

BBVA

RESEARCH

3rd QUARTER
2016



Outlook
Latin America

Main Messages

The global outlook has improved slightly, especially in emerging Asia. Financial stress increased briefly after Brexit, but it was offset by central banks in advanced economies, which are postponing the normalization of their monetary policies. Global growth will increase slowly.

Slowdown of Latam GDP will end in 2016 (-0.9%) in 2016, with a gradual recovery in 2017 (1.8%). The fall in 2016 will mark the third year of growth below OECD's, something that will also happen in 2017. Recovery in 2017 will be driven by the external sector and stronger investment in places like Argentina, Peru and Colombia.

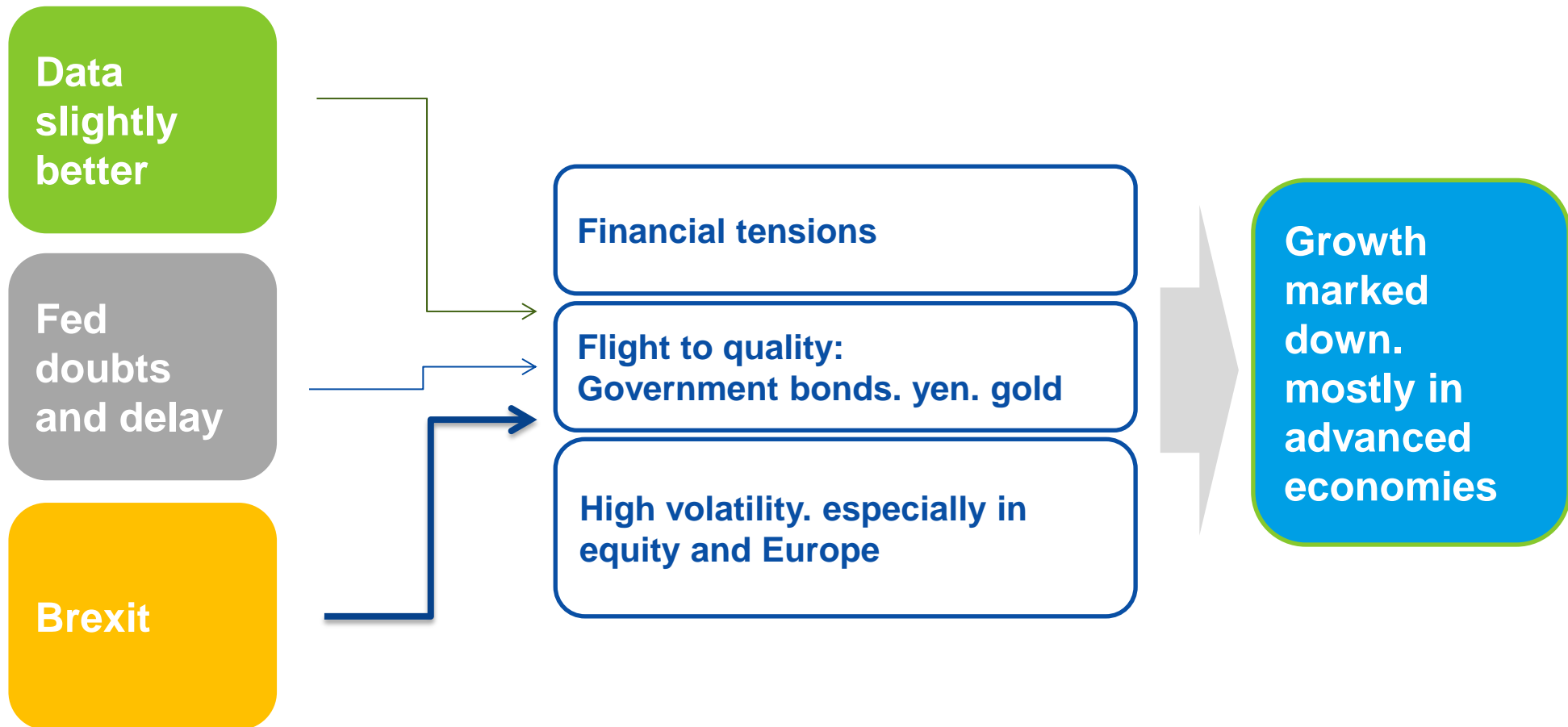
Inflation, though still high in South America, continues to abate in most countries. Main exceptions are Argentina, Colombia and Uruguay, although in the first two inflation will start to come down in the next months. Lower exchange rate depreciation and weak demand will underpin lower inflation pressures.

Central banks adopt a more dovish bias, except in Colombia and Mexico. Lower inflation and weak domestic demand will allow central banks to have this more dovish bias. The main exception is Colombia, where there will be two more rate hikes, and Mexico, which will continue to synchronize with the interest rate hikes by the Fed.

