Latin America Economics

LatAm Macro Outlook – Weathering the global cycle

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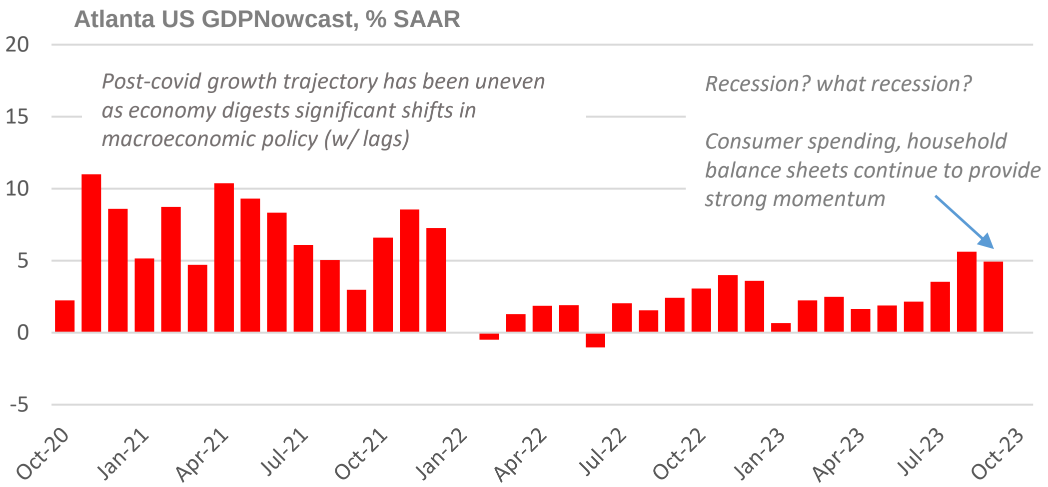
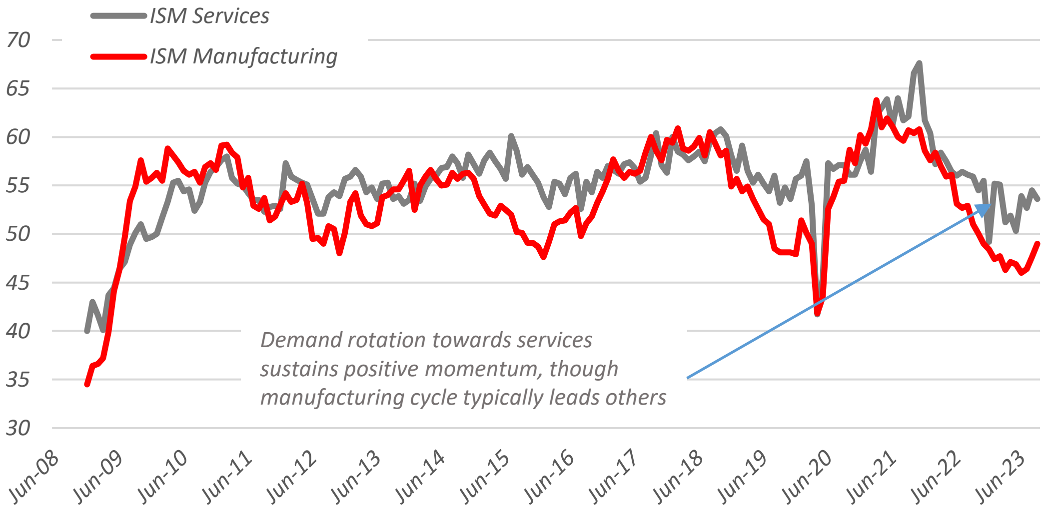
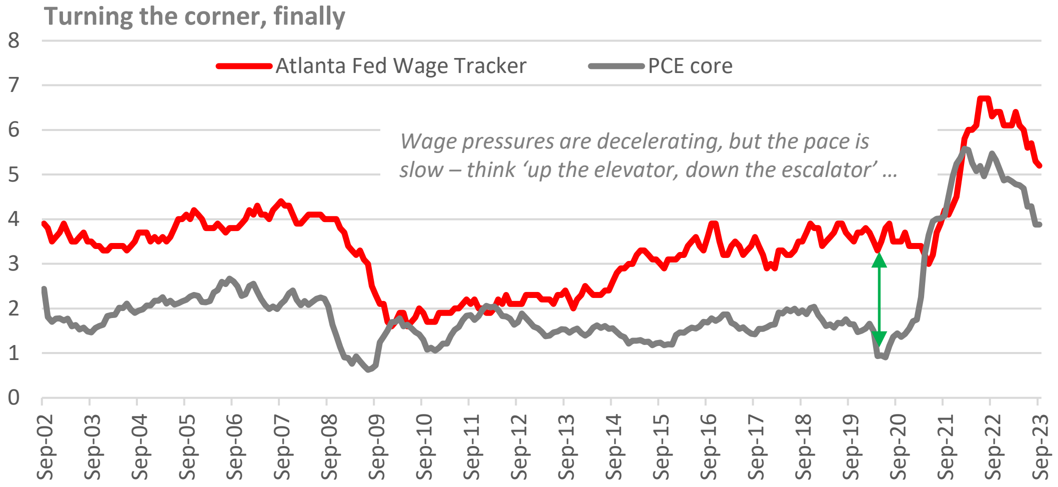
US economic cycle has surprised in resilience and duration

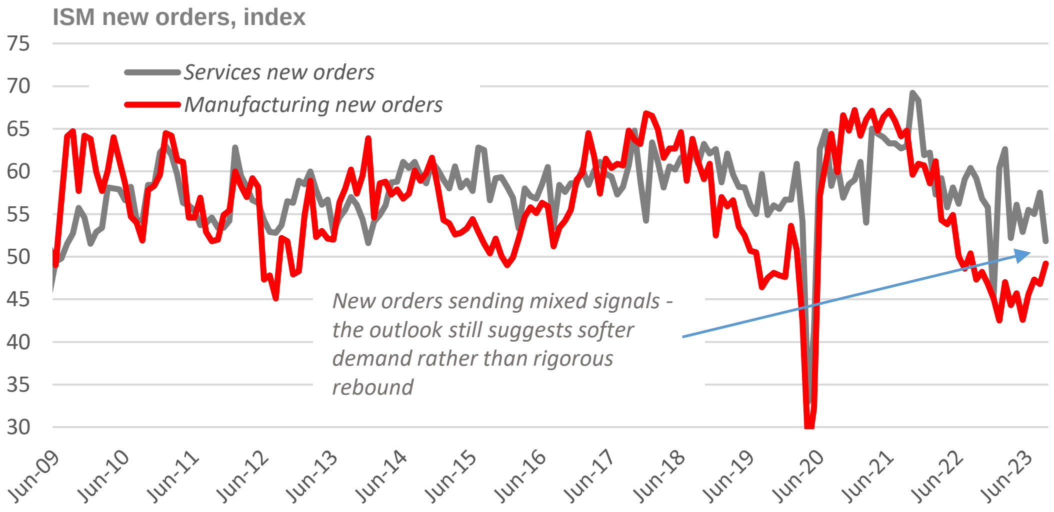
The mystery of ‘*long and variable lags*’





‘Up the elevator, down the escalator’

