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Latin America Economic Outlook

3Q19

July 2019

Creating Opportunities

Key messages

- A challenging global environment. Persistent trade tensions and the slowdown in world growth will negatively impact economic activity in Latin America. However, a new round of policy stimulus, in particular by the Fed and the ECB, may create some room for maneuver to the region.

- Latin America will grow only 1.0% in 2019, significantly less than previously expected (1.7%). The generalized downward surprise in growth in the first half of the year is behind this revision.

- In 2020 growth will reach 2.2%, slightly below the previous forecast (2.3%), favored by greater dynamism from the second half of 2019 onwards. The acceleration of growth will be supported by further policy stimulus, mainly monetary, thanks to the U-turn by the Fed and a context where inflation is, in general, under control.

- The deterioration of short-term growth prospects is particularly strong in Brazil and Mexico. In both, GDP will expand by less than 1.0% in 2019, partly due to uncertainty about internal policies. In 2020 growth will increase in both countries, but will remain below 2%.

- In Peru and Paraguay downward revisions to 2019 growth have also been significant, but have been more influenced by temporary supply shocks, with which their growth will once again approach 4% in 2020. In Chile and mainly in Colombia and Uruguay downward growth revisions have been smaller. In Argentina, GDP is still expected to grow 2.5% in 2020 after contracting 1.2% in 2019.

- The balance of risks is tilted to the downside: both global factors (trade tensions, risk aversion) and local issues (political noise, fiscal policy) could further delay the process of convergence to potential of growth in the countries of the region.

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Index

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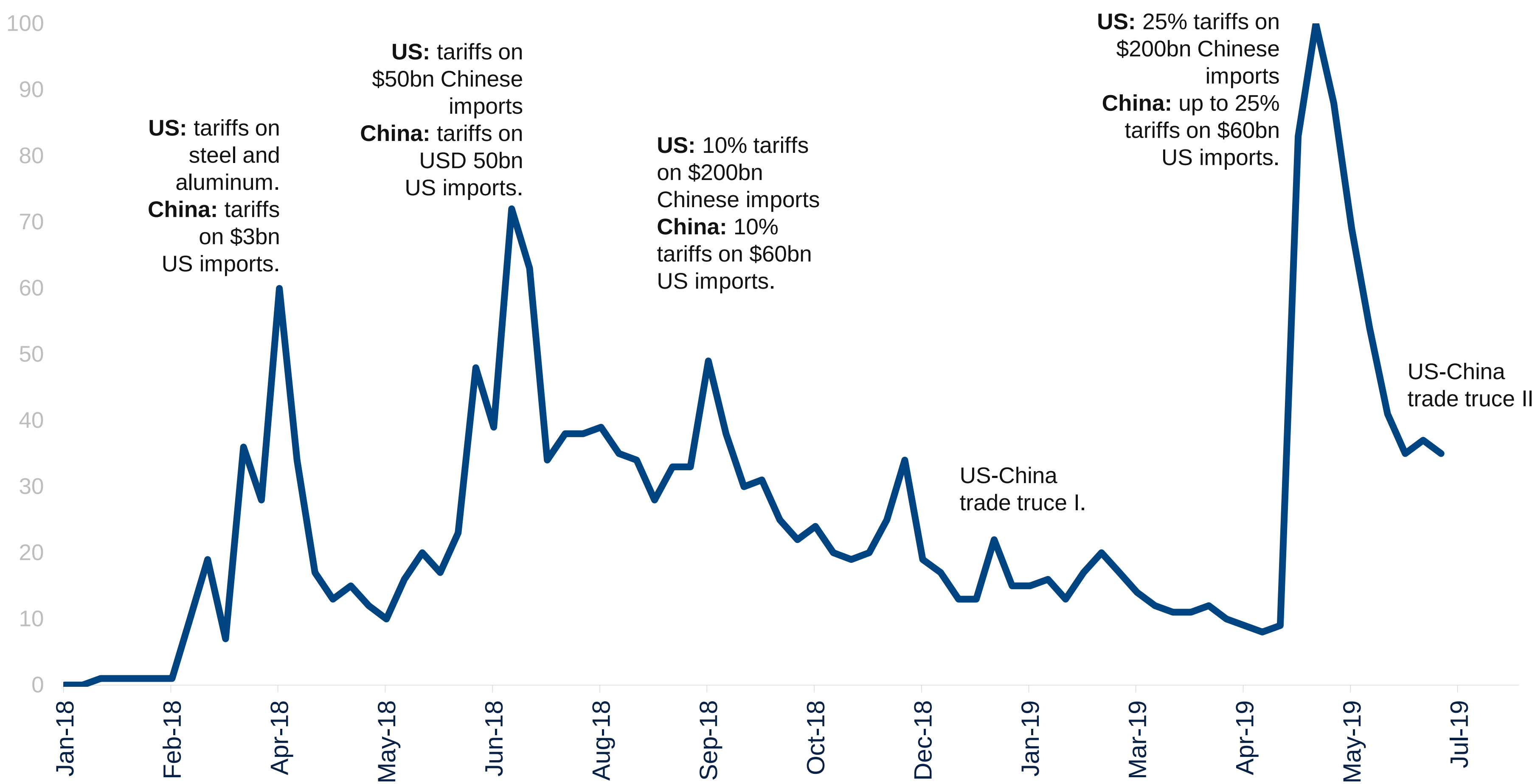
01

Global environment: growth will soft-land, amidst stimulus measures and trade tensions

The protectionism escalation continues to be a source of global uncertainty, even after the most recent US-China trade truce

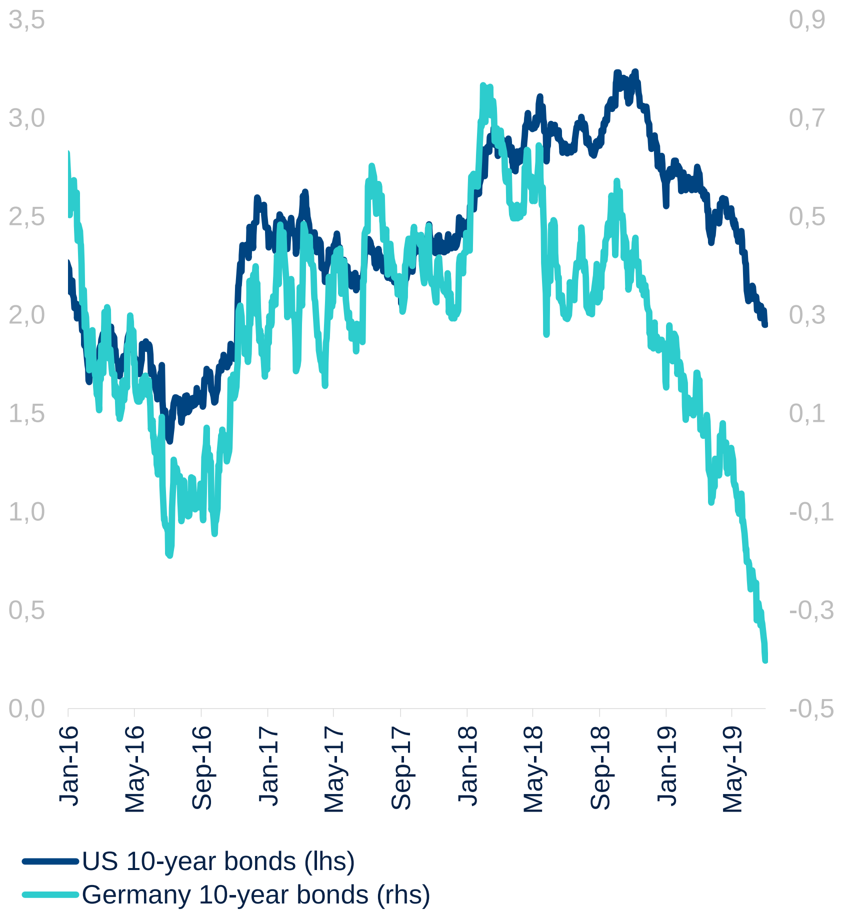
TRADE WAR INDEX: WORLDWIDE GOOGLE SEARCHES ABOUT THE TOPIC "TRADE WAR"
(INDEX: 0 TO 100)



Source: BBVA Research, Google Trends

In financial markets, a flight to safety

SOVEREIGN DEBT YIELDS
(%)

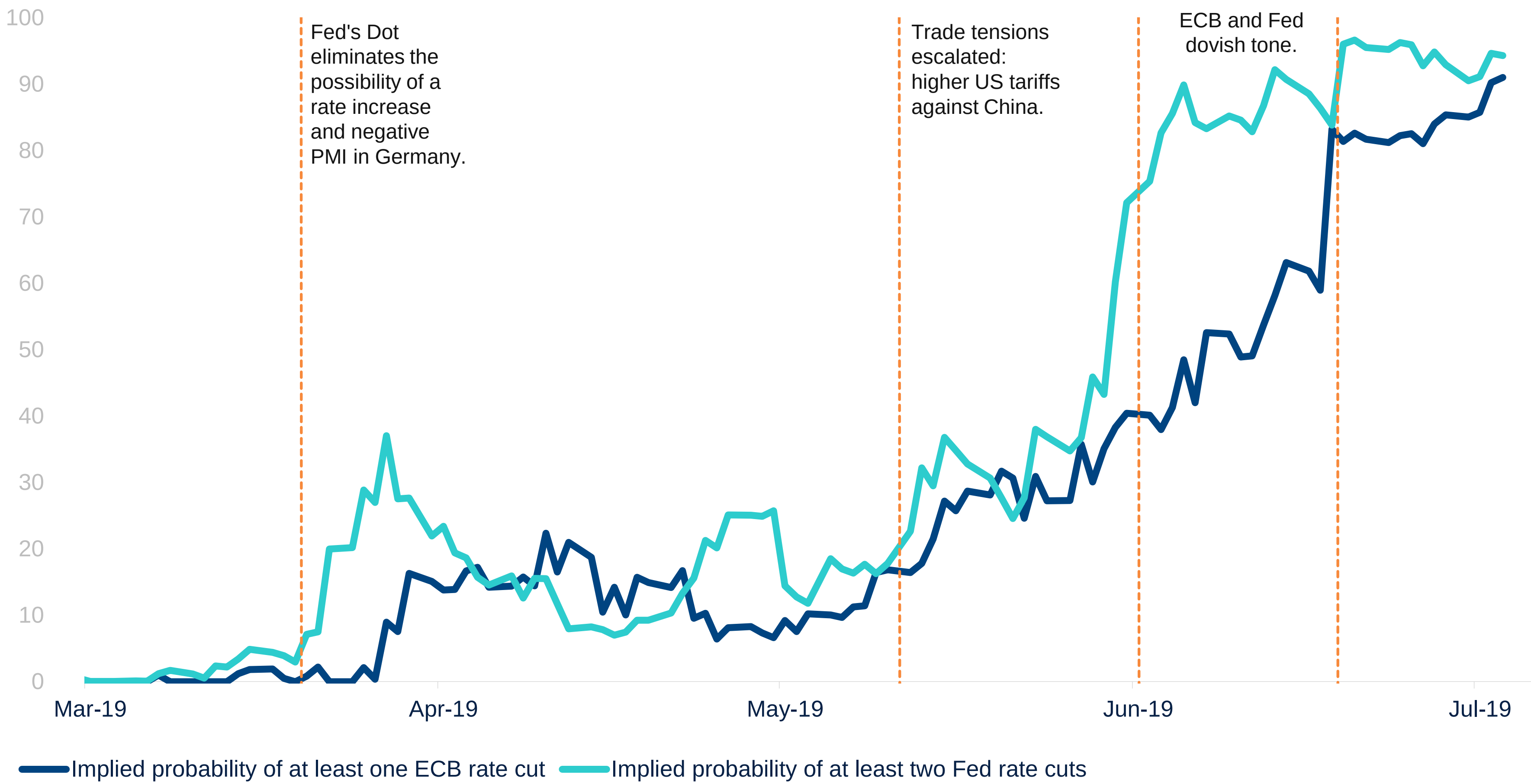


Source: BBVA Research and Bloomberg

- Growth risks and trade tensions led bond yields to very low levels.
- U-turn by the Fed and the ECB triggered search for yield and gains in periphery markets...
- ...but no signs of risk-on mood.

