



## Economic Review

### Americas

#### Fourth Quarter 2011

As the year 2011 ended, the clouds of pessimism about the economy lightened across the Americas region, as key data trends suggested that earlier fears of a steep downturn were unfounded. Financial markets stabilized as investors turned more optimistic about the outlook for 2012. Concerns over external risks, particularly about the European fiscal crisis, also calmed down as hope was renewed that enduring political

#### At a Glance

**United States:** Gains across several segments of the economy lifted the growth optimism for 2012. The moderate improvement in labor market conditions buoyed consumer sentiment, and in response, manufacturers are now raising output. The trade deficit was smaller than expected while the housing sector now seems to be stabilizing.

**Canada:** Though the economy recovered during the third quarter from the previous quarter's unexpected decline, growth for the second half of 2011 may lag behind forecasts. The outlook for 2012 will likely be restricted by the stronger currency and risks to domestic demand.

**Brazil:** The economy stalled during the third quarter, but subsequent data suggested a recovery during the fourth quarter. The government announced several fiscal measures and the central bank cut its benchmark rate by 150 basis points to prevent further decline.

**Mexico:** Third quarter growth was above expectations and conditions remain favorable for sustained expansion in 2012 as well. Increased demand from the U.S. will likely benefit exporters, while foreign industrial investments and remittances from workers continue to expand.

**Argentina:** Helped by strong farm sector growth, the economy accelerated during the third quarter. However, the pace of growth is expected to slow in 2012 on weaker domestic demand.

**Chile:** The economy maintained its growth through the third quarter of 2011, but likely slowed during the fourth quarter. The central bank's policy flexibility is limited by higher inflation.

**Peru:** Though the government has become friendlier towards businesses, protests have dampened the sentiment and are delaying investments in the crucial mining sector.

**Colombia:** Domestic demand has shielded the economy from external risks so far, but has also fueled inflation. Though the pace of growth has moderated, the central bank increased interest rates in November.

solutions will be found for the fiscal challenges facing the developed countries.

The improvement in U.S. economic activity over the last quarter of 2011 has done the most to lift sentiment across the Americas region as well as the rest of the world. The U.S. economy has so far proved to be resilient, helped by the more confident consumers encouraged by the upswing in labor market conditions. With this, growth forecasts for 2012 are being revised higher. While the Canadian economy is likely to slow down in 2012, the decline is expected to be only marginal.

Among the Latin American economies, only Brazil saw a substantial decline in economic growth during the third quarter of 2011. Mexico, Colombia, Chile, Peru, and Argentina all managed to sustain their growth rates, though their pace of expansion likely moderated during the fourth quarter. While the region is expected to expand more slowly in 2012, average growth is forecast to be relatively healthy, unless the external risks worsen. Increased demand from the U.S. should help most countries in the region, particularly Mexico and Colombia. Higher energy and commodity prices are also likely to favor economic activity in the region.

## **United States: All round improvement in economic data lifts growth optimism**

**Better than expected gains across several segments of the U.S. economy have helped erase fears of another recession and lifted the optimism for 2012.** The moderate recovery in the labor market has buoyed consumer sentiment and manufacturers are now responding by increasing production. Job gains for the month of December were above forecasts and the unemployment rate slipped again. Income growth also picked up in recent months, though gains in household incomes remains below the inflation rate. Consumer spending during the holiday season was robust, especially in durables such as automobiles. After weakening during the third quarter, manufacturing activity gained pace again in December, signaling improved business confidence.

**The labor market improvement has been the most significant U.S. economic trend recently, particularly during the last quarter of 2011.** Even as the federal and state governments continue to shed jobs, the private sector has stepped up hiring. While part of the hiring could have been to meet seasonal demands during holidays, the sustained gains over the last few months suggest that the recovery is more enduring than thought earlier. At the same time, recent data from the Department of Labor indicate that there are still more than four unemployed persons for every job opening. Also, if the jobs market recovery is sustained, the unemployed who have stopped looking for jobs may rejoin the workforce. Hence, at the current rate of job additions, it will take several years before the unemployment rate reverts to its long-term average.

