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What to Expect from Latin American Economies in the Current Global Context?

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Main messages

1. Latin America has changed both in politics and economics. It is now better prepared to weather global instability.

2. Volatility has returned to Latam markets, but we expect differentiation going forward, based on fundamentals. Most countries have good buffers to withstand the Fed's tapering

3. Latam GDP growth will increase from 2.2% in 2013 to 2.5% in 2014 and 2.6% in 2015. Growth differences within the region will increase: the Pacific Alliance will grow close to 4% in 2014 and 2015, more than double the pace in Mercosur.

4. Regional growth will remain relatively high for its income level, converging to its potential in most countries. We expect growth for the region to converge to nearly 4% in the medium-long run.

5. However, it is crucial that reforms continue to be pushed through to avoid weakening drivers of long-term growth

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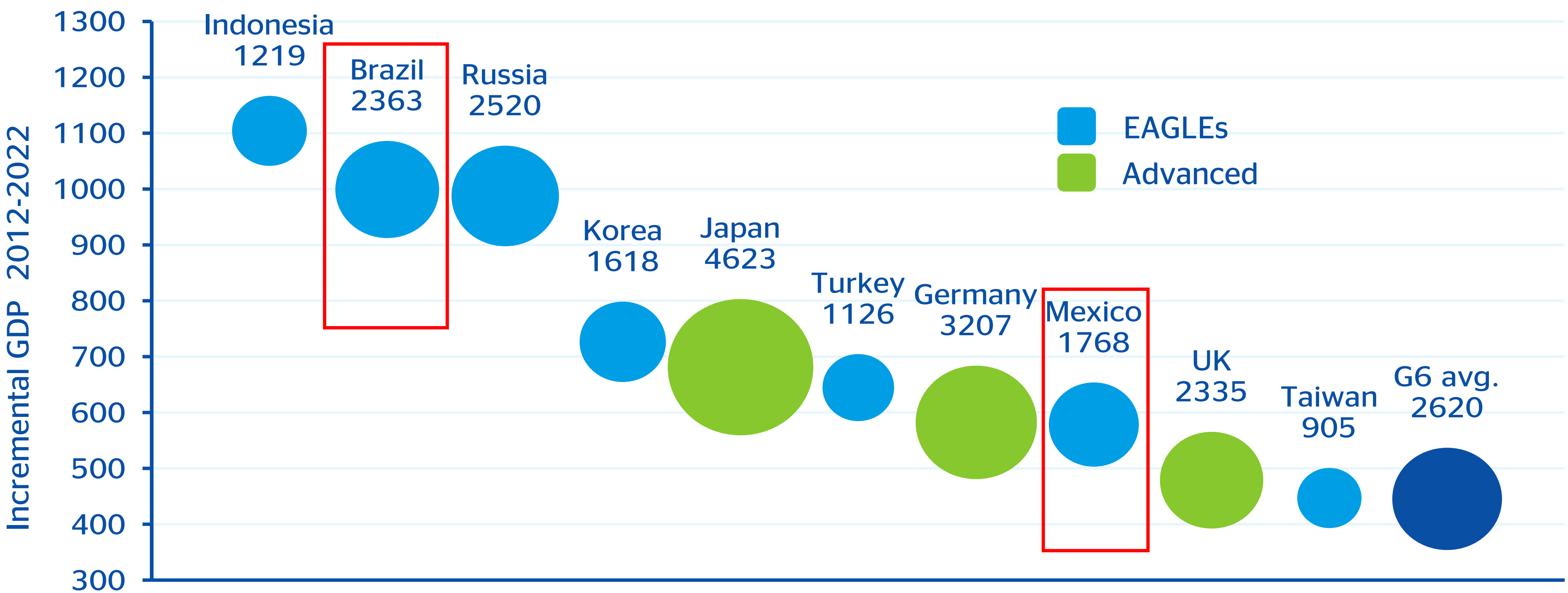
Beyond China and India, some Latin American countries are world players

EAGLEs (excluding China and India)* vs G6 Economies: current economic size and contribution to World economic growth 2012-2022 in billion USD adjusted by PPP**

** Size of the bubble are proportional to 2012 level; below country labels

Source: BBVA Research and IMF WEO

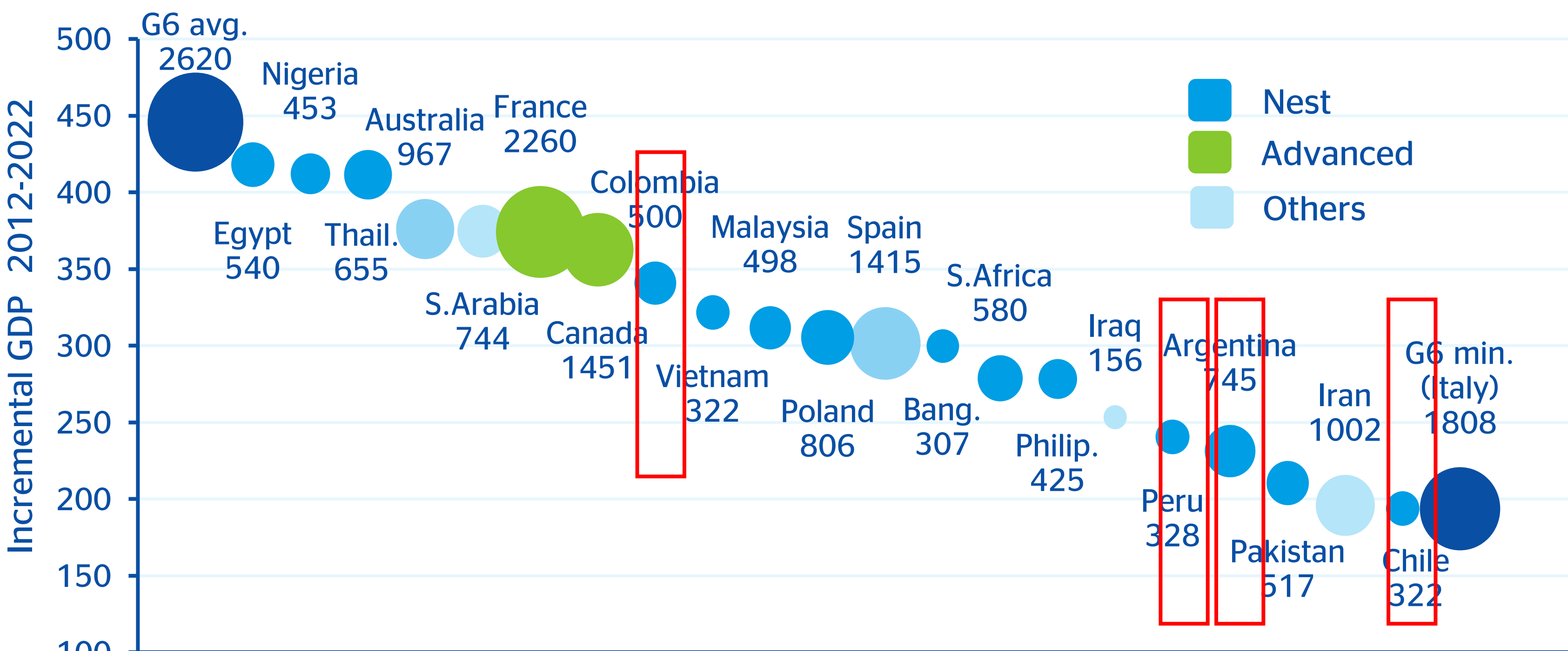


Note: EAGLEs members, according to January 2013 forecast.

Other smaller ones also globally relevant

- As many as 15 economies in the NEST (contributing more to global GDP than smallest G6, Italy)
- Egypt relegated from the EAGLEs; Chile and Ukraine advanced from the group of other EM to NEST

Nest, G6 and Other Economies: current economic size and contribution to World economic growth 2012-2022 (%)* in billion USD adjusted by PPP
** Size of the bubble are proportional to 2012 level; below country labels
Source: BBVA Research and IMF WEO



Note: NEST members, according to January 2013 forecast.

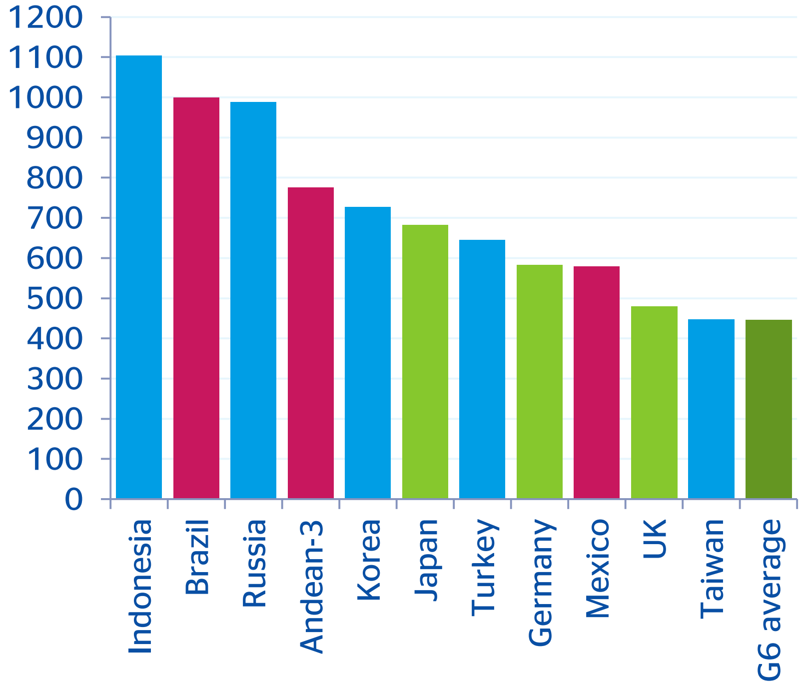
Pacific trio taken together also huge

- Colombia, Peru and Chile belong to the Nest, with average expected growth of around 5% for the next 10 years.
- The three countries are characterized by their reform drive, prudent macroeconomic policies and increasing integration with the global economy (including the Asia-Pacific region).

