Latin America: a rather “NICE” outlook in times of political uncertainty

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November 2017

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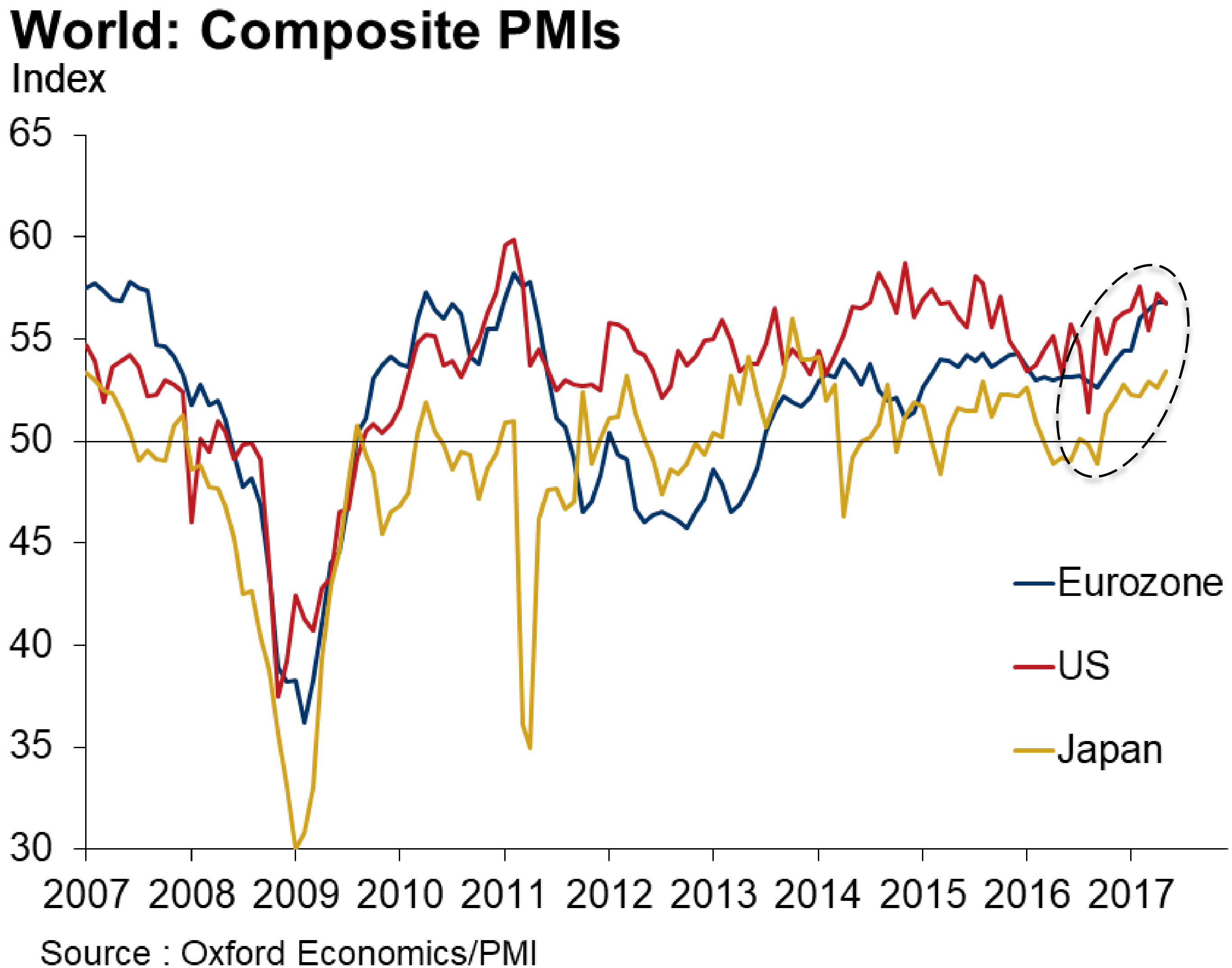
Global overview

Global economy enjoying synchronized upturn…



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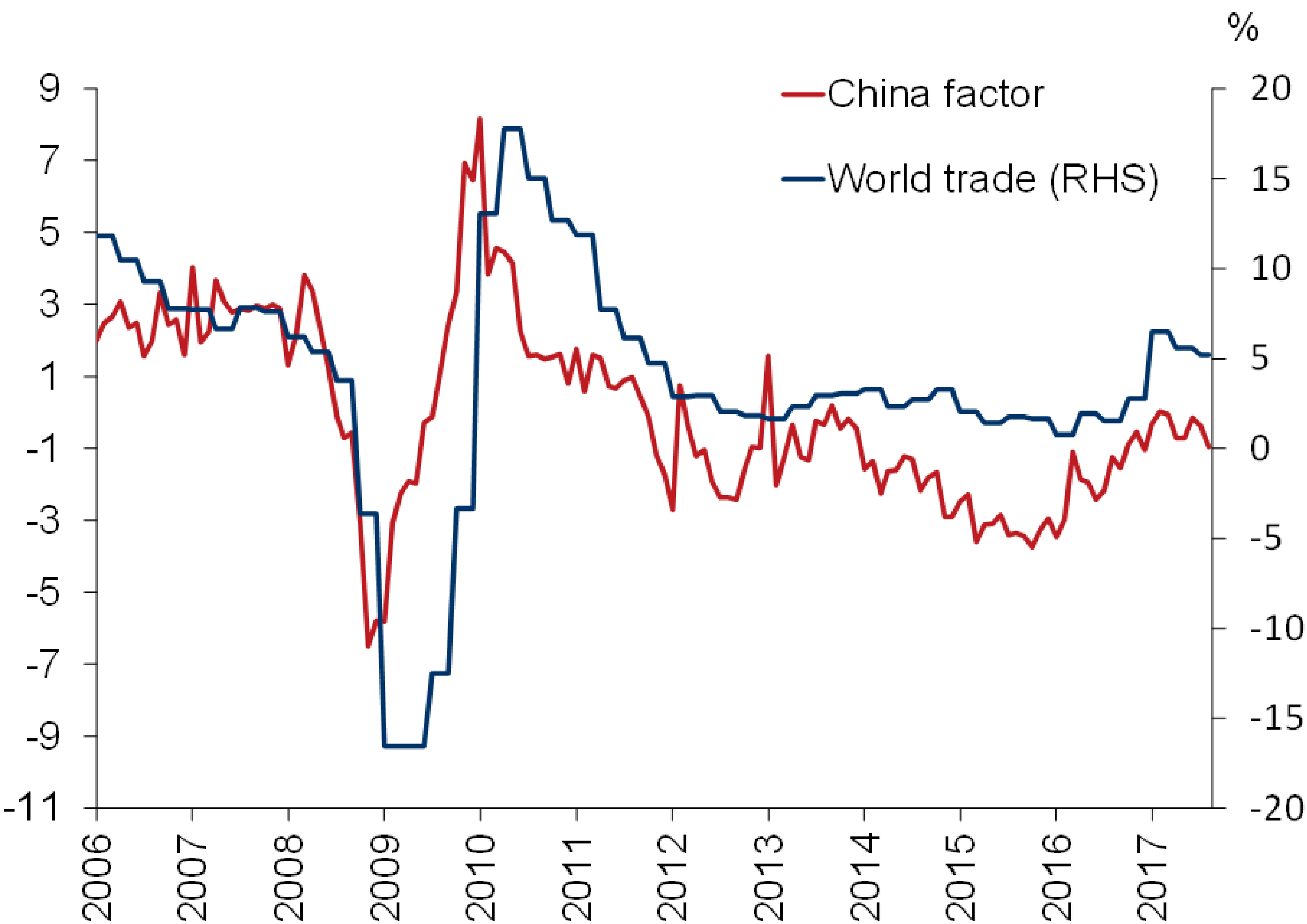
…initially triggered by the "China-factor"…

Chinese activity leading world trade



Source: Oxford Economics/Haver Analytics

China factor:
1. Construction
2. Steel Output
3. PMI: Manuf new orders
4. PMI: Manufacturing
5. Industrial production
6. Trucks
7. Freight Traffic
8. Imports Volume
9. Export Volume
10. Electricity Production

- 3-month ahead correlation between China-factor and world trade growth >80%
- Model simulations: China accounted for up to 60% of upturn