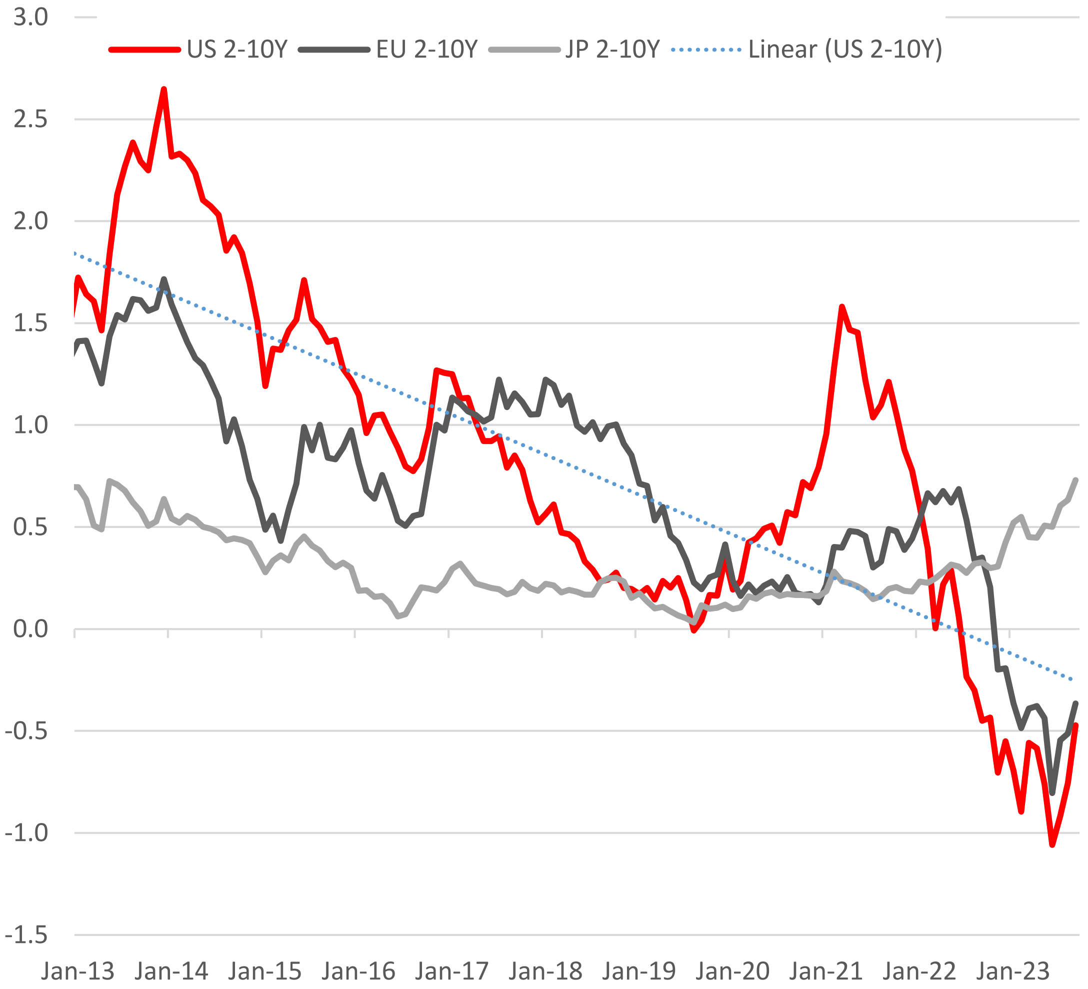




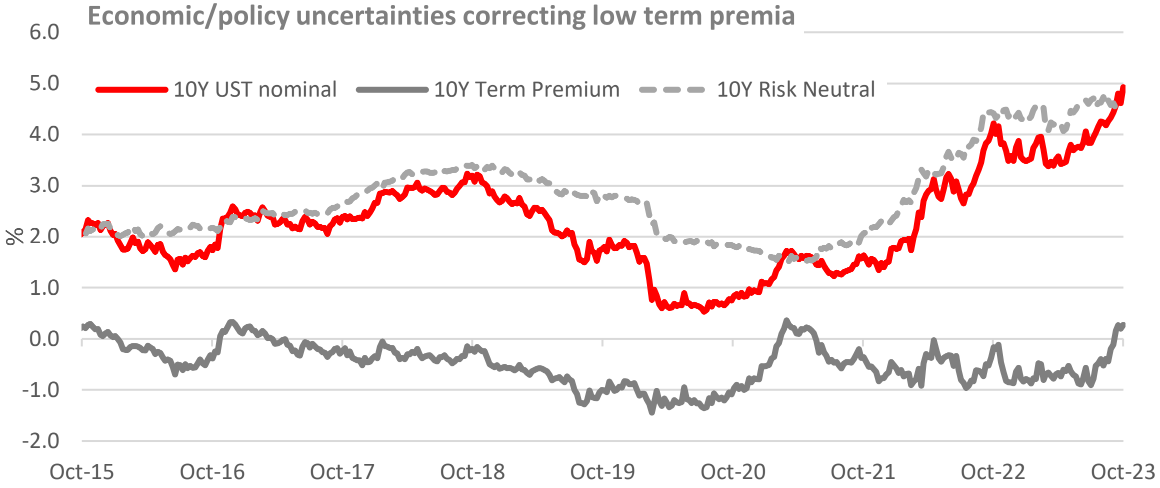
Sources: Santander, Bloomberg, Atlanta Fed

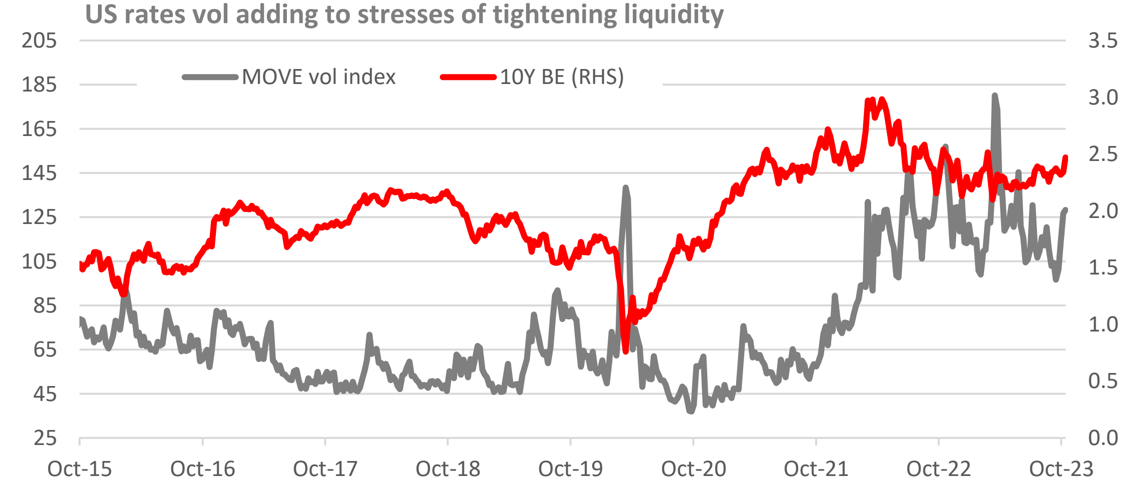
US yields – Are we there yet?

