

## Latin America: The party is over, what follows?

6 DECEMBER 2011

*Growth is set to slow down across LatAm, though inflation will likely remain high in many countries. Policymakers, despite ample tools, could only partially offset strong global headwinds.*

Next year will be full of challenges and uncertainties. Major economies in the region are likely to grow around potential at best, with a fair likelihood of growth being below potential. Price pressures remain high and inflation sticky; we do not expect inflation to converge to target in both Brazil and Mexico, the region's biggest economies. The debt crisis in Europe and a possible China "hard landing" are the swords of Damocles, hanging over policymakers. Most of them have plenty of room to cut interest rates and adequate reserves to stabilize exchange rates; yet these efforts may only partially offset strong global headwinds. The party is now over. What is next?

### Brazil

We expect the Brazilian economy to continue to grow below potential in 2012. If the expected performance in 2011, with growth at 3.2%, was mostly attributable to the policy tightening promoted by the government at the beginning of 2011 to correct for the 2010 election-year excesses, for 2012 it is strong external headwinds that promise to constrain growth.

While the Central Bank of Brazil (BCB), concerned about the external scenario, surprisingly cut the Selic policy rate in August, it is still hard to see concrete signals of any contagion. Capital inflows remain strong, credit is growing at a double-digit rate and commodity prices remain relatively firm. Insofar as growth has slowed materially, it has been mainly for domestic reasons, specifically very weak performance in industrial production, due to previously tight monetary policy and an overvalued currency, even as domestic demand and labor markets stayed firm. This is clear evidence of the "two-speed" nature of the Brazilian economy.

The domestic nature of the current slowdown presents a challenge for policymakers. The recent market volatility, and the expected deceleration of key economic partners such as China in early 2012, should finally bring about the negative external pressures foreseen by the BCB in August. Thus, even given what we expect to be a substantial ease of monetary policy, with the Selic policy rate being cut to 9%, 2012 growth, projected at 3.2%, is unlikely to be better than in 2011. It is only in 2013 that there could be a strong rebound, helped by the lagged effects of easier monetary policy and improvements in the economic performance of Brazil's key trading partners.

We do not see inflation falling to the 4.5% target in the forecast period, closing out 2012 at an expected 5.1%. For the inflation target to be met, either there would have to be a stronger-than-expected external shock, or the government would have to choose to sacrifice some short-term growth. Given continued signals by the government, if not necessarily the BCB, we believe a period of "opportunistic disinflation" is unlikely. Therefore, we continue to expect inflation to stay relatively high, oscillating between the 4.5% target and

### Fixed Income Research

#### Contributing Strategists

#### Tony Volpon

+1 212 667 2182

[tony.volpon@nomura.com](mailto:tony.volpon@nomura.com)

#### Benito Berber

+1 212 667 9503

[Benito.Berber@nomura.com](mailto:Benito.Berber@nomura.com)

#### Boris Segura

+1 212 667 1375

[Boris.Segura@nomura.com](mailto:Boris.Segura@nomura.com)

#### George Lei

+1 212 667 9947

[George.Lei@nomura.com](mailto:George.Lei@nomura.com)

#### Tanuja Gupta

+1 212 667 1072

[Tanuja.Gupta@nomura.com](mailto:Tanuja.Gupta@nomura.com)

#### Flora Hsu

+1 212 667 8907

[Flora.Hsu@nomura.com](mailto:Flora.Hsu@nomura.com)

This report can be accessed electronically via: [www.nomura.com/research](http://www.nomura.com/research) or on Bloomberg (NOMR)

the 6.5% upper band of the target range.

Clearly the risks to our scenario are to the downside, and we estimated what could happen with shocks of greater sizes and different lengths (see Box: What if 2008 repeats itself?). The main message that we take from these simulations is that, if faced with a severe shock, given the measured external linkages and the key place commodities have in the Brazilian economy, even a very aggressive policy response is unlikely to boost growth meaningfully.

## Mexico

Assuming GDP in the US grows by around 2% Mexico's economy should expand around potential, estimated at 3%, with a more balanced mix between domestic consumption and exports. We think Banxico will lower the policy rate to 4.25% and keep it at this level for 2012 amidst sticky inflation, projected to be around 4% (target band: 2-4%). The Mexican peso (MXN) is likely to remain under pressure owing to heightened volatility in the global financial markets.

2012 is an election year, which should support domestic consumption owing to extra expenditures by political parties (see Box: Key elections in 2012). A combination of higher-than-normal election spending and robust growth in consumer credit should support domestic demand, even as exports decelerate.

The combination of a weak MXN, the closure of the output gap, and high gasoline prices makes it unlikely that inflation will converge to the 3% target, it being more likely to remain between 3.5% and 4.0%. While the government has been unwinding the gasoline subsidies initiated in 2009, the MXN depreciation has made it difficult to close the US-Mexico gasoline price gap. As a result, gasoline prices are expected to continue increasing at 10% y-o-y in 2012.

We see the policy rate at 4.25% for most of 2012, in spite of sticky high inflation, and predict Banxico will start a gradual tightening cycle in Q1 2013. We only expect aggressive policy rate cuts if the US enters into a recession.

The current account deficit will likely remain at 1-2% of GDP, easily financed by FDI. Barring any big external shocks, the current account deficit tends to be stable, exports and imports of manufactures (which comprise the bulk of exports and imports) being strongly correlated.

We think the main downside risk is that both the US and Europe plunge into severe recessions. A slowdown in the US would affect exports and overall economic activities. A shock in Europe would tighten monetary conditions, leading the European banks operating in Mexico to contract credit. This would send the MXN to historically weak levels, and likely cause a Banxico intervention to both stabilize the exchange rate and cut the policy rate by approximately 150bp, in order to ensure negative real rates (something rare in Mexico). Lower oil prices due to a severe global slowdown would put pressure on the 2013 fiscal outlook, but not affect 2012 fiscal accounts, as the government always hedges oil exports for the following year.

