

# Market Update

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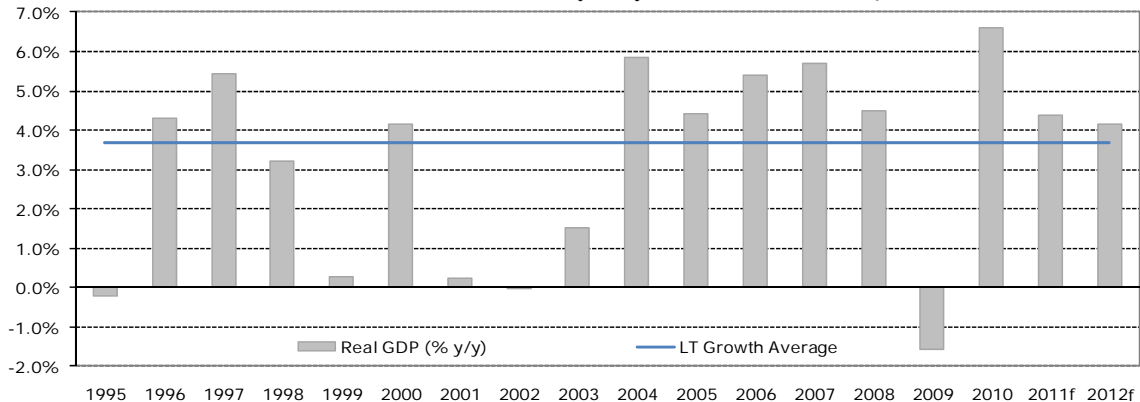
**BullTick**  
Capital Markets

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## LATAM UPDATE—Take-Aways From Presidential Appearances

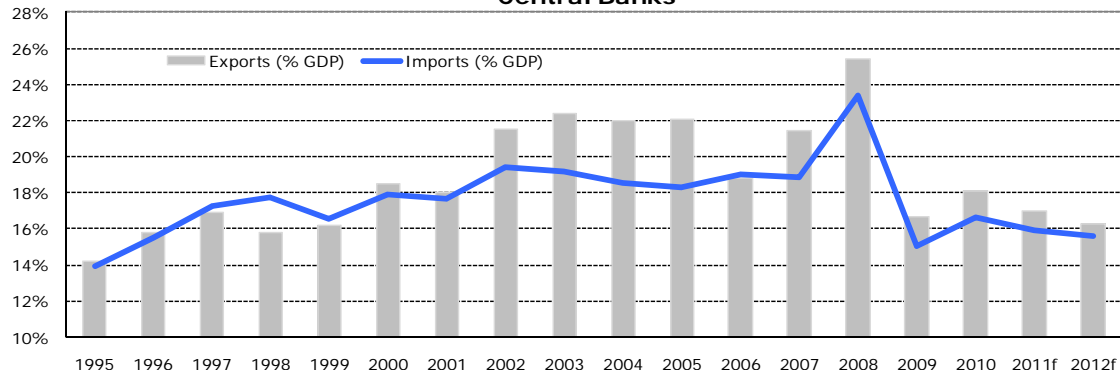
**KEY POINT:** Last week we attended many heads-of-state addresses to investors in New York City at the time of the United Nations meetings including lunches or dinners with the Presidents of Mexico, Chile, Peru, and Colombia. In this piece we cover our take-aways and perspectives on the region in the face of ongoing global economic tumult. The bottom-line is that regional growth is certainly decelerating amid the global slowdown, but this year Latin America will still grow above potential this year at 4.5% and next year at 4.2% by our forecasts. Latin America in general is well-prepared for a global slowdown as the region finds itself in a better place now than it has in the past considering several quantitative and qualitative variables, making it better able to withstand external shocks. However, despite the advances we note below, the region is not bulletproof from the possibility of a severe global shock.

LATAM--Economic Growth (Y/Y). Source: Bulltick, IMF.



