ANDBANK RESEARCH

Global Economics & Markets

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LatAm - A brief discussion on the general state of the region

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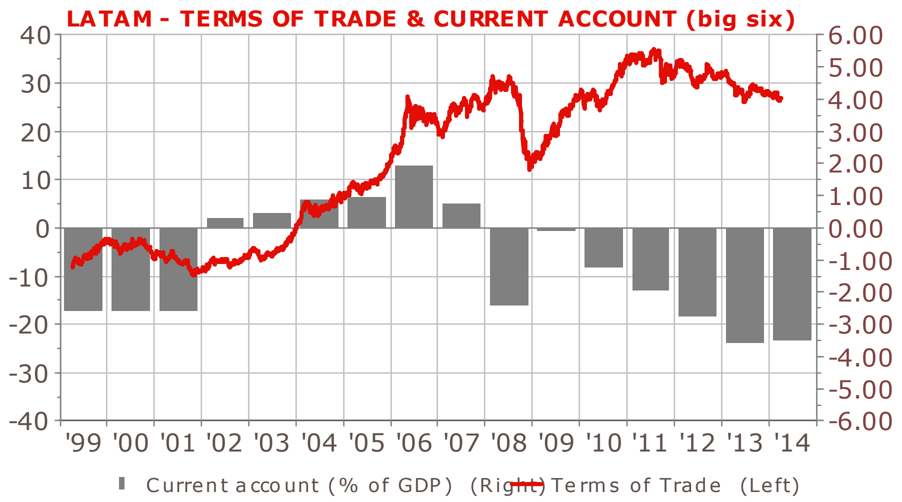
Region – Economy: "A new era of sluggish economic growth"

- **There have been further signs during this 1Q14 that the region has entered a new era of sluggish economic growth.** With most of the official data for 4Q released, regional GDP growth seems to have slowed to 2.6% y/y in Q4 (from 2.9% y/y seen in Q3). Some independent trackers point that output is expanding at a similar pace in 1Q13.

- **Although it seems unlikely that these trend could reverse in the foreseeable future, we believe that most of these economies will not show further deterioration due to the following reasons:**
    1. Concerns about a hard landing in China are overdone.
    2. Concerns that the shift within the Chinese economy away from commodity-intensive investment will weight on Latam's heavy commodity producers are also overdone in the sense that the intensive activity will be done in other parts of Asia.

- Perhaps **the most concerning issue** is that tightening global monetary conditions will make the entire region to rein in its bulging current account and fiscal deficit, making it necessary to weaken domestic demand.



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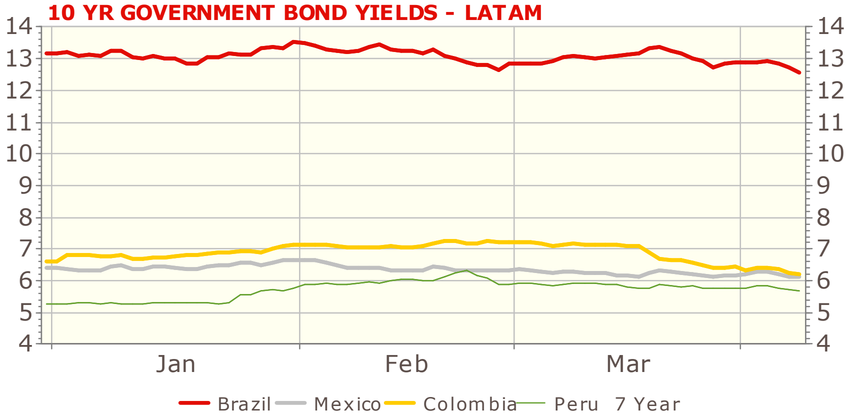
Region – Financial Markets: "The worst is behind for most of the region's markets"

- **Current Assessment:** Latin America's financial markets stabilized in March after a woeful start to the year.

