

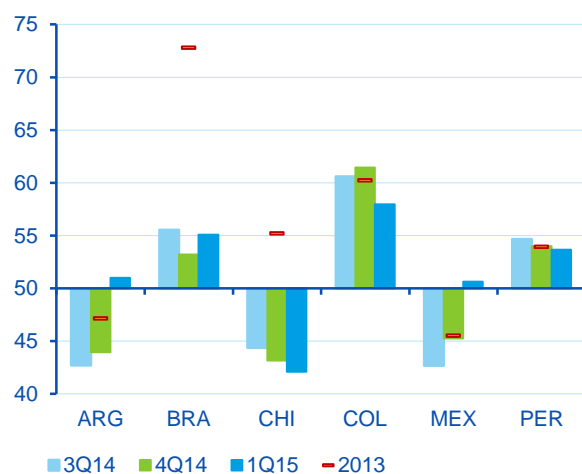
4 Latin America's growth will remain low in 2015 and pick up in 2016, yet it will still remain below potential

Private-sector domestic demand continues to flag, dogged by poor confidence indicators

The region's confidence indicators continued to point to pessimism over the first quarter of the year, particularly from the standpoint of producers. In Brazil, Mexico and Peru, producer confidence took a notable turn for the worse coming into the year, while in Chile, Colombia and Peru this happened too among households (see Figures 4.1 and 4.2). Among the factors behind such gloomy sentiment are i) the increase in political ructions in certain countries, ii) uncertainty with regard to economic policies, including reform processes in some economies, and iii) the cyclical decline, with an impact on the prospects for disposable income and returns on investment, which are to a large extent influenced by a less bright external environment, where a key factor has been the drop in commodity prices. On the other hand, it is worth mentioning the cases of Argentina and Mexico at this point, where consumer confidence has improved considerably in recent quarters (and even significantly since 2013 in Argentina), and Brazil, where it is holding relatively unchanged, though far below the levels of 2013. Looking at business confidence, this has improved in Colombia, and although it has in Chile too, it is still in pessimistic territory.

Figure 4.1

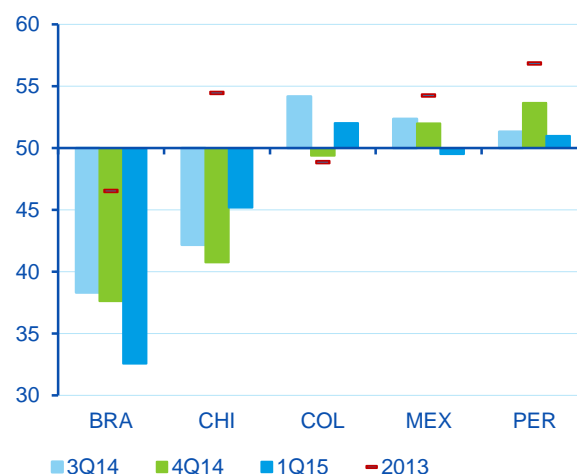
LatAm: consumer confidence
(levels over 50pts indicate optimism)



Source: BBVA Research and national statistics

Figure 4.2

LatAm: producer confidence
(levels over 50pts indicate optimism)



Source: BBVA Research and national statistics

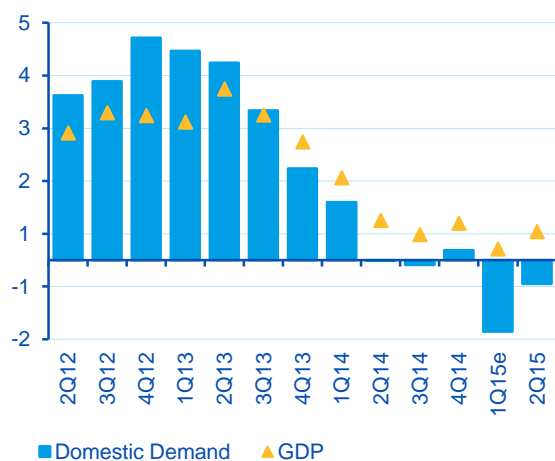
On the other hand, there was a notable YoY contraction of domestic demand in 1Q, which is something that has been influential in the substantial slowdown in GDP: from YoY growth of 1% for domestic demand in the region in 4Q14, we estimate that this has sunk to -0.1% in 1Q15 (see Figure 4.3).