Term structure of interest rates at inflection point …



… with term premia repricing leading the adjustment

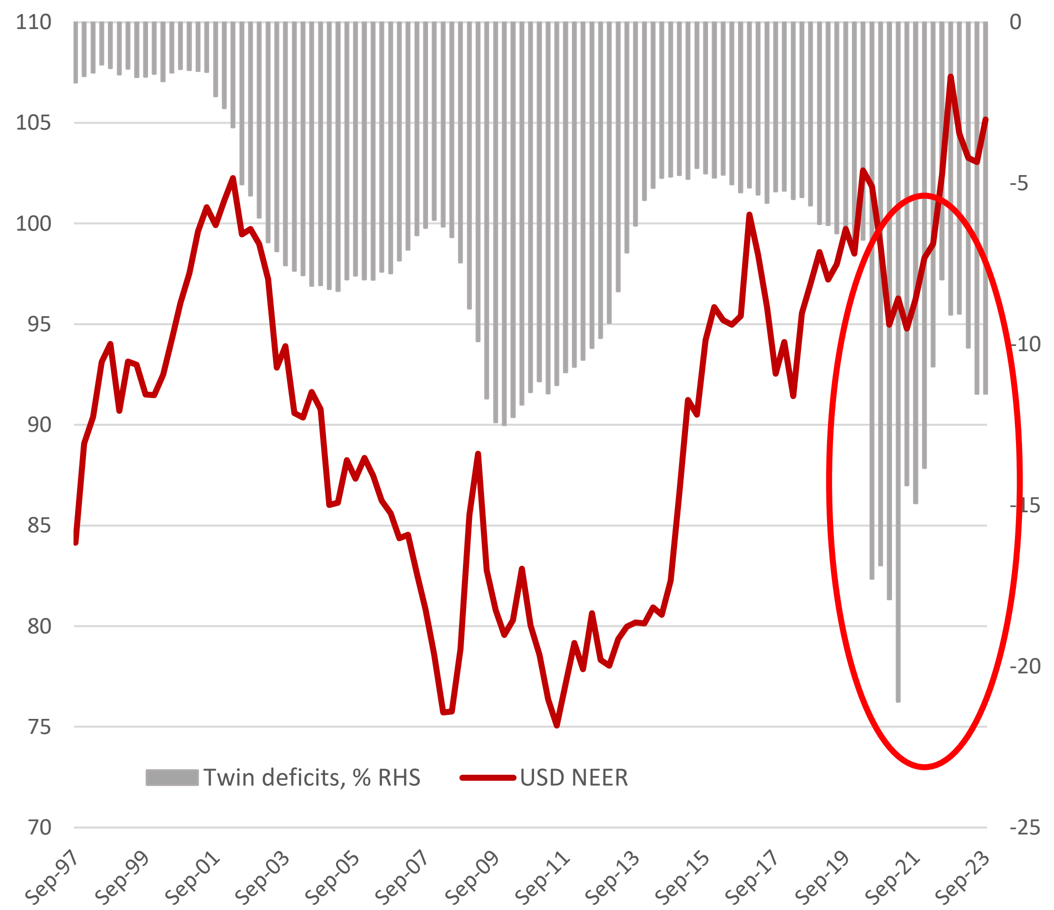




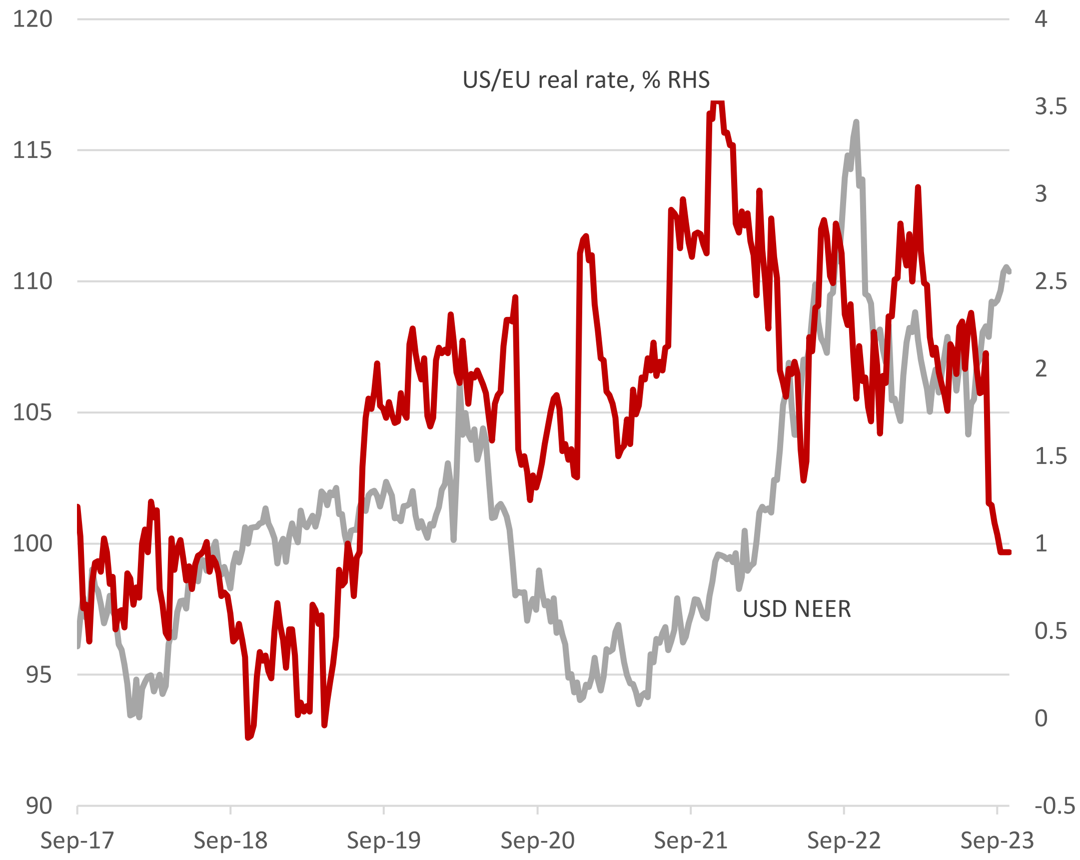
Sources: BEA, NY Fed, Bloomberg, Santander

