BBVA Research

Latam Economic Outlook

1Q20

January 2020

Creando Oportunidades

Key messages

Latin America's growth has been of only 0.6% in 2019, well below the previous year's rate (1.6%), the expectations at the beginning of the year (2.1%) and the potential GDP growth (close to 2.5%).This low growth has been the result of the global slowdown, but also of political and policy uncertainty in many Latin American countries.

A recovery is expected in 2020 and 2021: growth should reach 1.4% this year and 2.1% the next. This recovery would be based on an improvement in the global environment, some reduction in idiosyncratic uncertainty, and an expansionary monetary policy in an environment of under-control inflation. The increased growth in these two years will be mainly based on domestic demand, especially investment.

The recovery will be widespread, although heterogeneous across countries. Growth in the next two years will be over 3% in Peru and Colombia, and at rates close to 2% in Brazil, Uruguay, Chile and Mexico. In the latter, the approval of the USMCA will support an acceleration of investment and a good export performance. In Argentina, the recession will continue in 2020, within the context of a shortage of foreign currencies and high inflation.

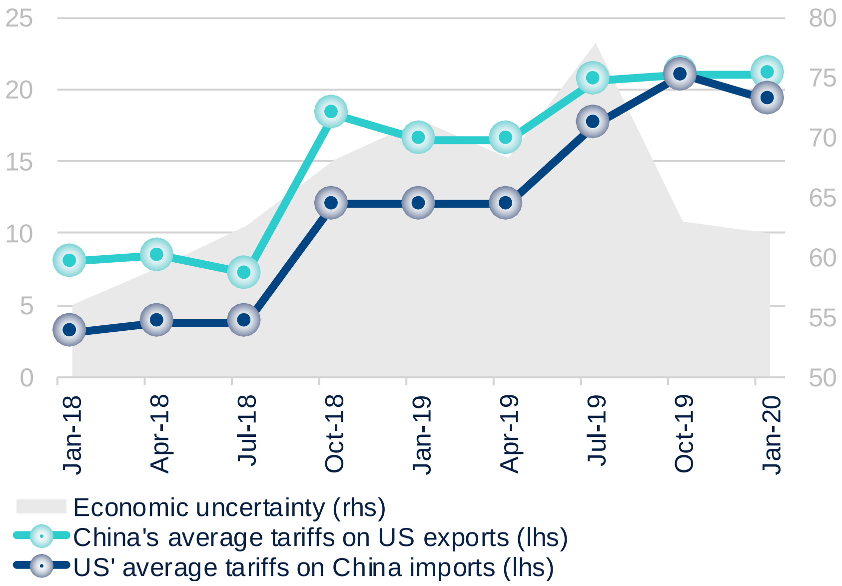
Increasing growth will be a major challenge, as commodity prices will remain low and the risk balance biased downward. In addition, there are a number of vulnerabilities to address: i) Brazil and Argentina must ensure the sustainability of public debt, ii) political uncertainty in Peru, policy uncertainty in Mexico, and institutional uncertainty in Chile must be reduced; iii) inflation must be controlled in Uruguay and Argentina; and iv) Colombia must limit its external vulnerability.

01

Global environment: reinforced prospects of growth stabilization

The trade agreement between the US and China has significantly reduced uncertainty, but not protectionism levels

TARIFFS AND ECONOMIC UNCERTAINTY*
(%, INDEX: 0 TO 100)

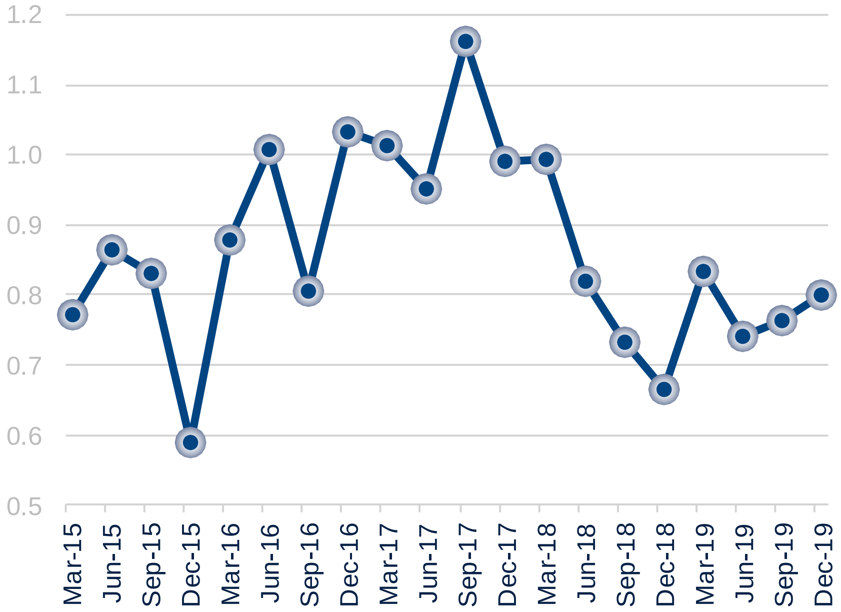


* Average tariffs at the beginning of each quarter. BBVA Research Index of Economic Uncertainty: tone of the news about economic uncertainty; quarterly average (except 1Q20: average until January 9, 2020).
Source: BBVA Research, PIIE

- US-China "phase one" trade deal is positive news, but partial:
  - Import tariffs will continue to be high despite the announced reductions.
  - We are still far from a definitive solution to structural problems.
- The risk of disorderly *brexit* in the short-term has disappeared, contributing to reduce global uncertainty, but it can resurface in the second half of the year.

Global growth has remained relatively low throughout 2019

WORLD GDP GROWTH*
(% Q/Q)

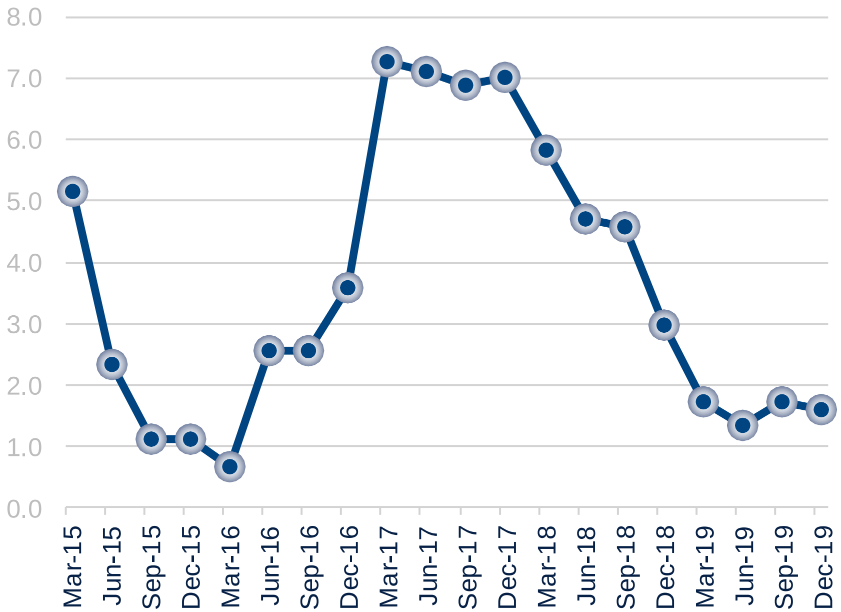


* Estimations based on BBVA-GAIN model.
Source: BBVA Research

- The world economy expanded around 0.75% in quarterly terms throughout 2019, below what was observed in previous years.
- In addition to the high uncertainty, the structural moderation of China and the cyclical slowdown of the US were behind the weak global growth in 2019.
- In any case, global growth has been slightly higher than expected in the second half of the year.