  1. ***Fx:*** Most of the region's floating currencies strengthened in March but it was the Colombian peso that was the out performer appreciating by 4% against the US$.
  2. ***Equity markets*** have also performed well this month. Argentina, Mexico and Brazil's benchmark equity indices made significant gains of 2-6%. Colombia outperformed again with the benchmark COLCAP index gaining 8.2%. In the other hand, Peru's equities performed woefully, with the benchmark IGBVL declining by 9% this month.
  3. ***Bonds:*** Argentine and Venezuelan bonds have rallied (+7% and +5% respectively) although it is expected these markets to come under renewed pressure as the countries remain on the brink of balance of payments crises. Colombian bond also posted a good performance

- **General Outlook:** For the rest of the region's financial markets, we think the worst is probably behind us although admittedly, lower commodity prices could weight and put some downward pressure on these markets. But in contrast, we do not expect that the "gradual normalization" of interest rates in the developed world will take place as intensively as market participants expect, at least globally. Additionally, a relatively stronger economic growth, aided by the EU recovery and the US stable path, could support financial markets in the region.



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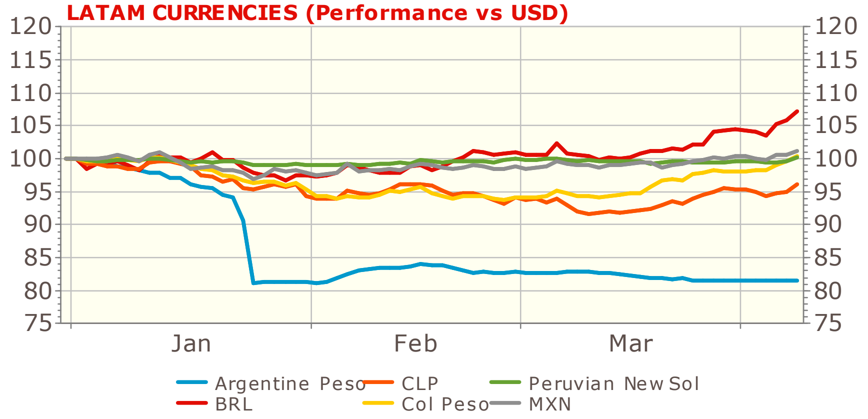

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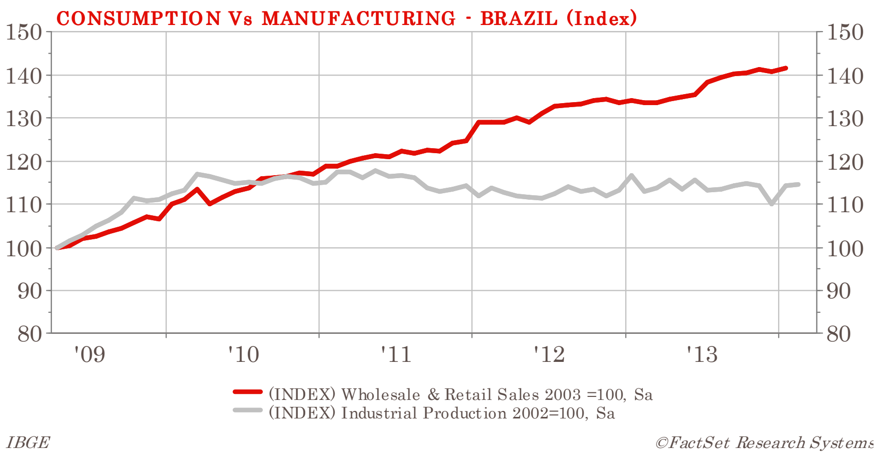
Brazil – Growth is disappointing and unbalanced

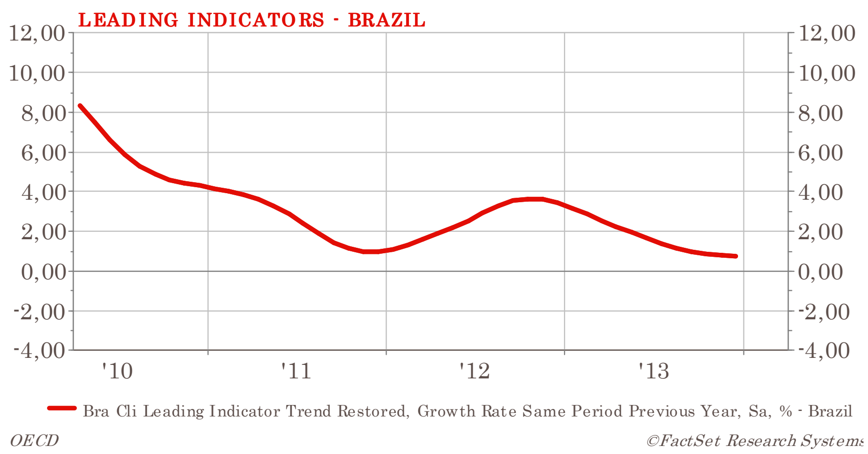
- *Positive aspects*:

    1. S&P's downgrade of Brazil's debt rating to BBB- comes as no surprise.

- *Negative aspects*:

    1. The poor growth outlook points to an era of larger budget deficits and rising debt.
    2. More timely economic data indicates that growth remains extremely disappointing at around 2% y/y in Q1.
    3. Drivers for growth are still skewed towards consumer spending (something that must be curved).
    4. Industry remains very weak.
    5. Central bank raised rates (to 11%) given the pick up in IPCA-15 (to near 6%) and this does not help.
    6. Inflation is set to remain stubbornly high and thus, the interest rates are set to remain at double-digits for some time, and this neither will not help.





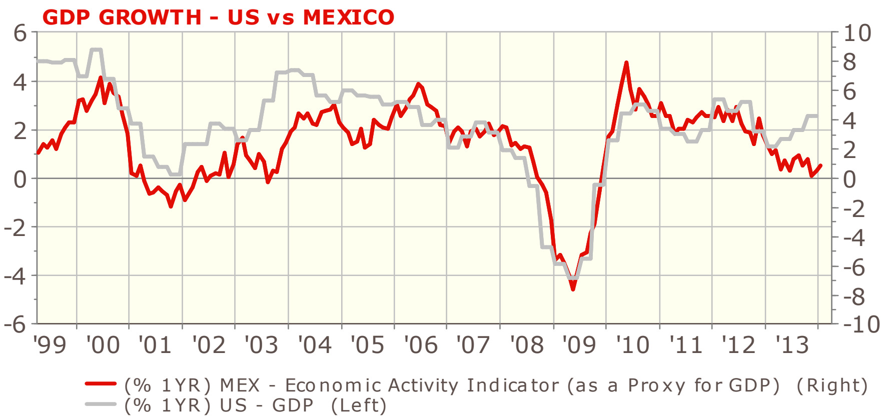
Mexico – Hope lies only in the forward-looking indicators

- *Positive aspects*:

  1. Forward-looking indicators show some signs of improvement with the IMEF services survey picking up and the US ISM manufacturing index consistent with positive dynamics in the Mexican manufacturing sector.
  2. Headline CPI fell to 4.2% in February (from 4.5%) and could remain around the 4% mark (upper band of the 2%-4% range), meaning that interest rates could remain at the current historical low of 3.5% for much of this year, and this should help.

- *Negative aspects*:

  1. The poor performance of the economy in 2013 spilled over into the first months of 2014, with the IGAE Activity index slowing to just 0.6% y/y in January (3m average) from 0.8% y/y.
  2. Primary and secondary sectors contracted, while the tertiary sector slowed growth.



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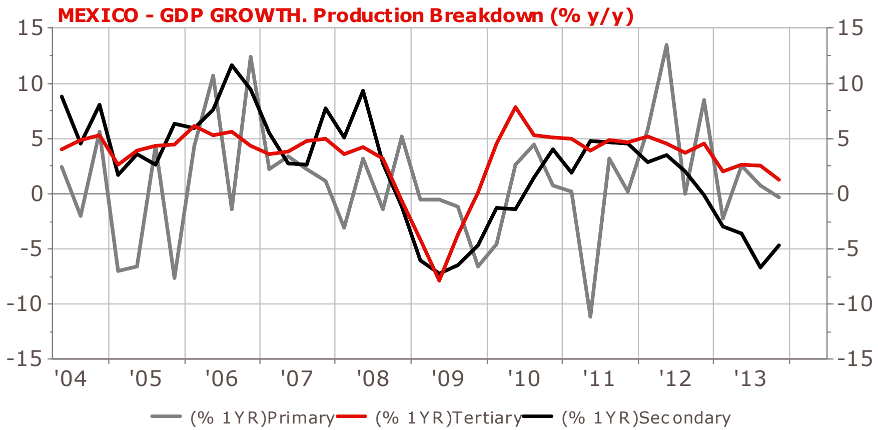

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Argentina – Fx reserves have stabilized but still not out of the woods

- *Positive aspects*:

  1. Financial markets seem to have stabilized, with foreign currency bond yields falling by 50bp to 11.3%, and the official peso that has stabilized around 8/$ (requiring very little intervention by the BCRA).
  2. Foreign exchange reserves also seem to have stabilized.

