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Latin America Economics Analyst

Talk the Talk and Walk the Walk

Alberto Ramos
+1(212)357-5768 |
alberto.ramos@gs.com
Goldman Sachs & Co. LLC

Paulo Mateus
+1(212)357-5772 |
paulo.mateus@gs.com
Goldman Sachs & Co. LLC

Gabriel Fritsch
+1(212)902-0170 |
gabriel.fritsch@gs.com
Goldman Sachs & Co. LLC

Shifting Sentiment and Financial Conditions Across LatAm

Business and consumer confidence, policy uncertainty, and financial conditions have changed considerably in the larger LatAm economies in recent months. In Brazil confidence indicators firmed and financial conditions eased visibly after the October election on the expectation of investment-friendly pro-growth policies, but in Mexico sentiment indicators have started to soften and financial conditions have tightened on rising concerns about policy direction under the newly inaugurated administration. Argentina is undergoing a severe macro adjustment: financial conditions tightened rapidly to multi-year highs during 2H2018 and confidence indicators are currently tracking deep in pessimistic territory.

Sentiment a Key Driver of Growth

We estimate the impact of changes in confidence and uncertainty indicators on real activity, and show that a one standard deviation increase in business confidence increases real GDP in LatAm by 0.5-1.4pp, while a similar rise in economic policy uncertainty reduces output by 0.4-0.7pp. A sharp decline in confidence in Argentina coupled with tight financial conditions should weigh down on real activity in 2019, and early signs of deteriorating sentiment in Mexico could intensify the headwinds to the growth outlook. On the other hand, the recent rebound in confidence in Brazil should, alongside accommodative financial conditions, contribute to the expected firming of the growth dynamics in 2019.

Talk the Talk and Walk the Walk

Our forecast of a moderate acceleration of real GDP growth in LatAm in 2019 is conditional on the continuation of easy financial conditions, and, to a non-minor extent, low/contained policy uncertainty and no deterioration in confidence indicators. In Argentina, this implies staying the course on the macro adjustment in an election year, in Brazil, progress towards fiscal consolidation to stabilize the debt dynamics, and in Mexico, preserving the hitherto orthodox disciplined policy mix and solid fiscal backdrop.

Talk the Talk and Walk the Walk

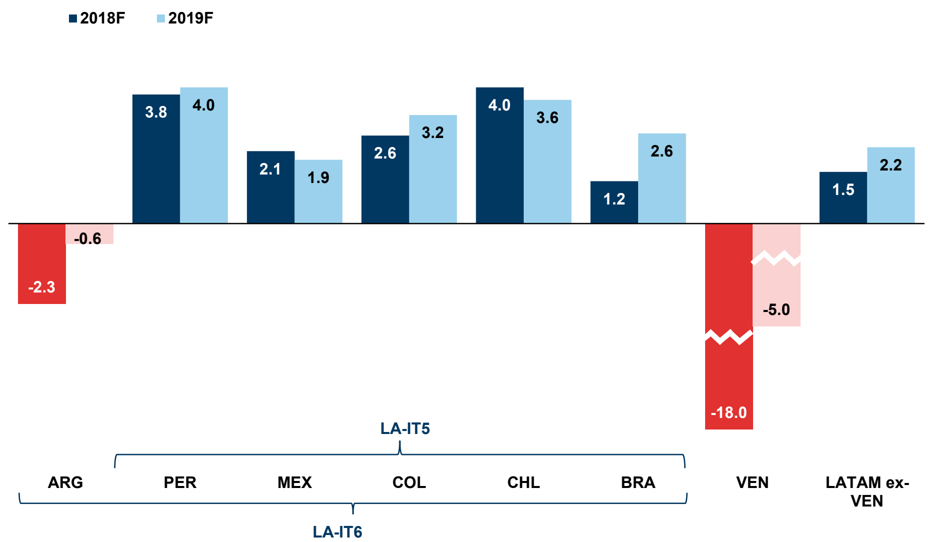
Introduction

Business and consumer confidence, policy uncertainty, and financial conditions have changed considerably in the larger LatAm economies in recent months. In Brazil confidence indicators firmed and financial conditions eased visibly after the October election on the expectation of investment-friendly pro-growth policies, but in Mexico sentiment indicators have started to soften and financial conditions have tightened on rising concerns about policy direction under the newly inaugurated administration. Argentina, which is undergoing a severe macro adjustment saw financial conditions tighten rapidly to multi-year highs during 2H2018 highs, and confidence indicators are currently tracking deep in pessimistic territory.

We estimate the effects of changes in confidence and uncertainty indicators on real activity, and show that a one standard deviation increase in business confidence increases real GDP in LatAm by 0.5-1.4pp, while a similar rise in economic policy uncertainty reduces output by 0.4-0.7pp. The impact on investment is larger than that on GDP for all countries, which squares with the theoretical assumption that investment is one of the main channels through which confidence and uncertainty affect activity. A sharp decline in confidence in Argentina, coupled with tight financial conditions, should remain a headwind to growth in 2019, while the deterioration of sentiment in Mexico in recent months could add to other headwinds to growth outlook (e.g., tight monetary and financial conditions and projected deceleration of the US economy). On the other hand, the recent firming of confidence indicators in Brazil, alongside accommodative monetary and financial conditions, should contribute to firmer growth next year.

Overall, we forecast an uneven and patchy recovery in Latin America in 2019. The expected modest acceleration in aggregate growth is conditional on keeping financial conditions accommodative, policy uncertainty contained, and confidence indicators in positive territory. As such, maintaining an investment-friendly environment and embracing disciplined macroeconomic policies are key assumptions underpinning our macro outlook.

Exhibit 1: LA-IT6 Real GDP Growth Forecasted to Accelerate Modestly in 2019
Real GDP Growth, % yoy



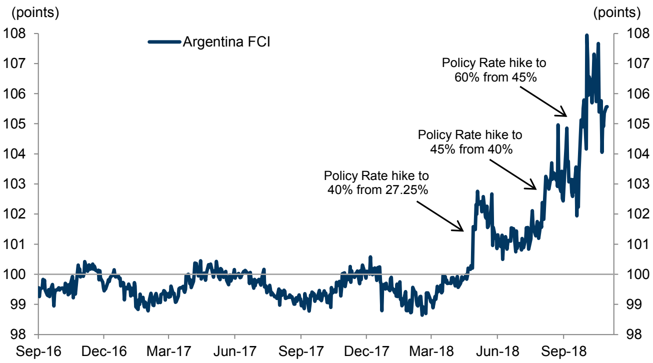
Source: Goldman Sachs Global Investment Research

A Disappointing Growth Performance in 2018

The year that is about to end was not particularly kind to the larger economies in Latin America. The late 2017 expectation of a stronger cyclical recovery in 2018 faded as the year progressed. A sharp downward correction in EM asset prices, a noisy election cycle and a number of country-specific developments acted together to keep policy uncertainty elevated, and consumer and business confidence downbeat. Countries that experienced sharper negative shifts in these variables saw the growth momentum significantly eroded, thus contributing to the region's disappointing aggregate performance.

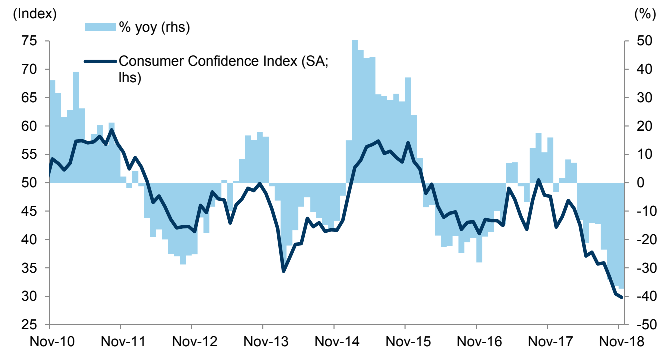
Argentina was the clearest example, witnessing a dramatic tightening of financial conditions (Exhibit 2) following a run on the currency and accelerating inflation as a result of a testier external backdrop, a few domestic policy missteps, and excessive gradualism in overcoming its large fiscal imbalances. The central bank was forced to validate very high and distressed levels of short-term interest rates and consumer confidence declined significantly (Exhibit 3). Together with the adverse weather impact on agricultural production in 2Q18, these developments severely weakened the real business cycle's forward momentum, and a deep recession is now in the pipeline as the economy shifted to a faster, riskier, and unstable macroeconomic adjustment path.

