

Latin America Economics Analyst LatAm 2018 Macro Outlook: Better But Far From Great!

GS MACRO OUTLOOK 2018

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Macro Picture to Strengthen Further in 2018

Following the unmemorable 2015-16 performance, LatAm's macroeconomic backdrop strengthened gradually but steadily throughout 2017, and is expected to improve further in 2018. We expect the cyclical demand recovery to firm and broaden, supported by accommodative domestic financial conditions and strengthening confidence indicators. Inflation is forecasted to moderate further, and the cross-country dispersion of inflation outcomes to narrow. Overall, we forecast real GDP growth (ex-Venezuela) to accelerate to 2.7% in 2018, up from 1.7% in 2017. We forecast above-trend growth in Argentina and Brazil, the return to trend-like growth in Chile and Peru, but still subpar, below-trend growth in Colombia and Mexico. Venezuela is expected to remain trapped in a recessionary hyperinflation spiral, with real GDP forecasted to decline for the fifth year in a row.

Macro Rebalancing Has Now Been Fundamentally Accomplished

Outside of Venezuela, where very large macro and financial imbalances have been feeding an economic collapse of historical proportions, most LatAm economies underwent a classic macroeconomic adjustment during 2016-17. To a large extent, the adjustment from the 2014-16 correction of commodity prices and less-supportive capital account conditions is now completed. Therefore, as we enter 2018 the initial macro conditions are stronger and more balanced than at any time since 2013.

Additional Fiscal Consolidation Needed to Cement Cyclical Recovery

The forecasted acceleration of GDP growth is contingent on the implementation of disciplined policies, which in most places involves further progress towards fiscal consolidation. It is also contingent on keeping policy risk and political uncertainty relatively contained in a year packed with presidential and legislative elections. In some of these elections, we detect a non-negligible risk of policy reversals.

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LatAm 2018 Macro Outlook: Better But Far From Great!

"Excellence is never granted to man, but as the reward of labor"

Sir Joshua Reynolds (1723-92); English painter, founder and first president of the Royal Academy of Arts; knighted by George III in 1769.

Introduction

Following the unmemorable 2015-16 performance, Latin America's (LatAm) macroeconomic backdrop strengthened gradually but steadily throughout 2017—real GDP growth moved into (modest) positive territory after two consecutive years of contracting real activity; inflationary pressures eased in most economies; policy rates declined, in a number of places to below-neutral levels; and fiscal and current account imbalances moderated slightly. The LatAm macroeconomic environment is expected to improve further in 2018: in broad terms, we see room for the ongoing cyclical real business cycle recovery to firm, without stoking inflationary pressures or undermining external balances. Specifically, we expect:

- (1) The cyclical economic recovery to firm and broaden, supported by overall accommodative domestic financial conditions, recovering credit flows, and strengthening confidence indicators. The external backdrop is expected to remain supportive given the forecasted solid above-trend global growth, firmer terms of trade (particularly for industrial metal exporters, less so for energy and agricultural exporters) and, in general, still abundant global liquidity;
- (2) Inflation to moderate further, and the cross-country dispersion of inflation outcomes to narrow. For the *LA-IT6* economies (the *Inflation Targeting six* include Argentina, Brazil, Chile, Colombia, Mexico and Peru) inflation is forecasted to moderate from 8.8% in 2016, to 6.3% in 2017 and further down to 5.3% in 2018. Inflation is forecasted to decelerate visibly where it has been high and above the target (Argentina and Mexico, and to some extent Colombia) and to gradually normalize upward where it has been tracking below the target (Brazil and Chile);
- (3) **Monetary conditions to remain supportive of growth,** except in Argentina and Mexico where real rates will remain above neutral for a while given the need to further disinflate the economy;
- (4) **Current account imbalances to widen slightly** given the forecasted cyclical rebound of domestic demand. However, current account deficits are forecasted to remain moderate as a share of GDP and to be significantly covered by FDI inflows; and
- (5) **Fiscal picture to improve slightly**: small decline in primary fiscal deficits but not large enough to stabilize the debt dynamics; with the exception of Mexico where a primary surplus close to 1% of GDP should contribute to further reduce of the public debt load. Cyclically adjusted, the forecasted improvement in the fiscal stance is not very impressive.

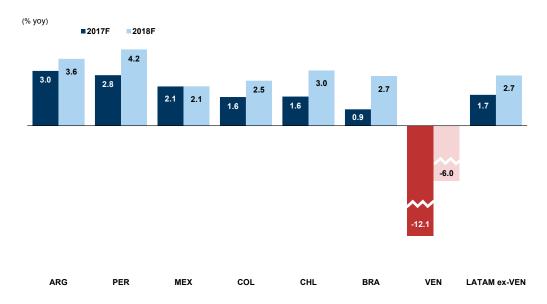


Exhibit 1: LA-IT6 Real GDP Growth Forecasted to Accelerate in 2018

Source: Goldman Sachs Global Investment Research

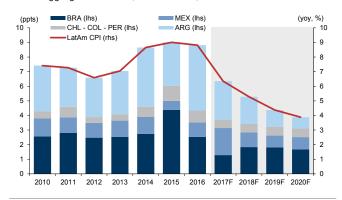
Overall, we forecast aggregate LA-IT6 real GDP growth to accelerate to 2.7% in 2018, up from the projected 1.7% expansion in 2017, and leaving further behind the 2016 recession (Exhibit 1). The forecasted firming of regional growth to the highest level since 2011 is expected to be driven by the acceleration of real GDP growth in Brazil (from a projected 0.9% in 2017 to 2.7% in 2018) but also by firmer growth profiles in Argentina. Chile, Colombia and Peru. We forecast above-trend growth in Argentina and Brazil, the return to trend-like growth in Chile and Peru, but still subpar, below-trend growth in Colombia and Mexico. In Mexico, the underwhelming 2.1% forecast for 2018 real GDP growth reflects the impact of tighter fiscal and monetary policies and the corrosive effect on spending decisions of uncertainty around the outcome of the NAFTA renegotiation and post-July presidential election policy mix. Peru is the only economy where we project growth in 2018 to exceed the 4.0% threshold: overtaking Argentina, which, given the recent solid growth momentum, is now forecasted to be the fastest-growing regional economy in 2017 among the set of economies we cover. With the exception of Argentina and Peru, all other economies are projected to grow 3.0% or less in 2018. Finally, beyond the LA-IT6 group, we expect Venezuela to remain trapped in a recessionary hyperinflation spiral, with real GDP forecasted to decline for the fifth year in row. The Venezuelan economy has been contracting uninterruptedly since 2014: real GDP is estimated to have declined by 25% during 2014-16, and is expected to decline further during 2017-18. Overall, we project that by year-end 2018 real GDP will have contracted by an astonishing 34% from 2014. In truth, Venezuela is experiencing one of the worst economic downfalls in modern Latin American history, with the contraction of real GDP exceeding that of the United States during the Great Depression.

Exhibit 2: Country Contribution to Aggregate Real GDP Growth LA-IT6 Aggregate Growth, % yoy; Contribution by country, ppts



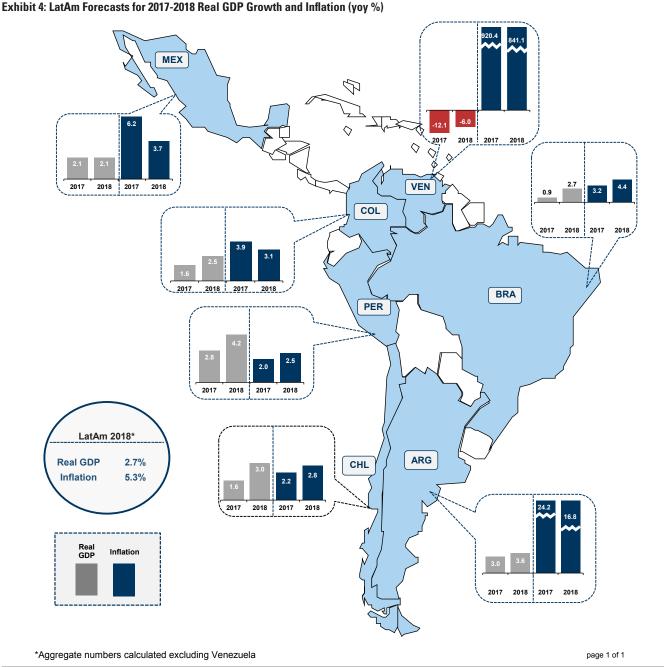
Source: Goldman Sachs Global Investment Research

Exhibit 3: Inflation Expected To Moderate Further in 2018 LA-IT6 Aggregate Inflation (ex-Venezuela)



Source: Goldman Sachs Global Investment Research

The forecasted moderate 100bp acceleration of real GDP growth takes place off an admittedly low comparison base, and would still fall far short of the region's economic potential and social and economic enfranchisement aspirations. Furthermore, the forecasted improvement in the macro outlook is far from assured. It is, in fact, contingent on the implementation of disciplined investment-friendly macro policies, which in most places involves further tangible progress towards fiscal consolidation. It is also contingent on keeping policy and political uncertainty relatively contained in a year packed with presidential and legislative elections in several of the largest regional economies. In some of these elections, voters' rejection of the political establishment could disrupt old/traditional political structures and significantly shift the balance of political power. In fact, in a number of places, early polls point to electoral outcomes that would entail a significant risk of policy reversals, i.e., risk to the continuity of disciplined market-friendly policies. Overall, as in previous years, for most LatAm economies, particularly the larger ones, the key policy and development challenge remains to boost domestic savings and investment (particularly by the public sector) and to identify endogenous engines of growth, so as to finally overcome the region's perennial dependence on commodity prices and capital inflows to grow and develop. Finally, over a longer horizon, the region needs to prepare for the fiscal, social security, and growth challenges of a deteriorating demographic profile, as in a number of countries the optimal demographic window is gradually closing.

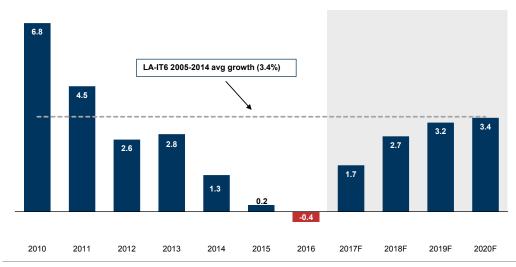


Source: Goldman Sachs Global Investment Research

Macro Rebalancing Has Now Been Fundamentally Accomplished

Recent history has shown that growth across LatAm has been underwhelming outside periods of favorable external winds. Aggregate LA-IT6 real GDP growth peaked at a robust yet unsustainable 6.8% in 2010, and from there decelerated steadily throughout 2011-13. The growth performance downshifted further to a below-trend pace in 2014, stagnated in 2015, and contracted in 2016 under the crippling weight of large macro and financial imbalances that undermined growth in a number of key large economies, and more broadly, a less supportive balance of payments driven in part by declining commodity prices and slowing net capital inflows.

Exhibit 5: Real GDP Growth Back to Positive Territory in 2017-2018 Following 2014-16 Macro Adjustment Real GDP, % yoy, LA-IT6

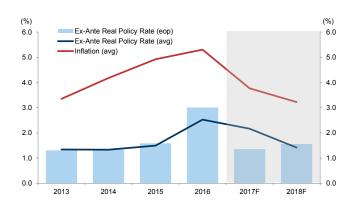


Source: Goldman Sachs Global Investment Research

Outside of Venezuela, where very large macro and financial imbalances have been feeding an economic collapse of historical proportions, most LatAm economies underwent a classic macroeconomic adjustment during 2016-17. To a large extent, the adjustment from the 2014-16 correction of commodity prices and less-supportive capital account conditions is now virtually completed. Therefore, as we enter 2018 the initial macro conditions are broadly stronger and more balanced than at any time since 2013.

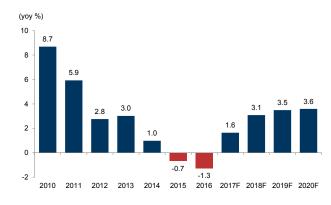
The multi-year macroeconomic rebalancing involved the *classic expenditure-switch dynamics* facilitated by a combination of: weaker currencies, higher real interest rates, and downshift in domestic absorption (Exhibits 6 and 7). Against this backdrop, current account imbalances peaked in 2015 (2014 in Brazil), narrowed significantly in 2016, and are forecasted to narrow further in 2017 (except in Argentina), reaching a cyclical low of approximately 1.7% of GDP for the LA-IT6. Fiscal imbalances also peaked in 2015, but adjustment here has been disappointingly slow, particularly among the large deficit countries of Argentina and Brazil. A backdrop of lower domestic interest rates and recovering domestic demand should, through the operation of automatic fiscal stabilizers, contribute to slightly stronger fiscal outturns in 2018-19; assuming overall spending restraint. Furthermore, fiscal consolidation should also be more easily accepted and digested from a political and social standpoint in an environment of recovering growth and employment.

Exhibit 6: LA-IT5 Inflation and Ex-Ante Real Policy Rate LA-IT5 (ex-Argentina and Venezuela)



Source: Goldman Sachs Global Investment Research

Exhibit 7: LA-IT6 Domestic Demand Growth Experiencing a Cyclical Recovery



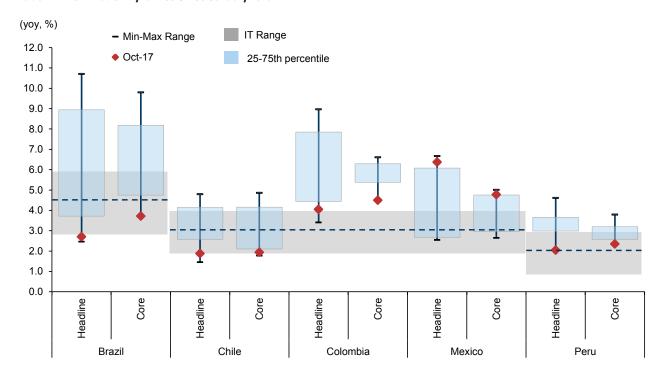
Source: Goldman Sachs Global Investment Research

Given the expected evolution of the external macro and financial backdrop, LatAm is not expected to benefit in 2018 from a significant balance of payments impulse (current or capital account) to leverage its economic recovery. Current account deficits are expected to widen moderately in 2018-19 (more than moderately in Argentina), and capital account inflows are expected to remain contained with likely limited portfolio inflows amidst rising Dollar yields, and the fact that foreign investors' exposure to some local markets is already quite high (e.g., in Colombia, Mexico and Peru). Furthermore, given the need for additional strengthening of fiscal stances, we also do not foresee room for countercyclical fiscal policy to support a more vigorous recovery. In fact, rather than an instrument to support demand, in virtually all the economies further fiscal consolidation is critically needed to sustain policy credibility. stabilize debt dynamics, preserve sovereign debt ratings, and boost sentiment. That is certainly the case in Argentina, Brazil, and Colombia, and to some extent in the low-debt economies of Chile and Peru as well. Mexico's fiscal stance has strengthened visibly over the last two years and, therefore, the key challenge will be to create fiscal space to boost currently low public investment without reducing the primary fiscal surplus.

Improving Inflation Backdrop

The inflation outlook for most of the LatAm Inflation Targeting economies (LA-IT5; Brazil, Chile, Colombia, Mexico, and Peru) improved visibly throughout 2017 (Exhibit 8). In addition, inflation expectations have either improved or remained stable at levels that are broadly consistent with the inflation target midpoints. Furthermore, the growth momentum across most economies has been either weak (below-trend) or restrained, and output gaps are still slightly negative (significantly negative in the case Brazil), and thus, there are no current or prospective demand-pull pressures on inflation.

Exhibit 8: LA-IT5: Inflation Dynamics Since January 2016



Source: Goldman Sachs Global Investment Research

Overall, across the region, inflation became less of a concern during 2017 and, therefore, less of a policy restriction. Mexico remains the exception to the broader regional trend as inflation was quite benign during 2015 and most of 2016, but accelerated sharply to multi-year highs, driven by major adverse but transient supply shocks. But even in Mexico the inflation outlook is a lot friendlier than what the current annual headline inflation picture would suggest. That is, inflation is high but Mexico does not seem to have a long-lasting, deep-rooted inflation problem. In fact, in both Colombia and Mexico we expect to observe a significant decline in the annual inflation rate during 1Q2018 due to high 1Q2017 statistical base effects (VAT rate increase in Colombia and large fuel price hike in Mexico following the liberalization of the fuel market). Outside the LA-IT5, there has also been progress on the inflation front in Argentina—which has recently joined the group of central banks with a formal inflation targeting framework. While still high and sticky in the mid-20s, the annual inflation rate in Argentina has almost halved from a year ago (as proxied by the so-called CPI-Congress) and our expectation is that the disinflation trend will continue throughout 2018, aided by tighter monetary policy (the ex-ante real policy rate is now tracking above 10%). Finally, in Venezuela there has been no progress on the inflation front and therefore the outlook remains dismal: fiscally driven hyperbolic money supply growth and currency overshoot (in the unofficial market) is keeping the country under the tight grip of hyperinflationary dynamics.

In summary, with a few exceptions, the inflation outlook and overall balance of risks has been improving since 4Q2016 due to a combination of: (1) fading FX pass-through to local prices as most currencies have been relatively stable, or appreciating (Exhibits 9 and 10); (2) weak real business cycles (below-trend final demand

growth) and soft labor markets, (3) higher real interest rates as most monetary authorities responded to the 2015-16 inflation challenge by raising nominal and real interest rates visibly during 2016, and, in a number of countries, (4) significant mean-reversion of large negative food-supply shocks (most visible in Brazil and Colombia).

Exhibit 9: Real Effective Exchange Rates

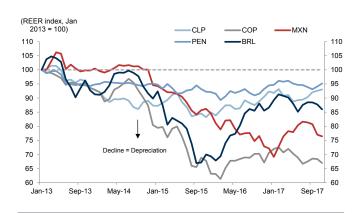
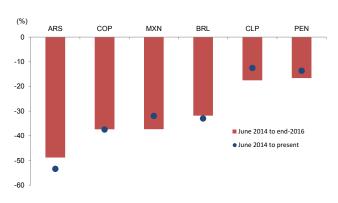


Exhibit 10: Significant Spot Exchange Rate Variation Against USD from Mid-2014 to End-2016; Stability Thereafter



Source: Goldman Sachs Global Investment Research

Source: Bloomberg

Easing Cycles Coming to an End...

The moderation of inflation since 4Q2016, allowed most central banks (except Mexico) to reduce the restrictiveness of monetary policy throughout 2017, in most cases driving the policy rate and overall financial conditions into stimulative territory. Most easing cycles across LatAm have, however, either ended or are now winding down, but the continuation of favorable inflation prints could open a window of opportunity for some central banks to ease a bit further into early 2018. In Brazil, assuming the forecasted December 50bp Selic rate cut to a historical low 7.00%, we expect the Copom to leave the policy rate unchanged throughout 2018. However, we acknowledge the risk of moderate additional easing during 1Q2018 (between 25bp and 50bp) if inflation continues to surprise on the downside and the pace of the ongoing cyclical recovery stalls or disappoints. In Mexico, we expect the central bank to leave the policy rate unchanged at 7.00% at least until 2H2018 and to preserve a vigilant/conservative stance in the near term given the vector of domestic (mid-2018 presidential election) and external (NAFTA renegotiation, FOMC balance sheet and policy rate normalization) risks. We do, however, entertain the possibility of rate cuts in Mexico during 2H2018 if the NAFTA renegotiation and July's presidential election play out in a market-friendly, MXN-supportive way, and the market digests well the expected steady normalization of monetary policy in the United States throughout 2018. In addition, we forecast rate cuts in Argentina (from the current 28.75% to 22.50%), in tandem with the expected moderation of inflation. In Colombia, we expect the central bank to cut the policy rate by another 100bp by 2Q2018, to 4.00%—driving the policy rate from broadly neutral into stimulative territory—in tandem with the expected further moderation of annual headline inflation. Finally, we forecast moderate policy rate normalization in Chile (+50bp) and **Peru** (+75bp) towards the end of 2018, as the forecasted recovery in growth momentum, and inflation hovering at around the target would no longer justify

maintaining the current significant degree of monetary accommodation. However, we still expect the policy rate in both Chile and Peru to remain below neutral by the end of 2018.

