

# Latam: converging to potential growth

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# Main messages

- 1 Global growth will recover gradually from the trough of 2011Q4.** Recovery will be more pronounced in Asia.
- 2 Latin America will grow 3.7% in 2012 and 3.8% in 2013** supported by domestic demand and high commodity prices.
- 3 Central banks will keep a cautious tightening bias, except in Brazil.** They will have to balance inflationary pressures and a strong domestic demand against resilient capital flows and external uncertainty.
- 4 Risks to the region's outlook are focused on the external environment,** especially a new flare-up of the European crisis.
- 5 Policymakers should take advantage of tailwinds** to continue reducing vulnerabilities and replenishing monetary and fiscal buffers.



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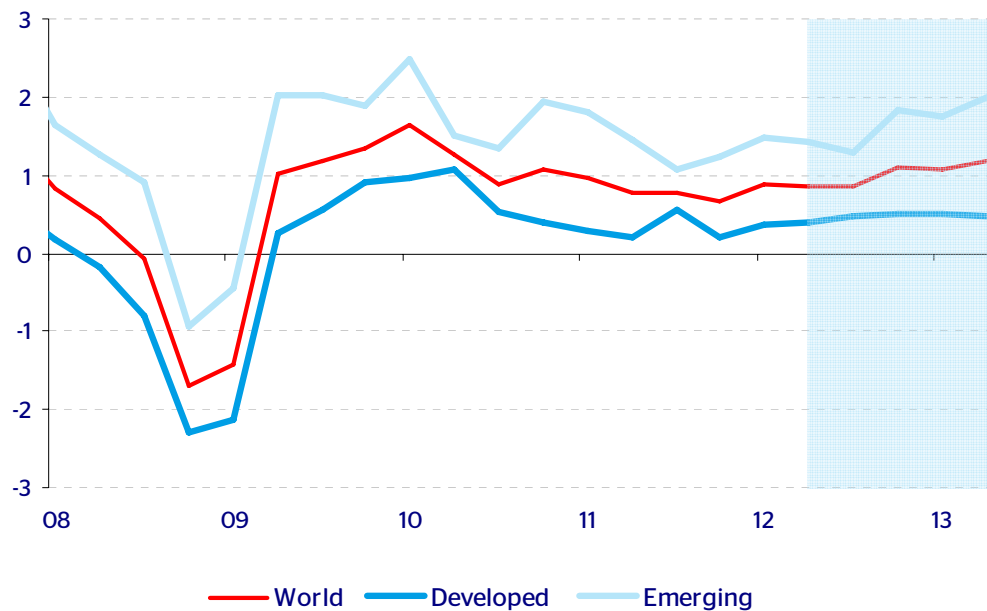
- 1 The global economy will still grow strongly**
- 2 The European debt crisis is still the main global risk
- 3 Latin America is landing softly in its potential growth rate
- 4 Vulnerability is reduced, but buffers need to be replenished

# The global slowdown in 2011Q4 will revert during 2012

The global slowdown at the end of 2011 will revert starting in the second quarter of 2012. But global growth will still be below trend. Acceleration will be most pronounced in Asia

**Global GDP growth (%qoq at annual rates)**

Source: BBVA Research and Haver Analytics



Wider growth divergence between US and Japan vs. Europe

Emerging economies continue growing faster than advanced economies

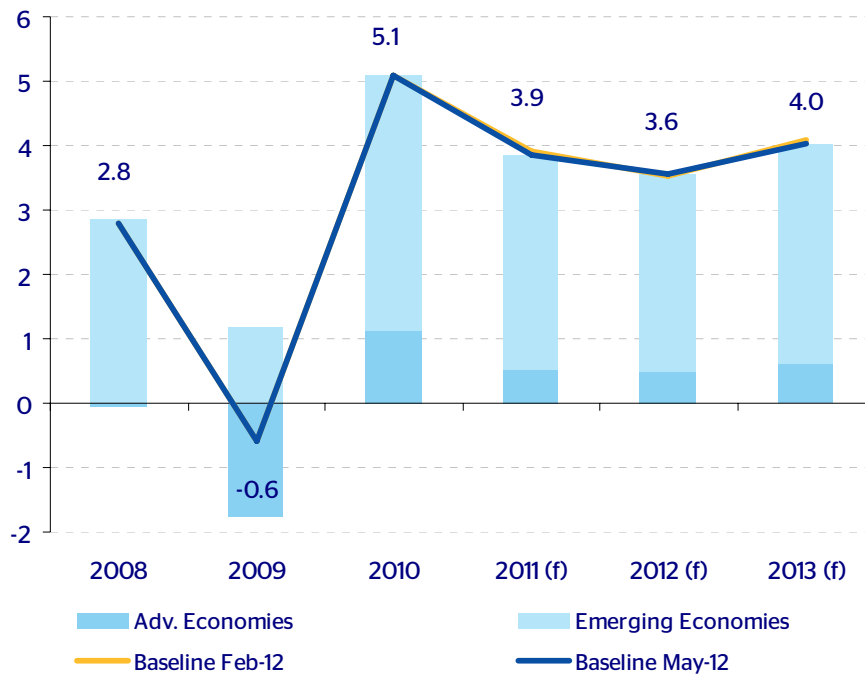
Moderate global growth going forward

# Global growth will be supported by emerging economies.

Global growth projections remain mostly unchanged relative to three months ago. But risks are strongly tilted to the downside due to the crisis in Europe.

## Global growth (%)

Fuente: BBVA Research



Global growth between 3,5% and 4% in the next two years

Emerging economies will account for 80% of global growth

Risks are strongly tilted to the downside due to the crisis in Europe



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# European crisis continues

Some advances ...

