ANDBANK RESEARCH

Global Economics & Markets

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Working paper - 49

Latam – Reviewing our estimates … after the recent crash

June 12th , 2013

ANDBANK Private Bankers

Latam – *Key Forecasts*

	GDP (bn US$)	GDP x Capita (US$)	GDP (% y/y) 2012	GDP (% y/y) 2013 f	Inflation (% y/y) 2012	Inflation (% y/y) 2013 f
LATAM			***2,80%***	***3,0%***	***7,40%***	***7,60%***
Brazil	*2.400*	*12.000*	*0,90%*	*2,75%*	*5,40%*	*6,00%*
Mexico	*1.150*	*10.088*	*3,90%*	*3,00%*	*4,10%*	*4,00%*
Argentina (1)	*450*	*11.250*	*1,90%*	*1,00%*	*23,50%*	*24,00%*
Colombia	*331*	*7.043*	*4,00%*	*3,15%*	*3,20%*	*2,50%*
Chile	*250*	*14.706*	*5,60%*	*4,30%*	*3,00%*	*1,75%*
Peru	*175*	*6.034*	*6,30%*	*5,30%*	*3,70%*	*2,75%*

Sources - Factset, Trading Economics

(1) Inflation figures are the result of proxies used by private & independent research firms

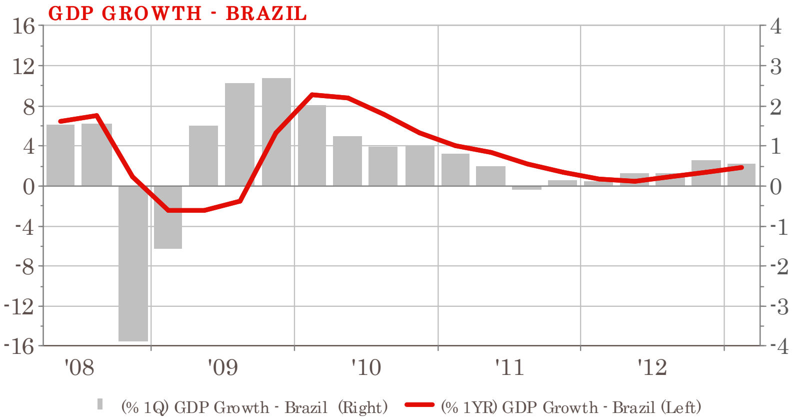
Brazil. *Unlikely to regain its shine in 2013-2014*

Current Assessment.

- The economic recovery continues to disappoint. Q1 data revealed that output expanded at a meagre 0.6% q/q for the second consecutive quarter, which means that the economy is advancing at a sluggish 1.9% annual pace and that GDP has increased by just 2% since Q4 2011. Certainly, a very disappointing return given the huge amount of stimulus.
- Additionally, despite the poor figures on activity, inflation breached the upper band of the target range, meaning that the economy is stuck in stagflation, a clear sign of the serious imbalances yet to be adjusted.

Outlook for the Economy and Financial Assets.

- Growth is likely to remain lacklustre over the next couple of years for several reasons. (1) Credit looks set to slow after 5 years booming and because banks have tightened lending conditions. (2) Constraints on the supply side remain a brake on growth since they prevent investment from becoming a larger share of the economy. (3) Despite the promising signs coming from the expenditure breakdown, where investment grew at 4.6% q/q, Brazil remains the worst country in the region in terms of Gross Fixed Capital Investment as a % of GDP, with a mere 18% share, well behind Chile and Colombia, with a 25% share. Thus, the figures shown in the latest report will need to continue for a prolonged period if Brazil's notoriously low investment is to be raised significantly. (4) The strong currency is weighing on competitiveness.
- The good news could be that inflation is close to peaking (food inflation should soon start to slow), which means that interest rate hikes are likely to be more modest than the market expects (good for the economy, good for bonds). We bet on a stable Selic rate at 8%, or a mild hike of a maximum of 50bps (to 8.5%) in the next 12 months. We lower our GDP estimate and predict 2.75% growth in 2013.
- Outlook for Financial Assets: **Brazilian Equity (Marketweight):** The Brazilian equity market is located at mid-table in our valuation ranking, occupying the 13th position out of 28 markets rated. **Fixed Income local (Overweight):** We expect Yields in the **10Yr government bond** to remain high but stable due to moderation in the pace of inflation. **Currency (Underweight):** Still expensive. Low investment and constraints on the supply side, etc. will not help. Our outlook for the Real is that it will continue depreciating against the USD to breach the 2,25 mark.



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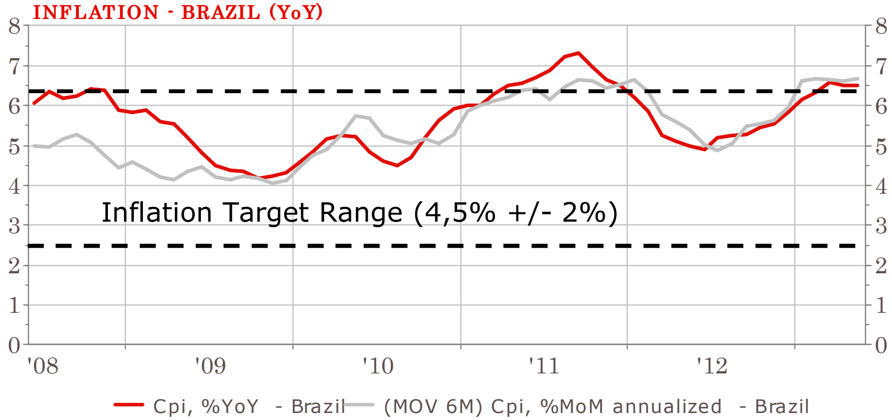

