

January 3, 2011



UNDER A DIFFERENT VOLCANO IN 2011

ARGENTINA

CRUISING UNTIL ELECTIONS

BRAZIL

(RE)BUILDING CREDIBILITY

CHILE

2011 GROWTH: LOCAL DRIVERS NEED GLOBAL SUPPORT

COLOMBIA

MAKING THE TRANSITION TO INVESTMENT GRADE

MEXICO

GROWTH NOW DEPENDS ON THE DOMESTIC SECTOR

PERU

GDP GROWTH STILL STRONG, BUT POLITICS TAKES SPOTLIGHT

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UNDER A DIFFERENT VOLCANO IN 2011

First, the bottom line is that Latin America will do fine again in 2011, especially compared with the rest of the world.

The regional macroeconomic story may appear to be a bit shopworn as the year wears on because of “tougher comps,” a pick up in inflation, more fiscal red ink, a weaker balance of payments, and more political uncertainty with a new government in Brazil and presidential elections looming in Peru, Argentina, and eventually Mexico.

Also, Latin America may suffer slightly more in comparison as a small measure of economic growth returns to North Asia, Europe, and North America.

To complicate matters, many Latin Americans may decide in 2011 to restrict the activities of arbitrageurs bringing hard currencies into local financial markets in order to stem currency appreciation and maintain competitiveness *vis-à-vis* the rest of the world.

However, compared with current market preoccupations about life on the rest of the planet, ranging from the extent of the U.S. economic recovery, to the host of concerns surrounding the word “China,” to the future of the euro, concerns about Latin America seem tiny and very manageable.

The damage that can be done to asset values and macroeconomic prospects alike in the region from spikes in risk aversion, lost aggregate demand, and interrupted funding originating in negative developments in Europe and elsewhere is likely to eclipse completely any economic policy stumbles that may or may not come in Brazil or Colombia or anywhere else.

Political turns in the wrong direction in Peru, Argentina or Mexico, if they come at all, will be dwarfed in terms of market impact by any accelerated bickering and procrastination in the U.S. or Europe over making necessary political determinations to keep the industrialized world glued together.

Thus far, foreign investors have been relatively steadfast in keeping their monies invested in Latin America, and, according to an IMF report we cited months ago,¹ the main reaction of foreign financial entities operating in the region to the global credit crunch was *not* to sharply curtail domestic lending programs in Latin America, suggesting perhaps that future negative surprises on the credit front will have minimal impacts on the availability of domestic credit.

All of this suggests that not too much time should be spent reading the tea leaves in Latin America, given all the other scenario-building that has to be worked through in other parts of the world. To help the investor contemplating 2011 better manage her or his time, we offer this *Inside Latin America* as a quick study in what to watch for in 2011.

Our team of economists scattered throughout the hemisphere look for overall economic growth to be lower in 2011, around 4% instead of the 6% we estimate for 2010. The growth story isn’t uniform: lower growth in Argentina, Brazil, Mexico, and Peru is partly offset by accelerating growth in Chile and Colombia. Inflation in 2011 is again expected to be around 5%, but with more inflation in Argentina, Chile, and Colombia offset by lower readings in Brazil, Mexico, and Peru. See “Recent Economic Data” on page 5 for a bit more color on the regional aggregates.

Our team in **Argentina** suggests keeping an eye on money growth and overall economic activity as money growth accelerates and economic growth slows, keeping inflation on an upward trend. If, as seems possible in our view, a fiscal budget will not be agreed for 2011, government spending will likely continue, but without the oversight of Congress in a presidential election year. The death of former President Nestor Kirchner adds considerably to the uncertainty surrounding the outlook for both economic policy and the election.

Our **Brazil** team notes that President Dilma Rousseff comes into office with a *tabula rasa*, but strongly associated with the successful stabilization policies of her predecessor. Furthermore, early commentary from the incoming government leads our team to conclude that changes in policy from Lula could involve a more aggressive pursuit of fiscal austerity, but that changes in economic management add a note of uncertainty.

¹ H. Kamil, S. Rai, “The Global Credit Crunch and Foreign Banks’ Lending to Emerging Markets: Why Did Latin America Fare Better?” (IMF Working Paper WP/10/102) International Monetary Fund, Washington, D.C., April 2010.

With the economy growing vigorously and mixed signals about forthcoming monetary policy management, a major near-term worry is resurgent inflation.

In **Chile**, economic growth is accelerating going into 2011, driven mainly by consumer spending, abundant consumer credit, and expansionary fiscal policy. As the government sharply scales back post-earthquake spending, more growth must come from a recovery of exports if high growth is to be sustained. Demand from other emerging markets, mainly in Asia, will be crucial ingredients for this continued recovery.

Growth is also picking up in **Colombia**, and is likely to continue to do so into 2012. Inflation is rising as well but remains within the range targeted by monetary authorities. We look for a decline in the fiscal deficit, aided by recovery, a fiscal reform, and higher dividends for the government from Ecopetrol. If important reforms are passed in 2011, we believe that Colombia's investment grade rating could be restored in 2011.

In **Mexico**, growth is slowing. Growth in 2010 was driven by recovery of manufacturing industry from a sharp downturn in 2009, with exports of manufactures to the U.S. providing all of the variation. With moderate recovery in the U.S. continuing, growth of internal demand will play a more central role in determining the course of the business cycle in Mexico. We look for a recovery in consumer credit, aided to a lesser extent by growth in corporate and real-estate mortgages. We also expect job growth of just under 5% in 2011, after being a bit over that same level in 2010.

Peru, like Brazil and Argentina, has seen rebound growth above 8% in 2010. Unlike the other two, in Peru inflation is likely to have closed the year near our 2.4% forecast and in 2011 it will very likely be within the same range without any effort to tighten monetary policy. The presidential election is set for April 11. The three main candidates, all well-known politicians, are seen as market-friendly.

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RECENT ECONOMIC DATA

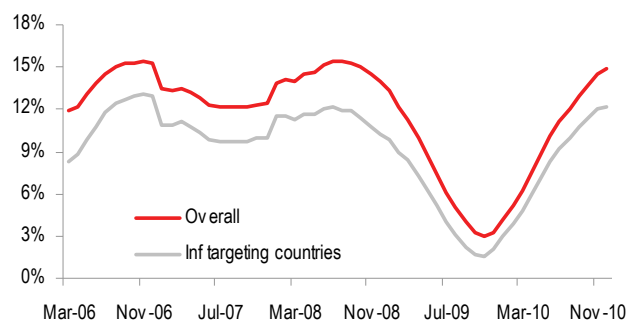
According to our estimates, Latin America's nominal GDP will close 2010 with a 15% annual increase, which means a full return to the pre-crisis levels of mid-2008. LatAm nominal growth has picked up quickly this year, considering the low 3% seen in late 2009. Given our 6% real GDP growth estimate for 2010, GDP prices are implicitly growing by 9%. Considering inflation-targeting countries only, GDP prices are running near 6% annually (nominal GDP is growing a slightly milder 12%), which looks a bit high given the 3-4% inflation targets.

The recent increase in soft commodity prices is gradually appearing in Latin American inflation, although from a very low starting point. Considering inflation-targeting countries only, overall food inflation is now at 4.9% y/y, after hitting a 2.9% low in June. The steepest price increases were seen in the non-processed food component (inherently more volatile than processed foodstuffs), which jumped to 5.8% y/y from 1.7% four months ago. As experienced in 2008, non-processed foodstuff inflation is a good leading indicator to assess overall food inflation pressures six months ahead.

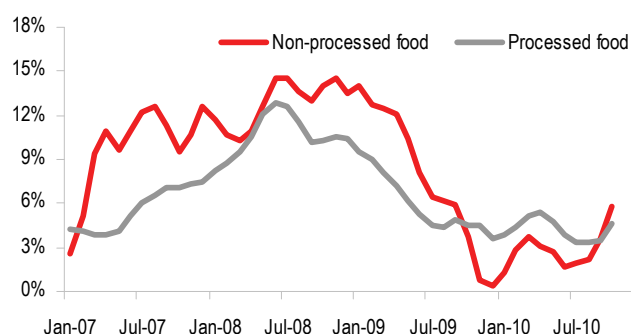
Regional fiscal numbers showed really no new news in October, as the 0.91% of GDP primary surplus recorded that month was virtually unchanged relative to September. Compared with June levels, the region's fiscal position improved by 0.33% of GDP, although the recovery is not as widespread as one might think: Venezuela, Mexico, and Colombia still show stable or declining fiscal balances before interest payments. The outperforming country is definitely Chile, where the last-12-months measure is again in positive territory, accumulating an impressive turnaround of almost 5% of GDP in only ten months.

Our aggregate measure of Latin American exports to China suggests that regional shipments to the Asian giant have stabilized at high levels, doing slightly better than the rest of China's trading partners. In October, LatAm exports to China reached US\$6.22 billion (s.a.), somewhat above the YTD average of US\$5.92 billion. In y/y growth terms, LatAm is exhibiting a robust 45%, which compares favorably with 28% for total Chinese imports. LatAm market share stands at 5.1%, very near historical highs, and should remain on the rise in coming months.

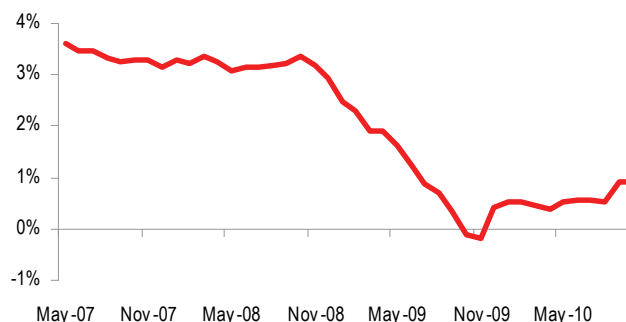
Latin America's nominal GDP growth (y/y)



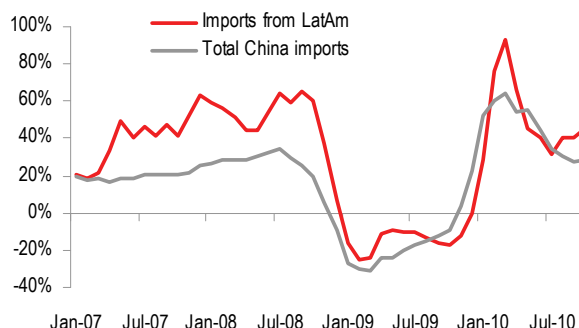
LatAm food inflation (y/y changes)



LatAm primary balance (% of GDP)



Latin America's exports to China (y/y)



Sources: Bloomberg and Santander.

ARGENTINA

CRUISING UNTIL ELECTIONS

POSITIVES

- **The Consumer Confidence Index reached the highest level since 2007, suggesting that private consumption growth will likely continue to be brisk.**
- **Amid a good external environment, the Central Bank continues accumulating FX reserves.**
- **Next year's financing needs are quite manageable.**

NEGATIVES

- **Provincial inflation is not likely to deviate from its upward trend.**
- **Growth of money in circulation continues accelerating.**
- **The primary surplus is expected to decrease in 2011 toward ARS17.9 billion from the ARS31.3 billion estimated for 2010.**

PROSPECTS

Activity – Slowly decelerating activity growth, but still at high rates.

In recent months the Monthly Economic Activity Estimator (EMAE, a leading indicator of official GDP figures) has predictably lost some steam, expanding at an average 0.3% m/m s.a. in August-September 2010, down from the 1.1% m/m s.a. observed between January and May. However, economic activity keeps growing at fairly high rates (7.7% y/y in September, according to the INDEC), and the current situation points to a scenario of very gradual deceleration, with a likely more prominent role of public spending as a driver of growth and, on the other side, rising inflation.

As expected, industrial activity expansion regained some strength after July's energy supply restrictions. In that month alternative indicators of manufacturing output edged up 3.5% y/y, but output expanded 6.8% y/y in the August-October period. However, its rate of growth has predictably descended in recent months from the 11.4% annual expansion observed in 1H10, as the result of high capacity utilization levels in many sectors. According to the measure issued by the INDEC, the overall capacity utilization level reached a record high of 82.3% in September (the month of peak industrial output). Consequently, the output gap in the industrial sector stood at a record low. Although this indicates that room for further expansion remains narrow, there have been announcements of new investment in some sectors, notably cement and automobiles, which will help manufacturing production keep expanding in the medium term.

The Consumer Confidence Index (ICC) reached the highest level since March 2007 in November, suggesting that private consumption growth will continue to be brisk in the next months, mostly in a context of deeply negative real interest rates. While the ICC increase in the last few months has been mostly driven by an expansion in the buying intention subindexes (for both cars & homes and for household appliances), the last monthly jump (+10.6% m/m in November) was chiefly caused by a sharp increase in 1-year and 3-year macroeconomic situation outlooks (up 28% m/m and 12% m/m, respectively).

We maintain our GDP expansion estimate at 5.5% for 2011. However, as both monetary and fiscal policies will continue in a very stimulative stance, there is a growing chance of somewhat stronger growth than anticipated. As usual, this will also entail an increasing risk of mounting price tensions throughout the next year. On the monetary front, real interest rates continue at very low (negative) levels, stimulating consumption as a hedge mechanism. On the fiscal front, the fact that presidential elections will be held in October 2011 ensures the intensification of an already highly expansionary policy position.



Agricultural production remains an important factor to consider with regard to growth. While grain output could reach approximately 101 million tons in 2011 (+7%) according to current projections, there is growing concern about the impact of lower rainfall during the summer season (which could eventually affect yields). Recall that while agriculture on its own does not appear to be central to the performance of the economy (with a 6% GDP share in 1H10), it is highly intertwined with other sectors (mostly industry, transport, and commerce) and remains one of the key engines of overall GDP output.

Monetary policy – Accelerating growth in monetary aggregates.

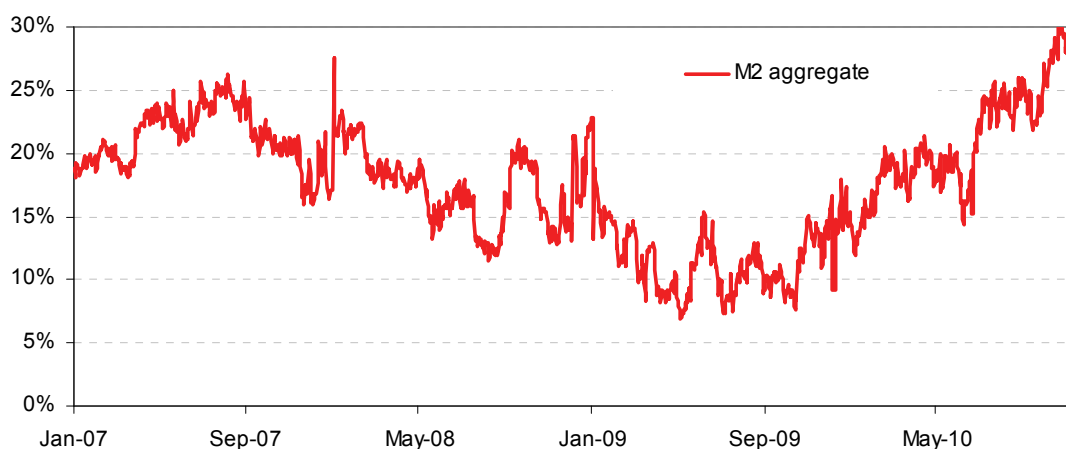
With a good external environment explained mostly by the high terms of trade and a 95 million ton crop, the Central Bank continues accumulating FX reserves, estimated to be US\$53 billion by the end of December 2010. International reserves accumulation is mainly the result of the Central Bank intervention in the FX market (US\$10.3 billion in 2010 to November 19).

Although part of the money printed to acquire U.S. dollars is sterilized through the issuance of Central Bank debt (ARS20.7 billion since January), money in circulation continues growing at an accelerating rate. As of November 19, 2010, currency held by the public expanded at 33.6% annually, almost doubling the expansion rate recorded by early January (16% y/y). The same occurred with other aggregates such as M2 (currency held by the public plus sight deposits), which grows at a 29% annual rate, up from the 14% observed in January.

The strong growth in money issuance seems to put the recently revised monetary program in some difficulty. Bear in mind that, according to the goals of the program, by December 2010 the average M2 should not exceed ARS254.7 billion. If the Central Bank transferred the remaining ARS17 billion of the 2009 result to the Treasury on December 31, the M2 average growth rate would not exceed 27.8% annually in 2010. In other words, the M2 aggregate expansion rate should decelerate from current levels in order to comply with the goals of the program.

The growth observed in the monetary aggregates seems to suggest that the Central Bank strategy is focused on two objectives: the accumulation of international reserves and the maintenance of low interest rates. In recent months, policy interest rates (Lebac and Nobac) have been declining steadily in the primary issuances: the one-year Lebac cut-off yield is now at 12.6%, down from the 14.3% registered in December.

Accelerating M2 aggregate growth



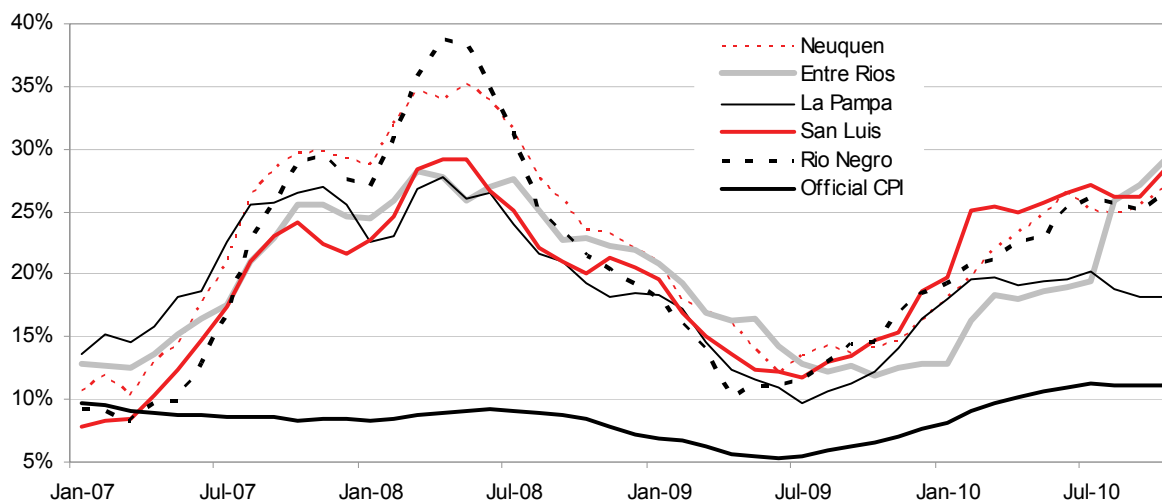
M2 aggregate annual growth rate. Sources: Central Bank and Santander

Inflation – Government asks for technical support from the IMF.

The outlook for inflation has not changed since our last *Inside Latin America*. Monetary aggregates continue expanding at accelerating rates, government spending is growing at 40% annually, there is evidence that the output gap in the industrial sector is narrowing, and salaries are expanding above 20% annually. As a result,

provincial inflation is now at 25.3% annually, according to several provincial Economy ministries, and is not expected to shift from its current trend.

Prices on an upward trend



Annual CPI provincial inflation and CPI-GBA inflation. Sources: Provincial Economy ministries, INDEC, and Santander.

The most positive and surprising change comes mainly from the political side, as the government has recently asked the IMF for technical assistance to create a new CPI at national level. Bear in mind that in the past few years the official CPI-GBA index has been subject to debate, as there are significant discrepancies between the government’s 11% inflation measure and results coming from the private sector, which are more in line with the numbers published by provinces.

According to INDEC officials, the new index won’t replace the CPI-GBA (which is currently used to calculate the CER index); the indexes are going to coexist. The creation of the new index is, however, a good development from our point of view and will help the country get closer to the international financial community.

However, the new index should not be expected soon, because the process might take some months.

Currency – The supportive external scenario ensures slow peso depreciation in short term.

The foreign exchange market has not experienced any major events since our last *Inside Latin America*. The ARS/USD exchange rate continued a slight depreciation path, with the Central Bank keeping a tight hold on the market.

Both commercial and capital flows helped the monetary authority maintain calm in the exchange rate while continuing with its strategy of piling up reserves and reducing peso volatility.

Agricultural exporters’ dollar sales continued abundant, although predictably below levels observed during harvest time: they reached a US\$90 million daily average in August-November, below the US\$120 million daily average of the April-July period. Also, non-financial private sector capital outflow remains relatively tranquil: it reached only US\$750 million average in August and September (according to Central Bank statistics). Moreover, the spread between the implicit exchange rate and the spot exchange rate (the usual indicator of capital movements’ direction and magnitude) sank below the zero mark in the last few months, suggesting gross financial capital inflow into the economy.

As usual, the excess dollar supply (we estimate current account surplus may have surpassed US\$2.5 billion in 2H10) was acquired by the monetary authority (which pocketed US\$1.7 billion in October-November), injecting pesos into the economy.

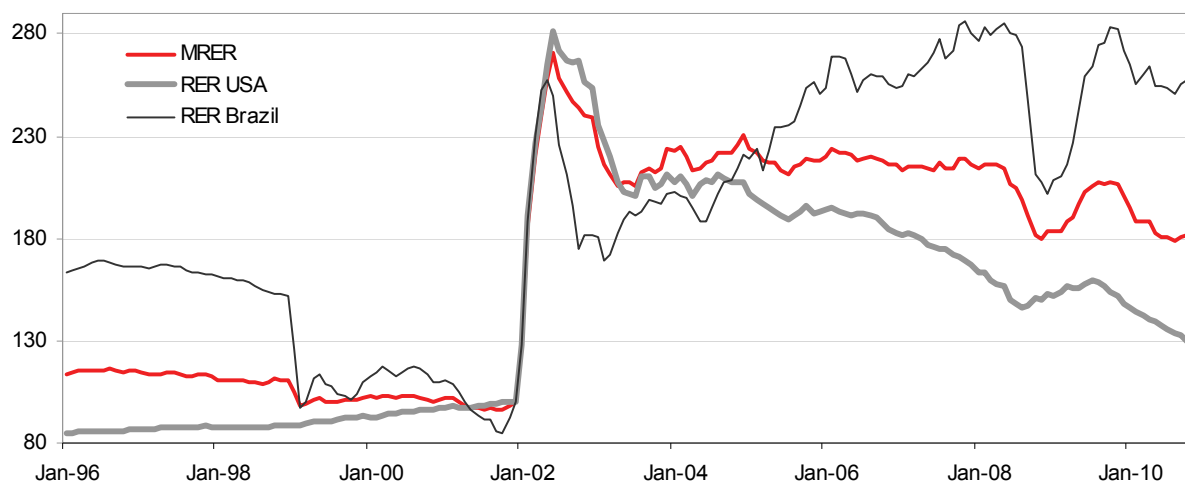


Beyond the local factors, the expansive monetary policies in central economies and the subsequent mounting liquidity are the relevant factors behind the supportive scenario for the foreign exchange market. These policies result in a quest for return (which encourages capital to enter the economy) and also may stimulate the increase in agricultural commodities quotes, which further buttresses the external surplus.

Although it is clear that the slow pace of peso weakening combined with a far higher level of local inflation has been translating into steady real appreciation (the MRER strengthened 13.5% in the 12 months prior to November 2010), we see room for this trend to continue in the next few months without significantly affecting economic activity.

We expect the peso to continue weakening at a slow pace in the next few months. It is likely that internal events related to the presidential election campaigns could add some noise (with increasing capital outflows), mostly in 2H11, but we expect the Central Bank will react, capping peso depreciation to address nervousness.

Strengthening of EM currencies has cushioned real appreciation



Multilateral real exchange rate and real exchange rate versus Brazil and the U.S. Sources: Bloomberg and Santander.

External sector – Commodities prices continue supporting the external surplus.

In previous reports we have emphasized the importance of agricultural commodities (and a few other items) as key drivers of merchandise exports growth, particularly during recent quarters. For example, only two items (cereals and oilseeds) explained more than 10 percentage points out of the 23% export growth year to October. Adding car sales, these three items contributed 16 percentage points (or two-thirds).

As a result, it is important to examine both grain production and prices as a way to estimate external sales performance. On the quantities side, we currently project overall grain production could reach 101 million tons in 2011, 7% above 2010, a record high. Nevertheless, we have to remain slightly cautious about this number, given the possibility of lower than normal rainfall during summertime, which has recently raised some concerns.

On the prices side, the expectation and subsequent confirmation of expansionary monetary policies in the U.S., among other likely causes, contributed to a significant spike in important agricultural commodities quotes: in the three months to November 30, soybean, soy meal, and soy oil prices jumped 24%, 28%, and 11%, respectively (corn jumped 25% in the same period). We estimate that the Commodities Price Index gained 17% in the last three months.

The increase in both agricultural production and commodities prices continues supporting the maintenance of a robust trade surplus (which we estimate at US\$10.3 billion in 2011). In turn, the trade surplus is the basis for the current account surplus, which should stand at 0.9% of GDP in 2011.

Strong tailwinds, again



Commodities Price Index. Sources: Central Bank and Santander.

Fiscal policy – Financing needs are not a problem for the government.

The primary surplus is expected to decrease in 2011 toward ARS17.9 billion from the ARS31.3 billion estimated for 2010. The decline in the government savings would be mainly explained by lower Central Bank transfers to the Treasury and accelerating government spending due to electoral factors. In this context, we expect government revenues to grow 28% annually while primary spending is expected to expand 35% annually.

Government financing needs in 2011

	ARS	USD	Total
Uses (1)	37,145	9,943	19,003
Interest**	3,241	995	1,785
GDP warrants	9,200	1,000	3,244
Amortizations	4,704	5,948	7,095
Paris Club		2,000	2,000
Provinces & other	20,000		4,878
Sources (2)	17,946	9,083	13,460
Primary surplus*	-54		-13
BCRA/ANSES	18,000		4,390
International reserves		7,500	7,500
IFI		1,583	1,583
Gap (1-2)	-19,199	-860	5,543

In ARS and USD millions. *Net of BCRA/ANSES transfers. **Debt service net of public sector holdings. Sources: Mecon and Santander.

The 2010 Central Bank profit will be much lower, implying less in Central Bank transfers to the Treasury in 2011. Our estimates suggest that the Central Bank profit will be close to ARS10.0 billion, down from the ARS23.5 billion recorded in the previous year. The decline in Central Bank profit is explained by the lower ARS depreciation (5%) observed in 2010 compared with 2009 (10%).

If we exclude Central Bank and ANSES transfers to the Treasury in 2011, the government fiscal accounts should be practically in equilibrium.

Despite the expected deterioration on the fiscal front, the government seems to be moving in the right direction, as it announced that it is about to start negotiations with the Paris Club. Remember that the country has US\$6.5 billion in defaulted debt with the Club. From our point of view, resolving the default with the Club will help the country to improve its access to international financial markets.



In this context, 2011 financial needs are quite manageable for the government. Our estimates suggest that the financing gap is around US\$5.5 billion – an amount that could be easily covered issuing debt in the markets (and or into the public agencies) and/or doing some liability management. Our figures suggest that most of the gap is in ARS terms (ARS19.2 billion), while the dollar portion is almost negligible (US\$0.9 billion).

Politics – The political environment makes presidential candidacies difficult.

After the death of former President Nestor Kirchner on October 27, the political scenario has changed considerably, as he was one of the main candidates going into the next presidential election and a major player in the political arena.

The opposition strategy was heavily focused on disapproval of the policies implemented by Nestor and Cristina Kirchner, which have increasingly come under question. But Nestor Kirchner's death leaves the opposition without a target, and it remains unclear who will run in the election.

On one side, the dissenting portion of the Peronist Party has begun to fall apart, with many of its former figures abandoning the coalition and aligning themselves closer to the government wing of the party (although not formally joining it).

