

Latin America: A slow recovery

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Key takeaways:

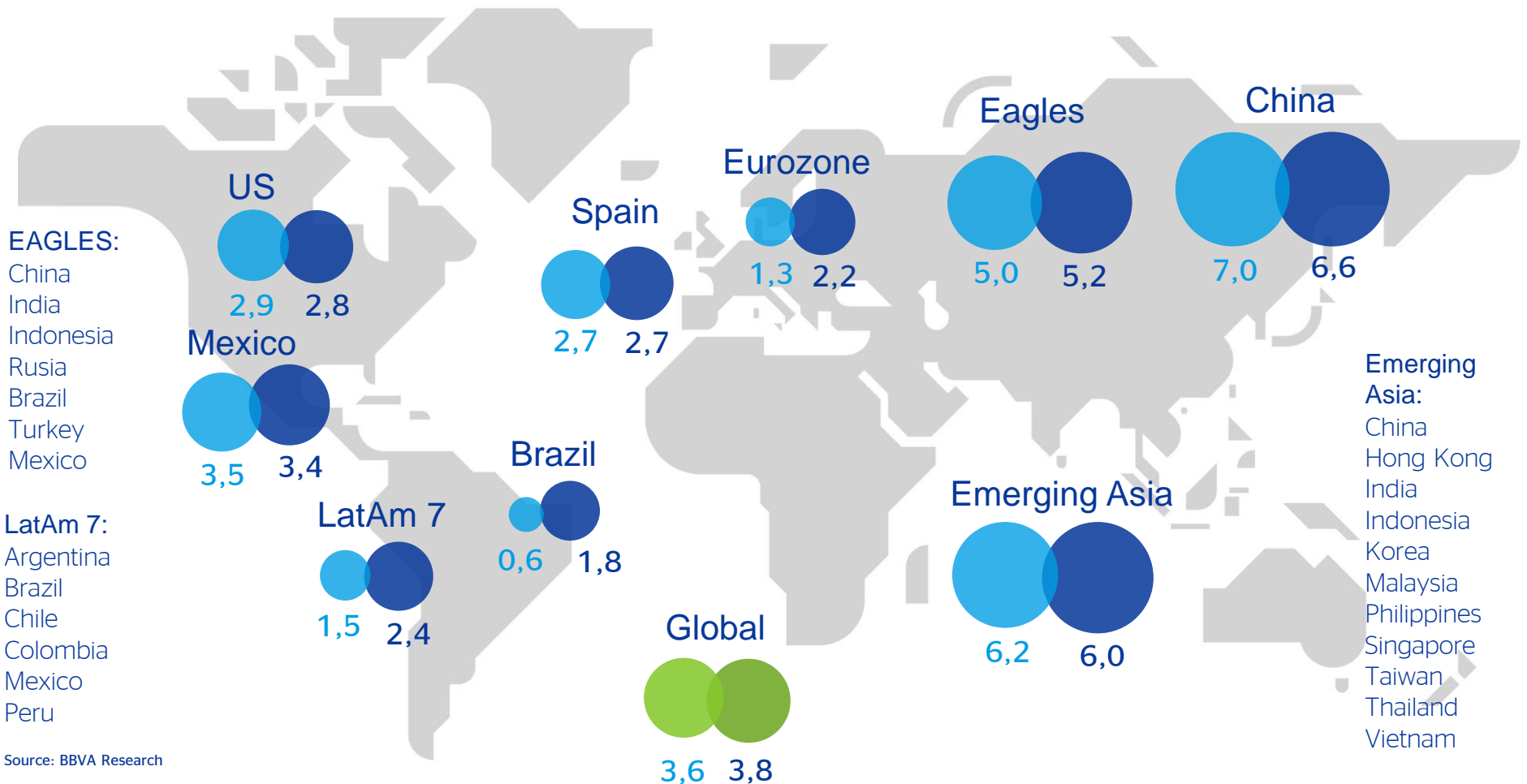
- 1 World growth will continue to move upwards, albeit slowly and very unevenly.** The fall in oil prices is positive for the world economy, but it has varying effects.
- 2 Volatility in the region's financial markets will continue.** The Fed rate hikes will have a negative effect on capital flows into the region, which adds to lower commodity export prices.
- 3 Growth in LatAm should increase gradually, from 0.8% in 2014 to 1.5% in 2015 and 2.4% in 2016,** due to the increased global growth and the rise of public investment in the Andean countries. The Pacific Alliance should grow by 3.6% and 3.8% in 2015-16.
- 4 The central banks will continue to show a looser bias, given the cyclical weakness, and could even disengage from the Fed rate hikes, with the exception of Mexico.** Interest rate cuts are anticipated in Colombia, Peru and Chile.
- 5 Exchange rates will continue to depreciate in 2015,** in a scenario of lower commodity prices, and will disengage from the Fed's monetary policy.

