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Latin America Economic Outlook

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Contents

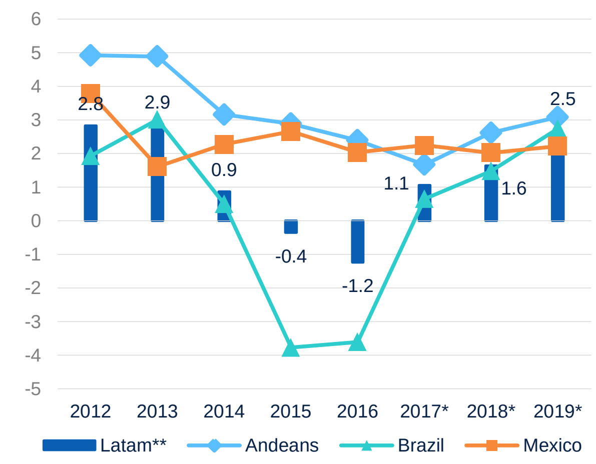
Closing date: **16 October 2017**

1. Summary

Latin American financial markets have continued to post gains across nearly all countries and asset classes, with low volatility. This positive trend contrasts somewhat with the relative weakness of economic activity, which has however recovered significantly in Argentina, Brazil and Chile in the past few months. Commodity prices have continued to recover, particularly in the case of copper, which showed significant gains that are likely to be temporary since they were largely associated with financial factors. Looking ahead, we expect regional currencies to depreciate moderately, with the risk of an increase in volatility from the unusually low levels of the past three quarters.

Latin America will grow by 1.1% in 2017 and 1.6% in 2018. Thus confirmation is building up that 2017 will be an inflection point after five years of slowdown in the region, with the last two (2015 and 2016) showing a contraction in activity (Figure 1.1). Our growth forecast for 2017 is 0.3 pp higher than it was three months ago, due to the upward revision of forecast growth for Mexico and Peru in view of more robust than expected domestic demand in the first half of the year. We are maintaining our growth forecast for 2018, which continues to be supported by the impulse both from the external sector (with improved terms of trade and higher world growth) and from investment in Argentina, Colombia and Peru. However, as pointed out in previous reports, growth is still slow in relation to both the region's potential (in the 2.5% to 3% range) and that of the developed economies (around 2%).

Figure 1.1 Latin America: GDP growth (%)



*Forecasts. ** Weighted average of Argentina, Brazil, Chile, Colombia, Mexico, Paraguay, Peru, Uruguay and Venezuela
Source: BBVA Research

Inflation continues to decline in South America, and is starting to come down in Mexico. Price increases have slowed in the past few months, helped by stable exchange rates and weak domestic demand (and moderating food prices in several countries). With the prospect of lower inflation going forward (below target in the cases of Brazil and Chile), we anticipate an even more accommodative stance from the region's central banks, with further cuts in interest rates in South America in the remainder of this year or in early 2018 depending on the country. In the case of Mexico, the central bank will probably start to cut interest rates from the third quarter of 2018 on as inflation returns to the target range and if volatility in its financial markets remains low.

The risks around this growth forecast are biased downwards. On the external front, the short-term risks associated with China and US monetary policy have diminished, but the risk of volatility in the financial markets has increased. Within the region, the risks associated with political noise and delays to infrastructure projects in several countries have diminished somewhat, but remain significant.

2. Latin America: recovery under way, but slow

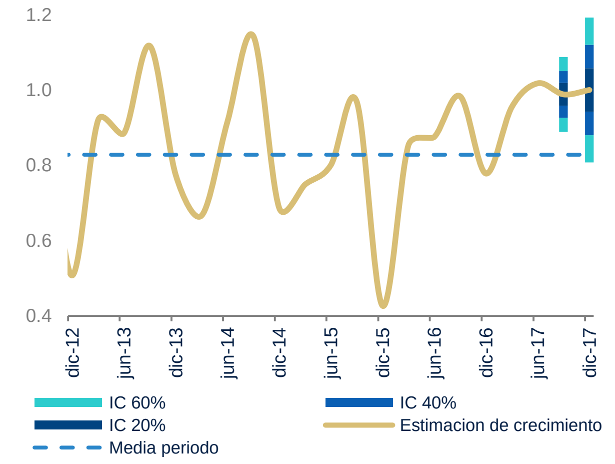
Global growth robust, stable and more generalised

The growth of the world economy stabilised mid-way through the year at around 1% per quarter, and the indicators already out suggest that this progress will continue in the second half of the year (Figure 2.1). This positive momentum reflects better economic performance in all areas, making the current recovery the most synchronised recovery since the financial crisis of 2008-09.

This backdrop of positive and more synchronised growth has thus far been accompanied by moderate levels of inflation, which have also generally been the case by area, despite the abundance of liquidity in the markets, with no clear signs of a build-up of inflationary pressure. This context helps central banks in the emerging economies to have greater room for manoeuvre when continuing to use monetary policy to support growth, while it allows the monetary authorities in the advanced economies to remain cautious when implementing normalisation. In an environment where growth remains spirited and with no inflation surprises on the downside, the central banks are pressing ahead with the gradual process of withdrawing monetary stimuli. In particular, we expect the US Federal Reserve to increase its official rates by 25 bps in December this year, with two further hikes up to 2% in 2018. However, the uncertainty surrounding the timing and extent of the hikes has increased, not only because inflation remains low but also in view of a number of changes in Fed membership.

