THE **LATIN AMERICAN ECONOMIES** IN H2 2017

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Monetary Policy Easing Continues, Offsetting Political Risk

* **Economic growth in Latin America has been under pressure so far this year, but we expect a gradual recovery in the second half and into 2018.** Falling inflation, easier monetary policy, and decent growth in the U.S. and China will be the key drivers. But increasing political uncertainty, and the looming end of favourable base effects in the inflation rates in some economies will limit policymakers' scope for action.

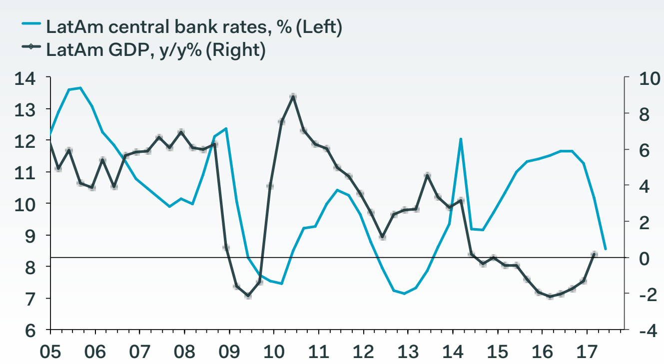
* **We look for regional GDP growth of 1.2% in 2017 as a whole, much better than the 1.3% *drop* in 2016, thanks mainly to better performances in Brazil and Argentina, and the resilience of the Mexican economy, despite external and domestic threats.** We expect LatAm to grow about 2.4% in 2018 as domestic fundamentals strengthen, lifting capex, and political risks ease. We also assume a *modest* further increase in commodity prices and favourable U.S. trade policies.

* Brazil is now growing, albeit slowly, thanks to falling inflation and interest rate cuts, which have boosted confidence. But the political crisis is delaying the reform agenda and could, in the worst-case scenario, derail the recovery. Mexico, however, remains resilient, with improving exports offsetting the confidence hit following the U.S. presidential election. Andean economies had a weak first half, but falling inflation and low interest rates will help drive a modest recovery. Argentina's economy is set to improve further over the second half, and interest rate cuts are looming. Venezuela, meanwhile, will remain a disaster area.

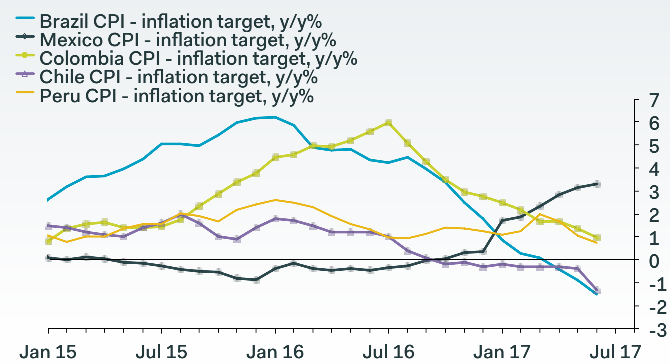
* **Brazil's** mediocre recovery will continue. We expect the economy to grow by 0.5% this year, but next year will be better. The primary sectors will continue to lead the recovery, while domestic demand remains under stress. Monetary easing, falling inflation and improving external trade are all supporting growth, but downside risks remain. Political uncertainty has the potential to delay badly-needed fiscal reforms and hit confidence once again. Inflation will remain benign, hovering around 3.5% year-over-year for the remainder of this year. **We expect the BCB to cut rates by a total of 225bp during the second half, to 8.0%.** Weak growth, and good inflation prospects underpin our view, despite the political mess.

