

1st QUARTER
2016

Economic Outlook
Latin America

The global economy will continue to grow, but more slowly and with more risks. Uncertainty about China remains and recovery in advanced economies will be fragile. Risks around the baseline scenario were behind increased market volatility in January and February. In addition, oil and copper prices suffered significant corrections.

Deceleration of Latam GDP will continue in 2016. The region's GDP as a whole will shrink -0.9% in 2016, dragged by strong recession in Brazil. Recovery in 2017 (1.9%) will be driven by a stronger global growth, improved terms of trade and an increase in investment in places like Argentina, Peru or Colombia.

Inflation remains high (except Mexico and Paraguay). due to exchange-rate depreciation and food prices. These factors, together with rate hikes by the Fed, induce central banks in the region to tighten their monetary policy stance.

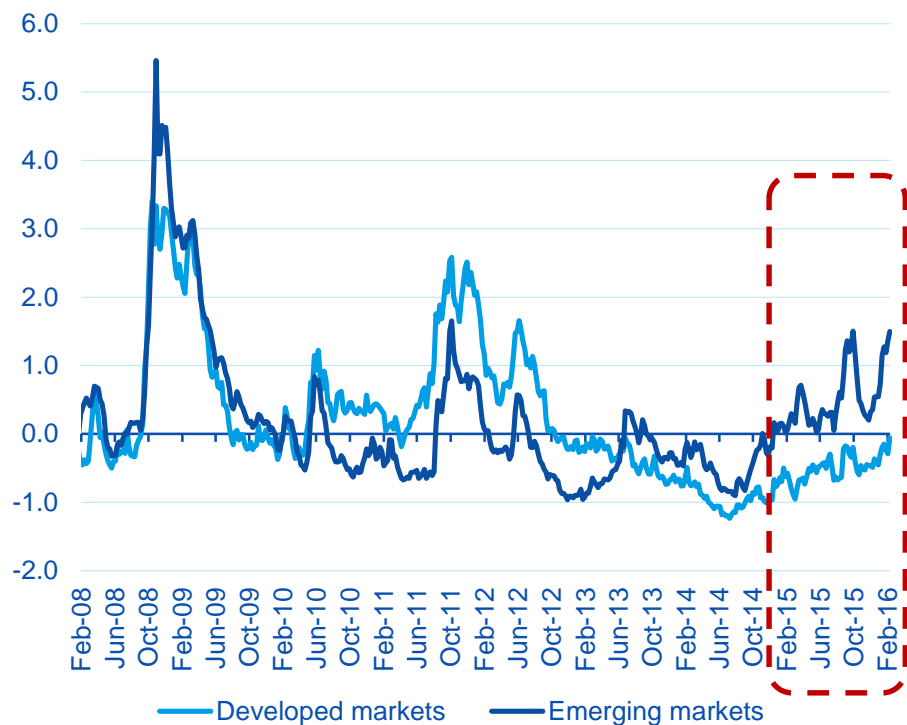
External deficits begin to shrink in many countries, but pressure on fiscal deficits increases. Exchange-rate depreciation and deceleration of domestic demand start to reduce external deficits, but they are still sizable in some countries. In contrast, deceleration of domestic demand has worsened the fiscal outlook in many countries in the region.

Global

Global economy will continue to grow.
but more slowly and with more risks

Financial stress increased significantly in emerging economies

BBVA Financial stress index



Financial stress increases again in the last quarter, especially in emerging economies

Capital flows rebalancing towards advanced economies

Market pressure on countries more dependent on external financing and commodity exporters

Source: BBVA Research

How to read recent market volatility?

Is it a delayed response to Fed's rate hike

Unlikely: Fed's liftoff was already priced in by markets. If anything, markets now expect a more gradual pace of rate hikes going forward.

Is global growth being revised down?

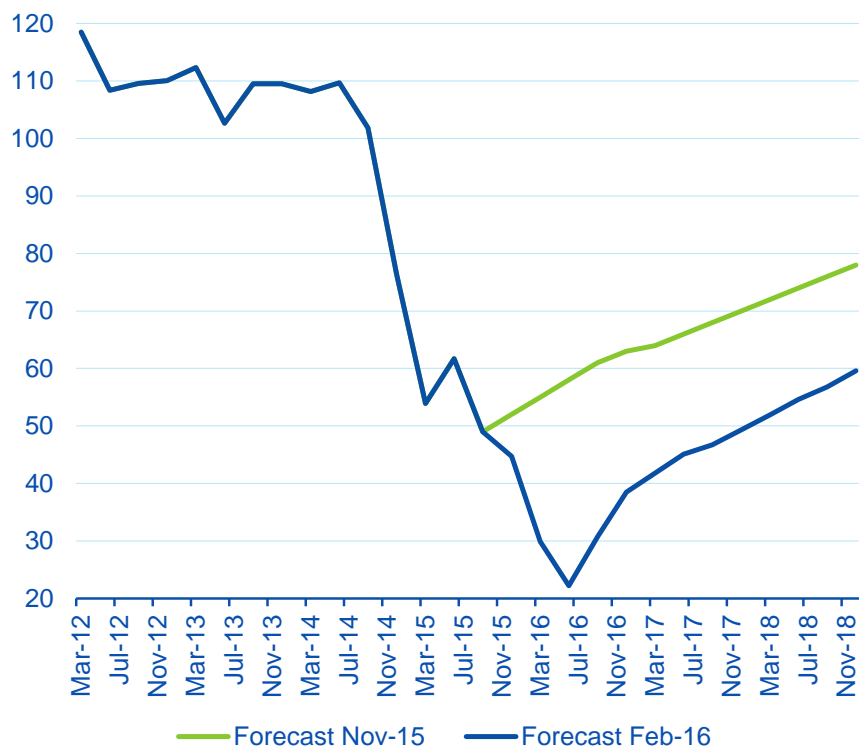
Unlikely: recent hard data do not show significant changes from expected path, except in a few emerging economies.