**After several false dawns, the housing market too is now showing signs of stabilizing as both home buyers and home builders appear more optimistic.** Sales of previously owned homes have increased recently and so have building permits, especially for multi-unit housing. Average home prices have stopped falling in several cities, which is expected to attract potential buyers who have been fearful of further price falls. Mortgage rates remain at historic lows, though tougher credit standards have put the low rates beyond the reach of most borrowers. The decline in foreclosures and bank repossessions due to administrative delays has also helped improve the market. However, foreclosures are expected to rise again this year and negatively affect the housing market once again.

**Despite the stronger dollar, U.S. exports held up through October of last year and the trade deficit narrowed.** Exports for the month of September 2011 were the highest on record, on continued overseas demand for capital goods and manufactured products. Most of the gains in the export of U.S. manufactured goods have come from the emerging economies, which now account for nearly half of all U.S. exports. At the same time, increasing domestic production of oil and natural gas has made the country less reliant on imported petroleum. Accordingly import growth has slowed and this has contributed significantly to containing the trade deficit.

**While there is continuing speculation about further quantitative easing, the Federal Reserve has so far not given any indication about such a measure.** At its most recent policy meeting, the Fed took note of the moderate improvement in the labor market and the overall economy. Unless the outlook deteriorates further, either due to worsening external risks or a decline in domestic activity, the Fed is not expected to consider additional policy measures. Going forward, in its efforts to improve policy transparency, the central bank will publish the target fed rate forecasts. The Fed is also said to be considering inflation rate targets, like central banks in several other countries do.

### **Canada: Subdued economic outlook for 2012 as strong currency expected to restrict export gains**

**While the Canadian economy likely performed better than expected during the second half of 2011, the outlook has become more subdued on global uncertainties and a slowdown in domestic demand.** The economy recovered stronger than expected during the third quarter, after contracting marginally during the previous quarter, supported by better than forecasted export gains. Despite higher spending on housing, domestic consumption growth declined during the quarter. Bank of Canada continues to maintain its benchmark rate at the historical low of 1%, though inflation is expected to fall from 2.9% in November to about 1% by the middle of 2012.

**However, after surpassing U.S growth for five successive years, Canada is expected to see its growth pace fall below its neighbor in 2012.** Most forecasters, including the OECD, now expect Canadian GDP growth for this year to be below 2%. The relatively strong Canadian dollar will likely limit expansion in exports even as domestic consumption growth may face additional risks. After recovering strongly after the 2009 recession, the Canadian jobs market is showing signs of slowing down again. Job additions declined significantly during the second half of 2011 and unemployment crept up to 7.5% by the end of the year. Central bank surveys suggest that the unemployment rate will likely remain at this level in 2012. On the positive side, industrial output growth gained pace in December and energy exports will likely maintain the uptrend if the recent rebound in oil prices is sustained.

**The relatively stronger currency is dissuading industrial manufacturers from making new investments in Canada, most noticeably in the automobile industry.** While several global car manufacturers have announced significant future investments in Mexico, Brazil, and the U.S., no major assembly plants have been proposed in Canada. The currency competitiveness has become all the more important as small cars with low profit margins become increasingly popular. This trend will likely restrict future growth of the Canadian auto industry, though output growth may recover this year if the healthy U.S. consumer demand is sustained.

**At the same time, Canada will likely see continued increase in energy sector investments, especially to develop the tar sands fields and shale deposits.** However, as its energy output increases, the country may need to open up to markets other than the U.S. Larger investments in pipelines should help energy producers transport oil to the Pacific coast and export to Asian countries, where they can fetch a higher price for the precious energy commodity. Currently, almost all of Canada's energy exports are destined for the U.S. But, concerns about oil spills and other environmental damage could potentially slow down pipeline construction.

