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Week Ahead in Latin America

Latin America: Macro Notes From London

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We hosted our annual Latin America Conference in London earlier this week. After countless conversations with Latam watchers who attended the event, we decided to bring you our take on the issues that dominated most of the macro talks. Besides concerns about the more challenging external backdrop for emerging markets, most of the attention was on political uncertainty and its consequences for the regional outlook. The topics ranged from electoral scenarios in Brazil and the prospects for pension reform, to the ability of Argentina's government to deliver a successful fiscal adjustment and what the drag from fiscal austerity on an economy already in recession means for next year's elections. Latam watchers also wanted to discuss the reform agenda under Colombia's new administration and, from Mexico, prospects for policy continuity and what the new bilateral trade deal with the US means for Mexico's economy. Our views on the most frequently asked questions about the region's major economies follow, and if there is any aspect of the debate that you'd like to hear more about, do not hesitate to reach out.

What's new?

In **Brazil,** all eyes continued to be focused on the elections, where polls still do not yet signal any of the possible outcomes. On the data front, weak retail sales show that this uncertainty is also taking a toll on the consumer. After a surprising contraction in the second quarter, incoming data from **Mexico** suggest that activity is normalizing in the third quarter, consistent with our view that part of the second quarter slump may have been linked to temporary drags; for example, July industrial output surprised to the upside, August car production bounded to a three-month high, and formal job growth accelerated from the weakness seen in June-July. **Argentina**'s central bank kept the policy rate unchanged at 60%, consistent with their compromise not to cut rates at least until December, a prudent decision, in our view, given still accelerating inflation as pointed out by the August CPI report. On the political front, the executive is making important progress on negotiations on the 2019 budget: provincial governors seem to be largely supportive of the ambitious fiscal adjustment required for next year. Discussions about the tax reform bill carry on in **Chile**'s congress: the administration is pushing for faster approval to have the reform up and running with the 2019 budget, while legislators are signaling that the final vote should only take place early next year. Evidence that the executive is succeeding in building consensus on tax initiatives, we suspect, would be a positive sign regarding policymakers' ability to deliver a better business environment. **Peru**'s central bank held rates unchanged at 2.75%, yet the more relevant news came from the political front: the executive raised the possibility of requesting a vote of confidence from congress on his latest reform initiatives (aimed at addressing corruption) which, depending on its result, could open the door to the dissolution of congress and early elections – an outcome that doesn't seem to be in the interest of the major political players, in our view.

What's next?

In **Brazil**, we have the last decision of the central bank ahead of the elections, and believe the bank will keep rates unchanged but will shift to a more hawkish tone. Given the new currency level, the 2019 inflation outlook has probably worsened and requires a signal that the authorities are ready to react if needed. The next meeting will be on the Wednesday following the second-round decision. In **Mexico**, it's a quiet week on the data front so our focus will stay on ongoing trade talks between Canada and the US; while Mexican officials have signaled their openness to advance a bilateral deal with the US, there are several legal hurdles with the US congress, as our US colleagues explain, that may prevent such an agreement from materializing. **Argentina** unveils its second quarter GDP, which should show growth contracting at the strongest sequential pace since the 2009 crisis as a result of the hit from the drought happening at the same time the economy was coming to a standstill due to the currency sell-off; in the political arena, we will be watching negotiations of the 2019 budget, expected to be presented to congress over coming days. **Colombia** releases its July GDP proxy: we expect it to show a mild sequential gain given the mixed data seen in higher frequency indicators. **Chile**'s central bank releases the minutes of the September 5 meeting, when it adopted a more hawkish tone by signaling that conditions were in place for tightening to start "in coming months." With swaps pricing in quarter-point adjustments in October and December – something we find overly aggressive – the minutes will be important to gauge policymakers' degree of confidence in the new guidance. **Peru** will release the GDP report for July and we don't expect much improvement from the weak June figures, which broke a three-month string of surprisingly strong activity; July details, however, should have a positive bent as much of July's weakness seemed to come from mining and fishing, whereas non-commodity sectors held up better.

Saludos,

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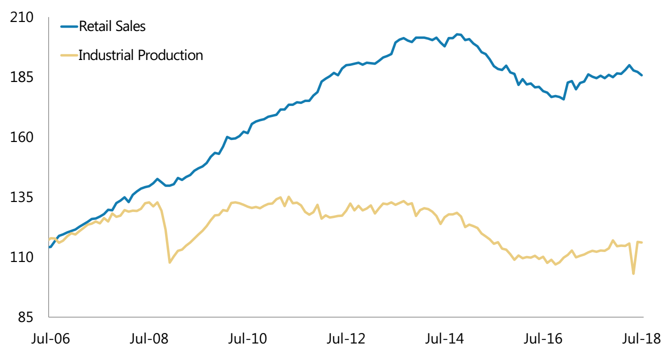
Latin America: Macro Notes from London

Earlier this week, we hosted our annual Latin America Conference in London. The discussions centered on the consequences of the more challenging external environment for Latin America, as well as political uncertainty and its implications for the region's prospects. From the ability of Argentina's government to deliver a successful fiscal adjustment to electoral scenarios in Brazil and the implications of the recent bilateral trade between Mexico and the US, below are our views on the most frequently asked questions we heard from investors attending the event.

How is the Brazilian economy doing ahead of the election? What will be the starting point for the next president?

Exhibit 1: Brazil: Industrial Production and Retail Sales (seasonally adjusted, 2012=100; 2003=100)



Source: IBGE, Morgan Stanley Latam Economics

The Brazilian economy suffered a shock in May from the truckers' strike, and while it bounced back in most production and sales measures (see Exhibit 1), the strike and the uncertainty related to the electoral process never allowed confidence to fully recover, leaving the economy growing at a softer pace than before. We have seen capital goods production slow down and hiring basically brought to a halt, although we are not seeing an increase in firing yet, as if the economy has entered wait-and-see mode. We believe this means that corporates will continue to wait before they make any more strategic decisions about future plans.