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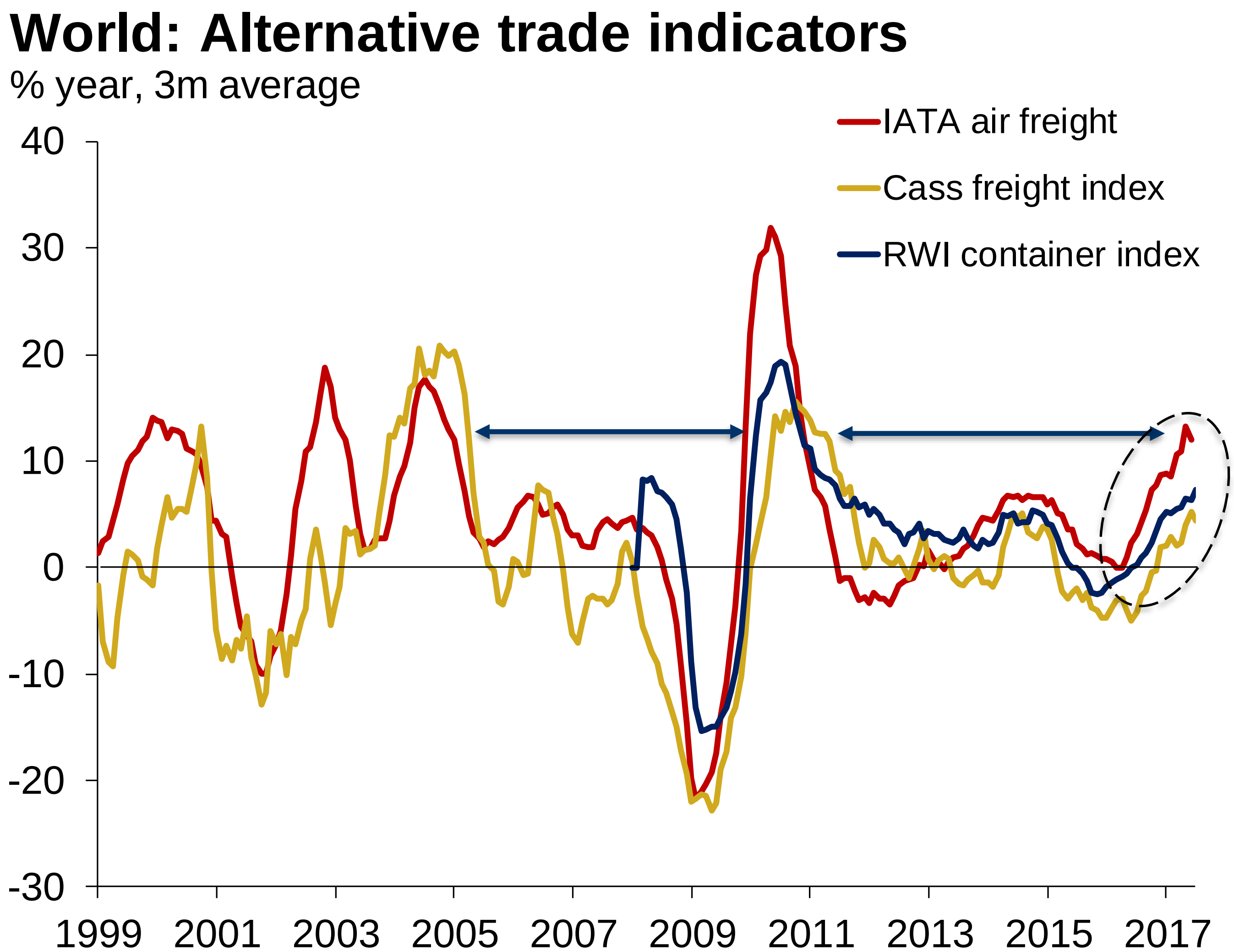
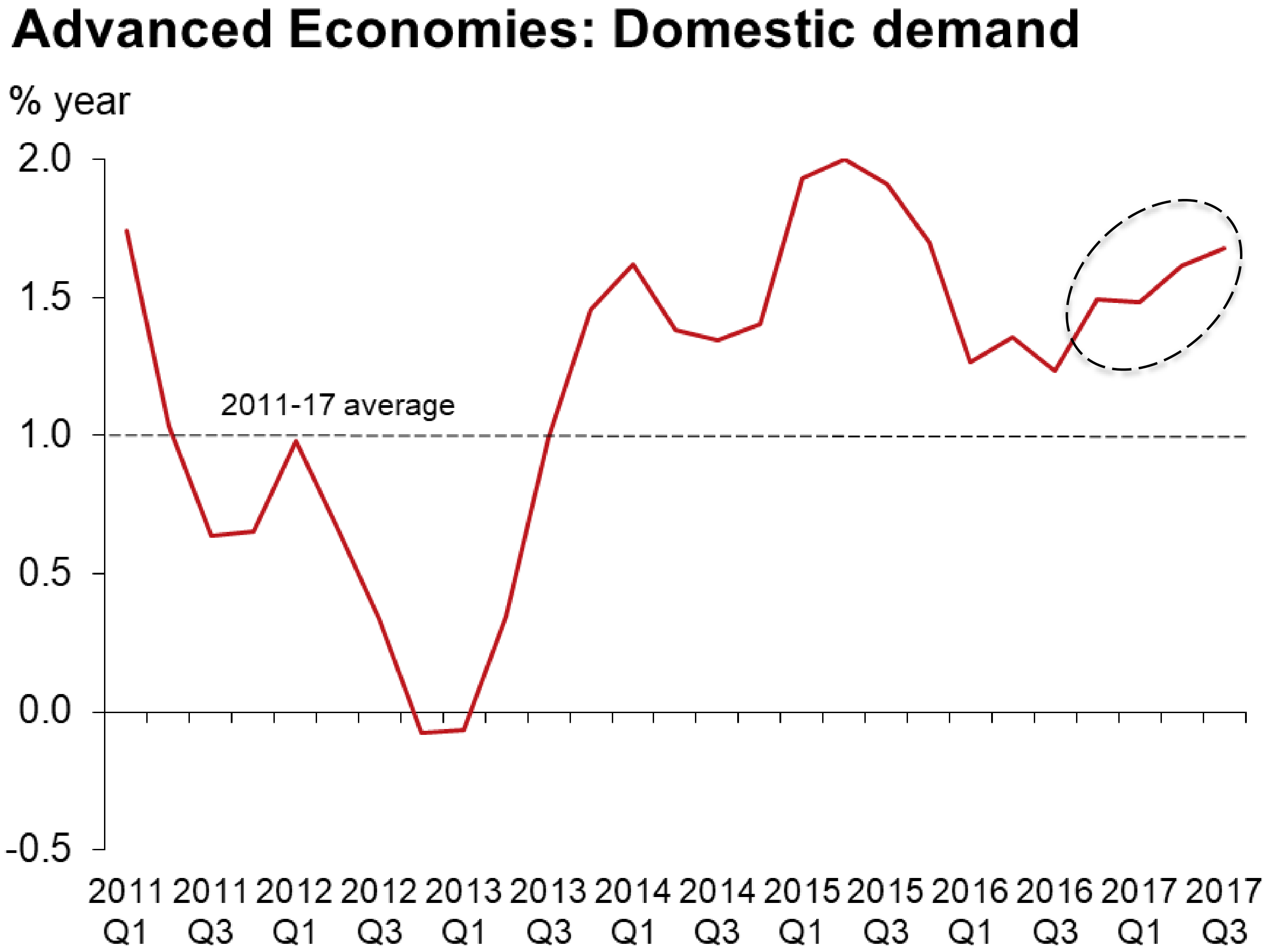
…causing world trade growth to be the fastest since GFC…



Source : Oxford Economics/Haver Analytics/IATA

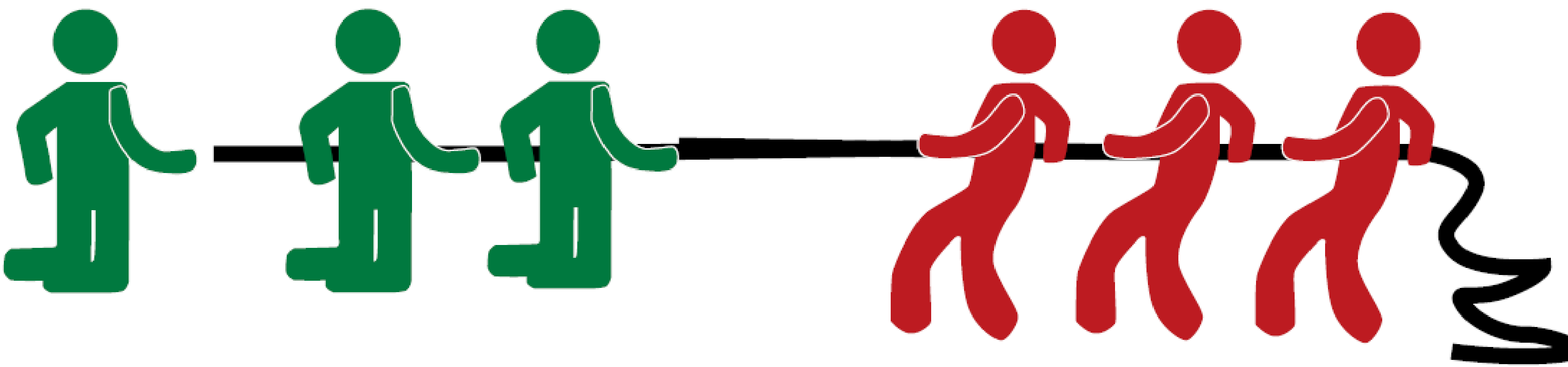
…which then fed back into domestic demand growth in AEs



Source: Haver/Oxford Economics

All that, despite no Trump stimulus (at least, not yet!)

A "trial and error" presidency



- Tax cuts
- Infrastructure spending
- Less regulation

- Massive uncertainty
- Trade protectionism
- Anti-immigration

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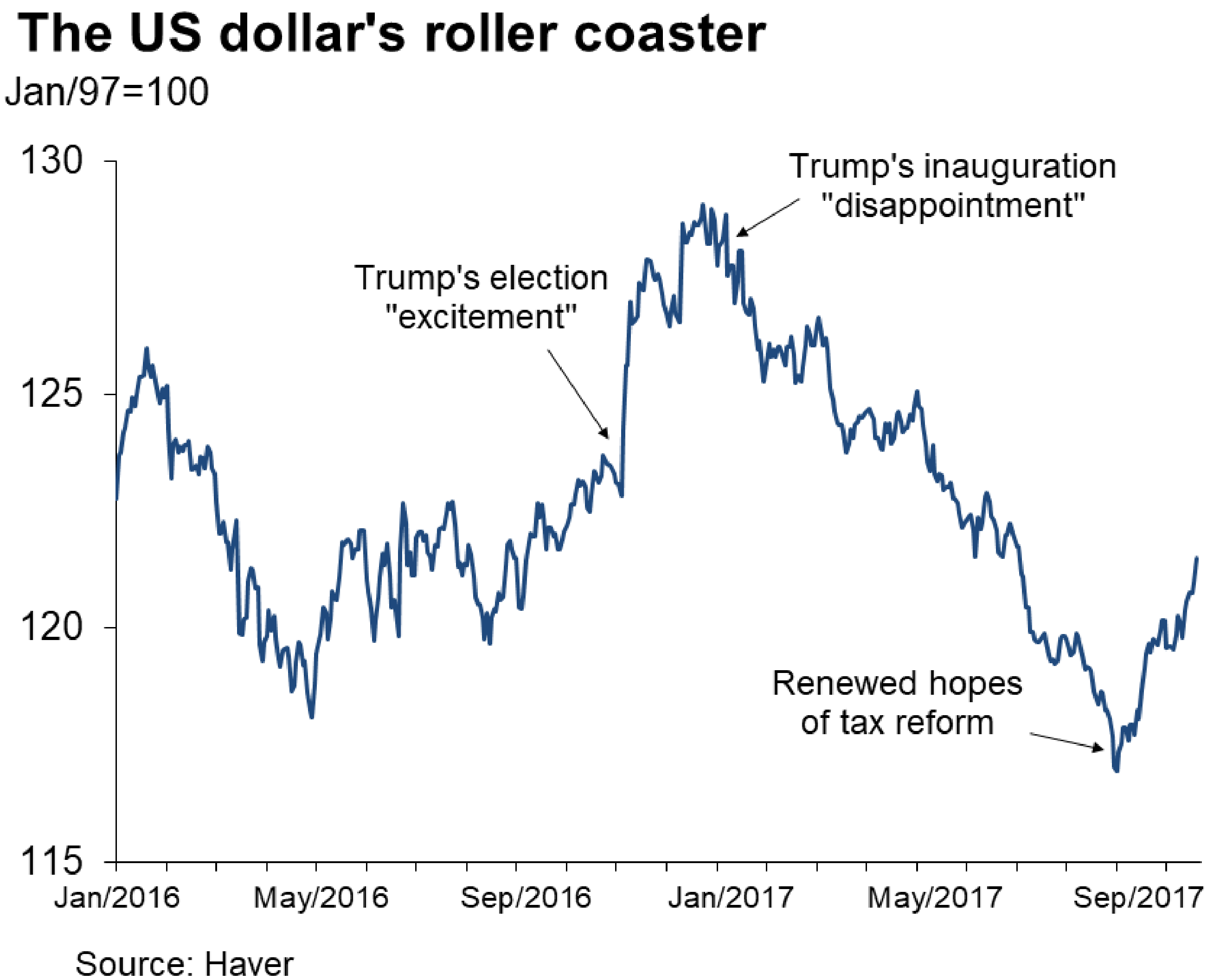
Tax cuts? No tax cuts? Ask the US$-barometer!