The Radical Party, the main and oldest opposition political party, has not yet identified who will be its primary candidates, or “precandidates,” so internal party primary elections can determine who will face the Peronists. There is an ongoing dispute between Ricardo Alfonsín, son of a former president, and Julio Cobos, the current vice president and a principal opposition figure. Briefly, Cobos has yet to say whether he's a candidate, but Alfonsín only has partial support from his party. As a result, the party's president, Ernesto Sanz, is threatening to compete with both of them in primaries, seeking to consolidate his party and strengthen the electoral strategy.

Daniel Scioli, the current governor of Buenos Aires province (a typical Peronist bastion and the most important electoral district in Argentina) remains a strong figure. He had maintained an acceptable public image before Kirchner's death. Although some observers pointed to him as a possible candidate for the government party or the opposition, he showed himself as very close to Cristina Fernandez, and he might bid for re-election as governor, though a run for president is not out of the question.

At the moment the most likely official candidate is Cristina Fernandez Kirchner. After the death of her husband, her positive image has grown considerably, and despite the difficult circumstances, she is showing strength and the ability to emerge as a party leader, although with a more moderate and apparently more conciliatory tone than in the past.

In this context, all opposition parties remain in wait-and-see mode. Now that the president is a widow, a campaign based on criticizing her for Nestor Kirchner's policies seems risky for the opposition.

The Congress concluded the ordinary session with the lowest number of enacted laws since 1987. A total of 64 acts were approved during the year, below the average of recent years (100). This reflects a fragmented Parliament as a result of the mid-term elections of 2009, which represented a big loss for the government party. Only one extraordinary session has been scheduled, to deal with a bill regarding a tobacco tax hike and military personnel promotions.

One of the most important consequences is that the budget law for 2011 was not approved. The reason is that the official party did not accept changes to its proposal, and the opposition insisted on modifying the expected GDP rates of growth and inflation. These rates are lower than expected by the market. As a consequence, the government has discretion to distribute US\$9.25 billion, according to opposition estimates. Unable to discuss any changes, the opposition has refused to allow the necessary quorum to vote the budget law. For this reason, the current government might not have a budget during its last year in office. However, this won't impede the government from continuing to spend, as it can make use of decrees (under the so-called “superpowers”), which give the executive the power to reallocate budget items without the approval of Congress.

In summary, the changes brought by Nestor Kirchner's death are not clear yet. In the coming months, as the campaign for the presidential election starts up, the country's political future will become clearer.

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Argentina – Economic projections, 2007-2012F

	% GDP	2007	2008	2009	2010E	2011F	2012F
National Accounts, % change							
Real GDP ($\Delta\%$ y/y)		8.7	6.8	0.9	8.5	5.5	6.5
Consumption ($\Delta\%$ y/y)	80.9	8.7	8.4	1.7	9.1	5.7	4.0
Private ($\Delta\%$ y/y)	66.5	8.9	6.5	0.5	7.7	5.5	4.6
Public ($\Delta\%$ y/y)	14.4	7.6	6.9	7.2	9.9	7.1	1.0
Investment ($\Delta\%$ y/y)	11.3	14.3	9.1	(10.2)	14.2	9.0	22.0
Private ($\Delta\%$ y/y)		NA	NA	NA	NA	NA	NA
Public ($\Delta\%$ y/y)		NA	NA	NA	NA	NA	NA
Exports ($\Delta\%$ y/y Local Currency)	14.1	8.8	1.2	(6.4)	17.0	12.0	15.0
Imports ($\Delta\%$ y/y Local Currency)	-6.3	20.4	14.1	(19.0)	31.0	18.0	23.4
GDP (US\$ bn)		260.5	324.6	307.1	364.8	412.6	420.5
GDP Per Capita (US\$)		6,742	8,313	7,783	9,148	10,238	10,325
Industrial Production ($\Delta\%$ y/y) (EMI)		7.5	5.0	0.4	8.5	5.2	6.0
Population (mn)		38.6	39.0	39.5	39.9	40.3	40.7
Monetary and Exchange Rate Indicators							
CPI Inflation (Dec Cumulative)		8.5	7.2	7.7	12.0	13.0	10.0
WPI Inflation (Dec Cumulative)		14.4	9.0	10.0	15.5	16.0	12.0
US\$ Exchange Rate (Year-End)		3.15	3.45	3.80	4.05	4.40	5.15
US\$ Exchange Rate (Avg)		3.12	3.17	3.73	3.91	4.20	4.75
30 day, BADLAR private banks (year end)		14.0	19.8	10.5	11.7	12.5	15.0
30 day, BADLAR private banks (average)		10.2	13.5	12.5	10.2	12.1	13.8
Monetary Aggregate M3-end of period (US\$ bn)		73.1	74.3	72.2	96.0	109.0	129.7
Monetary Aggregate M3-end of period (% y/y)		14.4	1.7	(2.8)	33.0	13.5	19.0
Fiscal Policy Indicators, %							
Fiscal Balance, % of GDP		0.5	1.4	(0.6)	0.7	(0.5)	(0.1)
Primary Balance, % of GDP		3.5	3.1	1.5	2.0	1.0	0.2
Government Financial Needs (peso bn) (a)		23.0	20.8	39.1	35.4	37.8	30.3
Gross Total Government Debt (US\$ bn) (c)		134.3	140.5	140.4	149.3	152.3	158.3
Local Currency (US\$ bn)		60.4	67.4	67.4	68.7	70.1	69.7
Foreign Currency (US\$ bn)		73.9	73.1	73.0	80.6	82.3	88.7
Balance of Payments							
Trade Balance		11.1	13.0	16.9	12.6	10.3	8.2
Merchandise Exports fob (US\$ bn)		55.9	70.3	55.7	68.0	79.5	95.8
Merchandise Imports cif (US\$ bn)		(44.8)	(57.3)	(38.8)	(55.4)	(69.2)	(87.6)
Services and Income Receipts (US\$ bn)		16.2	17.6	14.3	15.4	18.5	19.7
Services and Income Payments (US\$ bn)		(22.5)	(23.7)	(22.5)	(23.0)	(25.3)	(26.3)
Transfers (US\$ bn)		0.3	0.1	2.7	0.6	0.1	1.0
Current Account (US\$ bn)		7.2	7.0	11.4	5.6	3.6	2.6
Current Account, % of GDP		2.8	2.2	3.7	1.5	0.9	0.6
Gross Foreign Direct Investment (US\$ bn)		6.4	5.0	1.0	1.6	2.0	7.0
Debt profile							
International Reserves (US\$ bn)		45.9	46.4	48.0	53.0	49.0	54.0
Total Internal Government and Central Bank Debt (US\$ bn)		99.4	122.2	99.1	108.2	114.5	116.2
Short Term (less than 12 months) (US\$ bn)		NA	NA	NA	NA	NA	NA
Long Term (over 12 months) (US\$ bn)		NA	NA	NA	NA	NA	NA
Total Internal Govt. And Central Bank Debt (% of GDP)		38.2	37.6	32.3	29.6	27.7	27.6
Total External Debt (US\$) (bn)		114.1	114.1	111.1	113.7	117.9	125.2
Short Term (less than 12 months) (US\$ bn)		NA	NA	NA	NA	NA	NA
Long Term (over 12 months) (US\$ bn)		NA	NA	NA	NA	NA	NA
Total External Debt (% of GDP)		43.8	35.2	36.2	31.2	28.6	29.8
Total External Debt (% of Exports of Good and Services)		158.3	129.8	158.7	136.4	120.3	108.4
Debt Service Ratio (b)		24.5	20.0	24.4	21.0	18.5	16.7
Labor Markets							
Real Salary Index (% chg, Dec cumulative)		(2.9)	3.0	0.8	2.0	2.0	0.2
Unemployment Rate (year-end, % of EAP)		7.5	7.3	8.4	7.4	7.0	6.8
Total Payroll in the formal sector (% chg, real, Dec cumulative)		4.2	1.5	0.0	1.1	0.8	1.0

(a) (Amort + Fiscal Deficit). (b) (Amort+Interest Ext Debt)/Export Good & Services. (c) Holdouts for US\$25.2 billion are excluded. E Santander estimate. F Santander forecast. Sources: Economy Ministry, Central Bank, and Santander estimates.



BRAZIL

(RE)BUILDING CREDIBILITY

POSITIVES

- **Domestic demand growth should remain strong, considering the current excellent performance of credit and labor markets.**
- **The pace of deterioration of current accounts has not been as fast as we expected, particularly due to the very favorable momentum of commodity prices, which directly affect Brazilian terms of trade.**
- **According to statements by the new economic team, the main pillars of macroeconomic policy (fiscal solvency, inflation targeting, and a floating exchange rate) will not be touched, but the primary surplus could be increased in order to help monetary policy contain inflation and to speed the reduction of the debt to GDP ratio.**

NEGATIVES

- **Inflation and expectations are on the rise and dangerously straying from the target, while domestic demand seems to have accelerated in 4Q10.**
- **Promises of a tougher fiscal stance won't persuade economic agents to reverse their skepticism regarding price dynamics for 2011.**
- **The central bank will not only have to tighten, but also be convincing about its intentions to comply with its objectives as defined by law.**
- **In the last 15 years there have been only three episodes of spending contractions, each followed by fast expansion.**

PROSPECTS

Even though President-elect Dilma Rousseff, who takes office on January 1, 2011, has promised to maintain the macroeconomic policy of her predecessor, the current rhetoric suggests a government that could be leaning toward a more conservative fiscal policy than the Lula administration. According to statements by the new economic team, the main pillars of macroeconomic policy (fiscal solvency, inflation targeting, and a floating exchange rate) will not be touched, but the primary surplus could be increased in order to help monetary policy contain inflation and to speed the reduction of the debt to GDP ratio. From a longer-term perspective, these and other policies should be enough to bring real interest rates down toward 2% p.a. and net public sector debt to 30% of GDP by the end of Rousseff's term.

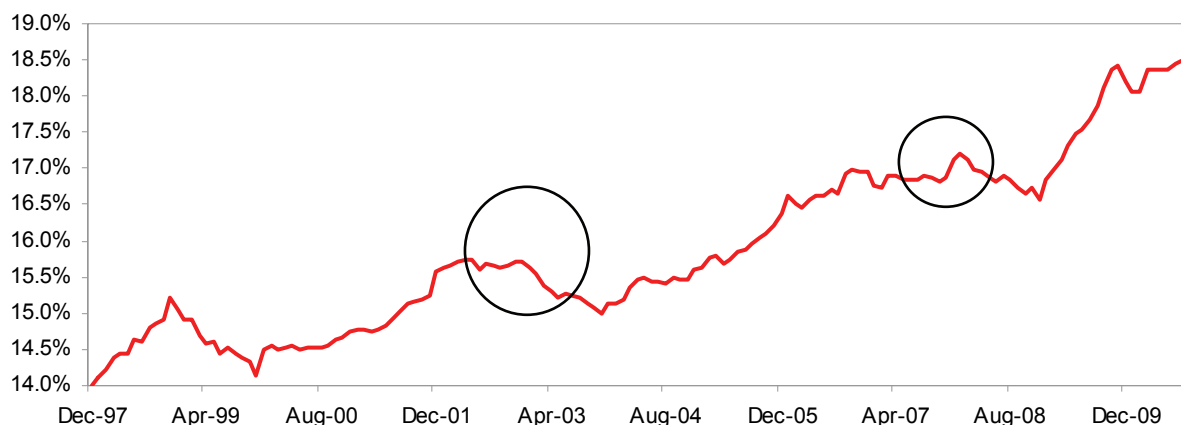
While these targets are challenging, we must recognize that the plan makes perfect sense in macroeconomic terms. The Central Bank itself conducted a survey of market participants, who on average concluded that for each 1 p.p. of GDP in spending cuts, interest rates could fall by approximately 1 p.p. without affecting inflation. And the task of reducing outlays by 1 p.p. per year should not be seen as very difficult. Assuming that nominal GDP grows at the same pace as in this decade, expenditures could increase, in nominal terms, by 4% to 5% each year in order for the ratio of spending to GDP to fall by 1 p.p. per year.

But the problem lies with reputation and implementation. Since 1998 central government expenditures have increased from 14% of GDP to (probably) 19% in 2010. During this period there were three episodes of moderate contraction, all of them rapidly reversed. The selection of the new economic team sends an interesting signal. Meirelles, who managed to keep inflation very close to the target during his term, is leaving, while Guido Mantega, who has been in charge of the Finance Ministry since 2006, when expenditures

increased by 2 p.p. of GDP, is staying on. This does not mean the government will be unable to deliver on its promises one to four years from now. However, it surely represents an additional challenge: building credibility through consistent action.

In the case of monetary policy the situation seems more urgent: inflation and expectations are on the rise and dangerously straying from the target, while domestic demand seems to have accelerated in 4Q10. Promises of a tougher fiscal stance won't persuade economic agents to reverse their skepticism regarding price dynamics for 2011. The central bank will not only have to tighten, but to be convincing about complying with its objective as defined by law. The new administration has four years to implement the policies it was elected for, but only three months to show to markets what it is capable of.

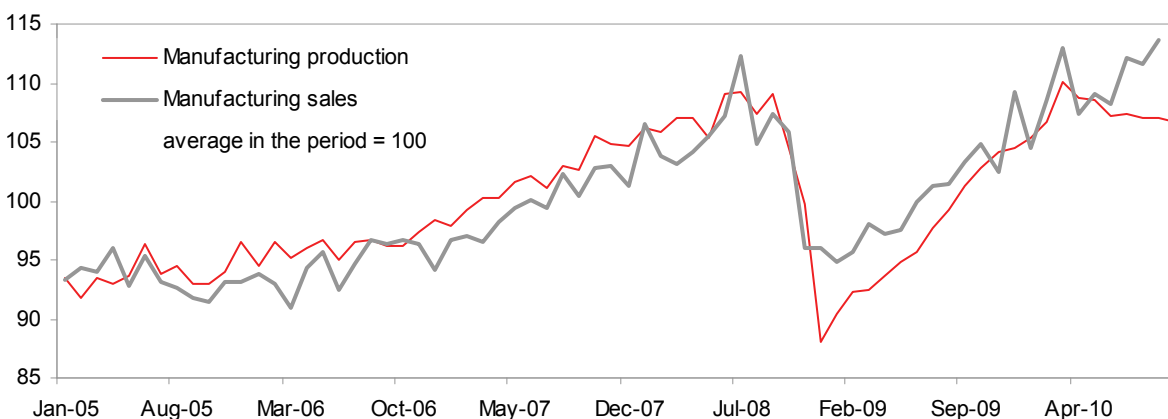
Recent episodes of spending contraction were moderate and rapidly reversed



Central government primary expenditures (% of GDP). Source: National Treasury.

Economic growth – Industrial production has been falling since April, contributing to poor GDP growth during the second and third quarters of 2010. This is the opposite of the dynamic presented by demand indicators, such as retail sales, which continued to rise. More than a substitution of domestic production by imported goods, we believe this process is related to an inventory adjustment, as indicated by the performance of manufacturing goods sales, still increasing despite the opposite dynamic of production. Domestic demand growth should remain strong, considering the current excellent performance of credit and labor markets. As a consequence, and with the end of the inventory cycle, industrial production is expected to resume growth and accelerate GDP from 4Q10 on. We expect GDP growth in 2010 of 7.8%. For 2011 and 2012 we expect 4.5%.

Expanding manufacturing sales, while production is contracting



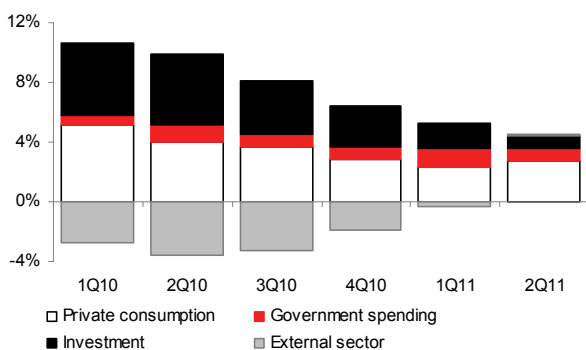
.Sources: IBGE and CNI.



GDP decelerated from 1.8% q/q in 2Q10 to 0.5% q/q in 3Q10 due to a reduction in industrial inventories, but we expect a strong rebound in 4Q10 and 1Q11. The drivers of domestic demand remain the same: the expansion of the domestic labor market, solid consumer and business confidence, and robust credit expansion. Stronger-than-expected import growth and the persistence of annual growth of retail sales in the neighborhood of 10% suggest that demand did not lose momentum in the last few months.

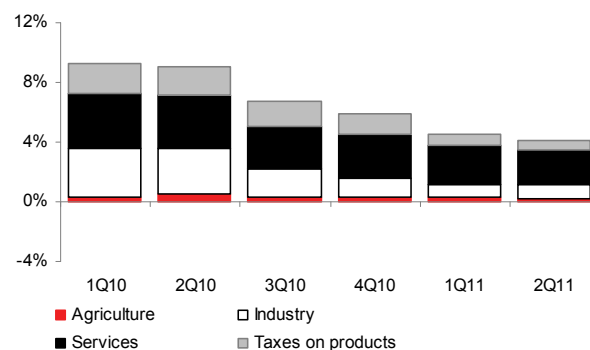
Contribution to y/y GDP growth, by component

From the demand side . . .



Sources: IBGE and Santander forecasts.

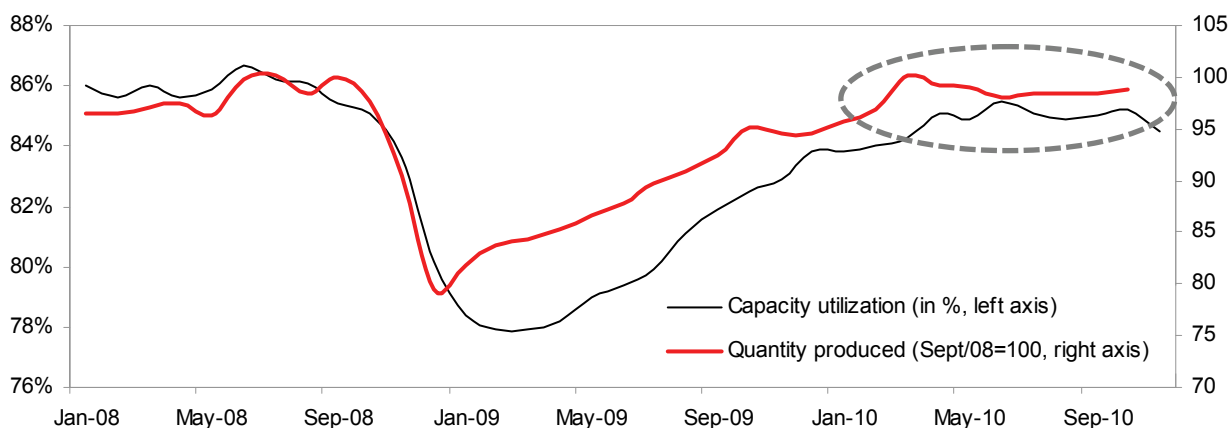
. . . and from the supply side



Sources: IBGE and Santander forecasts.

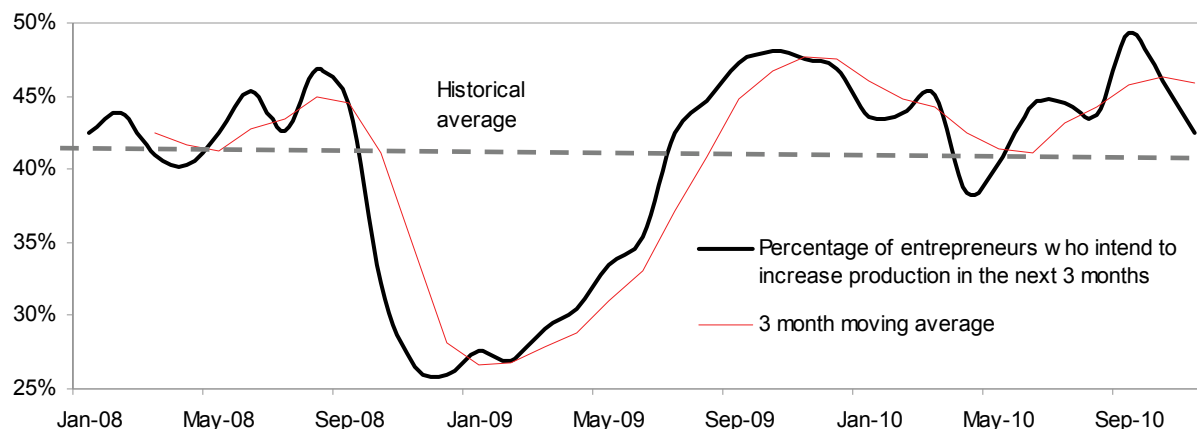
Industrial production did decelerate, from 1.2% q/q in June to 0% in October. The quantity produced has been roughly the same in the last seven months, and capacity utilization fell slightly. However, the intention of increasing production continues above the historical average, which points to a reacceleration in the following months.

Industrial production roughly stable in recent months; capacity utilization down slightly



Seasonally adjusted data. Sources: IBGE and FGV.

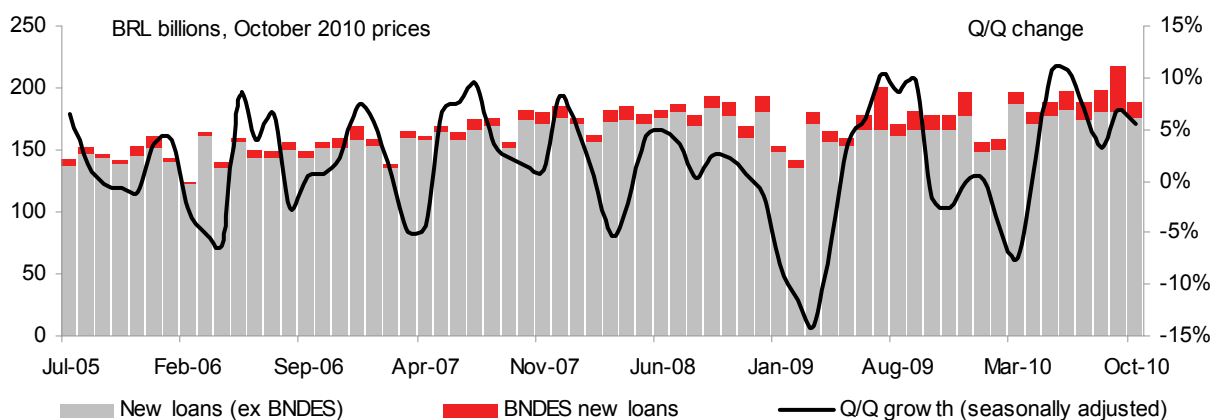
Intention to increase production is still above historical average



Seasonally adjusted data. Source: FGV.

Aside from the industrial sector, the rest of the economy has not decelerated, and we don't see it happening in the coming months. For instance, Services PMI has risen from 51.8 in October (already above 50, thus signaling expansion) to 52.1 in November. New loans continue to rise at a strong pace, boosted by the robust 15.3% y/y growth in real terms of BNDES new loans. The unemployment rate is at the lowest level in more than 15 years, and due to its well-known resilience against economic deceleration, it is unlikely to rise in the coming months. Therefore, we believe inflationary pressures will also continue to be strong.

New loans rose 5.6% q/q in October, helped by the strong growth of BNDES credit



Sources: Central Bank and Santander.

Inflation and monetary policy – The upside risks for the Central Bank's inflation scenario materialized in the fourth quarter of 2010. Because of this, market expectations for 2010, 12 months ahead, and 2011 IPCA accelerated. Moreover, the inertia coming from inflation in wholesale prices in 2010, which is likely to accumulate 11.4%, should boost some services prices in 2011. That said, we have revised our 2010 IPCA estimate to 5.7% from 5.2% and the 2011 IPCA to 5.5% from 5.0%, even with the expectation of a new monetary tightening cycle starting in January 2011, when we expect the Selic rate to start to be raised toward 13%. We believe the Selic rate hike is likely to be efficient in getting inflation to the target in 2012 given the effect the inertia on inflation in 2011.

In 2011, we expect controlled prices to register an increase of 3.8% and market prices to post an increase of 6.2%. Our forecast for the 2012 IPCA is 4.5%, with controlled and market prices rising 4% and 4.7%, respectively. We expect some factors to pressure inflation in the next year: (1) the acceleration of wholesale prices (IGPM), which is likely to accumulate 11.4% in 2010 and is the reference index in many contracts defining price adjustments, is likely to produce inflationary pressure on rents as well as condominium and



school fees (accounting for about 12% of IPCA) in 2011; (2) the inertia coming from the 2010 IPCA, which will be above the inflation target (4.5%), including the inflationary surprise in 4Q10, which should reach 0.8 p.p.; (3) the wideness of the gap between the inflation expectations for 2011 and the target; and (4) the effects of weather problems (*La Niña*) on food commodities, mainly cereals, sugar cane, and meat prices. In all, we believe that the risks for 2011 and 2012 inflation scenario are on the upside, given that the inertia from 2010 and 2011 could be higher than expected depending on the monetary and fiscal policies during the same period. We do not expect that the likely slowdown of the economies of developed countries will promote the same disinflationary process observed in 2009. Therefore, a constrained fiscal policy is the only factor that would implement the monetary tightening needed to ensure the convergence of inflation toward the target in the coming years.

CPI breakdown: inertia and deviation of expectations rising in 2011

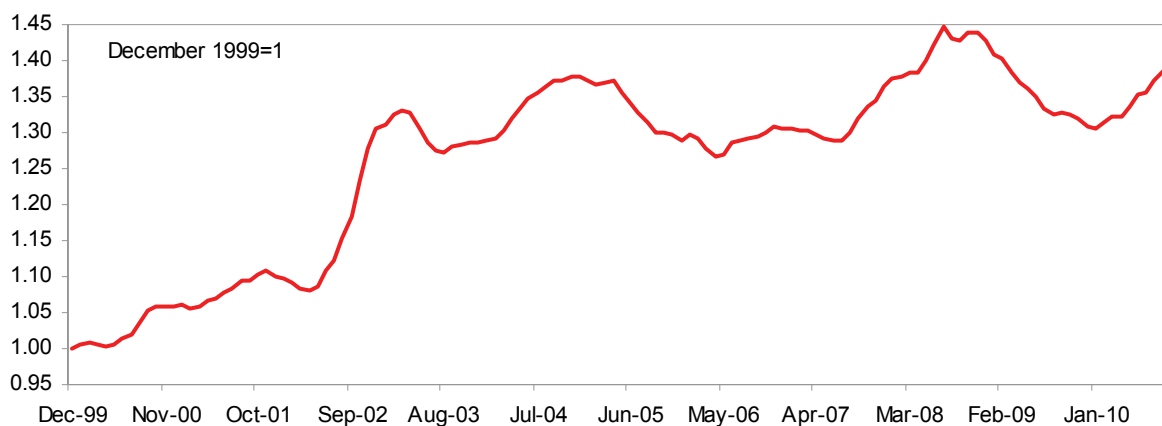
	2007	2008	2009	2010E	2011F
inertia (1)	0.01%	0.23%	0.00%	0.09%	0.49%
deviation of expectations (2)	-0.43%	0.22%	-0.10%	0.62%	0.78%
FX variation (3)	-1.12%	0.63%	-0.24%	0.05%	0.09%
market prices*	5.03%	3.77%	3.47%	4.14%	3.97%
monitored prices**	0.96%	1.05%	1.18%	0.80%	0.17%
IPCA headline	4.45%	5.90%	4.31%	5.70%	5.49%

*Excluding 1, 2, and 3. **Excluding 1 and 3. Sources: Central Bank and Santander.

