LATIN AMERICA CHART BOOK

29th Apr. 2009

CAPITAL ECONOMICS

Industrial production and exports continue to fall

- **Latin America** continues to slide into recession. Although the pace of decline of most economies in the region has eased, talk of recovery is premature. Indeed, exports and industrial production remain significantly below last year's levels. In turn, the fall in economic activity has caused inflation to drop. Accordingly monetary authorities across the region continue to cut interest rates. Finally, the recent rise in global risk appetite, which we believe is likely to be short-lived, caused most local currencies to appreciate against the dollar during March and April. But in Mexico the peso fell sharply after the outbreak of the swine flu.

- The slight improvements witnessed in **Brazil**'s economy in recent weeks were caused by the rise in global risk appetite. However, the rebound in markets seems unlikely to last. Consequently, we expect Brazil's outlook to deteriorate further during the rest of the year. (Page 2.)

- The ongoing contraction of **Mexico**'s exports to the US keeps hitting industrial output. In addition, the outbreak of the swine flu is likely to exacerbate the fall in Mexico's service sectors. (Page 3.)

- Despite a modest recovery in **Argentina**'s economic performance during March, the country's GDP is likely to suffer significantly on the back of falling agricultural output. (Page 4.)

- **Venezuela**'s oil exports and industrial production continue to contract. The collapse of government revenues, triggered by the drop in oil prices, has forced the government to cut expenditure and increase taxes to avoid running a massive fiscal deficit. (Page 5.)

- **Colombia** continues to be hit by the recession in the US and the slowdown in Venezuela, its main trading partners. The drop in economic activity is likely to push inflation down. Accordingly, further interest rates cuts are expected. (Page 6.)

- Despite of the recent rise in copper prices, **Chile**'s exports are in free-fall. The drop in economic activity has lowered inflation. The monetary authorities cut rates by 50bps in March. (Page 7.)

- **Peru**'s GDP shrank by 1.4% m/m in February signalling that the country is heading for recession. The Peruvian Central Bank has responded by cutting interest rates aggressively. (Page 8.)

- Since **Ecuador**'s economy is dollarized, the contraction of foreign exchange revenues is causing money supply to shrink further. This could exacerbate the fall in economic activity. The government has offered to buyback $3bn of external debt after defaulting on the interest payments. However, it is uncertain if investors are willing to accept Ecuador's terms (Page 9.)

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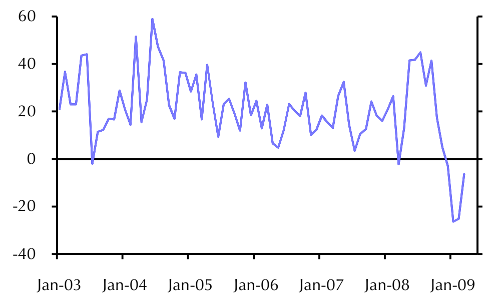
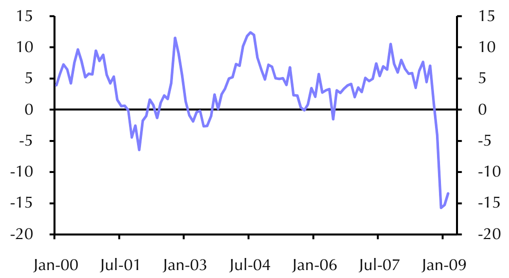
Brazil

- The pace of decline in the Brazilian economy has shown signs of easing. But talk of recovery is premature. Admittedly, the pace of contraction of exports eased from -25% in February to -6.4% last month **(1)**. Accordingly, industrial production rebounded by 1.8% m/m in February, causing the annual rate of decline to rise to -13.5% from a low of -15.3% in January **(2)**.
- This rebound was mainly driven by car production, which shrank by a more modest 8% y/y in February after having contracted by 65% y/y in December **(3)**. But the pace of decline of other key sectors, such as mining and basic metallurgy, continued to accelerate. Meanwhile, unemployment rose to 9% in March (**4**). Given this context, we are sticking to our forecast for GDP to contract by 2% this year.
- Equities have rallied by 15% since early March and the real has appreciated by 3% against the dollar. However, the rebound in markets could prove to be short-lived if the recovery in the global recovery and risk appetite runs out of steam. A renewed sell-off in the real would raise fears of a pick-up in inflation, which dropped to 5.6% in March (**5**). But as large amounts of spare capacity open up, we expect inflation to fall further this year. The monetary authorities cut interest rates to 11.25% in March (**6**). We think rates could hit 8% by the end of the year.

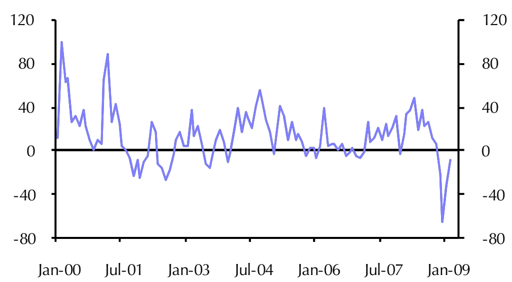
1. Exports (% y/y)



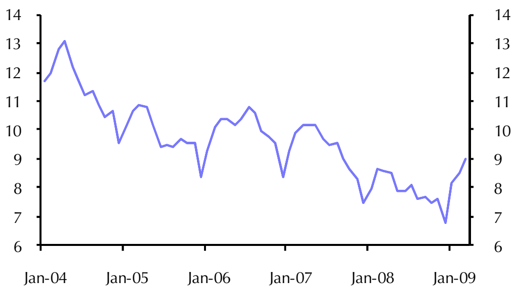
2. Industrial Production (% y/y)