USD could defy structural deficiencies a little longer

Long term structural vulnerabilities are papered over …



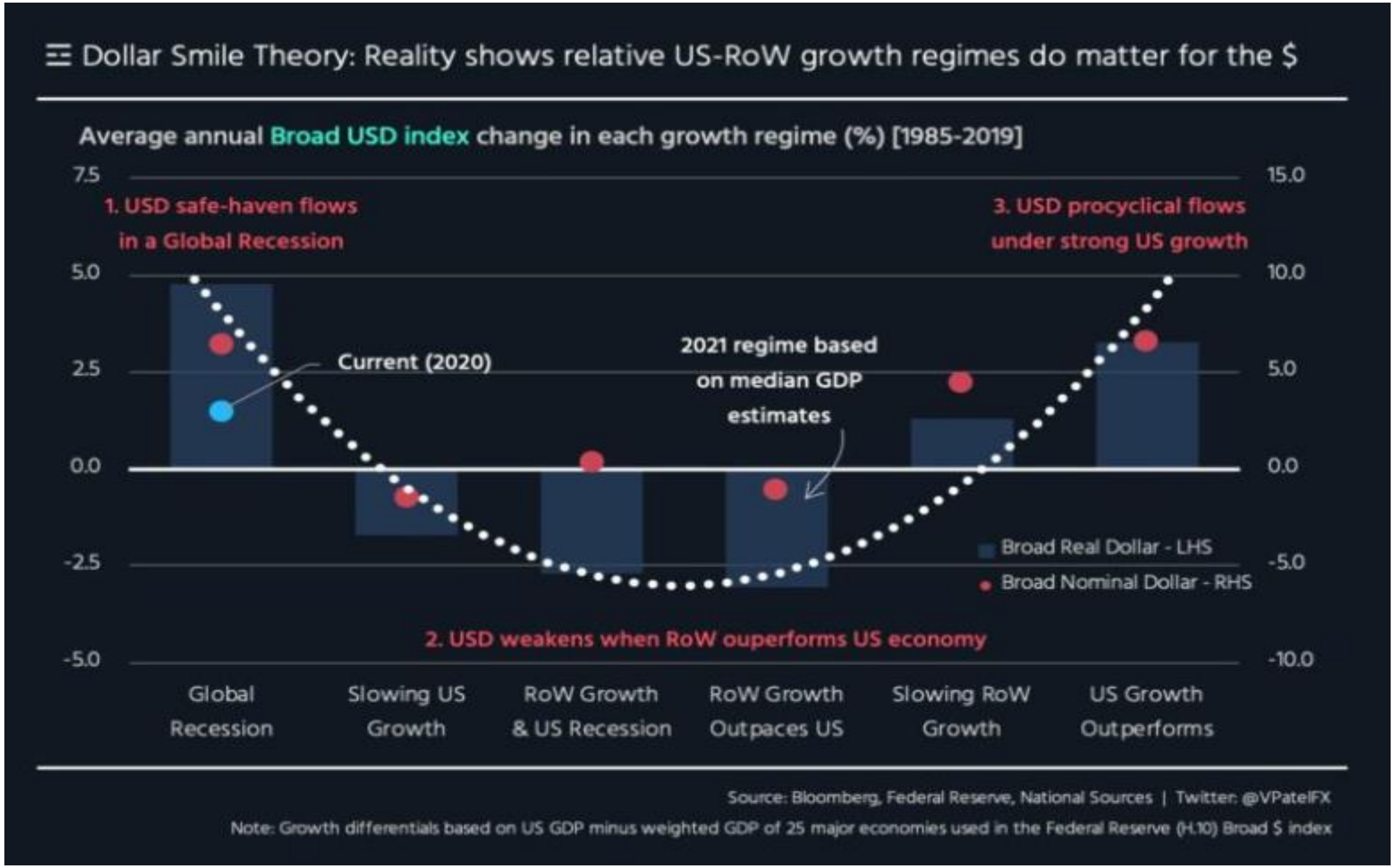
… by short term cyclical incentives



Sources: Bloomberg, BIS, Santander

The Dollar Smile Theory – It’s all relative

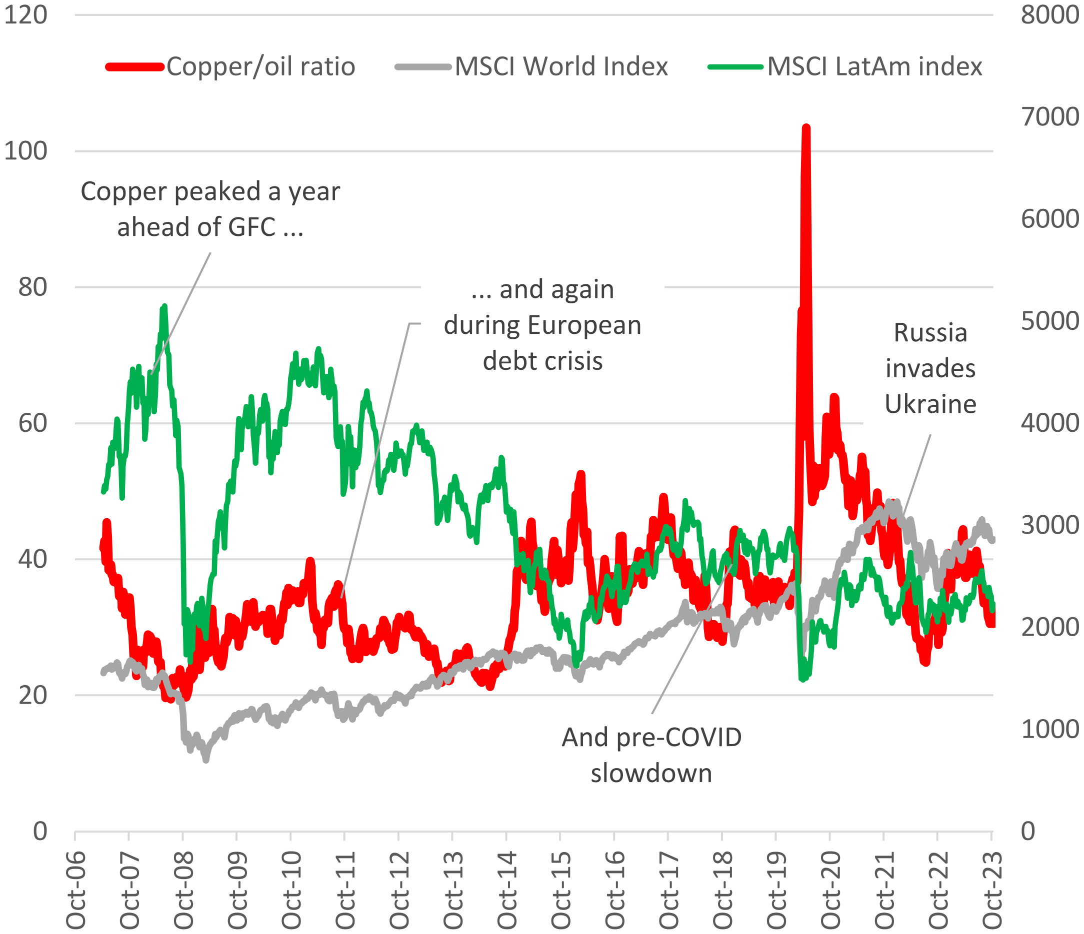
A broad framework for visualising USD dynamics



Global cyclical indicators suggest demand/supply (and risk pricing) dynamics yet to bottom

Global macro indicators flashing red

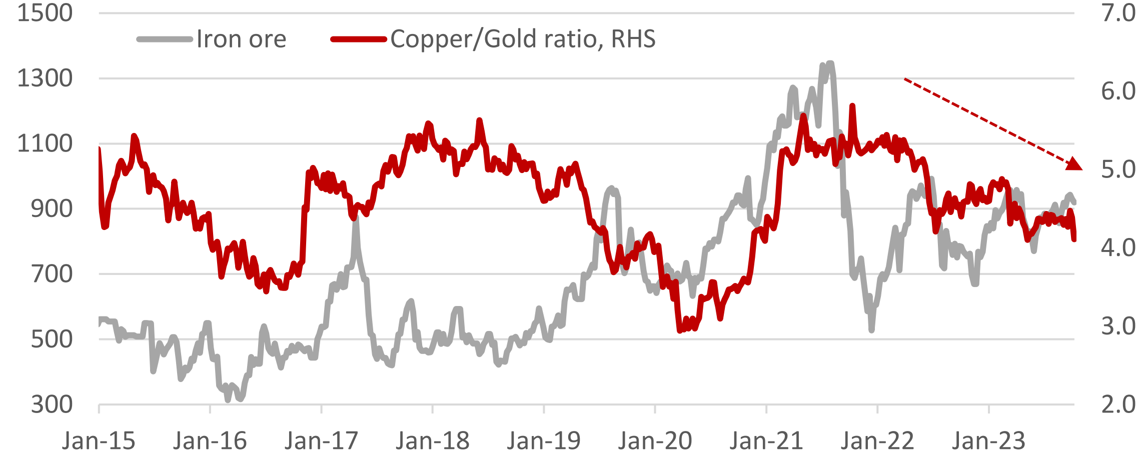
Copper/Oil ratio warns of weakening global backdrop