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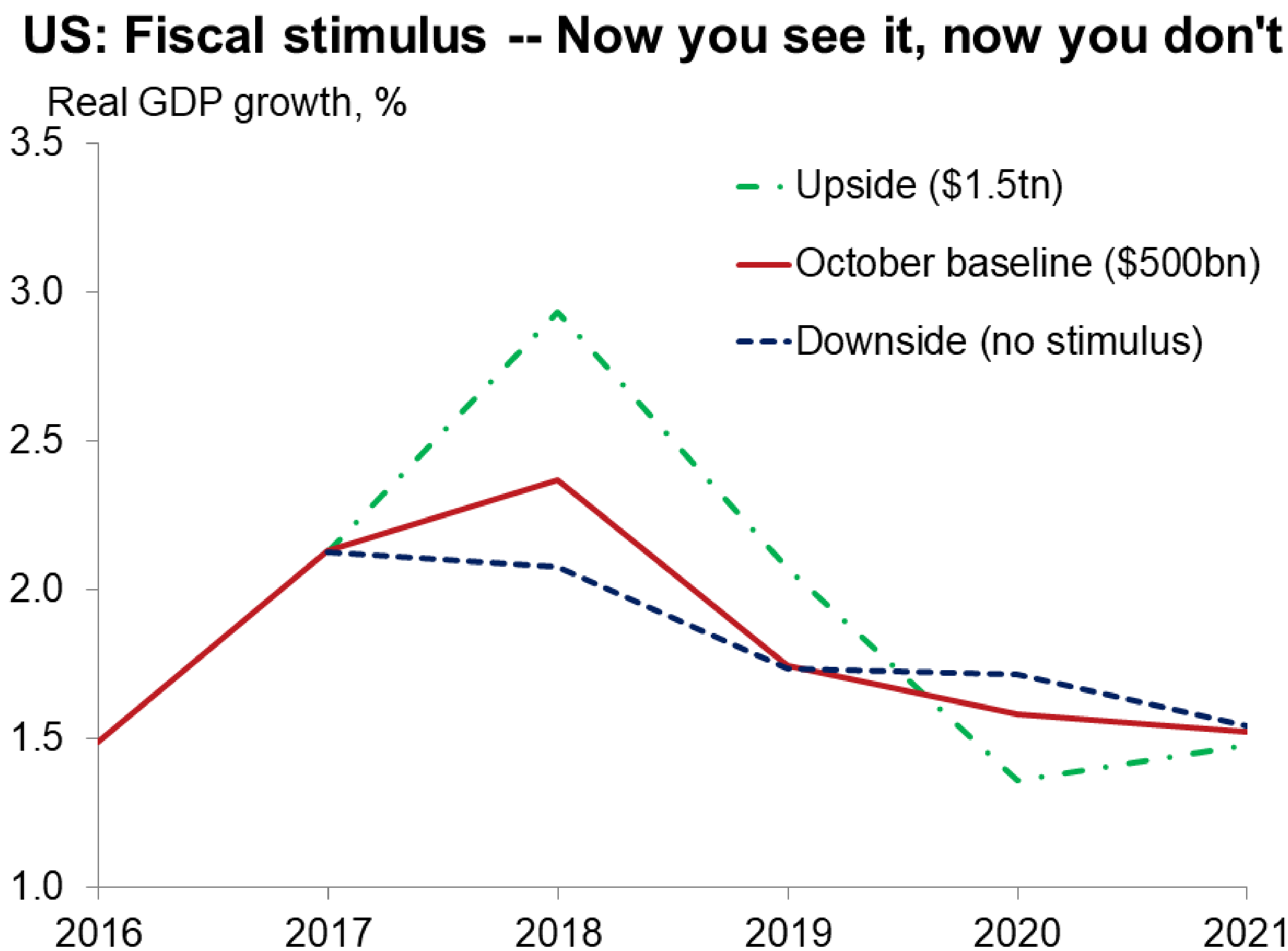
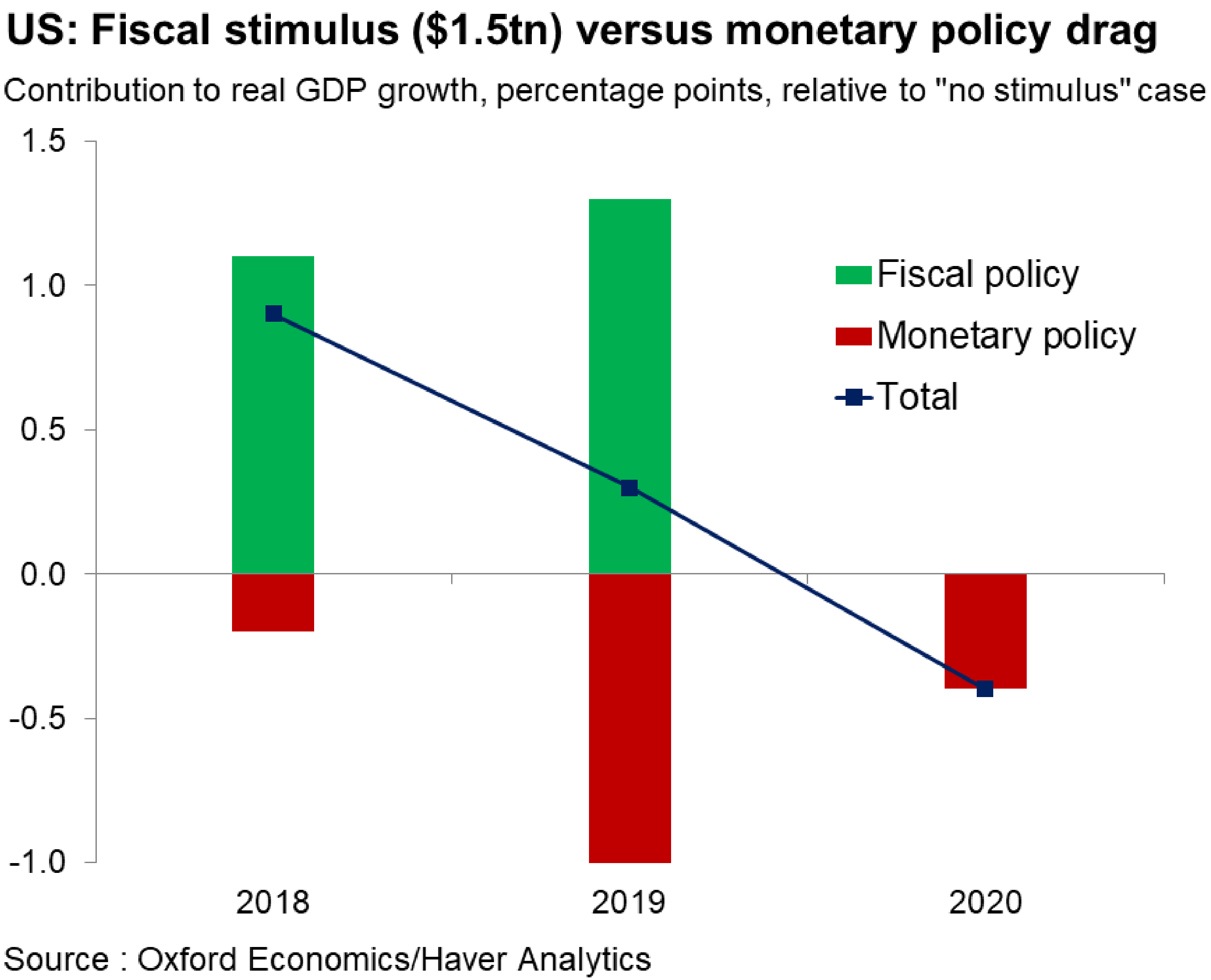
If Trump delivers on tax reform, we may get a bump…followed by a dip



Source : Oxford Economics/Haver Analytics

…as a short-term fiscal stimulus will become a long-term drag



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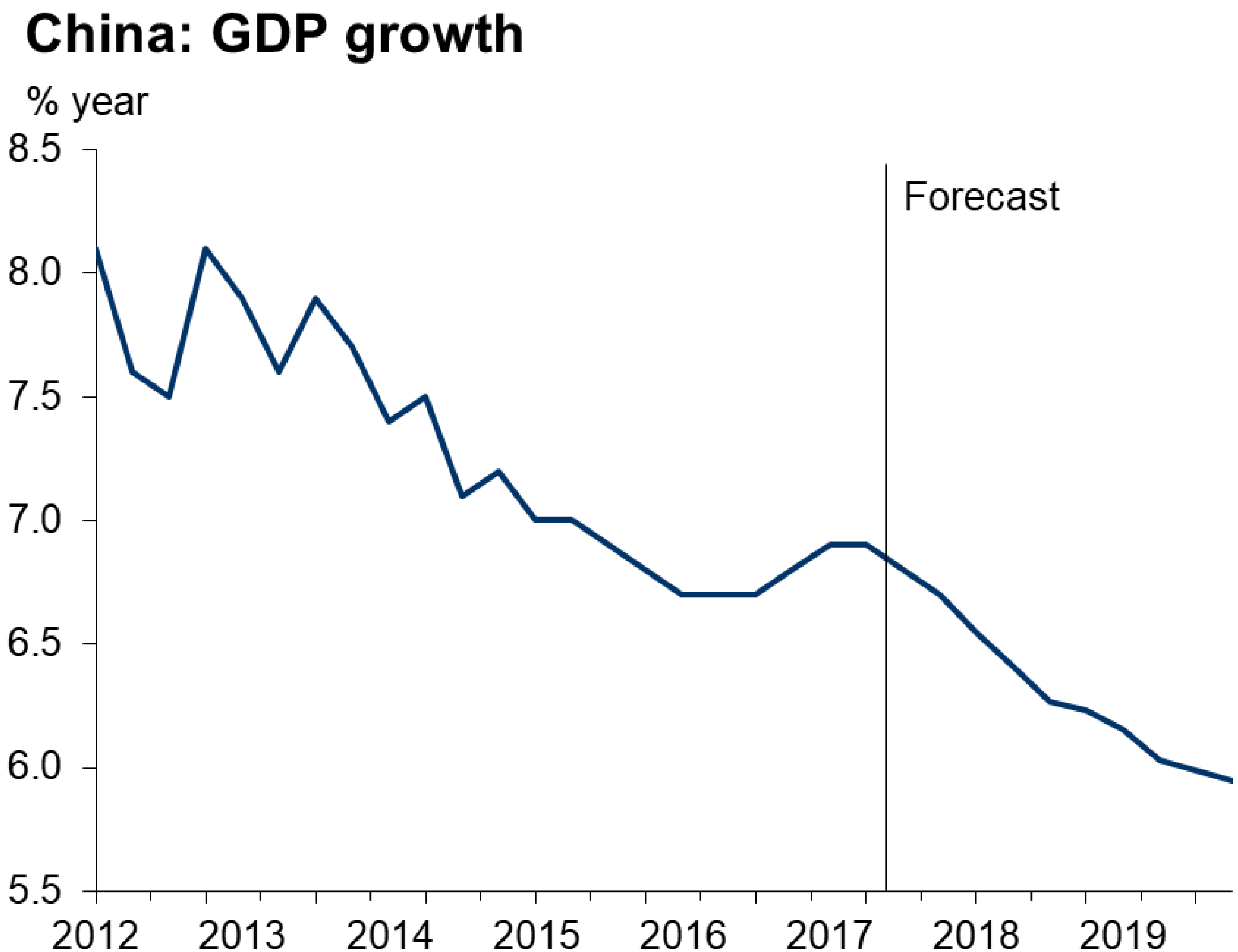
Meanwhile in China…

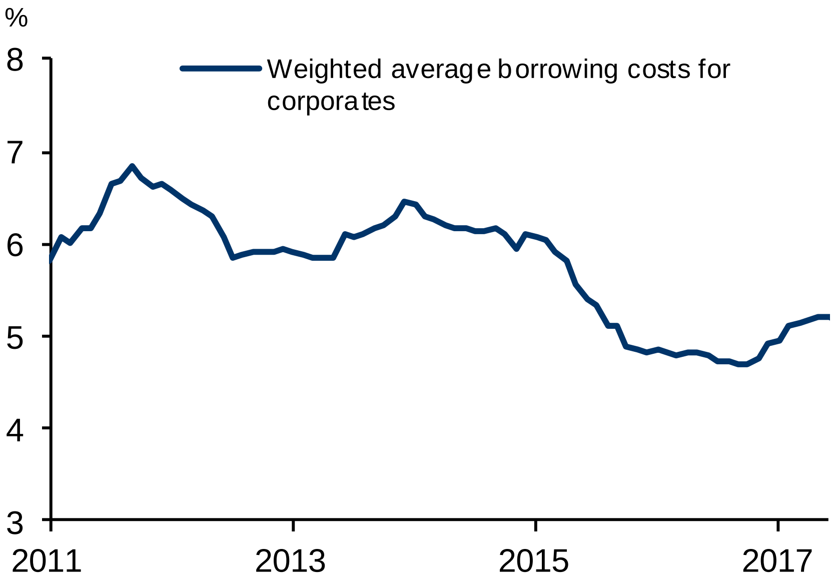
Growth has peaked in H1, managed slowdown to follow