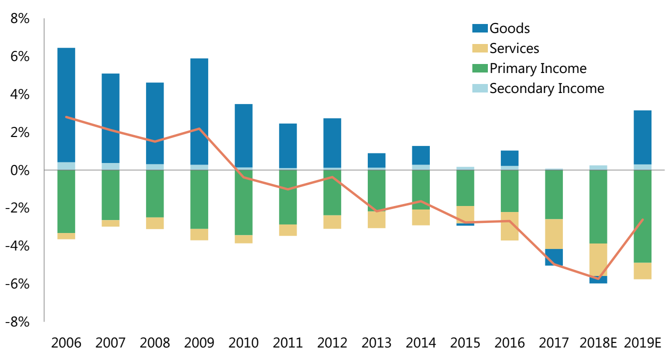
Inflation also went through important fluctuations as a result of the supply chain disruptions, touching 4.5% in July, but it is already back to 4.2% after a surprisingly good print in August, where we saw a 0.09% deflation. More importantly, services inflation is still running around 3.3%, showing very few signs of spillover from the disruptions. This has allowed the central bank to not hike rates while the currency is weak, avoiding an even sharper slowdown, but future monetary policy is not guaranteed. If this wait-and-see mode on growth were to persist, we believe banks would eventually slow down the current credit growth as economic growth would be moving sideways and the risk of delinquencies would be on the rise, bringing the economy to a gradual deceleration despite very low rates. But we do not believe this is sustainable. We believe that, following the elections, we will have either a positive or negative confidence shock, which will lead the economy either to accelerate or decelerate. This same confidence shock would lead to an appreciation or deprecation of the FX, eventually even possibly forcing the central bank to hike rates this year, depending on the magnitude of the move. We believe in the event of a candidate who defends unorthodox policies being elected, the currency could devalue to above 4.50, in which case the bank might hike as much as 150 basis points. In this scenario, the economy would already be materially weaker when the new president takes office (see more here).

Does it really matter who wins the election in order to approve pension reform? Isn't it almost given that anyone elected would have to do it?

We believe that by 2022, when the president who is elected this year will finish his/her term, Brazil will have completed a pension reform, but the ultimate result depends on the willingness to make hard choices and the ability to get reform approved. Let's start by noting that while it might seem as if Brazil could continue to avoid reform as long as markets are willing to finance the country, the spending cap ultimately makes it impossible to muddle through without reform. We estimate that 2018 expenditures will come very close to reaching the cap, which means that in order to spend within the cap in 2019, assuming well behaved payroll growth, the government would need to cut R$24 billion in expenditures. If nothing is done about pensions or other expenditures, another R$30 billion would need to be cut in discretionary spending, which we believe to be almost impossible politically as this would affect key areas such as social programs, healthcare, and education. This means that by August 2019, in the administration's first year, either they would have a pension reform already approved, or they would likely have to submit a watering down of the spending cap, which would most likely trigger a market reaction. Hence, the spending cap will bring the pension reform debate to 2019, and we believe that, in the event of a market sell-off, leading to rate hikes and eventually more inflation, almost any of the candidates would deliver a pension reform in a somewhat acceptable form. Although the end result might differ little, the path for markets differs a lot as an unorthodox candidate becoming president might mean a material increase in risk premiums before we would see reform delivered and hence some relief.

What can we expect from Argentina's ability to deliver a fiscal adjustment relative to IMF targets? And what is the outlook for the currency and the political fallout from the ongoing recession?

Exhibit 2: Argentina: Current Account Balance Breakdown (as % of GDP)

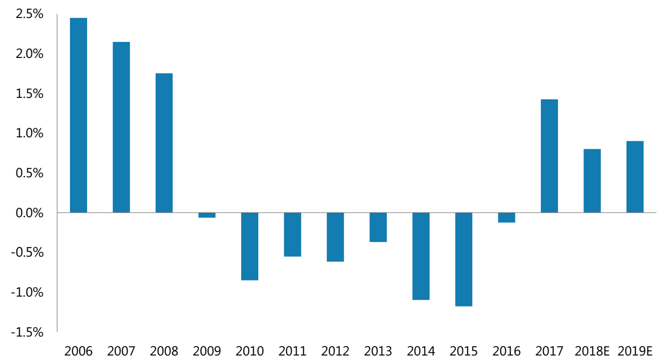


Source: INDEC, Morgan Stanley Latam Economics

The most frequently asked questions on Argentina were centered on the government's ability to deliver on three key fronts: the outlook for the currency, the twin deficit adjustment, and the impact of the ongoing recession on politics. Regarding the currency, we cannot rule out further volatility, given the many moving parts that could eventually lead to further currency weakness. These include a relatively somber outlook in EM and Brazil's elections, which could culminate with implementation of non-market-friendly policies that could put pressure on the BRL and potentially negatively impact the Argentine peso. Another aspect worth watching is how much intervention power authorities will have under a revised IMF program. Regarding twin deficits, our view is that the adjustment in underway (see "Argentina: What You Need to Know Ahead of the Adjustment", September 6, 2018.). The current account deficit should be significantly reduced in the coming months and approach the $10 billion handle (~2.6% of GDP) in 2019 (see Exhibit 2). In terms of fiscal consolidation, we think the authorities are totally committed to deliver on this front – there is no alternative to that, in our view – and it seems that they have enough support from opposition leaders to approve the 2019 budget law aiming at eliminating the primary deficit next year. We maintain our view of no major shift in policy direction after the October 2019 elections.

Based on the feedback from companies and investors attending the conference, there seems to be growing optimism about policy continuity under Mexico's new administration. Is there evidence pointing in that direction? And what are important signposts to watch in coming months?