Greek debt restructuring and  
ESM brought forward in time

Fiscal compact approved

Reforms in Portugal, Spain and Italy

Long-term liquidity provision by the ECB

... but still important pending issues

1. Doubts about Greece and Portugal

2. An effective sovereign firewall still needed

3. Further advances toward a fiscal union

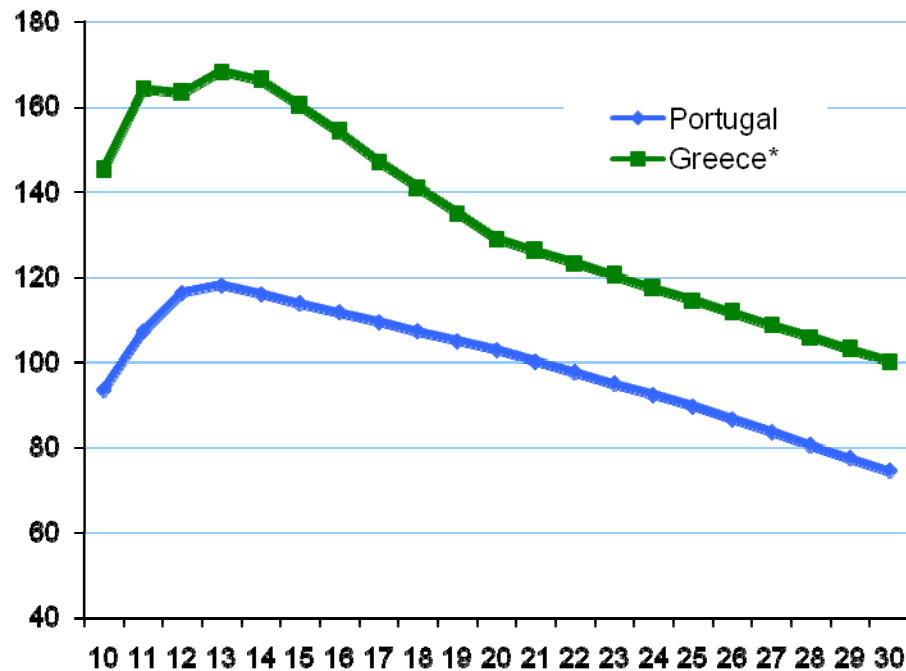
4. Growth agenda

Authorities have been behind the curve so far  
→ Continue to muddle through the crisis

# 1. Doubts in Greece and Portugal

## Greece and Portugal: public debt projections

Source: BBVA Research and IMF



\* Optimistic scenario for Greece. Assumes growth rates close to 3% from 2015 and a primary fiscal surplus of 4.5% of GDP from 2014 (compared to 2.4% deficit in 2011).

Greece: ambitious goals but with high uncertainty after the elections and in the context of a deep recession

Portugal: adjustment and reforms on track, but its return to markets in 2013 is not guaranteed

High risk of “accidents”



## 2. An effective sovereign firewall is needed

Debate usually around funds available,  
but it is more fundamental than that.

Fresh lending capacity : 500 bn EUR  
(besides 200 bn already committed to programme countries by EFSF)

EFSF may continue lending until mid-2013,  
to cover the slow process of capitalizing the ESM

Increase in IMF resources  
(330 bn EUR)

More important: use existing resources efficiently.  
Do not crowd-out bond demand from private sector

### 3. Further advances towards a fiscal union

From the fiscal compact ...

Despite the difficulty to estimate them, it rightly emphasizes adjustment of structural deficits ...

... but leaves some doubts about the use of “special circumstances” to allow deviations from the rule

May be seen as not strong enough to justify a more forceful and decisive action by the ECB and Germany

... to a fiscal union

Eurobonds: convenient as a way to pool risks

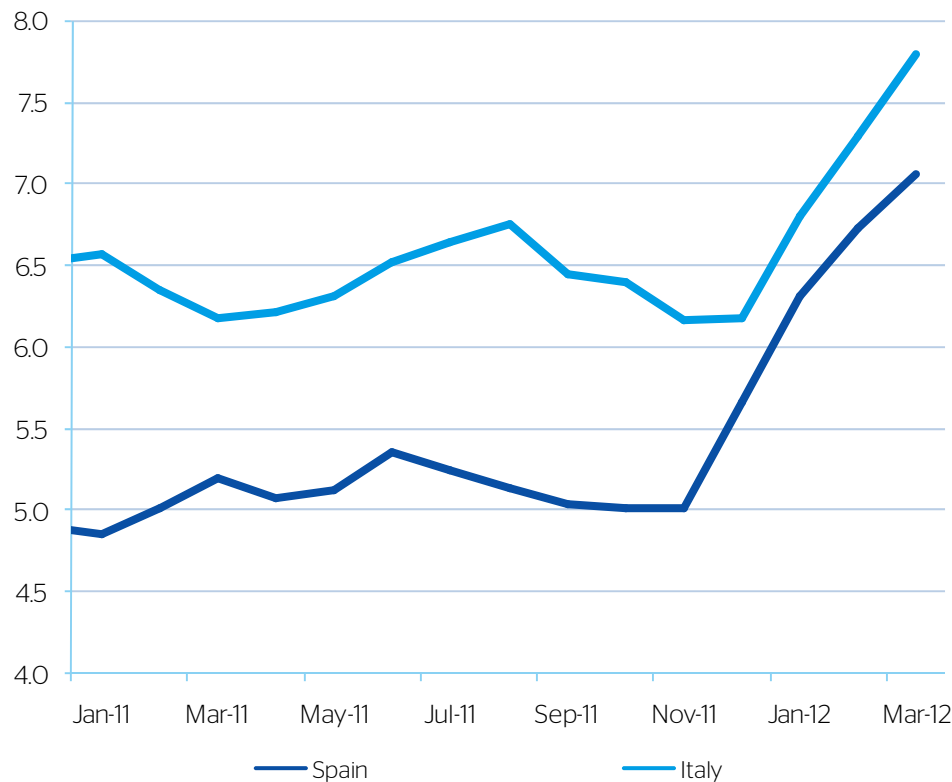
Red-bond/Blue-bond proposal keeps market discipline

