Grant Thornton

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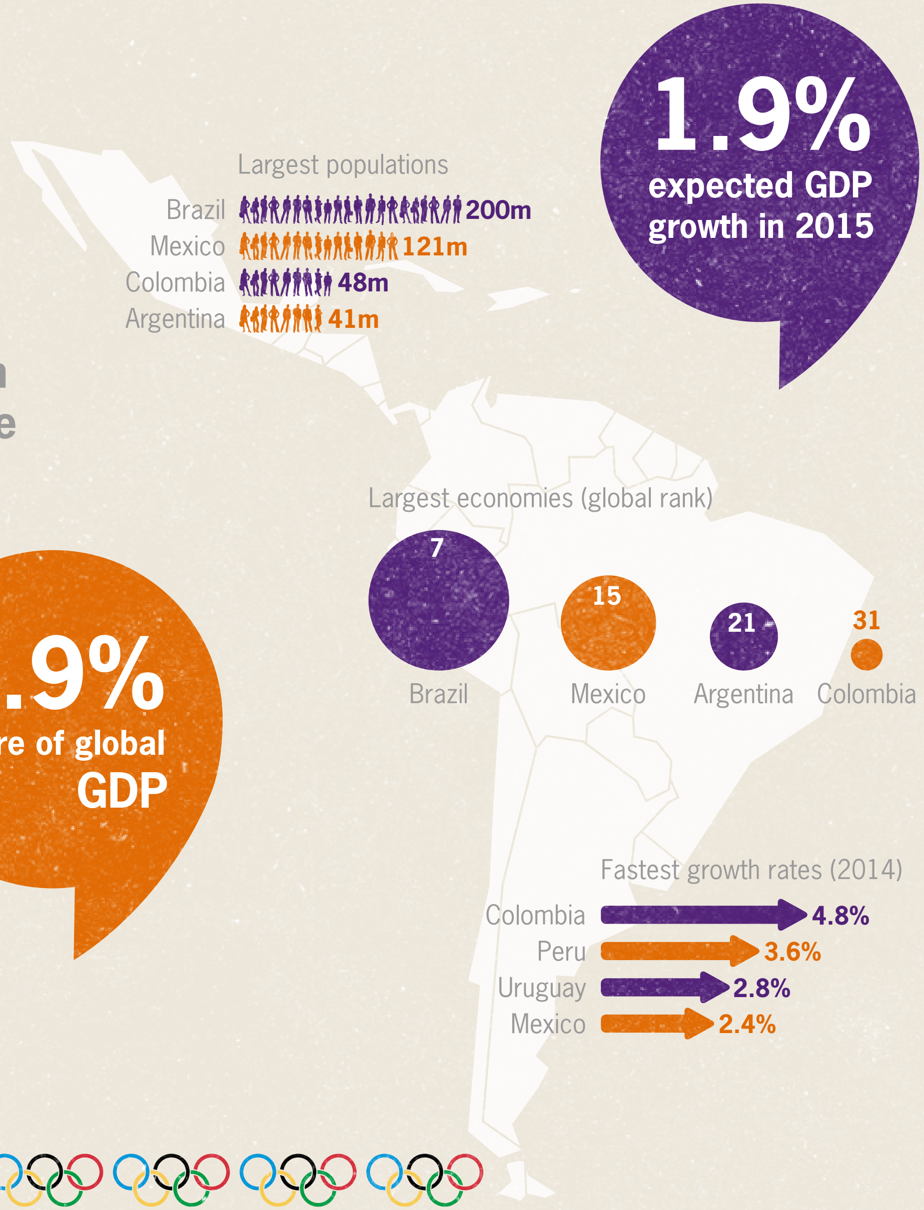
Focus on: *Latin America*

Grant Thornton International Business Report 2015

Latin America in 2015

Drawing on data and insight from the Grant Thornton International Business Report (IBR), the Grant Thornton Global Dynamism Index (GDI), the Economist Intelligence Unit (EIU) and the International Monetary Fund (IMF), this short report considers the outlook for Latin America in 2015.



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10,500 athletes from 205 countries will be participating in the Rio Olympic Games in 2016

The economy

The end of the commodity supercycle has had a profound effect on Latin America. For a decade or more, regional economies grew principally by selling their primary commodities to China and other rapidly developing markets in Asia. The financial crisis saw economies across Latin America stall – and even contract sharply in the case of Mexico due to its close economic ties with the United States – but the recovery was swift with the region posting some of the fastest growth rates in the world. In 2010, Brazil grew by 7.5% in 2010, Peru and Uruguay by 8.4% and Argentina by 9.1%.

