LATIN AMERICA CHART BOOK

Nov. 2011

CAPITAL ECONOMICS

Better placed, but not immune

- The past month has brought further signs that growth in Latin America has started to slow in response to the deepening crisis in the euro-zone, the turmoil in world markets and weaker demand from China. Admittedly, Mexican growth surprised on the upside in Q3. But this was due in large part to a surprisingly large pick-up in agricultural production, which is unlikely to be sustained. More ominously, growth in Chile – which as the region's most open and most commodity dependent economy is often a bellwether for global demand – slowed to just 2.6% annualised in Q3. Meanwhile, Brazil looks to have expanded by just 0.1% q/q in the third quarter. Looking ahead, while Latin America suffers from few of the debt and deficit concerns plaguing the Western world, it is clear that the region is not immune from the effects of the various crises sweeping through the G7. At best, leading indicators point to much weaker growth in Q4 and in some cases – notably Brazil – it seems that output might contract in q/q terms. The scope for policy stimulus should cushion the slowdown, but we still expect regional growth to ease to a below-consensus 2.5% in 2012, from 4.0% this year.

- **Brazilian** inflation has peaked and, with the economy on track to contract in Q4, the central bank remains in easing mode. Interest rates will be cut by at least another 50bps this month. (Page 2.)

- While the **Mexican** economy has surprised on the upside in recent months, the deteriorating outlook for the global economy means that it is almost inevitable that growth will slow next year. (Page 3.)

- In **Argentina,** the Fernández government has made a flurry of policy announcements after last month's election victory. But the early signs are that the central pillars of the current 'model' – namely unsustainably loose monetary and fiscal policy – will remain intact. (Page 4.)

- **Colombia** has continued to outperform and, with inflation still rising, policymakers hiked interest rates earlier this month. (Page 5.) Meanwhile, the **Venezuelan** government has already begun to pump economic growth ahead of October's presidential elections. But the current measures are unsustainable and the economy remains vulnerable to a drop in oil prices next year. (Page 6.)

- The latest data suggest that the **Peruvian** economy expanded by 1% q/q or so in Q3 – solid enough, but well down on the quarterly rates of growth seen earlier in the year. (Page 7.) The slowdown in **Chile** has been even more marked – growth here dropped to just 0.65% q/q in Q3. (Page 8.)

- There are signs that overheated growth in **Uruguay** has started to slow, which should ease inflation pressures over the coming months. Meanwhile, in **Ecuador**, it seems that that domestic demand is beginning to falter despite the fact the government is spending bumper oil revenues. (Page 9.)

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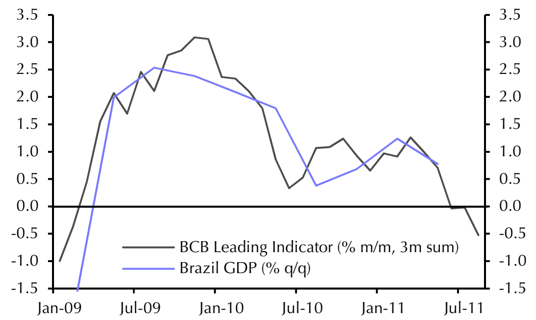
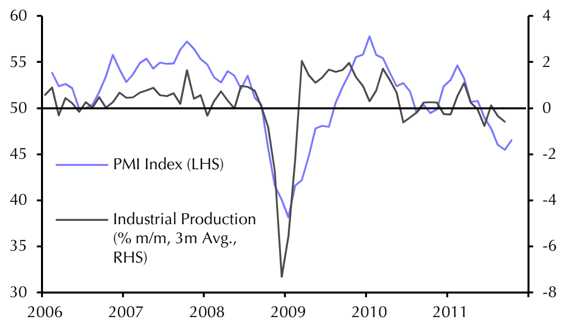
Brazil

- Brazil has been hit harder than most by the turmoil in Europe and weakening demand from China. According to preliminary estimates from the Finance Ministry, GDP grew by just 0.3% q/q (1.2% annualised) in Q3. Official Q3 data will be released on 6th December but the monthly activity data suggest that this may actually be an overestimate – output seems to have stagnated in Q3 and looks on track to *contract* by 0.3% or so in Q4 **(1)**.
- Growth, such that there is any, remains two-speed. Industry contracted by 2% m/m in September and the manufacturing PMI remains consistent with further falls in output over the coming months **(2)**. Export orders seem to be falling particularly sharply. By contrast, consumer-facing sectors seem to be holding up rather better. Retail sales grew by 0.6% m/m in September (5.3% y/y) **(3)**. But even so, there are signs that a two-year boom in consumer spending may now start to ease. Credit growth is slowing, as are imports of consumer goods **(4)**.
- The good news is that inflation has peaked. The headline rate fell to 7% in October, from a six-year high of 7.3% in September. Further rate cuts look likely over the coming months and this should lead to a recovery in growth from the second half of next year **(5)**. For now though, the markets remain focussed on downside risks in the global economy – Brazilian equities fell by 4% this month, while the real lost 8% against the US$ **(6)**.

