BBVA Research

Latin America Economic Outlook

2Q19

April 2019

Creating Opportunities

Main messages (I)

- Uncertainty remains amid continued weak global economic activity, leading to a shift toward more expansionary policies, especially by the central banks of the major world economies
- The price of some of the most important commodities for the region, such as oil and copper, will be reduced going forward in line with the decreased global demand, although the price of soybeans will probably recover. We are maintaining our previous forecasts for oil, while slightly adjusting projections for the price of copper (upwards) and soybeans (downwards)
- Latin America is moving in line with the global economy: we expect a regional growth of 1.7% in 2019 and of 2.3% in 2020, less than previously expected (2.1% and 2.4%, respectively), due to the increased difficulties in implementing necessary adjustments and the weaker economic activity figures released in recent months, mainly in Argentina, Brazil and Mexico, against the backdrop of a slowdown in the world economy

Main messages (II)

- The revision of growth forecasts has been concentrated in Brazil, Mexico and Argentina, although there are also downward adjustments in Paraguay and Uruguay's forecasts. In Brazil and Mexico, where the capacity to boost investment through policies will be key, growth is expected to be between 1.4% and 2.2% in both 2019 and 2020. And in Argentina, following a 1.2% contraction this year, GDP is expected to expand by 2.5% next year alongside a recovery of domestic demand
- Chile, Colombia and Peru are showing greater resilience in the face of a less favorable global environment: the growth forecasts remain around 3.5% in 2019 and 2020
- The shift amongst the major world economies toward more expansionary monetary policies creates room for maneuver for the central banks of the countries in the region. Thus, in a context where inflation remains under control, most central banks in the region will postpone the upward adjustment of their interest rates, while in Mexico the easing cycle of monetary policy will begin earlier. The situation in Argentina stands in contrast with the regional trend: monetary conditions will be tighter than previously anticipated, given higher inflationary pressures
- A more abrupt slowdown of global growth than expected and new protectionist measures would pose additional problems for the region. In addition to these risks, those related to local political and fiscal issues remain significant

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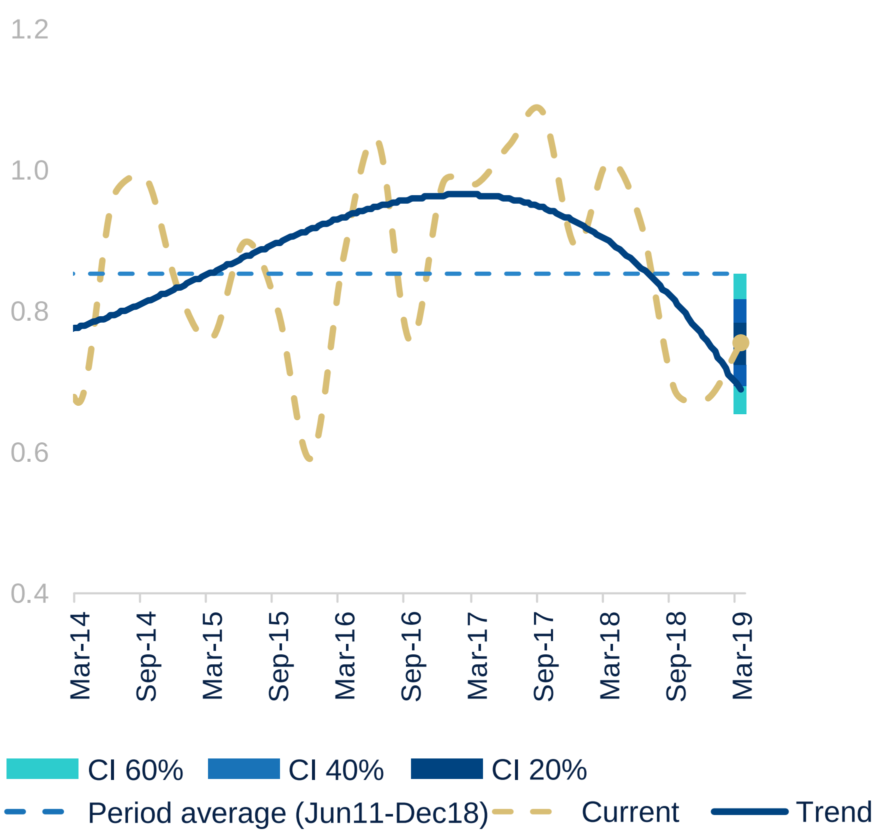
Global Environment: mild growth moderation

Global GDP has moderated more than expected

World GDP growth

(Forecasts based on BBVA-GAIN % QoQ)

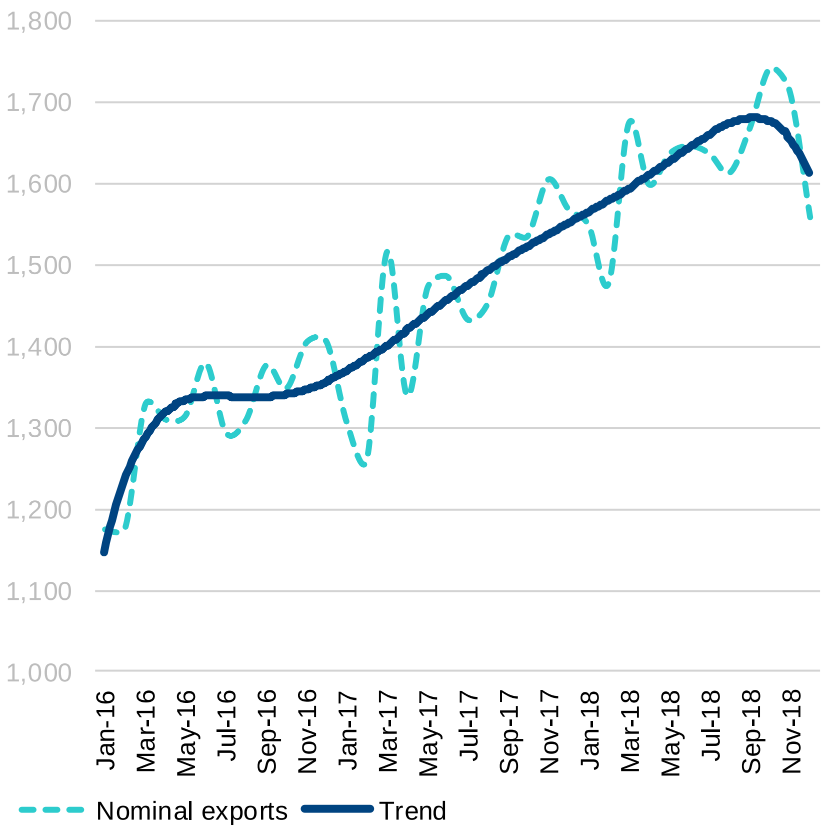


- Global growth has slowed due to China's structural moderation, high uncertainty in Europe, trade protectionism and the cyclical slowdown in the US
- A slight improvement is possible in the short, but activity will remain less dynamic than in previous years

Source: BBVA Research

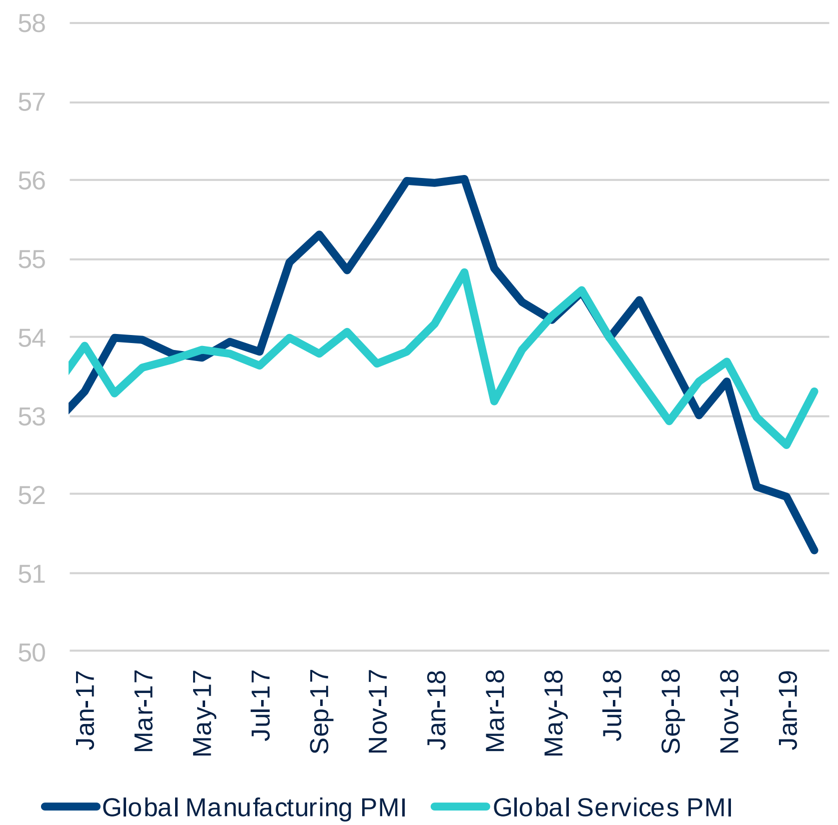
Weak exports and investment, but private consumption remains relatively robust

World Exports
(Thousands of dollars)



Source: BBVA Research based on IMF data

PMIs
(Level)



Source: BBVA Research based on IHS Markit data

Growth moderation has caused a shift in monetary policy in the US and the Eurozone, and new stimuli in China

Fed

- **Long pause in the rate hike,** but there could be a hike by the end of the year
- **The normalization (reduction) of the balance sheet will end earlier than expected** (September 2019)

BCE

- **Postponement of monetary normalization**
- **Lower interest rates** for longer and additional liquidity

China

- **Additional monetary stimulus:** RRR and lending rate reductions in 2019
- **Increase in public deficit,** to 2.8% of GDP in 2019
- **Tax cuts** (2% of GDP)

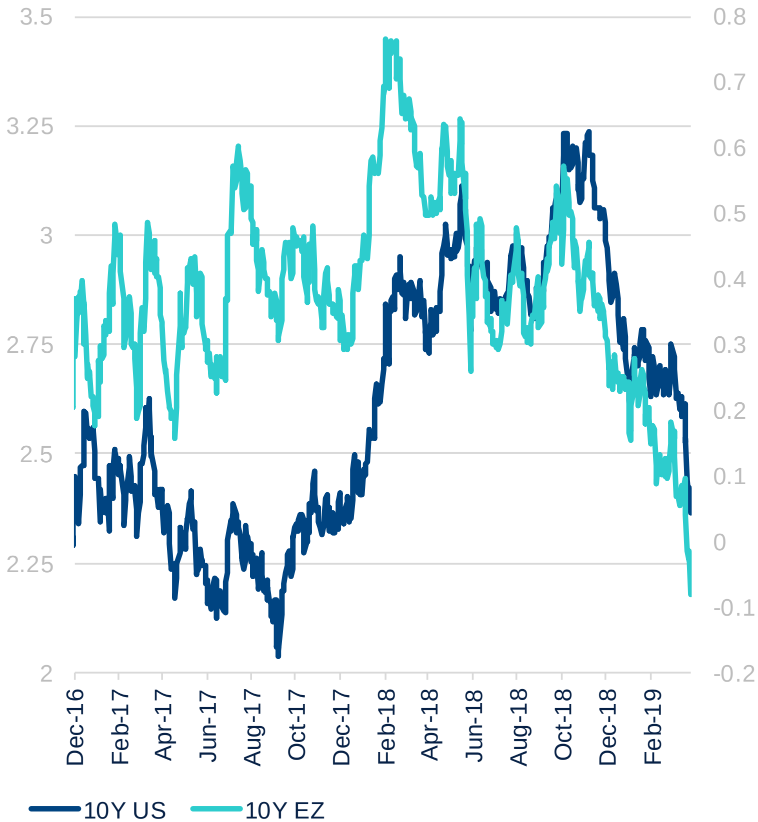
Latam and other emerging countries

- There is room for a **more dovish monetary policy**

Markets: long-term yields excessively low due to cyclical risk and “safe haven” effect , with volatility limited by central banks' dovish tone