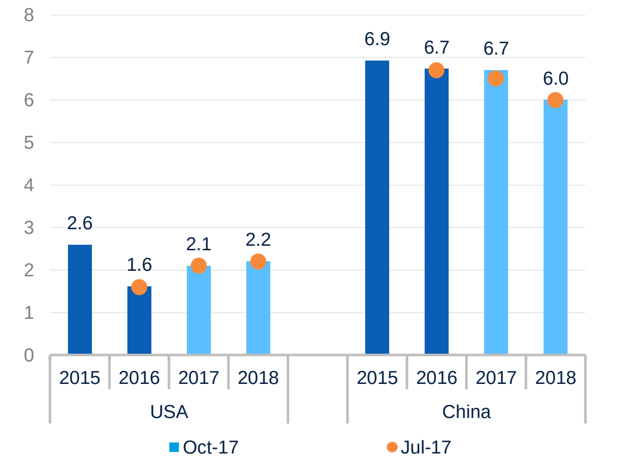
As with the previous quarter, the combination of low volatility, low rates and dollar weakness have set the scene for a favourable environment for EMs. Strategies to seek out profitability have been conducive to strong inflows entering EMs, particularly in the bond market, as well as currency strength. In general, the international panorama has featured relatively complacent financial markets that have not suffered persistent stress from domestic or international political sources.

Figure 2.1 World GDP growth. Forecasts based on BBVA-GAIN (% QoQ)



Source: BBVA Research

Figure 2.2 GDP growth in the US and China (%)



Source: BBVA Research

We have increased our world growth forecast for 2017 to 3.4% in view of increased growth in Europe and China

Our new forecasts mean global growth is picking up pace to 3.4% in 2017-18, which implies an upward revision of around 0.2 pp this year and an acceleration from 3.2% last year. This change is due to higher forecast growth now for both China and Europe in 2017, on account of positive surprises in both regions since Q2. Thus we expect China to grow by 6.7% and 6% in 2017 and 2018 respectively (Figure 2.2), and Europe to do so by 2.2% and 1.8%. For the United States, we are standing by our estimate of sustained growth of a little over 2% within the forecast horizon (Figure 2.2), while the better progress predicted for the Latin American economies is being borne out. Growth for the rest of the Asian economies will continue to be robust, although it will feel the effects of the foreseeable moderation in the Chinese economy in the next few quarters.

The factors underlying the gathering momentum and stability of world growth will remain present, even though some of them could gradually wear off in the coming quarters. The most immediate will be the normalisation of monetary policy by both the Federal Reserve and the European Central Bank, as it will lead to a gradual reduction in global liquidity and less support for capital flows into the emerging economies. On top of this, there is still a raft of political risks that stand to influence economic confidence and how the markets perform.

The downside risks for this global scenario likely to affect Latin America most continue to be, as regards the US, the unknowns regarding the implementation of the economic policy measures announced, while the long period of cyclical expansion together with lax demand-side policies continue to be conducive to a build-up of financial vulnerabilities that could trigger a recession in the medium term. As for China, the authorities' strategy and the more gradual slowdown in growth have reduced the risks over the forecast horizon, although they are still building up over the medium term given that borrowing remains on the rise, with some debt servicing indicators running at high levels, while the streamlining of state companies is still being put off.

International markets and commodities are supporting Latin American financial assets: for how much longer?

Latin American financial markets have posted further gains in the past three months, confirming the upward trend in regional financial asset prices seen since the beginning of 2016.

The region's risk premium as measured by the EMBI Latam fell by 3% in the past three months, bringing the cumulative reduction since the beginning of 2016 to 25%. This reduction in the risk premium was across the board. The risk premium fell in all countries in the region in the past three months (see Figure 2.3). As a result cumulative reductions since the beginning of 2016 are 21% for Argentina, 20% for Mexico, 41% for Colombia and Uruguay, 50% for Chile, 52% for Peru and 54% for Brazil.

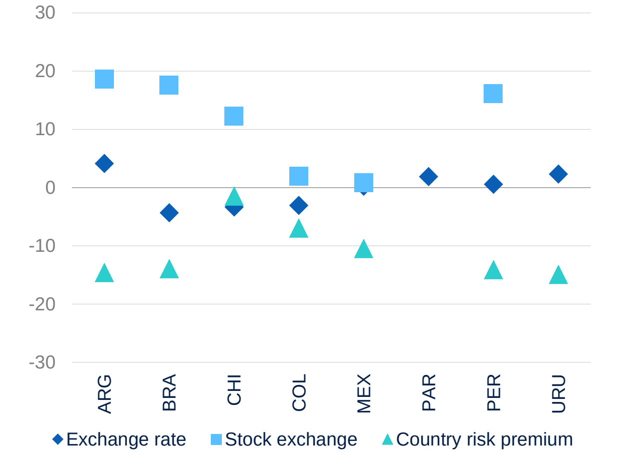
Most of the region's stock markets also showed gains in the past three months, especially those of Argentina, Brazil, Chile and Peru (Figure 2.3). In contrast, Mexico's stock market posted a loss of 3% in the period, due to growing concerns in the past few weeks about the outcome of the trade talks with the United States. Relative to the beginning of 2016, gains amounted to 132% in the case of Argentina, 101% in that of Uruguay, 77% in Brazil, 49% in Chile, 30% in Colombia and 16% in Mexico.

As for the currency markets, gains were less significant in the past three months (Figure 2.3). More specifically, the Chilean and Colombian currencies appreciated by between 3% and 5%, while those of Brazil, Peru and Paraguay were practically unchanged and the Argentine, Uruguayan and especially Mexican pesos depreciated in nominal terms. Again, relative to the beginning of 2016, the majority of the region's currencies have shown cumulative appreciation in real terms.

