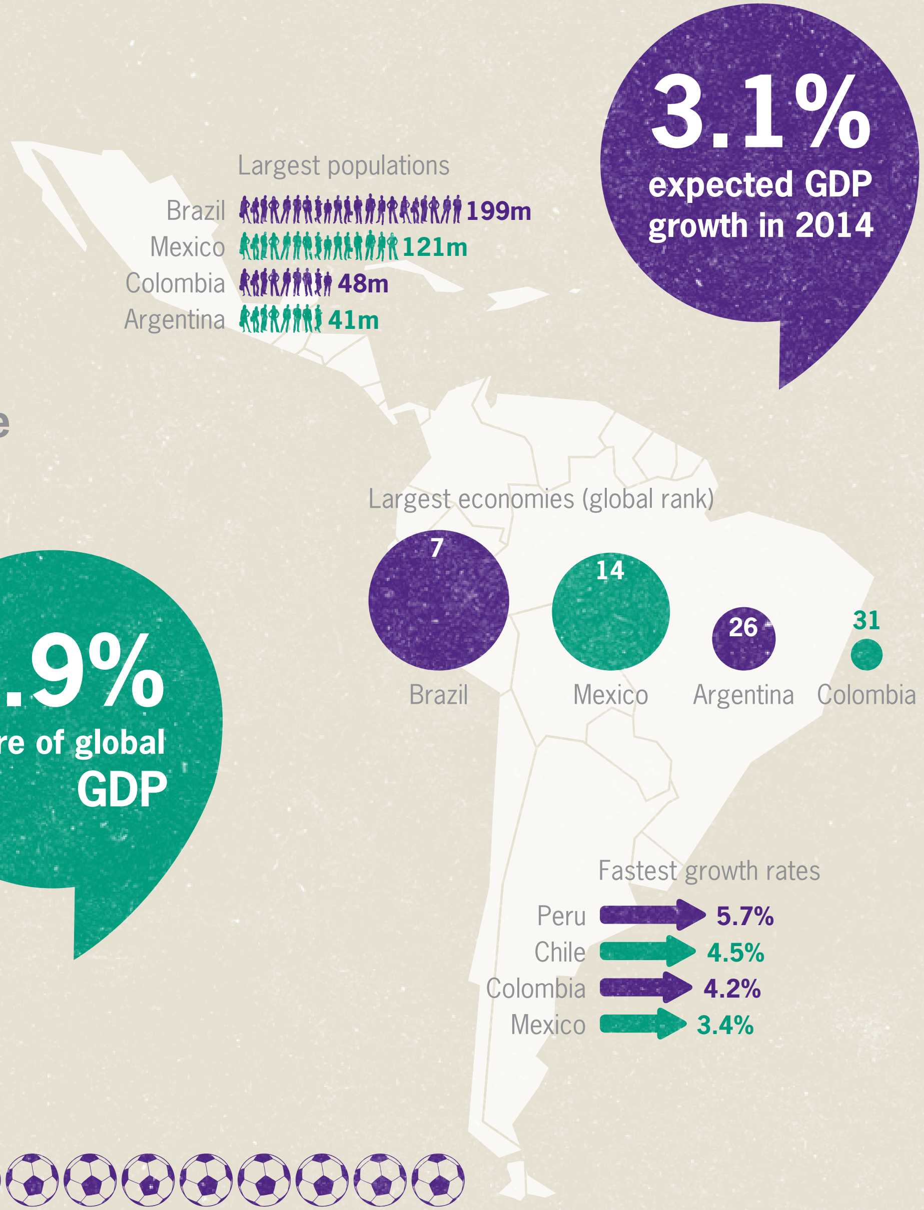
Grant Thornton
An instinct for growth™

Focus on: *Latin America*

Grant Thornton International Business Report 2014

Latin America in 2014

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 2014.



7.9% share of global GDP

8.1% share of global population

Contents

600,000 – Visitors expected in Brazil for the FIFA World Cup

The economy

Opportunities and challenges

The next 12 months hold a number of opportunities and challenges for Latin America. An estimated 600,000 visitors will descend on Brazil for the FIFA World Cup. They will be joined by television viewers across the globe as Brazil attempts to show the world that despite stadia construction delays and social unrest during the Confederations Cup last summer, it is open for business.

To the north, Latin America's other giant, Mexico, had a turbulent 2013 as Enrique Pena Nieto's government pushed through a series of tough education and energy reforms. The early signs are that these will benefit the economy in the long term but entrenched interests and security issues could put a brake on developments.