External environment

Central banks offset the fallout from Brexit

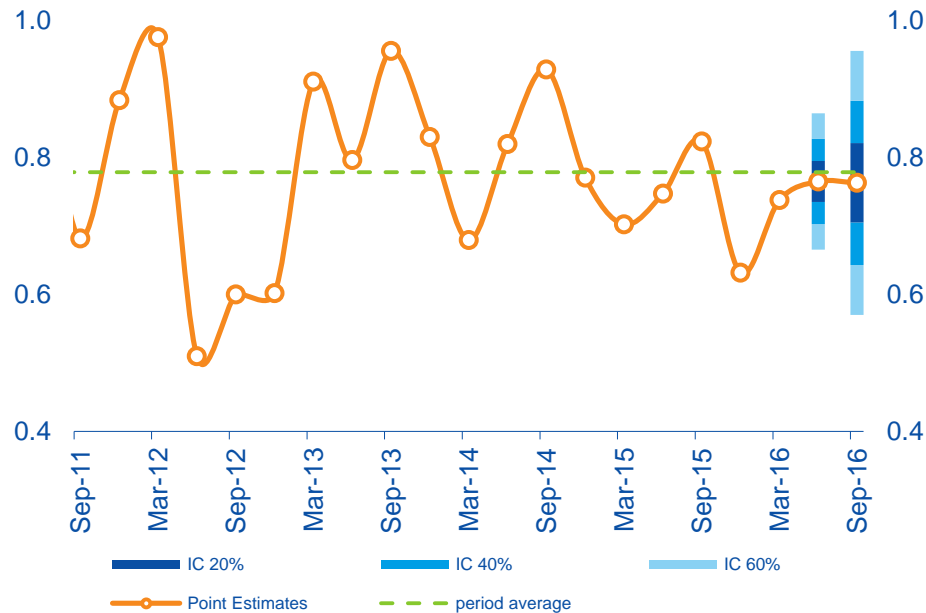
Global drivers over the last quarter



1. Data points to global growth steady at 3.1%

Global growth (% qoq at annual rate)
(Forecasts based on BBVA-GAIN model)

Source: BBVA Research



Industrial production recovers slightly in April and May, especially in emerging Asia. Developed economies remain weak.

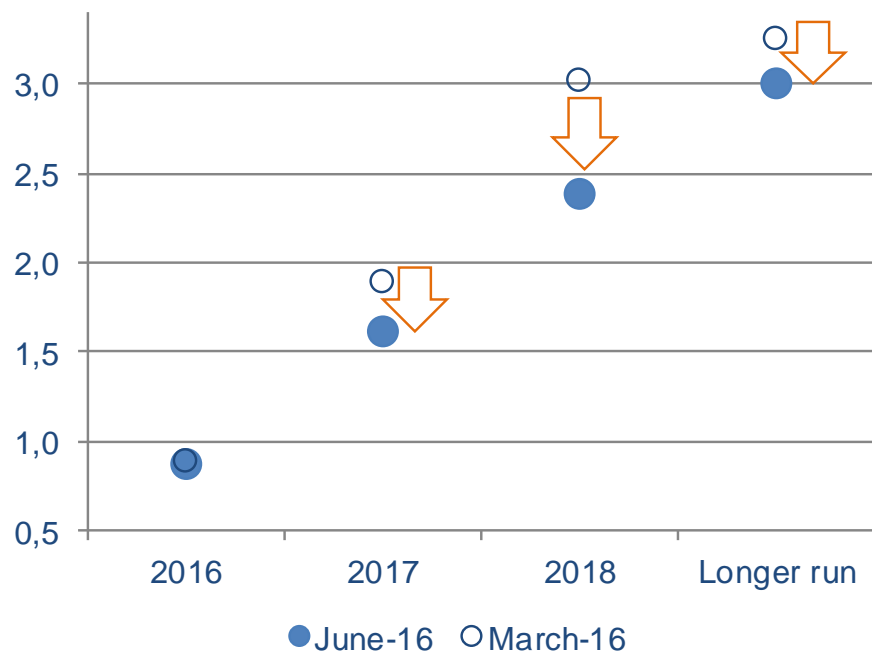
Confidence indicators slightly more optimistic. Global trade recovers in June, after many months of subdued activity.

Global growth marked down slightly, to 3.1% in 2016 and 3.2% in 2017.

2. Fed doubtful about hikes. Seems to delay monetary policy normalization

US: Federal Funds rate. FOMC forecasts.

Source: BBVA Research and Federal Reserve



Fed doubtful about

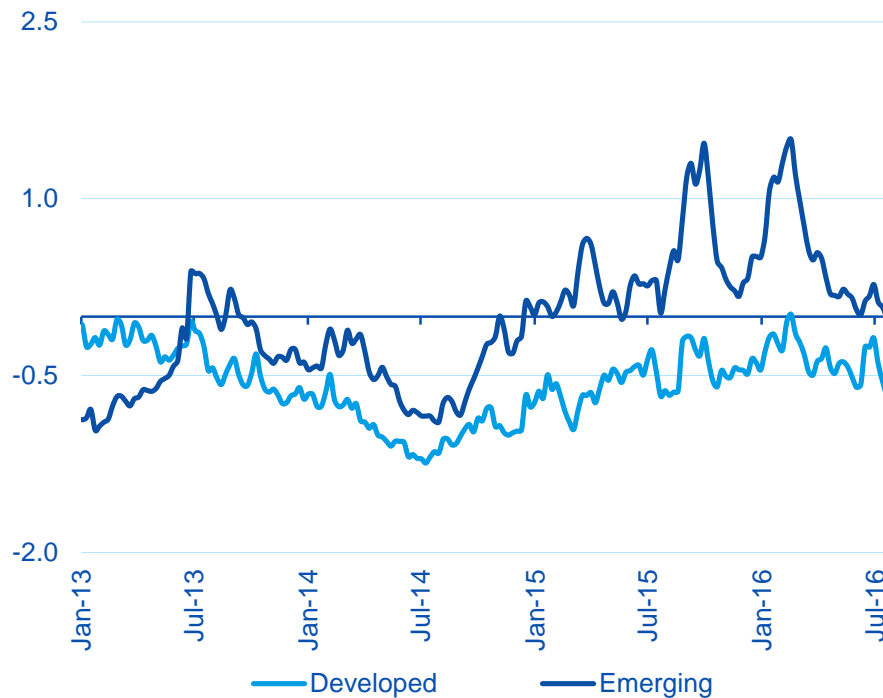
1. Long-run US growth and productivity
 2. How low are real equilibrium interest rates
 3. Global shocks and their impact on the US
- Fed seems more reluctant to raise rates until some uncertainty is lifted

Elections increase uncertainty even more, with potential effects on consumption and investment

We anticipate an additional interest rate hike at end-2016 and two more during 2017.