The positive trend in the region's financial markets in the past few months is somewhat in contrast with the relative weakness of economic activity and the gradual reduction in the differential between regional interest rates and those of the major developed economies. Although the prospects for recovery in economic activity underpin regional financial asset prices, their recent performance mainly reflects improvements in the global environment. Specifically, the relative weakness of the dollar, the still abundant global liquidity, the gathering pace of global growth and the increases in commodity prices are the main factors behind the gains posted in the region's financial markets (Figure 2.4).

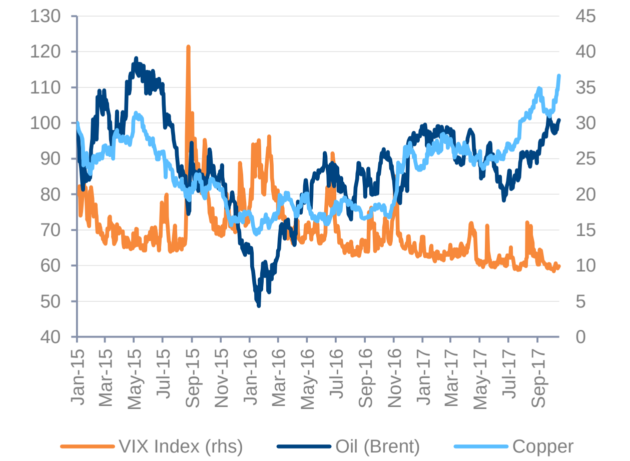
As regards commodities, although price increases have been general, the upward adjustment in the price of oil stands out, as does that of certain metals such as copper, which is particularly important for some Latin American countries. In the case of oil, the 19% increase in the last three months (55% since the beginning of 2016) is explained by an improvement in the fundamentals, basically due to compliance with the OPEC production quotas and increased demand in an environment of greater global growth. In the case of copper, recent price increases (19% in the last three months and 52% since the beginning of 2016) are mainly due to financial factors, specifically the depreciation of the dollar and the build-up of long financial positions by non-commercial agents.

Figure 2.3 Financial markets: percentage change over the last three months*



* Changes between 16 October and 17 July. Exchange rate: domestic currency/US dollar. In this case, an increase indicates depreciation. Country risk premium: EMBI.
Source: Haver Analytics, Datastream and BBVA Research

Figure 2.4 Volatility, price of copper and barrel of Brent oil*



* Oil and copper prices: indices with base of 100 as at 1 January 2015.
Source: BBVA Research, Datastream and Bloomberg

Although the Federal Reserve has so far been able gradually to normalise monetary conditions in the United States without generating too much volatility in the markets, and China has been able to manage its structural risks without its economy slowing abruptly, global financial markets will continue to keep a close eye on how both these factors evolve over the next few months. In this environment, we cannot rule out the possibility of further turbulence emerging in the coming months, with negative effects on global markets, and particularly those of Latin America.

Also, the gains in the region's financial markets could be reduced if any of the large number of presidential elections end up significantly increasing uncertainty about the future path of a particular country in the region.

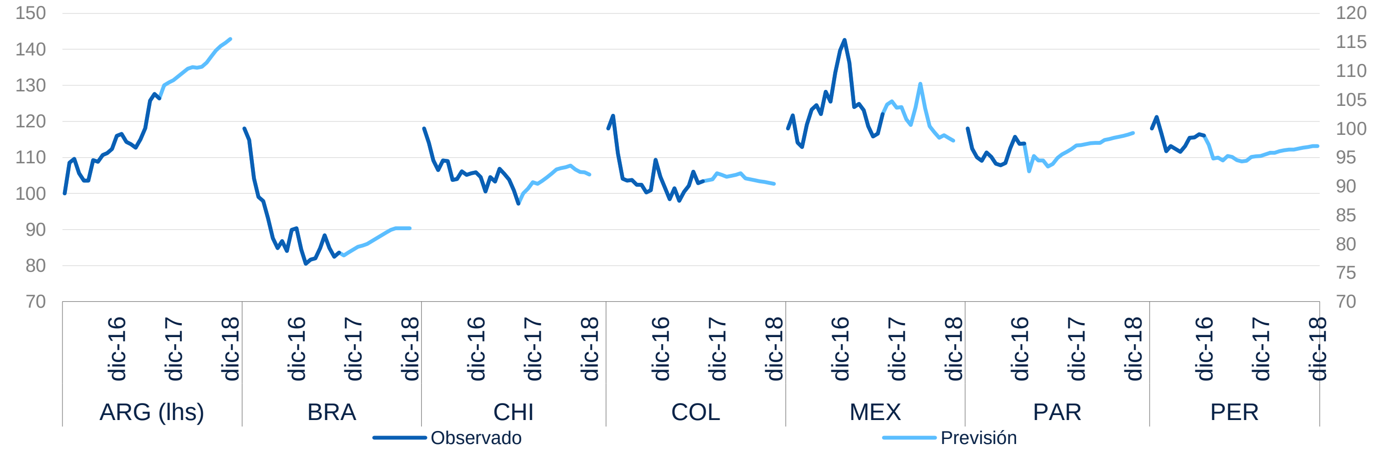
In the case of Mexico, as well as the presidential elections in July 2018, there is also the risk that a new setback in relations with the United States, in particular in the context of the renegotiation of the North American Free Trade Agreement (NAFTA) now under way, might once again lead to increased volatility in Mexico's financial markets. (In the final part of this section 2, we analyse the external and internal risks facing the region in more detail.)

Current loose international financial conditions might reverse abruptly

In this environment, although we have revised the forecasts for Brent crude and copper upwards, in line with recent trends in both markets, we see little room for oil prices to continue rising, and we think it likely that copper prices will be adjusted downwards from the beginning of 2018. Specifically, we foresee crude reaching US$54 per barrel at the end of this year and US$60 at the end of 2018, with copper ending 2017 and 2018 at US$2.94 and US$2.66 per lb. respectively. As for soybeans, we continue to foresee prices holding relatively steady at around US$352 per metric ton for the remainder of this year and throughout next.

