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Latin America Macro Outlook

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Global economy: No pain, no gain

- **Growth: policy driven recessions**
  - Mild recessions in US, EA, JA and UK
  - Slow recovery in China
- **Inflation: easy start, tough finish**
  - Supply side drivers should fade fast
  - But getting down to 2% is tough
- **Policy rates: higher for longer**
  - US peak: 5.00-5.25%
  - Global: 5.9%
- **Risks: more inflation, recession**
- **Markets: still some pain**

Forecast summary
The global recovery has been uneven

	2021	2022F	2023F	2024F
Global				
GDP	6.2	3.3	2.3	3.2
CPI	4.0	8.5	6.4	4.4
Policy rate (% eop)	2.3	4.7	5.9	4.7
US				
GDP	5.9	1.8	-0.4	0.9
CPI	4.7	8.1	4.4	2.5
Policy rate (% eop)	0.1	4.4	4.9	2.9
Euro area				
GDP	5.3	3.4	0.1	1.2
CPI	2.6	8.5	5.6	2.0
Policy rate (% eop)	-0.5	2.0	3.25	2.5
China				
GDP	8.1	3.0	5.5	6.5
CPI	0.9	2.1	2.0	3.5
Policy rate (% eop)	3.8	3.7	3.7	3.7

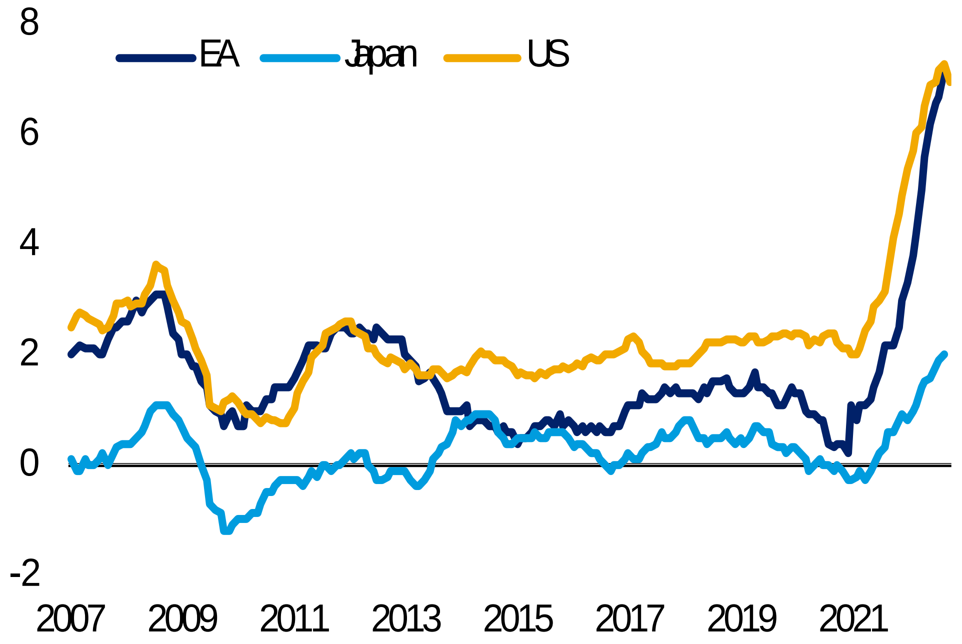
Source: BofA Global Research

Global inflation

- **High almost everywhere**
  - Europe more food and energy
  - US more underlying inflation
  - Even Japan is above-zero
- **Supply shocks should fade**
  - Low growth=flat commodities
  - Low goods demand=better supply chains
- **But landing zone varies**
  - Back to target in Euro Area
  - Takes long in the US
  - ROW in between

Underlying inflation pressure

Trimmed mean is a much better metric than the traditional core



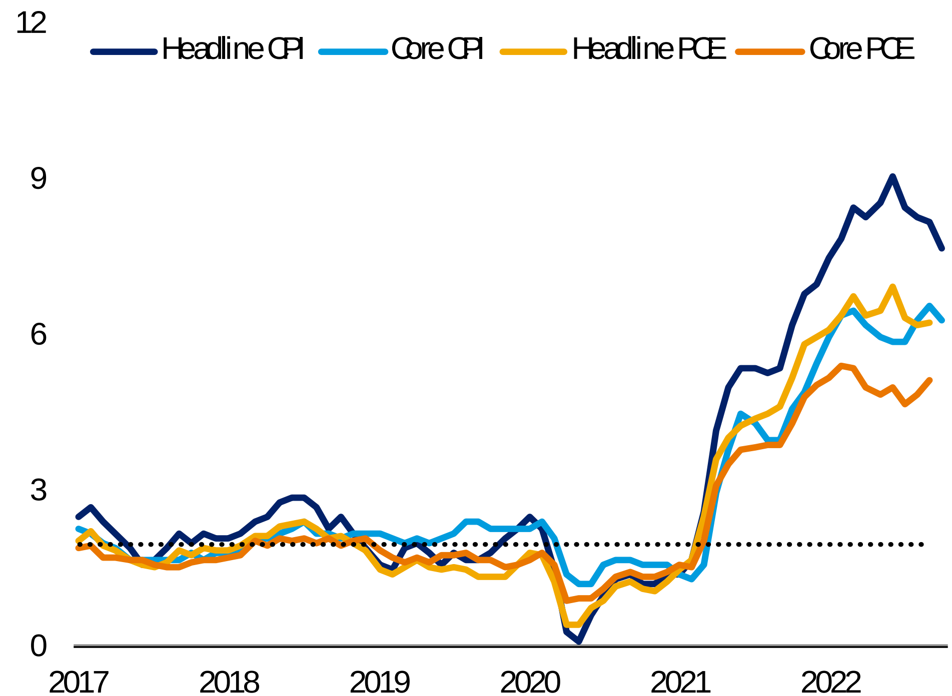
Source: BofA Global Research, ECB, BoJ, FRB Cleveland