3. Financial stress jumped after Brexit, but moderately and temporarily.

BBVA Research Financial Stress Index



Source: BBVA Research

Brexit was not priced-in by markets as a systemic shock. Its effect has been short-lived:

- Limited financial turbulence
- Central banks came to the rescue. postponing monetary policy normalization

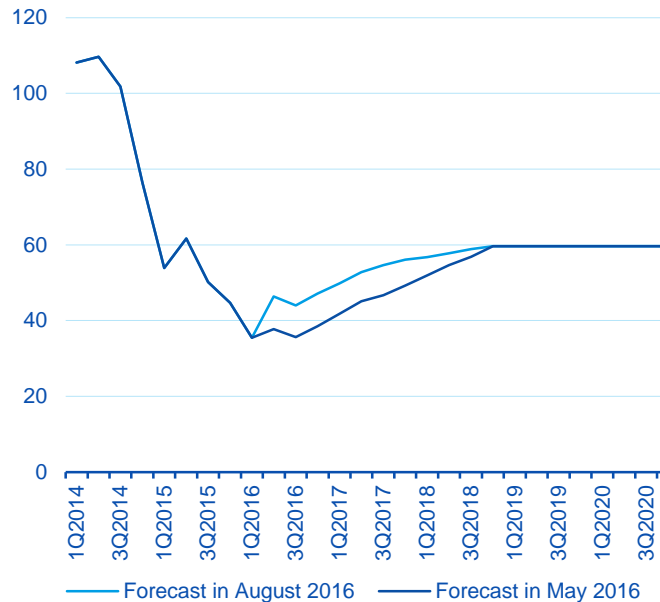
All in all, Brexit contributed to extend previous ongoing trends:

- Downward pressure on long-term interest rates
- Weak equity markets in Europe

Oil and soybean prices benefitted from weak supply

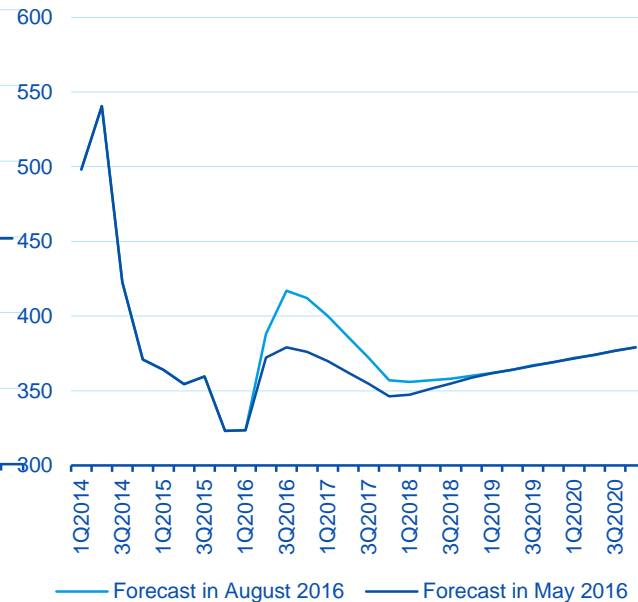
Brent oil: (USD/b)

Source: BBVA Research and Bloomberg



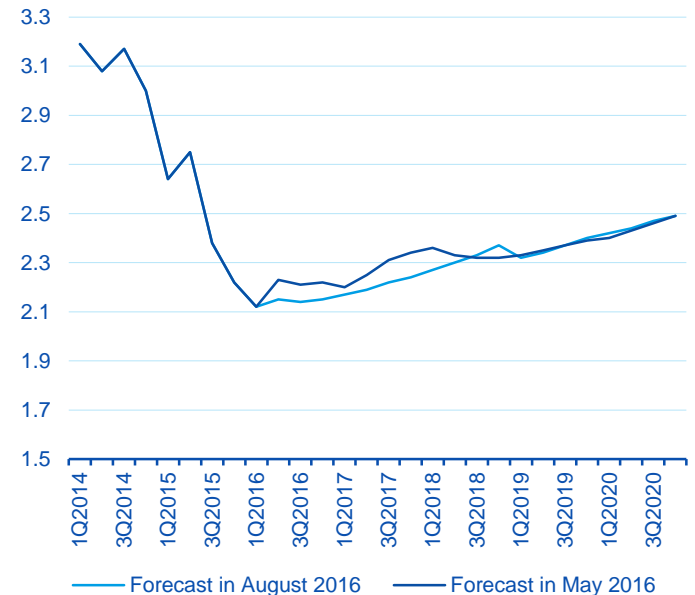
Soybeans: (USD/mt)

Source: BBVA Research and Bloomberg



Copper: (USD/lb)

