

March  
**2016**

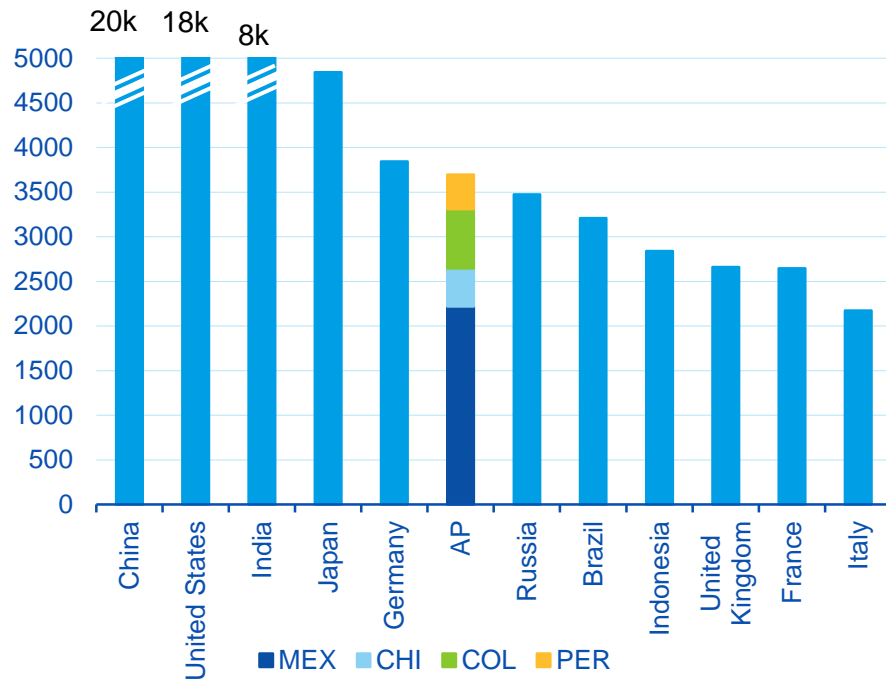
**Potential and  
Outlook for the  
Pacific Alliance**

# Outline

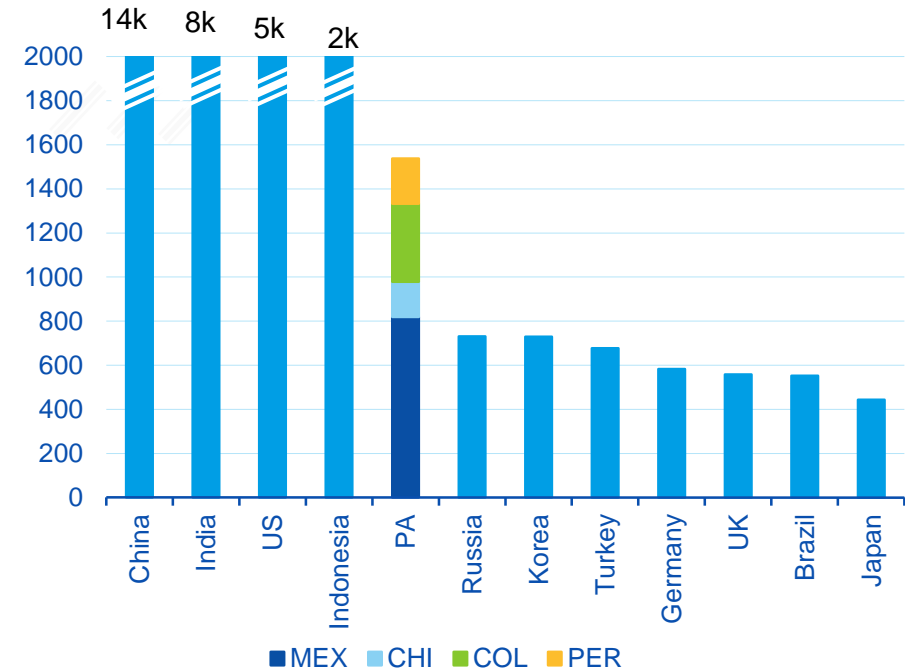
- 1 Pacific Alliance: aiming for integration into the global economy
- 2 Pacific Alliance: outlook and challenges

