

Latin America remains strong

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Latam Economic Outlook-Second Quarter 2013 | Madrid, 14th May 2013

Main messages

- 1 **The world economy continues to grow**, but there is an increasing unevenness between the different areas, especially within developed countries
- 2 **The international backdrop continues to present major challenges for the region**, including moments of extreme market volatility, a downward trend in commodity prices and increased capital inflows
- 3 **Domestic demand will underpin sustainable growth in the region**. Latin American GDP will grow at 3.5% in 2013 and 3.7% in 2014, if Brazil finally recovers
- 4 **Central banks will maintain a wait-and-see stance in 2013, and begin to raise interest rates early in 2014**. The exceptions are Mexico, with a reduction of the rates in the third quarter, and Brazil, where upward adjustment will continue
- 5 **The region should promote reforms to increase productivity and consolidate long-term growth**. If the region wants to consolidate its high rates of growth, it has to recognize that sustainable per capita income growth cannot be based solely on capital accumulation and increasing employment: productivity also has to improve

Contents

- 1. A more uneven global scenario**
2. Latin America remains strong
3. Latin America must not lose sight of the long-term picture

Markets remained immune to risk events

BBVA Financial Stress Indicator

Source: BBVA Research



Eurozone: political gridlock in Italy; Bail-out in Cyprus; Portugal's Constitutional Court ruling on some austerity measures

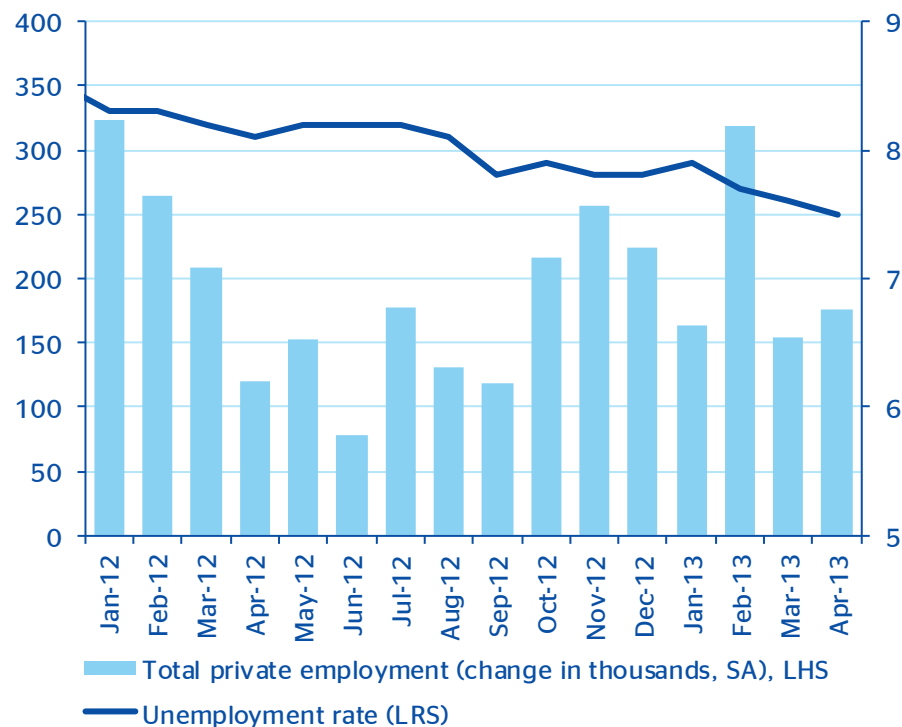
USA: political deadlock over long-term fiscal policy

China: deeper-than-expected slowdown and increasing risks of local debt and shadow banking

Yet growth losses momentum in some regions. In the US the slowdown is shallow ...

US: labour market

Source: BBVA Research and Haver



Private spending continues resilient despite fiscal cliff and sequester

Growth in private consumption is underpinned by employment rise, though the unemployment rate decreases slowly

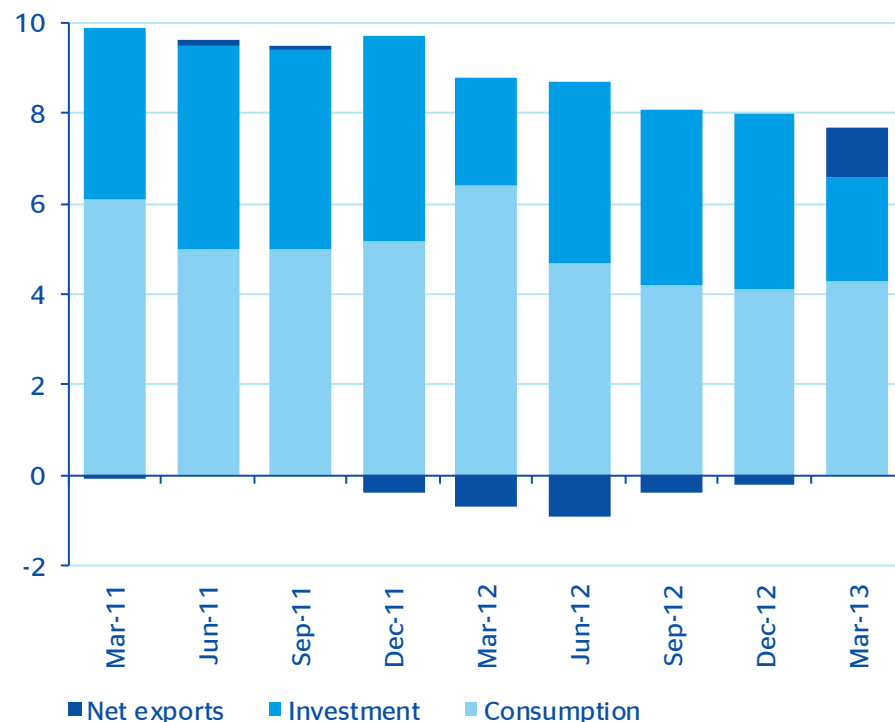
Quantitative easing will continue shoring up growth until prospects for labour market improves

