

## Latin America Economic Reference Presentation

EM, Latin America Economic and Policy Research

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**Ben Ramsey** <sup>AC</sup>  
(1-212) 834-4308  
benjamin.h.ramsey@jpmorgan.com  
J.P. Morgan Securities LLC

**Cassiana Fernandez** <sup>AC</sup>  
(55-11) 4950-3369  
cassiana.fernandez@jpmorgan.com  
Banco J.P. Morgan S.A.

**Gabriel Lozano** <sup>AC</sup>  
(52-55) 5540-9558  
gabriel.lozano@jpmorgan.com  
Banco J.P.Morgan, S.A., Institución de Banca Múltiple,  
J.P.Morgan Grupo Financiero

**Diego Pereira** <sup>AC</sup>  
(1-212) 834-4321  
diego.pereira@jpmorgan.com  
J.P. Morgan Securities LLC

**Cristiano Souza** <sup>AC</sup>  
(55-11) 4950-3913  
cristiano.souza@jpmorgan.com  
Banco J.P. Morgan S.A.

**Lucila Barbeito** <sup>AC</sup>  
(54-11) 4348-7229  
lucila.barbeito@jpmorgan.com  
JPMorgan Chase Bank Sucursal Buenos Aires

**Steven Palacio** <sup>AC</sup>  
(52 55) 5382-9651  
steven.palacio@jpmorgan.com  
Banco J.P.Morgan, S.A., Institución de Banca Múltiple,  
J.P.Morgan Grupo Financiero

**Katherine Marney** <sup>AC</sup>  
(1-212) 834-2285  
katherine.v.marney@jpmorgan.com  
J.P. Morgan Securities LLC

**Vinicius Moreira** <sup>AC</sup>  
(1-212) 834-4144  
vinicius.moreira@jpmorgan.com  
J.P. Morgan Securities LLC

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# Agenda

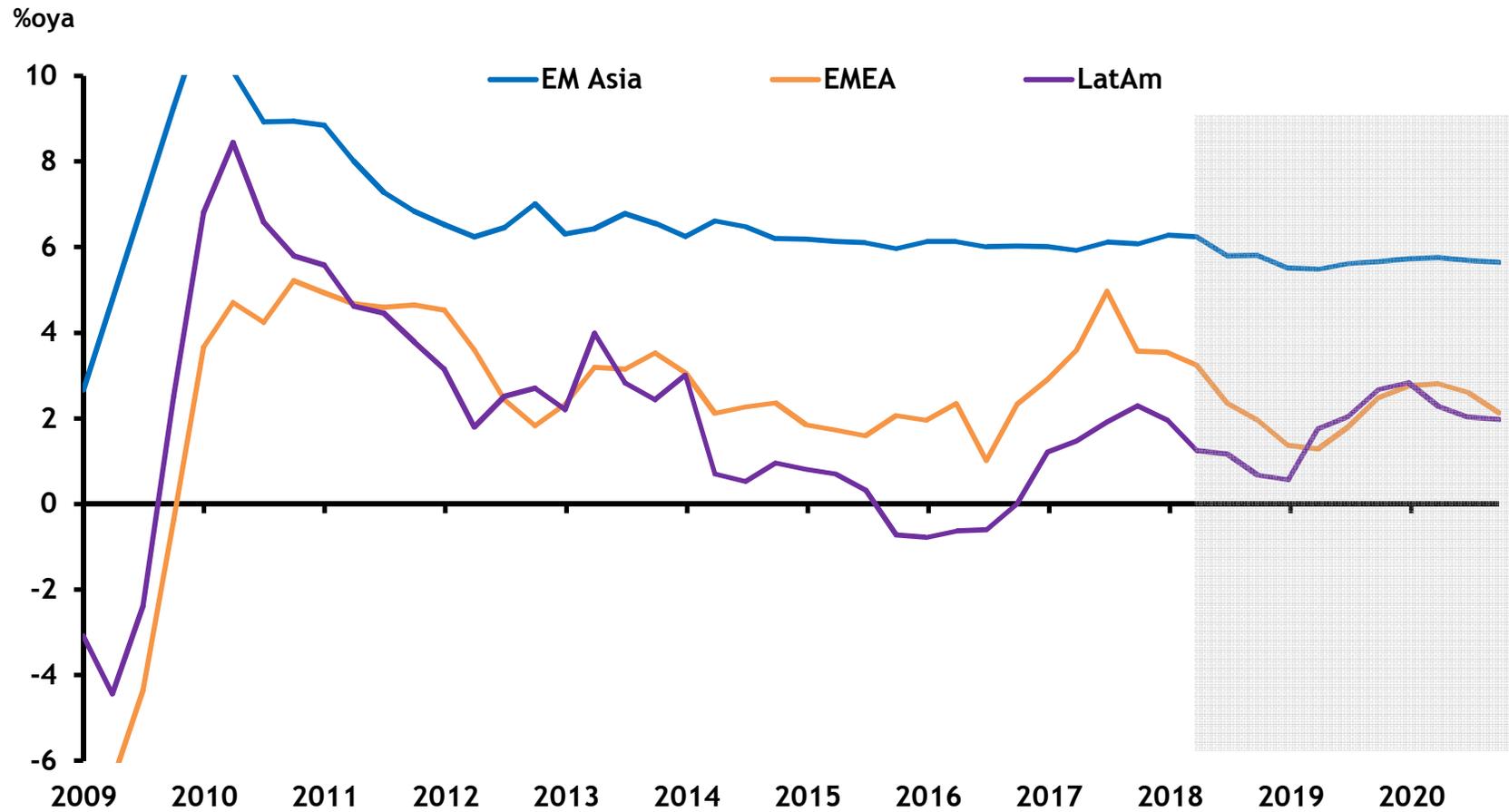
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## Latin America: The external backdrop is better than feared, but domestic factors gain even more focus in the big three economies

- With prospects of a US-China trade truce and the Fed shifting to the dovish side, the negative external tone seems to have faded, leaving domestic narratives in the spotlight. A tepid growth recovery in the region will be led by Brazil, with Mexico sliding and Argentina searching for green shoots. The market based Andean economies are seeing solid growth around potential, while the Venezuelan crisis is reaching a climax.
- **Brazilian** President Bolsonaro presented a broader proposal for social security reform (SSR) than the one his predecessor saw stall in Congress. According to government estimates, in 10 years the current proposal will save BRL1.07 trillion, significantly higher than the BRL780 billion we estimated Temer proposed (later reduced to about BRL470 billion). Bolsonaro has shown strong public commitment to what looks like a very solid proposal, increasing the chances of a more robust reform being approved. But starting the process from scratch adds to its length and increases the risk of not getting a deal. In other words, the tails of probability are now fatter.
- Combined with a better global backdrop, this past month we've softened our outlook for BRL, inflation and the policy rate. The looser financial conditions will support growth this year, even if external demand now looks softer. The disaster in a mining region recently, which in our calculations may shave off a tenth or two of this year's GDP, also weighs on our growth forecasts. We therefore keep our 2019 GDP forecast at 2.3% (compared to potential around 2.0%), but raising the 2020 forecast to 2.5%.
- In **Mexico**, 4Q data disappointed, weaker carry-over into 2019 has led us to also cut this year's growth forecast to 1.7% from 1.9% before. This would mark a step-down from last year's expected 2% gain and the third consecutive year of below-trend growth.
- In **Argentina**, a less pronounced contraction for the last quarter of 2018 lifts our 2019 GDP growth estimate, as the statistical carryover diminishes. We thus revised 2019 GDP to -1.2%/y, from -1.5%/y. We maintain our base-case scenario for sequential activity growth to resume in 2Q19, though the risk is skewed to an earlier recovery. However, confidence should remain fragile in a critical election year.
- On the **central bank** front, we see similar pause, but an opposite stance, in Brazil and Mexico. In **Brazil**, inflationary pressures should remain muted with anchored inflation expectations, subdued economic growth and stronger BRL. Thus, we believe that the Central Bank (CB) can maintain a stimulative monetary policy stance for longer. We are now looking for flat Selic rate this year down from our previous 8.25% estimate. Lower inflation forecasts, given the improvement in domestic and global outlook, may stimulate markets to flirt with rates cuts. However, we think that the CB would cautiously wait for more progress on the approval of the reforms.
- **Mexico** will continue to emphasize the importance of monitoring the Fed's stance, but in our view, the main focus will remain on domestic factors, namely inflation expectations, economic activity, and as has been the case recently, risks related to credit downgrades and changes in policy actions from the new government. We now see the policy rate unchanged at 8.25% until 1Q20.
- **Argentina's** BCRA returned to a cautious monetary stance following last week's January CPI print, which came above market expectations and triggered an upward revision in expected inflation, driving USDARS back into the non-intervention zone. The BCRA reacted to the FX depreciation amid a deteriorated inflation outlook by shifting its recent dovish stance into a restrictive one: it announced that it will undershoot the February's monetary base target. **Andean** CBs are biased to normalize rates higher, but a dovish Fed and low inflation removes pressure.

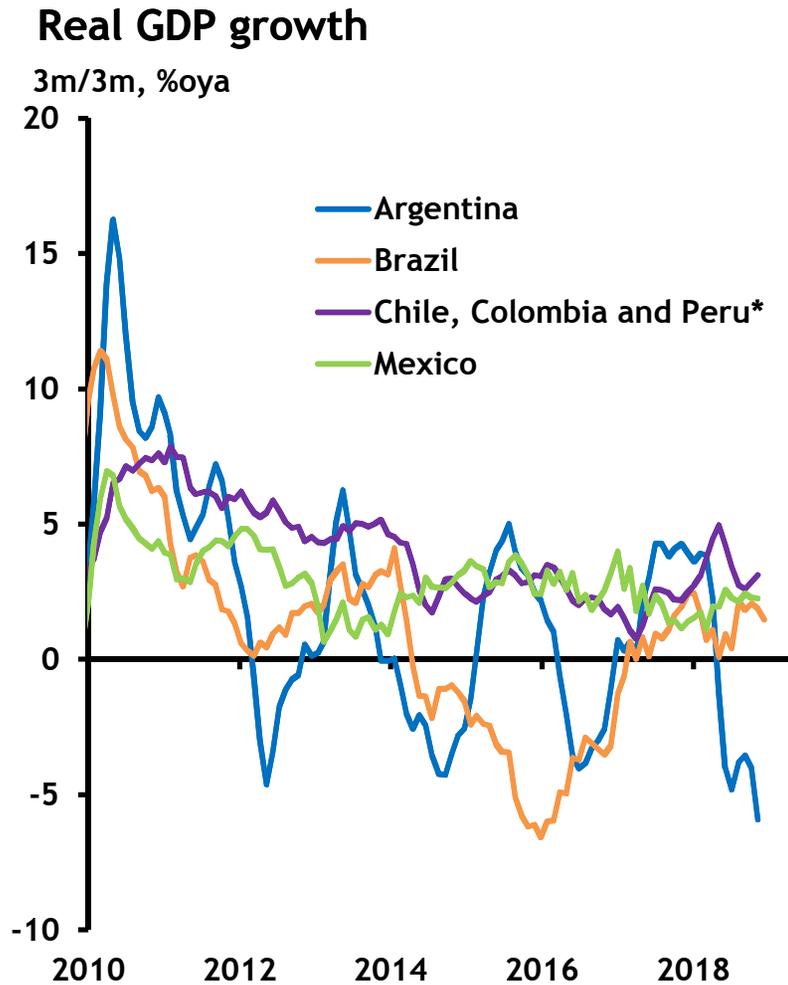
# Not fast, but faster: Latam “bolsters” EM growth in 2019

## Latin American growth is catching up

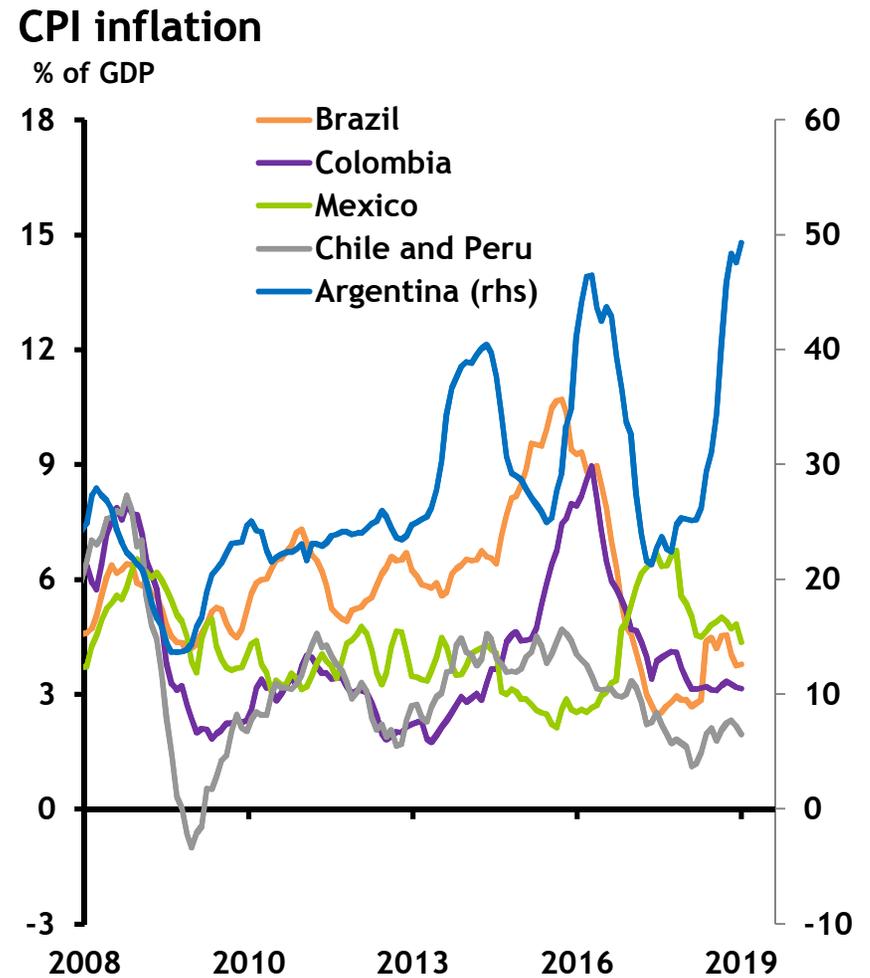


Source: J.P. Morgan

# Latin America: Growth is trading water below potential while inflation remains modest in the South American targeters and decelerating in Mexico



Source: J.P. Morgan \*simple average



Source: J.P. Morgan \*simple average

# A mixed bag within regional growth as it recovers to its (low) potential

## Real GDP growth forecasts (%oya, except quarterly data)

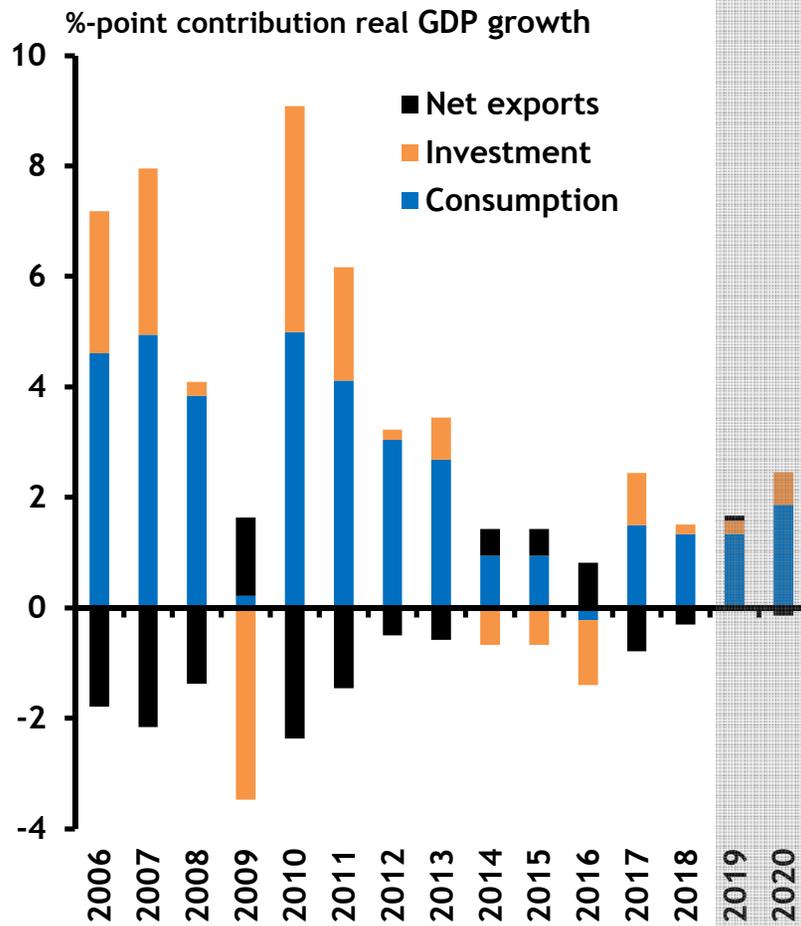
	2018	2019	2019 (%q/q, saar)				2020	Potential
			1Q19	2Q19	3Q19	4Q19		
<b>Latin America*</b>	<b>1.3</b>	<b>1.7</b>	<b>1.6</b>	<b>3.6</b>	<b>3.0</b>	<b>2.5</b>	<b>2.4</b>	<b>2.3</b>
Argentina	-2.7	-1.5	-0.1	6.0	4.0	3.0	2.6	2.5
Brazil	1.2	2.3	1.8	3.8	3.2	2.4	2.5	2.0
Chile	3.9	3.5	4.0	4.2	4.0	3.8	3.0	3.2
Colombia	2.7	3.1	2.8	4.5	3.5	3.5	3.1	3.3
Ecuador	1.1	-0.2	1.0	-1.5	-2.0	-1.0	-0.8	2.3
Mexico	2.0	1.5	0.8	2.0	1.8	2.0	1.7	2.4
Peru	4.0	3.9	4.5	4.0	4.0	4.0	3.6	3.5
Uruguay	2.1	1.9	2.0	3.0	4.0	2.0	1.7	2.5
Venezuela	-10.0	-					-	

Source: National statistical agencies, J.P. Morgan estimates

\*Note: Aggregate is WEIGHTED average ex- Venezuela

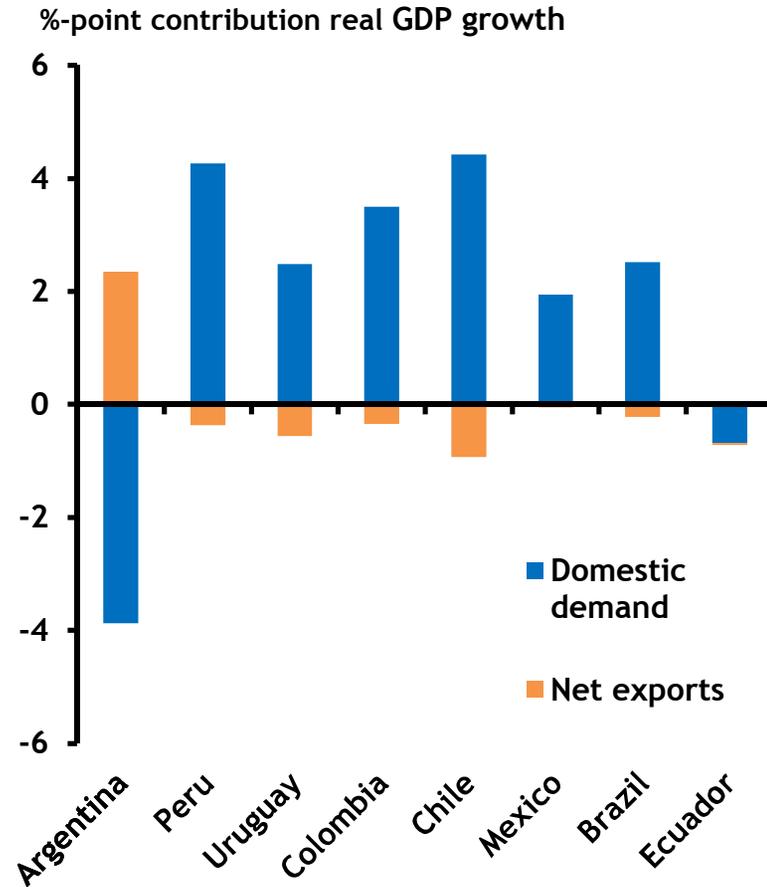
# Domestic demand rebound remains muted, finally with a little push from investment

## GDP growth in Latin America\*



Source: J.P. Morgan forecasts \*GDP weighted

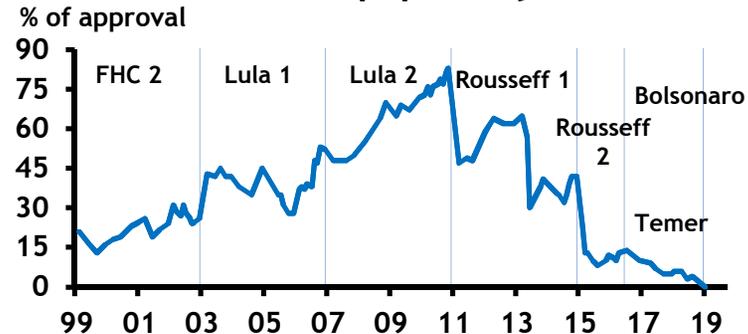
## Domestic demand in 2019



Source: J.P. Morgan

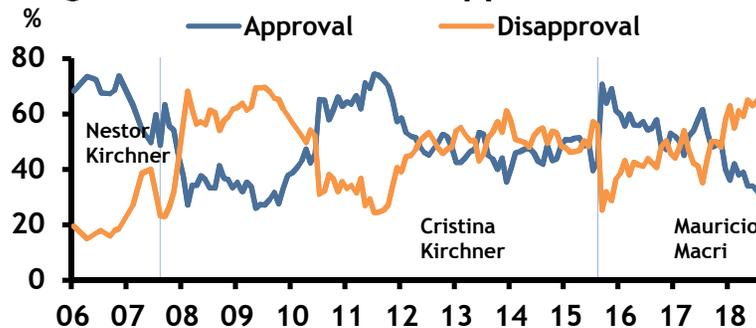
# Election cycle over, but politics still matter to set and execute agendas

## Brazil: Government popularity



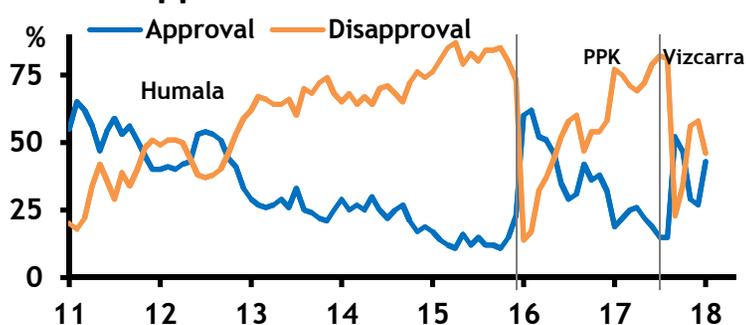
Source: Datafolha; XP/Ipespe for Bolsonaro as president-elect

## Argentina: Government approval



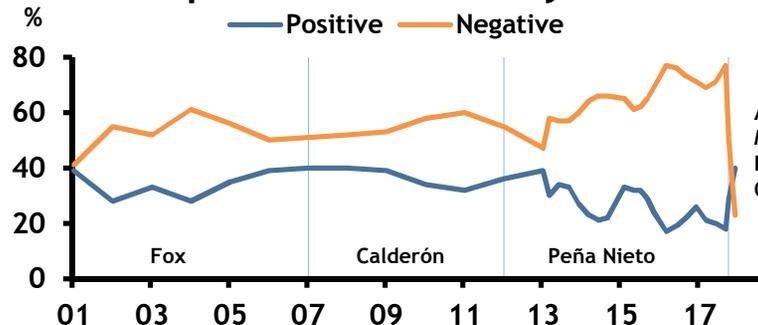
Source: Poliarquia

## Peru: Approval of the President



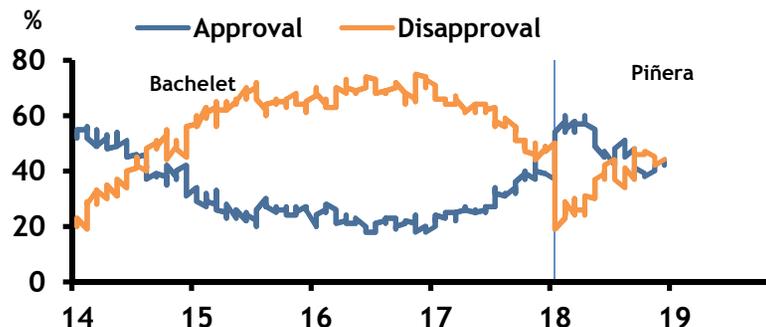
Source: GFK, Datum for first survey for Vizcarra

## Mexico: Opinion on the country's outlook



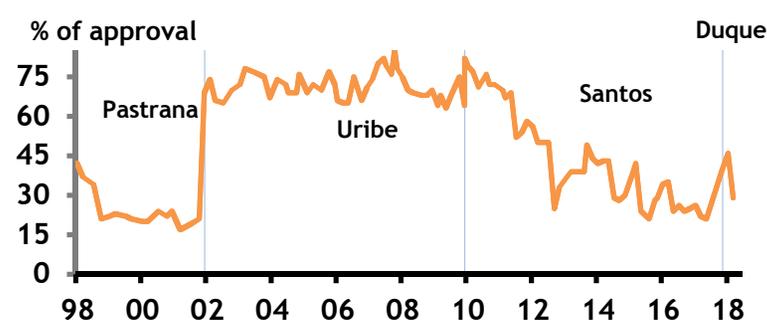
Source: Consulta Mitofsky; AMLO as president-elect in November 2018

## Chile: Approval and Disapproval rates



Source: Cadem

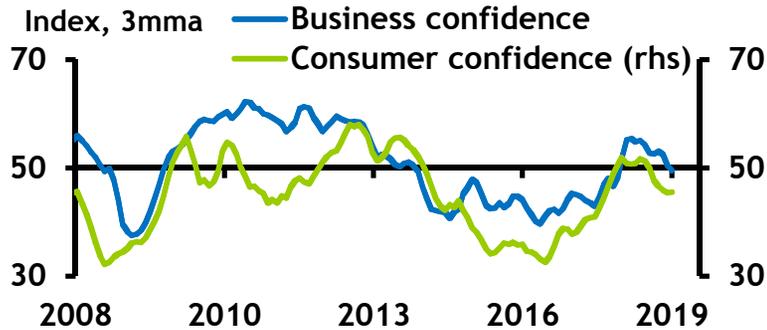
## Colombia: Approval of the President



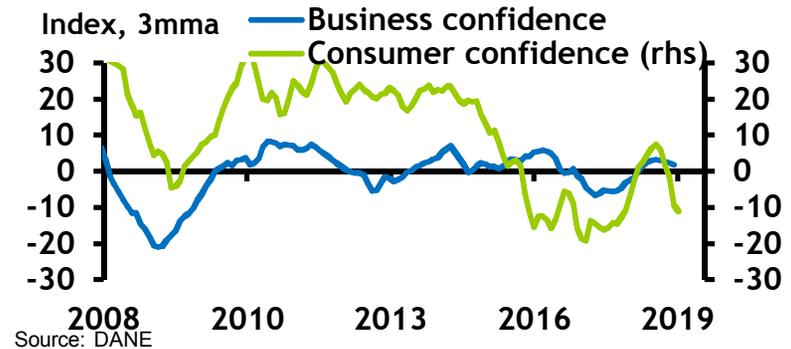
Source: Gallup

# Confidence indicators improved in Colombia, Chile and now Mexico, but there may be risks ahead; elsewhere, they are less than stellar

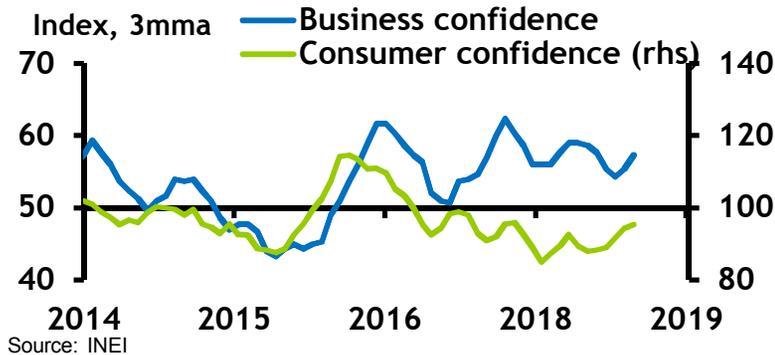
## Chile



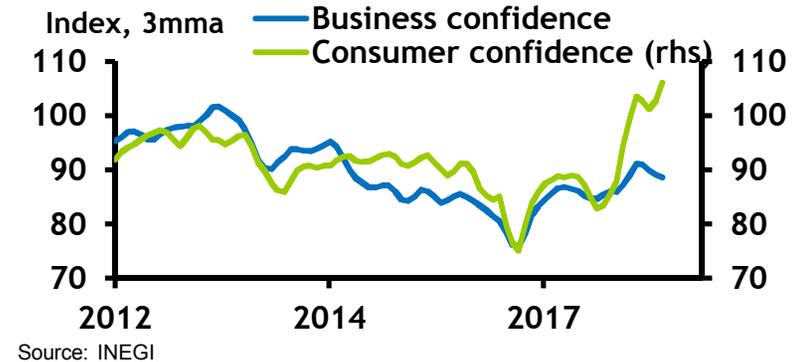
## Colombia



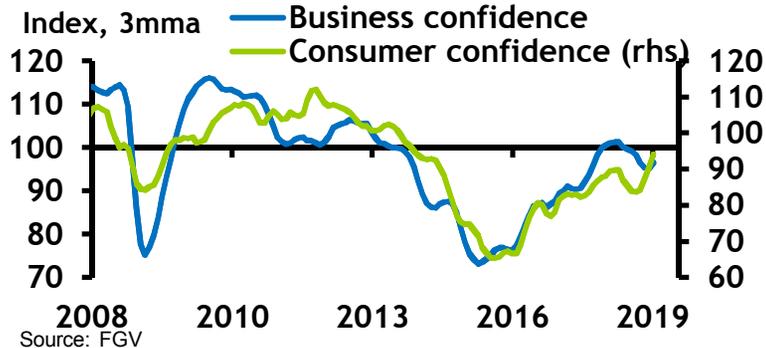
## Peru



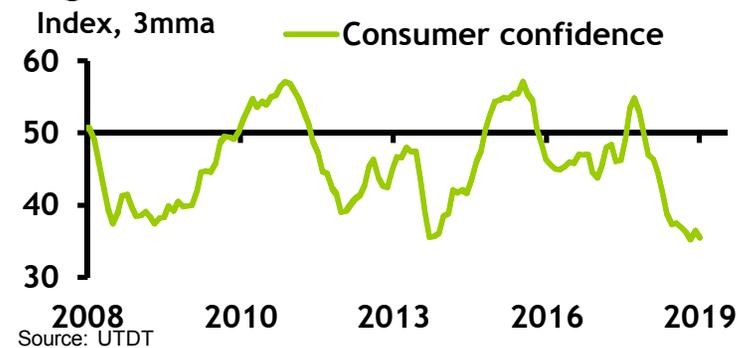
## Mexico



## Brazil

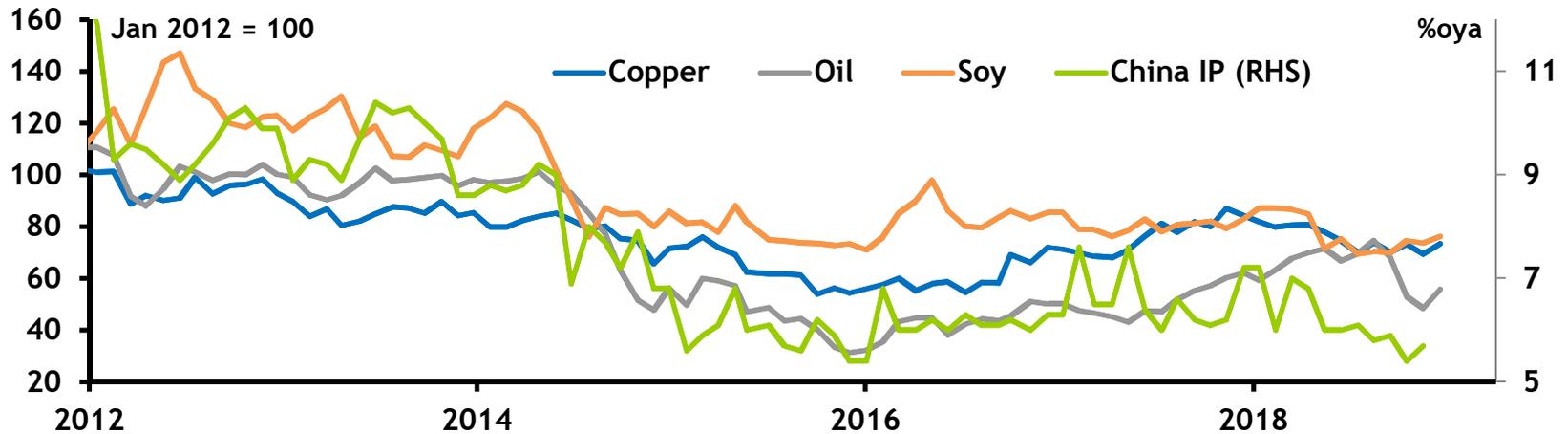


## Argentina



# The more things change, the more they stay the same: Commodities prices remain the dominant transmission channel of shocks