With persistent uncertainty and low inflation, central banks have reassessed their monetary stance and consider new measures

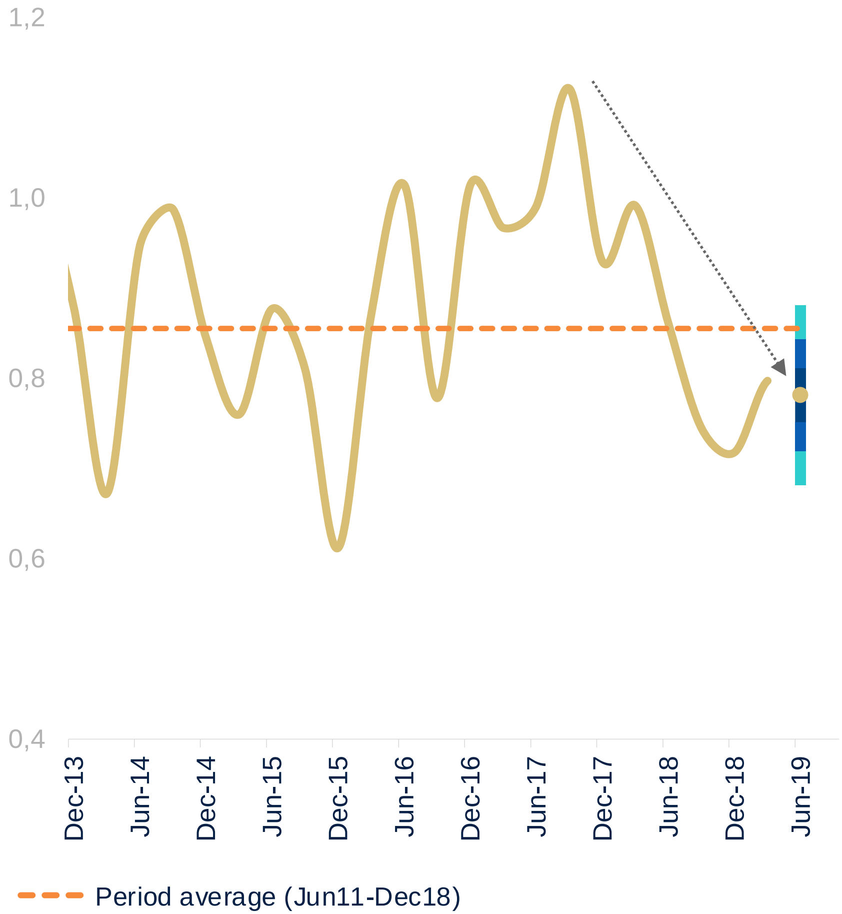
PROBABILITY OF RATE CUTS BY THE FED AND THE ECB, ACCORDING FINANCIAL MARKETS
(%)



Source: BBVA Research and Bloomberg

Global growth continues on a soft downward path, despite a rebound in the first quarter

WORLD GDP GROWTH
(FORECASTS BASED ON BBVA-GAIN % QOQ)



Source: BBVA Research

- Growth has been particularly low since the middle of 2018.
- Weak performance of exports and manufacturing
- 1Q19 growth was higher than expected, while prospects for 2Q19 are broadly unchanged.

Looking ahead, policy stimulus is expected to offset the effect of protracted trade tensions

High trade tensions

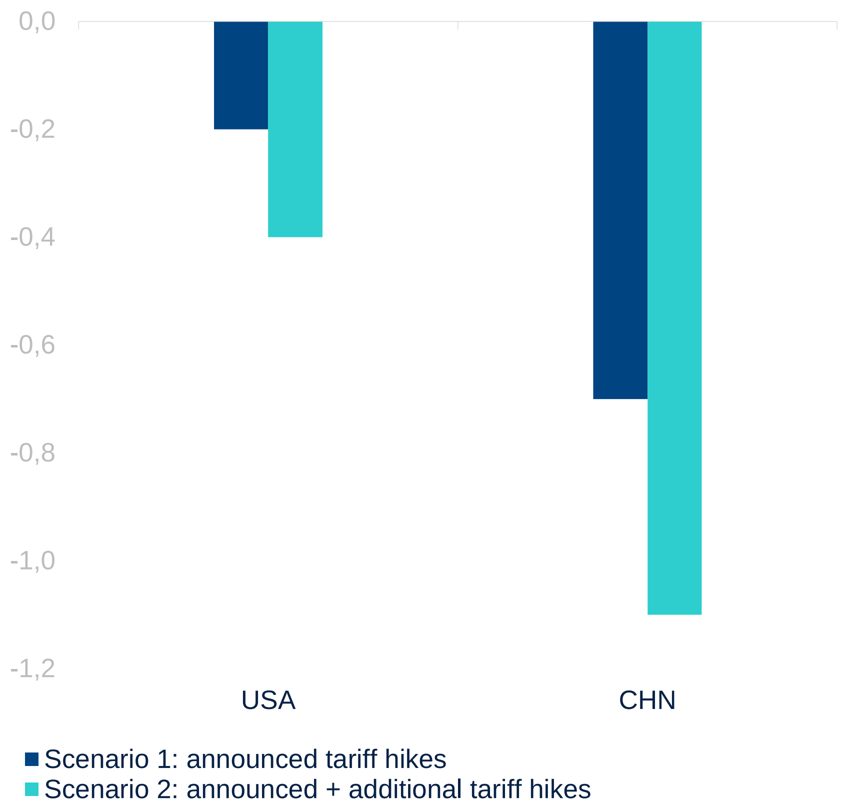
- Irreversible damage has already been done.
- Strategic rivalry is here to stay.
- Lingering uncertainty to weigh on business decisions.

Further stimulus

- FED and ECB: rate cuts in the short-term.
- China: further stimulus expected.
- Financial tensions will likely remain under control.
- Capital flows into EM are expected to slow down.

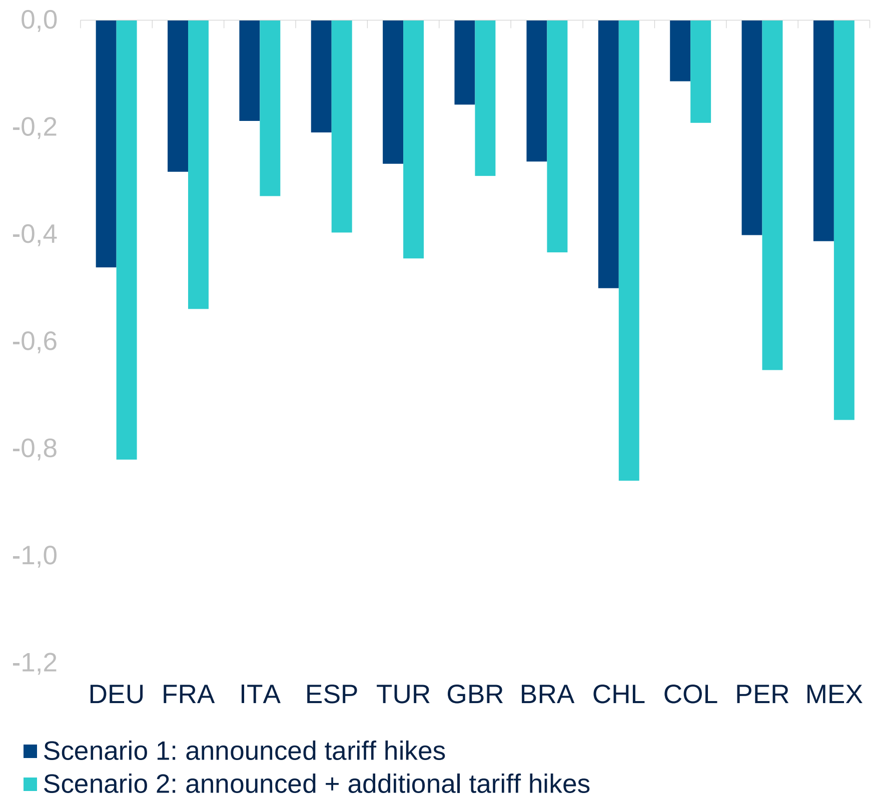
Trade tensions will have a negative effect on global growth

IMPACT ON GDP LEVEL OF TWO TRADE WAR SCENARIOS ON THE US AND CHINA
(TWO YEARS, PP)



Scenario 1: Approved: 25% tariff increase on steel, 10% on aluminum, 25% on Chinese USD250bn imports. China's retaliation: 25% on USD110bn on US imports.
Scenario 2: All Chinese imports: Previous simulation +25% on all Chinese imports (more than USD500bn). China's retaliation: 25% on USD130bn on US imports.
Source: BBVA Research

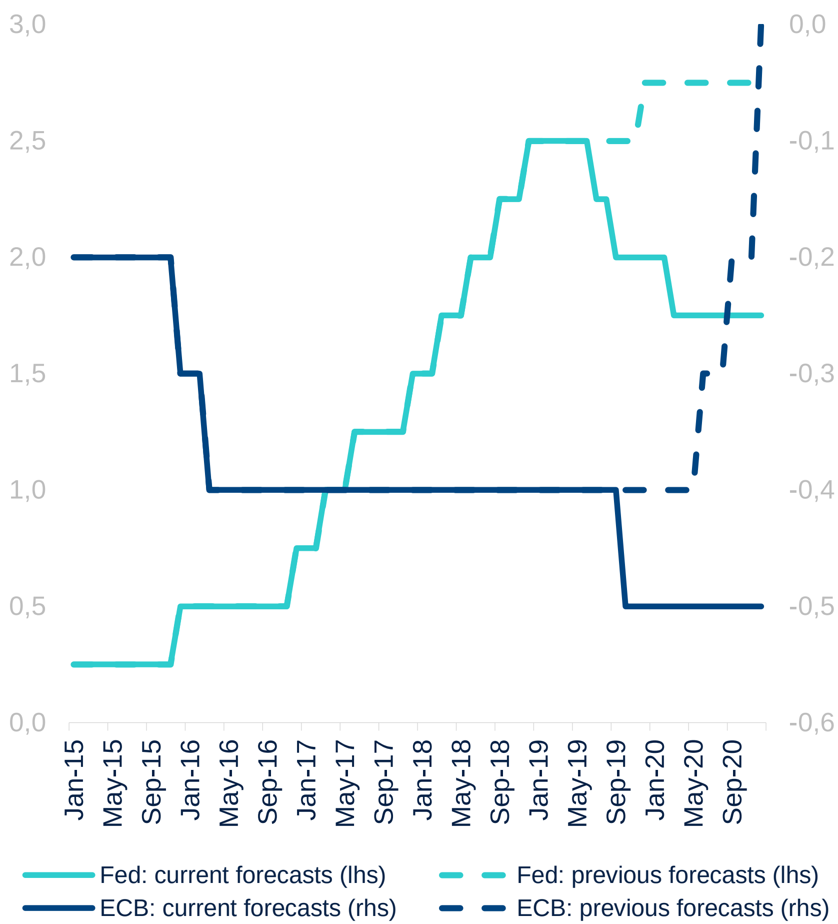
IMPACT ON GDP LEVEL OF TWO TRADE WAR SCENARIOS ON SELECTED COUNTRIES
(TWO YEARS, PP)



Scenario 1: Approved: 25% tariff increase on steel, 10% on aluminum, 25% on Chinese USD250bn imports. China's retaliation: 25% on USD110bn on US imports.
Scenario 2: All Chinese imports: Previous simulation +25% on all Chinese imports (more than USD500bn). China's retaliation: 25% on USD130bn on US imports.
Source: BBVA Research

The policy reaction to a more negative global environment will continue to be led by central banks

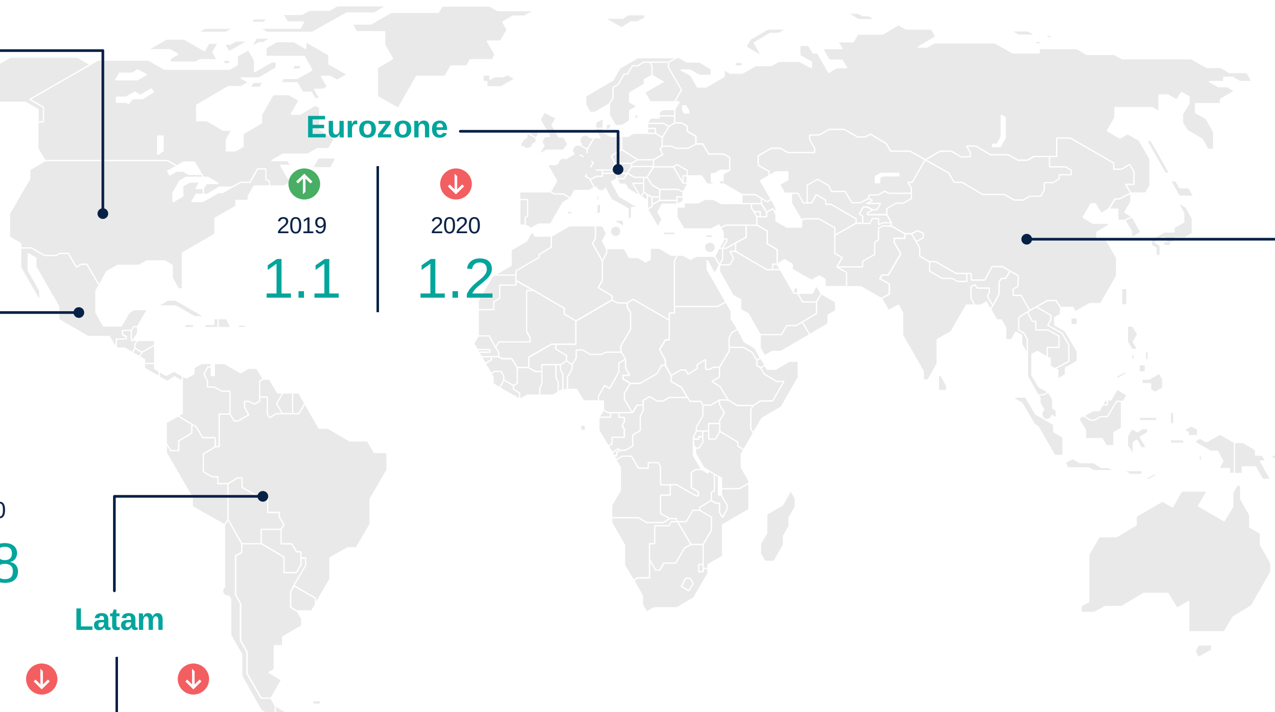
FED AND ECB: INTEREST RATES (*)
(%, END OF PERIOD)



(*) In the case of the ECB, deposits interest rates.
Source: BBVA Research

- Growth risks and low inflation set the stage for lower rates for longer.
- Fed: up to 75bps rate cuts.
- ECB is now expected to:
  - cut depo rates by 10bps in 3Q19.
  - adopt a tiered deposit system.
  - strengthen forward guidance.
- In China, fiscal policy will also play a role in the effort to sustain growth.

