

Latin America: growth held back by domestic demand

Juan Ruiz

BBVA Research | Chief Economist for Latin America

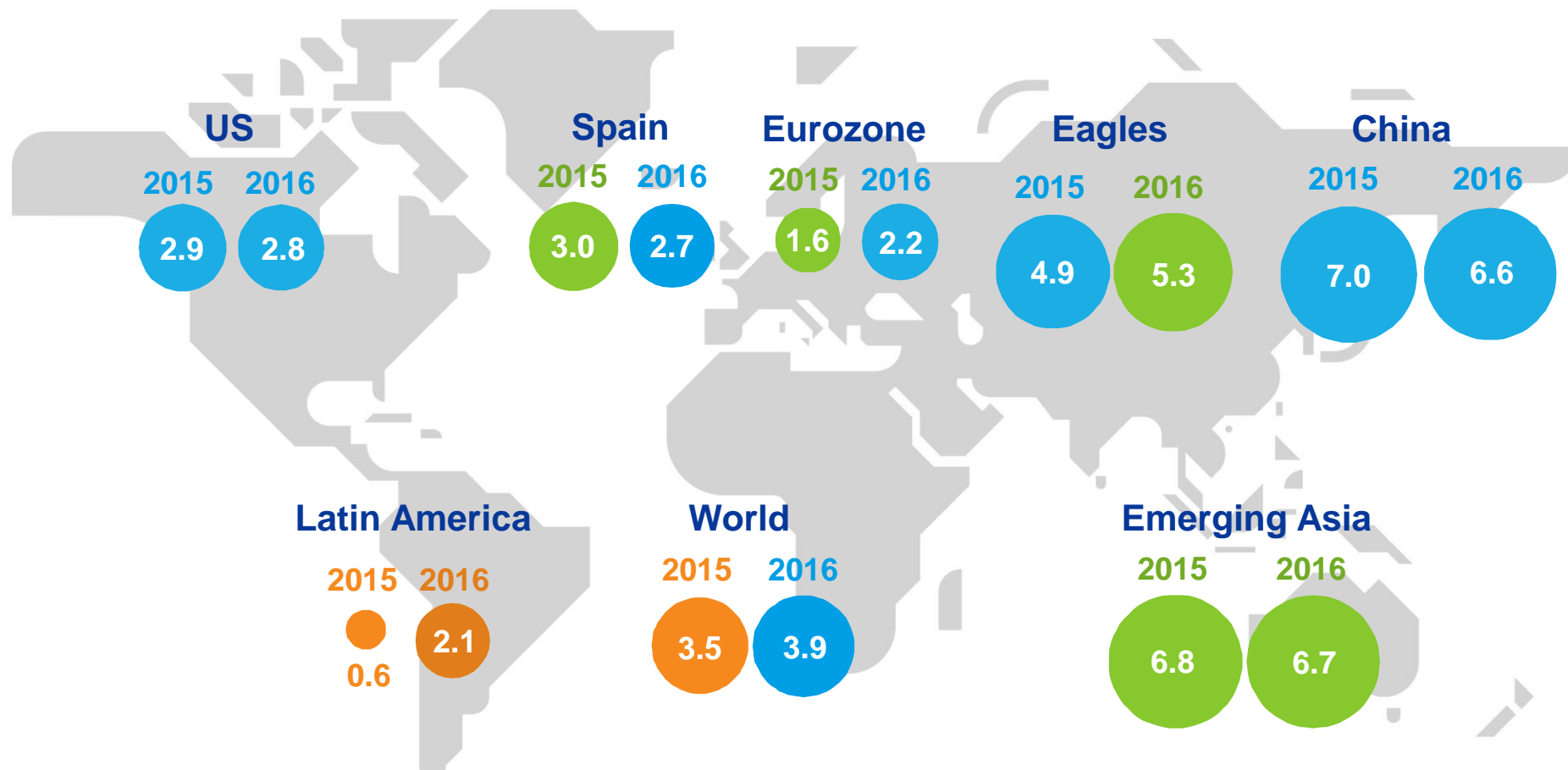
Key messages

- 1 The growth in the global economy continues, but growth is weaker and more uneven.** China continues to decelerate in a controlled manner, and US economic policy is preparing for a hike in interest rates, which will increase market volatility.
- 2 We are revising LatAm growth downwards to 0.6% in 2015 and 2.1% in 2016.** The weakness of confidence is hampering domestic demand, but regional growth will rise in 2016, spurred by a concerted public investment effort in the Andean countries and greater world growth. The Pacific Alliance will continue to grow at above the regional average.
- 3 The recession in Brazil will produce spill-over, primarily into Argentina, Uruguay and Paraguay,** although the impact will be very marginal in the other countries.
- 4 Inflation is holding at a level above previous forecasts in those countries with inflation targets,** partly due to the exchange-rate depreciation, yet also because of other, idiosyncratic, factors. Even so, it will converge towards central bank targets in 2015-16.
- 5 The window for monetary stimulus in the Andean countries is closing due to inflation shocks (and exchange-rate volatility in Peru).** Interest rates should hold steady in 2015 in the Andean countries, whereas we expect Brazil to raise the Selic by a further 50bp and Mexico will shadow the Fed very closely.

Outline

- 1 Global economy: weaker and more uneven world growth
- 2 LatAm: growth is flagging, dragged by domestic demand

A less convincing and more uneven global recovery



See: <https://www.bbvarsearch.com/public-compuesta/situacion-global-segundo-trimestre-2015//>