## Argentina

Argentina has had to face the macro imbalances engendered in the run-up to last October's elections. We suspect that significant portfolio dollarization and incoherent FX policy moves following the elections are forcing the authorities to take on our convergence scenario. In a nutshell, this indicates a shift away from the exchange rate to another nominal anchor for domestic prices; the authorities embrace this scenario out of necessity, not conviction.

# What if 2008 repeats itself?

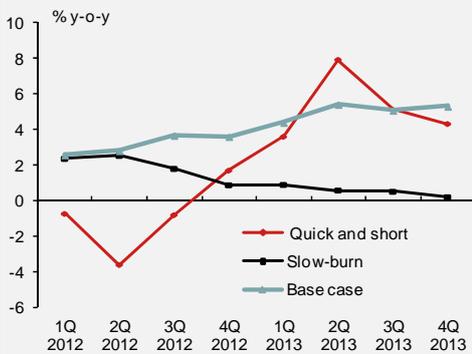
T Volpon | B Berber | G Lei | T Gupta

Aggressive policy responses would have a limited impact on growth. Real rates in Brazil and Mexico may turn negative.

How would major LatAm economies perform in the face of a severe external shock? We simulated two scenarios for Brazil and Mexico for 2012-13: 1) a V-shaped 2008-style shock, where external factors quickly normalize after brief turbulences (the “quick and short” case); 2) an L-shaped shock, where external conditions fail to immediately improve (the “slow burn” case). We believe the two cases represent the robust outer bounds to the likely paths both economies and policymakers will take. For ease of comparison, in “quick and short”, we vary our exogenous variables<sup>1</sup> by the same percentage as in the 2008 crisis; in “slow burn”, we assume deterioration in exogenous variables on the same scale as 2008, spread across a 2-year horizon. We further assume the shocks begin in Q1 2012, though taking into account the fall in external variables that have already occurred this year.

Simulations for Brazil reveal some interesting results: for GDP, in “slow burn” there is no recession, but an extended period of below-potential growth. In “quick and short”, we will likely see a 2012 recession of -0.9% growth, followed by a robust 5.2% recovery in 2013 (Figure 1). Investment is the main driver, as the drop in corporate lending rates is unable to offset the impact of lower growth momentum and commodity prices. For the exchange rate, given the strong co-integration between the BRL and metal prices, a collapse of the latter on a 2008 scale would likely send BRL to the 2.3-2.4 region, though it will be difficult to pinpoint the exact timing. For the policy rate, in “quick and short” we see Selic falling to 6% by end-2012, before rising again as the economy recovers (Figure 2). In “slow burn”, Selic could even drop to 4% by Q3 2013, implying negative real rates, something unprecedented in Brazil. Because of the pro-cyclical effects of commodity and asset prices on the Brazilian economy, the steep fall in the policy rate is insufficient to boost 2012 growth to potential, in both cases (See “Brazil: ‘Quick and short’ vs. ‘slow burn’” for a full discussion of all scenarios).

Fig. 1: Brazil: GDP growth projections



Source: Nomura Global Economics.

Fig. 2: Brazil: Interest and exchange rate projections

	USDBRL (period end)		Policy rate (period end)	
	Quick & short	Slow burn	Quick & short	Slow burn
1Q 2012	2.38	1.81	9.0	10.0
2Q 2012	2.43	1.85	7.0	9.0
3Q 2012	2.06	1.90	6.0	8.0
4Q 2012	1.94	1.96	6.0	7.0
1Q 2013	1.84	2.04	7.0	6.0
2Q 2013	1.74	2.13	8.5	5.0
3Q 2013	1.76	2.24	9.5	4.0
4Q 2013	1.68	2.37	9.5	4.0

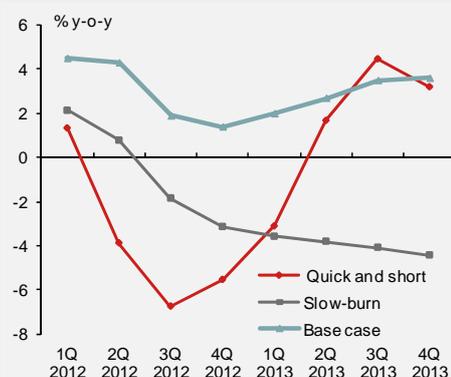
Source: Nomura Global Economics.

For Mexico, since our underlying assumption is a contracting US economy, we see recessions in both scenarios. In “quick and short”, growth will likely fall to -3.8% in 2012, followed by a modest recovery of 1.5% in 2013. In “slow burn”, the economy is likely to be in recession in both 2012 and 2013, falling to 0.6% and 3.9% respectively (Figure 3). In both cases, a US recession impacts exports and investments severely. For the exchange rate, not taking into account the FX intervention policies by Banxico, in “quick and short” the MXN depreciates to 16.68 in 2012 and comes back to 15.5 by end of 2013. In “slow burn” the peso falls to 16.0 by end of 2013.

In terms of the policy rate, in both scenarios the Taylor-rule model points to hikes in 2012 due to inflation pressure and then cuts in 2013. While it is unlikely that Banxico would hike when GDP is collapsing, the model clearly illustrates the initial rise in inflation due to a weak MXN and the FX pass-through. The main takeaway is that ultimately policy rates can fall substantially. Indeed a policy rate of around 2% is feasible under these extreme shocks (provided US policy rate remains around 0% for the 2012-2013 period).

1. Note: external variables include CRB commodity indices, VIX, country CDS and S&P 500 index, US GDP, US IP

Fig. 3: Mexico: GDP growth projections



Source: Nomura Global Economics.

