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Latin America Economics Analyst

Brazil/Chile: The Effects of Sentiment on Economic Activity

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Improving Sentiment Since 2016

Confidence indicators have been firming in both Brazil and Chile. Policy uncertainty has also declined: in Brazil, this has been driven by macroeconomic rebalancing and the expectation that the Temer administration will continue to push forward with key structural reforms (e.g., Social Security); in Chile, by signs of a cyclical economic turnaround and the expectation of a market friendly presidential election outcome.

Sentiment as a Driver of Activity

Our analysis suggests that firming business confidence has a significant positive impact on GDP, industrial production, and investment, while a rise in policy uncertainty has a significant contractionary effect. The investment response is larger than that for GDP and industrial production, which is in line with the theoretical assumption that investment is one of the main channels through which business confidence and policy uncertainty affect activity.

Rising Confidence and Declining Uncertainty to Support Cyclical Recovery

The results support our view that alongside low inflation, stimulative financial conditions, and a favorable external backdrop, improving sentiment will likely be a key contributor to the expected cyclical recovery in both countries. This is particularly important considering that fiscal policy will not be able to leverage the recovery given the need for further fiscal consolidation, particularly in Brazil.

Brazil/Chile: The Effects of Sentiment on Economic Activity

Introduction

Sentiment indicators in both Brazil and Chile have been recovering in recent quarters from cyclically depressed levels. Not only have confidence indicators been firming but, as importantly, policy uncertainty has declined. This is largely a result of an improving political outlook, particularly in Chile, and an incipient economic recovery in both countries, aided by a low inflation environment, accommodative financial conditions, and a favorable external scenario.

As theory suggests, sentiment can itself be a source of business cycle fluctuations. As mostly a forward-looking variable, a shift in confidence signals a change in beliefs about the economic outlook that drives current and future consumption and investment decisions and, hence, growth. On the other hand, policy uncertainty may have a contractionary effect on activity primarily through the investment channel: as uncertainty increases, risk and default premia also rise, and higher financing costs lead to reduced or delayed investment spending and an increase in precautionary savings (reduced consumption, particularly of durable goods).

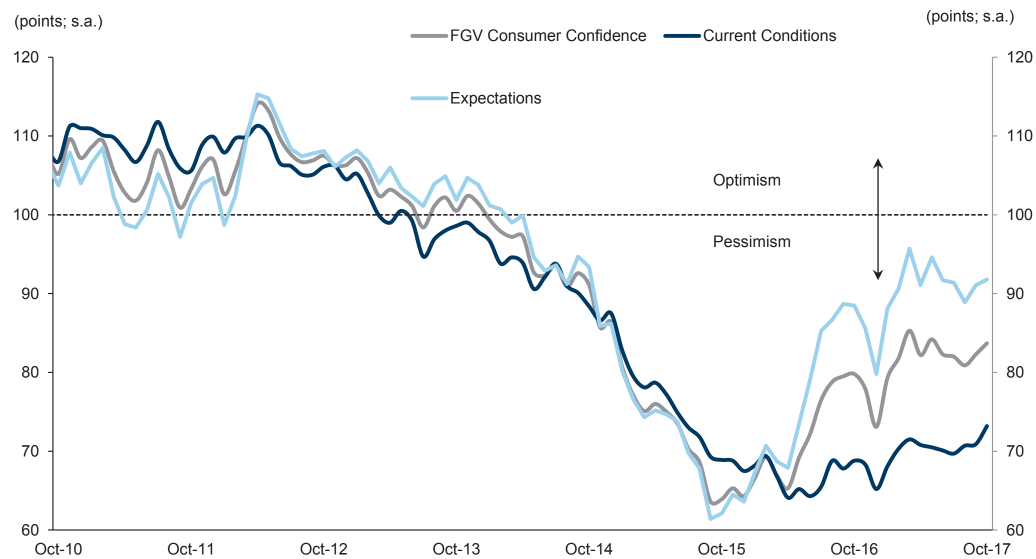
We estimate the effects of changes in sentiment on economic activity in Brazil and Chile, and find significant positive effects from business confidence and negative effects from policy uncertainty. For example, a one standard deviation increase in business confidence results in a positive impact on GDP that peaks at around 0.8% in Brazil and 0.6% in Chile after 4-5 quarters. A similar increase in policy uncertainty drives GDP down, with the contraction peaking at around -0.7% in Brazil and -0.4% in Chile after 2-4 quarters. The industrial production response is larger, and the investment spending response is the largest. These results thus support our view that improving sentiment will likely be a key pillar to support the expected cyclical recovery in both economies.

Improving Sentiment since 2016

Brazil and Chile have witnessed a noticeable improvement in sentiment since 2016: confidence indicators have been on a recovering trend and economic policy uncertainty indices have declined.

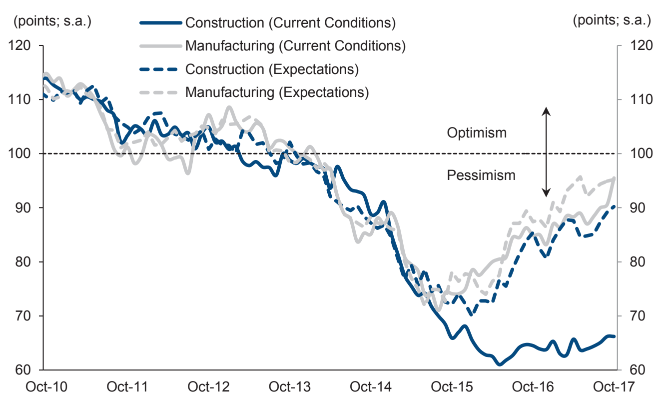
In Brazil, the improvement in confidence has been the result of a slow transition towards a better macro equilibrium with an incipient recovery in activity (led by private consumption, exports, and inventory rebuilding), lower inflation and anchored inflation expectations, monetary policy easing, and current account adjustment. As seen in Exhibits 1, 2, and 3, consumer confidence has experienced a visible, albeit bumpy, improvement since 1Q16, and all sector-level business confidence indicators have recovered from historically low levels at the end of 2015. For all indicators, the forward-looking expectations sub-indices are tracking above those that measure current conditions, hinting that domestic agents are expecting better days ahead.

Exhibit 1: Brazil: Consumer Confidence Recovering from Record Lows



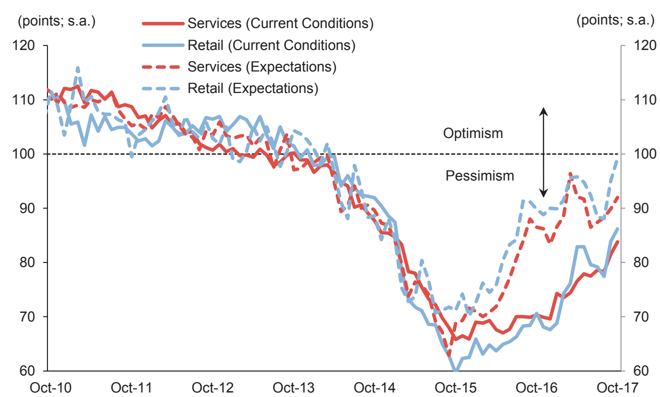
Source: Fundação Getulio Vargas

Exhibit 2: Brazil: Construction and Manufacturing Confidence Indicators



Source: Fundação Getulio Vargas

Exhibit 3: Brazil: Retail and Services Confidence Indicators

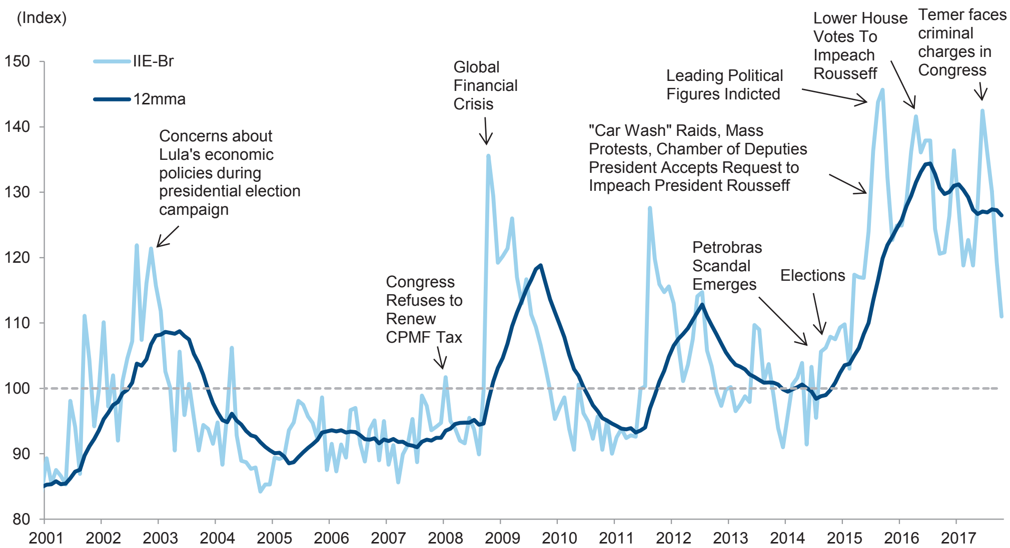


Source: Fundação Getulio Vargas

Although the weak fiscal stance is still the main caveat to the improving macro picture, the expectations that President Michel Temer will serve the remainder of his mandate and that a capable, reform-oriented economic team will continue to set the policy and reform agenda have contributed to the decline in policy uncertainty and the firming in confidence. This is evident in Exhibit 4, which shows the evolution of the IIE-Br Economic Uncertainty Index.[1] Although policy uncertainty is still high, it has been on a declining trend since former President Dilma Rousseff's impeachment in May 2016.

