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UPDATE

November 27, 2016 10:30 PM GMT

2017 Latin America Economic Outlook

Recovering in a Risky World

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The global economy is set to accelerate in 2017 above its 3% long-term potential with Latin America playing a role in this recovery as Brazil and Argentina emerge from deep recessions. Our global team upgraded growth to 3.4% in 2017 on the back of stronger outlooks for the US and Japan, but it is emerging economies that are leading the recovery, picking up to 4.7% from 4.1% this year, led by commodity exporters - Latin American included. In the region, the improvement is not uniform: Mexico, where we already expected a deceleration, seems even more vulnerable as uncertainty about US trade policy is set to hit confidence, capex and hiring plans, even if US policy does not actually change materially.

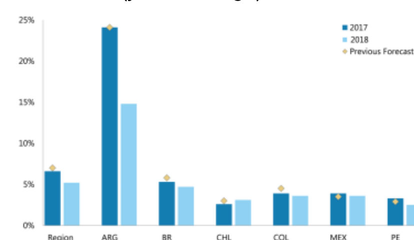
While the world seems to be leaving lowflation behind, in Latin America highflation should be a thing of the past by 2017. Fiscal stimulus late in the cycle should increase inflation in the US, while higher oil prices and firmer growth also push prices up elsewhere in the developed world. Latin America keeps moving in the other direction with inflation easing in several economies that have struggled with highflation in recent years. While inflation is already moving down in many countries - such as Chile - this trend should intensify in 2017 led by Brazil and Argentina, and to a lesser extent Colombia. Again Mexico bucks the trend with prices expected to rise due to fuel quotes and a weaker peso.

With stronger global growth and reflation also come material risks, mainly from politics and policy choices in the developed world. Our global team argues that a populist backlash against globalization and immigration could have negative short-term cyclical impacts on trade and also be a medium-term drag on potential GDP. The second risk arises from the Fed possibly tightening too fast, which could disrupt markets including in Latin America. As with inflation, the region is diverging from the rise of populism elsewhere in the world by adopting a more orthodox policy mix. Venezuela remains the outlier, but we believe that the new policy mix implemented in Argentina and Brazil should pay off in 2017. Even Peru, where policy has been prudent, could see reform improvement ahead. Finally, Chile should join the club thanks to prospects of positive political change in 2017. Mexico, by contrast, could see rising risks of populism as a reaction to a possible protectionist wave in the US.

Exhibit 1: Latin America: Real GDP Growth Forecasts (% change y-o-y)

Source: Morgan Stanley Latam Economics *regional aggregate based on IMF PPP weights

Exhibit 2: Latin America: Inflation Forecasts (year average)



Source: Morgan Stanley Latam Economics *regional aggregate based on IMF weights, region excludes Venezuela

For important disclosures, refer to the Disclosures Section, located at the end of this report.

Latin America: Recovering In a Risky World

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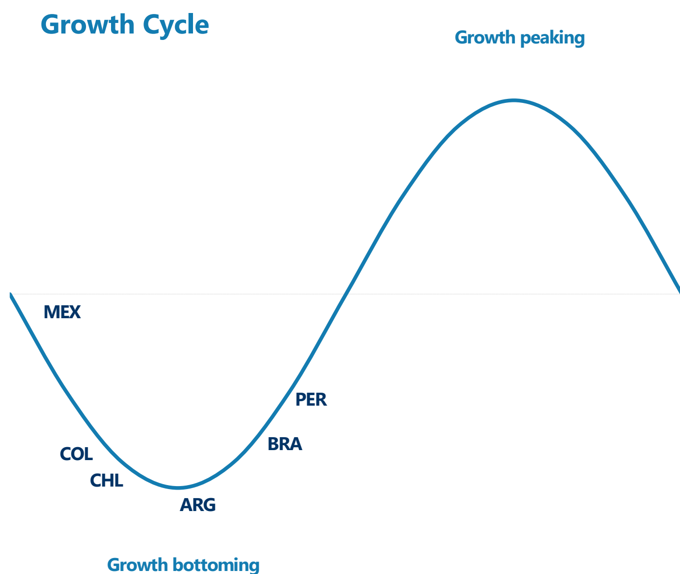
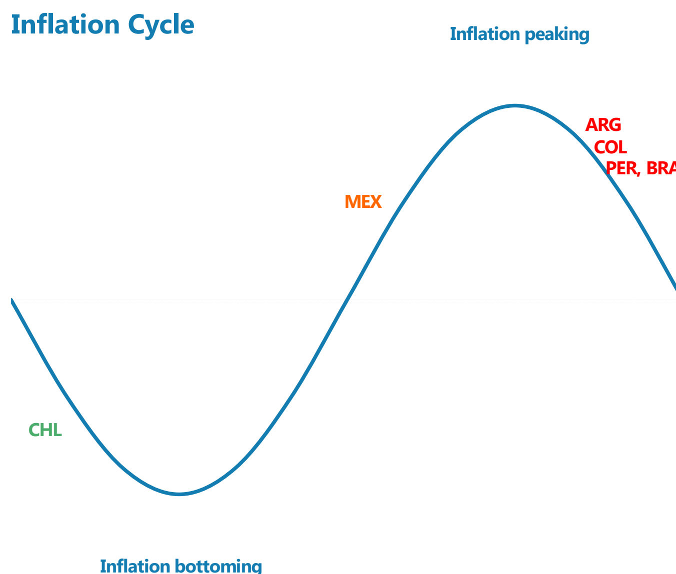
The year ahead is shaping out to be a stronger one for the global economy, with growth gaining momentum in 2017 and moving above its long-term potential of around 3%, leading to rising capacity utilization and higher employment levels. Compared to our Summer Outlook, our global team is upping growth for the rest of this year and next, leading to a welcome pickup in global activity to 3.4% in 2017 from 3.0% in 2016. Growth in the industrialized world inches marginally higher to 1.6% next year from 1.5% thanks to upgraded outlooks for the US and Japan, which in turn receive a boost from more expansionary fiscal policy. The expected acceleration in emerging economies – to 4.7% in 2017 from 4.1% this year – remains the main motor of the global recovery, in part reflecting a better outlook for commodity exporters, including Latin America, which has undergone the bulk of its adjustment, helping offset further moderation in China. The risks to this stronger outlook, however, have increased considerably; renewed strength in the emerging world, for example, is set to be tested by rising US interest rates, a stronger dollar and the risk of trade protectionism.

Exhibit 3: Latin America: Growth Cycle



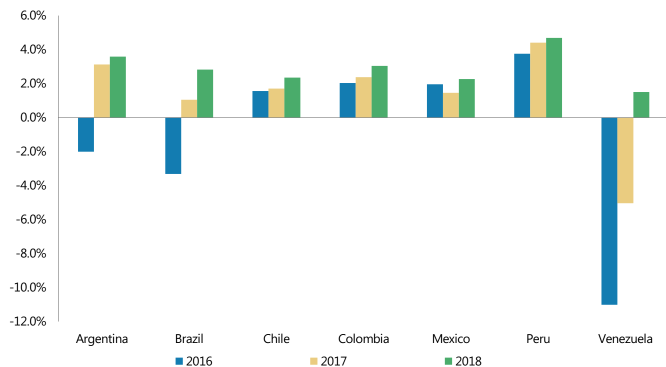
Source: Morgan Stanley Research; position corresponds to country's stage in growth cycle.

Exhibit 4: Latin America: Inflation Cycle



Source: Morgan Stanley Research; position corresponds to country's age in inflation cycle, colour to current inflation level relative to CB's inflation target (red ≥ target ceiling, amber within the target range, green < target).

