
Update on the Global Crisis: The Worst is Over, Is LAC Poised to Recover?

5 November 2009

Chief Economist Office
Latin America and the Caribbean Region
The World Bank



Structure of Presentation

- The worst is over for the global economy, but fragilities remain
 - The nature of the incipient recovery
- How has LAC fared in comparative terms?
 - Recession in LAC and elsewhere
 - Growth collapse in LAC and elsewhere
 - Explaining the differences in growth collapse
- Looking ahead: haziness in the horizon and challenges for LAC
 - On average, LAC is well positioned to recover...
 - ... but medium-term global environment is clouded by risk & uncertainty
 - LAC-specific opportunities and challenges

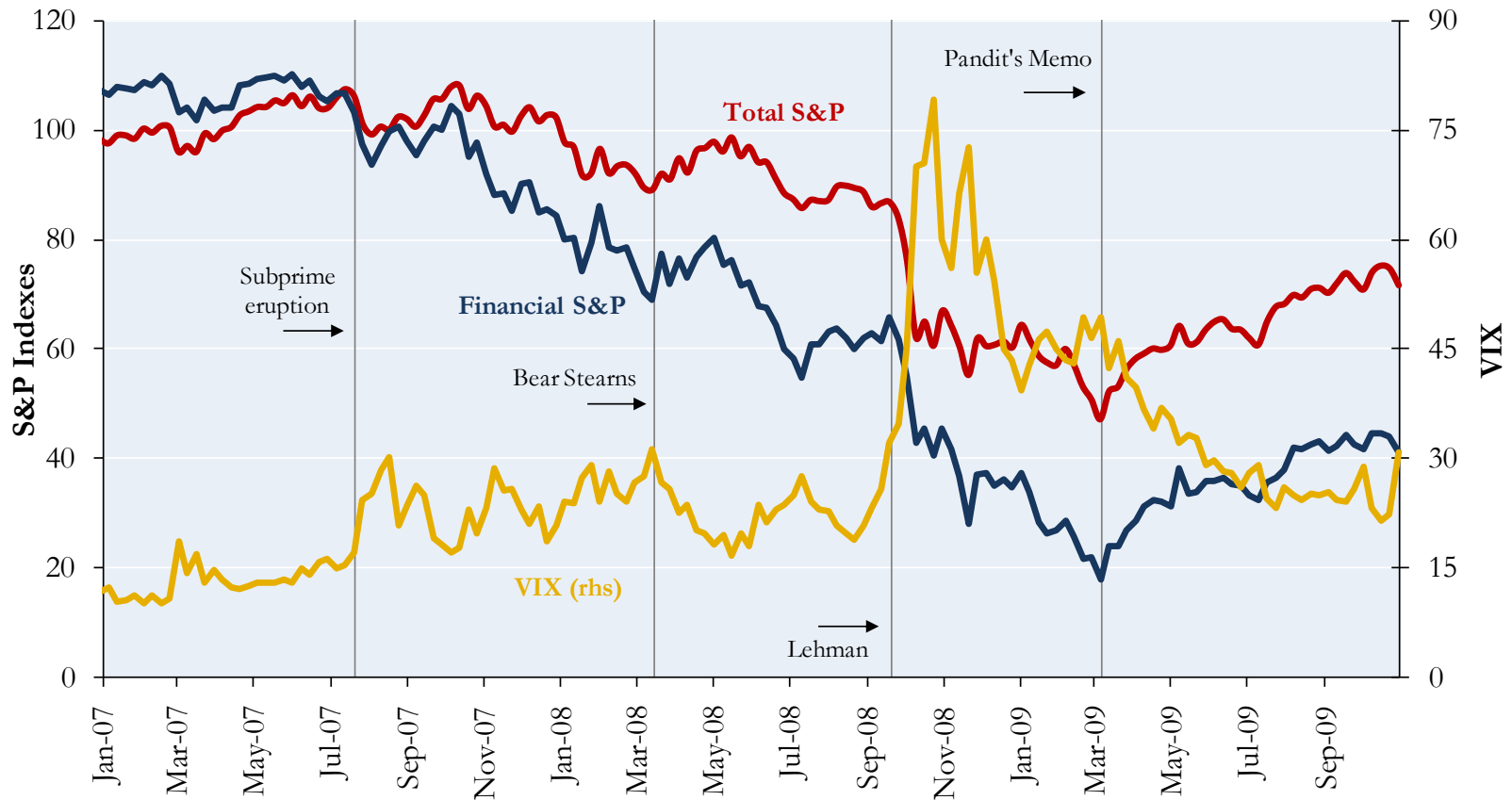
The Worst is Over for the World But Fragilities Remain

Part 1

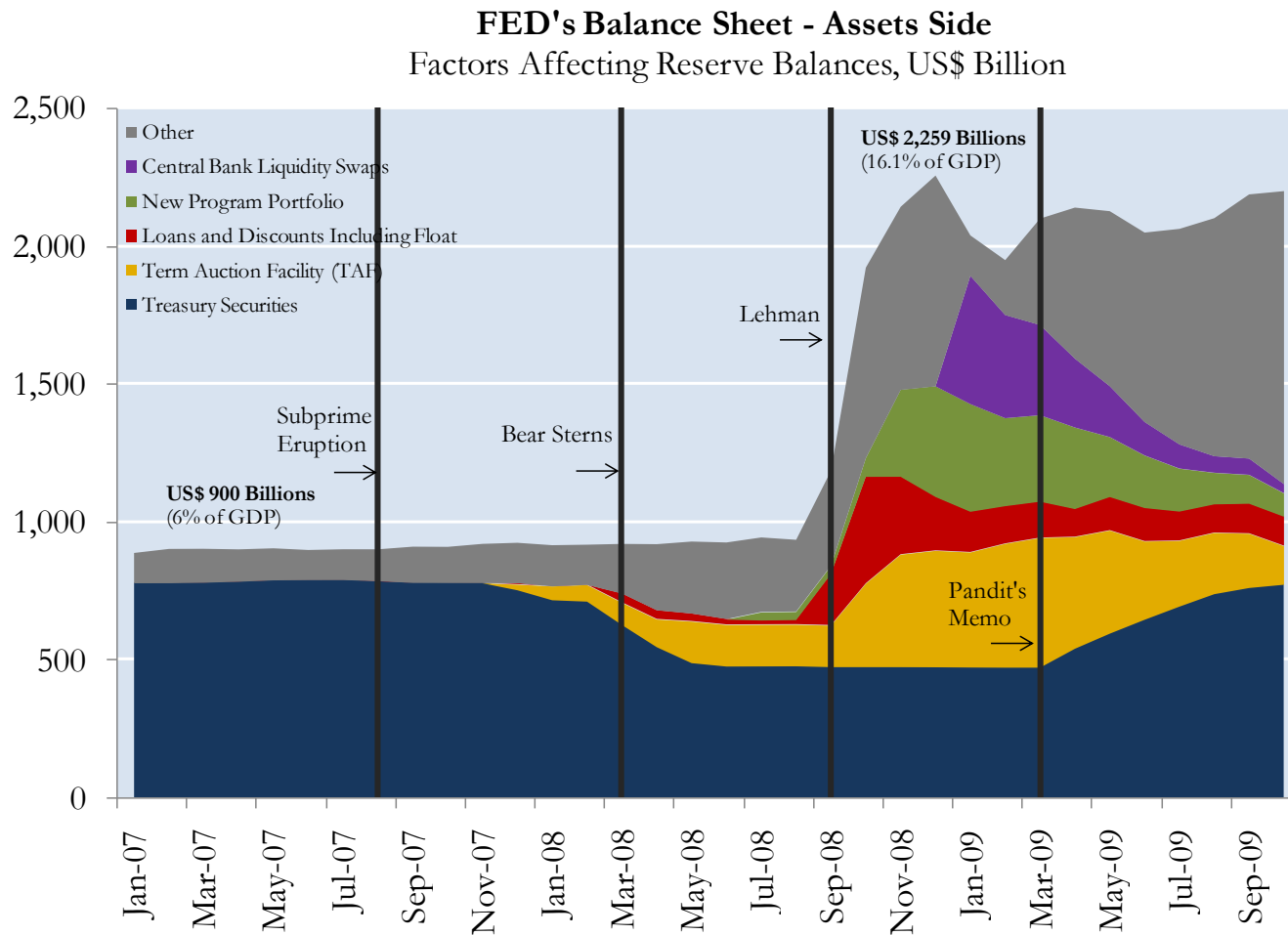
The catastrophic scenario was averted...

Standard & Poor's (Financial and Total Indexes) and VIX

Index number Aug-15-2007 = 100 (S&P indexes)

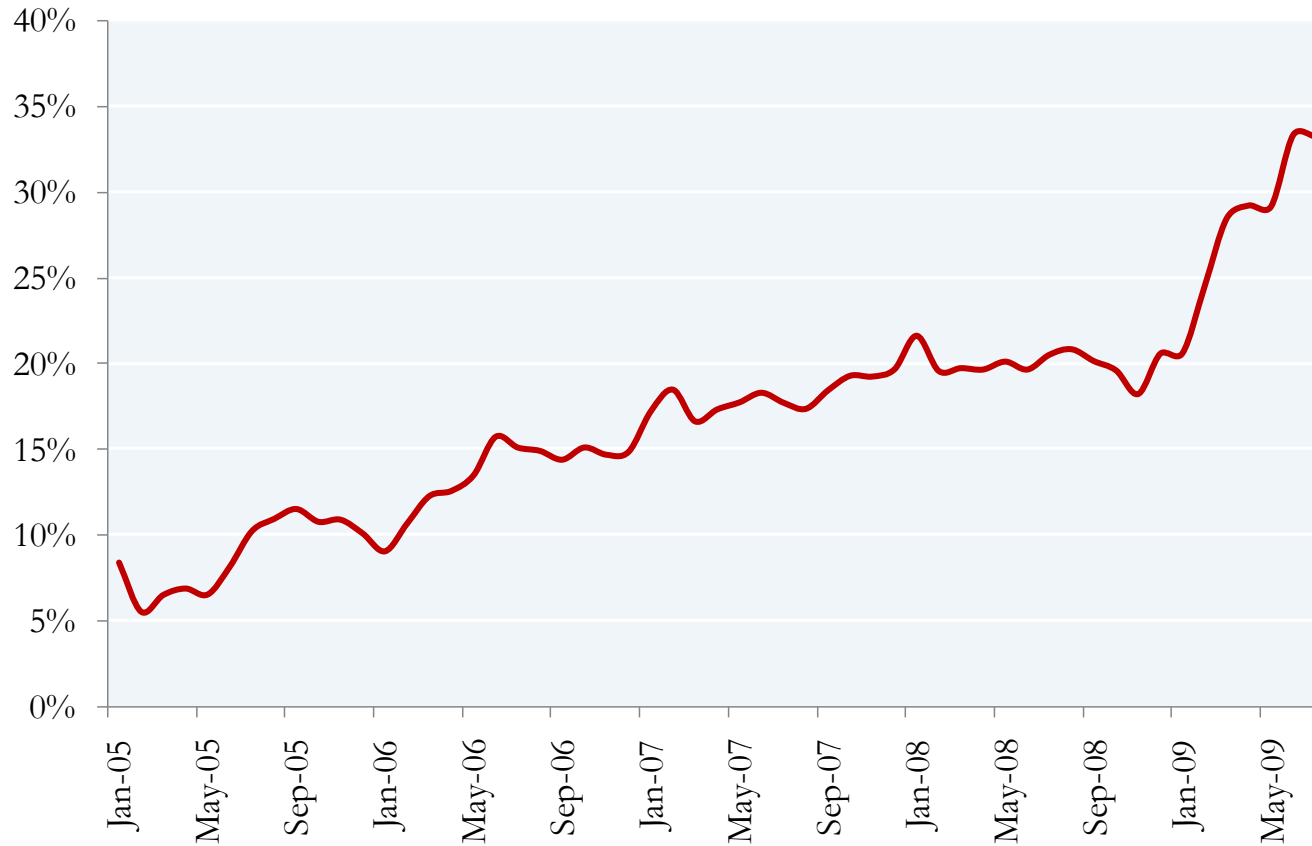


... thanks to bold risk absorption and countercyclical actions by central banks, led by the U.S. Fed ...



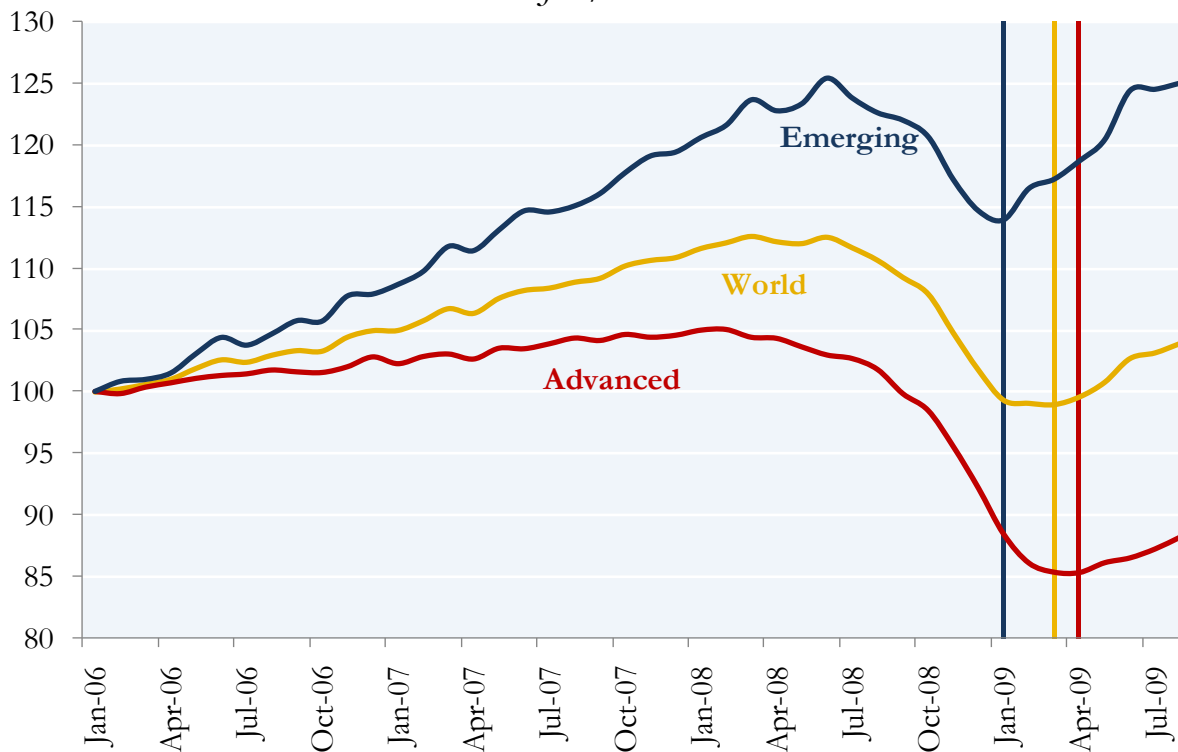
... and to substantial injections of fiscal and credit stimuli, including in large EMs, especially China

China: Real Private Domestic Credit
Annual Variation



The large emerging economies, including Brazil, are leading the world's recovery

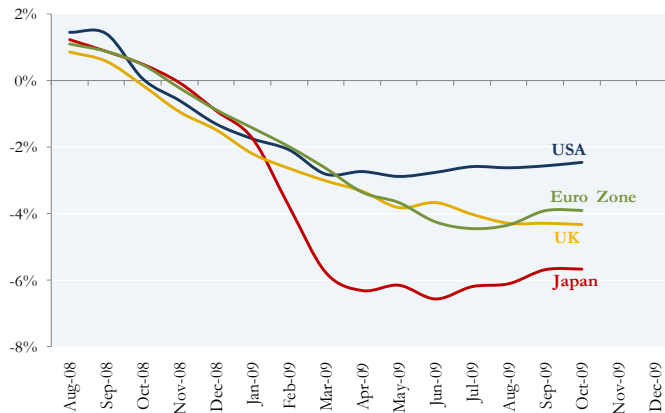
World Industrial Production
Index Jan/2006=100



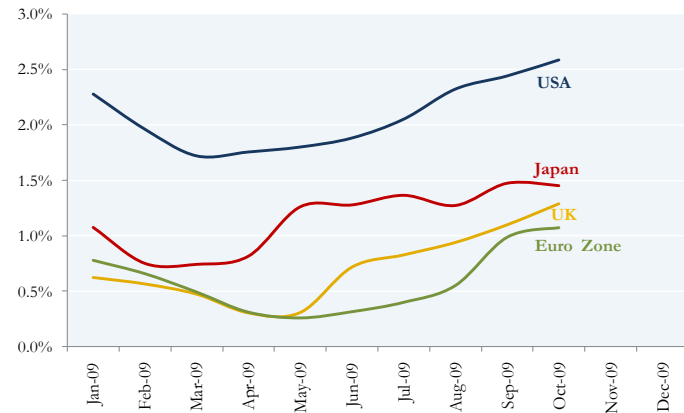
- *The emerging economies with strongest recoveries include Brazil, China, India, Korea, Malaysia, Philippines and Thailand*
- *They represent 52% of emerging economies' GDP*
- *Industrial production for this group increased by 18% from January to June 2009*

With surprises on the upside, ST growth forecasts for the center and periphery are being revised upwards ...

