

Latin America: Subdued growth in 2015-16

Juan Ruiz

BBVA Research | Chief Economist for South America

Key messages

- 1 The world economy continues to grow but more weakly, especially in the emerging countries.** Growth forecasts for China and the US are adjusted downwards, while the Fed is preparing for an imminent raise in interest rates, probably in September.
- 2 LatAm growth is revised down, to 0.2% in 2015 and 1.1% in 2016, below the region's potential (2.7%).** Confidence indicators remain weak, weighing on consumption and, above all, private investment. The stronger growth in 2016 will come from the public investment in the Andeans and increasing global growth.
- 3 Inflation surprised on the upside and remains above central banks' targets.** Surprises were partly due to the depreciation of exchange rates, although the degree of pass through has not increased. In addition, idiosyncratic shocks have also played an important role to push inflation up in the region. However, inflation will converge to central banks' goals in 2015-16.
- 4 Monetary policy dilemmas in South America are increasing, while Mexico's synchronisation with the Fed will continue.** We expect a tighter interest rate path in Brazil than three months ago, in order to regain credibility. Meanwhile, we expect Chilean interest rates to be cut by the end of 2015 and to remain stable in Peru and Colombia for the remainder of 2015 and 2016.

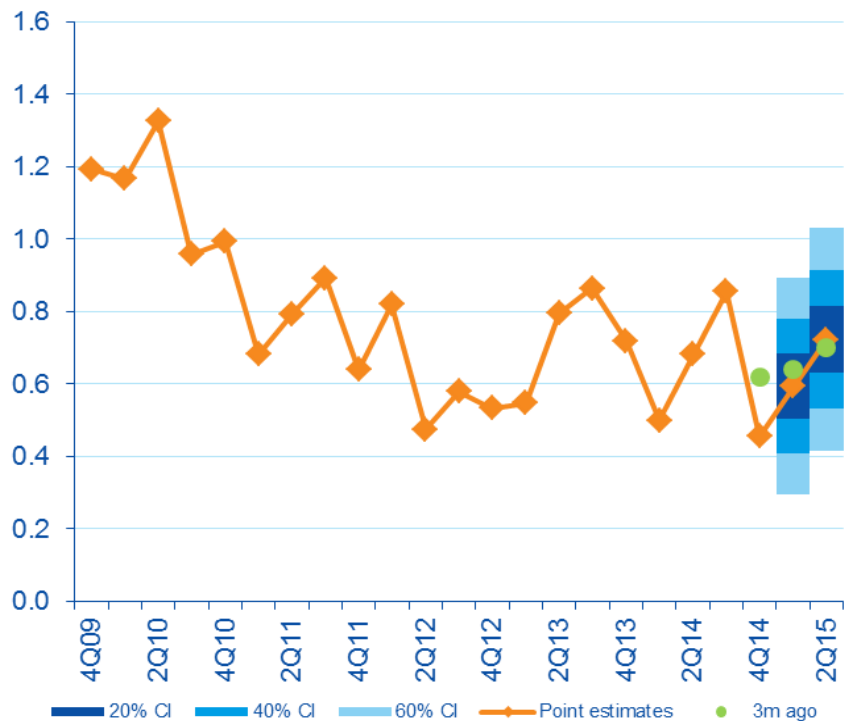
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- 1 Softer global recovery, with less dynamism in emerging economies
- 2 LatAm: subdued growth in 2015 and 2016

The improvement in global growth slows down: emerging economies slow even more

BBVA-GAIN indicator of global growth (% quarterly)

Source: BBVA Research



The global recovery slowed down in the first half of 2015 due to the temporary adjustment in the US and a lingering slowdown in China

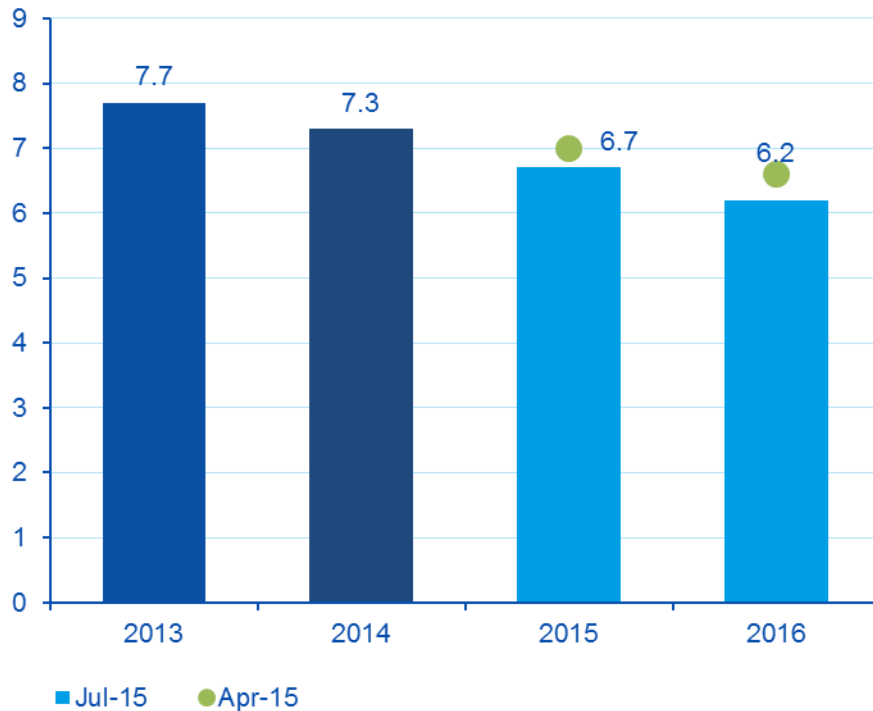
Emerging economies face a more uncertain outlook due to the imminent rate hike by the Fed and the adjustment of commodity prices

The balance of risks remains tilted to the downside: normalisation of the Fed's monetary policy; consequences of the Greek crisis and the slowdown in China

China: lower growth and higher risks with the bursting of the stock-market bubble

China: GDP growth (%)