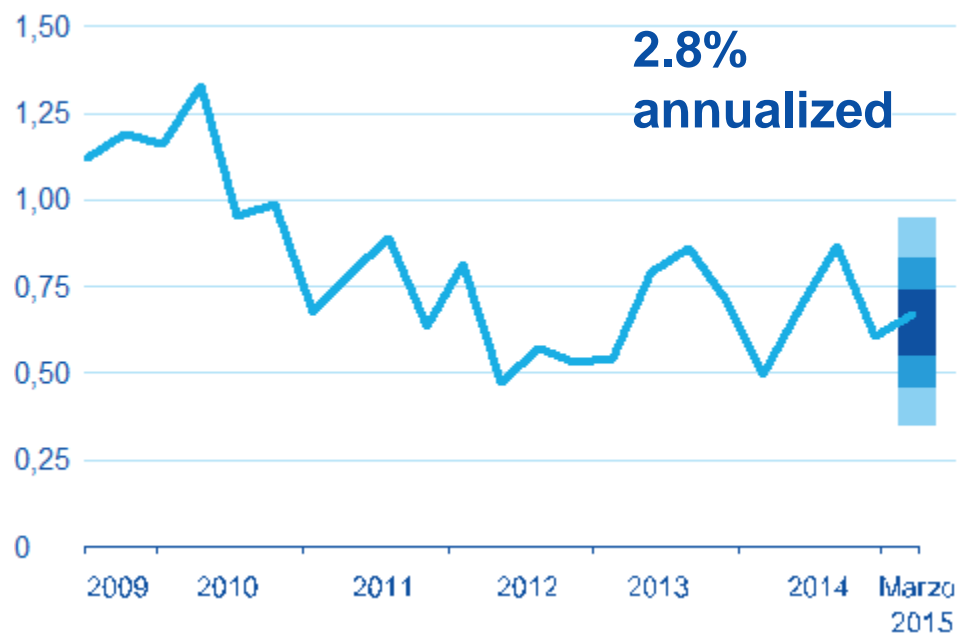
Source: BBVA Research

● Down
 ● Steady
 ● UP

A less convincing and more uneven global recovery

BBVA-GAIN world growth indicator (% by quarter)

Source: BBVA Research



In Europe the improvement in activity intensifies

Growth loses momentum in EMs

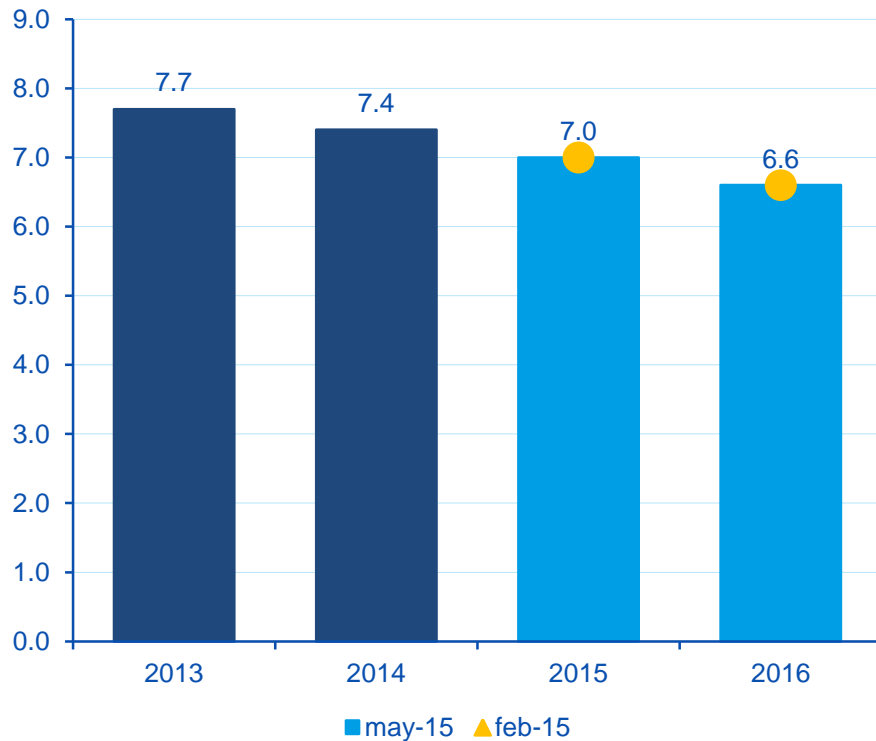
The deceleration in the US will be transitory

■ IC al 20% ■ IC al 40% ■ IC al 60% — PIB (% T/T)

China: the gradually decelerating trend in activity continues

China: GDP growth (%)

Forecast 2015-16
Source: BBVA Research



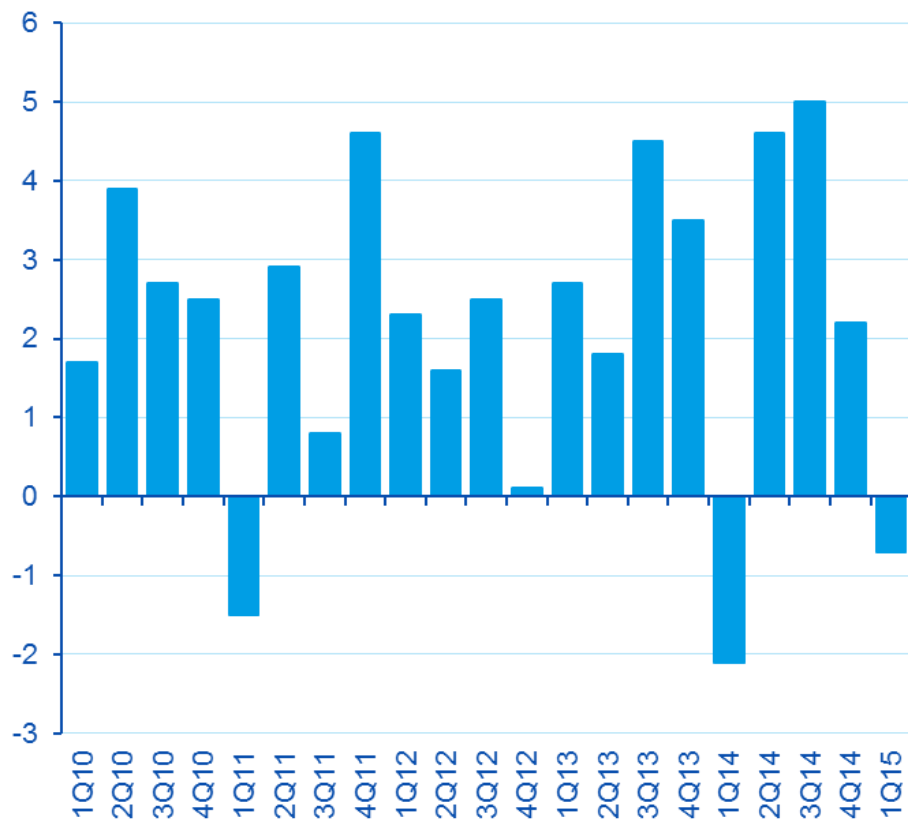
Deceleration as a reflection of the real estate correction and fiscal consolidation in local government

