

Latam: growth on a less favorable external outlook

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Main messages

- 1** The global economy will grow by 3.1% in 2013 and 3.8% in 2014. However, the slowdown in emerging economies and the uncertainty regarding monetary stimuli in the USA will be a source of stress to financial markets in the region
- 2** Growth forecasts in Latam have been revised downwards to 2.7% in 2013 and 3.2% in 2014 on less favorable external outlook. The main downward adjustment in forecast is related to Brazil for cyclical and structural factors
- 3** Foreign and fiscal accounts have deteriorated due to the external outlook and a less buoyant domestic tone. Even so, both imbalances remain at manageable levels
- 4** Laxer monetary policy bias in the region, except in Brazil. The outlook of withdrawal of monetary stimuli in the US will favor a trend towards devaluation in exchange rates partly contained by central banks

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- 2 A less favorable external outlook affects foreign balance in Latam
- 3 Latin American growth has been revised downwards in 2013

Tightening of financial conditions at global level from May to July

US: 10 y Treasury, yield (%)

Source_ Bloomberg



Shift in financing conditions took place with the details announced by the Fed to limit and then put an end to its program of monetary expansion

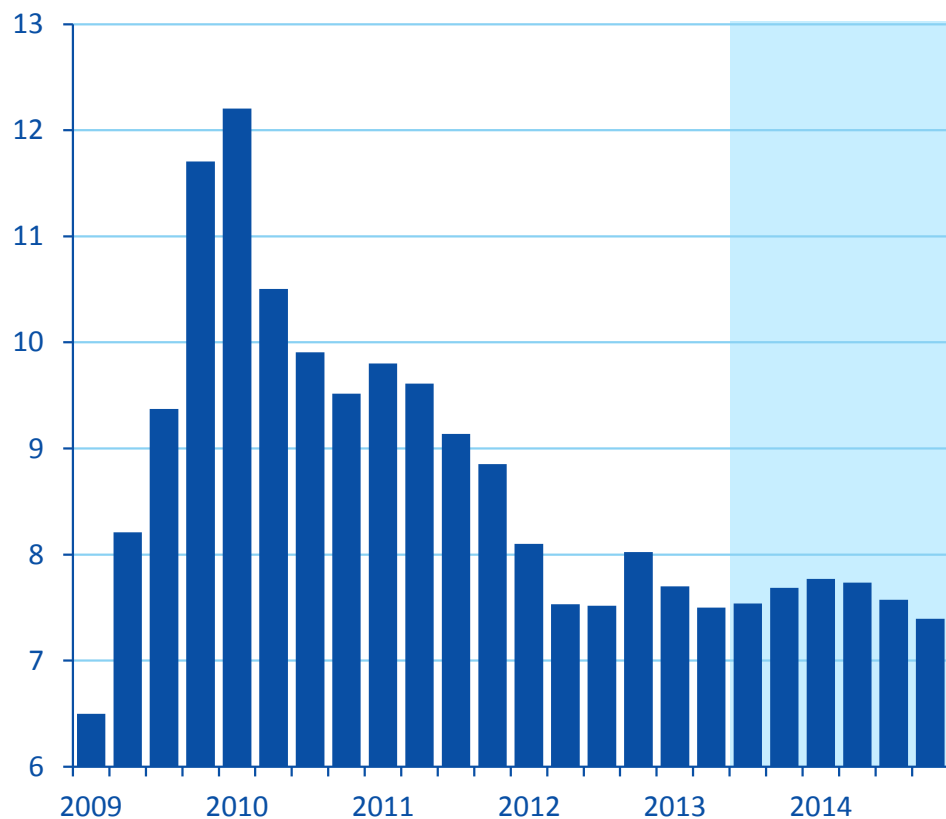
Market reaction to this plan has been stronger than probably desired by the Fed

Start of a cycle of normalization of financial conditions, with higher interest rates and lower demand for risk assets

Slowdown in China continues...

