BBVA | RESEARCH

OUTLOOK

LATIN AMERICA

4th QUARTER 2016

Main messages

The global economy is heading for a slow recovery. Global GDP growth will improve slightly from the second half of 2016. Incoming data are positive, with a slow recovery of growth (especially in emerging economies). Quiet financial markets in emerging economies were jolted by the US elections in November. In addition, global risks are still high.

An inflection point in Latin America. Regional GDP growth will increase from -1.3% in 2016 to 1.3% in 2017. First signs of a turnaround of economic activity are starting to appear in some countries, but the recovery in 2017 will be gradual. Growth will remain below potential in many countries

Inflation will continue to abate in South America, but will increase in Mexico. Consistent with these trends, central banks in South America will continue to cut interest rates in coming months (except Peru). In turn, rate hikes in Mexico will continue, at a faster pace than that anticipated for the Fed.

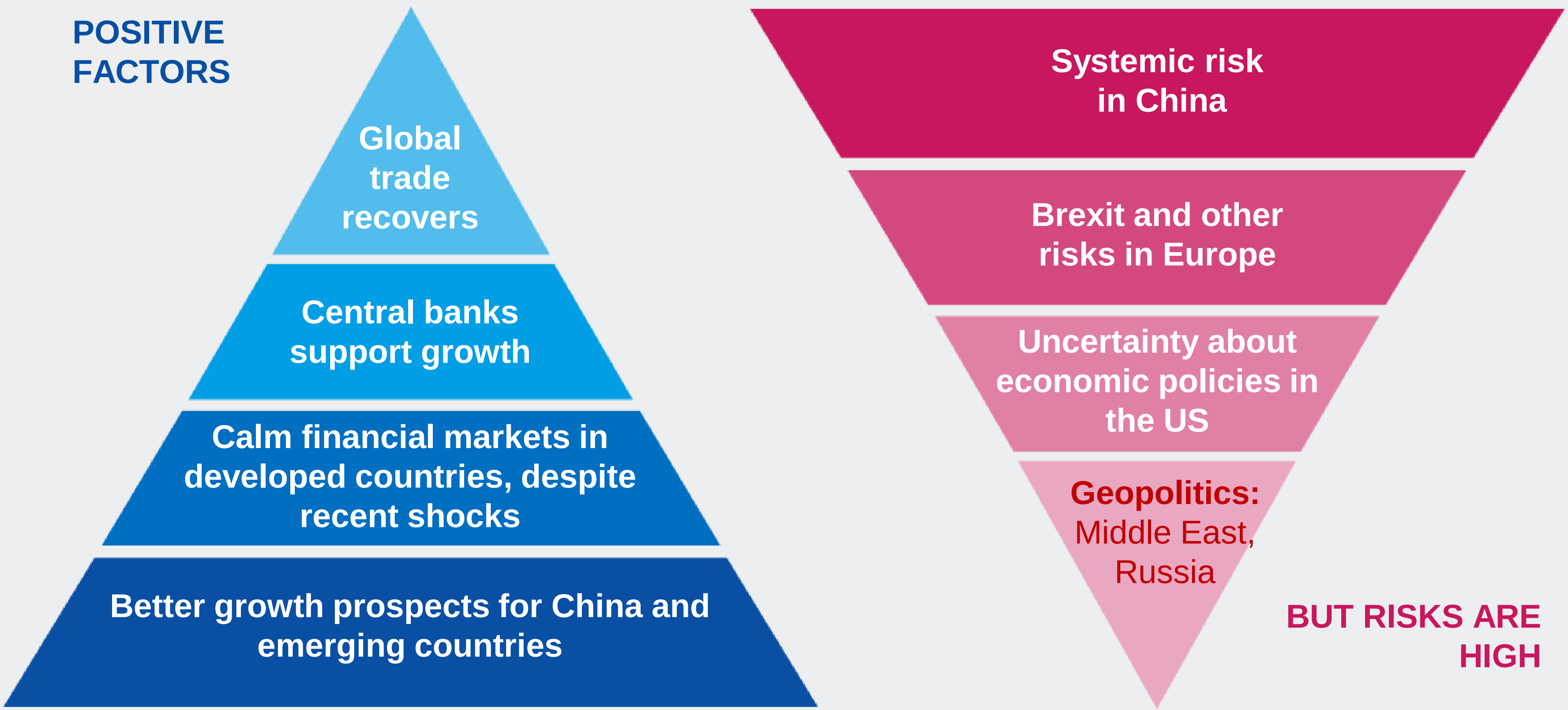
Risks to growth projections are tilted to the downside. On the external front risks are centered in the short run on uncertainty around the future economic policy in the US and market reaction after the next interest rate hikes by the Fed. In the medium term, risks are focused on the possibility to implement structural reforms in China.