A union with permanent transfers is not needed. But transitory transfers are needed :

# 3. Further advances towards a fiscal union

## Banks: Holdings of euro area government debt over total assets (%)

Source: ECB and BBVA Research



Objective: eliminate feedback between sovereign and banking risk

Indirect ECB intervention in sovereign bond markets through the banking system

Increase in banks' exposure to the sovereign increases the potential for negative feedback loops between them

Reinforces the need for a definitive solution to doubts about sovereign solvency

## 4. A growth agenda

A growth agenda to complement fiscal austerity is needed

Clear roadmap to the future of the monetary union

Balance between growth and austerity:  
reforms in exchange for a growth strategy

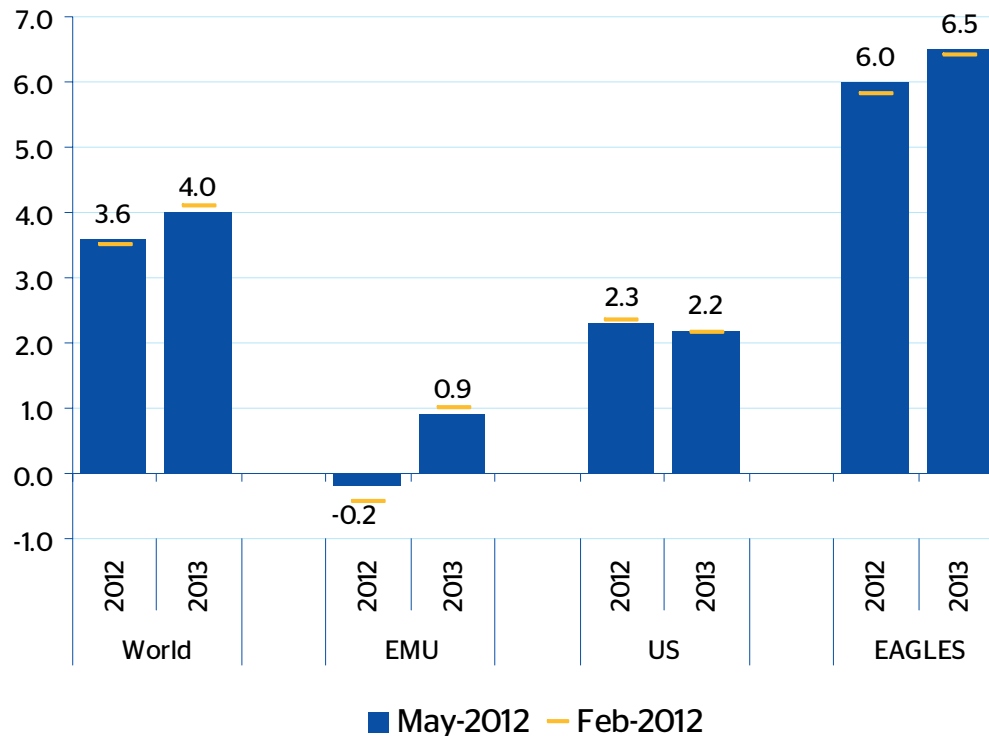
Gradual fiscal adjustment with multi-annual plans.  
Focus on structural deficits in the spirit of the Fiscal Compact

Short-run objective: avoid a negative feedback between austerity and recession and further doubts about sovereign solvency

# Europe decouples from global growth

## GDP growth (% yoy)

Source: BBVA Research



Debt crisis continues, with Portugal in the crossroads and worries about Spain

US: ongoing but fragile recovery, with risks from a sharp fiscal tightening

China: on track for a soft landing



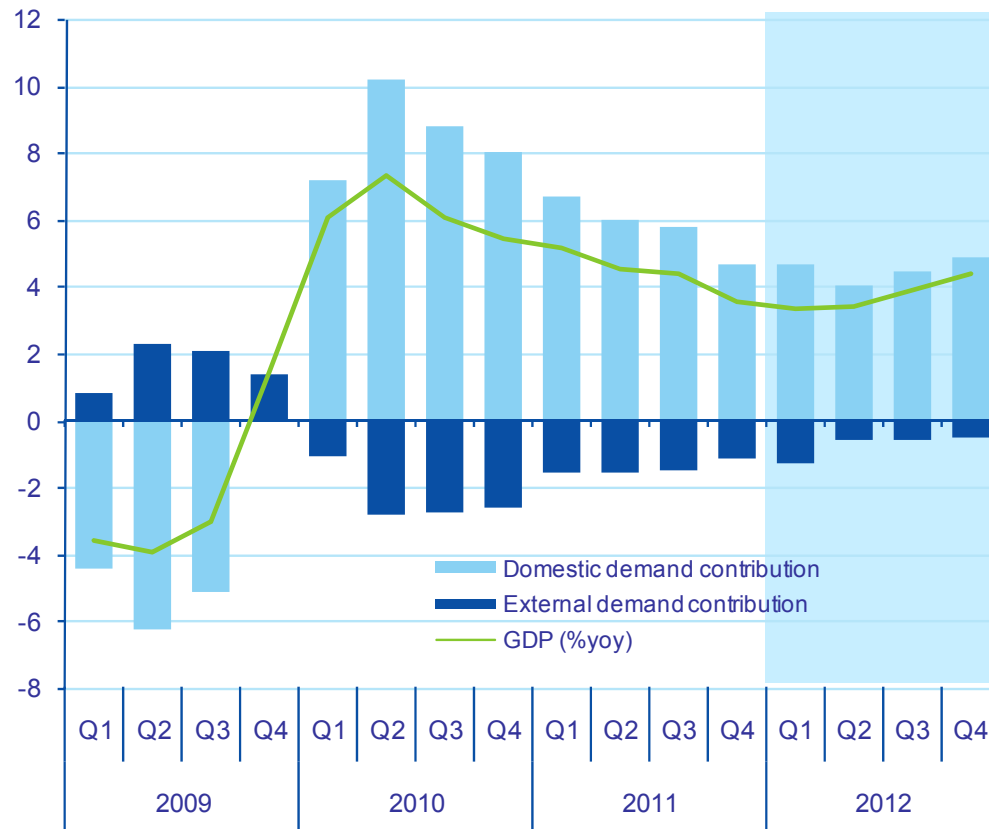
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# Latin America growth slowed down at end-2011