Moderate slowdown in China

China: contribution to GDP growth

(NSA, percentage points)

Source: BBVA Research and Haver



In Q1 GDP growth disappointed, despite stronger external demand

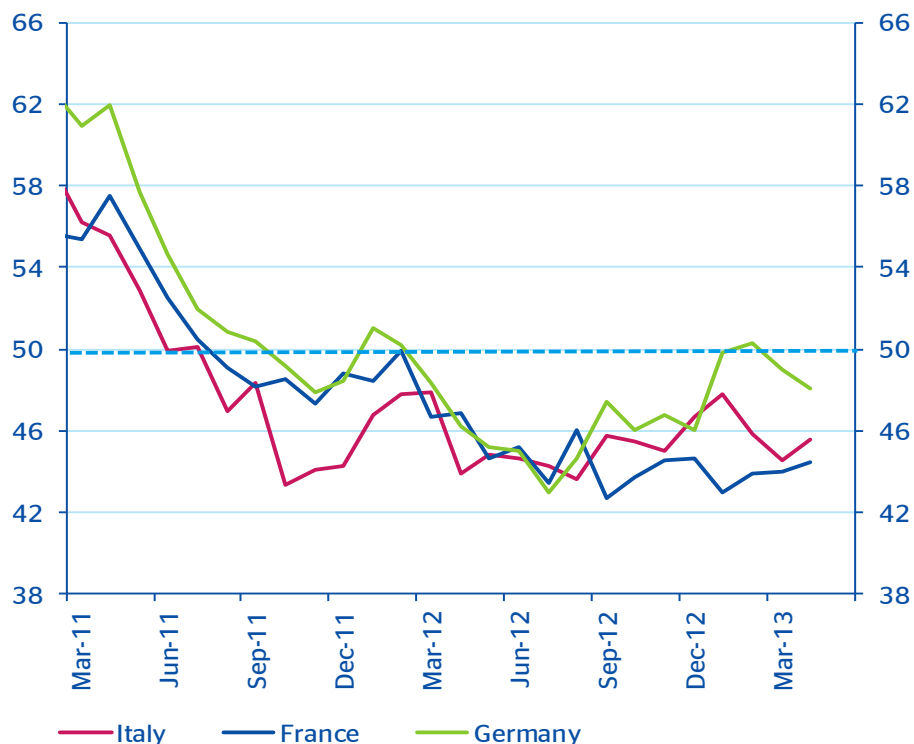
The change in the Chinese model towards consumption continues

Authorities are committed to sustained growth. Room for manoeuvre underpinned by lack of inflationary pressures

Growth disappoints in Europe. The slowdown hits Europe's core economies

Manufacturing confidence (PMI)

Source: BBVA Research and Haver



Germany's exports slows, despite resilience of emerging markets

In **France**, uncertainty over taxation policy, fiscal consolidation plans and lack of reforms dampens confidence