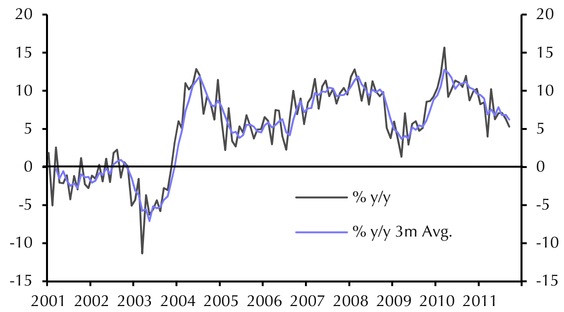
1. Central Bank's Activity Indicator & GDP Growth



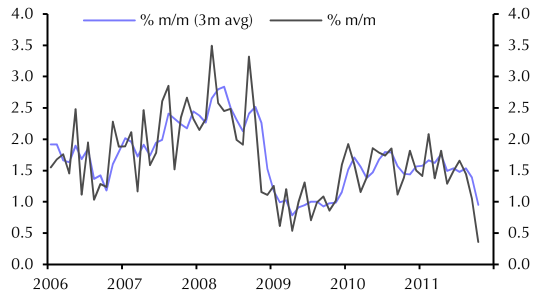
2. Industrial Production & Manuf. PMI



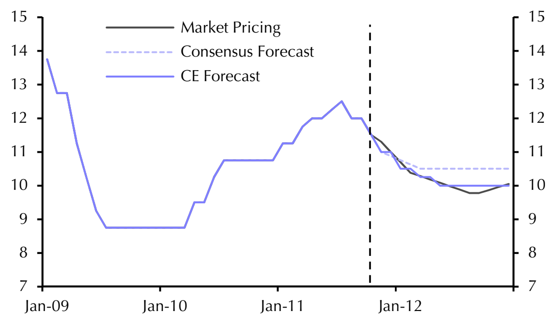
3. Retail Sales



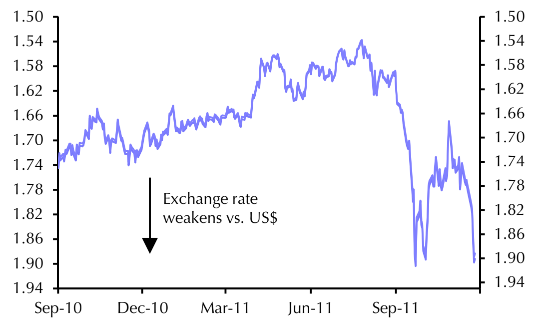
4. Total Credit to the Private Sector (Seasonally-Adjusted)



5. Interest Rates (%)



6. Exchange Rates vs. US$

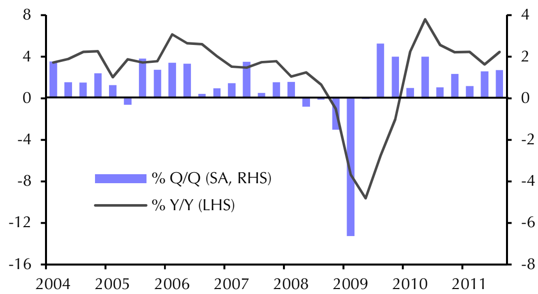


Sources – Thomson Datastream, Bloomberg, BCB

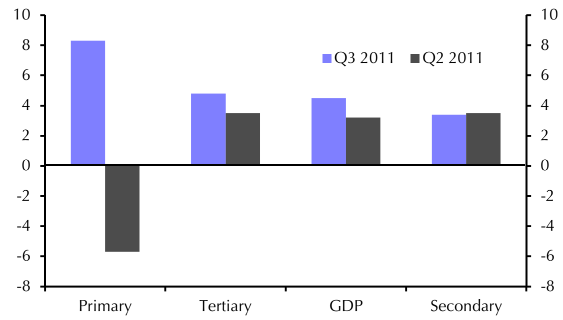
Mexico

- While the Mexican economy surprised on the upside in Q3, it remains vulnerable to a slowdown next year. GDP expanded by a seasonally-adjusted 1.3% q/q, which caused the annual rate of growth to accelerate to 4.5% (from 3.2% in Q2) **(1)**. The pick-up was largely due to strong increase in agriculture and service sector growth **(2)**.
- What's more, the rebound in both the manufacturing and non-manufacturing IMEF surveys in October suggests that the economy made a decent start to Q4 **(3)**. Nonetheless, although GDP may now expand by 4.0% this year, there are reasons to think that a slowdown is almost inevitable next year. The recent bounce in agricultural growth is unlikely to be sustained, while there are already signs that the US is slowing **(4)**.
- Meanwhile, so far at least, there has been little evidence of any pass through from the 16% depreciation of the peso against the dollar since the summer to higher inflation. Although headline inflation did edge up to 3.2% in October (from 3.1% in September), it should remain close to the central bank's 3% target next year giving room for policymakers to cut interest rates if needed. We think that policy easing may begin in Q1 of next year and have pencilled in 50bps of cuts to 4.0% **(5&6)**.

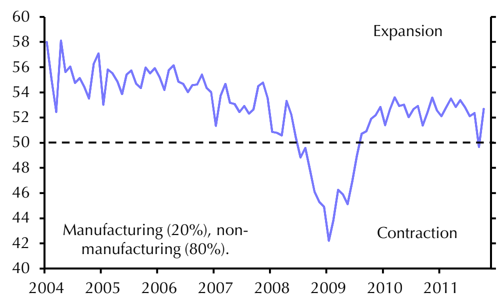
1. GDP Growth



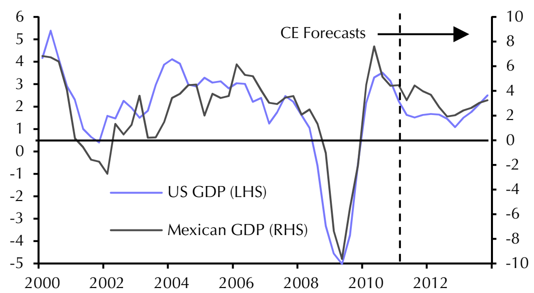
2. GDP (Production Breakdown, % y/y)