EAGLEs and Latam: increase of GDP in the next 10 years

(PPP-adjusted bn USD)

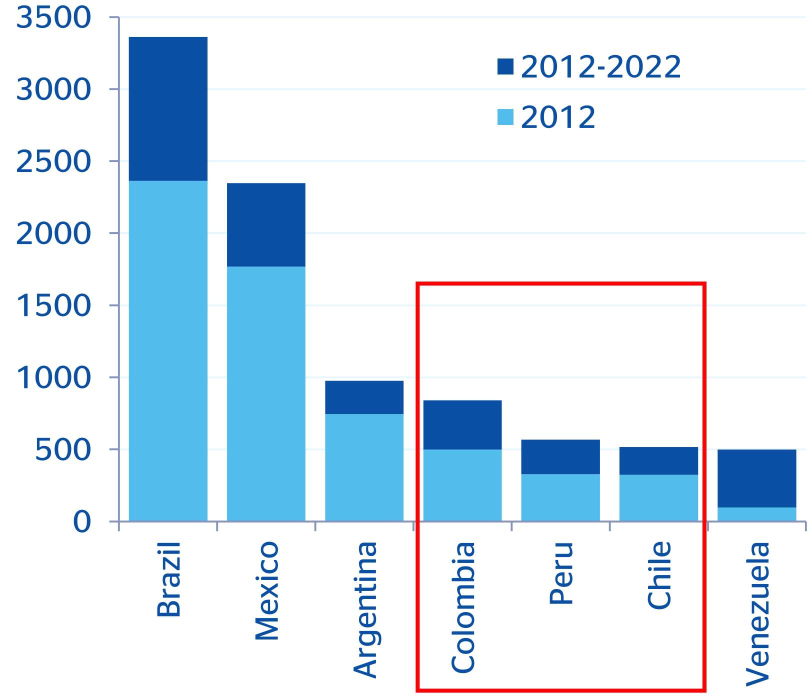
Source: BBVA Research and IMF (WEO)



Latam: current GDP size and increase in the next 10 years

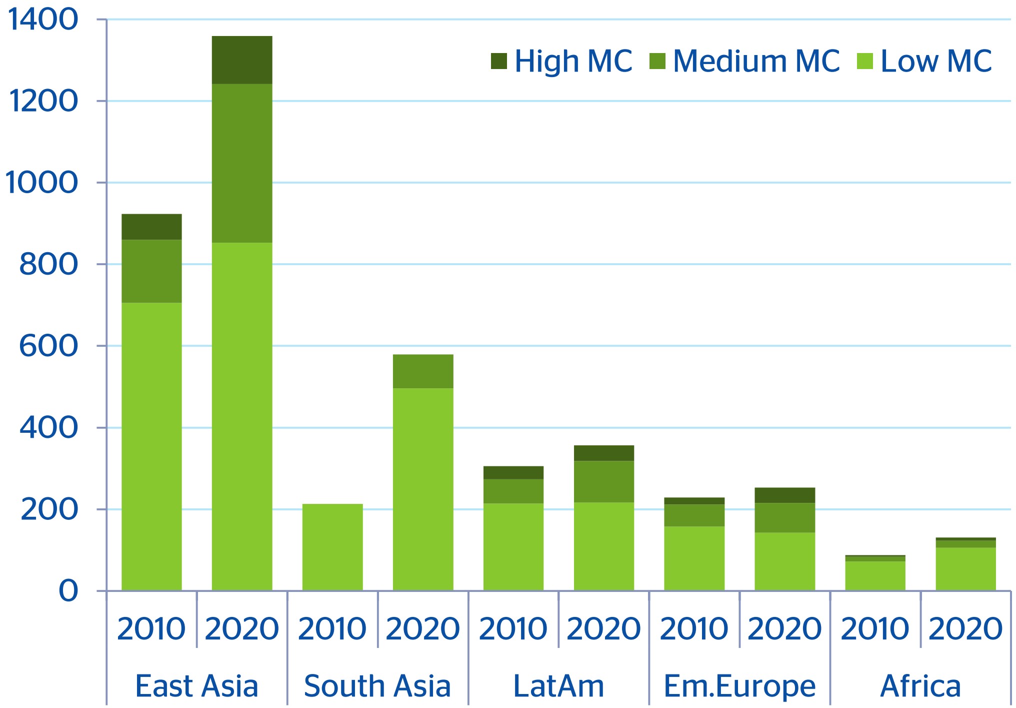
(PPP-adjusted bn USD)

Source: BBVA Research and IMF (WEO)



New middle class to support domestic demand but trend much bigger in Asia than in LATAM

Emerging Markets: middle classes ranges by area
(2010 PPP-adjusted USD)
Source: BBVA Research



Middle class: High (25,000-40,000 USD), Medium (15,000-25,000 USD) & Low (5,000-15,000 USD).

- Latam economies face intense competition from Asia, as the region where middle classes will increase the most.

East Asia = China, Indonesia, Korea, Malaysia, Philippines, Thailand, Vietnam

South Asia = India, Bangladesh, Pakistan

LatAm = Brazil, Mexico, Argentina, Chile, Colombia, Peru

Em. Europe = Russia, Turkey, Poland, Ukraine

Africa = Egypt, Nigeria, South Africa

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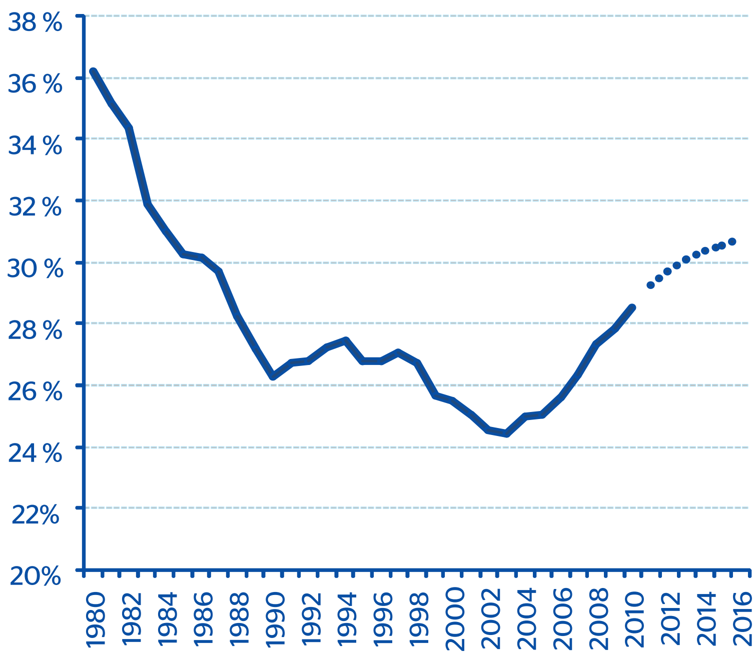
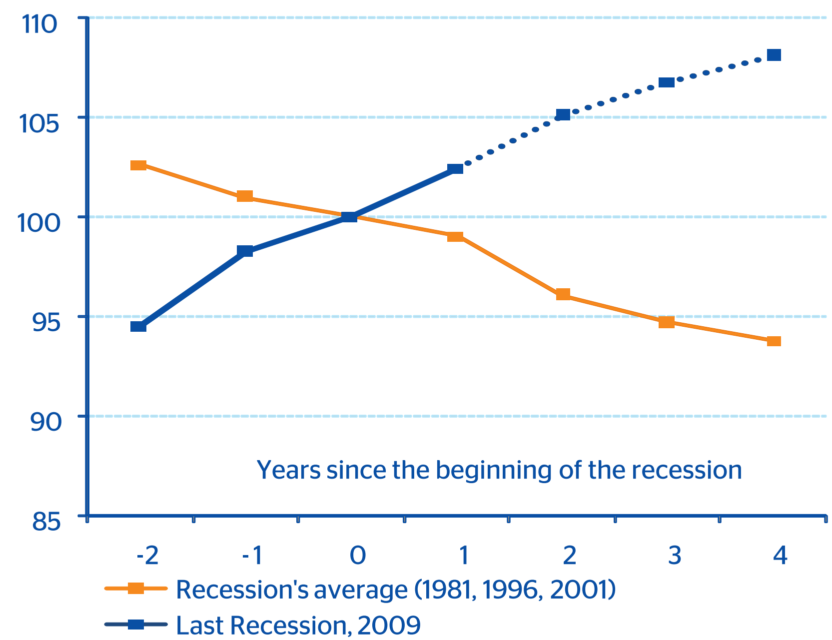
LATAM breaking with the past

After decades of poor performance, LATAM growing solidly and closing the gap with developed economies. The 2008-09 crisis was the stress test: it was the first big shock without a divergence in terms of per capita GDP.