US Inflation: Easy too get to 3-4%, hard to get to 2%

- **Four drivers of inflation**
  - Surging commodity prices
  - Supply chain problems
  - Overheating labor markets
  - Higher inflation expectations
- **The first two are easy to correct**
  - Leveling off means lower inflation
  - Fed plays small role
- **The second two are a major challenge**
  - US needs a labor recession
  - Hopes inflation expectations haven't' unanchored

Major consumer price measures all peaking (% yoy)

A tiny step in the return to normal



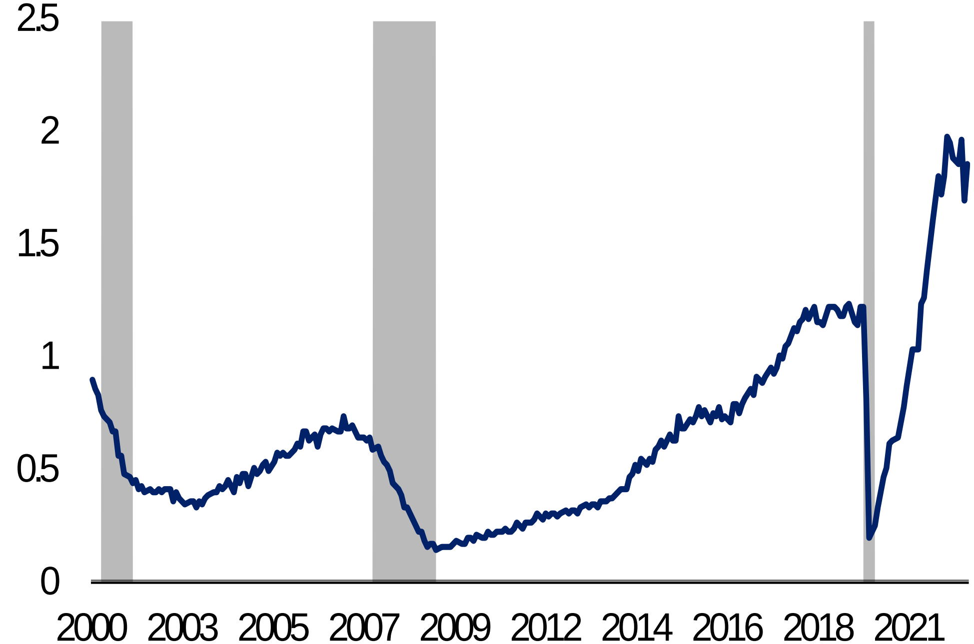
Source: BEA, CPI

US inflation: The job market is still overheating

- **The hottest labor market in history**
  - Record job openings
  - Record quits
  - Surging wages
  - Plunging productivity
- **Sharing the blame**
  - Cool supply
  - Fed- and fiscal-induced demand
- **Cooling off requires**
  - Job growth << labor force growth
  - Push unemployment up
  - But labor slowdown is lagging

Record high ratio of job openings to unemployed

The labor market is red-hot but job openings have started to fall



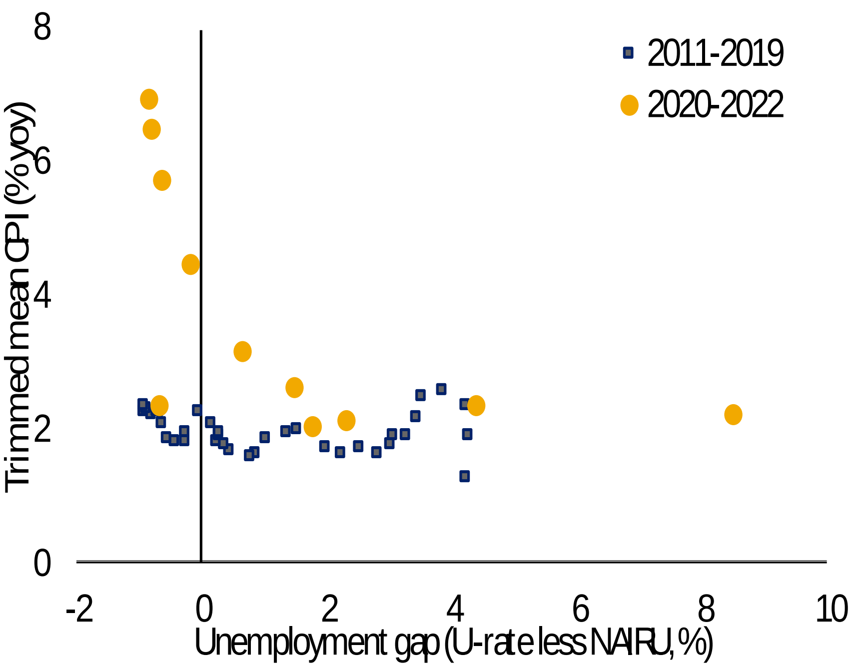
Source: BLS

US inflation: The new-old Phillips Curve

- **Curve can't be flat all the way to zero**
- **Flatness a function of a proactive Fed**
- **Exploiting the curve makes it steeper**
- **Blank check fiscal policy added fuel to the fire**
- **Two additional problems**
  - Job openings point to even bigger imbalance
  - Higher inflation expectations also problematic
- **Three kinds of shifts**
  - Steeper curve—just need to return to NAIRU
  - Higher NAIRU—bigger rise in unempl. needed
  - Curve shifted up—major problem

