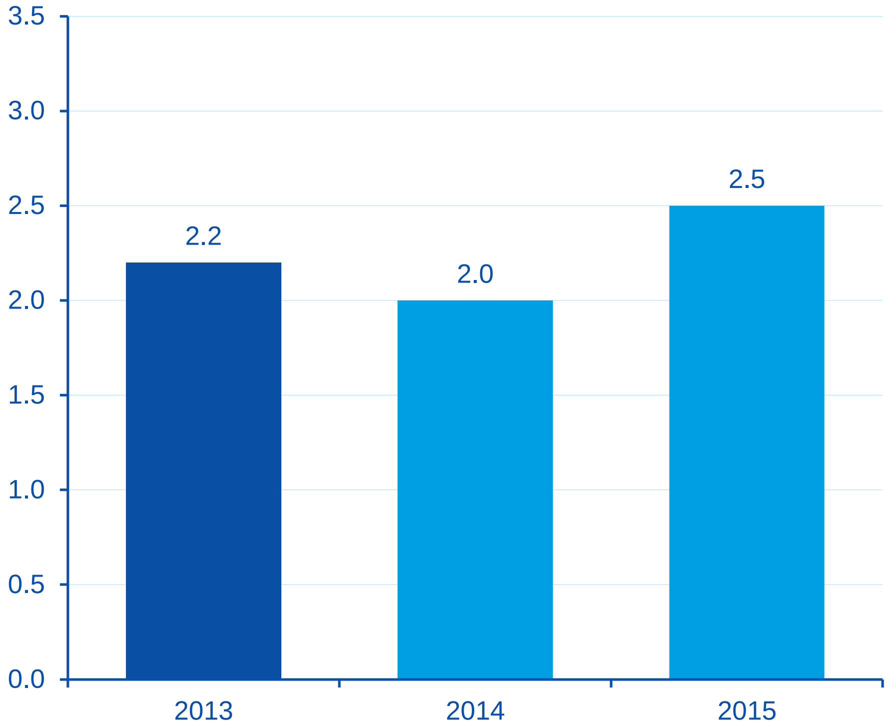
Authorities remain prepared to intervene so that the deceleration does not strengthen and drag growth down below the targets

Further easing of monetary policy is expected, together with an expansionary fiscal policy at central government level and continuity in the execution of structural reforms

Risks to the downside, due to deceleration in demand from Europe and the ongoing correction in the property sector

US: growth in line with expectations; the Fed is handling the withdrawal of QE well

US: GDP growth (%)
Source: BBVA Research



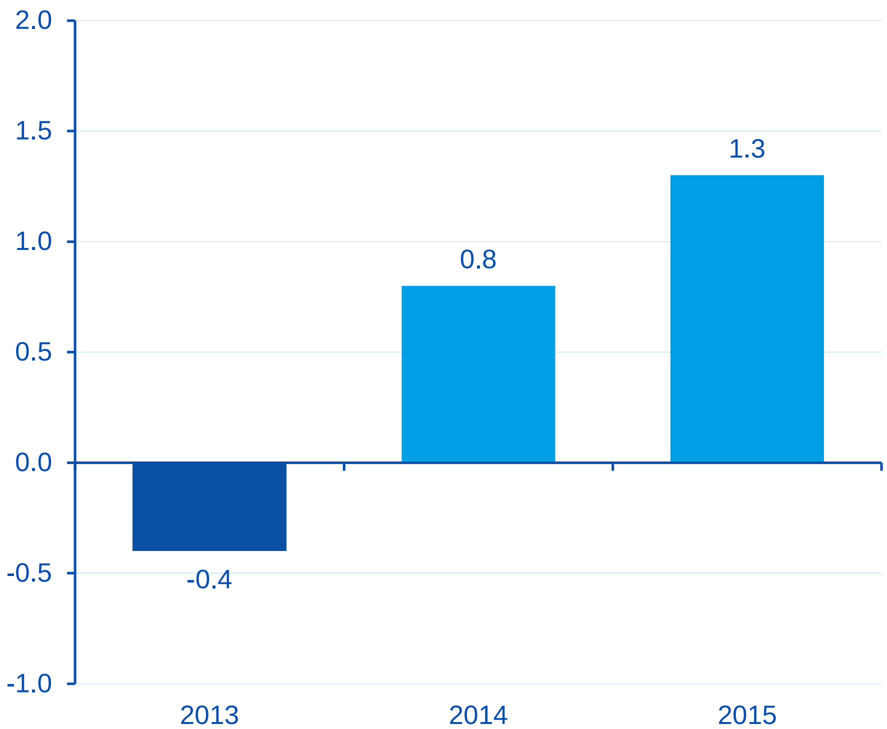
Improved growth in the second half of 2014 puts a bias to the upside on the whole year's forecast

There may be interest rate rises in September 2015; the timings will be dependent on improvement in the labour market

The Fed is still supporting the scenario of a cyclical recovery in the US, underpinned by solid job creation and an increase in household wealth

