



Americas: Economic Review September 2011

Financial markets faced significant volatility as the global economic outlook weakened and concerns about the European crisis worsened. Markets in the Americas region were also affected by the erosion in investor confidence, though the developed markets in the region fared relatively better. Latin American currencies saw steep falls against the U.S. dollar, as the weaker economic outlook is expected to force the central banks to cut interest rates in the future, potentially reducing the relative

At a Glance

- **United States:** While the economic outlook remains highly uncertain, better than expected economic data in recent weeks have partly offset fears of another recession. Even as a new fiscal stimulus plan has failed to gather enough political support, the Fed has announced a program to bring down long-term interest rates.
- **Canada:** The economy is showing signs of a moderate recovery after the unexpected contraction during the second quarter. Job additions in September were way above expectations, the housing market trends have remained healthy, and the cheaper currency may help exports.
- **Brazil:** High inflation and interest rates have triggered worker strikes and demands for wage hikes. While domestic consumption growth continues to see signs of a slowdown, export growth was healthy in August and the currency decline will likely help in the future.
- **Mexico:** The manufacturing sector is showing signs of moderation as anticipated, due to slower demand from the U.S. However, the cheaper peso is expected to make Mexican exports more competitive.
- **Argentina:** The economy expanded more than 9% during the second quarter as the government continues to expand public spending ahead of the presidential elections. High inflation remains a concern.
- **Chile:** The steep correction in copper prices will likely drag down economic growth significantly below the 8% achieved during the first half of this year, though the currency decline should help exports.
- **Peru:** The government has announced a fiscal stimulus plan to preempt an economic slowdown as concerns over overseas demand growth. Monetary policy remains on hold despite higher inflation.
- **Colombia:** The economy expanded faster than expected during the second quarter, though slower global demand could restrict growth in the future. The central bank held interest rates steady yet again.

attractiveness of these markets to global investors.

Though their economies remain weaker than earlier forecasted, the most recent data suggests moderate improvement in economic conditions in the U.S. and Canada. However, in the absence of bi-partisan consensus, fiscal policy remains highly restricted in the U.S. and the upcoming presidential election has made it all the more difficult. Also, while the Fed has promised further steps to support the economy, the modest results from its earlier monetary policy measures have made the markets skeptical about their effectiveness.

Latin American economies are expected to see modest declines in their economic growth for the current year as well as in 2012, mostly due to lower demand for resources in Asia. The IMF has marginally lowered its current year growth forecast for the region to 4.5% from 4.6%, and expects Argentina and Chile to lead the region in aggregate growth. Growth in Brazil and Mexico are anticipated to decline to around 3.8% each, and both economies will likely slow to an annual growth pace of 3.6% each in 2012. The IMF said the regional economies should be prepared to launch additional stimulus measures if global and domestic demand weakens further. Meanwhile, the World Bank said most of the regional economies are in a position to lower interest rates to support their economies.

United States: Better than expected data reduce fears of another recession

Even as the U.S. economic outlook remains clouded, better than expected economic data released recently have strengthened the hope that the economy is unlikely to slip into another recession. September payroll gains were better than anticipated, as the private sector added 137,000 jobs during the month, though the unemployment rate remained unchanged. Even after adjusting for the return of 45,000 workers after a strike, the private sector job additions were healthy. Manufacturing activity expanded in September, most likely due to increased export demand, while construction spending climbed in August as public construction rose more than expected. Capital goods orders were strong in August, suggesting robust growth in business investments, both within the U.S. and abroad. Consumer spending has also seen relatively healthy trends as same-store sales for major retailers were better than expected in September and automobile sales rebounded. Lower gasoline prices should also support consumer spending going forward.

To revive the labor market and help the economy recover, the Obama administration proposed a new stimulus plan worth nearly \$450 billion. The plan envisions a further cut in payroll taxes for employees and employers alike, while boosting incentives to employers for new hiring. The administration has also proposed increased spending on infrastructure and some senators have added a new tax on the wealthy to pay for some of the additional spending.

However, the proposals are mostly perceived by Congress as short term measures and therefore lack bi-partisan support.