Fig. 4: Mexico: Interest and exchange rate projections

	USDMXN (period end)		Policy rate (period end)	
	Quick & short	Slow burn	Quick & short	Slow burn
1Q 2012	16.88	14.25	6.0	5.5
2Q 2012	17.49	14.50	5.5	5.5
3Q 2012	16.27	14.75	5.3	5.8
4Q 2012	16.68	15.00	4.8	5.8
1Q 2013	16.16	15.25	4.0	5.0
2Q 2013	15.26	15.50	3.0	3.8
3Q 2013	15.97	15.75	2.3	3.0
4Q 2013	15.54	16.00	1.3	2.0

Source: Nomura Global Economics.

The authorities are tightening monetary and fiscal conditions. On the monetary side, domestic interest rates have risen noticeably as the central bank attempts to defend the currency and banks try to maintain peso liquidity. With the announcement of an overhaul to the subsidies scheme covering energy and public transport, we now expect slower primary spending growth.

Economic activity is already decelerating due to portfolio dollarization; industrial export demand from Brazil is also slowing. We expect a significant deceleration of GDP growth next year (3% versus 8% this year). Despite the phase-out of generalized subsidies to energy and transportation, we expect inflation to slow in tandem with more subdued economic activity, but remain at relatively high levels, around 18%.

We expect Argentine peso (ARS) depreciation to continue, but at a gradual pace. The authorities fear faster inflation and financial instability, possibly associated with disorderly ARS depreciation. Import growth will likely be held back by slower economic activity and further discretionary curbs by the authorities, so as to keep the current account close to balance.

## Chile

After registering the highest GDP growth since 1997, we project the Chilean economic growth to slow to 4.6% in 2012, slightly below potential. Falling terms of trade and a phase-out of post-quake reconstructions should lead to lower growth in both consumption and investments. Given our working assumption of a fall yet no collapse in commodity prices, we expect the central bank (BCCh) to start cutting its policy rate in Q1, with a 100bp easing cycle. Price pressures should ease in 2012 and CPI will likely remain well-anchored around the 3% target.

However, as a small open economy with high export exposure to copper, risks in Chile are obviously to the downside. The BCCh has made it clear that, should a major global shock occur, it would quickly deliver aggressive rate cuts. The government also has ample room for countercyclical fiscal policies to spur growth. Nonetheless, investments would still likely contract if a 2008-magnitude shock happened, dragging overall growth to close to zero, if not negative.

## Colombia

We forecast 2012 GDP to expand by 4.5%, which coincides with potential growth. The current strength of domestic consumption contrasts with the risks to growth in the global economy.

We see the central bank (BanRep) keeping the policy rate at 4.75% throughout 2012, with a small current account deficit being financed by FDI, and a stable currency. We also expect the government to continue working towards a fiscal rule (2.3% deficit of GDP) by 2014.

Under a scenario of plummeting commodity prices, growth would fall to near zero, the current account deficit would widen and FDI inflows would decelerate. BanRep would lower rates to below 3.0% and simultaneously intervene to stabilize the Colombian peso.

## Key elections in Latin America

Boris Segura | Benito Berber

In 2012, financial markets will keep a close eye on the presidential elections in Venezuela and Mexico.

### Venezuela

Venezuela will be holding key Presidential elections on 7 October 2012. This contest is likely to be tight, as the 12 years in office are taking a toll on President Hugo Chavez’s popularity, and the opposition looks more united than ever.

In the short term, the market will focus on the opposition’s primaries to take place next 12 February. Henrique Capriles (Primer Justicia), Governor of Miranda, has been leading the pack lately, with a comfortable lead over the rest of hopefuls (Figure 1). The opposition has learned from past mistakes, and realizes that if it hopes to unseat President Chavez, it must remain united.

In the end, we think that the key for the opposition is not only to energize its own support base, but also to appeal to the independent voters. In recent history, Venezuela electorally tends to be split into three similarly-sized groups: the chavismo, the opposition and the independents.

The other major factor to affect the October elections is the health status of President Chavez. He is the ultimate campaigner, particularly as elections approach. But his campaigning mode crucially depends on him being physically fit, which is now unknown, given recent health issues.

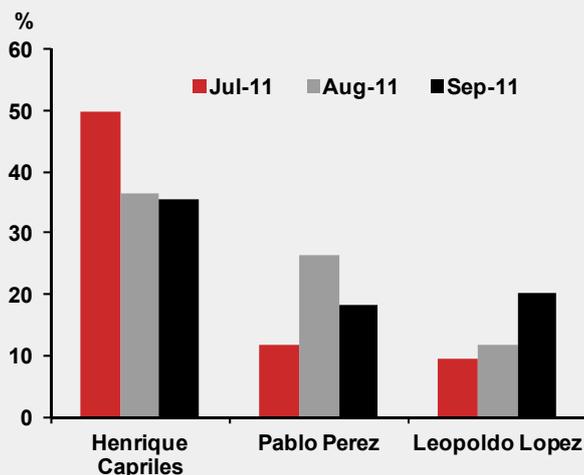
Given Venezuela’s slow but steady deterioration of creditworthiness, the market certainly hopes for “regime change” in 2012. Venezuela’s assets would go through an interesting repricing if an orderly, peaceful transition occurs.

### Mexico

Mexicans will elect a new president and congress on July 1, 2012. The center-left PRI party is the favorite to win both the presidency and majority in congress, re-gaining its hegemonic status consolidated in the aftermath of the 1910 Revolution. The PRI doesn’t have a clear ideology: Former President Echeverria (’70-’76) became the leader of International Socialist, while President Salinas (’88-’94) signed NAFTA and privatized several major companies. So it is not moot to ask what policies would its candidate, Enrique Peña Nieto (former governor of the State of Mexico), implement if he wins the election. He has emphasized the need to allow private investment in the oil sector and to pass a comprehensive fiscal reform to reduce the dependency of fiscal accounts on oil revenues (the PRI has blocked both proposals in the past). Peña Nieto also wants to enhance social benefits by granting unemployment, and health insurance.