[1] The IIE-Br Index is obtained from FGV-IBRE, and includes three components: IIE-Br Media, based on the frequency of news related to economic uncertainty; IIE-Br Expectations, based on the dispersion of analysts' FX and inflation forecasts; and IIE-Br Market, based on Ibovespa volatility. The overall index is a weighted average of the three components: IIE-Br = 0.7*IIE-Br Media + 0.2*IIE-Br Expectations + 0.1*IIE-Br Market.

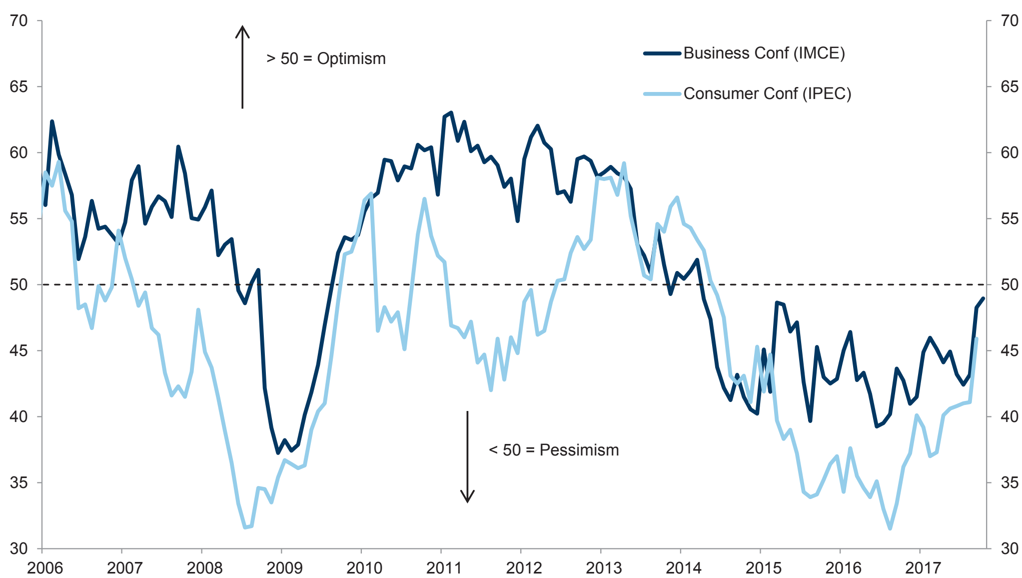
Exhibit 4: Brazil: IIE-Br Economic Uncertainty Index



Source: Fundação Getulio Vargas

In the Chilean case, the recovery in business and consumer confidence since mid-2016 (Exhibit 5) reflects early signals of firmer growth following the anemic performance of recent years, aided by easier monetary policy and a favorable external backdrop supported by higher commodity prices (especially copper) and solid growth in both developed and emerging economies. As we argued in an earlier report, the Chilean economy may have reached a turning point in 2017 with strengthening domestic demand and a gradual improvement in labor market conditions.

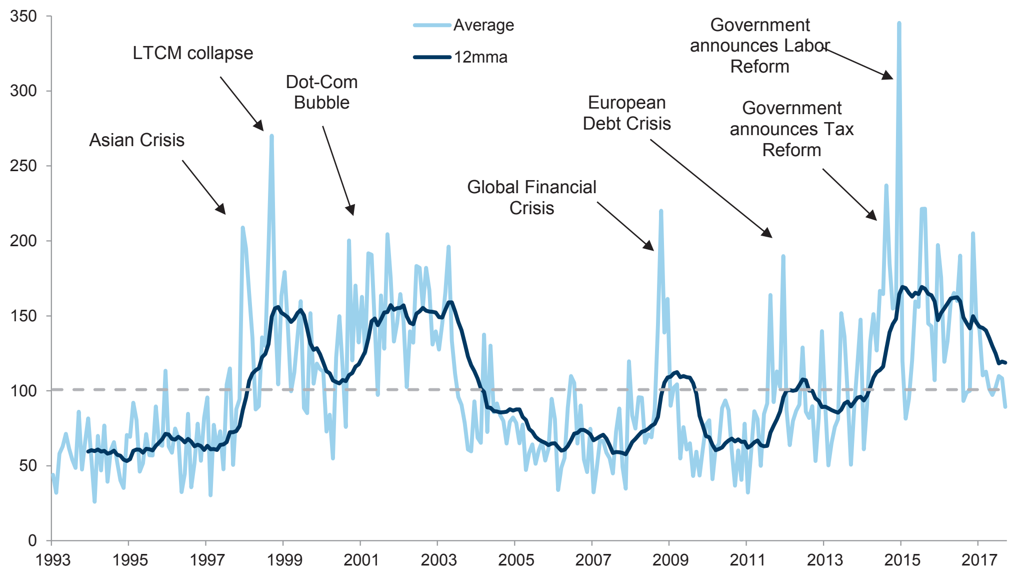
Exhibit 5: Chile: Business and Consumer Confidence



Source: GFK Adimark

While there is still considerable political uncertainty in Chile owing to the upcoming presidential elections in November 2017, the Economic Policy Uncertainty (EPU) Index[2] has gradually declined throughout 2017 (Exhibit 6). This is likely linked to the fact that former president Sebastian Piñera – considered the most market-friendly candidate among presidential hopefuls – has consolidated his lead in the polls over Senator Alejandro Guillier and Beatriz Sanchez (Exhibits 7 and 8). A Piñera victory could generate a positive market response, as he has campaigned on a pro-business platform, promising to roll back or mitigate some of President Michelle Bachelet's controversial labor and tax reforms that some have credited with driving down confidence and weighing on investment and growth.

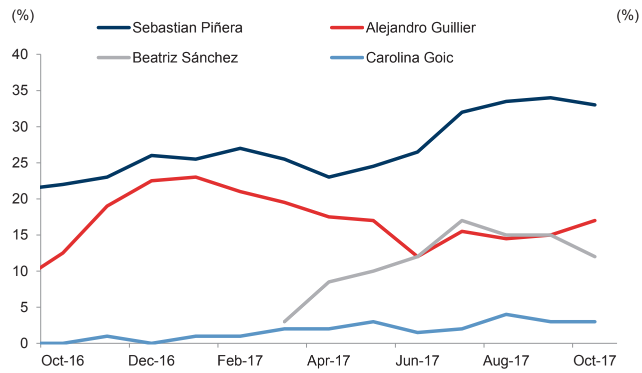
Exhibit 6: Chile: Economic Policy Uncertainty Index



Source: policyuncertainty.com

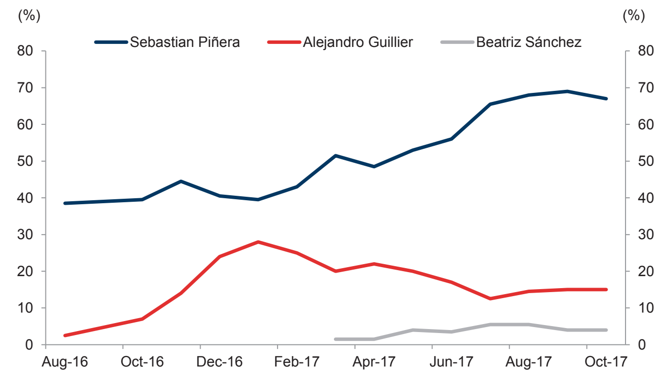
[2] The Economic Policy Uncertainty Index is constructed in Rodrigo Cerda, Álvaro Silva & José Tomás Valente, "Economic Policy Uncertainty Indices for Chile", November 2017. The index is available at policyuncertainty.com and follows the narrative approach outlined in Baker, Bloom & Davis (2016), with a normalized frequency of articles in newspaper archives (in this case, Folha de São Paulo) that are related to economic uncertainty.

Exhibit 7: Piñera Leading the Polls by a Considerable Margin



Source: GFK Adimark, Plaza Publica Cadem

Exhibit 8: Q: Who Do You Think Will Win?