Trimmed-mean CPI and unemployment gap

The Phillips curve appears to have shifted and steepened

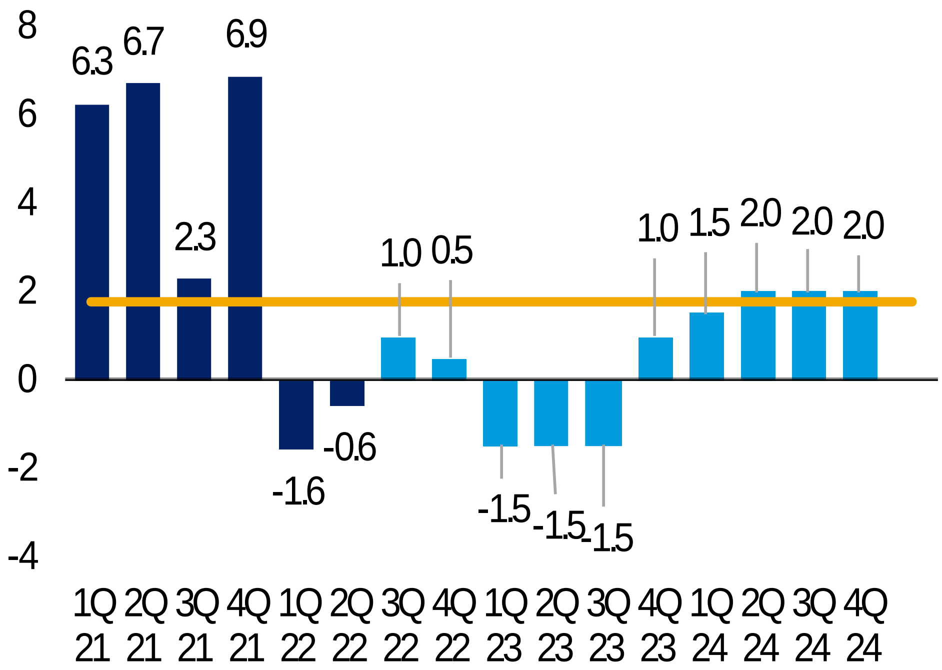


Source: BofA Global Research, BLS

US growth: A mild recession

- **Strong momentum**
  - Reopening
  - Strong and liquid balance sheets
  - Pent-up demand
- **Two kinds of shocks**
  - Serious, sustained supply shocks
  - Inflation fighting Fed
- **Recession highly likely**
  - But could be delayed
  - Resilience means more rate hikes

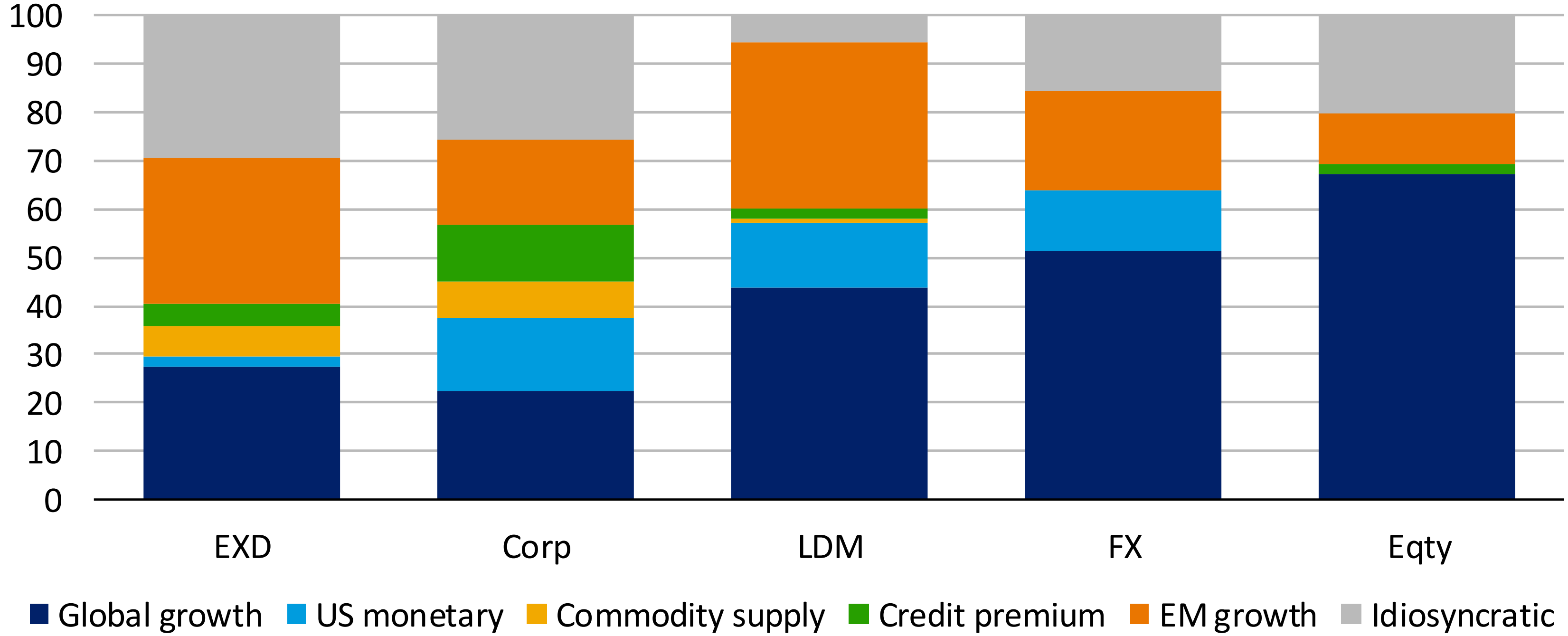
Really weak GDP growth (qoq, ar)
We expect GDP growth to drop below potential next year