Eurozone: achingly slow recovery 2014-15

Eurozone: GDP growth (%)
Source: BBVA Research



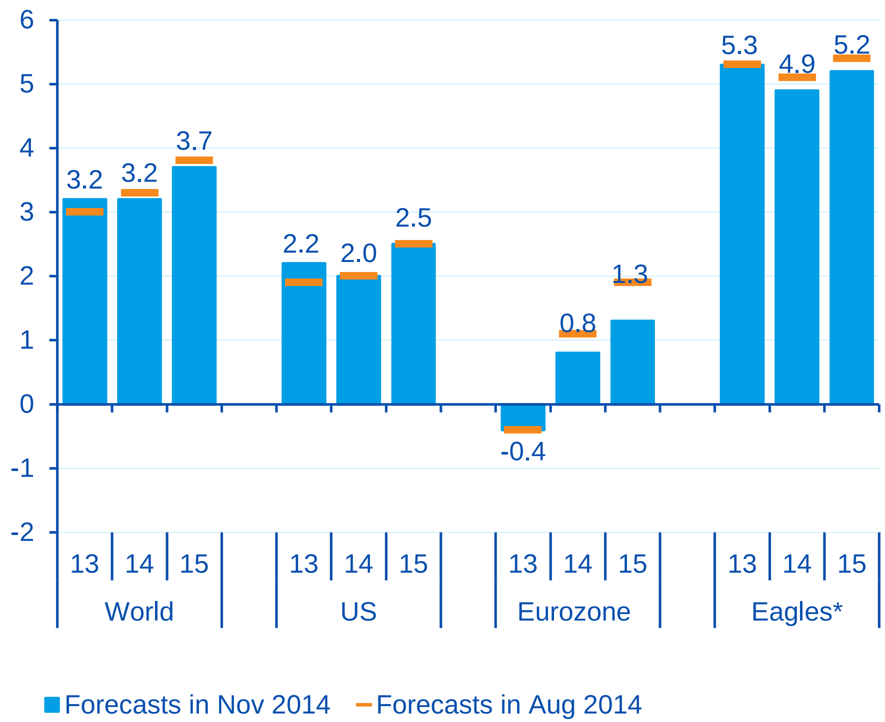
GDP stagnation in 2Q14 forces a downward correction in the outlook for the area's growth in 2014 and 2015

Impact of the crisis between Ukraine and Russia makes itself felt on the trade of the most exposed economies in central Europe

The euro's depreciation will continue as long as the ECB and the Fed follow different monetary policies

In summary, slow global recovery with risks to the downside in Europe

World growth forecasts (%)
Source: BBVA Research



Global growth will continue to show improvement in developed economies, especially in the US, whereas we anticipate a gentle slowdown in China

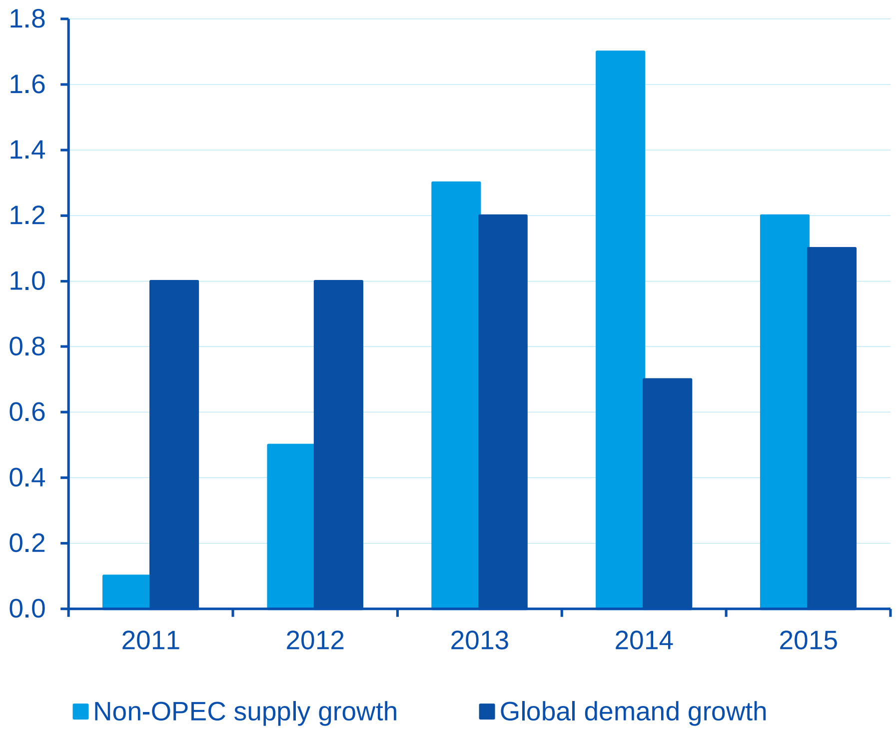
Global growth will recover in 2015, but more slowly than in previous crisis exits in developed countries

EAGLEs is the group of emerging economies which will contribute most to world GDP in the next 10 years.
Group made up of China, India, Indonesia, Brazil, Russia, Turkey and Mexico.