Is a risk scenario now more likely?

Probably: uncertainty about China (growth rebalancing and exchange rate policy) and fall in oil price could have second-round effects (vulnerability of oil companies and oil-exporting countries)

Oil prices have adjusted driven by supply and demand factors (Box 1)

Brent oil: (USD/b)



Source: BBVA Research and Bloomberg

Prices fell recently on:

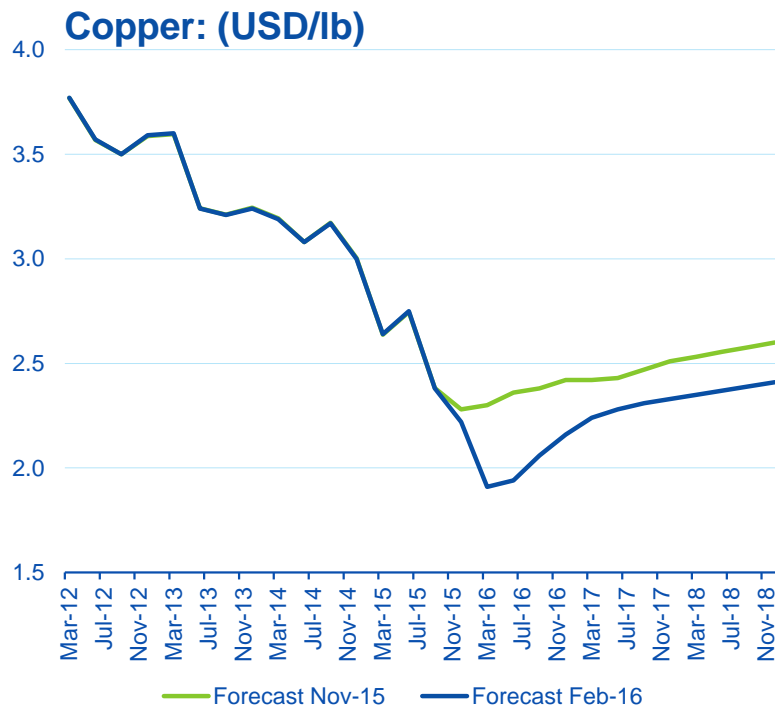
1. Lower demand (weather)
2. Resilient supply (US shale. OPEC reluctance to cut production quotas)
Uncertainty about future demand (China) and future OPEC behavior

Prices may adjust even further in 1H16 (OPEC. Iran. resilient USshale) and doubts about Chinese growth

Gradual rebound in 2H16 as non-OPEC supply falls (lower investment. lower financing)

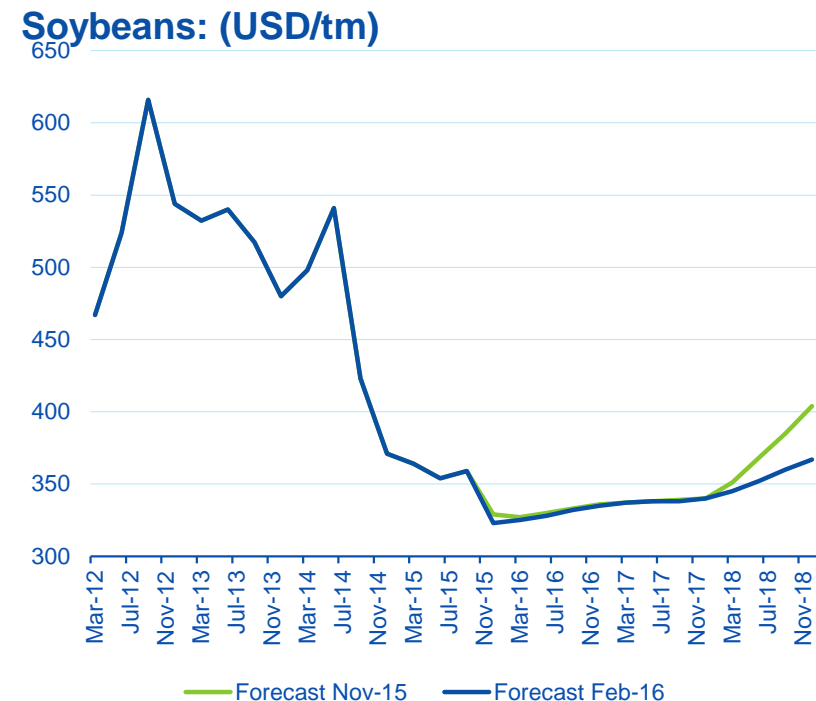
Convergence to 60 USD/b as oil oversupply is reduced

Other commodities linked to the cycle have been affected. but not as strongly



Source: BBVA Research and Bloomberg

Copper prices dragged by concerns about global growth and the derivatives market...