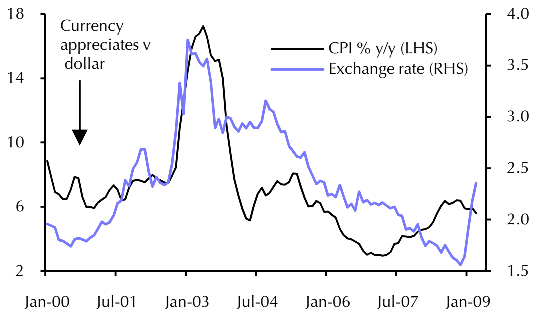
3. Car Production (% y/y)



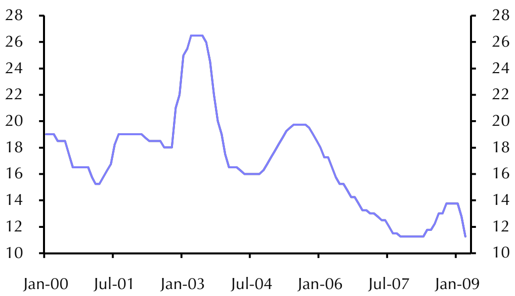
4. Unemployment (%)



5. Exchange Rate (vs. dollar) & Consumer Prices



6. Policy Interest Rate (%)

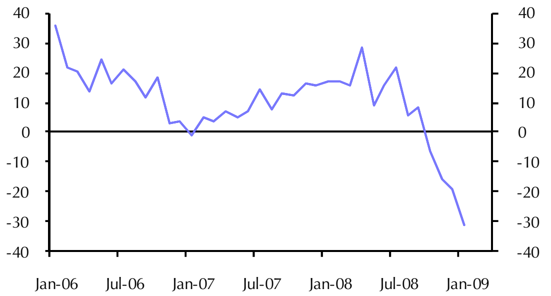


Sources – Thomson Datastream, Bloomberg

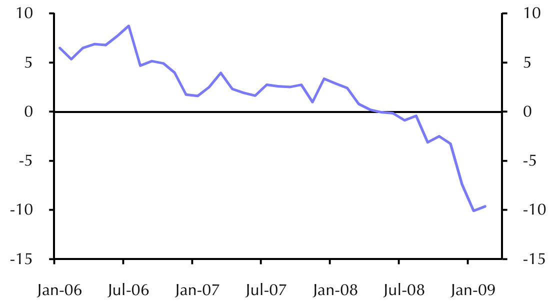
Mexico

- The outlook for the Mexican economy remains bleak. Exports shrank by 30% y/y during January and manufacturing output contracted by around 10% y/y during this year (**1 & 2**). Admittedly, the pace of decline of industrial production has eased due to a sharp increase in oil refinery, which grew by 11% m/m in February (**3**). But these should not be viewed as signs of recovery as consumer confidence and US demand continue to fall (**4**).
- The outbreak of swine flu has marginally hit the real economy. While some services (mainly entertainment, public sector and tourism) have partially shut down, the damage to the economy should be small and short-lived provided the disease is brought quickly under control and advice against travel to the country is withdrawn.
- The rise in risk appetite during March has caused the Mexican equity markets to rally by 26%. Meanwhile the peso has appreciated against the dollar by 12% (**5**). Nevertheless, both Mexico's stock market and the peso fell as reports of the swine flu spread across the world. While the depreciation of the currency could act as an inflationary force, the fall in economic activity would offset a rise in inflation. Accordingly, the monetary authorities cut interest rates by 75bps to 6% in April (**6**). We expect rates to fall to record low of 4% this year.

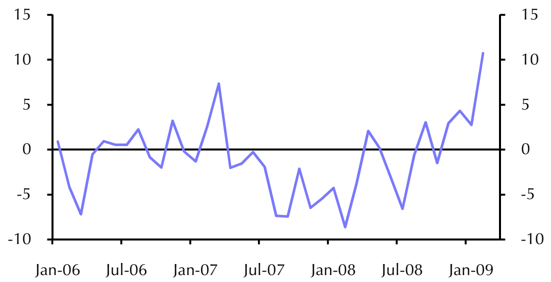
1. Nominal Exports (% y/y)



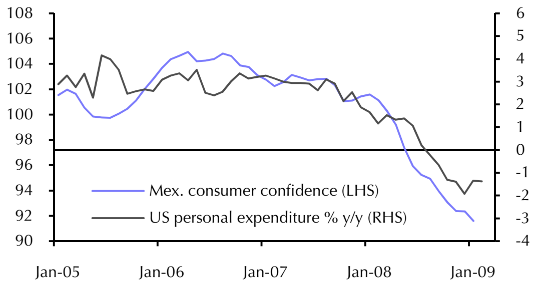
2. Industrial Production (% y/y)



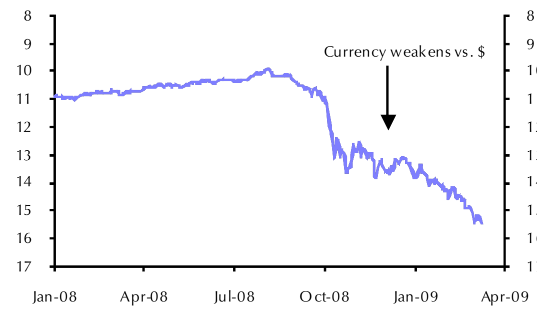
3. Oil Refinery Output (% y/y)