Forecast 2015-16
Source: BBVA Research



The debt-intensive growth model is reaching its limits

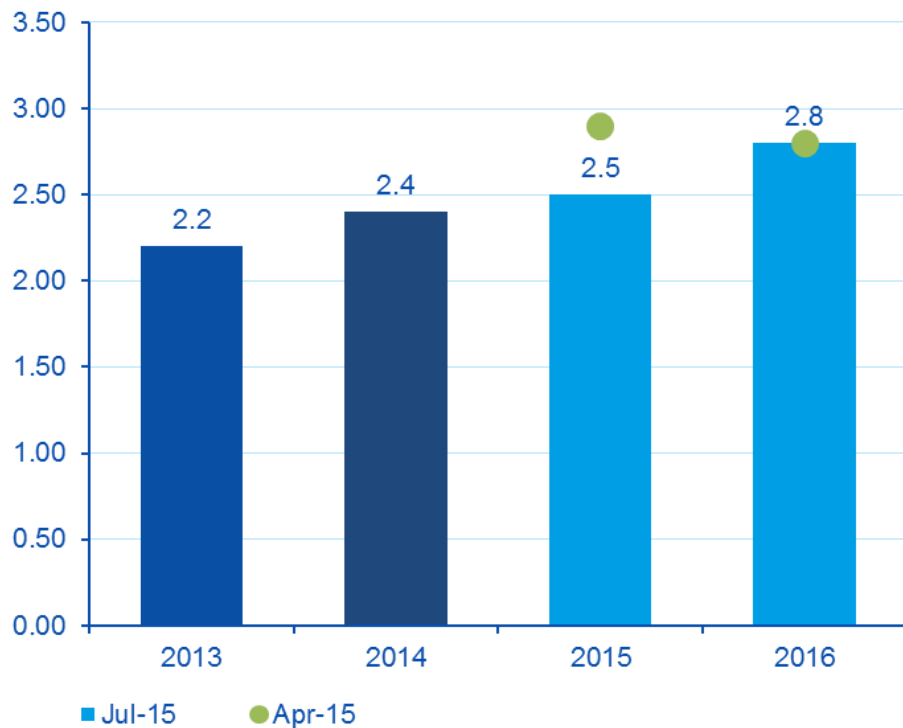
The stock market shock is unlikely to have a big impact on Chinese wealth, although financing conditions will be tighter and business confidence is likely to deteriorate

All in all, we revise down our growth forecasts in 2015 and 2016, to 6.7% and 6.2%

US: improving outlook in the second half of 2015

US: GDP growth (%)

Source: BBVA Research and Haver



Strong recovery, but data revisions can be significant; Inflation remains low

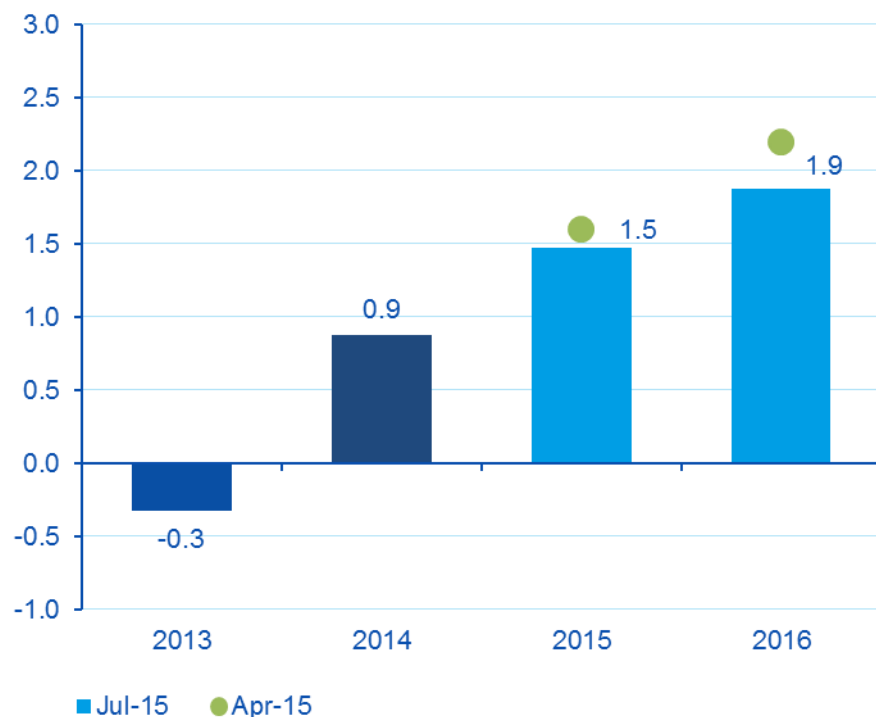
Labour market strengthens. Equilibrium unemployment rate is not far from current levels

Fed's liftoff of interest rates nears (probably in September)

Eurozone: resilience of domestic demand in a less favorable external environment

Eurozone: GDP growth (%)

Source: BBVA Research and Haver



Weaker external demand (in spite of the recent appreciation of the euro) weighs on growth, despite the positive effect of lower oil prices

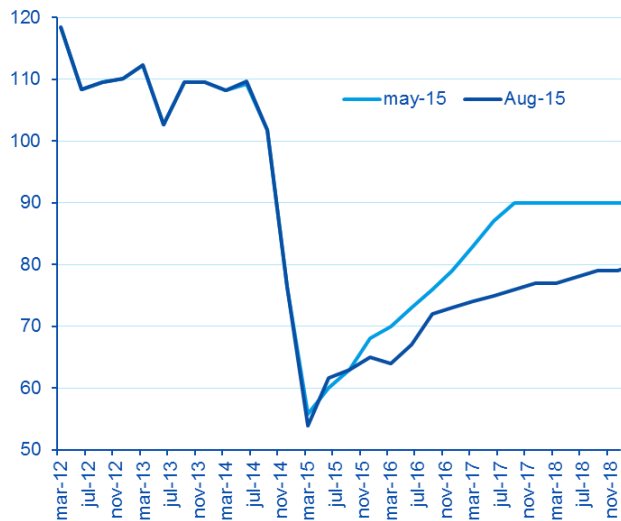
Household consumption grows, underpinned by disposable income

The risk of deflation recedes, but inflation will continue below the ECB's target on the forecasting horizon, supporting monetary stimulus

