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THE LATIN AMERICA ECONOMIC MONITOR

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The two biggest economies in South America will have a tough H2; but 2017 will be much better.

Chile's inflation marginally above expectations, but the sluggish recovery will drag it down soon.

The minutes from BanRep's last meeting revealed a split Board; a final rate hike, in July, is on the cards.

Brazil and Argentina are Both Hurting, but Healing has Begun

Brazil and **Argentina**, South America's biggest economies are going through a metamorphosis. Brazil is emerging from its recession and a modest recovery is on the horizon. Exports have rebounded, thanks to the lagged effect of the BRL's sharp sell-off last year, and confidence has improved significantly in recent months. The likelihood that interim President Michel Temer will stay on as head of Brazil's government has also helped to boost sentiment. Dilma Rousseff's impeachment trial is expected to end in late August, but we doubt that she will return as President. *Her reappearance is the biggest single risk to Brazilian markets—she is incapable of the necessary reforms—but she has little support in Congress, and her party's standing has been battered by new corruption claims.*

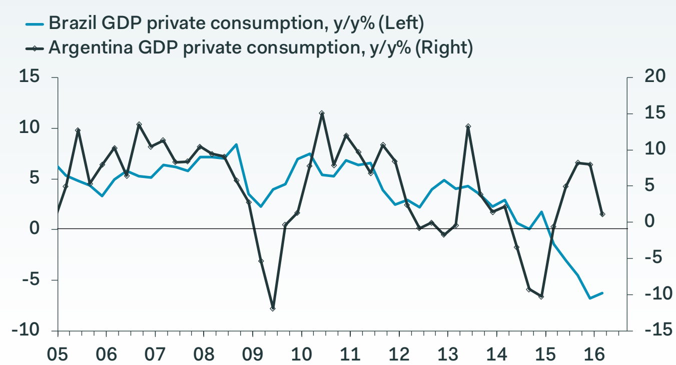
Interim President Temer's administration, meanwhile, is generally considered willing and able to make meaningful fiscal adjustment and reforms. ***If Mr. Temer continues to deliver on the fiscal front, we expect investors' perceptions of Brazil's balance of risks to improve steadily throughout the rest of this year and into 2017.***

The economic cycle has favoured Mr. Temer's administration. The severity of the recession during late 2015 and the early part of this year, along with favourable base effects and the fading impact of El Niño, is helping to reduce inflation pressures. Inflation expectations for next year have declined considerably, and we think that the positive resolution of Brazil's political drama points to further improvement ahead. *Against this backdrop, we think the BCB should be in position to start easing cycle in the fourth quarter.* Lower rates would in time lift consumer spending, which is currently holding back Brazil's economy.

Argentina, meanwhile, is in the middle of a policy-induced recession, following the imposition of tighter monetary and fiscal policy earlier this year. But we expect President Macri's reforms to lead to faster growth next year. Argentina's government has outperformed expectations since Mr. Macri took office, and its approval ratings have followed suit. The president's own approval ratings have slipped recently, but this was expected. *Since taking office six months ago, he has undertaken many unpopular reforms in his bid to restore economic orthodoxy and bring Argentina back to international capital markets.*

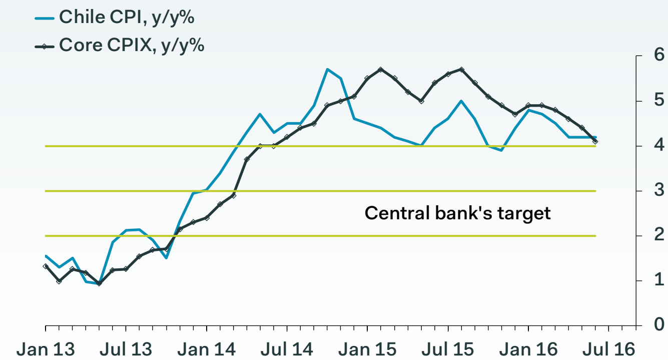
To offset the negative impact of reforms on the Argentines, Mr. Macri has maintained some important social programs and softened his approach to fiscal consolidation. But he has been able to tackle long-standing economic problems with few political repercussions. He has overhauled Argentina's

ARGENTINA IS LAGGING THE CYCLE, PAIN THIS YEAR, BETTER 2017



CONFIDENCE WILL REMAIN UNDER PRESSURE, FOR NOW

STUBBORNLY HIGH, BUT IT WILL FALL DURING THE SECOND HALF



statistical office, improved the country's foreign policy and is gradually restoring its status as a global player, following many years of being the region's financial pariah, along with Venezuela.