Source: GFK Adimark, Plaza Publica Cadem

Sentiment as a Driver of Activity

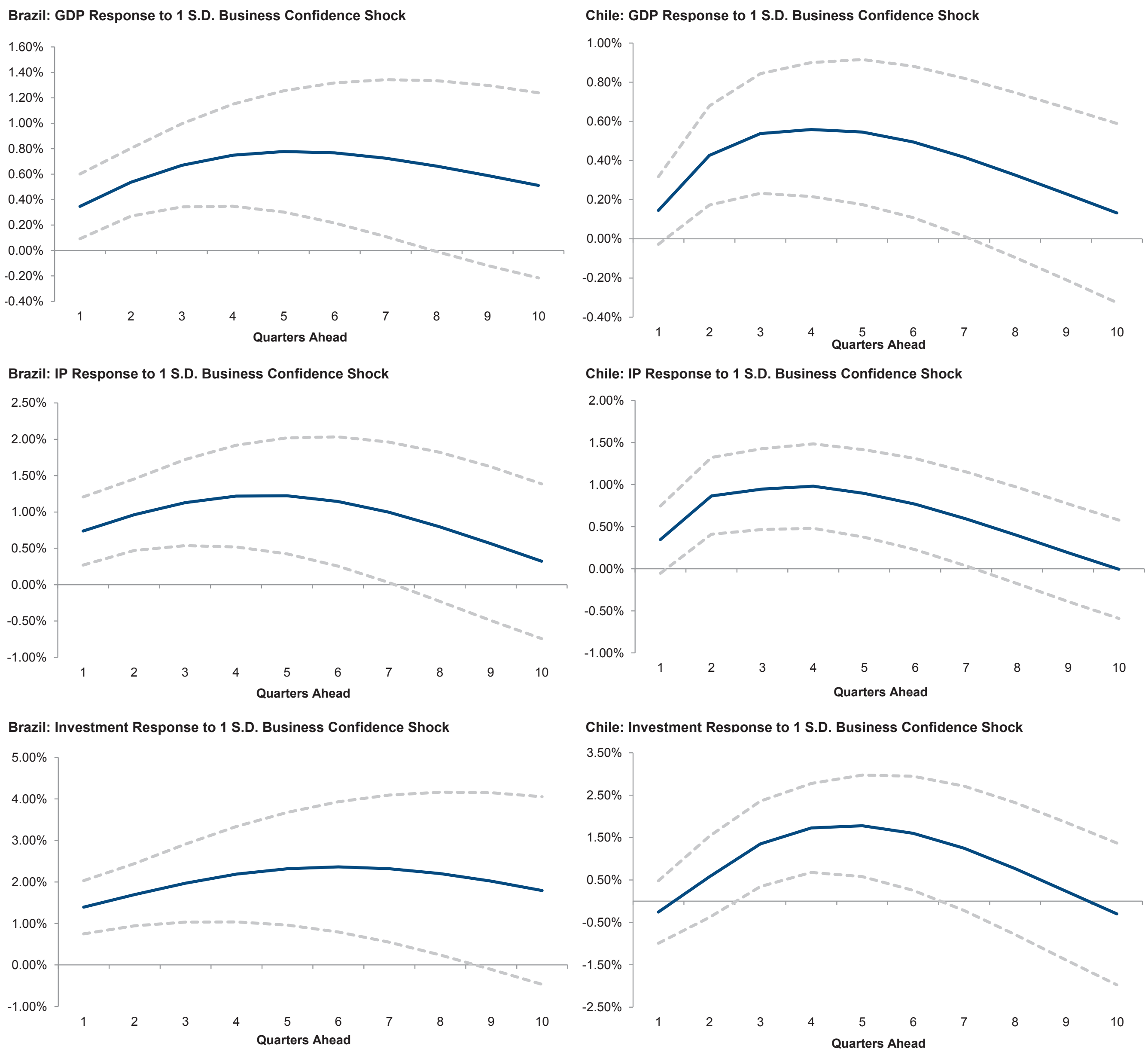
Considering the recent shift in sentiment indicators in both Brazil and Chile, we estimate the effects of both confidence and policy uncertainty on GDP, industrial production, and investment. For Chile, we use non-mining GDP and industrial production in the manufacturing sector in order to filter out the volatile impact of mining activity on headline indicators, as it is highly dependent on global copper prices.

The estimation is done by constructing a vector autoregression model, with impulse-response functions showing the impact of one standard deviation increases in each sentiment indicator (i.e., business confidence or uncertainty) on economic activity (i.e., GDP, industrial production, or investment).[3]

With regards to **business confidence**, we estimate a significant positive response for all three activity indicators in both countries, with the impact peaking 4 to 6 quarters after the shock. Exhibit 9 shows the responses from GDP, industrial production, and investment for Brazil and Chile. In Brazil, the impact on real GDP is roughly 0.4% in the first quarter, with the impact peaking at a significant 0.8% in five quarters. In Chile, non-mining GDP also responds positively to an improvement in business confidence, rising 0.4% in the second quarter and nearly 0.6% four quarters after the shock, with the impact fading after three years. **The response from industrial production is larger than that from GDP, peaking at 1.2% in Brazil and 1.0% in Chile. Finally, the investment response is the strongest, with a 2.4% expansion in Brazil and 1.8% expansion in Chile.**

[3] See technical appendix for further details.

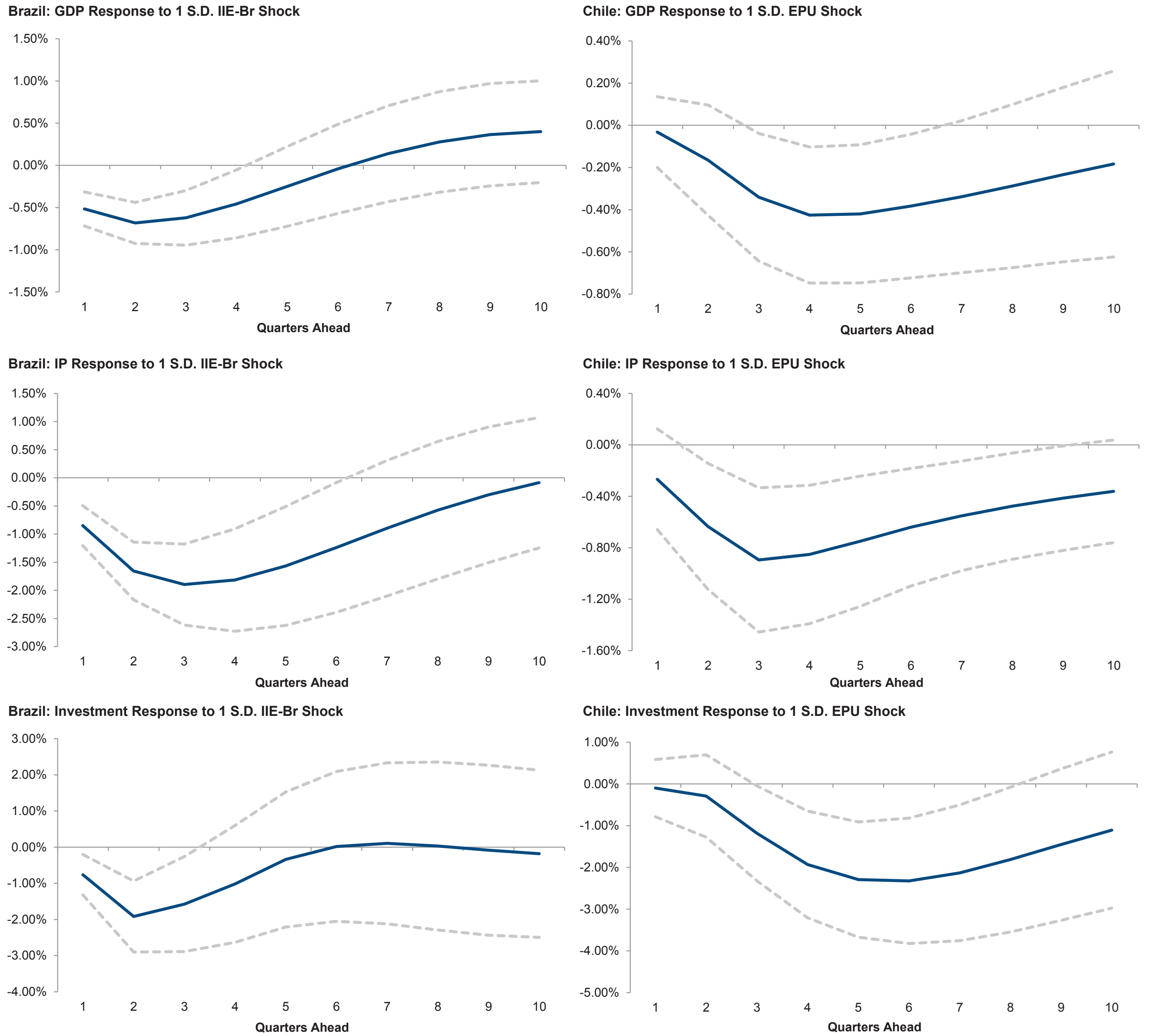
Exhibit 9: Responses to 1 S.D. Business Confidence Shock



Source: Goldman Sachs Global Investment Research

On the other hand, the **effect of an increase in policy uncertainty** is significantly negative for all three activity variables, with responses peaking at 2-4 quarters following the shock. The absolute magnitude of shocks follows a similar pattern: the GDP response is more muted while the investment response is the largest (Exhibit 10). **In Brazil, GDP contracts by 0.5% in the first quarter and 0.7% in the second quarter, with the impact fading after three years. In Chile, the GDP response is slower, with virtually no impact in the first quarter but a considerable 0.4% contraction in four quarters. Industrial production contracts by 1.9% in Brazil and 0.9% in Chile at the peak, and investment contracts by 2.0% in Brazil and 2.3% in Chile.**

Exhibit 10: Responses to 1 S.D. Economic Policy Uncertainty Shock



Source: Goldman Sachs Global Investment Research

These results are broadly in line with the theory: both business confidence and policy uncertainty affect activity primarily through the investment channel and therefore the impact on investment is higher than on industrial production or GDP.[4]

Finally, we highlight that there is some degree of endogeneity in these results as rising confidence and declining policy uncertainty can be a reflection of improving current and expected growth and investment dynamics, rather than the driver of improving conditions. Therefore, drawing causal inferences from our baseline vector autoregression model is challenging. However, these models are still useful in identifying dynamic relationships between the macro variables in question and the

4 See, for example, Nicholas Bloom, "The Impact of Uncertainty Shocks", Econometrica, May 2009.

magnitudes of the impact of shocks to confidence/uncertainty indicators: they allow us to measure the extent to which changes in confidence or policy uncertainty affect activity when controlling for other macro and policy variables.

Rising Confidence and Declining Uncertainty to Support Cyclical Recovery

As discussed in Latin America Economics Analyst (October 3) *LatAm: Easing Inflationary Pressures and Financial Conditions Likely to Support Cyclical Recovery*, the low inflation environment and accommodative financial conditions in both countries should help stabilize the business cycles and provide a valuable impulse to domestic activity in the quarters ahead. Our results show that beyond the drivers mentioned above, firming confidence and declining policy uncertainty are also expected to support real activity as we go into 2018, particularly with regard to investment spending. In all, accommodative financial conditions and policies that further strengthen domestic sentiment and reduce lingering policy uncertainty are important to accelerate the hitherto mediocre growth performance, especially when fiscal policy cannot be counted upon to leverage the recovery given the need for further fiscal consolidation, particularly in Brazil.