The wholesale price index (IGP-M) is not likely to pressure controlled prices in 2011, with some favorable factors in the pipeline, such as the energy electricity tariff revision in São Paulo, price competition in the telecommunication sector, which kept the tariffs almost unchanged in the last two years, and stable fuel prices (accounting for about 40% of controlled prices). These should produce a lower indexation profile for controlled prices in 2011, even with a high probability that bus fares will be raised in the majority of cities in anticipation of municipal elections in 2012.

For 2010, we forecast an increase of 11.4% in the wholesale prices index (IGP-M). However, we estimate an increase of 4.7% in the wholesale prices index in 2011, mainly due to the outlook for commodities prices (we expect commodities prices excluding food quite unchanged in the next year). In other words, we expect non-tradable prices to increase more than tradable prices in 2011 to reduce the imbalance between tradable (embodied by IPA-M) and non-tradable prices (embodied by IPCA) that occurred in 2010.

Tradables vs. non-tradables (IPA-M vs. IPCA)



Sources: IBGE, FGV, and Santander.

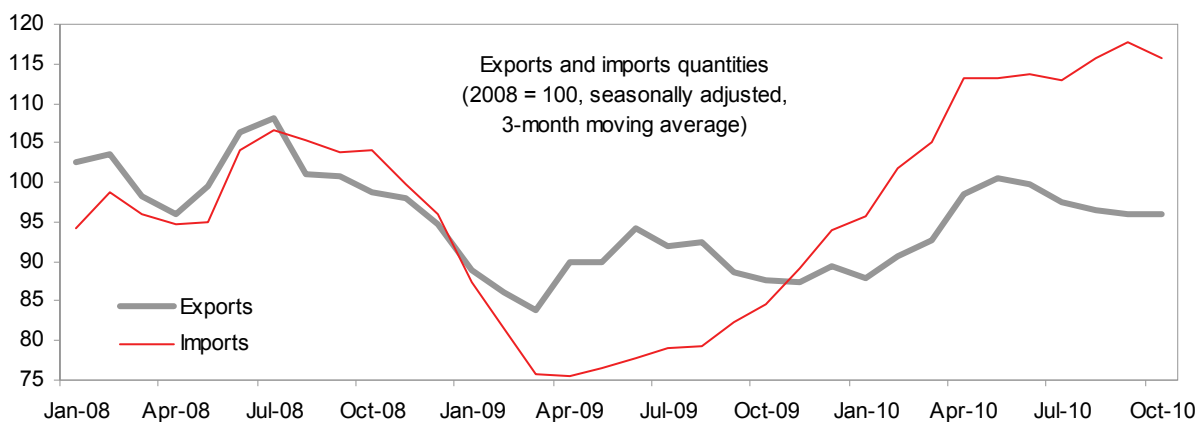
Therefore, we maintain our view that the deterioration of current and expected inflation beyond COPOM expectations (chiefly regarding the former), coupled with the continued strength of domestic demand and

further labor market tightening, is likely to put pressure on the committee. Thus, we maintain our call about the need for the Central Bank to tighten monetary policy early in 2011, with further hikes in the Selic rate to 13%, although the Central Bank has reinforced its belief in the convergence of inflation to the target path. We still believe that the consistent deterioration of fiscal figures, which – creative accounting aside – reveal a stronger impulse to the economy than apparently contemplated in the COPOM’s forecasts. Moreover, it remains unclear that credit expansion under BNDES has come to a halt, which has been a constant source of demand expansion in the past eight quarters.

External financing and exchange rate – Expanding demand with virtually stable domestic savings is a mirror image of growing external imbalances. Our estimates for the trade balance and the current account deficit are, respectively, US\$14.5 billion and US\$52.7 billion for 2010. The deterioration is likely to continue in the following years, when the negative result of current account should increase from 2.6% of GDP in 2010 to 3.4% of GDP (US\$74.1 billion) in 2011 and 4.1% (US\$94.3 billion) in 2012. The government has been expressing concerns about the strong BRL, to which it assigned most of the blame for the negative balance. If implemented as promised, a fiscal adjustment characterized by increased public sector savings could lead to higher domestic savings and a lower external imbalance. Cutting expenditures could also have a negative impact on the real exchange rate, by reducing the demand for non-tradable goods, as well as providing room for lower interest rates. But this is not the scenario we consider most likely. Public expenditures are not expected to grow at the same (fast) pace as in previous years, but we do not believe important cuts will be implemented. We expect the exchange rate to remain virtually stable: BRL1.80/USD at the end of 2010, BRL1.85/USD in 2011, and BRL1.90/USD in 2012. This slight depreciation, according to our scenario, is a consequence of some strengthening of the USD against the currencies of major developed economies.

The performance of domestic demand continues to boost goods and services imports, while exports remain basically stable in quantities. Nevertheless the pace of deterioration of current accounts has not been as fast as we previously thought, due in particular to the very favorable momentum of commodity prices, which directly affect Brazilian terms of trade. We do not believe this favorable momentum will continue in 2011, which is likely to result in even lower trade balance and current account results in 2011 and 2012.

Imports are rising fast, while exports fell in recent months



Exports and Imports (quantities, 2008 = 100, seasonally adjusted, three-month moving average). Source: Funcex.



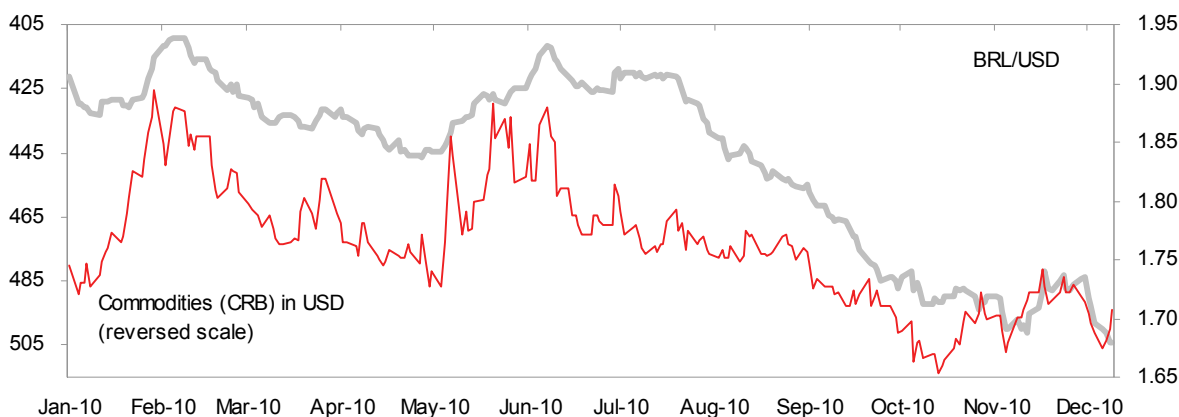
Booming terms of trade



Terms of trade (prices of exports/price of Imports, seasonally adjusted). Source: Funcex.

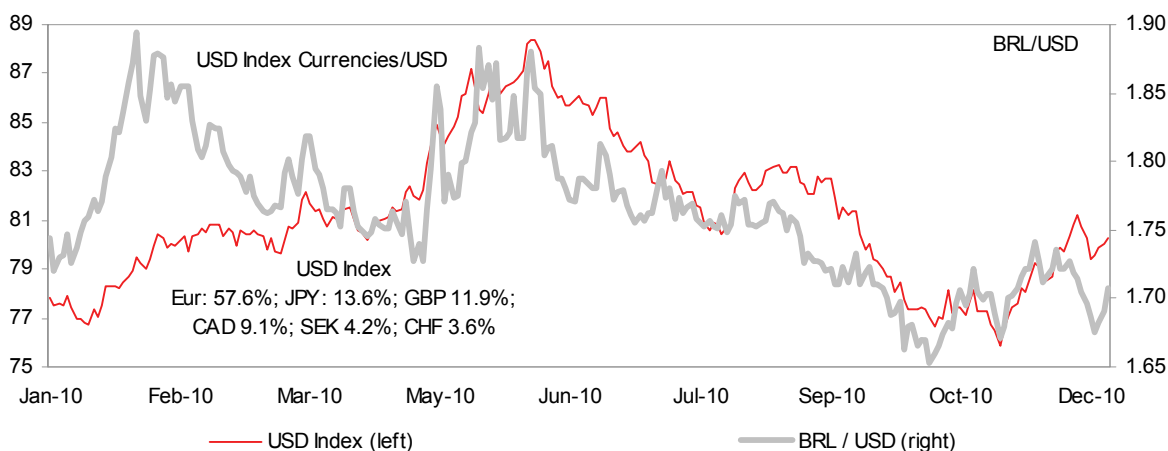
Global liquidity conditions should sustain a strong capital account, comfortably financing the current account deficit. However, we do not expect net positive foreign currency flows to strengthen the BRL further. On one side, the Central Bank will likely continue absorbing excess supply, increasing reserves. On the other, the dynamics of the most important factors behind recent appreciation – the dollar and commodities – may not be repeated in 2011.

Commodities price increases contained further BRL weakening . . .



BRL and commodity prices (CRB). Sources: Bloomberg and Central Bank of Brazil.

. . . Which should result from USD recovery against major currencies



BRL and USD Index. Sources: Bloomberg and Central Bank of Brazil.

Uses and sources of foreign funds (Billions of USD)

	Estimates		Santander forecast	Central Bank forecast
	2009	2010	2011	2011
Uses of funds	(54.4)	(84.6)	(104.1)	(90.1)
Current account	(24.3)	(52.7)	(74.1)	(60.0)
Amortization	(30.1)	(31.9)	(30.0)	(30.1)
Sources of funds	101.0	130.6	139.1	94.9
FDI	25.9	30.0	35.0	45.0
Portfolio	47.1	38.0	45.0	36.0
Debt issuance	35.8	51.0	55.0	46.0
Brazilian Assets Abroad	(15.8)	(27.4)	(20.0)	(33.1)
Short term capital	8.0	39.0	24.1	1.0
Balance	46.6	46.0	35.0	4.8
Rollover rate	119%	160%	183%	
Reserves	239.0	285.0	320.0	

Sources: Central Bank and Santander estimates.

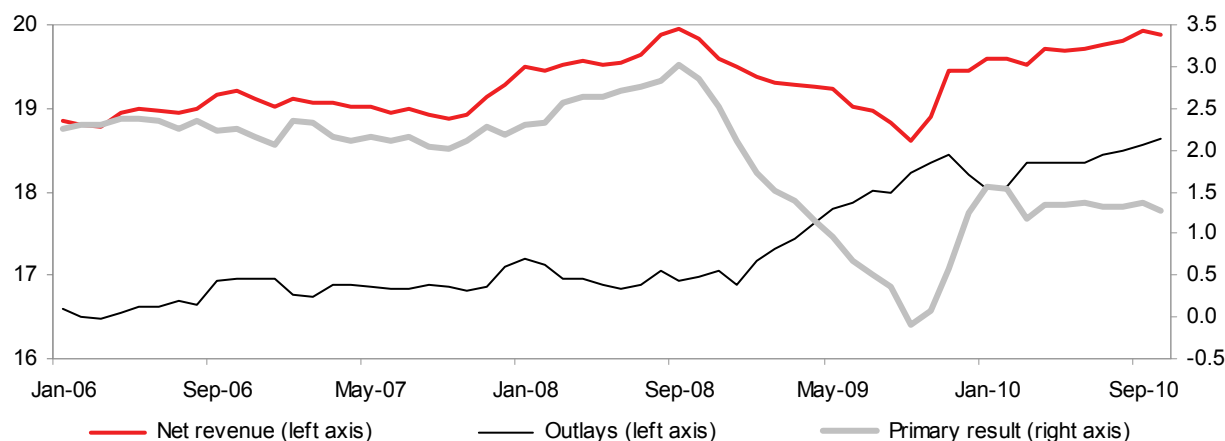
Fiscal policy – The government has promised a fiscal adjustment, but this it is the opposite of what has recently been implemented by the same policymakers. Not only have expenditures been growing fast, but also, and more importantly, creative accounting has been used to increase the primary surplus. In the last 15 years there were only three episodes of spending contractions, followed by fast expansion. The public sector has a long way to go to construct a reputation as a fiscal hawk. We expect primary surplus targets to be met: 3.1% of GDP in 2010, 2011, and 2012. The contribution of non-fiscal revenues (concessions, dividends, and sale of oil fields) should decrease, meaning some marginal improvement in the quality of the fiscal performance. Another possibility would be some contribution of new revenues in order to achieve or even surpass the targets (the reinstatement of the tax on financial transactions is a candidate). But we do not expect a significant (1 p.p. of GDP or higher) contraction of expenditures. Nevertheless, debt to GDP should continue to fall. Our forecasts for gross debt/GDP ratio are 59.9%, 59.1%, and 58.9% for, respectively, 2010, 2011, and 2012. One important task for the new government will be to fight the recent deterioration of the fiscal accounts. That would lend a helping hand to the Central Bank in its aim of fighting the growing inflation.

The rebound of the Brazilian economy from the financial crisis was quick. By 4Q09 GDP was already growing above its potential, bringing tax revenues along. Outlays nevertheless remained high throughout 2010, boosting aggregate demand and contributing to the current inflationary scenario. Thus, in the past few months Brazil saw a supposedly countercyclical fiscal policy turn procyclical, widening the output gap even further.

Another result was the relative stability in the primary surplus (fiscal balance before interest payment) at a level below the government's target. The government figures, for instance, show the primary surplus at 1.3% of GDP in the 12 months to October (chart below, excluding the extraordinary revenue coming from the capitalization of Petrobras in the month) against a target of 2.15% for the year.



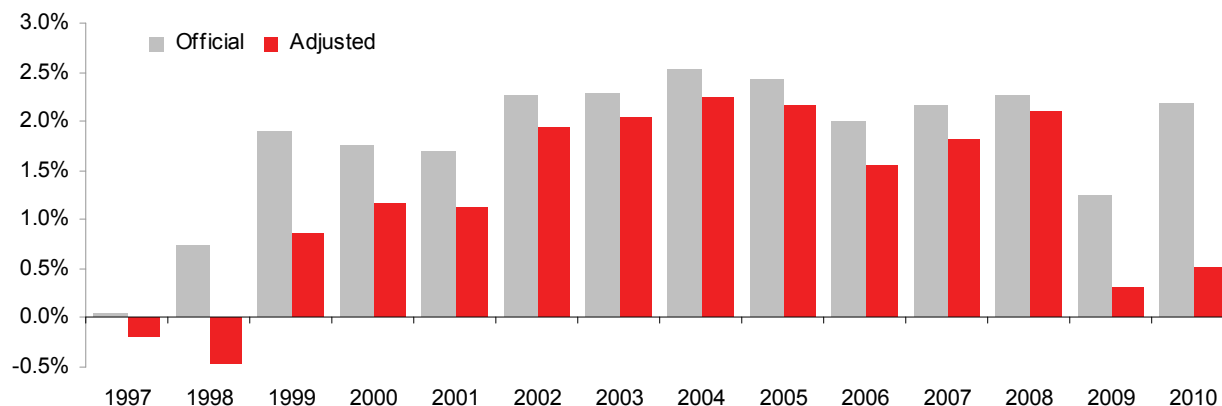
Primary surplus sustained by tax collection growth



Fiscal figures – Federal government (% of GDP). Sources: National Treasury and Santander.

However, there is a deeper concern with the fiscal figures. A large part of the growth in revenues has come from concessions and dividends linked to state-owned enterprises, which are, by nature, extraordinary. When those sources of revenue are removed from the official fiscal accounts (we refer to these below as the “official” and “adjusted” primary surpluses, respectively), it is startling to see that they were not so representative between 2002 and 2008, when the government was generating bigger surpluses, but the primary result is much smaller in the adjusted figures of 2009 and 2010 than the primary shown in the official figures. There is thus an underlying fiscal push to domestic demand that has led to further deterioration of the fiscal accounts lately.

Excluding non-fiscal revenues, fiscal expansion is approximately 1.5 p.p. of GDP



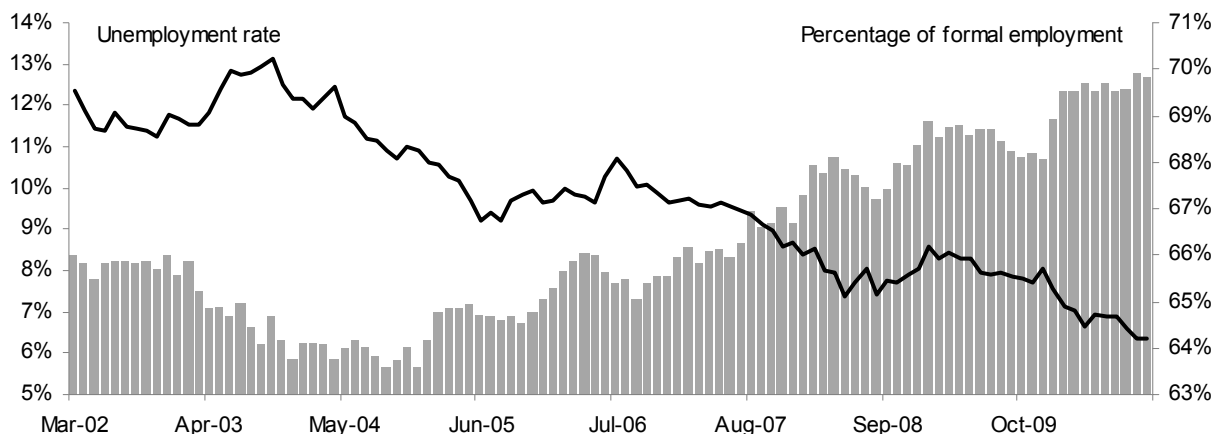
Primary surplus as % of GDP. Sources: National Treasury and Santander.

The government seems to be pushing domestic demand by more than is apparent from a simple observation of the consolidated figures. An important test in the coming months would be to curb the growth of expenditures somehow. The signals coming from the new government have been mixed, with both Rousseff and Finance Minister Guido Mantega stating that a fiscal adjustment is not necessary, but with the latter also reasserting the government’s commitment to better fiscal management, which could also help the Central Bank in its aim of cooling the economy.

Employment and labor market trends – Brazil’s labor market continues its positive trend. Businesses continue to hire, and the downward unemployment trend continues to be associated with strong creation of jobs in the formal sector, as opposed to informal sector job creation. This is, in our view, a very positive scenario in terms of private consumption, especially if it is associated with abundant credit supply. Because unemployment is a lagging indicator, we do not expect relief on this front until 2H11.

In its publications, the Central Bank points out that tight labor markets are one of the risk factors for inflation now and over the next few months. Although the Brazilian economy has slowed down slightly in recent months, labor markets typically respond to economic conditions with a lag. As such, at least over the next few months, we do not expect any relief coming from data regarding the labor market.

Unemployment rate continues to fall and formality rate is the highest ever



Unemployment rate is seasonally adjusted. Sources: Santander and IBGE.

Politics – Many of Dilma Rousseff’s selections for the Cabinet were already serving under President Lula. Some are staying in their posts and some will be given new responsibilities, but the process thus far sends a signal that Rousseff’s team is likely to represent continuity, closely aligned with the previous government.

The market’s main concern was naturally centered on whether the economic policy would be maintained. The choice of Guido Mantega to remain as the Finance Minister (his position since 2006) and to make a current deputy governor of the Central Bank, Alexandre Tombini, its new president, replacing Henrique Meirelles (he may still head a new ministry in charge of ports and airports) seemed to soothe the market’s fears. Nevertheless, they still have to build reputations as, respectively, fiscal and monetary hawks.

Mantega has promised a sounder fiscal policy in Rousseff’s administration, which would help the Central Bank in its task of reducing inflation. Tombini is a longtime civil servant, joining the Central Bank in 1998. His solid academic background enabled him to be one of the three developers of the inflation targeting regime in Brazil back in mid-1999 (the other two being Joel Bogdanski and Sergio Werlang, both now out of the Central Bank) and a member of the Monetary Policy Committee (COPOM) since June 2005. Tombini seems to have the credentials for the task that lies ahead, mainly in 1H11, when the COPOM will have to tighten the monetary policy.

Other posts are worth mentioning. First, Antonio Palocci was chosen as Chief of Staff, a position previously held by Rousseff herself. That is a key selection, since Palocci will be pivotal in political negotiations, mainly with the Congress, something he excelled at during his stint as Finance Minister in President Lula’s first term. However, his position will lose some importance, as the administration of the Growth Acceleration Plan (GAP), a set of measures to boost growth, is to be moved to the Ministry of Planning and Budget. That post will be filled by Miriam Belchior, an aide to Rousseff. The outgoing minister, the well-regarded Paulo Bernardo, will move to the Ministry of Communication with the mission of restructuring the bureau, which lost importance with the late 90s privatization of the telecommunication sector. Finally, the Ministry of



Development, Industry and Trade may be headed by Fernando Pimentel, former mayor of Belo Horizonte (Brazil's sixth most populated city) and one of the few novices on the team.

The political core of the new government is composed of Michel Temer (the vice-president elected), Mantega, Tombini, Belchior, Palocci, Bernardo, Alexandre Padilha (remaining at the head of the Secretariat of Institutional Relations), and Gilberto Carvalho (staying on as General Secretary of the President). Once again, the familiar faces were important to reassure the market of the smooth transition. Moreover, their proven capabilities, along with a solid political base (Rousseff's coalition has with more than 65% seats in both houses, more than the three-fifths required for any constitutional amendment) will more than equip the new government with the tools necessary to overcome the current shortcomings of the country, particularly the relative inefficiency of the public sector in providing quality services.

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Brazil – Economic projections, 2007-2012F

	% GDP	2007	2008	2009	2010E	2011F	2012F
National Accounts							
Real GDP ($\Delta\%$ y/y)		6.1	5.2	(0.6)	7.7	4.5	4.5
Supply: Agriculture ($\Delta\%$ y/y)	5.2	4.8	6.1	(4.6)	7.5	5.9	4.5
Industry ($\Delta\%$ y/y)	21.8	5.3	4.1	(6.4)	10.5	4.3	4.7
Services ($\Delta\%$ y/y)	58.9	6.1	4.9	2.2	5.6	4.3	4.5
Demand: Private Consumption ($\Delta\%$ y/y)	62.8	6.1	5.7	4.2	6.3	4.2	4.8
Public Consumption ($\Delta\%$ y/y)	20.8	5.1	3.2	3.9	4.1	4.0	3.5
Investment ($\Delta\%$ y/y)	16.5	13.9	13.6	(10.3)	22.9	6.4	5.5
Exports ($\Delta\%$ y/y)	11.3	6.2	(0.6)	(10.2)	11.0	9.5	4.5
(-) Imports ($\Delta\%$ y/y)	(11.4)	19.9	15.4	(11.5)	36.4	7.8	8.0
GDP (USD bn)		1,366.6	1,653.0	1,594.6	2,064.6	2,264.6	2,352.1
GDP Per Capita (US\$)		7,409	8,861	8,453.1	10,824.8	11,755.8	12,089.0
Industrial Production ($\Delta\%$ y/y)		5.92	3.10	(7.38)	11.10	4.17	4.50
Population (mn) (1)		184.5	186.5	188.6	190.7	192.6	194.6
Monetary and Exchange Rate Indicators							
IPCA-IBGE Inflation (Dec Cumulative) (%)		4.5	5.9	4.3	5.8	5.5	4.5
IGP-M Inflation (Dec Cumulative) (%)		7.8	9.8	(1.7)	11.4	4.7	4.5
US\$ Exchange Rate (Year-End)	2.34	1.77	2.34	1.74	1.70	1.85	1.90
US\$ Exchange Rate (Avg)		1.95	1.83	2.00	1.76	1.78	1.88
Relevant Interest Rate (Overnight – SELIC) (Target - Year-End)		11.25	13.75	8.75	10.75	13.00	11.50
Relevant Interest Rate (Overnight – SELIC) (Effective - Accum)		11.82	12.38	9.88	9.80	12.38	11.77
Monetary Base (BRL bn)	99.9	146.6	147.5	166.1	189.3	208.7	227.9
Monetary Base (US\$ bn)	42.7	82.8	63.1	95.4	111.4	112.8	120.0
Monetary Base ($\Delta\%$ y/y in US\$)		94.1	(23.7)	51.1	16.7	1.3	6.3
Stock of Credit To Nonfinancial Private Sector (% y/y)		27.8	31.1	15.2	19.6	17.7	17.7
Fiscal Policy Indicators							
Public Sector Fiscal Balance (harmonized) (% of GDP)		(2.7)	(1.9)	(3.3)	(2.5)	(3.0)	(1.8)
Primary Balance (% of GDP)		3.5	3.5	2.1	3.0	3.0	2.5
Gross General Government Debt (US\$ bn) (4)		871	745	1,134	1,303	1,298	1,380
Internal (US\$ bn)		805	683	1,070	1,237	1,238	1,322
External (US\$ bn)		66	62	64	66	60	59
Balance of Payments							
Trade Balance (US\$ bn)		40.0	24.7	25.3	14.5	6.5	(8.4)
Merchandise Exports (US\$ bn)		160.6	197.9	153.0	198.7	226.2	244.3
Merchandise Imports (US\$ bn)		120.6	173.1	127.6	184.2	219.7	252.7
Net Income and Services Account (US\$ bn)		(42.5)	(57.2)	(52.9)	(71.2)	(84.7)	(90.0)
Unrequited Transfers (US\$ bn)		4.0	4.2	3.2	4.0	4.0	4.0
Current Account (US\$ bn)		1.6	(28.3)	(24.3)	(52.7)	(74.1)	(94.3)
Current Account (% of GDP)		0.1	(1.7)	(1.5)	(2.6)	(3.3)	(4.0)
Foreign Direct Investment (US\$ bn)		34.6	45.1	25.9	30.0	35.0	40.0
Debt Profile							
International Reserves (US\$ bn)		180.3	193.8	238.5	285.0	320.0	329.9
Federal Gov't & Central Bank Domestic Securities (US\$ bn) (2)		753.1	598.0	860.2	1,029.4	1,024.8	1,106.9
Short term (less than 12 months) (US\$ bn)		212.4	151.9	203.0	242.9	241.8	261.2
Short Term (less than 12 months) (% total)		28.2	25.4	23.6	23.6	23.6	23.6
Total Government Gross Debt/GDP (%) (4)		61.1	61.8	68.9	63.1	57.3	58.7
Total External Debt (US\$ bn)		193.2	198.3	202.4	225.1	264.2	318.6
Short Term (maturity less than 12 m when issued) (US\$ bn)		38.9	36.4	30.5	30.5	30.5	30.5
Long Term debt (maturity more than 1y when issued) (US\$ bn)		154.3	161.9	171.9	194.6	233.7	288.1
Total External Debt (% of GDP)		14.5	12.7	12.7	10.9	11.7	13.5
Total External Debt (% of Exports of Goods)		120.3	100.2	132.3	113.3	116.8	130.4
Debt Service Ratio		28.2	16.5	24.2	24.0	22.0	22.0
Labor Markets							
Change in Payroll ($\Delta\%$ y/y) - IBGE (3)		1.6	1.8	0.7	3.4	2.1	2.2
Average wages (real $\Delta\%$ y/y) - IBGE		3.8	2.2	2.4	3.2	1.0	1.6
Unemployment Rate Avg. (% of EAP) - IBGE		9.3	7.9	8.1	6.7	7.1	6.9
Aggregate Wages (real $\Delta\%$ y/y)-Santander, based on IBGE data		5.5	4.0	3.1	6.7	3.1	3.8

Sources: IBGE, MDIC, FIPE, FGV, Central Bank, SEADE, and Santander. (1) The IBGE revised its estimate for population in 2007, but has not yet revised the historical series. 2004-2006 are Santander estimates. (2) Revised Series, now reporting gov't securities by their market price. (3) Data for 2003, excludes Salvador and Porto Alegre. (4) The Central Bank revised its methodology for reporting the general government gross debt. The new series excludes Treasury securities held by the Central Bank and includes Central Bank repo operations.