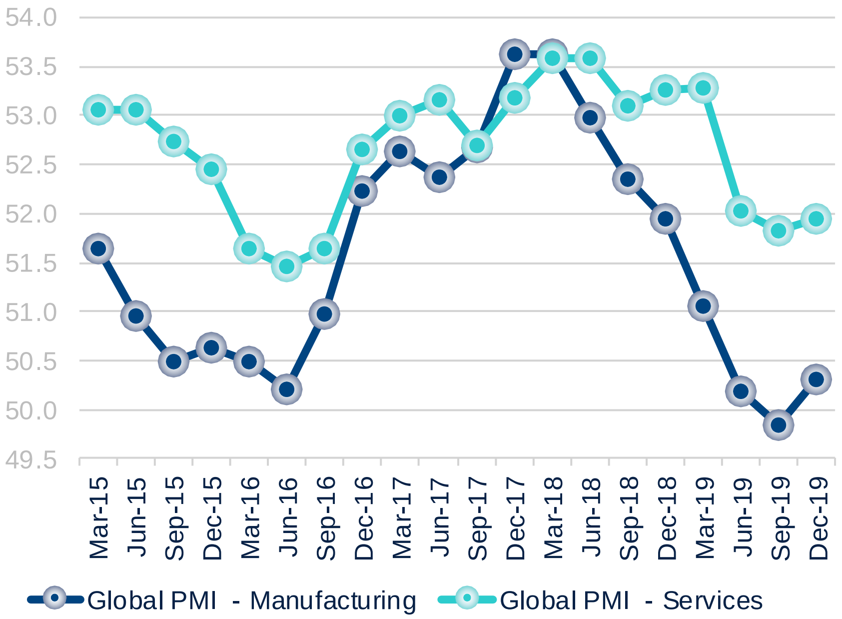
Signs of stabilization: the slowdown of both exports and services as well as the contraction in manufacturing seem to be over

EXPORTS*
(% Y/Y, ANNUAL GROWTH AVERAGE IN EACH QUARTER)



* 4Q19 average only includes Oct/19 and Nov/19 data.
Source: BBVA Research

PMI INDICATORS
(HIGHER THAN 50: EXPANSION; LOWER THAN 50: CONTRACTION)

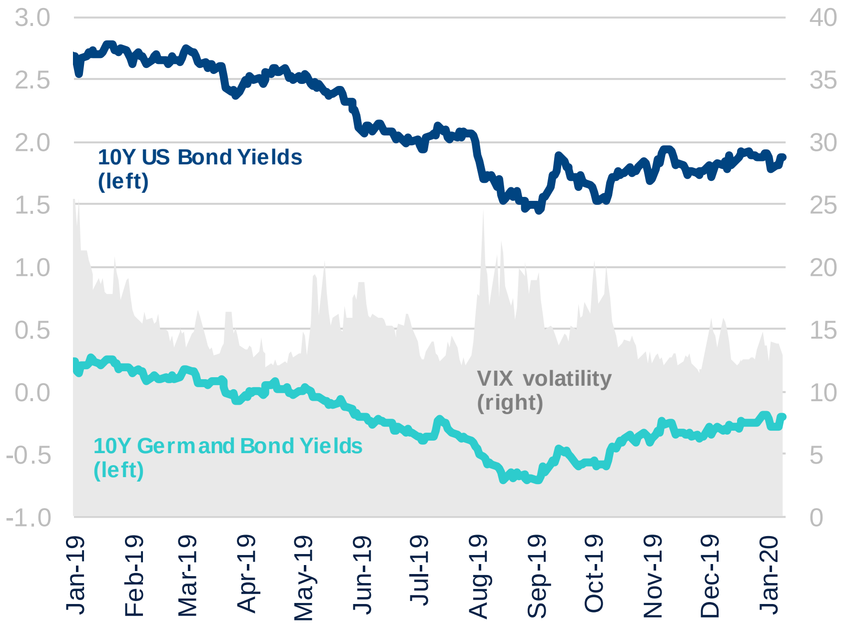


Source: BBVA Research based on Haver data

Financial markets exhibit a better mood

SOVEREIGN DEBT YIELDS AND EQUITY VOLATILITY

(%, INDEX)



Source: BBVA Research based on Haver data

- The recent improvement of the global environment has spurred some optimism in the financial markets:
  - Volatility reduction
  - Recovery of long-term rates
  - Stock Market improvement
  - Increased appetite for risk

The environment will favor a soft landing of global growth

LOWER TRADE TENSIONS

- **US-China positive but partial deal.**
- **Protectionism** will continue to be a source of concern, also in other regions.
- **A less disruptive *brexit***, at least in the short-term.

COUNTER-CYCLICAL POLICIES

- The expansionary tone of **monetary policy** will be maintained, following recent rate cuts.
- A limited **fiscal stimulus** in Europe and somewhat greater in China.

LIMITED FINANCIAL VOLATILITY

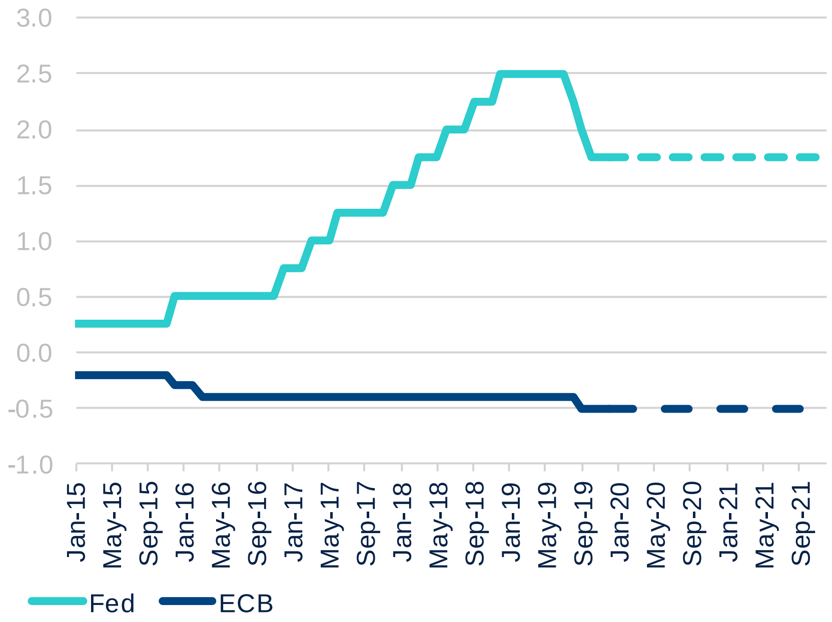
- Volatility will be limited by the **actions of central banks.**
- Some **appetite for risk.**

COMMODITY PRICES UNDER CONTROL

- **Oil prices** around 61 dollars in 2020-21
- Relative **weakness of demand** and **increase in the supply of non-OPEC countries.**

Pause at both the Fed and the ECB: no prospects for changes in interest rates on the horizon

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

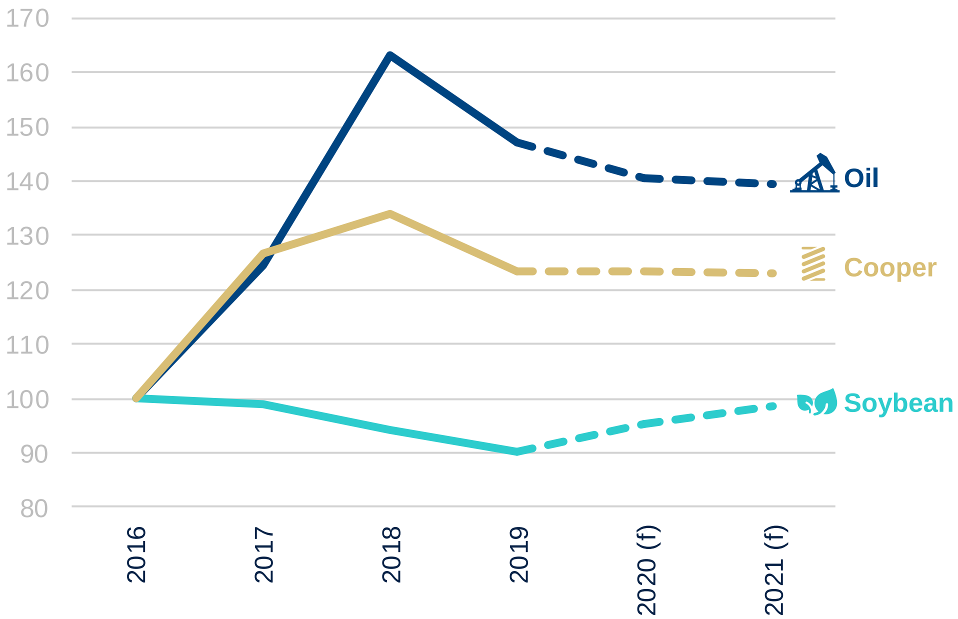


* In the case of the ECB, deposits interest rates. Forecasts from Jan/19 onwards.
Source: BBVA Research

- Fed: the relative resistance of the economy improves the balance of risks and generates the conditions for a long monetary pause.
- ECB: growth stabilization and the communication by the new presidency reinforce the expectations of interest rate stability.

Better prospects for commodity prices, which, however, will remain relatively low

COMMODITIES: AVERAGE ANNUAL PRICES
(INDEX, 2016 AVERAGE = 100)



(f) Forecast.
Source: BBVA Research

- Moderate upward revision in forecast for commodity price, due to less pessimism about the global environment:
  - Oil: 2020 forecasts revised 8% up to 61 dollars.
  - Copper and soybean: 2020 forecasts revised 4% and 1% to the upside, respectively.
- Anyway, prices will remain under control given the relative robustness of supply in a context of lower demand.
- The escalation of tensions in the Middle East represents a risk: an oil price of $ 70 in 2020 would reduce world growth by one or two decimal points.