Global growth will stabilize at relatively lower levels



US
2019: 2.5 | 2020: 2.0

Eurozone
2019: 1.1 | 2020: 1.2

China
2019: 6.0 | 2020: 5.8

Mexico
2019: 0.7 | 2020: 1.8

Latam
2019: 1.0 | 2020: 2.2

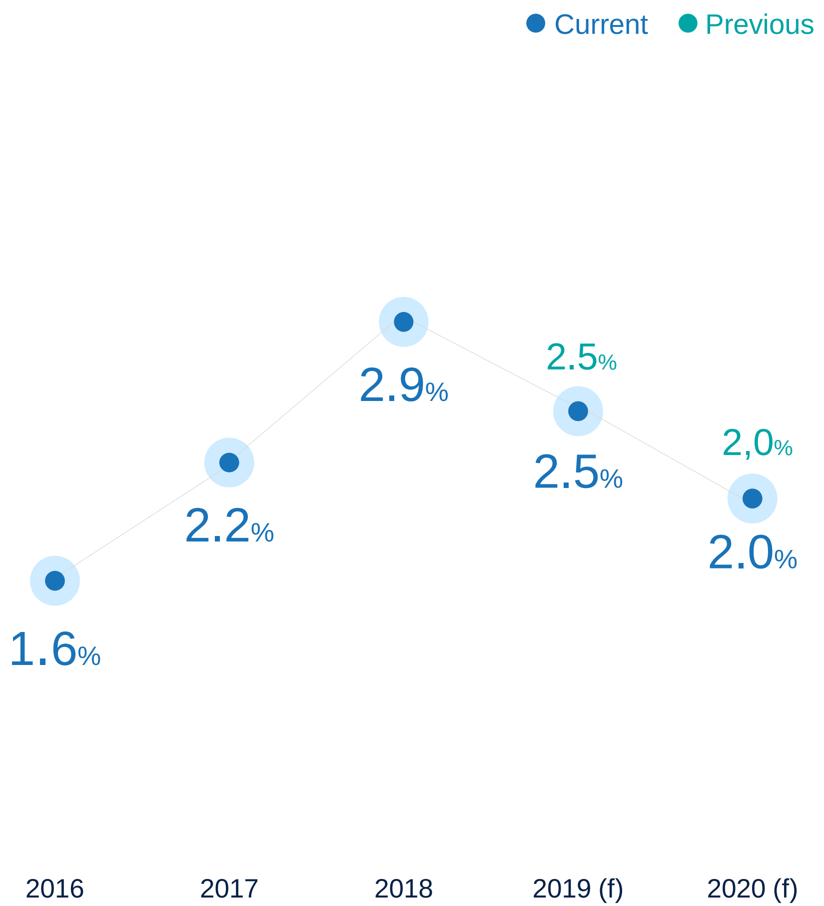
World
2019: 3.3 | 2020: 3.3

Upward revision
Remains unchanged
Downward revision

Source: BBVA Research

US: growth to slow down, with a larger than previously expected support by the Fed

GDP GROWTH
(%)

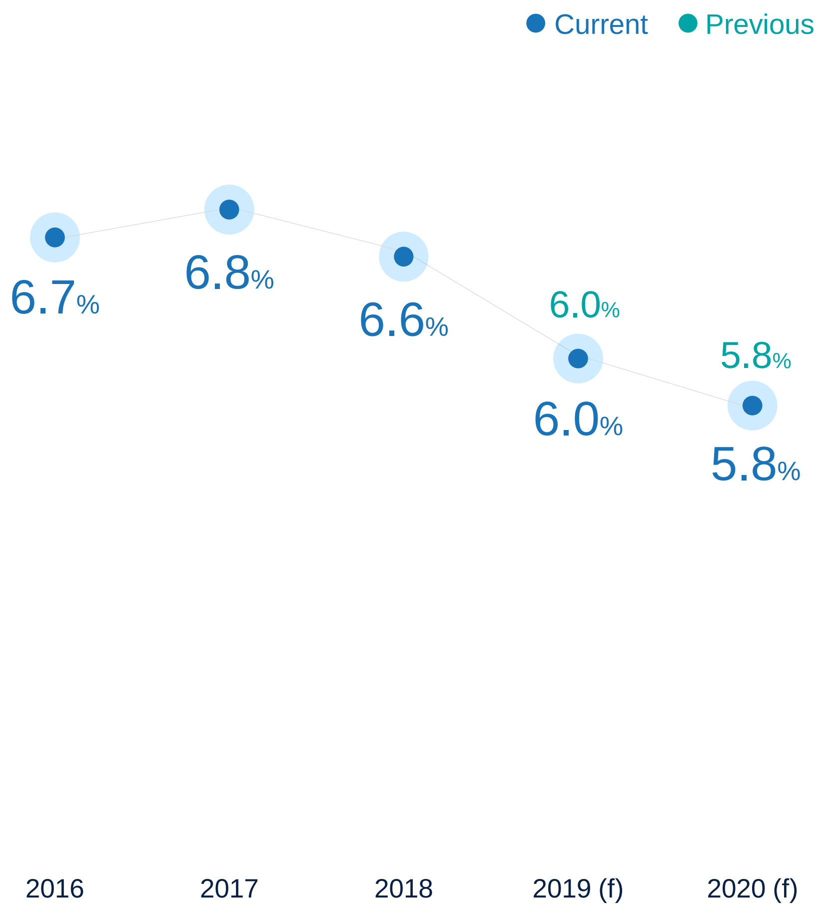


(f) Forecast.
Source: BBVA Research

- GDP growth will trend closer to potential moving forward.
- Core inflation is expected to remain below Fed's 2% target.
- Probability of recession remains high, tilting risks to the downside.

China: further policy measures to counterweight headwinds from trade tensions

GDP GROWTH
(%)

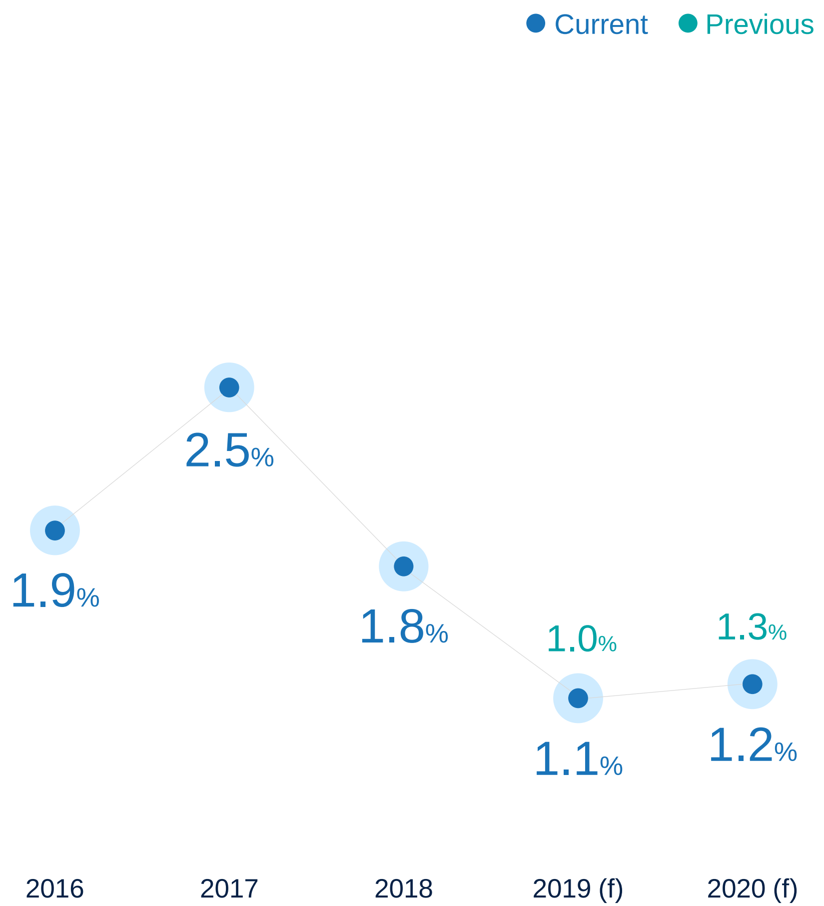


(f) Forecast.
Source: BBVA Research

- More stimulative measures:
  - debt issuance by local governments.
  - targeted monetary stimulus.
  - increase in public deficit.
- Better outlook for consumption, than for exports and investment.
- Risks: trade war, growth hard-landing and disorderly deleveraging.

Eurozone: softer growth from 2H19 on due to the persistence of both industry weakness and uncertainty

GDP GROWTH
(%)

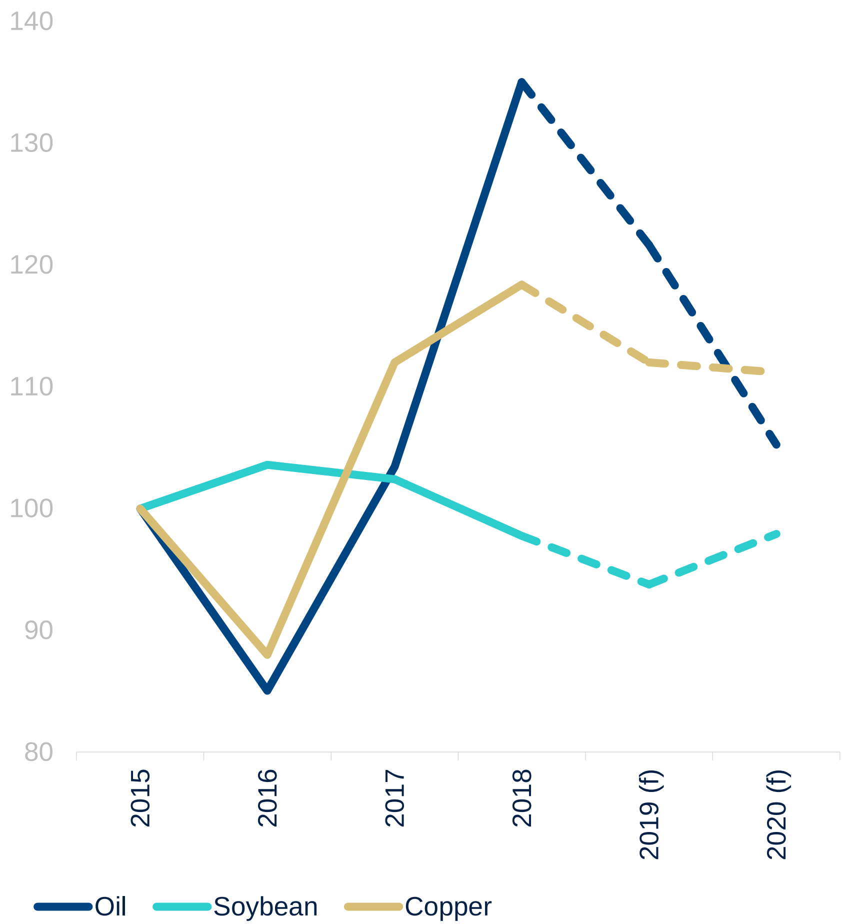


(f) Forecast.
Source: BBVA Research

- **Uncertainty remains high** due to trade issues and Brexit.
- **Monetary policy** to support mainly domestic demand.
- Slightly expansive **fiscal policy.**
- A gradual increase of core **inflation** is still expected.

