RESEARCH

Latam Economic Outlook

Second Quarter 2014

Economic Analysis

- **Latam will grow by 2.3% in 2014 and 2.5% in 2015,** marked by the slowdown in China, lower commodity prices and Fed tapering. The Pacific Alliance will grow close to 4% each year.
- **Foreign deficits remain high,** but will start to trend downwards in 2014. **The fiscal outlook worsens** with the slowdown in domestic demand. However, in general terms both deficits remain manageable.
- **The region's exchange rates will depreciate in 2014 and 2015**, by very diverse degrees.
- **A greater-than-expected slowdown in China would have a substantial negative impact on South America.** The Andean countries have the greatest buffers to face this scenario.

Index

Closing date: 9 May 2014

1. Summary

The global recovery continues, but the improvement is hampered by the slowdown in the emerging economies. Global GDP will quicken from 3.0% in 2013 to 3.4% in 2014 and 3.8% in 2015. The global cycle remained robust at the start of 2014, due to the sustained recovery of the developed economies, which will continue in 2015. This recovery has made up for the slowdown in some emerging economies, particularly in China. Our growth forecasts for this country have been revised to the downside, although growth will remain above 7% over the next years. The financial markets have also performed diversely depending on the area but, in general, a recovery has been seen in emerging economy asset prices and capital flows in March and April, after the idiosyncratic shocks experienced at the start of 2014.

The greater slowdown in China has a negative effect on commodity prices, especially industrial metals. We thus expect the downward correction of copper prices to intensify toward the long-term equilibrium, while the oil price would remain around current levels, supported by the high costs of production. For their part, soy bean prices would rise in the short term, before converging toward their long-term level, which remains unchanged.

The recovery of the financial markets in March and April also took place in Latin America. Prices of the main assets, such as equities, sovereign spreads and exchange rates recovered after the strong correction observed at the start of the year, although the recent rally has not entirely offset the losses accumulated since May 2013, when markets began discounting the effects of Fed monetary tightening. Going forward, the evolution of the region's markets will be characterised by both potential surprises in the pace of US monetary stimulus withdrawal, and the progress of growth in China, without neglecting the idiosyncratic factors.

The region's domestic demand has weakened over the last quarters, especially due to the slowdown in investment. In many cases, this investment slowdown is associated with the maturing investment cycle for large export sector projects (Chile, Peru, Uruguay), but deceleration in sectors such as construction in Mexico and delays in the execution of public investment in Chile and Paraguay have also contributed.

Latin America will grow by 2.3 and 2.5% in 2014 and 2015, at a similar pace to 2013. These growth rates remain below the region's potential, which is estimated at around 3.5%, a growth toward which we expect the region will gradually converge. The region's dynamism will gradually rise, supported by higher global growth and the cyclical recovery of domestic demand. These growth rates account for a cut to our forecasts of around three-tenths versus three months ago, especially due to a lower-than-expected growth for the fourth quarter of 2013 and the first months of 2014, and to a less dynamic foreign and domestic scenario than that expected in February.

The Pacific Alliance countries will remain the region's most dynamic, growing well above the average for Latin America in 2014 and 2015. Specifically, Pacific Alliance countries will grow by 3.8% in 2014 and 3.7% in 2015, more than twice the average growth expected for Mercosur (1.1% and 1.5% respectively). Paraguay, Peru and Colombia will continue to be the countries that will grow the most over the next two years. In particular, Paraguay will grow 5.3% in 2014, followed by Peru (5.2%) and Colombia (4.7%). In 2014, Mexico and, to a lesser degree, Colombia, will stand out for their higher growth versus 2013. In the first case, the greater dynamism will occur as the US industrial sector recovers, public expenditures rise and the slump that has afflicted the construction sector since 2013 is overcome, while consumption will consolidate in Colombia. Growth in Brazil will remain moderate in 2014 and 2015, weighed down by the structural problems and the ongoing tightening of monetary policy.

The outlooks for the region's fiscal balances are worsening, due to less buoyant domestic demand and lower commodity prices. Nevertheless, fiscal deficits remain at sustainable levels and should improve as the cycle improves together with domestic demand.

On another note, the region's house prices continue to display strong dynamism, but do not reveal risks of a significant overvaluation, except in the case of Brazil. Both the House Price-to-Disposable Income and Price-to-Rent ratios would point to an overvaluation in the case of Brazil and, to a lesser degree, in Colombia and Peru. That said, when supplementing these indicators with others related to the evolution of housing supply and demand, the conclusion may be reached that the rise in prices would not be too far from the fundamentals, and an abrupt correction in prices would thus not be expected. However, even in the case of a price correction, the contagion to other sectors would be highly limited, due to the small weight of the mortgage portfolio in the financial system.

On the external side, the region's current account deficits will begin to shrink from 2014 onwards, in spite of lower terms of trade and more moderate growth in China. This reduction of deficits will be assisted by both the rise in global growth and the moderation of domestic demand in most of the region's countries. Notwithstanding sizeable foreign deficits in some countries (especially Peru and Uruguay), external vulnerability remains limited, given relatively stable external financing (through direct investment), and international reserve stocks that, in most cases, are adequate.

Inflation will converge toward central banks' targets at the end of 2014, with the exception of Uruguay and, to a lesser degree, Brazil, where it will remain high. Inflation in the region was driven early this year by food price shocks and the effect of the exchange rate depreciation. Nevertheless, that additional boost to inflation will tend to revert toward the end of 2014 and disappear in 2015.

The region will be on a monetary pause for the rest of 2014, except for Colombia and Chile, while monetary tightening will take place in the region in 2015, in tune with the Fed, but also due to domestic factors. For the rest of 2014, the heterogeneity of monetary policy among the region's countries with inflation targets will be conditioned by pressures on inflation (still highly significant in the case of Brazil and Uruguay), and by the different cyclical positions of the countries: Colombia and, to a lesser degree, Mexico are in a rising phase, versus an activity slowdown in the rest of the region. Thus, we continue to anticipate interest rate cuts in Chile, while the interest rate hikes that began in Colombia in April will continue. For the other countries, we expect interest rate stability for the remainder of the year. As early as 2015, the beginning of interest rate increases by the Federal Reserve will be an additional factor (together with persistent pressure on inflation in Brazil and Uruguay, and the cyclical recovery of the remaining economies), that will determine an across-the-board interest rate hike in the region.

The region's exchange rates will depreciate in 2014 and 2015 by very diverse degrees, pressured by less global liquidity and lower commodity prices. The degree of the depreciation will be greater in those countries with (i) higher inflationary pressures (Brazil, Uruguay); (ii) greater exposure to falling commodity prices (Chile and Peru); (iii) lower exposure to the cyclical recovery in the US (South America in general, except for Colombia); (iv) greater central bank willingness to refrain from intervening in the currency market (Chile); and (v) higher foreign deficits (Peru, Uruguay). We thus expect that the greatest currency depreciations over the rest of the year and in 2015 will occur in Brazil and Uruguay, and will be very moderate in the remaining countries with flexible exchange rates.

A hard-landing scenario in China, which is unlikely, would have a substantially negative effect on South America. This shock would affect South America through (i) a reduction of its external demand; (ii) a fall in the price of the main export commodities; and (iii) a negative impact on household and business confidence in Latin America. These conduits would be particularly felt in the countries of South America, although scarcely so in the case of Mexico.

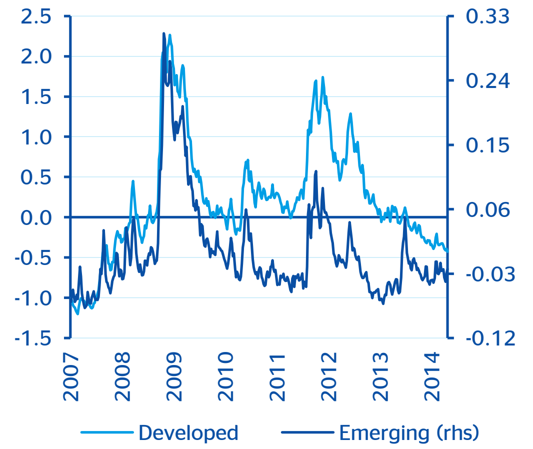
The impact of this hypothetical shock would be buffered better by the Andean countries. Notwithstanding their heavy exposure to China, they have more leeway in the region to implement countercyclical economic policies that would reduce the impact of this scenario.

2. Global scenario marked by the deceleration in China and the Fed's tapering

The global recovery continues, but the improvement is being hampered by the slowdown in the EMs

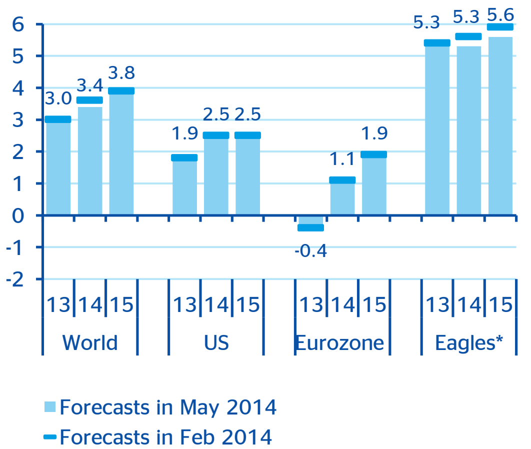
The global economic cycle remains robust at the start of 2014. According to our estimates, in the first quarter of 2014 global GDP has accelerated very slightly to around 0.8% QoQ, and we expect this pace to be maintained for the first part of the year. The driver of this sustained global recovery is the cyclical improvement in the DMs, which has offset the deceleration in some EMs in Asia and Latin America. Meanwhile, in the last few months the financial markets have performed very differently in the two regions and, within them, with more differentiation between the EMs. Capital flows, asset prices, interest rates and financial tension indicators have fundamentally performed in line with the outlook for rate hikes in the US, and, in the case of emerging economies, in line with expectations as to the intensity of China's deceleration and with idiosyncratic factors. So, in the last few months, and particularly in March and April, there has been a recovery in asset prices in emerging economies and a reduction in financial tensions, increased slightly at the beginning of 2014 (Figure 2.1).

Figure 2.1
BBVA Research Financial Tensions index in DMs and EMs



Source: BBVA Research

Figure 2.2
GDP growth forecasts (%)



* EAGLEs is the group of emerging economies which will contribute most to world GDP in the next 10 years. It is formed by China, India, Indonesia, Brazil, Russia, Turkey and Mexico.
Source: FMI AND BBVA Research

To sum up, our assessment of the global scenario has a downward bias compared with our valuation three months ago, which is reflected in the adjustments to our forecasts. After growing at 3.0% in 2013, global GDP will start to accelerate again in 2014 and 2015 at around 3.4% and 3.8% respectively (Figure 2.2), figures that demonstrate both the variations in growth expectations in diverse regions and the increased, although slight, contribution to global growth by the developed economies. Although there have been no significant changes in either the US or the eurozone, the downward pressures on our forecasts are above all visible in the EMs in 2014 and 2015, in both Asia and Latin America, in line with concerns over the slowing of the Chinese economy. In this context, there are still short- and medium-term downside risks to our forecast. Some factors with a global impact could make themselves felt more intensely than expected in the base scenario on a short-term time horizon, such as a tighter monetary policy on the part of the Fed, reduced global demand stemming from economic slowdown in China or, with an (even) lower macroeconomic impact, geopolitical risks derived from Eastern Europe.

In the developed economies, the US overcomes the impact of an unusually cold winter and the perspectives for an improvement in the eurozone have strengthened

US GDP has maintained steady growth at the beginning of 2014 in spite of the impact of unusually adverse weather conditions, and the labour market has improved. As a result, the Fed has pressed ahead with the announced moderation in its balance-sheet expansion. In this context, we are expecting the Fed to complete its exit from the asset-purchase programme towards the end of the year, and the market to focus on a possible change in inflation trends as it anticipates the start of interest-rate hikes in a scenario of a gradual acceleration in GDP growth. The leading indicators point to a more robust start to the second quarter than to the first and support our arguments for maintaining our forecast for US growth at 2.5% in 2014, and the same in 2015 (Figure 2.2). The forecast has upside risks if the improvement in confidence provides additional incentives to corporate investment and job-creation.

On the European side, our short-term models point to an acceleration of around 0.5% QoQ in 1Q14. However, the boost from the external sector could moderate in the coming months due to: i) euro appreciation; ii) the reduced demand from China; and iii) geopolitical risks in the East if the crisis in Ukraine continues. In the light of all these factors, we maintain our forecasts for the eurozone in 2014 at 1.1%, and 1.9% in 2015, (Figure 2.2) in a scenario of contained financial tensions and fiscal and monetary policies that do not put a brake on growth.

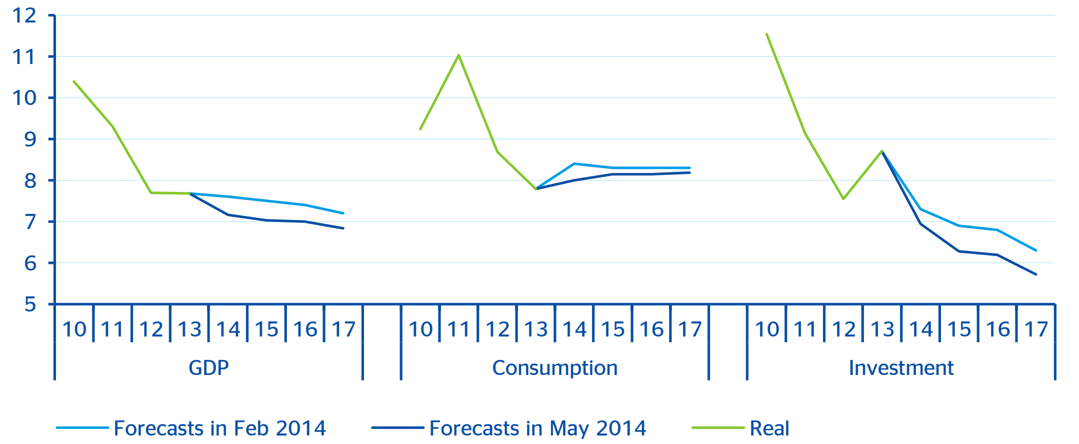
Finally, among developed economies, there is slightly more uncertainty about the growth outlook for Japan, which has a QE programme underway since January 2013, together with fiscal stimuli to return to having inflation and favouring consumption and investment. Thus, we have revised downwards our outlook for growth in 2014 by four basis points to 1.1%, and we are maintaining our estimate for 2015 at 1.3%.

In China, the deceleration at the start of 2014 is here to stay, in an environment of lower-than-expected inflation

In line with our outlook in our last quarterly report, uncertainties about the cyclical strength of the Chinese economy have materialised, with a deceleration in activity during the first quarter of 2014, although lower than anticipated by the analyst consensus. The latest data from indicators on both domestic and foreign demand show the loss of momentum in the cycle, more so in investment than in consumption (Figure 2.3), in an environment of lower-than-expected inflation. At the same time, the authorities are starting to introduce measures to deal with the vulnerabilities arising from economic policy decisions taken in the last few years to support growth in the short term. Those decisions involved postponing the deleveraging of local governments and companies, and continuing to approve infrastructure projects and excess installed capacity which are unlikely to be profitable, while households, who are financing the process, are receiving negative real interest rates on their savings. This is an inefficient allocation of resources, which has also encouraged the development of financial systems in parallel with the more regulated one and which may be a source of problems in the future. To this end, regulations on the non-banking financial sector, shadow banking and environmental protection are all being made more robust.