Exhibit 5: Latin America: GDP Growth Forecasts (%Y)

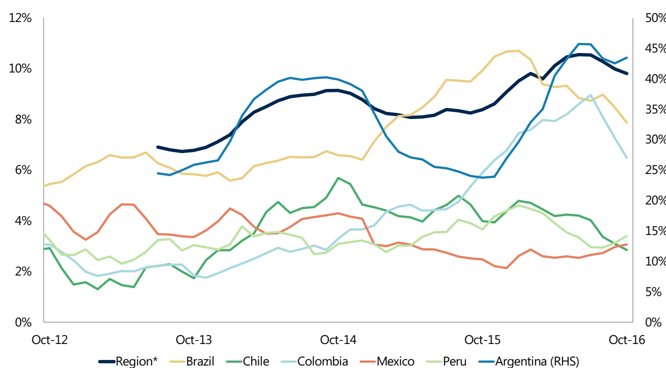


Source: Morgan Stanley Latam Economics

And Latin America is playing a positive role in the better growth story. Our forecasts for a recovery in 2017 are little changed from our Summer Outlook; we are trimming it slightly to 1.4% from 1.7% previously. The region has already started to show signs that it turned the corner earlier this year, and even after the rise in policy uncertainty in the developed economies, we believe the growth narratives are unchanged, with the exception of Mexico, which is most vulnerable to the risk of protectionism (seeExhibit 5). The biggest contributions should come from Brazil and Argentina as their economies emerge from deep recessions. In Brazil we expect a subdued recovery of just 1.1% in 2017 due to three main drags: credit contraction from public banks, tight fiscal policy and a slightly stronger currency that will be a drag on the external sector. Argentina seems poised to experience the strongest expansion in 6 years, up 3.1% in 2017, as lower inflation helps the consumer and the agricultural sector contributes positively after last year's lifting of export barriers by the new administration. For Mexico, where we were already expecting a slowdown in 2017 as consumption cools off, we are taking a more cautious stance with a more pronounced deceleration to 1.5% (2.0% previously). While our US team is working under the assumption that trade protectionism goes little further than threats – hence the tail risk of a Nafta la Vista scenario is averted – the uncertainty regarding the US policy path is set to take its toll on confidence, investment and hiring decisions. But overall, the narrative of Latin America having "turned the corner" – our Summer Outlook theme – remains intact as the bulk of the adjustment is now behind us, coupled with better policymaking (see "Latin America: Turning the Corner," in Latin America Economics Summer Outlook, July 18, 2016).

The global economy also seems poised to leave lowflation behind. The reflation trend that began in 2015 – temporarily interrupted by China's currency regime shift in August 2015 – continues into next year, pushing up inflation in developed economies towards and in some cases above central bank targets. For Latam watchers, the implications of reflation for the Federal Reserve stand front and center. More expansionary fiscal policy is set to shift the US late-cycle recovery – when unemployment is already low – into higher gear, prompting the Fed to hike rates this December and twice more in 2017 on our forecasts.

Exhibit 6: Latin America: Inflation (% change y-o-y)

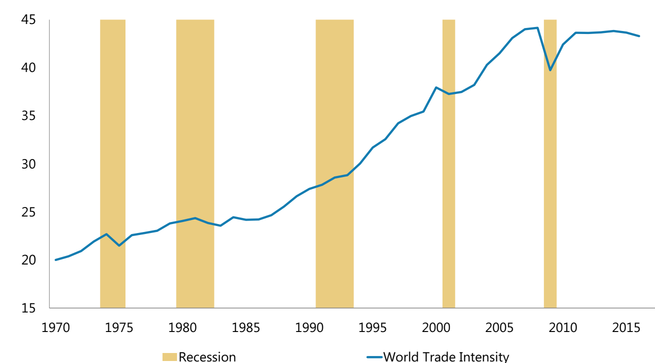


Source: IBGE, Indec, DANE, INEGI, INE, INEI, Morgan Stanley Latam Economics *Regional aggregate excludes Venezuela

Meanwhile, highflation is quickly becoming a thing of the past in Latin America. As we had highlighted in our Summer Outlook, the region is putting the highflation challenge behind, allowing it to move into a better growth and inflation combination. By the end of 2017, we see regional inflation easing to 5.8% from a peak of 10.6% in June this year, excluding Venezuela. In Brazil, Colombia, Chile and Peru consumer price inflation has eased quite materially over the past few months from their peaks earlier in the year; in Chile headline inflation recently dipped below the 3% target for the first time in nearly three years (see Exhibit 6). Argentina is the one country where headline inflation has not fallen as fast, but the latest prints point to a stronger disinflation next year. This disinflationary trend is the result of tight monetary policy in many countries, but also due to base effects. Fortunately, this new trend has already allowed

Brazil and Argentina to start to ease monetary policy, and we expect that Colombia and Chile will start in the first quarter of next year. Mexico, which never experienced the stubborn highflation seen elsewhere in the region despite seeing its currency plunge in value, is again bucking the regional trend: we have upped our inflation forecast for next year to 3.9% from 3.2% in 2016 and we see Banxico hiking rates further, mirroring Fed tightening through 2017.

Exhibit 7: World: Trade Intensity (Exports + imports % GDP)



Source: OCED, Morgan Stanley Research

But with firmer global growth and reflation also come material risks, emanating mainly from political dynamics and policy decisions. One dominant theme for 2017, according to our colleague Elga Bartsch, is likely to be the ongoing populist voter backlash – against globalization and immigration – as markets grapple with the implications of the surprising US election outcome, the UK referendum and votes in coming months, particularly in Europe. The specter of rising protectionism would undermine the recovery in global trade, as well as disrupt supply chains and the movement of labor and capital (see Exhibit 7). Elga argues that the repercussions of such disruptions could be meaningful, dealing a near-term cyclical blow to global growth and also having a negative long-term structural impact on potential growth. And barriers to trade would lead to job losses and higher inflation, in turn causing even more voter discontent. Another important risk comes from the Fed and the potential for too fast tightening, which could be disruptive to markets, including for Latin America. The prospects of fiscal stimulus coming late in the cycle could overheat the economy, forcing the Fed's hand. In the meantime, the uncertainty about the policy priorities of the new US administration could weigh on confidence, while concerns about China's economy – absent since the early-2016 scare – could resurface.

While politics in the industrialized world have become a source of uncertainty, Latin America has been swinging in the other direction, namely away from populism and towards orthodox policymaking. Indeed Latin America, which historically has been prone to populism, shows many of the pitfalls of pursuing such policies. The combination of protectionism aimed at boosting domestic industrial sectors and lax fiscal policy – either through lower taxes or higher spending – has not delivered sustainable strong growth in the region. Instead, the results have been consistently the same: higher inflation coupled with slower growth. The most extreme case is Venezuela, which is still facing an unsustainable policy mix that has forced the current administration to curb imports in order to be able to service its external obligations. Next year, slightly higher oil prices should help Venezuela to barely be able to pay its external obligations but once again at the cost of import restrictions, hyperinflation and a deep recession. We still see scars from milder versions of these policies in Argentina and Brazil, which this year faced deep recessions and still high inflation, but new administrations in both countries have been adopting more sustainable policies and we believe there will be payoff in 2017 as both economies expand again. Peru has also experienced a shift, albeit a less dramatic one, towards more business-friendly policies following the mid-2016 presidential election, which has boosted confidence and growth prospects. Finally Chile, whose economy has been struggling with external headwinds compounded by domestic policy uncertainty, faces the prospects of positive political change next year when it holds its next presidential election (see "Chile: The Copper Balancing Act," in *Week Ahead in Latin America*, November 4, 2016). Mexico, where

prudent policymaking has been the norm, faces a more uncertain outlook because of the potential for US protectionism to play into the hands of the local populist camp against a backdrop of a more fragmented voter base (see "Mexico: Protectionism and the Risk from Within," *in Week Ahead in Latin America*, November 18, 2016).

