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Editors: Roger Bootle and Julian Jessop

Worst recession in 80 years

- Latin America's GDP looks set to contract by 4% this year due to the collapse of commodity prices in 2008, low risk appetite and the sharp fall in demand for Latin American exports. There have been some signs that global conditions are recovering, or at least no longer in free-fall. But since most governments in the region failed to build up surpluses during the commodity price boom, they are now unable to implement significant fiscal stimulus measures to prevent the recession from extending well into next year.
- Despite **Brazil's** relative isolation (the economy is not only the least open in the region, but also one of the least dependent on commodity exports), GDP is on track to shrink by 2% this year, led by falls in investment and consumption. (Page 4.)
- The recession in the United States, the region's main trading partner, will cause GDP to contract in **Mexico** (Page 5), **Colombia** (page 9), **Uruguay** (page 12), and most countries in **Central America** (page 13) this year and during 2010. The rise in risk aversion and the collapse of commodity prices will exacerbate the recession in these economies.
- By contrast, while **Chile** (page 9) and **Peru** (page 10) face similar problems, their governments are in a better position to implement significant fiscal stimulus measures to partially offset the deterioration in their terms of trade. However, the full benefit will not be felt until 2010.
- The situation in **Argentina** (Page 6), **Venezuela** (page 7), **Ecuador** (page 11) and **Bolivia** (page 12) is most worrying. For a start, their strong dependency on commodity exports implies that they will be hit hardest by the collapse of prices and lower global demand. In addition, the policies adopted by their governments in recent years will seriously limit the authorities' ability to cushion the blow. The threat of nationalisation or, in the case of Ecuador, the possibility of de-dollarization of the economy, is a major deterrent to much needed investment. Thus, these economies will underperform the rest of the region.

Luis Carlos Niño

Capital Economics Ltd

Europe

150 Buckingham Palace Road
London SW1W 9TR
United Kingdom
Tel: +44 (0)20 7823 5000
www.capitaleconomics.com

North America

2 Bloor Street West, Suite 1740
Toronto, ON, M4W 3E2
Canada
Tel: +1 416 413 0428

Managing Director: Roger Bootle (roger.bootle@capitaleconomics.com)

Chief International Economist: Julian Jessop (julian.jessop@capitaleconomics.com)

Latin America Economist: Luis Carlos Niño (luis.nino@capitaleconomics.com)

Emerging Europe Economist: Neil Shearing (neil.shearing@capitaleconomics.com)

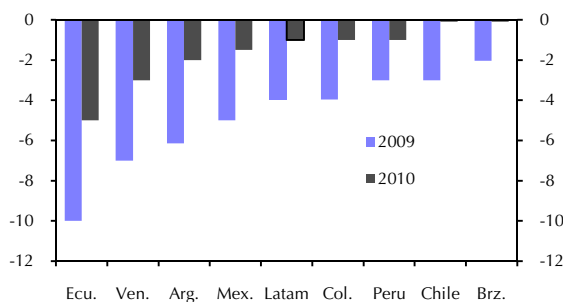
Key Forecasts

TABLE 1: REAL GDP & INFLATION

% y/y	Share of World ⁽¹⁾	GDP				Inflation ⁽²⁾			
		2007	2008	2009f	2010f	2007	2008	2009f	2010f
Brazil	2.80	3.3	5.1	-2.0	0.0	3.6	5.7	3.0	3.5
Mexico	2.10	3.3	1.3	-5.0	-1.5	4.0	5.1	4.5	4.5
Argentina	0.80	8.7	6.7	-6.0	-2.0	8.8	8.1	10.0	11.0
Venezuela	0.50	8.4	4.8	-7.0	-3.0	18.7	30.6	25.0	20.0
Colombia	0.50	7.5	2.5	-4.0	-1.0	5.5	7.0	4.0	4.0
Chile	0.36	4.7	3.0	-3.0	0.0	4.4	8.7	1.0	1.5
Peru	0.33	8.9	9.8	-3.0	-1.0	1.8	5.1	2.0	2.0
Ecuador	0.15	2.7	4.8	-10.0	-5.0	2.3	8.4	3.0	2.5
Guatemala	0.10	5.7	3.4	-7.0	-3.5	6.8	8.0	6.0	5.3
Costa Rica	0.07	6.8	5.0	-4.5	-2.5	9.4	9.5	4.0	4.0
Uruguay	0.06	7.4	9.5	-3.0	-0.5	8.1	7.4	6.5	6.5
El Salvador	0.06	4.7	2.1	-6.0	-4.0	3.9	5.5	4.5	3.5
Panama	0.05	11.3	8.3	0.0	2.0	4.2	7.4	3.5	4.0
Bolivia	0.06	4.6	5.9	-5.5	-3.0	8.7	15.1	10.0	10.0
Honduras	0.04	6.3	3.4	-6.5	-3.0	6.9	9.6	8.5	7.0
Paraguay	0.04	6.8	6.0	-4.5	-2.0	8.1	7.6	4.5	4.5
Nicaragua	0.03	3.8	2.8	-7.0	-3.0	11.1	13.8	7.5	7.0
Suriname	0.01	5.5	4.7	-5.0	-3.0	6.4	8.0	7.0	6.0
Guyana	0.01	5.4	3.2	-8.0	-6.0	12.2	6.2	6.5	5.5
Belize	0.004	2.2	2.1	-6.0	-3.5	3.0	2.8	2.5	2.5
Cuba		7.2	-1.0	-12.0	-3.0	3.5	1.0	1.0	1.0
Latin America	8.1	5.7	4.3	-4.0	-1.0	6.9	7.8	5.5	6.0
G4 Countries									
US	19.3	2.0	1.1	-3.0	0.0	2.9	3.8	-1.0	1.0
Euro-zone	14.2	2.6	1.0	-4.0	-0.5	2.1	3.3	2.0	1.0
Japan	6.2	2.4	-0.7	-5.0	2.0	0.0	1.4	-0.7	0.2
UK	3.1	3.0	0.7	-4.0	-1.0	2.3	3.6	1.4	0.8

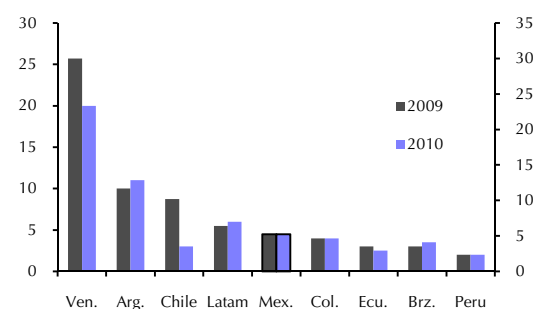
(1) %, 2007, in PPP terms. (2) All % y/y annual average.

Chart 1: Real GDP (%/y)



Sources – Thomson Datastream, Capital Economics

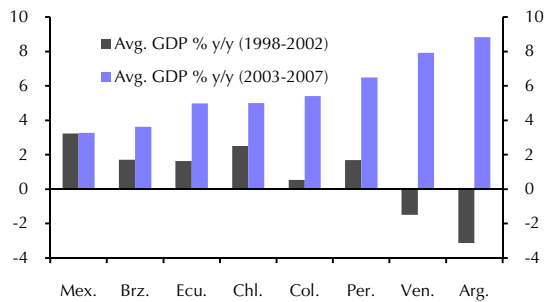
Chart 2: Inflation (%/y)



Sources – Thomson Datastream, Capital Economics

Overview

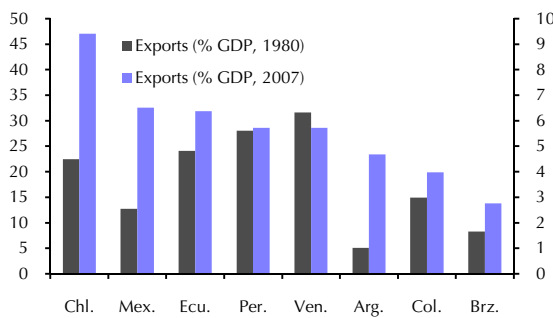
After the economic crises in the late 1990s and the Argentine default in 2001, the region has boomed since 2003.



