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Economic Analysis

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Latam outlook: Brazil is the key

Market sentiment on the outlook for the global economy has improved in recent months in tandem with the ongoing decline of financial stress in developed economies, substantially reducing the probability of an external shock hitting Latin America.

This improved external environment, the continued strength of domestic demand and very favorable commodity export prices --supported by high growth in Asia-- is sustaining strong growth in those countries that were already the most dynamic in the region: Chile and Colombia, with average growth rates of around 5% in the next two years, and especially Peru, which should grow well above 6% in the same period.

Likewise, in Mexico, the outlook looks very promising this year. It is not just the projection of growth above 3%, with continued gains in productivity and increasing export-market share in the US. Much more importantly, the reform plan proposed by the new government and scheduled to be discussed in parliament during this year could, if implemented correctly, have a strong positive effect on potential growth to bring it to around 4%.

Something very important in these four countries is that growth will be accompanied by subdued inflation --within the target range of their central banks-- and perfectly manageable public and external balances. What difference from previous expansionary spells in Latam, which led to a rise in inflation and usually ended abruptly, choked by fiscal or external constraints!

Nevertheless, among all the good news we must not forget that in 2013 the performance of Brazil will be monitored very closely by markets and policymakers alike. This is not just because we have already been disappointed during the last three quarters of 2012, when we thought that strong fiscal and monetary stimulus and the expansion of credit would induce the take-off of Brazilian GDP only to be faced once and again with very low growth rates. The big question is whether we could be witnessing the exhaustion of the Brazilian growth model of recent years, based on demand stimulus, especially to consumption. Although the government has taken steps to promote the supply side, such as partnerships with the private sector to develop infrastructure projects or implementing tax cuts, its commitment to reform does not appear as strong as in the case of Mexico. This supports analysts' and markets' misgivings about the sustainability of higher growth in Brazil in 2013. If growth does not take off as expected, it would have a strong negative impact in the region, especially through trade with its Mercosur partners and indirectly to most countries through the negative signal sent to financial markets. In particular, further difficulties for growth in Brazil to take off would alert the rest of the region about the risks of a strong dynamism of economic activity supported by domestic demand but not accompanied by supply-side reforms.

Hopefully these risks on the Brazilian outlook will end up not being realized, in which case Latin America as a whole would increase their growth from 2.8% in 2012 to around 4% in the next two years.