Meanwhile, the Federal Reserve followed up its August pledge to hold interest rates low until mid-2013 with a new program to lower long-term bond yields. The Fed said it will extend the average maturity of its treasury bond holdings by switching short-term securities with long-term issues. The Fed expects the lower long-term interest rates to stimulate increased business investments and hiring. The 30-year treasury bond yield fell below 3% a few days after the Fed announcement. The low yields are expected to encourage investors seeking higher returns to invest in corporate bonds and mortgage securities, actions that will bring down the yields of those securities as well.

However, personal incomes and consumer credit growth have shown subdued trends and will likely restrict domestic consumer spending. Personal incomes declined in August for the first time in nearly two years and real incomes, adjusted for inflation, fell even more. As the unemployment rate remains high, it will take a while before labor market conditions turn tight and start lifting average wage levels. Besides, consumers remain anxious, as seen from the recent readings in most consumer sentiment surveys. Consumer credit declined unexpectedly in August, further confirming buyer reluctance to step up consumption. The continued weakness in the housing sector, despite the fall in the 30-year mortgage rate to below 4% for the first time, is also affecting consumer confidence.

Canada: Data suggests moderate economic recovery from second quarter decline

After the unexpected decline in economic activity during the second quarter, the Canadian economy has shown signs of a moderate recovery. The economy expanded 0.3% in July from the previous month, on better than expected output growth in manufacturing. Wholesale trade, utilities, and transport services also showed moderate growth, while activity decreased in mining and retail trade. In the coming months, the decline of the Canadian dollar is expected to help exports, which account for more than 30% of the country's GDP. The IMF now expects the Canadian economy will expand 2.1% this year and 1.9% in 2012.

The Canadian housing market remains healthy as record low mortgage rates and relatively affordable home prices continue to attract buyers. Home sales increased 15% in September from a year ago, after expanding 21% during the previous month. Housing starts for the month were well above estimates and the starts for August have been revised higher, suggesting increased confidence among builders. The Canadian housing market has seen a strong recovery since 2009, forcing the government to tighten credit rules earlier this year to prevent the market from overheating. The IMF also warned recently that Canada needs to take additional measures

to restrain the housing market if mortgage debt as a percentage of average disposable incomes continues to rise.

The labor market data was highly positive for the month of September, with the economy adding more than 60,000 jobs, well above expectations. All the gains were in full-time positions, as temporary and part-time positions declined and the unemployment rate dropped further to 7.1%. While part of the gains were due to seasonal factors that are unlikely to be repeated in subsequent months, the strong data has helped ease concerns about a labor market slowdown following somewhat weak data in earlier months. Also, though the hours worked declined marginally in September and growth in real wages remains low, average wage levels are expected to rise as the unemployment rate falls further. The Canadian economy had regained all the jobs lost during the recession by the beginning of this year and the healthy job additions are expected to sustain domestic demand, even as external demand growth slows.

Brazil: Worker strikes for wage increases spread as domestic consumption growth slows

Brazil is facing a wave of protests and strikes by workers demanding higher wages that have caused production disruptions in several industries. The sustained rise in consumer prices and the interest rate increases by the central bank have fueled the demand for higher wages. Consumer price inflation rose to a six year high of 7.3% in September, well above the central bank's upper target of 6.5%. The labor market has tightened since 2009 and the unemployment rate remains low, giving the workers better bargaining power. The government has recently reduced a tax on gasoline prices and the central bank unexpectedly cut its benchmark rate in August, but these measures have not been enough to calm the protestors.

Signs of a slowdown in domestic demand growth in Brazil have become stronger recently, as data from several segments show that consumers have become less willing to spend. Imports for the month of September were lower than expected and this trend is anticipated to continue as the cheaper currency has made imports costlier. Sales of automobiles declined nearly 5% in September as banks are becoming more cautious about credit standards. Consumer debt defaults have steadily increased this year and climbed nearly 6% in September alone.