However 2010 proved to be something of a highpoint for the region with developments since markedly less encouraging, especially in the more inward-looking Atlantic economies, such as Argentina, Brazil and Venezuela. In 2014, Argentina, which defaulted on a sovereign debt repayment and remains gripped by political protest and investment inertia ahead of the elections later this year, contracted by an estimated 1.7%. Venezuela, where the fall in the oil price has cut a gaping hole in the government budget even as businesses and consumers struggle with exchange and price controls, fared even worse, shrinking by an estimated 3.0%.

Brazil, which accounts for around 40% of regional output also had a tough 2014. Despite hosting a relatively successful FIFA World Cup (off the pitch, at least) the economy grew by just 0.3% in 2014 and while Dilma Rousseff was re-elected, she gained only 51.6% of the vote, the tightest victory in electoral history, and lost heavily in the most productive states such as Sao Paulo. If each Brazilian state was weighted by GDP (as opposed to population), her challenger, Aécio Neves would have taken 53% of the vote.[1]

Latin America's Pacific economies fared better in 2014, although they too suffered from the regional slowdown. Mexico has embarked on an ambitious raft of reforms with the aim of opening sectors such as education, energy and telecoms up to further competition. The economy grew by just 2.4% in 2014 but the hope is that the reform programme will raise long-term growth potential. Chile (2.0%) and Peru (3.6%) saw growth slip in 2014 due to the slide in global copper and gold prices driven by slowing demand from China. Growth rates in Colombia (4.8%) continue to impress and government talks with the FARC guerrilla group appear to be progressing well.

Tellingly, the Pacific economies have made greater strides towards embracing globalisation. Not only have Chile, Peru, Colombia, and Mexico formed the Alianza del Pacífico (the Pacific Alliance), a trade bloc that seeks to advance economic integration, free trade and free markets, but they (excluding Colombia) are also involved in ongoing negotiations regarding the Trans Pacific Partnership (TPP). Mexico alone has 11 free trade agreements covering 43 economies.

GDP growth rates (estimated, 2014)

Source: IMF 2015

[1] 'By a whisker, more of the same' – The Economist (2014)

Economic outlook

The more outward-looking Pacific economies of Latin America look set to be rewarded with quicker growth rates in 2015, while the Atlantic economies are likely to stagnate at best.

Peru is expected to be the star performer although growth will remain below 2005-08 levels. Lower global commodity prices are expected to weigh on exports but stimulus measures introduced by the government and the gradual implementation of huge new infrastructure and mining projects should support growth of 4.7% in 2015, accelerating to 5.3% in 2016.

The improving security situation in Colombia is expected to help attract more foreign direct investment while the government seeks to maintain macroeconomic stability via sound monetary policies and an improved fiscal position. However, the fall in the oil price (which accounts for 56% of exports) will widen the current account deficit and growth is likely to slow to 3.5% this year, before accelerating to 4.0% in 2016 as tourism inflows and services exports increase.

In Mexico, much will depend on the government's ability to implement the raft of reforms passed over recent months while it fights public anger over security and corruption. Strong consumer confidence and growth forecasts north of the border (the US accounts for approximately 80% of Mexican exports) should support growth of 2.8% in 2015 but increased investment in the energy sector will be dependent on the oil price.

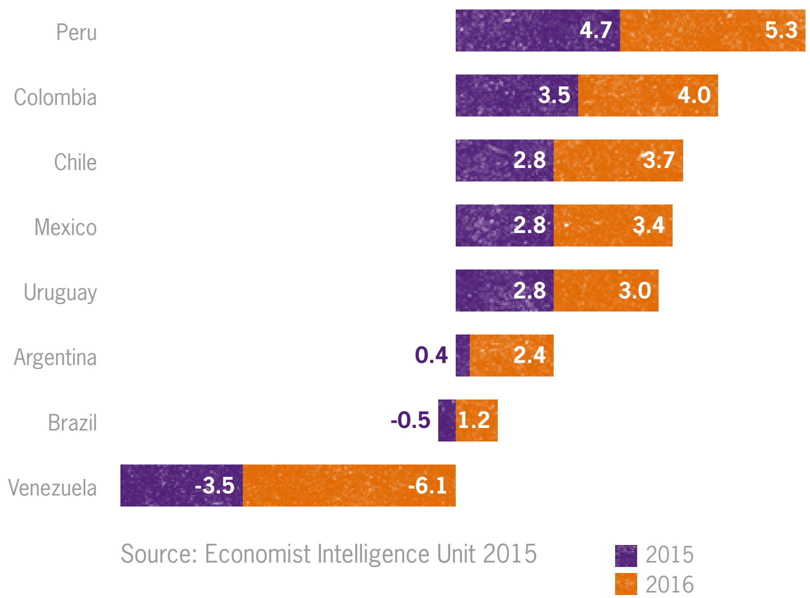
The slowdown in China (which accounts for 25% of exports) and the slump in global commodity prices have put downward pressure on Chile's open economy but growth is expected to climb to 2.8% this year, rising to 3.7% in 2016 as the government pursues policies to reduce inequality (increasing social and education spending) that will boost the long-term growth potential of the economy.