Exhibit 2: Argentina: Sharp Tightening of Financial Conditions



Source: Goldman Sachs Global Investment Research

Exhibit 3: Argentina: Consumer Confidence at Historical Lows

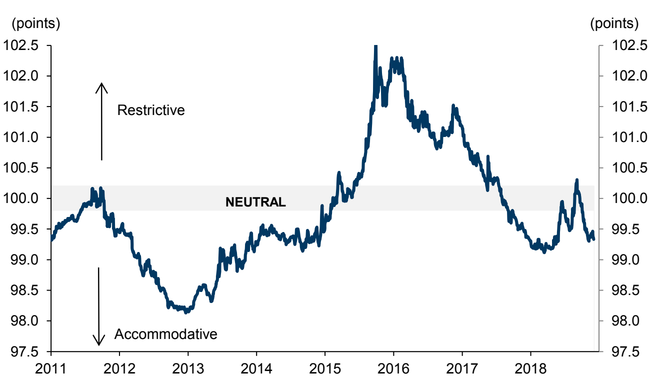


Source: Universidad Torcuato di Tella, Goldman Sachs Global Investment Research

Elsewhere in the region, the spotlight shone on the domestic political dynamics for most of the year: polarizing presidential and legislative elections in Brazil and Mexico were the subject of intense market focus and a driver of asset market volatility. Rising concerns with violence and corruption in both countries led to the election of anti-establishment candidates, with the axis of political power shifting to the slightly right in Brazil and clearly to the left in Mexico.

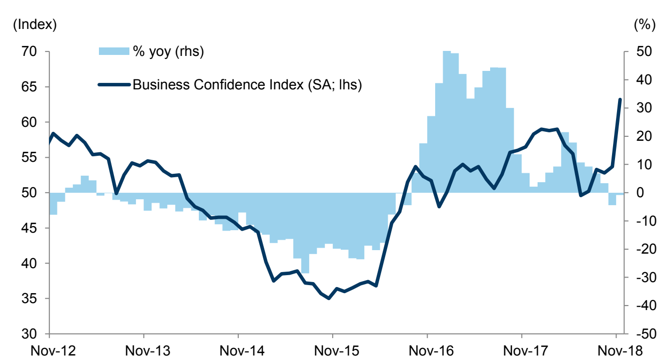
In **Brazil**, electoral noise coupled with a disruptive and costly 11-day truckers' strike in May and insufficient progress on the fiscal front kept policy uncertainty elevated, business sentiment subdued, and financial conditions tighter for part of the year despite a record low monetary policy benchmark rate (Exhibits 4 and 5). However, financial conditions have recently eased back to accommodative territory (driven by lower CDS spreads and long-term rates) and business confidence has rebounded, as markets have reacted positively to the election of Jair Bolsonaro and the incoming administration's hawkish remarks on fiscal policy, liberal-minded economic policies, and market-friendly appointments to the economic team. For instance, the CNI business confidence indicator rose a high 17.7% mom sa in November (or a 1.3 standard deviation increase).

Exhibit 4: Brazil: Financial Conditions Back to Accommodative Territory



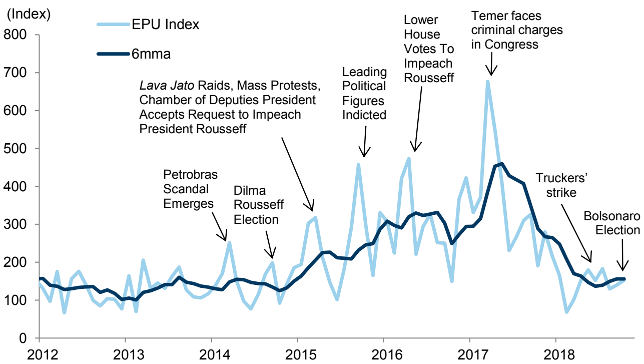
Source: Goldman Sachs Global Investment Research

Exhibit 5: Brazil: Sharp Recovery in Business Confidence after October Elections



Source: CNI, Goldman Sachs Global Investment Research

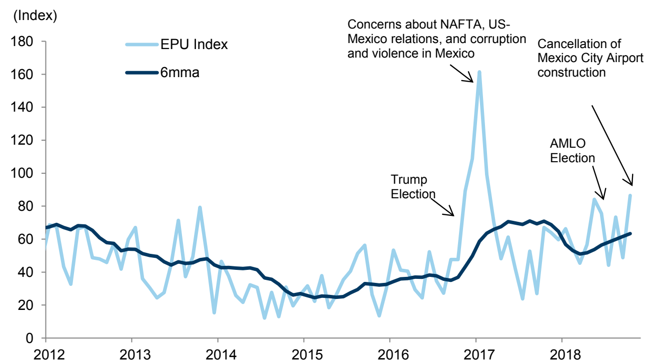
Exhibit 6: Brazil: Uncertainty High but Relatively Contained
Economic Policy Uncertainty Index



In each month, the EPU index is based on the count of articles containing the terms "incerto" or "incerteza", "econômico" or "economia", and one or more of the following policy-relevant terms: regulação, déficit, orçamento, imposto, banco central, alvorada, planalto, congresso, senado, câmara dos deputados, legislação, lei, tarifa. To obtain the EPU rate, the raw EPU count is scaled by the number of all articles in the same newspaper and month. The resulting series is multiplicatively rescaled to a mean of 100 from January 1991 to December 2011.

Source: policyuncertainty.com, Goldman Sachs Global Investment Research

Exhibit 7: Mexico: Uncertainty Increasing at the Margin Since Early 2018
Economic Policy Uncertainty Index

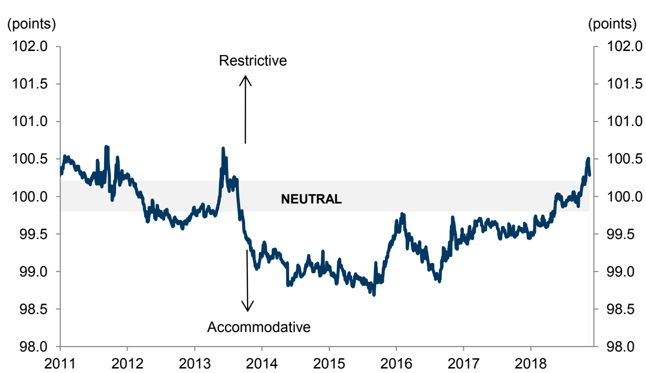


For each month, the EPU index is based on the count of articles in El Norte, Mural, and Reforma containing the terms "incierto" or "incertidumbre", "económica" or "economía", and one or more policy-relevant terms. To obtain the EPU rate, the raw EPU count is scaled by the number of all articles in the newspaper within the month, and normalized to a mean of 100.

Source: policyuncertainty.com, Goldman Sachs Global Investment Research

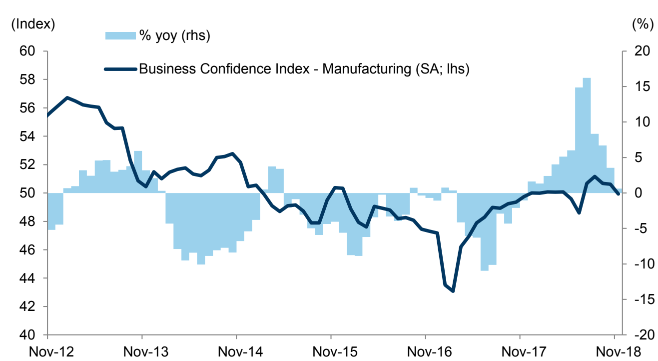
In **Mexico**, domestic political developments combined with a tense and volatile renegotiation of NAFTA on the external front to keep financial conditions tight, policy uncertainty high, and confidence subdued in 1H2018, which weighed down on the buoyancy of investment spending. In the immediate aftermath of Andrés Manuel López Obrador (AMLO) election in early July, business confidence rose and financial conditions eased as financial markets reacted positively to moderate and conciliatory statements from the president-elect. However, this soon gave way to renewed concern about a potential policy shift towards a more populist and heterodox stance following the new administration's poorly justified decision to cancel the construction of the partially-built Mexico City airport in October and recent legislative initiatives by AMLO's political base in Congress that signal a risk of deeper government intervention and tighter regulation over key sectors of the economy. As a result, sentiment has been deteriorating at the margin and financial conditions moved into restrictive territory, driven by additional policy rate hikes and rising risk-premia across Mexican assets.