In view of this, we have revised Chinese growth downwards to 7.2% and 7.0% in 2014 and 2015 respectively, nearly half a point less than expected three months ago (Figure 2.3). The increasing importance of China as a source of world demand in the last few years is undeniable. But the differentiation between areas is unchanged, with higher exposures in Southeast Asia, some South American and African countries and, among developed economies, Germany. According to our estimates, the impact on world growth of each point of Chinese growth lost is around 4pp, principally as a result of lower demand from China itself. Note also that the expected adjustment in the Chinese scenario is limited, and clearly not enough to unleash episodes of global financial uncertainty.

Figure 2.3
China: growth forecasts (%)



Source: BBVA Research

In summary, there are two factors with a global impact on the forecast horizon: possible surprises in the Fed's tapering process and lower growth of Chinese demand, with macro-economic repercussions that are clearly differentiated between economies. As happened in May 2013, the sudden perception by the market that the tightening by the Federal Reserve of the monetary cycle was imminent, with a withdrawal of quantitative easing, increased financial volatility in emerging economies. There was a clear differentiation between different countries, however, with greater FX volatility in those economies with more exposure to foreign short-term funding. Within the EMs, it is the Asian economies which are most exposed to a drop in Chinese demand, as well as a handful of raw materials exporters in South America. The result of all these factors is a map of vulnerabilities where differentiation is a vital factor.

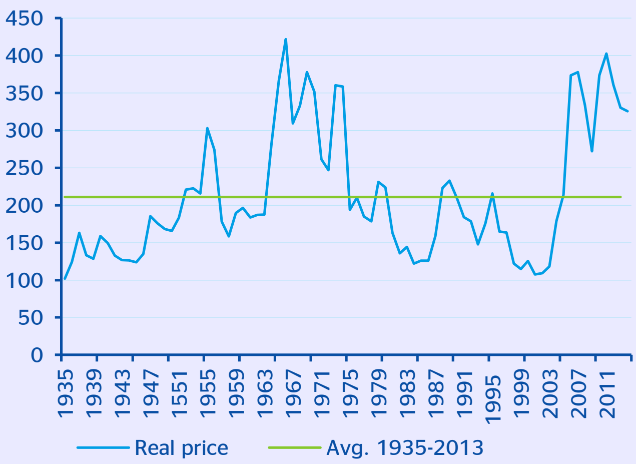
Box 1. Deceleration in China weighs on raw materials prices

The recent deceleration in China, which we forecast will continue for the next few years, will have a negative impact on external demand in Latin America, especially in the South American countries. But it is also likely to put downward pressure on prices of many of the key raw materials exports from the region, inasmuch as China is one of the world's principal consumers of many of them. Specifically, we forecast that China will grow by 0.4pp and 0.5pp less in 2014 and 2015, respectively, vs. our baseline scenario in February (see Figure 2.3 in the main body of text). Chinese growth, still slightly above 7%, will tilt towards a greater weighting in consumption than is the case now, whereas the weight of investment, which particularly affects world demand for industrial metals such as copper, will gradually diminish. In this box we analyse in depth the implication of deceleration and the change in the composition of growth in China on the copper price and that of other key raw materials exported by the region, such as oil and soya beans.

Copper: declining price trend, but with support on the supply side in the medium- and long-term

The so-called supercycle of the copper price began in 2004 and carried the value of the metal well over its historical average (see Figure B.1.1). Although the price has fallen in the last two years, its real value remains high from a historical perspective.

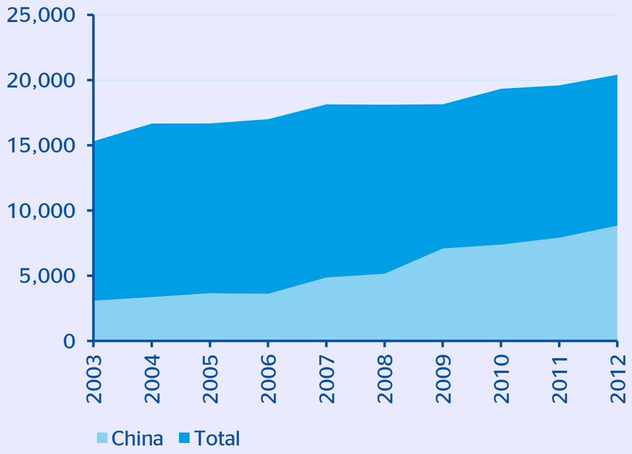
Figure B.1.1
Real copper price in 1935-2013 (USDc/lb)



Source: Cochilco and BBVA Research

The cause of this supercycle has been hotly debated, with China mentioned as the main determinant. Between 2003 and 2012, the Asian giant more than doubled its share of world copper consumption, climbing from 20% to 43% of the total, which accounts for more than 100% of the increase in world consumption over that period (see Figure B.1.2). This greater demand for copper has gone hand in hand with investment growth in that country, so deceleration there would affect demand for the metal.

Figure B.1.2
Copper consumption in China and the rest of the world in 2004-12 ('000s tonnes of fine copper)



Source: BBVA Research based on data from Cochilco

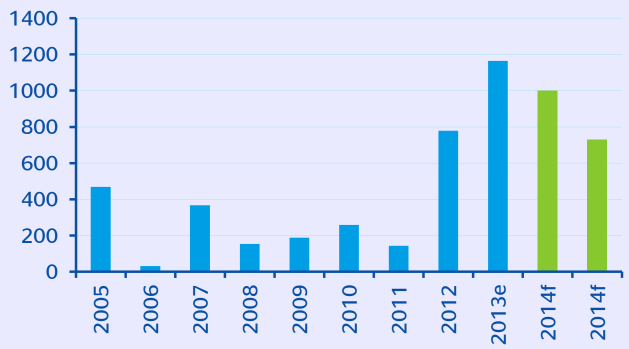
China's weak macro-economic indicators unleashed a swift fall in the copper price (-8%) in the first half of March, to levels not seen since July 2010 (see Figure B.1.3). Apart from the deceleration in investment and, to a lesser degree, in consumption on the part of the Asian giant, doubts about the sustainability of shadow banking are also having a negative impact on the copper price, since the metal has been increasingly used as collateral by some companies for operations in the parallel banking system.

Figure B.1.3
Copper price (LME, USD/lb)

Source: BBVA Research

After several years of high copper prices, supply of the metal reacted, contributing to a surplus in the market. Between 2004 and 2012, the average growth in world consumption of refined copper was 3.3%, while world copper mine production grew at an average rate of 2.5%. Nevertheless, this trend has changed in the last few years. In 2012 the global copper mine supply increased by 4.8% and available estimates point to a 6.8% growth for 2013 (see Figure B.1.4). Consequently, between 2013 and 2015 the refined copper market will report an increased surplus of supply over demand. Between 2018 and 2020, the market will have a deficit once again, a result of the natural attrition that some operations will suffer.

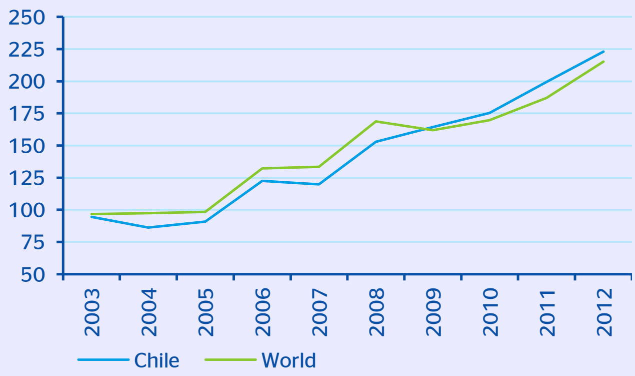
Figure B.1.4
Increase in world supply of mined copper ('000s tonnes of fine copper)



Source: BBVA Research based on data from Cochilco

This being so, in the short term we expect the copper price to converge faster than we previously forecast towards its equilibrium value, estimated at USD2.80/lb, ten cents below our February estimate (see Figure B.1.3). Nevertheless, increasing production costs (see Figure B.1.5), the Chinese government's ability to adopt countercyclical policies and the increase in new consumers all support the price and reduce the risk of it dropping to the levels prior to the copper supercycle, which began in 2004 (see Figure B.1.1).

Figure B.1.5
Copper cathode production costs (C3) 2011 USDc/lb

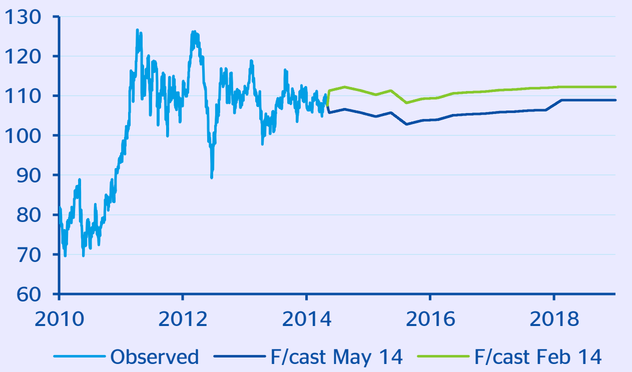


Source: BBVA Research based on data from Cochilco

Oil: price stability in the short term, also with prices supported by high production costs

The price of Brent crude has remained relatively stable in the first quarter of this year. Although energy demand (higher in developed countries and weaker in the emerging markets) continues to put pressure on the market, buoyant inventories in the United States have smoothed out possible price fluctuations.

Figure B.1.6
Price of Brent crude (USD per barrel)



Source: BBVA Research

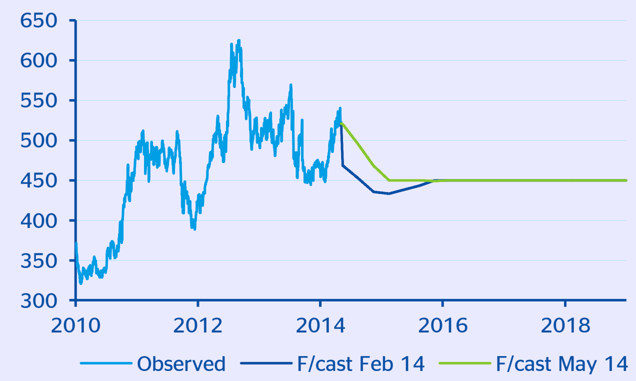
From here on, expectations of lower growth in China, and the corresponding reduction in demand for crude oil (the Asian giant accounted for 12% of world consumption in 2012), has led us to revise downwards (by 5%) our forecast of three months ago for oil prices (see Figure B.1.6). This price review is less severe than in the case of copper, due to the relatively lower elasticity of oil consumption to investment in China (furthermore, the rise in consumption could also have a positive effect on the demand for crude), and because geopolitical tensions in producer countries (principally Russia) are pushing prices higher.

In addition, high production costs, particularly in marginal fields (shale oil) also prop up prices. Bear in mind that in the case of shale oil, which has higher production costs, the entry and exit of small producers depending on price variations is much more dynamic in the short and medium term than in the case of traditional fields, contributing to much greater price elasticity of supply than a decade ago. For this reason, in the event of reduced demand for crude, we expect that the downward effect on price will be much more limited than ten years ago, due to the exit of small marginal producers of shale oil. This also justifies our forecast of relatively stable prices in the short term and a slight upward trend in the medium term, which goes hand in hand with the increased marginal costs of new extraction projects.

Soya beans: temporary boost because of bad weather conditions in major production areas

Demand for soya bean is less linked to investment and, as such, less affected by the progressive deceleration in China of this GDP component, so we do not forecast changes in the long-term soya bean price, estimated at USD450/tonne (see Figure B.1.7). In fact, the price of soya beans surprised to the upside in 1Q14 because of the disappointing harvest in the US and the drought in Brazil, although we continue to expect a major adjustment to the downside in the second half of the year towards its long-term price. This fall in price will be driven by the entry into the market towards the end of the year of a "super harvest" in the US.

Figure B.1.7
Soya bean price (USD/tonne)

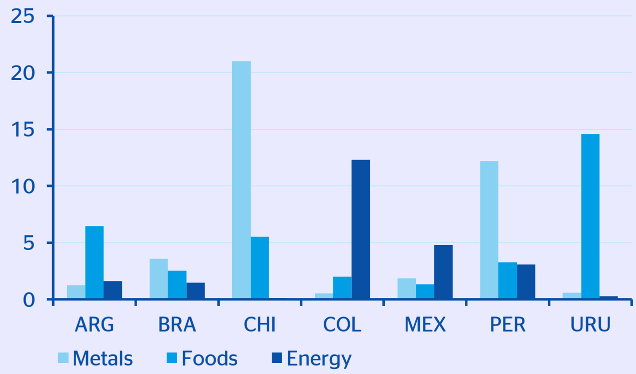


Source: BBVA Research

Impact in Latin America: differentiated by countries, depending on the composition of their exports

The deceleration of Chinese growth, and its change in composition towards a greater weight in consumption to the detriment of investment, will have an uneven impact in South America, depending on the composition of each country's export basket. Industrial raw materials will be worse affected than components linked to consumption (food and, to a lesser degree, oil), which implies that the direct impact may be greater in countries such as Peru and Chile, where exports are focused on industrial metals, than in Argentina and Uruguay, more centred on food exports (see Figure B.1.8).

Figure B.1.8
Exports of raw materials as % of GDP



Source: WITS and BBVA Research

3. In Latin America, the markets forget about tapering (for the time being)

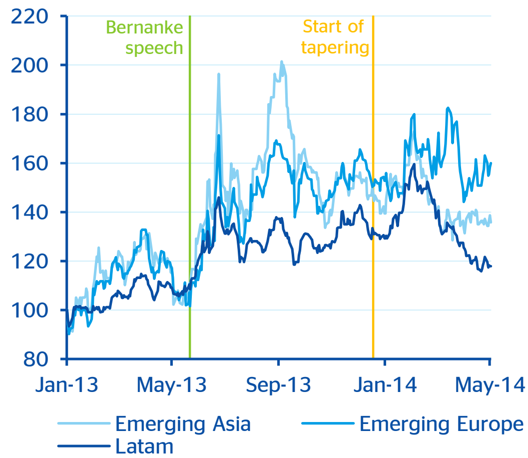
Asset prices recovered across the board after the strong correction seen early this year

Although monetary tightening in the US is in progress, over the last months, especially since March, Latin American financial markets have shrugged off their pessimism and moved to the upside. This partly reflects that the rise in volatility in the financial markets of the emerging economies over the first months of 2014 was mainly the result of important idiosyncratic factors. In some countries, it was also related to the deterioration of their fundamentals (for further details, see our previous Latam Economic Outlook).

The slowdown in the Chinese economy and moderation in the prices of some important commodities for the region were also unable to put a brake on the recovery of asset prices, even though they are already starting to contribute to lower growth in economic activity. Actually, the performance of the local financial markets is to a certain extent in contrast with the moderation of economic growth (see the following Sections on the performance of the region's economic activity).