Source: Oxford Economics/Haver Analytics

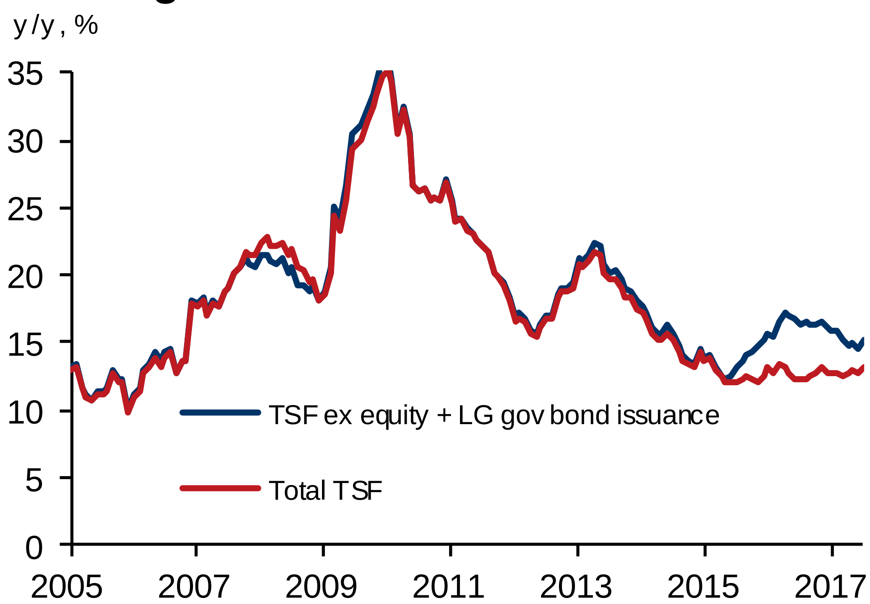
…as authorities changed tone towards less expansionary policy

Interest rates faced by corporates



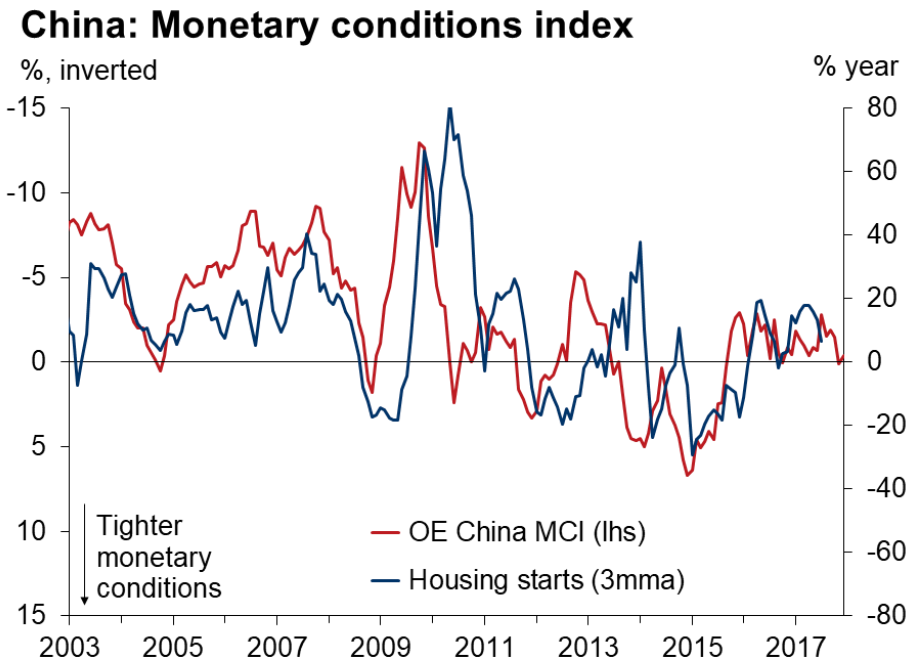
Source: Oxford Economics, CEIC Data

Credit growth

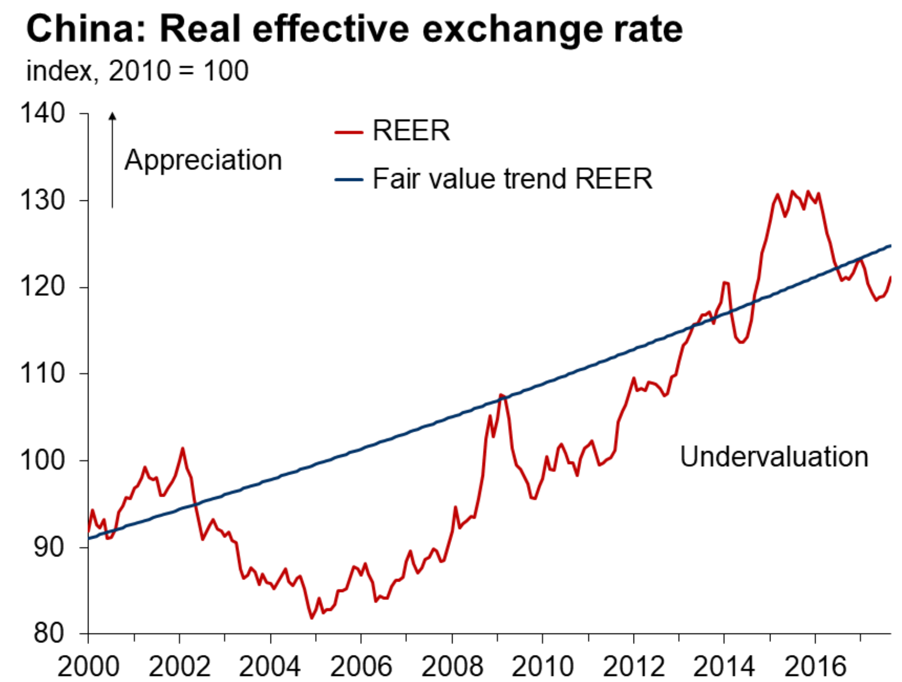


Source: Oxford Economics, CEIC Data

But will China overdo the tightening? No, because:



Source : Oxford Economics/Haver Analytics/CEIC



Source : Oxford Economics/Haver Analytics

- The credit tightening is actually quite modest.
- Real effective interest rates have been falling despite higher nominal rates.
- RMB is no longer overvalued – a big effective monetary loosening
- Don’t underestimate the ability of policymakers to steer Chinese economy and their determination to meet their target to double GDP between 2010 and 2020

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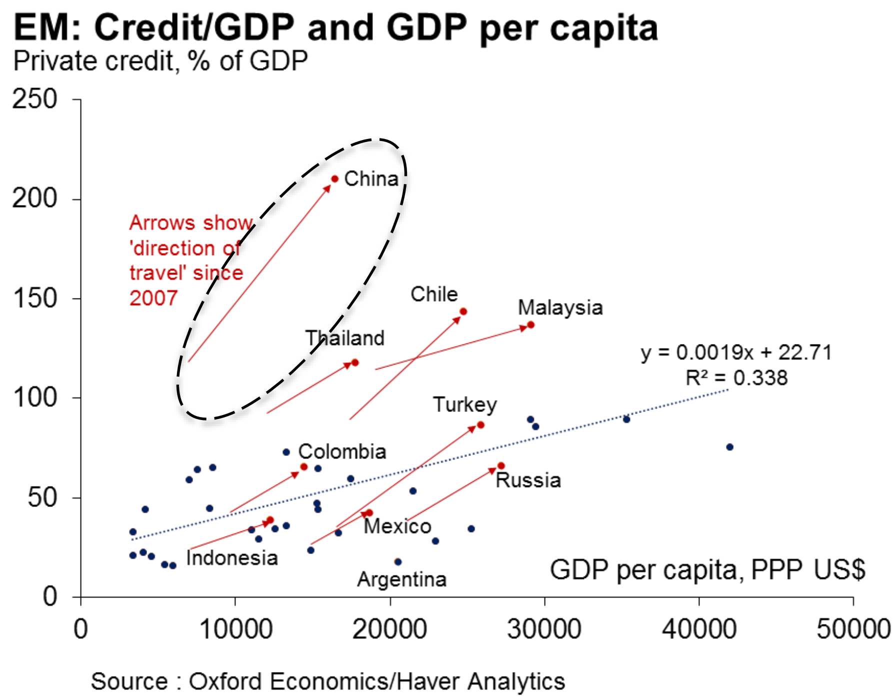
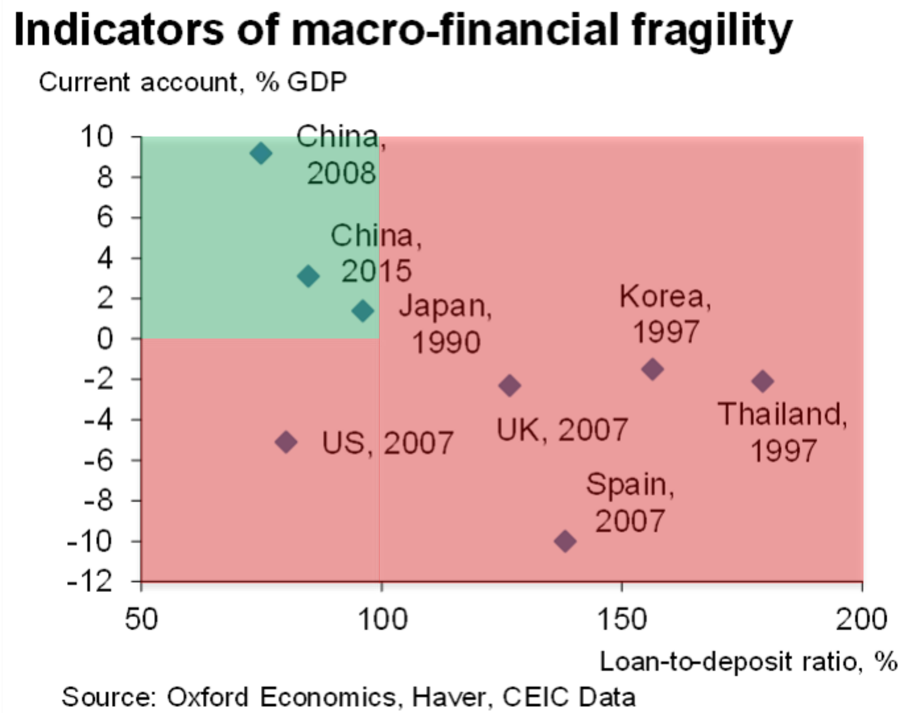
And we also do not see a ‘Minsky moment’ or a hard-landing





- Although China accumulated more debt than any other EM in the last decade (and its levels of debt are way higher than its GDP per capita would suggest)…
- …its borrowing is entirely financed domestically (positive current account) and its loans are fully covered by deposits
- Hence, we do not see a Minsky moment for China any time soon