This slowdown in domestic demand has been particularly significant in investment (see Figure 4.4), a component which strayed from its path of recovery in early 2015, as a result of the sluggishness at large, especially in the Andean countries and Mexico. In Chile the waning investment there has been associated with transitory factors linked to the stormy weather in the north of the country in March, as well as lower private investment, partly on account of the uncertainty surrounding the process of approving the reforms.

Furthermore, the slowdown in the mining cycle associated with the lower copper price, among other factors, has not been made up for by the increased investment in other tradable sectors. In Colombia, Mexico and Peru the main problem has been the poor level of execution of public investment in addition to the lethargic recovery of industry in spite of currency depreciation. In Peru's case, as with Chile, the correction of the copper price has also slowed the mining investment cycle. In terms of private investment, certain economic agents are likely to have brought forward a portion of the investment planned for 2015 to 4Q14, thereby avoiding higher future costs of imported assets. With respect to public investment Peru stands out, as this item contracted by around 25% YoY in the first quarter of the year, while private investment dropped 3.9%, which marked the fourth quarter in a row of setbacks.

Figure 4.3

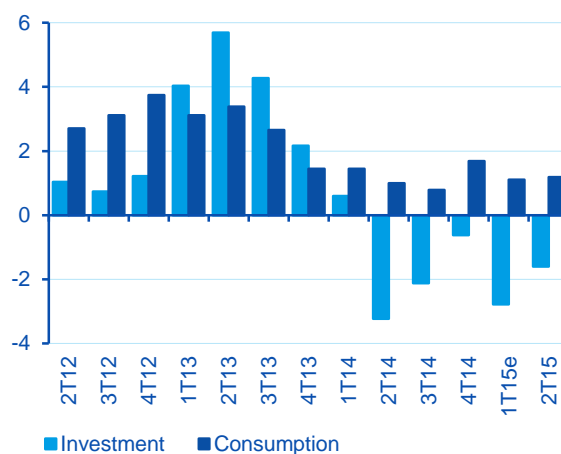
LatAm: GDP and domestic demand (% var. YoY)



Source: BBVA Research and national statistics

Figure 4.4

LatAm: investment and private consumption (% var. YoY)



Source: BBVA Research and national statistics

Meanwhile private consumption has kept up modest growth in recent quarters, showing 1.2% in 2014, which was below the average of 2.7% for the region in 2013, plagued by the lower confidence levels (Brazil, Chile) and labour market weakness (Brazil, Chile, Mexico), which, in combination with the high inflation level in Brazil, have undermined household disposable income.

There are, however, major differences among the regions, which has been the consistent factor in the last few quarters: whereas for the Pacific Alliance countries domestic demand will show growth of about 1.6% YoY for 1Q15, for the Mercosur economies this will be a fall of around 2.3% YoY. This difference for the domestic demand indicators is a determining factor in expected GDP growth for 1Q, which we estimate was 0.2% for the region on aggregate, -1.7% in the Mercosur block (although there was growth in Uruguay and Paraguay) and 2.5% in the block comprising the Pacific Alliance countries (see Figure 4.8).

