

Latin America Outlook

4th QUARTER 2017



Main messages

1. **Global growth continues increasing and becomes more widespread.** Financial markets still favor emerging economies. Global risks still remain alive.
2. **Growth recovers in Latin America, but will still be low in 2017-18.** Growth is revised up 0.3pp in 2017 to 1.1% and remains unchanged at 1.6% in 2018. Growth in 2018 will be driven by the external sector and infrastructure investment in Argentina, Colombia and Peru.
3. **Inflation continues falling in South America and starts to do so in Mexico,** driven by stable exchange rates, weak demand and, in some countries, lower food prices. Consequently, central banks will cut interest rates in South America in coming months and at end-2018 in Mexico
4. **External risks for Latam decrease somewhat, apart from the possible overvaluation in financial markets.** On the internal front, political noise and uncertainty also moderate, but remain high.

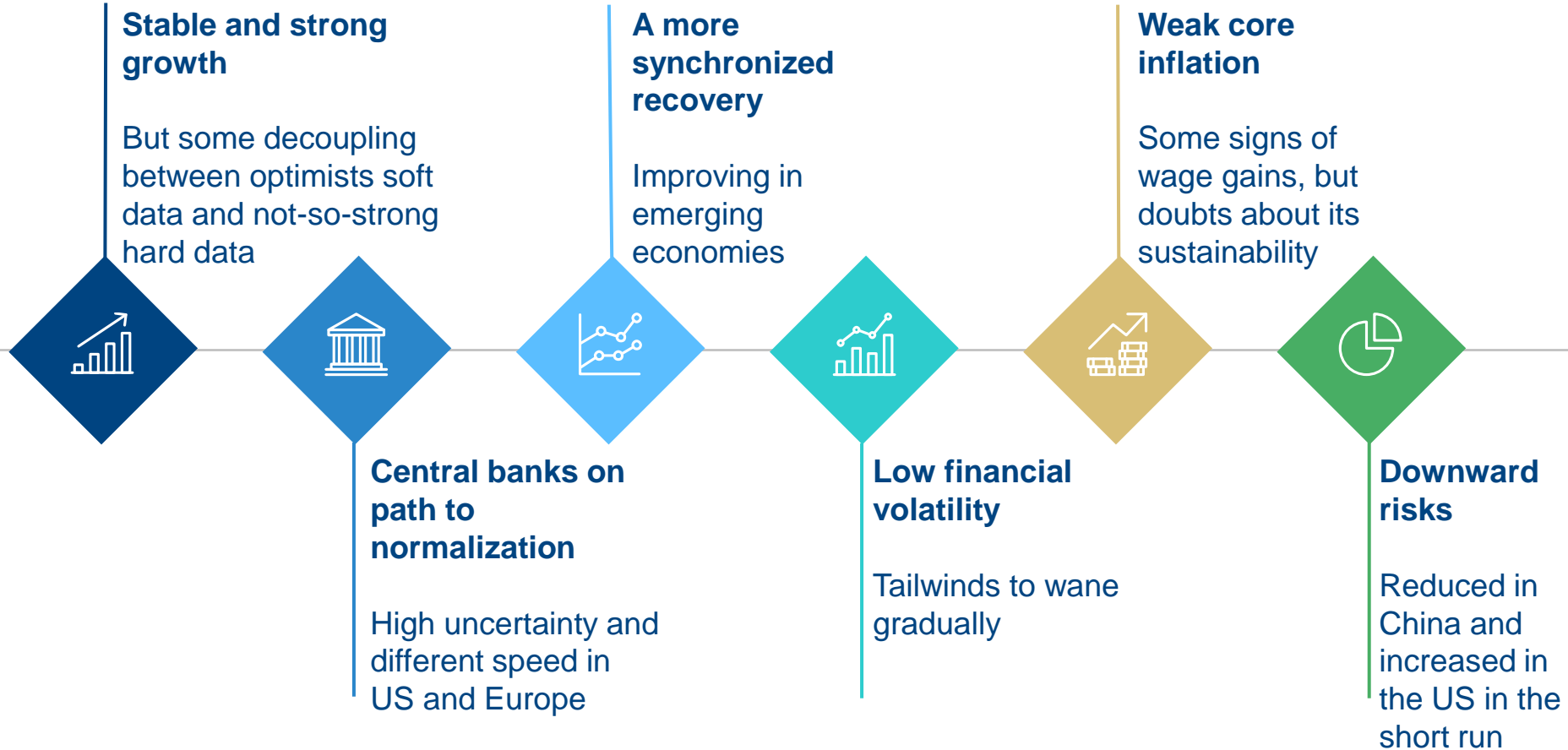


GLOBAL

Positive global momentum gets reinforced, but still with downside risks



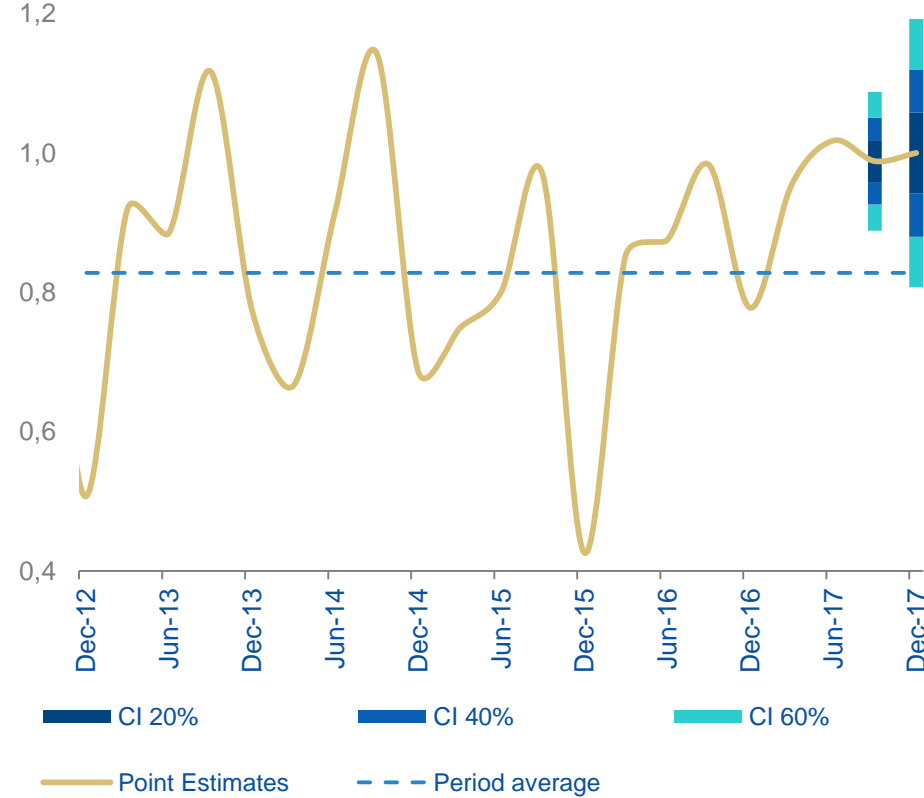
Positive global momentum gets reinforced



Global growth: strong and stable in 2H17

Global GDP growth

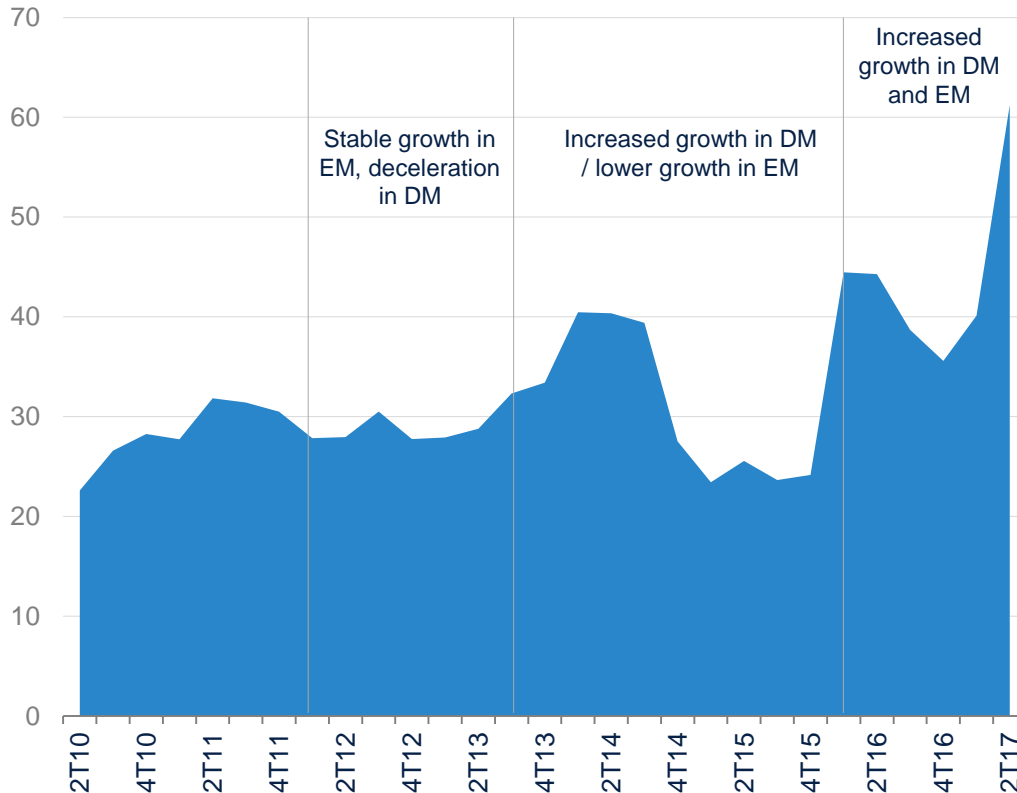
Forecasts based on BBVA-GAIN model (% qoq)