A more negative global environment weighs on commodity prices

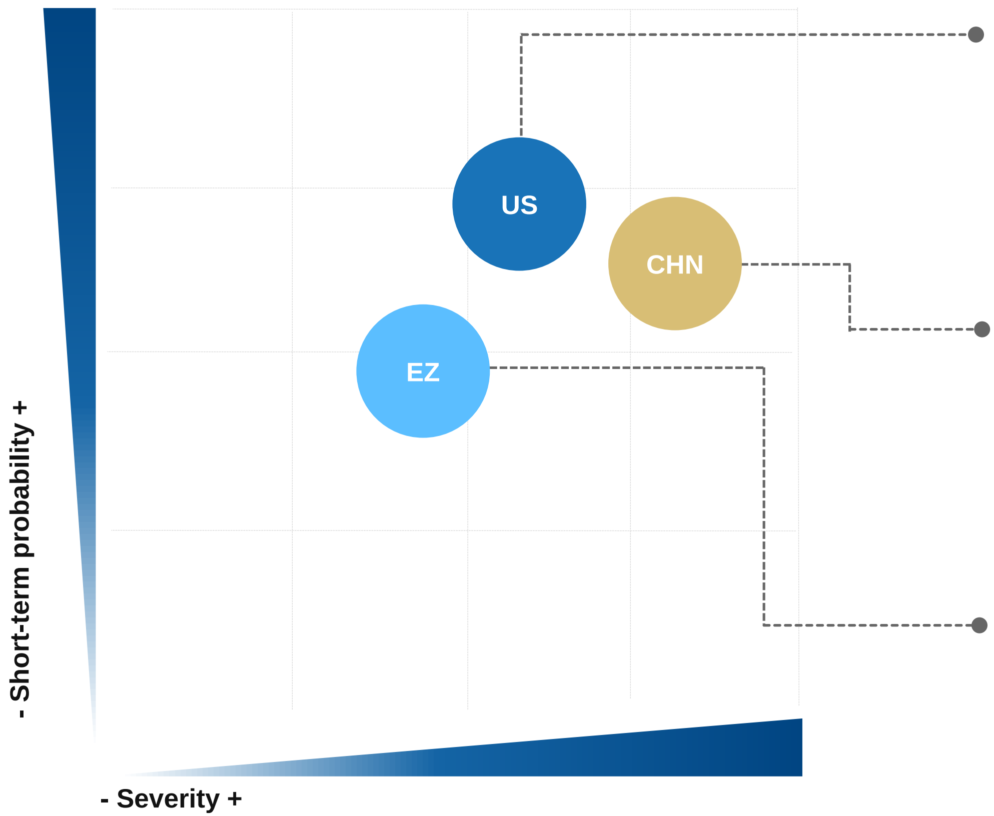
COMMODITIES: ANNUAL AVERAGE PRICES
(INDEX: 2015 AVERAGE = 100)



(f) Forecast.
Source: BBVA Research

- Uncertainty and weaker global growth will affect prices negatively.
- Rising US shale production will help to keep oil prices limited, despite output cuts and supply disruptions.
- Soybean forecasts revised down on weakening demand and high inventories.
- Room for higher copper prices in 2020; demand for electric cars to be supportive in medium/long run.

Global risks: moving upwards on the back of a full-scale trade war, especially given its potential impact on China



- Recession: very high
- Protectionism: higher

- Protectionism: higher
- Disorderly deleveraging : relatively higher

- Growth concerns: relatively high
  - *Brexit*
  - *Italy*
- Protectionism: still contained but increasing

Source: BBVA Research

Financial vulnerabilities can amplify the severity of the risks.

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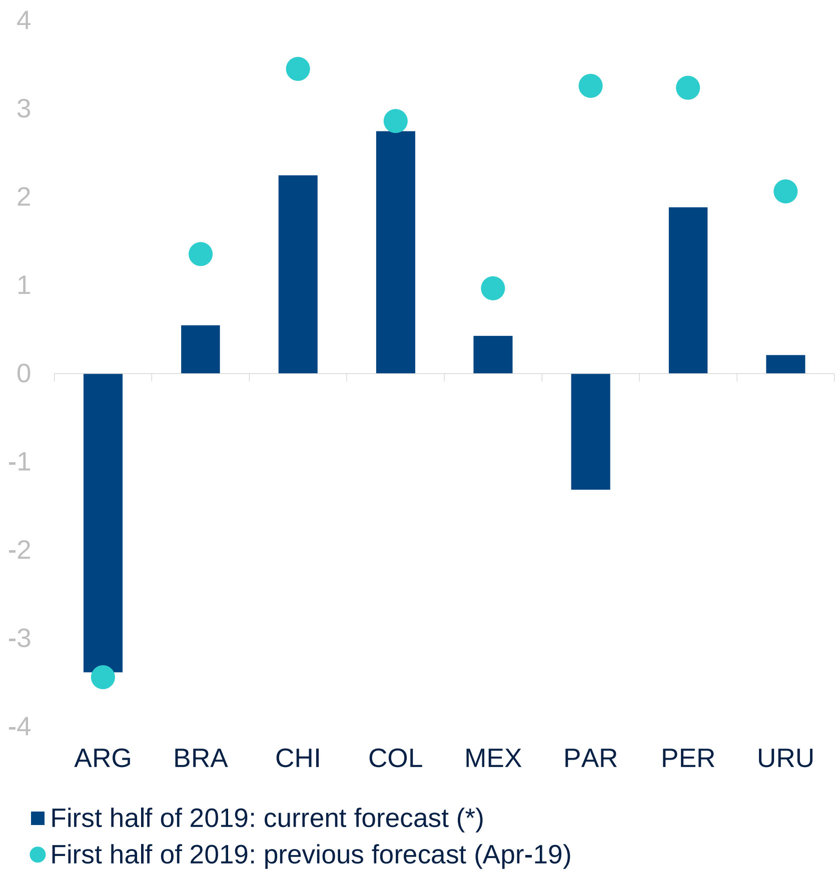
02

Latin America: growth will be of only 1.0% in 2019 and will recover to 2.2% in 2020

Growth in the region was disappointing at the beginning of the year...

AVERAGE GDP GROWTH IN 1H2019: CURRENT AND PREVIOUS FORECASTS
(YOY %)

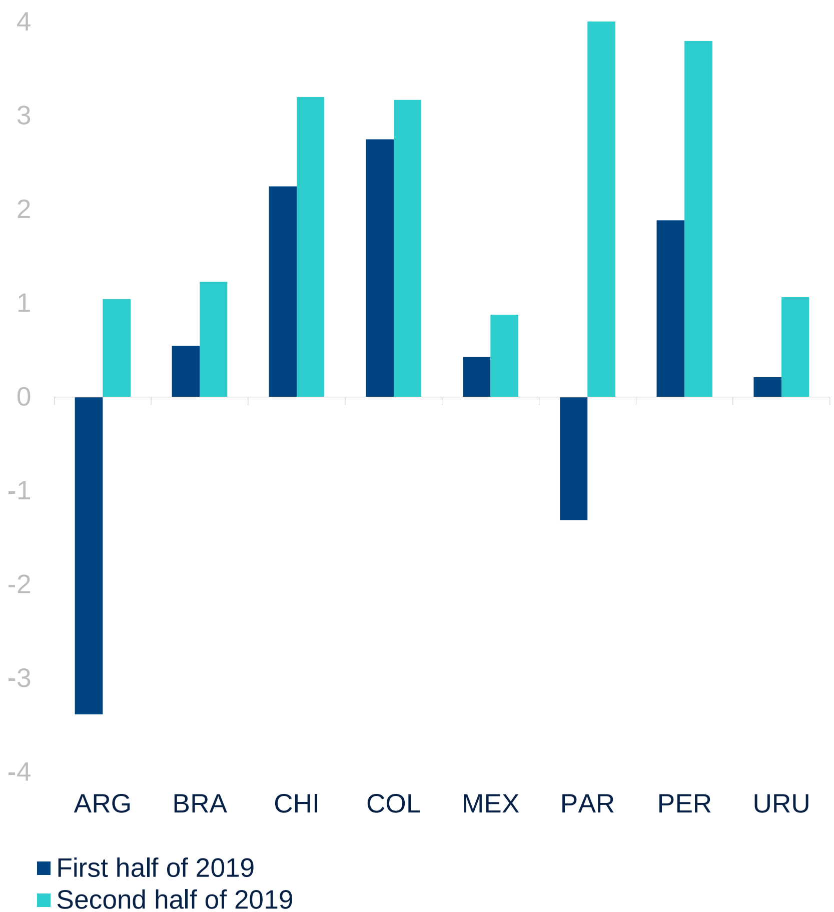


(*) 1Q19: Observed GDP. 2Q19 to 4Q19: Estimated GDP.
Source: BBVA Research

- The global environment has weighed negatively on regional growth in the first months of the year.
- The low growth in the period was also influenced by local factors, such as the high uncertainty about internal policies and the political environment...
- ... as well as some supply shocks, in general of a temporary nature.
- In this context, the performance of investment and exports has been particularly weak.

... but improvements are expected from the second half of 2019 on

AVERAGE GDP GROWTH: CURRENT FORECASTS
(YOY %)

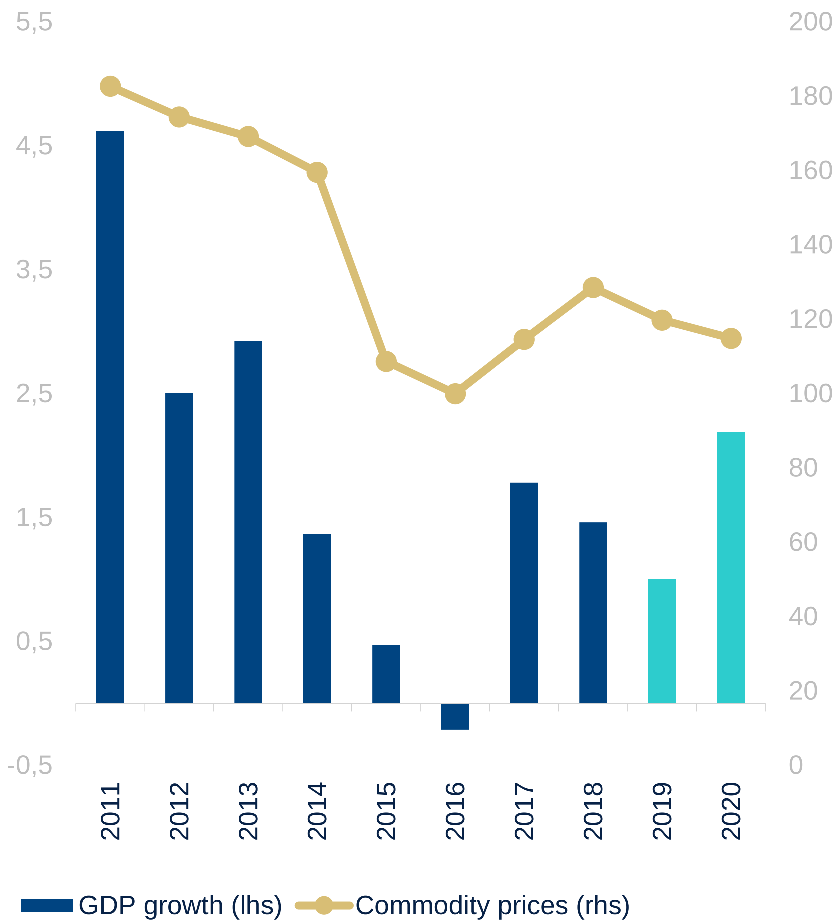


Source: BBVA Research

- In most countries, **growth has presumably been higher in 2Q19 than in 1Q19.**
- **The economic dynamism will possibly increase** in the second half of 2019.
- **An acceleration of growth is expected in all countries**, particularly in Argentina, after the ongoing adjustment, and in Paraguay and Peru, after the fading of supply shocks.