Global growth will converge to 3.2% in 2020 and 3.3% in 2021

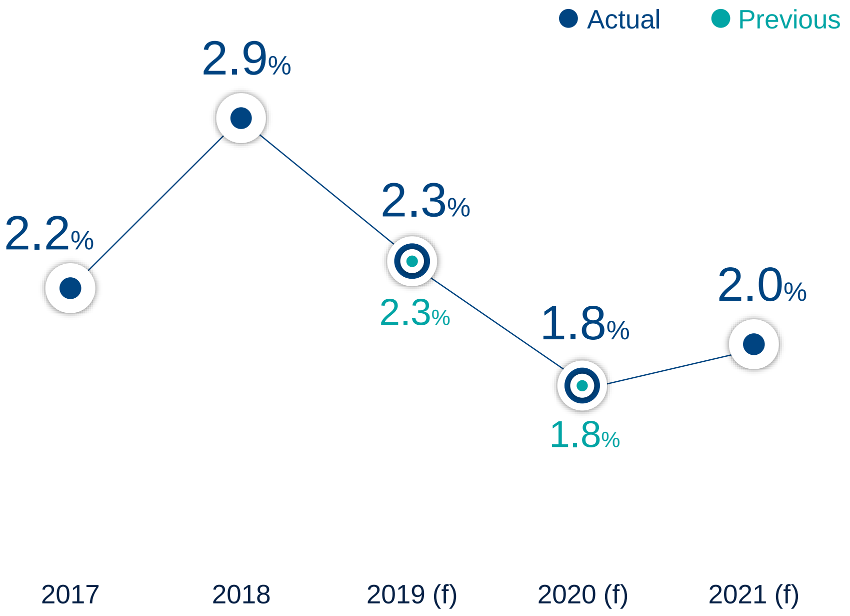
	USA	Eurozone	China	World
2018	2.9	1.9	6.6	3.6
2019	2.3	1.2	6.1	3.2
2020	1.8	0.9	5.8	3.2
2021	2.0	1.2	5.5	3.3

- Upward revision
- Unchanged forecast
- Downward revision

Source: BBVA Research

USA: the prospects of a smooth deceleration ahead remain in place

GDP GROWTH
(%)

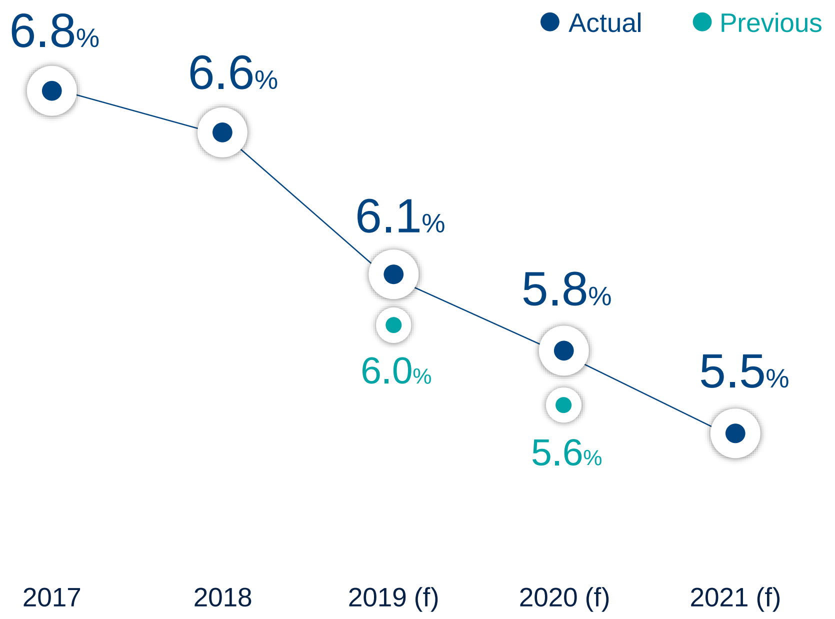


(f) Forecast.
Source: BBVA Research

- Private consumption shows strength, in contrast with the weakness of investment.
- Inflation will remain close to 2.0%, with more balanced risks.
- Probability of recession has declined.
- The 2020 presidential elections may increase political and geopolitical tensions.

China: growth slowdown, somewhat slower than expected

GDP GROWTH
(%)

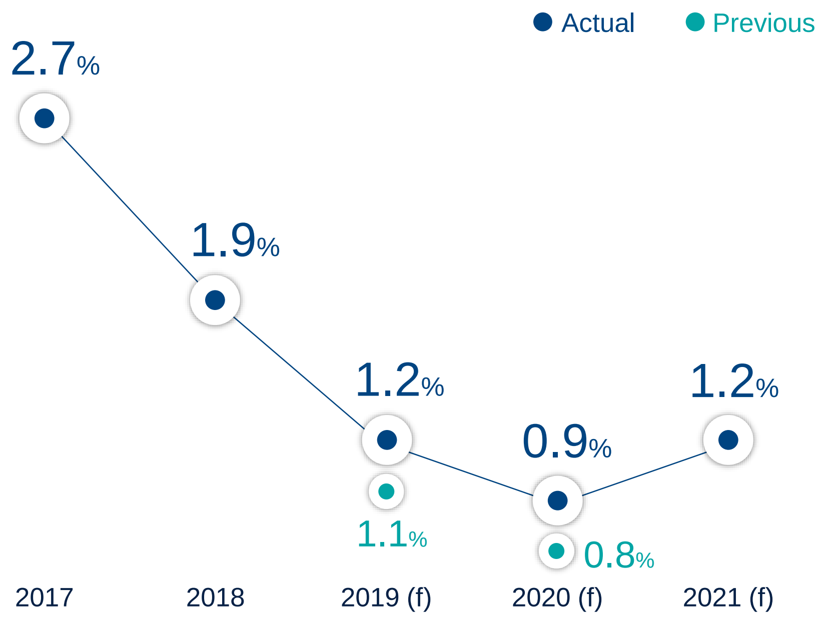


(f) Forecast.
Source: BBVA Research

- A generalized economic slowdown is still in place
- Upward revision of the forecast for 2019: the recent growth deceleration has been smoother than expected.
- Small upward revision of 2020 GDP growth forecast:
  - Improved relation with the US.
  - Greater willingness to increase the fiscal stimulus.
- Monetary stimulus: gradualism moving forward, in a context of temporarily high inflationary pressures.

Eurozone: slightly upward revision of growth forecasts, due to better than expected incoming data

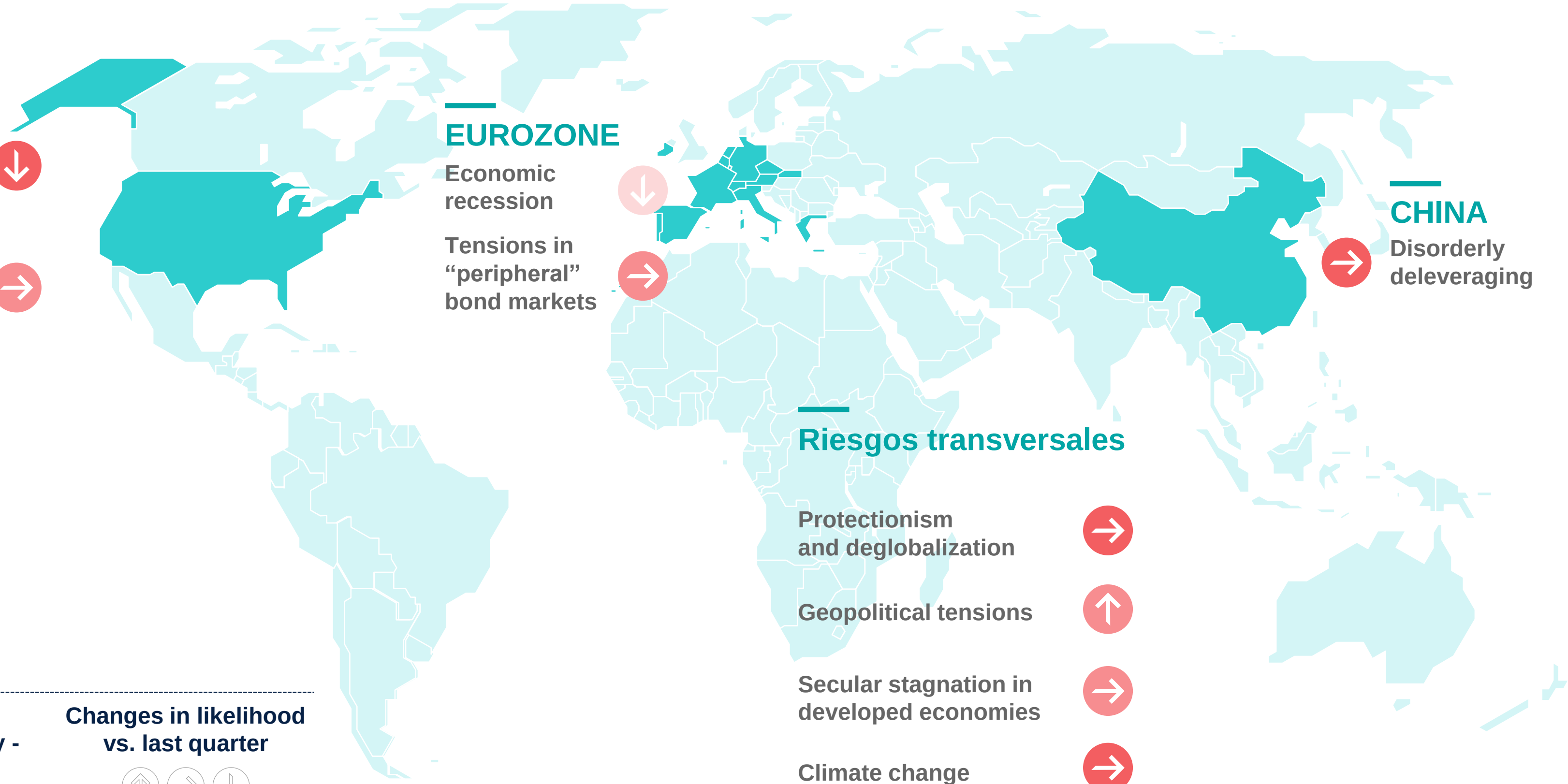
GDP GROWTH
(%)



(f) Forecast.
Source: BBVA Research

- Growth is stabilizing at low levels.
- The economic dynamism will increase from mid-2020, partly due to higher exports.
- The growth divergence among large countries will be reduced, mostly due to a better performance in Germany.
- Inflation will remain very low, despite the strong monetary stimulus and some fiscal support.