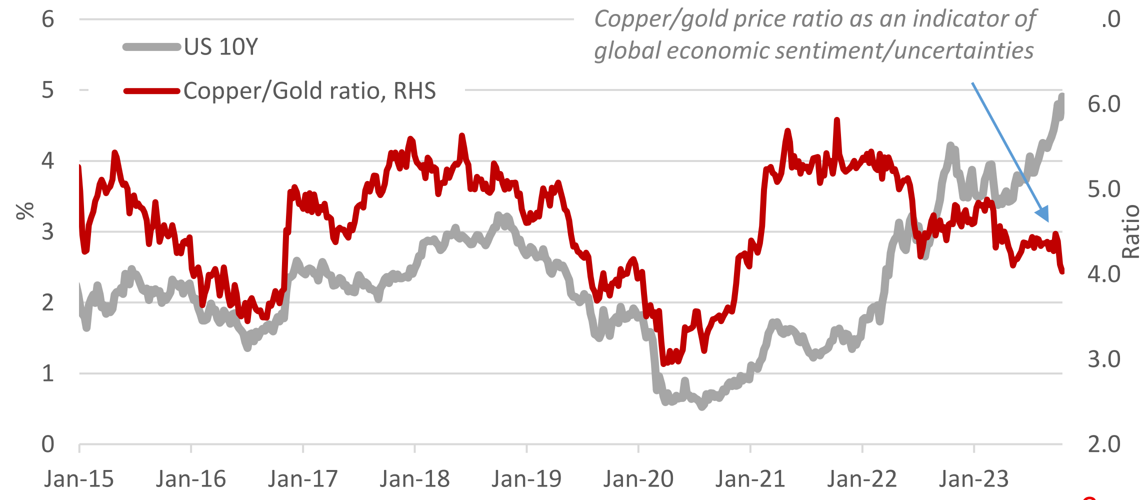


Sources: Bloomberg, Santander

Industrial commodities imply caution too

While other precious/base metals trends also suggest caution

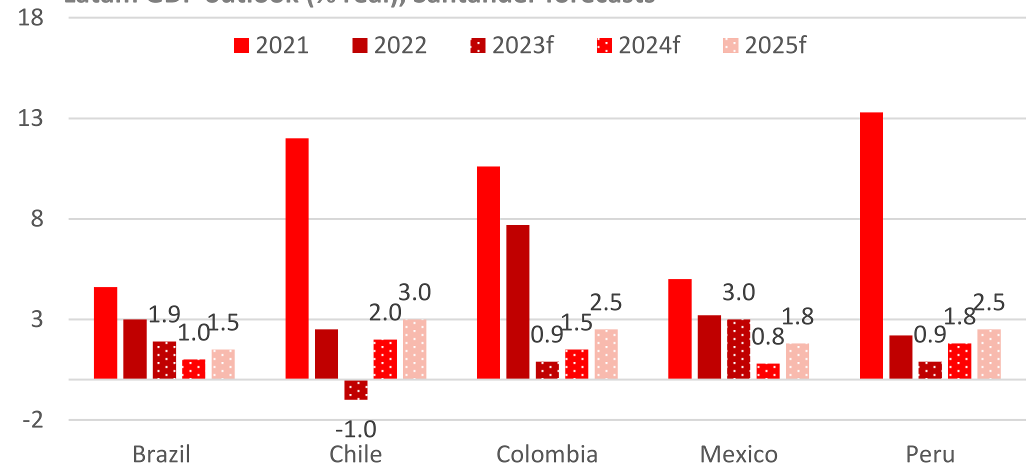




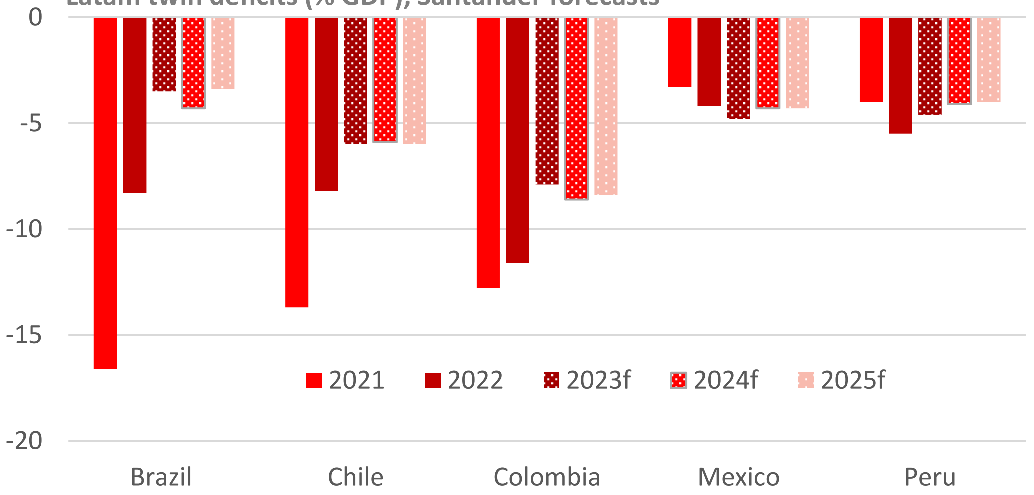
LatAm Outlook: Cyclical pressures recede but structural challenges remain

Macro forecasts 2021-2025

Latam GDP outlook (% real), Santander forecasts



Latam twin deficits (% GDP), Santander forecasts



- **Growth challenges (cyclical and structural) remain top of mind after a difficult and "uneven" 2023,** as the adjustment process from domestic disinflation, reduced fiscal impulse, high historical real rates and a difficult external environment, continue to run its course.
- **Big question marks remain on the quality of the recovery** Economic 'scarring' (*hysteresis*) is still inadequately understood – the problems of longer term unemployment, wealth and savings destruction on m/t growth, business response to formal hiring / investment plans, how public debt loads can be managed. FDI has been an encouraging counter narrative though.
- **Wildcards for LatAm outlook** represented by global commodity price adjustments (regional terms of trade), international rates volatility and the evolution of Chinese growth dynamics.
- **Despite political uncertainties, on balance, *core LatAm's* institutional framework and credibility has proven durable** and underscore the effectiveness of regional "checks and balances" alongside orthodox economic anchors.

