

# What now for Latam

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London - January 18th, 2016



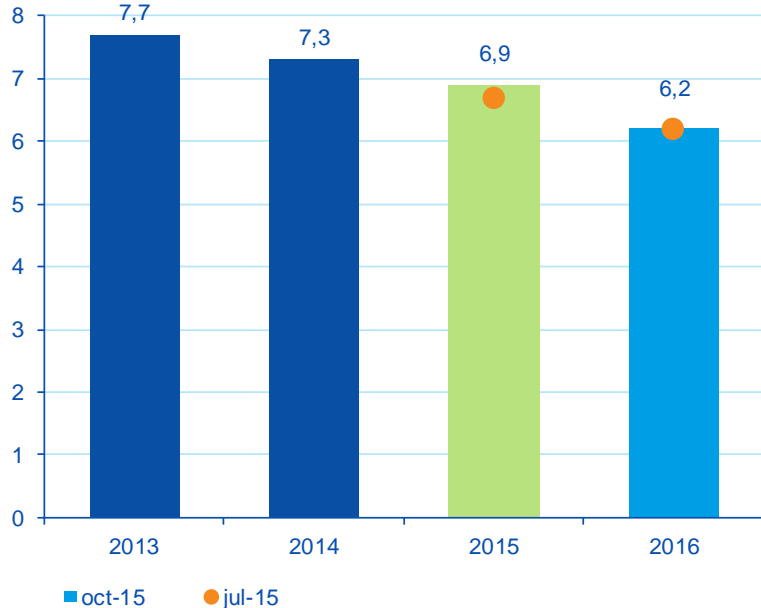
# Outline

1. **Latam: outlook and vulnerabilities**
2. Policy options
3. Brazil: a quick overview

# A new environment for Latam (I): Deceleration towards 6% and rebalancing in China

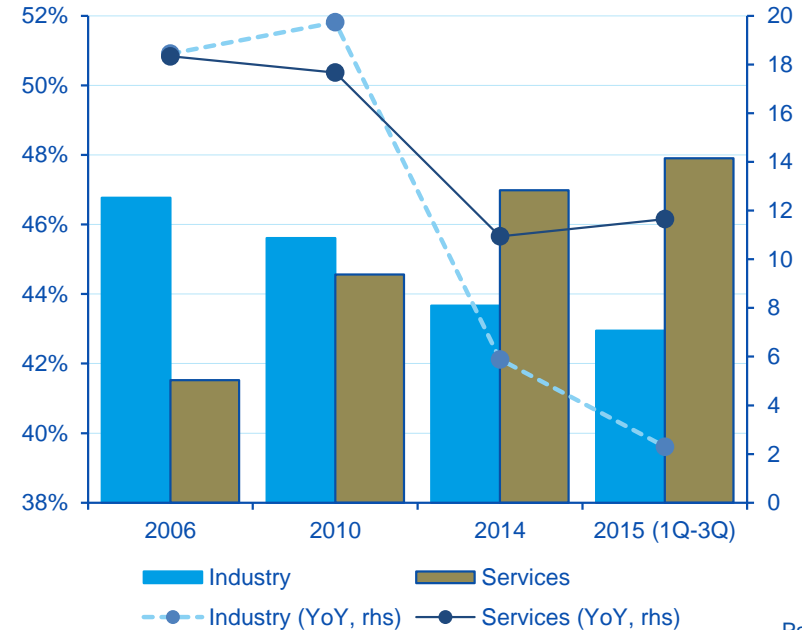
**China: GDP growth (%)**

Source: BBVA Research



**China: GDP by sector (growth rate and % of GDP)**

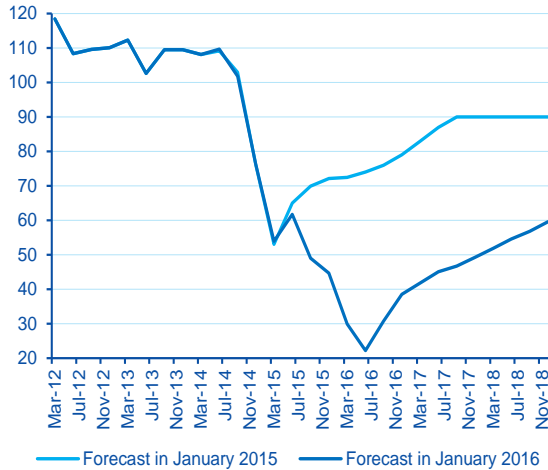
Source: BBVA Research



# A new environment for Latam (II): Lower commodity prices are here to stay

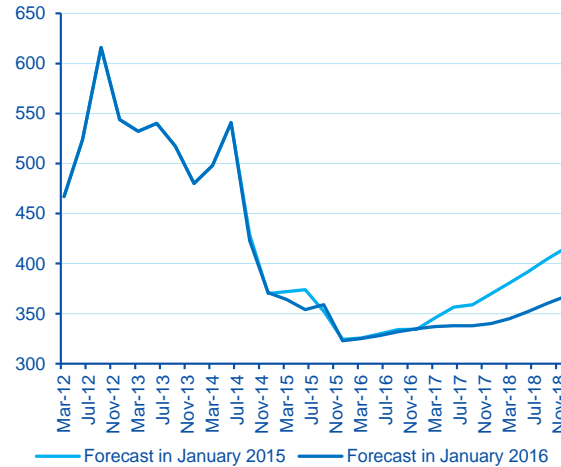
## Brent oil: (USD/b)