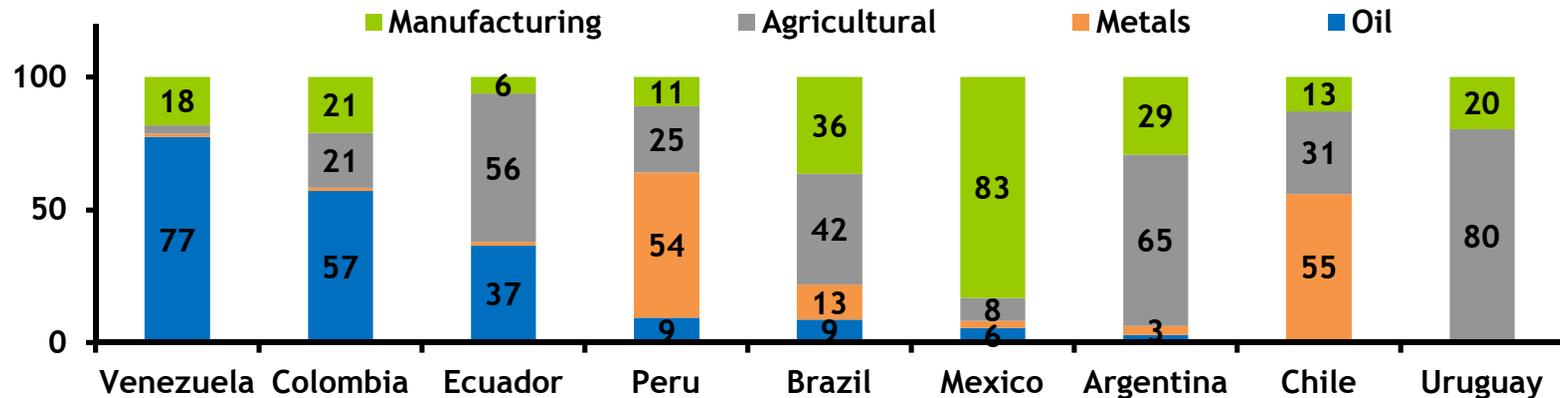
## Key commodity prices versus Chinese industrial production growth



Source: Bloomberg and J.P. Morgan

## Participation in total exports

As % of total exports, 2017

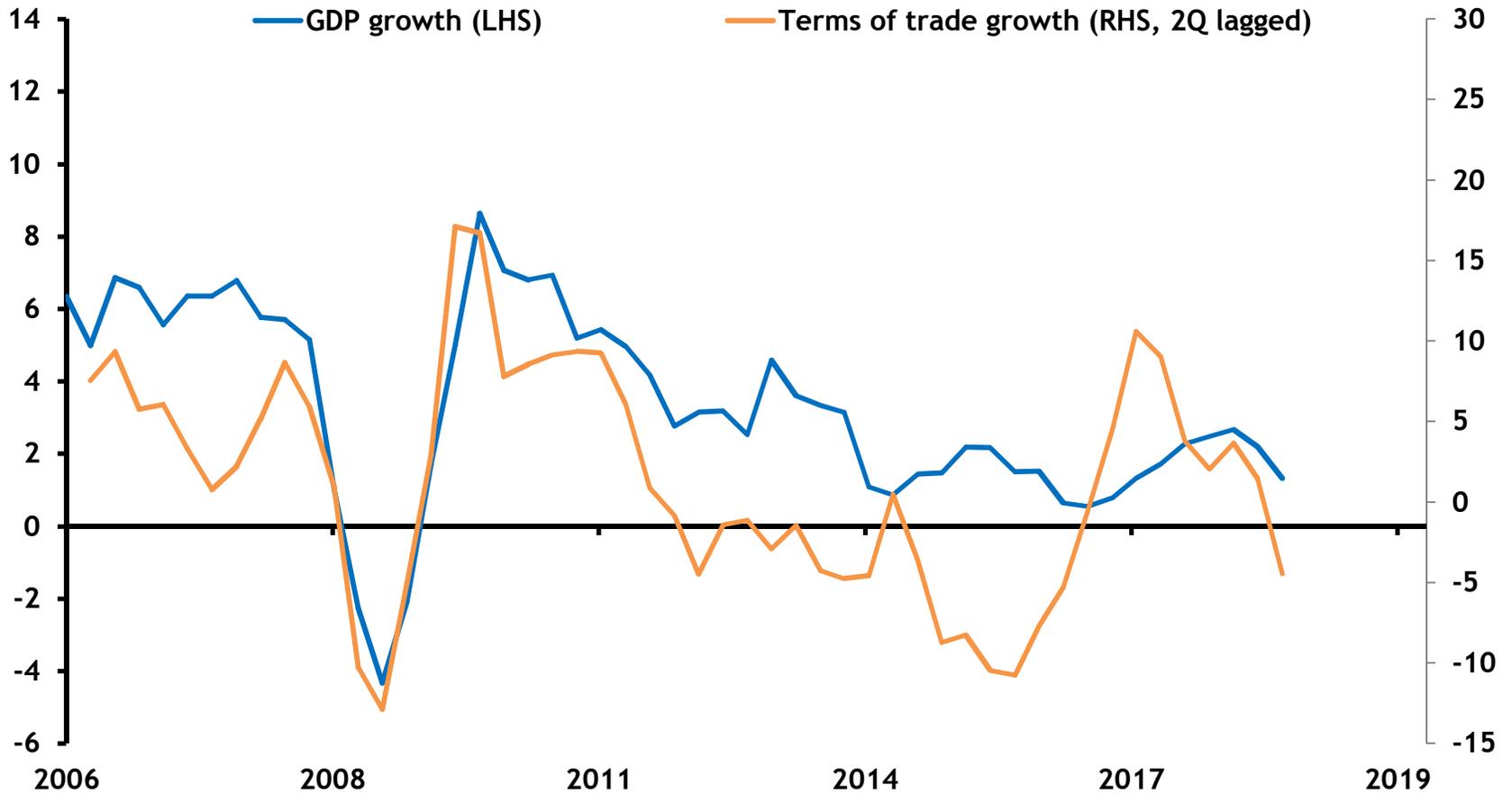


Source: UNCTAD and J.P. Morgan \*Does not include gold and precious stones

# Terms of trade had improved, but the outlook ahead may be more challenging given global risks

## Growth and terms of trade\*

%oya, quarterly

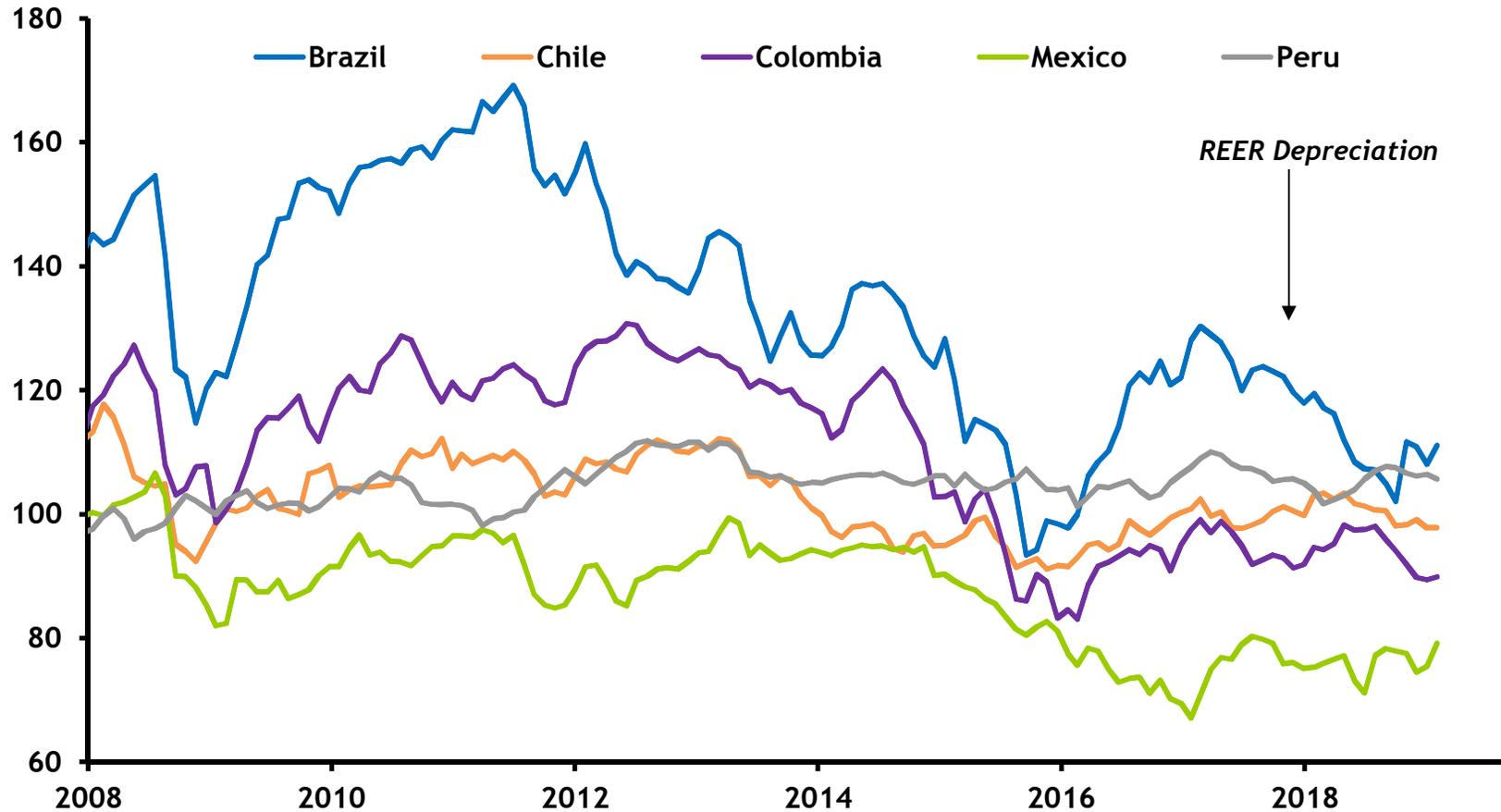


Source: J.P. Morgan  
\*Non-weighted average growth

# Real exchange rates adjusted after 2015 but now are drifting lower again

## Multilateral real exchange rate

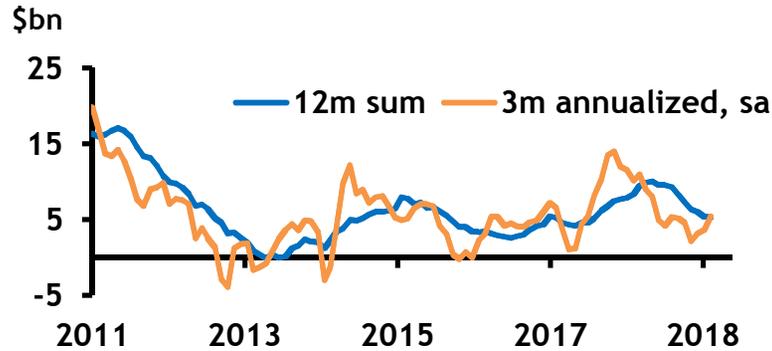
levels, 2005=100



Source: J.P. Morgan.

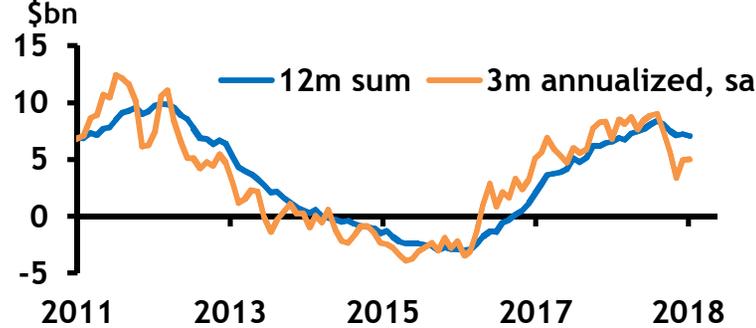
# Trade balances initially stabilized after 2015 due to import compression; Brazil has the largest cushion

## Chile: Trade balance



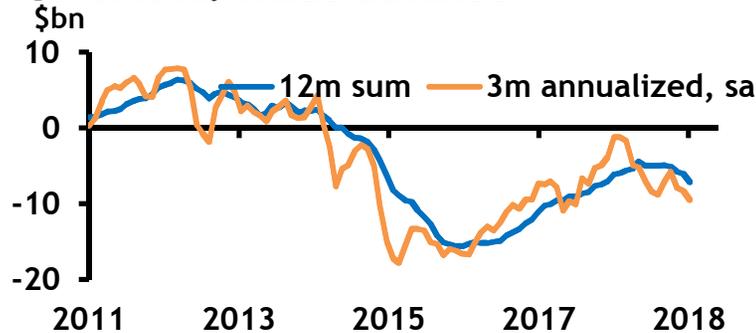
Source: INE, J.P. Morgan seasonal adjustment

## Peru: Trade balance



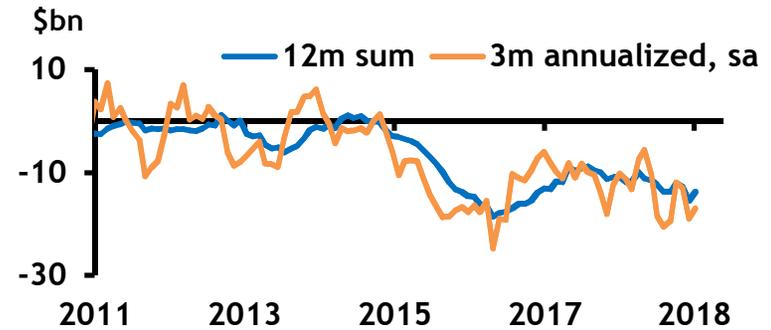
Source: INEI, J.P. Morgan seasonal adjustment

## Colombia: Trade balance



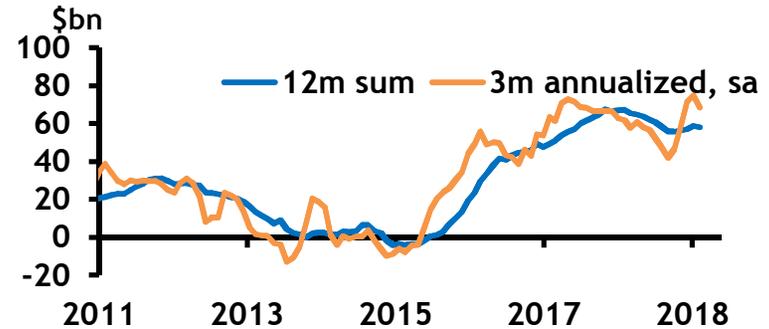
Source: DANE, J.P. Morgan seasonal adjustment

## Mexico: Trade balance



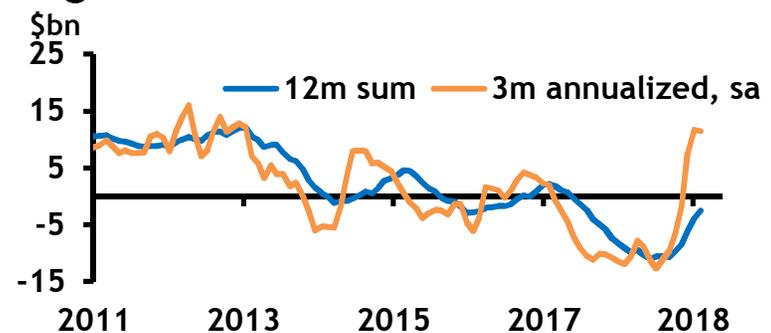
Source: INEGI, J.P. Morgan seasonal adjustment

## Brazil: Trade balance



Source: MDIC, J.P. Morgan seasonal adjustment

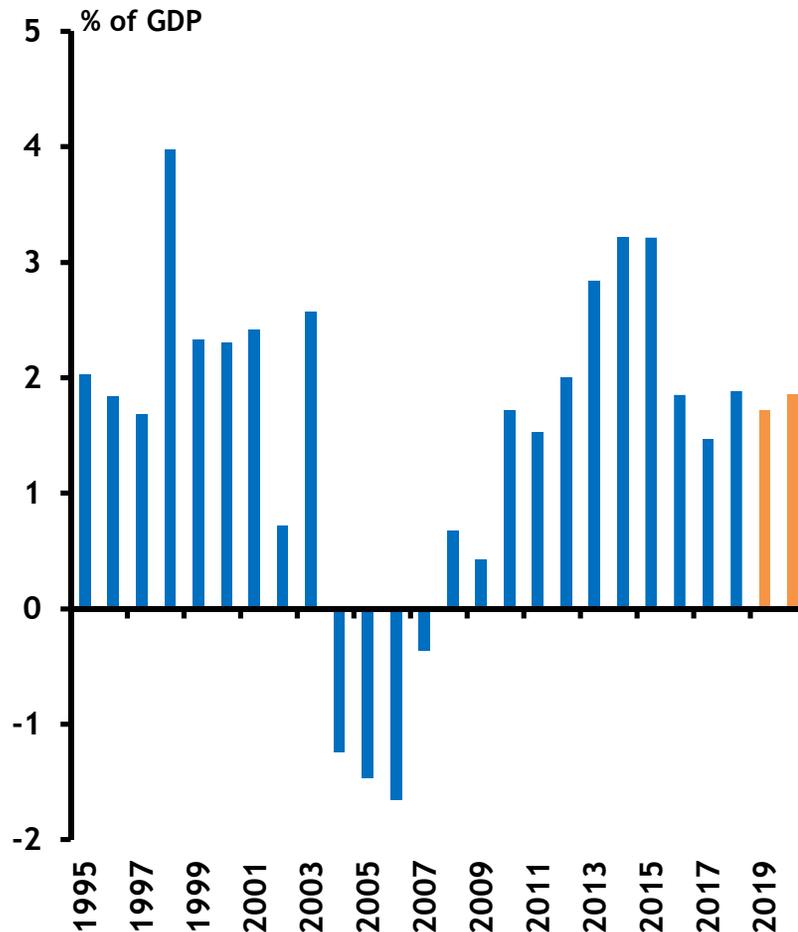
## Argentina: Trade balance



Source: INDEC, J.P. Morgan seasonal adjustment

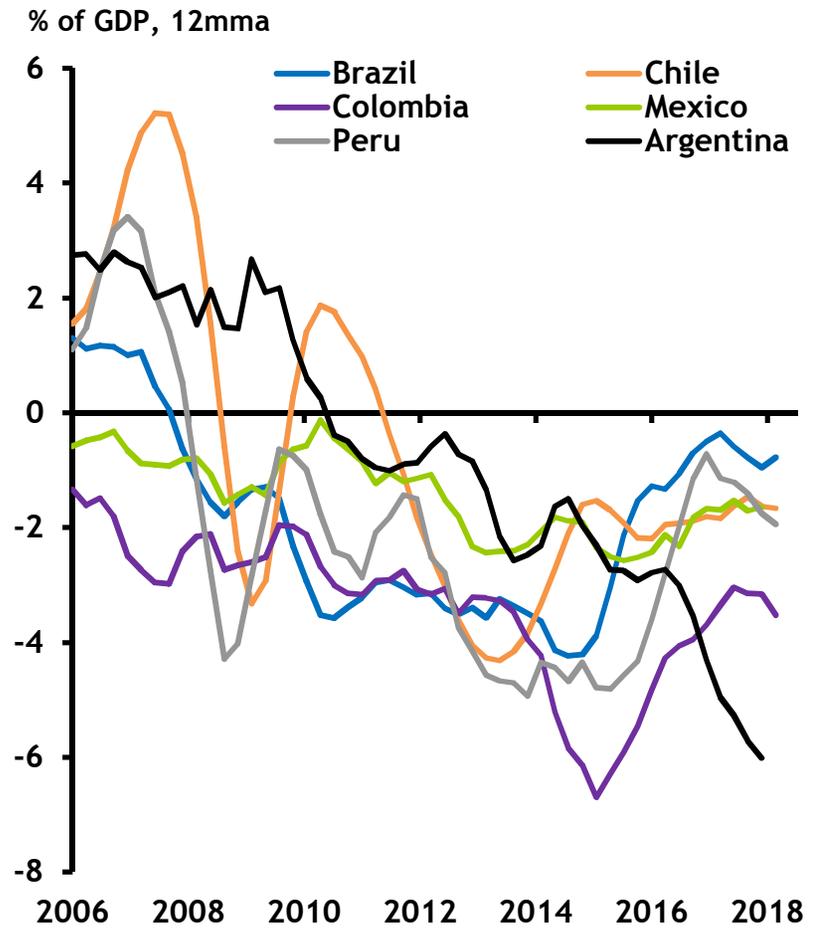
# FX adjustment and subpar growth helped narrow current account deficits, while Argentina has widened (but is now quickly closing)

## Aggregate current account deficit



\* Regional CAD includes Argentina, Brazil, Chile, Colombia, Ecuador, Mexico, Peru, Uruguay, and Venezuela, weighted by nominal GDP  
Source: J.P. Morgan

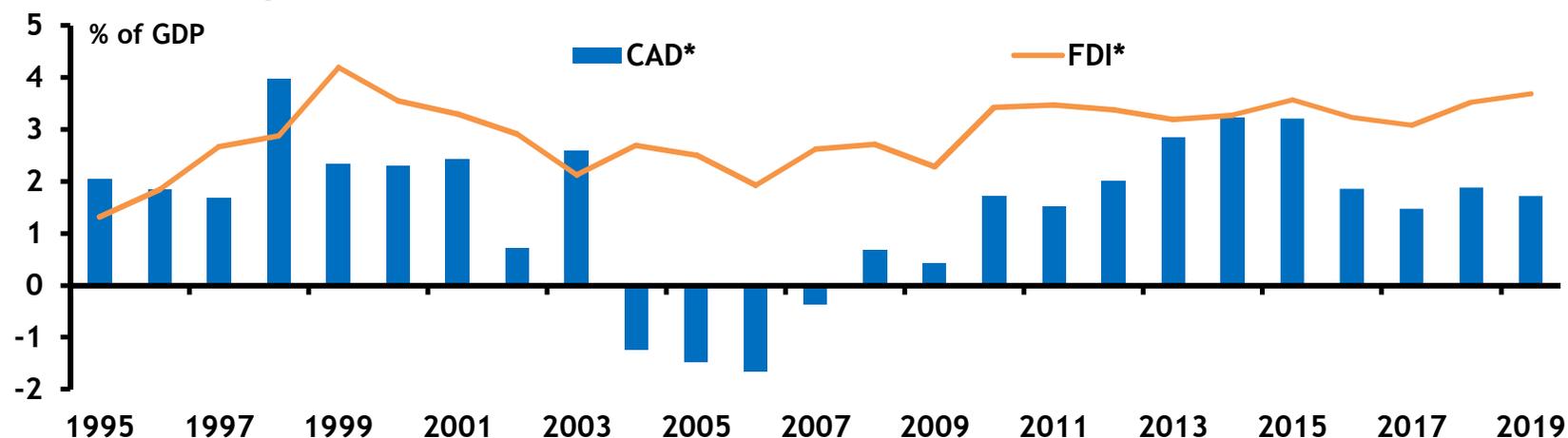
## Single-country current account balances



Source: J.P. Morgan.

## For the region, FDI inflows exceed the CAD

### FDI and CAD performance and forecast



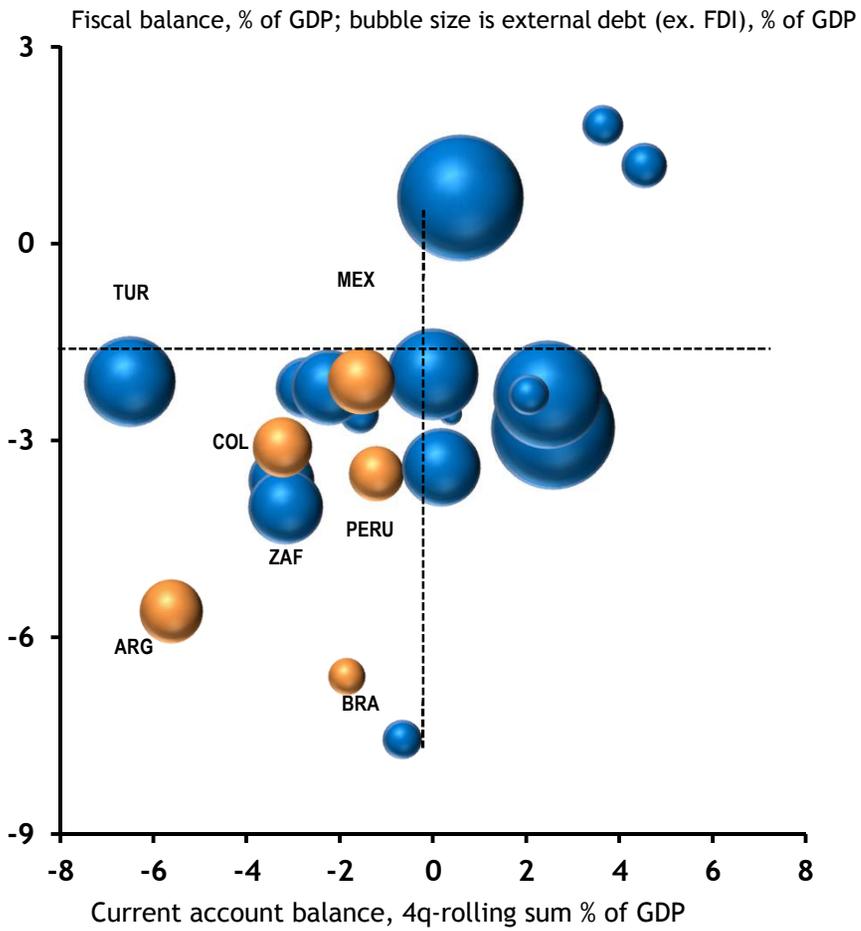
### FX reserves, FDI and current account balances

% GDP	Current account balance					FDI inflows (\$bn)				FX reserves (eop, \$bn)			
					2019f								
	2017	2018	2019f	2020f	(\$bn)	2017	2018	2019f	2020f	2017	2018	2019f	2020f
<b>Latin America*</b>	<b>-1.0</b>	<b>-1.4</b>	<b>-1.7</b>	<b>-1.9</b>	<b>-82.1</b>	<b>132.6</b>	<b>151.8</b>	<b>153.0</b>	<b>159.0</b>	<b>806</b>	<b>807</b>	<b>819</b>	<b>822</b>
Argentina	-4.8	-5.1	-1.8	-2.3	-7.4	8.5	7.0	4.0	10.0	56.2	55.2	65.2	71.2
Brazil	-0.3	-0.8	-1.2	-1.5	-25.5	68.5	85.0	90.0	95.0	382.0	388.0	392.0	396.5
Chile	-1.0	-1.4	-1.9	-2.3	-5.7	6.4	10.0	8.0	6.0	36.5	37.3	37.3	37.3
Colombia	-3.4	-3.5	-3.5	-3.5	-12.2	14.5	13.0	13.0	13.0	46.8	46.8	46.8	46.8
Ecuador	-0.3	0.1	0.3	0.2	-0.3	0.5	0.5	0.5	0.5	2.4	2.1	2.4	3.1
Mexico	-1.6	-2.0	-2.2	-2.3	-27.6	29.7	30.0	30.0	28.0	173.4	173.9	174.4	174.9
Peru	-1.1	-1.6	-1.8	-1.6	-4.4	5.6	7.0	6.0	5.0	64.6	62.6	63.1	61.1
Uruguay	0.7	-0.4	-0.7	0.4	-0.4	-1.1	-0.7	1.5	1.5	33.2	32.0	30.5	31.5

Source: J.P. Morgan  
 \* GDP weighted  
 ex Venezuela;

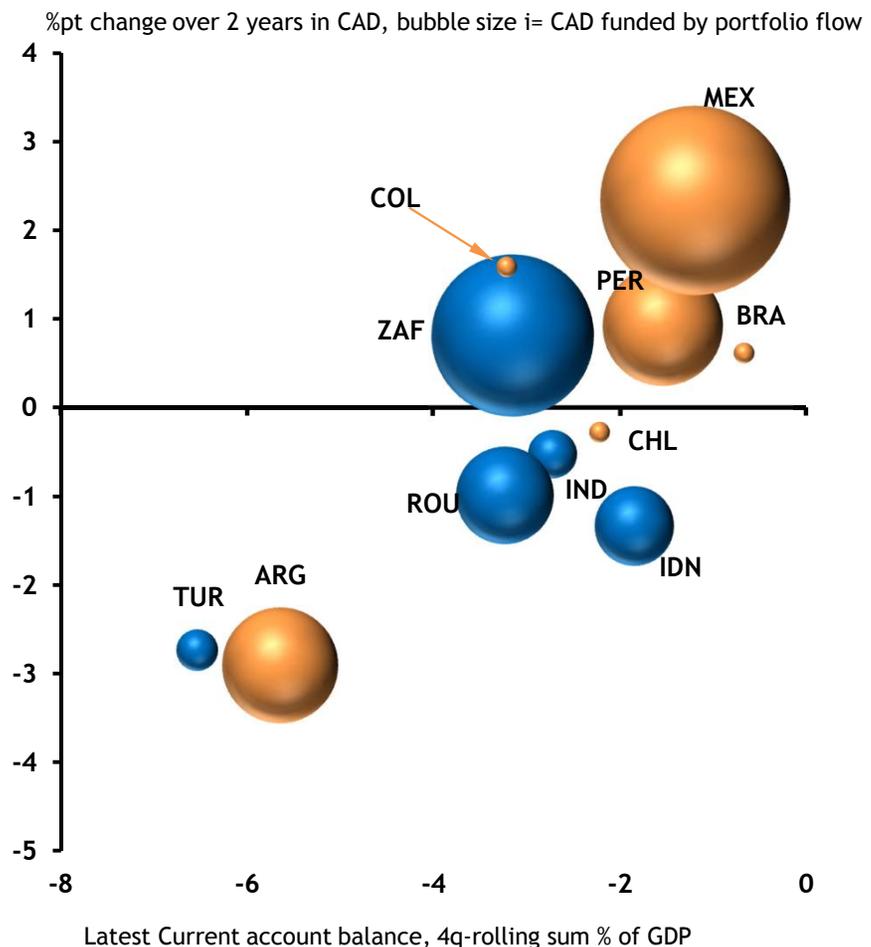
# After Argentina, the rest of LatAm appears less vulnerable, and a dovish Fed removes pressure