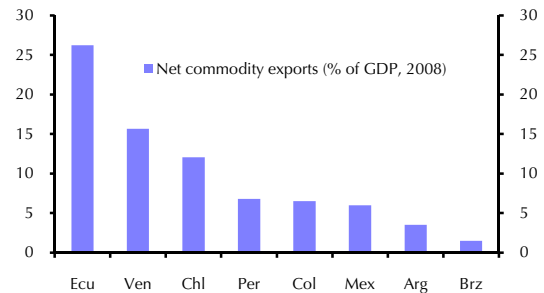
Most countries have lowered external debt burdens ...



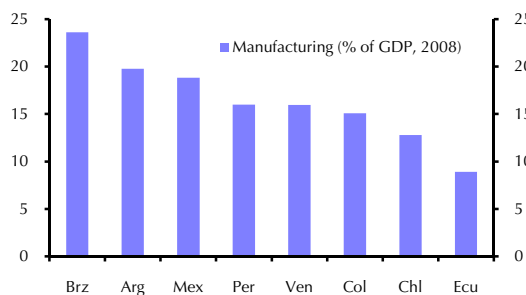
... and the region has become more integrated with the rest of the world.



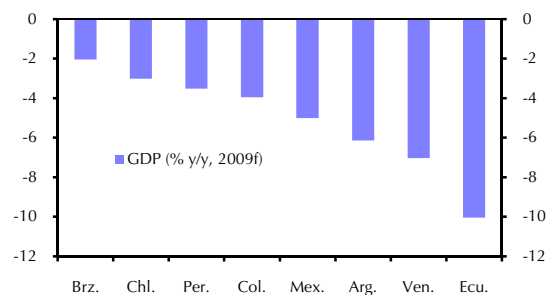
But some countries in the region remain overly dependent on commodities ...



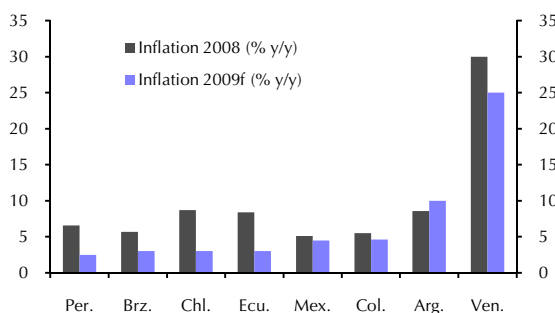
... and in some cases manufacturing output is still only a small fraction of GDP.



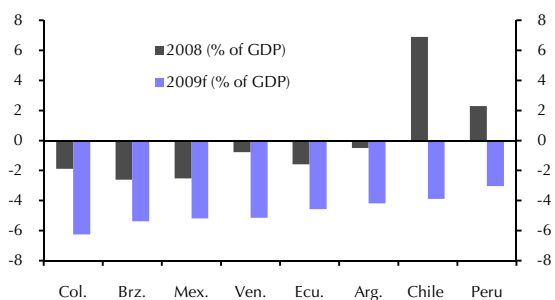
The world recession and the collapse of commodity prices are likely to cause the region to fall into deep recession ...



This should lead to a fall in inflation ...



... and a rapid deterioration in fiscal balances.



Sources – Thomson Datastream, Bloomberg, Capital Economics

Brazil

Heading for recession

- Following a five-year economic boom, Brazil is heading for a recession this year. (See Chart 1.) GDP is set to shrink by 2% driven by the collapse of investment and consumption. Exports are also likely to contract, but so are imports. The effect of net trade should, therefore, be neutral. What's more, Brazil is a fairly closed economy and, contrary to popular belief, less dependent on net commodity exports than some of its neighbours. This will soften the blow of lower global demand and the collapse of commodity prices.
- Nevertheless, a renewed rise in risk aversion, both at home and abroad, plus the withdrawal of capital from the region could cause investment to shrink by at least 10% this year. As credit conditions deteriorate, firms will find it difficult to raise working capital needed to finance their operations.
- Accordingly, we expect many firms to close down and the unemployment rate to return to double-digits. (See Chart 2.) This, combined with a collapse in consumer confidence, could cause private consumption to contract by 2%. The \$52bn (4% of GDP) fiscal stimulus plan announced by President Lula will support growth, but it remains unclear how much of this package is new expenditure and how much was already in the budget.
- The weakness in economic activity is likely to cause headline inflation to fall to 3% by the end of the year. Accordingly, we expect interest rates to be cut to a record low of 8%. (See Chart 3.)
- Although we do not expect Brazil's GDP to contract for two consecutive years (unlike most of its peers) Brazil's economy is set to stagnate in 2010 in the absence of a strong global recovery next year.

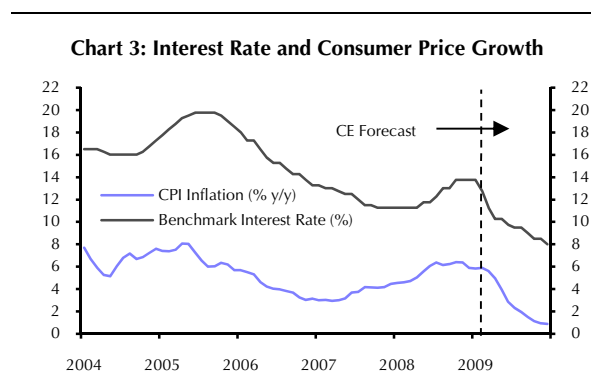
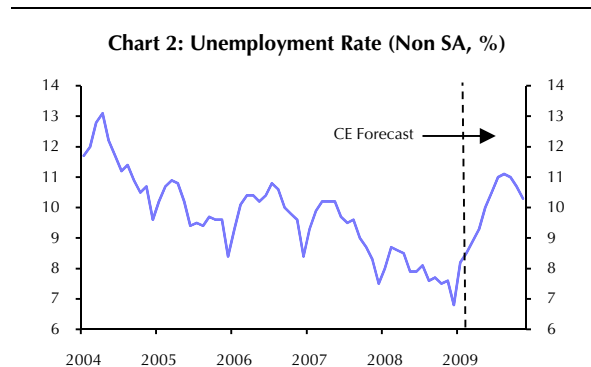
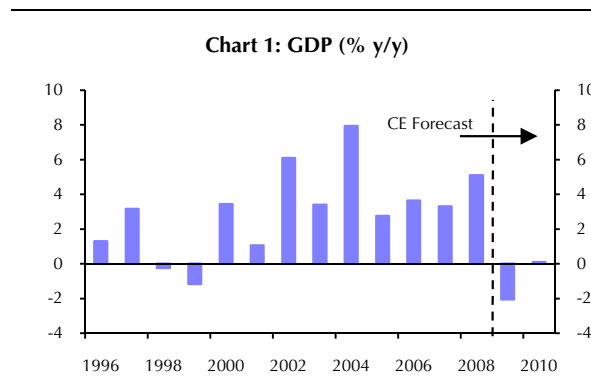