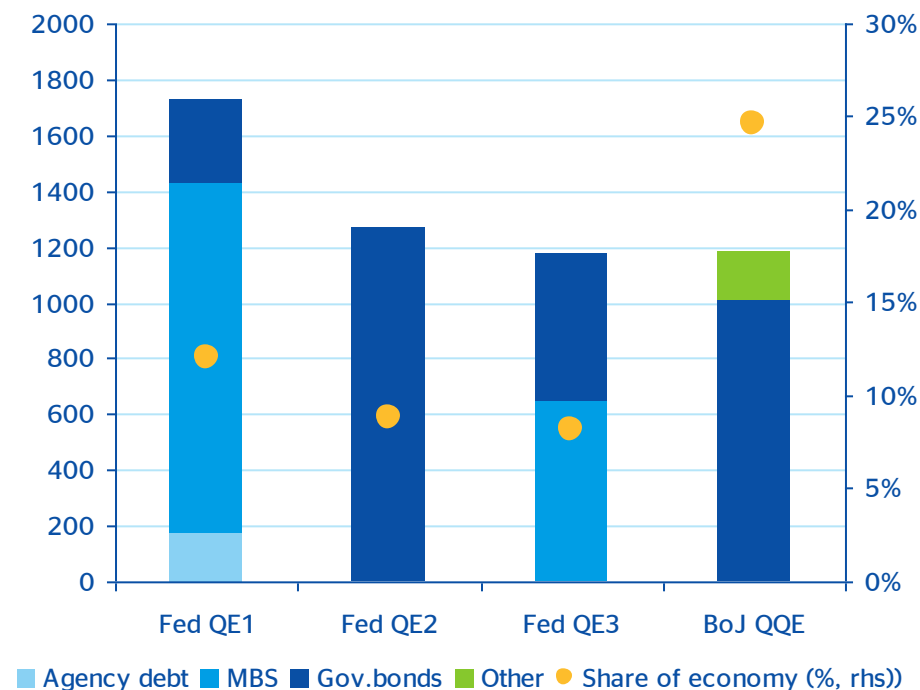
Easing financial tensions will support growth, especially if accompanied by measures to bolster **credit access** and **diminish financial fragmentation**

A new factor arises: massive monetary expansion in Japan

Monetary expansion in US and Japan

USD bln and % GDP

Source: BBVA Research, Haver



In the next two years, the BoJ will inject as much liquidity as the Fed has been injecting since 2008

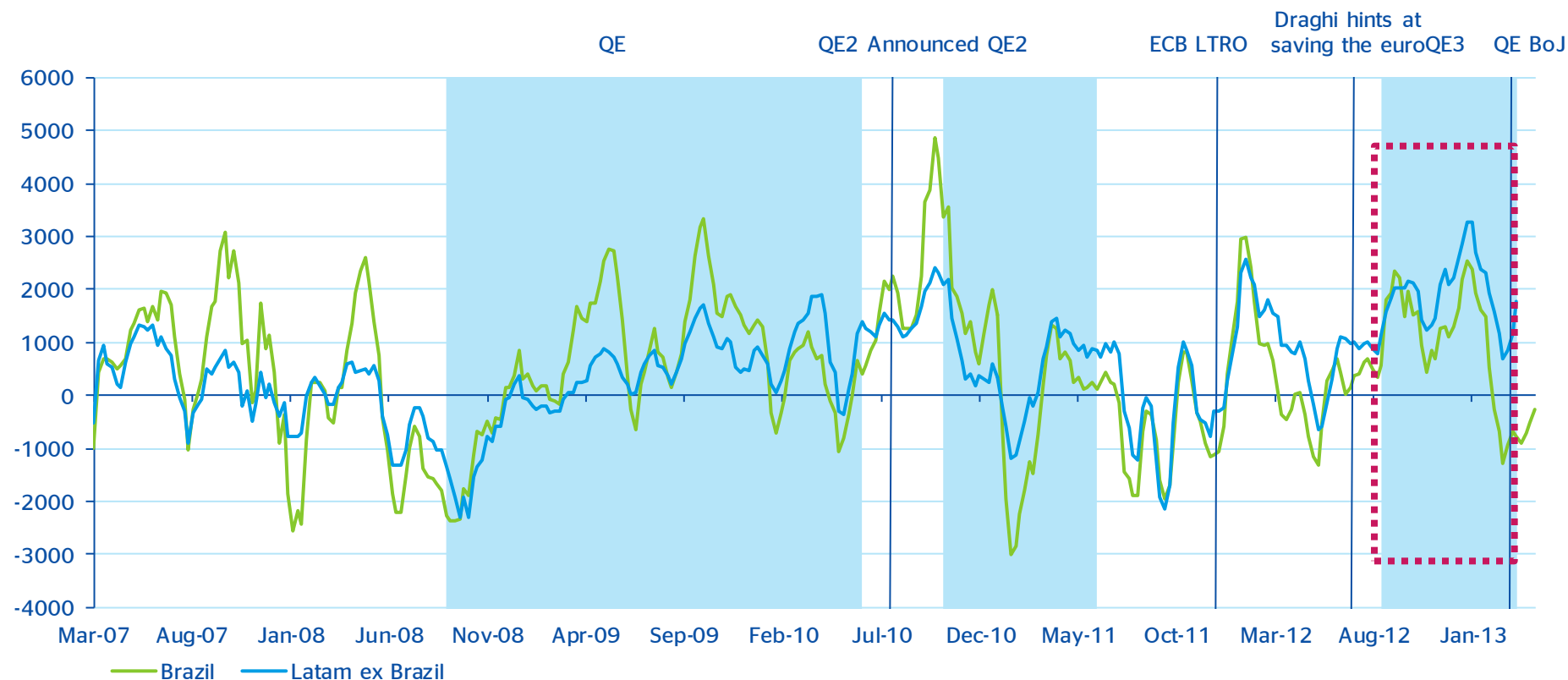
Monetary expansion aims at stamping out deflation and bolster Japan's growth