China: GDP growth (% YoY)

Source: BBVA Research



Chinese authorities have made efforts to limit risks associated with rapid credit growth both in the official and shadow banking sectors

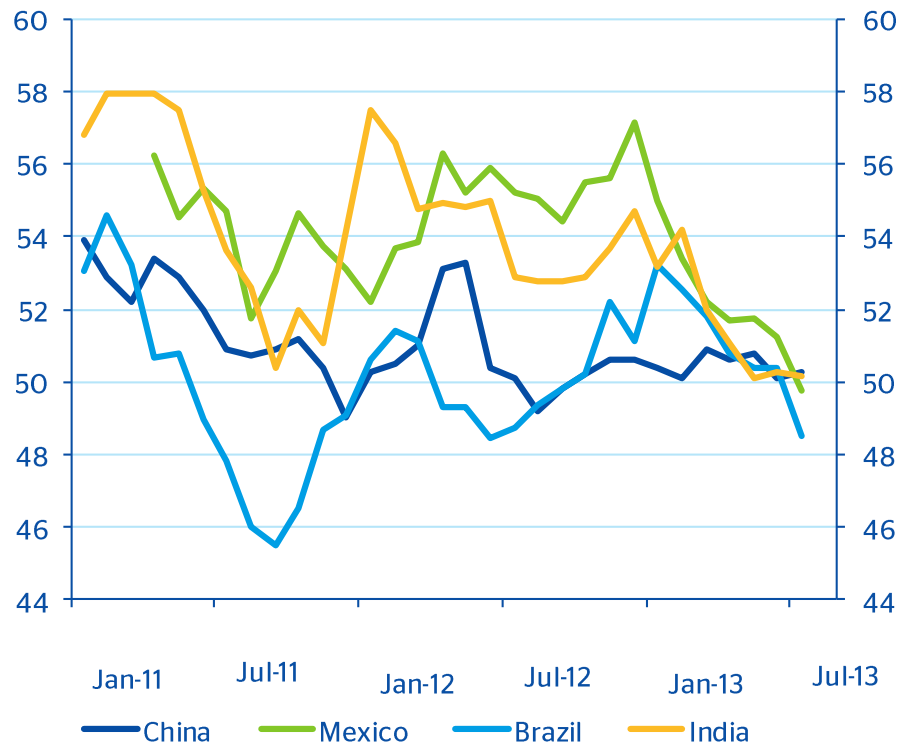
Chinese authorities appear more comfortable with the current rates of GDP growth

The government has room for maneuver if the growth slips below the official targets

... and growth deteriorates, in general, in emerging economies

Emerging economies: PMIs manufacturing

Source: Haver, BBVA Research



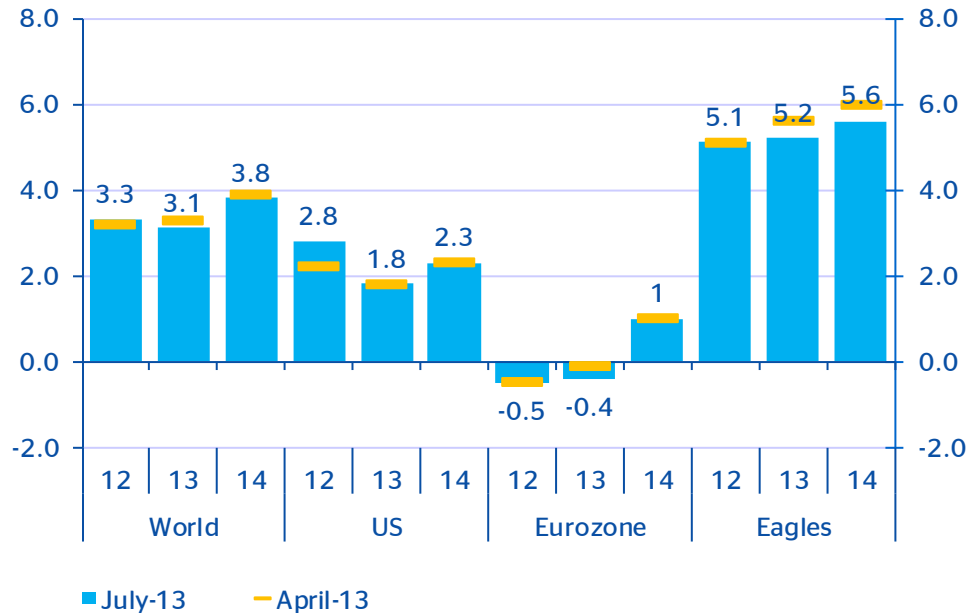
Chinese deceleration has dragged many emerging economies in Asia and Latam

Domestic demand has weakened in big economies (Brazil, India)

What implies an adjustment in growth outlook

Economic growth (%)

Source: BBVA Research, Haver



We maintain growth outlook at 3 different speeds: USA, Europe, Emerging Economies