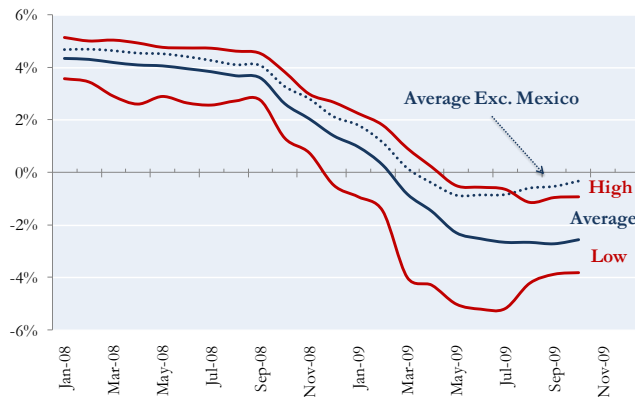
Developed Countries: 2009 Real GDP Growth Forecasts
Annual Growth Rate



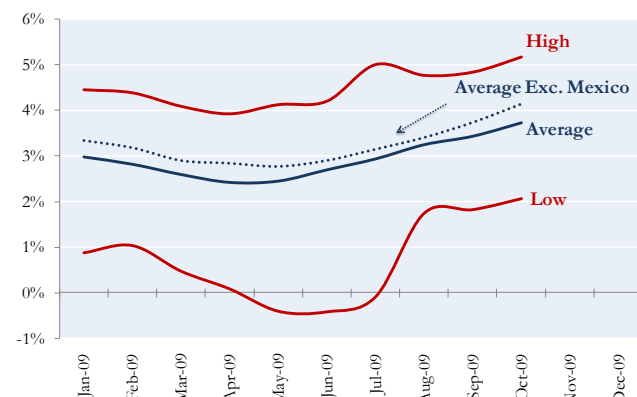
Developed Countries: 2010 Real GDP Growth Forecasts
Annual Growth Rate



LAC Countries: 2009 Real GDP Growth Forecasts
Annual Growth Rate

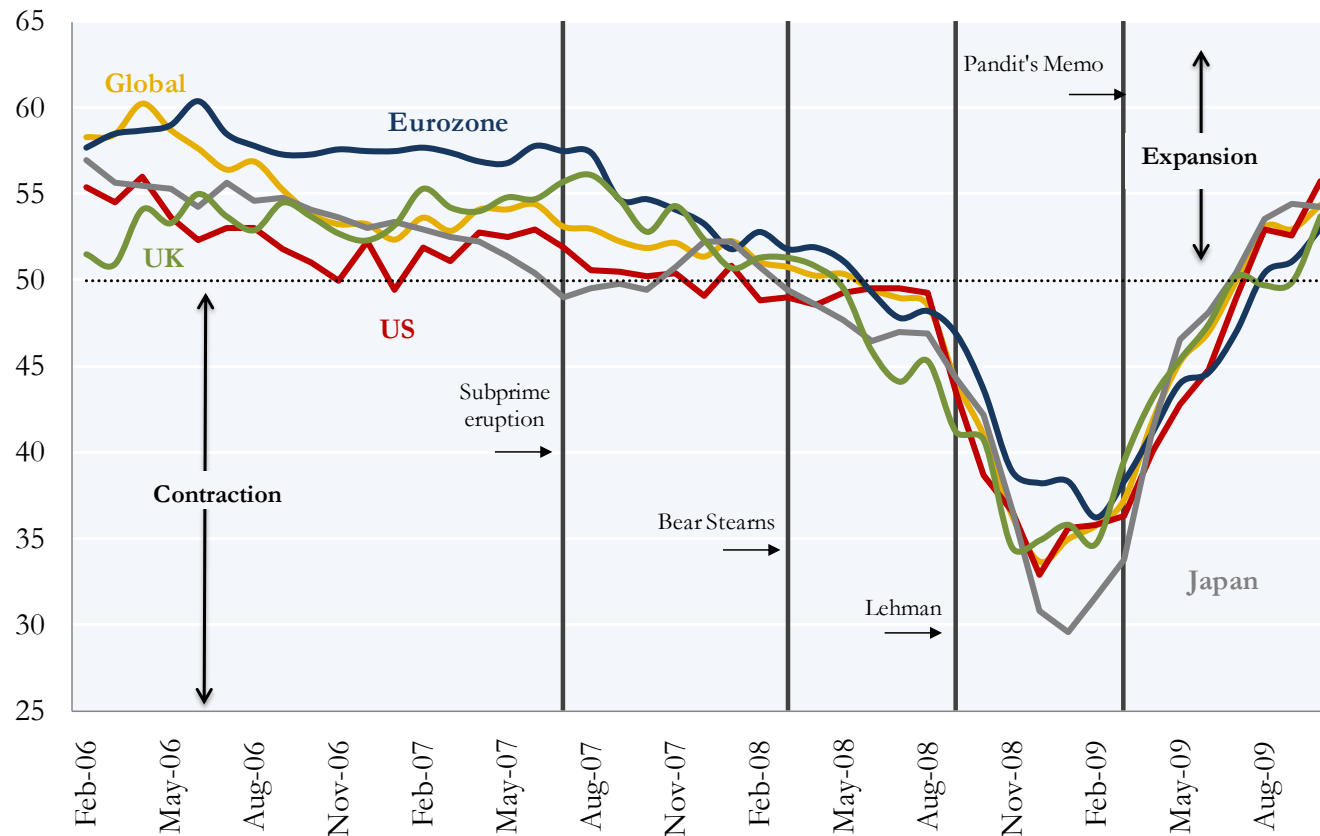


LAC Countries: 2010 Real GDP Growth Forecasts
Annual Growth Rate



However, the process of economic repair in rich countries is still incomplete ...

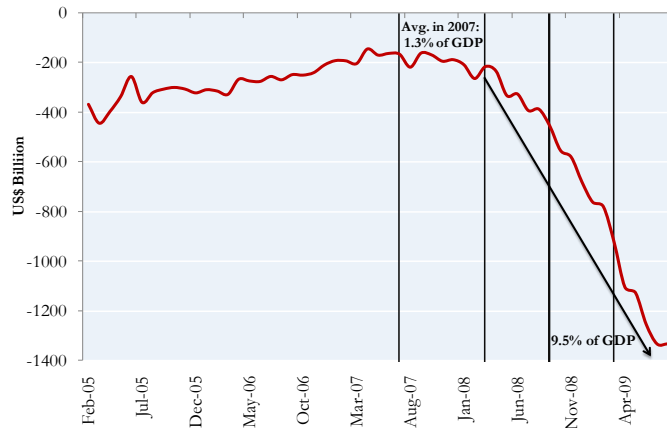
Developed Economies: Manufacturing PMI
Seasonally Adjusted



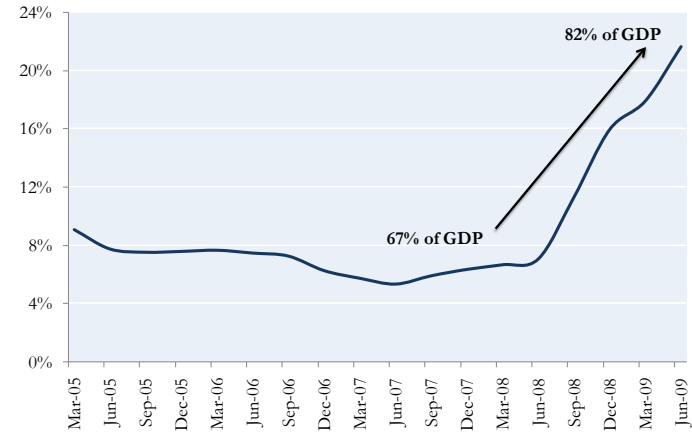
Manufacturing Purchasing Managers Index: assess business conditions in the manufacturing sector. A number above 50 indicates an expected increase of business conditions (expansion). A number below 50 indicates deterioration. Source: Bloomberg

... as the stimuli is most of the story so far behind the incipient recovery, especially in the US...

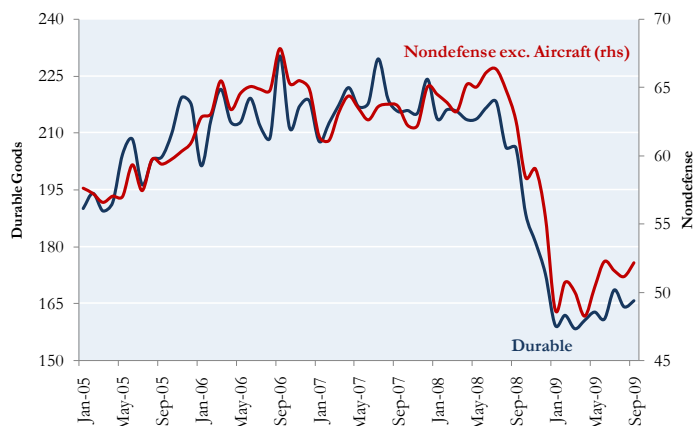
Budget Balance of Central Government
Accumulated in 12 Months



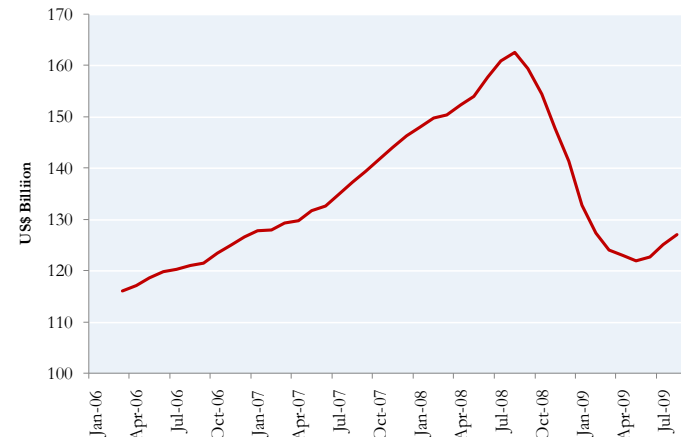
Gross Nominal Public Debt
Annual Variation



Manufacturers' New Orders
US\$ Billion, Seasonally Adjusted

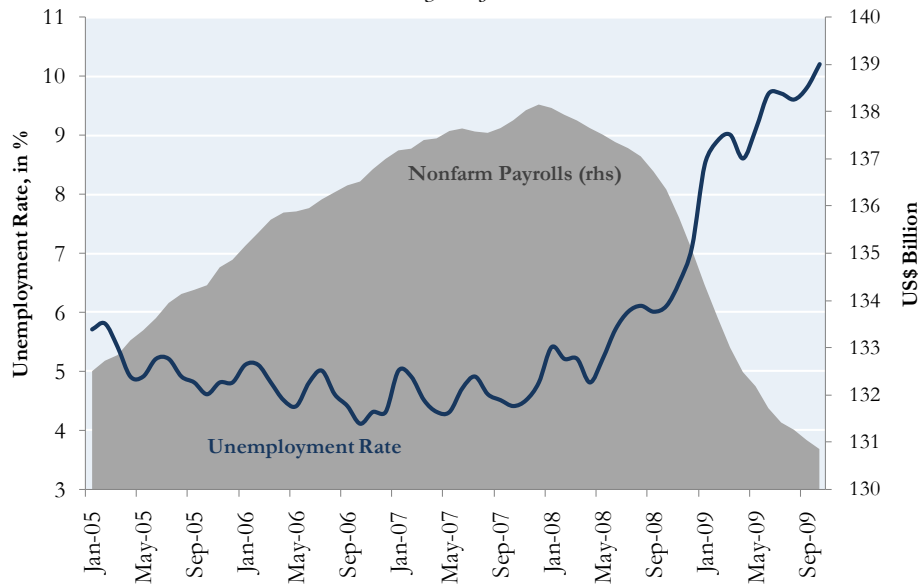


Exports of Goods and Services, BOP Basis
Seasonally Adjusted

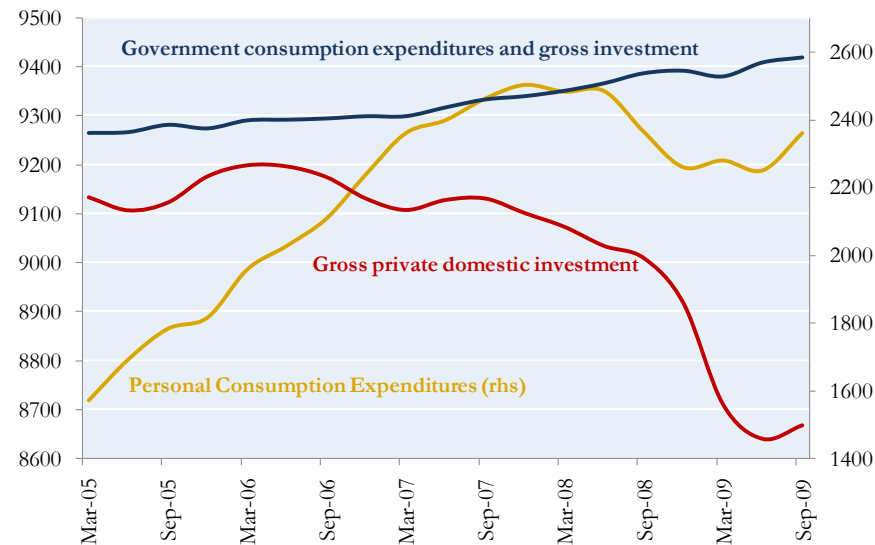


... and fragilities remain in labor markets and in private demand...