LatAm: GDP per capita relative to G7 (%)
Source: IMF and BBVA Research



LatAm: GDP per capita, relative performance to G7 during recession periods
Source: IMF and BBVA Research



Why is LATAM breaking with the past?

1) **Structural reforms**: reforms that began in the 80s are transforming Latin America.

Macroeconomic reforms

- **Fiscal consolidation with higher and better taxes**
- **Independent Central Banks**
- **Financial reform**
- **Opening of the Economy**

Microeconomic reforms

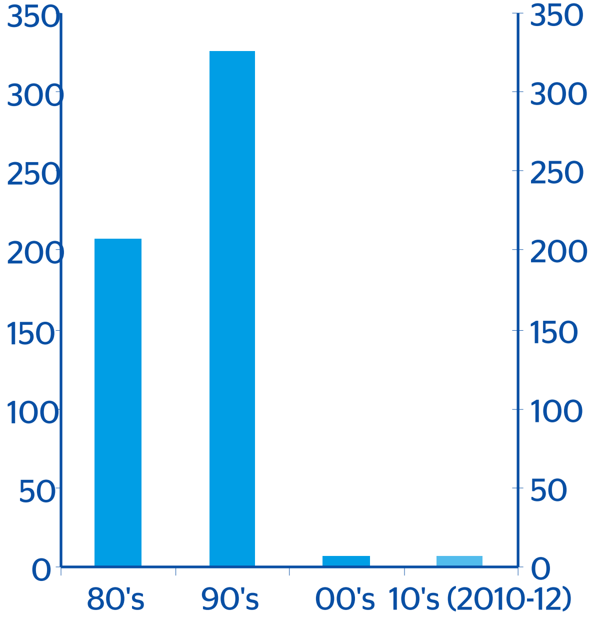
- **From labor protection to targeted transfers to the poor**
- **Liberalization of internal markets and privatizations**
- **Receptiveness of FDI**
- **Pension system reforms**

Better Business Climate for investment and more equitable societies

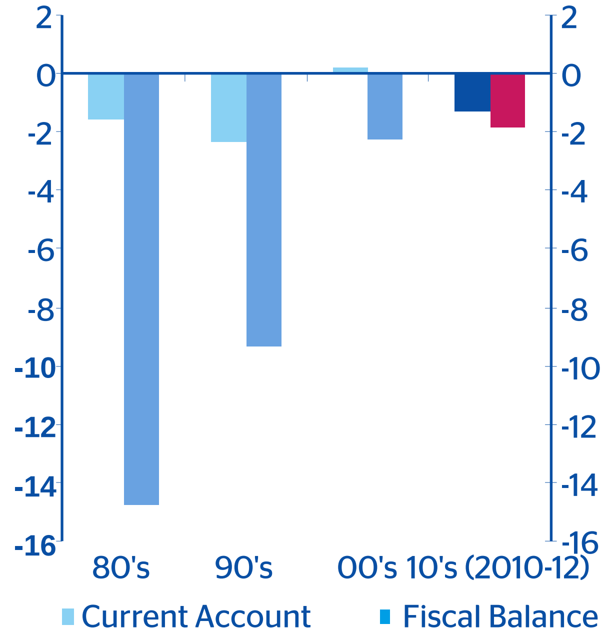
Why is LATAM breaking with the past?

2) **Economic stability**: While taming inflation in the late 90s, the region made sustained progress in external and public solvency over the years.

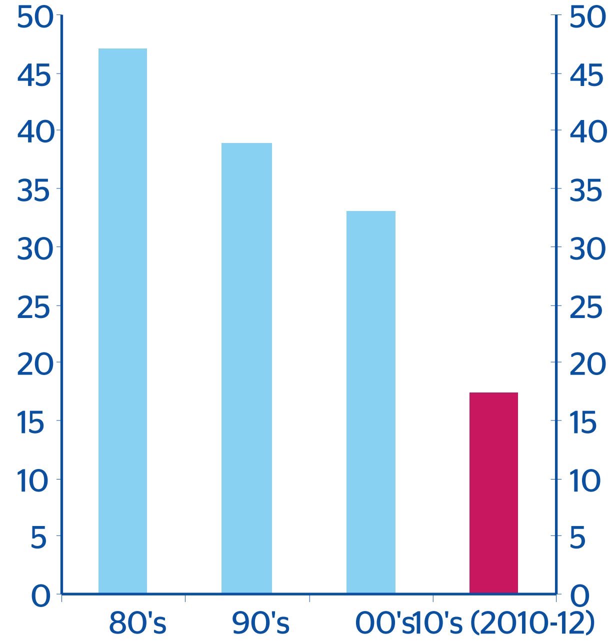
LatAm: Inflation
(CPI, % yearly average)
Source: BBVA Research



LatAm: External and Fiscal Balance.
(As % of GDP)
Source: BBVA Research



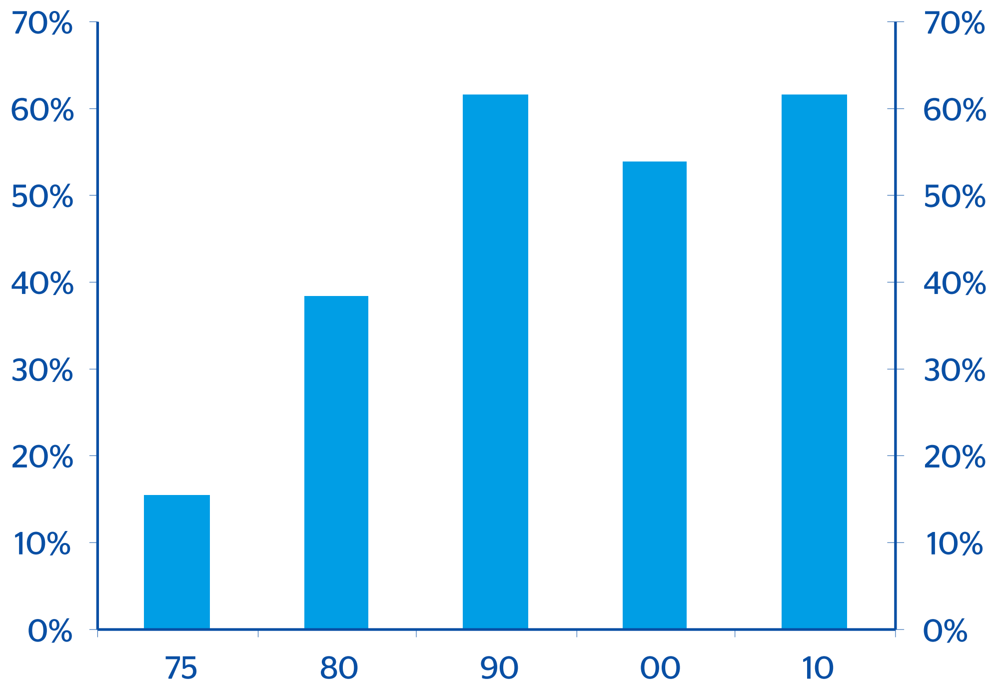
LatAm: External Debt
(As % of GDP)
Source: BBVA Research



Why is LATAM breaking with the past?

3) Institutional stability: Economic change has come along with institutional progress

LatAm: Political Freedom
(Freedom House Index, % of free countries)
Source: BBVA Research with Freedom House data

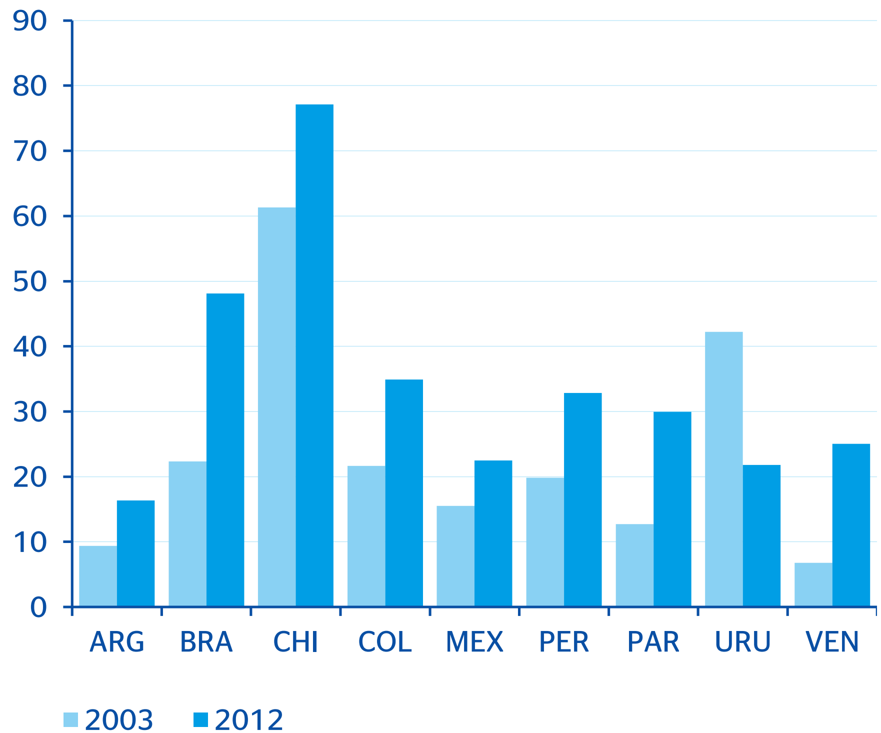


Why is LATAM breaking with the past?