CHILE

2011 GROWTH: LOCAL DRIVERS NEED GLOBAL SUPPORT

POSITIVES

- **Local factors support an expansion of about 9% of internal demand in 2011, implying GDP growth above 6%.**
- **A sound labor market, economic confidence, and increasing credit lead us to expect strong consumption in 2011, increasing 7.1%.**
- **The Chilean government's fiscal position continues to be strong. Chile is a net creditor to the equivalent of 10% of GDP (as of June).**

NEGATIVES

- **Although it remains high, there is some deceleration in economic growth, which we see as linked to the impact of the international scenario on industrial exports. We believe a recovery in the developed world is needed to achieve sustained growth rates in exports in mid-2011 onward.**
- **There have been execution problems in public-financed rebuilding and housing plans that have affected the performance of the construction industry. Our base-case scenario assumes that these problems will be resolved.**

PROSPECTS

Economic growth – The Chilean economy is running at high speed. After an estimated increase of 5.3% in 2010, we forecast GDP expansion of 6.2% in 2011. Local factors are driving growth, but we believe the support of a better international scenario is required to allow sustained growth rates from the export sector (which accounts for 40% of GDP) in mid-2011 onward.

We believe 2011 will be in general terms a year like 2010, a mix between strong local factors and uncertainty from the international scenario. We expect consumption growth to remain strong, but returning to normal levels in 2011. In 2010 private consumption was pushed by an extraordinary monetary stimulus, optimistic economic expectations, and an improving labor market. Therefore, we estimate private consumption increased 10% in 2010. In 2011 consumption should increase by around 7%.

Unemployment could fall to the NAIRU level (7.0-7.5%) in 2011, supporting payrolls and thereby driving consumption growth. Confidence has been in optimistic territory since September 2010 and could continue improving, as it deteriorated following the earthquake. It benefited from low unemployment and strong economic growth. One risk is contagion to expectations from uncertainty in international markets, but we see a low probability of this owing to the strong local dynamics in Chile, including a good outlook for job creation, as well as improving consumer confidence in the developed world.

In addition, we expect credit conditions to be favorable in 2011. Consumer loans increased 10% y/y in September, continuing the upward trend since September 2009. In our view, financial conditions in Chile will continue improving. It is important to note that although the BCCh has increased rates, the credit base is expanding, so the impact of the reference rate remaining at expansive levels is larger.

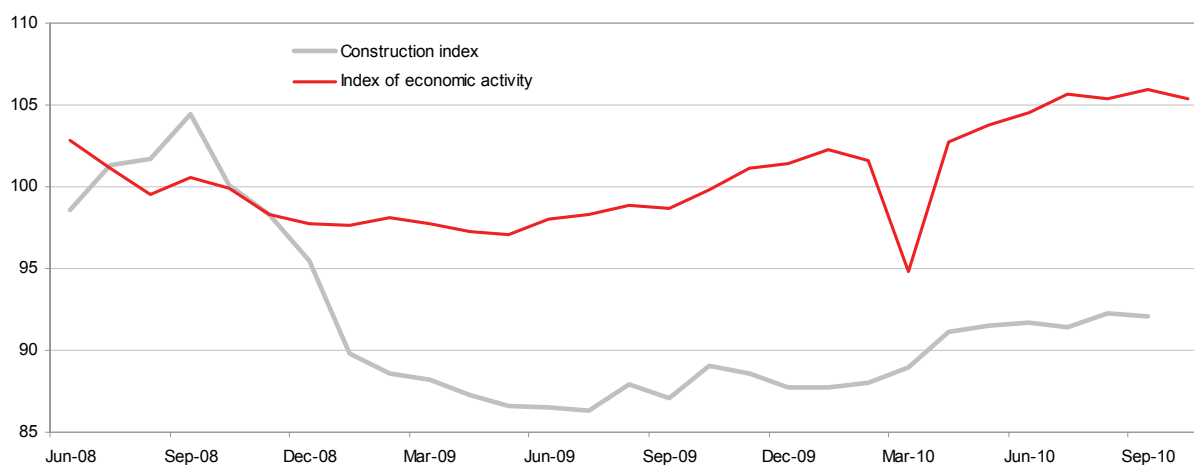
Consumption fundamentals in positive territory in 2011



Sources: INE, Central Bank, and Santander.

Another local driver in 2011 is government spending. We expect the government’s spending plans to be increasingly important for economic growth. We see the fiscal budget as slightly expansive, because although the real increase could be lower than GDP (5.8% vs. 6.2%), the composition of the budget means that consumption (direct and through social spending) and capital expenditures are growing at two-digit rates. Some parts of the 2010 budget are not expected to be fully executed, including some delays in expenditures related to rebuilding efforts. Execution rates of spending programs could be improved, which would boost the construction sector, where public investment has been lower than expected this year. Also, with regard to consumption, we expect a better labor market and good confidence to boost housing sales, which posted a weak performance in 2010 due to the impact of the earthquake on demand for apartments, along with the last impacts on demand from the 2009 recession.

Construction is well below 2008 levels, but could boost growth with rebuilding efforts



100=average in 2H08. Sources: Santander estimates, Central Bank, and Chilean Chamber of Construction.

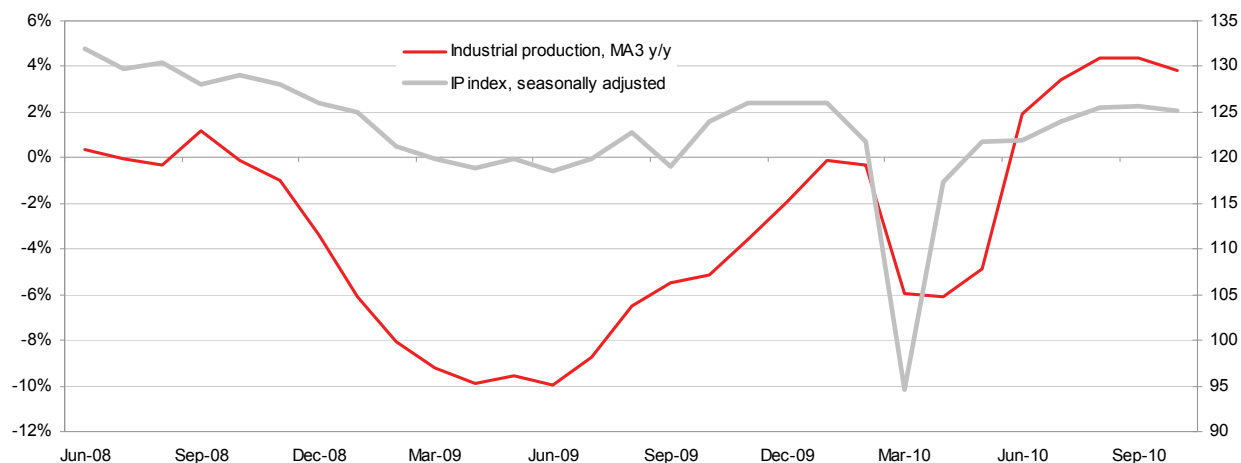
We expect these local factors to drive a healthy increase of 8.6% in internal demand in 2011.

Next we focus on the external scenario. Exports correspond to about 40% of GDP, so it is important to ask how a small, open economy can decouple from the developed world. The breakdown of exports of goods shows that almost 70% are commodities, including mining (copper), pulp, and fresh fruits. Most of these commodities show record-high prices due to demand from the emerging world, most importantly China. Thus, the value of exports from Chile is more affected by emerging markets than by the developed world. Nevertheless, we believe that volume growth is likely to come from the demand of developed countries. It is important to note that the exports that are not increasing now are mainly related to industry (processed food,



wood products, capital products), and their main markets are developed countries. Therefore, looking into mid-2011 and beyond, being a commodity exporter could allow Chile's exports to avoid decreasing even if the international scenario deteriorates, but in order to grow Chile will need additional support from demand in developed countries.

Industry is affected by post-earthquake impacts on capacity and low external demand

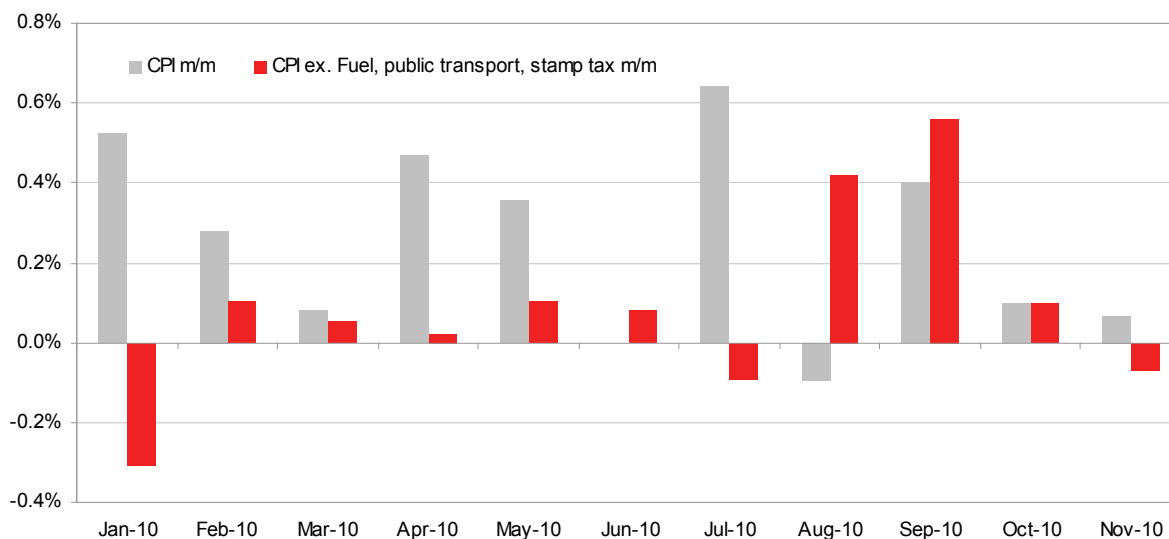


Sources: INE and Santander estimates.

Monetary policy and inflation – Low inflation was the rule in 2010. Some factors that explain that trend could persist in 2011, but we expect closure of the output gap and wage pressures to imply a CPI hovering between 3% and 3.5% in most of 2011.

CPI inflation has been lower than expected in the last year. We have been arguing that the strong economy could be reflected in higher core inflation. Nevertheless, higher inflation has not appeared yet. Therefore, we believe in order to project 2011 inflation, it is important to review the causes of the lower than expected CPI. 2010 is likely to have ended with minimal inflation. CPI inflation accumulated 2.9% up to November, but if we exclude fuel and public transport fees, CPI accumulated only 1.9% in the year through November. And if we also exclude the stamp tax increase, inflation up to November would be only 1%. We estimate December's CPI at 0.0-0.1% m/m, ending 2010 at 3.0%.

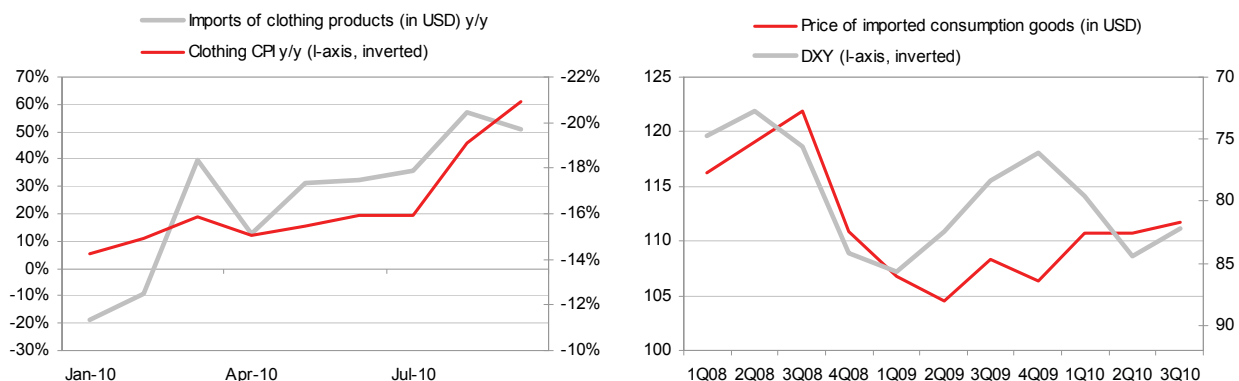
Despite growth, inflation is low, accumulating only 1% this year (ex-fuel and one-time events)



Sources: INE and Santander estimates.

The big question is when we are going to see an increase in inflation. We believe inflation will remain contained due to the phenomenon of importing of deflationary pressures from advanced economies. We have seen a negative correlation between the growth of imports and prices. This phenomenon can be seen in the prices of imports. Indeed, although the USD depreciated 2.7% q/q in 3Q10 (measured by the DXY index), price of imports of consumption goods only increased 1% q/q. This phenomenon could be explained by the fact that prices of global consumption goods remain stable or even decreasing in local currencies as a result of weak consumption prospects in developed world. In line with this view, looking at the CPI basket, there is a relationship between those that have experienced larger price falls, with an increase in imports of the products part of the component. In contrast, those goods that are mostly produced within the country are the ones that have experienced larger increases.

We have observed a negative correlation between growth of imports and prices of products



Sources: Customs service, INE, and Santander estimates.

If this scenario continues, we believe inflation in 2011 will be anchored between 3% and 3.5% most of the year, where the closure of the output gap and labor market pressures could be offset by more imports of low inflation due to the weak international scenario, as seen this year. Therefore, inflation would be relatively contained as the world economy (and developed countries) fails to recover.

Another important topic is the methodological changes in the CPI. Recall that in 2010 the National Institute of Statistics updated the calculation of the CPI, incorporating a nationwide survey and other methodological changes. We noted a change in seasonality and the magnitude of some divisions, such as clothing, which in 2010 decreased 19.5% or 21.5% y/y.

In the short term, the usual seasonal factors are spring/summer price increases in apparel with the start of the season and interurban transport due to summer vacations. On the other hand, fruits and vegetables should show a drop in December, given the input of crops. However, and based on what happened the rest of the year, the timing of these events will add volatility to the short-term estimates. In the medium term, we expect that in 2011 the projections will have a lower error, as consensus will be able to incorporate into the calculation the experience of 2010 under the new methodology, which could lead to better timing of seasonality and one-time factors.

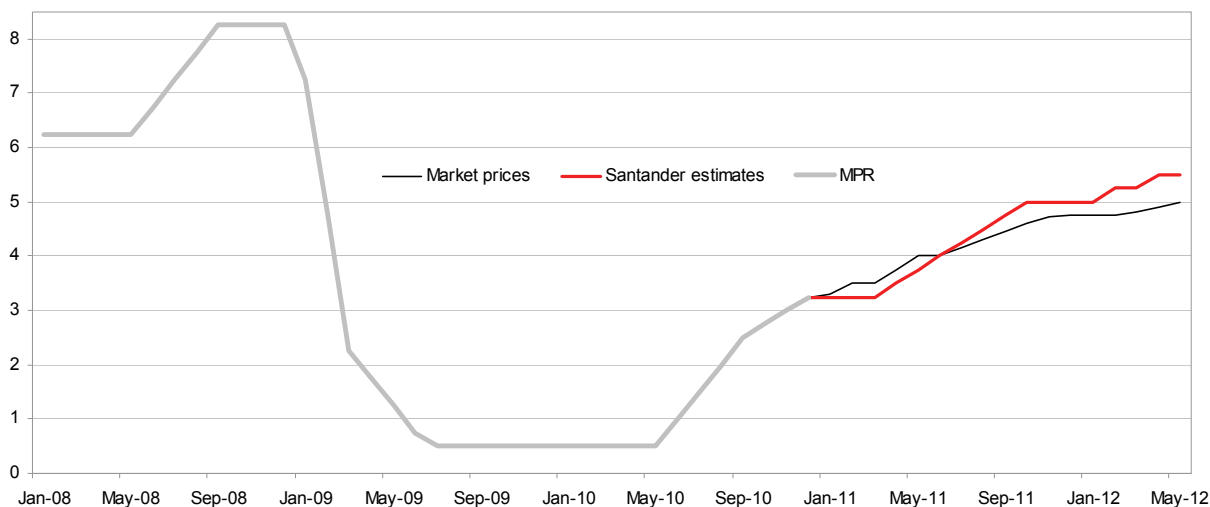
We expect a 2011 CPI at 3.4% y/y. Under our assumption, the output gap is likely to be closed at some point in 2Q11, implying increasing demand pressures. The labor market may be another source, as unemployment could be about the NAIRU rate estimated for Chile (7-7.5%) in 1H11. Both sources of core inflation could be offset by the maintenance of the importing of low inflation phenomenon. Therefore, we expect annual CPI inflation around 3-3.5% in most of 2011, ending the year at 3.4%.

Regarding monetary policy, we believe after increasing the reference rate 275 bps to 3.25% in 2010, the Central Bank is likely to pause the tightening of the monetary stimuli. Recently, and for the first time since the start of the tightening cycle in June 2010, when the reference rate was at 0.5%, the Board has seriously considered the option of keeping the MPR steady. We believe that at the margin, the possibility of a pause in monetary normalization is based on low inflation, decelerating economic growth, and international uncertainty.



Strong and higher than expected economic growth was the main factor leading the BCCh to increase the reference rate and maintain the bias toward more tightening in the communiqués, despite the environment of low inflation and international uncertainty. Analyzing the macroeconomic developments in recent months, we note that economic growth remains in line with expectations, with high rates of growth, although decelerating at the margin, especially since October. Moreover, inflation remains lower than expected, and our estimates indicate that after lower than expected CPI inflation in November at 0.1% m/m, for December we estimate minimal inflation, at 0.0-0.1% m/m. We expect year-end 2010 CPI inflation was around 3%, well below expectations a few months ago (in September the Central Bank estimated a 2010 CPI at 3.9%). Also, the international scenario has deteriorated at the margin, and we think uncertainty will continue.

We expect a back-loaded monetary normalization process in 2011



Market prices as of December 9, 2010. Sources: Bloomberg and Santander estimates.

Therefore, a pause is likely in January or early 1Q11. A nominal level at 3.25% throughout the first quarter of 2011 would imply a slightly positive real interest rate, in contrast to the negative real rate seen in most of 2010, which we see as in line with a macro scenario marked by high domestic growth, although decelerating, with persistent low inflation and uncertainty about the international scenario, where everything points to historically low global rates. Still, we continue to believe that the Central Bank will resume the normalization process in 2Q11, while timing would be determined by the emergence of demand inflation pressures. Therefore, we expect the reference rate to be at 4.25% mid-2011, to finish the year at 5%. Although 5% is low compared with historical estimates for a neutral rate in Chile (closer to 6%), we believe it is a fair level for an economy with no excess capacity but with low inflation and low global interest rates.

Fiscal policy – We see the fiscal budget in 2011 as slightly expansive, due to a high growth compared with the effective expenditures in 2010 and a bias toward demand components such as social and capital expending.

The 2011 fiscal budget law provides funds for US\$53,387 million. This implies an increase of 5.5% in real terms compared with forecasted expenditures in 2010, although we believe the real increase is going to be higher due to the under-execution of the 2010 budget. In terms of the structural balance, the budget used a potential GDP growth of 4.8% for 2011 and a long-term copper price of US\$2.59/pound. Both variables were estimated by independent committees. Considering this, the estimated structural deficit would fall from 3.1% in 2010 to 1.8% in 2011.

The law contemplates an increase of 14.9% y/y in social spending, 18.7% y/y in capital investment, including rebuilding plans, 12% y/y in health care, and 8% in education. One of the highlights in capital investment is the strong emphasis that has been given to the construction of public works and housing, reflecting rebuilding plans that were delayed in 2010, one of the reasons for the lower-than-expected performance of construction this year, but also a factor behind the strong growth projected for 2011.

We see the 2011 fiscal budget as slightly expansive, as it has a bias toward demand components such as social and capital expending, despite showing a moderation in the growth rate (to a 5.8% expansion from 7.3% in 2010).

Regarding the execution issue, the percentage of the annual budget spent in each month has remained low compared with past years in recent months, after the extra expenditures due to the earthquake. Even if we consider a 4Q10 spending pattern in line with history, annual expenditures could be at 98.7% of the July forecast of spending.

From May to September, 40.6% of the annual budget was spent, which is 4.5% under the historical average. We believe this is mostly because of the delay in reconstruction work and less spending by the government in other areas, particularly housing. Following this trend, we expect the government to spend just 27% in the last quarter. Thus, we estimate that in 2010 the government used just 98.8% of the amount provided in the 2010 budget law. This implies a boost in the fiscal impulse next year, as expenditures could increase more compared with 2010.

In addition, the 2011 budget includes revenues from the issuance of US\$6,000 million in debt, close to the level provided in the 2010 budget. In addition, it requests authorization to issue additional US\$1,800 million if needed. It is important to note that the budget is fully financed by the government's own resources (the public sector is a net creditor), and debt issuance is intended to provide liquidity to local benchmarks and to offset CLP appreciation from limiting the sale of USD revenues in the spot market. Thus, given the worries over CLP appreciation, and the fact that government has a deficit of CLP (its revenues in CLP are lower than its expenditures in local currency, as the taxes of mining and exports companies and Codelco revenues are denominated in USD), in our opinion it is likely that debt issuance will focus on long bonds (10 to 30 years) in local currency, placed mostly locally, but also overseas due to the good placement of the bond in pesos this year.

The fiscal financial position remains very strong. Until June 2010 gross financial liabilities increased from 6.1% in 2009 to 7% of the GDP. The total financial assets decreased from 17.2% in 2009 to 17% of the GDP. Therefore, the net creditor position decreased slightly at the margin, but reached a strong 10.1% of GDP (June 2010) against 11.1% in 2009. With regard to sovereign wealth funds, up to October both the economic stabilization fund and the pension fund reached US\$16.9 billion, while other financial assets were up to US\$5 billion.

Chile has a very low CDS rate, again



Sources: Bloomberg and Santander estimates.



Trade balance and current account – Chile’s export sector has not been significantly affected by deterioration of international prospects due to the strong exposure of Chile’s exports to commodities and emerging countries. Nevertheless, additional growth at the margin is at risk if the international scenario does not improve.

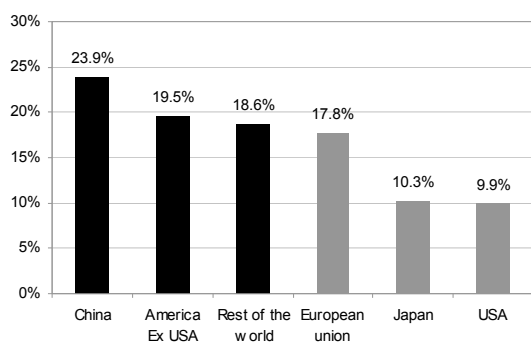
2010 exports grew on average 35% y/y. Only 38% of Chile’s exports go to developed countries, as emerging markets are the main destinations of Chile’s exports, with China as the biggest market. In early 2009, developed countries accounted for 52% of Chilean exports. The exposure to commodities and emerging markets has increased almost 15% since early 2009.

Another important factor is the composition and price of exports. The exports of commodities account for 77% of total exports. Copper exports make up 55% of total exports, and pulp & paper make up 5% of the total. Also, the price of the relevant commodities for Chilean exports has remained high. The average price of copper in 2010 has been 336¢/lb (42% higher than 2009), and the average pulp pine price has been US\$929/ton (nearly 41% higher than 2009).

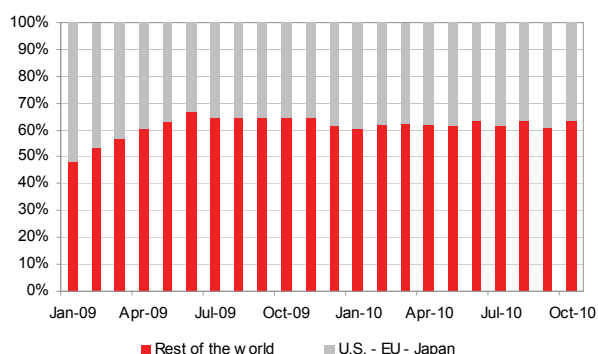
As prospects for emerging markets remain positive, we expect Chile’s exports to continue at high levels. But to experience a steady growth in 2011, we believe a better international scenario is needed. As commodity exports remain high and could continue at that pace in 2011 and going forward, growth at the margin has to come from non-commodities exports. Most of these are related to industry and processed food, the main markets for which are developed countries. So, although exports could show a high growth rate in 2011 owing to a low comparison base, as the export sector was affected by both the earthquake and low demand in 2010, we believe growth from 2H11 on will be more linked to developed markets.

Further export growth depends on increased demand from developed markets

Major export markets 2010



Evolution of Chile’s export partners



Sources: Customs service and Santander.

Since late 2009 Chile has experienced a sharp increase in imports, especially coming from consumer goods. To October 2010, imports amount to US\$44.310 million, an increase of 38% over the same point in 2009. Consumer goods have grown on average 55% y/y this year, in line with the sharp increase of durable goods consumption. Looking forward, as we expect durable goods to decelerate, we believe there is going to be a more normal growth rate of consumption imports next year, close to 12%.

Imports of capital goods experienced a sharp increase at the beginning of the year, probably due to reconstruction after the February 27 earthquake, followed by a deceleration in the middle of the year linked to the relatively weak performance of construction compared with other components of internal demand. We expect the growth of capital goods imports to moderate, as they have a very cyclical trend, and with high growth rates continuing due to a boost from the construction sector. Thus, we expect imports to increase 11% in 2011, implying a trade balance at US\$15 billion.

Currency – The CLP has appreciated significantly against the USD, a trend we see linked to the value of the USD internationally. Thus, we see limited room for the exchange rate to strengthen further, but it is important to analyze the decoupling story seen in recent months.

The exchange rate was the main topic of discussion in 2010. Not surprisingly, from its peak of CLP540-550/USD in May, the peso has strengthened more than 12% against the U.S. currency. Local factors can explain part of this trend. First, the Chilean economy has been growing well above most of the world. We expect a 2010 GDP growth at 5.3%, compared with the IMF’s estimate of 4.8% for the world’s economy and 2.7% for the developed world. The overall picture shows that countries with higher growth rates tend to have stronger currencies, reflecting higher spending power. Also as a result of the strong economic growth, the Central Bank has increased interest rates, which attracts capital flows through a widening of the interest rate differential, appreciating the currency. And copper, Chile’s main export, shows a very positive cycle in prices, which suggests an increased flow of dollars into the country.

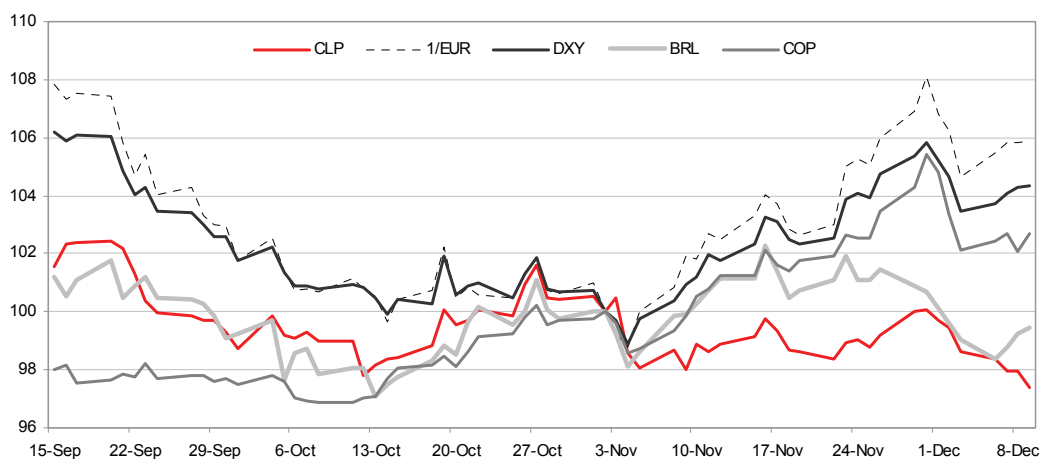
But can these internal factors explain a 12% appreciation of the currency? We think not, and to support our view we have to look at Chile’s peers. Until late October, all emerging market currencies and other developed country currencies, like the euro, showed a similar level of appreciation against the dollar and the Chilean peso. That is, rather than focusing on internal factors, we have to look to the dollar.