Nonfarm Payrolls and Unemployment Rate
Seasonally Adjusted

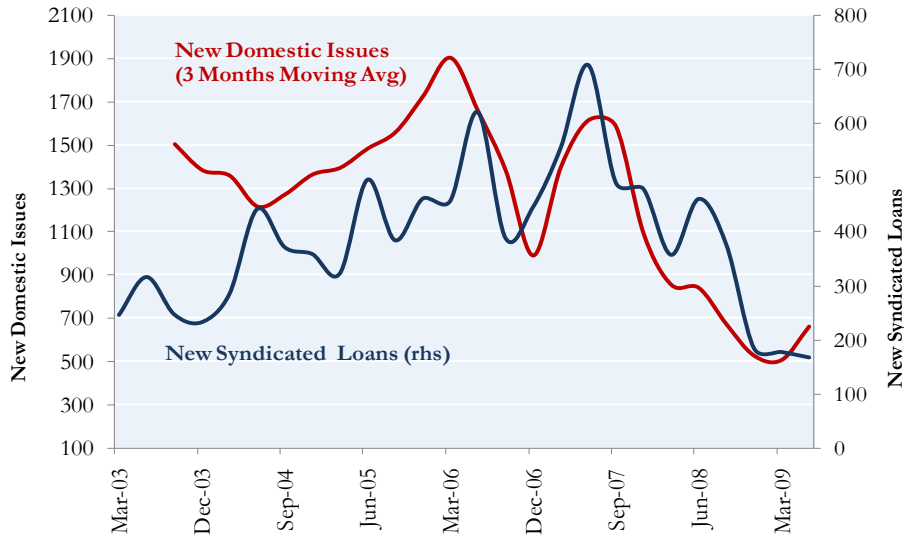


Private Demand Components
US\$ Billion, Chained (2005)

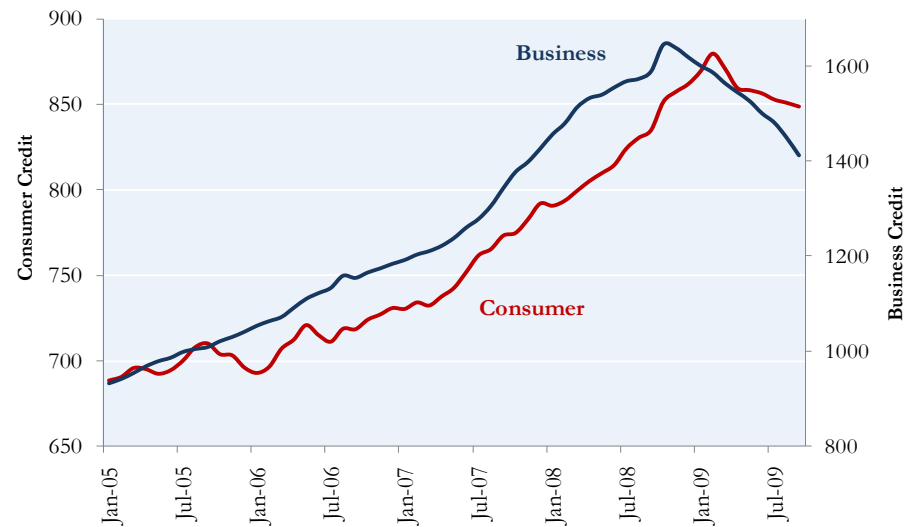


Also, domestic credit to households and firms remains depressed

Capital Markets in the US
New Capital Raisings, US\$ Billion

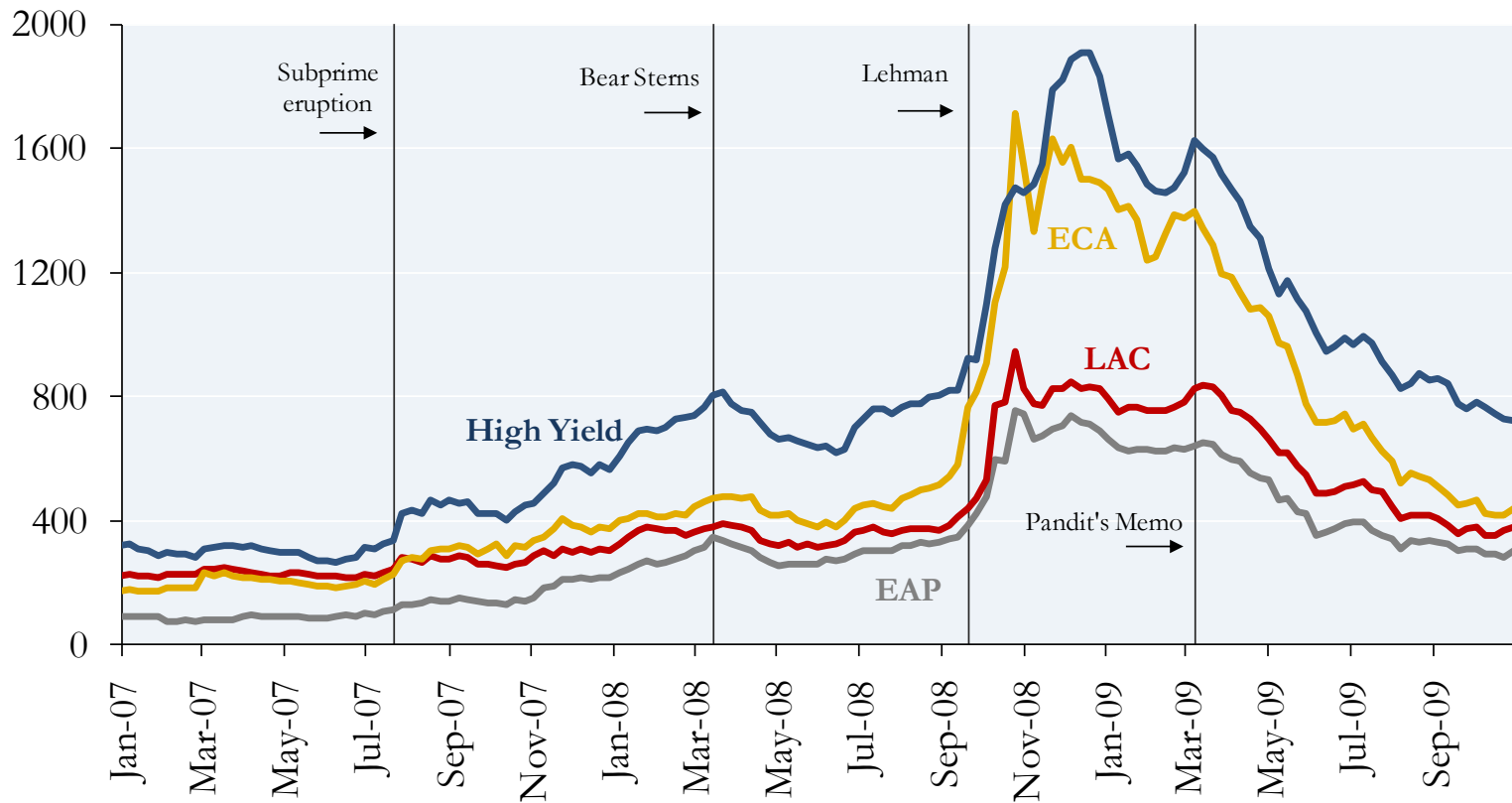


Private Credit in the US by Banks
US\$ Billions Seasonally Adjusted



External financial conditions have improved significantly for LAC and other emerging regions

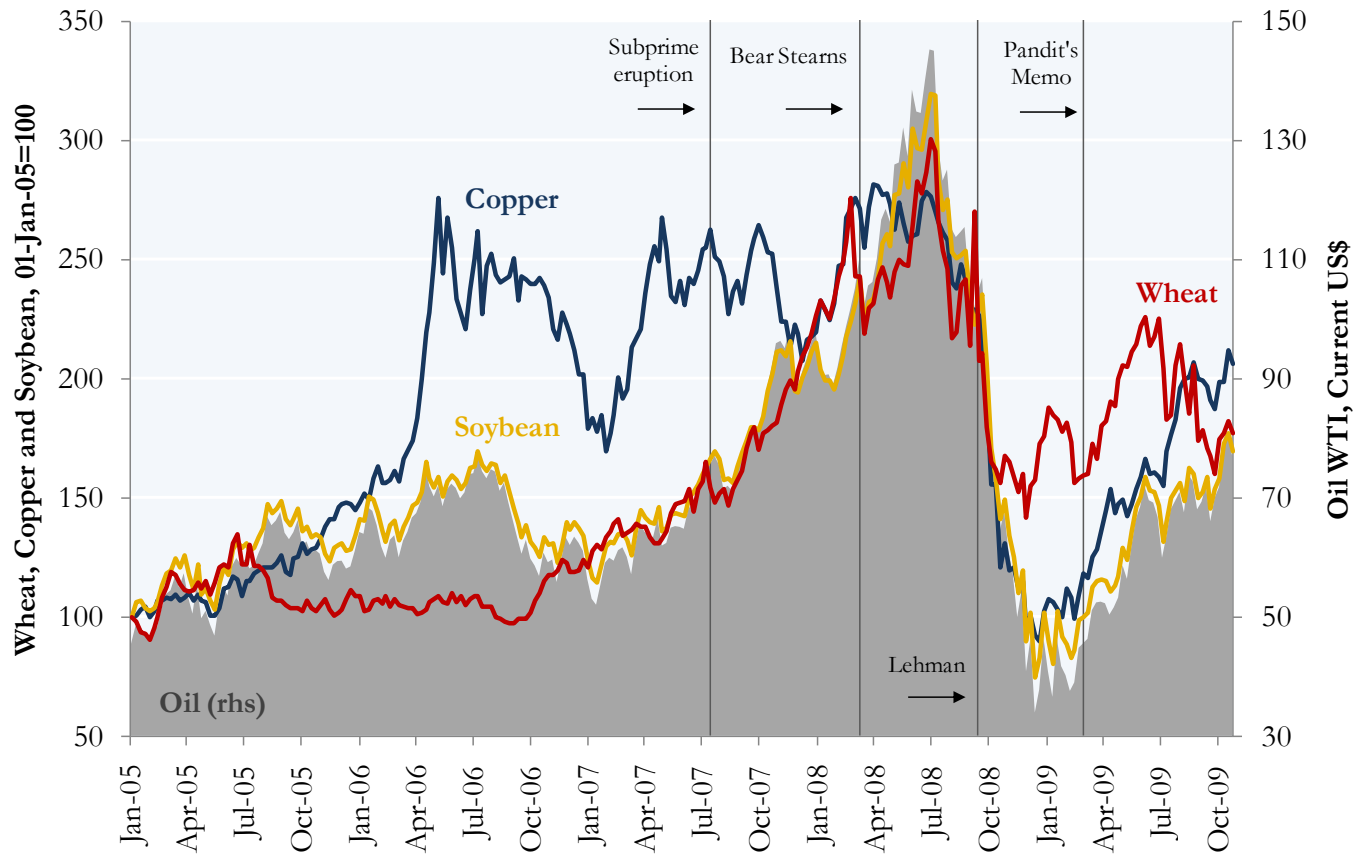
Corporate EMBI & U.S. High Yield Bond Spread
in basis points



And the rebound in commodity prices benefit net exporting countries in the region

Commodity Prices

Oil WTI in Current US\$, Wheat, Copper and Soybean: Index 01-Jan-05=100

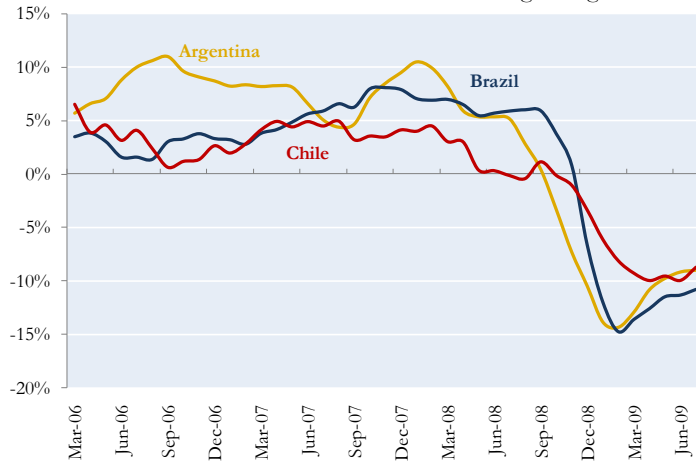


- *About 95% of LAC's GDP and 90% of LAC's population reside in countries that are net commodity exporters*
- *About half the number of countries in LAC are net commodity importers and are mainly located in Central America and the Caribbean*

There is considerable heterogeneity in the pace of recovery across LAC countries

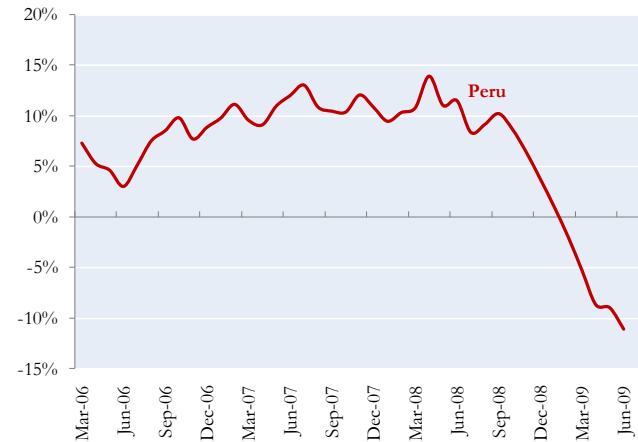
Rebounding

Industrial Production, YoY, 3 Months Moving Average



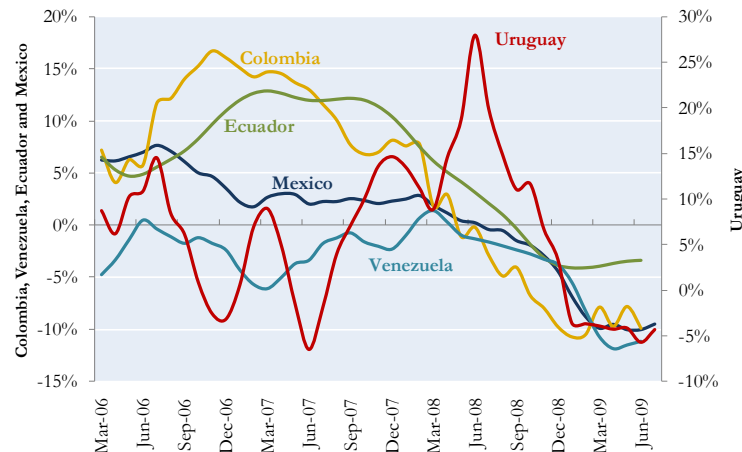
Still Falling

Industrial Production, YoY, 3 Months Moving Average



Stabilized?