## EM Fiscal and external balances



Source: J.P. Morgan

## CADs have narrowed in the region



Source: J.P. Morgan

# Significant depreciation poses risk to inflation for big three economies

## FX depreciation and passthrough to inflation

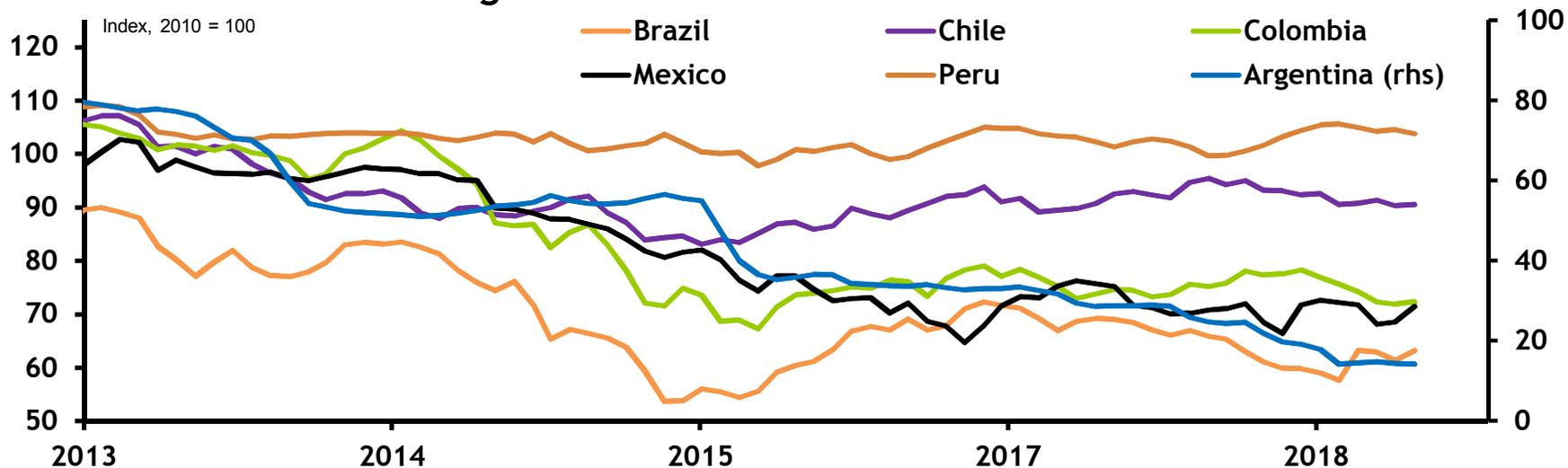
	FX change (avg Dec'14/Dec'15) <sup>1</sup>	Tradables (Dec'15/Dec'14) <sup>2</sup>	FX change (avg Sep'17/Sep'18) <sup>1</sup>	Tradables CPI (Sep'17/Sep'18) <sup>2</sup>	Estimated impact of 1% FX depreciation on headline inflation (in bp)
Argentina	32%	30%	124%	25%	20-30
Brazil	47%	6.6%	31%	1.7%	5.5
Chile	15%	4.7%	9%	2.3%	12-14
Colombia	38%	7.1%	4%	1.6%	5
Mexico	18%	2.9% <sup>2</sup>	7%	3.2%	6.5
Peru	14%	4%	2%	2.7%	10-12

1. Positive indicates stronger USD vs local currency

2. Ex food and fuel, except in Argentina; note in Mexico tax reform depressed tradables by about 1%pt in 2014.

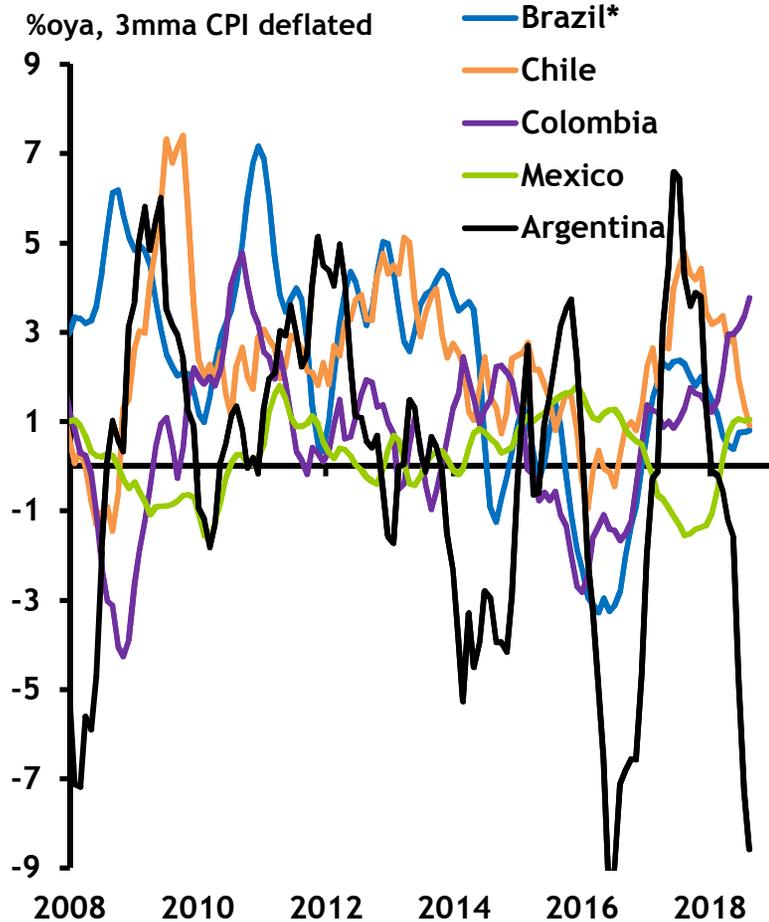
Source: J.P. Morgan estimate

## Nominal effective exchange rate



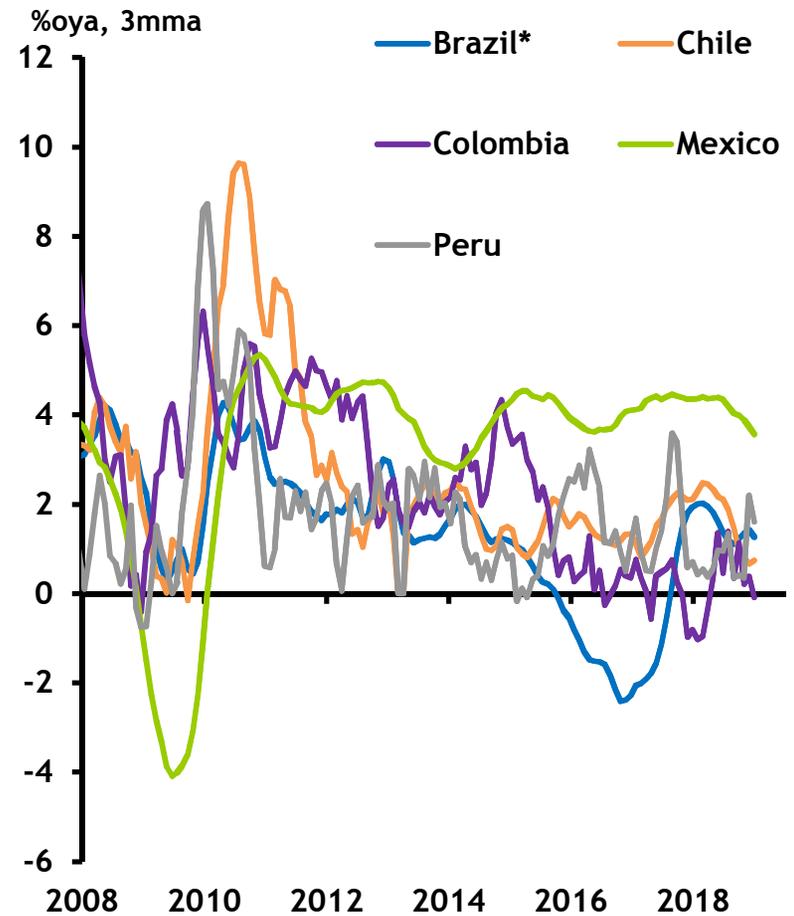
# Labor markets and real wages broadly supportive of demand

## Real wage growth



Source: J.P. Morgan \*Old and new series

## Employment growth



Source: J.P. Morgan \*Old and new series

## Inflation to moderate in Mexico and – from a high level – Argentina but to accelerate a tad in Brazil, Colombia and Chile

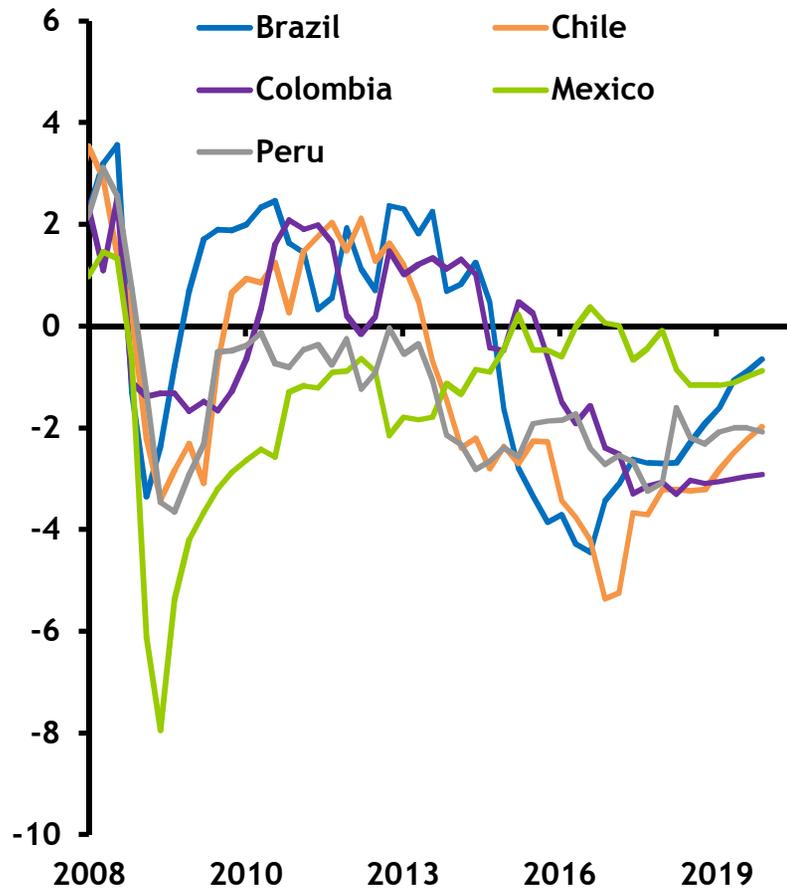
### Headline inflation - forecasts and targets (%Dec/Dec, except where noted)

	2017	2018	2019	2019 (%oya)				2020	Inflation target
				1Q19	2Q19	3Q19	4Q19		
<b>Inflation targeters</b>	<b>4.1</b>	<b>3.9</b>	<b>3.8</b>	<b>3.8</b>	<b>3.8</b>	<b>3.5</b>	<b>3.6</b>	<b>3.8</b>	
Argentina	24.8	47.5	27.3	49.3	49.3	40.9	28.5	17.8	
Brazil	2.9	3.7	3.8	3.9	3.7	3.3	3.4	4.0	2019: 4.25 (+/-1.5) 2020: 4.00 (+/-1.5)
Chile	2.3	2.6	3.6	2.9	3.3	3.4	3.5	3.2	3.0 (+/-1.0)
Colombia	4.1	3.2	3.7	3.5	3.5	3.7	3.7	3.4	3.0 (+/-1.0)
Ecuador	-0.2	0.3	0.7	0.7	0.6	0.4	0.4	0.3	
Mexico	6.8	4.8	4.0	4.1	4.2	3.8	3.9	3.7	3.0 (+/-1.0)
Peru	1.4	2.4	2.7	2.6	2.6	2.9	2.7	3.0	2.0 (+/-1.0)
Uruguay	6.6	8.5	7.7	7.7	7.8	7.9	7.2	7.0	5.0 (+/-2.0)

Source: J.P. Morgan forecasts

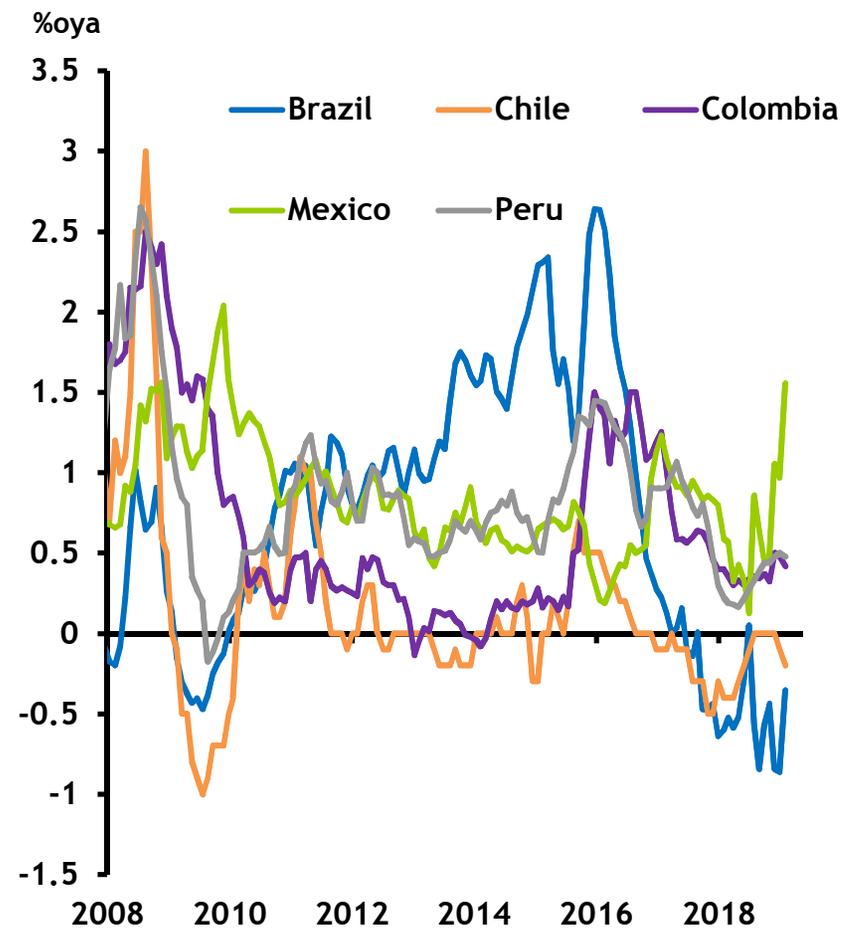
# Inflation outlook well anchored and output gaps closing ...

## Latin America: cumulative output gaps



Source: BCB, BCCh, Superfinanciera, Banxico, BanRep and J.P. Morgan

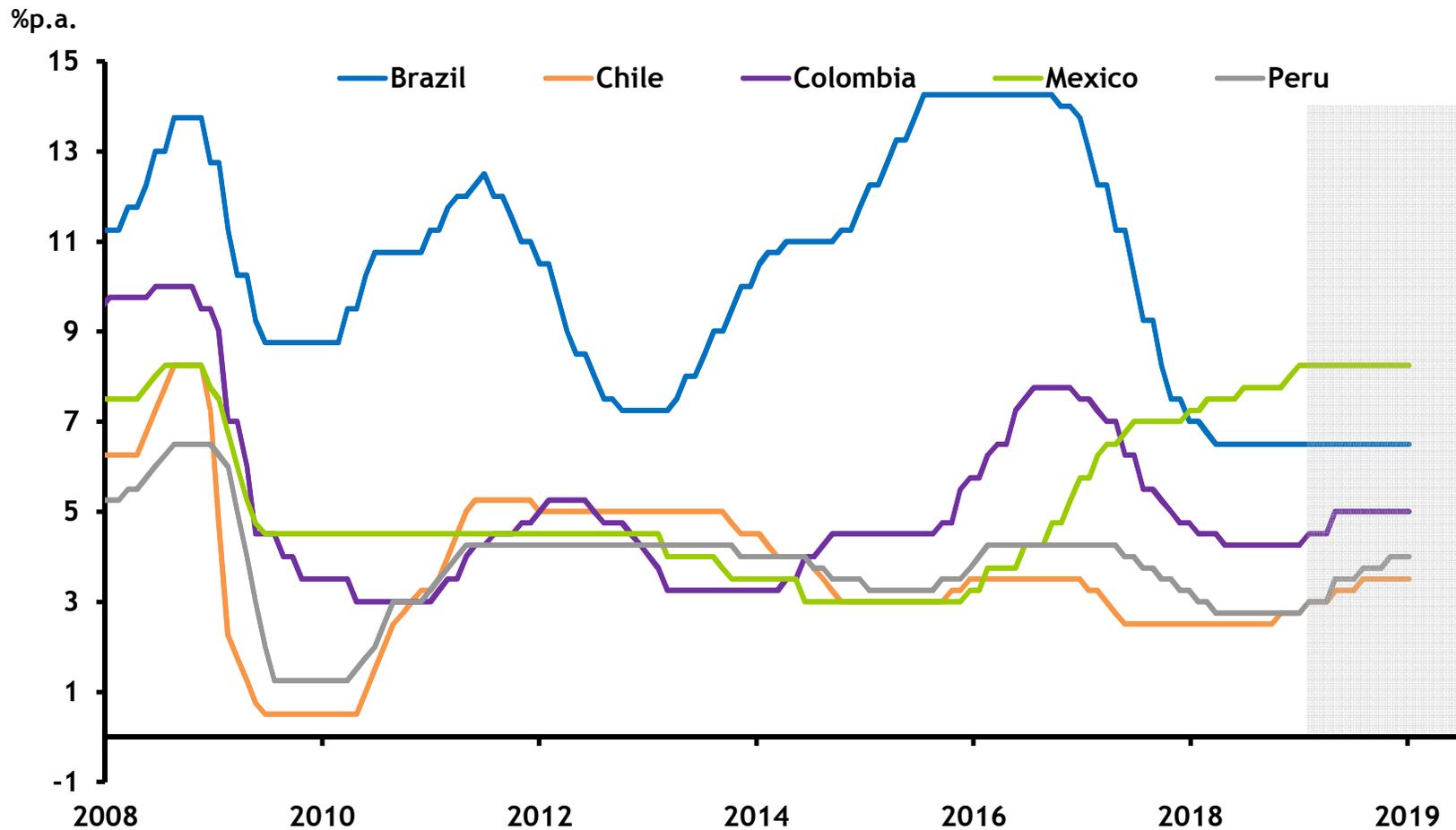
## 1-year ahead inflation minus target



Source: J.P. Morgan.

... allow for a gradual normalization of monetary policy though a more dovish Fed removes urgency; Mexico is an outlier

### Latin America: Monetary policy rate



Source: BCB, BCCh, Superfinanciera, Banxico, BanRep and J.P. Morgan

Source: J.P. Morgan.

# Latin America policy rate forecasts

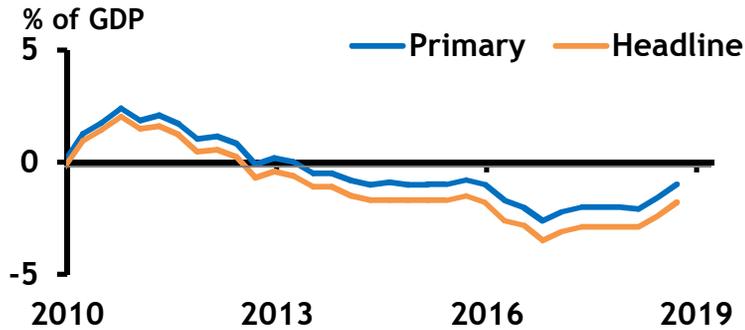
## Policy rates (%)

	Current	Next change	1Q19	2Q19	3Q19	4Q19	1Q20
Brazil	6.50	Jan 20 (+25bp)	6.50	6.50	6.50	6.50	7.00
Chile	3.00	Jun 19 (+25bp)	3.00	3.25	3.50	3.50	4.00
Colombia	4.50	Apr 19 (+25bp)	4.25	4.75	5.00	5.00	5.50
Mexico	8.25	6 Feb 20 (-25bp)	8.25	8.25	8.25	8.25	8.00
Peru	3.00	Jan 19 (+25bp)	3.00	3.50	3.75	4.00	4.25

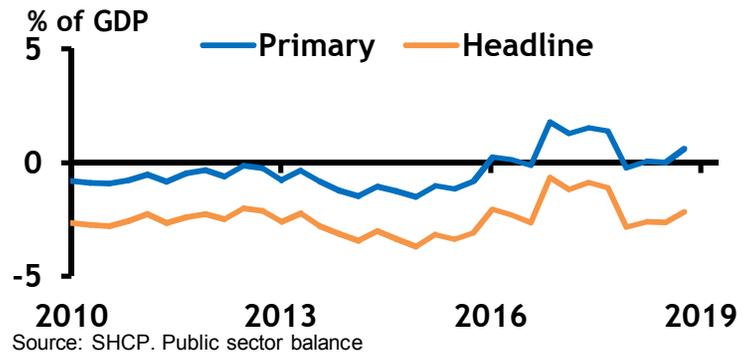
Source: J.P. Morgan

# Fiscal accounts are generally stretched, with little flexibility

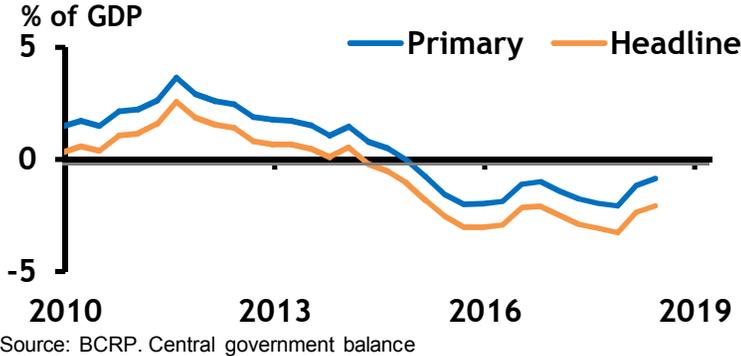
## Chile: Fiscal balance



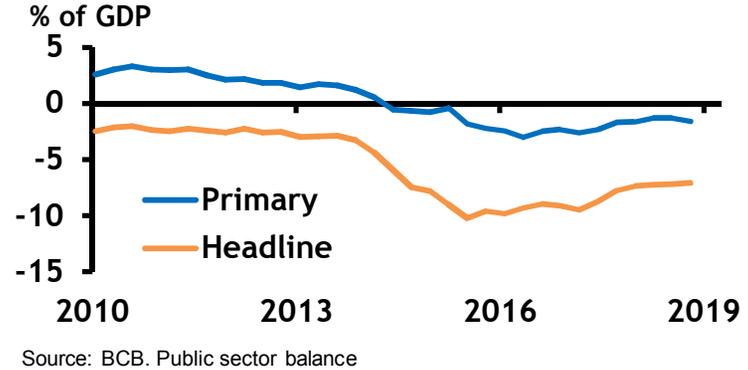
## Mexico: Fiscal balance



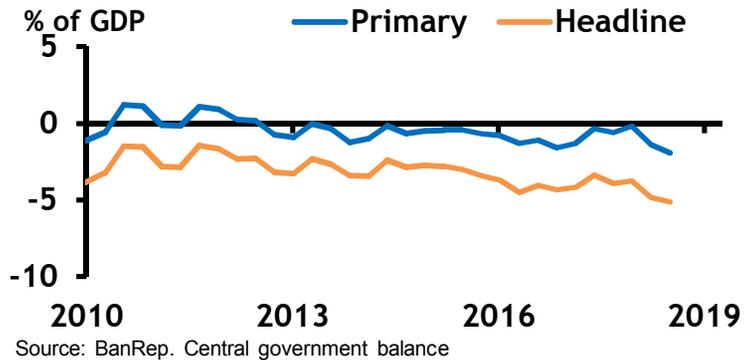
## Peru: Fiscal balance



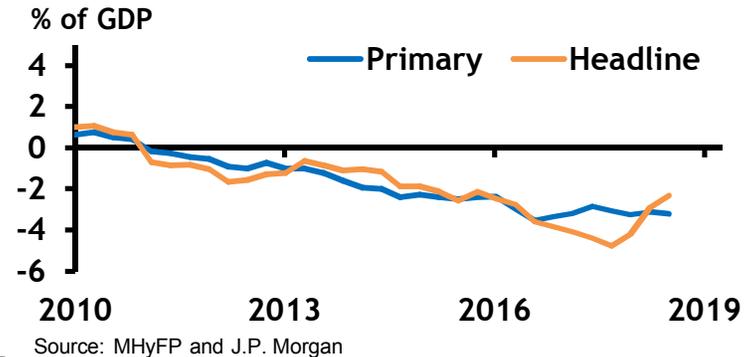
## Brazil: Fiscal balance



## Colombia: Fiscal balance



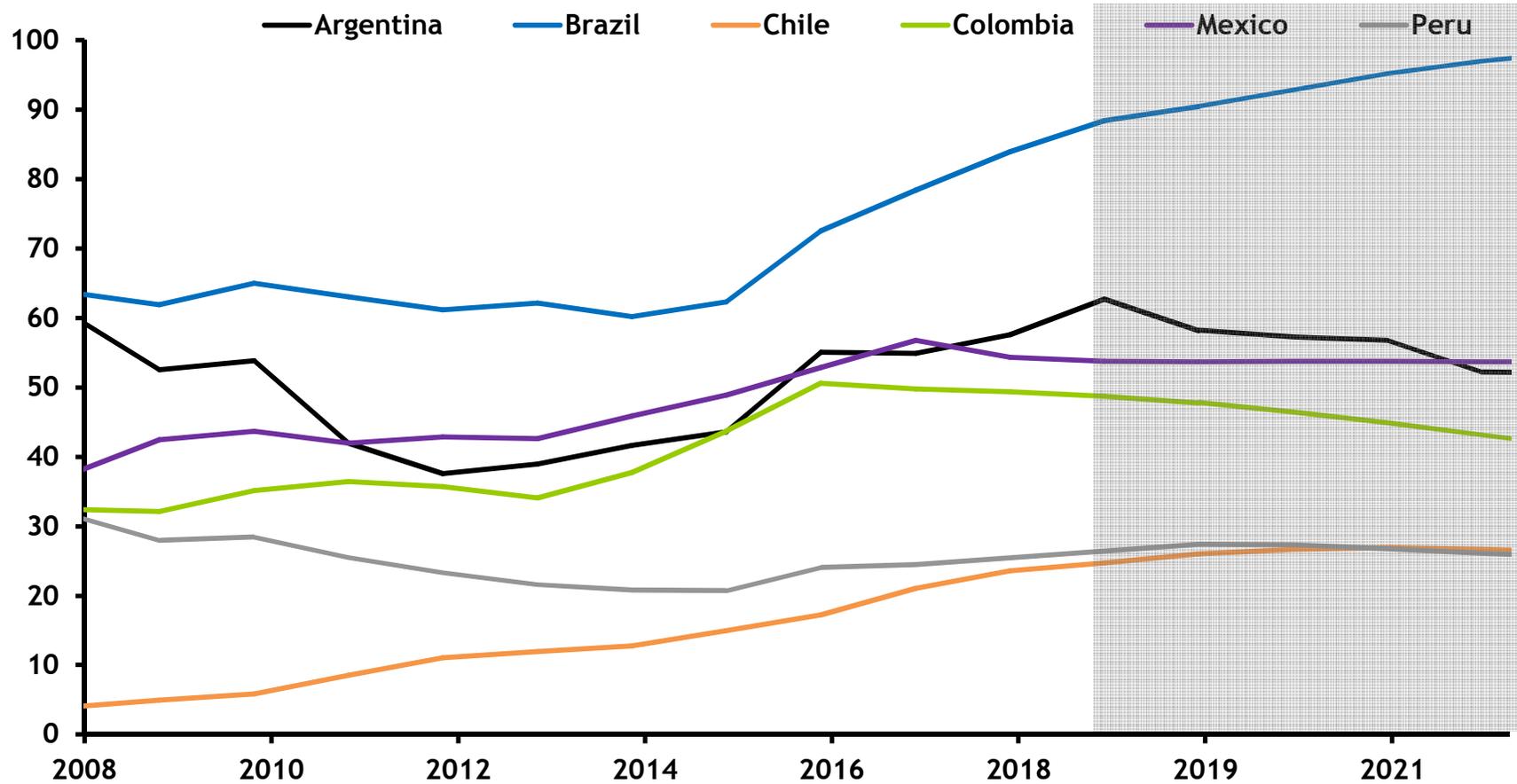
## Argentina: Fiscal Balance



# Debt levels stabilizing in some countries, but Brazil is still challenged; Chile and Peru have more space

## Gross debt to GDP\*

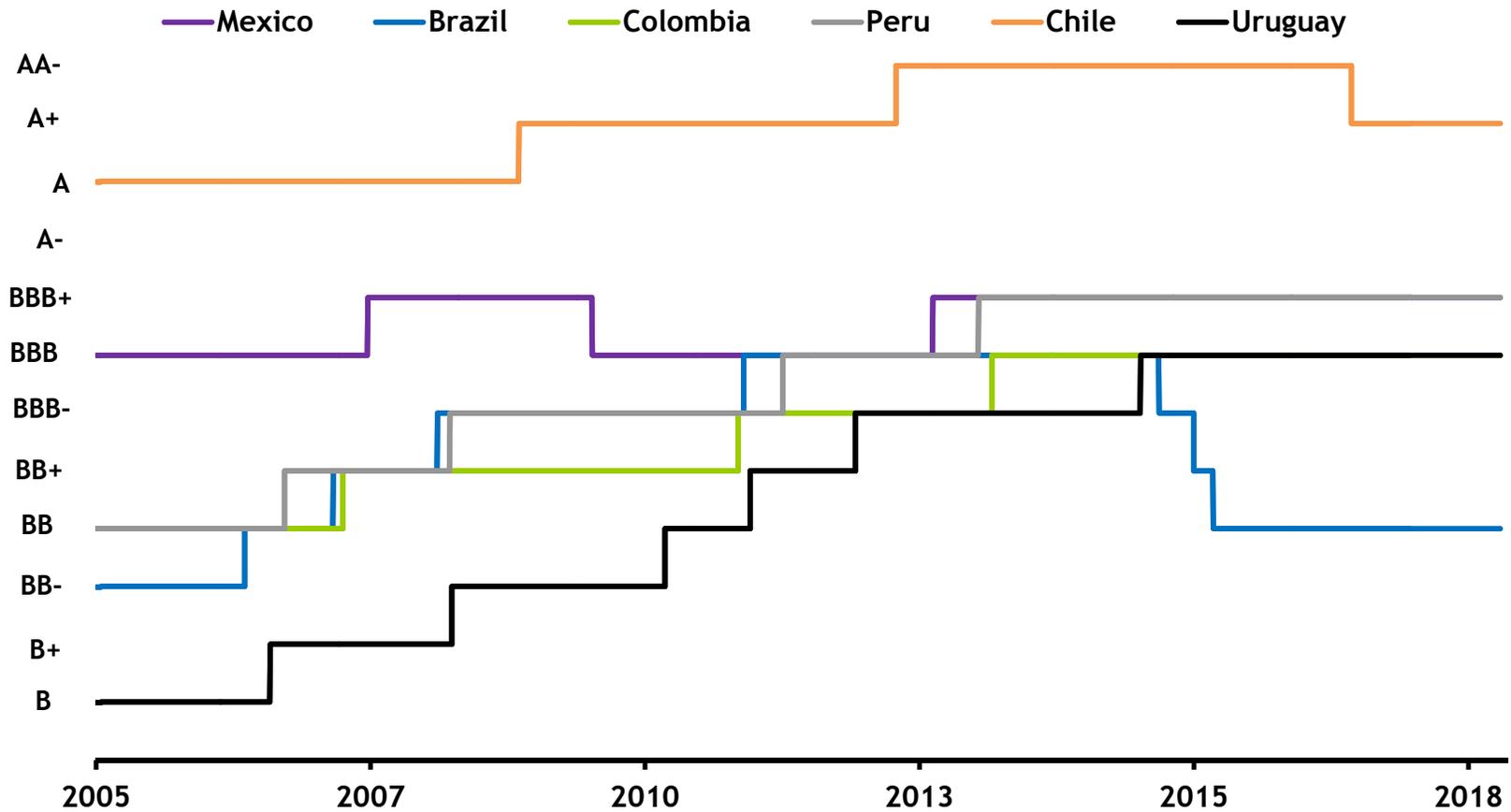
% of GDP



Source: IMF, April 2018 WEO database  
 \*The methodology may differ from the local statistics of debt

# Rating outlooks stabilizing, negative pressures linger for some

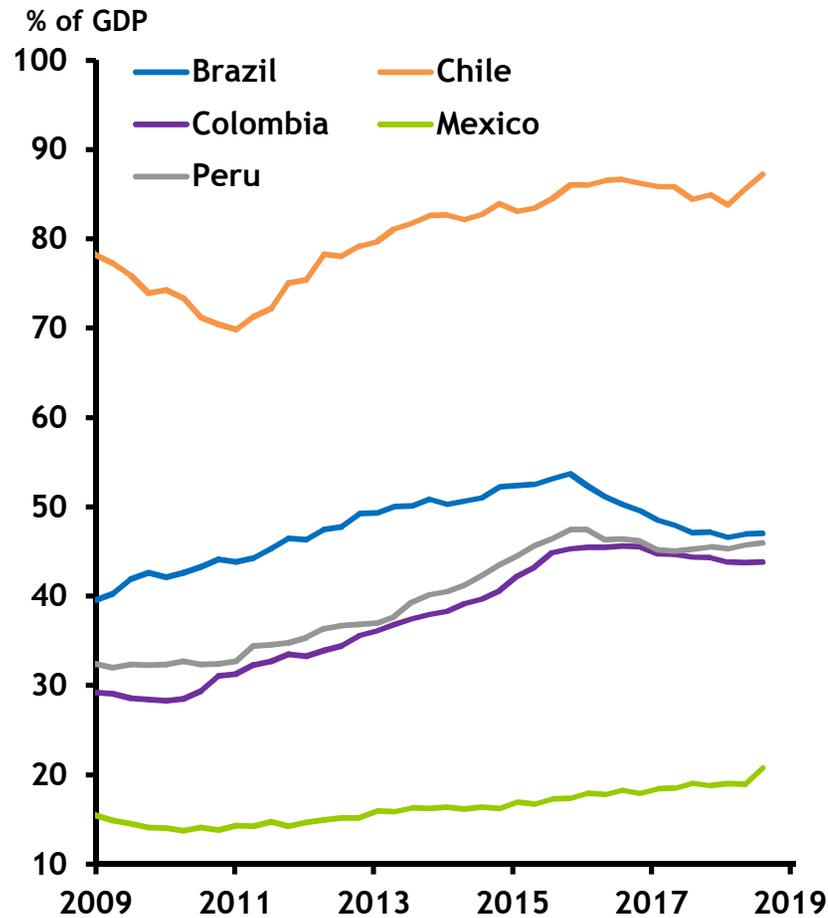
## Credit ratings



Source: S&P, Moody's, Fitch and J.P. Morgan;  
 Reflects median rating and scale corresponds to S&P and Fitch scales; on Moody's scale  
 AA- corresponds to Aa3 and so on.