Source: BofA Global Research, Bureau of Economic Analysis

LatAm: a very large exposure to global factors

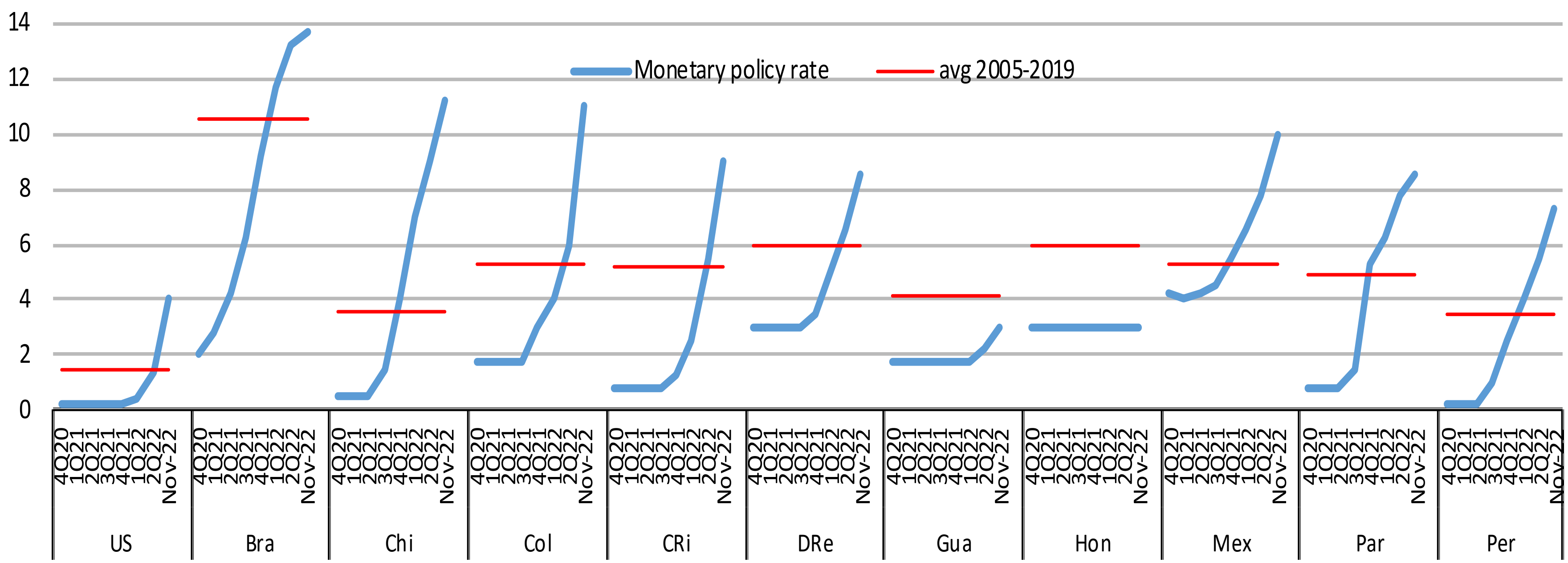
LatAm assets are highly exposed to global factors
Variance explained by global factors (%)



Source: BofA Global Research, Blooomberg.

… which prompted central banks to hike aggressively

LatAm has embarked on an aggressive hiking cycle
Policy rate hikes across the inflation-targeting central banks of Latin America



Source: BofA Global Research, Bloooomberg.

LatAm is a good candidate for stagflation

LatAm GDP growth will decelerate to 3.7% in 2022 and 1.1% in 2023
BofA forecasts

	Real GDP growth (% yoy)				CPI inflation (%)				Monetary Policy rate (%, eop)		
	2022F	2023F	2024F		2022F	2023F	2024F		2022F	2023F	2024F
LatAm	3.8	1.0	2.1		7.8	5.0	4.0				
Argentina	5.0	1.0	-1.0		99.4	85.0	51.0		75.00	60.00	60.00
Brazil	3.3	0.9	2.4		5.8	4.8	3.7		13.75	10.50	8.00
Chile	2.5	-1.0	2.0		12.6	5.5	3.9		11.25	8.00	6.00
Colombia	8.1	2.5	2.8		12.2	7.4	5.2		11.50	12.00	8.00
Costa Rica	4.3	2.9	3.5		10.0	4.4	3.0		9.50	6.00	4.75
Dom Rep	5.5	4.2	4.5		8.0	5.1	4.0		9.00	7.50	5.50
Ecuador	3.7	3.4	2.8		4.0	2.7	2.6		-	-	-
El Salvador	3.0	2.1	2.8		7.1	3.0	2.4		-	-	-
Guatemala	4.0	3.2	3.5		9.7	5.1	4.2		3.50	4.50	4.50
Mexico	2.5	0.0	2.2		8.4	4.7	4.5		10.50	11.00	7.50
Panama	7.0	3.9	4.0		3.6	2.5	1.7		-	-	-
Peru	2.6	2.1	2.9		8.0	4.2	2.8		7.50	6.75	3.75
Uruguay	5.3	3.0	2.8		9.3	7.1	6.5		11.50	11.50	8.25
Venezuela	10.0	5.0	3.0		205	252	214		-	-	-

Source: BofA Global Research.

Brazil

(+) **5 Positives:**

- **Better-than-expected fiscal inheritance for incoming Lula government:** primary surplus of 1.5% ’22F.
- **Checks and balances:** Right-wing shift in Congress could be a check on incoming government.
- **Improving growth and fiscal expectations,** with repeated upward revisions to GDP growth (BofA: 3.25%).
- **Spending cap bent but did not break in 2021,** signal that Congress recognizes fiscal constraints.
- **Political moderation:** Lula chose centrist VP running mate Alckmin.

(-) **5 Negatives:**

- **Spending cap is likely to be reformed due to pressure for more spending.**
- **Extremely large government interest bill,** among highest in the world (as a % of GDP)
- **Lula administration**, even if fiscally reasonable, less likely to pursue growth-enhancing reforms. Views on Petrobras fuel pricing policy are market-negative.
- **Tax cuts** approved in 2022 will erode fiscal gains.
- **Significant pressure for public sector wage hikes** given salary freezes and high inflation.

What to Watch:

- Cabinet nominations and economic team.
- Potential waiver to the spending cap for 2023 (stop-gap measure before fiscal rules are reformed)
- Risk of social protests after the elections.
- **Important Dates:** *1 January* Lula’s inauguration.

Mexico

(+) **5 Positives:**

- **Fiscal austerity** and government's preference for tight fiscal policy at expense of growth, means deficit unlikely to widen significantly.
- **Near-shoring / friend-shoring** is a lifetime opportunity for Mexico and it is already happening.
- **Higher oil revenues help Pemex and the government.**
- **Failure of energy counter-reform** shows that Congress is a check on the government**.**
- **Tax enforcement** against companies has improved.

