THE **LATIN AMERICA** ECONOMIC MONITOR

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Colombia's recovery continues, and improving fundamentals point to a good second half.

Opinion polls suggest that centre-right candidate Iván Duque is likely to win the presidency...

...But he likely will have to face a run-off in June with leftist candidate Gustavo Petro; little risk here.

Better Fundamentals and Fading Political Risk to Support Colombia

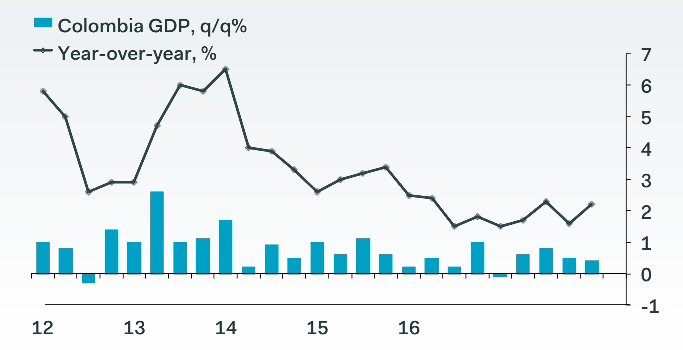
Colombia's Q1 GDP report confirms that the economy is improving. Leading indicators and survey data suggest that the recovery will continue over the second half of the year. Real GDP rose by 0.4% quarter-on-quarter in Q1, following a 0.5% increase in Q4, thanks mainly to the lagged effect of monetary easing since late 2016, falling inflation, and the favourable external environment. The main boost to growth came from a sharp rebound in retail/wholesale activity, professional services, and manufacturing. *Activity in the financial sector also contributed to the headline, offsetting drags from the mining sector, including oil, and the construction sector.*

Activity in the retail sector, for instance, rose 4.3% quarter-on-quarter in Q1, after a 1.4% *fall* in Q4. The sector has been helped by low inflation and the stabilizing labour market, as well as the impact of lower interest rates. *Some of these drivers, coupled with the recent COP rebound, are still supporting the sector, so we expect the recovery of private spending to continue over the second half of the year.* Output in the financial sector, meanwhile, rose a huge 4.1% quarter-on-quarter in Q1, the biggest gain since Q2 2016, and following a healthy 2.1% increase in Q4.

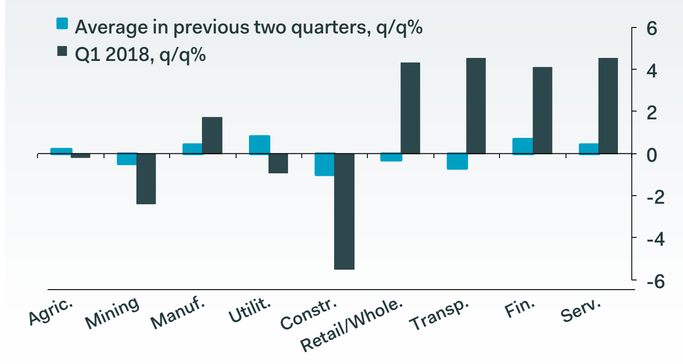
The main offset came from a sharp slowdown in construction output, which plunged 5.5% quarter-on-quarter, the biggest contraction since mid-2012, after a 2.5% fall in Q4. Both residential and infrastructure activity are under stress, but low interest rates, rising confidence, and improving credit conditions will support the sector over the next three-to-six months. Delays in the infrastructure agenda also contributed to the decline in Q1 private investment, but we expect some key projects to resume soon. *We expect BanRep to keep interest rates on hold at just 4¼% throughout the year, contributing to the recovery of this key sector, but a modest easing is possible.*

First quarter GDP rose by 2.2% on a year-over-year basis, accelerating from 1.8% in Q4. The demand-side breakdown, due in coming weeks, likely will confirm that accelerating consumers' spending was the main driver, offsetting weakness elsewhere. We expect the economy to recover gradually over the second half of the year, assuming steady interest rates, an acceleration in the execution of key

THE RECOVERY IS FINALLY HERE



THE SERVICES SECTOR IS LEADING THE REBOUND



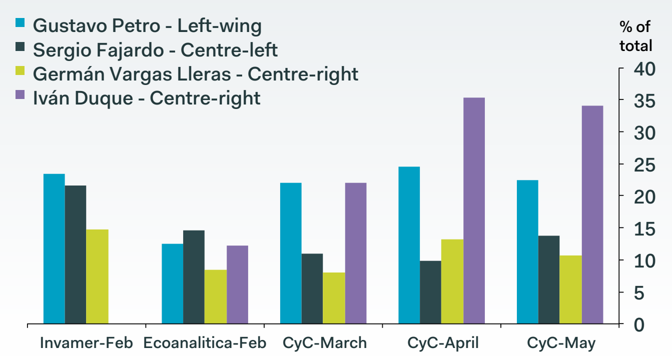
infrastructure works, and firm oil prices. Higher oil sector investment, and the boost from oil royalties will help the rebound in Q2 and Q3.