Exhibit 8: Mexico: Financial Conditions Now in Restrictive Territory



Source: Goldman Sachs Global Investment Research

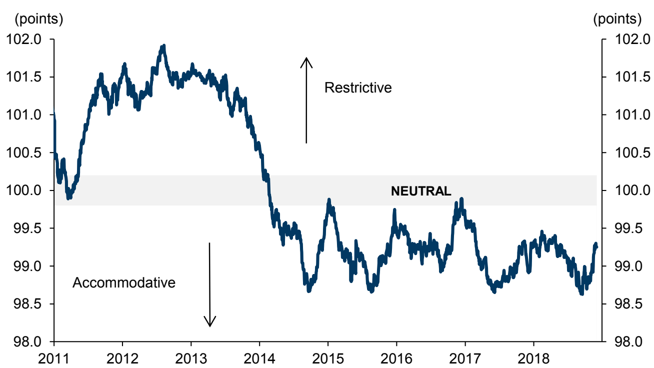
Exhibit 9: Mexico: Business Confidence Deteriorating at the Margin



Source: INEGI, Goldman Sachs Global Investment Research

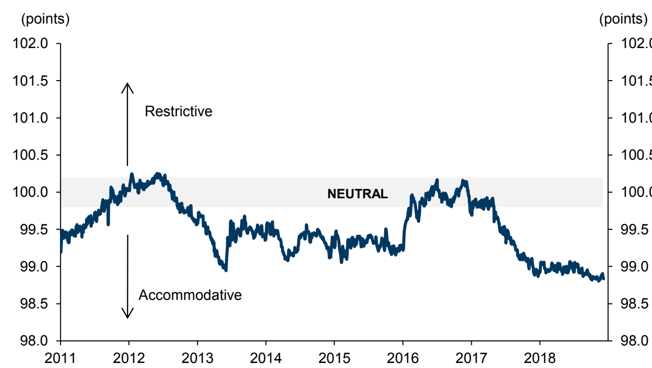
Surprises weren't all negative in Latin America, however. The small open Andean economies were the bright spots of the region and saw their growth outlooks improve. **Chile**, **Colombia**, and **Peru** better withstood the more challenging global backdrop, aided by solid domestic and external macro fundamentals and market-friendly political transitions that kept policy uncertainty contained and financial conditions comfortably in accommodative territory (Exhibits 10 and 11). Sentiment also broadly strengthened throughout the year and remained supportive of growth, especially in Chile. Activity indicators therefore surprised mostly on the upside, driven by recovering investment and consumption spending. Recently, confidence has declined at the margin in Chile and Colombia amid increasing political challenges faced by the new administrations, but financial conditions remained supportive of activity.

Exhibit 10: Financial Conditions Remain Accommodative in Chile...
Chile FCI



Source: Goldman Sachs Global Investment Research

Exhibit 11: ...As Well as in Colombia
Colombia FCI



Source: Goldman Sachs Global Investment Research

Exhibit 12: Financial Conditions Have Tightened in Mexico but Remain Accomomodative in Brazil and the Andeans

Financial Conditions Index

	End-2016	End-2017	Current	End-16/Current (bp)	End-17/Current (bp)
Brazil	101.3	99.4	99.4	-190	1
Chile	99.8	99.1	99.1	-65	-2
Colombia	99.9	98.9	98.9	-103	-8
Mexico	99.4	99.6	100.3	94	76
Peru	99.6	99.0	98.6	-98	-39

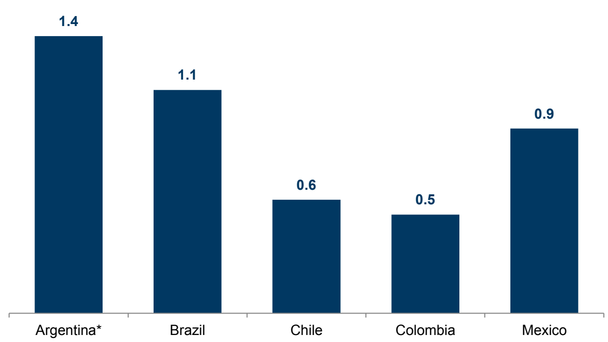
Source: Goldman Sachs Global Investment Research

Sentiment as a Driver of Activity

In order to gauge the impact of confidence and uncertainty on growth in LatAm, we estimate their impact on GDP growth for different countries. In theory, these factors should affect the decisions of economic agents, as they are mostly forward-looking variables. 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.

Our findings confirm this hypothesis. As evident in Exhibit 13, a one standard deviation rise in **business confidence increases real GDP by 0.5-1.4pp**. Confidence has the highest impact in Argentina, followed by Brazil and Mexico, while Colombia experiences the smallest effect at a still-significant 0.5pp of GDP. Conversely, a similar rise in **economic policy uncertainty**[1] produces a **negative response in real growth of between -0.4 and -0.7pp** (Exhibit 14)**.** This impact is highest in Brazil and lowest in Mexico. These effects are statistically significant for all countries.

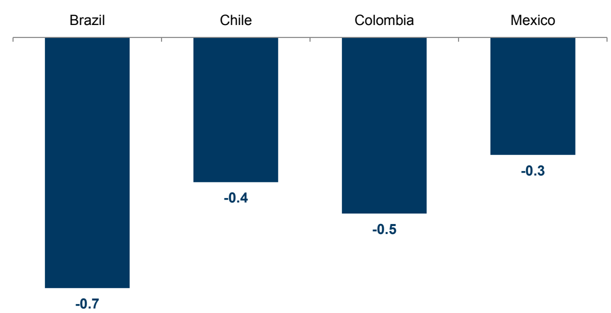
Exhibit 13: Business Confidence Provides a Positive Impulse to Activity...
Impulse responses of real GDP to 1 S.D. Business Confidence Shock (pp)



*We estimate the GDP response to a consumer confidence shock in Argentina, as no business confidence index is available. The available series for business confidence for Peru is not long enough for a satisfactory estimation.

Source: Goldman Sachs Global Investment Research

Exhibit 14: ...While High Policy Uncertainty Drags Growth
Impulse responses of real GDP to 1 S.D. Economic Policy Uncertainty Shock (pp)



No estimate for Argentina or Peru due to unavailability of Economic Policy Uncertainty Index.

Source: Goldman Sachs Global Investment Research

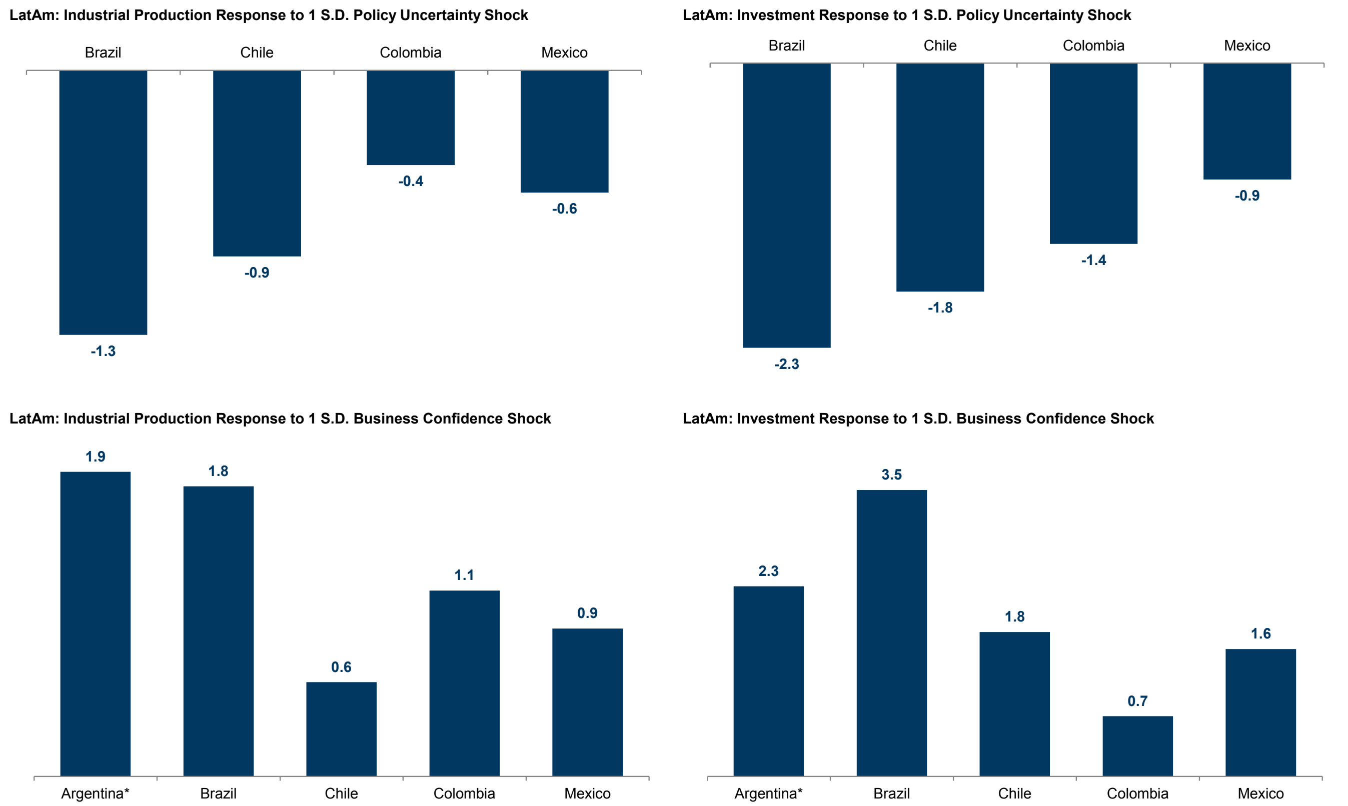
We also tested for these effects on industrial production and gross fixed investment (Exhibit 15). The direction of responses are similar to that of GDP and statistically significant for all countries, and the **magnitude of the investment response was consistently larger**, which is in line with the theoretical assumption that the investment channel is one of the key ways through which sentiment and financial conditions affect real activity.[2]

[1] As measured following the approach outlined in Baker, Bloom & Davis, "Measuring Economic Policy Uncertainty", November 2016. Indices are available at policyuncertainty.com.