Exhibit 3: Mexico: Primary Budget Balance (as % of GDP)



Source: SHCP

The debate around policy continuity remains fluid, but since the July 2 vote the incoming administration has softened its tone on several of the more unorthodox aspects of the campaign platform (see "Mexico's Choice Between Plan A and B: Elections, Institutions and Policy Continuity," April 8, 2018). On the fiscal front, we've heard plenty of pragmatic comments by prospective finance-ministry officials. Specifically, they stressed their intentions to follow a prudent policy stance and the importance of maintaining healthy government accounts as a prerequisite for broad financial stability, in addition to respecting the independence of the central bank. While details about the programs – such as more generous pensions and scholarships – that they may advance and their respective costs remain elusive, signs so far hint at a 2019 budget that is likely to be inertial, meaning one that foresees borrowing requirements (2.5% of GDP) and a primary surplus (~0.8% of GDP) broadly similar to the 2018 budget (see Exhibit 3). It is important to keep in mind that if oil prices hold at September average levels of $78 per barrel for Brent, the next administration may enjoy as much as 1.2% of GDP in additional revenue (relative to the preliminary 2019 guidelines presented by the current administration in March), thus providing room to fund more social spending and public works without additional borrowing.

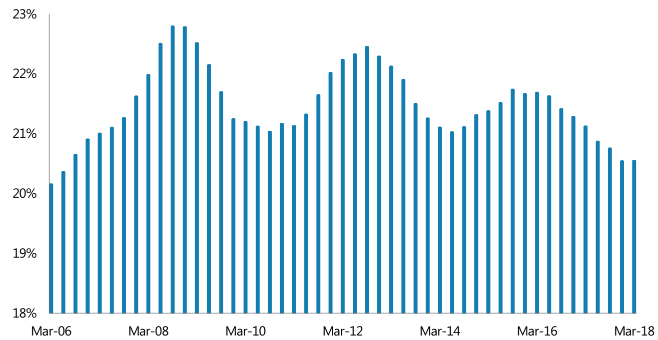
The bilateral trade agreement with the US, for all its shortcoming relative to our hope for a more comprehensive NAFTA 2.0 reboot, should still act as an important anchor for Mexican exporters and foreign investment, pointing to continuity regarding the country's commitment to trade and financial openness (see "NAFTA 1.1 – Lighter than a 2.0 Reboot," August 30, 2018). The outlook for the other relevant pillar of Mexico's narrative, namely energy, remains more uncertain, in our view. At the very least, at this juncture there are no tangible signs of a push for a full reversal of the energy reform that opened the country to foreign and private capital; since mid-2015, over 100 contracts were already awarded for oil and gas exploration and production. Oil auctions scheduled for September were postponed, but apparently not permanently scrapped. Though details about the costs and timelines are lacking, the plan to build new refineries seems to have been scaled back (now limited to one new facility and upgrades to existing capacity). So as we wait for details of an official energy strategy, for now the downside scenario seems to be a scaled-back energy-sector opening.

Regarding signposts before the December 1 inauguration, perhaps the most relevant development will be the outcome of the Mexico City airport (known as NAICM). Currently, the incoming administration is reviewing expert opinions regarding the viability of the NAICM and alternatives; these associations of engineers have been in favor of advancing the NAICM. The final decision is expected after a public consultation in October; however, it is likely to be a political rather than a technical one. Scrapping the NAICM, in our view, would send a negative message to private investors, incur (avoidable) fiscal costs and add further uncertainty about the prospects for policy continuity during the six-year term (see "Mexico: Strong Mandate and Fundamentals but

Uncertainty Lingers," July 2, 2018).

Is the new NAFTA deal good for Mexico? And if an agreement with Canada fails, what are the prospects for approval of a bilateral deal with the US?

Exhibit 4: Mexico: Gross Fixed Capital Formation (4Q-rolling, as % of GDP)



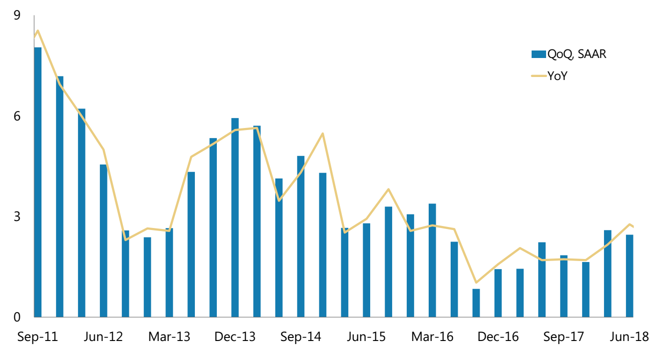
Source: INEGI

In broad terms, having a deal in place is a positive development as it removes a tail risk to the Mexico story. As we have highlighted in the past, uncertainty regarding NAFTA's future has been a drag on sentiment and investment, which has been stagnant in recent years despite record high capacity utilization and the positive industrial and export cycles (see Exhibit 4 and "Mexico: Elections and Policy Continuity Risk," *in Latin America Macro Mid-Year Outlook*, May 13, 2018). Surely the new agreement would water down some protections – such as the Chapter 19 anti-dumping mechanism, while weakening the Chapter 11 investor-state dispute tribunal – that may leave Mexico more vulnerable to protectionist measures, for example. And the deal may leave more scope for Mexico's new administration to influence energy policy vis-à-vis the original aim of adding an energy chapter to the new NAFTA that would in effect institutionalize Mexico's energy-sector opening. The car sector, not surprisingly, has gathered most of the attention and here Mexico seemed to make the bulk of the concessions. While details are not fully clear, our equity auto analysts argue that increasing local sourcing (to 75%) and requiring greater content from higher-paid workers (40-45%) will ultimately drive higher manufacturing costs – meaning a switch to a higher-cost supplier that would require an adjustment in Mexico (see "NAFTA Remix and Autos: Sentiment over Substance?" August 29, 2018). The new auto rules, moreover, would come at a time when overall US light vehicle sales are trending lower – our auto sector team expects 16.8 million this year, off from 17.2 million in 2017 – in a cycle that is already at unprecedented levels in several metrics including credit and average transaction prices (see "US Auto Sales: Swimming Upstream," September 5, 2018). One positive aspect of the bilateral car deal is that it may shield Mexico's existing production from the risk of potential 25% tariffs on all auto imports under Section 232. It is also worth highlighting that if the deal in fact forces NAFTA producers to rely on higher-cost suppliers, then it would put them at a disadvantage vis-à-vis other car exporters that may be subject to only a 2.5% tariff under WTO rules; accordingly, high Section 232 tariffs – or concessions that restrict imports from outside NAFTA – may be necessary to prevent a more meaningful adjustment among Mexico and North American carmakers.