Industrial Production, YoY, 3 Months Moving Average



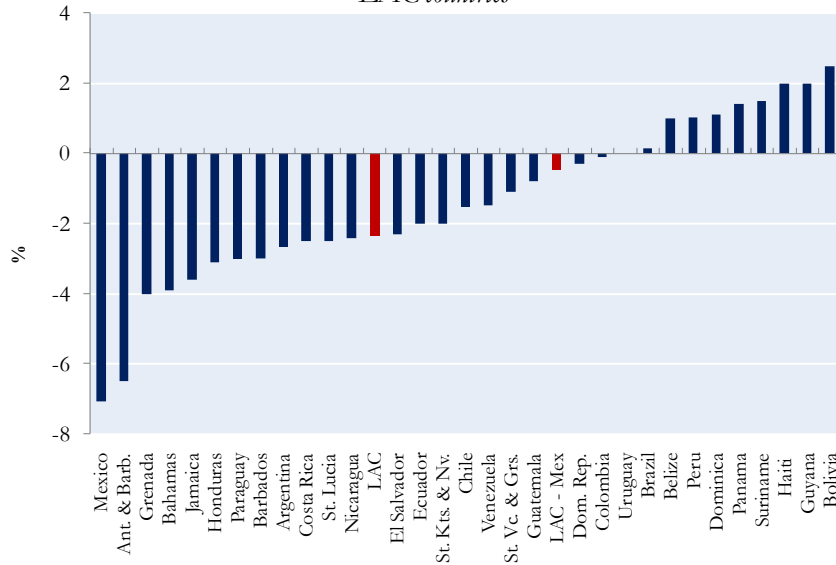
How Has LAC Fared in Comparative Terms?

Part 2

2009 will be a year of recession for LAC (Mexico the hardest hit) but a broad recovery is expected for 2010

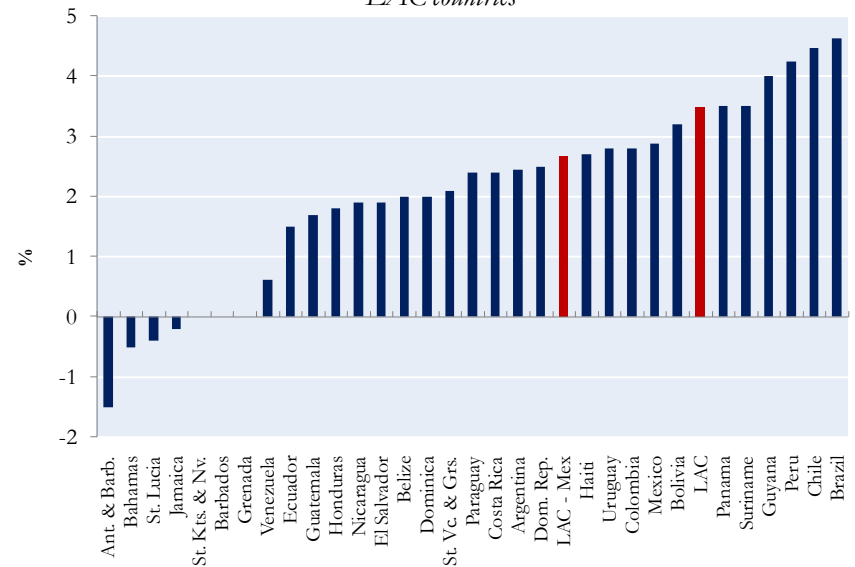
Real GDP Growth Forecasts for 2009

LAC countries



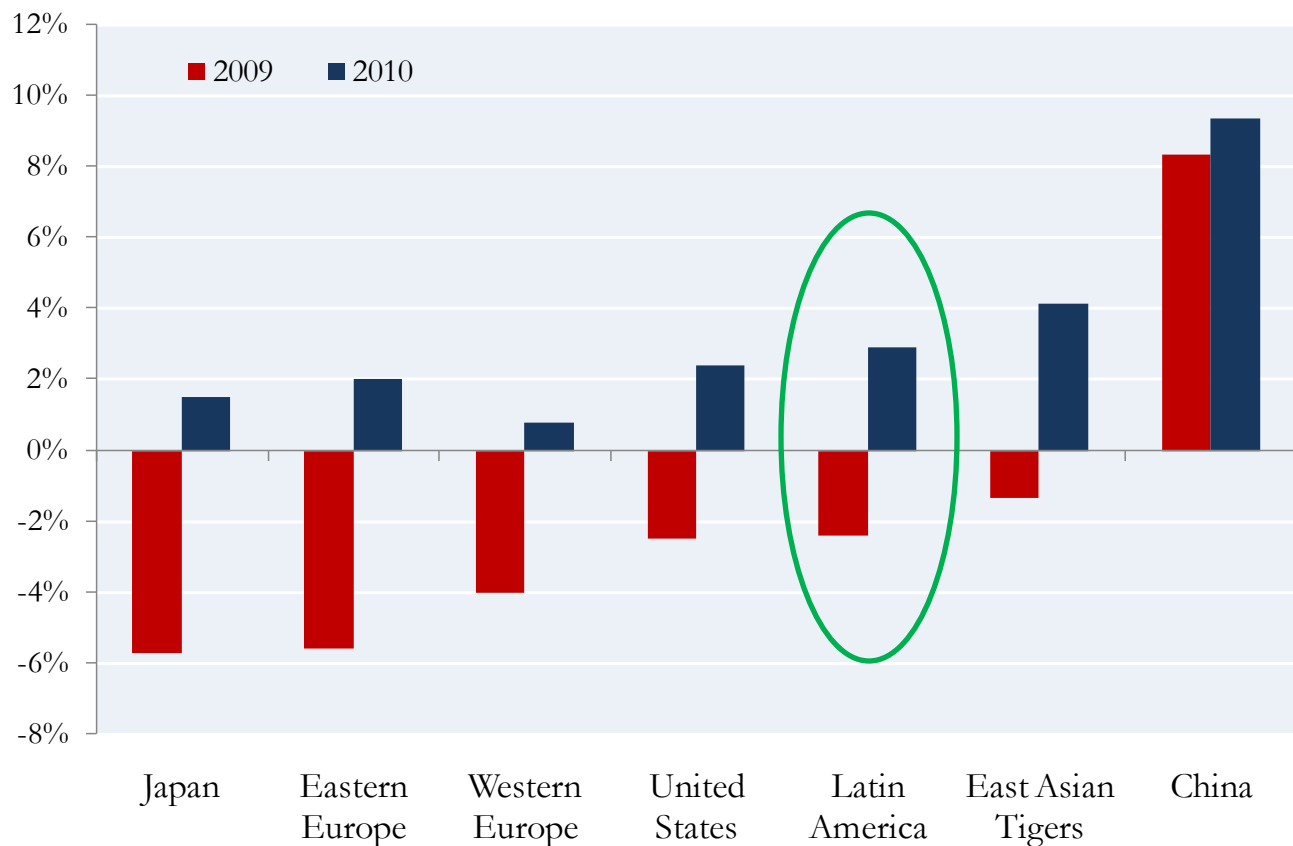
Real GDP Growth Forecasts for 2010

LAC countries

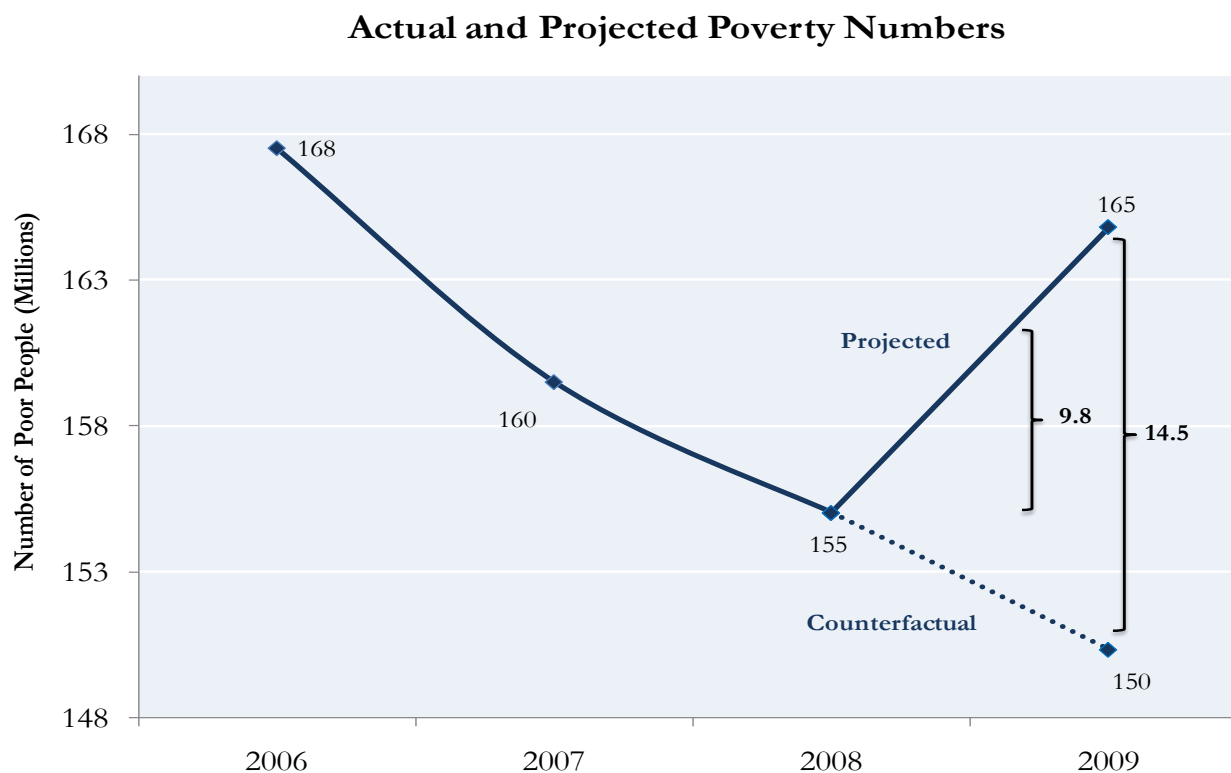


The 2009 recession in LAC is less pronounced than in other areas of the world

Recent Real GDP Growth and Forecasts for 2009-2010
Annual GDP Real Growth Rate,

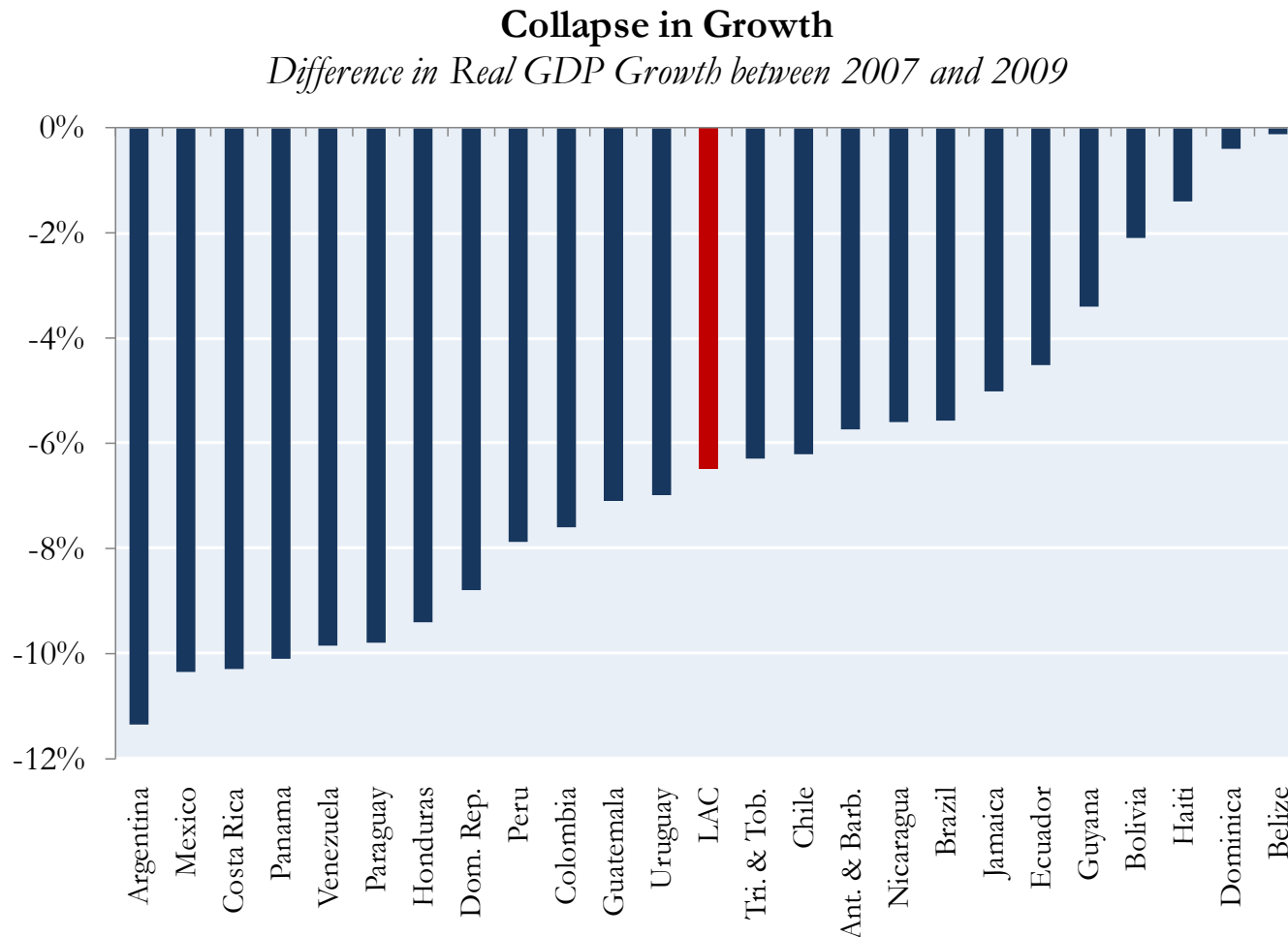


But the recession in LAC threatens social gains



- *Between 2002 and 2008, almost 60 million people in LAC moved out of poverty*

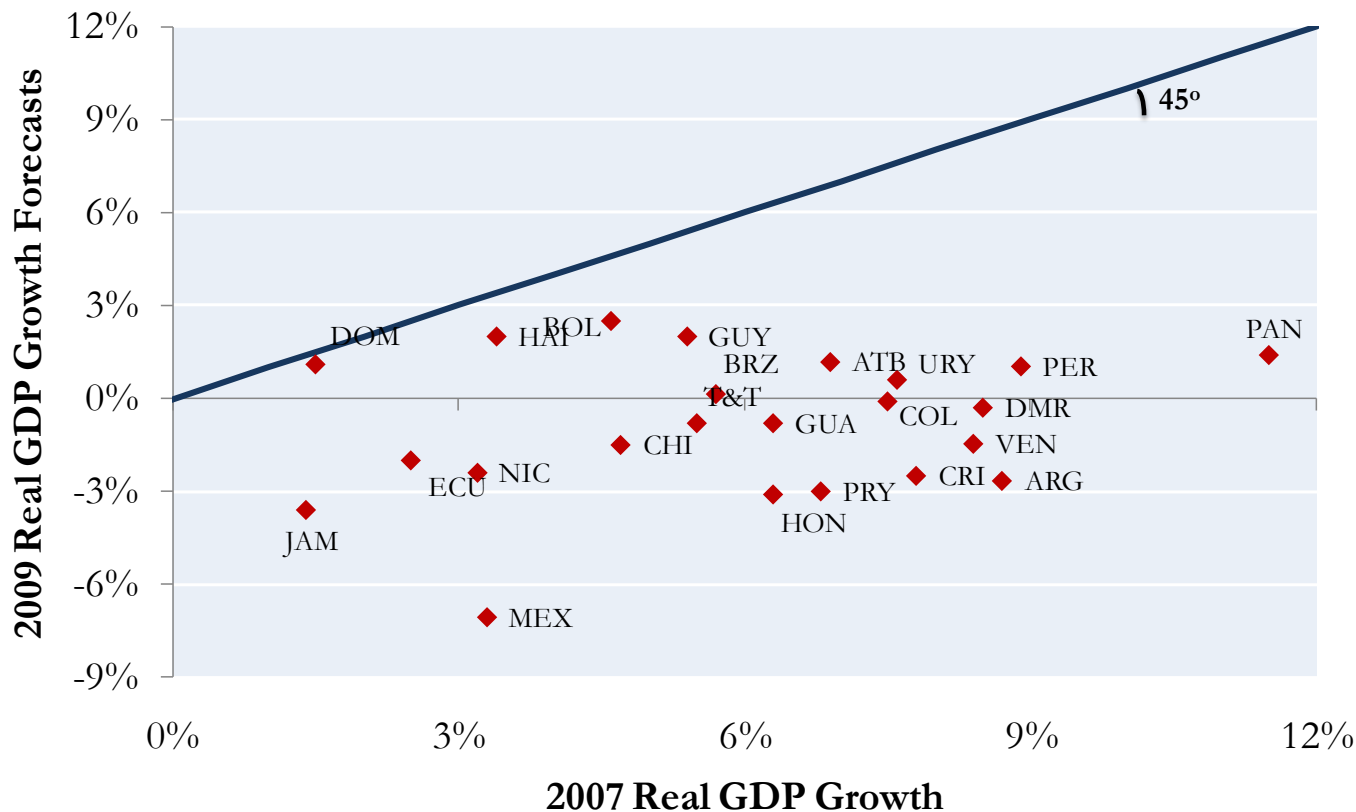
The *growth collapse* in LAC is significant on average, but cross-country variation is nontrivial