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

Exhibit 15: IP and Investment Responses are Larger than GDP Responses Across the Board

Impulse responses to Industrial Production and Gross Fixed Investment to Shocks in Confidence and Uncertainty (pp)



Source: Goldman Sachs Global Investment Research

Finally, we highlight that drawing causal inferences from a vector autoregression (VAR) model as the one used above is challenging, as uncertainty and confidence can respond to either current or future economic conditions. However, these models are still useful in identifying dynamic relationships between the macro variables in question: they allow us to measure the extent to which changes in confidence or policy uncertainty affect future activity when controlling for other macro and policy variables.

Talk the Talk and Walk the Walk

The developments in Latin America in 2018 as well as our empirical results show that variations in sentiment matter for growth. The sharp decline in confidence in **Argentina**, coupled with tight financial conditions, should remain a headwind to real activity in 2019: we currently expect a -0.6% real GDP variation in 2019, adding to the forecasted -2.3% in 2018. In **Mexico**, early signs of deteriorating sentiment and additional monetary and financial tightening are set to intensify the headwinds to the growth outlook: we currently forecast a deceleration of real GDP growth to below-trend sub-2% next year. On the other hand, the recent significant rebound in business confidence (+1.3 standard deviation in November) and lower uncertainty in **Brazil** should likely contribute to a firmer cyclical recovery next year, by, among other things, boosting the impact of stimulative financial conditions. The same is true for the small Andean economies, where we expect around-trend growth in 2019, with a soft-landing in **Chile** and growth firming in **Colombia** and **Peru**.

We expect an uneven and patchy recovery in Latin America for 2019, and the forecasted modest acceleration in aggregate growth is still conditional on keeping financial conditions and policy uncertainty contained and consumer and business sentiment indicators in positive territory. To achieve that, authorities should look at maintaining an investment-friendly environment and, most importantly, at implementing disciplined macroeconomic policies. In Argentina, this implies staying the course on the macro adjustment, with a successful implementation of the IMF program in an election year, in order to boost sentiment and to transition gradually to a less restrictive monetary policy set-up and financial conditions backdrop. In Mexico, it involves preserving the current orthodox and investment-friendly policy orientation - in particular, responsible fiscal, credit, wage, monetary, and FX policies. Finally, in Brazil, further progress towards fiscal consolidation to stabilize the unsustainable public debt dynamics is necessary to keep sentiment and financial conditions supportive of growth; failure to do so could hurt confidence, tighten financial conditions, and ultimately undermine the forecasted economic recovery.

Gabriel Fritsch

LatAm and Global Macroeconomic Outlook

Consolidated Latin America Selected Economic Indicators

	2011	2012	2013	2014	2015	2016	2017	2018F	2019F	2020F	2021F	2022F
I. Economic Activity and Prices												
Nominal GDP (US$bn)	5,083	5,078	5,223	5,182	4,366	4,168	4,648	4,435	4,715	5,171	5,608	5,979
Real GDP growth (% yoy)	4.6	2.6	2.8	1.3	0.3	-0.2	1.7	1.5	2.2	2.7	3.0	3.1
CPI Inflation (% yoy)	7.3	6.6	7.1	8.7	9.0	8.8	6.5	8.6	6.6	4.9	4.2	3.8
Domestic Demand (% yoy)	6.0	2.7	3.0	1.0	-0.7	-1.0	1.8	2.3	1.8	2.8	3.2	3.2
II. External Sector (US$bn)												
Current Account Balance	-111.8	-122.3	-152.2	-170.9	-140.5	-83.0	-77.2	-82.8	-84.8	-106.9	-130.1	-153.4
Trade Balance	64.9	46.7	9.8	-3.6	-10.7	34.6	57.4	49.1	50.5	38.9	27.5	14.0
Gross International Reserves	663.6	722.6	715.9	737.9	705.2	729.3	751.7	757.1	774.3	794.2	810.4	826.0
Change in Reserves	109.2	59.0	-6.8	22.0	-32.7	24.1	22.4	5.5	17.2	19.9	16.2	15.6
Net Capital Inflows	221.0	181.3	145.5	192.9	107.9	107.1	99.6	88.2	102.0	126.8	146.3	169.0
Foreign Direct Investment	148.2	155.4	168.1	176.8	164.2	150.0	143.1	149.1	155.8	162.6	172.6	182.6
III. Public Finance and Indebtness (% GDP)												
Primary Fiscal Balance	1.3	0.8	0.4	-0.9	-1.7	-1.8	-1.0	-0.9	-0.2	0.0	0.4	0.5
Overall Fiscal Balance	-2.1	-2.1	-2.5	-4.3	-6.3	-5.6	-4.7	-4.6	-4.1	-3.9	-3.5	-3.3
Total Public Sector Debt	41.4	42.0	42.1	46.2	51.3	55.1	56.0	58.2	60.4	61.0	61.0	61.2
Total External Debt	22.2	24.7	26.1	29.1	34.5	36.8	34.8	37.7	38.8	38.2	37.7	37.6

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

Source: Goldman Sachs Global Investment Research

Global Macroeconomic Framework

						2018				2019F			
	2016	2017	2018F	2019F	2020F	Q1	Q2	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
Real GDP Growth (%, yoy)													
United States	1.6	2.2	2.9	2.5	1.6	2.6	2.9	3.0	3.1	3.1	2.7	2.2	2.0
Euro Area	1.9	2.5	1.9	1.6	1.6	2.4	2.2	1.7	1.4	1.5	1.4	1.7	1.7
Japan	1.0	1.7	0.9	1.0	0.6	1.1	1.4	0.3	0.6	1.3	0.8	1.4	0.6
World Economy	3.1	3.7	3.8	3.5	3.6	4.0	4.0	3.6	3.6	3.5	3.4	3.6	3.6
CPI Inflation (%, yoy)													
United States	0.9	2.1	2.5	1.7	2.3	2.3	2.6	2.6	2.3	1.6	1.7	1.8	1.8
Euro Area	0.2	1.5	1.8	1.3	1.2	1.3	1.7	2.1	2.0	1.7	1.4	1.1	1.0
Japan	-0.1	0.5	1.0	1.0	1.4	1.3	0.6	1.1	1.0	0.9	0.8	0.7	1.4
Interest rates (%, e.o.p)													
Fed Funds	0.54	1.30	2.38	3.38	3.38	1.51	1.82	1.95	2.38	2.63	2.88	3.13	3.38
UST 10-Year	2.45	2.40	3.20	3.50	3.30	2.74	2.85	3.05	3.20	3.30	3.40	3.50	3.50

Source: Goldman Sachs Global Investment Research

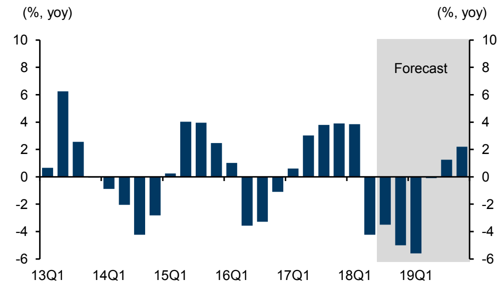
LatAm Country Data Tables

Argentina

	2016	2017	2018F	2019F
Activity and Prices				
Real GDP Growth (% yoy)	-1.8	2.9	-2.3	-0.6
Nominal GDP (US$bn)	554	637	526	442
Consumer Prices, IPC (yoy, e.o.p.)*	N.A	24.8	46.5	28.7
Consumer Prices, IPCBA (yoy, e.o.p.)*	41.0	26.1	44.8	28.7
External Sector				
Current Account (% GDP)	-2.7	-4.9	-5.3	-1.5
Trade Balance (% GDP)	0.8	-0.9	-0.5	3.1
Exports (% yoy)	2.0	0.9	3.8	12.0
Imports (% yoy)	-7.1	19.6	-0.8	-14.8
Exchange Rate ($/ARS, e.o.p.)	15.9	18.6	38.0	48.1
Gross International Reserves (US$bn)	39.3	55.1	57.5	59.0
Monetary Sector				
Monetary Base (% yoy)	26.6	24.7	33.0	18.0
Credit to the Private Sector (% GDP)	13.7	16.1	15.2	13.2
Reference Interest Rate	24.75	28.75	57.00	35.00
Fiscal Sector **				
Federal Govt Primary Balance (% GDP)	-4.3	-3.9	-2.5	0.0
Federal Govt Overall Balance (% GDP)	-5.9	-6.0	-5.3	-3.9

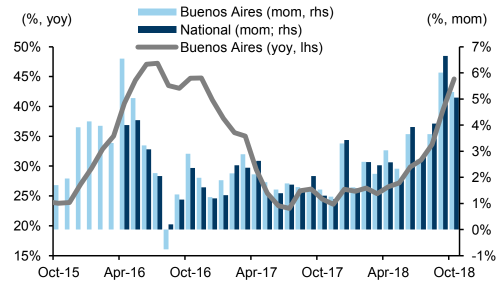
*IPC computed by INDEC, IPCBA by Statistical Institute City of Buenos Aires. **Before Rents from CB and Anses. Accumulated 4Q. *** Including non-performing debt.

