From Global Collapse to Recovery: Economic Adjustment and Growth Prospects in LAC

IMF-World Bank Spring Meetings

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Outline

- After the fall, LAC stands tall
  - LAC fared better in this crisis in comparative terms
  - Why?

- LAC recovering in a multi-polar world
  - A heterogeneous rebound

- Challenges for LAC going forward
  - An uncertain and complex global context
  - Short-run: currency appreciation pressures
  - Longer-run: it is mostly about growth
After the fall, LAC stands tall

LAC fared better compared to other regions and its own past
LAC’s 2009 economic downturn was less dramatic than that of other regions

**Real GDP Growth in 2009 Around the World**
*Annual Real GDP Growth Rate*

**GDP Growth Collapses Around the World**
*Differences Between Growth in 2007 and 2009*

*Note: Growth collapse is defined as the difference between the GDP growth rate in 2009 vis-à-vis growth in 2007. ECA refers to Eastern Europe and Central Asia countries. East Asian Tigers are Hong Kong, China; Indonesia; Korea, Republic of; Malaysia; Singapore; Taiwan, China; and Thailand. OECD refers to OECD-member countries. LAC refers to countries in Latin America and the Caribbean. SSA refers to Sub-Saharan Africa countries. MENA makes reference to Middle East and North African countries. Data comes from Consensus Forecast as of December 2009 for countries that have not published 2009 growth figures yet. Source: Bloomberg, IMF International Financial Statistics (IFS) and Consensus Forecasts.*
Excluding Mexico, a regional outlier, LAC’s GDP would have hardly contracted in 2009.

Source: Bloomberg. We used Consensus Forecast as of Dec. 2009 for the countries that didn’t published the 2009 growth yet (the latest 2009 forecast for Consensus).
Consistent with a comparatively milder recession in 2009, LAC also experiences a milder rise in unemployment.

- 3.5 million Latin Americans joined the ranks of the unemployed in 2009.
- LAC’s economically active population in 2009 was about 272 million.

The sensitivity of unemployment to economic activity was generally lower than in previous downturns...

**Semi-Elasticity of Unemployment With Respect to GDP Growth**

- **Previous recession**
- **Current Recession**

...even though real wages did not decline this time around, reflecting downward nominal rigidity and low inflation.
...even though real wages did not decline this time around (cont.)

Note: The graph depicts the evolution of quarterly average male real wages for the whole economy (all sectors) and the CPI index around recession periods for Argentina. For Uruguay, median wages are graphed. Source: LCRCE calculations for Argentina based on Encuesta Permanente de Hogares (EPH) and Encuesta Permanente Continua de Hogares (EPHC), and for Uruguay, INE, and IFS.
Surprisingly, informality did not rise in most of LAC during the 2009 downturn

![Graph showing Share of Workers Relative to the Total Number of Employees](image)

**Share of Workers Relative to the Total Number of Employees**

*Change from 2008 to 2009, in Percentage Points*

Note: For Argentina and Brazil, LCRCE Staff calculations based on Households Surveys. When the bars are not shown in the graph is because the information for that specific country is not available. Source: International Labor Organization.
Crucially, LAC counties did not experience domestic financial crises – the dog that did not bark

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*The global crisis bruised LAC’s “income statement” but it did not impair its “balance sheet”*

*The table shows the start year of banking crises. Source: Laeven and Valencia (2008) and Reinhart and Rogoff (2008)*
After the fall, LAC stands tall – Why?

Reason 1: improved macro-financial “immune system”

The domestic factors that used to magnify external shocks (currencies, fiscal, banking) in the past, this time cushioned the shock

Reason 2: safer international financial integration

Reason 3: timely multilateral and bilateral response

Reason 4: the China connection
The region has moved to more robust monetary policy frameworks managed by credible central banks...

Monetary Policy Rates
Inflation-Targeting Latin American Countries, in %

Source: Bloomberg
...virtuously interacting with reduced currency mismatches

Corporate and Banks' Dedollarization in LAC

Composite Dollarization Index
LAC, Emerging Europe

Share of the Domestic and Foreign Public Debt in Total Debt
Selected LAC Countries

Sources: Gozzi et al (2009), Reinhart, Rogoff and Savastano (2003), IFS.
While far from perfect, fiscal processes have become more viable, even if they remain pro-cyclical (excepting Chile)

Fiscal Policy Reaction Function: Model with 2003 break in output gap and government debt

*Method: Instrumental Variables*

<table>
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<th>Dependent variable: Fiscal indicator as % of GDP (FI)</th>
<th>Actual</th>
<th>Cyclically-adjusted</th>
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<td></td>
<td>Primary</td>
<td>Government</td>
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<td>I. All LAC Countries (17)</td>
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<tr>
<td>Output gap, 1990-2003</td>
<td>-0.109486</td>
<td>-0.066482</td>
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<td>Output gap, 2003-2008</td>
<td>-0.10535</td>
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<td>Govt Debt, 1990-2003</td>
<td>0.006994</td>
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<td>Govt Debt, 2003-2008</td>
<td>0.020370***</td>
<td>0.002222</td>
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<td>No. Observations</td>
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*Standard errors in brackets*** p<0.01, ** p<0.05, * p<0.1*

Note: We define the fiscal primary surplus as the general government receipts (including grants received and loan repayments) less non-interest expenditures, as a percentage of GDP. For Mexico, we use the Budgetary Public Sector. Source: EIU
Following frequent crisis, banking systems in LAC have become sounder.