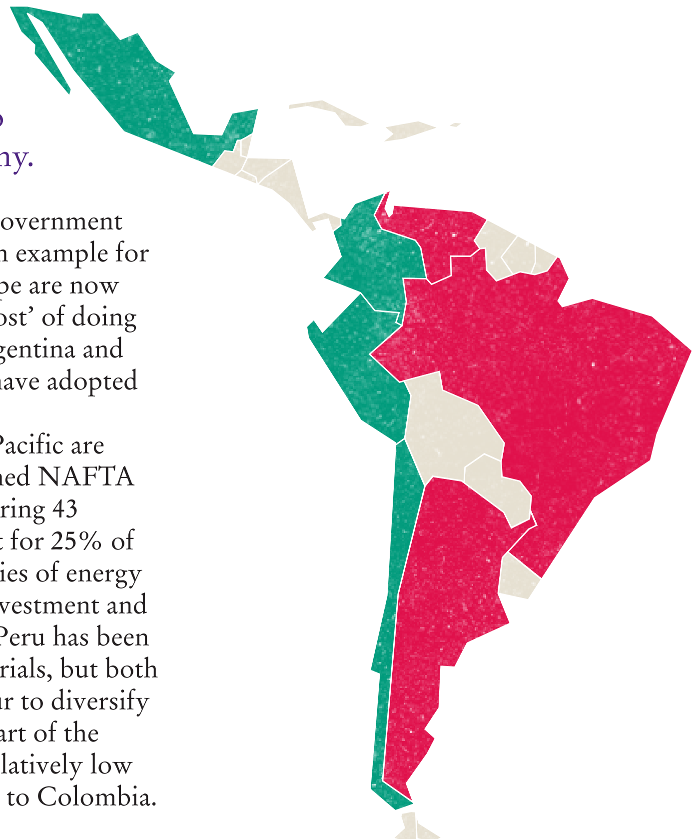
Argentina's economy is struggling; growth is tepid, the fiscal deficit is widening, and a series of foreign exchange and import control measures have failed to cool rampant inflation. In Colombia, peace talks between the government and the FARC guerrilla movement which are vital to improving the business investment climate continue. Governments in Peru and Chile continue to pursue pragmatic, centrist policies to prevent runaway budget deficits but both need to come to terms with slowing demand for their key raw materials from China.

Two Latin Americas: looking in and out

The ongoing Trans Pacific Partnership (TPP) expansion talks, which include Chile, Mexico and Peru, have accentuated a growing continental split between those economies prepared to embrace free trade and free markets and those most averse to globalisation who want to keep the state deeply embedded in the economy.

In 2010, when Brazil was growing by 7.5%, its government held up its model of economic development as an example for the rest of the world, but taxes, tariffs and red tape are now so high that business leaders talk of the 'Brazil cost' of doing business there. Similarly, the governments of Argentina and Venezuela are much more interventionist; both have adopted price controls to try to tame inflation.

By contrast, the economies which border the Pacific are much more open. It is 20 years since Mexico joined NAFTA and it now has eleven free trade agreements covering 43 economies. Manufactured products now account for 25% of output (compared to just 4% in Brazil) and a series of energy reforms conducted in 2013 could attract more investment and boost growth. Like Brazil, growth in Chile and Peru has been bolstered by Chinese demand for their raw materials, but both have done much more than their larger neighbour to diversify and strengthen other exports. And though not part of the TPP talks, sound macroeconomic policies and relatively low government debt is helping to attract investment to Colombia.



Economic outlook

Pacific economies set to grow faster in 2014

The Latin American economy is forecast to expand by 3.2% in 2014, up from 2.9% in 2013, accelerating to 3.5% in 2015 as global conditions improve, especially in the United States and Europe. This growth will be supported by largely sound macroeconomic policies, important as the region moves away from producing raw materials for China which is itself entering a less commodity-intensive stage of development.