- ◆ Confidence indicators improve significantly, and point to a more positive outlook than hard data
- ◆ Trade grows strongly and industrial production continues recovering
- ◆ Signs of stronger consumption despite waning tailwinds

A more synchronized recovery of global growth across regions

Index of growth synchronization between developed and emerging economies



- ◆ Developed markets:
 - Strong US rebound.
 - Positive surprises in Europe
- ◆ Emerging:
 - Slight deceleration in China, though milder than expected. Still supporting growth in rest of Asia.
 - Russia and Brazil recover, and do not drag global growth
 - Growth improves in Latam
- ◆ Growth gets more support from economic policies

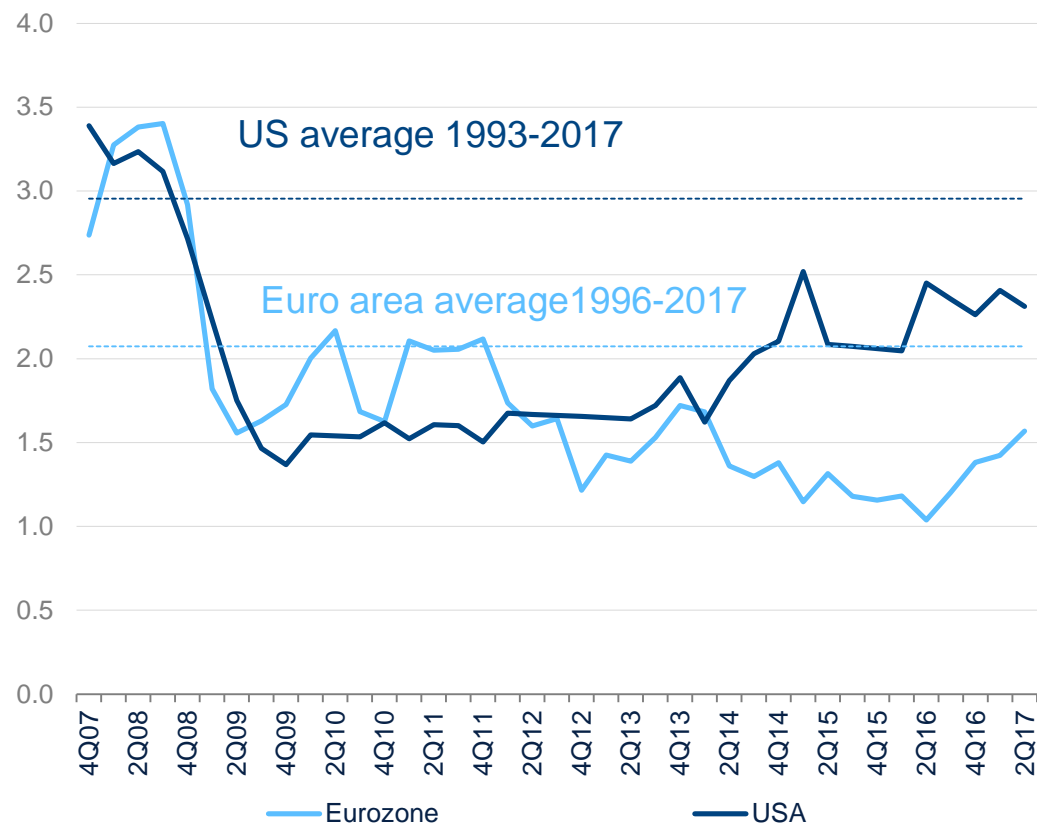
Synchronization index is the inverse of the standard deviation of quarterly growth across countries. Lower volatility is associated with higher synchronization of global growth.

Source: National sources, Markit Economics and BBVA Research

No warning signs regarding core inflation

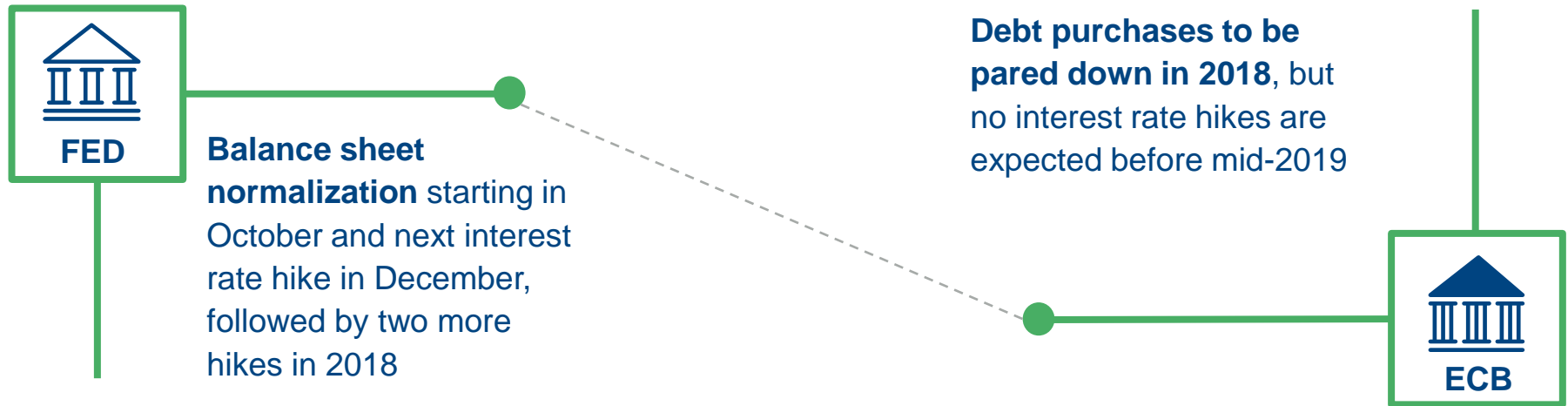
US and Euro area: wages

(%yoy)



- ◆ Despite growth and tighter labor market, **core inflation remains low**
- ◆ Doubts whether recent wage gains will persist. **Inflationary pressures remain low.**
- ◆ **Uncertainty about drivers of inflation:** Permanent or temporary changes?
- ◆ **Caution at central banks, especially in developed markets. Some more policy space in emerging economies**

Central banks on track for a gradual policy normalization



High uncertainty



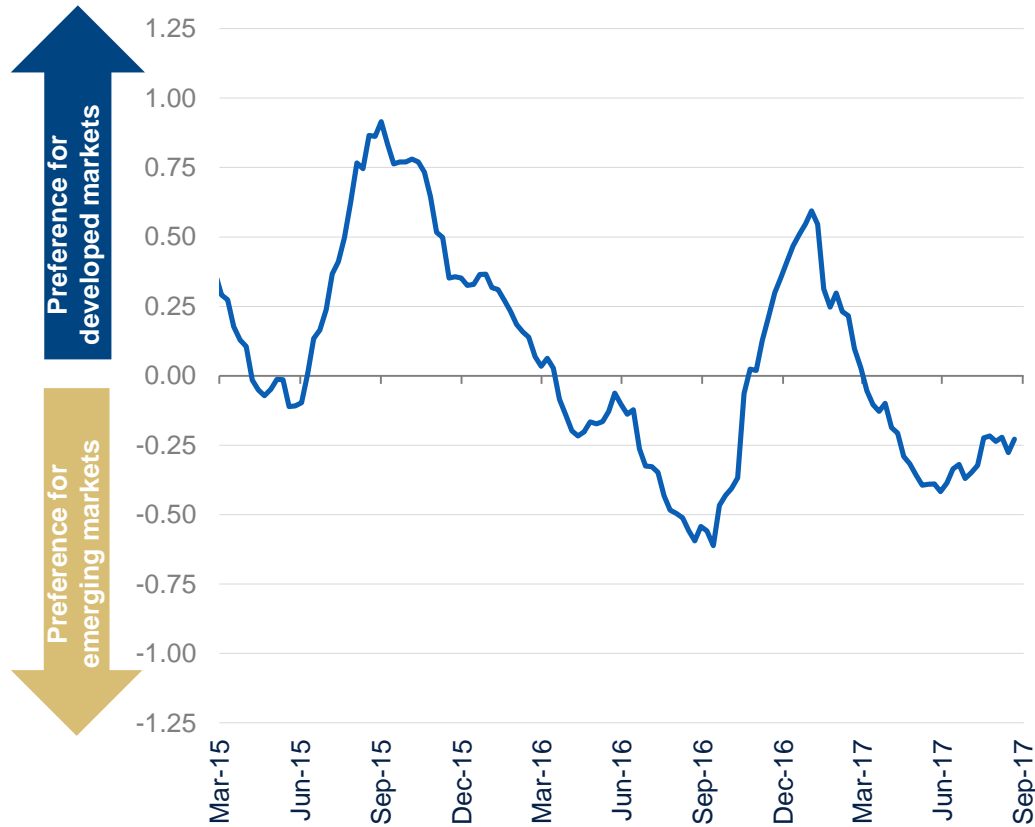
- In **US**, due to subdued inflation and expected changes to FOMC composition in 2018