We still expect the economy to grow by 2.5% this year, speeding up from 1.8% in 2017, and the risks are to the upside. The outlook for the oil industry is improving on the back of rising prices, driven by geopolitical factors including sanctions in Iran and the chaos in the Venezuelan oil industry. ***Most importantly, political risks have eased significantly in recent months after centre and centre-right parties became the largest group in Congress in the legislative elections in March.***

Low political risk will help to boost investment over the second half of the year, once the new administration takes office. The latest polling data, ahead of the first-round presidential election on Sunday May 27, suggest conservative senator Iván Duque—the protégé of former President Álvaro Uribe—and the leftist Gustavo Petro, Bogotá's former mayor, are leading the race. Support for the independent and centrist Sergio Fajardo, the former mayor of Medellín, has increased slightly in recent weeks, but he is unlikely to make it to the second round. President Santos' former vice president, the centre-right Germán Vargas, is still running in fourth place, and centrist Humberto de la Calle, Mr. Santos' former chief negotiator for the peace deal with FARC, is barely tracking in the polls.

Without alliances, it has proved to be very difficult for the centrists to overtake Mr. Duque and Mr. Petro in the polls. These two candidates, who represent the extremes in Colombia's political spectrum, are well ahead of the others, and we expect them to win the first round comfortably. *It is entirely possible that Mr. Duque will win outright in the first round, avoiding a run-off on June 17, but this is not our base case.* We expect Mr. Duque to face, and defeat, leftist Gustavo Petro in the run-off vote. *Mr. Duque likely will receive support from centrist candidates, and voters will vote tactically, choosing the least-bad alternative.*

POLLS STILL POINT TO MR. DUQUE WINNING THE PRESIDENTIAL RACE



Mr. Duque has benefited from the sharp deterioration in approval ratings for the incumbent president, Juan Santos, due mainly to poor economic performance in recent years, and his apparently too-generous peace deal with the FARC guerrillas in 2016. This explains the low support for his vice-president Vargas in the polls. Mr. Santos' former president and opposition rival, Mr. Uribe, who has a loyal and large support base, and effective political machinery, has also helped Mr. Duque's cause. *Admittedly, Mr. Duque is a capable politician, with good credentials, strong economic training and solid financial experience in international institutions.* Most importantly, he is accompanied on the presidential ticket by Marta Ramírez, an experienced politician.

If we are right, and Mr. Duque wins, markets will be hopeful of more investor-friendly policies. The risk of Mr. Petro's brand of economic populism succeeding seems relatively remote. *Even in the unlikely event that he wins the presidency, Mr. Petro would have to govern with a Congress that has shifted to the right since March.* Mr. Duque's proposals, meanwhile, are moderate and will help to consolidate Colombia's economic recovery. And he will inherit an economy that is officially rebounding, which will make things easier, at least in the first instance.

The honeymoon likely will not last long. Mr. Duque will have to deal with the humanitarian crisis triggered by Venezuela, with thousands of refugees fleeing across the border to Colombia to escape poverty and chaos. In addition, the new president will have to face medium-term fiscal challenges, and try to diversify an economy that it is highly dependent on oil resources. ***The good news is that Mr. Duque, and the other candidates, excluding Mr. Petro, have pledged to keep the current policy framework broadly in place, and are committed to improving the fiscal accounts.***

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THIS WEEK IN BRIEF

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

Monday, May 14

- **No significant data released.**

Tuesday, May 15

- **Colombia GDP (Q1)/11:00 Local**

GDP rose **0.4%** quarter-on-quarter, following an upwardly revised 0.5% increase in Q4. The economy expanded by **2.2%** year-over-year, up from 1.6% in Q4. Growth has been supported by higher private consumption, thanks to falling inflation and low interest rates. Rising oil prices since June have also helped. The rebound will be more evident in Q2.

- **Argentina Consumer Prices (4)/16:00 Local**

The index should rise **2.5%** month-to-month in April, due to regulated price increases. The year-over-year rate should fall trivially to 25.2% from 25.4% in March. Inflation pressure will remain high this year. **Consensus: N/A.**

Wednesday, February 16

- **Brazil Economic Activity Index (3)/8:30 Local**

The index likely will increase **0.3%** year-over-year, down from 0.7% in February. The underlying trend is falling, but we expect a good Q2, consistent with the strength of leading indicators. Low inflation, improving financial conditions and a positive external backdrop will also help. We still expect the economy to grow by 3.0% in 2018 and 3.5% in 2019. **Consensus: 0.3%.**