# The Pacific Alliance (PA): the true Latam giant

**Biggest economies in 2015**  
(bn. USD, PPP adjusted)



**Biggest contributions to GDP growth in the next 10 years**  
(m USD, PPP adjusted)

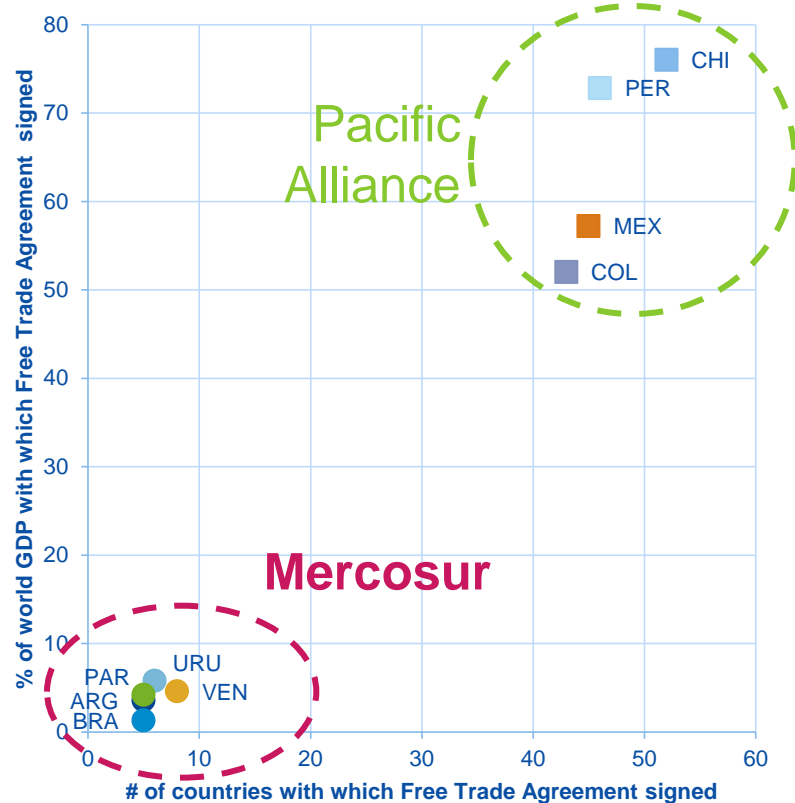


Source: BBVA Research and IMF

Source: BBVA Research and IMF

# Pacific Alliance: committed to integration with the global economy...

Number and size of trade agreements signed



Internal trade opportunities are low for now, tilted on Mexico

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Trade between PA countries is just 4% of their total foreign trade

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There is scope to increase trade within PA but, potential is highest in the case of Mexico

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Pacific Alliance aims also for integration in financial markets and free movement of labor

