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Brazil's industrial sector ended 2018 poorly, and likely was a key drag on GDP growth in Q4.

The labour market also stalled in Q4, but the underlying trend is improving; we expect better numbers ahead.

The credit market is on the mend, suggesting that consumer demand will remain relatively fit.

Brazil's Q4 Industrial Weakness was Offset by Robust Consumption

Brazil's December industrial production and labour reports, released late last week, confirmed that the recovery was struggling at the end of last year. Production rose 0.2% month-to-month in December, overshooting market expectations, but pushing the year-over-year rate down to -3.6%, from a downwardly-revised -1.0% in November. In Q4 as a whole, output fell by 1.3% quarter-on-quarter, slowing from a solid 2.5% increase in Q3. These numbers will drag on the GDP data, released later this month. *This weakness is temporary, driven by the lagged effect of political uncertainty around the presidential election and one-time shocks in previous quarters, including the truckers' strike.*

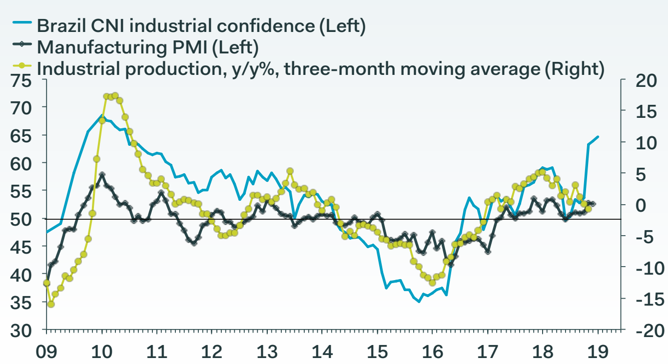
The modest month-to-month headline December gain was lifted by rising output in two of the four major categories and in 11 of the 26 sectors surveyed. Intermediate goods production was the main driver, rising by 0.7% month-to-month for a second consecutive month. Non-durable goods production rose 0.2%, but this followed a 0.9% drop in November. Capital goods production was the main drag in December, plunging 5.7% month-to-month; note this comes after a downwardly-revised 4.4% drop in November. The underlying trend is falling, suggesting that fixed asset investment weakened in Q4. Durable goods production was also soft at the end of 2018. Car production was one of the main down-ward forces, plunging 3.1% month-to-month, the second consecutive drop, and the underlying trend has been falling rapidly since June.

Overall, we think Brazil's industrial sector will continue to expand this year, thanks to improving domestic demand, supported by low interest rates and stable inflation, coupled with a better external outlook. Industrial surveys signal better numbers over the next three-to-six months. A recovery in Argentina—the biggest foreign market for Brazilian cars—over the second half of the year will also help.

The manufacturing PMI released on Friday rose trivially to 52.7 in January, from 52.1 in Q4, indicating that a cyclical upturn in Brazil's industrial sector is coming. ***Business confidence was relatively solid in the final stretch of the year, with continued sturdy trends in the forward-looking indices in January.*** Firms' own production outlook, and expectations for industry as a whole, remained consistent with improving output growth. That said, the ongoing weakness in the capital goods and durable components, particularly in the auto industry—driven mainly by weak external conditions—suggest that the overall rebound will be modest in the near term. This is also in line with the performance of the FGV capacity utilization index, which eased in January to its lowest level since September 2017.

Still, we remain relatively upbeat about the industrial sector this year, particularly in the second

THE INDUSTRIAL ECONOMY WILL DO WELL THIS YEAR



half. But downside risks remain high, with the U.S.-China trade war still running, with severe collateral damage in EM. According to CPB data released late last month, global import demand is falling rapidly, and EM are leading the way, with a 3% fall. The trade war should abate in spring, but the latest news is not encouraging. *A sharper slowdown of the Chinese and U.S. economies would be bad news for Brazil, despite being a relatively closed economy.*

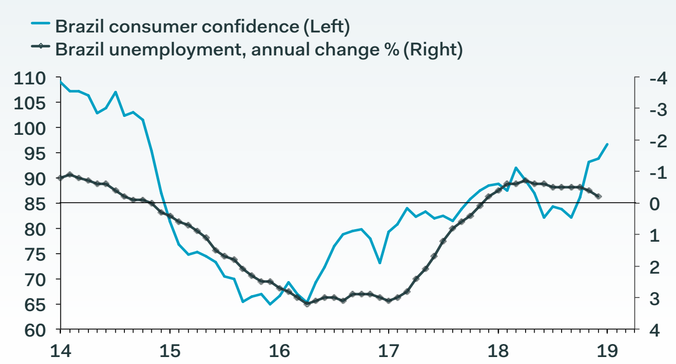
On the domestic front, meanwhile, progress on the reforms front is vital in order to keep financial metrics in check, boost investors' confidence, and put the economy on a sustainable path, helped by low interest rates for longer than expected. ***We still expect reforms to be approved, but the highly fragmented Congress suggest it won't be an easy task.*** Moreover, recent events, including the ongoing scandal involving lawmaker Flavio Bolsonaro—son of the president—concerning suspicious financial transactions, suggest that political volatility will remain relatively high. President Bolsonaro needs strong political capital and this kind of incident hurts his chances of transforming the economy.