Oil price corrects downwards because of greater supply and weak demand [Box 1]

Oil: variation in the non-OPEC supply and demand (additional mb/d to last year)

Source: BBVA Research and International Energy Agency



Oil prices correct downwards due to: i) dollar appreciation; ii) increased supply (shale oil in US; Libya); iii) lower increase in demand forecast

Huge uncertainty about the future prices of oil: high implicit volatility (OVX)

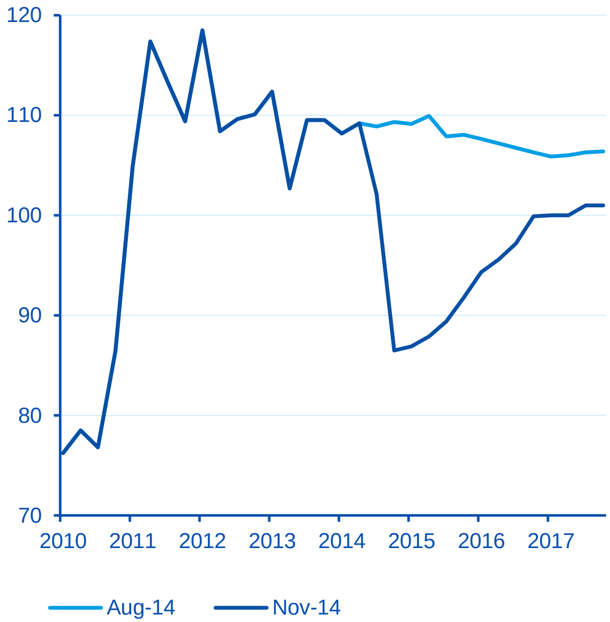
Current prices at USD80/bbl (Brent) already very close to the operating costs of shale oil. But not close enough to justify new investments

Current prices below the levels necessary to balance fiscal accounts of most OPEC countries, including Saudi Arabia

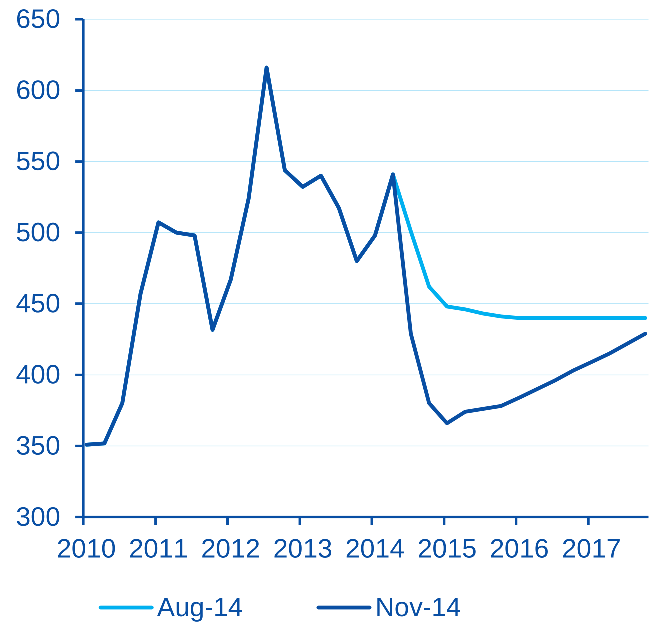
Current prices are seen as a floor. We expect a slow convergence towards levels close to USD100/bbl for Brent as investment in shale oil decreases

Commodity prices fall in the short term; oil and soybean should recover in the medium term