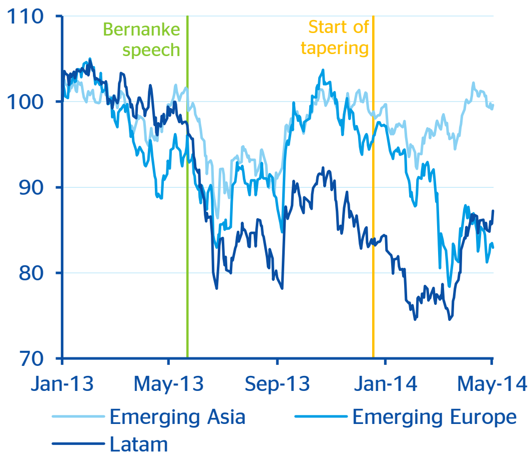
Likewise, the sovereign spread for Latin America, for example, has contracted roughly 60 basis points since the end of February, and 130 points since the peak of early February. These are more significant corrections than those seen in other emerging regions (Figure 3.1). Equity indices reveal similar dynamics: rises of 13% since the end of February and 17% since the lows recorded at the beginning of that month, higher than those of other emerging areas (Figure 3.2).

Figure 3.1
Sovereign spreads in EMs (EMBI)



Source: Haver Analytics and BBVA Research

Figure 3.2
Evolution of stock prices in EMs (MSCI, index Jan 2013 = 100)



Source: Haver Analytics and BBVA Research

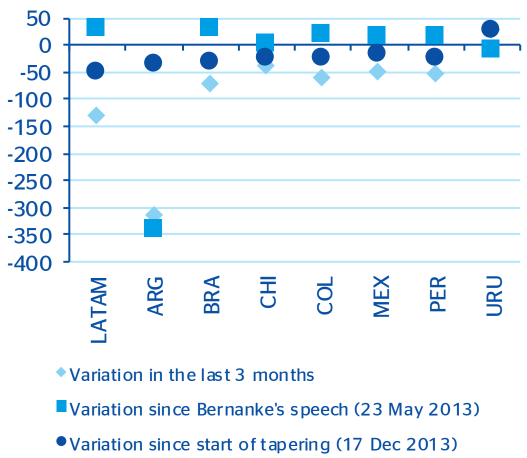
Two external factors helped this positive behaviour in the region's financial markets. First, the widespread perception that the rise in US interest rates will be gradual and will not occur immediately. Second, a less intensive than expected moderation of growth in the Chinese economy.

That said, there are a series of factors of a local nature that also contributed to the rally in the markets over the last months. Of note among these idiosyncratic factors are, for example, some recent adjustments in Argentina's economic policy, including its success in keeping the exchange rate relatively stable after the sharp depreciation early this year, which were relatively well-received by the markets. Additional factors were the tightening of monetary conditions and the perspectives for an adjustment of economic policy in Brazil, after the October presidential elections, notwithstanding Standard & Poors' downgrade of the country's sovereign debt rating from BBB to BBB-. Furthermore, local markets reacted positively to the increase in Colombia's weighting within J.P. Morgan's fixed-income indices.

Figures 3.3 and 3.4 reveal that the drop in sovereign spreads and the rises in equity indices over the last three months have been not only significant, but also widespread among the main economies in the region.

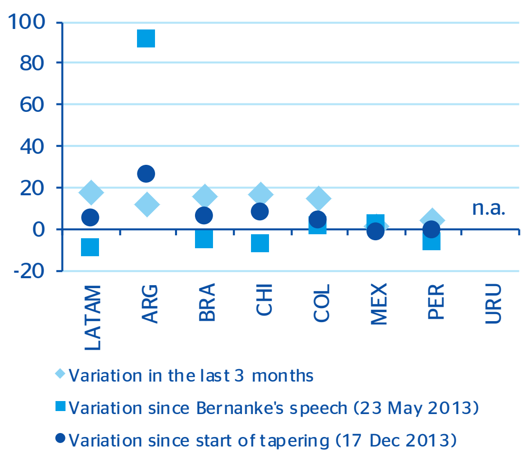
Likewise, Latin American exchange rates have been appreciating over the past few months (Figure 3.5). In line with the above-mentioned idiosyncratic factors, notable are the appreciation of the Brazilian real and the Colombian peso, as well as the stability of the Argentinian peso after the sharp depreciation recorded in January.

Figure 3.3
Sovereign spreads in Latin America (EMBI, bp)



Source: Haver Analytics and BBVA Research

Figure 3.4
Share prices in Latin America (% var.)



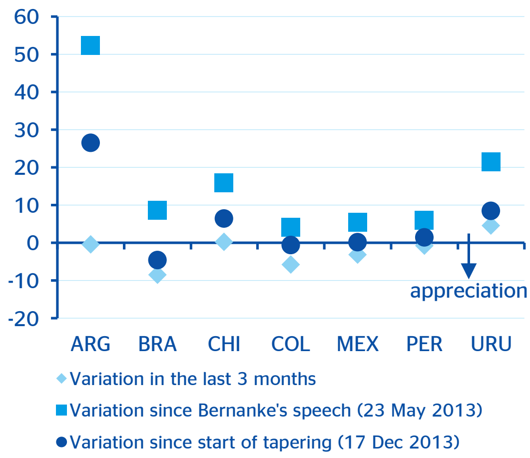
Source: Haver Analytics and BBVA Research

The recent appreciation of most Latam currencies is also a reflection of the weakening dollar in global markets. This effect was also bolstered in some countries by the positive impact of dollar depreciation on commodity prices. This financial factor helps in understanding the recent recovery of commodity indices, such as the CRB and its sub-indices (Figure 3.6). At any rate, notwithstanding this positive financial impact, some important commodities in the region were affected by the moderation of growth in China (see Box 1).

The rally in prices of Latin American assets benefited from portfolio flows that were more favourable towards emerging markets, which can be gleaned not only from global portfolio flow statistics, but also from local indicators, such as the data of the financial account of the balance of payments and non-resident sovereign bond holdings (Figures 3.7 and 3.8).

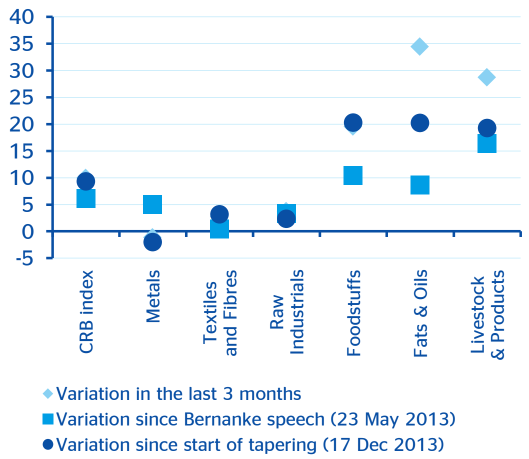
That said, the rise in the region's financial asset prices over recent months is proportional to the decline seen from the 17 December announcement of the start of the tapering to February. Thus, in general terms, after the recent rally, asset prices are not at very different levels than immediately prior to the initiation of Fed monetary tightening, as shown in the previous Figures.

Figure 3.5
Latam exchange rates (% var.)



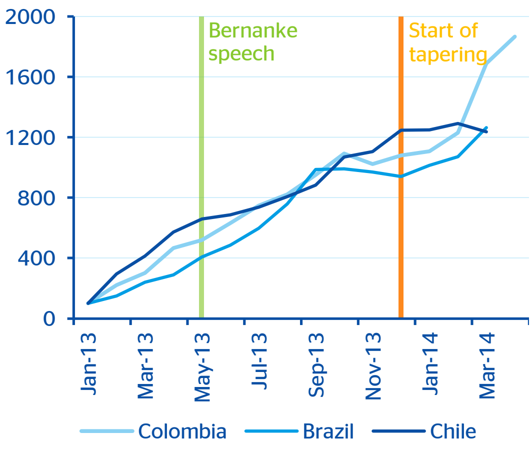
Source: Haver Analytics and BBVA Research

Figure 3.6
Commodity prices (% var.)



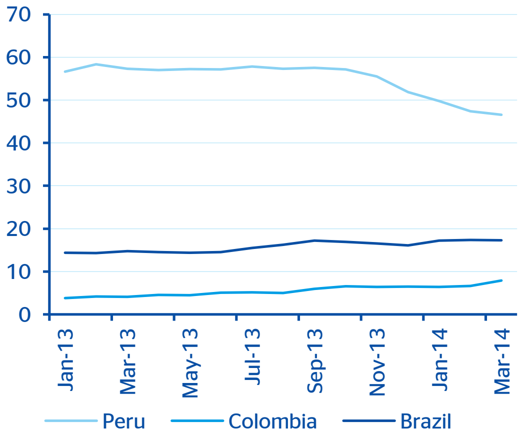
Source: Haver Analytics and BBVA Research

Figure 3.7
Non-resident portfolio flows (cumulative balance of payments data, index: January 2013 = 100)



Source: National Statistics and BBVA Research

Figure 3.8
Non-resident sovereign bond holdings (% of total)



Source: National Statistics and BBVA Research

The recent rally does not entirely make up for the cumulative losses recorded since May 2013, when markets began discounting the effects of Fed monetary tightening

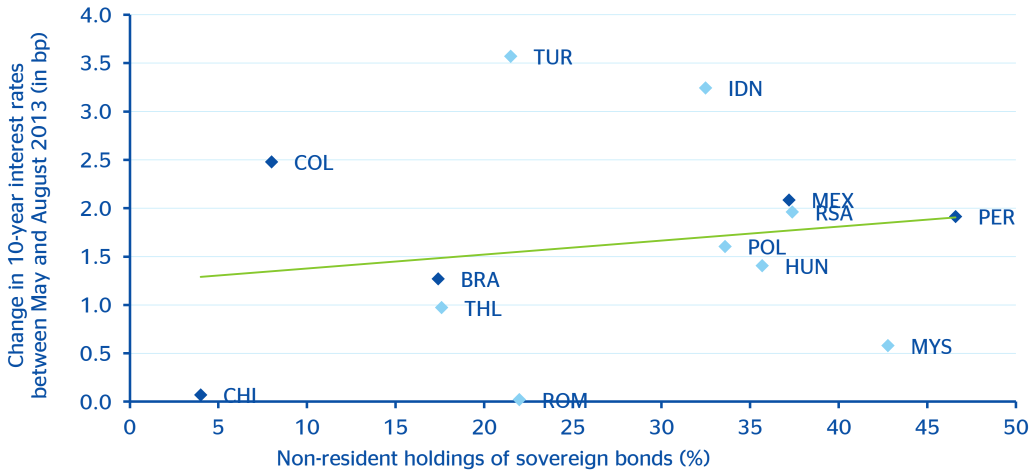
The markets' optimistic tone in recent months has generally allowed the losses seen at the end of 2013 and start of 2014 to be erased, but not the cumulative falls since May 2013, when former Fed Chairman Ben Bernanke commented on the monetary authority's intention to withdraw the stimulus measures introduced during the 2008 crisis.

More specifically, Figure 3.3 shows that the sovereign spread of most countries remains above the level recorded immediately after the time at which markets began reacting toward the threat of tapering in May 2013. Similarly, Figures 3.4 and 3.5 generally reveal that equities and exchange rates did not recover to the levels recorded at the beginning of May 2013, notwithstanding the positive price dynamics of commodities (Figure 3.6). The main exception is Argentina, where the sovereign spread and stock prices have reacted positively to the new exchange rate and the monetary and fiscal policy measures either implemented or announced since the start of this year.

Likewise, Figures 3.3, 3.4 and 3.5 show that the level of heterogeneity among asset price variations of the region's main countries is much higher in the cumulative period since Bernanke's speech, than in the period from the start of the tapering in December 2013. In our opinion, this increased heterogeneity reflects that what tends to prevail over the medium and long term is financial markets' discrimination based on each country's fundamentals and idiosyncrasies. Moreover, the structure of local markets can condition the magnitude and speed of adjustment. Specifically, the adjustment tends to be stronger in countries where foreign participation in local markets is higher (Figure 3.9).

In future, we expect the potential surprises in the process of Fed monetary policy tightening and China's slower growth to condition the performance of global financial markets, although in a differentiated manner, according to each country's exposure to each of these global factors.

Figure 3.9
Non-resident sovereign bond holdings and 10Y interest rates



Source: National Statistics and BBVA Research

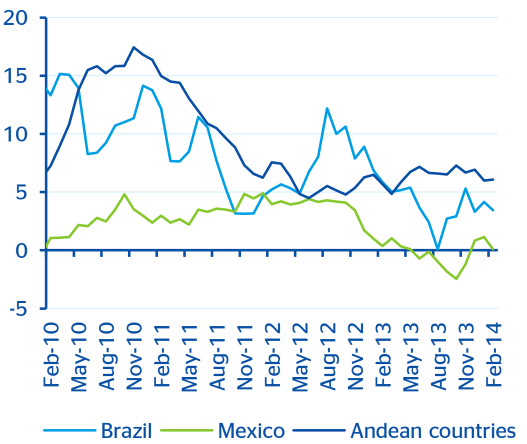
4. Latin America will grow by 2.3% and 2.5% in 2014 and 2015, below potential

Domestic demand weakened in recent quarters, mainly due to the slowdown in investment

The region's domestic demand moderated over the first quarter of this year and in the first months of the second quarter. The slowdown in both consumption (except for Colombia) and investment contributed to this moderation, although with a high level of diversity between countries.

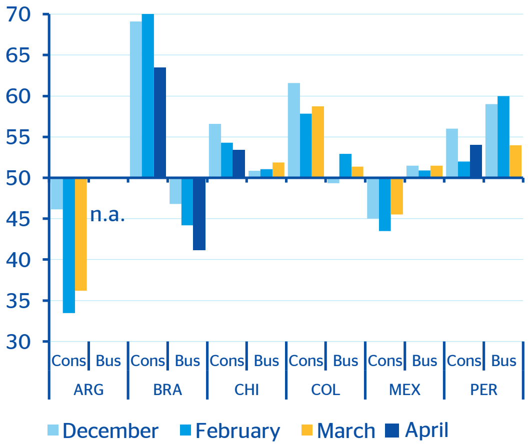
With regard to consumption, the slowdown was mainly associated with increased labour market weakness in many of the region's economies - especially in Peru, Chile and Mexico - as well as the persistence of high inflation and a contractive monetary policy in the cases of Brazil and Uruguay. This was reflected in the slowdown in retail sales (Figure 4.1) and declining consumer confidence indicators vs. the levels of the first months of the year (with the exception of Colombia, see Figure 4.2), albeit still within optimistic territory in most cases. We expect private consumption to continue to moderate, as a result of a degree of weakness in the labour markets. This will have a negative impact on the total wages bill, due to the deterioration in terms of both real income and employment.