However, it will not be enough. Bolstering growth also requires reforms and changes in fiscal policy

... that will continue feeding Latam with capital inflows

Capital inflows to Latin America, fixed income and equity (million of dollars, moving average of 4 weeks)

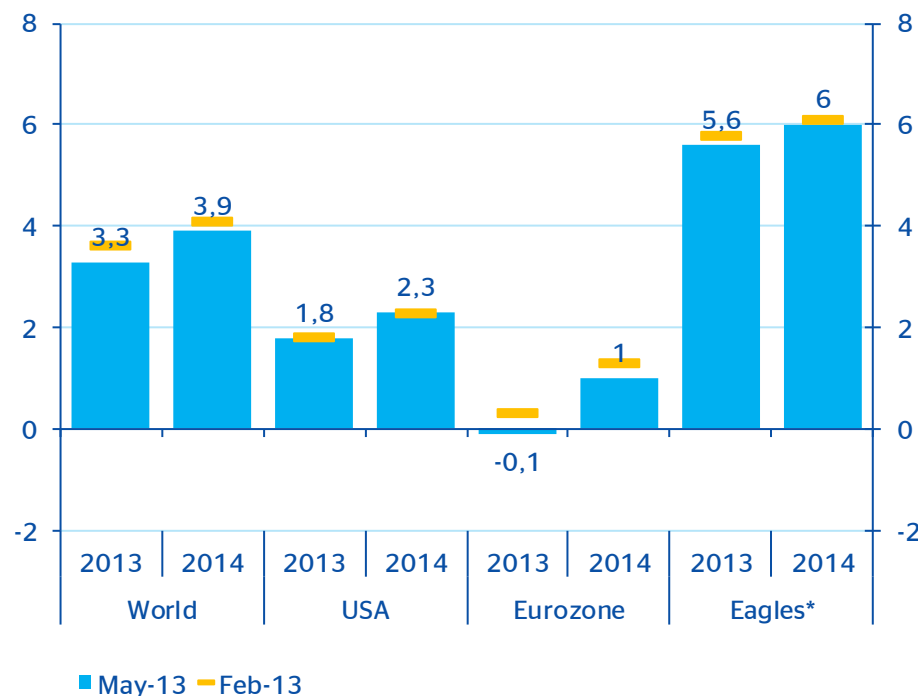
Source: BBVA Research and EPFR



The sound global growth belies regional differences

Global GDP growth (%)

Source: BBVA Research y Haver



Global growth boosted by emerging markets

Advanced economies will grow slowly, especially the eurozone, where recovery is not likely until 2014

Latin America accelerates its growth towards its potential; China will continue growing fast, but the balance of risks is tilted to the downside

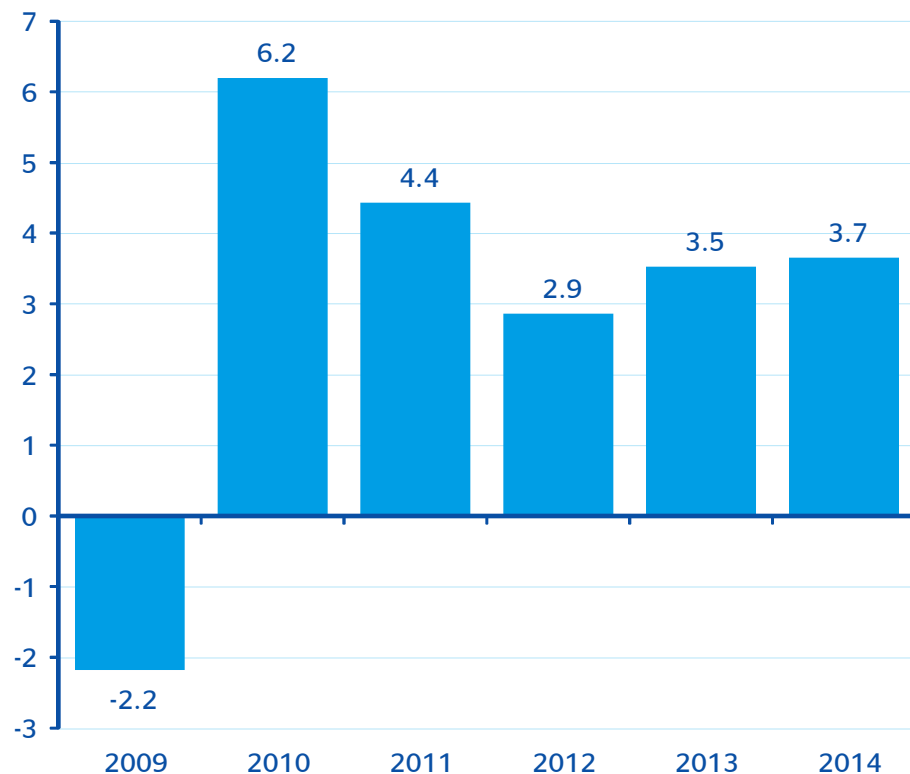
Contents

1. A more uneven global scenario
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Growth will be underpinned by domestic demand: the region will grow at 3,5% in 2013 and 3,7% in 2014