4) **Sound banking system**: The banking systems have been able to speed up credit supply, to cut NPL losses and to preserve high capital to assets levels.

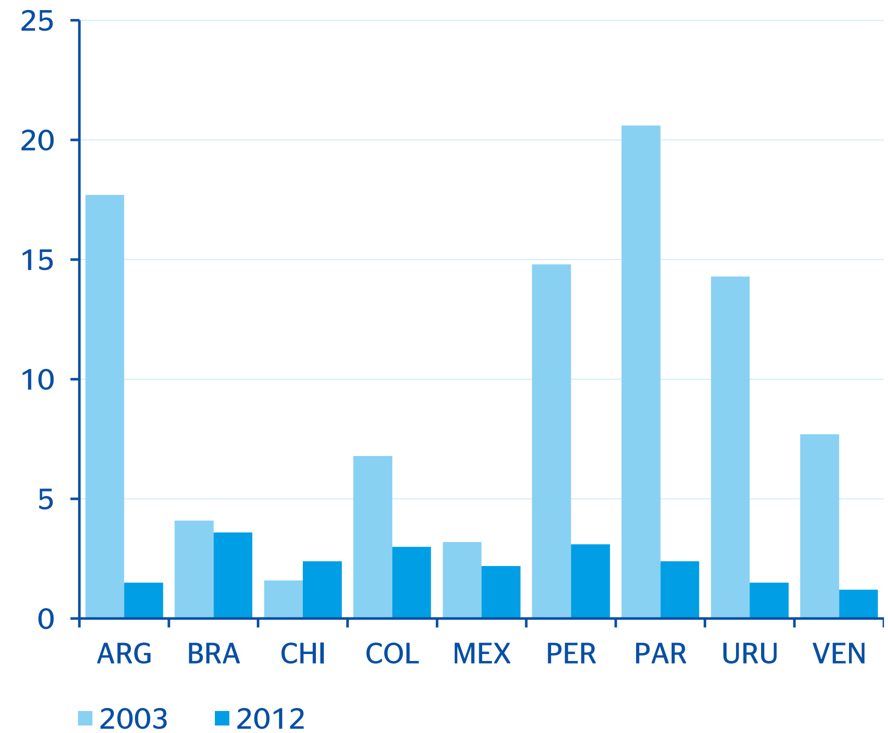
Latam: credit as % of GDP

Source: BBVA Research,



LatAm: NPL %

Source: BBVA Research, GSFR. *Last available information

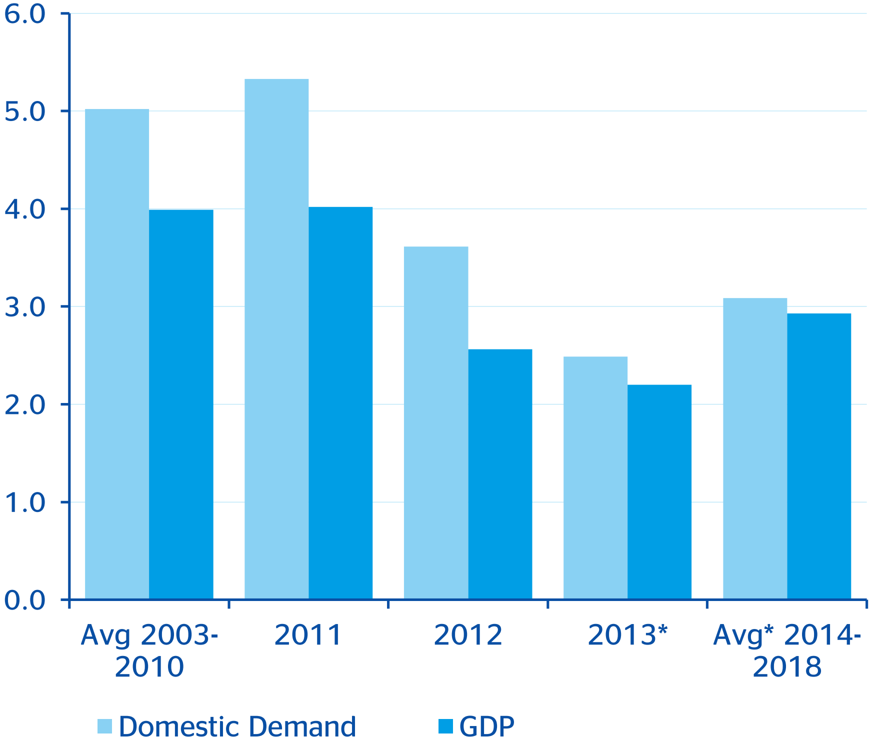


Why is LATAM breaking with the past?

5) **Supportive domestic demand**: LATAM growth rests on the strength of domestic demand. For the first time in decades, growth comes along with the reduction of poverty and inequality, which drives domestic demand up.

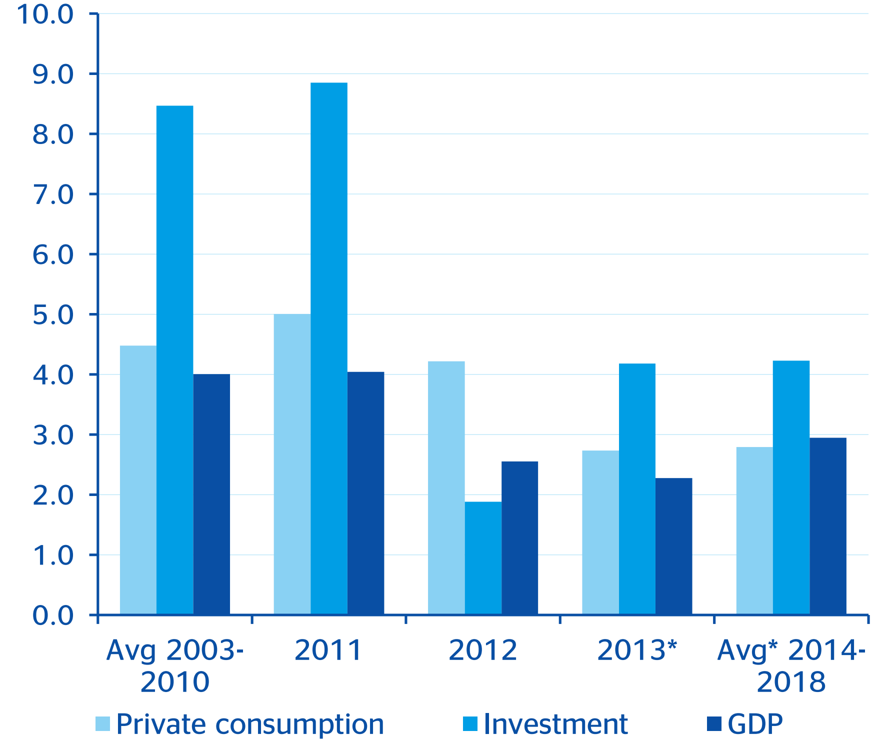
Latam: Domestic demand and GDP (%yoy)

Source: BBVA Research. LatAM: ARG, BRA, CHI, COL, MEX, PAN, PAR, PER, URU, VEN



Latam: Private Consumption, Investment & GDP (%yoy)

Source: BBVA Research. LatAM: ARG, BRA, CHI, COL, MEX, PAN, PAR, PER, URU, VEN

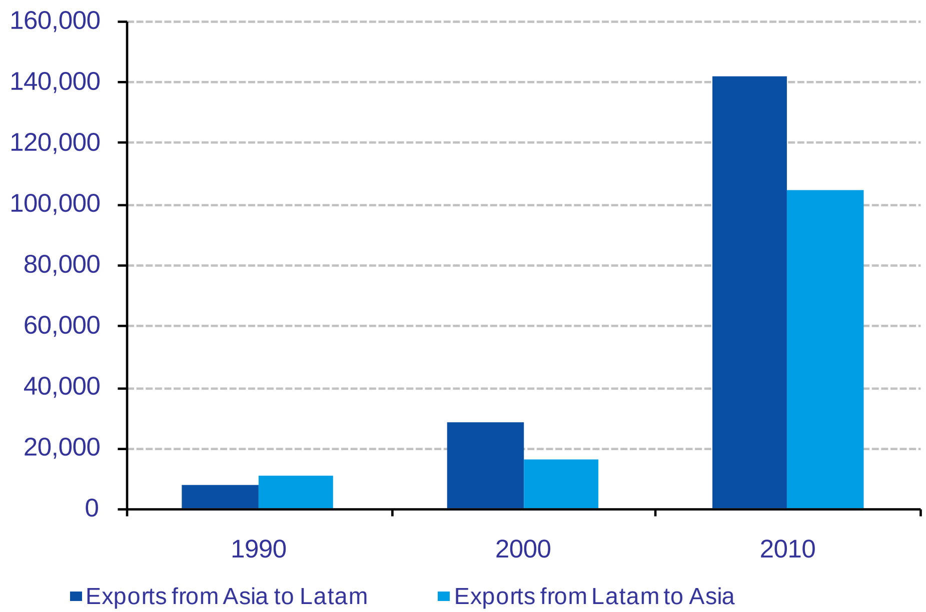


Why is LATAM breaking with the past?

