The World Economic Crisis and its Impact on Latin America

Rafael Amiel
Managing Director, Latin America
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The Worst Global Recession in Six Decades

- Globalization has increased business-cycle synchronization
- North America, Europe, and Japan are facing severe downturns
- Growth in emerging markets will slow dramatically
- A Great Depression or Japan-style lost decade is unlikely
- Huge fiscal and monetary stimuli will help to spark recovery
- Bottom Line: a deep recession in 2009, modest recovery in 2010, and a stronger rebound in 2011
U.S. Expected To Contract by 2.5% in 2009
Purchasing Manager Indexes for Manufacturing Signal a Severe Global Downturn

(Index, over 50 indicates expansion)
The World Economy Faces the Worst Recession of the Postwar Era
It’s Still a Two-Speed World Economy

(Real GDP, percent change)


- Advanced Countries
- Emerging Markets
- Developing Countries
Wide Variations in Regional Economic Growth

(Real GDP, percent change)
Industrial Production Is Declining in Many Regions

(Percent change)

NAFTA  Western Europe  Japan  Other Americas  Emerging Europe  Mideast-N. Africa  Sub-Saharan Africa  Other Asia-Pacific

2007  2008  2009  2010
The Financial Crisis: Big, Bad, Broadly Based

- Perhaps the biggest global housing & credit bubble in history
- Credit growth was strong everywhere
- Bank loan/deposit ratios were especially high in Europe
- U.S. subprime mortgage crisis was the first symptom
- Driving forces: loose monetary policies, financial innovation, deregulation, globalization, government policies favoring debt
- No region will be unscathed
Bubbles Are Bursting Around the World

- Equities
- Commodities
- Currencies
- Housing
- Commercial Real Estate
A Global Stock Market Correction in 2008

(Percent change, local currencies)

- China (SSEA)
- Emerging Markets* (MSCI)
- Eurozone (FTSE Euro 100)
- World, Developed* (MSCI)
- Japan (Nikkei 225)
- United States (S&P 500)
- Canada (S&P TSX)
- United Kingdom (FTSE 100)

* In U.S. Dollars

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Lessons from Past Financial Crises

• Financial crises are “hardy perennials”
• The worst crises have occurred in heavily regulated systems
• Deflation is a bigger threat than inflation
• There are limits to crisis management; system solutions are needed—sooner rather than later
• Key ingredients of a successful fix: ample liquidity, capital infusions, deposit insurance, debt guarantees, fiscal stimulus
Policy Interest Rates Are Dropping

(Percent)

United States  Eurozone  Japan  United Kingdom
Long-Term Government Bond Yields Are Low

(10-year government bond yields, percent)

- United States
- Germany
- Japan
Fiscal Balances Will Deteriorate Across Regions

(Federal budget balance, % of GDP)

-9 -6 -3 0 3 6 9

2007 2008 2009 2010

NAFTA Western Europe Japan Other Americas Emerging Europe Mideast-N. Africa Sub-Saharan Africa Other Asia-Pacific
Forces That Drove Up Commodity Prices

• Strong economic growth in emerging markets
• Stimulative monetary policies
• Lagging supply responses to higher prices
• Government subsidies—being removed slowly
• Export restrictions
• U.S. dollar depreciation
• Speculation
A Sharp Retreat in Crude Oil Prices

(West Texas Intermediate price, dollars per barrel)
Oil Prices Are Still a Risk

• Additions to supply continue to disappoint
• Lower prices are discouraging development
• Periodic supply disruptions, geopolitical events, and speculation contribute to price volatility
• Long-term growth in emerging markets will be strong
• The world has abundant energy resources, but they are concentrated in high-risk countries
And A Swift Correction in Industrial Materials Prices

(IHS Global Insight Indexes, 2002:1=1.0)
# U.S. Economic Growth by Sector

(Percent change)

<table>
<thead>
<tr>
<th>Sector</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
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<tbody>
<tr>
<td>Real GDP</td>
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<td>Consumption</td>
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<td>Residential Investment</td>
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<td>State &amp; Local Govt.</td>
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<td>Imports</td>
<td>2.2</td>
<td>-3.1</td>
<td>-9.6</td>
<td>6.2</td>
</tr>
</tbody>
</table>
U.S. Real GDP and Industrial Production Growth

(Percent change)


Real GDP  Industrial Production
Global Economic Crisis: Contagion in LATAM

- The combination of a deep U.S. recession and the global financial crisis will impose severe damage to the Latin American economies.