Reduction in the cyclical global risks, but not in the structural ones



USA

Economic recession

Fall in bond prices due to higher inflation

EUROZONE

Economic recession

Tensions in "peripheral" bond markets

CHINA

Disorderly deleveraging

Riesgos transversales

Protectionism and deglobalization

Geopolitical tensions

Secular stagnation in developed economies

Climate change

\+ Global severity -

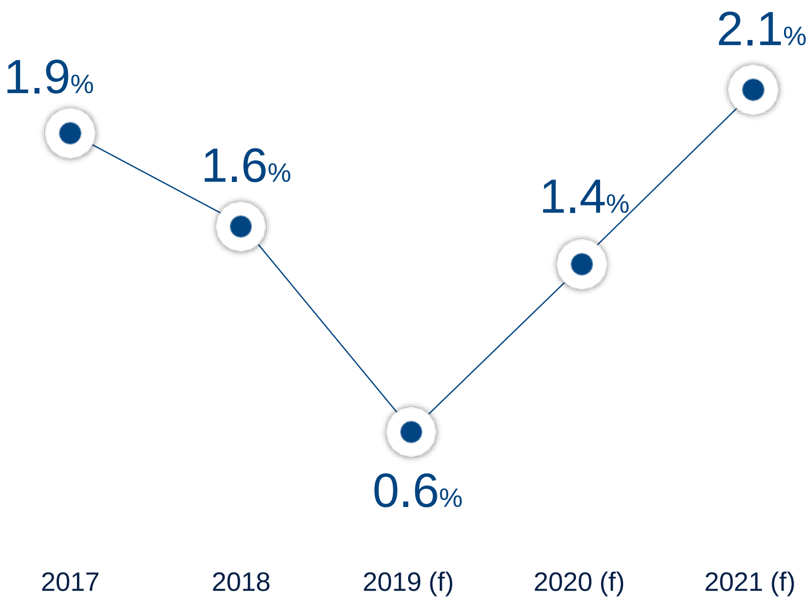
Changes in likelihood vs. last quarter

02

Latin America: Gradual recovery in 2020-21, but the surge in uncertainty represents a risk

Growth has slowed in 2019, but there are reasons to expect a recovery in the coming years

GDP GROWTH: LATIN AMERICA (*)
(%, YoY)

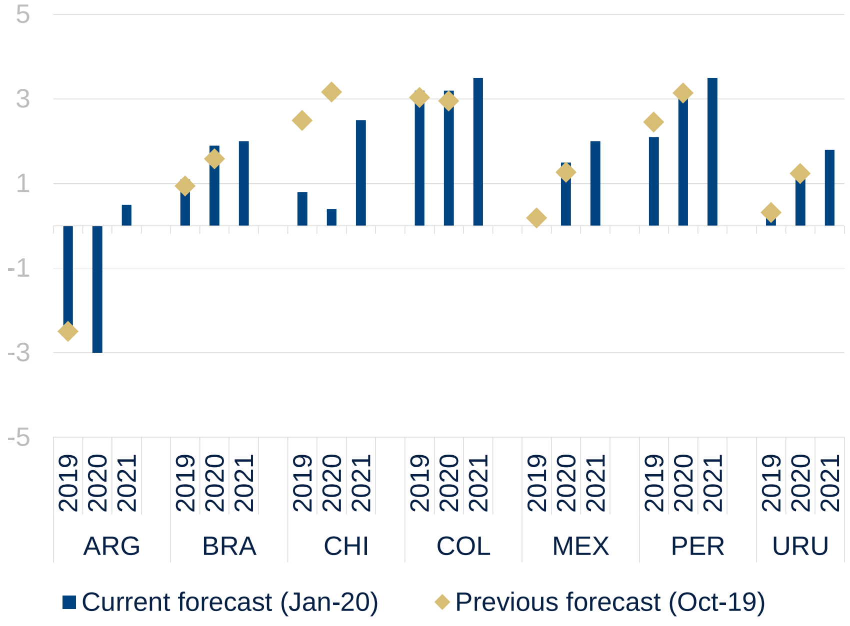


(*) Weighted average of Argentina, Brazil, Chile, Colombia, Mexico, Peru, and Uruguay.
(f) Forecast.
Source: BBVA Research

- In 2019, Latin America grew significantly less than expected and less than the potential, which is around 2.5%.
- Growth will increase moderately in 2020-21.
- Recovery is conditioned in an improvement in two factors that contributed negatively to growth in 2019:
  - Global environment.
  - Political and economic policy uncertainty in many countries of the region.
- The expansionary monetary policy, within a context of under-control inflation, will also support growth in 2020-21.

The recovery will be widespread, although heterogeneous across countries

GDP GROWTH (*)
(%, YoY)



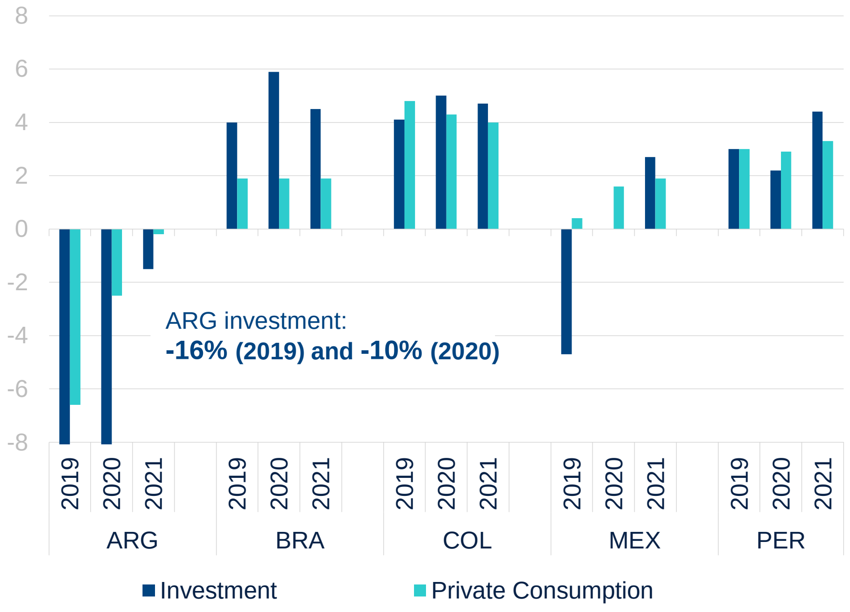
(*) Forecasts for 2019, 2020 and 2021.
Source: BBVA Research

- In addition to an improving global environment and a likely fall in uncertainty, recovery will be supported by some idiosyncratic factors:
  - Mexico: the approval of the USMCA.
  - Peru: Increased public investment and mining production.
  - Colombia: Greater than expected strength in domestic demand.
  - Brazil: The best prospects for reforms and their impact on confidence.
  - Uruguay: Implementation of major investment projects.
- Chile's forecasts were revised downwards due to the impact of the protests, while in Argentina, the recession will continue in 2020, within a context of shortages of US dollars.