* In **Mexico,** solid growth in the manufacturing and services sectors is offsetting temporary weakness in capex and consumption. We expect the economy to grow by 2.4% this year. Next year, the lagged effects on growth of the drop in confidence after the U.S. election, and tight monetary policy, will fade. Inflation will edge lower in Q4, and fall rapidly in Q1 as the effects of temporary shocks disappear and a favourable base effect kicks in. **Banxico's tightening cycle is over, and it likely will start to ease in the first half of next year, before the presidential election in July.** The strength of the MXN will facilitate Banxico's decoupling from the Fed.

FALLING INTEREST RATES WILL BOOST GROWTH IN 2018



INFLATION IS UNDER CONTROL; MEXICO'S RATE WILL FALL SOON



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* **Argentina's** recovery continues, but the legacy of the Kirchner era has taken time to clear. Economic activity will be supported in the second half by improving exports and consumption, and increasing public spending ahead of the mid-term elections, but growth likely will slow a bit. Activity will then regain momentum in 2018, thanks to the lagged effect of falling inflation and lower interest rates. **We expect the first rate cut at the end of Q3 on the back of a clear downtrend in core inflation.** The performance of the ARS political developments in Brazil will determine the pace of easing, but we expect rates to end the year close to 22%. News on the fiscal front will be positive in H2, boosting both consumer and investor confidence.

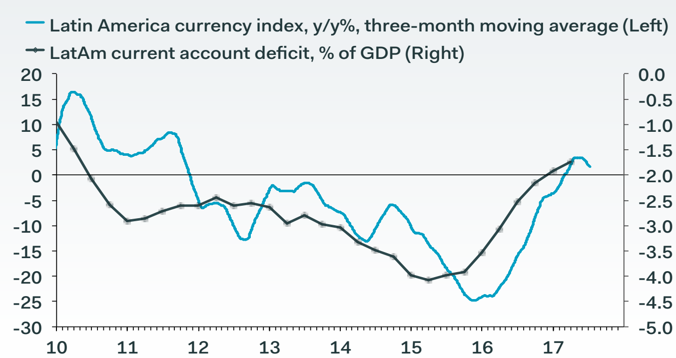
* **Colombia** started the year slowly, but we expect the economy to improve over the second half thanks to falling inflation, easier monetary policy and the modest rebound in oil prices over the past year. The hit from the VAT increase in Q1 on consumption will disappear soon. The execution of part of the 4G infrastructure program and a speeding-up of regional development plans also will help. Inflation fell rapidly in the first half, but it will stabilize during the second as favourable base effects disappear. **BanRep likely will ease by 50bp to 5.25% this month, and leave rates at this level for the remainder of the year.** The budget deficit should fall to 3.6% of GDP from 4.0% last year, in line with the Government's new target.

* November's presidential election will be the key driver in **Chile** over the second half. **We expect confidence and investment to improve if former centre-right President Piñera, wins the race, as we expect.** The economy likely will pick up on the back of rising copper prices, and the effect of interest rate cuts during the first half. Private investment should stabilize after significant declines in the past few years. GDP growth for the year will be only about 1.2%, after the poor start to the year, but next year will be better. The BCCh will keep interest rates at just 2.5% over the second half, given weak GDP growth and below-target inflation. Rates likely will be increased in the second half of next year.

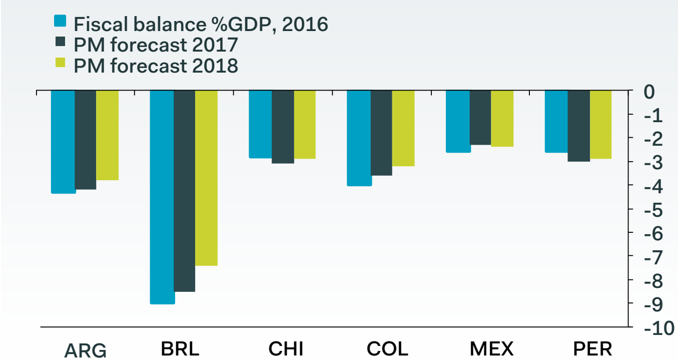
* **Peru's** economy suffered from temporary shocks at the start of the year, notably very heavy rains and the scandal involving Brazilian construction company, Odebrecht. We now expect the economy to improve, thanks mainly to rising mining output, faster execution of infrastructure projects and improving business and consumer confidence. Inflation is falling rapidly, but will remain relatively high, above the 2% target, for some time yet. **We expect interest rates to fall by 25bp in July, to 3.75% and then to remain on hold in H2.** Political volatility will remain relatively high this year following the exit of Minister of Finance Alfredo Thorne.

