

OUTLOOK

LATIN AMERICA

1st QUARTER 2017



Main messages

The global economy still points to higher growth, but also more uncertainty and significant risks in the long run.

Markets recover in South America since January, supported by commodity prices. But asset prices still under pressure in Mexico

South America will grow 1% in 2017 and leave 4 years of deceleration behind. Mexico is on the receiving end of uncertainty about US economic policies. Growth falls to 1% in 2017

Interest rates will fall further in South America in 2017. But Mexico will continue to tighten monetary policy given rising inflation.

GLOBAL

Stronger growth, higher uncertainty



GLOBAL GROWTH

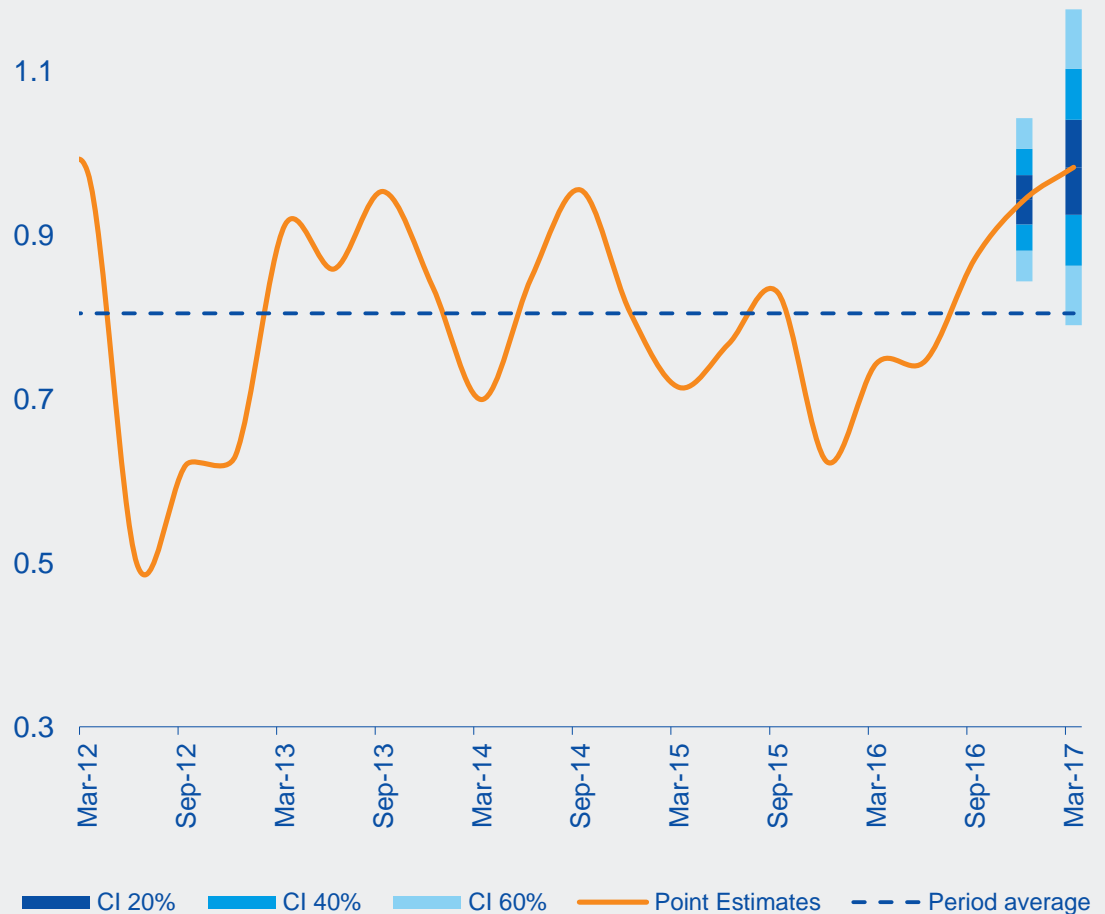
Increasing global growth

- Better-than-expected data in Q3 in US and China, and stable in Europe
- Recovery of industrial production and international trade
- Increasing confidence levels
- Global growth will increase from 3,0% in 2016 to 3,2% in 2017 and 3,3% in 2018

GLOBAL GROWTH

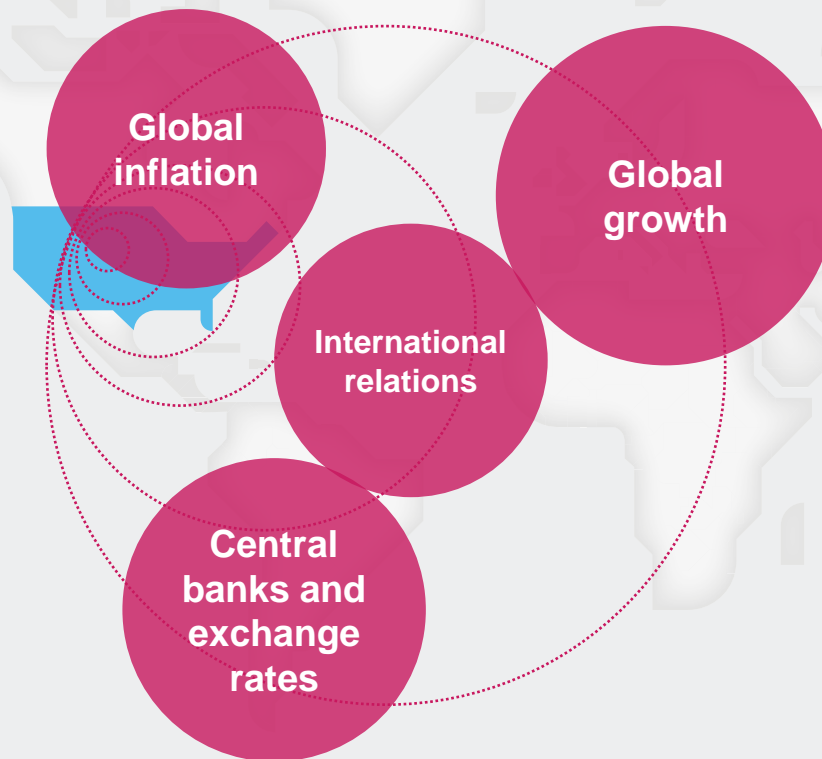
(% qoq at annual rate)