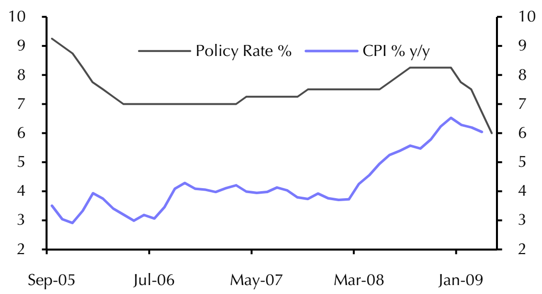
4. Mexican Consumer Confidence & US Real Personal Expenditure



5. Exchange Rate (vs. US$)



6. Interest Rate & Consumer Prices

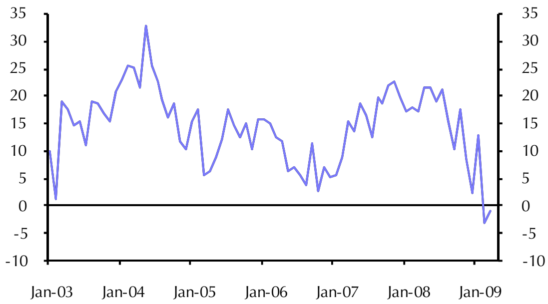


Sources – Thomson Datastream, Bloomberg.

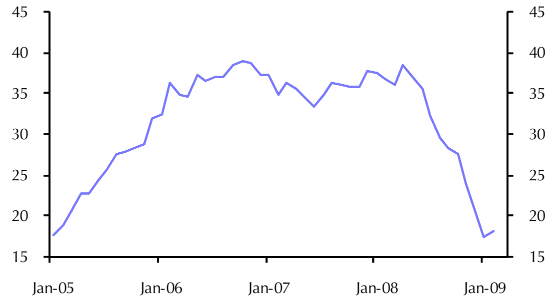
Argentina

- While the Argentine economic outlook continues to deteriorate, it has showed signs of slowing down – at least for the moment. For a start, retail sales expanded by 5.8 % m/m in February, causing the annual rate to rise from –3% in January to -1% in February (**1**). In addition, total credit grew by 1% m/m in February, which means that the annual growth rate rebounded to 19% **(2)**. A similar pattern has been witnessed for industrial production, according to both official and independent sources **(3)**.
- The outlook for the agricultural sector is worrying. Although hopes of a global recovery caused corn and soybean prices to rise by 10% and 20% respectively since early March, commodity prices remain well below last year's levels (**4**). To make matters worse, unofficial estimates indicate crops were badly hit by this year's drought and production is expected to shrink by around 20% (**5**).
- Finally, while the recovery in risk appetite caused a rally in financial markets worldwide, the Argentine peso continued to fall against the dollar during in March. Since late February the peso has depreciated by 3.5% **(6)**.

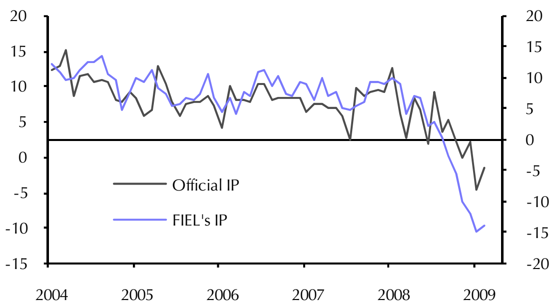
1. Retail Sales (SA,% y/y)



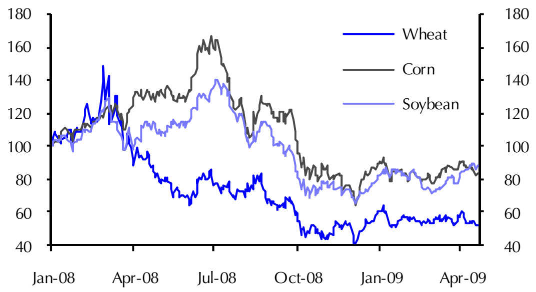
2. Total Credit (% y/y)



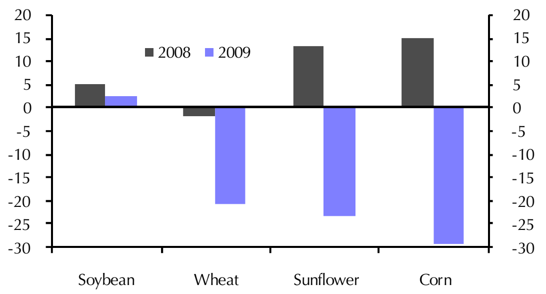
3. Industrial Production (% y/y)



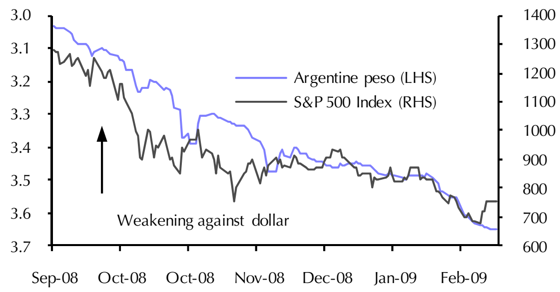
4. Soybean, Corn & Wheat Price Index(Jan 2008=100)



