



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

IMF-World Bank Spring Meetings

*April 21, 2010
Washington, DC*

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



Outline

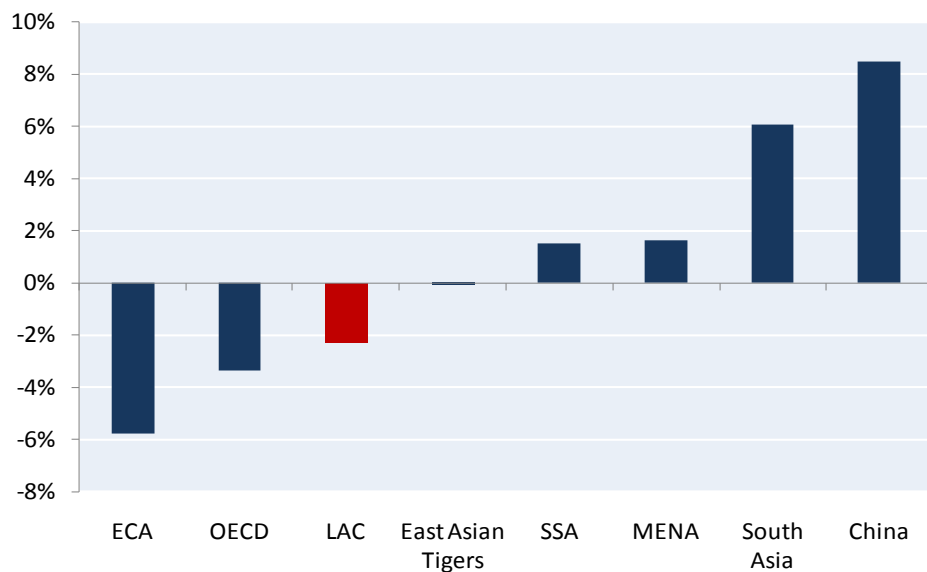
- After the fall, LAC stands tall
 - LAC fared better in this crisis in comparative terms
 - Why?
- LAC recovering in a multi-polar world
 - A heterogeneous rebound
- Challenges for LAC going forward
 - An uncertain and complex global context
 - Short-run: currency appreciation pressures
 - Longer-run: it is mostly about growth

After the fall, LAC stands tall

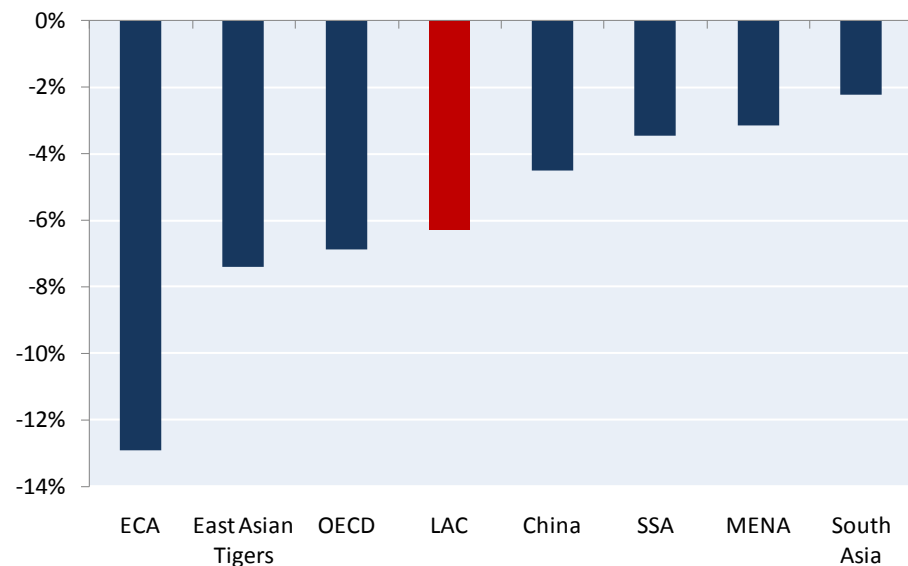
LAC fared better compared to other regions and its own past

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



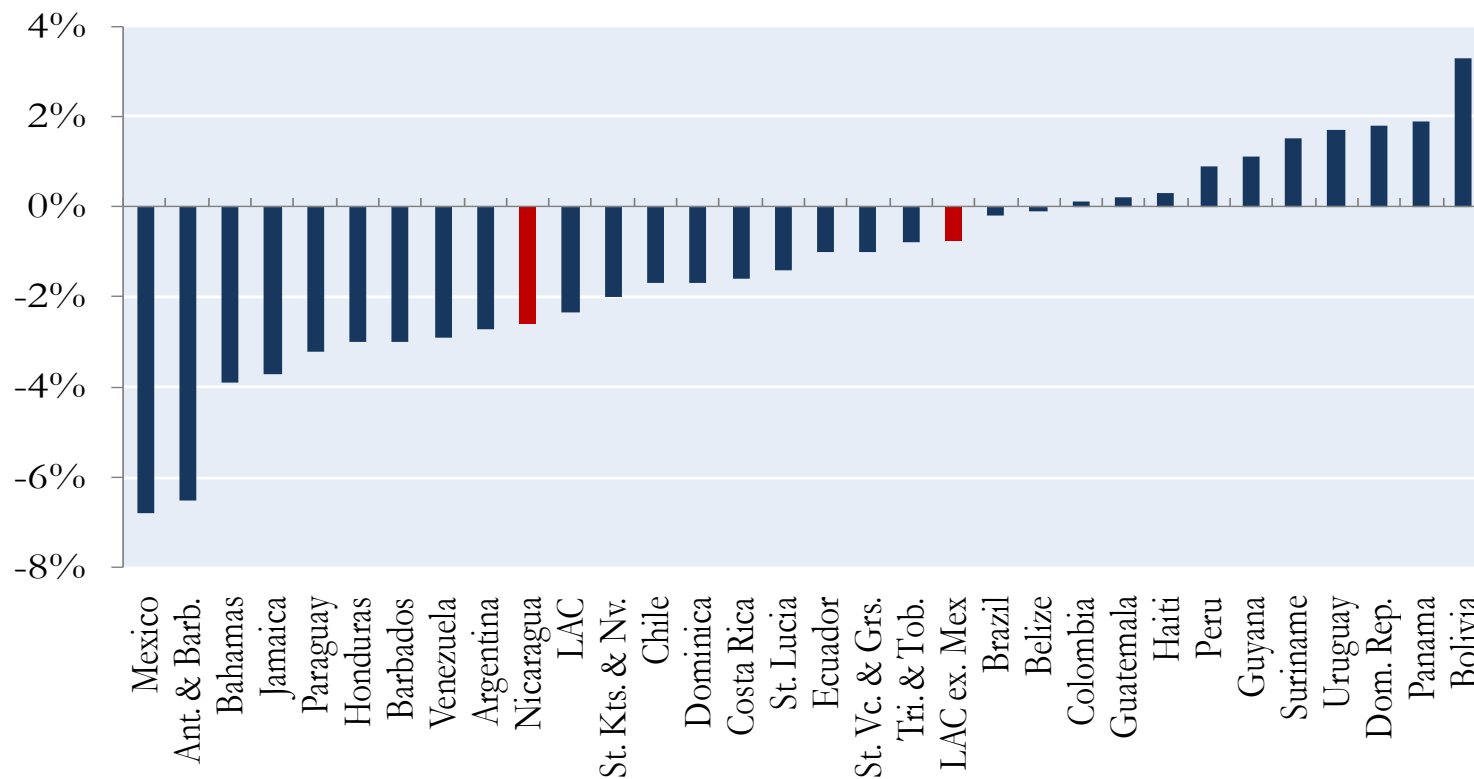
GDP Growth Collapses Around the World
Differences Between Growth in 2007 and 2009