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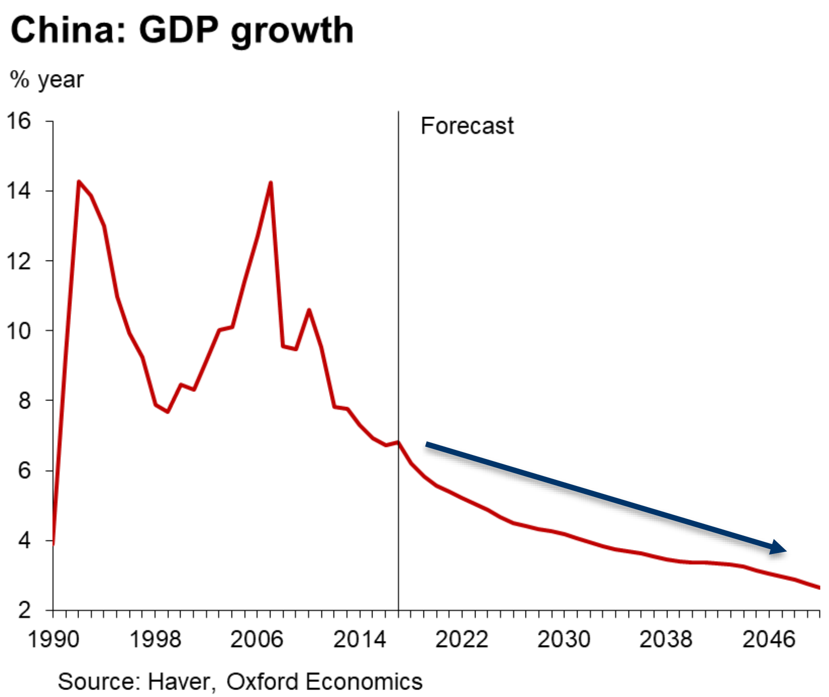
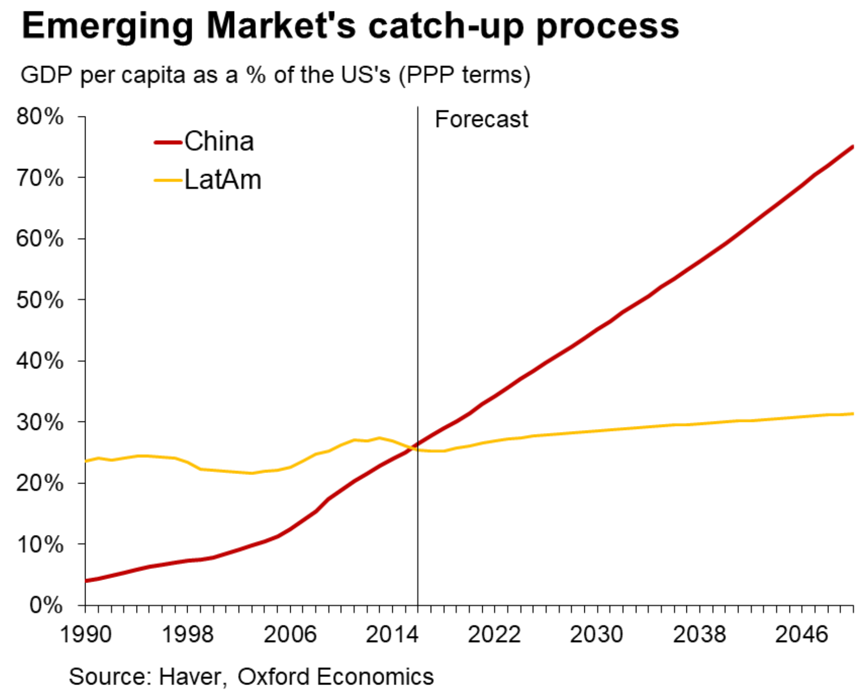
19th National Congress: quality (and equality) over quantity





- President Xi JinPin gave a speech outlining his view of China's development through 2050
- No quantitative targets were set; we think quality & equality will drive policy, with focus on better education, health, pensions provision and ecology
- These principles are in line with our forecast of a gradual slowdown from 2017
- But even growing more gently, China's per capita GDP will continue to rise fast (even as a % of the US's), leaving LatAm and other commodity exporters behind in the catch-up process

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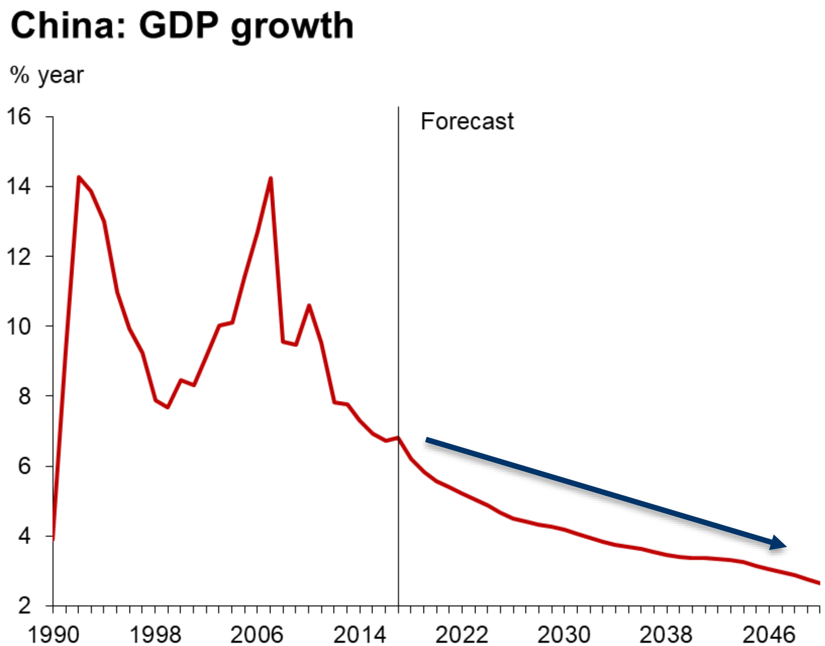
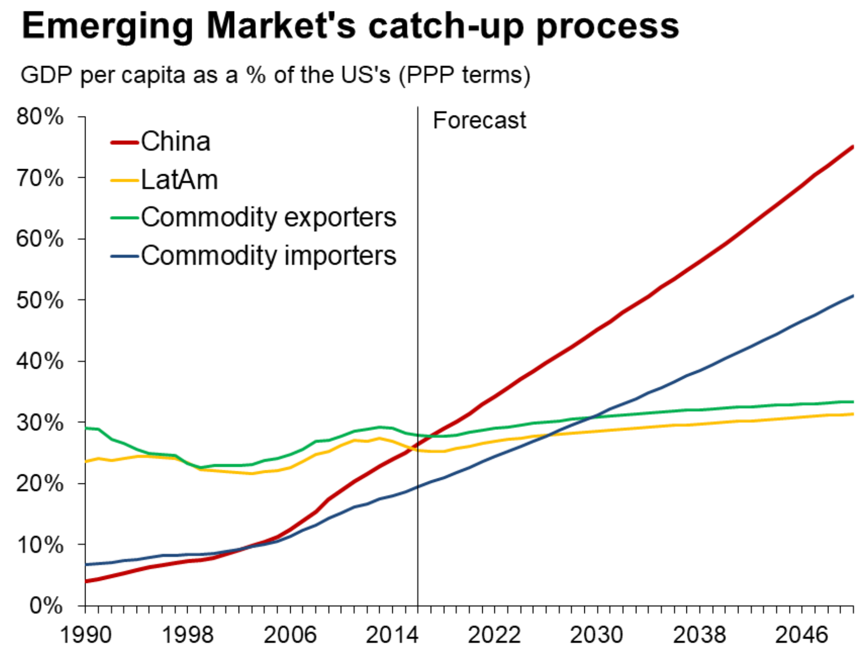


Source: Haver, Oxford Economics



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Latin America is in a sweet spot in 2017: but will it last?

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LatAm is in a ‘sweet spot’ in 2017

Higher ToT, weaker US$ and better politics are helping

- As the world’s major commodity exporter, the region benefited vastly from the upswing in oil and industrial metal prices in 2017

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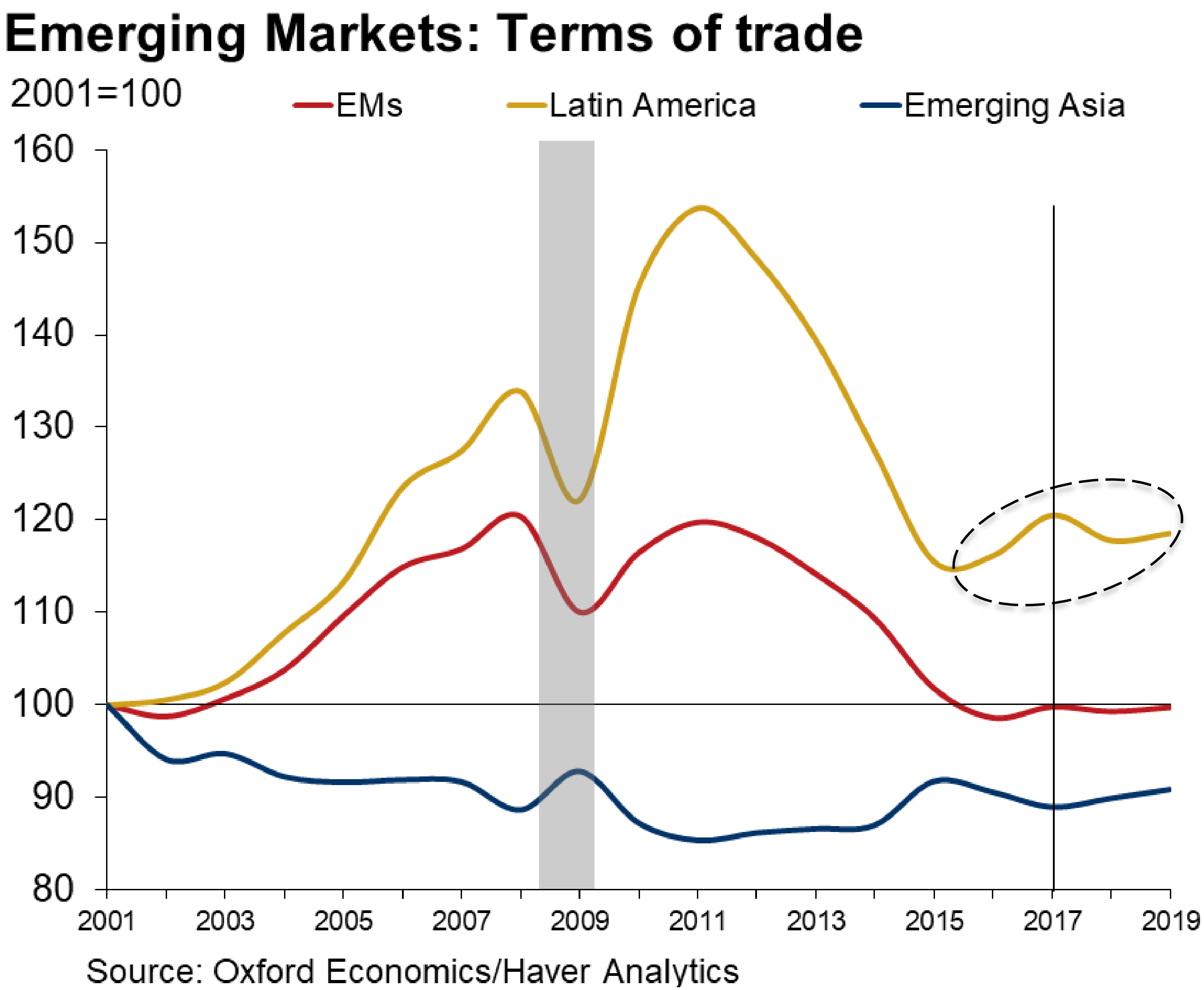
Terms of trade are supportive again after a long decline!