Source: BBVA Research and Bloomberg



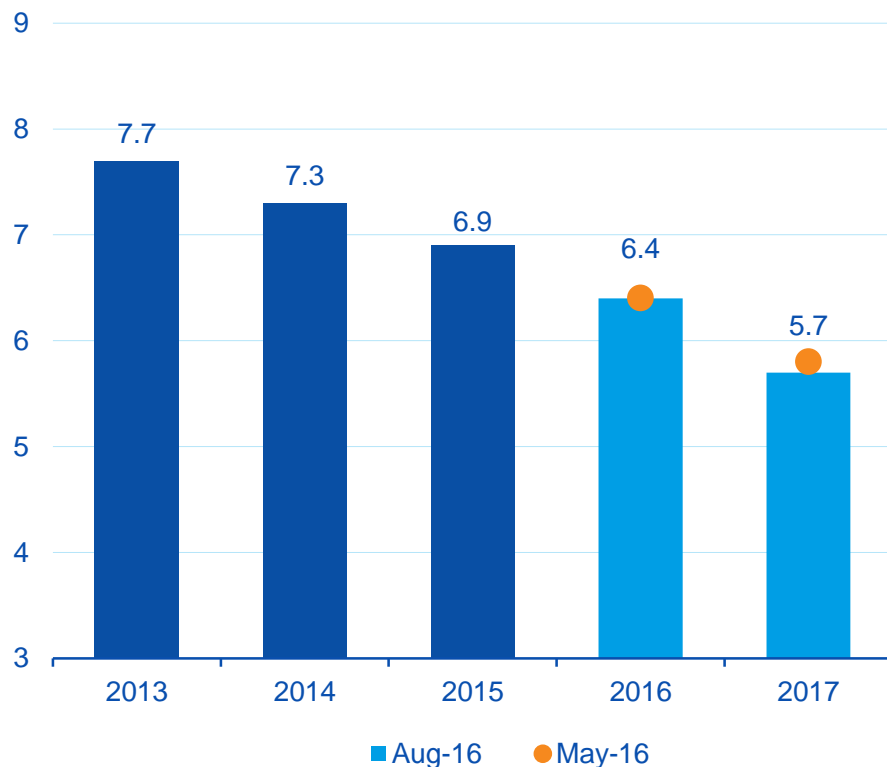
Oil and soybean prices recovered driven in part by weak supply and adverse weather respectively.

Copper prices weaken slightly on global uncertainty, although production costs will limit further falls.

China: gradual adjustment to continue

China: GDP growth (%)

Source: BBVA Research



Concerns about a hard landing in China have eased, given recent data. But investment remains weak.

Authorities have slowed the pace on monetary easing over concerns of potential inflation and financial risks.

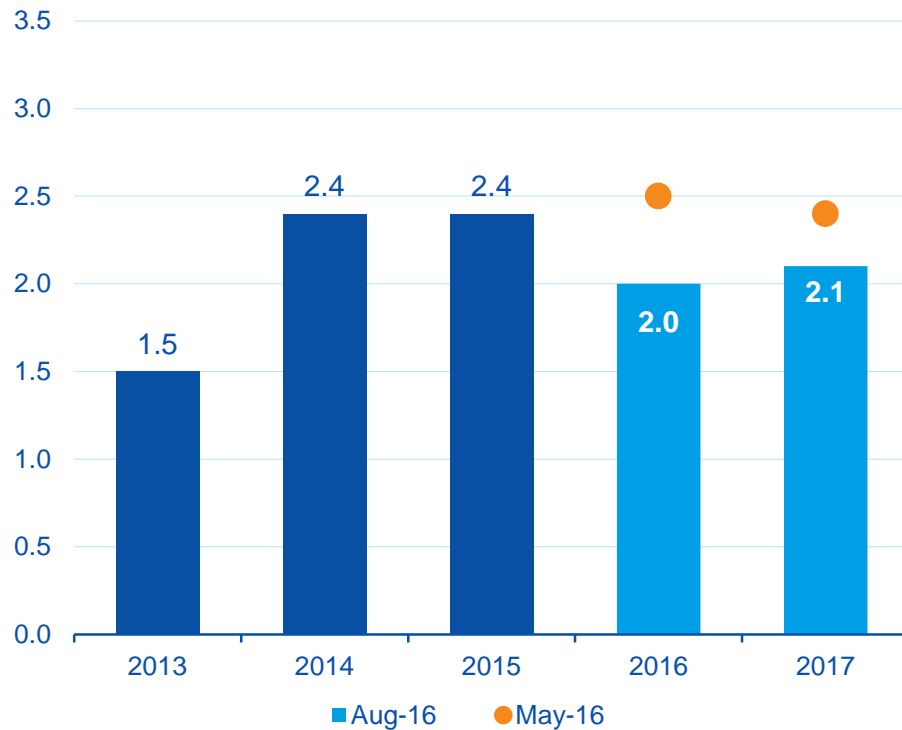
However, tail risks are high:

1. exchange rate depreciation, capital outflows;
2. strength of recovery of real estate market;
3. corporate sector debt;
4. deteriorating global trade environment.

US: growth marked down to 2% on disappointing H1 data and weak investment

US: GDP growth (%)