### **Brazil: Fiscal and monetary stimulus may prevent further economic decline**

**Brazil is now the sixth largest economy in the world, but has seen the steepest slowdown in economic growth among the large emerging economies, during the second half of 2011.** The economy came to a standstill during the third quarter, as compared to the previous quarter, though GDP expanded 2.1% from a year ago. Significant gains in farm sector output and the sustained growth in net exports were offset by weakness in the industrial and services sectors. Industrial output declined further in October and November, suggesting that aggregate GDP growth would be subdued during the fourth quarter as well. The government had lowered its 2011 GDP growth expectations to between 3.0% and 3.5%, as compared to 7.5% achieved during the previous year.

**Nevertheless, the fiscal stimulus measures initiated by the government to prevent further weakness in the economy have already started yielding results.** Consumer confidence has

improved and retail sales expanded again in November as the government cut taxes on select durables and staples to boost demand. The government also said it is considering further measures, including cuts in payroll taxes and taxes on consumer loans. In addition, the unemployment rate for the month of November declined to the lowest on record and the robust labor market conditions continue to favor domestic consumption growth. Investments to develop the recent large oil and natural gas discoveries as well as to build infrastructure ahead of the 2014 Soccer World Cup and the 2016 Summer Olympics are expected to sustain the job gains. The government now expects the economy to expand between 4% and 5% this year.

**The Central Bank of Brazil has been the most aggressive among all major central banks in cutting interest rates during the second half of 2011.** The bank brought down its benchmark rate by a total of 150 basis points over that period to support the economy, and lower interest rates have led to a rebound in credit growth during the month of November. Inflation during the month of December slowed to the central bank's upper target of 6.5%, and is expected to decline to 5.3% by the end of this year. This will likely allow the central bank more flexibility in its policy decisions in 2012.

**The Brazilian real declined more than 10% in 2011 and removed the sting from the Brazilian government's repeated claims that low interest rates in the developed countries are boosting emerging market currencies and making exports uncompetitive.** The currency weakness has also triggered capital outflows from Brazil, as seen in select other emerging countries, during the last quarter of 2011. Nevertheless, it is expected that the cheaper currency will favor export growth from Brazil this year. The government has maintained that it will take the necessary steps needed to keep the currency competitive, compared to the currencies of its major trading partners.

### **Mexico: Outlook remains positive as the rebound in external demand will likely help exports**

**The Mexican economy continues to expand at a healthy rate and the recent improvement in U.S. economic activity could help sustain the expansion in 2012 as well.** Third quarter growth in Mexico was higher than expected at 4.5%, supported by strong growth in farm output. However, manufacturing output was weaker than anticipated during the third quarter and continued to moderate through November. Automobile manufacturing was a notable exception and it is estimated that total auto production increased 13% in 2011 over the previous year. Higher oil prices will also likely support growth and the government now expects the economy to expand 3.5% in 2012.

**Foreign industrial investment inflows and remittances by Mexicans working abroad have increased at a healthy pace in 2011, contributing to the economy's growth momentum.** Mexico received nearly \$13.5 billion in foreign industrial investments, including reinvested

profits by foreign companies operating in the country, during the first nine months of 2011. Remittances into the country by Mexicans living abroad is estimated to have increased 8% in 2011 from the previous year to a total of \$23 billion, according to central bank data.

**At the same time, drug related crimes continue unabated and one of the country's leading banks recently estimated that the violence reduces Mexico's annual growth by 100 basis points.** While this has not hampered the Chinese and others to relocate manufacturing units to Mexico in order to take advantage of the country's proximity to the U.S. market, growth in tourist arrivals has been affected.

**Unlike other central banks in the region, the Bank of Mexico is still not in a position to contemplate lower interest rates, despite the increased global risks.** Apart from better than expected economic growth, the rise in consumer inflation for the month of November has also made the central bank more cautious about easing its monetary policy. Mexico had enjoyed a period of relatively benign inflation trends since 2010, even as other countries in the region such as Brazil have been struggling with higher prices. This had allowed the central bank to keep its benchmark rate steady, and it is now widely expected that the bank will continue to do so for an indefinite period. The central bank has also stepped up its sales of government bills to reduce liquidity in the system and calm inflation.