Exhibit 11: Monetary Easing Cycles Coming to an End

	P	olicy Rate	Forecasts	s (%; e.o.p	(change; bp)								
	2014	2015	2016	2017E	2018F	2019F	2014	2015	2016	2017E	2018F	2019F	
BRA	11.75	14.25	13.75	7.00	7.00	8.25	175	250	-50	-675	0	125	
MEX	3.00	3.25	5.75	7.00	7.00	6.00	-50	25	250	125	0	-100	
CHL	3.00	3.50	3.50	2.50	3.00	4.00	-150	50	0	-100	50	100	
COL	4.50	5.75	7.50	4.75	4.00	4.50	125	125	175	-275	-75	50	
PER	3.50	3.75	4.25	3.25	4.00	4.25	-50	25	50	-100	75	25	
ARG	-	-	24.75	28.75	22.50	14.00	-	-	-	400	-625	-850	

Source: Goldman Sachs Global Investment Research

...Leaving Financial Conditions Now in Stimulative Territory

In a number of places the policy rate is already at a below-neutral level (Brazil, Chile, Peru), or is about to get there (Colombia), but financial conditions, as proxied by our proprietary FCI indices, are now in easing/stimulative territory across the board. Overall, our **PPP-weighted LA-IT5 FCI index has eased by slightly over a full standard deviation since year-end 2016** and is currently tracking at 99.4, which is below our 100 proxy level for neutrality (Exhibit 12). Even in Mexico, where the central bank has hiked the policy rate by 400bp to a slightly restrictive 7.00% in order to deal with the acceleration of inflation, overall financial conditions have tightened since August 2016 (+0.8 of a standard deviation, to 99.6) but are still mildly stimulative to growth.

The easing of financial conditions should provide a mild impulse to domestic demand as we go into 2018. Overall, the fact that most central banks were able to shift monetary policy from the restrictive stance of 2015-16 that focused on disinflation towards an accommodative/stimulative stance is a positive development and supports our view that growth in the region will firm in 2018.

99.0

98.5

2016

2017

(points) (points)

101.0

100.5

100.0

NEUTRAL

99.5

Exhibit 12: LA-IT5: Financial Conditions Now Back in Stimulative Territory PPP-Weighted LA-IT5 FCI

Source: Goldman Sachs Global Investment Research

2012

Accommodative

2013

2014

2015

99.0

98.5

2011

Constructive FX Backdrop

We are constructive on the overall LatAm FX backdrop. We are forecasting currency strengthening in Chile (CLP) and Peru (PEN), on the back of stronger terms of trade (higher industrial metal prices) and firmer domestic demand conditions. We expect the BRL to remain well anchored over the forecasting period given the modest current account imbalance, solid FDI inflows at around 4% of GDP, low inflation environment, and firming cyclical demand recovery. Political and policy uncertainty could, however, undermine market sentiment towards the currency, particularly if the market begins to auestion post-election policy continuity and the medium-term fiscal policy outlook. The MXN has been under pressure since mid-September given heightened domestic and external uncertainty but we highlight that the currency's fundamentals are stronger than they have ever been over the last few years. Following the decisive 2016-17 monetary policy response the MXN is now a high-carry currency, the current account deficit has narrowed visibly, the fiscal stance has tightened and the central bank set up a US\$20bn NDF facility to provide hedge to the market during periods of FX market distress. That notwithstanding, the MXN may still be vulnerable to bouts of enhanced volatility given the spectrum of domestic (complex mid-2018 elections) and external risks (NAFTA renegotiation, FOMC policy rate and balance sheet normalization). Finally, we highlight that although the ARS/USD is expected to depreciate in double digits in 2018, it could become even more overvalued (depreciate less than the forecasted approximately 20% average inflation in 2018), particularly if the federal and provincial governments continue to meet a significant part of their large funding requirements by borrowing abroad, and an improving domestic macro picture attracts sizeable capital inflows (portfolio and FDI).

The **external risks** to our macro outlook are to a significant extent similar to the ones the region faced in recent years. In our assessment the main stylized external risks are:

- 1. sharp deceleration of capital inflows (or outright portfolio outflows) triggered by faster-than-expected tightening of G3 monetary conditions, and/or renewed bouts of volatility in international financial markets that could dampen sentiment towards emerging markets. A key concern here is that versus our forecasts, markets may be underestimating (underpricing) the pace of FOMC rate normalization during 2018-19;
- 2. downward corrections in commodity prices;
- sharper- and bumpier-than-expected growth deceleration and/or potentially disorderly FX policy moves in China, and;
- 4. rising protectionism which could hamper trade and investment flows into the region.

In addition, as seen in recent months, new risks could always emerge to alarm global and regional markets: among the known unknowns we highlight tensions in the Korean peninsula, the future of NAFTA, the Brexit negotiations, Italian elections, and the Catalonia vote. Finally, there is a rising probability that the region could witness a sovereign credit event: in Venezuela. Such a potential event should, however, have a fairly limited impact across the region; after all, current financial asset prices already imbed/anticipate a significant probability of default and Venezuela's trade and financial links with the rest of the region are very limited. Overall, while the external backdrop is still beset with significant risks we highlight that the region is today better prepared to deal with potential adverse external shocks, given the significant macroeconomic rebalancing that has occurred since 2015, the firmer growth profile, and the stronger policy mix (particularly in Argentina and Brazil).

On the domestic front one of the main risks is lack of progress, or back-pedaling, on the fiscal consolidation front. That could dampen sentiment, and trigger capital account outflows and sovereign rating downgrades in countries such as Argentina, Brazil, and Colombia. Finally, political (policy reversal) risk and uncertainty will be much higher in 2018 than in previous years, given the crowded election calendar.

Crowded and Potentially Noisy Election Cycle

The *political dynamics* are expected to be the subject of intense market focus given the packed electoral calendar, which includes elections in the two largest LatAm economies, and a non-negligible risk of left-leaning populist outcomes triggering significant policy reversal. Election-related market volatility could pick up as the key and riskier 2H2018 elections draw close.

The electoral cycle kicked off with the October 2017 **mid-term legislative elections in Argentina** and the outcome was market-friendly inasmuch as it contributed to strengthen governability conditions for the reformist Macri administration while reducing somewhat the perceived risk of a strong unified populist comeback in 2019. Next on deck will be **presidential and legislative elections in Chile on November 19** (if

needed, a second round would be held on December 17) and there polls also point to a market-friendly outcome, with center-right former president Sebastian Piñera leading a divided center-left field of candidates. If elected, Sebastian Piñera is expected to focus on a pro-growth investment and productivity-enhancing agenda and would face the challenge of improving the lackluster business environment and satisfying growing demands for additional social spending, while persevering on a path of fiscal consolidation.

Exhibit 13: Political Events Calendar (2017-2019)

Year	Month	Country	Event							
2017	November	Chile	Presidential and Congressional Elections							
	March	Colombia	Congressional Elections							
May		Colombia	Presidential Election							
2018	July	Mexico	Presidential and Congressional Elections							
	October	Peru	Gubernatorial and Municipal Elections							
	October	Brazil	Presidential and Congressional Elections							
2019	October	Argentina	Presidential and Congressional Elections							

Source: Goldman Sachs Global Investment Research

Colombia will hold congressional (March) and presidential (May) elections in 2018.

Early polls show left-wing Gustavo Petro with a small lead over a wide and atomized field of candidates. This is the first time in many years in which a left-wing alternative seems to be very competitive in Colombia, but local pundits are of the view that ultimately a centrist candidate has higher chances of winning as center-right alliances are formed and the field of competitive candidates narrows.

The most market-relevant and also the riskier elections from a market standpoint are reserved for 2H2018. Presidential and legislative elections will take place in Mexico (July 1, single round) and Brazil (October 7; second round October 28, if needed).

These elections present significant risks to policy continuity and the overall macro outlook. In both countries the incumbent is quite unpopular and is not running for reelection, the political establishment has been rocked by allegations of official corruption, the macro performance has been unsatisfactory, and there is a strong anti-establishment sentiment among voters.

In **Mexico**, left-wing anti-establishment twice runner-up Andrés Manuel López Obrador (AMLO) is leading in early polls. AMLO is proposing a new economic and political paradigm under a populist-nationalist, inward-looking platform, which many see as a latent risk to roughly three decades of pro-market policies. While AMLO is leading the early presidential race, and is likely to remain a very competitive candidate with a significant chance of winning the election, we caution that the field of candidates is still not defined: the main parties have yet to select their presidential candidates and potential electoral political alliances are still being discussed. In our assessment, NAFTA and domestic political risks are positively correlated. A break-up of the ongoing negotiations and eventual abandonment of the NAFTA treaty could contribute to a rise in nationalist sentiment in Mexico and increase the risk of a populist/heterodox choice in the mid-2018 election. That is, ultimately it may become **increasingly difficult to disentangle NAFTA from domestic political risk premia inasmuch as the**

materialization of one risk could well precipitate the materialization of the second risk.

In Brazil, two-time president Lula is leading the very early polls with a comfortable margin but is facing a number of legal/judicial charges that may preclude him from running. Overall, the election outlook in Brazil remains open as the field of presidential candidates is still extremely diffuse; it should consolidate by 2Q2018. Given the Temer administration's very gradual back-loaded approach to fiscal consolidation, the next administration (2019-2022) will be challenged to deepen the fiscal adjustment in order to stabilize the deteriorating public debt dynamics. As such, a populist/heterodox 4Q2018 election outcome—which would bring about concerns regarding the continuity of the current orthodox market-friendly policy approach—would likely trigger an adverse market reaction and could undermine the sustainability of the economic recovery. So far, the market seems to have taken the early poll signals in stride: still assessing a reasonably high probability that a pragmatic mainstream centrist administration will be empowered that would then guarantee the continuity of the current market-friendly conventional policy mix and approval of the reforms needed to overhaul the very challenging fiscal picture. However, there is no guarantee that any of this will be the case as it is very uncertain whether the October 2018 election will empower an administration that would be both committed to, and politically capable of, pursuing a reformist/adjustment path.

Finally, in **Venezuela** political dynamics remain front-and-center of the national debate. Social confrontation, political polarization, and institutional gridlock reached new heights in 2017. The presidential election should take place by year-end 2018, but the authorities are yet to announce the election date. This election will put to the test the ruling PSUV's tight grip on power and key institutions, but will also be a test for the divided opposition camp. Given recent developments, strategic, political, and financial considerations could lead the authorities to bring up the presidential election to 1H2018.

Exhibit 14: Consolidated LA-IT6 (ex-Venezuela) Aggregate Selected Economic Indicators

	2010	2011	2012	2013	2014	2015	2016	2017F	2018F	2019F	2020F	2021F
. Economic Activity and Prices												
Nominal GDP (US\$bn)	4,349	5,081	5,073	5,218	5,180	4,352	4,155	4,651	5,019	5,405	5,785	6,142
Real GDP growth (% yoy)	6.8	4.5	2.6	2.8	1.3	0.2	-0.4	1.7	2.7	3.2	3.4	3.3
CPI Inflation (% yoy)	7.4	7.3	6.6	7.0	8.6	9.0	8.8	6.3	5.3	4.4	3.9	3.6
Domestic Demand (% yoy)	8.7	5.9	2.8	3.0	1.0	-0.7	-1.3	1.6	3.1	3.5	3.6	3.6
I. External Sector (US\$bn)												
Current Account Balance	-92.4	-112.6	-119.6	-152.5	-169.2	-138.1	-82.2	-78.6	-112.4	-129.3	-138.0	-153.8
Trade Balance	43.2	53.8	46.7	9.8	-3.0	-10.5	33.8	52.6	39.4	28.4	26.7	26.2
Gross International Reserves	564.3	673.8	722.6	715.9	737.9	705.2	729.3	756.3	774.8	799.7	826.3	852.4
Change in Reserves	93.3	109.5	48.8	-6.8	22.0	-32.7	24.1	27.0	18.5	24.9	26.6	26.1
Net Capital Inflows	185.7	222.2	168.4	145.7	191.2	105.4	106.3	105.6	130.9	154.2	164.6	179.9
Foreign Direct Investment	116.3	153.5	155.3	167.9	176.1	162.9	148.8	147.9	172.9	185.2	194.6	209.8
II. Public Finance and Indebtness (% GDP)												
Primary Fiscal Balance	0.8	1.3	0.9	0.5	-1.0	-1.7	-1.8	-1.2	-1.3	-0.5	0.0	0.5
Overall Fiscal Balance	-2.3	-2.0	-2.1	-2.5	-4.3	-6.3	-5.6	-5.2	-5.3	-4.6	-4.1	-3.6
Total Public Sector Debt	42.1	41.4	42.1	42.2	46.2	51.2	55.3	57.6	60.0	61.1	61.7	62.2
Total External Debt	22.8	22.2	24.7	26.2	29.1	34.5	36.9	35.8	35.5	36.3	36.8	36.9

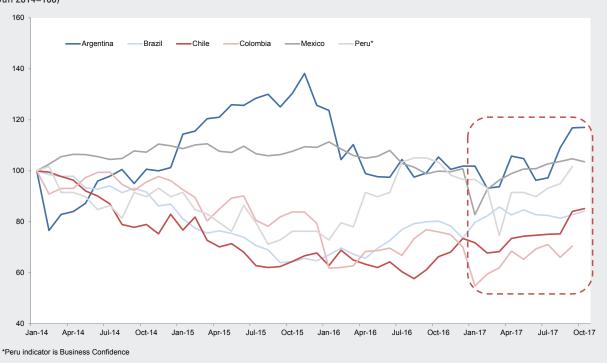
Note: Aggregates weighted by nominal GDP in US\$ at PPP exchange rates.

Source: Goldman Sachs Global Investment Research

Box 1: Recovering Sentiment to Support Cyclical Recovery

A broad trend across Latin America since 2016 has been the recovery in sentiment indicators, against a backdrop of cyclical recovery, easier financial conditions, and lower inflation. As shown in Exhibit 15, consumer confidence has firmed for LatAm ex-Venezuela. For countries with available data (i.e., Brazil and Chile), business confidence has also recovered and policy uncertainty has declined.

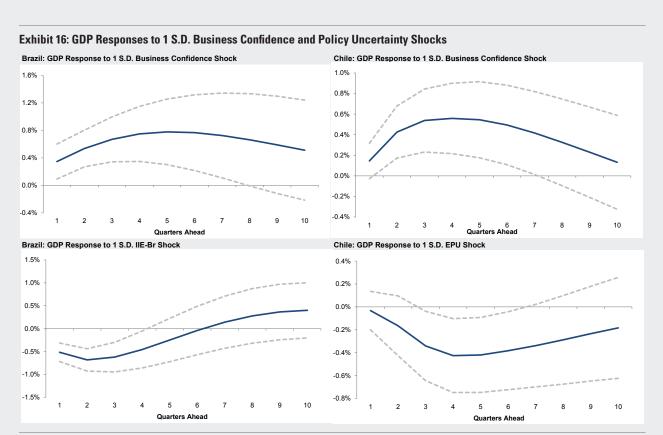
Exhibit 15: Improving Consumer Confidence Indicators (Jan 2014=100)



Source: Haver Analytics, Goldman Sachs Global Investment Research

In a recent piece,¹ we estimated the effects of shifts in sentiment on economic activity for Brazil and Chile. Our analysis suggests that firming business confidence has a significant positive impact on GDP, industrial production, and investment, while a rise in policy uncertainty has a significant contractionary effect. Exhibit 16 is a snapshot of our results: a one standard deviation increase in business confidence results in a positive impact on GDP that peaks at around 0.8% in Brazil and 0.6% in Chile after 4-5 quarters; a similar increase in policy uncertainty drives GDP down, with the contraction peaking at around -0.7% in Brazil and -0.4% in Chile after 2-4 quarters. The industrial response is larger and the investment spending response is the largest, which is in line with the theoretical assumption that business confidence and uncertainty affect activity primarily through the investment channel.

See "Brazil/Chile: The Effects of Sentiment on Economic Activity", Latin America Economics Analyst,



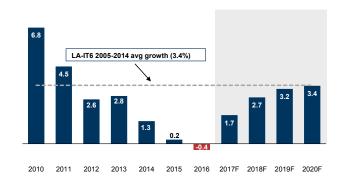
Source: Goldman Sachs Global Investment Research

These results support our view that improving sentiment is likely to provide an important impulse to real domestic activity across Latin American economies in the quarters ahead, in addition to other factors such as a low inflation environment and accommodative financial conditions. Policies that further strengthen domestic sentiment and reduce uncertainty will be important in accelerating growth, especially because fiscal policy cannot currently leverage the recovery given the need for further fiscal consolidation in several countries in the region.

Latin America's Macro Outlook in 12 Stylized Charts

Exhibit 17: Cyclical LA-IT6 Real GDP Recovery

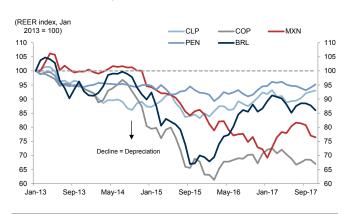
Real GDP, % yoy



Source: Goldman Sachs Global Investment Research

Exhibit 19: Well Anchored Real Exchange Rates Contributing to Anchor Inflation

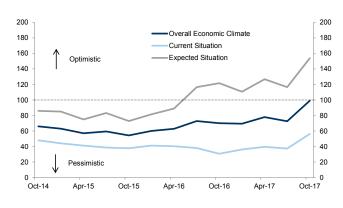
Real Effective Exchange Rate Index



Source: Goldman Sachs Global Investment Research

Exhibit 21: Firming Sentiment with Expected Conditions Tracking Above Current Conditions

Aggregate LatAm Sentiment Indicator



Source: Ifo, FGV

Exhibit 18: Recovery driven by broad-based firmer growth profiles (except Mexico)

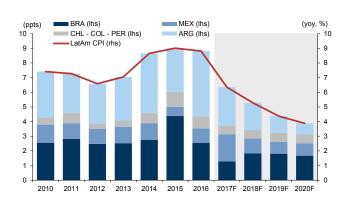
LA-IT6 Aggregate Growth, yoy %; Contribution by Country, ppts



Source: Goldman Sachs Global Investment Research

Exhibit 20: Moderating LA-IT6 Inflation

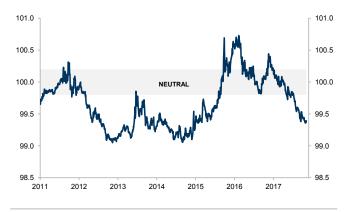
LA-IT6 Aggregate Inflation, yoy %; Contribution by country, ppts



Source: Goldman Sachs Global Investment Research

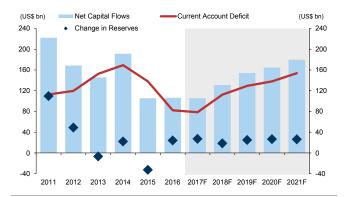
Exhibit 22: LA-IT5 Financial Conditions Now Back in Stimulative Territory

PPP-Weighted LA-IT5 FCI



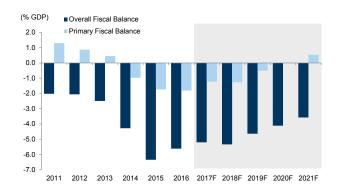
Source: Goldman Sachs Global Investment Research

Exhibit 23: Moderate Widening of LA-IT6 Current Account Imbalance



Source: Goldman Sachs Global Investment Research

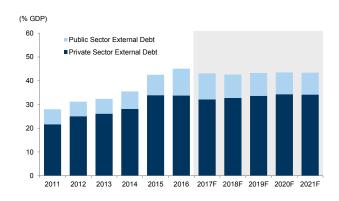
Exhibit 25: Additional and Faster Fiscal Consolidation Needed to Build Policy Credibility and Boost Sentiment



Source: Goldman Sachs Global Investment Research

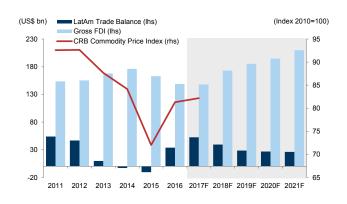
Exhibit 27: Moderating External Debt Load

(Public and Private External Debt, % GDP)



Source: Goldman Sachs Global Investment Research

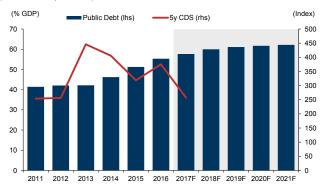
Exhibit 24: Modest Pick Up in FDI Inflows After a Three Year Slide



Source: Goldman Sachs Global Investment Research

Exhibit 26: Debt Load to Continue to Rise due to Very Gradual Fiscal Adjustment

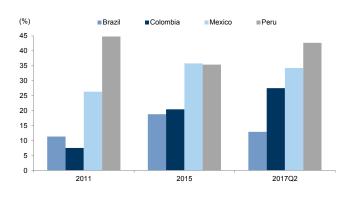
(Public Debt, % GDP)



Source: Bloomberg, Goldman Sachs Global Investment Research

Exhibit 28: Foreign Investor's Exposure to Local Fixed Income Markets Remains High (Except Brazil)

(Non-Resident Holdings Share of Total Government Debt in Local Currency)



Source: IMF, Goldman Sachs Global Investment Research

Global Macro Picture: Continuation of Solid Global Growth²

At first glance, the forecasted global backdrop facing LatAm is rather constructive: global growth is projected to accelerate further in 2018 from the already-robust above-trend 2017 pace, global inflation is expected to remain contained, and industrial metal and energy prices are projected to firm.