Brazil: On Track

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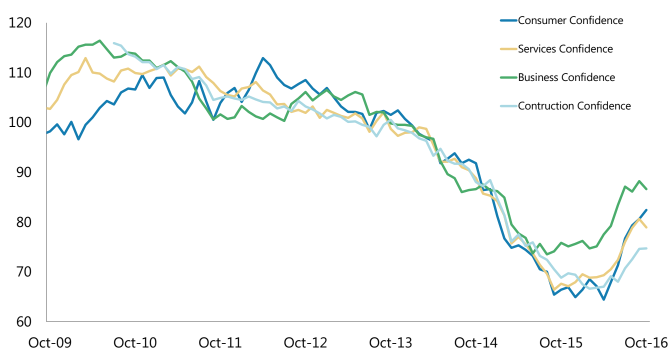
The Brazilian economy should emerge from its two-and-a-half-year recession due to a combination of better policy-making and stronger confidence: But the recovery should still be sub-par as a result of several drags – tighter fiscal policy, a stronger currency that will no longer help the external sector, and limited credit growth from the public banks. Given this weak growth picture, combined with benign base effects, we expect inflation to be materially lower next year at just below 5%Y, allowing the central bank to cut rates aggressively to 10% by year-end even in the face of tighter international financial conditions. In our base case, we assume that some version of pension reform, which is key for fiscal consolidation, will be approved in 2017 - critical to keep economic agents' confidence high (see Exhibit 8).

We see an investment-led recovery in 2017, albeit a mild one: After the sharp contraction in investment over the past four years (-12.8%), and in light of low inventory levels currently, we look for investment to accelerate in 2017, growing by 3.2%Y. Moreover, easing monetary policy will help corporates to finance some much-needed investment to at least cover depreciation from the past few years. Although capacity utilization is still very low, in the past this has not been an impediment for some recovery in investment. We expect consumers to increase their spending modestly, but still at very weak growth pace. There are two main drags on the consumer in 2017 – the still weakening labor market (where we only expect unemployment to peak in 2Q17) and tight credit conditions, especially from the public banks. On the other hand, falling inflation led by food prices should help to ease some of the pressure on real income for consumers.

Exhibit 8: Brazil: Confidence Indicators



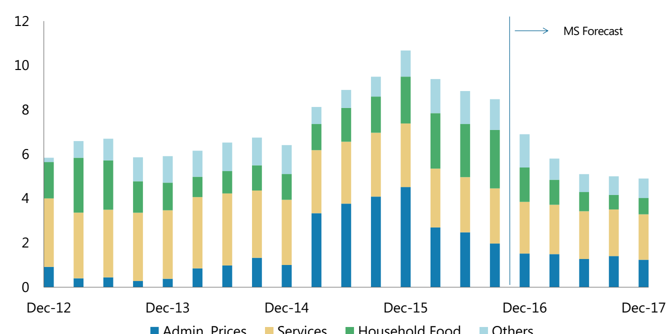
Source: FGV, Morgan Stanley Latam Economics

Meanwhile government spending will continue to be a drag on growth as the spending cap bill is implemented with materially lower real expenditures growth next year. Moreover, the shrinking of Brazil's quasi-fiscal policy apparatus, which used public banks to pump subsidized credit into the economy, will also retard growth. Investments will be especially impacted, as the two largest lenders – the national development bank and Caixa Economica (savings and loans) – were geared to investments and the housing market.

Finally, the external sector should provide a positive contribution, although smaller than the previous year, when the contribution was 420 basis points, mostly due to a collapse on imports but also a decent soft commodity harvest. The slightly stronger currency should dampen this trend in 2017. This also means that Brazil's balance of payments, although the current account deficit should widen in 2017 versus this year (we forecast 1.2% of GDP in 2016 and 2% of GDP in 2017), is still easily financeable by FDI.

After two very challenging years, we believe that inflation will finally get close to the 4.5%Y center of the target: Inflation has been hit by two powerful consecutive shocks. In 2015, government-controlled prices were allowed to float in order to rein in the fiscal cost of some subsidies, with the increase reaching 18.1%Y in December 2015. In 2016, although government-controlled prices only rose 7.0%Y by October, food at home accelerated, peaking at 16.8%Y by August 2016. Of course there are second-round effects from these shocks, but we believe they have been relatively limited, given how fast core inflation continues to decelerate. As a result, we expect inflation to decelerate to 4.9%Y in 2017 and 4.5%Y in 1H18, already assuming a weakening currency (see Exhibit 9).

Exhibit 9: Brazil: Inflation Breakdown (% change y-o-y)



Source: IBGE, Morgan Stanley Latam Economics

This should allow the central bank to cut rates throughout 2017, taking them to 10% by year-end: We believe that Brazil's idiosyncratic story will dominate the rates debate, rather than tighter global financial conditions. Brazil's disinflationary process and its weak economic recovery should allow the central bank to cut rates further than what the market currently expects. We believe that as the public banks – that normally lend at subsidized rates – step out of the credit markets due to capital constraints, Brazil should be able to enjoy lower nominal interest rates.

As mentioned, fiscal policy will continue to be contractionary in 2017. The upcoming approval of the spending cap bill in mid-December should be a landmark for fiscal policy for years to come. Real expenditure growth – that has averaged 6.0% over the past years – should move to zero growth over the next couple years, and the government intends to keep it around that level until 2037. That being said, without a pension reform, the spending cap might become too politically onerous to be honored by future governments. Currently pension expenditures represent around 40% of total expenditures and are growing around 3% in real terms due to demographics and indexation; without a reform this would mean that all other expenditures would have to contract at a similar pace to fulfill the expenditure cap restriction, which is unrealistic in political terms. Hence, Brazil watchers will now focus on the upcoming pension reform approval process during the first semester in Congress. Failure to pass a pension reform would threaten fiscal credibility and debt sustainability.

Exhibit 10:

Brazil Summary	2015	2016E	2017E	2018E
Real GDP (%Y)	-3.8	-3.3	1.1	2.8
Private consumption	-4.1	-4.5	0.5	2.6
Gross fixed investment	-14.3	-8.9	3.2	6.0
Current account (% GDP)	-3.4	-1.2	-2.0	-2.5
CPI (%Y)	9.0	8.8	5.3	4.7
Policy rate (eop, %)	14.25	13.75	10.00	10.00
Fiscal balance (% GDP)	-10.3	-9.3	-7.9	-6.9
Int'l Reserves ($US bn)	356.5	365.0	365.0	365.0

Source:: IBGE, Banco Central do Brasil, Morgan Stanley Latam Economics

Risks in Brazil continue to be political above all: If the political equilibrium that has been formed since the change in administration in August falls apart and the fiscal reforms are not approved, there could be another confidence crisis, leading to lower growth, a weaker currency, higher inflation and higher rates. In addition, materially tighter global financial conditions could threaten Brazil's plan to implement a gradual fiscal adjustment, which is the most that politics seems to allow at this point. On the upside, better delivery on reforms would drive a faster recovery.

Mexico: Rebalancing Without a Plan B

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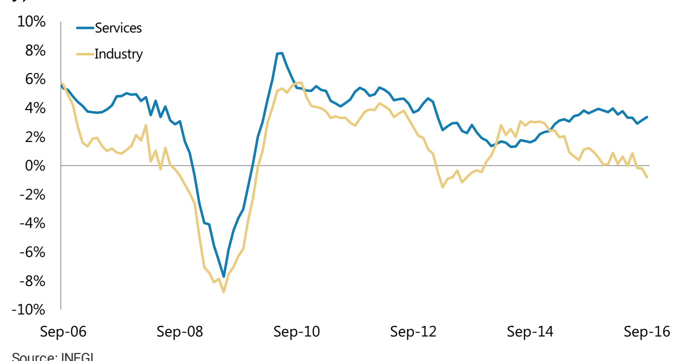
The already difficult task of managing external headwinds has turned a lot more challenging for Mexico following the outcome of the US election. A well-known duo of negatives that have been features of the recent Mexican narrative should continue to play out during 2017 (see "Mexico: Managing External Shocks," *in Latin America Spring Outlook*, March 16, 2016). The first one comes from low oil prices and falling output leading to fiscal belt tightening and pressure on energy capex. The second comes from weak export performance linked to the anaemic US industrial cycle, which has hurt Mexico's external-focused manufacturers (see "Mexico: Trading Trouble," *in Week Ahead in Latin America*, April 1, 2016). Now these two headwinds could be compounded by an even greater, narrative-changing threat: the potential for rising US trade protectionism. With its strong links to the US mainly in manufacturing, but also via remittances, energy trade, investment and technology transfer, a US backlash against free trade would have far reaching implications for Mexico, dealing a blow to its export-focused, North-America centric economic model. While our US team's base case is for protectionism to go only a little further than threats – averting a withdrawal from NAFTA – the associated uncertainty is set to take its toll on confidence, capex and hiring plans. While it is still early to tell how persistent the drag from this uncertainty may turn out to be, the fallout from the US election outcome may already be leading to greater caution among Mexico's businesses and their spending decisions (see "TMT Conference 2016 Highlights: Latam Telecommunications," November 18, 2016). Against this backdrop, we are adopting a more cautious view for 2017, forecasting growth to slow to a below-consensus 1.5% from 2.0% with risks skewed to the downside; for 2018, we look for a normalization with activity picking up to 2.3% as the US policy dust settles.