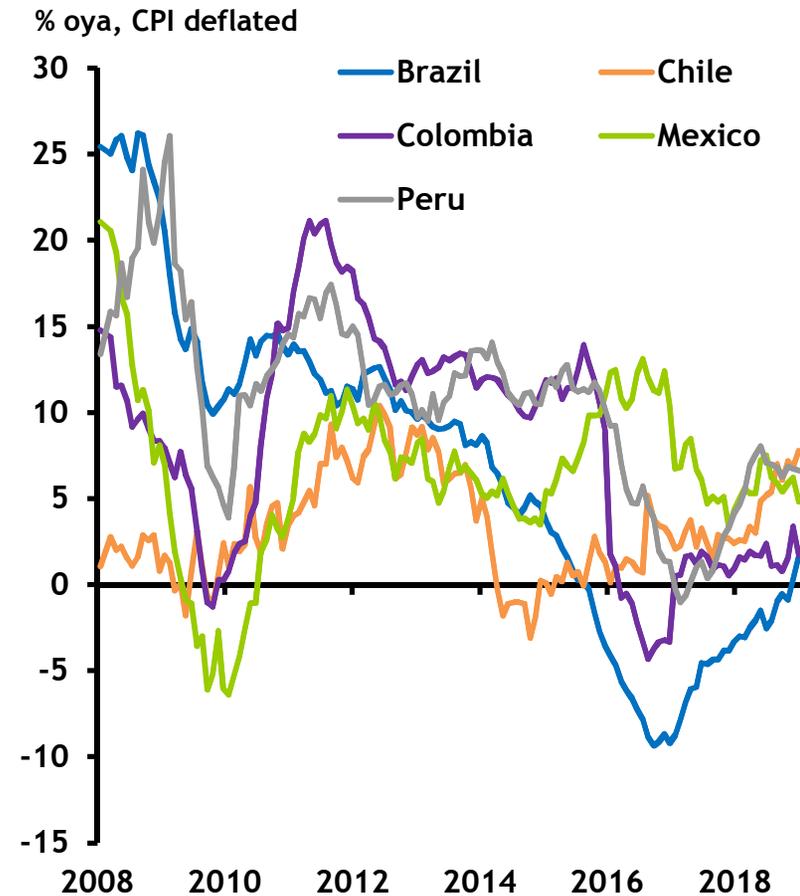
# Deleveraging has posed some headwinds to growth, but process appears to be close to an end

## Credit-to-GDP ratio



Source: BCB, BCCh, Superfinanciera, Banxico, BanRep and J.P. Morgan

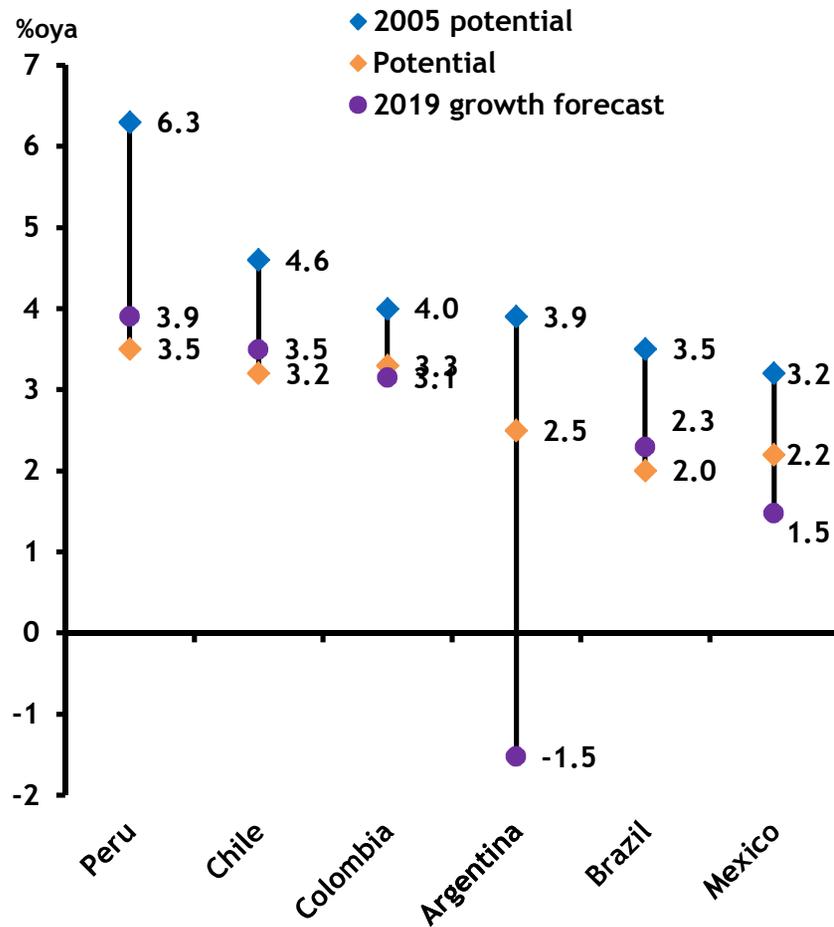
## Credit to private sector growth



Source: BCB, BCCh, Superfinanciera, Banxico, BanRep and J.P. Morgan

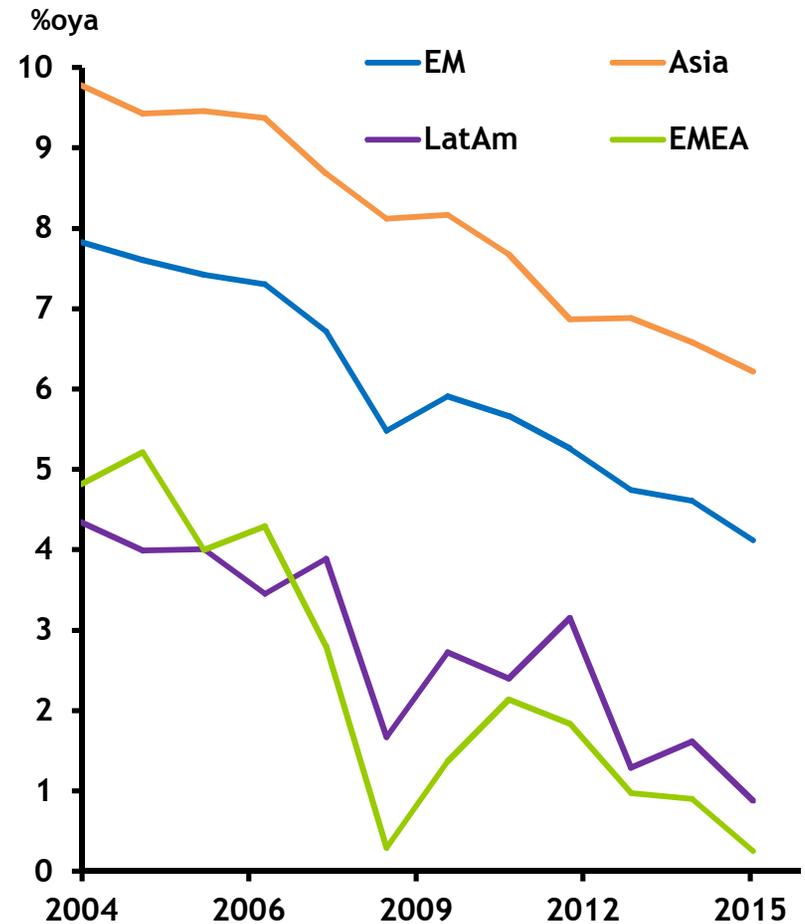
# Potential growth and structural reform: A downward trend to potential growth in LatAm

## Growth close to trend in most countries



Source: J.P. Morgan estimates

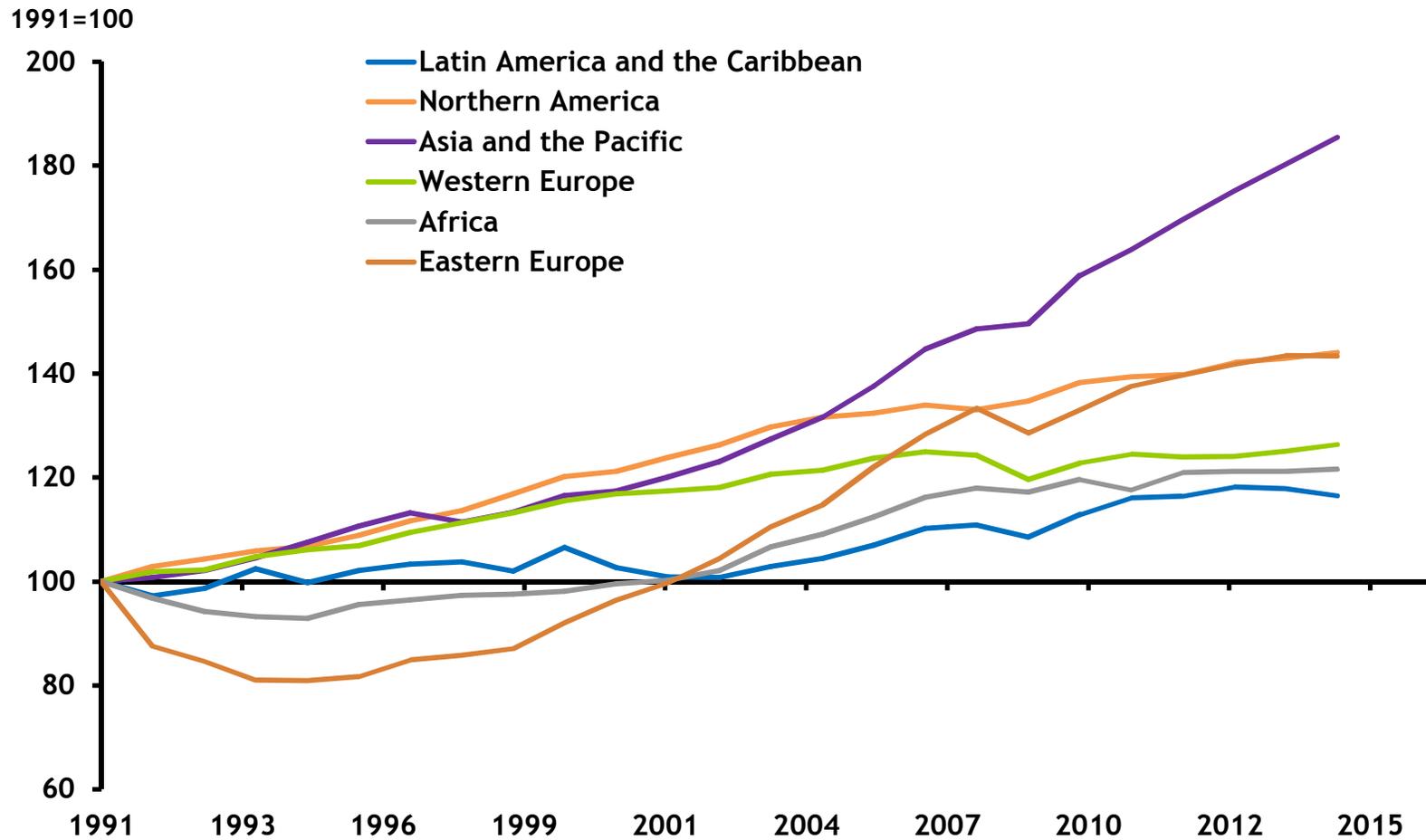
## Potential growth also trended downward in other EM regions



Source: J.P. Morgan estimates

# Structural obstacles: Latin America productivity growth lagging behind all other regions

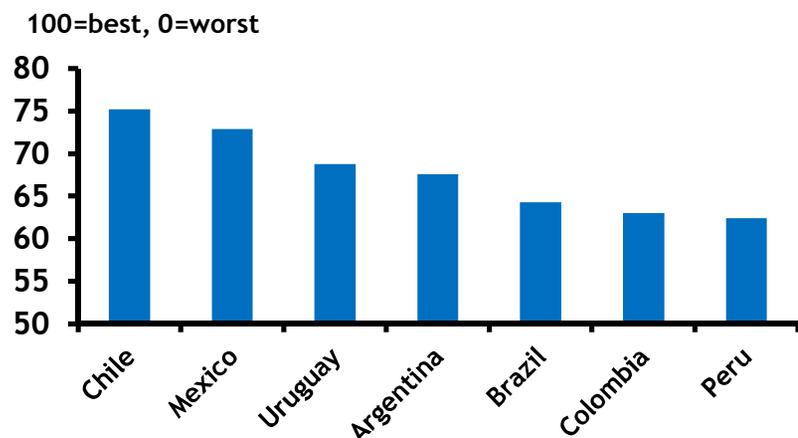
## Labor productivity: Output per worker (constant 2011 international \$ in PPP)



Source: ILO

# Structural obstacles: Infrastructure spending still a laggard; red tape and institutions remain hurdles

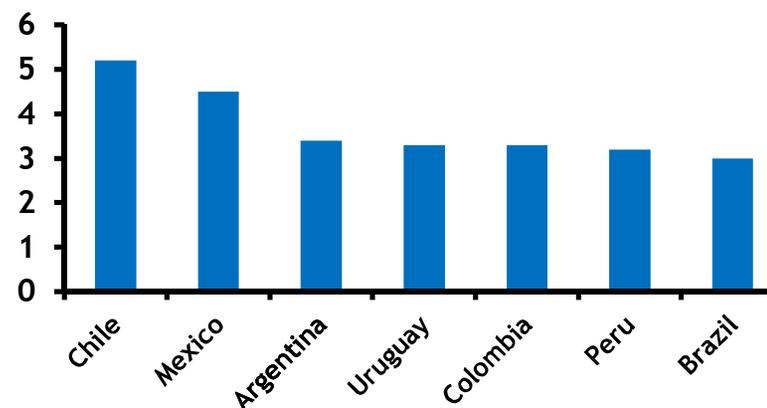
## Latin America: Infrastructure score



Source: The World Economic Forum, 2018-19

## Latin America: quality of roads

1= extremely underdeveloped; 7=extensive and efficient



Source: The World Economic Forum, 2018-19

## Competitiveness ranking

	Position
Chile	33
Mexico	46
Uruguay	53
Colombia	60
Peru	63
Brazil	72
Argentina	81
Ecuador	86
Venezuela	127

Source: The World Economic Forum, 2018-19

## Quality of institutions ranking

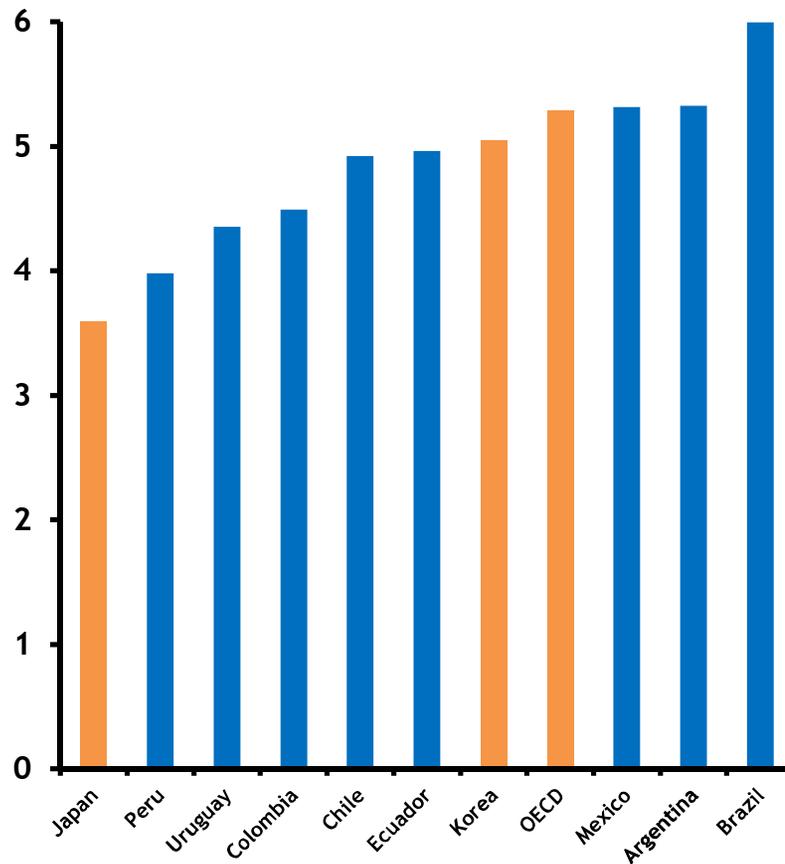
	Position
Chile	32
Uruguay	34
Argentina	77
Colombia	89
Peru	90
Brazil	93
Ecuador	100
Mexico	105
Venezuela	140

Source: The World Economic Forum, 2018-19

# Latin America spends on education but is not necessarily yielding the dividends

## Government spending on education

% of GDP



Source: World bank; data is for 2014 or latest available

## Lagging in quality of education and innovation

	Skills (Education)	Innovation capability
Chile	42	53
Brazil	94	40
Argentina	51	54
Uruguay	59	70
Mexico	86	50
Colombia	80	73
Ecuador	75	88
Peru	83	89
Venezuela	78	95

Source: Global Competitiveness Index 2018-2019, WEF

# Outlook for currencies

## Latin America: FX forecasts

### J.P. Morgan Forecasts

Currency	Mar-19f	Jun-19f	Sep-19f	Dec-19f
ARS	40.00	42.00	44.00	46.00
BRL	3.60	3.60	3.70	3.90
CLP	700	710	725	740
COP	3125	3150	3175	3200
MXN	19.50	19.75	20.00	20.25
PEN	3.36	3.38	3.39	3.40
VEF*	10,000	50000	100,000	500000
UYU	33.0	33.5	34.5	35.0

Source: J.P. Morgan

\*Official rate

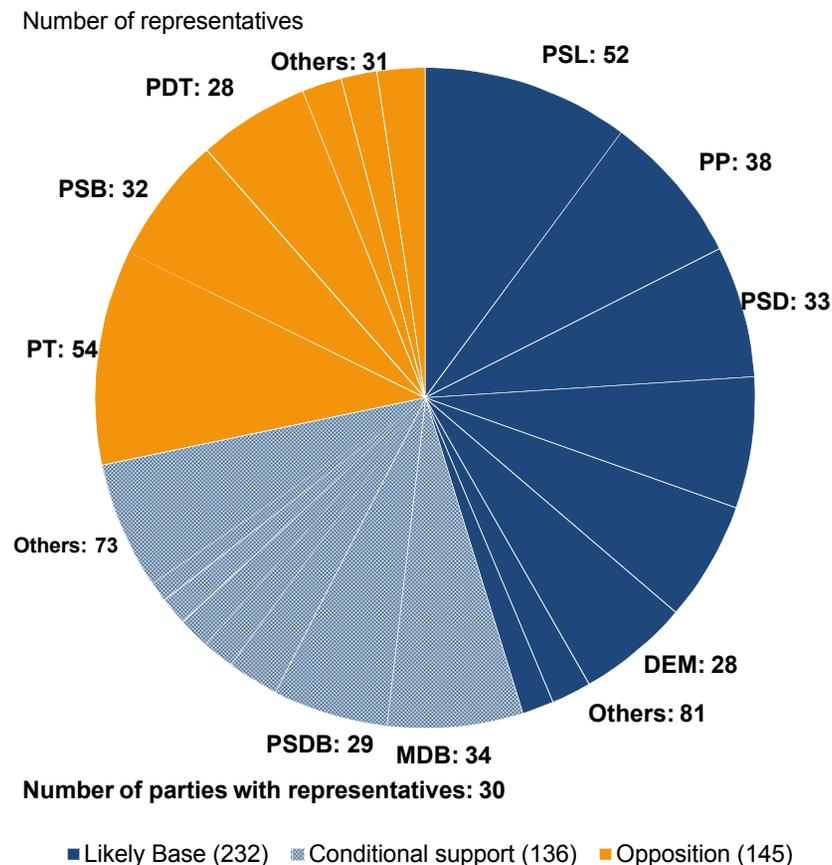
# Agenda

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Country specific outlook & regional themes	31

# Brazil: Time to focus on the reforms, particularly the social security reform

- Attention turned to the Congress.** Rodrigo Maia, a reform-friendly leader, was recently reelected as the speaker of the Lower House. In the Senate, Davi Alcolumbre, the candidate supported by Bolsonaro’s Chief-of-Staff emerged victorious after a controversial and long election process. The government’s economic team has hinted at the proposal of high quality economic agenda, reiterating the autonomy of Economy Minister Paulo Guedes.
- Our take.** Bolsonaro’s proposal for the social security reform foresees savings of BRL1.167 trillion in 10 years, according to the government, significantly higher than the BRL780 billion we estimated for former President Temer’s original proposal. However, the proposal has a long way to go in Congress before the final vote and requires 60% of votes in both houses to be approved, after passing in two committees in the Lower House. For that reason, while Guedes’ general agenda will most likely continue to be welcomed by market participants, the devil will be in the details and execution risk remains

## The Lower House is heavily fragmented

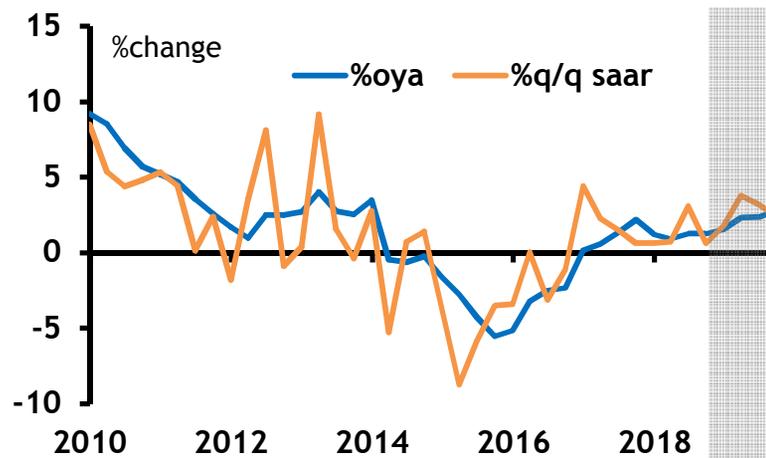


Source: Congress website and J.P. Morgan. Total deputies: 513

## Brazil: GDP slowly recovering

- **GDP should end 2018 on a weak note.** The 2018 data suggested that the economic recovery continued overall, albeit a moderate pace. Brazil's GDP expanded 3.1%q/q saar in 3Q, affected by some one-offs. For 4Q18, GDP growth is expected to have decelerated to 0.6%q/q saar as the effects of few one-offs - the government's public fund release, the payback from the truckers strike on May and a change in the rules for imports of oil equipment - phase out.
- **Looser financial conditions should support growth this year.** We expect the government's more market-friendly agenda to help the business sentiment recover while looser financial conditions should also support growth this year. We thus project that GDP growth will accelerate to 2.3%/y/y in 2019, below consensus as fiscal policy and global growth slowdown should prevent a sharper recovery. Looking ahead, monetary stimulus and positive developments with the reforms should also transpire into next year, when we expect GDP to grow 2.5%.

### GDP should grow 0.6%q/q saar in 4Q18



Source: IBGE and J.P. Morgan forecasts

### We expect GDP to grow 2.3% this year

% oya

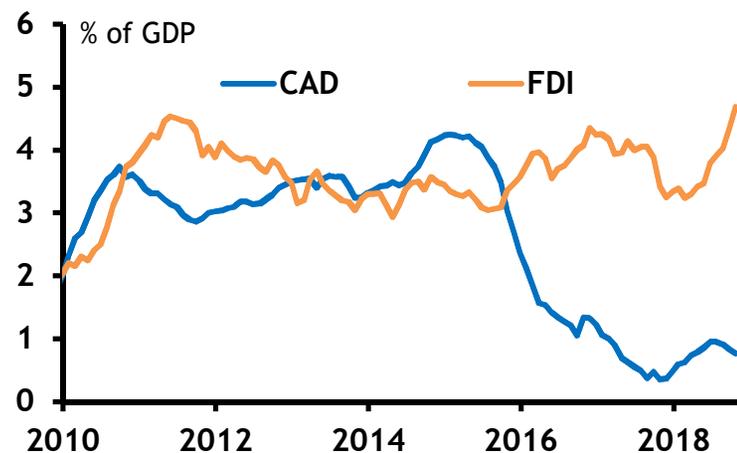
Items	Weight (%)	2016	2017	2018	2019	2020
GDP	100	-3.3	1.1	1.2	2.3	2.5
<i>Demand components:</i>						
Private Consumption	63	-3.9	1.4	1.8	3.2	3.1
Government Consumption	20	0.2	-0.9	0.0	-1.0	-0.8
Investment	16	-12.1	-2.5	4.2	4.5	5.0
Exports	13	0.9	5.2	2.6	2.2	2.5
Imports	-12	-10.3	5.0	9.0	4.0	3.0

Source: IBGE and J.P. Morgan forecasts

## Brazil: Fiscal imbalances must be addressed

- The fiscal problems remain.** While external accounts are in good shape, the fiscal deficit should remain wide and demand reforms to achieve debt sustainability. In that sense, we expect the government to approve at least a modest social security reform. Also, a large one-off coming from an auction of excess deep water oil reserves should help to improve the primary deficit significantly and reduce the speed of the rise in debt in 2019.
- Current account deficit widening, but still at very low levels.** In 2019, we expect higher GDP growth to impact the CAD, increasing it to 1.3% of GDP. Nevertheless, foreign direct investment (FDI) inflows will remain solid and continue to offset the current account deficit, so we will continue to see healthy external accounts.
- We are looking for BRL around 3.90 by year-end.** Domestically, the market approval of Bolsonaro's policies and optimism after the ascension of pro-reform leaders in the Congress should help to keep the BRL at a more appreciated level in the short term. However, with expectations of lower domestic interest rate, and a rise in trade tensions and tighter monetary conditions abroad in 2H2019, USDBRL should depreciate to 3.90 by the end of 2019.

### FDI is largely exceeding CAD



### One-off revenues helping primary balance in 2019 (% of GDP)

Variables	2016	2017	2018	2019	2020
Central government primary balance (BRLbn)	-161	-124	-120	-46	-70
Consolidated government primary balance	-2.5	-1.7	-1.6	-0.5	-0.8
Nominal balance	-9.0	-7.8	-7.1	-5.9	-5.8
Gross debt	69.9	74.1	76.7	77.3	78.2
GDP growth (%)	-3.3	1.1	1.2	2.3	2.5

Source: BCB and J.P.Morgan forecasts.