Objective of 7% growth in 2015 will set in motion new fiscal and monetary stimulus measures

US: a transitory deceleration in the first quarter

US: GDP growth (quarterly annualized rate)

Source: BBVA Research and Haver



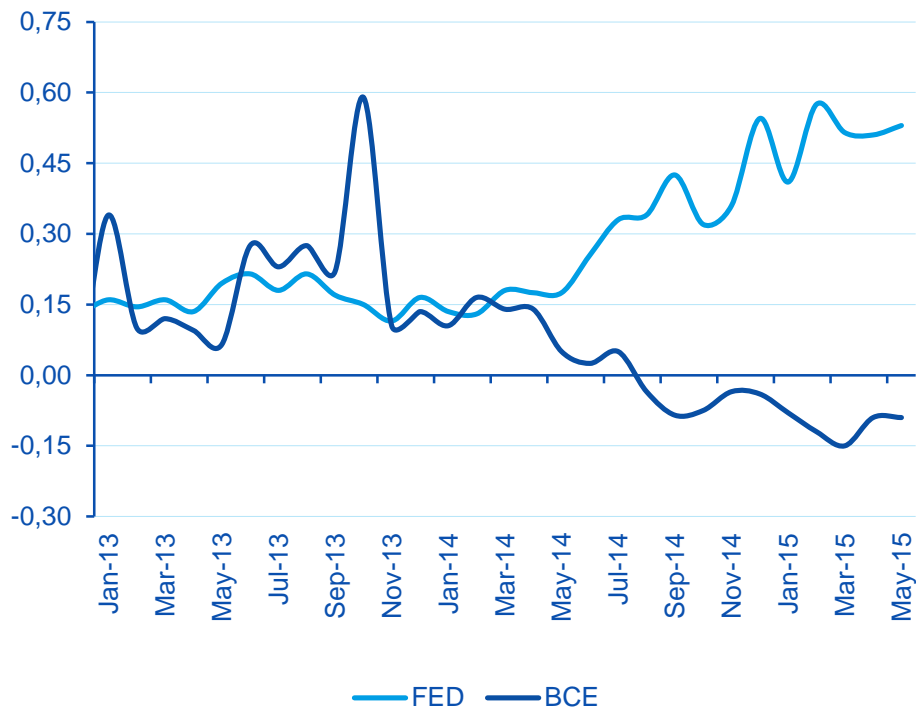
Employment rising and inflation falling support household income and consumption

This will offset dollar appreciation and the weakness in external demand

Monetary policy differentiation between the US and the rest of the world

Interest Rate expectations (%, expectations one year forward)

Source: BBVA Research, Haver Analytics



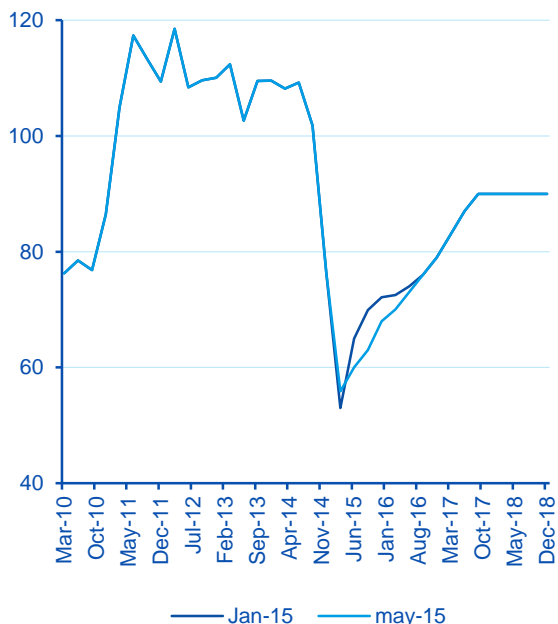
Since January 2015, central banks have taken 27 decisions to lower interest rates and only two to raise them

Recent volatility associated with the change in the likely timing for the Fed's hike cycle

Commodity prices are recovering slightly, but remain subdued

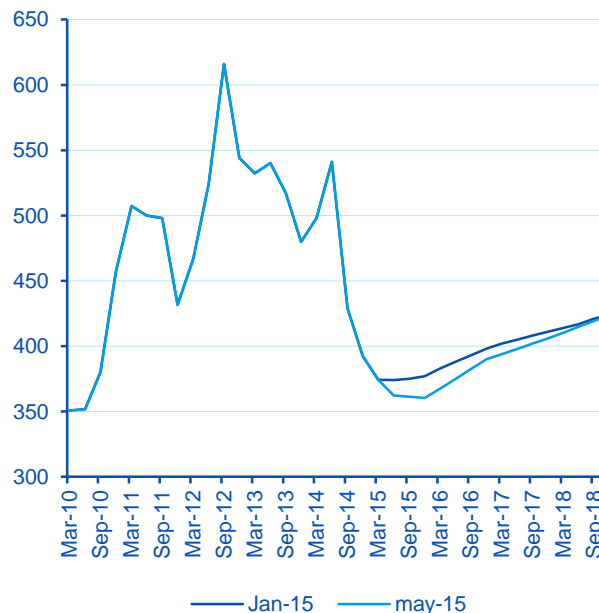
Brent: (USD/b)

Source: BBVA Research and Bloomberg



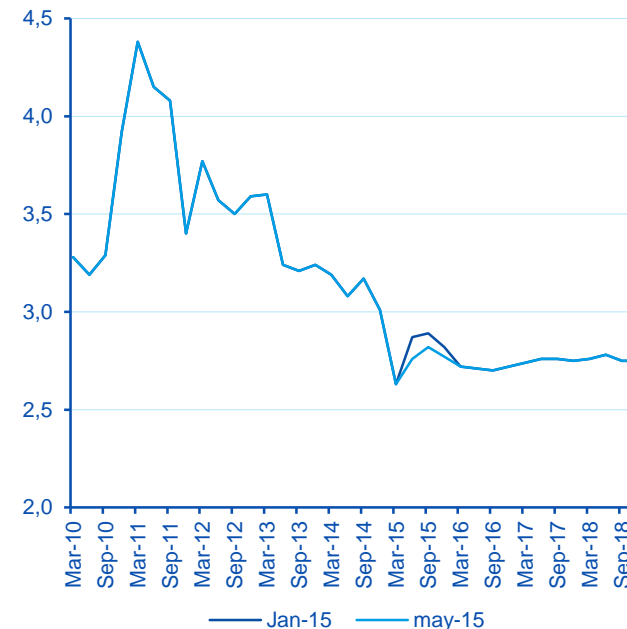
Soy: (USD/tm)