Taking this into account, the majority of the region's currencies will most likely depreciate slightly towards the end of 2017 and in 2018, cancelling out part of the recent gains (Figure 2.5 and forecast tables in Section 3). On the other hand the slight increase expected in oil prices and the recovery of growth should allow the Colombian peso to appreciate from the second half of 2018. Similarly, the Mexican peso could appreciate once again starting in mid-2018, at least if the risks associated with the trade talks with the United States and with its own presidential elections do not materialise.

Figure 2.5 Nominal exchange rate: observed and expected (local currency/US dollar) (January 2016=100)*

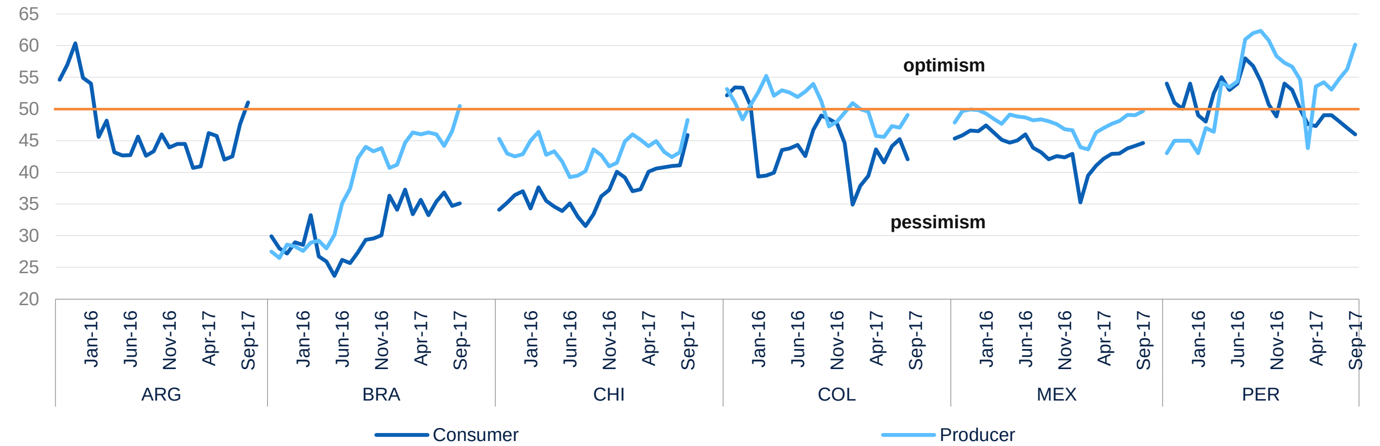


* Increases indicate depreciation.
Source: BBVA Research

Growth still slow in Latin America, but recovering

Confidence indicators in the region have generally remained at levels associated with pessimism, except in Peru, although with some recovery in certain countries. As far as businesses are concerned, the recovery was partly inspired by the calm in international financial markets (and the increase in commodity prices, especially copper), but also by a decline in political noise and uncertainty in some countries, especially Argentina (Figure 2.6) and to a lesser extent Brazil and Chile. In Mexico, confidence in the private sector continued to improve in view of the moderation in the new US administration's tone on its trade policy. In the case of households, the easing of inflation in the majority of countries has continued to improve purchasing power and levels of confidence, but the weakness of the labour markets kept sentiment pessimistic in net terms.

Figure 2.6 Consumer and manufacturing confidence (values over 50 points indicate optimism)



Source: BBVA Research

This slight recovery in confidence, which remains however at pessimistic levels, has been reflected in a measure of recovery in economic activity in the region, with highly disparate degrees of dynamism. For example activity continues to gather pace significantly in Argentina and is consolidating the inflection point that was starting to be discernible in Brazil last quarter. At the same time the impulse from mining activity has characterised growth in Chile in the past few months, while domestic demand has boosted growth in Peru. In contrast, economic activity continues to be lacklustre in Colombia and has started to slow in Mexico (despite the economic impact of the September earthquakes being very limited).

Latin America as a whole should grow by 1.1% in 2017 and 1.6% in 2018. This confirms our view of an inflection point for the region in 2017, after five years of slowdown and two (2015 and 2016) of contraction. The main drivers of this recovery in growth going forward will be the external sector and investment. In the case of the external sector, the international environment will be more favourable for the region's exports, thanks to greater competitiveness as a result of the currency depreciations of recent years, some recovery in commodity prices, and accelerating world GDP as mentioned above. Investment will continue to be the main growth driver in Argentina, Colombia and Peru, in the last two especially in view of infrastructure plans, and in the case of Peru also thanks to the fiscal impulse aimed at reconstruction following the damage caused by the El Niño weather event at the beginning of this year.

Our new growth forecasts for 2017 are 0.3 pp higher than those of July, while those for 2018 are unchanged. The upward revision of our forecasts for 2017 is characterised in particular by that applied to México, from 1.6% to 2.2%, in view of the unexpected strength of consumption and the service sector, while the risks relating to trade relations with the US have also eased, though they are still high. We have also revised growth for Peru by 0.2 pp, from 2.2% to 2.4%, in view of the strength of domestic demand in the past few months. As for 2018, we have not altered our growth forecast, but it is likely that growth will be somewhat higher if some of the positive trends seen recently in the majority of countries are confirmed.