**Deposit to Loan Ratios**
**Emerging Countries, 2007 Data**

Emerging countries were defined as lower middle income and upper middle income, World Bank Classification. Source: Beck, Demirgüç-Kunt and Levine (2009): Financial Structure Database.
LAC has migrated towards a safer form of integration into international financial markets.

A Safer Integration in LAC

Source: The net debt position (vis-à-vis ROW) is the sum of debt assets and reserves minus debt liabilities. In turn, the net equity position (vis-à-vis ROW) is the sum of net FDI assets and net portfolio equity assets. The sample ranges from 1990 to 2007. Source: Lane and Milesi-Ferretti (2007).
Flexible and timely provision of liquidity and budget support financing from multilaterals

Note: 2010 numbers projected based on submissions to OPCS. Source: IBRD
A part of LAC has deepened its trade links to Asia

**LAC Exports to Selected Regions**
*as % of total exports, 2008 data*

Source: IMF’s Direction of Trade Statistics (DOTS).
...the co-movement of growth between many LAC countries and China has been on the rise...

Source: National Authorities. Note: Solid colors reflect correlation values significant at a 10% confidence interval.
China’s commodity-intensive growth is a boon to Latin commodity exporters

- About 97% of LAC’s GDP and 93% 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

Note: The cumulative variation in the terms of trade index is calculated using quarterly data. The blue bars represent the cumulative percentage change during the recent commodity price boom up to the peak in 2008q2. The red bars capture the cumulative percentage change in terms of trade from its trough in 2008q4 to the most recently available quarter (2009q4). Source: WDI, DECPG, and Haver Analytics.
LAC recovering in a multi-polar world economy

_Growth engines are being reignited at different pace and intensity, with dynamic EMs in the lead_
The world economy is rebounding.

**World Trade Volumes**
*Seasonally Adjusted, index Jan-06 = 100*

**Commodity Prices**
*Oil WTI in Current US$, Wheat, Copper and Soybean: index 01-Jan-05=100*

**Stock Prices Around the World**
*Indexes: 1-Apr-08 = 100*

**Net Private Capital Flows to Emerging Economies**
*US$ Billion*

*Note: EAP represents East Asia and the Pacific region. Source: Bloomberg, and CPB (Netherlands Bureau for Economic Policy Analysis).*
But recovery patterns contrast sharply between the rich countries and the dynamic EMs

Emerging economies with strongest recoveries include Brazil, China, India, Korea, Malaysia, Philippines and Thailand

They represent 52% of emerging economies’ GDP

Note: The group of developed countries refers to OECD countries excluding Turkey, Mexico, Republic of Korea, and Central European countries. Source: CPB (Netherlands Bureau for Economic Policy Analysis).
Growth forecasts for LAC in 2010-2011 are robust, but less so than for the East Asian Tigers.

Note: Western Europe comprises Euro Zone countries, Denmark, Sweden, UK, Norway, and Switzerland. Source: Consensus Forecasts (December 2009 and March 2010), and Bloomberg.
... with Brazil, Peru, Chile and Panama leading the pack; and Colombia behind the regional average.
Dynamic EMs, including several LAC countries, are basically back to the pre-crisis peak in economic activity.
If inflation pressures are surfacing, it is in the EMs

Inflation in Selected Regions
Seasonally Adjusted, YoY Growth Median

Source: DECPG
Challenges for LAC going forward

An uncertain and complex global context
LAC prospects will still depend on the global environment, where much haziness and risks exist

- Will rich countries be able to overcome the growth-impairing effects of their weakened balance sheets?
  - Will private demand pick up as stimulus policies unwind?
  - Or, given limited space for additional fiscal stimulus, will low interest rates foster again financial excesses?
  - Will problems in Club Med Europe be contained?
  - Will fiscal/debt dynamics in rich countries be restored to viability without inflation down the line?

- Will regulatory uncertainty in rich countries be adequately dispelled?

- Will a new, robust source of consumption demand arise outside the U.S.?
  - A revaluation of the Renminbi is arguably essential in this regard
Challenges for LAC going forward

*In the short-run: currency appreciation pressures*
Currency appreciation pressures are already felt and bound to intensify...

Note: The Exchange Market Pressure Index is the weighted average of year-on-year percentage changes in: (a) the nominal exchange rate of the local currency vis-à-vis the US dollar (such that an increase represents an appreciation of the LAC currency), and (b) the level of international reserves. The weights are given by the inverse of the annual standard deviation of the changes in the nominal exchange rate and the standard deviation of the changes in reserves. An increase in the Exchange Market Pressure index signals appreciation pressures and/or accumulation of reserves. Source: LCRCE Staff calculations based on IMF’s IFS.
... as Latin countries are likely to be compelled to tighten monetary policy ahead of rich countries...

Note: Inflation pressures are calculated as the difference between the 2010 inflation rate forecast and an estimated target of 4% (assumed to be the target for most countries in the region). The output gap calculated as the difference between the (log of) actual and potential GDP, with the latter being calculated using the Hodrick-Prescott filter. Source: LCRCE Staff calculations based on Consensus Forecasts as of March 2010.
Challenges for LAC going forward

*It is mostly about growth and, for most of the LAC economy, growth linked to natural resource wealth*
The virtuous development triad

Growth

Sustainable development

Fairness

Stability
100 years of growth solitude for LAC!

GDP Per Capita of Selected Regions / US GDP per Capita

Note: The group of East Asian tigers includes Hong Kong (China), Indonesia, Malaysia, Republic of Korea, Singapore, Thailand, and Taiwan (China). Source: LCRCE Staff calculations based on Maddison (2007, 2009), WDI and DECPG
Thank you