- *Negative aspects*:

  1. January's devaluation is likely to have aggravated the already-high inflation, perhaps near the 30% y/y now.
  2. Inflation will remain stubbornly high due to the large (and monetized) government spending ahead of next year's presidential election.
  3. This combination of factors will weight on the activity and will cause capital flights, putting pressure on the peso, maybe until 10/$.
  4. Some trackers suggest that the economy remained very weak in 4Q and our forecast is that the GDP will contract in 2014.

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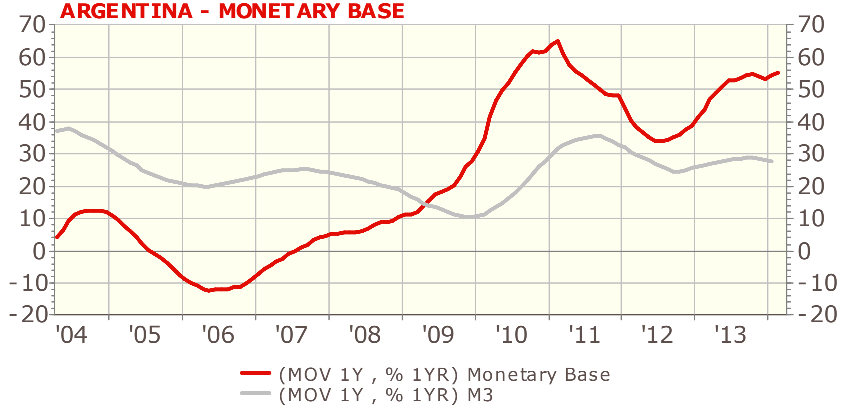

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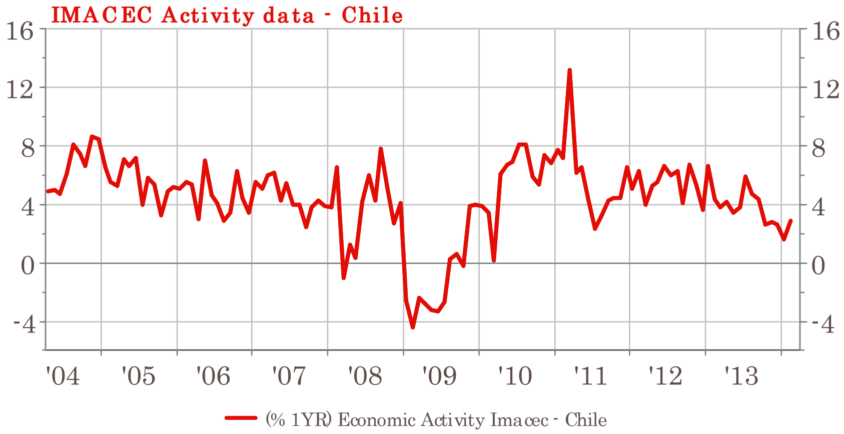
Chile – The slowdown persist but the economy runs at full employment

- *Positive aspects*:

  1. Retail sales have been growing at a less frenetic rate of 6.6% y/y on a 3month average basis in February. Indeed it is lower than the 8% pace seen for most of 2013 but is still healthy.
  2. Although inflation has picked up to 3.2% y/y in February it remains still well within the official 2-4% target range, allowing the Central Bank to cut interest rates to 4% in a move that could help the broad economy. Nevertheless we think is unlikely to see further monetary easing if CPI remains above the central point.
  3. The currency weakness and recent slowdown in domestic consumption should help to curve down the problematic current account deficit, that is already improving mildly and is now at 3.5% of GDP, down from the previous 4%.

- *Negative aspects*:

  1. The slowdown seen in 4Q13 continued in the 1Q14. The IMACEC activity index suggests growth slowed to a very low 1.3% y/y in January although recovered in February to a mild 2.87% y/y.
  2. The slowdown has been apparent in most major sectors, with industrial activity posting a -1.9% y/y pace in February in what represents the fourth consecutive month of contraction.