Revision to oil and copper price forecasts driven mainly by supply shocks, and also by China

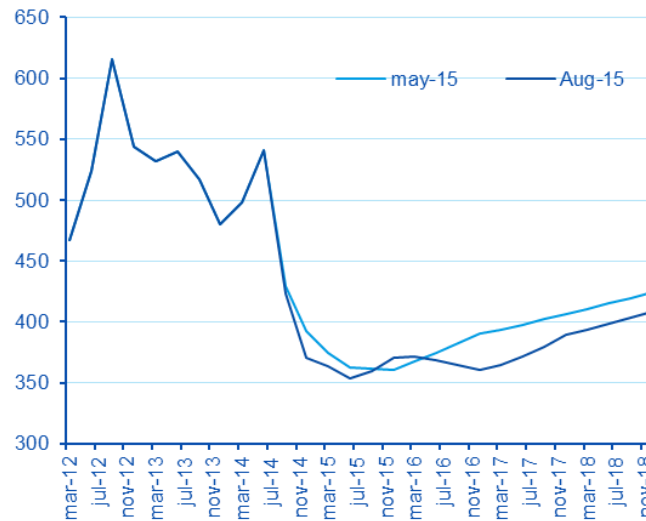
Brent: (USD/b)

Source: BBVA Research and Bloomberg



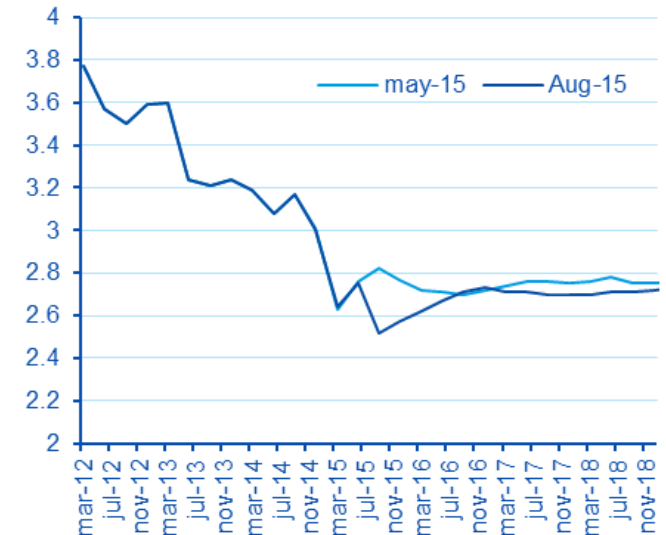
Soybean: (USD/ton)

Source: BBVA Research and Bloomberg



Copper: (USD/lb)

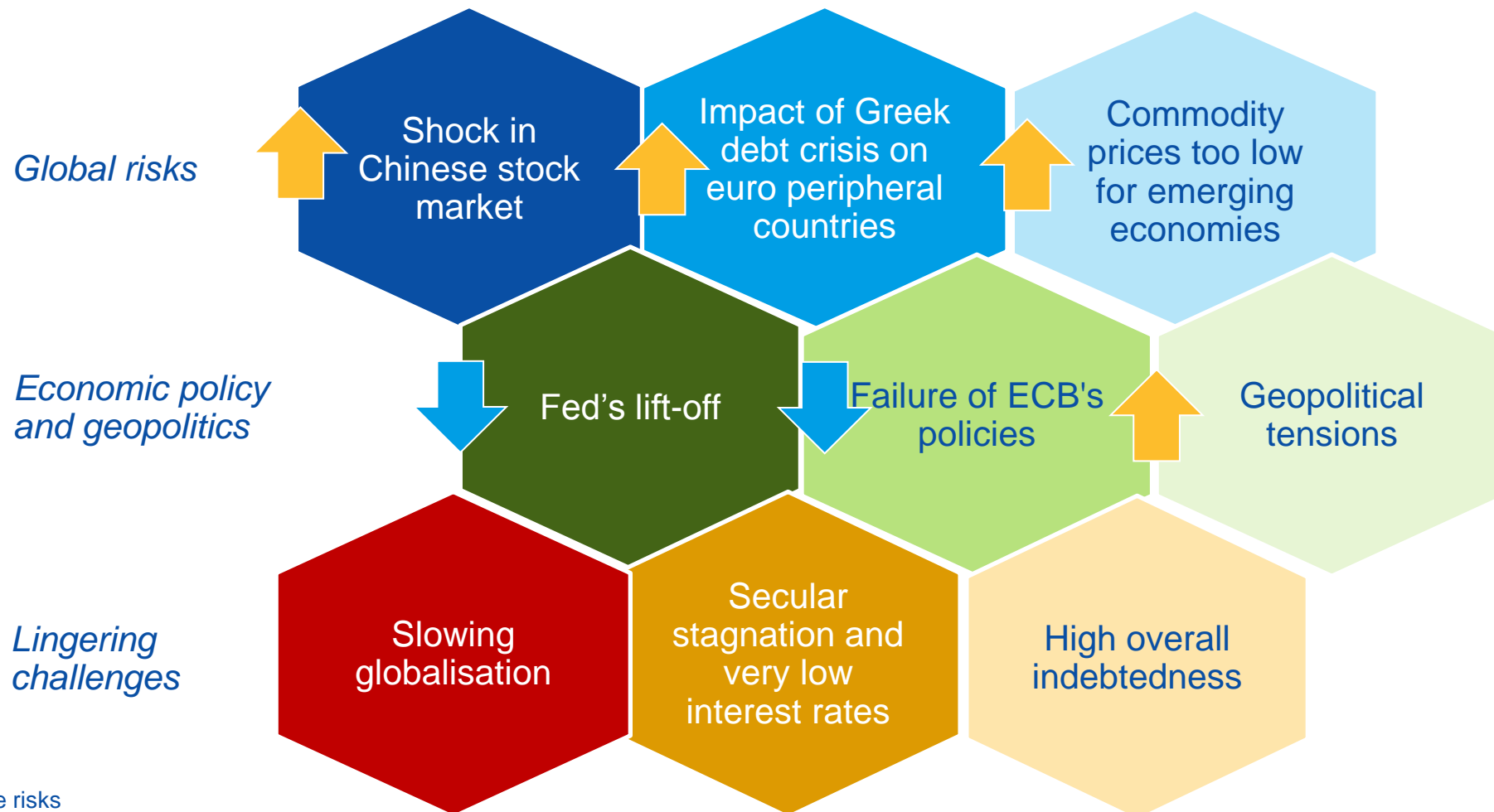
Source: BBVA Research and Bloomberg





Fall in oil prices was driven by an increase in current and expected supply ...