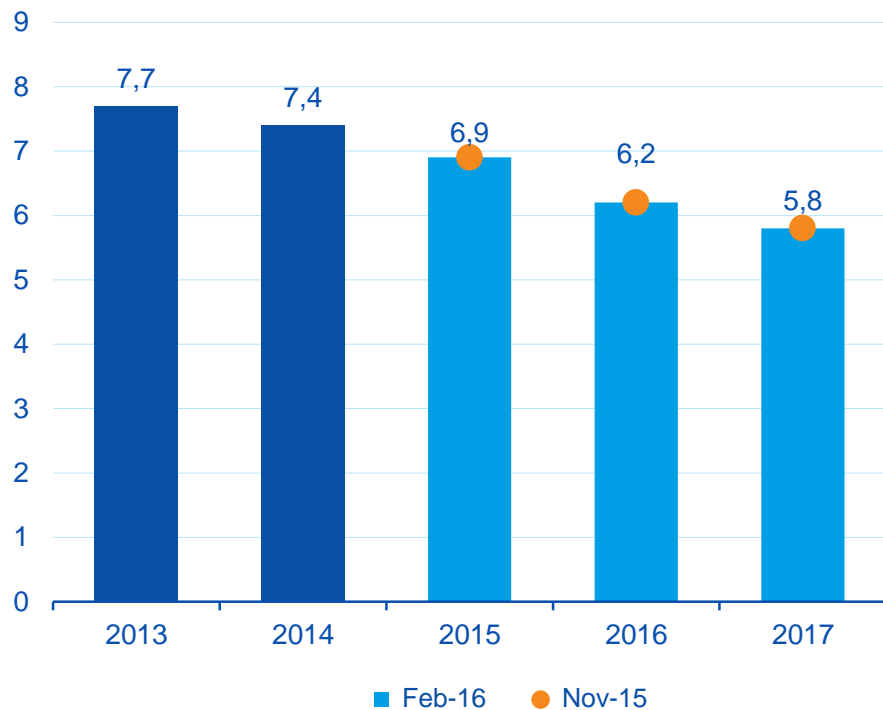


Source: BBVA Research and Bloomberg

... whereas soybean prices. less affected by growth rebalancing in China have evolved as expected.

China: deceleration as expected. but increased uncertainty

China: GDP growth (%)



Source: BBVA Research

Central scenario: gradual, controlled deceleration to 6% in 2016-2017. driven by lax economic policies. including the exchange rate

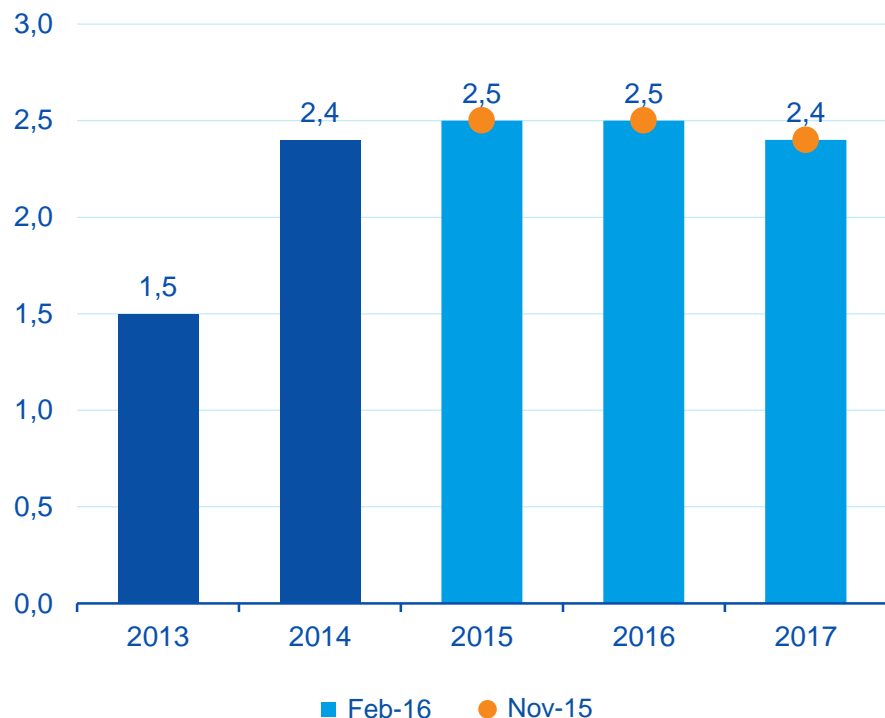
... but there is significant uncertainty on:

1. Ability to successfully manage the transition to lower and more balanced growth
2. Exchange-rate policy and incentives to capital outflows

More likely that doubts about exchange-rate policy will vanish sooner than doubts about authorities' ability to engineer a successful transition to lower growth

US: growth around 2.5%. supported by consumption.

US GDP growth (%)



The positive effect on consumption from lower oil prices offsets its negative effect on investment and the drag from dollar appreciation

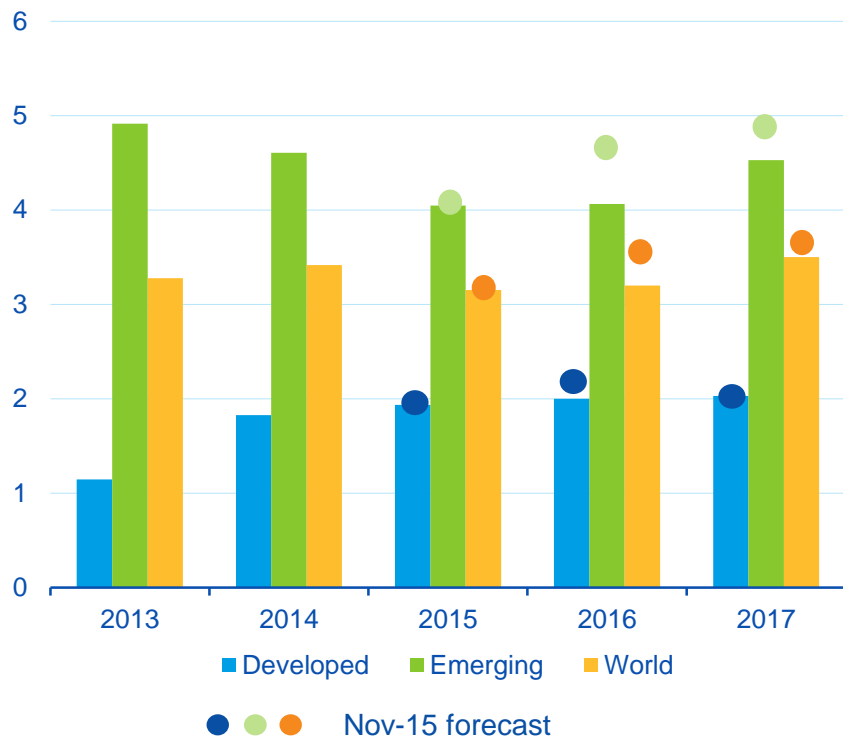
Growth momentum seems to have abated in the last weeks

Fed will implement gradual rate hikes. conditional on incoming data on economic activity and inflation. We expect two 25bp interest rate hikes during 2016.