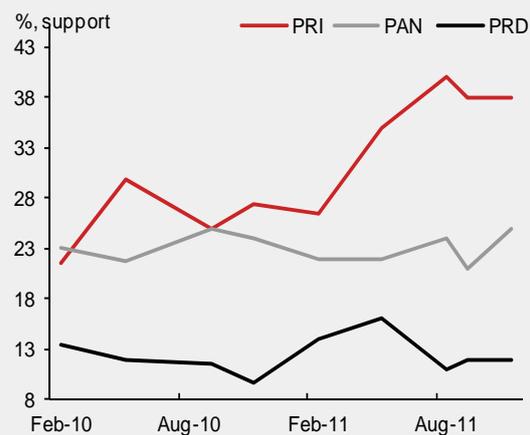
The left PRD party nominated Andrés Manuel López Obrador (AMLO) as its presidential candidate. AMLO narrowly lost the 2006 presidential election to President Felipe Calderón (PAN). However, AMLO’s popularity is declining among independents. The party remains divided and it lost key gubernatorial elections. Therefore according to pollster El Universal, the chances of him winning the election are low. The PAN will elect its candidate in February between the former Finance Minister Ernesto Cordero, former Education Minister Josefina Vázquez and Senator Santiago Creel. According to El Universal pollster the chances of PAN winning the election are low given the lackluster economy and rising violence (Figure 2).

Fig. 1: Venezuela’s opposition vote intention



Source: Datanalisis, Nomura Global Economics. Note: Vote intention means percent of respondents to poll saying would vote for candidate listed.

Fig. 2: Mexico’s presidential election poll



Source: El Universal, Nomura Global Economics.

## Brazil: Braced for a crisis

*The fallout from the eurozone sovereign debt crisis should hit growth in 2012. But the policy response should be sufficient to keep growth positive and lead to a stronger recovery in 2013.*

**Activity:** The Brazilian economy is experiencing a broad-based slowdown, and we expect it to expand by only 3.0% in 2011. After raising rates at the beginning of 2011, fearing a greater growth deceleration, the central bank surprised markets and slashed the Selic policy rate by 50bp in August, beginning an easing cycle which we expect to take the Selic policy rate to 9% by Q2 2012 as policymakers, with a very negative view of the global outlook, are determined to boost economic growth. We expect the easing of monetary policy to help keep growth at 3.2% in 2012 despite heavy external headwinds. Easier policy and what we expect to be a better external environment, likely in the second half of the year, should set the stage for a stronger cyclical recovery in 2013, with growth reaching 5.1%.

**Inflation:** Inflation has been elevated throughout 2011, running at 6.97% y-o-y as of October, above the 6.5% upper bound of the target band. Non-tradable goods inflation is running close to 8%, owing partly to the buoyant labor market as unemployment has been hitting several record lows this year. Commodity prices have moderated, but not enough to have a big impact on headline inflation. As policymakers appear to be targeting inflation below the top of the band (6.5%), instead of the centre (4.5%), inflation expectations have remained sticky. As the Brazilian economy slows, we expect inflation to fall, but given the decision to protect growth by aggressively lowering rates, we do not expect inflation to close below 5% in either 2012 or 2013.

**Policy:** In our view, policymakers are attempting to operate a new economic regime with multiple targets – growth, inflation and the exchange rate. To this end the government is using a multitude of instruments. More discretionary and non-market-based measures are likely to be employed in the course of policy execution, leading to less transparency and more uncertainty for overall policymaking, which should lower potential growth.

**Risks:** Given a more complex and discretionary policy framework that seems to have multiple targets, policy uncertainty higher is today. We believe the multiple-targeting framework will lead to a “stop-and-go” monetary policy, with inflation risks remaining high even in a period of external headwinds. Risks are clearly to the downside for growth, given the large external risks faced by Brazil, whose economic performance remains closely tied to that of China.

### Brazil macro forecast details

% y-o-y change unless noted	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	2011	2012	2013
Real GDP	<b>2.1</b>	1.8	2.6	2.8	3.7	3.6	4.4	5.4	3.0	3.2	5.1
Personal consumption	<b>2.8</b>	3.0	3.3	3.6	4.4	4.9	5.7	6.8	4.9	4.0	6.3
Fixed investment	<b>2.5</b>	2.3	2.6	5.6	4.3	6.2	6.6	8.9	4.3	4.7	8.6
Government expenditure	<b>1.2</b>	1.5	1.3	1.3	4.1	4.5	3.3	3.2	2.5	2.9	3.1
Exports	<b>4.1</b>	-1.3	3.2	-0.3	0.8	2.5	6.0	7.8	2.9	1.5	7.9
Imports	<b>5.8</b>	5.5	4.3	5.6	6.4	13.2	13.7	16.4	7.6	7.5	16.3
Contributions to GDP growth (pp)											
Industry	<b>0.5</b>	0.4	0.6	0.7	0.9	0.9	1.1	1.3	0.7	0.8	1.2
Agriculture	<b>0.1</b>	0.1	0.1	0.1	0.2	0.2	0.2	0.3	0.1	0.2	0.2
Services	<b>1.2</b>	1.0	1.5	1.6	2.1	2.1	2.5	3.1	1.7	1.8	2.9
IPCA (consumer prices)	<b>7.3</b>	6.5	5.5	5.4	4.9	5.1	5.2	5.3	6.5	5.1	5.4
IGPM (wholesale prices)	<b>7.5</b>	6.8	6.3	6.0	5.5	5.4	5.7	5.8	6.8	5.4	6.1
Trade balance (US\$ billion)	<b>31</b>	27	23	20	18	15	17	20	27	15	25
Current account (% GDP)									-2.5	-3.0	-3.0
Fiscal balance (% GDP)									-2.0	-2.0	-2.0
Net public debt (% GDP)									39.0	36.0	35.0
Selic %	<b>12.00</b>	11.00	10.00	9.00	9.00	9.00	9.50	10.00	11.00	9.00	11.00
BRL/USD	<b>1.88</b>	1.78	1.85	1.90	1.72	1.65	1.64	1.63	1.78	1.65	1.55