Sovereign debt yields

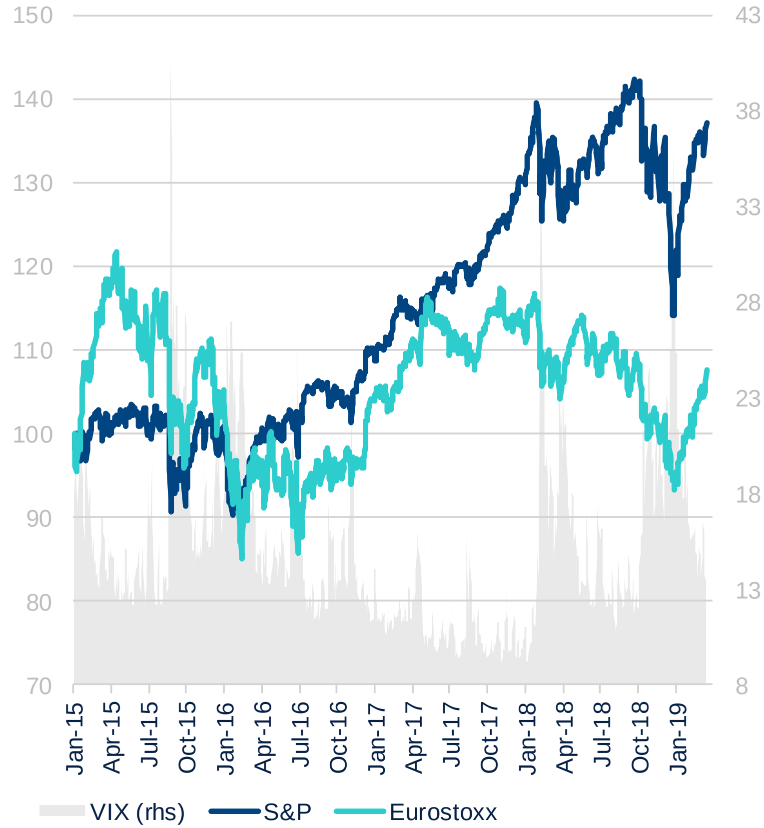
(%)



Source: BBVA Research based on Haver data

Equity indexes and Volatility (VIX)

(Base 100 in Jan-15 and %)



Source: BBVA Research based on Haver data

Protectionism: US-China trade agreement delayed, as the EU begins to gain prominence as focus of tensions

U.S.

Negotiations are still ongoing; the most likely is an agreement in 2Q19

U.S. threatens to increase tariffs on EU vehicles

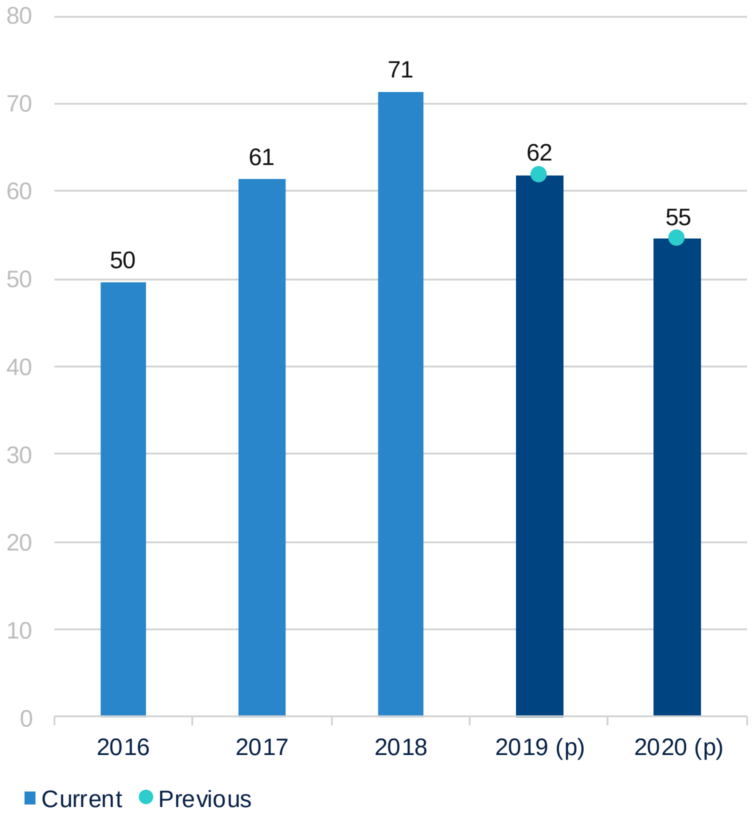
China

EU toughens stance on China, seen as "economic competitor" and "systemic rival"

European Union

Oil markets: as expected, supply adjustments provided support to prices in 1Q19, which will likely move down from now onwards

Brent prices
(USD per barrel, end-of-period)



Source: BBVA Research based on Haver data

- Production cuts have driven oil prices up (65 dollars per barrel, on average, in 1Q19)
- We maintain prospects for lower prices in 2H19 and 2020, on slower economic growth and rising US supply
- The lower global demand will also favor a drop in copper prices, although we have revised our forecasts slightly up, mainly due to supply disruptions
- In the case of soybeans, we have revised our forecasts slightly upwards, but we continue to expect prices to recover moving forward

Action by central banks and an absence of "accidents" would enable global growth to soft-land

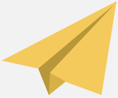
More signs of global slowdown

New stimulus policies

Assumption on the evolution of the global outlook: no "accidents"

01
Protectionism
An US-China trade agreement is still likely, despite the delay

02
***Brexit*:**
Greater uncertainty, for a longer time

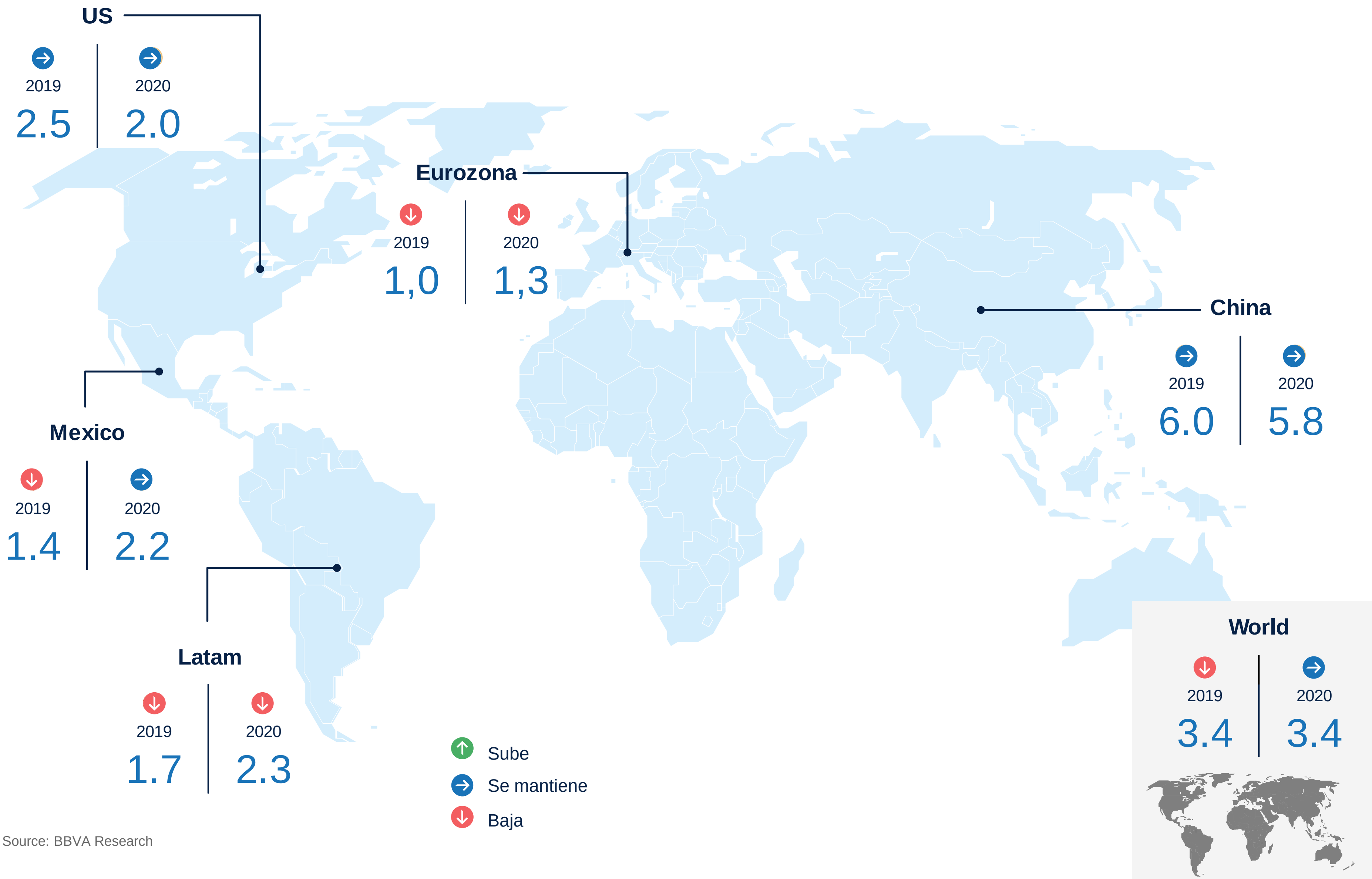


03
Financial markets: volatility constrained by central banks' measures

04
Oil:
Price moderation following the recent upturn

Global growth soft-lands

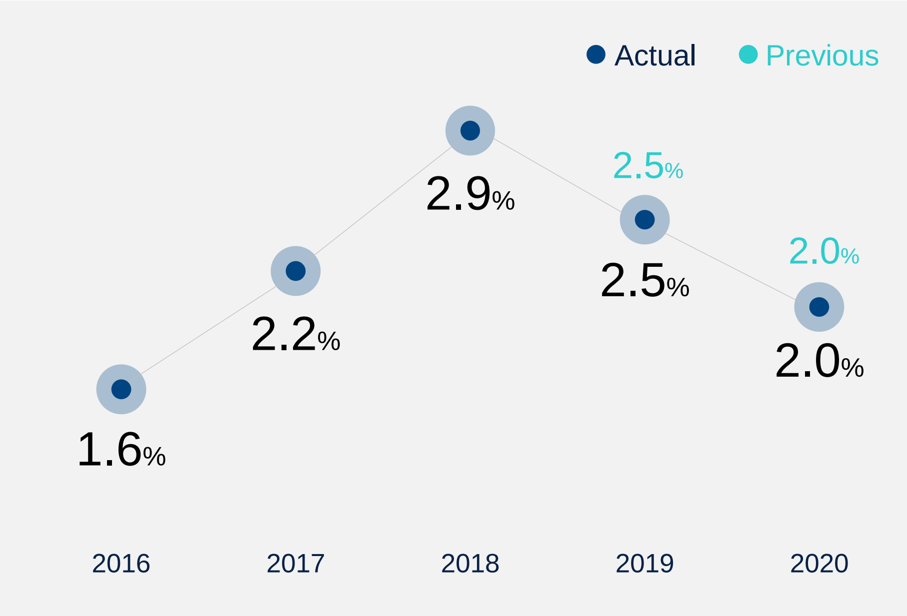
Without "accidents", global growth will decelerate gradually