Brazil is expected to post a mild contraction in 2015 (-0.5%) before recovering to growth of 1.2% in 2016. The Petrobras (state oil company) scandal which has engulfed the government and touches the president herself (she was chair of the board from 2003 to 2010 when much of the graft allegedly took place) caused more than a million protestors to take to the streets in March. Inflation remains high, so more monetary tightening is expected, while consumer and business confidence are low.

The volatile political and economic environment in Argentina and Venezuela makes forecasting difficult but both economies are expected to post little – if any – growth. Argentina may recover to 0.4% expansion in 2015, rising to 2.4% in 2016 once a new administration, which is likely to be more business and market-friendly, takes office. Inflation is still running at more than 35% but should fall due to weak domestic demand and the falling oil prices this year. By contrast, the falling oil price is a major concern in Venezuela: oil accounts for 25% of GDP and 95% of export earnings and the economy is expected to contract by 3.5% this year.

Peru set to grow fastest in 2015

GDP growth rates (forecast, 2015-16)



Source: Economist Intelligence Unit 2015

Business growth prospects

Business confidence in Latin America plunged to its lowest point in IBR history in Q1 2015 with just 5% of local business leaders expressing optimism in the economic outlook for the next 12 months – a 38pp drop compared to the same time last year. The dramatic fall in optimism is once again driven by businesses in Argentina (-38) and Brazil (-18) both of which hit record lows this quarter. Political instability, high inflation and the strengthening US dollar are all dampening growth prospects across the region.

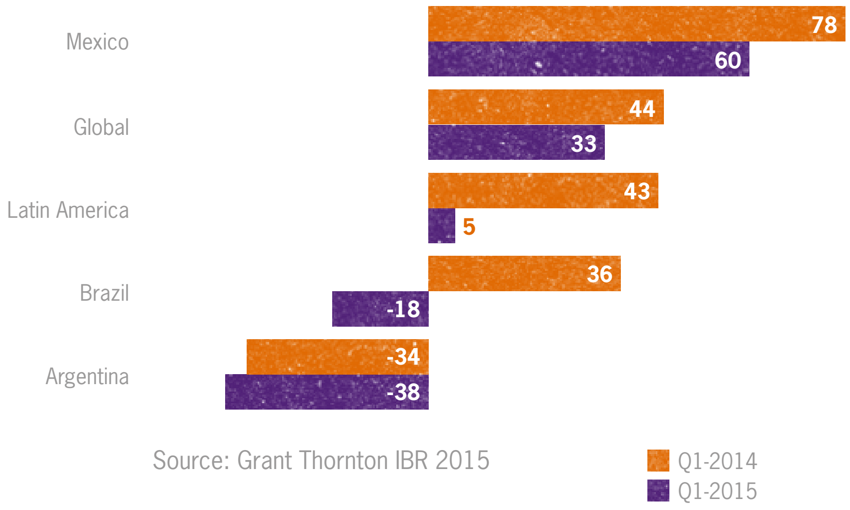
This uncertainty has begun to affect business growth prospects. Revenue expectations in Argentina remain in negative territory while Brazil has seen a massive 54pp downward swing compared with this time last year. The outlook for Mexico however, is decidedly more positive where business leaders are ranked seventh in the 35 economy survey for optimism in Q1-2015. Revenue expectations in Mexico avoided the decline seen in the rest of the region and remained flat (52%) while more than half expect profits to rise (52%), a slight rise from this time last year (47%).