5. Harvest Area (Mil. Hectares, % y/y)



6. Exchange Rate(vs. dollar) & S&P 500 index (Latest =23rd April)

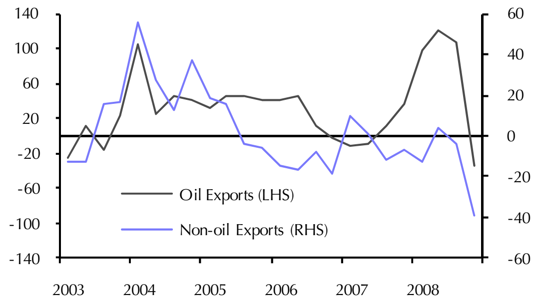


Sources – Thomson Datastream, Bloomberg

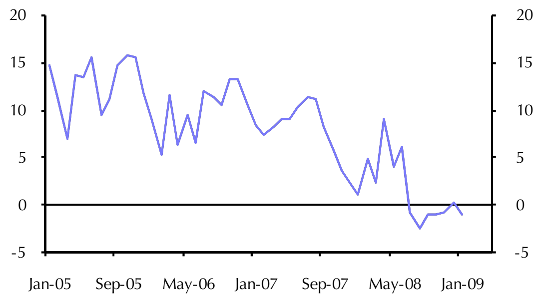
Venezuela

- Timely data from Venezuela is scarce. The latest export figures show that export revenues shrank by 45% y/y during Q4 last year. Oil exports, which account for 90% of total exports, contracted by 33%, while non-oil exports shrank by 40% y/y in the last quarter of 2008 (**1**). The ongoing deterioration of external conditions has contributed to industrial production contracting by 1.2% y/y during January (**2**).
- Similarly, domestic demand continues to fall. Total imports shrank by 13% y/y during February (**3**). Admittedly, car sales bounced in March after the government decided to lift the ban on vehicle imports from Colombia, which was set last year amid a political row between the two countries. But the bigger picture is that car sales remain more than 20% below last year's levels (**4**). In addition, credit in Venezuela continues to fall. In Q1 the growth rate of private domestic credit fell to 23% y/y, from 25% y/y in the last quarter of 2008 **(5)**
- While the slowdown in economic activity has already lowered inflation, it remains stubbornly high at around 30% with food prices growing by 40% y/y in March **(6)**. Finally, the collapse of oil revenues has forced President Chavez to increase taxes and reduce expenditure in order to avoid running a massive fiscal deficit at a time when governments elsewhere are loosening the purse strings.

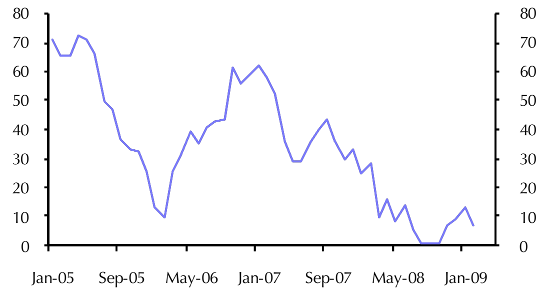
1. Nominal Exports (% y/y)



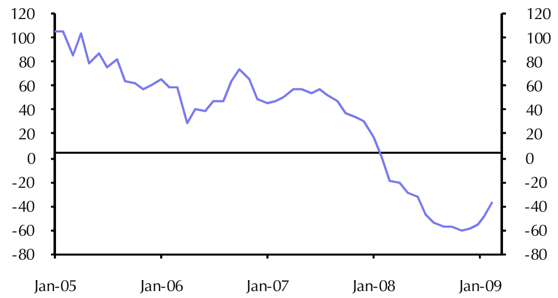
2. Industrial Production (% y/y)



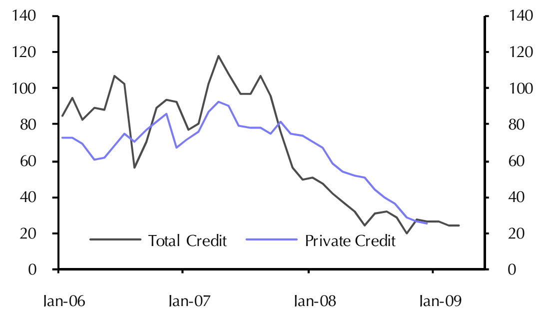
3. Nominal Imports (3m. Avg. % y/y)



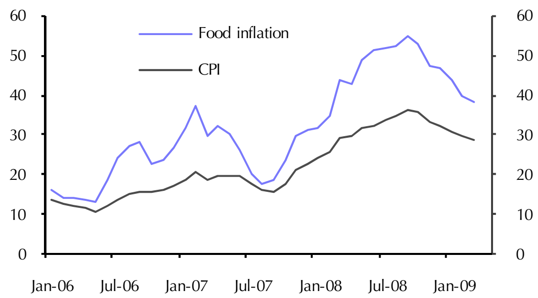
4. Car Sales (3m. Avg. % y/y)