And Mexico's ability to lean against these headwinds is very limited. Mexico has no Plan B in the event of a protectionist shock, leaving the country with a near-term narrative likely dominated by policymakers' efforts to limit the fallout from potential trade barriers and to manage other external headwinds (see "Mexico: What Plan B? Coping with the Threat of Protectionism," *in Week Ahead in Latin America*, November 11, 2016). Counter-cyclical stimulus is out of the question as policymakers have been tightening policy – on both the monetary and fiscal fronts – as a way to address financial stability concerns. The 2017 budget contains the first primary surplus since 2008 and the smallest public works' budget – which has borne the brunt of the adjustment – in a decade. The central bank has tightened by 200 basis points so far this year and it is unlikely to be done: we see Banxico matching the Fed moves - following the new path laid out by our US team - this year and next pushing rates to 6.0% by the end of 2017, then taking some of the upfront hikes back (5.5%) in 2018. The wave of reforms from 2012-2013 is yielding clear benefits – in terms of lower inflation, greater formalization and investment – but the nature of such structural changes means that the bulk of the boost will only materialize over time. On the positive side, we sense that policymakers' focus on financial stability means that they stand ready to borrow measures from the toolkit used in the crisis to limit the potential for disorderly market adjustments.

Exhibit 11: Mexico: Services and Industry GDP (3mma, % change y-o-y)



Source: INEGI

With slower growth also comes a much-needed rebalancing. Brisk consumption has been the bright spot in Mexico's growth story. Yet as we have been arguing, the lopsided growth dynamic of solid consumption and stagnant production should converge more noticeably next year as consumer spending finally shifts into lower gear (see Exhibit 11). The good news is that a healthy starting point for consumers – with the unemployment rate back to pre-crisis levels, record-high remittances, rising bank credit and real wages – points to a gradual cooling off rather than a more abrupt slowdown. But consumers are unlikely to be immune to the negative effect of uncertainty about the US policy path and associated peso jitters, which should undermine confidence. And after enjoying two years of exceptionally low inflation, rising prices are set to start hitting consumers' pockets; indeed, we are upping our inflation forecast for 2017 to 3.9% – and moving above the 4% mark temporarily around mid-year – from 3.5% previously reflecting the impact of higher fuel prices and a weaker path for the peso (see "MXN: The Good, the Bad and the Uncertain," in *FX Pulse*, November 23, 2016). The economy's rebalancing should also translate into a narrowing in the current account shortfall – a constant source of concern among Mexico watchers – to 2.6% of GDP next year after hovering near 3.0% of GDP this year.

Exhibit 12:

Mexico Summary	2015	2016E	2017E	2018E
Real GDP (%Y)	2.5	2.0	1.5	2.3
Private consumption	3.1	2.3	1.8	2.0
Gross fixed investment	3.8	0.7	-0.4	2.4
Unemp. rate (% labour force)	4.4	3.9	4.1	4.0
Current account (% GDP)	-2.9	-2.9	-2.6	-2.4
CPI (%Y)	2.7	2.8	3.9	3.6
Policy rate (eop, %)	3.3	5.50	6.00	5.50
Fiscal balance (% GDP)	-3.5	-2.9	-2.5	-2.1
Int'l Reserves ($US bn)	176.7	175.0	175.0	175.0

Source: INEGI, Banxico, SHCP, Morgan Stanley Latam Economics

Politics are set to heat up into 2017 ahead of an important gubernatorial contest in the middle of next year and the 2018 presidential election. The mid-2016 vote already pointed toward greater voter fragmentation and rising support for the left. Against this backdrop, US protectionist measures that hit Mexico's export-focused northern states disproportionately could erode their traditional support for the current model, and thus play into the hands of the populist camp – and populism is something Mexico can ill afford (see "Mexico Equity Strategy & Economics: Risk from the North and from the South," November 15, 2016). We believe fragmentation could also complicate efforts to reach consensus on how to work with the new US administration in order to prevent legislation that goes against Mexican interests. And even if a populist shift is ultimately averted, Mexico may be heading towards a more fragmented voter base, representing a challenge for the next administration that takes office at the end of 2018.

Argentina: Cranking Up

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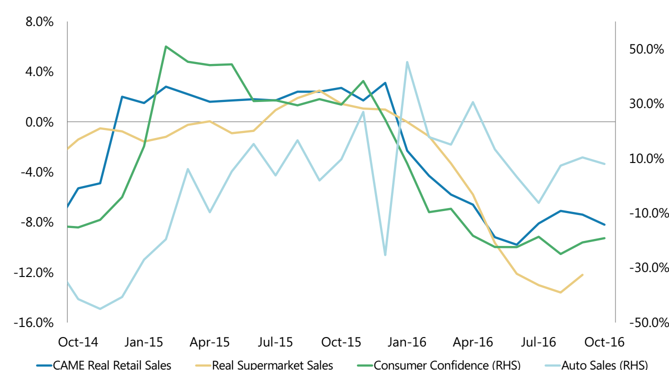
We have lowered our growth forecast for 2016 (from -1.6% to -2%) as the ongoing recession is deeper than anticipated and as the economy is not yet showing clear signs of a rebound. While previously we foresaw the economy bottoming out in 3Q2016, the evidence is that activity have weakened further in this time frame. A deeper than anticipated recession in 2016, led us to revise down our 2017 growth forecast slightly from 3.2% to 3.1%.

Despite the downgrades, we expect economic growth to start rebounding late in 2016 or early in 2017. We think the ongoing disinflation should improve real wages and year-end bonuses combined with the gradual implementation of pension adjustments will help the battered consumer. In addition, the public works agenda - mainly transport and social infrastructure - is clearly cranking up and some private investments should slowly begin to be deployed, especially in the energy generation sector. Finally, we think residential construction should boost growth and employment in 2017, particularly as some of the ongoing tax amnesty-related inflows channel through this sector. Progress in macro rebalancing and micro reforms should foster activity beyond 2017, leading us to believe in an investment-led growth cycle as the economy normalizes. Consequently, we expect 2018 growth at 3.6%.

We think lower inflation and improving real wages combined with some job gains should take consumers out of the doldrums (seeExhibit 13**).** With disinflation, interest rates should continue their downward path, gradually driving consumption via the credit channel. State transfers to consumers' pockets like the end-of-year bonuses in some sectors and the upward adjustment in pensions should gradually foster consumption, provided sentiment levels rise.

Exhibit 13: Argentina: Consumer Indicators (% change y-o-y)



Source: CAME, Indec, UTDT, Morgan Stanley Latam Economics

We continue to believe that a government-led boost to aggregate demand may help the economy rebound late this year. Consistent with the most recently released budget figures, it seems clear that the administration is jump-starting public works in an attempt to reinvigorate the weakened economy. With the October 2017 mid-term elections in mind, there seems to be a political decision to make progress on the infrastructure plans as soon as possible, to make sure the rebound takes place sooner rather than later.