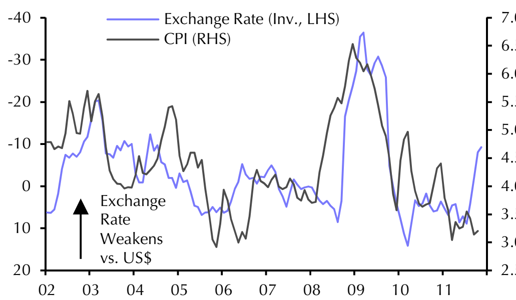
3. CE Composite IMEF Survey



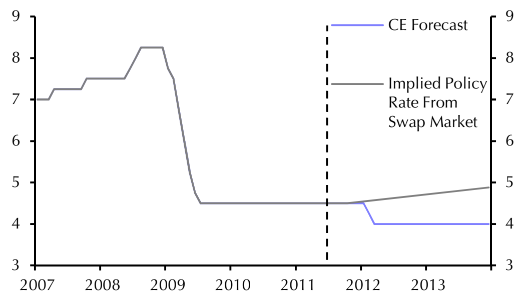
4. Mexican & US GDP Growth (% y/y)



5. Exchange Rate & Inflation



6. Interest Rates (%)

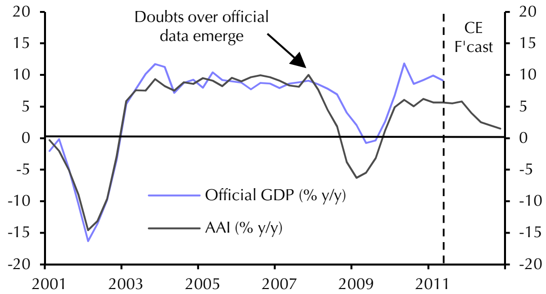


Sources – Thomson Datastream, Bloomberg, Banxico

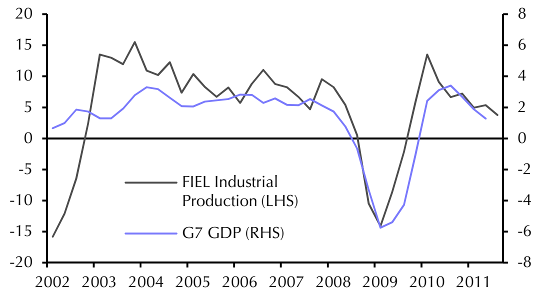
Argentina

- The Fernández government has made a flurry of policy announcements following last month's election victory. While these included some conciliatory spending cuts, heterodox policymaking clearly remains the order of the day. Heavy pre-election government spending and resilient private consumption should underpin Q3 GDP growth of 5-5.5% y/y – similar to that in Q2 **(1)**. Official statistics will, as ever, report stronger figures.
- Domestic industry slowed in the third quarter as a result of weaker demand from Argentina's key export markets **(2)**. Rising inflation has also caused a continued appreciation of the peso in real terms, hurting the competitiveness of exporters. There is growing pressure on the peso to devalue but, for the time being, the government has resisted, instead running down its FX reserves to stabilise the nominal peso exchange rate at close to 4.25/$ **(3&4)**.
- Elsewhere, capital flight continues to run apace. Private bank deposit rates have spiked sharply over recent days as locals lose confidence in the peso as a store of value **(5)**. Financial markets have also turned increasingly bearish this month. The MERVAL equity index has fallen by 17% since the end of October – far more than for other major economies in the region **(6)**. Meanwhile, bond yields and CDS premia continue to trend steadily higher.

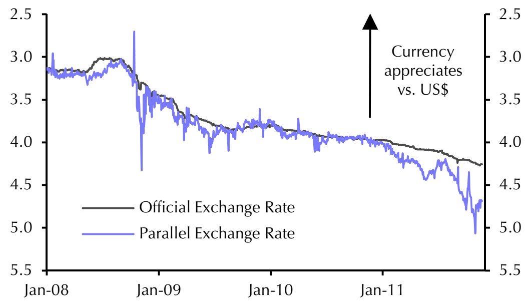
1. CE Argentina Activity Indicator (AAI) & GDP



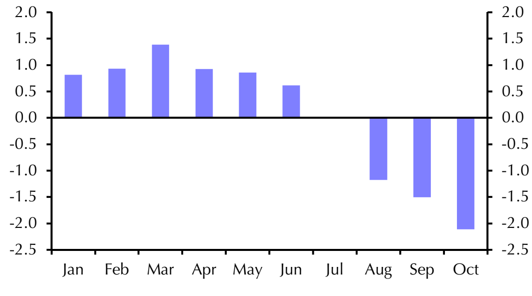
2. FIEL Industrial Production & G7 GDP (% y/y)



