Latin American Economic Focus
Latin America Economic Outlook 2015-16

Economics

Latin America

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More adjustment and weak growth ahead
Inside we present our revised 2015 forecasts and unveil our 2016 numbers for the first time. In 2015, we see Latin America expanding by a lowly 1.4%, and accelerating to a still modest 2.8% in 2016. This means that the region would continue to underperform the global economy by a large margin in the period. Latin America is in transition and will use the next two years to adjust to an external environment that, on balance, will be less supportive for growth than it was in the past decade.

External conditions are clearly less benign
Latin America will continue to suffer from lower capital inflows as the Fed moves to normalise policy and from lower demand for commodities on account of a strong dollar and the shift in Chinese growth away from investment-intensive sectors. Outside of Mexico, few will be able to take full advantage of improved US growth conditions.

Domestic conditions also weighing on growth
The soft business and consumer confidence we see in most countries reflect not just less benign external conditions, but also the uncertainty created by policy initiatives aimed at trying to define what the growth model should be going forward.

Weaker currencies will be part of the equation
We think regional currencies will have to slide to correct sizable current account deficits in a context of shrinking capital flows, lower commodity prices, and falling elasticity of exports to global growth, a phenomenon the region is not immune to. Those currencies showing the highest degree of overvaluation –we see BRL, COP within the inflation targeters-- will have a harder time ahead.

Brazil is the elephant in the room
The region's fortunes will largely be determined by whether its biggest economy will finally turn its fortunes around. We think it is unlikely that new Rousseff administration will introduce the type of structural reforms needed to boost savings and investment in the economy. We see growth in 2015 and 2016 at lowly levels of 0.6% and 1.8%, respectively.

Mexico needs to show it can implement reform
Mexico is structurally best placed to benefit from a stronger US. But the authorities have to show that they can implement reform. Failure to get fiscal stimulus spending going in 2014 was not promising: we are lowering our 2015 growth forecast to 3.3%.

A mixed-bag in the Andeans
Strong monetary and fiscal stimulus should allow Chile and Peru to post modest rebounds in 2015, but growth will remain well below potential in both cases. We expect Colombia to remain the best performing economy in the region next year, but we worry that growth is too skewed to non-tradable sectors at present.

More pain to come in Argentina and Venezuela
We forecast that both countries will remain in recession next year, both could be in default on their external debt, and both will need to see large devaluations. At least in the case of Argentina, we see scope for improving conditions in 2016.

Risk assessment
We see a sharp slowdown in Chinese growth, increased capital outflows from EM, and Europe drifting into deflation as the biggest downside risks facing the economy. To the upside, we see the potential for higher US growth, a turnaround in policy in Brazil, and quicker implementation of structural reforms in Mexico.

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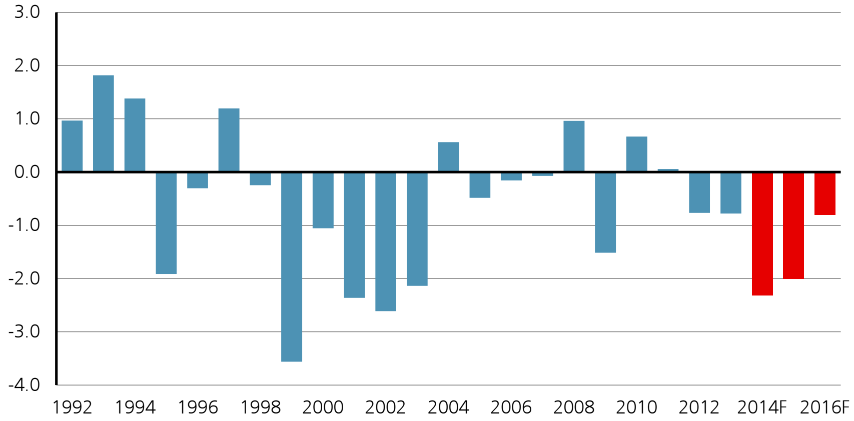
Latin America: More adjustment to come

2014 was a major economic disappointment for Latin America. By our estimates, the region will grow by a mere 0.9% this year, far lower than we had originally expected (3.2% in our year-ahead publication last year) and well below our global growth forecast (3.3%). Indeed, Latin America, which had shown strong correlation with global growth in the previous decade, has delivered a degree of economic underperformance this year that in the past was traditionally associated with a major economic dislocation, such as in the wake of the Tequila, Russian, Asian, or Argentine crises. Even excluding Argentina and Venezuela from our sample-- countries potentially spiralling down towards a macroeconomic episode of that type-- the region still underperformed this year, expanding by only 1.5% by our estimates.

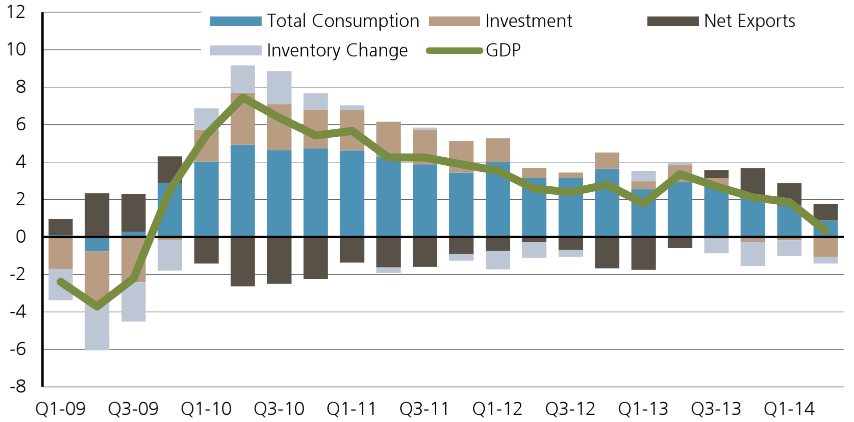
The region's growth underperformance in the absence of a major macro crisis is disconcerting and worrisome.

Figure 1: Latam vs Global Growth Differential, %



Source: IMF, UBS

Figure 2: Latam Real GDP Growth by Components, % y/y

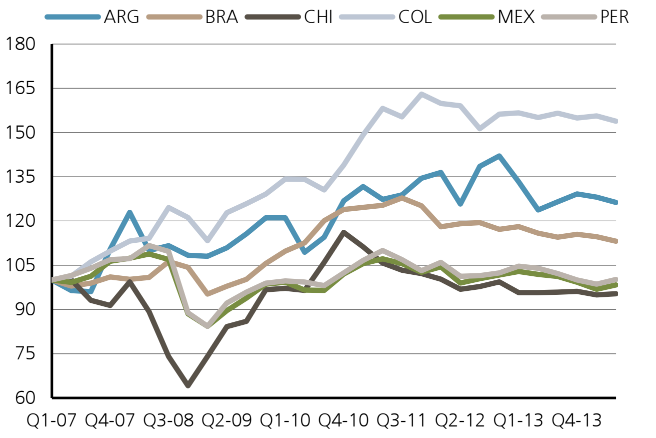


Source: Haver, UBS

There is both a glass half-full and a glass half-empty interpretation of this underperformance. The glass half-full version would posit that despite the weak growth, and again excluding Argentina and Venezuela, Latin America has not suffered major financial, fiscal, or balance of payments distress, a testament to the region's improved macroeconomic fundamentals. The glass half-empty version, however, portrays a region that has delivered much weaker growth in an external context that, whilst undeniably less favourable than in years past, has only just began to turn: the commodity super-cycle may have come to an end, but countries' terms of trade have thus far worsened only moderately. The Fed's quantitative easing, meanwhile, may be over, but global interest rates remain accommodative and capital flows to the region have declined moderately, far from the sudden-stops of old.

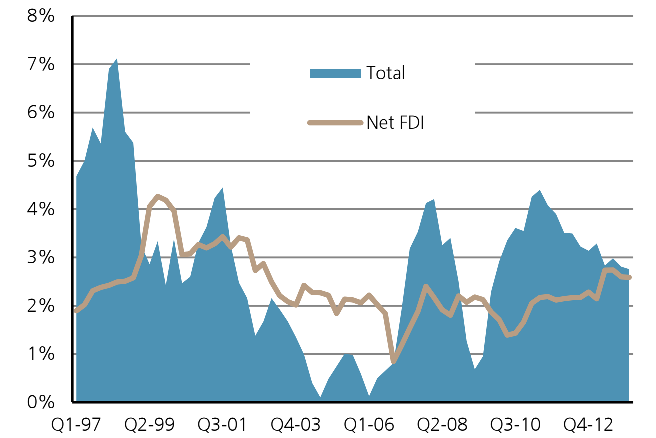
On balance, external conditions are likely to get worse for the region, not better.

Figure 3: Terms of Trade, Q1-07=100



Source: Haver, UBS

Figure 4: Capital Inflows into Latin America, % of GDP



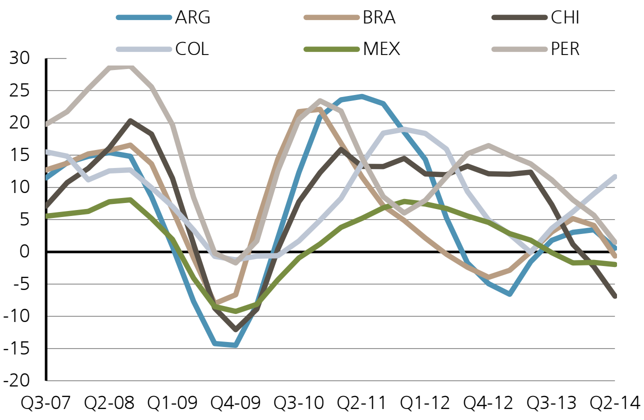
Source: Haver, UBS

Unfortunately, we have more sympathy for this latter view and worry that, on balance, the external conditions facing the region will continue to pose headwinds going forward. In particular, lower and less capital intensive economic growth out of China and higher interest rates in the United States will continue to put downward pressure on local investment and tighten credit conditions.

But external conditions alone cannot explain this year's underperformance. The weak and declining business and consumer confidence levels we have witnessed in much of the year are also a reflection of policy uncertainty, much of it created by countries trying to deliver improved domestic demand conditions or even structural overhauls in order to revive their economic fortunes. For instance, in Brazil, excessively loose and inconsistent macro-economic policies aimed at keeping household consumption strong reduced the corporate sector's willingness to invest in the past three years. In Chile, President Bachelet's decision to favour an overhaul of the education system and to increase taxes on corporations to finance it has also taken a toll on business confidence. And even in Mexico, rightly praised for its structural reforms, the corporate sector has been side-lined waiting for regulatory clarity and for fiscal spending to kick in effectively.

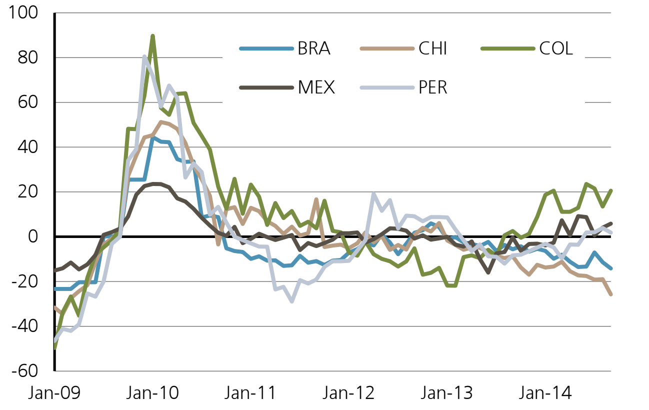
Policy uncertainty has also taken a toll on growth this year.

Figure 5: Real Fixed Capital Investment, % y/y, 4q ma



Source: Haver, UBS

Figure 6: Business Confidence, % y/y



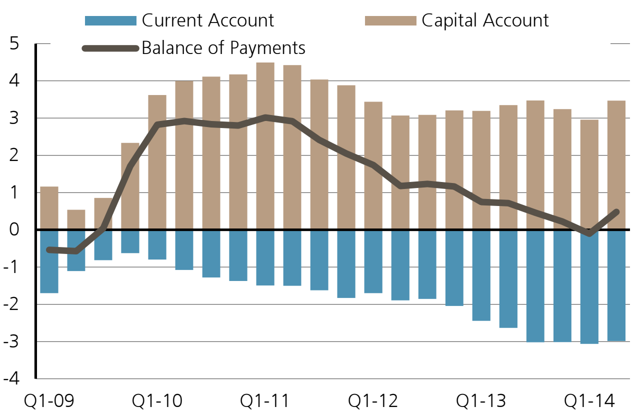
Source: Haver, BCRP, GSP, UBS

What all these policies have in common -- despite their glaring differences in terms of design, desirability, or even effectiveness -- is that they are all aimed at trying to redefine the growth model these countries should adopt going forward, particularly in light of the complicated external conditions described above. The key question facing the region in 2015 is whether these policies will bear fruit. Will they provide the catalyst the region needs?

Growth will remain modest. We expect the region to expand by 1.4% in 2015 and by 2.8% in 2016.

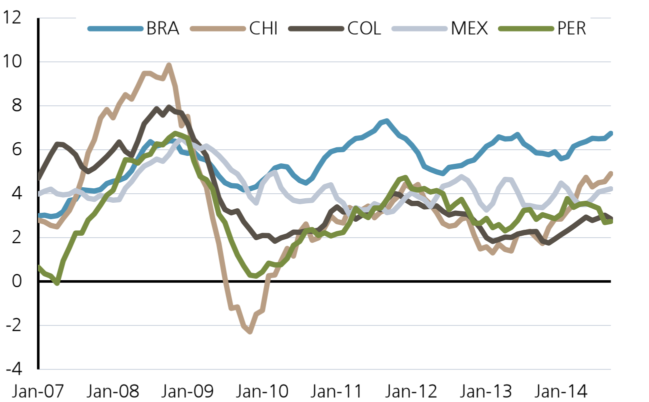
We have become more sceptical in this respect. At 1.4%, we estimate growth in 2015 will post some modest improvement relative to 2014, but will remain well-below UBS' global growth forecast for next year (3.5%). This is largely on account of the fact that we see the cyclical adjustment in the region as largely incomplete. Despite the current low growth environment, the region's current account deficit remains high. Many economies are only just beginning to veer away from full employment; fiscal deficits have increased across the board; both the demand and supply of credit look more impaired; inflation pressures have risen; and currencies are, on the whole, expensive in real terms. 2015 will therefore remain a year of adjustment –and of low growth. By 2016, we expect the region to start exhibiting a recovery (2.8% growth), with some structural reforms kicking-in in a number of countries, and with Argentina and Venezuela climbing out of their respective holes. Note, however, that even then the region will likely underperform global growth: Latin America is in an ongoing process of adjustment.

Figure 7: Latam Balance of Payments, % of GDP, annual



Source: Haver, UBS

Figure 8: Headline Inflation, 12m %



Source: Haver, UBS

Figure 9: Latam Growth, Inflation and Current Accounts Forecasts

Real GDP Growth	2011	2012	2013	2014F	2015F	2016F
Argentina	8.6	0.9	2.9	-1.9	-2.5	3.0
Brazil	2.7	1.0	2.5	0.3	0.6	1.8
Chile	5.8	5.4	4.1	1.8	2.8	3.5
Colombia	6.6	4.0	4.7	4.8	4.2	4.0
Mexico	4.0	4.0	1.1	2.2	3.3	3.8
Peru	6.5	6.0	5.8	3.3	4.0	4.8
Venezuela	4.2	5.6	1.3	-3.0	-1.5	0.5
Latam	**4.2**	**2.6**	**2.5**	**0.9**	**1.4**	**2.8**
Latam ex Arg and Ven	**3.7**	**2.6**	**2.5**	**1.5**	**2.0**	**2.9**
World	**4.3**	**3.3**	**3.3**	**3.3**	**3.5**	**3.6**
Year-End Inflation	**2011**	**2012**	**2013**	**2014F**	**2015F**	**2016F**
Argentina	9.5	10.8	10.9	26.0	30.0	25.0
Brazil	6.5	5.8	5.9	6.4	6.8	5.8
Chile	4.4	1.5	2.8	4.7	3.2	3.3
Colombia	3.7	2.4	1.9	3.3	3.0	3.0
Mexico	3.8	3.6	4.0	4.1	3.4	3.3
Peru	4.7	2.6	2.9	2.9	3.0	2.5
Venezuela	27.6	20.1	56.2	68.0	75.0	60.0
Latam	**7.2**	**6.3**	**9.2**	**10.8**	**11.4**	**9.3**
Latam ex Arg and Ven	**5.4**	**4.5**	**4.7**	**5.2**	**5.0**	**4.4**
World	**4.2**	**3.2**	**3.2**	**3.5**	**3.4**	**3.2**
Current Account, % of GDP	**2011**	**2012**	**2013**	**2014F**	**2015F**	**2016F**
Argentina	-0.7	-0.2	-0.8	-0.9	-0.9	-0.9
Brazil	-2.1	-2.4	-3.7	-3.7	-3.4	-3.3
Chile	-1.3	-3.4	-3.5	-1.6	-1.6	-2.0
Colombia	-2.9	-3.2	-3.4	-4.1	-3.5	-3.4
Mexico	-1.2	-1.3	-2.1	-2.1	-2.6	-2.4
Peru	-1.8	-3.1	-4.4	-5.1	-3.5	-3.5
Venezuela	7.7	2.9	2.1	5.1	4.2	4.0
Latam	**-1.2**	**-1.6**	**-2.6**	**-2.5**	**-2.4**	**-2.4**
Latam ex Arg and Ven	**-1.9**	**-2.3**	**-3.2**	**-3.2**	**-3.1**	**-2.9**

Source: Haver, UBS

We see few prospects for structural reform in Brazil.

Of course, such broad regional strokes hide important differences at the country level. Much of the region's malaise this year, and the underperformance we continue to foresee in years to come, is driven by Brazil. 2014 was plagued by electoral uncertainty, but we think the bigger problem facing Brazil is that without deep structural reforms aimed at lifting both the saving rate and investment, the economy will be mired in a low growth environment.

Mexico's fortunes will depend on the government's ability to implement its reforms.

Contrary to most countries in the region, Mexico's economy is on a clear upswing and closely tied to the United States. But a failure to implement capital spending effectively by the government has led to lower than expected growth this year, a phenomenon that we think will still weigh on the economy in 2015.

We think Chile and Peru will soon halt their economic slide and start exhibiting signs of recovery, thanks in large part to looser monetary conditions and more expansionary fiscal policies. But we do not see either returning to their traditional rates of growth any time soon. The catalyst for that to happen, especially in economies where the household sector still needs to experience to tighten its belt further, is simply not there, in our view.

Peru and Chile will rebound in 2015, but their growth will remain well below potential.

Colombia is the living proof that with the right countercyclical policies, especially with a focus on infrastructure spending, an economy can ride out some the external headwinds the region is currently experiencing. However, we think 2015 will show that such policies have their limits, especially in light of a widening current account deficit and low growth from tradable sector. Growth will likely be lower and COP will have to adjust next year.

Colombia remains the star performer in the region, but we worry about the composition of its growth.

Both Argentina and Venezuela remain mired in crises that are largely of their own-making. Excessively lax fiscal policies, a reliance on the money press for financing, and a proclivity for fixed exchange rates to anchor inflation are the backbone of both models, ultimately fuelling inflation, economic compression, and capital flight. Both countries appear to be reaching a breaking point, but policy response remains slow. Our base scenario remains one where these countries remain mired in recession.

Argentina and Venezuela will remain mired in recession next year.

In what follows, we analyse the region's sensitivity to different growth scenarios. We also examine in more detail some key themes that have featured highly in UBS' global research, including the strong dollar, the importance of infrastructure, the sluggishness in global trade, and the risk posed by China. Lastly, we have a country section where we provide a more detailed outlook for the seven largest economies in the region.