Source: BBVA Research and Bloomberg



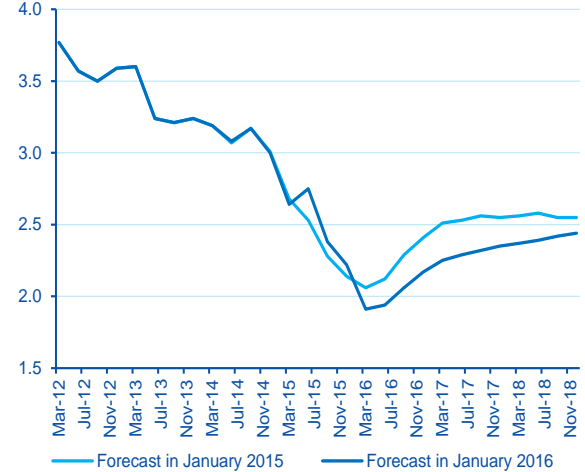
## Soybeans: (USD/tm)

Source: BBVA Research and Bloomberg



## Copper: (USD/lb)

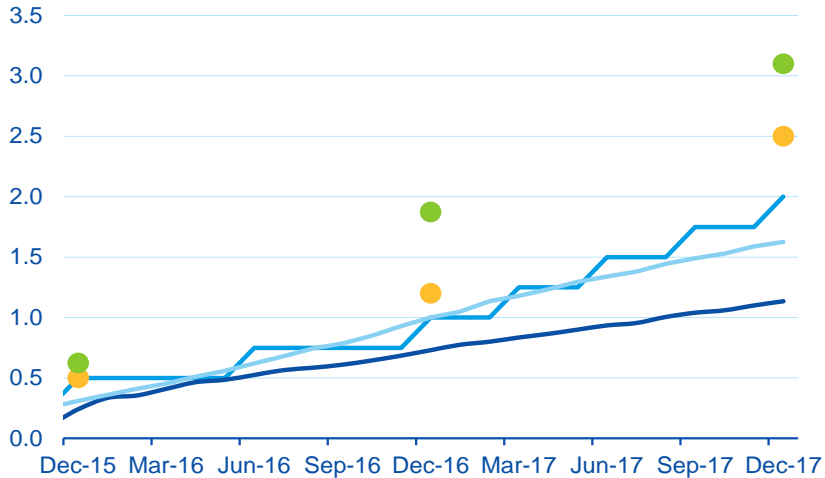
Source: BBVA Research and Bloomberg



# A new environment for Latam (III): Less favorable financial conditions

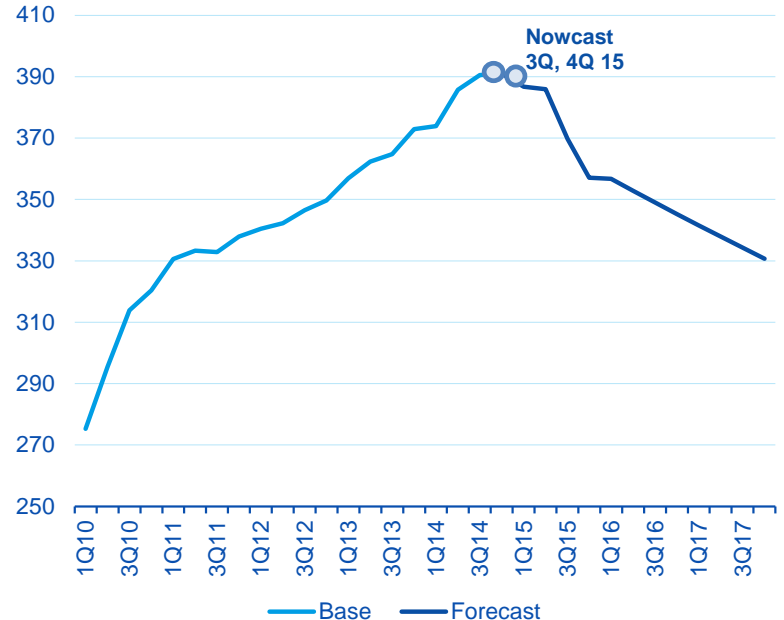
## Fed funds rate: expected tightening paths