(Forecasts based on BBVA-GAIN model)



GLOBAL UNCERTAINTY

Biggest uncertainty is the future course of US economic policy and its global effects



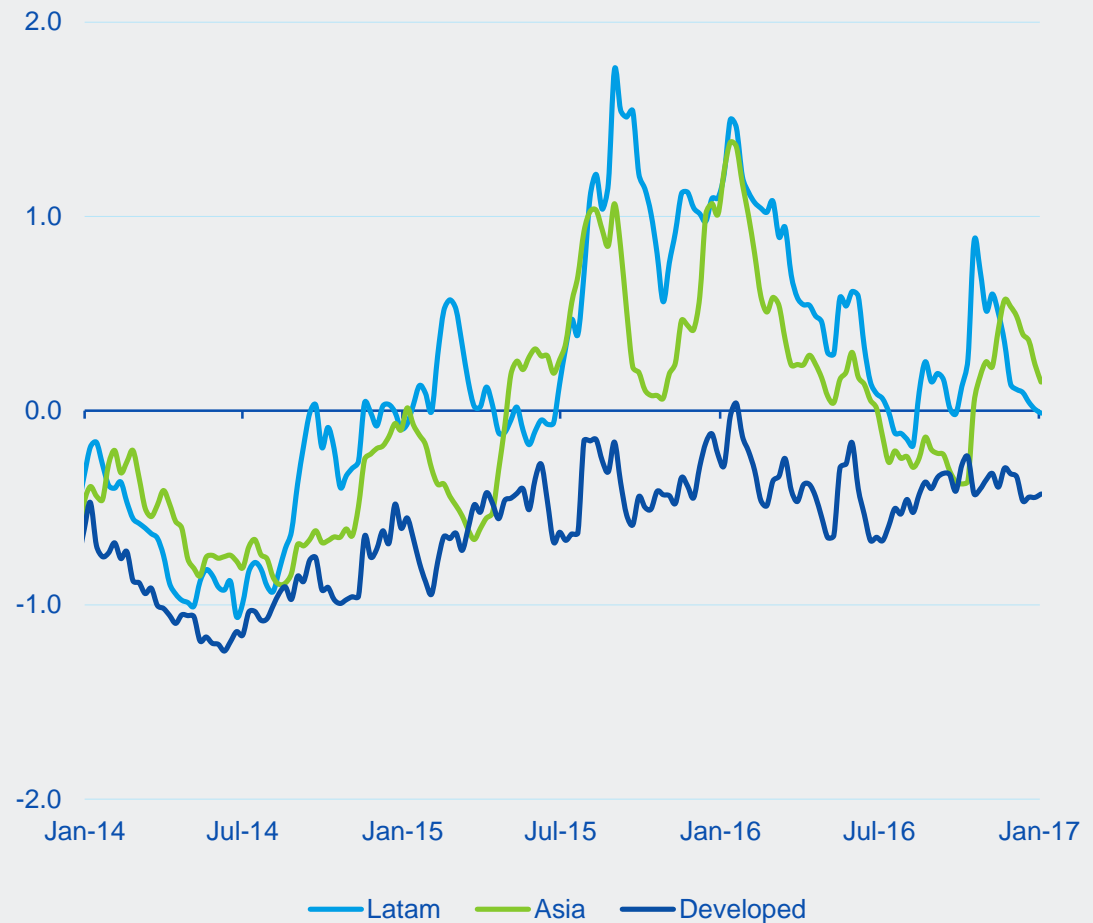
- **Fiscal policy priorities?** Tax cuts vs increased spending
- **Effect of fiscal stimulus on growth and inflation?** Fiscal expansion comes at time of small room for extra growth
- **Which protectionist measures?**, When will they be implemented? What impact?
- What will be the **reaction from other countries** (e.g. China)?
- **Which sector will be deregulated** and how?
- What will be the impact of policy changes on **potential growth**?

INTERNATIONAL FINANCIAL MARKETS

Temporary increase of stress in emerging financial markets (especially Latam), after US elections

- Financial stress in emerging economies rose significantly after US elections. But increase was temporary, especially in South America. Stress still lingers in China.
- In contrast, financial stress remain limited in developed markets.

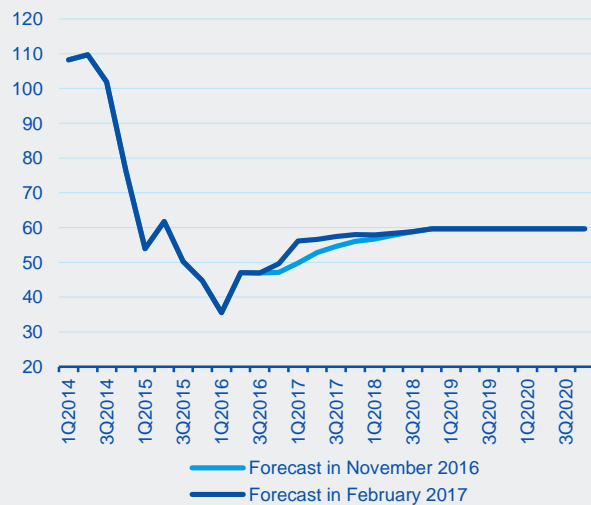
BBVA FINANCIAL STRESS INDEX
(normalized)