6) **Asia and commodities**: LATAM countries are also benefiting from Asian demand for commodities.

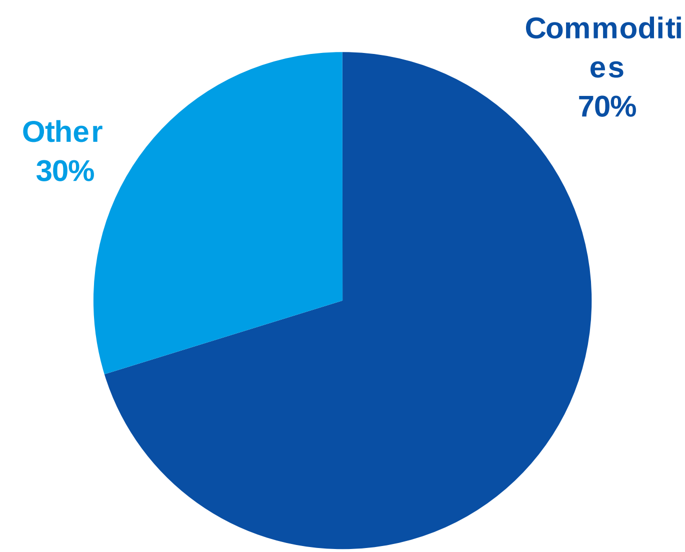
Trade flows Asia-LATAM (USD millions)

Source: BBVA Research y COMTRADE.



Composition of Exports from LATAM to Asia (% total)

Fuente: BBVA Research y COMTRADE.



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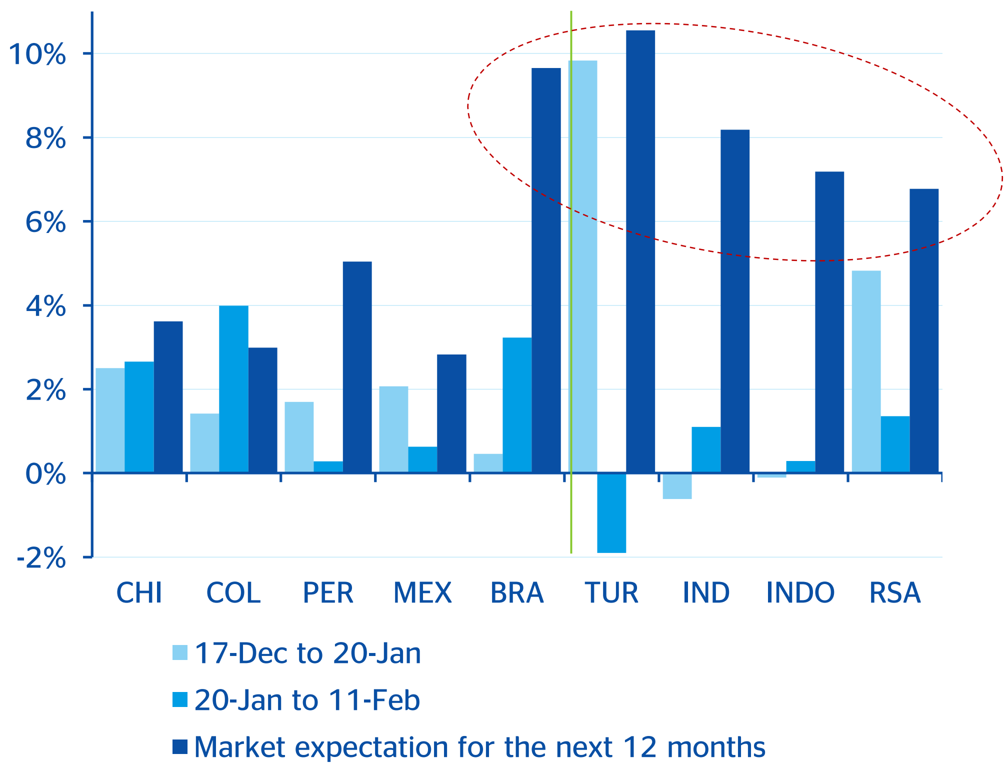
Volatility returned to Latam markets but, recently, more differentiation

Variations in EM exchange rates (%)

Source: BBVA Research and Bloomberg



***RSA: Republic of South Africa**

Volatility also affected Latam: currency depreciation, higher sovereign spreads and weaker equity markets

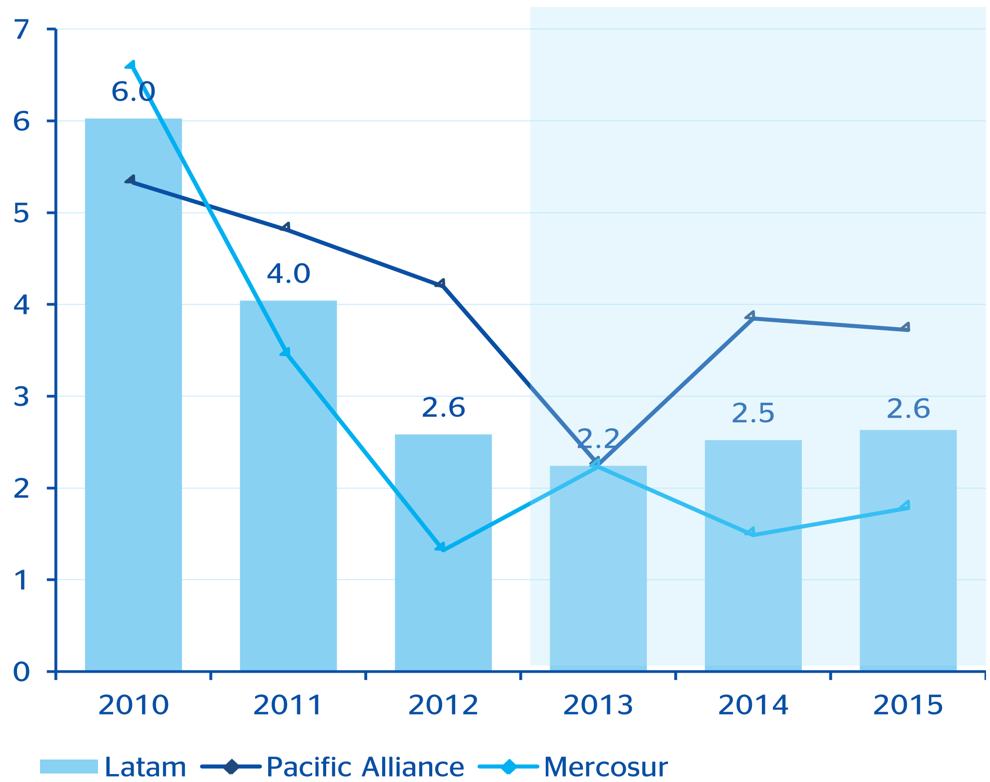
However, capital flows into the region have not reversed, just slowed

We expect contagion from the sharp currency depreciation in Argentina to be limited, with only a moderate effect on Brazil and Uruguay

The markets already appear to be starting to differentiate on the basis of macro fundamentals and solid policies

Growth will increase from 2.2% in 2013 to 2.5% in 2014 and 2.6% in 2015

Latam*: GDP growth (%)
Source: BBVA Research



Activity will accelerate in 2014 as Mexico leaves behind temporary negative shocks …