Source: Nomura Global Economics. Note: Numbers in bold are actual values, others forecast

## Mexico: Growth supported by domestic demand

*With exports to the US decelerating, growth is increasingly supported by domestic demand. A weaker Mexican peso should keep monetary conditions loose but put pressure on inflation.*

**Activity:** The Mexican economy is on track to expand at potential, which we estimate at 3.0%, in the remainder of 2011 and in 2012. However, there are significant risks to growth associated with an outlook of decelerating economic activity in the US and the eurozone, which are Mexico's largest trade partners. On the positive side, domestic demand in Mexico has finally started to pick up, evidenced by strong private consumption and investment. Consumption has been supported by credit and stabilization of remittances from workers in the US.

**Inflation:** We expect inflation to be above the 3.0% target but below the 4% upper bound of the target band throughout 2012. While the labor market continues to indicate that there is slack in the economy, our estimation is that the output gap has already closed. The combination of Mexican peso (MXN) weakness and a positive, albeit small, output gap, should put upward pressure on inflation. Gasoline prices, expanding at 10% y-o-y, should be another source of inflation pressure.

**Policy:** We forecast the central bank of Mexico (Banxico) to pre-emptively cut the policy rate in Q1 2012. This is due to an increased likelihood of more globally coordinated actions to loosen monetary policy further linked to rising risks in the eurozone. After the November 2011 announcement about selling dollars whenever the MXN depreciates 2%, we cannot rule out discretionary intervention by Banxico to further stabilize the currency. However, we expect the peso to remain under pressure and above 13 throughout 2012 as a result of the complicated external backdrop. Unlike monetary policy, there is little degree of freedom in fiscal policy, as economic contraction and falling oil prices would severely limit government revenues. Therefore, similar to 2008, we would expect the government to limit spending and the fiscal deficit to widen to 2.5% of GDP, which is in line with the approved 2012 budget.

**Risks:** The main risk to Mexico is a double-dip recession in the US. In terms of inflation, we see the following risks to our call: (1) pass-through effects due to a sizable MXN depreciation; and (2) increases in gasoline prices. In terms of fiscal policy, the main risk stems from a protracted (more than year-long) downward correction in oil prices that would put pressure on fiscal revenues.

### Mexico macro forecast details

% y-o-y change unless noted	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	2011	2012	2013
Real GDP	<b>4.5</b>	4.1	4.5	4.3	1.9	1.4	2.0	2.7	4.1	3.0	3.0
Personal consumption	4.5	3.5	3.1	3.9	2.5	2.6	2.8	3.0	3.5	3.0	3.1
Fixed investment	4.0	2.2	1.8	2.6	2.9	3.2	3.2	3.2	5.2	2.7	3.2
Government expenditure	-0.2	3.5	3.8	6.6	5.5	2.8	2.5	2.1	0.5	4.7	1.9
Exports	7.1	6.4	2.8	3.0	3.7	5.0	5.4	5.8	8.8	3.7	5.7
Imports	4.9	6.8	4.4	4.1	2.8	2.8	3.5	4.3	7.2	3.5	4.7
Contributions to GDP (pp):											
Industry	1.3	1.2	1.3	1.3	0.6	0.4	0.6	0.8	1.2	0.9	0.9
Agriculture	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.2	0.1	0.1
Services	2.9	2.6	2.9	2.7	1.2	0.9	1.3	1.7	2.6	1.9	1.9
CPI	<b>3.14</b>	3.89	3.95	3.90	3.94	3.97	3.70	3.70	3.89	3.97	3.70
Trade balance (US\$ billion)	<b>-3.8</b>	-5.0	-4.0	-4.0	-4.1	-3.9	-3.8	-3.8	-5.5	-16.0	-15.2
Current account (% GDP)									-0.9	-1.5	-1.5
Fiscal balance (% GDP)									-2.5	-2.4	-2.2
Gross public debt (% GDP)									34.0	33.5	33.0
Overnight Rate %	<b>4.50</b>	4.50	4.25	4.25	4.25	4.25	4.75	5.25	4.50	4.25	6.00
USD/MXN	<b>13.90</b>	13.45	13.60	13.90	13.50	13.00	12.80	12.80	13.45	13.00	12.80

Source: Nomura Global Economics.

Note: Numbers in bold are actual values, others forecast

## Argentina: Embracing convergence

The authorities are likely to embrace convergence out of necessity, not conviction

	2010	2011	2012	2013
Real GDP % y-o-y	<b>9.2</b>	8.0	3.0	4.6
Consumption % y-o-y	<b>9.0</b>	9.1	4.0	4.3
Gross Investment % y-o-y	<b>21.2</b>	16.7	6.9	7.3
Exports % y-o-y	<b>14.6</b>	2.4	5.9	5.5
Imports % y-o-y	<b>34.0</b>	24.0	12.3	6.9
CPI % y-o-y *	<b>10.9</b>	9.8	9.4	9.6
CPI % y-o-y **	<b>25.9</b>	22.5	18.2	15.4
Budget balance % GDP ***	<b>1.7</b>	2.1	1.9	2.5
Current account % GDP	<b>0.8</b>	-0.5	-0.5	0.2
Policy Rate %	<b>10.10</b>	19.5	18.0	16.0
USDARS	<b>3.98</b>	4.30	5.10	5.85

\* Official data, \*\* Private estimate, \*\*\*Primary budget balance, Bold is actual data

Source: Nomura Global Economics.