Source: BBVA Research and Bloomberg



Copper: (USD/lb)

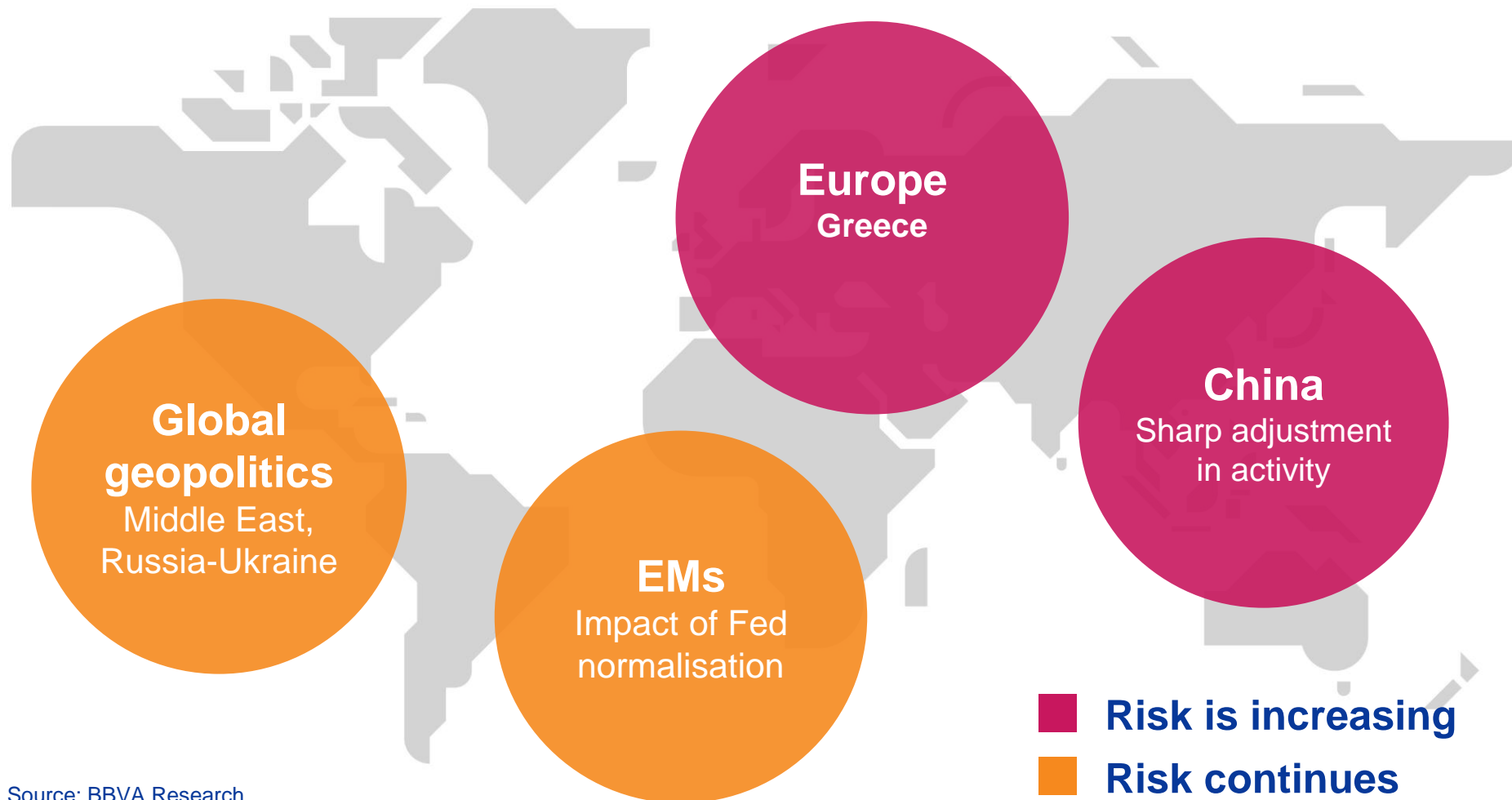
Source: BBVA Research and Bloomberg



Oil and copper prices increased slightly in the last quarter ...

... for fundamental supply reasons, as well as dollar weakness in recent weeks

What are the global risks?



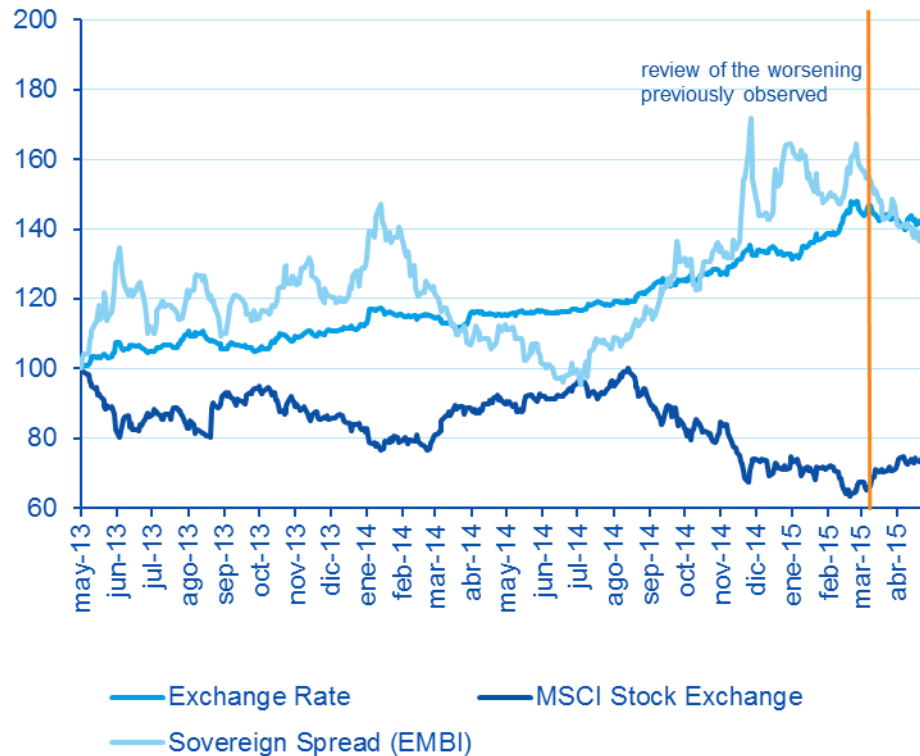
Outline

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Volatility continued to prey on financial markets in the region, being swayed by the Fed

