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The Economic Forecast for Latin America in 2012

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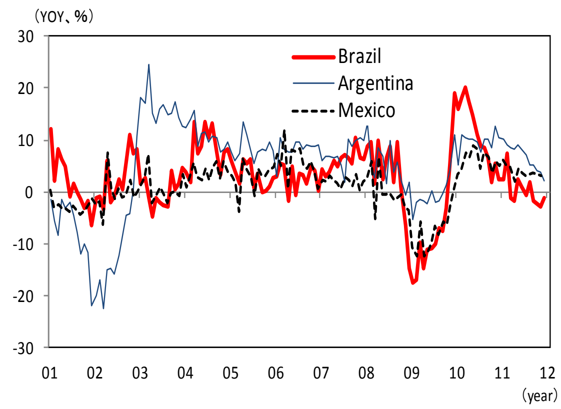
1. Latin America in general

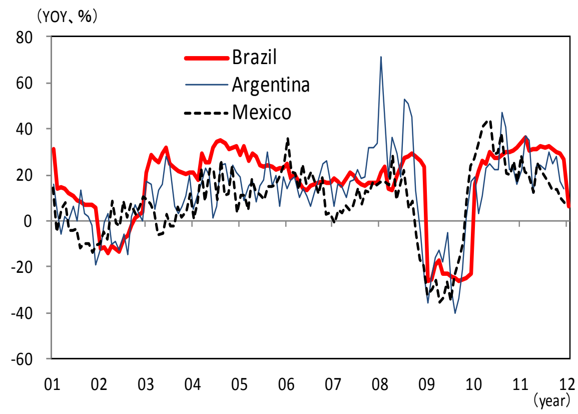
The economies of the three major countries in Latin America, in general, showed a declining trend from the end of 2011 to the beginning of 2012. It is clear that slackening of the pace of world economic growth, particularly in Europe, blunted their exports and production. For Brazil in particular, the rate increases toward around the middle of the year blunted expansion of the pace of personal consumption and corporate investment, and because of the lack of strength in both domestic and foreign demand, the slowdown in growth was conspicuous. In terms of prices, while the rise in consumer prices maintained high levels in Brazil and Argentina even while easing off somewhat, in Mexico, prices of foodstuffs and energy fell, as a result of stabilized import prices thanks to a favorable exchange rate and other factors. Mexico's inflation remained within the target range set by the central bank (3 percent ±1 percent).

Figure 1: Industrial Productions in Three Major Countries



（Source:Central Bank of each country）

Figure 2: Exports in Three Major Countries



（Source:Central Bank of each country）

The three major Latin American economies will be able to avoid recession, and appear headed toward overall recovery toward around midyear. However, the general view is that their pace of growth will be lower than levels prior to the Lehman Crisis.

2．Brazil

（1）Current Situation

The Brazilian economy, since the latter half of 2011, showed a clear trend toward deceleration. The real GDP growth rate in the fourth quarter declined to 1.4 percent, due to such factors, stagnant exports caused by low growth in the world economy and a deceleration in investment caused by raising interest rates the year before last. Exports and production have remained sluggish with slight economic growth. However such factors as the continuing decline in the unemployment rate at around a historical low level and rising consumer confidence has helped to firm up consumer spending. On the other hand, inflation continues to be subdued, and the year-on consumer price rise in January was 6.2 percent, below the upper target set by the BCB (the central bank of Brazil).

With BCB continuing to confront subdued inflation, it has continued to adopt a monetary easing policy in order to deal with the deceleration of domestic business conditions and low growth in the advanced economies caused by the worsening European debt crises and other factors. From August 2011 to January 2012, the central bank reduced the interest rate by a total of 275bps (the overnight interest rate, SELIC, as of March 8 was 9.75 percent).

As for Brazil's international balance of payments, its trade surplus showed a slight decline due to the deceleration of the world economy. Also increases in foreign-based companies' repatriation of interest and dividend payments sent the investment income balance significantly into the negative, and the trend toward a current account deficit continues. The $52.6 billion current account deficit posted in 2011 rises by a considerable margin over 2010.

The value of the Real, up to the end of 2011, had declined due to the deceleration of the economy and monetary easing. Afterwards it showed an upswing due to such factors as the reduction in taxes on financial transactions applied to foreign exchange used to purchase stocks and the expectation of Brazil's economic recovery. To halt the appreciation of the Real, the central bank intervened in the foreign exchange market in February 2012, to sell off the Real.