Sharp Contraction in 2Q18



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

Deteriorating Inflation Dynamics



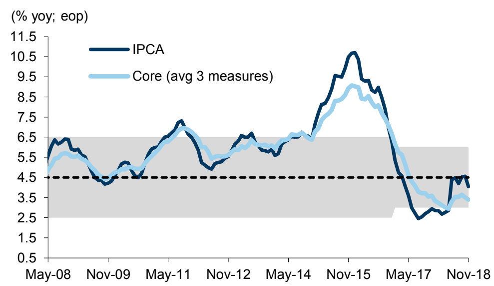
Source: INDEC, Statistical Inst. City of Buenos Aires, Goldman Sachs Global Investment Research

Brazil

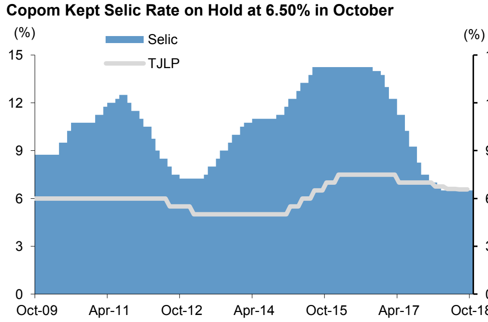
	2016	2017	2018F	2019F
Activity and Prices				
Real GDP Growth (% yoy)	-3.3	1.1	1.2	2.6
Nominal GDP (US$bn)	1,808	2,053	1,820	2,001
IPCA Inflation (yoy e.o.p)	6.3	2.9	3.7	4.3
External Sector				
Current account (% GDP)	-1.3	-0.5	-0.8	-1.7
Trade balance (% GDP)	2.5	3.1	3.0	2.0
Exports of goods (% yoy)	-3.0	17.8	9.2	5.5
Imports of goods (% yoy)	-19.1	9.9	19.7	14.0
Nominal Exchange Rate ($/BRL e.o.p.)	3.26	3.31	3.75	3.60
Net International Reserves (US$bn)	365	374	381	393
Monetary Sector				
Monetary base (% yoy)	5.9	9.8	7.0	8.0
Credit to the Private Sector (%GDP)	45.8	43.8	44.0	46.1
SELIC rate (e.o.p)	13.75	7.00	6.50	8.00
Fiscal Sector				
Public Sector Primary Balance (% GDP)	-2.5	-1.7	-1.9	-0.7
Public Sector Nominal Balance (% GDP)	-9.0	-7.8	-7.5	-6.4
Debt Indicators				
Gross general govt debt (% GDP)	70.0	74.0	77.0	79.0
Domestic public debt (%GDP)	66.3	0.0	73.5	75.4
External public debt (%GDP)	3.6	0.0	3.5	3.6
Total external debt (% GDP)	30.3	26.7	29.6	29.7

Source: Goldman Sachs Global Investment Research

Headline/Core Inflation Back to Target Range



Copom Kept Selic Rate on Hold at 6.50% in October



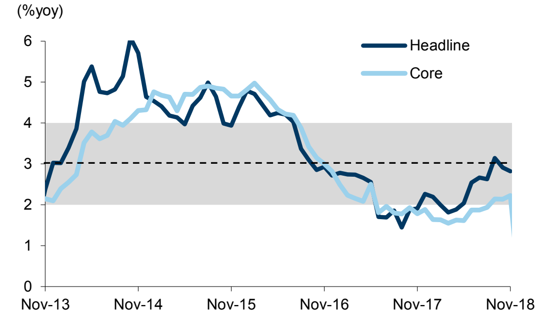
Sources: Bloomberg, Goldman Sachs Global Investment Research, Haver Analytics, IBGE

Chile

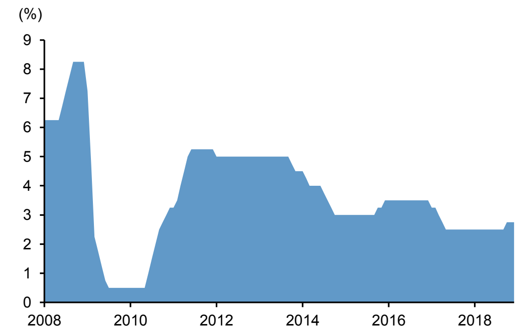
	2016	2017	2018F	2019F
Activity and Prices				
Real GDP Growth (% yoy)	1.3	1.5	4.0	3.6
Nominal GDP (US$bn)	250	277	298	319
Consumer Prices (% yoy, e.o.p.)	2.7	2.3	2.7	3.4
External Sector				
Current Account (% GDP)	-1.4	-1.5	-2.1	-1.7
Trade Balance (% GDP)	2.2	2.9	2.5	2.6
Exports (% yoy)	-2.1	14.0	11.7	5.7
Imports (% yoy)	-5.7	10.9	14.0	5.2
Exchange Rate ($/CLP, e.o.p.)	667	615	659	630
Gross International Reserves (US$bn)	40.5	39.0	37.3	37.6
Monetary Sector				
Broad Money (M3, % yoy)	8.2	4.8	9.0	9.0
Credit to the Private Sector (% GDP)	81.3	80.2	81.7	82.7
Policy Rate (e.o.p.)	3.50	2.50	2.75	4.00
Fiscal Sector				
Central Gov't Primary Balance (% GDP)	-2.0	-2.0	-1.0	-0.8
Central Gov't Overall Balance (% GDP)	-2.7	-2.8	-1.9	-1.7
Debt Indicators				
Central Govt Debt (% GDP)	21.0	23.6	24.2	24.7
Domestic (% GDP)	17.0	19.2	19.1	19.2
External (% GDP)	4.0	4.4	5.1	5.5
Total External Debt (% GDP)	66.7	65.4	62.8	60.5

Source: Goldman Sachs Global Investment Research

Headline Inflation Back to Target Range



Central Bank On Hold at 2.75% in December



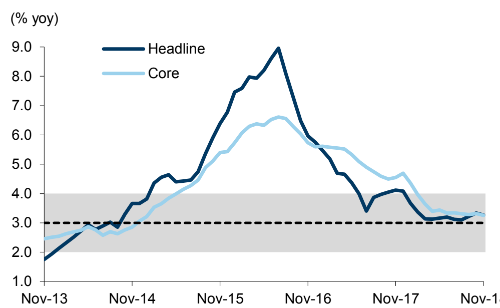
Source: Haver Analytics, INE, Central Bank of Chile

Colombia

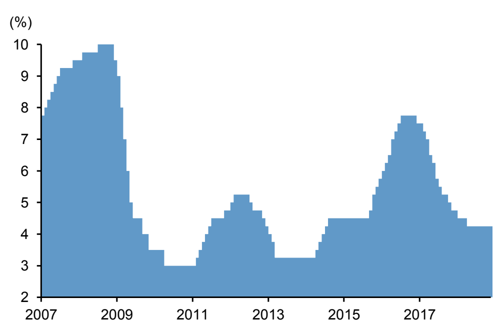
	2016	2017	2018F	2019F
Activity and Prices				
Real GDP Growth (% yoy)	2.0	1.8	2.6	3.2
Nominal GDP (US$bn)	283	314	334	350
Consumer Prices (% yoy, e.o.p.)	5.7	4.1	3.3	3.3
External Sector				
Current Account (% GDP)	-4.2	-3.3	-3.3	-3.5
Trade Balance (% GDP)	-3.2	-1.5	-1.1	-1.1
Exports (% yoy)	-11.6	16.4	12.6	4.8
Imports (% yoy)	-16.9	2.3	9.4	4.8
Exchange Rate ($/COP, e.o.p.)	3001	2984	3202	2950
Gross International Reserves (US$bn)	46.2	47.1	47.3	49.0
Monetary Sector				
Monetary Base (% yoy)	2.5	5.0	7.0	9.0
Credit to the Private Sector (% GDP)	48.8	50.8	52.4	53.8
Policy Rate (% e.o.p.)	7.50	4.75	4.25	5.00
Fiscal Sector				
Central Government Primary Balance (% GDP)	-1.1	-0.8	-0.2	0.4
Central Government Overall Balance (% GDP)	-4.0	-3.6	-3.1	-2.4
Debt Indicators				
Gross Non-fin. Public Sector Debt (% GDP)	54.9	55.9	57.4	57.8
Domestic (% GDP)	31.1	33.0	34.9	35.3
External (% GDP)	23.7	22.8	22.5	22.5
Total External Debt (% GDP)	42.5	39.6	37.5	38.0