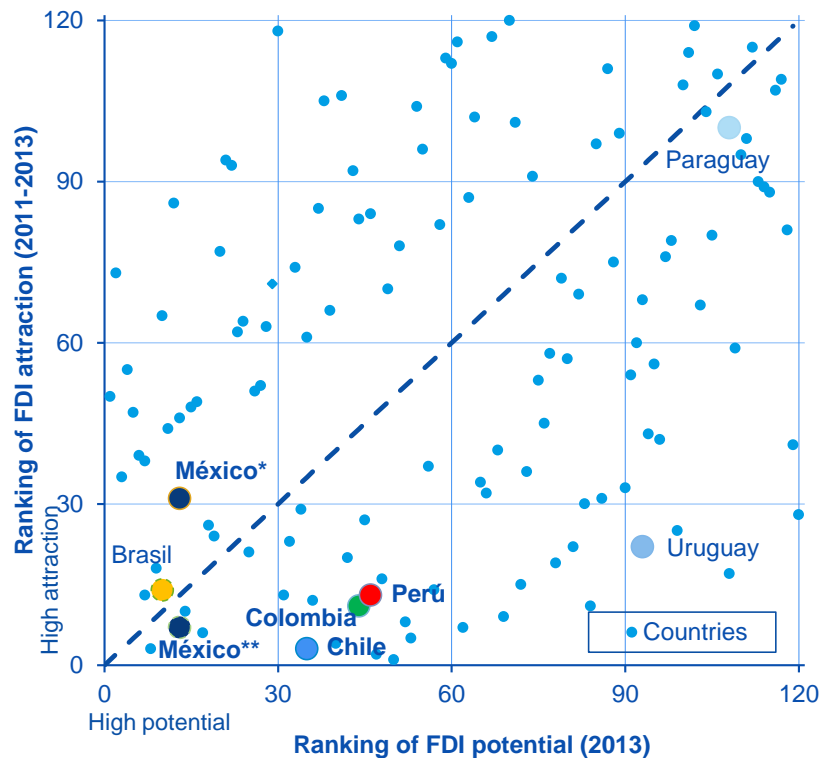
Source: BBVA Research and WTO

# ... especially with the main economic regions

Trade agreements signed						
	with US	with EU	with Japan	with China	with EFTA (Switzerland)	Total number of agreem'ts
Chile	✓	✓	✓	✓	✓	21
Colombia	✓	✓	✗	✗	✓	11
Mexico	✓	✓	✓	✗	✓	18
Peru	✓	✓	✓	✓	✓	16
Brazil	✗	✗	✗	✗	✗	5

# Pacific Alliance attracts FDI even beyond its high potential....

## FDI attraction and potential to attract FDI



PA countries among those with highest potential to attract FDI

FDI potential index:

- i. attractiveness of domestic market;
- ii. qualified labor force;
- iii. availability of natural resources;
- iv. infrastructures

FDI attraction:

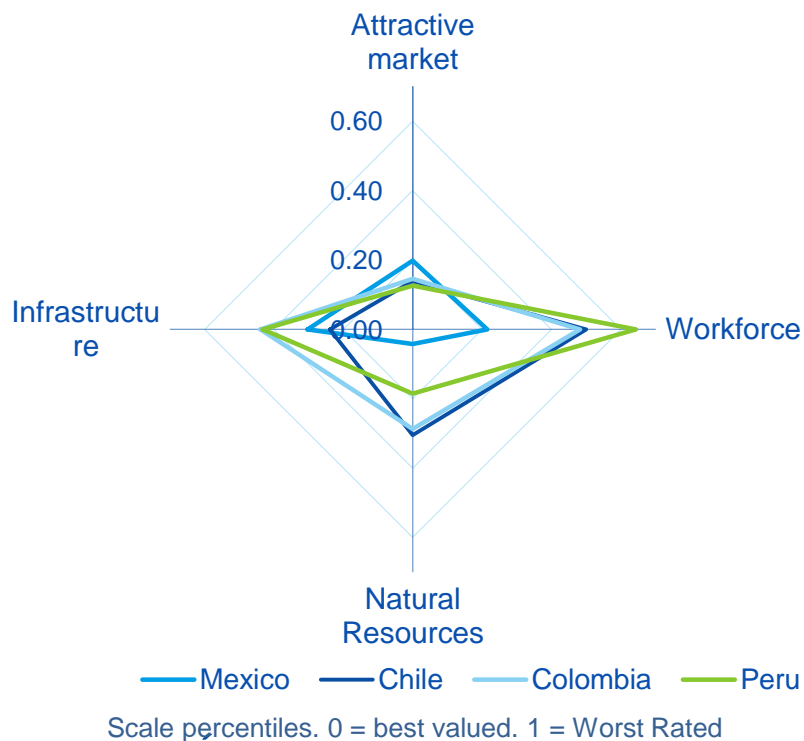
ranking of inward FDI both in absolute terms and relative to country size