Prices of the main assets in LatAm (index May 2013=100) Precios de los principales activos en Latam (índice mayo 2013=100)

Source: BBVA Research and Haver



Volatility remained high among the region's key assets, with corrections in stock markets, sovereign spreads and exchange rates over the first quarter

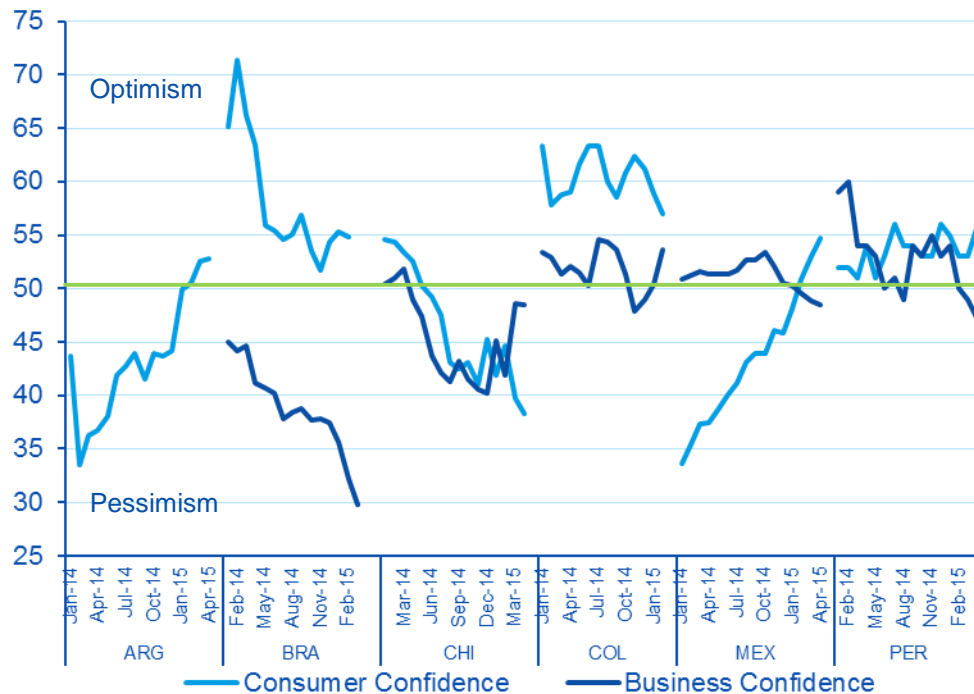
... until the prospect of a delay to the first rate hike by the Fed restored market prices

Going forward, volatility will continue as US macro data prompts shifting expectations over Fed rate hikes

Confidence indicator weakness across the board

Latam: Household and Business Confidence indexes.

Source: BBVA Research and Haver



Confidence in the region has been battered by political turbulence in some countries ...

... though also by the uncertainty over economic policies...

... and on top of all this there is the cyclical decline itself, as well as the gloomier external scenario, which impacts disposable income and investment returns

We are revising forecasts for Latin America downwards to 0.6% in 2015 and 2.1% in 2016

Latam*: GDP growth (%YoY)

Source: BBVA Research



* Average of Argentina, Brasil, Chile, Colombia, México, Paraguay, Perú, México, Uruguay y Venezuela

Activity figures surprised on the low side in 4Q14 and 1Q15

Weak private sector consumption and investment, held back by waning household and business confidence

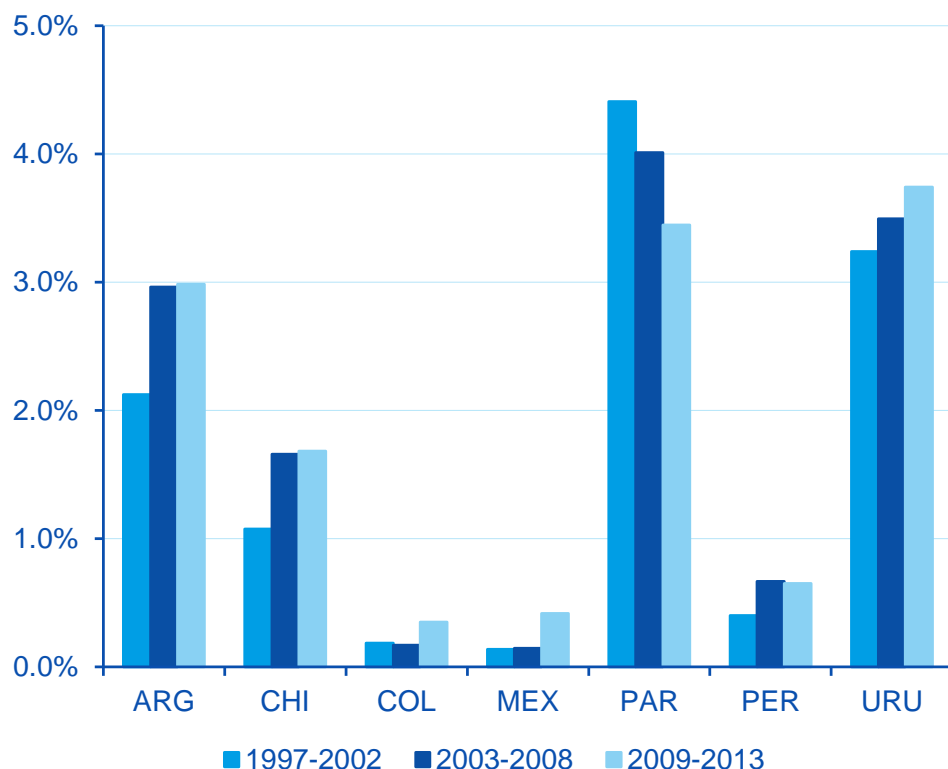
Falls in public spending in some major economies in the region (BRA, MEX, COL and PER)

