Latin America amid lower oil prices

The economic outlook for 2015 and beyond

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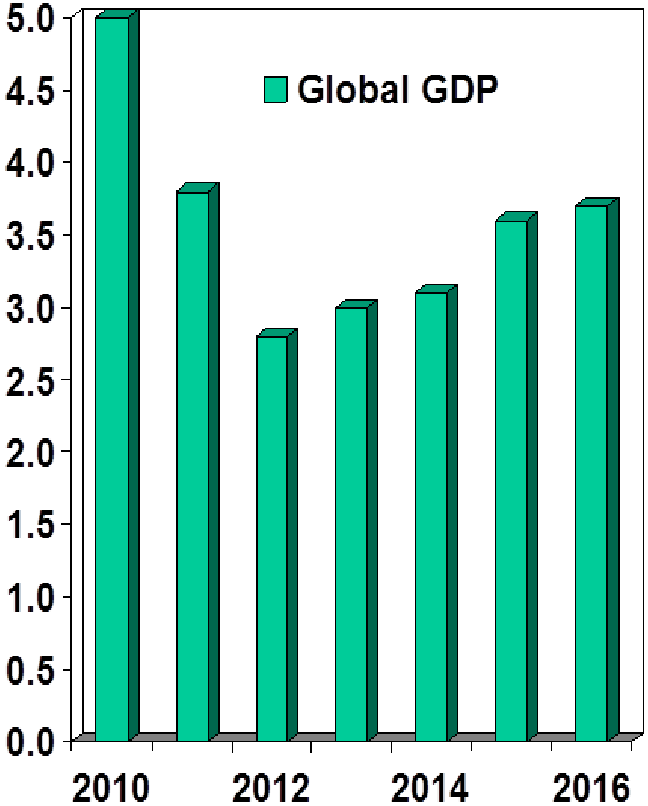
Key points for global economy in 2015

- US performing best of large, advanced economies
  - Recent GDP growth surpassed 4%
  - Europe: slumping yet again
  - Japan: from boom to bust in 6 2014

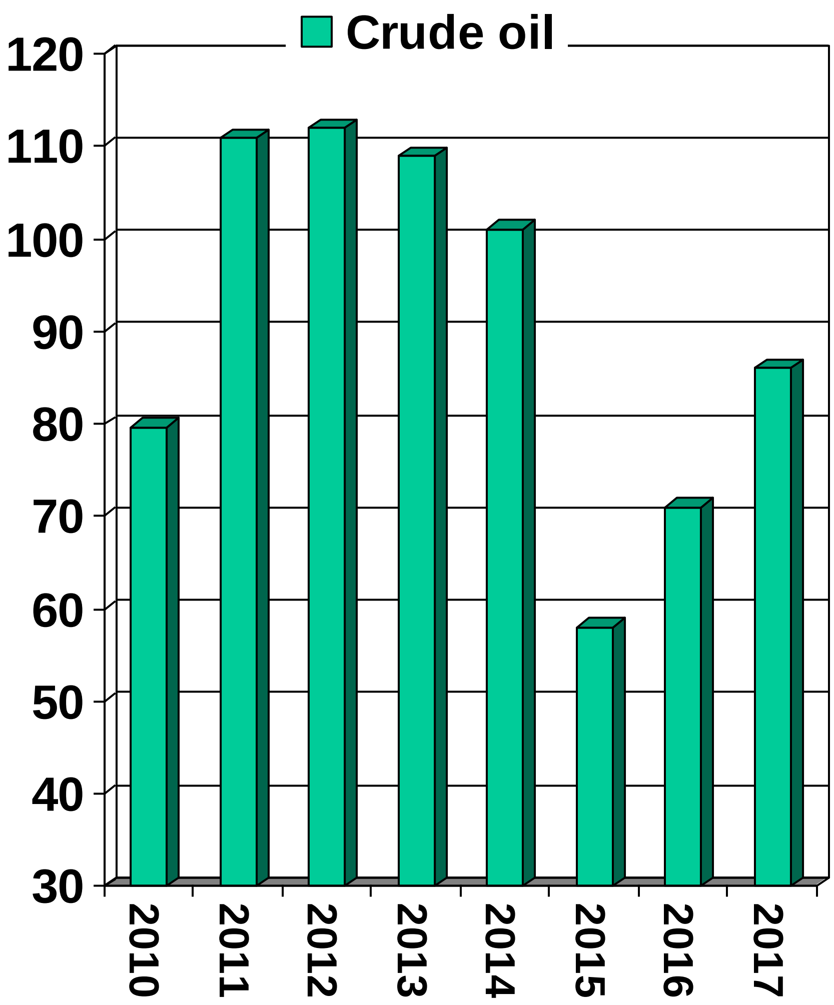
- It's all about interest rates, inflation, prices
  - US Fed will tighten policy; ECB, BOJ loosening
  - Oil price down; dollar up; risk of deflation?