5. Domestic Credit (% y/y)



6. Consumer Prices (% y/y)

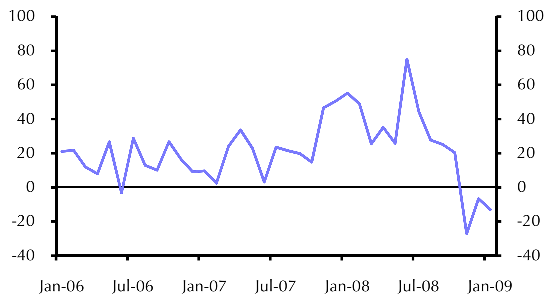


Sources – Thomson Datastream, Bloomberg

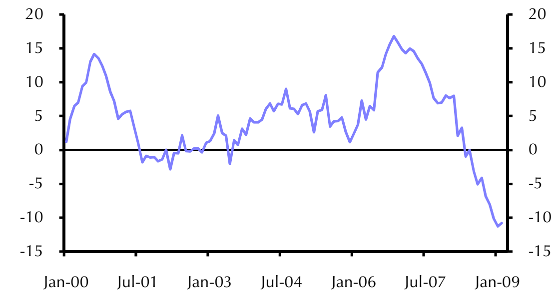
Colombia

- Colombia's economy continues to be hit by external factors. The deterioration of demand in the US and Venezuela, Colombia's main trading partners, caused exports to contract by 13% y/y in January **(1)**. As 50% of Colombian exports are non-commodities, the collapse of external trade has contributed significantly to worsen the outlook for industrial production. In January manufacturing output shrank by 12% y/y (**2**).
- The slump in both, global demand and Colombia's industrial sector, has begun to affect private consumption. Indeed, retail sales shrank by 2.3% in February **(3)**. Admittedly, the unemployment rate fell to 12.5% in February but this is due to seasonal patterns **(4)**. We expect unemployment to reach 20% this year.
- Like elsewhere in the region, the rise in risk appetite observed in recent weeks caused the peso to appreciate by around 10% against the dollar since early March (**5**). However, we believe this new-found strength is unlikely to last. Although a sell-off of the peso could push inflation upwards, the drop in economic activity is likely to keep inflation falling in line with the monetary authorities' target of 5% (**6**). Accordingly, the Central Bank, which cut rates by 100bps in March to 6%, is expected to maintain a dovish stance during the year.

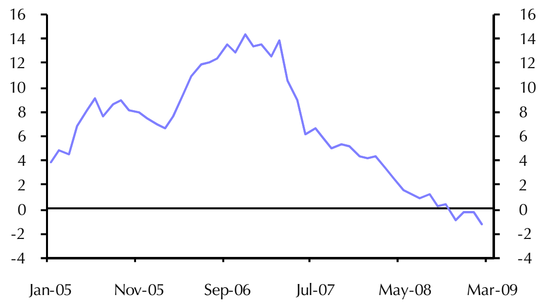
1. Exports (% y/y)



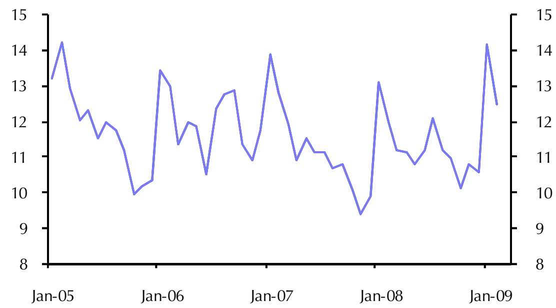
2. Industrial Production (3m. Avg. % y/y)



3. Retail Sales 3m. Avg. (% y/y)

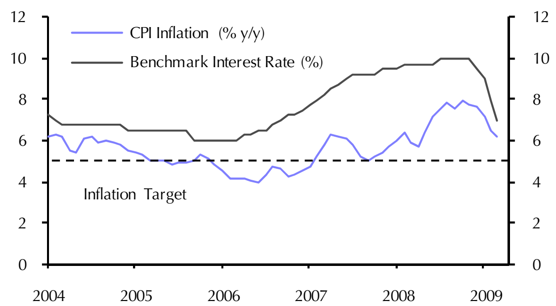


4. Unemployment Rate (Non SA,%)



5. Exchange Rate (vs. dollar)

6. Consumer Prices & Interest Rates

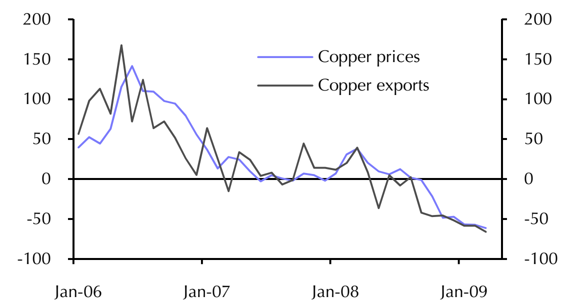


Sources – Thomson Datastream, Bloomberg

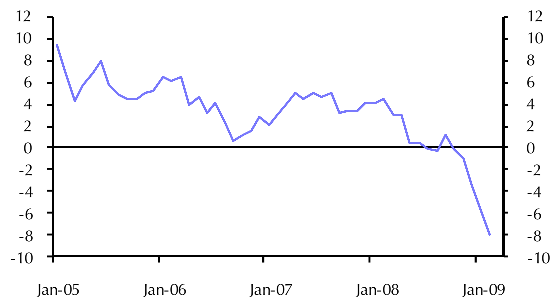
Chile

- Chile's economic prospects remain gloomy. Despite the rise in copper prices, which increased by 33% during March, Chilean copper exports contracted by 66% y/y last month **(1)**. This is because copper prices remain well below last year's levels. In addition, demand for Chilean exports continues to fall. Indeed, merchandise exports shrank by 45% y/y during March. Of course, this had a negative effect on the manufacturing sector, causing it to contract by 11.5% y/y in February **(2)**. Accordingly, the unemployment rate reached 9.2% in February **(3)**.
- The Chilean authorities eased the pace of public spending during February, given the ongoing deterioration of fiscal revenues **(4)**. Nevertheless, we expect that government expenditure to increase significantly over coming months when the authorities begin to implement their $4bn (2.8% of GDP) fiscal stimulus plan announced earlier this year.
- The observed rise in risk appetite contributed to the strengthening of the peso in recent weeks. Indeed, during March Chile's currency appreciated by 3% against the dollar **(5)**. Although the peso is still below last year's levels, which implies that the currency could still act as an inflationary force, the overall contraction in economic activity has cause inflation to fall to 5% in last month. Accordingly, the Chilean Central Bank (BCC) cut in April interest rates by 50bps down to 1.75% **(6)**.