3. Official & Parallel Exchange Rates vs. US$

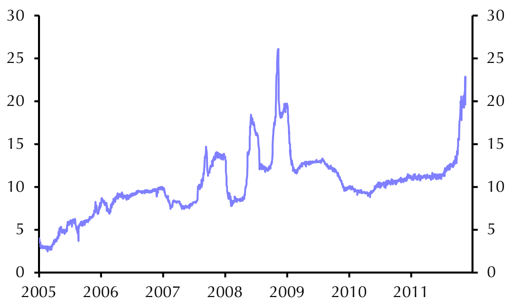


4. Central Bank Net Foreign Ccy. Purchases 2011 ($bn)

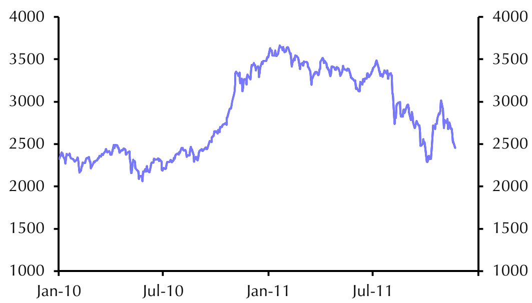


* Estimate for full month

5. Badlar Private Bank Deposit Rate 30-35 Days (%)



6. MERVAL Equity Market Index

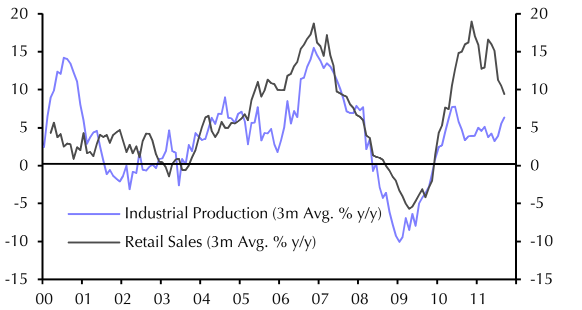


Sources – Thomson Datastream, Bloomberg, CEIC, CE, BCRA

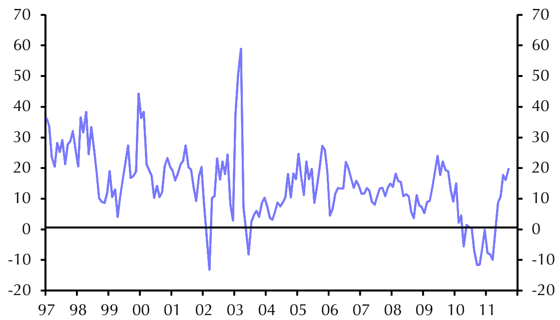
Colombia

- Leading indicators suggest that the Colombian economy performed well in Q3. Admittedly, the latest activity data show that both retail sales growth and industrial production slowed by more than the consensus had expected. Retail sales growth eased to 8.1% y/y in September, from 8.8% y/y in August. At the same time, industrial production slowed to 5.2% y/y (from 9.7% y/y in August) **(1)**.
- Nevertheless, the monthly data are volatile and both sectors performed well in Q3 as a whole. Indeed, coupled with the acceleration in government spending and a pick-up in export revenues, it appears that GDP growth accelerated in Q3. Our leading indicator points to Q3 GDP growth of around 6.5% y/y **(2,3&4)**.
- Meanwhile, rising food inflation pushed the annual rate of headline inflation to 4.0% y/y in October, from 3.7% y/y in September - the top of the central bank's 3±1% target range **(5)**. Accordingly, policymakers bucked the regional trend and hiked interest rates by 25bps to 4.75% earlier this month. Even so, we still expect them to turn their attention back to monetary *easing* next year in response to a weaker global economy **(6)**.

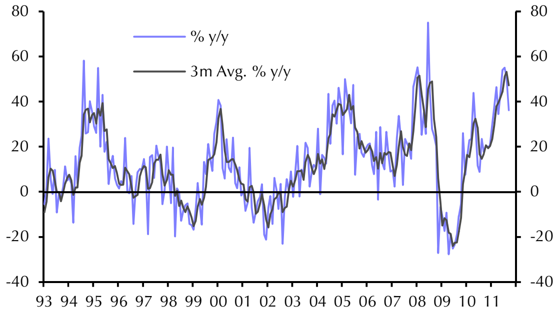
1. Industrial Production & Retail Sales



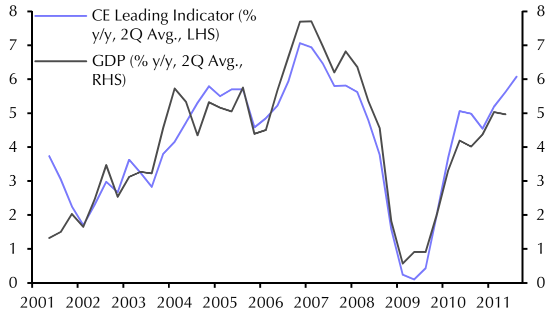
2. Central Government Spending (% y/y)



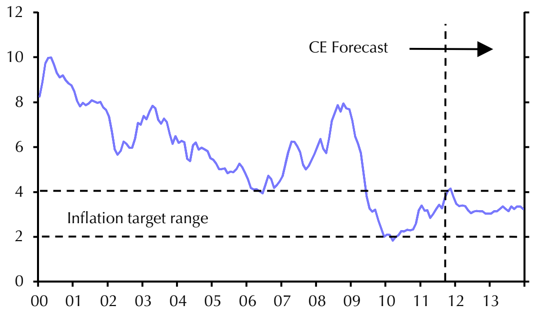
3. Nominal Exports (% y/y)



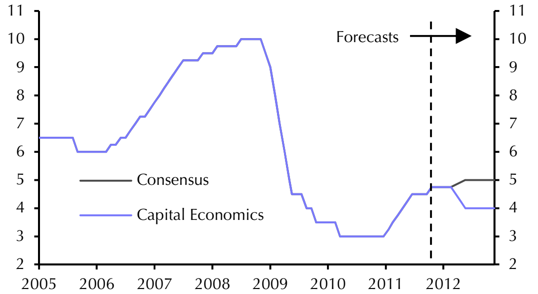
4. GDP & CE Leading Indicator (% y/y)



5. Consumer Prices (% y/y)



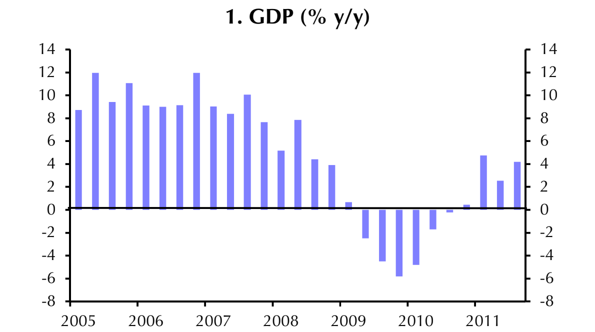
6. Interest Rates (%)