Developed economies, USA and Euro Area maintains outlook for 2014

Cyclical weakness particularly in emerging markets

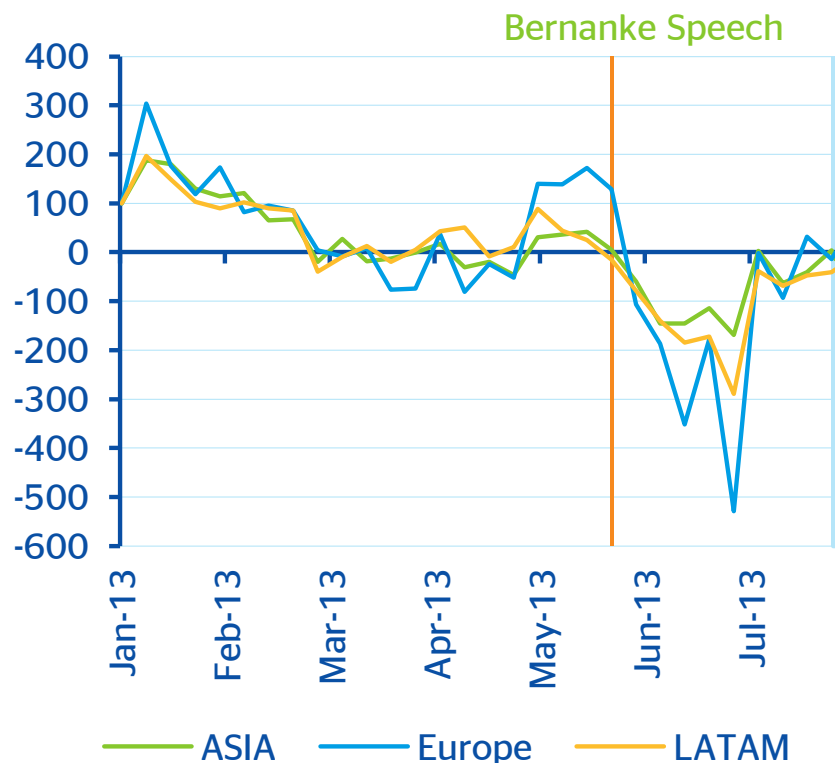
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Less favorable global economic scenario for Latam, but ground for optimism looking ahead

Capital flows in emerging markets (index January 2013 = 100)

Source: BBVA Research and EPFR



Latam, has been one of the hardest hit in this new environment. Some degree of volatility will be maintained

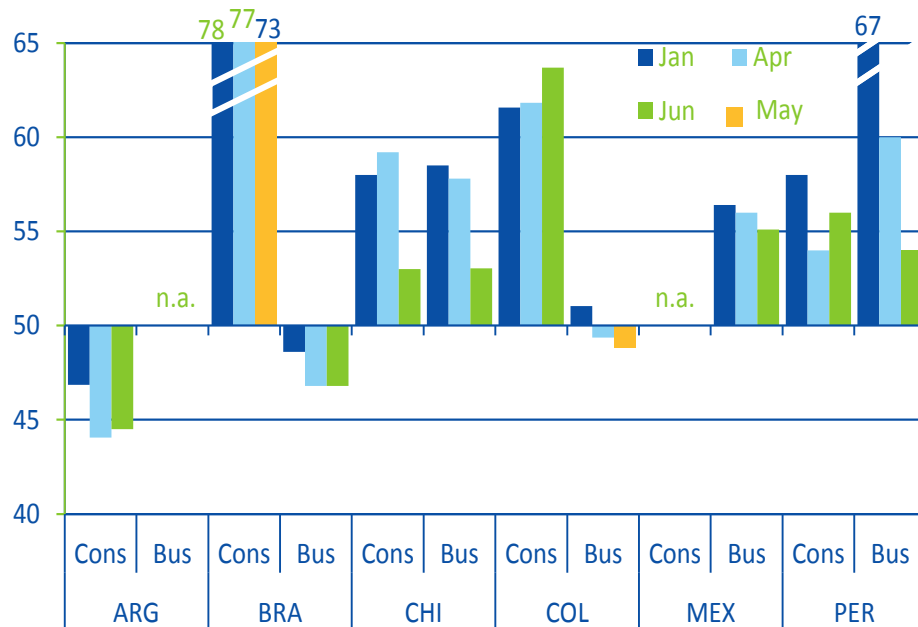
Some grounds for optimism: (i) we expect to see a slowing or reversal of capital outflows; (ii) institutional investors maintain Latam exposition; (iii) an eventual withdrawal of monetary stimulus will coincide with better cycle in USA

Prices of the main export commodities have also been affected, but have stabilized at high levels