Source: Bloomberg and BBVA Research



## Capital flows to Latam

Source: BBVA Research based on Balance of Payments data

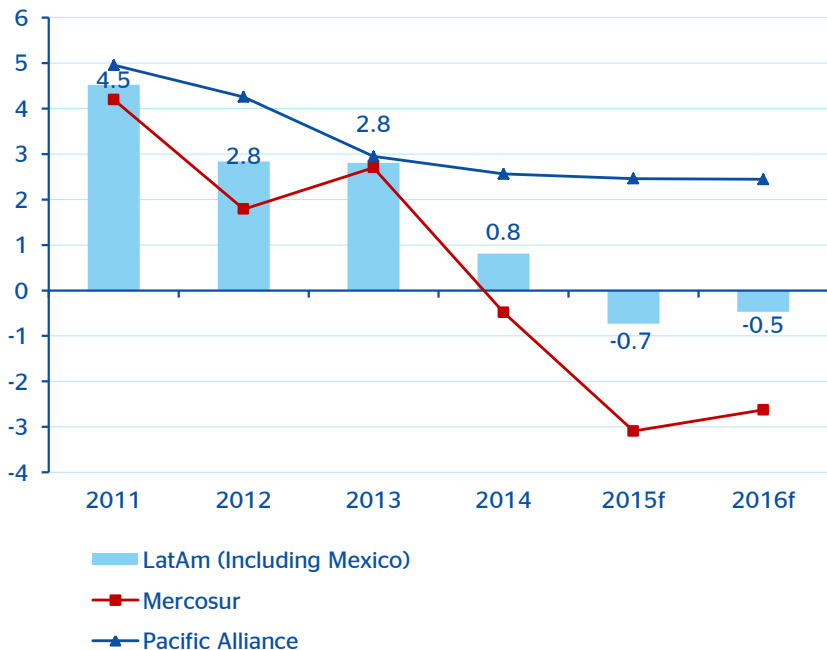


# How vulnerable is Latam? (I)

## Growth has already been marked down, but still ...

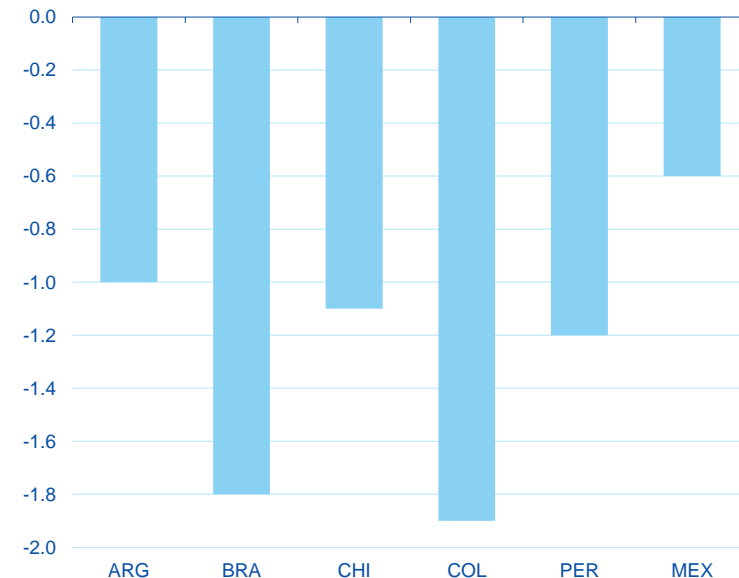
Latam: GDP growth

Source: BBVA Research



Impact on Latam growth of a permanent slowdown of Chinese growth to 4% (pp difference from baseline growth in 2016-17)

