WHITE PAPER

"It is better to strike now to control this inflation"

The "year of sacrifice" for investors in Latin America

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GRI CLUB

INTRODUCTION

GRI Club Real Estate Latam kicked-off a series of events that will be held in 2023 to connect players in the Latin American real estate market and enable them to build lasting relationships aimed at advancing the sector. To open the agenda, an online meeting took place on February 1st, providing political and economic perspectives for Latin America over the next two years - based on the projections of Munir Jalil, Head of Economic Research for the Andean Region at BTG Pactual.

Jalil led the conversation with more than 120 real estate market decision makers, all interested in understanding the direction of the region's economy after high inflationary levels and, consequently, constant interest rate hikes. Under the discourse of a "year of sacrifice" for the Latin American territory, the executive notes that it will be necessary to control inflation to obtain better growth dynamics from 2024.

Discussions around topics such as economic performance in developed regions and their impact on emerging countries, the way inflation has been behaving and the resulting monetary policy response in Latin America, as well as the political uncertainties in the region's countries have all led to this conclusion.

DEVELOPED ECONOMIES COUNTER PROJECTED RECESSION

The consensus in the second half of 2022 was that the world would enter an economic recession in 2023: Europe due to the effects of the Russia-Ukraine War, the natural gas crisis, and high levels of inflation; and the United States as a result of the impacts from the sharp rise in interest rates carried out by the Federal Reserve (FED).

However, the year started out better than calculated for developed countries. Starting with the US, where the economy is expected to grow 1.4% in 2023, according to projections made by the International Monetary Fund (IMF) - in October of last year, just 1% growth was projected.

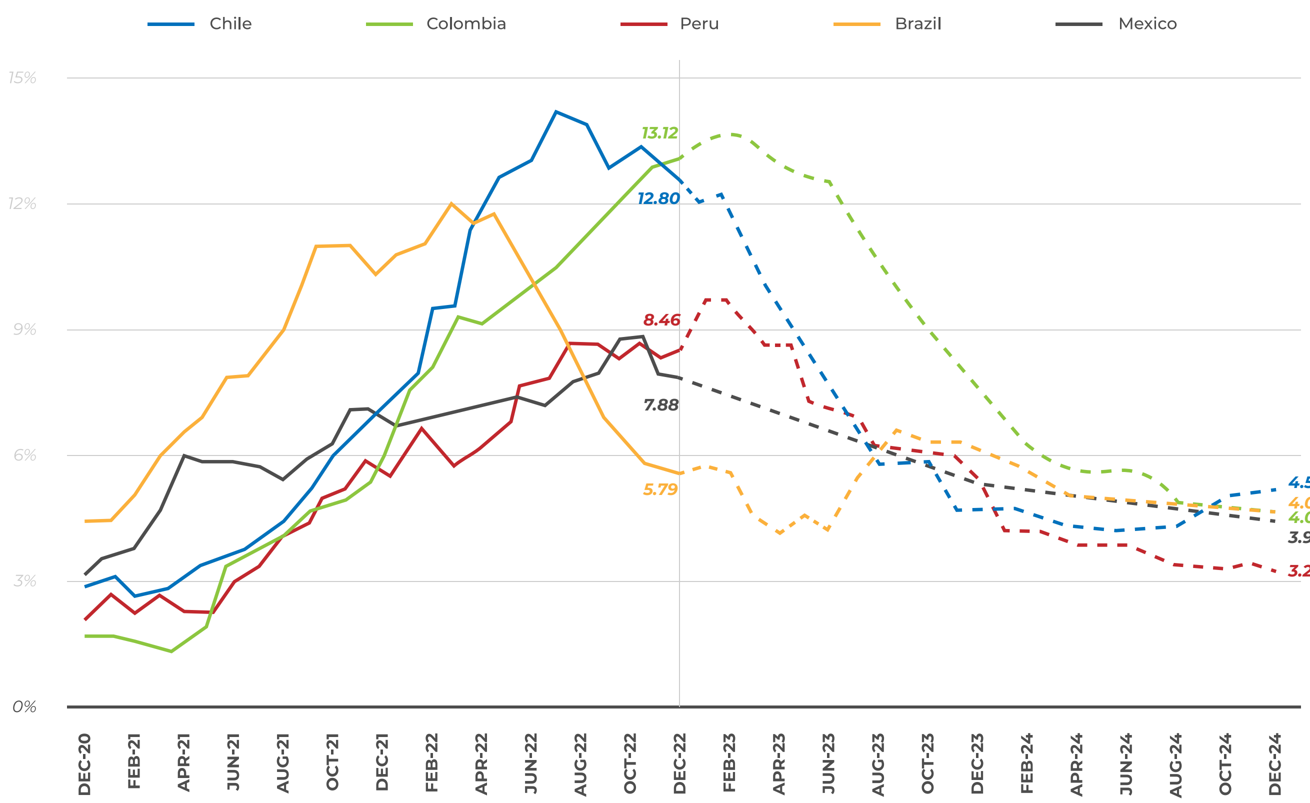
The European continent, in turn, is predicted to see an increase of 0.7% - above the projected 0.5%. It is important to highlight the fact that the winter was less severe than expected, reducing the demand for gas for heating purposes and resulting in a decrease in prices. This situation was key to economic relief in the region.

