RESEARCH

Latam Economic Outlook

First Quarter 2014
Economic Analysis

- **Global expansion will continue in 2014 (3.6%) and 2015 (3.9%),** this time with a greater contribution from developed economies.
- **Financial tensions return to emerging economies,** but markets will start to differentiate between countries depending on their fundamentals and the soundness of their economic policies.
- **Latam will grow 2.5% in 2014 and 2.6% in 2015 with increasing differentiation between countries.** The Pacific Alliance will grow 3.8% in 2014, while Mercosur will do so by 1.5%.
- **External deficits will start to go down from 2014 onwards.** These deficits are still financed with long-term capital. Even so, the region shows a certain loss of competitiveness in the last few years.
- **Most countries in the region have good buffers to withstand the Fed's tapering,** but in the light of less expansive financial conditions countries will reflect the difference between their fundamentals more clearly.

Index

Closing date: February 14, 2014

1. Summary

The global cycle is improving, with more growth and more balanced risks. Global GDP growth will accelerate from 2.9% in 2013 to 3.6% in 2014 and 3.9% in 2015. This improvement has been supported by the acceleration in the developed economies, above all the US, which we expect to continue in the next two years. This cyclical improvement in the US has given the Fed space to start the tapering of monetary stimulus, which, as is to be expected, will have a global impact. Emerging economies have been the most affected, with reductions in capital inflows and depreciations of their currencies, although this is more due to idiosyncratic events in the major emerging economies than as a result of the start of tapering. Among these countries, the worst affected are those with the largest foreign-currency deficits financed with short-term capital. These tensions do not alter our growth forecasts for the emerging economies as a whole (and, of particular importance for Latin America, they do not change our growth forecasts in China) but they do mean a not inconsiderable risk to the downside, although lower than six months ago.

Volatility also returned to Latin American markets, although we expect that fundamentals should foster differentiation from now on. Although the start of tapering by the Fed did not cause much turbulence in exchange rates or asset prices, which had already discounted the move, idiosyncratic events in key emerging economies did provoke an increase in risk aversion in emerging markets. Even so, the adjustment is nothing like the one in May 2013 or in earlier episodes of volatility. Similarly, capital inflows have not reversed in the region, with the exception of Brazil in the last few months. Further on, markets should start to discriminate on the basis of the soundness of their macroeconomic fundamentals, and little contagion is expected from the sharp exchange rate depreciation in Argentina to the rest of the region, although there could be a moderate effect on Brazil and Uruguay, through the trade channel.

Latin America will increase growth from 2.2% in 2013 to 2.5% in 2014 and 2.6% in 2015. This year, growth will gradually increase as domestic demand picks up, particularly due to the recovery in Mexico, after the temporary bump in 2013. Exports growth will also contribute, thanks to the recovery in global growth, especially in developed countries, and helped by a more competitive exchange rate. In the longer term, growth in the region will continue to converge gradually towards its potential, at slightly below 4%.

Growth in the region will be increasingly heterogeneous. The Pacific Alliance will grow at more than double the rate of the Mercosur countries in 2014 and 2015. In particular, we are revising slightly upwards our forecast of three months ago for average growth in the Pacific Alliance, up to 3.8% in 2014 and 3.7% in 2015, while revising downwards that for Mercosur, to 1.5% and 1.8% respectively. Again the three Andean countries (Peru, Colombia and Chile) – together with Paraguay – will be most dynamic in 2014 and 2015. Peru, especially, will grow by 5.6% in 2014, Colombia by 4.7%, Chile by 4% and Paraguay 5.3%, rates which (except in the case of Paraguay) will increase significantly in 2015. Mexico should also raise its growth strongly in 2014 up to 3.4%, once the construction sector has passed through and out of its bad patch. Brazil, however, will show only moderate growth of 2.5% in 2014 since, despite being in an election year, it will be held back by monetary tightening and structural economic problems, which will also push down its growth in 2015 to 1.9%.

The merely moderate growth in domestic demand and a slightly downward trend in commodity prices will maintain the pressure on fiscal deficits in the region. Nevertheless, we expect fiscal deficits will begin to curve downwards from 2015 onwards in most countries, as growth and external demand recover.

On the external side, current account deficits will begin to go down between 2014 and 2015, especially in those countries with a higher external gap, such as Peru and Uruguay.

Prospects for external balance are improving thanks to the end of supply-side problems in some countries' export sectors, exchange rate depreciation and the recovery in global growth. Moreover, external deficits are still largely financed through foreign direct investment flows, which limit external vulnerability for most countries in the region. Even so, the region has been losing some competitiveness in the last few years, after the progress made up until the beginning of the global crisis of 2008.

With the exception of Uruguay and Brazil, the countries in the region with inflation targets will see gradual convergence of inflation towards the core of their central banks' target range throughout 2014. Although we expect some effect on inflation from the depreciation in exchange rates, we estimate that this pass-through will be limited and temporary, with greater pressure on Brazil and Uruguay, due to the greater exchange depreciation undergone there. It is precisely in these two countries that we expect pressure on inflation to continue throughout 2014 and 2015.

Inflationary pressures will condition monetary tightening in Brazil and Uruguay. The other countries with inflation targets (the Pacific Alliance countries) will each follow their own path, according to their cyclical positions. Nevertheless, interest rates in the Pacific Alliance countries will converge towards an interest rate range between 3.5% and 4.25% at the end of 2014, in sharp contrast with interest rates of more than 10% in Brazil. In 2015 we expect interest rate hikes in all countries with inflation targets, to keep inflationary pressures at bay (Brazil, Uruguay) or in line with their cyclical strength (countries in the Pacific Alliance, particularly in the three Andean nations) and in the context of the interest rate rises that will start in the US in that year.

The withdrawal of quantitative easing by the Fed should already be priced into the exchange rate. We expect relatively stable exchange rates in the next two years, apart from Brazil and Uruguay, which will suffer significant depreciations. In Brazil depreciation will reflect the lack of progress made on reforms to recover the erosion of productivity and competitiveness, weak growth, high inflation rates and the impact of the exchange rate depreciation in Argentina. Uruguay will also experience significant depreciation in 2014 and 2015, dragged down by that of its main trading partners and by higher inflation than its neighbours.

The region has effective buffers to deal with the Fed's tapering and other external shocks. There are a range of factors which reduce most countries' vulnerability to an external shock such as the reduction in global liquidity. Foreign deficits, explained by an increase in investment, are financed by long-term capital (FDI, mainly) and are now starting to curve downwards. Reserve levels continue increasing in most countries at the same time as public and private borrowing is reduced, particularly that conducted in foreign currency, reducing currency mismatches. Even more so, given a lower currency mismatch, flexible exchange rates have already worked as an initial buffer to external shock.

Less liquidity will mean that markets will increasingly focus on fundamentals, which heightens the importance of continuing the reform agenda. As mentioned in earlier editions of our Latam Economic Outlook, it is crucial to increase productivity growth in order to ensure per capita growth in the long term. Otherwise, it will be increasingly difficult to grow at the same path with the same rate of investment, given slower growth in both population and the efficiency in the usage of factors. Therefore, it is essential that the region drives forward its second generation reforms, after winning consensus in the 90s about the benefits of implementing prudent economic policies.

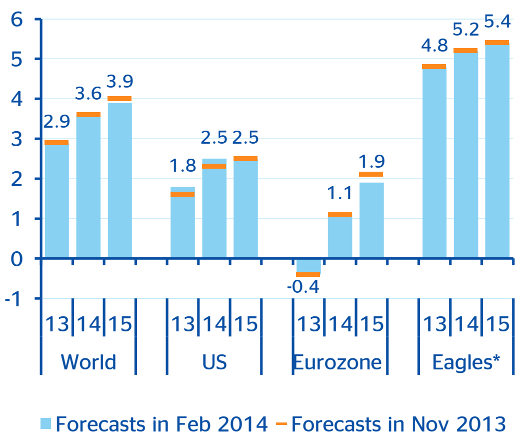
2. External environment: more growth and more balanced risks

The global economic cycle is improving and we now have clarity on some economic policy uncertainties

The global economic cycle strengthened during the latter months of 2013. According to our estimates, during the second half of 2013, global GDP accelerated to a rate close to 1% QoQ, leaving behind the moderation with its roots in 2012 and its low at the beginning of 2013, when growth was barely 0.5%. This improvement was driven by the acceleration of the developed economies – particularly the US, but also the eurozone, which started to see moderate growth. In the emerging markets, the situation is more diverse, but some of them (e.g. China) are posting relatively stable rates of growth.

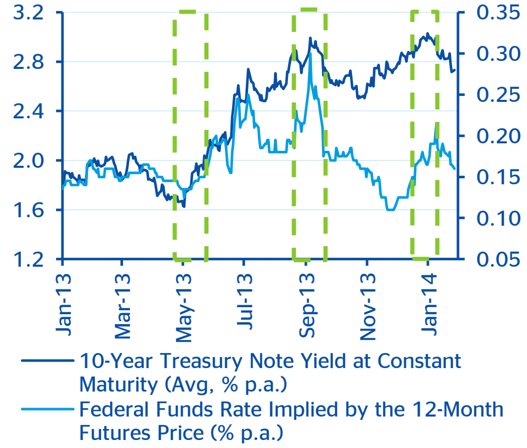
Our improved assessment of the global scenario is also the result of the developments in economic policy, inasmuch as this helps to reduce uncertainty. First, the US reached a more far-reaching agreement on fiscal policy than we expected. Meanwhile, the improvement in activity allowed the Fed to start tapering its expansive monetary policy at the beginning of 2014. In Europe, further steps have been taken towards the construction of banking union, which together with the ECB's determination to keep risks under control, should eliminate the hobble represented by financial fragmentation. The global outlook would be clearer if it were not for the effect that the tapering is having on financial markets in the EMs, and which could eventually affect economic growth in some of the countries included in this category.

Chart 2.1
GDP growth forecasts (%)



EAGLES is the group of emerging economies that will make the biggest contribution to global GDP in the next 10 years. The group comprises China, India, Indonesia, Brazil, Russia, Korea, Turkey, Mexico and Taiwan.
Source: BBVA Research and IMF

Chart 2.2
EU: Federal funds futures and long-term interest-rates (%)



Source: BBVA Research and Bloomberg

Thus, global GDP growth, which in 2013 had decelerated to 2.9%, will increase to 3.6% and 3.9% in 2014 and 2015, respectively (Chart 2.1), almost the same as our forecasts three months ago. The expected increase in global growth does not detract from the existence of downside risks to our forecasts. Although these risks are a long way from having the systemic nature that they had in the past, some recent events such as the fall in asset prices and currency depreciation in EMs have made themselves felt.

The US starts to unwind its monetary stimulus

US GDP growth has been accelerating through 2013, which by year-end allowed the Fed to take the first steps towards withdrawing monetary stimulus. Furthermore, in December, an agreement was reached that represents an important step forward in eliminating the uncertainty regarding the funding of the government's activity in 2014-15, as well as reducing the fiscal adjustment initially forecast for that period.

The outlook for monetary policy has also clarified recently, in line with our expectations. As a consequence of an acceleration in activity with well-anchored inflation expectations, the Fed decided to start to taper its monthly purchases of financial securities. All in all, in the fourth quarter of 2014, the central bank will have stopped expanding its balance sheet. Our base scenario also assumes that the first increase in interest rates will take place in the second half of 2015, although the FED will continue to use its forward guidance to anchor interest-rate expectations. In fact, the Fed's efforts to explain its exit strategy have been relatively successful in avoiding episodes of volatility like we saw last summer. Both long-term interest rates and expectations regarding Fed funds remain at levels no higher than the beginning of the summer (Chart 2.2). This is significant because part of the US recovery was due to interest-rate sensitive sectors such as real estate.

In this context, we have revised upwards our forecast for US growth in 2014 to 2.5%, the same as our estimate for 2015 (Chart 2.1). This adjustment reflects both the strength of the US economy in the second half of 2013 and the additional momentum contributed by the reduced fiscal drain thanks to the agreement reached at the end of last year. Note that there are also upside risks to our forecast if the improvement in confidence results in additional corporate investment and hiring.

The withdrawal of monetary stimulus in the US could cloud the outlook for some emerging economies

The change of direction in US monetary policy has, as usual, had a global impact. The emerging economies are being subjected to reduced capital inflows and currency depreciation, intensified in some cases by domestic events that have increased uncertainty regarding the management of their respective economic policies. In addition, there continues to be a differentiation between economies depending on their fundamentals: higher external deficits and more dependence on short-term and foreign-currency funding are associated with greater vulnerability to capital outflows and currency depreciation (Chart 2.3).

The recent tensions have not changed our growth forecasts for the EMs as a whole, but they do represent a significant downside risk. This risk is higher in the economies that have a higher weighting in global investment portfolios and that have the above-mentioned vulnerabilities: Turkey, Brazil, Indonesia and India in particular. The monetary tightening being introduced by some of these countries to control currency depreciation and inflation expectations will inevitably have a negative impact on growth. All in all, the diversity within the EM group means that our outlook remains favourable for some parts of South America, such as the Andean economies, emerging Asia and Mexico, some of which are benefiting from the cyclical momentum of the US economy (Chart 2.4).

Growth in China remains at around 7.5%, but the vulnerabilities are more evident

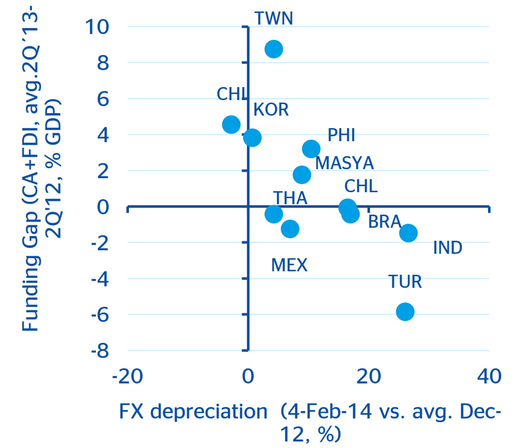
The fourth quarter was a clear example of the duality of China's economy as both a support for the global economy and a potential risk factor. The uncertainty at the beginning of the last year regarding the sustainability of its growth and the possibility of a hard landing dissipated in the short term. The economy recovered in the second half of 2013 (Chart 2.4) and maintains a good tone, although some of the more recent data on confidence and expectations of manufacturing activity are once again below market expectations.