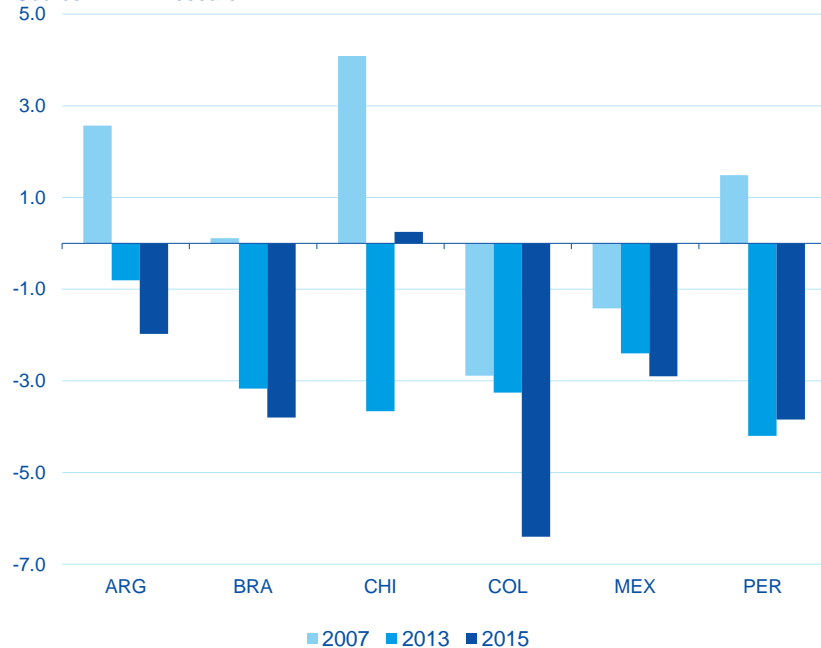
Source: BBVA Research



# How vulnerable is Latam? (II) External deficits widen and become more difficult to finance

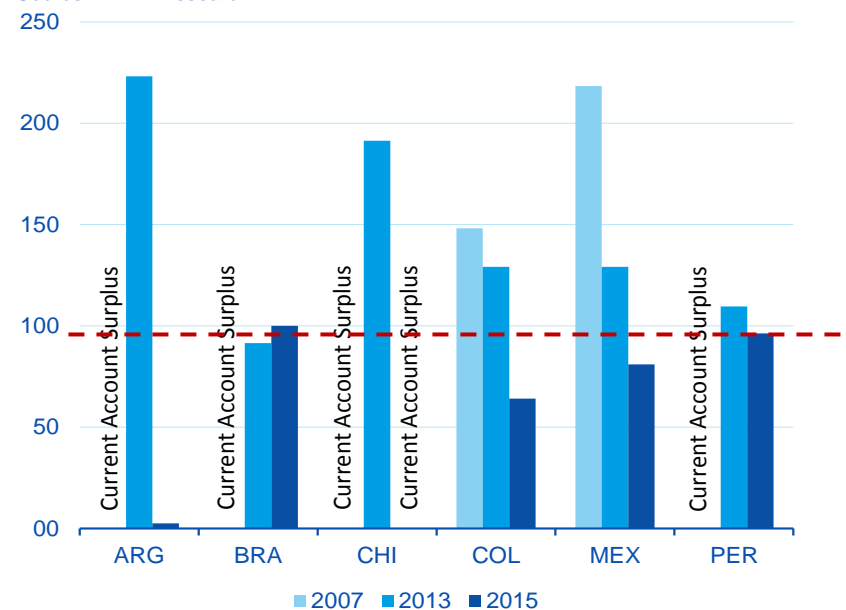
Latam: Current account balances (% GDP)