* Finally, **Venezuela's** economy is still in disarray and will continue to be a mess as long as President Maduro remains in power. **The economy will contract in 2017 for a fourth consecutive year.** International reserves are still plunging and the country is flirting with hyperinflation. The modest rise oil prices over the past year will help the economy over the second half of the year, but only marginally, as production cannot rise much. 2018 will be the key year for Venezuela due to presidential elections, while the state oil company and the Government will face tough debt payment calendars. Amortizations due in October and November are very challenging; the risk of default is high.

EXTERNAL ACCOUNTS HAVE IMPROVED BUT WILL STABILIZE SOON



FISCAL METRICS ARE IMPROVING, BUT WEAK GROWTH IS A RISK



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GDP (year-over-year, %)	2014	2015	2016	2017	2018
Argentina	-2.5	2.6	-2.3	2.5	2.8
Brazil	0.5	-3.8	-3.6	0.5	2.4
Chile	1.9	2.3	1.6	1.2	2.4
Colombia	4.4	3.1	2.0	1.7	2.5
Mexico	2.2	2.5	2.3	2.4	2.5
Peru	2.4	3.3	3.9	2.7	3.8
Venezuela	-3.9	-5.7	-10.0	-3.5	-2.5
Latin America	*0.8*	*-0.6*	*-1.3*	*1.2*	*2.4*
Inflation, CPI (year-over-year, %, average)					
Argentina	37.2	28.3	41.0	24.0	15.0
Brazil	6.4	9.0	8.8	3.7	4.2
Chile	4.4	4.3	3.8	2.7	2.5
Colombia	2.9	5.0	7.5	4.3	3.5
Mexico	4.0	2.7	2.8	5.8	4.2
Peru	3.3	3.5	3.5	3.0	2.4
Venezuela	61.8	120	340	500	400
Latin America ex-Venezuela and Argentina	*4.1*	*5.4*	*5.6*	*3.0*	*3.0*
Central Bank Rate (end of year)					
Argentina	29.50	--	--	22.00	15.00
Brazil	11.75	14.25	13.25	8.25	8.25
Chile	3.00	3.50	3.50	2.50	3.00
Colombia	4.50	5.75	7.75	5.25	4.50
Mexico	3.00	3.25	5.00	7.00	6.00
Peru	3.50	3.75	4.25	3.75	4.00
Venezuela	18.73	--	--	--	--
Current Account Balance (% GDP)					
Argentina	-1.5	-3	-2.8	-3.5	-3.3
Brazil	-4.3	-3.2	-1.3	-1.0	-1.5
Chile	-1.8	-2.1	-1.4	-1.5	-1.4
Colombia	-5.3	-6.6	-4.2	-3.6	-3.4
Mexico	-1.8	-2.5	-2.1	-2.0	-1.8
Peru	-4.4	-4.8	-2.7	-1.6	-1.5
Venezuela	1.7	-7.8	-2.4	-1.0	-0.5
Currency/USD (end of year)					
Argentina	8.5	12.9	15.89	18.2	20.2
Brazil	2.7	3.96	3.26	3.30	3.50
Chile	606.5	708.6	670.4	660	670
Colombia	2,377	3,175	3,002	2,980	3,020
Mexico	14.8	17.2	20.7	18	19
Peru	2.98	3.41	3.36	3.25	3.30
Venezuela	6.29	6.29	10	10	10