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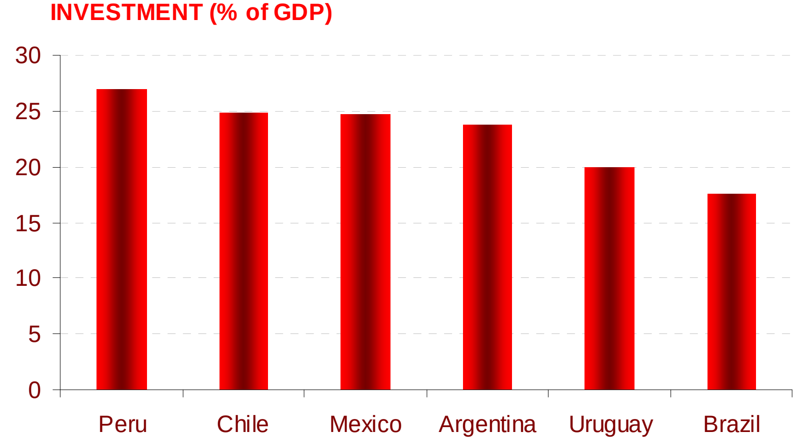
Brazil – *Other charts of interest*



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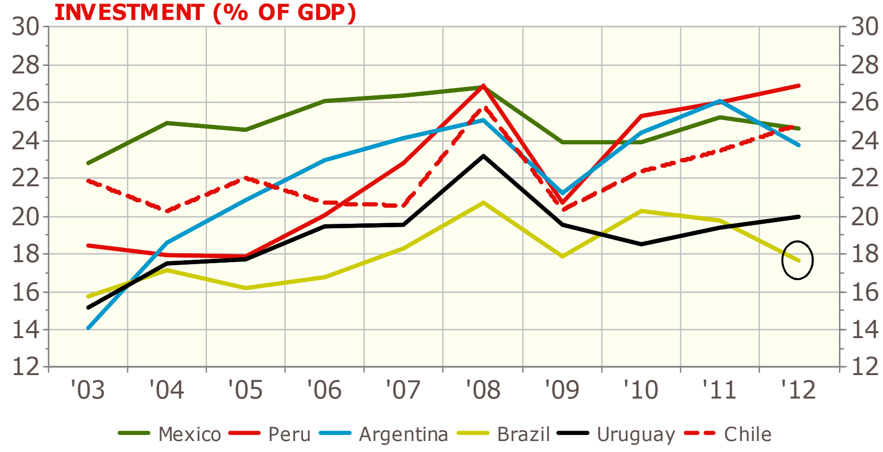

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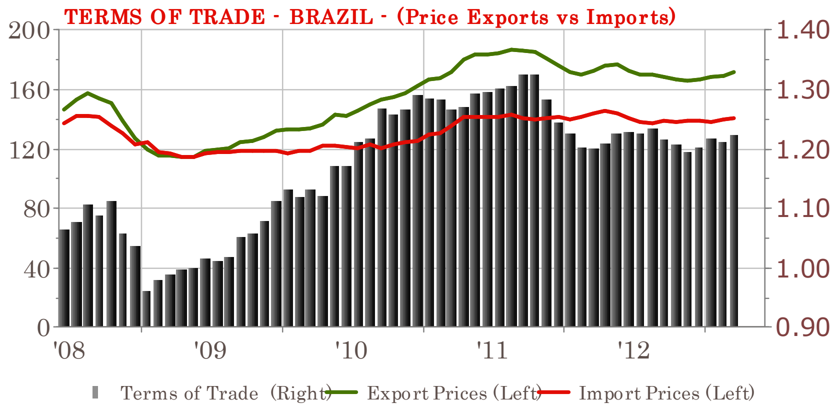

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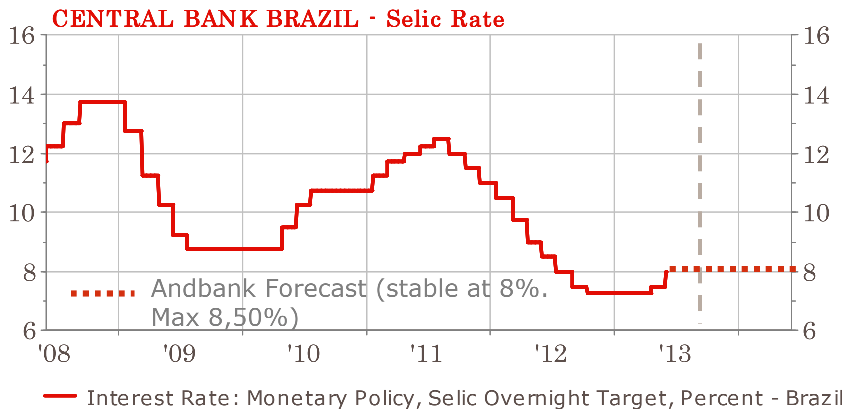

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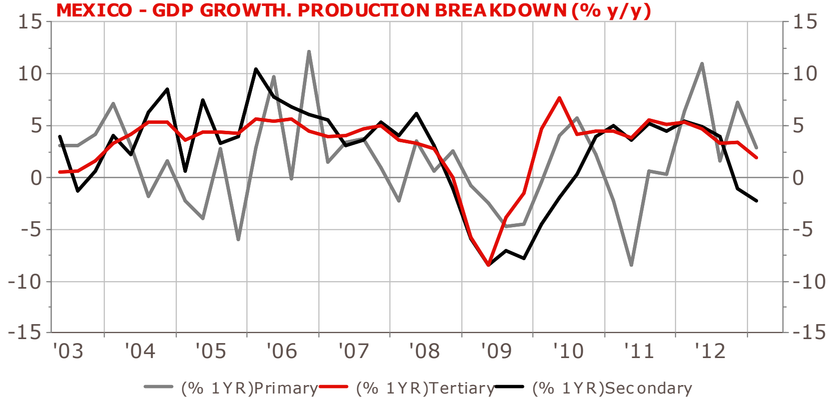
Mexico. *Set for a 2H recovery after a temporary slowdown?*

Current Assessment.