Despite the strengthening US dollar, export hopes amongst businesses in Latin America remain amongst the lowest in the world in 2015 but have increased slowly in each of the last four quarters (from 11% in Q2-2014 to 17% in Q1-2015) . However, investment has stayed consistently above the global average (35%) with almost half (43%) of businesses in the region planning to invest in plant and machinery in the next 12 months. Expectations for investment in new buildings also held at 19%.

Unsurprisingly business leaders in the region are focusing their efforts on growth initiatives this quarter. Incentivising productivity appears to be the most popular across Brazil (63%), Argentina (78%) and Mexico (94%) with an overwhelming number of businesses planning to implement related programmes within the next 12 months. 66% of Brazilian business leaders also plan to improve sales force effectiveness and more than half of Mexican businesses expect to increase investment in marketing.

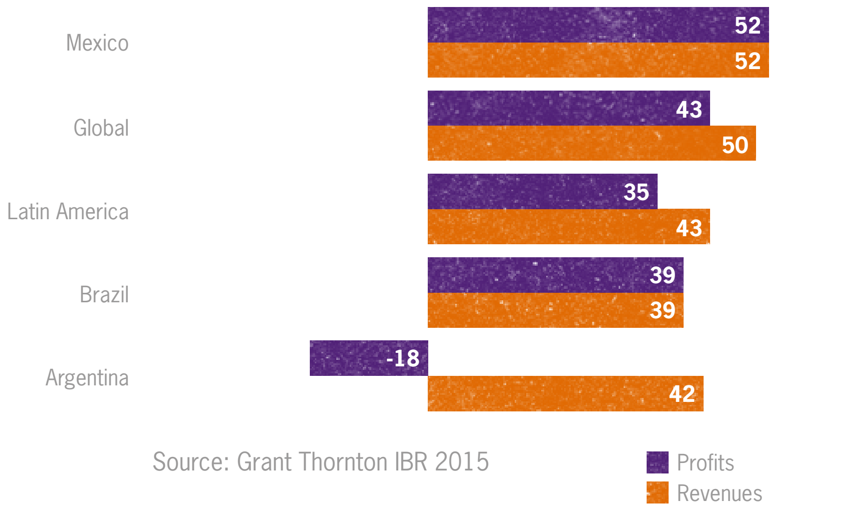
In the short term, some businesses in Latin America should benefit from the lower oil price, and consumers from the subsequent impact on inflation. Brazil also has the prospect of the 2016 Olympics in Rio which should provide opportunities for tourism, transport and construction businesses across the region.

Net percentage of businesses optimistic for the economic outlook (next 12 months)



Source: Grant Thornton IBR 2015

Net percentage of businesses expecting to increase profits /revenues (in the next 12 months)



Source: Grant Thornton IBR 2015

Business growth constraints

Perhaps unsurprisingly given levels of political upheaval, social protest and ongoing security concerns across the region, Latin American businesses continue to cite economic uncertainty as the biggest constraint to business growth. In 2015 over half of all business leaders expressed concern regarding the economic situation in their markets. This figure is largely driven by Argentinian (78%) and Brazilian (56%) businesses, with peers in Mexico (38%) apparently more satisfied with the macro environment.