Nonetheless, there are also important risks lurking in the background. Chief among them may be the risk that the market could be underestimating (underpricing) the pace of interest rate normalization in the United States during 2018-19. We forecast a 25bp hike in December (subjective probability 85%) and maintain a baseline forecast of 3¼-3½% by late 2019, while short-term interest rate futures for late 2019 imply just 2%, even after the recent bond market selloff. Overall, GS' forecast of faster-than-consensus normalization of monetary policy in the United States could create policy challenges in a number of places across LatAm, inasmuch as such a shift could limit the capacity of many central banks to keep monetary conditions accommodative to support the economic recovery, and may also create headwinds for the few economies with large external funding requirements (e.g., Argentina).

Broadly speaking, rather than economic/financial, the most significant risks to the global outlook may well be political in nature. In that regard, a number of key events and developments will likely remain on investors' radar screens, namely: tensions in the Korean peninsula and parts of the Middle East, the future of NAFTA, the Brexit negotiations, the Italian elections, the Catalonia vote, etc.

Strong Growth Expected to Continue in 2018; Divergent Monetary Conditions Across the G10

- In 2017, for the first time since 2010 the world economy outperformed consensus expectations. We expect this strength to extend into 2018.
- The global economy's underlying strength is broad-based and balanced across sectors:
 - almost all major DM and EM economies are growing above their post-crisis averages; and
 - while the initial thrust to global growth came mainly from firming industrial cycle dynamics, the growth momentum has quickly spilled over into other parts of the economy.
- Our FCI impulses suggest continued above-trend growth over the next 1-2 years, though the DM boost is likely to ease somewhat. In addition, fiscal policy—which shifted from drag to boost in recent years—is expected to leverage growth modestly in 2018.
- We expect continued strong expansion in the world economy in 2018. Our global team expects global real GDP to expand 4.0% in 2018, up from a forecasted 3.7% in 2017.

² This section draws heavily upon "As Good As It Gets", Global Economics Analyst, November 15, 2017.

- The most recent growth momentum figures suggest that the risks to our forecasts are still tilted to the upside;
- The underlying strength of the global economy in 2018 is forecasted to be broad-based: above-trend growth in most advanced economies, including the United States (at 2.5%), Euro area (2.2%) and Japan (1.6%);
- We also forecast acceleration of real GDP growth in 2018 in a number of key emerging economies, including India (to 8.0%), Brazil (2.7%) and Russia (3.3%). China is expected to continue its "bumpy deceleration," growing 6.5% in 2018 and 6.1% in 2019;
- Despite the budding productivity rebound, spare capacity is diminishing sharply across the advanced economies (the aggregate unemployment rate across advanced economies has fallen back almost to pre-crisis levels);
- Most advanced economies are now near full employment: the United States and United Kingdom have already slightly moved past full capacity, and Japan's output gap is closing rapidly;
- Significant slack remains in the Euro area, but is concentrated in the South (especially Spain and Italy) as Germany already moved slightly past full employment;
- Our global team's inflation models suggest the "Phillips curve" relationship between slack and core inflation is alive, but weak across OECD economies. Wage growth data confirms that Phillips Curve relationships have not broken down.
- As the significant and long-lasting drag from the earlier weakness in import and commodity prices fades, higher levels of resource utilization are expected to push global core inflation gradually up (US, UK), but to levels still below central bank targets in most places (Euro area, Japan);
- Divergence of monetary conditions across the G10 is likely to continue. A number of central banks are already facing labor market overheating (Fed, BoE, BoC), but the ECB and BoJ still quite far from full employment and price stability;
- Some central banks may seek to reverse a portion of the significant easing in financial conditions seen over the past 18-24 months if inflation does move up, as the strength in output and employment may soon feel like "too much of a good thing";
- Consistently, our Fed call is considerably more hawkish than market pricing, and we are also above the market consensus in smaller G10 economies such as Sweden and Australia;
- GS's Fed call is considerably more hawkish than market pricing: 25bp hike in December (subjective probability 85%) and a baseline forecast of 3¼-3½% by late 2019:
- Our forecast for the ECB and BoJ are modestly dovish versus the market given the soft below-target inflation dynamics:
 - ☐ The ECB's asset purchases are expected to continue to year-end 2018 (with some chance of purchases extending into 2019) and no hikes in the deposit rate until late 2019.

☐ The BoJ is expected to stick to its yield curve control regime through QQ easing as long as inflation remains significantly below the 2% target.

Exhibit 29: Strong Global Growth Expected to Continue in 2018

Real GDP Growth									
Barrant Change von	2015	2016	20	17 (f)	20 ⁻	18 (f)	2019 (f)		
Percent Change yoy			GS	Cons*	GS	Cons*	GS	Cons*	
us	2.9	1.5	2.2	2.2	2.5	2.4	1.8	2.1	
Japan	1.1	1.0	1.6	1.5	1.6	1.1	1.3	0.9	
Euro Area	1.9	1.7	2.3	2.2	2.2	1.9	1.8	1.6	
Germany	1.5	1.9	2.6	2.2	2.5	2.0	2.0	1.6	
France	1.0	1.1	1.8	1.7	2.0	1.8	1.8	1.6	
Italy	0.7	1.0	1.5	1.5	1.1	1.2	0.9	1.1	
Spain	3.2	3.2	3.1	3.1	2.5	2.6	2.2	2.2	
UK	2.3	1.8	1.5	1.5	1.3	1.4	1.6	1.6	
China	6.9	6.7	6.8	6.8	6.5	6.4	6.1	6.1	
India**	8.0	7.1	6.4	6.8	8.0	7.4	8.3	-	
Russia	-2.8	-0.2	2.2	1.9	3.3	1.8	2.9	1.8	
Brazil	-3.8	-3.6	0.9	0.7	2.7	2.4	3.1	2.5	
Developed Markets	2.3	1.7	2.3	2.2	2.3	2.1	1.9	1.9	
Emerging Markets	4.6	4.7	5.0	4.5	5.6	4.9	5.7	5.0	
World	3.5	3.2	3.7	3.5	4.0	3.6	3.9	3.4	

^{*}Bloomberg consensus forecasts as of November

Source: Bloomberg, Goldman Sachs Global Investment Research

Commodity Price Outlook: Industrial Metals Price Upside

Commodity prices have an important bearing on Latin America's macroeconomic outlook. The region is a large commodity producer and a net commodity exporter, and its terms of trade and currencies tend to track the evolution of global commodities markets closely. Unsurprisingly, the plunge in commodity prices in recent years was followed by widening external imbalances, weakening currencies, and lower fiscal revenues in most of the LatAm economies we follow.

In 2017, the performance across commodities has been mixed, with metal prices surging and energy prices also increasing, while agriculture prices are flat to down. With commodity markets experiencing strong global demand, supply is now the key driver of differentiation across commodities. The GS Commodities Research team's 2018 outlook is bullish for energy and industrial metals given the late-stage business cycle, at which point capacity constraints set in and commodities tend to outperform.

- The GS Commodities Research team's Brent oil price forecast is \$58/bbl at year-end, and also throughout 2018, up from the projected \$54/bbl average for 2017. The main risks to our team's forecasts come from (1) the recent increase in disruptions in Iraq, Venezuela, and potentially Iran, as well as increased geopolitical tensions in Saudi Arabia, (2) shale producers becoming marginally more cautious on spending, and (3) upside risk to global demand given robust macro indicators.
- The price outlook for base metals is broadly positive. The GS Commodities Research team views the recent copper rally as largely fundamental-driven, which should carry on to 2018 as healthy mine supply will not be enough to meet strong global demand growth. Prices should be broadly sustained for aluminum and zinc due to supply constraints and declining inventory, while excitement about electric vehicles imposes upside risks to nickel prices. As for precious metals, silver is likely to outperform gold against a backdrop of strong DM growth, but lingering geopolitical and US policy

- concerns (i.e., North Korea, Iraq, NAFTA, tax reform) are likely to continue to support gold prices.
- Finally, agricultural commodities are expected to stabilize at lower prices in 2018, with flat 3, 6, and 12 month forecasts across the board. For corn, soybean, and wheat, the GS Commodities Research team is of the view that the declining trend production costs has come to an end given the recent stabilization in oil and BRL, with upward revisions in price forecasts. For cotton, resilient output figures, despite hurricanes and floods in the United States, are matched by robust global demand. The same is true for coffee and sugar, where production is recovering from recent droughts in Brazil and India.

Exhibit 30: Commodities Outlook

	Unit of	Current*		Average	Prices		F	orecasts		Forecas	t/Spot %	change		% yoy o	hange	
	Measure	Current"	2015	2016	2017E	2018F	3m	6m	12m	3m	6m	12m	2015	2016	2017F	2018F
Energy																
WTI Crude Oil	\$/bbl	51.5	48.9	44.1	51.3	55.0	55.0	55.0	55.0	6.7%	6.7%	6.7%	-46.4%	-9.9%	16.2%	7.3%
Brent crude Oil	\$/bbl	57.6	54.0	45.7	54.2	58.0	58.0	58.0	58.0	0.7%	0.7%	0.7%	-44.6%	-15.4%	18.8%	7.0%
Industrial Metals																
LME Aluminum	\$/mt	2,120	1,659	1,627	1,958	2,000	2,000	2,000	2,000	-5.6%	-5.6%	-5.6%	-11.5%	-2.0%	20.4%	2.1%
LME Copper	\$/mt	6,724	5,472	4,931	6,240	7,050	6,750	6,900	7,050	0.4%	2.6%	4.8%	-19.7%	-9.9%	26.5%	13.0%
LME Nickel	\$/mt	11,486	11,580	9,590	10,698	11,000	12,500	12,000	11,000	8.8%	4.5%	-4.2%	-31.0%	-17.2%	11.6%	2.8%
LME Zinc	\$/mt	3,190	1,920	2,149	2,801	2,700	2,700	2,800	2,700	-15.3%	-12.2%	-15.3%	-11.4%	11.9%	30.3%	-3.6%
Precious Metals																
London Gold	\$/troy oz.	1,296	1,152	1,250	1,260	1,225	1,250	1,200	1,225	-3.6%	-7.4%	-5.5%	-7.9%	8.5%	0.8%	-2.8%
London Silver	\$/troy oz.	17.1	15.5	17.1	17.2	17.2	16.5	16.0	17.2	-3.7%	-6.7%	0.3%	-16.6%	10.6%	0.1%	0.3%
Agriculture																
CBOT Wheat	cent/bu	436	658	647	630	425	425	425	425	-2.6%	-2.6%	-2.6%	-0.9%	-1.7%	-2.6%	-32.6%
CBOT Soybeans	cent/bu	973	1,197	1,165	1,124	980	980	980	980	0.8%	0.8%	0.8%	-2.2%	-2.7%	-3.5%	-12.8%
CBOT Corn	cent/bu	349	410	404	393	350	350	350	350	0.4%	0.4%	0.4%	-1.3%	-1.5%	-2.6%	-11.0%
NYBOT Coffee	cent/lb	128	183	180	176	140	135	140	140	5.1%	9.0%	9.0%	1.7%	-2.0%	-2.1%	-20.4%
NYBOT Sugar	cent/lb	14	16	16	15	14	14.0	14.0	14.0	-1.2%	-1.2%	-1.2%	-0.4%	-1.3%	-3.1%	-9.4%
CME Live Cattle	cent/lb	113	153	154	155	100	110	100	100	-2.5%	-11.4%	-11.4%	0.7%	0.4%	0.8%	-35.5%

^{*} Current value is the daily price average since 9/1/2017

Source: Goldman Sachs Global Investment Research

A Tour D'Horizon Across the Latin American Map

In this section, we present a brief 2017-2019 financial and macroeconomic outlook for the main economies of Latin America.

ARGENTINA: Additional Fiscal Consolidation Required for Macro Rebalancing

We hold a constructive view of Argentina's 2018-19 macro financial outlook, but that hinges critically on further tangible progress towards fiscal consolidation, for that is key to guarantee medium-term domestic (low and stable inflation) and external (moderate current account deficit) balance. The authorities are expected to continue to embrace a market-/investment-friendly policy approach, and governability conditions have likely improved following the mid-term legislative elections. We expect further, albeit gradual, fiscal consolidation and moderation of hitherto high and sticky inflation in 2018-19. Real GDP contracted during 2016, but the economy reached a clear inflexion point during 2H2016, with the growth forward momentum accelerating to an above-trend pace since 4Q2016. The monetary policy stance is likely to remain tight in order to facilitate the disinflation process but the central bank is unlikely to meet its demanding 2018 inflation target, after missing the 2017 target by a significant margin. In the meantime, given the still-high domestic inflation environment the ARS is becoming more overvalued. More than other LatAm economies, Argentina remains vulnerable to a shift in external market conditions and investor sentiment: the public sector and external funding requirements are expected to remain high, with the twin fiscal-current account deficits expected to remain stuck in double digits. However, a rising international reserves buffer and a more flexible currency regime enhance policy flexibility by acting as valuable shock absorbers. The public debt load is still moderate, but the rising trend needs to be arrested. Real effective ARS strengthening has prevented a more visible deterioration of the public debt dynamics. Overall, in order to overcome the imbalances left by years of heterodox/interventionist policies and to endow the central bank with extra degrees of freedom to calibrate monetary policy, we are of the view that the authorities need to remain committed to steadfast fiscal consolidation, particularly against a backdrop in which the public debt interest bill is likely to continue to increase and large public sector borrowing requirements are met to a significant extent by external borrowing.

On the political front, the horizon seems clear until 2019, but not devoid of challenges. President Macri's *Cambiemos* coalition performed well in the October 2017 mid-term legislative elections: it secured close to 42% of the national vote, exceeding the 34% obtained in the first round of the 2015 presidential election. In the process, Mr. Macri's *Cambiemos* became a nationwide political force, growing strongly beyond its original Buenos Aires stronghold. The official candidates won in the five largest electoral battlegrounds, home to roughly two-thirds of the electorate: the Provinces of Buenos Aires, Córdoba, Mendoza, and Santa Fe, and the City of Buenos Aires. No other party had won all five of the largest electoral districts in a mid-term election in more than 30 years. Consequently, the pro-government *Cambiemos* coalition increased its representation in Congress, although it is still short of a simple majority in both chambers. President Macri's solid electoral performance should endow the

administration with a stronger mandate to purse its reformist economic policy agenda. The strong nationwide electoral showing and larger Congressional representation should reduce opposition to key policy measures and facilitate the building of *ad-hoc* coalitions to approve key pieces of legislation. Also playing in favor of the Macri administration is the fact that the opposition remains fragmented, deeply divided, and without clear leadership. This bodes well for the approval of key reforms during the second half of President Macri's term: tax, fiscal (spending ceiling), capital markets, deregulation, and labor market reforms. However, the administration is likely to continue to favor just a gradual fiscal consolidation path. Finally, the strong showing by President Macri increases the probability of reelection in 2019, giving continuity to the current market-and investment-friendly set of policies. Likewise, the underwhelming showing of former president Cristina Kirchner in the mid-term elections reduces the probability that she will be able to reunify the currently divided Peronist camp and build a competitive heterodox/populist ticket for the 2019 election.

Large fiscal deficits alongside high and sticky inflation remain the key macro imbalances of the Argentine economy. They are interconnected and combine to keep the currency misaligned (overvalued) and the external accounts out of balance. The authorities are expected to adopt additional measures to reduce the large primary fiscal deficit and have announced an ambitious set of structural reforms (e.g., labor, tax, capital markets, etc.) to modernize the economy and turn it more efficient and flexible. Given the solid performance of fiscal revenue and overall discipline on current spending the government is expected to outperform the 4.2% of GDP primary fiscal deficit target for 2017 by up to 0.2% of GDP. The authorities have committed to reduce the primary fiscal deficit to, a still sizeable, 3.2% of GDP in 2018. The 2018 fiscal target looks feasible—and is expected to be achieved through a combination of additional cuts in costly public subsidies and overall non-investment expenditure restraint—but additional fiscal adjustment in the outer years is required. The overall nominal fiscal deficit is likely to decline from a projected 6.2% of GDP in 2017, to a still-high 5.6% of GDP in 2018 as the public sector net interest bill is expected to rise to 2.4% of GDP in 2018 as the public debt load continues to creep higher. The government unveiled a tax reform proposal that is estimated to cost 1.5% of GDP; with the cost expected to be broadly offset from the fiscal dividend of higher growth and formalization of labor contracts. Overall, fiscal retrenchment is needed to stabilize the debt dynamics and rebalance the economy.

Real GDP contracted 2.2% in 2016, but last year was a year of two very different halves. The economy contracted during 1H, reached the inflexion point (stabilized) during 3Q2016, and grew at a robust pace in 4Q2016. Between 4Q2016 and 2Q2017, the quarterly annualized growth momentum tracked at a solid 4.0%, driven by the robust positive impulse from investment spending. In recent quarters, domestic demand has been expanding at higher rates than overall GDP (net exports have been a drag on overall growth). Leading hard (IP) and soft indicators for 3Q suggest the annual and sequential growth rate is likely to have accelerated further during 3Q2017. Overall, we expect the economy to grow 3.0% in 2017 (despite the very tight monetary policy stance), with real GDP growth forecasted to accelerate further to 3.6% in 2018, driven by a significant capital-deepening drive and robust private consumption

growth supported by firming credit flows, strengthening labor market, and rising confidence indicators. The statistical carry-over from 2017 into 2018 is projected at

+11/4%. Fiscal consolidation is expected to generate a mild drag on overall activity: more on public consumption than investment. Finally, the ongoing cyclical rebound of the Brazilian economy should incrementally support the manufacturing sector (production and investment) but net exports may remain a drag on activity, which suggests the real business cycle would benefit from a weaker currency.