Source: BBVA Research. BEA

Global GDP will grow 3.2% in 2016. postponing recovery to 2017

Global GDP growth (%)



Confidence indicators and the increase in financial tensions point to moderate growth at the beginning of 2016

Subdued growth in 2016 (similar to 2015) is driven by weak demand in emerging economies

Recovery in developed economies continues to be fragile

Source: BBVA Research

The background of the entire slide is a satellite view of the Earth, showing the Americas, the Atlantic Ocean, and parts of Europe and Africa. The colors are vibrant, with deep blues for the oceans and various shades of green and brown for the continents.

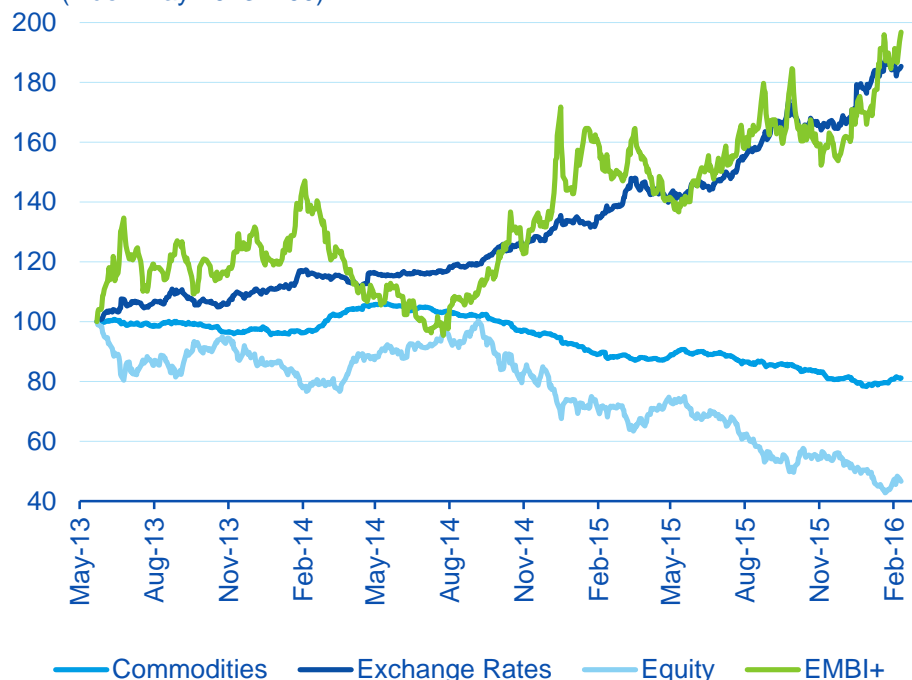
Latam

deceleration continues in 2016

Global volatility. lower commodity prices and concerns about Chinese growth continued dragging Latam markets

Latam: main asset prices

(index May 2013=100)



Asset prices and exchange rates continued to weaken in January and February, reenacting the losses of July and August last year...

... dragged by global volatility, increase in risk aversion, concerns about Chinese growth and lower commodity prices

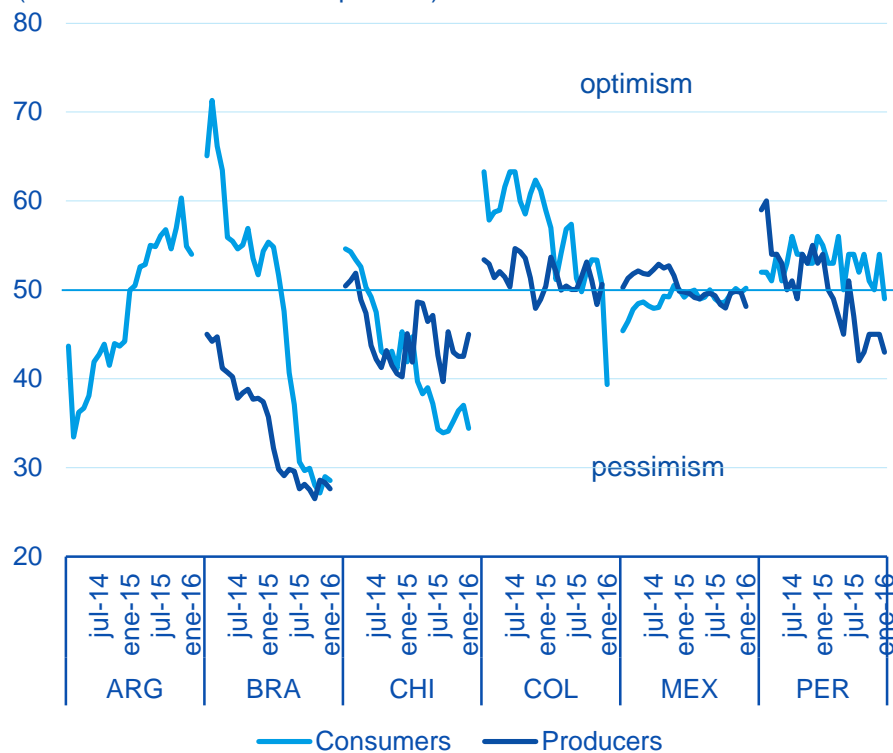
Going forward, volatility will continue while doubts remain about the strength of the US recovery and the speed of deceleration in China