Growth will be of only 1.0% in 2019 and will recover to 2.2% in 2020

GDP GROWTH IN LATIN AMERIC AND COMMODITY PRICES (*)
(GDP: YOY %; COMMODITY PRICES: INDEX 2016 = 100)

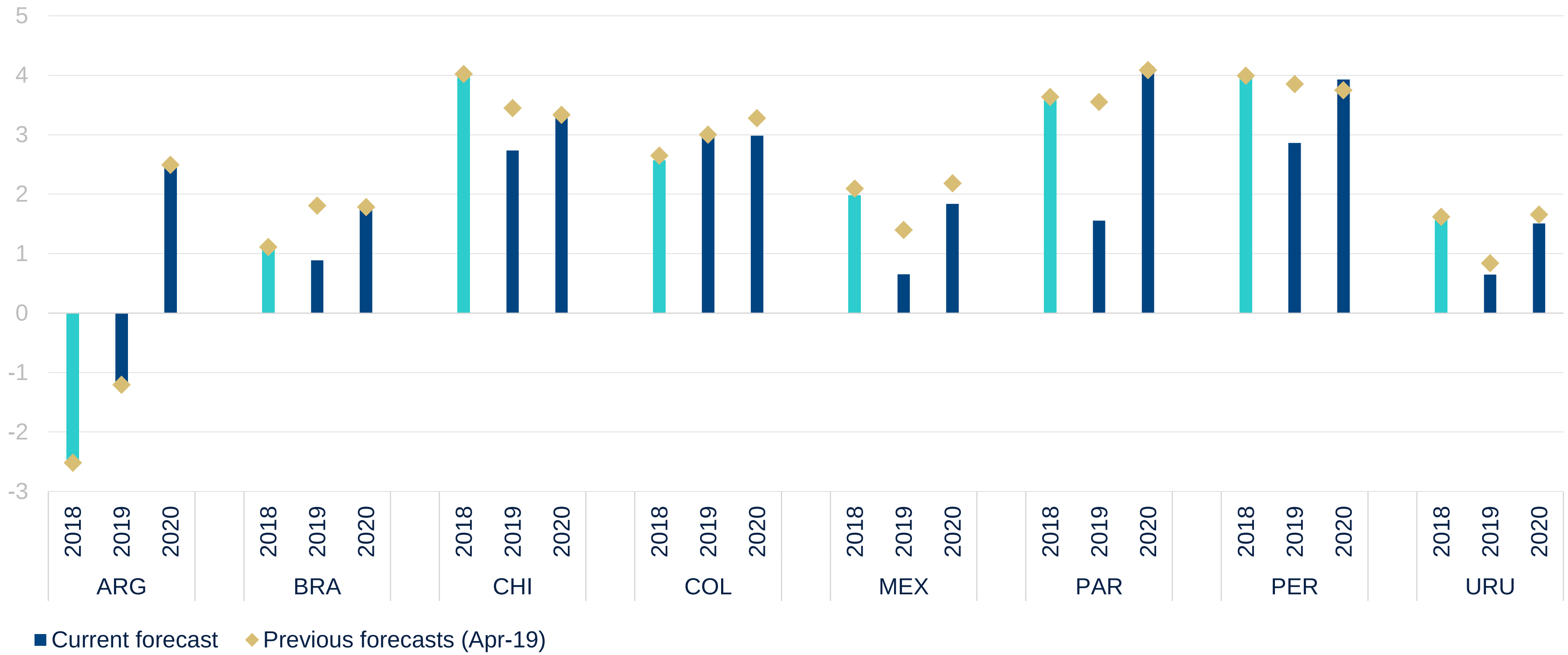


(*) Weighted average of Argentina, Brazil, Chile, Colombia, México, Paraguay, Peru and Uruguay.
Source: BBVA Research

- Latin America will grow in 2019 significantly less than previously expected (1.7%).
- Behind this revision is the downside surprise of growth in the first half of the year.
- In 2020 growth will reach 2.2%, slightly below the previous forecast (2.3%).
- The acceleration of GDP in 2020 will be supported by further economic stimulus, mainly by the central banks...
- ... and will benefit from positive statistical effects derived from poor growth in the first half of 2019.

Slump in growth in 2019 and recovery in 2020 in most countries

LATAM: GDP GROWTH
(%)

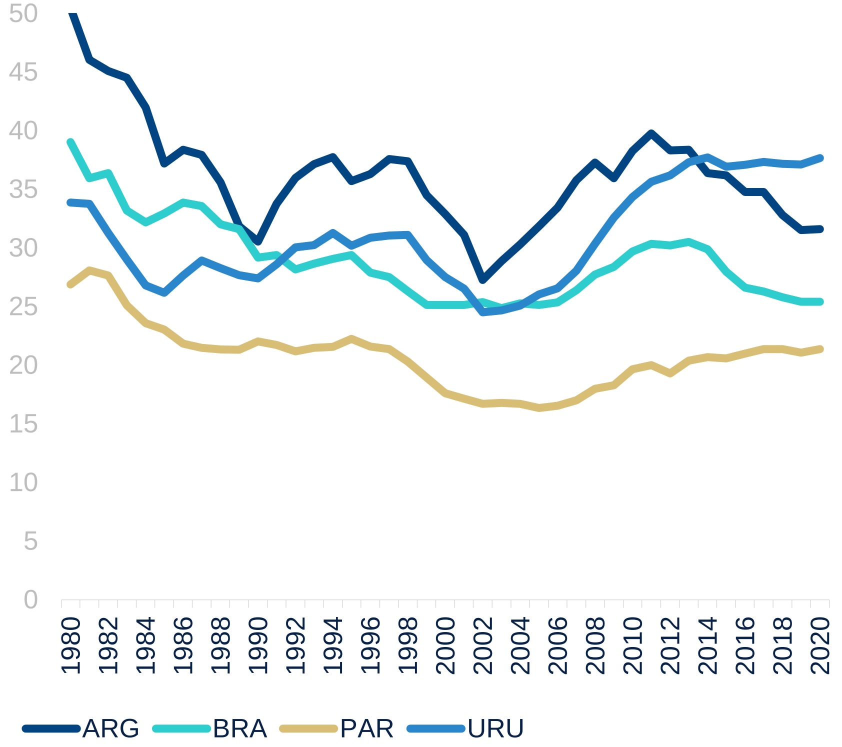


Source: BBVA Research

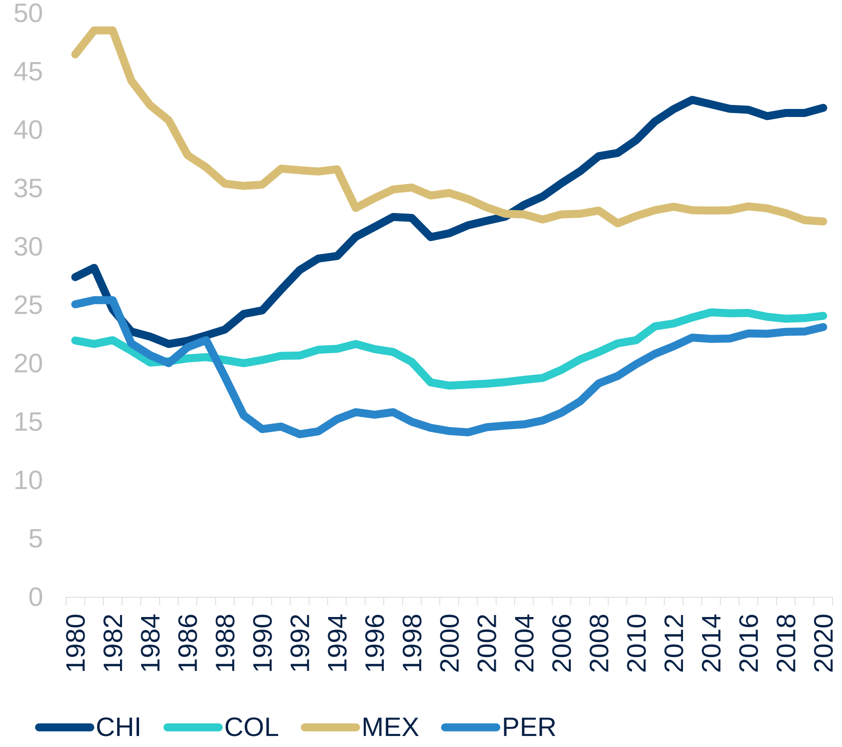
Downward adjustments in 2019 growth in all countries, with the exception of Argentina and Colombia. Uncertainty about domestic policies in Brazil and Mexico persists, while temporary supply shocks weakened growth in the first semester in Peru and Paraguay.

There has been no further closing of the income gap income between Latin America and the United States in the last few years

GDP PER CAPITA: AS A SHARE OF US GDP PER CAPITA
(%, PPP-ADJUSTED)



GDP PER CAPITA: AS A SHARE OF US GDP PER CAPITA
(%, PPP-ADJUSTED)

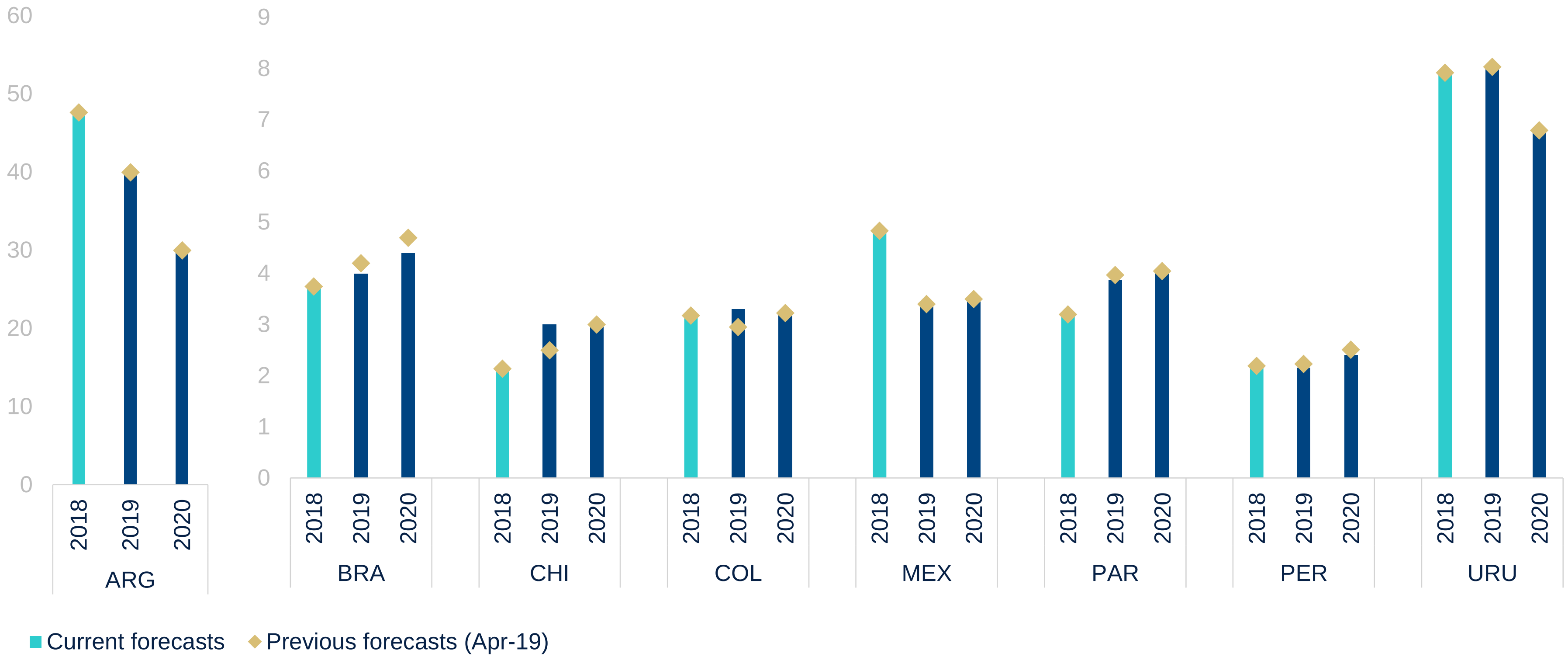


(*) Forecasts for 2019 and 2020.
Source: BBVA Research, IMF

The deceleration in regional growth in recent years has interrupted the process of convergence towards the US of per capita income in most countries. In this regard, no significant improvements are expected in 2019-20.