Exhibit 31: Firming Real Business Cycle Dynamics

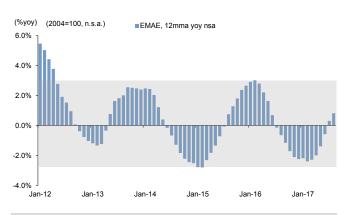


Exhibit 32: Solid Sequential Real GDP Growth



Source: INDEC, Goldman Sachs Global Investment Research

Source: INDEC

The flip side of solid domestic-demand investment-intensive growth and real exchange rate overvaluation has been the steady deterioration of the trade and current account balances. During Jan-Sept 2017 the trade balance recorded a sizeable US\$5.2bn deficit, down from a US\$1.9mn surplus during Jan-Sept 2016. The rapidly widening trade deficit was the main force behind the significant worsening of the current account balance. However, the services and factor payment balances' deficits have also increased from a year ago. The 12-month trailing current account deficit worsened to a sizeable US\$19.7bn in 2Q2017 (3.4% of GDP) from US\$14.5bn (2.7% GDP) in the four-quarter period ending 4Q2016. This is the highest deficit since the 1990s and a very significant and rapid deterioration of the current account, particularly given that the country is going through just the early stages of a cyclical recovery. The larger current account imbalances have been financed by rising capital account surpluses (US\$21bn during 1H2017), supported by surging portfolio inflows, the bulk of which has been driven by heavy bond issuance by the federal and provincial governments. FDI inflows have been gradually firming but remain modest as a share of GDP (roughly 1% of GDP).

Heavy government external bond issuance is leading to a large increase in external liabilities. Total external debt surged to US\$205bn in 2Q2017 from US\$176bn a year ago, driven chiefly by increasing public sector indebtedness. The external debt of the General Government rose to US\$128bn during 2Q2017 from US\$94bn during 2Q2016, while the external debt load of the non-financial private sector has risen just US\$2.3bn since 2Q2016 to a moderate US\$34bn. As most of the public sector external issuance proceeds have been surrendered to the central bank, international reserves have been rising: by mid November 2017 reserves were tracking at a comfortable US\$54.7bn, more than double the US\$25.6bn recorded at year-end 2015. In essence, the large capital

account inflows observed since 4Q16 and related accumulation of reserves were intimately linked to the large fiscal imbalances and their funding with external savings/borrowing. However, the large external capital inflows to fund the still-wide fiscal deficit are challenging the central bank to prevent an excessive expansion of domestic liquidity (critical for a successful disinflation strategy) and over-valuation of the currency.

Exhibit 33: Rapidly Deteriorating Trade Balance Driven by Surging Imports

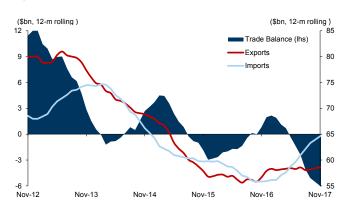


Exhibit 34: Rising Central Bank International Reserves



Source: INDEC, Goldman Sachs Global Investment Research

Source: BCRA, Goldman Sachs Global Investment Research

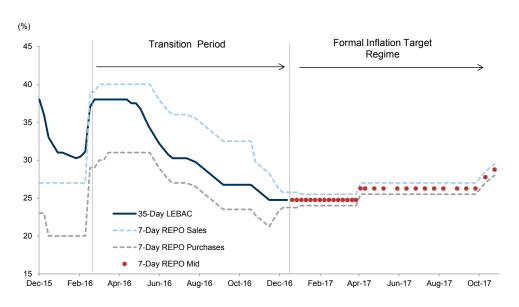
Overall, we expect the current account deficit to widen to US\$31.9bn in 2018 (-4.8% of projected dollar GDP), from a projected US\$26.8bn in 2017 (-4.3% GDP), and US\$14.5bn in 2016 (-2.7% GDP), driven by real currency overvaluation and the cyclical acceleration of domestic demand growth. The **significant deterioration of the current account during the initial stages of a cyclical real business cycle recovery is a source of growing concern and makes it even more imperative to deepen the fiscal adjustment.** That is, fiscal consolidation (ideally by cutting current spending given the already very high tax burden) and the associated increase in the public sector savings rate would prevent the ongoing healthy and desirable expansion of investment from putting added pressure on the external balance.

Inflation remains high and sticky, particularly at the policy-sensitive core level. The new National-CPI, which will serve as the yardstick for the inflation targeting framework, rose 19.4% during Jan-Oct, already exceeding the 17% upper limit of the IT band for 2017. During its September 12 meeting the MPC abandoned the pursuit of the original inflation target for 2017 (12%-17%), and is now focused on the $10\% \pm 2\%$ inflation target for 2018. Given strong inertial forces and indexation mechanisms and sizeable adjustments of regulated prices/tariffs, we expect headline inflation to end 2017 at a high 23.2%, moderating to a still-high 16.3% in 2018 and further down to 10.6% in 2019. Hence, we expect inflation in 2018 to exceed the ambitious $10\% \pm 2\%$ inflation target. In this regard, on the inflation front one of the key things to monitor will be the upcoming collective wage negotiations in an environment in which inflation expectations remain unanchored (above target).

Faced with sticky inflationary pressures the central bank Monetary Policy Committee (MPC) hiked the policy rate by 150bp in April. **The intensification of inflationary**

pressures during 3Q2017, higher-than-expected increases in regulated tariffs during 4Q2017, and further deterioration of inflation expectations prompted the MPC to hike the policy rate again in Oct/Nov: by a bold +250bp in a span of two weeks, driving the policy rate to an even more restrictive 28.75%. On an *ex-ante* basis the 12-month real policy rate is now hovering above 10%. The decisive policy rate hikes of the last two meetings show the determination of the monetary authority to anchor expectations and force core inflation down at a faster pace and are, therefore, likely to reinforce the central bank's inflation-fighting credentials.

Exhibit 35: MPC Hiked Policy Rate to Very Restrictive 28.75%



Source: BCRA, Goldman Sachs Global Investment Research

We expect inflation to moderate gradually throughout 2018 but are of the view that monetary policy needs to remain tight in view of persistence/inertia among core and non-tradable inflation, the gradual recovery of real wages, and unanchored inflation expectations. As such, beyond the proper calibration of the policy rate, tight liquidity management will be critical to guarantee that inflation continues to moderate: the large purchase of international reserves and still-significant, although moderating, financing of the federal treasury have admittedly rendered the control of domestic liquidity more challenging. Finally, we highlight that preserving a hawkish/conservative monetary stance is facilitated by the fact that the economy is now expanding at a solid pace, which allows the central bank to focus on the challenging inflation targets. Overall, we expect the central bank to hold the policy rate unchanged at the high 28.75% level for the remainder of 2017 and only to entertain rate cuts once core inflation enters a clear moderating trend (likely no earlier than late in 1Q2018). Against this backdrop, we expect the central bank to cut the policy rate to 22.50% by year-end 2018 and further down to 14.00% by year-end 2019.

BRAZIL: Sustainability of Cyclical Recovery Demands Progress on Fiscal Consolidation and Public Debt Stabilization

The 2018-19 macro and financial outlook for Brazil remains challenging and complex, but admittedly more constructive and hopeful than in 2016-17. The 2008-15 heterodox, experimental policy approach generated large domestic and external imbalances that visibly undermined the domestic and external resilience of the Brazilian economy. Since late 2015 the economy has been undergoing a classic macroeconomic rebalancing and adjustment process. Following the May 2016 political transition—which culminated in the Senate impeachment trial of former president Dilma Rousseff in August—the macroeconomic adjustment process has been supported by a more disciplined and conventional macro policy mix and by the approval of a number of meaningful microeconomic and macroeconomic structural reforms. Slowly but steadily the Brazilian economy has been moving towards a better macro equilibrium but slow progress towards fiscal consolidation could potentially jeopardize the recently achieved gains in macroeconomic performance and asset prices. Overall, we expect the ongoing cyclical recovery to continue to firm, with real GDP growth projected to accelerate from under 1% in 2017 to a projected above-trend 2.7% in 2018, amidst well-anchored inflation (current and expected) and modest current account imbalance. Presidential and legislative elections in October 2018 will be a key focus of market attention and a source of economic uncertainty and market risk. Given the Temer administration's gradual approach to fiscal consolidation, the next administration (2019-2022) is likely to face the challenge of deepening the fiscal adjustment in order to stabilize the deteriorating public debt dynamics. A populist/heterodox 4Q2018 election outcome—which would give rise to concerns about the continuity of the current orthodox market-friendly policy approach—would be likely to trigger an adverse market reaction and could undermine the sustainability of the economic recovery.



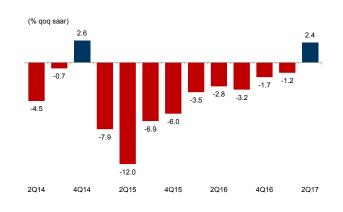
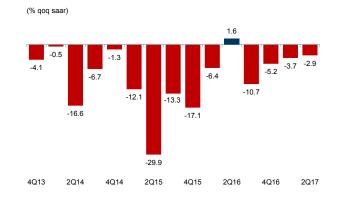


Exhibit 37: Severe Gross Fixed Investment Contraction



Source: Haver Analytics, Goldman Sachs Global Investment Research

Source: Haver Analytics, Goldman Sachs Global Investment Research

The last three years were extraordinarily challenging but the recession seems to have now moved into the rear-view mirror. The 11-quarter long recession (2Q2014-4Q2016) was the longest and second-deepest on record. For instance, gross fixed investment declined by a cumulative 30% between 3Q2013 and 2Q2017, dropping to the 2Q2009 level, and per-capita consumption declined by close to 12% cumulatively

between 1Q2015 and 1Q2017. The real business cycle reached an inflexion point during 1Q2017, and we expect the ongoing cyclical recovery to firm on the back of: (1) declining inflation (which is supporting real wages); (2) gradually less stringent and exigent credit conditions (declining lending rates and gradually firming credit to households); (3) progress on household sector balance sheet deleveraging; (4) a gradual pick-up in private investment spending (following a 3-year slump) supported in part by an ambitious privatization and public concessions program; and (5) firming consumer and business confidence and incipient formal job creation. In general, the economic recovery should be supported by accommodative/stimulative overall financial conditions as measured by our proprietary FCI-Brazil index. However, we underscore that tangible signs of progress towards fiscal consolidation at the federal and sub-national levels remain, in our assessment, quintessential to anchor market sentiment and support further improvements in consumer and business sentiment. Overall, we forecast a mild 0.9% real GDP expansion in 2017 (up from -3.8% in 2015 and -3.6% in 2016), with real growth firming to an above-trend 2.7% in 2018. The firming growth dynamics are expected to lead to further labor market improvement, with the unemployment rate expected to decline from a cyclical high of 13.2% (seasonally adjusted; sa) in April 2017 to a projected 12.4% (sa) by year-end 2017 and further down to 11.5% (sa) by year-end 2018.

(points) (points) 102.5 102.5 102.0 102.0 Restrictive 101.5 101.5 101.0 101.0 100.5 100.5 100.0 100.0 99.5 99.5 99.0 99.0 98.5 98.5 98.0 98.0 Accommodative 97.5 2012 2013 2014 2015 2016 2017 2011

Exhibit 38: Financial Conditions Index Dips Into Stimulative Territory for First Time Since Early 2015

Source: Bloomberg, Goldman Sachs Global Investment Research

A deep, permanent, structural fiscal adjustment remains front-and-center on the policy agenda. In our assessment, failure to deliver tangible and credible measures to reduce the fiscal deficit (flow) and through that stabilize the debt dynamics (stock) could jeopardize the recent advances in confidence indicators and undermine the forecasted economic recovery, particularly in the 2019-2020 outer years. A comprehensive social security reform to contain the unsustainable growth of

social security spending is a pressing need. The short-term outlook for any such reform is poor, though. At most, the Temer administration may manage to secure Congressional support for a minimal, stripped-down version of a social security reform. Hence, measures and reforms to address the large social security imbalance, particularly for public sector workers, should be part of the agenda of the administration that will come to power in 2019. Failure to approve even a minimal pension reform during President Temer's remaining tenure would likely trigger further sovereign rating downgrades. In the meantime, we expect the consolidated public sector primary fiscal balance to reach -2.3% of GDP in 2017 (very minor improvement from -2.5% of GDP in 2016) and the overall public sector fiscal deficit to reach a high -8.8% of GDP (vs. -9.0% of GDP in 2016 and -10.2% of GDP in 2015). Gross general government debt surged to 73.9% of GDP in September 2017, from 69.9% of GDP at year-end 2016 and 51.5% of GDP at year-end 2013. Given the slow progress on fiscal consolidation and the implied path of sizeable primary fiscal deficits for a number of years (-2.2% of GDP forecasted for 2018), we do not expect to see primary surpluses before 2021, at best. Hence, we expect the public debt picture to continue to deteriorate and for the gross level to surpass a disquieting 80% of GDP before stabilizing. This leaves the fiscal picture, and the economy at large, vulnerable to adverse domestic and external shocks.

Exhibit 39: Large Primary Fiscal Imbalance (% GDP; 12-m flows)

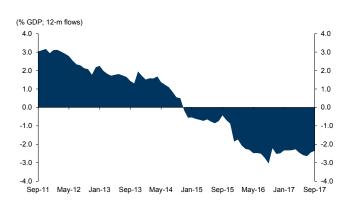
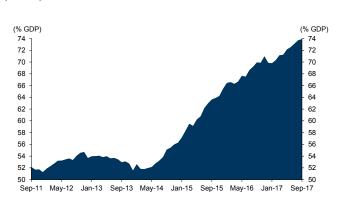


Exhibit 40: Rising Gross General Government Debt (% GDP)



Source: Haver Analytics

Source: Haver Analytics

In our assessment, **fiscal consolidation in Brazil will be a multi-year endeavor that will have to be continued and deepened by the next administration.** Most likely, going back to primary fiscal surpluses will take no fewer than 3-4 years, and reaching a primary surplus level that stabilizes the debt dynamics (around 2.0%-2.5% of GDP) is likely to require 5-6 years, or perhaps longer. At the end of the fiscal consolidation process we estimate that Brazil needs to end up with a primary surplus of 3.0% to 3.5% of GDP. This would be the level of primary surplus that would put gross public debt on a clear declining trajectory, something that is required for Brazil to rebuild fiscal buffers and regain room to use fiscal policy counter-cyclically. Furthermore, we believe a deep fiscal adjustment that would elevate public sector savings is needed to facilitate a permanent structural current account adjustment (rather than just a cyclical adjustment driven by the sharp contraction of domestic demand and imports), and also to endow the central bank with extra degrees of freedom to set monetary policy.

The inflation outlook improved markedly throughout 2017 in even some of the most inertial components, such as core services, a reflection of a large favorable food supply shock and the pulling impact of an almost 3-year long recession that drove the unemployment rate above 13%. Furthermore, inflation expectations have fully aligned with the inflation targets all the way through 2020 (for 2017-18, inflation expectations are in fact tracking below the target midpoint). With the exception of regulated prices (which were heavily repressed during 2013-14), by 3Q2017 most IPCA components were tracking at the bottom of the range spanning the last 6 years, with some of them well below the 4.50% inflation target midpoint. Headline inflation decelerated to a very low 2.7% by October, and inflation among freely determined prices (prices not regulated by the government) to an even lower 1.5% yoy. In addition, the average of the three main core inflation measures dipped to 3.7% yoy, the lowest print since March 2012. Finally, the policy sensitive core-services inflation measure continues to decelerate: to 3.7%, from 9.4% at end 2015 and the lowest level in at least a decade.

Overall, we forecast headline IPCA inflation to end 2017 at a low below-target 3.2%, down from 6.3% in 2016 and 10.7% in 2015, driven to a significant extent by the moderation of inflation among market determined (non-regulated) prices, which is forecasted to decline from 6.5% in 2016 to 1.7% in 2017. Still-significant slack in terms of resource utilization, particularly in the labor market, a well-anchored currency and inflation expectations and the enhanced credibility of the monetary authority should keep inflation well behaved in 2018-19. Hence, we expect inflation to remain well contained in 2018, at a slightly below-target 4.4%, with the increase from 2017 driven mostly by the normalization of food and tradable inflation. Against this backdrop, we expect the central bank to push the policy rate a bit further into stimulative territory.

The current easing cycle is quite advanced/mature and at the current 7.50% level the ex-ante Selic real policy rate is already stimulative. However, the benign current and prospective inflation outlook, well-anchored inflation expectations, sizeable output and labor market gaps, broadly stable currency dynamics, and still-friendly external financial backdrop should altogether allow the central bank to ease monetary policy a bit further. Overall, following the 675bp in Selic policy rate cuts since October 2016, we expect the Copom to end the long and deep easing cycle with a 50bp cut at the December 2017 meeting. This would drive the Selic policy rate to a clearly stimulative and record-low 7.00%. Furthermore, we expect the Copom to keep the policy rate unchanged at the 7.00% level throughout 2018. While not part of our baseline, we do not rule out additional modest rate cuts during 1Q2018 (between 25 and 50bp) if inflation surprises further on the downside and the pace of the ongoing cyclical recovery stalls or disappoints. Overall, our proprietary FCI-Brazil (defined in real terms) is now tracking into stimulative territory and we expect it to decline further as the policy and lending rates continue to come down and inflation rises from the current bottom. The moderate inflation environment and accommodative financial conditions should support the expected cyclical recovery of the Brazilian economy during the remainder of 2017 and throughout 2018.

Exhibit 41: Freely Determined Prices Tracking Below 2%

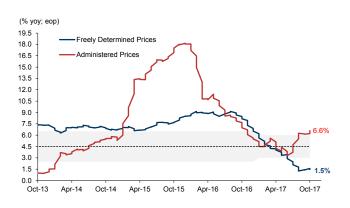


Exhibit 42: Copom Still in Easing Mode



Source: Haver Analytics, IBGE

Source: Bloomberg, Goldman Sachs Global Investment Research

Beyond the observed domestic rebalancing, significant progress has also been recorded on the external side in recent years, but the quality of this adjustment has been far from ideal. Overall, the current account deficit has narrowed significantly since early 2015 (by 3.8ppt of GDP) and FDI inflows have been remarkably resilient despite the poor growth dynamics and heightened political uncertainty. However, the observed current account adjustment has been: (1) more cyclical than structural (driven by the collapse in imports of goods and services following an extraordinarily long and deep recession), (2) of low quality (driven by the severe retrenchment of investment spending rather than an increase in the national savings rate), and (3) exclusively and excessively shouldered by the private sector. In fact, we argued in the Latin America Economics Analyst (July 28) Brazil: Current Account Adjustment? Mostly Cyclical, Poor Quality, and Excessively Shouldered by the Private Sector that it was the widening fiscal imbalance that, for instance, prevented the current account from actually moving into surplus at the bottom of an exceptionally long and deep recession and record trade surplus (supported in part by a record harvest). Overall, the private sector has been adjusting its savings-investment financial balance since 2011, and since 2014 was forced to over-adjust in order to compensate for the additional deterioration of the public sector fiscal balance and its rising dis-saving. This suggests that some form of the classical Ricardian Equivalence has been at play: rising fiscal imbalances at the flow (large fiscal deficit) and stock levels (rising public debt load) have been offset by rising private sector savings and financial surpluses. That is, since 2014 the private sector has shouldered most of the burden of macroeconomic adjustment (through a significant increase in its savings rate and reduction in investment) and therefore has been generating increasing financial surpluses and gradually deleveraging its balance sheet. But the public sector is, unfortunately, yet to shoulder its fair share of the adjustment, particularly when it was to a large extent the fiscal profligacy of recent years that generated the large macro imbalances that eventually led the country to lose its coveted investment grade rating. In all, we expect the current account deficit to reach a low 0.6% of GDP in 2017 (US\$12bn) and to widen slightly to 1.5% of GDP in 2018 (US\$34bn) in 2018, on the back of a more moderate trade balance surplus and larger services and factor payments deficits. Finally, we expect the capital account to

remain in surplus in 2018-19, anchored by solid FDI inflows (US\$75bn-plus), debt-creating flows, and moderate portfolio inflows.