Source: BBVA Research and UNCTAD

Mexico\* = current position; Mexico\*\* = expected position after energy reform

# But there is still ample room to improve the attractiveness of Pacific Alliance for FDI flows

## Four dimensions of attractiveness for FDI (ranking among 120 countries)



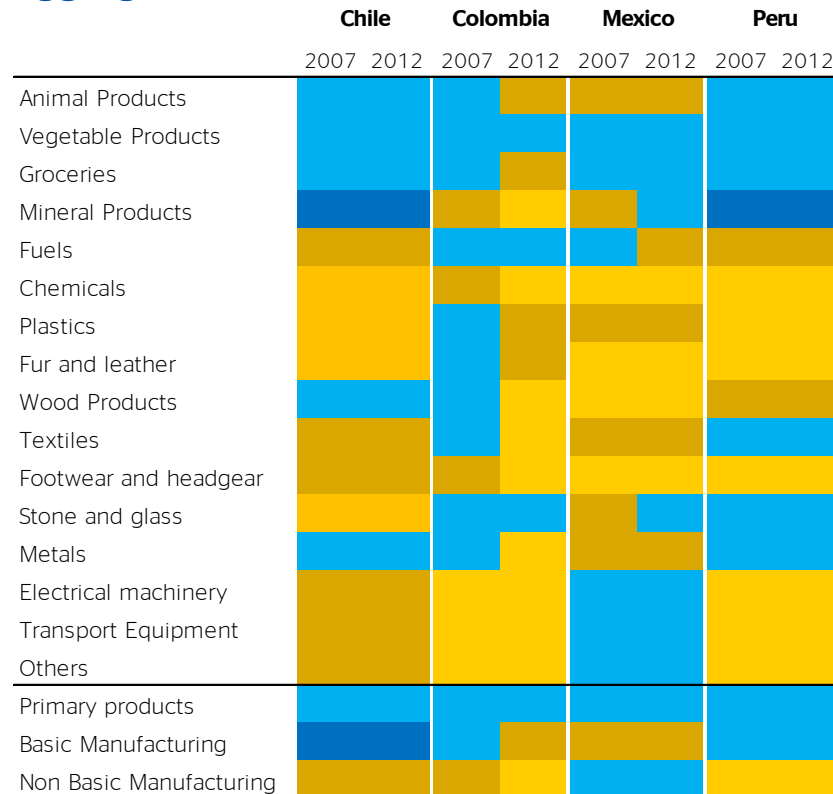
Some areas with room to improve attractiveness for FDI:

- ✓ Labor force qualification
- ✓ Labor costs
- ✓ Quality and quantity of infrastructures

Key: education and labor market reform.  
Infrastructure investment

# Revealed Comparative Advantage of Andeans in primary products; manufactures in Mexico ...

**Index of Revealed Comparative Advantage (RCA) by aggregate sector**



Source: WITS and BBVA Research



**Primary products**



**More complex manufacturing**



... and this pattern also shows up when thinking about most competitive sectors in each country

## Chile

- Copper and articles thereof
- Ores, slag and ash
- Edible fruit and nuts
- Pulp of wood
- Fish and crustaceans

## Colombia

- Coffee, tea, mate and spices
- Live trees, plants, flowers
- Edible fruit and nuts
- Sugar and confectionery
- Mineral fuels, oils and bituminous

## Mexico

- Meat and Edible meat offal
- Plaiting materials (yarn)
- Furniture
- Motor Vehicles
- Alcoholic beverages

## Peru

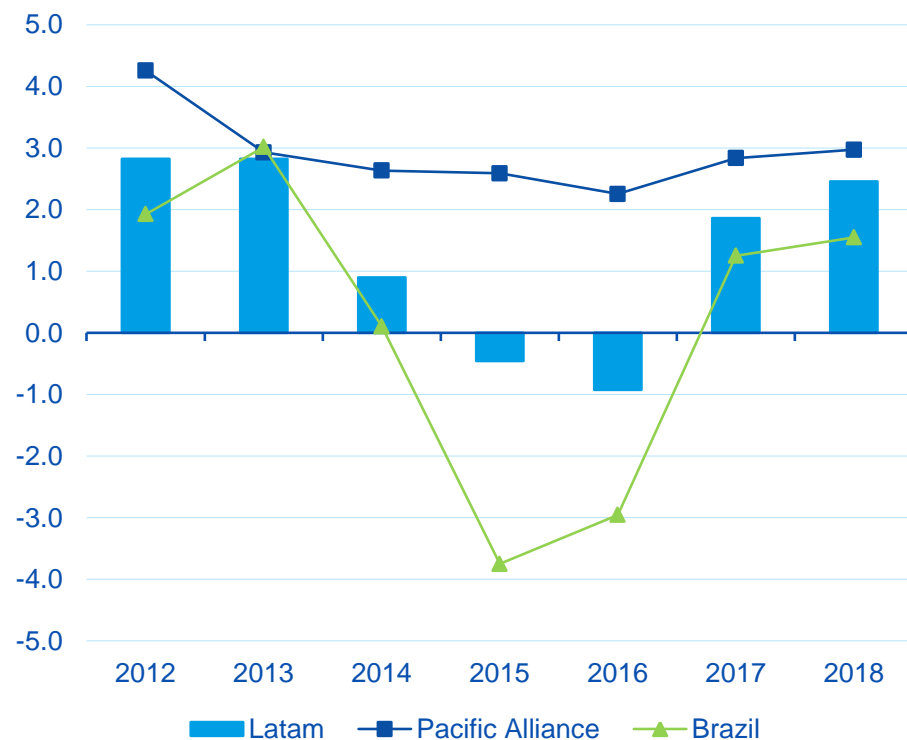
- Tin and articles thereof
- Plaiting materials (yarn)
- Ores, slag and ash
- Fishmeal
- Lead and articles thereof