- Emerging markets looking for answers
  - India strengthening; China's soft landing
  - Russia in deep recession; Brazil struggling



The price of oil has come down—and should stay down

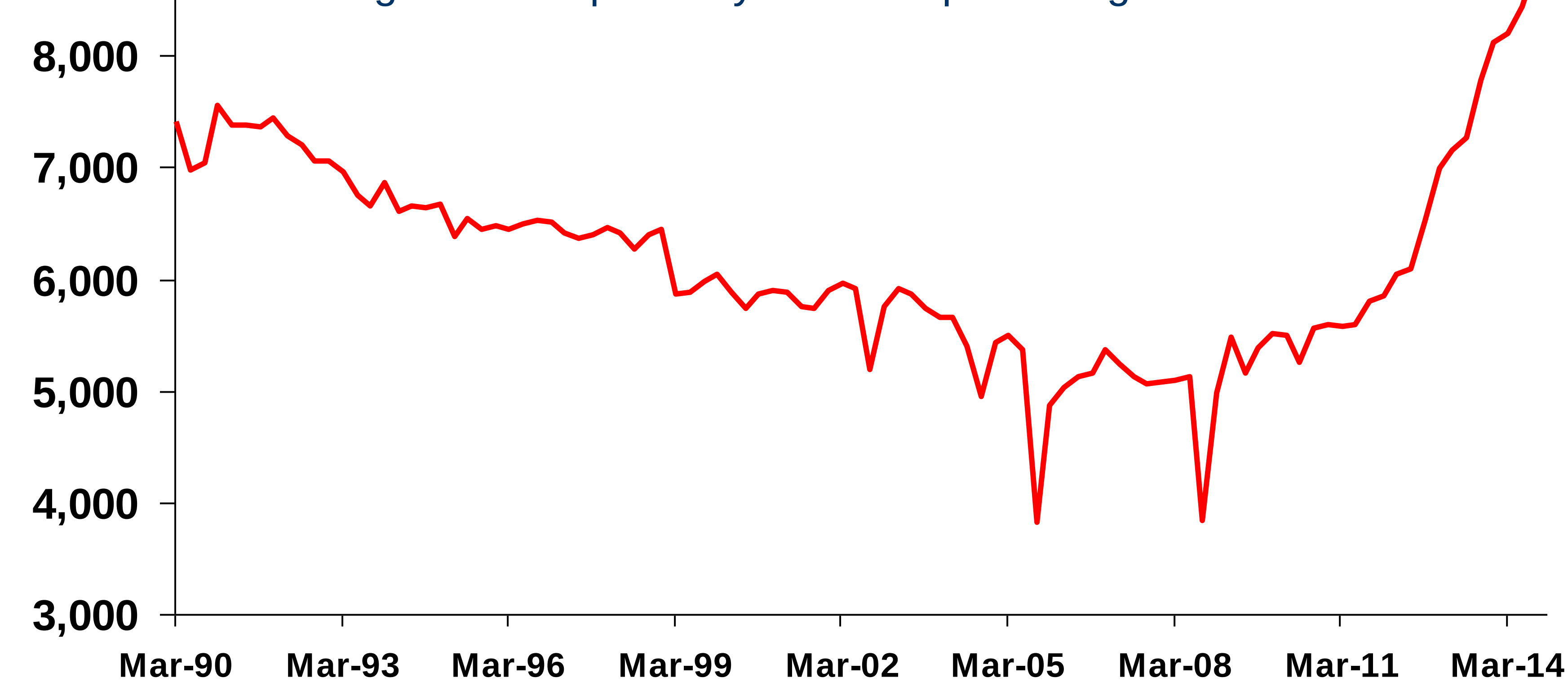
- Plenty of supply in the market
  - ➢ But less from US shale producers
  - ➢ Price seems to have bottomed at $45/b in January; risen since then
  - ➢ Price will be volatile in 2015
- Daily surplus in the oil market at 1.6m b/d vs long-term avg of 1m b/d
  - ➢ Showdown: who will cut output?
- Less oil demand from Europe, China
- Always risk, though, that political turmoil could push price back up