- In **Euro area**, bias toward more gradual tapering (strong euro) and delaying interest rate hikes (low inflation)

Financial markets still favor emerging economies

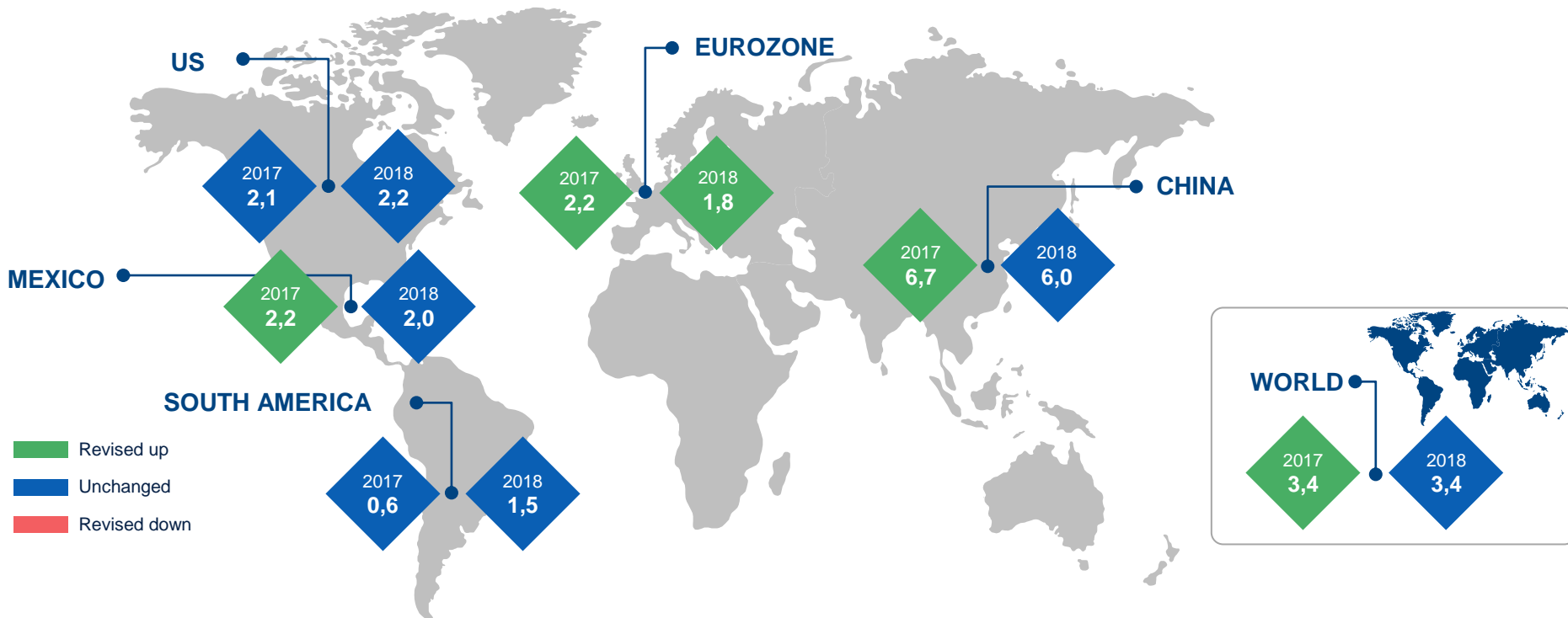
Index of regional asset relocation

(standardized deviation relative to historical mean)



- ◆ Weak dollar and low interest rates support search for yield and emerging market assets
- ◆ Global liquidity will remain high, given gradual policy normalization by Fed and ECB. But these tailwinds will start to wane.

Growth in Europe and China revised up. Upward bias in Latin America

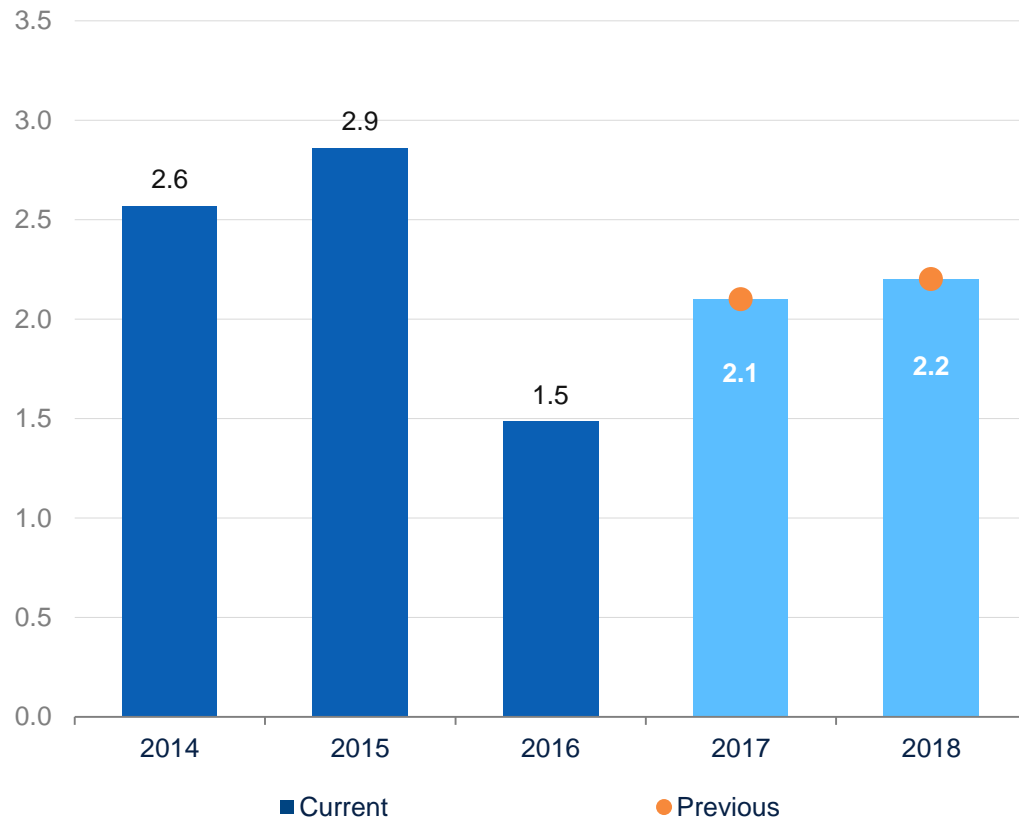


Source: BBVA Research. South America includes: Argentina, Brazil, Chile, Colombia, Mexico, Paraguay, Peru, Uruguay and Venezuela

US: sustained growth despite political uncertainty and hurricanes

US: GDP growth

(%)