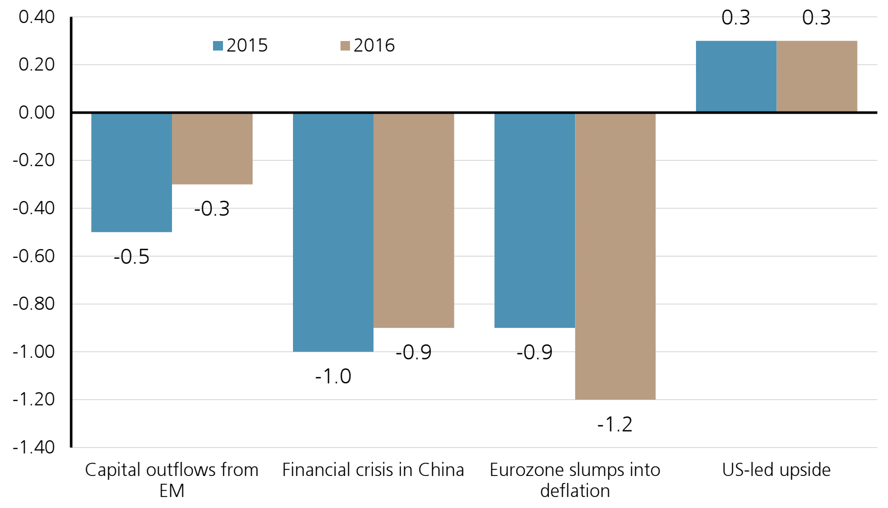
Growth sensitivity analysis

Our baseline scenario described for Latin America is not without risks. A number of factors could still destabilize the world economy, with relevant implications for Latam. Upside growth scenarios are also possible. In our latest *Global Economic Outlook 2015-2016*, Nov 3, 2014, Larry Hatheway and Andrew Cates lay out how some of these possible outcomes could impact regional and global growth. Specifically, they show the impact on GDP growth of four specific scenarios (with 55% probability given to the base scenario used in our core numbers): 1) capital outflows from EM (10% probability); 2) a financial crisis in China (15%); 3) an European deflation scenario (10%); and 4) a US-capex led boom (10%).

We examine the impact on Latin American growth of different shocks, including a bursting of China's credit bubble, Europe sliding into recession, a contraction in flows to EM, and stronger than expected US growth.

In the first scenario, they assume capital outflows from EM will intensify in response to a more rapid normalization of Fed policy than is currently anticipated. If so, underlying fragilities in some emerging markets with external vulnerabilities could come to the fore. In the second scenario, the assumption is an increase in financial stress in China— led by a bursting of China's credit bubble to the property sector – which could trigger a jump in NPLs and a sharp drop in asset prices. In the third, they assume the Eurozone fails to generate higher inflation and instead faces a long period of deflation. This scenario could arise if the European recovery falters. Finally, they assume a more positive outcome: the US economy grows faster than expected, driven by high profitability, faster business investment and stronger housing activity. In figure 10, we summarize how our baseline scenario, which has global GDP growth reaching 3.5% in 2015 and 3.6% in 2016 (from 3.3% in 2014), would be affected by each of these events.

Figure 10: Impact on Latam Growth from Potential Global Shocks



Source: UBS

To give some sense of how these issues could impact the Latin American economies, we outline in figure 11 the sensitivity of growth in the region to key sources of shocks. We ran a VAR model for the most important countries in the region. To control for its impact on the global economy, the model also incorporates GDP growth for the US, the Eurozone and Latin America. We also include commodity prices in an attempt to assess the secondary effects of the slowdown on these prices and, as a consequence, on the economy.

According to our simulations, the most adverse scenario for the region is clearly the financial crisis in China. With Chinese growth moving down to 5.2% next year (from 6.8% in our base case), we would expect Latam growth to drop by 0.9 p.p. to 0.5% in 2015 (from a baseline of 1.4% growth in 2015). Brazil would lead the way down, with the GDP contracting by 0.7% in 2015. As this scenario is the most important risk factor for the region and has the highest probability of occurring among the four shown scenarios, we discuss it in further detail in theme 4 below. The second major risk for the region is a Eurozone deflation outlook, which would have the potential to cut growth in the region by 0.8 p.p. in 2015 – this scenario assumes the Eurozone contracts by 0.1% in 2015 compared with our baseline of +1.2%. In this case, the most affected country in the region would be Peru (-1.5 p.p.), followed by Argentina (-1.0 p.p.), Brazil (-0.8 p.p.) and Mexico (-0.8 p.p.). A capital outflow from EM is also an important shock for the region, with Brazil again being the most affected (-0.9 p.p.).

According to our sensitivity analysis, the region is particularly sensitive to a downturn in Chinese growth.

Figure 11: Sensitivity Analysis

	2014F	2015F	2016F		2014F	2015F	2016F
Base case (55%)				**The Eurozone slumps into deflation (10%)**			
World	3.3	3.5	3.6	**World**	3.3	2.5	2.4
Latam	1.0	1.4	2.8	**Latam**	1.0	0.6	2.9
Argentina	-1.9	-2.5	3.0	**Argentina**	-1.9	-3.5	2.4
Brazil	0.3	0.6	1.8	**Brazil**	0.3	-0.2	2.2
Chile	1.8	2.8	3.5	**Chile**	1.8	2.7	3.6
Colombia	4.8	4.2	4.0	**Colombia**	4.8	3.8	3.9
Mexico	2.2	3.3	3.8	**Mexico**	2.2	2.5	3.8
Peru	3.3	4.0	4.8	**Peru**	3.3	2.5	4.7
Venezuela	-3.0	-1.5	0.5	**Venezuela**	-3.0	-2.0	0.0
Capital outflows from emerging markets intensify (10%)				**US-led upside (10%)**			
World	3.3	2.9	3.3	**World**	3.3	3.7	3.9
Latam	1.0	0.8	2.7	**Latam**	1.0	2.3	2.9
Argentina	-1.9	-2.9	3.0	**Argentina**	-1.9	-2.0	3.9
Brazil	0.3	-0.3	1.7	**Brazil**	0.3	0.9	1.5
Chile	1.8	2.5	3.3	**Chile**	1.8	3.8	3.7
Colombia	4.8	3.6	3.9	**Colombia**	4.8	5.2	3.8
Mexico	2.2	2.8	3.9	**Mexico**	2.2	4.8	3.8
Peru	3.3	3.4	4.2	**Peru**	3.3	4.5	4.4
Venezuela	-3.0	-2.6	-1.1	**Venezuela**	-3.0	-0.2	3.1
Financial crisis in China (15%)							
World	3.3	2.4	2.7				
Latam	1.0	0.5	2.6				
Argentina	-1.9	-3.0	3.0				
Brazil	0.3	-0.7	1.7				
Chile	1.8	2.4	3.3				
Colombia	4.8	3.4	3.8				
Mexico	2.2	2.6	4.0				
Peru	3.3	3.2	4.0				
Venezuela	-3.0	-3.0	-1.6				

Source: UBS

Theme 1: Latin America and the strong US dollar

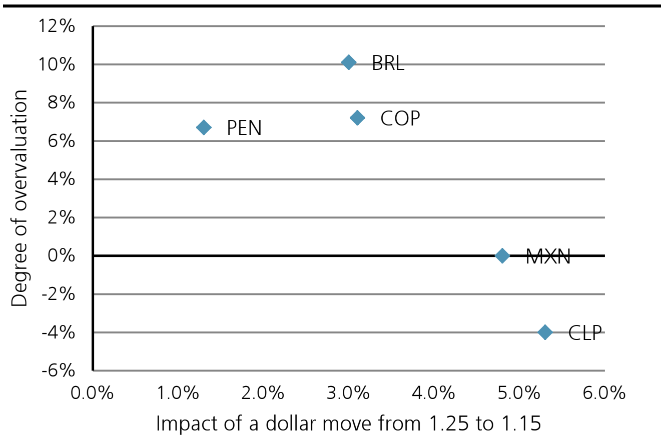
One of UBS' central global themes for coming quarters is a stronger dollar (see Larry Hatheway's and Andrew Cates' "A Strong Dollar" published on Sep 15). Premised on both cyclical and structural factors, we see the greenback appreciating to 1.20 and 115 against the euro and yen respectively by the end of 2015 and to 1.15 and 120 by YE 2016.

A stronger dollar spells greater currency slides for Latin American currencies ahead.

What will the stronger dollar mean for Latin America? For most countries in our sample, it almost inevitably translates into further currency weakness ahead. Latin America is heavily skewed towards the production and export of commodities, whose prices tend to move in opposite direction to that of the dollar (precisely because they are usually quoted in dollars: the stronger the dollar, the fewer dollars it takes to buy one unit of a given commodity). Also, in recent years, Latin America has, as a region, diversified its trade away from the US, making it less of a beneficiary of US economic strength. Lastly, the region currently exhibits sizable current account deficits that will likely require further currency adjustment. This is particularly true as the elasticity of Latam exports to a global recovery appears to be lower in this cycle than it has in the past, something that our Emerging Market strategist, Bhanu Baweja, has been emphasizing for some time now (and that we explore further in Theme 3).

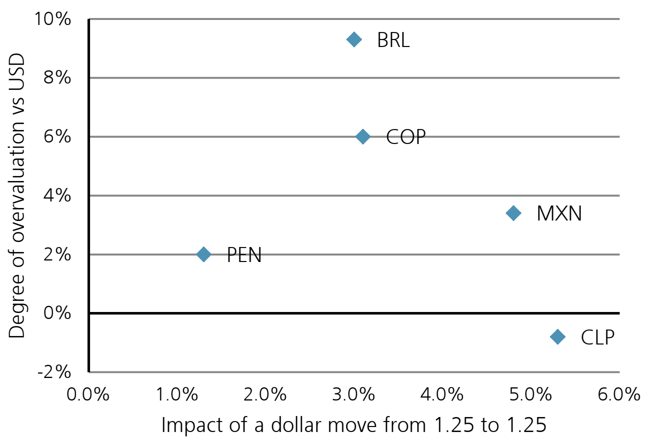
To see just how much Latin American currencies will be affected by the stronger dollar, we run a regression analysis using the dollar (DXY or the Eurodollar cross), country spreads (EMBI), commodities (CRB index), selected commodity prices (Brent oil and copper) and the VIX as explanatory variables. Other things being equal, a stronger dollar (1.15 vs. 1.25 to the euro; +8%) would affect currencies in the region in the following way: CLP (-5.3%), MXN (-4.8%), COP (3.1%) and BRL (-3.0%) and the PEN by only -1.3%. Note that in the case of BRL, dollar strength is felt particularly through the commodity channel.

Figure 12: Degree of Overvaluation (PPP) vs Impact of USD Move on Latam Currencies



Source: Haver, UBS

Figure 13: Degree of Overvaluation (FEER) vs Impact of USD Move on Latam currencies



Source: Haver, UBS

Of the inflation targeters, BRL and COP show both sensitivity to the dollar and a high degree of overvaluation.

How does this mesh with measures of fair value for these currencies? Figures 12 and 13 map the predicted depreciation of Latam currencies against two measures of "fair value" calculations for the currency: one, a traditional PPP calculation using CPI as a deflator, and the other using UBS' in-house FEER measure (a measure of how much a currency would have to move in real terms in order to bring the current account plus FDI back into balance). Broadly speaking, both are showing

that BRL, COP, and PEN exhibit the highest degree of overvaluation in the region (outside ARS and VEF, of course, which we do not include in this exercise). CLP and MXN exhibit low levels of overvaluation (indeed both the FEER and PPP measures show CLP to be undervalued at present) but they are also the currencies that appear more sensitive to dollar strength, implying that they could suffer moves that bring them back to equilibrium (MXN) or move them deeper into cheap territory (CLP).

Figure 14 shows our FX forecast for the region. Note that within the inflation targeters, we have the biggest depreciation moves in BRL, COP, and PEN next year. Our FX forecast for MXN and CLP are consistent with the degree of overvaluation we currently see in them, but they may be challenged by their exposure to USD as outlined by our sensitivity analysis above. We expect sizable devaluations in ARS and VEF (for details, see country write-ups).

Figure 14: Latam FX Yr-End Forecasts, local currency/USD

	2011	2012	2013	2014F	2015F	2016F
Argentina	4.29	4.88	6.32	8.70	12.50	18.00
Brazil	1.87	2.05	2.36	2.60	2.75	2.90
Chile	521	479	524	590	610	600
Colombia	1943	1768	1927	2000	2150	2250
Mexico	13.99	13.01	13.08	13.20	13.30	13.00
Peru	2.70	2.57	2.79	2.92	3.05	3.10
Venezuela	4.30	4.30	6.30	16.21	27.56	45.47

Source: Haver, UBS

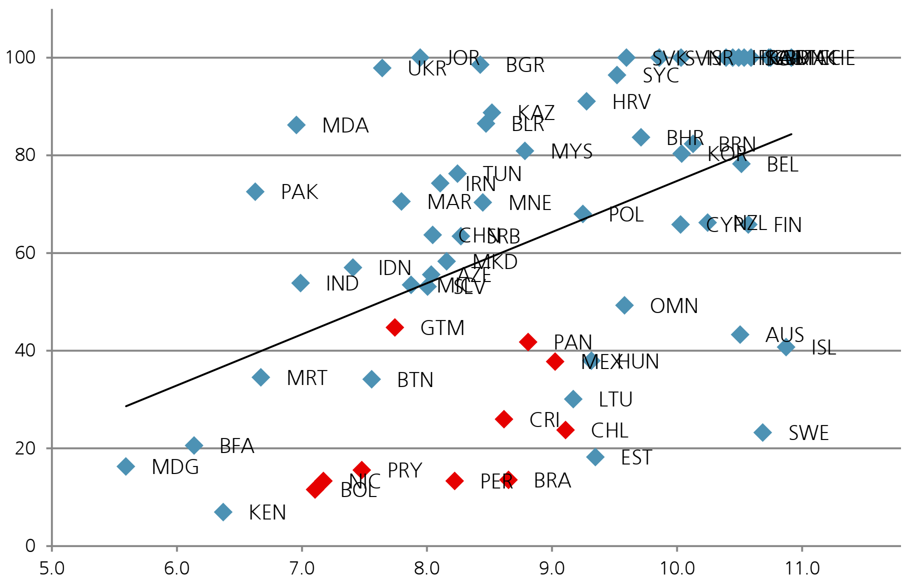
Theme 2: Infrastructure spending as the new saviour?

Most policymakers in Latin America have turned their heads towards infrastructure spending as the new holy grail of growth in coming years. In a world where domestic demand conditions are weak and exports are failing to get much traction, public-sector-led infrastructure projects or projects engaging the private sector through PPPs enjoy undeniable attraction. Infrastructure spending can help provide a boost to domestic demand, increase productivity, and deliver a positive multiplier effect to wider sectors in the economy. Indeed, in its most recent World Economic Outlook, the IMF devotes a whole chapter to extolling the virtues of pushing infrastructure spending in the current economic juncture.

All policy-makers in the region are enamoured with higher infrastructure spending to boost productivity growth and gains.

Latin America would appear to be an excellent candidate to invest in infrastructure given that it lags badly behind other regions in this regard (as exemplified by figure 15, showing low road penetration, and figure 16, showing the region's lowly ranking in indicators of competitiveness).

Figure 15: GDP per capita log (constant 2005 US$, x-axis) vs. Paved Roads (% of total roads, y-axis) , 2011

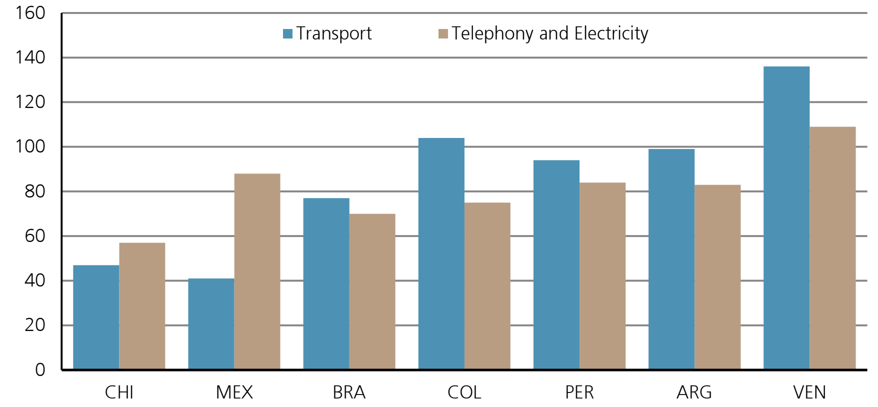


Source: World Bank, UBS

Financing poses a challenge…

Still, engaging in infrastructure spending is not without its challenges. Financially, local banking systems may not be geared up to help fund long term projects, and government development banks may not always be in place to lend a hand. Instruments matching the long term funding needs of these projects with pockets of long term savings in the economy -- such as pension funds -- are still underdeveloped in the region. Attracting foreign funding, meanwhile, may not be easy in a world where capital flows become scarcer as interest rates start to rise and in one where more countries look to push infrastructure simultaneously. Hedging local currency exposure in such long term projects is also a challenge. Last of all, of course, securing government financing may also prove challenging, especially in economies that may already be slowing down.

Figure 16: Global Competitiveness Report: Infrastructure Rank*



*Out of 144 countries

Source: World Economic Outlook

... as do environmental and community concerns.

Beyond financing, infrastructure projects can run into important constraints. Increased awareness of the negative environmental externalities infrastructure projects can impose coupled with weak institutions to assess those costs can delay or even derail important projects. Moreover, local community-activism is also on the rise, demanding compensation for the construction of infrastructure projects on their lands, a thorny issue in areas where the provision of public services by the state is particularly lacking. Lastly, of course, there is implementation risk, including that of potential corruption.

Colombia appears to have the best laid infrastructure plans at the moment.

So who gets it right? All countries in the region pay lip service to their commitment to infrastructure spending, but where is it actually working? Top of the class at the moment is Colombia, where a combination of social housing projects and infrastructure spending --particularly through its 4G road program-- keep the construction sector as the main engine of growth in the economy. The 4G program calls for USD25bn in total investment and 6 out of 40 projects have already been awarded. Despite its success, securing financing remains a challenge. In Peru, the government is trying to make up for lower investment in mining with increased infrastructure spending, with a particular focus on transport and sanitation. But implementation has been poor, particularly at the regional level, where a number of high profile corruption scandals have derailed spending. In Chile, the slowdown in economic activity has prompted the authorities to budget a record 27.5% increase in public investment next year. Still, for an administration whose focus has been elsewhere (education, tax reform), it is unclear that projects can be lined up sufficiently quickly and efficiently for them to materialise.

The failure to kick-start capital spending by the administration in Mexico is disappointing.

Mexico, meanwhile, has been beating the drums of infrastructure spending since President Peña Nieto took office, but so far, with negligible impact on activity. The 2014-18 National Infrastructure Plan calls for a whopping USD575bn accumulated infrastructure spending. About two-thirds of this is supposed to come from the public sector and about half of the total plan is centred on energy. This is all well and good, but government capital spending this year has been disappointing, even on small scale road projects over which the authorities should have exerted greater control.