... as well as by slower growth in China, which also hit copper prices

Global risks



 Upside risks
 Downside risks

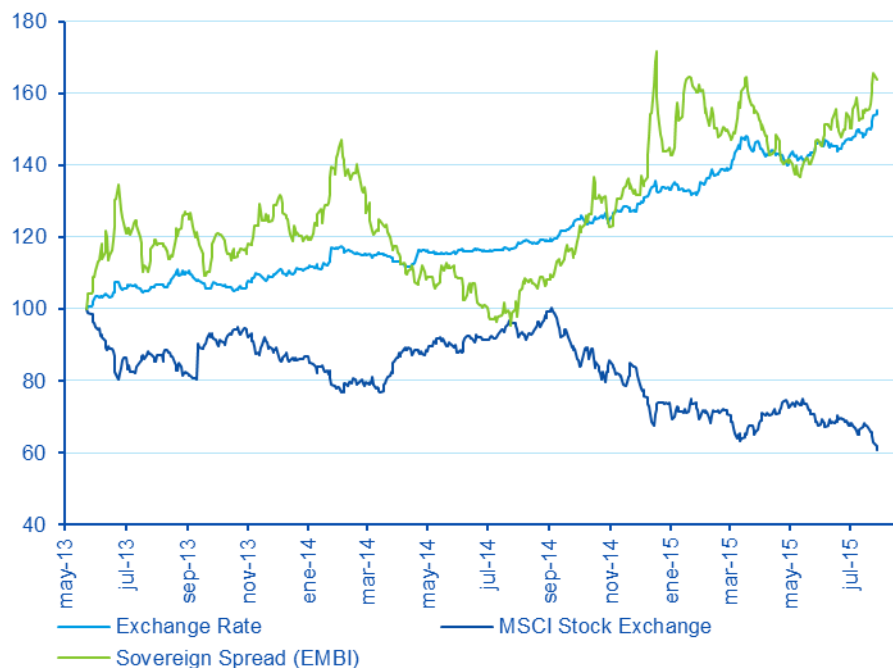
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The Fed, China and a weak cycle weighed down on Latin American markets

Asset prices in LatAm (Index May 2013=100)

Source: BBVA Research and Haver



The prices of LatAm's main financial assets and exchange rates continued to weaken between April and August...

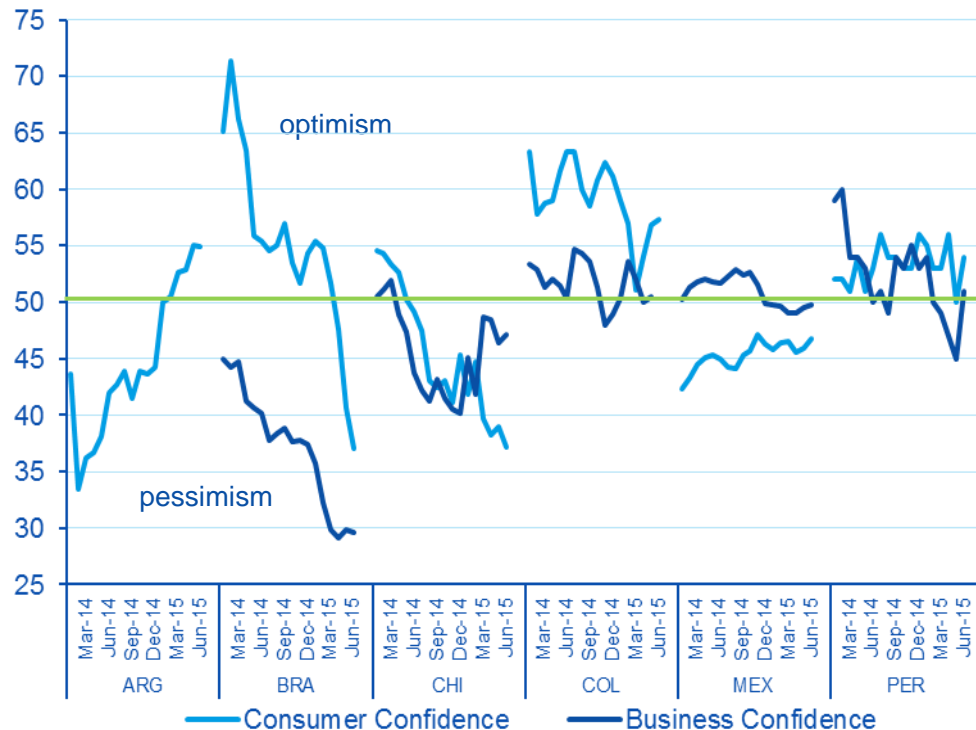
... weighed down by concerns about the Chinese economy, the adjustment of commodity prices and the approach of the first interest rate hike in the US...

... and, in the domestic front, a weak economic cycle.

Confidence indicators continued to weaken, dragging down domestic demand

LatAm: household and business confidence (values above 50 indicate optimism)

Source: BBVA Research and Haver



Subdued confidence indicators due to political noise in some countries and the uncertainty regarding economic policies ...