(-) **5 Negatives:**

- **Potential growth is falling** due to decline in private investment. **Lower growth requires tighter fiscal.**
- **Oil windfall is being spent on subsidies.**
- **Government unwilling to raise taxes** (relying on enforcement instead) **and rainy day funds are depleted.**
- **Pemex** contingent liabilities and business plan.
- **Independence of government agencies has declined,** negative for checks and balances.

What to Watch:

- US request for consultations under USMCA over Mexico's energy policies (favoring PEMEX, CFE).
- Does strong growth begin to moderate later in the year?
- Does AMLO's reaction function (preference for financial stability over growth) change?

Argentina

(+) **5 Positives:**

- **Fiscal course correction under new FinMin Massa** (spending control, energy subsidy changes) leading to financial stabilization.
- **Low debt service** reduces risk of credit event until 2024 or 2025.
- **Higher chances of political transition in 2023** given results of the 2021 mid-term elections.
- **Soy prices** are still elevated, though well below recent peaks.
- **Huge potential for Vaca Muerta energy to improve external accounts** (though it requires investments).

(-) **5 Negatives:**

- **Recent currency and local debt crisis** will negatively impact growth and fiscal dynamics and this narrows path to muddle through until ’23 elections.
- **Very low net international reserves.** More adjustments to FX policy are needed. System of ad-hoc special FX regimes are not efficient. Paris Club renegotiation not as favorable as expected.
- **Government coalition** is politically divided and with low approval.
- **Opposition** is divided and without clear leadership.
- **Inflation remains very elevated.** It helps the government in the short-term but hurts if inflation declines (pension formula).

What to Watch:

- International reserves, blue-chip gap, acceleration of crawling peg, or devaluation.
- Whether Argentina meets IMF’s reserve accumulation target (imports jumped with GDP growth).
- Whether IMF targets (especially fiscal, reserves, and monetary financing) are changed.
- Whether government coalition (Frente de Todos) or opposition (Juntos por Cambio) fractures.
- Support for Milei (anti-establishment, economic liberal).
- **Important Dates:** *Dec 2022* IMF program third review;

Chile

(+) 5 Positives:

- **Constitutional referendum rejected** proposed new constitution by a wide margin.
- **Referendum results are leading to moderation** in government's tax and pension reforms.
- **Low starting point for debt ratio (37% 2022F).**
- **Large fiscal improvement in '22** to 1.5% surplus, but easing to -2.7% deficit in '23 (government expectations).
- **Finance Minister Marcel** perceived as stronger after constitutional referendum.

(-) 5 Negatives:

- **Constitutional reform process likely to continue,** extending uncertainty.
- **Boric's government approval has declined significantly** (very short honeymoon) and there is pressure from far-left part of coalition.
- **Tax reform** will weight on savings and investment.
- **Higher social spending** unlikely to be fully matched by higher taxes right away (putting upwards pressure on debt ratio).
- **Copper prices** have declined sharply and **current account deficit** is very wide.

What to Watch:

- Process for 2nd attempt to reform constitution (Congress, new convention, committee of experts, etc.)?
- Risk of social protests.
- FX intervention ended: BCCh could restart if financial markets are not working properly.
- Pension and tax reform proposals.
- Political support for Marcel (FinMin).
- Copper prices.

Peru

(+) 5 Positives:

- **Right-wing Congress is important check on government proposals.**
- **Very low debt ratio (34% 2022F).**
- **Difficult institutionally for government to spend.** Political gridlock preserves status quo of low spending.
- **Fiscal rule** re-introduced after pandemic.
- **Fiscal deficit improving significantly (to -1.8% for 2022),** helped by higher revenues and high commodity prices.

(-) 5 Negatives:

- **High political volatility.**
- **High social tensions** amid low approval for government.
- **Microeconomic populism** and erosion of civil service.
- **Government would like to amend constitution (not enough support in Congress).**
- **Pension fund withdrawals** reduced depth of domestic market (leading to more EXD issuance).

What to Watch:

- Relationship between Castillo and Congress and impeachment attempts.
- Push by new FinMin to increase capex spending.
- Protests in the mining communities.

Ecuador

(+) 5 Positives:

- **Biggest winner in LatAm from higher oil prices.** BofA expects ’22 overall fiscal surplus of 0.4% (we shaved forecast by 0.6% due to protests).
- **Strong IMF support.** New IMF program is possible after current program ends in Dec.
- **Low debt service after 2020 restructuring** (first EXD amortization is only in 2026).
- **EXD issuance in 2022 not needed** given higher oil prices and multilateral support.
- **Indigenous groups in favor of targeting fuel subsidies** (specifics still need to be decided).

(-) 5 Negatives:

- **June ’22 social protests** have negative implications for growth and fiscal (but government is in stronger position to afford concessions vs. ‘19 protests).
- **Political instability risks** due to low governability in Congress (president’s party has small minority) and risk of early elections.
- **Pro-market reforms unlikely to prosper in Congress.** Government must rely on decrees.
- **Oil production remains low** compared to 2019 levels.
- **Congress attempting to repeal 2021 tax reform** (BofA thinks unlikely to succeed).

What to Watch:

- Potential debt-for-climate swap.
- Implementation of focalization strategy for fuel subsidies.
- Type of new IMF arrangement (funded or monitoring) and access to new resilience facility.
- Government referendum’s on economic, political, security reforms (alongside local elections in Feb ’23).
- Clarity on whether Article 130/2 impeachment can be attempted again in the current legislature.
- Implementation of salary hikes for teachers.
- Sale of Banco del Pacifico and monetization of Sacha oil field.
- Oil production trends (government is focused on increasing it).
- **Important Dates:** *End-2022* IMF program concludes. *5 Feb 2023* Local elections.