Fundamental changes in economic policy have also been announced. At the Third Plenum of the Chinese Communist Party, the authorities reiterated their commitment to maintaining high rates of growth, while proposing measures that will strengthen the role of the market in allocating resources and a rebalancing from a model of investment and exports towards increasing household consumption. These announcements are steps in the right direction, but their effectiveness will depend on their execution, and they are not without risk.

For example, as regards the financial sector, the authorities are continuing to demonstrate their commitment to tackle the current vulnerabilities, fundamentally linked to the rapid growth of credit. This is being reflected in liquidity tensions in the interbank market which are above all affecting the so-called shadow banking sector[1], although the authorities have not managed to moderate the rate of growth in credit.

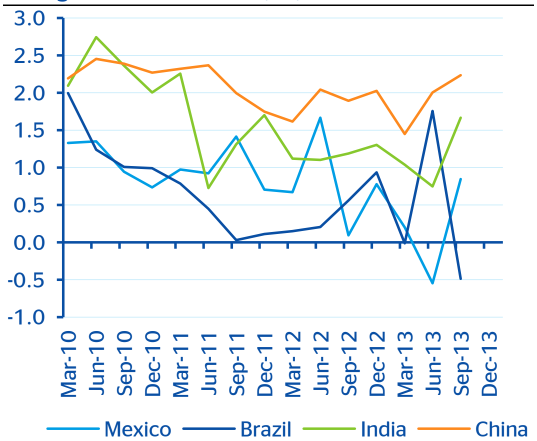
In any case, our 2014 and 2015 growth forecasts for China's economy remain unchanged (at 7.6% and 7.5% respectively), based on our confidence in the authorities' scope and ability to take action.

Chart 2.3
Exchange-rate depreciation (%) vs. external funding gap (CA + FDI, % GDP)



Source: BBVA Research and Haver Analytics

Chart 2.4
GDP growth in EMs (% QoQ sa)



Source: BBVA Research

The gradual recovery in the eurozone continues, with the support of the ECB and with banking union in its sights

After starting the year in recession, the eurozone managed to sustain moderate expansion throughout the second half of the year, in line with our forecast. Thus the fourth quarter data indicate YoY growth of 0.4%, which although only slight, is its best since the end of 2011. The driver of this slight improvement was the prospect of an increasing role played by domestic demand and the sustained improvement in credit financial conditions, favoured by the determination and commitment of the ECB to an expansive monetary policy. Nonetheless, the engine of European growth in 2013 and 2014 was, and will continue to be, the export sector.

In any case, we cannot rule out periods of instability as we approach events that could alter the panorama of progress in banking union and of strengthening the monetary union in Europe in general. The events to watch in this context include the European Parliamentary elections, and developments on the conditions and results of the stress test and asset quality review of the banking sector.

All in all, we reiterate our forecast for eurozone GDP growth at 1.1% for 2014. For 2015 we estimate 1.9%. However, given our projection of continued cyclical weakness, we are also maintaining as a risk event to our forecast horizon a scenario of significant deflation, although we assign a low probability to this risk.

1: The group of financial institutions and vehicles that fall outside the regulation of the banking system, but that carry out the same intermediary functions between the economic agents with surplus liquidity and those with insufficient savings to take consumption or investment decisions.

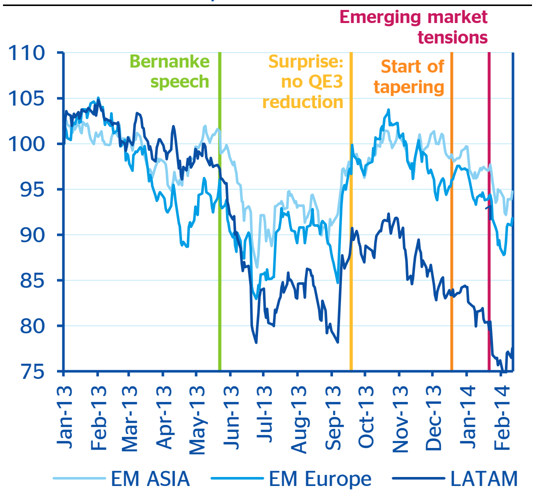
3. Return to volatility in the financial markets in Latin America

Volatility in financial markets has increased again, as a result of the start of tapering and, above all, due to domestic events in some emerging economies

The US economy's recovery and its rosier prospects enabled the Federal Reserve to announce, at its 18 December meeting last year, the gradual withdrawal of its aggressive monetary stimulus, which it began to implement at the beginning of 2014. However, the immediate reaction of key asset prices in emerging markets, and in particular Latin America, was not particularly noticeable.

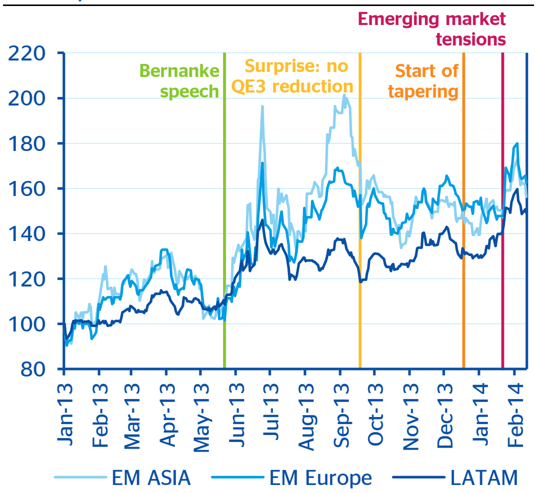
Movements in Latin American financial markets, since tapering was announced on 18 December up until the middle of January, were basically determined by idiosyncratic issues and not by the actions of the US Federal Reserve. It is worth pointing to several localised episodes of volatility, such as the mild depreciation of exchange rates in the region and, in some cases, the fall in stock exchange indexes (as happened in Colombia), as well as the slight uptick in country risk (in Brazil, for example).

Chart 3.1
Evolution of stock prices in emerging markets (MSCI index January 2013 = 100)



Source: BBVA Research and EPFR

Chart 3.2
Sovereign spreads in emerging markets (EMBI January 2013 = 100)



Source: BBVA Research and Haver Analytics

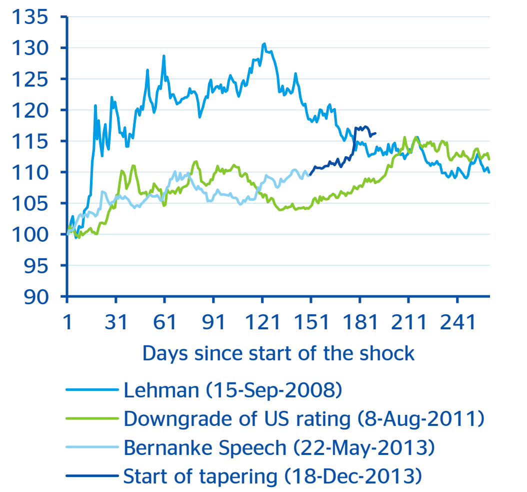
After the adjustments made from the end of May onwards, when the then Chairman of the Federal Reserve, Ben Bernanke, indicated that the beginning of the withdrawal of quantitative easing would not be long in coming, the relative calm in financial markets in the region at the end of 2013 and beginning of 2014 reinforced the feeling that tapering had in general already been reflected in asset prices.

A series of better news than expected on the economic cycle meant that the markets anticipated the interest rate rise in the US (see Chart 2.2), raising concerns about a reduction in global liquidity. More recently, a series of negative events in key emerging economies, such as a degree of fear of renewed weakness in China, political tensions in Turkey, strikes in South Africa and a sharp depreciation in the exchange rate in Argentina, caused a pronounced spike in volatility in emerging markets, including those in Latin America (see the most recent data in Charts 3.1 and 3.2).

So it was that since the middle of January exchange rates in the region depreciated by between 0.3% and 4% in the major countries (without including the 15% depreciation in Argentina), more strongly in Chile and Colombia and less so in Peru and Mexico. Furthermore, stock exchange indexes in these countries fell around 4% in most countries and the sovereign differential increased between 1pp in Mexico and 15pp in Colombia (+31pp in Argentina). We should highlight that these movements in the last month were in an environment in which metal raw material prices went down, with a negative impact which mainly affected Chile and Peru, while oil prices remained relatively stable and agricultural product prices in general went up (due to supply-side issues), with a positive impact on Mercosur countries.

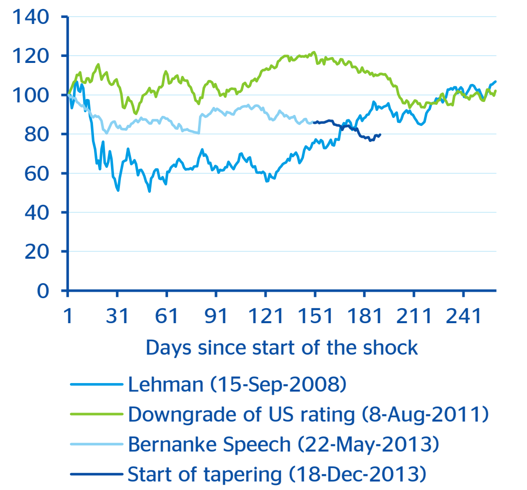
Although the turbulences recorded from mid-January have not been trivial, they are not comparable with those of May 2013 and in particular with previous episodes of volatility such as after Lehman Brothers went bankrupt or after the US credit rating was revised downwards (see Charts 3.3 to 3.5).

Chart 3.3
Evolution of exchange rate in Latam in episodes of high volatility (volatility index start = 100)



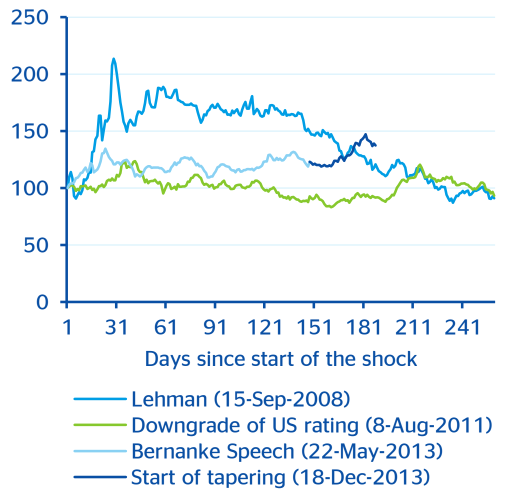
Source: Bloomberg and BBVA Research

Chart 3.4
Changes in stock prices in Latam in episodes of high volatility (MSCI Latam index, volatility start = 100)



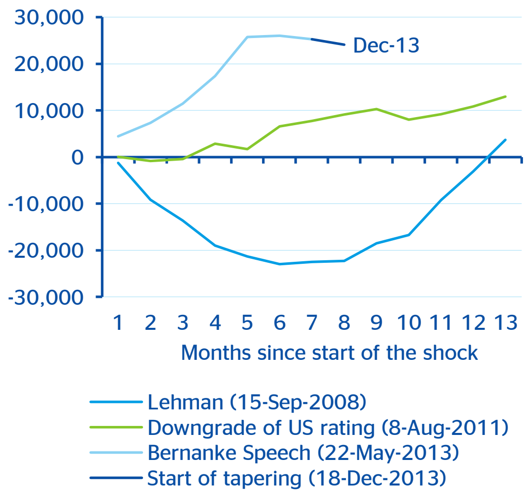
Source: Bloomberg and BBVA Research

Chart 3.5
Evolution of the sovereign spread in Latam in episodes of high volatility (EMBI volatility start = 100)



Source: Bloomberg and BBVA Research

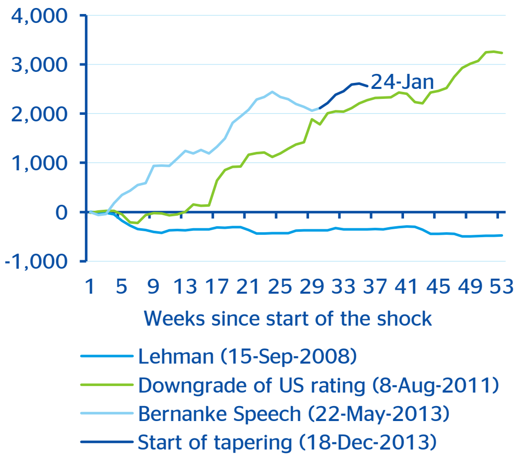
Chart 3.6
Portfolio flows of non-resident, Brazil (cumulative, USD million)



Source: National statistics and BBVA Research

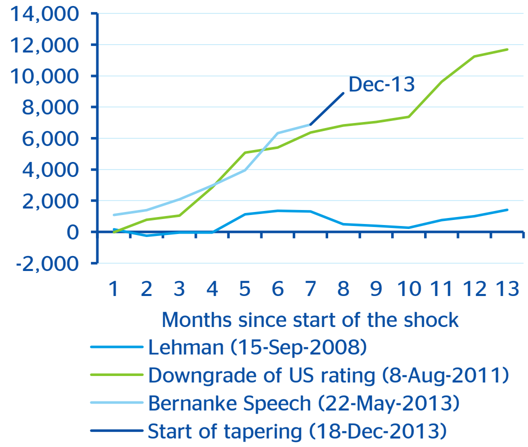
Finally, capital flows data, which are as yet still scarce for the end of 2013 and beginning of 2014, suggest that in general there has not been a short-term capital outflow on the part of residents, although there has been a reduction in the inflows of non-residents. This reduction even implied moderate recent outflows in countries such as Brazil and Colombia (see Charts 3.6 and 3.7), but not in countries such as Chile, where inflows have continued to be positive (see Chart 3.8).

