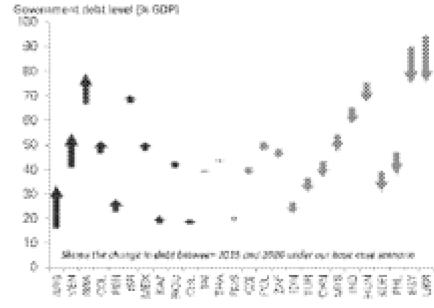
Countries' recent investment performances also allow us to identify the most challenging macroeconomic outlooks in the region, led again by Brazil and Argentina, but including also the special case of Chile. In the latter, the combination of worsening external backdrop and controversial reforms has badly affected confidence and investment, but this effect should be partly temporary in nature, as policy uncertainties are expected to fade, and macro policy is actively helping the recovery in confidence and growth.

The suboptimal investment performance is also a good indicator of the need for a second round of reforms in the region. Unfortunately Mexico has been the only country to show a clear determination to push for reforms in a couple of specific areas, particularly in the energy sector. By contrast, in Argentina, Brazil, and in particular in Venezuela, there has been an increasing intervention of some form of state capitalism, with expanding governments, increasing trade protectionism, and economic controls. This appears to explain the observed characteristics of the recent slowdown in the region, particularly visible in the industrial sector, and in countries reporting significant increases in unit labor costs, typical of a middle income malaise.

In this regard, recent presidential elections in Argentina provide room for hope. The new administration is expected to introduce corrective policies for existing macro-imbalances, while bringing Argentina back to international markets after a likely resolution of the pending holdouts case. Similarly, a mid-term election in Venezuela could bring a more balanced policy making, although the risk of a power vacuum should not be disregarded. By contrast, ongoing political instability in Brazil is likely to remain a big burden for fiscal adjustment and economic performance at least in 2016. A warranted fiscal adjustment has been announced, and steps are being taken to reestablish much needed policy credibility, but President Rousseff's conviction and power to support these policies remain major question marks.

Figure 3: Public debt dynamics turning fragile for some countries



Source: IMF, Deutsche Bank Research

Low external debt is a plus but fiscal dynamics could worsen fast

The last several years of ultra-low global interest rates have been a bonus for emerging countries and a likely rise in US rates has the potential to create further turbulence in capital flows. Similarly, the recent decline in commodity prices might prove too strong a test to external balances in producer countries. However, low levels of hard currency debt, with Brazil, Chile, Peru, and Mexico being actually creditors of the world economy, provide an exceptional buffer this time around. Expectations for slow-motion rate normalization in the US are another blessing for emerging economies in this cycle.

This notwithstanding, public debt dynamics show that countries like Brazil, Venezuela, and Colombia might face significant increases in their debt levels if they fail to reduce their large primary deficits. Furthermore, at current oil prices, external conditions in Venezuela remain unsustainable, as a low level of reserves barely covers the projected balance of payment deficit of a single year under the status quo. Besides, a public debt restructuring appears difficult to avoid, with the government being harshly constrained politically by a protracted recession with inflation.

Gustavo Cañonero, (1) [redacted]

Figure 4: Deutsche Bank forecasts:

(% yoy, unless stated)		2014	2015F	2016F	2017F
Argentina	GDP	-1.5	1.0	-0.1	3.9
	CPI	38.6	27.9	37.3	23.6
	CA bal., % GDP	-1.7	-2.3	-2.4	-2.3
Brazil	GDP	0.1	-3.7	-2.4	1.0
	CPI	6.3	9.0	8.5	6.2
	CA bal., % GDP	-4.3	-3.5	-1.8	-1.9
Chile	GDP	1.9	2.1	2.2	2.7
	CPI	4.4	4.4	3.6	3.5
	CA bal., % GDP	-1.2	-0.7	-1.3	-0.9
Colombia	GDP	4.6	3.0	2.8	3.2
	CPI	2.9	4.9	6.0	3.5
	CA bal., % GDP	-5.2	-6.2	-5.9	-5.1
Mexico	GDP	2.3	2.3	2.7	3.2
	CPI	4.0	2.5	3.1	3.4
	CA bal., % GDP	-2.3	-2.5	-2.7	-2.9
Peru	GDP	2.4	2.8	3.4	4.2
	CPI	3.2	3.5	3.8	3.3
	CA bal., % GDP	-4.0	-3.6	-3.3	-2.5
Venezuela	GDP	-3.4	-9.7	-7.6	-3.2
	CPI	62.0	120.0	175.0	250.0
	CA bal., % GDP	4.6	-0.3	-0.9	0.2

Source: National authorities, Deutsche Bank Research