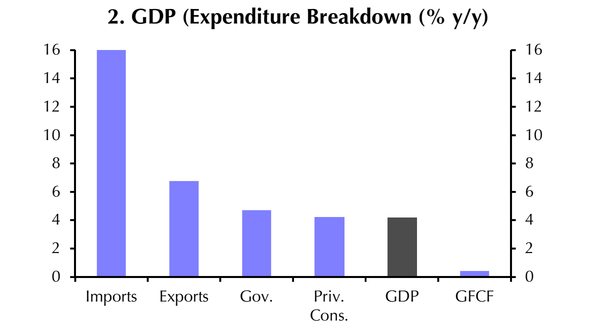


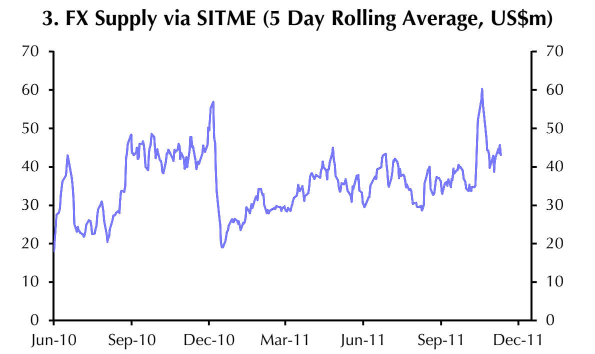
Sources – Thomson Datastream, Bloomberg, CEIC, CE

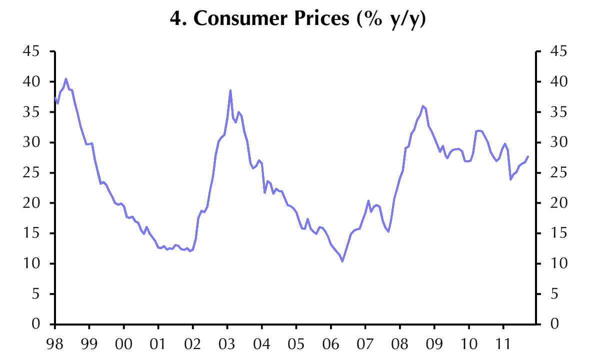
Venezuela

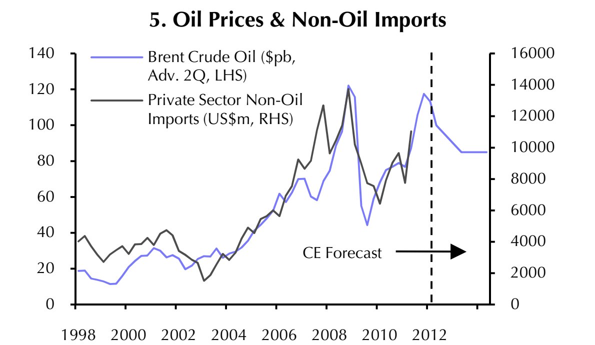
- Campaigning ahead of October's crucial presidential election has begun in Venezuela. Indeed, with the Opposition expected to mount a strong challenge next year, it seems that the government has already begun to pump the economy ahead of the vote. GDP growth accelerated to 4.2% y/y in Q3, from 2.5% y/y in Q2, on the back of strong government spending while the authorities have also increased the supply of FX to the economy **(1,2&3)**.
- Even so, there are signs that shortages are re-emerging as the authorities struggle to supply enough FX to satisfy demand in the import-dependent economy. As a result, inflation has begun rising again and the CPI rate rose to 27.7% y/y in October (from 26.7% y/y in September) **(4)**.
- The government has responded in two, very familiar, ways. First, price controls, which have been in place for staple items since 2003, have been broadened and policymakers have signalled that more caps are likely in the future. Second, the authorities have secured an additional $4bn of bilateral loans from China. The quick fixes may help to give some temporary relief from the shortages. But, if oil prices fall next year, as we expect, it seems likely that the authorities will be forced to cut the import bill thus intensifying the problem **(5&6)**.

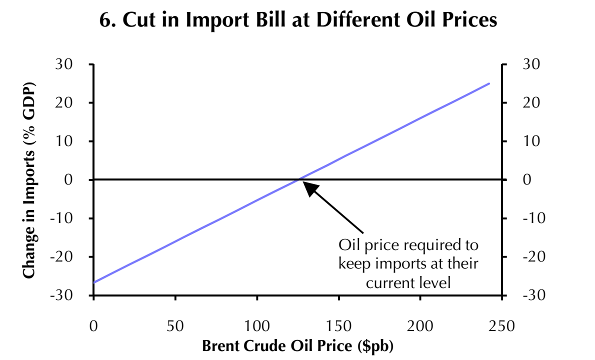










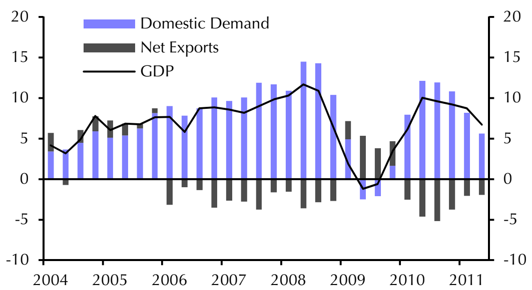


Sources – Thomson Datastream, Bloomberg, CEIC, CE

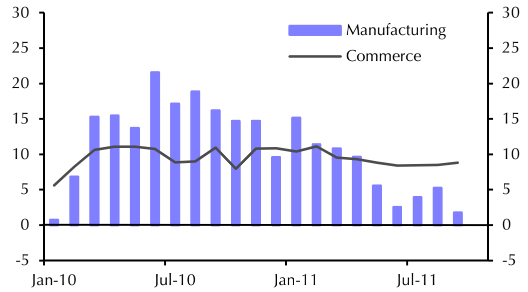
Peru

- Monthly GDP data suggest that the Peruvian economy expanded by around 6.5% y/y in Q3, consistent with growth of 1% on the quarter. **(1)**. Continued strength in consumer-facing sectors has so far offset weakness in manufacturing and construction **(2)**. Nevertheless, growth is likely to slow over the coming quarters as deteriorating terms of trade undermine domestic demand.
- The government is committed to supporting growth at the first sign of a downturn and has already begun priming the pump with an infrastructure spending plan worth 1% of GDP. Elsewhere, interest rates have been kept on hold at 4.25% since Q2 as inflation pressures have mounted **(3)**. The headline CPI rate reached 4.2% y/y in October, up from 3.7% y/y in September, while core inflation is above the central bank's 3% upper tolerance band **(4)**.
- Returning FDI flows in the wake of June's election will be an important support for growth over the next 12-18 months. Business confidence has almost recovered from a mid-year slump and financial markets have held up well in November despite a broad global sell-off **(5)**. The IGBVL equity index has fallen by just 3% over the month to date; the sol also remains stable, helped by central bank intervention in foreign exchange markets **(6)**.