… and external demand gradually recovers in line with global growth

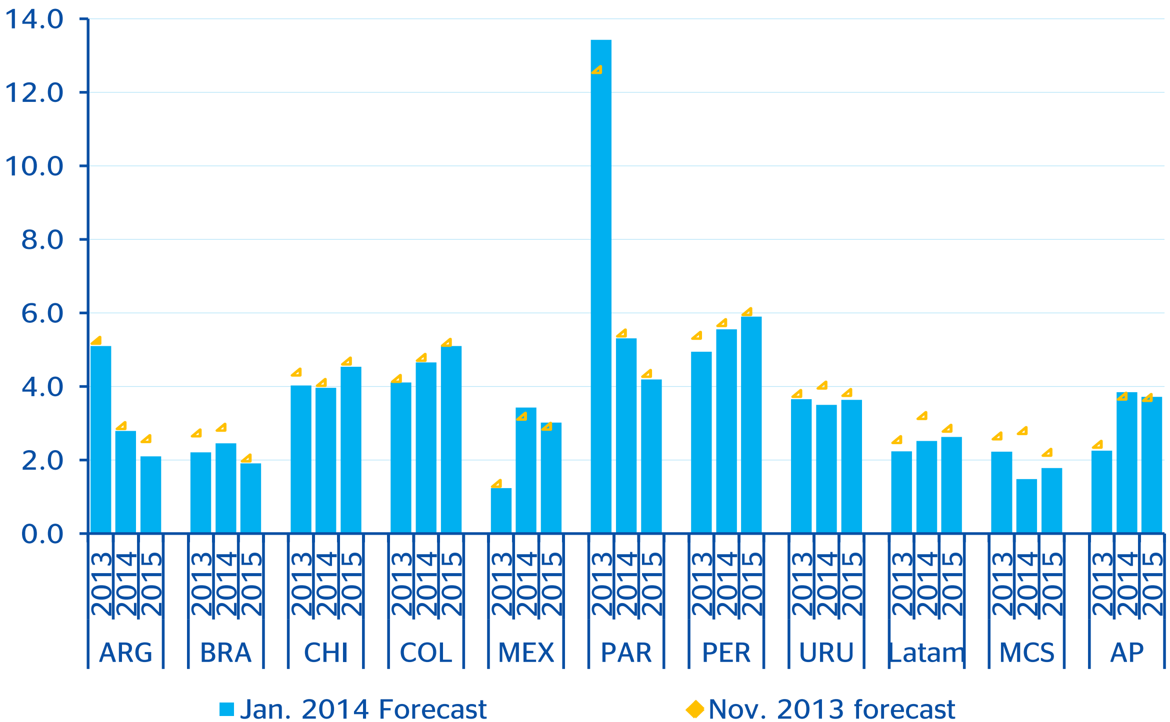
In the longer term, regional growth will start to converge to its potential, around 3.5%

Increasing divergence: Pacific Alliance will grow 3.8% in 2014 and 3.7% in 2015, more than double the rate in Mercosur

*** Latam: weighted average of Argentina, Brazil, Chile, Colombia, Mexico, Paraguay, Peru, Uruguay and Venezuela; Pacific Alliance: Chile, Colombia, México, Peru. Mercosur: Argentina, Brasil, Paraguay, Uruguay, Venezuela**

The Andean countries and Paraguay will continue to post the fastest growth

Latam countries: GDP growth (%)
Source: BBVA Research



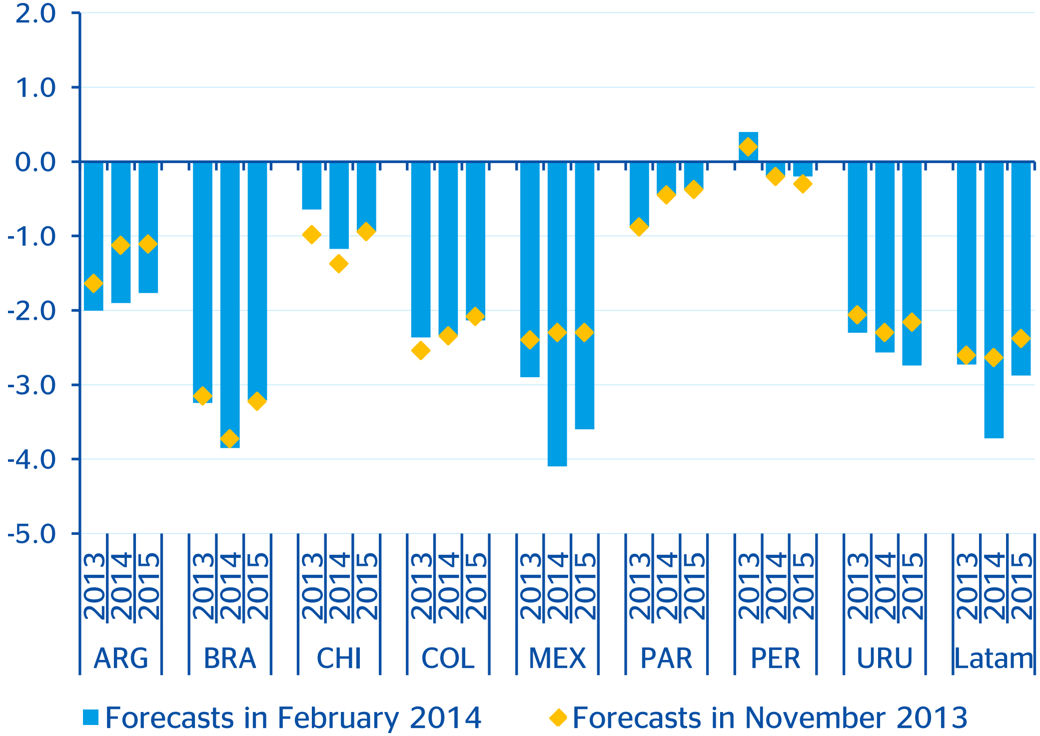
Mexico will see strong growth in 2014 after the downturn in the construction sector in 2013

Brazil will record moderate growth of 2.5% in 2014, reflecting the negative impact of tighter monetary policy and structural problems

Pressure on fiscal deficits will continue, but they will remain manageable

Latam: Fiscal deficits (% GDP)

Source: BBVA Research and Haver Analytics



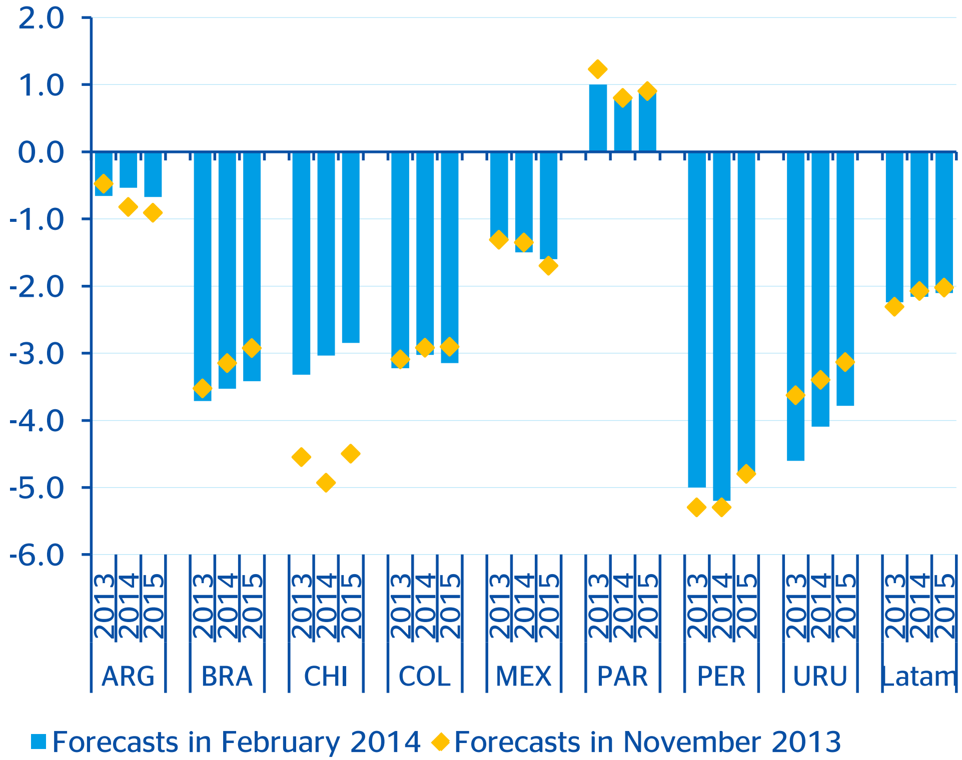
Only moderate growth in internal demand and lower raw materials prices will continue to put pressure on fiscal balances

Fiscal deficits should start to ease from 2015 onwards, as growth and external demand recover

External deficits will start to shrink in 2014

Latam: Balance on current account (% GDP)