In Brazil, after almost a decade without engaging the private sector in infrastructure projects, the government finally announced in late 2012 a concession program of around USD100bn for roads, rails, airports and ports. However, the government's attempt at controlling the profits on such projects led

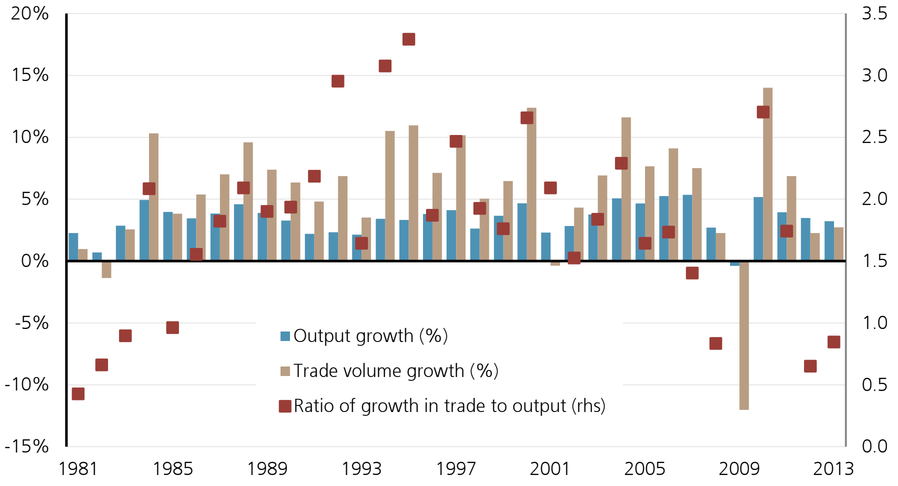
to a failure in attracting investors and to a delay of the first auctions by more than one year. After several failures, the government finally agreed to increase the return on projects and did succeed at attracting investors for many airports and a few roads. Even if the government is now less restrictive on making PPPs, the most attractive assets were already offered, which means that attracting private investors for coming projects may not prove easy.

Theme 3: Slower global trade and Latin America

In the report "Is the trade slowdown cyclical or structural (August 1, 2014) our strategists Baweja, Cates, Narain and Lamaa argued that the main issue facing EM over the medium term is the loosening relationship between global growth and global trade (figure 17). Trade has a high beta element of output, which means that each unit of output growth should lead to a more than proportional effect on trade growth. But in recent years this relationship is narrowing and the beta is getting close to 1.

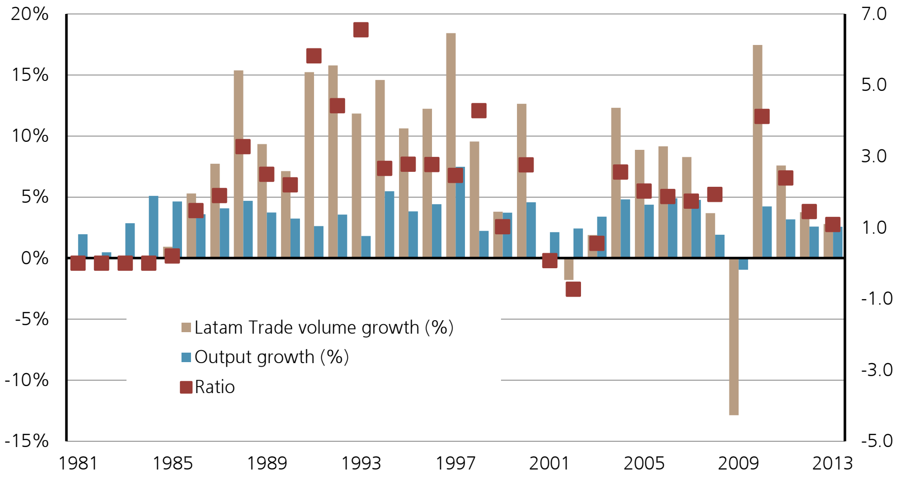
Lower trade elasticity to global growth is a key reason for soft EM growth in the current cycle…

Figure 17: Global Output vs Trade Growth



Source: IMF, UBS

Figure 18: Global Output vs Latam Trade Growth



Source: IMF, UBS

The drivers for this new trend are in part due to cyclical factors (e.g. European crises, slow pace of US recovery), but more importantly, our strategist argue, are largely due to structural changes. After the big recession in 2008-2009, globalization seems to have lost momentum and this can be seen in the slower pace of global financial flows as well as in international migration flows. Moreover, a re-balancing of the Chinese economy away from investment and toward

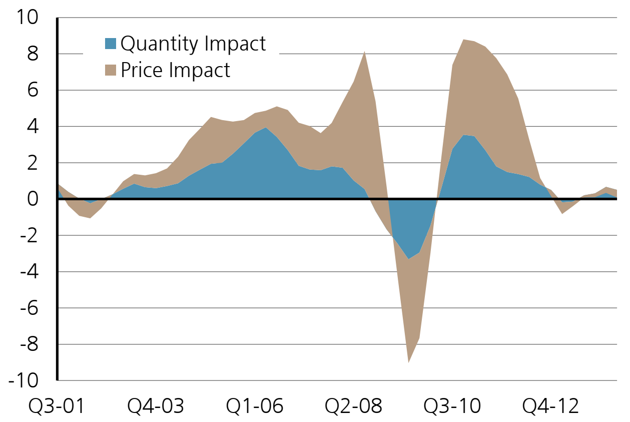
consumption, as well as technological advances that could reduce the ramifications of the supply chain, could also be important structural forces affecting global trade.

To investigate this phenomenon for the Latam economies we analysed the aggregate trade flow volume (imports + exports) of the most important countries in the region – i.e. Brazil, Mexico, Chile, Colombia, Peru, Argentina and Venezuela. Interestingly, the ratio of Latam trade growth to global output growth also deteriorated in the period after the crisis. For instance, this ratio dropped to 1.1 in 2013, from 4.12 in 2010, while the global trade to output growth in the same time frame deteriorated to 0.8 in 2013, from 2.6 in 2010.

…Latin America is not immune to this phenomenon. Notice, however, that Mexico's export volumes are improving.

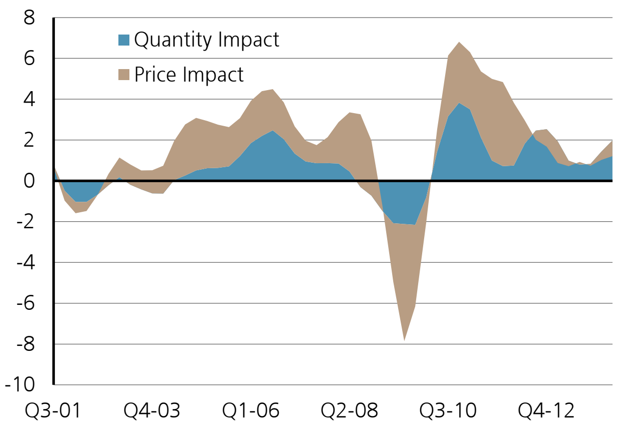
The slowdown in global trade is probably one of the reasons behind the weak growth in Latam after the crisis. In fact, if we examine the regional GDP slowdown between 2010 to 2013 (from 6.1% to 2.5%), much of it can be attributed to a sharp fall in exports volume growth (from 10.7% to 0.7% in the period). Currently, we continue to see sluggish export growth in the region, despite weaker currencies and a (modest) global rebound. Even star performers, like Colombia, are witnessing weak volume growth performance. Nevertheless, we are seeing some sign of improvement. The contribution of exports to growth in Latam picked up to 2.9% in Q2'14, on the back of Mexican exports which are now growing at a much faster pace – they grew 8.0% y/y in Q2'14 in volume terms, from a trough of -0.4% y/y in Q1'13. Indeed, despite concerns that Mexico may have lost competitiveness to the US because of energy costs differentials, Mexico's close ties to the US in consumer durable sectors appear to be behaving as expected.

Figure 19: Latam Exports Growth Contribution, Annual, % of GDP



Source: Haver, UBS

Figure 20: Mexico Exports Growth Contribution, Annual, % of GDP



Source: Haver, UBS

Theme 4: The risk of a Chinese slowdown

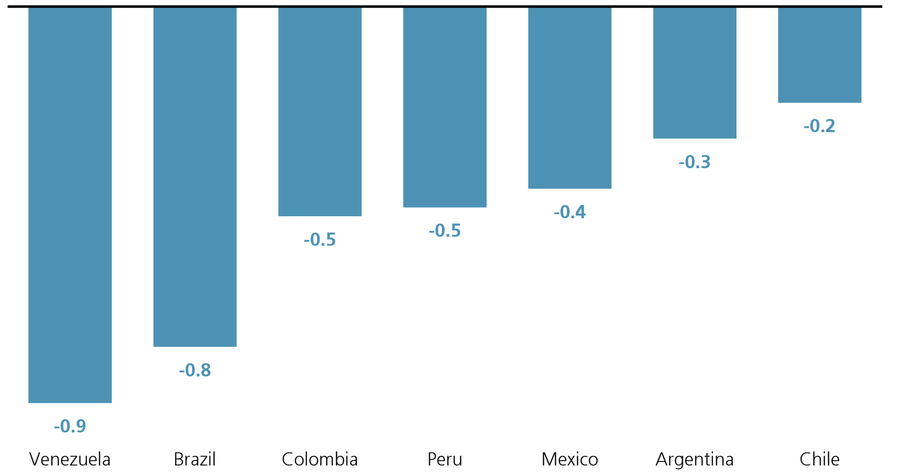
A fall in Chinese economic growth would have a major impact on Latin America. The region's ties to China are much greater than they were only a decade ago. From negligible levels at the beginning of the 2000s, the region now sends 10% of its exports directly to China. If we exclude Mexico from the sample, that share rises to 17%, with some countries like Chile closer to 25%. Moreover, because some 45% of the region's exports are commodities (64% excluding Mexico), Latin America is also quite sensitive to commodity price decreases that might result from a Chinese property crisis, particularly those of base metals.

To gauge the impact of a decline in Chinese growth, we run a VAR model for the most important countries in the region. To control for its impact on the global economy, the model also incorporates GDP growth for the US, the Eurozone and Latin America. We also include the IMF commodity index to assess the secondary effects of the slowdown on these prices and, as a consequence, on the economy.

A 1% drop in Chinese growth would knock off 0.7 p.p. from Latin American growth by our estimates.

According to the model, a decline in Chinese growth from 6.8% to 5.2% (in line with the stress scenario outlined on page 8) would reduce regional growth by 0.9 percentage points. This result is very much in line with a study recently published by the Inter-American Development Bank[1]. Given that we currently expect Latin America's GDP to expand by 1.5% next year and 2.8% in 2016, a negative shock of this nature would leave the region on the verge of recession. The most impacted economy is Venezuela which would contract 3.0% in 2015 in this adverse scenario, from -1.5% in the base case. Brazil has the most negative contribution for Latam growth and should fall by 0.7% in 2015, from +0.6% in the base case. Peru and Colombia falls in an intermediary group and may have their growth cut by 0.8 p.p. each. Mexico, by contrast, due to its closer ties to the US, would see a smaller fall in output and should have its growth cut by 0.7 p.p. Finally, we see Argentina, which is closing its borders, being less affected with a negative impact of 0.5 p.p. In Figure 21, we can see in details how each percentage point fall in Chinese growth impacts GDP growth of each of these countries.

Figure 21: Impact on GDP Growth (%) by Country of 1 p.p. Fall in Chinese Growth

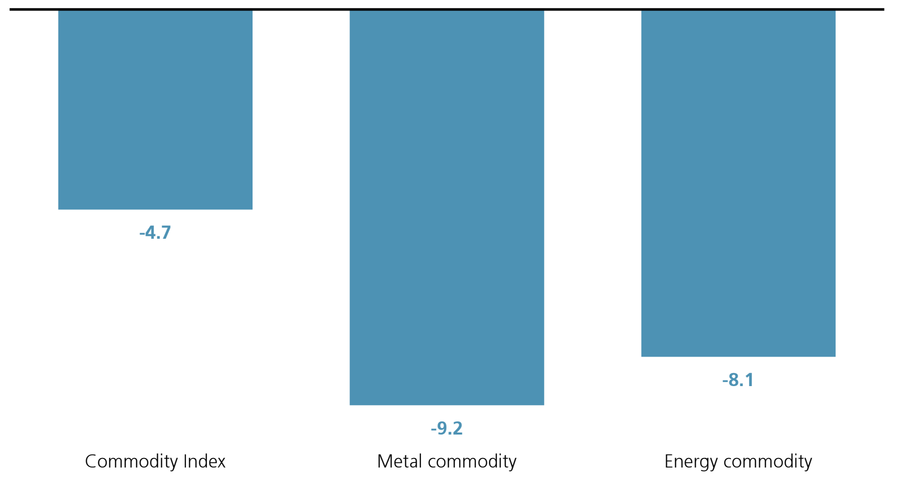


Source: UBS

[1] "Global Recovery and Monetary Normalization", IDB (2014)

Chile deserves closer scrutiny because the model attributes to it the lowest sensitivity to a decline in Chinese growth (a mere -0.4%), which is counterintuitive given the weight of copper in its exports and its close trade ties with China. However, the ability of Chile to withstand external shocks is stronger than elsewhere in the region because of its large fiscal rainy-day funds, which give it room to conduct aggressive countercyclical policies (as was the case in the 2008/09 crisis). Here what might matter is how persistent the Chinese shock ultimately turns out to be. According to the model, base metal prices would fall by about 10% in reaction to a 1 percentage point fall in Chinese growth. In the stress scenario described above, these could send copper prices down by some 25%, which, if sustained, would put great stress on the profitability of copper production and ultimately on the size of the fiscal cushions.

Figure 22: Impact on Commodity Prices (%) of 1 p.p. Fall in Chinese Growth



Source: UBS

Brazil: No significant changes on the horizon

Incentive for change seems low

With elections behind us, market will now focus on the direction of policy and on the appointment of the new economic team.

Politics has dominated Brazilian market sentiment throughout most of 2014. Doubts about the sustainability of the current economic model and a highly unpredictable presidential election have led to market swings. Now, with the election behind us, all eyes will be on possible changes in the economic policy mix and the appointment of a new economic team. While Minister of Finance Guido Mantega's departure is almost certain, it is not yet clear who will replace him. Appointing a market-friendly team remains critical to restoring confidence.

Absent a larger market correction, it is unclear what incentives the new Rousseff administration will have for changing course.

In our view, adopting an orthodox macroeconomic policy and attacking structural issues are critical if Brazil is to boost its growth rate. However, there are doubts as to whether the market's muted reaction after the election will be enough to incentivize the elected government to nominate a market-friendly team, with clear authority to implement sound policies going forward. Thus far, we have not seen yet signs that the government intends to make drastic changes to the current economic policy and/or start to address Brazil's structural problems.

However, Dilma's second mandate will be different from the first.

This does not mean Dilma's second mandate will be a repeat of her first. The government will clearly avoid actions that could rock the boat and put at risk the country's investment-grade rating. Therefore, it will likely make the minimum adjustments necessary to prevent Brazil's sovereign credit rating from being downgraded to junk, such as tightening fiscal/quasi-fiscal policies and raising the Selic rate (as we saw last week). But delivering a credibility shock and/or a reducing the government's interventionist bias in such a way as to improve sentiment (figure 23) does not seem to be on the cards at present. Business and consumer confidence will likely remain subdued, imposing a drag on growth.

No reforms = no growth

Without structural reforms, Brazil will remain mired in low growth.

Even if we are wrong and there is a credibility shock, we do not think it would be enough to lift Brazil's growth trend. A rebound in sentiment could lead to a better growth outlook in the short term, but it would likely do little for medium- and long-term growth. Brazil's bigger growth issues are structural.

Boosting savings, investment, and productivity are the key challenges.

Compared with other countries, investment in Brazil is low, as is the domestic savings rate; the tax burden, meanwhile, is high, and the current account deficit has climbed to uncomfortable levels. Also, there is little room to cut government expenditures; the drivers that helped boost potential growth in 2004-10 are gone; and profit margins continue to move lower. Therefore, a reform agenda that focuses on increasing the domestic savings rate, raising investment and boosting productivity (Figure 24 and 25) is the only way to reverse the trend of declining potential growth (see Brazil: Why It Fails to Deliver on Potential, October 9, 2014).

However, Dilma has less support in Congress than she did in her first mandate (see Brazil Election Watch: Dilma wins, in a divided country, October 26, 2014) and the government seems to have a wrong diagnosis of the causes behind Brazil's weakness. The likelihood of strong economic reforms is not high in coming years.

Finally, it also worth to flag that while our base case scenario does not include energy rationing in 2014 and/or 2015. However, the risk of energy shortages is still alive in Brazil and could be an important constraint to growth in coming quarters.

Revised 2015 and new 2016 GDP forecasts

It is hard to image that real GDP growth will recover anytime soon in Brazil. In fact, we are cutting our growth forecasts to 0.3% in 2014 (previously 0.6%) and 0.6% in 2015 (previously 1.5%). For 2016, we see growth picking up to 1.8% given the diminishing effects of tighter fiscal and monetary policies along with a more balanced policy mix. However, even 1.8% real GDP growth is only slightly north of the average for 2011-2014. The biggest drag on growth is the outlook for investment, which we expect to fall by 7.6% in 2014 (from +5.2% in 2013) and by 6.5% in 2015 before stabilizing at -0.3% in 2016 (figure 26). With profit margins still moving lower and no recovery in sentiment, the outlook for investment is unlikely to improve.

We expect the economy to grow by a modest 0.6% next year and by 1.8% in 2016. Investment will be the biggest drag on growth.

We see private consumption growth slowing to 1.2% this year (from 2.6% in 2013) and only 1.0% in 2015. A rise in the average annual unemployment rate from 4.9% in 2014 to 5.9% in 2015 and 6.9% in 2016, along with higher inflation next year, will likely be headwinds to consumption. For 2016, we see a moderation in inflation helping to sustain private consumption growth of around 1.7%. Meanwhile, net exports, which shaved about 1.0 p.p. off of growth in 2013, will likely boost growth by 0.5 p.p. in 2014 and 0.8 p.p. in 2015, after which they will have no effect on growth. In our view, a weaker BRL, along with better global demand and sluggish domestic demand, should set the stage for some improvement in net exports and the current account deficit in the coming years (3.4% of GDP in 2015 and 3.3% in 2016, from 3.7% in 2014).

Higher inflation and rising unemployment will take a toll on the consumer. Net exports should improve.

We now see the USD/BRL at 2.60, 2.75 and 2.90 in 2014/15/16

Although the BRL has responded better than expected to Dilma's re-election, we continue to believe it is overvalued and will depreciate going forward on the back of: i) economic policy uncertainty; ii) the expectation of interest rate hikes in the US in 2015; and iii) an increase in global market volatility. Our base case now has the USD/BRL at 2.60 by 2014 year-end (previously 2.45), 2.75 in December 2015 (previously 2.55) and 2.90 in 2016.

We now see a weaker BRL ahead. The currency is still overvalued.

The expectation of a weaker currency is one of the main factors behind our IPCA inflation forecasts. While commodity prices are helping to keep global inflation low, we have not yet seen clear signs that the weaker currency is passing through to the IPCA. According to our simulations, the FX pass-through to the IPCA is around 5.0%, which means that a 10% depreciation of the BRL adds around 50bps to inflation over 12 months. Thus, even if we expect to see a slowdown in services inflation to 7.3% y/y in 2015 and to 6.2% in 2016 from 8.5% in 2014 owing to the moderation of domestic demand, higher regulated prices combined with a weaker BRL will likely push IPCA inflation above the upper end of the target range for next year. We now see inflation reaching 6.8% in 2015 (from 6.4% in 2014) and then falling to 5.8% in 2016.

Higher regulated prices and a weaker BRL will push inflation above the top of the band in 2015.

The combination of higher inflation and weaker growth also indicates that conflicting forces will drive monetary policy in the coming quarters (figure 27). Last week, the Central Bank surprised the market by hiking the Selic rate by 25bps in an attempt to ensure a more benign inflationary outlook in 2015 and 2016 in light of the currency sell-off. The decision came earlier than we expected (our base case was that the BCB would begin the tightening cycle only in early 2015), but we welcome the decision, as it could be the first step toward helping the BCB to regain credibility. However, we think it is premature to see this move as one signalling an inflection point towards a more orthodox economic policy. In any

Last week's 25bp hike in the Selic rate does not signal a change in policy stance by the authorities, in our view.

case, with our weaker USD/BRL outlook, we now see the BCB taking the Selic rate up to 12.5% in two hikes of 50bps and a final 25bp hike in March 2015.

