1 Overview

We have revised our world growth forecast for 2015 to 3.5%, 0.1pp less than predicted in February, whereas we have raised our estimate for 2016 a shade to 3.9%. The downward revision for 2015 is to a large extent because of the slowdown in world growth in 1Q, the brief slowdown in the United States, and the decline in activity in certain key emerging markets. In a scenario of gradual, trend slowdown in China, the emerging economies should reverse their current deceleration thanks to the pull effect from the developed economies, the slow but sure rise in commodity prices, and a potentially more restrained rate hike than in previous Fed normalisation processes.

The volatility in the region's financial markets continued, strongly influenced by the revisions to forecasts regarding the start of the Fed's rate hike. Prices of the major financial assets and interest rates continued to weaken until mid-March, when they began to tick up again (without fully making up the lost ground) as the belief took hold that the Fed's rate adjustment would be later and more gradual than was anticipated coming into the year. Looking ahead, the volatility in financial markets will continue as activity and employment figures in the United States go on altering expectations concerning the beginning of the Fed rate hikes.

Meanwhile, commodity prices have stayed at modest levels, with one or two upturns in oil and copper. Part of the price rises related to supply fundamentals, but they were also influenced by a bit of dollar depreciation at the start of 2Q, in line with the other financial assets in the region.

In a context of virtually general weakness in the confidence indicators, we have revised our growth forecasts for Latin America downwards, to 0.6% in 2015 and 2.1% in 2016. The downward revision has been brought about by i) lower-than-expected growth in 4Q14 and 1Q15; ii) the decline in household and business confidence, caused by an escalation of political ructions and uncertainty over the economic policies in a number of the region's economies, which has weighed on private-sector consumption and investment, and iii) the fall in public expenditure in certain major economies in the region, such as Brazil, Mexico, Colombia and Peru. The increase in LatAm growth in 2016 should be driven by i) dynamic external demand in step with the increase in world growth; ii) the boosting of public investment, especially among the Andean economies, and iii) a milder macroeconomic adjustment in larger economies such as Brazil.

By countries, the downward revision to 2015 growth forecasts is concentrated in particular among Brazil, Mexico and Peru, although it affects almost all of the region's economies. In Brazil, the lower growth forecast (-1.3pp in 2015, to -0.7%) arises due to a stronger-than-expected macroeconomic adjustment, higher inflation and uncertainty overshadowing the crisis affecting Petrobras. The sharp shift in Brazil's growth should have a significant spill-over effect, basically on Argentina, Paraguay and Uruguay, although this will be minimal in relation to the other economies in the region (Box 1). Besides Brazil, the downward revisions to forecasts are also very substantial for Mexico (-1pp, to 2.5%, partly from the oil price slide, the weak 1Q growth in the United States, and the public expenditure adjustment) and Peru (-1.7pp to 3.1%, hindered by low confidence and delays in public investment).

Unevenness will continue to prevail in the region and it will still be the Andean countries and Paraguay which grow the most in 2015 and 2016. The Pacific Alliance will carry on growing at 2.7% in 2015, much as it did the previous year, and growth will then increase to 3.2% in 2016, above the regional average, although below its potential, which we estimate to be slightly over 4%. Notable above other cases will be the surge in growth in Peru and Chile over 2014-16, at rates of 2.2pp and 1.6pp respectively (see the tables of forecasts in section 9).

Inflation rose in the region in spite of the cyclical weakness, but it should come back to central bank target levels at the end of 2015 or 2016, except in Brazil and Uruguay (although it will be within the target range in Brazil). With the exception of Mexico, inflation at the end of 1Q was above our estimate of one year ago and also three months back, due to the currency depreciation (especially in Peru and Chile) as well as idiosyncratic factors, which include tax hikes (Chile, Brazil), the rise in administered prices (Brazil), food price shocks (Peru and Colombia) and inertia-related factors (Uruguay and Brazil).

Despite the cyclical weakness, the window of opportunity is closing up for a cut in interest rates by the Andean central banks given the persistence of inflation (and in Peru, the exchange-rate volatility). This means that instead of the interest rate cuts in the Andean countries which we were counting on three months ago, the most likely occurrence if that rates will be kept at current levels until at least mid-2016. With respect to Brazil, the inflation shocks and the need to restore the credibility of monetary policy will force a larger-than-expected rate hike. In conclusion, given the synchronisation of activity in Mexico and the United States we still anticipate a rise in Mexican rates that shadows the course taken by the Fed very closely.