We have revised the growth forecast for 2017 upwards for Mexico and Peru, holding it unchanged for the remaining countries and for 2018

All in all, as indicated in our last few reports, regional growth will continue to be low, both in terms of the region's potential (in the 2.5% to 3% range) and relative to the growth needed to restart the process of narrowing the gap between the region's per capita income and that of the developed economies.

By country, the regional dynamic continues to be highly uneven, and we continue to see Argentina, Peru, Paraguay and Uruguay as the countries with the most growth in 2018 (Figure 2.7):

- In **Brazil,** year-to-date activity figures have been surprisingly positive, especially as regards private consumption. Despite these positive data, we are maintaining our growth forecast at 0.6% for 2017 and 1.5% for 2018 in view of the political uncertainty and the deterioration in the fiscal outlook, which are likely to prevent activity from gathering pace more strongly. Growth in 2017-18 is likely to be driven by the external sector and private consumption.

- For **Mexico**, we have revised our 2017 growth projection from 1.6% to 2.2%, while holding the 2018 forecast at 2.0%. The revision takes account of the strength of consumption and services in the first half of the year, although we see signs of a slowdown in the second half of this year. Given the weakness of consumption and investment going forward, growth will be driven mainly by the external sector, assuming that the renegotiation of the North American Free Trade Agreement (NAFTA) is concluded successfully.

- In **Argentina**, indicators in the second quarter continued to rise and point to a recovery in growth in line with our expectations. Our growth projections are unchanged, at 2.8% and 3.0% in 2017 and 2018 respectively, supported by public and private investment.

- For **Colombia**, we are holding our growth forecasts unchanged at 1.5% for 2017 and 2.0% for 2018, with a recent slowdown in public sector spending, residential construction and exports. However, investment in infrastructure will continue to be the main engine of growth, especially in 2018.

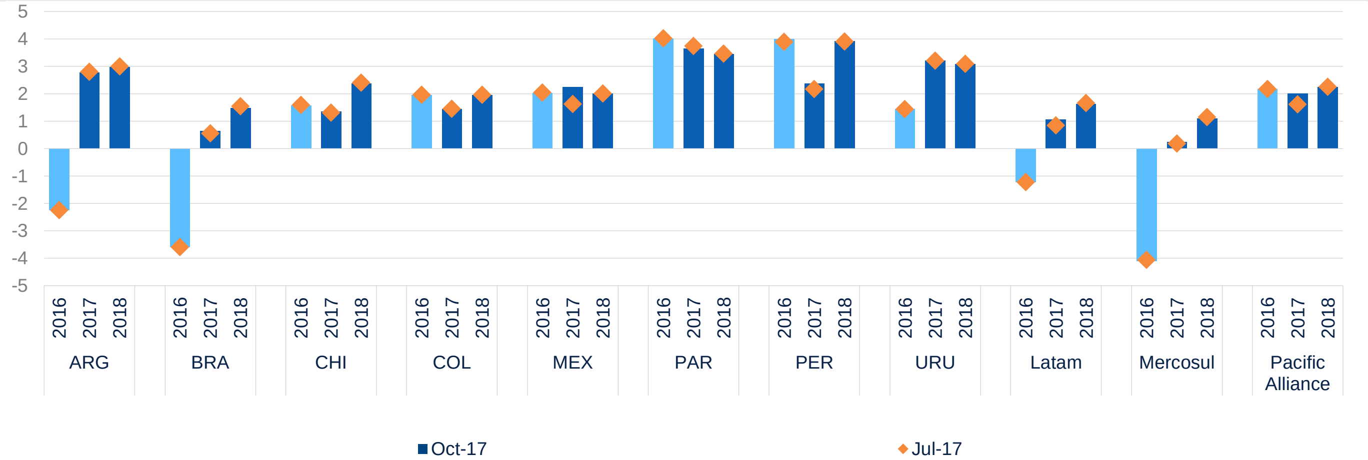
- In **Peru**, we estimate growth of 2.4% and 3.9% in 2017-18, driven this year by the extractive sectors, especially mining, and in 2018 by works on infrastructure and on reconstruction due to the damage caused by "El Niño costero" at the beginning of 2017. Forecast growth in 2017 is 0.2 pp higher than that projected three months ago (there is no change for 2018) in light of higher copper prices and more dynamic domestic demand in the past few months.

- For **Chile**, we are maintaining our growth forecasts for 2017 and 2018 unchanged at 1.3% and 2.4% respectively. A few negative surprises regarding investment and exports should be more than offset by the prospect of higher copper prices than those anticipated three months ago. We continue to foresee growth being driven by recovering confidence, accommodative monetary policy and an end to the uncertainty surrounding the outcome of the upcoming elections.

- In **Uruguay**, second quarter growth figures reflected the extended maintenance shutdown of the ANCAP refinery. Discounting this effect, we are maintaining our growth forecast at 3.2% for 2017 and 3.1% for 2018, with next year's growth being driven by capital expenditure on the country's third cellulose plant and strengthening private consumption.

- For **Paraguay**, we are holding our growth forecast at 3.7% and 3.5% for 2017 and 2018 respectively in light of the data observed in the first half of the year and advance third quarter figures. Growth this year will have been based on investment, whereas next year it will be driven by domestic demand in general and to a lesser extent by exports, in a context of recovering growth in Brazil.