Chart 3.7
Portfolio flows of non-resident, Colombia (cumulative, USD million)



Source: National statistics and BBVA Research

Chart 3.8
Portfolio flows of non-resident, Chile (cumulative, USD million)



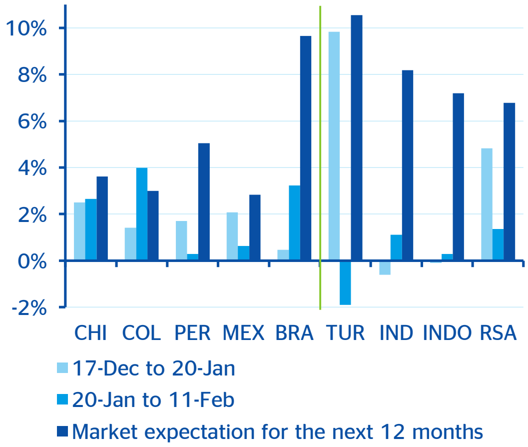
Source: National statistics and BBVA Research

Nevertheless, after a first phase of similar moves, markets ought to start discriminating on the basis of fundamentals and the solidity of economic policies

Although recent volatility has been generalised, we expect markets to begin differentiating those countries with solid fundamentals from those which are more vulnerable. Heavy turbulence in economies such as Argentina, Turkey and South Africa reinforce this view. However, as Charts 3.9 and 3.10 show, in the remaining emerging economies there has not yet been much discrimination. Whether it is the movements that have taken place since tapering was announced in December, those made after the increase in volatility in the middle of January, and even the more recent correction in the last few days, there is little heterogeneity. So, for the moment, we see relatively little differentiation between countries with better fundamentals and those with worse ones, both in and outside Latin America.

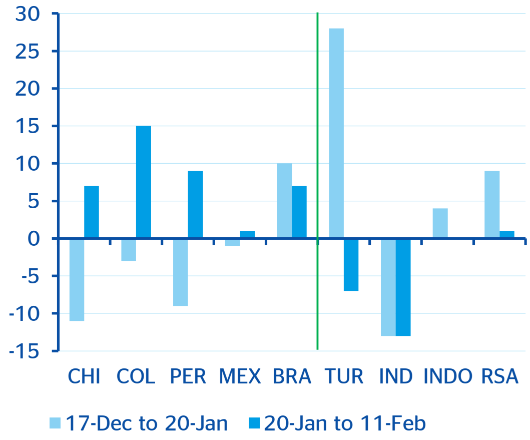
Among the still scanty signs of discrimination are implicit depreciations in future exchange rate contracts (see Chart 3.9), which show that the adjustment due in exchange rates in countries like Brazil, Turkey and India is much more significant that in countries such as those in the Pacific Alliance. Furthermore, the improvement in Mexico's sovereign debt rating from Baa1 to A3 announced by Moody's at the beginning of February and that of Colombia to BBB by Fitch in December contrast, for example, with the comments made by the main ratings agencies about the possible downgrading of Brazil in the next few months.

Chart 3.9
Variation in exchange rate from start of tapering and expected change in 12 months based on exchange rate futures (%)



* A positive (negative) figure corresponds to depreciation (appreciation).
Source: Haver Analytics

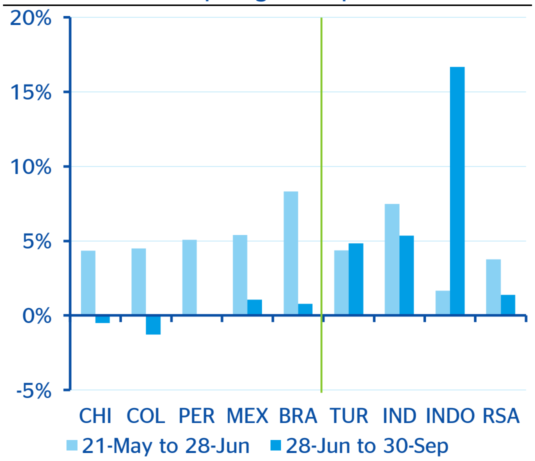
Chart 3.10
Change in sovereign spread from the start of tapering (pb)



Source: Datastream

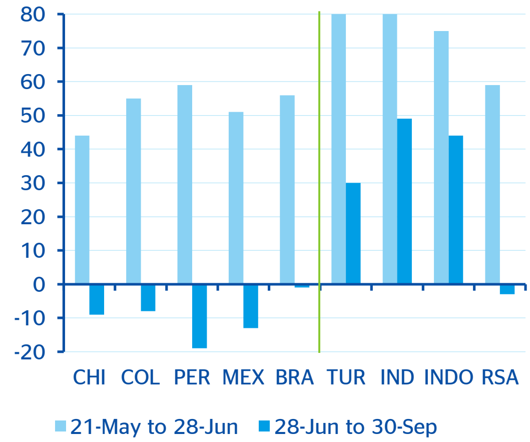
The view that markets ought soon to start to discriminate on the basis of fundamentals is supported by earlier episodes of turbulence. So, for example, after the movements in financial markets in May 2013 when it was announced that tapering would begin before long, the markets started to discriminate between the more and less solid economies (see Charts 3.11 and 3.12). The economies which, for example, depended least on short-term capital flows were the least impacted by the asset price correction process (see Chart 2.3).

Chart 3.11
Change in exchange rate between the announcement of tapering and September 2013 (%)



Source: Haver Analytics

Chart 3.12
Change in sovereign spread between the announcement of tapering and September 2013 (pb)



Source: Datastream

Therefore, we expect the withdrawal of liquidity by the Federal Reserve to expose the vulnerabilities of those countries with worse fundamentals, more exposed to idiosyncratic shock effects. Since most countries in the region, including the Pacific Alliance countries (Mexico, Chile, Colombia and Peru), maintain solid economic policies and are displaying few imbalances, contagion is not expected from the worse affected economies, particularly in a scenario in which we anticipate that China will stabilise its growth at current rates. Not even the tensions in Argentina will have a significant impact on the region as a whole, and in any event this will be very limited in the case of Brazil and Uruguay, as analysed in Box 1.

Box 1. Limited contagion from Argentina to the rest of Latin America, concentrated on Brazil and Uruguay

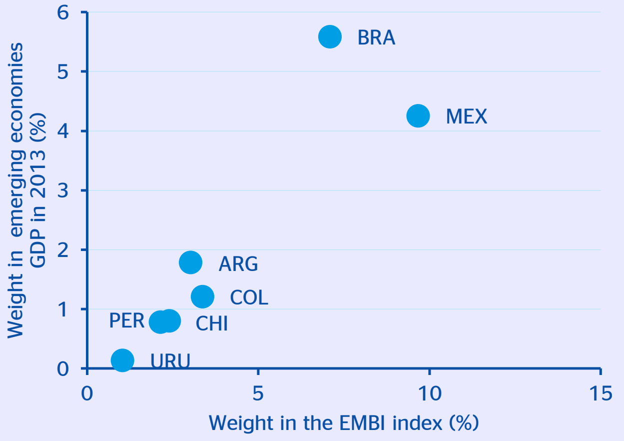
One of the events towards the end of January which contributed to raising doubts about the progress of emerging economies was the increase in the rate at which exchange rates were going down in Argentina. In particular, between 21 and 23 January, the rate of exchange went down by 14% to 6.88 pesos per USD, stabilising a few days later on 23 January at around 8 pesos per USD.

The drop in exchange rates in Argentina coincided with a sharp depreciation of other emerging currencies, such as the Turkish lira and the Russian rouble. Latin America's other currencies all weakened against the dollar from the end of January too. All this has led to certain concerns about the possibility of a widespread crisis in emerging economies. Our view is that the turbulence in financial markets during January and February has had some global components (such as a possible bringing forward of interest rate rises in the US and short-term worries about the Chinese growth rate), but also idiosyncratic factors in the most affected economies (Argentina, Turkey, India, Indonesia and South Africa, among others).

Specifically, there is a series of reasons for which sharp depreciation in the Argentinean exchange rate and a slowdown in its economic activity which might be the consequence of an increase in market interest rates, would have a very limited effect on other countries in the region, apart from Brazil and Uruguay. But even in these two the effect would, in any case, be contained.

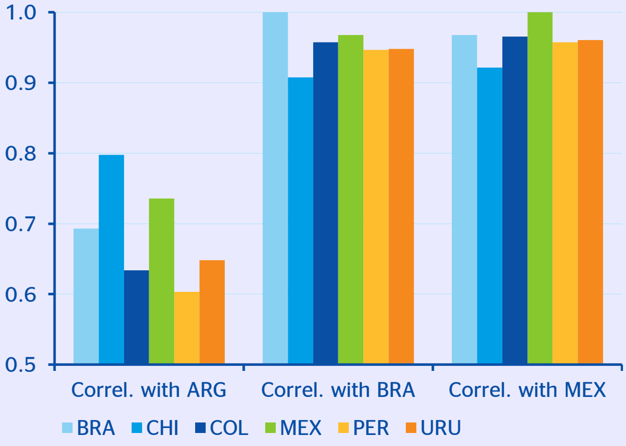
The main channel through which turbulence in Argentina might affect the remaining countries in the region is through its effect on international financial markets and investor mood in the area. However, Argentina's involvement in international financial markets is much less than its economic weighting in the region. Argentina has not returned to international financial markets since it suspended payments in 2001, which has brought its foreign debt level down from 130% of GDP in 2002 to 70% in 2005 and 31% in 2013. Furthermore, capital inflows on the part of non-residents have also been limited in the last few years. All this has meant that Argentina's input in the region's main indexes is very small (see, for example, Chart B.3.1 for the EMBI index). So it is highly unlikely that it can trigger an exit of funds centred on the region. Likewise, the correlation between changes in sovereign spreads in Argentina and the remaining countries in the region is much less than the correlation between Mexico and Brazil, to a large degree because the change in spread in the case of Argentina has been mainly due to idiosyncratic factors.

Chart B.1.1
Weight of Latam countries in the EMBI index and percentage of GDP of emerging economies



Source: BBVA Research and JP Morgan

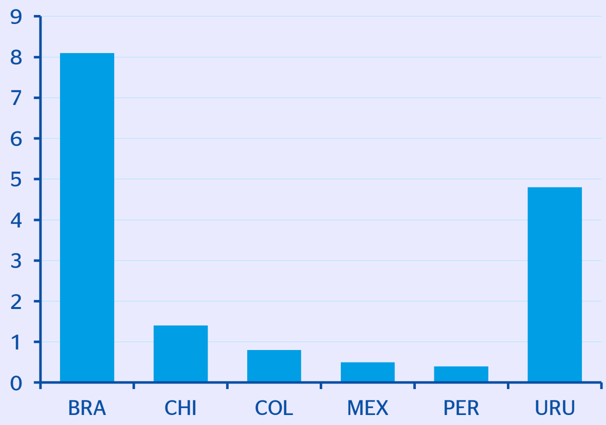
Chart B.1.2
Correlation of sovereign spreads of each country with those of Argentina, Brazil and Mexico (January 2009 - February 2014)



Source: BBVA Research and Haver

The second channel through which contagion might spread from Argentina to the rest of the region is trade and direct investment. However, Argentina's trade links with its neighbours are relatively limited (Chart B.3.3). Exports from the rest of the region to Argentina only make up 2.2% of its total trade, although this percentage is greater in the case of Brazil (8.1% of its exports, particularly in the automotive and chemicals sectors) and Uruguay (4.8% of the total).

Chart B.1.3
Exports to Argentina as percentage of total of each country



Source: BBVA Research and Haver

In the case of Brazil, impact on growth in 2014 is likely to be around -0.2pp, although it could be less if Argentina loosens some of the restrictions it currently applies on imports from Brazil, which is more likely now that the peso is at a more competitive level. This impact would stem particularly from a 10% drop in Brazilian exports to its neighbour (in January 2014 the fall in exports was 14% YoY). In any event, this negative impact on Brazil of the depreciation of the peso and the slackening of activity in Argentina is not entirely incorporated into our growth forecast of 2.5% for Brazil's GDP in 2014, which reinforces the downside risk of this forecast.

In the case of Uruguay the effect on growth would be less than in the case of Brazil, not only because the exposure level is lower, current growth is more robust and economic policy margins are somewhat greater, but also because the relative greater ease of access to foreign currency on the part of individuals as decreed by the Argentinean government could have a positive effect on tourism in Uruguay, which partly compensates the price effect and that of a possible slowdown in economic activity in Argentina.

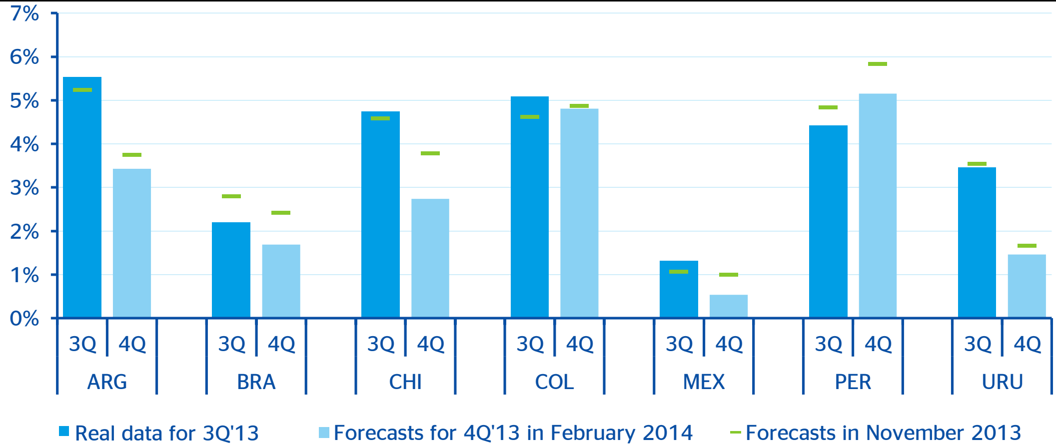
To sum up, the recent currency depreciation in Argentina and a possible slowdown in its economic activity as a result of the increase in domestic funding costs will have very limited effects on most Latin American countries; even in the case of Brazil and Uruguay, the most exposed to the trade channel, the effect would be very contained. The key risk for the region comes from a possible sharp slowdown in China (with effects on the demand for raw materials and impact on their price) or of a disorderly retreat from monetary stimulus in the US which causes heavy turbulence in international financial markets. Fortunately, the likelihood of either risk event occurring has gone down considerably since the middle of 2013.

4. Increasing heterogeneity in Latin America

Worse data than expected in the third quarter held back growth in 2013, but internal demand is already showing recovery in most countries

After a third quarter with some surprises to the downside in output, we have adjusted our estimate for growth in 4Q13, factoring in a generally orderly moderation in regional activity. Downside surprises in the third quarter focused mainly on Brazil and Peru (Chart 4.1). In the first case, it should be pointed out that the surprise to the downside in the case of the Brazilian economy has implied an adjustment in our estimate for the year, from the 2.6% initially estimated to 2.2%[2]. When it came to positive surprises, 3Q13 growth was slightly higher than initially forecast in Colombia, a result which was nuanced by having been unbalanced and because of the downward revisions in previously published data. For their part, in Chile, Argentina, Mexico and Uruguay third-quarter results were practically in line with expectations.