Gabriel Fritsch

Technical Appendix

We used a structural vector autoregression (VAR) model with quarterly data to obtain our results, with a specification similar to that proposed of the existing empirical literature on this topic[5]:

$$AY_t = B_0 + \sum_{i=1}^{N} B_i C_{t-i} + DZ_t + u_t$$

The vector of endogenous variables Y_t includes the following variables: a sentiment indicator, log(stock market index), log(real ex-ante policy rate), log(employment) and log(GDP or industrial production), in this order. When including investment as the response variable, we add it as the most endogenous variable after log(GDP). The 5x5 (or 6x6) matrix A contains simultaneous effects; matrix B_i contains lagged effects; Z_t is a vector of exogenous controls used for robustness checks to the baseline specification; and u_t is a vector of structural shocks.

The ordering of variables in the baseline specification is based on assumptions made about their contemporaneous causality. As different arguments for different orderings are possible, we tested different orderings as robustness checks to our model. Other robustness checks are specifications controlling for exogenous variables such as commodity prices, global economic activity (proxied by a measure of global industrial production), terms of trade, and the Fed Funds rate. In other specifications, we exclude either log(employment) and log(stock market index), or add log(real effective exchange rate) to the endogenous variable matrix (in between log(stock market index) and log(real ex-ante policy rate) on the baseline ordering). Overall, our main results remained valid under different controls and orderings of variables.

[5] See Scott R. Baker, Nicholas Bloom & Steven J. Davis, "Measuring Economic Policy Uncertainty", Quarterly Journal of Economics, November 2016; Ricardo de Menezes Barboza & Eduardo Zilberman, "Os Efeitos da Incerteza sobre a Atividade Economica no Brasil", PUC-Rio Department of Economics Working Paper, July 2017.

LatAm and Global Macroeconomic Outlook

Consolidated Latin America Selected Economic Indicators

	2010	2011	2012	2013	2014	2015	2016	2017F	2018F	2019F	2020F
I. Economic Activity and Prices											
Nominal GDP (US$bn)	4,582	5,388	5,440	5,433	5,380	4,595	4,412	4,882	5,275	5,452	5,734
Real GDP growth (% yoy)	6.4	4.7	2.8	2.7	0.7	-0.6	-1.2	1.5	2.6	3.1	3.3
CPI Inflation (% yoy)	9.0	8.9	7.9	10.3	14.1	18.4	25.6	12.1	5.6	3.9	3.7
Domestic Demand (% yoy)	8.4	6.4	3.8	2.9	0.0	-1.7	-2.1	1.7	2.7	3.4	3.5
II. External Sector (US$bn)											
Current Account Balance	-86.8	-96.3	-117.0	-147.9	-165.6	-156.2	-91.3	-79.9	-109.8	-117.7	-124.4
Trade Balance	80.1	106.1	78.6	41.4	24.2	-10.1	40.3	63.8	51.0	48.4	51.8
Net Capital Inflows	173.0	206.1	176.0	132.7	188.1	117.8	110.1	100.4	127.9	146.7	148.6
Foreign Direct Investment	113.5	153.7	161.2	170.6	176.5	165.9	153.3	159.0	189.7	216.6	247.4
Gross International Reserves	583.7	693.5	752.5	737.4	759.9	721.6	740.3	760.8	778.9	807.9	832.0
Change in Reserves	86.2	109.8	59.0	-15.2	22.6	-38.4	18.8	20.5	18.1	29.0	24.2
III. Public Finance and Indebtness (% GDP)											
Primary Fiscal Balance	0.1	0.6	-0.3	-0.6	-2.1	-2.4	-2.4	-1.4	-1.0	-0.1	0.5
Overall Fiscal Balance	-3.1	-2.8	-3.3	-3.7	-5.3	-7.2	-6.4	-5.8	-5.3	-4.4	-3.8
Total Public Sector Debt	41.8	40.9	41.5	43.8	49.5	54.2	58.2	60.0	61.2	62.5	63.2
Total External Debt	24.5	23.7	26.0	28.3	32.3	35.3	37.4	35.2	34.9	35.9	36.3

Note: Aggregates weighted by nominal GDP in US$ at PPP exchange rates.

Source: Goldman Sachs Global Investment Research

Global Macroeconomic Framework

						2017F				2018F			
	2016	2017F	2018F	2019F	2020F	Q1	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
Real GDP Growth (%, yoy)													
United States	1.5	2.2	2.5	1.7	1.5	2.0	2.2	2.3	2.5	2.8	2.6	2.4	2.2
Euro Area	1.7	2.2	1.8	1.6	1.5	1.9	2.2	2.4	2.1	2.0	1.8	1.6	1.6
Japan	1.0	1.6	1.2	1.3	1.0	1.5	1.4	1.7	1.6	1.5	1.1	1.1	1.3
World Economy	3.2	3.8	3.9	3.9	3.8	3.5	3.7	3.9	3.9	4.0	4.0	3.9	3.9
CPI Inflation (%, yoy)													
United States	0.9	2.1	2.1	2.1	2.2	2.6	1.9	2.0	2.1	1.8	2.4	2.4	2.0
Euro Area	0.2	1.5	1.2	1.3	1.6	1.8	1.5	1.5	1.4	1.1	1.3	1.3	1.2
Japan	-0.1	0.5	0.6	1.0	1.6	0.3	0.4	0.7	0.7	0.6	0.6	0.6	0.6
Interest rates (%, e.o.p)													
Fed Funds	0.54	1.38	2.38	3.38	3.38	0.79	1.04	1.15	1.38	1.63	1.88	2.13	2.38
UST 10-Years	2.40	2.75	3.25	3.60	3.70	2.40	2.50	2.65	2.75	2.90	3.00	3.10	3.25

Source: Goldman Sachs Global Investment Research

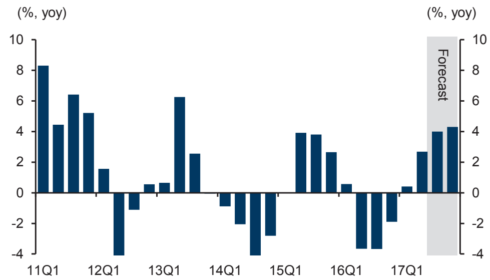
LatAm Country Data Tables

Argentina

	2016	2017F	2018F	2019F
Activity and Prices				
Real GDP Growth (% yoy)	-2.2	2.9	3.7	3.6
Nominal GDP (US$bn)	544	609	659	687
Consumer Prices, IPC (yoy, e.o.p.)*	N.A	23.2	16.3	10.6
Consumer Prices, IPCBA (yoy, e.o.p.)*	41.0	24.1	16.8	10.7
External Sector				
Current Account (% GDP)	-2.7	-4.0	-3.7	-3.4
Trade Balance (% GDP)	0.8	-0.6	-0.4	-0.2
Exports (% yoy)	1.7	1.5	7.1	6.5
Imports (% yoy)	-6.9	16.6	5.4	4.1
Exchange Rate ($/ARS, e.o.p.)	15.9	17.0	18.4	19.6
Gross International Reserves (US$bn)	38.8	51.0	55.6	59.1
Monetary Sector				
Monetary Base (% yoy)	26.6	24.5	13.4	10.2
Credit to the Private Sector (% GDP)	14.0	14.3	14.8	15.5
Policy Interest Rate	24.75	23.50	14.00	9.00
Fiscal Sector **				
Federal Govt Primary Balance (% GDP)	-4.5	-4.2	-3.5	-3.2
Federal Govt Overall Balance (% GDP)	-6.9	-6.6	-5.8	-5.5
Debt Indicators ***				
Gross Non-fin. Public Sector Debt (% GDP)	50.6	52.3	54.1	56.6
Domestic (% GDP)	33.4	34.5	35.4	36.4
External (% GDP)	17.2	17.8	18.7	20.2
Total External Debt (%GDP)	36.9	36.2	36.4	37.4

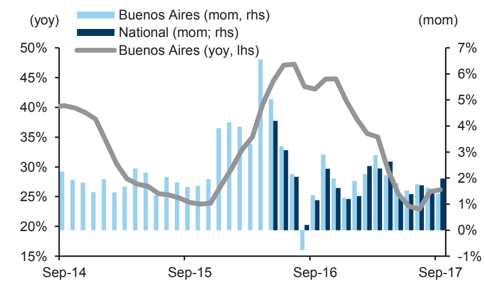
*IPC computed by INDEC, IPCBA by Statistical Institute City of Buenos Aires. **Before Rents from CB and Anses. Accumulated 4Q. *** Including non-performing debt.
Source: Goldman Sachs Global Investment Research.

Economic Recovery Underway



Source: INDEC, Statistical Inst. City of Buenos Aires, Goldman Sachs Global Investment Research.

Improving Inflation Dynamics



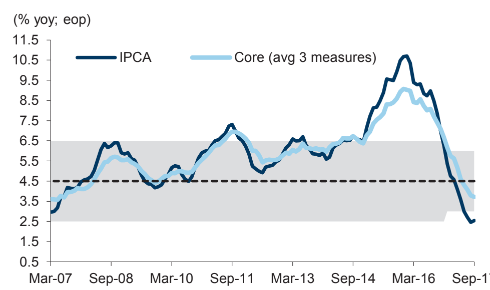
Source: INDEC, Statistical Inst. City of Buenos Aires, Goldman Sachs Global Investment Research.