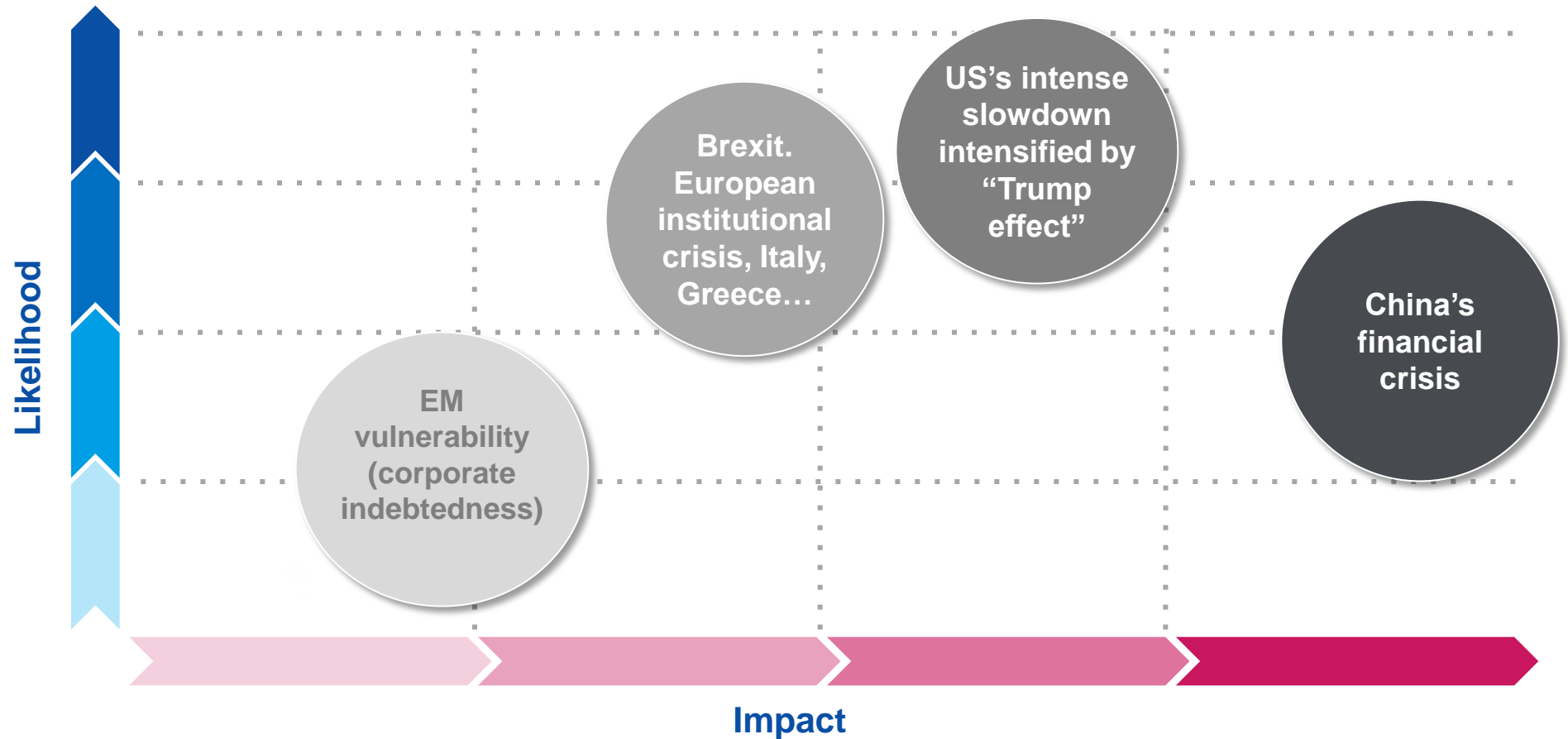
Source: BBVA Research



Disappointing growth data in first semester, with persistently weak investment

High global uncertainty (Brexit, China in the long run) and about prospects for US productivity growth.

Risks stemming from China abate somewhat, but those from advanced economies increase



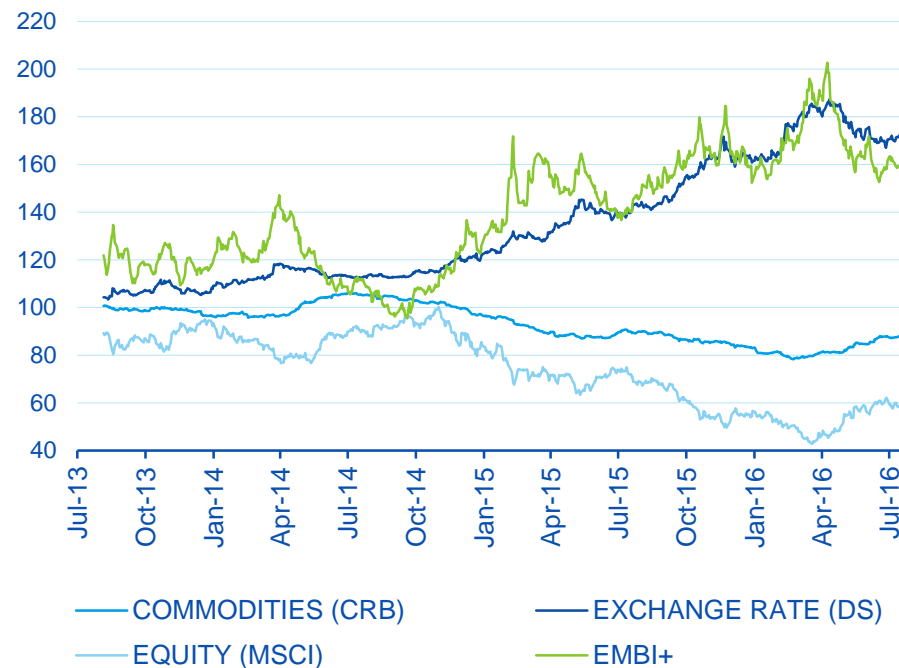
Latam

Towards a gradual recovery of growth

Latam markets continued to recover, lifted by a more dovish Fed

Latam main asset prices

(Index May 2013=100)



Main asset prices and exchange rates in the region continued showing significant gains since February...