Source: BBVA Research



Latam: % of current account deficit financed by FDI\*

Source: BBVA Research

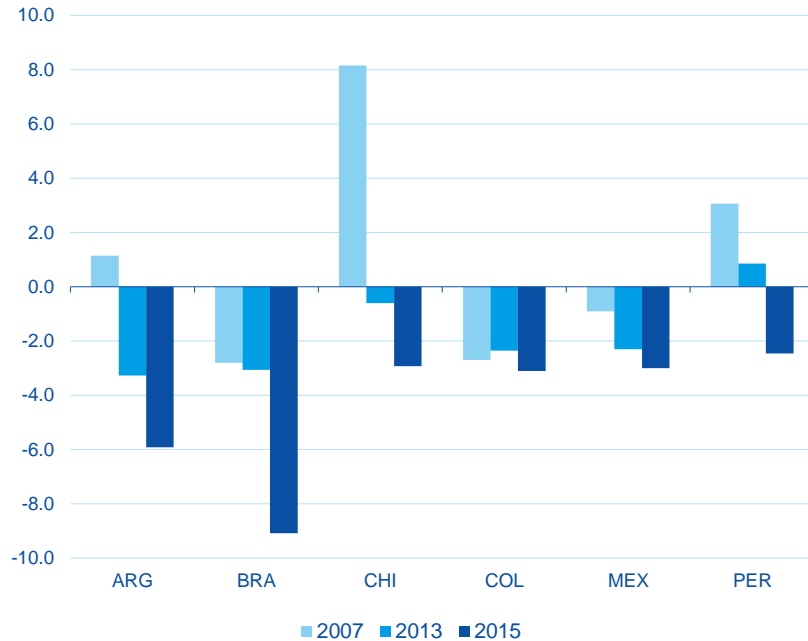


\*FDI to 2Q15

# How vulnerable is Latam? (III) Fiscal space exhausted in most countries

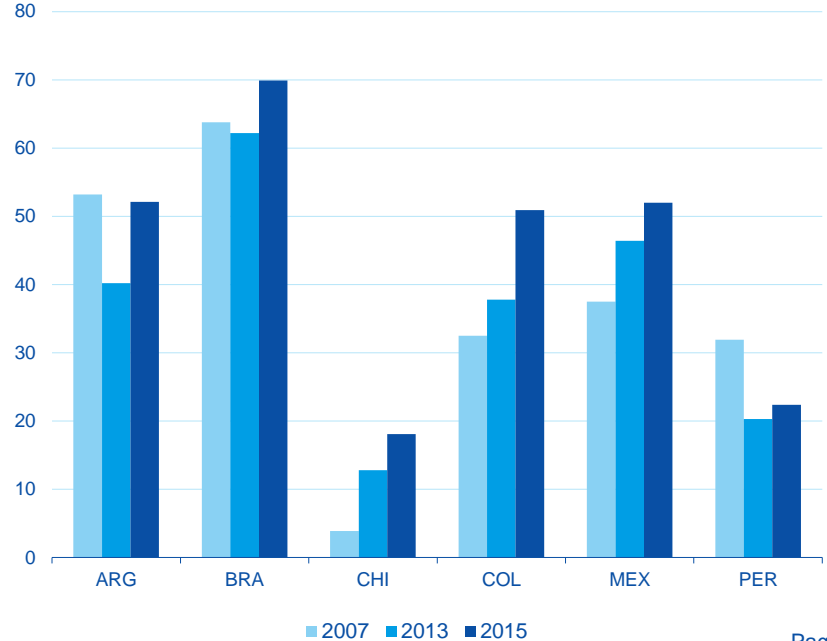
## Fiscal balance

Source: BBVA Research



## Gross Government Debt

Source: IMF, Fiscal Monitor

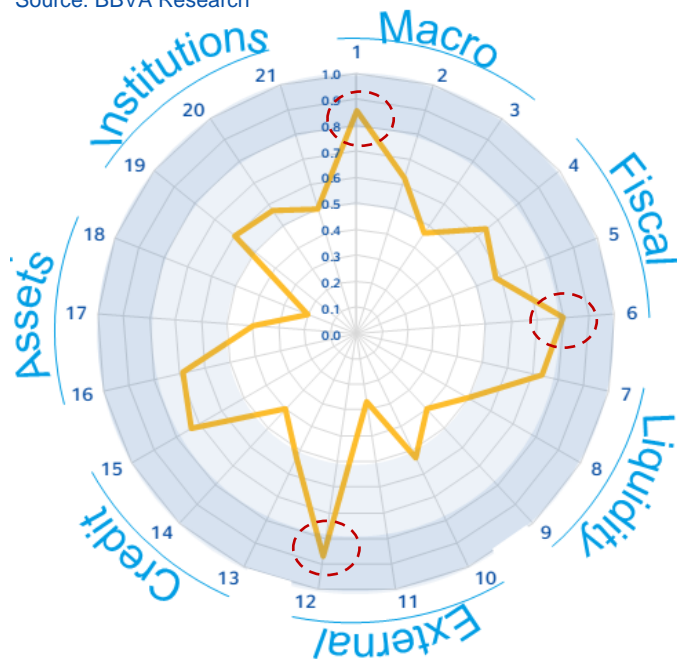




# How vulnerable is Latam? Macro vulnerabilities focused mainly on growth, fiscal and external sector

## Latam: Vulnerability radar\*

Source: BBVA Research



max risk=1  
min risk=0

### Definition of variables

Macro: (1) GDP (%yoy) (2) Prices (% yoy) (3) Unemployment (% LF). Fiscal: (4) Structural Balance (%) (5) Interest rate – GDP %yoy (6) Public Debt (% GDP). Liquidity: (7) Debt by Non Residents (%total) (8) Financial Needs (%GDP) (9) Financial Pressure. External: (10) External Debt (%GDP) (11) RER Appreciation (%yoy) (12) CAC Balance (% GDP). Credit: (13) Household (%yoy) (14) Corporate (%yoy) (15) Credit-to-Deposit (%). Assets: (16) Private Credit to GDP (%yoy) (17) Housing Prices (%yoy) (18) Equity (%). Institutional: (19) Political Stability (20) Corruption (21) Rule of Law

\*. Median of Latam countries.

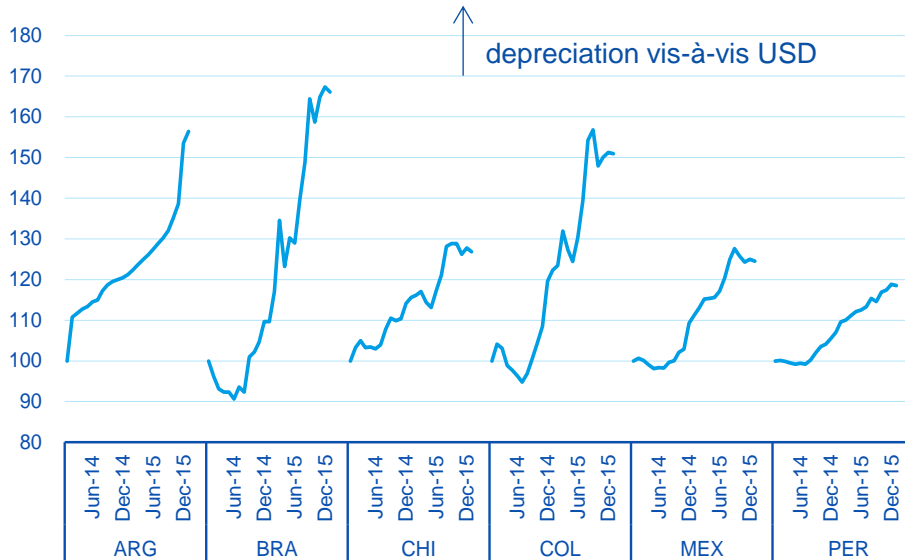
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# How is monetary policy going to react? Pass-through has been stable but depreciation has been strong...