We believe that 2011 will see a stronger dollar internationally. Increases in risk aversion are associated with a higher dollar value, as it is seen as a safe haven. Using the VIX as a proxy of risk aversion, after reaching a minimum in October, when it was at levels comparable to those seen prior to any sign of the financial crisis in 2007, risk aversion has increased with fiscal solvency problems in Europe. We believe these problems in the world economy will not end soon, so risk aversion is likely to boost the dollar.

Moreover, the appreciation of the dollar could reflect that while the U.S. economy is showing a weak recovery, it is nonetheless a recovery.

Since November 2010, the peso has remained stable against the dollar. Indeed, the euro has fallen from 1.42/USD to 1.33 and the *real* has depreciated from 1.66 to 1.69, while the peso is around 478-480/USD. We estimate that if the peso were behaving as it did until October, it would now be over 490/USD. In our view there is increasing pressure on the currencies in which there is no pro-dollar intervention. Given that Chile stands out in the region because there is no intervention in the FX market, it is possible that this decoupling will continue. And so, while the peso has remained stable against the dollar, it has gained value against most other currencies – at least 3% since November, according to our estimates. This implies a real appreciation of the peso, which increases the probability of intervention by the Central Bank. Under this scenario, we see little room for appreciation of the peso over CLP475/USD. Therefore, we believe Chile’s peso will range between 475 and 490 in the short term. By year-end 2011, we expect the CLP to depreciate to 510/USD, mostly owing to a stronger dollar, but also because of a moderation of the widening of interest rate differentials. We expect BCC to increase the reference rate 175 bps in 2011, lower than the 275 bps in 2010.

CLP has appreciated, increasing the probability of intervention by the Central Bank



100=price as of November 3, 2010. Sources: Bloomberg and Santander.



Employment and labor market trends – The labor market has shown strength, but analysis is difficult owing to the new methodology for employment data.

The labor market saw a strong performance in 2010. In October unemployment reached 7.6%, the lowest level for 2010. It is important to note that the NAIRU rate is estimated at around 7-8%, so although the interpretation of the unemployment rate is affected by changes in the methodology, we believe the labor market is strong and supports consumption along with wage pressures.

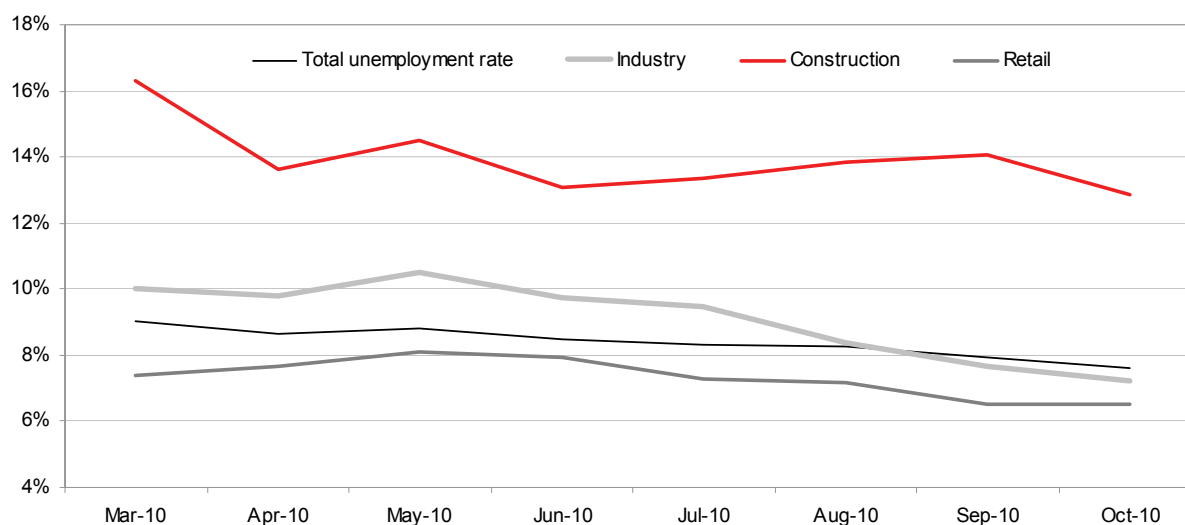
The labor market improvement stands out because under the new survey methodology unemployment fell from 10.7% in 2009 to 7.6%, with strong growth (8.9% y/y) in employment. In addition, in 2010 we did not see an increase in unemployment in the winter months as usually happens.

Historical comparisons are difficult due to the new survey implemented in 2010. The survey is intended to allow international comparison of labor market data, as it was based on OECD standards, so it does represent an improvement over the previous survey. Nevertheless, the change in the employment survey adds difficulty to the analysis, because there is no fair comparison between the current data and the previous series.

Nevertheless, strong employment is a good sign for consumption. In a quarter-to-quarter analysis, job positions increased between 0.5% and 0.8% m/m in the last few months. New job positions have come mainly from retail (21% of total jobs) and industry (12% of total). The good prospects for consumption and the recovery in industry after the earthquake support healthy labor creation in these sectors. Moreover, construction, which represents about 8% of total jobs, should benefit from increasing activity going forward.

With the data on employed and unemployed workers from the National Statistics Institute (INE) and estimates of the number people looking for a job for every economic activity, we can estimate the unemployment rate by economic sector. The highest unemployment rate (12.8% in October) is in the construction sector. This is important because construction accounts for 8% of total workers employed. Retail, accounting for 21% of employed workers, has shown a decreasing unemployment rate (6.5% in October). Industry, accounting for 21% of employed workers, has shown a downtrend, reaching 7.2% in October.

Better prospects for construction could imply a lower unemployment rate in 2011



Sources: Santander estimates and INE.

A report by the Chilean Chamber of Construction shows that the low activity in the construction sector is mostly due to the slower than expected progress of reconstruction after the February earthquake. The 2011 budget law contemplates an increase of 18.7% y/y in capital investment, and 42% y/y in housing. This is good news for the construction sector, where it should bring down the unemployment rate.

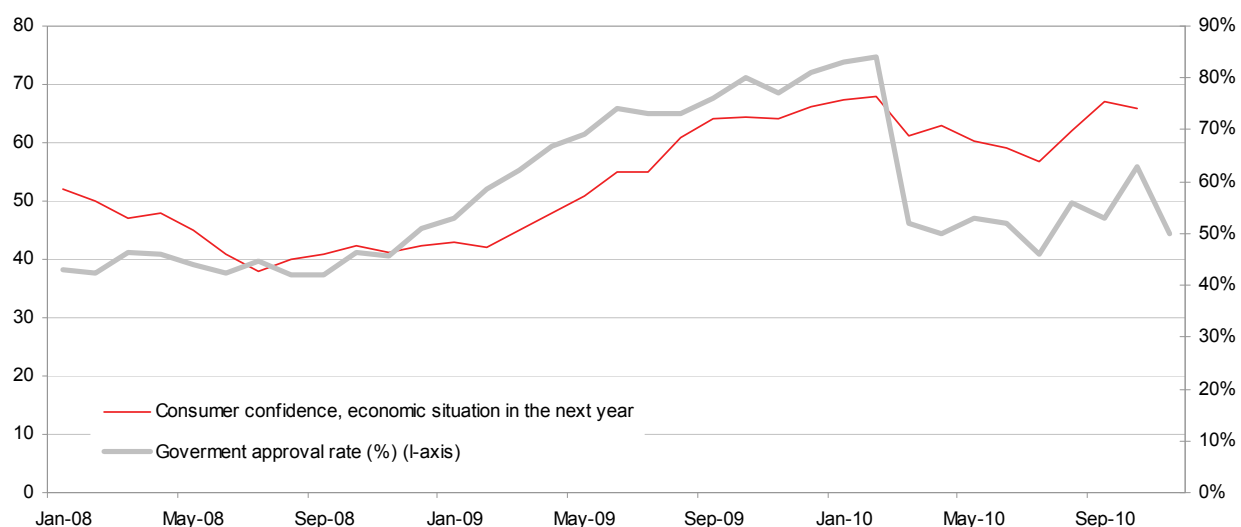
Under these assumptions, unemployment averaged 8.2% by the end of 2010; we expect it to average 7.9% or lower in 2011.

Politics – The rescue of the trapped miners temporarily boosted the government’s approval ratings, but they have decreased to around 50%. We expect the government to encourage the full execution of the fiscal budget and measures intended to support economic growth as a way to improve its support.

Government support has been volatile in recent months. After hovering at around 50% before August, the government’s approval rate was significantly helped by the rescue of the 33 trapped miners, but this impact faded and government support fell back again. Meanwhile, there has been increasing criticism from the opposition about the execution of the budget and, more specifically, rebuilding efforts.

It is important to note that the new administration has been through something of a “trial run” period, as reflected in the under-execution of the fiscal budget this year. As economic perception is highly correlated with government support, we expect more commitment of the administration toward fully executing the budget, and some progress on the core programs related to rebuilding efforts. We expect to see an additional impact of the fiscal impulse in the next few months.

The government could improve its political support by supporting economic growth



Sources: Adimark and Santander.

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Chile – Economic projections, 2007-2012F

	% GDP	2007	2008	2009	2010E	2011F	2012F
National Accounts							
Real GDP (Δ% y/y)		4.7	3.2	-1.5	5.3	6.2	5.0
Total Demand (Δ% y/y)	104.1	7.8	7.4	-5.9	16.1	8.6	6.4
Consumption (Δ% y/y)	66.6	7.1	4.2	1.8	8.7	7.1	6.3
Investment (Δ% y/y)	25.5	9.9	17.0	-26.1	43.3	12.8	6.7
Gross fixed capital formation (Δ% y/y)	24.1	12.0	19.5	-15.3	16.7	14.1	7.8
Government Spending (Δ% y/y)	11.9	8.5	7.7	16.9	7.3	5.8	5.0
Exports (Δ% y/y Real)	37.8	7.6	3.1	-5.6	1.9	8.0	6.5
Imports (Δ% y/y Real)	41.9	14.9	12.9	-14.3	28.5	12.7	9.0
GDP (US\$ bn)		164.0	169.2	163.8	185.4	190.2	201.5
GDP Per Capita (US\$)		9,877.9	10,093.5	9,677.0	10,845.7	11,027.1	11.6
Industrial Production (Δ% y/y)		3.1	0.0	-6.7	0.9	6.7	4.2
Population (mn)		16.6	16.8	16.9	17.1	17.2	17.3
Monetary and Exchange Rate Indicators							
CPI Inflation (Dec Cumulative %)		7.8	7.1	-1.4	3.0	3.3	3.0
CPIX Inflation (Dec. Cumulative %) (1)		6.5	8.6	-1.8	2.1	3.1	3.0
CPIX1 Inflation (Dec. Cumulative %) (2)		6.3	7.8	-1.1	0.1	3.1	3.0
US\$ Exchange Rate (Year-End)		498.0	638.5	507.5	482	509	521
US\$ Exchange Rate (Avg)		522.2	523.2	559.1	509	502	516
Central Bank rate (interbank 24h target) (Year-End)		6.0	8.3	0.5	3.3	5.0	5.8
Central Bank rate (interbank 24h target) (Avg)		5.3	7.2	1.8	1.5	4.4	5.5
Money Base (US\$ bn)		5.6	6.8	7.5	10.2	12.0	13.0
M1 Nominal (Δ% y/y)		17.9	12.0	14.2	27.3	5.5	11.7
Fiscal Policy Indicators							
Fiscal Balance (% of GDP)		8.8	5.3	-4.0	-1.2	-0.3	0.2
Primary Balance (% of GDP)		9.4	5.8	-3.4	-0.8	0.1	0.5
Government Financing Needs (US\$ bn equiv.) (4)		0.0	0.0	6.2	2.2	0.6	0.0
Gross Total Government Debt (a) (US\$ bn)		6.7	8.8	11.1	14.2	17.6	20.1
Local Currency (US\$ bn)		3.3	5.3	7.8	9.7	12.3	14.3
Foreign Currency (US\$ bn)		3.5	3.5	3.3	4.6	5.3	5.8
Balance of Payments							
Trade Balance (US\$ bn)		23.6	8.8	13.3	14.7	14.8	14.0
Merchandise Exports (US\$ bn)		67.7	66.5	53.0	66.2	71.8	76.0
Merchandise Imports (US\$ bn)		44.0	57.6	39.7	51.5	57.0	62.0
Services and Income Receipts (US\$ bn)		14.0	15.7	14.2	18.7	19.5	20.0
Services and Income Payments (US\$ bn)		33.6	30.9	25.9	36.5	38.5	39.3
Net Transfers (US\$ bn)		3.1	2.9	2.1	3.1	3.0	3.0
Current Account (US\$ bn)		7.2	-3.4	4.5	-0.1	-1.2	-2.3
Current Account (% of GDP)		4.4	-2.0	2.9	-0.1	-0.6	-1.1
Foreign Direct Investment (US\$ bn)		9.6	9.9	5.5	10.2	11.5	12.0
Terms of Trade Index (Δ% y/y) (5)		1.5	-15.0	0.8	26.6	-2.3	-8.0
Copper Price (12-month average, US\$ per lb.)		3.2	3.2	2.3	3.4	3.6	3.3
Debt Profile							
Total External Assets		38.2	50.8	41.2	44.0	45.7	46.8
Fiscal Assets		21.3	27.6	17.1	15.3	16.3	16.8
Central Bank International Reserves (US\$ bn)		16.9	23.2	24.1	28.7	29.4	30.0
Total Internal Govt. and Central Bank Debt (US\$ bn)		20.3	29.5	26.2	33.7	38.7	41.2
Total Internal Govt. and Central Bank Debt (% of GDP)		12.4	17.4	16.6	18.8	21.0	20.5
Total External Debt (US\$ bn)		55.7	64.8	64.4	73.6	79.3	82.5
Short Term (less than 12 months) (US\$ bn)		11.1	14.9	13.8	17.2	18.6	18.8
Long Term (over 12 months) (US\$ bn)		44.6	49.9	50.6	56.5	60.7	63.8
Total External Debt (% of GDP)		34.0	38.3	40.9	41.1	42.9	41.0
Total External Debt (% of Exports)		72.7	83.9	101.7	93.9	93.4	108.6
Debt Service Ratio (6)		31.8	25.7	31.5	33.4	32.0	31.0
Labor Markets							
Wages Index (real Δ% y/y)		2.8	-0.2	4.4	2.6	3.1	1.5
Unemployment (%)		7.0	7.7	9.6	8.2	7.9	7.8
Employment Creation (Δ% y/y)		2.6	3.2	-0.5	7.0	2.0	1.0
Total Payroll (real Δ% y/y)		5.5	3.0	3.9	9.6	5.1	4.5

(1) CPIX is core inflation, excluding fresh food, fuels; (2) CPIX1 also excludes regulated services; (3) Chilean equiv. 10 year treasuries; (4) Dollars and pesos combined; (5) Ratio of Export prices to import prices; (6) (Amort+Interest Ext. Debt)/(Exports goods & services). E Santander estimate. F Santander forecast. Sources: National Institute for Statistics, Central Bank, and Santander.

COLOMBIA

MAKING THE TRANSITION TO INVESTMENT GRADE

POSITIVES

- **Inflation remains subdued and should allow the maintenance of favorable monetary policy in 2011.**
- **External accounts remain positive, bolstered by robust foreign direct investment.**
- **Progress in the debate on structural reforms improves the medium- and long-term fiscal outlook.**

NEGATIVES

- **Economic growth is accelerating but lags growth in most peers in the region.**
- **The fiscal deficit remains high, with effects on market interest rates and the exchange rate.**
- **Unemployment remains high, and labor market conditions weak.**

PROSPECTS

Economic growth – We estimate GDP growth reached 4.5% in 2010, and we expect it to climb to 5.0% in 2011 and 5.5% in 2012. Strong domestic demand and growth in the mining, construction, retail, and financial sectors should be the main drivers of positive results.

Economic activity in the second half of 2010 remained positive, despite evidence of weaker growth in some sectors. We estimate the economy grew close to 4.0% y/y between July and September and 5.4% in the fourth quarter, compared with growth of 4.2% in the first three months of the year and 4.5% in the second quarter. We estimate growth climbed to 4.5% in 2010 from 0.8% in 2009.

Robust retail sales and consumer credit growth show positive economic activity was explained by strong private consumption. Average retail sales growth rose to 15.3% y/y in 3Q10 from 12.1% in the previous quarter and 7.1% in the first three months of the year, and consumer credit growth climbed to 11.5% from 7.3% and 3.5%, respectively, over the same period.

Increasing imports of capital goods and leading indicators in the construction sector show investment also contributed to economic growth. Imports of capital goods jumped 23% y/y in the third quarter compared with 4% in the second quarter and -6% in the first three months of the year. When excluding transport equipment, imports of capital goods grew 33%, mainly driven by equipment for the industrial sector. Cement sales grew 5.3% y/y in the third quarter to the highest level in the previous four quarters, and the total area approved for new building projects jumped 19% to the highest level since 3Q08. These positive results are in line with mortgage loan growth that grew 20.6% on average in the third quarter compared with 19.1% between April and June and 13.8% in the first three months of the year. Strong activity in the housing sector was partially offset by investment in infrastructure projects that fell 17.7% in the third quarter.

Growth in the mining and industrial sectors was also positive but weaker than in previous quarters. Activity in the mining sector was bolstered by average crude oil output that jumped 18.1% y/y to 790,000 barrels per day between July and September and gold output that grew 6.1% to 12.4 million tons in the same period. Positive momentum was partially offset by coal output that contracted 2.4% to 18.0 million tons. Average industrial production growth fell to 2.7% in 3Q10 from 8.0% in the previous quarter and 4.0% in the first three months of the year. Weaker growth was partially explained by the strong exchange rate. According to results from the survey conducted by the national industrial association (ANDI), the number of companies that complained about the exchange rate rose to 18% in the third quarter from 13% between May and June and 11% in the first three months of the year.



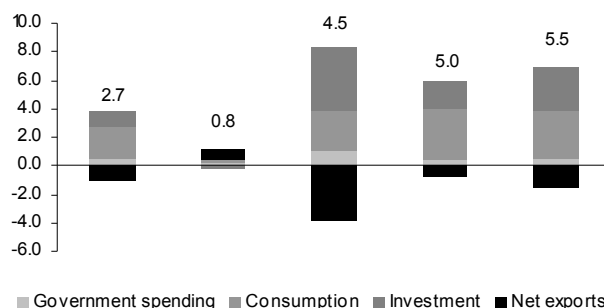
We expect GDP growth to rise to 5.0% in 2011, mainly driven by stronger domestic demand. Private consumption and investment should benefit from high consumer and business confidence, low interest rates, and conditions for credit to continue rising. Our forecast for increased private investment is in line with evidence of rising installed capacity utilization and plans outlined by companies. According to results from the survey conducted by ANDI, the number of companies with plans to invest in the next 12 months rose to 59.4% in September from 56.8% in March and 47.1% one year before.

Growth to be driven by domestic demand and activity in the mining and construction sectors

Annual GDP growth by sectors (%)

	2008	2009	2010E	2011F	2012F
Agriculture	-0.6	-0.4	0.0	2.0	3.0
Oil & Mining	7.0	9.6	13.0	10.0	9.0
Manufacturing	-4.2	-5.9	5.0	5.0	6.0
Construction	3.0	14.6	3.5	6.0	10.0
Retail	2.5	-2.3	5.5	5.5	5.5
Financial	8.5	3.1	4.5	5.0	5.0
Other	3.0	1.0	3.0	4.0	4.0
GDP	2.7	0.8	4.5	5.0	5.5

Annual GDP growth by components (%)



Sources: Dane and Santander.

Domestic demand is also likely to benefit from increased central government investment in strategic sectors and higher decentralized public sector spending prior to the local government elections in October. According to official figures, total central government expenses should increase 10.8% y/y in 2011. The increase would be mainly explained by investment that is officially estimated to climb to COP13.1 trillion (2.2% of GDP) in 2011 from COP10.1 trillion (1.9% of GDP) in 2010, bolstered by higher transfers to the housing, infrastructure, and agricultural sectors. Investment plans announced by public sector companies in the oil and utilities sectors are also likely to contribute to positive growth.

The contribution of the net external sector to growth is likely to remain negative, as strong import growth should more than offset higher exports. We expect import growth to remain high, bolstered by robust domestic demand, the strong exchange rate, and lower import tariffs. Exports should continue benefiting from strong growth in the mining sector. According to official forecasts crude oil output will increase 19% y/y to 950,000 barrels per day by year-end in 2011 and gold and coal output will increase by 6% and 4%, respectively. Non-commodity exports are likely to remain subdued by weak economic growth expected in Colombia's main trading partners (the U.S., Europe, Venezuela, and Ecuador), limited trade with countries in emerging markets that are leading global growth, and the strong exchange rate. Exports to Venezuela have stabilized at one-third of the level in 2008 and should not be a drag in 2011.

Monetary policy and inflation – We expect inflation to climb to 3.1% in 2011 and 3.6% in 2012 from an estimated 2.8% in 2010. Although inflation is likely to remain in line with the official target of 3.0% +/- one percentage point, we expect the central bank to gradually raise interest rates in the second half of 2011 and the first six months of 2012 toward levels consistent with a neutral monetary policy.

We expect year-end inflation to climb to 3.1% in 2011 from an estimated 2.8% in 2010. Higher inflation is in line with our forecast for economic growth to increase and the output gap to turn positive in 2011. Installed capacity utilization has recovered from the sharp drop in 2008 and since June remained above the average of the last decade at levels consistent with recovering economic activity and a narrowing output gap. Our higher inflation forecast is also explained by inflation in 2010 that, although still low, is higher than inflation of 2.0% in 2009 and implies that prices of goods and services that are adjusted in line with inflation in the year before will have a higher increase in 2011 than in 2010. Domestic fuel prices are also likely to continue rising along with international oil prices, and will put pressure on inflation as well.

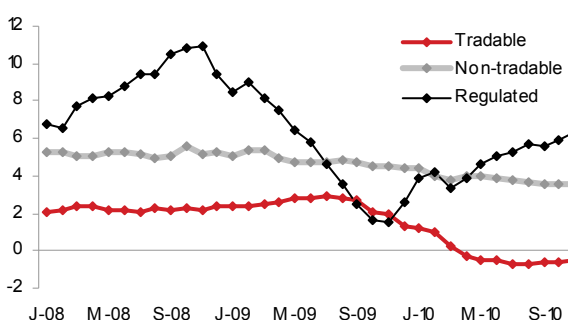
Inflation of tradable goods is likely to remain low in line with the strong exchange rate and lower import tariffs, partially offsetting some of the upward pressure on prices of other goods and services and keeping

inflation in line with the official target. Evidence that pressure on salaries remains subdued despite recovering employment should also help keep inflation under control.

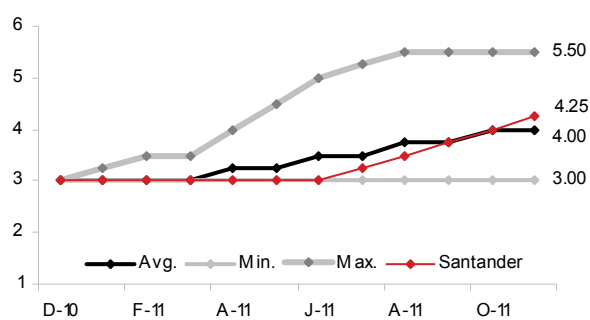
Floods in November due to the stronger than average rainy season have disrupted activity in the agricultural sector and increased the risk of higher food prices and headline inflation in the short term. The impact is difficult to predict given the high volatility of food prices, but it should only be temporary and is likely to be reversed once the rains are over and normal conditions in the agricultural sector are restored. Uncertainty about food prices has increased the inflation risk premium but has not affected inflation expectations, which remain in line with the official target. According to the central bank's survey in December the market consensus expects year-end inflation to climb from 2.8% in 2010 to 3.2% in 2011. The market consensus forecast is in line with the official target of 3.0% +/- one percentage point. The official central bank forecasts show inflation falling to 2.0% by year-end in 2011 and continuing to decline in 2012.

Inflation should remain in line with the official target, with tightening in the second half

Annual inflation excluding food prices (%)



Expected benchmark interest rate, Dec. 2010 - Nov. 2011



Sources: Banco de la República and Santander.

We expect monetary policy to remain unchanged in the short term at current levels, which continue providing stimulus to economic activity. Additional interest rate cuts are unlikely, as current interest rates are already low, the economy is recovering, and inflation is rising. We expect the central bank to keep monetary policy unchanged until the second half of the year, when it would begin withdrawing the current monetary stimulus and raise the benchmark policy interest rate from 3.0% to 4.5% by year-end 2011 and 5.5% in the first half of 2012. Our forecast implies the benchmark interest rate when adjusted by inflation excluding food prices would climb from close to 0.5% in 2010 to 1.5% in 2011 and 2.5% in 2012, and by the end of the tightening cycle it would be close to the real interest rate consistent with a neutral monetary policy.

Expected tightening is in line with the increasing focus of the central bank on the need for prudent macroeconomic policies. Central bank officials have recently emphasized that keeping interest rates too low for too long is not desirable, as this has been proven to result in macroeconomic imbalances and sharp economic downturns.

Fiscal policy – The debate on key economic reforms to improve the medium- and long-term fiscal outlook is moving forward according to schedule and in line with conditions for Colombia to get investment grade in 2011. We expect the fiscal deficit of the consolidated public sector to fall to 3.0% of GDP in 2011 and 2.4% in 2012 from an estimated 3.4% in 2010.

We expect the fiscal deficit of the central government alone to fall to 3.9% of GDP in 2011 and 3.3% in 2012 from an estimated deficit of 4.2% in 2010. The lower deficit is mainly explained by our expectation of higher tax revenues owing to recovering domestic demand, high commodity prices, and tax reforms approved in 2009 and 2010. Higher dividends transferred from Ecopetrol to the government, in line with increasing oil output and high oil prices, also help explain the lower deficit. Including local governments and other public sector institutions, we expect the fiscal deficit of the consolidated public sector to fall to 3.0% in 2011 and 2.4% in 2012 from an estimated 3.4% of GDP in 2010.

Our deficit forecast is smaller than the official target for the deficit of the consolidated public sector to fall to 3.6% of GDP in 2010 and 3.2% in 2011. The difference is mainly explained by economic growth and oil price



assumptions. The official fiscal deficit forecast assumes GDP growth would be close to 4.5% compared with our forecast of 5.0%, and an average oil price of US\$83 per barrel for the WTI against our forecast of US\$87 in 2011. The government expects the fiscal deficit of the consolidated public sector to fall to 1.4% in 2012, mainly as a result of the fiscal impact of the reform to royalties and other reforms that we have not yet incorporated into our forecast.