Chart 4.1
Surprises in growth forecasts in the third quarter and forecast adjustments in the fourth quarter of 2013 (% y/y)



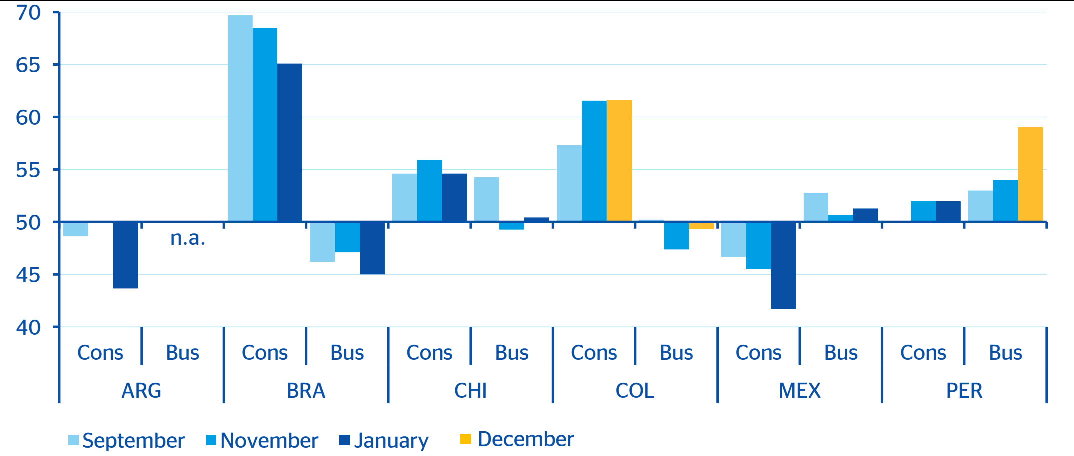
Source: National statistics and BBVA Research

Meanwhile, domestic demand indicators in the final months of 2013 and the beginning of 2014 showed, in general, a trend towards improvement in most countries. Good performance from the confidence indexes (Chart 4.2) was a highlight, as were retail sales (Chart 4.3) in Andean countries in the last months of 2013. In particular, the retail sales indicator (data to November) indicates a growth profile from less to more throughout the whole of 2013, a situation that is similar to a certain degree to that of the consumer confidence indicators. In the Andean countries, private consumption continued to be one of the engines of growth, backed up by good employment and wage figures.

In the case of Brazil, retail sales improved towards the end of the year, contrasting with the first eight months, and consumer confidence indicators continued in a positive frame, although less so than in previous months, as the labour market and disposable income gradually weakened. Meanwhile, business confidence continued in negative territory. For its part, in Mexico sales fell on a YoY comparison throughout the second half of the year, while consumer confidence saw continued and increasing falls, a pessimism that is possibly related to the fall in real wages and a slowdown in employment.

2: See our Brazil Flash: Contraction in the third quarter.

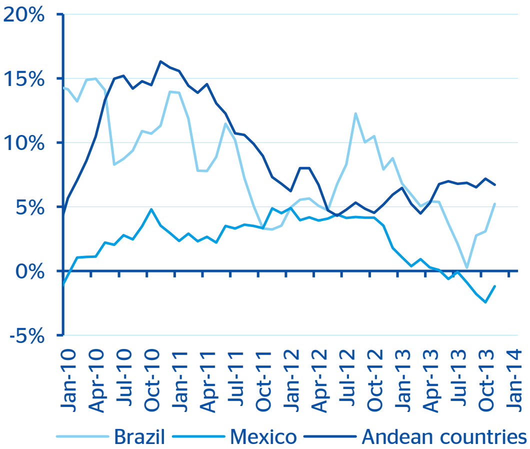
Chart 4.2
Confidence indicators



Source: National statistics and BBVA Research

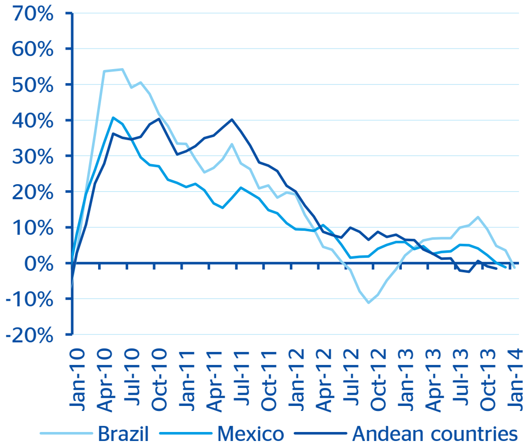
When it comes to imports, these continued to slacken toward the end of the year (Chart 4.4), both in the Andean countries and in Mexico and Brazil, partly related to a slowdown in production (manufacturing in particular) and to exchange rate depreciation. The situation was similar to the investment component, which in Chile slowed down toward the end of the year, coinciding with the end of the mining investment cycle. In a parallel manner, investment recovery in Peru was slower than expected at the end of 2013. In Colombia, however, the construction component was outstanding, in fact representing the main engine of growth.

Chart 4.3
Retail sales (% y/y)



Source: Bloomberg and BBVA Research

Chart 4.4
Imports (% y/y)



Source: Bloomberg and BBVA Research

Thus, internal demand indicators point to a good growth to the end of 2013, although somewhat below expectations three months earlier (Chart 4.1). In 4Q13, we estimated that expansion in Chile was around 2.7%, well below the average from previous quarters (4.5%), while in Colombia growth stood at around 5%, slightly less than the previous quarter. In Peru, momentum in the sectors linked to domestic demand, such as trade and services, was key in the final quarter, influencing an uptick at the end of the year to 5% YoY, although a little less than expected. In the case of Mexico, a slowdown in growth continued up until 4Q13, and at a deeper rate than initially forecast, with growth of around 0.5% YoY. In Brazil, on the other hand, the most recent indicators show that output still was not showing signs of recovery in the final months of 2013, and there are even clues that the country may have gone into recession at the end of 2013. We need to point out at this stage that the negative figures from Brazil for the last part of the year fit into the context of an economy where private consumption, which represents practically 80% of GDP, is losing momentum.

So, for 2013 as a whole, we estimate growth in Colombia at 4.1% and that of Chile at 4%, while it was approximately 5% in Peru, around 2.2% in Brazil, and just about 1.2% in Mexico, where we need to bear in mind the important negative surprise in the second quarter[3]. Although half-year profiles differ – Colombia's being skewed towards the second half of the year, the opposite of Chile and the more stable Peru – they coincide in having profited from internal demand that is still high.

Growth in Latin America will increase gradually, from 2.2% in 2013 to 2.5% in 2014 and 2.6% in 2015, and in subsequent years will approach its potential

In 2014, output in Latin America will speed up gradually as internal demand becomes more lively (Chart 4.5), particularly as a result of the return to growth in Mexico, after overcoming the temporary shocks to the construction sector and the delay in executing public expenditure. Also, to a lesser degree, a slight recovery compared to 2013 in Brazil and, above all, in Peru and Colombia, will contribute to this increase, only partly offset by the slowdown in Argentina and Paraguay compared to 2013.

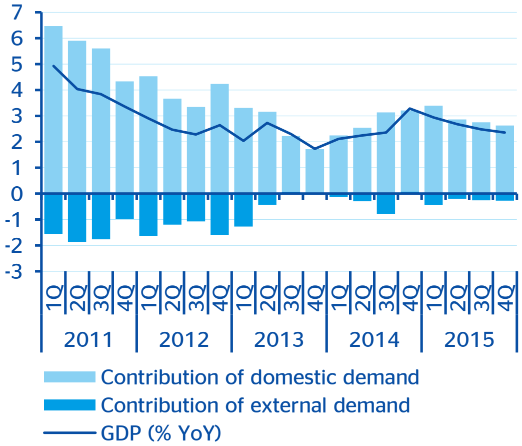
In 2014, apart from the impetus of internal demand, the highlight is the increase expected in exports from the region, in line to the recovery of developed economies, mainly the US and the Eurozone, and continuing momentum on the emerging economies receiving export products from South America (Chart 2.1). Likewise, exports will benefit from a less appreciated exchange rate in the region. We should recall, too, that recent moderation in exports in Andean countries – negative YoY changes to the end of 2013 – and Brazil have more to do with temporary supply-side shocks and the high benchmark for comparison, so exports should rise again in the next few months.

Meanwhile, prices in raw materials ought to carry on supporting dynamism in the region, some downward adjustments notwithstanding. On a medium-term horizon, we forecast that the soybean and copper prices will continue with their slightly downward profile, whilst oil will continue to stay high, similar to those at present (Chart 4.6). In the latter case we see no important changes from the previous forecast, although towards 2015-2016 the outlook is for a greater downward adjustment of around 5-6%, bearing in mind the increased production expected from the US and Iran. In the case of copper, in 4Q its price continued to surprise to the upside; and given the expectations of stable growth in the near future in China as well as the recovery in the US and the eurozone, we estimate a slower convergence than previously anticipated for this metal, although maintaining its downward trend. The soybean price changed in line with expectations a quarter ago, and also in line with the bias to the downside which will continue into 2014-2015. This bias is related to the surplus resulting from estimating higher production for the 2013-2014 season. Even so, raw material prices will stay at similar levels to the average for 2006-2012, levels that are clearly positive for the region.

As a result, for the region as a whole, we have reviewed growth forecasts slightly downwards from November, although still on a rising profile, with growth rates estimated at 2.2%, 2.5% and 2.6% in 2013, 2014 and 2015 respectively (Chart 4.7), from a previous estimate of 2.4%, 3.1% and 2.7%. Nevertheless, the region will gradually trend towards its growth potential, at slightly under 4%, by the end of this decade. Internal demand will continue to have an important weight in regional growth, but will be aligned more with GDP growth (Chart 4.7), a symptom of improved contribution from the foreign sector.

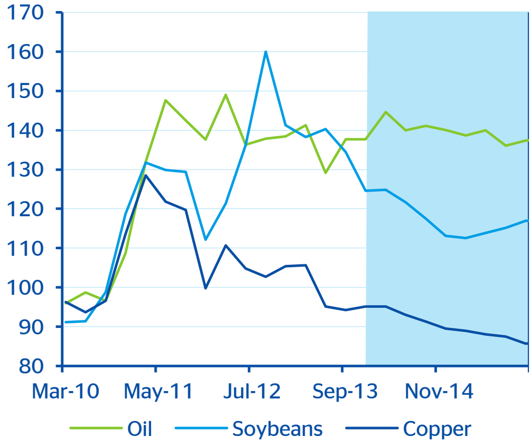
3:See Mexico GDP Flash 2Q13: GDP surprises to the downside.

Chart 4.5
Domestic demand and net exports contribution to annual growth



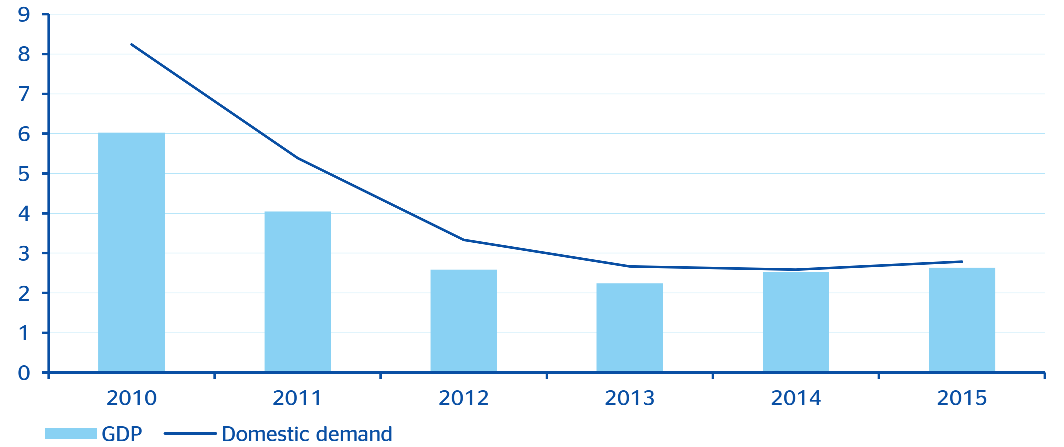
Source: National statistics and BBVA Research

Chart 4.6
Price of the main raw materials (January 2011 = 100 Index)



Source: BBVA Research and Haver

Chart 4.7
Latam: GDP growth and domestic demand (%)



Source: National statistics and BBVA Research

There will be increasing differentiation within the region. The growth of the Pacific Alliance, close to 4% in 2014 and 2015, will be more than double that of Mercosur countries

Heterogeneity in the performance of the economies of the region will remain the main feature of the macroeconomic environment in Latin America in our forecast horizon. By major blocks of countries, expected growth for the Andean region and Mexico, members of the Pacific Alliance, contrasts with that of Mercosur economies (Argentina, Brazil, Paraguay, Uruguay and Venezuela). So, while expansion in the first group in 2014 and 2015 has been revised slightly to the upside (from 3.6% expected in November for 2014 and 2015 to 3.8% and 3.7% forecast now), expected growth for Mercosur has gone down by -1.2pp and -0.3pp in 2014 and 2015, to growth rates of 1.5% and 1.8% respectively (Chart 4.8). This difference is also the manifestation of even greater differences in internal demand dynamics between the two country-blocks (Chart 4.9).

The Andean block is characterised by the solidity of its internal market with growth rates that are still high, both in consumption and in investment, although with a gently declining profile; they also have the impetus of external demand, both because of the expected recovery in the eurozone and the US, and because of the greater inter-region trade expected in coming years. It should be pointed out at this juncture that the implementation of the agreements to eliminate trade tariffs that belonging to the Pacific Alliance involves, means that these four economies are getting rid of 92% of trade tariffs on their products, and will translate into progress for trade in the region, as well as enabling these countries to exploit international production chains[4].