- Q1 GDP data confirmed that the Mexican economy cooled considerably. Output expanded at a tepid pace of 0.5% q/q, leading to an inter-annual GDP rate that has slowed to just 0.8% (well below the 3.2% pace seen in Q4). Nevertheless, the fact that there were four fewer working days in Q1 of this year partially explained the apparent slowdown in the inter-annual pace.
- The production breakdown reveals that the slowdown was broad-based, with the secondary sector contracting by -2.26% on the back of weaker demand from the US, while the tertiary sector also slowed as a spike in inflation probably squeezed real incomes. Thus, bad news again from the inflation arena, with prices rising above the central bank's 3+/-1% target.
- The deterioration in activity was also a reflection of the poor progress in the external sector, with the current account deficit widening a touch in Q1 due to weaker exports and resilient imports. Nevertheless, the 6-month rolling commercial deficit remains small by historical standards (see charts on next page).

Outlook for the Economy and Financial Assets.

- Speculation that the US Fed will soon taper its asset purchases, coupled with the statutory mandate in the USA to continue improving the deficit, are definitely not good news either for the US or for the Mexican economy. These factors have triggered some retreat from Mexican assets, making the peso weaken by 6% to 12.8 in May. However, we have several reasons to think that the slowdown in Mexico will be short-lived. (1) Inflation should start to ease over the second half of the year as the recent spike in food prices fades, helping to boost real income. (2) Despite the recent slowdown in the US economy, we still project 2% GDP growth in 2013 (and 2.5% in 2014), which is consistent with growth in Mexico of 3%-4% a year. (3) The government's economic reform program should provide an additional prop to Mexican confidence, although the effects will not be seen until the following years.
- Outlook for Financial Assets: **Mexican Equity (Underweight):** The market is located near the bottom in our valuation ranking, occupying the 24th position out of 28 markets rated. **Fixed Income (Overweight):** The 10Yr government bond yield has skyrocketed to 5.30%. Our growth & inflation estimates suggest that the central bank will not raise rates. Current yield levels are an excellent opportunity to buy. **Currency (Overweight):** We expect a reversal of the recent retreat from Mexican assets, which will bring the peso back to around 12/$.



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Mexico – *Other charts of interest*

Mex Industrial Production & US ISM Manuf Index

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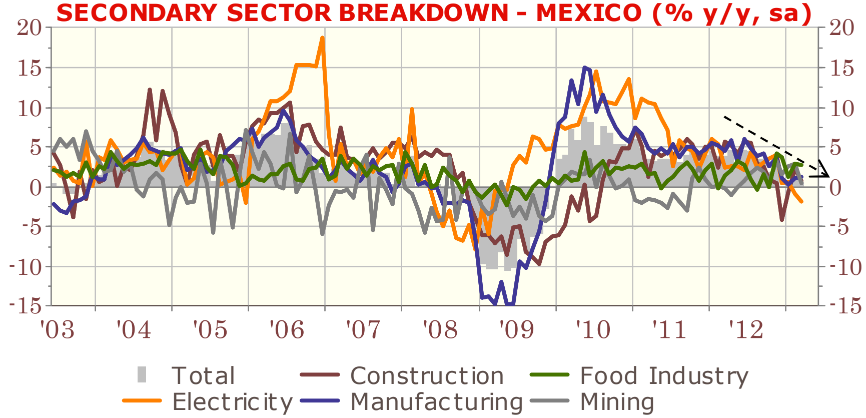
SECONDARY SECTOR BREAKDOWN - MEXICO (% y/y, sa)



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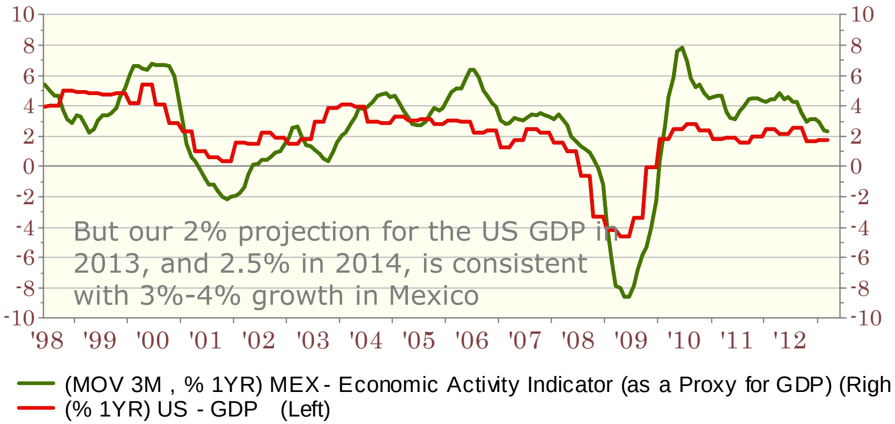
MEXICO & US GDP (Economic Activity Indicator as a proxy for GDP)



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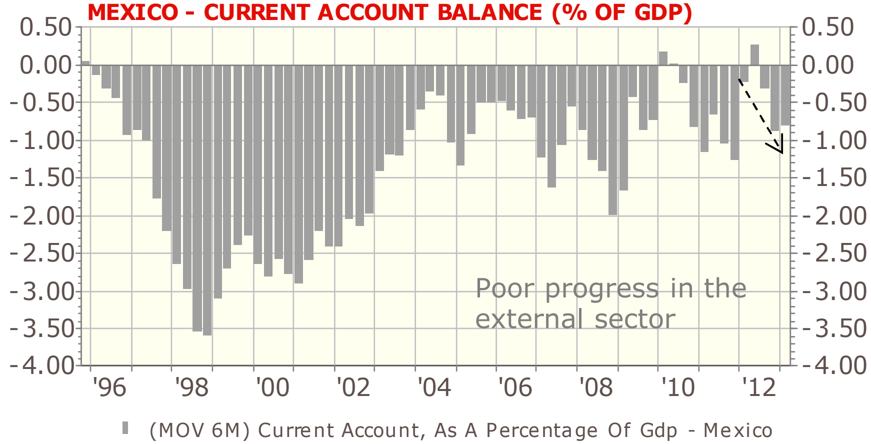
MEXICO - CURRENT ACCOUNT BALANCE (% OF GDP)



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Argentina. *Puzzling economic "boost" in 1H13, but BoP problems persist*