GLOBAL

A very gradual recovery

GLOBAL FACTORS

Positive data, but risks are still high

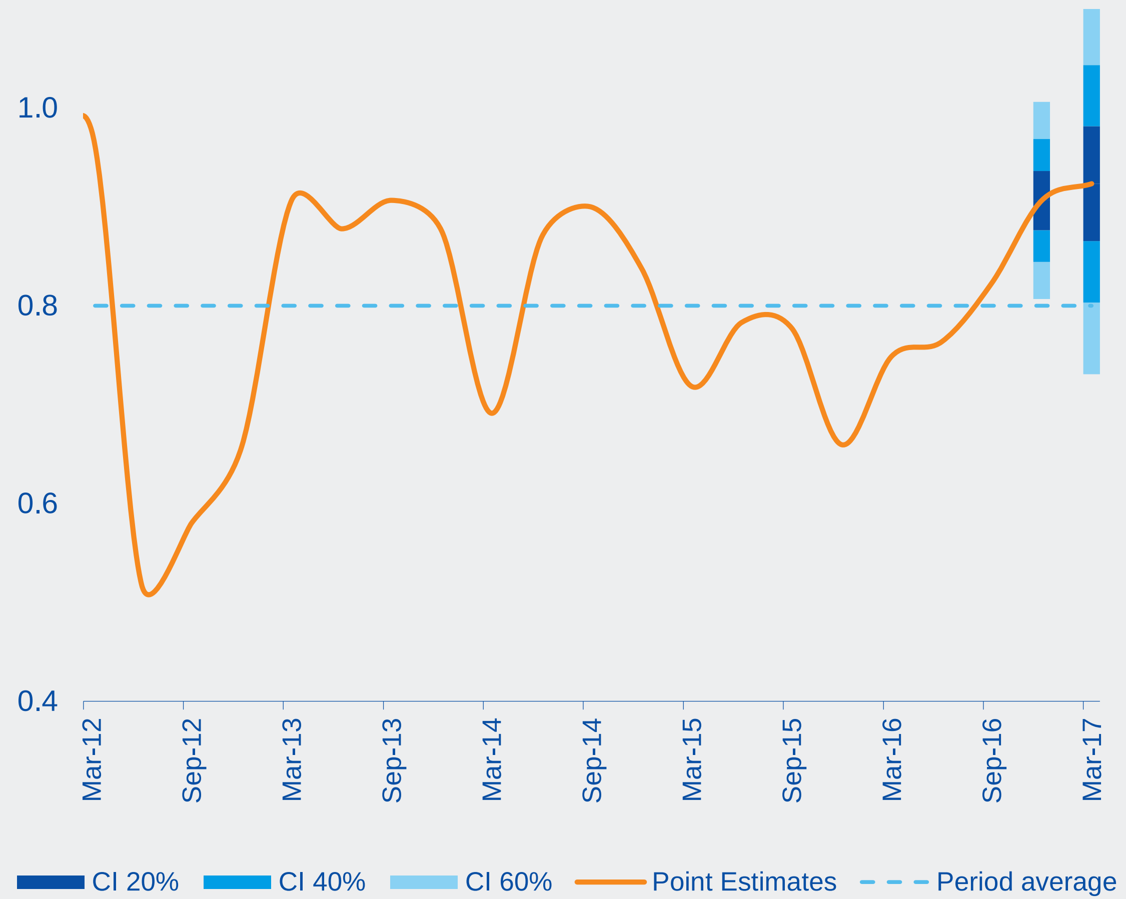


GLOBAL GROWTH

Data shows a slight recovery of global growth in second half of 2016

- Retail sales suggest a strong impulse for global consumption
- Confidence indicators more optimistic, recovering in many countries, but hard data is still inconclusive
- Stronger global growth in the second half of 2016 would also extend to the first quarter of 2017
- Global growth revised down in 2016, to 3.0%. Recovery still on for 2017, with slight increase in growth to 3.2%.

GLOBAL GROWTH
(% qoq at annual rate)
(Forecasts based on BBVA-GAIN model)



Source: BBVA Research

GLOBAL GROWTH

Factors affecting global recovery

Central Banks and interest rates

Interest rates will remain low for a long time, despite recent hikes, because of cyclical and structural factors.

Effectiveness of monetary policies is approaching its limits. Costs are beginning to outweigh benefits of lower rates

Policy Coordination

Fiscal and structural policies should complement monetary policy

US and Germany have room for expansionary measures, which are more likely in the US

Other countries have scope to modify the composition of public expenditure without expanding it.

Global trade

Slowdown in global growth affects trade

The elasticity of trade to GDP growth is lower than before the crisis

1. Shrinking global value chains (China)
2. Lower global investment
3. Protectionism

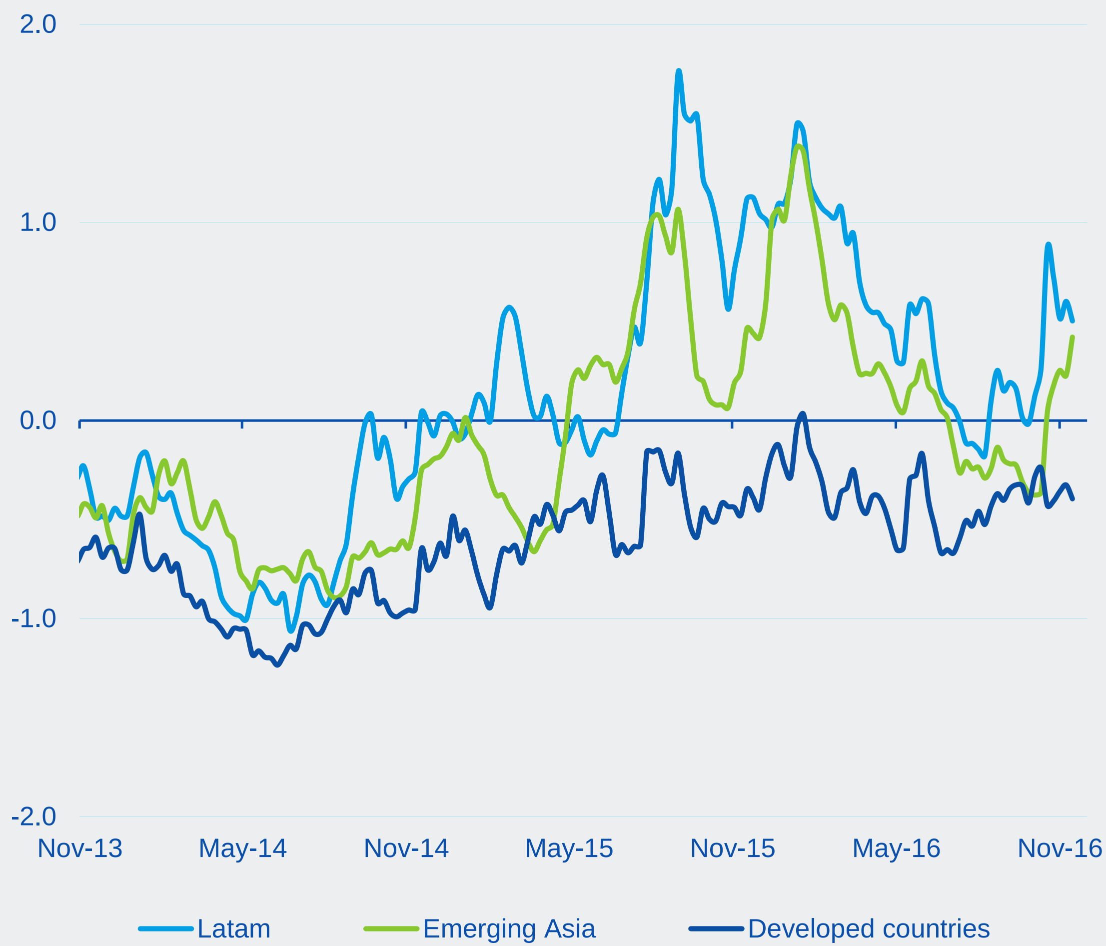
Trade to recover very gradually

INTERNATIONAL FINANCIAL MARKETS

Increased volatility in emerging markets, after the US elections and the recent rate hike by the Fed

- Financial stress in emerging economies rose significantly, given increased uncertainty after the US elections (as the fallout may impact emerging markets more strongly), and the Fed's rate hike in December..
- In contrast, financial stress was quite limited in developed markets. Capital flows even started to be rerouted, especially towards US equity.

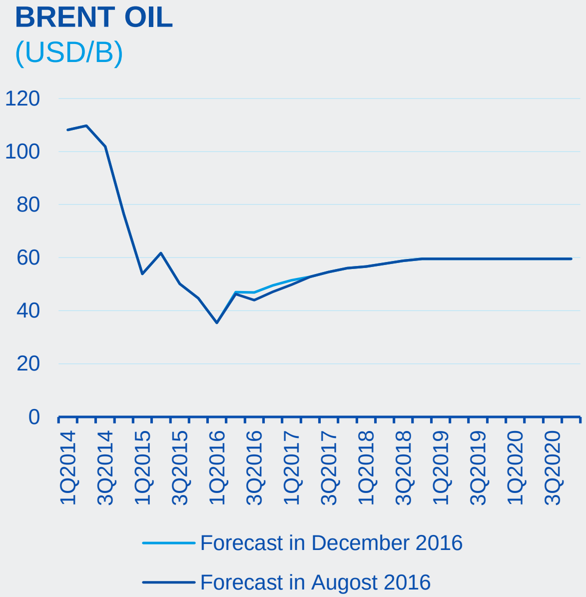
BBVA FINANCIAL STRESS INDEX
(normalized)