Moving onto individual countries, in Chile moderation in internal demand components will continue (as well as the additional negative effects of strikes in major ports in January). Despite this, we estimate that the effects will be transitory, with no changes to our estimate of a 4% growth rate for the year (Chart 4.10), and this in a context where the labour market will be slightly less dynamic and the unemployment rate will go up slightly. For Colombia we expect robust growth to continue in the first half of 2014, based on internal sectors such as consumption and construction, plus an improvement in industry. In Colombia, 2014 will also be a year of more balanced growth between internal demand components, which will lead consumption to grow from the 3.9% expected in 2013 to 4.5% in 2014 and for investment to rise from 3.9% to 4.5%. This means that YoY expansion will be around 4.7% (Chart 4.10). Meanwhile, indicators available for Peru suggest that growth momentum will continue in the first quarter, with renewed optimism on the part of producers and consumers, and the impetus of the mining sector will be particularly strong; in this case we estimate that the contribution of internal demand to growth in 2014 will be slightly over 5pp, which will mean overall 2014 growth of around 5.6%, the highest in the region.

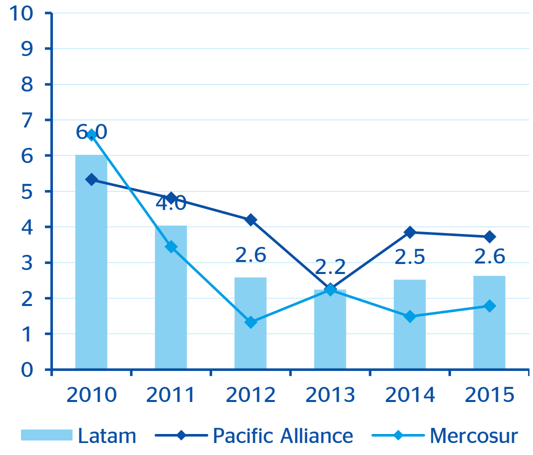
With Mexico it is important to highlight the revision to the upside in the forecast for 2014, over the estimate a quarter ago, from 3.1 to 3.4%. This adjustment is the result of an improvement in external demand and expansion in the public component of demand, which speeded up at the end of 2013, reversing the under-execution it had shown at the beginning of the year. Better outlooks, both in external demand and public expenditure, will also help towards better growth for 2015, estimated now at 3.0% (from 2.8% before). This rosier forecast is also helped by the improved perception in the outlook for the Mexican economy as a result of having passed reforms to taxes, the financial system, the labour market, education and, most particularly, the energy sector[5].

In contrast, in Mercosur growth will be overshadowed mainly by the above-mentioned exhaustion of Brazil's expansion based on internal consumption in previous years, as well as by the negative impact on output of the recent devaluation and the increase in interest rates in Argentina, only partly mitigated by the depreciation of the BRL compared to the rest of its trading partners. The dynamism of the public sector before the 2014 elections will enable Brazil to grow 2.5% in 2014, but a likely subsequent adjustment will imply a slowdown to 1.9% in 2015 (Chart 4.10).

For their part, Uruguay and Paraguay will continue to stand out because of their high growth, although they will be partly held back by the unfavourable dynamics of Brazil and Argentina. In the case of Paraguay, expansion will be around 5.3% in 2014, driven by investment and exports. Growth in Uruguay will continue in line with its potential for 2014, at around 3.5%, although it will be affected by the slackening in Argentina's growth because of its major trading links with that country, which will imply that there will be fewer resources from engines such as tourism and construction.

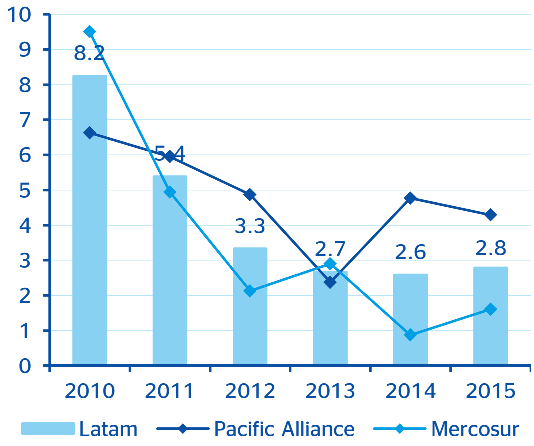
4: For more details see our Latam Flash: Trade protocol for the Pacific Alliance signed.
5: The Energy Reform passed in December in Mexico involves a deep-seated change in the sector, which will enable domestic and foreign private companies to operate in the energy sector. For more information see Energy Reform Flash: Far-reaching reform of the sector which could prompt large investments and increase potential growth.

Chart 4.8
GDP Growth: Mercosur vs. Pacific Alliance (%)



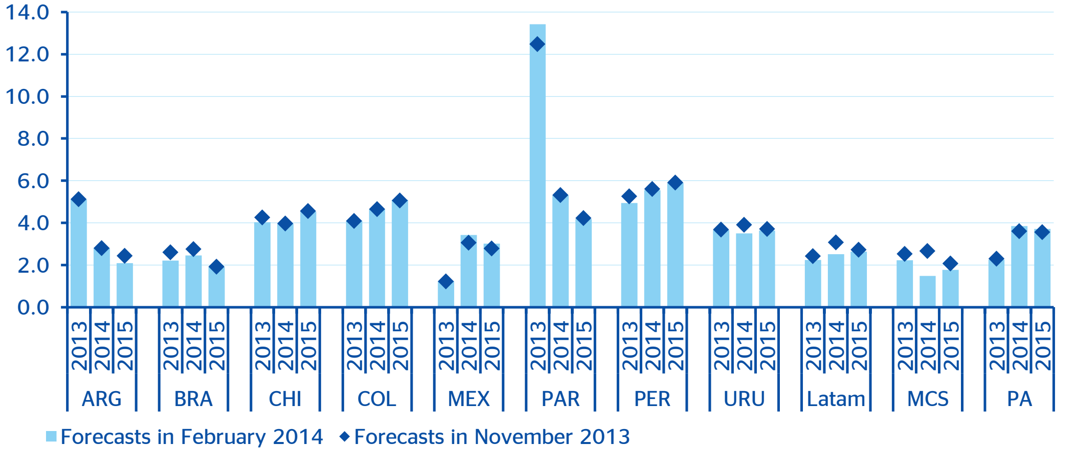
Source: National statistics and BBVA Research

Chart 4.9
Internal Demand growth: Mercosur vs. Pacific Alliance (%)



Source: National statistics and BBVA Research

Chart 4.10
Latam: GDP growth forecast, 2013-2015 (%)



Source: National statistics and BBVA Research

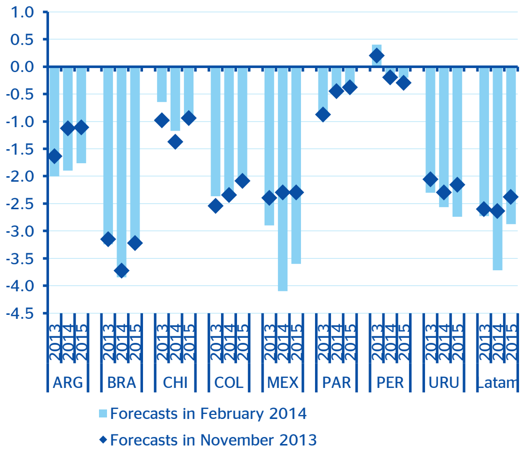
Only moderate growth of internal demand and a slightly decreasing bias in the price of raw materials will keep up the pressure on fiscal deficits which, nevertheless, will begin to curve downwards in 2015 in most countries

In the countries of the region, while the internal market will continue forming the basis for GDP growth, it will do so to a lesser degree than in the recent past (Chart 4.7 and 4.9). Furthermore, the price of raw materials, especially metals and soybeans, will continue to slide, which will have a negative impact on tax revenues in 2014 (Chart 4.11). However, recovery of growth and external demand in 2015 should help to bring about a downward curve to fiscal deficits from the end of 2014 and beginning of 2015.

During 2013, Brazil's tax balance deteriorated significantly, as a result of higher expenditure compared to revenue. This balance is not expected to improve in 2014, a year of general elections and higher interest rates. In Chile, public expenditure is expected to grow at its fastest rate since 2010 and slower momentum in the economy will affect tax revenues. However, the dollar-denominated revenues will grow as a result of the greater depreciation expected, all this in the expectation of the tax reform announced by the government which will take office in March and which in theory will raise tax revenues by 3% of GDP in the medium term. We should not forget that Chile's fiscal policy follows a rule of structural balance, to prevent changes arising from cyclical GDP movements and the copper price. The fiscal deficit rule opens up the possibility of greater room for public expenditure this year, due to higher structural revenues, mainly arising from the currency depreciation, and because of the possibility of a greater structural deficit existing in 2014, depending on the goal that the new government sets itself. In Colombia there is a commitment to fiscal discipline, so that tightening on spending (which will mainly be adjusted by cutting investment) will imply gradual convergence with the fiscal programme's goals. In Peru, the slight slowdown in internal demand and lower metal prices will imply lower fiscal revenue, while public expenditure will retain its expansive tone, with public sector investment growing at double digits in 2014 and 2015. Even so, a small deficit is expected in 2014 although it should be pointed out that Peru and Chile are the countries with the greatest scope for implementing countercyclical expenditure policies, should these be necessary (Chart 4.12). In any event, the Andean countries' fiscal policy will continue being characterised by their disciplined management and by a decreasing ratio of public debt to GDP.

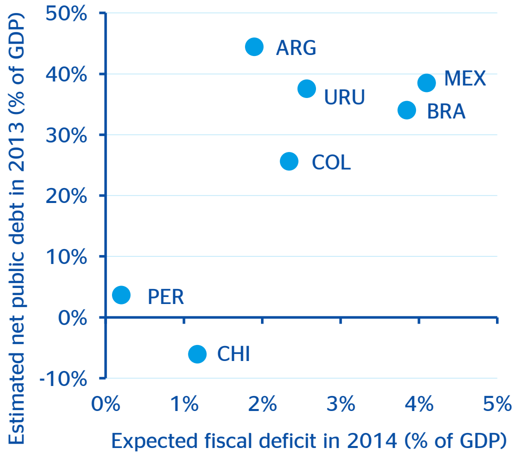
It should be pointed out that last October Mexico passed its tax revenue reform, which posits a fiscal deficit of 1.5% of GDP in 2014 and that this will gradually reduce towards a balanced budget by 2017. In addition, it has a provision in the event of the economy increasing above its potential (to be defined), of a cap on current expenditure growth. New duties on consumption and income have also been created which are forecast to bring in additional tax revenue of 1.0% of GDP in 2014[6].

Chart 4.11
Latam: fiscal deficit (as % of GDP)



Source: National statistics and BBVA Research

Chart 4.12
Latam countries: fiscal deficit expected in 2014 and estimated at 2013 (% of GDP) Net public debt



Source: IMF and BBVA Research

6: The main adjustments involve new duties on soft drinks and food with a high calorie content, a tax on motor fuels, a limit to special regimes, higher tax rates on individuals, etc. For more details, see our Mexico Economic Watch: Fiscal Reform: in the right direction, but not enough and Update of Fiscal Reform: approved in both Chambers with few changes.

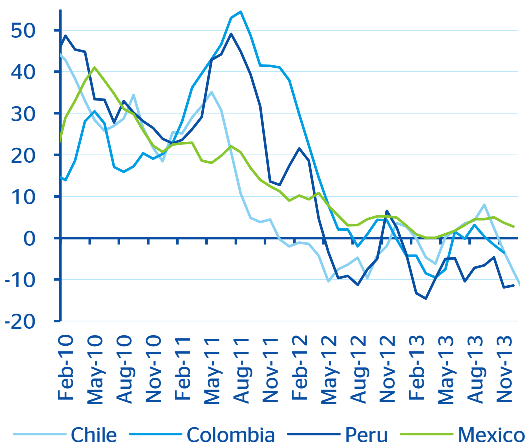
5. External deficits will start to shrink in 2014

The outlook for the region's external balance is improving slightly, thanks to the end of the supply-side problems in some countries' export sectors, depreciation in exchange rates and the recovery of growth worldwide

External deficits in the region's countries will trend downward as the more depreciated exchange rates and recovery in the Eurozone and US, plus China's stability, all have a positive influence on exports. These have evolved weakly over the last few months (Charts 5.1 and 5.2). In any event, external deficits will start to contract in most countries from 2014 and 2015 onwards, especially in those with a bigger external gap such as Peru and Uruguay (Chart 5.3), which will contribute to the reduction in external vulnerabilities.

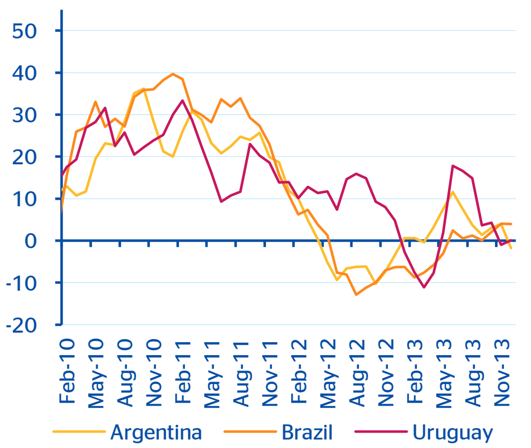
In Brazil the foreign deficit deteriorated significantly over the course of last year, affected to a large degree by worse terms of trade, some supply-side problems in the oil market and the loss of competitiveness in manufacturing (see box on competitiveness in the region, below), standing at around 3.7% of GDP. For 2014 the deficit is expected to remain high, at around 3.5%. In Chile the current account deficit has improved significantly over the previous estimates, from 4.6% of GDP, forecast three months ago, to 3% now. This is the main correction to foreign balance of trade forecasts in the region, and responds to factors such as a lower investment weight and a greater contribution by the foreign sector to growth, the latter partly as a consequence of greater currency depreciation and a slight adjustment to the upside over the previous estimate of the expected copper price, as mentioned above. In any event, the reduction which we had already anticipated in Chile's foreign deficit will come faster. In Colombia the current account deficit will stay at around 3%, a manageable figure in an environment where oil prices will remain high in the short term and imports have shown less elasticity to internal demand. For these effects we should also add the fact of mining companies' lower profits in 2013, which will determine a lower dividend flow abroad in 2014. In Peru the deficit will stay at around 5% of GDP in 2014 and exports will be particularly helped in the mining sector, thanks to the commissioning of mega projects in the sector this year. A current account surplus is expected in Paraguay of around 1%, reflecting recovery in the agricultural sector and higher export levels. For Mexico, a current account deficit of around 1.5% of GDP is expected in 2014, slightly higher than last year.