The dynamism of investment will, in general, lead the process of recovery of economic activity

INVESTMENT AND PRIVATE CONSUMPTION (*)

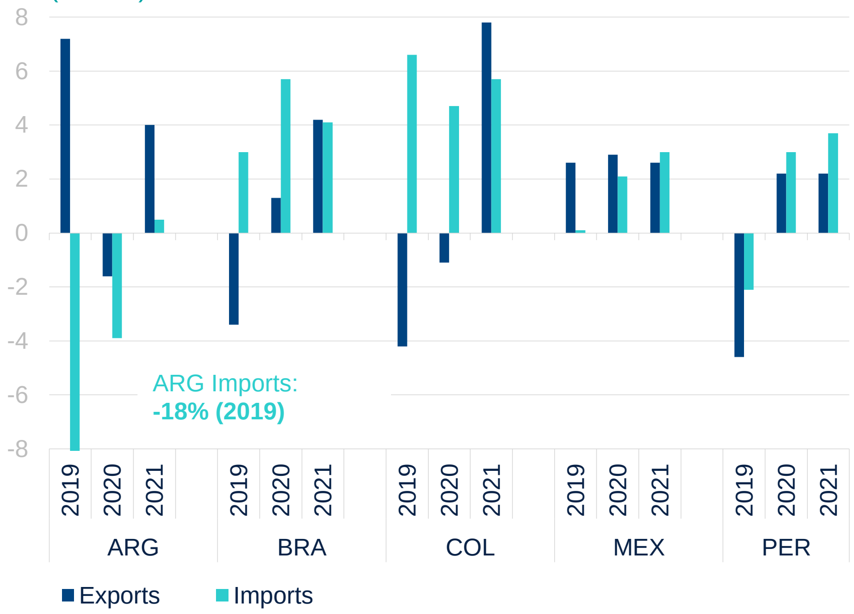
(% YoY)



(*) Forecasts for 2019 and 2020-21. The 2020-21 data refers to the expected average annual growth for the period.
Source: BBVA Research

EXPORTS AND IMPORTS (*)

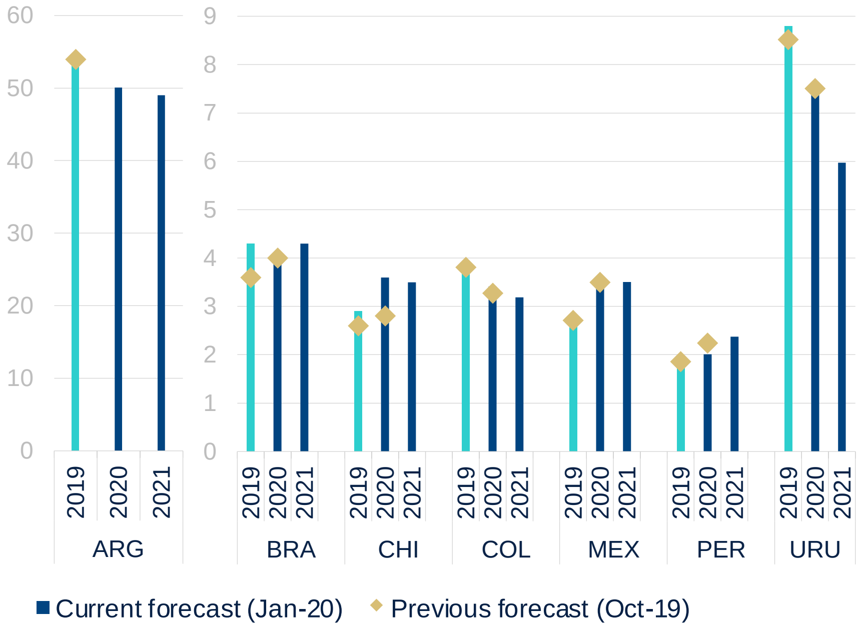
(% YoY)



(*) Forecasts for 2019 and 2020-21. The 2020-21 data refers to the expected average annual growth for the period.
Source: BBVA Research

Inflation will remain under control in most of the region, but will continue high in Uruguay and especially in Argentina

ANNUAL INFLATION (*)
(%, END OF PERIOD)

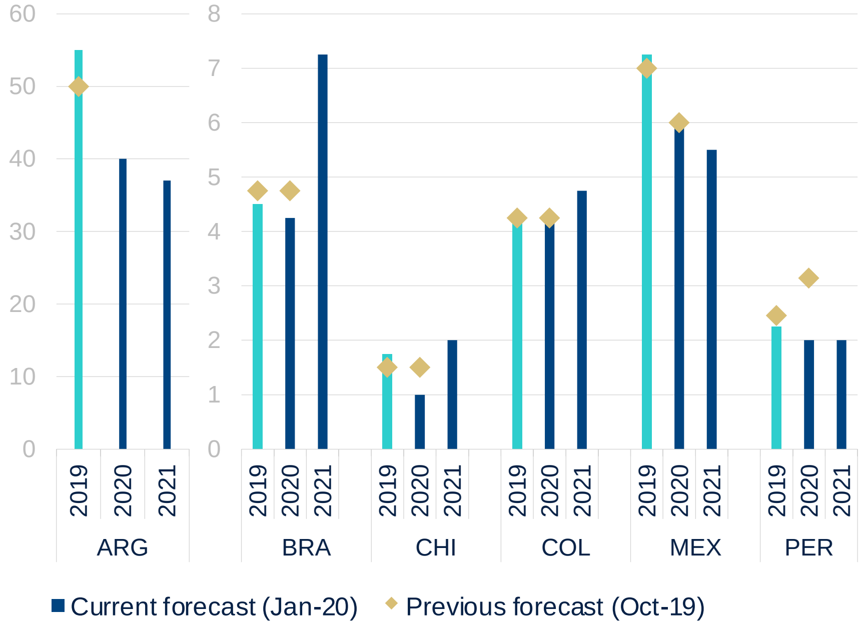


(*) Forecasts for 2020 and 2021.
Source: BBVA Research

- Inflation will remain close to inflation targets in Mexico, Colombia, Peru, Chile and Brazil.
- Despite the expected increase in activity dynamism, demand pressures will remain relatively weak.
- Likewise, low global inflation will continue to contribute to maintaining relatively stable domestic prices.
- In Argentina, currency depreciation and more aggressive interest rate cuts will help keeping inflation high.

Within a context of inflation under control, expansionary monetary policy will support economic activity

MONETARY POLICY INTEREST RATES (*)
(%, END OF PERIOD)

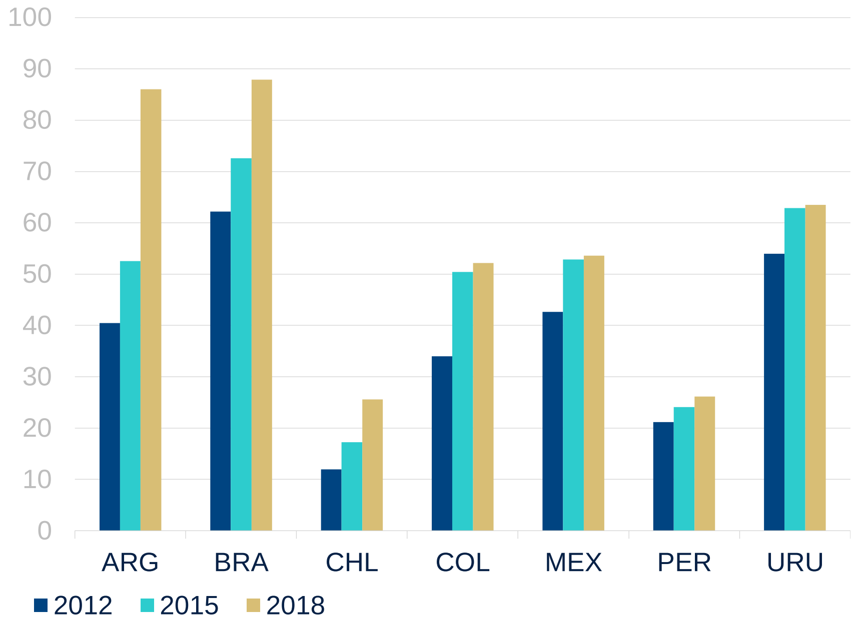


(*) Forecasts for 2020 and 2021.
Source: BBVA Research

- In Colombia, Peru, Chile and Brazil, interest rates will remain low, below the average for the 2012-18 period:
  - Colombia: prospects of stable rates at 4.25% until 2021 remain in place.
  - Peru: An additional monetary cut of 25bp is expected in the first half of 2020.
  - Chile: Strong demand moderation creates room for falling rates in 2020.
  - Brazil: The monetary relaxation cycle will end with a 25bp cut in February 2020.
- In Mexico, additional cuts will bring the interest rate to 6% throughout 2020.
- Recent signs suggest a more aggressive rate reduction in Argentina, despite high inflation.