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- Even though governments have largely avoided the 'original sin' of the 1990s of issuing debt in US$, corporates have not. So the region also benefited from the weakness in the US$ in 2017

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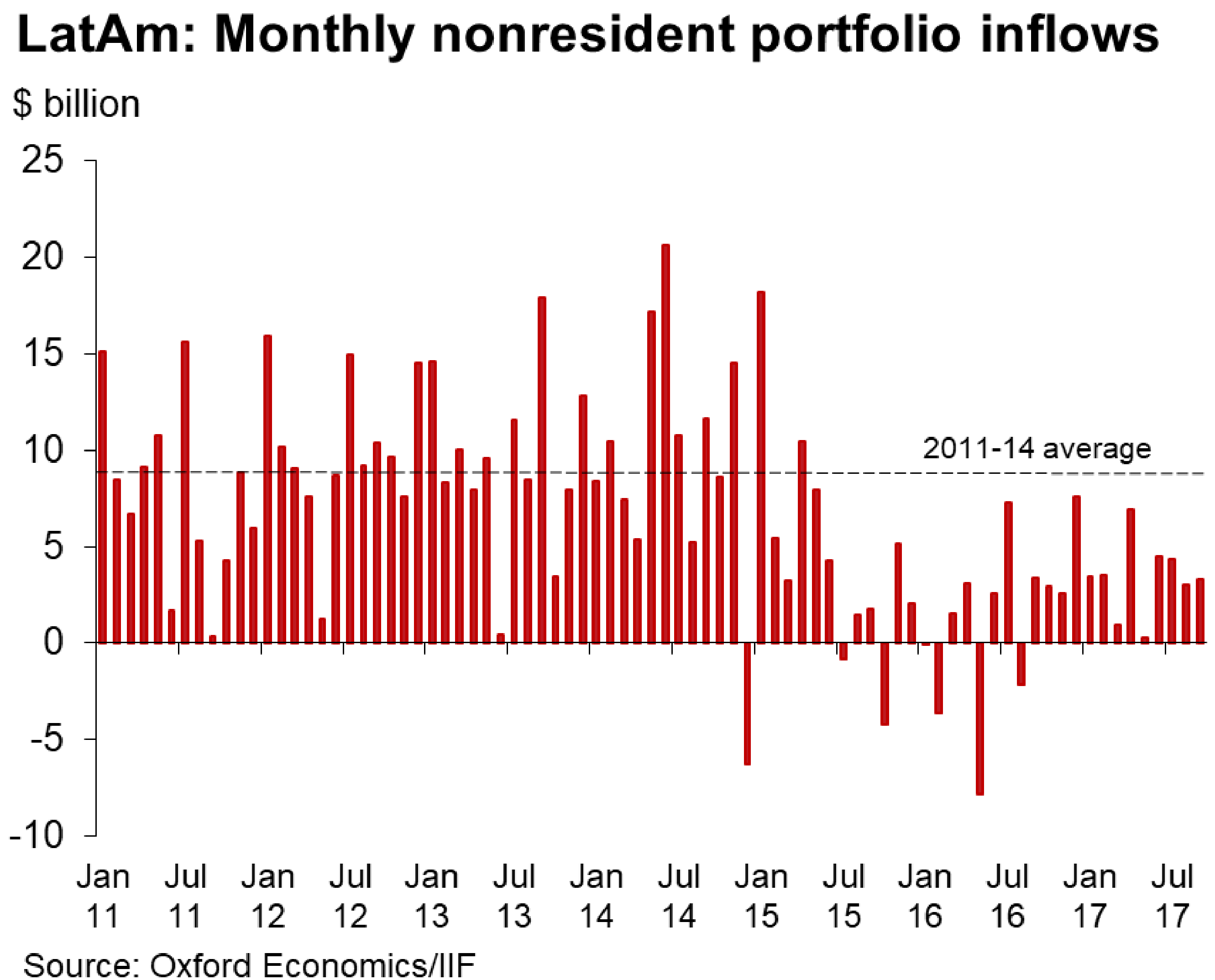
Triggering a gradual return in portfolio inflows…



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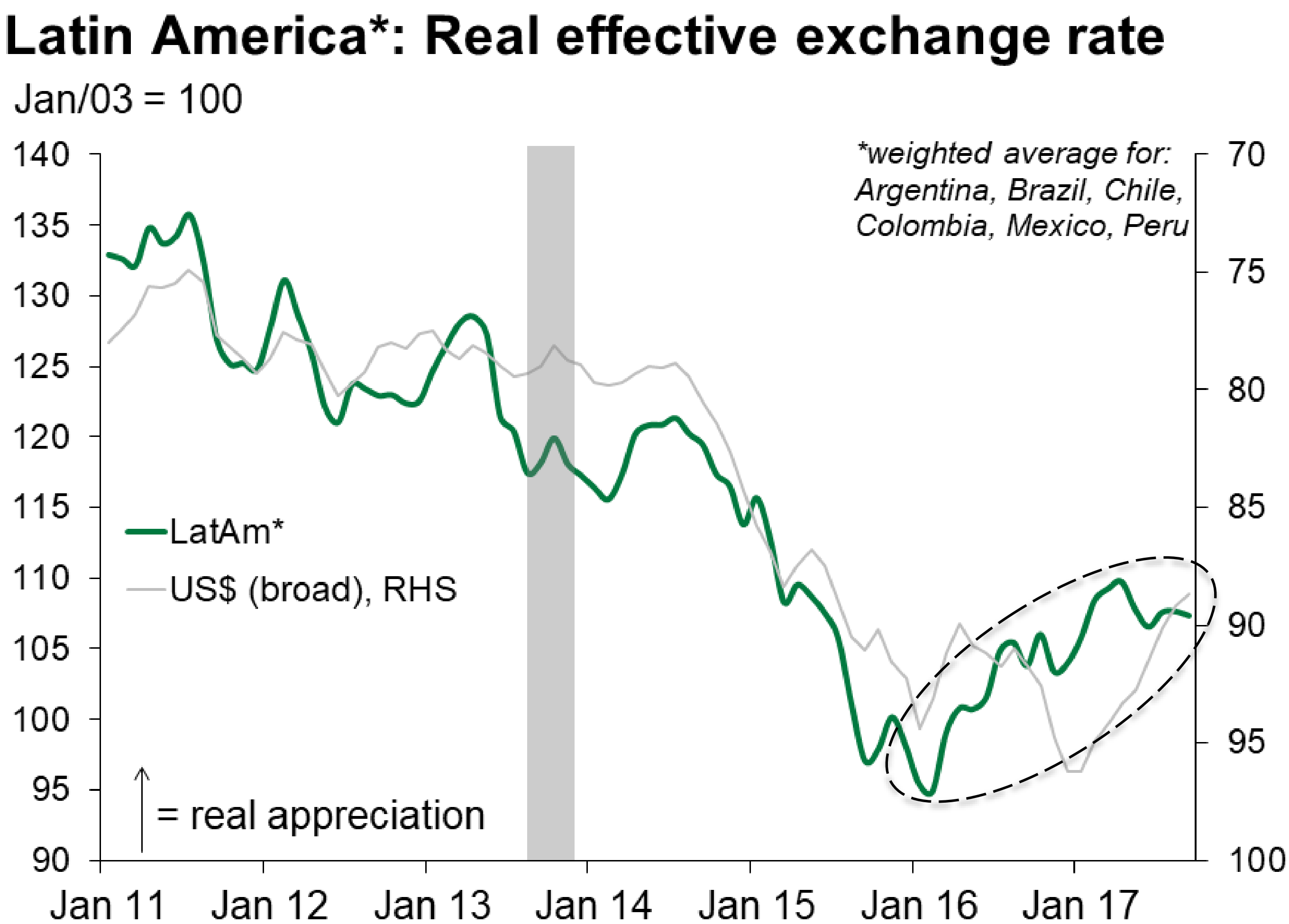
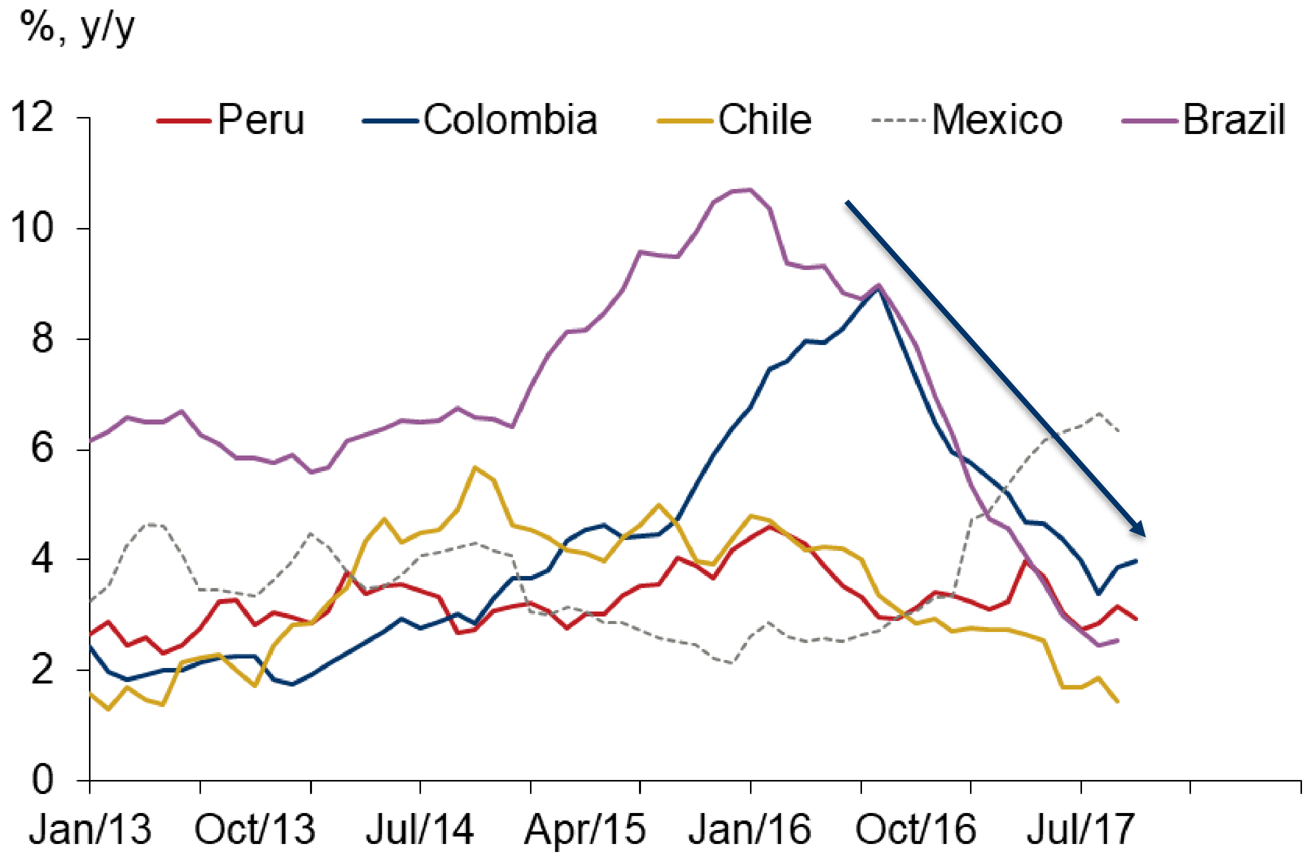
…helping to strengthen LatAm currencies…



Source: BIS / Haver Analytics

…supporting the decline in inflation…

Latin America: CPI



Source : Oxford Economics/Haver Analytics

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- Even though governments have largely avoided the ‘original sin’ of the 1990s of issuing debt in US$, corporates have not. So the region also benefited from the weakness in the US$ in 2017
- Traditionally, LatAm’s growth is highly correlated to the performance of terms of trade and the US$ (70% since 1995)