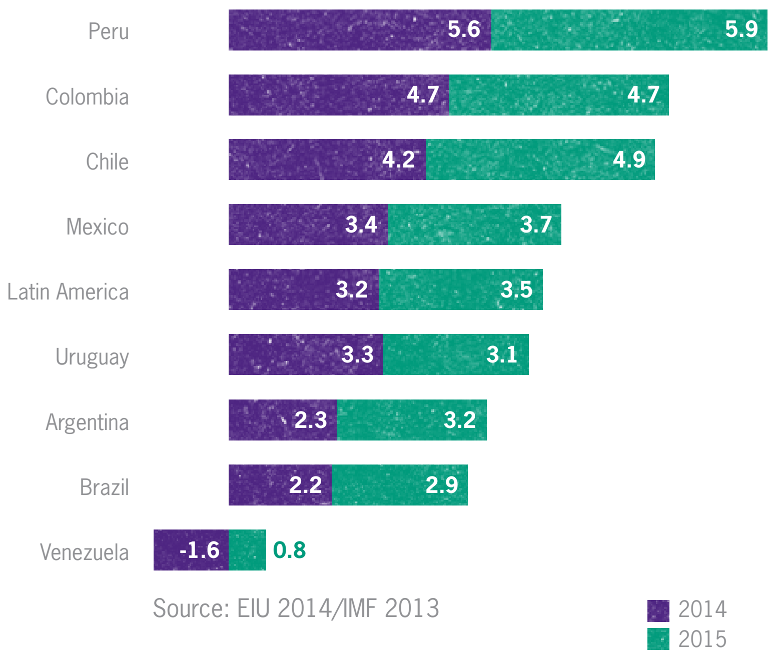
Despite this improvement, there are some notable intra-region variations. For example, the while the Pacific Alliance trade bloc (Chile, Colombia, Mexico and Peru) are forecast to grow at 4.3% in 2014, the Atlantic group of Argentina, Brazil and Venezuela are expected to post expansion of around half that.

Brazil, Latin America's largest economy, accounting for 39% of GDP, is expected to grow by just 2.2% in 2014 despite the investment and tourism impact of the FIFA World Cup. Brazil's economy has showed sharply in recent years due to inadequate investment in infrastructure, capacity constraints and the misallocation of public resources. Growth is expected to accelerate slightly to 2.9% in 2015 as the country gears up to host the Olympic Games but government intervention and currency volatility have dampened investor confidence.

By contrast Mexico, which accounts for 24% of regional GDP, is expected to bounce back in 2014 following a tough 2013. Growth this year is expected to reach 3.4%, rising to 3.7% in 2015 as a series of hard-fought energy, education and electoral reforms begin to bear fruit. Growth could even accelerate if competition in key sectors such as oil and telecommunications, infrastructure investment and education standards improve, although much will depend on the strength of the US economy which accounts for around three-quarters of Mexican exports.

Colombia (7% of regional GDP), Chile (5%) and Peru (4%) are all expected to grow at above the regional average rate with business investment and exports forecast to remain strong as their governments follow prudent macroreconomic policies. The outlook for Argentina is more difficult although the economy is expected to improve following the presidential elections in 2015.

Forecast GDP growth rates (%)



Source: EIU 2014/IMF 2013

Business growth prospects

Business confidence has fallen dramatically in Latin America over the past 12 months. The time last year, net 69% of business leaders expressed optimism in the economic outlook, compared to 26% now. Globally the average has risen by 23 percentage points due to improvements in Japan, the United Kingdom and United States.

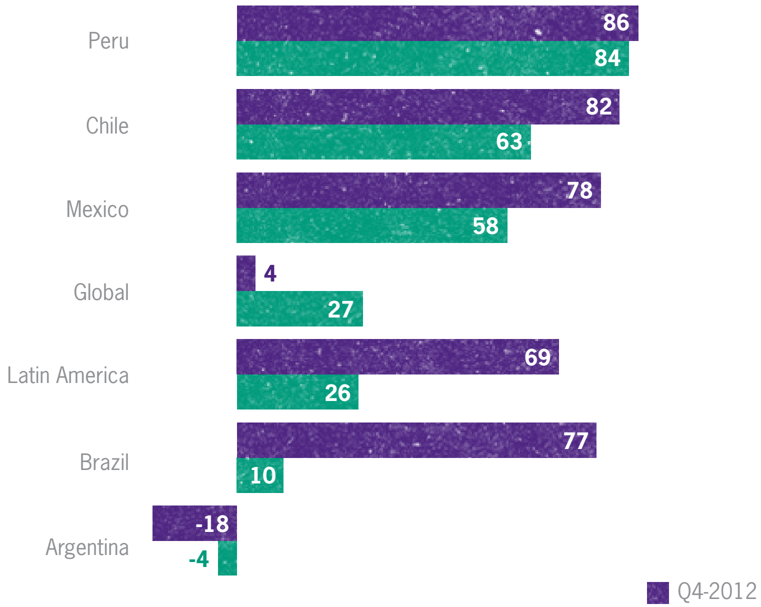
Brazilian businesses have driven the regional decline; optimism has fallen from 77% at the start of 2013 to just 10% today, the lowest level in IBR history. Argentinian business leaders are even more pessimistic (-4%). The contrast with other economies in the region is stark: business leaders in Peru (84%), Chile (63%) and Mexico (58%) are less optimistic that 12 months ago, but rank in the top eleven for optimism in the 45-economy survey.