TABLE 1: KEY FORECASTS

	%y/y unless stated				
	2006	2007	2008	2009	2010
Private cons'ptn	5.2	6.3	5.4	-2.0	0.0
Total fixed invest.	9.8	13.5	13.7	-10.0	-3.0
GDP	3.6	3.3	5.1	-2.0	0.0
Unemp. rate (%)	10.0	9.3	7.9	11.0	9.0
CPI inflation ⁽¹⁾	4.2	3.6	5.7	3.0	3.5
Cent'l gov't bal ⁽²⁾	-2.9	-2.0	-2.6	-5.5	-6.5
Cent'l gov't debt ⁽²⁾	45.1	42.9	39.0	44.0	49.0
Current account ⁽²⁾	1.3	0.1	-1.8	-3.0	-3.5

Source – Thomson Datastream. (1) Year average (2) as % of GDP

Mexico

Dragged down by the US

- The Mexican economy is the most exposed in the region to the US downturn. With exports to the US equivalent to 25% of GDP, the recession there is likely to cause Mexico's GDP to shrink by 5% this year. (See Chart 1.) Industrial production, especially the automotive sector, is collapsing.
- What's more, high risk aversion, despite the slight improvement in global conditions witnessed recently, looks set to cause investment to shrink by 10% this year. This too will contribute significantly to the 10% contraction in industrial production. Consequently, the unemployment rate is likely to reach 10% this year, the highest in the decade. (See Chart 2.)
- To make matters worse, oil revenues, which account for more than 30% of government receipts, are set to fall further this year. (See Chart 3.) Indeed, the benefits from having hedged 70% of this year oil production at \$70 per barrel are likely to be offset by a contraction in output. What's more, Mexico will be hit by again in 2010 when the oil hedge expires if, as we expect, oil prices are still well below \$70 per barrel.
- Admittedly, the authorities have at their disposal a \$47bn (5% GDP) IMF flexible credit line, approved in April, which can be used to pay external debt or support trade finance. But this is unlikely to prevent a recession this year.
- The contraction in the economy will cause inflation to fall to the Central Bank's target of 3% by the end of the year. While there is a risk that a sharp depreciation of the peso could trigger a pickup in inflation (imports account for one third of GDP), we feel the economic downturn will deter firms from fully passing on to consumers any rise in import prices. Consequently, interest rates are still likely to drop to 4%, the lowest since 2003.

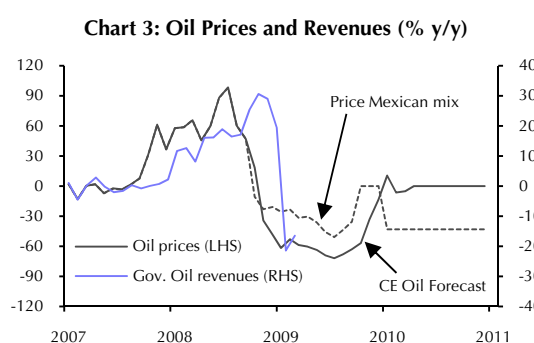
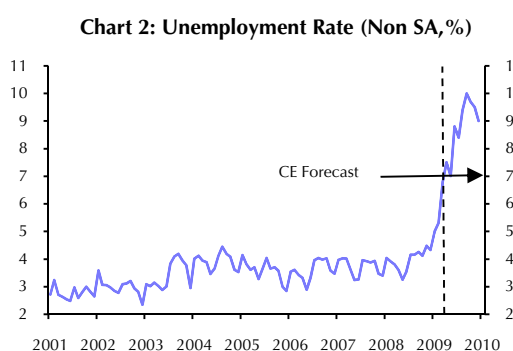
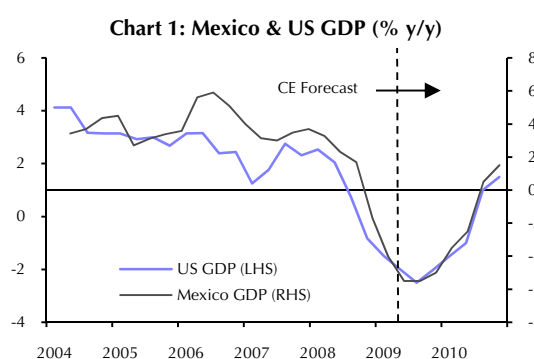


TABLE 1: KEY FORECASTS

	%y/y unless stated				
	2006	2007	2008	2009	2010
Private cons'ptn	5.7	3.9	1.6	-5.0	-1.0
Total fixed invest.	9.8	7.2	5.0	-10.0	-3.0
GDP	5.1	3.3	1.3	-5.0	-1.0
Unemp. rate (%)	3.6	3.7	4.0	6.0	5.5
CPI inflation ⁽¹⁾	3.6	4.0	5.1	4.5	4.5
Cent'l gov't bal ⁽²⁾	-1.7	-1.9	-2.5	-5.2	-5.5
Cent'l gov't debt ⁽²⁾	23.3	23.2	23.5	29.5	34.3
Current account ⁽²⁾	-0.4	-0.8	-1.9	-2.5	-3.0

Source – Thomson Datastream. (1) Year average (2) as % of GDP

Argentina

Devaluation and default risks grow

- Despite the improvements in Argentina's external and fiscal positions in recent years, the country remains extremely vulnerable to external shocks. We believe that the fall in global demand and the deterioration in the terms of trade are likely to cause GDP to contract by 6% this year and by a further 2% in 2010. (See Chart 1.) In turn, the risk of another default has increased significantly.
- Argentina's agricultural exports, a key source of government income, will be hit not only by collapse of commodity prices, but also by a severe drought that has damaged more than one third of crops. In addition, the combination of rising risk aversion, deteriorating terms of trade and tightening credit conditions will cause investment to contract by around 15% this year. Accordingly, industrial output is likely to shrink by around 15% this year. However, official data, which have been manipulated in the past, are likely to paint a different picture. (See Chart 2.) Either way, the unemployment rate could reach 20% this year. (See Chart 3.)
- The deterioration of the economic environment leaves the authorities in a very difficult position given Argentina's history of political instability during economic crisis. Indeed, the government failed to save during the boom and now is desperate to raise cash. After nationalising the \$25bn pension system in December, the government is eyeing up the deposits of nationals abroad, mainly in Uruguay. However, we believe Argentineans are unlikely to repatriate their savings.
- The peso is likely to continue falling against the dollar. In turn, this will force authorities to sell foreign exchange to defend the currency, an unsustainable strategy. We believe the central bank will have to devalue the peso by at least 50% by the end of the year.