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- 2 LatAm: gradual recovery, held back by lower commodity prices

Global growth: moderate and uneven acceleration

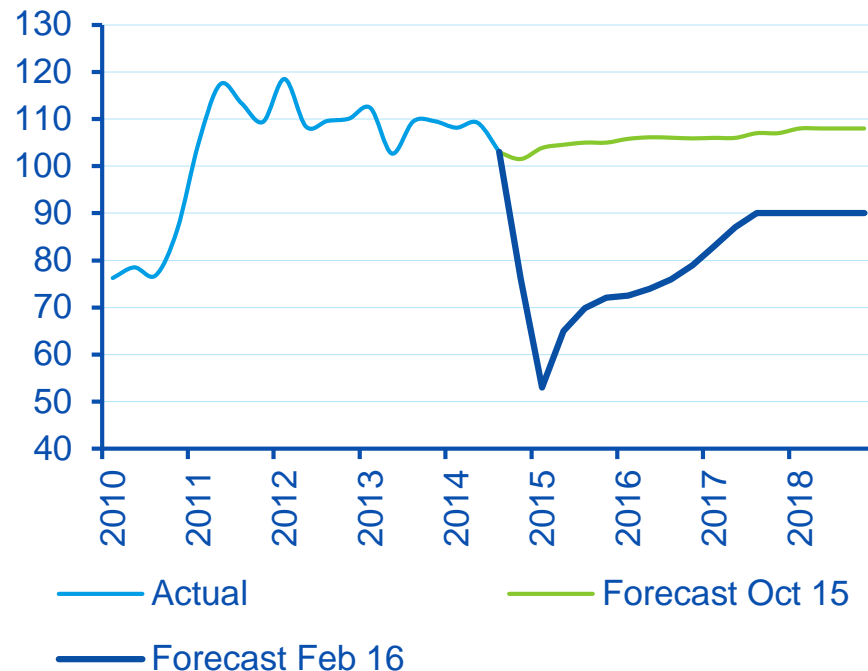
● 2015 ● 2016



The fall in oil prices is positive for the world economy

BBVA Research price forecasts for Brent oil (USD/bbl, quarterly averages)

Source: BBVA Research



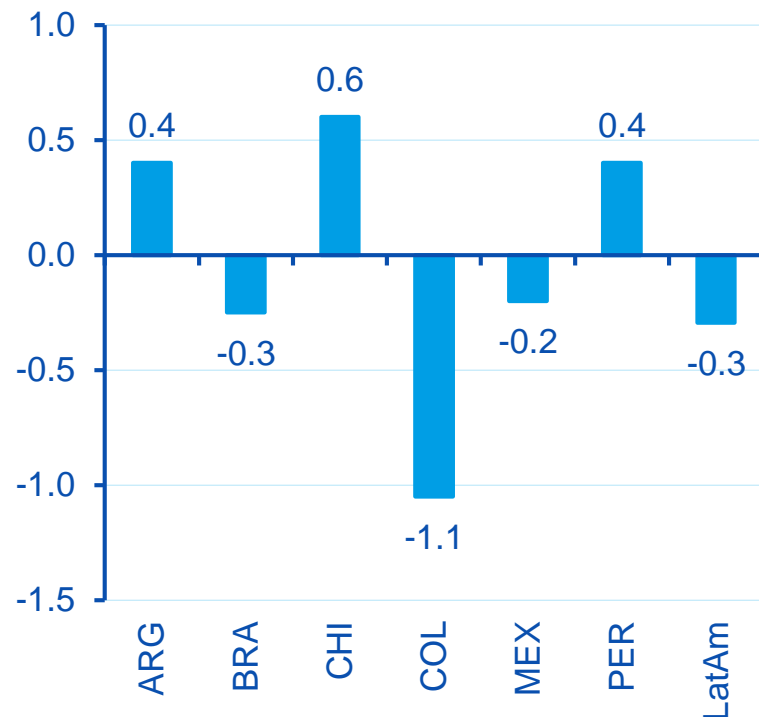
Uneven impact depending on countries

Direct impact on the overall drop in inflation

...although lower oil prices have an uneven impact in LatAm [Box 1]