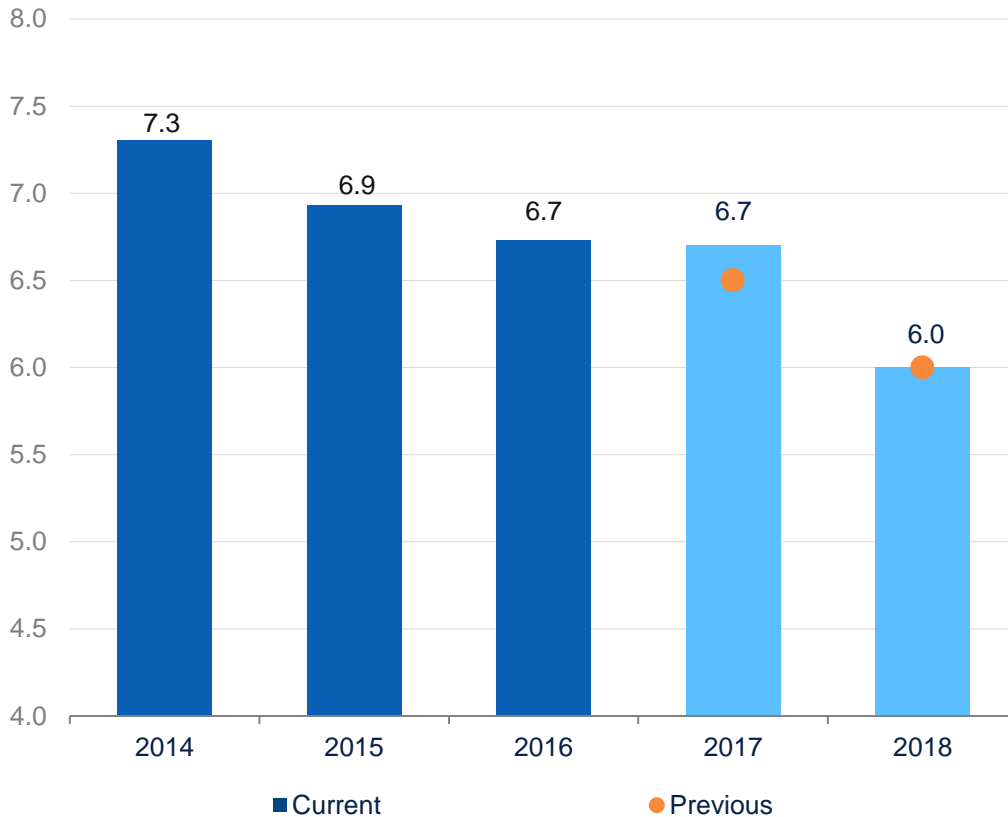
◆ Hurricanes will have a limited impact on activity and thus we keep unchanged our growth forecasts for 2017-18

◆ Pending issues:

- Tax reform still to be fully spelled out
- Uncertainty about economic policy
- Some signs of financial vulnerability
- Increased geopolitical risk

China: more favorable outlook in the short run

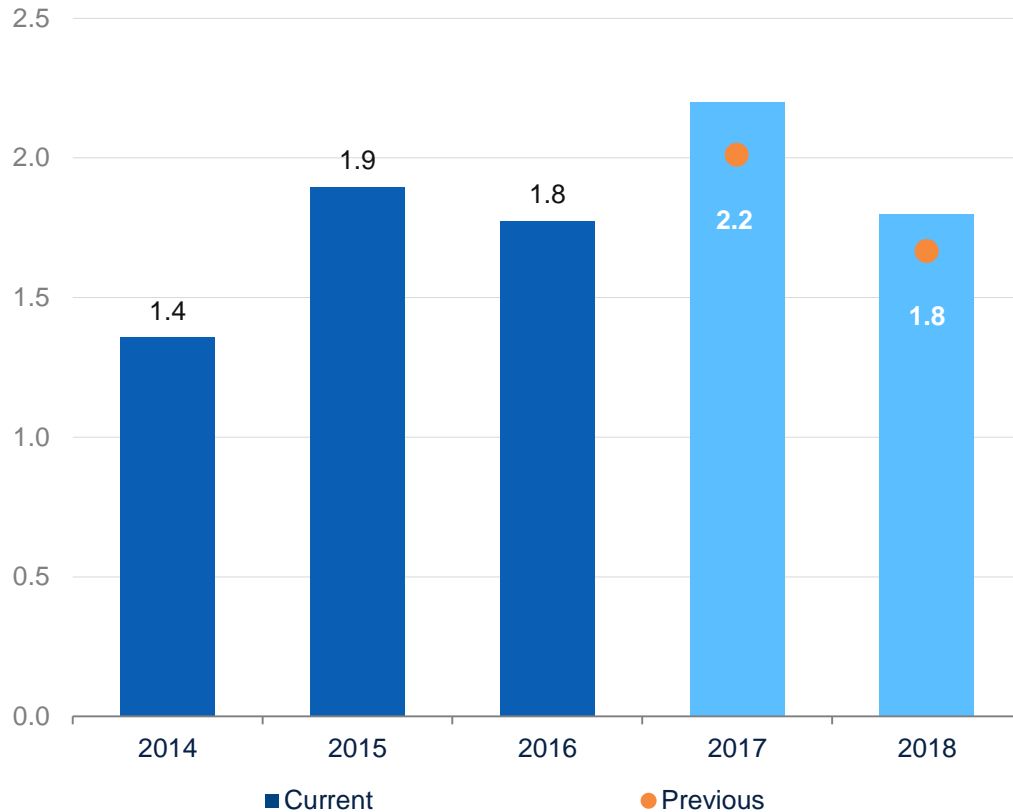
China: GDP growth
(%)



- ◆ Slight upward revision of our 2017 growth forecast, due to better incoming data on 1S17
- ◆ Deceleration in 2018 due to lower impulse from economic policies and exchange rate appreciation
- ◆ Uncertainty about the outcome of the upcoming Communist Party Congress
- ◆ Long-run risks remain, even though financial vulnerabilities have improved given recent regulatory measures.

Euro area: higher growth due to stronger domestic demand

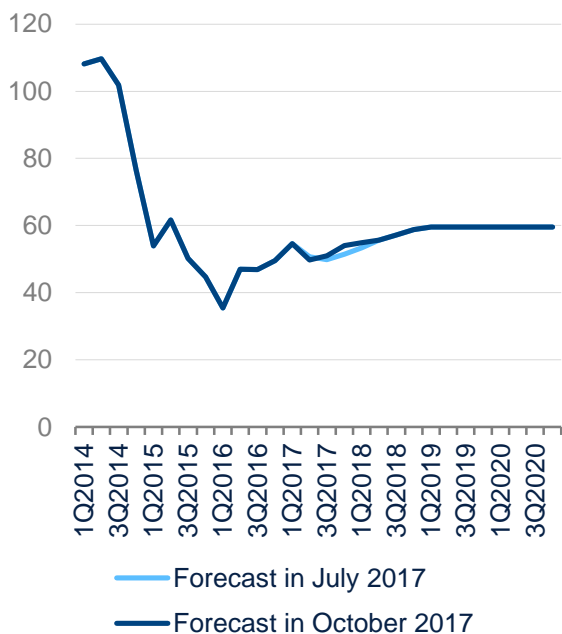
Euro area: GDP growth (%)



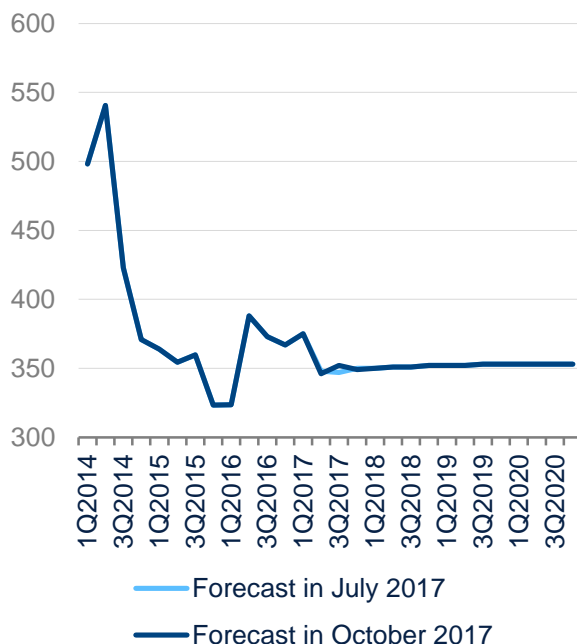
- ◆ Consumption and investment strengthen, with limited fallout from euro appreciation
- ◆ Inflation increases slowly towards ECB target
- ◆ Monetary policy normalization will allow it to continue supporting growth
- ◆ Political and banking risks remain (Spain, Italy, support to European project, brexit) but they become more contained.

Oil and soybean prices on track towards their long-run equilibrium . Copper prices increase temporarily.