Figure 2.7 Latin America countries: GDP growth (%)



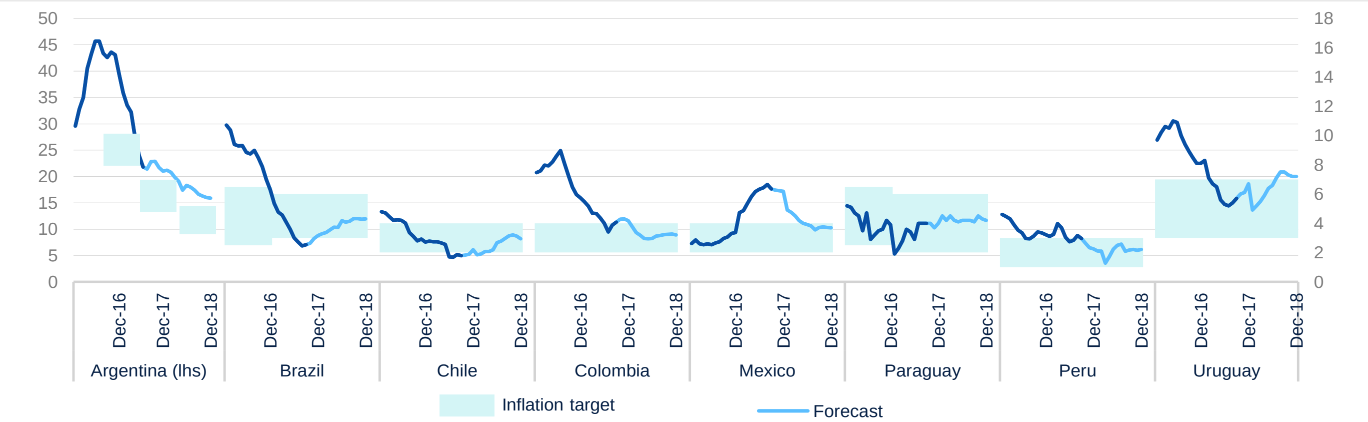
Source: BBVA Research

Inflation continues to fall in South America, and is starting to come down in Mexico

Inflation has continued to fall in most of South America. In Chile and Brazil the deceleration seen recently has taken the latest figures to 2.5% and 1.5% respectively, below the target ranges of their respective central banks. In Uruguay, following the equally marked moderation seen recently, inflation is now close to the central target of 5.0%. In Peru too, and more particularly in Colombia, the loss of dynamism of domestic prices so far this year has been significant, and the latest figures are close to the upper limit of the target range, 3.0% for Peru and 4.0% for Colombia. In the case of Argentina, although inflationary pressures have eased this year (the CPI was up 23.8% YoY in September, compared with more than 40% in 2016), they have done so more slowly than expected, mainly in the last few months. In Paraguay, although the recent trend has not been exactly downward, inflation is being kept under control, well anchored within the target range of 2% to 6% (Figure 2.8).

Despite Mexico's inflation having risen strongly until August, the reduction seen in September, from 6.7% in the previous month to 6.3%, reinforces the view that the worst is behind us in terms of upward pressure on prices.

Figure 2.8 Inflation: observed and forecast (YoY %)



Source: BBVA Research

In general terms, the absence of significant pressures from the demand side has contributed substantially to the moderation of inflation in Latin America. Furthermore, in many cases, such as Brazil, Chile, Colombia and Peru, the recent dynamic in food prices has been significantly favourable. Lastly, the relative strength of the region's currencies has been a fundamental factor in the slowing of inflation, at least in South America, since in the case of Mexico it was precisely the lagged effect of the peso's depreciation seen until the beginning of the year that led to inflation increasing so strongly until very recently.

Stable exchange rates, weak domestic demand and, in some countries, lower food prices helped to bring inflation down

To a greater or lesser extent, the macroeconomic environment should continue to help keep inflationary pressures relatively under control. In countries where inflation is currently above or close to the upper limit of the target range, it should ease over the forecast period: in Argentina, although it will remain above target, it should fall to 21% in December and to around 15% by the end of next year; in Colombia, although a temporary uptick due to a base effect will generate upward pressure in the short term, inflation should come down to 3.3% over the course of 2018 after ending 2017 at 4,3%; in Mexico, the loss of dynamism in domestic prices which started in September should continue, albeit gradually and with significant risks, and inflation should reach 6.3% in December 2017 and 3.7% in December 2018; lastly, in Peru, after returning to the target range in September, inflation should come close to the central target of 2.0%.

Apart from this, in Brazil, Chile and Uruguay the effect of expected currency depreciation and strengthening economic activity on prices is likely to predominate in the next few months. In the particular case of Brazil, inflation should now start to increase slightly to close 2017 at 3.2% and 2018 at 4.3%, below the central target of 4.5%. In Chile, the CPI should show an increase of 2.2% at the end of this year and 2.9% at the end of next. In the case of Uruguay, we see inflation moving close to the 7.0% upper limit of the target range. Lastly, in Paraguay inflation will most probably remain relatively stable at around 4.0% (Figure 2.8 and forecast tables in Section 3).

In many cases our inflation forecasts are lower than they were previously (see our Latin America Economic Outlook, 3rd quarter report.) The downward adjustments have been most significant in the cases of 2017 inflation in Brazil and Chile and inflation for 2017 and 2018 in Uruguay, which is explained by the impact of lower food prices, the favourable trend in these countries' currencies and, in the case of Uruguay, the coming of age of the new wage adjustment scheme which reduces indexation. We have also made some small adjustments of one or two tenths of a percentage point in the forecasts for Colombia for both 2017 and 2018 and in the inflation forecast for Mexico in 2018. Although less numerous and in general less significant, we have made upward revisions in some cases, such as that of Argentina in 2018 (in view of higher-than-expected inflation and the greater impact of the increase in prices regulated by the government in the new national CPI), for Chile in 2018 (in view of the greater currency depreciation expected) and for Peru in 2017 (given the recent upward surprises.)