Our scenario assumes Moody's downgrades Brazil by one notch

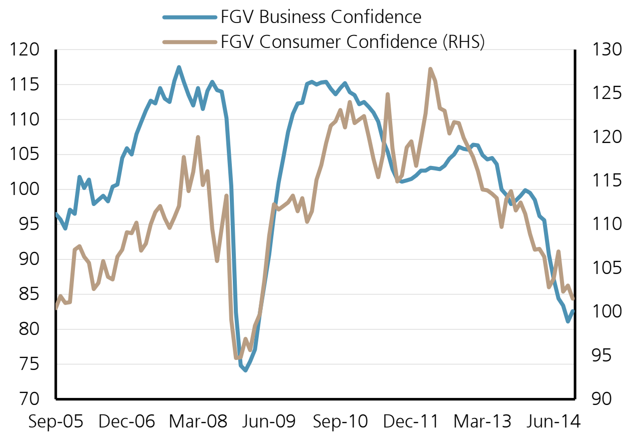
Fiscal policy remains a weak link.

Last but not least, the combination of weak growth and a large increase in government spending this year led to a considerable deterioration in fiscal policy. Year-to-date, while real revenues grew by only 1.1% y/y, government expenditures rose by 6.0%, and we expect no major change in this trend until year-end. We now see a 0.7% of GDP primary surplus in 2014 (previously 1.2% and down from 1.9% in 2013). Moving forward, we expect a rise in taxation (CIDE and IPI tax will likely rise) and moderation in government spending growth to lift the primary surplus to 1.0% of GDP in 2015 and 1.3% in 2016 (figure 28) to prevent Brazil's sovereign credit rating from being downgraded to junk. Nevertheless, this is still below the primary surplus level (around 2.5% of GDP) that would be consistent with a sustainable debt-to-GDP ratio dynamics, and more adjustment will be necessary going forward.

A downgrade by Moody's and Fitch is likely in the first half of 2015.

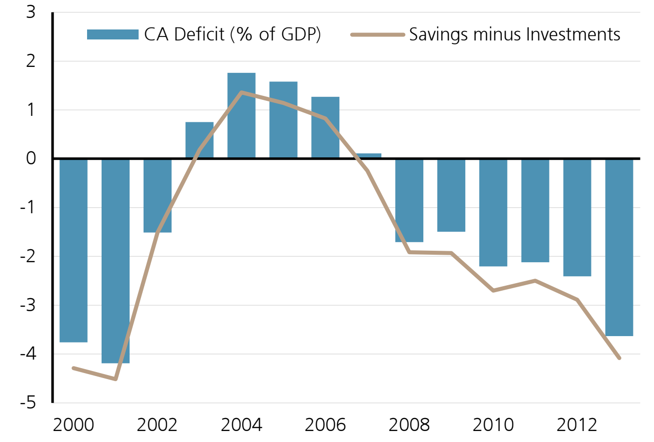
We now see net debt/GDP remaining flat at 33.6% this year (due to the weaker BRL) but rising to 34.9% in 2015 and 35.2% in 2016. Meanwhile, gross debt/GDP should move up to 60.6% in 2014 and to 61.6% in 2015 from 56.8% in 2013. Although our base case does not envision Brazil losing its investment-grade rating, we think this fiscal trend will lead Moody's and Fitch to downgrade Brazil's sovereign credit rating by one notch in 1H 2015. This could serve as a much-needed wake-up call for the government to return the fiscal account to a more sustainable trajectory.

Figure 23: Brazil - Consumer and Business Sentiment



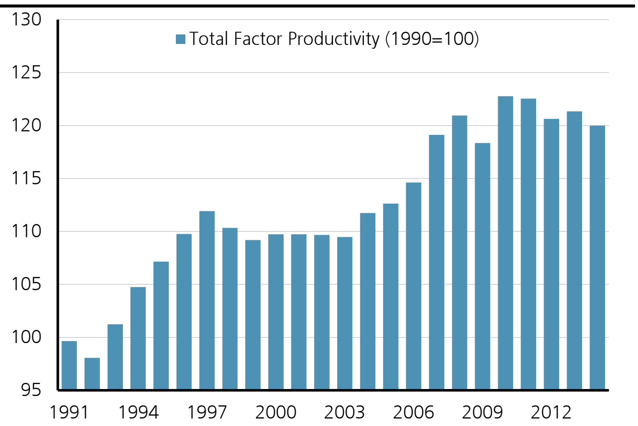
Source: FGV, UBS
Note: Seasonally adjusted indexes

Figure 24: Brazil - Domestic Savings Rate Minus Investments vs. Current Account, % of GDP



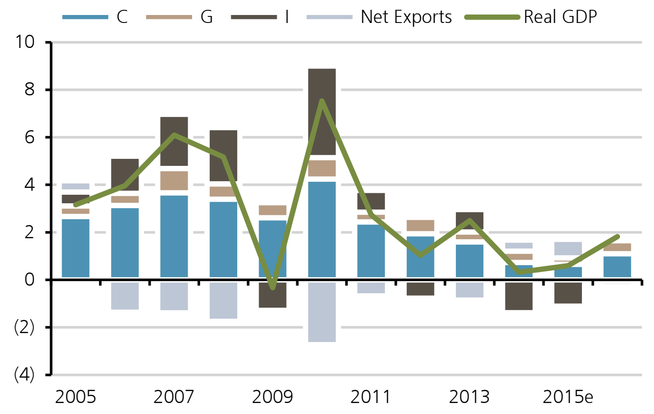
Source: IBGE, BCB, UBS

Figure 25: Brazil - Total Factor Productivity Evolution



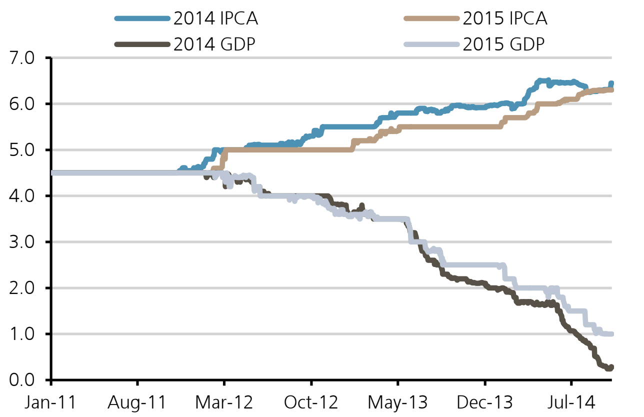
Source: Penn World Table, UBS

Figure 26: Brazil - Contribution to real GDP Growth, %



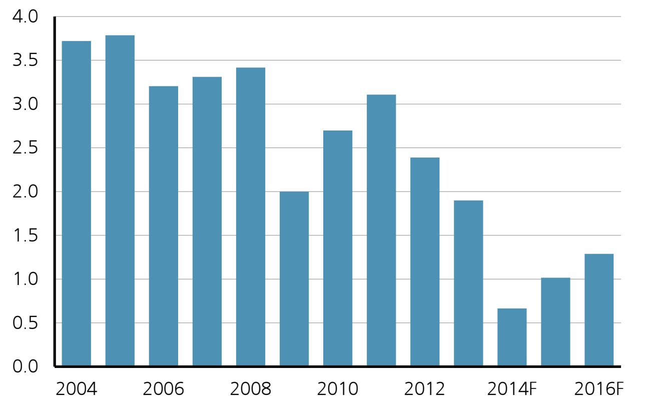
Source: IBGE, UBS

Figure 27: Brazil - Growth/Inflation Trade-off, Market Consensus



Source: BCB, UBS

Figure 28: Brazil - Public sector primary surplus, % of GDP



Source: BCB, UBS

Brazil	2009	2010	2011	2012	2013	2014F	2015F	2016F
Economic Activity and Prices								
GDP , BRL bill	3,239	3,770	4,143	4,392	4,845	5,139	5,679	5,937
GDP, US$ bil.	1,625	2,142	2,475	2,237	2,220	2,176	2,118	2,095
GDP per Capita, US$	8,397	10,956	12,536	11,226	11,045	10,730	10,358	10,197
Real GDP Growth, %	-0.3	7.5	2.7	1.0	2.5	0.3	0.6	1.8
Household consumption, %	4.4	6.9	4.1	3.2	2.6	1.2	1.0	1.7
Government consumption, %	3.1	4.2	1.9	3.3	2.0	2.2	1.3	2.5
Fixed capital formation, %	-6.7	21.3	4.7	-4.0	5.2	-7.6	-6.5	-0.3
Exports, %	-9.1	11.5	4.5	0.5	2.5	2.4	2.9	2.7
Imports, %	-7.6	35.8	9.7	0.2	8.3	-1.1	-2.7	4.0
Industrial GDP, %	-5.6	10.4	1.6	-0.8	1.7	-1.3	-2.6	-0.2
Unemployment, % (avg)	8.1	6.7	6.0	5.5	5.4	4.9	5.9	6.9
IPCA inflation, Dec/Dec %	4.3	5.9	6.5	5.8	5.9	6.4	6.8	5.8
IPCA inflation, Avg %	4.9	5.0	6.6	5.4	6.2	6.4	6.6	6.1
Financial Markets								
Exchange Rate (yr end) - R$/US$	1.74	1.66	1.87	2.05	2.36	2.60	2.75	2.90
Exchange Rate (yr avg) - R$/US$	1.99	1.76	1.67	1.96	2.18	2.36	2.68	2.83
Selic basic interest rate (yr end), %	8.75	10.75	11.00	7.25	10.00	11.75	12.50	12.00
Selic basic interest rate (yr avg), %	10.05	10.00	11.71	8.46	8.44	11.02	12.46	12.42
M2, Dec/Dec %	8.8	16.6	18.9	9.1	10.9			
Bank lending, % of GDP	43.7	45.2	49.1	53.5	56.1	58.2	57.4	59.3
Balance of Payments , USD bill								
Exports	153.0	201.9	256.0	242.6	242.2	233.1	235.4	249.9
Imports	127.7	181.8	226.2	223.2	239.6	235.7	232.6	245.3
Trade balance	25.3	20.1	29.8	19.4	2.6	-2.6	2.8	4.6
Net interest payments	-9.1	-9.6	-9.7	-11.8	-14.2	-12.7	-13.1	-12.9
Current account	-24.3	-47.3	-52.5	-54.2	-81.4	-81.3	-71.7	-68.6
% of GDP	-1.5	-2.2	-2.1	-2.4	-3.7	-3.7	-3.4	-3.3
FDI (net)	25.9	48.5	66.7	65.3	64.0	59.8	49.8	42.6
International reserves (end of period)	238.5	288.6	352.0	373.1	375.8	376.7	376.3	375.3
Reserves / Imports (months)	22.4	19.1	18.7	20.1	18.8	19.2	19.4	18.4
Fiscal Accounts, % GDP								
Fiscal Revenue	33.7	34.3	36.1	36.3	36.3	36.2	35.6	36.4
Interest Payments	5.3	5.2	5.7	4.9	5.2	5.2	5.5	5.5
Domestic	5.4	5.2	5.7	4.9	5.1	5.2	5.5	5.5
External	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Non-interest spending	32.6							
Overall balance	-3.3	-2.5	-2.6	-2.5	-3.3	-4.5	-4.5	-4.2
Primary balance	2.0	2.7	3.1	2.4	1.9	0.7	1.0	1.3
Public Debt								
Net public debt , USD bill.	684	838	901	789	746	731	738	736
Net public debt , % of GDP.	42.1	39.1	36.4	35.3	33.6	33.6	34.9	35.2
External Debt and Debt Service								
Total external debt , USD bill.	198.2	256.8	298.2	312.9	308.6	344.0	353.7	367.6
Total external debt , % of GDP	12.2	12.0	12.0	13.9	13.8	15.8	16.7	17.5
Total external debt , % of Exports	129.5	127.2	116.5	130.6	127.4	147.6	150.2	147.1
Amortization, USD bill.	30.1	33.8	37.7	39.7	59.5	59.1	83.4	33.4
Total debt service, USD bill	43.6	46.4	52.6	54.1	74.9	68.3	98.4	48.4
Total debt service, % of Exports	28.5	23.0	20.5	22.3	30.9	29.3	41.8	19.4
Credit Ratings (year-end & latest)								
Moody's	Baa3	Baa3	Baa2	Baa2	Baa2	Baa2	Baa3	Baa3
S&P	BBB-	BBB-	BBB	BBB	BBB	BBB-	BBB-	BBB-

Source: Haver, UBS

Mexico: Implementation risk

Manufacturing exports are behaving well, as one would expect on the back of the US recovery.

Going into 2015, the Mexican economy has exhibited mixed signals in terms of the strength of the recovery that started in Q2 of this year. On the positive side, we have the manufacturing export sector, which is behaving as one would expect in view of the pick-up in US activity. In the first nine months of this year, manufacturing exports expanded by 6.3% y/y, an increase that was not only confined to autos (non-auto manufacturing exports rose by 4.5% y/y and their growth is accelerating). Mexico may have lost competitiveness to the US in energy intensive sectors on account of the shale gas revolution, but on the whole, recent performance suggests that Mexico is still geared to benefit from stronger US demand.

Private investment is showing some signs of life.

We also see positive signs in private investment, which appears to be making a comeback, albeit from very low levels. This is both true of equipment and machinery –where increasing capacity constraints in manufacturing may be pushing companies to invest – but also of construction –mostly in residential outside of the troubled social-housing space.

The failure to kick-start public investment was the biggest disappointment of 2014 and could remain a drag next year.

Beyond these areas of demand, others remain more tentative. The largest disappointment in this regard comes from public investment. Faced with a sharp economic slowdown in 2013, the Peña Nieto administration made the bet that it would reinvigorate growth in 2014 through increased capital expenditure, particularly on infrastructure. To this end, it raised taxes by over 1.0% of GDP and increased the budget deficit by some 1.5% of GDP in 2014. Thus far this year, however, the results have been dismal. According to the national accounts data, public investment in the first half of the year fell by a whopping 8.4% y/y. Civil engineering works are down 1.2% y/y in the same period. These numbers are particularly baffling when considering that, according to the government's fiscal accounts, capital spending is up by close to 30% in real terms so far this year. The money, it would appear, has been allocated to projects but not yet spent

If this is the case, why has the money not yet been deployed? One popular explanation is that local governments under the PRI are still having problems learning the ropes of spending, which appears hard to believe twenty one months into current administration. Another is that local governments are waiting to concentrate their spending ahead of the 2015 mid-term elections in July, but here too one would have to argue that they are cutting it rather thin in terms of timing. Yet another explanation would posit that new transparency and anti-corruption legislation is making life more difficult for civil servants to spend as they used to.

It is unclear why the government has failed to deploy the funds in capital spending.

All these are plausible explanations and would appear to be at least partially corroborated by the growing backlog of projects we see in key infrastructure companies such as ICA. But there is also a risk that some of these monies have ended up funding the general deficit of the government. After all, economic growth and oil production for this year are far below what the authorities originally budgeted.

Which view one takes of this debate is critical in determining the outlook for growth next year. If the capital allocated but not disbursed shown in figure 31 ultimately materializes in H1'15, then growth could greatly accelerate (we estimate the "firing power" of the bulge represented in figure 31 at between 0.5% and 1.0% of GDP). If, on the other hand, this money has largely been spent or fails to make an impact, then growth would likely disappoint for a third consecutive year.

We are now on the less-constructive side of this argument. We are revising down our growth for 2014 from 2.8% to 2.3% partly in recognition that the much awaited fiscal thrust has not materialised. For next year, we are also bringing down our GDP growth from 3.7% to 3.3%, again reflecting the sluggishness with which public works are being implemented. We are now at the bottom of consensus.

We see growth at 2.2% and 3.3% in 2014 and 2015, respectively.

Lacklustre public investment spending has another consequence: it lowers employment growth, particularly in construction, at a time when it is very much needed to spark a sustained recovery in household consumption. While different metrics on private consumption are pointing in diverging directions at present, the overall picture that emerges is still one of overall weakness (even the new, revised and much more positive official retail sales series still shows growth so far this year at a mere 2.3%). Given the softness we see in most traditional drivers of consumption (low real wage growth on account of outstanding slack in the labour market; a modest expansion in remittances; slowing consumer credit growth), the onus is placed on employment to prop up household spending. While we have seen some improvement on the employment front –primarily through a transfer of workers from the informal to the formal sector of the economy -- it has still been insufficient to prop up the economy's real wage mass. This is why the failure to kick-start public spending on capital is doubly disappointing.

We need to see a sustained recovery in employment to lift household consumption.

What about inflation? We think the CB's view that inflation will fall sharply in 2015 is largely correct. The combination of favourable base effects (on account of this year's tax reform), lower gasoline price increases as of January, and softer global food prices will indeed generate a sharp fall in inflation in H1'15. However, we think the convergence to the CB's inflation target will be slower than what the authorities are currently expecting on account of likely upward pressure from agricultural prices as well as from a likely upward adjustment to the minimum wage. While the latter is a concern for the CB, we think the outstanding excess capacity in the labour market will keep widespread wage pressures in check. We see inflation at 3.4% at YE 2015.

We see inflation falling sharply in 2015, though a potential minimum wage increase is a risk.

Where does this leave monetary policy? With growth likely to remain softer than expected and inflation falling, we still see the CB raising interest rates only after the Fed. We still pencil in 50bps of hikes next year, with the first move coming in 2015. Could Banxico move ahead of the Fed, perhaps concerned about ongoing weakness in the peso? We doubt it. We think Banxico would only be concerned about a peso move if it had a sizable impact on inflation. Again, given the size of the output gap (which we expect to close only towards end 2015) and the slack in the labour market, we see no major fundamental price pressures at present.

We see Banxico moving only after the Fed in H2'15.

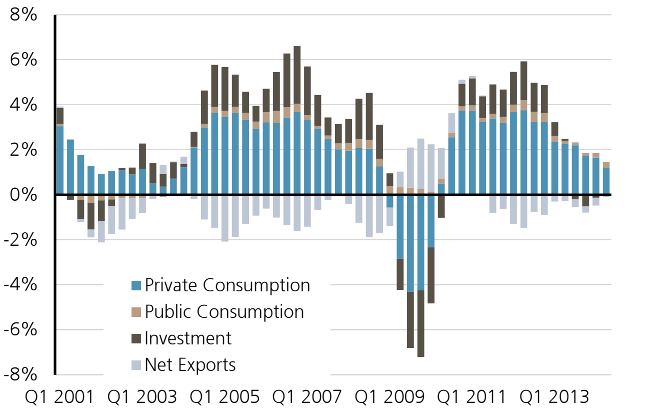
We are, however, adjusting our peso forecasts. The start of Fed hikes will keep MXN under pressure, and counter-balancing FDI flows from the structural reforms are unlikely to materialise in earnest until 2016. Fundamentally, though, we still think the peso is cheap. We see MXN at 13.3 in YE'15 and at 13.0 in YE'16.

We push back our nominal appreciation of MXN to 2016.

Lastly, a word on risks. As we write, oil prices have fallen by 32% from their peak this year. We think the short to medium terms risks on the budget are limited by the government's successful hedging program. Lower oil prices could, however, reduce interest in some of Mexico's marginal oil fields in Round 1. We think a more pressing problem is the ongoing fall in oil production. A wholly different risk, but equally dangerous, is that President Peña Nieto gets sucked into a crisis of confidence over the government's handling of the Iguala-Guerrero student disappearance. In terms of upside risk, if government spending ultimately materializes in earnest, we could see a higher expansion than we forecast.