- Argentina is in the process of unwinding macro imbalances engendered over the last few years as the international environment turns hostile.
- Rampant portfolio dollarization and a shrinking trade surplus are putting pressure on international reserves.
- Growth in government primary spending is likely to slow down because of the overhaul of subsidies to utilities and public transportation. Interest rates are likely to remain high, and become less negative in real terms.
- We expect ARS depreciation to pick up but in a controlled fashion, as the authorities try to avoid pass-through to inflation and financial instability.

## Chile: Back to normal

Both growth and inflation are set to decelerate, after a robust 2011; we expect a 100bp easing cycle in 2012

	2010	2011	2012	2013
Real GDP % y-o-y	<b>5.2</b>	6.3	4.6	5.8
Consumption % y-o-y	<b>9.3</b>	9.0	6.5	7.5
Gross Investment % y-o-y	<b>18.8</b>	16.0	11.5	13.0
Exports % y-o-y	<b>1.9</b>	6.8	2.8	4.4
Imports % y-o-y	<b>29.5</b>	15.5	9.6	11.0
CPI % y-o-y *	<b>3.0</b>	3.8	2.9	3.1
CPI % y-o-y **	<b>1.4</b>	3.3	2.8	3.2
Budget balance % GDP	<b>-0.3</b>	1.6	1.0	1.0
Current account % GDP	<b>1.9</b>	-1.5	0.0	1.8
Policy Rate % *	<b>3.25</b>	5.25	4.25	5.50
USDCLP *	<b>468.00</b>	500.00	480.00	465.00

\* End of period, \*\* Period average, Bold is actual data

Source: Nomura Global Economics.

- Chile's economy is set to slow in 2012, after posting its strongest growth since 1997. Falling terms of trade and phase-out of post-quake reconstructions should lead to lower growth in both private consumption and investments.
- Inflation is likely to stay elevated throughout this year, but start a downward path from Q1 2012, in tandem with cooling growth and falling commodity prices. We expect CPI inflation to remain around the 3% target for most of 2012.
- Improvements in the growth-inflation balance should enable the Central Bank of Chile (BCCCh) to launch an easing cycle in Q1, cutting 100bp.
- Risks are to the downside because of Chile's small, open economy and a high export exposure to copper.

## Colombia: Growing amidst a complicated external backdrop

Mostly supported by domestic consumption, we expect the economy to expand at potential in 2012 and 2013

	2010	2011	2012	2013
Real GDP % y-o-y	<b>4.3</b>	5.0	4.5	4.5
Consumption % y-o-y	<b>4.5</b>	5.0	4.5	4.4
Gross Investment % y-o-y	<b>6.7</b>	10.0	9.0	9.2
Exports % y-o-y	<b>2.2</b>	7.0	7.0	6.5
Imports % y-o-y	<b>15.5</b>	18.0	9.0	8.0
CPI % y-o-y *	<b>3.2</b>	3.8	3.7	3.7
CPI % y-o-y **	<b>2.3</b>	3.5	3.7	3.7
Budget balance % GDP	<b>-3.8</b>	-3.0	-3.0	-2.5
Current account % GDP	<b>-3.1</b>	-3.0	-3.5	-3.0
Policy Rate % *	<b>3.00</b>	4.75	4.75	7.00
USDCOP *	<b>1907.70</b>	1900.00	1850.00	1750.00

Source: Nomura Global Economics.

- We forecast 2012 and 2013 GDP to expand at its potential growth. The current strength of domestic consumption contrasts with the risks to growth in the global economy.
- We see BanRep keeping the policy rate at 4.75% throughout 2012 with a small deficit in the current account being financed through FDI and a stable COP. We expect the government to meet the fiscal deficit rule of 2.3% of GDP by 2014.
- If commodity prices plummet, growth would collapse to near zero, the current account deficit would widen and FDI inflows would decelerate. BanRep would lower rates to below 3.0% and intervene in the exchange rate to stabilize the COP.

## Disclosure Appendix A-1

### ANALYST CERTIFICATIONS

Each research analyst identified herein certifies that all of the views expressed in this report by such analyst accurately reflect his or her personal views about the subject securities and issuers. In addition, each research analyst identified on the cover page hereof hereby certifies that no part of his or her compensation was, is, or will be, directly or indirectly related to the specific recommendations or views that he or she has expressed in this research report, nor is it tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

### Important Disclosures

#### Conflict-of-interest disclosures

Important disclosures may be accessed through the following

website: <http://go.nomuranow.com/research/globalresearchportal/pages/disclosures/disclosures.aspx>. If you have difficulty with this site or you do not have a password, please contact your Nomura Securities International, Inc. salesperson (1-877-865-5752) or email [grpsupport-eu@nomura.com](mailto:grpsupport-eu@nomura.com) for assistance.

#### Online availability of research and conflict-of-interest disclosures

Nomura research is available on [www.nomuranow.com](http://www.nomuranow.com), Bloomberg, Capital IQ, Factset, MarkitHub, Reuters and ThomsonOne.

Important disclosures may be read at <http://go.nomuranow.com/research/globalresearchportal/pages/disclosures/disclosures.aspx> or requested from Nomura Securities International, Inc., on 1-877-865-5752. If you have any difficulties with the website, please email [grpsupport-eu@nomura.com](mailto:grpsupport-eu@nomura.com) for help.