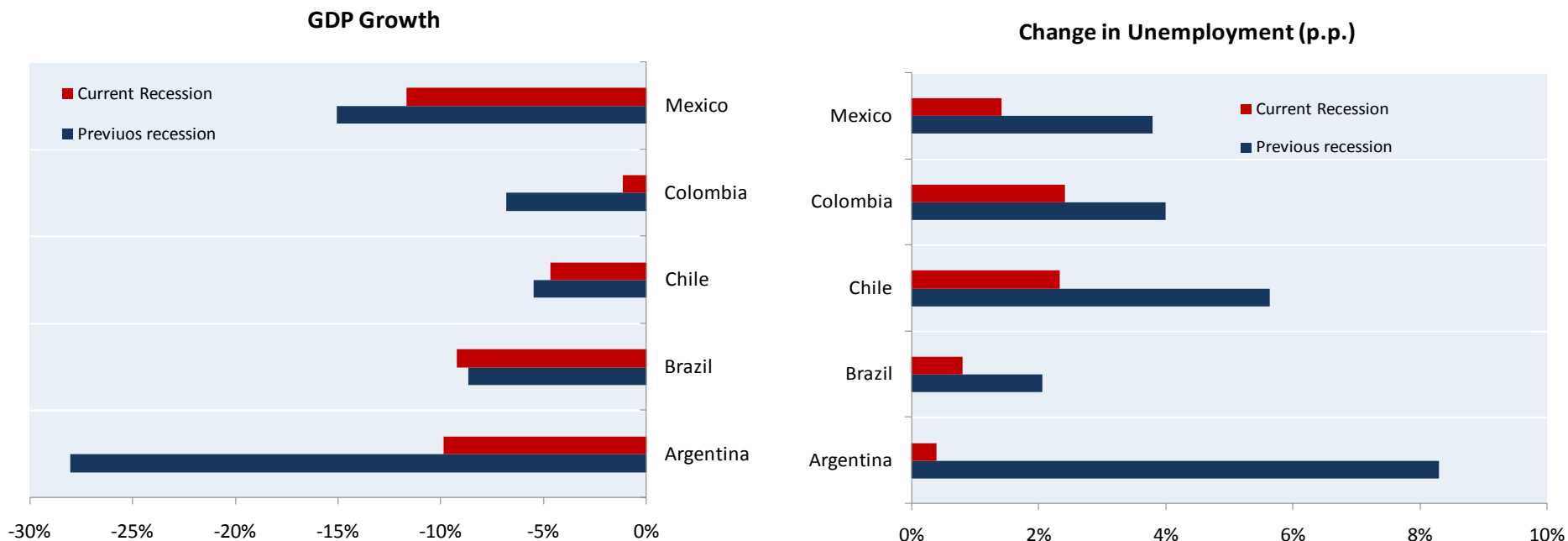
Note: Growth collapse is defined as the difference between the GDP growth rate in 2009 vis-à-vis growth in 2007. ECA refers to Eastern Europe and Central Asia countries. East Asian Tigers are Hong Kong, China; Indonesia; Korea, Republic of; Malaysia; Singapore; Taiwan, China; and Thailand. OECD refers 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

Real GDP Growth for 2009
LAC Countries



Consistent with a comparatively milder recession in 2009, LAC also experiences a milder rise in unemployment

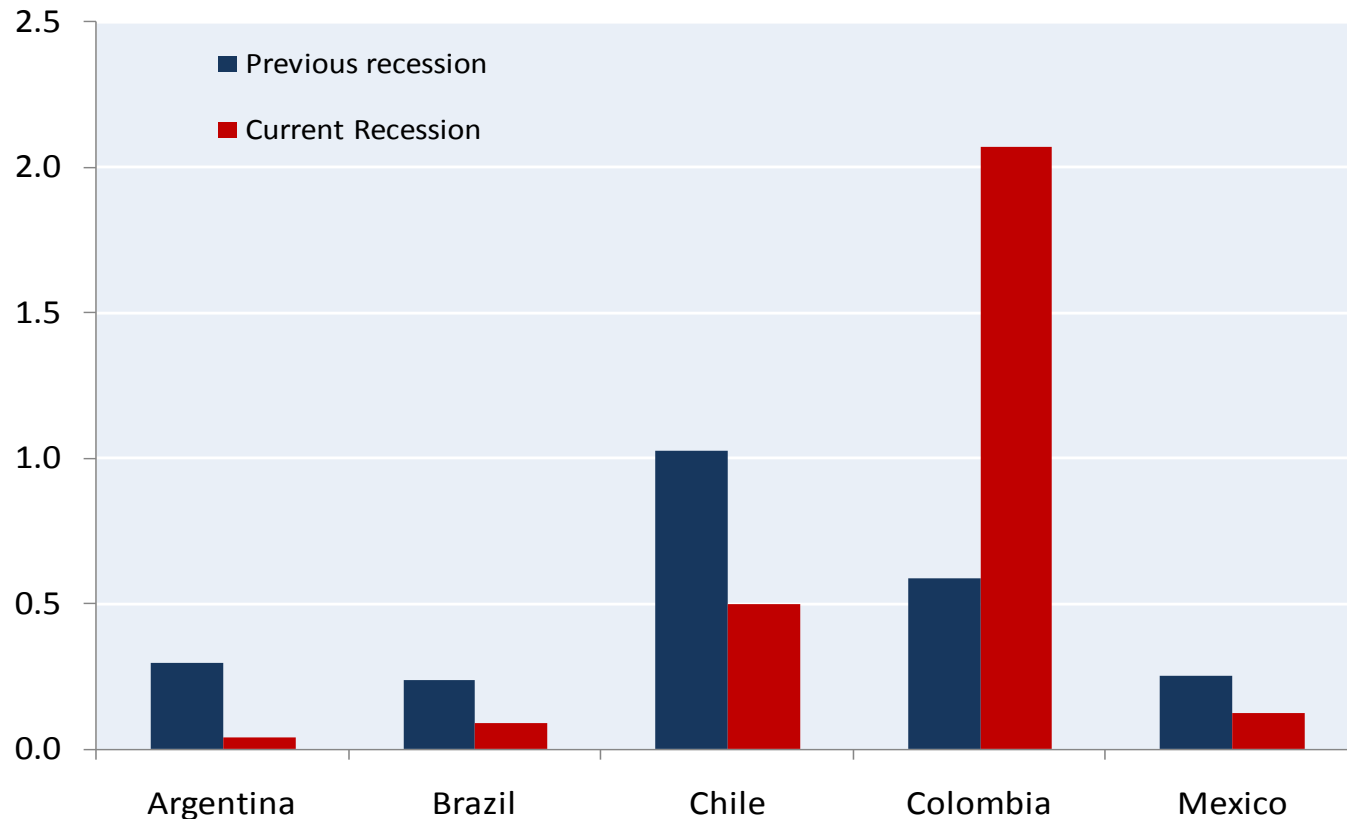


- ***3.5 million Latin Americans joined the ranks of the unemployed in 2009***
- ***LAC's economically active population in 2009 was about 272 million***

Note: Previous recession periods are: Argentina (1998.Q4 – 2002.Q2); Brazil (1997.Q4 – 1998.Q2); Chile (1998.Q3 – 1999.Q4); Colombia (1998.Q3 – 1999.Q4); and Mexico (1995.Q1 – 1996.Q1). Current recession periods are: Argentina (2008.Q3 – 2009.Q2); Brazil (2008.Q4 – 2009.Q2); Chile (2008.Q3 – 2009.Q3); Colombia (2008.Q3 – 2009.Q2); and Mexico (2008.Q2 – 2009.Q2). Source: LCRCE Staff calculations based on National Statistical Institutes data.