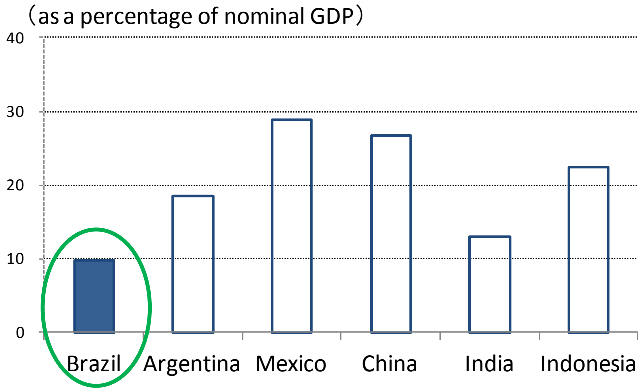
（2）Outlook

①　For some time in the future

We believe that for the time being the economy will continue a slowing trend, with a gradual recovery from some time after midyear. The income environment for households is expected to show a trend toward comparative firmness, or, supported by the results of rate cuts up to now, can be expected to show a gradually accelerating expansion of the domestic demand.

As the worsening debt crises aggravate the sense of deceleration in European business conditions, the Brazilian economy won't be able to count on external demand. However one of Brazil's strengths has been its larger domestic demand and less dependence on exports compared to other Latin American nations (Figure 3). With the instability of financial and capital markets in the economically advanced countries of Europe and North America, it is expected that a portion of financial institutions will adopt a more severe attitude toward loans, so while excessive optimism is unwarranted, the economy in 2012 is unlikely to undergo a severe drop, and growth for the year is likely to exceed 3 percent or thereabouts.

Figure 3: Dependence on Exports of Various Economies



(Source : IMF)

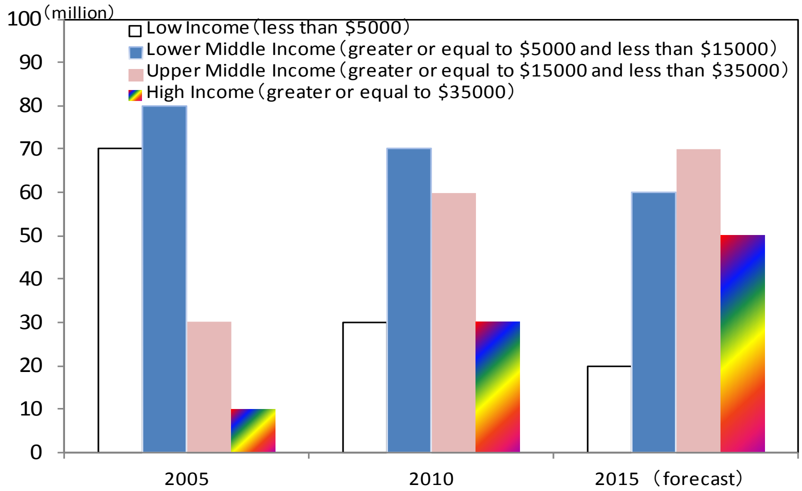
For some time in the future household income and results of monetary easing policies are expected to be the factors that boost the economy. While the economy has declined, the unemployment rate has stayed historically low, and real wages continue their rising trend. Also, the minimum monthly wage of 622 Real in 2012 will show a year-on increase of 14.1 percent, the highest growth in the past five years, which can be expected to lift the incomes of those in lower income segment. The Central Bank has already reduced interest rates by 275 bps, and considering that the monetary easing policy will actualize the effects of an economic stimulus centered on future consumption of durable goods and others, the economy is expected to recover from midyear.

② The economy in the mid-term

Also, factors to support the circulatory recovery of business conditions, as components that will boost the economy in the mid-term, are anticipated in the form of expansion of the middle and upper income segments and expansion of automobile sales.

In Brazil, the middle and upper income classes (the upper portion of the middle-income segment and the affluent segment) are expected to grow, and are forecast to become the leading income classes by 2015 (Figure 4). In comparison to Argentina, where income growth has favored the affluent segment, we suppose the mid-term rise in consumption will be the factor that results from an economy where all incomes rise from the bottom up.