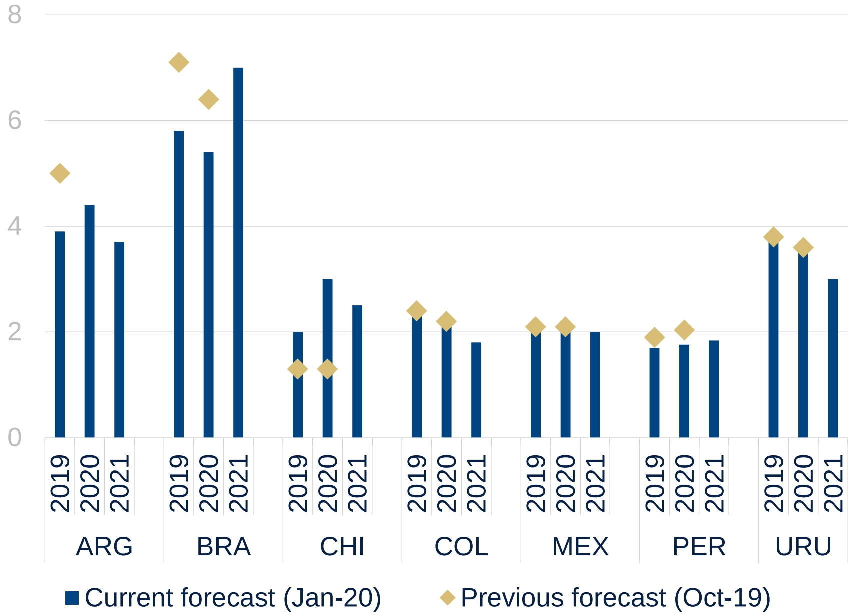
Fiscal policy will focus more on maintaining fiscal risks under control than on supporting growth

PUBLIC DEBT
(% OF GDP)



Source: BBVA Research based on IMF data

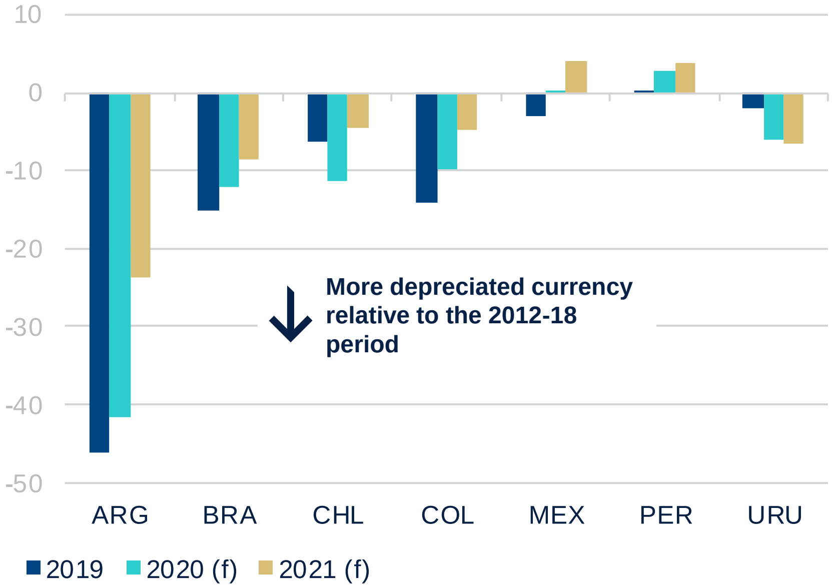
TOTAL FISCAL DEFICIT (*)
(% OF GDP)



(*) Forecasts for 2019, 2020 and 2021.
Source: BBVA Research

More depreciated exchange rates will favor the region's adjustment to a more limited commodity price environment

BILATERAL REAL EXCHANGE RATE: 2019-2021 AVERAGE LEVELS COMPARED TO 2012-18 AVERAGE LEVELS
(DOLLARS/LOCAL CURRENCY; %)

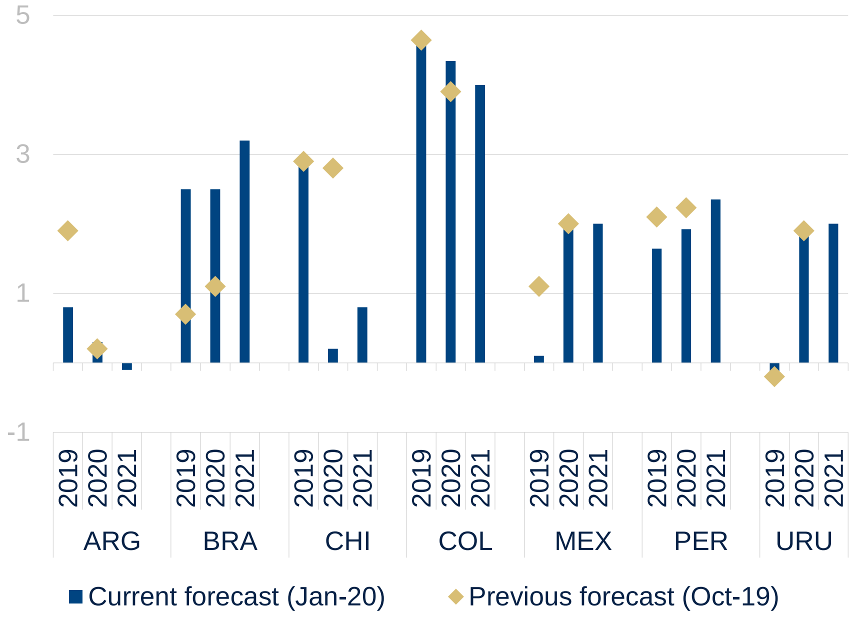


(f) Forecast.
Source: BBVA Research

- Regional currencies have weakened in recent years, as terms of trade deteriorated.
- Increased global and local uncertainty has also contributed to the depreciation of exchange rates.
- Improving the global and regional environment will create room for gradual appreciation in real terms in 2020-21.
- In any case, most currencies will remain relatively weak.
- In Argentina, a depreciated peso will be fundamental to the recovery of activity and the external adjustment.

The current account deficit remains high in Colombia, is increasing in Brazil and continues to fall in Argentina

CURRENT ACCOUNT DEFICIT (*)
(% OF GDP)

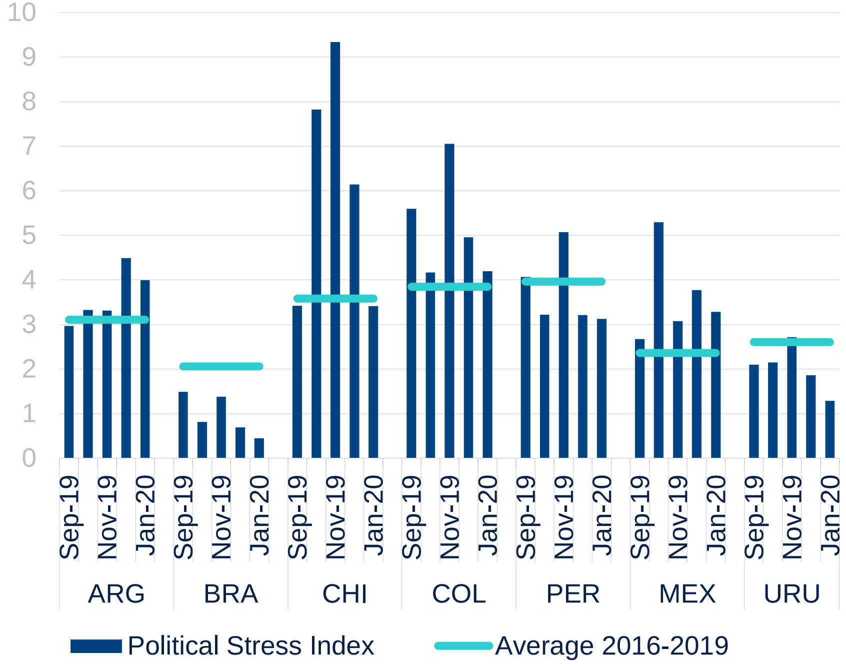


(*) Forecasts for 2019, 2020 and 2021.
Source: BBVA Research

- External deficits will remain constrained, in a context of depreciated currencies and limited demand.
- In Colombia, the relative strength of demand and low crude prices will keep the external deficit high.
- Upward adjustments of the forecast current account deficit in Brazil, due to a revision of the historical series, and downward in Chile, due to the fragility of domestic demand in 2020.
- In Argentina, the adjustment of the current account deficit has been made possible due to the collapse of imports.
- The external deficit in will increase in Uruguay and Mexico, in line with the recovery of demand.

The risks, while biased downward, have moderated slightly in recent months

POLITICAL STRESS INDEX (*)



(*) Tone of news and comments on politics in the local press, weighted by total media coverage. The January 2020 data refers to the average daily indicator in the month up to day 13.
Source: BBVA Research, GDELT

- In the global context, the risks related to high protectionism remains in place, despite lower tensions between the US and China.
- However, the risk of recession in the US has been reduced.
- With regard to internal risks, of note is a possible increase in uncertainty about economic policies and a reappearance of social protests that hinder the expected rebound in investment.

In an uncertain environment with limited commodity prices, the big challenge is increasing growth, but there are others as well

ARGENTINA

- **Debt restructuring.**
- Inflation **reduction.**
- **Fiscal adjustment in the context of higher spending demands**

BRAZIL

- Sustainability of **public debt.**
- **Reforms** to increase productivity.

CHILE

- **Social unrest.**
- **Institutional uncertainty** due to the constituent process.

COLOMBIA

- **External vulnerability.**
- Fulfilling **fiscal targets.**

MEXICO

- **Uncertainty** about economic policy.
- Take advantage of opportunities created by **USMCA.**
- **PEMEX problems.**

PERU

- Increasing **public investment.**
- **Political uncertainty.**

URUGUAY

- Sustainability of **public debt** and adoption of fiscal rules.
- **Inflation** reduction.