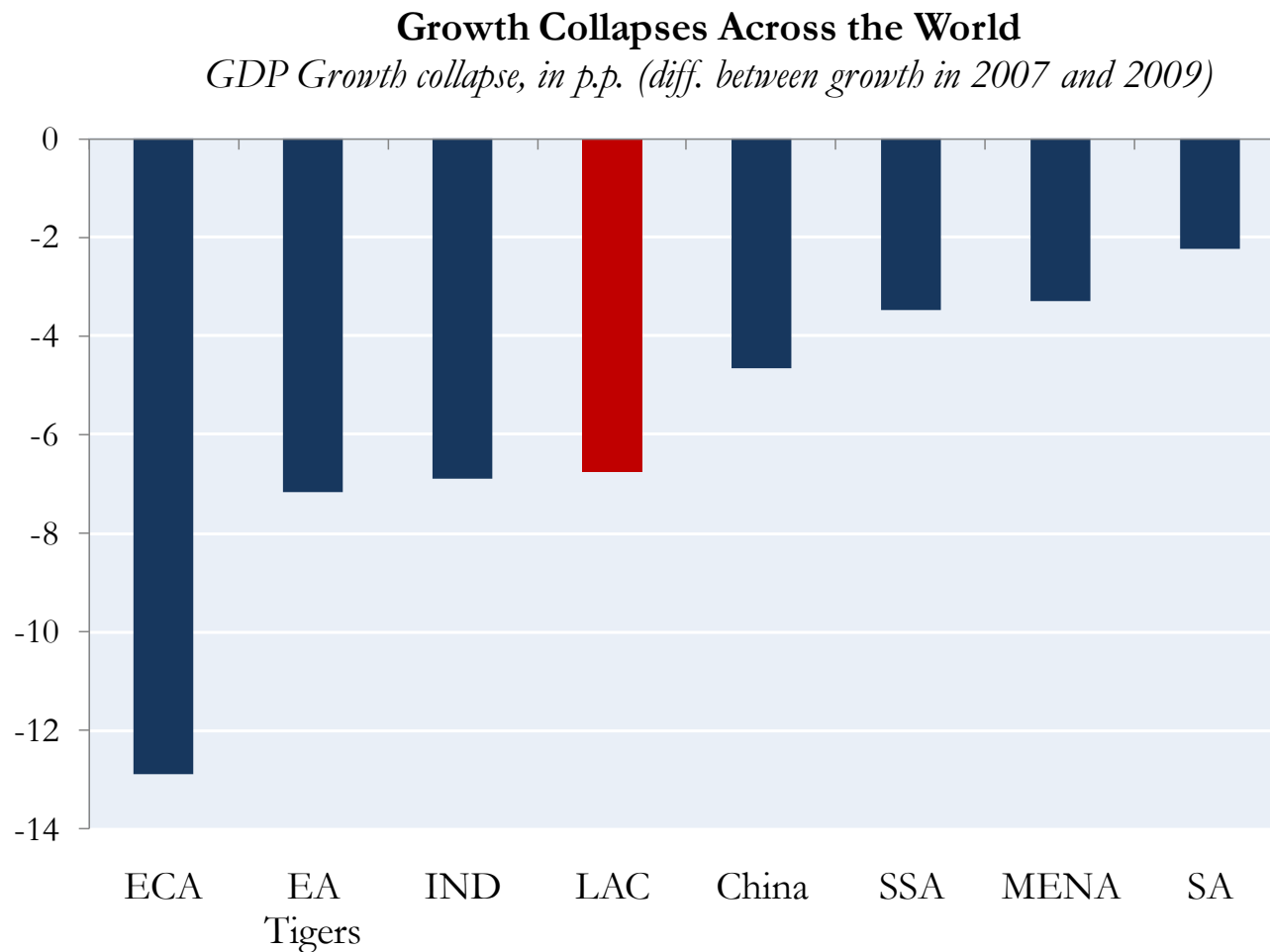
For many LAC countries, the collapse was from relatively high growth rates

Real GDP Growth in LAC

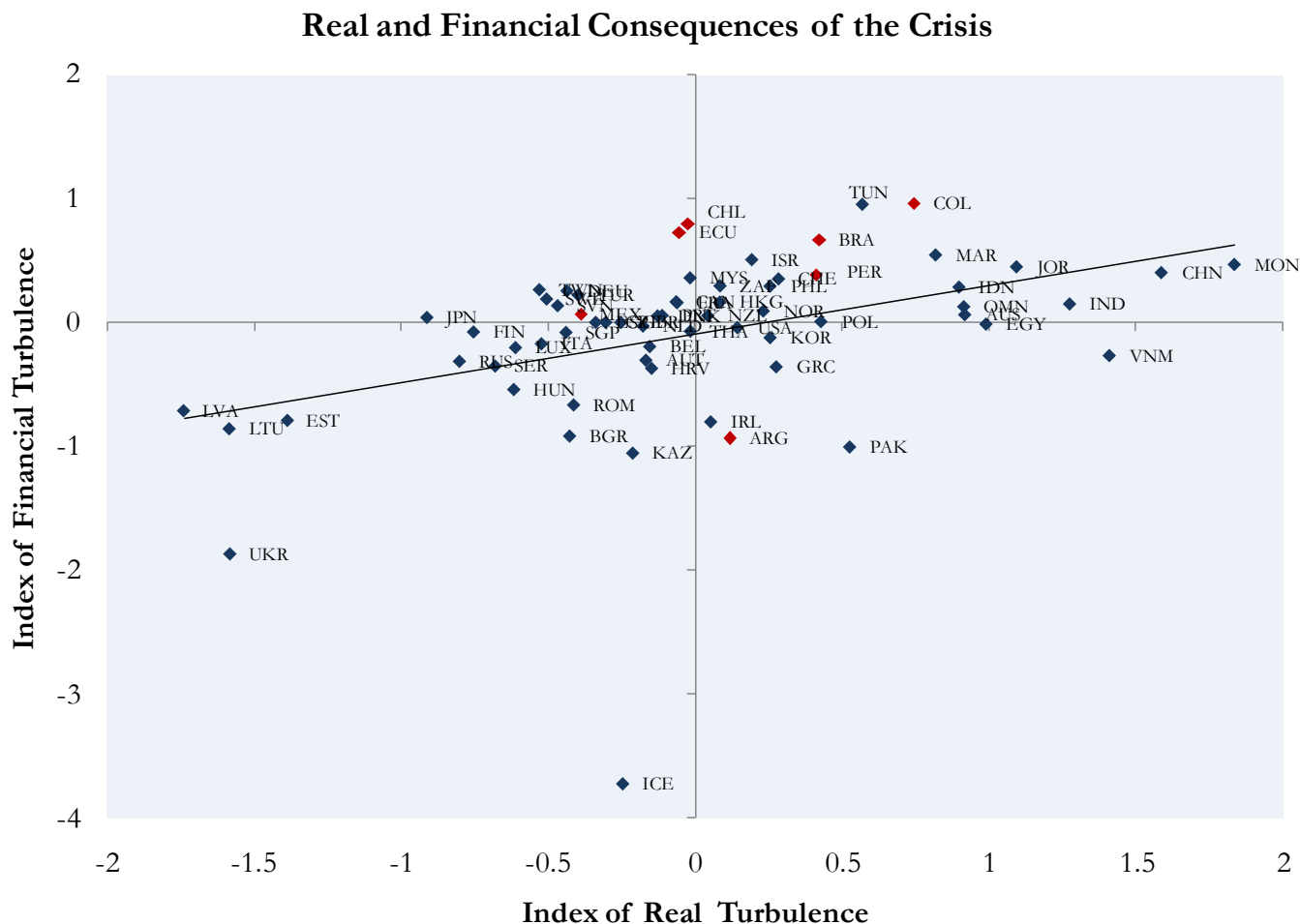
2007 and 2009 Forecasts



LAC's growth collapse is no greater than that in rich countries & the Tigers, and much smaller than ECA's



All things considered, LAC was not hit as hard...



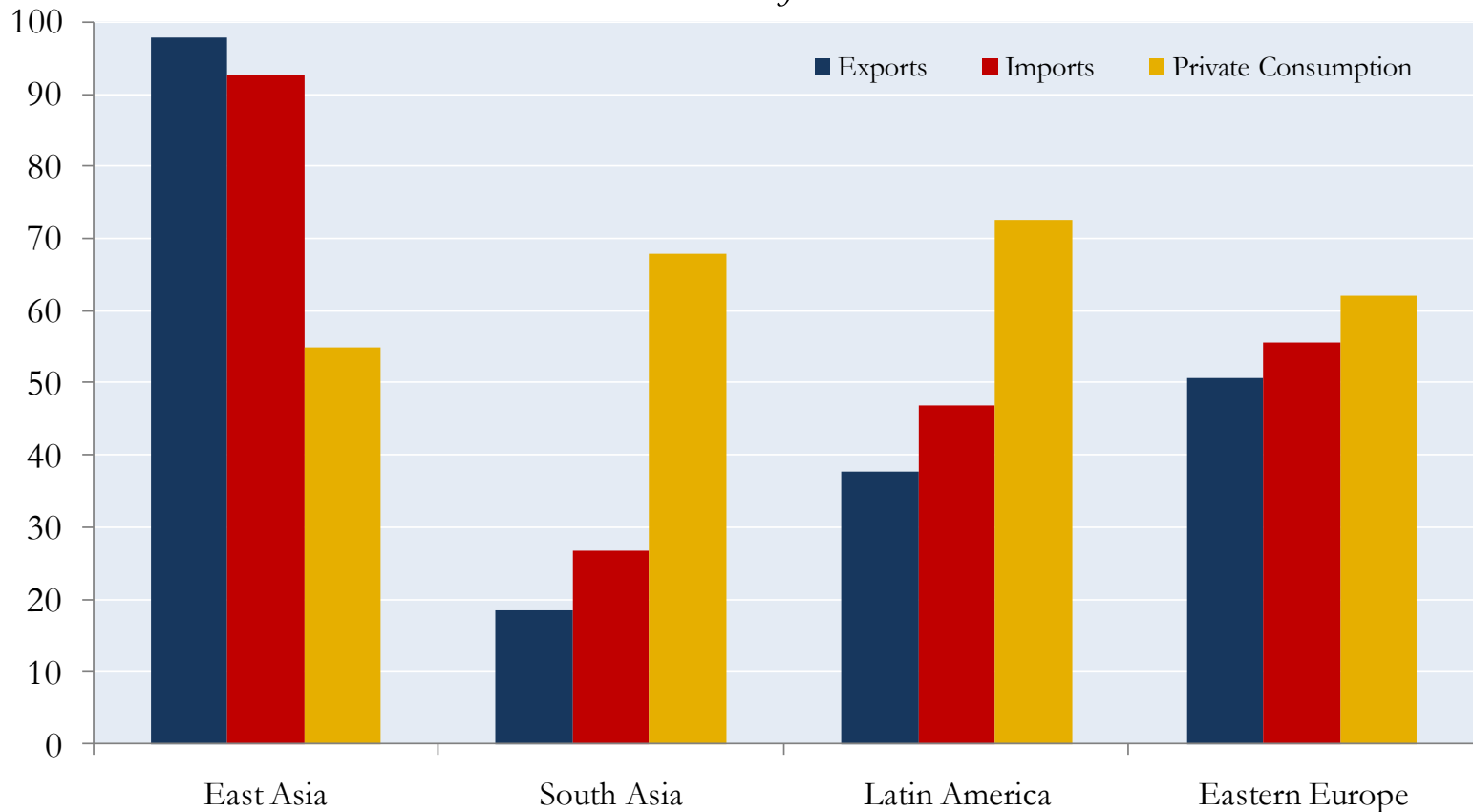
Source: LCRCE Staff calculations. Computed as the "principal factor". Summarizes information of the following variables: (a) 2009.Q3 y-o-y GDP growth, (b) 2009.Q3 y-o-y industrial production, (c) 2009.Q3 y-o-y growth in exports, (d) March 2009 y-o-y % change in stock prices, (e) March 2009 y-o-y % change in the REER, and (f) March 2009 y-o-y % change in the Institutional Investor's country credit risk rating. (a), (b) and (c) for the real index and (d), (e) and (f) for the financial index.