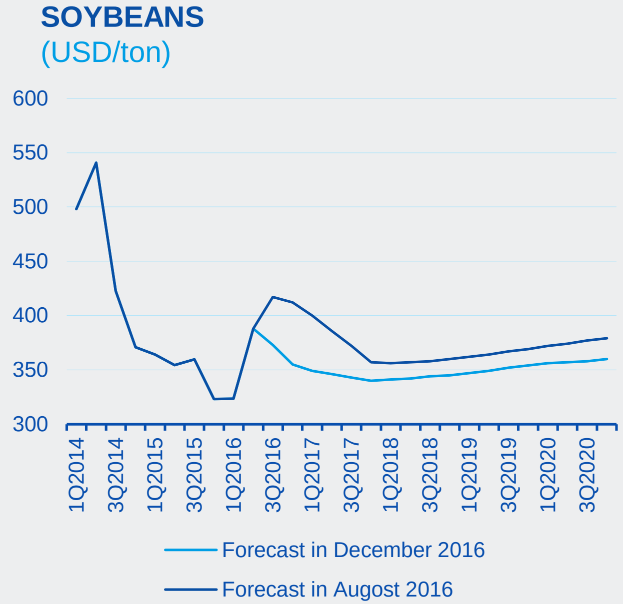


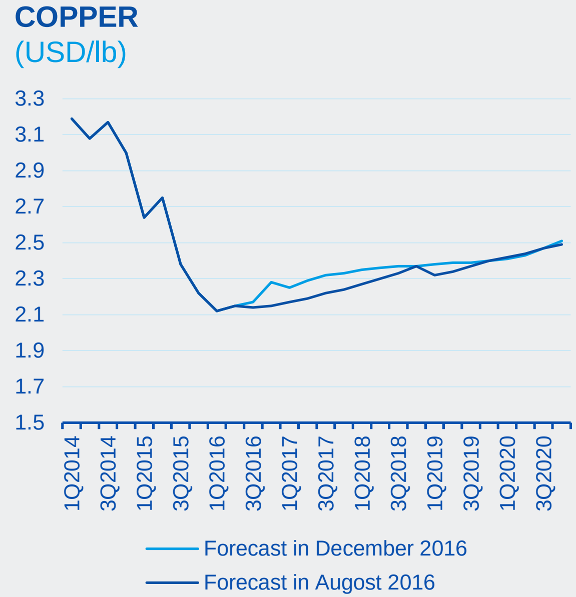
Source: BBVA Research

COMMODITY PRICES

Oil and copper prices on track for a gradual recovery. Soybeans hit in the short run by bumper harvest







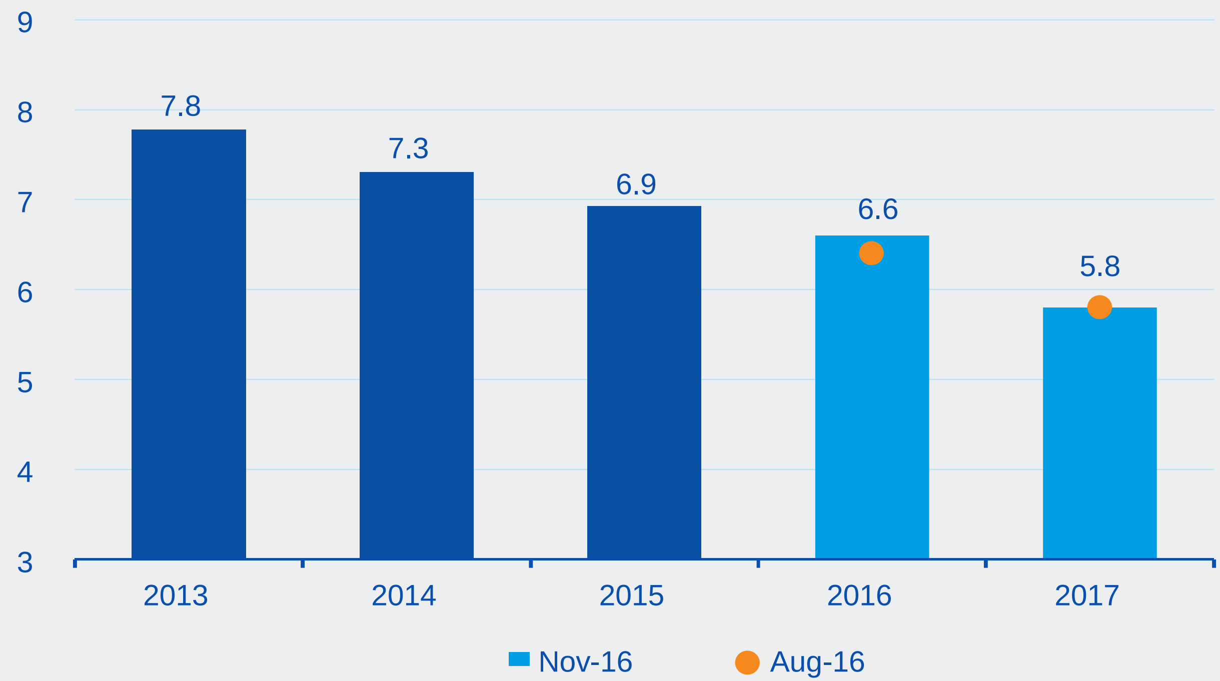
- Oil and copper prices to recover gradually as current oversupply is reduced. Recent OPEC agreement introduces an upward bias to oil price forecasts.
- Soybean prices adjusted downwards given a bumper harvest, especially in US and Brazil.

Source: BBVA Research and Bloomberg

CHINA

Baseline scenario points to gradual deceleration. Slight upward revision of growth in 2016.

CHINA: GDP GROWTH
(%)



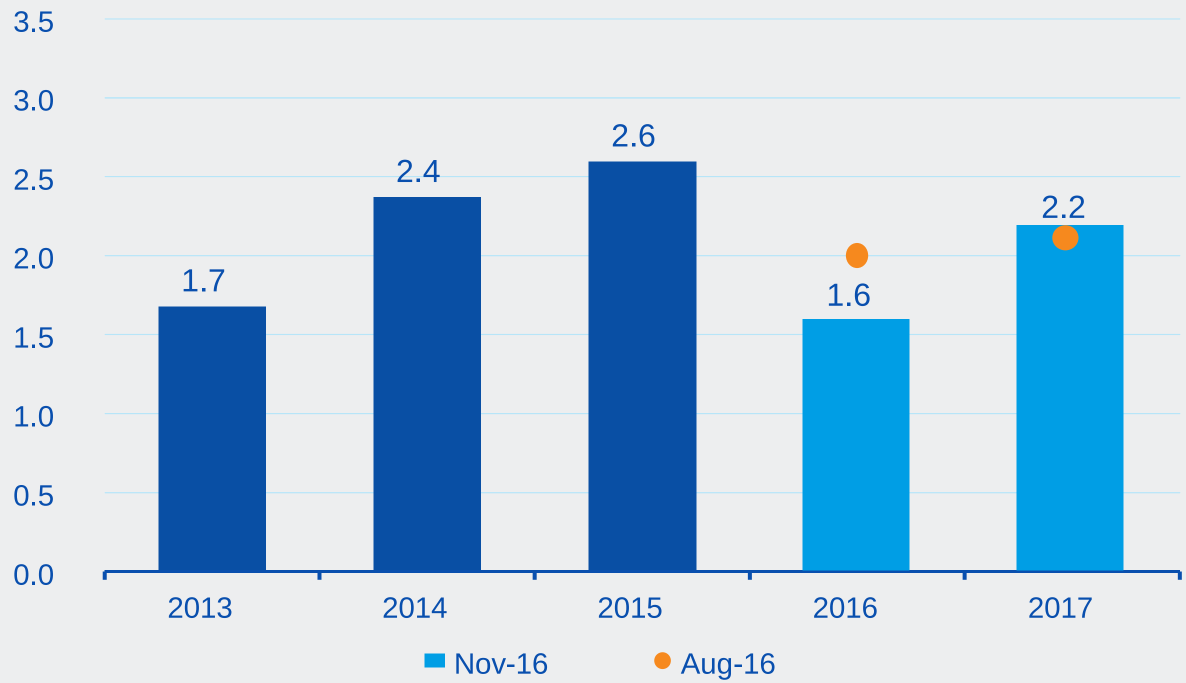
- Domestic demand strengthened by new monetary and fiscal impulse
- Additional monetary measures are postponed, to curb the housing bubble, while macro-prudential measures are brought forward
- Medium term risks remain:
  1. Private corporate leverage and lack of reforms in State-owned enterprises (SOEs)
  2. Real estate market
  3. Capital outflows and exchange rate depreciation spiral
  4. Shadow banking