While Mexico officials have suggested their openness to advance a trade deal with the US, our US policy experts question whether the administration could complete it using the current trade promotion authority (TPA) (see "US Public Policy: Trade FAQs – NAFTA, China and Autos," September 12, 2018). In a nutshell, entering a deal with just Mexico may not be in accordance with the notification the administration made to congress at the outset of these negotiations, and therefore legislators could challenge it. If congress were to disallow the use of the fast-track process under TPA, the administration could try passage under a regular procedure, which has the drawbacks of not having a time limit and being open to amendment by legislators – adding further uncertainty. Even if Canada fails to join the deal before October 1 and if the bilateral agreement is off the table, our US team argues that NAFTA 1.0 is likely to remain in place and negotiations should continue.

What are the prospects for reform progress under Colombia's new administration that took office in late July?

Exhibit 5: Colombia: Real GDP Growth (% change)



Source: DANE

When it comes to Colombia, investors seem interested to hear our thoughts on the prospects for reforms. We highlight that Colombia's macro framework has improved significantly over the past decade or so, helping the economy deal with sizable external shocks – such as the oil price and weather-related food supply shocks in recent years – and avoid a hard landing. After all, although growth slowed significantly in 2016 and 2017, the economy did not experience a recession (see Exhibit 5). Having said that, we remain concerned about the country's fiscal outlook and the economy's high dependence on oil and coal. On the fiscal front, we think another tax reform is needed, one that aims at reducing the corporate tax burden to encourage investment and formal job creation. This reform should also include efforts to increase revenues in the short term, in order to comply with the fiscal consolidation objectives set by the fiscal rule while keeping public investment from falling too drastically. Indeed, avoiding sustained cuts in public investment in infrastructure and creating the conditions to advance faster on the 4G infrastructure projects are keys to diversifying the economy. Oil and coal still represent more than half of exports (57% of total in the past 10 years) and considering that both oil and coal production may decline in coming years, we think Colombia needs new growth drivers. We think the new administration's agenda should focus on reforms that encourage economic diversification without jeopardizing the progress done on reducing macro vulnerabilities.

O Que Aconteceu? / ¿Qué Pasó?

Recent Economic Releases (Sep 7 - Sep 13)

Argentina

Monetary Policy Meeting
Actual: 60.00%; Consensus: 60.00%

Widely expected on-hold decision as authorities compromised not to cut rates at least until December. Policymakers see inflation accelerating in August and September on the back of regulated tariff hikes and FX pass-through; assessment on economy downbeat with recession this year and muted growth next year.

National CPI (August)
Actual: 3.9% m-o-m; Consensus: 3.8% m-o-m

Inflation keeps accelerating: annual reading moved up to 34.4% (31.2% in July) as regulated tariffs (+6.2% m-o-m and 48.1% y-o-y) and FX weakness pressured prices, in turn reflected on core inflation which continues running high at +3.4% m-o-m, in line with other readings since beginning of currency selloff.

Brazil

Retail Sales (July)
Actual: -1.0% y-o-y; Consensus: 1.1% y-o-y

Retail sales contracted sequentially by -0.5% m-o-m. The main negative contributions were Furniture & Household Appliances (-4.8%), apparels (-1.0%) and Office Equipment (-2.7%). On the opposite side, supermarket sales edged up by 1.7%. Broad retail rales decreased sequentially by -0.4%.

Chile

Trade Balance (August)
Actual: -$302 million; Consensus: $141 million

Seasonally adjusted trade surplus hit its narrowest level since early 2015, mainly a function of export downside linked to lower copper prices. Other details were favorable including rise in industrial exports to new record highs and imports of capital goods holding up near four-year highs.

CPI (August)
Actual: 0.2% m-o-m; Consensus: 0.2% m-o-m

In line with expectations, suggesting inflationary pressures remain contained despite peso sell-off. Despite further upside in energy prices – which are up 8.9% from a year ago – annual headline rate stayed essentially stable at 2.6% (2.7% in July). Core rate similarly stable, holding at 1.9% since June.

Consumer Confidence (August)
Actual: 47.0; Consensus: n/a

Even if still above the 50 neutral threshold, confidence shifted lower in the past couple of months: seasonally adjusted index stood at 50.3 points in August, off by 2.5 points from its peak in June. Recent market jitters – including the sharp peso sell-off and lower stock prices – may be part to blame.

Mexico

Industrial Production (July)
Actual: 1.3% y-o-y; Consensus: 1.0% y-o-y

Good start to the third quarter: output posted a modest sequential gain (+0.2%) for the third straight month, contributing further evidence to our view that the economy's second-quarter contraction in was likely temporary. Construction, which struggled in the past quarter, outperformed in August (+1.4% sequential).