Brent crude: (USD/bbl)
Source: BBVA Research and Bloomberg



Soybean: (USD/mt)
Source: BBVA Research and Bloomberg

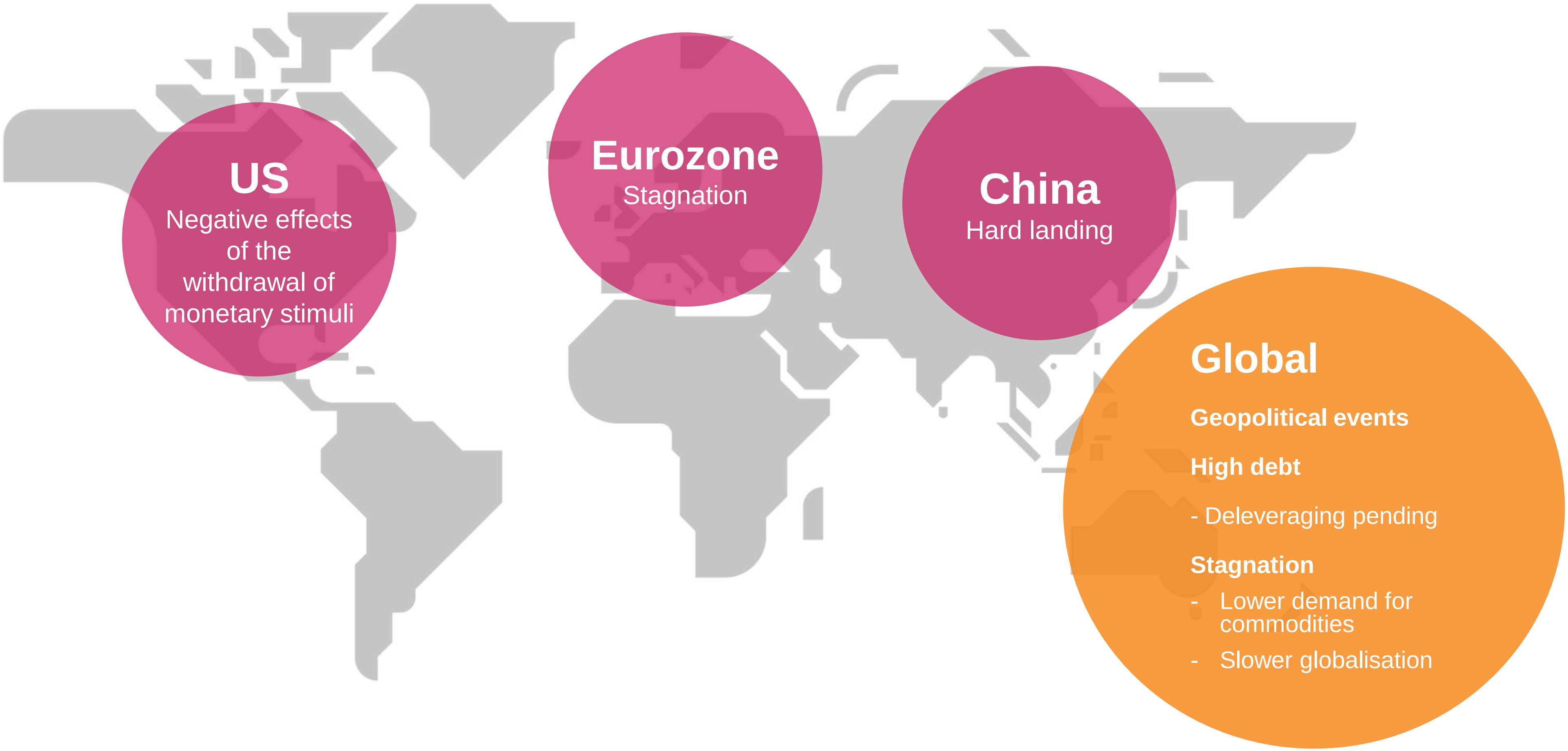


Copper: (USD/lb)
Source: BBVA Research and Bloomberg

Prices of oil and soybean driven downward, mainly because of the increase in supply

Long-term prices basically unchanged from our forecast three months ago

What are the risks in the global scenario?



Source: BBVA Research

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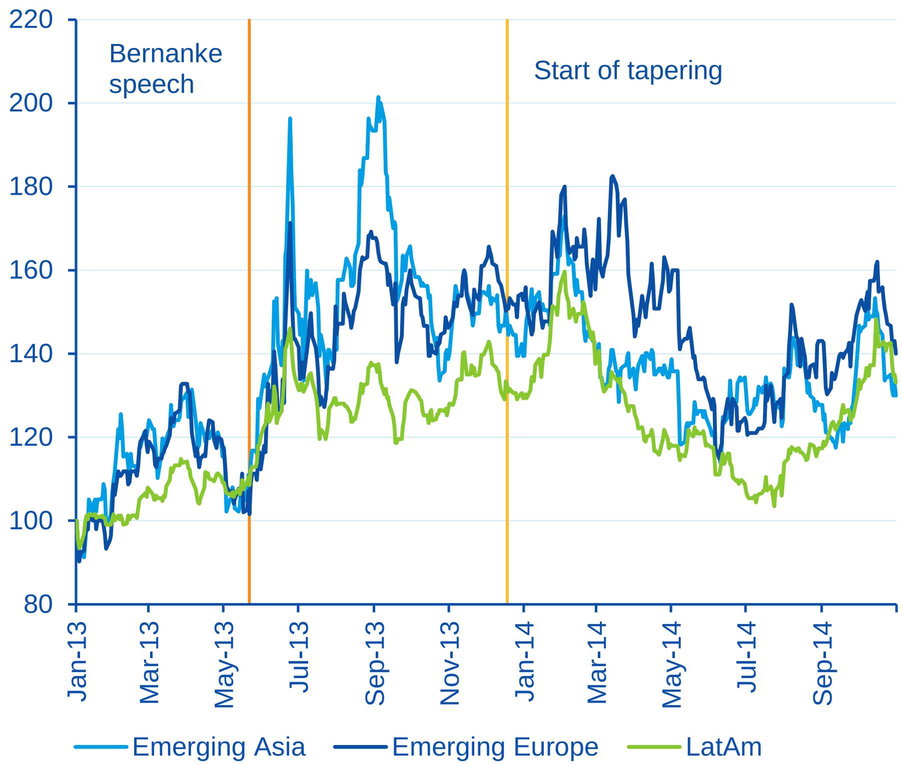
Volatility in international financial markets: LatAm caught cold too

Sovereign differentials in emerging economies (%)
Source: BBVA Research and Haver Analytics



Latin America's greater volatility and deceleration provoked severe corrections in the price of key assets