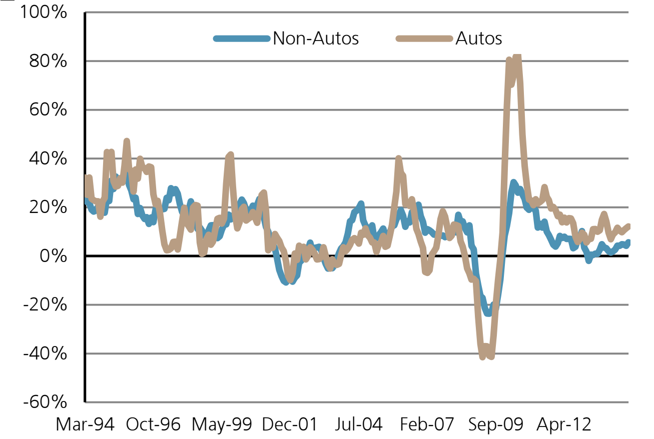
Falling oil production and prices pose risks to the economy, as does the infiltration of armed groups in social and political spheres.

Figure 29: Mexico - Contributions to GDP Growth, 4q accumulated



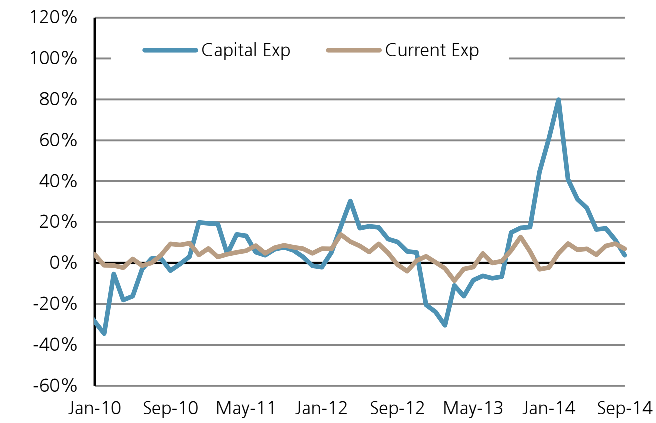
Source: Haver, UBS

Figure 30: Mexico - Manufacturing Exports, 3m y/y



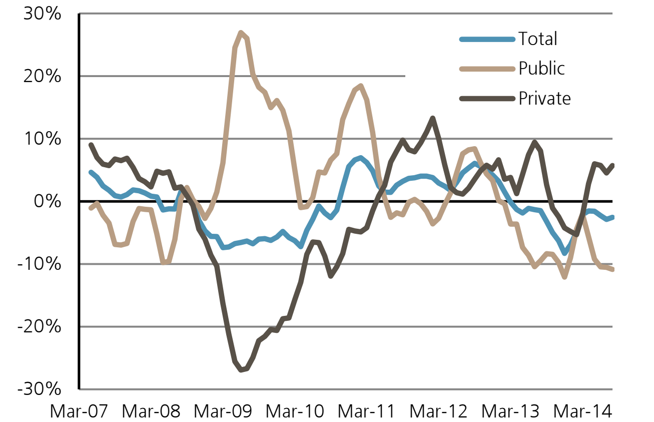
Source: INEGI

Figure 31: Mexico - Current vs Capital Expenditure,Real 3m y/y



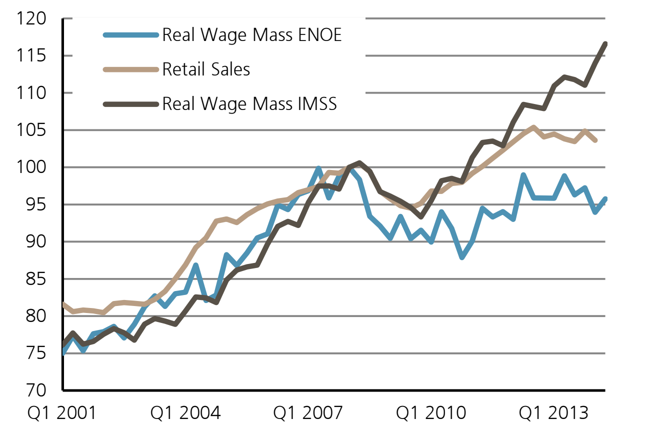
Source: SHCP

Figure 32: Mexico - Value of Construction by Sector, Real 3m y/y



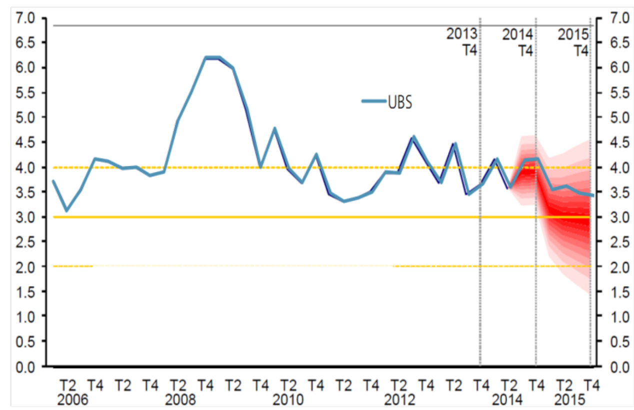
Source: INEGI

Figure 33: Mexico - Real ENOE vs IMSS Wage Mass vs Retail Sales, 1Q 2008=100



Source: INEGI, UBS

Figure 34: Mexico - UBS Headline Inflation Forecast vs CB Fan Chart, 3m % y/y



Source: INEGI, Banxico, UBS

Mexico	2009	2010	2011	2012	2013	2014F	2015F	2016F
Economic Activity and Prices								
GDP , MXN bn	12,094	13,282	14,550	15,615	16,104	16,592	17,134	17,781
GDP, USD Bill.	926	1,075	1,040	1,200	1,232	1,257	1,288	1,368
GDP per Capita, US$	8,531	9,861	9,455	10,716	10,920	11,067	11,264	11,876
Real GDP Growth, %	-4.7	5.1	4.0	4.0	1.1	2.2	3.3	3.8
Private consumption, %	-6.5	5.7	4.8	4.9	2.5	2.3	3.5	3.8
Government consumption, %	2.2	1.7	2.4	3.4	1.2	2.8	2.0	2.5
Capital formation, %	-9.3	1.3	7.8	4.5	-1.8	1.7	4.0	5.0
Exports, %	-11.8	20.5	8.2	5.9	1.2	4.2	6.3	7.5
Imports, %	-17.6	20.5	8.0	5.5	1.5	4.1	5.5	8.0
Industrial Production, %	-6.2	4.6	3.4	2.7	-0.7	2.0	3.0	3.0
Unemployment, avg %	5.5	5.4	5.2	5.0	4.9	4.8	4.7	4.6
Inflation IPC, Dec/Dec %	3.6	4.4	3.8	3.6	4.0	4.1	3.4	3.3
Inflation IPC, Avg %	5.3	4.2	3.4	4.1	3.8	4.0	3.6	3.3
Inflation Core, Dec/Dec %	4.2	3.6	3.4	2.9	2.8	3.4	2.9	3.1
Financial Markets								
Exchange Rate, yr end	13.06	12.36	13.99	13.01	13.08	13.20	13.30	13.00
Exchange Rate, avg	13.58	12.64	12.49	13.17	12.83	13.20	13.28	13.14
Interest rate 3m Cetes, avg %	5.36	4.61	4.36	4.34	3.73	3.05	3.32	4.50
Banxico Overnight Rate, yr end %	4.50	4.50	4.50	4.50	3.50	3.00	3.75	5.00
Broad money, M2, Dec/Dec %	6.4	8.0	11.9	8.4	8.8	11.8	12.7	12.3
Balance of Payments (US$ billion)								
Exports of goods	229.7	298.5	349.4	370.8	380.0	397.2	421.5	454.2
Imports of goods	234.4	301.5	350.8	370.8	381.2	398.5	430.7	466.2
Trade balance	-4.7	-3.0	-1.4	0.0	-1.2	-1.3	-9.2	-12.0
Other current transactions (net)	-3.5	-1.1	-11.3	-15.3	-25.1	-25.3	-23.8	-20.9
Current account	-8.2	-4.1	-12.8	-15.3	-26.3	-26.6	-33.0	-32.9
% of GDP	-0.9	-0.4	-1.2	-1.3	-2.1	-2.1	-2.6	-2.4
Net FDI (US$ billion)	7.7	8.4	11.1	-4.7	26.0	13.8	16.0	26.0
Other capital flows (net, incl errors)	5.8	18.3	30.1	40.6	18.0	18.4	14.0	14.0
Overall balance	5.3	22.7	28.4	20.7	17.6	18.9	1.0	1.1
International reserves US$ billion, eop	90.8	113.6	142.5	163.5	176.5	182.8	192.1	193.2
Reserves / Imports, mnth	4.2	4.2	4.5	4.6	5.0	4.9	4.9	4.6
Fiscal Accounts (Central gov't, % GDP)								
Fiscal Revenue	23.8	22.6	22.8	22.7	22.5	23.5	23.5	23.9
Interest Payments	2.2	2.1	1.9	1.8	1.8	2.0	2.0	2.0
Domestic	1.7	1.6	1.6	1.6	1.4	1.6	1.6	1.6
External	0.6	0.5	0.5	0.4	0.4	0.4	0.4	0.4
Non-interest spending	24.3	23.5	23.4	23.5	22.7	25.1	25.0	24.7
Overall balance	-2.3	-3.0	-2.5	-2.6	-2.0	-3.6	-3.5	-2.8
Primary balance	-0.1	-0.9	-0.6	-0.8	-0.2	-1.6	-1.5	-0.8
PSBR	-2.7	-3.5	-2.7	-3.2	-2.5	-4.2	-4.0	-3.5
Gross Public Debt (% of GDP)								
Total Public Debt	34.7	34.9	35.3	36.8	38.0	41.0	43.5	43.5
External debt	9.4	9.0	10.0	9.6	9.5	11.0	11.5	11.5
Domestic debt	25.3	25.9	25.3	27.2	28.5	30.0	32.0	32.0
External Debt and Debt Service								
Total external debt , USD bill.	190.1	198.1	210.9	227.3	259.6	245.0	260.0	260.0
Total external debt , % of GDP	20.5	18.4	20.3	18.9	21.1	19.5	20.3	19.0
Total external debt , % of Exports	77.7	63.1	57.7	58.7	64.8	58.4	58.1	54.0
Amortization, USD bill.	33.8	36.1	33.0	34.3	35.4	37.0	37.0	37.0
Total debt service, USD bill	45.6	50.0	47.0	49.4	50.0	52.0	52.0	52.0
Total debt service, % of exports	18.6	15.9	12.9	12.7	12.5	12.1	11.6	10.8
Credit Ratings (year-end & latest)								
Moody's	Baa1	Baa1	Baa1	Baa1	Baa1	A3	A3	A3
S&P	BBB	BBB	BBB	BBB	BBB+	BBB +	BBB +	BBB +

Source: Haver, UBS

Chile: Expect only a modest rebound in 2015

Both structural and cyclical factors explain the sharp slowdown in economic activity this year.

The Chilean economy appears to be in free fall. In the first eight months of 2014 it grew by 1.7% y/y, down sharply from the 4.0% growth registered last year. Moreover, seasonally adjusted data suggest that the slowdown continues: in the last three months, the economy expanded at a mere 0.5% annualised rate.

As we have written before, we think the Chilean economy has been buffeted by a triple whammy this year. First, it is undeniable that it is suffering from the end of the super commodity cycle and what that means for copper production and prices. Investment has fallen sharply, as exemplified by a whopping 24% contraction in capital goods imports this year. Second, the economy is going through a cyclical downturn that was partly engineered by the CB through tight monetary policy. Recall that for much of 2011-2013, the authorities were concerned about the strong outperformance of domestic demand versus GDP growth. That adjustment has now come home to roost, both in terms of investment and consumption.

But loss of business confidence on the back of structural reforms introduced by the Bachelet administration has also played a role.

But cyclical and structural issues cannot fully explain the collapse in business confidence that we are currently seeing in Chile. Indeed, business confidence is now at close to historic lows. We think the arrival of President Bachelet and her push to overhaul the tax system -- with a higher tax burden for corporations-- and to spend heavily on public education has put the business community on the defensive, fearing a slide towards more populist economic measures.

Expansionary fiscal and monetary policies should allow the economy to rebound next year.

We think such fears are overdone. The beauty of Chile's democratic system is precisely that it has generated strong consensus around a set of core economic policies (fiscal responsibility and Central Bank independence, for instance) that are unlikely to be challenged. Moreover, the authorities have put in place substantial policy stimulus for next year: the CB has lowered its benchmark interest rate to 3%, well below inflation at present; and the proposed 2015 budget calls for a 9.8% increase in spending next year (27.5% in capital), partly courtesy of the cushion offered by the sovereign wealth funds.

Still, growth will remain well below potential.

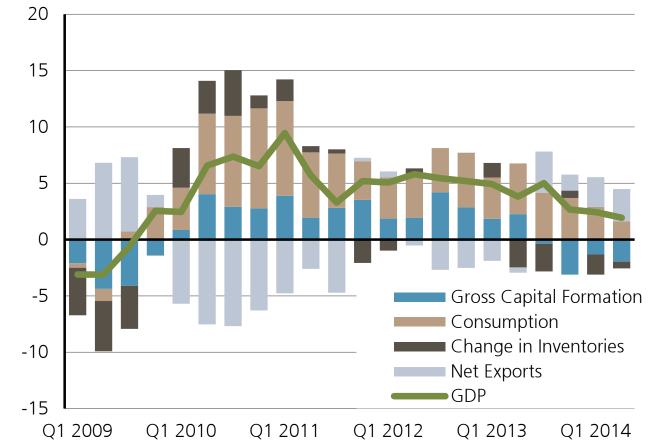
Still, we see 2015 as one of adjustment and of sluggish growth by Chilean standards. The household sector is still in the process of cleaning its balance sheet and we see know strong catalyst to growth next year, especially if infrastructure spending is subject to delays. We see the Chilean economy expanding by 2.8%, up from 1.8% this year.

In terms of inflation, we think it will steadily converge to target in 2015 as the labour market starts to show more slack. In this context, the CB could contemplate further easing, but our base scenario is one of moderate hikes towards year-end, shadowing the Fed.

The peso has done its job: the adjustment in the current account deficit this year is notable.

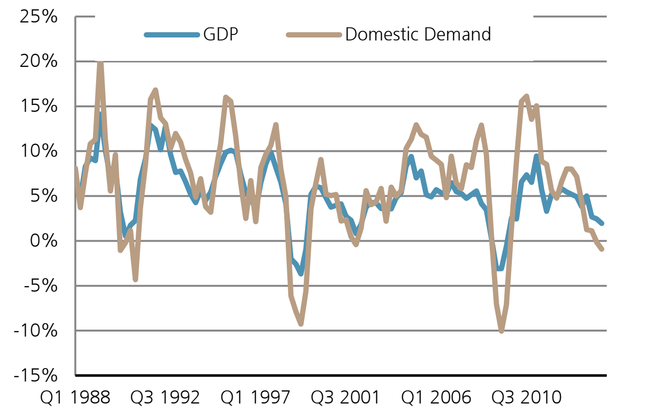
Lastly, a word on the peso. We see limited scope for much larger CLP devaluation. Since May 2013, the peso has weakened by 23%, and this move has helped the current account deficit to adjust, from 3.6% of GDP in 2013, to an estimated 1.6% this year. Indeed, Chile is the only country in the region to have shown a meaningful correction in its external imbalance. Others will follow.