Retail Sales - ANTAD (Real) (August)
Actual: 3.7% y-o-y; Consensus: n/a

The recovery in sales – they jumped at a sequential 9.0% annualized pace in the January-July period – took a breather in August, declining sequentially for only the second time this year. Improving incomes, record-high remittances and elevated confidence suggest August's weakness is likely temporary.

Formal Employment (August)
Actual: 3.9% y-o-y; Consensus: n/a

Encouraging news, hinting that recent signs of softening in labor market conditions may turn out to be temporary: after two slow months of hiring rising at a sluggish sequential 2.5% annualized pace – the weakest two-month stretch since early 2014 – August job growth accelerated topping 4.5% annualized.

Contractual Wages (August)
Actual: 5.5% y-o-y; Consensus: n/a

Private sector adjustments averaging 5.7% so far this year – up from 5.0% in the same period in 2017 – translating into modest real wage gains to the tune of 0.7% (compared to -0.7% in 2017). Hikes for factory workers – a sector benefiting from rising external demand – keep outperforming up 6.1%.

CPI (August)
Actual: 0.58% m-o-m; Consensus: 0.53% m-o-m

Inflation keeps surprising to the upside: annual headline rate rose to 4.90% from 4.81% in July mainly on pressure from energy and, to a lesser extent, fruits & vegetables. Core rate stable at 3.63%, though seasonally adjusted figures point to sequential acceleration to above 4% annualized clip in July-August.

Peru

Monetary Policy Meeting
Actual: 2.75%; Consensus: 2.75%

Rates unchanged as widely expected. Guidance stayed neutral, emphasizing that it is “appropriate to keep an expansionary stance” until policymakers are sure that inflation convergence to target is happening in the context of well-anchored expectations and growth near potential.

Trade Balance (July)
Actual: $438 million; Consensus: n/a

Surplus so far this year reached $4.4 billion, up from $2.7 billion in the same period a year ago, led by a price-driven jump in exports (+17.3% in January-July compared to 2017, with prices up 14.7%). Imports also on the rise up 12.4% this year, including modest gains in consumer (7.9%) and capital (7.4%) goods.

Source: Government data, Morgan Stanley Latam Economics

What's Next? – Upcoming Data Releases (Sep 14 - Sep 21)

Friday, Sep 14

	MS Forecast/ Consensus	Last[2]
Brazil		
IGP-10 - FGV (September)	n/a 0.75% m-o-m	0.51% m-o-m
Colombia		
Industrial Production (July)	n/a 3.0% y-o-y	1.3% y-o-y
Retail Sales (July)	n/a 5.0% y-o-y	6.3% y-o-y
Peru		
GDP (July) (See Exhibit 6)	2.0% y-o-y 2.3% y-o-y	2.0% y-o-y
Unemployment Rate (August)	n/a 6.1%	6.2%

Monday, Sep 17

	MS Forecast/ Consensus	Last[2]
Brazil		
GDP Proxy (IBC-Br) (July) (See Exhibit 7)	1.4% y-o-y n/a	1.8% y-o-y
Colombia		
Consumer Confidence (August)	n/a n/a	9.8

Tuesday, Sep 18

	MS Forecast/ Consensus	Last[2]
Brazil		
IGP-M (Second Preview) (September)	n/a n/a	0.67% m-o-m
CPI - FIPE (Second Preview) (Aug 16 - Sep 15)	n/a n/a	0.40% m-o-m
Colombia		
Trade Balance (July)	n/a n/a	-$719.2 million

Wednesday, Sep 19

	MS Forecast/ Consensus	Last[2]
Argentina		
GDP (2Q) (See Exhibit 8)	-4.2% y-o-y n/a	3.6% y-o-y
Brazil		
Monetary Policy Meeting (See Exhibit 9)	6.50% n/a	6.50%

Thursday, Sep 20

	MS Forecast/ Consensus	Last[2]
Argentina		
Unemployment Rate (2Q)	n/a n/a	9.1%
Budget Balance (August)	n/a n/a	-Ar$ 14.3 billion
Brazil		
CAGED - Formal Job Creation (August)[1]	n/a n/a	47,319
Tax Collections (August)	n/a n/a	R$ 129.6 billion
Mexico		
GDP - Supply and Demand (2Q) (See Exhibit 10)	n/a n/a	2.4% y-o-y

Friday, Sep 21

	MS Forecast/ Consensus	Last[2]
Brazil		
IPCA-15 (September) (See Exhibit 11)	0.15% m-o-m n/a	0.13% m-o-m
Chile		
Monetary Policy Minutes (See Exhibit 12)	n/a n/a	n/a
Colombia		
Economic Activity Index (July) (See Exhibit 13)	n/a n/a	2.9% y-o-y
Mexico		
Retail Sales - INEGI (July)	n/a n/a	3.7% y-o-y

n/a = not available or not applicable

[1] Earliest possible release date

[2] *Last* denotes last published data by a non-Morgan Stanley source.