Source: Goldman Sachs Global Investment Research

Headline/Core Inflation Back to Target Range



Central Bank On Hold at 4.25% in October



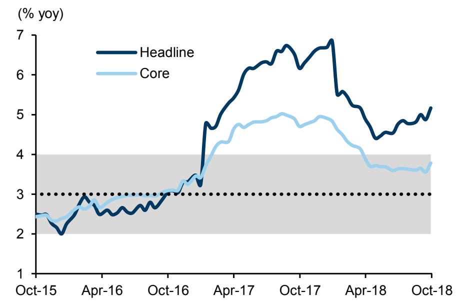
Source: Banco de la Repœblica

Mexico

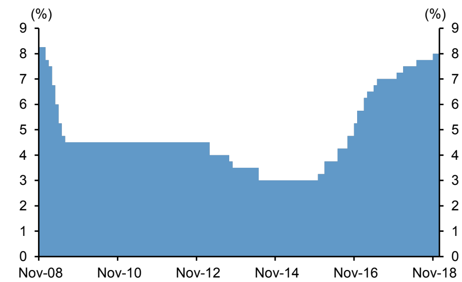
	2016	2017	2018F	2019F
Activity and Prices				
Real GDP Growth (% yoy)	2.9	2.1	2.1	1.9
Nominal GDP (US$ bn)	1078	1158	1222	1268
Consumer Prices (yoy, e.o.p.)	3.4	6.8	4.5	3.7
External Sector				
Current Account (% GDP)	-2.2	-1.6	-1.5	-1.6
Trade Balance (% GDP)	-1.2	-0.9	-1.0	-1.1
Exports (% yoy)	-1.7	9.5	10.2	4.9
Imports (% yoy)	-2.1	8.6	10.2	5.1
Exchange Rate ($/MXN, e.o.p.)	20.73	19.79	19.80	19.30
Net International Reserves (US$ bn)	176.5	172.8	174.0	174.0
Monetary Sector				
Monetary Base (% yoy)	14.4	8.8	11.8	10.3
Credit to the Private Sector (% GDP)	18.0	18.5	19.0	19.2
Tasa de Fondeo Rate (e.o.p.)	5.75	7.25	8.00	8.00
Fiscal Sector				
Public Sector Primary Balance (% GDP)	-0.1	1.4	0.9	0.5
Public Sector Overall Balance (% GDP)	-2.5	-1.1	-2.0	-2.4
Debt Indicators				
Gross Federal Govt Debt (% GDP)	48.7	45.8	45.5	45.6
Domestic (% GDP)	30.9	28.9	28.8	29.4
External (% GDP)	17.8	16.9	16.6	16.2
Total External Debt (% GDP)	38.5	37.9	37.2	37.7

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

Headline Inflation Has Likely Peaked



Banxico Hiked 25bp to 8.00% in November



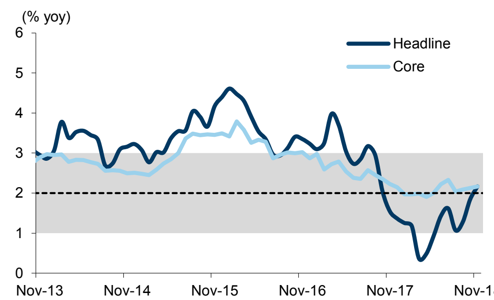
Source: Haver Analytics; INEGI; Goldman Sachs Global Investment Research.

Peru

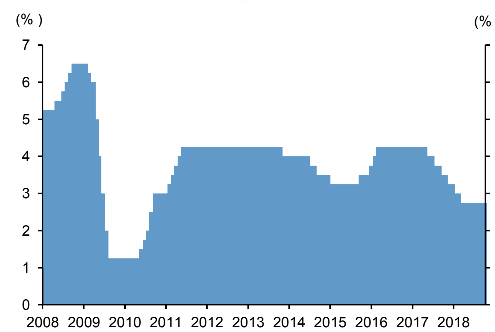
	2016	2017	2018F	2019F
Activity and Prices				
Real GDP Growth (% yoy)	4.0	2.5	3.8	4.0
Nominal GDP (US$bn)	195	215	226	243
Consumer Prices (% yoy, eop)	3.2	1.4	2.3	3.0
External Sector				
Current Account (% GDP)	-2.7	-1.1	-1.8	-2.1
Trade Balance (% GDP)	1.0	3.1	3.0	2.1
Exports (% yoy)	7.7	22.1	8.7	3.5
Imports (% yoy)	-5.9	10.2	9.9	8.0
Gross International Reserves (US$bn)	61.7	63.7	60.0	61.7
Exchange Rate ($/PEN, e.o.p.)	3.36	3.24	3.36	3.25
Monetary Sector				
Monetary Base (% yoy)	4.1	7.2	4.1	9.6
Credit to the Private Sector (% GDP)	24.4	23.7	27.0	29.0
Reference Interest Rate (e.o.p.)	4.25	3.25	2.75	4.00
Fiscal Sector				
Non-fin Pub. Sector Primary Balance (% GDP)	-1.4	-1.9	-1.8	-1.5
Non-fin Pub. Sector Overall Balance (% GDP)	-2.5	-3.1	-2.8	-2.6
Debt Indicators				
Total Federal Govt Debt (% GDP)	23.8	24.9	25.7	26.5
Domestic Public Debt (% GDP)	13.5	16.1	16.4	16.6
External Public Debt (% GDP)	10.4	8.7	9.3	9.8
Total External Debt (% GDP)	38.3	35.8	36.9	37.6