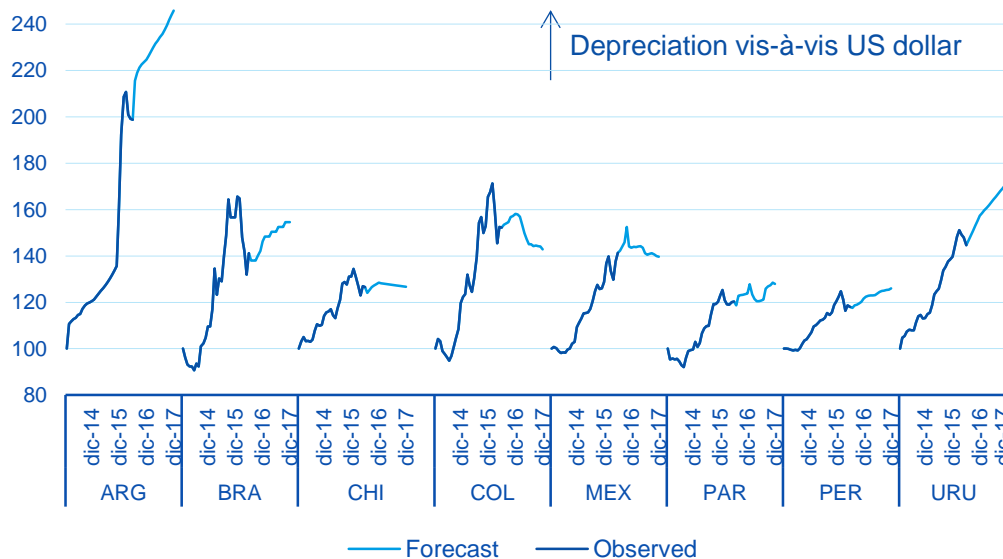
... driven by the bias to postpone monetary policy normalization in developed markets (especially the Fed). This trend was reinforced after Brexit. Lower concerns on China also helped.

Going forward, the evolution of financial markets in Latam will depend on communication about future monetary policy by the Fed.

Source: BBVA Research y Haver

Exchange rates will depreciate going forward, but there is some room for appreciation in Colombia and Mexico

Exchange rate to the US dollar (Index Dec 2014=100)



FX appreciation in the last months driven by a more dovish view of the Fed and recovery of capital flows to the region

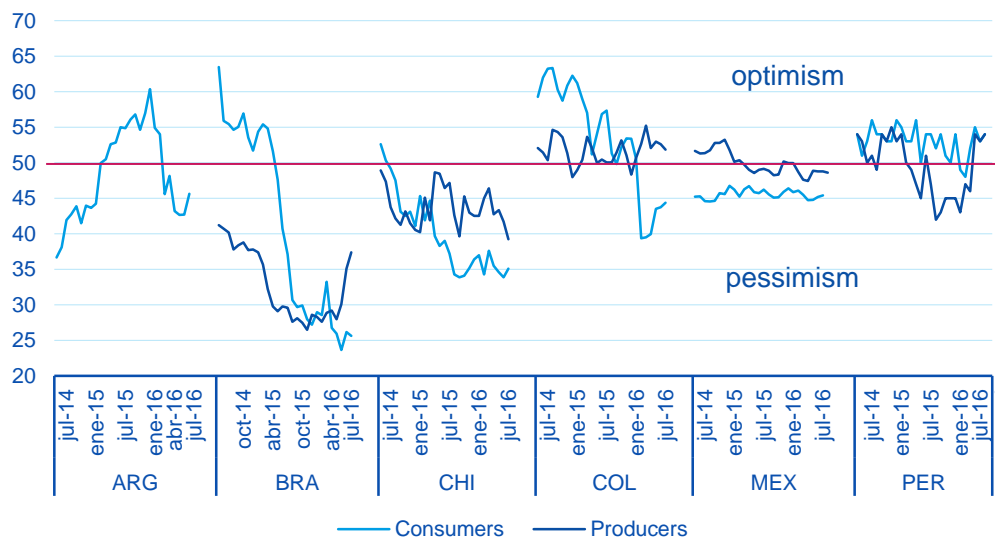
Going forward, exchange rates will depreciate but at a slower pace than in 2015.

In Mexico and Colombia there is some room for appreciation given improving fundamentals and an expected rise in oil prices.

Confidence indicators remain weak, but an inflection seems in sight

Latam: Confidence indexes (households and firms)

(values over 50 indicate optimism)



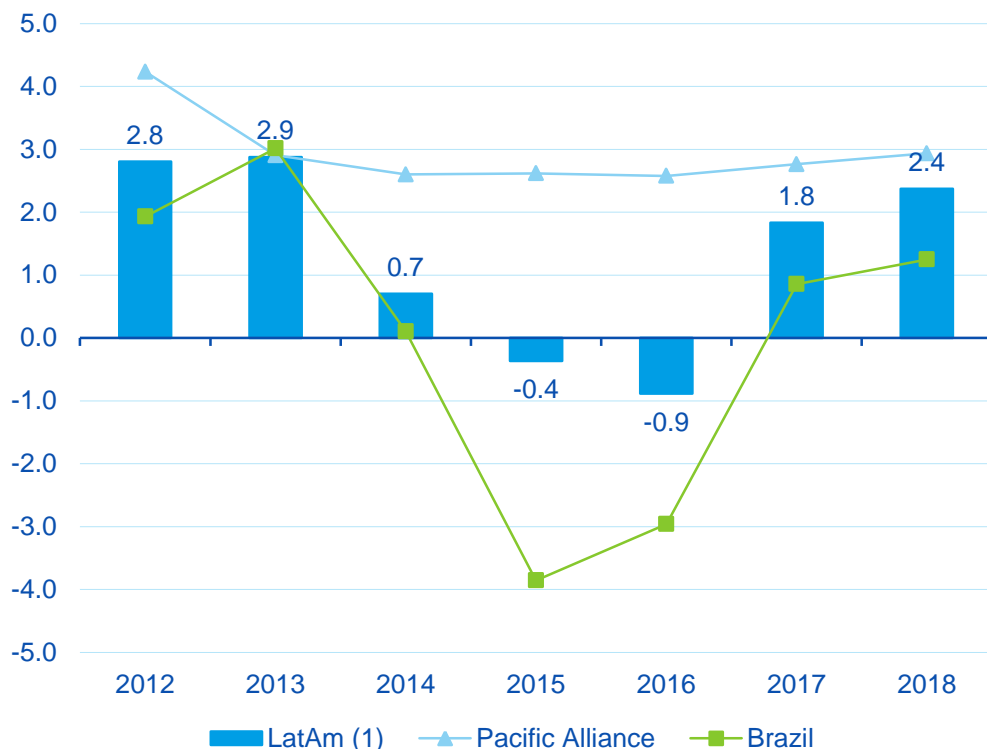
Confidence indicators in pessimist levels in many countries, but the seem to recover in part because of lower political uncertainty (Brazil, Peru)

Firms: low confidence on the weak external environment, political noise in some countries

Households: pessimism on weak labor markets and still-high inflation

Latam: GDP slowdown to end in 2016, with a gradual recovery in 2017

Latam*: GDP growth (%yoy)



Growth forecasts mostly unchanged relative to last quarter. Impact of Brexit compensated by a more dovish path for the Fed.