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

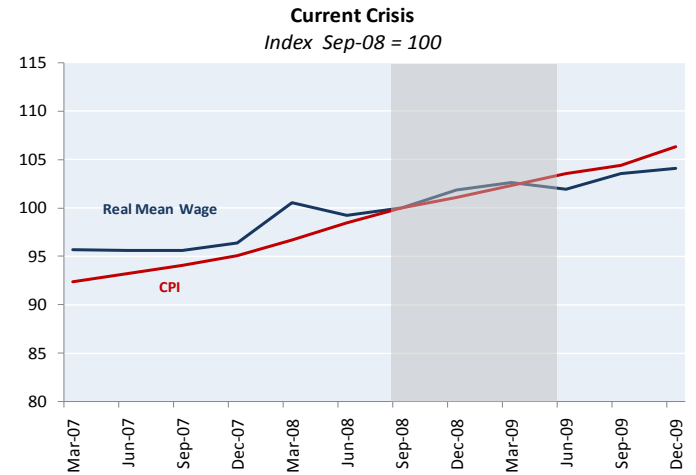
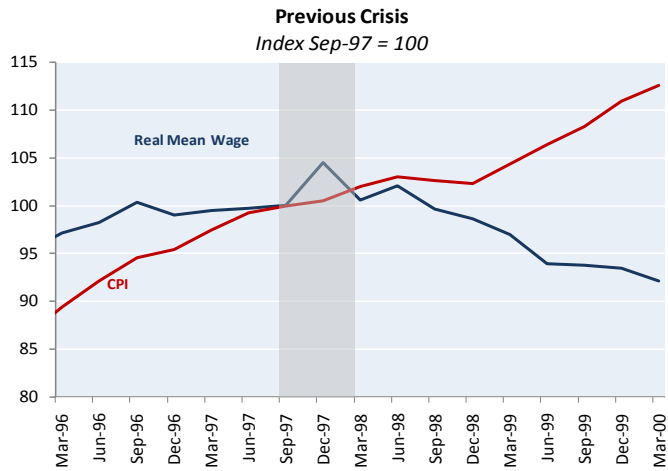
Semi-Elasticity of Unemployment With Respect to GDP Growth



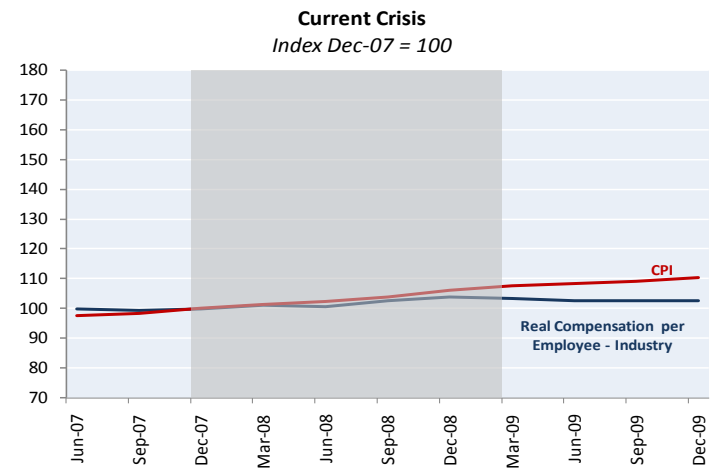
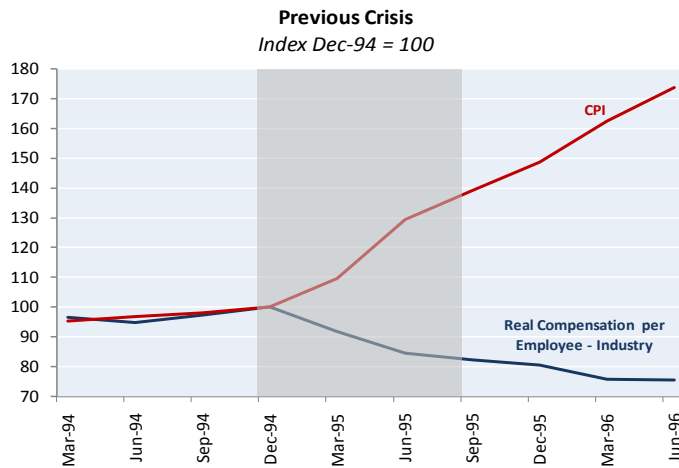
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...even though *real* wages did not decline this time around, reflecting downward nominal rigidity and low inflation

Brazil



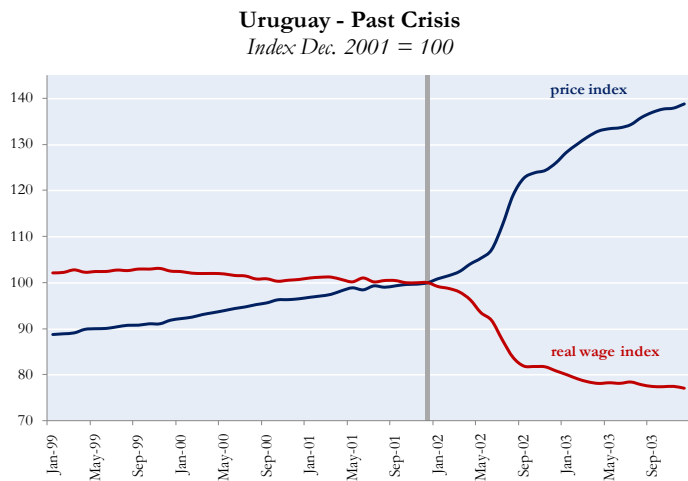
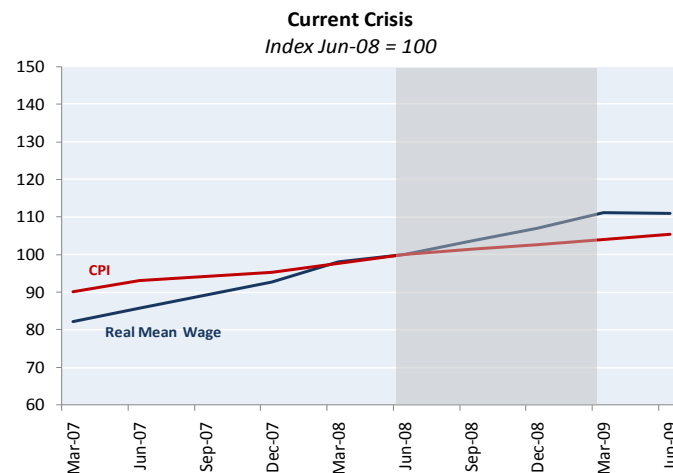
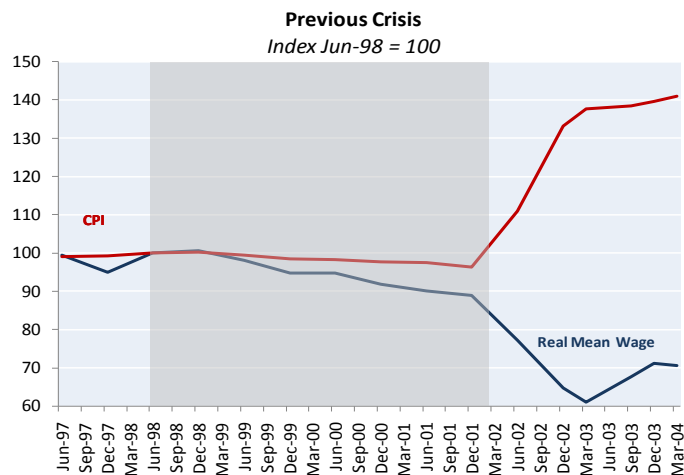
Mexico



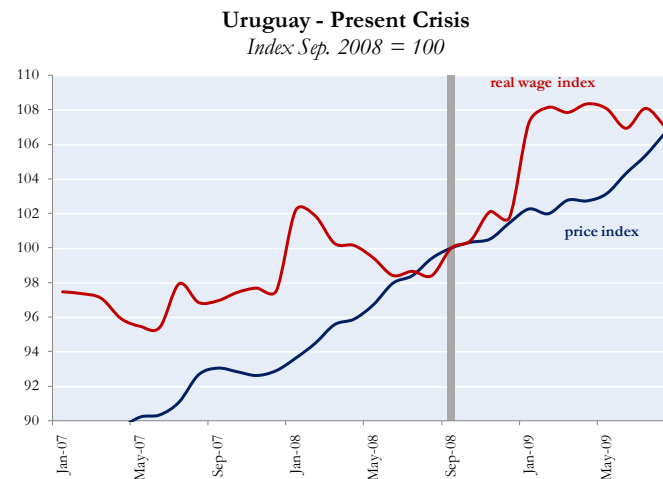
Note: The graph depicts the evolution of quarterly average male real wages for the whole economy (all sectors) and the CPI index around recession periods for Argentina and Brazil. For Mexico, wage data refers to average compensation per employee in the manufacturing sector. Source: LCRCE calculations for Argentina based on Encuesta Permanente de Hogares (EPH) and Encuesta Permanente Continua de Hogares (EPHC) and for Brazil based on Pesquisa Mensal de Emprego (PME). For Mexico, Banco de México and INEGI.

...even though *real* wages did not decline this time around (cont.)