Source: BBVA Research and Haver

Confidence indicators remain weak. except in Argentina

Latam: household and firm confidence indicators

(values above 50 indicate optimism)



Source: BBVA Research and Haver

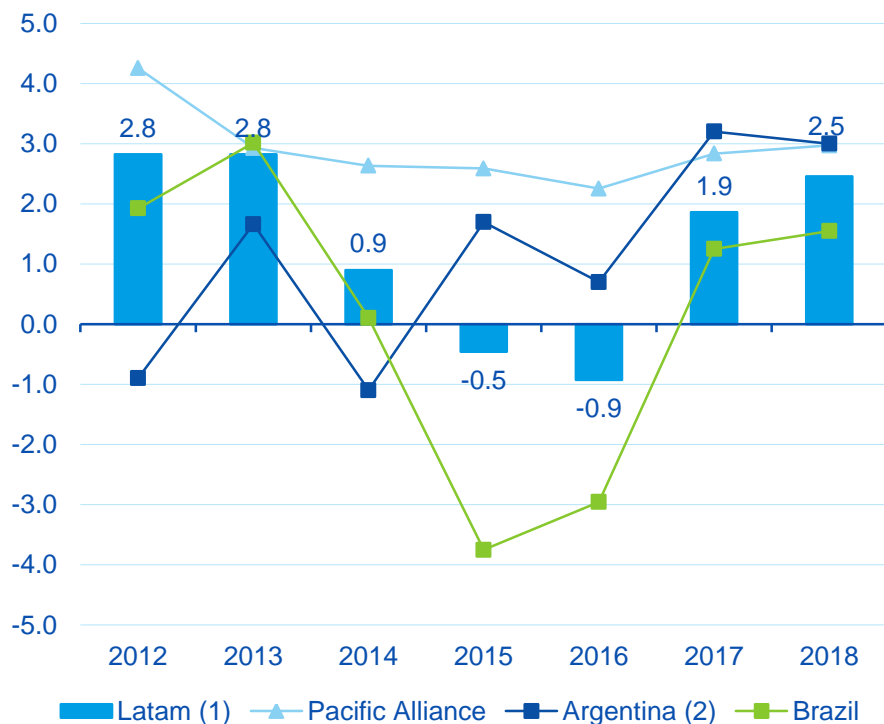
Confidence indicators remain subdued. except in Argentina. This translates into weak consumption and private investment throughout the region

Firms: low confidence due to the external environment. political noise in some countries and uncertainty about economic policy

Households: subdued expectations given weak labor markets and the increase in inflation

Latin America: deceleration continues in 2016. and recovery is postponed to 2017

Latam: GDP growth (%)



Growth forecasts for 2016 and 2017 are revised down. due to weak domestic demand...

... and a challenging external environment. including lower commodity prices and concerns about growth in China

Recovery of growth in 2017 driven by :

1. Stronger global growth;
2. Exchange rate depreciation and improved terms-of-trade
3. Lower political uncertainty in Brazil
4. Surge of private investment in Argentina and infrastructure investment in Peru and Colombia