Brazil

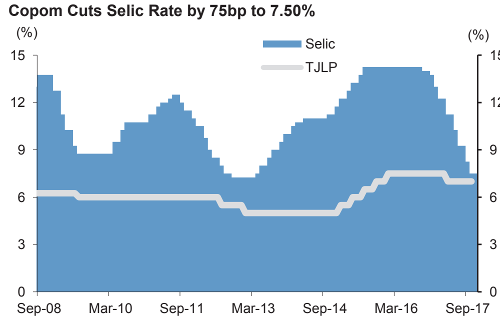
	2016	2017F	2018F	2019F
Activity and Prices				
Real GDP Growth (% yoy)	-3.6	0.9	2.1	2.7
Nominal GDP (US$bn)	1,808	2,078	2,147	2,213
IPCA Inflation (yoy e.o.p)	6.3	3.1	4.3	4.3
External Sector				
Current account (% GDP)	-1.3	-0.6	-1.5	-1.8
Trade balance (% GDP)	2.5	3.2	2.6	2.5
Exports of goods (% yoy)	-3.0	19.0	3.8	5.5
Imports of goods (% yoy)	-19.1	10.1	11.5	7.5
Nominal Exchange Rate ($/BRL e.o.p.)	3.26	3.25	3.35	3.50
Net International Reserves (US$bn)	365	380	385	400
Monetary Sector				
Monetary base (% yoy)	5.9	7.0	7.0	8.0
Credit to the Private Sector (%GDP)	45.8	44.1	44.8	46.8
SELIC rate (e.o.p)	13.75	7.00	7.00	8.25
Fiscal Sector				
Public Sector Primary Balance (% GDP)	-2.5	-2.0	-1.5	0.0
Public Sector Nominal Balance (% GDP)	-9.0	-8.9	-8.0	-6.6
Debt Indicators				
Gross general govt debt (% GDP)	69.9	75.0	78.0	81.0
Domestic public debt (%GDP)	66.2	71.5	74.6	77.6
External public debt (%GDP)	3.6	3.5	3.4	3.4
Total external debt (% GDP)	30.3	27.4	28.0	29.4

Source: Goldman Sachs Global Investment Research.

Headline/Core Inflation Continue to Moderate



Copom Cuts Selic Rate by 75bp to 7.50%



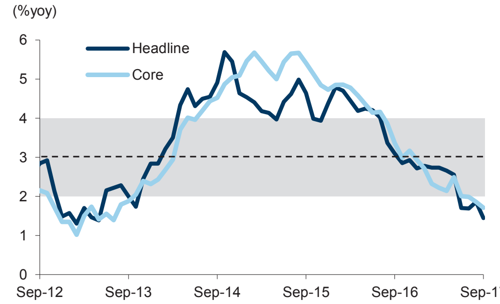
Sources: Bloomberg; Goldman Sachs Global Investment Research; Haver Analytics; IBGE.

Chile

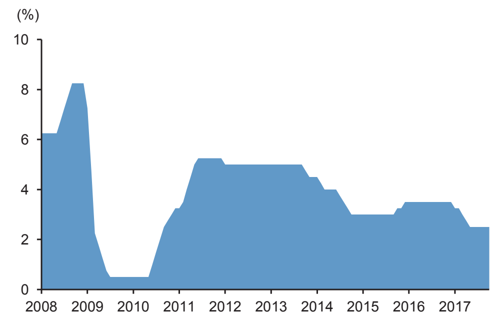
	2016	2017F	2018F	2019F
Activity and Prices				
Real GDP Growth (% yoy)	1.6	1.5	3.0	3.1
Nominal GDP (US$bn)	247	272	302	319
Consumer Prices (% yoy, e.o.p.)	2.7	2.1	3.0	3.0
External Sector				
Current Account (% GDP)	-1.4	-2.8	-3.4	-3.6
Trade Balance (% GDP)	2.1	1.1	0.2	-1.5
Exports (% yoy)	-2.6	4.2	2.5	2.4
Imports (% yoy)	-5.8	8.5	6.6	11.0
Exchange Rate ($/CLP, e.o.p.)	667	625	615	627
Gross International Reserves (US$bn)	41.2	37.6	37.6	37.6
Monetary Sector				
Broad Money (M3, % yoy)	8.5	8.0	8.0	8.0
Credit to the Private Sector (% GDP)	82.3	84.5	86.1	87.5
Policy Rate (e.o.p.)	3.50	2.50	3.00	4.25
Fiscal Sector				
Central Gov't Primary Balance (% GDP)	-2.0	-2.3	-1.7	-1.0
Central Gov't Overall Balance (% GDP)	-2.7	-3.2	-2.7	-2.1
Debt Indicators				
Central Govt Debt (% GDP)	21.3	23.9	25.6	26.6
Domestic (% GDP)	17.5	18.9	20.4	21.1
External (% GDP)	4.1	5.0	5.3	5.5
Total External Debt (% GDP)	66.2	62.2	57.7	56.4

Source: Goldman Sachs Global Investment Research.

Headline/Core Inflation Tracking Below Target



Central Bank on Hold at 2.50% in October



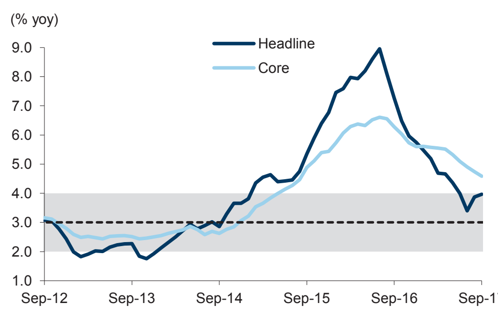
Source: Haver Analytics; INE; Central Bank of Chile.

Colombia

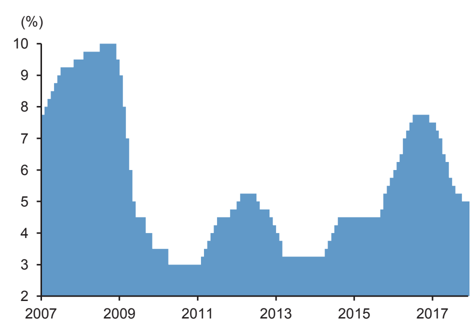
	2016	2017F	2018F	2019F
Activity and Prices				
Real GDP Growth (% yoy)	2.0	1.6	2.7	3.3
Nominal GDP (US$bn)	283	314	327	339
Consumer Prices (% yoy, e.o.p.)	5.7	4.1	3.5	3.0
External Sector				
Current Account (% GDP)	-4.3	-3.7	-3.1	-3.0
Trade Balance (% GDP)	-3.5	-2.9	-2.7	-2.6
Exports (% yoy)	-12.8	10.1	6.5	5.1
Imports (% yoy)	-16.9	5.9	4.4	4.6
Exchange Rate ($/COP, e.o.p.)	3001	3000	3030	3121
Gross International Reserves (US$bn)	46.2	46.7	46.7	46.7
Monetary Sector				
Monetary Base (% yoy)	5.0	10.0	10.0	9.0
Credit to the Private Sector (% GDP)	48.2	49.6	51.3	52.6
Policy Rate (% e.o.p.)	7.50	5.00	4.50	4.50
Fiscal Sector				
Central Government Primary Balance (% GDP)	-1.3	-0.9	-0.5	0.3
Central Government Overall Balance (% GDP)	-3.8	-3.6	-3.2	-2.5
Debt Indicators				
Gross Non-fin. Public Sector Debt (% GDP)	56.3	59.1	61.1	62.0
Domestic (% GDP)	34.3	37.1	40.1	41.0
External (% GDP)	22.0	22.0	21.0	21.0
Total External Debt (% GDP)	42.5	43.0	43.0	44.0

Source: Goldman Sachs Global Investment Research.

Inflation Near Target Upper Limit



Central Bank Cut Rate by 25bp to 5.00% in October



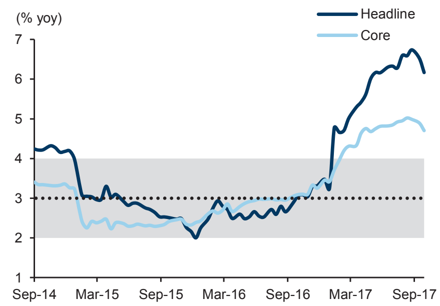
Source: Banco de la República.

Mexico

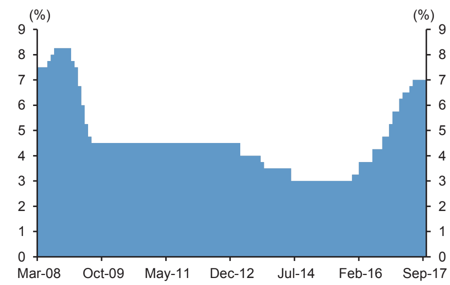
	2016	2017F	2018F	2019F
Activity and Prices				
Real GDP Growth (% yoy)	2.3	2.1	2.5	3.5
Nominal GDP (US$ bn)	1047	1144	1333	1462
Consumer Prices (yoy, e.o.p.)	3.4	6.2	3.7	3.0
External Sector				
Current Account (% GDP)	-2.2	-1.6	-2.0	-1.9
Trade Balance (% GDP)	-1.2	-0.8	-0.9	-0.9
Exports (% yoy)	-1.7	8.5	6.5	7.3
Imports (% yoy)	-2.1	7.3	7.0	7.1
Exchange Rate ($/MXN, e.o.p.)	20.73	17.50	17.00	16.52
Net International Reserves (US$ bn)	176.5	175.0	182.0	190.0
Monetary Sector				
Monetary Base (% yoy)	14.4	14.0	12.0	12.0
Credit to the Private Sector (% GDP)	18.5	18.7	19.0	19.1
Tasa de Fondeo Rate (e.o.p.)	5.75	7.00	7.00	6.00
Fiscal Sector				
Public Sector Primary Balance (% GDP)	-0.1	1.3	0.8	0.8
Public Sector Overall Balance (% GDP)	-2.6	-1.3	-2.0	-2.0
Debt Indicators				
Gross Federal Govt Debt (% GDP)	50.1	47.2	46.3	45.7
Domestic (% GDP)	31.8	30.9	30.1	29.7
External (% GDP)	18.3	16.3	16.2	16.0
Total External Debt (% GDP)	39.6	39.4	38.6	39.0

Note: *Public Sector Borrowing Requirements
Source: Goldman Sachs Global Investment Research.