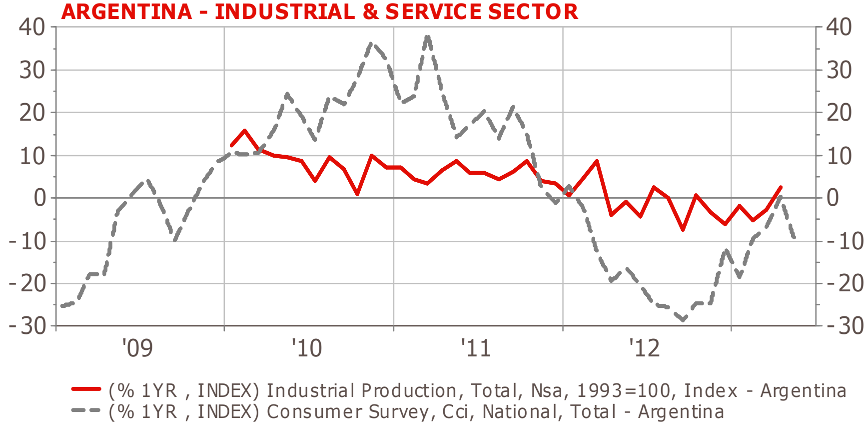
Current Assessment.

- The economy appears to have made an encouraging start in Q2, helped by a rebound in the construction and agricultural sectors.
- While it is still too early to get a clear idea of the actual pace of GDP growth, it could be expanding at 1.5% to 2% y/y in Q2 (up from 1.4% y/y in Q1, and higher than our initial estimates).

Outlook for the Economy and Financial Assets.

- Admittedly, growth has picked up in the first half of this year but we remain extremely cautious about the future performance of the Argentinian economy due to the following factors: (1) Despite the recent acceleration, recovery remains narrow in scope, with the two largest sectors (services and industry) still struggling to gain momentum. (2) Although it may seem that there is a break also on the inflation front, with the weighted average provincial CPI retreating from the highs of December (25%) to levels of 20%, we do not interpret this as good news for two reasons. First, 20% growth in inflation after prices have grown at a rate of 25% over the last two years is simply unsustainable. Second, the apparent fall in inflation is just that, apparent, and was predominantly due to official price controls, which are unlikely to tackle the root of the problem. With monetary & fiscal policy set to be eased again ahead of elections in October, inflation could easily pick up again during 2H2013. (3) The steady decline in FX reserves to just 6 months of imports is a reminder that strains in Argentina's balance of payments persist, which means that the gap between the official and black market exchange rate is not going to disappear in the short term, ensuring strong pressure from imported inflation. On a brighter note, exports (agriculture) are set to give a seasonal boost to hard currency inflows. This access to USD, though temporary, should help alleviate shortages of dollars. Our estimate is for a 2013 GDP of +1%.
- Outlook for Financial Assets: **Argentine Equity (Underweight):** By far the best performer YTD in the region (+22%) and one of those showing better performance in the world. We do not have the necessary information to assess whether the market is cheap or not, but in light of the recent rally and given our outlook for the economy, we cannot consider this market as a good trade. **Fixed Income (Underweight):** With inflationary pressures persisting over the medium to long term, we do not feel comfortable recommending buying these assets. **Fx (Underweight):** The gap between official and black market exchange rates will persist, putting downward pressure on the official price.

ARGENTINA - INDUSTRIAL & SERVICE SECTOR



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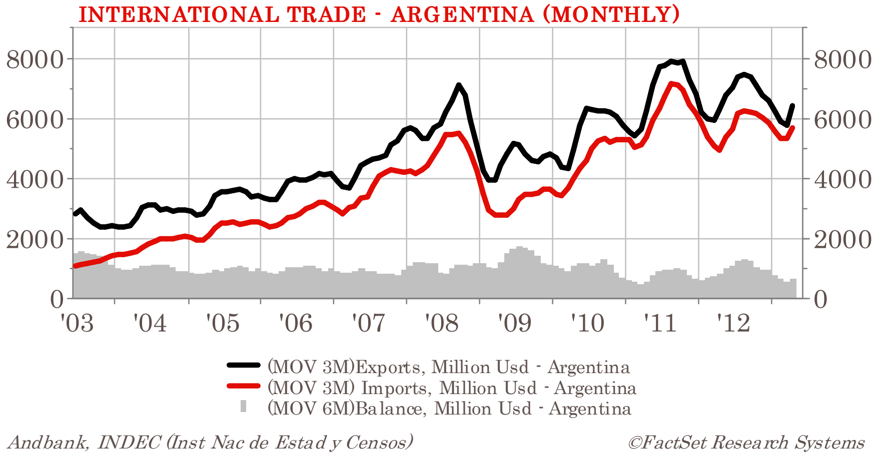
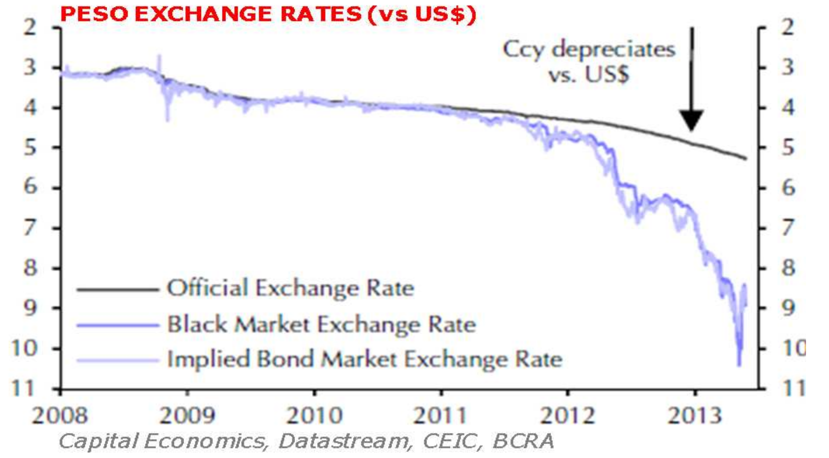
CENTRAL BANK FOREIGN EXCHANGE RESERVES