Dominican Republic

(+) **5 Positives:**

- **One of the best track records on growth in LatAm.** DomRep has proven resilient to the oil shock.
- **Outperforming budgets.** BofA expects DomRep to outperform budgeted fiscal deficit (-2.7% '22F). Same happened in 2021 and 2020.
- **Track record of political stability.**
- **Electricity pact to increase tariffs was agreed last year** (though hikes were paused recently).
- **DomRep increased its tourism market share in 2021.**

(-) **5 Negatives:**

- **Ukraine-Russia: DomRep is one of the most negatively affected countries in LatAm** from terms-of-trade shock.
- **Government is increasing fuel and electricity subsidies** (recently paused planned electricity hikes).
- **Government failed to approve broad tax reform** in 2021 and no reform is likely for rest of administration.
- **Low tax revenues as % of GDP.**
- **Government seems unwilling to pay political cost of unpopular reforms.**

What to Watch:

- Approval of US pre-entry at Dominican airports (boost to tourism).
- Issuance (BofA believes DomRep does not need to issue externally for remainder of '22).
- Discussions to adopt a fiscal rule.
- Do electricity tariff hikes resume?
- Are energy subsidies extended?
- Do remittances moderate?
- Does tourism suffer from higher competition from other islands and/or lower disposable income in rich countries.

Guatemala

(+) 5 Positives:

- **Record of conservative fiscal management.** Fiscal deficit basically back to pre-pandemic levels (-2.4% for '22F and -2% for '23F, better than budgeted).
- **Growth above LatAm median, but with lower volatility.**
- **Low indebtedness (30% of GDP)** and debt ratio likely to remains stable.
- **High level of international reserves (24% of GDP).**
- **Local investor demand** reduces need to issue in external markets.

(-) 5 Negatives:

- **Low governance scores.**
- **Low revenues and high labor informality** mean that it would be challenging to sustain a much higher debt ratio.
- **Exposure to US deceleration** via remittances and trade.
- **Risk of social discontent** and protests due to high inflation.
- **Vulnerability to natural disasters.**

What to Watch:

- Possible re-instatement of diesel subsidies.
- First monetary policy meeting with new central bank governor A. Gonzalez Ricci (November).
- Whether recent deceleration in growth is deeper than expected.
- Impact of US housing market on employment of Guatemalan immigrants and US demand for exports (especially clothing, given high inventories).
- Approval of 2023 budget in Congress (deadline is 30 November).

Panama

(+) **5 Positives:**

- **Recovered quickly from severe recession in '20,** though July protests could lead to technical recession.
- **Likely to meet fiscal target of 4% in 2022** (we no longer expect outperformance due to protest concessions).
- **Savvy fuel subsidy policy is resulting in lower costs** (administrative hurdles to obtaining cheap fuel).
- **Very dynamic economy with political stability.**
- **Mining taxes were increased,** providing 0.5% of GDP per year in extra revenues.

(-) **5 Negatives:**

- **Social protests in July** led us to cut our growth forecasts and they required important fiscal concessions (fuel subsidies).
- **2021 fiscal deficit was revised to show wider deficit** (explained mostly by higher capex, but still below the ceiling of the Fiscal Responsibility Law).
- **Legacy defined benefits pension fund will run out of reserves by 2024** (central government would need to start subsidizing pensions after reserves are depleted).
- **Tax revenue is low as % of GDP.**
- **Debt ratio is relatively elevated at 61.5% '22F** (but it is trending down after peaking in 2020).

What to Watch:

- Potential issuance (pre-funding for 2023).
- Do social tensions result in new protests?
- Whether fuel subsidies are temporary or extended.
- Panama's potential removal from GAFI grey list.
- Rebasing of GDP could lead to level change in GDP statistics (reduce debt ratio).
- Final approval of mining tax agreement by Congress.
- Discussions on pension reform.

Costa Rica

(+) 5 Positives:

- **Structural strengths of the economy:** export-driven, political stability (oldest democracy in LatAm), environmental policies (ESG), security (migration), educated workforce compared to LatAm peers
- **Fiscal rule is working:** Big improvement in fiscal balance versus 2019. Primary surplus. Fiscal stability arguably most important challenge of Chaves administration.
- **IMF program** provides low-cost financing and oversight.
- **Public employment reform** was approved in last administration. Positive spillovers on fiscal outlook.
- **Green energy supply** makes Costa Rica less exposed to global energy shock.

(-) 5 Negative:

- **Risk of stalemate in Congress.** President's party has small minority. Some populist proposals have emerged (pension fund withdrawals).
- **Fiscal rule could be amended because it is too strict**. Markets would react negatively. High budget rigidity. Earmarking of revenues.
- **Domestic debt** (most of the debt stock) is expensive and keeps Costa Rica's interest burden elevated. Crowding-out effect.
- **Political opposition to raising taxes.** despite the fact that tax revenues are very low as % of GDP.
- **High financing needs** (mostly domestic). Around 10% of GDP.

What to Watch:

- Authorization by Congress to issue external debt (at least $1.5bn expected to be approved by year-end). Multi-year authorization would be more positive than one-off authorization.
- Alleged campaign financing irregularities affecting President Chaves.
- Proposal to sell government banks and insurance company.
- IMF program reviews.

El Salvador

(+) **5 Positives:**

- **BofA believes government has capacity to pay Jan 2023 Eurobond amortization ($800mn).** Bond buyback plan shows willingness to pay and repurchase of '25s at a deep discount reduced financing "hump".
- **Government has political capital to improve fiscal deficit** (high popularity, super-majority in Congress).
- **Room to get more domestic financing from banks and pension funds.**
- **Fiscal revenue is outperforming** (stronger enforcement). BofA expects primary surplus of 0.5% in 2022.
- **Debt structure is manageable** (interest/GDP of 4.8%). Eurobonds have long maturities, without bunching.