US$ per barrel, dated Brent. Source: Economist Intelligence Unit

US oil production: Unprecedented

- US crude oil production has risen by nearly 80% since the start of 2008—less than seven years!!
- Number of newly drilled US shale wells is falling sharply, though existing wells will probably continue producing for some time



US crude oil production, barrels/day. Source: Energy Information Administration, US Dept of Energy

The economic outlook for Latin America

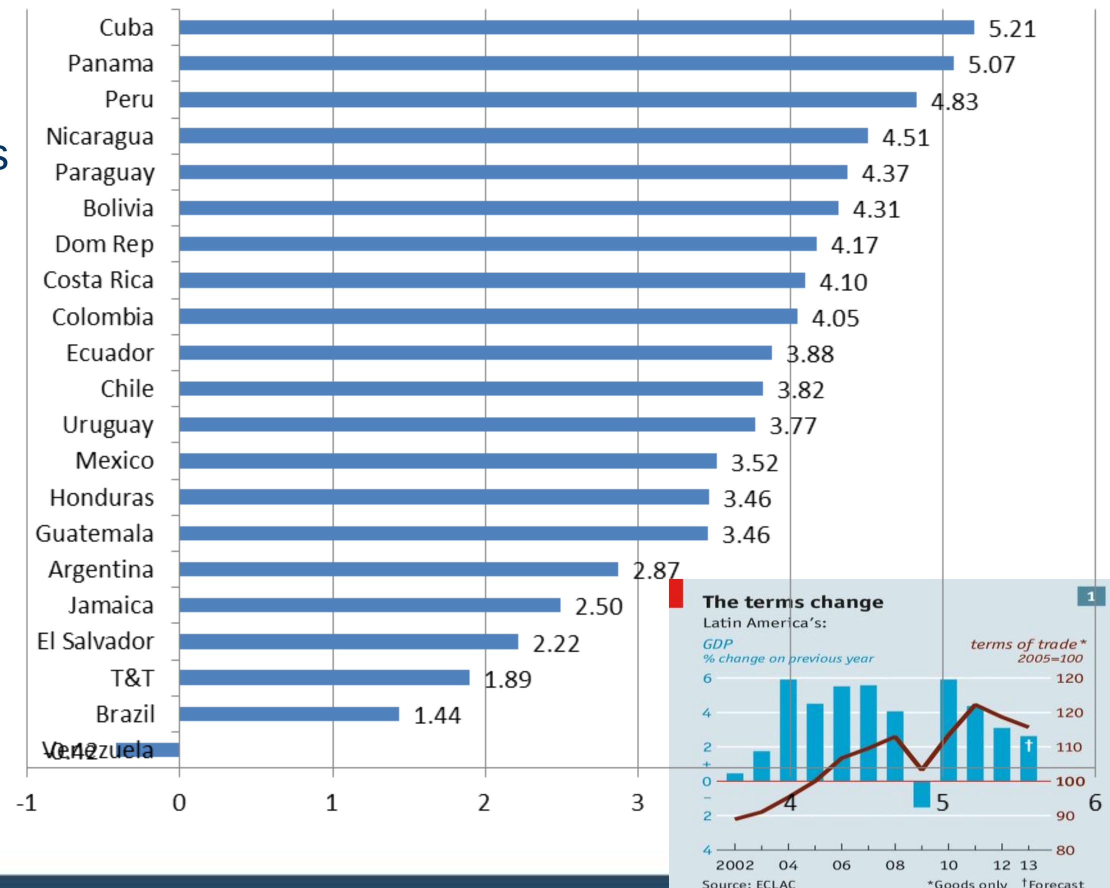
Growth decelerated to 1.3% and will be slightly stronger in 2014 (1.9%)