Impact on growth of the revised course of oil prices: forecasts in February 2015 vs. October 2014 (pp, 2015-16 average)

Source: BBVA Research



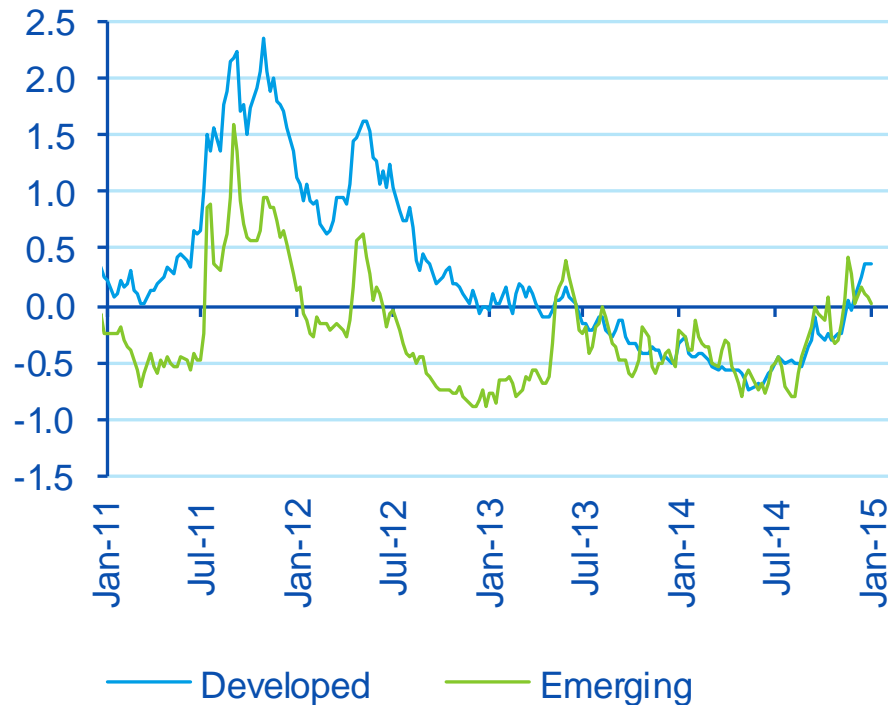
Positive impact in importing countries and overall drop in inflation

Negative effect in Mexico, partially offset by the increased growth in US

Monetary policy divergence between the Fed and the ECB increases financial tensions

BBVA Research Financial Tensions Index

Source: BBVA Research



Increasing financial tensions in a context of divergence between the monetary policies of the Fed and the ECB

The strength of emerging economies will be tested by the normalisation of monetary policy in the US

What are the risks of the global scenario?



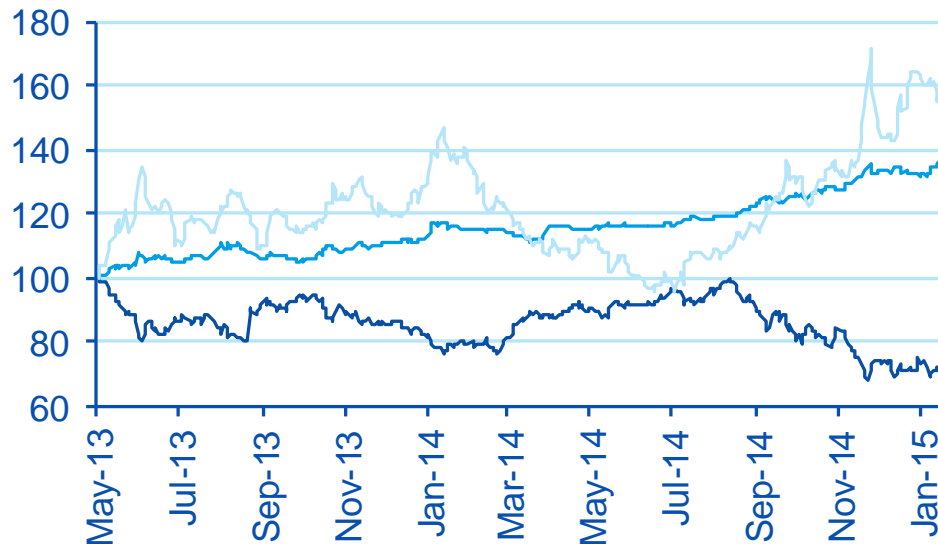
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The correction in commodity prices also contributed to volatility in LatAm