Figure 4.1
Latam: retail sales (% YoY)*



*Based on constant prices.
Source: Bloomberg and BBVA Research

Figure 4.2
Confidence indicators: consumer and business



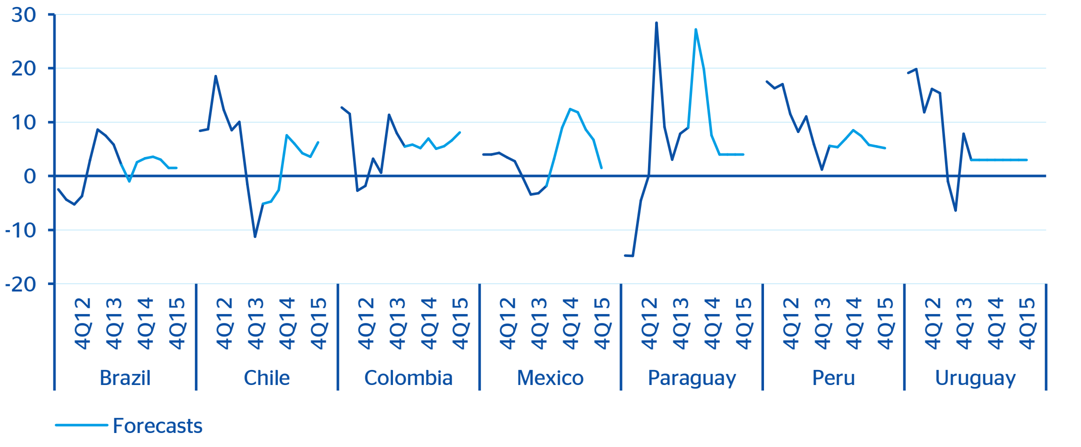
Source: BBVA Research

As previously noted, the main exception to the downward trend in consumption is and will continue to be Colombia, which remains in the rising phase of the cycle, somewhat out of sync with the rest of the region. It should be remembered that most of the positive surprise in 2013 came from revisions of previously published data, particularly private consumption and exports. The retail trade data up to February continue to show intensive growth (in the order of 6.6% YoY over the first two months of the year), while the labour market is consolidating and the consumer confidence indicator remains within the optimistic zone (Figure 4.2).

Meanwhile, investment has suffered a substantial and widespread moderation in the region over the past few quarters, in many cases associated with the maturity of the investment cycle in large projects, such as the case of mining in Chile (and to a lesser degree, Peru), and in the paper sector in Uruguay. Additional contributors have been the slowdown in some countries' construction sectors, especially in the case of Mexico, as well as delays in the execution of public investment in Chile and Paraguay. All these factors have also been reflected in very moderate or even declining business sector confidence indicators, with respect to those seen at the start of the year (Figure 4.2).

The slowdown in investment was particularly notable in Chile, where total investment fell 12.3% YoY in the fourth quarter of 2013, resulting in an overall annual growth of barely 0.4% for 2013 (Figure 4.3). The drop was mainly associated with lower investment in machinery and equipment, although it also included construction (no growth in 4Q13). Led by lower investment and consumption, imports have already declined significantly, particularly capital goods (closely related to investment), but also intermediate and consumer goods.

Figure 4.3
Latam: investment (% var. YoY)



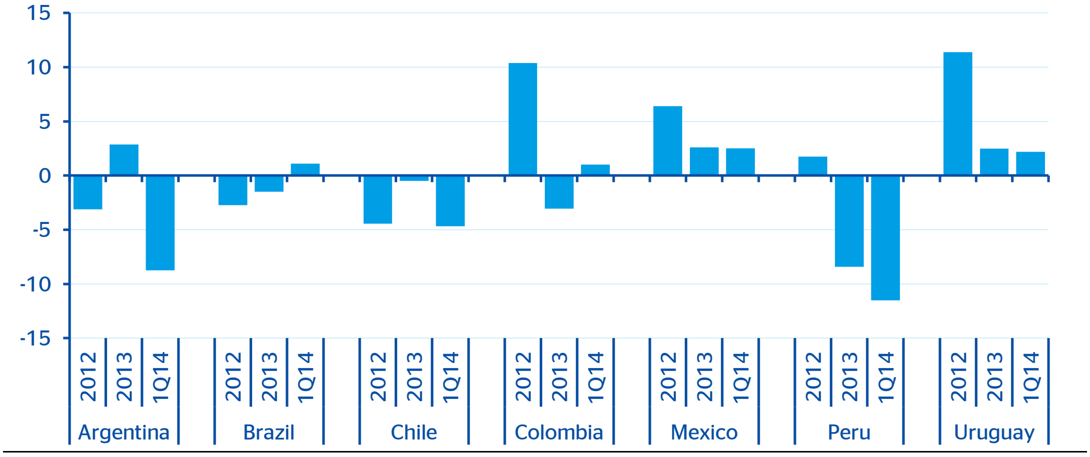
Source: BBVA Research

Exports fall short of a full recovery

Over the first quarter of 2014, Latam exports have not entirely recovered from the slowdown experienced since mid-2013 (Figure 4.4). This has been due to the concurrence of both weak external demand (especially in the case of Brazil and Uruguay, associated with their exports to Argentina) and some supply-side problems in the case of Colombia (in the coal sector and among some manufacturers) as well as in Argentina and Brazil in the fossil fuel sector. On another note, the end of labour conflicts at Chilean ports and the signs of external demand recovery in the cases of Peru and Mexico will assist in generating a strong upturn in these countries' exports over the coming months.

Supported in part by the forecast of FX depreciation in the region and by the consolidation of the recovery in the US and Europe, the outlooks for exports are good, although slightly less optimistic than three months ago, influenced by the adjustment in demand from China and the lower export commodity prices (see Box 1).

Figure 4.4
Exports (% var. YoY, USD)



Source: BBVA Research

Latin America will grow by 2.3% in 2014 and 2.5% in 2015, at levels similar to 2013, but below potential

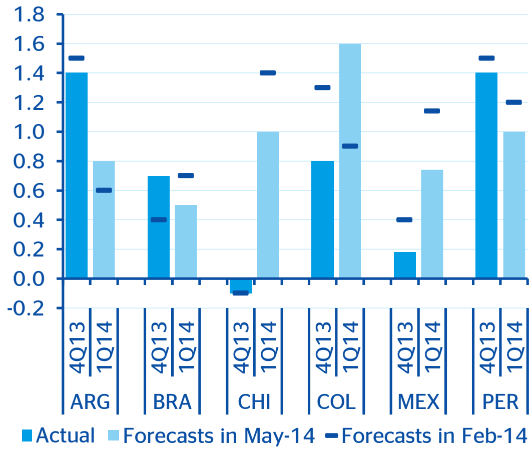
Within a context of internal and external demand that is less dynamic than expected, fourth quarter growth surprised to the downside across the board, with the important exception of Brazil, although that was due to temporary factors. Furthermore, the persistence of this weakness has led us to revise our growth expectations significantly downwards for the first quarter of this year (Figure 4.5), with the important exception of Colombia, where first quarter strength in consumption and the construction sector surprised sharply to the upside.

The negative surprises in first quarter growth, and less robust internal and external demand than we anticipated three months ago, lead to a downward revision of Latin American growth vs. the February 2014 projection: 30bp in 2014 and 20bp 2015. We estimate the region's growth to be 2.3% in 2014 and 2.5% in 2015, very similar to 2013 (2.4%). Furthermore, we continue to expect a recovery in 2014, led by rising growth in the main developed economies (which would make up for the slowdown in China) and by a cyclical recovery in a number of the region's economies, notably in Mexico and Colombia, but also in Peru, Paraguay and Chile. The recovery would manifest itself as a rise in growth in 2015, although at a slower pace than we previously forecast, weighed down in particular by the low growth in Brazil (1.6% in 2015).

On the side of internal demand, as previously mentioned, we expect moderate consumption, somewhat burdened by the labour market weakness in most of the countries. An environment of less favourable export prices and lower demand perspectives will act as headwinds to investment.

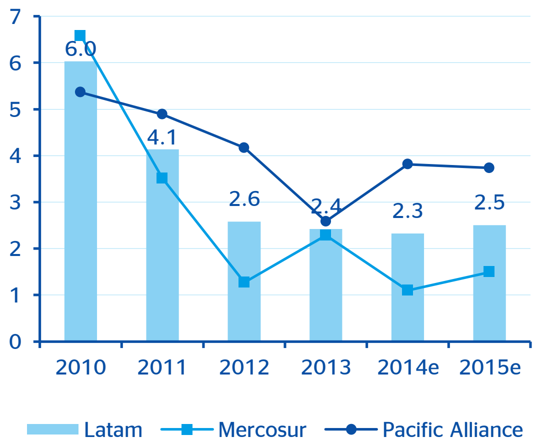
The revision to growth forecasts is particularly significant in the case of Chile, Brazil and Peru, but somewhat less so in the case of Argentina and Uruguay. Meanwhile, we maintain our forecasts of three months ago for Mexico, Colombia and Paraguay. All in all, growth for these years will tend to be below the region's potential, at around 3.5%.

Figure 4.5
Latam: surprises in growth forecasts (% QoQ)



Source: BBVA Research

Figure 4.6
GDP growth: Latam, Mercosur and Pacific Alliance (%)



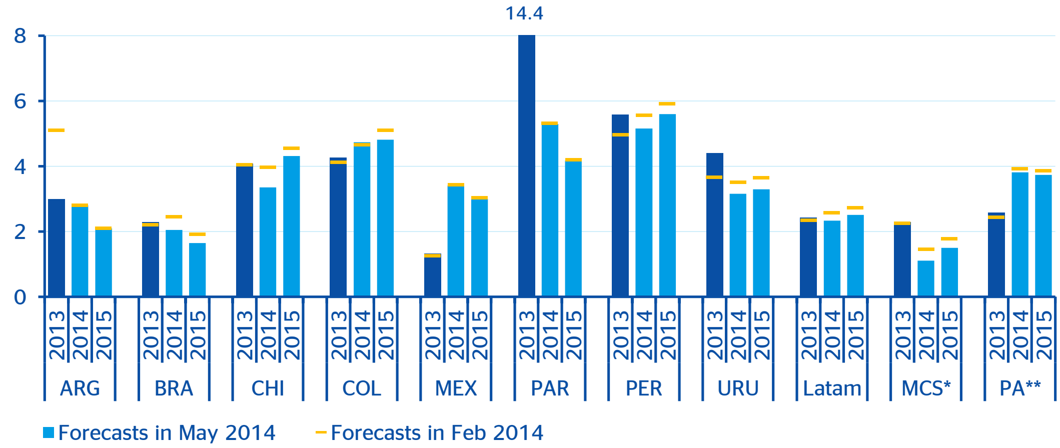
Source: BBVA Research

The Pacific Alliance countries will remain the most dynamic, growing on average by close to 4% in 2014 and 2015, well above the region overall

Growth in the region will remain highly heterogeneous. In 2014 and 2015, the average growth of Pacific Alliance countries of close to 4% will be more than double that of the Mercosur block, which will be 1.1% in 2014 and 1.5% in 2015 (Figure 4.6). On a country-by-country basis, Peru, Paraguay, Colombia and Chile will continue to have the highest growth rates, especially after the recovery expected at the end of 2014 and in 2015 (Figure 4.7). Specifically, Peru will grow by 5.2% in 2014, Paraguay 5.3%, Colombia 4.7% and Chile 3.4%.

With the exception of Colombia and Mexico, growth perspectives point to a slowdown in 2014 versus 2013, albeit followed in most countries by a recovery period beginning in 2015 (Figure 4.7). In the case of Colombia, the country continued to stand out for its improved growth in the fourth quarter of 2013 and in the indicators released for the first quarter of 2014, and for the positive forward-looking perspectives which support our standing by our 2014 growth estimate. For 2015, however, we have revised our growth estimate to the downside (from 5.1% to 4.8% YoY), mainly due to the delay in the execution schedule of the 4G Roadway Plan infrastructure works, now scheduled for the second half of that year. In the case of Mexico, after a disappointing 2013, the factors that led to slowing growth over the course of that year, such as the delay in the execution of public expenditures, the unfavourable performance of the construction sector and the moderation in non-oil exports have tended to correct, which means that growth for this year (3.4%) will be significantly better than the 1.3% of 2013.

Figure 4.7
Latam Countries: GDP growth (%)



MCS: Mercosur. **AP: Pacific Alliance.
Source: BBVA Research

In the case of Chile, the most influential factor when considering the downward revision to the growth forecast is lower investment, particularly private, with a mild growth in public investment, in line with the projections of the Budget Law. We expect investment to rise gradually from the second half of 2014, once the uncertainty over the details of the tax reform is dispelled. It should be noted that public investment will partially offset the expected contraction in private in 2014 (from 2% to 3%), and that the recovery would lead to year-on-year growth rates of around 4% in the fourth quarter of 2014.

In the case of Peru, the downward revision to growth forecasts is determined by a more moderate expansion of exports and private sector domestic demand, only partially offset by a rise in public sector demand. On the supply side, the main revision to the forecasts lies in the mining sector which, although highly dynamic, will be less so than expected three months ago, with some delay in the start-up of full production at some new deposits.

In contrast, Mercosur growth will be clouded mainly by the weakness of growth in Brazil, following the exhaustion of a growth model based on the expansion of credit and consumption. The worse perspectives of external demand from China and Argentina, and the recent appreciation of the exchange make unlikely an export rebound that would offset consumption weakness. On another note, the greater monetary tightening than that expected three months ago, and the uncertainty over politics and the supply of electrical power, will also inhibit investment more than expected. Furthermore, we continue to stand by our perspective of an unavoidable adjustment after the elections, which would restrict growth in 2015 to 1.6%. For its part, Argentina will also see a moderation in its growth, due to adjustments in monetary and, to a lesser degree, fiscal policy. Meanwhile, growth in Uruguay will slow down due to the impact of the lower growth of its neighbours, the drop in investment after the completion of the Montes del Plata cellulose plant and the delay in its start-up.

Worsened outlooks for the region's fiscal balances in 2014, in line with less buoyant internal demand and lower expected prices for the main commodities

The slowdown in domestic demand and the perspective of lower prices for the main commodities will have a negative impact on the region's fiscal revenues, although with differences across countries. For example, in the case of Colombia, given that revenues are largely determined on the basis of the dynamics of previous-year oil prices and in dollar terms, the negative effect will be postponed until 2015 and will be buffered by the effect of the depreciation. Within this context, the 2014 structural deficit target of 2.3% will be met, but it will be tight (Figure 4.8).

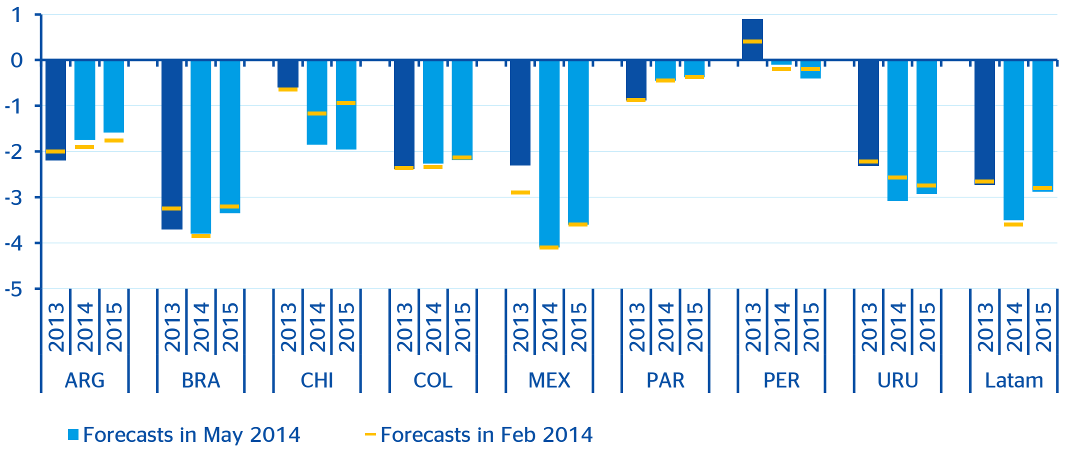
The common features shared by Chile and Peru will be the rise in expenditure and in the deficit. In the first case, this is assisted by the comparison with the 2013 budget under-implementation and by the financing of reconstruction after the natural disasters. Chile's fiscal revenues will be affected by the lower dynamics of activity and lower copper prices, but structural revenues will rise due to higher inflation and a more depreciated exchange rate. As a result, with higher structural revenues, the expenditure level will probably also be higher. On the part of Peru, lower ore prices will entail some deterioration of revenues, while an acceleration of expenditure, especially in investment, is expected.