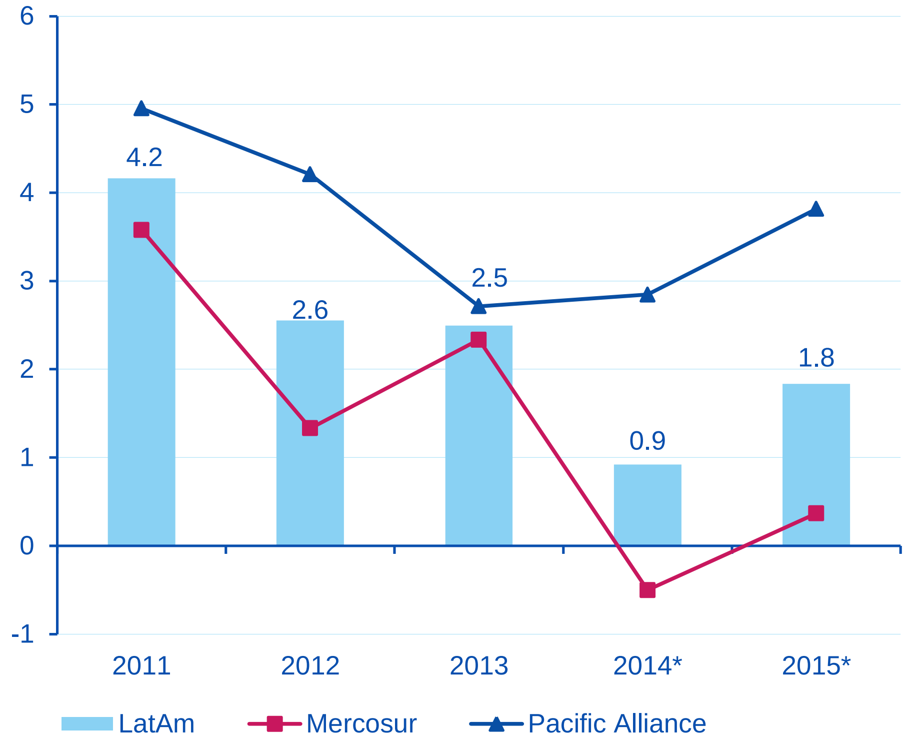
Capital flows to LatAm have also decelerated in recent months, but without reaching a reversal

Market volatility in LatAm will very probably persist. The Fed's interest rate rise will not be offset by Europe's greater monetary relaxation

We have adjusted our Latin American forecasts by 0.7pp (to 0.9% in 2014 and 1.8% in 2015)

LatAm*: GDP growth (% YoY)

Source: BBVA Research



* Weighted average for Argentina, Brazil, Chile, Colombia, Mexico, Paraguay, Peru, Mexico, Uruguay and Venezuela

Activity data surprised to the downside over the first three quarters of 2014

Negative supply shocks (CHI, PER), but also lower household and company sentiment indicators (except for COL)

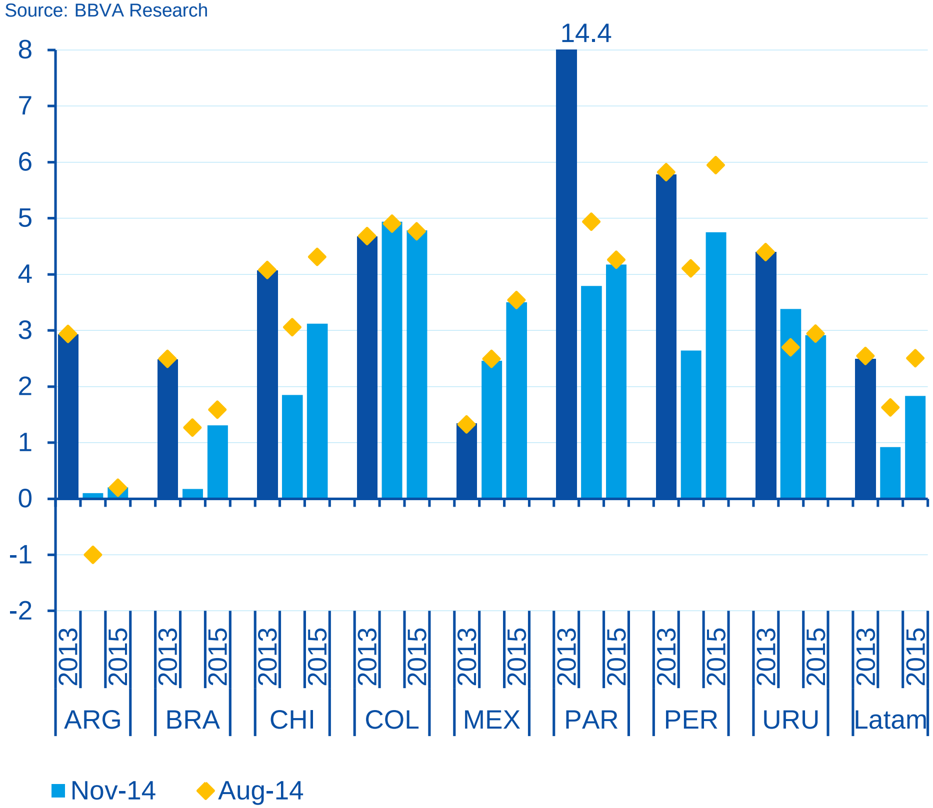
The average for the region will be an improvement on the worst part of the slowdown in 2Q. Growth will rise because of greater growth worldwide and increased public investment