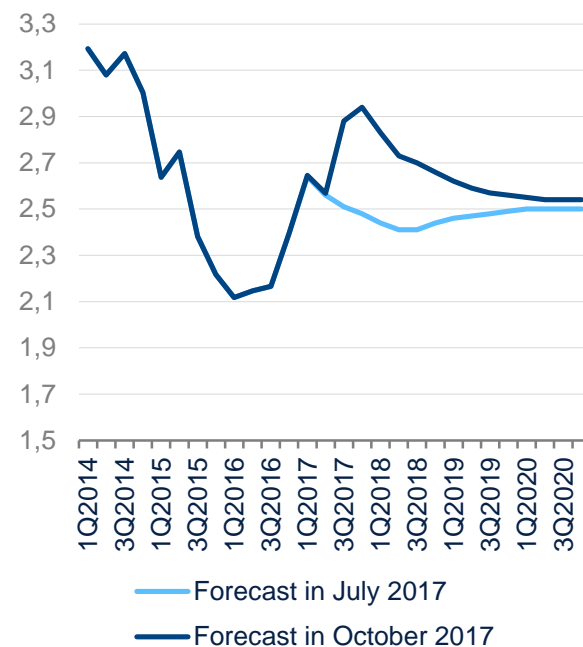
BRENT OIL
(USD/B)



SOYBEANS
(USD/mT)



COPPER
(USD/lb)

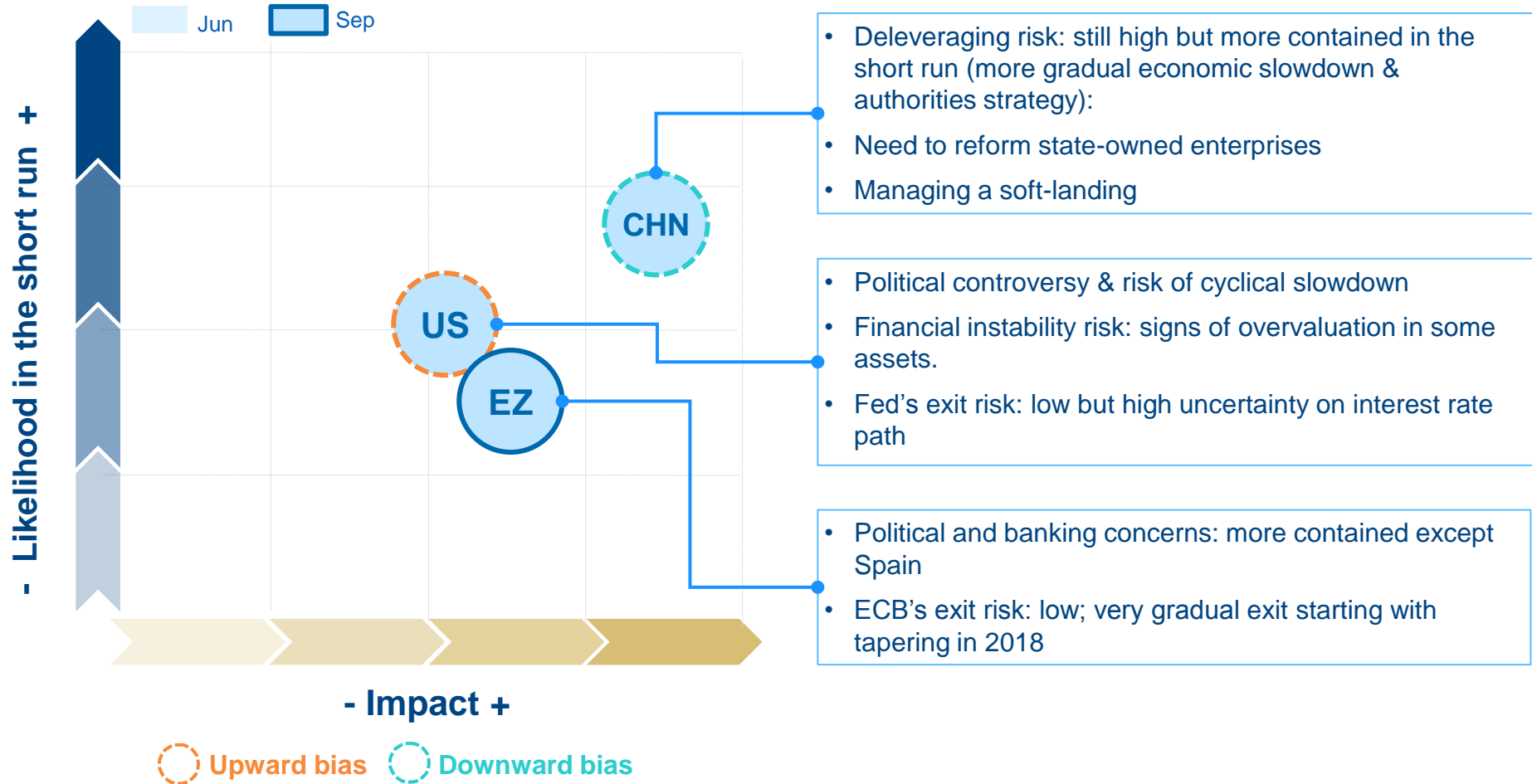


Source: BBVA Research and Bloomberg

Oil and soybean prices maintain our view of gradual convergence towards long-run equilibrium prices. We still expect Brent oil prices to converge towards 60USD/b.

Copper prices increased strongly in the last months driven by financial flows, which should abate gradually going forward. We keep unchanged our view for long-term prices.

Global risks: rebalancing from China to US in the short run



**Other risks: Geopolitics (North Korea); Protectionism

LATAM

Growth recovers, but it
is still low



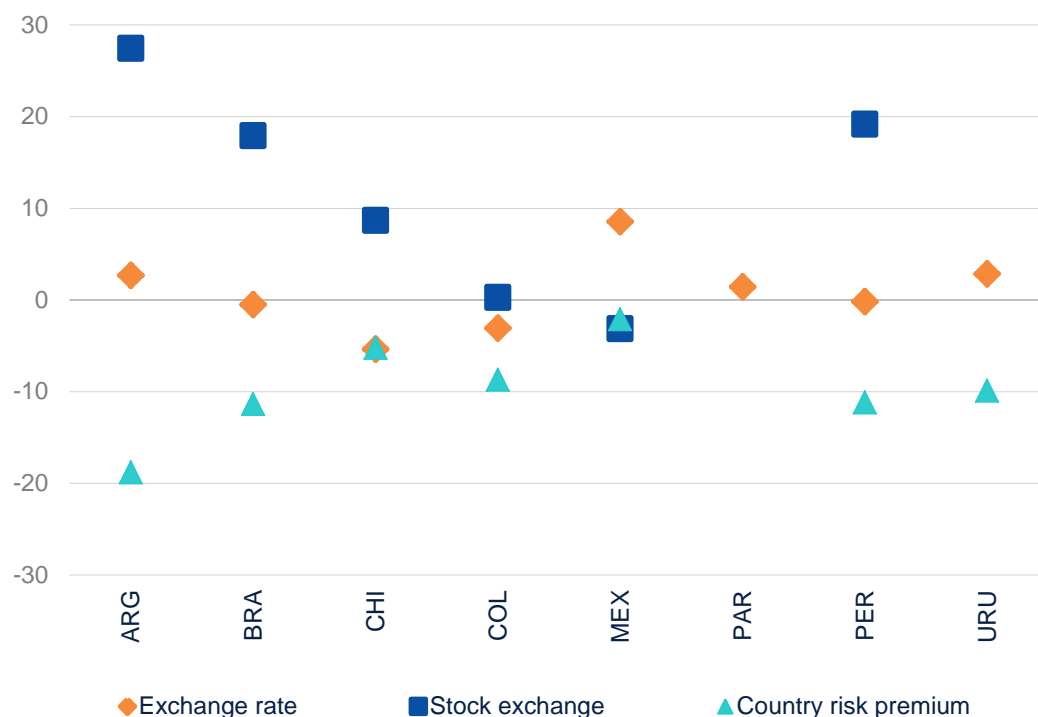
Financial markets continued to show gains for Latam assets...

◆ Asset prices continued to see **significant gains in the last months**, extending the trend since the beginning of 2017, driven mainly by global factors:

- Strong dollar
- Still ample global liquidity
- Increasing global growth
- Higher commodity prices

◆ In addition, **economic activity starts to recover in Latam**

Latam asset prices: percent change in the last 3 months to October 16*

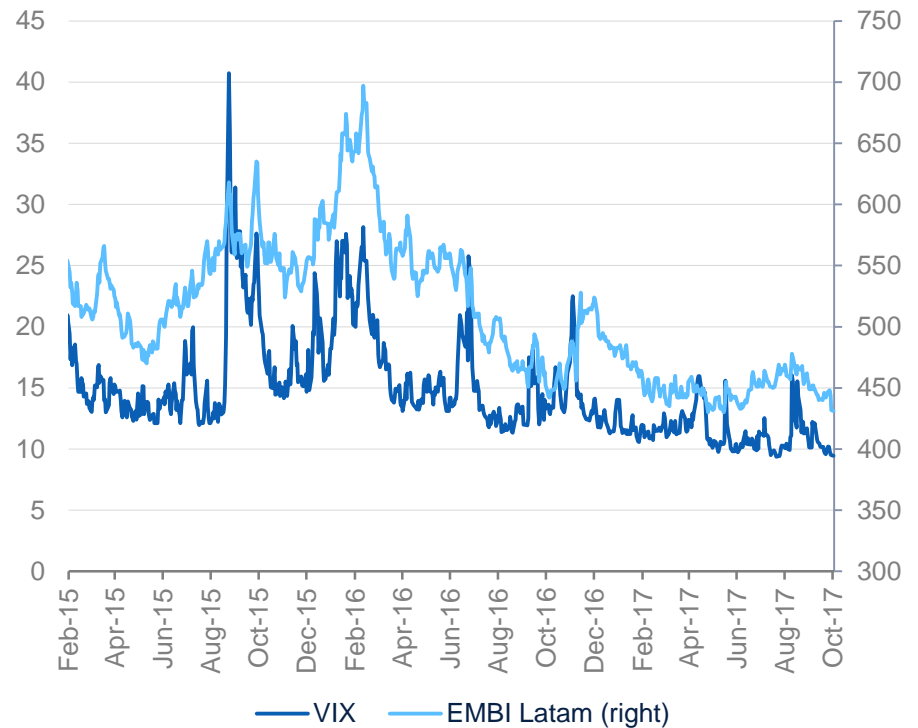


Source: BBVA Research and DataStream * Changes between October 16 and July 17. Exchange rate: local currency per USD. In this case, an increase signals a depreciation. Country risk premium: EMBI.