Source: BBVA Research

US: a cyclical activity moderation and a more patient Fed

US: GDP growth
(% y/y)

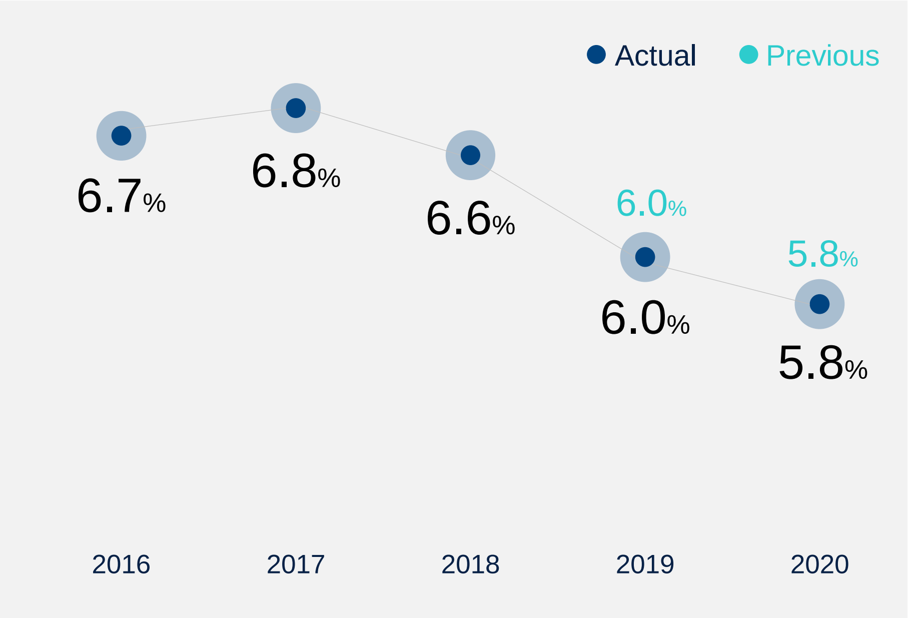


- Growth will continue to lose steam moving forward, converging to the potential rate
- Unchanged growth forecasts (with a downward bias), while the risk of recession remains high
- Inflation is expected to continue below the 2% mark during 2019

Source: BBVA Research

China: a trade deal with the US and more supportive policies to favor a soft-landing of the economy

China: GDP growth
(% y/y)

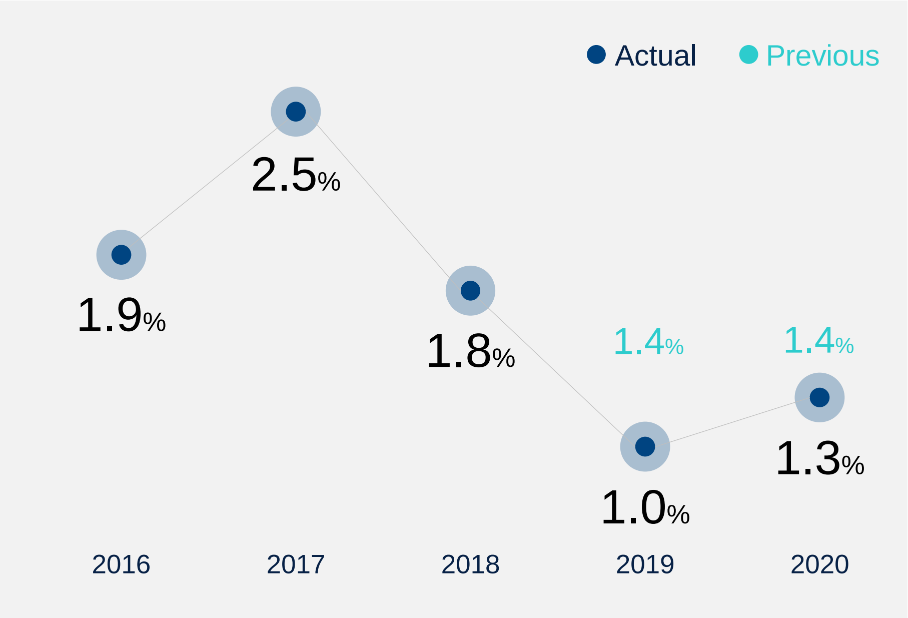


- The growth target was lowered to a range between 6.0% and 6.5%
- Growth deceleration is the prime risk throughout 2019
- Monetary stimulus: expected cuts in both RRR and lending rates
- Fiscal stimulus: tax cuts (mainly VAT) of 2% of GDP

Source: BBVA Research

Eurozone: more prolonged activity weakness to cause lower growth in 2019, some recovery expected in 2020

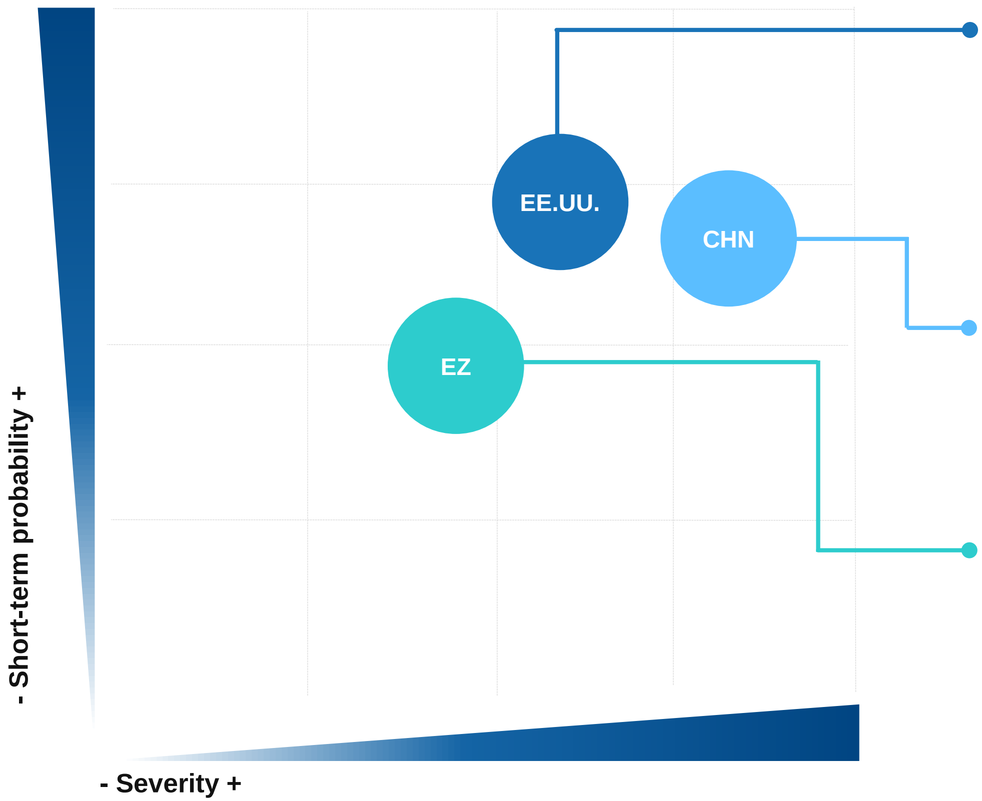
Eurozona: GDP growth
(% y/y)



- Downward revision of GDP growth forecasts
- Adjustment in activity expectations concentrated on exports and investment, given lower external demand and lingering uncertainties
- The euro is expected to appreciate from mid-2019 onwards, but at a more gradual pace than expected

Source: BBVA Research

Global risks: increasing fears about a recession in the US and in the Eurozone, in spite of central banks' broader support



- **Recession: high**
- **Proteccionism: high**
- **Fed's exit: significantly lower**

- **Disorderly deleveraging : relatively higher**
- **Proteccionism: high**

- **Recession: on the rise**
  - *Brexit*
  - Italy
  - Surge of Eurosceptic forces in the European Parliament
- **Proteccionism: on the rise**
- **ECB's exit: significantly lower**

Source: BBVA Research

Financial vulnerabilities can amplify the severity of the risks

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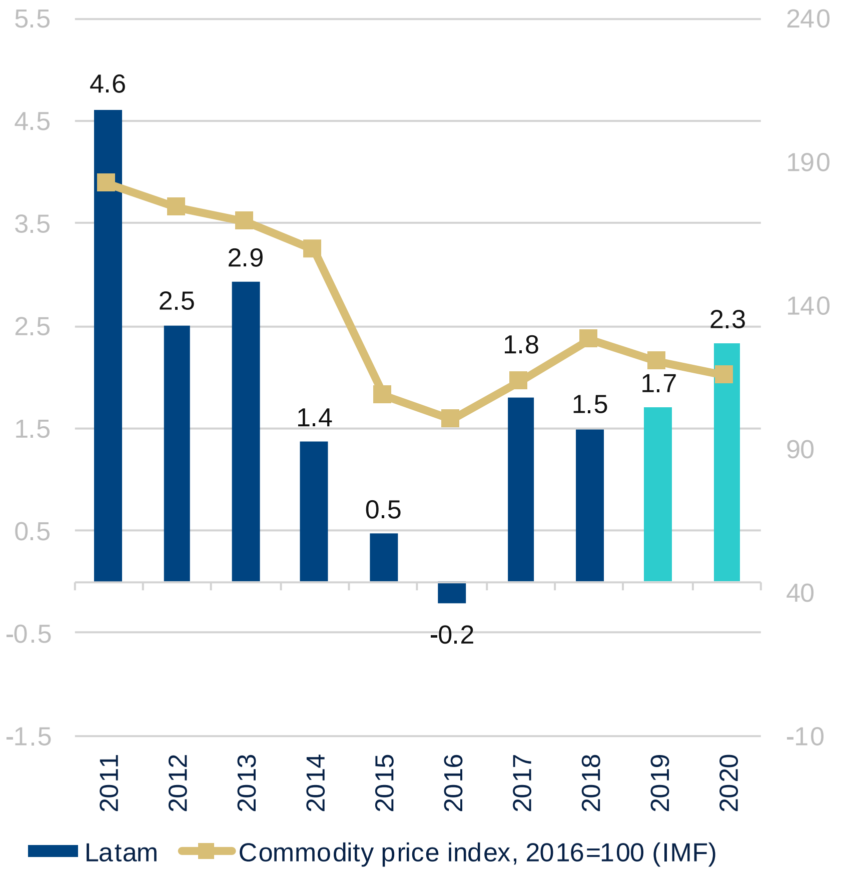
02