- U.S. and global recession affect Latin America and Caribbean:
  - Trade: lower demand for LATAM exports, lower employment in manufacturing sector
  - Capital: credit tightening, higher interest rates, lower foreign direct investment, capital outflows, flight to quality
  - Lower remittances
Global Economic Crisis: Contagion in LATAM

• Lower oil prices is good news for the large majority of countries in the region, but not all. It will help external and fiscal accounts and price stability.

• Inflation: external pressures vanish with lower commodity prices. This will give some relief to fiscal accounts, as subsidies may be ended.

• Exchange rate corrections may continue as external deficits widen.
Latin America

GDP Growth
(y/y in percent)

Exports
(growth nominal terms y/y in percent)

Current Account Balance
(percent of GDP)

Inflation
(y/y in percent)
Latin America: A Temporary Setback

- Exports are falling in response to global slowdown
- Lower commodity prices will hurt several countries
- Currencies are under pressure as investors avoid risk
- But compared with the late 1990s, the region is better shielded from the global financial crisis
- Long-term prospects are bright for countries attracting foreign investment, including Brazil, Chile, Peru, Panama and Colombia
- Policy mismanagement and resource nationalism will take a toll on Argentina, Venezuela, Bolivia, and Ecuador
Devaluations Bring Down Nominal US$ GDP

- Nominal GDP (US$, billions)
- GDP Per Capita (US$, right axis)
In the last tranche of the cycle, investment was the major driver of growth.
Higher perception of risk and cost of funding: Argentina and Venezuela push up the average
## Improved Fiscal Accounts

<table>
<thead>
<tr>
<th></th>
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<td>-0.8</td>
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<td>Peru</td>
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<td>Mexico</td>
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<td>-1.0</td>
<td>-0.1</td>
<td>-0.0</td>
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<td>Panama</td>
<td>-2.7</td>
<td>-2.7</td>
<td>-1.6</td>
<td>0.8</td>
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The Inflation threat has Vanished, but not for all

<table>
<thead>
<tr>
<th>Country</th>
<th>CPI Percent Change</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
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<td>Brazil</td>
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<td>4.2</td>
<td>9.0</td>
<td>6.7</td>
</tr>
</tbody>
</table>
Exchange Rates: Overshooting? ... not yet, maybe Mexico
Enhanced Debt Profile: Total Debt as percent of GDP declined substantially

Latin America & Caribbean: Total Foreign Debt

- as % of GDP (left scale)
- in US$ Billions (right scale)
Enhanced Debt Profile: Debt Service unchanged in nominal terms but significantly lower compared to exports
Enhanced Debt Profile: A sizeable cushion of International Reserves

Latin America & C: Foreign Exchange Reserves

- Bars represent reserves in US$ Billions (left scale)
- Line represents reserves as % of Debt (right scale)

Will the Region remain attractive for foreign investors?

Latin America & C.: Foreign Direct Investment (U.S $ Billions)
External accounts are back to negative territory but partially financed by FDI
Stock Market Correction

Stock Markets
(Jan 2001 = 100)

Stock Markets
(Jan 2001 = 100)

- Brazil
- Mexico
- Argentina
- Chile

- Colombia
- Peru
Slow down all across the region

<table>
<thead>
<tr>
<th>GDP Percent Change</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
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</thead>
<tbody>
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<td>Brazil</td>
<td>5.7</td>
<td>5.1</td>
<td>1.5</td>
<td>4.0</td>
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<tr>
<td>Argentina</td>
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<td>1.0</td>
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<td>6.1</td>
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<td>Mexico</td>
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<td>1.3</td>
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<td>Latin America &amp; Caribbean</td>
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<td>4.0</td>
<td>1.0</td>
<td>3.5</td>
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</table>
Final Remarks

- The region is set for a sharp deceleration, although risks differ across countries.
- Latin American economies are better prepared for external shocks, however a severity of the US crisis will bring some countries into recession too.
- External inflationary pressures are fading with correction in commodity prices.
- Under the assumption that commodity prices will not drop substantially from current levels, external and fiscal imbalances will be manageable.
Final Remarks

• The region should recover in 2010 in line with improved US and world economic conditions, but growth rates are expected to be moderate

• Venezuela, Argentina and Ecuador may have to deal first with macroeconomic mismanagement

• Under the assumption that commodity prices will not drop substantially from current levels, external and fiscal imbalances will be manageable
Thank you!