Increased growth in 2016 due to: i) momentum of world growth, ii) public-sector investment in the Andean countries, and iii) less macro adjustment in Brazil

[Box 1] The impact of recession in Brazil will be more keenly felt in Argentina, Uruguay and Paraguay

Latam countries: Exports to Brazil (% of GDP for each country)

Source: BBVA Research



The bigger-than-anticipated impact of macroeconomic policy adjustment in Brazil will lead to a recession in 2015 (-0.7%)

Argentina, Uruguay and Paraguay stand out in all potential channels for any spill-over effect ...

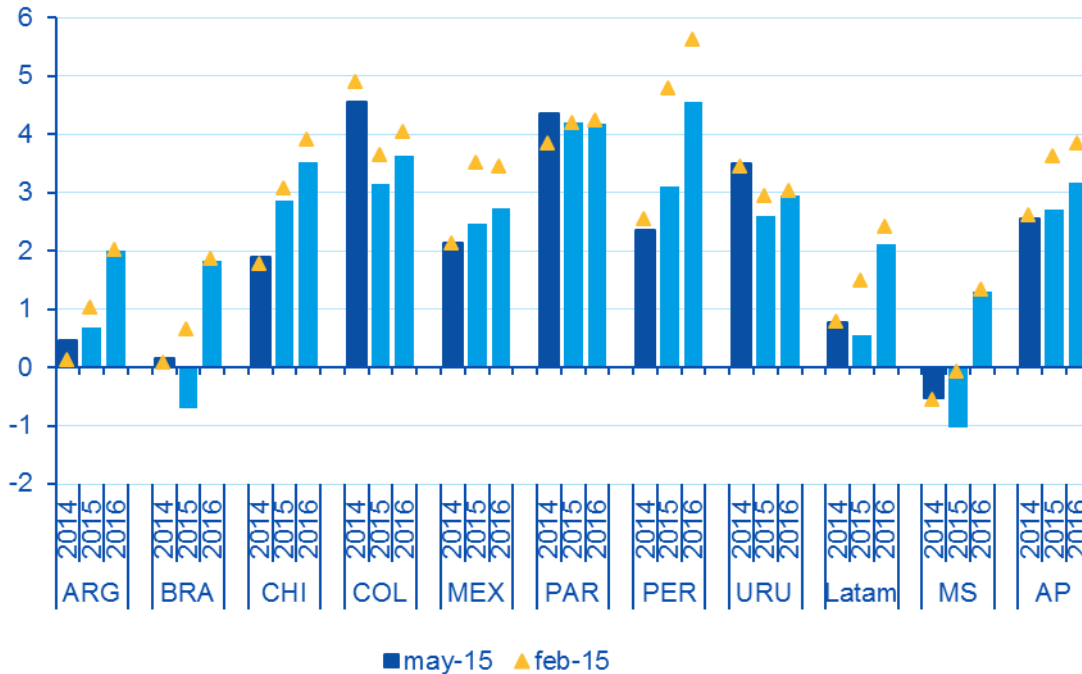
... which include: i) goods trade, ii) tourism, iii) FDI, iv) Brazilian interests in local banking

The other countries in the region should only suffer a very small amount of contagion

The downward revisions for growth in 2015 centres on Brazil, Mexico and Peru

LatAm countries: GDP growth (%)

Source: BBVA Research



MS: Mercosur AP: Pacific Alliance

The downward revisions to forecasts affect almost all countries except for Paraguay

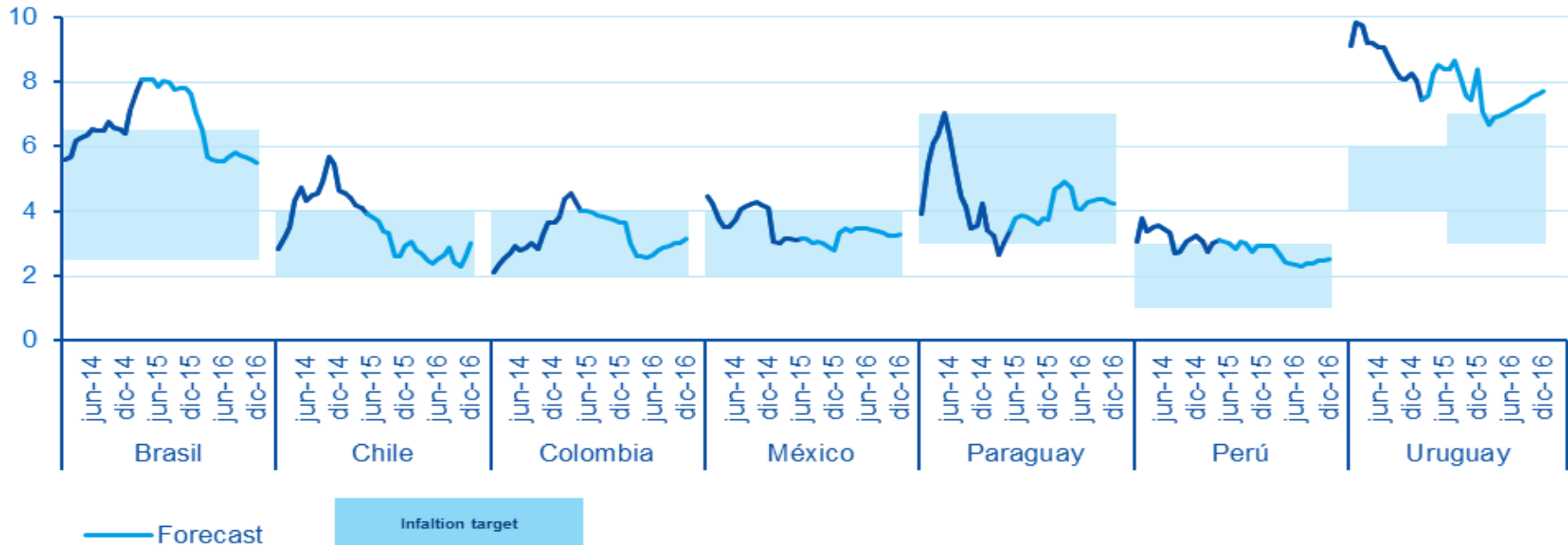
Brazil: macroeconomic adjustment
Mexico: weak US growth and lower public spending
Peru: low confidence and delay in public investment