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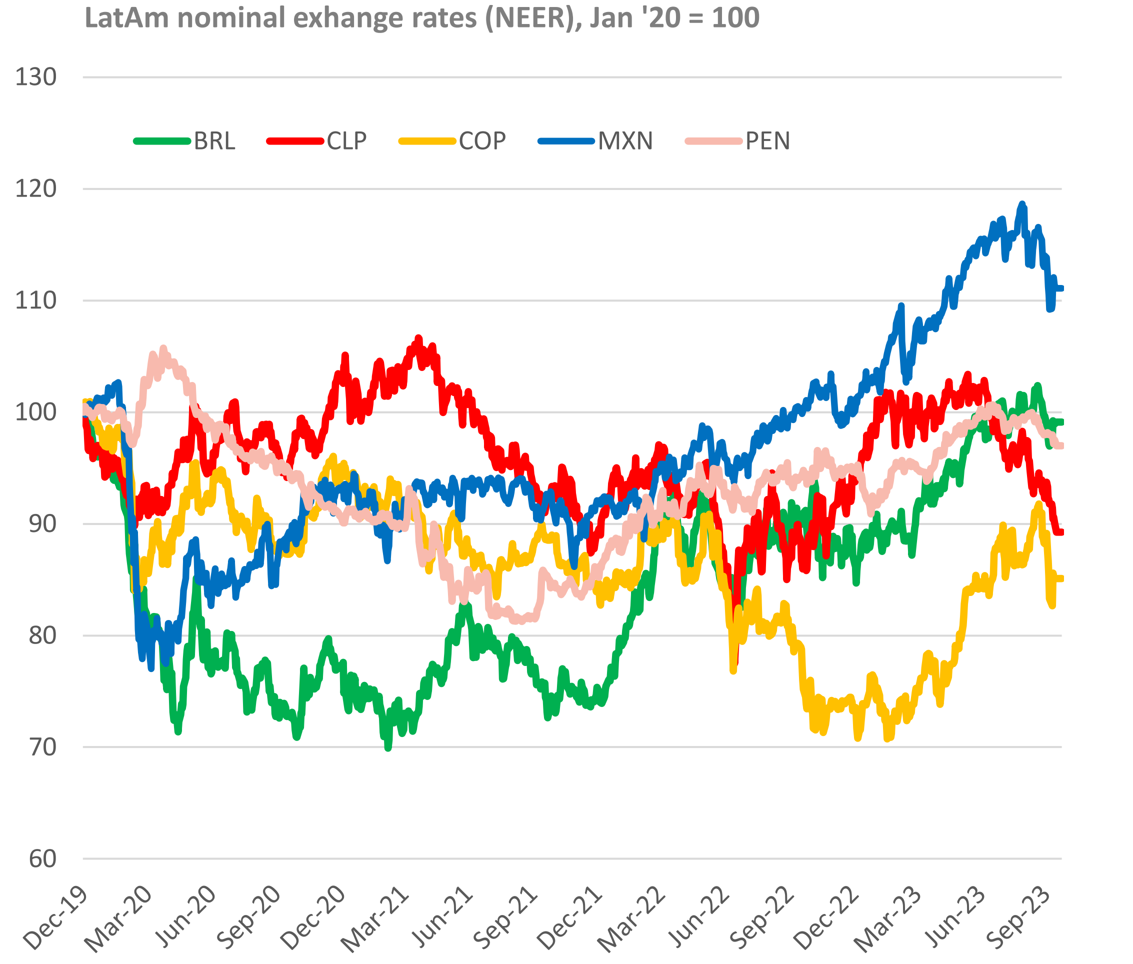
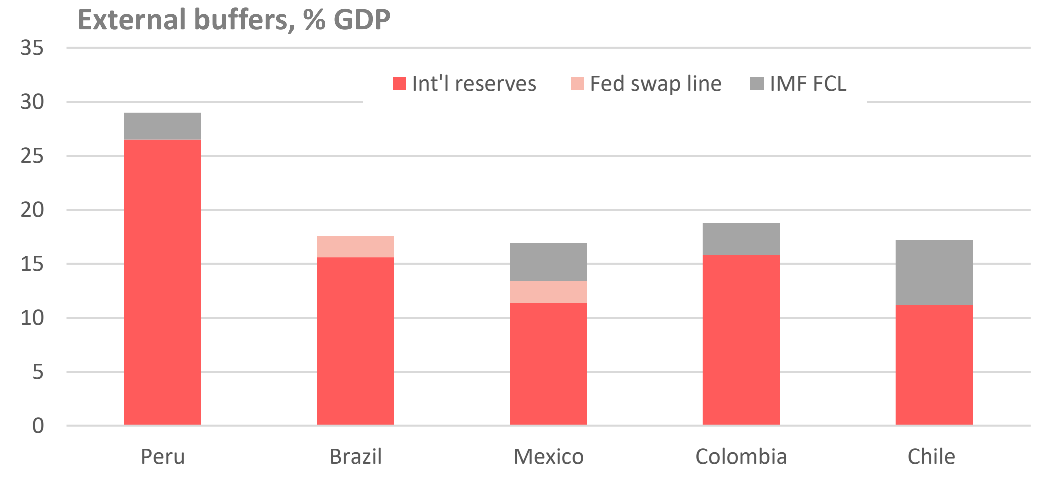
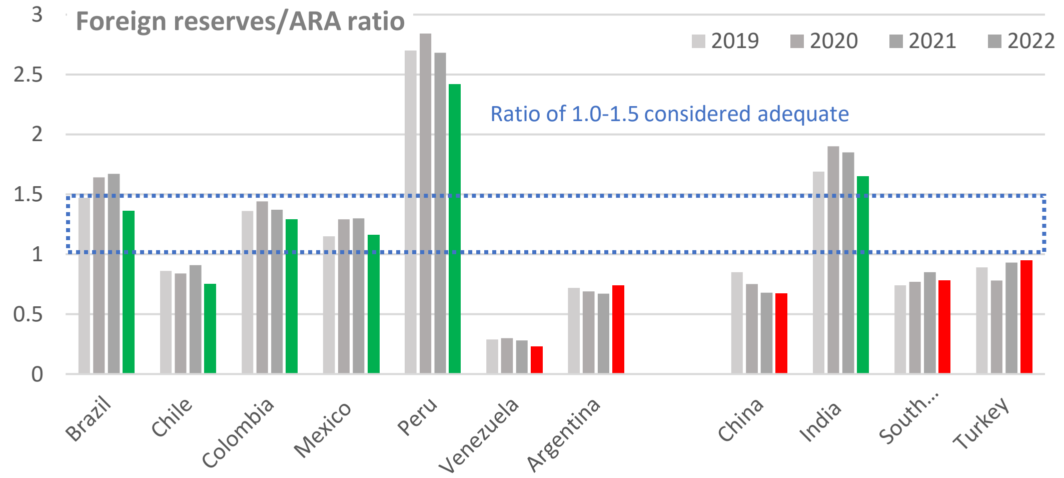
Sources: Santander

Regional FX resilience reflects confidence, with a lot of help from high carry

Shock absorbers remain in good shape





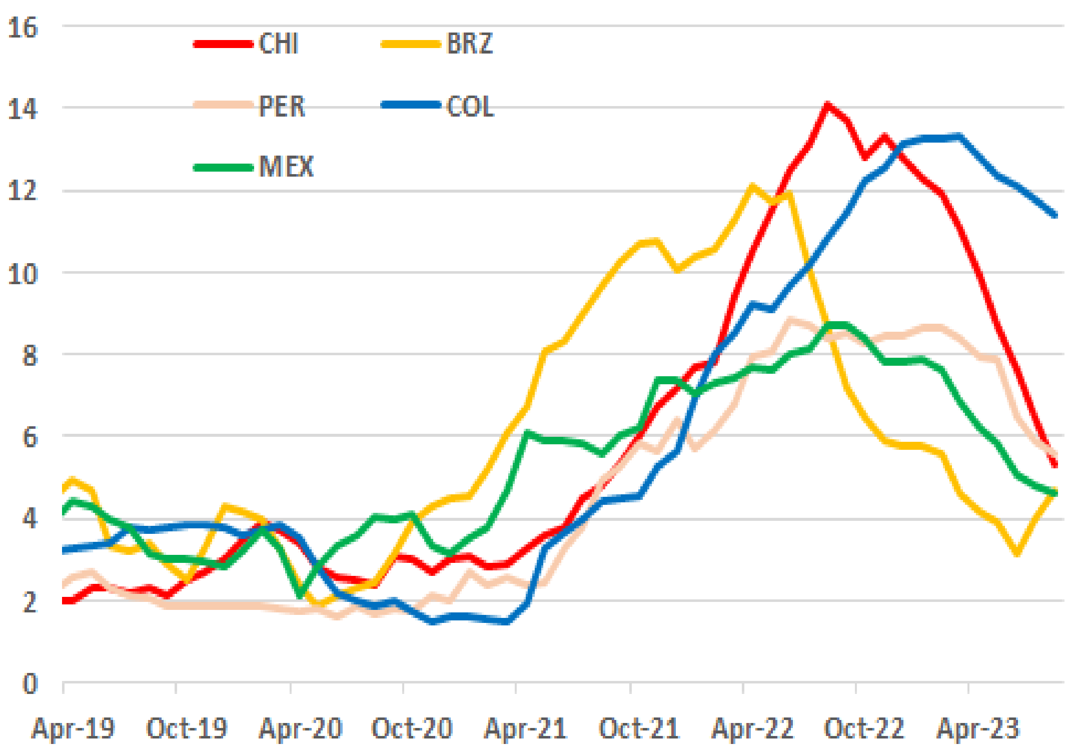


Sources: Bloomberg, IMF, Santander

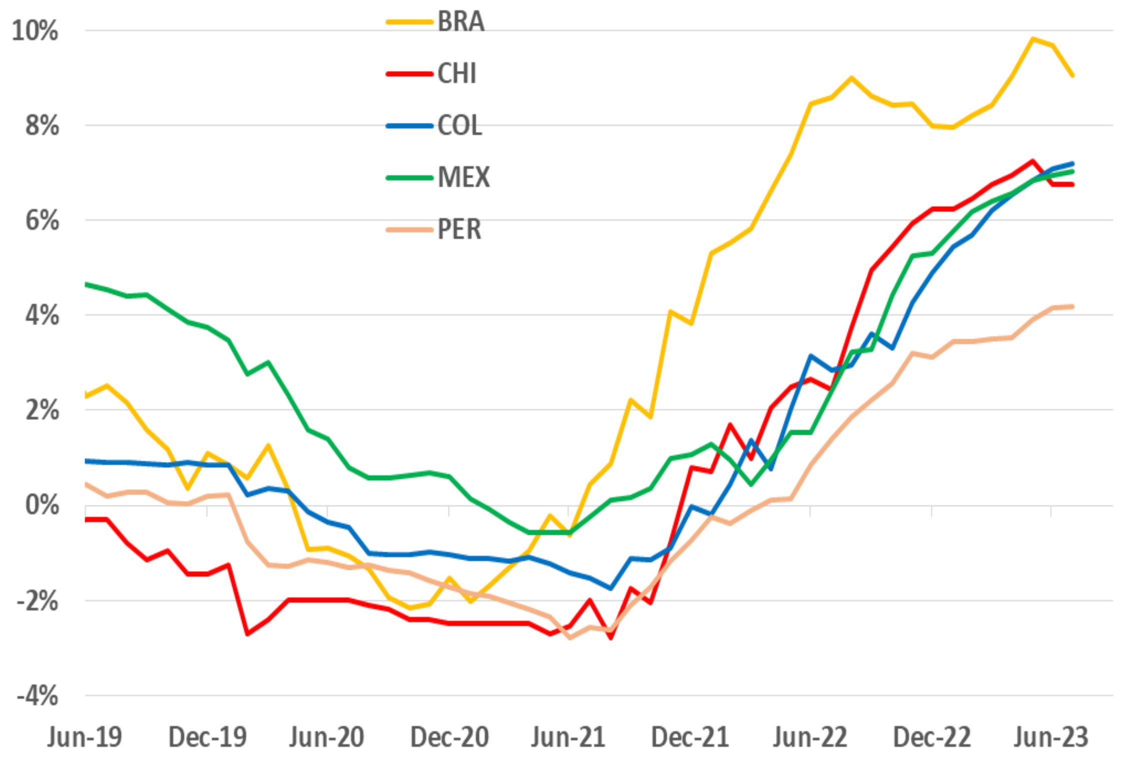
Cost of inflation fight to be borne on growth risks in 2024