- Less favorable external environment (lower oil prices supportive in general short term)
- Domestic distortions in some cases
- Little progress in structural reforms

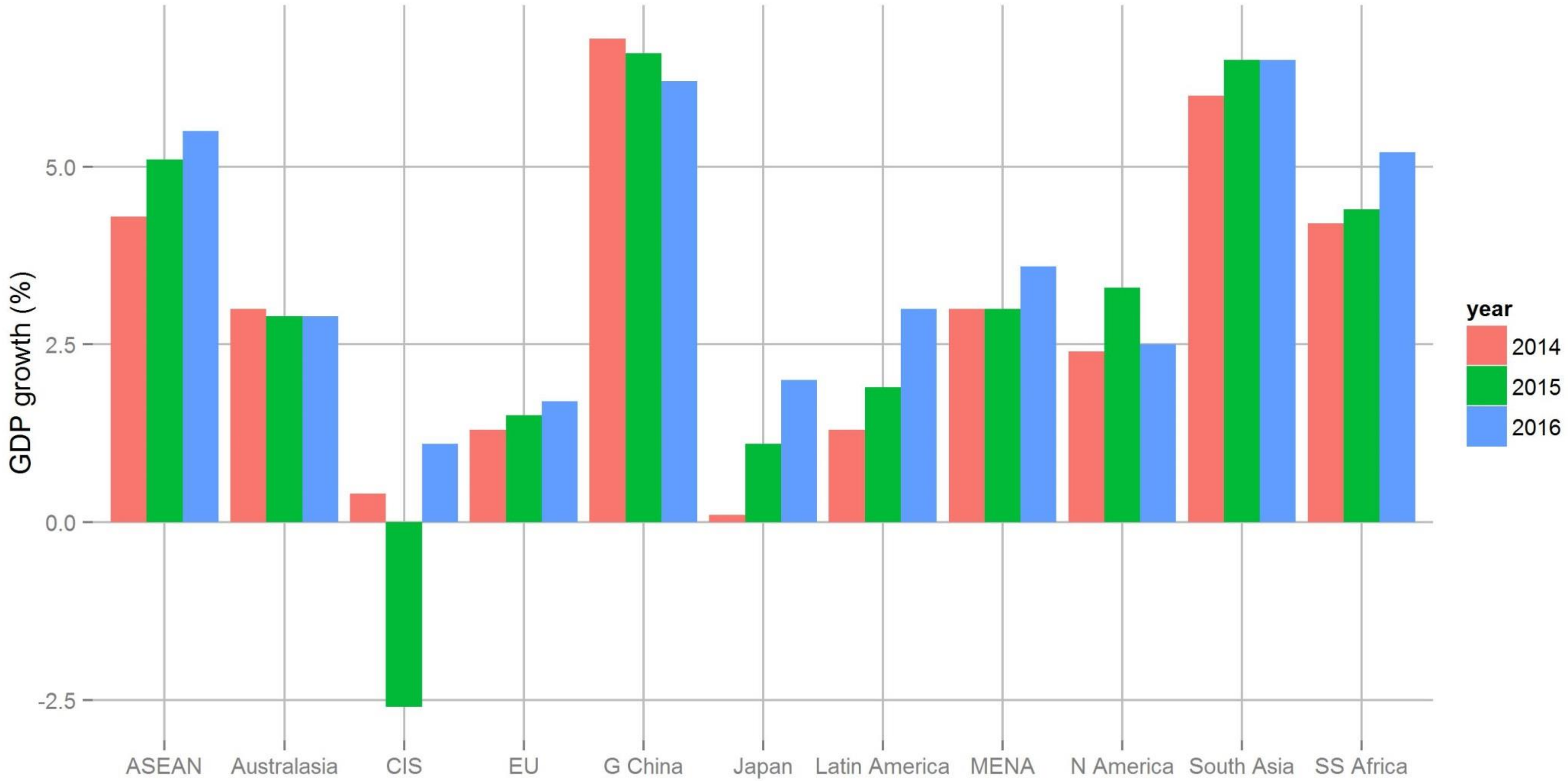
We expect GDP growth to pick up in 2015-19 (3.3%)