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Mexico’s Economy Chilled by U.S. Recession

- Manufacturing and remittances are adversely affected by the U.S. recession
- Monetary policy makes a U-Turn
- Fiscal policy is expansionary
- Currency adjustments have improved competitiveness
- Declining oil production is a problem
- More structural reforms are needed
A Downturn in Mexico’s Economy

(Percent change, real GDP)

Mexico
United States
A Downturn in Mexico’s Economy
Mexico Outlook Summary

**Real GDP Growth (%)**

**Consumer Price Inflation (%)**

**Exchange Rate per US$**

**Current Account Balance**

*Annual average, **Billions of U.S. dollars
### Mexico’s Real Economic Growth by Sector

<table>
<thead>
<tr>
<th>(Percent change)</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
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<tbody>
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<td>Real GDP</td>
<td>3.2</td>
<td>1.3</td>
<td>-2.3</td>
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<tr>
<td>Private Consumption</td>
<td>4.2</td>
<td>3.1</td>
<td>1.3</td>
<td>1.9</td>
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<td>Fixed Investment</td>
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<td>1.9</td>
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<td>1.8</td>
<td>-3.2</td>
<td>4.3</td>
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<tr>
<td>Imports</td>
<td>7.1</td>
<td>7.9</td>
<td>-1.4</td>
<td>4.6</td>
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</table>
Brazil’s Economy Faces Competitive Challenges

• The engines of growth—business investment and exports—have slowed abruptly

• Sound monetary policies have kept inflation low, but interest rates are still very high

• The global financial crisis has put downward pressure on the real’s exchange rate, correcting an overvaluation

• Competitiveness is undermined by high and complex taxation, heavy bureaucracy, and insufficient infrastructure investment
Brazil Outlook Summary

Real GDP Growth (%)

Consumer Price Inflation (%)

Exchange Rate per US$*

Current Account Balance**

*Annual average, **Billions of U.S. dollars
### Brazil’s Real Economic Growth by Sector

<table>
<thead>
<tr>
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<td>20.8</td>
<td>20.4</td>
<td>9.0</td>
<td>5.4</td>
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Chile’s Solid Fundamentals Payoff During Crisis

• Chile’s Economy is well positioned to weather the current crisis:
  ➢ Low level of public debt (below 5% of GDP),
  ➢ US$ 50 billion in sovereign wealth funds and foreign reserves
  ➢ Countercyclical fiscal policy and prudent monetary policy
  ➢ Financial system with minimal exposure to global credit crisis

• The global financial crisis has put downward pressure on the peso’s exchange rate, mainly through less favorable terms of trade.

• The Chilean economy should resume a higher growth rate in 2010 as local demand and exports recover from the crisis.

• Annual inflation will converge to the 2-4% target zone by mid-2009
Chile Outlook Summary

Real GDP Growth (%)

Consumer Price Inflation (%)

Exchange Rate per US$*

Current Account Balance**

*Annual average, **Billions of U.S. dollars
## Chile’s Real Economic Growth by Sector

<table>
<thead>
<tr>
<th>(Percent change)</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
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<td>15.1</td>
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Argentina’s Economy Faces Local and External Shocks

- Lower commodity prices will test external and public accounts
- Severe drought is affecting the agriculture sector
- Debt service secured in 2009 thanks to retirement funds
- Manipulation of inflation statistics continues, but inflation is decelerating
- Fiscal balances continues to deteriorate. 2009 is an electoral year
- Deteriorating consumer confidence will contain household expenditure
Argentina: Surviving the 8-year economic cycle

(Percent change)


Real GDP

Industrial Production
Argentina Outlook Summary

Fiscal Balance*

Inflation (%)

Exchange Rate per US$**

Current Account Balance***

*As % of GDP. **End of period, ***Billions of U.S. dollars
## Argentina’s Real Economic Growth by Sector