Private sector investment should also pick up gradually in coming quarters. On top of the evident investment surge in agriculture, investment in energy generation should pick up pace next year. Also, if the expected rebound materializes, we think that a strong currency should help businesses update their equipment after years of import restrictions, given that capital goods mostly come from abroad. Moreover, we also see upside from a relatively better outlook in Brazil - Argentina's biggest trading partner - which should encourage export-led projects. With the recently approved PPP law, infrastructure-

related projects should have a positive impact on investment going forward. Finally, some of the tax amnesty-related inflows should also drive residential construction, which has a sizable impact on the investment rate and also on job creation.

We continue to think that net exports will put a dent in GDP growth going forward. After all, any investment-led rebound in Argentina is highly associated with rising imports. A strong currency and the gradual dismantling of protectionism in some sectors should stimulate imports. Although we believe exports will increase in 2017 and 2018 driven by agriculture and Brazil's recovery, the expected strong REER will put a ceiling on export growth.

Inflation will continue to subside in coming years, although our forecasts remain above the central bank targets. Disinflation should be driven by sound monetary policy - our view is that the announced inflation targeting scheme should work - and by the sizable slack in the economy created by 5 years of stagnation. We expect inflation to stand around 24.1% next year, with the December 2017 estimate at 18% y-o-y, above the central bank's upper limit of the target band of 17%.

Exhibit 14:

Argentina Summary	2015	2016E	2017E	2018E
Real GDP (%Y)	2.5	-2.0	3.1	3.6
Private consumption	3.6	-0.7	2.2	3.6
Gross fixed investment	4.2	-5.2	8.8	12.1
Current account (% GDP)	-2.5	-2.5	-2.5	-2.7
CPI (%Y)	26.7	40.6	24.1	14.8
Policy rate (eop, %)	33.00	25.00	20.00	11.50
Fiscal balance (% GDP)	-4.8	-5.1	-4.9	-4.6
Int'l Reserves ($US bn)	25.6	37.0	45.0	49.0

Source: Indec, Mecon, BCRA, Morgan Stanley Latam Economics

Our bull and bear cases hinge mostly on external factors, namely on how global conditions evolve and how those impact Brazil's and China's outlook. Our bear case assumes a significant deterioration in global liquidity conditions, with fiscal gradualism becoming an increasingly risky strategy. FDI and portfolio inflows are lower than anticipated and the government is forced to devalue the currency and make unpopular fiscal adjustments. With a weaker currency, progress on inflation is limited and depressed confidence triggers a vicious cycle of lower investment and consumption. As a result, growth remains muted; political risks and social tensions surge, leading the government to perform poorly at the 2017 mid-term elections, further weakening governability from then onwards. Alternatively, our bull case assumes global financial conditions remain relatively benign and that the fiscal deficit continues to be financed by debt issuance. China and Brazil grow above expectations as U.S. protectionism does not rise significantly, lifting activity via the external sector and FDI. Strong private sector investment coupled with public works lead to higher employment, boosting consumer sentiment. A faster disinflation process also weighs positively on consumer confidence and leads the central bank to cut rates more aggressively.

Chile: Approaching an Inflection Point?

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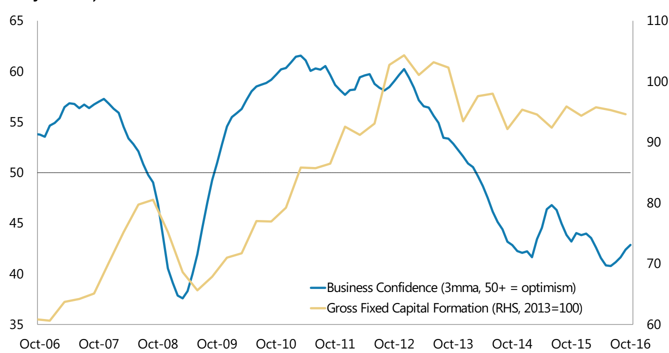
After a year dominated by downward growth revisions, Chile may be approaching an inflection point on the back of the prospects for positive political change, allowing the country to move past the narrative of domestic uncertainty and external headwinds which kept the economy in a sub-2% slow growth channel in the past two years. While the country has undergone the bulk of its adjustment to lower terms of trade and has ample fiscal buffers - which should allow it to successfully withstand additional negative external shocks associated to risks linked to politics and policy decisions in industrialized countries - it is on the domestic policy front where we see room for optimism. And this represents a major shift in the right direction from our previous cautious stance. The ruling coalition experienced a major defeat in October's regional elections, reinforcing the prospects for welcome political change in 2017 which could help reverse widespread pessimism among businesses and consumers (see "Chile Equity Strategy: Ready for Change. Overweight," October 17, 2016). Meanwhile, rapidly subsiding price pressures – headline inflation plunged below 3% to the lowest level in nearly three years – prompted the central bank to put the option of cutting rates back on the table for the first time since October 2014, paving the way for potentially easing in 2017.

Despite our optimism about political change, a near term turnaround in the country's growth narrative should remain elusive as the potential for tighter external financial conditions and a deteriorating job market should undermine any recovery. After all Chile, as other emerging economies, will be tested in 2017 by a stronger US dollar, higher US rates and uncertainty regarding protectionism. Given that Chile's economy is open by Latin American standards with trade representing 45% of GDP - well above other Latam commodity exporters - and the external indebtedness of the non-financial private sector is relatively high (at over 25% of GDP), these external factors represent important risks for the country's outlook. Meanwhile, consumers should keep struggling with deteriorating labor market conditions –unemployment reached a 5-year high in the third quarter. That said, our growth forecasts for this year (1.6%) and next (1.7%) remain unchanged as the fallout on investment from weak global demand and worse terms of trade keeps playing out while worsening labor markets cap any upside from consumption. Looking further ahead, we see prospects for positive political change next year providing a breath of fresh air for Chile, as the most likely presidential candidates are expected to implement market-friendly policies and break from the confidence-sapping political polarization that has characterized the country's narrative in recent years. Accordingly, we are initiating 2018 growth at 2.4%, the strongest pickup since 2013.

Exhibit 15: Chile: Business Confidence & Investment (seasonally adjusted)



Source: ICARE, BCCL, Morgan Stanley Latam Economics

The political jockeying ahead of November's presidential vote is likely to dominate the Chile narrative in the year ahead. The upcoming elections could act as powerful catalyst to dissipate the generalized domestic policy uncertainty that has undermined confidence, in turn conspiring to keep investment stalled since 2014 (see Exhibit 15). Indeed, presidential approval ratings stand at a 10-year low while data from a local pollster shows the percentage of Chileans that are pessimistic with the direction of the country rose to 85% by mid-year. With that in mind, a new administration could open the door to broad dialogue with the goal of improving recent reforms, which were contentious and approved without broad consensus. The list runs long, ranging from simplifying the tax system revamped in 2014 to refocusing resources towards tackling shortcomings with the quality of schooling and addressing infrastructure bottlenecks, following the successful example of the energy sector in recent years.

Politics aside, we also see further room for optimism ahead given the benign inflation dynamics that Chile has been enjoying lately. A relatively stable exchange rate and greater slack in the labor market are helping keep a lid on price pressures. In fact, inflation dipped to 2.8% in October, below the central bank's target for the first time in almost three years. Coupled with mounting signs of dovishness in policymakers' comments and statements, we are maintaining our long-standing call that a modest easing cycle is in store for 2017.

Exhibit 16:

Chile Summary	2015	2016E	2017E	2018E
Real GDP (%Y)	2.3	1.6	1.7	2.4
Private consumption	1.9	1.8	1.5	1.8
Gross fixed investment	-1.5	1.4	1.5	4.0
Current account (% GDP)	-2.0	-1.8	-2.1	-1.9
CPI (%Y)	4.3	3.8	2.6	3.1
Policy rate (eop, %)	3.50	3.50	3.00	3.00
Fiscal balance (% GDP)	-2.2	-3.2	-3.3	-2.9
Int'l Reserves ($US bn)	38.6	39.0	39.0	39.0

Source: Banco Central de Chile, INEI, Morgan Stanley Latam Economics

Political change after next year's elections may allow Chile to break out of the slow growth channel, but in the short run domestic uncertainty and external headwinds should continue keeping activity subdued. By focusing on the still weak prospects for growth, Chile watchers may be missing the forest for the trees. The real story in Chile lies with the possibility of a positive break away from the recent years of political polarization and domestic policy uncertainty; and that inflection point could arrive in 2017, setting the stage for an investment-led rebound in 2018.