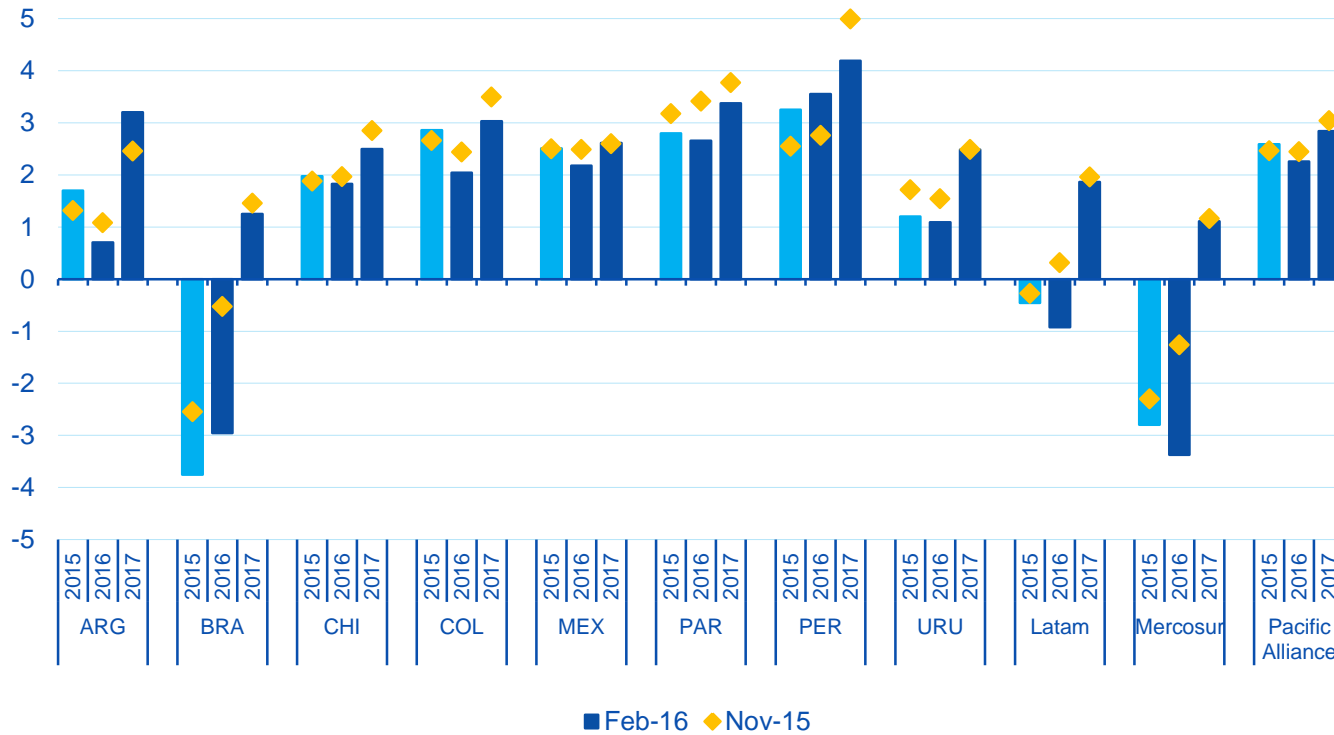
Source: BBVA Research

(1) Weighted average of Argentina, Brazil, Chile, Colombia, Mexico, Paraguay, Peru, México, Uruguay and Venezuela

(2) Privately estimated GDP is used due to lack of comparable official figures.

Peru. Colombia. Mexico and Paraguay. the most dynamic economies in 2016

Latam countries: GDP growth (%)



Downward revision to 2016 growth projections in all countries except Peru (less intense El Niño than anticipated)

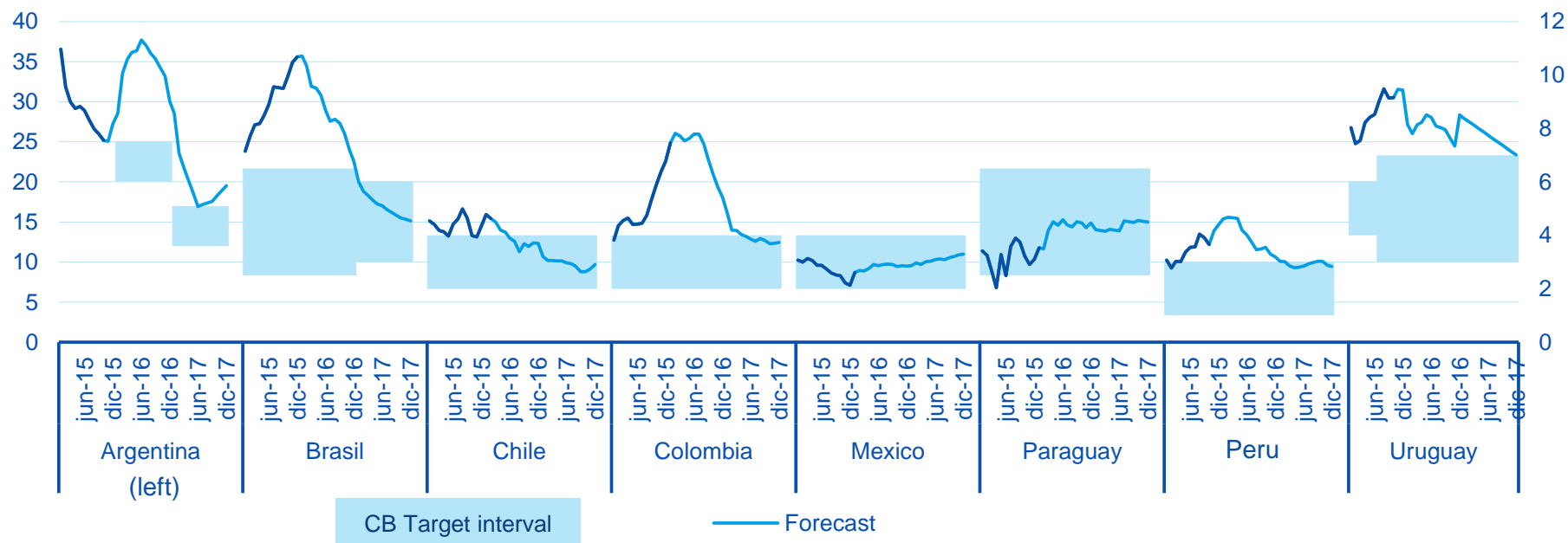
Pacific Alliance will grow around 2.5% in 2016-17. still below its potential (3.8%)

Argentina will regain strong growth in 2017. driven by strong private investment

Source: BBVA Research

Exchange-rate depreciation and food prices continues to push inflation above targets. except Mexico