... in and environment of unusually low volatility, which could be abruptly reversed

- ◆ **Volatility at historical lows** despite increasing economic, political and geopolitical uncertainty
- ◆ **Risk of complacency by markets,** at a time of increasing rates by the Fed.

Volatility in developed markets and country risk premium in Latam

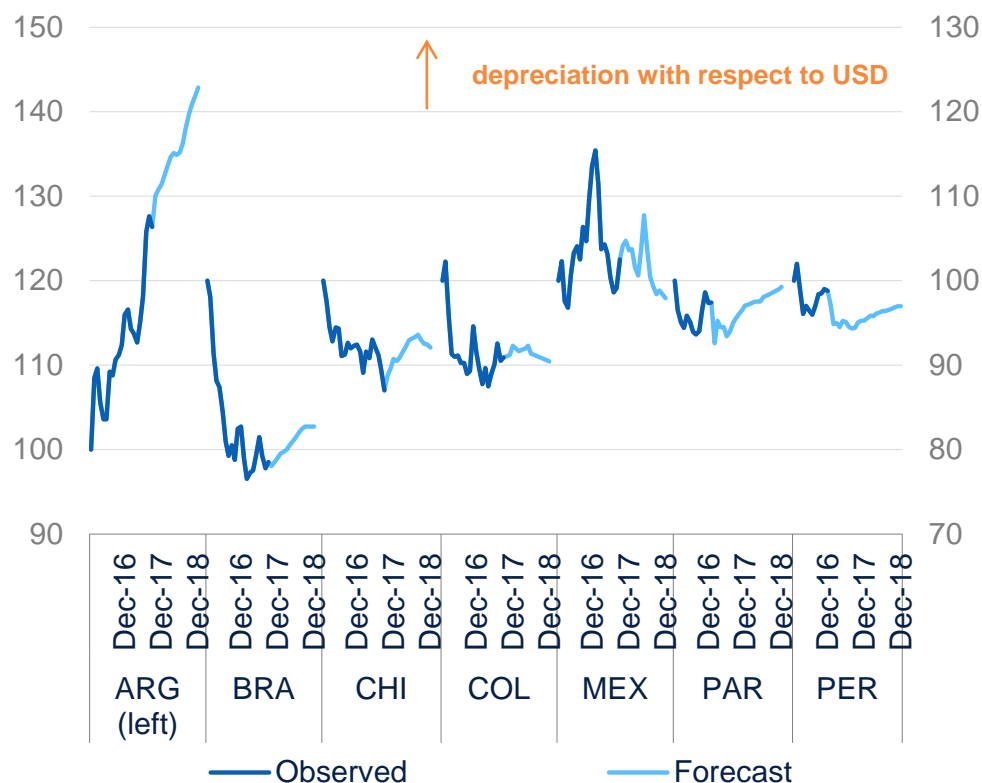


Limited exchange rate depreciation in 2018

- ◆ **Stable or appreciating exchange rates** in the last 3 months. Real exchange rate appreciation in all countries.
- ◆ We continue to expect a **mild depreciation of exchange rates going forward**, consistent with diverging policy interest rates between US and Latin America
- ◆ **Mexican peso could appreciate in 2018** if risks relative to renegotiation of NAFTA and local elections remain contained.

Exchange rates to the USD

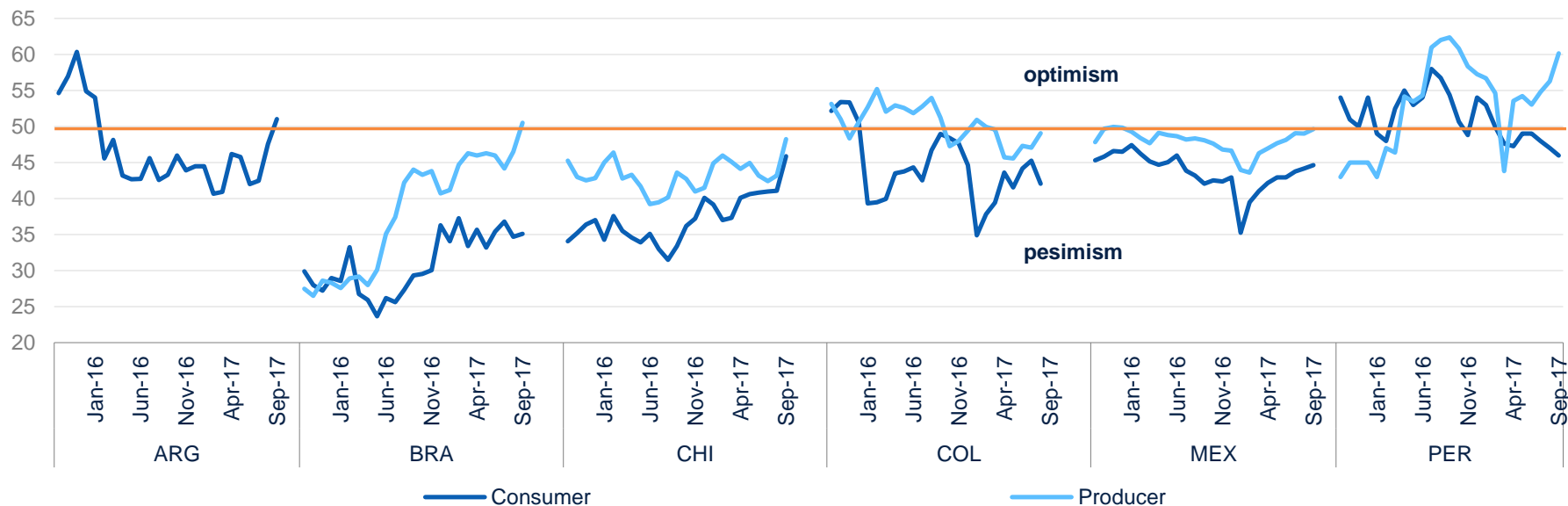
(Index Dec 2016=100)



Confidence indicators remain pessimistic throughout the region, but improved in the last months

Latam: Confidence indicators for households and firms

(values above 50 pts indicate optimism)



Source: BBVA Research and Haver

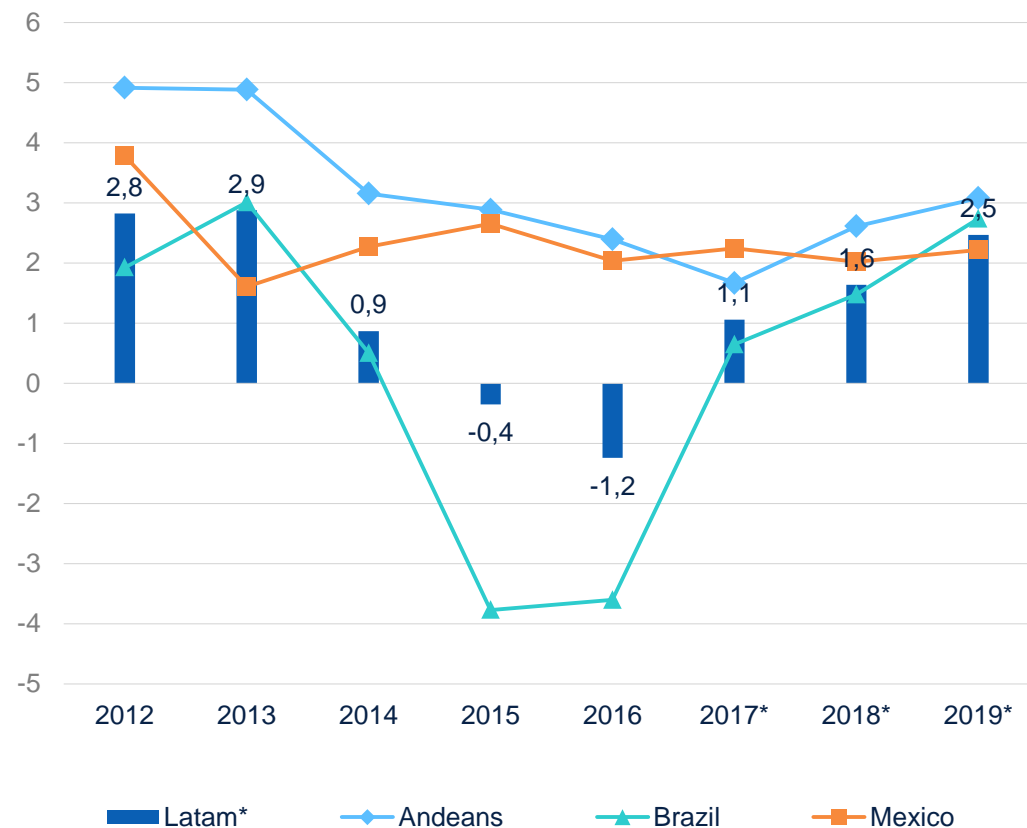
Some recovery of producer confidence, supported by low volatility in financial markets, higher commodity prices and somewhat lower political noise and uncertainty in some countries.