LatAm's inflation fight is not over; the cost to local investment/growth risks will be felt in 2024

CPI inflation, % y/y



Real interest rates (*ex ante*), %

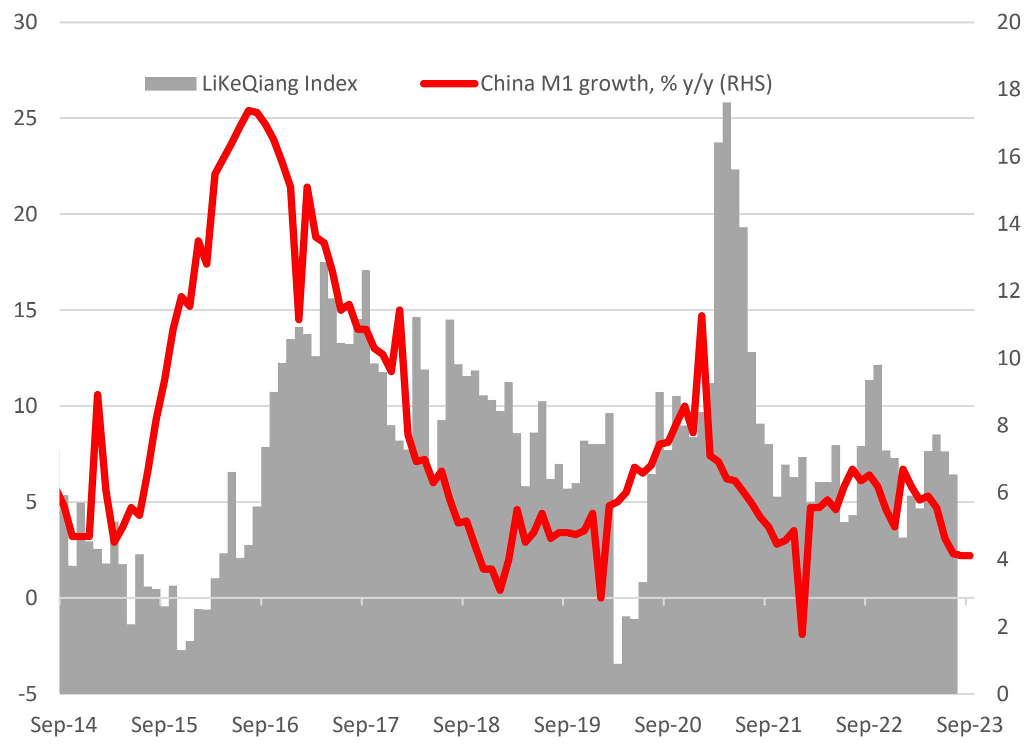


Sources: National govts, Santander

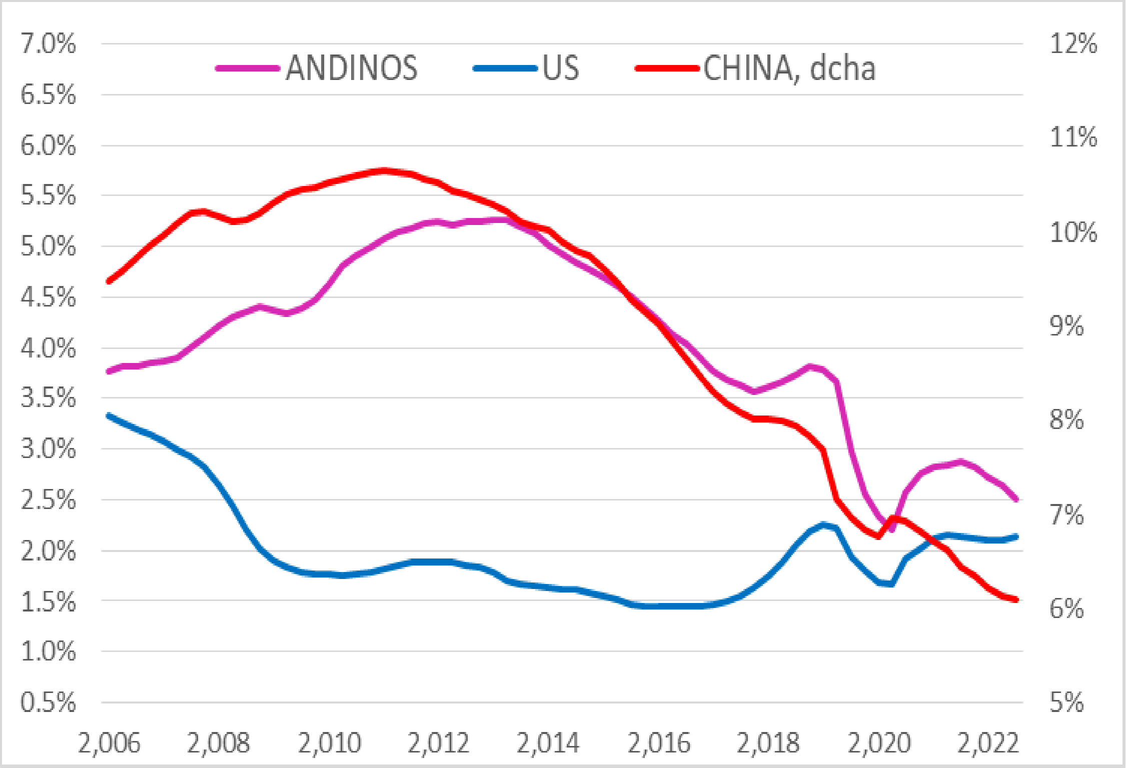
China's maturation poses longer term questions for some regional economies

China's malaise remains a risk for LatAm prospects (and global/EM more generally)