Latam: inflation (%yoy) in inflation-targeting countries



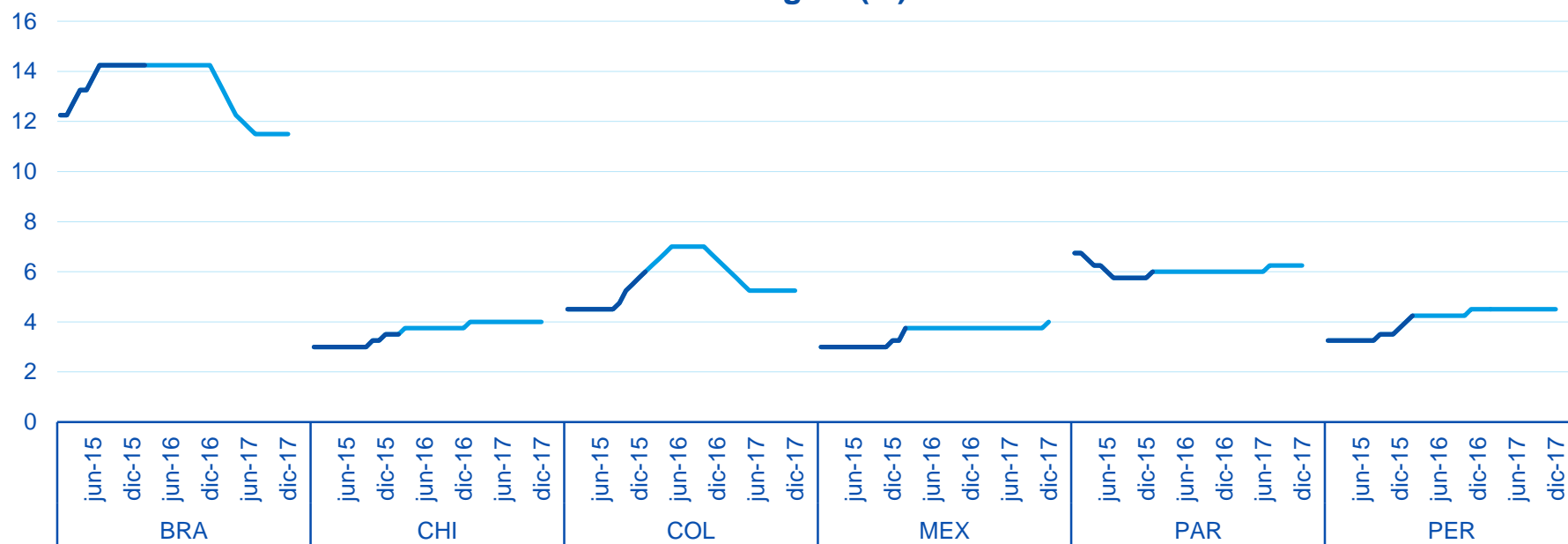
Source: BBVA Research and Haver

Inflation remains above central bank targets (except Mexico and Paraguay). despite cyclical weakness ...

... due to strong exchange-rate depreciation and rise in food prices. Convergence back to targets is postponed. except in Peru

Elevated inflation and Fed rate hikes push central banks to continue tightening monetary policy

Official interest rates in countries with inflation targets (%)



Source: BBVA Research and Haver

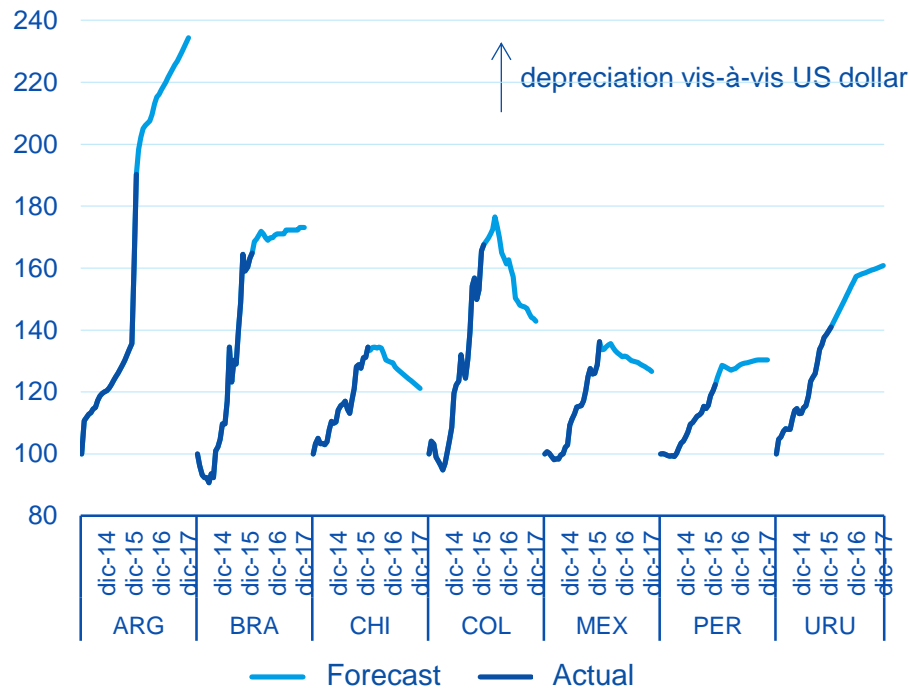
— Forecast

Facing the risk of unanchored inflation expectations. Andean countries continued hiking interest rates ...

...and Mexico also hiked rates. to lower pressures on the exchange rate and. thus. over inflation in the near future

Exchange rates will remain depreciated. given the external environment and risks. and deceleration of activity

Exchange rate gains the USD (index Dec 2014=100)



Intense depreciation in December and January. similar to the July-August event. A tail-event (one in 100 event)

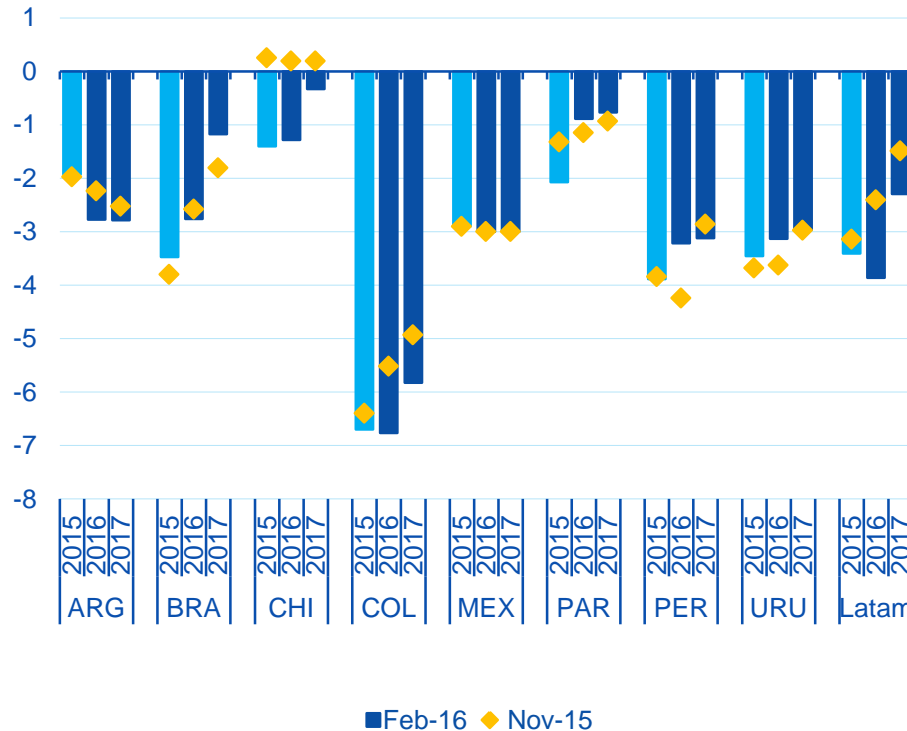
Going forward. markets will closely monitor the rate of Fed tightening. possible further deceleration in China and its exchange-rate policy