Source: BBVA Research and Haver Analytics



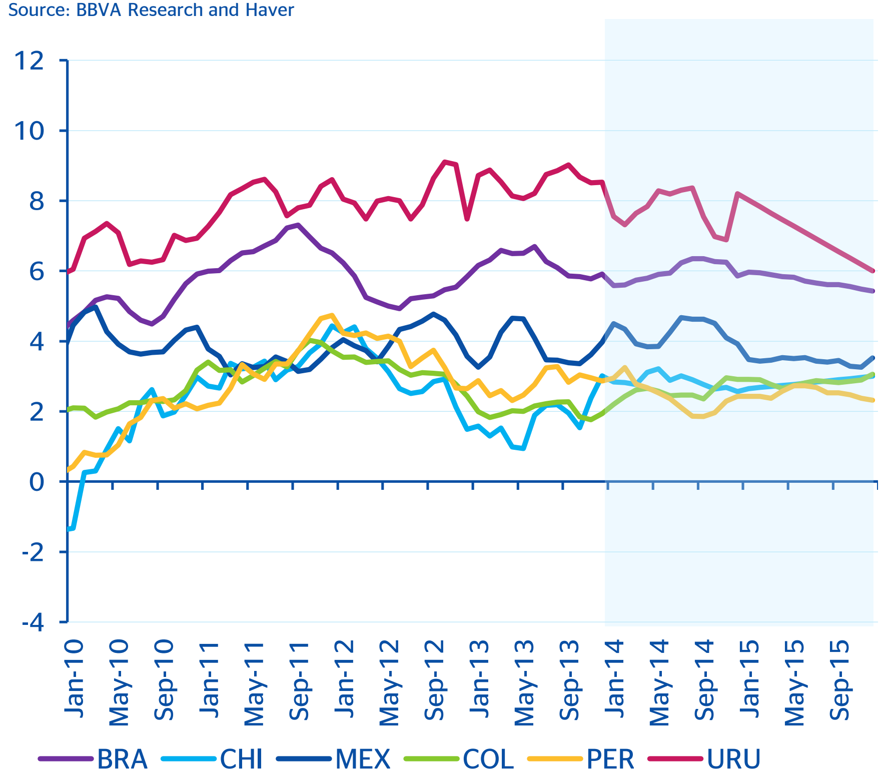
Deficits will start to decline, particularly in those countries with a bigger foreign trade gap (Peru, Uruguay)

The outlook for exports will improve as the supply problems in the export sector in some countries improve ...

....as well as due to currency depreciation and the recovery in global growth

Inflation mainly to converge to central bank targets (Uruguay and Brazil exceptions)

Inflation (%yoy)
Source: BBVA Research and Haver



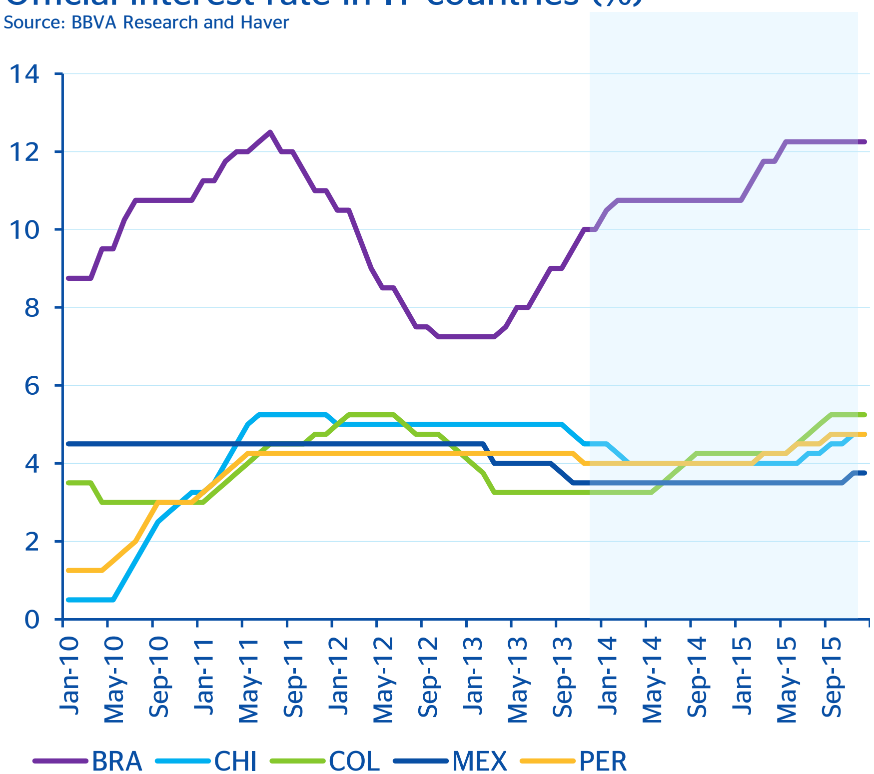
Gradual convergence of inflation with central bank' central target, except in Brazil and Uruguay

Contained demand pressure and more moderate food prices will help to contain inflation

Currency depreciation will in general terms have a limited pass-through to inflation

Heterogeneous monetary policy due to different inflation and cyclical positions

Official interest rate in IT countries (%)
Source: BBVA Research and Haver



In future, tighter monetary policy in Brazil and Uruguay due to the pressures on inflation

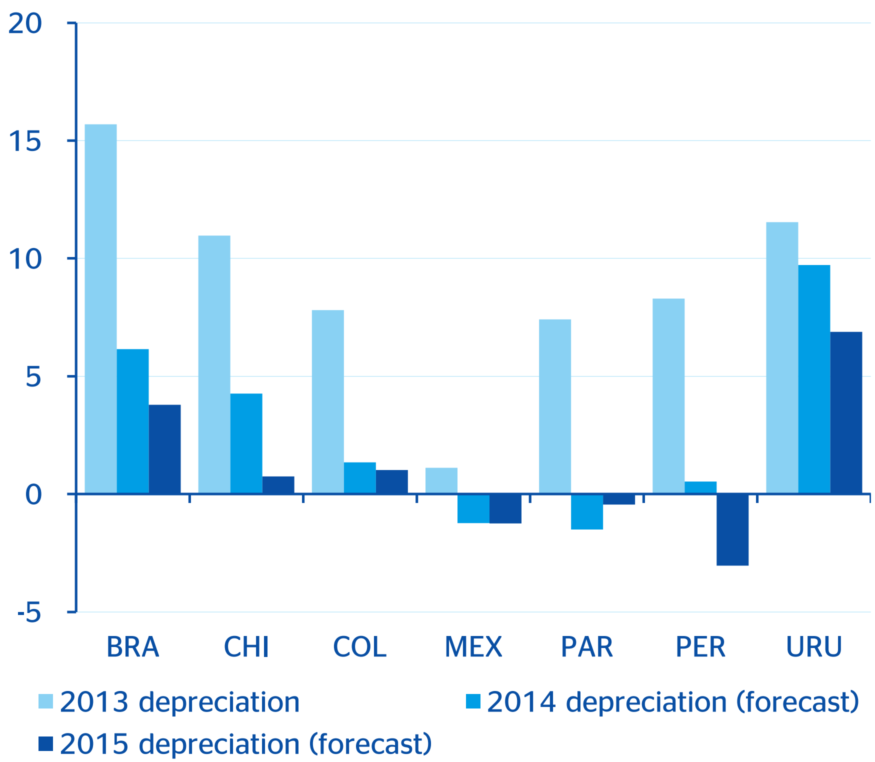
The Pacific Alliance countries will follow different paths, in line with their cyclical positions

The divergence between nominal and real interest rates will continue between Brazil and the Pacific Alliance countries

Interest rates will rise in 2015, due to inflation (Brazil) or cyclical improvement (Pacific Alliance)

Relatively stable exchange rates in 2014-2015 with the exception of Brazil and Uruguay

Latam: exchange rate depreciation vis a vis USD (%)
Source: BBVA Research and Haver



Contained depreciation: most of the impact of tapering in the US was priced-in by the markets in 2013

The principal exception will be Brazil: sharp depreciation in 2014 and 2015 due to higher inflation and efforts to recover part of the loss of competitiveness...

Uruguay will also be dragged by higher inflation than its neighbours and the currency depreciation experienced by its trade partners

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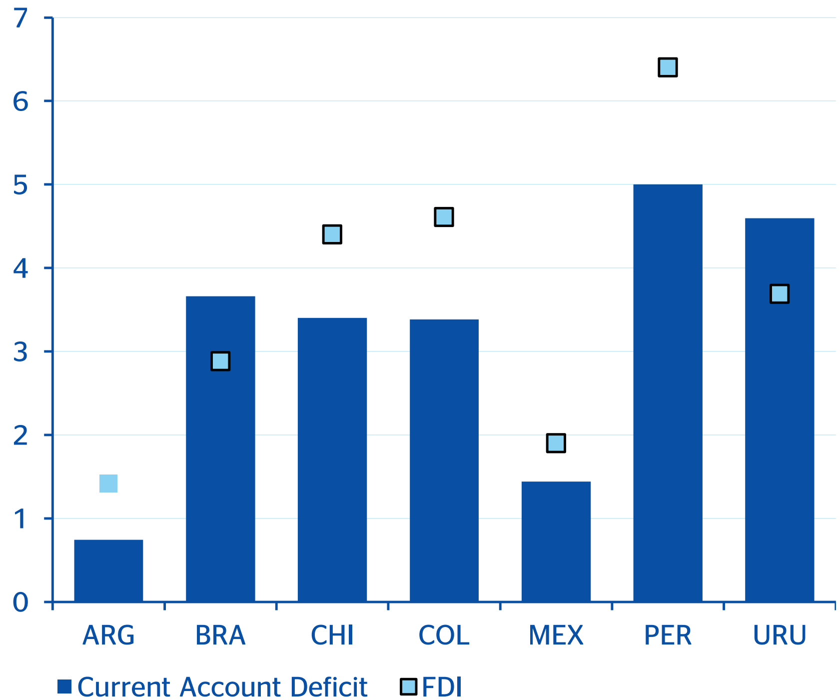
Reduced vulnerability to external shocks, both in terms of flows …