Latam*: GDP growth (%)

Source: BBVA Research



* Weighted average of Argentina, Brasil, Chile, Colombia, Mexico, Panama, Paraguay, Peru, Mexico, Uruguay and Venezuela

GDP growth of 2,9% in 2012 was dragged down by Brazil (0,9%)

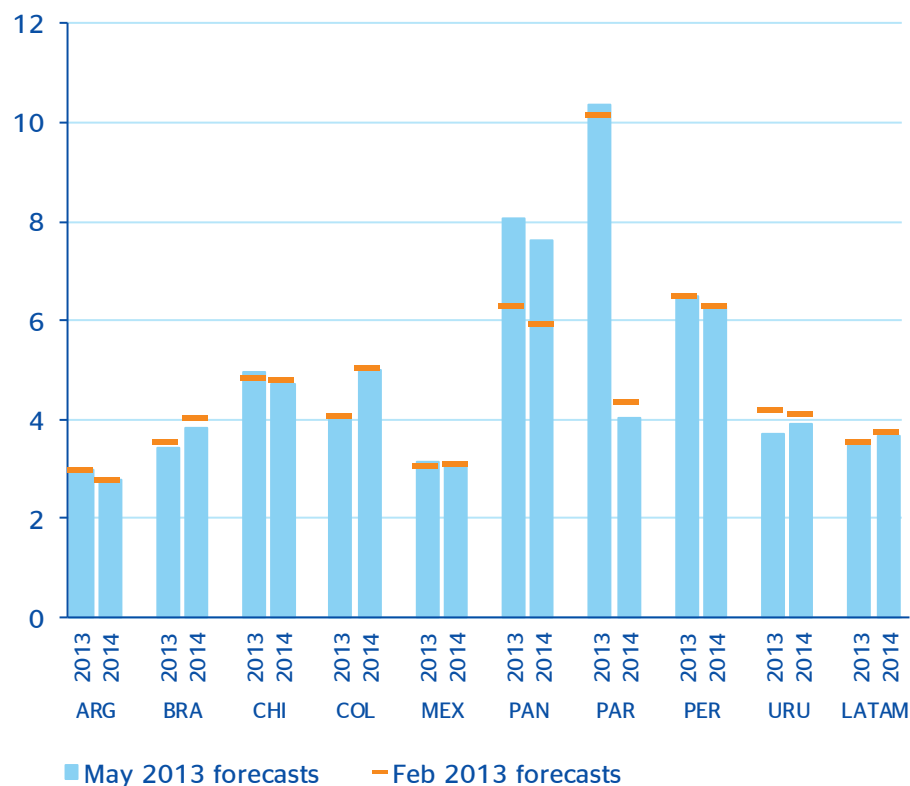
Recovery in Brazil is necessary, although growth forecasts are biased downwards

Confidence indicators keep a positive perspective in most of the countries, what will support the domestic demand

Andean countries will grow particularly strong; Panama and Paraguay

GDP growth estimations, 2013-2014 (%)

Source: BBVA Research



Slowdown in Colombia was compensated with fiscal and monetary stimuli

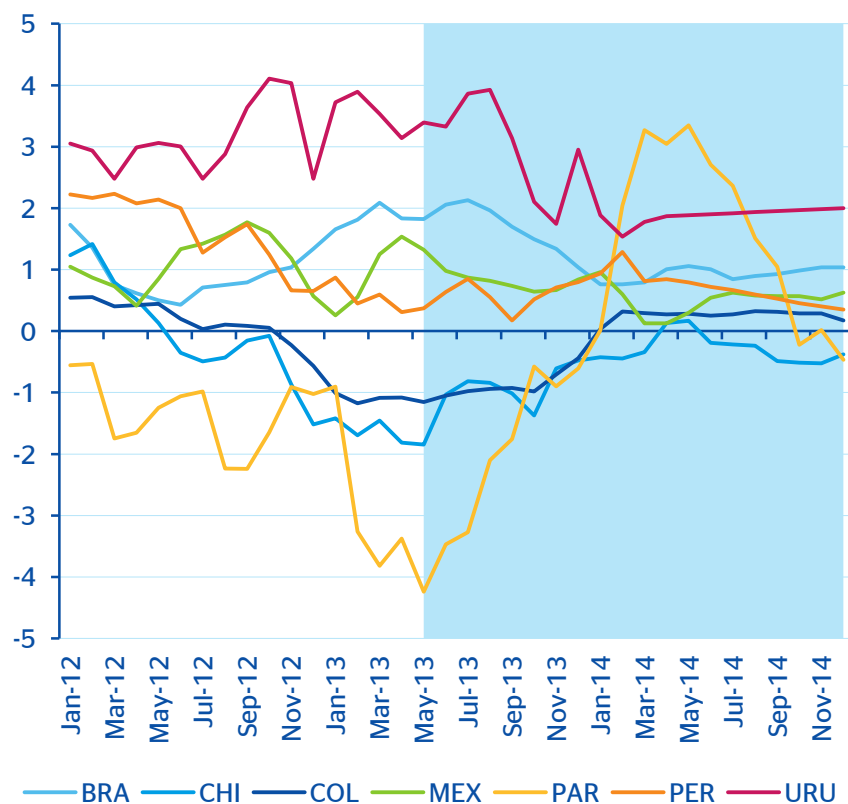
Fiscal stimuli in Peru compensate the weakness of the external sector