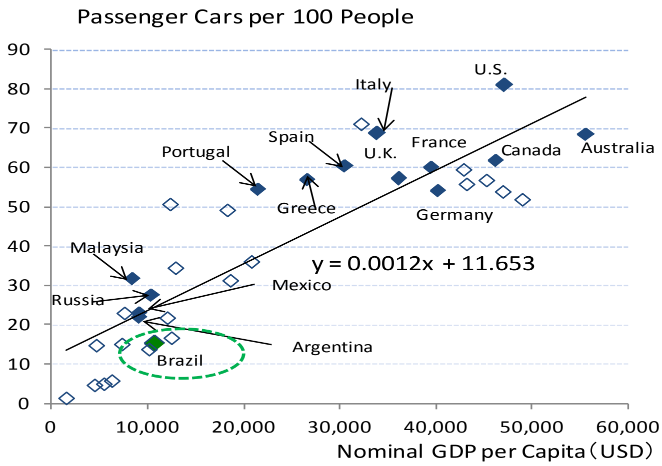
Figure 4: Dependence on Exports of Major Latin American nations



(Source) Ministry of Economy, Trade and Industry "White Paper on International Economy and Trade 2011"

In addition, Brazil in 2010 emerged as a huge market for automobiles, ranking sixth in the world in production and fourth worldwide in sales. Nevertheless per capita vehicle ownership is still low. While the level of income in terms of per capita GDP has surpassed the level of $10,000, the rate of vehicle ownership is only 15.3 units per 100 people, a rate considerably lower than countries with similar income levels, such as Russia (with 27.6 units per 100 people), or in other Latin American nations with lower income levels, such as Mexico (23.1 units) and Argentina (21.9 units). The reasons for this are believed to be due to the extremely low percentage of paved roads (5.5 percent) compared to other countries, and the greater weight assumed by rail freight. However, before the country hosts the Football World Cup and Olympic Games in the future, it is expected to develop its road infrastructure, which raises the likelihood that vehicle ownership will increase. While some fluctuations in business conditions cannot be avoided, as vehicle ownership is buoyed by these favorable conditions, auto sales in the span of the mid-term future are expected to maintain their growth.

Figure 5:Income Stage and Vehicle Ownership



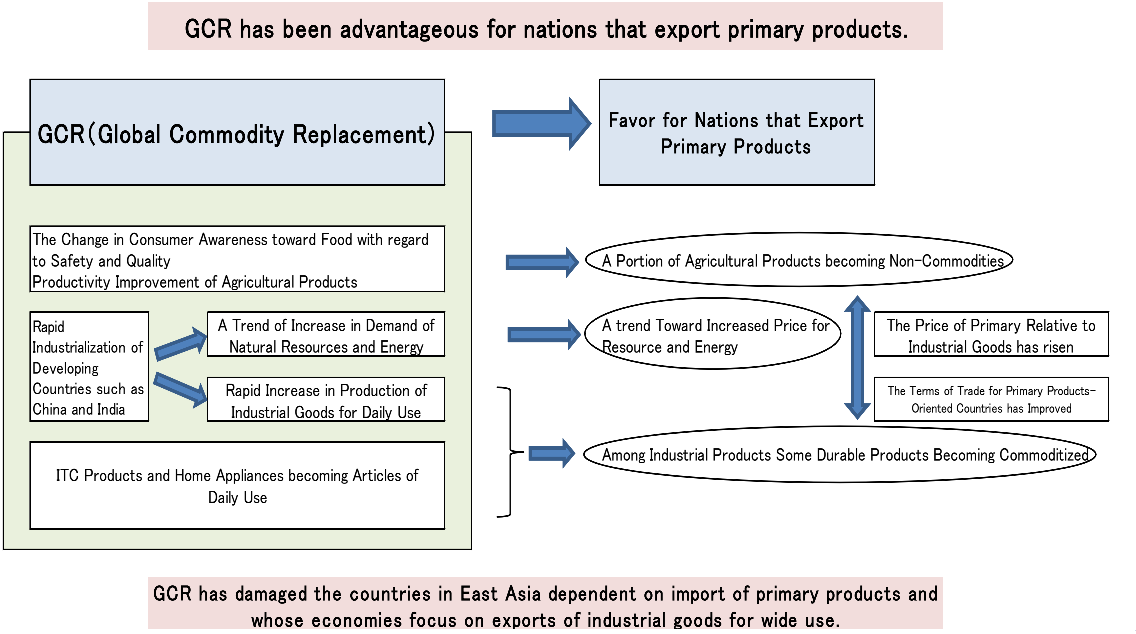
（Source）World Bank“World Development Indicators”