We expect the BRL to remain well anchored over the forecasting period given the low current account imbalance, solid FDI inflows at around 4% of GDP, low inflation environment, and firming cyclical growth recovery. Political and policy uncertainty could however undermine market sentiment towards the currency, particularly if the market starts to question post-election policy continuity and the medium-term outlook for fiscal policy.

All in all, the macroeconomic picture has rebalanced and the economy seems to have embarked upon a more constructive and promising path supported by a stronger orthodox policy framework. There is, however, a big caveat to the overall macro adjustment witnessed during 2016-17: The fiscal stance remains weak, the public debt load is reaching new highs, and the aggregate savings and investment rates have reached new lows. Hence, in order to strengthen macro credibility, further enhance domestic resilience, and consolidate the value of a strong external balance sheet (external resilience) the authorities' top priority should be to address a number of remaining domestic macro imbalances (weak fiscal picture at the flow and stock levels) and embrace investment- and savings-friendly, pro-growth policies. Some of the issues that continue to handicap the performance of the economy are structural in nature rather than cyclical (e.g., low investment, even lower domestic savings, and low productivity and, hence, low potential growth). Therefore, beyond strengthening the policy mix, Brazil would benefit from a deep structural reform drive (e.g., fiscal spending, tax system, social security, opening to foreign trade, etc.) in order to raise the domestic savings and investment rates, boost overall productivity and elevate potential GDP.

The positive policy agenda detailed above would contribute to a further rebalancing of the economy and would support asset price valuation. In the short term the main risk with regards to the adoption of measures to accelerate the needed fiscal consolidation and approval of pro-growth and investment reforms is, in our assessment, the approaching October 2018 presidential election, for electoral considerations may undermine the required legislative political support for such policies. But delaying the required domestic adjustment into 2019-20 would be a risky proposition as it could undermine the resilience gains accumulated since late 2015. Furthermore, it is uncertain whether the October 2018 election will empower an administration that would be both committed to, and politically capable of, pursuing a reformist/adjustment path. Ultimately, if the large fiscal imbalance and very negative public sector savings rate are not properly and swiftly addressed, they could undermine and compromise part of the hard-won macroeconomic adjustment gains in terms of disinflation, stabilization of the business cycle, and current account adjustment. Fundamentally, the public sector—federal and local governments—is now more than ever challenged to simultaneously increase its investment and also savings rate (ideally by cutting current spending). Limited progress on this front is expected for the last year of the Temer administration. The onus is therefore on the next administration to show tangible and decisive progress towards fiscal consolidation and stabilization of the public debt dynamics.

CHILE: Returning to Trend Growth

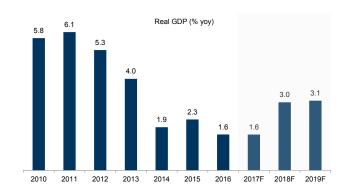
After four years of disappointing economic activity, the economy finally seems poised to emerge off the bottom. Since the trough in 1Q2017, several activity indicators have firmed, policy uncertainty has declined, and confidence levels have gradually improved from near record-low levels. Inflationary pressures have eased considerably, allowing the central bank to cut the policy rate even further below what was already an accommodative stance at the end of 2016. In fact, while we continue to expect the policy rate to remain on hold, we see increasing risks for additional cuts in the near term if inflation fails to pick up and/or the business cycle recovery loses momentum. Despite rating downgrades by Fitch and Standard and Poor's earlier in 2017, stronger growth and higher copper prices are set to support a much-needed fiscal consolidation in coming years. Furthermore, on the political front, the latest polls show that market-friendly candidate and former president Sebastian Piñera has consolidated his lead and is widely expected to win the presidential election, with the first round scheduled for November 19. In all, we believe the combination of a supportive external environment, easier financial conditions, and an expected favorable election outcome will help accelerate economic growth to the fastest pace since 2013.

The first signs of economic recovery appeared during 1H2017. After a weak performance towards the end of 2016, the economy has firmed as domestic demand growth accelerated considerably. Certainly, the cyclical inventory build-up after a three-year downturn has played an important role, but private consumption has also remained resilient. Indeed, we expect private consumption growth to accelerate, favored by the low inflation environment, stronger currency, and gradually improving labor market conditions. The negative effects from the record contraction in mining production during 1H2017, owing to a long-lasting strike at Chile's largest copper mine, have started to dissipate. As production levels continue to normalize and copper prices firm at much higher levels than those seen in 2016, we expect the mining sector to provide an important contribution to growth in 2018, which we see rising to 3.0% from a disappointing 1.6% in 2017.

On the negative side, the construction sector has continued to struggle, becoming the main drag on domestic activity. Moreover, fixed investments have lagged the solid expansion in capital goods imports, despite the high historical correlation between the two. We believe the main risks to our growth recovery scenario stem from a more prolonged weakness in construction activity and further delay in a more solid and sustained recovery in private investment.

We expect faster economic expansion, higher copper prices and further normalization of copper production to support stronger fiscal revenue growth and facilitate fiscal consolidation. Recently, total revenue expansion has accelerated on the back of a surge in copper revenues, and expenditure growth has gradually moderated as lower capital spending offset higher personnel costs. We expect this trend to persist over the medium term, leading to a considerable nominal deficit reduction of 0.7pp of GDP to 2.1% in 2018.

Exhibit 43: Growth Expected to Accelerate Considerably...



Source: Haver Analytics, Goldman Sachs Global Investment Research

Exhibit 44: ... Supported by Higher Copper Prices

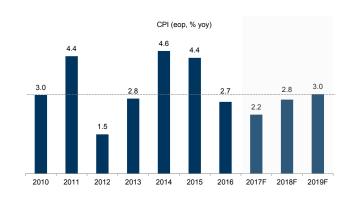


Source: Haver Analytics, Bloomberg

Though the growth outlook has become increasingly favorable, the observed data so far have shown only a very gradual recovery in non-mining sectors, which has failed to prevent further widening of the output gap but helped to contain demand-pull inflationary pressures. In addition, tradable inflation has declined to the lowest levels in four years amid significant CLP appreciation and lower food prices, driving headline inflation below the target range. More recently, however, the latest October CPI print reversed the large September drop in annual inflation, easing concerns that the temporary inflation decline was a sign of a more pervasive disinflationary trend that could jeopardize the convergence to the target over the 2-year policy horizon. As growth accelerates into next year, the favorable FX pass-through wanes, and food prices mean-revert, we expect inflation to gradually climb towards the 3% target, reaching 2.8% by the end of 2018.

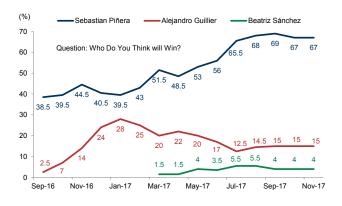
The benign inflation environment has allowed the central bank to cut the policy rate by 100bp since January 2017 to 2.50%, leading the way to a considerable easing in broad financial conditions. Given our expectation of a steady growth recovery and gradual convergence of inflation to the target, and the fact that the current policy rate is already around 125-175bp below its neutral level according to central bank estimates, we reiterate our baseline scenario whereby the policy rate remains on hold through most of 2018. Still, we recognize that recent low inflation prints and the risk that inflation remains at or below the 2% target lower bound for an extended period have increased the likelihood of additional rate cuts in the near term. In our view, though the current monetary stimulus is consistent with the inflation/growth outlook, the central bank might opt to cut rates further in order to better anchor inflation expectations around the target and prevent a rise in the ex-ante real policy rate that could slow the growth recovery. At this point, however, we believe the needle remains tilted more in the direction of stable rates for longer rather than additional cuts.

Exhibit 45: Benign Inflation Outlook



Source: Haver Analytics, Goldman Sachs Global Investment Research

Exhibit 46: Sebastian Piñera Expected to Return to Presidency



Source: GFK Adimark, Plaza Pública Cadem

The central bank's quarterly business sentiment survey published recently showed that most companies "linked the performance of their businesses, as well as the materialization of investment projects, to the election result." Indeed, the prospect of a victory by market-friendly candidate and former president Sebastian Piñera on the November 19 presidential election (with a second round scheduled for December 17 if no candidate secures at least 50% of the votes) seems to have been a key factor behind improved confidence indicators and an overall better outlook for the economy. As Mr. Piñera continued to consolidate his lead in the polls, policy uncertainty declined considerably after remaining at near record-high levels throughout most of the current administration, which implemented controversial tax and labor reforms that raised corporate taxes and empowered labor unions. While the market seems to have mostly priced in the outcome suggested by the polls, we believe the confirmation of such result could give an additional near-term boost to the CLP and further improve business confidence. On the other hand, an upset victory by government-backed candidate and current senator Alejandro Guillier could lead to an immediate repricing in asset prices, increased volatility and a return to high policy uncertainty levels. Therefore, while the polls currently suggest that the presidential race will extend into the second round on December 17, the first-round result could have an important impact on markets as it will be an important gauge of Mr. Piñera's chances of returning to the presidency.

COLOMBIA: Deeper Monetary Easing on Lower Inflation and Fragile Growth Outlook

The macro, financial and political outlook for Colombia has become increasingly complex. Since December 2016, the central bank cut the policy rate by a large 275bp, exceeding the expectations of the majority of market analysts amid a difficult combination of weak activity growth and above-target inflation rates. Still, despite the sizeable move and the fact that both observed and expected inflation remain stubbornly above the 3% target, we see room for another 100bp easing to a stimulative 4.00% by the end of 202018. While we expect growth to accelerate meaningfully in 2018 on the back of more accommodative financial conditions, activity will likely fall short of a return to its potential level, lagging the performance of the other Andean economies of Chile and Peru. The tax reform approved at the end of 2016 was able to eliminate the imminent risk of a credit rating downgrade, though concerns over weak fiscal revenues and a costly peace process with the FARC guerrilla movement have mounted, leading to the widespread belief that further progress is needed on the fiscal front. Finally, the presidential election of May 2018 presents, for the first time, a real risk of shift away from orthodox economic policies that have served the country well in the past.

Despite a more favorable external environment with higher commodity prices and robust growth in developed economies, the Colombian economy slowed down even further in 2017 from what had already been a disappointing year in 2016. Lagged effects from a decisive monetary policy tightening, coupled with persistent core inflation pressures and a significant tax hike have weighed on domestic activity. The expansion of oil refining, which made an important contribution to GDP growth in 2016, moderated considerably as production levels in the modernized Reficar refinery reached peak capacity. Moreover, crude oil production has continued to decline as reserves dwindle. Even the considerable rise in oil prices since the US presidential election has not been sufficient to drive a recovery in the struggling oil sector, which we expect will continue to hinder economic growth in the near term.

Exhibit 47: Sluggish Growth Recovery

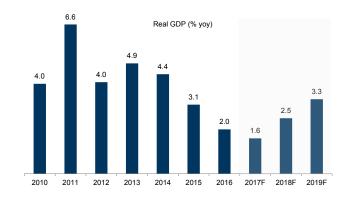
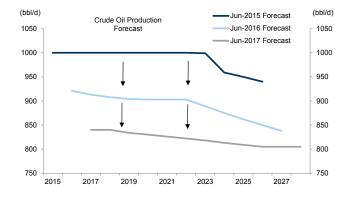


Exhibit 48: Deteriorating Outlook for Oil Production



Source: Haver Analytics, Goldman Sachs Global Investment Research

Source: Ministry of Finance

Not all news is bad, though. Private consumption has remained surprisingly resilient despite a large VAT hike in February 2017, supporting overall domestic demand and preventing an even more serious economic slowdown. Fixed investments have started

to bounce back after a severe contraction in 2016 and are expected to continue to pick up gradually on the back of higher infrastructure spending, leading to a modest acceleration of domestic demand growth. **Still, we believe these positive developments will be insufficient to boost total GDP growth towards its potential level and expect an underwhelming 2.5% expansion in 2018**.

As economic growth has failed to recover, the output gap has widened further and labor market conditions have softened, easing demand-pull inflationary pressures. Moreover, the mean-reversion of food prices and a relatively stable COP have driven down key components behind the high 5.7% inflation print in 2016. Despite elevated non-tradable inflation close to the highest levels in nearly eight years, headline inflation has moderated considerably over the past months, surprising the market consensus on the downside in five of the past six CPI releases. As a result, we now expect inflation to end 2017 just under the target upper limit at 3.9% after exceeding the target range in 2015 and 2016. We expect the considerable inflation decline from the 2016 peak to help ease the persistent inertia that pushed up prices of indexed goods and services (e.g., education, housing rent). Moreover, the absence of the VAT hike, which added an estimated 50bp to 2017 inflation, and a more modest increase in the minimum wage in 2018 (the latest news suggest an adjustment of around 4.5%, lower than 7.0% in 2017) further support a more benign inflation outlook. **Overall, we now expect inflation to decline toward 3.1% by the end of 2018, from our previous estimate of 3.5%.**

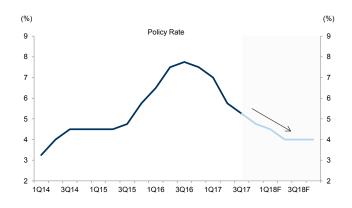
Though inflation has returned to the target range more recently, both headline and core figures were still well above the target upper limit in the early stages of the current monetary easing cycle. In spite of a difficult combination of soft domestic activity, high core inflation readings and above-target inflation expectations, the central bank has cut the policy rate by more than most analysts expected at the turn of the year in what has been a very bumpy ride: the Monetary Policy Committee (MPC) surprised market analysts on five occasions since the first rate cut in December 2016, driving the policy rate down by 100bp more than the median survey forecast at that time. Still, given the more favorable inflation outlook, further widening of the output gap and low likelihood of a major acceleration in domestic demand, we now see room for even more rate cuts than our previous expectation towards a stimulative 4.00% terminal level (from 4.50% before) by the end of 2Q2018, with the next 25bp rate cut likely taking place at the December MPC meeting.

Exhibit 49: Inflation Finally Converging to Target...



Source: Haver Analytics, Goldman Sachs Global Investment Research

Exhibit 50: ... Opening Room for Below-Neutral Policy Rate



Source: Haver Analytics, Goldman Sachs Global Investment Research

We note that 12-month-ahead inflation expectations are currently around an above-target 3.6% level. Given our below-consensus inflation forecast, we reckon that the policy rate should decline by another 50bp from the current 5.00% level in order to offset the inflation decline and prevent an increase in the real policy rate. Moreover, as inflation approaches the target midpoint and the economy continues to grow below its potential, we believe the MPC will shift to a somewhat accommodative stance, driving the policy rate to a slightly below-neutral level.

We see two main risks to our forecast. First, the room for rate cuts could be limited by tighter financial conditions abroad. In particular, our US economics team expects the Fed to continue on its path of quarterly funds rate hikes through the end of 2019, considerably more than what is currently implied in the market. Second, the rapid current account adjustment observed since the end of 2015, which the central bank highlighted as a key factor behind its decision to cut the policy rate, has recently stalled. Despite higher prices, oil exports have failed to recover in a meaningful way as crude production declined. As a result, the current account deficit has remained high at just over 4% of GDP, and we expect it to decline very gradually in the near term.

Declining oil production has affected not only the current account balance, but also fiscal revenues from oil, which reached a peak of over 3% of GDP in 2013 and now stand at virtually zero. In addition, the fiscal outlook has become even more uncertain as details regarding the costs involved in the peace process with the FARC have emerged. Recently, the Finance Minister stated that the total costs were expected to reach 15% of GDP over the next 15 years, and that finding funding sources for such expenses was a priority. Given mounting fiscal challenges, we believe the next administration will likely need to pursue meaningful measures to raise revenues and/or reduce other expenditures. As highlighted by Fitch in its recent confirmation of a stable outlook for Colombia's sovereign rating, both total net public sector and external debt ratios are already above those of its BBB peers. Therefore, **fiscal consolidation remains front and center in the policy agenda in order to preserve fiscal sustainability and prevent a credit rating downgrade**.

Fiscal consolidation is just one of the key issues at stake in the presidential election of May 2018. Amidst a divided field with nearly 20 possible candidates, former Bogotá

mayor and leader of the leftist *Movimiento Progresistas* Gustavo Petro has consistently ranked at or near the top of the polls. Among his policy proposals, Mr. Petro favors a populist agenda of higher taxes on the wealthy and greater income redistribution. In addition, the newly formed center-left coalition *Coalición Ciudadana* joined three popular candidates and has gained momentum in the latest polls. As popular demands have shifted away from the peace and security concerns of the violent years of confrontation with guerrilla movements towards more basic needs such as employment, health and education, the appeal of populist policies has grown. **Still, the left has never won a Colombian presidential election, and we believe it is still too early to tell whether their solid standing in the early polls will continue to grow until election day.** What we can say is that noise from the political race will increase considerably as the dispersed field consolidates around the few key candidates with real chances of winning, which will likely lead to increased volatility in asset prices.

MEXICO: Significant External and Domestic Risks

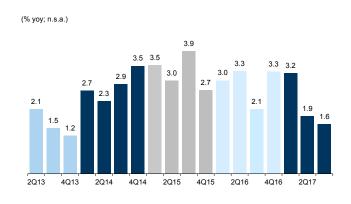
The current macroeconomic backdrop is far from dismal but yet provides little to celebrate. The macro picture remains complex—modest growth, sharply declining oil production, multi-year high inflation, high interest rates, binding restrictions on fiscal spending, a testy relationship with the dominant trading partner, and lingering rule of law (security) and corruption issues. Largely, the 2018-19 macro-financial outlook is uninspiring and faces significant domestic and externally driven challenges. On the external side we highlight the uncertain outlook for the renegotiation of the NAFTA treaty and Fed policy and balance sheet normalization, and on the domestic side, a presidential election in July that could potentially foreshadow a shift towards a more inward-looking, interventionist policy mix. Overall, while inflation is expected to moderate throughout 2018 (returning to the 2%-4% inflation target band by mid-year), growth is expected to remain modest and with the balance of risks clearly skewed to the downside.

Notwithstanding the domestic and external risks and challenges, we reckon that the economy continues to be well-managed, the policy approach conventional and market-friendly, and, on all counts, there are no signs of major deep-seated domestic or external macro imbalances. In fact, in the calibration of monetary, FX, and fiscal policy the authorities have been steadfast in responding proactively to the evolving challenges in the quest to strengthen domestic macro fundamentals. Furthermore, we highlight that the currency is trading at a competitive level (visibly above fair-value estimates from our suite of valuation models) and foreign sponsorship of local bond duration has been firm despite the recent bouts of volatility and gyrations in international financial markets. Finally, on the political front investors should remain attuned to the movements on the political chessboard ahead of the July 2018 presidential election. Overall, in the absence of major negative spillovers from US policy shifts (NAFTA/trade in particular) and/or a shift towards heterodox policies following the presidential election, Mexico could remain an attractive defensive and diversification choice among LatAm and other EM credits, given that it is still offering a balanced macro story with low external funding needs and limited exposure to both commodities and China.