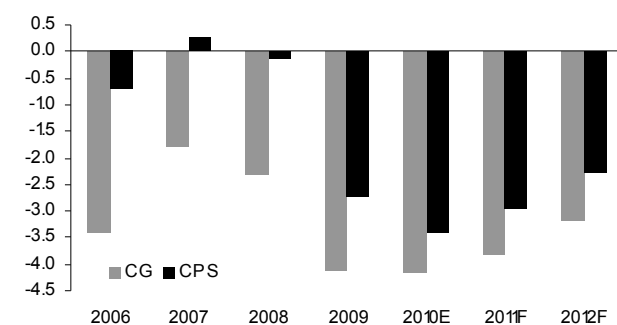
We estimate government financing needs would be close to COP38.8 trillion in 2011, explained by a deficit of COP23.2 trillion, domestic debt amortization for COP13.5 trillion, and external debt amortization for US\$1.2 billion. Financing needs compare with those in 2010 for close to COP40.3 trillion. The government has already announced a gross domestic bond (TES) issuance target of COP28 trillion and plans to raise US\$2.2 billion in external capital markets and US\$1.5 billion from official external creditors in 2011. We expect most of the additional financing required of COP3.8 trillion to come from cash in dollars that the government kept abroad in 2010 for close to US\$1.5 billion and cash in local currency and short-term financing that the government can raise with suppliers and other public sector institutions.

The target for domestic bond issuance is only COP500 billion higher than the COP27.5 trillion issued in 2010 and should be completed without problems. External financing from bond issuance, multilateral loans and cash add to US\$5.2 billion and compare with obligations in dollars for US\$3.7 billion from external debt service (interest payments for US\$2.5 billion and amortizations for US\$1.2 billion). The difference of US\$1.5 billion implies that the government would continue selling dollars and putting strengthening pressure on the exchange rate in 2011. The potential amount of dollars that the government could sell is similar to the amount we estimate it sold in 2010.

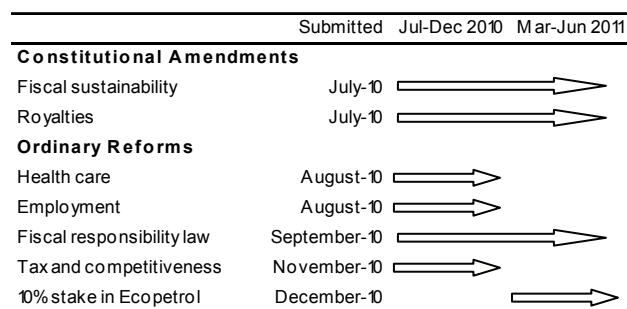
External bond issuance is likely to include new dollar denominated bonds as well as new global bonds denominated in local currency (global TES). Government officials have also mentioned the possibility of raising financing in Asia and other markets, depending on market conditions. We also expect the government to consider doing domestic and external debt liability management operations early in 2011 given that most of the maturing debt in 2011 is concentrated in the second quarter.

Progress on the debate of the reforms improves the fiscal outlook

Fiscal balance (% of GDP)



Main economic reforms



Sources: MHCP and Santander.

With information available up to the third week of December the debate of key economic reforms to improve the medium- and long-term fiscal outlook was moving forward according to schedule. The reforms have changed during the debate in Congress but kept most of their expected fiscal impact.

The constitutional amendment to change the distribution of royalties was approved in four debates and needs to be approved in four more in the next legislative period between March and June 2011. The reform seeks (1) to save part of the revenue for countercyclical fiscal policy in local governments and reduce the impact from the potential windfall on the exchange rate and the economy and (2) improve the distribution and use of the revenue to reduce the disparities between regions and increase the productivity and growth potential of the economy. According to the reform approved in the first four debates, royalties would be distributed 10% to continue building up reserves for pensions of regional government employees, 10% for investment in research and development, and the rest between local governments and a savings and stabilization fund that would accumulate resources when royalties are above their trend and use savings when royalties are below that trend.

According to official forecasts the reform could have a positive fiscal impact in the consolidated public sector balance between 0.4% and 0.5% of GDP starting in 2012.

The constitutional amendment to include fiscal responsibility as a constitutional right was approved in four debates and needs to be approved in four more in the next legislative period. The government expects that if the bill is approved it would force the Constitutional Court and the judiciary to take into account the impact of their decisions on fiscal sustainability. The approval of the reform would not have any direct or immediate fiscal impact but could reduce the risk of court decisions continuing to pressure public sector expenses and the fiscal balance.

The reform to increase tax revenues and the competitiveness of the economy was approved. The reform (1) eliminates loopholes in the financial transactions tax and gradually reduces the tax rate from 0.4% to 0% between 2014 and 2018, (2) lowers the average import tariff from 12% to 8%, (3) reduces the surcharge on the electricity tariff to the industrial sector from 20% to 10% in 2011 and 0% in 2012, (4) eliminates the exemption of 30% of investment in fixed income assets from the income tax starting in 2011, and (5) makes other adjustments to increase tax collection. The reform does not have any significant fiscal impact in 2011, as the various changes practically offset each other, but it could have a positive fiscal impact of close to 0.8% of GDP in 2012, when the elimination of the exemption of 30% of investment in fixed income assets from the income tax would be reflected.

The bill proposing a fiscal responsibility law was submitted to Congress in September, and has been approved in one debate. The reform needs to be approved in a total of four debates before the end of the next legislative period in order to have an impact on the budget for 2012. According to the bill, (1) the central government would be obliged to maintain a fiscal deficit of no more than 2.0% of GDP after adjusting revenues by the output gap and extraordinary revenues from the oil and mining sector, (2) the law would be effective beginning in 2012, but the government would have until 2015 to gradually adjust the fiscal deficit, and (3) savings from the fiscal responsibility law would go into a fiscal and macroeconomic stabilization fund to be used for countercyclical fiscal policy and to reduce the central government's debt. According to government forecasts the fiscal responsibility law could have a positive fiscal impact of close to 0.9% of GDP starting in 2012.

Other important economic reforms include (1) a health care reform to establish the obligations of the public health care system and the cost and financing sources to meet these obligations was approved, (2) a reform to give tax incentives and other benefits to companies that hire new employees and to employees that move from the informal to the formal labor market was approved, and (3) a reform to allow the government to sell 10% of its stake in Ecopetrol and use the proceeds to finance government investment in new infrastructure projects, submitted in December is expected to be debated starting in February, requiring approval in four debates.

Progress in the debate of the reforms is a necessary condition for Colombia to get investment grade. Colombia's foreign currency issuer rating is BB+ by Standard & Poor's and Ba1 by Moody's, one notch below investment grade. We expect the government of President Santos to continue using its majorities in the Senate and the Lower House to get the reforms approved on time and with as few changes as possible, so that the reforms can have the expected fiscal impact, clearing the way to investment grade in 2011. Getting investment grade would not significantly reduce the government's financing costs, as yields are already in line with those of other investment-grade countries in the region. However, it would broaden the investor base and have a significant positive impact on the private sector. Investment grade would increase access to external capital markets under more favorable conditions for the private sector and reduce provisions and other costs that most foreign companies that invest in Colombia are required to do.

Trade balance and current account – We expect external accounts to remain positive and the exchange rate under strengthening pressure, as net capital inflows from foreign direct investment and public sector financing should be more than enough to offset the current account deficit.

Export revenues in the first ten months of 2010 grew 21% y/y to US\$32.5 billion. The sharp increase was mainly explained by oil exports that jumped 67.6% to US\$13.3 billion, boosted by prices that rose 30.3% and volumes up 28.5%. Gold and coal exports that grew 39.7% to US\$1.7 billion and 11.9% to US\$5.1 billion, also benefiting from higher prices and exported volumes. We estimate total export revenues reached US\$41.8 billion in 2010, and we expect them to rise to US\$50.5 billion in 2011. Our forecast is in line with average oil exports increasing 19% y/y to 700,000 barrels per day in 2011 and prices reaching US\$87 per barrel for the



WTI. Our forecast also implies coal and gold export revenues would increase 26% and 16%, supported by higher exported volumes and prices. Exports excluding commodities are likely to remain subdued by the strong exchange rate and weak economic growth in developed economies and in Venezuela and Ecuador, which buy most of the non-commodity exports.

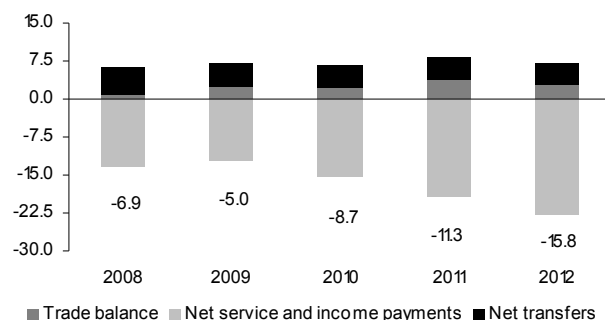
Imports in the first nine months of the year grew 21% y/y to US\$27.6 billion, driven by higher imports of consumer goods and intermediate goods for the industrial sector. We estimate total imports reached US\$39.4 billion in 2010 and could increase to US\$46.7 billion in 2011, bolstered by the strong exchange rate, recovering domestic demand, and lower import tariffs. Despite higher imports we expect the trade surplus to climb to US\$3.8 billion in 2011 from an estimated US\$2.4 billion in 2010. Increasing exported volumes of commodities and favorable terms of trade due to high commodity prices and low inflation in developed economies explain our positive forecast.

We expect the current account deficit to increase to US\$11.3 billion (3.5% of GDP) in 2011 and US\$15.8 billion (4.7% of GDP) in 2012 from an estimated deficit of US\$8.7 billion (3.0% of GDP) in 2010, as increasing net service and income payments are likely to more than offset the positive trade results. Since most of the main players in the oil and mining sectors are foreign companies, profits and dividends transferred by these to their headquarters abroad should increase in line with growing commodity exports and push income payments up. Dividends and profits transferred by companies in other sectors should also increase, in line with recovering economic growth and the strong exchange rate. Remittances from employees working abroad fell 4% y/y to US\$3.2 billion in the first ten months of 2010, dragged down by high unemployment in Spain and the U.S., which account for 70% of total remittances. The weaker euro also helps explain the decline in 2010. Expectations for unemployment in the U.S and Spain to remain high but stable imply that remittances could remain subdued but should not continue falling in 2011.

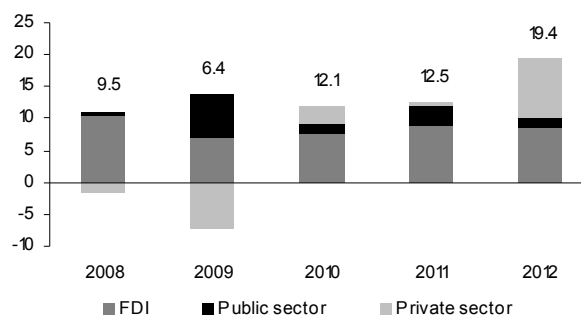
Foreign direct investment in Colombia remains strong, attracted by the positive outlook of the mining sector and the economy and the favorable regulatory environment. We estimate foreign direct investment in Colombia reached US\$7.6 billion in 2010, US\$8.6 billion when adjusted for capital outflows from the stake that BP sold to Ecopetrol in its oil operations in Colombia. We expect foreign direct investment to climb to US\$8.8 billion in 2011, enough to cover close to 80% of the current account deficit. Net external financing to be raised by the central government for US\$2.5 billion and short-term capital inflows from savings kept abroad for an estimated US\$1.5 billion in 2010 that could be used for financing in 2011 would be another important source of capital inflows and, together with foreign direct investment, should be more than enough to cover the current account deficit in 2011.

Peso appreciation is mainly explained by strong capital inflows

Current account (US\$ billion)



Capital account (US\$ billion)



Sources: Banco de la Republica and Santander.

According to central bank officials, the monetary authority will continue buying dollars for at least US\$20 million per day at least until mid-March 2011. This intervention implies that the central bank will buy at least US\$1.0 billion in the first three months of the year. Additional intervention seems likely, as we expect the exchange rate to remain under strengthening pressure, but as in the past it would probably be used to moderate the speed and volatility of the strengthening trend, not to prevent the exchange rate from appreciating. Intervention would be limited to the ability of the central bank to drain the liquidity injected when buying

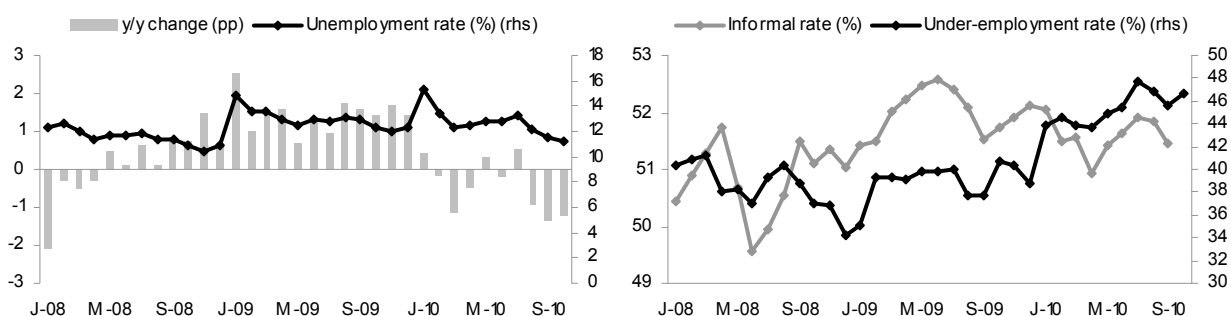
dollars. Currently the central bank has COP1.2 trillion (US\$630 million) of domestic government bonds in its portfolio that it could sell to drain liquidity. The central bank could start issuing its own debt or use other instruments to drain the liquidity if necessary. Low inflation should also give the central bank more room to intervene.

We expect the exchange rate to be under strengthening pressure from strong capital inflows and positive trade results and the exchange rate to move from an estimated COP1,850/USD by year-end 2010 to below COP1,800/USD in the first six months of the year, when we believe capital inflows from external financing to the public sector could be higher. A potential adjustment in the sovereign rating that we believe is likely in the first half of the year could also put additional strengthening pressure on the exchange rate. However, we believe the exchange rate could partially reverse the trend and fall to COP1,875/USD by year-end 2011. This would be in line with an increasing current account deficit. It would also fit with reduced expectations for capital inflows from external financing to the public sector late in 2011 and in 2012. Financing needs are likely to fall in 2012 because of increased government revenue growth and the lower fiscal deficit expected as a result of economic reforms. Reforms are also expected to keep part of the commodity windfall abroad starting in 2012, and this should reduce strengthening pressure on the exchange rate.

Employment and labor market trends – Employment is increasing in line with recovering economic activity, and as a result we expect the unemployment rate to fall from an estimated 11.5% by year-end 2010 to 10.1% in 2011 and 9.1% in 2012. Labor market conditions are also likely to improve but at a slower rate given the still high unemployment rate and high level of informality.

The unemployment rate in Colombia’s main 13 cities fell to 11.1% in October from 12.4% one year before. Monthly figures released since the beginning of the year show that the unemployment rate peaked in 2009 and fell steadily in 2010. The decline is explained by increasing employment that has been enough to absorb new labor supply and is in line with evidence of recovering economic growth. Average employed population in the first ten months of the year grew 4.2% y/y to 9.2 million fueled by increasing self-employment and private jobs added in the retail and services sectors. Average jobs in the industrial sector in the first ten months of the year fell 44,000 to 1.56 million. Jobs added have been enough to absorb new labor supply and bring the unemployment rate down but not to reduce the unemployed population, which was practically unchanged at 1.34 million on average in the first ten months of the year.

Unemployment in the main cities seems to have peaked, but labor market conditions remain weak



Sources: Dane and Santander.

Despite the lower unemployment rate, conditions in the labor market remain weak, as according to official figures about 50% of the jobs added in the year to October were in the informal sector. Poor labor conditions are also evident from official figures, according to which only 42% of employees get social security benefits, or the increase in the number of employees that feel they are overqualified, not working enough time, or earning less than they should from an average 39% between January and October 2009 to 45% in 2010.

We expect the current legal minimum salary of COP515,000 (US\$280) per month to be increased between 3% and 4% in 2011. The increase is negotiated between labor unions, the private sector, and the government and set by decree if there is no consensus. According to current regulations the minimum salary must be adjusted by at least inflation in the year before. However, pressure on wage costs from the increase in the minimum salary should remain subdued, as the increase in the minimum salary applies only to those earning the



minimum salary, and only in the formal market. Many in the informal market work for a salary below the minimum wage, and unemployment is still high. Employees who earn more than the minimum salary or in the informal market could see a smaller increase. Despite the decline in 2010 and the decline expected in 2011 and 2012, the unemployment rate would remain above the 9% level considered consistent with labor market conditions that do not put pressure on wages or inflation.

Politics – President Santos maintains strong popular and political support that should allow additional progress in the debate on reforms in Congress. Tension between the executive and the judicial powers has eased and bilateral relations with Venezuela and Ecuador have been restored. Local government elections in October 2011 will be a key opportunity for President Santos to start building a broader political agenda independent of former President Uribe and start thinking about reelection in 2014.

According to results from the latest survey conducted by the Centro Nacional de Consultoria, in November President Santos has an approval rating of 89%. This compares with the 64% approval rating at the beginning of his mandate in August and is the highest of any president in the recent history of Colombia. During the eight years that President Alvaro Uribe was in power his favorable rating fluctuated between 63% and 85%.

President Santos has consolidated the government coalition that controls between 70% and 80% of the vote in the Senate and the Lower House. Broad political support has not prevented some changes to the reforms submitted by the government but has allowed their approval. Political opposition remains limited to the left-wing Polo Democratico that continues losing strength, dragged down by the poor results of the current mayor of Bogotá, Samuel Moreno, and the decision by Gustavo Petro, the Polo Democratico candidate in the presidential election in 2010, to abandon the party.

Relations between the executive and the judicial powers have been restored. The situation had significantly deteriorated during the last year of the government of President Uribe, amid the debate over the referendum for a potential reelection of President Uribe for a third term and the delayed appointment of the attorney general and other key positions in the judiciary.

Contrary to expectations, President Santos has rapidly restored bilateral relations with Venezuela and Ecuador. Exports to Ecuador have recovered but those to Venezuela remain subdued due to negative GDP growth in Venezuela, skepticism about the sustainability of the improved bilateral scenario, and unwillingness among companies in Colombia to increase their exposure to the volatile environment in Venezuela. Improved bilateral relations are also expected to help the government move forward in the war against terrorism and drug trafficking and consolidate security on the border with both countries.

Elections to appoint the governors, mayors, and deputies of the regional governments will be held in October 2011. Elected officials will take office in January 2012. In the election President Santos will have an opportunity to consolidate the government coalition and start building a broader political agenda of his own to pursue a second term in the presidential election in 2014.

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Colombia – Economic projections, 2007-2012F

	% GDP	2007	2008	2009	2010E	2011F	2012F
National Accounts							
Real GDP ($\Delta\%$ y/y)		6.9	2.7	0.8	4.5	5.0	5.5
Consumption ($\Delta\%$ y/y)	66.1	7.3	3.0	1.1	4.3	5.2	5.1
Investment ($\Delta\%$ y/y)	23.2	12.1	4.2	(2.7)	21.1	9.1	11.6
Private ($\Delta\%$ y/y)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Public ($\Delta\%$ y/y)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Government Spending ($\Delta\%$ y/y)	16.0	6.0	2.6	2.8	6.7	2.8	3.0
Exports ($\Delta\%$ y/y Local Currency)	17.1	6.9	6.1	(2.8)	1.8	12.6	13.0
Imports ($\Delta\%$ y/y Local Currency)	21.8	14.0	8.8	(7.9)	19.4	11.9	14.6
GDP (US\$ bn)		207.9	245.2	235.2	287.4	320.4	336.8
GDP Per Capita (US\$)		4,844	5,647	5,352	6,464	7,124	7,400
Industrial Production ($\Delta\%$ y/y)		10.8	-2.9	-6.2	7.2	9.4	7.2
Population (mn)		42.9	43.4	43.9	44.5	45.0	45.5
Monetary and Fiscal Policy Indicators							
CPI Inflation (Dec Cumulative)		5.7	7.7	2.0	2.8	3.1	3.6
WPI Inflation (Dec Cumulative)		1.3	9.0	(2.2)	2.1	2.6	4.2
US\$ Exchange Rate (Year-End)		2,002	2,244	2,046	1,850	1,875	1,950
US\$ Exchange Rate (Avg)		2,078	1,968	2,160	1,888	1,850	1,919
Reference Interest Rate (Overnight REPO Rate) (Year-End)		9.5	9.5	3.5	3.0	4.5	5.5
Reference Interest Rate (Overnight REPO Rate) (Avg)		8.7	9.8	5.7	3.2	3.4	5.3
M1 (US\$ bn)		22.6	21.9	25.8	32.8	35.6	37.6
M1 ($\Delta\%$ y/y)		24.9	(3.4)	17.9	27.2	8.5	5.8
Fiscal Policy Indicators							
Fiscal Balance, % of GDP		0.3	(0.1)	(2.7)	(3.4)	(3.0)	(2.3)
Primary Balance, % of GDP		4.0	3.1	0.3	(0.5)	(0.1)	0.7
Total Government Financing Needs (US\$ bn) (a)		14.1	16.0	20.6	18.3	18.9	19.1
Gross Total Government Debt (US\$ bn)		94.1	91.3	112.9	124.7	133.6	139.2
Local Currency (US\$ bn)		69.0	65.3	80.4	91.2	98.2	102.4
Foreign Currency (US\$ bn)		25.1	26.0	32.4	33.4	35.4	36.8
Balance of Payments							
Trade Balance (US\$ bn)		(0.6)	1.0	2.5	2.4	3.8	2.8
Merchandise Exports (US\$ bn)		30.6	38.5	34.0	41.8	50.5	59.1
Merchandise Imports (US\$ bn)		31.2	37.6	31.5	39.4	46.7	56.4
Services and Income Receipts (US\$ bn)		5.5	5.9	5.4	5.3	5.2	6.2
Services and income Payments (US\$ bn)		16.1	19.3	17.6	20.7	24.5	29.1
Transfers (US\$ bn)		5.2	5.5	4.6	4.3	4.3	4.3
Current Account (US\$ bn)		(6.0)	(6.9)	(5.0)	(8.7)	(11.3)	(15.8)
Current Account (% of GDP)		(2.9)	(2.8)	(2.1)	(3.0)	(3.5)	(4.7)
Foreign Direct Investment (US\$ bn)		9.0	10.6	7.2	7.6	8.8	8.5
Debt Profile							
International Reserves (US\$ bn)		21.0	24.0	25.4	28.5	29.7	33.3
Total Internal Govt. and Central Bank Debt (US\$ bn)		66.2	62.8	77.7	89.9	83.1	88.2
Short Term (less than 12 months) (US\$ bn)		2.3	2.0	1.9	2.7	2.7	2.6
Long Term (12 months or more) (US\$ bn)		63.9	60.8	75.9	87.2	80.4	85.6
Total Internal Govt. and Central Bank Debt (% of GDP)		31.8	25.6	33.1	31.3	25.9	26.2
Total External Debt (US\$ bn)		44.6	46.4	53.7	63.2	66.3	69.5
Short Term (less than 12 months) (US\$ bn)		5.1	5.6	4.1	6.8	7.2	8.3
Long Term (over 12 months) (US\$ bn)		39.4	40.8	49.6	56.4	59.1	61.2
Total External Debt (% of GDP)		21.4	18.9	22.8	22.0	20.7	20.6
Total External Debt (% of Exports)		130.2	108.7	140.6	137.4	121.2	109.8
Debt Service Ratio (b)		25.8	19.9	23.2	19.6	18.3	18.4
Labor Markets							
Unit Wages (real $\Delta\%$ y/y)		1.5	0.7	0.0	1.5	1.5	1.5
Unemployment (%)		10.2	10.9	12.3	11.5	10.1	9.1
Total Payroll (real $\Delta\%$ y/y)		6.2	1.4	(5.4)	7.3	5.0	5.0

a (Amort + Fiscal Deficit). b (Amort + Interest Ext Debt)/(Exports Goods & Services). E Santander estimate. F Santander forecast. Sources: Economic Ministry, Central Bank, and Santander.



MEXICO

GROWTH NOW DEPENDS ON THE DOMESTIC SECTOR

POSITIVES

- **Healthy growth continues, and we expect GDP to expand 3.5% y/y in 2011, after 5.1% growth estimated in 2010, supported by a gradual recovery of domestic demand.**
- **We expect limited pressure on the peso from external accounts, with a current account deficit lower than 1% of GDP in 2011.**
- **We estimate that inflation closed 2010 at 4.3%, and should further decline to 3.9% in 2011, aided by a strong and stable Mexican peso (MXN), reduced inflation pressures abroad, and stable wages and salaries.**
- **Macroeconomic fundamentals are solid, and we estimate a fiscal deficit equivalent to 2.5% of GDP and inflation below 4.0% y/y in 2011, somewhat better than in 2010.**

NEGATIVES

- **Moderate growth in the U.S. economy could result in less growth of manufacturing exports.**
- **The financial markets are highly sensitive to external volatility, which could affect investment flows.**
- **No major structural reforms are expected in 2011.**

PROSPECTS

Economic growth – We are expecting an economic expansion of 3.5% y/y in 2011, a rate similar to that seen before the financial crisis. Now we are looking for gradual strengthening of the domestic market supported by employment recovery and less pressure from inflation.

The recovery of the Mexican economy in 2010 was mainly driven by the manufacturing sector, which is highly linked to U.S. industrial activity. We estimate that manufacturing production grew 9.3% y/y in 2010 after a significant drop of 9.8% y/y in 2009. Manufacturing exports expanded strongly in 2010 (we estimate it grew 22.8% y/y), boosted by the recovery of the auto industry.

However, recent figures on manufacturing production and exports suggest that the growth will moderate in coming quarters in line with U.S. economic prospects, and will depend on a recovery in consumer spending in the external markets. We expect manufacturing production to grow 3.8% y/y in 2011, while manufacturing exports should expand 9.2% y/y. Note that there will be a high annual basis of comparison against 2010. We expect exports to continue contributing to economic expansion, but at a more moderate rate than in previous quarters.

On the domestic side, we believe that the main driver in 2011 will be employment, which registered good figures in 2010. We estimate that permanent jobs registered in the social security system grew 5.3% y/y at the end of the 2010, but in 2011 we could see additional growth of 4.7% y/y at the end of the year. With salaries growing in a range of 4.5-5.0% y/y in 2011 and inflation in a range of 3.5-4.0% y/y, we expect a continued expansion in total payroll of around 6.0% y/y in real terms.

Moreover, we expect a recovery in banking credit, mainly in consumption credit, with non-performing loans at low levels after the pickup in 2009 and the first months of 2010. Also, mortgages and corporate credit maintain a gradual growth, and we expect strength in 2011. We project a banking credit recovery of around 10% y/y in real terms in 2011.

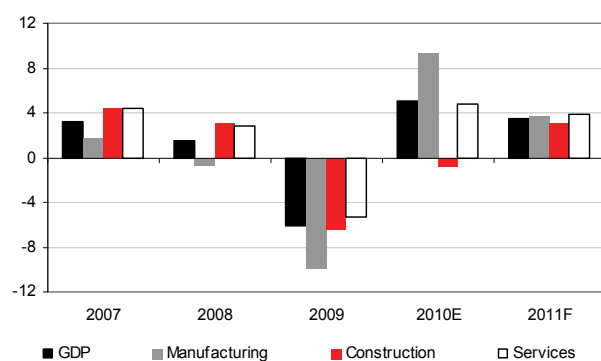
Meanwhile, construction activity registered the first signals of recovery at the end of 2010, mainly due to infrastructure spending. However housing and private investment remain weak. We believe that infrastructure activity will show better performance in 2011 boosted by government spending, part of it reconstruction programs in states that were affected by natural disasters.