Figure 35: Chile - Contributions to GDP Growth, %



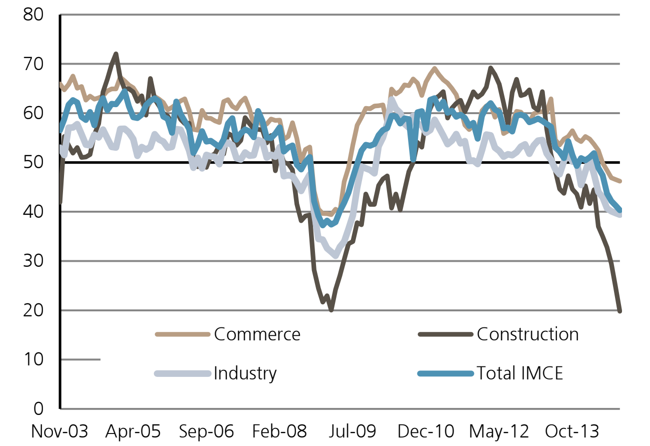
Source: BCentral

Figure 36: Chile - Domestic Demand and GDP Growth, y/y



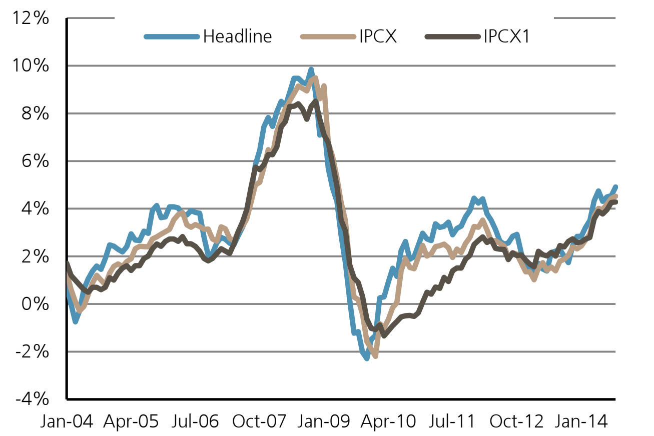
Source: Haver

Figure 37: Chile - IMCE Business Confidence and its Components



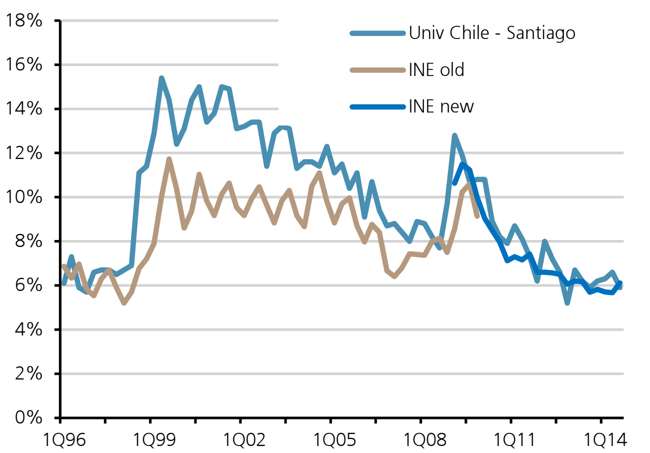
Source: ICARE

Figure 38: Chile - Headline CPI, IPCX, and ICX, y/y



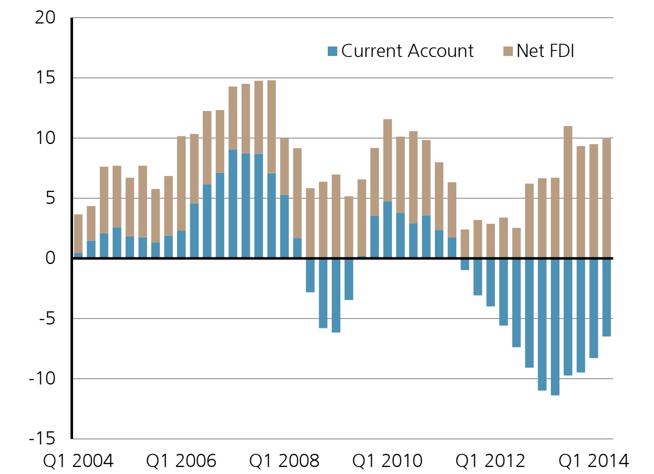
Source: Haver

Figure 39: Chile - Unemployment Rates



Source: INE, Haver

Figure 40: Chile - Current Account vs Net FDI, USD bn



Source: Haver, UBS

Chile	2009	2010	2011	2012	2013	2014F	2015F	2016F
Economic Activity and Prices								
GDP , CLP Trill.	96,444	111,008	121,403	129,601	137,212	146,201	155,050	165,379
GDP, USD Bill.	174	217	251	266	276	256	257	273
GDP per Capita, US$	10,261	12,552	14,319	15,046	15,395	14,147	14,063	14,144
Real GDP Growth, %	-1.0	5.8	5.8	5.4	4.1	1.8	2.8	3.5
Private consumption, %	-0.8	10.8	8.9	6.0	5.6	2.0	2.5	3.6
Government consumption, %	9.2	4.6	2.5	3.7	4.2	4.7	5.0	5.3
Capital formation, %	-12.1	12.2	14.4	12.2	0.4	-5.0	1.5	4.0
Exports, %	-4.5	2.3	5.5	1.1	4.3	-0.4	3.5	3.0
Imports, %	-16.2	25.9	15.6	5.0	2.2	-5.4	2.8	4.0
Industrial Production, %	-8.7	2.2	3.6	2.9	3.5	1.0	2.7	2.9
Unemployment, avg %	10.8	8.2	7.1	6.4	5.9	6.7	7.2	7.5
Inflation IPC, Dec/Dec %	-1.5	3.0	4.4	1.5	2.8	4.7	3.2	3.3
Inflation IPC, Avg %	1.5	1.4	3.3	3.0	1.9	4.3	3.7	3.3
Inflation Core IPCX, Dec/Dec %	-1.9	2.5	3.3	1.4	2.3	4.4	2.9	3.0
Financial Markets								
Exchange Rate, yr end	506	468	521	479	524	590	610	600
Exchange Rate, avg	554	511	484	487	498	571	602	606
Interest rate 3m PDBC, avg %	1.2	1.7	5.0	5.2	5.2	3.6	3.1	4.6
Overnight Policy Rate, yr end %	0.50	3.25	5.25	5.00	4.50	3.00	3.50	5.00
Broad money, M2, Dec/Dec %	3.1	4.1	12.4	16.0	10.9	11.9	11.4	12.0
Balance of Payments (US$ billion)								
Exports of goods	55.5	71.1	81.4	78.0	76.7	76.0	77.2	79.7
Imports of goods	40.1	55.4	70.4	75.5	74.6	68.6	70.3	74.7
Trade balance	15.4	15.7	11.0	2.5	2.1	7.3	6.9	4.9
Other current transactions (net)	-11.8	-12.2	-14.1	-11.6	-11.6	-11.5	-10.9	-10.5
Current account	3.5	3.6	-3.1	-9.1	-9.5	-4.2	-4.1	-5.6
% of GDP	2.0	1.6	-1.3	-3.4	-3.5	-1.6	-1.6	-2.0
Net FDI (US$ billion)	5.7	6.3	3.2	6.2	3.5	9.0	9.0	9.0
Other capital flows (net, incl errors)	-7.5	-13.1	14.1	2.5	6.2	2.7	1.7	5.7
Overall balance	1.6	3.0	14.2	-0.4	0.3	7.5	6.6	9.1
International reserves US$ billion, eop	25.4	27.9	42.0	41.6	41.1	48.6	55.2	64.4
Reserves /Imports, mnth	6.0	4.9	5.8	5.5	7.5	7.0	7.9	8.8
Fiscal Accounts (Central gov't, % GDP)								
Fiscal Revenue	19.6	21.0	22.1	22.1	20.9	20.7	21.6	22.5
Interest Payments	0.2	0.3	0.4	0.6	0.6	0.6	0.6	0.5
Non-interest spending	24.0	21.0	20.3	20.9	21.0	21.0	22.9	23.0
Overall balance	-4.3	-0.3	1.5	0.5	-0.6	-0.9	-1.9	-1.0
Primary balance	-4.1	0.0	1.8	1.1	0.0	-0.3	-1.3	-0.5
Gross Public Debt (% of GDP)								
Total Public Debt	6.1	8.6	11.1	11.9	12.8	14.0	15.0	15.5
External debt	1.4	1.5	1.9	1.9	1.7	1.7	1.9	2.0
Domestic debt	4.7	7.1	9.2	10.0	11.1	12.0	13.1	13.5
External Debt and Debt Service								
Total external debt , USD bill.	74.0	85.0	100.0	105.0	110.0	120.0	125.0	125.0
Total external debt , % of GDP	42.5	39.1	39.9	39.4	39.9	46.9	48.7	45.7
Total external debt , % of Exports	115.8	103.3	105.8	116.1	157.9	135.1	137.8	133.2
Amortization, USD bill.	12.5	9.1	15.0	15.8	15.0	16.4	17.0	17.0
Total debt service, USD bill	14.5	11.4	8.3	8.7	8.3	9.1	9.5	9.5
Total debt service, % of exports	22.7	13.8	8.8	9.7	11.9	10.2	10.4	10.1
Credit Ratings (year-end & latest)								
Moody's	A1	Aa3	Aa3	Aa3	Aa3	Aa3	Aa3	Aa3
S&P	A+	A+	A+	AA-	AA-	AA-	AA-	AA-

Source: Haver, UBS

Colombia: Robust but unbalanced growth

The Colombian economy is the best performer in the region and indeed the world at present. The government's emphasis on construction is paying off.

Colombia remains the shining light in the region and indeed is one of the best performing economies in the world at present. Despite some deceleration, we expect it to grow by 4.8% this year, almost the same growth recorded in 2013. Behind this robust performance lies a boost in construction, led primarily by infrastructure and housing. Private sector investment through PPPs will increase its relevance with the execution of the Fourth Generation (4G) infrastructure projects targeting the concession of roads, tunnels, bridges and viaducts. While its full effect will be felt in 2016, 4G projects are expected to add over 1 percentage point to 2015's growth, as a consequence of both direct and indirect spill-overs. However, while more than half of the first wave of tenders has already been awarded, the low participation rate in the bidding process amongst firms remains a sign of caution indicating the government still needs to simplify regulations at lower level governments, facilitate the access to financing (both local and external), and ensure its own share of funding of these projects. Colombia's robust economic performance, without any evident risks of overheating in terms of inflation over the coming quarters, has been reflected in the Central Bank's gradual hiking strategy, which we believe will be resumed more moderately in 2015.

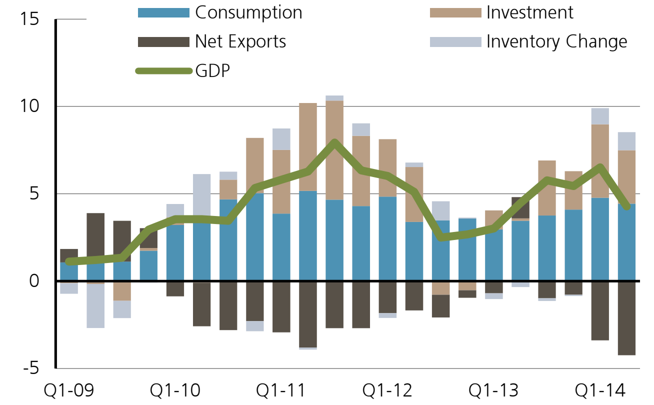
Over time, however, we think that excessive growth in non-tradable sectors versus that in tradables could lead to growing macro imbalances.

While there is no doubt that these infrastructure projects will boost productivity, the fundamental question we think this country will have to grapple with in coming years is just what sort of growth this type of infrastructure is seeking to unleash and what imbalances it could generate in the process. We are somewhat concerned about the current growth model. While we do not wish to rain on Colombia's parade, we would highlight the fact that the drivers of growth are highly lopsided at present: non-tradable sectors are doing all the pulling (construction, and services around it, including financial and commercial activities benefitting from financing needs and increased employment respectively) while tradable sectors are lagging. This is not only true of manufacturing, a sector that remains in the doldrums, but increasingly of traditional export sectors (oil, mining) as well. Oil, in particular, appears to be in a pickle not just because of bureaucratic paralysis related to environmental licencing, attacks by armed groups, and conflicts with local inhabitants but also because of the more fundamental challenge of finding new oil to replenish quickly depleting reserves.

We expect lower growth in 2015 and 2016 and the peso to slide.

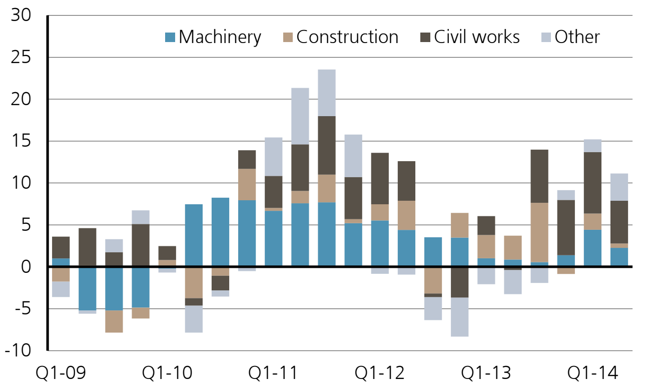
What gives in this scenario is the current account deficit, which continues to widen and will breach 4% of GDP this year. We also expect more pressure on the government fiscal accounts, on the back of taxes that lapse and now the sharp fall in oil prices. Failure to sell Isagen, the power generator, may also impair the government's ability to fund the infrastructure program. No wonder then that the Santos administration has embarked on yet another tax reform worth close to 1.5% of GDP. Putting it altogether, we would draw two key conclusions. First, growth next year should slow from today's heady levels. Indeed, in some ways a moderate slowdown would be welcome. We are expecting growth to come down to 4.2% next year and to 4.0% in 2016. The second conclusion we would draw is that in this environment the currency should continue to weaken. In a context of lower FDI into key sectors like oil, weaker portfolio flows in an environment of higher interest rates abroad, and with the rebalancing of JP Morgan's GBI-EM Global indices now behind us, a slide in COP is likely to ensue, alleviating the current account deficit in the process. We see COP at 2150 at YE'2015.

Figure 41: Colombia - Real GDP by Components, % y/y



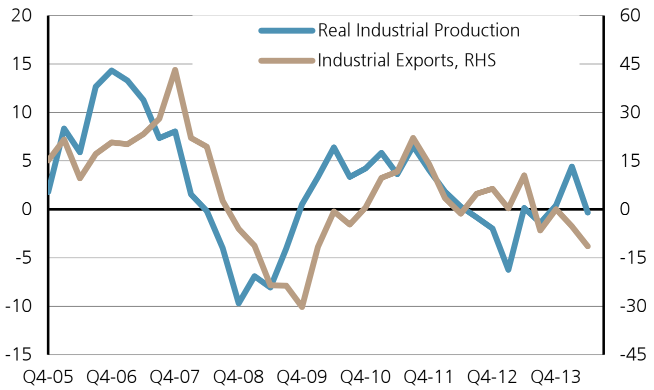
Source: Haver, UBS

Figure 42: Colombia - Contribution to Fixed Capital Formation Growth, % y/y



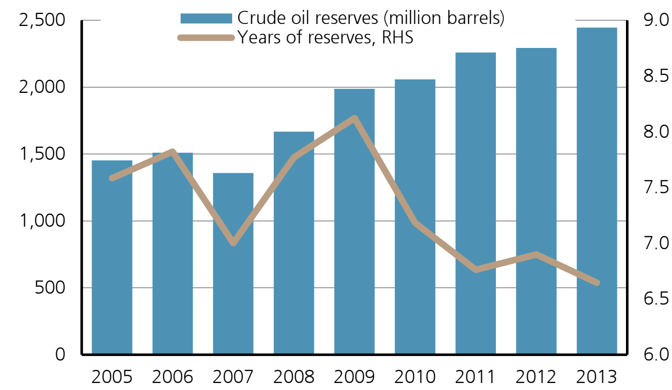
Source: DANe, UBs

Figure 43: Colombia - Industrial Exports and Industrial Production, % y/y



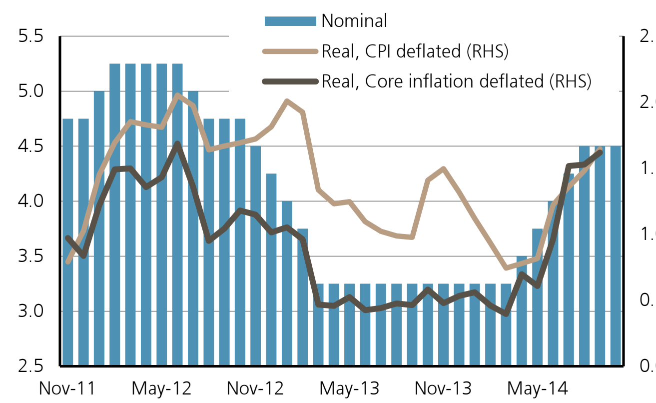
Source: Haver, UBS

Figure 44: Colombia - Crude Oil Reserves



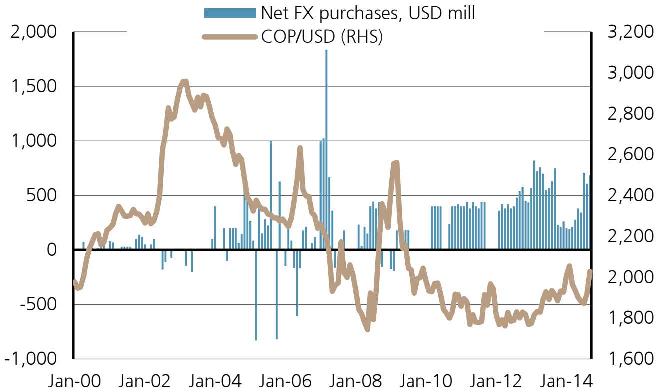
Source: ANH, UBS

Figure 45: Colombia - Central Bank Reference Rate, %



Source: Haver, UBS

Figure 46: Colombia - COP/USD and CB Net FX Purchases



Source: Haver, BanRep

Colombia	2009	2010	2011	2012	2013	2014F	2015F	2016F
Economic Activity and Prices								
GDP, COP trill	504.6	544.9	619.9	665.4	707.2	764.4	819.8	877.2
GDP, USD bill	233.9	287.0	335.4	370.1	378.4	389.3	395.1	398.7
GDP per Capita, USD	5,200	6,305	7,285	7,945	8,030	8,169	8,194	8,176
Real GDP Growth, %	1.7	4.0	6.6	4.0	4.7	4.8	4.2	4.0
Private consumption, %	0.6	5.0	6.0	4.4	4.2	5.2	3.8	3.5
Government consumption, %	5.9	5.6	3.6	5.7	5.8	6.2	4.5	4.0
Capital formation, %	-4.1	7.4	18.9	4.5	5.1	12.8	6.5	6.0
Exports, %	-2.8	1.3	11.8	6.1	5.4	2.7	5.0	5.0
Imports, %	-9.1	10.8	21.5	8.9	4.5	11.0	6.2	5.5
Industrial Production, %	-5.1	4.2	4.9	-0.3	-1.2	2.4	2.6	3.2
Unemployment, avg %	12.0	11.8	10.8	10.4	9.7	9.0	8.8	8.6
Inflation IPC, Dec/Dec %	2.0	3.2	3.7	2.4	1.9	3.3	3.0	3.0
Inflation IPC, Avg %	4.2	2.3	3.4	3.2	2.0	2.6	3.1	3.0
Output per person (2004=100)	111.2	110.8	113.4	114.1	117.4	NA	NA	NA
Financial Markets								
Exchange Rate, yr end	2,044	1,914	1,943	1,768	1,927	2,000	2,150	2,250
Exchange Rate, avg	2,158	1,899	1,848	1,798	1,869	1,963	2,075	2,200
Interest rate Dep 1-6 mths, avg %	6.14	3.66	4.21	5.35	4.24	4.80	5.20	5.20
BDLR Intervention Rate, yr end %	3.50	3.00	4.75	4.25	3.25	4.50	5.00	5.50
M2, Dec/Dec %	5.4	10.2	18.9	16.5	14.7	12.0	14.0	14.0
M2, % of GDP	35.2	35.2	35.9	37.6	40.8	44.0	45.6	48.5
Balance of Payments, USD bill								
Exports of goods	32.5	39.5	56.7	59.8	58.0	59.0	63.0	68.1
Imports of goods	30.5	37.3	50.5	54.6	55.0	61.5	66.5	71.5
Trade balance	2.0	2.2	6.1	5.2	3.0	-2.5	-3.5	-3.4
Other current transactions (net)	-7.1	-11.1	-16.0	-17.0	-15.7	-13.6	-10.4	-10.1
Current account	-5.1	-8.9	-9.9	-11.8	-12.7	-16.1	-13.9	-13.5
% of GDP	-2.2	-3.1	-2.9	-3.2	-3.4	-4.1	-3.5	-3.4
Net FDI	4.5	0.9	6.2	8.3	12.0	10.0	10.0	10.0
Other capital flows (net, incl errors)	2.0	11.1	7.4	8.9	7.7	10.0	6.3	5.5
Overall balance	1.5	3.1	3.7	5.4	6.9	4.0	2.4	2.0
International reserves, eop	25.4	28.5	32.3	37.5	43.6	47.6	50.0	52.0
Reserves /Imports, mnths	10.0	9.1	7.7	8.2	9.5	9.3	9.0	8.7
Fiscal Accounts, Central gov't, % GDP								
Fiscal Revenue	15.3	13.8	15.2	16.1	16.9	15.9	16.1	16.2
Interest Payments	2.9	2.6	2.5	2.4	2.2	2.3	2.3	2.3
Domestic	2.1	1.9	1.9	1.9	2.2	2.2	2.2	2.2
External	0.8	0.7	0.6	0.5	0.1	0.1	0.1	0.1
Non-interest spending	16.4	14.9	15.3	15.8	16.9	15.9	16.0	16.0
Overall balance	-4.1	-3.9	-2.8	-2.3	-2.2	-2.3	-2.2	-2.1
Primary balance	-1.1	-1.1	-0.1	0.2	0.0	0.0	0.1	0.2
Gross Public Debt (% of GDP)								
Central Govt Public Debt	36.6	37.0	35.5	33.7	35.7	37.7	39.7	41.6
External debt	11.7	10.7	10.1	9.1	9.5	9.9	10.3	10.7
Domestic debt	24.9	26.3	25.5	24.7	26.2	27.8	29.4	30.9
Total Public Sector Debt	43.4	45.4	42.5	39.9	41.7	43.6	45.4	47.1
External Debt and Debt Service								
Total external debt, USD bill	53.6	64.9	75.5	78.8	92.3	94.5	95.7	96.5
Total external debt, % of GDP	22.9	22.6	22.5	21.3	24.4	24.3	24.2	24.2
Total external debt, % of exports	164.6	164.2	133.2	131.8	159.1	160.1	151.9	141.7
Amortization, USD bill	2.5	2.5	2.6	6.1	2.6	4.5	5.0	5.0
Total debt service, USD bill	5.5	5.5	5.9	10.0	6.7	8.7	9.2	9.2
Total debt service, % of exports	17.0	13.8	10.5	16.7	11.6	14.8	14.6	13.5
Credit Ratings (year-end & latest)								
Moody's	Ba1	Ba1	Baa3	Baa3	Baa3	NA	NA	NA
S&P	BB+	BB+	BBB-	BBB-	BBB	NA	NA	NA

Source: Haver, UBS

Peru: The challenges of a former best-in-class

2014 was a year of marked economic deceleration for Peru on account of lower commodities prices, the delay in certain key mining projects, excessive red tape, uncertainty arising from political noise, and an ensuing noticeable fall in business confidence. In Jan-Aug, growth decelerated to 2.8% y/y vs the 4.9% recorded in same period a year ago.

Looser monetary policy and a weaker peso will help Peru adjust.

In general, we think that the monetary authority's policy response to the slowdown has been adequate. PEN liquidity has been injected by lowering the reference rate but mostly by reducing reserve requirements. While the growth of credit in PEN has decelerated, it is still expanding robustly at double-digits. We think there is still room on reserve requirements for further loosening of domestic credit conditions. The PEN was allowed greater flexibility and weakening, which we think will continue throughout 2015, especially in the context of lower mineral prices, weaker capital inflows and the PEN's relative strength vis á vis other trading partners' currencies. The fact that the current account deficit remains the highest in the region also augurs for a weaker sol. We foresee the PEN/USD at 3.05 by YE 2015, from 2.92 we project at YE 2014. With worries about El Niño dissipating, at this stage we are not particularly worried about any sustained inflationary risk building up.