Latin America: Growth will remain modest in 2019 and recovery has been postponed to 2020

Latin America: growth will remain below 2% in 2019 and recovery has been postponed to 2020

GDP growth in Latin America and commodity prices (*)

(% YoY)



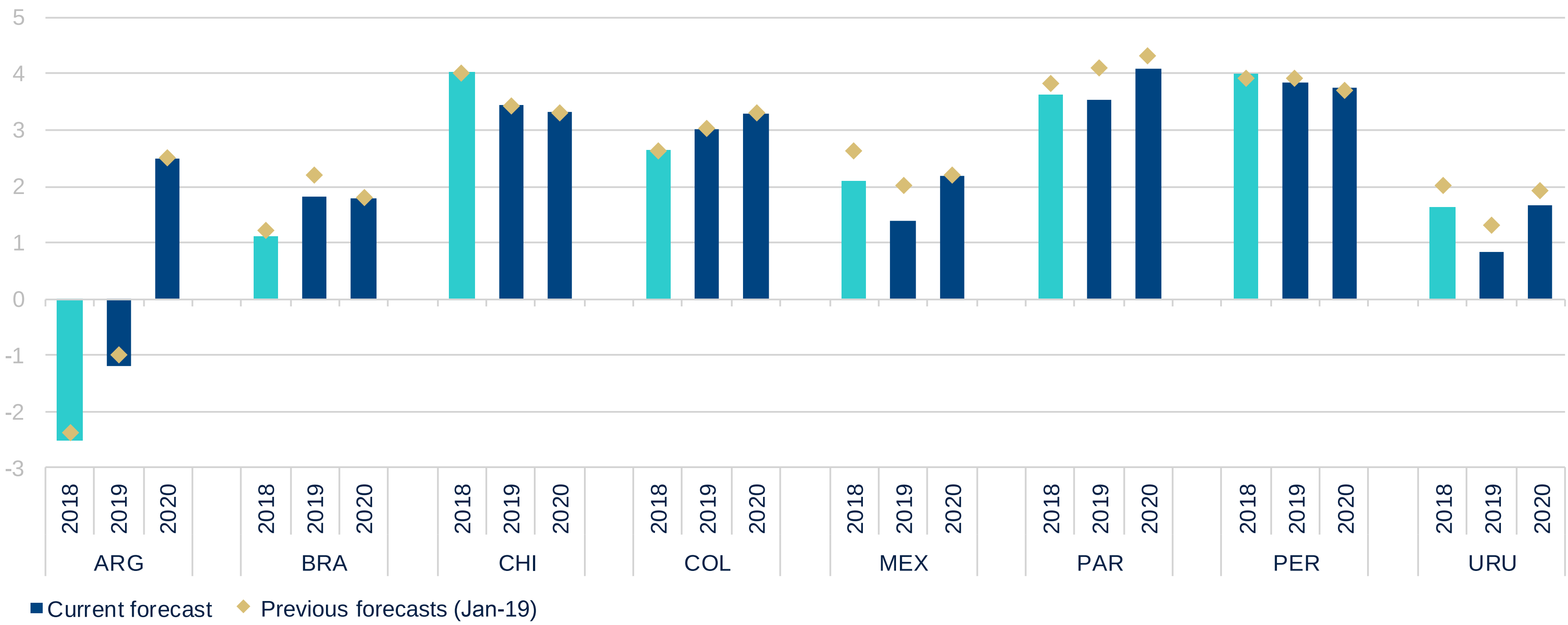
(*) Weighted average of Argentina, Brazil, Chile, Colombia, Mexico, Paraguay, Peru and Uruguay.
Source: BBVA Research

- Regional growth is revised downwards, from 2.1% to 1.7% in 2019 and from 2.4% to 2.3% in 2020
- The slowdown in global growth, as well as lower commodity prices are resulting in growth in the region remaining below that seen in 2010-13
- Reduced reformist momentum in a majority of countries has limited productivity gains and thus helps explain the lack of dynamism in economic activity

Growth prospects are worsening in Argentina, Brazil, Mexico, Paraguay and Uruguay, due to the global context and local factors...

Latin America: GDP growth

(%)



Source: BBVA Research

The forecast revision has focused on 2019 and is mainly due **to the slowdown in global growth and the negative surprises of local growth in recent months**

In **Argentina**, quarterly growth is expected to be in positive terrain from 1Q19 onwards, in an environment marked by a restrictive monetary policy, but will be negative in the year due to strong statistical carry-over

... and remain the same in Peru, Colombia and Chile, three of the countries with the highest and most stable economic growth

Latin America: Average GDP growth and volatility in the last decade (2009-2018)

(%)

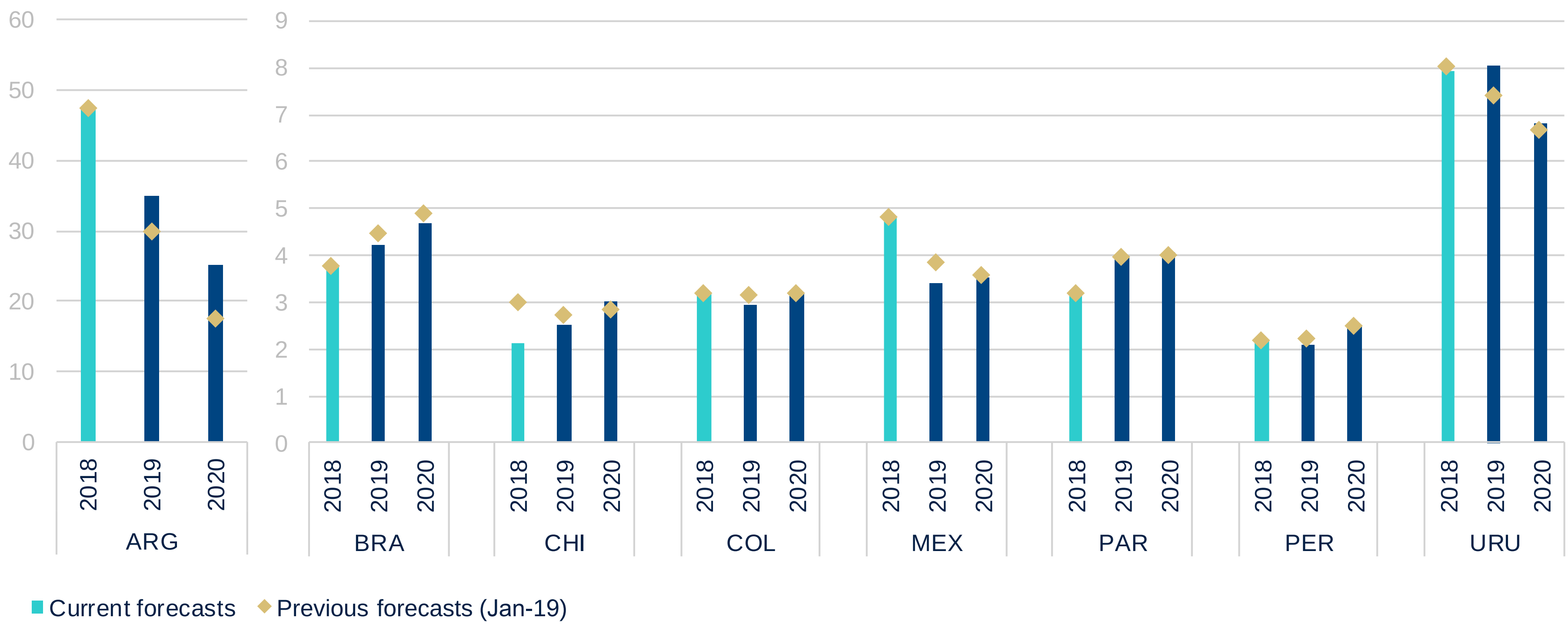
Source: BBVA Research

- The countries with the highest growth have generally also been able to improve the well-being of their citizens in the last decade through greater growth stability
- Countries such as Peru, Colombia, Chile and Uruguay have been able to grow in an increasingly stable way in part due to more prudent and more consistent macroeconomic policies
- They may also have benefited - given their greater dependence on raw materials - by China's strength and relative stability compared to the US
- Even so, it is striking that some of the countries with the greatest productive diversity have exhibited greater volatility

In the face of still weak demand pressures, inflation expectations are generally reduced, except in Argentina and Uruguay

Latin America: Inflation

(% YoY; end of period)



Source: BBVA Research

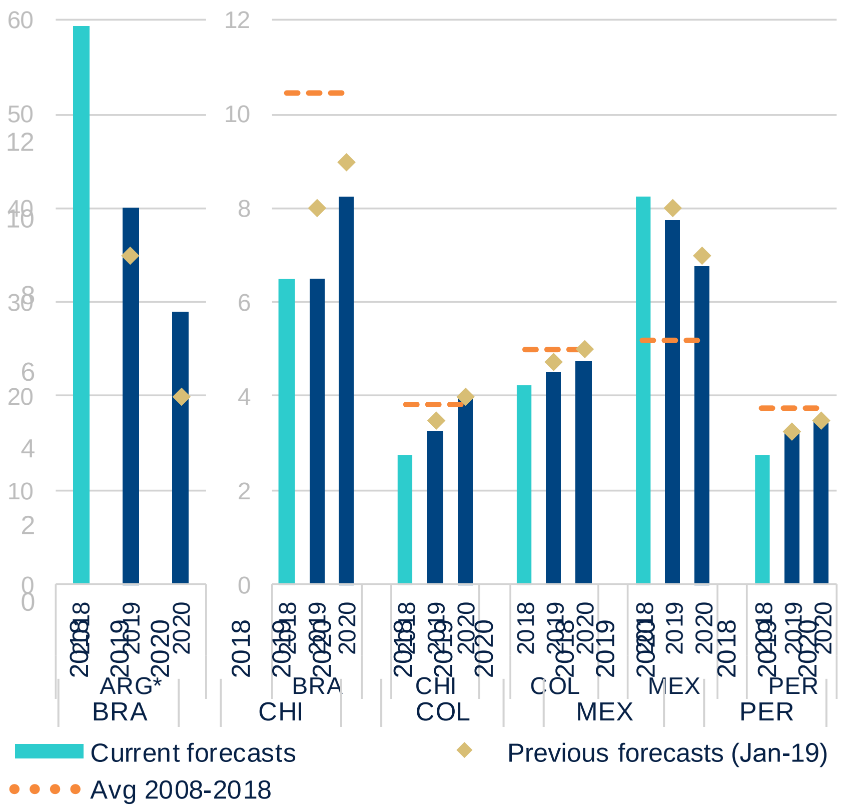
A global backdrop marked by modest growth and low inflation, as well as a lack of strong demand pressures in the region's economies will help keep **inflation under control and close to central bank targets**

The exceptions are **Uruguay** and primarily **Argentina**, where strong inflation inertia has led to a deterioration in the perspectives for inflation, which should nevertheless trend gradually downwards going forward

Monetary policy will remain loose for longer in South America; in Mexico, interest rates will be cut earlier than expected

Latin America: Monetary policy interest rates (*)

(%, end of period)