Argentina



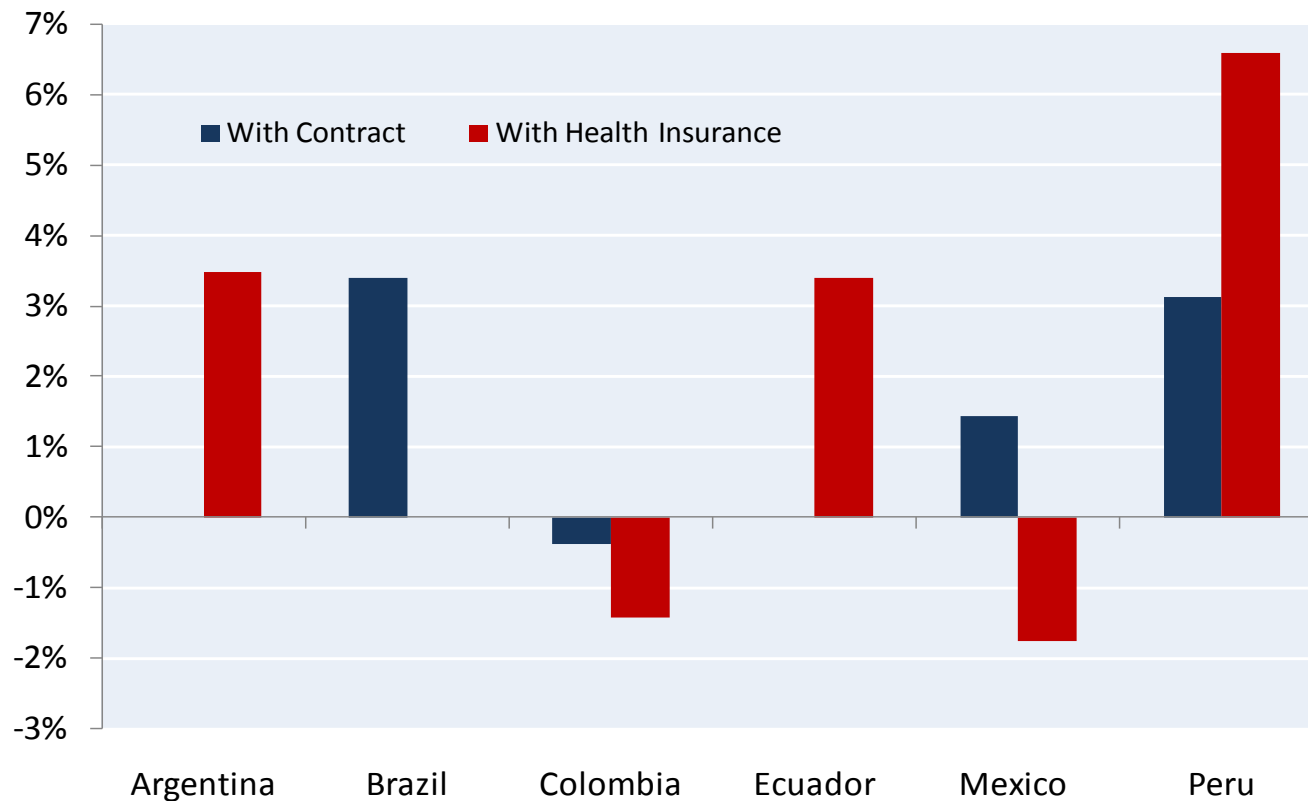
Uruguay



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

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 countries did not experience domestic financial crises – the dog that did not bark

Banking Crises in LAC Countries

1980-1985		1995-2000		2008-2009
		Mexico	1995	
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	

No financial crises

The global crisis bruised LAC's "income statement" but it did not impair it's "balance sheet"

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

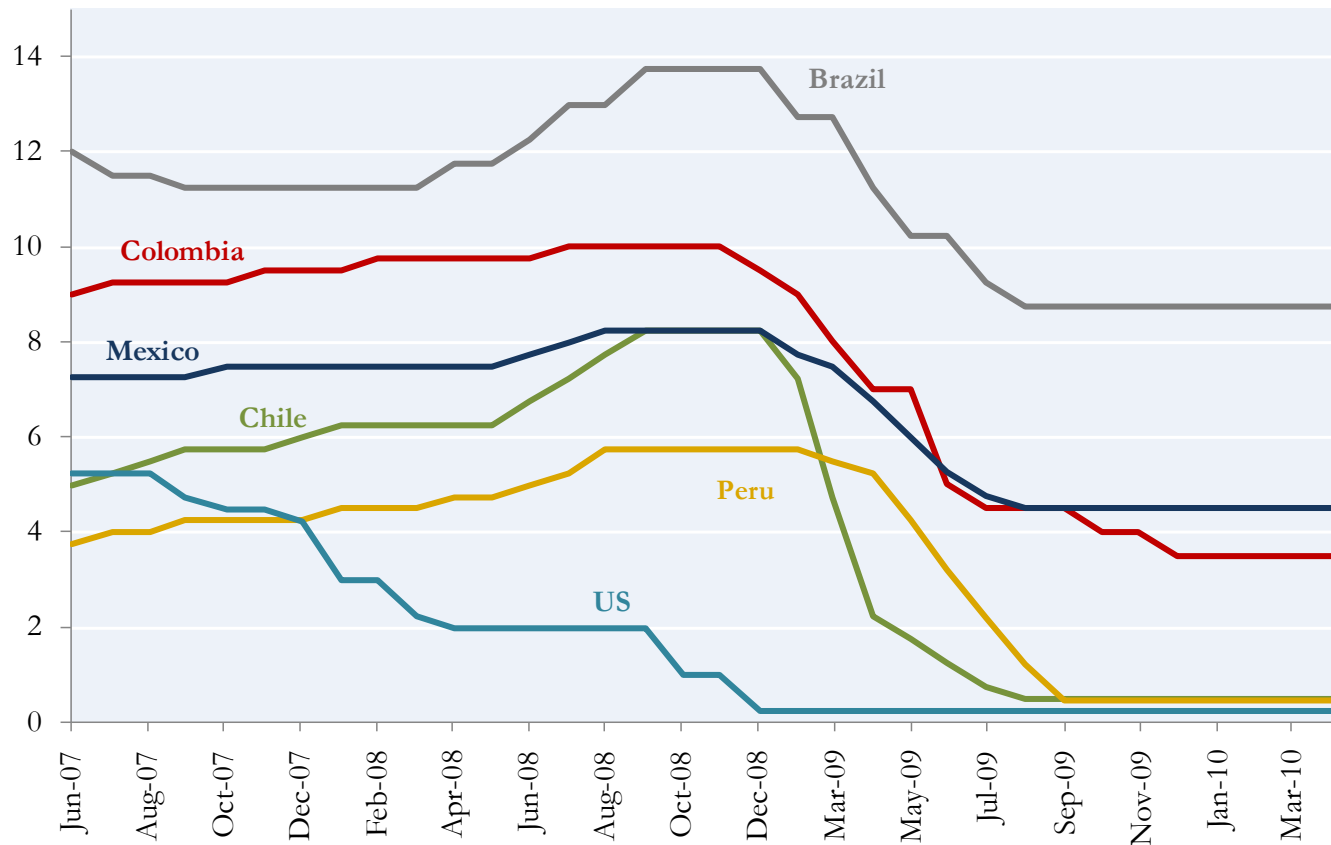
Reason 2: safer international financial integration

Reason 3: timely multilateral and bilateral response

Reason 4: the China connection

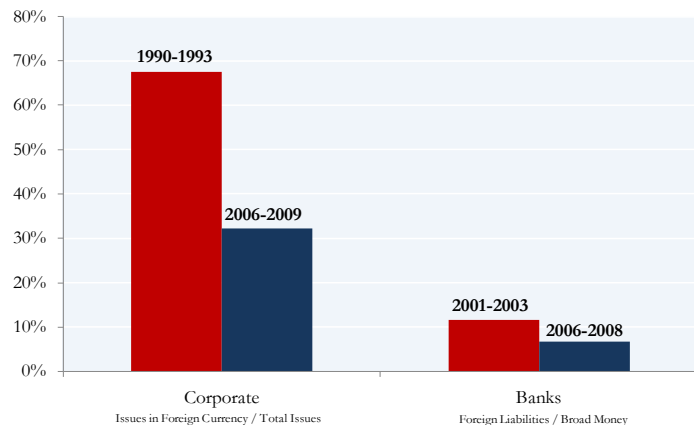
The region has moved to more robust monetary policy frameworks managed by credible central banks...