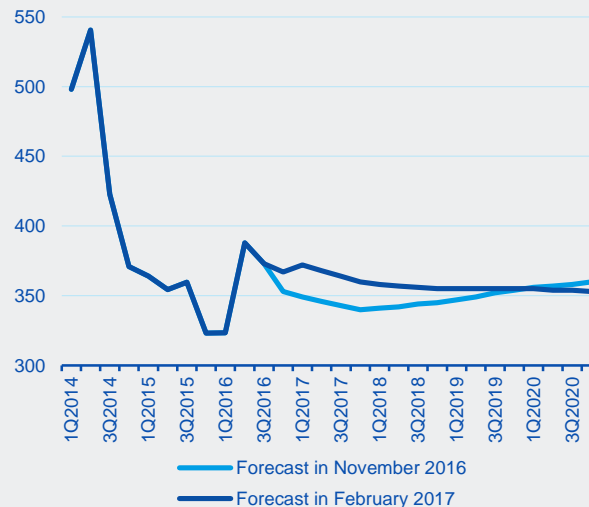
COMMODITY PRICES

Commodity prices in line with a gradual recovery going forward.
Recent price increase driven by fundamentals

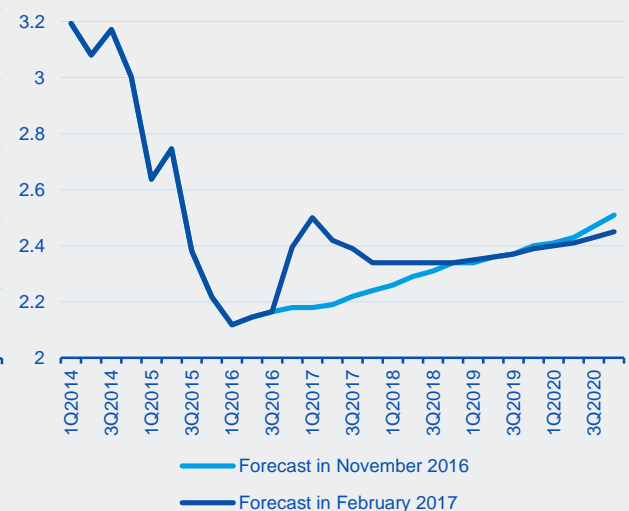
BRENT OIL
(USD/B)



SOYBEANS
(USD/ton)



COPPER
(USD/lb)

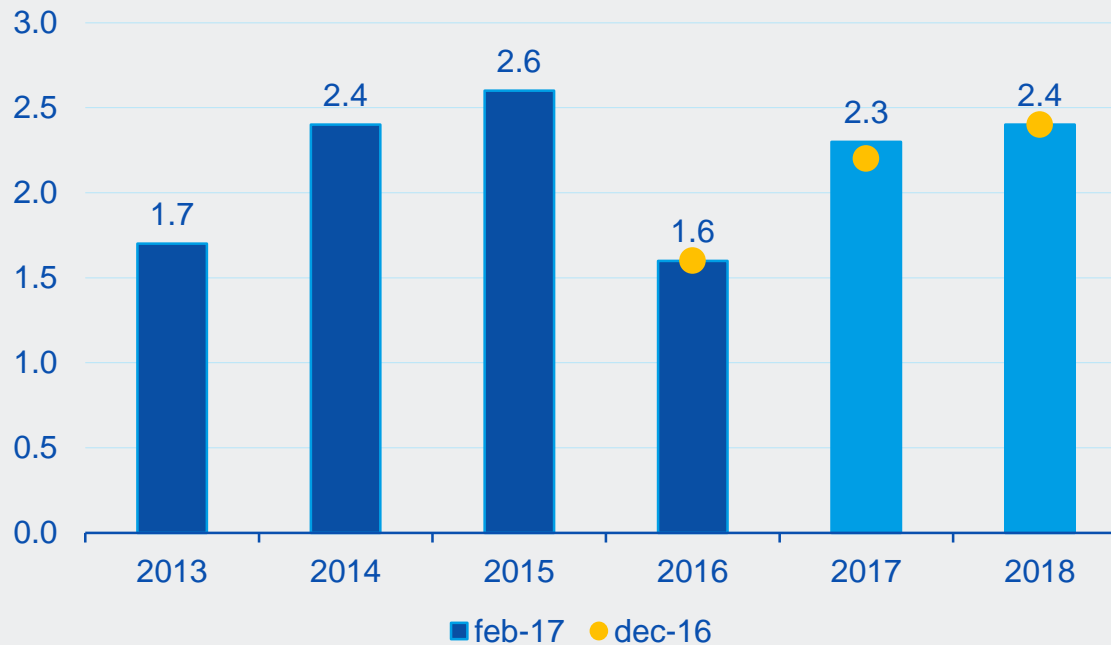


- Oil prices increase faster than expected, given OPEC agreement. Copper prices benefit from financial speculation and robust fundamentals, especially stronger demand
- No significant changes in long-term view for commodity prices, but we anticipate a slightly faster convergence to those long-run levels.

US

Growth revised down in 2016

US: GDP GROWTH
(%)