Chart 5.1
Pacific Alliance countries: exports (% YoY)



Source: BBVA Research and Haver Analytics

Chart 5.2
Mercosur countries: exports (% YoY)



Source: BBVA Research and Haver Analytics

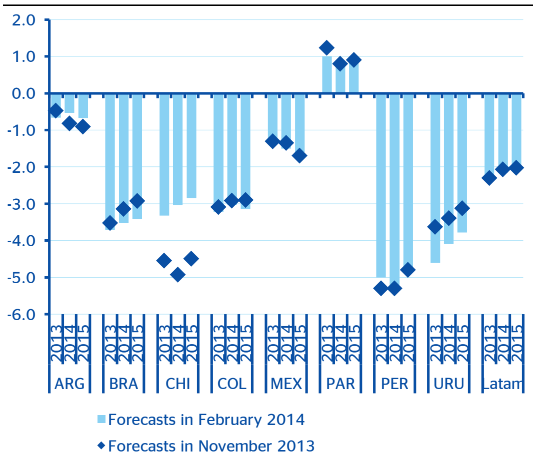
As we commented above, the recent moderation in export performance has been manifest both in the Andean countries and in Brazil. We estimate that this moderation is to a large extent a result of temporary shocks relating to ad-hoc supply side problems in Brazil, Peru and Colombia. We should point out, in any event, a shared medium-term risk of a loss of competitiveness in the region, after the progress shown up until the beginning of the 2008 global crisis, as per the analysis in Box 2.

Foreign deficit financing remains stable in the region through foreign direct investment flows, which narrows external vulnerability

Most Latin American countries finance their external deficit mainly through Foreign Direct Investment (FDI), particularly in tradable sectors. Brazil's and Uruguay's foreign deficits are greater than FDI, but in any case this covers most of the deficits. This long-term financing of foreign deficits considerably reduces the region's foreign vulnerability, which in fact is reflected in a lower exchange rate depreciation than that of other emerging economies with greater foreign funding needs based on short-term capital (see, for example, Chart 2.3). The fate of these FDI flows will remain closely linked to good output prospects for 2014 and 2015. Meanwhile, short-term capital inflows from non-residents continue to be positive in most countries, which supports the building up of international reserves.

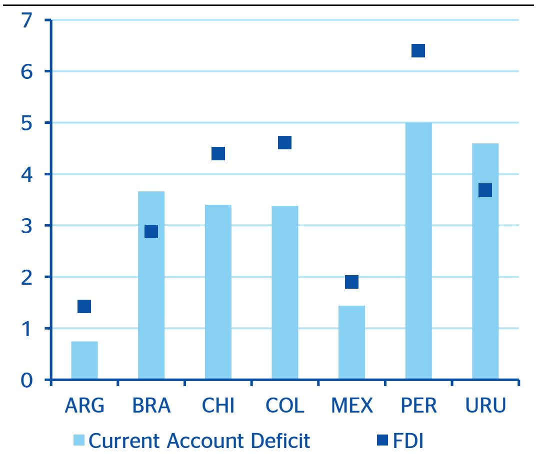
As the box in the previous quarter's Latam Economic Outlook: Structural external balances in Latam: what do they tell us about Current Account sustainability? shows, the structural current account deficit in the region will drop to less than 3% in the next few years. These deficits will remain stable or tend to close in the Andean countries and Uruguay, while they will tend to open up slightly in countries such as Argentina. An analysis of structural deficits and how they are expected to behave reveals that their expected levels are consistent with the estimated potential growth level and expected financial conditions, meaning that foreign financing is playing a significant role in development and greater productivity.

Chart 5.3
Latam Countries: Estimated current account deficit (% of GDP)



Source: National statistics and BBVA Research

Chart 5.4
Deficit on current account and FDI (latest data available,% GDP)



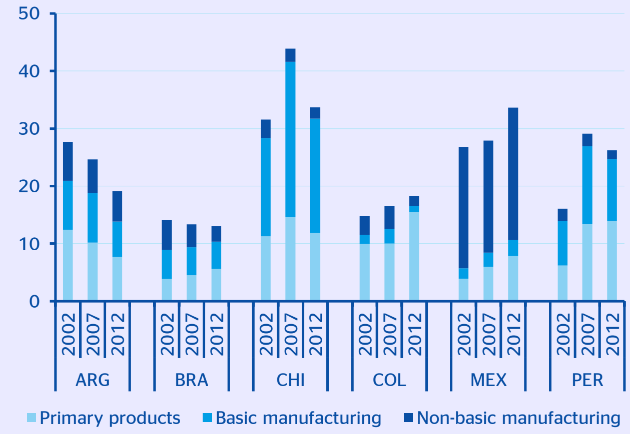
Source: Bloomberg and BBVA Research

Box 2. Manufacturing competitiveness in Latin America: recent setback after rising until 2007

Economic growth in Latin America in the last decade (Avg. 3.7% YoY), significant in historical terms and in comparison with other regions, has been accompanied in many countries in the region by an appreciation in real exchange rates, rises in wages and, in some cases, a rise in the level of taxation. This has led to a growing concern about a possible loss of manufacturing competitiveness in the region's economies, even though, on the whole, countries have also introduced reforms to improve the institutional environment and increase productivity.

International trade data show that the weight of primary product exports in GDP increased in practically all countries between 2002 and 2012, to a large degree because of historically high raw material prices. However, the weight of non-basic manufacturing has fallen (those which are less primary-resource intensive), with the sole exception of Mexico, which is the only country in the region in which these more advanced exports predominate (see Chart B.2.1). When it comes to basic manufacturing exports, more intensive in primary resources, their weight in GDP has gone down in some countries (Argentina, Brazil and Colombia) and increased in others (Chile, Mexico and Peru), although in all cases they have gone up in absolute terms at high rates in the last 10 years.

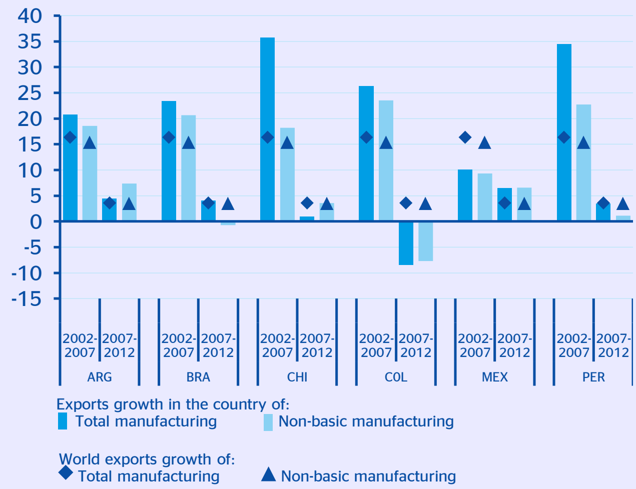
Chart B.2.1
Total exports (as % of GDP)



Source: WITS and BBVA Research

A standard competitiveness indicator based on trade data is the Revealed Comparative Advantage index. The RCA is calculated as the coefficient between the share of a sector in a country's exports and the share of this same sector in world exports. In this way an RCA over 1.0 indicates that the country has a comparative advantage in that sector, since the weight of the sector in the country is greater than the world average.

Chart B.2.2
Annual growth (%) of manufactured exports: Latam vs. world



Source: WITS and BBVA Research

All countries, with the sole exception of Mexico, reveal a comparative disadvantage in the exports of non-basic manufactured goods and, furthermore, the RCA of this group of products – considered as a whole – has fallen over the last decade, except in Argentina thanks to a large degree to the sale of transport equipment to Brazil (see Table B.2.1). Mexico, for its part, has a comparative advantage in non-basic manufactured goods and has gained competitiveness in most sub-sectors. In the remaining countries, those non-basic manufacturing sectors which have performed positively (with increases in RCA) are: transport equipment in Peru and Colombia, footwear and hats in Peru and chemicals and textiles in Brazil. In basic manufacturing we can see a more varied performance: four countries have a comparative advantage (Chile, Peru, Brazil and Argentina), while Colombia and Mexico reveal a relative disadvantage. Over the period analysed, some countries have gained competitiveness in these products (Chile, Brazil and Mexico), others have experienced losses (Peru and Colombia) and Argentina, for its part, is showing a marginal increase. RCA indicator data show in general a poorer performance in the second five-year period of the decade analysed.

Another competitiveness indicator is the gain or loss of world share a country has undergone in terms of the various products it exports. If we analyse manufacturing (basic and non-basic) as a whole, most countries had growth rates above the world average in the first half of the decade and below or practically the same as in the second half, which suggests competitiveness gains in the first years followed by a worsening (see Chart B.2.2). Mexico is an important exception to this general behaviour, since its manufacturing exports grew less than world exports up to 2007 and more in the last few years, as it started to recover competitiveness and share in the export market to the US, after the displacement it suffered at the beginning of the decade because of Chinese exports. Among those which followed the general pattern, Chile and Peru had the best performance in the first five years, and Colombia fell the most in the second. If we limit the comparison to non-basic manufacturing (less intensive in natural resources) we also see in most countries growth rates above the world average in the first period and lower, or similar, between 2007 and 2012.

Table R.2.1
Indicator of revealed comparative advantage (RCA) by sector and aggregate products

	Argentina			Brazil			Chile			Colombia			Mexico			Peru		
	2002	2007	2012	2002	2007	2012	2002	2007	2012	2002	2007	2012	2002	2007	2012	2002	2007	2012
Animals and animal products	3.4	4.1	3.4	2.7	3.5	2.7	4.9	3.7	4.2	0.6	1.1	0.2	0.3	0.4	0.5	1.3	1.1	1.1
Vegetable products	9.6	12.2	9.6	4.2	4.2	5.0	5.8	3.0	3.2	8.1	6.2	3.5	0.9	1.1	1.0	4.4	3.0	3.6
Food products	5.0	6.4	6.7	4.3	3.9	4.2	2.9	1.9	1.8	1.4	1.5	0.7	0.7	0.9	0.9	5.7	3.0	2.9
Mineral products	2.4	1.8	1.6	10.3	9.6	10.5	15.6	17.5	13.8	1.1	0.5	0.1	0.5	0.6	0.8	24.6	25.8	19.2
Fuels	2.0	0.9	0.5	0.4	0.5	0.6	0.2	0.1	0.0	4.3	2.7	3.5	1.0	1.1	0.7	0.7	0.6	0.6
Chemical products	0.6	0.6	0.9	0.5	0.6	0.6	0.7	0.4	0.6	0.7	0.6	0.2	0.3	0.3	0.3	0.3	0.2	0.2
Plastics and rubber	0.8	0.6	0.6	0.6	0.7	0.5	0.3	0.2	0.3	0.8	1.0	0.5	0.4	0.5	0.5	0.3	0.3	0.3
Hides and skins	4.0	3.4	2.4	2.1	2.3	1.4	0.2	0.1	0.1	1.4	1.4	0.6	0.2	0.2	0.2	0.3	0.2	0.2
Wood and wood products	0.5	0.6	0.5	2.1	2.1	1.8	3.7	2.8	3.2	0.7	1.0	0.2	0.2	0.3	0.3	0.7	0.5	0.4
Textiles	0.3	0.3	0.2	0.3	0.3	0.4	0.1	0.1	0.0	1.0	1.2	0.3	1.1	0.7	0.5	1.8	1.4	1.0
Footwear and headgear	0.1	0.1	0.1	2.8	1.7	0.7	0.1	0.2	0.0	0.2	0.5	0.0	0.2	0.2	0.3	0.1	0.1	0.1
Stone and glass	0.2	0.2	0.8	0.8	0.6	0.3	0.4	0.5	0.5	1.3	1.5	1.9	0.6	0.7	1.1	2.7	3.1	3.5
Metals	1.0	0.5	0.5	1.6	1.2	1.0	4.3	4.5	5.3	0.6	1.0	0.4	0.6	0.6	0.6	2.9	2.0	1.5
Machinery and electrical equipment	0.1	0.1	0.1	0.4	0.4	0.3	0.0	0.0	0.0	0.1	0.1	0.0	1.3	1.4	1.4	0.0	0.0	0.0
Transport equipment	0.5	0.9	1.6	0.9	1.0	0.8	0.1	0.1	0.0	0.2	0.3	0.3	1.6	1.7	2.4	0.0	0.0	0.0
Miscellaneous	0.2	0.1	0.1	0.3	0.2	0.2	0.1	0.0	0.0	0.1	0.2	0.1	1.3	1.2	1.3	0.1	0.1	0.0
Primary products	2.7	1.9	1.5	1.7	1.7	1.8	2.3	1.9	1.6	3.8	2.7	2.9	0.8	1.0	0.8	2.7	2.9	2.5
Basic manufacturing	2.4	2.4	2.4	2.9	2.7	3.2	4.6	5.0	5.4	0.8	1.0	0.4	0.5	0.6	0.6	4.3	4.1	4.0
Non-basic manufacturing	0.4	0.4	0.5	0.6	0.6	0.4	0.2	0.1	0.1	0.3	0.4	0.2	1.1	1.1	1.2	0.2	0.2	0.1

Source: WITS and BBVA Research

Taken in conjunction with a detailed analysis of national idiosyncrasies, competitiveness indicators based on international trade data allow us to conclude that after a really positive period, the manufacturing sector lost competitiveness in the second half of the decade. This recent deterioration, which was worse in Brazil and Colombia, is linked to currency exchange appreciation, pressures on labour costs and insufficient progress in productivity. The main exception to these regional tendencies is Mexico, where competitiveness gains in the manufacturing sector continued beyond 2007, partly because the exchange rate had gone down more and costs and labour productivity showed more positive performance than in South American countries. However, from 2011 onwards a reversal in these trends has been making it difficult to gain competitiveness in the Mexican manufacturing sector.

Although the exchange rate, costs and labour productivity were the main causal factors in how manufacturing competitiveness performed over the last decade in Latin America, the impact of the remaining variables was not inconsiderable: the results show that competitiveness earnings have been greater and competitiveness losses lower in those countries, such as Chile and Peru, which have succeeded in improving the institutional environment and have reduced or kept under control their logistics and energy costs.