Explaining cross-country differences in the collapse

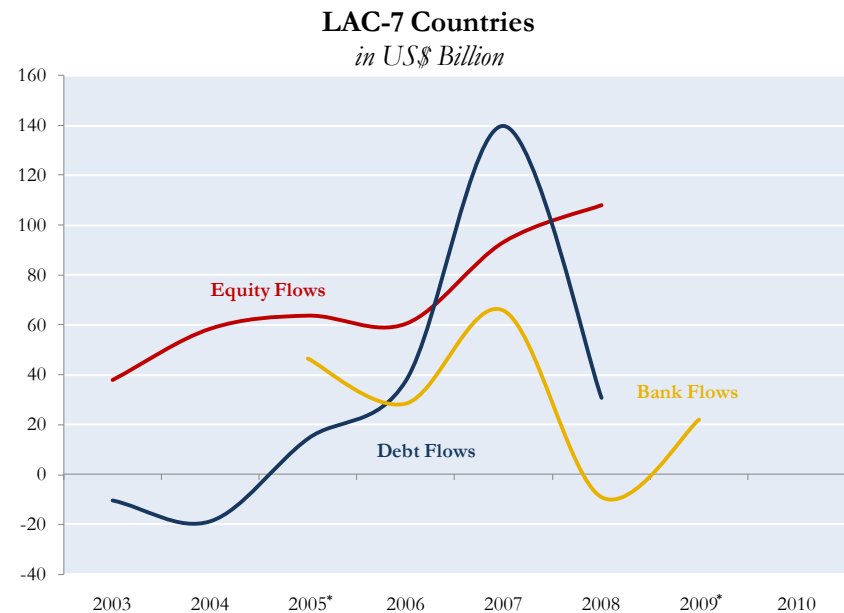
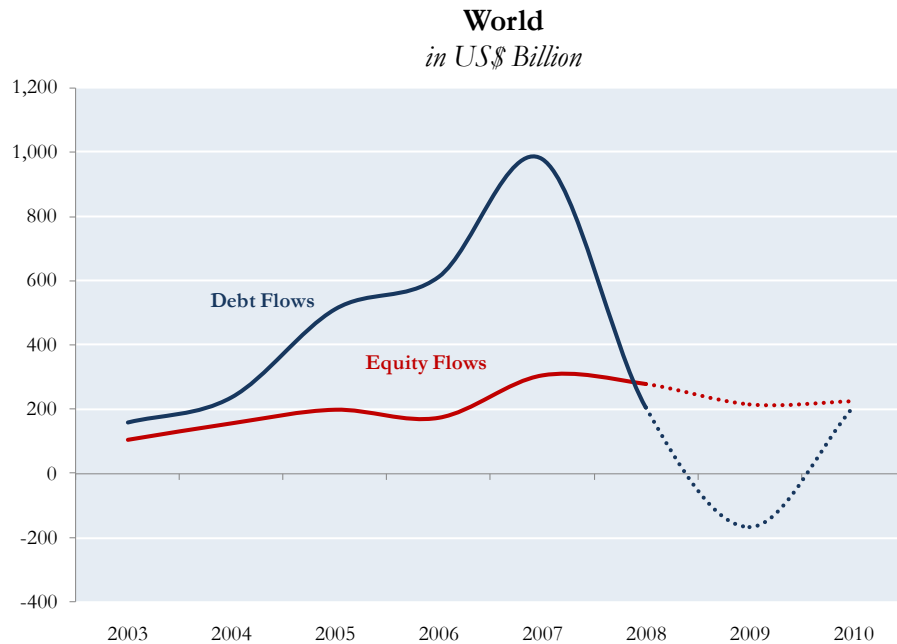
- Regression analysis of the growth collapse from 2007 to 2009
 - Sample of 126 countries
- Collapses were larger in countries characterized by
 - Greater trade and financial openness
 - Higher share of manufacturing exports
 - Greater export reliance on US and other rich country markets
 - Weaker banking systems
- This helps explain contrasts in the collapse
 - Brazil-Mexico; LAC-Eastern Europe; LAC-East Asian Tigers
- Better macro-financial policies in LAC → no systemic damage
 - They helped dampen the growth collapse somewhat...
 - ... but they mainly raised financial sector resilience (the Caribbean is an exception) and enabled countercyclical (particularly monetary) policy

Trade openness across emerging regions

Structure of GDP *as % of GDP*

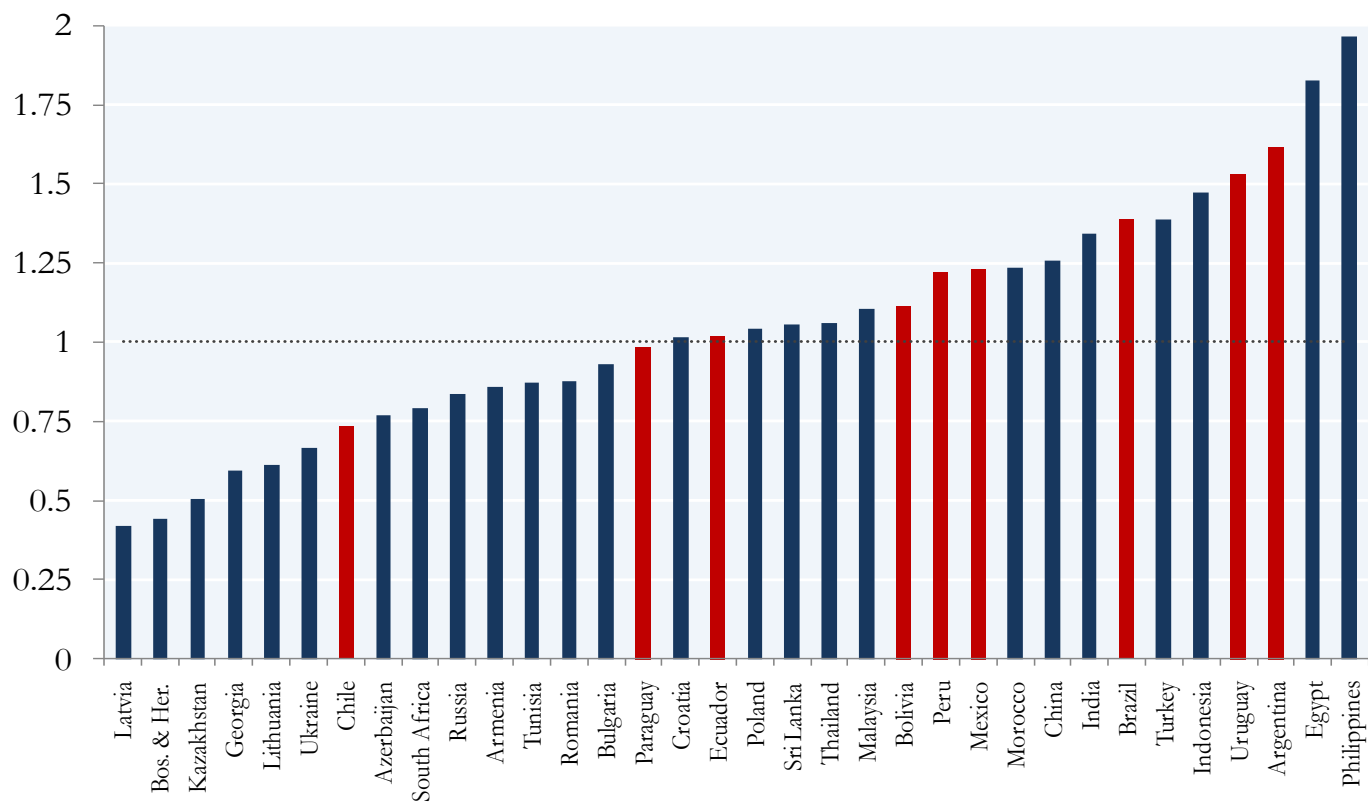


LAC-7: foreign debt flows fell sharply but FDI remained stable and a rebound in debt flows is now underway



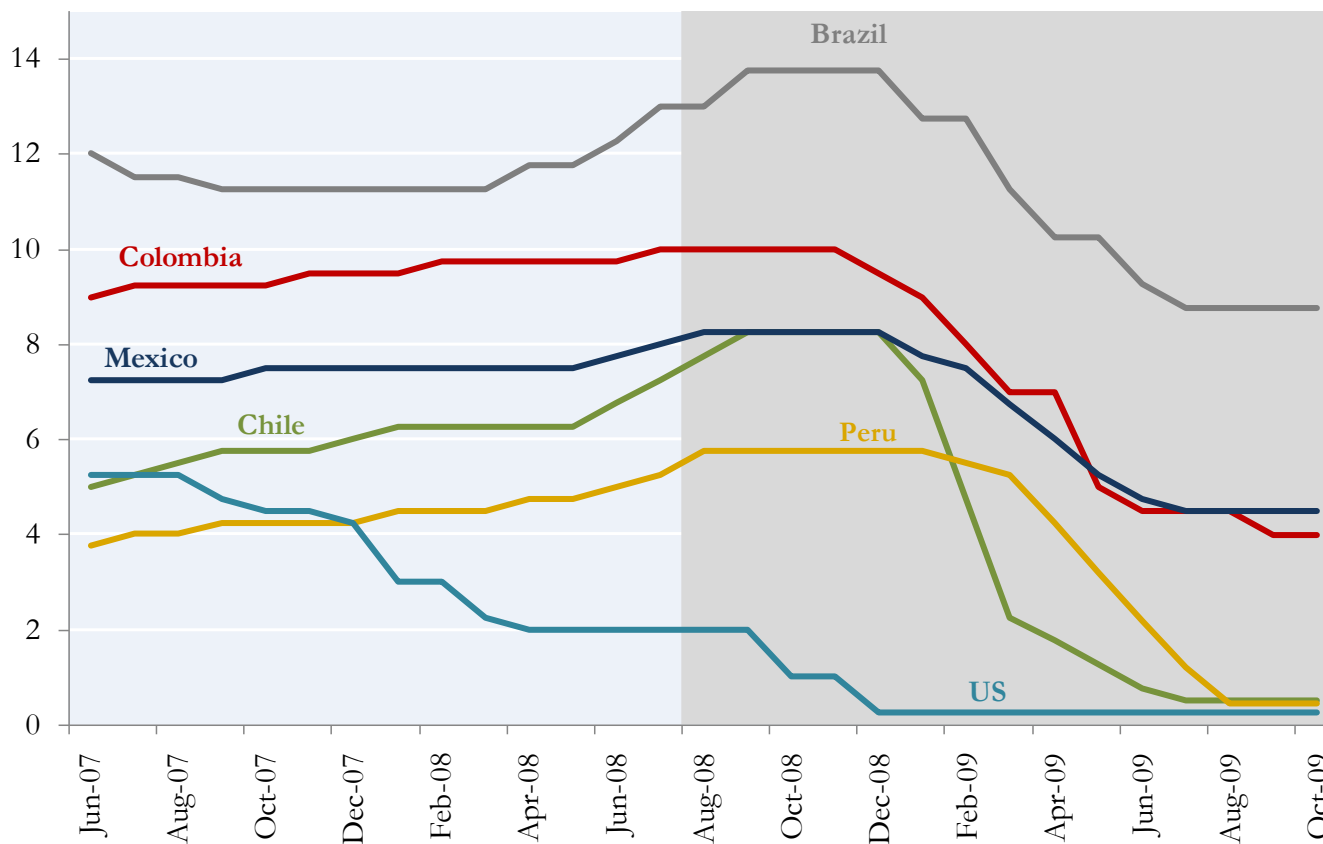
Healthy banking systems dampened the collapse

Deposit to Loan Ratios
Emerging Countries, 2007 Data



Inflation-targeting countries in LAC undertook aggressive countercyclical monetary policies

Monetary Policy Rates
Inflation-Targeting LAC Countries, in %



The dog that did not bark: absence of domestic crises in a region traditionally plagued by them

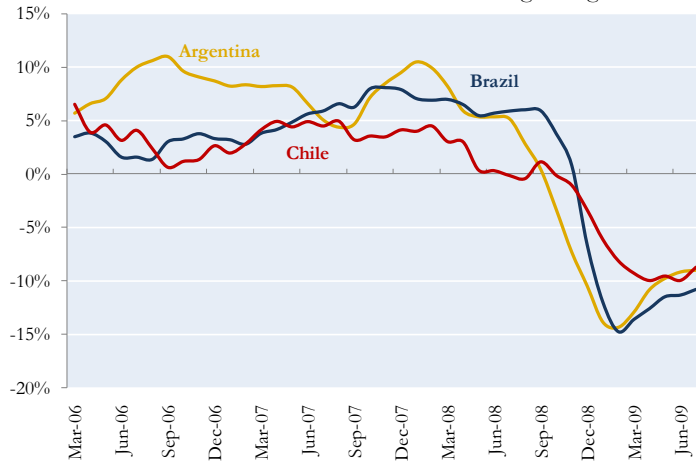
Banking Crises in LAC Countries

1980-1985		1995-2000		2008-2009
Argentina	1980	Argentina	1995	
Brazil	1985	Brazil	1995	
Chile	1980	Colombia	1998	
Colombia	1982	Ecuador	1996, 1998	
Ecuador	1980	Honduras	1999	
Mexico	1981	Jamaica	1996	
Peru	1983	Nicaragua	2000	
Uruguay	1981	Paraguay	1995	
		Peru	1999	

There is considerable heterogeneity in the pace of recovery across LAC countries

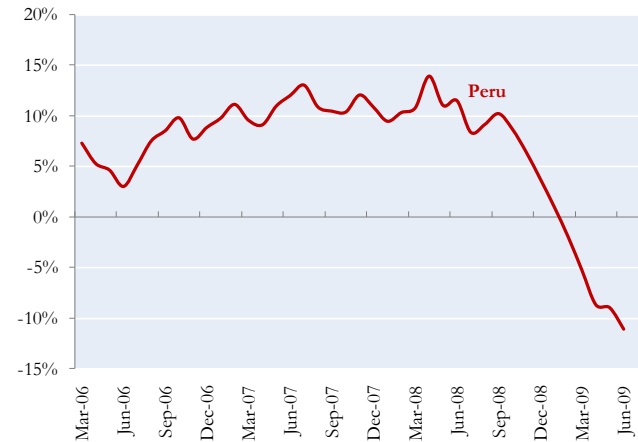
Rebounding

Industrial Production, YoY, 3 Months Moving Average



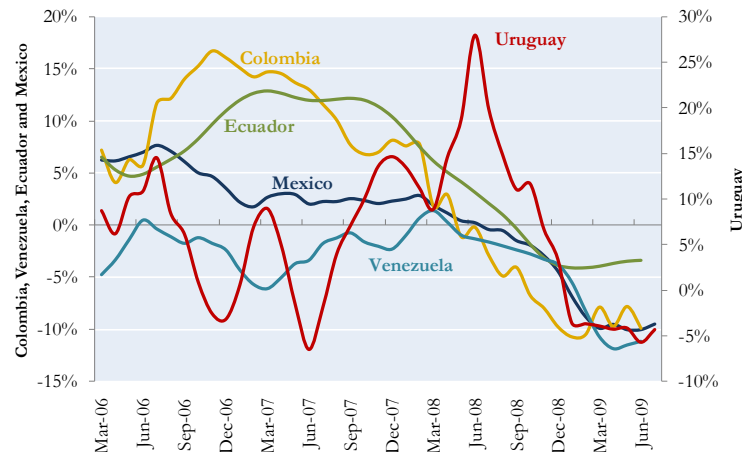
Still Falling

Industrial Production, YoY, 3 Months Moving Average



Stabilized?

