

Latin American Prospects: Assessing the region's resilience to current global financial turmoil



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Latin America Strong Performance

Until Mid-2007, Latin America strongly benefited from a combination of two factors:

- A very positive International Environment
- Solid Domestic Macroeconomic and Financial Indicators

Latin America Strong Performance

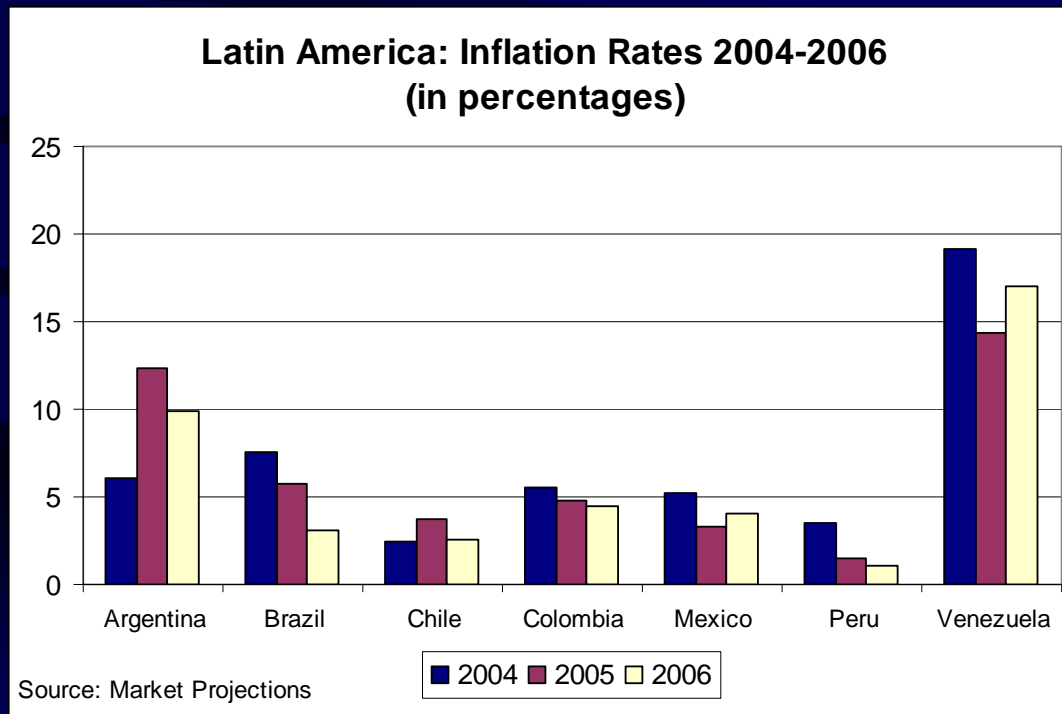
External factors: Latin America strongly benefited from:

1. Rapid global growth in the past four and a half years, which increased the demand for exports from the region.
2. Low interest rates in major industrialized countries which (a) allowed for the buy-back of external sovereign debt, and (b) increased appetite of foreign investors for Latin American securities.
3. Sharp increase in the price of commodities exported by the region, resulting in a positive terms of trade shock for many countries.

Latin America Strong Performance

Domestic factors:

1. Low Inflation Rates

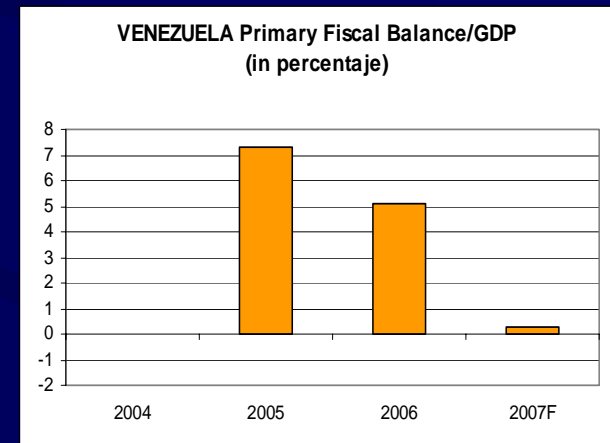
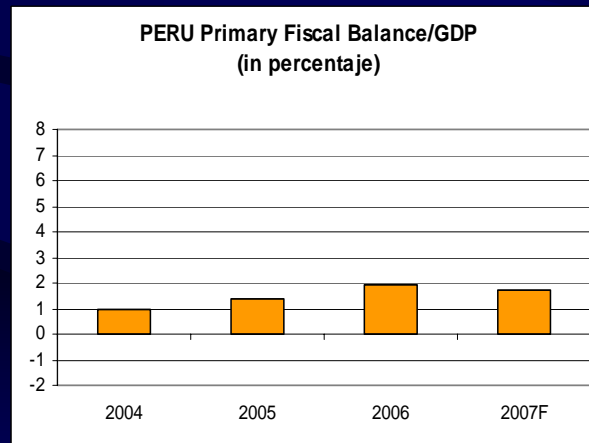
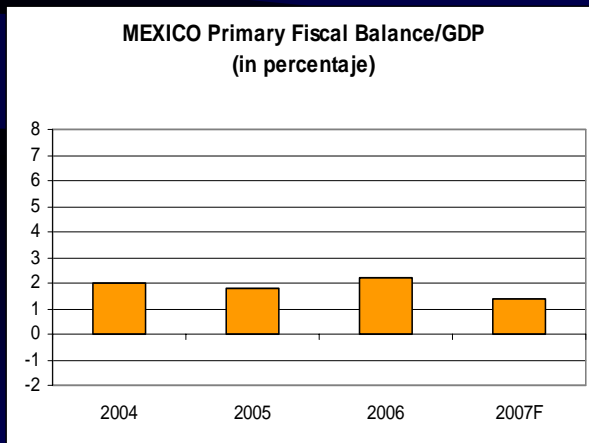
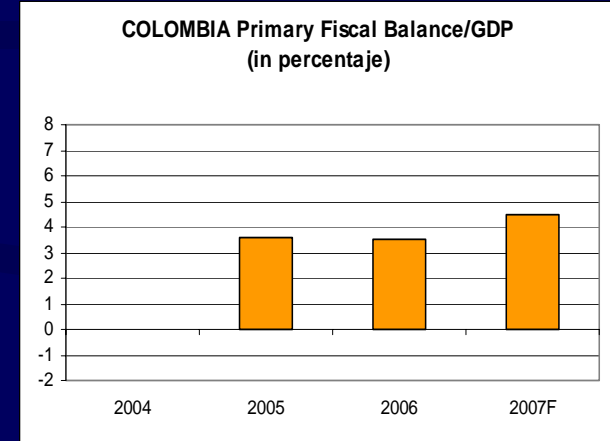
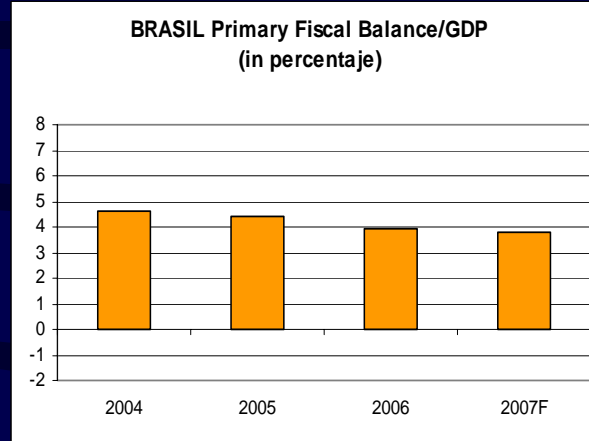
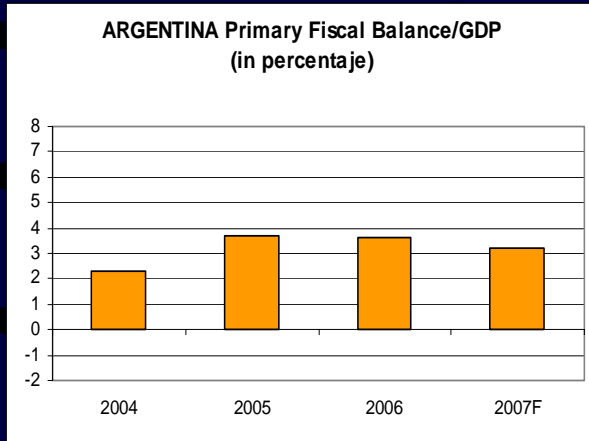