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



...virtuously interacting with reduced currency mismatches

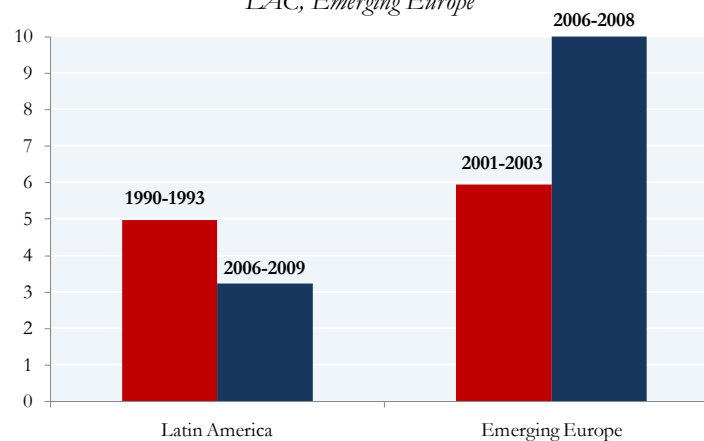
Corporate and Banks' Dedollarization in LAC



Note: GDP-weighted averages of the periods noted.

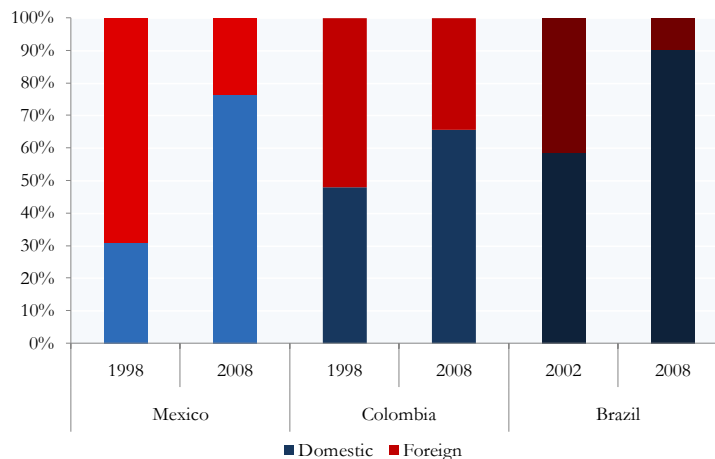
Source: Gozzi et al. (2009), IFS

Composite Dollarization Index
LAC, Emerging Europe



Source: Schmukler (2009) based on Reinhart, Rogoff, Savastano (2003)

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



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

Dependent variable: Fiscal indicator as % of GDP (FI)

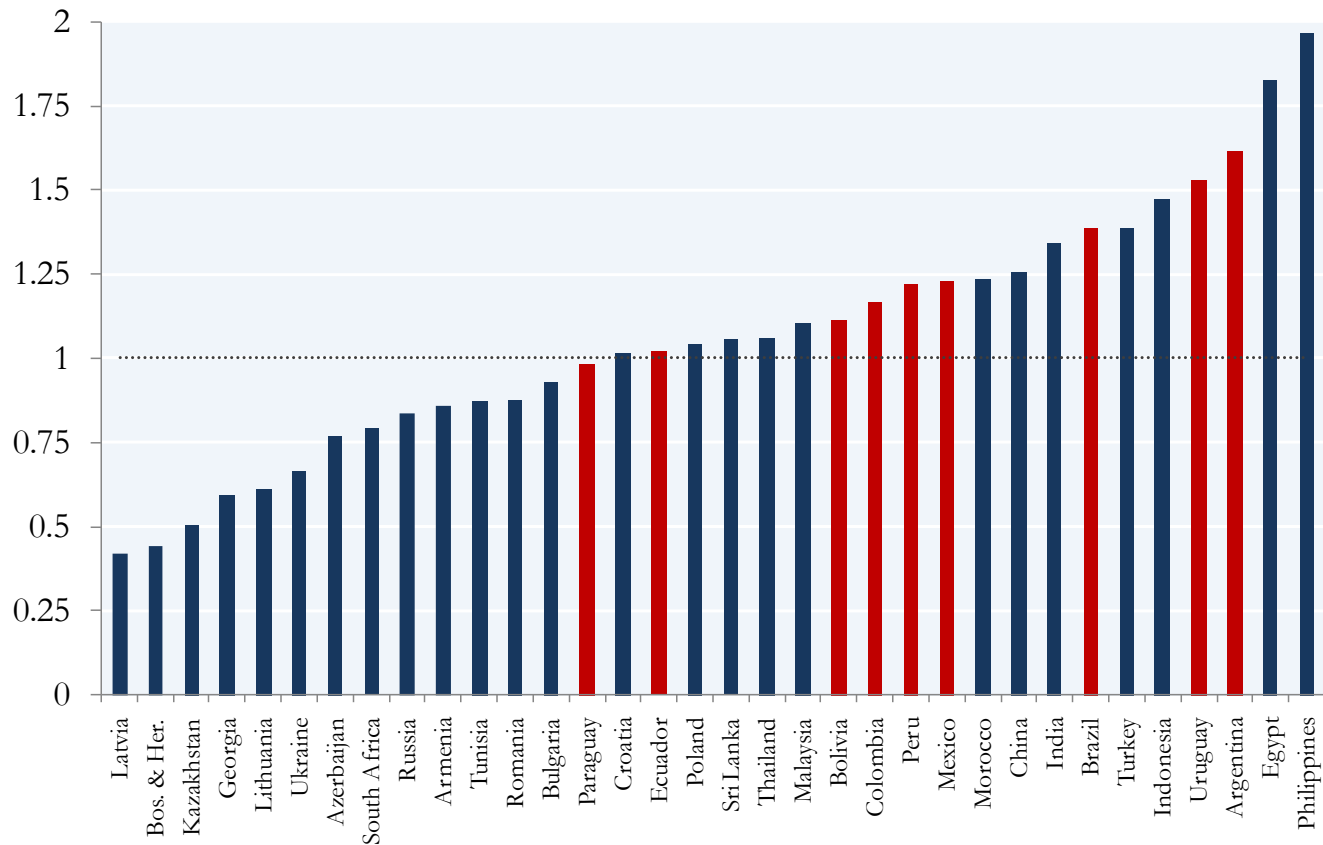
	Actual			Cyclically-adjusted		
	Primary Balance	Government Revenues	Primary Expenditure	Primary Balance	Government Revenues	Primary Expenditure
I. All LAC Countries (17)						
Output gap, 1990-2003	-0.109486	-0.066482	0.209820**	0.001678	0.081457	0.249023**
Output gap, 2003-2008	-0.10535	-0.060685	0.211770*	0.004452	0.088687	0.251989**
Govt Debt, 1990-2003	0.006994	-0.005468	-0.009512*	0.007275	-0.005738	-0.008646
Govt Debt, 2003-2008	0.020370***	0.002222	-0.012584	0.024904***	0.006603	-0.012623
No. Countries	17	17	17	17	17	17
No. Observations	272	272	272	272	272	272

Standard errors in brackets *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