Domestic demand has slowed in the region

Confidence Indicators (above 50pts implies optimism)

Source: BBVA Research



Latam countries have experienced deterioration in consumer and producer confidence although in positive side

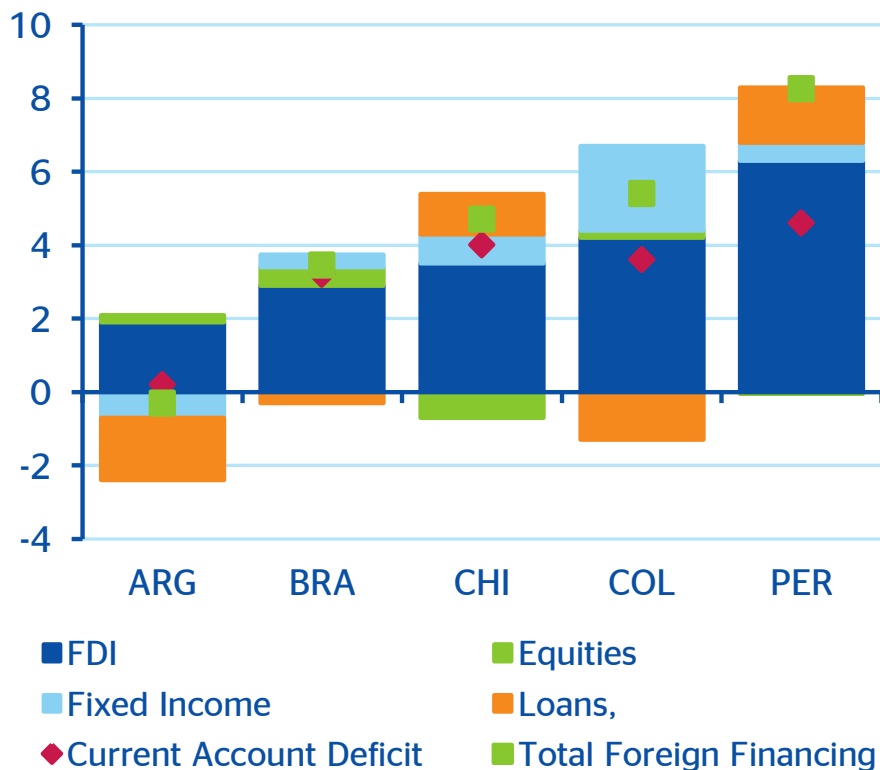
Deceleration of retail sales and imports

Domestic demand continued to be the main factor underpinning growth

Outlook for foreign balances in South America has worsened but are still sustainable

Financing of foreign deficits in South America (last 12 months until June 2013)

Source: BBVA Research



External deficits worsen because of the correction in commodities and weaker external demand

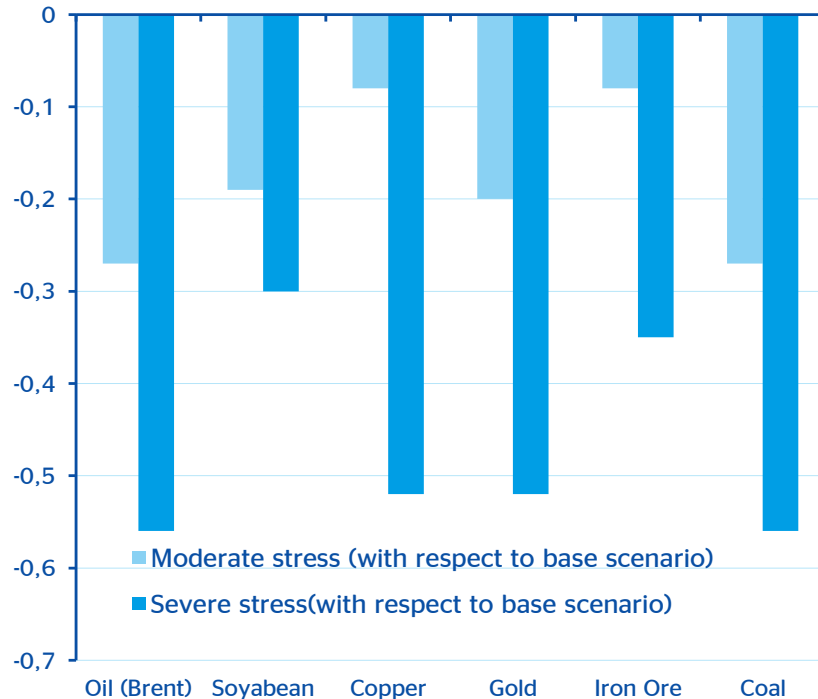
External balances continue to be sustainable, mainly financed by foreign direct investment