**Latam: GDP growth (%yoy) and contribution from domestic and external demand (pp)**

Source: BBVA Research



Lagged effects of monetary tightening in 2011

Uncertain external environment

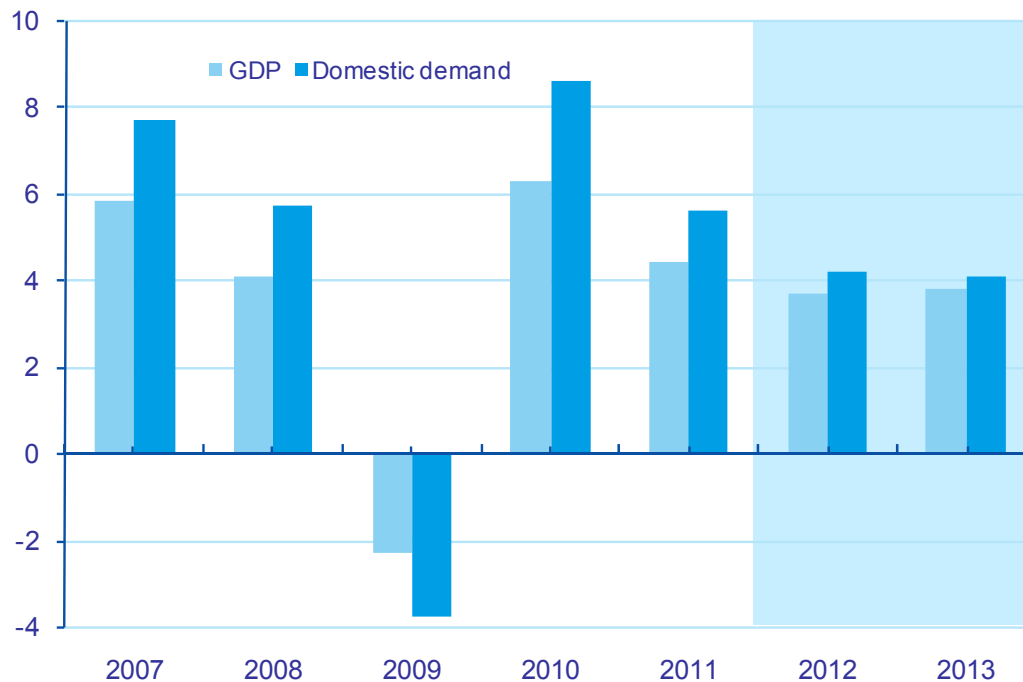
Resilient confidence indicators buttressed a robust domestic demand

First-quarter data show and inflexion point

# Growth will continue landing softly on its potential rates

## Latam: GDP growth and domestic demand growth (%)

Source: BBVA Research



Small change in regional growth forecasts relative to February

Lower growth in 2012 and 2013 relative to 2011 consistent with global slowdown and tighter policies

Domestic demand will continue growing more than GDP, supported by confidence

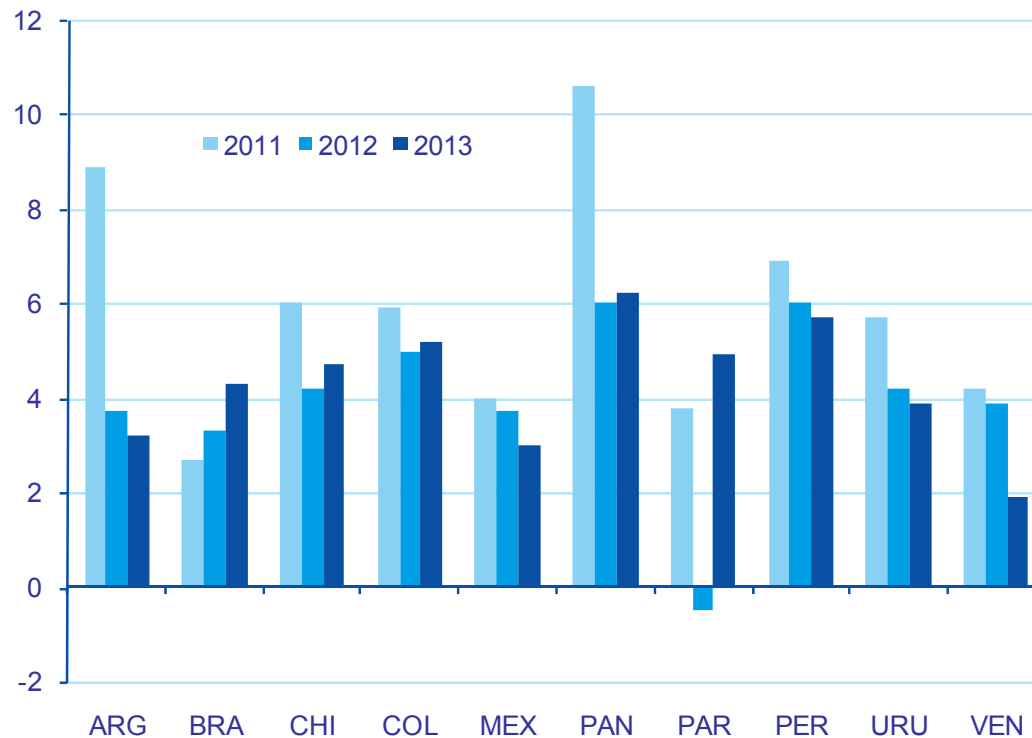
Slowdown closer to potential growth will reduce overheating risks seen in 2011



# Slowdown in 2012 in all countries, except Brazil

## Latam countries: GDP growth (%)

Source: BBVA Research



Positive growth surprises in Q1 in most countries

Brazil: higher growth after the stagnation in 2011H2. Support from economic policies.