Heterogeneous results: the Pacific Alliance will grow 2.8% in 2014 and 3.8% in 2015, well above the regional average

Robust uptick in growth expected in Peru, Chile and Mexico. Colombia's momentum will continue

LatAm countries: GDP growth (%)

Source: BBVA Research



Adjustments to the downside in the forecasts for most countries, apart from Colombia and Mexico

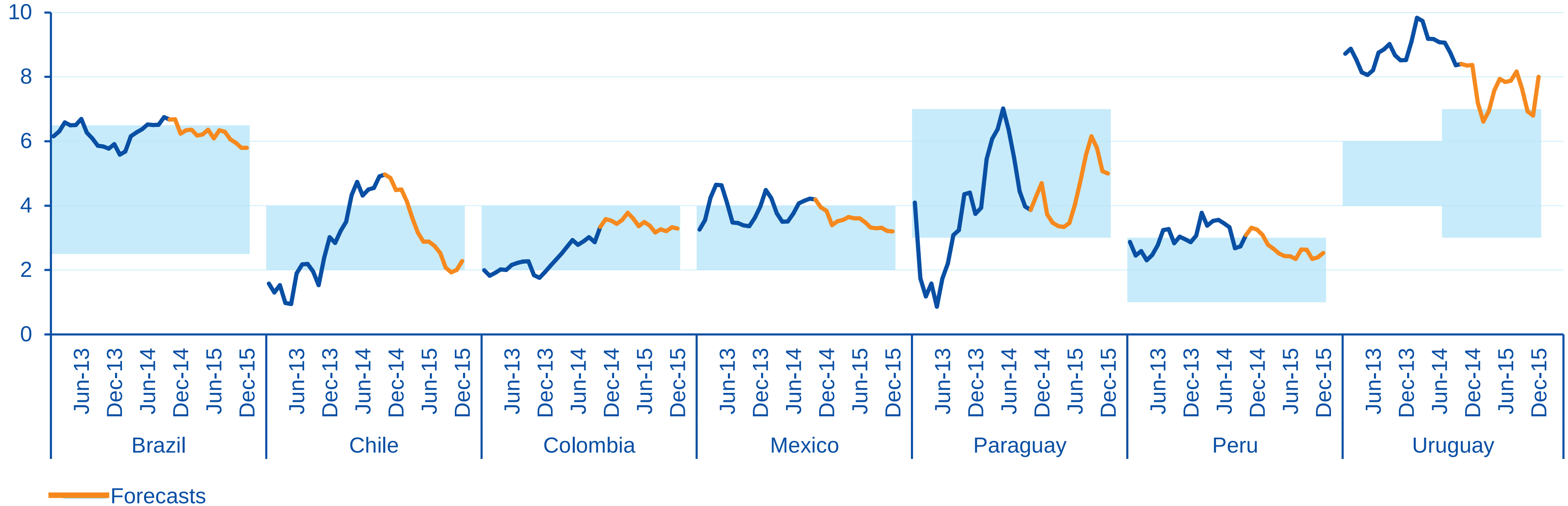
Increase in long-term growth forecasts in Mexico, thanks to the structural reforms (particularly energy)

Brazil will continue with very moderate growth. 2015 will be a year of policy adjustment

Inflation will remain within the target ranges, except in Uruguay

LatAm: inflation (% YoY) in countries with inflation targets

Source: BBVA Research and Haver Analytics

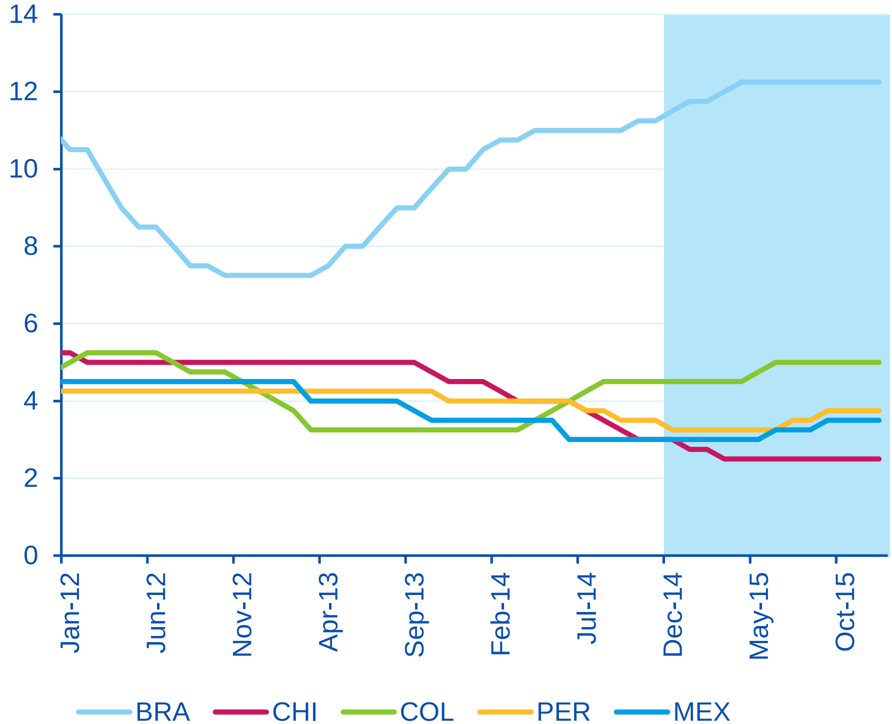


Cyclical weakness has removed some of the pressure on inflation, but the supply shocks have remained at the high end of the target range