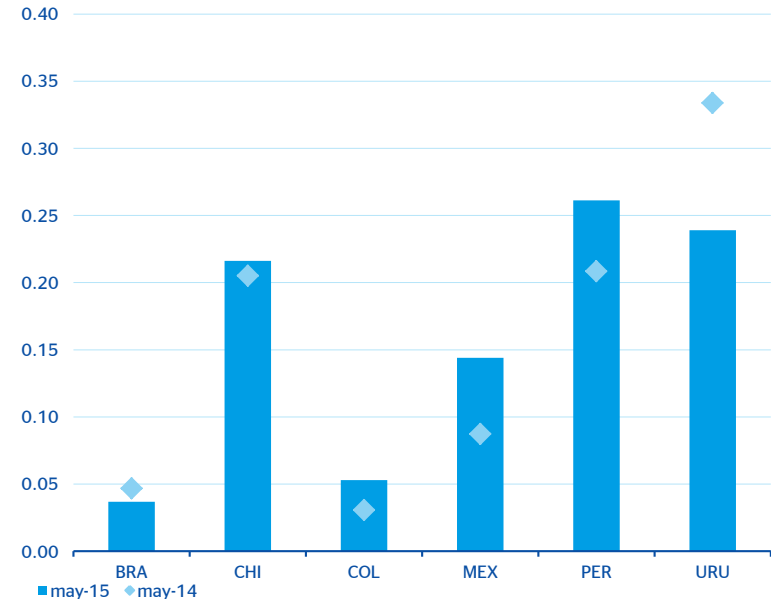
## Latam: Exchange rates (index Dec 2004=100)

Source: Bloomberg and BBVA Research



## Pass through to inflation from a 1% depreciation of the exchange rate to the USD

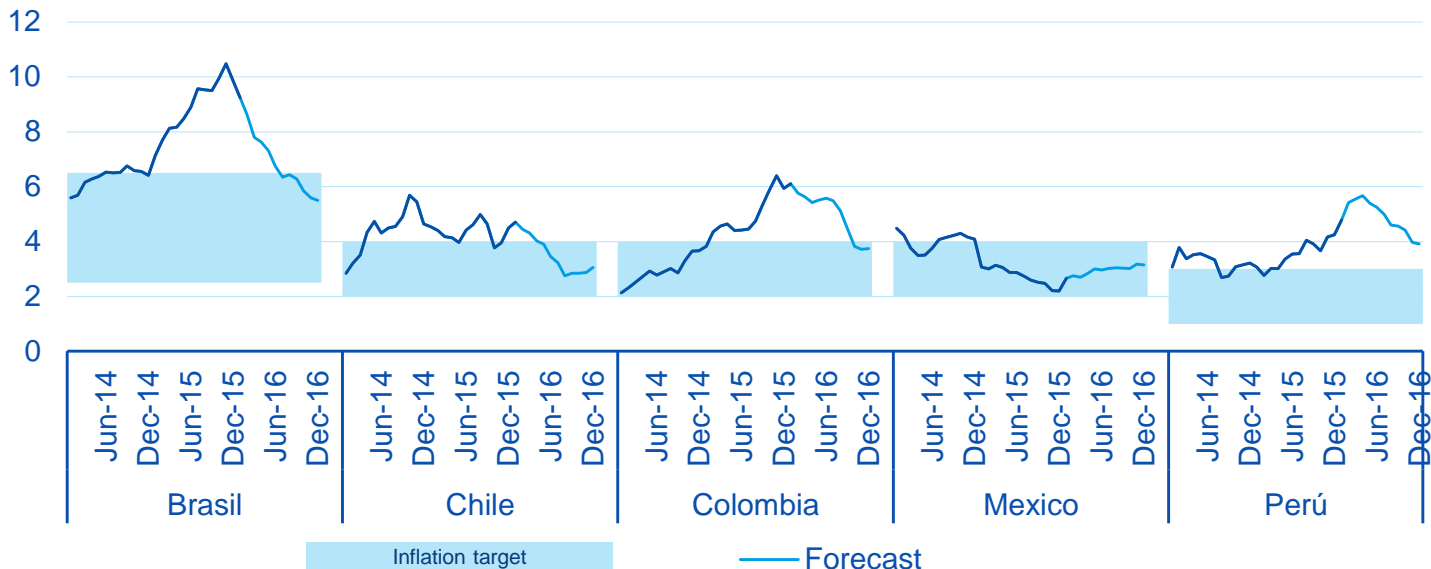
Source: BBVA Research



# ... leading to inflation above targets (bar Mexico), and policy tightening despite a weak cycle

Latam: Inflation (%yoy)