# Brazil: Low inflation and more balanced global risks allowing the Central Bank to keep rates stable this year

- **We see inflation below the target next year.** Following another year of low inflation – IPCA ended 2018 at 3.75% – inflationary pressures should remain muted this year. The fundamentals for low inflation remain in place: inflation expectations are anchored, spare capacity is high and the BRL has appreciated recently. In this context, we expect inflation at 3.8% in 2019, significantly below the target of 4.25%.
- **Rate hikes only by next year.** Low inflation and a more balanced global risk of tighter DM monetary policy should allow the Central Bank to maintain a stimulative monetary policy stance for longer. We thus expect the SELIC rate to remain flat throughout 2019, with a normalization of monetary policy only by the beginning of 2020

## Brazil: Economic indicators

	Average				
	2012-16	2017	2018f	2019f	2020f
Real GDP, % change	-0.3	1.1	1.2	2.3	2.5
Consumption <sup>1</sup>	0.3	0.7	1.2	1.8	1.8
Investment <sup>1</sup>	-1.4	0.2	0.8	0.7	0.8
Net trade <sup>1</sup>	0.7	0.1	-0.7	-0.2	-0.1
Consumer prices, %oya	7.1	3.4	3.7	3.6	4.1
% Dec/Dec	7.0	2.9	3.7	3.8	4.0
Producer prices, %oya	7.3	-0.5	7.5	3.3	4.2
Government balance, % of GDP	-5.7	-7.8	-7.1	-5.9	-5.8
Merchandise trade balance (US\$ bn)	14.8	64.0	50.6	45.5	46.9
Exports	216.5	217.2	231.0	240.7	255.5
Imports	201.7	153.2	180.4	195.2	208.5
Current account balance	-68.4	-5.5	-15.2	-25.5	-29.6
% of GDP	-3.1	-0.3	-0.8	-1.3	-1.4
International reserves, (US\$ bn)	368.2	382.0	388.0	392.0	396.5
Total external debt, (US\$ bn)	649.0	667.1	663.2	658.3	656.8
Short term <sup>2</sup>	46.1	51.3	50.2	48.2	45.7
Total external debt, % of GDP	28.8	32.7	35.1	32.5	32.1
Total external debt, % of exports <sup>3</sup>	238.6	241.9	224.9	216.0	205.5
Interest payments, % of exports <sup>3</sup>	10.0	8.7	7.1	6.5	6.3

1. Contribution to growth of GDP.

2. Debt with original maturity of less than one year.

3. Exports of goods, services, and net transfers.

Source: J.P. Morgan

# Mexico: Rating downgrade more likely than not on Pemex woes

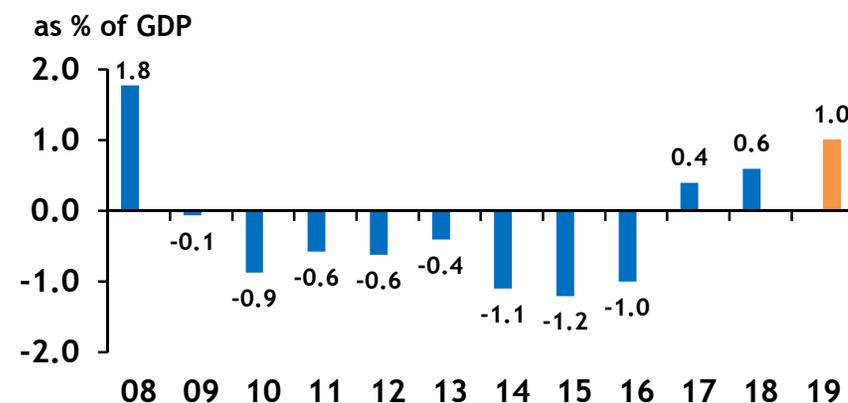
- Budget points to fiscal prudence.** Late December, Congress approved with no major hurdles the 2019 fiscal budget, which markets were watching closely for any risks of a sudden shift in fiscal policy under the new AMLO administration. In the event, the budget built on the past administration's fiscal consolidation efforts, targeting a 1% of GDP primary surplus. One of markets' main concerns was the likely increase in social programs and infrastructure spending, which we estimated could exceed 2% of GDP. The government took a more cautious approach, phasing in the different programs rather than implementing them all at once, bringing the estimated fiscal burden to around 1% of GDP. Besides some reengineering of spending, these programs also are expected to be financed through higher tax collection, which is projected to bring additional revenues worth 0.6% of GDP. In our view there are downside risks to the ambitious primary surplus target.
- But Pemex risks likely to eventually trigger rating downgrade by at one of the big credit agencies.** Besides risks inherent to the budget assumptions themselves—2% GDP growth, stable oil output and ambitious tax collection targets—Pemex is the most pressing concern on the fiscal front, as the company struggles with a fragile operational and financial position. Against this backdrop the government announced [support measures for the state-owned company](#), which might help partly relief liquidity concerns but fell short of addressing the company's structural deficiencies—among them a large tax burden. We think the government will have to provide further support to Pemex further down the road at the expense of its own balance sheet, leading to a downgrade to its credit rating in twelve months or less by at least one credit agency, but very likely two of them (Fitch and Moody's).

## PEMEX and Mexico ratings profile

	Fitch	Moody's	S&P
PEMEX	BBB- (Negative)	Baa3 (Stable)	BBB+ (Stable)
Mexico	BBB+ (Negative)	A3 (Stable)	BBB+ (Stable)
PEMEX standalone	CCC	B3	bb-
Notching vs Mexico	-2	-2	Equalized

Source: J.P. Morgan with data from Fitch, Moody's, S&P

## Ongoing fiscal consolidation faces risks



Source: Ministry of Finance. Not including Banxico's transfers for 2016 and 2017

# Mexico: Some good, some bad – Inflation down, but also growth

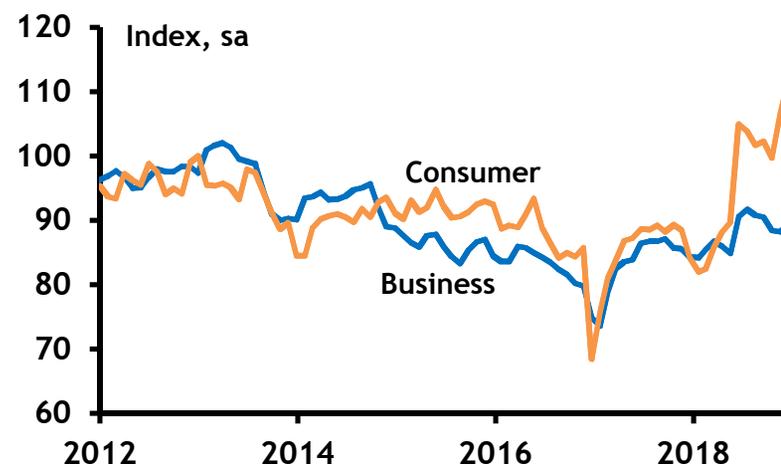
- Following two years of above-target prints, inflation is rapidly nearing the target range early in the year.** Consumer price inflation has surprised to the downside early this year, rapidly falling from 4.8%oya late last year to 3.89% in 1H February, near the ceiling of the central bank target range for the first time since late December. This is certainly welcome news and should add to other fundamental drivers of consumer spending. That said, not all has been as bright a news. The drop in inflation has been almost entirely driven by easing non-core inflation, while core inflation has remained sticky around 3.6%oya. Encouragingly core goods inflation has eased, suggesting fading passthrough pressures amid a stronger currency, but sticky core services inflation remains a source of concern as it could be reflecting some modest demand-driven inflation pressures, particularly amid sustained wage gains that exceed productivity growth. At any rate, all said, there is downside to our year-end inflation forecast of 4%.
- GDP growth likely to undershoot potential for a third consecutive year, and by a larger margin.** There are increasing signs that activity lost momentum late last year and weakness extended into 2019. Industrial production stumbled 6.5% ar in 4Q18—the largest drop so far in the expansion—while PMIs signaled weakness in January in both manufacturing and services. Along with temporary disruptions—gasoline shortages and strikes in some regions of the country—led us to revise down this year’s growth to 1.5%/y/y from 1.7%, almost a full point below potential. Seen from a demand side perspective, consumption will likely be the sole driver of growth, as net exports contribute positively only on the margin and investment remains a significant drag. To this point, consumer fundamentals remain solid, even if less than in past years, and consumer confidence is soaring. In contrast, however, business sentiment and capex plans remain subdued, likely reflecting uncertainty around the policies of the new administration, and point again to investment remaining a drag on growth.

## Inflation falling faster than expected



Source: INEGI and J.P. Morgan forecasts for February (boxed).

## Upbeat consumers vs downbeat businesses

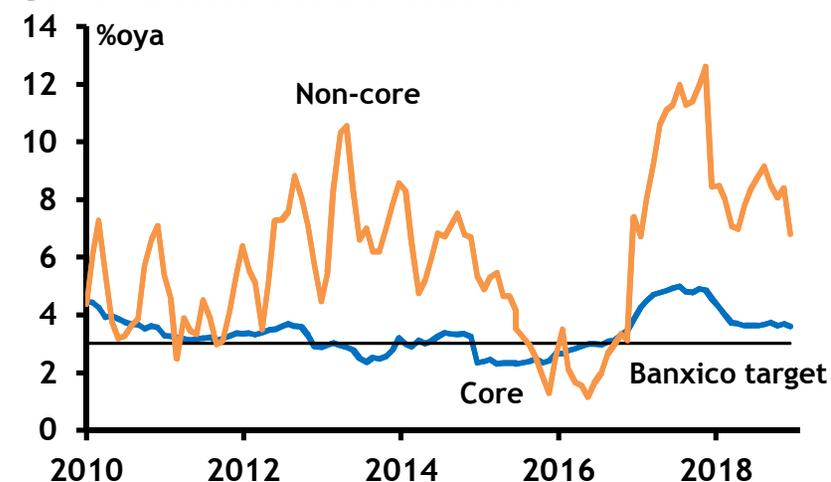


Source: INEGI and J.P. Morgan.

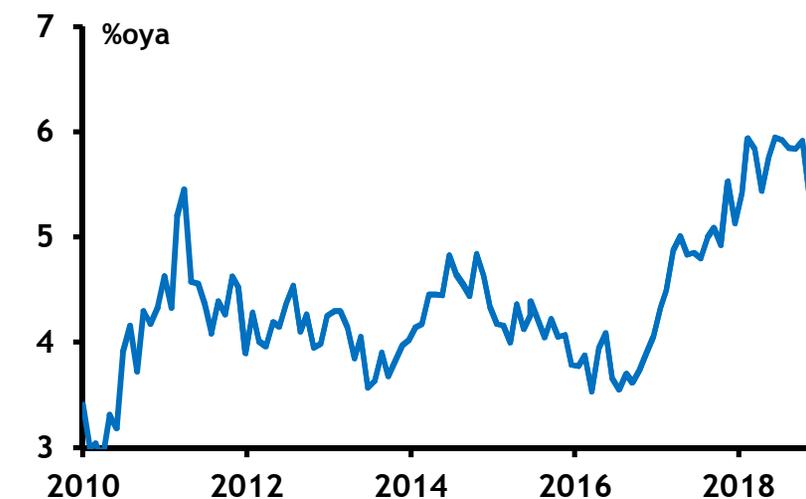
## Mexico: Banxico to continue to err on the hawkish side

- **Cyclical consideration could warrant lower interest rates...**Headline inflation has rapidly moved lower early in the year, and is now near the central bank's target range for the first time in more than two years. At the same time growth has slowed markedly and is likely to grow below potential for the third year in a row, leading to a negative output gap. Other indicators are also showing signs of growing slack, or at least less strained resource utilization (i.e., the labor market seems to be cooling, even if still tight). Against this backdrop and an admittedly restrictive policy stance, the debate about the appropriateness of high real policy rates amid cyclical weakness has gradually crept into the central bank's policy discussions
- **...but risks to inflation expectations amid sticky core inflation and financial stability risks are likely to keep Banxico on guard.** That said, the consensus within the central bank is that conditions are not appropriate to relax the hawkish grip just yet. For starters, the drop in inflation has been led by non-core prices, as core inflation has remained worryingly sticky around 3.6%oya and risks pulling longer term inflation expectations toward this levels on a sustained basis. High nominal wage growth and slow productivity are additional reasons to remain wary on this front. Meanwhile, the board also acknowledges that while a case for lower rates could be built on cyclical considerations, financial stability concerns currently trump such considerations. Apparently, Banxico thinks that maintaining high rates—and particularly a high rate differential vis-à-vis other economies—is the best way to accommodate risks stemming from domestic political concerns, Pemex's financial fragility and the potential reemergence of financial volatility, signaling that past episodes of this latter had been navigated efficiently largely due to this prudent relative policy stance. We thus think Banxico will keep the policy rate at its current high level fro the remainder of the year

### Core vs non-core inflation



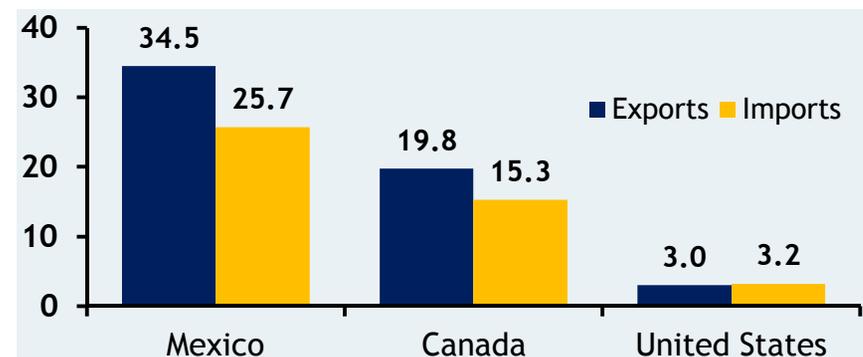
### Nominal wage growth has accelerated



# Mexico: NoFTA risks will resurface given hurdles in all three countries

- **The USMCA was signed on November 30 but it still requires legislative approval** in all three countries in order to turn the bill into law, and make the new agreement binding. For this to occur, several hurdles need to be breached.
- **A delay is increasingly likely** considering not only the political divide in the US after the midterm election in November, but also nearing elections in Canada and the delay in approving an update to the labor legislation in Mexico. Also, the fact that steel and aluminum (S&A) tariffs are still on, will probably cause further delays. While we still expect a favorable vote, it is increasingly likely that the legislative approval takes place until late 3Q19 at the earliest.
  - For the US, the main concern is not only at congressional level, but also in terms of the trade-tensions with other regions, and the unresolved Section 232 tariffs.
  - Concerns for Canada are related to the October election and on the abovementioned tariffs, an issue that also concerns Mexico. Officials have said that they expect S&A disputes to be solved in the next few weeks. Both Canada and Mexico were pushing to scrap S&A and retaliatory tariffs after the November signing, but an agreement has not been reached yet. The ongoing investigation into auto tariffs is an additional concern for Canada and Mexico.
  - The chapter on labor includes an annex that requires the modernization of the Labor Federal Law (LFT) in Mexico and the three governments agreed that USMCA will not be approved at legislative level until Mexico modernizes it.
- **We cannot disregard the possibility of the US invoking the six-month notice to withdraw from NAFTA, as Trump suggested recently, given recent political tensions.**

## Trade within NAFTA as % of total trade



Source: J.P. Morgan and Capital Economics.

## Mexico: Economic indicators

	2012-16	2017	2018f	2019f	2020f
Real GDP, % change	2.8	2.1	2.0	1.5	1.7
Consumption <sup>1</sup>	1.9	2.0	2.1	1.8	1.8
Investment <sup>1</sup>	0.6	1.0	0.1	-0.2	0.0
Net trade <sup>1</sup>	0.3	-0.9	-0.2	-0.1	0.0
Consumer prices, % oya	3.5	6.0	4.9	4.0	3.8
% Dec/Dec	3.4	6.8	4.8	4.0	3.7
Government balance, % of GDP	-2.8	-1.1	-2.1	-2.1	-2.1
Merchandise trade balance (US\$ bn)	-6.2	-8.1	-12.3	-14.6	-14.8
Exports	381.0	405.1	441.5	480.9	522.6
Imports	387.2	413.2	453.8	495.5	537.5
Current account balance (US\$ bn)	-23.8	-18.8	-24.2	-27.6	-28.8
% of GDP	-2.0	-1.6	-2.0	-2.2	-2.3
International reserves, (US\$ bn)	177.8	173.4	173.9	174.4	174.9
Total external debt, (US\$ bn)	331.6	370.6	385.6	395.6	404.1
Total external debt, % of GDP	26.9	31.4	31.6	31.8	32.0

1. Contribution to growth of GDP.

Source: INEGI and J.P. Morgan

# Argentina: We revised 2019 GDP growth higher on lower statistical carryover

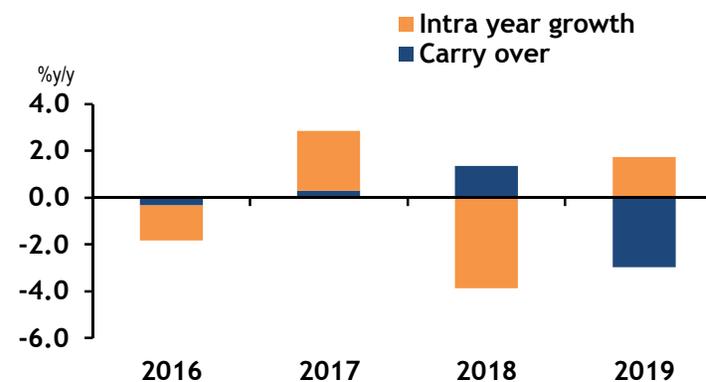
- We recently revised higher 2019 GDP growth on less of a drag from statistical carry over. We revised 2019 GDP growth to -1.2%/y, from -1.5%/y before, with the statistical carryover estimated at 3.0%-pt.
- The 'within-year' growth in our baseline scenario would add 1.8%-pts, of which about 1.0%-pt would come from the normalization of agricultural production (which subtracted around 0.9%-pt in 2018). Thus, the within-year growth for activity ex.agriculture is expected at a modest 0.8%, which is predicated on consumption recovery on real wage mass gains (with real wages more than offsetting a likely higher unemployment rate in the months to come). We don't foresee any gains stemming from investment recovery in an election year.
- In all, we maintain our base-case scenario for sequential activity growth to resume in 2Q19, although the risk is skewed to an earlier recovery. Data for construction, auto production and exports, cement sales, and tax revenues suggest economic activity strengthened in January. When we input the early-month supply and demand data, our models suggest headline activity expanded 0.5%/m/m, sa, consistent with a 6.7%oya annual contraction in January.
- January's sequential gain would come on the heels of a 0.1%/m/m, sa print in December. Yet, despite the two consecutive sequential monthly gains the 3m/3m saar pace would still print at -9.3% in January.
- If our model is on the mark for both December and January, it would set a bit of upside risk to our current 1Q19 sequential growth forecast (-0.1%q/q saar), increasing the odds for an early recovery vis-à-vis our current base case scenario.
- Our own seasonal adjustment shows monthly gains in construction, auto production, cement sales, and some revenue categories mostly associated with consumption. But consumer confidence declined in the month, as did overall tax collection.

## Economic indicators

Argentina: economic indicators					
	Average				
	2012-16	2017	2018f	2019f	2020f
Real GDP, % change	-0.1	2.9	-2.5	-1.2	2.6
Consumption <sup>1</sup>	0.8	2.8	-0.8	-1.1	2.6
Investment <sup>1</sup>	-0.5	3.9	-3.0	-2.4	1.2
Net trade <sup>1</sup>	-0.4	-3.9	1.3	2.3	-1.3
Consumer prices, %oya	31.0	25.7	34.2	42.0	20.7
% Dec/Dec	31.4	24.8	47.5	28.7	17.8
Producer prices, %oya	19.7	17.7	90.0	32.0	18.0
Government balance, % of GDP	-3.8	-6.1	-5.2	-3.5	-2.8
Merchandise trade balance (US\$ bn)	5.8	-5.5	-2.6	9.2	6.2
Exports	67.8	58.4	58.2	66.5	72.2
Imports	62.1	64.0	60.7	57.3	66.1
Current account balance	-11.4	-30.8	-22.4	-7.4	-10.9
% of GDP	-1.9	-4.8	-4.2	-1.7	-2.4
International reserves, (US\$ bn)	32.3	56.2	55.2	65.2	71.2
Total external debt, (US\$ bn)	153.2	210.2	258.2	274.2	282.2
Short term <sup>2</sup>	39.9	46.3	44.3	47.3	51.3
Total external debt, % of GDP	26.0	29.1	43.9	61.6	60.9
Total external debt, % of exports <sup>3</sup>	181.0	240.6	268.2	280.1	274.8
Interest payments, % of exports <sup>3</sup>	6.9	13.3	16.6	14.8	13.3

1. Contribution to growth of GDP.
2. Debt with original maturity of less than one year.
3. Exports of goods, services, and net transfers.

## Breaking down GDP growth

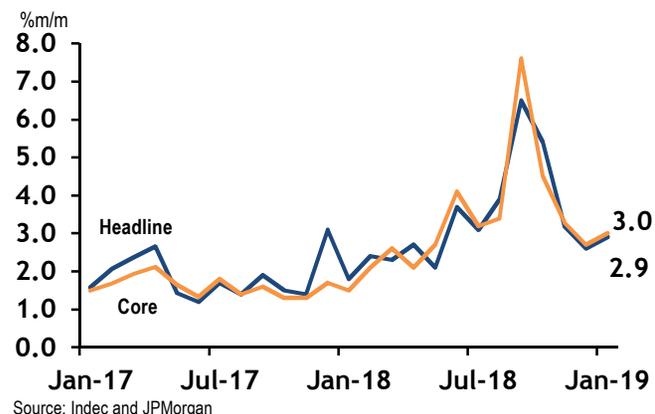


Source: INDEC and JP. Morgan

# Argentina: And up we go again... January CPI came in above expectations; we expect further acceleration in February

- The headline national CPI rose 2.9%/m in January (49.3%oya), above our expectations and the market consensus forecast (2.5%/m). Thus, despite FX stability, headline CPI interrupted the disinflation in train since October, rising 0.3%-pt more than in December.
- Core inflation also surprised to the upside, printing at 3.0%/m, after 2.7%/m in December. The 3-month average sequential core inflation rate is running at 3.1%, still a deceleration from the 3.6% reported the prior month. Yet, we expect core CPI inflation to prove sticky around these levels in the coming months, reflecting second-round effects from regulated price increases.
- Food CPI and regulated prices are to blame for the pickup in sequential CPI inflation, jointly adding 1.7%-pts to the headline print. Food prices led the acceleration in core inflation, increasing 3.4%/m and explaining the bulk of the inflation surprise (contributing 0.9%-pt to the headline print), after rising 1.7%/m and adding 0.5%-pt in December. Regulated prices added another 0.8%-pt to the headline print (vs. our 0.6%-pt estimate), on the back of increases in transportation and housing services costs.
- As we flagged in prior research, regulated price increases through May will continue to pressure headline CPI, preventing a further slowdown in 1H19. In fact, we forecast 1H19 CPI to average at 2.6%/m, in line with December's print.
- A combination of stronger regulated price hikes and sticky core CPI will buoy the February CPI. We expect price increases for electricity, transportation, and prepaid medical services to jointly add 1.1%-pts to the headline print. The high frequency data tracked by EcoGo over the first two weeks of February also point to another above-3%/m rise in the food CPI, driven by strong carryover from January as well as still-high increases in meat prices.
- In all, based on month-to-date high-frequency data and higher-than-expected carryover from January CPI, we raise our February monthly CPI inflation forecast to 3.2%/m from 2.8%/m. Based on January and February CPI revisions, we also adjust our December 2019 inflation forecast to 28.5%oya.

## Headline and core National-CPI



## Tentative tariff adjustments

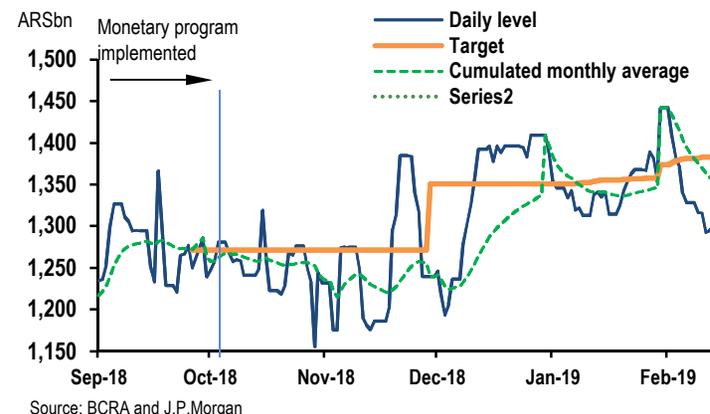
	Weights*	Feb-19	Mar-19	Apr-19	May-19
Electricity	2.25%	26%	14%		4%
Gas	3.18%			35%	
Water	0.85%				26%
Bus	2.91%	10%	9%		
Train	0.19%	13%	9%		
Subway	0.14%	7%	15%		
<b>CPI Impact (Tariffs)</b>		<b>0.9%</b>	<b>0.6%</b>	<b>1.1%</b>	<b>0.3%</b>
Prepaid medical services	3.43%	5%			
<b>Total CPI Impact</b>		<b>1.1%</b>	<b>0.6%</b>	<b>1.1%</b>	<b>0.3%</b>

Source: EcoGo and J.P. Morgan. \*GBA-CPI adjusted by regulated price increases.

# Argentina: BCRA to over-fulfill the monetary target after validating a hefty Leliq compression on the month

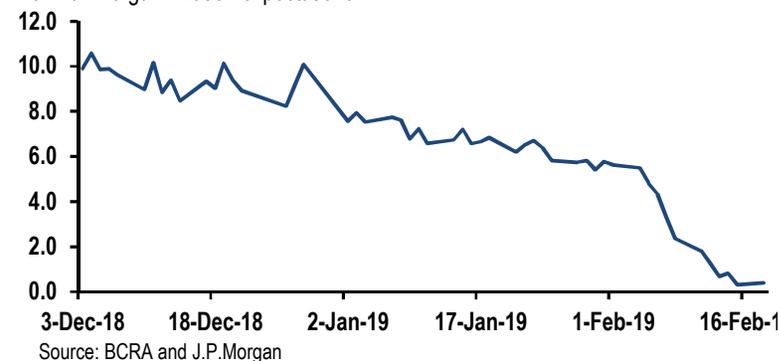
- The BCRA has returned to a cautious monetary stance following higher realized and expected inflation prints. The BCRA anticipated that it will over-achieve the MB's target for February by more than ARS40bn, which represents around 3% of the MB's target.
- Despite the cautious approach in regards to the marginal expansion of the monetary base, the permanent increase the BCRA allowed in December (merited on seasonality) together with the decline in the country's credit premium in January, allowed the monetary authority to validate a hefty decline of the Leliq rate. Worth noting, the Leliq (monetary policy interest rate) collapsed by about 938bp through February 15th (14,940bp since December 28).
- The central bank explains the simultaneous target over-compliance and the decrease in the monetary policy rate by: i) a more favorable international backdrop with a reduction in the country credit premia, ii) the expansion of the MB as a result of the non-sterilized foreign currency purchases, and iii) a 'firm' demand for money (when controlling for seasonality).
- **Has the Leliq declined too fast, to too low of a level?** The limits of the Leliq compression became evident last week. The BCRA not only halted the validation of lower Leliq but has increased its level by around 210bp to 46% since February 18<sup>th</sup>. Three factors weigh in our view. First, the fact that the Leliq premium vis-à-vis the 1yr NDF + EMBIG yield turned negative, for the first time since the monetary program came to be effective. Second, the fact that inflation has been proving more resilient than expected with January CPI print surprising to the upside. Third, the sudden compression of real ex-ante time deposit rates. The BCRA validation of lower Leliq levels in matter of weeks amid higher than expected headline inflation has reverberated in the 3m ex-ante real deposit rate collapsing to just 0.4% from 5.8 % by the end of January.
- Worth noting, time deposits have increased by ARS328bn since the monetary program came to be effective in October, which is equivalent to \$8.5bn at the current FX level. The overall stock stands at ARS1,134bn (about \$29.2bn) of which 65% matures in less than 60 days (\$18.6bn).
- Moreover, political risk is likely to become more of a player in the coming weeks. The fact that the local currency real premium has compressed as much as 5% in just a couple of weeks exacerbates the potential effects of political risk on time deposit rollover and thus on the exchange rate.

## Monetary base evolution



## 3-month real ex ante deposit rate

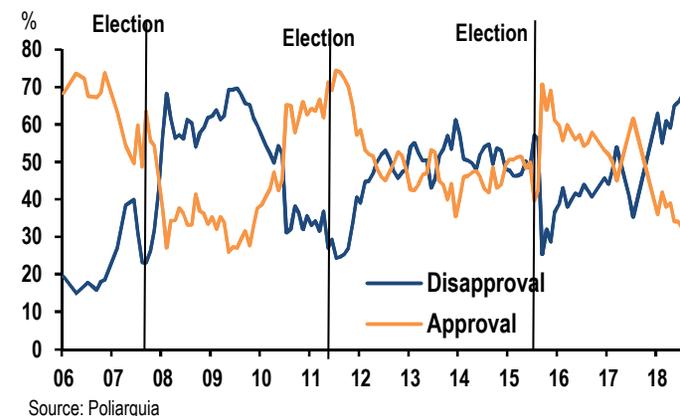
%, calculated as the return of a 3m time deposit at Badlar deflated by next 3m JPMorgan inflation expectations



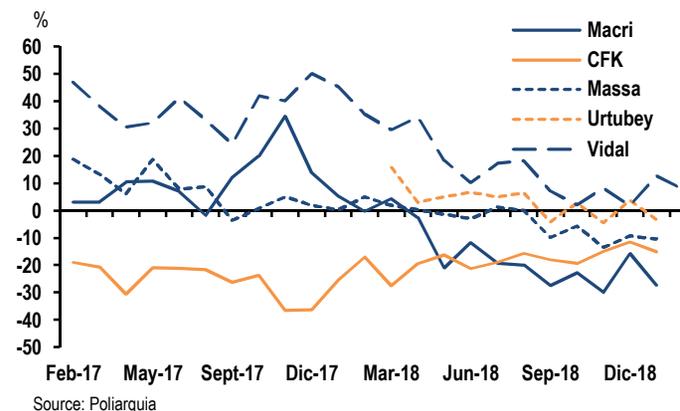
# Argentina: The 2019 political roadmap

- The 2019 presidential election will be held together with the legislative election, in which half of the Lower House and one-third of the Senate seats will be renewed. In addition, governor elections will take place in 22 provinces, while provincial legislators will be elected in all but one district.
- The electoral year ahead will prove intense, not only because of the heavy political calendar, but also because of the likely tight competition between pro-market policy continuity and populists for main office and Congress. In fact, the combo of devaluation, recession and IMF assistance last year drove President Macri's approval rating to the lowest level since he took office, resetting the run for the main office into an open race amid adverse macro-cyclical conditions.
- From a national standpoint, the most relevant dates to bear in mind are June 22nd (when electoral alliances should present their pre-candidates) and August 11th (when the primary elections are held). Importantly, the primary elections are compulsory, and had proved in the past as key for voters as well as for candidates to reassess their strategies going into the first round scheduled for October 27th. We expect the main potential candidates to confirm their intentions to run for main office by April/May.
- In October, to win outright, the candidate needs 45% of the votes or at least 40% with a 10%-pt gap with respect to the second most voted candidate. If neither condition is fulfilled, the two most voted candidates go into a run-off, scheduled for November 24th.
- But the national elections calendar is complemented by a rich and heavy provincial calendar, which started as soon as mid-February. The provinces' results will likely affect the momentum of the national campaign and, thus, the expected likelihood of policy continuity.
- Our base-case scenario: A tight race with polarization favoring the incumbent in a runoff scenario. The political premium is to remain elevated going into the 2019 election, but we see limited probability of populism returning to the main office. Despite the dire macro-cyclical conditions, we believe the same distribution will prevail in 2019. The fact that the opposition remains fragmented and has not been able to capitalize on the government's image deterioration together with the still high rejection of populism prompts us to attach a probability around 65% to policy continuity, and our base-case scenario is for Cambiemos and CFK to reach a second round, with Cambiemos winning by 3-4pt.

## Government approval



## Net image differential

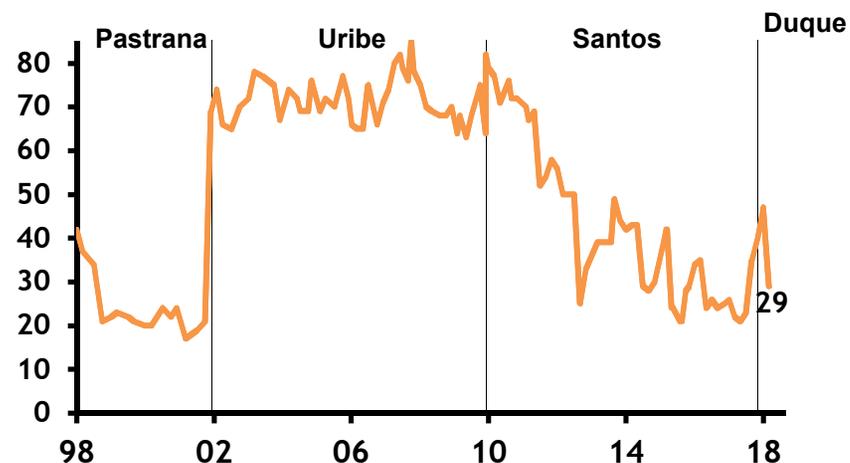


# Colombia: Duque stumbles out of the gate

COUNTRY SPECIFIC OUTLOOK & REGIONAL THEMES

- As expected, Ivan Duque won the second round of Colombia's presidential election on Sunday. Duque, a technocratic 41 year old Senator from former President Uribe's right wing Democratic Center party, won 53.98% of the vote, defeating Gustavo Petro, a veteran leftist politician and former M-19 guerrilla, who won 41.81% of the vote.
- Duque's governing coalition in the Congress is narrower than that of Santos, as center-left and left leaning parties such as the Greens and the Polo Democratico moved into the opposition. Petro is back in the senate but will keep his gaze firmly fixed on 2022, and attempt to lead the anti-Duque block, despite his Decencia party having relatively small representation. Even so, Duque should still be able to construct governing majorities with his own Centro Democratico party (CD), the Conservatives, de la U, and potentially with independent parties (Cambio Radical and the Liberals) depending on the proposed reform.
- Duque represents continuity in terms of the overall orthodox framework of Colombia's macroeconomic policy, with an ostensibly more pro-business stance. New president Duque has stumbled out of the gate with many early proposals falling short and struggled to build a coalition in congress. Early "friendly fire" from factions of his own Centro Democratico party and from the opposition had weighed on the new administration's ability to build bridges. In addition, a proposal to broaden the VAT base was met by backlash from Congress and the public alike, which seems to have sapped Duque's popularity, which fell to 29% in December. The administration successfully navigated the financing law through Congress in December, and former president Uribe seems to be taking a more active role to improve governability. Duque's popularity has improved in recent months by according to recent opinion polls.