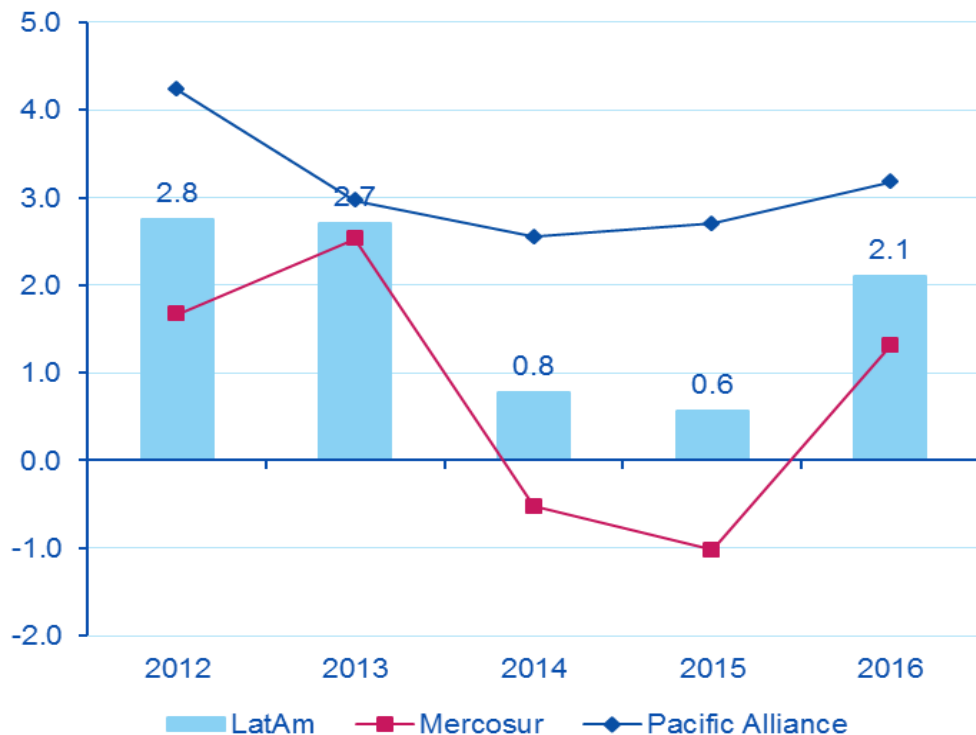
...in addition to a worse external environment ...

... have dragged down private investment and household consumption

We revise down our GDP growth forecast for Latin America, to 0.2% in 2015 and 1.1% in 2016

LatAm*: GDP growth (%YoY)

Source: BBVA Research



Weak private consumption and investment, dragged down by subdued households and business confidence

A less favourable external environment (China, commodity prices)

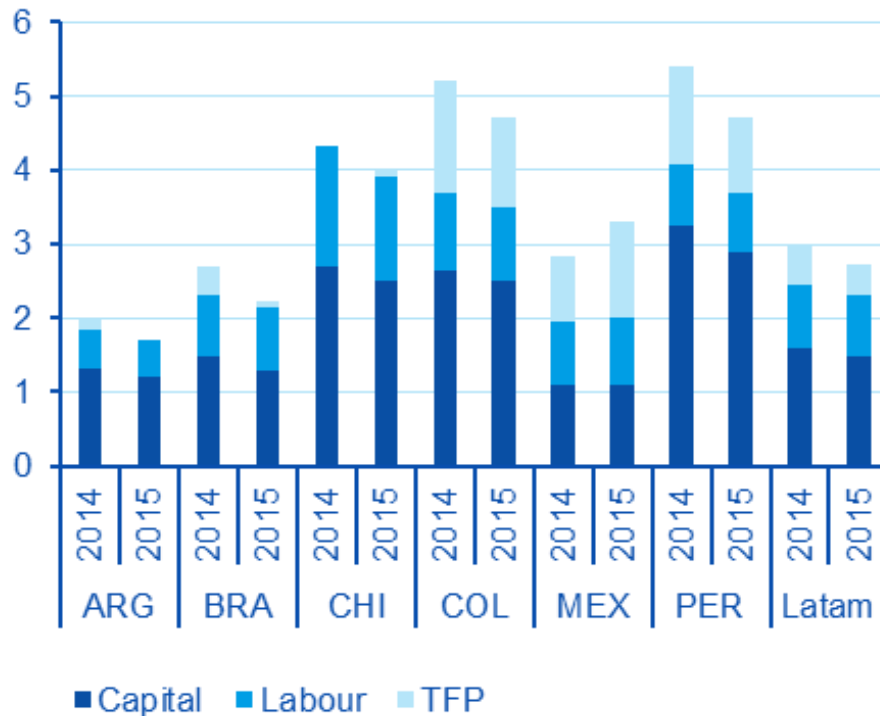
Rising growth in 2016 from:
 i) boost in global growth;
 ii) public investment in the Andeans, and
 iii) lower drag from macro adjustment in Brazil

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

[Box 1] Growth to converge with its potential, which we estimate at 2.7% for 2016-20

LatAm: 2016-20 potential growth
 (% , current estimate vs. Feb 2014 estimate)

Source: BBVA Research



Estimated LatAm potential growth (2.7%) has been adjusted from a year earlier (3%)

...due to the adjustment in South America as the external environment deteriorates...

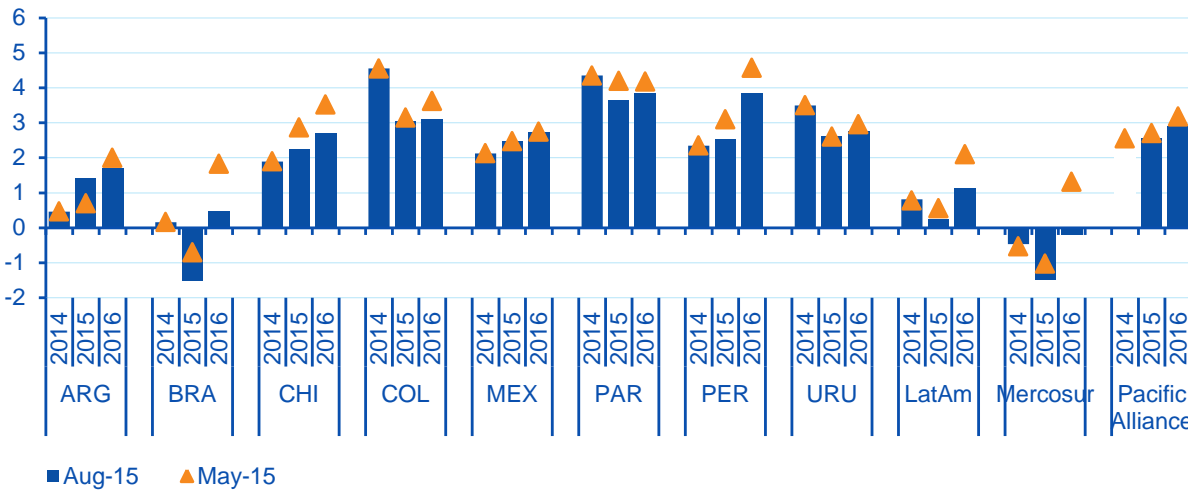
... which is not entirely offset by the increase in potential growth in Mexico