Source: IMF

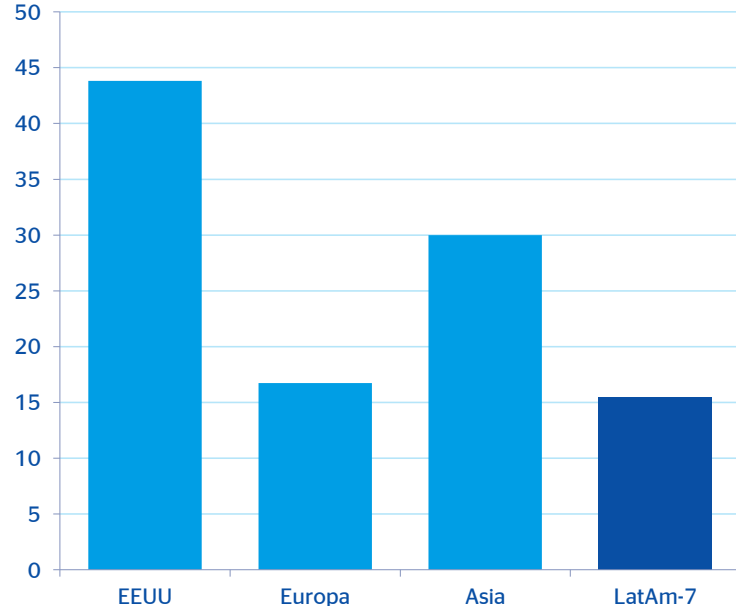


# A new growth model for Latam?

## Need to focus on productivity growth

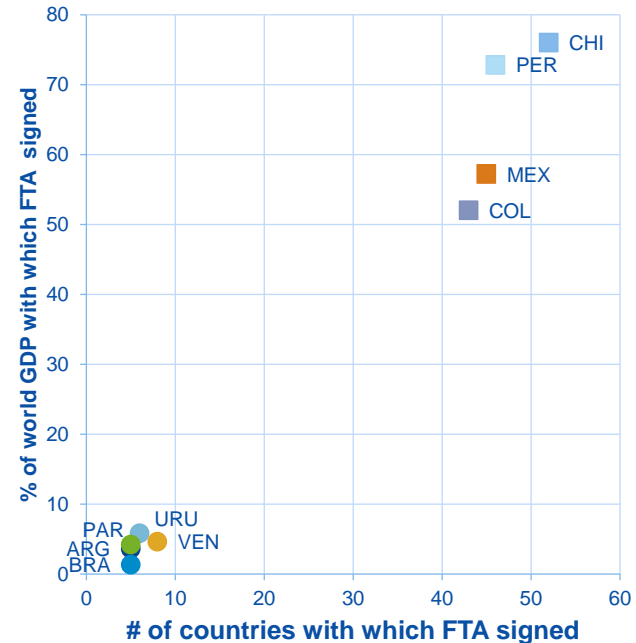
### Contribution of total factor productivity to growth in 2001-2010 (% of total)

Source: BBVA Research and IMF



### Trade integration (FTAs signed)

Source: Unctad and BBVA



# As we said last year: LatAm still controls its future ...but starting point is now more challenging



Still on time  
to implement Reforms 2.0

Reforms that enhance productivity:  
Physical capital,  
human capital,  
reduce informality

3%-4% growth may be ideal  
environment to push reforms  
(not too high, not too low)