Infrastructure spending spearheaded by the government should also help the economy recover.

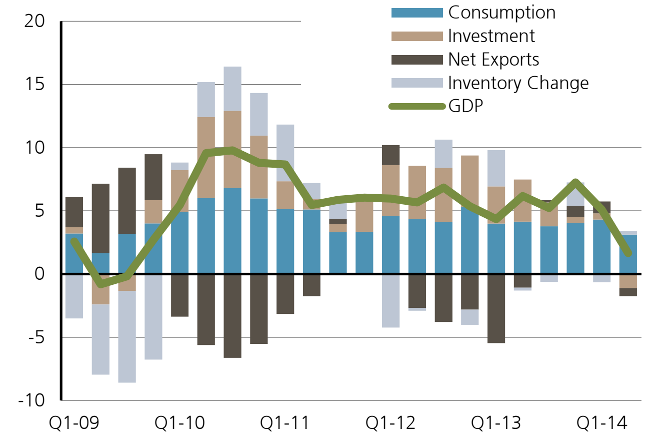
This monetary expansion has also had a fiscal counterpart. The government has fostered investment and public spending. More recently, stimulus packages will target tax and labour market reforms. Furthermore, the government has engaged in a large PPP investment program over the 2015-2018 horizon including the construction of the southern gas pipeline, the Chinchero airport and further improvement of the Talara oil refinery.

Poor implementation at the regional level is a key risk of this economy.

Yet, there are reasons to remain concerned. Although so far this year the national government's investment has expanded in real terms, its overall effect has been more than offset by the contraction in lower level governments, especially at a regional level. Delays in the execution of the infrastructure works, excessive bureaucracy, poor coordination, and corruption amongst state agencies have frequently been denounced by businessmen. We remain particularly concerned about the change of authorities in local and regional governments after the recently-held elections, as this could lead to paralysis in investment projects and thus offset the attempts of the national government to foster growth. One of the key challenges for the Humala administration over the coming months will be effectively coordinating this fiscal stimulus and assuring that business confidence recovers as the only means for fostering private investment and thus putting the economy back on track towards its potential. With general elections scheduled for April 2016, we cannot discard that political noise could arise and, thus, impair any strengthening in the level of confidence within the local business community.

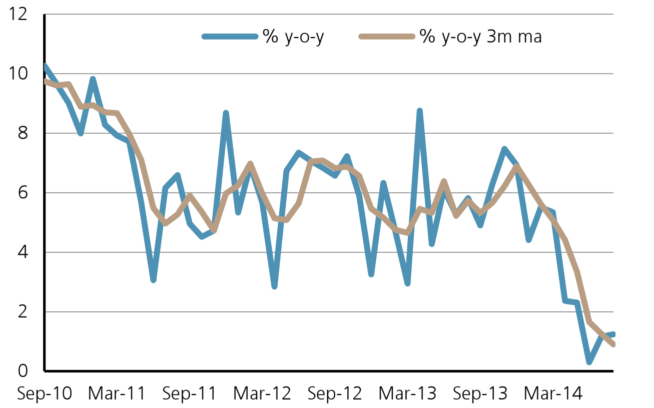
Having said this, we do foresee momentum coming from infrastructure investment projects, while enhanced production and export capacity should come from mining projects at Toromocho and Constancia. Add the fact that 2014 will end up being a lower base of comparison and the conditions are there to see a moderate bounce in 2015, though, again, we would not discard ex ante downside risks to our forecast. We expect 4.0% growth next year, up from 3.3% in 2014. Note that this is still well-below what we think Peru's growth potential is at.

Figure 47: Peru - Real GDP by Components, % y/y



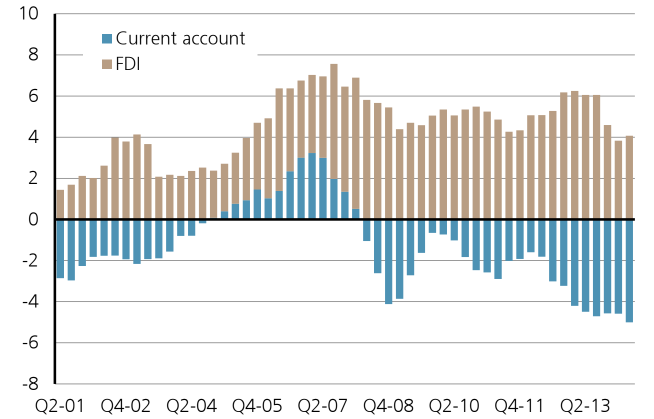
Source: Haver, UBS

Figure 48: Peru - Monthly Activity Indicator, % y/y



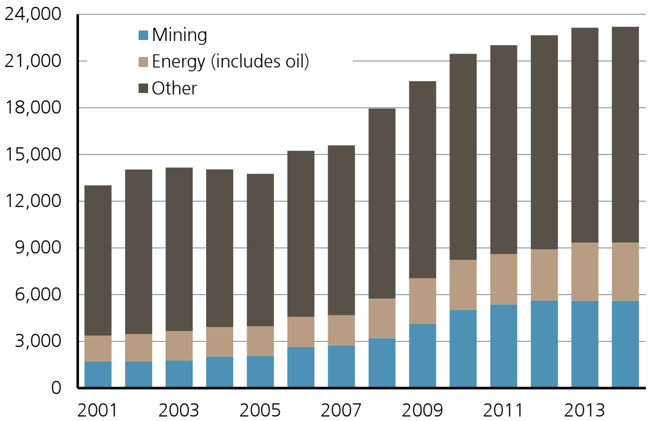
Source: Haver, UBS

Figure 49: Peru - Balance of Payments, $Q Rolling, % of GDP



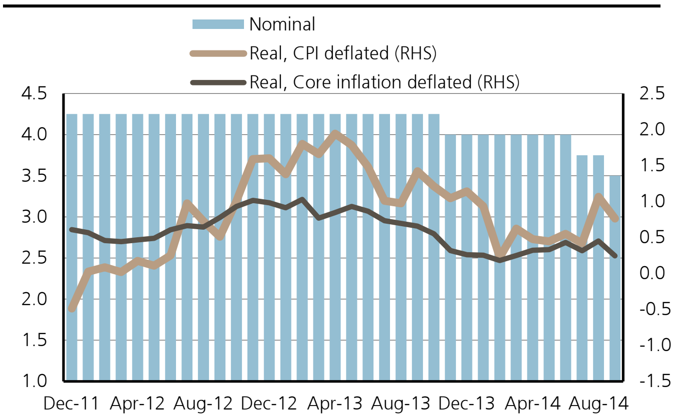
Source: BCRP, UBS

Figure 50: Peru - FDI Stocks by Sector, USD mn



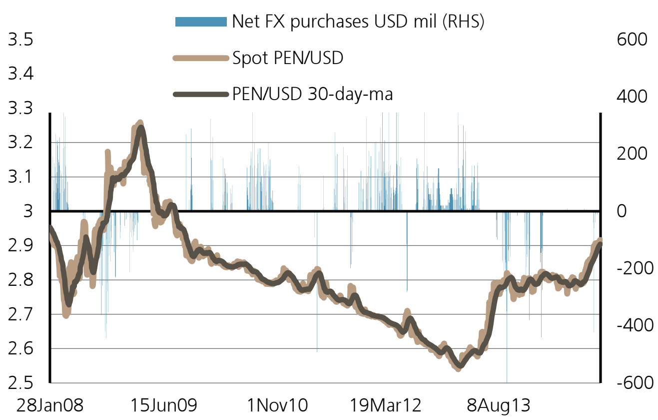
Source: Proinversion, UBS

Figure 51: Peru - Central Bank Reference Rate, %



Source: Haver, UBS

Figure 52: Peru - PEN/USD and CB Net FX Purchases



Source: BCRP, UBS

Peru	2009	2010	2011	2012	2013	2014F	2015F	2016F
Economic Activity and Prices								
GDP, PEN bill	382.3	434.5	486.2	526.4	558.1	592.7	634.4	680.9
GDP, USD bill	126.9	153.8	176.5	199.5	206.5	207.6	212.5	221.4
GDP per Capita, USD	4,356	5,219	5,923	6,621	6,776	6,735	6,816	7,021
Real GDP Growth, %	1.0	8.5	6.5	6.0	5.8	3.3	4.0	4.8
Private consumption, %	2.8	8.7	6.0	6.1	5.4	4.4	4.2	4.2
Government consumption, %	11.4	5.6	4.8	8.1	6.7	4.8	4.8	4.5
Capital formation, %	-22.9	38.8	12.9	12.3	10.5	1.6	3.3	4.6
Exports, %	-0.7	1.3	6.9	3.7	-0.9	-2.0	5.0	7.0
Imports, %	-16.7	26.1	11.6	11.3	3.6	-0.4	4.8	5.0
Industrial Production, %	-6.9	14.1	5.7	-0.9	4.9	0.0	4.2	5.2
Unemployment, avg %	8.4	7.9	7.7	6.8	5.9	6.2	6.1	6.1
Inflation IPC, Dec/Dec %	0.2	2.1	4.7	2.6	2.9	2.9	3.0	2.5
Inflation IPC, Avg %	2.9	1.5	3.4	3.7	2.8	2.5	3.0	2.7
Output per person (2004=100)	124.7	129.4	135.8	142.0	145.5	NA	NA	NA
Financial Markets								
Exchange Rate, yr end	2.88	2.82	2.70	2.57	2.79	2.92	3.05	3.10
Exchange Rate, avg	3.01	2.83	2.76	2.64	2.70	2.86	2.99	3.08
Interest rate Dep 1-6 mths, avg %	4.35	2.14	3.67	3.88	3.52	3.60	3.90	4.00
BCRP Intervention Rate, yr end %	1.25	3.00	4.25	4.25	4.00	3.50	3.75	4.50
Broad money, Dec/Dec %	5.2	22.6	11.9	14.8	16.5	8.0	10.0	10.0
M2, % of GDP	29.4	29.5	30.9	32.7	36.2	36.8	37.9	38.8
Balance of Payments, USD bill								
Exports of goods	27.1	35.8	46.4	46.4	42.2	38.0	43.0	48.0
Imports of goods	21.0	28.8	37.2	41.1	42.2	40.5	44.0	48.5
Trade balance	6.1	7.0	9.2	5.2	0.0	-2.5	-1.0	-0.5
Other current transactions (net)	-6.7	-10.5	-12.4	-11.5	-9.1	-8.1	-6.5	-7.3
Current account	-0.6	-3.5	-3.2	-6.3	-9.1	-10.6	-7.4	-7.8
% of GDP	-0.5	-2.3	-1.8	-3.1	-4.4	-5.1	-3.5	-3.5
Net FDI	6.0	8.2	7.5	11.8	9.2	9.5	10.0	10.0
Other capital flows (net, incl errors)	-4.4	6.5	0.3	9.6	1.6	-0.1	-1.1	-0.2
Overall balance	1.0	11.2	4.7	15.2	1.7	-1.2	1.5	2.0
International reserves, eop	33.2	44.2	48.9	64.0	65.7	64.5	66.0	68.0
Reserves /Imports, mnths	18.9	18.4	15.8	18.7	18.7	19.1	18.0	16.8
Fiscal Accounts, Central gov't, % GDP								
Fiscal Revenue	16.0	17.4	18.2	18.5	18.7	19.1	18.9	19.0
Interest Payments	1.3	1.1	1.0	1.0	1.0	1.0	1.0	0.9
Domestic	0.5	0.4	0.5	0.5	0.5	0.5	0.5	0.4
External	0.8	0.7	0.5	0.5	0.5	0.5	0.5	0.5
Non-interest spending	16.2	16.2	16.2	16.3	17.2	17.6	18.1	18.4
Overall balance	-1.4	0.1	1.0	1.3	0.5	0.5	-0.2	-0.3
Primary balance	-0.2	1.2	2.0	2.3	1.5	1.5	0.8	0.6
Gross Public Debt, % of GDP								
Central Government Debt	26.0	23.5	21.4	19.7	19.2	19.0	19.0	18.6
External debt	15.4	12.7	11.0	9.5	8.6	8.2	8.2	7.8
Domestic debt	10.5	10.8	10.4	10.2	10.6	10.8	10.8	10.8
Total Public Sector Debt	25.7	23.4	21.5	19.6	18.5	18.8	18.3	18.3
External Debt and Debt Service								
Total external debt, USD bill	35.2	43.7	48.1	59.4	60.8	64.3	68.3	72.9
Total external debt, % of GDP	27.7	28.4	27.2	29.8	29.5	31.0	32.1	32.9
Total external debt, % of exports	129.9	122.0	103.7	128.1	144.2	169.1	158.8	151.8
Amortization, USD bill	3.5	7.1	4.2	3.8	5.6	4.5	3.7	4.0
Total debt service, USD bill	5.1	8.8	6.2	6.0	8.2	7.1	6.3	6.6
Total debt service, % of exports	18.8	24.5	13.4	12.9	19.3	18.6	14.6	13.7
Credit Ratings (year-end & latest)								
Moody's	Ba1	Ba1	Baa3	Baa3	Baa2	NA	NA	NA
S&P	BB+	BB+	BBB-	BBB-	BBB+	NA	NA	NA

Source: Haver, UBS

Argentina: In a hole and still digging

Argentina is in stagflation.

2014 has been an *annus horribilis* for Argentina. Despite an attempt at macro-adjustment earlier in the year following a run on the currency --an adjustment that included a devaluation, a hike in interest rates, and restructuring of a number of creditors' claims-- the economy has been buffeted by falling foreign trade volumes, declining construction, plummeting car production, underperforming consumption, and contracting manufacturing. Furthermore, inflation has climbed higher, the gap between the official and parallel exchange rates is elevated, and international reserves stand at precariously low levels.

Despite the government's claims to the contrary, the decision not to settle with the holdouts but instead default on the restructured bonded debt in the middle of the year has accelerated this economic deterioration. The government's attempts at making bond payments through channels outside US jurisdiction have unsurprisingly fallen flat thus far.

Financing the fiscal deficit is the biggest challenge, the level of reserves is the biggest constraint.

In sum, Argentina is mired in stagflation, with the economy due to contract by 1.9% this year and unofficial inflation hovering around 40%. The key question facing the country going into 2015 is whether President Cristina Fernandez de Kirchner changes policy direction in her remaining year in office or whether instead she digs in her heels with her current set of policies. At the heart of her dilemma is how she finances the growing government deficit, which is increasingly funded by the money-printing press, putting upward pressure on inflation and the currency in the process. Her biggest constraint is the level of net reserves, which at just three months of imports worth are already dangerously low and could fall further on account of lower soy prices and higher external debt amortization.

President Kirchner could opt to resolve the holdouts issue or she could dig her heels in deeper and give continuity to the current set of unorthodox policies.

One option for President Kirchner is to regain access to international debt markets. This would reduce the need for monetization of the deficit and would increase the supply of dollars to the economy, alleviating the exchange rate. For it to work, however, the government would need to resolve the holdout situation in the new year, something that from a political standpoint the government appears loathed to do. The alternative scenario is one where President Kirchner deepens the current policy mix: default, monetary financing, import restrictions, and increasingly Draconian capital and price controls. In this scenario, the Argentine situation deteriorates further.

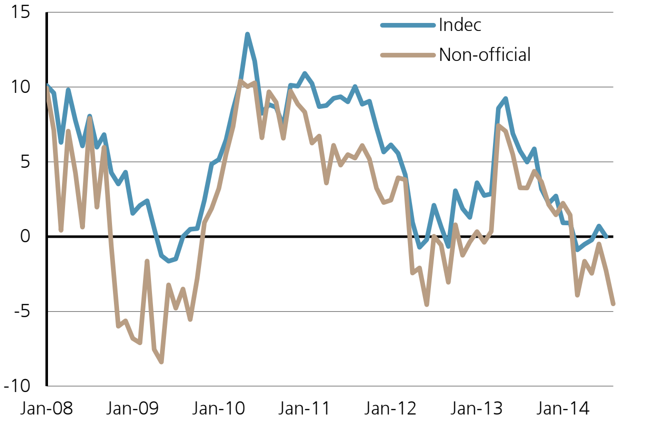
Which option she chooses will depend on how bad the situation gets. We see a sizable devaluation as inevitable in 2015.

Which option she chooses will depend on how bad the economic and social situation get. However, the passage of controversial legislation recently, such as the Suppy Law allowing the government to regulate all aspects of the supply chain, does not bode well for a change in direction short term. We see the economy remaining in recession in 2015 with a 2.5% contraction. We think a large devaluation is inevitable next year and see the ARS/USD rate at 12.5 by a year-end 2015.

All candidates in next year's presidential race are pledging reform. 2016 should see a recovery.

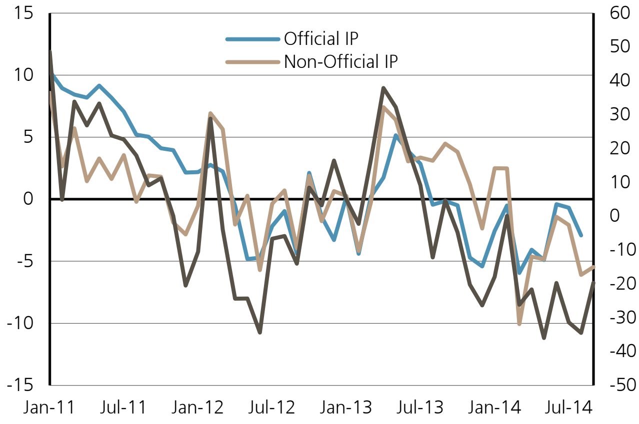
Against this background, 2015 presidential elections will take place in two stages: primary elections in August and full elections in October, with the new administration taking up office in December. The candidates that nowadays appear more likely to win are expected to advance quite moderate agendas and, despite shades of grey, they will all foster a much more market friendly environment in which solving the debt in arrears will be a key pillar. We see 2016 as a year of recovery.