Capital Economics, Datastream, CEIC, BCRA

Argentina *– Other charts of interest*





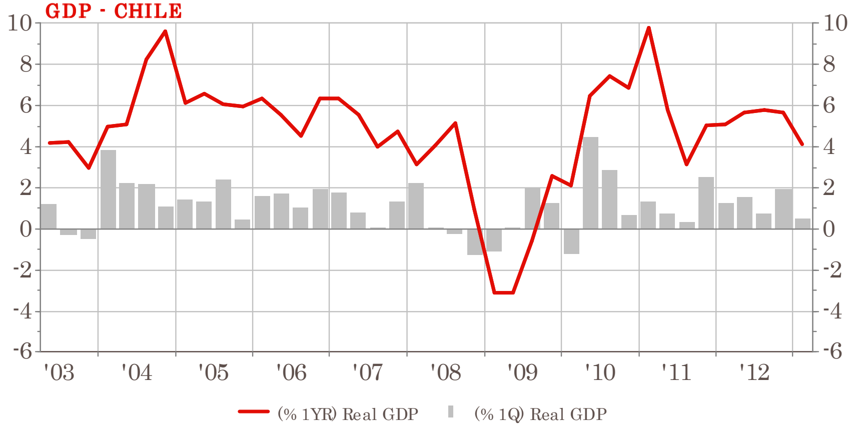
Chile. *Also a weaker than expected Q1, but still decent figures*

Current Assessment.

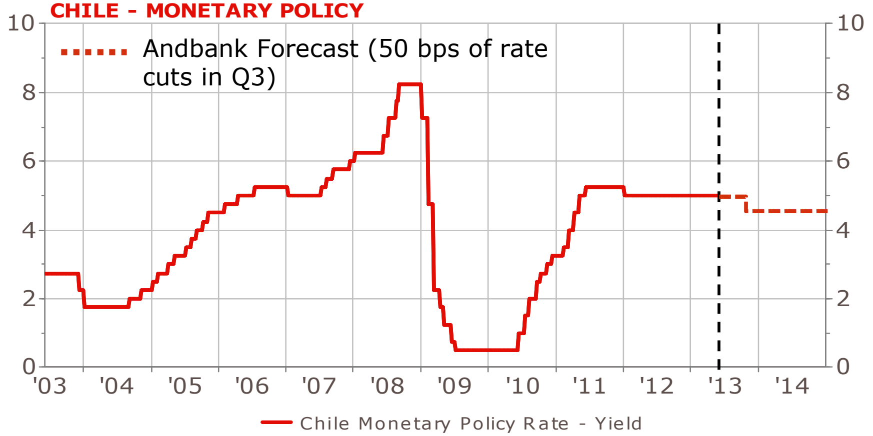
- Admittedly, the economy came off the boil in the first quarter, with GDP growth moderating to 4.1% y/y (from 5.7% in 4Q). The factors behind this slowdown are a cooling in gross fixed asset investment (to 9.57% y/y from 18% in Q4) and a more worrying slowdown in exports (to 1% y/y from 4.6% in Q4).

Outlook for the Economy and Financial Assets.

- Despite the recent slowdown, we have reason to remain optimistic and continue betting on Chile as one of the region's best performers over the next decade. (1) As usual, inflation remains carefully controlled, after tumbling to just 1.0% y/y in April, which suggests that there is plenty of scope for monetary easing, if required (in contrast to Brazil or even Mexico). We now forecast 25-50 bp rate cuts in the second half of the year. (2) Despite the slowdown in investment, it still represents 25% of GDP, making Chile the second largest economy in the region, with the highest investment as a share of GDP. In per capita terms, however, Chile is by far the best positioned, with almost 3,700 US$ of investment per person and year, 126% higher than Peru, 80% higher than Brazil and 46% higher than Mexico. (3) Speculation that the US Fed will soon taper its asset purchases has also triggered some retreat from Chilean assets, making the peso weaken by 6% to 501CLP/US$. This shift follows a rally in the peso that was exacerbated by foreign investor inflows and squeezed Chilean non-commoditiy export and industrial sectors, which have barely grown over the past five years and could now find respite in this depreciation. (4) Chile is the country that has made most progress on the fiscal front. Its fiscal stabilization rule, the FEES fund with almost US$15bn of AUMs, the 2% volatility in its GDP, the 10% debt to GDP ratio, the 6.4% of GDP in FDI each year and the avoidance of political profligacy are factors that make Chile still the first candidate destination for external investment. We forecast a GDP expansion of 4.3% in 2013.
- Outlook for Financial Assets: **Chilean Equity (Marketweight):** This market stands in 27th position out of 28 markets rated, in terms of valuation. **Fixed Income (Overweight):** At 5.25% yield and our prospects for monetary policy, we consider the 10yr government bond as an excellent investment opportunity. **Currency (Overweight):** We expect a reversal of the recent retreat and a return of the CLP to around 470.