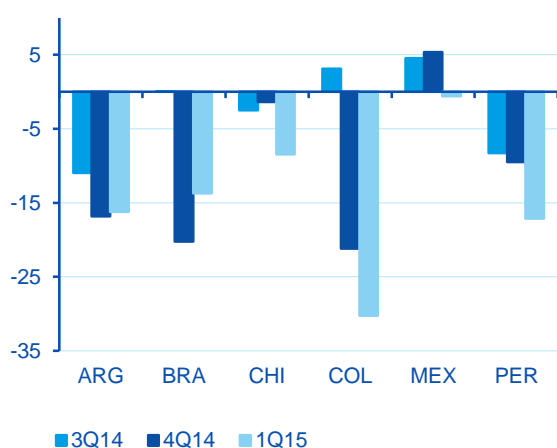
Exports have suffered from the impact of the fall in commodity prices, although one or two supply-side shocks still persist as well

Export indicators continued to slip back in 1Q15 with respect to the previous year, to a large extent caused by the lower prices of key exports, especially commodities (see section 3). This trend was intensified in Chile, Peru and, conspicuously, Colombia, while in Mexico manufacturing exports failed to offset the nosedive in oil exports, which made the overall variation for exports slightly negative (see Figure 4.5). Colombia, Mexico and Brazil were especially hit by the 1Q deterioration in their terms of trade. With respect to Brazil, foreign sector weakness fuels the same situation in Argentina, and vice versa successively, despite the depreciation in their currencies.

In Peru and Chile, supply-side problems which began in 2014 continued to blight their extractive sectors mostly, in a situation that was exacerbated by the lower commodity prices. Here it should be recalled (see Section 2) that commodity prices have been somewhat slower than expected in recovering, which has hit Colombia and Mexico particularly hard given the importance of oil in their export mix (50% and 10% of exports respectively).

Figure 4.5

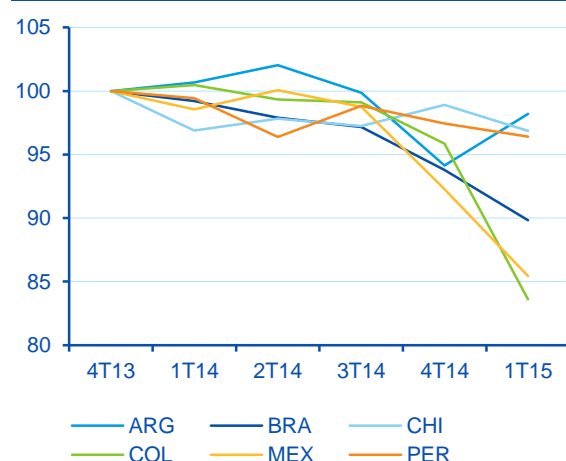
Exports
(% var. YoY, 3-month moving average, USD)



Source: BBVA Research and national statistics

Figure 4.6

Terms of trade (1Q13=100)



Source: BBVA Research and national statistics

We have revised our growth forecasts for LatAm in 2015 and 2016 to 0.6% and 2.1%, mainly on domestic demand weakness and a larger-than-expected impact of Brazil's economic policy correction.

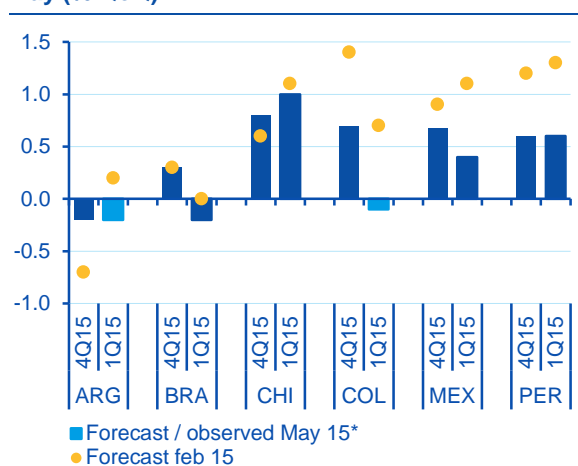
The performances of domestic demand and the export sector led to negative surprises as regards the growth forecast for 4Q (except for in Argentina and Chile) and have prompted us to revise our 1Q forecasts downwards, in some cases significantly. Based on data published as of 1Q for Brazil, Chile, Mexico and Peru, our seasonally adjusted analysis (which allows a quarter vs. previous quarter comparison) throws up results which are far below those anticipated for the last two of these countries (Figure 4.7). We have thus revised our growth estimates for 2015 downwards, and in some cases those for 2016 as well. Besides the knock-on effect from the lower growth in 1Q, this revision arises due to i) the greater impact of the macroeconomic policy correction in Brazil, which will also have a sizeable effect on Mercosur countries, as is examined in Box 1; ii) the weak private sector growth, where the drop in investment mentioned in the