The potential shift of policies in the United States in areas of significant relevance for Mexico— most notably on trade, immigration, security, financial flows (FDI and remittances), etc.—remains a key source of short-term uncertainty and potentially medium-term downside risk. Beyond the friction and rising risks around the outcome of the ongoing renegotiation of the NAFTA treaty, Mexican financial asset markets have in recent months also been unsettled by domestic political risks and the possibly that the July 2018 presidential election could herald a policy shift from the current conventional market-friendly mix towards a more heterodox, interventionist stance. The 2018 presidential election will likely take place in an environment of modest growth, moderating but still-high inflation, and tight monetary and credit policies. This macro backdrop is unlikely to be favorable for incumbents, but could favor candidates such as left-wing anti-establishment Andrés Manuel López Obrador (AMLO), who is proposing a new economic and political paradigm under a populist-nationalist platform. While AMLO is leading the early presidential race, we caution that the field of candidates is still not defined: the main parties are yet to select their presidential candidates and potential

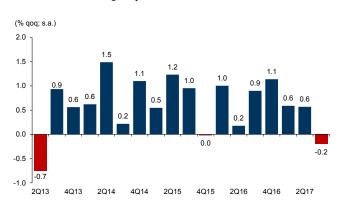
electoral political alliances are still being discussed. We highlight that, in our assessment, **NAFTA and domestic political risks are positively correlated**. A break-down in the ongoing negotiations and an eventual abandonment of the NAFTA treaty could contribute to a rise in nationalist sentiment in Mexico and increase the risk of a populist/heterodox choice in the mid-2018 election. That is, it may become increasingly difficult to disentangle NAFTA from domestic political risk premia inasmuch as the materialization of one risk could well precipitate the materialization of the second risk. Overall, in the near term we expect Mexican asset price volatility to remain high.

Exhibit 51: Moderate but Steady Real GDP Growth



Source: Haver Analytics, INEGI, Goldman Sachs Global Investment Research

Exhibit 52: Weakening Sequential Growth Momentum



Source: Haver Analytics, INEGI, Goldman Sachs Global Investment Research

Activity proved more resilient than expected during 1H2017 but there are now growing and clear signs that the forward momentum is softening. We expect growth to moderate and the engines of growth to rebalance—with higher contributions from manufacturing and net exports and less thrust from services and private consumption. Overall, during 1H2017 the services sector on the supply side and private consumption on the demand side were the main engines of growth, supported by solid credit and remittance flows and a robust labor market, and have shown remarkable resilience to heightened domestic and external uncertainty. However, rising interest rates, surging inflation, gradually more exigent credit standards/conditions, moderating remittances growth when expressed in local currency, and the uncertainty and risks ahead, are starting to weigh down on the buoyancy of private consumption spending. Furthermore, the outlook for investment spending remains weak. The binding fiscal constraints on public sector investment, rising interest rates and more exigent domestic and external financing conditions, as well as an overall lackluster outlook for final domestic demand should all remain a drag on investment spending. Finally, uncertainty with regard to the outcome of the 2018 presidential election and renegotiation of the NAFTA treaty are likely to continue to have a negative impact on activity by rendering domestic economic actors more defensive: important investment decisions may be postponed, scaled down or even canceled, particularly in export-oriented sectors, given the uncertain terms under which Mexican exporters would have future access to the US market.

In all, we expect **real GDP growth to downshift to a lackluster 2.1% in 2017** (from 2.9% in 2016 and 3.3% in 2015). Our forecast for 2017 is consistent with a projected deceleration of the annual growth rate to 1.7% yoy during 2H2017 from 2.5% yoy during

1H2017. We expect the growth rate to remain broadly stable in 2018 (2.1%) helped in part by a still-solid labor market, real wage gains supported by the expected moderation of inflation, easier/stimulative overall financial conditions and a lower drag from oil production and construction. Absent major disruptions to trade, solid growth in the United States should support manufacturing export growth in 2018. Overall, real activity is expected to remain sluggish during 1H2018 given heightened uncertainty around the renegotiation of NAFTA and the early July elections, but is expected to firm moderately during 2H2018 once uncertainty dissipates. We acknowledge that our forecasts' range of uncertainty is quite large given that 2018 will be an important electoral year in Mexico and policy in the United States could shift in a way that negatively impacts the Mexican economy. Towards the end of our forecasting horizon (2020-21) we expect the economy to start to incrementally collect the growth, investment and job creation dividends from the structural reforms approved in recent years, particularly in the energy sector.

The authorities have been meeting the fiscal targets and the 2018 draft budget reinforces the commitment to restrain spending and continuing down the path of gradual fiscal consolidation. Overall, we expect the non-financial public sector to post a primary surplus of 0.9% of GDP in 2018, consistent with moderate gross public sector financing requirements of 2.5% of GDP. The authorities' medium-term fiscal plan envisages moderate and stable fiscal deficits (slightly under 1% of GDP primary fiscal surpluses), which would be sufficient to maintain gross public debt on a slight declining trajectory. Overall, a robust fiscal stance is needed to strengthen the domestic macro fundamentals, shore up domestic and external confidence in the economy, and preserve current sovereign ratings. In that regard, the next administration will likely need to embrace a fiscal reform that would, among other things, limit the growth of social spending and reinforce the fiscal accounts.

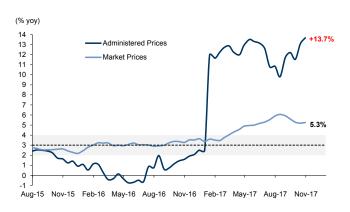
Inflation remains high and above-target, but Mexico does not seem to have a deep-rooted inflation problem. The inflationary pressures started to pick up and became more visible during 4Q2016, only to intensify during Jan-Aug 2017. Overall, annual headline inflation peaked at 6.74% during 2H Aug (highest print since May 2001) and has moderated slightly since then (to 6.44% by 2H Oct) driven by favorable core-goods inflation dynamics and the mean reversion of food prices. The worst of the inflationary pressures now seems behind us. We forecast headline inflation to end the year at 6.2%, and to return to within the inflation target band by mid-2018 given the combination of a tight monetary and fiscal stance, the expectation of a stable exchange rate, subdued domestic demand conditions, and likely, further mean-reversion of the recent food price negative shock.

Against the admittedly challenging inflation backdrop, the central bank has shown an unmistakable predisposition to act boldly, and has been reiterating its commitment to remain vigilant. Faced with an unanchored currency, accelerating inflation, and a perceived increase in external risks, the bank hiked the policy rate from a low and stimulative 3.0% in November 2015, to 5.75% by December 2016, and further up to a slightly restrictive 7.00% by June 2016. Since then the central bank has been on hold but has maintained a clear hawkish/conservative stance. That is, **despite the downside risk**

to growth the central bank has shown little inclination to reduce the focus on inflation.

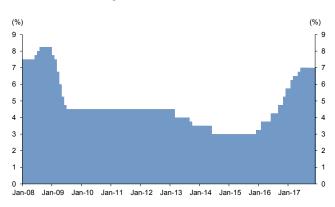
At its November meeting the MPC changed the forward guidance to give more emphasis/importance to the relative monetary conditions vis-à-vis the United States and to add potential wage pressures to the set of variables the MPC will monitor. These were, in our assessment, hawkish modifications to the forward guidance. Overall, among the set of variables the MPC will monitor, the relative stance of monetary policy vis-à-vis the United States was upgraded from third in the list, to first place (on a list that now has four main items rather than the prior three). Specifically, the MPC vowed to monitor very closely the evolution of all determinants of inflation and its medium- and long-term expectations, "in particular changes in the relative stance of monetary policy vis-à-vis the US, the potential pass-through of the exchange rate variation to prices, the evolution of the output gap, and potential wage pressures." Given the expected FOMC rate hike in December and additional policy rate and balance sheet normalization expected for 1H2018, the tweak to the forward guidance should, in our evaluation, be read as a forewarning that if a tighter domestic-US policy rate differential were to generate unwarranted market volatility and pressure the MXN, the MPC would stand ready to adjust its monetary policy stance.

Exhibit 53: Moderating Inflation Among Market-Determined Prices



Source: Haver Analytics, Goldman Sachs Global Investment Research

Exhibit 54: Banxico Vigilant and on Hold at 7.00%



Source: Haver Analytics

The still-high level of annual headline and core inflation, above-target inflation expectations, hitherto fairly resilient non-oil economy dynamics, tight labor market, rising unit labor costs, renewed MXN depreciation pressures, capital account risk management considerations, and significant domestic (complex mid-2018 elections) and external risks (NAFTA negotiation, FOMC policy rate and balance sheet normalization) should, altogether, discourage the **central bank** from entertaining rate cuts in the very near term and **to preserve a hawkish/hiking bias despite growing downside risks to activity**. Against this backdrop, we expect the MPC to leave the policy rate unchanged at 7.00% for the remainder of 2017 and throughout 2018, but do acknowledge some small probability of additional near-term moderate rate hikes if external factors (Fed policy and/or NAFTA) drive market volatility up and push the MXN weaker. Conversely, we also attribute some probability to moderate post-election rate cuts during 2H2018 if the NAFTA renegotiation and July's presidential election play out in a market–friendly,

MXN-supportive way, and the market digests well the expected steady normalization of monetary policy in the United States throughout 2018.

While on an ex-ante real basis at 7.00% the policy rate is at a slightly above-neutral (restrictive) level, overall financial conditions, as proxied by our proprietary FCI-Mexico, are not yet restrictive. That is, financial conditions have indeed tightened since late 2015 (by close to a full standard deviation) but are still mildly supportive to growth. This is likely yet another reason why the central bank has preserved a clear hawkish bias despite judging that the overall balance of risks to growth has deteriorated in recent months.

The MXN has been under pressure given the heightened domestic and external uncertainty but we highlight that its fundamentals are stronger than they have ever been over the last few years. Following the decisive 2016-17 monetary policy response the MXN is now a high-carry currency, the current account deficit has narrowed, the fiscal stance has tightened and the central bank has created a US\$20bn NDF facility to provide hedge to the market in periods of FX market distress.

The trade balance has been improving, despite a deteriorating oil balance. On a 12-month basis, the overall trade deficit moderated to US\$9.9bn in September, visibly lower than the cyclical bottom deficit of US\$18.6bn in April 2016. The trade balance dynamics have been driven exclusively by the non-oil trade balance, which improved to a cyclical high +US\$7.2bn surplus in September, from -US\$7.3bn in April 2016 (this balance moved into surplus for the first time in 22 years). In the meantime, the oil trade balance deficit widened, to -US\$17.1bn from -US\$12.0bn a year ago and -US\$8.9bn two years ago. Crude oil production and export volumes have been declining and gasoline imports surging due to declining domestic refining capacity and rising domestic consumption. We expect the non-oil trade balance to continue to improve, albeit at a more moderate pace, driven by a competitive currency, subdued final domestic demand, and firm US external demand. This presumes no major near-term change in the terms and conditions under which Mexican exporters have access to the US market. Finally, the net oil trade balance may deteriorate further if domestic oil production and output of refined products (e.g., gasoline) continue to decline.

The current account dynamics should not be a source of macro or market concern.

The current account deficit narrowed to a moderate US\$23.0bn in 2016 (2.2% of GDP), from US\$28.8bn during 2015 (2.5% of GDP), driven by a lower trade balance deficit driven exclusively by the non-oil trade deficit as the oil balance continued to deteriorate. Lower deficits in services and factor payments and rising workers' remittances also contributed to the observed current account adjustment from 2015 to 2016. The current account adjusted further during 1H2017, driven by similar dynamics (significant improvement in the non-oil trade balance).

Exhibit 55: Non-Oil Trade Balance at 22 Year High

(12-month cumulative sum)

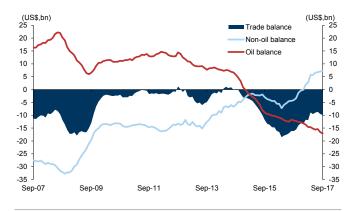
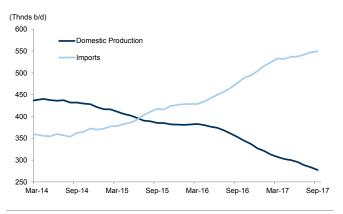


Exhibit 56: Gasoline Import Volume Increases As Domestic Production Declines

(12-month average)



Source: PEMEX, Goldman Sachs Global Investment Research

Source: Haver Analytics, INEGI

Overall, we are comfortable with the current account dynamics, but are a bit more uncomfortable with the capital account, particularly when taking into account that Mexico is a highly financially integrated economy with a sizeable foreign presence in local markets. In all, we project the current account deficit to widen slightly in 2018: to 2.0% of GDP (-US\$24.5bn) from a projected 1.7% of GDP in 2017 (-US\$19.5bn). Finally, modest current account deficits of under US\$25bn per year should be comfortably financed by a capital account anchored by FDI flows, which could be supported by incrementally higher foreign investment in the oil and gas sectors. FDI into the manufacturing sector may, however, be negatively impacted by US policy uncertainty and the outlook for the NAFTA treaty, and into the oil & gas sectors by potential changes in the regulatory and investment environment after the July election. Finally, as witnessed since 2015, capital account portfolio inflows are expected to remain modest, at best, given the expectation of rising core Dollar yields and heightened domestic macro and political uncertainty. Altogether, in our assessment the balance of payments remains significantly more exposed to an external

confidence or policy shock from the United States that could affect capital account flows, than to a widening current account balance. However, we do acknowledge that over the medium term the current account could also be negatively affected by US policy-driven frictions that could impact both exports to the United States, and workers' remittances from the United States.

In conclusion, given a domestic and external backdrop beset with significant risks and challenges, we expect the monetary and fiscal authorities to remain vigilant and to continue to work diligently to strengthen the domestic macro fundamentals.

Box 2: The Risks Around NAFTA and the Implications for Macro Policy

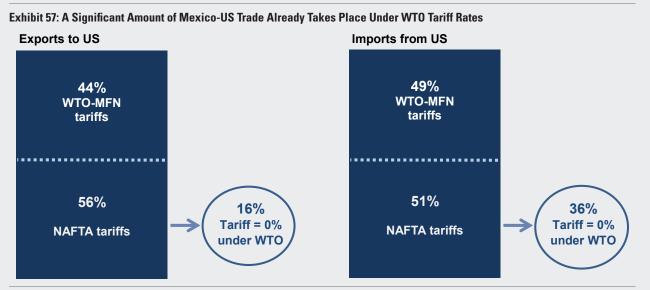
The potential break-up of the NAFTA treaty remains a source of short-term uncertainty and medium-term downside risk. The fourth round of **NAFTA** talks ended with the three countries involved far apart on key issues. The US negotiating team remains focused on finding ways to reduce the bilateral trade deficits,

and tabled a number of proposals that Canada and Mexico do not seem inclined to accept. Mexico will host the fifth round of negotiations, scheduled for November 15-21 in Mexico City. Additional negotiating rounds will be scheduled through the first quarter of 2018. While extending the negotiations into 1Q2018 would give the three parties extra time to overcome the current disagreements and find common ground, there is also the risk that as we enter 2018 the negotiations could become politicized and captured by the political dynamics ahead of the mid-2018 presidential and legislative elections in Mexico and the US midterm Congressional elections during 4Q2018. Finally, we highlight that a lengthy negotiation prolongs uncertainty about the outcome and can have a corrosive impact on investment, particularly in the tradable sectors of the Mexican economy. In all, we seem to have reached a critical stage in the tripartite negotiations and there is a non-negligible risk that the negotiations may not reach a successful conclusion: i.e., the attempt at revamping and modernizing the old NAFTA treaty may not succeed.

For Mexico, exit from NAFTA would likely simultaneously generate both a contractionary and a short-term inflationary shock. This would present a significant challenge for the calibration of macro policy, in particular monetary policy given the trade-off involved in setting policy to keep inflationary pressures at bay while at the same time avoiding adding pressure on an already struggling economy.

The impact on sentiment, activity and inflation (via higher tariffs on imported goods and likely a weaker MXN) will depend critically on the terms of a potential "NAFTA divorce". A friendly separation, whereby the parties acknowledge that it was not possible to find common ground to revamp NAFTA, but do pledge to remain committed to explore avenues to facilitate and deepen economic and trade integration, would likely be received constructively by the market inasmuch as the current pattern of bilateral trade would not be significantly altered or disrupted (no major trade diversion or change in current cross-border supply chains). In this case, we judge that the impact on sentiment, investment in the Mexican economy, and the impact on the exchange rate would be modest to moderate.

There is, however, no guarantee that in case of a NAFTA exit, the separation process would be amicable. A long, bitter and ultimately unsuccessful negotiation could eventually destroy goodwill between the parties, and trigger aggressive trade-related measures that substantially worsen the terms under which Mexican exporters have access to the US market, particularly if the key US objective remains to reduce the bilateral deficit and discourage US investment in Mexican exporting sectors. In the case of a non-cooperative unfriendly separation, we consider that access to the US market could deteriorate significantly and eventually lead to a trade environment, both quantitatively and qualitatively, that would be noticeably worse than under the WTO-MFN tariff regime. In this case, the shock to domestic Mexican sentiment would be great, important domestic and foreign investment decisions would likely be significantly scaled down or outright canceled, and rising uncertainty would likely precipitate an increase in precautionary savings, further depressing private consumption. In this environment, the expected deterioration of the trade balance and overall balance of payments outlook (lower trade surplus and most likely also weaker FDI) would magnify the shock to the MXN. That is, the shock to activity would be large but so in the short term would be the inflationary shock from the FX pass-through. Over the medium term, the outlook for activity would remain constrained by the limited set of trading and foreign investment opportunities but the shock to inflation would likely fade once the MXN settles at a more depreciated level and the initial inflationary pressure triggered by the change in relative prices fades.



Source: United States International Trade Commission (USTIC), Customs Records of Mexico

The key question under the unfriendly separation scenario is whether the central bank would react with additional interest rate hikes in order to anchor the currency (prevent an overshooting), protect the capital account, and limit second-round inflation effects from the expected significant depreciation of the currency. As under this scenario we would be envisaging a permanent, or at least long-lasting, shock to trade conditions, the real effective exchange rate would have to depreciate to a new level in order to guarantee the external balance. As such, we believe the central bank would not attempt to re-anchor the MXN at the level that prevailed before the trade shocks; i.e., below18 per USD. That is, we would expect the monetary authority to validate a MXN/USD move up to the 20 handle, but likely not much higher than that.

Given that at 7.00% the policy rate is already at a slightly restrictive level and the balance of risks for growth and investment would deteriorate significantly in the case of an unfriendly NAFTA separation, we would not expect the central bank to hike rates further. Keeping the policy rate constant while inflation temporarily accelerates would already turn the real policy rate more stimulative. We judge that keeping the policy rate constant at the current level amidst a deteriorating growth outlook could suffice, unless the shock to confidence and the exchange rate turned out to be very large and acute capital account pressures were to emerge.

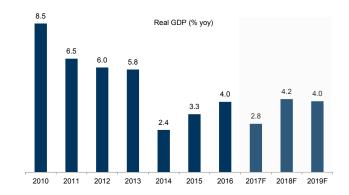
We are of the view that the best strategy to fend off potential currency pressures would not be through even higher interest rates, but through the auction of MXN/USD NDFs in order to provide hedge/FX protection to the economy. In this regard, the recent central bank decision to offer up to US\$4bn in NDFs between October 26 and December 6, is somewhat revealing about the central bank's reaction function and policy preferences. Furthermore, if FX market conditions become illiquid and price formation dysfunctional, the central bank could eventually also sell some reserves in order to restore orderly market conditions. We consider that temporary and limited FX market spot intervention would be appropriate in case of sizeable spot market capital outflows.