With the exception of Venezuela and, lately, Argentina

Latin America Strong Performance

Domestic factors:

2. Improved Fiscal Positions



Although with important differences between countries. For example, Venezuela's primary surplus is decreasing rapidly. Also, although Colombia's primary balance is strong, the Central Government still shows a large fiscal deficit (projected at 3.8% in 2007)

Latin America Strong Performance

Domestic factors:

2. Improved Regulatory Environment and some advances in reforms have led to better “Governance” indicators...

**World Bank Governance Indicators 1/
(Scores)**

	Voice and Accountability		Political Stability		Government Effectiveness		Regulatory Quality		Rule of Law		Control of Corruption		Average of Indicators	
	1996	2006	1996	2006	1996	2006	1996	2006	1996	2006	1996	2006	1996	2006
Argentina	0.39	0.27	0.11	-0.03	0.37	-0.19	0.81	-0.74	0.12	-0.58	-0.18	-0.47	0.27	-0.29
Brazil	0.13	0.37	-0.57	-0.09	-0.27	-0.11	0.39	0.00	-0.20	-0.48	-0.18	-0.33	-0.12	-0.11
Chile	0.53	1.15	0.44	0.85	0.95	1.25	1.30	1.41	1.24	1.15	1.29	1.31	0.96	1.19
Colombia	-0.30	-0.25	-1.42	-1.62	0.23	0.01	0.59	0.10	-0.65	-0.64	-0.52	-0.22	-0.34	-0.44
Mexico	-0.20	0.06	-0.83	-0.40	-0.04	0.16	0.65	0.43	-0.48	-0.49	-0.39	-0.35	-0.21	-0.10
Peru	-0.13	0.04	-1.28	-0.90	-0.13	-0.46	0.69	0.11	-0.58	-0.75	-0.14	-0.35	-0.26	-0.39
Venezuela	0.15	-0.58	-0.84	-1.24	-0.98	-0.88	-0.14	-1.35	-0.67	-1.39	-0.83	-1.05	-0.55	-1.08
OECD Countries	1.09	1.24	0.78	0.76	1.53	1.40	0.98	1.27	1.37	1.31	1.44	1.38	1.20	1.23

Source: World Bank, Aggregate Governance Indicators 1996-2006

1/ The six governance indicators are measured in units ranging from -2.5 to 2.5, with higher values corresponding to better governance outcomes.

...although most countries still have a long way to go. In opposite extremes are: Chile with an average of the indicators similar to the average for the OECD countries and Venezuela that has shown a deterioration in governance since the mid 1990s

Latin America Strong Performance

The combination of a favorable international environment and important progress in macro management has resulted in a series of upgrades of sovereign debt