<table>
<thead>
<tr>
<th>Sector</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
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<tbody>
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<td>Private Consumption</td>
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<td>20.5</td>
<td>17.4</td>
<td>-3.3</td>
<td>5.8</td>
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</tbody>
</table>
Colombia’s Private Sector will Drag Economic Growth

- Monetary easing started rather late due to inflation resilience
- Limited maneuver space for fiscal expansion. The government is, in fact, cutting expenditures.
- Exporters are recovering some competitiveness thanks to a weaker peso
- Increasing unemployment and ponzi-schemes recently discovered affect consumer confidence
- Lower FDI will make it difficult to finance the current account deficit
A Downturn in Colombia’s Economy

(Percent change, real GDP)


Colombia
United States
Colombia Outlook Summary

Fiscal Balance*

Inflation (%)

Exchange Rate per US$$**

Current Account Balance***

*As % of GDP. **End of period, ***Billions of U.S. dollars
# Colombia’s Real Economic Growth by Sector

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
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<tr>
<td><strong>Private Consumption</strong></td>
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<td><strong>Fixed Investment</strong></td>
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<td><strong>Government Consumption</strong></td>
<td>4.5</td>
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<td>7.3</td>
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</tbody>
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Venezuela and the Oil Bust

(year-on-year percentage change)

-15 -10 -5 0 5 10 15 20


6.5 9.7 6.1 0.3 4.0 6.4 0.3 3.7 3.4 18.3 10.3 10.4 8.4 5.6 1.7 3.2 3.7 3.8

Oil Price Slumps

Oil production drops 9.1%

Coup attempt, Oil strike
Overdependence on Oil and Macroeconomic Mismanagement

• Chavez will redirect resources towards the domestic economy, Petro-Diplomacy will take a back seat during the oil price slump.

• New taxes and VAT tax rate raises already in the pipe.

• Risk of Devaluation of local currency, 35%-45% in 2009

• Inflation is still a problem.

• Myopic Short-Term Planning => Market Distortions:
  • Price Controls on Food Items and Essentials
  • Foreign Exchange Controls, inefficiencies in the system
  • Capital Controls
  • Arbitrary Import Quotas, Higher Tariffs, on Selected Items
  • Import Subsidies on Food Items
## Show me the Money

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>2009 Fiscal Budget</strong></td>
<td>US$59.4 billion</td>
</tr>
<tr>
<td><strong>IHS Global Insight’s Estimated Fiscal Revenues from Oil Sector</strong> (WTI price of US$37 per barrel)</td>
<td>US$22.9 billion</td>
</tr>
<tr>
<td><strong>New Debt to issue, approved in budget</strong></td>
<td>US$5.7 billion</td>
</tr>
<tr>
<td><strong>Revenues needed from the rest of the economy</strong></td>
<td>US$30.8 billion</td>
</tr>
</tbody>
</table>

### Venezuela’s Net Public Sector Assets (as of January 2009)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>International Reserves</td>
<td>US$28.7 billion</td>
</tr>
<tr>
<td>FEM (Macroeconomic Stabilization Fund)</td>
<td>US$0.8 billion</td>
</tr>
<tr>
<td>Fonden (Development Fund, unallocated funds)</td>
<td>US$16 billion</td>
</tr>
<tr>
<td>Accounts Receivables (credit lines to other countries/foreign enterprises)</td>
<td>US$22.9 billion</td>
</tr>
<tr>
<td>Portfolio Investments</td>
<td>US$12.3 billion</td>
</tr>
<tr>
<td>Deposits Abroad</td>
<td>US$27.7 billion</td>
</tr>
</tbody>
</table>
Venezuela Outlook Summary

Real GDP Growth (%)

Consumer Price Inflation (%)

Exchange Rate per US$*

Current Account Balance**

*Annual average, **Billions of U.S. dollars
### Venezuela’s Real Economic Growth by Sector

(Percent change)