Another of Brazil's strengths that will be a conspicuous factor in the mid-term will be a worldwide change in relative prices of primary products and industrial goods. In the past, because the rate of increase in prices of primary goods was relatively slow in comparison with that of industrial goods, the terms of trade of the economies whose exports are based on primary products tended to fare worse in comparison with the advanced economies whose exports are based on industrial goods. However, from the 1990s, such factors as the rapid industrialization of developing countries, particularly those with huge populations such as China and India; the change in consumer awareness toward food; and with such durables as communications equipment and large home appliances becoming articles of daily use, the situation changed. In other words, concerning primary products, with a portion of agricultural produce becoming non-commodities and a trend toward increased prices for resource energy[1], among industrial products some durable products have become commoditized. Through the progress of replacement of the positioning of these products worldwide, referred to as Global Commodity Replacement (henceforth GCR), the relative price of primary goods to industrial goods has risen (Figure 6). As a result, the trade conditions for Brazil and other primary products-oriented countries has improved, and it has been reaping the economic benefits from favorable external

[1] The prices of primary products underwent a sharp drop for a brief period following the Lehman Brothers crisis, but the trend toward increase is foreseen for the mid-term, from the next three to five years.

trade. In contrast to South Korea and other countries in East Asia dependent on import of primary products and whose economies focus on exports of industrial goods for wide use, have been hit hard by GCR, this has been advantageous for Brazil and other Latin American nations that export primary products.

Figure 6:Background and Influence of Global Commodity Replacement



③ Inflation, External Sector and Foreign Exchange Rate

Prices are expected to remain low in conjunction with the sluggish economy, but with the low unemployment rate, and because of the high possibility that the acceleration in the increase in wages cannot be easily subdued, it is likely that the degree of decline will be moderate. The rate of rise in consumer prices will continue for the time being to exceed the rate targeted by the central bank (year-on of 4.5 percent), but it is foreseen that the figure will be at the mid-5 percent level throughout 2012.

The trade balance is expected to result in a slight surplus due to main strength in primary products, but due to the payout of dividends by locally based foreign firms, because it is expected that the deficit of investment income balance will continue, we foresee an increase in the current account deficit during 2012.

Instability in the movement of the value of the Real will continue due to concerns over the ongoing European debt problems. There are also aspects that favor its upward value including expectations for future recovery of the Brazilian economy, but because intervention by the BCB can be foreseen to resist any sharp rise, it is expected that the Real will maintain its current level for the time being.

(3) Risk Factors

The following two items are seen as risk factors related to future economic recovery and the deployment of local business operations. First, the worsening European debt crisis raises concerns that the reduction of European-based bank assets will accelerate. Presently, the outstanding bank loans to the private sector has shown a slight slackening of growth, and at the present stage we expect that moves toward further reduction of European-based bank loans will be limited. Because much of the profits of Spain's banks are borne by Brazil, it is possible that this might make it difficult for them to reduce credit. In the future, it is necessary to continue to exercise caution over the possibility of sharp change in lenders' attitudes if international financial markets are further rocked, but the additional rate cuts by BCB and liquid supply using abundant foreign currency reserves and other factors, suggest a high feasibility to respond, and should conditions worsen a swift response would be expected.

Second are moves toward boosting taxes on automobiles. The government is reinforcing import tariffs on finished cars and domestic taxes. In January, it requested a revision of the accord with Mexico on automobile tariffs. Many foreign based auto manufacturers, including Japanese firms, build and sell cars in Mexico, and concerns have arisen that Brazilian government guidelines might form a barrier to business activities, so caution is warranted.

3. Argentina

（1）Current Situation

Due mainly to such factors as personal consumption and investment, the growth rate of real GDP rose in the third quarter, but due to slackening of the growth of exports and production, and a decline in the pace of increase in construction, etc., the economy is showing precursor signs of peaking out. The drop in the rate of rise in consumer prices is continuing at a rate surpassing the 9 percent of the year before.

International balance of payments has continued to realize a surplus, but with exports stagnating due mainly to the decelerating world economy, the size of the surplus is declining, and for this reason the current account will continue to run a deficit.

The Peso has maintained its declining trend. Since September 2011, the decline in the currency's value has accelerated, leading the central bank to intermittently intervene by buying Pesos and selling Dollars. After these interventions, however, the trend toward the declining rate of the Peso resumed.

