Latin America Watch

Group Economics

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Recovery still some way off

- **First quarter almost universally weak, second quarter more mixed**
- **Outlook far from rosy**
- **Increased public spending not an option in most countries**
- **Limited room for monetary easing**

Growth forecasts revised down

In view of the steadily escalating trade war, we further reduced our growth forecasts for both industrialised countries and emerging markets last month. As well as the global challenges, many Latin American countries are also contending with negative internal developments. Due to this combination of factors, we also lowered our growth forecasts for the six largest countries in the region: Argentina, Brazil, Chile, Colombia, Mexico and Peru.

Economic growth (forecasts)

% yoy	Av. 99-18	2018-Q4	2019-Q1	2018e	2019f	2020f
Argentina	2.0	-6.1	-5.8	-2.5	-1.5	2
Brazil	2.3	1.1	0.5	1.1	1	2
Chile	3.7	3.6	1.6	4.0	3	3
Colombia	3.5	2.7	2.3	2.8	3	3
Mexico	2.2	1.7	1.2	2.0	0.5	1.5
Peru	4.7	4.8	2.3	4.0	3.5	3.5
Venezuela	-0.4	n.a	n.a	-18.5	-25	-1
Regional average	2.3			0.6	-0.1	1.9

Source: ABN AMRO Group Economics, EIU

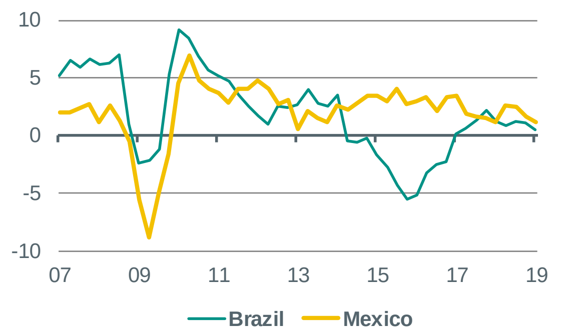
Figures for Venezuela are extremely unreliable and forecasts are difficult to make. After shrinking over 60% in the past five years, the country has sunk in the regional rankings for economic size from fifth place in 2014 to seventh place in 2018. According to the latest EIU data, the country appears to be rushing headlong towards more than 25% contraction this year - a lot worse than the 6% shrinkage expected at the start of the year. As a result, regional economic growth (based on the seven largest countries) is now set to stagnate, after showing 0.6% growth in 2018. Stripping out Venezuela, growth this year will fall to 1% (in round figures), versus 1.3% in 2018.

First quarter weak, second quarter more mixed

Many countries in the region contended with weakening growth in the first quarter of this year. Argentina is sinking ever-deeper into an economic morass. In the first quarter the economy once again shrank about 6% yoy. Compared to a year earlier, growth in Mexico and Brazil remained in positive territory. However, the rate of growth did decelerate from an already low level and both countries are increasingly moving in step with each other. Even in countries with relatively strong growth such as Chile, Colombia and Peru, the reasonably good fourth quarter was followed by a substantial deceleration. The second-quarter figures are not yet known for most countries but, except in Colombia, signs of a strong recovery are nowhere to be seen. Monthly GDP growth data point to a marginally stronger second quarter in Brazil, while the pace of contraction in Argentina appears to be slowing. In Peru, by contrast, the second quarter will probably be weaker still, albeit only slightly. Mexico and Chile published (preliminary) figures for the second quarter. These indicate that the economy of Mexico has shrunk 0.7% compared to a year earlier, while growth in Chile picked up to 1.9%.

Growth reconverging in Brazil and Mexico

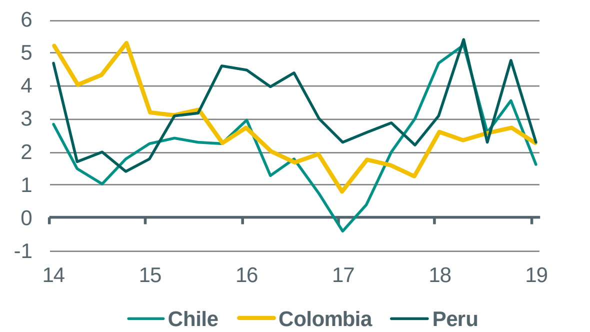
GDP figure, % yoy



Source: Bloomberg

Also lower growth in Chile, Colombia and Peru in Q1

GDP figure, % yoy



Source: Bloomberg

Longer-term outlook far from rosy

The continuing uncertainty about global developments such as the deepening trade conflict and the associated increase in risk aversion is pushing business and consumer confidence in the region even lower than it already was. Added to this, many countries are contending with political tensions. The massive corruption scandal surrounding the Brazilian construction company Odebrecht, which held the region in thrall in recent years, is still putting a drag on growth. As well as adding to the crisis of confidence, it has also further delayed vital infrastructure investments.