Deterioration can be largely explained by the increasing investment more than the consumption (private or public)

The region is ready to stand a correction in commodity prices

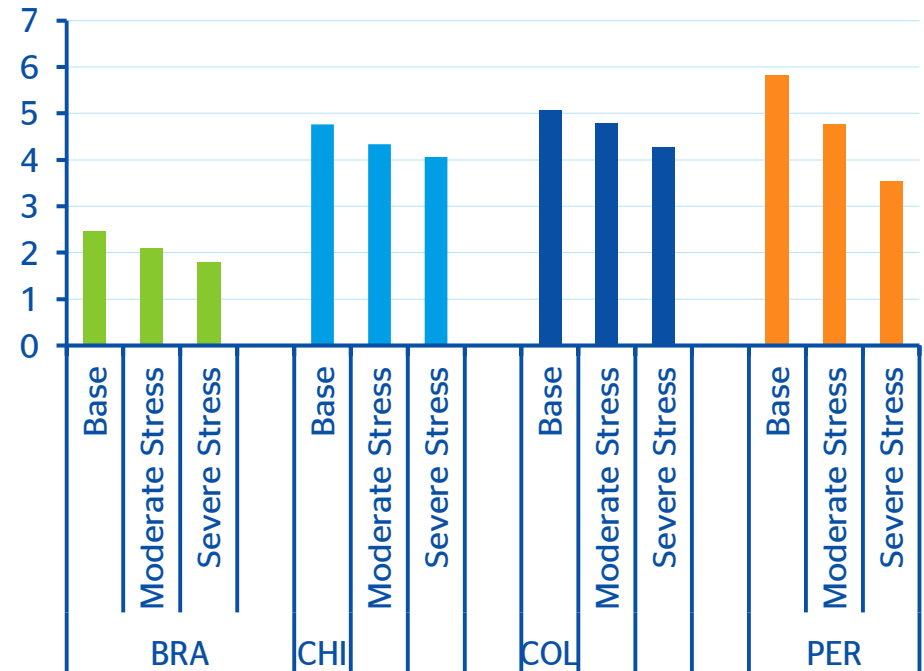
Hypothetical scenario of falling commodity prices (% respect to the base scenario)

Source: BBVA Research



GDP growth in both base and stress scenario(%)

Source: BBVA Research



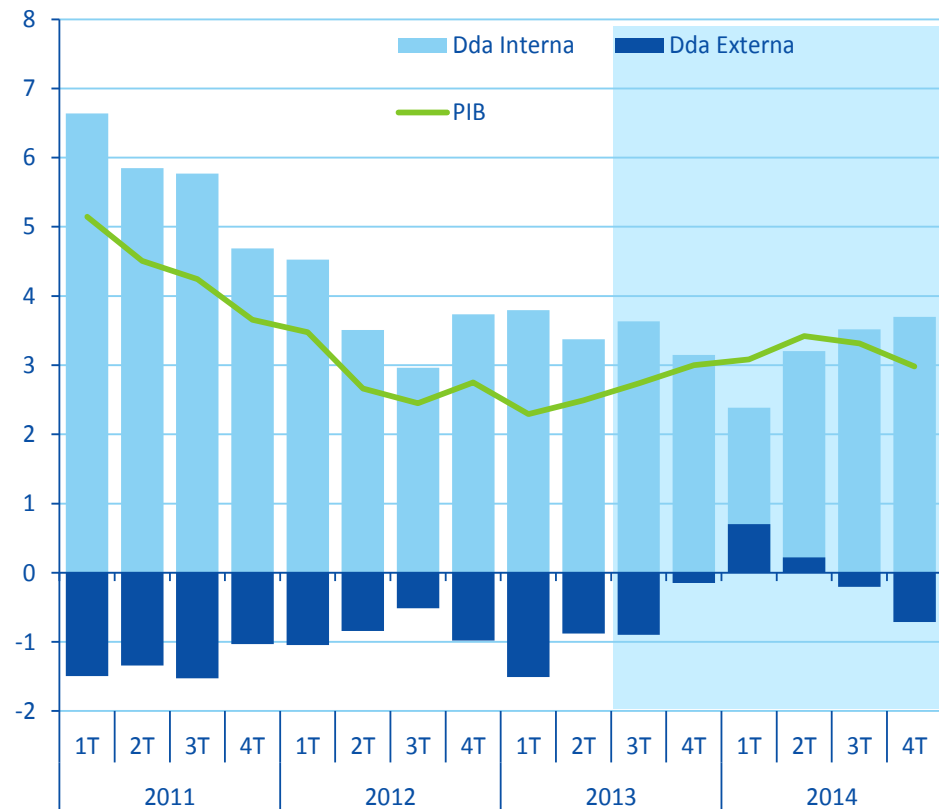
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GDP forecasts are revised downwards: 2.7% in 2013 and 3.2% in 2014