Banking credit to the housing sector is growing, and government programs such as housing programs might boost employment growth in construction. We believe that construction activity will pick up 3.0% y/y in 2011 from a stagnant -0.8% y/y in 2010.

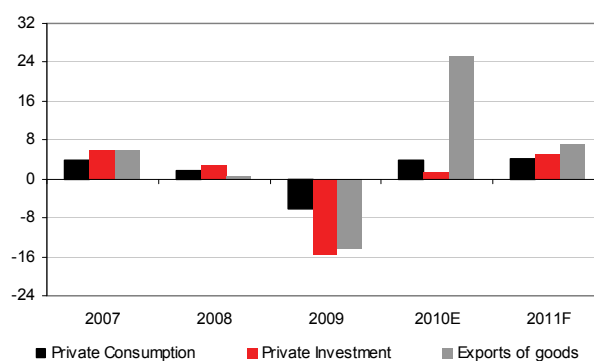
In the service sector we expect better results in tourism, financial activities, professional and personal services, as well as in commerce, transport, and communications services. Better expectations for consumption spending supported by employment recovery and the gradual expansion of banking credit should result in strength in the services sector.

Domestic demand will be a key driver of GDP growth in 2011

GDP growth by sectors (%)



GDP growth by spending (%)



Sources: INEGI and Santander.

Monetary policy and inflation – We estimate that inflation finished 2010 at 4.3% y/y and will fall to a range of 3.5-3.9% y/y in 2011. We expect the central bank to remain on hold in 2011, tracking the monetary policy of the U.S. Federal Reserve amid global liquidity. Also, Banxico has noted its concern about scenarios of external financial volatility that could result in a quick reversal of foreign investment flows.

Inflation came down at the end of 2010 from a pickup in the early months of the year, due to exchange rate appreciation, a modest recovery in domestic spending, and lower pressure from external inflation, mainly from the U.S. (core rate). We estimate inflation of 4.3% at the end of 2010, down from 5.0% at the end of 1Q10.

For 2011 we expect inflation to fall below 4.0% y/y at the end of the year, probably in a range of 3.5-3.9% y/y, supported by stability in salaries and exchange rate, and only marginal pressures from taxes on tobacco and energy drinks approved by Congress.

In 2011 the government will continue a price adjustment mechanism for the price of gasoline using a constant peg, which in 2010 added 6-8 cents (MXN) to the pump price every month. The Ministry of Finance has mentioned that the higher oil prices in the external market (also gasoline prices), will require a monthly increase in domestic prices. In fact, we forecast that this is one of the main risks for inflation in 2011 and will produce a divergence of inflation (3.9% y/y) from the central bank's 3.0% y/y by the end of 2011.

There is also an inflation risk from possible increases in electricity and gas tariffs, we believe, in 2011. We are now assuming an increase of 6.0% y/y in energy prices, similar to the 6.3% y/y in 2010E.

Core inflation is likely to have finished 2010 around 3.7% y/y, down from 4.5% y/y in 2009, due to exchange rate appreciation along with diminished pressure on the international prices of grains, particularly in the first



half of the year. We estimate that the inflation in processed foods ended 2010 at 3.8% y/y, down from 5.6% y/y in the preceding year.

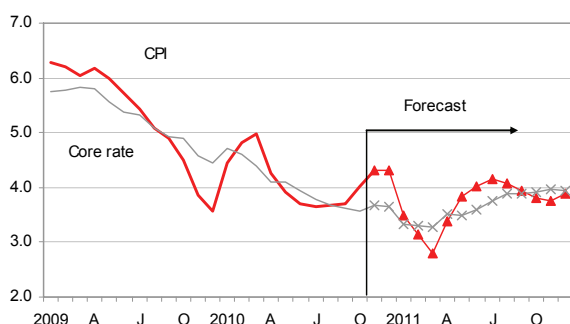
Recent pressures in some prices of soft commodities, possibly related to the strong demand from emerging economies, could result in slight increase in the internal prices of processed foods and in core inflation in 2011.

Moreover, we are looking for a soft recovery in the price of services with gradual strengthening of domestic demand, particularly consumption spending. The service sector, including housing, restaurants and hotels, tourism, and educational services, registered impacts in 2009 and 2010 from weakness in employment, consumer spending, and credit contraction. We believe that in 2011 the continuity of economic recovery should result in a soft growth of the services prices.

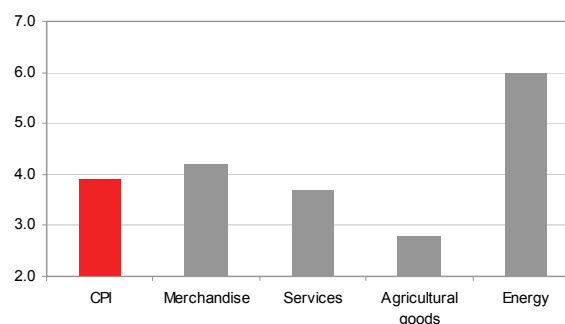
We estimated that the core rate will finish 2011 at 3.9% y/y, which includes a pickup in processed foods of 4.5% y/y, and 3.7% y/y in services prices. MXN stability *per se* expected in 2011 could partially offset these pressures, mainly from more stable prices of non-food merchandise.

We expect CPI to finish 2011 below 4.0% y/y

Inflation forecast (y/y % .)



CPI by components in 2011 (y/y %.)



Sources: Banxico, Bloomberg, and Santander.

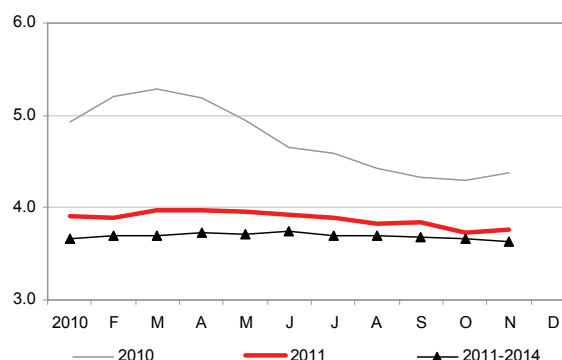
With regard to monetary policy, Banxico will have to watch the behavior of some commodity prices in the external markets, including soft commodities and energy prices, but given exchange rate stability, no important pressures in salaries, and well anchored inflation expectations, we believe that the authority will wait for some change in global monetary conditions and, barring this, will remain on hold in 2011. Currently the market consensus for CPI in 2011 is in a range of 3.5% y/y and 4.0% y/y, while Banxico projects that it will be reaching the target of 3.0% by the end of the year.

Inflation expectations remain well anchored

Banxico's base case inflation forecasts (Quarterly average of the y/y % chg)

Quarter	Banxico's estimate
2010-IV	4.25-4.75
2011-I	3.75-4.25
2011-II	3.00-4.00
2011-III	3.0 (+/- 1 p)
2011-IV	3.0 (+/- 1 p)

Private sector expectations (y/y % chg)*



*Banxico's Survey of Expectations. Sources: Banxico, Bloomberg, and Santander.

Fiscal policy – Congress approved a fiscal deficit equivalent to 2.5% of GDP for 2011, with no major changes in taxes. The government expects that increased domestic demand and employment recovery will boost tax collection in 2011.

Congress approved a budget for 2011 with no relevant changes in taxes, with expectations that economic growth projected at 3.9% y/y and oil revenues will strengthen government revenues. Congress approved a plan that is expected to raise additional revenues (above the Ministry of Finance proposal) estimated at MXN60.5 billion, including: (1) MXN12 billion from an increase in the estimated oil price to US\$65.40 per barrel from US\$63 per barrel in the government plan; (2) additional fiscal revenues of MXN10 billion from economic growth in 2011 estimated at 3.9% rather than the government’s 3.8% figure; (3) a higher fiscal deficit at 0.5% of GDP (excluding Pemex investment, which represents 2.0% of GDP), not the 0.3% of GDP set by the Finance Ministry, for an additional MXN28 billion; and finally (4) a special tax on tobacco and energy drinks that could bring in around MXN12 billion. Total revenues approved amounted to MXN3.4 trillion (including a fiscal deficit of MXN0.4 trillion or 2.5% of GDP).

On the spending side the budget amounted to MXN3.4 trillion, an increase of 4.1% y/y (real terms) compared with the budget for 2010. Without Pemex investment the budget for 2011 is MXN3.2 trillion, also 4.1% y/y higher than planned for 2010. Social development spending is 2.6% y/y higher in real terms, national security programs will grow 8.2% y/y, and tourism programs will rise 17.2% y/y, all compared with the budget approved for 2010.

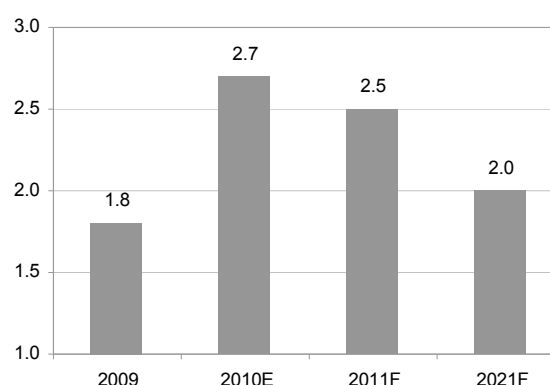
According to the Ministry of Finance, budgeted investment will grow 6.5% y/y in real terms from the investment planned in 2010, while investment assistance from the government will rise 6.4% y/y from the 2010 budget. Meanwhile, the resources for states amount to MXN493.7 billion, which represents an increase of 7.5% y/y in real terms from the original 2010 level.

Mexican government’s macroeconomic outlook for 2011

Economic policy criteria for 2010

Variable	2010	2011
GDP (y/y real growth)	4.8	3.9
Inflation (y/y % chg)	5.0	3.0
Exchange rate (MXN/USD)	12.6	12.9
28-day Cetes (end of year %)	4.5	5.5
Fiscal Balance (% of GDP)	-2.7	-2.5
Oil price (average US\$ per barrel)	65.0	65.4

Fiscal deficit (% of GDP)



Sources: Ministry of Finance and Santander.

In 2010 there was no room for fiscal reform, and the budget approved by Congress for 2011 is mainly supported by assumptions on economic growth, oil prices, and debt from the fiscal deficit. Moreover, for 2011 we do not see major political efforts to achieve a structural reform in this area.

Trade balance and current account – We expect a moderate widening of the current account deficit on the back of the gradual strengthening of domestic demand. However we expect a current account deficit below 1% of GDP, fully financed by foreign direct investment.

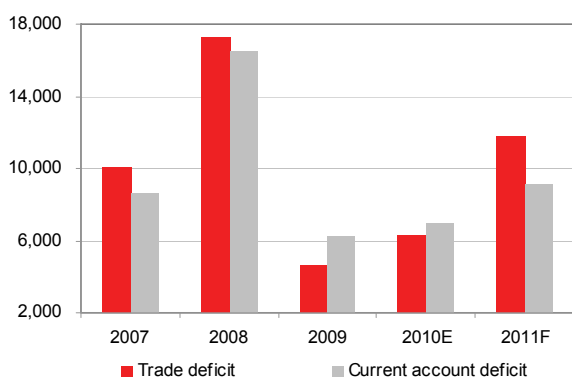
We expect the recovery of trade volumes to continue in 2011, and this will probably result in a moderate widening of the trade deficit as well as the non-factorial accounts. The 2011 trade deficit should reach US\$11.8 billion, against a deficit of US\$6.3 billion estimated for 2010.



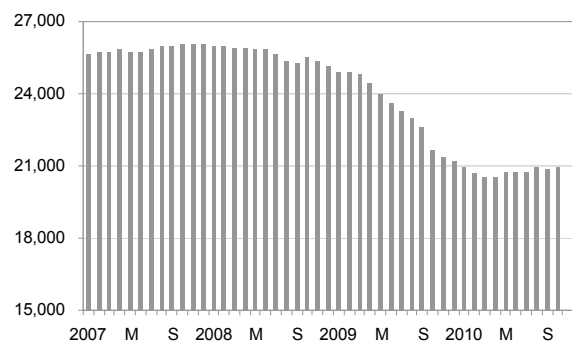
The flow of remittances should grow around 10% y/y, which represents revenue of US\$23.6 billion, up from US\$21.5 billion estimated for 2010 based on better prospects for employment in the U.S. This should partially offset the expected deficit in factorial and non-factorial accounts, which should result in a current account deficit of US\$9.1 billion in 2011 (0.8% of GDP), up from a deficit of US\$6.9 billion estimated for 2010 (0.7% of GDP).

Current account deficit could widen in 2011 as domestic demand improves

Trade deficit and current account deficit (US\$ million)



Flow of remittances (US\$ million in the past 12 months)



Sources: Banxico and Santander.

One of the main issues for 2011 will be the performance of manufacturing and its impact on economic activity. Obviously, a better than expected performance in the U.S. economy (we are assuming a GDP growth of 2.5% y/y in 2011) could result in a larger expansion in manufacturing exports. We estimate that manufacturing exports increased 28% y/y in 2010 after a significant drop of 18% y/y in 2009. For 2011 we estimate an expansion of 9.0% y/y, supported by expectations of a gradual recovery in employment and consumption in the U.S.

However, the volume of oil exports in 2010 was higher than expected. While the government projected an oil exports volume averaging 1.1 million barrels per day, Pemex reported that from January to October it was 1.32 million barrels per day (20% more than estimated). This is despite the fact that total crude oil production remained at 2.6 million barrels per day in 2010, similar to the level registered in 2009. For 2011 the government expects export volume to average 1.13 million barrel per day, but we believe that it could also be higher, as in 2010.

External financing – We expect foreign inflows will continue to recover in 2011, particularly foreign direct investment. The main risk is that the high volatility in the financial markets could induce a reversal in the financial inflows that were very important in 2010.

We expect the recovery of external flows to continue, boosted by the global liquidity, improvement in global economic activity, particularly in the U.S., and in risk appetite for emerging markets. But there are some important financial volatility scenarios, probably most related to fiscal and sovereign issues in Europe.

We assume that the authorities in the U.S. will continue their efforts to boost the economic activity through monetary and fiscal expansion. The U.S. Federal Reserve purchasing program (QE2) continues in the first half of 2011, and we also assume that other major foreign central banks maintain their current stance with low interest rate levels.

In this scenario we expect that there will be widely available financing for the Mexican current account deficit in the balance of payments. Foreign direct investment (FDI) could improve to around US\$21.0 billion in 2011 from around US\$18.0 billion estimated for 2010. These figures represent more than twice the level of the projected current account deficit. FDI in Mexico will likely be supported by expectations of the recovery of U.S. economic performance and the competitiveness of investing in Mexico, particularly labor costs. We

believe that in 2011 FDI will continue with the recovery toward historical trends. FDI registered an annual average of US\$24.0 billion from 2005-2008, before the global financial crisis.

Investment in the equity market will depend on global economic recovery, especially in U.S. markets, given the strong links between two countries, while flows to fixed income markets will also depend on global liquidity.

Banco de Mexico's monetary policy has had to face the strong flows of foreign investment that have resulted in an extraordinary rally in the bond market, despite the recent volatility, as well as exchange rate appreciation. The response from the authority has been to remain on hold, keeping the banking funding rate at 4.50%, while there has been a significant increase in international reserves. We believe that this will continue in coming months. We could see a level of US\$124.0 billion in central bank international reserve assets at the end of 2011, up from an estimated US\$110.0 billion at the end of 2010, most of it coming from Pemex.

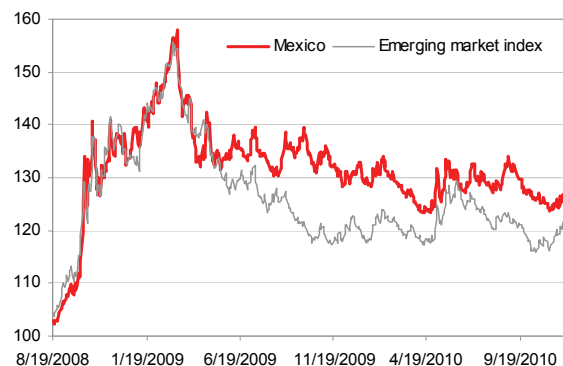
However, we believe that the main downside risk to this scenario could be a sharp reversal of global liquidity, related to a dramatic change in monetary policy at central banks, the Fed in the U.S., and an extraordinary deterioration of financial markets (debt sovereign problems, banking crisis, among others).

Currency – We expect the peso to trade in a range of MXN12.30-12.70/USD in 2011. We believe that the authorities could increase the dollar sales options to avoid an extraordinary appreciation of the peso, but we do not see major interventions if the exchange rate goes close to the MXN13.0/USD.

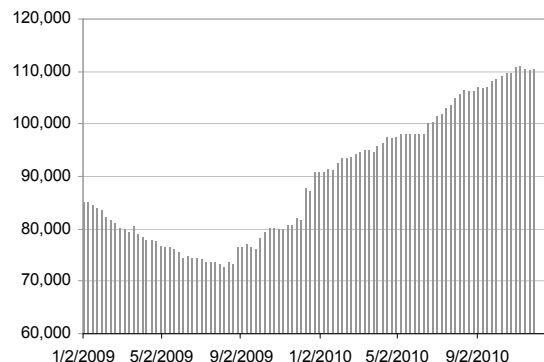
In 3Q10 the exchange rate continued gradual appreciation owing to abundant global liquidity that produced an extraordinary flow of foreign investment, particularly to the fixed income market. But the Fed announcement of further monetary easing (QE2) resulted in an additional strength in the currency to a range if MXN12.20-12.5/USD.

The Mexican peso amid the global liquidity

Mexican peso vs. Emerging Markets Currency Index*



Banxico's international reserves (US\$ million)



Sources: Bloomberg, Banxico, and Santander.

Of course, the currency also registered volatility from external financial markets, like the problem in the euro zone. But with external accounts in a strong position, with a low current account deficit and gradual recovery of FDI, and a moderate growth in the U.S. economy, the MXN shows a trend of appreciation.

The Mexican currency could face two major issues in 2011. On one hand global monetary conditions of further easing from Federal Reserve could induce an additional strength of the currency. We believe that the authorities in Mexico want to prevent a loss of competitiveness and promote a larger accumulation of reserves at the central bank. But if the monetary policies continue for long time in response to a lower than expected performance in the economy that could affect non-oil Mexican exports, there is a risk for the peso.

Meanwhile, a better than expected recovery in the U.S. might result in expectations of a quick reversal of the liquidity conditions and pressure on interest rates. This could also result in pressure for the exchange rate, despite the fact that the improvement in the U.S. economy would be good news for non-oil exports and for economic activity.



Given these factors, we believe that the currency will move in a range of MXN12.30-12.70/USD in 2011.

Politics – No major structural reforms are expected for 2011, once again. Politics will be focused on the state elections for governor, particularly in Estado de Mexico.

There is no room on the political agenda for structural reforms like fiscal or energy sector initiatives in 2011. The PRI, the main opposition party that controls the Deputy Chamber, expects tax collection from economic growth, oil revenues, and the fiscal deficit (2.5% of GDP) to support macroeconomic stability in 2011. We believe that the PRI agenda does not include major reforms, at least not as a central concern.

The PRI is mainly focused on the electoral calendar in the states, particularly in Estado de Mexico, and on internal politics going into the presidential election in 2012. This is important because according to several surveys the likely PRI candidate for 2012 is Enrique Peña Nieto, who is the current governor of this state in the central zone of Mexico. Some political analysts believe that if the PRI wins the governorship of Estado de Mexico, Peña Nieto could get the support of his party.

Election calendar for 2011

Date	Election
January 30	Governor in the state of Guerrero
February 6	Governor in the state of Baja California Sur
July 3	Governor in the state of Mexico, Coahuila, and Nayarit
November 13	Governor in the state of Michoacan

Sources: Tribunal Federal Electoral and Santander.

But the election in Estado de Mexico is also relevant for PAN and PRD, both of which have significant support in the state. Some politicians from both parties are seeking a political alliance for this election, as seen in some states during 2010 (Oaxaca, Puebla, and Sinaloa). They believe that the electoral alliance is the only way to win in the run for governor of Estado de Mexico.

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Mexico – Economic projections, 2007-2012F

	% GDP	2007	2008	2009	2010E	2011F	2012F
National Accounts							
Real GDP (Δ% y/y)		3.3	1.5	(6.1)	5.1	3.5	3.7
Private Consumption (Δ% y/y)	70.2	4.0	1.9	(6.1)	3.9	4.3	4.7
Investment (Δ% y/y)	23.9	6.9	4.4	(10.1)	1.6	5.7	5.5
Private (Δ% y/y)	21.4	5.9	3.1	(15.4)	1.5	5.1	6.9
Public (Δ% y/y)	2.5	11.3	9.5	9.7	2.0	7.5	1.6
Government Spending (Δ% y/y)	7.0	3.1	0.9	2.3	2.0	1.5	1.4
Exports (Δ% y/y Local Currency)	30.6	5.7	0.5	(14.8)	24.0	7.2	10.2
Imports (Δ% y/y Local Currency)	(31.7)	7.1	2.8	(18.2)	22.4	13.2	12.0
GDP (US\$ bn)		1,036.2	1,104.2	885.5	1,035.8	1,119.7	1,174.7
GDP Per Capita (US\$)		9,846.8	10,104.9	7,993.2	9,221.4	9,869.9	10,252.0
Industrial Production (Δ% y/y)		1.7	(0.7)	(9.8)	9.3	3.8	3.8
Population (mn)		106.3	109.3	110.8	112.3	113.4	114.6
Monetary and Exchange Rate Indicators							
CPI Inflation (Dec Cumulative) (%)		3.8	6.5	3.6	4.3	3.9	3.8
PPI Inflation (Dec Cumulative) (%)		5.4	7.8	4.1	5.1	4.7	4.6
US\$ Exchange Rate (Year-End)		10.9	13.8	13.1	12.3	12.7	13.0
US\$ Exchange Rate (Avg)		10.9	11.2	13.5	12.6	12.5	12.8
28-day Cetes Interest Rate (Year-End)		7.4	8.0	4.5	4.5	4.5	5.5
28-day Cetes Interest Rate (Avg)		7.2	7.7	5.4	4.5	4.5	5.2
Monetary Base (US\$ bn)		40.1	34.9	36.7	43.6	46.3	49.7
Monetary Base (Δ% y/y)		8.2	(13.0)	5.0	18.7	6.2	7.3
Fiscal Policy Indicators							
Fiscal Balance, % of GDP		0.0	(0.1)	(1.8)	(2.8)	(2.5)	(2.0)
Primary Balance, % of GDP		3.0	1.8	0.0	(1.0)	1.5	2.0
Government Financing Needs (US\$ bn) (a)		167.3	184.0	174.8	190.0	195.6	2,012.0
Gross Total Government Debt (Includes Central Bank)		229.1	207.2	217.1	218.7	218.2	279.7
Local Currency (US\$ bn) (c)		173.7	154.0	162.9	165.6	166.2	196.8
Foreign Currency (US\$ bn) (Includes Tesobonos)		55.4	53.1	54.2	53.1	52.1	82.9
Balance of Payments							
Trade Balance (US\$ bn)		(10.1)	(17.3)	(4.6)	(6.3)	(11.8)	(15.0)
Merchandise Exports (US\$ bn)		271.9	291.3	229.8	294.1	314.2	347.7
Merchandise Imports (US\$ bn)		281.9	308.6	234.4	300.4	326.0	362.7
Services and Income Receipts (US\$ bn)		25.2	25.6	20.1	20.5	22.8	24.2
Services and Income Payments (US\$ bn)		50.3	50.3	43.2	42.7	44.0	47.0
Transfers (US\$ bn)		26.4	25.5	21.5	21.5	23.9	25.2
Current Account (US\$ bn)		(8.7)	(16.5)	(6.2)	(6.9)	(9.1)	(12.6)
Current Account (% of GDP)		(0.8)	(1.5)	(0.7)	(0.7)	(0.8)	(1.1)
Foreign Direct Investment (US\$ bn)		29.1	24.9	14.5	18.0	20.8	22.6
Debt Profile							
International Reserves (US\$ bn)		78.0	85.4	90.8	110.2	124.2	134.2
Total Internal Govt. and Central Bank Debt (US\$ bn) (c)		173.7	154.0	162.9	165.6	166.2	196.8
Short Term (less than 12 months) (US\$ bn)		23.9	30.8	32.6	33.1	33.2	39.4
Long Term (over 12 months) (US\$ bn) (c)		149.8	123.2	130.3	132.5	132.9	157.4
Total Internal Govt. and Central Bank Debt (%GDP) (c)		16.8	14.0	18.4	16.0	14.8	16.8
Total External Debt (US\$) (bn)		126.8	128.6	130.4	130.0	129.8	142.0
Short Term (less than 12 months) (US\$ bn)		21.1	22.4	22.6	22.8	23.0	17.5
Long Term (over 12 months) (US\$ bn)		105.8	106.2	107.7	107.2	106.7	124.4
Total External Debt (% GDP)		12.2	11.6	14.7	12.6	11.6	12.1
Total External Debt (% Exports)		46.7	44.1	56.7	44.2	41.3	40.8
Debt Service Ratio (b)		11.4	10.8	21.1	10.0	10.9	10.6
Labor Markets							
Unit Wages (real Δ% y/y) (d)		1.4	0.2	(1.0)	(0.8)	1.4	1.0
Unemployment (Open Unemployment Rate %)		4.8	4.9	6.8	6.7	6.5	5.7
Total Payroll (real Δ% y/y) E		5.3	(0.3)	(3.0)	4.5	6.2	5.2

a (Amort + Fiscal Deficit). b (Amort + Interest Ext Debt)/(Exports Goods & Services). c Includes Fobaproa as of 99 d Contractual Wages. E Santander estimate. F Santander forecast. Sources: Ministry of Finance, Banco de Mexico, and Santander.



PERU

GDP GROWTH STILL STRONG, BUT POLITICS TAKES SPOTLIGHT

POSITIVES

- Strong GDP growth driven by private and public investment should continue, taking GDP growth to about 8.5% in 2010 and 6% in 2011.
- Investment continues to grow, with gross fixed capital creation up 31.9% y/y in 3Q10 and 25.1% y/y for the first three quarters of 2010.
- The engines of growth continue to be construction (expanding 18.2% y/y in the first nine months of 2010), manufacturing (14.3% y/y), and banking (10.7% y/y).

NEGATIVES

- The presidential election will take center stage in 2011. Although we expect a market friendly candidate to prevail, the level of “mudslinging” during the campaign could generate volatility.
- Faltering Chinese and U.S. economies could affect metal prices and Peru’s terms of trade.

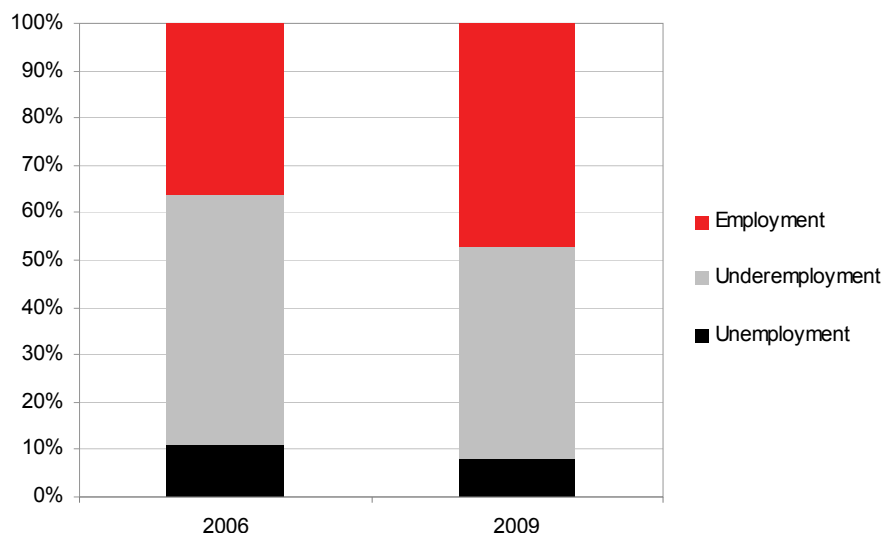
PROSPECTS

Economic growth – GDP grew 9.5%, y/y in 3Q10 fueled by construction (with a y/y growth of 18.2% in the first nine months of 2010), followed by manufacturing (14.3% y/y in the same period) and banking (11.5% y/y in the same period).