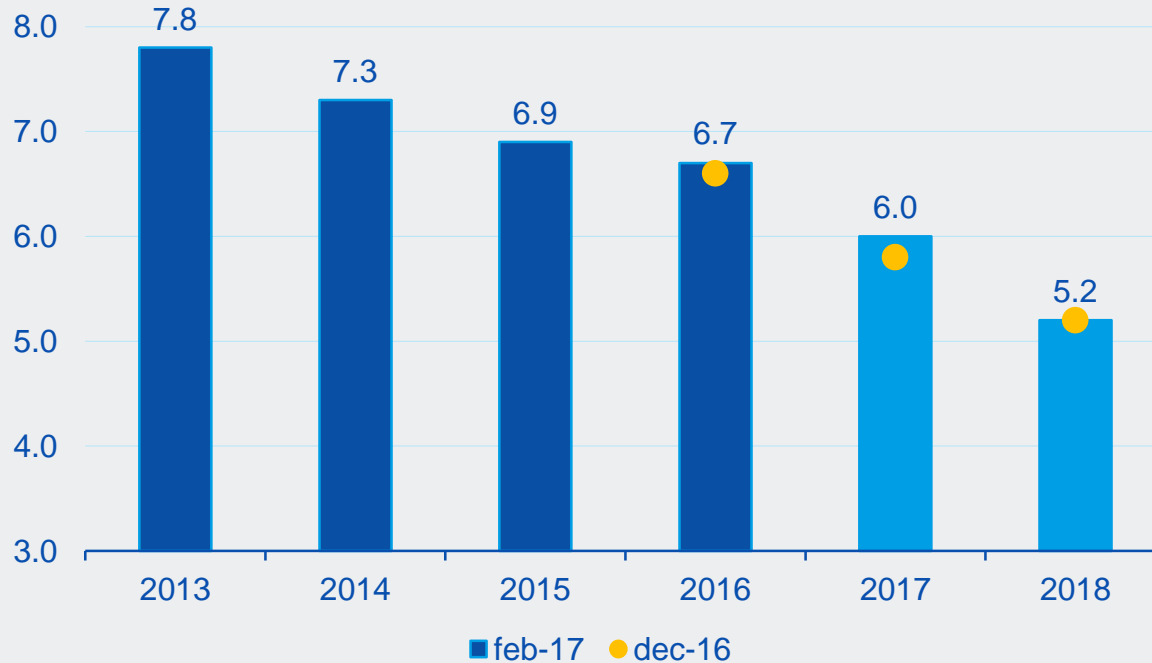
- **Growth revised up in 2017:**
 1. Lower downward pressure on growth from primary sectors and construction
 2. Solid employment and wage growth, and recovery of business profits
 3. Confidence improves, together with market expectations
- **Fed:** we expect two more rate hikes during 2017 and additional two in 2018, until 1.75%, given higher growth and inflation, but Fed will remain cautious.
- **Uncertainty** about economic policies.

CHINA

Stability gains priority over growth.

CHINA: GDP GROWTH





















(%)



- China continues stimulus to ensure growth in the short run.
- Additional monetary measures are postponed, to curb the housing bubble, while macro-prudential measures are brought forward and fiscal policy continues supporting growth
- Risks remain high:
 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
 5. Geopolitical risks
 6. US trade policy

GLOBAL RISKS

Global risks most relevant for Latam centered around China and protectionism

	US	China	Europe	South America	Mexico
Expanding populism					
Protectionism					
China's imbalances					
Geopolitical risks					

LATAM

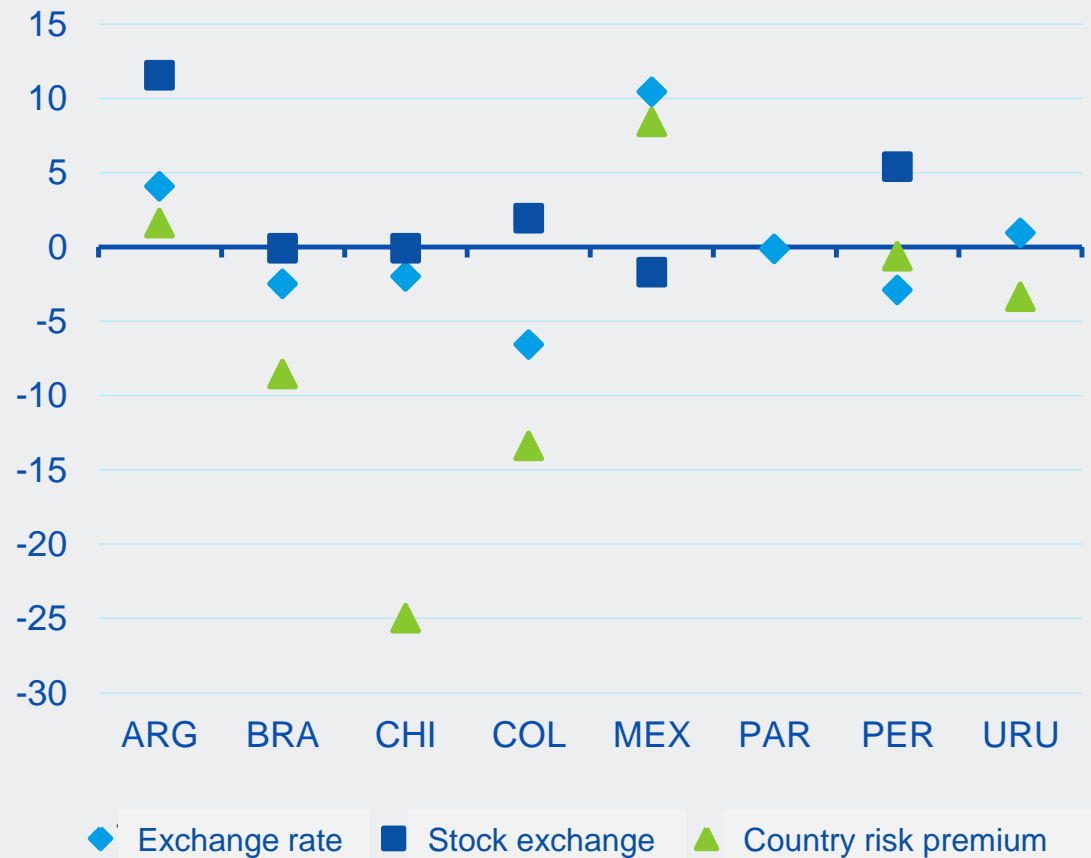
North-south divergence



Financial markets recover in South America, but pressure continues in Mexico

- Main asset prices and exchange rates registered losses after US elections, especially in Mexico
- After initial shock, markets recovered since end of 2016. Asset prices in South America managed to recover levels seen before US elections
- Mexican asset prices recovered since January 20, but still remain below levels seen at the beginning of November.