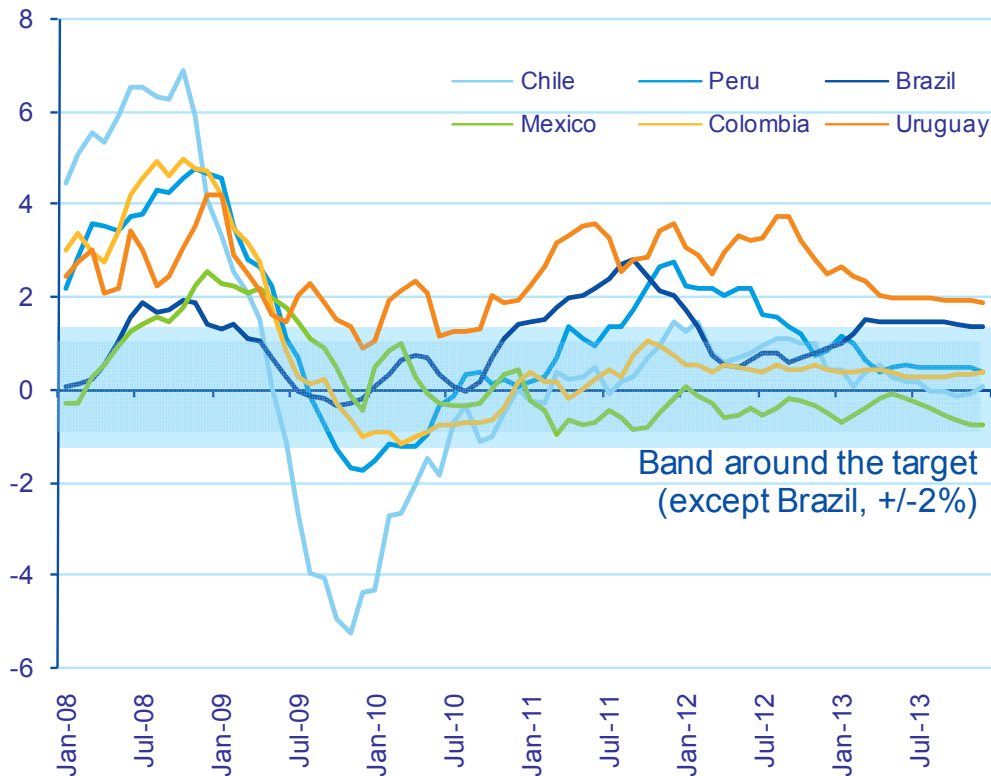
Mexico: very synchronized to the US cycle

Transitory impulse in Panama will moderate going forward. Paraguay suffers the effect of the drought.

# Inflation will remain high ...

## Inflation: difference from central bank 's objective (pp)

Source: BBVA Research y Haver



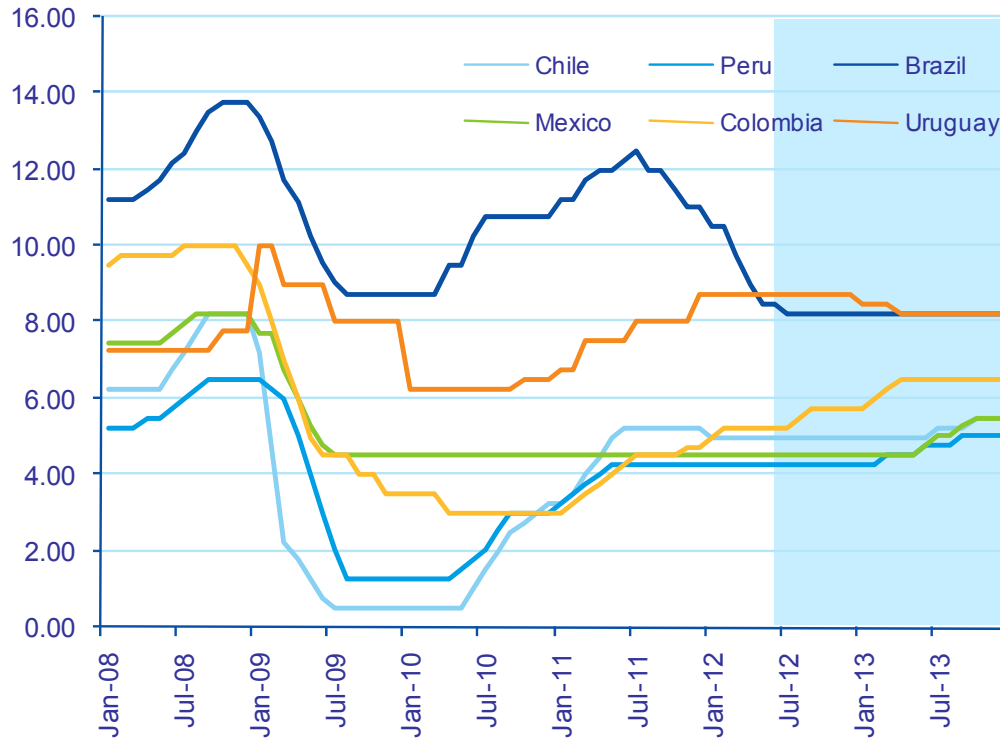
Inflation influenced by strong domestic demand and commodity prices

Except in Mexico, inflation will remain high, close to the upper bound of the target