The lower dynamism of domestic demand will, in general, help central banks to keep inflation close to their targets

LATAM: ANNUAL INFLATION
(%, END OF PERIOD)

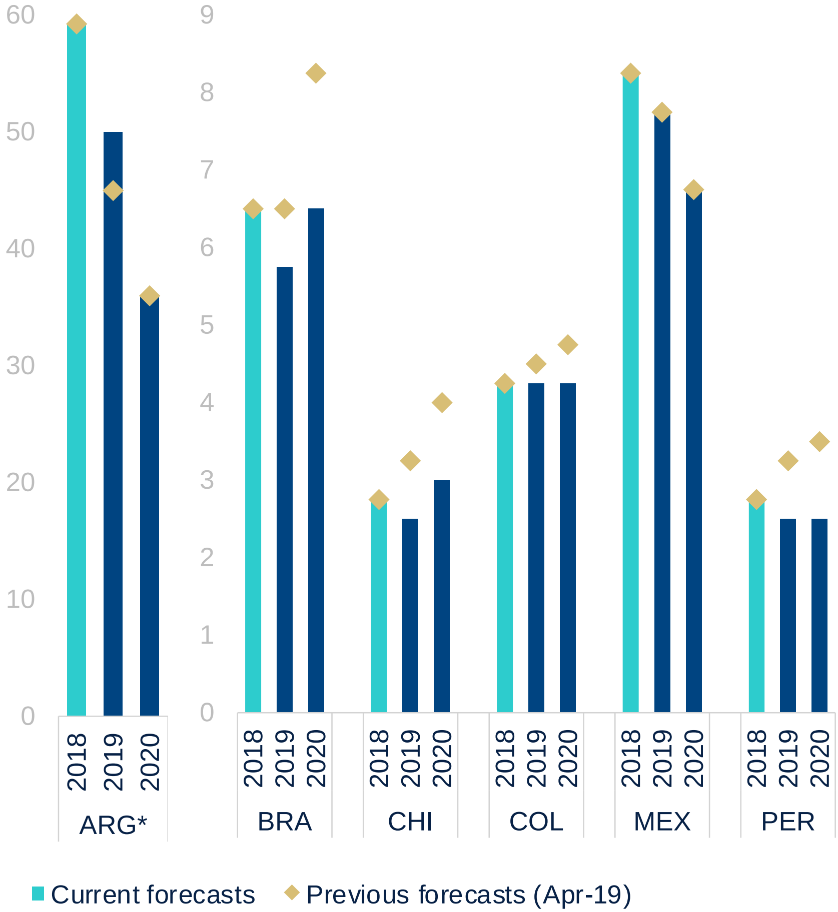


Source: BBVA Research

Inflation will remain high in Argentina and Uruguay, despite the (unchanged) prospects of moderation. In the other cases, it will remain close to the targets and without significant changes compared to previous forecasts.

The Fed's U-turn and favorable inflation prospects create room for a more accommodative monetary policy

LATAM: MONETARY POLICY INTEREST RATES (*)
(YOY %)

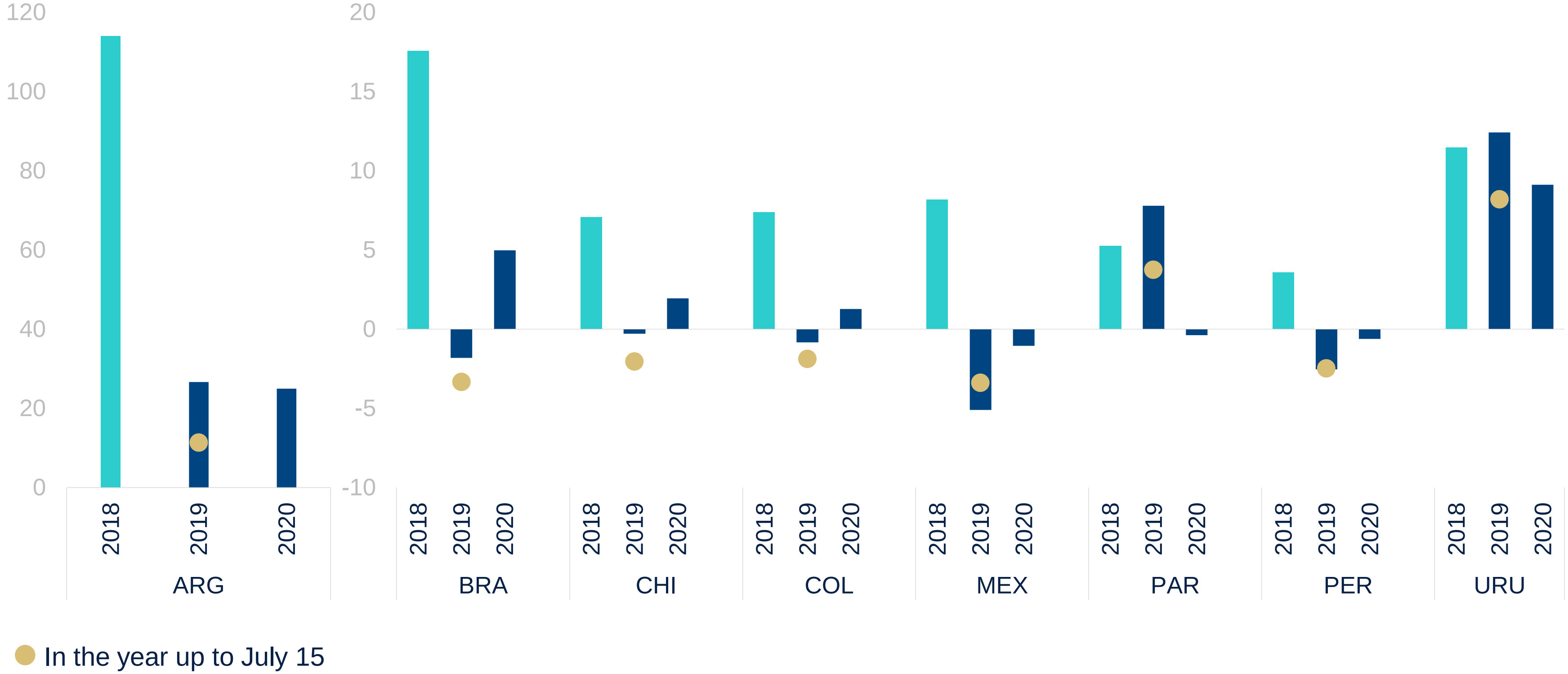


Source: BBVA Research

- A surprising cut in interest rates in Jun-19 in Chile.
- And now we expect interest rate cuts in the coming months in Peru and Brazil.
- Prospects of interest rate cuts also in Mexico, in line with the relative stability of the exchange rate and the moderation of inflation.
- In Colombia, the high current account deficit will leave no room for an easing of the monetary conditions...
- ... but, as in other countries in the region, interest rate hikes are no longer expected in 2019-20.

Regional currencies will, in general, depreciate moving forward, although not as much as in 2018

LATAM: CHANGE IN NOMIANL EXCHANGE RATES (*)
(%; LOCAL CURRENCY PER US DOLLAR)

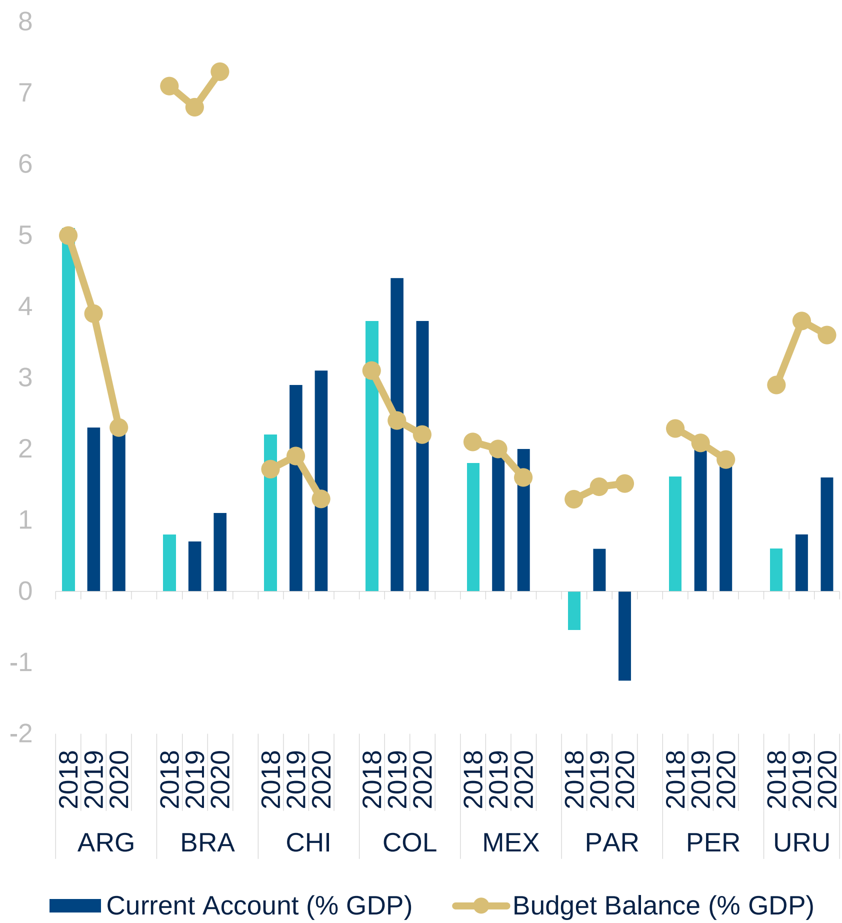


(*) Positive values indicate depreciations and negative values indicate appreciations
Source: BBVA Research

An increase in global risk-aversion could increase exchange rate volatility once again, which would reduce the margin for central banks to adopt a more expansive monetary policy.

The need to reduce fiscal deficits leaves, in general, scarce room for fiscal stimulus policies

LATAM: FISCAL AND CURRENT ACCOUNT DEFICITS
(% OF GDP)

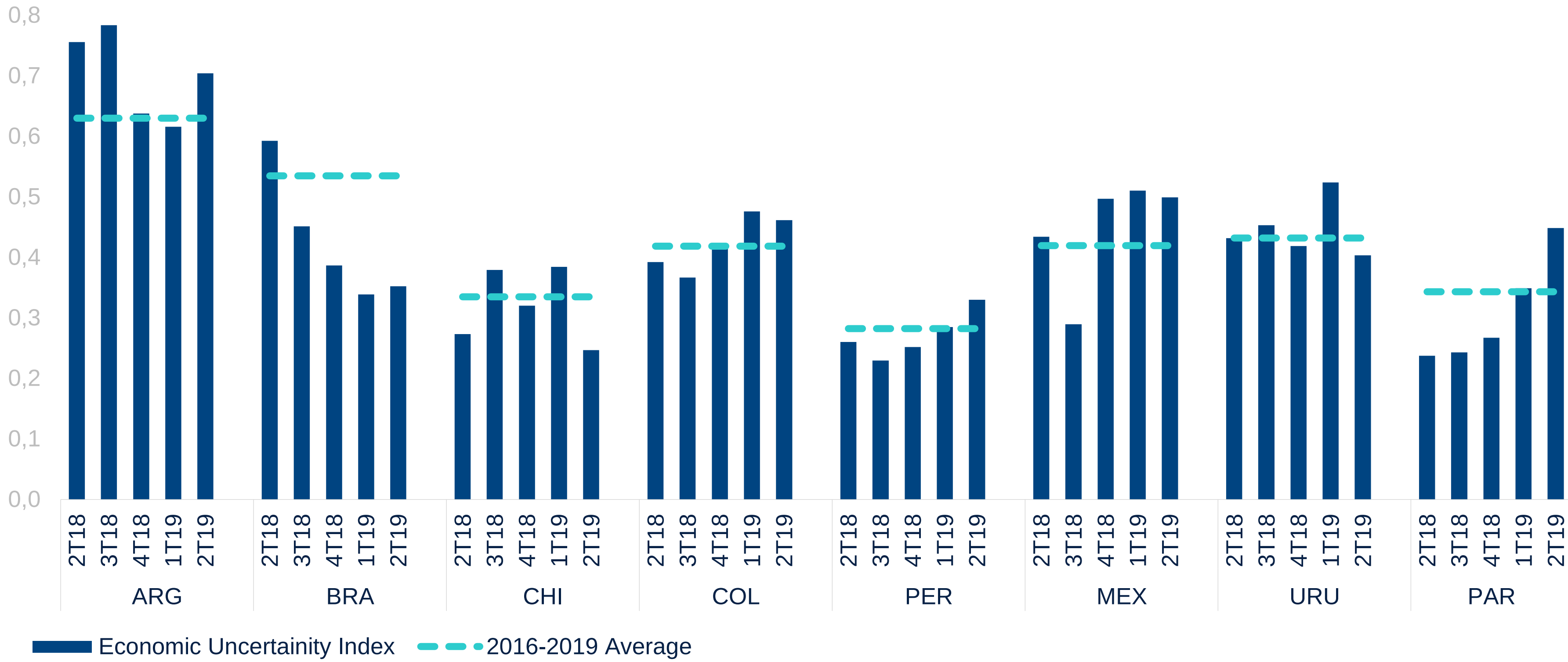


Source: BBVA Research

- The relatively **high public deficits** and the need to comply with **fiscal goals**, in a context where **public debt is higher** than some years ago, prevent the adoption of countercyclical fiscal measures...
- ... mainly in Argentina and Brazil, but also in Colombia, Mexico and Uruguay.
- Slow economic growth helps to **keep current account deficits under control**...
- ... except in **Colombia**, where declining oil prices will play a negative role.

Uncertainty increases, not only due to global factors, but also due to political and fiscal risks

LATAM: ECONOMIC UNCERTAINTY INDEX (*)



* Tone of the news on economic uncertainty in the local press, weighted by media coverage.
Source: BBVA Research and GDELT

Uncertainty remains high and even increases in a large part of the region. In addition to fiscal issues, political risks and doubts about domestic policies continue to weigh negatively in some countries.