Central Bank of Chile *©FactSet Research Systems*



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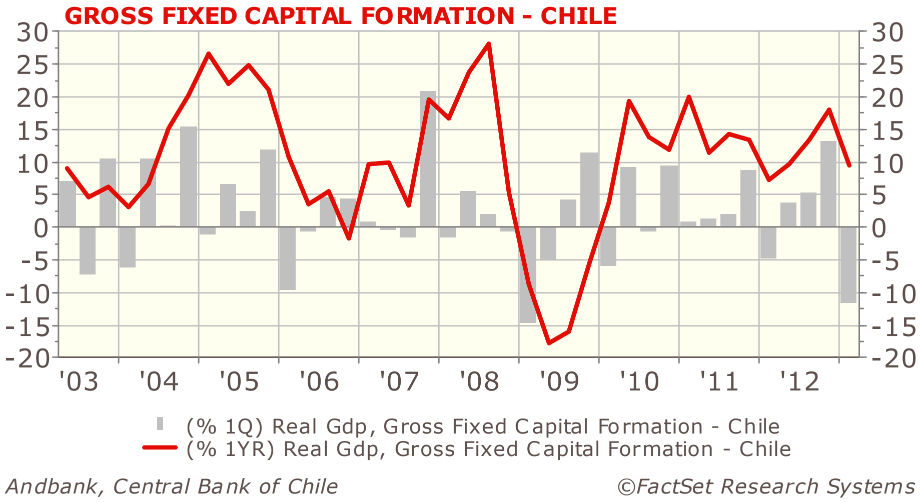
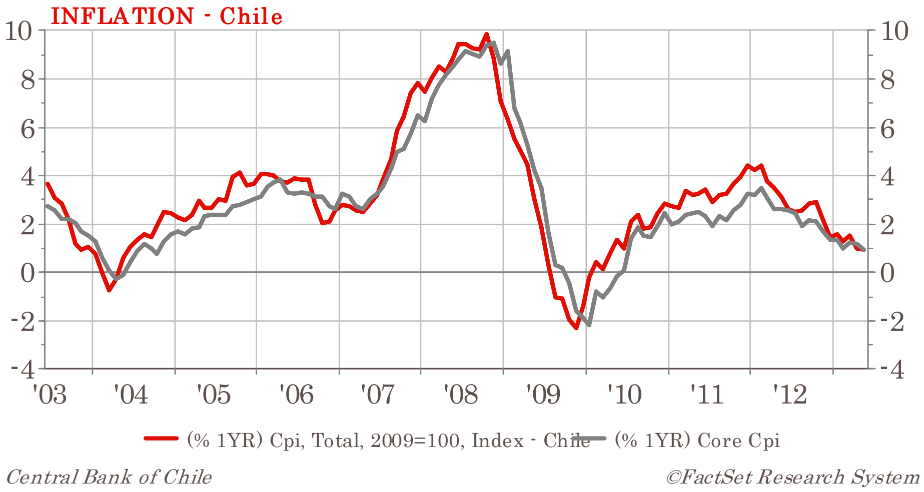
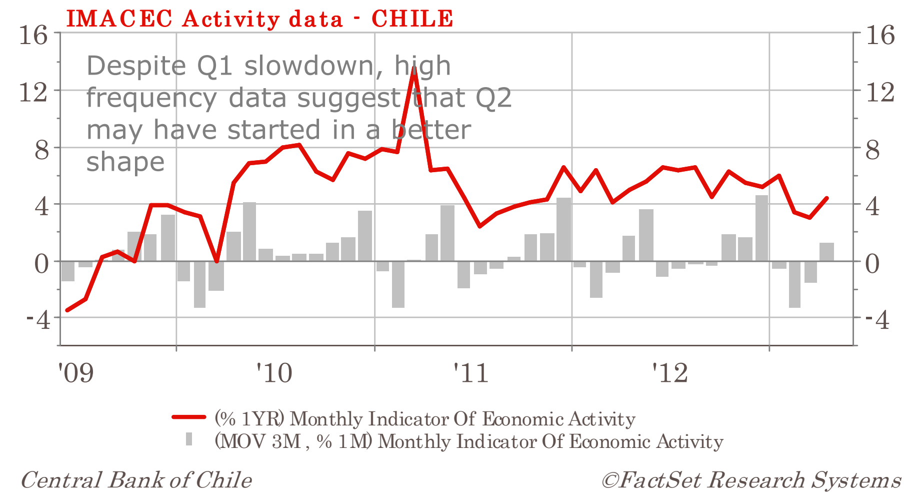
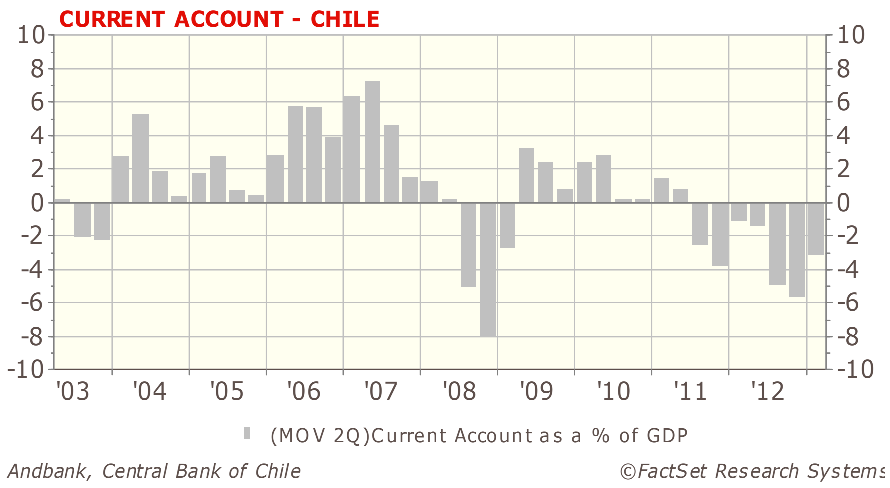
Chile – *Other charts of interest*









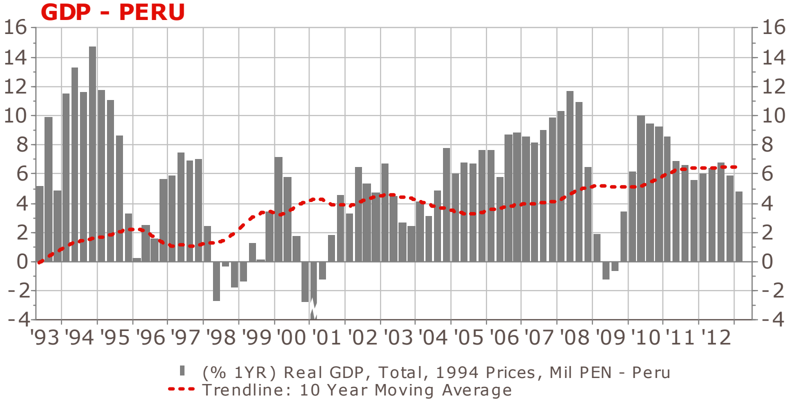
Peru. *Still a star, but a little less bright.*

Current Assessment.