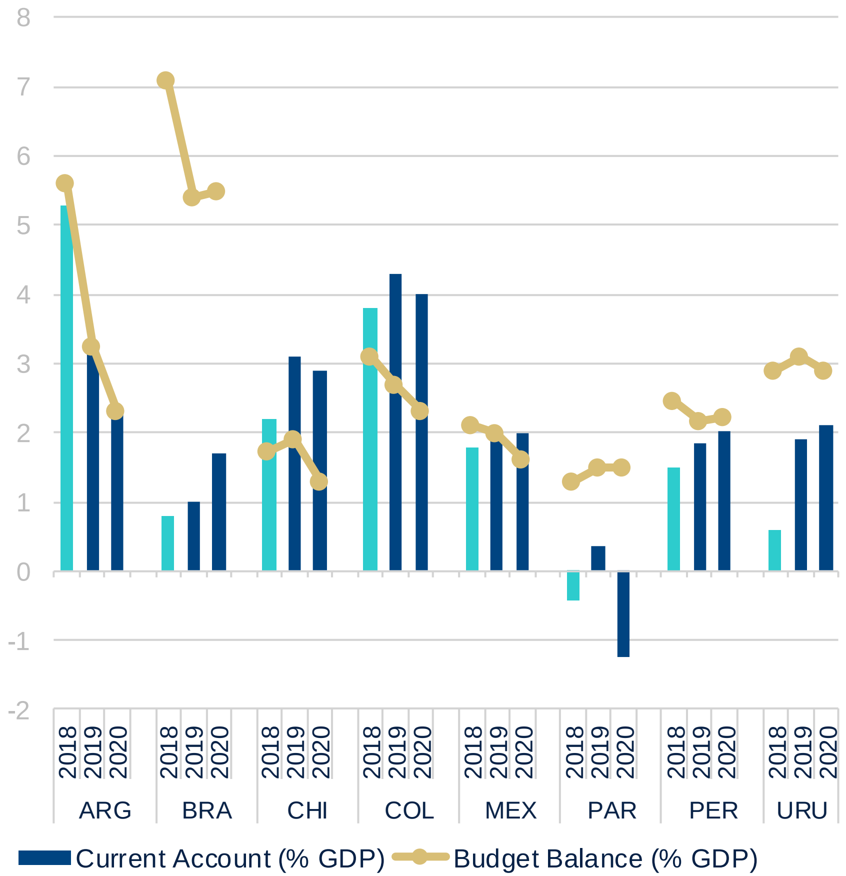
(*) Argentina does not operate an inflation targeting system. As such, instead of the reference monetary policy interest rates, the Leliq rate created in 2018 is included in this chart (due to lack of previous observations, the 2008-2018 average is not included).
Source: BBVA Research

- The shift of the Fed and the ECB toward a more expansionary monetary policy has increased the margin for maneuver of the central banks of the region
- Thus, in Mexico the stability of the exchange rate and the improved inflation outlook will allow Banxico to relax its monetary stance earlier than expected
- In Brazil, Chile and Colombia the rate forecasts are adjusted downwards, which would therefore rise more slowly than expected going forward
- In Argentina, by contrast, the stance of monetary policy will be tighter than expected three months ago due to the increased persistence of inflation

Moderate activity growth avoids additional pressures on the current account deficit, but makes it more difficult to reduce fiscal deficits

Latin America: Fiscal and current account deficits

(% of GDP, 2018)



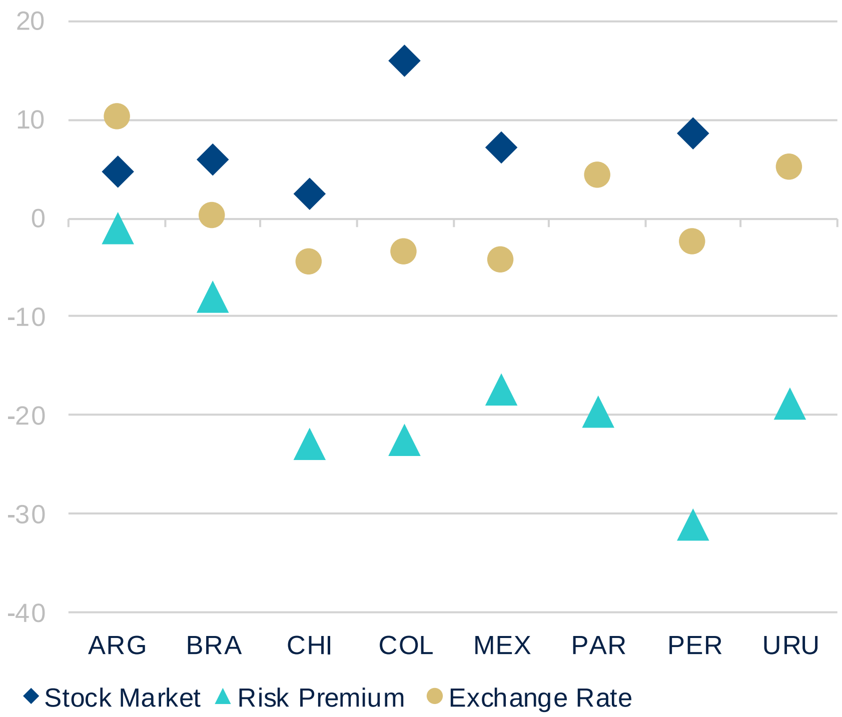
Source: BBVA Research

- The current account deficit remains at relatively low levels in most of the region; in Argentina it is adjusting sharply downwards
- The exception is Colombia, largely due to the expected fall in the oil price
- Fiscal deficits are particularly high in Brazil and Argentina, where reforms should be carried out, mainly in pensions, in order to reduce them
- In virtually all countries there are fiscal consolidation efforts to prevent an increase in public debt and in order to comply with fiscal rules
- In Colombia it will be important to establish a structural fiscal consolidation plan from 2020

The shift toward the more expansionary policies of the Fed and the ECB will limit financial volatility and favor local assets

Latin America: Financial Markets

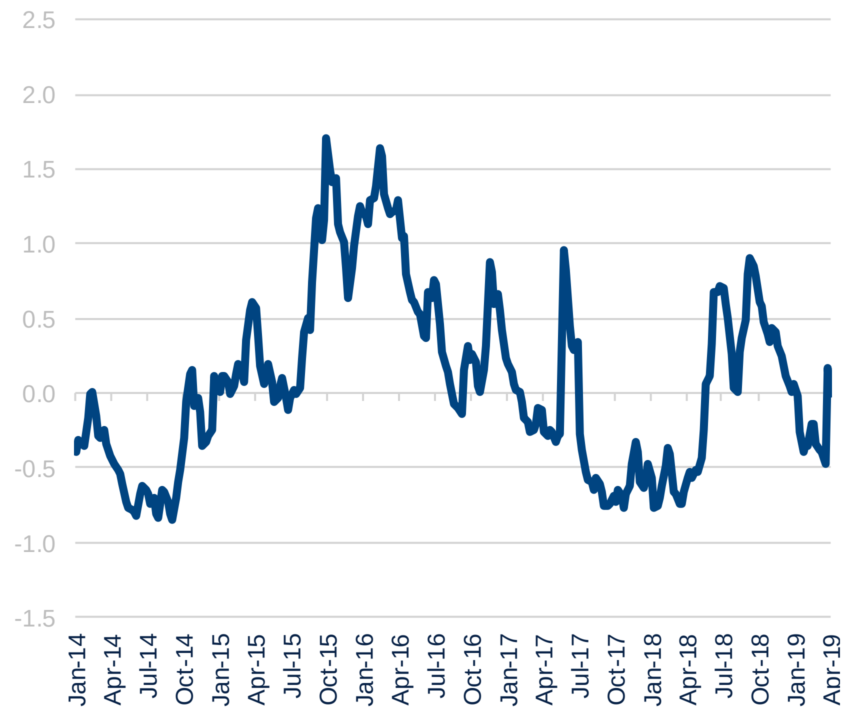
(Cumulative percentage change since the beginning of 2019)



Source: BBVA Research

Latin America: BBVA Financial Stress Index

(Average since Jan-06 = 0)



Source: BBVA Research

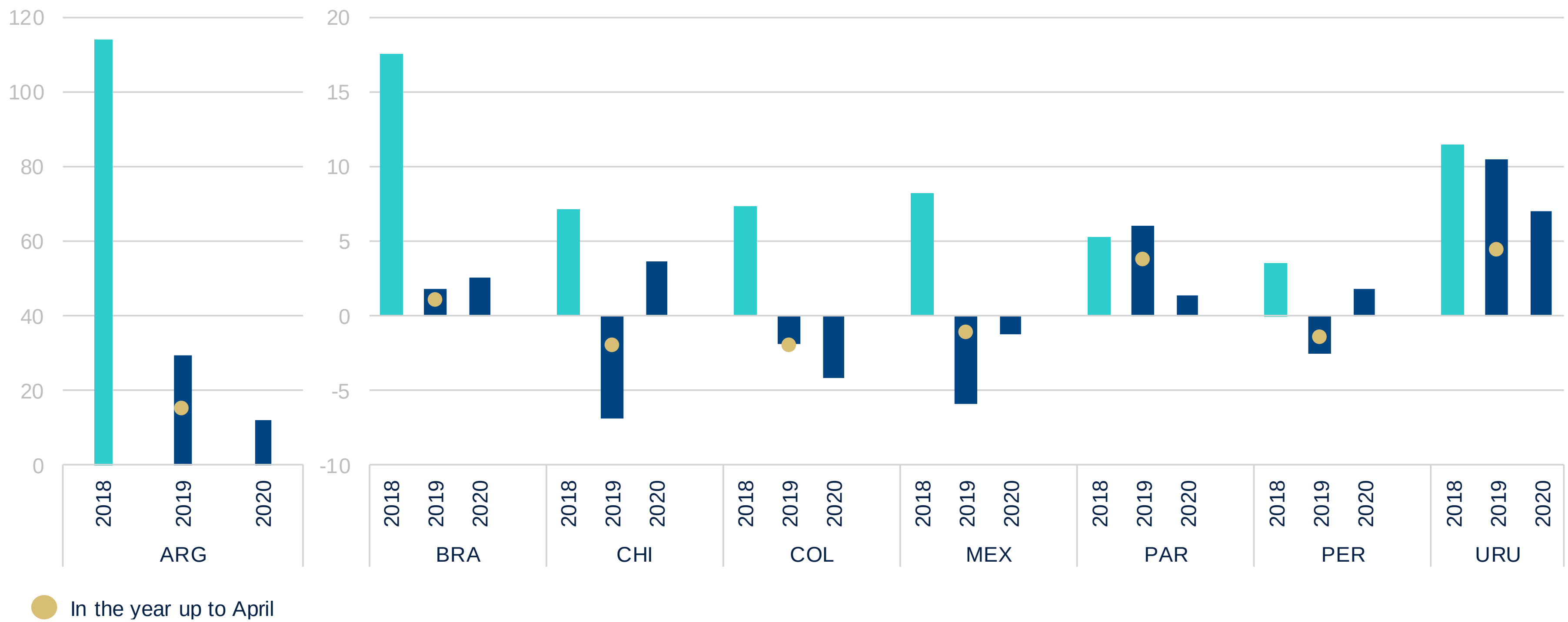
The risk premium has declined in most economies in the region, as has (although to a lesser extent) the exchange rate which tended to appreciate, with gains in the stock market overall