The opposite situation will occur in Brazil, where the fiscal deterioration that began in 2010 will continue, characterised by a worsening of the main indicators: gross government debt, public sector net debt, and total and primary fiscal balances. In the present situation, the current government is unlikely to make significant adjustments prior to the elections; we expect the primary surplus to hit a new low of 1.5% of GDP in 2014.

Lastly, the tax reform approved in Mexico at the end of 2013 will entail additional tax revenues in the order of 1.0% of GDP, plus the resources from an authorised public deficit of 1.5% this year (from the 0.4% of GDP in 2013). The proposal was that this deficit would drop over time until converging at equilibrium in 2017. We expect the negative effect on consumption from the fiscal adjustments[1] to be offset by the increased public deficit, which would minimise the negative impact on growth.

All in all, notwithstanding the deterioration of fiscal outlooks, the region's deficits remain manageable and, in most of the region's countries, the sustainability of public accounts is not in question.

Figure 4.8
Fiscal Balance (% of GDP)



Source: BBVA Research

1: The main adjustments are the reconciliation of border VAT, new taxes on high-caloric content foods and beverages and a new petrol tax. Also, special regimes for businesses have been repealed and higher taxes will be levied on high-income individuals.

Box 2. House prices in Latin America: very dynamic, but no significant risks

As the IMF warned in 2011, house prices in real terms in Latin America have been growing at an average annual rate of 10% since 2005[2], significantly above previous decades[3]. Why might this rate of expansion in house prices be a concern? The increase in an asset price may represent a problem when the increase is not justified by the supply and demand fundamentals and is sustained simply by the expectation of higher prices in the future. We should remember that sharp falls in house prices are usually associated with production and lifestyle losses that are twice as intense and long-lasting as those associated with stock market corrections, for example[4]. This box analyses the recent changes in house prices in the main countries in Latin America to see whether there are signs of a potential problem deriving from the property market.

Identifying overvaluation in the housing market

It is very difficult to discern whether there is a bubble in an asset price, and the property market is no exception. Nevertheless, indicators do exist which can flag up possible overvaluations in house prices over and above supply and demand fundamentals. One of these is to make comparisons with previous price cycles to detect "excessive" rises.[5] In the case of industrialised countries, house-price cycles have been identified, and the data go back to 1970. Unfortunately, in the case of Latin America, house price series are not long enough to cover several cycles. In any event, strong house prices rises such as those mentioned above for Latin America are a necessary but not sufficient condition for the existence of a bubble, since they may be justified by a change in the supply and demand fundamentals. Additional indicators are needed, relating the house price with its fundamentals, to support any claim about the existence of a bubble.

Of these additional indicators, two stand out: the first measures the accessibility of housing; the second compares the price of buying with the price of renting. Among accessibility indicators, the most widely used measure is the ratio of house prices to household income, since a higher ratio implies a greater effort on the part of households to pay for housing, which will reduce demand and eventually lead to downward pressure on prices.

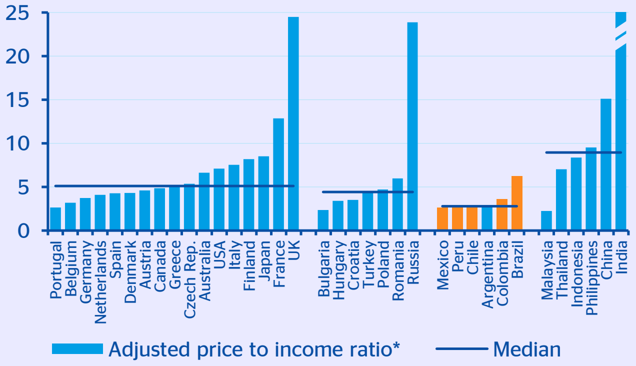
On the other hand, if we use as an additional indicator the relationship between sale and rental prices, we start from the basis that renting represents the implicit benefit of possessing a property, in the same way as the dividend is the benefit of possessing a stock. Rentals tend to be more connected to market factors, so that an excessive hike in the ratio of the sale price to the rental (taking into account taxes, maintenance costs and other outgoings), indicates that the benefit of a property asset for its owners is low when compared with other assets and, as such, it is difficult to sustain it in the future. For the benefit of owning a property asset to increase to a level commensurate with that of other assets, its price will tend to adjust downwards.

In the case of Latin America, the metrics available from those mentioned above point to relatively low ratios compared with other country blocks, with the exception of Brazil. Of particular interest, among the accessibility indicators, is that the median price to income ratio in Latin America is below developed countries in Europe, other emerging countries and the Asian countries (see Figure B.2.1)[6]. Looking only at Pacific Alliance countries, the time it takes an average household to finish paying for their home is slightly higher in Colombia and very similar in Chile, Peru and Mexico.

Of course, comparing international measures of accessibility to housing omits idiosyncratic factors which might account for the differences mentioned above, such as, for example, the differing degrees of access to mortgage lending (greater in developed countries and in emerging Europe), or the rate of demographic growth. So another important dimension is to detect upward trends in the accessibility indicators or substantial deviations from historical averages which may give rise to concerns about overvaluation in property markets. Within the limitations imposed by the flimsy historical data in Latin America, the ratio of accessibility in Brazil in 2013 was particularly high vs. its historical average and, to a lesser degree, also in Colombia and Peru, while in Chile and Mexico the ratios are actually below their historical averages (Figure B.2.2). However, bear in mind that, with the exception of Brazil, the trend towards lower long-term interest rates in the region will favour an increase in the price to income ratio, since it will make higher-value housing financially more accessible, even though the size of the mortgage market is relatively small in the region (see below).

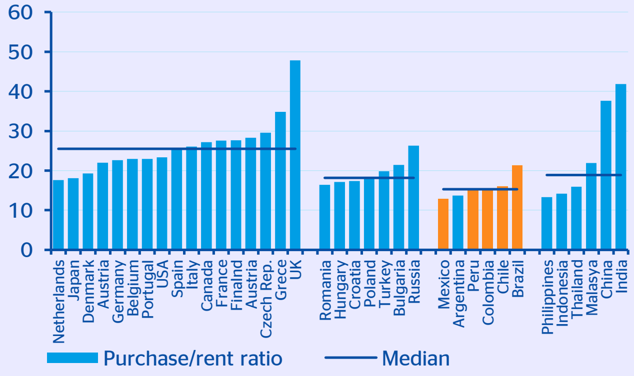
2: Average growth in house prices in the Pacific Alliance countries between 2011 and 2013 is exactly 10%.
3: IMF, Regional Economic Outlook. Western Hemisphere: Watching Out for Overheating. April 2011 pg. 39-44.
4: IMF, World Economic Outlook 2003, chapter 2: When Bubbles Burst.
5: IMF, WEO (2013).
6: Data based on the Global Property Guide and the United Nations statistical division, prices adjusted for PPP and average size of household. The median is taken rather than the mean in order to avoid extreme values, particularly important in Europe, the emerging European markets and Asia. In the case of Asian countries this is particularly relevant, since the median is 9 years and the mean is 14, influenced by India. In Latin America, the mean and median are 2.8 and 3.5 years, respectively.

Figure B.2.1
Price to income ratio



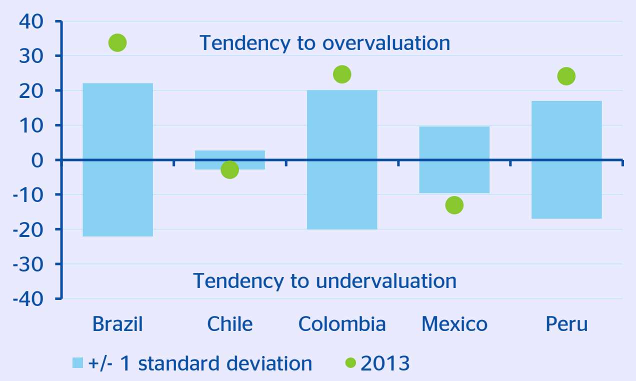
* Adjusted for PPP and average size of households in each country.
Source: Global Property Guide and BBVA Research

Figure B.2.3
Purchase to rental ratio



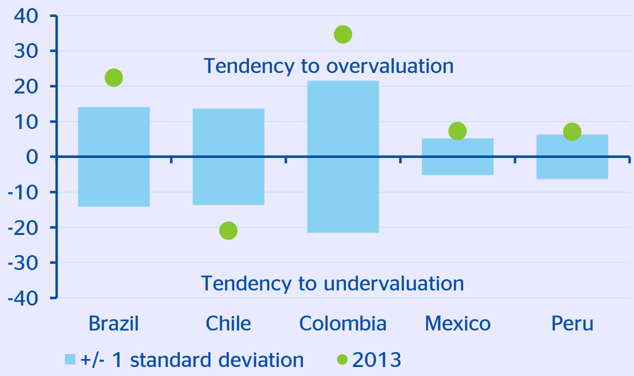
Source: Global Property Guide and BBVA Research

Figure B.2.2
Price to income ratio as % of the historical average*



* The periods with available data are, in the case of Brazil, from 2008 to 2013; 2001-2013 for Chile; 1998-2013 for Colombia; 2000-2013 for Mexico and 2007-2013 for Peru.
Source: Global Property Guide and BBVA Research

Figure B.2.4
Purchase to rental ratio as % of the historical average*



* The periods with available data are, in the case of Brazil, from 2008 to 2013; 2001-2013 for Chile; 1998-2013 for Colombia; 2000-2013 for Mexico and 2007-2013 for Peru.
Source: Global Property Guide and BBVA Research

As with the accessibility indicator, the purchase to rental price ratio (Figure B.2.3) is lower in Pacific Alliance countries than in Brazil and than the median in the remaining economies. As in the case of the accessibility index, it is important to back up the transversal analysis with a look at recent trends in the purchase/rental price ratio, compared to each country's track record, in order to eliminate idiosyncratic factors. The results are similar to the accessibility ratio, with the same data limitation of a relatively short time series. The changes and current situation of the purchase to rental ratio point to a major misalignment in Brazil and a smaller one in Colombia, while both Peru and Mexico are more aligned with their historical averages and Chile[7] is significantly below.

The recent changes in house prices have been sustained by additional supply and demand factors

The measures described above indicate that, in general, there are no signs of an increase in house prices that go beyond that dictated by the fundamentals, except in Brazil and, to a much lesser degree, in Colombia and Peru. Even so, it is advisable to analyse the momentum of these prices over the last few years. On the whole, apart from Brazil, we can say that although there has been a sustained and robust climb in house prices, this increase has gone hand in hand with growth in disposable income in these countries, so there are no significant signs of misalignment with the fundamentals.

7: The purchase to rental price ratio ought to be adjusted to take into account the effect of changes on interest rates and taxes. Higher income taxes (from which interest payments on mortgages are deducted) would encourage a higher purchase to rental price ratio. Meanwhile, higher taxes on property transactions (or on owning property), or higher interest rates would favour a lower ratio by penalising property ownership. In the case of Peru, the only country for which indicators for rentals and prices in monetary terms exist, and where the ratio can be calculated adjusted for taxes and interest rates, the indicator corroborates the trends found in the case of the non-adjusted indicator.

In Brazil, the gap between the recent growth in house prices and income suggests the existence of a not inconsiderable misalignment in pricing. Despite signs of overvaluation, the evidence available indicates that the problem is concentrated in particular regions, such as Rio de Janeiro and Sao Paulo. Furthermore, we should also bear in mind that in the case of Brazil, the sharp increase in house prices is partly due to the very low base due to the virtual stagnation of the housing market in that country. Finally, there are recent signs of moderation in prices: after growing at rates of over 20% in real terms a few years ago, in 2013 growth was below 10% even in the most dynamic markets. It is to be hoped that this moderation will continue in the coming years in order to avoid an even greater misalignment of prices.

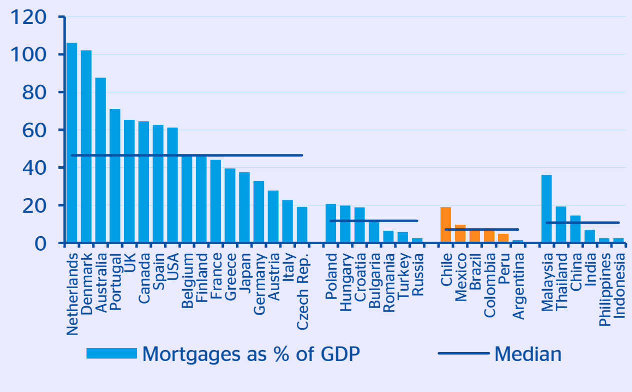
When it comes to Colombia, house prices went up in the order of 10% in real terms in 2013, although there were major differences between cities and an upward push on prices in Bogotá, linked to significant restrictions to extending the housing supply, which indicates that the price rise is not a widespread phenomenon. The purchase to rental ratio indicator has remained stable since 2011 although above the levels of the previous decade, related to the population's greater purchasing power, better transport systems and low interest rates. The mortgage market, which is increasingly leaning towards higher value housing, reflects the booming middle classes. For the future we estimate a moderation in prices, a result of lower public incentives for middle-income housing. We calculate that prices will have to grow below a real rate of 6% in the next few years to offset the moderate overvaluation centred on some of the country's cities.

In Chile and Peru the market has been characterised by dynamism in sales and sustained rises in price in real terms, which in the last quarter of 2013 reached 5.5% YoY in Chile and 12.2% in Peru, although in the latter country very influenced by the significant depreciation in the exchange rate in a highly dollarised property market[8]. In Chile the rise in sales has reduced the existing stock, which has contributed to maintaining prices high but with lower growth than in the past. In both cases, the areas with the biggest increases have been those targeted at middle-incomes, which is consistent with the growth in the population of the middle- and upper-middle income segments. In the future we estimate that growth will continue in price but at a slower rate than between 2008 and 2012.

Finally, in Mexico the situation is somewhat different, since house prices have risen by around 4% YoY in real terms in the last few years, a rate similar to that of the national consumer price index. There has been no increase in momentum on the demand side, although borrowing conditions are historically the best they have ever been. The price to income ratio is at its lowest ever recorded level, helped by widespread competition between banks and low interest rates. The effects of the phenomenon of excess housing supply continue, particularly for new units in the social housing category. Thus, prices in middle-income and residential segments have risen faster than in the social housing segment, reflecting greater preference for existing housing stock[9].

In terms of macroeconomic risks arising from a possible property market adjustment, the main channel for contagion to other sectors tends to be through the negative impact on the quality of mortgage lending, which in turn affects the health of the financial system. In the case of Latin America in general, and the Pacific Alliance in particular, mortgage lending still represents a relatively small proportion of total credit (Figure B.2.3). Except in the case of Chile (18.7% of GDP), in the other PA economies, mortgage lending accounts for a very small proportion: in the order of 9.1% in Mexico, 7.7% in Brazil, 5.3% in Colombia and 4.9% in Peru[10]. For this reason, in our view a possible overvaluation scenario in the sector, followed by a price correction, would have a very contained impact on the financial sector in the region.