China's cyclical indicators remains sluggish



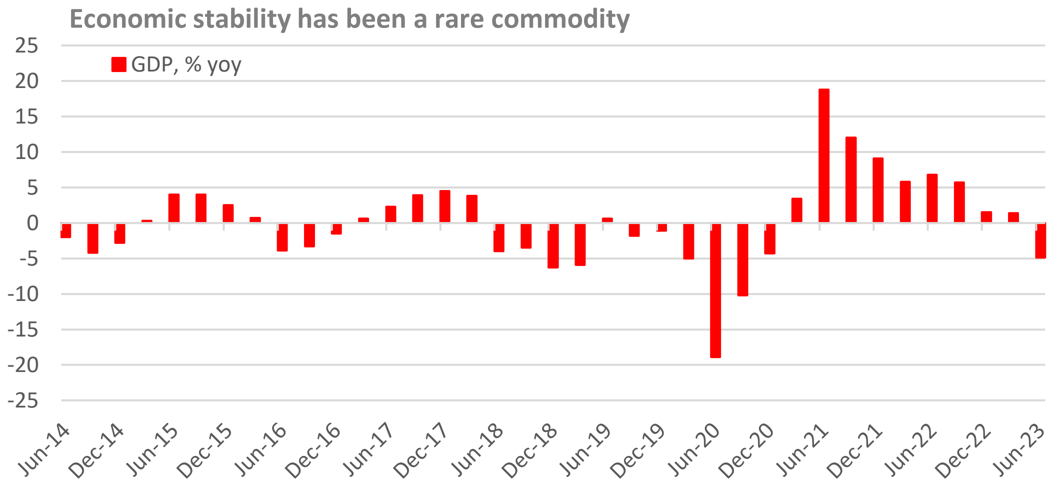
Avg GDP growth, 10Y rolling, %

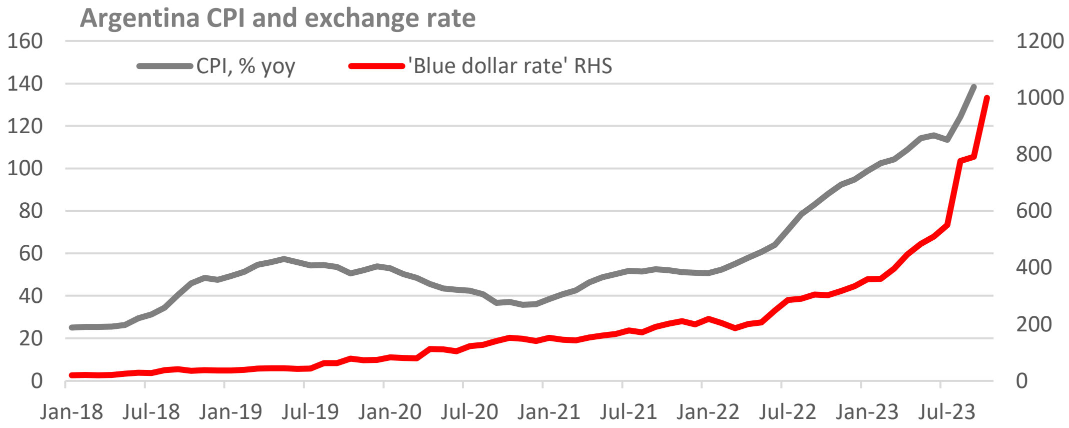


Sources: National govts, Santander

Dollarization can be a double-edged sword

Argentina | Looking for the silver bullet



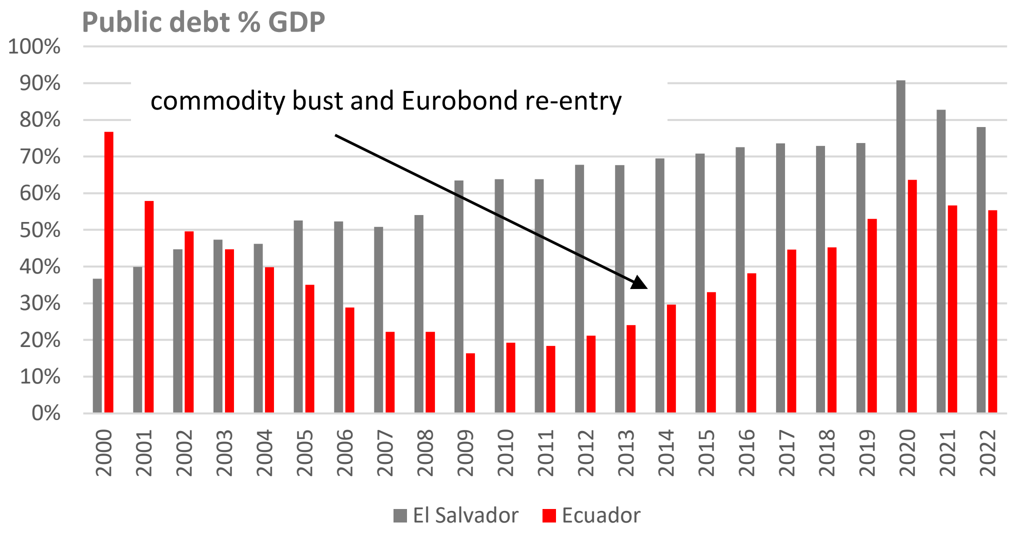


Sources: Santander

- **The dollarization project will be incredibly challenging considering that the net stock of foreign reserves is negative for c. USD 5-10bn**
- **In practical terms, an estimated USD 40bn (maybe more) required to dollarize** (covering monetary base and central liabilities for starters).
- **Post-dollarization impact on inflation trends have been encouraging** when looking to other economies with similar regime shifts. But maintenance requires stricter fiscal discipline and coherent macro-policy balance (and credibility!).
- **Loss of external competitiveness and flexibility could be key longer-term policy risk**, especially with major trading partners that maintain more flexible currency regimes, e.g. Brazil.
- **Otherwise, without monetary/FX flexibility** to withstand domestic and/or external economic shocks, the real economy is the mechanism of transmission, with inherent social-political risks.

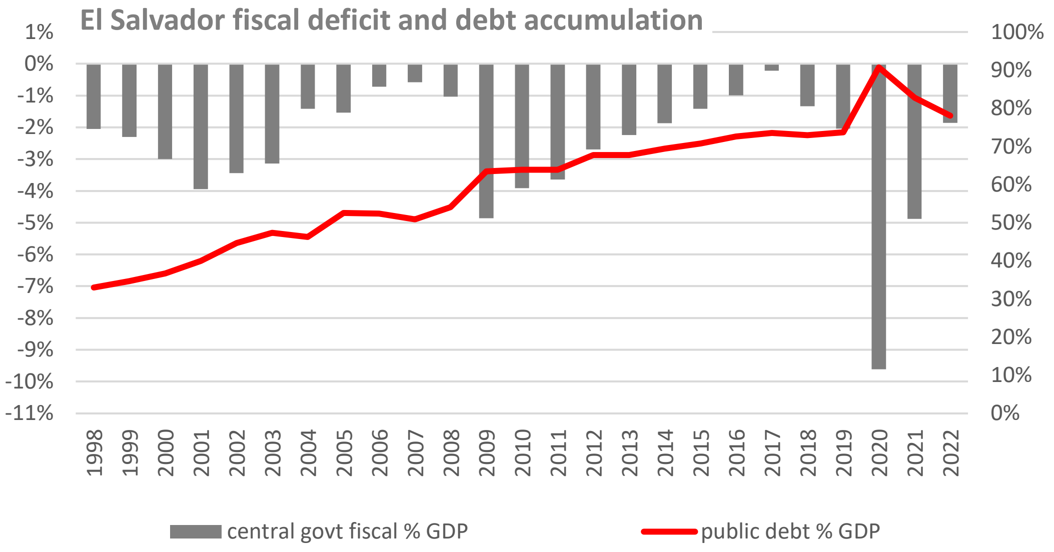
Dollarization can be a double-edged sword

Ecuador



- **Ecuador's dollarization in 2000, and its efficacy, remains a continued source of debate.**
- **Low inflation but also low FDI, low trend GDP growth,** higher structural fiscal deficit, high immigration, high labor informality and successive debt defaults.
- **Giving up local currency puts higher demands on prudent fiscal management** and makes economy more susceptible to external shocks (competitiveness, terms of trade, real economy adjustments).

El Salvador



- **El Salvador dollarized from a position of strength in 2001** after a long period of fixed peg and investment grade status. Relative macro stability, averaging growth of 2% p.a., 2% nominal fiscal deficits.
- **However, consistent nominal fiscal deficits and periodic shocks led to consistent debt accumulation and subsequent rating downgrades.** Dollarization requires more adept policy management to external shocks and consistent fiscal discipline absent positive shocks to growth and low FDI.