- **Brazil Selic Rate /No specific time**

We expect the BCB to cut by **25bp** to **6.25%**. The economic recovery lost momentum in Q1, while inflation is rising only marginally, and will remain benign. We believe that this action will mark the end of the easing cycle. **Consensus: 6.25%.**

Thursday, May 17

- **Mexico Overnight Rate /13:00 Local**

Banxico will keep rates on hold at **7.50%**, as inflation is finally falling and inflation expectations are coming under control. Moreover, the MXN has been under pressure in recent weeks due to rising geopolitical risks. Banxico likely will remain on hold for the rest of the year, as long as MXN volatility remains contained, as we expect. A NAFTA deal would help. **Consensus: 7.50%.**

Friday, May 18

- **D: Chile GDP (Q1)/8:30 Local**

We expect real GDP to rise **0.9%** quarter-on-quarter in Q1, pushing the year-over-year rate up to **4.1%**, from 3.3% in Q4. We expect further good news this year, in line with increasingly upbeat survey data. **Consensus: 4.0%.**

Expected During the Week

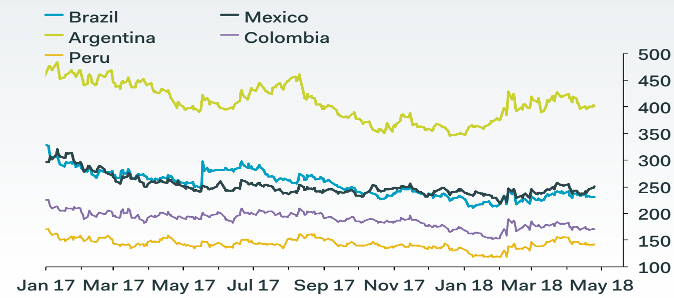
- **Peru GDP (Q1)/No specific time**

We expect real GDP to rise **3.0%** year-over-year in Q1, from 2.2% in Q4. The economy continues to grow below its potential rate, but business expectations are improving, and investment and consumption are finally on the mend. **Consensus: N/A**

PANTHEON'S LATAM FINANCIAL CONDITIONS DASHBOARD

	Currency			Benchmark Stock index		
	Value	Week, %	YTD, %	Value	Week, %	YTD, %
Argentina	23.21	-5.8	-19.7	29,852	4.5	-0.7
Brazil	3.60	-2.0	-8.0	85,220	2.5	11.5
Chile	619.8	0.3	-0.7	5,703	1.4	2.5
Colombia	2,836	-0.5	5.3	12,362	0.5	7.7
Mexico	19.42	-0.8	1.2	46,729	-0.6	-5.3
Peru	3.26	0.4	-0.6	21,249	0.5	6.4
Venezuela	69M	-1.4	-100.0	19,927	-1.2	1,477.6

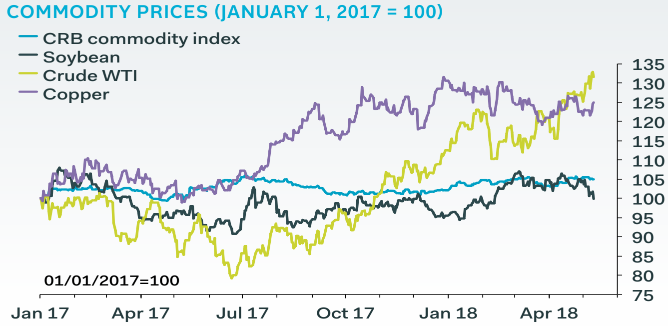
INDEX EMBIG SPREAD LATAM HISTORY



PANTHEON'S ECONOMIC FORECASTS

	Real GDP, y/y%		Inflation, Avg.		Interest rate, Q4	
	2017	2018	2017	2018	2017	2018
Argentina	2.9	2.3	24.8	23.5	28.75	30.00
Brazil	1.1	3.0	3.2	3.3	7.00	6.25
Chile	1.5	3.8	2.2	2.6	2.50	2.75
Colombia	1.8	2.5	4.3	3.0	4.75	4.25
Mexico	2.0	2.4	6.0	4.2	7.25	7.50
Peru	2.5	3.7	2.8	2.0	3.25	2.75
Venezuela	-10.5	-8.0	1500	5000	--	--

COMMODITY PRICES (JANUARY 1, 2017 = 100)



PANTHEON'S FINANCIAL FORECASTS

	Currency			Benchmark Stock index		
	Q2F	Q3F	Q4F	Q2F	Q3F	Q4F
Argentina	24.0	24.5	25.1	32,000	32,800	32,200
Brazil	3.60	3.65	3.50	85,600	88,100	90,100
Chile	610	605	603	5,850	6,100	6,350
Colombia	2,800	2,783	2,670	1,670	1,750	1,890
Mexico	19.8	19.1	18.9	47,900	49,800	51,300
Peru	3.23	3.24	3.22	21,300	21,600	21,900
Venezuela	12.0	12.0	12.0	--	--	--