Source: Morgan Stanley Latam Economics estimates

On the Horizon

	AR	BR	CL	CO	MX	PE	VE	Region**
Real GDP growth (%)								
2015	2.7%	-3.8%	2.3%	3.1%	3.3%	3.3%	-6.2%	0.2%
2016	-2.2%	-3.6%	1.3%	2.0%	2.9%	3.9%	-16.5%	-0.4%
2017	2.9%	1.0%	1.5%	1.8%	2.0%	2.5%	-15.6%	1.7%
2018E	-2.3%	1.5%	3.7%	2.5%	2.0%	3.3%	-15.8%	1.5%
2019E	0.1%	2.1%	3.3%	3.0%	2.3%	3.4%	-12.4%	2.2%
Inflation (year-end, %)								
2015	26.9%	10.7%	4.4%	6.8%	2.1%	4.4%	181%	9.1%
2016	39.3%	6.3%	2.7%	5.7%	3.4%	3.2%	482%	8.7%
2017	24.8%	2.9%	1.9%	4.1%	6.8%	1.4%	1829%	6.5%
2018E	41.4%	4.3%	2.6%	3.2%	4.0%	2.0%	857604%	8.1%
2019E	24.4%	4.6%	3.0%	3.3%	3.3%	2.6%	26266146%	6.1%
FX rate (year-end vs. US$)								
2015	12.94	3.90	707	3149	17.21	3.41	6.3	
2016	15.87	3.15	667	3001	20.73	3.35	n/a	
2017	18.60	3.31	615	2984	19.64	3.24	n/a	
2018E	44.00*	3.90*	630*	3000*	20.50*	3.26*	n/a	
2019E	48.00*	3.40*	555*	2740*	18.00*	3.15*	n/a	
Current account balance (% GDP)								
2015	-2.7%	-3.4%	-1.9%	-6.4%	-2.5%	-4.8%	n/a	-3.3%
2016	-2.7%	-1.3%	-1.4%	-4.4%	-2.1%	-2.7%	n/a	-2.0%
2017	-4.8%	-0.5%	-1.5%	-3.4%	-1.6%	-1.9%	n/a	-1.7%
2018E	-5.7%	-0.8%	-1.6%	-2.9%	-1.8%	-0.9%	n/a	-1.9%
2019E	-2.6%	-1.3%	-1.9%	-2.9%	-2.1%	-1.0%	n/a	-1.8%
Trade balance (US$ bn)								
2015	-3.0	19.7	3.5	-18.1	-14.7	-2.9	6.2	-9.4
2016E	2.0	47.7	5.4	-13.5	-13.1	1.9	6.6	36.9
2017	-8.5	67.0	7.9	-8.3	-10.9	6.5	21.0	74.7
2018E	-8.2	61.0	6.9	-3.8	-12.3	5.2	10.8	59.6
2019E	-6.3	52.0	3.7	-4.5	-18.6	4.0	14.9	45.2
Interest rate (year-end)								
2015	33.00%	14.25%	3.50%	5.75%	3.25%	3.75%	n/a	
2016	24.75%	13.75%	3.50%	7.50%	5.75%	4.25%	n/a	
2017	28.75%	7.00%	2.50%	4.75%	7.25%	3.25%	n/a	
2018E	60.00%	6.50%	2.50%	4.25%	7.75%	2.50%	n/a	
2019E	34.00%	7.50%	3.50%	5.00%	6.00%	3.50%	n/a	
International reserves (US$ bn)								
2015	25.6	356.5	38.6	46.7	176.7	61.5	16.4	722.0
2016	39.3	365.0	40.5	46.7	176.5	61.7	11.0	740.8
2017	55.1	374.0	39.0	47.6	172.8	65.0	9.5	762.9
2018E	62.6	375.0	38.0	48.0	170.0	65.0	9.3	767.9
2019E	68.0	375.0	38.0	48.1	170.0	65.0	9.1	773.2
Public sector balance (% GDP)								
2015	-5.2%	-10.4%	-2.2%	-3.1%	-3.4%	-2.1%	n/a	-6.3%
2016	-5.9%	-9.0%	-2.7%	-3.8%	-2.5%	-2.6%	n/a	-5.6%
2017	-6.1%	-7.8%	-2.8%	-3.6%	-1.1%	-3.1%	n/a	-4.7%
2018E	-5.5%	-7.5%	-2.1%	-3.1%	-2.0%	-3.6%	n/a	-4.7%
2019E	-3.3%	-6.9%	-1.9%	-2.6%	-2.2%	-3.3%	n/a	-4.2%

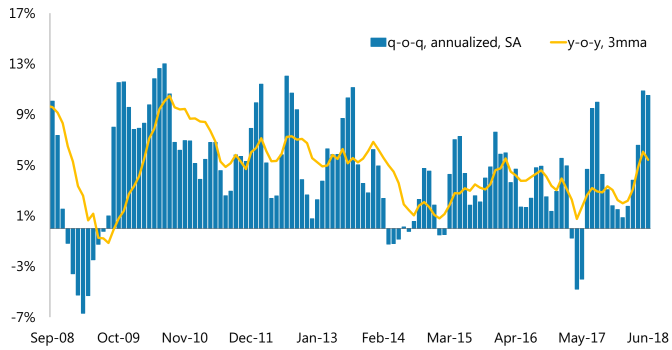
E = Morgan Stanley Forecast

Source: Morgan Stanley Research, *FX Strategy Team, Updated forecasts in bold, **Regional inflation and GDP figures exclude Venezuela

What's Next? – A Closer Look

Friday, Sep 14

Exhibit 6: Peru: Economic Activity (% change)



Source: INEI

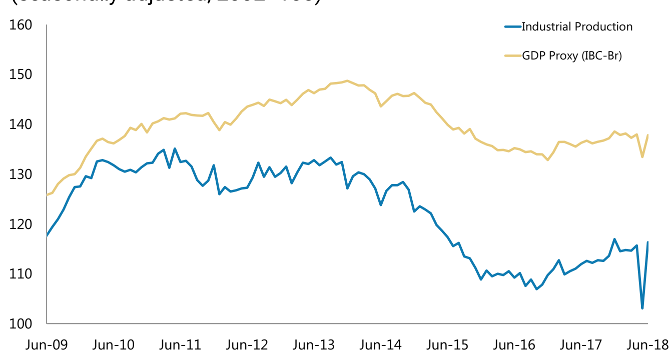
Peru's July GDP

Morgan Stanley Forecast: 2.0% y-o-y; Consensus: 2.3% y-o-y

- Activity in June dipped on a sequential basis, ending a three-month strength of upside surprising during which the economy expanded at an unsustainable sequential pace topping 11% annualized.
- And don't look for much improvement in July: downside from fishing and mining were big drags in the month, similarly to June. Non-commodity sectors help up better, as suggested by preliminary indicators including cement shipments, government spending and electricity consumption.