And this time it was no different…

Source: Haver/Oxford Economics

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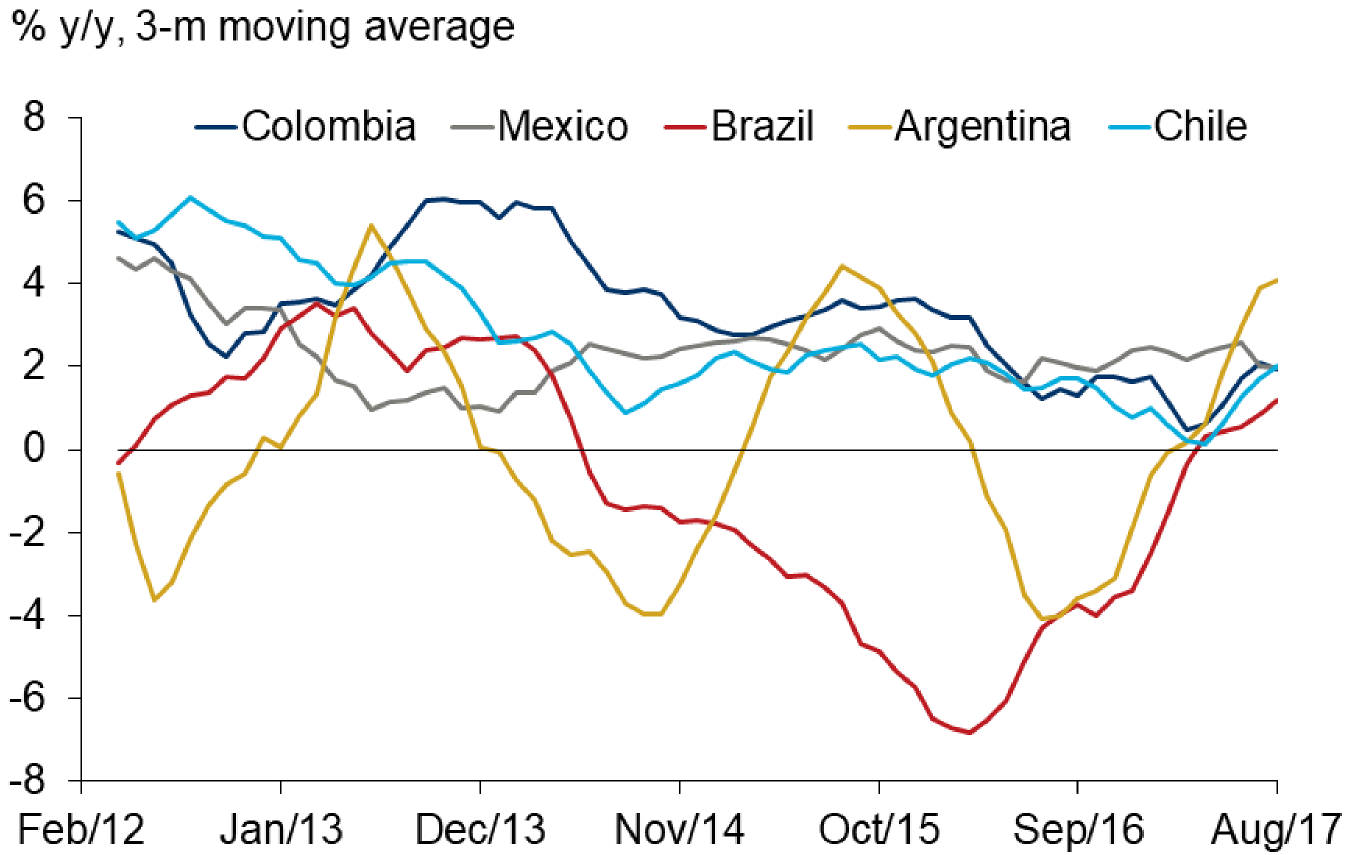
…with growth picking up across the board

Latin America: Monthly Activity Indicators



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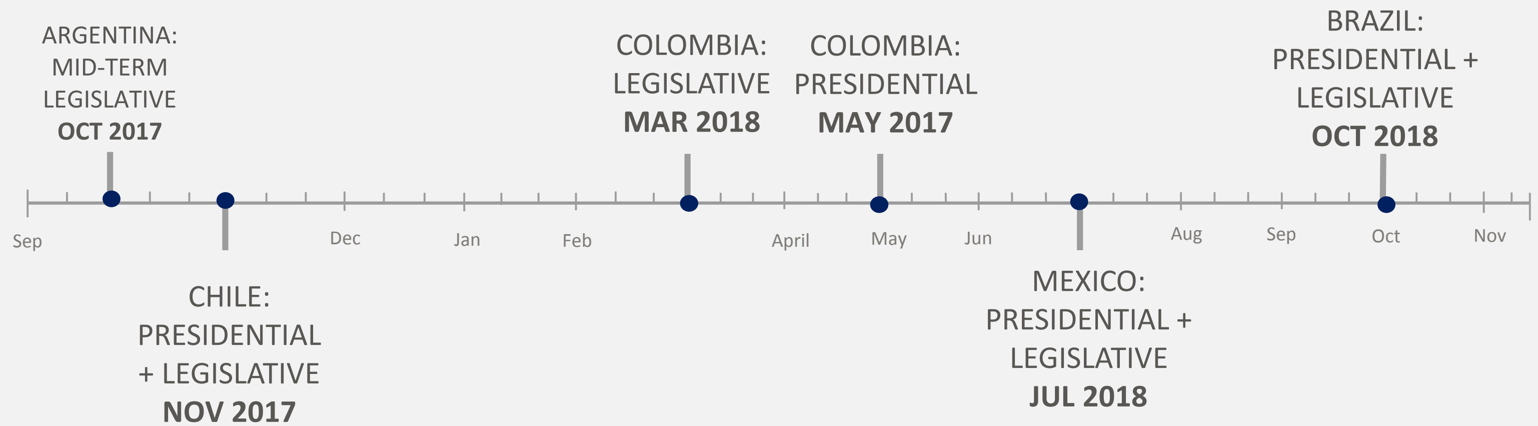
- Traditionally, LatAm’s growth is highly correlated to the performance of terms of trade and the US$ (70% since 1995)
- Last, but not least, domestic policymaking has improved in two of the largest countries in LatAm, helping Argentina and Brazil to emerge from recessions.

Can the ‘sweet spot’ resist the 2018 electoral schedule?

Next 12 months look like a political minefield in Latin America



Source: Oxford Economics

Aside from tail risks in Brazil and Mexico, we think so!

Chile and Colombia's battle is in the centre

- Out of the 4 elections in 2017-18, only Mexico's and Brazil's represent a populist threat.

- In Chile and Colombia, orthodoxy seems largely well rooted:

  - Chile: battle in the centre
  - Alejandro Guiller: continuation of Bachelet (centre-left)
  - Sebastian Pinera: continuation of his previous term (centre-right)

  - Colombia: the centre and the peace deal
  - Uribe's Centro Democractico (CD) playing anti-peace game
  - Santos' U unpopular, several independents, too early to call

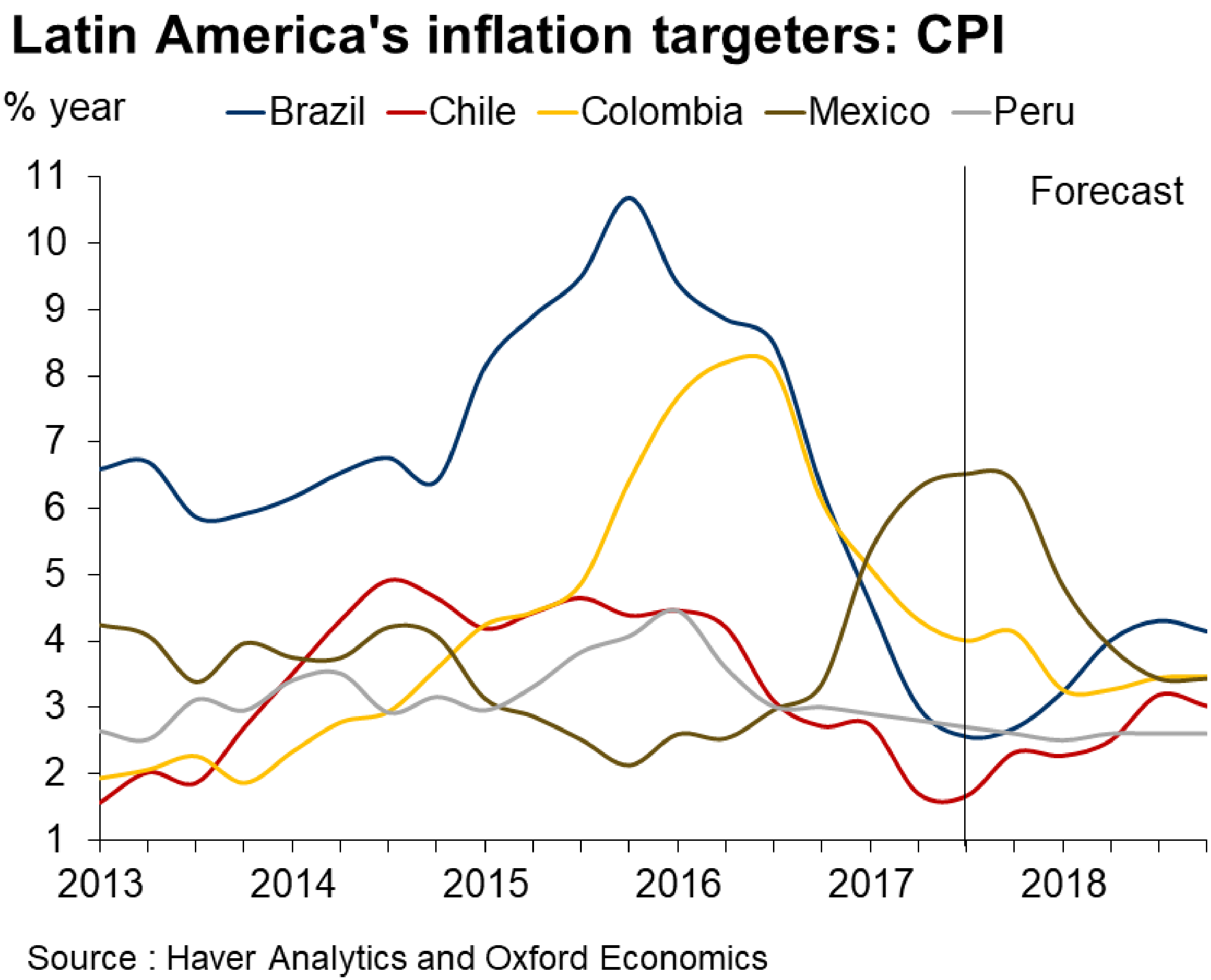
Aside from tail risks in Brazil and Mexico, we think so!

AMLO and Lula are threats, but they have their hands tied too

- AMLO may prove that his bark is worse than his bite
  - May govern like Brazil's Lula in 2002-2006
  - Showed pragmatism as Head of Gov't of Mexico City in 2000s
  - He's from Tabasco, oil state, unlikely to undo energy reforms
  - Macro: Banxico is independent and structural fiscal rules are strong – hands tied.