previous section will take a little more time to be restored, to which we should add the expected effect on consumption which is foreseeable given the loss of optimism in several economies; iii) the political ructions and uncertainty surrounding certain reform processes in Andean countries, and iv) the public spending cuts in Mexico and Colombia to abide by their fiscal rules.

We have revised downwards our growth forecasts for 2015 for all countries except Paraguay. These are particularly significant cuts for Peru (-1.7pp), Brazil (-1.3pp), Mexico (-1.0pp) and Colombia (-0.5pp), and more discreet for Argentina and Uruguay. For 2016 we have also trimmed our growth forecasts for Peru (-1.0pp), Mexico (-0.7pp) and Colombia and Chile (-0.4pp). Growth for the region as a whole in 2015 would therefore come down from 1.5% estimated a quarter ago to a forecast of 0.6% now, while for 2016 estimated growth is reduced from 2.4% in February to 2.1% now.

Figure 4.7

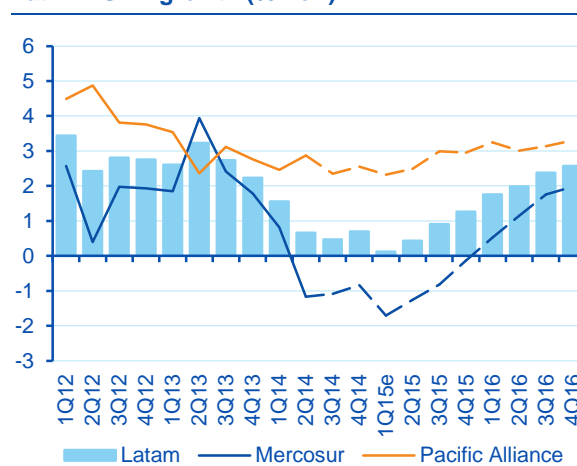
LatAm: GDP growth estimated in January and May (% QoQ)



*Dark blue indicates an observed figure
Source: BBVA Research and national statistics

Figure 4.8

LatAm: GDP growth (% YoY)



Source: BBVA Research and national statistics

For Peru the revision of its growth forecasts comes after the sharp contraction in investment (particularly in the public sector) as well as the slowdown in household consumption. Among the sectors most affected are construction and non-primary manufacturing, by the weakness of domestic demand. Towards 2016 private spending weakness will persist in a climate where the implementation of counter-cyclical public policies has run up against problems, which has hampered growth.

For Brazil we have brought down forecast growth for 2015 from 0.6% three months ago to our current level of -0.7%. Among the factors behind this are i) the deterioration in the terms of trade; ii) more restrictive fiscal and monetary policy than we anticipated three months ago; iii) the large rise in inflation and its effect on real wages and production costs; and iv) the Petrobras crisis and its impact on investment and sentiment. As for Mexico, we are downgrading our growth estimate for 2015 from 3.5% previously to 2.5%, as a result of i) the deterioration in the oil price and production platform; ii) a poor 1Q performance by the US economy, partly associated with a harsher-than-expected winter; iii) the weakness of the domestic market, with a slow recovery in the construction sector, and iv) the public spending cuts and the delay in the bidding process for contracts within the energy reform¹.