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# Latam has decelerated, but less so in the Pacific Alliance

## Latam: GDP growth forecasts



**Pacific Alliance:** MEX, COL, PER, CHI

Source: BBVA Research

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

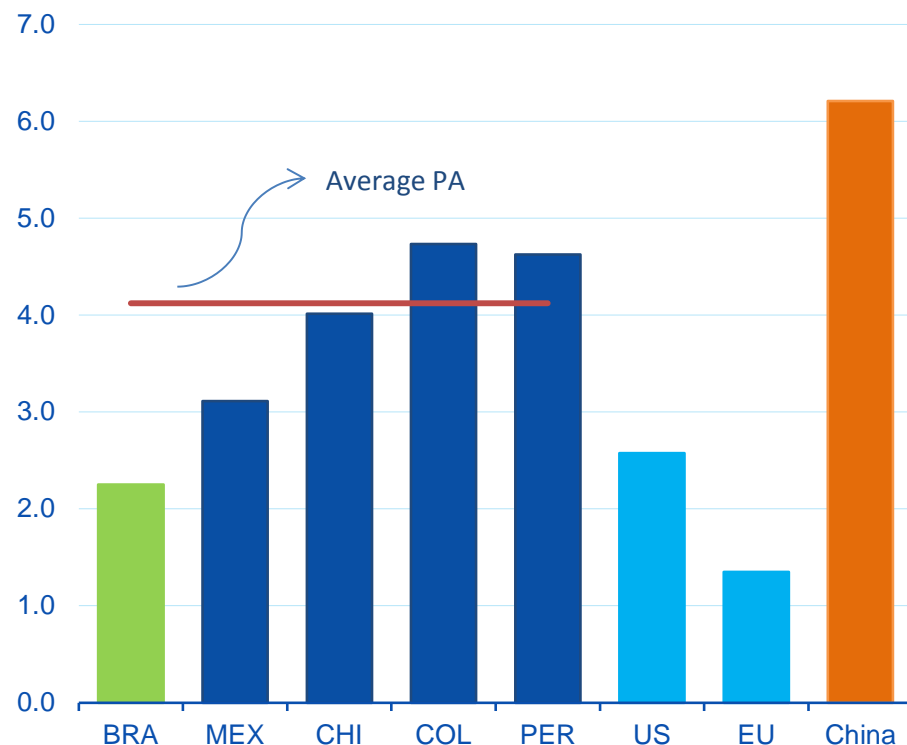
Pacific Alliance will grow around 2.5 in 2016-17, still below its potential (closer to 4%)

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

# Pacific Alliance: high potential growth

**Potential GDP growth next 10 years (%)**

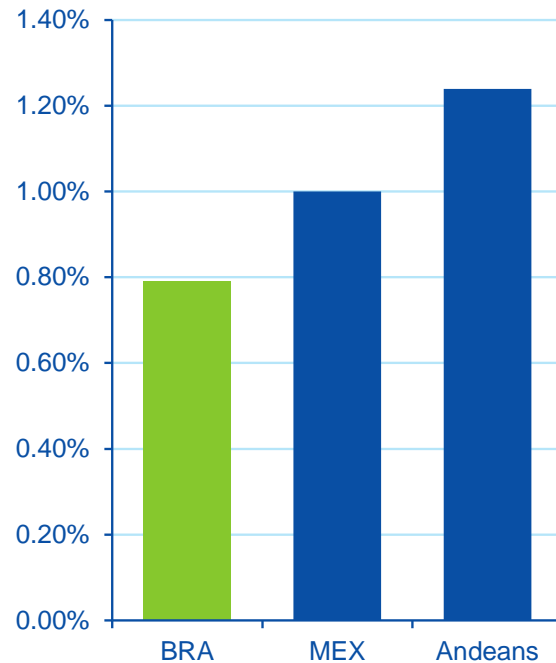


Besides a high contribution to global growth, a high potential growth rate, although lower commodity prices have dented it recently