LatAm: Stock market prices, sovereign spreads (EMBI) and exchange rates (January 2013=100)

Source: BBVA Research and Haver Analytics Analytics



- Exchange rate
- Stock market prices (MSCI)
- Sovereign spreads (EMBI)

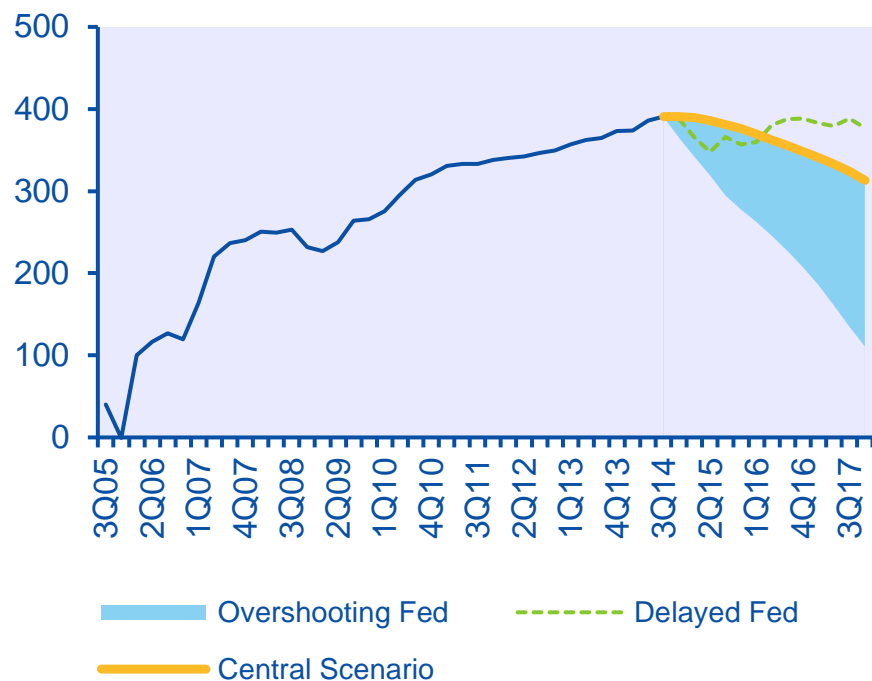
Increased volatility in major assets in the region, with corrections in stock markets, sovereign spreads and exchange rates

The two main drivers were the correction of commodity prices and the expectation of the Fed increasing interest rates

The Fed rate hikes will negatively impact capital flows into the region

Scenarios for capital flows to LatAm (cumulative figures since 2005, USD bn)

Source: BBVA Research and Haver Analytics



An increase of QE by the ECB would not offset the effects of the Fed's monetary normalisation on LatAm

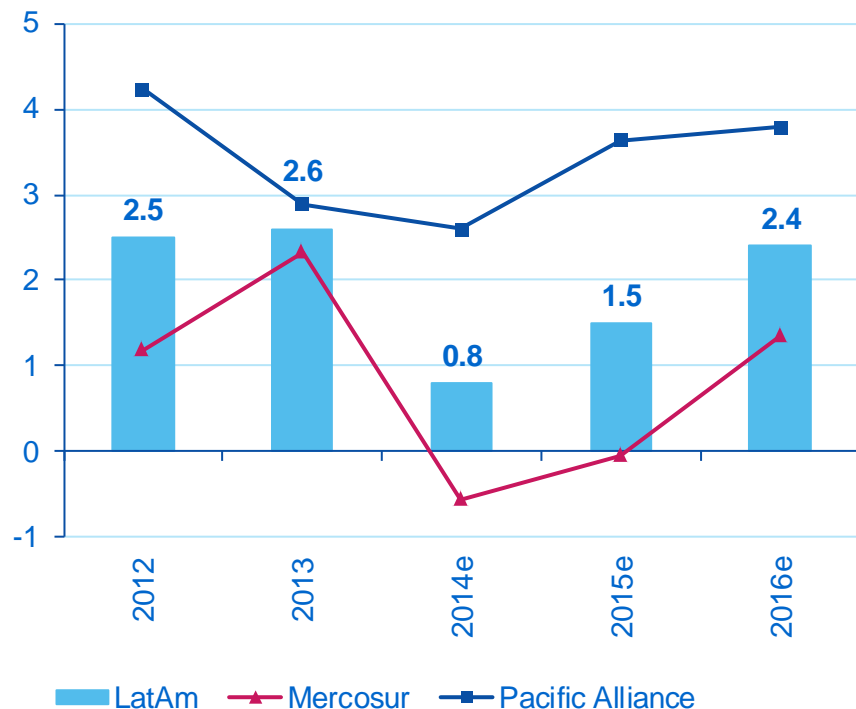
Different scenarios depending on the pace of normalisation of the Fed's monetary policy