However this uncertainty has not dampened business growth prospects: net 63% of Latin American businesses expect to increase revenues in 2014 (down just 1pp compared with 12 months previously) and 48% are forecasting increased profitability (down 2pp). Business leaders in Peru are most bullish regionally regarding revenues (82%) and profits (75%); peers in Argentina are the least hopeful, and a majority actually expect profits to decline in 2014. Brazilian expectations for revenue (64%) are level with those in Mexico, but they are more confident regarding profits (57% vs 46%).

The more outward-looking economies, notably Chile (37%) and Mexico (32%), are most optimistic regarding exports; regionally net 17% expect to increase sales of their goods and services abroad in 2014. Levels of investment also remain robust at 42%, unchanged from 12 months previously, and led by Peru (61%) and Chile (51%).

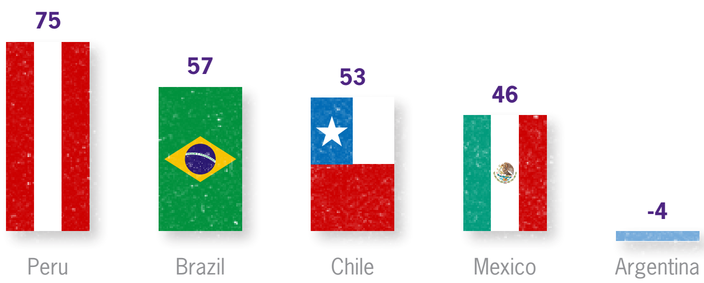
The outlook for the labour market remains tricky with net 36% of businesses across the region expecting to hire in 2014, down 3pp from 12 months previously, although still well above the global average (29%). Again, Peruvian businesses are expecting the most activity – 73% expect to hire new people in 2014 – with businesses in Mexico (26%), Argentina (28%) and Brazil (37%) more circumspect.

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



Source: Grant Thornton IBR 2014

Net percentage of businesses expecting to increase profits (next 12 months)



Source: Grant Thornton IBR 2014

Business growth constraints

Economic uncertainty is the biggest concern for Latin America's business leaders in 2014: 47% expect this to constrain them from growing their business. Aside from domestic drivers, there are a number of factors contributing to this lack of confidence in the outlook, including the rebalancing of China's economy away from investment, ongoing weakness in the eurozone following the sovereign debt crisis and the speed of asset purchase tapering in the United States. Businesses in Argentina (78%) and Brazil (48%) feel most constrained in this regard.

Exchange rate fluctuations are the second biggest concern for businesses in Latin America. Again businesses in Argentina (70%) and Brazil (49%) feel more constrained that their Pacific coast rivals. Brazil has been named as one of the 'fragile five' economies whose currencies could suffer most from investor flight once the US begins to taper and Argentina has imposed a range of foreign exchange controls (including recently raising the tax on credit card payments made outside the country from 25% to 40%) to prop up the peso.