The fundamental changes behind the drivers of current GDP growth are a much more interesting story than the drivers themselves.

The 1980s practically obliterated the middle class in Peru. Price controls, complicated business regulation, and rampant inflation eroded the middle class. As the 1990s approached, industry was in shambles, exports were complicated by strict controls on foreign funds, and consumption was plagued by low wages, informality, and the scarcity of many essential consumer products.

Development of employment and underemployment 2006-2009



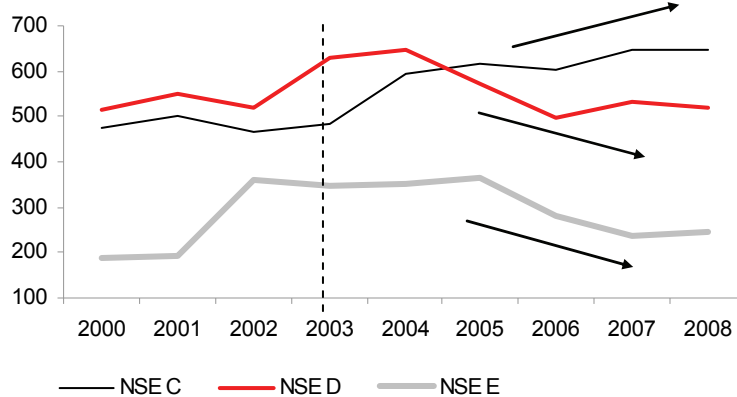
Source: INEI.

The growth experienced by the Peruvian economy since then, especially in the last five years, has increased employment, personal income, and the number of households in the middle class.

The current growth of manufacturing, construction, and banking is the end result of this growing middle class demanding more consumer products and houses, and the debt necessary to fuel consumption and buy homes.

This trend should continue in 2011 and beyond, as the GDP per capita increases (our estimate is US\$1,000 per capita more between 2010 and 2012) and more households move into the middle class.

Middle and lower income households in Lima



Households in Lima by socioeconomic level (NSE), in thousands. Middle class is "C", lower income is "D" and "E". Source: INEI.

We expect private consumption to have grown 5.4% in 2010, increasing to 6.2% in 2011.

In 2011 we will not see the inventory restocking effect we saw in 2010, which explained 1.5% of GDP growth in the year, and we will most likely also see fiscal incentives withdrawn in 2011. We are also expecting a slowdown in investment in 1Q11, as large mining projects will want to wait to get a better indication of who might win the April 2011 election before committing such large sums to invest in the country. We should still see a strong 6.0% GDP growth in 2011, driven by private investment and private consumption.

Monetary policy and inflation – Inflation picked up in 1H10 but was surprisingly subdued late in the year. September and October had deflation, while inflation in November was 0.01% m/m.

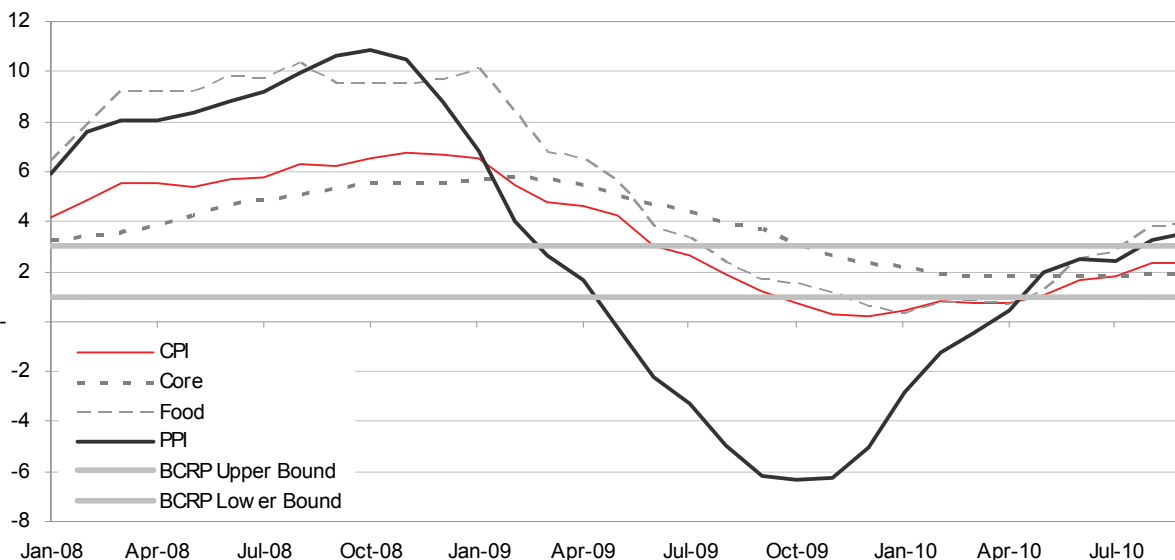
Inflation picked up in the first seven months of 2010, reaching a 12-month rate of 1.82%. Oil and food prices were the principal culprits, as international prices of oil and grains increased. Food contributed 84 bps to inflation in the first seven months of 2010 while oil contributed 25 bps in the same period.

However, after August, inflation dropped significantly and, contrary to our previous estimates, the Central Bank stopped its monthly rate hikes. So far the Central Bank has kept the reference rate at a low 3.0% and it is unlikely, considering that inflation will probably land squarely in the Central Bank's range, that it will be increased again soon.

In 2011 the Central Bank will have to walk a thin line between inflation and appreciation of the Peruvian currency. We are not expecting significant inflationary pressure in 2011, but if they were to materialize, any increase in the reference rate would probably make Peru more attractive to foreign funds, putting pressure on the exchange rate.



Inflation annualized percentage changes



Sources: Globalsource, BCRP, and Santander.

Fiscal policy – The government showed a fiscal deficit of 1.6% of GDP in 3Q10 due to a timing issue with interest payments on the debt (which are higher in the first and third quarters of every year). The first nine months of 2010 still showed a fiscal surplus of 1.3%.

Government proceeds increase 22.6% y/y in 3Q10 driven primarily by a 25.5% increase in tax collection, while government non-financial expenses increased 7.4% y/y in the same period.

Non-financial expenses of the central government represented 19.2% of GDP, higher than the previous quarter by 2.3 percentage points of GDP, but 0.4% of GDP lower than 3Q09. Government payroll represented 5.0% of GDP in 3Q10, similar to government purchases of goods and services (5.0%) and lower than capital expenditures (6.1%).

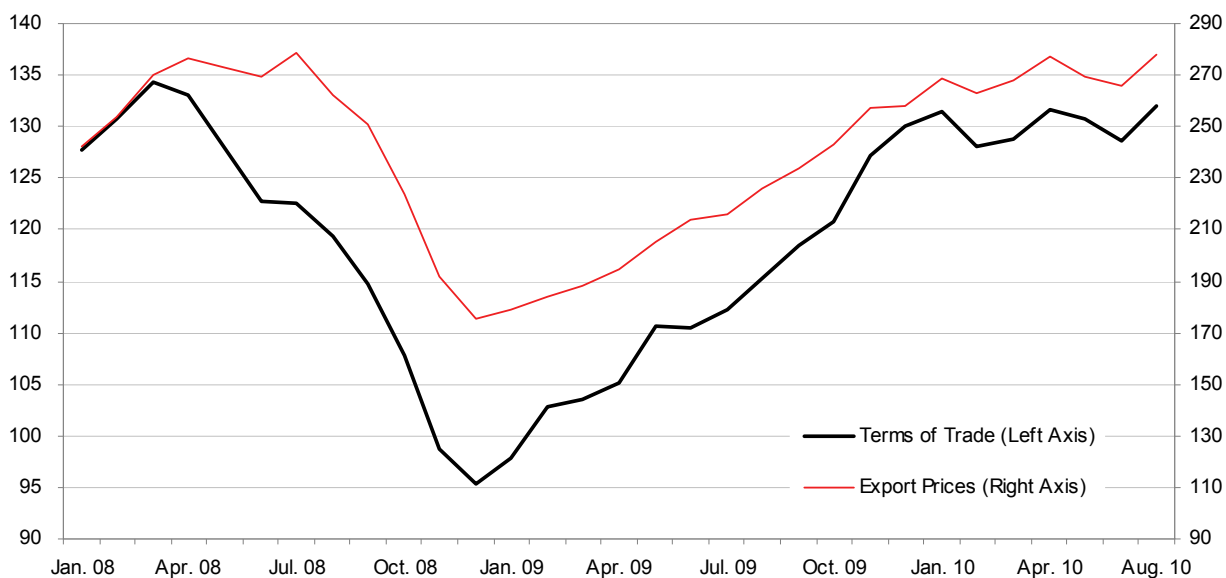
We estimate a small reduction in metal prices that should slow the growth of Peruvian exports and reduce income tax collection for the government. At this point we have not factored into our tax collection estimates any possible increase in mining royalties (despite the proposal presented to Congress in November to increase royalties for mining companies), so we expect a fiscal deficit by the end of 2010 at 1.6% of GDP.

Trade balance and current account – The 3Q10 trade balance reached US\$1.4 billion due to a significant expansion of export prices in 1Q10 that held through most of 2Q10 and 3Q10, resulting in a 29.2% y/y growth in exports for the quarter.

Exports grew 29.2% y/y in 3Q10 due to a growth of 31.5% in traditional exports and 20.5% in nontraditional exports. Growth in traditional exports (metals, fishmeal, coffee, and sugar) was due to higher prices (26.9% y/y) while growth in non-traditional exports (textiles, asparagus, avocados, and fruits) was due to higher volumes (12.2% y/y).

In the same period imports grew 46.7% y/y driven by a 54.9% growth in capital goods, a 48.4% growth in consumer goods, and a 40.8% growth in raw materials.

Peru terms of trade and export price index (1990=100)



Sources: Globalsource and Santander.

Terms of trade recovered significantly throughout 2009 and 1Q10, due primarily to a recovery in metal prices, which represent the bulk of traditional exports, but remained generally flat in 2Q10 and 3Q10, although still 14.3% above the same period last year.

Net foreign direct investment in 3Q10 was US\$2.42 billion, up 45.1% y/y, signaling a continuation of the investment growth seen at the beginning of 2010. About 77.3% of foreign direct investment came from the reinvestment of profits, primarily from mining companies.

Despite the strong performance of the trade balance, the current account showed a small deficit in 3Q10 of US\$846 million due to repatriation of profits by large multinationals, primarily in the mining sector. However, the balance of payments remained positive, as the financial accounts more than make up the current account deficit, leaving the balance of payments US\$6.4 billion in the black for the quarter as well as a positive balance of US\$9.2 billion for the first nine months of 2010.

Currency – Strong metal prices and increasing foreign direct investment have put upward pressure on the PEN, which has been systematically countered by the BCRP. The PEN appreciated 3.5% in the first nine months of 2010 but in November 2010 the problems in Europe and the appreciation of the U.S. dollar versus the euro also affected the USD/PEN exchange rate.

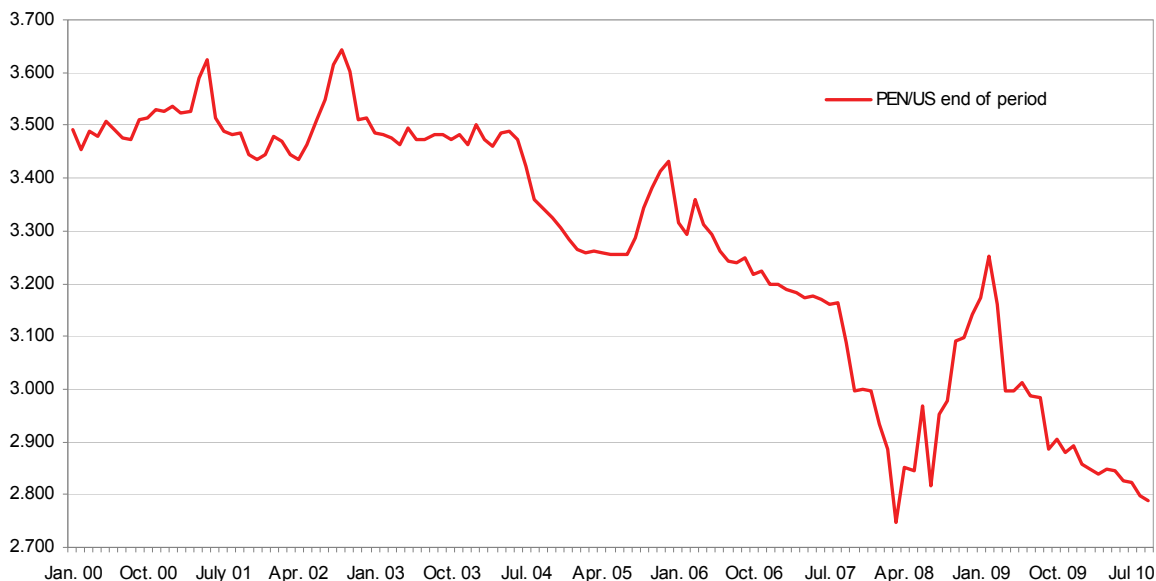
The exchange rate was relatively stable throughout the 3Q10, although it required constant buying of U.S. dollars by the Central Bank.

With the current appreciation of the U.S. currency versus the euro as well as the increase in marginal reserve requirements in Peru from 35% to 75% and the special reserve requirement for credit lines from abroad with terms shorter than two years from 65% to 120%, the PEN/USD exchange rate has increased about 0.11%.

Although we don't have enough information yet to give an informed opinion, a look at the strong increase in PEN/USD forwards since September could indicate a move by foreign companies to cover part of their PEN-denominated earnings ahead of the 2011 elections.



Exchange rate over the past decade

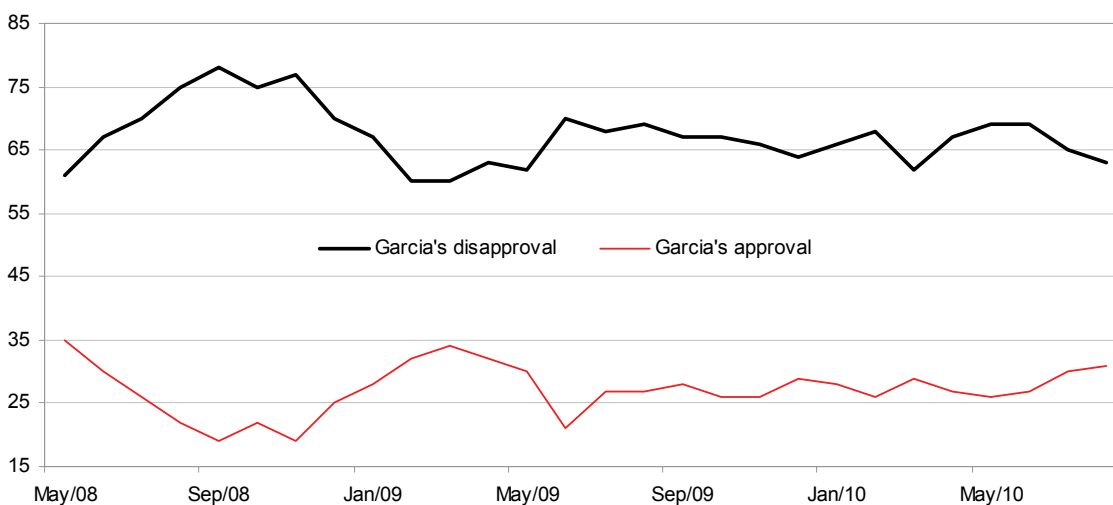


Sources: Globalsource and Santander.

Politics – The presidential election is just around the corner.

President Garcia's popularity has been low throughout his administration, despite the fact that the economy has grown during his time in office at the fastest pace seen in the past three decades. The reasons given for disapproval of Garcia include inflation (cited by 43% of those polled who disapproved of his performance), failure to fulfill his electoral promises (41%), and corruption (37%). Those who approved Garcia's performance gave as reasons his work on infrastructure (53%), his ability to avoid mistakes he made in his first government (37%), and education (32%).

President Garcia's approval rating has been low



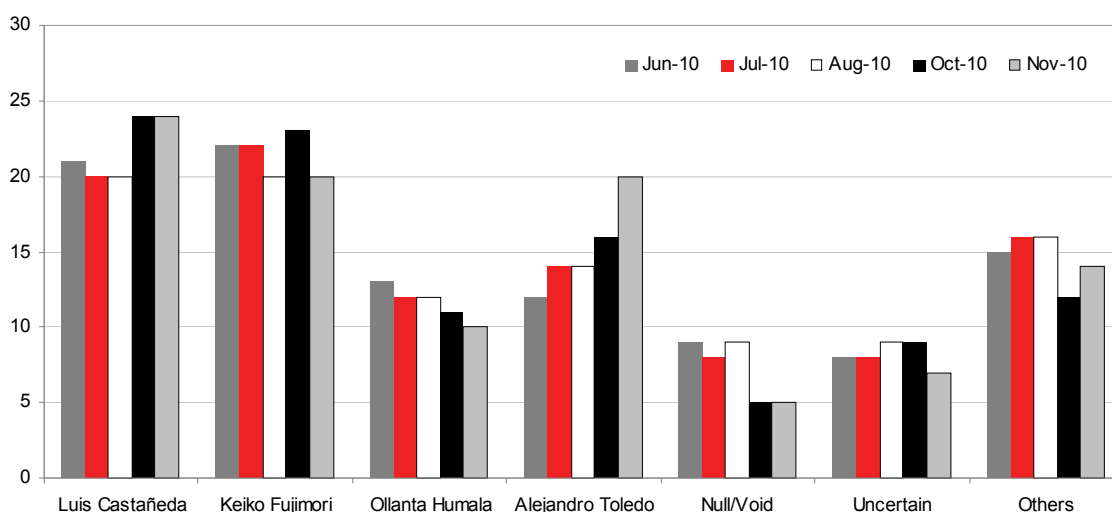
Sources: Apoyo Ipsos and Santander.

With the election right around the corner, the timetable is as follows: On December 11, all political alliances were registered. On December 20 there were internal party elections to choose presidential and vice-presidential candidates. On January 10, 2011, candidates for president and vice-president must be registered. On January 19 internal elections for congressional candidates should take place. On February 9 candidates for Congress need to register, and, finally, the election will take place April 11.

Urban polls are already showing some favorites. Luis Castañeda, the current mayor of Lima, is still ahead, while Keiko Fujimori (former President Alberto Fujimori’s daughter) has lost ground and is currently tied in second place with former President Alejandro Toledo. All three candidates seem to have plans to continue with the current economic model and are generally viewed as market friendly. Ollanta Humala is running fourth in the polls, 14 points behind Castañeda and 10 points behind Fujimori and Toledo. In previous elections, the three candidates that ended up fighting for the first two slots in the first round of voting were already at the top of the polls in December of the previous year. If the current polls hold, investors will likely have a very positive outlook on the election, as all of the top three candidates are openly market friendly.

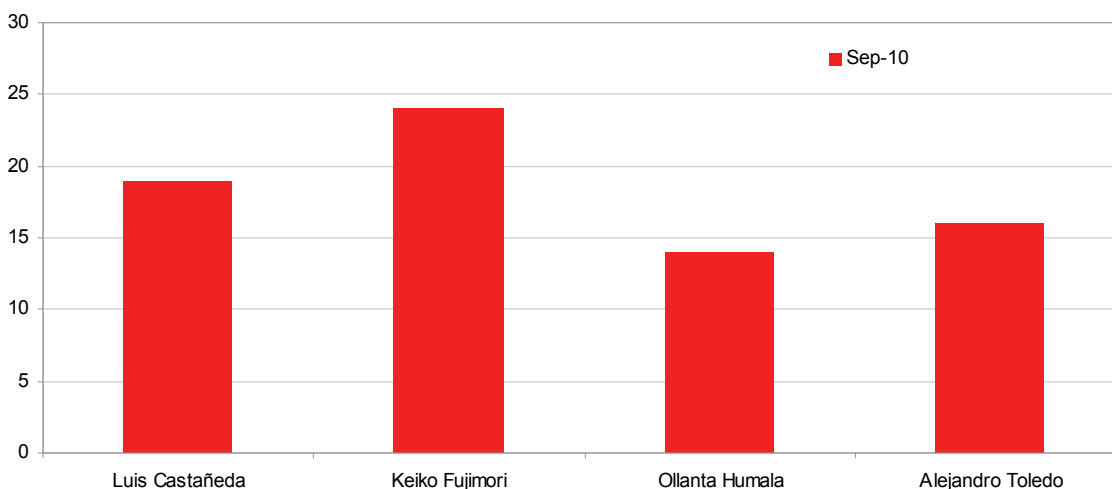
It is important to note that urban polls tend to ignore one-third of the Peruvian population, which is rural and usually takes a different political view. The only poll that includes both urban and rural voters was done in September by Ipsos-Apoyo, and it confirms our view that Fujimori has taken away some of Humala’s rural support and is currently in first place. However, with the strong performance of Toledo in urban polls since September, he may be ahead in the overall voting intentions.

Voting intention for the upcoming presidential election – urban areas



Sources: Apoyo-Ipsos and Santander.

Voting intention for the upcoming presidential election – urban and rural areas



Sources: Ipsos-Apoyo and Santander.

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Peru – Economic projections, 2007-2012F

	% GDP	2007	2008	2009	2010E	2011F	2012F
National Accounts							
Real GDP (Δ% y/y)		8.90	9.80	0.90	8.5	6.0	6.2
Consumption (Δ% y/y)	77.7	7.90	7.90	2.90	6.1	5.7	5.5
Private (Δ% y/y)	64.3	8.3	8.7	2.4	5.4	6.2	5.9
Public (Δ% y/y)	9.7	4.5	2.1	16.5	11.2	2.7	2.8
Gross Domestic Investment (Δ% y/y)	25.0	22.6	28.3	(8.6)	17.8	6.0	10.2
Private (Δ% y/y)	19.8	23.4	25.8	(15.2)	9.6	11.3	11.3
Public (Δ% y/y)	5.9	18.2	42.8	25.9	17.7	7.7	7.8
Exports (Δ% y/y US\$)	20.2	17.5	12.8	(14.7)	5.0	8.9	4.5
Imports (Δ% y/y US\$)	19.2	31.8	45.1	(26.1)	4.3	4.8	6.2
GDP (US\$ Bn)		107.5	127.7	126.0	149.1	166.2	182.4
GDP Per Capita (US\$)		3,774	4,433	4,325	5,062	5,579	6,053
Manufacturing (Δ% y/y)		11.1	9.1	(7.2)	15.0	8.0	10.0
Population (Mn)		28.5	28.8	29.1	29.5	29.8	30.1
Monetary and Exchange Rate Indicators							
CPI Inflation (Dec Cumulative)		3.93	6.70	0.20	2.4	2.0	2.0
WPI Inflation (Dec Cumulative)		5.6	8.5	(3.6)	3.1	2.3	2.2
US\$ Exchange Rate (Year-End)		2.98	3.14	2.89	2.77	2.72	2.70
US\$ Exchange Rate (Avg)		3.09	3.06	3.02	2.83	2.75	2.71
Average Lending Rates in US\$ Terms (Year-End)		10.8	10.5	8.0	7.3	7.5	8.0
Average Lending Rates in US\$ Terms (Avg)		10.85	10.65	9.25	7.7	8.0	8.4
Base Money M0-end of period (US\$ Bn)		6.0	7.4	7.9	8.8	9.7	10.7
Base Money M0-end of period (Δ% y/y)		28.2	25.5	5.5	10.9	10.7	10.7
Fiscal Policy Indicators							
Fiscal Balance (% of GDP)		3.1	2.1	(2.1)	(1.6)	(0.9)	(0.3)
Primary Balance (% of GDP)		4.9	3.7	(0.7)	(0.3)	0.3	0.8
Public Sector's Financing Needs ^b (US\$ Bn)		(1.7)	0.8	5.1	6.9	3.1	2.3
Total Government and Central Bank Debt (US\$ Bn)		32.1	32.2	33.8	35.3	36.3	37.1
Local Currency (US\$ Bn)		11.8	14.5	13.1	14.8	14.7	15.6
Foreign Currency (US\$ Bn)		20.1	17.7	20.7	20.5	21.6	21.5
Balance of Payments							
Trade Balance (US\$ Bn)		8.36	3.09	5.87	0.4	1.7	1.3
Merchandise Exports (US\$ Bn)		27.96	31.53	26.89	27.6	31.6	34.1
Merchandise Imports (US\$ Bn)		19.60	28.44	21.01	27.1	29.9	32.8
Services and Income Receipts (US\$ Bn)		2.4	2.6	2.1	NA	NA	NA
Services and Income Payments (US\$ Bn)		4.0	4.1	4.1	NA	NA	NA
Transfers (US\$ Bn)		2.4	2.4	2.9	3.0	3.3	3.7
Current Account (US\$ Bn)		1.22	(4.18)	0.25	(1.23)	(2.82)	(2.40)
Current Account (% of GDP)		1.30	(3.30)	0.20	(0.82)	(1.70)	(1.32)
Foreign Direct Investment (US\$ Bn)		5.4	4.1	5.9	4.9	4.8	5.1
Privatization (US\$ Bn)		0.0	0.0	0.0	0.0	0.0	0.0
Long Term Loans to Private Sector (US\$ Bn)		0.3	0.2	0.0	0.0	0.0	0.0
Debt Profile							
International Reserves (US\$ Bn)		27.7	31.2	33.1	43.0	46.0	47.0
Total Internal Government and Central Bank Debt (US\$ Bn)		11.8	11.4	13.1	14.8	14.7	15.6
Short Term (less than 12 months) (US\$ Bn)		1.3	0.8	1.8	2.3	1.9	2.1
Long Term (over 12 months) (US\$ Bn)		10.5	10.6	11.3	12.5	12.8	13.5
Total Internal Government and Central Bank Debt (% of GDP)		11.0	8.9	10.4	9.9	8.8	8.6
Total External Debt (US\$ Bn)		33.1	34.6	33.8	35.3	38.4	40.1
Short Term (less than 12 months) (US\$ Bn)		1.3	4.0	3.7	1.0	1.3	1.3
Long Term (over 12 months) (US\$ Bn)		31.8	30.6	30.1	34.4	37.1	38.8
Total External Debt (% of GDP)		30.90	27.08	26.82	23.7	23.1	22.0
Total External Debt (% of Exports Goods and Services)		112.4	52.0	100.0	80.0	81.0	80.0
Debt Service Ratio ^c		17.3	15.2	15.0	19.5	11.5	11.5
Labor Markets							
Private Sector's Wages (Real Δ% y/y)		0.1	0.5	(3.7)	0.1	0.0	0.2
Unemployment (%)		7.5	7.7	7.9	8.3	7.5	7.0
Underemployment (%)		14.7	13.8	13.2	13.5	13.2	13.0

Sources: Central Reserve Bank of Peru (BCRP), National Institute of Statistics (INEI) Minister of Economy and Finance (MEF) and Santander. b Amortization+Fiscal deficit. c Amortization+External interest/Exports of goods and services.