Latam*: GDP growth (%YoY)

* Weighted average for Argentina, Brazil, Chile, Colombia, Mexico, Panama, Paraguay, Peru Uruguay and Venezuela
 Source: BBVA Research



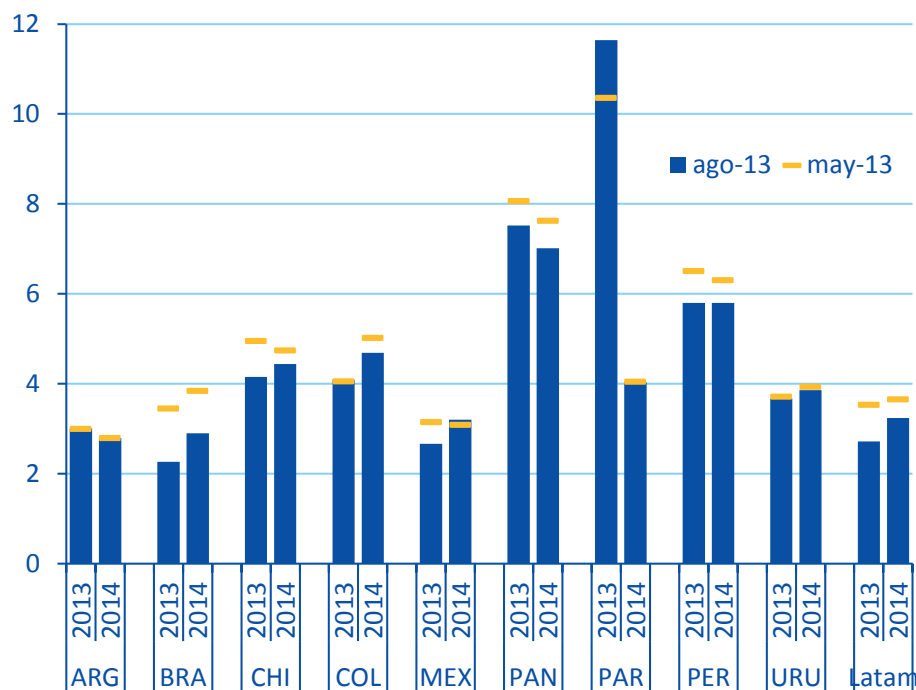
Conditional adjustment to the weakness of the external sector and the slow down of the domestic demand

We expect the region will continue in the recovery path for the next quarters

Andean countries growth will be outstanding, Panama and Paraguay

Latam countries: GDP growth (%)

Source: BBVA Research



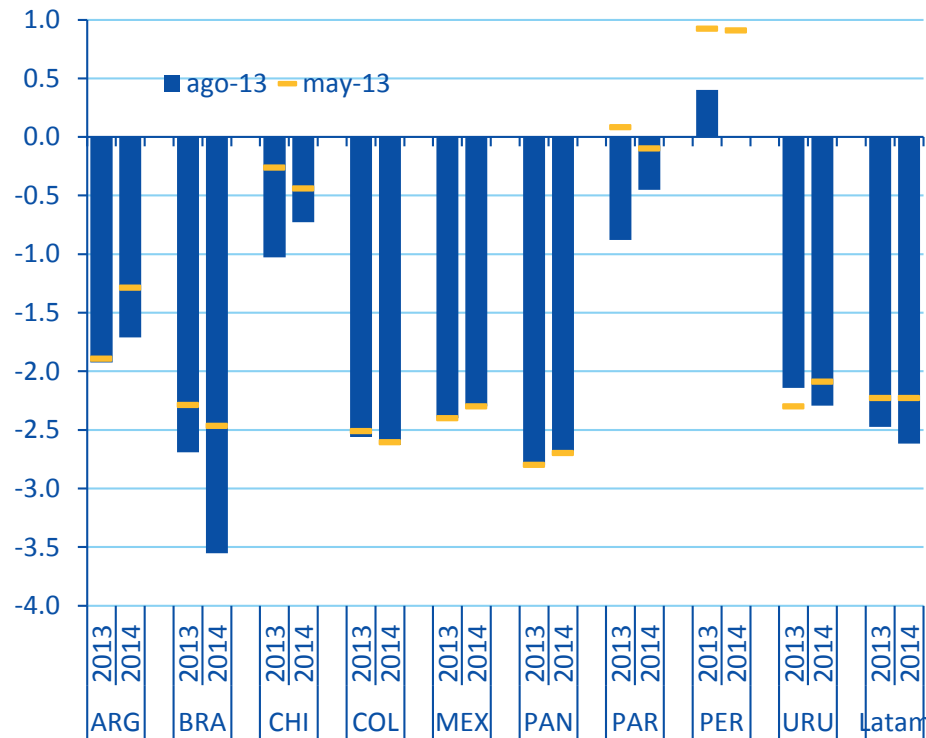
Brazil will continue to show a weak growth, due to cyclical and structural factors. The country has been revised downwards