- Peru's economy has been one of Latin America's growth stars in recent years but the economy also seems to be partially losing its shine. Q1 GDP data showed that growth slowed to 4.8% y/y, down from 5.9% y/y in Q4. As in Chile, the factors behind this slowdown are a weaker pace of investment spending and a drop in exports.

Outlook for the Economy and Financial Assets.

- As in most cases, the extent of the slowdown has been exaggerated by calendar effects, so we expect a pick-up in the pace of activity in the coming months. Nevertheless, several aspects make us a little less optimistic about this economy, so we have slightly lowered our 2013 GDP growth forecast to 5.3% (from 5.5%). (1) The outlook for the Mining sector is now less favourable, as lower Chinese growth is likely to reduce demand for Peru's metal exports. (2) This lower demand for metals adds uncertainty for foreign direct investment (FDI) compared to countries such as Chile (which is much more stable in this regard, as it does not suffer the volatility of capital flows with the same intensity). (3) A poorer FDI adds to the concerns about Peru's widening current account deficit. (4) President Humala has pledged to take additional steps to encourage investment, although this may be easier said than done.
- Central bank rates: The outlook for inflation remains fairly benign. Given our estimate of "slower" GDP growth and the fact that food inflation is set to fall further due to the lagged effects in global soft commodity prices, headline and core CPI should soften a bit, which means that there is plenty of scope for strong monetary stimulus. We forecast 25-50 bps of rate cuts over the coming 12 months, to 3.75%.
- Outlook for Financial Assets: **Peruvian Equity (Marketweight):** Equities remain among the worst performers in the region (YTD), mainly due to the high proportion of mining stocks in the benchmark index. We certainly believe that the commodities super-cycle is over, although we have reasons to believe that the price of raw materials is not going to sink. **Fixed Income (Overweight):** The 10-year government yield has also skyrocketed to 4.87% (from 4% one month earlier). At these levels, given our outlook for low inflation and our predictions for monetary policy, we consider the 10yr government bond as a buy opportunity. **Currency (Overweight):** Outflows from Peruvian assets have helped to push the sol to its weakest level against the US dollar in a year (at around PEN2.70). We expect some reversal towards 2.6.



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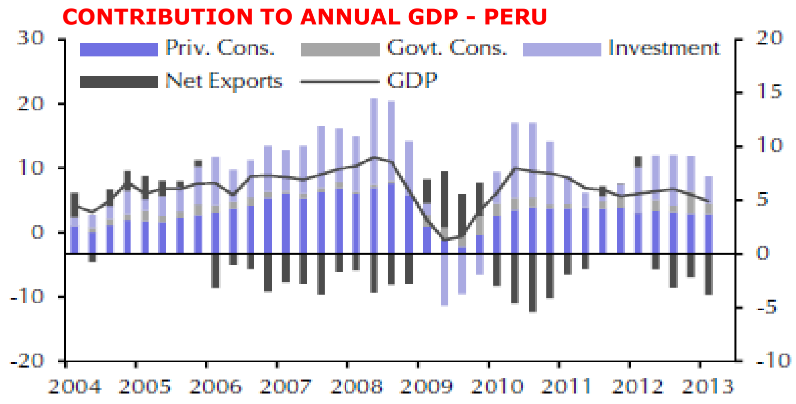
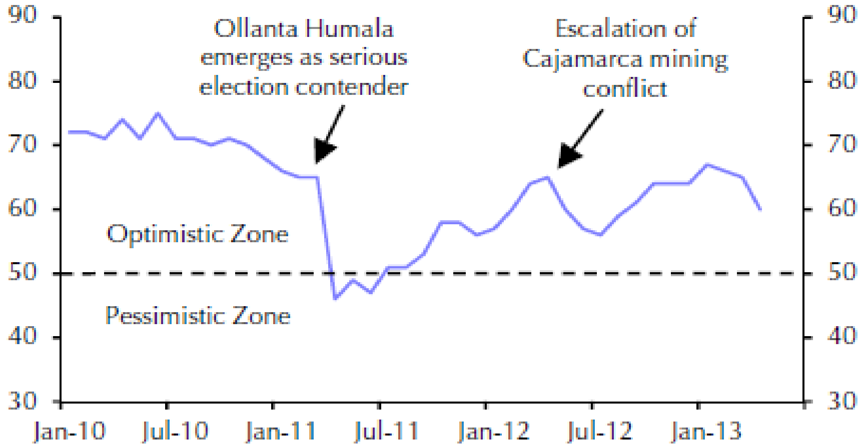


Capital Economics, Datastream, CEIC, BCRP

Peru – *Other charts of interest*

BUSINESS CONFIDENCE



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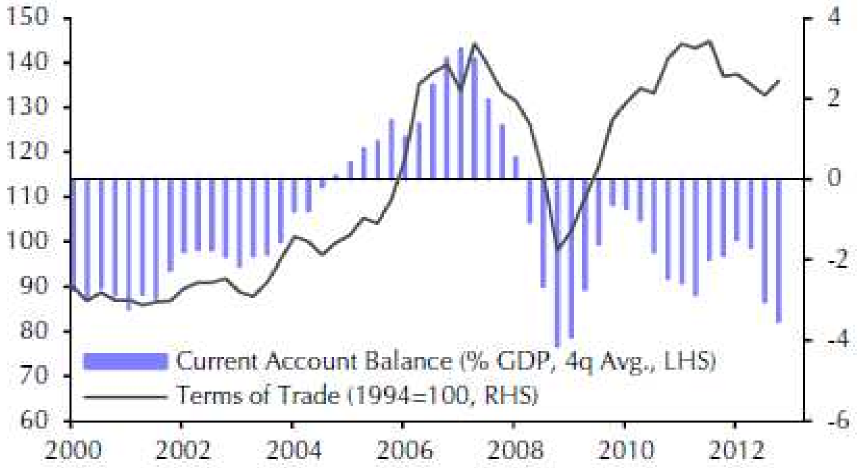
CURRENT ACCOUNT BALANCE & TERMS OF TRADE