Another positive surprise was China, which has an economic growth forecast of 5.2%,well above the 3.2% reported in 2022. Jalil comments that the Chinese advance is good for South American countries, since they are exporters of commodities.

2023: THE YEAR OF CONTROLLING INFLATION IN LATIN AMERICA

Although developed economies are one step ahead in containing the generalised increase in prices, it is observed that Latin American countries - whose central banks are independent and responsible for their own basic interest rates - have also started to reduce inflation since December. These countries are: Chile, Peru, Brazil, and Mexico. The one exception is Colombia, where inflation has not yet started to fall as it was the last of these countries to tighten monetary policy.

The first country to see inflation decline sharply was Brazil, with a drop of 5.59%; the decline in Chile was 12.80%; in Mexico it was 7.88%; and, finally, Peru registered a relatively stable decrease of 8.46%. However, Colombia is the opposite, with a 13.12% increase and the prospect of further highs.



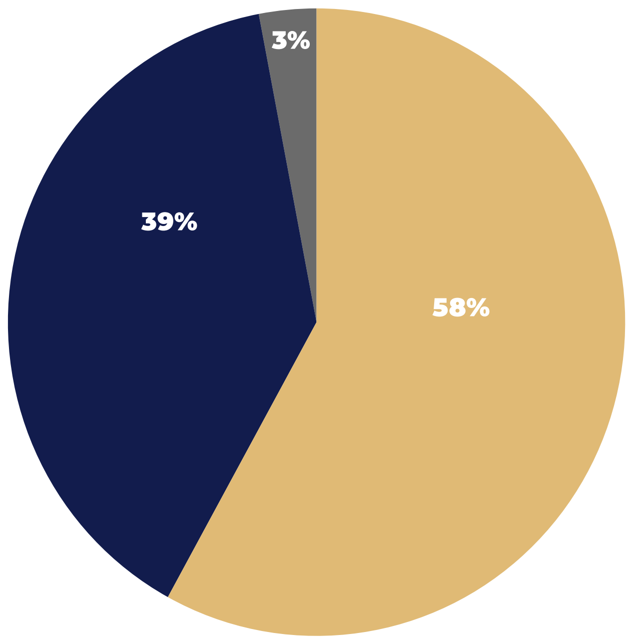
In all cases where inflation is decreasing, the projections taken during the online meeting point to a continued decline in the respective countries. In Colombia, it will likely only start to fall after March. Brazil has a caveat, as the drop should happen by the middle of the year, and then there may be a new rise in inflation due to potential fiscal policy decisions made by the Federal Government.

It is worth mentioning that Latin America's monetary response began even before the developed markets. Brazil started to raise its interest rates from March 2021, followed by Chile, Mexico, and Peru, all of which began to increase interest rates in the middle of the same year.

For Munir Jalil, countries in the region are sacrificing their economic growth to achieve better results in 2024, making it necessary to slow down demand with high interest rates, both on the consumption side and on the side of investment projects: "It's better take a hit now, control this inflation, so that in 2024 we can have better growth dynamics", he comments. He characterises 2023 as paradoxical, defining it as a "year of sacrifice" for the players.

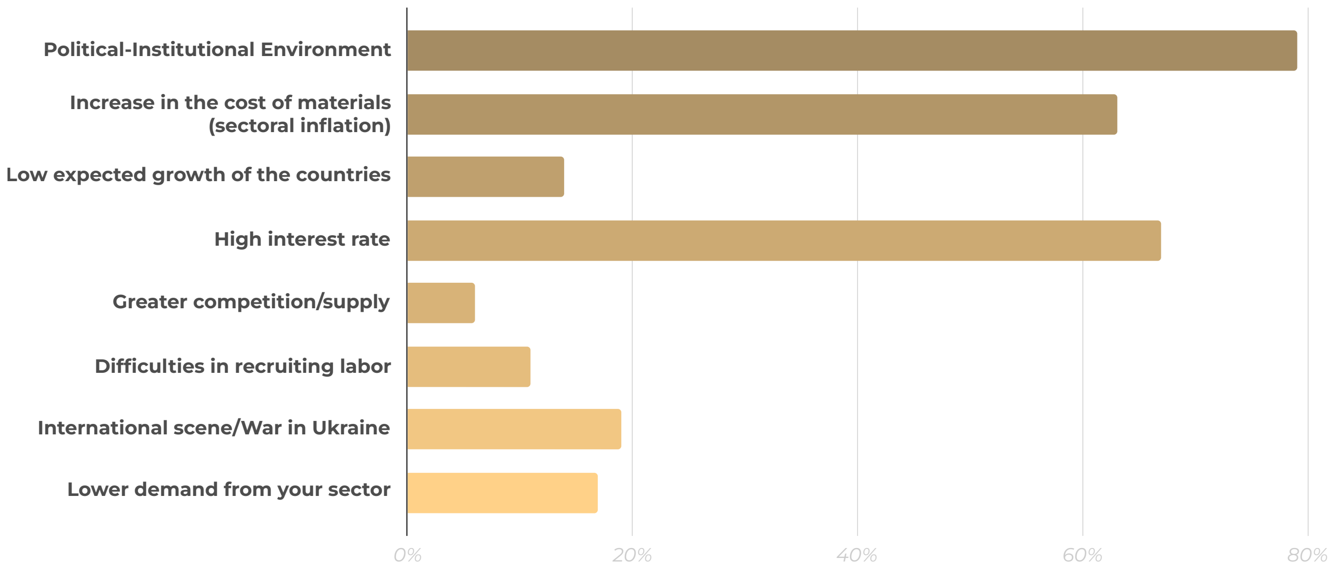
With regard to the pros and cons of this monetary policy, it is no surprise that the general increase in prices around the world triggers rate hikes, making it difficult to finance projects. The meeting, however, clarified that the opposite also has a downside: very low rates can compromise the clarity of where the risks are placed at the time of investment.