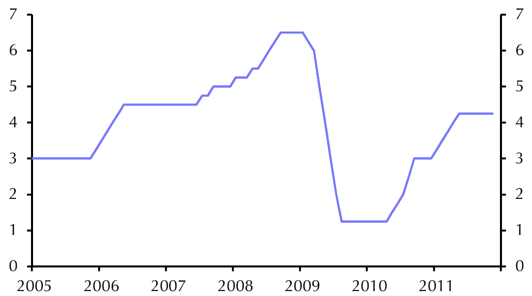
1. GDP Components (% y/y)



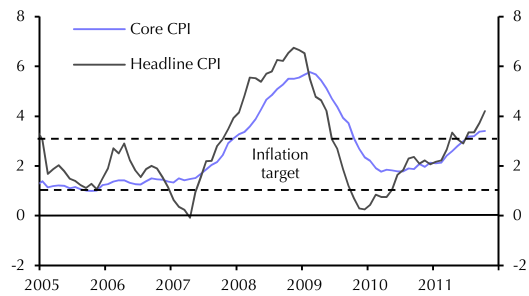
2. Manufacturing & Commerce (% y/y)



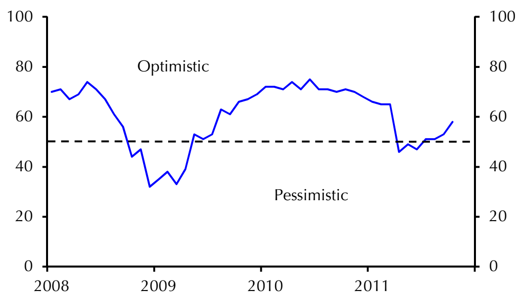
3. Interest Rates (%)



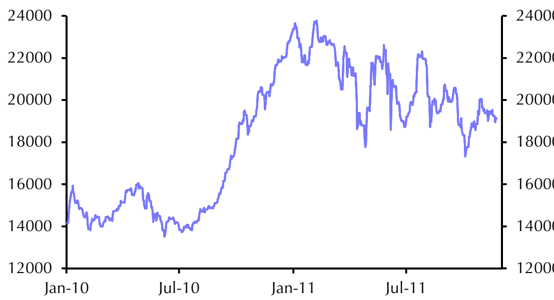
4. Consumer Prices (% y/y)



5. Business Confidence Index



6. IGBVL Equity Market Index



Sources – Thomson Datastream, Bloomberg, CEIC, BCRP

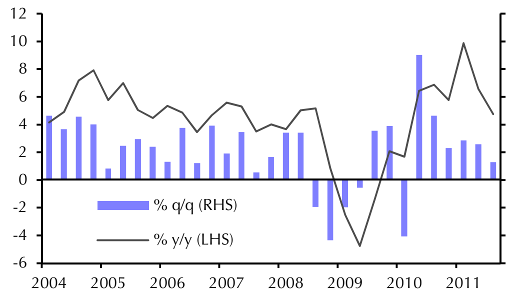
Chile

- Official statistics confirmed that the rate of growth in Chile cooled in Q3. GDP grew by 0.6% q/q in Q3, down from 1.3% q/q in Q2 **(1)**. This was driven by a slowdown in manufacturing and mining as external demand weakened **(2)**. By contrast, consumer-facing sectors have remained resilient in recent months **(3)**. Commerce grew by 8.6% y/y in Q3, up from 7.7% y/y in Q2.

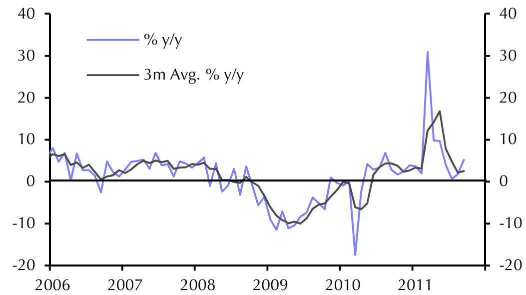
- Financial market volatility has shown no signs of abating in November. The peso, which tends to take its lead from copper prices, has fallen by 6% since the start of the month **(4)**. Elsewhere, the IPSA equity index has fallen by 6% over the past week or so as the escalating euro-zone debt crisis weighs on market sentiment **(5)**. Chile's dependence on external industrial demand means that it is highly sensitive to movements in the global business cycle.

- Recent consumer price data showed a larger-than-expected acceleration of inflation in October. Headline CPI increased by 3.7% y/y, from 3.3% y/y in September. Nevertheless, inflation remains well within its target range and should fall back from year-end as lagged food and energy price pressures subside. Consequently, after keeping interest rates unchanged since June, we expect the central bank to shift into easing mode in early 2012 **(6)**.