Source: BBVA Research

US

Growth revised down in 2016

US: GDP GROWTH
(%)

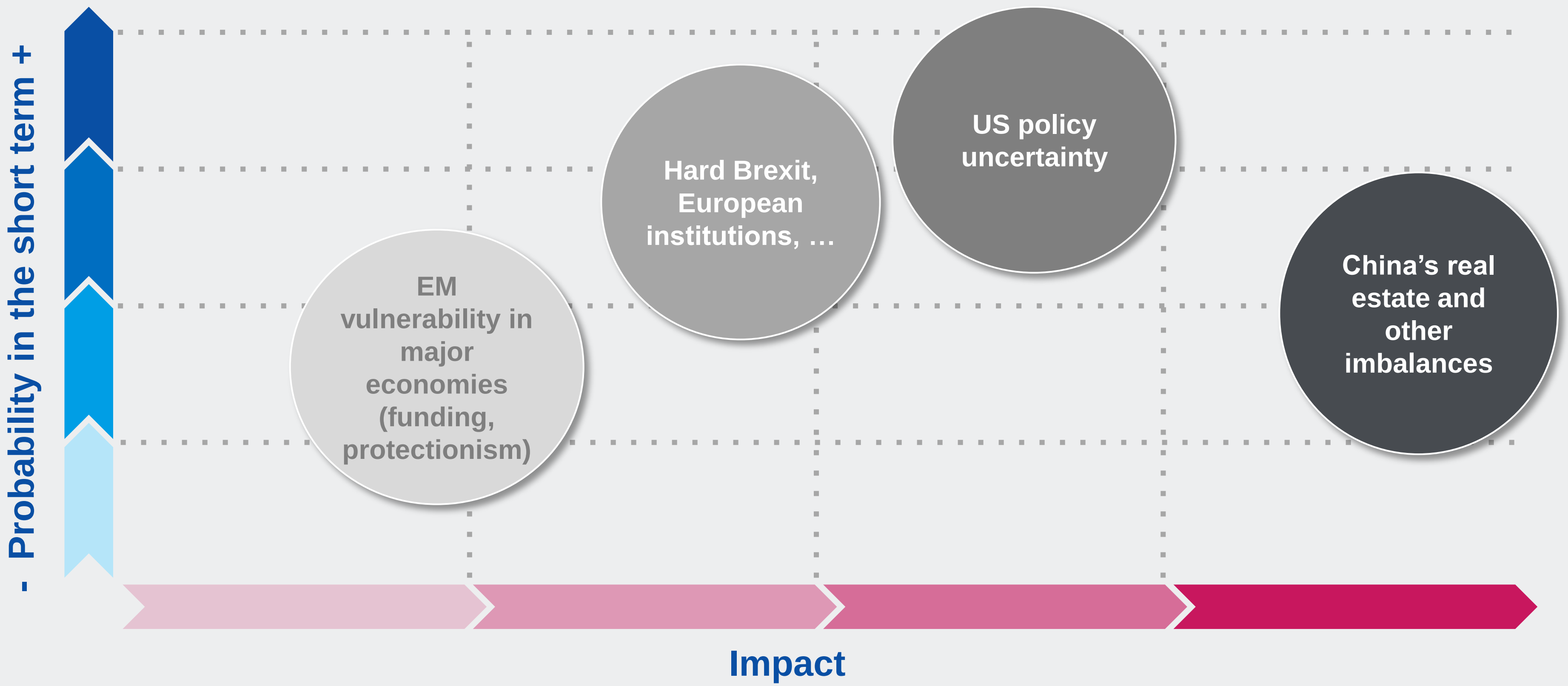


- **Downward revision in 2016 due to:**
  1. Data suggests weak growth in 2H16, after tepid 1S16.
  2. Persistent low productivity
- **Fed**: we expect two more rate hikes during 2017, until 1.25%, after the recent increase in December.
- Uncertainty about economic policies after the elections.

Source: BBVA Research

RISKS

Global risks: Increasing in advanced economies in the short-term, and in China in the medium-term