Monday, Sep 17

Exhibit 7: Brazil: Economic Activity and Industrial Production (seasonally adjusted, 2002=100)



Source: IBGE, BCB, Morgan Stanley Latam Economics

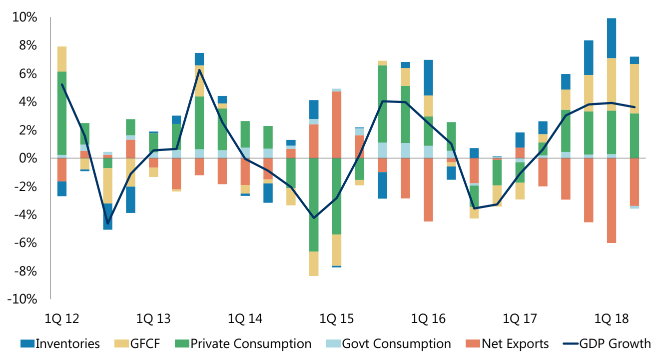
Brazil's July GDP Proxy (IBC-Br)

Morgan Stanley Forecast: 1.4% y-o-y; Consensus: n/a

- We expect GDP Proxy to decrease sequentially -0.1% m-o-m, dragged by both industrial production (-0.2%) and broad retail sales (-0.4%). This negative result would come as a consequence of the dip seen on capital goods production (-6.2%), auto sales (-0.8%) and construction input sales (-2.7%). The July print will likely add to the narrative that growth pick-up in Brazil is shifting into low gears.
- For the following months, rising uncertainty stemming from the presidential elections should keep confidence levels depressed, which by its turn would keep recovery subdued. Indeed, business confidence is already at the lowest level since the beginning of the year.

Wednesday, Sep 19

Exhibit 8: Argentina: GDP Growth Breakdown (% change y-o-y)



Source: INDEC, Morgan Stanley Latam Economics

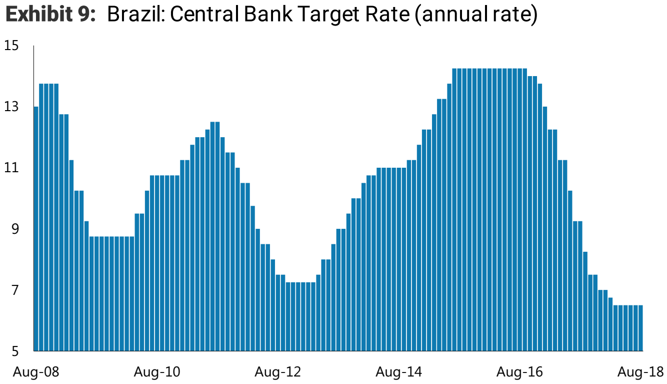
Argentina's 2Q GDP

Morgan Stanley Forecast: -4.2% y-o-y; Consensus: n/a

- The second quarter GDP reading is poised to post the strongest sequential contraction since the 2009 crisis. The bulk of the downside comes from the impact of the drought on agriculture, but there are mounting signs of broader deceleration in the economy: once excluding agriculture, the EMAE GDP proxy points to sequential growth of -1.8% q-o-q versus a -3.9% contraction with agriculture included.

- Following the latest string of weakness in the FX, higher rates and the announcement of more ambitious fiscal targets, we now expect the recession to be deeper and longer. The economy should keep contracting until 2Q19, when a recovery in agricultural output lifts Argentina out of recession, albeit growth will remain muted: we are penciling in a -2.3% contraction for this year and near flat growth next year (see: "Argentina: What You Need to Know Ahead of the Adjustment," September 6, 2018).

Exhibit 9: Brazil: Central Bank Target Rate (annual rate)



Source: BCB

Brazil's Monetary Policy Meeting

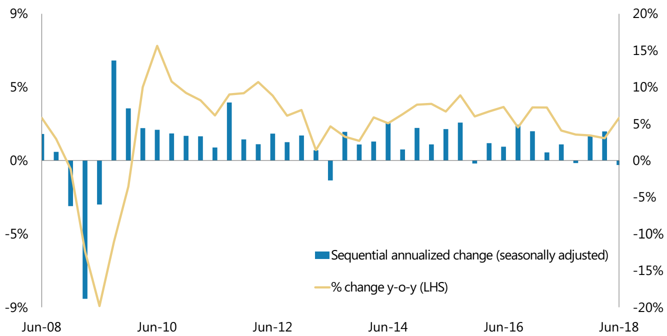
Morgan Stanley Forecast: 6.50%; Consensus: n/a

- Despite the recent currency depreciation, we expect the central bank to keep rates unchanged at 6.50% as inflation remains structurally well behaved. In fact, core inflation and services inflation actually decelerated in the August print. Despite that, we believe the BCB will shift its tone as its 2019 inflation outlook probably has deteriorated with the current currency levels, we expect the monetary authority to signal that if the current weakness proves to be permanent, or intensify the monetary authority will reach accordingly.

- We believe that depending on the electoral outcome, such as a more unorthodox candidate being elected, and therefore the currency depreciating fast, this could trigger the monetary authority to hike rates as much as 150 basis points still this year, earlier than our current base case expected.