Excluding Brazil, the rest of the countries will grow by 3,1% in 2013 and 3,5% in 2014, which is closer to its potential (4%)

External and internal weakness also worsen the fiscal balances

Fiscal deficit (% GDP)

Source: BBVA Research and Haver



Weaker domestic demand will drag down fiscal income

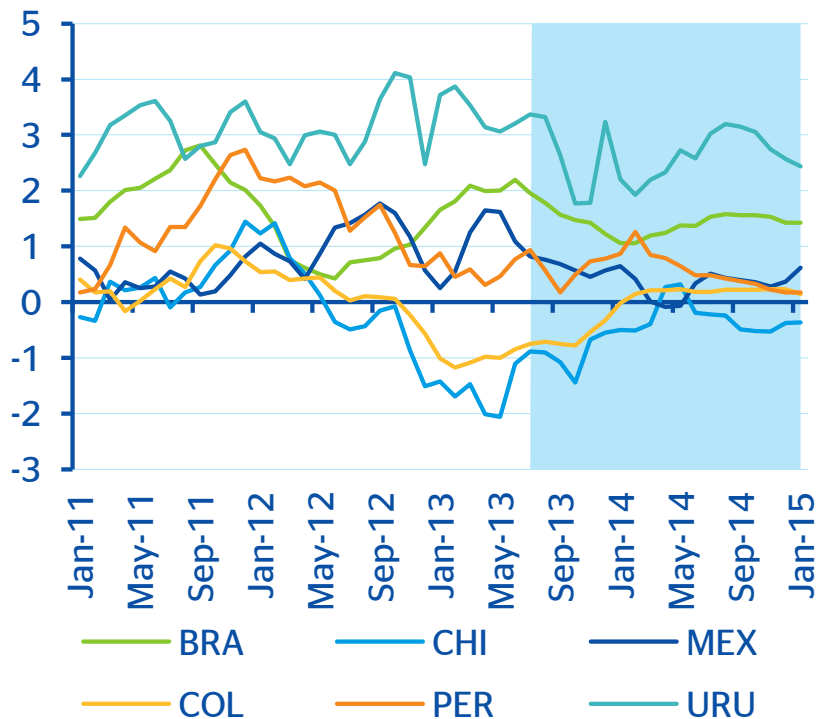
Also will be affected by a more expansive fiscal tone in Peru and Colombia

Fiscal balances continue to be manageable in the region

Inflation will be subdued within the central bank ranges, except in Uruguay

Inflation in prices with inflation targeting (% interanual)