Source: BBVA Research

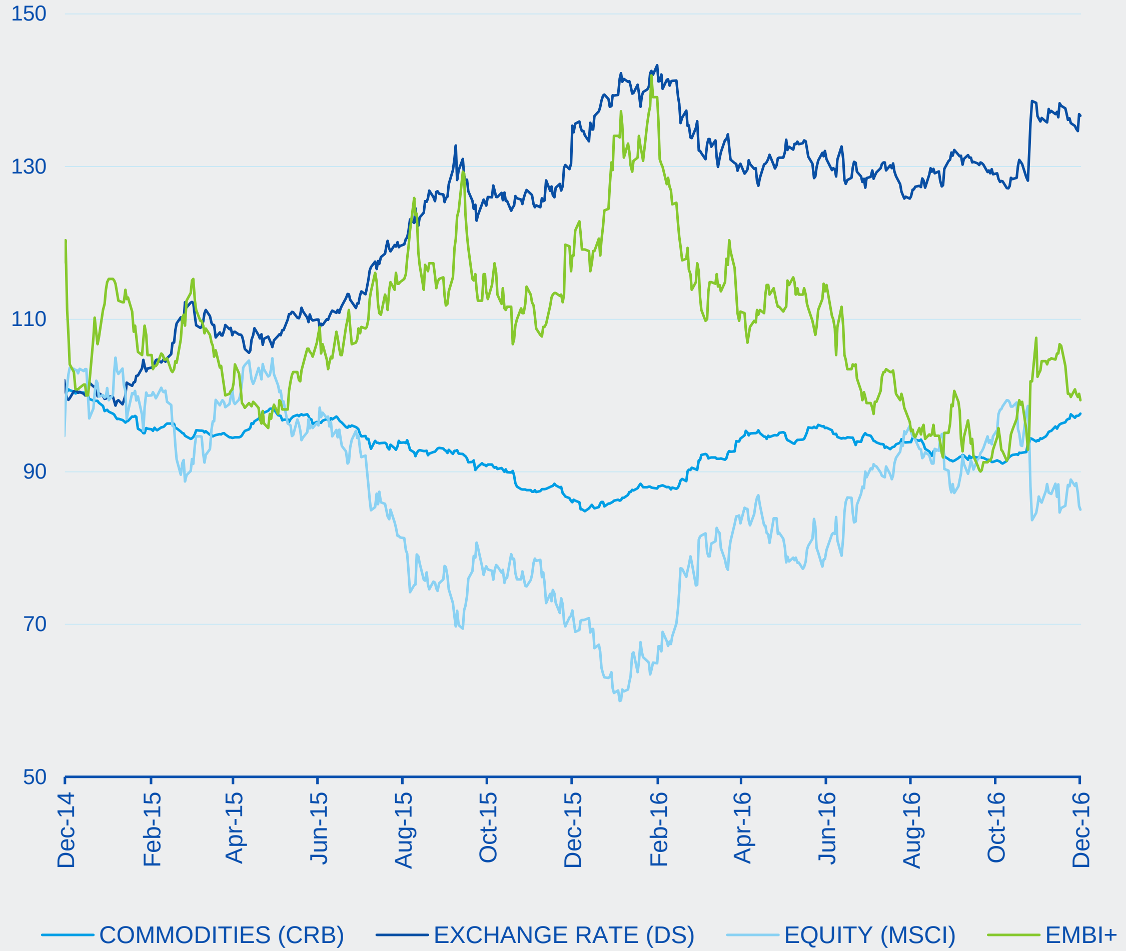
LATAM

An inflection point in 2017

Volatility returns to Latam financial markets, after the US elections

- Main asset prices and exchange rates continued to show gains until the US elections, continuing a trend started in February
- Volatility increased after November 8, given uncertainty about economic policies by the new US administration. Gains accumulated since February were partially reversed. Mexico was particularly affected, but also Brazil and Argentina.
- A return of bouts of volatility cannot be ruled out, if there are surprises in the process of policy normalization by the Fed or growth surprises in China

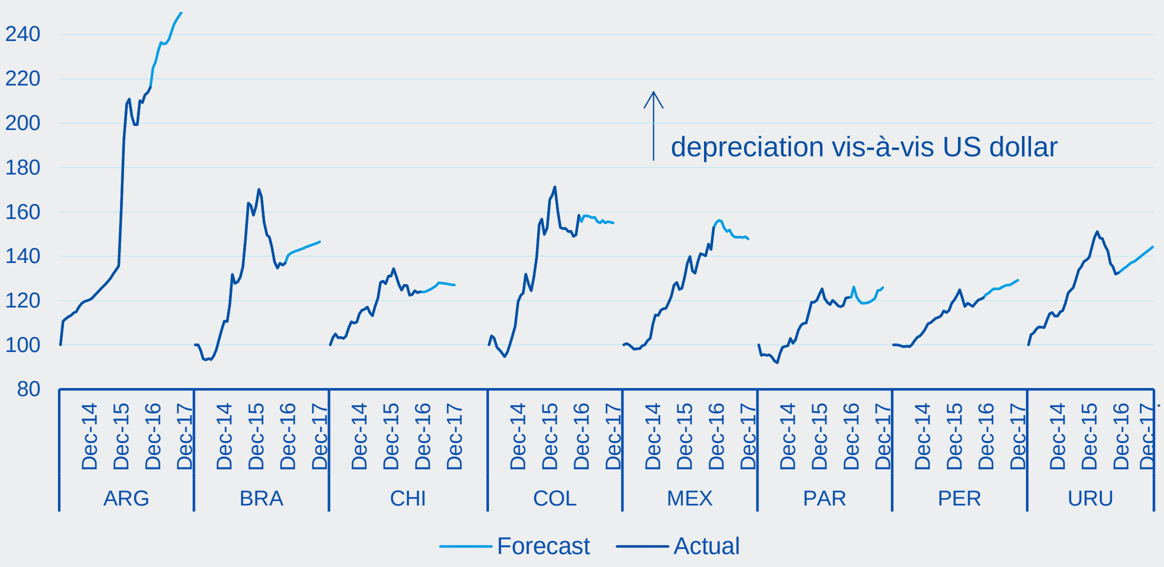
LATAM MAIN ASSET PRICES
(index May 2013=100)



Source: BBVA Research and Haver

Stable FX or moderate depreciations going forward

EXCHANGE RATE TO THE US DOLLAR
(Index Dec 2014=100)

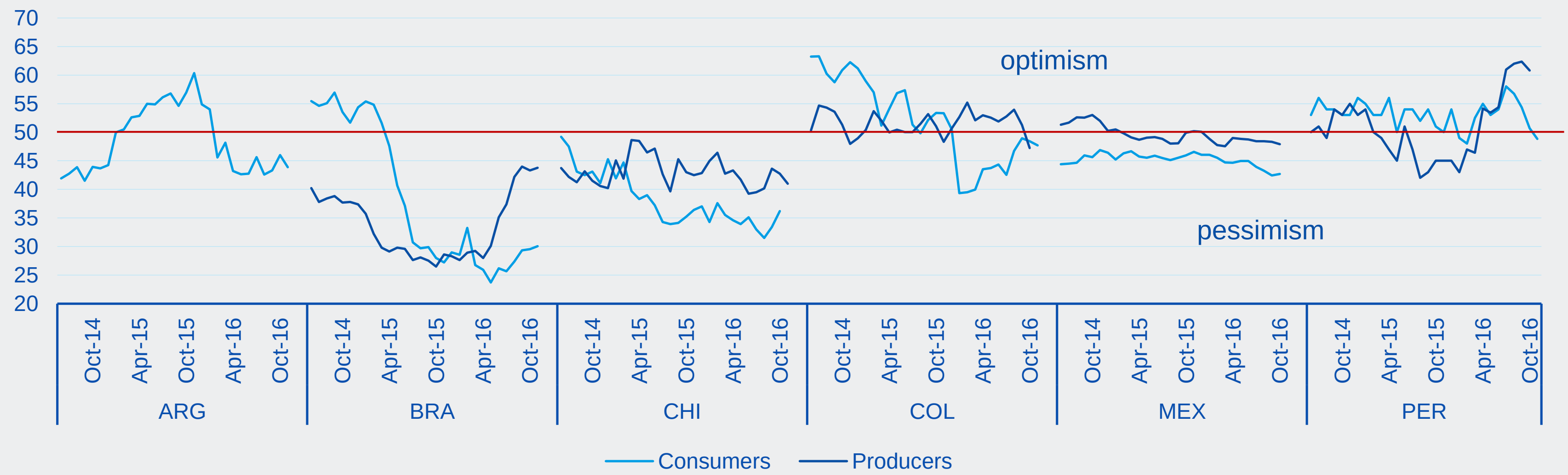


- FX depreciated in most countries in the region, after the US elections and, to a lesser extent, given a more hawkish outlook by the Fed after its December rate hike.
- Nevertheless, in some countries, the increase in commodity prices like oil and copper supported a moderate FX appreciation in December.
- Going forward, the most likely scenario is one of relatively stable exchange rates, or limited depreciations, but with volatility around next Fed rate hikes.