- Firmer global growth and solid domestic demand
- Competitiveness-enhancing reforms/ investment

Real GDP growth rates, 2015-19
% change

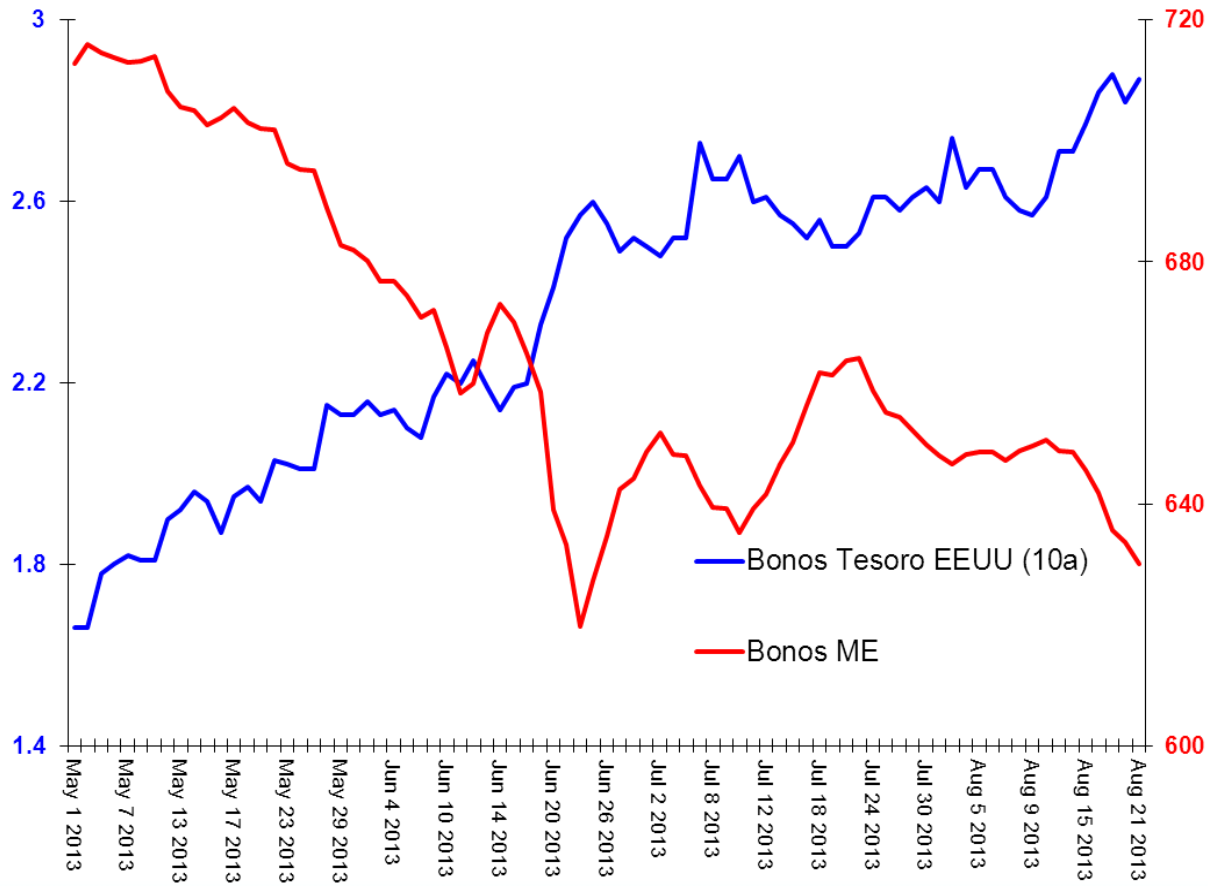


Latam's economic performance in perspective



Source: Economist Intelligence Unit

External risks



The current account will remain in deficit (2.5% in 2015-19), despite lower oil prices