Figure B.2.5
Mortgage lending as % of GDP



Data from 2013 for Mexico, Brazil and Colombia; 2012 for Chile, Peru and Argentina.
Source: Housing Finance Network (HOFINET) and BBVA Research

8: The increase in prices in Peru was 7.2% in dollars, less than in previous years.
9: Colombia Real Estate Outlook 2013, Chile Real Estate Outlook 2013, Peru Real Estate Outlook 2013, Mexico Real Estate Outlook 1H14.
10: In the case of Mexico this percentage only includes bank credit. If public housing institutions are included (Infonavit and Fovissste) the proportion represents 9.4% of GDP.

Conclusion

In view of the accessibility and profitability indicators for property ownership, the rapid rise in house prices in Latin America does not appear to be linked to the emergence of a price bubble, but rather to be supported to a large degree by the growing demand for housing, driven particularly by the improved financial situation of the middle classes in these countries, combined with a relatively inelastic supply in the short term, especially in some cities which have experienced the biggest price hikes in the last few years. However, it could be said that there will be a not inconsiderable overvaluation in house prices in the case of Brazil and to a lesser extent in Colombia and Peru, but it will not be enough to usher in a brusque price correction. In any event, even in the case of a substantial adjustment in house prices, the macroeconomic impact of this adjustment would be limited, unlike the situation six years ago in the US and in Spain, since mortgage lending represents a small fraction of total credit (except in Chile). In the context of greater stability and strong fundamentals, there is a lot of room for developing the mortgage sector in the region under appropriate financing conditions.

5. High external deficits in Latam, but easing to the downside from 2014 onwards

The region's external deficits will begin to shrink in 2014 and 2015, notwithstanding lower terms of trade and more moderate growth in China

Having risen steadily since 2010, the region's current account deficits will begin to ease downward in most countries beginning in 2014, with the main exception of Mexico (Figure 5.1). This expected reduction of current account deficits will be assisted, on the one hand, by the rise in global growth (see Section 2 of this Report) and, on the other, by the moderation in domestic demand in most of the region's countries.

Nevertheless, the downward easing of the region's external deficits will be a more gradual process than we anticipated three months ago. It is true that some factors should assist in a swifter convergence of external deficits toward what we consider to be the structural deficits of the region's countries, in no case greater than 3% of GDP: (i) the depreciation of the exchange rate in the region's countries; (ii) the end of some supply-side difficulties in the export sector (in Chile, Colombia, Brazil and Argentina); and (iii) the greater slowdown in domestic demand. However, these factors do not completely make up for the downward revision to the prices of the main export commodities and to global growth, especially in China. Therefore, although we continue to expect a downward trend in the region's external deficits, it will be more gradual than we had expected three months ago. Thus, we continue to expect that the region will gradually approach external deficits that, for Latin America overall, would be closer to 2% of GDP in 2018, versus a deficit for the region as a whole of close to 3% in 2014.

In Brazil, the current account will continue to deteriorate in 2014, due to a stronger currency in the short term (although weakening in the medium term), lower terms of trade and the impact of lower external demand from China and Argentina, a situation which will tend to revert in 2015.

In Colombia, the expected improvement in coal exports starting in April (and especially in the second half), as well as the lower dynamics of imports due to the currency depreciation, will more than make up for the negative effect of lower commodity prices, which means that the current account deficit will tend to narrow in 2014 and 2015. Nevertheless, this will occur at a slower pace than that expected one quarter ago.

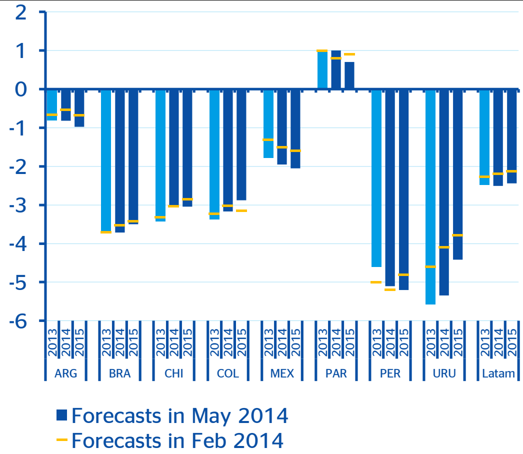
In Chile, the aforementioned combination will entail a faster convergence of the current account deficit toward sustainable levels. In Peru, the current balance (5% of GDP) will tend to deteriorate over 2014 due to lower terms of trade, although it will improve in 2015.

In Uruguay, the high deficit (5.6% of GDP in 2013) will tend to shrink over the next two years, crucially assisted by the higher exports expected from the start-up of the Montes del Plata cellulose plant and by the lower imports associated with the latter's investment phase.

For Mexico, the improvement in US demand will be key in the expected recovery of its balance of trade, with a critical role to be played by motor vehicle exports, which will continue to show strong dynamism. The latter notwithstanding, lower revenues are expected from exports other than motor vehicles as well as from oil exports, due to the price and quantity effect. We thus expect that the current account gap in our baseline scenario will tend to widen slightly over the next years, although at sustainable levels.

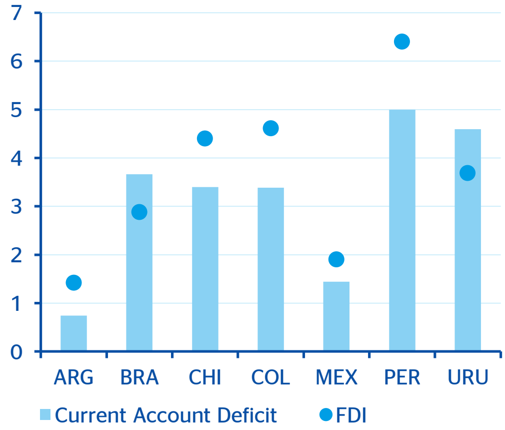
In Paraguay, the revision to soy bean price forecasts versus the estimate of one quarter ago will affect the performance of the balance of trade in 2014 and 2015, and the forecast for more appreciated currency levels will also have a negative influence on the current balance.

Figure 5.1
Latam countries: Current Account as % of GDP



Source: BBVA Research

Figure 5.2
Current Account Deficit and FDI as % of GDP



Source: BBVA Research

The region's external vulnerability remains limited, given relatively stable external deficit financing and generally adequate reserve stocks

Foreign Direct Investment (FDI) will continue to be the main source of financing for the region's current account deficit, even in Brazil where, at any rate, it covers close to 80%. In some cases such as Chile's, although the short-term external debt has risen (versus 2007, for example), it now accounts for a lower share of total debt, while long-term Foreign Direct Investment flows have increased the most.

The cases of Peru and Uruguay should be mentioned, where the prevalence of high deficits for several years may affect the perception of these economies' external vulnerability. Although this deficit will continue to be financed mostly by long-term capital, it should also be kept in mind that the sustainable levels of the external gap, related to the structural component (which removes cyclical fluctuations), must approach deficits of around 2% of GDP in both cases. This downward trend in the external deficit will be assisted by the start-up of a series of export sector investment projects (mining in Peru, cellulose production in Uruguay). That said, this process will also require a considerable effort in raising domestic savings.

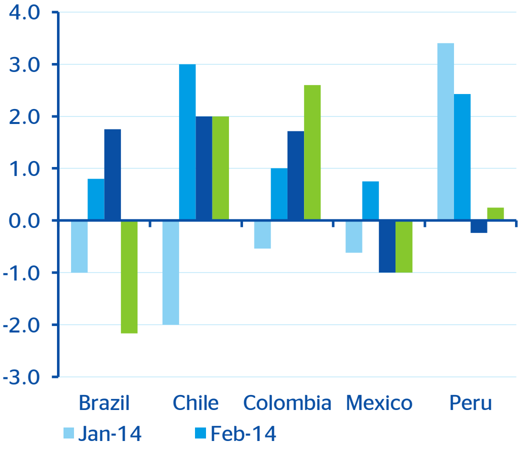
The reduced vulnerability from an external financing point of view must be considered together with a relatively comfortable position of international assets, with international reverse ratios at levels that can generally be deemed adequate in most countries. Consequently, most of the region's countries have good macroeconomic buffers to face a potential rise in external turbulence. Nevertheless, and in the event of an external shock, the foregoing does not rule out that there might be specific sectors in some economies (especially part of the non-financial corporate sector) which may be highly exposed and vulnerable to a swift depreciation of the exchange rate, particularly if their financial position is mismatched in terms of currencies and lacks effective hedging.

6. Across-the-board depreciation of exchange rates in 2014 and 2015, and heterogeneous monetary policies

Food price shocks and exchange rate depreciation effects have driven inflation

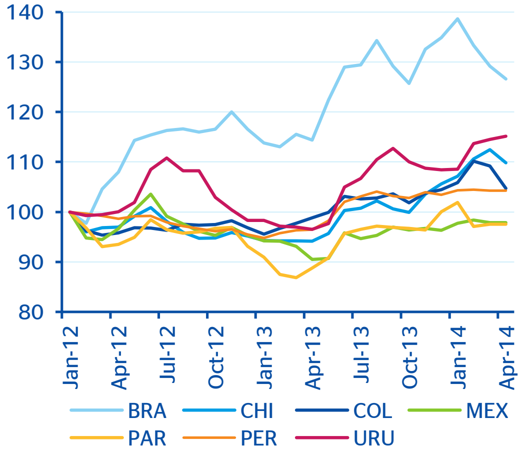
So far over 2014, and particularly in February and March, price rises in countries with inflation targets were greater than anticipated, with the important exception of Mexico, where the effects of the tax reform were briefer than anticipated (Figure 6.1). These surprises were related to various factors, depending on the country: (i) food supply shocks in Colombia and Brazil; (ii) rises in some regulated prices in Colombia, Brazil and Argentina; and (iii) a greater depreciation of the exchange rate (Figure 6.2), which has entailed a certain pass-through to prices in most of the region's countries, although to different degrees (see Box "Exchange rate pass-through to domestic prices" in the 1Q14 Latam Outlook).

Figure 6.1
Latam: Inflation surprises in 2014*



* Difference between the data observed and that expected by the consensus, adjusted for the standard deviation among analysts.
Source: Bloomberg and BBVA Research

Figure 6.2
Latam: Nominal exchange rate vs. Dollar (Index, January 2012=100)

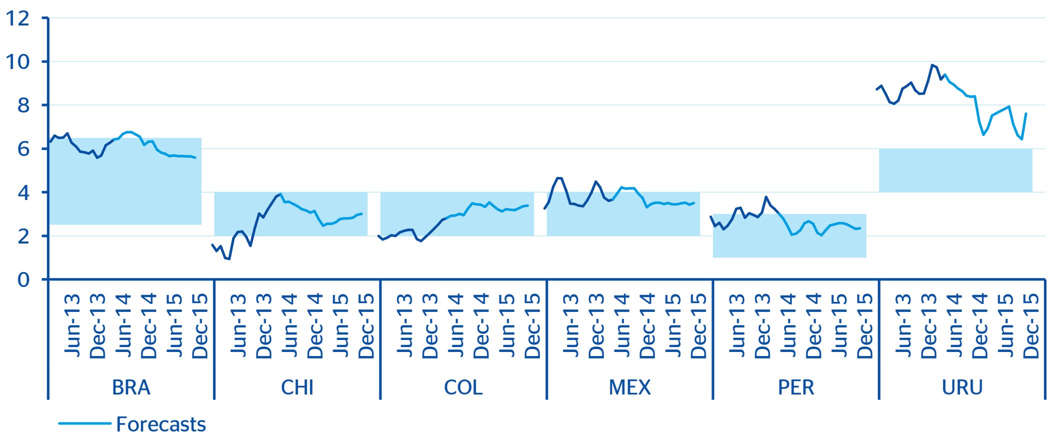


Source: BBVA Research

Inflation will converge toward central banks' targets at the end of 2014. The main exception will be Uruguay and, to a lesser degree, Brazil, where strong price pressures will persist

These upside surprises over the first quarter and the outlook for persistent upward pressure on food prices have led us to an upward revision of our expected inflation for the end of 2014 in most of the region's countries (except in the case of Mexico, where the revision is to the downside). That said, this inflationary pressure will tend to revert toward the end of 2014 and will vanish in 2015. Thus, we anticipate that inflation rates must converge toward the targets of the respective central banks of the three Andean countries at the end of 2014, with Mexico's remaining slightly above. As has been the case over the last few years, the main exceptions within the countries with inflation targets will remain Brazil and Uruguay, where pressures on inflation will persist, keeping it above the central bank's target range in the latter country (Figure 6.3).

Figure 6.3
Inflation (% YoY) and central bank target ranges



Source: BBVA Research

In Colombia, the rise in inflation over the first months of 2014, from 1.9% at the close of 2013 to 2.7% in April, is mainly related to the increase in the tradable goods group (food in particular), which accounts for 26%, and also to the greater-than-expected rise in some regulated goods. In the first case, the tradables were affected by the exchange rate depreciation; in fact, the last variation observed in this component was 50bp greater than one year ago.

In Chile and Peru, inflation surprised to the upside at the start of 2014, with rises associated with one-off and seasonal factors in the former country (mainly education and transportation), and with food prices in the latter. As well as these idiosyncratic effects, the impact of the currency depreciation must also be considered. Over the rest of the year, the depreciation will tend to drop and, also, given that there is still slack in the economy's production capacity, the recent increases do not entail widespread inflationary risks.

In the case of Brazil, inflation has also come in higher than expected, as a result of supply-side problems (supply of electrical power and drought), in addition to greater currency depreciation and inflation in administered prices. In this case, as opposed to the Andean countries, we believe that inflation will remain high over the coming months, and will not begin to decline until the end of the year. Towards 2015, we expect that inflation will begin to moderate, led by the economy and also assisted by the lagging effects of a more restrictive monetary policy rate.

The situation in Uruguay stands out negatively: wage inertia and fiscal laxity have entailed high levels of inflation for several years, reaching their 10-year high in February 2014 (9.8% YoY). Faced with this situation, the government reacted with measures such as cutting VAT on telecommunications and electricity and freezing the prices of some goods, although these measures have proved insufficient for the time being.