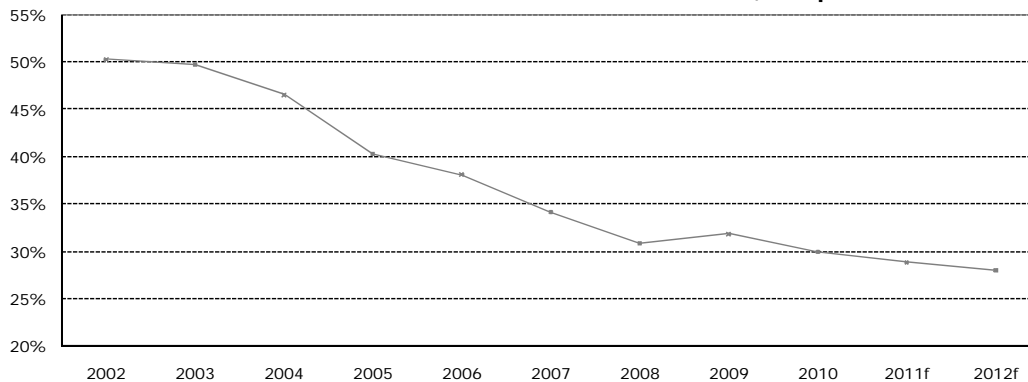
- Better public debt and fiscal deficit dynamics compared to historical norms and compared to developed markets (DM). This year, Latin American will average 28.8% public debt to GDP versus 50.3% of GDP in 2002 and compared to some 80% of GDP in the developed markets (DM). On the fiscal front, the region will average a deficit this year of -1.9% of GDP by our forecasts versus -4.2% in 2002 and compared to -8% of GDP on average in the developed markets.
- Lower consumer, banking sector leverage
- Latin America has amassed foreign-exchange reserves. Reserves for the region have risen more than 300% since 2002.
- Upward movement in sovereign ratings making taking trend financing more favorable
- Strong terms-of-trade

LATAM--Exports, Imports (% Of GDP). Source: Bulltick, Respective Central Banks



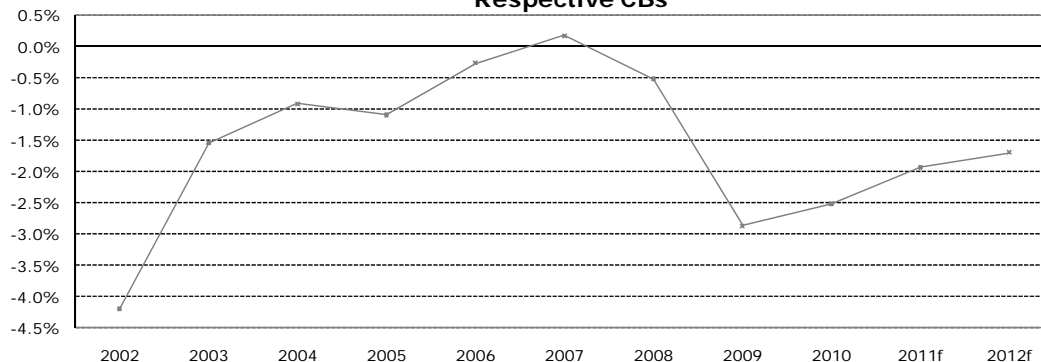
A severe global economic shock - not our base case scenario - but an event that must be considered, such as a recession in the U.S., hard landing in China, or the demise of the EMU, would affect these countries via several channels. Importantly, as Colombian President Santos mentioned in his speech to investors last week, this dynamic would begin with confidence. Domestic demand has been a driving force of not only Colombian economic expansion but across the region, particularly in Brazil, Chile and Peru. In addition to the devastating effect a shock would have on domestic confidence, causing a collapse in consumption and investment, the trade channel would suffer, as commodity demand and exports collapse.