Colombia: Heightened Uncertainty

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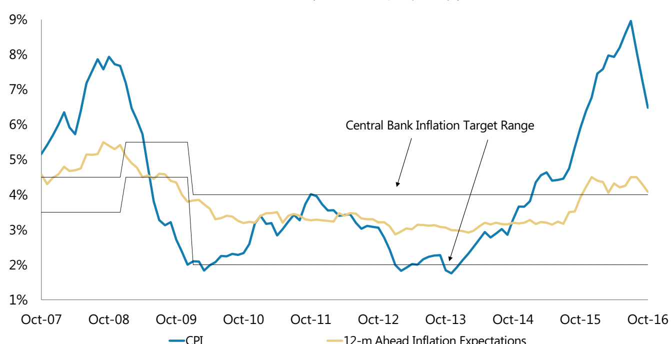
Colombia's adjustment to lower terms of trade remains in place. Growth has decelerated significantly, the current account deficit is narrowing, and the disinflation process is underway, in line with our summer call (see "Colombia: Orderly Adjustment," *In Latin America Economic Summer Outlook*, July 18, 2015). However, new uncertainties have weakened sentiment recently and may put a ceiling on growth going forward. Heightened uncertainty is a consequence of the peace process saga, the impact of an eventual tax reform, and the potential new policy direction in the U.S. that could hurt Colombia's outlook.

Amid elevated uncertainty, we have adjusted our growth forecasts slightly downward for this year and next, remaining below consensus. We now have GDP growth at 2% this year (from our previous 2.2%) and at 2.4% in 2017 (from 2.7%). We believe that domestic demand should continue weakening in an orderly manner as interest rates are kept at today's levels until year-end (7.75%) (see "Colombia: The Monetary Policy Debate," *In Week Ahead in Latin America*, August 5, 2016). We see BanRep starting to cut rates in 1Q2017, an easing cycle we estimate at 175bps by the end of 2017. With lower rates, recovering oil prices and reduced uncertainty, we foresee economic growth at 3% in 2018.

Exhibit 17: Colombia: Inflation (% change y-o-y)



Source: DANE, BanRep

Although inflation remains well above the target band (2-4%), it has decelerated sharply over the past few months – coming down from 9.0% at the July peak to 6.5% in October - mostly dragged by falling food prices (see Exhibit 17). We think that the ongoing disinflation process will continue in coming quarters - albeit at a diminished pace as food prices stabilize and as an eventual increase in VAT is passed on to consumers. In fact, we continue to think that Colombia is not out of the woods yet when it comes to inflation as FX-related pressures are likely to persist in a context of capital flight away from EM and as inflation expectations remain above the upper limit of the target band.

We think the consumer outlook remains bleak given the elevated uncertainty. Although a quick approval of the revised peace agreement could help lift consumer confidence, there are too many factors weighing against an improved consumer backdrop. First, higher personal taxes - as proposed in the tax reform – will weigh on sentiment and disposable income. Second, rising protectionism in the U.S. could have a negative impact on employment. And third, the ongoing tighter credit conditions should put a lid on consumption for a while. The easing cycle we expect next year should help, though it will take some time to filter through the system and reach consumers.

We expect investment and government spending to remain muted this year and next. Business investment, closely linked to the extractive industries, is expected to remain weak as long as uncertainty about oil prices, peace eventual approval and implementation, and U.S. trade policy stays high. Moreover, the needed fiscal

consolidation process requires government spending to remain low, even if a tax reform increases revenues.

Net exports may continue to marginally support economic growth this year and in 2017 on the heels of an improved oil outlook and lower imports. With oil representing at least 40% of Colombia's exports, higher oil prices play a major role in the overall trade balance. In the longer run, there are downward risks to our call as an eventual surge in protectionism in the U.S. - destination of 30% of Colombia's exports - could have a sizable negative impact on trade.

Exhibit 18:

Colombia Summary	2015	2016E	2017E	2018E
Real GDP (%Y)	3.1	2.0	2.4	3.0
Private consumption	3.9	2.2	2.5	3.0
Gross fixed investment	2.8	-2.1	2.2	5.6
Current account (% GDP)	-6.5	-4.9	-4.1	-3.6
CPI (%Y)	5.0	7.5	3.9	3.6
Policy rate (eop, %)	5.75	7.75	6.00	5.00
Fiscal balance (% GDP)	-3.1	-3.9	-3.4	-2.7
Int'l Reserves ($US bn)	46.7	46.0	47.0	48.0

Source: DANE, BanRep, Morgan Stanley Latam Economics

Our bull and bear scenarios are partially dependent on whether the peace process and tax reform are approved, and the eventual timing of those events. Another key factors are oil prices and the extent to which U.S. policy direction shifts. Under the bullish view, the revised peace deal and a tax reform are approved before end of 2016. Inflation declines faster than anticipated as a soft landing remains on track and as currency holds up relatively well, and higher oil prices and a stronger FX help. Global liquidity conditions remain benign and protectionism in the U.S is softer than anticipated, lifting sentiment. The central bank cuts rates more aggressively next year, fostering higher growth. On the contrary, the bear scenario assumes that the renewed peace deal and tax reform are not approved in the coming months, depressing sentiment further. Oil prices trend lower than expected and the fiscal deficit is wider than targeted, leading the government to cut spending further. Inflation remains elevated due to currency depreciation and despite weakening domestic demand. Protectionism in the U.S. hurts the export and investment outlook further.

Peru: Looking Past the Mining Boost

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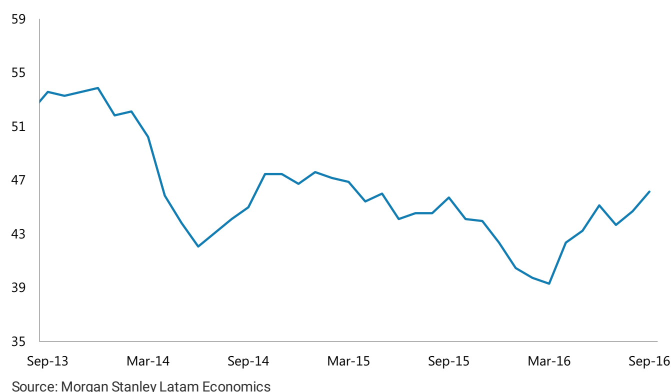
Peru should remain the bright star in the region thanks to a combination of solid growth momentum and a new administration focused on implementing its growth-enhancing reform agenda. Compared to our Summer Outlook, we are marking to market our GDP numbers, up to 3.8% in 2016 (from 3.5%) while taking a more constructive view for 2017 with activity rising 4.4% 2017 (from 4.0%) – the fastest among the region's major economies. The story for 2016 has been one of a single-engine growth dynamic driven by the mining sector – up 18.4% so far this year, contributing with 2.7pp of the 4.2% overall GDP growth - but this positive impact to the economy, caused mainly by the addition of major new capacity in copper, is already past its peak and should keep fading into 2017. Against this backdrop, it is critical for our positive outlook that growth gradually starts broadening beyond the rebound in primary activities. Encouragingly, there are some early signs that this broadening may be taking hold: though manufacturing activity has been stagnant, since early 2016 a rising number of industries have been contributing positively to industrial growth (see Exhibit 19 and "Peru: Broader and Better?", in *Week Ahead in Latin America*, September 9, 2016).