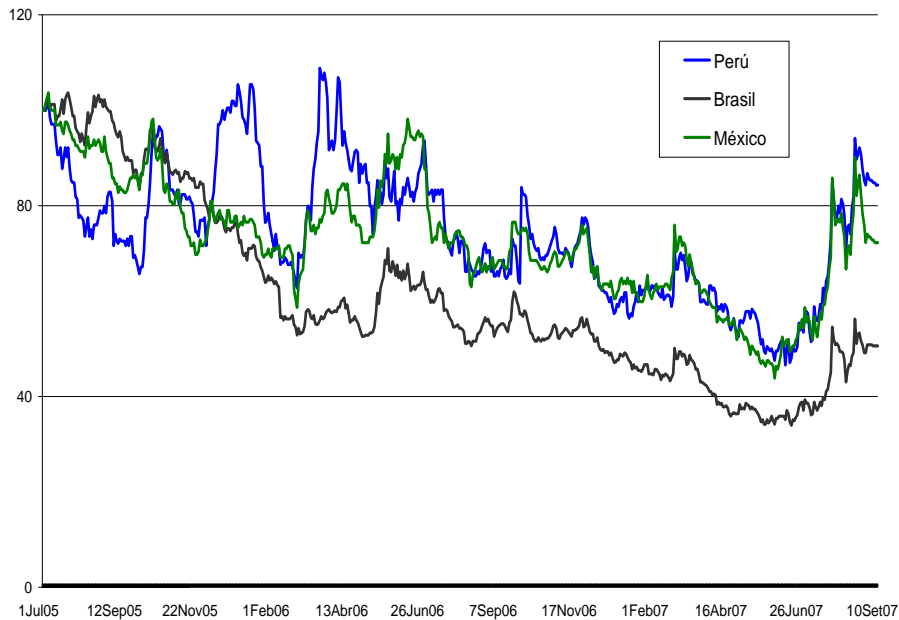
Long-Term Sovereign Debt Ratings in Foreign Currency

	Rating agencies														
	Moody's					Standard & Poor's					Fitch Ratings				
	2003	2004	2005	2006	2007	2003	2004	2005	2006	2007	2003	2004	2005	2006	2007
Argentina	Caa1	Caa1	Caa1	B3	B3	SD	SD	B-	B	B+	DDD	DDD	DDD	DDD	DDD
Brasil	B1	B1	Ba3	Ba2	Ba2	BB-	BB-	BB-	BB	BB+	BB-	BB-	BB-	BB-	BB+
Chile	Baa1	Baa1	Baa1	Aaa	A2	A	A	A	A	A	A-	A-	A-	A	A
Colombia	Ba2	Ba2	Ba2	Ba2	Ba2	BB	BB	BB	BB	BB+	BB	BB	BB	BB	BB+
Mexico	Baa1	Baa2	Baa2	Baa1	Baa1	BBB	BBB-	BBB	BBB	BBB	BBB-	BBB-	BBB	BBB-	BBB
Peru	Ba3	Ba3	Ba3	Ba3	Ba2	BB	BB	BB	BB	BB+	BB	BB	BB	BB	BB+
Uruguay	B3	B3	B3	B3	B1	B-	B	B	B	B+	B-	B	B	B+	BB-
Venezuela	Caa1	B2	Caa1	B2	B2	B-	B	B	BB-	BB-	B-	B+	B-	BB-	BB-

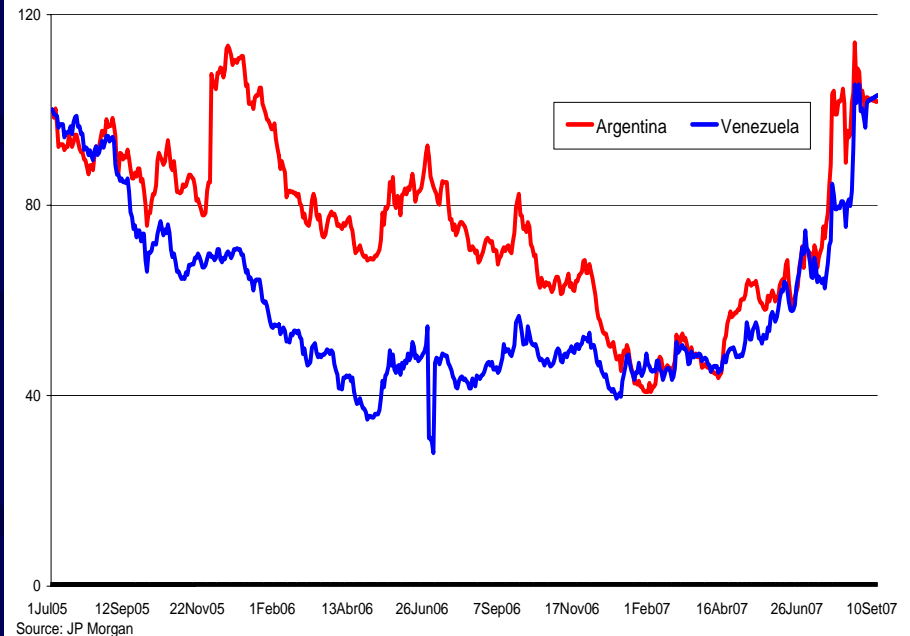
Source: Latin Focus, Moody's, Standard & Poor's, Fitch Ratings

The immediate impact of the Global Financial Turmoil on Latin America

Spread Embi + America Latina
(Jul 2005=100)



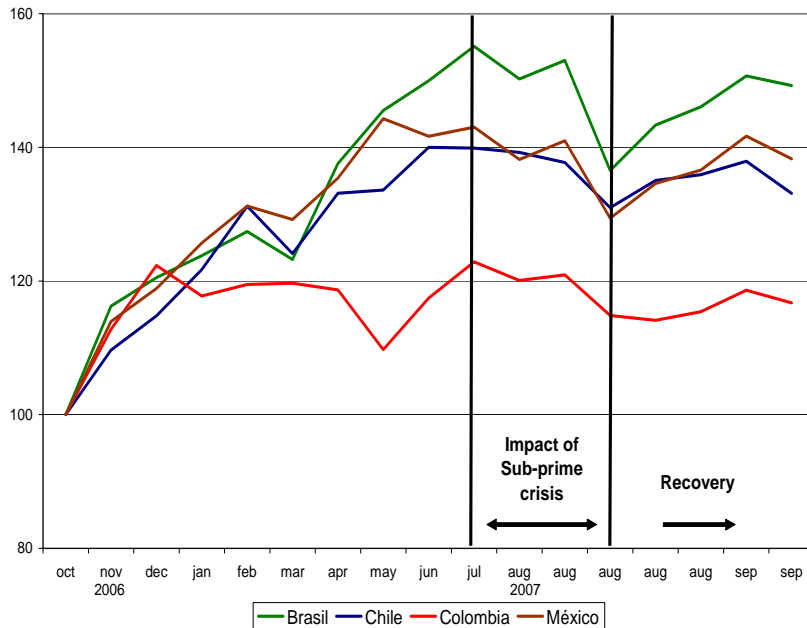
Spread Embi + America Latina
(Jul 2005=100)



- Although with lots of volatility, the impact on most Latin American countries spreads has not been dramatic. With the exception of Argentina and Venezuela, spreads are below the level of 2005
- Brazil stands out as the country least affected. In contrast to countries like Mexico and Colombia, exports of Brazil to the US as a percentage of total exports are less than 20 percent.