Commitment to reform will contribute to increase potential growth

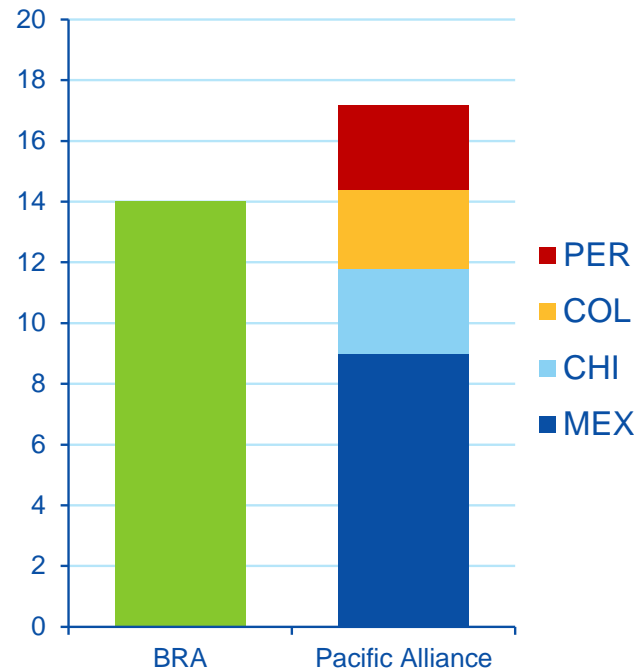
# Dynamism due in part to favorable demography and the rise of the middle class

**Population growth rate**  
(% annual, 2011-21)



Source: BBVA Research

**Increase in middle class**  
(million people, 2011-21)



Source: BBVA Research

## Increase in middle class

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Population growth,  
demographic dividend

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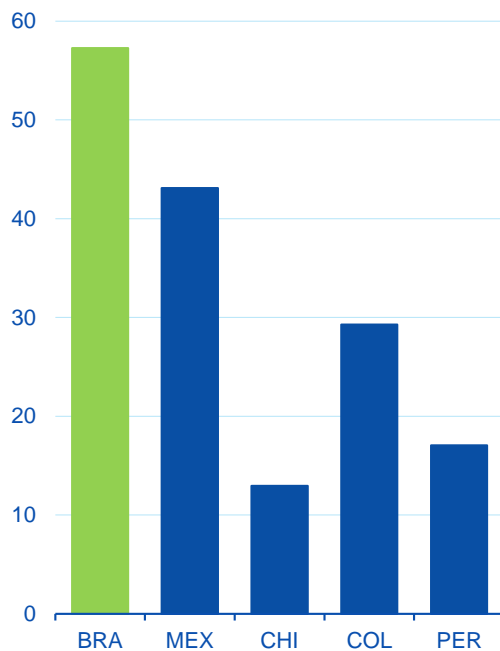
Increase in  
per capita income

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Progress in decreasing  
inequality

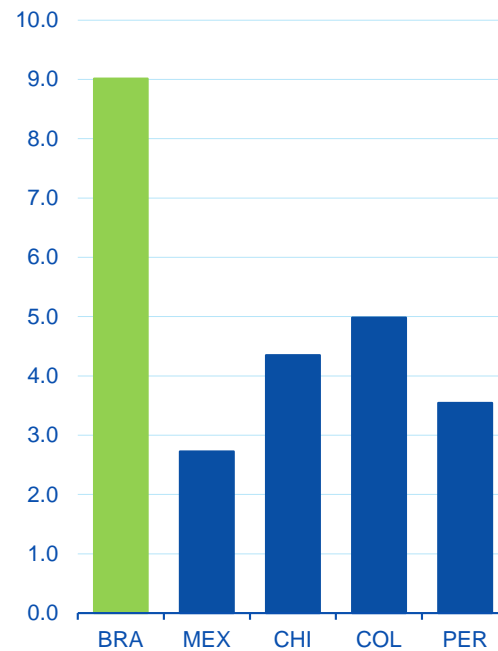
... also (and more importantly) due to prudent policies, low interventionism and openness