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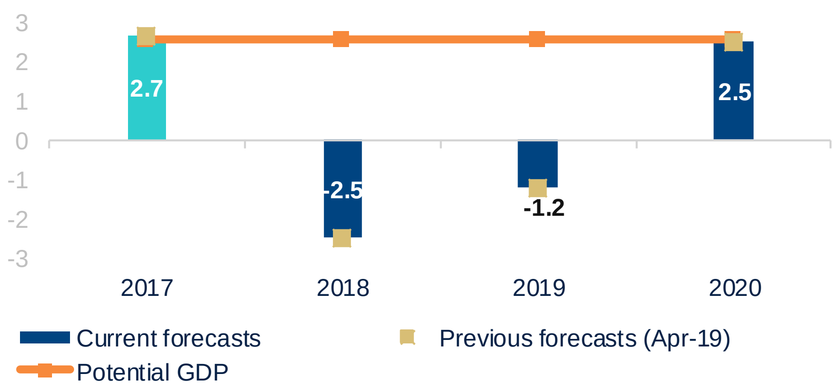
03

Latin America: prospects by country

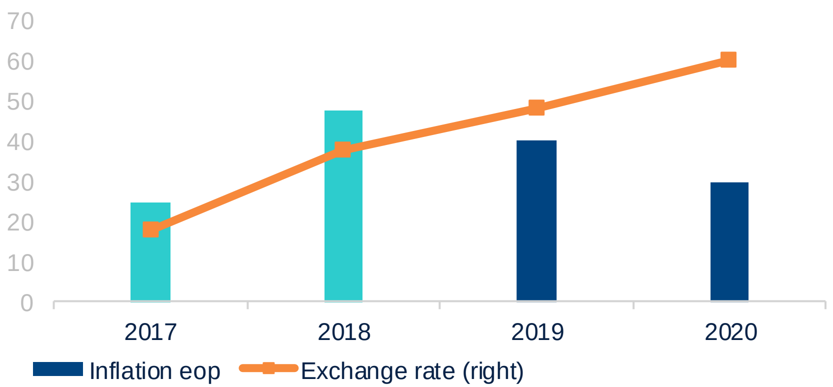
Creating Opportunities

Argentina: recent exchange rate stability reinforces prospects for recovery, but risks remain high

ARGENTINA: EXPECTED AND POTENTIAL GDP GROWTH
(YOY %)



ARGENTINA: INFLATION AND EXCHANGE RATE
(%, END OF PERIOD)

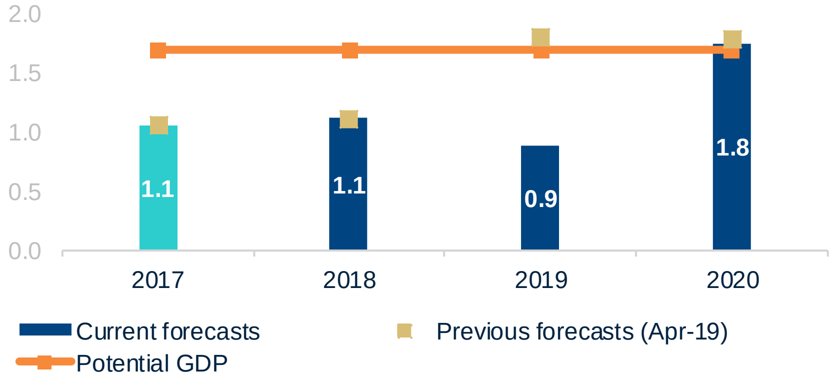


Source: BBVA Research

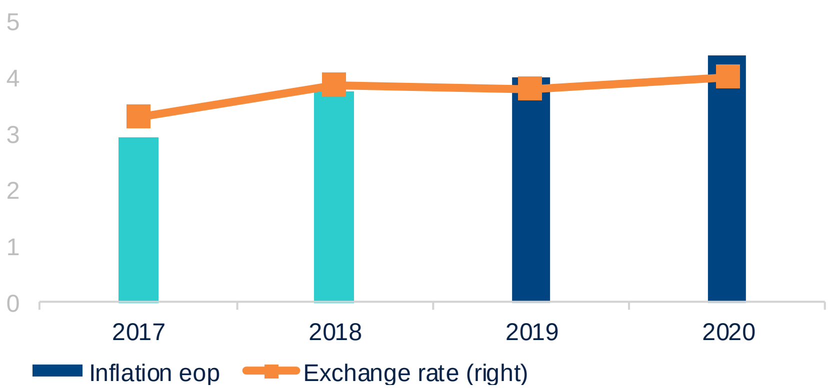
- Better prospects for the **exchange rate** in line with the relative stability registered since the beginning of May…
- … but the **electoral uncertainty** will keep the volatility high in the second half of the year.
- **GDP** will begin to grow positively in 2Q19, after the fall in 1Q19.
- After having peaked recently, **inflation** is expected to converge to 40% in 2019 and 30% in 2020.

Brazil: sharp deterioration of growth expectations for 2019 does not change perspectives of recovery from 2020 onwards

BRASIL: EXPECTED AND POTENTIAL GDP GROWTH
(YOY %)



BRASIL: INFLATION AND EXCHANGE RATE
(%, END OF PERIOD)

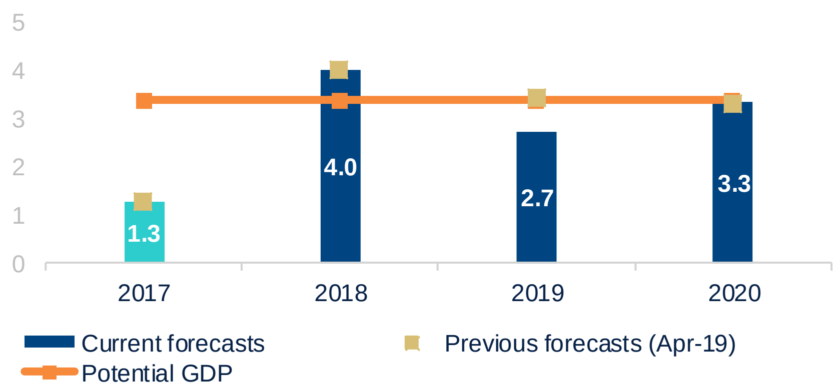


Source: BBVA Research

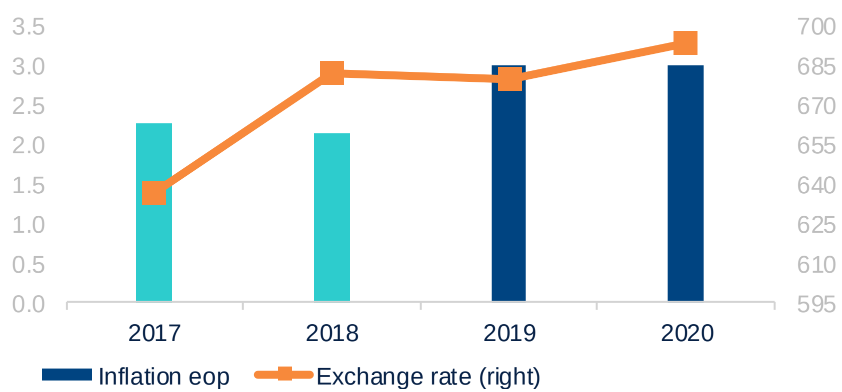
- Downward revision of 2019 GDP forecast due to more negative global scenario and declining domestic confidence.
- Unchanged GDP growth forecasts from 2020 on (with an upside bias).
- Advances regarding the approval of the social security reform and better perspectives of trade opening support recovery prospects.
- The new environment has created room for the central bank to start a monetary easing in the next few months.

Chile: lower growth in 2019, mainly due to the worse performance of investment and exports

CHILE: EXPECTED AND POTENTIAL GDP GROWTH
(YOY %)



CHILE: INFLATION AND EXCHANGE RATE
(%, END OF PERIOD)

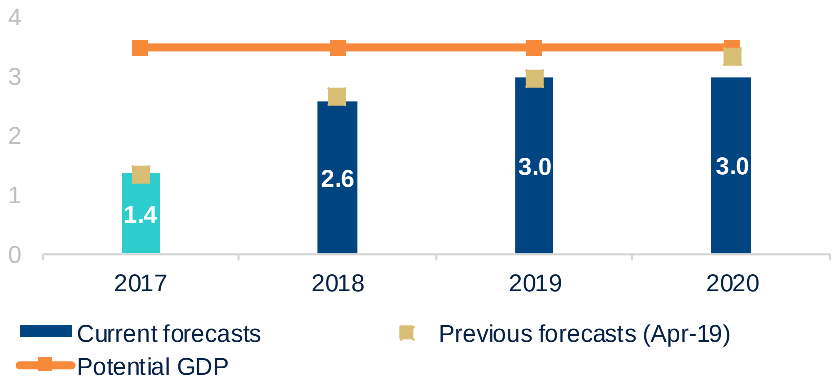


Source: BBVA Research

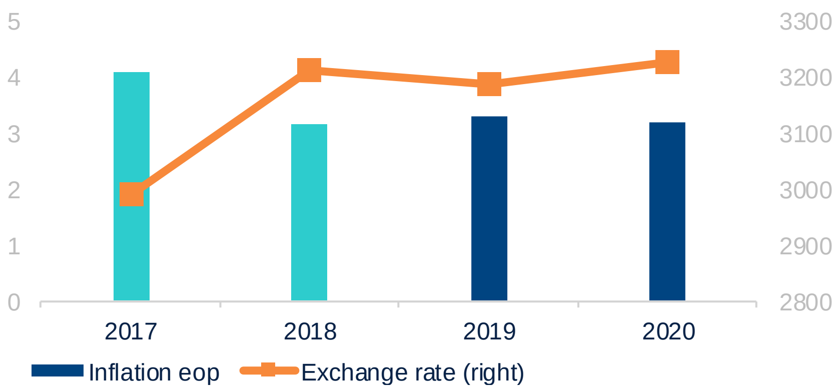
- Lower growth in the first half of the year drives down forecast for 2019 GDP.
- Growth prospects are maintained for 2020, and potential growth is revised upwards.
- Surprising 50bps cut in interest rates in Jun-19 due to weaker GDP in 1Q19 and updating of structural parameters (larger output gap and lower neutral interest rate).
- Inflation will increase moving forward, converging to 3.0% by the end of 2019.

Colombia: growth to stabilize at 3% in 2019-20

COLOMBIA: EXPECTED AND POTENTIAL GDP GROWTH
(YOY %)



COLOMBIA: INFLATION AND EXCHANGE RATE
(%, END OF PERIOD)

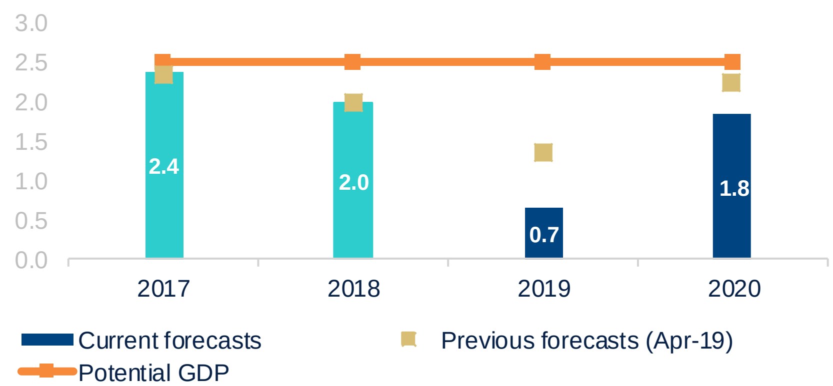


Source: BBVA Research

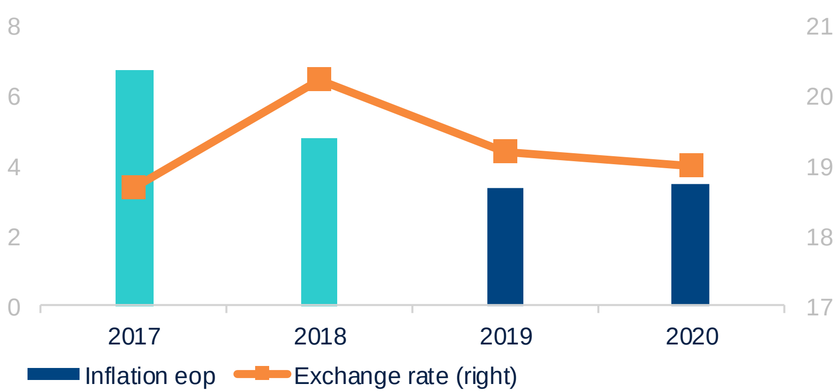
- Downward revision of the growth forecast for 2020 ...
- ... due to the impact of the higher global and local **uncertainty** on **investment** and **exports**.
- The **central bank will be patient** and will keep the interest rate unchanged until 2021.
- The **current account deficit** will not leave room for a cut in interest rates.
- Achieving **fiscal goals** will remain challenging.