In stark contrast: the Pacific Alliance will grow at 3% in 2015-16, above the regional average

Inflation increased in the region, but it will move back towards central bank targets in 2015-16

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

Source: BBVA Research y Haver



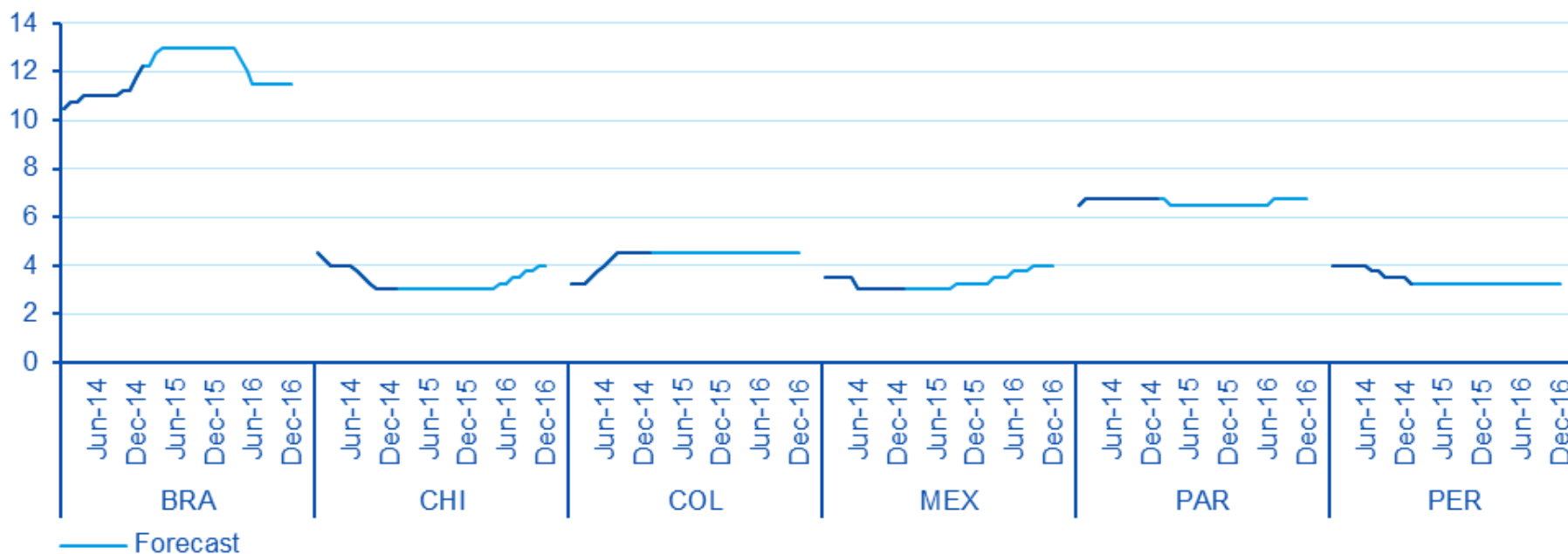
Currency depreciation has been one of the factors pushing up inflation ...

... but idiosyncratic factors are also very significant (taxation, food shocks, rises in administered prices, etc.)

The window of opportunity is closing for rate cuts, in spite of the cyclical weakness

Official interest rate in countries with inflation targets (%)

Source: BBVA Research and Haver



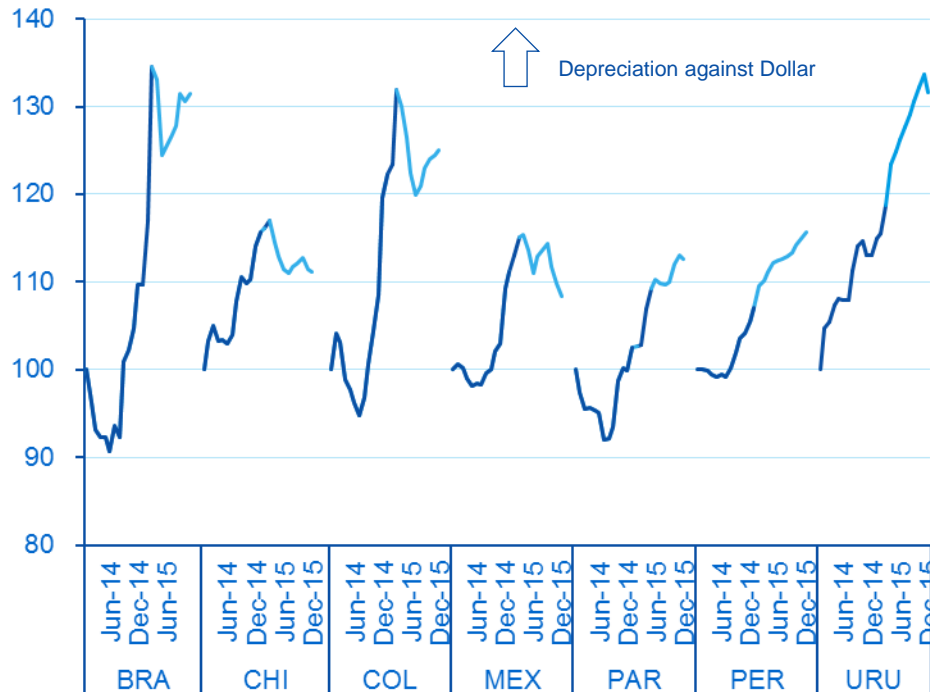
Rather than rate cuts in the Andean countries we predict stability up to 2016

Brazil will raise the Selic rate by another 50bp, while Mexico will fall into step with Fed hikes

Exchange rate depreciations in 2015, driven by uncoupling from the Fed

Exchange rate vs USD in inflation targeting countries (index Dic 2014=100)

Source: BBVA Research and Haver



Further ahead, market movements will hinge on the course taken by Fed rate hikes ...