PERU: Back to the Top

The economy experienced a sharp slowdown during 1H2017 after a severe coastal El Niño disrupted production and a corruption scandal caused the delay of major infrastructure projects. Lately, however, domestic activity has gradually bounced back, supported by a robust expansion of fixed investments which, while mainly driven by double-digit increases in public sector capital spending, has also reflected a long-overdue expansion in private investments. Certainly, the impressive rally in metal prices since the US presidential election, particularly copper - Peru's top export product - has contributed to an overall improvement in business sentiment and investment outlook. In fact, our expectation that economic expansion will continue to accelerate to a slightly above-trend pace of 4.2% in 2018 - the highest among LatAm's major economies - from 2.8% in 2017 rests in a relevant way on a favorable outlook for metal prices. Still, we believe more accommodative financial conditions and the low inflation environment will support a rather fast domestic demand recovery and contribute significantly to a stronger growth path. As a result, we believe the central bank ended the monetary easing cycle at its November meeting and will keep the policy rate on hold at 3.25% through most of 2018.

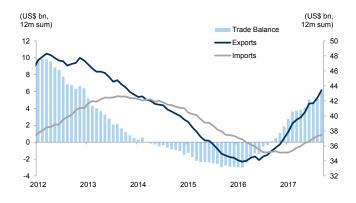
As growth firmed in developed economies, Chinese demand remained robust and metal prices soared, Peruvian exports increased significantly both in value and in volume, providing a boost to real GDP and supporting a faster current account adjustment. We expect the current account deficit to moderate further from a peak of 4.8% in 2015 towards 1.9% of GDP in 2017 and to remain near the 2.0% level going forward as a favorable outlook for metal prices helps offset the pressure from stronger domestic absorption to widen the deficit. On the other hand, while fiscal revenues are expected to grow on the back of stronger economic growth and further expansion in the mining sector, government efforts to rebuild and modernize damaged infrastructure after a severe coastal *El Niño* that hit major urban areas in February 2017 will lead to a temporary expansion in the nominal deficit to 3.5% of GDP in 2018. Still, we expect the government to remain committed to keeping the total debt burden under 30% of GDP in coming years and see no major risks for fiscal sustainability.

Exhibit 58: Rapid Recovery from Temporary Growth Slowdown...



Source: Haver Analytics, Goldman Sachs Global Investment Research

Exhibit 59: ... on the Back of Booming Exports



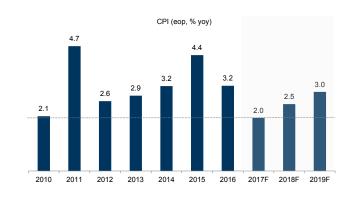
Source: Haver Analytics, Goldman Sachs Global Investment Research

Amid the temporary slowdown in domestic activity, more appreciated PEN, and the lagged impact from a tighter monetary policy stance up to April 2017, inflationary

pressures have subsided considerably since early 2017. In fact, headline inflation reached the 2% midpoint of the demanding 1-3% target range in October for the first time since 2010, and core inflation declined to 2.3% yoy – its lowest reading since 2013 – reflecting widespread moderation in most CPI components. Notably, both tradable and non-tradable inflation readings are now in line with the target midpoint. We expect inflation to decline further in the near term, reaching close to 1% yoy by March 2018 owing to favorable base effects, but to converge towards 2.5% by year-end, reflecting above-trend growth during 1H2018.

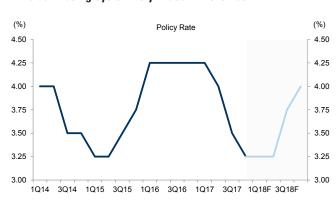
As inflation declined sooner than anticipated after a large downside surprise in October, the central bank caught most market analysts off guard and cut the policy rate by 25bp to 3.25% at its November meeting. Importantly, the MPC shifted the policy statement's forward guidance to a neutral stance, signaling the end of the easing cycle started in May. Given the change in forward guidance, the recent signs of a solid rebound in domestic activity, and the expectation that economic growth will continue to accelerate well into 2018, we expect the MPC to keep the policy rate on hold for the foreseeable future.

Exhibit 60: Inflation to Remain within 1-3% Target Range



Source: Haver Analytics, Goldman Sachs Global Investment Research

Exhibit 61: Easing Cycle Likely Ended in November



Source: Haver Analytics, Goldman Sachs Global Investment Research

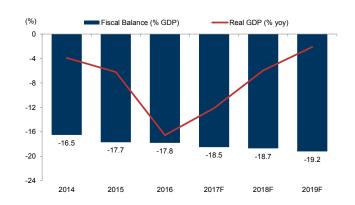
Though Peru is one of the few countries in the region without major elections in the near term (only regional elections are scheduled, for October 2018), the political landscape has become increasingly noisy given stiff opposition from the right-wing Fuerza Popular party, which holds 71 of the 130 seats in the unicameral congress. Tensions between the government and the opposition reached a peak in mid-September when congress rejected by 77-22 a vote of confidence requested by the then-Prime Minister Fernando Zavala, who also held a dual appointment as Minister of Finance, forcing the entire cabinet of ministers to resign. After a cabinet reshuffle that led to the appointment of six new ministers (including the posts of Prime Minister and Minister of Finance), the relationship between President Pedro Pablo Kuczynski's government and congress seems to have improved somewhat. Notwithstanding the political disagreements, we highlight that both government and opposition are broadly aligned in terms of economic policy orientation, recognizing the need for a market-friendly, pro-growth agenda while preserving fiscal sustainability. Therefore, we see no relevant risk of a major shift in economic policy from the recent tensions on the political front.

VENEZUELA: Increasingly Complex Economic, Financial, and Political Backdrop

The 2018-19 macro financial outlook for Venezuela is extraordinarily complex and exceptionally risky. The macroeconomic and social picture remains highly distressed, social and political polarization high, and institutional friction elevated. The probability of near-term improvement is low. The recent controversial election of a Constituent Assembly further increased partisan political friction. International pressure on the regime is also rising, leading a number of countries to move forward with financial sanctions, further limiting already-impaired access to international capital markets. The heterodox interventionist and highly centralized macro policy mix is unquestionably unsustainable (led to a major economic depression and hyperinflation) and the external hard currency cash restriction is increasingly restrictive. Lack of reliable and timely macro data, as recently highlighted by the IMF Executive Board, and a volatile political, social and economic backdrop render conventional economic analysis and macroeconomic forecasting virtually impossible. The true picture of the public sector consolidated liabilities is opaque, and the government has non-trivial outstanding liabilities to private companies from awards resulting from international arbitration disputes. A presidential election is scheduled to take place late in 2018 (date yet to be announced; could be brought up to 1H2018). Recent polls show that the Maduro administration has low and declining approval ratings, but anti-government protests have died down and the opposition camp remains fragmented and divided, even more so after the October 15 gubernatorial elections.

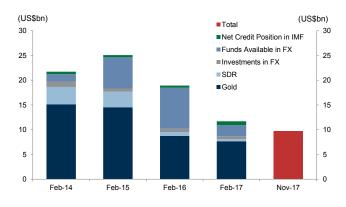
The heterodox macro policy mix of the last 18 years brought the economy to its knees. Real GDP is estimated to have contracted by more than 15% in 2016 and is projected to decline in double digits again in 2017. Overall, the economy has been contracting uninterruptedly since 2014: real GDP is estimated to have declined by 25% cumulatively during 2014-16, and is expected to decline further during 2017-19. Overall, we project that by year-end 2018 real GDP will have contracted an astonishing 34% from 2014: ranking within the set of worst economic downfalls in modern Latin American history and deeper than the US real GDP contraction during the Great Depression. In the meantime, the economy has ben operating with very high levels of goods scarcity (with acute shortages of food and medicine) given the repression of imports due the tight balance of payments picture and severe disruptions to the productive capacity of the economy: the production frontier of the economy is shrinking given lack of investment, rationed access to foreign exchange for imports of key inputs, and the accumulation of macro and micro distortions and inefficiencies. Finally, oil production has been steadily declining: likely to less to 2mm/bpd (according to Baker Hughes by October 2017 the oil rig count dropped to 39, down from 48 a year ago and a 14-year low).

Exhibit 62: Major Collapse of Real GDP Amidst Large Fiscal Deficits



Source: Goldman Sachs Global Investment Research

Exhibit 63: Dwindling Foreign Reserves



Source: Central Bank of Venezuela, Goldman Sachs Global Investment Research

The authorities have long since lost control over the monetary dynamics. Despite the severe economic depression the economy is living under the tight grip of hyperinflation; and the highest inflation rate on the planet. Hyperbolic price increases pushed inflation to high triple-digits, perhaps higher (the IMF projects an annual inflation rate in the thousands from 2017 through 2022). Fiscal profligacy and lack of confidence in the domestic currency as a store of value help to explain the high velocity of circulation of money and the hyperinflationary environment. The public sector has been running fiscal deficits since 2006, and double digit deficits since 2010. The fiscal imbalance is expected to remain high: the IMF projects fiscal deficits averaging a staggering 16% of GDP on average during 2018-19. The recurrent central bank monetization of large fiscal deficits generates excess domestic liquidity and the classical fiscal dominance of monetary policy, with negative implications for inflation, financial stability and overall social welfare.

Current account deficits have been moderate given the lack of conventional sources of financing. In order to reduce the external funding requirements the authorities have been suppressing imports, to an estimated historical low of around US\$10bn; this is at an increasing social and economic cost. The authorities have also been running down the stock of hard currency assets, driving the level of international reserves to a 15-year low of less than US\$10bn (down from US\$30bn in 2012 and US\$22bn in 2014), with the liquid cash portion of reserves likely below US\$2bn. Given increasingly limited access to conventional sources of funding in international capital markets, the authorities have been increasingly reliant on unconventional sources of financing and friendly country-level bilateral deals.

The exchange rate remains severely over-valued. Despite the hyperinflation environment the DIPRO highly subsidized exchange rate of the multi-tier currency regime has been fixed at a very low 10 VEF per USD since March 2016. Furthermore, the very limited supply of hard currency to the economy via the official DICOM foreign exchange market platform—where the VEF last traded at 3,345 per USD—has been clearly insufficient to cover the ongoing needs of the economy. The authorities' decision to stop the DICOM corporate FX auctions and migrate to a new "FX basket without the USD" has increased the demand for USD in non-official markets. Overall, the informal

market VEF/USD exchange rate has been weakening rapidly and is now tracking at between 53,000 and 57,000 VEF per Dollar.

Exhibit 64: Hyperbolic Expansion of the Money Supp

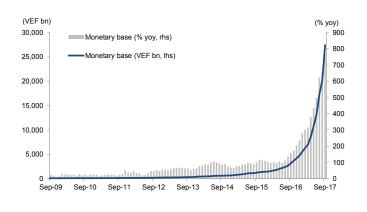
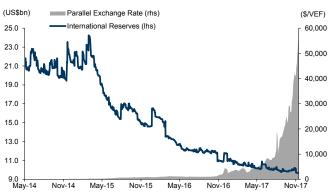


Exhibit 65: Dwindling Central Bank Reserves amid Rising Exchange Rate Pressures



Source: Central Bank of Venezuela, Goldman Sachs Global Investment Research

Source: Central Bank of Venezuela, Dolar Today

Given sizeable external debt service needs, very tight hard currency cash-flow position (very low external liquidity) and limited external funding options the authorities announced on Nov 3 the intention to create a special commission headed by Vice-President Tareck El Aissami to refinance/renegotiate (or "reformat" in the authorities' own words) the sovereign external debt obligations in order to find the right "equilibrium" to "cover the necessities of the country." The authorities summoned bondholders to Caracas for an official meeting on November 13. Overall, the authorities' capacity and hitherto strong willingness to stay current on external debt obligations is being increasingly questioned. The recent developments and delays in a number of external bond coupon payments triggered rating downgrades by the main rating agencies—S&P downgraded long-term foreign-currency debt rating to SD from CC on November 13, on failed coupon payments, and maintained CreditWatch as Negative to reflect the opinion "there as a 1-in-2 chance that Venezuela could default again within the next three months." An interruption of external debt service payments would be economically disruptive but would free up increasingly scarce hard currency (≈ US\$9bn) to boost critically low imports, which could pay short-term political dividends for the Maduro administration as it seeks reelection in 2018. But the medium- and long-term implications of a debt default would hardly be positive for it would likely severely compromise oil production and exports.

Overall, Venezuela's economic and political dynamics seem to have deteriorated further in recent months and the macro-financial outlook remains unusually uncertain. The country is already facing a severe economic and social crisis amidst very high levels of political and social polarization. A potential debt service moratorium followed by debt restructuring would add to what is already a complex and extremely difficult economic and financial picture. Finally, we would highlight that international financial sanctions, the low likelihood that the authorities will embrace the required policy shifts needed to overcome the very large macro imbalances (e.g., tighter fiscal and monetary policy and attractive investment environment), and very diverse group of

external creditors would render a potential debt restructuring extremely difficult to execute.

Alberto M. Ramos, Paulo Mateus and Gabriel Fritsch

LatAm and Global Macroeconomic Outlook

Consolidated Latin America Selected Economic Indicators (ex-Venezuela)

	2011	2012	2013	2014	2015	2016	2017F	2018F	2019F	2020F	2021F
Economic Activity and Prices											
Nominal GDP (US\$bn)	5,081	5,073	5,218	5,180	4,352	4,155	4,651	5,019	5,405	5,785	6,142
Real GDP growth (% yoy)	4.5	2.6	2.8	1.3	0.2	-0.4	1.7	2.7	3.2	3.4	3.3
CPI Inflation (% yoy)	7.3	6.6	7.0	8.6	9.0	8.8	6.3	5.3	4.4	3.9	3.6
Domestic Demand (% yoy)	5.9	2.8	3.0	1.0	-0.7	-1.3	1.6	3.1	3.5	3.6	3.6
II. External Sector (US\$bn)											
Current Account Balance	-112.6	-119.6	-152.5	-169.2	-138.1	-82.2	-78.6	-112.4	-129.3	-138.0	-153.8
Trade Balance	53.8	46.7	9.8	-3.0	-10.5	33.8	52.6	39.4	28.4	26.7	26.2
Gross International Reserves	673.8	722.6	715.9	737.9	705.2	729.3	756.3	774.8	799.7	826.3	852.4
Change in Reserves	109.5	48.8	-6.8	22.0	-32.7	24.1	27.0	18.5	24.9	26.6	26.1
Net Capital Inflows	222.2	168.4	145.7	191.2	105.4	106.3	105.6	130.9	154.2	164.6	179.9
Foreign Direct Investment	153.5	155.3	167.9	176.1	162.9	148.8	147.9	172.9	185.2	194.6	209.8
III. Public Finance and Indebtness (% GDP)											
Primary Fiscal Balance	1.3	0.9	0.5	-1.0	-1.7	-1.8	-1.2	-1.3	-0.5	0.0	0.5
Overall Fiscal Balance	-2.0	-2.1	-2.5	-4.3	-6.3	-5.6	-5.2	-5.3	-4.6	-4.1	-3.6
Total Public Sector Debt	41.4	42.1	42.2	46.2	51.2	55.3	57.6	60.0	61.1	61.7	62.2
Total External Debt	22.2	24.7	26.2	29.1	34.5	36.9	35.8	35.5	36.3	36.8	36.9

Note: Aggregates weighted by nominal GDP in US\$ at PPP exchange rates.

Source: Goldman Sachs Global Investment Research

Global Macroeconomic Framework

							20	17F			201	18F	
	2016	2017F	2018F	2019F	2020F	Q1	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
Real GDP Growth (%, yoy)													
United States	1.5	2.2	2.5	1.8	1.5	2.0	2.2	2.3	2.4	2.6	2.6	2.4	2.3
Euro Area	1.8	2.3	2.2	1.8	1.6	2.0	2.3	2.5	2.4	2.4	2.3	2.1	2.0
Japan	1.0	1.6	1.5	1.3	0.5	1.5	1.4	1.7	1.7	1.7	1.4	1.5	1.5
World Economy	3.1	3.7	4.0	3.9	3.8	3.5	3.6	3.9	3.9	4.0	4.0	3.9	4.0
CPI Inflation (%, yoy)													
United States	0.9	2.1	2.3	1.9	2.1	2.6	1.9	2.0	2.1	2.0	2.5	2.5	2.1
Euro Area	0.2	1.5	1.2	1.3	1.5	1.8	1.5	1.5	1.4	1.2	1.3	1.3	1.2
Japan	-0.1	0.5	1.0	1.0	1.5	0.3	0.4	0.6	8.0	0.9	0.9	1.1	1.0
Interest rates (%, e.o.p)													
Fed Funds	0.54	1.38	2.38	3.38	3.38	0.79	1.04	1.15	1.38	1.63	1.88	2.13	2.38
UST 10-Years	2.40	2.60	3.00	3.50	3.60	2.50	2.65	2.75	2.60	2.70	2.80	2.90	3.00

Source: Goldman Sachs Global Investment Research

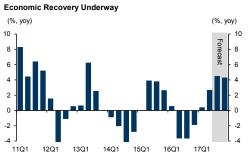
LatAm Country Data Tables

Argentina

	2016	2017F	2018F	2019F
Activity and Prices				
Real GDP Growth (% yoy)	-2.2	3.0	3.6	3.5
Nominal GDP (US\$bn)	544	619	665	696
Consumer Prices, IPC (yoy, e.o.p.)*	N.A	23.2	16.3	10.6
Consumer Prices, IPCBA (yoy, e.o.p.)*	41.0	24.2	16.8	10.7
External Sector				
Current Account (% GDP)	-2.7	-4.3	-4.8	-4.9
Trade Balance (% GDP)	0.8	-0.7	-1.1	-1.2
Exports (% yoy)	1.7	1.3	4.0	3.9
Imports (% yoy)	-6.9	18.2	8.0	5.4
Exchange Rate (\$/ARS, e.o.p.)	15.9	17.7	20.0	21.6
Gross International Reserves (US\$bn)	39.3	52.5	60.0	64.0
Monetary Sector				
Monetary Base (% yoy)	26.6	27.0	22.0	17.0
Credit to the Private Sector (% GDP)	14.0	16.2	17.7	18.6
Policy Interest Rate	24.75	28.75	22.50	14.00
Fiscal Sector **				
Federal Govt Primary Balance (% GDP)	-4.3	-4.0	-3.2	-2.8
Federal Govt Overall Balance (% GDP)	-5.9	-6.2	-5.6	-5.2
Debt Indicators ***				
Gross Non-fin. Public Sector Debt (% GDP)	50.6	53.8	60.7	63.7
Domestic (% GDP)	28.1	37.2	42.9	44.6
External (% GDP)	13.8	16.7	17.8	19.1
Total External Debt (%GDP)	36.9	34.8	35.3	36.1

*IPC computed by INDEC, IPCBA by Statistical Institute City of Buenos Aires. **Before Rents from CB and Anses. Accumulated 4Q. *** Including non-performing debt.