Strong upwards review of the GDP growth forecasts in Panama, due to the strong and continued public investment

In general, inflation will be back to the target ranges

Countries with inflation targets: difference between inflation and central bank target (pb)

Source: BBVA Research and Haver



Inflation is out of the target ranges in most of the countries, except in CHI, PAR (under the target) and BRA, URU and MEX (over the target), although anchored to the target in MEX)

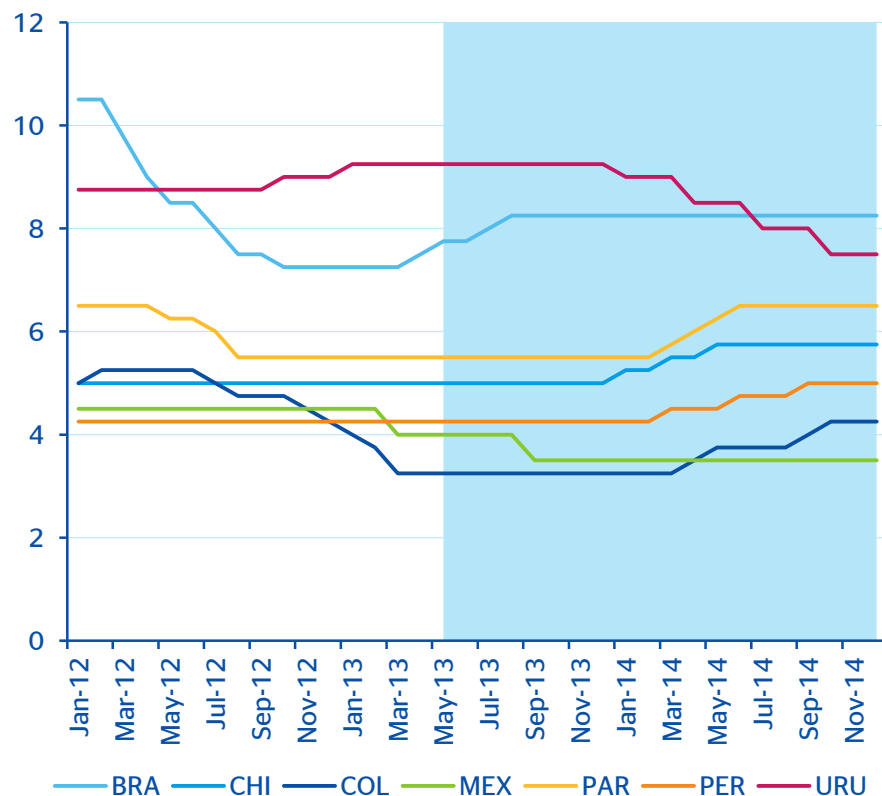
Inflation will be within the target ranges in 2013 and 2014, except in URU

In Brazil inflationary pressures will continue to accumulate in 2013. It will be controlled because of the tax cut and the interest rates raise

Central banks will maintain a wait-and-see stance in 2013, except in BRA and MEX

Monetary policy rates (%)

Source: BBVA Research and Haver



Balance between uncertainty on the external sector and strong domestic demand will determine stable interest rates, except in MEX and BRA

Mexico: interest rate cut, anchored inflation and easing of the monetary policy in the surrounding economies