This comment is important, demonstrating that investing remains on the radar of executives, even with the challenging scenario. In one of the surveys carried out during the conversation, participants were asked about the behaviour of their companies in the current scenario: 58% of them say that they continue to expand their businesses, albeit cautiously.



POLITICAL LANDSCAPE IN THE REGION

In another survey carried out by GRI Club during the online meeting, the players were asked which factors they consider most critical when investing in Latin America - 79% pointed to the political and institutional environment as the biggest obstacle. See the full survey below.



This result is in line with the analysis made by Munir Jalil, who defines 2023 as a period of transition and political uncertainty for countries in Latin America. According to the executive, one of the issues that leverages this uncertainty are the fiscal policies that could be implemented by the leftist leaders who are currently controlling the region.

Below is a country-by-country political overview of Latin America with a focus on real estate investments.

›› Colombia

October was marked by "extreme decisions" in Colombia, according to the executive. At the time, the government announced that it would not sign any new oil and gas exploration contracts in Colombia. Measures such as this create uncertainty about the country's economic direction, have a negative impact on investors' ability to pay, and jeopardise future income, especially as these are Colombia's main export products. The president currently maintains a strong coalition, but the hint of complex reforms that are to come could weaken this alliance.

Brazil

Brazil's political landscape is surrounded by uncertainties and the huge tax debt must be considered. Lula is leading the country for a third term, but the BTG Pactual executive has doubts when analysing the leader's actions: "Lula is in his third presidency, but it's as if we didn't know him", he says. When commenting that 2023 will be a year of political uncertainty in the region, he highlights Brazil as being key in this scenario.

Mexico

One of the first elected left-wing presidents in the region was Andrés Manuel López Obrador, who took charge of Mexico in July 2018. There were many doubts about his fiscal policy, but in macroeconomic terms the indicators have been quite positive, with levels of risk largely under control.

Chile

In Chile, President Gabriel Boric's difficulty in gaining a majority in Congress has prevented the government from moving forward with the reforms it wants to carry out - as is the case for tax and social security reforms. However, Jalil considers it to be a positive for the growth of the economy that these initiatives do not progress. Also highlighted were the head of state's low approval ratings, preventing him from acting politically. Chile is the only country among those analysed for which a recession is expected in 2023.

Peru

In Peru, the economic situation stems from an internal political conflict that is in a deadlock and leading the people to protest. This situation has a negative impact on medium and long-term investment decisions. The approval of an electoral process is currently being discussed which, while not carried out, leaves the country in a complicated situation.

CONCLUSION

Despite the unknowns in the political field and the caution with inflation, the conclusion drawn from this online meeting is that 2023 starts with a positive outlook for Latin America, based on three external factors. First, due to the resources available in developed countries, which are heading towards emerging markets - attracting investors to Latin American economies in January and generating an interesting valuation dynamic.

Second, due to China's position in the world economy positively affecting commodity prices in South American countries and contributing to overcoming crises. And third, due to the positive forecast for the second semester and an expected drop in interest rates.

In this sense, Munir Jalil reinforces the importance of analysing the external context, as they are "the waters in which Latin America is navigating". In fact, it is necessary to understand the existing challenge of inflation and face the year as a period of adjustment for these measures in order to seek growth in 2024.

Finally, these obstacles are easier to overcome for countries with strong institutions, an awareness of their objectives, and a commitment to controlling inflation. Countries with these attributes tend to achieve economic stability sooner, with no reason for large depreciations in exchange rates, mainly because they have independent Central Banks.

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REAL ESTATE

Founded in 1998 in London, GRI Club currently brings together more than 10,000 senior executives working in the real estate and infrastructure markets and spread across 100 countries.

GRI Club's innovative discussion model allows for open participation of all executives, encouraging the exchange of experiences and knowledge while promoting networking and business generation.

Club members also have access to an exclusive online platform through which they can find more information about executives and their companies, schedule meetings, and receive unrestricted access to all of our content.

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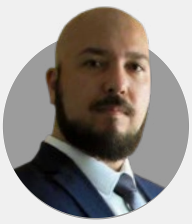

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