Chart 1: GDP (% y/y)

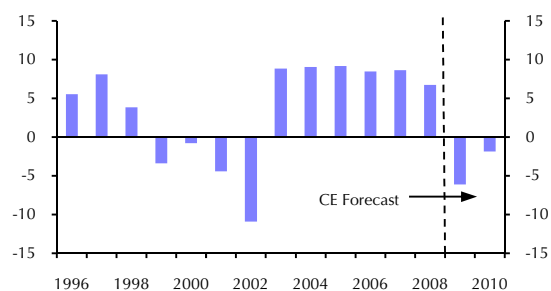


Chart 2: Industrial Production (% y/y)

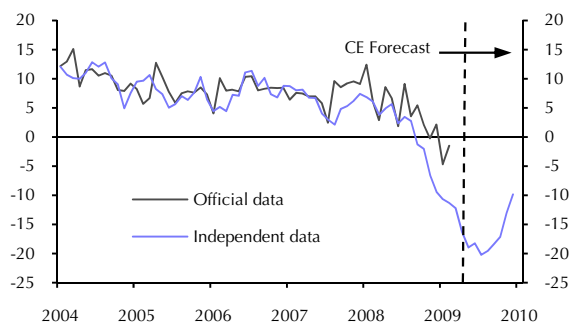


Chart 3: Unemployment Rate (Non SA, %)

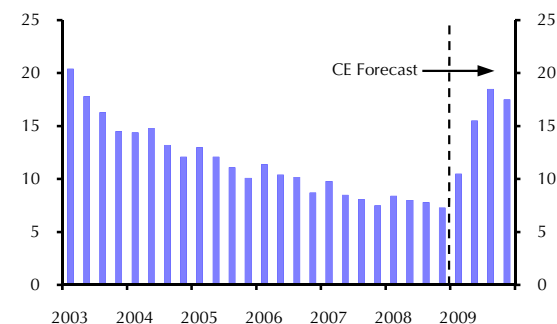


TABLE 1: KEY FORECASTS

	%y/y unless stated				
	2006	2007	2008	2009	2010
Private cons'ptn	7.8	9.0	6.6	-5.0	-2.5
Total fixed invest.	18.2	13.6	9.0	-15.0	-2.0
GDP	8.5	8.7	6.7	-6.0	-2.0
Unemp. rate (%)	10.2	8.5	7.9	20.0	15.0
CPI inflation ⁽¹⁾	10.9	8.8	8.1	10.0	11.0
Cent'l gov't bal ⁽²⁾	1.0	0.6	1.0	-4.5	-4.0
Cent'l gov't debt ⁽²⁾	63.6	53.5	46.0	48.0	48.0
Current account ⁽²⁾	3.6	2.8	3.7	2.0	1.5

Source – Thomson Datastream. (1) Year average official inflation. While we do not believe the official inflation figures, we still produce a forecast in the absence of an alternative (2) as % of GDP

Venezuela

The cost of poor policies

- Like in Argentina, the risk of default in Venezuela has increased substantially in the recent months. Indeed, a dangerous cocktail of collapsed oil prices, lower international demand and poor policies could cause Venezuela's GDP to contract by 7% this year and by 3% in 2010. (See Chart 1.)
- For a start, we expect the value of oil exports, which are the main source of fiscal revenues, to shrink by 50% this year. In addition, the rise in risk aversion (exacerbated by policy concerns) and the tightening of credit conditions are likely to cause investment to contract by 12% this year. Industrial production will fall sharply too. (See Chart 2.) Accordingly, the unemployment rate could reach 15% while consumption is set to contract by 4.5% this year.
- And just like in Argentina, government policies are at the core of Venezuela's problems. For a start, the government spent most of the income from last year's oil price rally. Now, while most governments in the world are loosening the purse strings, President Chavez is cutting expenditure and increasing taxes to avoid running a massive fiscal deficit. This will, of course, exacerbate the economic slowdown. In addition, the government continues to nationalise industries (Chavez now eyes a subsidiary of a Spanish bank), which harms business confidence.
- The bolivar fuerte, Venezuela's currency, will continue to be under heavy pressure this year. The authorities are likely to devalue the bolivar against the dollar by 50%. This will keep inflation relatively high despite weak economic activity. (See Chart 3.)

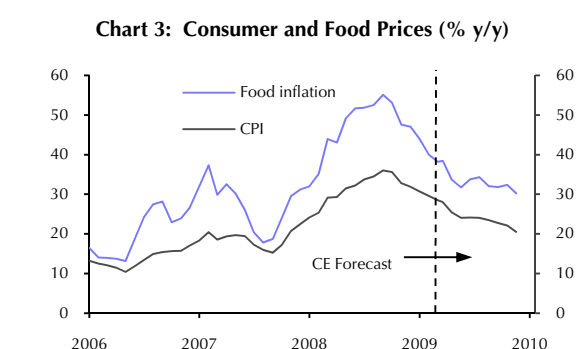
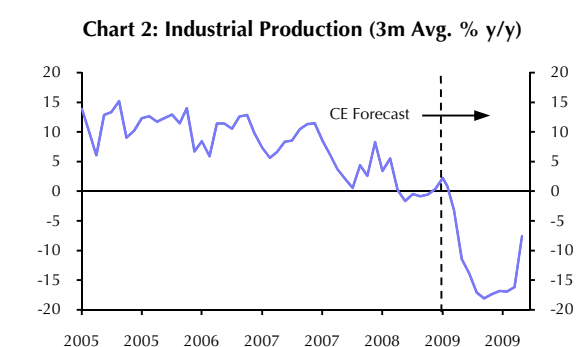
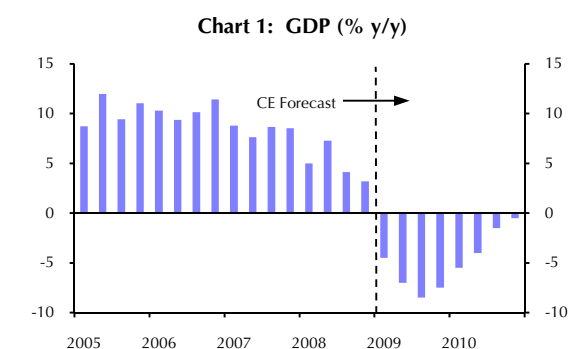


TABLE 1: KEY FORECASTS %y/y unless stated

	2006	2007	2008	2009	2010
Private cons'ptn	17.9	18.7	7.1	-4.5	-3.5
Total fixed invest.	26.6	25.4	-2.4	-12.0	-4.0
GDP	10.3	8.4	4.8	-7.0	-3.0
Unemp. rate (%)	9.7	6.7	6.3	15.0	12.0
CPI inflation ⁽¹⁾	13.6	18.7	30.6	25.0	20.0
Cent'l gov't bal ⁽²⁾	0.0	3.0	-0.8	-5.0	-4.0
Cent'l gov't debt ⁽²⁾	15.0	16.3	11.5	15.0	17.0
Current account ⁽²⁾	14.7	8.8	9.5	3.0	1.5

Source – Thomson Datastream. (1) Year average (2) as % of GDP

Colombia

Caught in the middle

- Colombia is heading for a two-year recession, the worst since the emerging markets crisis in the late 1990s. Indeed, GDP is on track to shrink by 4% this year and 1% in 2010, driven by a combination of external factors and the deterioration of domestic economic conditions. (See Chart 1.)
- The recession in the US, Colombia's main trading partner, is likely to cause export volumes to contract by 7% this year. (See Chart 2.) In addition, the collapse of commodity prices could cause export revenue to shrink by a quarter this year (nearly 50% of Colombian exports are commodities). Also, the deterioration in the terms of trade will cause investment and consumption to fall sharply this year.
- What's more, the lack of investment appetite and the tightening of credit conditions will exacerbate the drop in investment, which could shrink by 8% this year. This, plus the fall in exports, will have a devastating effect on industrial production. We think manufacturing output could contract by 15% this year, and the unemployment rate could rise to 20%. (See Chart 3.) Accordingly, consumption is set to shrink by 3% this year.
- In this context, we believe Colombia's inflation rate is likely to fall to 4% this year, in line with the Central Bank's target. While the peso looks set to continue falling against the dollar this year (as it did during January and February), we do not expect the depreciation of the exchange rate to have a strong effect on the inflation rate given weak economic activity. Accordingly, the monetary authorities are likely to maintain a dovish stance, slashing interest rates to a record low of 4% this year.