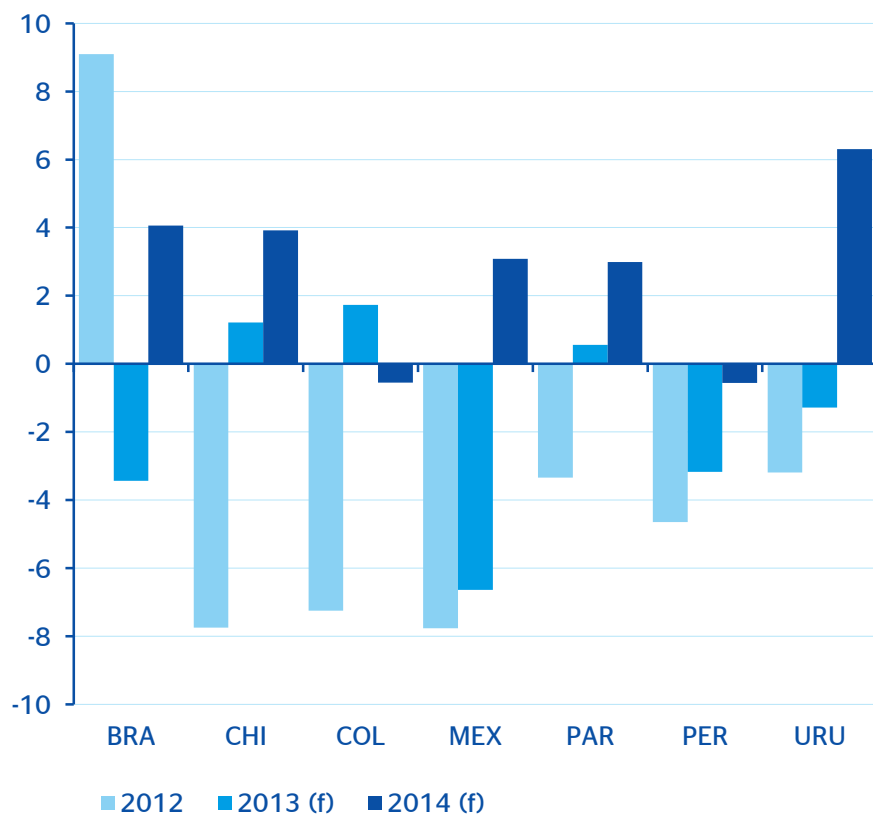
Brasil: monetary tightening will be kept due to the continued inflationary pressures

Less lax monetary policy in 2014, in the Andean countries and Paraguay. Interest rate cut in Uruguay

Domestic and international backdrop will keep appreciating pressures

Exchange rates against USD in countries with inflation targets (% change jan-dec)

Source: BBVA Research and Haver



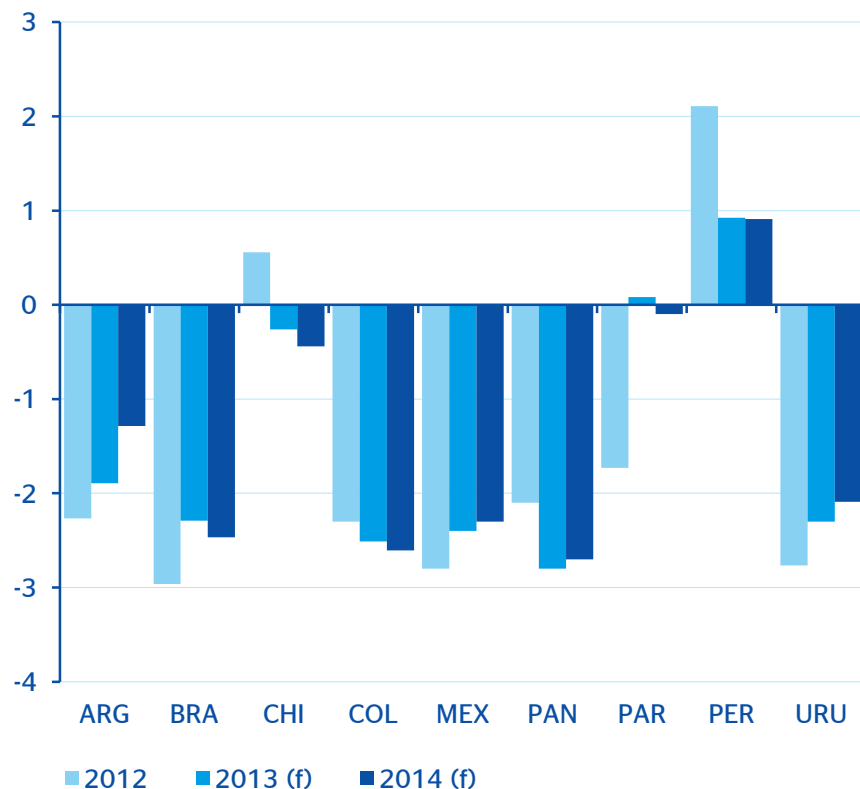
Pressions come conditioned by the monetary expansion programs of the developed economies, now including Japan

The active role of the central banks will continue in BRA, COL, PER and URU to moderate appreciations

Improving trend in the fiscal balance, except in the Andean countries

Fiscal balance (% GDP)

Source: BBVA Research and Haver



Dynamism of the domestic demand will lead to increase tax revenue in the region

Fiscal balances will improve in the region, except in the Andean countries

Fiscal balance worsens in Colombia, due to the slowdown of the contracyclical fiscal stimuli

In Chile, convergence to structural balance. In Peru, decreased superavit due to the contracyclical impulse of the public expenditure