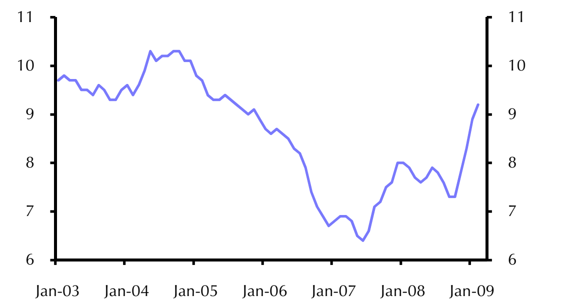
1. Copper Exports & Prices (% y/y)



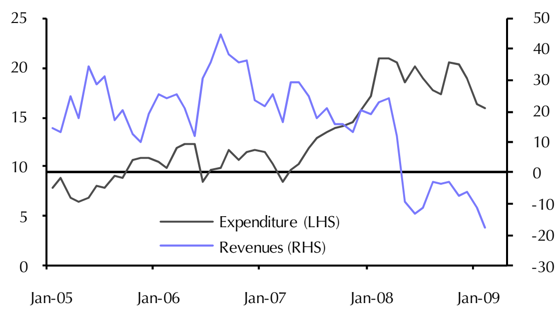
2. Manufacturing Production (3m. Avg. % y/y)



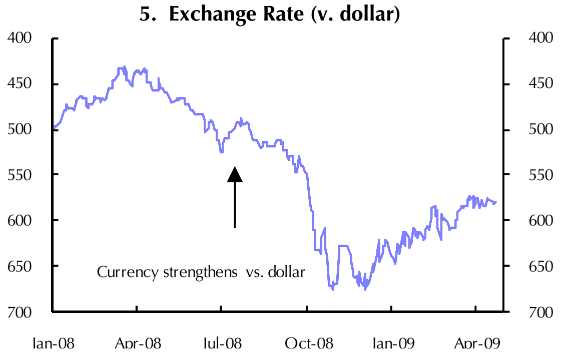
3. Unemployment Rate (%)



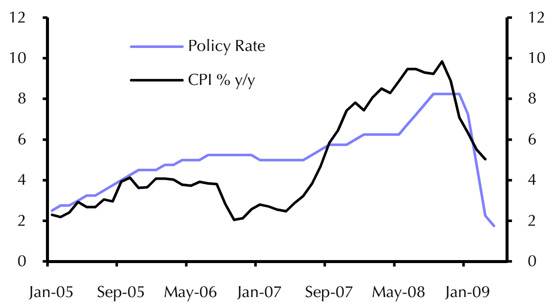
4. Government Expenditure & Revenues (3m. Avg. % y/y)



5. Exchange Rate (v. dollar)



6. Policy Interest Rate & Consumer Price

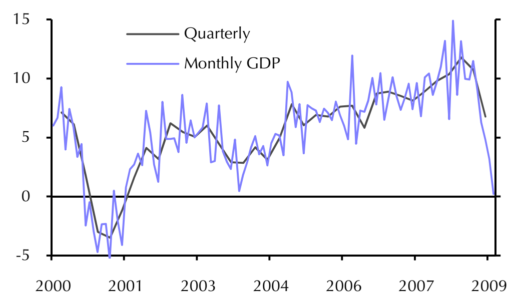


Sources – Thomson Datastream, Bloomberg

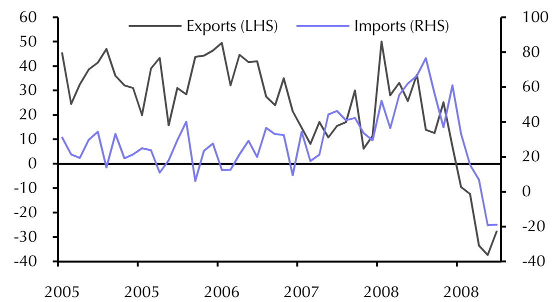
Peru

- Recession in Peru looks inevitable. GDP contracted by 1.4% m/m in February, which means that GDP grew by 0.2% y/y. February's figures contrast with the 6.7% y/y GDP average growth rate witnessed in Q4 of 2008 (**1**). Admittedly, a slight increase in global demand caused Peru's exports to grow by 12% m/m in February. However, in annual terms exports remain significantly below last year's levels (**2**). Accordingly, industrial production shrank by 7.4% y/y in February (**3**). As a consequence, the seasonal adjusted unemployment rate jumped to 9.8% in March **(4)**.
- In March headline inflation fell to 4.8%, from 5.5% observed during the previous month **(5).** This was caused by the overall contraction of the economy and the stabilisation of the supply of key crops, which drove food inflation downwards.
- The recent rise in risk appetite caused the nuevo sol, Peru's currency, to appreciate by 6.5% against the dollar since early March. This should contribute to lower inflation over the coming months. Accordingly, the Peruvian Central Bank cut interest rates by 100 basis points to 5% in early April (**6**). We expect further cuts as rates are likely to reach a record low of 2% this year.

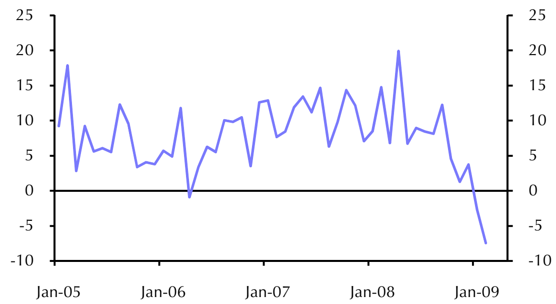
1. GDP (SA,% y/y)



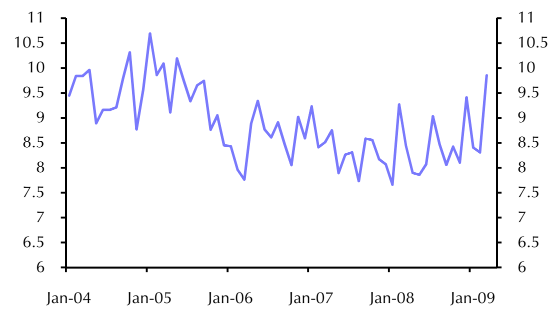
2. Exports & Imports (SA,% y/y)