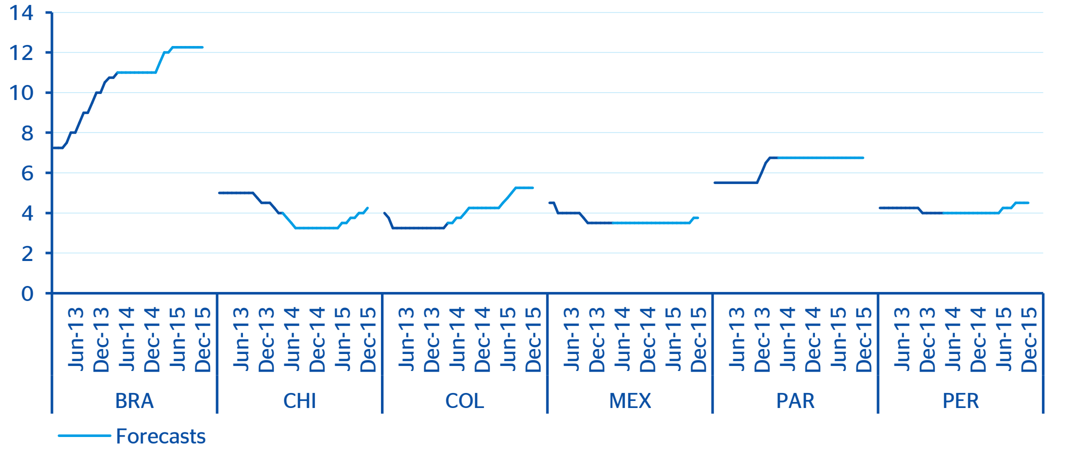
In Mexico the situation is somewhat different, given that the rise in the first quarter did not come as a surprise, but rather resulted from bringing forward the effects of the tax reform, which also proved to be temporary. We expect a mild pickup toward the middle of the year, associated with the effects of the basis of comparison, which nevertheless will be lower than initially considered. In this case, the revision to inflation has been to the downside, also bearing in mind that the output gap remains negative, and has even widened.

A monetary pause in Latam for the rest of 2014, except for Colombia and Chile. Monetary tightening will take place in the region in 2015, in tune with the Fed, but also due to domestic factors

Over the rest of 2014, the heterogeneity of the monetary policy of the region's countries with inflation targets will be conditioned by two factors which will affect the region unevenly. First, there are the pressures on inflation, which are still quite considerable in the case of Brazil and Uruguay (notwithstanding the monetary tightening already implemented over the last two years), but which have also manifested to a lesser degree over recent months in Chile, Peru and Colombia (while falling in Mexico). Second, and naturally not entirely independent of the first factor, are their different cyclical positions, with Colombia and, to a lesser extent, Mexico in the rising phase, versus an activity slowdown in the rest of the region.

Within the context of these two factors, we continue to anticipate that interest rates will be cut in Chile, while the interest rate increases that began in April in Colombia will continue. For the rest of the countries, we expect interest rates to remain stable for the remainder of the year (Figure 6.4). This scenario, of course, will depend crucially on the Fed's process of a gradual, orderly and well-communicated withdrawal of monetary stimulus continuing without any material changes with respect to current market expectations. By 2015, the initiation of Federal Reserve interest rates increases will be an additional factor (together with the persistence of pressures on inflation in Brazil and Uruguay, and the cyclical recovery in the rest of the economies) that will determine across-the-board interest rate increases in the region, although to different degrees (Figure 6.4).

Figure 6.4
Latam: Official Interest Rate in Countries with Inflation Targets (%)



Source: Bloomberg and BBVA Research

In Colombia, we expect the tightening of the monetary policy tone to continue, in line with our February expectations. It should be remembered that the central bank raised its policy rate by 25bp in April, earlier than the market had expected. The factors that led the central bank to start the adjustment process ahead of schedule included the inflationary surprises of the first quarter, and an economic expansion that proceeds at positive pace, in addition to the probable wish to make gradual adjustments to the rate. For the rest of the year, we expect three additional adjustments of 25bp each, in line with a convergence of inflation toward the target. We estimate additional increases totaling 100bp over the course of 2015, driven by greater growth, before reaching 5.25% in December 2015.

In Chile, we believe that the greater moderation in the economy compared to our estimate of three months ago, together with a contained inflation scenario within the forecasting horizon, will require greater monetary stimulus over the coming months. Thus, we expect the central bank to cut the monetary policy rate down to 3.25% by December of this year, and that the monetary normalisation process will begin in the third quarter of 2015, in step with the Fed's rate increase process expected at that time.

Peru's central bank will remain in a quandary in the short term. On the one hand, certain pressures on inflation, a sizeable current account deficit and the likely bouts of currency volatility in the future will require an upward adjustment of the benchmark rate. On the other hand, however, growth is moderate and remains somewhat below potential. That said, we believe that the central bank will leave the benchmark rate unchanged and, in the event of a worse-than-expected deterioration in activity, will (once again) choose to cut reserve requirements, although there is increasingly less leeway to use this tool.

In Mexico, the outlook for a recovery in activity and an inflation rate in line with expectations (and converging toward the central bank's expected range) have contributed to a moderation in the easing tone of the monetary institution's latest statements. We thus stand by our outlook for a extended pause in the target rate for the remainder of 2014 and a large part of 2015.

In the case of Brazil, the restrictive cycle is likely to be paused over the coming months, to assess the lagging impact on inflation of the interest rate increases of the last two years, although greater adjustments this year would probably be advisable, given the need to contain inflation. As for the remaining countries, we expect monetary tightening to resume in 2015, after the elections and also in harmony with interest rate increases by the Fed. Uruguay's monetary authority has not shown more aggressiveness toward the higher inflation over the last months. We also do not expect any material changes to monetary policy, which now includes a gradually declining rate of expansion in the broad M1 aggregate.

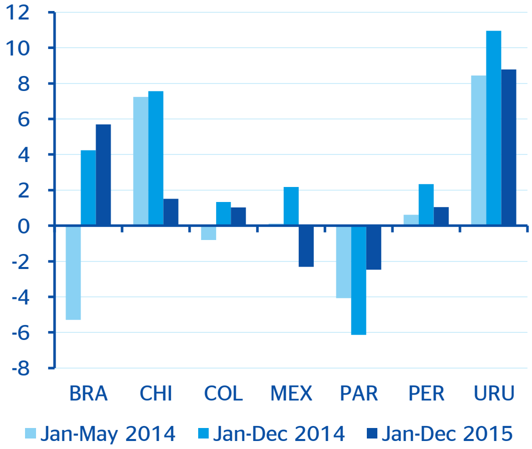
The region's exchange rates will depreciate in 2014 and 2015 by very diverse degrees, pressured by less global liquidity and lower commodity prices

Within the forecasting horizon, exchange rates in Latin America will be influenced by a continuation of the Fed's monetary tightening process, as well as by the evolution of the prices of the main export commodities which, as mentioned above, will be a crucial factor in determining the pace of narrowing of the current account deficits of the region's countries, especially in South America.

In particular, lower international liquidity and commodity prices will determine a more or less widespread depreciation of exchange rates (with the exception of Mexico and Paraguay), in addition to that already seen over the course of the year. That said, the degree of depreciation will be highly diverse, being greater in those countries with (i) higher inflationary pressures (Brazil, Uruguay); (ii) greater exposure to a fall in commodity prices (especially industrial metals, such as in Chile and Peru); (iii) lower exposure to the cyclical recovery in the US (South America in general, except for Colombia); (iv) greater central bank willingness to refrain from intervening in the currency market (Chile) and (v) higher external deficits (Peru, Uruguay). Furthermore, exogenous factors such as greater weighting in institutional investor benchmark indices, as in the recent case of Colombia, will support the exchange rate by promoting the entry of capital flows.

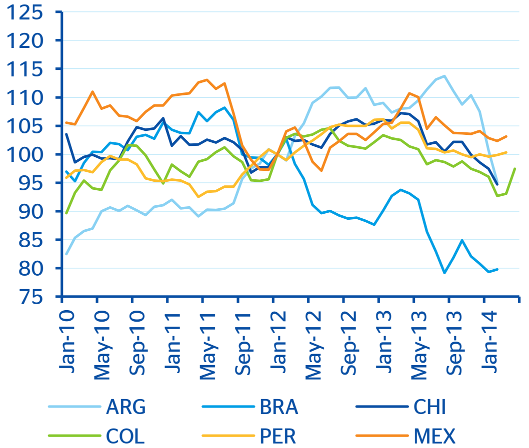
Consequently, we expect that the greatest currency depreciations over the remainder of this year and in 2015 will take place in Brazil and Uruguay (Figure 6.5). In Brazil, the depreciation would come after a period of short-term appreciation, due to the significant spread between Brazilian and US interest rates. In the medium term, the aforementioned global factors, together with the structural factors (which include high inflation and weak competitiveness), are consistent with a more depreciated currency over the medium term. In the case of Uruguay, the high inflation and the depreciation in its main trading partners (Brazil and Argentina) will weigh on the exchange rate, which will depreciate heavily to maintain the competitiveness of the tradable sector.

Figure 6.5
Latam: currency depreciation (% YoY eop)



* Negative sign indicates exchange rate appreciation.
Source: Bloomberg and BBVA Research

Figure 6.6
Latam: real effective exchange rates



Source: BBVA Research

On another note and looking ahead, the depreciation of the exchange rate in the three Andean countries is likely to be very moderate. In Colombia, the aforementioned internal and external factors point to a favourable differentiation within the forecasting horizon and, therefore, to a limited depreciation. In particular, we expect that pace of international reserves accumulation will continue, assisted by JP Morgan's announcement that it will increae Colombia's weighting in its GBI-EM index.

In Peru, the foregoing external factors, in particular the deterioration of the terms of trade and the persistence of sizeable current account deficits, will contribute to a weakening of the exchange rate, in line with the fundamentals. It should be noted, however, that the central bank's high availability of international reserves and its willingness to reduce exchange rate volatility will help to smooth this transition, as it has in the past.

In the case of Chile, the strong depreciation of the exchange rate recorded at the start of the year (in early March the depreciation was close to 10% versus the close of 2013) entailed currency levels that were out of line with the fundamentals, which anyway pointed to a more depreciated exchange rate due to the deterioration of the terms of trade. Over the last two months, that misalignment has tended to lessen, with a certain strengthening of the exchange rate (although less in comparison with other countries), which means that we do not expect significant additional pressures on the exchange rate in the future.

Lastly, in the case of Mexico, we believe that currency conditions will remain in line with the fundamentals and with little margin for appreciation. Nevertheless, we expect that the currency will have depreciated toward the end of the year by around 2% versus the close of 2013, and that said depreciation will correct over the course of 2015. Also in the case of Paraguay, the relative isolation of capital flows to the region and the maintenance of a robust external surplus will keep the pressure on the appreciation of the exchange rate for the rest of 2014 and in 2015.

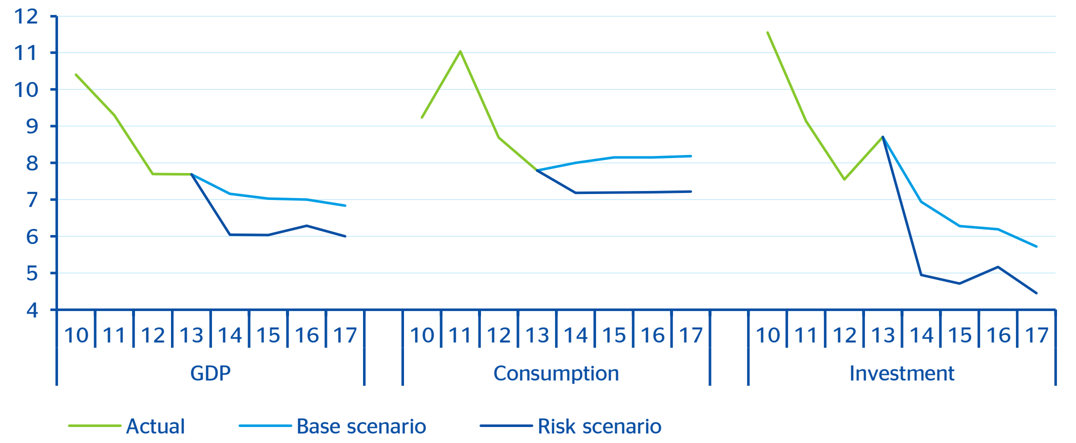
7. The risk that China poses for Latam

A scenario of a persistent slowdown in investment and growth in China is the main structural risk factor for Latin America

As we mentioned in Section 2, one of the main changes in the international economic scenario over the last three months has been the reassessment of China's growth perspectives. In our main scenario for Latin America described in the foregoing Sections, we already include a certain slowdown of growth in China (see Figure 2.3), as a result of (i) the authorities' efforts to change the country's growth composition (increasing the weight of consumption and reducing that of investment); and (ii) the implementation of measures to reduce the financial stability risks posed by shadow banking, which entail a certain tightening of financial conditions. That said, in this main scenario we expect that the authorities will act to ensure a minimum growth of 7% over the next years, which would keep unemployment under control.

This main scenario for the Chinese economy, however, is not devoid of risks, which arise precisely from the high financial fragility and uncertainty over the implementation of reforms. A very considerable risk for Latin America is the scenario of a hard landing for growth in China. This scenario could be the result, for example, of excessive pressure on the shadow banking system or of a sudden tightening in the interbank market, as in June 2013, that could lead to a financial crisis and a fall in confidence on the part of both consumers and the corporate sector.

Figure 7.1
China: Baseline and risk Scenario (% YoY)



Source: BBVA Research

As a result of this shock, consumption could collapse due to a slowdown in disposable income. However, the main impact would be on investment, due to the financial instability and the fall in risk appetite. This weakening of internal demand could weigh down growth to rates of around 5% at the end of 2014, followed by a recovery in 2015 and 2016, as the economic authorities halt structural reforms and implement strong monetary and financial stimuli. That said, the negative impact of this shock on growth would be relatively persistent, precisely due to delaying reforms to give precedence to short-term policy stimuli. Consequently, China's growth rates could remain below our baseline scenario for an extended period of time (Figure 7.1).

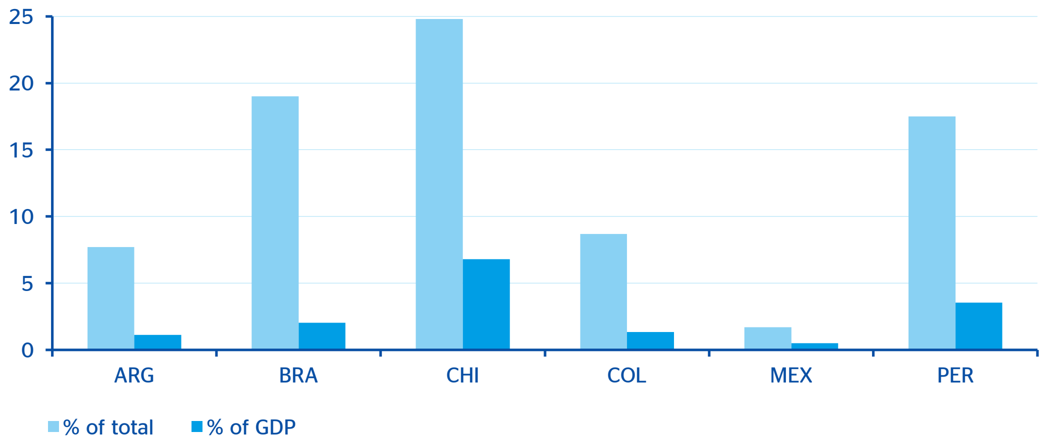
It is important to emphasise that the likelihood of this scenario occurring is very low, especially bearing in mind that the main scenario already includes a cut to growth forecasts versus those released three months ago. That said, this scenario would have a substantial impact not only on China but also on highly linked economies, such as South America's.

A negative shock to China's growth would affect South America via lower demand, lower commodity prices and the negative impact on household and business confidence

The aforementioned risk scenario would affect Latin America mainly through three conduits: (i) a reduction of Latin America's external demand; (ii) a drop in the price of the main export commodities; and (iii) a negative impact on household and business confidence in Latin America. These conduits would be especially relevant to South American countries, but only fractionally so in the case of Mexico, which relies less on commodity exports and is less linked to the Chinese cycle.