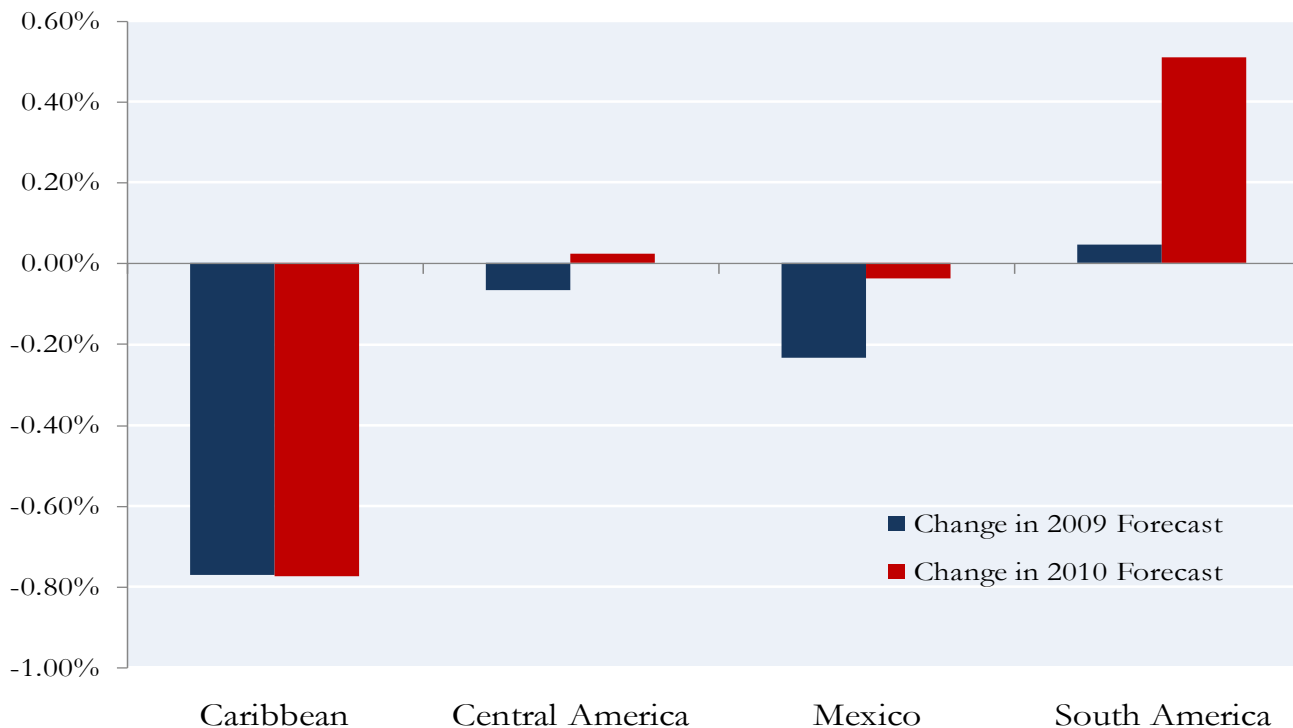
Industrial Production, YoY, 3 Months Moving Average



The Caribbean is LAC's softest spot, where delayed effects of the global crisis are most troublesome

Changes in Forecasts: LAC Countries

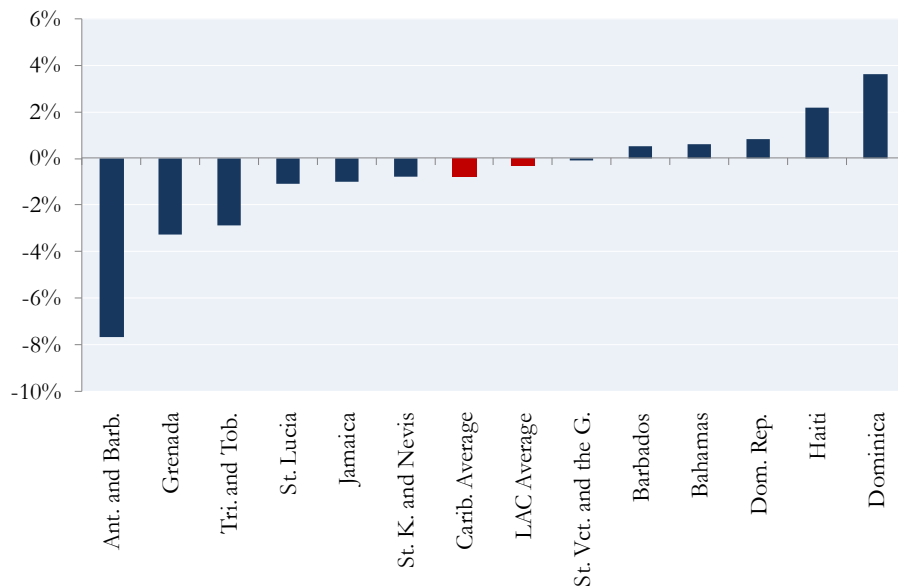
Comparison Between the Projections in May-09 and Oct-09



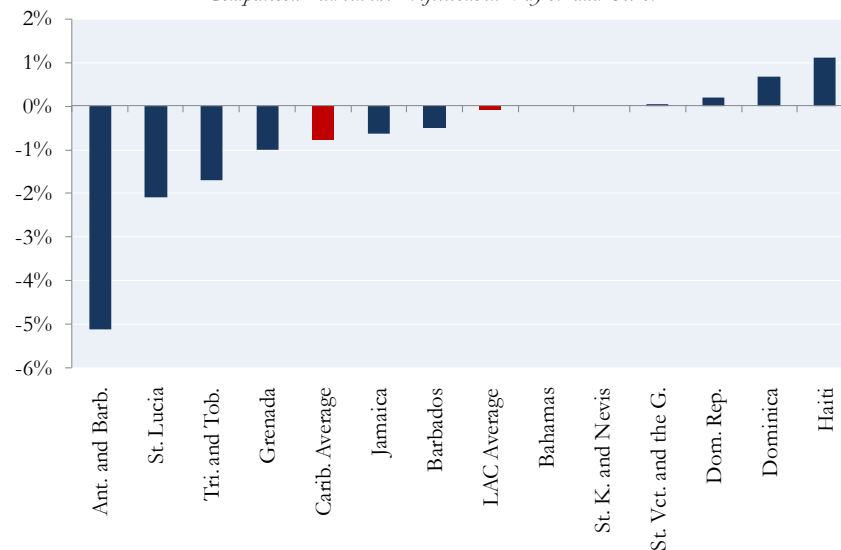
Caribbean:
Potentially explosive combination of financial sector fragility and high indebtedness, interacting with smallness

Caribbean: general deterioration in economic growth forecasts for 2009 and 2010

Changes in Forecasts: 2009 Real GDP
Comparison Between the Projections in May-09 and Oct-09



Changes in Forecasts: 2010 Real GDP
Comparison Between the Projections in May-09 and Oct-09



Looking Ahead: Haziness in the Global Horizon and Challenges for LAC

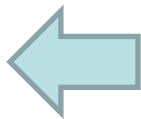
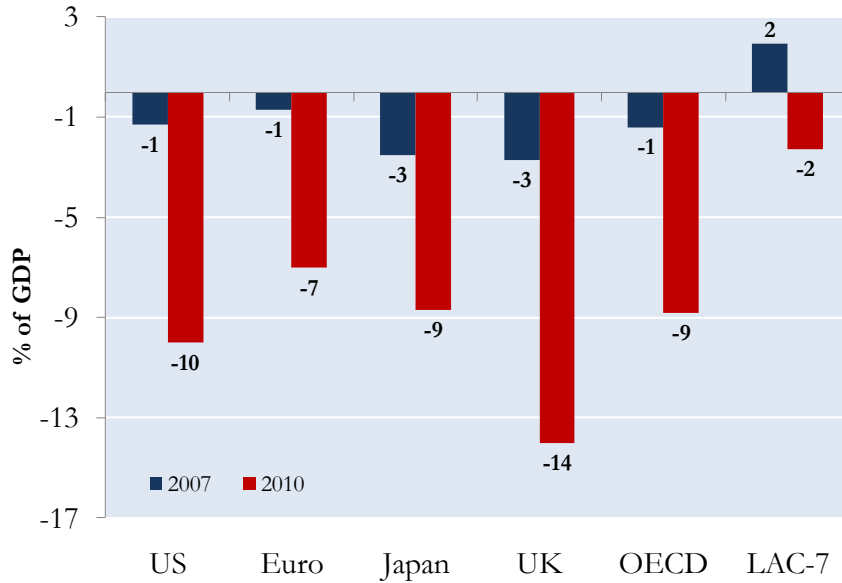
Part 3

By and large, LAC is well-positioned for recovery

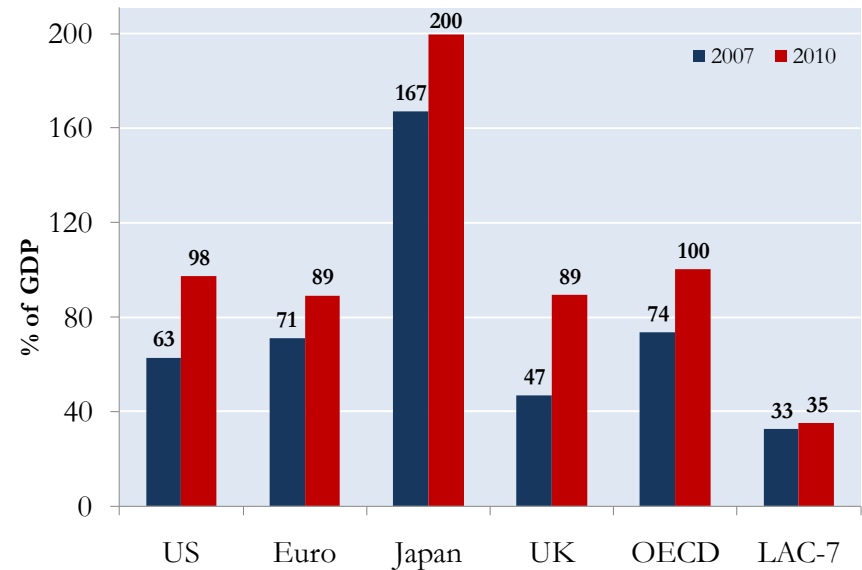
- Despite being financially globalized, LAC is coming out of the crisis without systemic damage
 - Improved macro-financial immune system passed a tough test
 - In contrast with rich countries, LAC's fiscal and debt positions remain comfortable 
 - Exchange rate flexibility acted as cushion (countercyclicality) and facilitated external adjustment at lower output cost than otherwise
- LAC's economies with more diversified export destinations and complementary to China's are recovering ahead of the pack
- On average, LAC emerges out of this crisis as a relatively more attractive destination for investment 

Unlike rich countries, LAC comes out of the crisis with comfortable fiscal & public debt positions

Fiscal Balance



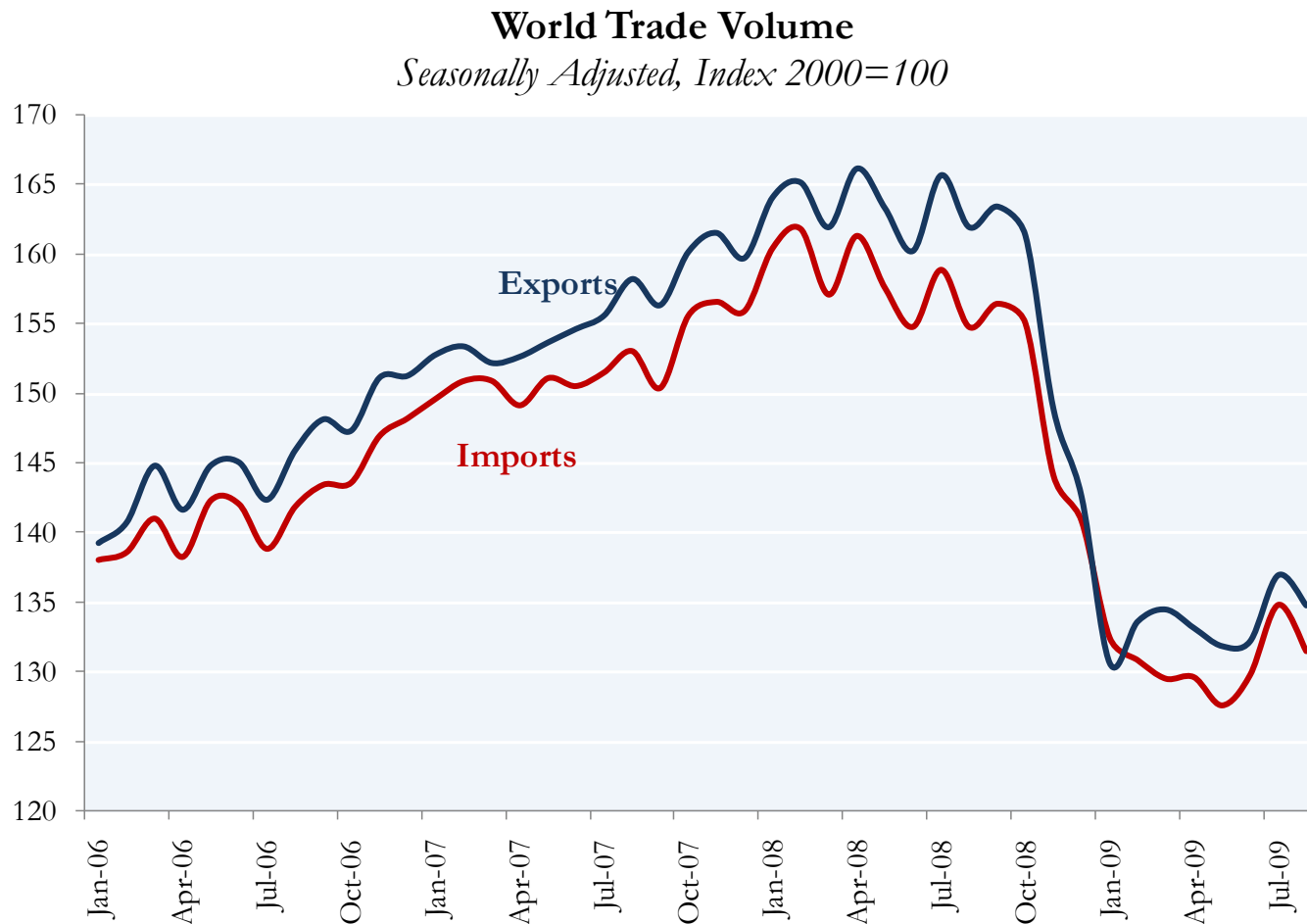
Gross Nominal Liabilities



But LAC prospects depend on world growth, where much haziness exist beyond the short run

- In the short run, the global recovery is looking a lot like a V...
- ...but economic repair is still incomplete and fragilities remain
 - Will private sector demand be strong when stimulus fizzles away?
 - Will exit from stimulus policies be well-timed and orderly?
 - Premature retreat can kill the recovery; delayed retreat can rise inflation specter
- Medium-term growth for the world might be subdued
 - Fiscal viability of the rich economies is in question
 - Financial systems in rich countries are still impaired
 - A slow expansion of world trade is likely in the context of rebalancing
 - Possible adverse impact on MT investment of regulatory uncertainty

World trade volume unlikely to grow fast for a while in a context of global rebalancing