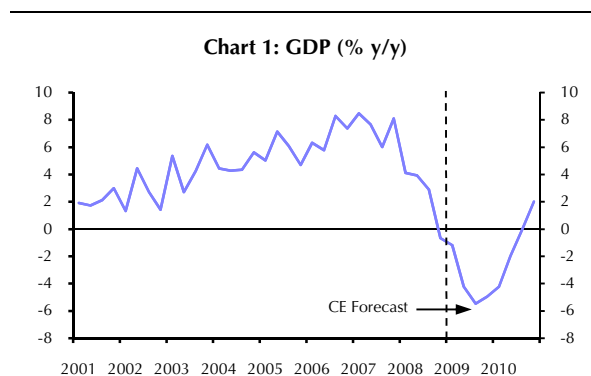


Chart 2: Colombian Nominal Exports & US Real GDP (% y/y)

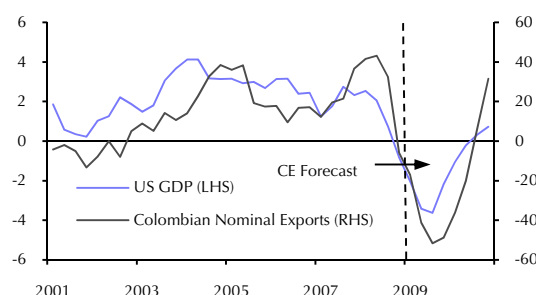


Chart 3: Industrial Production (% y/y)

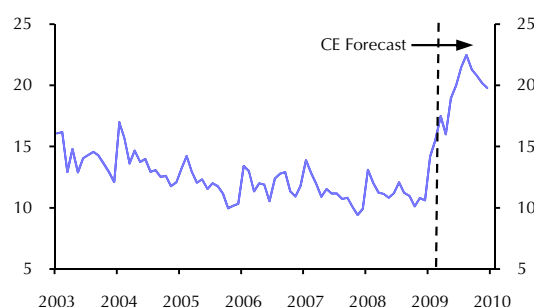


TABLE 1: KEY FORECASTS

	%y/y unless stated				
	2006	2007	2008	2009	2010
Private cons'ptn	6.8	7.6	2.5	-3.0	-1.0
Total fixed invest.	19.1	13.7	7.7	-8.0	-2.5
GDP	6.9	7.5	2.5	-4.0	-1.0
Unemp. rate (%)	11.8	9.9	10.8	20.0	18.0
CPI inflation ⁽¹⁾	4.2	5.5	7.0	4.0	4.0
Cent'l gov't bal ⁽²⁾	-3.8	-3.0	-1.9	-6.5	-6.0
Cent'l gov't debt ⁽²⁾	18.9	19.2	25.4	31.0	18.9
Current account ⁽²⁾	-1.8	-2.8	-2.8	-4.5	-6.1

Source – Thomson Datastream. (1) Year average (2) as % of GDP

Chile

The weight of copper

- While Chile made the largest savings in the region during the commodity price boom, the country's dependency on copper exports, which were equivalent to 25% of GDP in 2007, is still likely to cause GDP to shrink by 3% this year. (See Chart 1.)
- Although copper prices have recently picked up again, they are still little more than half the average in 2008. Accordingly, this will cause revenues from copper exports to contract by at least 30% y/y. (See Chart 2.) What's more, the deterioration in terms of trade will have a devastating effect on domestic demand. To make matters worse, the fall in global demand will hit agricultural and manufacturing exports as well. (Chile is the most open of Latin America's economies.) All in all, Chilean export volumes are likely to fall by 6% this year.
- The lack of investment appetite, the tightening of credit conditions and the sharp deterioration in terms of trade could cause investment to shrink by 9% this year. Accordingly this, plus the fall in exports, is likely to cause manufacturing output to shrink by 15%. The unemployment rate looks set to reach 11% this year, the highest in over a decade.
- In response, the Chilean authorities will tap into the \$25bn (15% of GDP) copper wealth fund to support the economy. (See Chart 3.) But the fiscal efforts to stimulate the economy are likely to have a bigger effect in 2010 than in this year.
- The recession will cause inflation to fall to 1%, below the Central Bank's target. In addition lower commodity prices will act as a disinflationary force. Accordingly, the Central Bank is likely to cut rates to a record low of 1% by the end of the year.

Chart 1: GDP (% y/y)

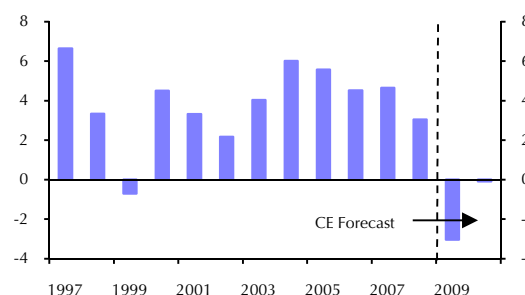


Chart 2: Copper Prices & Exports (% y/y)

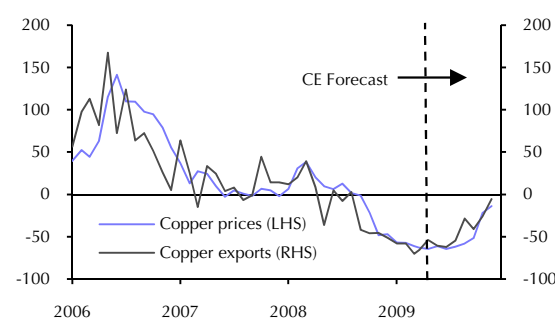


Chart 3: Central Government Budget Balance (% GDP)

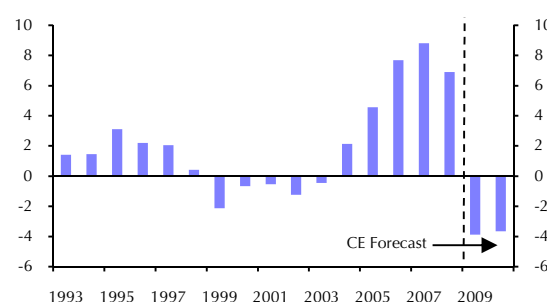


TABLE 1: KEY FORECASTS

	%y/y unless stated				
	2006	2007	2008	2009	2010
Private cons'ptn	7.1	6.9	4.3	-2.5	0.0
Total fixed invest.	2.3	12.0	19.5	-9.0	-3.5
GDP	4.5	4.7	3.0	-3.0	0.0
Unemp. rate (%)	8.0	7.0	7.7	11.0	9.5
CPI inflation ⁽¹⁾	3.4	4.4	8.7	1.0	1.5
Cent'l gov't bal ⁽²⁾	7.7	8.8	6.9	-4.0	-3.5
Cent'l gov't debt ⁽²⁾	5.3	4.9	4.5	4.5	4.5
Current account ⁽²⁾	4.7	4.4	0.4	-6.0	-6.5

Source – Thomson Datastream. (1) Year average (2) as % of GDP

Peru

Recession in 2009 despite previous strength

- After having achieved investment grade in 2008, on the back of sound macroeconomic policies and strong economic growth, Peru's GDP is on track to contract by 3% this year and by a further 1% in 2010.
- Like most of its peers, Peru will be hit by a combination of external shocks. Indeed, the world recession is set to cause exports *volumes* to shrink by 5% this year, while the collapse of commodity prices could cause export *revenues* to shrink by nearly 50%. (See Chart 1.)
- But the stronger impact on the economy will be felt through a massive contraction in investment, which accounts for nearly one quarter of GDP. A combination of deteriorated terms of trade, lower risk appetite and tight credit conditions will cause investment to drop sharply. While last year investment grew by 28%, we expect it to contract by 8% in 2009. (See Chart 2.) Industrial output is likely to shrink by 8%, while the unemployment rate looks set to increase to 15%.
- The government will respond to the crisis by increasing expenditure and turning the 2.3% of GDP fiscal surplus of 2008 into a deficit of around 3% of GDP by the end 2009. (See Chart 3.) This should cushion the blow to some degree.
- As the economy heads for recession, inflation is likely to ease. Although there is a small risk that a depreciation of the sol against the dollar may cause inflation to creep up, we believe disinflationary forces (lower energy prices and weak demand) are likely to dominate. Accordingly, we believe the Central Bank will slash interest rates to a record low of 2%.