1: Up to now the National Hydrocarbons Commission (the CNH) has issued the bidding guidelines for three out of the five stages which make up Round 1 of the energy reform. The two other stages concern deep water fields and unconventional resources. In both cases the date for invitations to tender has still not been set and indication has been given that the tenders have been postponed owing to the low oil price.

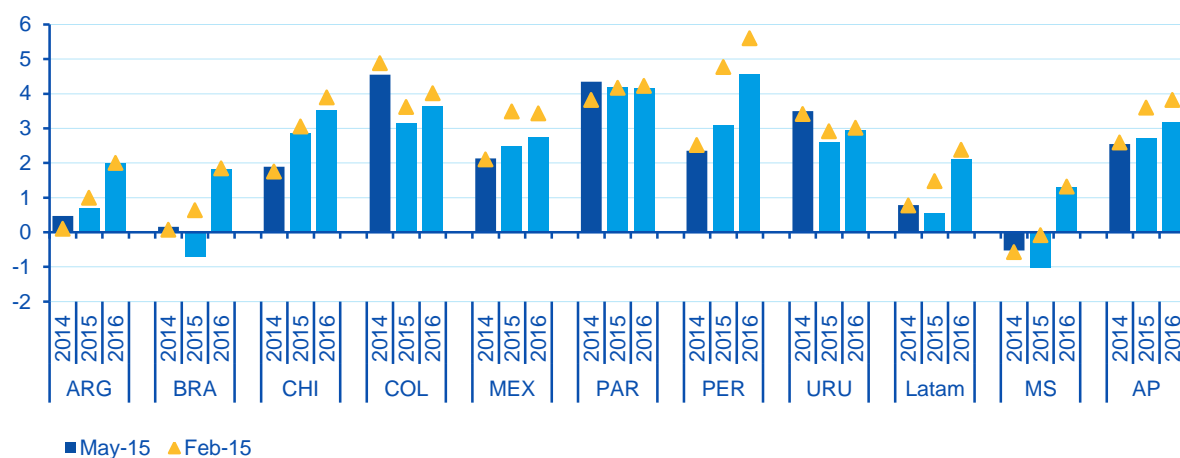
In Colombia and Chile, as with Peru, the revision is linked to the prospect of lower investment, which will take a bit more time to recover, and the half-heartedness of private consumption, to which should be added, on the one hand, the adverse effect on consumption that will come from the loss of optimism, and on the other hand, the political ructions and uncertainty emerging from certain reform processes.

The Pacific Alliance countries will continue to be the most dynamic, though still below their potential in 2015 and 2016.

Even so, the Pacific Alliance countries will be the most active by a long way. The end of 2014 and the start of 2015 will be the floor for growth but this will continue to be positive and show a rising trend, albeit below their potential. By way of contrast, the countries in the Mercosur block will remain in the downturn that began in 2Q14 and which we predict will continue over the rest of the year (see Figure 4.8).

By individual country, Paraguay, Peru, Chile and Colombia will stand out as those showing the most growth in the region over 2015-2016, while Chile (1pp), Peru (0.7pp) and Mexico (0.4 pp) are notable for rallying with respect to 2014. On the other hand, in Colombia the correction with respect to 2014 will be the most significant (1.4 pp), followed by Brazil (0.9pp), but even so, Colombia will still be one of the countries with the most growth in the region.

Figure 4.9
LatAm countries: GDP growth (% YoY)



Source: BBVA Research

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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

Argentina
Gloria Sorensen
gsorensen@bbva.com

Perú
Hugo Perea
hperea@bbva.com

Cecilia Posadas
c.posadas@bbva.com

Chile
Jorge Selaive
jselaive@bbva.com

Venezuela
Oswaldo López
oswaldo.lopez@bbva.com

Pablo Urbiola
pablo.urbiola@bbva.com

Colombia
Juana Téllez
juana.tellez@bbva.com

Alejandro Faci
alejandro.faci@bbva.com

México
Carlos Serrano
carlos.serranoh@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