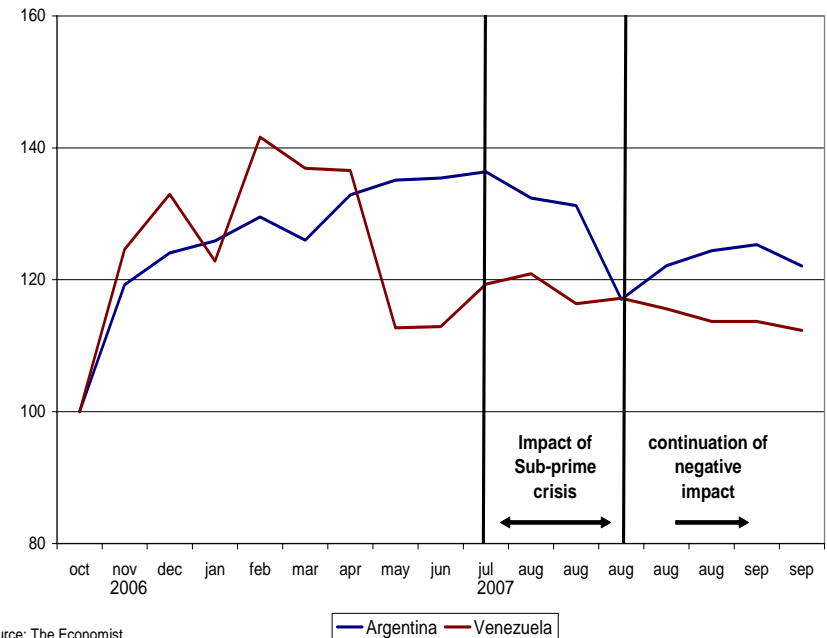
The immediate impact on Latin America of Sub-prime Crises

Latin America: Stock Market Index
(Oct2006=100)



Source: The Economist

Latin America: Stock Market Index
(Oct2006=100)



Source: The Economist

The impact on the local stock markets has also been mostly transitory, with strong differentiation among countries:

- In Brazil, Chile, Mexico and Peru, the strongest performers in the region, stock prices have almost recovered to their pre-August levels
- Although recovering, Colombia's fragilities keep stock market prices below the strongest countries in the region
- In Argentina and Venezuela, where vulnerabilities are more serious, stock market prices have not recovered.

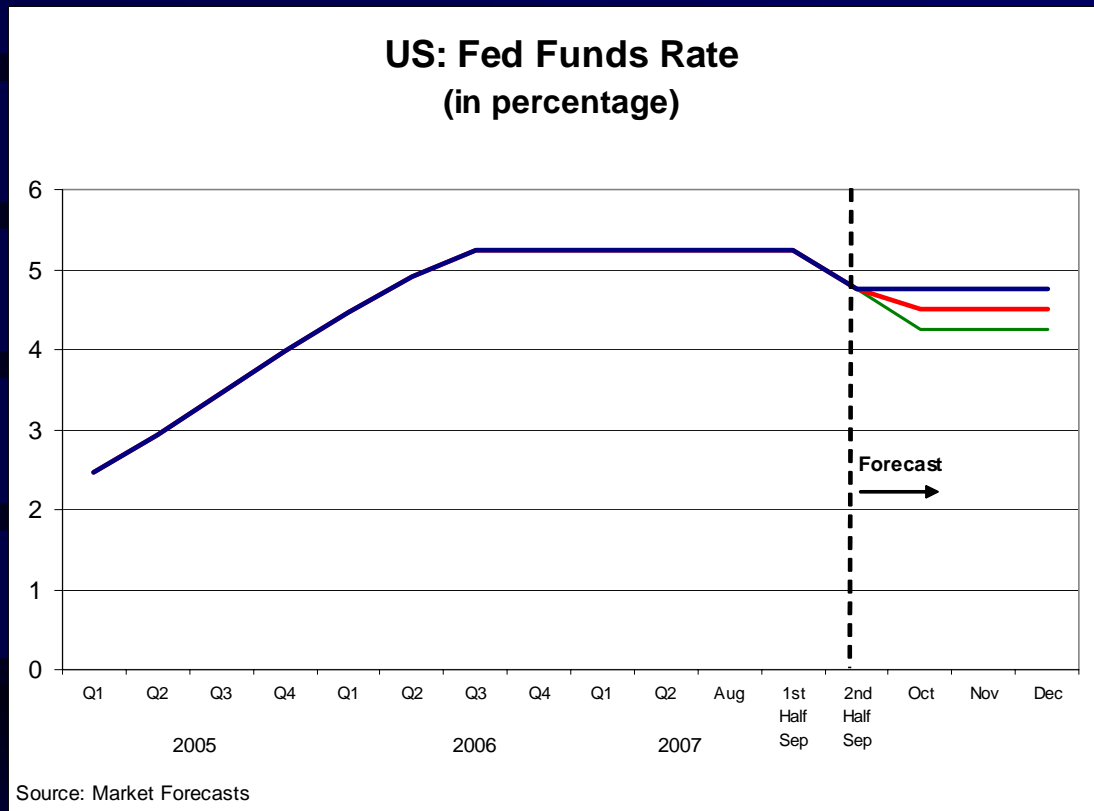
Looking forward: The risks to Latin America from the Global Financial Turmoil