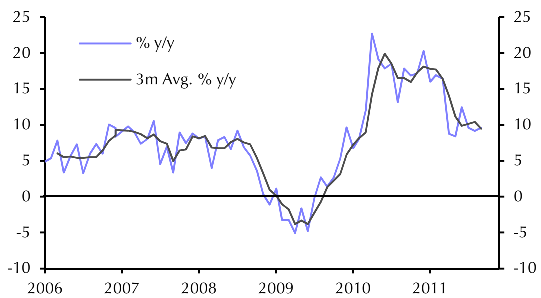
1. GDP (% y/y)



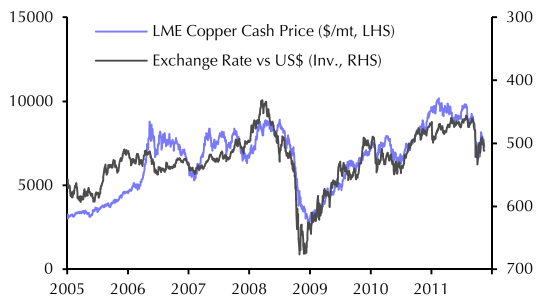
2. Industrial Production



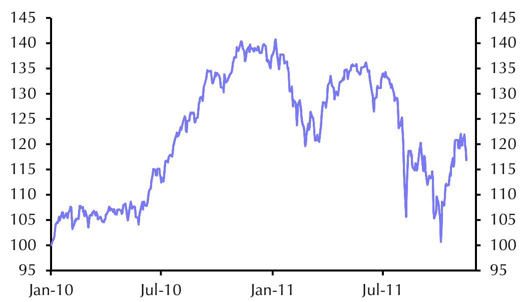
3. Retail Sales



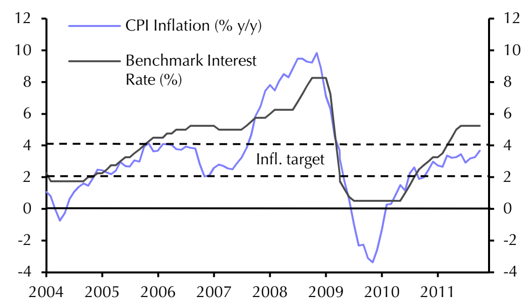
4. Chilean Peso & Copper Prices



5. IPSA Equity Index (Jan 2010 = 100)



6. Inflation & Interest Rates

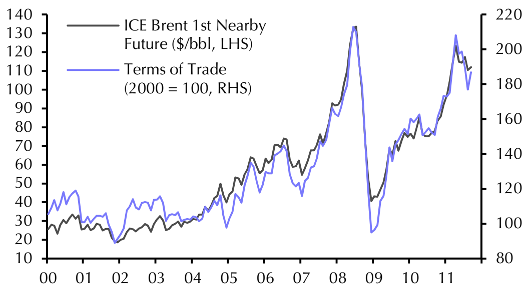


Sources – Thomson Datastream, Bloomberg, CE

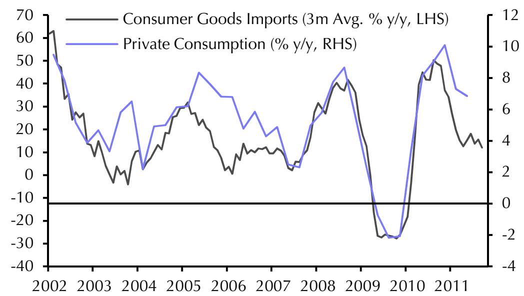
Ecuador & Uruguay

- The pace of growth in **Ecuador** probably moderated in Q3 as oil prices declined **(1)**. Over the first half of 2011, rising energy prices boosted domestic demand through increased private consumption and government investment spending. However, imports of consumer goods – a fairly reliable leading indicator of household spending – suggest that private consumption growth may now be starting to falter **(2)**.
- Inflation continued to climb in October, reaching 5.5% y/y, from 5.4% y/y in September **(3)**. This bulk of the recent rise has been driven by transitory food and energy price pressures which are close to peaking. Meanwhile, October's cabinet reshuffle is unlikely to have a significant impact on policy and, in all probability, will only act to strengthen President Rafael Correa's control over the executive.
- **Uruguay**'s overheated economy may have started to cool in recent months. Lower agricultural commodities prices and weaker demand from key trade partners will take a toll on exports **(4)**. Indeed, industrial production appears to be in the early stages of a slowdown **(5)**. This may help to ease capacity pressures, which have kept inflation close to 8% y/y in recent months. Even so, interest rates are likely to stay on hold until well into 2012 **(6)**.

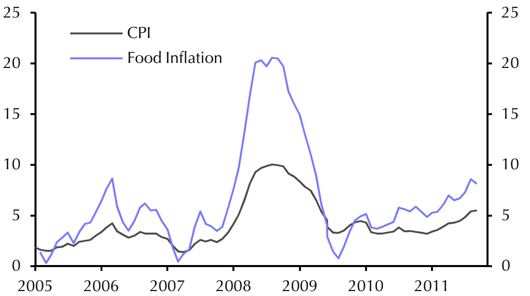
1. Ecuador Oil Price & Terms of Trade



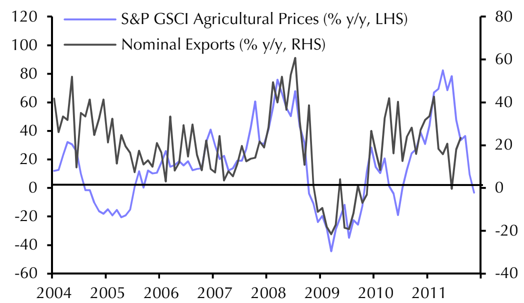
2. Ecuador Private Consumption & Consumer Goods Imports



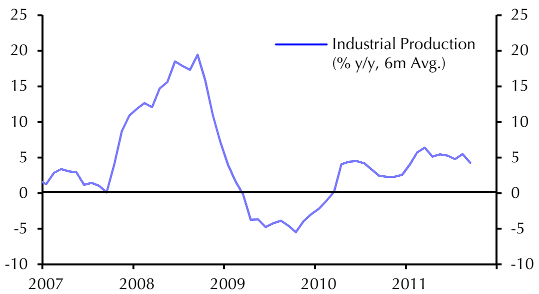
3. Ecuador Consumer Prices (% y/y)