The weaker global demand is yet to reflect in Brazil's external trade data as exports expanded at a healthy pace in September from the same month a year ago. The growth was driven by increased shipments of iron ore, soybeans, and sugar. While export demand is likely to be subdued going forward, the steep fall in the value of the Brazilian real against the U.S. dollar will likely benefit exporters. The currency did not favorably impact exports in September as the average exchange rate for the month was not significantly lower than the same month of last year. However, this would be more visible in subsequent months as the real has declined more than 10% from the levels seen at the beginning of this year.

The currency decline has also removed the pressure on the Brazilian government and the central bank to devise policies aimed at preventing currency appreciation. Brazil had taken several steps, including capital controls and taxes on foreign investment to stem inflows into the country and prevent the real from gaining. However, the wide interest rate differentials due to the high domestic rates in Brazil had rendered these efforts ineffective. In sharp contrast, the central bank had to intervene in September to arrest the real's decline against the U.S. dollar.

Mexico: Manufacturing growth slows, but weak currency could help exports

While the demand outlook for exports to the U.S. has turned more subdued in recent months, the Mexican economy is expected to benefit from growth in the farm and services sectors. An economic activity index gained more than expected in July, rebounding from a decline in the previous month. The country's external trade account swung to a surplus in August as gains in oil exports offset a decline in the export of other goods. The government estimates that more than 600,000 jobs have been added so far this year. While proposing a modest increase in public spending for the next year, the government said it expects the economy to expand 4% this year and 3.5% in 2012. Economists surveyed by the central bank have pegged the current year's GDP growth expectations at around 3.8%.

However, the slower U.S. demand has already started showing up in activity data for the manufacturing sector, which previously had seen strong recovery since 2008. Manufacturing activity growth stalled in September, according to the most recent survey results, and exports of manufactured goods were lower by more than 6% in August. Automobile exports to the U.S. declined by nearly 15% in August. Nevertheless, the recent steep drop in the value of the Mexican peso against the U.S. dollar could support exports in the coming months.

Unlike some other central banks in the region, the Bank of Mexico has so far refused to intervene in the currency market even as the peso slumped to its lowest in more than a year. The peso had remained relatively weak when compared to other regional currencies over the last year, giving Mexican exporters a competitive advantage. The low inflation levels in Mexico had allowed the central bank to avoid the rate hikes that had triggered currency appreciation in other countries. Inflation continued to weaken in September and the central bank is widely expected to hold the benchmark rate steady at its next policy meeting in October.

Argentina: Economic growth remains robust, but inflation concerns persist

The Argentinean economy expanded 9.1% during the second quarter from a year ago, as domestic private consumption growth remained exceptionally strong. Though the growth rate was slower than the nearly 10% pace reported for the first quarter, it is still well above most other economies in the region. Private consumption expanded 11.5%. while domestic

investments were higher by nearly 24%. The economy is expected to slow during the second half of the year and the government expects aggregate GDP growth of around 8.3% this year.

The Argentinean government is stepping up public spending ahead of the presidential elections due in October this year, and is dipping into pension funds to finance some of the spending. Though tax revenues are expected to rise to a record this year, public spending has outpaced tax collections. The government had recently hiked wages and will also increase payouts to poor families with children by 23%. The government is also planning to use \$5.7 billion from the central bank's currency reserves to pay down external debt next year, compared to \$7.5 billion from the same source used to retire debt this year.

Argentina will introduce a new consumer price inflation index in 2013 that will capture price trends from all regions of the country. The index currently used tracks price changes only in the capital Buenos Aires and has attracted a lot of criticism for being grossly inaccurate. While the official inflation index shows a current inflation level of below 10%, private estimates put the rate at close to 25%. The government had recently tried to curb the publication of private inflation estimates by imposing heavy financial penalties on the publishers of the data.

Chile: Despite copper price fall, economy to expand at healthy rate

Chile's GDP growth quickened to 4.6% in August from a year ago, compared to 4% in July, as domestic demand growth remained robust even as mining output declined.

However, the pace was slightly below expectations, and significantly lower than the more than 8% growth rate achieved during the first half of this year. The government now expects aggregate growth of 6.5% this year, which may slow to 5% in 2012. The more than 25% decline in copper prices since August will likely hurt export earnings and mining investments later this year. While it is anticipated that lower prices will likely encourage China to rebuild its stockpile of the metal, Chilean mining companies are struggling to increase output as labor unrest and adverse weather have hampered operations this year.

