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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

Source: BBVA Research
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?
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.

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

- 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.

Source: BBVA Research and Bloomberg
Growth revised down in 2016

**US: GDP GROWTH (%)**

- **2013**: 1.7%
- **2014**: 2.4%
- **2015**: 2.6%
- **2016**: 1.6%
- **2017**: 2.3%
- **2018**: 2.4%

**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.

Source: BBVA Research
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

Source: BBVA Research
Global risks most relevant for Latam centered around China and protectionism

<table>
<thead>
<tr>
<th></th>
<th>US</th>
<th>China</th>
<th>Europe</th>
<th>South America</th>
<th>Mexico</th>
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Source: BBVA Research
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.

Source: BBVA Research, Bloomberg and Haver.

Stable FX or moderate depreciations going forward

- 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.

Source: BBVA Research and Haver
Confidence drops sharply in Mexico, but remained stable (though pessimistic) in South America

- 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

Source: BBVA Research and Haver
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.

Source: BBVA Research
Latam: Weighted average for Argentina, Brazil, Chile, Colombia, Mexico, Paraguay, Peru, Uruguay and Venezuela
Peru, Colombia, Argentina and Paraguay will display the strongest growth in the region in 2017-18

- 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).

Source: BBVA Research,
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.

Source: BBVA Research and Haver
Lower inflation will allow for more further rate cuts in South America, but Mexico will have to keep tightening.

- 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.

Source: BBVA Research and Haver
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.

Source: BBVA Research and Haver
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

Source: BBVA Research and Haver
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ANNEX
Latin America GDP growth forecasts

<table>
<thead>
<tr>
<th>GDP (%y/y)</th>
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<th>2016</th>
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f = forecast