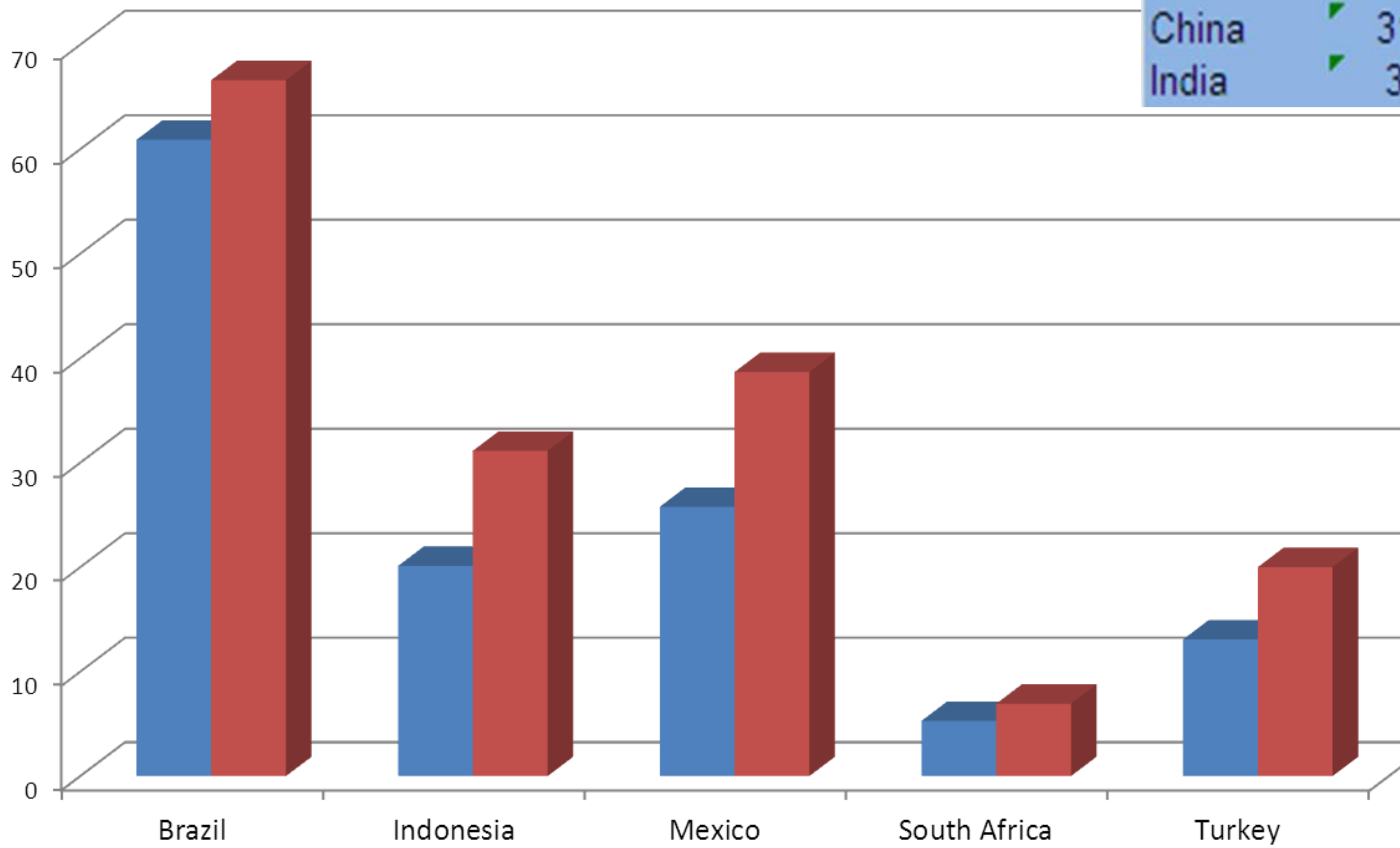
Capital inflows will continue to affect currencies in the region