With respect to the first conduit, it should be remembered that China is one of Latin America's main trading partners, especially with the countries of South America. The countries with the greatest reliance on direct demand from China are Chile, Brazil, Peru and Uruguay,which send between 15% and 25% of their exports to that country, and they would be the countries most affected by a fall in external demand. In contrast, Mexico only sends 2% of its exports to China (Figure 7.2).

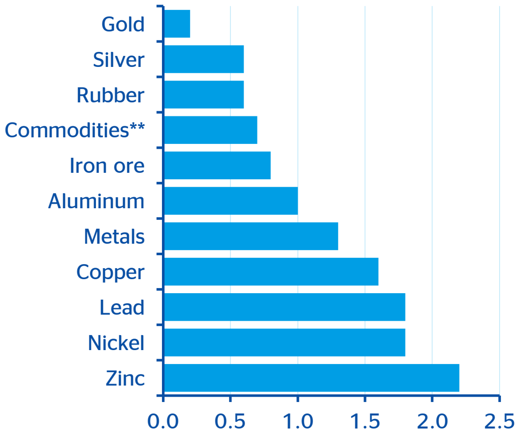
Figure 7.2
Latam: exports to China



Source: National Statistics and BBVA Research

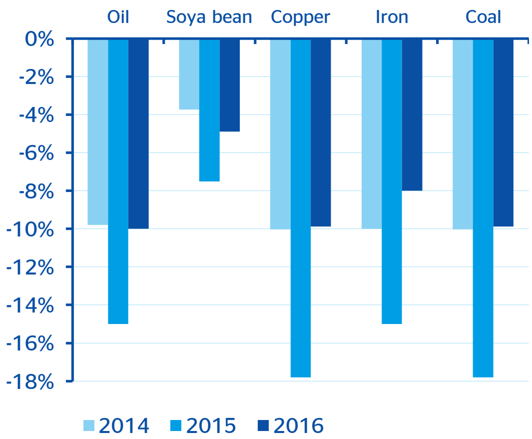
The second transmission conduit of lower Chinese growth would stem from the negative effect that it would have on the prices of Latin America's main export commodities. The effect would depend both on China's weight in the global demand for each commodity and on the intensity with which investment in China (the most affected demand component under this risk scenario) demands each type of commodity. Figure 7.3 displays the price elasticities of the main industrial commodities versus a drop in investment. Taking into account these elasticities and the impact that we expect on consumption and investment under the risk scenario, Figure 7.4 shows the expected impact on the region's main export commodities. What particularly stands out is the strong negative impact that this risk scenario would have on the prices of the main industrial metals (copper, iron), due both to the demand drop and to the reduction of inventories used as collateral in shadow banking system operations. The prices of energy commodities would also be strongly affected, while food prices would not suffer such a substantial drop, as they are more linked to consumption behaviour.

Figure 7.3
Commodity price elasticity* to investment in China



* Percentage impact on commodity prices one year after a 1pp drop in fixed asset investment growth in China.
Source: IMF and BBVA Research

Figure 7.4
Effect of China risk scenario on commodity prices (% change vs. baseline scenario)



Source: BBVA Research

The third transmission conduit of a China growth shock would be the negative effect on household and business confidence in the region. In fact, after the bankruptcy of Lehman Brothers in 2008, one of the main transmission conduits to Latin America was the strong drop in the confidence of both types of agents, which led to a severe and sudden contraction of internal demand. Given China's importance for South America, the recurrence of a strong drop in confidence is quite possible, although it would probably be less severe. In particular, we assume that the intensity of the negative effect on household and business confidence would be 50% of that observed after the bankruptcy of Lehman Brothers, with the exception of Colombia, where its relatively greater exposure to the US than to China would lead to a confidence impact on this occasion of only 25% of that seen in 2008.

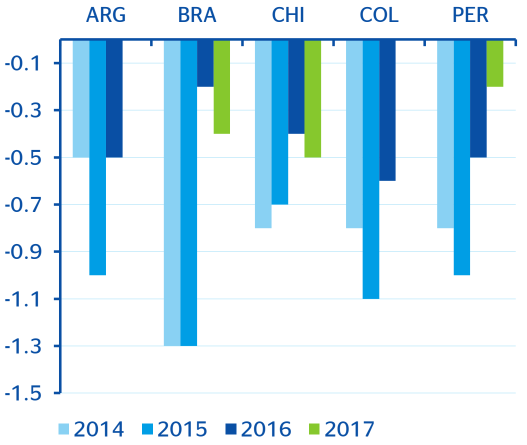
Of course, there is a potential additional contagion conduit from China to Latin America that was not considered in this exercise. A fall in China's growth could cause a substantial rise in global risk aversion and turbulence in the international financial markets. That said, it is worth noting that the expected adjustment in the China risk scenario is limited, clearly insufficient to trigger bouts of global financial uncertainty, which would seem to be more associated with an alternative risk scenario that would include a disorderly withdrawal of monetary stimulus in the US, for example.

A scenario of a slowdown in investment in China would have a substantial negative impact on South America, which would be weathered better by the Andean countries

In the event of a Chinese slowdown as described above, domestic demand in South America would be severely affected, by a drop in both consumption and investment, resulting from a fall in household and business confidence. While countries with room for countercyclical economic policies (mainly Chile, Peru and Colombia) would implement monetary and/or fiscal stimuli, internal demand would be negatively affected, although to a lesser extent than in countries with little leeway for countercyclical fiscal and monetary policies, such as Brazil. Figure 7.5 shows that Brazil would be precisely one of the most affected countries, as it is strongly exposed to China and has little room for countercyclical policies. For their part, the Andean countries are highly exposed to a shock from China, but have better buffers, due to the room they have to use countercyclical economic policies, which would temper the initial impact. In the case of Argentina, the impact would be lower, to a large degree because the shock to food prices (its main export product) is much lower than in the case of metals and energy. Lastly, there would be scant effect on Mexico.

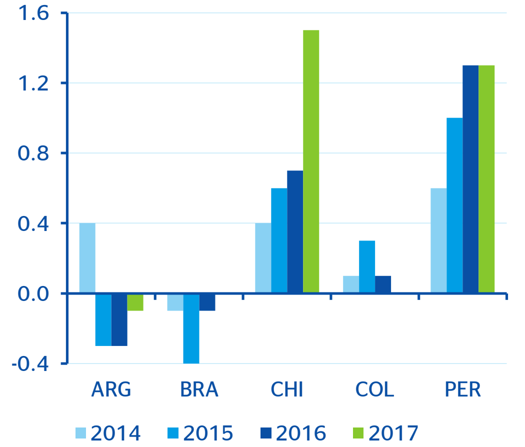
Consequently, and under the risk scenario, growth in Argentina and Brazil would be close to zero in 2014 and 2015, while in the case of the Andean countries growth would only be reduced to around 3 or 4%. It is interesting to highlight that, similarly to what occurred in 2008, the strong reduction of domestic demand would more than make up for the deterioration of external demand and the terms of trade which, in the case of the three Andean countries, would actually lead to an improvement of external deficits versus the baseline scenario (Figure 7.6). This improvement in the external balance would be equivalent to 25-30% of the external balance improvement seen from 2008 to 2009, as a result of the fall in confidence after the Lehman Brothers bankruptcy.

Figure 7.5
China risk scenario: impact on growth (difference in pp vs. baseline scenario)



Source: BBVA Research

Figure 7.6
China Risk Scenario: impact on Current Account (difference in pp vs. baseline scenario)



Source: Haver Analytics and BBVA Research

Thus, the results of this simulation exercise reveal that some of the region's countries, such as the Andeans, can withstand a China shock relatively well. At the same time, the exercise highlights the need to have room for countercyclical policies and the importance of restoring that room by taking advantage of favourable situations for that purpose.

8. Tables

Table 8.1
GDP (% YoY)

	2011	2012	2013	2014*	2015*
Argentina	8.6	0.9	3.0	2.8	2.1
Brazil	2.7	1.0	2.3	2.0	1.6
Chile	5.8	5.4	4.1	3.4	4.3
Colombia	6.6	4.0	4.3	4.7	4.8
Mexico	4.0	3.7	1.3	3.4	3.0
Paraguay	4.3	-1.2	14.4	5.3	4.2
Peru	6.5	6.0	5.6	5.2	5.6
Uruguay	7.3	3.7	4.4	3.2	3.3
Mercosur	3.5	1.3	2.3	1.1	1.5
Pacific Alliance	4.9	4.2	2.6	3.8	3.7
Latin America	4.1	2.6	2.4	2.3	2.5

*Forecasts.
Source: BBVA Research

Table 8.2
Inflation (% YoY, average)

	2011	2012	2013	2014*	2015*
Argentina	9.8	10.0	10.6	24.8	23.2
Brazil	6.6	5.4	6.2	6.3	5.8
Chile	3.3	3.0	1.8	3.4	2.8
Colombia	3.4	3.2	2.0	2.9	3.3
Mexico	3.4	4.1	3.8	4.0	3.5
Paraguay	8.3	3.7	2.7	5.1	4.5
Peru	3.4	3.7	2.8	2.8	2.4
Uruguay	8.1	8.1	8.6	9.0	7.3

*Forecasts.
Source: BBVA Research

Table 8.3
Exchange rate (against USD, average)

	2011	2012	2013	2014*	2015*
Argentina	4.13	4.55	5.47	8.66	12.16
Brazil	1.68	1.96	2.18	2.33	2.56
Chile	484	486	495	559	575
Colombia	1848	1798	1869	1955	1977
Mexico	12.4	13.2	12.8	13.3	13.2
Paraguay	4188	4417	4312	4458	4271
Peru	2.75	2.64	2.70	2.82	2.87
Uruguay	19.2	20.2	20.4	22.8	24.7

*Forecasts.
Source: BBVA Research

Table 8.4
Interest Rates (%, average)

	2011	2012	2013	2014*	2015*
Argentina	13.34	13.85	16.92	27.45	30.79
Brazil	11.71	8.46	8.44	10.92	12.04
Chile	4.75	5.00	4.90	3.63	3.58
Colombia	4.10	4.94	3.35	3.77	4.79
Mexico	4.50	4.50	3.94	3.50	3.54
Paraguay	8.49	6.00	5.54	6.73	6.75
Peru	4.04	4.25	4.21	4.00	4.23
Uruguay	18.97	18.59	17.70	20.62	17.74

*Forecasts.
Source: BBVA Research

Table 8.5
Current Account (% GDP)

	2011	2012	2013*	2014*	2015*
Argentina	-0.5	0.0	-0.8	-0.8	-1.0
Brazil	-2.1	-2.4	-3.7	-3.7	-3.5
Chile	-1.2	-3.4	-3.4	-3.0	-3.0
Colombia	-2.9	-3.2	-3.4	-3.2	-2.9
Mexico	-1.1	-1.2	-1.8	-2.0	-2.0
Paraguay	0.4	-0.9	1.0	1.0	0.7
Peru	-1.9	-3.3	-4.6	-5.1	-5.2
Uruguay	-2.9	-5.3	-5.6	-5.3	-4.4
Mercosur	-0.6	-1.4	-2.4	-2.4	-2.3
Pacific Alliance	-1.5	-2.0	-2.5	-2.6	-2.6
Latin America	-1.0	-1.7	-2.5	-2.5	-2.4

*Forecasts.
Source: BBVA Research

Table 8.6
Fiscal Balance (% GDP)

	2011	2012	2013*	2014*	2015*
Argentina	-1.6	-2.4	-2.2	-1.7	-1.6
Brazil	-2.6	-2.5	-3.7	-3.8	-3.4
Chile	1.3	0.6	-0.6	-1.9	-2.0
Colombia	-2.9	-2.3	-2.4	-2.3	-2.2
Mexico	-2.7	-2.6	-2.3	-4.1	-3.6
Paraguay	0.7	-1.4	-0.9	-0.5	-0.4
Peru	2.0	2.3	0.9	-0.1	-0.4
Uruguay	-0.9	-2.8	-2.3	-3.1	-2.9
Mercosur	-2.5	-2.8	-3.5	-3.8	-2.9
Pacific Alliance	-1.8	-1.7	-1.8	-3.1	-2.8
Latin America	-2.2	-2.3	-2.7	-3.5	-2.9

* Forecasts.
Source: BBVA Research

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RESEARCH

This report has been produced by the Latam Coordination Unit:

Chief Economist
Juan Ruiz
juan.ruiz@bbva.com

Enestor Dos Santos
enestor.dossantos@bbva.com

Cecilia Posadas
c.posadas@bbva.com

Pablo Urbiola
pablo.urbiola@bbva.com

Argentina
Gloria Sorensen
gsorensen@bbva.com

Chile
Jorge Selaive
jselaive@bbva.com

Colombia
Juana Téllez
juana.tellez@bbva.com

Mexico
Carlos Serrano
carlos.serranoh@bbva.com

Peru
Hugo Perea
hperea@bbva.com

Venezuela
Oswaldo López
oswaldo.lopez@bbva.com

With the contribution of:
Economic Scenarios
Julián Cubero
juan.cubero@bbva.com

BBVA Research

Group Chief Economist
Jorge Sicilia

Emerging Markets:
Alicia García-Herrero
alicia.garcia-herrero@bbva.com.hk

Cross-Country Emerging Markets Analysis
Álvaro Ortiz Vidal-Abarca
alvaro.ortiz@bbva.com

Asia
Xia Le
xia.le@bbva.com.hk

Mexico
Carlos Serrano
carlos.serranoh@bbva.com

Latam Coordination
Juan Ruiz
juan ruiz@bbva.com

Argentina
Gloria Sorensen
gsorensen@ bbva.com

Chile
Jorge Selaive
jselaive@bbva.com

Colombia
Juana Téllez
juana.tellez@bbva.com

Peru
Hugo Perea
hperea@bbva.com

Venezuela
Oswaldo López
oswaldo_lopez@ bbva.com

Developed Economies:
Rafael Doménech
r.domenech@bbva.com

Spain
Miguel Cardoso
miguel.cardoso@bbva.com

Europe
Miguel Jiménez
mjimenezg@bbva.com

United States
Nathaniel Karp
nathaniel.karp@bbvacompass.com

Global Areas:
Economic Scenarios
Julián Cubero
juan.cubero@bbva.com

Financial Scenarios
Sonsoles Castillo
s.castillo@bbva.com

Innovation & Processes
Clara Barrabés
clara.barrabes@bbva.com

Financial Systems & Regulation:
Santiago Fernández de Lis
sfernandezdelis@bbva.com

Financial Systems
Ana Rubio
arubiog@bbva.com

Financial Inclusion
David Tuesta
david.tuesta@bbva.com

Regulation and Public Policy
María Abascal
maria.abascal@bbva.com

Recovery and Resolution Strategy
José Carlos Pardo
josecarlos.pardo@bbva.com

Global Coordination
Matías Viola
matias.viola@bbva.com

Contact details:

BBVA Research
Paseo Castellana, 81 – 7th floor
28046 Madrid (Spain)
Tel.: +34 91 374 60 00 and +34 91 537 70 00
Fax: +34 91 374 30 25
bbvaresearch@bbva.com
www.bbvaresearch.com