Source: BBVA Research and Haver

Producers' confidence indicators show turnaround in some countries, especially Brazil and Peru

LATAM: CONFIDENCE INDEXES (HOUSEHOLDS AND FIRMS)
(values over 50 indicate optimism)



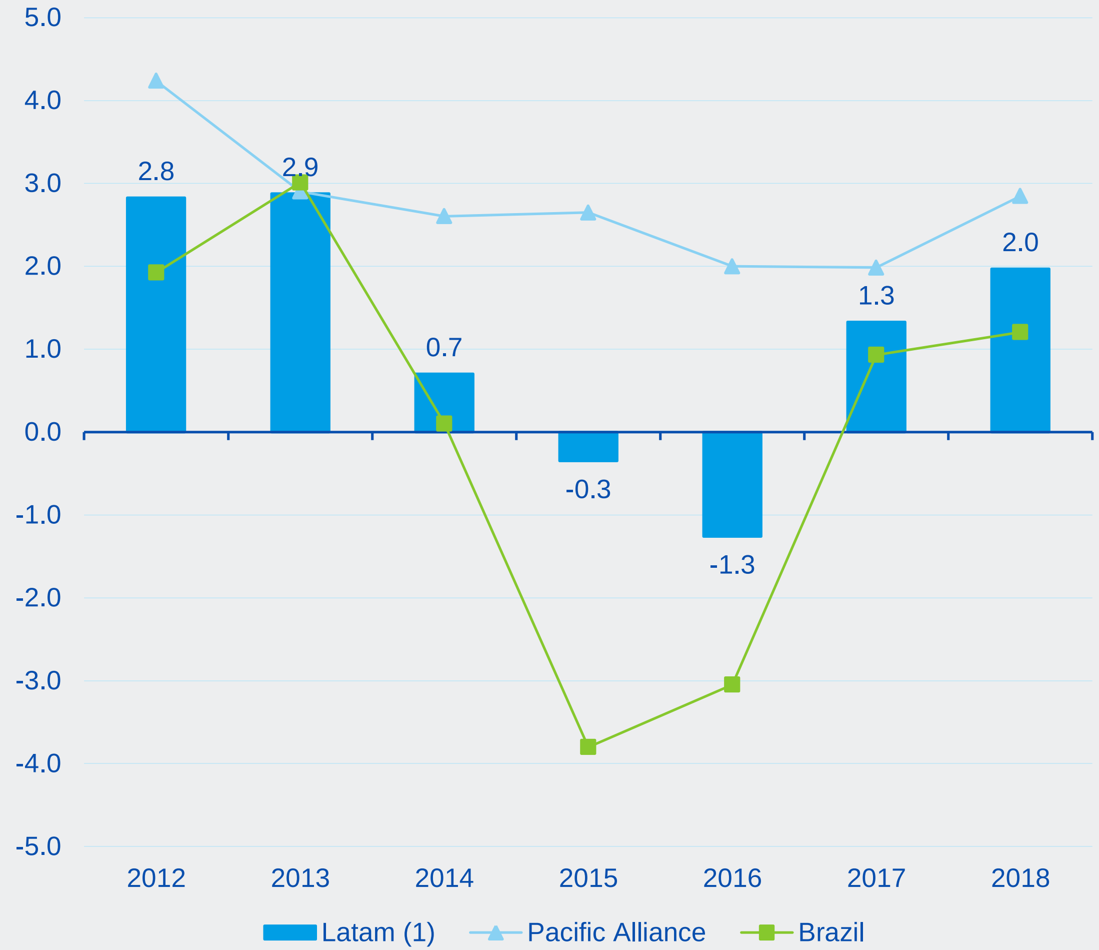
- Confidence still at low levels in many countries, but recover strongly in places where political uncertainty has diminished the most
- Lower inflation was also a positive driver for household confidence, but has not fully offset the effect of weak labor markets.

Source: BBVA Research and Haver

Latam: an inflection point in 2017, with the beginning of a gradual recovery

- Growth forecasts marked down by 0.4pp in 2016 and 0.5pp in 2017, relative to four months ago. In 2016 due to weak outturns in Q2 and Q3. In 2017 due to tighter fiscal policy and uncertainty about US economic policies.
- Growth to increase in 2017 in Latam driven by:
  - The external sector, due to depreciated exchange rates and improved terms of trade
  - Investment, especially in Argentina, Peru and Colombia
- Growth in 2017 will still be weak, below potential. But it will break the deceleration trend started in 2013

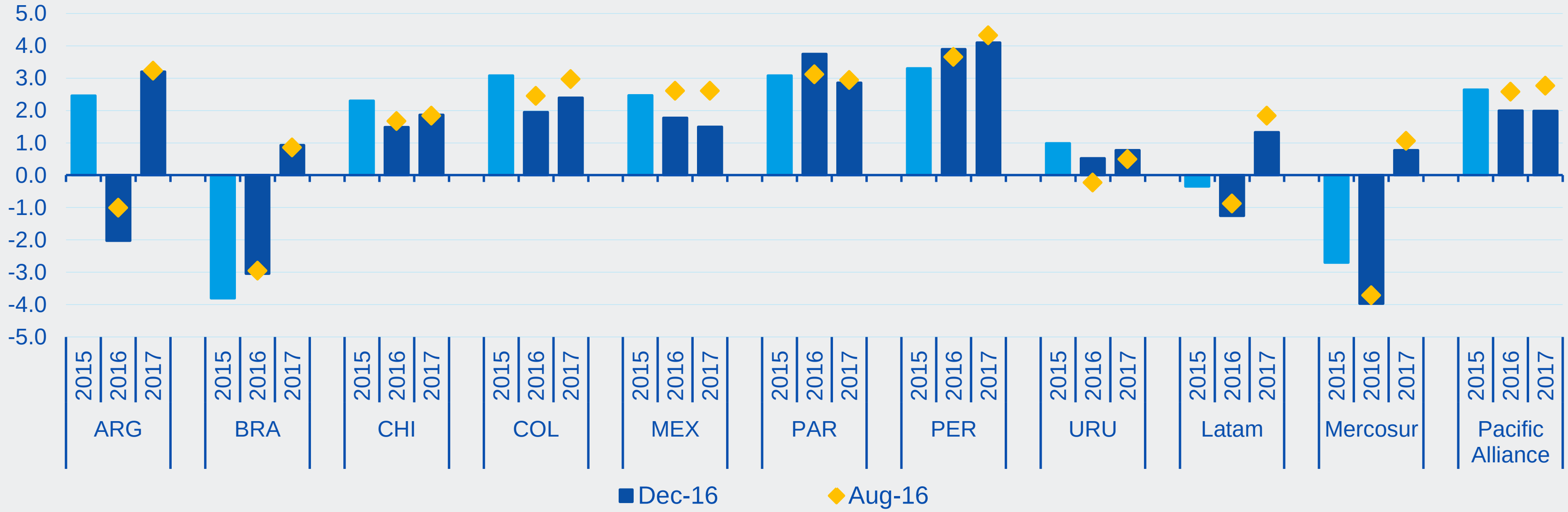
LATAM: GDP GROWTH
(%y/y)



Source: BBVA Research
(1) Weighted average for Argentina, Brazil, Chile, Colombia, Mexico, Paraguay, Peru, Uruguay and Venezuela

Peru, Argentina and Paraguay will display the strongest growth in the region in 2017

LATAM COUNTRIES: GDP GROWTH
(%)