The analysts responsible for preparing this report have received compensation based upon various factors including the firm's total revenues, a portion of which is generated by Investment Banking activities. Unless otherwise noted, the non-US analysts listed at the front of this report are not registered/qualified as research analysts under FINRA/NYSE rules, may not be associated persons of NSI, and may not be subject to FINRA Rule 2711 and NYSE Rule 472 restrictions on communications with covered companies, public appearances, and trading securities held by a research analyst account.

#### ADDITIONAL DISCLOSURES REQUIRED IN THE U.S.

Principal Trading: Nomura Securities International, Inc and its affiliates will usually trade as principal in the fixed income securities (or in related derivatives) that are the subject of this research report. Analyst Interactions with other Nomura Securities International, Inc Personnel: The fixed income research analysts of Nomura Securities International, Inc and its affiliates regularly interact with sales and trading desk personnel in connection with obtaining liquidity and pricing information for their respective coverage universe.

#### Valuation Methodology - Global Strategy

A "Relative Value" based recommendation is the principal approach used by Nomura's Fixed Income Strategists / Analysts when they make "Buy" (Long) "Hold" and "Sell"(Short) recommendations to clients. These recommendations use a valuation methodology that identifies relative value based on:

- Opportunistic spread differences between the appropriate benchmark and the security or the financial instrument,
- Divergence between a country's underlying macro or micro-economic fundamentals and its currency's value and
- Technical factors such as supply and demand flows in the market that may temporarily distort valuations when compared to an equilibrium priced solely on fundamental factors.

In addition, a "Buy" (Long) or "Sell" (Short) recommendation on an individual security or financial instrument is intended to convey Nomura's belief that the price/spread on the security in question is expected to outperform (underperform) similarly structured securities over a three to twelve-month time period. This outperformance (underperformance) can be the result of several factors, including but not limited to: credit fundamentals, macro/micro economic factors, unexpected trading activity or an unexpected upgrade (downgrade) by a major rating agency.

### Disclaimers

This document contains material that has been prepared by the Nomura entity identified at the top or bottom of page 1 herein, if any, and/or, with the sole or joint contributions of one or more Nomura entities whose employees and their respective affiliations are specified on page 1 herein or identified elsewhere in the document. Affiliates and subsidiaries of Nomura Holdings, Inc. (collectively, the 'Nomura Group'), include: Nomura Securities Co., Ltd. ('NSC') Tokyo, Japan; Nomura International plc ('Nlplc'), UK; Nomura Securities International, Inc. ('NSI'), New York, US; Nomura International (Hong Kong) Ltd. ('NIHK'), Hong Kong; Nomura Financial Investment (Korea) Co., Ltd. ('NFIK'), Korea (Information on Nomura analysts registered with the Korea Financial Investment Association ('KOFIA') can be found on the KOFIA Intranet at <http://dis.kofia.or.kr>); Nomura Singapore Ltd. ('NSL'), Singapore (Registration number 197201440E, regulated by the Monetary Authority of Singapore); Capital Nomura Securities Public Company Limited ('CNS'), Thailand; Nomura Australia Ltd. ('NAL'), Australia (ABN 48 003 032 513), regulated by the Australian Securities and Investment Commission ('ASIC') and holder of an Australian financial services licence number 246412; P.T. Nomura Indonesia ('PTNI'), Indonesia; Nomura Securities Malaysia Sdn. Bhd. ('NSM'), Malaysia; Nomura International (Hong Kong) Ltd., Taipei Branch ('NITB'), Taiwan; Nomura Financial Advisory and Securities (India) Private Limited ('NFASL'), Mumbai, India (Registered Address: Ceejay House, Level 11, Plot F, Shivsagar Estate, Dr. Annie Besant Road, Worli, Mumbai- 400 018, India; Tel: +91 22 4037 4037, Fax: +91 22 4037 4111; SEBI Registration No: BSE INB011299030, NSE INB231299034, INF231299034, INE 231299034, MCX: INE261299034); Banque Nomura France ('BNF'), regulated by the Autorité des marchés financiers and the Autorité de Contrôle Prudentiel; Nlplc, Dubai Branch ('Nlplc, Dubai'); Nlplc, Madrid Branch ('Nlplc, Madrid') and Nlplc, Italian Branch ('Nlplc, Italy').

This material is: (i) for your private information, and we are not soliciting any action based upon it; (ii) not to be construed as an offer to sell or a solicitation of an offer to buy any security in any jurisdiction where such offer or solicitation would be illegal; and (iii) based upon information from sources that we consider reliable, but has not been independently verified by Nomura Group.

Nomura Group does not warrant or represent that the document is accurate, complete, reliable, fit for any particular purpose or merchantable and does not accept liability for any act (or decision not to act) resulting from use of this document and related data. To the maximum extent permissible all warranties and other assurances by Nomura group are hereby excluded and Nomura Group shall have no liability for the use, misuse, or distribution of this information.

Opinions or estimates expressed are current opinions as of the original publication date appearing on this material and the information, including the opinions and estimates contained herein, are subject to change without notice. Nomura Group is under no duty to update this document. Any

comments or statements made herein are those of the author(s) and may differ from views held by other parties within Nomura Group. Clients should consider whether any advice or recommendation in this report is suitable for their particular circumstances and, if appropriate, seek professional advice, including tax advice. Nomura Group does not provide tax advice.

Nomura Group, and/or its officers, directors and employees, may, to the extent permitted by applicable law and/or regulation, deal as principal, agent, or otherwise, or have long or short positions in, or buy or sell, the securities, commodities or instruments, or options or other derivative instruments based thereon, of issuers or securities mentioned herein. Nomura Group companies may also act as market maker or liquidity provider (as defined within Financial Services Authority ('FSA') rules in the UK) in the financial instruments of the issuer. Where the activity of market maker is carried out in accordance with the definition given to it by specific laws and regulations of the US or other jurisdictions, this will be separately disclosed within the specific issuer disclosures.