**LATAM--Net Debt/GDP Ratio. Source: Bulltick, Respective CBs**



**In the event of an entrance into another global recession, we think, and affirmed by our attendance last week, that while there will be some uniform policy responses, others could distinctly diverge.** Many countries across the region have the arsenal for, and will likely, employ fiscal and monetary easing. Many have amassed enough reserves, are growing above potential, while some have fiscal surpluses and external sovereign wealth funds; in other words, many have the tools to respond, unlike much of the developed world. Chile is at the forefront of these countries with its 1% fiscal surplus this year and \$20B in sovereign wealth fund assets, or 10% of GDP, and 6.6% growth rate this year. Meanwhile, Colombia, Mexico, and Peru have disposable and will also likely employ countercyclical policies to confront a global storm.

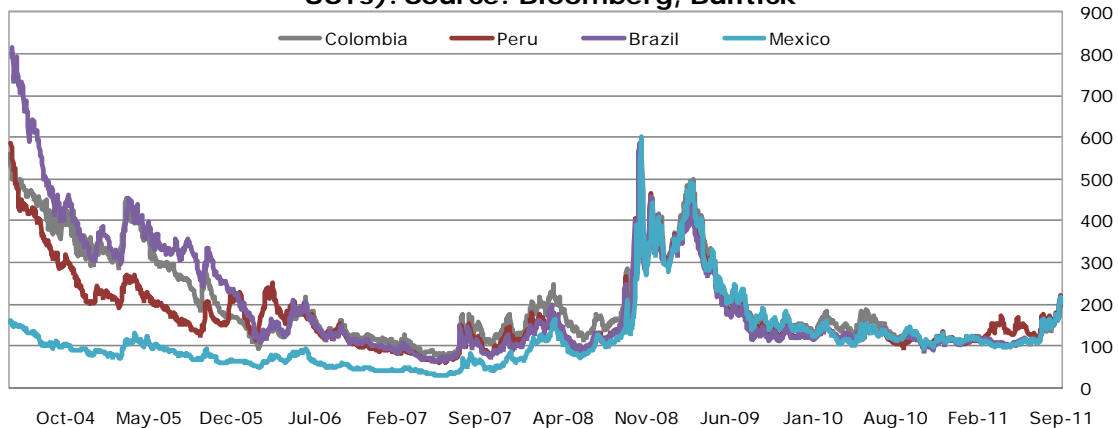
**LATAM--Nominal Fiscal Balance/GDP Ratio. Source: Bulltick, Respective CBs**



**With its distinctly more statist president, in Peru, despite its built-up arsenal of reserves and 2011 fiscal surplus to counter a slowdown, we think the risks are higher for a less conservative, orthodox policy response in the event of adversity.** We attended President Humala's dinner last week where his answers came up short to investor representatives requesting some more assurances of his intent to govern in a centrist, economically-prudent, free-market manner. President Humala cited his cabinet picks and moved on to further discussion of social inclusion and reference to role of the central government, likely, in our view, leaving the "market-friendly" talk for the week in New York to his finance minister, Luis Castilla, who is as cross-over from the previous Garcia presidency. President Humala focused

his speech to investors on the importance of the role of the state and the need for social inclusion and corporations' social responsibility. The Peruvian event with President Humala was the most in-demand, over-sold event that the Council of the Americas sponsored this week as many in the market still question what the Humala administration will look like – will he be a Chavez or a Lula? Initial signs since his election in June have been favorable and Peru bonds have seen strong gains since sell-off prior to Humala win. Strong fundamentals and prudent policy-making have been the Peruvian story in recent years, but we think it will be important to keep an eye on political developments out of this more uncertain administration particularly in the backdrop of a more difficult external environment.