Exhibit 19: Peru: Industrial Production Diffusion Index



Source: Morgan Stanley Latam Economics

Our call for a successful broadening in Peru's growth dynamic depends on policymakers' ability to advance the reform agenda, which includes addressing the country's high informality, cutting red tape to free up stalled investment projects, boosting infrastructure spending and tax reform (see "Peru Equity and Forex Strategy: Reforms Needed", October 25, 2016). Negotiations with the opposition-controlled congress will be critical for the reform outlook and we remain constructive on this issue, particularly given the meaningful overlap in the policy priorities of the executive and largest congressional block (see "Peru: Unlocking Potential", in *Latin America Summer Outlook*, July 18, 2016). The timing also matters, since it is important for the executive to make good use of its post-election honeymoon; encouragingly, despite some early pushback from lawmakers on the executive's proposal for broad legislative powers, both business and consumer confidence has been riding high suggesting optimism about the administration's ability to deliver on its pro-growth agenda. If successful, these measures could create a new narrative in Peru beyond the mining-centric growth dynamic, which would make the Peruvian economy less dependent on commodity prices and their inherent volatility.

There are three main risks to our positive outlook for the Peruvian economy in the year ahead. First, negotiations between the executive and legislative could turn more challenging, jeopardizing reform initiatives and undermining confidence. Second, delays in the execution of investment projects – both progress with public works and by addressing social tensions that have put mining projects on hold – combined with weakness in trading partners could hurt the prospects for a further strengthening in

growth next year. Last, higher US rates and a stronger dollar– risks for the entire EM space highlighted by our global team – could lead to market jitters and potential outflows, adding pressure to Peru's still heavily dollarized economy. Under such a scenario – which is not our base case – policymakers' hand may be forced into hiking interest rates. While Peru has been absent from anti-trade campaign rhetoric, the fact that it has a free-trade agreement with the US leaves it vulnerable to targeted barriers. Indeed, a new US administration could lead to frictions in the Trans-Pacific Partnership Agreement (TPPA); and by now the prospect for the US inclusion as an observer into the Pacific Alliance seems highly unlikely.

Exhibit 20:

Peru Summary	2015	2016E	2017E	2018E
Real GDP (%Y)	3.3	3.8	4.4	4.7
Private consumption	3.4	3.6	4.7	4.8
Gross fixed investment	-5.1	-5.3	1.8	6.7
Current account (% GDP)	-4.8	-3.8	-3.5	-3.4
CPI (%Y)	3.5	3.6	3.3	2.5
Policy rate (eop, %)	3.75	4.25	4.25	4.25
Fiscal balance (% GDP)	-2.1	-3.0	-2.8	-2.6
Int'l Reserves ($US bn)	61.5	60.6	61.0	61.5

Source: BCRP, INEI, Morgan Stanley Latam Economics

As in many of its regional neighbors, Peru's highflation challenge is now behind, allowing the central bank to stay on hold at 4.25% for a long period of time - until the end of 2018, in our view. Inflation has exhibited a benign behavior decelerating from the 4.6% peak early this year to just 2.9% in August. Despite the recent pickup that brought inflation to 3.4% in October, core inflation kept its downward trend. Renewed currency depreciation arising from a more risk averse environment due to the US elections should keep adding some modest pressure to prices; hence we are revising inflation to 3.0% in 2017 with some normalization in 2018 as inflation decelerates to 2.1%, closer to the 2%-target.

Venezuela: Survival Mode

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Venezuela has been one of the top performers in the index this year, but we think the market has been too complacent about the country's risks. With Venezuela's long end bonds trading about 7 points below the peaks of the year, bonds are trading more in line with oil now. We believe this is correct, as with reserves dwindling, limited scope for outside financing and fewer assets to sell, Venezuela's capacity to pay becomes increasingly dependent on the oil price. Social unrest and severe shortages will make it difficult to squeeze imports any further and the country's shortage of hard currency remains a binding constraint for debt service. We estimate that Venezuela and PdVSA will need an oil price of around $40 in the Venezuelan basket to be able to service its debt in 2017, but a material decline in oil prices (we estimate $10 per barrel) would make a credit event in 2017 very likely. Risk/reward of the Venezuela curve favors the long end of the curve, with bonds trading in the low 40s, compared to the very front end which is trading in the 70s.

Marginally higher oil prices in 2017 should help Venezuela ease some of the import restrictions. This is an important development that may help quell the social unrest recently seen in many areas, triggered by the lack of basic imported food items and medicines. Indeed, we expect imports to rise approximately 10% compared to 2016. Nevertheless, this would hardly solve the severe shortages that the country is currently facing, as it would still be 31% lower than the level as recently as 2015.

The combination of mildly higher oil prices and still constrained imports should allow the government to meet its external obligations. Recently, the government had to exercise a 30-day grace period to pay some coupons as funds were diverted to pay for imports of basic goods. To maintain investor confidence, Venezuelan officials provided assurances that they would continue to service the country's obligations in coming days. This highlights the tight constraints on the Venezuelan economy, but also shows how committed authorities are to service external obligations even at the cost of imports.

Exhibit 21:

Venezuela Summary	2015	2016E	2017E	2018E
Real GDP (%Y)	-5.7	-11.0	-5.0	1.5
Private consumption	-8.6	-13.5	-5.2	1.8
Gross fixed investment	-22.3	-22.8	-12.1	-0.4
Current account (% GDP)	n/a	n/a	n/a	n/a
CPI (%Y)	122	314	430	192
Policy rate (eop, %)	n/a	n/a	n/a	n/a
Fiscal balance (% GDP)	-14.1	-6.9	-6.0	-3.5
Int'l Reserves ($US bn)	16.4	5.0	3.0	3.0

Source: BCV, Morgan Stanley Latam Economics

Despite the marginally higher imports we expect, scarcity and stagflation should continue to plague Venezuela. The import restrictions have grave consequences for the economy: First, they constrain investments of any sort as Venezuela produces very little capital goods. In addition, many supply chains are disrupted, curbing final output. Finally, goods scarcity generates hyperinflation, which erodes purchasing power and, more importantly, creates hurdles to investments and corporate growth due to low pricing visibility.

In order to escape from this vicious cycle, Venezuela needs to tackle a series of reforms, such as liberalizing the exchange rate, implementing a monetary policy framework, and lifting price controls, amongst others. Such reforms are extremely unlikely in the existing political environment, and we are not expecting a material political shift any time soon.

Latin America Quarterly Forecast Profile

Latin America GDP Forecasts

Seasonally adjusted, % change q-o-q

		3Q16	4Q16	1Q17	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18
Argentina	GDP	-0.6	0.9	0.7	2.0	1.4	1.2	0.3	0.9	0.8	0.9
	Consumption	-2.6	-0.4	1.1	2.1	1.6	1.2	0.3	0.7	0.5	1.1
	Investment	-0.5	0.7	2.0	3.8	4.8	4.3	1.2	2.8	3.1	1.3
Brazil	GDP	-0.5	0.0	0.4	0.6	0.7	0.6	0.6	0.8	0.6	0.6
	Consumption	-0.8	-0.1	0.3	0.5	0.6	0.5	0.6	0.9	0.7	0.7
	Investment	-1.5	0.4	1.1	1.5	1.5	1.6	1.5	1.5	1.3	1.2
Chile	GDP	0.6	0.4	0.4	0.5	0.6	0.5	0.6	0.7	0.5	0.6
	Consumption	0.4	0.4	0.5	0.4	0.4	0.4	0.5	0.4	0.5	0.5
	Investment	0.8	0.3	0.3	0.5	0.5	0.8	1.1	1.5	1.0	0.9
Colombia	GDP	0.9	0.1	0.3	1.1	0.5	1.4	0.2	0.8	0.8	0.8
	Consumption	0.3	0.4	0.6	0.9	1.2	0.7	0.4	0.7	0.9	0.8
	Investment	0.3	-0.7	-0.3	1.3	1.8	2.8	0.6	1.0	0.8	1.6
Mexico	GDP	1.0	0.4	0.2	0.2	0.4	0.5	0.7	0.7	0.5	0.5
	Consumption	1.3	0.4	0.4	0.3	0.4	0.4	0.5	0.6	0.6	0.5
	Investment	1.2	0.1	-0.7	-0.6	0.2	0.7	0.8	0.7	0.9	0.8
Peru	GDP	1.3	0.4	1.1	1.5	1.3	1.1	1.2	1.2	1.0	0.9
	Consumption	1.0	1.0	1.3	1.4	1.2	1.0	1.2	1.3	1.1	1.0
	Investment	-2.6	-1.0	1.1	2.0	2.0	1.8	1.6	1.6	1.4	1.1
Venezuela	GDP	-2.6	-1.8	-0.8	-0.5	-0.1	0.4	0.4	0.8	0.6	0.5
	Consumption	-3.0	-1.5	-1.0	-0.8	0.5	0.7	0.7	0.5	0.5	0.5
	Investment	-5.0	-4.0	-3.5	-2.5	-2.0	0.0	1.1	0.1	0.0	1.0
Region	GDP	0.1	0.1	0.3	0.7	0.6	0.7	0.6	0.8	0.6	0.6
	Consumption	-0.3	0.0	0.4	0.6	0.7	0.6	0.6	0.7	0.7	0.7
	Investment	-0.6	-0.1	0.3	0.9	1.3	1.6	1.2	1.3	1.2	1.1