On the other hand, the depreciation pressure on the currencies will continue due to the uncoupling of the Fed rate with hikes and still sizeable external deficits. The recent currency depreciation in the region (only slightly corrected by dollar weakness since April) has arisen in spite of exchange rate intervention by some economies in the region (Peru). Looking ahead, currency markets will continue to be very much conditioned by the Fed's monetary policy normalisation strategy and movements in commodity prices, which suggests to us that further spells of volatility are highly likely. Despite some occasional currency appreciation in certain countries (mainly in Chile and Colombia), partly due to greater support from copper and oil prices, in many cases currency depreciation will persist over the forecast horizon, particularly in Brazil, Peru and Paraguay.

The low prices of the main export commodities will keep external deficits at high levels in the region. External balances will continue to show deficits (except for Chile and Paraguay), although there will be a certain narrowing of deficits in Peru, Uruguay and Brazil due to currency depreciation and domestic demand weakness. Even so, these factors in Colombia and Mexico ought not to be enough to counteract the effect of the fall in the oil price. In spite of the lower weight of foreign direct investment (FDI) as a source of financing to plug the external deficit, in general the region's vulnerability to the world outside remains limited.

Prospects for fiscal balances are still unchanged with respect to the situation three months ago, except as regards Brazil, where the public deficit is likely to be significantly larger than expected. The increase in the forecast for the public deficit in Brazil in 2015 (from an estimated -4.4% in January to -5.6%) is despite the bigger macroeconomic correction underway and partly because of the deterioration in forecast growth as well as the rise in interest rates on debt.

DISCLAIMER

This report has been produced by the LatAm Co-ordination unit.

Chief Economist
Juan Ruiz
juan.ruiz@bbva.com

Enestor Dos Santos
enestor.dossantos@bbva.com

Cecilia Posadas
c.posadas@bbva.com

Pablo Urbiola
pablo.urbiola@bbva.com

Alejandro Faci
alejandro.faci@bbva.com

Argentina
Gloria Sorensen
gsorensen@bbva.com

Chile
Jorge Selaive
jselaive@bbva.com

Colombia
Juana Téllez
juana.tellez@bbva.com

México
Carlos Serrano
carlos.serranoh@bbva.com

Perú
Hugo Perea
hperea@bbva.com

Venezuela
Oswaldo López
oswaldo.lopez@bbva.com

With the contribution of:

Economic Scenarios
Julián Cubero
juan.cubero@bbva.com

Rodolfo Mendez Marcano
rodolfo.mendez@bbva.com

Cross-Country Emerging Markets Analysis
Gonzalo de Cadenas
gonzalo.decadenas@bbva.com
+34 606 001 949

BBVA Research

Group Chief Economist
Jorge Sicilia Serrano

Developed Economies Area
Rafael Doménech
r.domenech@bbva.com

Spain
Miguel Cardoso
miguel.cardoso@bbva.com

Europe
Miguel Jiménez
mjimenezg@bbva.com

US
Nathaniel Karp
Nathaniel.Karp@bbva.com

Emerging Markets Area
Alicia García-Herrero
alicia.garcia-herrero@bbva.com

Cross-Country Emerging Markets Analysis
Alvaro Ortiz
alvaro.ortiz@bbva.com

Asia
Le Xia
le.xia@bbva.com

Mexico
Carlos Serrano
carlos.serranoh@bbva.com

LATAM Coordination
Juan Manuel Ruiz
juan.ruiz@bbva.com

Argentina
Gloria Sorensen
gsorensen@bbva.com

Chile
Jorge Selaive
jselaive@bbva.com

Colombia
Juana Téllez
juana.tellez@bbva.com

Peru
Hugo Perea
hperea@bbva.com

Venezuela
Oswaldo López
oswaldo.lopez@bbva.com

Financial Systems and Regulation Area
Santiago Fernández de Lis
sfernandezdelis@bbva.com

Financial Systems
Ana Rubio
arubiog@bbva.com

Financial Inclusion
David Tuesta
david.tuesta@bbva.com

Regulation and Public Policy
María Abascal
maria.abascal@bbva.com

Recovery and Resolution Strategy
José Carlos Pardo
josecarlos.pardo@bbva.com

Global Coordination
Matías Viola
matias.viola@bbva.com

Global Areas

Economic Scenarios
Julián Cubero
juan.cubero@bbva.com

Financial Scenarios
Sonsoles Castillo
s.castillo@bbva.com

Innovation & Processes
Oscar de las Peñas
oscar.delaspenas@bbva.com

Contact details:

BBVA Research
Paseo Castellana, 81 – 7th floor
28046 Madrid (Spain)
Tel.: +34 91 374 60 00 and +34 91 537 70 00
Fax: +34 91 374 30 25
bbvaresearch@bbva.com
www.bbvaresearch.com