**Colombia, Peru, Brazil, Mexico, Five-Year CDS Level (Bps over USTs). Source: Bloomberg, Bulltick**

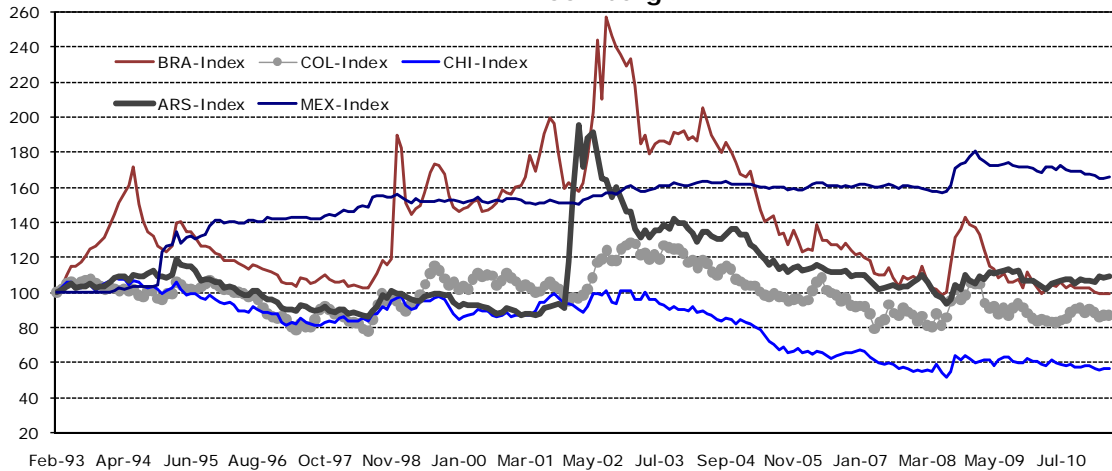


**The meetings with the Presidents of Colombia and Chile delivered no surprises, with these speeches being the most market-friendly of the bunch.** Both Presidents' Santos and Piñera speeches in NY asserted: the need for further FDI, free trade, free markets, fiscal responsibility, promotion of entrepreneurship, institutional strength and credibility, respect for private property and contracts. These are some of the obvious reasons why Chile is the strongest-rated in region and commands such low yields and Colombia is on a steady path of rating upgrades. Colombia's President Santos said he expects the FTA with the U.S. to pass in mid-October. Fruits of these developments, Chile this month issued at a record low yield (3.3%) in its 10-year issue and Colombia has seen massive FDI inflows after Santos and Uribe together weakened the FARC tremendously. Presidents Piñera and Santos, in our view, remain excellent models of strong economic stewardship in Latin America.

**We also attended a dinner with Mexican President Felipe Calderón, who in his speech, turned up pressure on the United States to curb demand for illicit drugs, hinting strongly that the legalization of drugs in the U.S. may be what is needed to weaken the Mexican drug cartels.** Some 90% of cocaine which enters the US is trafficked through Mexico according to the US State Department. Meanwhile, drug-related violence has jumped in Mexico with more than 40,000 deaths since Calderon became president, damaging support for PAN ahead of a July 2012 election and increasing the already high probability of a PRI (Peña-Nieto) win.

**Bottom-line for the markets:** Latin American FX collapsed last week, finally succumbing to global turmoil (BRL -10% CLP -8%, MXN -8%). In the current volatile, risk-off environment, we expect LatAm FX to remain pressured in near-term as commodities and equity markets remain subject to heightened volatility and vulnerable to changing developed market sentiment, but in trend deterioration on the back of weak economic data and little progress towards resolution of the DM's economic distortions.

**LATAM--Real Exchange Rate. (1993= 100). Source: Bulltick, Bloomberg**



Position unwinds over the past few weeks also contributed to the deterioration especially in BRL due to the imposition of the IOF tax combined with a decrease in credibility for the central bank in inflation targeting and the MXN due to risk aversion as market fears US recession and as the regional central banks likely ease rates from now through year-end.

EM fixed income had been holding up relatively well in the midst of the past months' market tumult, and probable immediate regional CB easing should support this, but there is really no safe haven at times of ultimate stress and investor psyche could move so negative that EM bonds see significant outflow. We see limited upside through year-end on the back of ongoing uncertainties on US and Europe fronts.

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