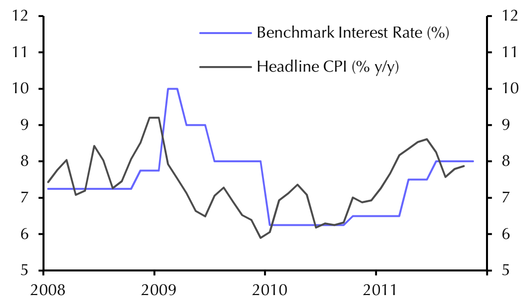
4. Uruguay Exports & Agricultural Prices



5. Uruguay Industrial Production



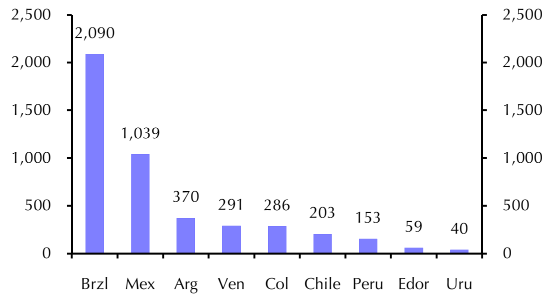
6. Uruguay Consumer Prices & Interest Rates



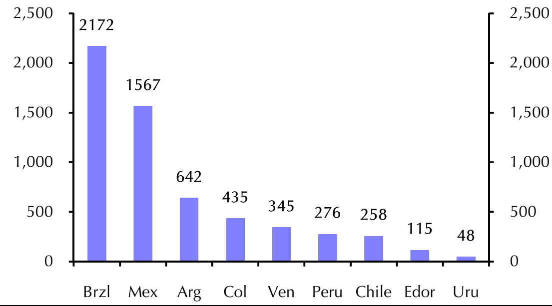
Sources – Thomson Datastream, Bloomberg, CEIC, CBU

Background Data

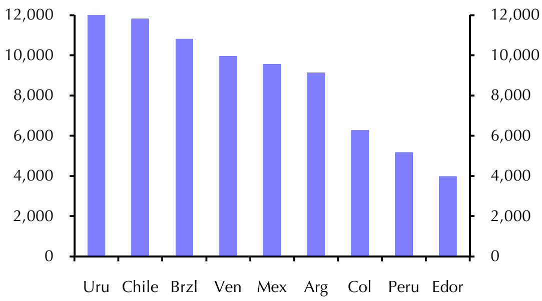
1. Current Price GDP ($bn, 2010, Market Exchange Rates)



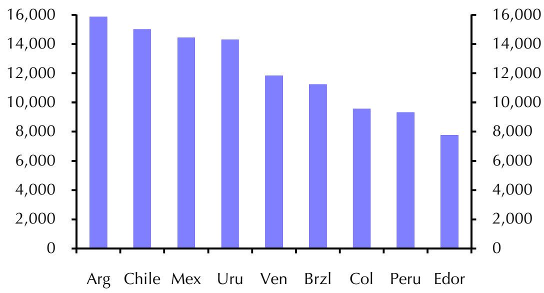
2. Current Price GDP ($bn, 2010, PPP)



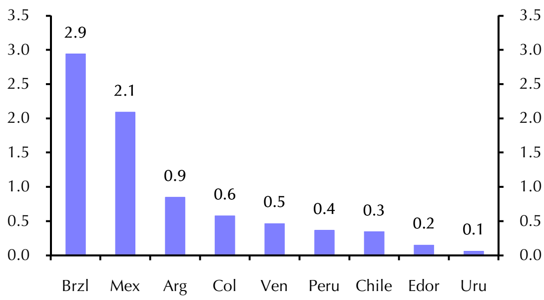
3. GDP Per Capita ($, 2010, Market Exchange Rates)



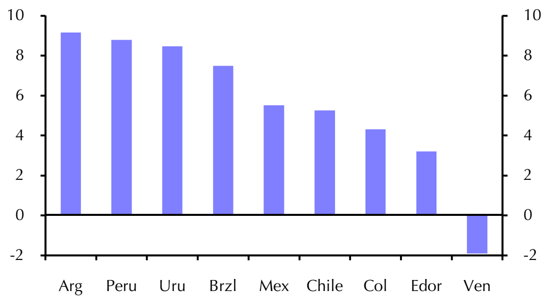
4. GDP Per Capita ($, 2010, PPP)



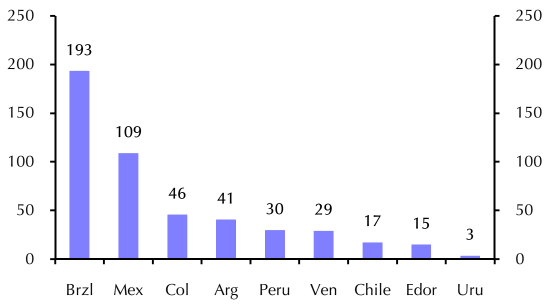
5. Share of World Output (%, 2010, PPP)



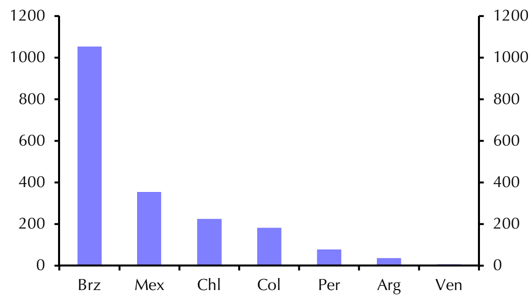
6. Real GDP Growth (% y/y, 2010)



7. Population (2010, Millions)



8. Stock Market Capitalisation ($bn, November ‘11)



Sources –IMF, Bloomberg, Capital Economics