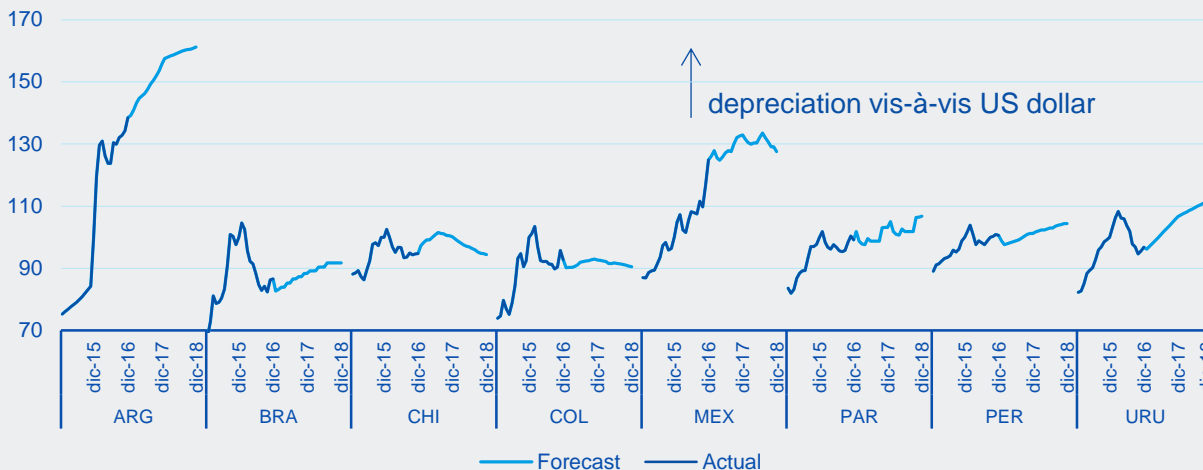
LATAM MAIN ASSET PRICES: CHANGE SINCE DAY BEFORE US ELECTIONS (%)



* Change from November 7 until February 6. Exchange rate: local currency vis-a-vis US dollar. An increase represents a depreciation. Country risk premium: EMBI.

Stable FX or moderate depreciations going forward

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

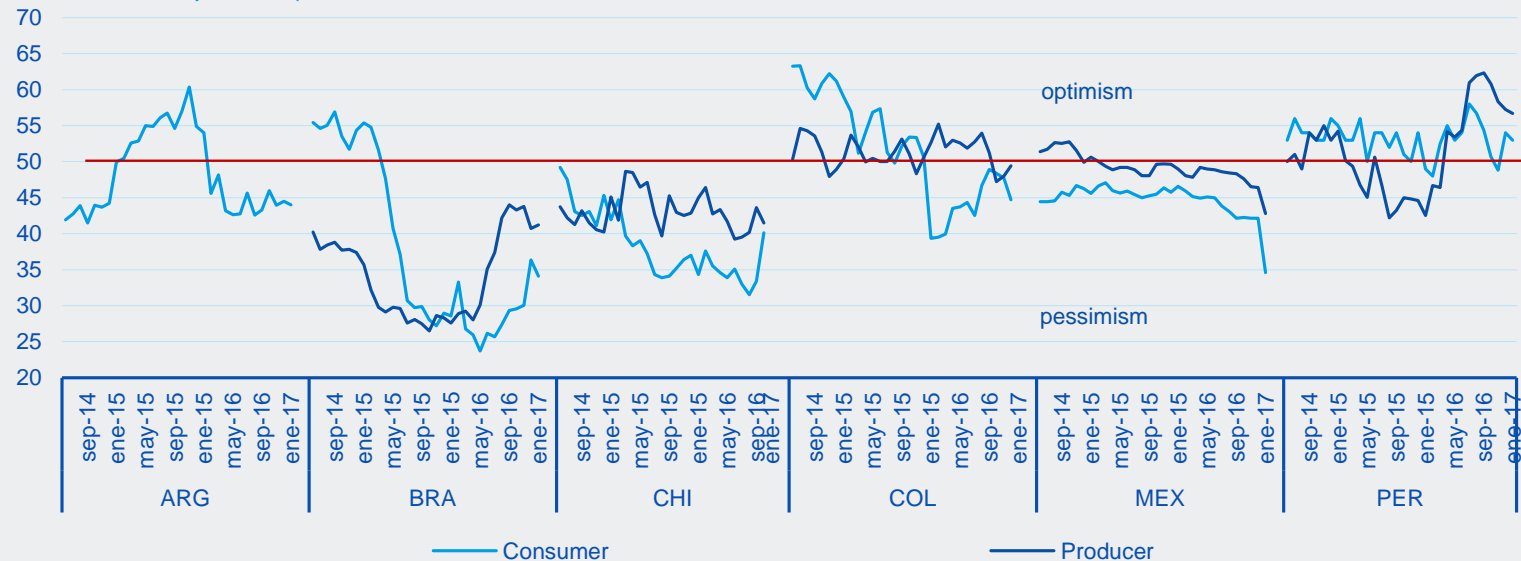


- FX depreciated in most countries in the region, after the US elections but corrected afterwards in South America, helped by rising commodity prices.
- Going forward, we anticipate moderate depreciations in South America, given smaller interest rate differentials with the US.
- Volatility could return to FX markets, depending on economic policies finally adopted in the US.

Confidence drops sharply in Mexico, but remained stable (though pessimistic) in South America

LATAM: CONFIDENCE INDEXES (HOUSEHOLDS AND FIRMS)

(values over 50 indicate optimism)