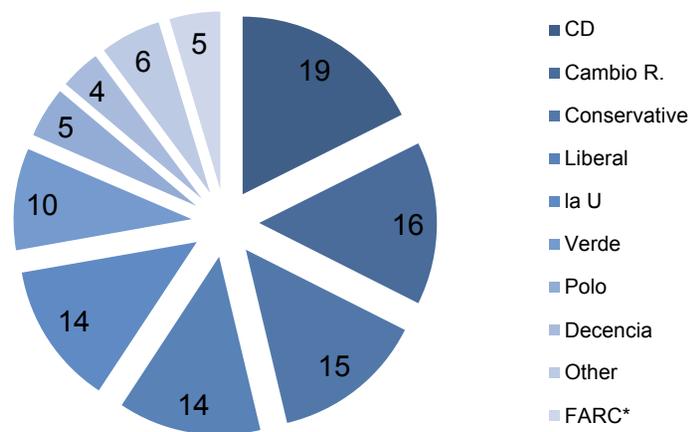
## Governability challenged by Duque's low approval



Source: Gallup

## A narrower governing coalition

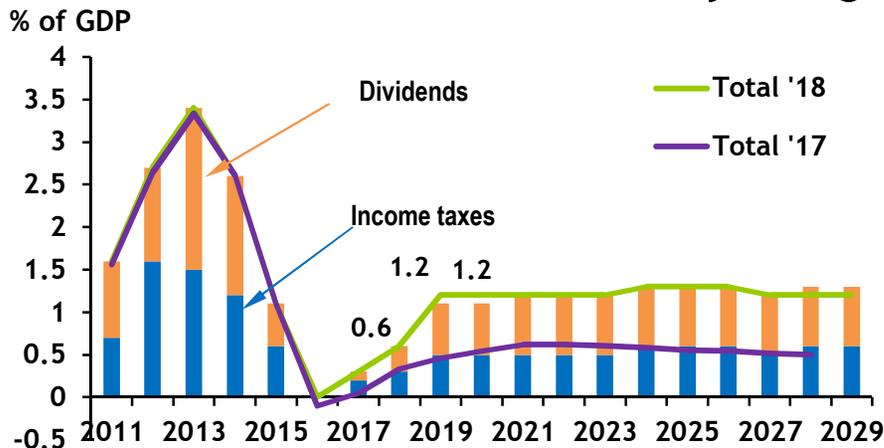
No. of seats in senate



Source: Senate

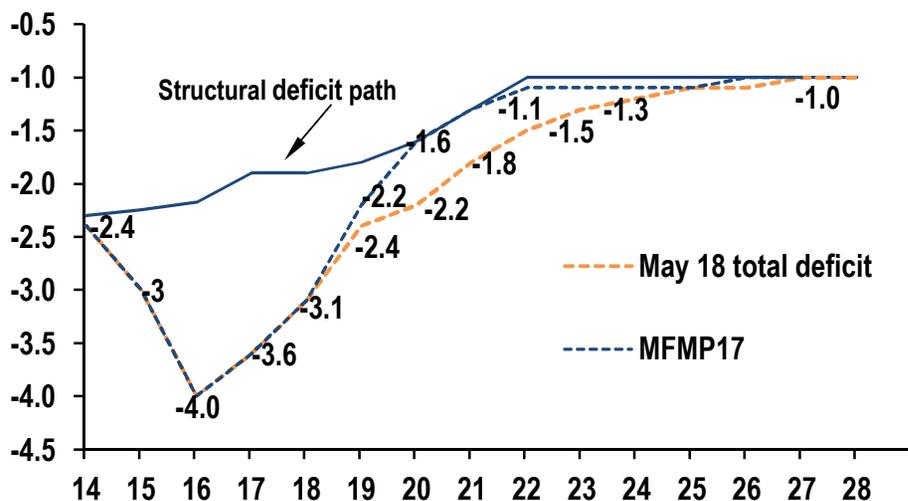
# Colombia: Financing law passed, but the work isn't done

## Oil fiscal revenues to do more heavy lifting



Source: Finance Ministry

## ... and a more gradual consolidation path envisioned



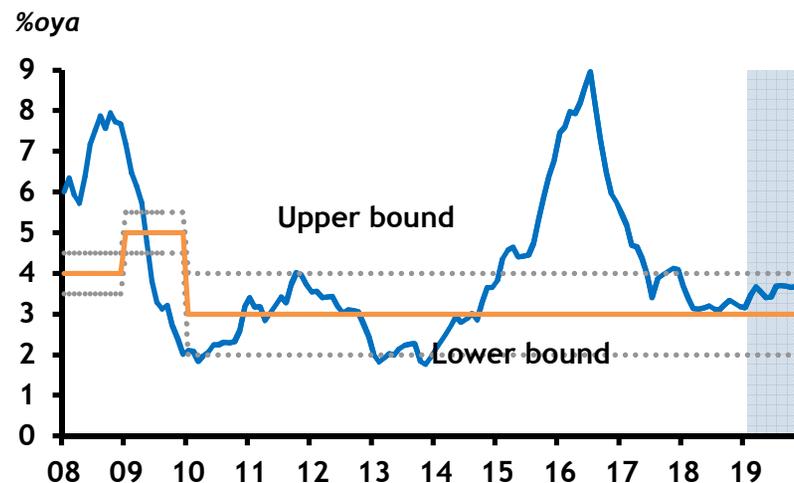
Source: Finance Ministry

- The central government deficit is slated to finish at 3.1% of GDP in 2018, consistent with a structural deficit of 1.9% of GDP (the theoretical balance consistent with structural revenues assuming growth running at potential and oil at its long-term prices). 2019's deficit is seen at 2.4% of GDP. In the longer-term, the fiscal rule committee has permitted for a more gradual path to consolidation, now allowing for a headline deficit of 1.1% in 2025 compared to 2022 previously.
- In December 2018 the congress approved the government's "financing law". In terms of revenue for the 2019 budget, the new law is expected to raise 0.7% of GDP, mostly from higher taxes on high net worth individuals. The law introduced VAT on the final sale of beer and wine. Among other notable items, the reduction of the withholding tax on foreigners' TES positions from 14% to 5% survived the political process intact and was included in the law. The new law established an oil fiscal stabilization fund (FEIF) that can legally carry out hedging for oil revenues
- While the 2019 deficit remains as is, the government has revised up both the expected revenue and expenditure projections compared to the June MFMP by roughly 0.6%pts of GDP. Spending rose to 18.6% of GDP from 18.0%, while tax revenues rose to 14% of GDP (from 13.5%) and capital revenues to 2.0% (from 1.2%). The government has continued to publicly discuss the fiscal strain coming from the inflow of Venezuelan migrants, estimated at 0.5% of GDP. As such, the Commission may well contemplate this shock when it meets in 1Q19, which we expect could lead to a modest loosening of the headline deficits targets for 2019 and beyond. Minister Carrasquilla stated that the government does not contemplate further fiscal reforms over the coming years, and would cut spending. Moody's and Fitch may turn a more critical eye on Colombia's BBB ratings if they have doubts on Colombia's willingness to cut spending and its ability generate new permanent revenues, but we don't think Colombia is at risk of losing investment grade,

# Colombia: CPI and rates on hold for now, but wait for it

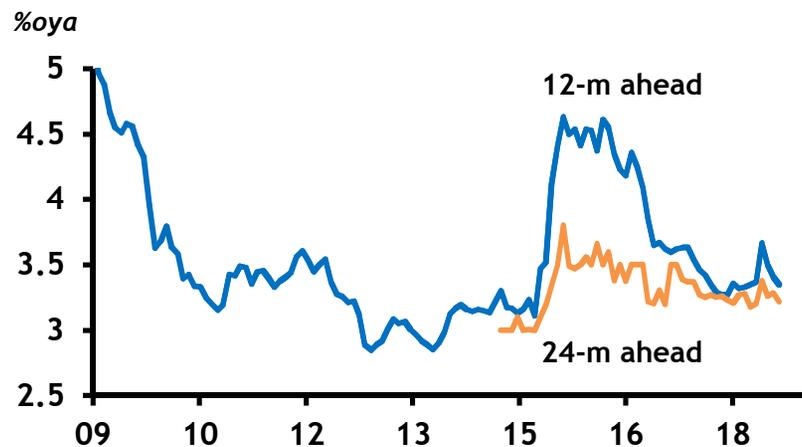
- Colombia's January CPI was reported with updated weights and a new base year, but little in the way of details. Consumer prices rose 0.60%mm, edging annual inflation lower to 3.15%oya edged down from 3.18% at the end of 2018. Core prices (ex. food) inched up 0.46%/m/m, taking the annual pace to 3.55%.
- DANE updated its CPI base year (from 2008 to 2018) and the CPI basket with the January release, but did not make any large-scale backward revisions to the headline or core indexes in this release. The revised weights may well lead to backward revisions and different contours for future releases once DANE makes more information available, we assume in future updates.
- For 2019, we now see year-end inflation at 3.7%. Our 2019 inflation profile would have inflation hovering just above the midpoint in the first half of the year, and then moving toward the upper half of the range in the second half. However, we still see an upward tilt to 2H19 inflation as the normalization of food and tradables prices will mingle with base effects in the second part of the year.
- We maintain our call for BanRep to normalize monetary policy starting in April, taking the policy rate up 75bp to 5% by July. This call is based on both the constructive tone for growth (even if Colombia maintains a modest output gap, according to BanRep) and some upside risks to inflation. These factors, together with stronger domestic demand and a widening current account deficit (and lingering fiscal concerns) should warrant a policy rate in neutral territory even if the Fed and global liquidity concerns are on the back burner. Our outlook for inflation expectations settling closer to 3.5% suggests the nominal rate should probably be at least at 5%.

## Inflation normalizing towards target



Source: DANE, BanRep and J.P. Morgan

## Medium-term expectations more elevated



Source: BanRep and J.P. Morgan

# Colombia: Growth gradually improving, Current account widening

- Colombia's 3Q18 GDP grew at 2.7%*oya*, *nsa* and 0.9%*q/q*, *saar* disappointing our forecast (3.0%*oya*). Domestic demand gained traction in 3Q, with both consumption and investment coming back firmly. We think this trend has solid momentum, as animal spirits from the market friendly election result should add additional tailwinds to a cyclical recovery already underway, as well a positive impulse from the terms of trade. While general government consumption continues to be firm (for better or for worse), we expect already improving household consumption to gradually carry the weight going forward. Meanwhile, the investment recovery—which has lagged—should slowly but surely continue to gain momentum.
- The 4Q economic data—activity, trade balance and civil works—continue to point to a significant acceleration in domestic demand in 4Q, leading us to revise up our forecast to 3.0%*oya* (from 2.5%). We left our 2.7%*oya* forecast for full-year 2018 as is, but if our 4Q forecast is on point, it would put upside risk to our 3.1% forecast for 2019.
- According to BanRep, the current account deficit for the first 9 months of 2018 was equivalent to 3.6% of GDP. The improvement in the trade balance (goods) has been basically more than cancelled out by a widening income deficit, the result of larger profit remittances. All told, and considering lower oil prices as we head into next year, Colombia's external accounts paint a picture of a current account deficit (CAD) which has stopped narrowing and is now heading wider, even in a scenario of recovering oil prices.
- With the trade balance set to widen in 4Q, we now revise the full-year CAD up to 3.7% of GDP and next year to 3.6%. The last round of data put modest upside risk to that call. That said, we still do not see undue stress on the financing of the CAD, with the FX and the factor income account playing the role of automatic stabilizers, and the financial account of the BOP still looking solid, both in terms of FDI and portfolio flows.

## Colombia: Economic indicators

	Average				
	2012-16	2017	2018f	2019f	2020f
Real GDP, % change	3.6	1.8	2.7	3.1	3.1
Consumption <sup>1</sup>	3.2	1.9	2.7	2.8	2.5
Investment <sup>1</sup>	1.0	0.1	0.5	0.7	0.9
Net trade <sup>1</sup>	-0.5	-0.2	-0.5	-0.3	-0.3
Consumer prices, % <i>oya</i>	4.1	4.3	3.2	3.6	3.3
% Dec/Dec	4.1	4.1	3.2	3.7	3.4
Producer prices, % <i>oya</i>	2.1	0.9	3.0	3.0	3.0
Government balance, % of GDP	-1.7	-3.6	-3.1	-2.6	-2.4
Merchandise trade balance (US\$ bn)	-4.2	-5.7	-4.8	-5.4	-7.0
Exports	49.9	38.6	44.5	46.4	47.4
Imports	54.2	44.3	49.3	51.8	54.4
Current account balance	-14.9	-10.6	-12.0	-12.2	-12.4
% of GDP	-4.4	-3.4	-3.7	-3.6	-3.6
International reserves, (US\$ bn)	43.9	46.8	46.8	46.8	46.8
Total external debt, (US\$ bn)	108.0	126.1	127.6	129.1	130.6
Short term <sup>2</sup>	13.1	14.3	14.3	14.3	14.3
Total external debt, % of GDP	30.2	39.9	38.6	37.8	37.5
Total external debt, % of exports <sup>3</sup>	155.5	222.6	204.2	198.8	195.4
Interest payments, % of exports <sup>3</sup>	6.2	8.2	9.8	9.7	9.0

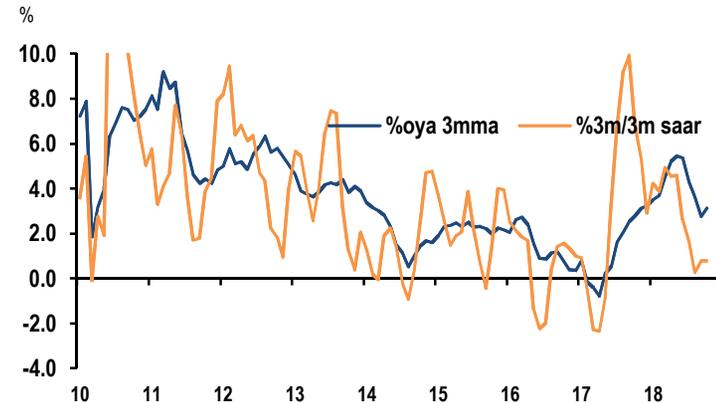
- Contribution to growth of GDP.
- Debt with original maturity of less than one year.
- Exports of goods, services, and net transfers.

Source: DANE and J.P. Morgan estimates

# Chile: Back to potential growth in 4Q18

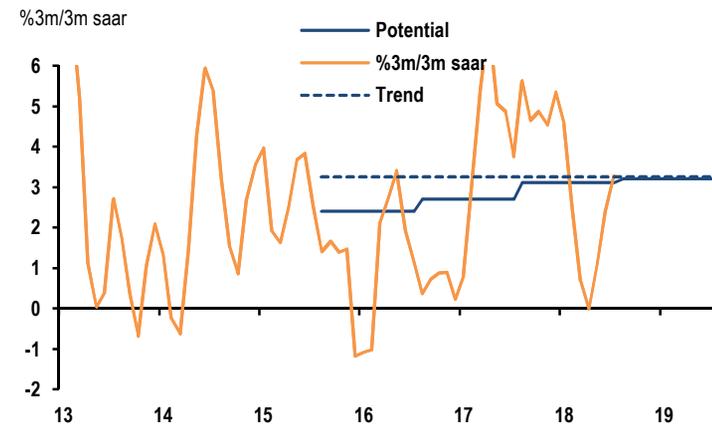
- Sequential growth in ex. mining activity returned to potential in 4Q18, leaving behind a weak 3Q18. Seasonally adjusted activity was a bit soft in December side, printing flat month-on-month. But that was enough to put 3m/3m saar growth at 3.3%, slightly above potential growth (3.2%). Compared to December 2017, ex. mining activity grew 2.8%, buoyed by one extra working day.
- Mining output dropped 6.7%/m, sa in December on the heels of an impressive 10.4% jump in November. We expected a contraction after the November jump. In all, mining activity expanded 4.1%q/q, saar in 4Q18, slowing from 8.0% in 3Q18.
- Despite global growth concerns and metal price declines, mining activity did accelerate in 2H18. Yet it remains to be seen whether mining production will remain at current levels. On an over-year basis, mining activity grew 0.5%oya in December.
- After the December print, the monthly economic indicator showed 2018 activity up 4.0%/y/y, slightly above our initial forecast. Yet we could see further revisions in the 4Q18 national accounts to be reported by mid-March. In any case, activity closed the best year since 2013, and the 4Q18 momentum leaves a solid 0.9%-pt statistical carryover for 2019.
- Given our current 2019 GDP projection at 3.5%/y/y, the carryover would be consistent with a 2.6% “within-year” growth). Such a pace would be stronger than in 2018 (2.0%) and similar to the 2013 performance (+2.7%).

## Economic activity indicator



Source INE, BCCh, and J.P. Morgan

## Ex. mining economic activity

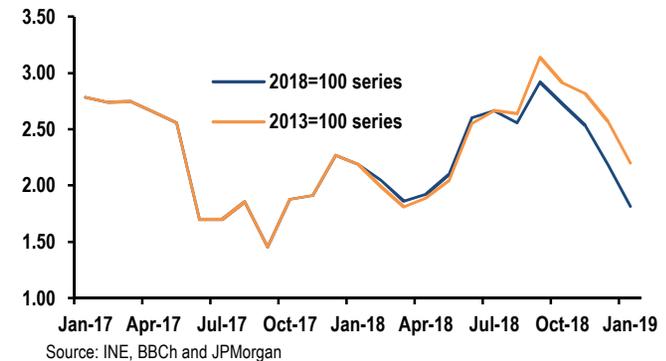


Source INE, BCCh, and J.P. Morgan

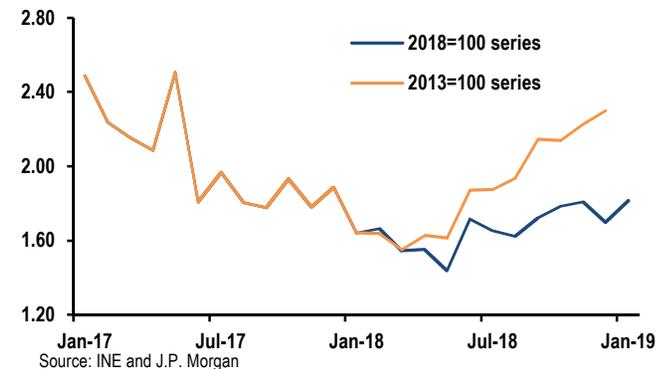
# Chile: The INE introduced an updated CPI basket with a couple of surprises

- Last week the INE introduced its CPI basket update, and presented the monthly figures for the main categories from February 2018. The revision brought notable changes to 12-month trailing inflation rates. Indeed, both headline and core (defined as headline ex. food and energy prices) inflation were revised lower in eight of the past 11 months.
- Taking into account these revisions, headline CPI inflation is now tracking at 1.8%oya and core CPI at 1.9%, both below the floor of BCCh's 3%±1% target range. The difference in levels vis-à-vis the prior series is noteworthy, in particular for core inflation (ex. food and energy), the metric we focus on when addressing the cyclical stance of the economy. In fact, core CPI inflation printed at 1.7% in December 2018, compared to 2.3% in the prior series. And, non-tradables CPI is now tracking at 2.9%oya, and tradables inflation at just 0.8%oya in December, substantially below the 3.4% and 1.8% under the 2013 CPI basket.
- Of note, two services price series explain the INE's revision: Telecommunications contributed 42% and tourist package services 58% of the downward revision in headline CPI.
- We lower 2019 inflation forecast to 3.0%. Despite the specific sectors explaining the CPI revisions, we are compelled to revise our 2019 inflation projections. We now forecast December 2019 CPI inflation to print at 3.0%oya, at the midpoint of BCCh's target range and lower 2020 inflation to 2.9%. In all, we see limited upside pressures even though the output gap is statistically no different zero, and we see GDP growing at an above-potential 3.5%/y/y pace in 2019. Headline inflation should remain low in 1H19, hovering around 1.9%oya, and accelerate in 2H19 to average 2.5%.

## Headline CPI revisions



## Core CPI revisions



# Chile: BCCh has more room for “gradual and cautious” removal of monetary accommodation

- BCCh raised the policy interest rate by 25bp to 3.0% in January, as the narrowing excess capacity merited less monetary accommodation. At the same time, the Board put global risks at the forefront and removed the words “highly expansionary” from its characterization of its monetary stance, suggesting it is comfortable with the current policy rate, at least for several months. On top of that cyclical stance, following the CPI basket update, headline and core inflation are now below the Board’s target range.
- We now see the Board on hold in 1H19, and hiking the policy rate 25bp in 2H19. Inflation hovering just below the 2% floor of the BCCh’s target range in 2H19 should limit the incentive to tighten monetary policy further, even if growth prints above potential.
- We thus pushed the 25bp hike originally penciled in for late 2Q19 to the September 3 policy meeting, when BCCh will be release its 3Q19 Monetary Policy Report.
- We still expect another 25bp hike in 4Q19, and thus keep our projected policy rate in December 2019 at 3.50%, and in December 2020 at 4.0%.

## Summary of economic forecasts

### Chile: economic indicators

	Average 2012-16	2017	2018f	2019f	2020f
Real GDP, % change	2.9	1.5	3.9	3.5	3.0
Consumption <sup>1</sup>	2.7	2.1	2.7	2.3	2.2
Investment <sup>1</sup>	0.0	1.0	1.6	2.1	0.6
Net trade <sup>1</sup>	0.2	-1.6	-0.5	-0.9	0.3
Consumer prices, %oya	3.5	2.2	2.4	2.2	3.1
% Dec/Dec	3.2	2.3	2.2	3.0	2.9
Producer prices, %oya	0.5	9.7..	..	..	..
Government balance, % of GDP	-1.3	-2.7	-1.9	-1.7	-1.5
Merchandise trade balance (US\$ bn)	4.0	7.9	6.6	5.6	4.1
Exports	70.5	69.2	74.2	78.6	78.6
Imports	66.5	61.3	67.5	73.0	74.5
Current account balance	-7.0	-2.9	-4.3	-5.7	-7.2
% of GDP	-2.7	-1.0	-1.4	-1.9	-2.3
International reserves, (US\$ bn)	39.8	36.5	37.3	37.3	37.3

1. Contribution to growth of GDP.

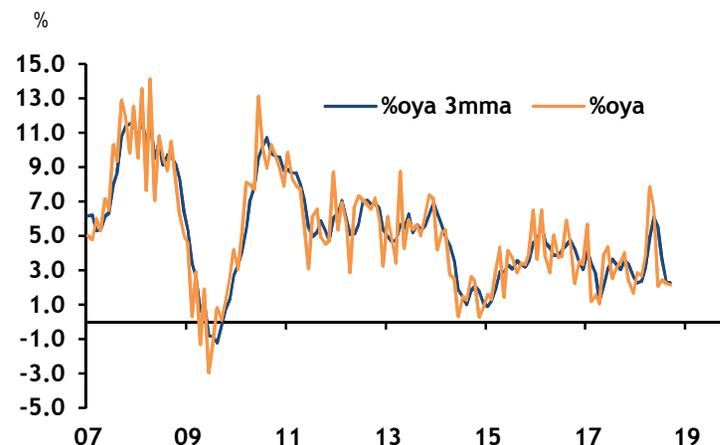
2. Debt with original maturity of less than one year.

3. Exports of goods, services, and net transfers.

# Peru: GDP growth expected at 4.0%/y for 2018 and 3.9%/y next year

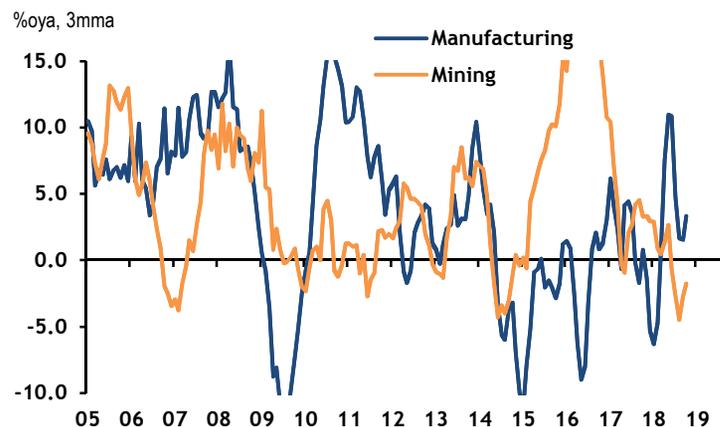
- 2018 GDP growth expected at 4.0%/y. 1H18 delivered strong growth momentum. The 5.4%q/q, saar expansion in 2Q18 came on the heels of 6.0% growth in 1Q, marking a second consecutive quarter of growth, well above BCRP's 3.5% estimate of Peru's potential growth rate and the 2.9%q/q, saar average quarterly pace in 2016-2017.
- Private investment picked up in 2Q, with the benign external backdrop helping to offset domestic political uncertainty. As a result, private sector fixed capital formation has expanded for four consecutive quarters, leaving behind a protracted three-and-a-half-year contraction.
- 3Q18 activity growth proved softer-than-expected, but October activity showed signs of recovering momentum.
- We expect activity to regain steam in 4Q18, bringing full-year 2018 growth to 4.0%/y.
- For 2019 we call for a 3.9%/y GDP expansion. Public sector investment should decelerate as structural fiscal consolidation unfolds and a less benign external environment weighs on growth, with terms of trade stable if not lower amid tighter financial conditions.
- Political uncertainty is likely to ease, although we can not discard further bouts affecting private sector investment. We currently forecast GDP growth easing to 3.9%/y, with the output gap likely closing in 1H19 (BCRP estimates output gap at -0.3% in 2019)

## Activity



Source: BCRP and J.P Morgan

## Manufacturing and mining production

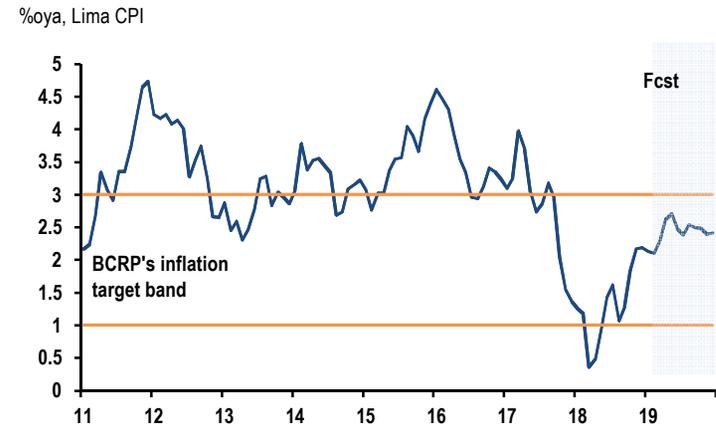


Source: BCRP and J.P Morgan

# Peru: Soft inflation print in January

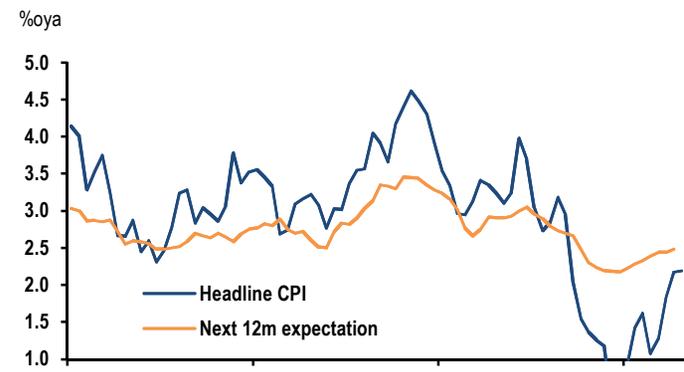
- Lima's headline CPI printed just 0.07%/m in January, below our forecast for +0.17%/m. Therefore, the last 12-month headline CPI eased again to 2.13%oya from 2.19%oya reported by December 2018. In all, headline inflation continued a tad above the mid-point of BCRP's target range (2%±1%).
- When excluding food and energy prices, inflation printed +0.05%/m, enough to drive over-year-ago core inflation to 2.40%oya, level not observed since 2Q17
- In terms of the headline CPI breakdown, in January two categories experienced deflation on the month: "Food & Beverages" and "Transport & Communications", contributing with -2.8bp and -9.6bp to headline CPI monthly variation, respectively. On the other side, "Housing & Energy" added 13.6bp to headline inflation.
- With more granularity, the most notable price variations were observed in residential electricity (contributed +8.2bp), more than offset by the 5.0% drop in chicken prices (subtracted 12.2bp on the month). In all, monthly headline inflation printed 16bp below last 14-year average.
- We expect inflation to mildly accelerate in 2019, closing the year at 2.4%oya. Headline inflation is likely to ease further in February, reaching 2.10%oya. But base effects will play more of a role in 2Q19, with inflation reaching a peak about 2.7%oya by May. In 2H19, we see inflation losing steam, converging to 2.42% by December, still on the upper side of BCRP's target band.

## Peru CPI



Source: INEI, BCRP and J.P Morgan

## Headline and expected inflation



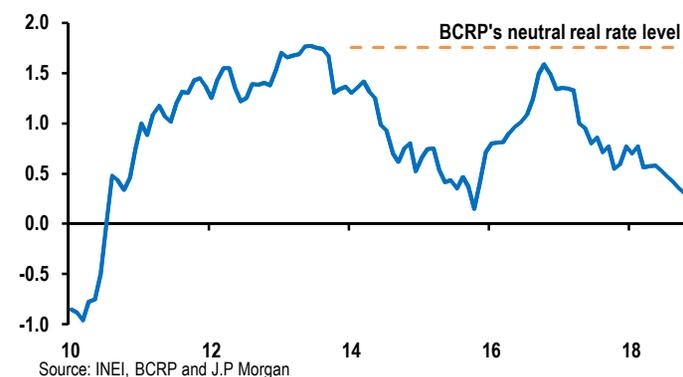
Source: INEI, BCRP and J.P Morgan

# Peru: BCRP is to tighten monetary conditions later in 2019

- BCRP stood pat in January, keeping the policy rate unchanged at 2.75%. BCRP seems under no pressure to start removing its monetary accommodative stance. Yet, we do expect a shift in language towards a more structural stance by February, so for our base case scenario to pan out and BCRP starting to remove monetary accommodation in 2Q19.
- Why do we refer to a more structural monetary stance? Because the real ex-ante policy rate has reached cyclical lows. With the policy rate stable at 2.75% and next 12-month inflation around 2.50%, the real ex ante policy rate reached a new cyclical low. At 0.25%, the real ex-ante policy rate appears 150bp below the neutral real rate.
- Therefore, we believe BCRP should commence a tightening cycle in the coming months as cyclical macroeconomic conditions approaching its neutral or trend levels, i.e., realized inflation inside the target range, the output gap converging to null, private investment and credit rising. In the same vein as for Chile, we expect BCRP to proceed with a gradual tightening cycle. We expect the policy rate to reach its neutral level (3.75%) in 1H20.
- Fiscal consolidation ahead. Following anti-cyclical fiscal stance in 2017 and 2018, the government is to consolidate the fiscal accounts starting 2019. The target is to drive the headline fiscal deficit to 2.7% of GDP by December 2019 and 1.9% in 2020, so to converge to 1.0% of GDP in 2021.
- Debt is to peak at around 27.5% of GDP in 2019, declining to 26.0% of GDP by 2022. Importantly, for the planned consolidation to come to fruition, the government must still pass in Congress fiscal measures for about 1.1% of GDP.