Next year, we expect Argentina's economy to fare better than this year. Higher commodity prices, the gradual recovery of Brazil's economy—Argentina's biggest trading partner—and the lagged effect of the ARS's fall will encourage a revival in growth. Inflation likely will stabilize next year, following the correction of relative price distortions this year and the drop in private spending. *We think that the BCRA will then implement a regime of inflation targeting to help to manage expectations.*

The Andes still struggling with high inflation

Chile's CPI rose 0.4% month-to-month in June, marginally above market expectations, but below the 0.5% print in June 2015. *Rounding meant the annual headline inflation rate was unchanged at 4.2%, remaining above the 4-to-2% target range set by the BCCh. We still think it will gradually slow this year.* The core index—ex-food and energy—rose 0.3% month-to-month in June, pushing the annual rate down to 4.2%, from 4.3% in May.

The June monthly headline reading reflected higher food prices, which were partly offset by modest declines in other key components, including clothes prices. Housing inflation, including utilities, fell to 5.9%, from 6.4% in May, while household items fell to 5.4% from 5.9% in May. Tradable goods inflation was unchanged at 3.9%, and the underlying trend is stable, highlighting that the pass-through from last year's CLP depreciation remains modest.

Chilean inflation will continue to edge lower, closing the year around 3.8%. The driver will be lower core inflation, pushed down by the sluggish pace of the country's economic recovery. But inflation will remain close to the top of the BCCh's target range, due mainly to the lagged effect of the CLP's depreciation and the modest rise in global oil prices. *Under these circumstances, the BCCh likely will leave rates on hold during the second half.*

Finally in **Colombia**, the minutes of BanRep's June monetary policy meeting suggest that the tightening cycle is nearing its end. The Board was split between the majority, which favoured a 25bp increase, and a minority arguing for no change. Note that in the previous meeting, policymakers were split over the magnitude of the rate increase, with the minority supporting more aggressive action. Some members are still worried about stubbornly high inflation, even though it will soon peak and then start to decline. *June's upside inflation surprise, though—the report was released after the meeting—likely will trigger a further increase in inflation expectations, putting pressure on policymakers to hike one last time. We We expect a 25bp hike this month, with rates then remaining at 7.75% for the rest of the year.*

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THIS WEEK IN BRIEF

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

Monday, July 11

- **No significant data released.**

Tuesday, July 12

- **D: Brazil Retail Sales (5)/9:00 Local**

We expect retail sales to increase rose **0.4%** month-to-month, pushing the year-over-year rate up to **-6.2%** from -6.7% in April. The private consumption outlook remains very poor despite the increase in recent months. **Consensus: -6.1%.**

- **D: Mexico Industrial Production (5)/8:00 Local**

We expect industrial production to increase **0.8%** year-over-year in May, down from 1.9% in April. Manufacturing production should rise **1.5%** year-over-year, down from 3.0% in April. **Consensus: 1.5%.**

Wednesday, July 13

- **Brazil Economic Activity Index (5)/No specific time**

We expect the economic activity index to fall **3.5%** year-over-year in May, up from a 5.0% contraction in April. The improving external sector is not enough to offset continued domestic weakness, but the economy has finally bottomed. **Consensus: -3.9%.**

Thursday, July 14

- **Banxico Monetary Policy Minutes /9:00 Local**

After increasing rates by 50bp at **4.25%** in the June 30th meeting, the monetary policy minutes should suggest that rates will be on hold for some time, providing that the MXN remains relatively stable over the coming months. Rate hikes are unlikely as long as the Fed stays on hold.