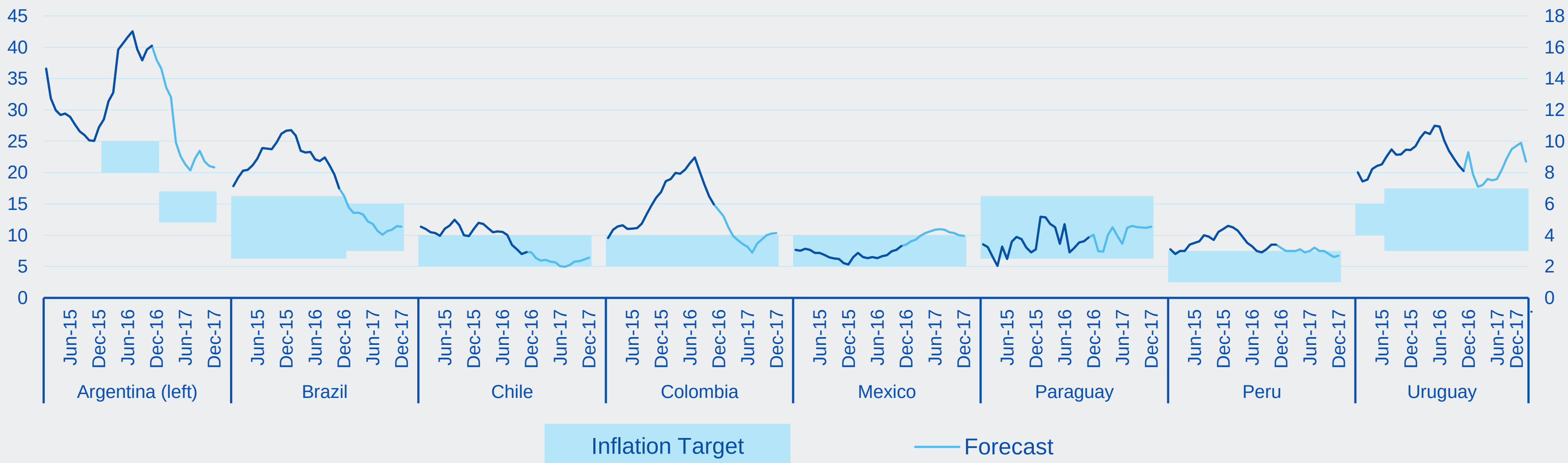


- Growth revised down in 2016 in Argentina, Chile, Colombia and México (weak outturns in Q2-Q3) and Uruguay (weak consumption)
- Growth revised down in Colombia and Mexico in 2017, given a tighter outlook for public expenditure. In México also due to uncertainty about US economic policies
- Most countries will display higher growth in 2017 than in 2016. The main exception will be Mexico.

Source: BBVA Research,

Inflation trends down in South America, but increases in Mexico

LATAM: INFLATION AND CENTRAL BANK TARGET RANGES
(%yoy)

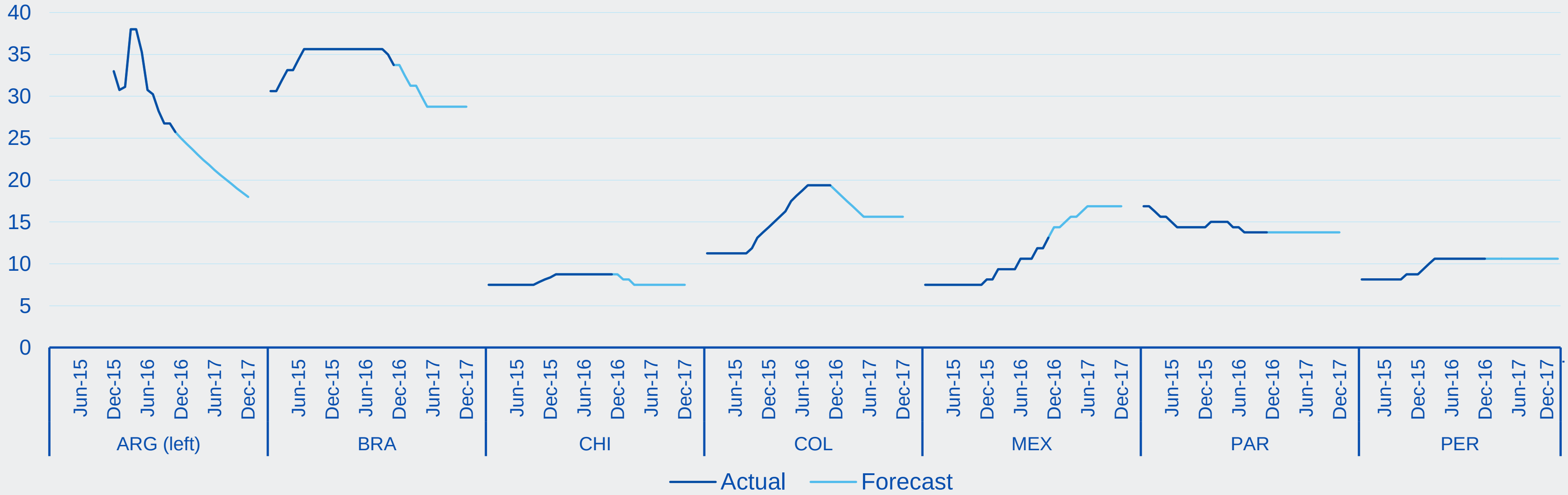


- Inflation to converge gradually to Central Bank targets in South America.
- Inflation to be dragged down in South America by a relatively moderate exchange rate depreciation and weak economic activity.

Source: BBVA Research and Haver

Lower inflation will allow for more dovish central banks and continuing rate cuts in South America

OFFICIAL INTEREST RATES
(%)



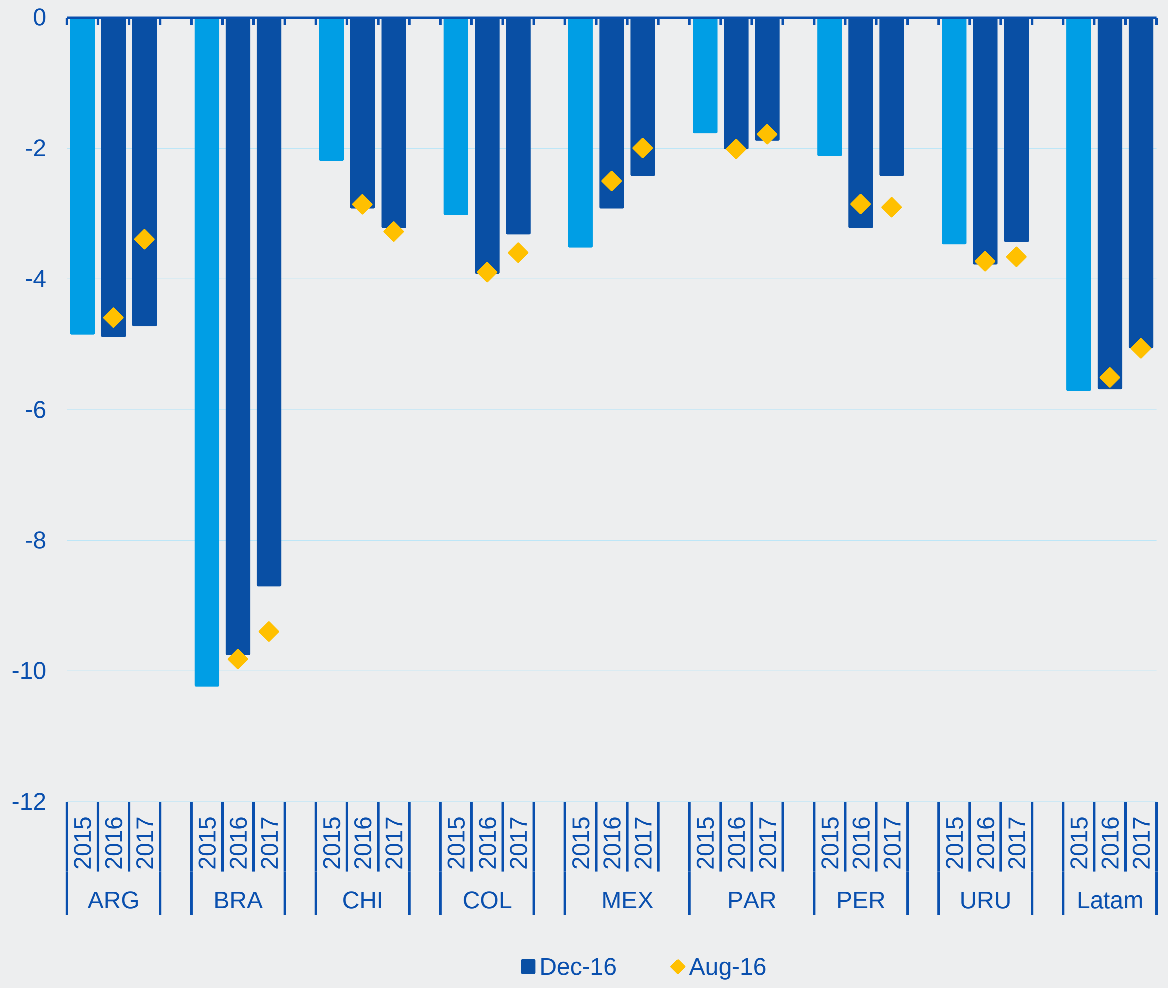
- Lower inflation in South America and weak growth will push central banks to continue cutting rates in coming months, except in Peru.
- In Mexico, Banxico will continue to increase interest rates in 2017, at a faster pace than the Fed