Chart 1: Exports (% y/y)

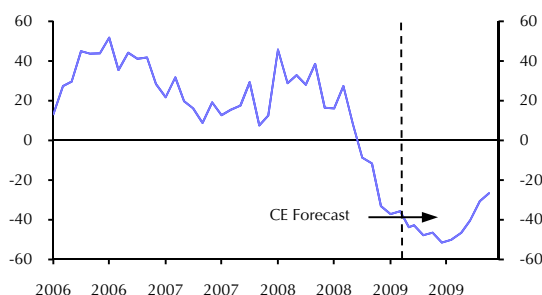


Chart 2: Investment (% y/y)

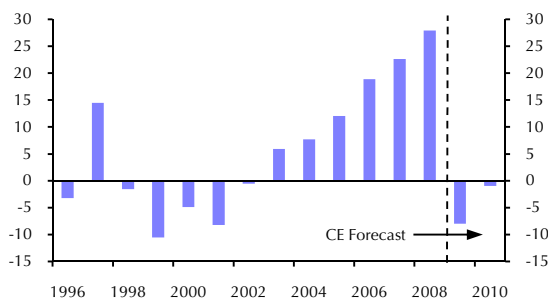


Chart 3: Central Government Budget Balance (% GDP)

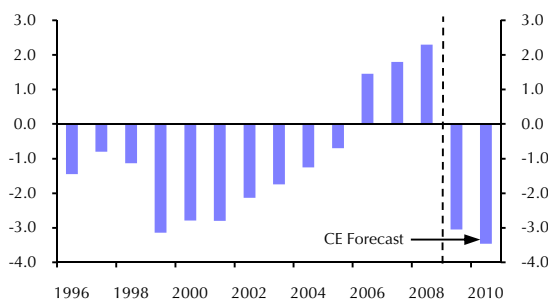


TABLE 1: KEY FORECASTS

%y/y unless stated

	2006	2007	2008	2009	2010
Private cons'ptn	6.4	8.3	8.8	-1.0	-1.5
Total fixed invest.	18.9	22.6	27.9	-8.0	-1.0
GDP	7.7	8.9	9.8	-3.0	-1.0
Unemp. rate (%)	8.5	8.4	8.4	15.0	14.5
CPI inflation ⁽¹⁾	2.0	1.8	5.1	2.0	2.0
Cent'l gov't bal ⁽²⁾	1.5	1.8	2.3	-3.0	-3.5
Cent'l gov't debt ⁽²⁾	23.0	19.0	14.2	17.5	21.0
Current account ⁽²⁾	3.0	1.4	0.6	1.0	0.0

Source – Thomson Datastream. (1) Year average (2) as % of GDP

Ecuador

Hardest hit in the region

- Ecuador will be hit the hardest in the region by the collapse of commodity prices given the country's dependency on oil exports. What's more, the dollarization of Ecuador's economy will exacerbate the fall in economic activity. We believe GDP is on track to shrink by 10% this year and by a further 5% in 2010. (See Chart 1.)
- Like in Venezuela, the collapse of oil prices should cause Ecuador's oil revenues to shrink by at least 30% this year. In turn, this will have a devastating knock on effect on the economy as a whole - the oil industry accounts for 25% of GDP. Lower oil prices will not only hit foreign exchange revenues, but also the fiscal position because taxes on oil exports total 40% of government earnings. To make matters worse, weak global demand will hit export volumes, which could contract by around 6% this year.
- But Ecuador's problems do not end there. As the economy is dollarized, the collapse in foreign exchange revenues is likely to cause monetary aggregates to contract by 10% y/y this year. (See Chart 2.)
- Unlike Chile or Peru, Ecuador failed to make any savings during the commodity price boom. Thus, the Ecuadorian government is now unable to loosen fiscal policy in response to the impending recession, as others have across the world. More worryingly, foreign exchange reserves are just a fraction of the country's total external debt. (See Chart 3.)
- This prompted the government to default on the interest payments on the external debt that were due in December and April, hoping that this measure will enable them to keep expenditure high and a steady flow of dollars in the economy. But, despite desperate efforts, recession is unavoidable. What's more, the risk of de-dollarization has increased substantially.

Chart 1: GDP (% y/y)

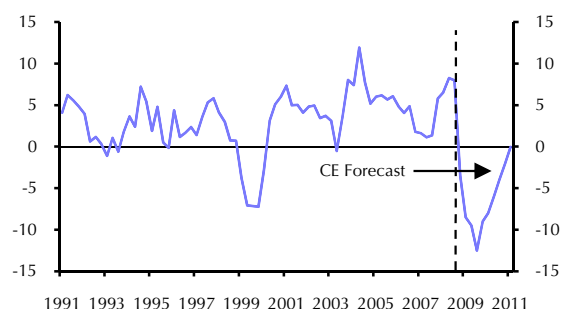


Chart 2: M1 & Oil Prices (% y/y)

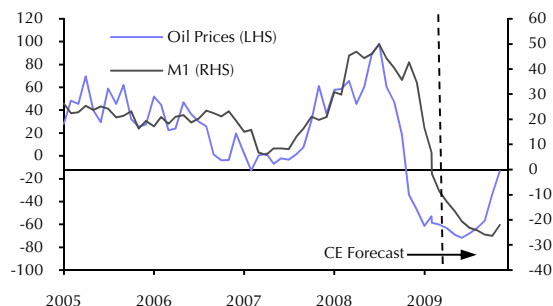


Chart 3: Foreign Exchange Reserves (% Total External Debt)

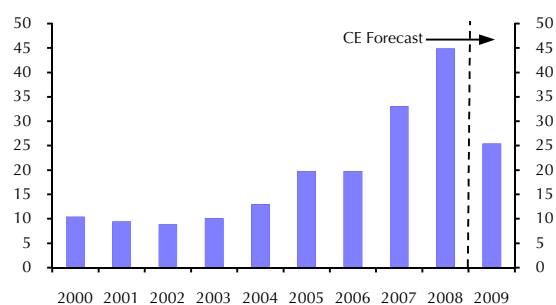


TABLE 1: KEY FORECASTS

	%y/y unless stated				
	2006	2007	2008	2009	2010
Private cons'ptn	5.5	3.5	6.9	-7.0	-4.5
Total fixed invest.	3.8	2.5	18.4	-15.0	-3.5
GDP	3.9	2.5	4.8	-10.0	-5.0
Unemp. rate (%)	10.1	0.0	8.0	12.5	14.0
CPI inflation ⁽¹⁾	3.3	2.3	8.4	3.0	2.5
Cent'l gov't bal ⁽²⁾	0.8	-0.8	-1.6	-4.5	-2.5
Cent'l gov't debt ⁽²⁾	24.5	23.2	22.1	28.0	32.0
Current account ⁽²⁾	3.9	3.5	2.5	-2.0	-3.5