Stronger 2017 growth in Latam driven by:

- 1. The external sector.** due to depreciated exchange rates and improved terms of trade
- 2. Investment.** especially by the private sector in Argentina and infrastructure investment in Peru and Colombia

2017 growth will still be weak, still below OECD's and below the region's potential

Source: BBVA Research

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

(2) For Argentina. private estimates of GDP are used while official statistics are released

Peru. Argentina. Colombia and Paraguay, the most dynamic economies in 2017

Latam countries: GDP growth (%)



Growth revised down in 2016 in Argentina (new statistics and monetary policy) and Uruguay in 2016-17 (lower consumption).

Pacific Alliance will grow 2.7% in 2016-17

Latin America maintains strong heterogeneity in growth momentum and forecasts

Source: BBVA Research

Inflationary pressures continue to abate except in Argentina, Colombia and Uruguay

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



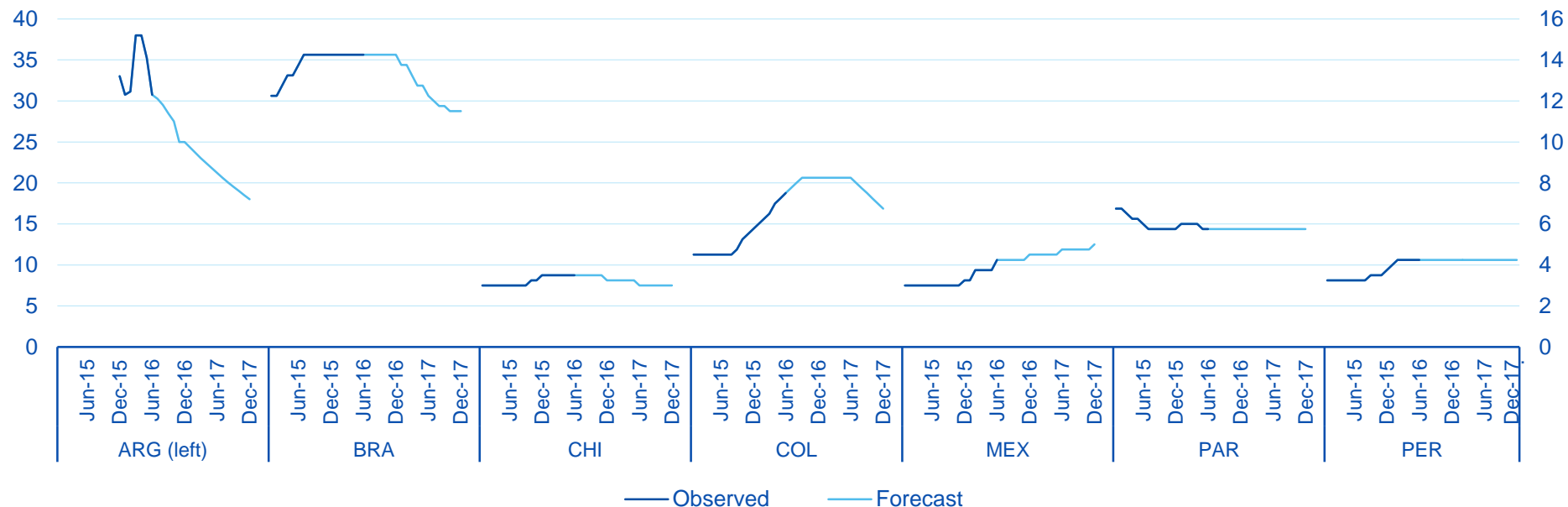
Source: BBVA Research and Haver

Inflation continues to flex down (except Argentina, Colombia and Uruguay)...

... due to low exchange rate depreciation and scant demand-side pressures.

Central banks take a slightly more dovish stance, except in Colombia and Mexico

Official interest rates in inflation-targeting countries (%)