- **Chile Overnight Rate Target /17:00 Local**

The BCCh will remain on hold at **3.5%** due to the sluggish recovery of the real economy in recent quarters. Inflation has edged lower in recent months, but remains above the BCCh's target range. **Consensus: 3.5%.**

- **Peru Overnight Rate Target /18:00 Local**

The BCRP likely will keep its main interest rate at **4.25%**, as inflation fell further in June. We expect rates to remain on hold over the coming months, to help the economic recovery. **Consensus: 4.25%.**

Friday, July 15

- **Colombia Industrial Production (5)/16:00 Local**

Industrial production should increase **4.2%** year-over-year, down from a solid 8.4% expansion in April, led by refining and the food industry. **Consensus: 7.0%.**

- **Colombia Retail Sales (5)/16:00 Local**

We look for a **2.0%** year-over-year contraction, down from the unsustainable 5.4% jump in April. The underlying trend has deteriorated recently, due to the lagged effect of the COP's sell-off, high interest rates, and low confidence. Consumers will remain under pressures this year, despite these recent strong-looking data. **Consensus: 4.5%.**

- **Peru Economic Activity Index (5)/No specific time**

The economic activity index should increase **4.0%** year-over-year, up from 2.5% in April. **Consensus: 4.5%.**

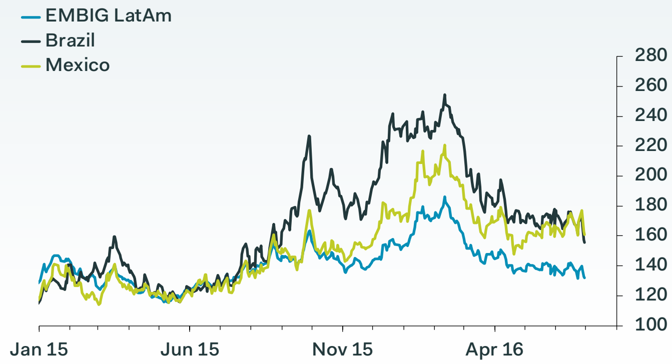
- **Peru Unemployment Rate (6)/No specific time**

The unemployment rate should edge lower to **7.0%** unadjusted in June from 7.1% in May. **Consensus: N/A.**

PANTHEON'S LATAM FINANCIAL CONDITIONS DASHBOARD

	Currency			Benchmark Stock index		
	Value	Week, %	YTD, %	Value	Week, %	YTD, %
Argentina	14.71	2.3	-12.1	14,690	0.0	25.8
Brazil	3.30	-1.8	20.1	52,867	1.2	22.0
Chile	662.1	-0.1	7.0	4,010	-0.5	9.0
Colombia	2,966	-1.1	7.0	9,686	-0.8	13.3
Mexico	18.62	-1.4	-7.6	45,508	-1.5	5.9
Peru	3.28	0.3	4.2	20,724	-0.1	60.6
Venezuela	9,988	0.0	-37.0	11,708	-8.8	-19.7

INDEX EMBIG SPREAD LATAM HISTORY (JANUARY 1, 2015 = 100)



PANTHEON'S ECONOMIC FORECAST

	Real GDP, y/y%		Inflation, Avg.		Interest rate, Q4	
	2015	2016	2015	2016	2015	2016
Argentina	2.0	-0.5	15.7	30.0	--	--
Brazil	-3.8	-3.2	9.0	8.6	14.25	13.75
Chile	2.1	1.6	4.3	3.6	3.50	3.50
Colombia	3.1	2.2	5.0	7.5	5.75	7.50
Mexico	2.5	2.1	2.7	3.0	3.25	4.50
Peru	3.2	3.5	3.5	3.5	3.75	4.50
Venezuela	-8.5	-8.0	120.0	220.0	--	--

COMMODITY PRICES (JANUARY 1, 2015 = 100)