Cyclical weakness will support convergence towards goals, except in Uruguay (indexing) and in Brazil (regulated prices and depreciation)

Central banks show a looser bias towards weak growth, except in Brazil

Official interest rate in countries with inflation targets (%)
Source: BBVA Research y Haver



Taylor rule estimates for Latin America justify an even laxer stance on the part of central banks, except in Mexico [Box 3]

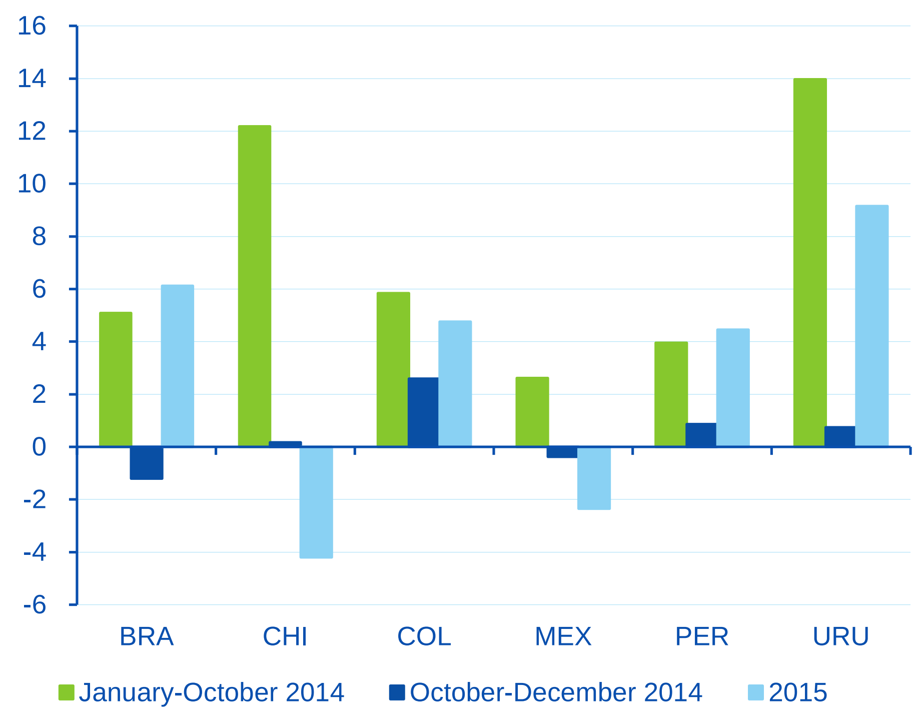
We expect more interest rate cuts in Mexico and Peru, with lower rises than anticipated in Colombia.
Mexico will keep its rates stable

Interest rate rises are expected for 2015, on the back of the recovery and the Fed's interest rate hikes

Brazil will bring forward the interest rate hikes we expected for 2015, partly as a sign that it is adjusting its economic policies

Depreciations in 2014 and 2015, pressurised by commodity prices and the Fed

Variation in the exchange rate with the dollar in countries with inflation targets (%)
Source: BBVA Research and Haver Analytics



Trend towards exchange-rate depreciation due to lower relative growth, lower commodity prices and increase in interest rates by the Fed in 2015

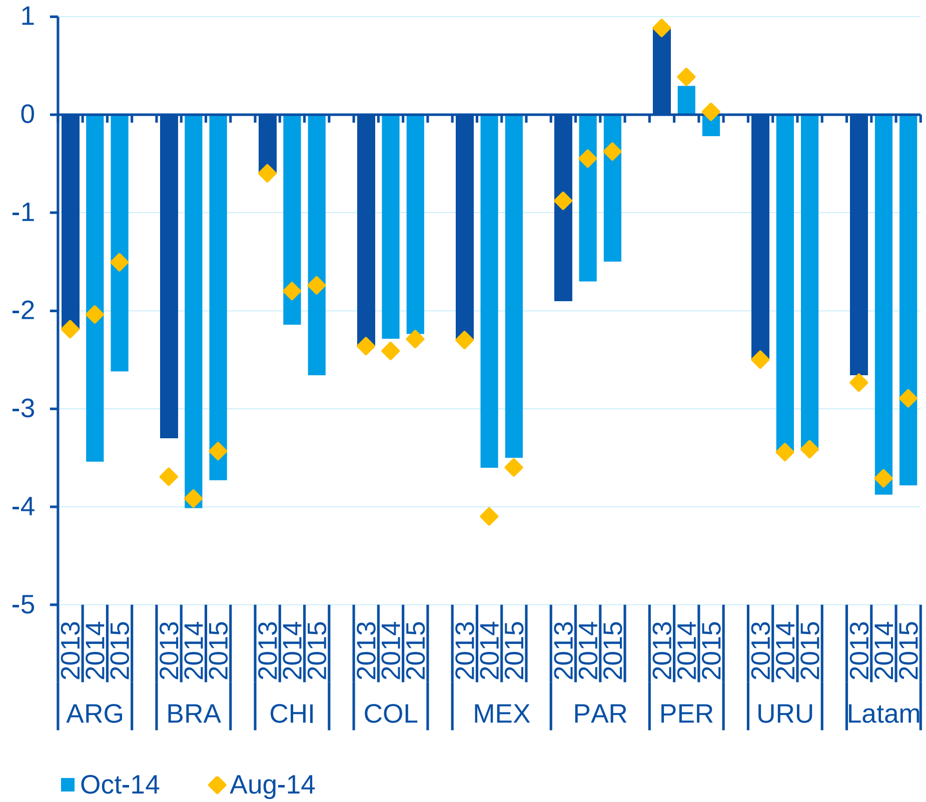
Greater depreciation in countries with stronger inflationary pressures (BRA, URU, ARG)