# ... which will prompt banks to keep a cautious tightening bias

## Policy interest rates in inflation-targeting countries (%)

Source: BBVA Research and Haver

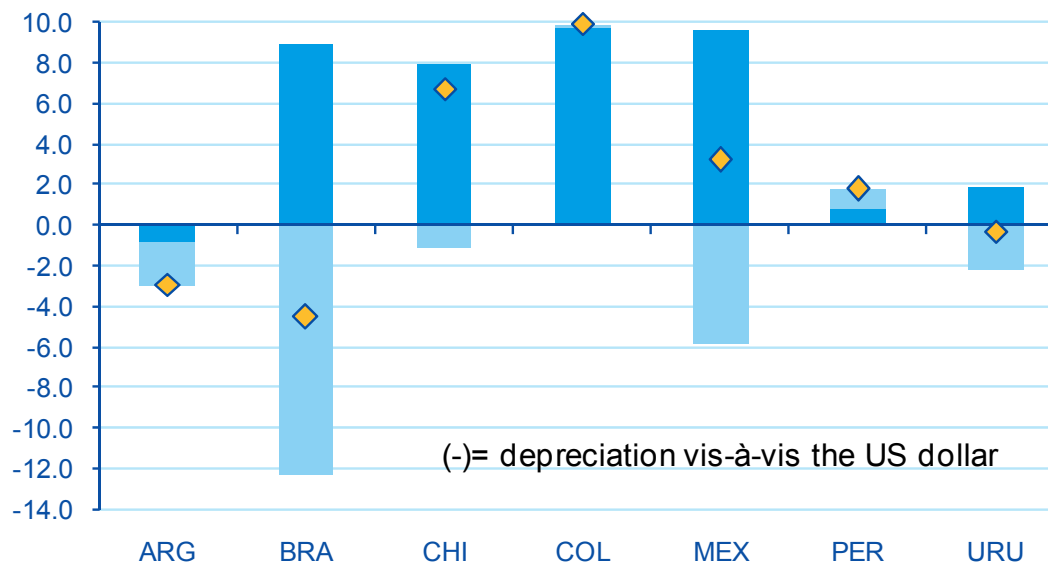


- Monitoring inflationary pressures
- Mexico: central bank pause until 2013, but some downward bias due to cyclical weakness
- Brazil: focus on cyclical weakness and reduction of nominal interest rates
- Ongoing use of macroprudential measures

# Appreciating trend will continue in most countries

## Change in the value of local currencies vis-à-vis the US dollar (%)

Source: BBVA Research and Haver



Appreciation in the first four months of 2012 prompted by lower global risk aversion until March

Contained global risk aversion will mean further appreciation in the remainder of 2012

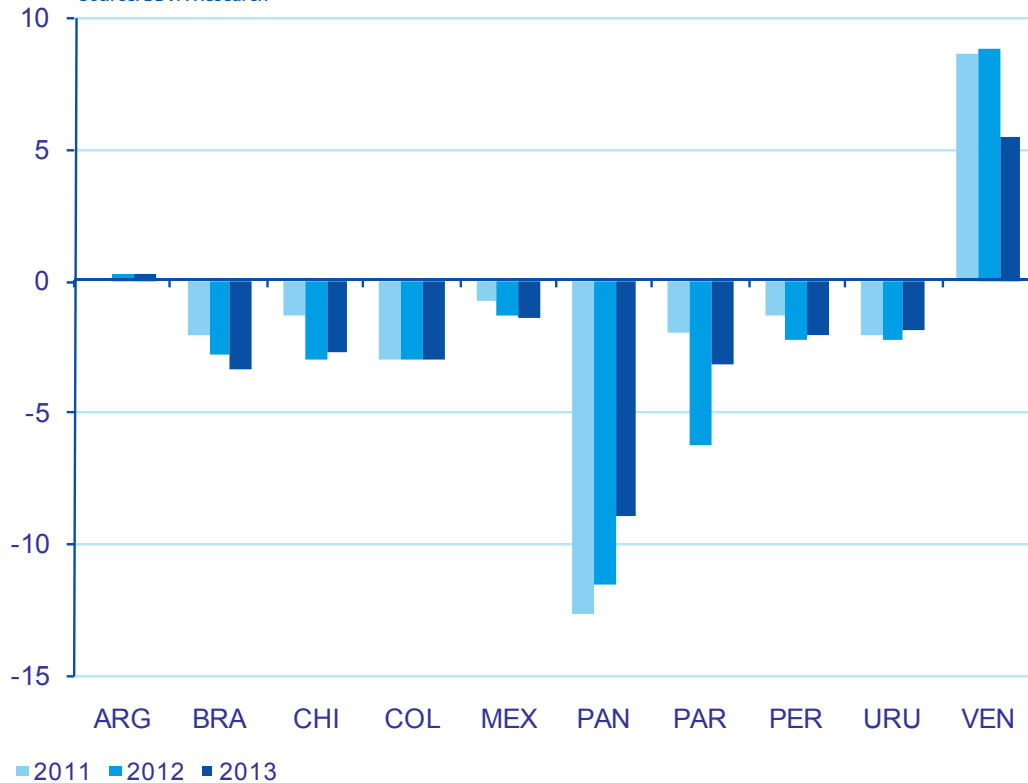
Strong activism in many countries to avoid further appreciation

■ Jan 1 to Mar 1   ■ Mar 1 to May 10   ◆ Jan 1 to May 10

# External balances remain under control

**Latam countries: Current account balance (% GDP)**

Source: BBVA Research



Resilient commodity prices

A dynamic domestic demand will worsen external balances, but still remain at manageable levels

Panama will continue adjustment after transitory demand impulses (investment)