Thursday, Sep 20

Exhibit 10: Mexico: Real GDP Growth (% change)



Source: INEGI, Morgan Stanley Latam Economics

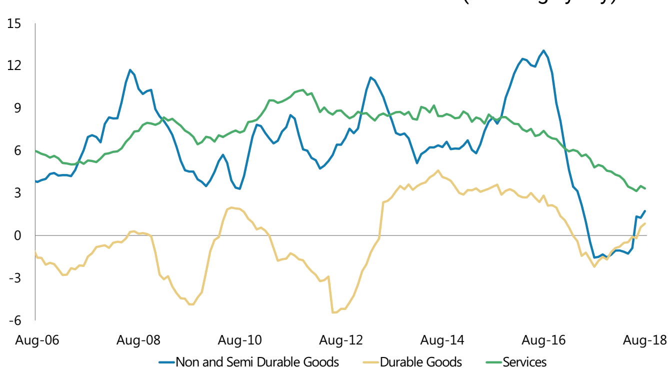
Mexico's 2Q GDP - Supply and Demand
Morgan Stanley Forecast: n/a; Consensus: n/a

- The Mexican economy posted a disappointing -0.2% contraction in the second quarter compared to the January-March period. Other than private consumption which experienced only a modest deceleration in the quarter, other components were likely quite weak including a decline in fixed investment and stagnation in exports.

- While the economy's second-quarter performance was disappointing, there is evidence suggesting that part of the downside reflected payback from a very strong first quarter (up 1.0% sequential), particularly in construction. Accordingly, we see activity returning to a positive trend in the third quarter, with the latest industrial production figures – which surprised to the upside in July, led by construction – lending support to our call (see "Mexico: Soft Patch or Inflection Point?" in *Two Weeks Ahead in Latin America*, August 24, 2018).

Friday, Sep 21

Exhibit 11: Brazil: Goods and Services Inflation (% change y-o-y)



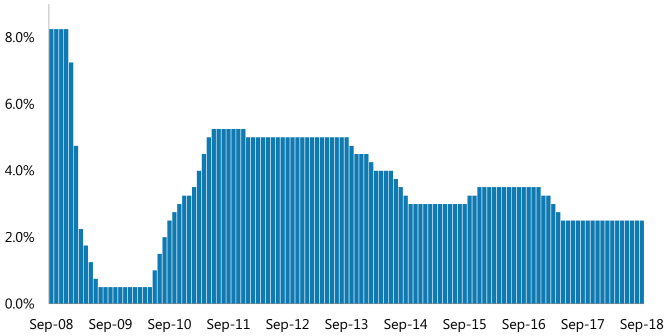
Source: IBGE, Morgan Stanley Latam Economics

Brazil's September IPCA-15
Morgan Stanley Forecast: 0.15% m-o-m; Consensus: n/a

- Inflation up to mid-September should accelerate compared to August' print (-0.09%). Two opposite vectors should roughly offset each other. On one hand, fuel prices should continue to normalize after the truck drivers' strike and air fares should pick up. On the other hand, food inflation is likely to keep its deflationary trend.

- Looking ahead, we will look for signs of whether the recent FX depreciation will generate enough second round effects on inflation to worry the Central Bank and potentially increase risks around our baseline scenario of no rate hikes this year. With services inflation maintaining its gradually decelerating trend, we haven`t seen many signs of second round effects so far. But if the currency depreciation generates expectations de-anchoring we believe that the central bank could eventually hike rates this year.

Exhibit 12: Chile: Central Bank Target Rate (annual rate)



Source: BCCh

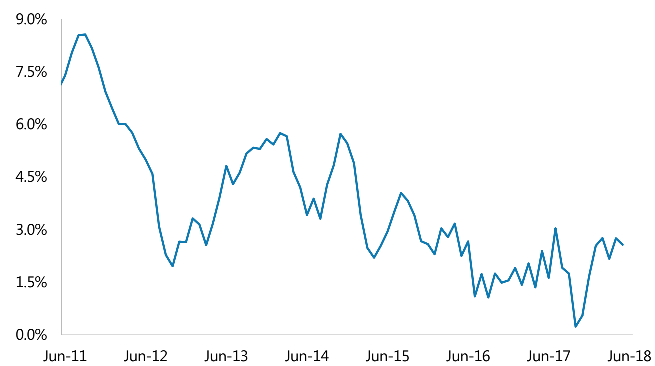
Chile's Monetary Policy Minutes

Morgan Stanley Forecast: n/a; Consensus: n/a

- The statement of the early September meeting, and the subsequent Monetary Policy Report (IPoM), showed a hawkish shift in policymakers' assessment of the economy and inflation, indicating that there seem to be conditions for rate hikes to start "in coming months." That contrasts with the previous, more open-ended tone that stressed the need for more information before considering tightening.

- The minutes will be important to gauge the degree of confidence with the new guidance and if "in coming months" involves a potential move in October or, as in the previous guidance, a December hike – swap markets are now pricing in quarter-point adjustments in October and December. Part of policymakers' more hawkish guidance, we suspect, was in response to external uncertainty and the peso's sell-off; accordingly, unless external funding conditions deteriorate further, we think that swaps pricing is overly aggressive as the minutes may show that an October hike is far from certain.

Exhibit 13: Colombia: Economic Activity Index (3mma, % change y-o-y)



Source: DANE, Morgan Stanley Latam Economics

Colombia's July Economic Activity Index

Morgan Stanley Forecast: n/a; Consensus: n/a

- High frequency data so far into July has been mixed: a solid labor market report is overshadowed by lackluster performance on exports beyond the positive price effect within the energy segment; cement shipments, meanwhile, kept struggling – signaling construction activity remains sub-par – while sentiment indicators have shifted lower at the margin but still hold up at optimistic levels.

- A broader look at Colombia's recent growth trends points to a consumption-led growth profile. Investment growth remains flat so far this year on weak construction activity and muted machinery & equipment growth despite higher oil prices; private consumption, meanwhile, has been growing at a moderate 2.9% annualized clip in the first half of the year mostly on strength in the services segment.

- Contingent on continuity of positive momentum on the consumer front – data so far supports this trend – we could see a slight pickup on growth ahead as oil-related investments pick up and the infrastructure agenda advances.

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