Headline Inflation Has Likely Peaked



Banxico on Hold at 7.00% in September



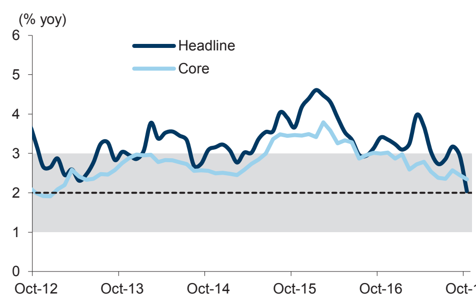
Source: Haver Analytics; INEGI; Goldman Sachs Global Investment Research.

Peru

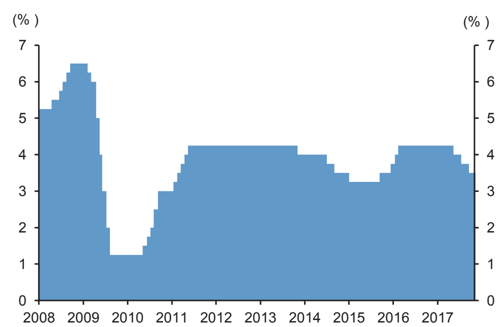
	2016	2017F	2018F	2019F
Activity and Prices				
Real GDP Growth (% yoy)	4.0	2.8	4.1	4.0
Nominal GDP (US$bn)	195	215	234	249
Consumer Prices (% yoy, eop)	3.2	2.0	2.8	3.0
External Sector				
Current Account (% GDP)	-2.7	-2.2	-3.3	-3.6
Trade Balance (% GDP)	1.0	2.0	1.1	0.8
Exports (% yoy)	7.6	14.2	2.5	7.0
Imports (% yoy)	-5.9	8.4	7.2	8.8
Gross International Reserves (US$bn)	61.7	63.0	63.0	63.0
Exchange Rate ($/PEN, e.o.p.)	3.36	3.25	3.15	3.20
Monetary Sector				
Monetary Base (% yoy)	4.1	15.5	9.8	10.2
Credit to the Private Sector (% GDP)	24.3	25.0	27.0	29.0
Reference Interest Rate (e.o.p.)	4.25	3.25	4.25	4.25
Fiscal Sector				
Non-fin Pub. Sector Primary Balance (% GDP)	-1.5	-1.7	-2.1	-1.6
Non-fin Pub. Sector Overall Balance (% GDP)	-2.6	-3.0	-3.5	-2.9
Debt Indicators				
Total Federal Govt Debt (% GDP)	26.8	30.8	34.5	37.5
Domestic Public Debt (% GDP)	14.5	17.1	19.7	21.9
External Public Debt (% GDP)	12.4	13.7	14.9	15.6
Total External Debt (% GDP)	39.4	38.9	38.7	38.9

Source: Goldman Sachs Global Investment Research.

Headline Inflation Back to Target Midpoint



Central Bank on Hold at 3.50% in October



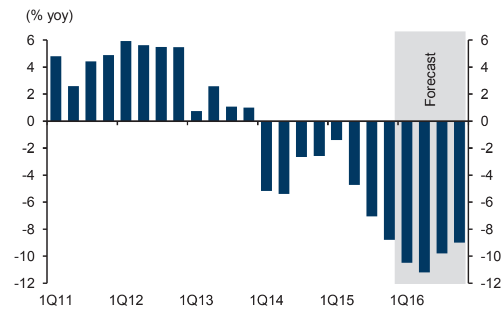
Source: BCRP; INEI; Goldman Sachs Global Investment Research.

Venezuela

	2015F	2016F	2017F	2018F
Activity and Prices				
Real GDP Growth (% yoy)	-5.7	-10.1	-5.3	-1.4
Nominal GDP (US$bn)*	260	287	252	273
Consumer Prices (yoy, e.o.p.)	180.9	483.1	916.6	839.0
External Sector				
Current Account (% GDP)*	-7.0	-3.0	-0.6	0.5
Trade Balance (% GDP)*	0.2	2.3	4.9	5.3
Exports (% yoy)	-50.0	-33.0	22.2	11.3
Imports (% yoy)	-26.9	-46.8	-1.8	7.3
Exchange Rate ($/VEF, e.o.p.)	6.3	10.0	20.0	33.0
Gross International Reserves (US$bn)	16.4	10.9	7.5	9.0
Monetary Sector				
Monetary Base (% yoy)	111	160	180	150
Credit to the Private Sector (% GDP)	17.0	6.9	2.0	0.4
90-day Deposit Rate (e.o.p.)	15.1	15.5	17.0	21.0
Fiscal Sector**				
Public Sector Primary Balance (% GDP)	-14.0	-16.2	-16.1	-14.7
Public Sector Overall Balance (% GDP)	-16.1	-18.4	-18.2	-16.8
Debt Indicators				
Total Public Sector Debt (% GDP)*	81.9	84.9	95.4	81.4
Domestic (% GDP)*	35.0	37.9	39.0	27.2
External (% GDP)*	46.9	47.0	56.4	54.2
Total External Debt (%GDP)*	53.8	53.1	63.2	60.6

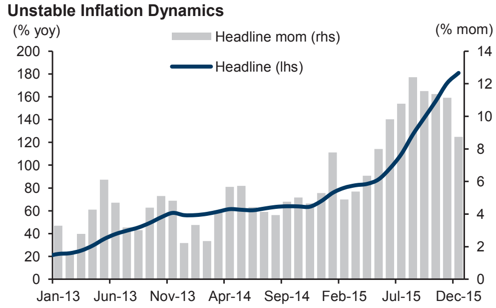
Source: Goldman Sachs Global Investment Research. *Based on IMF Nominal US$ GDP due to FX distortions** Restricted Public Sector

From Recession to Depression (GDP yoy)



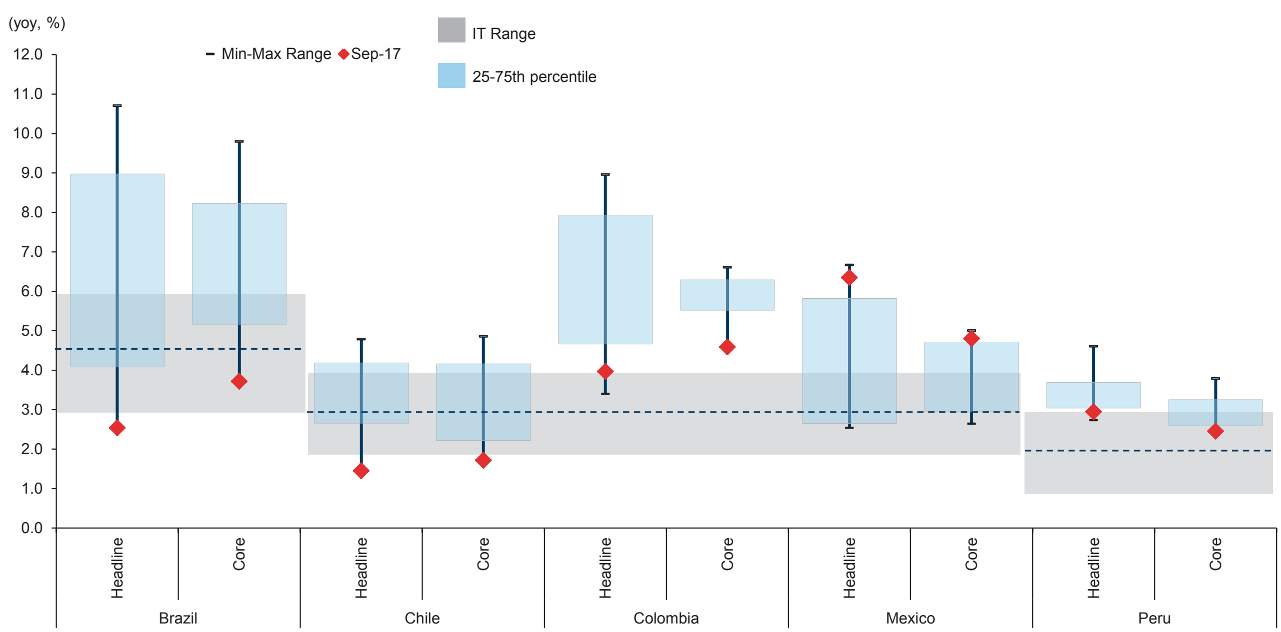
Source: BCV; Goldman Sachs Global Investment Research.

Unstable Inflation Dynamics



Source: BCV; Goldman Sachs Global Investment Research.