Increased **liquidity in major world economies** will support emerging economies, although concerns about a more abrupt slowdown in world growth, as well as Brexit and protectionism, could lead to **new outbreaks of volatility**

Changes in the global environment support the outlook of greater currency strength in the region after a strong correction in 2018

Latin America: Nominal exchange rates (*)

(% local currency / US dollar)



(*) Positive values indicate depreciations and negative values indicate appreciations.
Source: BBVA Research

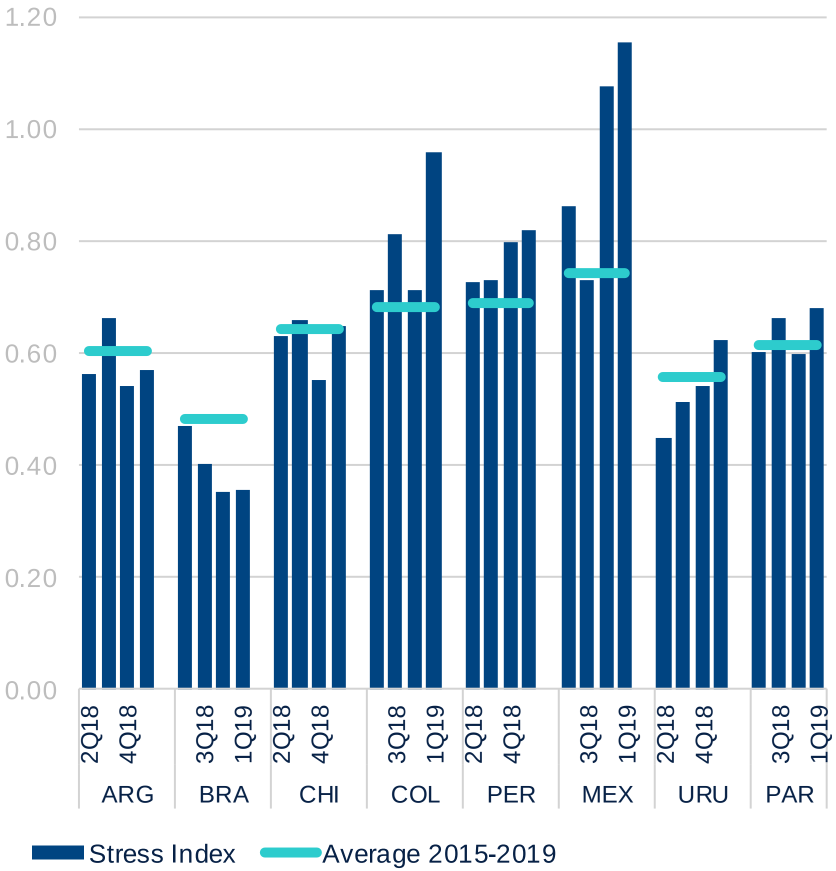
Exchange rate forecasts for Brazil, Chile and Peru are somewhat more favorable than three months ago. **Forecasts for the end of 2019 and 2020 remain the same in the cases of Mexico, Colombia and Argentina**

These forecasts reflect **the prospects for stable growth (even some acceleration) in the region, compared to the expected slowdown in G3 countries**. Also, in Argentina agricultural exports and sales of dollars by the Treasury will support the peso from 2Q19

Beyond global risks, risks related to local political and fiscal issues remain relevant

Latin America: political tension indexes*

(Tone of news and comments on politics in the press, weighted by total media coverage)



Source: BBVA Research

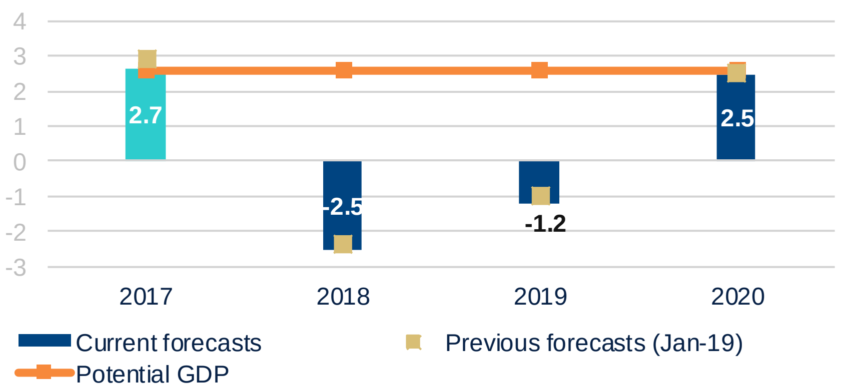
- The political environment will continue to be shaped in a macro environment, particularly in Argentina and Uruguay, where elections will be held in 2H19, and in Colombia, where local elections will be held in October 19
- Also in Brazil and Mexico, where markets still await the actions of the new governments, and in Peru, where the approval rating of the current government has fallen
- The increase in public debt is of concern in Brazil and Argentina, while in Mexico the situation of Pemex is a growing risk and in Colombia the focus is on compliance with fiscal rules

03

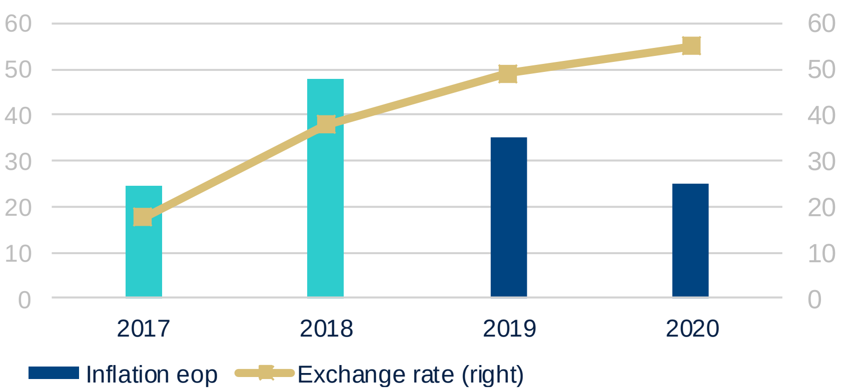
Latin America: Outlooks by Country

Argentina: Focused on stabilising the exchange rate and reducing (persistent) inflation

Argentina: GDP growth and potential
(% YoY)



Argentina: Inflation and exchange rate
(%, end of period)



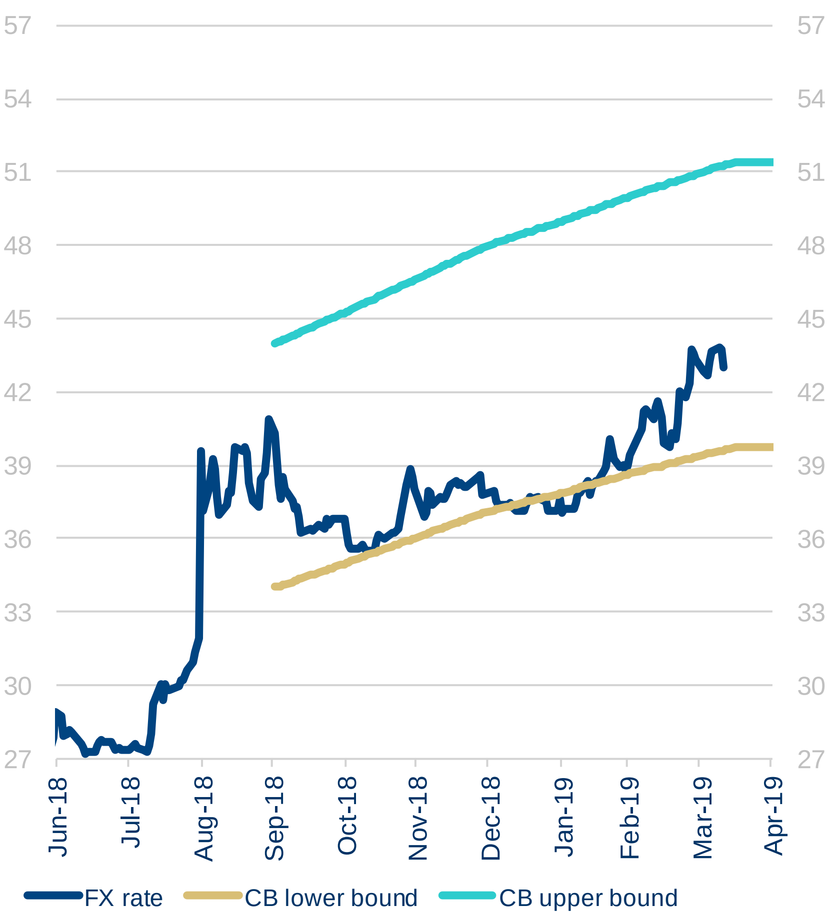
Source: BBVA Research

- Downward revision in the growth estimate, from -1.0 to -1.2% in 2019, mainly due to a more contractionary monetary policy
- Primary fiscal balance in 2019 and surpluses from 2020
- Upward revision in inflation in 2019, from 31% to 35%, due to greater inertia and regulated price pressure
- The exchange rate forecast of ARS 49 per USD will remain for the end of 2019, but volatility will remain high during the electoral process
- By 2020, Argentina will return to global financial markets and we estimate that its debt-to-GDP ratio will decrease from 85% in 2018 to 83% in 2019 and 75% in 2020

Argentina: Focused on stabilizing the exchange rate and reducing (persistent) inflation

Nominal exchange rate and exchange bands

(% YoY)

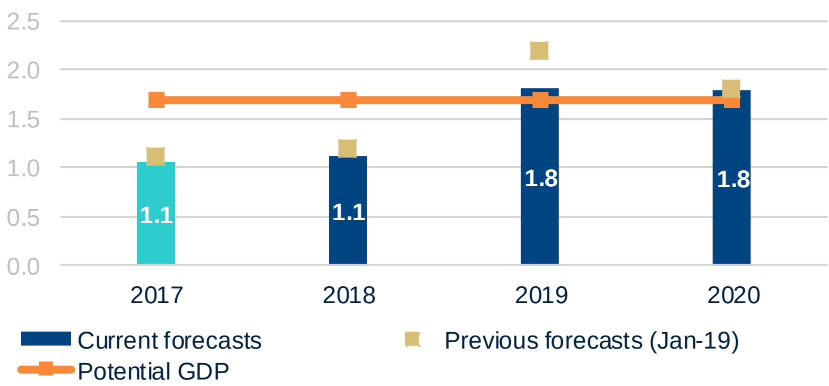


Source: BBVA Research

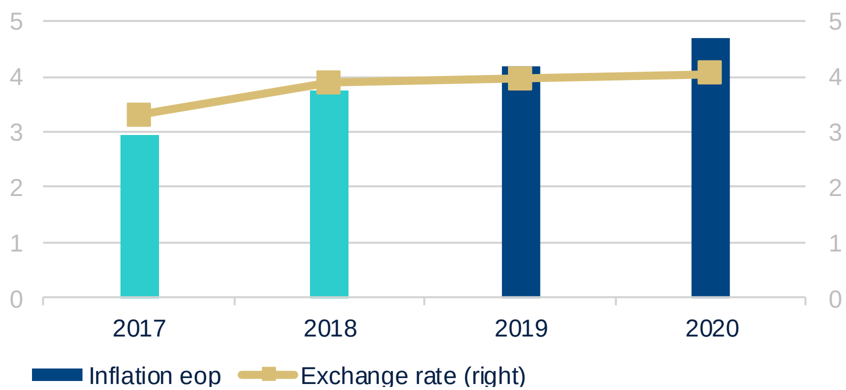
- New monetary policy measures are strengthening the contractive tone of monetary policy and include:
  - Freezing the exchange rate non-intervention zone at between 39.76 and 51.45 until the end of the year
  - The BCRA will not buy dollars if the exchange rate falls below the non-intervention zone until June 30
  - Price control mitigation measures to slow inflation expectations
- A minimum of 62.5% was set for the Leliq rate
- A bill was introduced to Congress to set price stability as the central bank's main objective and prevent it from financing the Treasury
- The Treasury will sell at least $9.6 billion of IMF loans at daily auctions of $60 million from April to November