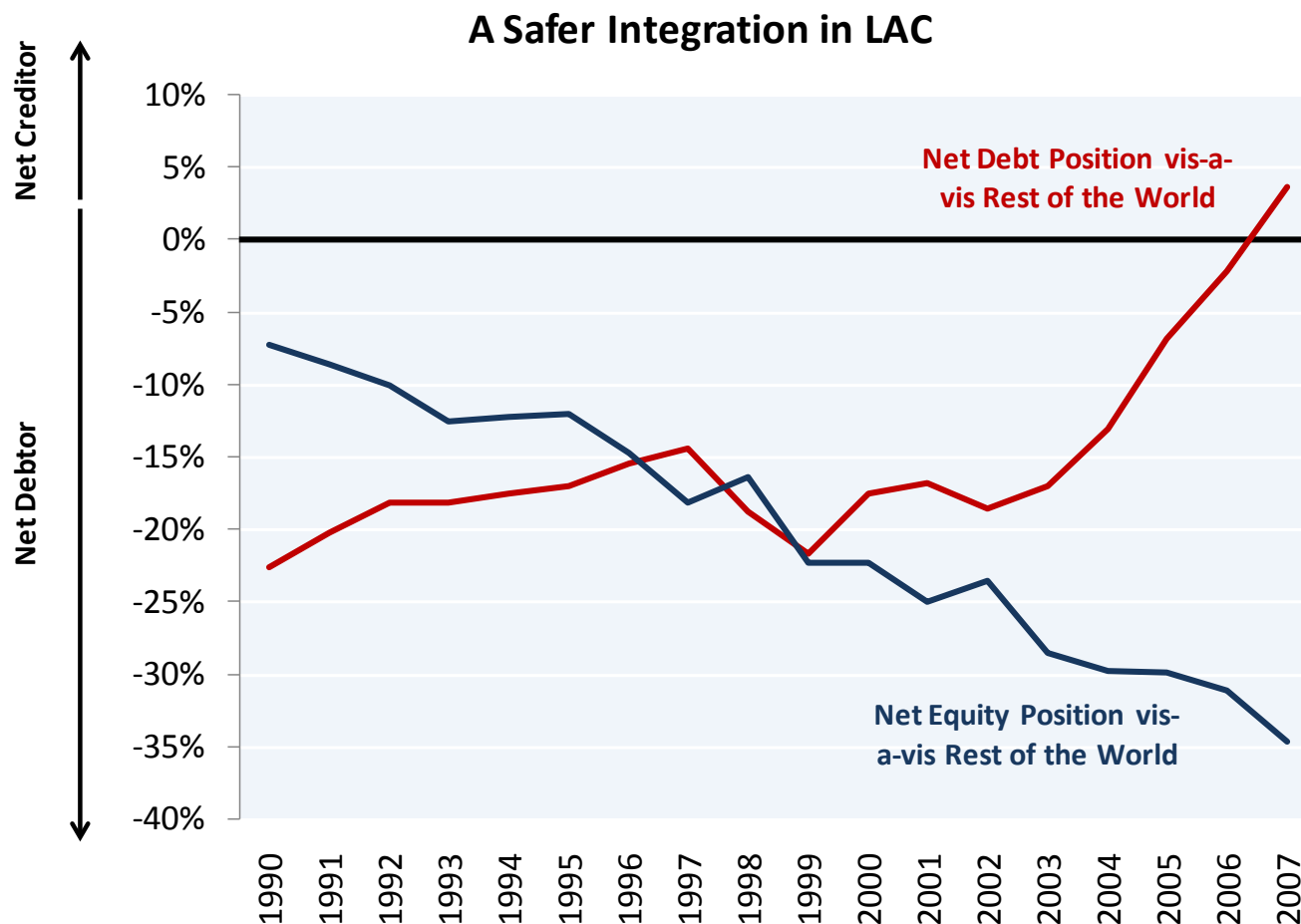
Note: We define the fiscal primary surplus as the general government receipts (including grants received and loan repayments) less non-interest expenditures, as a percentage of GDP. For Mexico, we use the Budgetary Public Sector. Source: EIU

Following frequent crisis, banking systems in LAC have become sounder

Deposit to Loan Ratios
Emerging Countries, 2007 Data



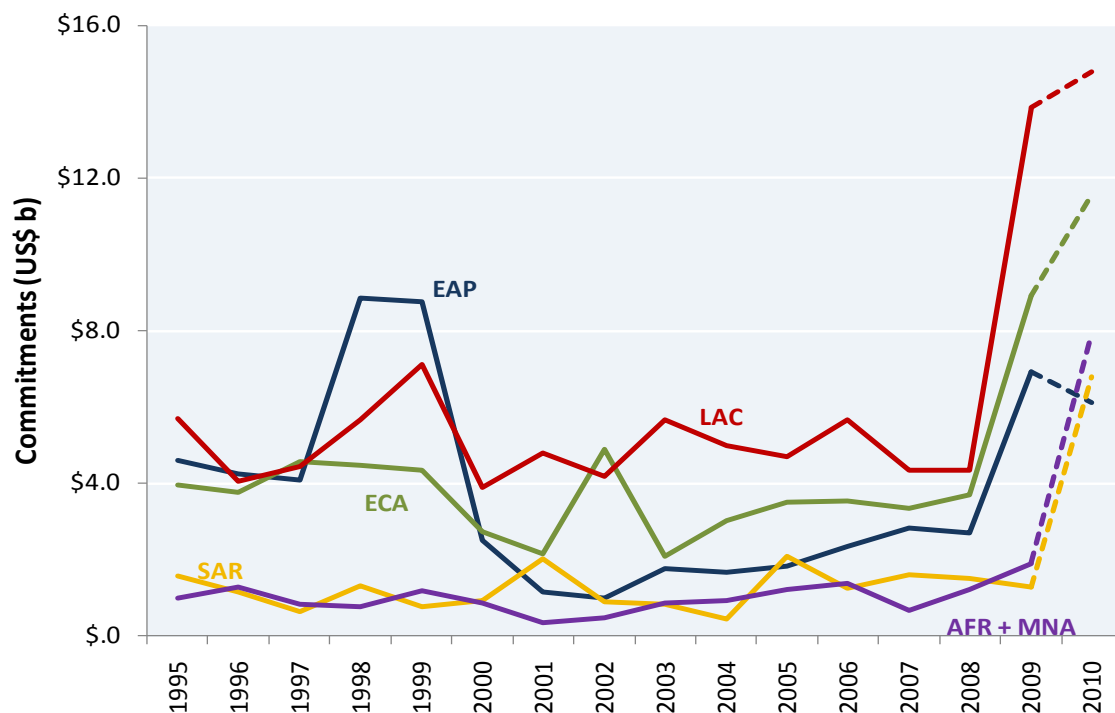
LAC has migrated towards a safer form of integration into international financial markets