Second-generation reforms are needed to boost productivity and long-run growth

Generalised downward revision of growth forecasts, except Mexico

LatAm countries: GDP growth (%)

Source: BBVA Research



Growth forecasts are marked down in almost all countries, except Mexico

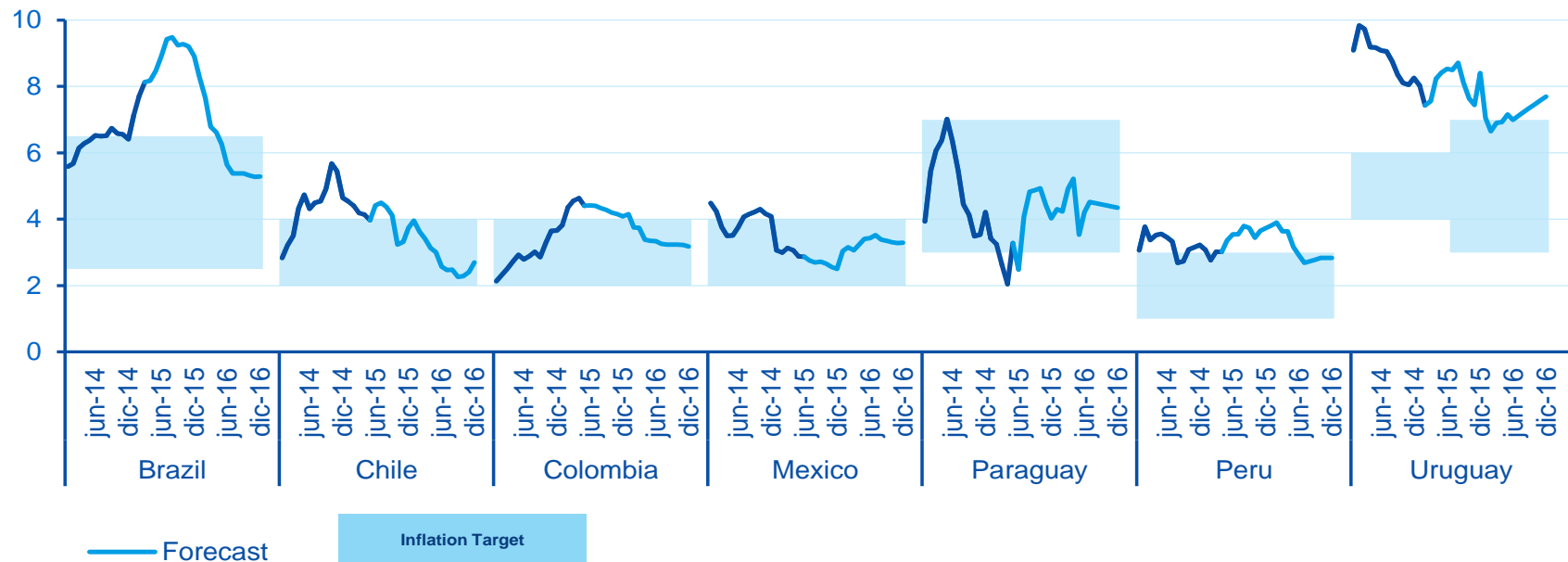
Pacific Alliance will grow 2.6% and 2.9% in 2015 and 2016. Still below its potential (3.8%)

Paraguay, Peru and Colombia will display highest growth in the region in 2015-16.

Inflation will converge to central banks' targets, but slower than anticipated

LatAm: inflation (% YoY) in inflation-targeting countries

Source: BBVA Research and Haver



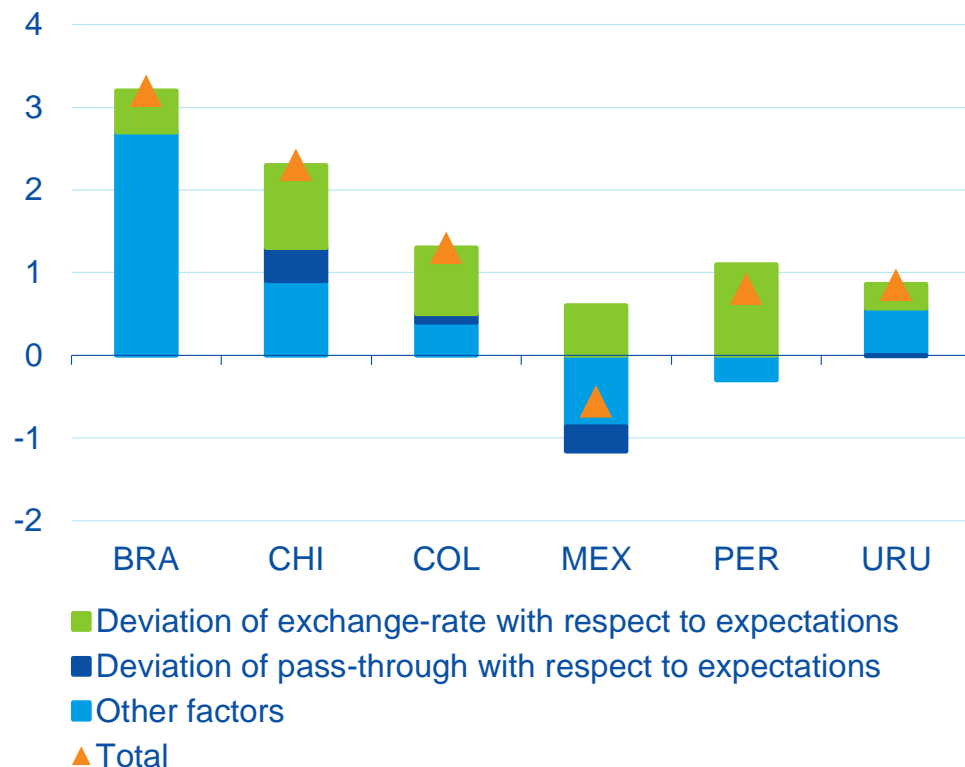
Inflation remains above central banks' targets ...