This document may contain information obtained from third parties, including ratings from credit ratings agencies such as Standard & Poor's.

Reproduction and distribution of third party content in any form is prohibited except with the prior written permission of the related third party. Third party content providers do not guarantee the accuracy, completeness, timeliness or availability of any information, including ratings, and are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, or for the results obtained from the use of such content. Third party content providers give no express or implied warranties, including, but not limited to, any warranties of merchantability or fitness for a particular purpose or use. Third party content providers shall not be liable for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including lost income or profits and opportunity costs) in connection with any use of their content, including ratings. Credit ratings are statements of opinions and are not statements of fact or recommendations to purchase hold or sell securities. They do not address the suitability of securities or the suitability of securities for investment purposes, and should not be relied on as investment advice.

Any MSCI sourced information in this document is the exclusive property of MSCI Inc. ('MSCI'). Without prior written permission of MSCI, this information and any other MSCI intellectual property may not be reproduced, re-disseminated or used to create any financial products, including any indices. This information is provided on an "as is" basis. The user assumes the entire risk of any use made of this information. MSCI, its affiliates and any third party involved in, or related to, computing or compiling the information hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability or fitness for a particular purpose with respect to any of this information. Without limiting any of the foregoing, in no event shall MSCI, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind. MSCI and the MSCI indexes are services marks of MSCI and its affiliates.

Investors should consider this document as only a single factor in making their investment decision and, as such, the report should not be viewed as identifying or suggesting all risks, direct or indirect, that may be associated with any investment decision. Nomura Group produces a number of different types of research product including, among others, fundamental analysis, quantitative analysis and short term trading ideas; recommendations contained in one type of research product may differ from recommendations contained in other types of research product, whether as a result of differing time horizons, methodologies or otherwise. Nomura Group publishes research product in a number of different ways including the posting of product on Nomura Group portals and/or distribution directly to clients. Different groups of clients may receive different products and services from the research department depending on their individual requirements.

Figures presented herein may refer to past performance or simulations based on past performance which are not reliable indicators of future performance. Where the information contains an indication of future performance, such forecasts may not be a reliable indicator of future performance. Moreover, simulations are based on models and simplifying assumptions which may oversimplify and not reflect the future distribution of returns.

Certain securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of, or income derived from, the investment.

The securities described herein may not have been registered under the US Securities Act of 1933 (the '1933 Act'), and, in such case, may not be offered or sold in the US or to US persons unless they have been registered under the 1933 Act, or except in compliance with an exemption from the registration requirements of the 1933 Act. Unless governing law permits otherwise, any transaction should be executed via a Nomura entity in your home jurisdiction.

This document has been approved for distribution in the UK and European Economic Area as investment research by Nipic, which is authorized and regulated by the FSA and is a member of the London Stock Exchange. It does not constitute a personal recommendation, as defined by the FSA, or take into account the particular investment objectives, financial situations, or needs of individual investors. It is intended only for investors who are 'eligible counterparties' or 'professional clients' as defined by the FSA, and may not, therefore, be redistributed to retail clients as defined by the FSA. This document has been approved by NIHK, which is regulated by the Hong Kong Securities and Futures Commission, for distribution in Hong Kong by NIHK. This document has been approved for distribution in Australia by NAL, which is authorized and regulated in Australia by the ASIC. This document has also been approved for distribution in Malaysia by NSM. In Singapore, this document has been distributed by NSL. NSL accepts legal responsibility for the content of this document, where it concerns securities, futures and foreign exchange, issued by their foreign affiliates in respect of recipients who are not accredited, expert or institutional investors as defined by the Securities and Futures Act (Chapter 289). Recipients of this document in Singapore should contact NSL in respect of matters arising from, or in connection with, this document. Unless prohibited by the provisions of Regulation S of the 1933 Act, this material is distributed in the US, by NSI, a US-registered broker-dealer, which accepts responsibility for its contents in accordance with the provisions of Rule 15a-6, under the US Securities Exchange Act of 1934.

This document has not been approved for distribution in the Kingdom of Saudi Arabia ('Saudi Arabia') or to clients other than 'professional clients' in the United Arab Emirates ('UAE') by Nomura Saudi Arabia, Nipic or any other member of Nomura Group, as the case may be. Neither this document nor any copy thereof may be taken or transmitted or distributed, directly or indirectly, by any person other than those authorised to do so into Saudi Arabia or in the UAE or to any person located in Saudi Arabia or to clients other than 'professional clients' in the UAE. By accepting to receive this document, you represent that you are not located in Saudi Arabia or that you are a 'professional client' in the UAE and agree to comply with these restrictions. Any failure to comply with these restrictions may constitute a violation of the laws of Saudi Arabia or the UAE. No part of this material may be (i) copied, photocopied, or duplicated in any form, by any means; or (ii) redistributed without the prior written consent of a member of Nomura Group. Further information on any of the securities mentioned herein may be obtained upon request. If this document has been distributed by electronic transmission, such as e-mail, then such transmission cannot be guaranteed to be secure or error-free as information could be intercepted, corrupted, lost, destroyed, arrive late or incomplete, or contain viruses. The sender therefore does not accept liability for any errors or omissions in the contents of this document, which may arise as a result of electronic transmission. If verification is required, please request a hard-copy version.

Nomura Group manages conflicts with respect to the production of research through its compliance policies and procedures (including, but not limited to, Conflicts of Interest, Chinese Wall and Confidentiality policies) as well as through the maintenance of Chinese walls and employee training.

Additional information is available upon request. Disclosure information is available at the Nomura Disclosure web page: <http://go.nomuranow.com/research/globalresearchportal/pages/disclosures/disclosures.aspx>