Domestically, the economic news has been more upbeat than the industrial numbers. Lower market rates and improving confidence indexes are driving a solid credit market recovery, and helping the labour market turnaround, despite a recent soft patch. Indeed, the headline unemployment rate—a three-month moving average—was unchanged at 11.6% in December, the lowest since July 2016, and down from 11.8% a year ago. *Unemployment is falling consistently, despite the pause at the end of last year, with leading indicators suggesting that the rate of decline will be sustained at the start of this year.*

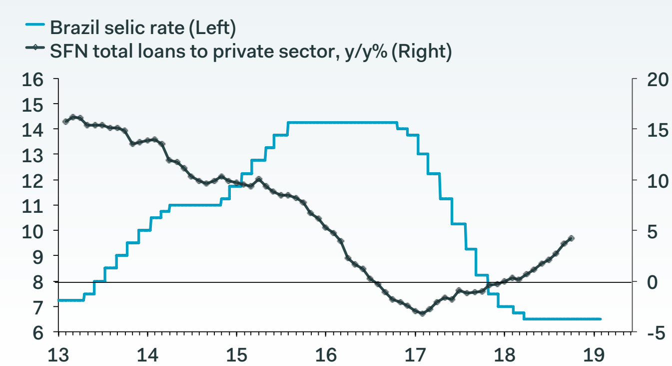
We reckon the unemployment rate will continue falling—we forecast an average jobless rate of 11.2% this year, below the 12.8% average in 2018—pushing up labour income. More immediately, the details of the December report were downbeat, showing that both informal and formal employment in the private sector slowed in Q4. The average real wage, meanwhile, rose 0.6% year-over-year, with the aggregate real wage bill rising a modest 1.7%, constrained by lower employment gains. Again, we believe that this is not the start of a deteriorating trend. *Leading indicators and other labour market surveys are portraying a better picture over the next three-to-six months.*

In the credit market, meanwhile, data released last week showed that origination for earmarked loans rebounded sharply over the second half of last year, reaching the highest level since late 2015. In December, new non-earmarked loans were driven by daily average gains of 6.1% in loans for non-financial corporations and 2.0% in loans for households. The underlying trends are rising rapidly. Moreover, delinquency rates are also falling in all segments, particularly in non-financial corporations. For individuals, delinquency rates are at the lowest level in ten years, and in the corporate sector they have fallen to pre-crisis level. *Overall, the prospects of resilient credit and labour markets will help to offset the relative weakness of the industrial sector in the very near term.*

THE LABOUR MARKET RECOVERY STALLED IN LATE Q4, TEMPORARILY



THE CREDIT MARKET IS GRADUALLY IMPROVING



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THIS WEEK IN BRIEF

Note: "**D**" prefix denotes Datanotes for these releases.

Monday, February 4

- **D: Chile Retail Sales (12)/9:00 Local**
Retail sales likely fell **1.0%** year-over-year in December, down from -0.8% in November. **Consensus: 3.0%.**

Tuesday, February 5

- **D: Chile Economic Activity Index (12)/8:30 Local**
The IMACEC likely increased **2.8%** year-over-year in December, down from 3.1% in November. The trend is stable, but downside forces remain. **Consensus: 3.3%.**
- **Argentina Industrial Production (12)/16:00 Local**
Industrial production likely fell 12% year-over-year, up from -13.3% in November. **Consensus: N/A.**
- **Colombia Consumer Prices (1)/19:00 Local**
The index should increase **0.7%** month-to-month in January, with the year-over-year rate rising to **3.3%**, from 3.2% in December. **Consensus: 3.3%.**

Wednesday, February 6

- **Mexico Consumer Confidence (1)/8:00 Local**
We expect the index to fall slightly to **104,** from 108.6 in December, the cyclical high. **Consensus: 104.1.**
- **Brazil Selic Rate /No specific time**
We expect the BCB to keep interest rates on hold at **6.50%**. The economy is stabilizing, following a soft patch in Q2 and Q3, while underlying inflation pressures are under control. Rates will remain on hold over the next three-to-six months, assuming progress on the pension reform. **Consensus: 6.50%.**