Less pressure to depreciate among Andean countries (even one-off appreciation in Chile) and in Mexico (support for the cycle in the US)

Economic deceleration knocks fiscal accounts …

LatAm: Fiscal deficits (%GDP)

Source: BBVA Research and Haver Analytics

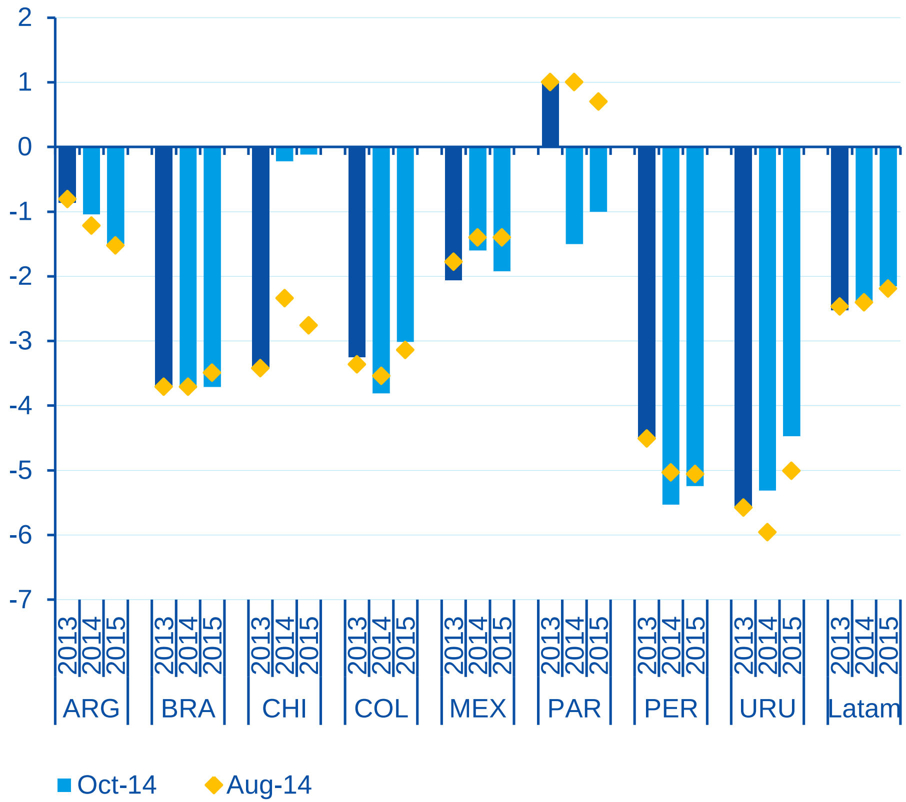


Decelerating demand and lower commodity prices are putting downward pressure on fiscal revenues

Added to this, some countries, such as Brazil and Argentina, are increasing their public spending

… but improves external accounts

LatAm: Current account deficit (% GDP)
Source: BBVA Research and Haver Analytics



External deficits will start to diminish from 2015 onwards, due to weak domestic demand and the increase in world growth …

…the end of a series of supply shocks in the exports sector (Peru, Colombia, Chile, Argentina)…

…and a more depreciated exchange rate, which will partly counteract the lower terms of trade

Key takeaways

1. **The world economy is still growing, albeit slowly.** Global growth will increase from 3.2% in 2014 to 3.7% in 2015. Commodity prices will fall in the short term because of increased supply, but should recover somewhat in the medium term.

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Appendix: Growth forecasts in Latin America

	2011	2012	2013	2014*	2015*
Argentina	8.6	0.9	2.9	0.1	0.2
Brazil	2.7	1.0	2.5	0.2	1.3
Chile	5.8	5.4	4.1	1.9	3.1
Colombia	6.6	4.0	4.7	4.9	4.8
Mexico	4.0	3.7	1.3	2.5	3.5
Paraguay	4.3	-1.2	14.4	3.8	4.2
Peru	6.5	6.0	5.8	2.6	4.8
Uruguay	7.3	3.7	4.4	3.4	2.9
Mercosur	3.6	1.3	2.3	-0.5	0.4
Pacific Alliance	5.0	4.2	2.7	2.8	3.8
Latin America	4.2	2.6	2.5	0.9	1.8

*Forecasts
Source: BBVA Research