(-) **5 Negatives:**

- **Lack of progress on IMF negotiations**. Bitcoin legal tender status appears to be obstacle.
- **Concentration of power** reduces checks and balances and can result in erratic policymaking.
- **Strained bilateral relationship with the US.**
- **Large external imbalance,** and reduction of international reserves to levels that are uncomfortable
- **Inflation is running high** for dollarized economy, putting pressure on government to subsidize fuels.

What to Watch:

- Potential second bond buyback.
- Whether state of emergency is extended (enacted to address gang violence).
- Pension fund reform (could increase their holdings of government bonds).
- Rollover rates of domestic debt (CETES and LETES).
- Reserve requirement cuts (would free up liquidity for banks to buy government bonds).
- Does government approve reforms to fiscal policy or Bitcoin regulation that could be "prior actions" towards IMF program?
- Diplomatic reaction to President's intent to run for re-election.
- **Important Dates:** *Jan 2023* $800mn Eurobond amortization.

Colombia

(+) 5 Positives:

- **Fiscal discipline. Only country in LatAm implementing in tax reforms simultaneously ('23).** Good fiscal signals, including respect for fiscal rule: BofA expects 0.6% primary surplus in '23 (vs. -1% in '22F).
- **Strongest GDP growth momentum in LatAm.** BofA expects growth of 8.1% in '22 after 10.6% in '21 and -6.8% in '20.
- **High oil prices** improve revenues, though fuel subsidies have increased significantly.
- **President Petro's coalition in Congress includes centrist parties**, supportive of policy moderation.
- **Likely moderation on energy reform.** Backing out from prohibition to award new oil exploration contracts.

(-) 5 Negatives:

- **Contradictory guidance** from officials (oil exploration, pensions, land purchases, capital controls, central bank) has increased risk aversion towards Colombia.
- **Petro administration** is less market-friendly, presenting risks to growth and investment, particularly in hydrocarbons. Reform proposals that create concern: energy, pension, labor, land, health.
- **Wide current account deficit** makes COP vulnerable to sudden stop in foreign financing.
- **Prolonged period of high inflation posing risks to credibility of Central Bank.** Inertia (indexation) in Colombia is high, and inflation expectations are de-anchored.
- **High food inflation** could lead to social distress.

What to Watch:

- Signals of moderation in energy reform.
- 2023 budget amendments. How much revenues of the tax reform will saved?
- Governability alliances in Congress.
- Implementation of plan to increase fuel prices gradually to reduce subsidies. Risk of protests?
- Moderation signals in other reforms: land, labor, health, pension.

Borrowing costs in October reached prohibitive levels

- Currently, the average interest rate in Colombia's public debt is 8%. Assuming 3 potential GDP growth, this means Colombia needs a 0.6% of GDP primary surplus to stabilize public debt.
- Currently, the local TES yield is around 12-13% (2yr, 5yr, 10yr). And this week the government issued Eurobonds at 8%. If funding costs converge to 10%, Colombia would need a primary surplus of almost 2% of GDP.
- Borrowing costs observed in October (15% for TES, 9-10% for Eurobonds) are unsustainable.

Debt-stabilizing primary balance (% of GDP)
= Public debt/GDP * [1 / (1 + g + π)] * (i – π – g) – Monetary base/GDP * (π + g)

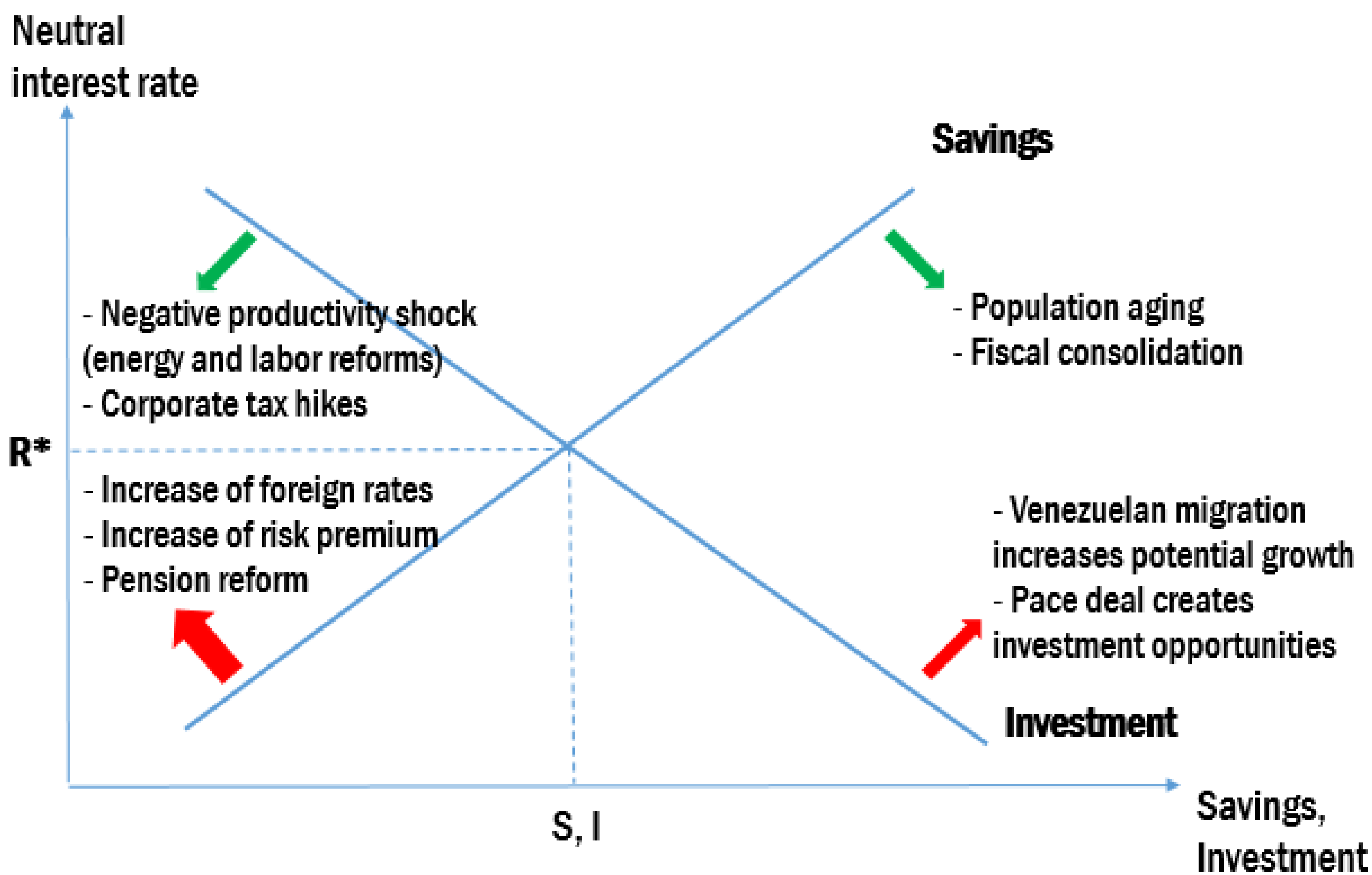
Average interest rate paid on public debt (%)	Potential GDP growth (%): 2.0	2.5	3.0	3.5	4.0	4.5	5.0
7.0	0.7	0.3	0.0	-0.4	-0.7	-1.0	-1.4
8.0	1.2	0.9	0.6	0.2	-0.1	-0.5	-0.8
9.0	1.8	1.5	1.1	0.8	0.4	0.1	-0.2
10.0	2.4	2.0	1.7	1.4	1.0	0.7	0.3
11.0	3.0	2.6	2.3	1.9	1.6	1.2	0.9
12.0	3.6	3.2	2.8	2.5	2.1	1.8	1.5
13.0	4.1	3.8	3.4	3.1	2.7	2.4	2.0
14.0	4.7	4.3	4.0	3.6	3.3	2.9	2.6
15.0	5.3	4.9	4.6	4.2	3.8	3.5	3.1