Capital flows into the region would contract to 3% of GDP (cumulative 2015-17)

We adjust our estimates of LatAm growth downward by 0.3pp in 2015 (to 1.5% in 2015 and 2.4% in 2016)

LatAm*: GDP growth (% YoY)

Source: BBVA Research



Activity data surprised to the downside during the fourth quarter of 2014

Major downward revisions of estimates due to the impact of lower oil prices

The average for the region left the worst of the deceleration behind in 3Q. Regional growth will increase because of more global growth and the increase in public investment

Heterogeneity: the Pacific Alliance will grow 3.6% in 2015 and 3.8% in 2016, more in line with its potential than the rest of the region

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

Strong increase in growth in 2015 in Peru, Chile and Mexico

GDP by country, 2014, 2015 and 2016 (% var. YoY)

Source: BBVA Research



Downward adjustments to prospects, especially in Brazil and Colombia

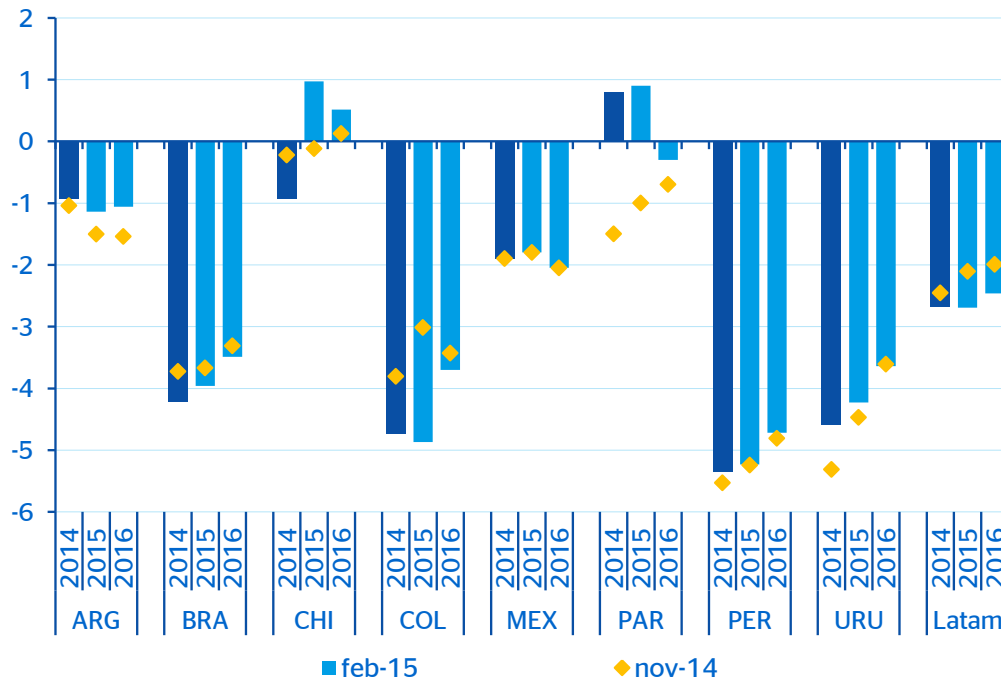
Brazil: strong macroeconomic adjustment in 2015

Colombia: significant impact of lower oil prices, but it will maintain one of the highest growth rates in the region

Lower commodity prices worsen the perspective of external balances ...