**Public debt (gross)  
%GDP, 2015**



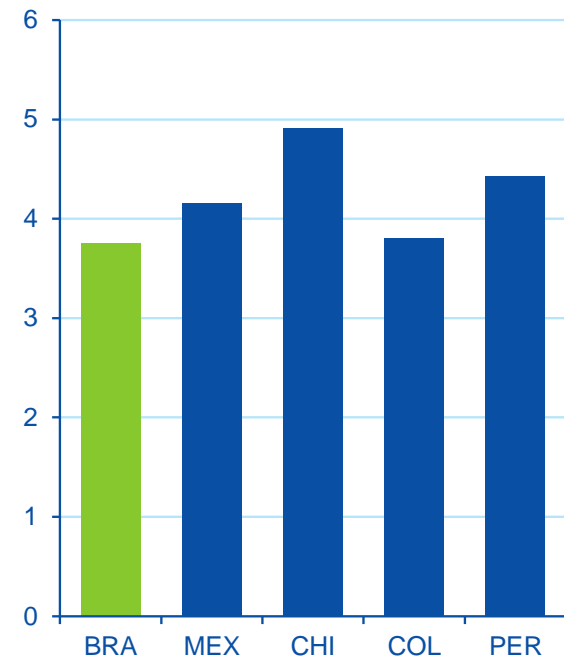
Source: BBVA Research and FMI

**Inflation (% , 2015)**



Source: BBVA Research and FMI

**Index (0-7) of competition in the domestic market  
(7 = maximum competition)**

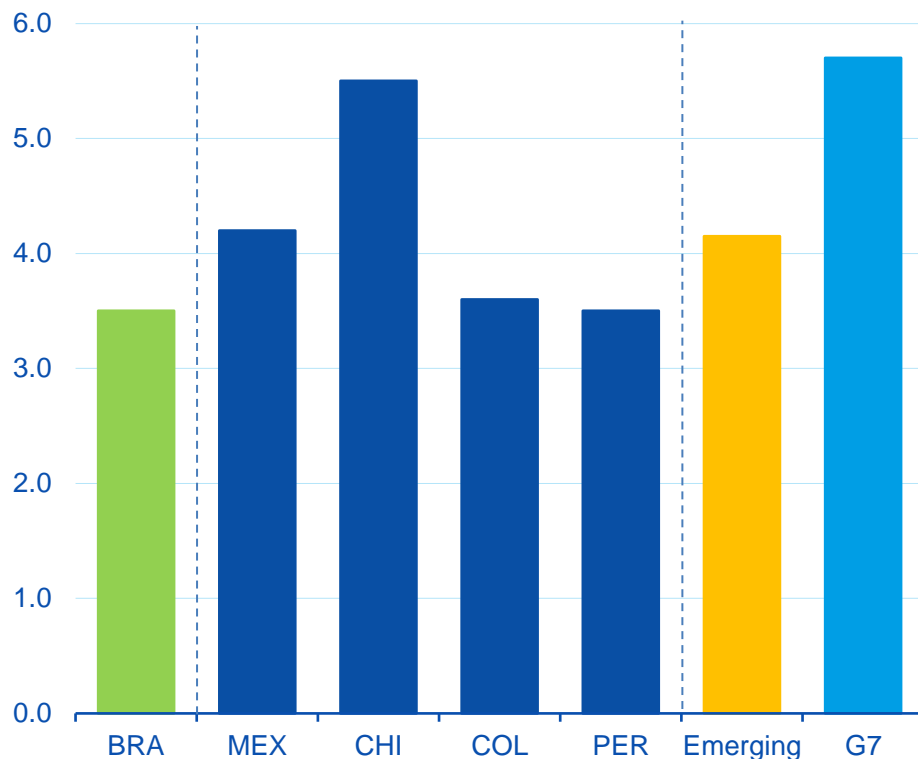


Source: BBVA Research and World Economic Forum

# But the Pacific Alliance also faces significant challenges

## Quality of infrastructure

(Index: 0-7, 7 = maximum quality)



Source: BBVA Research and World Bank

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High informal sector  
(labor market, underground economy)

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Human capital: quality of education

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Physical capital: quantity and quality of infrastructure (energy in Chile)

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Tax revenues highly dependent on a small number of exported commodities

# All in all: Pacific Alliance still controls its future ...

Still on time  
to implement Reforms 2.0

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

2%-3% 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

Long run:  
Inequality



# To summarize ...

- 1 The Pacific Alliance (PA) is the sixth biggest economy in the world and will be the fifth in term of contribution to global growth in the next 10 years.
- 2 The PA is committed to trade and financial integration both within the alliance as well as with the rest of the world. There is ample room to develop further integration within the AP.
- 3 The PA's potential growth is close to 4% during the next decade. Growth will be based on continuing reforms and prudent economic policies.
- 4 Growth could be even higher if there are further advances in reducing the informal sector and increasing investment in infrastructure and in human capital (education).