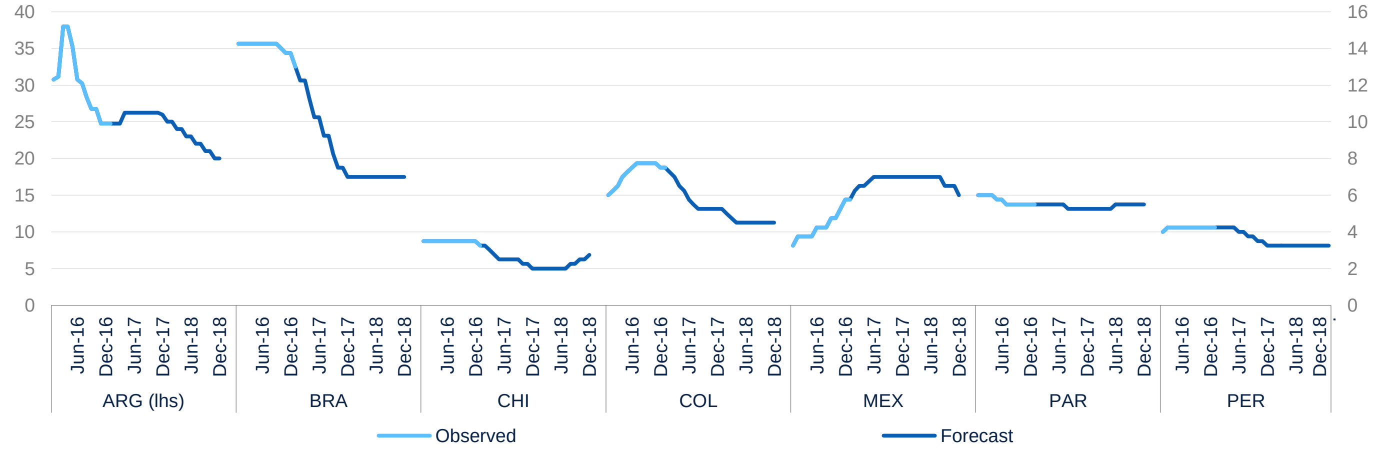
Further interest rate cuts in the majority of countries in the region in the next few months

The current economic environment continues to leave room for central banks to adopt a looser monetary policy The transition to lower interest rates will naturally take place in line with observed and expected trends in inflation in each case.

The most aggressive central bank interest rate cuts will probably be in Brazil, where the slowdown in inflation has been particularly significant (partly because it had recently been running so high). Brazil's monetary policy rate is now 8.25%, 600 bps lower than practically a year ago, and should soon fall to 7.0%.

Cuts announced in monetary policy rates in the last few months already amount to 250 bps in Colombia, 100 bps in Chile, 75 bps in Peru and 25 bps in Paraguay. In these cases, the process of easing monetary conditions has been more gradual, since inflation had still not fallen back within the target ranges or inflationary expectations were still not fully anchored. Despite lingering concerns about inflation, it is likely that additional interest rate cuts will be announced in Chile, Peru and Colombia in the coming months. In the case of Chile the short-term trend in inflation will force the central bank to announce two additional cuts of 25 bps in the remainder of the year. In Peru, a further cut of 25 bps could bring the base rate to 3.25% at year-end. In Colombia the central bank will no doubt keep rates unchanged in the short term, in which inflation is likely to increase temporarily, before going on to cut them gradually from the current 5.25% to 4.50% in the first few months of next year. In Paraguay the central bank will probably hold rates at 5.25% for some time (Figure 2.9).

Figure 2.9 Interest rates: observed and forecast



Source: BBVA Research and the IMF *Data for inflation and interest rates relating to July. The ex-ante interest rate is calculated using the observed YoY inflation or that which is anticipated twelve months later.

Monetary policy will remain restrictive in Argentina, but will become increasingly expansionary in Brazil, Chile and Peru

Although the recent direction of monetary policy in Argentina and Mexico contrasts with that of the other countries in the region, in both cases there must be a margin for reducing interest rates at the beginning of 2018 in the case of Argentina and from the third quarter of

2018 in that of Mexico. Indeed, Argentina's central bank had to raise rates by 150 bps in the first half of the year in view of the increased resistance of inflation. In this case, the reference rate should hold steady at 26.25% practically until year-end, by which time the fall in inflation should be clearer, allowing monetary policy to be eased. As regards Mexico, following the sharp adjustment to the funding rate for banks to 7.0% in June (compared with 4.75% one year ago and 3.0% two years ago), the central bank will probably hold interest rates at this level until the third quarter of 2018, providing inflation returns to its target range and volatility in the financial markets does not increase before the elections.

Compared with our previous forecasts, we have revised our interest rate forecasts downwards in the cases of Brazil, Chile, Paraguay and Peru, left those for Colombia, Mexico and Uruguay unchanged and adjusted those for Argentina upwards.

Also, monetary policy will generally tend to be restrictive during the forecast period in Argentina and Mexico, since in these cases real interest rates will be above the levels considered neutral. In Brazil, Chile and Peru monetary policy will mainly tend to be expansionary. Lastly, in Colombia according to our forecasts real interest rates will be close to neutral, such that monetary policy will be basically neutral both in the remainder of 2017 and in 2018.

External risks reduce in the short term, but are still significant.

The risks to our forecasts for Latin America remain biased downwards due both to factors related to the external environment and to factors of a domestic nature, although they have diminished relative to our assessment of three months ago.