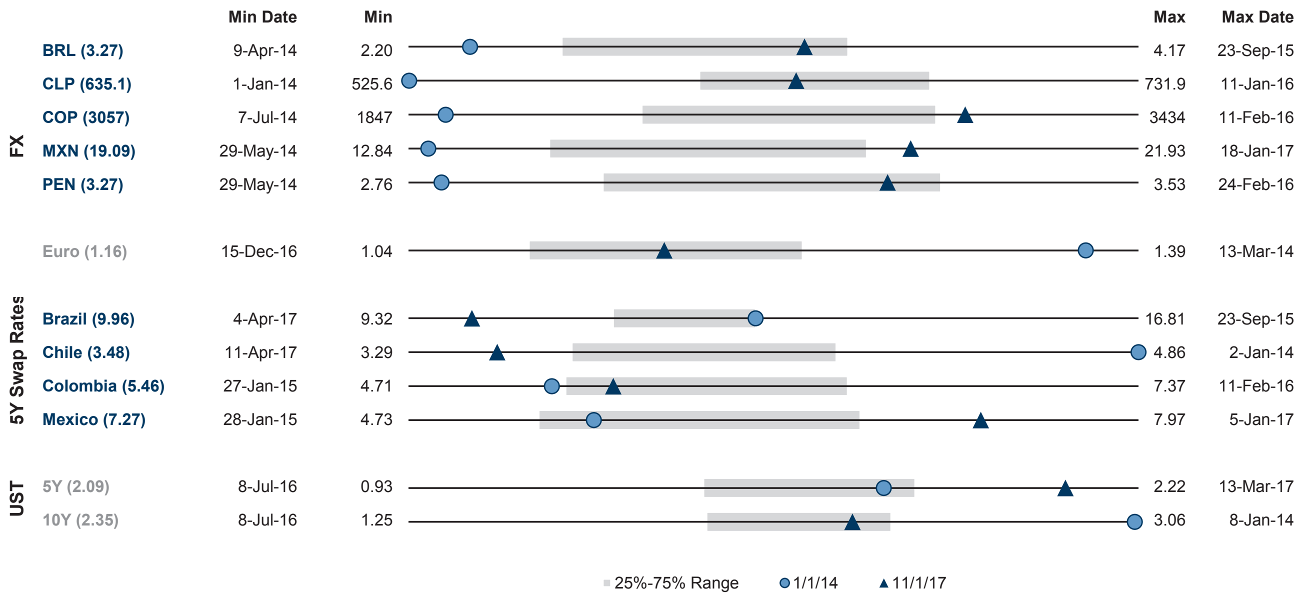
LAIT-5 Annual Headline and Core Inflation Dynamics Since January 2016



Source: Haver Analytics, Goldman Sachs Global Investment Research

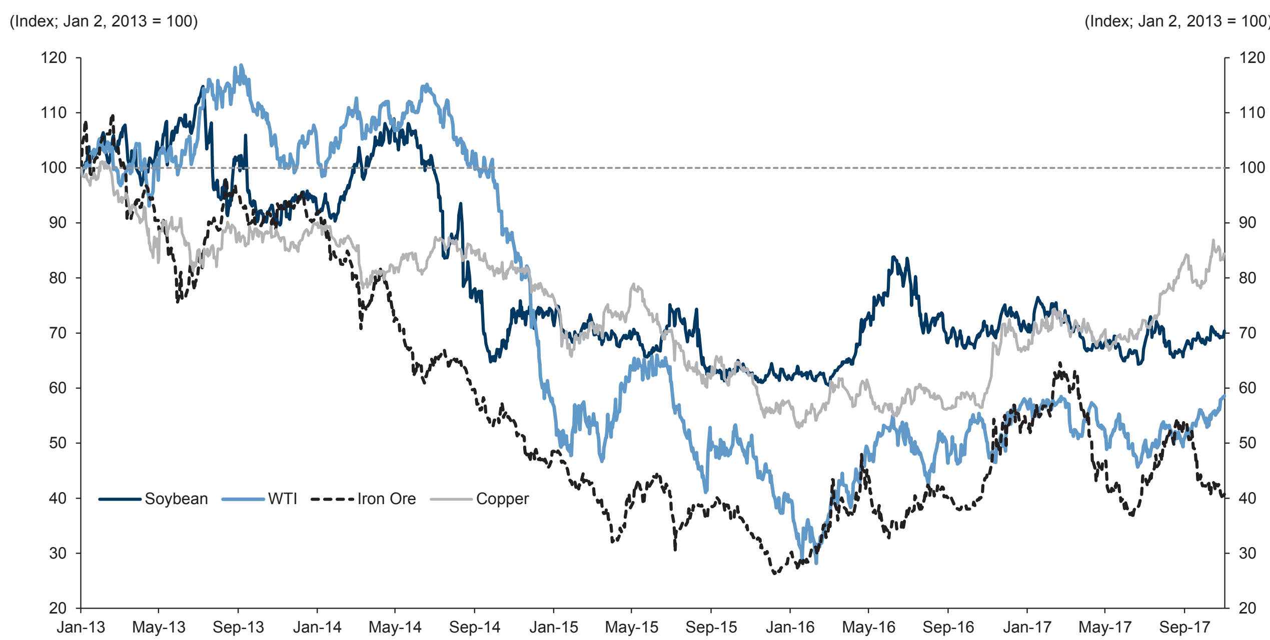
LatAm Financial Markets Outlook

LatAm Financial Markets Indicators (2014-2017)



Source: Goldman Sachs Global Investment Research

Key Commodities Prices



Source: Goldman Sachs Global Investment Research

Latin America Swap Rates

		End-2015	End-2016	Current (11/01/2017)	Change Since (bps) End-2015	Change Since (bps) End-2016
Swap Rates (%)	**Brazil**					
	2y	16.53	11.05	8.28	-825	-276
	10y	16.52	11.66	10.52	-600	-113
	Chile					
	2y	4.02	3.06	2.64	-139	-43
	10y	4.76	4.16	4.17	-59	1
	Colombia					
	2y	6.24	5.62	4.71	-153	-91
	10y	7.43	6.58	6.18	-125	-40
	Mexico					
	2y	4.44	7.28	7.37	293	9
	10y	6.43	8.01	7.48	105	-53
	United States					
	2y	1.18	1.48	1.83	65	35
	10y	2.21	2.38	2.36	15	-1

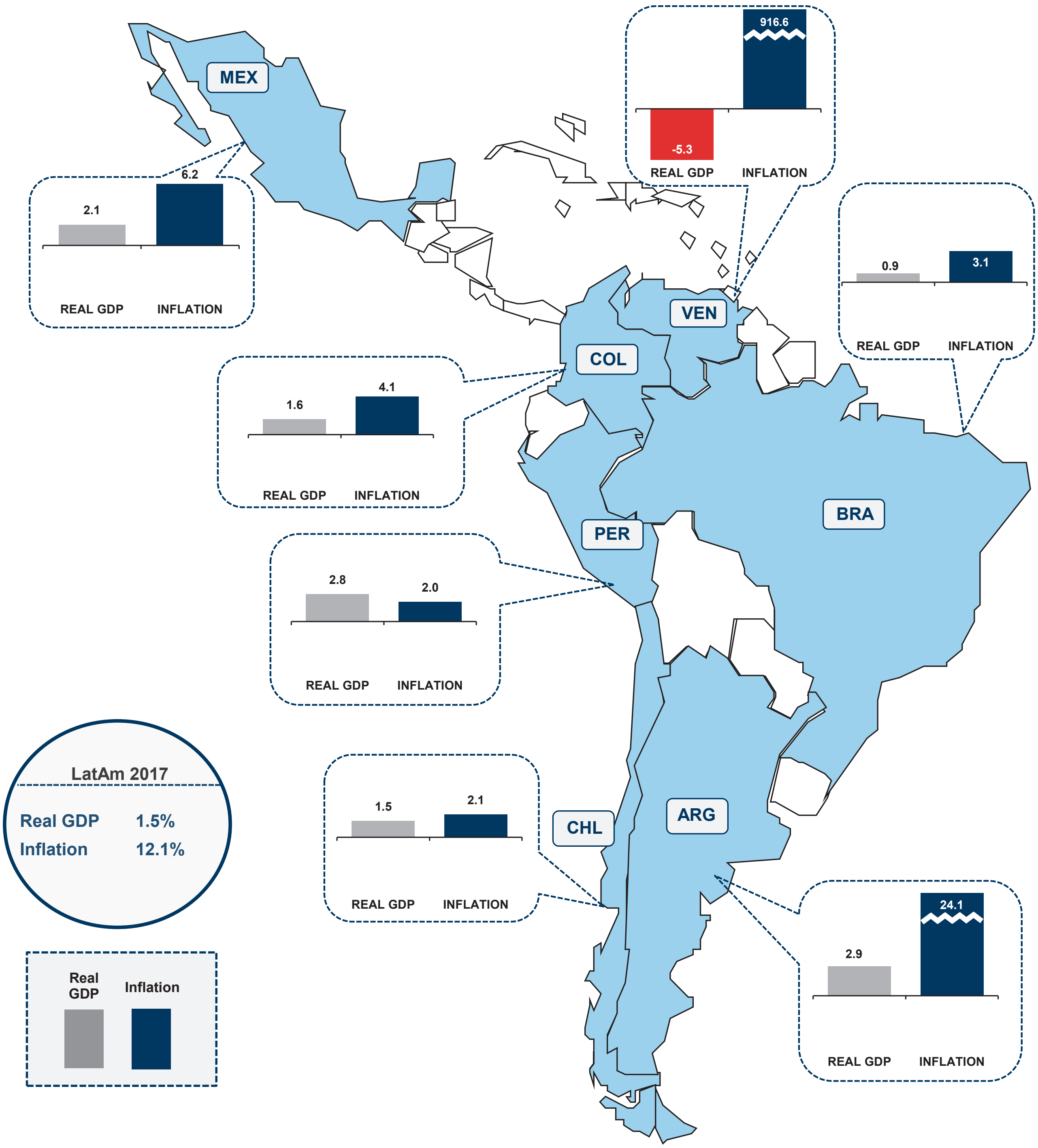
Source: Goldman Sachs Global Investment Research