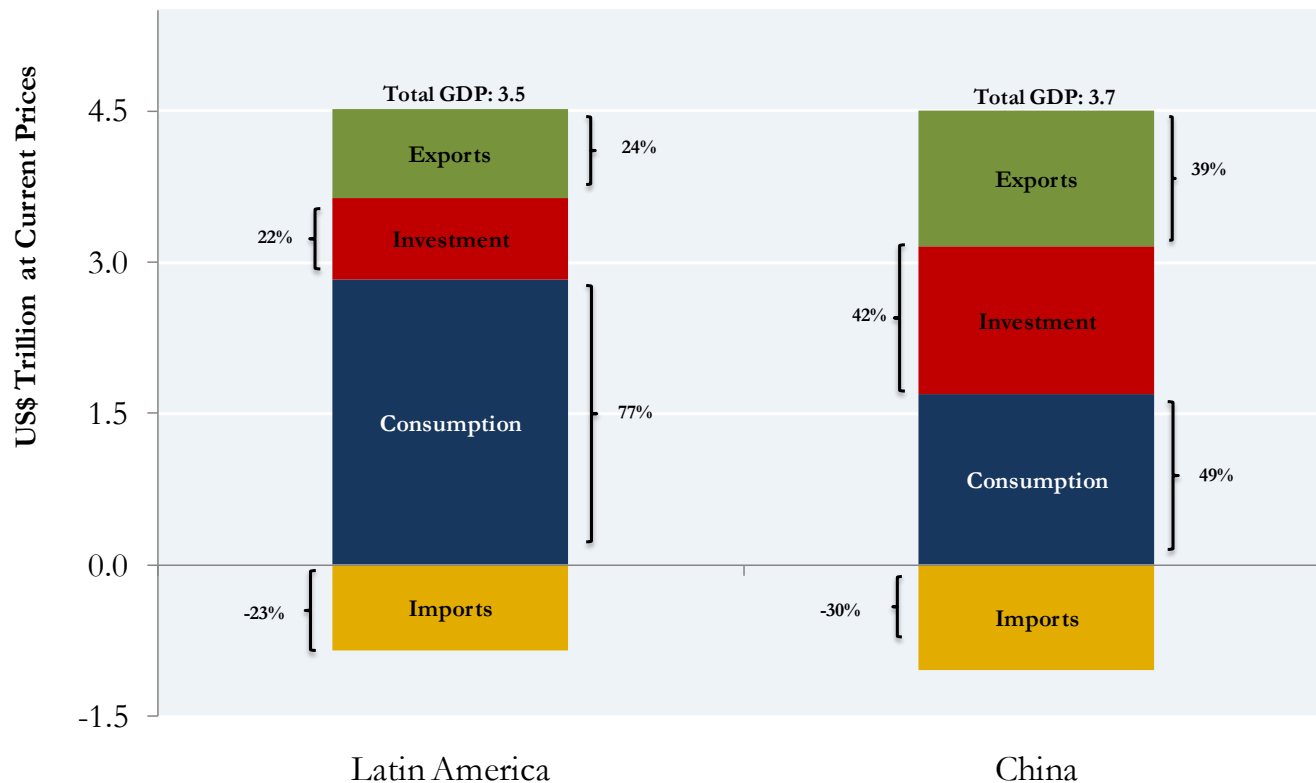
LAC-specific challenges and opportunities

- LAC can grow robustly while contributing to global rebalancing →
- In the *short-run*, larger LAC countries will:
 - Monetary policy dilemmas due to e-rate appreciation pressures
 - Challenges of orderly exiting from fiscal and credit stimulus policies
- ... while smaller LAC countries may:
 - Endure a lagged and longer recessionary impact...
 - ... complicated by debt & financial fragility in many Caribbean countries
- Labor market adjustment patterns likely to change deeply →
- In the *medium-term*, a premium will be on the long-delayed productivity-oriented agenda (to seize opportunities)
 - While keeping the course of social and macrofinancial improvements



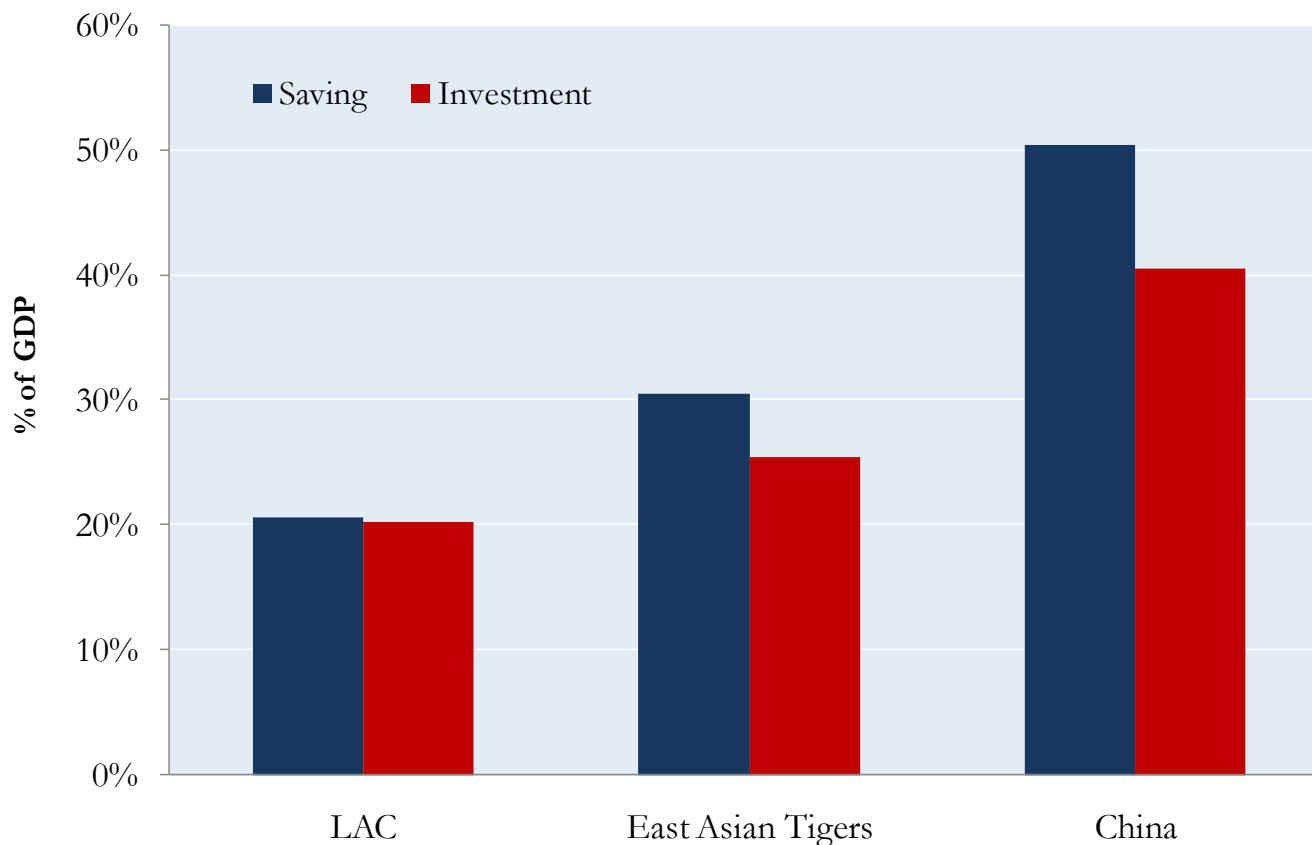
At the margin, LAC can contribute to global rebalancing more than China...

Output and Demand: China vs. LAC
GDP and Demand Components, 2007



... while raising savings and investment rates to underpin a higher growth path

Savings and Investment
Average Between 2006-2008



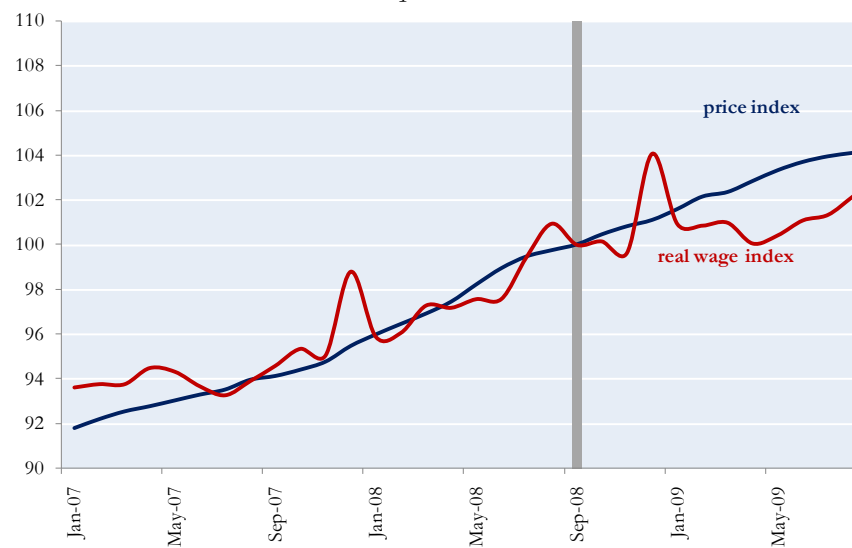
Brazil:

Real wage adjustment no longer via inflation

Brazil - Past Crisis
Index Sep.1997 = 100

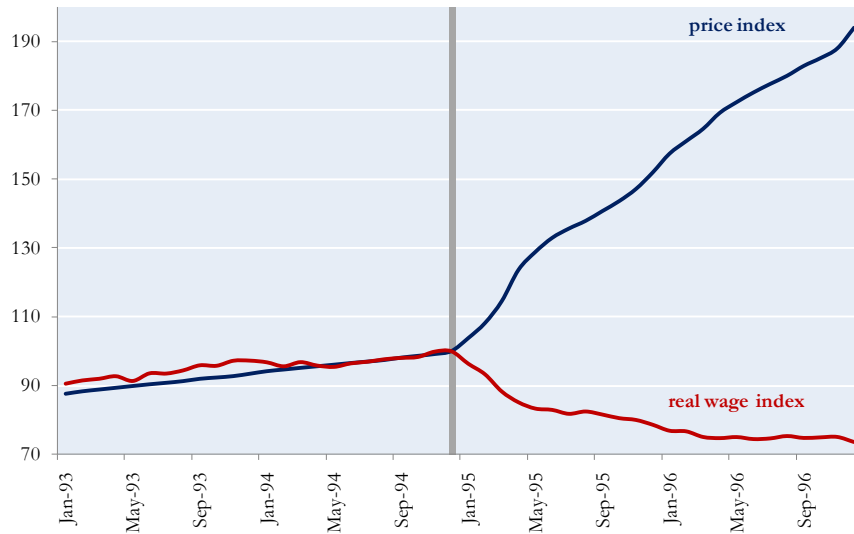


Brazil - Present Crisis
Index Sep. 2008 = 100

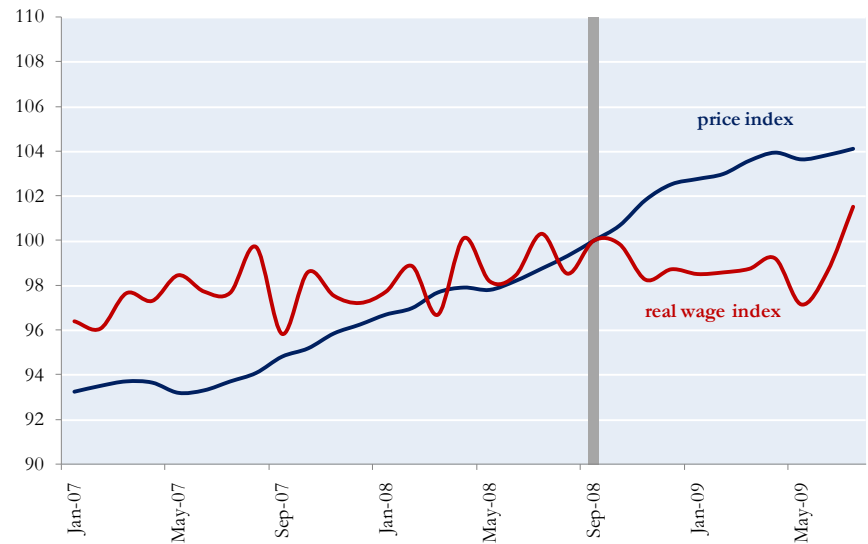


Mexico: Real wage adjustment no longer via inflation

Mexico - Past Crisis
Index Dec. 1994 = 100



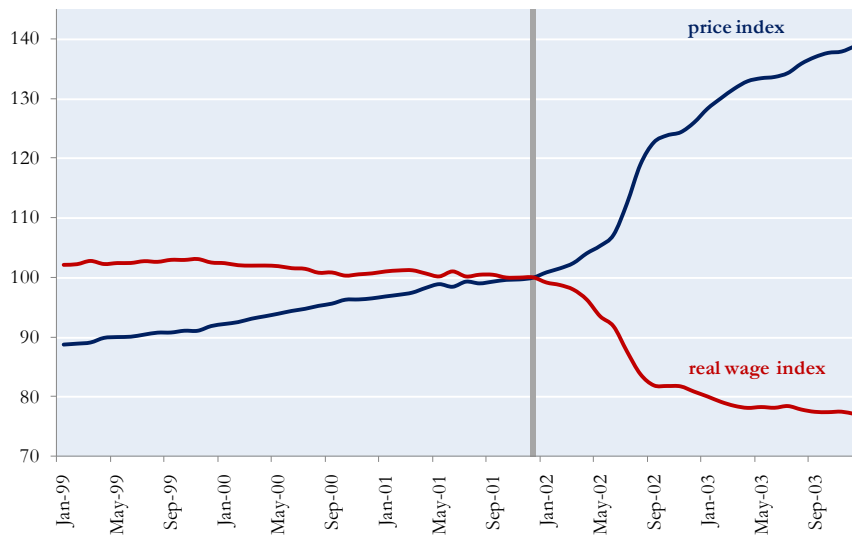
Mexico - Present Crisis
Index Sep. 2008 = 100



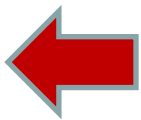
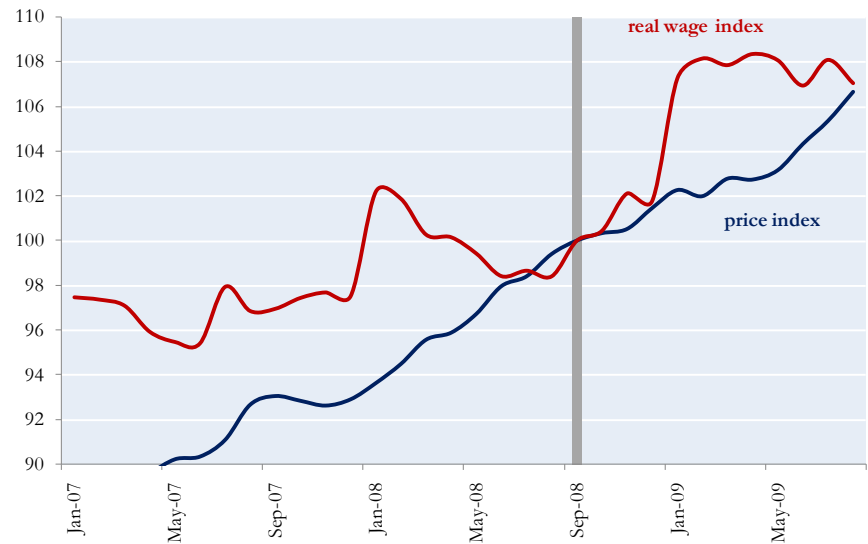
Uruguay:

Real wage adjustment no longer via inflation

Uruguay - Past Crisis
Index Dec. 2001 = 100



Uruguay - Present Crisis
Index Sep. 2008 = 100



Thank you