On the external front, two sources of risk to Latin America stand out, as we mentioned at the beginning of this report. Firstly, the imbalances in China's economy remain, and indebtedness continues to grow, while at the same time surplus capacity in the state enterprise sector continues to absorb a significant proportion of credit, which increases the risks to financial stability in the medium and long term. Even so, the authorities' strategy and the more gradual easing of the pace of growth have reduced the risks of an abrupt slowdown in the short term. As we have mentioned in previous reports, a sharp adjustment of the Chinese economy would especially affect the economies of South America through the fall in exports to China and in commodity prices, and would affect emerging economies generally through an increase in volatility in international financial markets.

Slight increase in the short-term risk associated with a possible overvaluation of assets in the US and marginal reduction in the risk of an abrupt slowdown in China in the short term

The second group of risks is related to US economic policies. On the one hand they are concentrated on the uncertainty about the new administration's trade and fiscal policies. Although the probability of very radical proposals on trade has diminished, there is still a high risk that a renegotiation of NAFTA will significantly impede the flow of trade between Mexico and the US. In fact the US proposals in the recent fourth round of talks point to a substantial increase in these risks. On the monetary policy side, we are already in a process of normalisation of monetary policy in the US, so we can expect an increase in the cost of financing globally. The communication policy will be crucial in this process, to avoid market overreaction, something the Fed has managed very well so far. Lastly, it is also necessary to highlight the increased risk of overvaluation of financial assets which in the event of an abrupt correction could have a significant effect on households and businesses.

As for domestic factors in Latin America, political noise continues to stand out in the majority of countries in the region, in several cases combined with accusations of corruption involving members of the political class. Although political uncertainty has declined slightly in some countries, where the probable outcome of upcoming elections has been clarified somewhat, precisely the concentration of a large number of elections in the region in the next 18 months provides fertile ground for surprises and for continuing political uncertainty, with negative effects, especially on confidence and investment.

Moreover, the possible delays to infrastructure projects in countries such as Argentina, Peru and Colombia also represent a significant risk to growth at the forecast horizon. It must not be forgotten that these countries rely on investment in infrastructure as one of the pillars of growth in domestic demand over the next two years. But progress on these projects (and their financing, when they rely on private sector concessions) may be slowed by suspicions of corruption.

3. Tables

Table 3.1 Macroeconomic forecasts

GDP (% YoY)

	2015	2016	2017*	2018*
Argentina	2.6	-2.2	2.8	3.0
Brazil	-3.8	-3.6	0.6	1.5
Chile	2.3	1.6	1.3	2.4
Colombia	3.1	2.0	1.5	2.0
Mexico	2.7	2.0	2.2	2.0
Paraguay	3.0	4.0	3.7	3.5
Peru	3.3	4.0	2.4	3.9
Uruguay	0.4	1.4	3.2	3.1
Mercosur	-2.8	-4.1	0.2	1.1
Pacific Alliance	2.7	2.2	2.0	2.3
Latin America	-0.4	-1.2	1.1	1.6

Inflation (% YoY, end of period)

	2015	2016	2017*	2018*
Argentina	26.9	39.4	21.2	15.5
Brazil	10.7	6.3	3.2	4.3
Chile	4.4	2.7	2.2	2.9
Colombia	6.8	5.7	4.2	3.2
Mexico	2.1	3.4	6.2	3.7
Paraguay	3.1	3.9	4.0	4.2
Peru	4.4	3.2	2.3	2.2
Uruguay	9.4	8.1	7.1	7.8

Exchange rate (vs. (USD, end of period)

	2015	2016	2017*	2018*
Argentina	11.4	15.8	18.0	19.5
Brazil	3.87	3.35	3.20	3.35
Chile	704	667	655	665
Colombia	3244	3009	3030	2970
Mexico	17.2	20.5	18.7	17.7
Paraguay	5767	5718	5700	5830
Peru	3.38	3.40	3.28	3.34
Uruguay	29.7	28.8	29.5	31.4

Interest rate (%, end of period)

	2015	2016	2017*	2018*
Argentina	33.00	24.75	26.00	20.00
Brazil	14.25	13.75	7.00	7.00
Chile	3.35	3.50	2.00	2.75
Colombia	5.75	7.50	5.25	4.50
Mexico	3.25	5.75	7.00	6.00
Paraguay	5.75	5.50	5.25	5.50
Peru	3.75	4.25	3.25	3.25
Uruguay**	23.23	24.70	23.00	24.00

Current account (% of GDP)

	2015	2016	2017*	2018*
Argentina	-2.7	-2.8	-4.3	-4.6
Brazil	-3.3	-1.3	-0.5	-0.6
Chile	-2.0	-1.4	-0.7	-1.8
Colombia	-6.4	-4.4	-4.0	-3.6
Mexico	-2.9	-2.7	-2.8	-2.9
Paraguay	-1.0	1.7	0.3	-0.2
Peru	-4.8	-2.7	-1.7	-1.9
Uruguay	-2.1	-0.1	-0.4	-1.5

Fiscal balance (% of GDP)

	2015	2016	2017*	2018*
Argentina	-5.2	-5.9	-6.1	-5.5
Brazil	-10.2	-9.0	-8.1	-6.8
Chile	-2.1	-2.7	-2.6	-2.1
Colombia	-3.0	-4.0	-3.6	-3.1
Mexico	-3.5	-2.6	-2.4	-2.0
Paraguay	-1.8	-1.4	-1.5	-1.5
Peru	-2.1	-2.6	-2.7	-3.3
Uruguay	-3.5	-3.9	-3.5	-3.1

COMMODITY FORECASTS

	2015	2016	2017*	2018*
Oil (Brent crude US$ per barrel) (average)	53	45	52	57
Soybeans (US$ per metric ton) (average)	350	363	355	351
Copper (US$ per lb.) (average)	2.50	2.21	2.76	2.73

Source: BBVA Research
*Forecasts. ** Interest rate on loans.

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