- For the rest of 2007 and for 2008, the most important risk for Latin America's economic prospects is the possibility of a US recession driven by the possibility that the current crunch in mortgage credit markets and asset backed securities spread broadly to other credit markets (especially corporate credit markets).
- Concerns about a broad credit crunch remain because of:
 - Uncertainties about the extent of “bad assets” in the books of large financial institutions
 - Uncertainties about the extent of the Fed response to the liquidity squeeze

Looking forward: The risks to Latin America from the Global Financial Turmoil

- **What will the Fed do?**
 - While pleased by the half a point reduction in the Fed funds rate on September 18, markets are betting for further reductions.
 - Three reasons support this market expectation:
 1. Inflationary pressures in the US have declined
 2. Labor markets show an increase in the unemployment rate
 3. Severe liquidity shortages as reflected by the still very high interbank rates.

Looking forward: The risks to Latin America from the Global Financial Turmoil

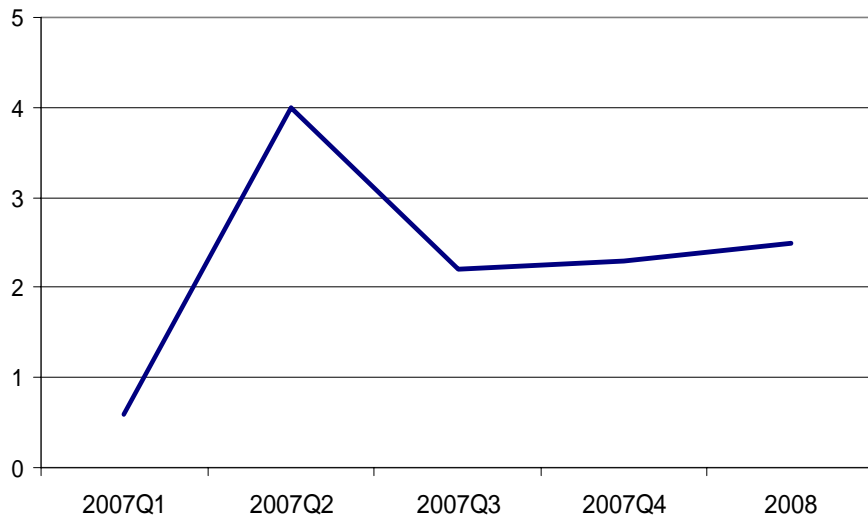


While there is a consensus about the decrease in Fed funds rate, there is no agreement about the extent of the decline...

Looking forward: The risks to Latin America from the Global Financial Turmoil

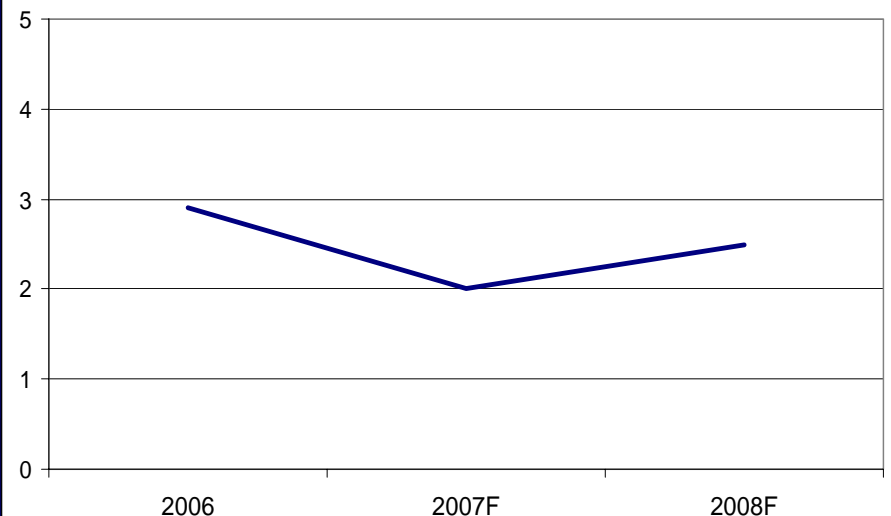
The markets' relatively positive outlook about the US economy: a slowdown, rather than a recession, is supported by IMF forecasts

US Quarterly GDP Growth Annualized Market Forecast (in percentages)



Source: Market Forecasts

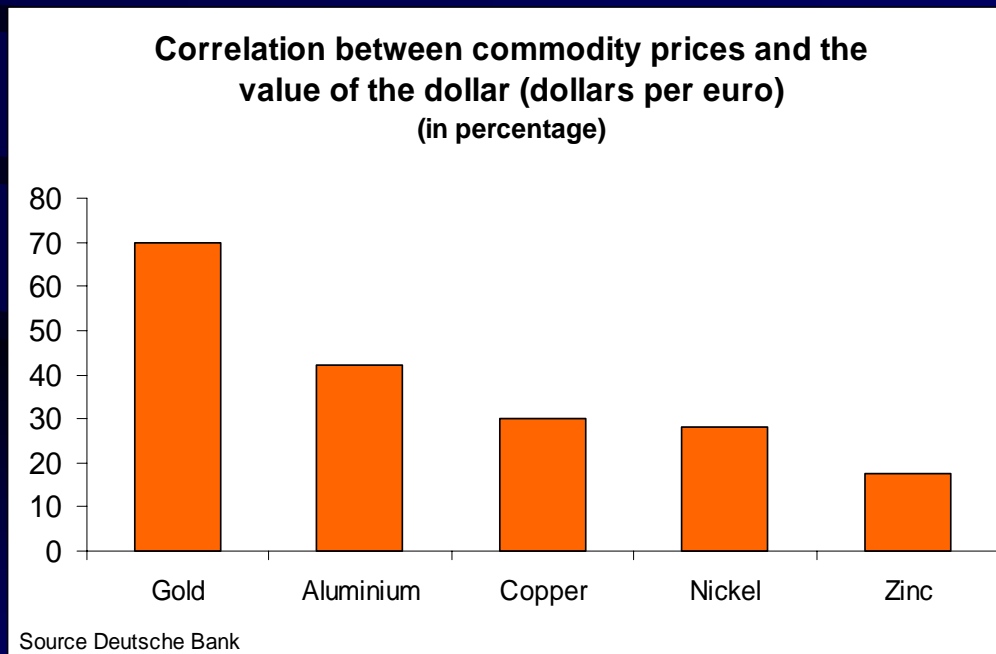
US Annual real GDP Growth Market Forecast (in percentages)