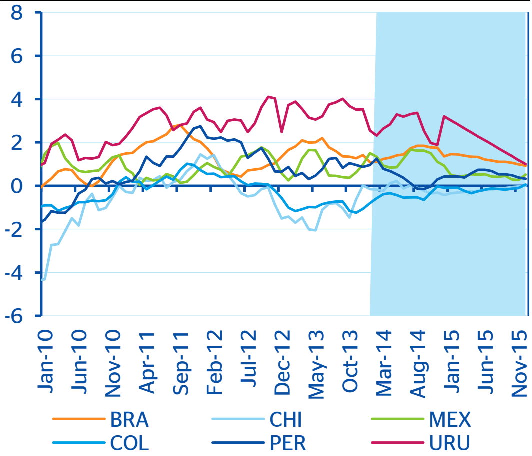
From here onwards, growth recovery in developed countries, although gradual, and the Federal Reserve's tapering may put an end to (or at least slow down) appreciation in the exchange rates of the region's currencies and the loss of competitiveness in manufacturing sectors. In this environment, a better institutional backdrop, more and better infrastructure, appropriate tax burdens and an increase in human capital through improvements in education and health will help to create margins for a new period of expansion in industrial competitiveness.

6. Differing monetary policies depending on cyclical outlooks and inflation

Inflation will converge in 2014 with central banks' targets: important exceptions in Uruguay and, to a lesser extent, Brazil

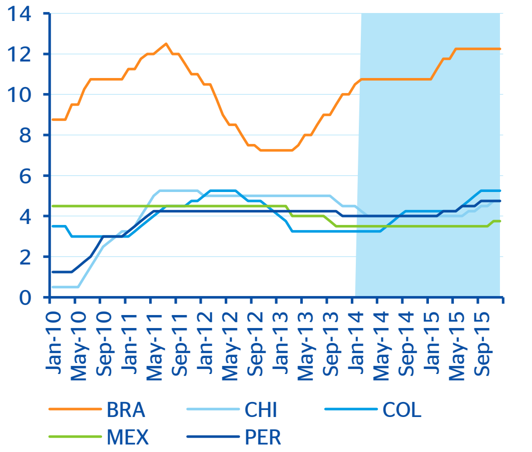
With the exception of Uruguay and Brazil, those countries in the region with inflation targets will see a gradual convergence towards central banks' targets over the course of 2014 (and, in the case of Mexico, in 2015), with little pressure on demand and the contribution of an expected moderation in international food prices. It needs to be said that we are expecting lower exchange rates to have some effect on inflation, although we estimate that the pass-through level is limited and, in any event, will be temporary (see Box 3 for more details). In this way, compliance with inflation targets will extend to these countries by 2015 (Chart 6.1), but pressure on inflation will remain in Brazil and – at somewhat more moderate levels than currently – in Uruguay.

Chart 6.1
Latam: deviation of inflation (% y/y) from the target of the Central Bank (pp.)



Source: National governments and BBVA Research

Chart 6.2
Latam countries: Official interest rates (%)



Source: Bloomberg and BBVA Research

In Chile, 2013 ended with inflation at 3%, in line with the central bank target, although with some surprises to the upside for the end of the year. By 2014, we estimate that inflation will remain contained as a result of lower wage pressures, a limited pass-through to prices (which on the whole has already happened) and international inflation under control, so that inflationary convergence is expected around levels of 2.6% for the end of the year.

Inflation in Colombia will slowly converge towards its 3% target. We should point out that deflationary surprises were seen in October and November, which even implied an adjustment to the downside of expected inflation for 2014. Influenced by these downside surprises, we believe that inflation will be throughout the year in the lower range of the central bank's target. This convergence is happening while the currency is depreciating which, in the context of the world economy recovering, will imply some inflationary pressures, particularly on tradable goods, although the impact of this is not expected to be high.

In Peru, although inflation closed last year within the central bank's target range, there are some signs of an exchange rate pass-through to prices, which has recently affected goods, particularly in the core basket. The cyclical slowdown expected for the next few months will tend to vanish demand pressures on prices: it should be noted here that we expect growth to converge towards its potential.

In Mexico, meanwhile, recent increases in the inflation rate have a major transitory component, linked to the tax reform, which includes new taxes on consumer goods (sugary drinks, food with high calorific content and fuels, among others). After this temporary effect, the inflationary trend ought to be to the downside from February onwards, helped by base comparison effects, and will close the year close to the upper bound of the range set by Banxico. In any event, we expect convergence with the central bank's target by 2015.

On the other hand, as we mentioned earlier, in the case of Brazil and Uruguay pressure will continue to weigh on inflation, which will remain above their central banks' core targets, although, in the case of Brazil, within the target range. In Brazil, although inflation has recently surprised to the downside, this moderation will be temporary. A more depreciated exchange rate, as well as the difficulties in keeping administered price inflation as low as in 2013 will imply an upward trend in inflation. As the analysis in Box 3 shows, although the pass-through rate is not one of the highest in the region, exchange rate depreciation has been one of the highest, which will heap more pressure onto inflation. Similarly, in Uruguay inflation will continue higher than the central bank's target (3-7%), partly as a result of the pass-through of an important share of the exchange rate depreciation to internal prices (Box 3), despite restrictive monetary policy efforts.

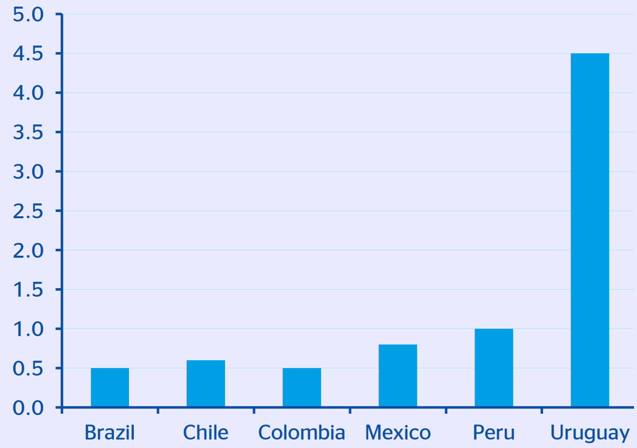
Box 3. Exchange rate pass-through to prices in Latam

Partly as a result of recent tensions, currencies in Latin American countries have been depreciating continually over the last 12 months. Specifically, the exchange rate has weakened by around 15% in the Andean countries and in Uruguay, somewhat less (around 5%) in Mexico, and significantly more so in Brazil (22%).

These depreciations in countries with flexible exchange rates, as well as the prospects of additional depreciation (see the section on exchange rates and the forecast table at the end of this report) may cause some concern over inflationary pressure throughout 2014.

In order to evaluate the impact on inflation, the exchange rate pass-through need to be looked at to measure to what extent a specific depreciation of the exchange rate is transferred to domestic prices.

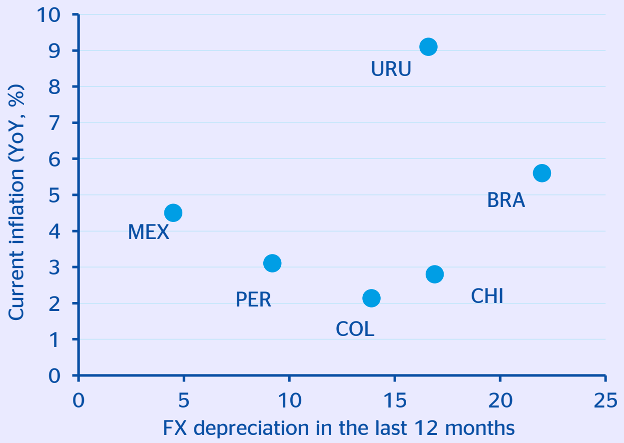
Chart B.3.1
Exchange rate pass-through ratio (impact on inflation of an exchange depreciation of 10%, in pp)



Source: BBVA Research and FMI

Economic literature suggests that the exchange rate pass-through to inflation has been dropping in recent years in Latin America as a result, amongst other reasons, of the effectiveness of monetary policies with inflation targets (see Colombia Economic Outlook, First Quarter 2014 for a review of the literature and more details on this subject). Our estimates indicate that the pass-through ratio in the region's countries is mainly in the range of 5% to 10%. That is, a depreciation of 10% in the exchange rate has an impact on inflation of between 0.5 and 1.0pp in a 12-month period (see Chart B3.1). The exception is Uruguay, with a pass-through of 4.5pp to inflation in the case of an exchange rate depreciation of 10%, as a result of a high inflation rate, with inflation expectations that are not anchored within the Central Bank's target range (between 3% and 7% starting from July this year), and heavy dollarization of the economy. Likewise in Peru, where the economy is also relatively highly dollarised, the pass-through ratio is significantly lower – although higher than in other countries in the region – due to the success of monetary policy in anchoring inflation expectation around a target of 2.0%.

Chart B.3.2
Inflationary risks: real inflation and exchange depreciation over the last 12 months (%)



Source: BBVA Research and Haver Analytics

Bearing in mind that, with the exception of Uruguay, pass through coefficients are at fairly low levels, the impact of movements in the exchange markets will depend above all on how much each currency depreciates and on current inflation levels. Chart B3.2 shows that in Mexico, where inflation is slightly above the target range, exchange rate depreciation has been small. In the Andean countries, where depreciation has been rather stronger, inflation is at low levels (both in absolute terms and when compared with the target). The most clearly unfavourable situation is that of Brazil and Uruguay, where inflation is still very high and depreciation has been very strong.

Thus, the effect on inflation of exchange rate depreciations ought to be limited in general and easily absorbable within central banks' target bands. The exceptions are Brazil and Uruguay, where the degree of depreciation and the already high inflation means that this is an additional shock in a situation with major pressures on internal prices, despite monetary tightening in the last few quarters.

Inflationary pressures will condition monetary tightening in Brazil and Uruguay. Different cyclical positions will trigger a rise in interest rates in Colombia in 2014, stability in Peru and Mexico and drops in Chile

The remaining high inflation in Brazil and Uruguay will mean that policy rate hikes will continue in the short term in the case of the former, and the contractive tone will be maintained in the latter. In Brazil, recent surprises to the downside in inflation and output will contribute to leading the BCB to raise interest rates 25bp at its February meeting (and not 50bp, as at previous meetings) after which we expect stability in rates provided that the balance of risks allows it (Chart 6.2). By 2015, and after the elections, interest rate hikes in Brazil will resume, conditioned by keeping pressure on inflation and by the beginning of the increase in interest rates by the US Federal Reserve. In Uruguay, meanwhile, growth will continue at around its potential (3.75% in the next few years) and inflation, still well above the Central Bank's target range, will condition the contractive tone for monetary policy over the next two years.

The remaining countries with inflation targets (those in the Pacific Alliance) will each pursue their separate courses, depending on their differing positions in the economic cycle, but they will converge on a range of official interest rates between 3.5% and 4.25% by the end of 2014, in marked contrast with interest rates of over 10% in Brazil, a difference which is also reflected in a major divergence between the ex-ante real interest rates between Brazil (around 5%) and countries in the Pacific Alliance, where they stand between 0% and 2% (Chart 6.3). Just as in Brazil, but generally less aggressively, in 2015 there will also be interest rate rises in the Pacific Alliance countries – especially in the three Andean countries – in line with their cyclical strength and in the context of the above-mentioned increase in US interest rates. The Andean countries will continue with their adjustments until they reach their neutral interest rates towards the end of 2015, provided that the product gap closes and inflation stands around the central banks' targets.

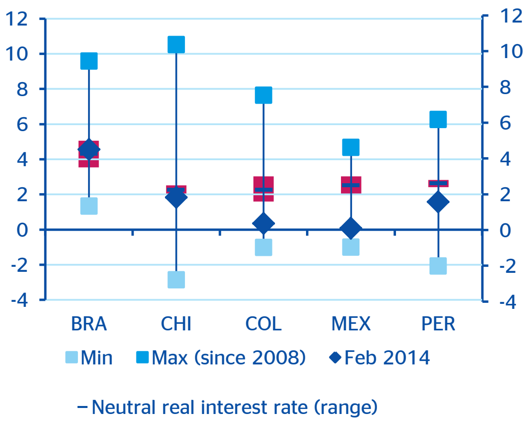
In Mexico, as long as no second-round effects in inflation take place and there is no significant depreciation going forward, better output prospects in a still expansive context in the economy will influence Banxico to continue with the moderately restrictive tone of its communications, designed to anchor inflationary expectations by keeping the monetary pause extended until the first interest rises at the end of 2015.

In Chile we expect the central bank to cut interest rates by 25bp at their February meeting and to be dependent on the data afterwards, but with a bias to continuing with the easing cycle, consistent with the base scenario (the cycle would have to take the rate to 4% by the end of the year). For 2015, monetary policy will have to approach a process of normalisation towards neutral levels of 5.25-5.75%, as long as the economy is close to its growth potential and inflation converges with the central bank's target.

In Colombia, unlike the situation two months ago, we believe that the lower-than-expected inflation to the end of the year, as well as the dynamics of activity, have implied for the central bank the possibility of postponing the first monetary rate rise until June, when it will raise it by 25bp to begin a cycle which will take it up to 4.25% (from its current 3.25%) at the end of the year. We believe that this cycle will continue to 2015, when it will be approaching the estimated neutral rate of 5.25%, thanks to the closing of the product gap towards the end of 2015.

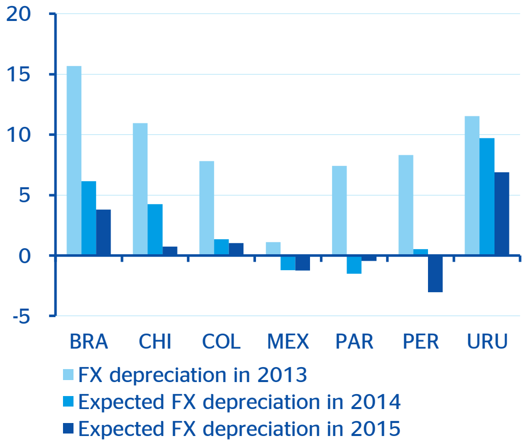
The Central Bank of Peru lowered its reserve requirements for PEN, effective from February, keeping the benchmark rate at 4%. Insofar as we estimate that growth will continue around its potential and that inflation will converge gradually towards the central bank range, we believe that the reference rate will stay at the same level. Should some stimulus from the monetary side be necessary, the central bank will opt to continue reducing its reserve requirements in the next few months, without altering interest rates.