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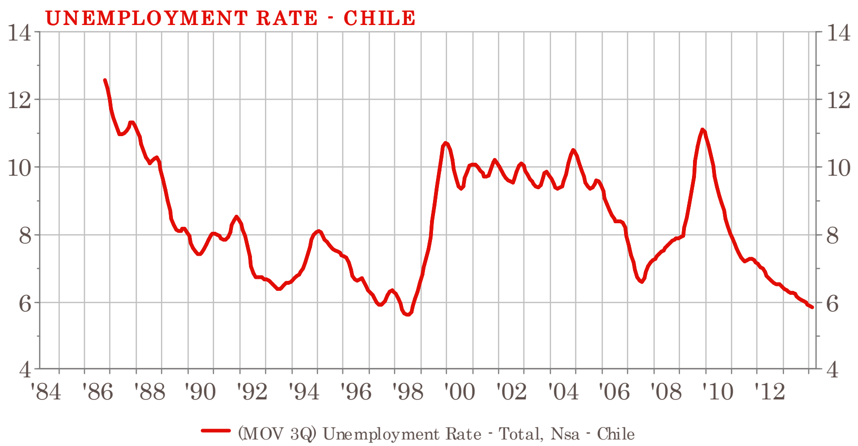

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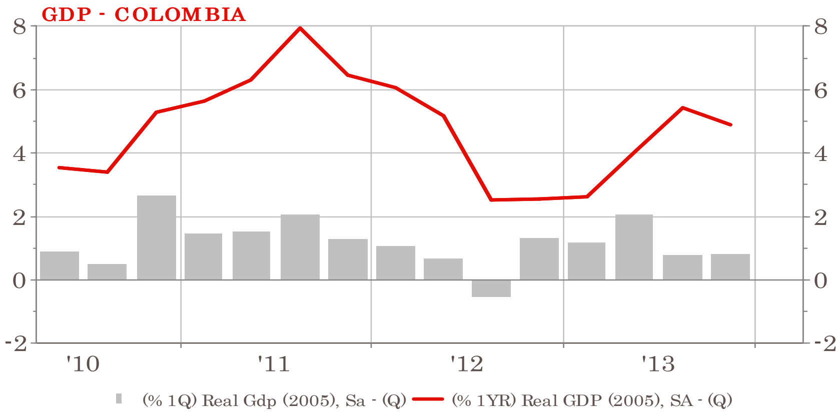
Colombia – Low official rates will help

- *Positive aspects*:

  1. The FY2013 GDP growth was 4.3%. While it is clearly below the average of 4.7% seen over the past decade, it is by no means a disaster.
  2. The pace seemed to have picked up in the last part of 2014 with 4Q14 GDP growth being 4.9%, and some GDP trackers suggests that Colombian GDP started the 1Q13 in a similar fashion, with growth being around the 4.5% y/y. Construction, Mining and consumption were among the main drivers for growth.
  3. CPI remains stable at a healthy 2.3% y/y (below the target of 3%) and will remain well controlled, allowing the interest rates to be left on hold at 3.25% for the entire year. This should help.

- *Negative aspects*:

  1. Although growth remains at a reasonable 4.5% y/y pace, it is still unbalanced and skewed towards consumer-facing sector, while the manufacturing sector continues to struggle. The manufacturing sector continued to perform woefully in what seems to be a constant in the region, suggesting (as we have pointed in many occasions) that these economies are not competitive.
  2. The Colombian peso has weakened against the USD since May 2013 (from 1800 to near 2000) but this is seen as insufficient to restore the external competitiveness of the industry.



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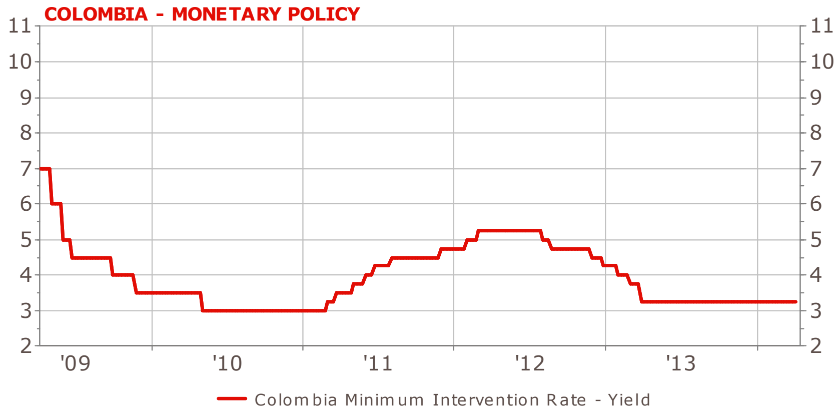