Brazil: A slowdown in recovery

Brazil: GDP growth and potential
(% YoY)



Brazil: Inflation and exchange rate
(%, end of period)



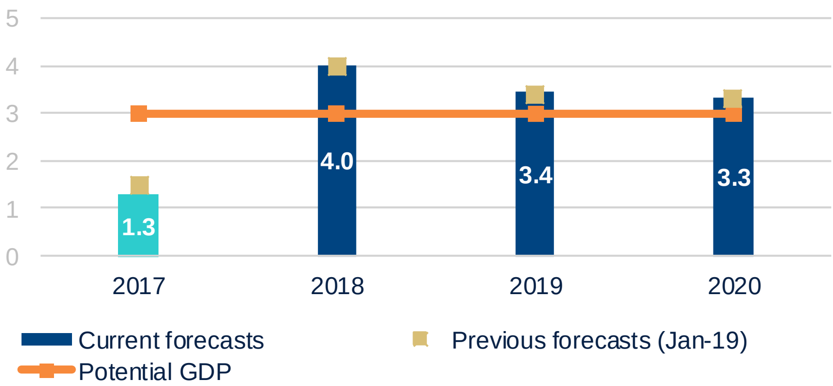
Source: BBVA Research

- The GDP forecast for 2019 was revised downwards from 2.2% to 1.8%, mainly due to the weakness shown in the new data; the forecast for 2020 has not changed
- Recent developments in the local situation support the view that progress in the adoption of economic reforms (including social security reforms) will be slow and limited
- This, along with moderation in world growth will limit the country's ability to grow in the following years
- Lower internal growth and the more accommodative stance of central banks around the world indicate that no interest rate increases will occur until 2020

Chile: No change in the growth forecast, lower inflation in the coming quarters

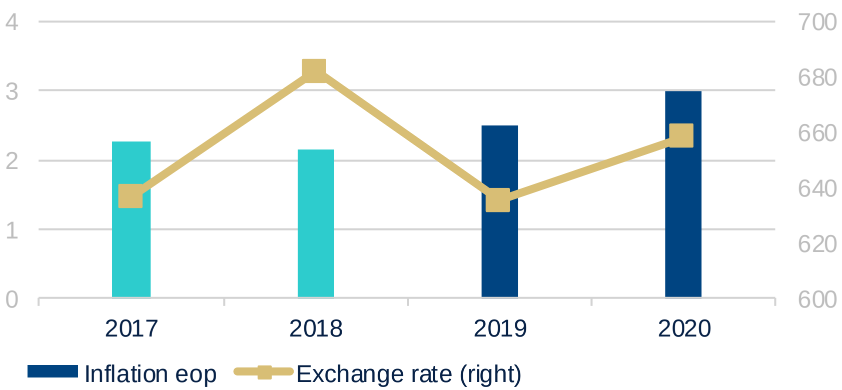
Chile: GDP growth and potential

(% YoY)



Chile: Inflation and exchange rate

(%, end of period)

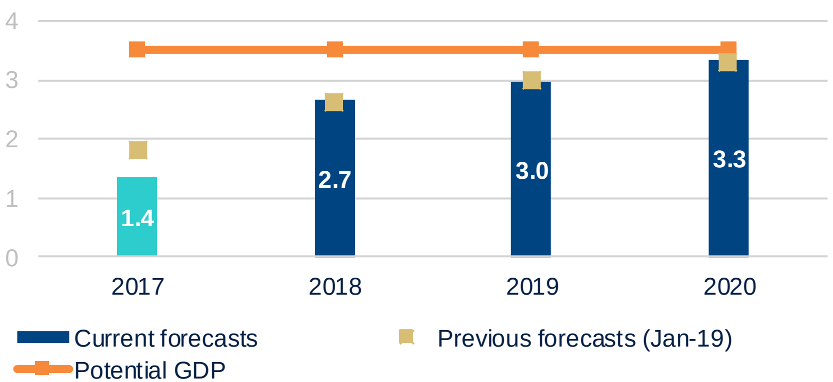


Source: BBVA Research

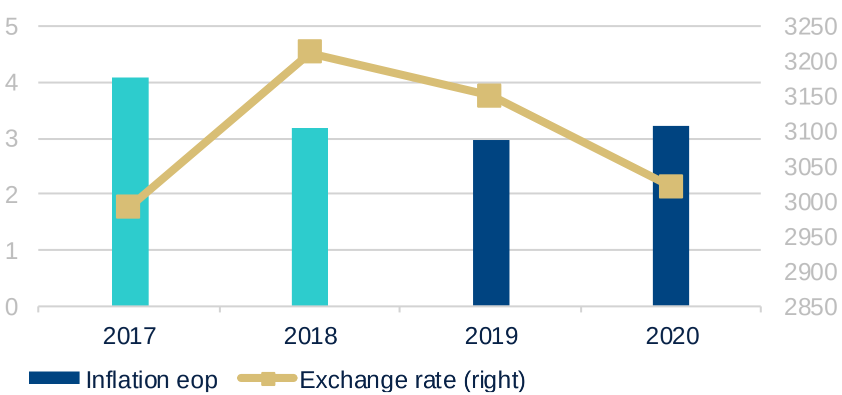
- Our growth forecast in 2019 and 2020 remains the same, which already takes external slowdowns and a slight recovery in copper prices into account
- The main thrust of growth will continue to be public and private investment
- Inflation eased rapidly at the end of 2018 as a result of lower food inflation and lower transfers; the inflation outlook for 2019 and 2020 is lower
- The Central Bank will only make a rate increase this year in the last quarter, ending at 3.25 (previously 3.50%) in 2019

Colombia: growth gradually recovering

Colombia: GDP growth and potential
(% YoY)



Colombia: Inflation and exchange rate
(%, end of period)



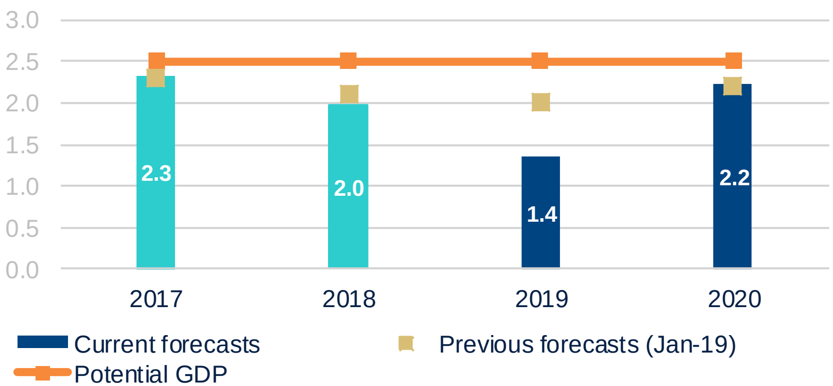
Source: BBVA Research

- No change in GDP forecasts as higher public consumption compensates for decreased construction investment
- Inflation is expected to close at 3.0% in 2019 and 3.2% in 2020; recent data suggests lower inflationary risks
- Positive news about inflation and economic activity that has not yet recovered means that interest rate increases can be delayed
- The exchange rate is expected to be 3150 at the end of 2019 and then increase to 3020 by 2020
- Fiscal rule changes allow a greater deficit but do not solve problems from 2020
- The current account deficit will widen this year and then decelerate

Mexico: Lower growth, inflation and interest rates

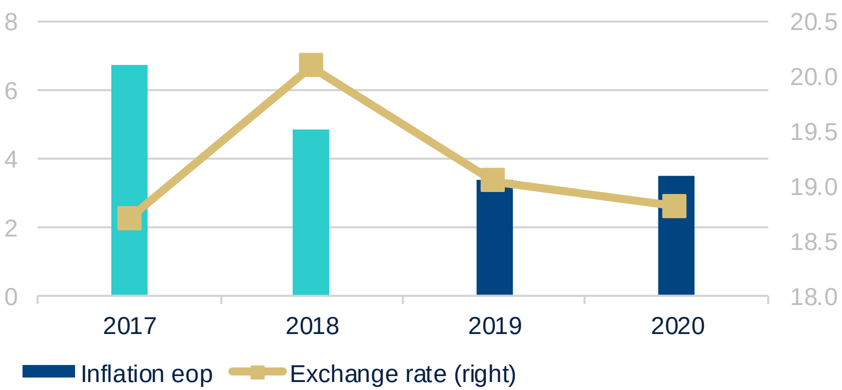
Mexico: GDP growth and potential

(% YoY)



Mexico: Inflation and exchange rate

(%, end of period)



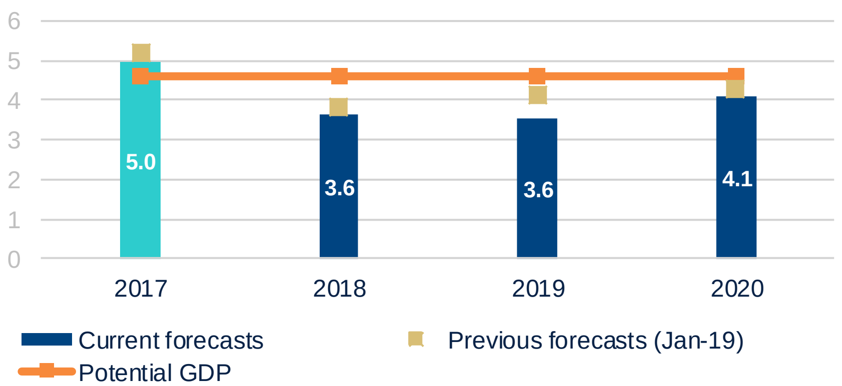
Source: BBVA Research

- GDP forecast for 2019 was revised to 1.4% due to weak data from 4Q18 and 1Q19, along with a weak US manufacturing sector and a delay in the expected return on investment
- Inflation is expected to close 2019 at 3.4%, less than previously expected, in line with the surprise decreases at the start of the year
- We anticipate a cut in interest rates from 50 basis points this year (up to 7.75%) and another 100 basis points next year (up to 6.75%)
- The exchange rate will remain close to this level for most of 2019 and 2020
- Risks related to Pemex and the ratification of the trade agreement with the US and Canada

Paraguay: High growth, which is expected to accelerate in 2020 rather than 2019 as previously expected