For households, lower inflation has improved sentiment somewhat, which nonetheless remains in pessimistic ranges, dragged by weak labor markets.

Growth recovers in Latam, but it will still be low in 2017-18

- ◆ Recovery after a 5-year deceleration and a GDP contraction in 2015-16
- ◆ Stronger growth in 2018 driven by:
 - External sector, supported by more favorable terms of trade and stronger global growth
 - Investment, especially in places like Argentina, Colombia and Peru
- ◆ Growth still low in 2017-18, below potential, and below developed economies

Latam: GDP growth (%)

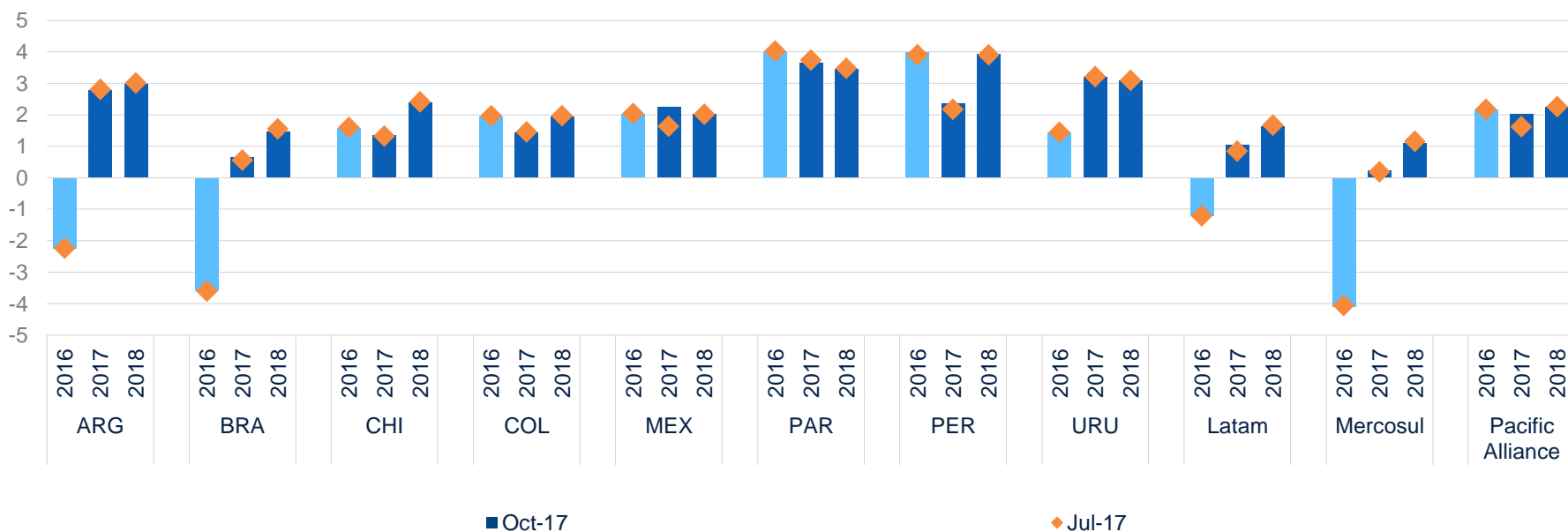


Source: BBVA Research

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

Latam growth revised up in 2017 (1,1%) and unchanged in 2018 (1,6%)

Latam countries: GDP growth (%)



Source: BBVA Research

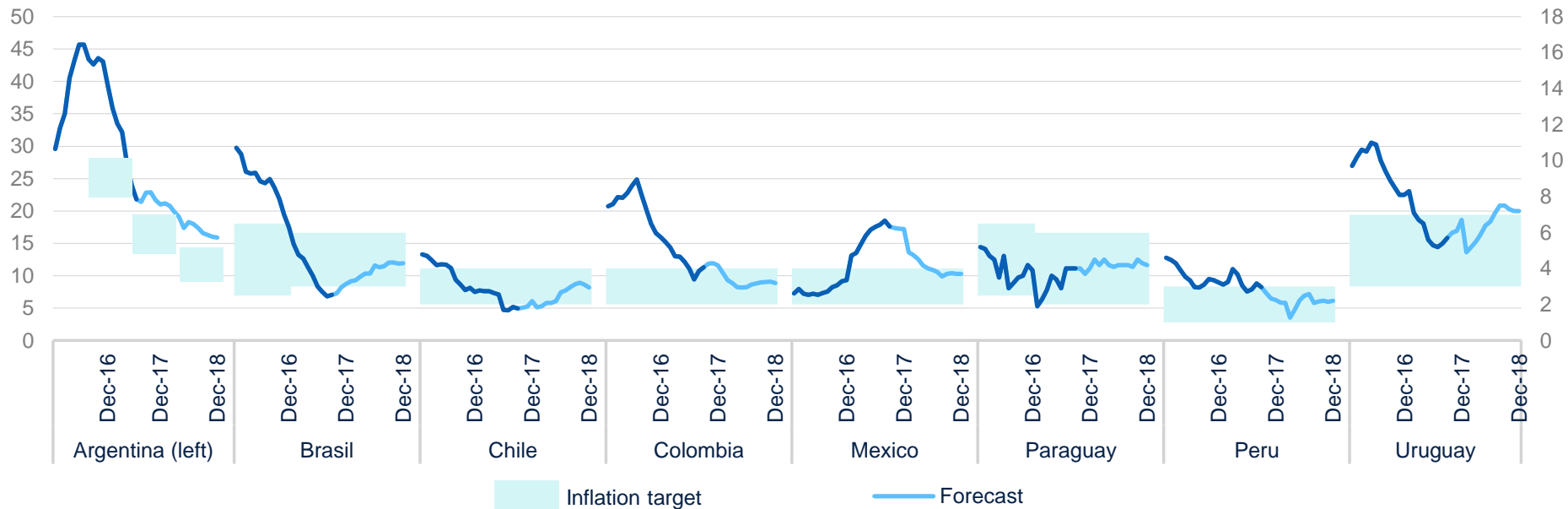
Recent data confirm recovery under way in Argentina and also in Brazil, Chile and Peru.

Economic activity in Mexico surprised to the upside in 1H17, but there are early signs of a deceleration in 2H17.

We revise up our growth forecasts for Mexico and Peru in 2017, given the strength of domestic demand in 1H17.

Inflation continues to diminish in South America and starts to do so in Mexico

Latam: inflation and central bank target ranges
(%, yoy)



Source: BBVA Research

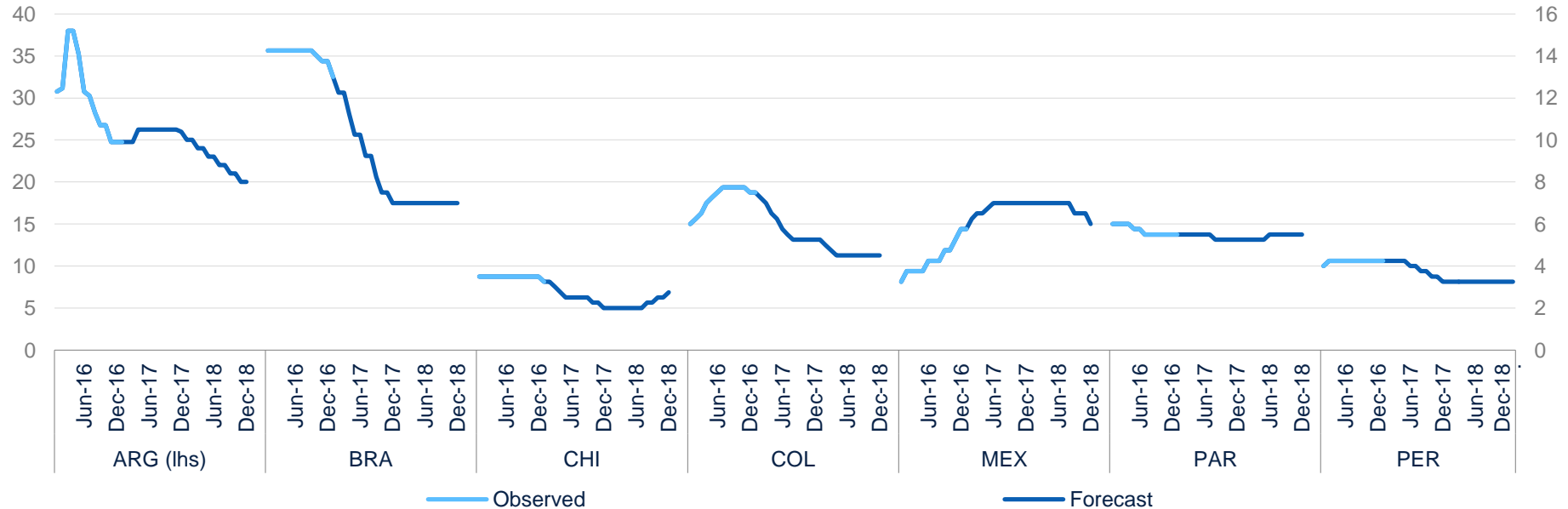
Lower inflation in South America due to a stable exchange rate, weak demand and lower food prices.