Current account as a % of GDP

Source: BBVA Research and Haver Analytics



Falling oil prices adversely affect the external balances of Colombia, Brazil and Mexico

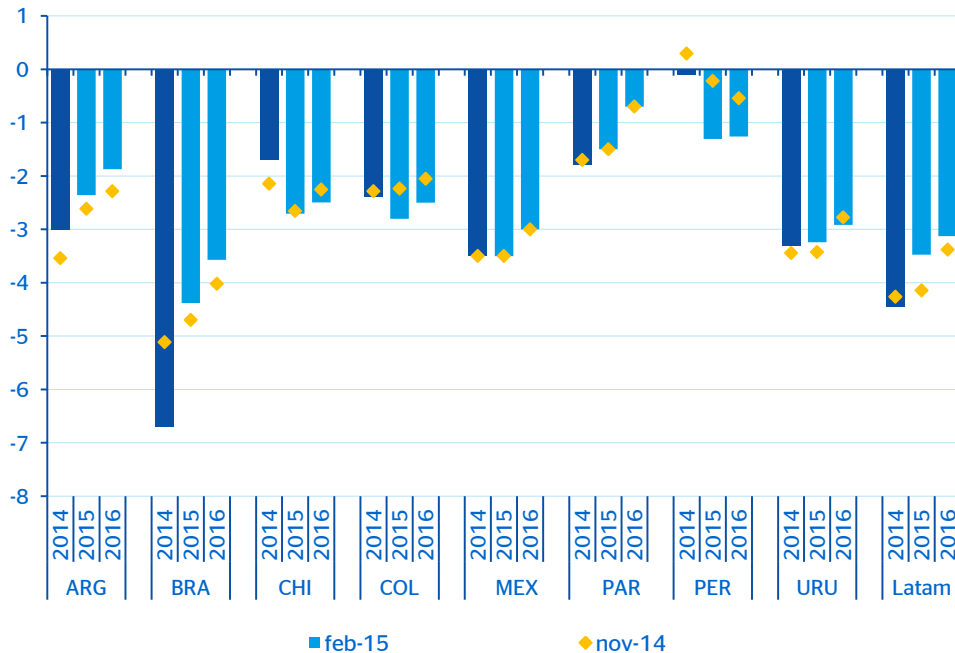
... and falling metal prices deepen the negative effect in Brazil, while moderating the positive effect of oil in Peru and Chile

The external vulnerability of the region remains bounded, although it is rising due to lower FDI into the region

... and also adversely affect fiscal balances

Fiscal balances (% of GDP)

Source: BBVA Research and Haver Analytics



The slowdown in demand and lower commodity prices will push tax revenues to the downside

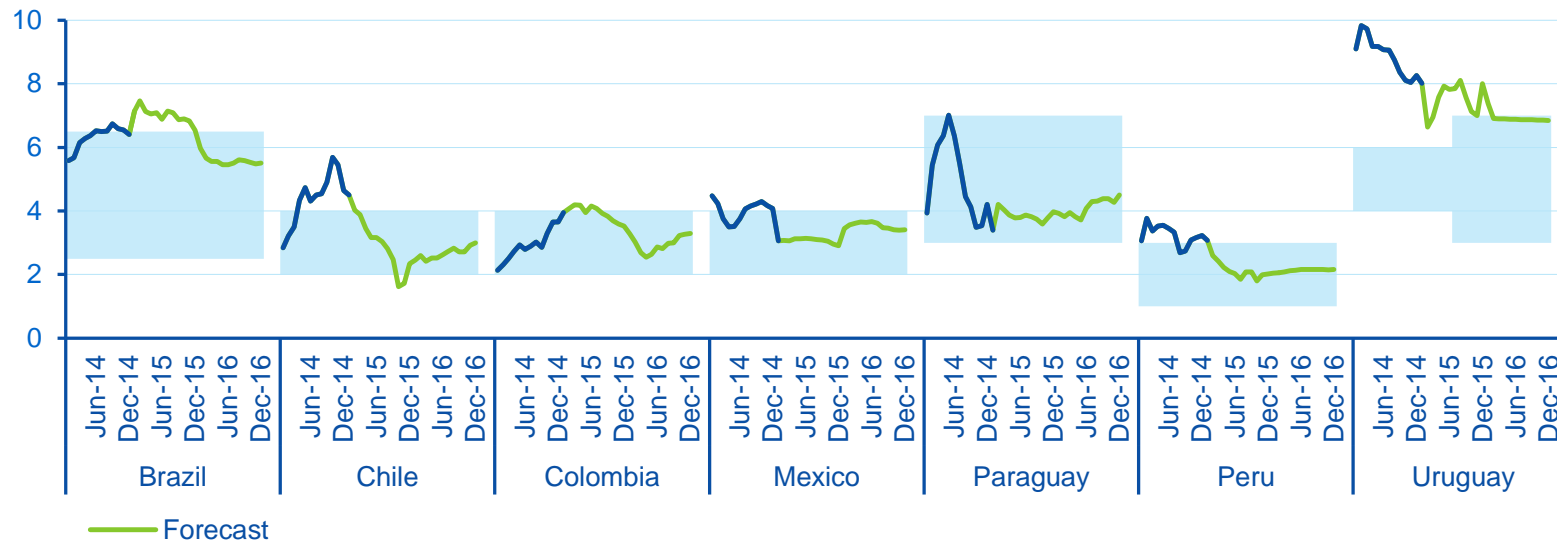
However, some countries would cushion part of this effect, through higher revenues (Chile, Colombia, after tax reforms) ...