### **Argentina: Economic growth expected to slow down, despite still healthy farm exports**

**Argentine President Cristina Kirchner won her reelection by a wide margin and has promised to focus more on job creation and improving the country's competitiveness during her second term.** However, worry over the president's health after she was diagnosed with cancer has cast a shadow over expected policy initiatives. Her first term was fairly successful as the economy expanded at a healthy pace and unemployment declined. At the same time, concerns about economic governance worsened after the government took several controversial steps such as using pension funds and currency reserves for the government's debt servicing, and removing the central bank chief who opposed the decision.

**Economic growth accelerated in Argentina during the third quarter of 2011 as the GDP expanded at an annual pace of 9.3% from a year ago, but growth is expected to moderate during the current year.** Expansion in industrial production declined in October while export shipments were lower for the month. The country also continues to see significant capital outflows, which is hampering investments. According to central bank data, capital outflows during 2011 nearly doubled from the previous year. Inflation is another significant risk, though the government continues to deny that consumer price increases are as high as 25% estimated by private researchers. Despite the inflation concerns, the central bank said it will expand the money supply by more than 26% during 2012.

**The economy received a significant boost in recent years from record exports of farm produce, especially corn and soybeans, at remunerative prices.** Though soybean prices corrected during 2011, they are still attractive for producers, when compared to historic averages. China, which imports more than half of the rest of the world's soybean shipments, continues to increase its purchases from Argentina. Corn prices recovered in December on expectations of higher global demand, and higher prices could partly offset the impact of the anticipated decline in Argentinean corn production due to drought.

## **Chile: Economic growth has started moderating, but inflation risks remain elevated**

**The Chilean economy had weathered the global slowdown until the end of the third quarter, but ensuing data shows that growth may be moderating.** The economy expanded 4.8% annualized during the third quarter on faster than expected growth in September, helped by higher retail sales and increased fisheries output. However, GDP growth slowed to 3.4% in October as industrial output declined. Retail sales growth for the month was a healthy 8.6%, but slowed from the previous month's rate. The government expects the economy to expand by 6.5% for 2011, but growth is expected to decline to between 4% and 5% in 2012.

**Chile's economic prospects are closely tied to global demand for materials, especially copper, which is the country's principal export.** The mining industry is one of the largest employers in Chile and accounts for nearly a fifth of the country's GDP, besides almost half of its exports. Copper prices have declined more than 30% this year, the second worst annual fall after 2008 in recent history. Nevertheless, current price trends in the copper futures market suggest that average realization for miners will likely remain around the current levels for the next few years. If global economic prospects improve further, demand for copper could pick up next year and support Chilean economic growth. Healthy demand outlook will also sustain the flow of investments into new mining projects, essential to sustain output growth.

**Despite the recent moderation in economic activity, inflation risks remain high in Chile on higher food and energy costs.** Consumer inflation in November rose to the highest level in more than two years, near the central bank's upper target of 4%, prompting the central bank to keep its benchmark unchanged for the sixth successive month in December. However, the central bank indicated that it is willing to cut interest rates if growth signals weaken further and the European debt crisis worsens. Inflation is expected to slip below 3% by the end of 2012 and the benchmark rate will be reduced by 75 basis points by the middle of next year, according to the latest survey of economists by the central bank.

**Intense protests by students demanding a free university education gripped Chile for several months and affected the popularity of President Sebastian Pinera.** The students temporarily stopped their agitation in November after the government threatened to cut off

funding to universities, but the protesters have indicated that they may again take to the streets if the demands are not met. The government has increased public funding for students and has twice replaced the education minister in recent months.