Latin America Forecasts

		Policy Rates and FX Levels (End of Period)						Implied Change by (Rates in bp; FX in %)		
		Current	4Q2017	1Q2018	2Q2018	3Q2018	4Q2018	4Q2017	1Q2018	2Q2018
Policy Rates (%)	**Brazil**	7.50	7.00	7.00	7.00	7.00	7.00	-50	-50	-50
	Chile	2.50	2.50	2.50	2.50	2.75	3.00	0	0	0
	Colombia	5.00	5.25	5.00	4.50	4.50	4.50	25	0	-50
	Mexico	7.00	7.00	7.00	7.00	7.00	7.00	0	0	0
	Peru	3.50	3.25	3.25	3.25	3.75	4.25	-25	-25	-25
FX (Local / USD)	**Brazil**	3.27	3.25	3.25	3.28	3.31	3.35	-0.6%	-0.6%	0.4%
	Chile	629.00	625.0	620.0	617.5	615.0	615.0	-0.6%	-1.4%	-1.8%
	Colombia	3028.00	3000	3000	3000	3000	3030	-0.9%	-0.9%	-0.9%
	Mexico	18.98	17.50	17.30	17.00	17.00	17.00	-7.8%	-8.9%	-10.4%
	Peru	3.25	3.25	3.20	3.18	3.15	3.15	0.0%	-1.5%	-2.3%
	Argentina	17.52	17.00	17.33	17.67	18.01	18.36	-3.0%	-1.1%	0.8%
	Venezuela	11.00	20.00	25.00	27.00	29.00	33.00	81.8%	127.3%	145.4%

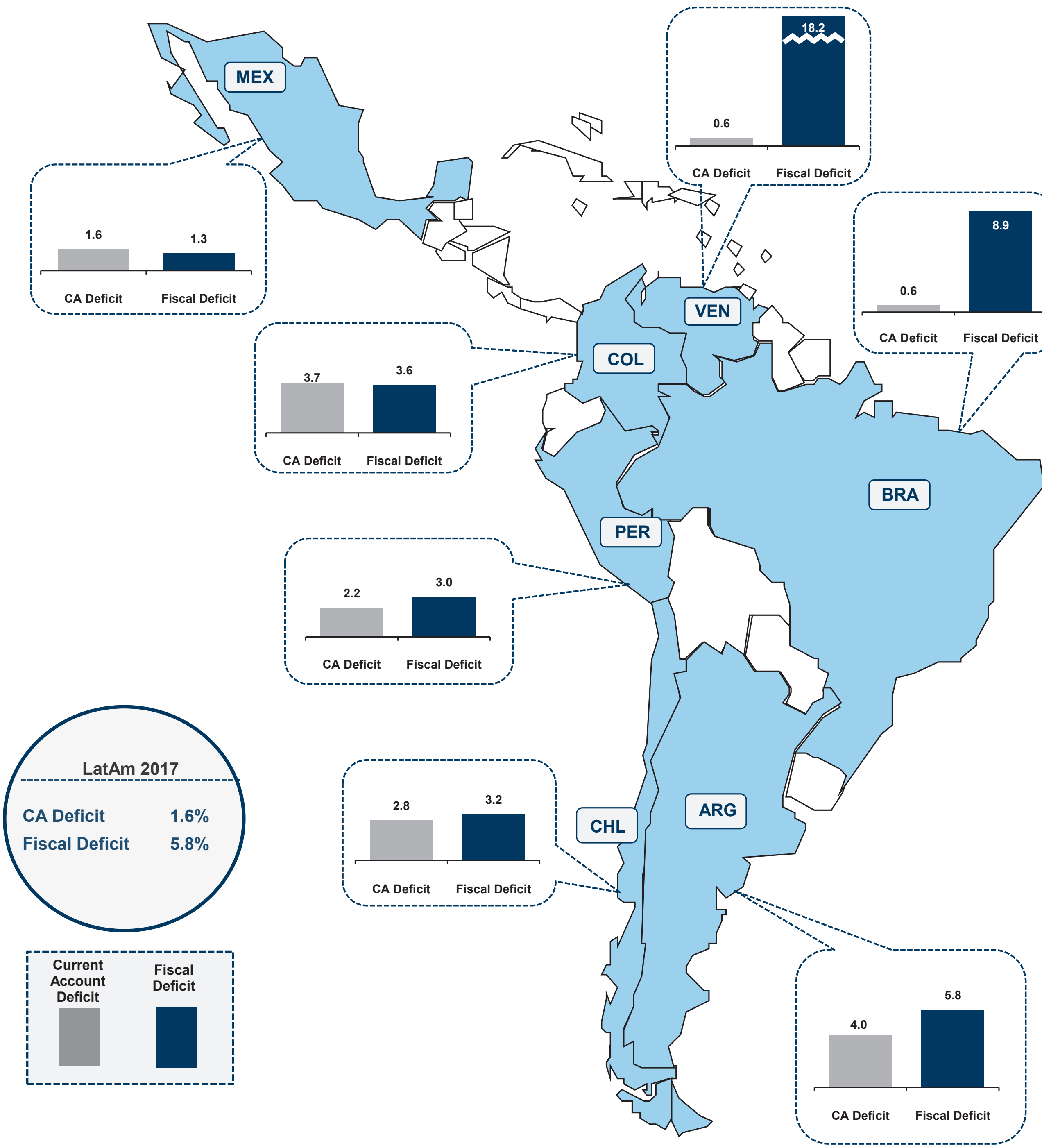
Source: Goldman Sachs Global Investment Research

LatAm Outlook for 2017: Real GDP Growth and Inflation (YoY, %)



Source: Goldman Sachs Global Investment Research

LatAm Outlook for 2017: Current Account and Fiscal Deficit (% of GDP)



Source: Goldman Sachs Global Investment Research

Forthcoming Data Releases

Date	Time	Economic Indicator	Period	Forecast mom/qoq	Forecast yoy	Previous mom/qoq	Previous yoy
Argentina							
07-Nov		Monetary Policy Meeting	Nov 1H	27.75%		27.75%	
14-Nov	11:00	Consumer Price Index (GBA)	Oct			2.00%	24.20%
14-Nov	11:00	Consumer Price Index	Oct			1.90%	
Brazil							
08-Nov	5:00	IGP-DI Inflation	Oct	0.05%	-1.12%	0.62%	-1.04%
10-Nov	5:00	IPCA Inflation	Oct	0.47%	2.75%	0.16%	2.54%
14-Nov	6:00	Broad Retail Sales	Sep	1.00%		0.10%	7.60%
14-Nov	6:00	Core Retail Sales	Sep	0.60%		-0.50%	3.60%
16-Nov	5:00	IGP-10 Inflation	Nov			0.49%	-1.29%
17-Nov	5:30	Economic Activity Index (yoy nsa)	Sep	0.40%		-0.38%	1.64%
Chile							
06-Nov	6:30	IMACEC	Sep		1.90%	0.30%	2.40%
07-Nov	6:30	Minutes of MPC Meeting	Oct				
08-Nov	6:00	Consumer Price Index	Oct	0.30%	1.60%	-0.20%	1.50%
14-Nov	16:00	Monetary Policy Meeting	Nov	2.50%		2.50%	
Colombia							
04-Nov	15:00	Consumer Price Index	Oct	0.10%	4.13%	0.04%	3.97%
10-Nov	15:00	Minutes of MPC Meeting	Oct				
14-Nov	12:00	Industrial Production	Sep		-3.00%		-3.10%
14-Nov	12:00	Retail Sales	Sep		1.00%		-1.20%
15-Nov	11:00	GDP	3Q17	1.10%	2.30%	0.70%	1.30%
Mexico							
06-Nov	9:00	Consumer Confidence	Oct			89.2	
07-Nov	9:00	Gross Fixed Investment	Aug		-0.80%	-1.50%	-2.50%
09-Nov	9:00	INPC Core Inflation	Oct	0.24%	4.76%	0.28%	4.80%
09-Nov	9:00	INPC Headline Inflation	Oct	0.58%	6.32%	0.31%	6.35%
09-Nov	14:00	Monetary Policy Meeting		7.00%		7.00%	
10-Nov	10:00	Industrial Production	Sep		-1.00%	0.30%	-0.50%
Peru							
09-Nov	18:00	Monetary Policy Meeting	Nov	3.25%		3.50%	
15-Nov		Economic Activity Index (yoy nsa)	Sep		2.80%		2.30%
15-Nov		Unemployment Rate	Oct	6.20%		6.40%	

Source: Goldman Sachs Global Investment Research

Calendar of Economic and Political Events

Date	Forthcoming Events	Comment
Argentina		
7-Nov	MPC Meeting	We expect the BCRA to remain on hold at 27.75% given signs of inertia/persistence among core inflation indicators.
Brazil		
6-Dec	COPOM Meeting	We expect the Copom to cut the Selic policy by 50bp to a stimulative and record low 7.00%.
Chile		
14-Nov	MPC Meeting	At this point, we expect BCCh to hold the policy rate at 2.50%, but another low inflation print in October could lead to further rate cuts.
19-Nov	Presidential Election	Former president and center-right candidate Sebastian Piñera has kept his lead in the polls over leftist candidates Beatriz Sánchez and senator Alejandro Guillier.
Colombia		
24-Nov	MPC Meeting	We expect Banrep to keep the policy rate on hold at 5.00%.
Mexico		
9-Nov	MPC Meeting	We expect Banxico to leave the policy rate unchanged at 7.00%.
Peru		
9-Nov	MPC meeting	We expect BCRP to cut the policy rate by 25bp to 3.25%.

Source: Goldman Sachs Global Investment Research

Disclosure Appendix

Reg AC

We, Alberto Ramos, Paulo Mateus and Gabriel Fritsch, hereby certify that all of the views expressed in this report accurately reflect our personal views, which have not been influenced by considerations of the firm's business or client relationships.

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