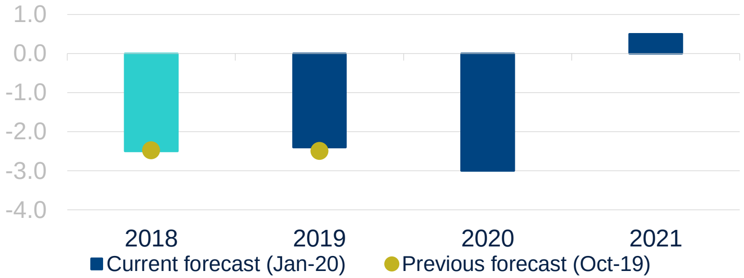
BBVA Research

03

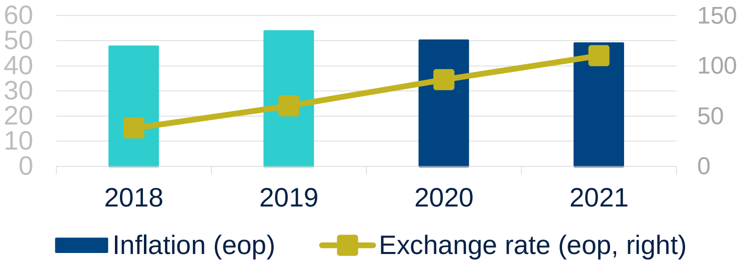
Latin America: Outlooks by Country

Argentina: the recession will extend until 2020

ARGENTINA: GDP GROWTH AND POTENTIAL
(% YoY)



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

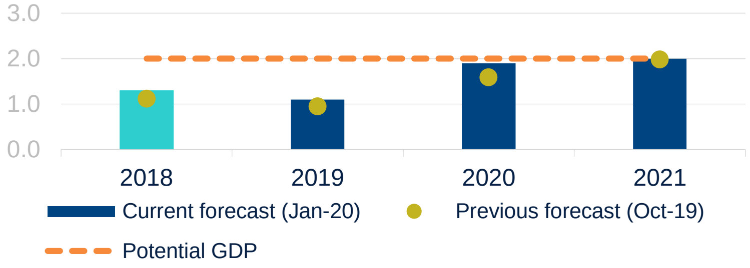


(*) Exchange rate: average for the month of December.
Source: BBVA Research

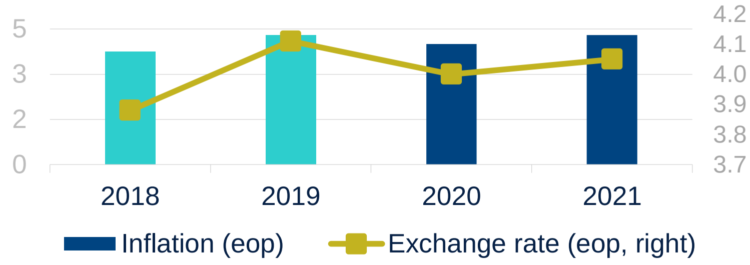
- Slight 2019 GDP revision due to better data than expected at the end of the year, but a negative outlook remains for 2020.
- Recent signals confirm a more agressive monetary easing: higher issuance and interest rates to reach 40% in 2020 and 37% in 2021.
- The measures adopted by the new government will increase tax revenues, but the primary deficit will remain high (1.5% of GDP), due to expected pressures on spending.
- Inflation will be around 50% in 2020-21, due to the peso depreciation and a fall in interest rates.
- The trade surplus will be the only source of foreign exchange in the coming months
- Main risks: debt renegotiation and monetization of the fiscal deficit.

Brazil: After three years of expansion close to 1%, growth should converge to 2% in 2020-21

BRAZIL: GDP GROWTH AND POTENTIAL
(% YoY)



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

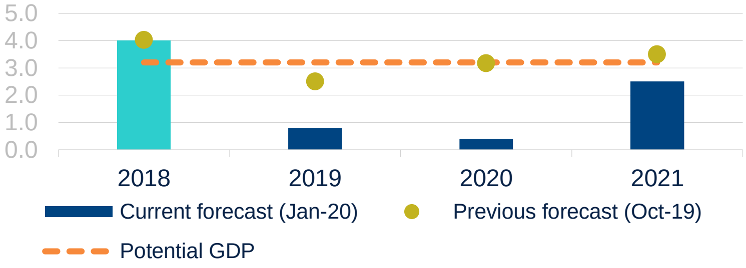


(*) Exchange rate: average for the month of December.
Source: BBVA Research

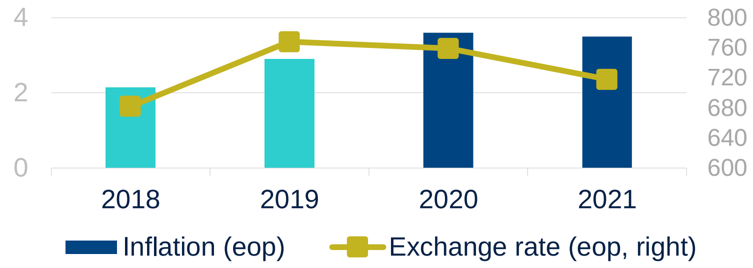
- Upward revision of forecasts for 2019-20 due to:
  - improving global environment;
  - upward surprises in incoming activity data;
  - monetary policy even more expansionary than expected;
  - effect on confidence of better prospects for economic reform.
- Despite the surprising upward trend at the end of 2019, inflation will remain under control.
- The adoption of social security reform reduces fiscal risks.
- The government's intention to adopt other structural measures skews the risk balance upward.

Chile: Social unrest, institutional uncertainty and slowing growth

CHILE: GDP GROWTH AND POTENTIAL
(% YoY)



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



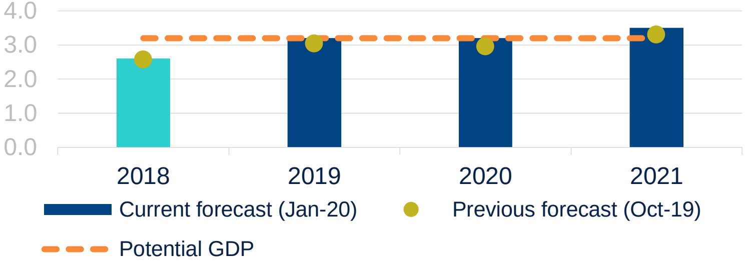
(*) Exchange rate: average for the month of December.
Source: BBVA Research

- Strong impact on the activity of the protests that started on October 18 and held throughout November, mainly on trade and non-mining sectors
- Strong downward revision of growth forecast in 2020-21: despite fiscal, monetary and exchange rate measures, institutional uncertainty will remain high with a probable start of a new constituent process
- Inflation will increase to about 3.6% in 2020 due to the exchange rate depreciation.
- The main risk is that social unrest and institutional uncertainty will have a lasting effect on confidence and investment.

Colombia: the economy will continue to expand at a rate of more than 3% in 2020-21

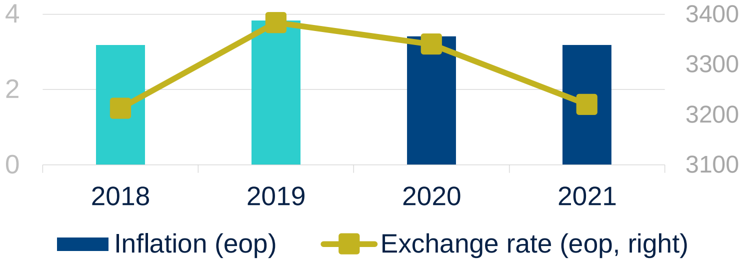
COLOMBIA: GDP GROWTH AND POTENTIAL

(% YoY)



COLOMBIA: INFLATION AND EXCHANGE RATE

(%, END OF PERIOD(*))

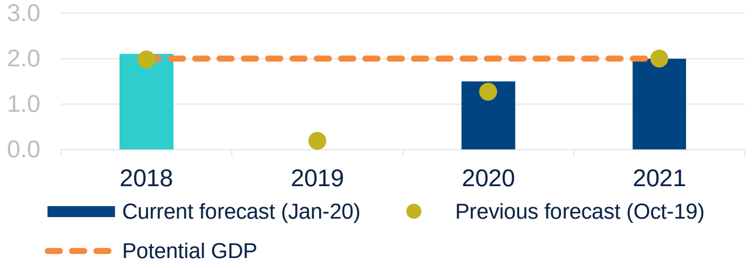


(*) Exchange rate: average for the month of December.
Source: BBVA Research

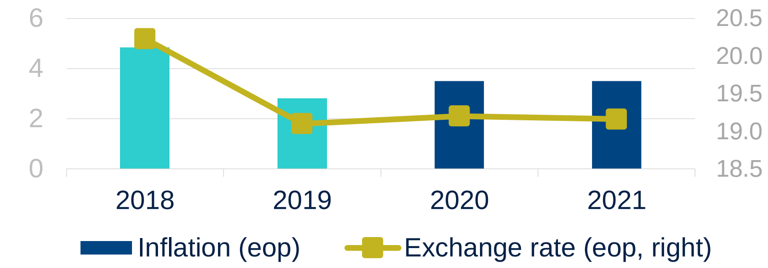
- Growth forecasts are revised upwards: recent data suggest stronger private consumption and investment (mainly machinery and equipment).
- Slight upward revision in 2020 of inflation, due to the increase in the minimum wage and larger inertia.
- The monetary policy rate will remain at 4.25% throughout 2020.
- The main risks are related to the deterioration of the current account and its financing, the fulfillment of fiscal objectives and a rebound in social unrest.