Source: BBVA Research and Haver

Public expenditure will grow more slowly to sustain credibility of fiscal policy frameworks

- Except in Argentina, we anticipate a somewhat tighter public expenditure in 2017, to fulfill fiscal rules
- Restricting public expenditure growth seems inevitable in countries with scant or no fiscal space, having received a sizable negative shock to fiscal revenues from lower commodity prices
- In Brazil, the approval of a new law to cap public spending will have a positive impact on the fiscal deficit (and GDP growth) in the medium and long-run.

LATAM: FISCAL BALANCE
(%GDP)

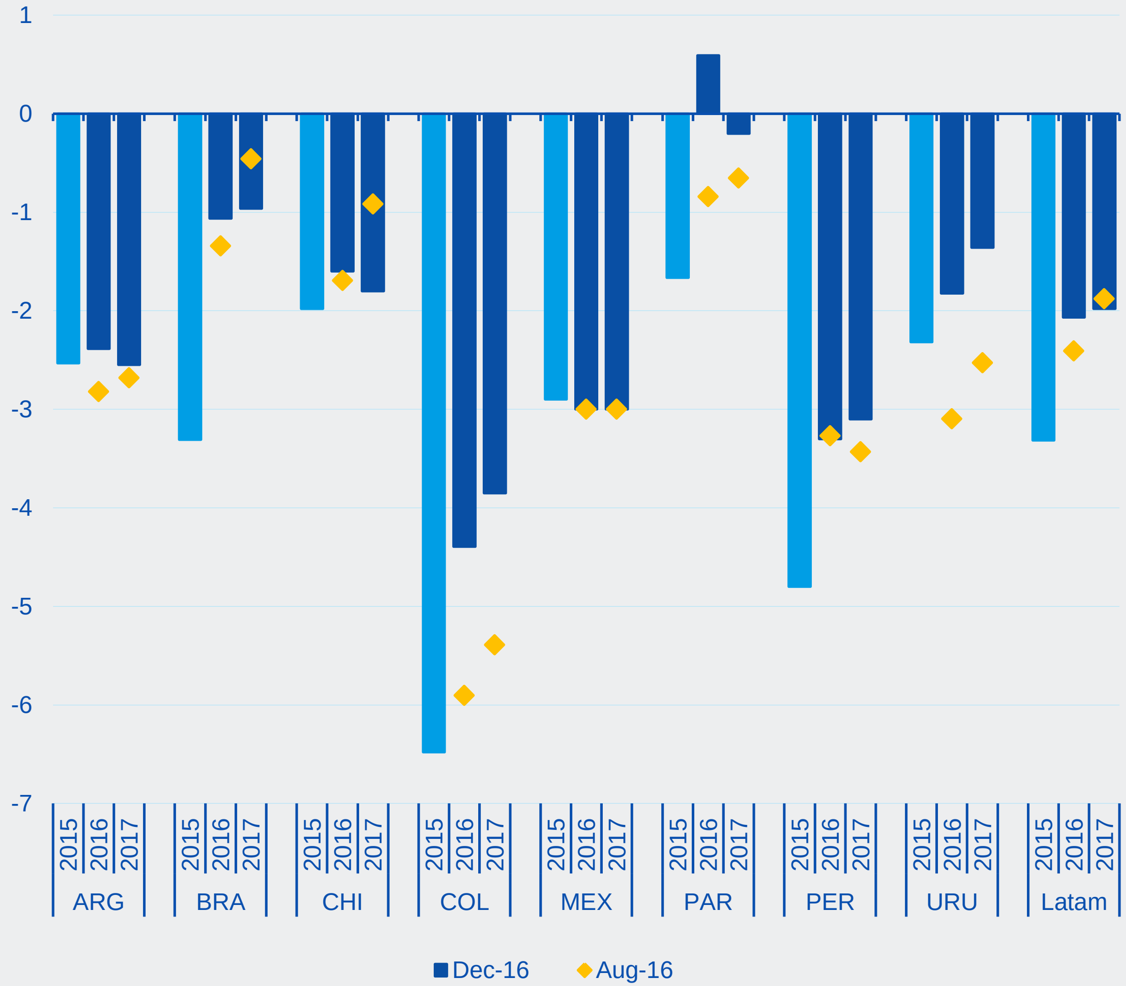


Source: BBVA Research and Haver

External deficits continue to shrink in most countries

- Current account deficits continue to shrink due to past exchange rate depreciations, weak domestic demand and gradual recovery of terms of trade
- However, stronger growth in 2017 will slow down the external adjustment in the region

LATAM: CURRENT ACCOUNT BALANCE
(%GDP)



Source: BBVA Research and Haver

Main messages

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ANNEX

Latin America GDP growth forecasts

GDP (%y/y)	2013	2014	2015	2016f	2017f
Argentina	2.4	-2.5	2.5	-2.0	3.2
Brazil	3.0	0.1	-3.8	-3.0	0.9
Chile	4.0	1.9	2.3	1.5	1.9
Colombia	4.9	4.4	3.1	2.0	2.4
Mexico	1.6	2.2	2.5	1.8	1.5
Paraguay	14.0	4.7	3.1	3.8	2.9
Peru	5.8	2.4	3.3	3.9	4.1
Uruguay	4.6	3.2	1.0	0.5	0.8
Mercosur	2.9	-0.7	-2.7	-4.0	0.8
Pacific Alliance	2.9	2.6	2.6	2.0	2.0
Latin America	2.9	0.7	-0.3	-1.3	1.3

f = forecast