## **Peru: Government turns more business friendly, but strikes delay new mine construction**

**The Peruvian economy has slowed since the beginning of this year as uncertainty over policy direction restricted private investments.** Ollanta Humala's victory in the presidential elections earlier this year triggered a steep correction in equity prices, as the new administration's policies were not expected to favor businesses. However, such concerns later proved to be unfounded as Humala tried to assuage the markets and private businesses to revive investments and employment generation. Despite the administration's best efforts, the investment climate in the country deteriorated again after protests by environmentalists and political groups stopped the construction of a nearly \$5 billion copper and gold mine. President Humala brought the disturbed region under emergency rules and has announced negotiations with the protesters. To improve administrative efforts, Humala has reconstituted his cabinet under a new prime minister who is perceived to be more business friendly.

**Meanwhile, third quarter GDP growth slowed marginally to 6.5% annualized, from 6.6% during the previous quarter.** Expansion in private investment nearly halved from the 16% reported for the second quarter, while the decline in private consumption was only marginal. The weaker global outlook affected the country's external account, as growth in both exports and imports slowed. Subsequent data points to further moderation, as economic growth weakened further to 5.1% in October as compared to 5.8% in September. Manufacturing output declined during October while retail sales increased at a slower pace. The government is currently implementing a fiscal stimulus plan, which the government says will be expanded if required. The government expects GDP growth of 7% for the current year, compared with 8.8% achieved in 2010.


**Despite the slowing economic growth and weaker credit expansion, higher inflation risks have restricted the central bank's policy options.** In November, inflation rose to the highest level in more than three years and well above the central bank's upper target of 3%. The bank had repeatedly hiked its benchmark rate during the first half of this year, but has left it unchanged since June. However, the central bank expects inflation to ease next year as food prices stabilize and consumer demand growth moderates. The UN's Development Policy and Analysis Division expects the Peruvian economic growth to decline to 5% in 2012.

## **Colombia: Domestic consumption growth has so far shielded the economy from external risks**

**The Colombian economy remains relatively unaffected by the global uncertainties and, fueled by domestic demand, GDP growth for 2011 is forecasted to exceed the previous year's pace.** During the third quarter, the Colombian economy expanded 7.7% annualized from the same quarter of last year, helped by strong growth in construction and mining. Subsequent data releases suggest that growth in most sectors remain healthy, though the pace of growth may have moderated. Retail sales expansion has slowed in recent months when compared to the first half of this year. The 6% growth in retail sales for the month of October was weaker than the 8% reported for September, while sales of automobiles declined more than 5% in November. Industrial growth also moderated in October from the previous month. Nevertheless, helped by increased interest in the energy and mining sectors, foreign industrial investments have been strong this year. The central bank expects the economy to expand by 5.5% in 2011, as compared to 4.3% the previous year.

**However, faster growth fueled inflation and Colombia became the only country in the region to lift interest rates this quarter,** when the central bank hiked its benchmark by 25 basis points in November. Inflation surpassed the central bank's upper target of 4% in October, but declined below that mark in November. The rise in the unemployment rate during November also suggested that the labor market is easing up. Accordingly, the central bank left the benchmark rate unchanged at its last meeting for the year in December.

**To Colombia's advantage, the country's fiscal balance is in better shape and the government can step up public spending, if required, to support the economy.** Better than expected economic growth has boosted tax revenues and the government has scaled down its fiscal deficit estimate for the current year as well as the size of its borrowing plans. Tax revenues are likely to be 8% higher than budget estimates while the deficit is expected to be limited to 3.3%, as compared to the 4% forecasted earlier. The government had reduced the size of its borrowing plan for 2012 earlier this year and may do so again, if the tax revenue growth continues.

**Strong domestic consumption in Colombia has fueled the growth in consumer credit demand this year.** Lending growth by non-government banks in Colombia this year has been among the highest in the region, as record high home prices are encouraging borrowers to leverage more. As deposits have expanded at a slower rate of 20%, banks are raising additional resources by selling more bonds. Colombian banks increased their bond issues by more than 30% during the first nine months of this year. Attracted by the opportunities in the fast expanding consumer credit market, foreign banks are stepping up their presence in the country and the larger domestic banks are raising capital to finance future acquisitions. 

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