Source: Market Forecasts

The Most Likely Scenario: A Slowdown in the US Economy

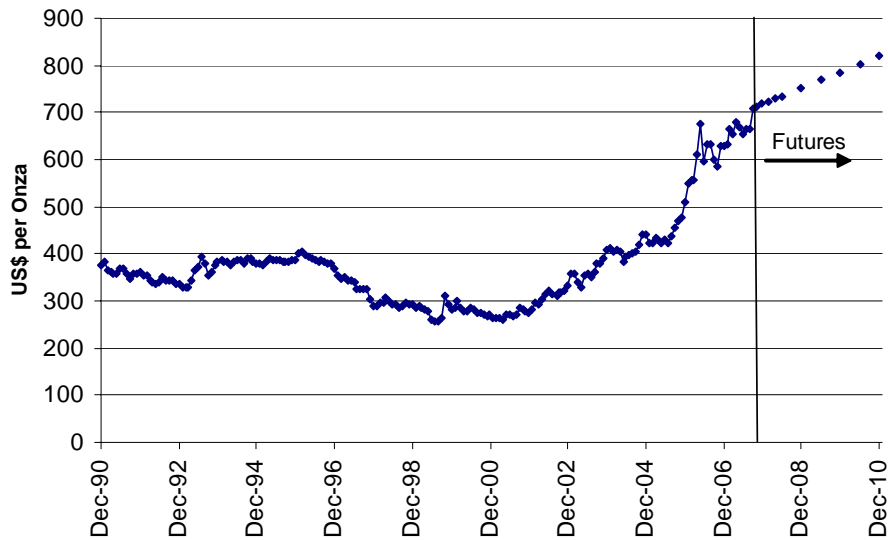
- In this scenario, the still large imbalances in the US (fiscal and current account balances) and the continuation of financial uncertainties, imply a further depreciation of the US dollar.
- Although the depreciation of the US dollar impinges negatively on the real value of foreign exchange reserves held by Latin American countries, the good news is that there is a positive correlation between the depreciation of the US dollar and the prices of the most important export minerals from Latin America.



- This is because at times of uncertainties, commodities are perceived as a safe haven

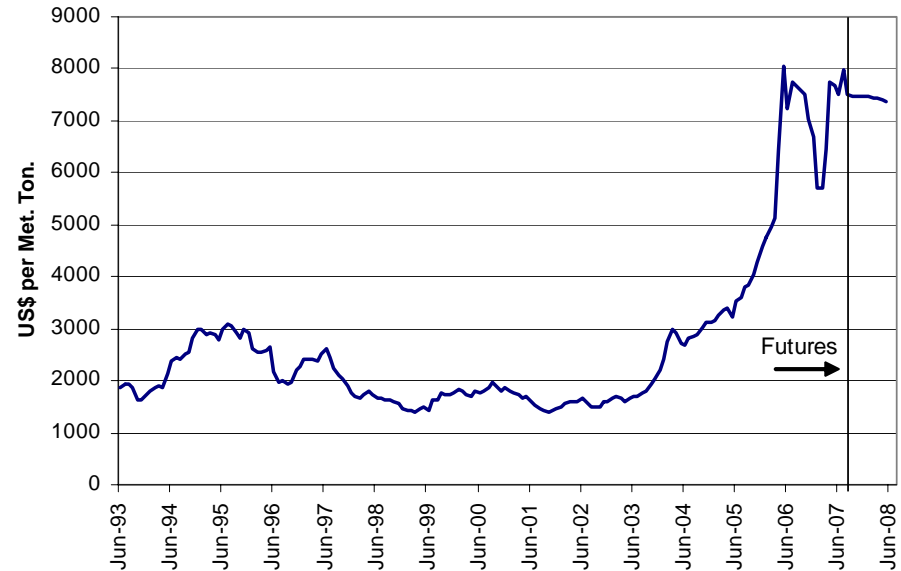
The Most Likely Scenario: A Slowdown in the US Economy