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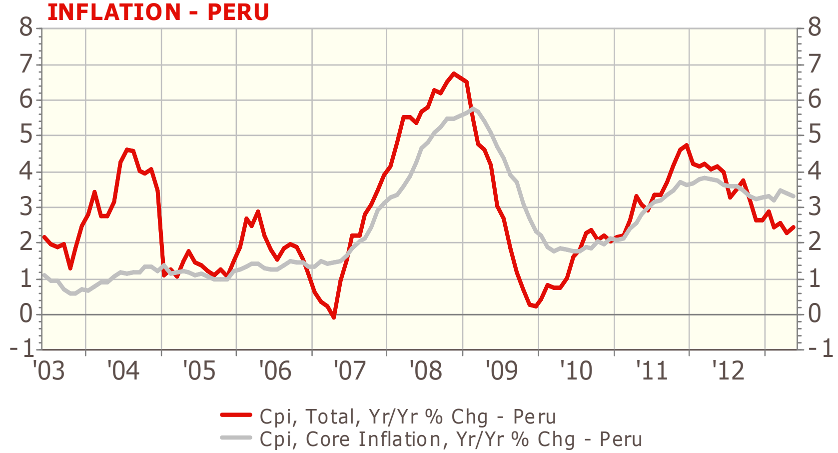
INFLATION - PERU



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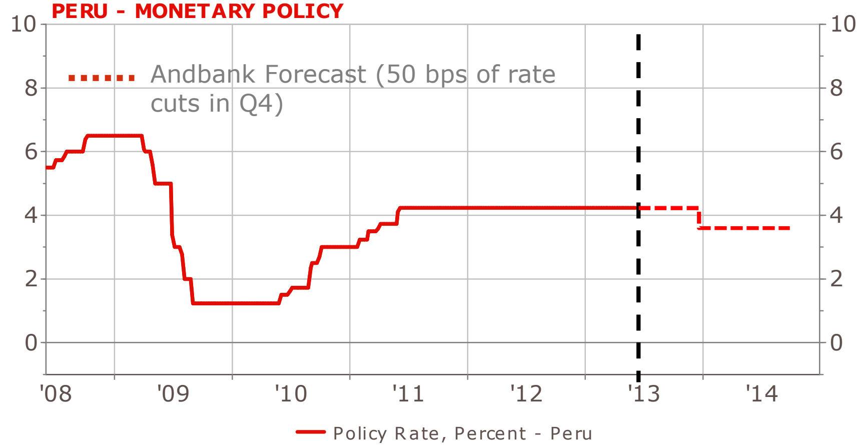
PERU - MONETARY POLICY



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Global Equity Ranking
Fundamental Valuation

	P to Book		Price to Earnings		Price to dividend		EV to EBITDA		Real yield ratio		VALUATION composite	
	Avg grade	Hierarchy	Avg grade	Hierarchy	Avg grade	Hierarchy	Avg grade	Hierarchy	Avg grade	Hierarchy	Avg grade	Hierarchy
World												
Hong Kong	-1.48	4	-0.43	8	-0.71	5	-0.74	5	1.17	2	4.8	1
Russia	-1.83	1	-2.03	1	1.77	26	-2.17	1	2.83	1	6	2
Germany	-0.62	14	-1.31	3	-0.48	7	-0.32	9	0.94	3	7.2	3
South Korea	-1.74	3	-0.94	4	-1.19	3	-0.06	11	-0.36	19	8	4
India	-0.28	15	-0.76	5	-0.10	12	-0.77	4	0.65	6	8.4	5
China	-0.83	11	-1.56	2	0.41	18	-0.71	6	0.75	5	8.4	5
Japan	-1.06	7	-0.47	7	-0.39	9	-0.61	7	-0.19	16	9.2	7
Italy	-1.78	2	1.19	20	0.43	19	-1.16	2	0.63	7	10	8
Israel	-0.67	13	0.26	12	-0.70	6	0.38	15	-0.28	17	12.6	9
Taiwan	-0.01	16	0.23	11	0.10	16	0.04	13	0.53	8	12.8	10
Poland	-1.43	5	-0.48	6	4.89	28	-1.01	3	-1.33	23	13	11
Eurozone	-0.81	12	1.01	19	-0.02	14	-0.03	12	0.32	10	13.4	12
Brazil	-0.86	9	0.30	13	0.49	20	1.31	23	0.81	4	13.8	13
France	-0.98	8	1.35	23	0.51	22	0.22	14	0.41	9	15.2	14
Malaysia	0.56	19	0.03	10	-0.01	15	-0.21	10	-1.39	25	15.8	15
Indonesia	2.57	28	0.46	14	-1.28	1	0.74	18	-0.34	18	15.8	15
Spain	-1.18	6	2.17	27	2.31	27	-0.39	8	0.31	11	15.8	15
Turkey	0.68	20	0.89	17	-0.23	11	1.35	24	0.09	12	16.8	18
United States	1.97	25	1.00	18	-0.26	10	0.74	19	-0.11	14	17.2	19
Canada	-0.85	10	-0.36	9	1.10	25	0.96	21	-0.66	21	17.2	19
United Kingdom	0.24	18	1.31	22	-0.07	13	1.19	22	0.05	13	17.6	21
South Africa	1.04	23	0.55	15	0.54	23	0.67	17	-0.13	15	18.6	22
Australia	0.07	17	0.73	16	0.60	24	0.82	20	-0.47	20	19.4	23
Mexico	2.49	27	1.56	25	-1.26	2	1.45	26	-1.34	24	20.8	24
Thailand	2.36	26	1.43	24	-0.72	4	1.86	28	-0.87	22	20.8	24
Sweden	0.90	21	1.31	21	0.50	21	0.44	16	-1.68	27	21.2	26
Chile	0.96	22	2.94	28	-0.42	8	1.83	27	-1.86	28	22.6	27
Switzerland	1.58	24	2.03	26	0.31	17	1.39	25	-1.46	26	23.6	28

CHEAP

EXPENSIVE

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