Paraguay faces a temporary supply shock in 2012



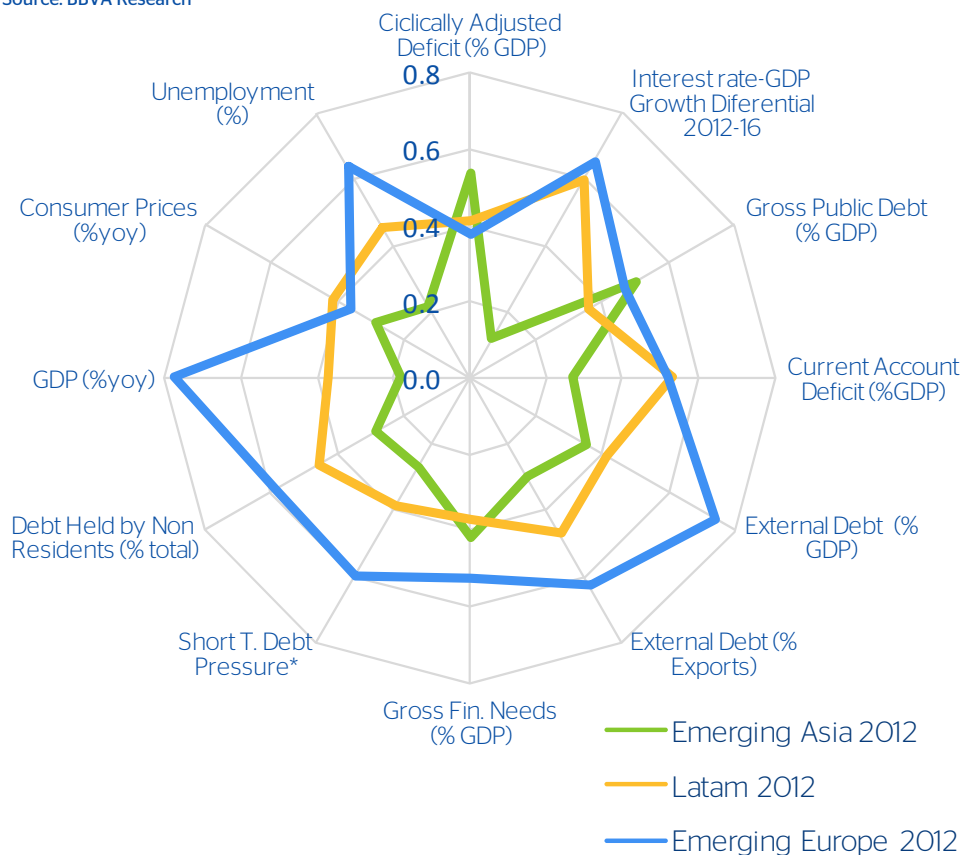
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# The region continues to be resilient to external uncertainty

## Vulnerability indicators in main emerging regions \*

Source: BBVA Research



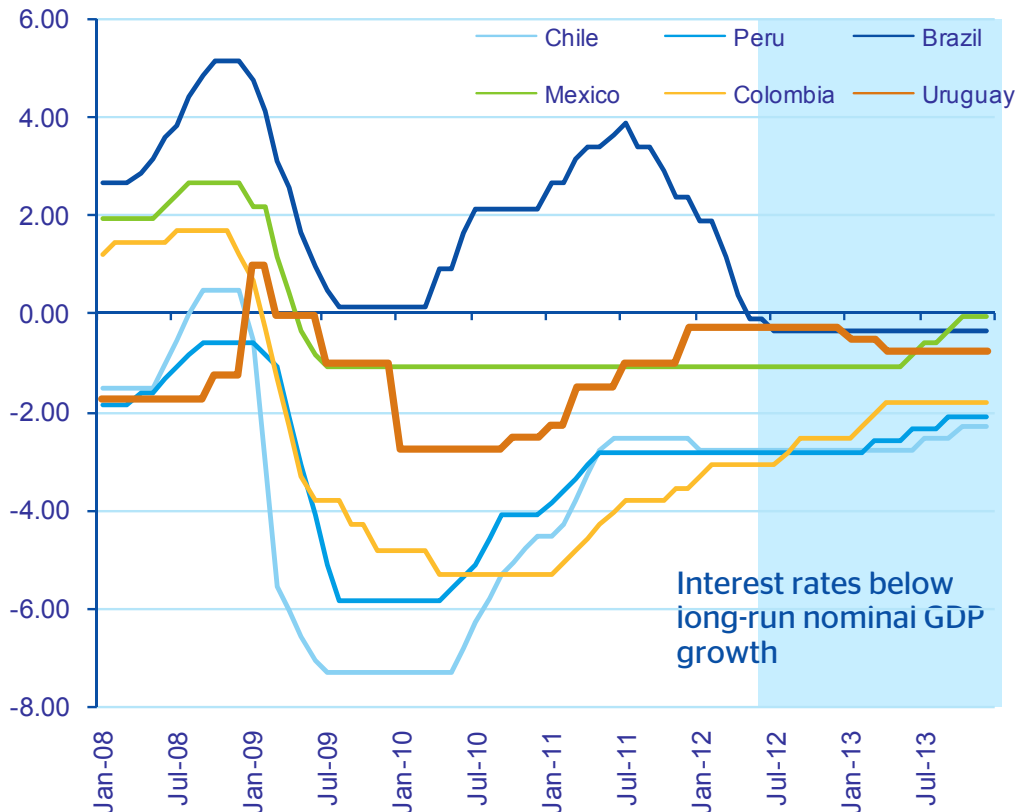
- Vulnerability indicators continue to be relatively low**
- Sovereign ratings are maintained**
- Favorable external financing conditions and high commodity prices**
- Rising international reserves**

\* Indicators closer to the center show lower vulnerability in that dimension

# The region should replenish its policy buffers ...

## Difference between policy rates and long-run nominal GDP growth \* (pp)

Source: BBVA Research and Haver



\* Approximated with the sum of potential growth and the central bank inflation target .