Source: BBVA Research y Haver



Inflation reached its highest in June, but pressures will still last

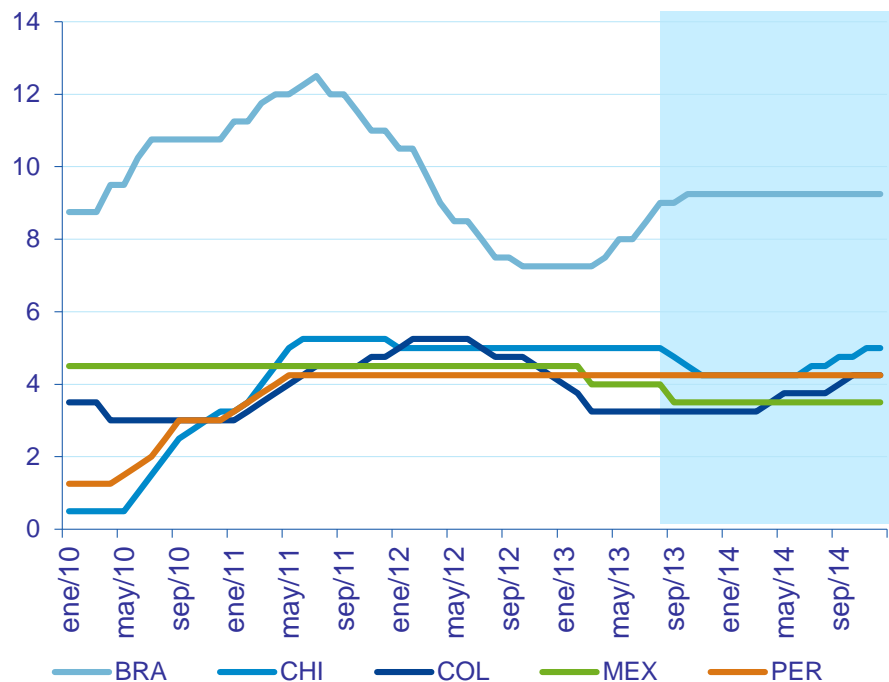
Uruguay is the only country where the inflation remain above the central bank target and will continue over it in 2014

Efecto de la depreciación sobre la inflación se sentirá más en Brasil y Uruguay, por sensibilidad y magnitud del ajuste cambiario

Central banks will adopt a laxer bias, except in Brazil

Policy rates in countries with inflation targeting (%)

Source: BBVA Research y Haver



Central banks will adopt a bias towards a laxer monetary policy. Dilemma between keeping internal activity and maintaining foreign capitals

At one hand, Chile bets for a more orthodox interest rate cut

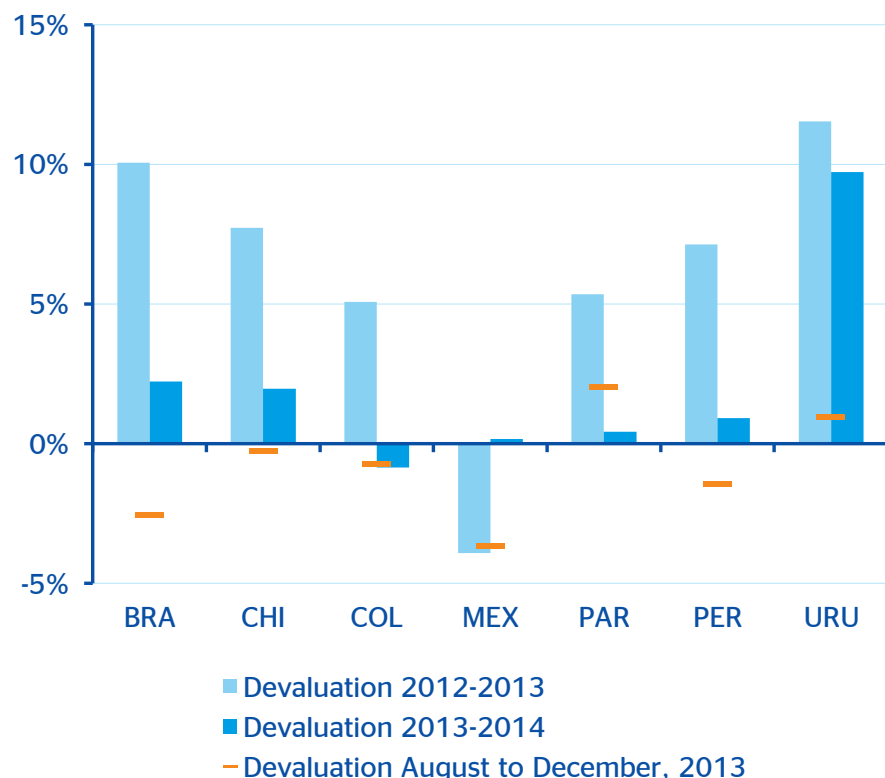
At the other hand, Peru would also choose a laxer monetary policy, but first it would try to reduce bank reserves

On the other hand inflation pressures in Brazil mean that further increases in official interest rates will be inevitable until October 2013

The devaluation in the exchange rate will also help to create laxer monetary conditions in the region.

Devaluation of exchange rate (%)

Fuente: BBVA Research y Haver



We expect a slight trend towards the devaluation of exchange rates in 2013 and 2014

... a greater aversion to risk and worsen foreign balances

Principal exception will be Mexico: initial level of less appreciation and positive impact of the recovery in USA economy for 2H13

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