## Real ex-ante policy rate

%, monetary policy rate deflated by next 12m expected inflation



## Summary of economic forecasts

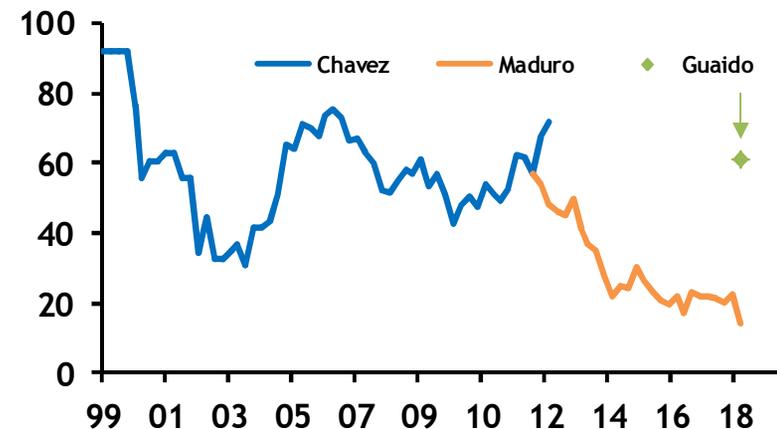
### Peru: economic indicators

	Average 2012-16	2017	2018f	2019f	2020f
Real GDP, % change	4.3	2.5	4.0	3.9	3.6
Consumption <sup>1</sup>	3.7	1.6	2.3	2.7	2.5
Investment <sup>1</sup>	0.3	-0.2	1.5	1.6	0.8
Net trade <sup>1</sup>	0.3	1.1	0.1	-0.4	0.3
Consumer prices, %oya	3.4	2.8	1.8	2.4	2.8
% Dec/Dec	3.3	1.4	2.4	2.7	2.9
Producer prices, %oya	1.4	0.9	1.6	4.0	3.0
Government balance, % of GDP	-0.4	-3.1	-2.8	-2.7	-2.0
Merchandise trade balance (US\$ bn)	0.9	6.7	5.0	4.3	3.4
Exports	40.2	44.9	47.1	48.1	47.6
Imports	39.3	38.2	42.1	43.8	44.2
Current account balance	-7.2	-2.3	-3.7	-4.4	-4.2
% of GDP	-3.7	-1.1	-1.6	-1.8	-1.6

# Venezuela: A political inflection point may be near with Maduro's 2013-19 term over and Guaidó unifying the opposition

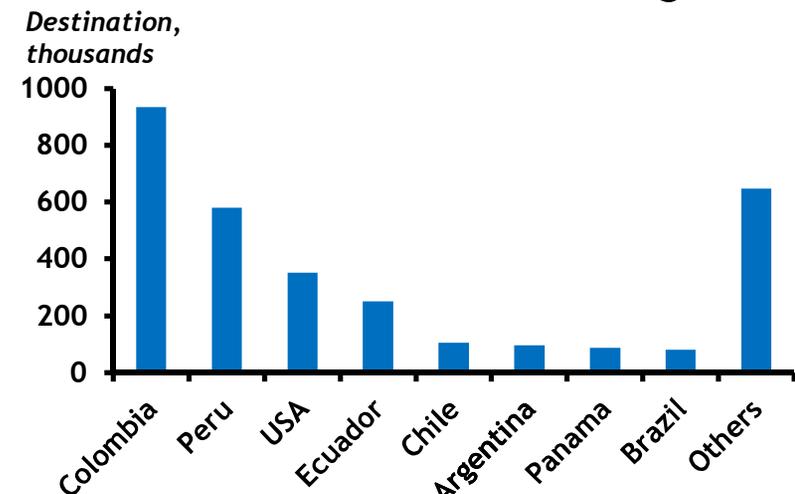
- After 14 years in power, Hugo Chavez's March 2013 death left Venezuela's political landscape deeply unsettled. While ill, Chavez won a decisive reelection in October 2012. His handpicked successor, Nicolas Maduro, barely won an April 2013 snap election to fill the remainder of the 2013-19 term.
- The government was challenged in 2014 by strong street protests. Opposition leader Leopoldo Lopez was controversially jailed as the alleged mastermind.
- The MUD won a resounding victory in December 2015 legislative elections, taking 56% of votes and two-thirds of seats—a qualified majority that in theory should have granted ability to check the executive. In practice, a Supreme Court (TSJ) loyal to Maduro blocked all legislative initiatives.
- By mid-2016 the opposition turned to constitutional strategies for regime change. A presidential recall referendum was blocked by courts, despite strong popular support. By end 2016, Maduro turned to the Vatican to defuse resulting protests. "Dialogue" talks ultimately produced no results other than to stall protests.
- In March 2017, the Supreme Court formally assigned to itself the functions of the National Assembly, a move that was condemned as a "coup". It also exposed fissures within the upper ranks of Chavismo and helped reignite nearly six months of street protests—which turned deadly amid repression.
- Under pressure, Maduro in 2017 launched a Constituent Assembly (ANC) to rewrite Chavez's '99 constitution. The rules for the ANC election were stacked in favor of Maduro. On July 16, the opposition held an unofficial plebiscite, with 7.6mn coming out to reject the ANC. On July 30, the government held a vote for the ANC anyway, amid allegations of fraud to boost the total votes to 8.1mn. The US, EU and LatAm governments have condemned the ANC as illegitimate; the US has imposed both individual and financial sanctions.
- The opposition MUD failed to win enough concessions in 1Q18 dialogue talks to ensure competitive presidential elections in 2018. Maduro "won" re-election on May 20 vote amid a MUD boycott and record low turnout. The US, the Lima Group and the EU did not recognize the result.
- With Maduro's recognized 2013-19 term ending on January 10, a surprisingly unified opposition—resolutely backed by Western and Latin American democracies—moved to declare the presidency illegitimately usurped, effectively vacant. This, according to the Venezuelan constitution, entitles the head of the (opposition-controlled) legislature, Juan Guaidó, to lead a transition government and call new elections. President Trump recognized Guaidó on January 23 and more than 50 nations have followed.

## Presidential popularity



Source: Datanalisis

## Some 3mn Venezuelans have migrated



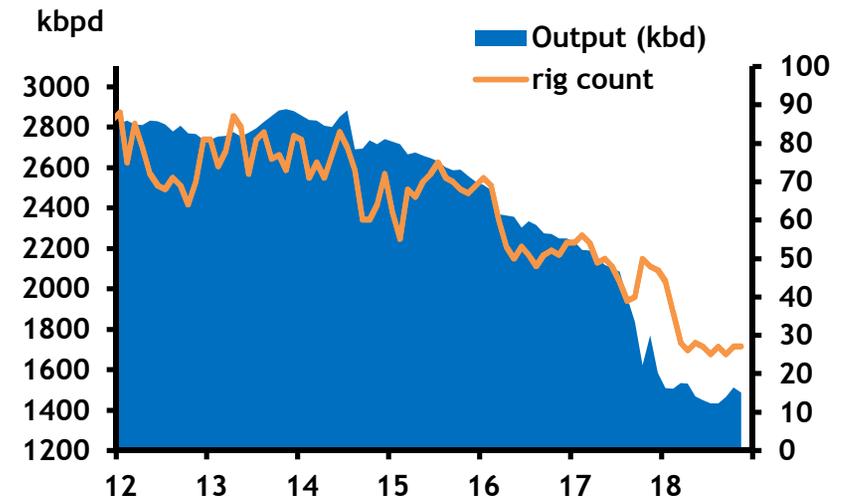
Source: International Organization for Migration, USAID, EFE, IMF and J.P. Morgan

# Venezuela: An already struggling oil sector is now subject to commercial sanctions

COUNTRY SPECIFIC OUTLOOK & REGIONAL THEMES

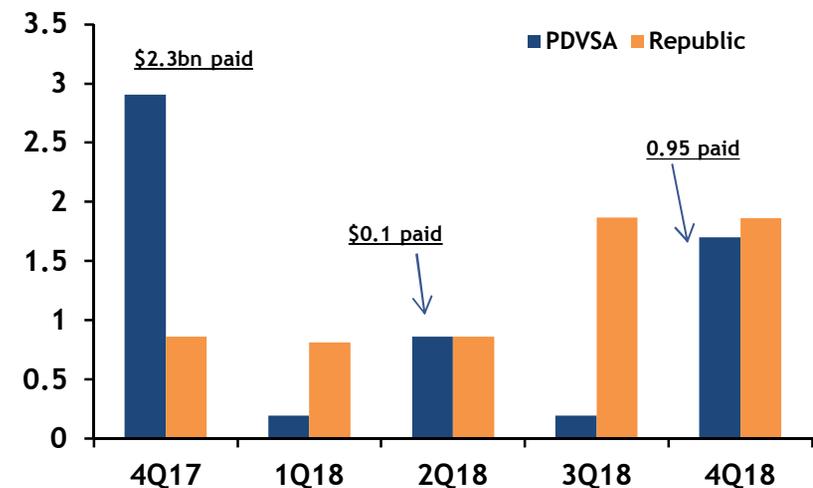
- Oil accounts for over 95% of exports and traditionally close to half of government revenues. Venezuela has close to 300 billion barrels of reserves when including the unconventional heavy crude, according to BP.
- State oil company PDVSA acknowledges that output of liquid hydrocarbons fell 12% in 2016 and another 29% in 2017. Of the 649k bpd lost in 2017, 464k bpd of the drop occurred in the last quarter. In 2018, secondary sources tell OPEC output was down 450k bpd (-27% ytd) to 1.2mbd. Direct reporting from PDVSA is at 1.4mbd output. Since 2017, financial sanctions and cashflow difficulties impacted PDVSA's ability to manage its relations with partners and service providers,
- Operational woes were compounded by Conoco's pursuit of a \$2bn arbitration award, leading to attachments in key facilities in the Dutch Caribbean. The difference between Conoco's claim, which was settled in September, and other (stalled) awards is that the former was against PDVSA, not the Republic (which has alter-ego and sovereign immunity defenses).
- Mining company Crystallex, with a \$1.2bn claim on the Republic, won an alter-ego decision in Delaware court that could result in the sale of PDVSA's main US asset, Citgo. However, the ruling has been appealed.
- In November 2017, Maduro announced he would pay \$2bn of PDVSA principal, while also decreeing the "refinancing and a restructuring" of \$36bn of Republic and \$27.9bn of PDVSA bonds. The authorities never declared moratorium. Since then, the only bond that has been serviced are Citgo-collateralized PDVSA 2020s have been paid this year, which received a \$950mn payment in November.
- So far, no formal proposal has been tabled, and there is no clarity on the next steps to engage bondholders. PDVSA debt service has been partially paid, and bondholders –while increasingly organized--have yet to accelerate their claims
- The imposition of US sanctions on January 28th on the oil sector and the explicit designation of PDVSA as a sanctioned entity should take a toll on PDVSA's crude oil production in the short term.
- PDVSA now finds itself in the position of finding alternate destinations for approximately 506mbpd in crude exports to the US concentrated in extra heavy crude and sourcing approximately 100mbpd of diluent necessary to maintain production levels. The US represents approximately a third of total crude exports and the lion's share of cash exports exacerbating the delicate cashflow situation. While some portion of the production could be diverted to Asia, particularly India, increased transportation costs, and material discounts are considerations.

## Oil output declining sharply



Source: OPEC (production, direct report) and Baker Hughes (rig-count)

## \$1.1bn paid to PDVSA '20s, \$7.3bn unpaid in 2018



Source: PDVSA, FinMin, Bloomberg and J.P. Morgan

# Ecuador: IMF and multilateral funding covers 2019 financing needs

- President Moreno unveiled that Ecuador had reached a “staff level agreement” with the IMF for a \$4.2bn loan, and for an additional \$6.0bn from other multilaterals. The IMF stated that their goal is to keep Ecuador out of markets until 2022. The authorities’ guidance is that the program would be brought in front of the Board in “the coming weeks”, likely by the mid- or end-March.
- Martinez provided a more details on the skeleton of the program in a later press conference. Of the \$10.2bn, \$6.7bn will “free to use” (for general fiscal financing) and \$3.5bn would be tied to specific program endorsed by the multilaterals. Disbursements would be more “front-loaded” with \$4.6bn in 2019, followed by \$3.15bn in 2020 and \$2.5bn in 2021, implying that Ecuador would receive \$1.4bn from IMF annually and the rest from multilaterals, contingent on the conditionality being met.
- The credit lines go a long way towards fulfilling a \$8.5-\$10bn financing gap over the next 21 months and minimize supply risks that Ecuador will return to tap markets for new issuance, aside from a potential liability management, in our view. With \$4.6bn in multilateral funding expected this year, along with previously scheduled disbursements and financing, Ecuador should be able to meet its 2019 financing needs without having to run to markets.

## Long term financing needs 2018-2022

\$bn	2018	2019	2020	2021	2022
<b>Financing needs</b>	<b>11.7</b>	<b>9.0</b>	<b>9.8</b>	<b>8.5</b>	<b>10.5</b>
Deficit	4.4	3.7	2.8	2.6	2.3
Internal amortization	1.8	1.7	2.3	3.4	3.6
External amortization	2.1	2.2	4.2	2.2	4.3
Others	2.0	1.5	0.4	0.3	0.3
Miscellaneous	1.4				

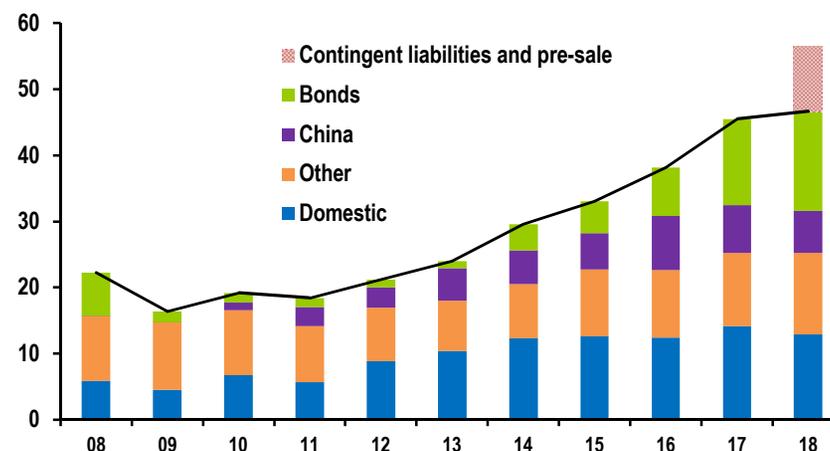
Source: Ministry of Finance

## Estimated 2019 financing needs and sources (\$bn)

Uses	
Central government deficit	3.7
Internal debt amortizations	1.6
External debt amortizations	3.0
Multilateral	0.7
Bilateral	1.2
Bonds	0.3
Pre-sale obligations	0.9
Arrears	0.6
Others	0.1
<b>Total</b>	<b>9.0</b>
Sources	
External Bonds	1.8
Internal bond issuance	0.8
Oil pre-sale disbursements	0.4
Multilateral disbursements	0.9
Private financial sector loans	2.9
Bilateral disbursements	1.8
Intra-public sector liquidity	0.3
<b>Total</b>	<b>9.0</b>

Source: Ministry of Finance

## Public debt starting to flatten out at 47% of GDP \$bn, ytd adjusted balance



Source: Ministry of Finance and J.P. Morgan

\* includes other bilateral, multilateral and banks debts

# Ecuador: The devil is in the details

- Ecuador capped off a significant fiscal consolidation in 2018. According to preliminary Ministry of Finance data showed a central government deficit at \$3.3bn in 2018 (about 3.1% of GDP) down from 5.9% seen in 2017. The end of the year also underscored the tight liquidity situation: the fiscal outperformance vis-a-vis the budgeted 4% of GDP deficit target reflected, in large part, a financing shortfall of about US\$1 billion at year-end and with the same amount of arrears owed. An expected US\$900 million loan from CDB was only partially disbursed and, in turn, to prop up international reserves, the Central Bank entered a US\$300 million short-term loan in exchange for gold.
- This year's budget aims for a 3.2% of GDP. But amid higher interest payments and transfers, we think adhering to the budget's spending target of 23% of GDP will be challenging. More flexible capital expenditure has borne much of the brunt of cuts to date, falling from 9.8% of GDP in 2016 to 6.5% in 2018, and would decline further to 6.3% in 2019's budget. Longer-term, the budget entertains a reduction in the CG deficit to 2.2% by 2021.
- Martinez shared that under IMF's EFF, the government aims to consolidate the NFPS deficit, which had peaked at 7.3% of GDP in 2016, from 1% of GDP in 2018 to a 3% surplus by 2021. Given that 2019 budget aims further reducing the central government deficit by 1% of GDP through 2021, it seems that much of the consolidation will take place in public enterprises (like the oil companies) or in social security. Efforts to raise oil production, improve efficiencies and reduce wages (as well as any bonus from oil prices) could help bridge the gap.
- The authorities are stressing the program as an endorsement of a "home-grown" economic plan, with a strong focus on social programs, in a nod to fending off criticism that the IMF has "imposed" the adjustment. More details should be available in the MoU in March upon the Executive Board's approval.

## Ecuador: Economic indicators

	Average				
	2012-16	2017	2018f	2019f	2020f
Real GDP, % change	2.6	2.4	1.1	-0.2	-0.8
Consumption <sup>1</sup>	1.6	2.7	2.1	-0.2	-1.2
Investment <sup>1</sup>	-0.3	2.6	0.8	-0.1	-1.0
Net trade <sup>1</sup>	1.3	-3.0	-1.9	0.0	1.4
Consumer prices, %oya	3.4	0.4	-0.1	0.7	0.5
% Dec/Dec	3.0	-0.2	0.3	0.7	0.3
Government balance,* % of GDP	-4.8	-6.0	-3.1	-3.2	-2.4
Merchandise trade balance (US\$ bn)	-0.1	0.3	-0.3	0.4	-0.1
Exports	22.6	19.6	22.2	23.7	23.0
Imports	22.8	19.3	22.4	23.4	23.1
Current account balance	-0.5	-0.3	-0.9	-0.3	-0.7
% of GDP	-0.6	-0.3	-0.8	-0.3	-0.6
International reserves, (US\$ bn)	4.4	2.4	2.1	2.4	3.1

Source: BCE and JP Morgan estimates

## NFPS and CG fiscal balances

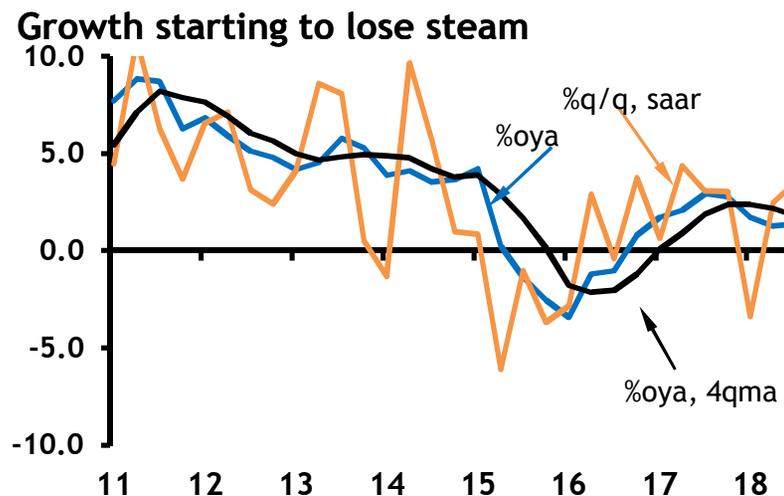


Source: BCE

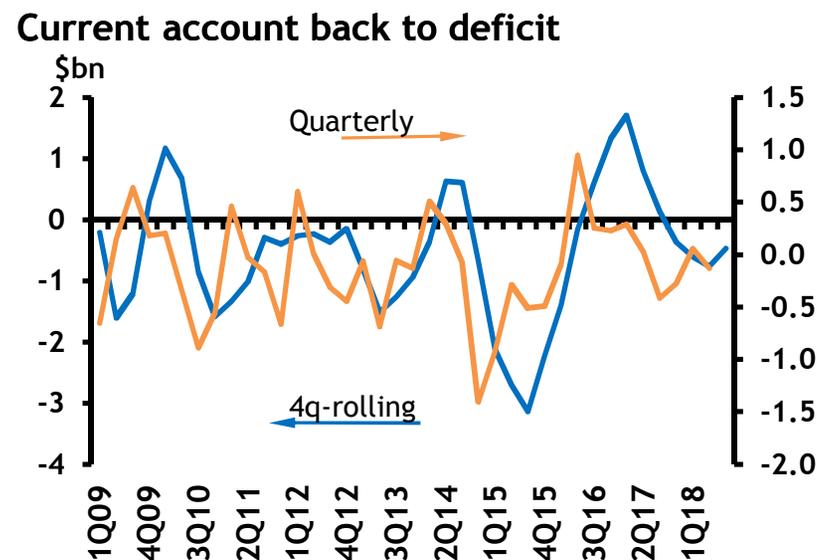
J.P.Morgan

# Ecuador: Engineering an economic adjustment won't be easy

- We expect growth to slow 1.1% in 2018 (from 2.4% in 2017) into a modest recession at -0.2% of GDP, with risks skewed to the downside. Lower public spending will inflict the necessary fiscal drag, and . While credit growth expanded and boosted consumption in 2018, banks will likely have to pull back next year as deposit growth slows, which will weigh on private consumption and imports. The oil and construction sectors could support investment, as could initiatives in fishing, retail and services promoted by the private sector.
- Strong import demand has kept the current account in deficit and drawn down on reserves, despite gains in oil prices. The trade balance registered a 0.5% of GDP deficit from a 0.1% surplus, as import rose 16%, outpacing export growth. We now expect that Ecuador finished with a 0.8% of GDP current account deficit in 2018 and while we await the final details of the IMF program, a CAD of 0.3% in 2019. The IMF program seems intent on using the fiscal adjustment to engineer a balance of payments surplus (via the current account) to rebuild reserves, but does not contemplate an earmarked flow for the central bank.
- Ecuador's oil sector represents a more concrete silver lining by making progress to open the sector with new fields and contracts under the direction of Hydrocarbons Minister Perez. The government continues to pursue private investment in the oil sector as part of its goal to grow production to 700k bpd by 2021. Petroamazonas aims to raise production at the ITT field from the current 70k bpd to 125k as the Ishpingo field comes online. The company's budget would be \$3.3bn, in line with 2018's expected execution, and production would rise to 30k barrels. The company expects to meet its mandated 10% staff reduction target by year-end, in a cost saving effort set by the government.



Source: BCE, JPMorgan estimates

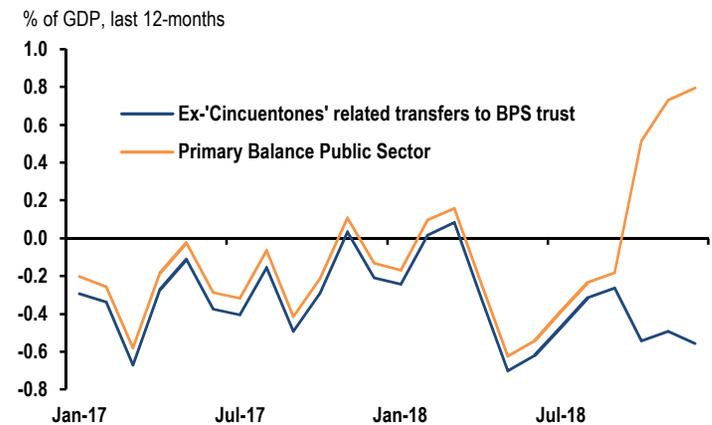


Source: BCE

# Uruguay: The overall fiscal deficit narrowed to 2.7% of GDP in 2018 thanks to the 'cincuentones' transfers

- December's overall fiscal deficit reached UYU19.2bn, driving the last 12-month headline shortfall to 2.7% of GDP. The headline deficit has narrowed by 0.8%-pt when compared to December 2017 when it reached 3.5% of GDP. With the overall interest bill at 3.54% of GDP, the primary balance reached +0.7% of GDP.
- The marked fiscal improvement in the past three months obeyed mostly to the AFAPs transfers to the social security trust (SST) on the back of the 'cincuentones' (above-50-year old) law that introduced changes to the pension system. The law 19590 allowed contributors approaching retirement to migrate from the capitalization regime to the pay-as-go-you regime administered by the Banco de Prevision Social (BPS). The transfers from the AFAPs to the BPS are recorded as a fiscal revenue, what is consistent with IMF methodology.
- As of end-2018, the total assets transferred to the SST accounted for about 1.3% of GDP. Transfers are likely to continue over the next three years, leading to further reductions in the headline fiscal deficit. The assets will be held in the SST until 2024, year by which the BPS is expected to start paying for the additional pensions over a 20-year period.
- From a macro-cyclical standpoint, we find informative to control for these transfers as they are not recurrent central government income. When adjusting for the 'cincuentones' transfers, the last12-month primary deficit reached -0.6% of GDP, and the underlying overall deficit 4.0% of GDP.
- We now expect the headline fiscal deficit to close 2019 at 4.0% of GDP (ex-'cincuentones' transfers). Admittedly, the political cycle the country is already embarked on is to limit fiscal adjustments and or structural reforms until the coming administration takes office in 1Q20. Yet, as we expected the authorities have taken steps to maintain revenues via raising utilities prices (see [note](#)). Beyond short term revenue-measures, the fiscal data set shows that pension spending has stabilized in real terms (i.e. as % pf GDP), while the upward trend for primary outlays has lost momentum in 2018. Also, public sector investment has consolidated below the 2012-16 average.

## Consolidated public sector balance



Source: MEF and JPMorgan

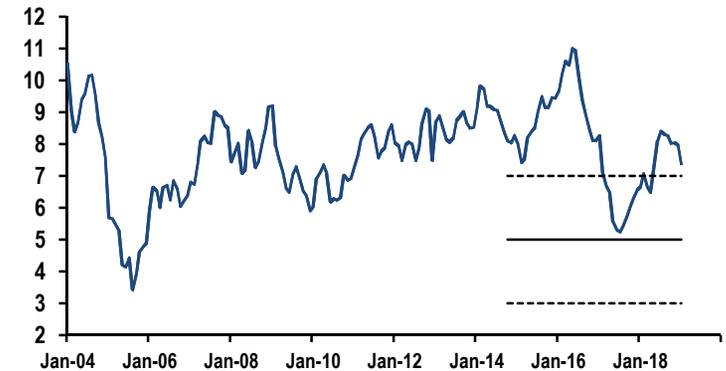
- The overall deficit (excluding the 'cincuentones' transfers) continues to print above previous targets, mostly explained by below-potential activity growth. In all, when controlling for the business cycle, the current fiscal stability does imply an actual structural fiscal consolidation. The stabilization of public spending is just the first step towards a much required consolidation of the underlying fiscal deficit. But this, together with a favorable debt profile and financial buffers that counter the high gross debt level, should allow Uruguay to avoid a costly downgrade to non-IG. The incoming administration will need to move swiftly in passing a pension reform, among other structural reforms the economy needs. We now expect the headline fiscal deficit to close 2019 at 4.0% of GDP ex-'cincuentones' transfers.

# Uruguay: Kicking off 2019 with a 'benign' inflation print

- The monthly headline printed 2.17%/m in January, below expectations (JPMorgan 2.40%/m, BCU's survey median 2.23%/m). January's print came 54bp below 2018, thus the over-year-ago headline inflation decelerated further to 7.39%oya, still above the BCU's target range ceiling (5% ± 2%), yet substantially below the intra-year peak at 8.41% observed in July.
- We revised 2019 inflation lower to 7.4%. We kicked off the year expecting inflation to reach 7.7% by December 2019. But January's 20bp downside surprise and most importantly, a moderation of the peso depreciation for the year, prompt us to revise our end-2019 projection lower. Regarding the exchange rate, as we commented one month ago (see [note](#)) a more benign external environment than the one we had envisioned prompted our colleagues to revise EM FX stronger, particularly BRL. Given our view on BCU's reaction function and the real exchange rate path ahead, we revised USDUYU lower to 35.0, from 36.0 previously. The FX revision for the stronger peso (vis-à-vis our prior forecast) subtracts 20-25bp from our initial inflation print. Thus, in our current base case scenario we now expect headline inflation to print 7.4% by December 2019 (BCU's survey median projection stands at 7.6%), and see convergence to the ceiling of BCU's inflation target band (5% ± 2%) by 1H2020.
- **We emphasize the very limited political risk stemming from the election cycle.** We see very low probability of structural reforms this year, but that does not imply lack of political understanding/ willingness of moving ahead with reforms once the new lawmakers and executive officials reach office in 2020. Supply side reforms and fiscal/social security reforms seem a necessary condition for the country to avoid declines in potential growth. In fact, in our view this episode of low growth has unmasked lingering structural issues: a rigid labor market and public spending structure. With activity running in a low gear, and inflation running above 7%, we expect unemployment to remain elevated and employment growth subdued. Moreover, the onerous tax burden continues to exert pressure on the private sector's profitability, with relatively elevated social and pension spending. In all, the administration taking office March 2020 will need to take due diligence and tackle these macro and microeconomic issues. It remains to be seen how the new government will tackle the reform needs amid the likely lack of majorities in Congress. The allocation of political capital to economic/financial reforms and other social dimensions (eg, security) is another dimension to track going forward

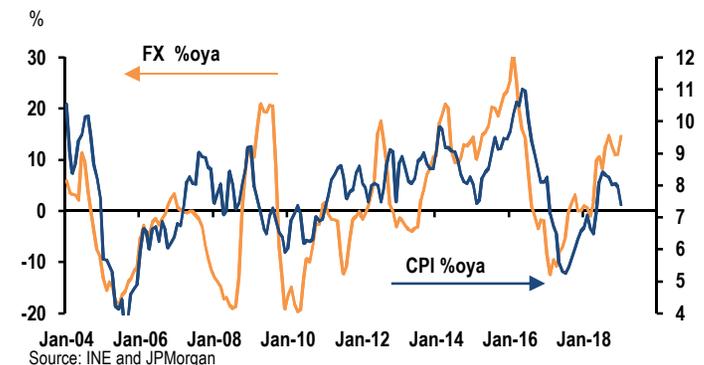
## Headline CPI

%oya, dotted lines correspond to BCU inflation target band



Source: INE and JPMorgan

## Exchange rate and headline inflation



Source: INE and JPMorgan

# Paraguay: The 4x4 economy

- The GDP growth pace moderated more than expected in 3Q18 and 4Q18. According to the monthly economic activity index, GDP expanded 3.7%/y/y in 2018, well below initial estimates for 2018 GDP to close at 4.1%/y/y. That said, we can't discard revisions higher once the national accounts are published. Going forward, the lackluster dynamism for Argentina should be offset by better prospects for Brazil following the election result.
- We see 2019 GDP growth gaining a bit of momentum, at 4.0%/y/y. In the same vein as for last year, we expect domestic demand to lead growth, particularly via investment.
- Inflation closed 2018 at 3.2%; we expect 4.0 % for 2019. In January CPI printed flat m/m, so headline inflation eased to 2.3%oya, below the 4.0% CPI target. Our base line scenario for 2019 entertains headline inflation at 4.0% and USDPYG at 6000 by eoy-2019
- We see the monetary authority standing pat for the foreseeable future. The monetary policy committee cut the policy rate in March 2018 to 5.25% from 5.50%, and has stayed put since then. Going forward, our base line scenario is consistent with a stable nominal policy rate as inflation is to drift just a bit north of the target.
- The fiscal responsibility law has limited the fiscal slippage. The law was enacted in October 2013 and limits the overall deficit to 1.5% of GDP. That said, in the last three years the fiscal deficit has averaged 1.2% of GDP, below the institutional limitation. We expect both 2018 and 2019 fiscal deficit to reach 1.3% of GDP. Away from flows and into stocks, the public sector gross debt reached US\$7.8bn by September 2018, equivalent to 18.7% of GDP. The external debt totaled US\$6.2bn (or 14.9% of GDP), of which US\$3.4bn are constituted in external bonds.