... or by a general adjustment of administered prices and public tariffs (Brazil)

The pressure on inflation declines in the region, because of the cyclical weakness and oil prices

LatAm: inflation (% YoY) and target ranges for central banks

Source: BBVA Research and Haver Analytics



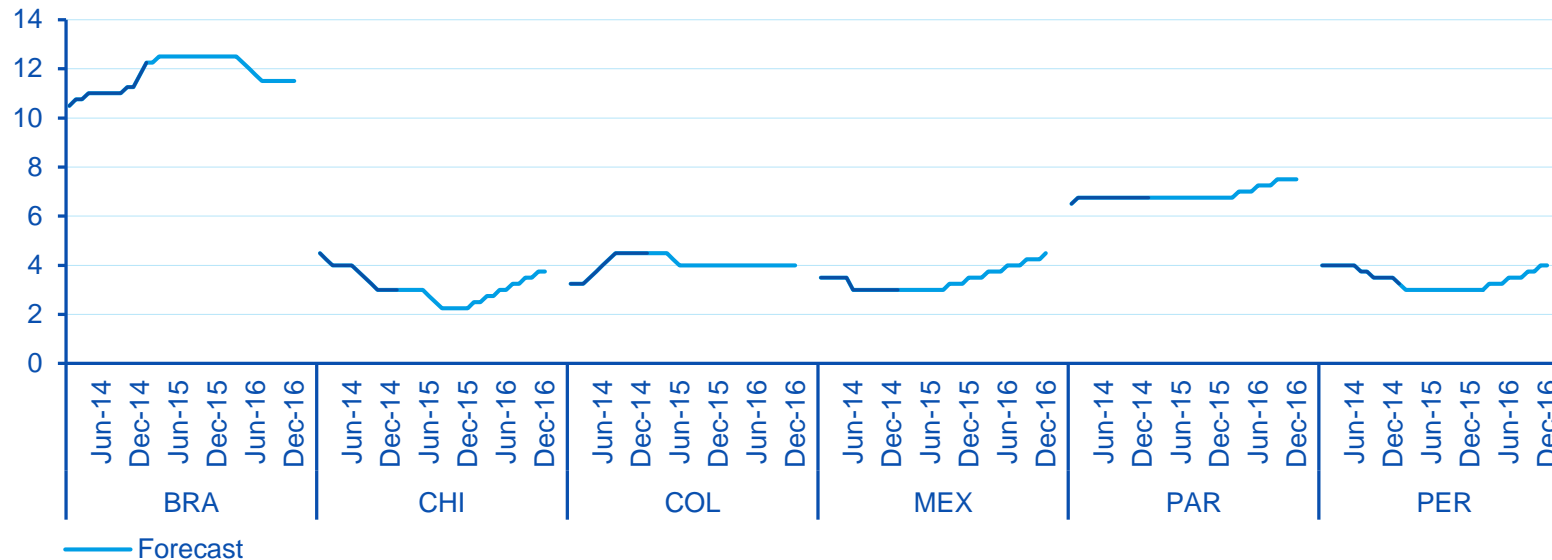
Pressure will remain on Brazilian inflation, because of the increase in administered prices and the depreciation of the exchange rate

Colombia will also see the impact of the recent depreciation of the exchange rate on inflation in 2015