Source - Thomson Datastream. (1) Year average (2) as % of GDP

Uruguay, Bolivia, Paraguay

Hit by the fall out from Argentina and Brazil

- Uruguay's economy is likely to contract by 3% year as a result of the global recession. For a start, the rise in risk aversion will cause investment, one of the main drivers of GDP growth in the past, to fall sharply. In addition, the collapse of demand in Argentina, which is one of Uruguay's main trading partner, will have a negative effect on the Uruguayan tourist industry and exports. Finally, Uruguay is dangerously exposed to exchange rate depreciation and contagion from an Argentine default because Uruguay's financial system is heavily dollarized (about 75% of deposits and loans are in dollars). External debt is about 40% of GDP, with public external debt accounting for nearly 90% of it.
- Bolivia's economy is on track to contract by 5.5% this year on the back of the fall in exports and the collapse of commodity prices. Gas and oil exports – a key source of national income – are set to contract sharply this year like in Venezuela and Ecuador. In addition, the ongoing risk of nationalisation of key industries, plus, political instability and the lingering threat that the energy-rich region of Santa Cruz could declare independence will deter investment.
- Paraguay's economy, one of the smallest and weakest of the region, will be hit on two fronts. First, Paraguay is one of the world's largest producers of soybeans and despite the rally this year, prices remain well below 2008 levels. Second, Paraguay depends heavily on trade with Brazil. Thus the deterioration of Brazilian domestic demand will have a negative effect on Paraguay's export volumes. Accordingly, we expect Paraguayan GDP to shrink by 4.5% this year and 2% in 2010.

Chart 1: GDP (% y/y)

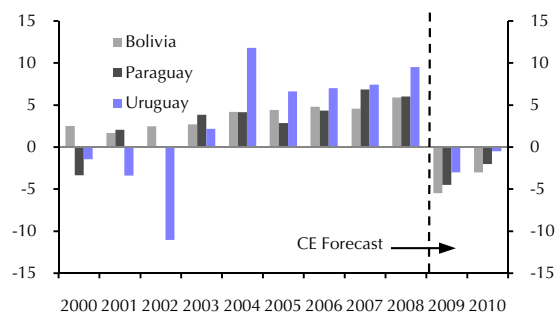


Chart 2: Public External Debt (% GDP)

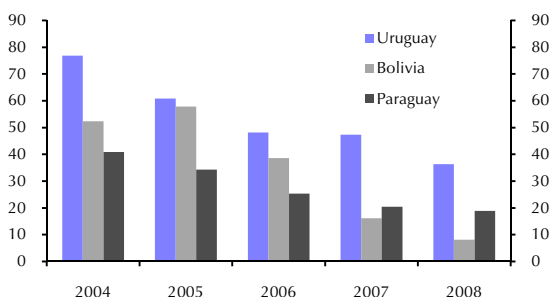


Chart 3: Inflation (% y/y)

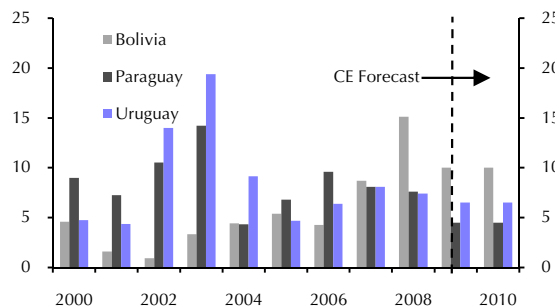


TABLE 1: KEY FORECASTS

	%y/y unless stated				
	2006	2007	2008	2009	2010
Uruguay					
GDP	6.9	7.4	9.5	-3.0	-0.5
CPI inflation ⁽¹⁾	6.4	8.1	7.4	6.5	6.5
Bolivia					
GDP	4.8	4.6	5.9	-5.5	-3.0
CPI inflation ⁽¹⁾	4.2	8.7	15.1	10.0	10.0
Paraguay					
GDP	4.3	6.8	6.0	-4.5	-2.0
CPI inflation ⁽¹⁾	9.5	8.1	7.6	4.5	4.5

Source – Thomson Datastream. (1) Year average

Costa Rica, Panama, Cuba

US recession, the canal and reforms

- Like Mexico and Colombia, Costa Rica (as well as most economies in Central America) will be hit badly by the collapse of commodity prices and the recession in the US, its main export destination and source of foreign direct investment. In addition, the rise in US unemployment will cause remittances from expats to fall. Accordingly, household income looks set to shrink. The combination of these elements is likely to contract GDP by 4.5% this and 2.5% in 2010.
- Despite strong performance in recent years, Panama's GDP will stagnate in 2009. The only element preventing Panama's economy from sinking into a deep recession is the expansion of the Panama Canal, which is expected to boost investment by around \$5bn (25% GDP) between 2007 and 2013. That said, the Colon free trade zone, an important commercial centre and source of employment in Panama, has been hit by the collapse of trade flows across the world.
- The recession in Cuba, which began after two hurricanes hit the Caribbean island in August 2008, will be exacerbated by the recession in Europe, the main source of tourists to the island. In addition, the rise in risk aversion will halt investment in the tourist and energy industries, which mainly came from Spain and Canada. Although the changes announced recently by the Obama administration regarding remittances from expats to their relatives in Cuba are welcome, the funds that could be sent from the US are unlikely to offset the fall in tourism. The official data are unlikely to reveal the true depth of the Cuban crisis. But we believe that GDP is set to contract by 10% to 15%.

Chart 1: GDP (% y/y)

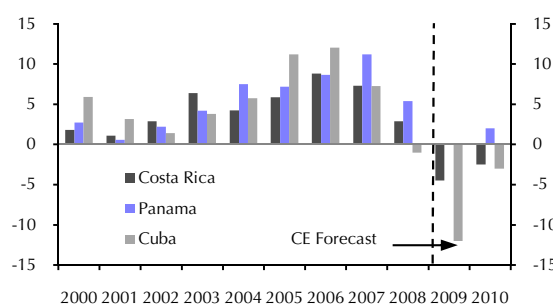


Chart 2: Inflation (% y/y)

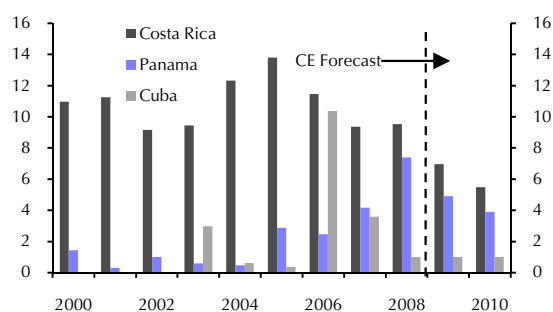


Chart 3: Real Export Growth (% y/y)