（2）Outlook

While Argentina's economy is expected to continue to decline, three factors are likely to result in recovery of exports, particularly primary products. These are: (1) improvement in the economy of Brazil, its largest trading partner; (2) results of its decline in currency up to now; and (3) results of the government’s protective trade policies. As a result, deceleration of the economy is likely to halt around midyear. However, the annualized GDP growth projection for all of 2012, at 4.8 percent, will still be considerably lower than the average (8.4 percent) realized during the five years prior to the Lehman Crisis.

The rate of increase in consumer prices is expected to decline due to the decelerating economy. With domestic demand comparatively solid and the continuing tightness in the labor supply, a rise in wages can be foreseen, so the degree of decline will remain within a small range at a relatively high level. It is likely that during 2012 double-digit inflation will continue, at average of 10.0 percent.

As for international balance of payments, as a slight deficit is foreseen due to a shrinking of the trade surplus, the current account surplus, which had already shrunk, is expected to turn into a slight deficit during 2012.

The government, under a new administration, continues to intervene in the economic activities of the private sector, and maintains restrictions on foreign trade. It continues to oblige the automobile industry to maintain a balance between imports and exports, and in 2012 it announced guidelines requiring importers to sign an "Anticipated Sworn Declaration of Imports" declaring the amount of imports in advance. While protectionism and authoritarianism may support the business conditions, it will be necessary to take precautions toward risks likely to arise from these domestic measures.

4. Mexico

(1) Current Situation

In the third quarter of 2011, Mexico's real GDP posted a year-on rise of 4.5 percent, an increase over the previous period (3.3 percent), maintaining its solid economic expansion from midyear onward. After that, its growth rate of real GDP decreased to 3.7 percent in the fourth quarter. Subsequently part of the consumer-related indicators and automobile sales realized high growth, showing that although not all domestic demand was favorable, the trend was comparatively solid. On the other hand due to the lack of strength in U.S. economic expansion and other factors, stagnant exports were conspicuous, and the economy overall decelerated.

Consumer price inflation has maintained a declining trend because prices of foodstuffs and energy fell from 2011 and the rising exchange rate contributed to the stability of import prices. Inflation remained within the target range set by the central bank (3 percent ±1 percent).

In international balance of payments, stagnant exports led to a trade deficit from the middle of last year, so the current account continues to post a deficit. On the other hand, for capital account balance, thanks to solid domestic demand and expectations of future long-term growth, capital inflow continues.

With investors taking a stronger position toward risk avoidance, the Peso was sold off, resulting in an exchange rate of 13 Pesos to 1 U.S. Dollar around the end of 2011, but it recovered to around 12 Pesos to the dollar at the beginning of 2012.

(2) Outlook

The U.S. economy, which affects business conditions in Mexico, is continuing to show moderate signs of recovery despite its precarious condition. Another important factor will be the price of petroleum, which is expected to move to the comparatively high rate of around $100 a barrel. As a result, Mexico's economy will avoid a serious drop, and turn toward recovery. The real GDP growth in 2012 is expected to drop from last year's 3.9 percent, barely surpassing 3 percent.

The slackened future recovery is expected to discourage consumer price increases, which will remain stable at around the 3 percent level.

As for international balance of payment, the slackening of domestic demand in 2012 is expected to halt the expansion of the trade deficit, but the deficit trend of income balance is expected to result in a slight expansion of a current account deficit over 2012.

Furthermore as major Japanese auto manufacturers based in Mexico have plans to expand their production facilities, growth in automobile production is foreseen over the mid-term. As mentioned previously the Brazilian government has requested revisions in the accord with Mexico on automobile tariffs, an indeterminate factor that will need to be monitored.

Table 1: Outlook for Latin America

	Real GDP % increase			Consumer Price % increase			Current Account Balance,US$bn		
	2010	2011	2012	2010	2011	2012	2010	2011	2012
Brazil	7.5	2.7	3.4	5.9	6.5	5.6	▲48	▲53	▲60
Argentina	9.2	9.2	4.8	10.9	9.8	10.0	3	1	▲2
Mexico	5.4	3.9	3.2	4.4	3.4	3.3	▲6	▲9	▲16
Latin America	**6.1**	**4.4**	**3.8**	**5.9**	**7.0**	**6.2**	**▲52**	**▲57**	**▲86**

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