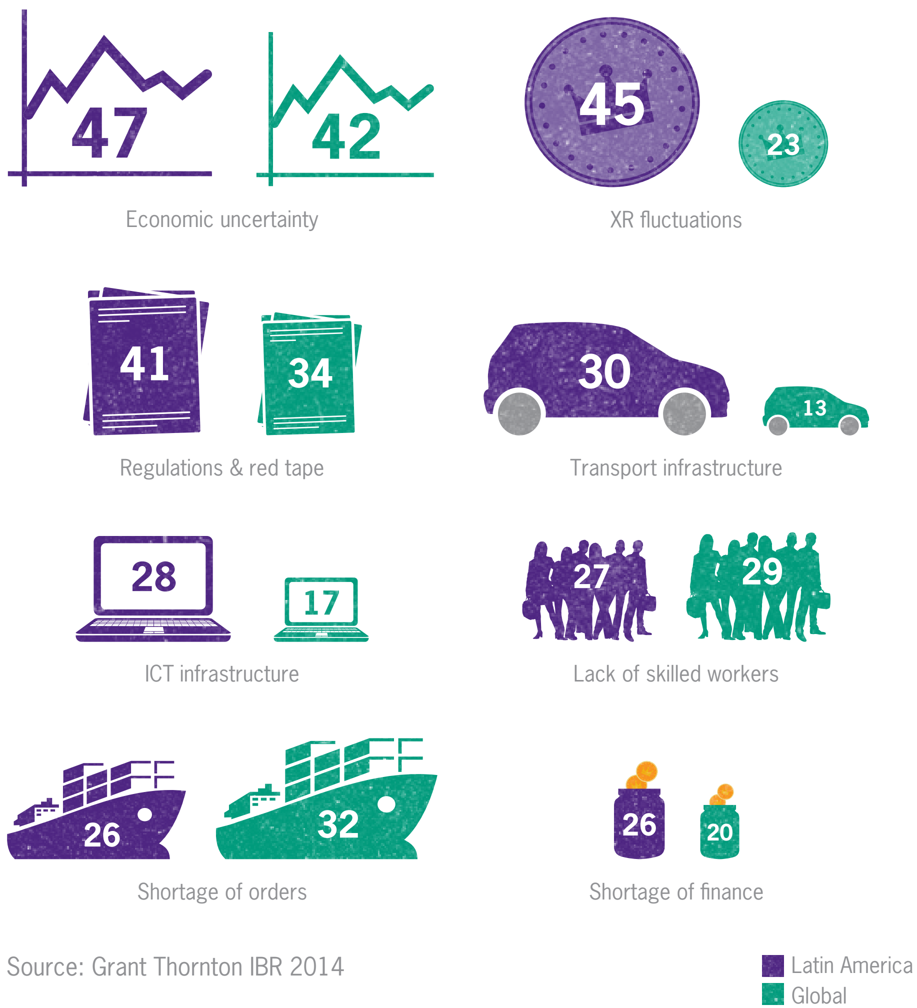
Bureaucracy is the third biggest constraint at the regional level: 41% cite regulations and red tape as a likely constraint on growth in 2014, led again by Brazil (53%) and Argentina (34%). This compares to just 22% in Mexico despite a long series of tax reforms due to come on line in 2014.

A large proportion of businesses also have infrastructure concerns. The proportions citing poor quality transport (30%) and ICT (28%) infrastructure are around double the global average. Business in Brazil, Mexico and Peru are most likely to cite the state of their economy's infrastructure as a constraint on growth.

The availability of skilled labour is an issue for just over a quarter of Latin American businesses (27%) but this rises to 42% in Chile. A similar proportion cite a lack of demand (26%) but this ranges from 31% in Brazil whose main export market is slowing China, to 20% in Mexico which exports mostly to the growing US.

Inflation also remains a challenge for many businesses across the region, increasing the price of inputs and putting pressure on them to raise workers' salaries. Prices across the region are expected to climb by 7.5% in 2014, slowing to 6.9% in 2015 with Argentina and Brazil especially vulnerable. Net 48% of businesses across the region expect to raise prices in 2014, led by Argentina (72%) – this compares to just 28% globally. With inflation broadly under control, workers in Chile (39%), Mexico (28%) and Peru (22%) much more likely to get an inflation-busitng pay rise in 2014 compared with peers in Argentina (6%) and Brazil (7%).

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[1], 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

[1] 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 2014 methodology

The Grant Thornton International Business Report (IBR) is the world's leading mid-market business survey, interviewing approximately 3,300 senior executives every quarter in listed and privately-held businesses all over the world. Launched in 1992 in nine European countries, the report now surveys more than 12,500 businesses leaders in 45 economies on an annual basis, providing insights on the economic and commercial issues affecting companies globally.

The data in this report are drawn from interviews with chief executive officers, managing directors, chairmen and other senior decision-makers from all industry sectors in businesses with 50-499 employees (Argentina, Brazil, Mexico) or 20-149 employees (Chile, Peru). Q4 data is drawn from 3,300 interviews globally (275 in Latin America) conducted in November and December 2013.

To find out more about IBR, please visit: www.internationalbusinessreport.com.

Dominic King
Grant Thornton International Ltd
Global research manager
T +44 (0)207 391 9537
E dominic.king@gti.gt.com

Javier Martinez
Grant Thornton International Ltd
Director – Marketing & business development, Latin America
T +54 11 4326 0631
E javier.martinez@gti.gt.com

Grant Thornton
An instinct for growth™