Source: BofA Global Research. Note: "g" is potential GDP growth, "π" is the inflation target, and "i" is the average interest rate paid on public debt

What is happening to interest rates in Colombia?

- Structural forces pushing interest rates up, dominate the forces pushing down

Forces shaping neutral rate in Colombia, negative shift of savings should dominate
Neutral interest rate is fundamentally pinned down by the balance of savings and investment

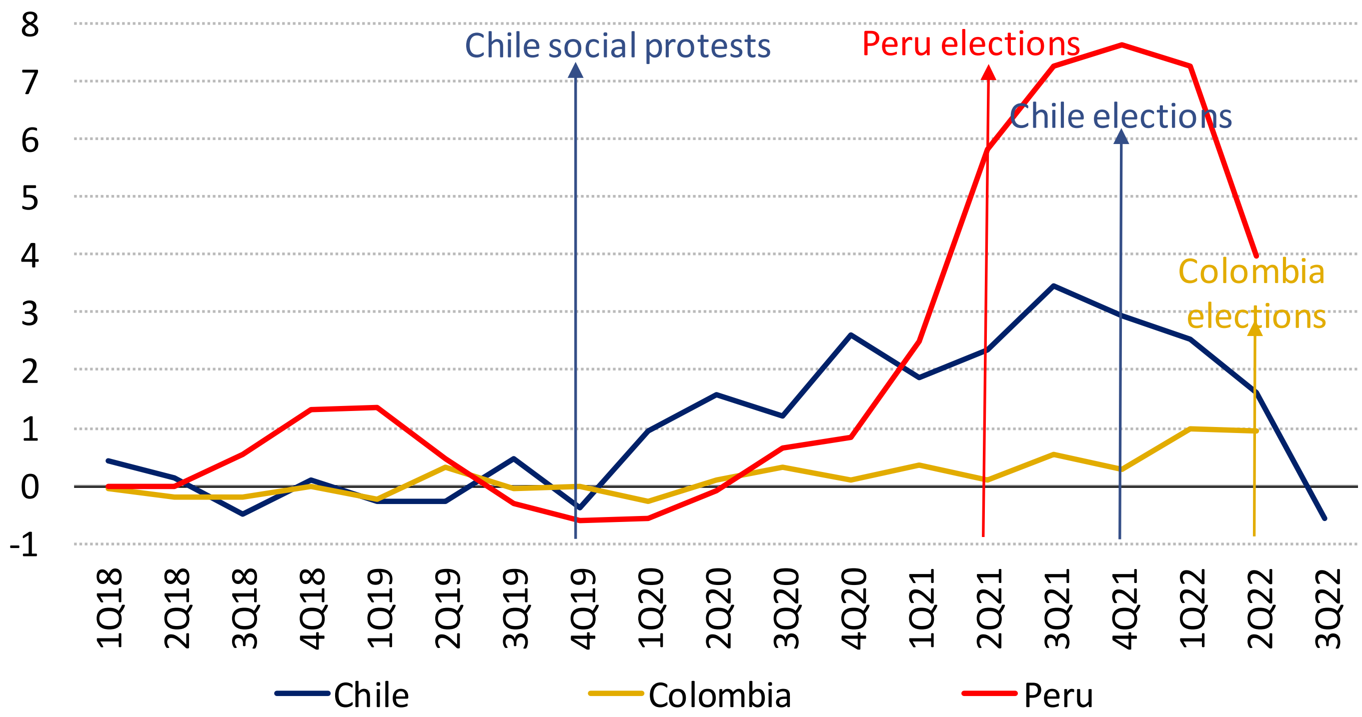


Source: BofA Global Research

Risk of capital outflows in Colombia

- Not portfolio, but rather capital outflows of households and non-financial corporations
- Similar to what happened in Peru and Chile.

Outflows of currency & deposits from households and non-financial corporations (rolling 4 quarters, % of GDP)
Q3 balance of payments data will reveal if Colombia suffered outflows that exacerbated sell-off of Colombian peso



Source: BofA Global Research, Central Banks of Chile, Peru, and Colombia

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