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

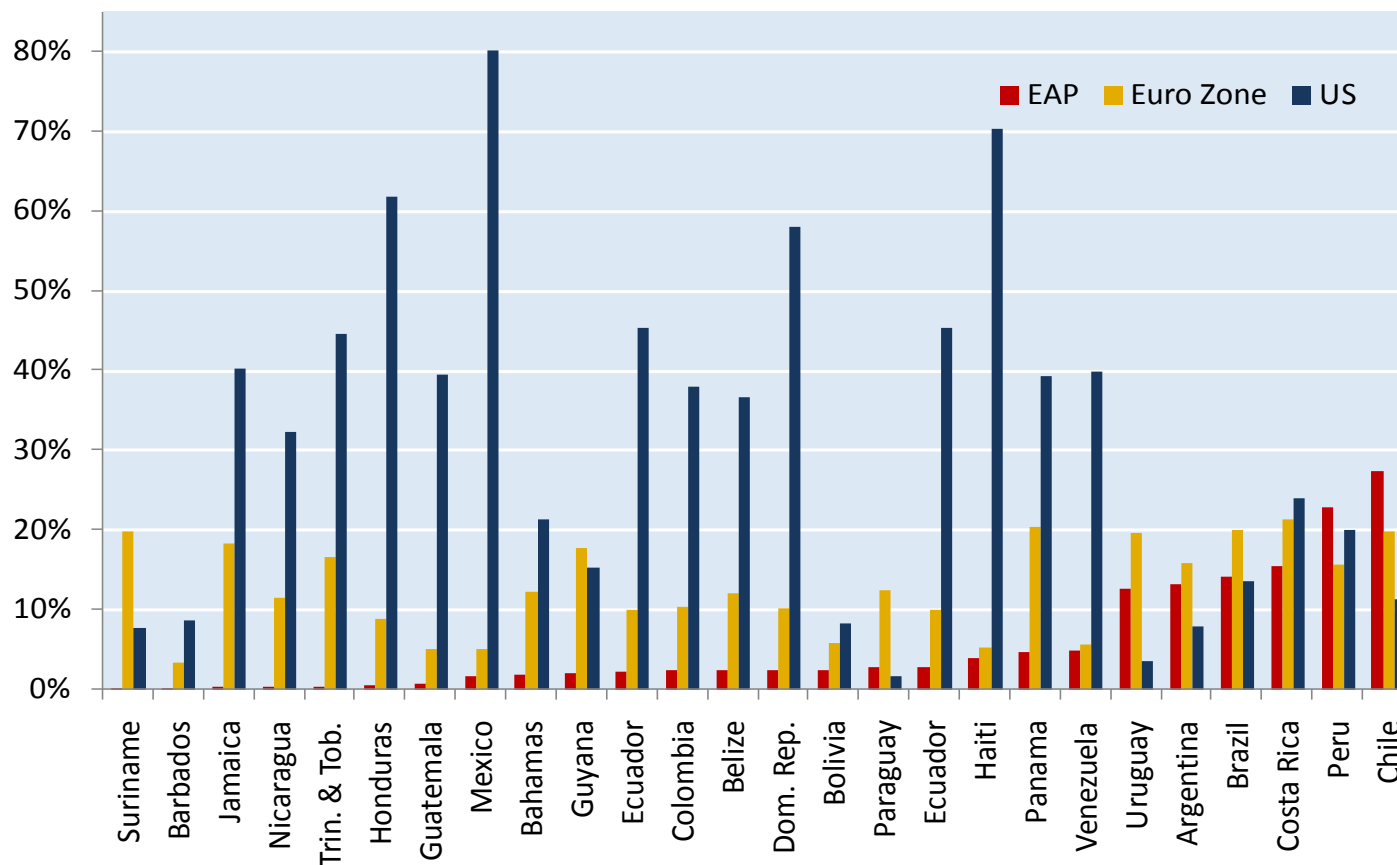
IBRD lending 1995-2009 by regions



- Oct-08
 - US Fed opens US\$ 120 bn swap lines with BRA, MEX, KOR, and SGP
 - IMF creates short-term liquidity facility
- Apr-09
 - IMF launches FCL
 - FCL agreement with Mexico (US\$ 47 bn)
- May-09
 - FCL agreement with Colombia (US\$ 10.4 bn)

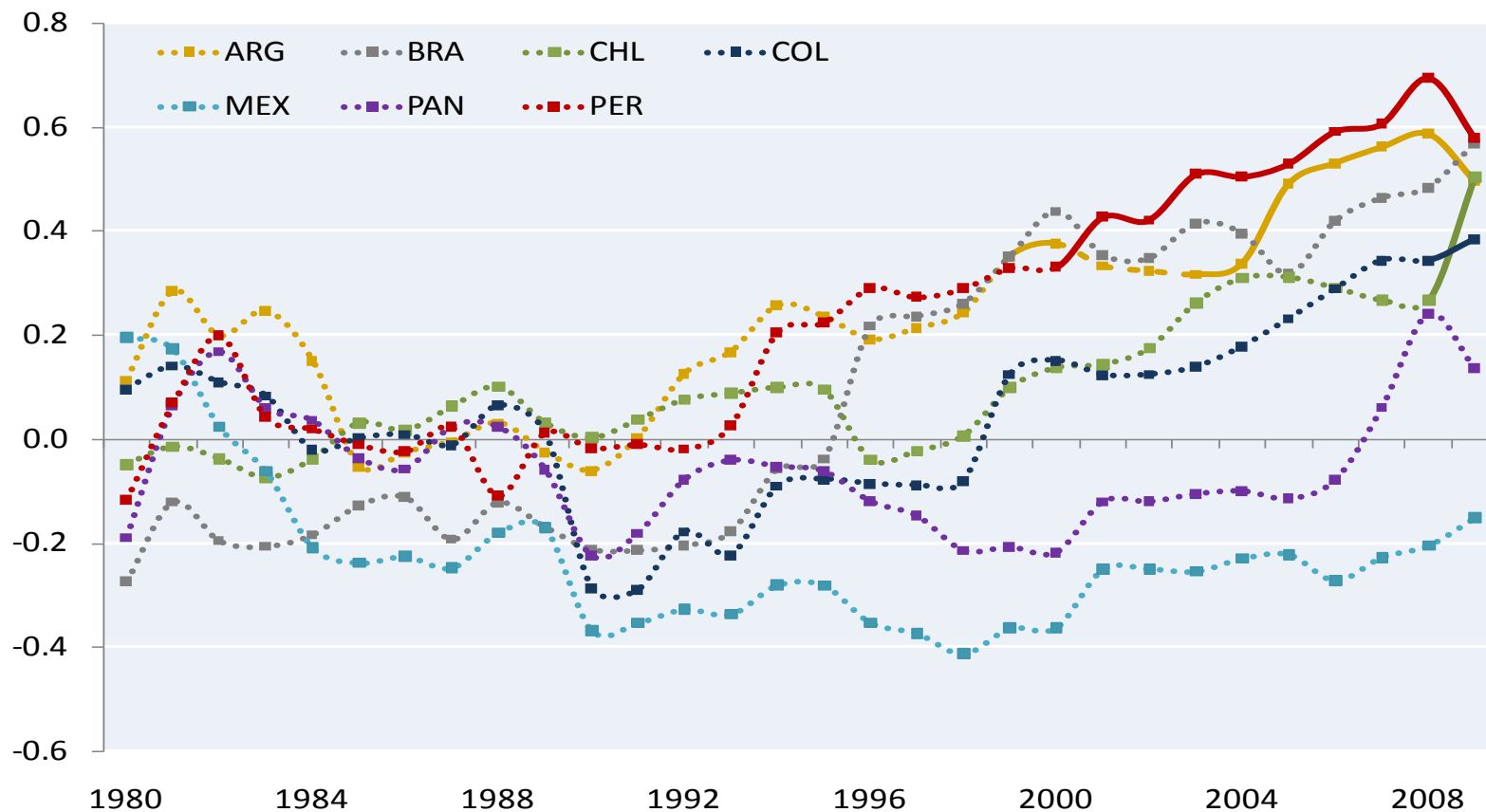
A part of LAC has deepened its trade links to Asia

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



...the co-movement of growth between many LAC countries and China has been on the rise...

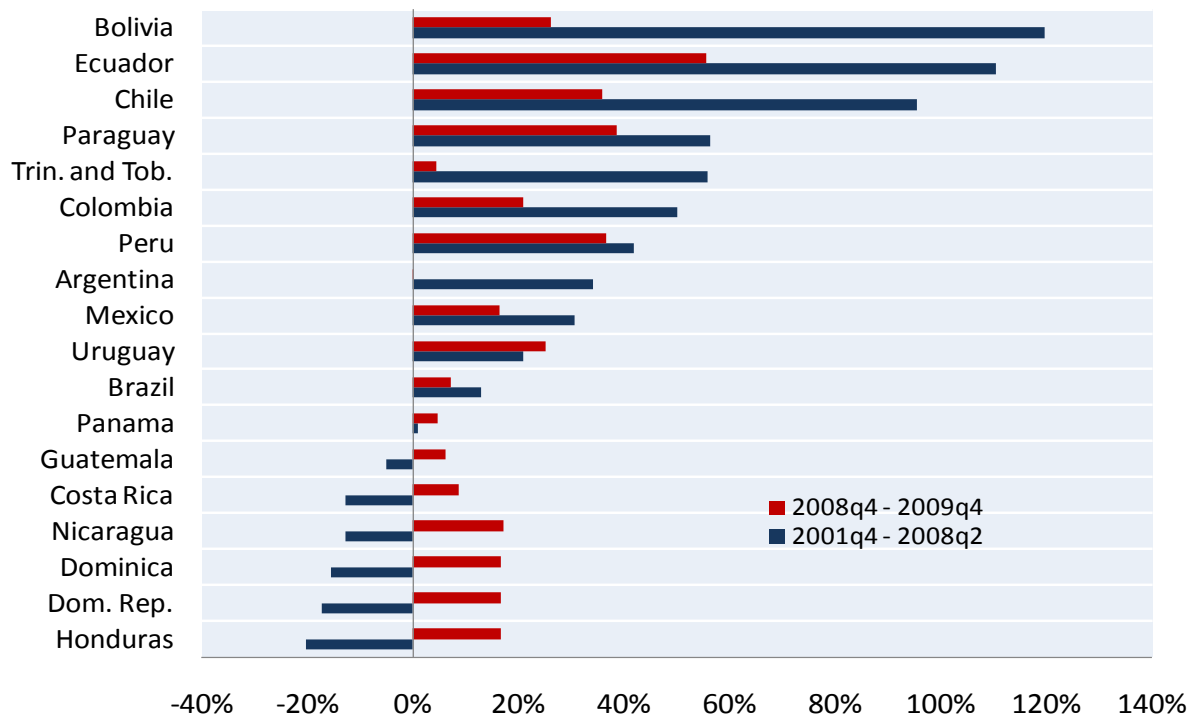
Output Co-Movement Between LAC and China
20 years rolling correlation of the Real GDP Growth