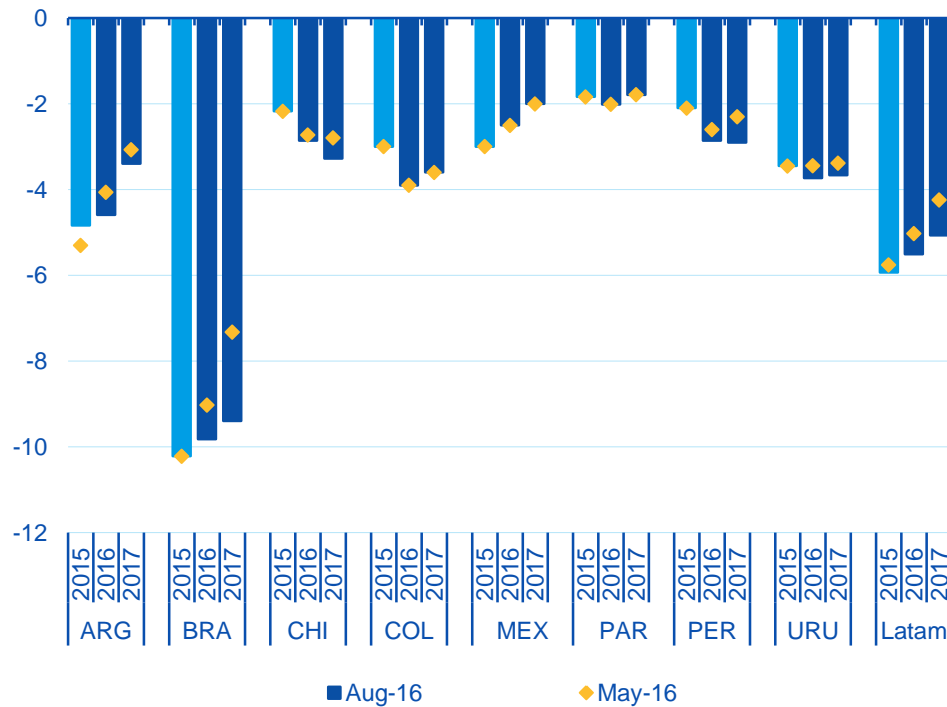
Source: BBVA Research and Haver

Lower pressure on inflation will allow Central Banks to have a more dovish bias, except Colombia and Uruguay.

Mexico kept its focus on the exchange rate and will synchronize with the Fed's hikes going forward.

Fiscal deficits will start to shrink in 2017, except Peru and Chile

Latam: Fiscal balance (%GDP)

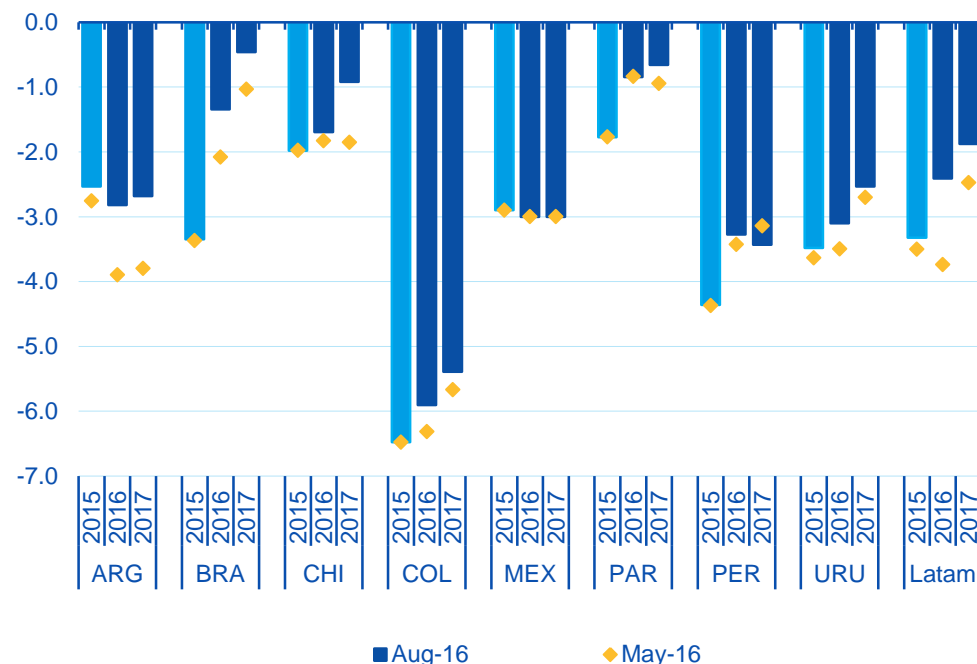


In Brazil, public expenditure cuts will be less ambitious than expected, limited by the political environment.

Correction of public expenditure seems unavoidable in countries with very low (or even non-existent) fiscal space, in the context of a significant negative shock to tax revenues from subdued commodity prices.

External deficits continue to correct in most countries, in part due to deceleration of domestic demand

Latam: Current account balance (%GDP)



External deficits continue to shrink in most countries ...

... driven by the depreciation of exchange rates in previous quarters, a weak domestic demand and a gradual improvement of terms of trade

Main Messages

The global outlook has improved slightly, especially in emerging Asia. Financial stress increased briefly after Brexit, but it was offset by central banks in advanced economies, which are postponing the normalization of their monetary policies. Global growth will increase slowly.

Slowdown of Latam GDP will end in 2016 (-0.9%) in 2016, with a gradual recovery in 2017 (1.8%). The fall in 2016 will mark the third year of growth below OECD's, something that will also happen in 2017. Recovery in 2017 will be driven by the external sector and stronger investment in places like Argentina, Peru and Colombia.

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A hand holding a tablet computer against a blurred city skyline background. The image is dominated by blue tones, with a white diagonal line running from the top right corner towards the center. The word 'Annex' is written in a large, bold, blue font in the lower right quadrant.

Annex

Latam GDP growth forecasts

GDP (%YoY)	2013	2014	2015	2016f	2017f
Argentina*	2.3	-2.6	2.4	-1.0	3.2
Brazil	3.0	0.1	-3.8	-3.0	0.9
Chile	4.0	1.9	2.1	1.7	1.8
Colombia	4.9	4.4	3.1	2.4	3.0
Mexico	1.6	2.2	2.5	2.6	2.6
Paraguay	14.0	4.7	3.1	3.1	2.9
Peru	5.9	2.4	3.3	3.6	4.3
Uruguay	4.6	3.2	1.0	-0.2	0.5
Mercosur	2.9	-0.8	-2.7	-3.7	1.1
Pacific Alliance	2.9	2.6	2.6	2.6	2.8
Latin America	2.9	0.7	-0.4	-0.9	1.8

f = forecast