Mexico: The approval of the USMCA reinforces the prospects for recovery

MEXICO: GDP GROWTH AND POTENTIAL
(% YoY)



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



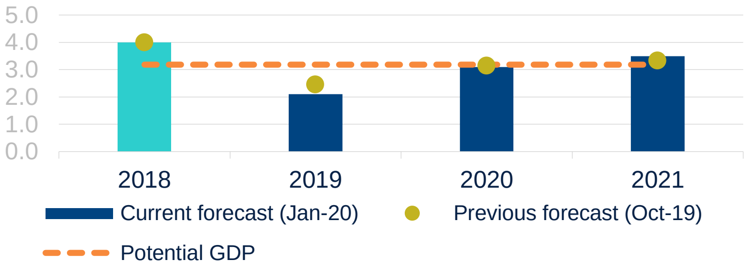
(*) Exchange rate: average for the month of December.
Source: BBVA Research

- The significant contraction in investment (close to 4%), resulting from uncertainty about the course of economic policy, resulted in growth stagnation in 2019.
- The approval of the USMCA, the new North American trade treaty, is expected to increase confidence and support a recovery in investment.
- Inflation will continue to perform well (3.5% in 2020 and 2021), allowing Banxico to reduce interest rates to 6.0% in 2020.
- PEMEX's situation and uncertainty about economic policy continue to be of concern.

Peru: GDP is expected to accelerate after a relatively poor performance in 2019

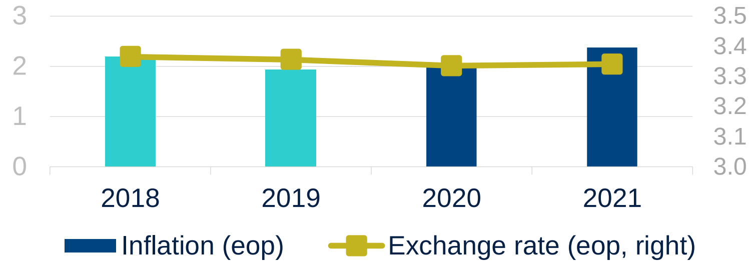
PERU: GDP GROWTH AND POTENTIAL

(% YoY)



PERU: INFLATION AND EXCHANGE RATE

(%, END OF PERIOD(*))

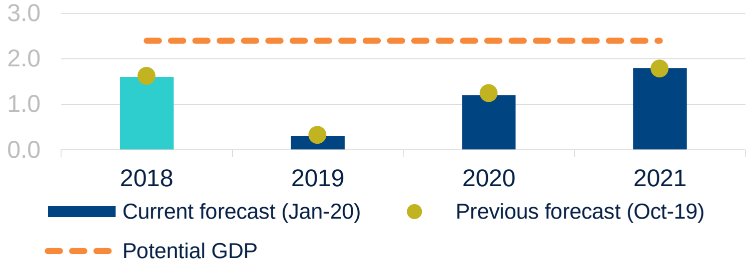


(*) Exchange rate: average for the month of December.
Source: BBVA Research

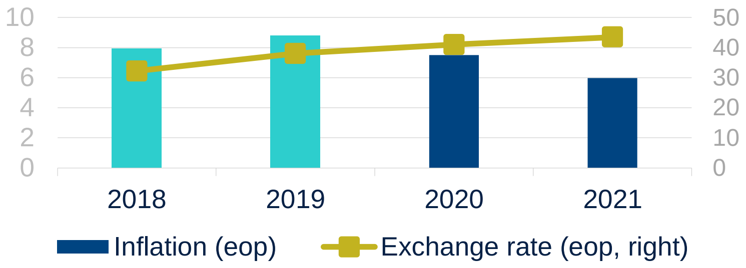
- Growth has been surprisingly negative in recent months, due to low public investment and lower production in the mining sector...
- ...but a reversal of these two "shocks" will allow growth to reach 3.1% in 2020 and 3.5% in 2021.
- Private demand will decelerate in 2020-21 due to high uncertainty (elections in 1Q20 and 2Q21).
- Benign inflation will allow interest rates to converge to 2.0% (-25bps) in 1Q20 and remain at that level until the end of 2021.
- Risks: political uncertainty, social conflicts, slow recovery of the primary sector and reduced investment in infrastructure.

Uruguay: Prospects for low growth remain

URUGUAY: GDP GROWTH AND POTENTIAL
(% YoY)



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



(*) Exchange rate: average for the month of December.
Source: BBVA Research

- Poor private consumption performance and weak investment in 2019.
- To a certain extent, growth will increase moderately, due to the effect of two major investment projects (pulp mill and railway line)...
- ... but the impact of the Argentine crisis, especially on tourism, may drag down the economy.
- Keeping inflation under control, as well as promoting fiscal consolidation, remain problems to be addressed.
- The crisis in Argentina represents a risk; it could affect the tourism sector, curb exports and increase exchange rate volatility.

BBVA Research

04

Latin America: Forecast tables

Growth, inflation, exchange and interest rate forecasts

	GDP (% YoY)					INFLATION (% YoY, END OF PERIOD)				
	2017	2018	2019	2020	2021	2017	2018	2019	2020	2021
Argentina	2.7	-2.5	-2.4	-3.0	0.5	24.8	47.6	53.8	50.1	49.0
Brazil	1.3	1.3	1.1	1.9	2.0	2.9	3.7	4.1	4.0	4.3
Chile	1.3	4.0	0.8	0.4	2.5	2.3	2.1	2.9	3.6	3.5
Colombia	1.4	2.6	3.2	3.2	3.5	4.1	3.2	3.8	3.4	3.2
Mexico	2.4	2.1	0.0	1.5	2.0	6.8	4.8	2.8	3.5	3.5
Peru	2.5	4.0	2.1	3.1	3.5	1.4	2.2	1.9	2.0	2.4
Uruguay	2.6	1.6	0.3	1.2	1.8	6.6	7.9	8.8	7.5	6.0

	EXCHANGE RATE (VS. USD, END OF PERIOD)					INTEREST RATE (%, END OF PERIOD)				
	2017	2018	2019	2020	2021	2017	2018	2019	2020	2021
Argentina	17.7	37.9	59.9	86.0	110.0	28.80	59.30	55.00	40.00	37.00
Brazil	3.30	3.88	4.11	4.00	4.05	7.00	6.50	4.50	4.25	7.25
Chile	637	6820	768	759	718	2.50	2.75	1.75	1.00	2.00
Colombia	2991	3213	3383	3340	3220	4.75	4.25	4.25	4.25	4.75
Mexico	18.7	20.2	19.1	19.2	19.2	7.25	8.25	7.25	6.00	5.50
Peru	3.25	3.37	3.36	3.34	3.34	3.25	2.75	2.25	2.00	2.00
Uruguay	28.9	32.2	37.7	41.0	43.4	*	*	*	*	*

* In Argentina and Uruguay monetary policy is executed according to monetary aggregates and there is no reference interest rate. Data for Argentina refer to the Leliq.
Source: BBVA Research

Fiscal Balance, Current Account and Commodities forecasts

	CURRENT ACCOUNT (% GDP)					FISCAL BALANCE (% GDP)				
	2017	2018	2019	2020	2021	2017	2018	2019	2020	2021
Argentina	-4.9	-5.1	-0.8	-0.3	0.1	-5.9	-5.0	-3.9	-4.4	-3.7
Brazil	-0.7	-2.2	-2.5	-2.5	-3.2	-7.8	-7.1	-5.8	-5.4	-7.0
Chile	-1.5	-3.1	-2.9	-0.2	-0.8	-2.8	-1.7	-2.0	-3.0	-2.5
Colombia	-3.3	-3.8	-4.6	-4.2	-3.9	-3.6	-3.1	-2.4	-2.3	-1.8
Mexico	-1.8	-1.8	-0.1	-2.0	-2.0	-1.1	-2.1	-2.1	-2.1	-2.0
Peru	-1.2	-1.6	-1.6	-1.9	-2.2	-3.0	-2.3	-1.6	-1.8	-1.8
Uruguay	0.7	0.1	0.2	-1.9	-2.0	-3.5	-2.9	-3.8	-3.6	-3.0

	COMMODITIES PRICE FORECAST (YEARLY AVERAGE)				
	2017	2018	2019	2020	2021
Oil (Brent USD/Barrel)	54.3	71.1	63.9	61.2	60.8
Soy (USD/metric tonne)	359	342	327	346	358
Copper (USD/lb)	2.80	2.96	2.73	2.73	2.72

Source: BBVA Research