Other than in Mexico, the central banks will continue to show a looser bias and could even disengage from the Fed

LatAm: Monetary Policy Rate (%)

Source:BBVA Research and Haver Analytics



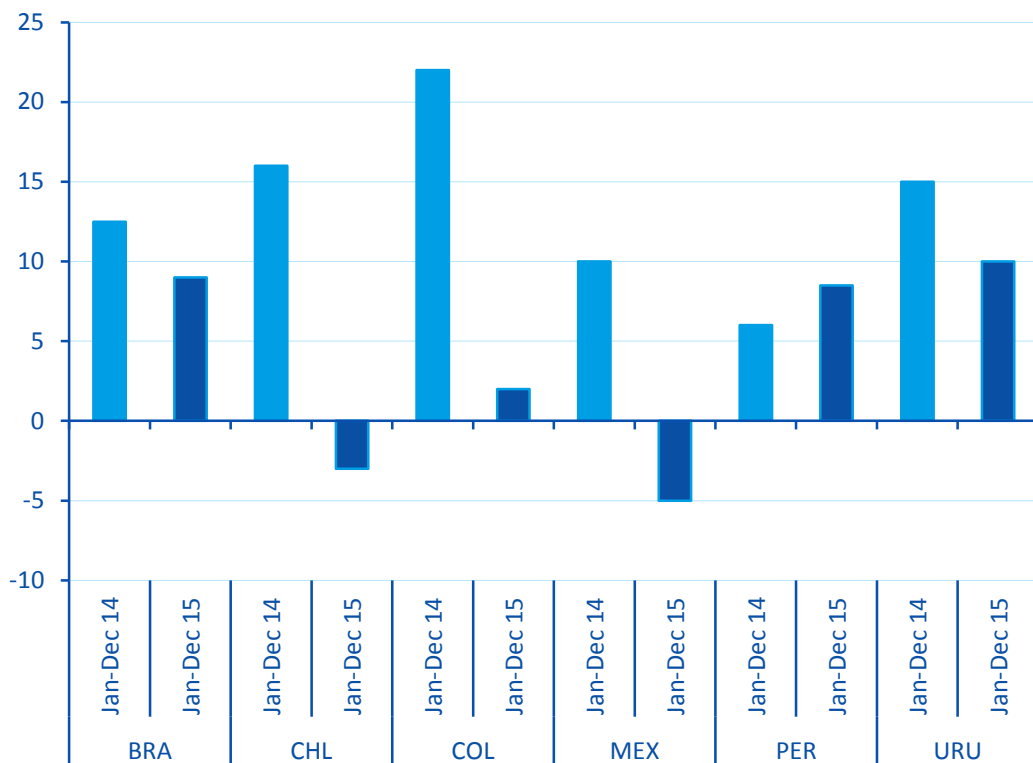
We anticipate further cuts in Peru, Chile and Colombia

Brazil will not join the Fed rate hikes, although Mexico will do so because it is more synchronised with the US

Depreciation in 2015, pressured by commodity prices and the Fed

Changes in the exchange rate against the dollar in countries with inflation targets (%)

Source: BBVA Research and Haver Analytics



Willingness of central banks in the region to decouple from the Fed not only because of cyclical weakness and the anchoring of inflation expectations ...

... but also from a greater willingness to allow the exchange rate adjustment, a limited exchange rate pass-through to inflation...

... and the view that the weakening of the exchange rate would not generate excessive losses for the non-financial corporate sector in the region (although the available evidence is inconclusive, especially in Peru and Colombia)

Key takeaways:

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Appendix: Growth forecasts in Latin America

GDP (% YoY)	2012	2013	2014e	2015*	2016*
Argentina	0.8	2.9	0.1	1.0	2.0
Brazil	1.0	2.5	0.1	0.6	1.8
Chile	5.4	4.1	1.8	3.1	3.9
Colombia	4.0	4.7	4.9	3.6	4.0
Mexico	3.8	1.7	2.1	3.5	3.4
Paraguay	-1.2	14.4	3.8	4.2	4.2
Peru	6.0	5.8	2.4	4.8	5.6
Uruguay	3.7	4.4	3.4	2.9	3.0
Mercosur	1.2	2.4	-0.6	-0.1	1.3
Pacific Alliance	4.2	2.9	2.6	3.6	3.8
Latin America	2.5	2.6	0.8	1.5	2.4

Source: BBVA Research. *Forecast