## Headline inflation



Source: BCRP and J.P.Morgan

## Monthly activity indicator

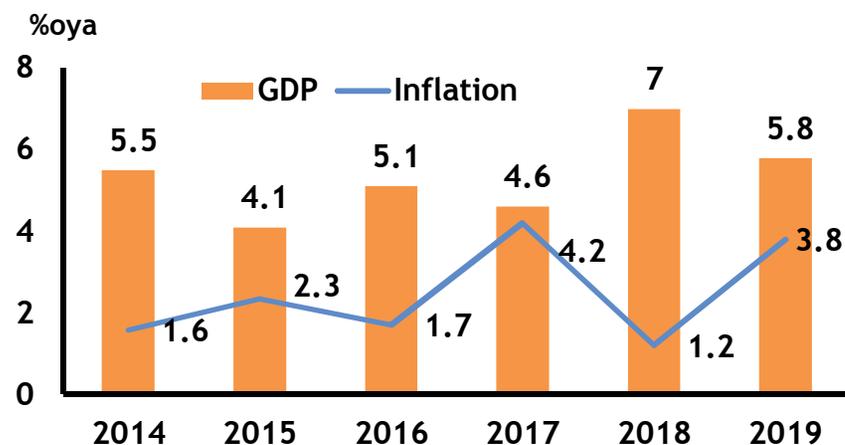


Source: BCRP and J.P.Morgan

# Dominican Republic: Still strong growth, inflation gradually moving higher

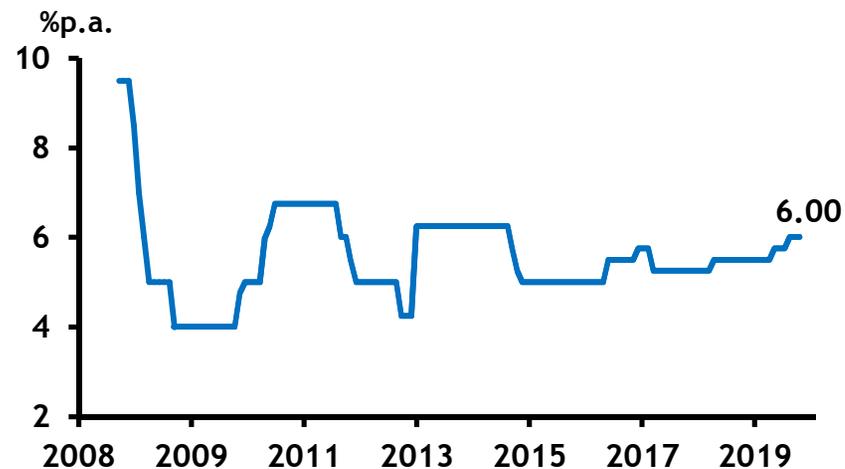
- **Solid growth last year is also our base case for 2019 now.** We maintain a constructive view on the economy, after an expansion of 7.0% last year on the back of well-balanced growth as investment, consumption and exports continue to contribute positively. Consumption has benefited from healthy growth in remittances, mainly from the US. From a supply-side perspective, the services sector should continue on a solid foot, with tourism supported by solid growth in travelers from Europe and the US. Tourism arrivals are increasing at a 5.3%oya pace in January-February, after a 6.6% average last year.
- We expect the economy to expand 5.8% this year, on the grounds of investment still expanding at high-single digits, and consumption benefiting from low inflation and healthy remittances. While softer growth in the US poses downside risks for this year and next, we do not foresee a hard landing.
- **Consumer prices are expected to increase to 3.8%.** We expect inflation at 3.8% by year-end given lower pressure on energy prices in the last few months, in addition to existing subsidies. Falling fuel prices in 2H18 resulted in an important decline in inflation at the end of the year, and we do not foresee an important increase in energy prices in 2019. Accordingly, average inflation should remain close to 2.0%. We do expect a steady increment toward 3.8% by the end of the year, given some demand side pressures on the economy and important base effects.
- **The central bank (BCRD) increased its policy rate to 5.5% in late July,** and has remained there ever since. We are now forecasting two 25bp hikes later this year. With soft inflation still on, the central bank is comfortably on hold in spite of vigorous growth. The BCRD is expected to maintain a vigilant stance given the risk of higher rates abroad, which could halt inflows into EMEs.

## GDP and inflation



Source: Bloomberg and J.P. Morgan forecasts.

## Steady for now, but more hikes by year-end

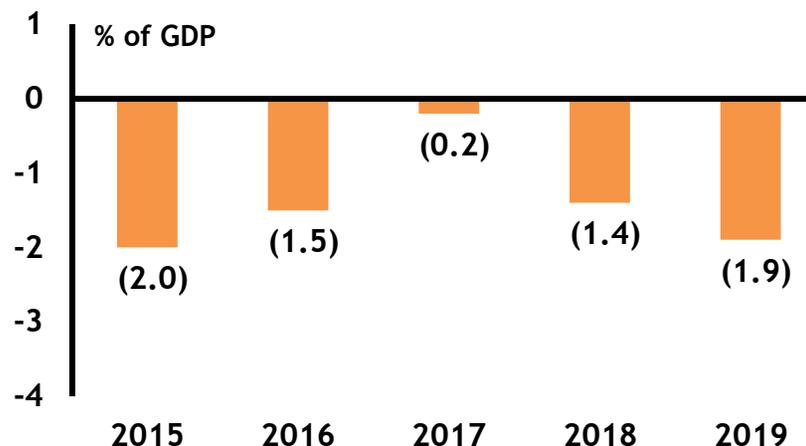


Source: BCRD.

# Dominican Republic: Manageable CAD, stable fiscal accounts

- **The current administration should press in favor of a fiscal overhaul** but the nearing electoral process next year could delay it. We do not expect credit rating changes in the foreseeable future, with major credit rating agencies currently holding a "stable" outlook for the sovereign, on the back of strong growth and no immediate fiscal pressures, but higher energy prices and lack of an energy pact could undermine this outlook.
- **Moody's upgraded Dominican Republic in 2017 and currently holds a Ba3 rating**, while S&P and Fitch hold a BB-grade (all with a **Stable outlook**). Public debt could deteriorate some in the next few quarters on the back of elections nearing and higher debt service but we do not see a deterioration in the access to external finance. Currently, we expect a fiscal deficit of 2.5% of GDP this year.
- **External accounts.** We now see CAD at 1.9% of GDP in 2019 followed by a modest deterioration to 2.1% in 2020. We revised down this year's CAD on the back of deteriorating terms of trade and higher imports, in spite of improving remittances and services trade balance (mainly tourism). The country is heavily dependent on imports for finished goods, and solid consumption dynamics should continue to underpin this upward trend in non-oil imports. We expect the currency (DOP) to reach 54.0 by year-end.
- **The next federal election is until 2020.** Recently, President Medina secured passage of a bill that allows parties to hold open primary elections to decide on each party's candidates. While this move was interpreted as an attempt from President Danilo Medina to run for president once more, the legal hurdles are still perceived as unsurmountable.

## Current Account Balance



Source: BCRD and J.P. Morgan forecast.

## Main economic indicators

	2016	2017	2018E	2019F
Nominal GDP (\$mn)	72,364	76,011	80,720	85,710
Real GDP (% change y/y)	5.1	5.0	7.0	6.2
Inflation (% change eop)	1.7	4.2	1.2	3.8
FX Rate (DOP/USD, eop)	46.66	48.25	50.00	52.00
Fiscal Balance (% GDP) <sup>1</sup>	-2.3	-2.2	-2.0	-2.5
Public Sector External Debt (\$mn) <sup>2</sup>	17,400	18,200	18,500	19,715
Public Sector External Debt (% GDP)	24.3	23.9	22.9	23.0
Public Sector Domestic Debt (% GDP) <sup>2</sup>	13.1	14.0	15.5	16.0
Total Public Sector Debt (% GDP)	37.3	38.0	38.4	39.0
Trade Balance (\$mn) <sup>3</sup>	-7559	-7580	-8660	-9500
Current Account Balance (\$mn)	-815	-165	-1450	-1630
Current Account Balance/GDP (%)	-1.5	-0.2	-1.8	-1.9
Foreign Reserves (\$mn) <sup>4</sup>	6,113	6,850	7,150	7,350

<sup>1</sup>CG. <sup>2</sup>NFPS; includes CB recap bonds. <sup>3</sup>BOP definition. <sup>4</sup>NIR. Sources: BCRD, IMF, MEPyD, MH, J.P. Morgan

# Costa Rica: Fiscal bill approved last year ... growth to remain below 3.0%

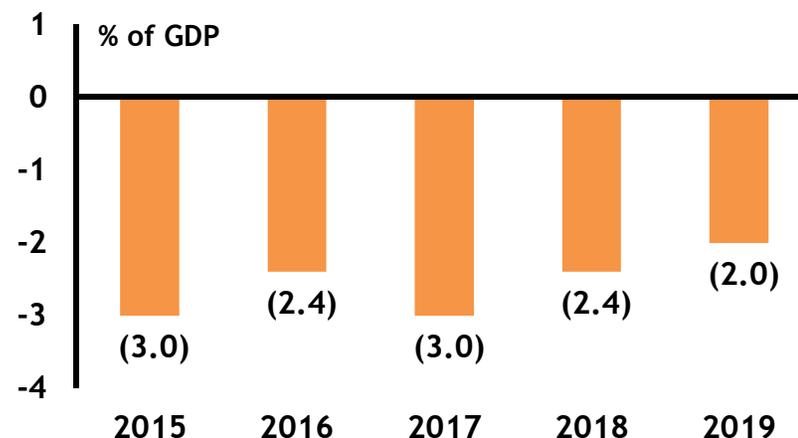
- **On May 30, the Ministry of Finance announced several changes intended to ease the fiscal challenges of the economy.** The proposed *Law for the Strengthening of Public Finances* was finally approved in late November after back-and-forth debates by the Supreme Court given challenges to the validity of such reform.
- The reform is expected to fill in loopholes and increase the tax base by introducing a Value Added Tax, which would replace the current Sales Tax. The new VAT would eliminate exemptions, including the *Zona Franca* or tax-free zone for businesses.
- The proposal included a new tax on profits for firms and individuals plus capping wages to public officials. A change to the capital gains tax (which currently only apply to real estate) was also part of the bill. Finally, a fiscal rule that restricts spending from mid-2019 onward was also approved, but in our view, will have limited effects in the short term. The fiscal deficit narrowed to 6.0% of GDP in 2018 given austerity measures and should reduce further to around 5.5% by the end of this year. We continue to expect a primary deficit in the foreseeable future, improving from 2.4% last year, to 2.0% of GDP this year.
- According to our own metrics, debt-to-GDP ratios will adjust only gradually, with revenues at 15.0% and expenditures at 20.5% of GDP in the medium term. While the effort to increase taxes and broaden the tax base through a new VAT could ease fears going forward, it remains to be seen how markets will receive the fiscal plan.

## Currency weakened as risk aversion lingered



Source: Bloomberg.

## Primary deficit to remain in place

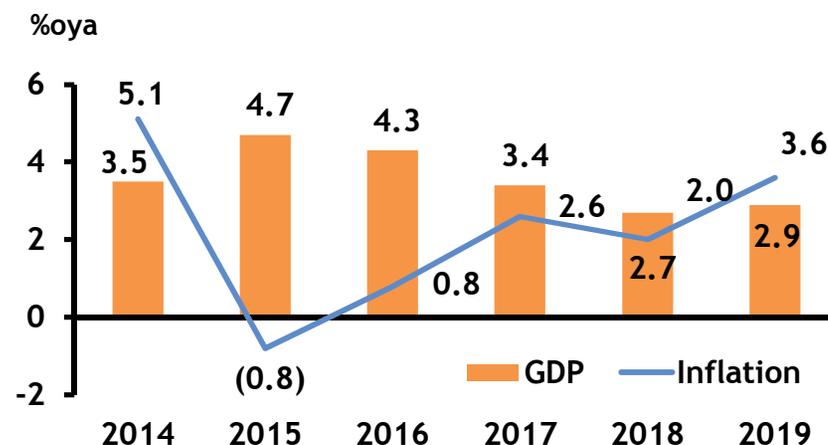


Source: EIU and J.P. Morgan forecasts for 2018

# Costa Rica: Tighter fiscal policy in sight; risk of further downgrades remain

- **The economy expanded 2.7%oya last year after a very disappointing 2H18**, in which business outlook deterioration in the context of the fiscal reform discussion and a nationwide strike, hit the economy hard. In spite of domestic concerns and fiscal constraints, the solid performance of the US economy and the knock on effects on sectors related to external demand, continues limit the damage from declining confidence. We see the economy expanding 2.9% this year.
- **Late last year, Moody's downgraded Costa Rica to B1, and early this year, Fitch downgraded the sovereign to B+.** The implementation of a skinny fiscal plan could result in another credit downgrade, considering that major rating agencies still hold a negative view on Costa Rica. Public debt reached 70% last year and is expected to increase to 73% in 2019.
- **On monetary policy, we believe the central bank will remain relatively hawkish** in spite of disappointing economic activity and modest inflation, which ended at 2.0% in 2018. We do not discard another rate hike this year, after the 25bp increment in late October. The policy rate now stands at 5.25% and we only forecast one 25bp hike in 2H19. The current fiscal stance might prevent an actual hiking cycle this year, but it remains to be seen what is the performance of the currency, considering the fiscal pressures, the risk of downgrades and the monetary policy in the US. We now forecast CRC at 615 by the end of the year.
- **We expect inflation at 3.6% this year**, up from 3.0%. Non-core prices (agricultural and energy) will exert some pressure on headline inflation. Also, a weaker currency is expected to pass-through some of its effects on the economy. However, modest growth will prevent full-fledged demand-side pressures on prices.

## Costa Rica: GDP and inflation



Source: BCCR, J.P. Morgan.

## Main economic indicators

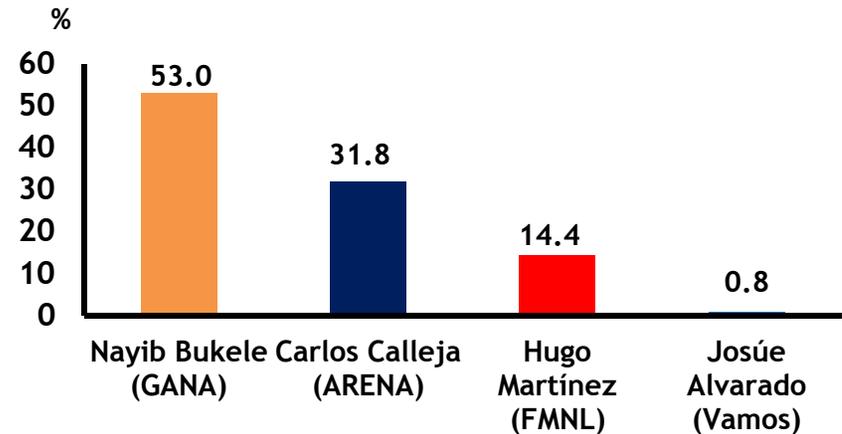
	2016	2017	2018E	2019F
Nominal GDP (\$mn)	57,433	58,210	60,120	61,860
Real GDP (% change y/y)	4.3	3.4	2.7	2.9
Inflation (% change eop)	0.8	2.6	2.0	3.6
FX Rate (CRC/USD, eop)	561	570	608	615
Fiscal Balance (% GDP) <sup>1</sup>	-5.2	-6.2	-6.0	-5.5
Public Sector External Debt (\$mn)	10,589	13,295	15,300	15,770
Public Sector External Debt (% GDP)	18.4	22.0	24.3	25.5
Public Sector Domestic Debt (% GDP)	41.7	42.1	44.2	44.0
Public Sector Total Debt (% GDP)	60.2	66.0	70.0	73.0
Trade Balance (\$mn)	-5405	-6187	-6187	-6350
Current Account Balance (\$mn)	-1880	-2551	-1800	-2165
Current Account Balance/GDP (%)	-2.2	-3.0	-3.0	-3.5
Foreign Reserves (\$mn)	7,574	7,150	7,450	6,900

<sup>1</sup>CG. Sources: BCCR, EIU, GlobalSource, IMF, MH, J.P. Morgan

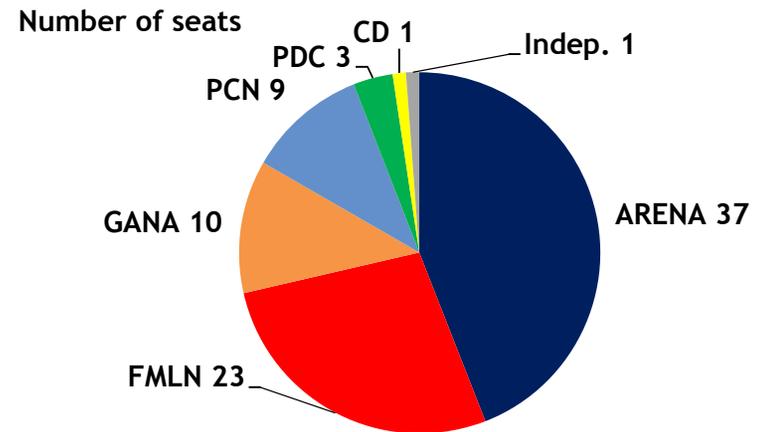
# El Salvador: Bukele presidency not necessarily a market-negative

- Bukele secured landslide victory in presidential election, avoiding second round.** Former FMLN member and Mayor of San Salvador, Nayib Bukele, secured a landslide victory in the presidential election. Right-wing GANA party candidate Bukele was likely to win the election, as polls pointed to an outsized lead over the main trailing candidate, ARENA's Calleja. That said, it was unclear whether a second-round would be needed given the large share of undecided voters. In the event, actual results were very close to those suggested by polls, showing Bukele won the election with 53% of votes, 21%-pts more compared to Calleja's 32%, securing the presidency without the need for a second round of voting.
- A Calleja victory likely would have been better received by markets, but Bukele's victory need not spell trouble.** Calleja's victory would have likely been perceived as a more market-friendly outcome given ARENA's moderate policy stance and their dominance in Congress. After all, political gridlock amid a divide between Congress and the government had led to a sustained political paralysis. That said, we think Bukele's victory should not be perceived as negative from a market perspective right away for a host of reasons: Bukele's stance appears more market friendly than that of the current FMLN administration; the political costs traditional parties have incurred for their inability to agree on key legislation is likely to avoid a pronounced political gridlock—despite Congress remaining largely dominated by ARENA; all candidates seem to have come to terms with the fact that fiscal discipline is and will remain a key priority; Bukele has teamed with a right-of-center party (GANA), which is ideologically closer to ARENA than was the case with Sánchez Cerén's FMLN; and, last but not least, external debt maturities will not be as binding a factor as they were in the past until well into the latter years of the administration (2023). Bukele will come into office on June 1.

## Bukele secured landslide victory



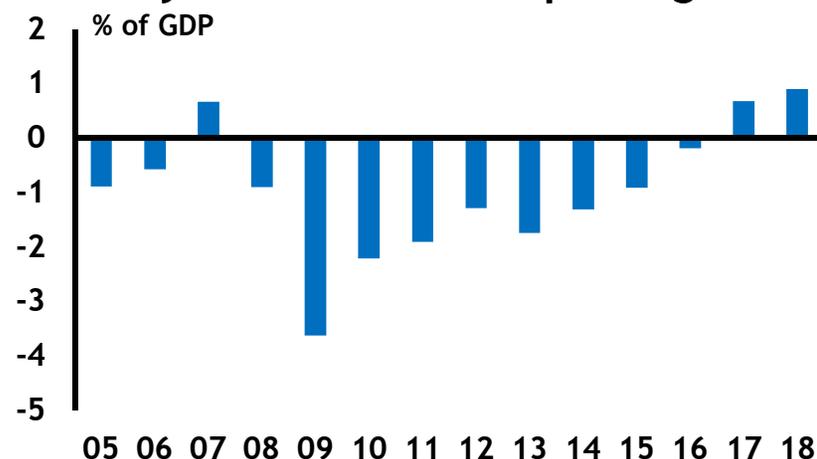
## Yet faces congressional opposition



# El Salvador: GDP growth healthily above potential; fiscal on the mend

- Following a brief dip in 2Q, activity accelerated in 2H18; we expect sustained momentum in 2019, despite modest moderation.** Activity stumbled in mid-year, but rapidly made up the ground lost by expanding 4% ar in 3Q18. The rebound was led by both construction and manufacturing, with the latter benefitting from the acceleration in US imports and manufacturing output. The GDP proxy points to some slowdown in 4Q, although activity is still tracking above-trend growth of about 2.6% ar late last year. While manufacturing and, to a lesser extent, construction, have cooled, externally-driven services, which lagged the rebound in manufacturing in 3Q, are firing on all cylinders, which should suffice to buoy growth in 4Q. We continue to forecast 2018 growth at 2.5%. Looking forward, sustained strength in US imports and solid remittances growth should keep momentum apace, even if the change in government might lead to some modest slowdown in activity. At any rate, we expect GDP to grow 2.3% this year, extending the years-long run of above-trend growth.
- Debt burden declined for the first time in over a decade; additional fall likely this year.** Last year's fiscal deficit was slightly smaller than we anticipated, printing at 2.7% of GDP. Furthermore, factoring in interest payments, the primary surplus rose to 0.9%, confirming fiscal accounts remained on the mend last year. Owing to these dynamics public debt declined for the first time in over a decade to 72.8% of GDP from 74.1% a year earlier. The approved 2019 budget calls for a somewhat higher fiscal deficit of 3.1% this year, but the increase largely owes to a rising interest bill. Once this bill is subtracted, the primary surplus would stand at 0.7%, according to our estimates. This should be consistent with an additional, marginal decline in the country's debt burden, suggesting the worst in terms of fiscal accounts is likely behind us—barring a sudden shift in policy by the new administration, which is not our base-case scenario.

## Primary fiscal balance\* improving...



Source: BCR. \* Non-financial sector borrowing requirements ex-interests.

## Main economic indicators

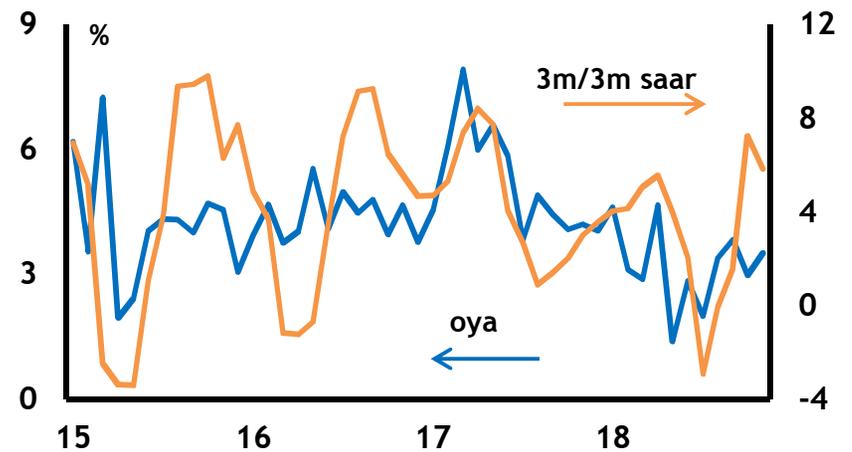
	2016	2017	2018f	2019f
Nominal GDP (\$mn)	23,912	24,805	26,077	27,354
Real GDP (% change y/y)	2.4	2.4	2.5	2.3
Inflation (% change eop)	0.9	1.6	2.0	1.9
FX Rate (USD/USD, eop)	1.0	1.0	1.0	1.0
Fiscal Balance (% GDP) <sup>1</sup>	-3.1	-2.5	-2.7	-3.1
Public Sector External Debt (\$mn) <sup>2</sup>	9261	9675	9565	10216
Public Sector External Debt (% GDP) <sup>2</sup>	38.7	39.0	36.7	37.3
Public Sector Domestic Debt (% GDP) <sup>2</sup>	34.7	35.1	36.1	35.2
Public Sector Total Debt (% GDP) <sup>2</sup>	73.4	74.1	72.8	72.5
Trade Balance (\$mn)	-4410	-4832	-5350	-5600
Current Account Balance (\$mn)	-500	-501	-700	-730
Current Account Balance/GDP (%)	-2.1	-2.0	-2.7	-2.9
Foreign Reserves (\$mn)	2900	3200	3450	3490

<sup>1</sup>NFPS. <sup>2</sup>Consolidated public sector. Sources: BCR, EIU, GlobalSource, IMF, MH, J.P. Morgan

# Panama: Growth slowed to expansion low; expecting rebound this year

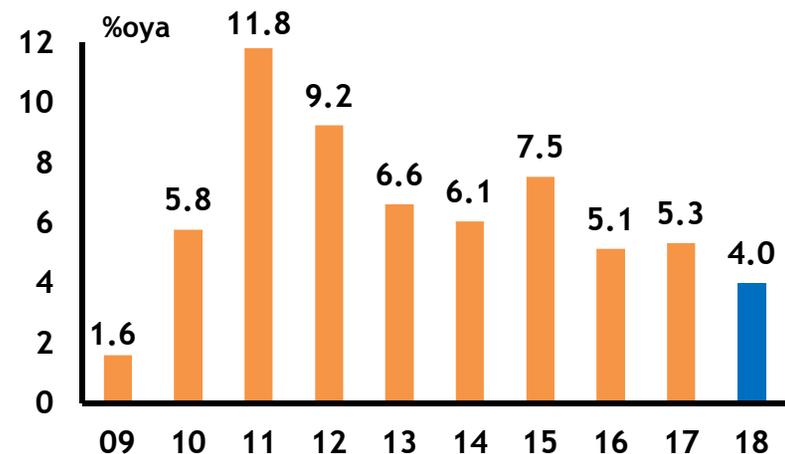
- GDP slowed to expansion low in 2Q18.** Activity continued its weak run through the middle quarters of last year, and appears likely to have moderated to an expansion low last year. We had looked for a rebound in activity in 3Q18 on the back of a v-shaped recovery in construction output, which had been affected by a month-long strike in Apr-May. In the event, the rebound in construction was moderate, and output growth seems on track to have slowed sharply from its 2017 pace. Other sectors performed better, with transportation industries still benefitting from strong US imports through 3Q18— however, the Canal activity seems to have resented the moderation in global trade last quarter. That said, monthly data suggest that despite this drags, activity accelerated last quarter, and is currently tracking a gain of over 5.5% ar in 4Q18. That said, this would still leave growth at about 4%oya in full-year 2019, below our earlier estimate of 4.6% and the weakest reading for the expansion.
- Signs of positive swing in momentum, alongside the coming in line of big mining project should help bring growth back to about 5.2%oya, very much in line with potential.** We expect this positive momentum to carry into 2019, as US import growth stabilizes at healthy rates, and global manufacturing steps up— usually in sync with trade. The gains driven by external activity should also support domestic demand, which has apparently started to benefit from externally-driven activity, as suggested by firming commercial activity after a weak spell. Additionally, mining should start to benefit from the coming in line of the Cobre Panama mine, which is expected to operate near half its full capacity this year, providing an important boost to growth. Estimates suggest that copper exports could reach as much as US\$2 billion once the new mining complex is at full capacity, which besides boosting growth should also help reduce the country’s current account deficit.

## GDP growth recovering...



Source: INEC and J.P. Morgan.

## ...yet likely slowed to expansion low in 2018

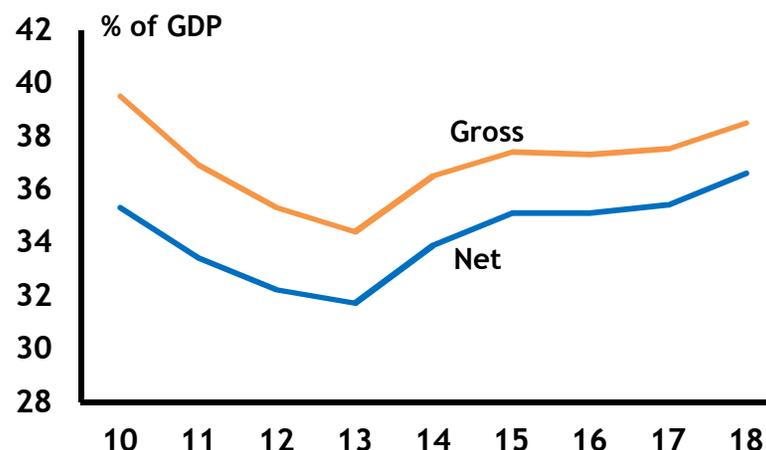


Source: INEC and J.P. Morgan forecasts (blue)

# Panama: Revised fiscal accounts reveal marginal, but ongoing fiscal slippage

- Fiscal burden continued to modestly grow in 2018; could be about to reach an inflection point, though.** Following decades of sharp deleveraging, public debt has been rising over the past years, reaching 38.5% of GDP last year from a 34.4% low back in 2013. The government has looked to stabilize a rising fiscal burden, gradually improving its primary fiscal position, despite some marginal uptick in its primary deficit last year. At any rate, at 0.2% of GDP, the primary deficit remained modest, and we look for this year's primary balance to be nearly flat. We expect this will suffice to keep the debt burden unchanged at its 2018 level this year, potentially marking the beginning of an inflection point. At less than 40% the fiscal burden remains manageable, although higher interest rates will warrant sustained fiscal efforts to keep the deficit below 2% in the medium-term. This year's headline deficit is likely to stand exactly at 2% of GDP, broadly unchanged with respect to last year.
- External accounts remain healthy.** The improvement in external accounts has been much more pronounced, with the current account deficit falling from about 13.6% in 2014 to just below 8% of GDP in 2017. Falling oil prices were partly behind the decline, so part of the improvement is likely to reverse this year. However, a rising service-sector surplus has also been a structural driver of a narrower current account deficit. We expect the current account deficit to have remained broadly stable in 2018 at about 8%, as a wider goods trade balance and rising interest payments offset the widening of the service-sector trade surplus. That said, we expect several factors to conflate to bring the current account to 7.4% this year, the most important of which should be the coming into line of the Cobre Panama mine. FDI should moderate from over 9% of GDP as investment projects come to and end, but this should have its flipside in a moderation in capital imports. As such, we expect that, just as last year, FDI should continue to fully cover current account financing needs.

## Public debt - looking for an inflection



Source: MEF

## Summary of economic indicators

	2016	2017	2018f	2019f
Nominal GDP (\$mn) <sup>1</sup>	57,821	61,838	64,930	69,475
Real GDP (% change y/y)	5.0	5.4	4.0	5.2
Inflation (% change eop)	0.9	0.8	1.5	1.0
FX Rate (USD/USD, eop)	1.0	1.0	1.0	1.0
Fiscal Balance (% GDP) <sup>2</sup>	-1.8	-1.9	-2.0	-2.0
Public Sector External Debt (\$mn)	21,567	23,189	24,998	26,747
Public Sector External Debt (% GDP)	29.2	29.5	30.9	31.0
Public Sector Domestic Debt (% GDP)	8.1	8.0	7.7	7.5
Public Sector Total Debt (% GDP)	37.3	37.5	38.5	38.5
Trade Balance (\$mn) <sup>3</sup>	-7,760	-8,470	-9,100	-8,800
Current Account Balance (\$mn)	-4,634	-4,941	-5,250	-5,138
Current Account Balance/GDP (%)	-7.9	-8.0	-8.1	7.4
Foreign Reserves (\$mn)	4192	4500	4720	4950

<sup>1</sup>Nominal GDP base 2007; <sup>2</sup>NFPS; <sup>3</sup>BOP definition. Sources: EIU, IMF, INEC, MEF, J.P. Morgan

# Disclosures

## Disclosures

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