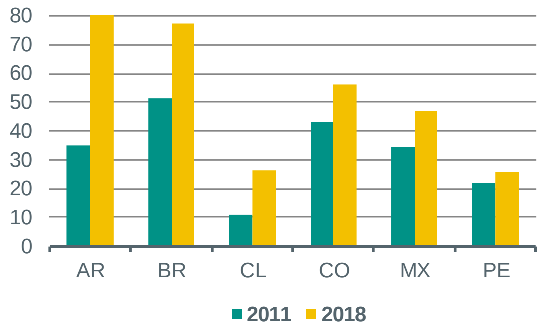
In general, the level of investment in the region is low at the best of times, which is hardly conducive to a strong recovery. The humanitarian crisis in Venezuela and the exodus of migrants from the country is another source of concern. All in all, despite signs that growth in many countries is bottoming out, this combination of global uncertainties, political turmoil and structural flaws suggests that any revival in the region is likely to be limited, even in the longer term.

Austerity is not helping

Rising public debt in many countries makes it impossible to pursue an anti-cyclical budget policy. Since the global financial crisis in 2009, public debt in most countries has soared. In that period, there seemed to be sufficient scope to raise public spending to give the economy an impulse. With high commodity prices fuelling growth, governments in most countries enjoyed bumper revenues and were able to push down their debt ratios. In 2011 public debt in Argentina and Brazil hit a low point at, respectively, 35% and 51% of GDP.

Public debt up across the board

% GDP



Source: EIU, ABN AMRO Group Economics

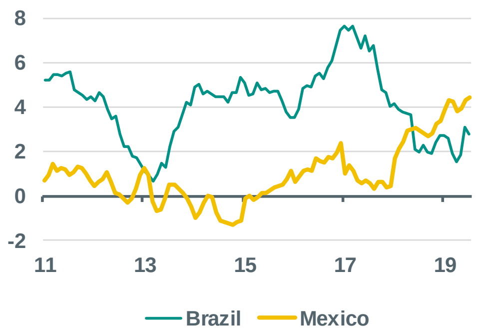
The big reversal of fortune came after 2014 when commodity prices plummeted, dragging government revenues in their wake. This headwind forced most countries to cut spending, while the economic tide turned increasingly hostile. Meanwhile, public debt in Argentina and Brazil has spiralled to around 80% of GDP. Debt has also risen in Colombia and Mexico, but their debt ratios of, respectively, 56% and 47% of GDP are still relatively benign. Chile and Peru are important positive exceptions. Both countries are running small public deficits and have modest public debts of less than 30% of GDP.

Limited room for monetary easing

Thanks to an improved external position and a favourable inflation picture, most countries have room to cut interest rates in line with the lower rates in the industrialised world. Brazil, in particular, has taken advantage of this latitude to further extend the monetary expansion cycle initiated at the end of 2016. Its policy rate has meanwhile been slashed to the historically low level of 6%. And a further cut of around 50 bp looks likely. Chile, like the United States, started to gradually raise rates early in 2018, but entirely reversed this in June with a 50 bp cut to 2.5%. In the meantime, Mexico and Peru have also joined the interest rate doves, reducing their rate by 25 bp, to respectively 8% and 2.5%.