Source: Bloomberg

FDI will remain high for region

Annual average FDI inflows (US$ bn)

	2010-14	2015-19
US	268.4	380.2
China	315.7	265.8
India	30.2	92.0



Source: Economist Intelligence Unit.

Oil prices: The winners in Latam

- In the short term, the impact of low oil prices will be beneficial to net oil importers as energy costs fall.
- These include Chile, Peru, Argentina, Panama and other Central American
- Impact will most likely materialise in improved terms of trade and lower inflationary pressures.

BUT CHALLENGES LOOM IN MEDIUM-LONG TERM
Sustained lower crude prices may deter investment in the oil industry throughout the region, mostly in high-cost shale and offshore projects. This could have particularly negative effects for the development of new key projects in Argentina and Brazil in the medium-to-long run if prices remain depressed for longer than expected

Oil prices: The losers in Latam

- **Venezuela**: Oil industry accounts for about 95% of export revenue, nearly 40% of fiscal income and about one-third of total GDP. The government assumed a price of US$120/b in the 2015 budget, it is estimated that prices below US$100/b will make Venezuela's huge government-subsidised programmes unsustainable. Prices close to US$50/b (similarly to what we forecast for 2015) severely increase the risk of sovereign default. This risk comes directly from the financial vulnerability of Petróleos de Venezuela (PDVSA, the state-controlled oil company)

- **Colombia**: Oil dependence is high, with this commodity accounting for 55% of export revenue, around one-quarter of total fiscal income and more than one-third of foreign direct investment (FDI). Although lower oil prices, together with a recent hike in taxes, reduce the attractiveness of the oil industry to investors, Colombia's free-floating foreign-exchange regime will provide for an adequate adjustment of external imbalances, while a relatively strong fiscal position will enable the implementation of a pro-cyclical fiscal policy

- **Ecuador**: Policy options more limited . Oil price of around US$120/b required to maintain fiscal stability and fiscal deficit already high (around 4% of GDP in 2014)

- **Mexico**: Oil industry provides about 1/3 total fiscal income. Mexico has hedged part of its oil-price risks for 2015 and has saved a portion of the oil bonanza in a stabilisation fund, thereby reducing the need for drastic public-spending cuts. Further, lower oil prices can help to reduce electricity costs, boosting the competitiveness of manufacturing exports at time of rising demand from US, their main destination. But lower world oil prices may affect expectations for an increased stream of foreign investment, following the comprehensive energy-sector reform currently being implemented.

What about Brazil?

- Brazil stands out as an outlier among oil importers. Fuel prices for consumers are actually like to rise shortly as taxation increases, contributing to headwinds for economy in 2015. Fuel prices at the pump are controlled by government and recent oil prices drop has been used as a means to rebuild Petrobras battered balance. Unlikely government will readjust prices downwards, even if oil remains subdued in international markets.

- **And in medium-long term**
- Largest pre-salt field Libra (with up to 12bn barrels) has break-even price perhaps around US$60/barrel, higher than the prevailing break-even estimates for other pre-salt fields (US$50-55). If taken at face value, extracting oil from Libra currently not viable, hurting the country's prospe as an oil exporter, and further damaging Petrobras.
- Petrobras woes: Rules are that Petrobras must have a minimum 30% stake in any consortium developing pre-salt fields yet to be auctioned. The government has insisted that it will not change these rules. Therefore, pre-salt development will advance only in tandem with Petrobras operational and financial capabilities. Some government officials publicly stated that they consider the 2016 round of auctions as a remote possibility now

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