While deciding to leave its benchmark rate unchanged for the third month in a row, Chile's central bank noted that sustained growth in wages and a falling unemployment rate will prevent rate cuts in the near future. The central bank is worried that tight labor market conditions will fuel inflationary pressures, though the heightened global economic uncertainties are also a concern. Despite a fall in copper production, industrial output expanded more than expected in August. The government's healthy fiscal situation will facilitate increased government spending next year. Chile is expected to report a fiscal surplus this year and a modest deficit in 2012, if copper prices remain at the current levels.

Like most other regional currencies, the Chilean peso also declined substantially in September, reducing one of the key concerns of the country's exporters since last year.

Alarmed by the strong currency gains, the central bank had announced an unprecedentedly large \$12 billion currency market intervention earlier this year. However, international investor interest in Chile remains strong, with the country holding one of the best credit ratings among all its Latin American neighbors. In early September, the Chilean government managed to sell \$1 billion in bonds denominated in U.S. dollars at the lowest ever yield.

Peru: Government announces preemptive stimulus program to avoid economic decline

Helped by better than expected output growth in fishing and other farm segments, Peru's GDP growth rebounded to 6.5% in July, from a year earlier. Growth in retail trade and other services continued, while the manufacturing and construction sectors saw moderation. The healthy rate of expansion has partly offset fears about a significant economic slowdown this year. Mining exports increased by more than 60% in August, though the correction in commodity prices could impact earnings from resource exports in the subsequent months. To prevent a deceleration, the government has recently approved a nearly \$500 million spending program that will focus on residential housing and infrastructure. The government also indicated its readiness to expand the current stimulus plan, if the economic signals weaken further. Peru's central bank expects the economy to grow by 6.3% this year and 5.7% in 2012.

Though annual inflation rose in September, the Peruvian central bank decided to leave its benchmark rate unchanged for the fifth successive month on heightened concerns over the global economic outlook. The bank repeated that domestic economic activity remains vigorous, but said it is ready to cut interest rates if the global or domestic economic signals weaken further. The bank is also prepared to improve liquidity by lowering reserve requirements of commercial banks, if global financial conditions deteriorate.


The Peruvian government has proposed a restructuring of its mining tax system by taxing operating profits, instead of the current method of taxing sales. Under the proposed regime, while the tax liability of miners is likely to increase when commodity prices are high as they are now, the country's miners are expected to be more competitive when prices turn weaker. The government says the new tax structure, to be approved by Peru's parliament, will also facilitate more than \$40 billion worth of new investments in the mining sector over the next several years.

Colombia: Economic trends continue to be healthy as monetary policy remains on hold

The Colombian economy expanded 5.2% during the second quarter, the fastest quarterly growth since the second quarter of 2008, helped by higher than expected increase in mining activity. Colombia continues to enjoy relatively better economic conditions when compared to its neighbors, as trends for the third quarter also suggest healthy expansion. Retail sales increased

nearly 12% in July from a year ago, though industrial growth slowed to slightly less than 4%. Unemployment rate declined further in July and may support domestic demand going forward. The central bank expects the economy to expand between 4.5% and 6.5% this year, while the government has maintained its growth forecast at 5.5%.

While Colombia, like most other economies, is susceptible to a significant global slowdown, the country is better prepared than it was in 2008. The government's tax revenues are likely to exceed earlier estimates and as a result, the fiscal deficit is expected to decline to 3.3% of GDP. This will allow the government to initiate additional fiscal stimulus measures, if necessary. The country's currency reserves have increased and its sovereign debt is now rated as investment grade.

Colombia's central bank held its benchmark rate unchanged for the second successive month, as concerns about the global economy persisted. The decline in inflation for the month of August also allowed the central bank to keep its policy more accommodative to support growth. The Colombian peso erased most of its gains from earlier this year as emerging market currencies came under pressure in September. Accordingly, the central bank has ended its U.S. dollar purchase program and has decided to intervene in the markets selectively to reduce currency volatility. 

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