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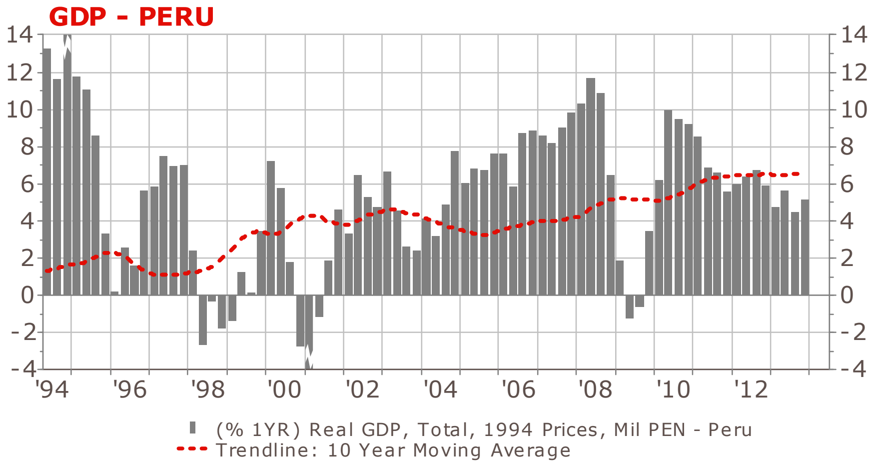
Peru – Better dynamics in GDP growth but also with imbalances

- *Positive aspects*:

    1. Unlike the rest of economies, Peru posted a strong end to 2013 and has recorded a robust 4.8% y/y pace in its INEI's economic activity indicator in the early stages of the year

- *Negative aspects*:

    1. We are also concerned about the underlying balance of growth. Mining, construction and retail sales are still strong but manufacturing continues to perform poorly (0.42% y/y in January) as sit has done in the last two years, in part due to the overvalued currency. Maybe the depreciation seen in 2013 (from 2.58 to 2.80) helps to reestablish competitiveness.
    2. Headline inflation rose to 3.8% y/y, well above the 1-3% target range, limiting therefore the authorities' capacity to ease policy (now rates stand at 4%), although RRR for banks were lowered to 12.5%.



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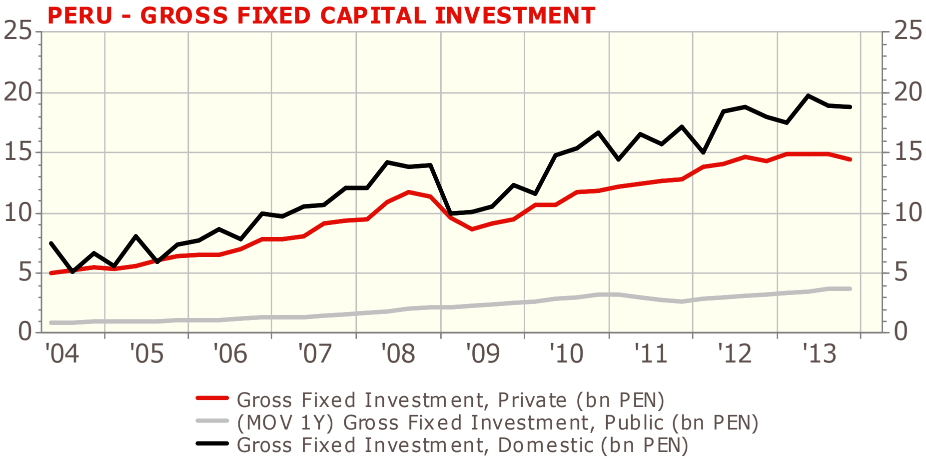

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Venezuela - the situation threatens to spiral out of control.

- *Negative aspects*:

  1. With no signs of an end to anti-government protests and clashes becoming increasingly violent, the situation threatens to spiral out of control.
  2. Shortage of foreign currency leads to widespread shortages of many goods, causing inflation to rocket to near 60% y/y in February.
  3. The recent sharp in motor vehicle sales of -70% y/y, suggests that the economic activity has collapsed.
  4. The government has responded by introducing a new foreign exchange mechanism –SICAD2- with the first transactions made at an exchange rate of 51.8$, equivalent to an almost 90% discount from the official rate. The goal is to help bring the black market rate down, but the dangerous low level of Fx reserves and the erosion of the current account surplus, make that the tensions in the balance of payment could mount rapidly.
  5. As such, it is likely that the dollar drought will persist, and so the shortage of goods and whit it the social unrest. As such, Fx and bond yields could head much higher during 2014.

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