<table>
<thead>
<tr>
<th>Sector</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP</td>
<td>8.4</td>
<td>5.6</td>
<td>1.6</td>
<td>3.2</td>
</tr>
<tr>
<td>Private Consumption</td>
<td>18.7</td>
<td>9.6</td>
<td>4.8</td>
<td>4.4</td>
</tr>
<tr>
<td>Fixed Investment</td>
<td>25.4</td>
<td>2.5</td>
<td>4.2</td>
<td>10.1</td>
</tr>
<tr>
<td>Government Consumption</td>
<td>5.1</td>
<td>6.5</td>
<td>4.6</td>
<td>-0.4</td>
</tr>
<tr>
<td>Exports</td>
<td>-5.6</td>
<td>-0.6</td>
<td>-3.5</td>
<td>2.4</td>
</tr>
<tr>
<td>Imports</td>
<td>33.6</td>
<td>5.9</td>
<td>4.9</td>
<td>8.3</td>
</tr>
</tbody>
</table>
Panama

Country Overview
While many world economies struggle to keep afloat, Panama posted a 9.2% year-on-year GDP growth in the third quarter of 2008.

- Construction, the Panama Canal, and the Colon Free-Trade Zone are the drivers of growth.

The Negatives:
- The global trade slowdown expected for 2009 will affect two of the main drivers of growth. Exports to the United States account for 34% of the total.
- They artificially fuel the construction boom, but will also raise the risk of a real estate bubble burst in Panama

The Positives:
- Panama's authorities and the Panama Canal authority have secured more than 50% of the funds needed to build the Canal's expansion project.
- Panama's on-course fiscal performance should help the country in building a good reputation on the external markets and gain access to external financing.
Sluggish Economic Growth in 2009

Panama Canal Extension Project, third locks

Tax incentives keep construction boom going

Global Economic Slowdown
Strong Growth in GDP per Capita

Nominal GDP (US$, billions)

GDP Per Capita (US$, right axis)
Median household income in 2004: US$4,800
Stable Local Currency

- Local currency pegged to the U.S. dollar is a double-edge sword.

- The annual inflation rate should reflect the impact of strong economic growth in the last stage of the Canal extension program.
Population Growth is Decelerating

- Total population estimated at 3.3 million in 2007
  - 49.6% Female

- Aging population
  - Share of individuals aged 14 to 44 drops from 48.1% in 2003 to 46.4% in 2013
  - Share of individuals aged 45 to 64 increases from 15.1% in 2003 to 18.5% in 2013

- Increasing participation rate in the labor force, declining unemployment rate, declining share of employment in the informal sector
Retail and Consumption

- Nominal Value-Added Retail Sector (NIA): US$489.3 in 2003 and US$729.3 million in 2007

- Private Consumption in Food and Beverages: US$3.8 billion in 2007

- Imports of Consumption Goods: US$2.6 billion in 2007, of which US$734 million were non-durable goods and estimated to have been US$1 billion in 2008

- Consumer confidence index indicates positive outlook in the next 12 months.
  - Positive outlook at household and country level
## A Comparison of Key Emerging Markets in 2007

<table>
<thead>
<tr>
<th>Country</th>
<th>GDP ($Billions)</th>
<th>Population (Millions)</th>
<th>GDP per Capita ($)</th>
<th>Real GDP Growth (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>3,281</td>
<td>1,321</td>
<td>2,483</td>
<td>11.9</td>
</tr>
<tr>
<td>India</td>
<td>1,140</td>
<td>1,169</td>
<td>975</td>
<td>9.0</td>
</tr>
<tr>
<td>Brazil</td>
<td>1,313</td>
<td>192</td>
<td>6,847</td>
<td>5.4</td>
</tr>
<tr>
<td>Mexico</td>
<td>1,023</td>
<td>105</td>
<td>9,720</td>
<td>3.2</td>
</tr>
<tr>
<td>Russia</td>
<td>1,288</td>
<td>142</td>
<td>9,037</td>
<td>8.1</td>
</tr>
<tr>
<td>Turkey</td>
<td>656</td>
<td>75</td>
<td>8,766</td>
<td>4.5</td>
</tr>
<tr>
<td>U.S.</td>
<td>13,808</td>
<td>303</td>
<td>45,595</td>
<td>2.0</td>
</tr>
</tbody>
</table>
Bottom Line

• The global recession now underway will be the most severe of the postwar era

• If the financial crisis dissipates, a modest rebound in 2010 is possible, if not …

• De-leveraging in worst-hit countries could take years

• Falling commodity prices will rebalance growth and change the terms of trade

• North American resilience and Asian dynamism will reassert themselves once the crisis has blown over
Thank you!

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