- Brazil's 2018 elections are a 'black box'
  - We think Lula (if allowed to run) will hardly exceed 30% support
  - After Lava-Jato, Lula has more rejection than support
  - One cannot rule out a right-wing Trump-like hardliner (Bolsonaro)
  - The middle will be fragmented with candidates
  - Yet, empty coffers will limit damage to the economy

Importantly, voters will reach the ballots with 'cheap food'…



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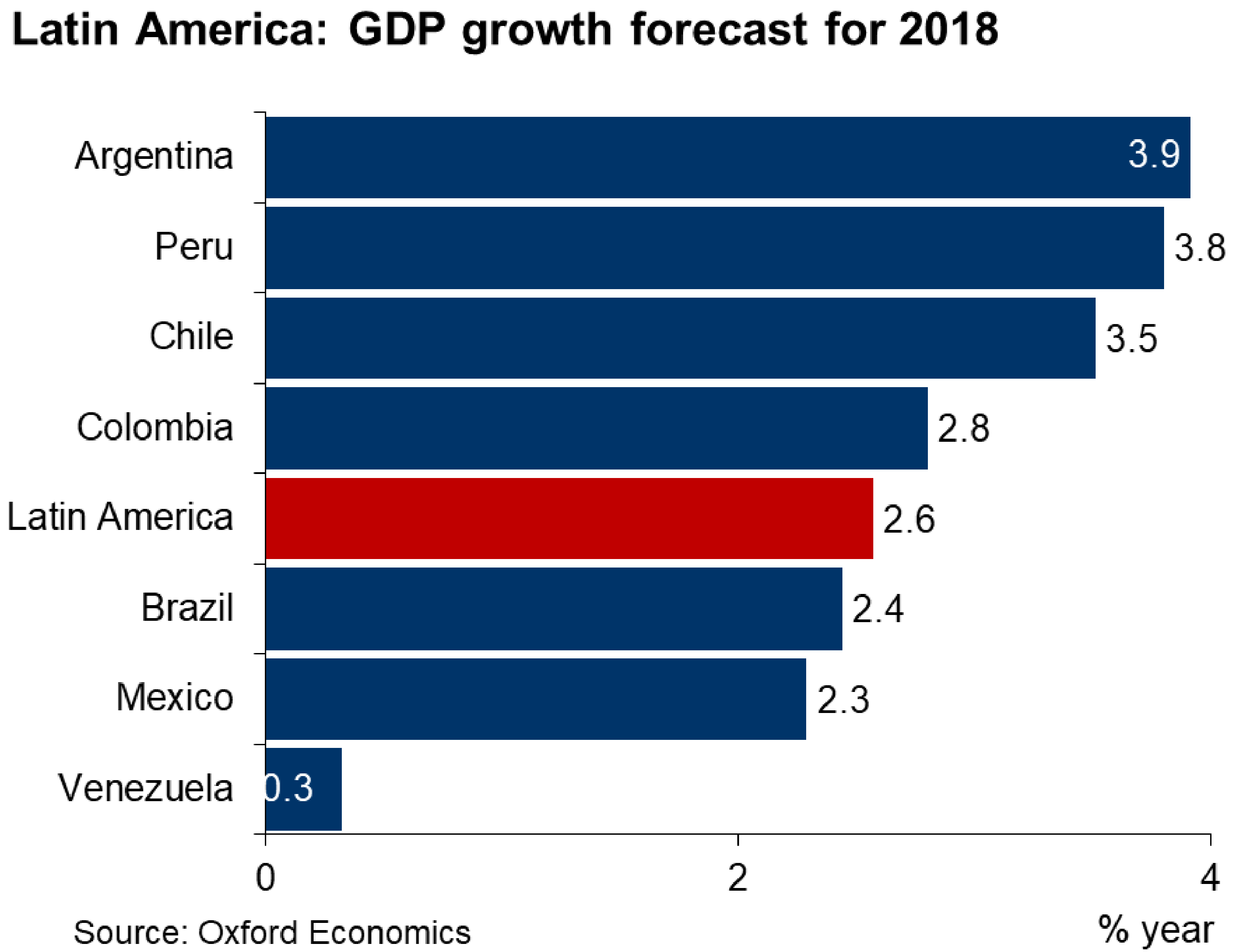
…and with economies growing at a decent pace



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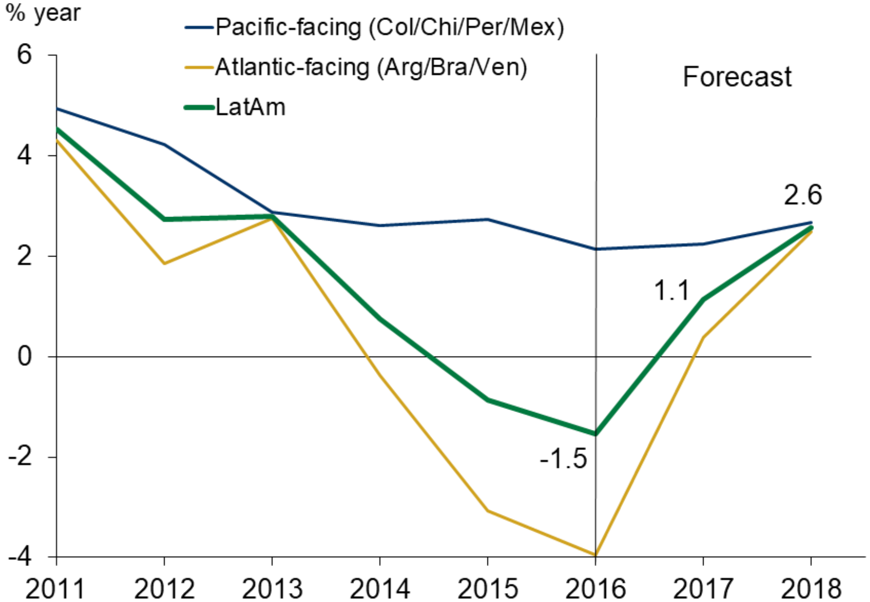
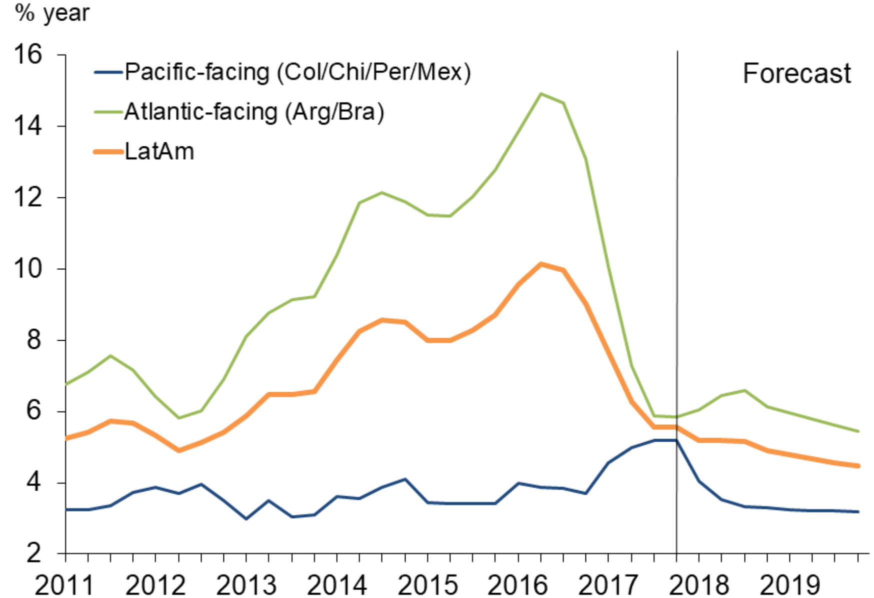
“NICE” outlook consolidates convergence within LatAm

Latin America: GDP growth



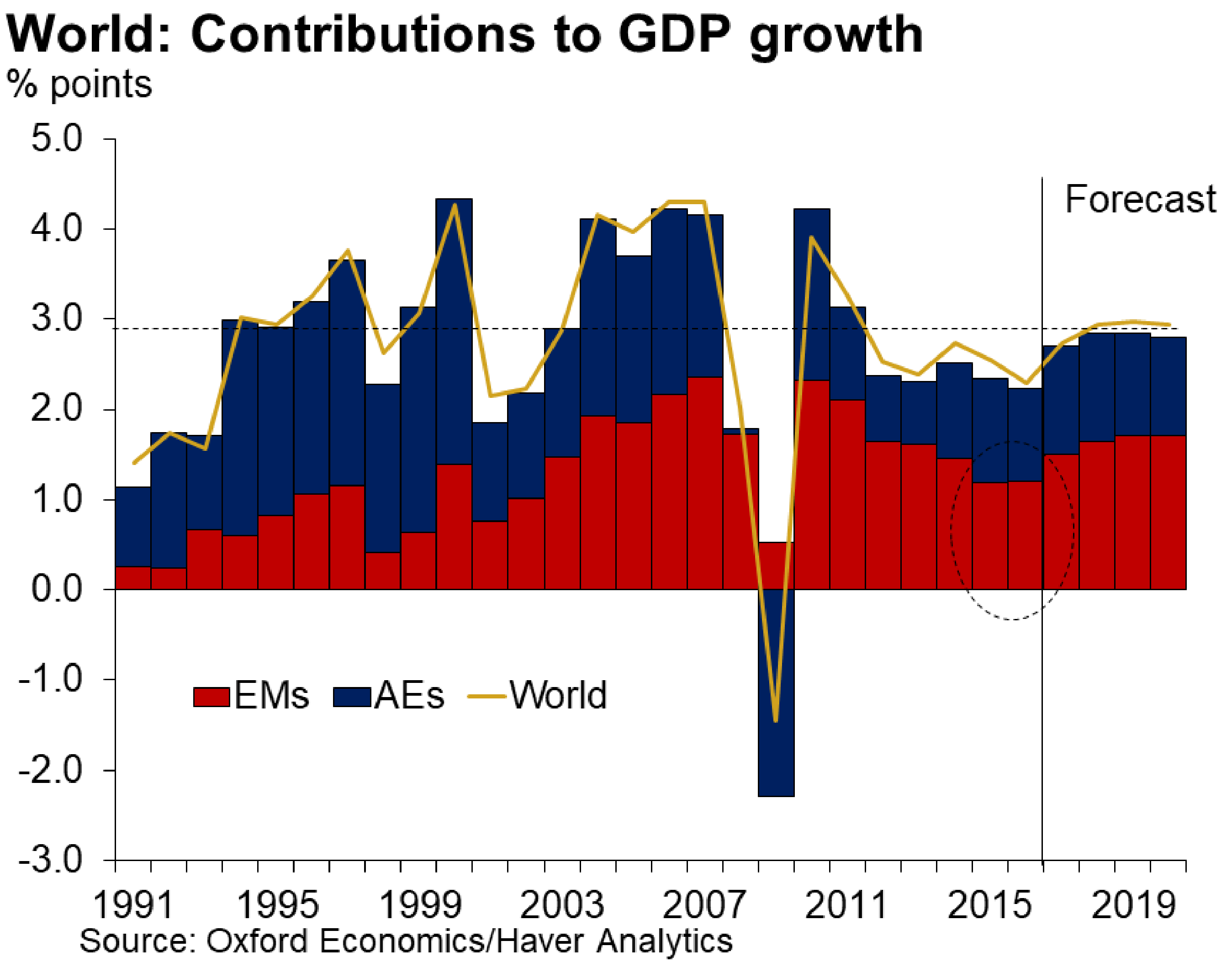
Source: Oxford Economics

Latin America: Inflation



Source: Oxford Economics

Sustained growth in LatAm to help world economy 'mean-revert'



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THANK YOU!

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Appendix: Nafta

Could the US abandon NAFTA?

A NAFTA collapse is <u>not</u> the most likely outcome:

- We think the parties will agree a 'modernized' NAFTA containing only modest changes.
- The overall impact on the North American economy would therefore be only very modest.

But the risk of an imminent US withdrawal from NAFTA should not be ignored:

- The parties have already cited "significant conceptual gaps" in how to rewrite the trade pact.
- If US negotiators insist on addressing bilateral trade deficits, talks could break down.

Mexico most exposed if the US withdraws from NAFTA

US withdrawal from NAFTA would create new barriers to US-Mexico trade:

- The US would be obliged to raise tariffs on Mexican imports of goods to "Most Favoured Nation" (MFN) rates – these rates are 3% on average.
- Likewise, Mexico would have to raise tariffs on US imports of goods to MFN rates – these rates are 8% on average.
- Added restrictions on cross-border sales for providers of services.

But US-Canada trade relations may remain largely unchanged, as the Canada-US Free Trade Agreement (CUSFTA) would come back into force.

Bilateral trade relations (2013-15 average)			
Location	**Partner**	**Non-energy bilateral exports, % total non-energy exports**	**Non-energy bilateral imports, % total non-energy imports**
United States	Canada	20%	11%
	Mexico	15%	13%
Canada	United States	73%	53%
	Mexico	1%	6%
Mexico	United States	81%	46%
	Canada	3%	3%

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