Source: Goldman Sachs Global Investment Research

Headline Inflation Back to Target Range

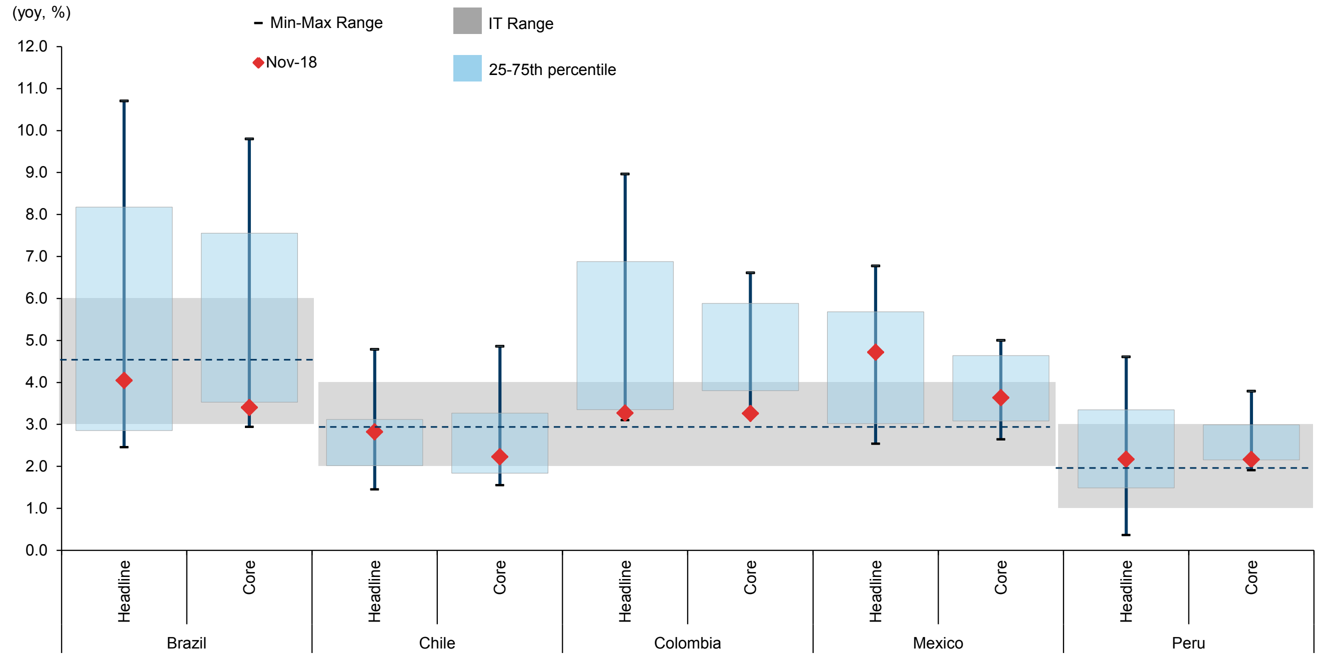


Central Bank On Hold at 2.75% in November



Source: BCRP, INEI, Goldman Sachs Global Investment Research

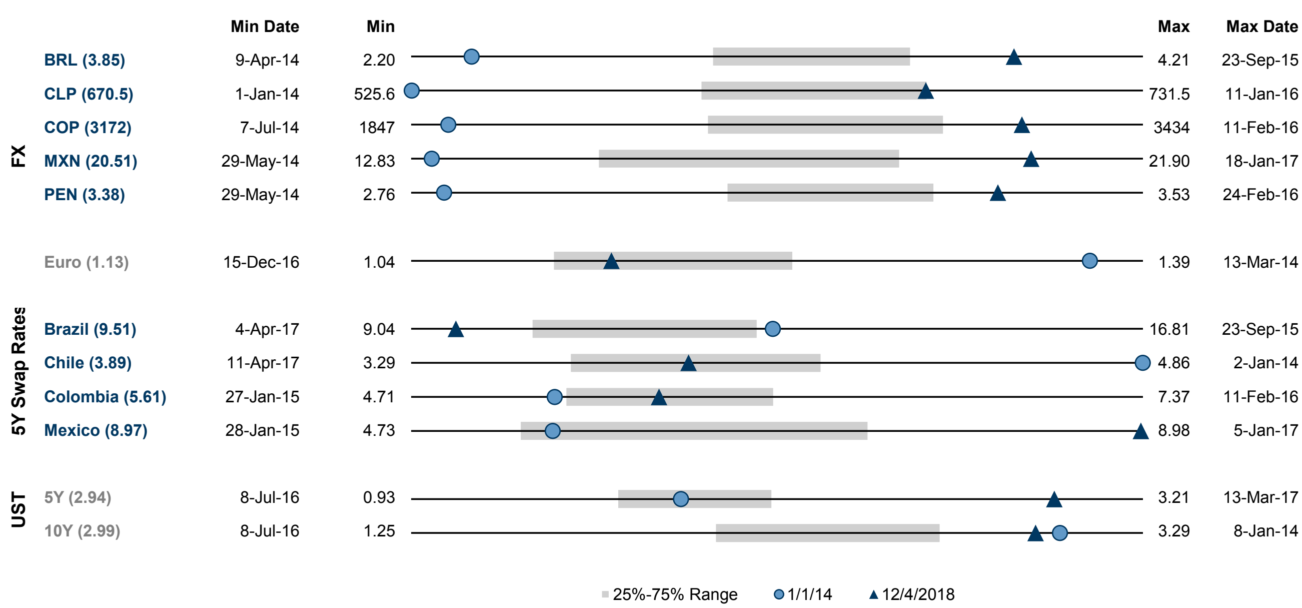
LAIT-5 Annual Headline and Core Inflation Dynamics Since January 2016



Source: Haver Analytics, Goldman Sachs Global Investment Research

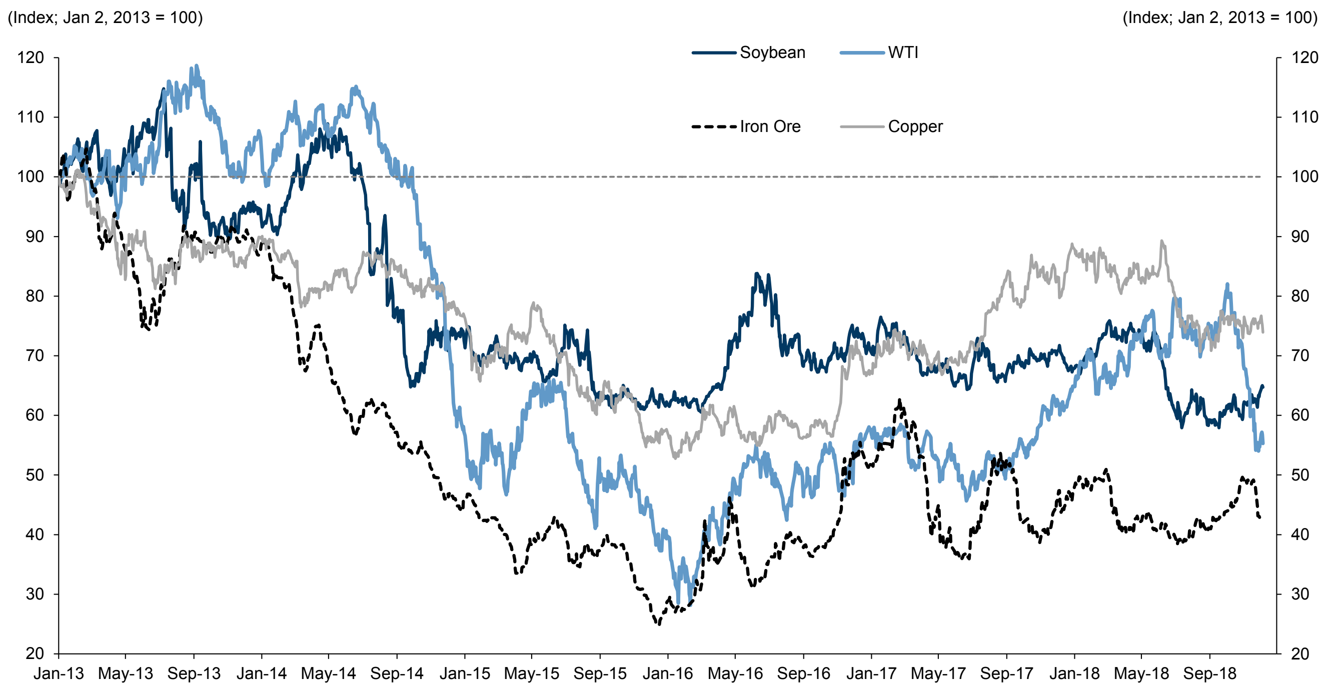
LatAm Financial Markets Outlook

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-2016	End-2017	Current (12/04/2018)	Change Since (bps) End-2016	Change Since (bps) End-2017
Swap Rates (%)	**Brazil**					
	2y	11.05	8.06	7.95	-310	-12
	10y	11.66	10.78	10.26	-140	-51
	Chile					
	2y	3.06	2.84	3.52	46	68
	10y	4.17	4.24	4.24	7	0
	Colombia					
	2y	5.61	4.44	4.89	-72	45
	10y	6.57	6.10	6.29	-28	20
	Mexico					
	2y	7.20	8.02	8.83	163	81
	10y	7.93	7.98	9.27	134	129
	United States					
	2y	1.45	2.08	2.96	151	88
	10y	2.34	2.42	2.98	64	56