México: lower growth and higher uncertainty despite macro stability

MÉXICO: EXPECTED AND POTENTIAL GDP GROWTH
(YOY %)



MÉXICO: INFLATION AND EXCHANGE RATE
(%, END OF PERIOD)

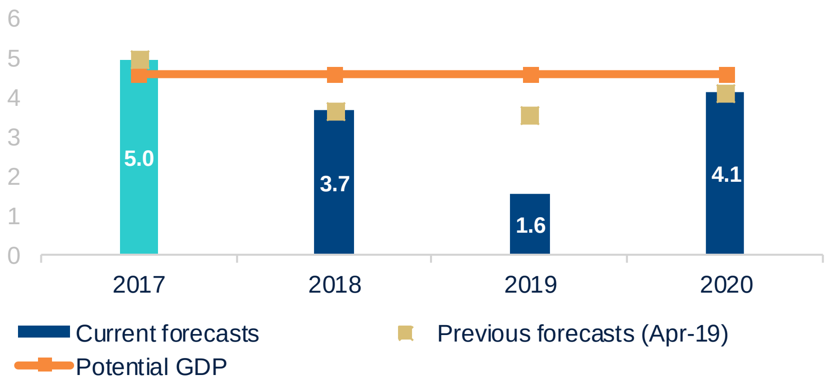


Source: BBVA Research

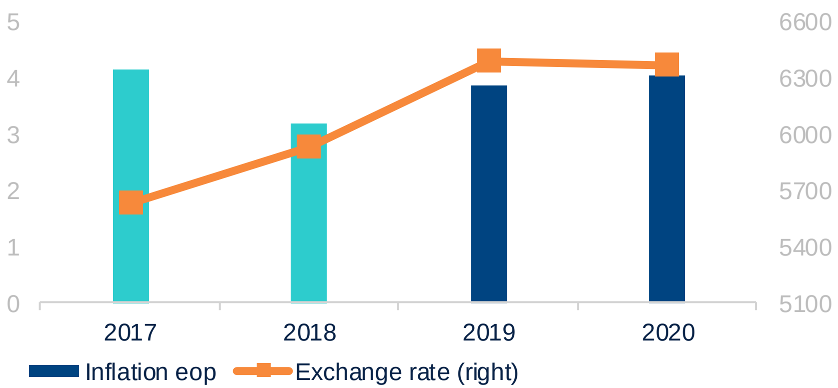
- Growth forecasts revised down mainly on a more negative view on investment and private consumption...
- ... against a backdrop of increasing uncertainty (mainly new US trade threats and Pemex).
- Decline of inflation, stable exchange rate and the Fed will pave the way for Banxico to start an easing cycle in Sep-19.
- Despite growth deterioration, we expect continued stable macro policies.

Paraguay: climatic shocks worsen prospects of growth in 2019

PARAGUAY: EXPECTED AND POTENTIAL GDP GROWTH
(YOY %)



PARAGUAY: INFLATION AND EXCHANGE RATE
(%, END OF PERIOD)

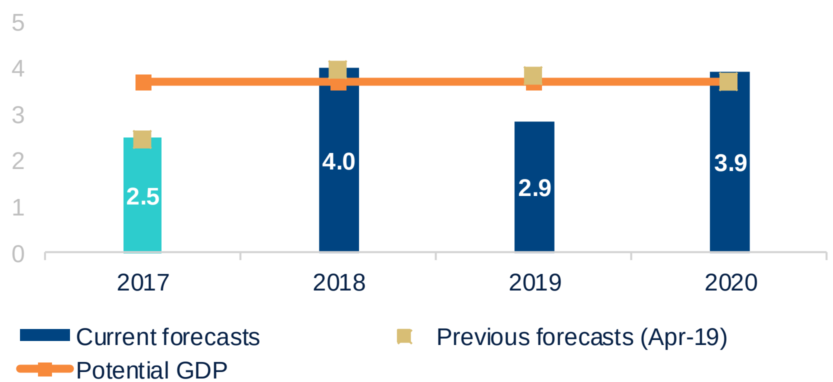


Source: BBVA Research

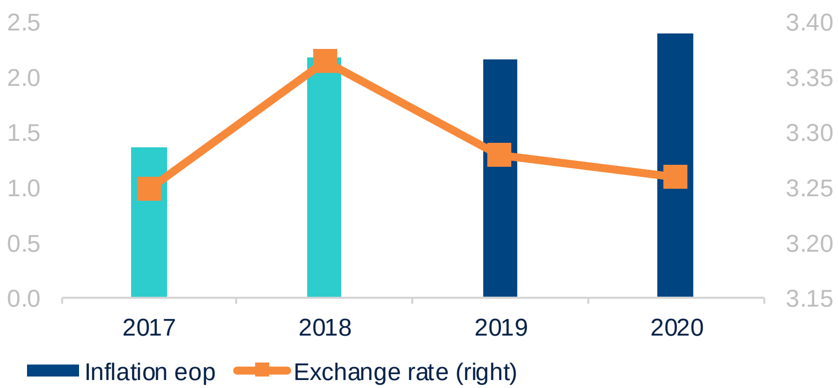
- **Temporary supply shocks** have affected mainly the agricultural sector (agriculture and livestock) and energy production.
- **The regional environment will be more negative** than expected (lower growth in Brazil).
- Thus, **2019 growth is revised downwards**, from 3.6% to 1.6%.
- **Inflation** will remain within the target range (2% -6%).
- The **interest rate** will remain at 4.50%, despite pressures to the downside in the short term.

Peru: supply shocks that affected the primary sector will drive growth temporarily down

PERÚ: EXPECTED AND POTENTIAL GDP GROWTH
(YOY %)



PERÚ: INFLATION AND EXCHANGE RATE
(%, END OF PERIOD)

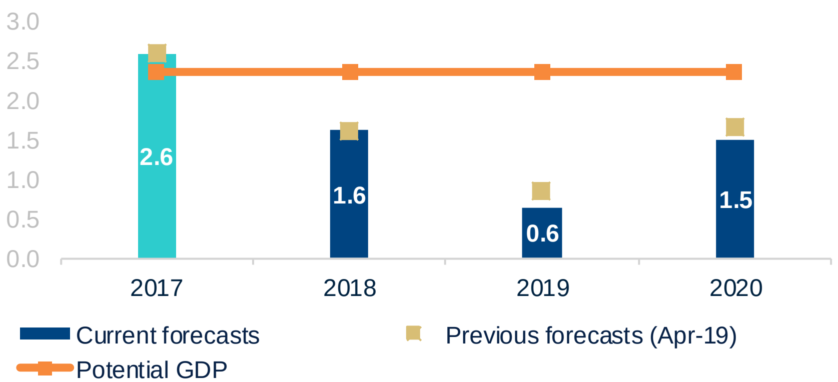


Source: BBVA Research

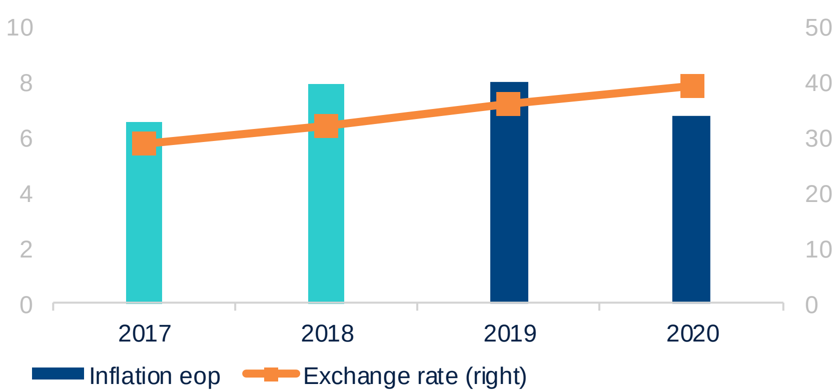
- **Growth will recover throughout 2019** as the shocks that affected the **primary sector** (mining and fishing) at the beginning of the year vanish and **public spending** accelerates.
- **Inflation** will remain under control: 2.3% in 2019 and 2.4% in 2020.
- A slower closing of the output gap and more accommodative monetary policies around the world now pave the way for **a cut in interest rates in 3Q19**.

Uruguay: slight downward revision of the growth forecasts, due to a less favorable global and regional environment

URUGUAY: EXPECTED AND POTENTIAL GDP GROWTH
(YOY %)



URUGUAY: INFLATION AND EXCHANGE RATE
(%, END OF PERIOD)



Source: BBVA Research

- Both the more negative global environment and the weak growth of Argentina and Brazil favor a downward revision of growth.
- Inflation will reach 8.0% this year, above the target range.
- The restrictive tone of monetary policy will allow relative stability of the exchange rate and a reduction in inflation in 2020.
- A more gradual than expected fiscal consolidation.
- No sharp turnaround in economic policies is anticipated after the presidential elections this year.

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04

Latin America: forecast tables

Forecasts for growth, inflation, exchange rates and interest rates

	GDP (% yoy)					**Inflation** (% yoy, eop)				
	2016	2017	2018	2019	2020	2016	2017	2018	2019	2020
Argentina	-1.8	2.9	-2.5	-1.2	2.5	39.3	24.8	47.6	40.0	30.0
Brazil	-3.3	1.1	1.1	0.9	1.8	6.3	2.9	3.7	4.0	4.4
Chile	1.3	1.5	4.0	2.7	3.3	2.8	1.9	2.1	3.0	3.0
Colombia	2.0	1.8	2.6	3.0	3.0	5.7	4.1	3.2	3.3	3.2
Mexico	2.7	2.3	2.0	0.7	1.8	3.2	6.6	4.8	3.4	3.5
Paraguay	4.3	5.2	3.7	1.6	4.1	3.9	4.5	3.2	3.9	4.0
Peru	4.0	2.5	4.0	2.9	3.9	3.3	1.6	2.2	2.2	2.4
Uruguay	1.7	2.7	1.6	0.6	1.5	8.2	6.3	7.9	8.0	6.8

	Exchange Rate (vs. USD, eop)					**Interest Rates** (%, eop)				
	2016	2017	2018	2019	2020	2016	2017	2018	2019	2020
Argentina	15.8	17.7	37.9	48.0	60.0	24.80	28.80	59.25	50.00	36.00
Brazil	3.35	3.30	3.88	3.81	4.00	13.75	7.00	6.50	5.75	6.50
Chile	667	637	682	680	693	3.50	2.50	2.75	2.50	3.00
Colombia	3010	2991	3212	3186	3227	7.50	4.75	4.25	4.25	4.25
Mexico	20.7	18.7	20.2	19.2	19.0	5.75	7.25	8.25	7.75	6.75
Paraguay	5787	5631	5928	6390	6365	5.50	5.25	5.25	4.50	4.50
Peru	3.40	3.25	3.37	3.28	3.26	4.37	3.26	2.75	2.50	2.50
Uruguay	28.8	28.9	32.2	36.2	39.5	**	**	**	**	**

* 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 balance and commodity prices

	Current Account (% of GDP)					**Fiscal Balance** (% of GDP)				
	2016	2017	2018	2019	2020	2016	2017	2018	2019	2020
Argentina	-2.7	-4.9	-5.1	-2.3	-2.3	-5.8	-6.0	-5.0	-3.9	-2.3
Brazil	-1.3	-0.3	-0.8	-0.7	-1.1	-9.0	-7.8	-7.1	-6.8	-7.3
Chile	-1.4	-1.5	-2.2	-2.9	-3.1	-2.7	-2.8	-1.7	-1.9	-1.3
Colombia	-4.3	-3.3	-3.8	-4.4	-3.8	-4.0	-3.6	-3.1	-2.4	-2.2
Mexico	-2.2	-1.6	-1.8	-2.0	-2.0	-2.5	-1.1	-2.1	-2.0	-1.6
Paraguay	3.5	3.1	0.5	-0.6	1.3	-1.1	-1.1	-1.3	-1.5	-1.5
Peru	-2.7	-1.1	-1.6	-2.2	-1.9	-2.5	-3.1	-2.3	-2.1	-1.9
Uruguay	0.6	0.7	-0.6	-0.8	-1.6	-3.8	-3.5	-2.9	-3.8	-3.6

	Commodity proces (average)				
	2016	2017	2018	2019	2020
Oil (Brent USD/Barrel)	44.8	54.4	71.1	64.0	55.4
Soja (USD/metric tonne)	363	359	342	329	343
Copper (USD/lb.)	2.20	2.80	2.96	2.80	2.78

Source: BBVA Research