Gold Price: Spots & Futures



Source: IFS y NYMEX

Copper Price: Spot & Futures



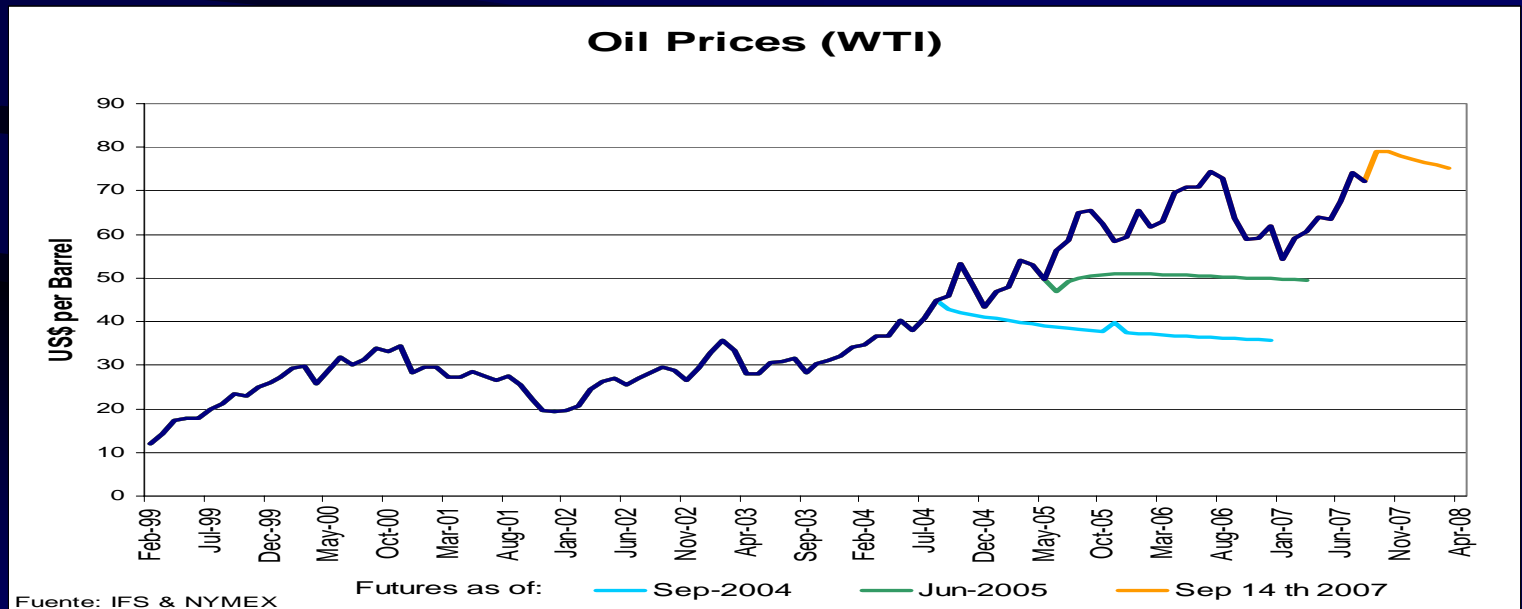
Source: IFS y NYMEX

- Thus, the combination of a weak dollar and financial uncertainties are contributing to a sustained increase in the price of gold as reflected in the future price
- In the case of other minerals, the expectation is still that activity in China and other Asian countries will sustain global demand for these commodities. In the case of copper, supply disruptions in mine production are supporting the maintenance of high prices

The Most Likely Scenario: A Slowdown in the US Economy

What about the price of oil? (an important commodity export for several Latin American countries)

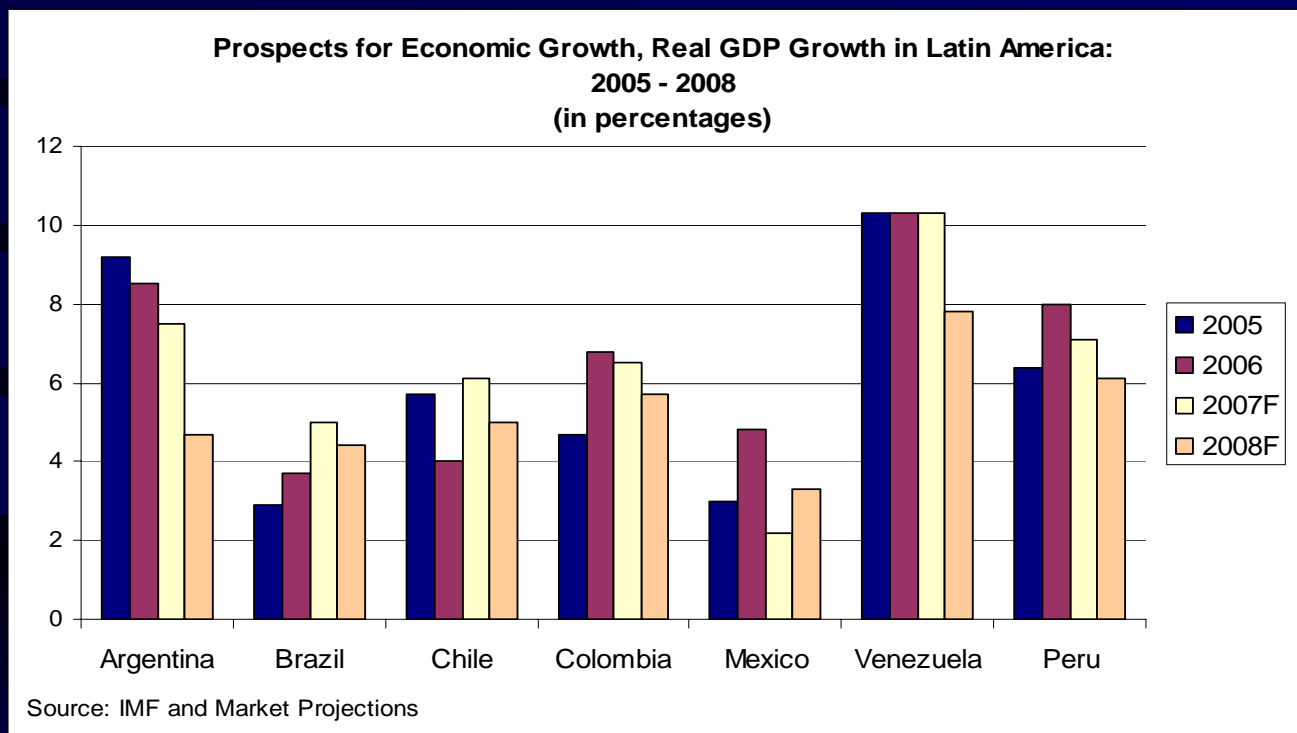
- Oil prices will continue at high levels in the remaining of 2007 and the beginning of 2008 mostly explained by:
 - A stable demand (China growth offsets US slowdown)
 - Uncertainty factors that keep supply at low levels, especially lagging non-OPEC supply



- Futures prices anticipate a modest decline
- But futures have not been effective predictors of oil returns in the past

Latin America in the Most Likely Scenario

Under the above conditions, Latin America's growth is expected to slowdown, but not severely.