Real rates vary widely from Brazil and Mexico …

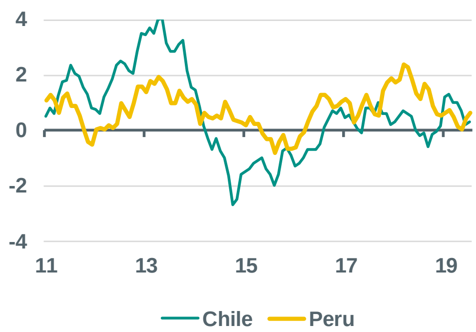
Policy rate –inflation in %



Source: Bloomberg

…to Chile and Peru

Policy rate –inflation in %



Source: Bloomberg

Mexico's economic foundations are in reasonably good shape, but uncertainty over the role of the US and internal political discord are putting currency and stock markets under pressure, which limits the scope for further rate cuts. Since mid-2014 the interest rate was steadily raised from 3% to 8.25%, where it has remained since the end of 2018 until last week. Mexico has also overtaken Brazil as the champion of high real rates. The difference between the policy rate and inflation has widened in Mexico to more than 4% points, while narrowing in Brazil to less than 3% points. Despite the strong economic deceleration, it is unlikely that Mexico can lower rates by much more than the policy rate in the US. But for the other countries too, the risk of severe currency depreciation due to heightened risk aversion will continue to weigh on the market for a while yet. This constrains their scope for further interest rate cuts. Colombia is now the only country that have so far refrained from rate cuts. In Colombia, inflation is creeping up and growth is also gaining traction, making a rate cut less likely here.

Argentina increasingly out on a limb

The IMF deal secured last year after a spell of currency unrest has taken a toll on President Macri's popularity. The enforced austerity measures, combined with extreme monetary tightening, pushed the economy back into recession and Macri now appears to be paying the price. After dropping sharply in recent months over concerns about the presidential elections in October, the Argentine currency went into free-fall in the wake of the primary elections. Fear gripped the markets as news broke that opposition candidate Alberto Fernandez and his vice-president and ex-president Cristina Fernandez had won no less than 47% of the votes against a meagre 32% for incumbent president Macri. A similar result in the real elections on 27 October would make a second round redundant. If Fernandez wins, consumer and producer confidence will probably be dealt a further blow, with negative knock-on effects for the growth outlook for 2020. However, regardless of who actually becomes president, the country's problems have now reached the point where the IMF package may no longer be sufficient and the chances of achieving the agreed budget targets look increasingly remote. As the currency continues to slide, the country is increasingly struggling to service its massive foreign debt. This increased probability of a sovereign default resulted in a recent downgrade of Fitch from B to CCC and of S&P from B to B-. Although this is not yet our baseline scenario, the weakening currency is for sure severely exacerbating the risk of renewed debt repayment problems.

Main economic indicators/forecasts

GDP growth (%)	2017	2018	2019e	2020e	Inflation (%)	2017	2018	2019e	2020e
Emerging Asia	6.4	6.3	5.7	5.5	Emerging Asia	2.4	2.7	2.9	3.1
Emerging Europe	6.4	5.4	1.4	2.2	Emerging Europe	5.5	6.7	7.0	5.3
Latin America	1.0	0.6	-0.1	1.9	Latin America**	6.9	7.5	9.1	6.4
Emerging markets total	**5.2**	**4.9**	**3.9**	**4.2**	**Emerging markets total**	**3.9**	**4.5**	**5.2**	**4.5**
Eurozone	2.5	1.9	0.8	0.6	Eurozone	1.5	1.8	1.1	1.0
US	2.3	2.9	2.2	1.3	US	2.1	2.4	1.8	2.0
World	4.0	3.8	2.9	2.9	World	3.1	3.5	3.7	3.3

Budget balance (%GDP)	2017	2018	2019e	2020e	Current account (%GDP)	2017	2018	2019e	2020e
Emerging Asia	-3.6	-3.9	-4.0	-4.0	Emerging Asia	1.1	0.0	0.0	0.0
Emerging Europe	-4.0	-4.0	-4.5	-4.5	Emerging Europe	0.1	-0.1	0.0	-0.5
Latin America	-5.3	-5.2	-4.5	-4.0	Latin America	-1.4	-1.9	-2.0	-2.5
Eurozone	-1.0	-0.5	-1.2	-1.4	Eurozone	3.9	3.4	3.0	2.8
US	-3.5	-4.1	-5.2	-5.0	US	-2.6	-2.4	-3.0	-3.0

Source: EIU, ABN AMRO Group Economics ** figures Emerging Markets regions are rounded*

***Inflation Latin America and World without Venezuela*

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