... key to deal with risks

Short run:  
lower global liquidity

Medium run:  
Chinese slowdown

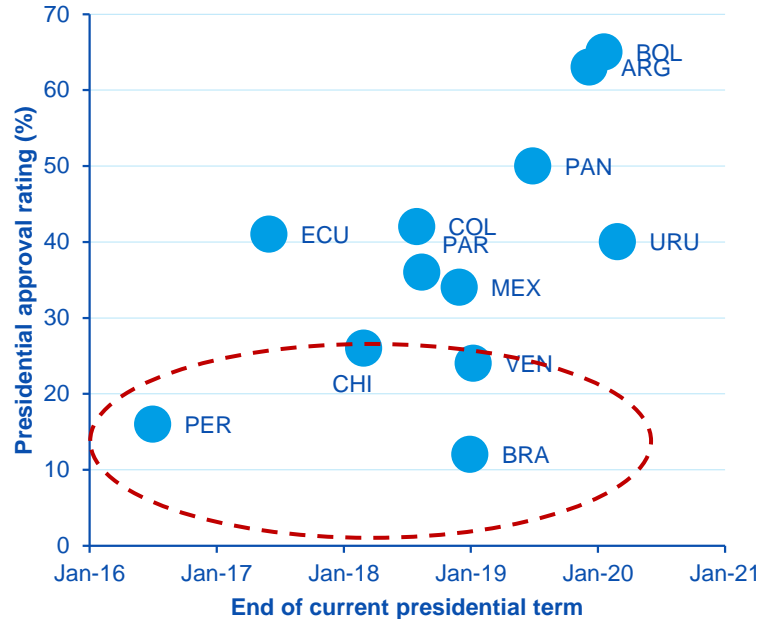
Medium run:  
Populism - *Caudillismo*

Long run:  
Inequality

# ...and the political political situation is not helping

## Latam: presidential approval rates and time until the end of the presidential term

Source: BBVA Research and polling agencies



# Outline

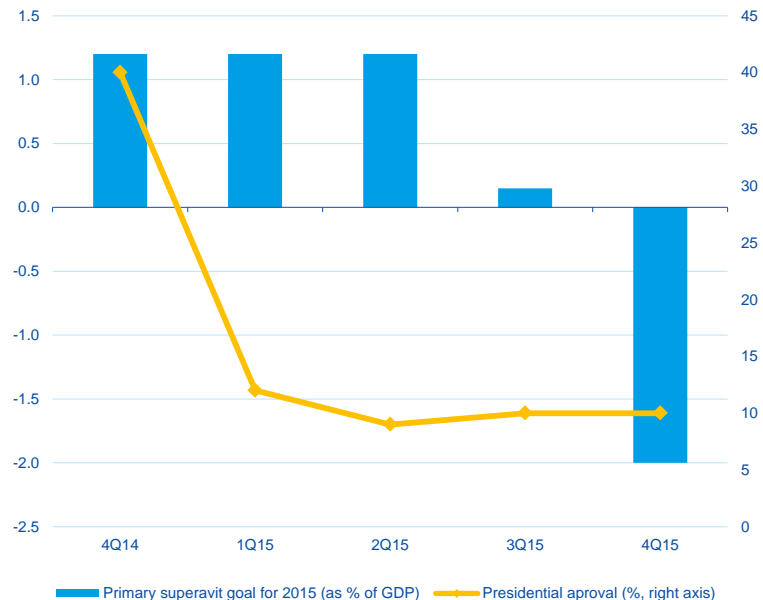
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# Brazil: what now?

**Brazil: Fiscal target (primary balance) for 2015 and presidential approval rate\***

Source: IPEADATA; CNI and Finance Minister



Political noise hinders approval of fiscal consolidation measures and other structural reforms

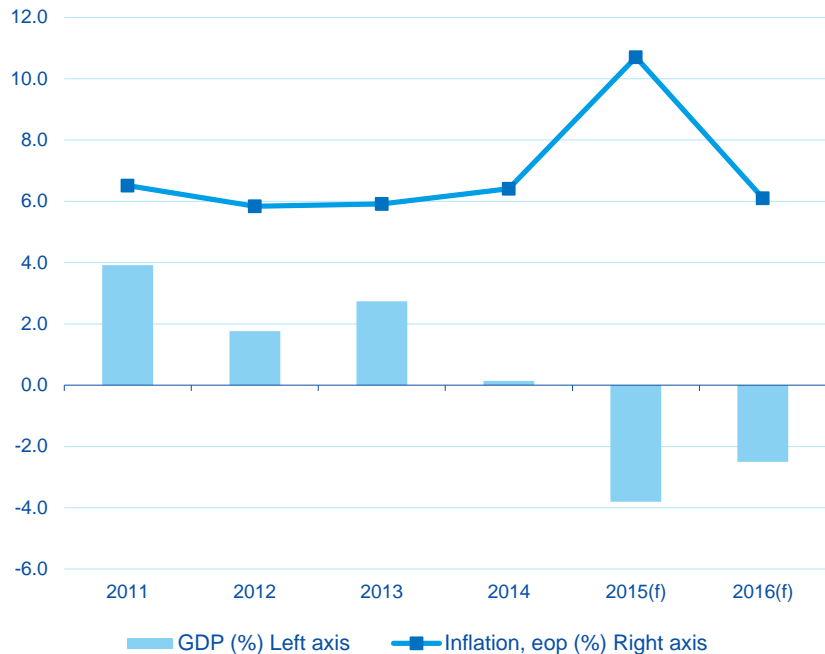
Baseline scenario: political impasse and inaction until 2018

Fiscal deficit (including interests) could reach close to 10% of GDP in 2015 and over 8.5% in 2016.  
Public debt: more than 70% GDP in 2016

# Brazil: political noise and fiscal woes will extend the recession and press on inflation

## Brazil: GDP and Inflation

Source: BBVA Research



Recession of close to 4% in 2015 would extend also to 2016

Lack of fiscal adjustment could press also on inflation and will continue to do it on the exchange rate

Resolving political impasse is crucial for a return to sustained growth

# A new Brazil?

Structural Reforms? Not before 2018

A more open Brazil?

Is this shock enough to change course or will it bring back heterodox policies?  
What's the trigger that will break political stalemate?

The stakes are high.  
For the region it is key in many ways

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Jorge Sicilia

London - January 18th, 2016