This is because the region's strong fundamentals combined with the continuation of high export prices will partially offset weaknesses in US growth

Latin America in the Most Likely Scenario

However, differences among Latin American countries are becoming more pronounced, with Brazil, Peru, Chile and Mexico showing the most strength and Argentina and Venezuela the least

	Inflation Forecast	
	2007	2008
Argentina	8.6	11.9
Brazil	4	4.2
Chile	5.6	3.4
Colombia	5.5	3.6
Mexico	3.7	3.5
Peru	2.5	2.2
Venezuela	17	18

Source: Deutsche Bank

- Rising Inflation in Argentina might induce contractionary monetary policies that could exacerbate the economic slowdown. Moreover, expansionary fiscal policies and increases in wages prior to the October elections are weakening macroeconomic fundamentals.
- Forecasts for Venezuela's fiscal situation point to a sharp deterioration in spite of extremely high oil prices

And, if there is a US recession?

In that environment, risks appear both in the commercial and the financial sides:

- The US is the main trading partner for Latin America. A US recession would adversely affect exports from the region.
- The US is a major importer of many non-oil commodities (copper, silver, gold, tin, zinc, coffee, sugar). A US recession could lead to a decline in commodity prices.
- A US recession would increase investors “risk aversion”.

By adversely affecting economic activity in Latin America, a US recession would hurt prices and activity in local stock and bond market and would increase international spreads on sovereign bonds

And, if there is a US recession?

- However, even under a US recession, most Latin American countries would be on solid ground to absorb the shock in a relatively short period of time
- There are two main reasons:
 - Huge accumulation of international reserves
 - Very low correlation in GDP growth between China and the US

And, if there is a US recession?

Latin America: International Reserves (US\$ billion)

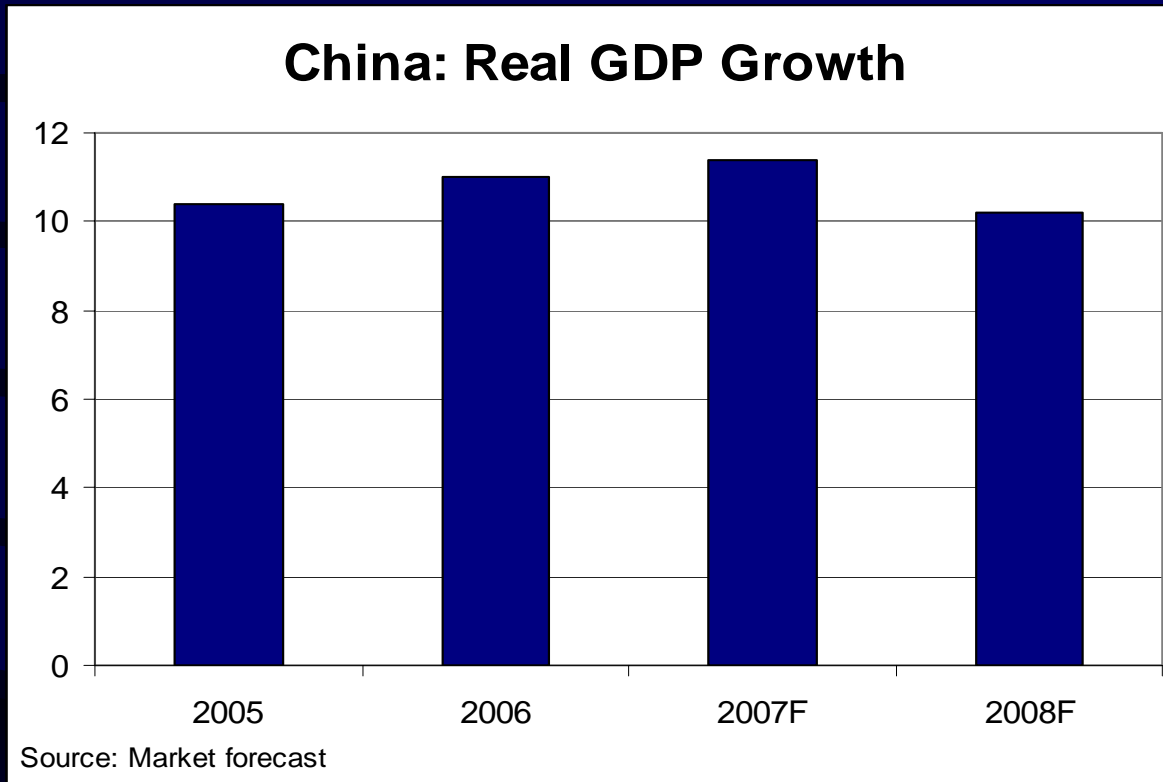
	1990	1995	2000	2007 ^{1/}
Argentina	4.59	14.29	25.15	42.99
Brazil	7.44	49.71	32.49	155.62
Chile	6.07	14.14	15.03	16.87
Colombia	4.63	8.35	8.92	20.05
Mexico	9.86	16.85	35.51	78.17
Peru	1.04	8.22	8.37	21.01
Venezuela	8.32	6.28	13.09	16.80

1/ To the last month available

Fuente: IFS 2007

- Lower foreign indebtedness combined with huge accumulation of reserves provides lots of “room” to satisfy financing needs even if capital inflows decrease considerably

And, if there is a US recession?



- China's economic growth will remain strong, supporting world aggregate demand for main Latin American Exports
- Because of profound differences in market structures and policies, China's economic growth displays a low correlation with US growth.

Conclusions

- As a region as a whole, Latin America remains strong and can absorb significant slowdowns in US economic growth
- Two major differences from the past:
 - Good macroeconomic management
 - The inclusion of China as a key international player keeping Latin America's export prices high
- However, important differences remain between countries and the global financial turmoil has served to expose relative strengths and weaknesses. In particular, given the quick recovery in financial prices in most other Latin American countries, the deteriorated performance of Argentina, Venezuela (and Ecuador not discussed in this presentation) are clearly the result of home-made economic and political mismanagement.