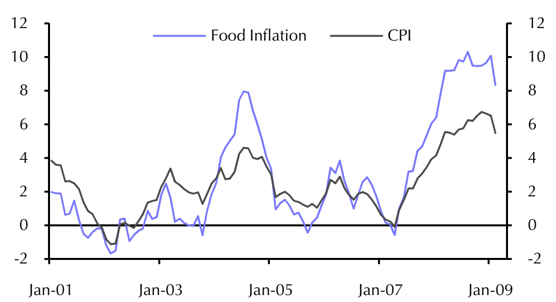
3. Industrial Production (SA, 3m. Avg. % y/y)



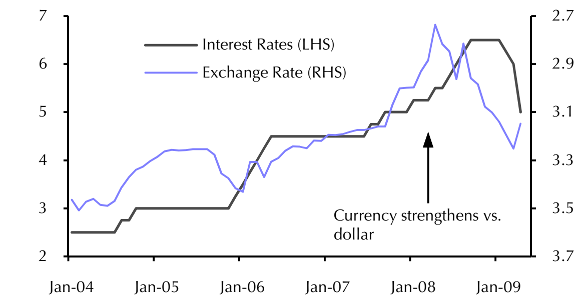
4. Unemployment Rate (SA,%)



5. Consumer Price (% y/y)



6. Interest Rate & Exchange Rate (vs. dollar)

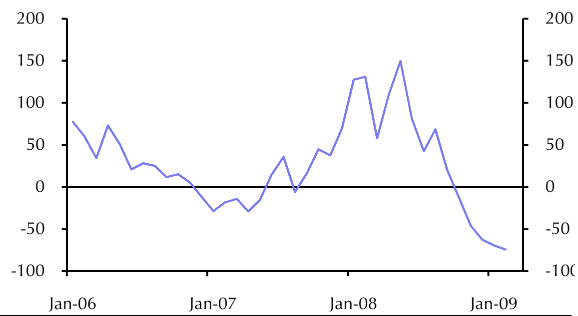


Sources – Thomson Datastream, Bloomberg, IMF, CE

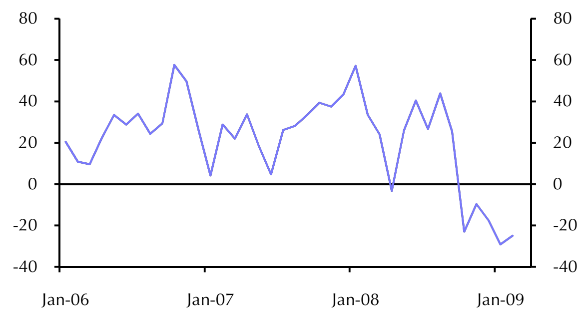
Ecuador

- The situation in Ecuador goes from bad to worse. The value of oil exports shrank by 75% y/y in February **(1)**. Admittedly, there was a small in improvement in merchandise exports during this month on the back of a moderate increase in global demand (**2**). Accordingly, the economic activity index, an indicator of GDP, bounced back in February (**3**). But we believe this small recovery is unlikely to last.
- Crucially, as Ecuador is a dollarized economy, the collapse of foreign exchange revenue is causing monetary aggregates to contract outright (**4**). Also foreign exchange reserves halved since November (**5**). At least inflation is likely to keep falling, as the money supply continues to shrink **(6)**. But the latter would further exacerbate the contraction of the real economy. We think President Correa has no choice but to de-dollarize the economy. The underlying risk is that if the new currency depreciates sharply Ecuador could face again the threat of hyper-inflation and massive defaults in the private sector. The cure would then be worse than the disease.
- Finally, after having defaulted on the interest payments on external debt in December and March, Correa has now offered to buyback $3bn of the principal of the government bonds that expire in 2012 and 2030. Ecuador is offering to pay one third of the bond's face value. The offer ends on 15th May.

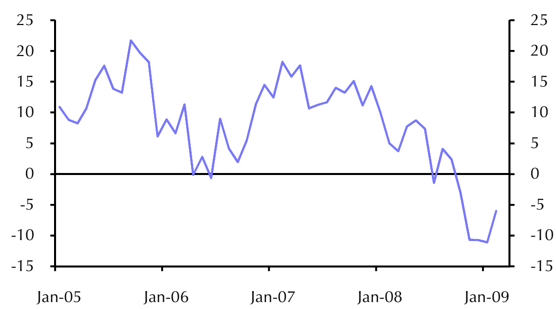
1. Oil Exports (% y/y)



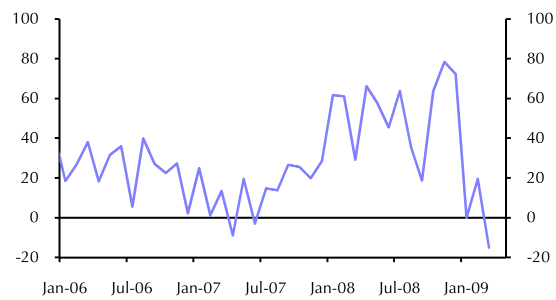
2. Industrial Exports (% y/y)