External deficits, in the majority of cases financed by FDI, less volatile in periods of market turbulence

Eliminating the cyclical component, the structural deficits in Latam will not exceed 3% of GDP: sustainable given the outlooks for growth in the region

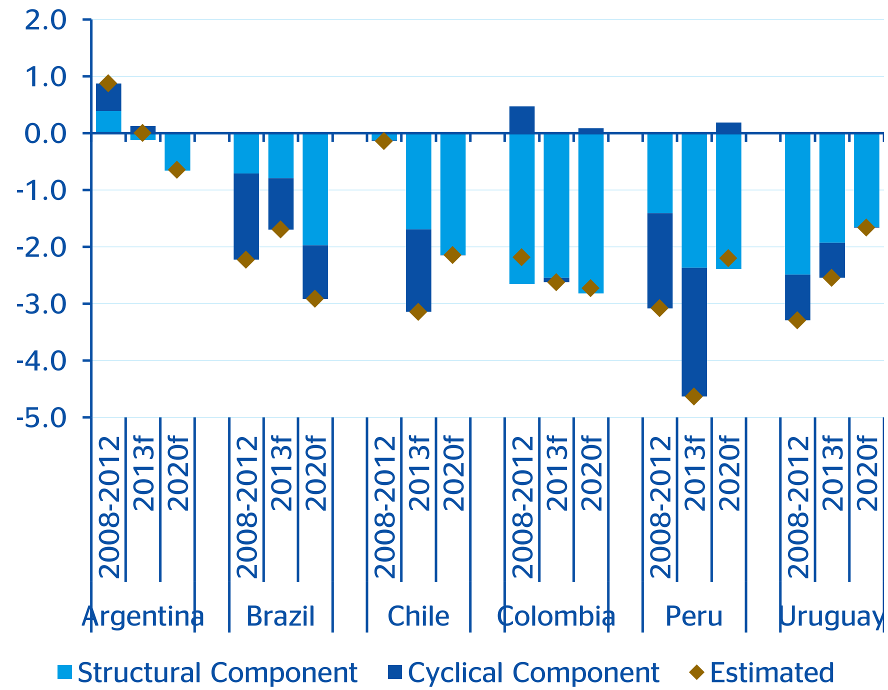
Deficit on current account and financing with FDI (% GDP)

Source: BBVA Research and national statistics



Balance on current account , cyclical and structural component (% GDP)

Source: BBVA Research and Haver Analytics



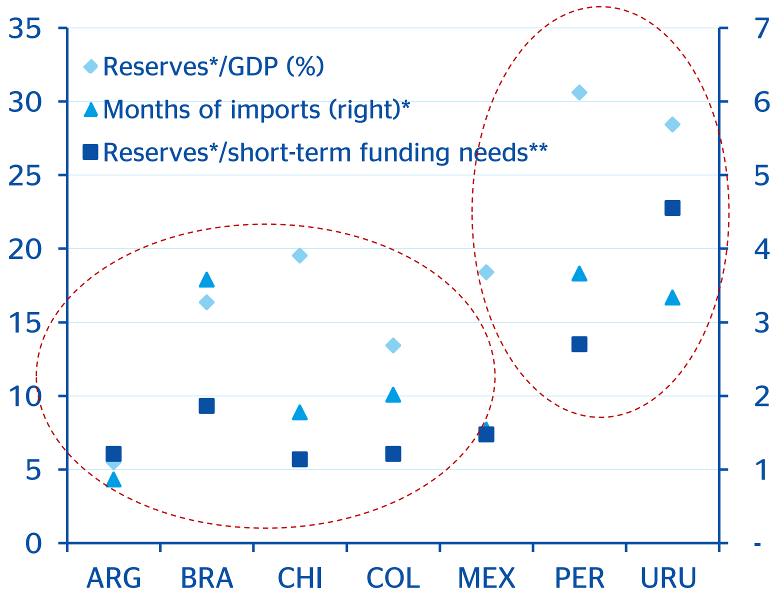
… and stocks

High levels of international reserves …

… and substantial reduction in public- and private-sector debt with less foreign-currency exposure

International reserve indicators

Source: BBVA Research, Haver Analytics and national statistics

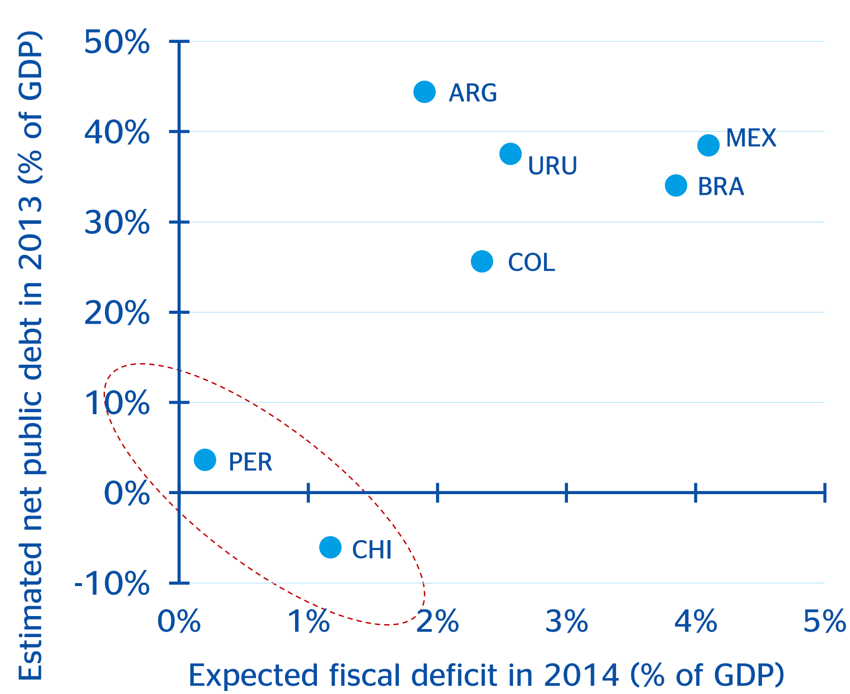


* International reserves include IMF FCL lines in the case of Colombia and Mexico and sovereign funds in the case of Chile and Peru

** The need for short-term financing is the sum of the deficit on current account in 2014, short-term debt and long-term debt maturities in 2014.

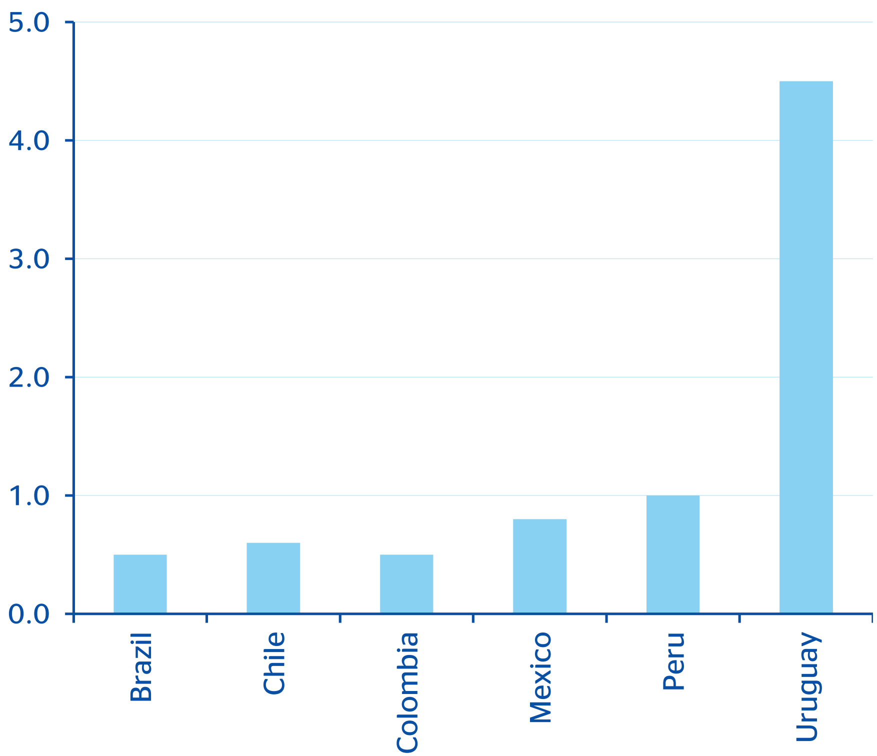
Deficit and public-sector debt (% PIB)

Source: BBVA Research and Haver Analytics



Flexible exchange rates have already acted as the first buffer against external shocks

Exchange-rate pass-through to inflation: impact on inflation of 10% currency depreciation
Source: BBVA Research and IMF



A flexible exchange rate is the first buffer against an external shock, and has already started to act

If this is to work as a buffer, it is crucial to reduce dollar exposure, as the region has done

The credibility of monetary policies has also helped to reduce the exchange-rate pass-through to inflation

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Thank you!

For comments and questions, please contact me at :

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