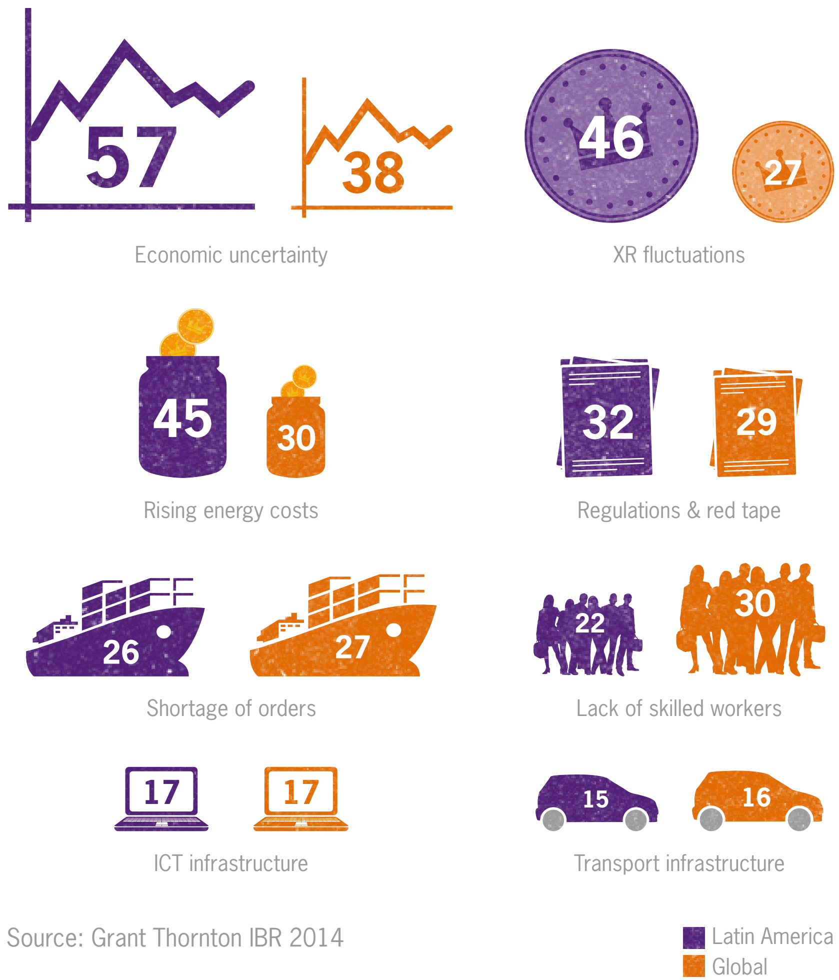
The second most significant concern shared by businesses in the region is exchange rate fluctuations. The rising strength of the US dollar is having an effect on most Latin American economies. This makes exports from the region to the US more competitive, but any businesses which issued dollar-denominated bonds over recent years will find their debt servicing costs rising. A rising dollar also has no impact if trade is principally with other countries whose currencies are declining relative to the greenback. Again, Brazil (45%) and Argentina (70%) are suffering in this regard, more so than their Mexican peers (38%).

Despite the falling oil price, Brazilian (59%) and Argentinan (48%) businesses are struggling with rising energy costs, which is much less of a problem in Mexico (20%). The impact of the falling oil price on the region could be severe. Argentina has the third largest shale reserves in the world, but this extraction method is comparatively expensive, meanwhile the effect of Mexico's energy reforms could suffer.

The availability of skilled labour is an issue for just under a quarter of Latin American businesses (24%) down from 27% in 2014 but this rises to 33% in Brazil where the shortage is most keenly felt. A similar proportion cite a lack of demand in the early months of 2015 (26%) this ranges from 28% in Brazil, whose main export market, China is slowing, to 22% in Mexico which exports primarily to the US market where growth is moving in the opposite direction.

A large proportion of businesses also have infrastructure concerns. The proportions citing poor quality transport (25%) and ICT (25%) infrastructure are particularly high in Brazil. Mexican businesses are seemingly unaffected by this – few highlighted transport (4%) or ICT (6%) as growth barriers.

Percentage of businesses citing factor as a constraint on growth



Source: Grant Thornton IBR 2014

Dynamism

The Grant Thornton Global Dynamism Index (GDI) 2013, which assesses the business growth environments of 60 of the largest economies in the world on 22 indicators of dynamism[2], ranks Latin America higher than Eastern Europe and the Middle East and Africa, but behind developing Asia-Pacific. It ranks high for the dynamism of its labour & human capital and economics & growth environment, but poorly for science & technology, financing environment and business operating environment.