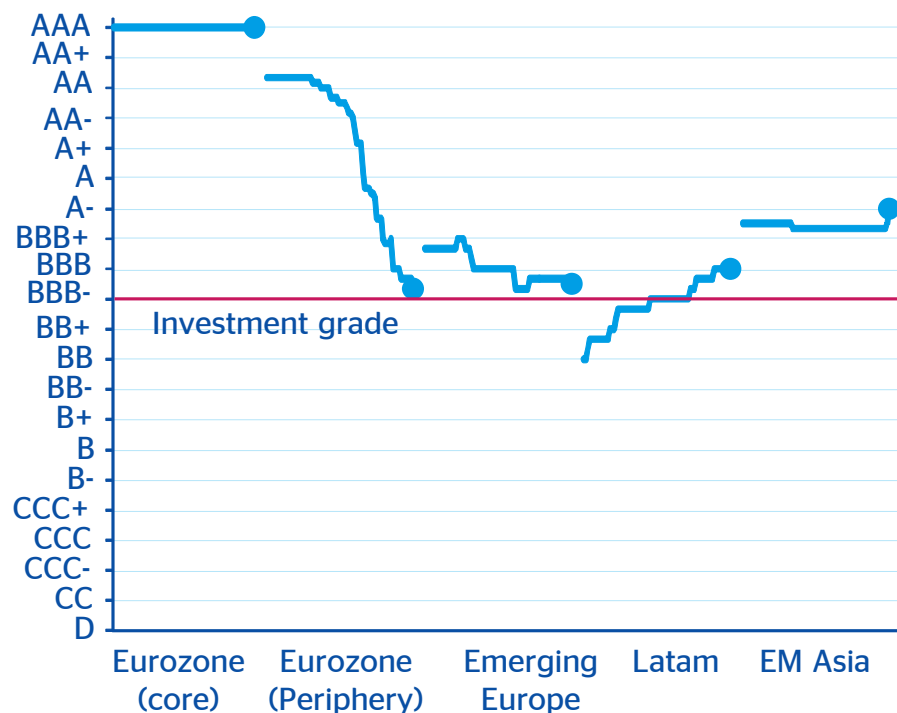
Contents

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The region has achieved high growth rates with low levels of vulnerability in recent years

Sovereign rating by regions: 2007-2012

Source: BBVA Research



Latam new normal: higher growth and lower vulnerability

Progress to medium level of GDP per capita and credit rating

Progress in reducing the poverty and the social inequality

Increasing middle class

But the region must improve its productivity

The challenge: keep the GDP per capita growth rate in Latam

Until now

Sustainable growth due to the accumulation factor (especially labor force): around 85% of the total

Accumulation of capital benefited by consensus on prudent economic handling: the effects are disappearing

Low saving and investment rates compared to Emerging Asia

Contribution of the labor factor for the reduction in the unemployment rate: also with natural limits

From now on

The region has to recognize that sustainable growth requires an improvement in productivity

There does not appear to be consensus in the region that productivity growth is essential for maintaining GDP growth

Structural reforms are needed: improvement of the business climate and more competition

It is needed to increase the savings rate to fuel investment in physical (above all infrastructures) and human capital

Main messages

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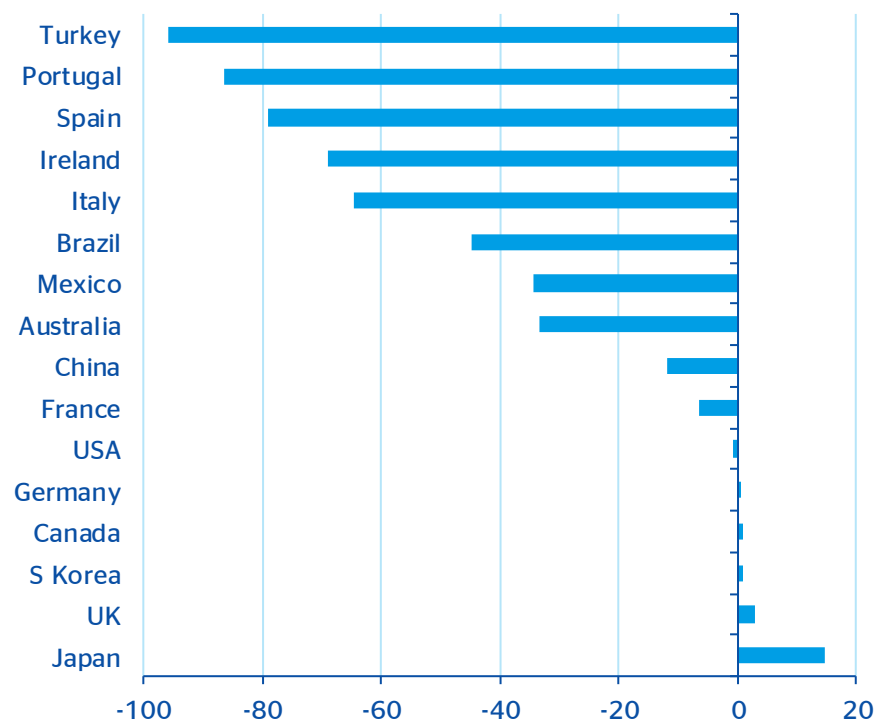
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Annex: Japan's monetary easing has had a positive effect on markets though there is volatility risk

Debt markets. 10Y Government yield change since BoJ QE announcement (4-April, bp)

Source: BBVA Research, Bloomberg



FX markets, percentage change since BoJ QE announcement (%)

Source: BBVA Research, Bloomberg