Figure 53: Argentina - Monthly GDP Proxy, % y/y



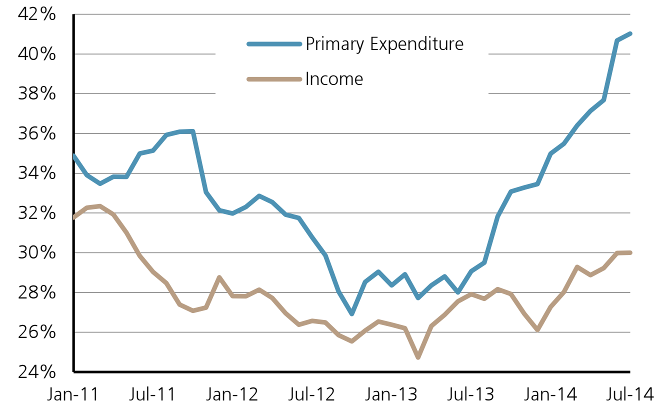
Source: Haver, OFJ, UBS

Figure 54: Argentina - Manufacturing Activity, % y/y



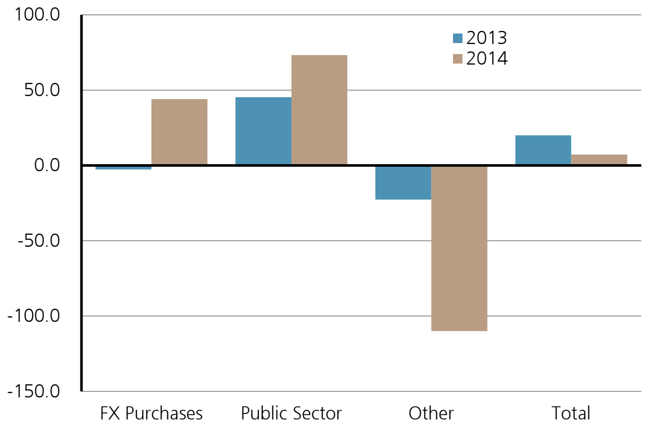
Source: Haver, ADEFA, OJF, UBS

Figure 55: Argentina - Fiscal Accounts, y/y*



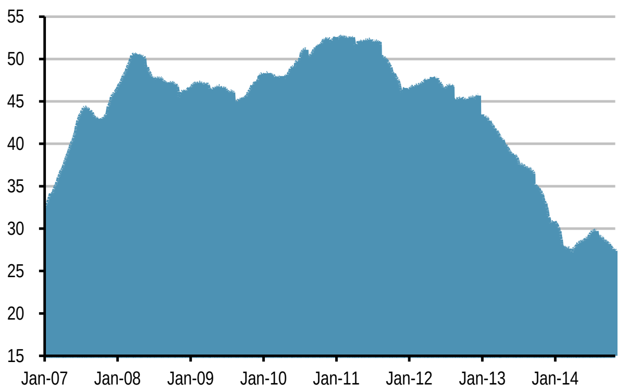
Source: ACM, UBS */ Expenditure excludes BCRA utilities and Social Security transfers

Figure 56: Argentina - Factors Explaining Monetary Base Expansion, Jan-Sep, ARS bn



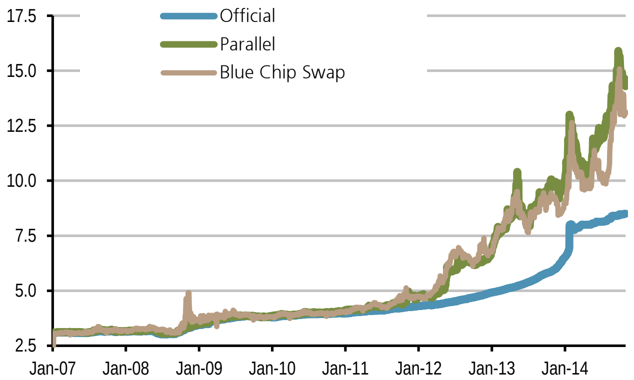
Source: ACM, UBS

Figure 57: Argentina - Central Bank Reserves, USD bn



Source: Reuters, ACM, UBS

Figure 58: Argentina - Exchange Rates, ARS/USD



Source: Reuters, UBS

Argentina	2009	2010	2011	2012	2013	2014F	2015F	2016F
Economic Activity and Prices								
GDP, ARS bill	1,411.5	1,810	2,303	2,745	3,340	4,413	5,979	8,130
GDP, US$ bill	376.8	462	557	603	596	588	564	533
GDP per Capita, US$	9,389	11,315	13,489	14,450	14,131	13,769	13,070	12,215
Real GDP Growth, %	0.1	9.1	8.6	0.9	2.9	-1.9	-2.5	3.0
Private consumption, %	3.5	7.1	10.8	4.2	4.4	-2.5	-1.0	3.2
Government consumption, %	8.5	7.2	8.8	6.5	5.1	1.0	0.5	3.5
Capital formation, %	-14.6	21.2	18.2	-5.2	3.0	-8.0	-9.5	6.0
Exports, %	-8.7	14.4	4.9	-5.9	-4.2	-12.6	-5.0	11.1
Imports, %	-19.3	35.0	19.8	-4.7	2.1	-11.8	-4.1	13.4
Industrial Production, Dec/Dec % (Official)	0.0	9.8	6.5	-1.2	-0.2	-3.0	-1.0	3.0
Industrial Production, Dec/Dec % (FIEL)	-4.2	9.6	4.7	-0.8	0.3	NA	NA	NA
Unemployment, % (avg)	8.7	7.8	7.2	7.2	7.1	8.5	9.0	8.2
Inflation IPC, Dec/Dec % (official)	7.7	10.9	9.5	10.8	10.9	26.0	30.0	25.0
Inflation IPC, Avg % (official)	6.3	10.5	9.8	10.0	10.6	18.9	28.2	27.2
Financial Markets								
Exchange Rate (yr end)	3.80	3.98	4.29	4.88	6.32	8.70	12.50	18.00
Exchange Rate (yr avg)	3.75	3.92	4.14	4.55	5.60	7.51	10.60	15.25
Interest rate - Depo 30-60 days	9.5	9.6	14.7	13.8	17.8	21.0	25.0	25.0
Interest rate - Depo <60 days (yr end)	9.5	9.6	14.7	13.8	17.8	21.0	25.0	25.0
Badlar 30d benchmark deposit rate	12.4	10.1	13.3	13.8	16.9	18.0	28.0	25.0
M2, Dec/Dec %	13.6	28.1	28.9	40.1	27.1	28.0	30.0	25.0
Total private sector deposits, Dec/Dec %	14.9	31.1	28.5	42.1	30.1	30.0	28.0	28.0
Balance of Payments , USD bill								
Exports goods	55.67	68.19	84.05	80.25	81.66	72.06	72.93	80.22
Imports goods	38.79	56.79	74.32	68.02	73.66	65.00	63.05	72.19
Trade balance	16.89	11.40	9.73	12.23	8.00	7.06	9.88	8.03
Net interest payments	2.3	2.7	3.2	3.2	3.4	3.5	3.5	3.4
Other current transactions (net)	-3.6	-9.5	-10.4	-9.9	-9.5	-8.6	-11.2	-9.6
Current account	11.00	-0.78	-3.82	-0.93	-4.81	-5.04	-4.82	-4.97
% of GDP	2.9	-0.2	-0.7	-0.2	-0.8	-0.9	-0.9	-0.9
FDI (net)	3.3	10.4	9.2	11.1	7.9	3.0	3.5	6.5
International reserves (end of period)	48.0	52.2	46.4	43.3	30.6	23.0	20.0	24.0
Reserves / Imports (months)	14.8	11.0	7.5	7.6	5.0	4.2	3.8	4.0
Fiscal Accounts, % GDP								
Fiscal Revenue	18.4	19.4	18.9	20.1	21.5	22.1	22.2	22.2
Interest Payments	1.7	1.2	1.5	1.9	1.3	1.6	1.8	1.5
Domestic	0.8	0.6	0.6	0.8	0.7	0.6	0.7	0.5
External	0.9	0.7	0.9	1.1	0.5	1.0	1.1	1.0
Non-interest spending	17.2	18.0	18.7	20.2	22.2	23.1	24.0	23.7
Overall balance	-0.5	0.2	-1.3	-2.0	-1.9	-2.5	-3.6	-2.9
Primary balance	1.2	1.4	0.2	-0.2	-0.7	-0.9	-1.8	-1.4
Public Debt								
Total public debt, USD bill.	147.1	164.3	179.0	197.5	202.6	215.1	246.6	242.0
Total public debt, % of GDP	39.0	35.6	32.2	32.7	34.0	36.6	43.7	45.4
- of which external	16.4	15.1	13.2	12.1	12.0	14.4	20.5	25.1
External Debt and Debt Service								
Total external debt, USD bill	115.6	156.9	164.8	160.7	154.4	167.4	198.4	216.7
Total external debt, % of GDP	30.7	34.0	29.6	26.7	25.9	28.5	35.2	40.6
Total external debt, % of exports	207.6	230.1	196.1	200.3	189.1	232.3	272.0	270.1
Amortization, USD bill.	8.9	9.1	7.1	11.0	13.1	9.2	14.5	3.8
Total debt service, USD bill	13.4	13.5	12.2	15.9	17.8	14.9	20.4	6.5
Total debt service, % of exports	24.0	19.9	14.5	19.8	21.8	20.7	27.9	8.1
Credit Ratings (year-end & latest)								
Moody's	B3	B3	B3	B3	B3	NA	NA	NA
S&P	B-	B	B	B-	CCC+	NA	NA	NA

Source: Haver, UBS

Venezuela: Walking on the tight rope of default

The spectre of default hovers once more over Venezuela.

Years of inconsistent macroeconomic policies are taking Venezuela closer to breaking-point. Runaway fiscal deficits coupled with a fixed or quasi-fixed exchange rate have mired the economy in recession (of size uncertain given that the government has not published activity figures since Q4'13), and have fuelled the highest inflation in the region (63%). Despite staunch capital controls, and rationing and shortage of goods at the shops, international reserves at the CB have continued to fall. Although Venezuela made close to USD5bn in external debt payments in October, the spectre of whether it can or should continue to service its foreign debt-- particularly in light of USD 10bn debt payments coming due on average in the next two years-- hovers over market sentiment.

Venezuela's ability to pay should never be in question on account of its oil assets.

In theory, Venezuela's ability to pay should never really be in question. Its dollar based assets – basically the income stream derived from sitting on some of the largest oil reserves in the world – greatly exceed its dollar debt. Even now with the official rate greatly overvalued, oil exports exceed debt payments by a factor of 3-to-1. Therefore, there is always a devaluation that can bolster government finances through the receipt of dollar oil revenues to close any fiscal gap. If this devaluation can be coupled with a fiscal adjustment in order to reduce the monetary financing of the deficit and thus control inflation, then the fiscal gains could be long lasting.

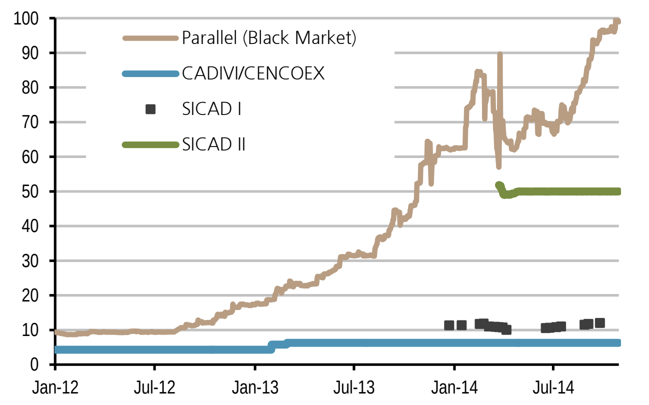
It is preferable to devalue and adjust fiscally than to default. But devaluation is no panacea and the fiscal windfall it generates is smaller than it once was.

The trouble is that implementing this type of macroeconomic adjustment is fraught with difficulty. For months now, the government has talked about unifying the exchange rates (read devaluing) and increasing gasoline prices (thus reducing its most burdensome fiscal subsidy). The fact that it has not yet moved in this direction despite its growing economic troubles speaks volumes as to the social costs such moves would impose, particularly on the worse-off. Politically, this situation is particularly difficult to manage ahead of the legislative elections scheduled for Dec'15. Moreover, the windfall gains from devaluation are now smaller than they were in the past. There are no private exporters left to leverage devaluation and the country's import dependence has grown in 15 years of Chavismo. Complicating matters further, oil production is down sharply from its 1998 peak, and a significant share of the country's oil sales are already pre-committed (China), sold in kind (Cuba), or sold at heavily subsidized rates (Petrocaribe). Last but not least, the recent fall in oil prices questions whether PDVSA's remains viable at these prices.

Venezuela walks a tight rope. For now, we think it avoids default by, for one, devaluing its currency in 2015.

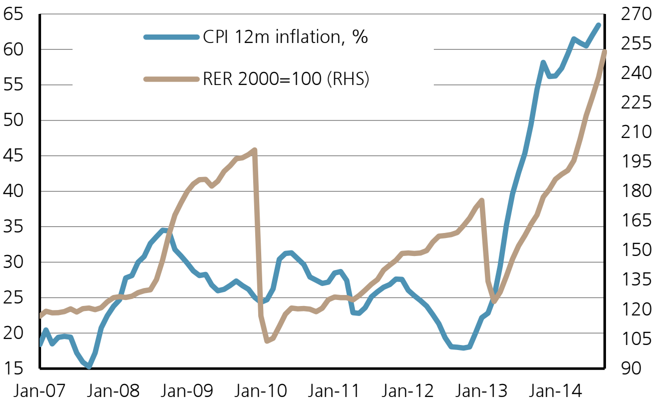
Our assessment is that the country will continue to take the minimum steps needed to avoid a default, but that is indeed walking on a tight-rope. We think that defaulting on the debt would provide little actual budgetary relief, would be subject to high risk of attachment, and would curtail PDVSA's ability to function financially (akin to killing the golden goose). The country still has assets it can sell, including gold reserves at the CB and assets held in off-balance sheet funds (of uncertain size, to be fair). In recent weeks, there have also been some signs of realism seeping into policy making: the duration of the Chinese loans has been lengthened, and there is talk that subsidised sales of oil to the Caribbean have been reduced. More importantly, the government has started to let PDVSA sell more dollars at the weaker Sicad II rate, which we see as a precursor of a much larger devaluation next years (one where the bulk of transactions go through a unified SICAD market). We see 2015 as one of a new large devaluation (we see the blended exchange rate at 27.6 at YE'15 vs 16.2 at YE'14 vs) and one of ongoing recession.

Figure 59: Venezuela - Exchange Rates, VEF/USD



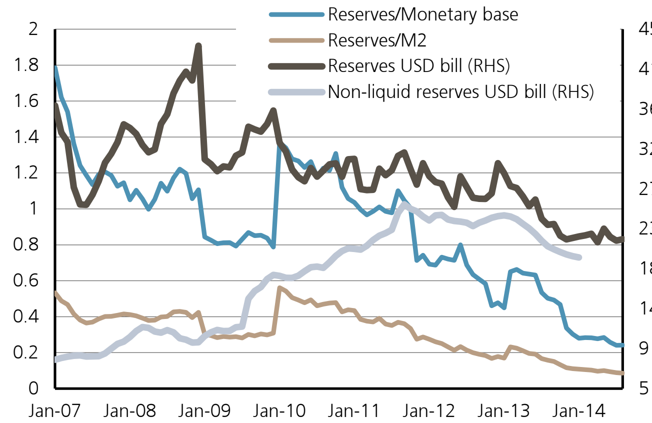
Source: BCV, Dolar Paralelo, UBS

Figure 60: Venezuela - 12m % Inflation and Real Exchange Rate



Source: Haver, UBS

Figure 61: Venezuela - Reserves and Monetary Aggregates



Source: Haver, UBS

Figure 62: Venezuela 5yr CDS Spread (bps)

Source: Bloomberg

Venezuela	2009	2010	2011	2012F	2013F	2014F	2015F	2016F
Real Activity and Prices								
GDP, VEF bill	707	1,017	1,357	1,635	2,461	4,037	6,963	11,106
GDP, USD bill	329.8	393.2	315.7	380.3	390.7	265.2	263.5	254.3
GDP per Capita, USD	11,702	13,731	10,859	12,888	13,046	8,722	8,535	8,110
Real GDP Growth, %	-3.2	-1.5	4.2	5.6	1.3	-3.0	-1.5	0.5
Private consumption, %	-2.9	-1.9	4.0	7.0	4.7	NA	NA	NA
Government consumption, %	1.5	2.1	5.9	6.3	3.3	NA	NA	NA
Capital formation, %	-8.3	-6.3	4.4	23.3	-9.0	NA	NA	NA
Exports, %	-13.7	-12.9	4.7	1.6	-6.2	NA	NA	NA
Imports, %	-19.6	-2.9	15.4	24.4	-9.7	NA	NA	NA
Industrial Production, % (real)	-11.9	-2.5	1.8	1.9	0.2	-3.0	-2.0	0.0
Unemployment, % (avg)	7.9	8.5	8.2	7.8	7.5	8.5	9.0	10.0
Inflation IPC, Dec/Dec %	25.1	27.2	27.6	20.1	56.2	68.0	75	60
Inflation IPC, Avg %	27.1	28.2	26.1	21.1	40.6	62.1	71.5	67.5
Output per Employed Person (2000=100)	102.4	99.3	101.9	106.0	105.9	101.2	98.1	97.1
Financial Markets								
Exchange Rate (yr end) 1/	2.1	2.6	4.3	4.3	6.3	16.2	27.6	45.5
Exchange Rate (yr avg)	2.1	2.6	4.3	4.3	6.3	15.2	26.4	43.7
Interest rate (Dep 30days) - (yr avg)	16.0	14.8	14.5	14.5	14.5	14.5	16.0	17.0
Broad Money Dec/Dec % change	14.3	19.1	50.6	61.0	69.7	67.0	60.0	45.0
M2, % of GDP	35.2	29.2	32.9	44.0	49.6	50.5	46.8	42.6
Balance of Payments, USD bill								
Exports of goods	57.6	65.7	92.8	97.3	90.3	78.4	72.3	75.8
Imports of goods	41.2	38.5	46.8	59.3	55.2	45.3	46.2	48.0
Trade balance	16.4	27.2	46.0	38.0	35.1	33.2	26.1	27.8
Other current transactions (net)	-14.2	-18.4	-21.6	-27.0	-26.9	-19.6	-15.0	-17.6
Current account	2.3	8.8	24.4	11.0	8.2	13.6	11.1	10.2
% of GDP	0.68	2.24	7.72	2.9	2.1	5.1	4.2	4.0
Net FDI	-4.4	0.1	4.9	0.8	1.0	1.0	1.0	1.5
Other capital flows (net, incl errors)	-8.1	-16.9	-33.3	-12.8	-17.6	-14.1	-12.6	-10.7
Overall balance	-10.3	-8.1	-4.0	-1.0	-8.4	0.5	-0.5	1.0
International reserves US$ billion (end of period)	35.8	30.3	29.9	29.9	21.5	22.0	21.5	22.5
Reserves /Imports mnths	10.4	9.4	7.7	6.0	4.7	5.8	5.6	5.6
Fiscal Accounts, National gov't, % GDP								
Fiscal Revenue	21.4	19.3	22.5	23.5	20.5	18.2	21.4	20.0
Interest Payments	1.3	1.4	1.6	2.7	3.0	3.9	2.7	1.9
Domestic	0.6	0.8	0.8	1.6	1.9	3.2	1.6	1.0
External	0.7	0.6	0.8	1.1	1.1	0.7	1.1	0.9
Non-interest spending	25.1	21.5	24.8	25.7	21.5	18.7	23.0	22.4
Overall balance	-5.0	-3.6	-4.0	-4.9	-4.0	-4.4	-4.3	-4.3
Primary balance	-3.7	-2.2	-2.4	-2.2	-1.0	-0.5	-1.6	-2.4
Total Public Debt (Central Govt)	18.2	18.3	25.1	29.1	24.9	34.5	33.3	31.9
External debt	10.7	9.4	13.8	11.9	11.2	15.6	15.4	15.5
Domestic debt	7.5	8.9	11.4	17.1	13.6	18.9	18.0	16.4
External debt and debt service								
Total Private and Public External Debt, USD bill	81.9	97.1	111	119	120	127	131	139
Total External Debt % of GDP	24.8	24.7	35.1	31.3	30.7	47.9	49.9	54.8
Total External Debt % of exports	142.3	147.7	119.3	122.2	132.8	161.9	181.8	184.0
Amortization, USD bill	3.9	6.1	11.0	1.6	6.6	8.4	8.2	NA
Total debt service, USD bill	6.8	9.4	15.2	7.8	12.3	14.9	14.6	NA
Total debt service, % of exports	11.7	14.3	16.4	8.0	13.7	19.0	20.1	NA
Credit ratings (yr end & latest)								
Moody's	B2	B2	B2	B2	Caa1	NA	NA	NA
S&P	BB-	BB-	B+	B+	B-	NA	NA	NA

Source: Haver, UBS

Rafael de la Fuente, Guilherme Loureiro, Thiago Carlos

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Security Recommendations			
Bond Recommendation	Outperform; Marketperform; Underperform	Up to 3 months	A corporate bond's expected relative performance versus a defined reference
CDS Recommendation	Buy Protection; Sell Protection	Up to 3 months	Recommendation to hedge a company's creditworthiness

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Source: UBS

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Issuer Name	Credit Rating	Outlook
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Chile	-	-
Colombia	-	-
Mexico	-	-
Peru (Republic of)	-	-
Venezuela	-	-

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