In Mexico. Colombia and Chile there is room for some appreciation of their exchange rates during 2016. as their fundamentals gradually improve. including some increase in oil and copper prices

Source: BBVA Research and Haver

External deficits begin to adjust in most countries. in part due to lower domestic demand ...

Latam: Current account deficit (%GDP)



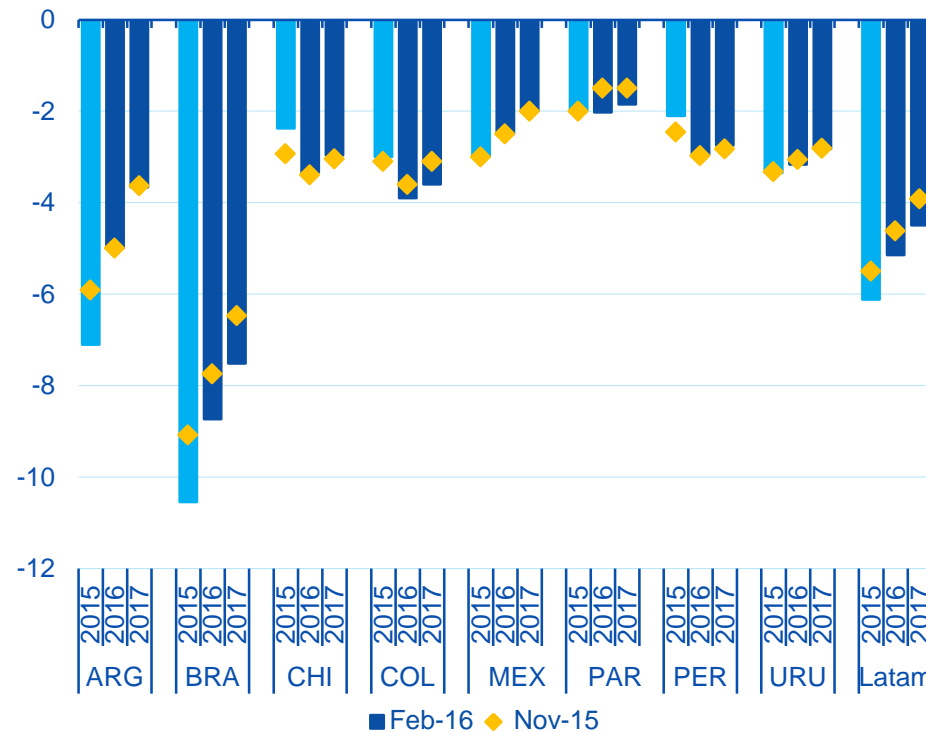
External deficits throughout the region (but quite small in Chile and Paraguay)

External deficits are starting to correct in 2016. due to depreciation and weak domestic demand. together with some recovery of terms-of-trade

Foreign direct investment (FDI) weakens given lower commodity prices. and loses weight as a source of foreign financing. But external vulnerability remains manageable

... but. on the other hand. fiscal outlook worsens. especially in Brazil

Latam: Fiscal deficits (%GDP)



Negative impact of deceleration of domestic demand on tax revenues. In addition. fiscal expenditure accelerates in some countries.

More pronounced worsening of fiscal outlook in Brazil. due to strong recession and political impasse. which prevent to attain primary surplus targets

Source: BBVA Research and Haver

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A hand holding a tablet computer against a city skyline background. The image is dominated by blue tones, with a bright white diagonal shape cutting across the upper right. The background shows a blurred cityscape with tall buildings under a bright sky.

Annex

Latin America GDP growth forecasts

| PIB (%a/a) | 2013 | 2014 | 2015e | 2016f | 2017f |
|------------------|------|------|-------|-------|-------|
| Argentina | 1.7 | -1.1 | 1.7 | 0.7 | 3.2 |
| Brazil | 3.0 | 0.1 | -3.8 | -3.0 | 1.3 |
| Chile | 4.2 | 1.9 | 2.0 | 1.8 | 2.5 |
| Colombia | 4.9 | 4.6 | 2.9 | 2.0 | 3.0 |
| Mexico | 1.6 | 2.3 | 2.5 | 2.2 | 2.6 |
| Paraguay | 14.0 | 4.7 | 2.8 | 2.7 | 3.4 |
| Peru | 5.8 | 2.3 | 3.3 | 3.6 | 4.2 |
| Uruguay | 5.1 | 3.5 | 1.2 | 1.1 | 2.5 |
| Mercosur | 2.7 | -0.4 | -2.8 | -3.4 | 1.1 |
| Pacific Alliance | 2.9 | 2.6 | 2.6 | 2.3 | 2.8 |
| Latin America | 2.8 | 0.9 | -0.5 | -0.9 | 1.9 |

e = estimated ; f = forecast