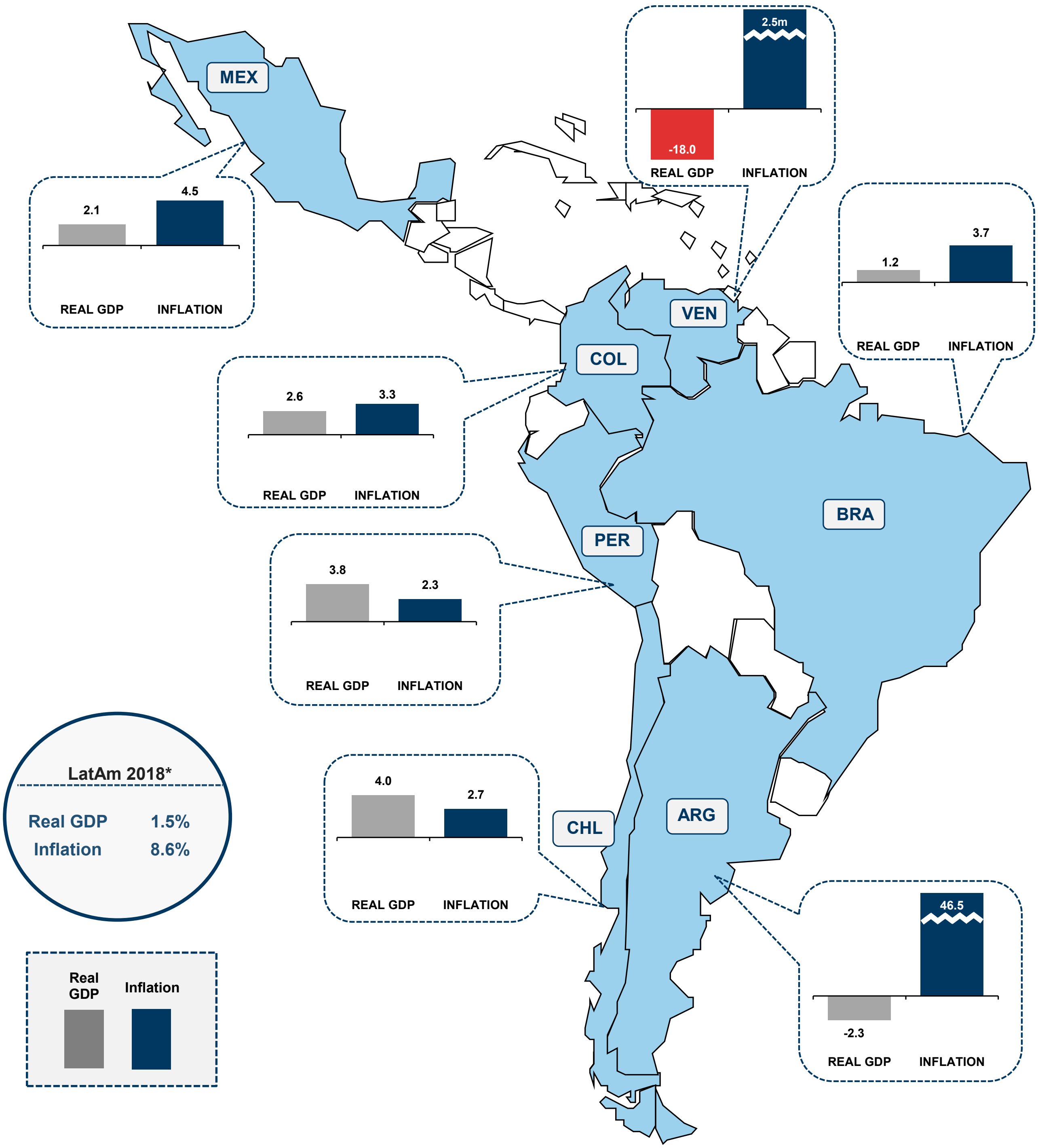
Source: Goldman Sachs Global Investment Research

Latin America Forecasts

		Policy Rates and FX Levels (End of Period)						Implied Change (Policy Rate in bps; FX in %)			
		Current	4Q2018	1Q2019	2Q2019	3Q2019	4Q2019	4Q2018	1Q2019	2Q2019	3Q2019
Policy Rate (%)	**Brazil**	6.50	6.50	6.50	7.25	7.75	8.00	0	0	75	125
	Chile	2.75	2.75	3.00	3.25	3.50	4.00	0	25	50	75
	Colombia	4.25	4.25	4.25	4.75	5.00	5.00	0	0	50	75
	Mexico	8.00	8.00	8.00	8.00	8.00	8.00	0	0	0	0
	Peru	2.75	2.75	3.00	3.25	3.75	4.00	0	25	50	100
FX (Local / USD)	**Argentina**	37.50	38.00	40.30	42.74	45.33	48.07	1.3%	7.5%	14.0%	20.9%
	Brazil	3.87	3.75	3.75	3.60	3.60	3.60	-3.0%	-3.0%	-6.9%	-6.9%
	Chile	672.70	658.6	646.7	638.3	633.3	630.0	-2.1%	-3.9%	-5.1%	-5.9%
	Colombia	3174.11	3202	3033	2992	2967	2950	0.9%	-4.4%	-5.7%	-6.5%
	Mexico	20.50	19.80	19.70	19.50	19.50	19.30	-3.4%	-3.9%	-4.9%	-4.9%
	Peru	3.38	3.36	3.29	3.27	3.26	3.25	-0.6%	-2.8%	-3.5%	-3.8%

Source: Goldman Sachs Global Investment Research

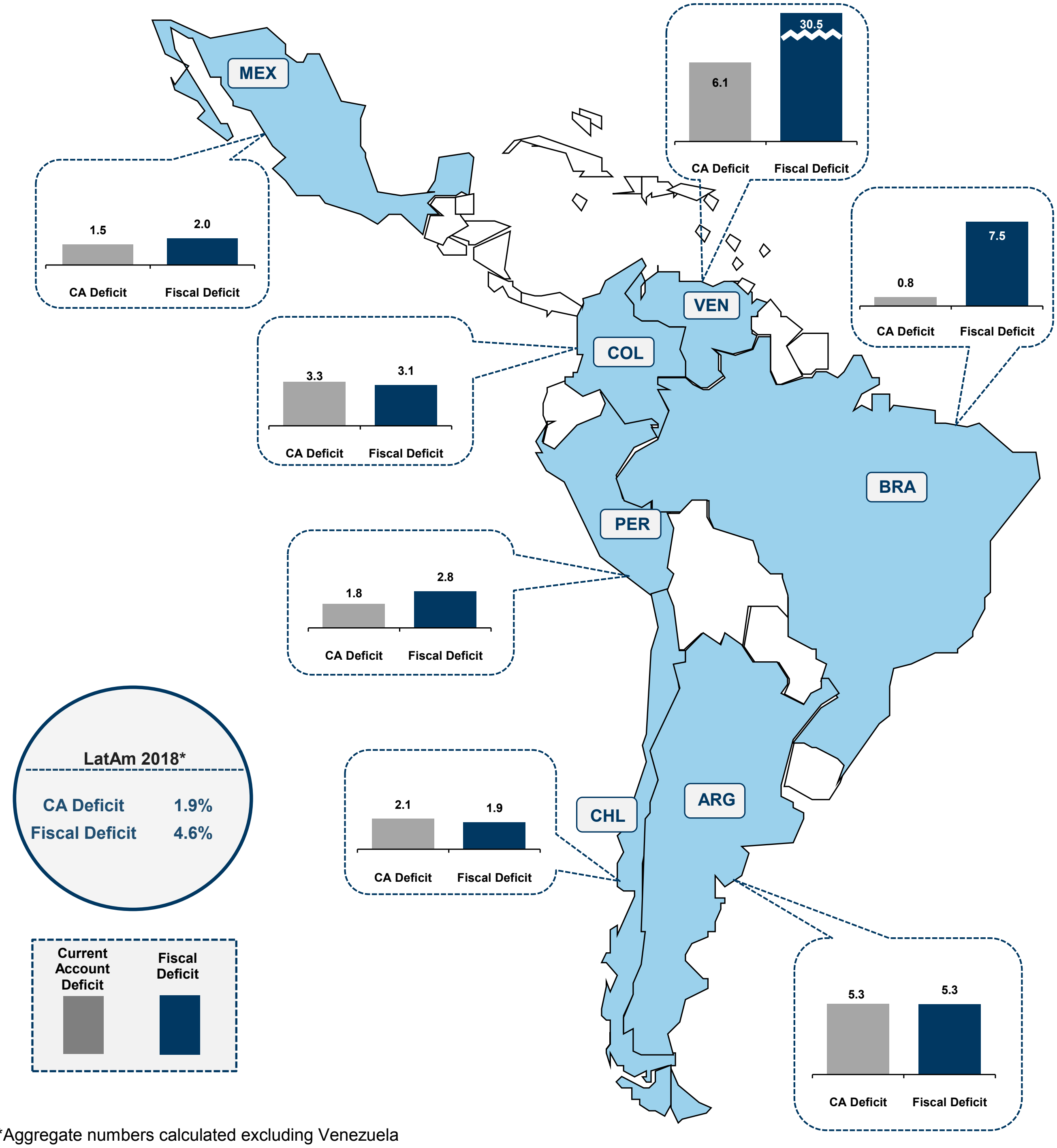
LatAm Outlook for 2018: Real GDP Growth and Inflation (YoY, %)



*Aggregate numbers calculated excluding Venezuela

Source: Goldman Sachs Global Investment Research

LatAm Outlook for 2018: Current Account and Fiscal Deficit (% of GDP)



Source: Goldman Sachs Global Investment Research

Calendar of Economic and Political Events

Date	Forthcoming Events	Comment
Brazil		
12-Dec	COPOM Meeting	We expect the Copom to leave the Selic policy rate unchanged at 6.50%.
Chile		
1-Feb	MPC Meeting	Following the pause in December, we expect the BCCh to hike the policy rate by another 25bp to 3.00%.
Colombia		
21-Dec	MPC Meeting	We expect Banrep to keep the policy rate at 4.25% in the near future.
Mexico		
20-Dec	MPC Meeting	The central bank MPC hiked the policy rate by 25bp, to 8.00%, at the November 15 meeting (with one dissenting director voting for a 50bp rate hike). The forward guidance/bias remained hawkish and vigilant, suggesting a significant risk of a follow-up 25bp rate hike at the December meeting.
Peru		
13-Dec	MPC meeting	We expect BCRP to keep the policy rate at 2.75%.

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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