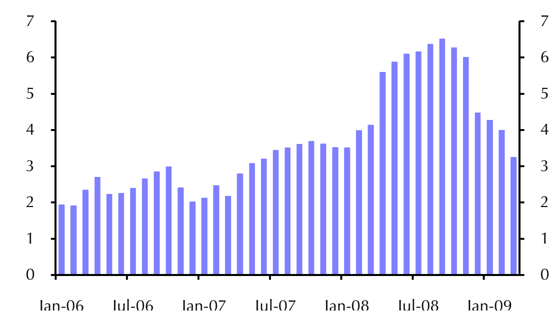
3. Economic Activity Index (SA, 3m. Avg. % y/y)



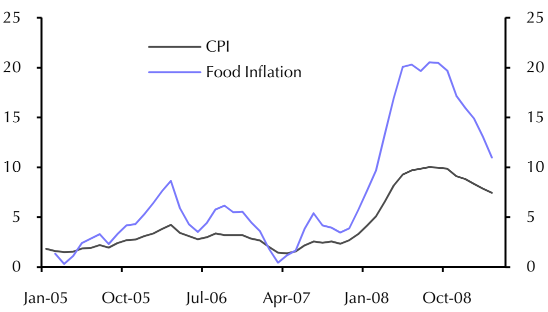
4. M0 (SA, % y/y)



5. Foreign Exchange Reserves ($bn)



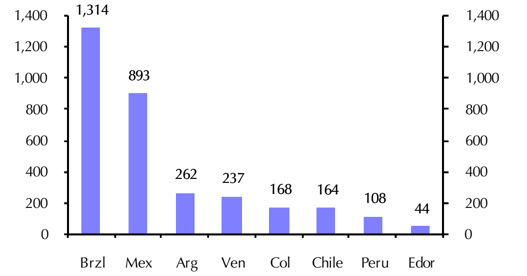
6. Consumer Prices (% y/y)



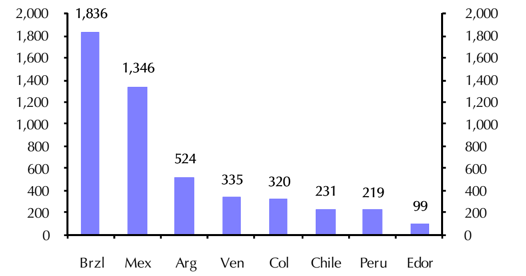
Sources – Thomson Datastream, Bloomberg, Ecuador Central Bank

Background Data

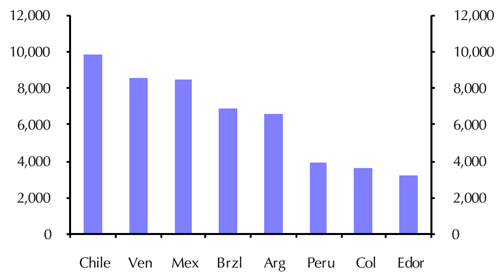
1. Current Price GDP ($bn, 2007, Market Exchange Rates)



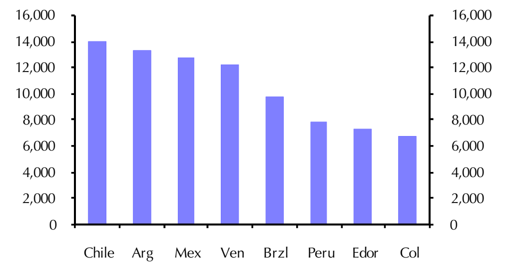
2. Current Price GDP ($bn, 2007, PPP)



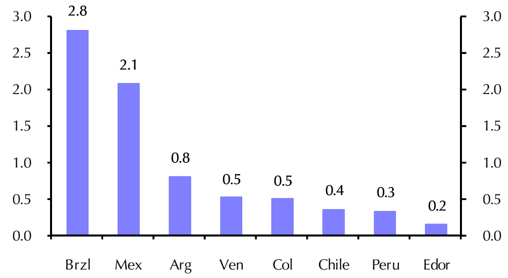
3. GDP Per Capita ($, 2007, Market Exchange Rates)



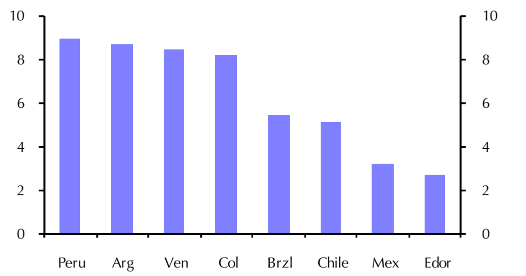
4. GDP Per Capita ($, 2007, PPP)



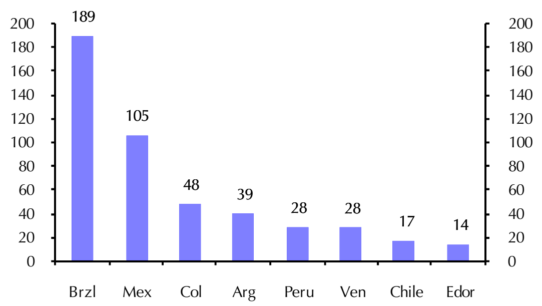
5. Share of World Output (%, 2007, PPP)



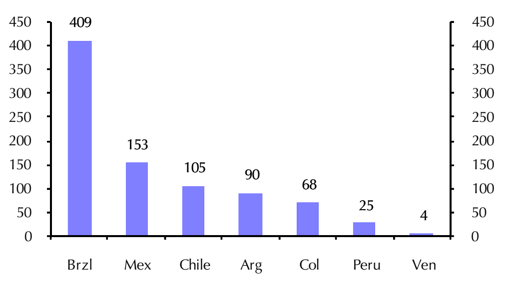
6. Real GDP Growth (% y/y, 2007)



7. Population (Millions)



8. Stock Market Capitalisation ($bn, Jan. '09)



Sources –IMF, Bloomberg, Capital Economics