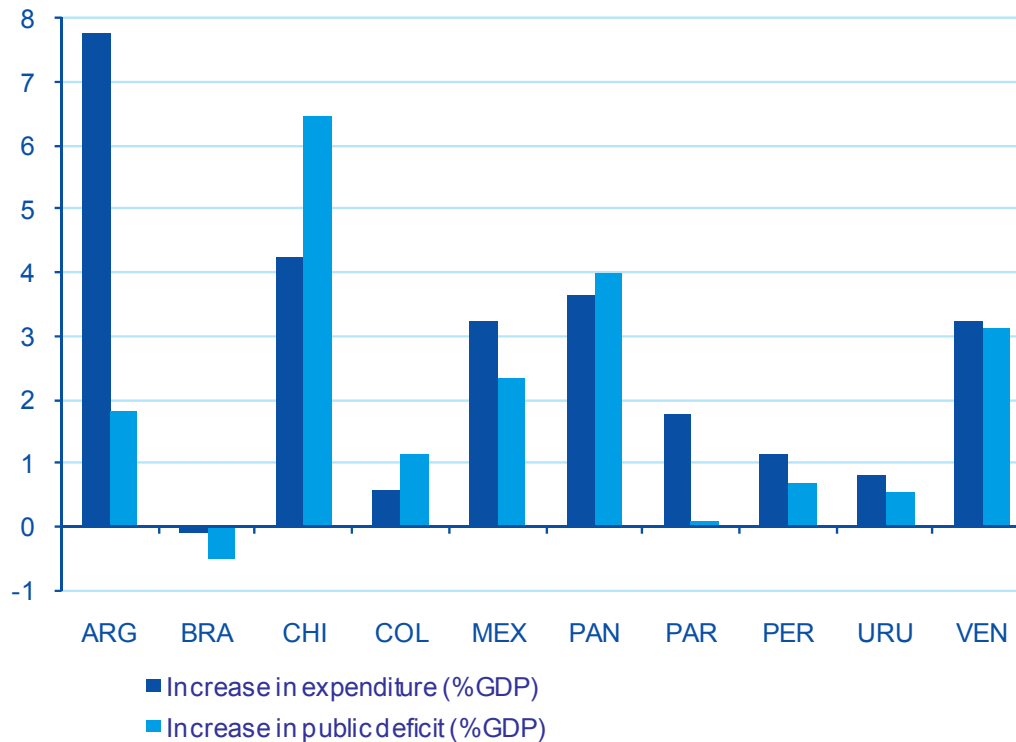
- Replenish policy buffers to be ready for a possible new shock
- Monetary policy dilemma: domestic demand and inflationary pressures versus external uncertainty
- Policy interest rates will continue converging towards more neutral levels



# ... especially regarding fiscal policy ...

## Increase of public deficit and spending: 2011 minus average 2006-2007 (% GDP)

Source: BBVA Research and IMF



Public deficits and spending will remain above the levels prior to the 2008-9 crisis.

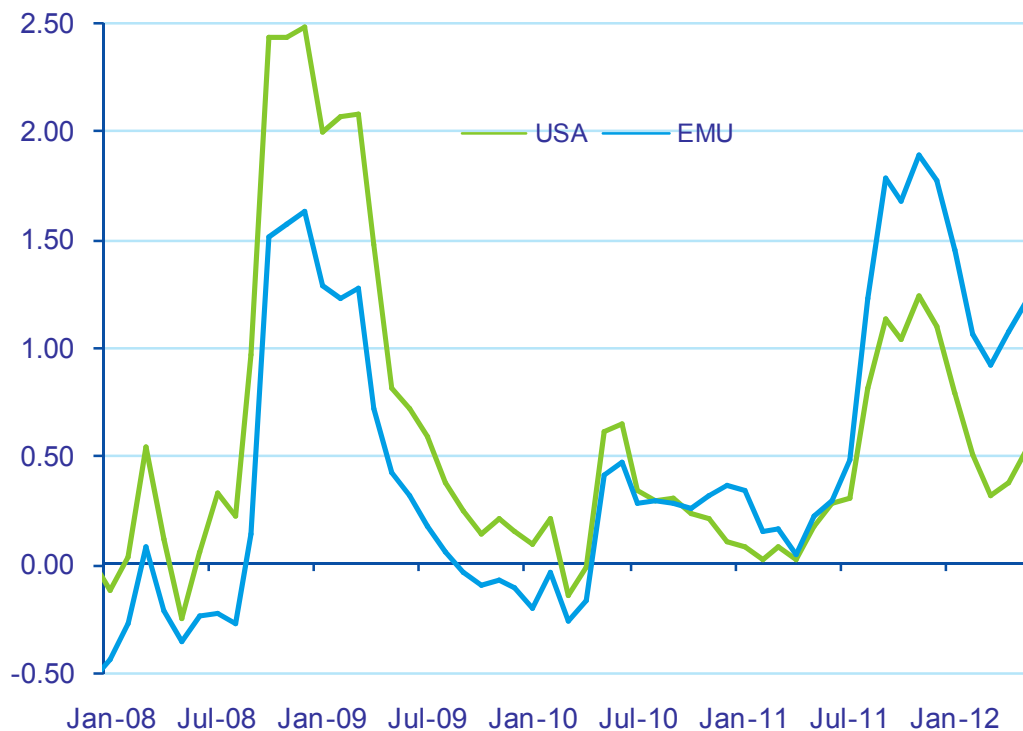
Still in manageable levels

Risk of complacency by policymakers on the fallout of a possible sudden change in market sentiment

# ... to recover the capacity to weather a new shock

## BBVA financial stress index

Source: BBVA Research



## Main risks

A new flare-up of the European debt crisis, with contagion to other areas (US, China)

A sudden and sharp increase in oil prices

A sharp fiscal contraction in the US in 2013

A hard landing in China

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