... except in Mexico and Paraguay

[Box 2] Depreciation has pushed inflation up, but degree of pass-through has not increased

LatAm: contribution to the difference between inflation in June 2015 and estimates 12 months ago

Source: BBVA Research



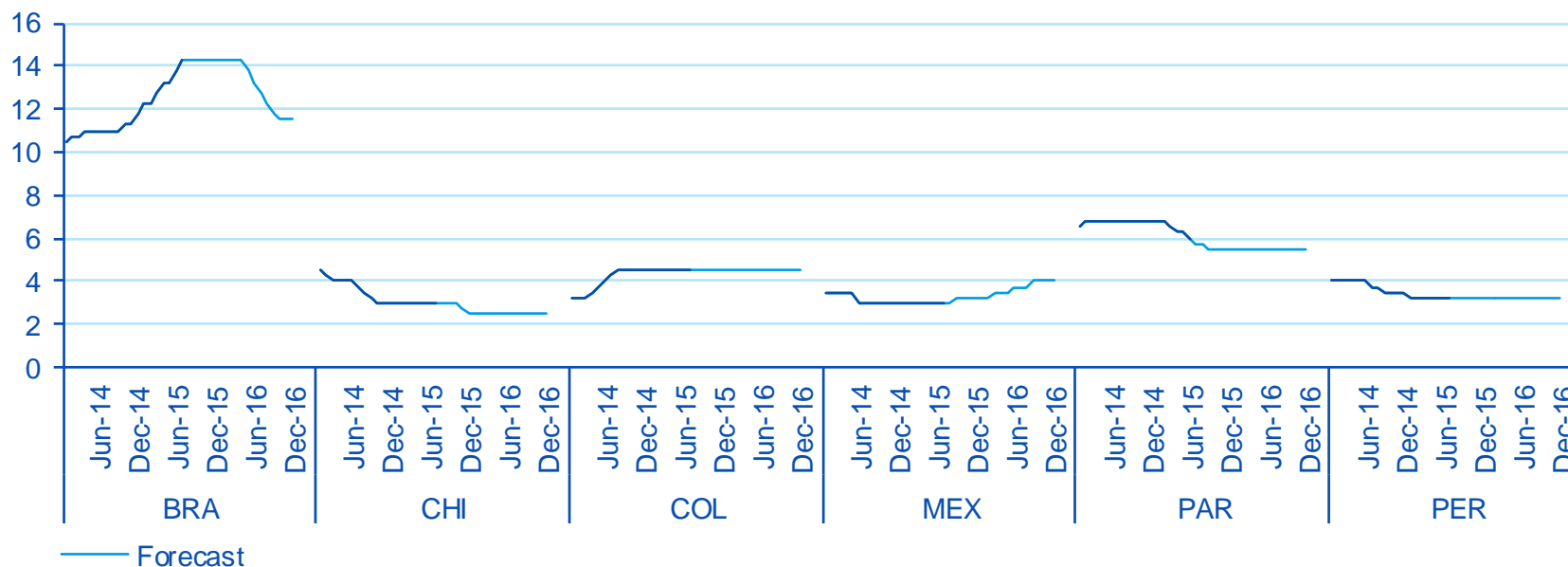
Inflation surprised to the upside due to strong FX depreciation, rather than an increase in the degree of pass-through from exchange rate to domestic prices

Also, idiosyncratic factors played an important role: taxes (Chile, Brazil), regulated prices (Brazil) and food price shocks (Peru, Colombia)

Monetary policy dilemmas in South America increase. Mexico still expected to synchronise with the Fed

Official interest rate in inflation targeting countries (%)

Source: BBVA Research and Haver



Brazil adopted a more restrictive path than expected three months ago, to regain credibility

Chile is expected to implement an easier interest rate path than expected three months ago.
No change in Peru and Colombia

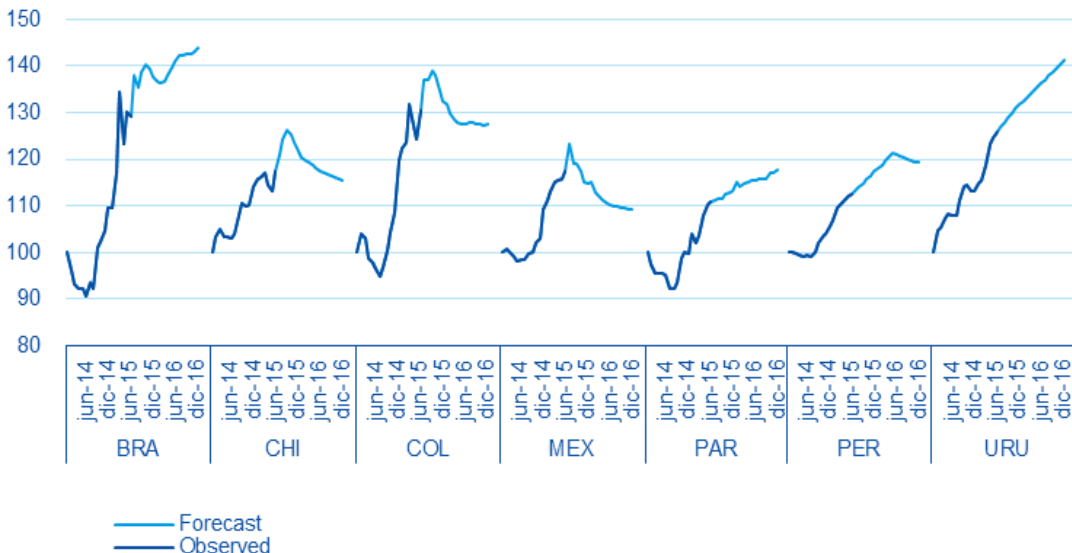
Depreciation fostered by decoupling from the Fed, and a less favourable external environment



depreciation vis-à-vis US dollar

Exchange rate against the US dollar in inflation-targeting countries (index Dec 2014 = 100)

Source: BBVA Research and Haver



Recent depreciation due to a weaker cycle, lower commodity prices and doubts about growth in China.