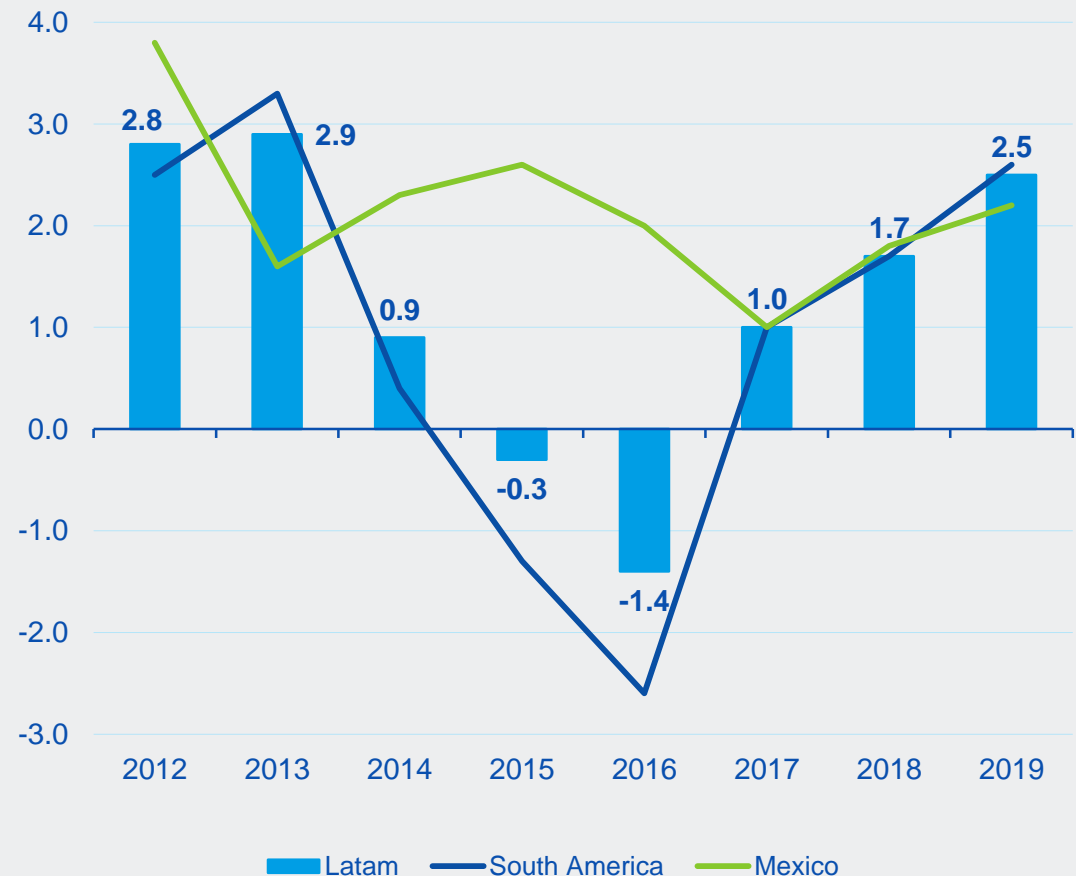


- Confidence still at low levels in many countries (but Peru), but recover in households in South America, given falling inflation
- In Mexico, falling confidence is directly related to uncertainty about US economic policies and rising inflation

Growth: different dynamics in Mexico and South America in 2017

- South America leaves behind 4 years of deceleration
- Mexico gets the brunt of the uncertainty about future US economic policies and will decelerate in 2017
- Growth to increase in 2017 in South America driven by:
 - The external sector, due to depreciated exchange rates and improved terms of trade
 - Investment, especially in Argentina, Peru and Colombia
- Growth in 2017-18 will still be weak, below potential.

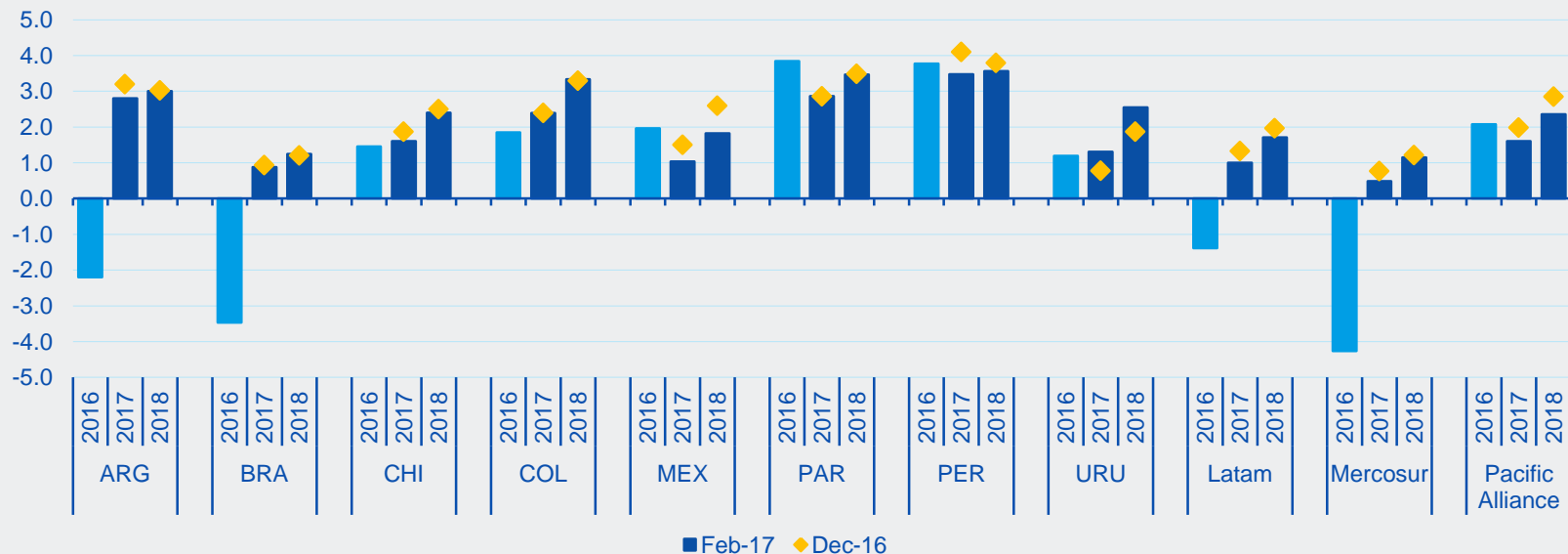
LATAM: GDP GROWTH
(%/y)



Peru, Colombia, Argentina and Paraguay will display the strongest growth in the region in 2017-18

LATAM COUNTRIES: GDP GROWTH

(%)