Thursday, February 7

- **Chile Trade Balance (1)/8:30 Local**
We look for an unadjusted **USD0.9B** surplus in January, down from USD1.2B a year ago. **Consensus: USD0.9B.**
- **D: Mexico Consumer Price Index (1)/8:00 Local**
We expect consumer prices to rise **0.2%** month-to-month unadjusted in January. Inflation likely will fall to **4.5%** year-over-year, from 4.8% in December. Core inflation likely will fall to **3.6%**, from 3.7% in December. Inflation is finally falling, easing markets' concerns. **Consensus: 4.5%.**
- **Mexico Overnight Rate /13:00 Local**
We expect Banxico to keep interest rates on hold at **8.25%**, as the MXN has stabilized in recent weeks due to reduced political risk. **Consensus: 8.25%.**
- **Peru Overnight Rate Target /18:00 Local**
The BCRP likely will keep its key interest rate on hold at **2.75%**. We think the Board will adopt hawkish rhetoric in Q2. **Consensus: 2.75%.**

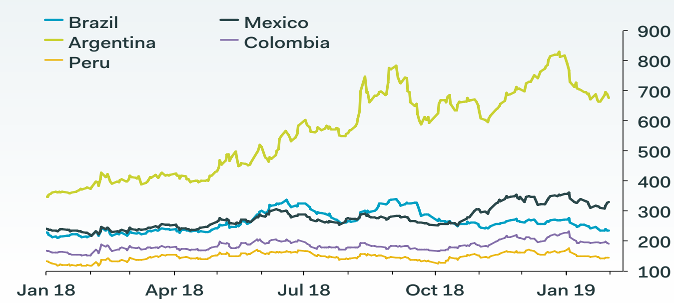
Friday, February 8

- **D: Brazil IBGE Inflation IPCA (1)/9:00 Local**
The index should rise **0.1%** month-to-month in January, driven by food prices. The year-over-year rate likely will be unchanged at **3.8%**. **Consensus: 3.8%**.
- **Chile Consumer Prices (1)/8:00 Local**
We look for the index to increase **0.1%** month-to-month in January. The year-over-year rate likely will fall to **2.2%**, from 2.6% in December. **Consensus: 2.2%.**
- **Mexico Gross Fixed Investment (11)/8:00 Local**
GFI likely *fell* **2.5%** year-over-year in November, down from 3.4% in October. **Consensus: -1.5%.**

PANTHEON'S LATAM FINANCIAL CONDITIONS DASHBOARD

	Currency			Benchmark Stock index		
	Value	Week, %	YTD, %	Value	Week, %	YTD, %
Argentina	37.17	-0.3	1.3	36,600	5.1	20.8
Brazil	3.66	3.1	6.1	97,861	0.2	11.3
Chile	652.1	2.3	6.4	5,453	0.2	6.8
Colombia	3,091	2.0	5.3	11,935	1.4	7.1
Mexico	19.11	-0.6	2.9	43,738	0.2	5.0
Peru	3.33	0.4	1.2	20,294	2.2	4.9
Venezuela	--	--	--	5,286	-11.5	229.3

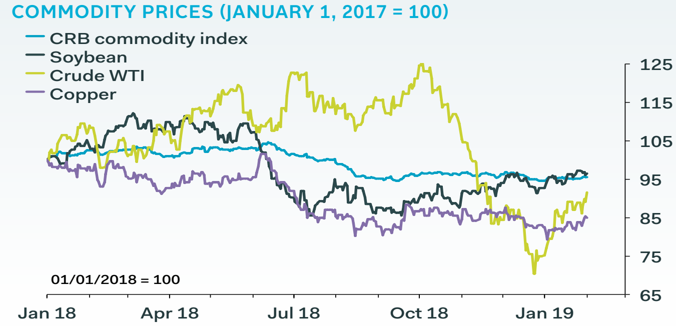
INDEX EMBIG SPREAD LATAM HISTORY



PANTHEON'S ECONOMIC FORECASTS

	Real GDP, y/y%		Inflation, Avg.		Interest rate, Q4	
	2018	2019	2018	2019	2018	2019
Argentina	-2.4	-0.4	33.8	35.0	59.25	30.00
Brazil	1.4	2.4	3.7	3.7	6.50	6.50
Chile	4.0	3.6	2.4	2.8	2.75	3.50
Colombia	2.6	3.1	3.2	3.2	4.25	4.75
Mexico	2.0	2.0	4.9	4.2	8.25	8.00
Peru	3.8	4.1	1.3	2.5	2.75	3.25
Venezuela	-17.0	-20.0	1.3M	20M	--	--

COMMODITY PRICES (JANUARY 1, 2017 = 100)



PANTHEON'S FINANCIAL FORECASTS

	Currency			Benchmark Stock index		
	Q1F	Q2F	Q3F	Q1F	Q2F	Q3F
Argentina	38.5	39.1	39.8	32,100	32,900	33,100
Brazil	3.79	3.67	3.65	88,100	89,200	89,500
Chile	680	676	672	5,120	5,240	5,480
Colombia	3,130	3,080	3,010	1,320	1,480	1,510
Mexico	19.5	19.2	19.0	42,310	43,500	44,300
Peru	3.34	3.28	3.25	20,050	21,200	22,500
Venezuela	--	--	--	--	--	