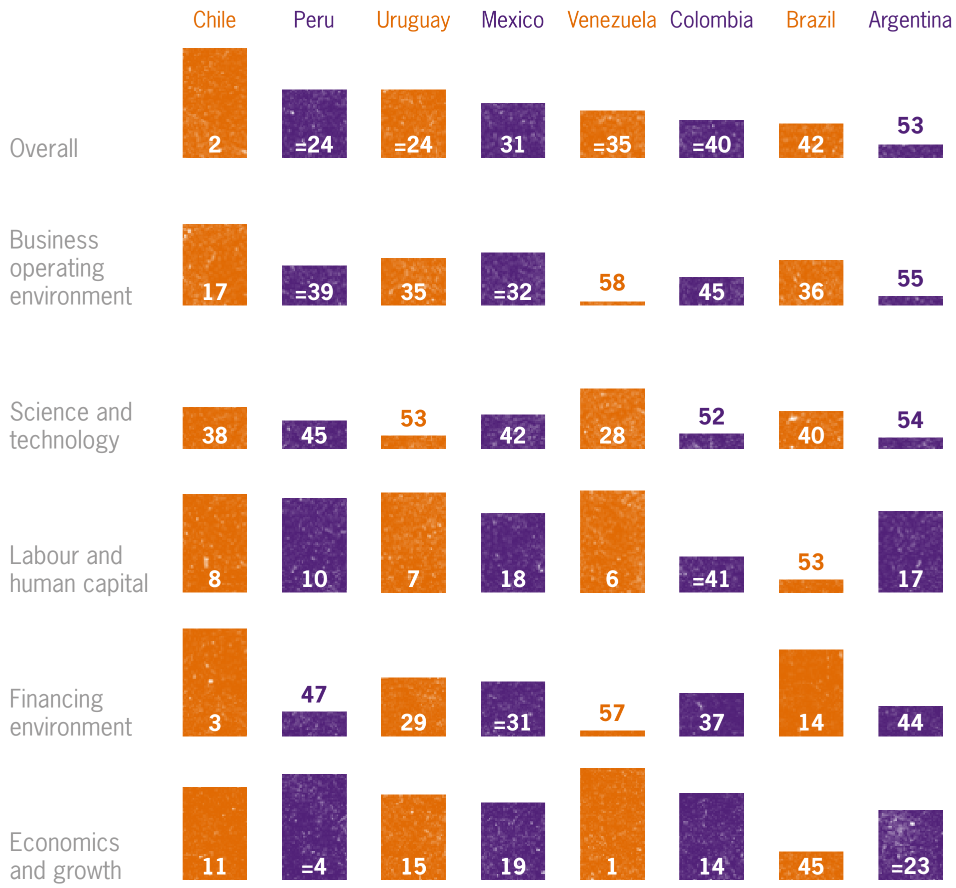
Chile ranks highest in Latin America, and second overall, behind only Australia – this means that over the past 12 months, only Australia has improved more as a place to grow your business. It scores consistently in the index, ranking third for financing environment, eighth for labour & human capital and eleventh for economics & growth. Entry into the OECD in 2010 confirms the progress Chile has made in terms of rules and regulations, political and institutional stability, the ease of doing business and access to finance over the past two decades.

Peru and Uruguay rank next highest in the GDI 2013 at joint 24th. Peru ranks fourth for economics & growth and tenth for labour & human capital, while Uruguay ranks seventh for labour & human capital and fifteenth for economics & growth. Mexico ranks 31st, scoring well in labour & human capital (18th) and economics & growth (19th) but less well for science and technology (42nd).

Interestingly, Venezuela (35th) ranks above Colombia (40th) Brazil (42nd) in the 2013 index largely due to the pre-election spending by Hugo Chavez which took Venezuela into first place for economics & growth. It is important to note that the index does not suggest Venezuela has a better business growth environment than Brazil or Colombia (rather than it improved faster over the past 12 months). Brazil ranked 45th for economics & growth and 53rd for labour & human capital, although it was behind only Chile, and 14th globally, for the dynamism of its financing environment. Colombia ranked 14th for economics & growth but 52nd for science & technology.

Argentina ranked last in Latin America and 53rd overall, scoring particularly badly for business operating environment (55th) and science & technology (54th).

Global ranks of Latin American economies



Source: GDI 2013

[2] Dynamism refers to the changes in the economy over the past 12 months which are likely to lead to a faster future rate of growth

IBR 2015 methodology

The Grant Thornton International Business Report (IBR) is the world's leading mid-market business survey, interviewing approximately 2,500 senior executives every quarter in listed and privately-held companies all over the world. Launched in 1992 in nine European countries, the report now surveys more than 10,000 businesses leaders in 35 economies on an annual basis, providing insights on the economic and commercial issues affecting the growth prospects of companies globally.

The data in this report are drawn from more than 10,000 interviews (700 in Latin America) conducted between May 2014 and February 2015 with chief executive officers, managing directors, chairmen and other senior decision-makers from all industry sectors in mid-market businesses in 35 economies. A further 20 in-depth interviews were conducted with business leaders from inside and outside Grant Thornton.

The definition of mid-market varies across the world: in mainland China, we interview businesses with 100-1000 employees; in the United States, those with US$20m to US2bn in annual revenues; in Europe, those with 50-499 employees.

Publications: www.grantthornton.global/en/insights/?tags=ibr
Methodology: www.grantthornton.global/en/insights/articles/About-IBR/
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Dominic King
Editor, global research
Grant Thornton International Ltd
T +44 (0)207 391 9537
E dominic.king@gti.gt.com

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