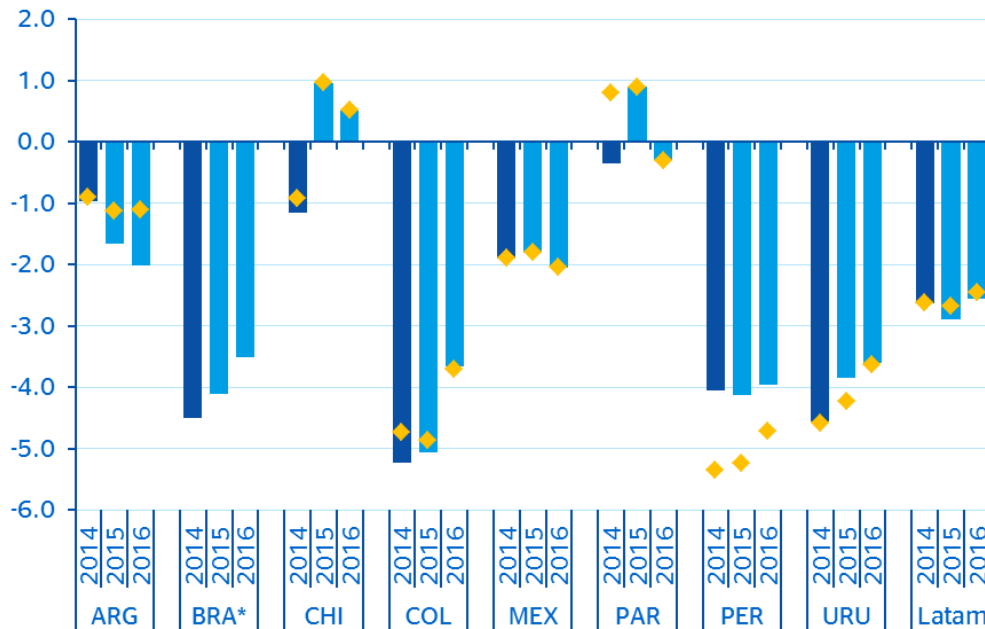
... as well as commodity prices

Generally, the depreciation will continue into the future, although there could be occasional spells of currency appreciation

Lower commodity prices will keep external deficits at high levels

Latam: External Deficit (%GDP)

Source: BBVA Research and Haver



* Cambio de Metodología adoptado por la BCB. Previsiones anteriores y actuales no comparables

■ may-15

◆ feb-15

External deficits, except in Chile and Paraguay

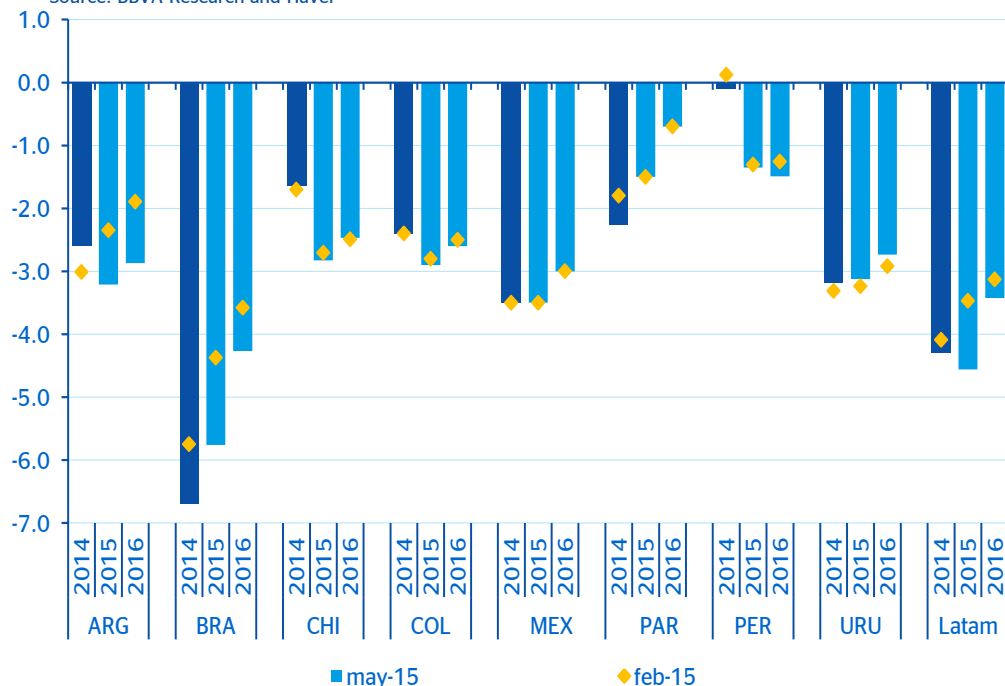
Some taming of deficits in Peru, Uruguay and Brazil owing to currency depreciation and domestic demand weakness

But these factors will not be enough to counteract the effect of a lower oil price on the external accounts of Colombia and Mexico

The fiscal outlook is becoming gloomier in Brazil and Argentina, but remains unchanged in the rest of the region

Latam: Fiscal Deficit (%GDP)

Source: BBVA Research and Haver



No major changes in our fiscal forecasts compared to three months ago...

... with the notable exception of Brazil, where the deficit should reach 5.6% of GDP, on account of lower growth and higher interest rates that apply to debt servicing

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Annex: GDP Growth Forecast in LatAm

GDP (YoY%)	2012	2013	2014	2015*	2016*
Argentina	0.8	2.9	0.5	0.7	2.0
Brazil	1.8	2.7	0.2	-0.7	1.8
Chile	5.5	4.2	1.9	2.9	3.5
Colombia	4.0	4.9	4.6	3.1	3.6
Mexico	3.8	1.7	2.1	2.5	2.7
Paraguay	-1.2	14.2	4.4	4.2	4.2
Peru	6.0	5.8	2.4	3.1	4.6
Uruguay	3.3	5.1	3.5	2.6	3.0
Mercosur	1.7	2.5	-0.5	-1.0	1.3
Pacific Alliance	4.2	3.0	2.6	2.7	3.2
Latam	2.8	2.7	0.8	0.6	2.1