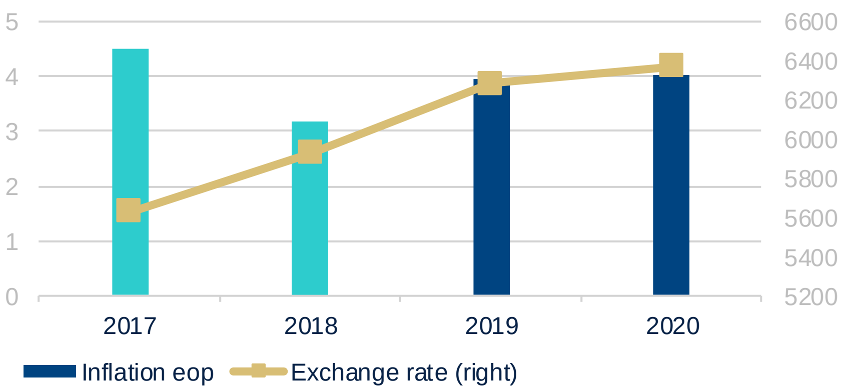
Paraguay: GDP growth and potential

(% YoY)



Paraguay: Inflation and exchange rate

(%, end of period)



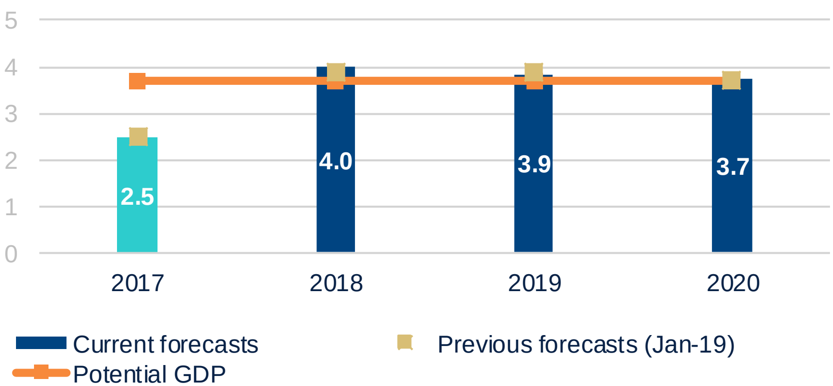
Source: BBVA Research

- We revised growth forecasts for 2019 from 4.1% to 3.6% in 2019 and from 4.3% to 4.1% in 2020, due to decreased energy and agricultural (soya beans) production and negative surprises in early year indicators, as well as lower growth outlooks in major trading partners (Argentina and Brazil)
- Inflation will remain close to the centre of the central bank's target range (4%)
- Risks are skewed downwards and relate to delays in infrastructure construction and a continued slowdown in agricultural production

Peru: Growth will be higher at slightly below 4%, but risks are decreasing

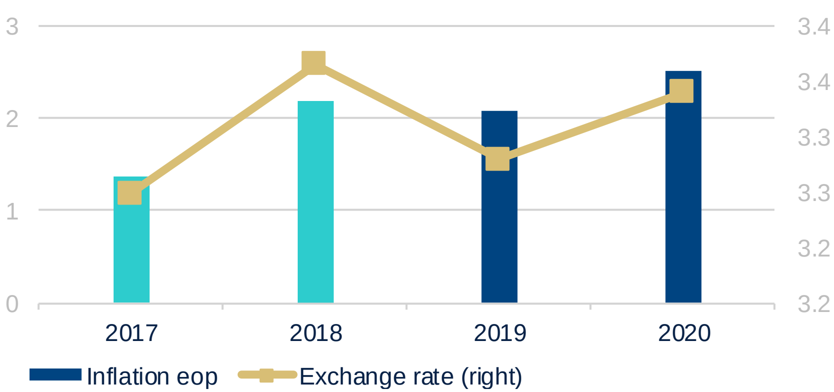
Peru: GDP growth and potential

(% YoY)



Peru: Inflation and exchange rate

(%, end of period)



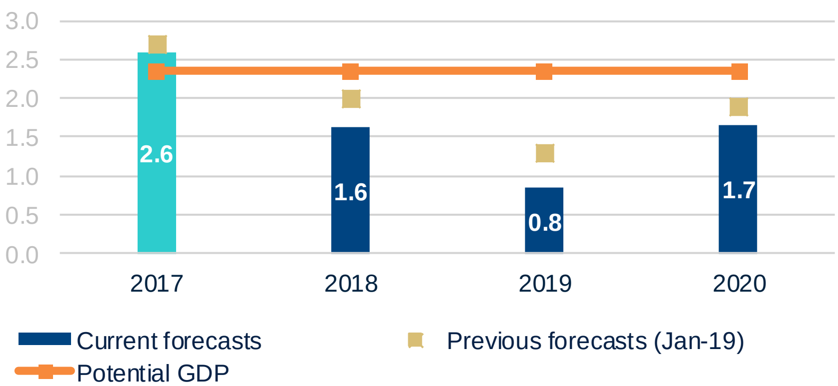
Source: BBVA Research

- Economic activity indicators suggest that GDP slowed in 1Q19, due to problems in primary sectors (mainly mining)
- The GDP forecast for 2019 remains at 3.9%, but the recent slowdown in growth and the risk of falling production at the Las Bambas mine due to a road blockade results in downward revision in 2019
- In an environment in which inflation tends to rise and the negative output gap is closing, the central bank is likely to start decreasing monetary stimulus from mid-year (the risk is that it will start later)
- A strong fiscal position, a tight external deficit and high international reserves will help the country to react to external slowdown

Uruguay: Strong slowdown in 2019 and recovery in 2020

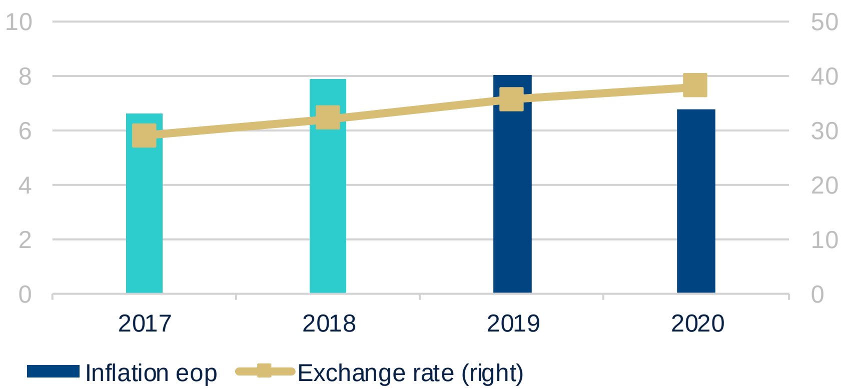
Uruguay: GDP growth and potential

(% YoY)



Uruguay: Inflation and exchange rate

(%, end of period)



Source: BBVA Research

- A strong downward revision in expected growth for 2019 from 1.3% to 0.8% and for 2020 from 2.2% to 1.7% due to weak domestic demand recovery, lower growth in Argentina and negative statistical effect
- Fiscal consolidation will evolve slower than initially expected
- Pressure will be put on the exchange rate in the coming years; upward revision of inflation for the 2019-2020 period
- Local risks due to the presidential election in October, which will result in greater exchange rate volatility

04

Latin America: Forecast tables

Forecasts for growth, inflation, exchange rates and interest rates

	GDP (% YoY)					Inflation (% YoY, end of period)				
	2016	2017	2018	2019 (Forecast)	2020 (Forecast)	2016	2017	2018	2019 (Forecast)	2020 (Forecast)
Argentina	-1.8	2.9	-2.5	-1.2	2.5	39.3	24.8	47.6	35.0	25.0
Brazil	-3.3	1.1	1.1	1.8	1.8	6.3	2.9	3.8	4.2	4.7
Chile	2.3	1.5	4.0	3.4	3.3	2.7	2.3	2.1	2.5	3.0
Colombia	2.0	1.8	2.6	3.0	3.3	5.7	4.1	3.2	3.0	3.2
Mexico	2.7	2.3	2.0	1.4	2.2	3.2	6.6	4.8	3.4	3.5
Paraguay	4.3	5.2	3.6	3.6	4.3	3.9	4.5	3.2	4.0	4.0
Peru	4.0	2.5	4.0	3.9	3.7	3.3	1.4	2.2	2.2	2.5
Uruguay	1.7	2.7	1.6	0.8	1.7	8.1	6.6	8.0	8.0	6.8

	Exchange rates (vs. USD, end of period)					Interest rates (%, end of period)				
	2016	2017	2018	2019 (Forecast)	2020 (Forecast)	2016	2017	2018	2019 (Forecast)	2020 (Forecast)
Argentina	15.8	17.7	37.9	49.0	55.0	24.80	28.80	59.30	40.00	29.00
Brazil	3.35	3.30	3.85	3.95	4.05	13.75	7.00	6.50	6.50	8.25
Chile	667	637	680	635	658	3.50	2.50	2.75	3.25	4.00
Colombia	3010	2991	3195	3150	3020	7.50	4.75	4.25	4.50	4.75
Mexico	20.7	18.7	20.1	19.0	18.8	5.75	7.25	8.25	7.75	6.75
Paraguay	5787	5631	5928	6285	6369	5.50	5.25	5.25	4.75	5.00
Peru	3.40	3.25	3.37	3.28	3.34	4.37	3.26	2.75	3.25	3.50
Uruguay	28.8	28.9	32.2	35.6	38.1	**	**	**	**	**

* In Argentina and Uruguay, monetary policy is implemented according to monetary aggregates and not through a system of objectives. The data from Argentina refers to the Leliq rate.
Source: BBVA Research

Forecasts for fiscal balance, current account and commodity prices

	Current account (% GDP)					Fiscal balance (% of GDP)				
	2016	2017	2018	2019 (Forecast)	2020 (Forecast)	2016	2017	2018	2019 (Forecast)	2020 (Forecast)
Argentina	-2.7	-4.9	-5.3	-3.3	-2.3	-5.8	-6.0	-5.6	-3.3	-2.3
Brazil	-1.3	-0.3	-0.8	-1.0	-1.7	-9.0	-7.8	-7.1	-5.4	-5.5
Chile	-1.4	-1.5	-2.2	-3.1	-2.9	-2.7	-2.8	-1.7	-1.9	-1.3
Colombia	-4.3	-3.3	-3.8	-4.3	-4.0	-4.0	-3.6	-3.1	-2.7	-2.3
Mexico	-2.3	-1.7	-1.8	-2.0	-2.0	-2.5	-1.1	-2.1	-2.0	-1.6
Paraguay	3.5	3.1	0.4	-0.4	1.2	-1.1	-1.1	-1.3	-1.5	-1.5
Peru	-2.7	-1.2	-1.5	-1.9	-2.0	-2.5	-3.1	-2.5	-2.2	-2.2
Uruguay	0.6	0.7	-0.6	-1.9	-2.1	-3.8	-3.5	-2.9	-3.1	-2.9

	Commodity Prices (Annual Average)				
	2016	2017	2018	2019 (Forecast)	2020 (Forecast)
Oil (Brent USD/Bbl)	44.75	54.43	71.05	63.15	55.75
Soybeans (USD/metric tonne)	362.88	358.75	342.50	336.50	350.50
Copper (USD/lb.)	2.20	2.80	2.96	2.87	2.77

Source: BBVA Research