- Growth revised down in 2017 in Argentina and Chile, given slow growth at the end of 2016.
- Growth revised down in Mexico in 2017-18, given uncertainty about US economic policies and tightening monetary policy
- Growth revised down in Peru in 2017-18 given delays in key infrastructure projects (Southern gas pipeline)

Inflation continues to trend down in South America, but increases sharply in Mexico

LATAM: INFLATION AND CENTRAL BANK TARGET RANGES

(%yoy)



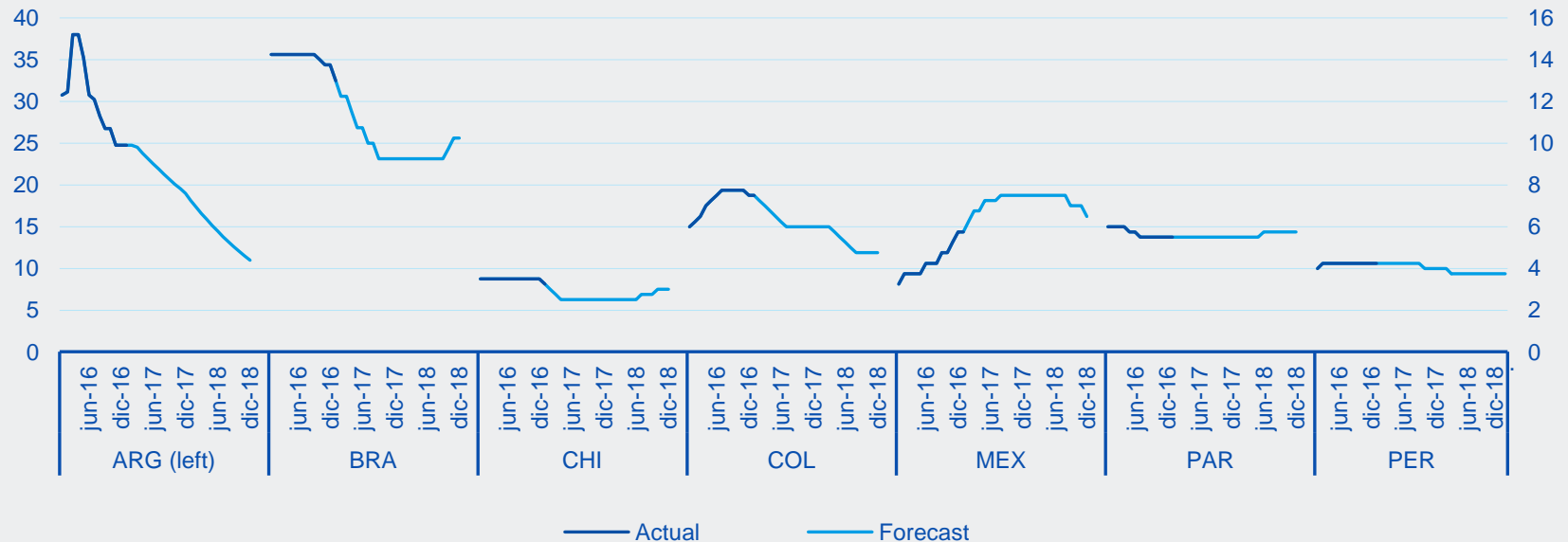
- Inflation to converge gradually to Central Bank targets in South America, given light pressure from exchange rate depreciation and weak domestic demand

- Inflation will increase sharply in Mexico, pushed by exchange rate depreciation and energy prices.

Lower inflation will allow for more further rate cuts in South America, but Mexico will have to keep tightening

OFFICIAL INTEREST RATES

(%)



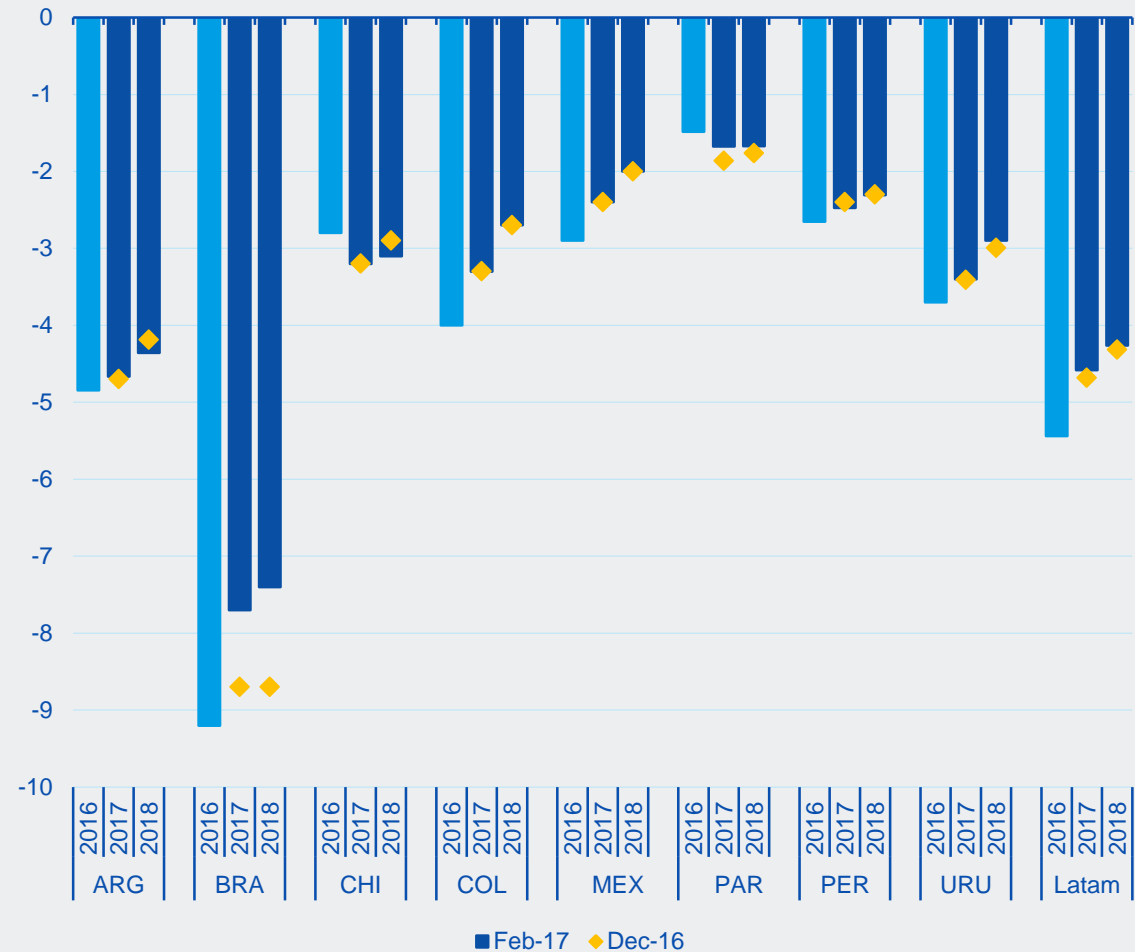
- Lower inflation in South America and weak growth will push central banks to continue cutting rates in coming months.