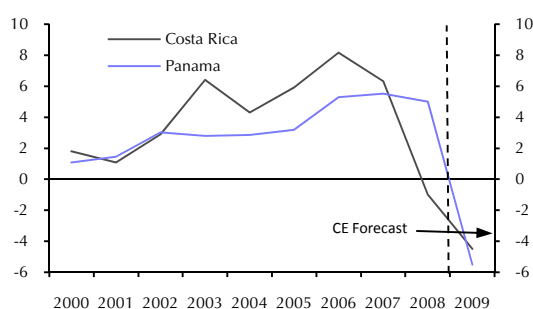


TABLE 1: KEY FORECASTS

%y/y unless stated

	2006	2007	2008	2009	2010
Costa Rica					
GDP	8.7	6.8	5.0	-4.5	-2.5
CPI inflation ⁽¹⁾	11.5	9.4	9.5	4.0	4.0
Panama					
GDP	8.7	11.3	8.3	0.0	2.0
CPI inflation ⁽¹⁾	2.4	4.2	7.4	3.5	4.0
Cuba					
GDP	12.0	7.2	-1.0	-12.0	-3.0
CPI inflation ⁽¹⁾	10.3	3.5	1.0	1.0	1.0

Source – Thomson Datastream. (1) Year average

Financial Markets

High risk of devaluation in Argentina and Venezuela

- Most Latin American currencies appreciated against the dollar during March on the back of the rise in risk appetite witnessed both in emerging and developed economies. Nevertheless, the currencies in the region remain well below levels observed last year. (See Chart 1.) What's more, this new-found strength could soon fade if global risk appetite falters in the coming months.
- The sell-off is likely to vary depending on the prospects of economic recovery in 2010. As we believe Brazil and Chile should be the first in the region to make a comeback next year, the Brazilian real and the Chilean peso could depreciate less against the dollar this year than some of the other currencies in the region. (See Chart 2.)
- By contrast, the situation could be particularly critical for the Argentine peso and Venezuelan bolivar fuerte given their relatively weak fundamentals. Unlike other countries in the region, Argentina and Venezuela do not have a floating exchange rate regime. (The former operates under a managed regime, while the latter is fixed). Thus, the contraction of these economies and the rise in risk aversion (exacerbated by policy concerns) is likely to cause a massive devaluation of the two currencies this year. This would, of course, put upward pressure on inflation, which is already higher there than elsewhere in the region.
- Like the currencies in the biggest countries in Latin America, bond spreads and the main equity markets in the region have staged a partial recovery. (See Chart 3 & 4.) However, they are likely to fall sharply once more as concerns about the region's economic outlook rise again.

Chart 1: Appreciation/depreciation rate against the dollar (%)

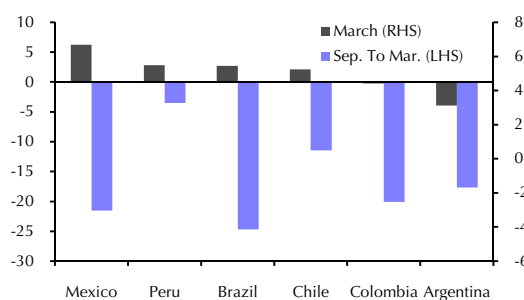


Chart 2: Brazilian real, Mexican & Chilean peso (Jan. 2000=100)

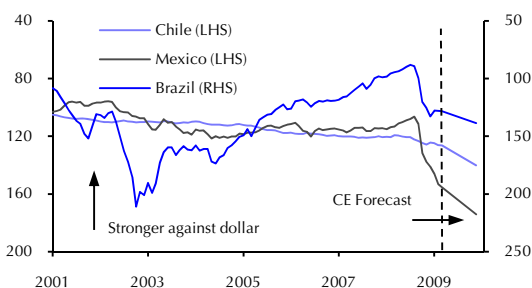


Chart 3: EMBI Global & EMBI Latin America Bond Spreads (bps over USTs)

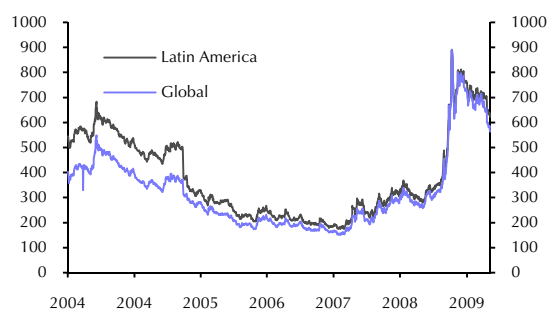
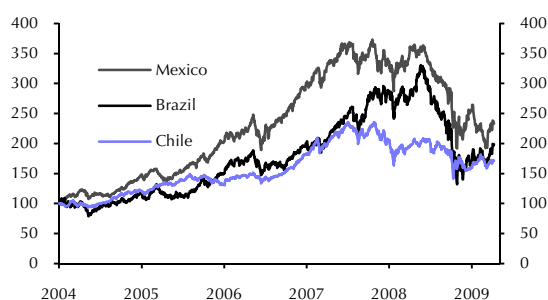


Chart 4: Equity Market Indices (Jan. 2004=100)



Source – Thomson Datastream, Bloomberg

Market Forecasts

Country	Currency versus \$				Equity Markets **				Policy Interest Rates			
	End-08	Current*	End-09	End-10	End-08	Current*	End-09	End-10	End-08	Current*	End-09	End-10
Brazil	1.8	2.2	2.5	2.7	34740	44430	30000	34000	13.75%	11.25%	8.00%	10.00%
Mexico	13.5	13.3	16.5	17.0	19533	21587	16700	19100	8.25%	6.00%	5.50%	6.00%
Argentina	3.1	3.68	5.5	6.5	925	1193	800	900	N/A	N/A	N/A	N/A
Venezuela	2.15	2.15	4.0	4.0	207	228	180	200	N/A	N/A	N/A	N/A
Colombia	1946	2343	2700	3000	7174	8158	6100	7000	9.50%	7.00%	4.00%	4.50%
Chile	629	581	700	750	2334	2543	2000	2300	8.25%	2.25%	1.00%	1.50%
Peru	3.14	3.15	4.0	4.5	11601	15909	10000	11300	6.50%	5.00%	2.00%	2.50%
Ecuador	N/A	N/A	N/A	N/A	10350	949	900	1000	N/A	N/A	N/A	N/A
US	N/A	N/A	N/A	N/A	828	832	700	800	0.25%	0.25%	0.25%	0.25%

* Current as of 20th April.

**BOVESPA index in Brazil, IPC Index in Mexico, MERVAL in Argentina, DS Market Index in Venezuela, BVC Index in Colombia, IPSA Index in Chile, ISBL Index in Peru, BVQ Index in Ecuador and S&P 500 Index in US. Equity market forecast largely based on performance of US S&P500.

Long-term Growth Prospects

Country (ranked by forecast GDP Growth to 2010)	Real GDP Growth* (next five yrs.)	Real GDP Growth* (next fifteen yrs.)	GDP Per Capita as a % of US	Comments
1. Brazil	2.0%	5.0%	15.1%	Strengthening of trade links with Europe could boost mid-term growth.
2. Chile	2.5%	4.0%	21.5%	Diversification of export portfolio is needed to reduce exposure to commodity shocks.
3. Peru	2.5%	4.0%	8.4%	Further development of industry and new trade links with Asia and Europe are important to strengthen external sector.
4. Mexico	2.0%	4.0%	21.0%	Diversification of export destination is key to reduce vulnerability to downturns in US
5. Colombia	1.5%	4.0%	9.8%	Deep institutional reforms are needed to reduce chronic fiscal deficits.
6. Argentina	2.0%	3.0%	14.3%	A massive monetary and fiscal reform is needed to secure long term growth.
7. Venezuela	1.0%	3.0%	18.0%	Reforms to reduce dependency on oil revenues will need to be adopted but this is unlikely to take place under current regime.
8. Ecuador	0.5%	3.0%	7.4%	Dollarization and dependency on commodity exports implies vulnerability to external shocks will remain high.

*Annual average.