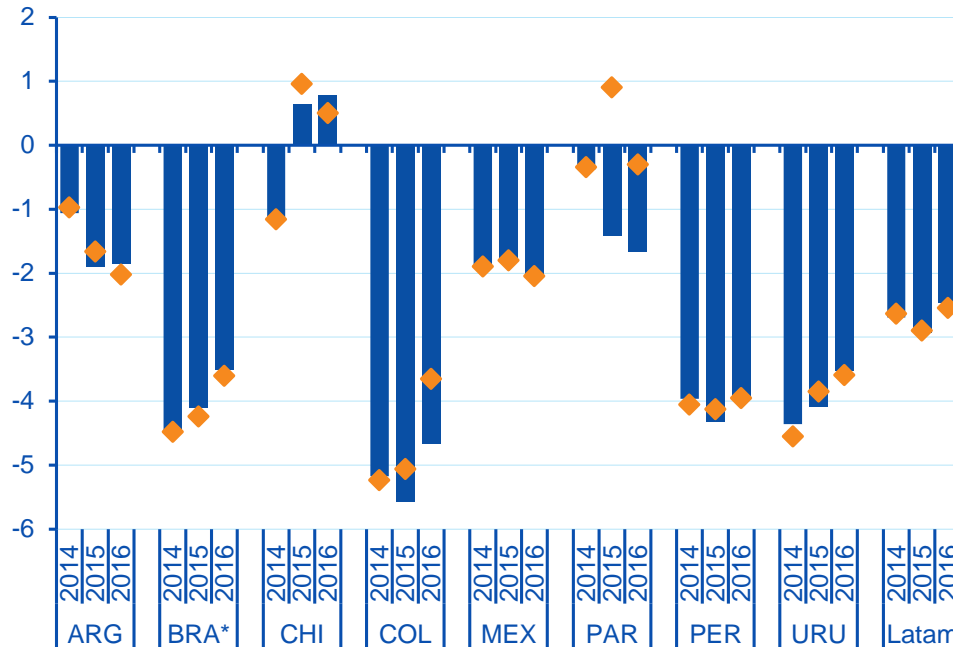
Markets will continue to focus on the Fed's lift-off of interest rates.

In Mexico, Colombia and Chile, some appreciation may take place from the end of 2015, driven by a slight increase in growth and also in oil and copper prices.

Lower commodity prices will help maintain sizable external deficits

LatAm: Current account deficit (%GDP)

Source: BBVA Research and Haver



■ Aug-15 ◆ May-15

Current account deficits throughout the region, except in Chile.

Somewhat lower deficits in 2016 due to FX depreciation, weak domestic demand and a slight recovery in the terms of trade.

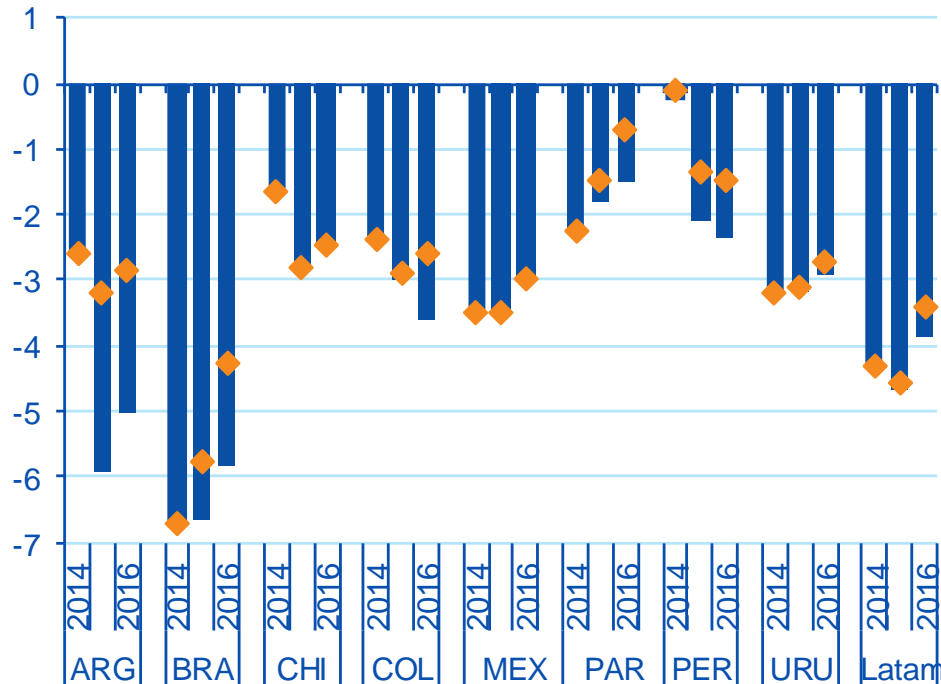
Foreign Direct Investment loses weight as a source of external funding, but external vulnerability remains subdued in the region.

*Change of methodology by the BCB. New and old forecasts not comparable

Fiscal outlook worsens in most countries, particularly in Brazil and Argentina

LatAm: fiscal deficit (%GDP)

Source: BBVA Research and Haver



■ Aug-15 ◆ May-15

Negative impact of the slowdown in domestic demand on tax collection, coupled with an acceleration of spending in some cases.

The main fiscal deterioration occurs in Argentina (greater increase in spending) and Brazil (difficulties in achieving primary surplus targets).

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Annex: LatAm GDP growth forecasts

GDP (% YoY)	2012	2013	2014	2015*	2016*
Argentina	0.8	2.9	0.5	1.4	1.7
Brazil	1.8	2.7	0.2	-1.5	0.5
Chile	5.5	4.2	1.9	2.2	2.7
Colombia	4.0	4.9	4.6	3.1	3.1
Mexico	3.9	1.5	2.1	2.5	2.7
Paraguay	-1.2	14.2	4.4	3.6	3.9
Peru	6.0	5.8	2.4	2.5	3.8
Uruguay	3.3	5.1	3.5	2.6	2.8
Mercosur	1.7	2.5	-0.5	-1.5	-0.2
Pacific Alliance	4.3	2.9	0.4	2.6	2.9
LatAm	2.8	2.7	0.8	0.2	1.1