- In Mexico, Banxico will continue to increase interest rates in 2017, at a faster pace than the Fed

Fiscal deficits continue to shrink

- We anticipate a somewhat tighter public expenditure in 2017, to fulfill fiscal rules
- Despite this, we see some slack for public spending in Colombia and Peru, given higher-than-anticipated tax resources.
- 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

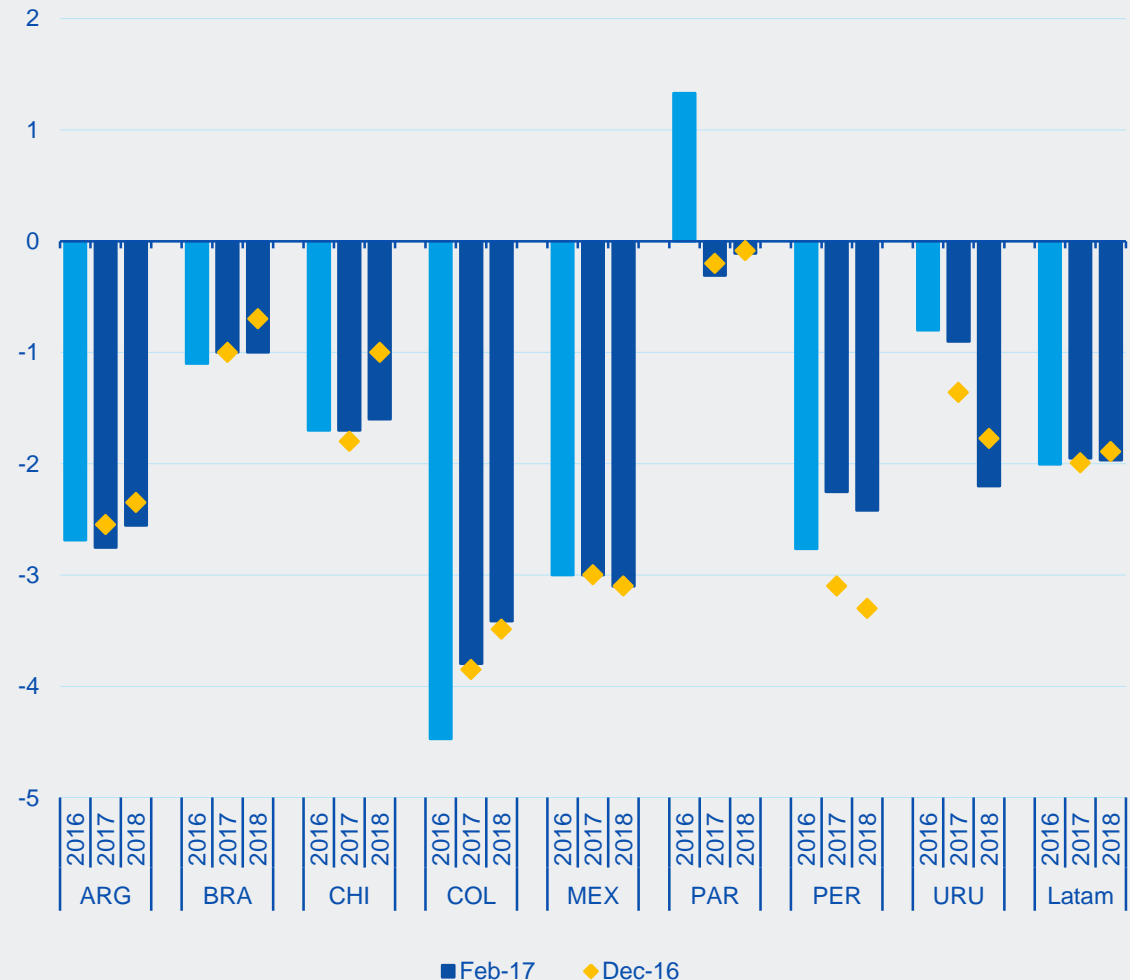
LATAM: FISCAL BALANCE
(%GDP)



External deficits continue to lower 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)



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ANNEX



Latin America GDP growth forecasts

GDP (%y/y)	2014	2015	2016	2017f	2018f
Argentina	-2.5	2.6	-2.2	2.8	3.0
Brazil	0.5	-3.8	-3.5	0.9	1.2
Chile	1.9	2.3	1.5	1.6	2.4
Colombia	4.4	3.1	1.9	2.4	3.3
Mexico	2.3	2.6	2.0	1.0	1.8
Paraguay	4.7	3.1	3.8	2.9	3.5
Peru	2.4	3.3	3.8	3.5	3.6
Uruguay	3.2	1.0	1.2	1.3	2.6
Mercosur	-0.4	-2.7	-4.3	0.5	1.2
Pacific Alliance	2.6	2.8	2.1	1.6	2.4
Latin America	0.9	-0.3	-1.4	1.0	1.7