Inflation will stop falling in Brazil and Chile, but will remain below their central bank target during some time. It will continue to converge to target in Peru and Colombia. Inflation will start to abate in Mexico and will continue to fall in Argentina

Additional interest rate cuts in South America in coming months. Rate cuts in Mexico at end-2018.

Latam: official interest rates

(%)



Source: BBVA Research and Haver

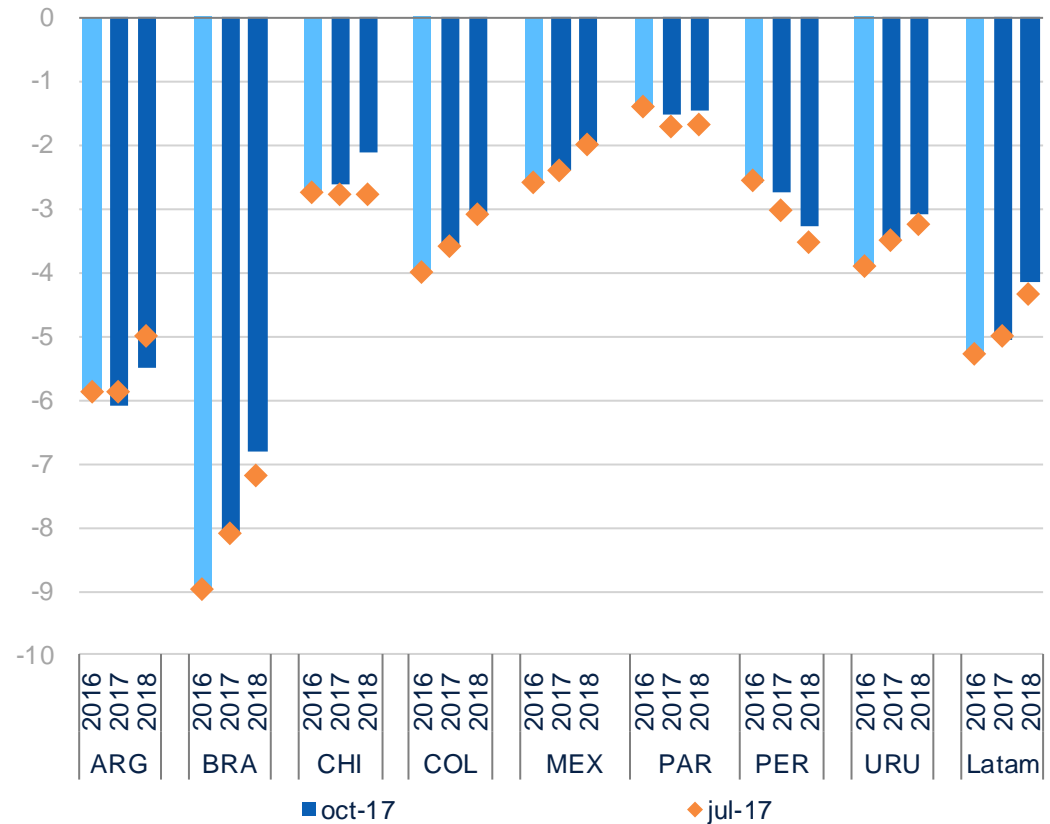
Interest rate cuts in South America will continue during the rest of 2017 or at the beginning of 2018 (varying by country), given low or declining inflation and weak domestic demand.

In Mexico, Banxico will keep interest rates unchanged until 3Q18, when it will start cutting rates, provided inflation returns to the target range and volatility in financial markets does not increase.

Fiscal deficits will continue to shrink, except (temporarily) in Peru

- ◆ Increase in our forecast for fiscal deficits in Argentina, due to interest payments and despite the more positive performance of primary deficit targets.
- ◆ A slower fiscal consolidation path in Brazil, due to less ambitious primary deficit targets, compensated with lower interest rate payments.
- ◆ Fiscal outlook improves in Peru and Chile, given higher copper prices.

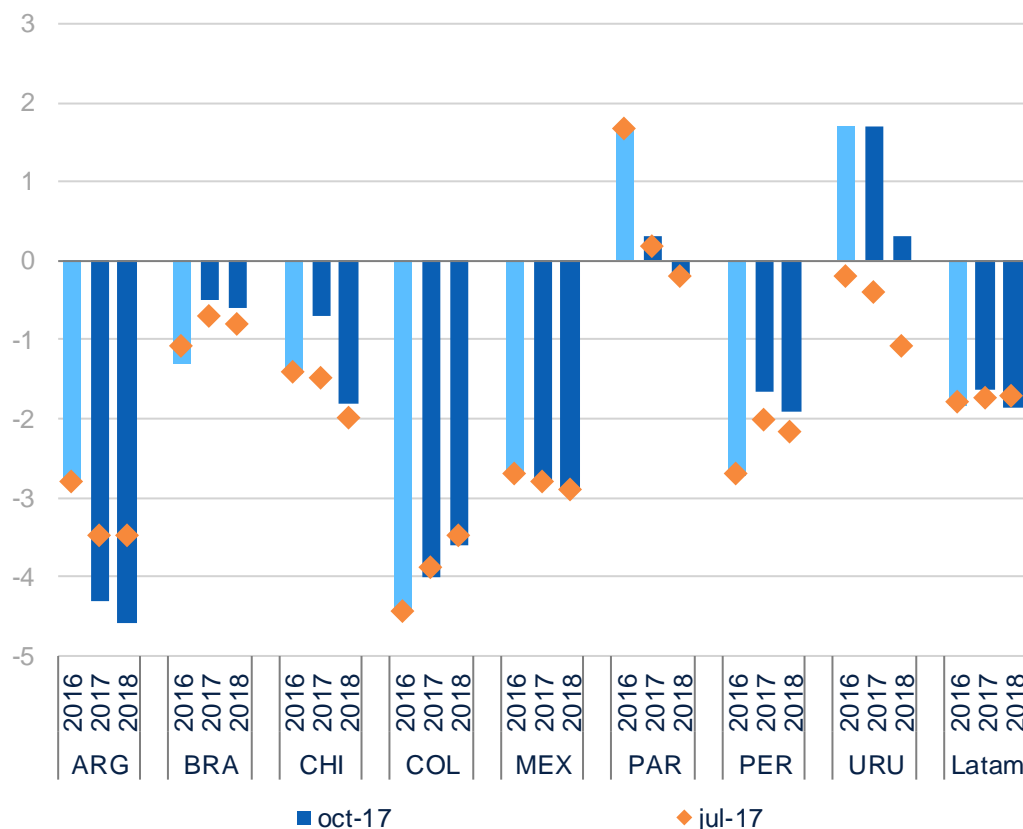
Latam: fiscal balance
(%, GDP)



Current account deficits improve in most countries. Better outlook in Brazil, Chile and Peru

- ◆ External deficits continue to shrink in countries with the widest gap, like Colombia, although at a slower pace than anticipated in some cases
- ◆ On the contrary, Argentina's externa deficit worsens, given strong increase of imports.
- ◆ External outlook in Brazil, Peru and Chile improves, given increase of metal prices.

Latam: current account balance
(%, GDP)



Main messages

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ANNEX



Latin America GDP growth forecasts

GDP (%)	2014	2015	2016	2017f	2018f
Argentina	-2.5	2.6	-2.2	2.8	3.0
Brasil	0.5	-3.8	-3.6	0.6	1.5
Chile	1.9	2.3	1.6	1.3	2.4
Colombia	4.4	3.1	2.0	1.5	2.0
Mexico	2.3	2.7	2.0	2.2	2.0
Paraguay	4.7	3.0	4.0	3.7	3.5
Peru	2.4	3.3	4.0	2.4	3.9
Uruguay	3.2	0.4	1.4	3.2	3.1
Mercosur	-0.4	-2.8	-4.1	0.2	1.1
Pacific Alliance	2.6	2.7	2.2	2.0	2.3
Latin America	0.9	-0.4	-1.2	1.1	1.6