Source: Goldman Sachs Global Investment Research



Source: INDEC, Statistical Inst. City of Buenos Aires, Goldman Sachs Global

Improving Inflation Dynamics



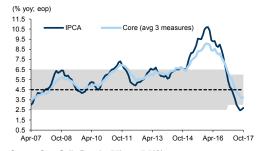
Source: INDEC, Statistical Inst. City of Buenos Aires, Goldman Sachs Global Investment Research

Brazil

	2016	2017F	2018F	2019F
Activity and Prices				
Real GDP Growth (% yoy)	-3.6	0.9	2.7	3.1
Nominal GDP (US\$bn)	1,808	2,078	2,263	2,409
IPCA Inflation (yoy e.o.p)	6.3	3.2	4.4	4.3
External Sector				
Current account (% GDP)	-1.3	-0.6	-1.5	-2.0
Trade balance (% GDP)	2.5	3.2	2.4	2.0
Exports of goods (% yoy)	-3.0	19.0	3.8	5.2
Imports of goods (% yoy)	-19.1	10.1	12.9	10.4
Nominal Exchange Rate (\$/BRL e.o.p.)	3.26	3.25	3.15	3.20
Net International Reserves (US\$bn)	365	380	385	395
Monetary Sector				
Monetary base (% yoy)	5.9	7.0	7.0	8.0
Credit to the Private Sector (%GDP)	45.8	43.7	43.7	45.4
SELIC rate (e.o.p)	13.75	7.00	7.00	8.25
Fiscal Sector				
Public Sector Primary Balance (% GDP)	-2.5	-2.3	-2.2	-0.8
Public Sector Nominal Balance (% GDP)	-9.0	-8.8	-8.6	-7.3
Debt Indicators				
Gross general govt debt (% GDP)	69.9	75.0	77.0	79.0
Domestic public debt (%GDP)	66.2	71.5	73.5	75.4
External public debt (%GDP)	3.6	3.5	3.5	3.6
Total external debt (% GDP)	30.3	27.4	26.5	27.0

Source: Goldman Sachs Global Investment Research.

Headline/Core Inflation Continue to Moderate



Copom Cuts Selic Rate by 75bp to 7.50%



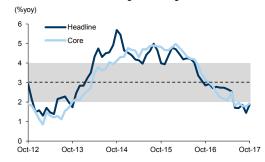
Sources: Bloomberg; Goldman Sachs Global Investment Research; Haver

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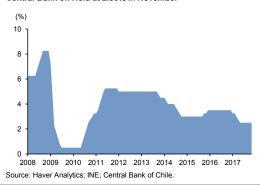
Chile

	2016	2017F	2018F	2019F
Activity and Prices				
Real GDP Growth (% yoy)	1.6	1.6	3.0	3.1
Nominal GDP (US\$bn)	247	270	303	326
Consumer Prices (% yoy, e.o.p.)	2.7	2.2	2.8	3.0
External Sector				
Current Account (% GDP)	-1.4	-1.6	-2.0	-1.4
Trade Balance (% GDP)	2.1	2.4	2.1	1.4
Exports (% yoy)	-2.6	9.8	8.0	3.7
Imports (% yoy)	-5.8	8.4	8.9	6.8
Exchange Rate (\$/CLP, e.o.p.)	667	625	605	600
Gross International Reserves (US\$bn)	40.5	39.3	39.8	40.1
Monetary Sector				
Broad Money (M3, % yoy)	8.2	7.0	9.0	9.0
Credit to the Private Sector (% GDP)	82.3	82.9	84.7	86.2
Policy Rate (e.o.p.)	3.50	2.50	3.00	4.00
Fiscal Sector				
Central Gov't Primary Balance (% GDP)	-2.0	-2.0	-1.2	-0.9
Central Gov't Overall Balance (% GDP)	-2.7	-2.8	-2.1	-1.8
Debt Indicators				
Central Govt Debt (% GDP)	21.3	23.5	24.6	25.3
Domestic (% GDP)	17.5	18.5	19.3	19.8
External (% GDP)	4.1	5.0	5.3	5.5
Total External Debt (% GDP)	66.2	64.7	61.5	60.5

Headline/Core Inflation Tracking Below Target



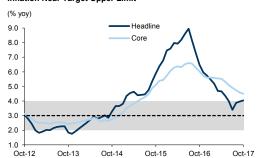
Central Bank on Hold at 2.50% in November



Colombia

	2016	2017F	2018F	2019F
Activity and Prices				
Real GDP Growth (% yoy)	2.0	1.6	2.5	3.3
Nominal GDP (US\$bn)	283	311	326	346
Consumer Prices (% yoy, e.o.p.)	5.7	3.9	3.1	3.0
External Sector				
Current Account (% GDP)	-4.3	-3.8	-3.2	-3.1
Trade Balance (% GDP)	-3.5	-3.0	-2.7	-2.6
Exports (% yoy)	-12.8	9.6	6.4	5.1
Imports (% yoy)	-16.9	6.0	4.4	4.6
Exchange Rate (\$/COP, e.o.p.)	3001	3000	3000	3000
Gross International Reserves (US\$bn)	46.2	47.0	47.0	47.0
Monetary Sector				
Monetary Base (% yoy)	2.5	5.0	7.0	9.0
Credit to the Private Sector (% GDP)	49.2	50.7	52.6	53.9
Policy Rate (% e.o.p.)	7.50	4.75	4.00	4.50
Fiscal Sector				
Central Government Primary Balance (% GDP)	-1.3	-0.9	-0.5	0.3
Central Government Overall Balance (% GDP)	-3.8	-3.6	-3.2	-2.5
Debt Indicators				
Gross Non-fin. Public Sector Debt (% GDP)	56.3	59.2	61.3	62.2
Domestic (% GDP)	34.3	37.2	40.3	41.2
External (% GDP)	22.0	22.0	21.0	21.0
Total External Debt (% GDP)	42.5	43.0	43.0	44.0
Source: Goldman Sachs Global Investment Research.				

Inflation Near Target Upper Limit



Central Bank Cut Rate by 25bp to 5.00% in October



Mexico

	2016	2017F	2018F	2019F
Activity and Prices				
Real GDP Growth (% yoy)	2.9	2.1	2.1	3.1
Nominal GDP (US\$ bn)	1077	1158	1229	1373
Consumer Prices (yoy, e.o.p.)	3.4	6.2	3.7	3.0
External Sector				
Current Account (% GDP)	-2.2	-1.7	-2.0	-1.9
Trade Balance (% GDP)	-1.2	-0.9	-0.7	-0.7
Exports (% yoy)	-1.7	8.1	4.8	4.9
Imports (% yoy)	-2.1	7.3	4.2	5.0
Exchange Rate (\$/MXN, e.o.p.)	20.73	19.00	18.50	18.04
Net International Reserves (US\$ bn)	176.5	173.0	178.0	188.0
Monetary Sector				
Monetary Base (% yoy)	14.4	9.0	12.0	12.0
Credit to the Private Sector (% GDP)	18.0	18.1	18.5	18.7
Tasa de Fondeo Rate (e.o.p.)	5.75	7.00	7.00	6.00
Fiscal Sector				
Public Sector Primary Balance (% GDP)	-0.1	1.4	0.9	0.9
Public Sector Overall Balance (% GDP)	-2.5	-1.3	-2.0	-2.0
Debt Indicators				
Gross Federal Govt Debt (% GDP)	48.7	47.4	47.3	46.5
Domestic (% GDP)	30.9	30.3	30.0	29.5
External (% GDP)	17.8	17.1	17.3	17.0
Total External Debt (% GDP)	38.5	39.3	40.4	42.3

Note: *Public Sector Borrowing Requirements

Source: Goldman Sachs Global Investment Research.





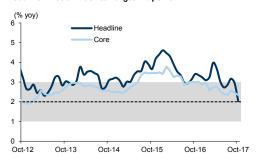
Source: Haver Analytics; INEGI; Goldman Sachs Global Investment Research.

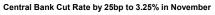
Peru

	2016	2017F	2018F	2019F
Activity and Prices				
Real GDP Growth (% yoy)	4.0	2.8	4.2	4.0
Nominal GDP (US\$bn)	195	215	234	255
Consumer Prices (% yoy, eop)	3.2	2.0	2.5	3.0
External Sector				
Current Account (% GDP)	-2.7	-1.9	-2.1	-2.1
Trade Balance (% GDP)	1.0	2.0	1.5	1.2
Exports (% yoy)	7.6	14.9	4.4	8.1
Imports (% yoy)	-5.9	8.7	7.2	10.1
Gross International Reserves (US\$bn)	61.7	64.5	65.0	65.6
Exchange Rate (\$/PEN, e.o.p.)	3.36	3.25	3.15	3.10
Monetary Sector				
Monetary Base (% yoy)	4.1	15.5	9.8	10.5
Credit to the Private Sector (% GDP)	24.3	25.0	27.0	29.0
Reference Interest Rate (e.o.p.)	4.25	3.25	4.00	4.25
Fiscal Sector				
Non-fin Pub. Sector Primary Balance (% GDP)	-1.5	-1.9	-2.3	-1.6
Non-fin Pub. Sector Overall Balance (% GDP)	-2.6	-3.1	-3.5	-2.8
Debt Indicators				
Total Federal Govt Debt (% GDP)	23.8	25.3	27.1	28.6
Domestic Public Debt (% GDP)	13.5	14.5	15.7	16.8
External Public Debt (% GDP)	10.3	10.8	11.4	11.8
Total External Debt (% GDP)	38.2	38.7	39.6	40.3

Source: Goldman Sachs Global Investment Research.

Headline Inflation Back to Target Midpoint







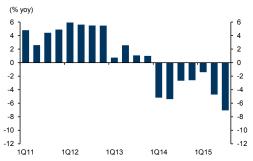
Source: BCRP; INEI; Goldman Sachs Global Investment Research.

Venezuela

	2015F	2016F	2017F	2018F
Activity and Prices				
Real GDP Growth (% yoy)	-6.2	-16.5	-12.1	-6.0
Nominal GDP (US\$bn)*	243	236	215	208
Consumer Prices (yoy, e.o.p.)	180.9	294.4	920.4	841.1
External Sector				
Current Account (% GDP)*	-7.5	-3.7	-0.7	0.6
Trade Balance (% GDP)*	0.2	2.8	5.8	7.0
Exports (% yoy)	-50.0	-33.0	22.2	11.3
Imports (% yoy)	-26.9	-46.8	-1.8	7.3
Exchange Rate (\$/VEF, e.o.p.)	6.3	10.0	10.0	25.0
Gross International Reserves (US\$bn)	16.4	11.0	8.7	7.0
Monetary Sector				
Monetary Base (% yoy)	111	160	180	150
Credit to the Private Sector (% GDP)	17.1	8.8	3.0	0.7
90-day Deposit Rate (e.o.p.)	15.1	15.5	17.0	21.0
Fiscal Sector**				
Public Sector Primary Balance (% GDP)	-15.6	-15.6	-16.4	-16.6
Public Sector Overall Balance (% GDP)	-17.7	-17.8	-18.5	-18.7
Debt Indicators				
Total Public Sector Debt (% GDP)*	87.8	100.2	132.2	112.4
Domestic (% GDP)*	37.5	43.1	66.3	41.2
External (% GDP)*	50.3	57.1	66.0	71.2
Total External Debt (%GDP)*	57.7	64.5	73.8	79.6

Source: Goldman Sachs Global Investment Research. *Based on IMF Nominal US\$ GDP due to FX distortions** Restricted Public Sector

From Recession to Depression (GDP yoy)

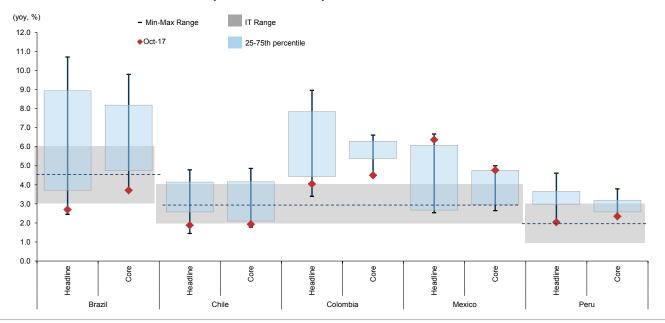


Source: BCV; Goldman Sachs Global Investment Research.



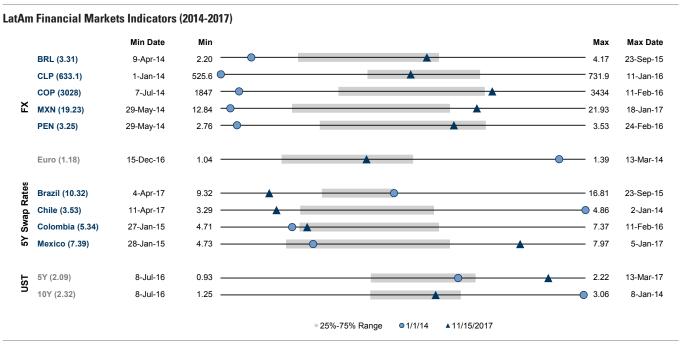
Source: BCV; Goldman Sachs Global Investment Research.

LAIT-5 Annual Headline and Core Inflation Dynamics Since January 2016



Source: Haver Analytics, Goldman Sachs Global Investment Research

LatAm Financial Markets Outlook



Source: Goldman Sachs Global Investment Research

Key Commodities Prices



Source: Goldman Sachs Global Investment Research

Latin America Swap Rates

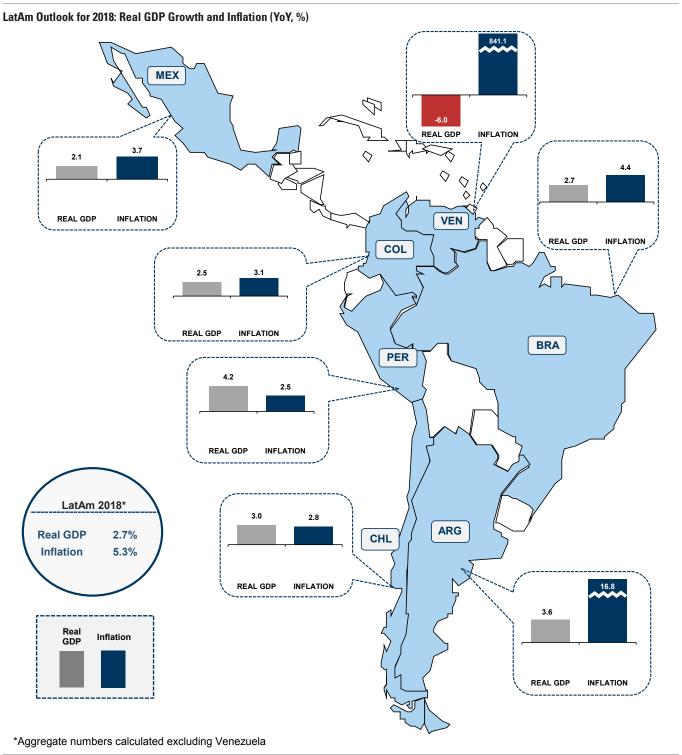
					Change S	ince (bps)
		End-2015	End-2016	Current (11/14/2017)	End-2015	End-2016
	Brazil					
	2y	16.53	11.05	8.49	-804	-255
	10y	16.52	11.66	11.06	-546	-59
	Chile					
	2y	4.04	3.06	2.76	-129	-31
	10y	4.78	4.17	4.14	-64	-3
	Colombia					
Swap Rates (%)	2y	6.26	5.61	4.58	-168	-103
	10y	7.44	6.57	6.27	-117	-30
	Mexico					
	2y	4.40	7.20	7.48	308	27
	10y	6.40	7.93	7.54	114	-39
	United States					
	2y	1.18	1.45	1.87	69	42
	10y	2.19	2.34	2.36	17	2

Source: Goldman Sachs Global Investment Research

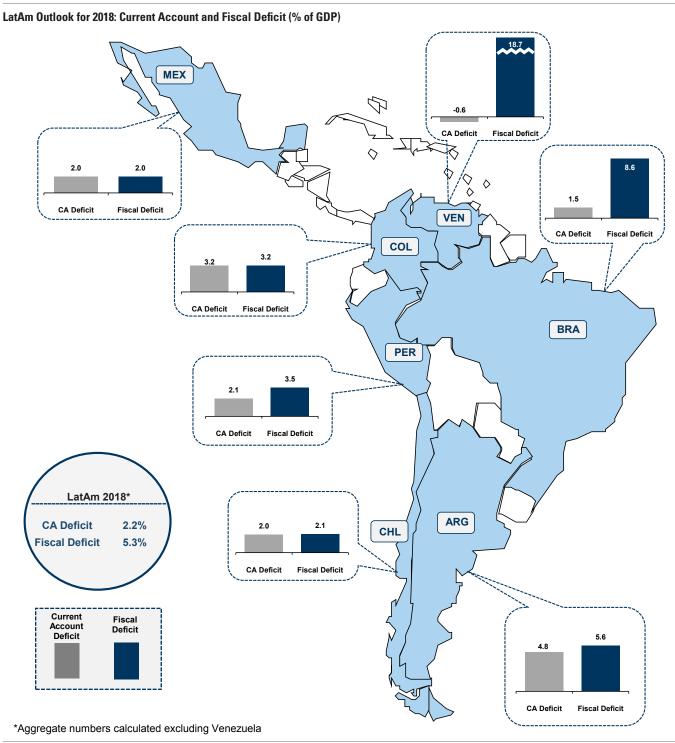
Latin America Forecasts

			Policy Rat	tes and FX L	_evels (End	of Period)		Implied Change by (Rates in bp; FX in %)		
		Current	4Q2017	1Q2018	2Q2018	3Q2018	4Q2018	4Q2017	1Q2018	2Q2018
	Brazil	7.50	7.00	7.00	7.00	7.00	7.00	-50	-50	-50
	Chile	2.50	2.50	2.50	2.50	2.50	3.00	0	0	0
Policy Rates (%)	Colombia	5.00	4.75	4.50	4.00	4.00	4.00	-25	-50	-100
	Mexico	7.00	7.00	7.00	7.00	7.00	7.00	0	0	0
	Peru	3.25	3.25	3.25	3.25	3.75	4.00	0	0	0
	Brazil	3.28	3.25	3.10	3.12	3.13	3.15	-0.9%	-5.5%	-5.0%
	Chile	629.30	625.5	616.7	611.7	606.7	605.0	-0.6%	-2.0%	-2.8%
	Colombia	3008.00	3000	3000	3000	3000	3000	-0.3%	-0.3%	-0.3%
FX (Local / USD)	Mexico	19.13	19.00	19.50	19.50	19.00	18.50	-0.7%	1.9%	1.9%
,	Peru	3.24	3.25	3.22	3.18	3.16	3.15	0.2%	-0.8%	-1.8%
	Argentina	17.50	17.65	18.22	18.80	19.41	20.03	0.9%	4.1%	7.5%
	Venezuela	9.99	10.00	10.00	10.00	25.00	25.00	0.1%	0.1%	0.1%

Source: Goldman Sachs Global Investment Research



Source: Goldman Sachs Global Investment Research



Source: Goldman Sachs Global Investment Research

Calendar of Economic and Political Events

Date	Forthcoming Events	Comment
Argentina		
21-Nov	MPC Meeting	We expect the BCRA to remain on hold at 28.75% given signs of inertia/persistence among core inflation indicators.
Brazil		
6-Dec	COPOM Meeting	We expect the Copom to cut the Selic policy by 50bp to a stimulative and record low 7.00%.
Chile		
14-Dec	MPC Meeting	We expect BCCh to hold the policy rate at 2.50%.
19-Nov	Presidential Election	Former president and center-right candidate Sebastian Piñera has kept his lead in the polls over leftist candidates Beatriz Sánchez and senator Alejandro Guillier.
Colombia		
24-Nov	MPC Meeting	We expect Banrep to keep the policy rate on hold at 5.00%.
Mexico		
14-Dec	MPC Meeting	We expect Banxico to leave the policy rate unchanged at 7.00%. Small probability of a 25bp rate hike to match the expected FOMC 25bp rate increase.
Peru		
14-Dec	MPC meeting	We expect BCRP to hold the policy rate at 3.25%.

Source: Goldman Sachs Global Investment Research

Disclosure Appendix

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We, Alberto Ramos, Paulo Mateus and Gabriel Fritsch, hereby certify that all of the views expressed in this report accurately reflect our personal views, which have not been influenced by considerations of the firm's business or client relationships.

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