Source: Morgan Stanley Latam Economics

Latin America GDP Forecasts

% change y-o-y

	3Q16	4Q16	1Q17	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18
Argentina	-3.0	-1.7	-0.7	3.4	4.9	4.7	4.7	3.6	3.6	2.6
Brazil	-2.7	-1.5	-0.7	0.5	1.7	2.5	2.6	2.9	2.7	3.1
Chile	1.5	1.7	1.6	1.8	1.6	1.9	2.2	2.4	2.4	2.4
Colombia	2.1	1.5	1.6	2.5	2.1	3.3	3.3	2.9	3.3	2.7
Mexico	2.0	1.7	2.1	1.4	1.2	1.2	1.8	2.3	2.4	2.4
Peru	4.4	2.8	3.5	4.6	4.2	5.1	5.2	4.7	4.6	4.4
Venezuela	-12.8	-12.9	-11.0	-5.9	-3.0	-0.5	-0.4	1.3	2.6	2.3
Region	-1.0	-0.6	0.1	1.2	1.8	2.4	2.6	2.8	2.9	2.8

Source: Morgan Stanley Latam Economics

Latin America CPI Forecasts

% change y-o-y

	3Q16	4Q16	1Q17	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18
Argentina	43.9	42.2	35.5	23.8	20.7	18.8	16.4	14.9	14.7	13.5
Brazil	8.7	7.3	6.0	5.4	4.7	5.0	4.9	4.7	4.7	4.5
Chile	3.5	2.9	2.5	2.4	2.6	3.0	3.2	3.2	3.1	3.0
Colombia	8.1	6.1	4.5	3.6	3.5	4.0	3.7	3.6	3.5	3.5
Mexico	2.8	3.2	3.5	4.0	4.0	3.9	3.7	3.7	3.5	3.4
Peru	3.1	3.4	3.2	3.4	3.5	3.0	2.8	2.6	2.4	2.1
Venezuela	335	400	454	444	430	400	322	243	160	100
Region*	10.3	9.4	8.1	6.6	6.0	5.9	5.5	5.3	5.1	4.9

Source: Morgan Stanley Latam Economics. * Regional CPI Forecasts exclude Venezuela.

Latin America Policy Rates Forecasts

Annual rate

	3Q16	4Q16	1Q17	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18
Argentina	26.75	25.00	25.00	22.50	21.00	20.00	16.55	14.60	12.70	11.50
Brazil	14.25	13.75	12.50	11.25	10.00	10.00	10.00	10.00	10.00	10.00
Chile	3.50	3.50	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00
Colombia	7.75	7.75	7.25	6.50	6.00	6.00	5.75	5.25	5.00	5.00
Mexico	4.75	5.50	5.50	5.50	5.75	6.00	6.00	6.00	5.75	5.50
Peru	4.25	4.25	4.25	4.25	4.25	4.25	4.25	4.25	4.25	4.25

Source: Morgan Stanley Latam Economics

On the Horizon

Latin America Annual Economic Forecasts

		Argentina	Brazil	Chile	Colombia	Mexico	Peru	Venezuela
Real GDP Growth (%Y)	2015	2.5	-3.8	2.3	3.1	2.5	3.3	-5.7
	2016E	-2.0	-3.3	1.6	2.0	2.0	3.8	-11.0
	2017E	3.1	1.1	1.7	2.4	1.5	4.4	-5.0
	2018E	3.6	2.8	2.4	3.0	2.3	4.7	1.5
Private Consumption (%Y)	2015	3.6	-4.1	1.9	3.9	3.1	3.4	-8.6
	2016E	-0.7	-4.5	1.8	2.2	2.3	3.6	-13.5
	2017E	2.2	0.5	1.5	2.5	1.8	4.7	-5.2
	2018E	3.6	2.6	1.8	3.0	2.0	4.8	1.8
Gross Fixed Investment (%Y)	2015	4.2	-14.3	-1.5	2.8	3.8	-5.1	-22.3
	2016E	-5.2	-8.9	1.4	-2.1	0.7	-5.3	-22.8
	2017E	8.8	3.2	1.5	2.2	-0.4	1.8	-12.1
	2018E	12.1	6.0	4.0	5.6	2.4	6.7	-0.4
FX Rate (year-end vs US$)	2015	12.94	3.90	707	3149	17.21	3.41	6.3
	2016E	16.10	3.40	670	3100	20.50	3.40	10.0
	2017E	18.00	3.60	705	3325	21.70	3.60	250
	2018E	22.50	3.70	700	3300	21.80	3.60	1200
Trade Balance ($ billion)	2015	-3.0	19.7	3.5	-18.4	-14.6	-3.1	6.2
	2016E	1.7	42.0	3.9	-13.6	-16.5	-0.5	10.5
	2017E	-1.7	31.0	3.8	-11.8	-13.7	-0.7	19.0
	2018E	-4.5	28.0	3.2	-10.3	-11.2	-0.8	12.0
Policy Rates (% year-end)	2015	33.00	14.25	3.50	5.75	3.25	3.75	n/a
	2016E	25.00	13.75	3.50	7.75	5.50	4.25	n/a
	2017E	20.00	10.00	3.00	6.00	6.00	4.25	n/a
	2018E	11.50	10.00	3.00	5.00	5.50	4.25	n/a
CPI Inflation (% year end)	2015	26.9	10.7	4.4	6.8	2.1	4.4	180.9
	2016E	39.9	6.9	2.8	5.8	3.2	3.4	400
	2017E	18.0	4.9	3.1	4.0	3.9	3.0	400
	2018E	13.2	4.5	3.0	3.5	3.4	2.1	100
C/A Balance (% of GDP)	2015	-2.5	-3.4	-2.0	-6.5	-2.9	-4.8	n/a
	2016E	-2.5	-1.2	-1.8	-4.9	-2.9	-3.8	n/a
	2017E	-2.5	-2.0	-2.1	-4.1	-2.6	-3.5	n/a
	2018E	-2.7	-2.5	-1.9	-3.6	-2.4	-3.4	n/a
International Reserves ($ billion)	2015	25.6	356.5	38.6	46.7	176.7	61.5	16.4
	2016E	37.0	365.0	39.0	46.0	175.0	60.6	5.0
	2017E	45.0	365.0	39.0	47.0	175.0	61.0	3.0
	2018E	49.0	365.0	39.0	48.0	175.0	61.5	3.0
Public Sector Balance (% GDP)	2015	-4.8	-10.3	-2.2	-3.1	-3.5	-2.1	-14.1
	2016E	-5.1	-9.3	-3.2	-3.9	-2.9	-3.0	-6.9
	2017E	-4.9	-7.9	-3.3	-3.4	-2.5	-2.8	-6.0
	2018E	-4.6	-6.9	-2.9	-2.7	-2.1	-2.6	-3.5

Source: Morgan Stanley Latam Economics. Notes: E = Morgan Stanley estimates

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