Chart 6.3
Latam countries with inflation targets: real official interest rates*



* Nominal interest rates minus year-on-year inflation observed 12 months afterwards. For the November observation the 12 month inflation forecasts are used.
Source: Bloomberg and BBVA Research

Chart 6.4
Latam countries: Exchange rate depreciation (% y/y, end of period)



Source: Bloomberg and BBVA Research

Gradual withdrawal of quantitative easing by the Fed ought to reduce volatility in the region's exchange rates, at the same time as contributing to a slight depreciation in most countries in the region

Exchange rate movements in the 2014-15 period will be influenced in the first place by how the Fed's tapering process goes. Even so, provided that this withdrawal is gradual and orderly, it ought to generate only slight pressures on exchange rate depreciation, as a good part of tapering's effects has already been priced into the region's exchange rates. A further factor putting depreciation pressure on rates will come from possible idiosyncratic events in the main emerging economies, which will increase international investors' risk aversion. In addition, some economies' continuing high external deficits will also be an adjustment factor, although these will already be declining by 2014 and 2015, as well as the downward price curve on raw materials such as copper and soybeans.

In Brazil, depreciation will tend to be higher than in the rest of the region (Chart 6.4), which reflects the lack of progress in reforms to foster productivity and competitiveness, weakness in growth, higher inflation rates and the impact of exchange rate depreciation in Argentina (Box 2). Likewise, in Uruguay depreciation will also be significant in 2014 and 2015 due to pressures on the effective real exchange rate, as a result of the depreciation in key trading partners such as Brazil and Argentina, as well as higher inflation than its neighbours.

Exchange rates in Andean countries will remain relatively stable in 2014 and 2015, with the possible exception of Chile, where the exchange rate will be clearly influenced by the expected downward curve in the copper price. Going forward, concerns about the generalisation of the crisis in emerging economies will gradually vanish, and all three countries' good fundamentals will start to be recognised. The same will happen in Mexico, where after the recent depreciation we expect a certain degree of appreciation from 3Q14 onwards, in line with the country's strengthening cycle.

7. Latin America has buffers to withstand the Fed's tapering

The region has made a lot of progress in reducing its vulnerability to external shocks, both in flows and in stocks

As a result of the Fed merely talking in May about the start of tapering in the US, emerging countries - and Latin America was no exception – saw a loss of interest from international investors, on the expectation of lower global liquidity.

In this context, the voice of alarm has been raised about the supposed fragility of Latin America in the event of a reduction in short-term capital inflows. It is true that in general we have seen an increase in current account deficits in the last few years, particularly in South America (Chart 5.3). However, there is a series of factors which significantly reduces most countries' vulnerability to the onset of tapering. Without a doubt, the region is in a very different position from the one it was in when it had to deal with the crisis in the Asian emerging economies in 1998.

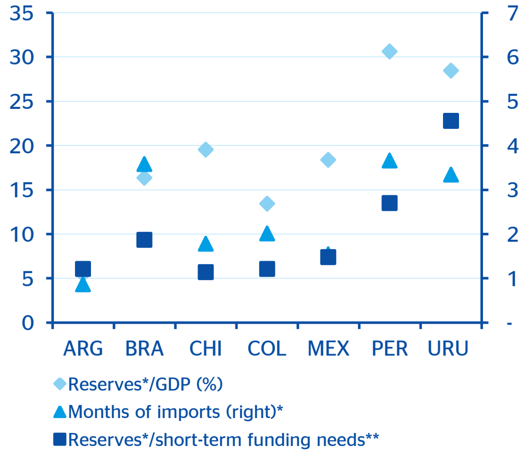
First, as we mentioned in section 5, we should bear in mind that many of the current account deficits in the region have been the result, above all, of an increase in non-resident investment, rather than an uptick in consumption, which means a greater production capacity in the future and that these deficits are more sustainable.

Furthermore, our forecasts point to a downward trend in these deficits between this year and the next, particularly in those countries with a more pronounced deficit, as in the case of Peru and Uruguay (Chart 5.3). For example, in Peru, the current account deficit (5% of GDP in 2013, the biggest in the region) has been conditioned by investment in mining projects which, when they start to operate, will contribute to an increase in exports and the reduction of those foreign deficits down to 3% of GDP in the medium term, levels that are clearly manageable. The situation is similar in Uruguay, where exports will start to gain momentum with the commissioning of one of the biggest paper-pulp production plants in the world, which will add up to 2pp to GDP in exports.

Second, as we mentioned in section 5 and as Chart 5.4 shows, short-term capital inflows are not at this stage essential in covering current account deficits in the region, which are wholly financed with FDI — although in Brazil these FDI flows are in a downward trajectory in the context of a lack of progress in the reform agenda. We should remember that FDI is intrinsically less volatile that the portfolio flows in the face of turbulence on international markets, such as the episodes seen since May 2013. Even so, as we mentioned in section 2, after the Fed began the debate about starting its tapering that same month, capital inflows into Latin America have weakened, but there has been no net capital outflow by non-residents, with the notable exception of Brazil in the past few months, which is also the country with the weakest macroeconomic fundamentals among the countries most involved in international financial markets.

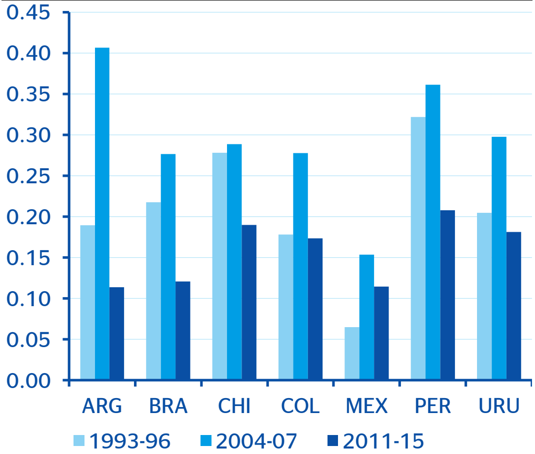
Third, the region has also reduced its vulnerability in terms of stocks. Those countries in the region which are integrated in international financial markets have high levels of international reserves, according to the most commonly used vulnerability metrics (Chart 7.1). These are complemented, in some cases, with flexible IMF funding lines (Colombia and Mexico), sizeable sovereign funds (Chile and Peru) and even major residents' portfolio investments overseas (pension funds). At the same time, public sector debt has been substantially reduced, below 40% of GDP (Chart 4.12), as well as private sector debt. Similarly, a good part of public and private borrowing is carried out in local currency, so currency mismatches are much lower. We should not forget that banking systems in emerging economies are now much more solid than 15 years ago, which enables them to act as buffers instead of extending the shocks in the real sector.

Chart 7.1
Indicators of Foreign Reserve Adequacy



* International reserves include IMF FCL lines in the case of Colombia and Mexico and sovereign funds in the case of Chile.
** The need for short-term financing is the sum of the deficit on current account in 2014, short-term debt and long-term debt maturities in 2014.
Source: Haver, national statistics and BBVA Research

Chart 7.2
Investment efficiency in Latam: Percentage points of growth per point ratio Investment / GDP



Source: BBVA Research and FMI

What is more, a floating exchange rate has already served as an initial buffer against an external shock

It must be said that the reduction in capital inflows into Latin America as a result of tapering has had negative effects on the region's asset prices and on exchange rates, but that is very different from a scenario of foreign unsustainability. The key difference is that the countries in the region which are active on international financial markets have a flexible exchange rate, which acts as the first shock absorber in softening the effects of international financial turbulence on local economic output, something they did not have during the external crises in the eighties. Here the reduction in mismatched dollar positions, whether held by the private sector or governments, has been key (even in countries which still have high dollarization, such as Peru and Uruguay). This reduction in foreign currency mismatched means that exchange rate depreciation generates a stimulus in net exports and economic activity without this positive effect being outweighed, as would have happened thirty years ago, by the negative effect on the wealth of families and companies which were mainly indebted in foreign currency.

So the recent depreciation in exchange rates and asset price correction in these countries can be interpreted as a sign that these buffers are working. Therefore, maintaining exchange rate flexibility (with the option of a degree of intervention in order to mitigate volatility, but not the underlying trends) ought to remain the main line of defence against an external shock.

Less expansive financial conditions will focus attention on the difference in fundamentals between emerging economies. This means that second generation reforms need to continue

It is encouraging that nearly two months after the Fed started tapering in earnest, we have not seen abrupt changes in capital inflows in the region and the markets remain open, with investors' interest in sovereign and corporate issues. Going forward, the region will be facing less favourable financial conditions because of the withdrawal of the Fed's financial stimulus and the downward correction of commodities prices, but both these and sovereign and corporate spreads will continue being clearly benign in historical comparison.

However, tighter financial conditions will mean that international financial markets focus more clearly on macroeconomic fundamentals and their outlook in the future. In terms of the first point, as we have commented in earlier sections, Brazil appears, among those countries which are financial integrated, as the country with the least robust fundamentals, with an exhaustion of its growth model based on driving consumption and credit, and little room for manoeuvre for expansive policies, given the pressures on inflation. The Pacific Alliance countries, meanwhile, will have to continue showing solid fundamentals and economic policies which will keep capital flowing in.

Altogether, the outlook for the future will depend on progress made in the reform process, essential if supply-side tightness is to be freed up in the medium term and to ensure sustained per capital income growth in the long term. We have already mentioned in previous issues of Latam Economic Outlook that it is essential to maintain productivity growth in order to ensure per capita growth in the long term. Another way of looking at the region's risk of a slowdown is through the reduction in the ability of investment to generate growth. As we can see in Chart 7.2, the forecasts indicate that it will be increasingly difficult to grow at the same speed with the same capital accumulation rate, given lower population growth and low productivity growth. This is why it is essential that the region drives forward its second generation reforms (that is, going beyond the fiscal and monetary policy reforms of the nineties) in order to generate a productivity increase through a savings rise which funds the necessary investment in physical capital (infrastructure in particular) and human capital (education and health).

8. Tables

Table 8.1
GDP (% y/y)

	2011	2012	2013*	2014*	2015*
Argentina	8.9	1.9	5.1	2.8	2.1
Brazil	2.7	1.0	2.2	2.5	1.9
Chile	5.9	5.6	4.0	4.0	4.5
Colombia	6.6	4.2	4.1	4.7	5.1
México	4.0	3.7	1.2	3.4	3.0
Paraguay	4.3	-1.2	13.4	5.3	4.2
Peru	6.9	6.3	5.0	5.6	5.9
Uruguay	6.5	3.9	3.7	3.5	3.6
Mercosur	3.4	1.3	2.2	1.5	1.8
Pacific Alliance	4.8	4.2	2.3	3.8	3.7
Latin America	4.0	2.6	2.2	2.5	2.6

* Forecast.
Source: BBVA Research

Table 8.2
Inflation (% yoy. average)

	2011	2012	2013	2014*	2015*
Argentina	9.8	10.0	10.6	16.0	21.3
Brazil	6.6	5.4	6.2	6.0	5.7
Chile	3.3	3.0	1.8	2.9	2.8
Colombia	3.4	3.2	2.0	2.6	2.8
México	3.4	4.1	3.8	4.3	3.4
Paraguay	8.3	3.7	2.7	4.8	4.9
Peru	3.4	3.7	2.8	2.4	2.5
Uruguay	8.1	8.1	8.6	8.5	6.3

* Forecast.
Source: BBVA Research

Table 8.3
Exchange rate (against USD, average)

	2011	2012	2013	2014*	2015*
Argentina	4.13	4.55	5.48	8.99	12.17
Brazil	1.68	1.96	2.18	2.45	2.57
Chile	484	486	495	548	554
Colombia	1848	1798	1869	1933	1977
México	12.4	13.2	12.8	12.9	12.7
Paraguay	4188	4417	4312	4515	4513
Peru	2.75	2.64	2.70	2.80	2.75
Uruguay	19.2	20.2	20.5	22.6	24.5

* Forecast.
Source: BBVA Research

Table 8.4
Interest Rate (%, average)

	2011	2012	2013	2014*	2015*
Argentina	13.3	13.8	16.9	30.6	30.8
Brasil	11.7	8.5	8.4	10.7	12.0
Chile	4.8	5.0	4.9	4.1	4.3
Colombia	4.1	4.9	3.4	3.7	4.7
México	4.5	4.5	3.9	3.5	3.5
Paraguay	8.5	6.0	5.5	5.9	6.0
Peru	4.0	4.3	4.2	4.0	4.4
Uruguay	19.0	18.6	16.8	16.9	15.4

* Forecast.
Source: BBVA Research

Table 8.5
Current Account (% GDP)

	2011	2012	2013*	2014*	2015*
Argentina	-0.5	0.0	-0.7	-0.5	-0.7
Brazil	-2.1	-2.4	-3.7	-3.5	-3.4
Chile	-1.3	-3.5	-3.3	-3.0	-2.8
Colombia	-2.9	-3.3	-3.2	-3.0	-3.1
México	-0.9	-1.0	-1.3	-1.5	-1.6
Paraguay	1.1	1.6	1.0	0.8	0.9
Peru	-1.9	-3.3	-5.0	-5.2	-4.8
Uruguay	-2.9	-5.3	-4.6	-4.1	-3.8
Mercosur	-0.6	-1.4	-2.3	-2.1	-2.0
Pacific Alliance	-1.3	-1.8	-2.1	-2.2	-2.2
Latin America	-0.9	-1.6	-2.2	-2.2	-2.1

* Forecast.
Source: BBVA Research

Table 8.6
Fiscal balance (% GDP)

	2011	2012	2013*	2014*	2015*
Argentina	-1.6	-2.3	-2.0	-1.9	-1.8
Brazil	-2.6	-2.5	-3.2	-3.8	-3.2
Chile	1.3	0.6	-0.6	-1.2	-0.9
Colombia	-2.9	-2.3	-2.4	-2.3	-2.1
México	-2.7	-3.2	-2.9	-4.1	-3.6
Paraguay	0.7	-1.4	-0.9	-0.5	-0.4
Peru	2.0	2.1	0.4	-0.2	-0.2
Uruguay	-0.9	-2.8	-2.3	-2.6	-2.7
Mercosur	-2.5	-2.7	-3.1	-4.1	-2.9
Pacific Alliance	-1.9	-2.2	-2.3	-3.2	-2.8
Latin America	-2.2	-2.5	-2.7	-3.7	-2.9

* Forecast.
Source: BBVA Research

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