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

Cumulative Change in Terms of Trade



- 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

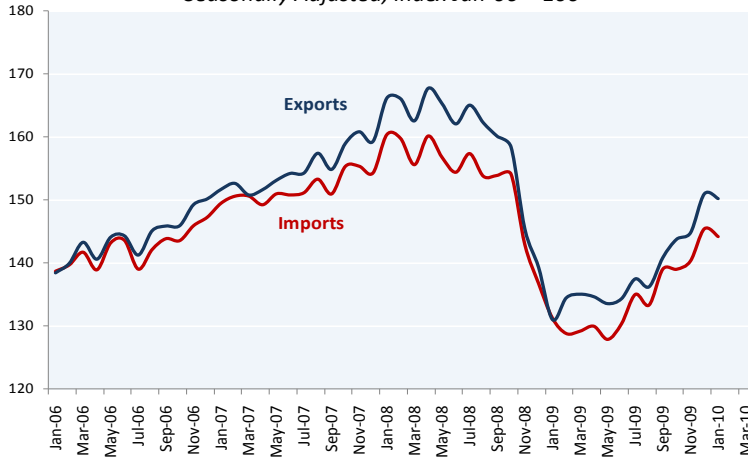
Note: The cumulative variation in the terms of trade index is calculated using quarterly data. The blue bars represent the cumulative percentage change during the recent commodity price boom up to the peak in 2008q2. The red bars capture the cumulative percentage change in terms of trade from its trough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

LAC recovering in a multi-polar world economy

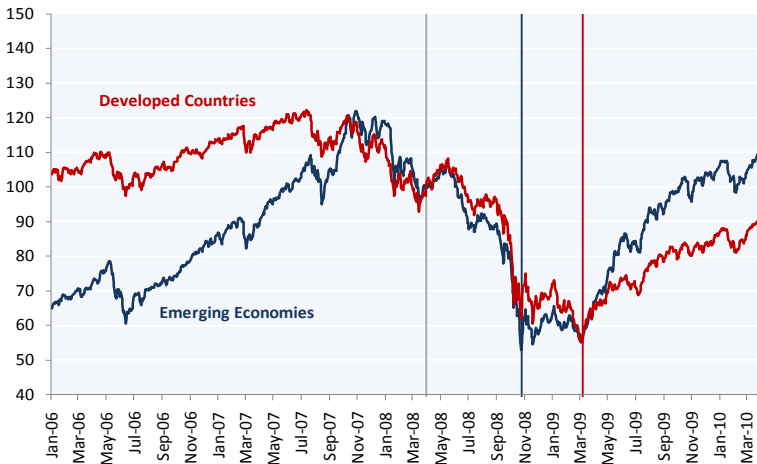
Growth engines are being reignited at different pace and intensity, with dynamic EMs in the lead

The world economy is rebounding

World Trade Volumes
Seasonally Adjusted, Index Jan-06 = 100

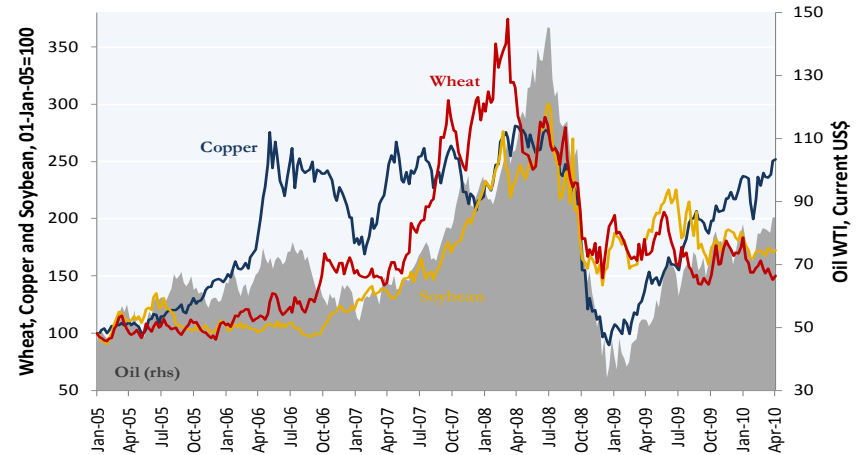


Stock Prices Around the World
Indexes: 1-Apr-08 = 100

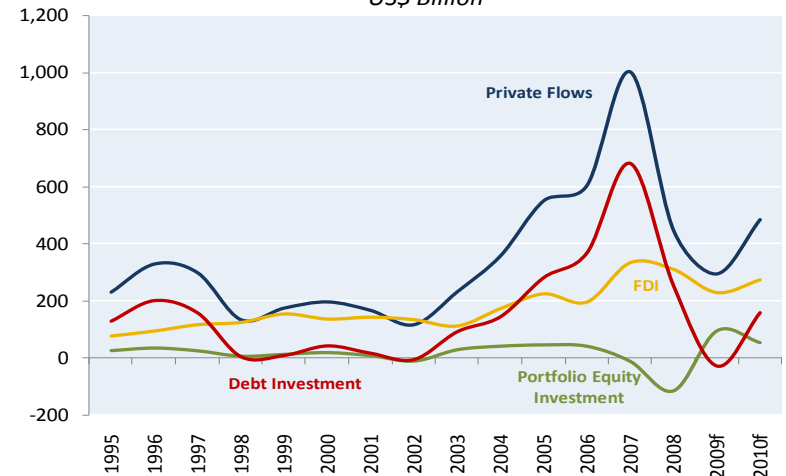


Commodity Prices

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

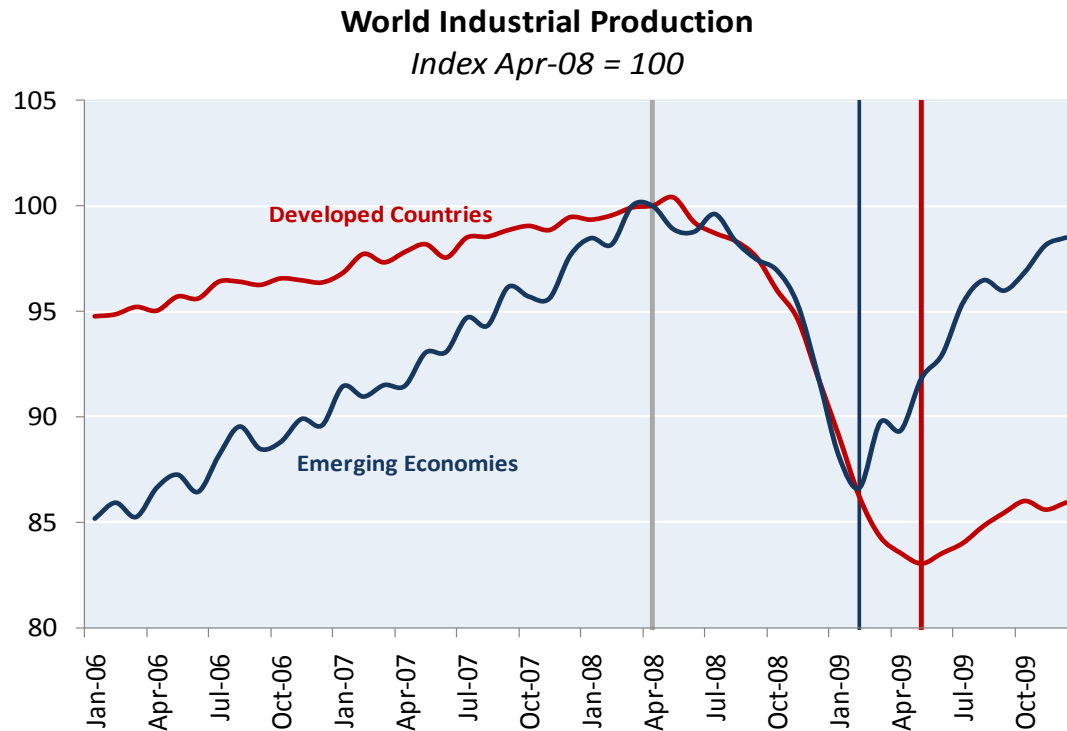


Net Private Capital Flows to Emerging Economies
US\$ Billion



Note: EAP represents East Asia and the Pacific region. Source: Bloomberg, and CPB (Netherlands Bureau for Economic Policy Analysis).

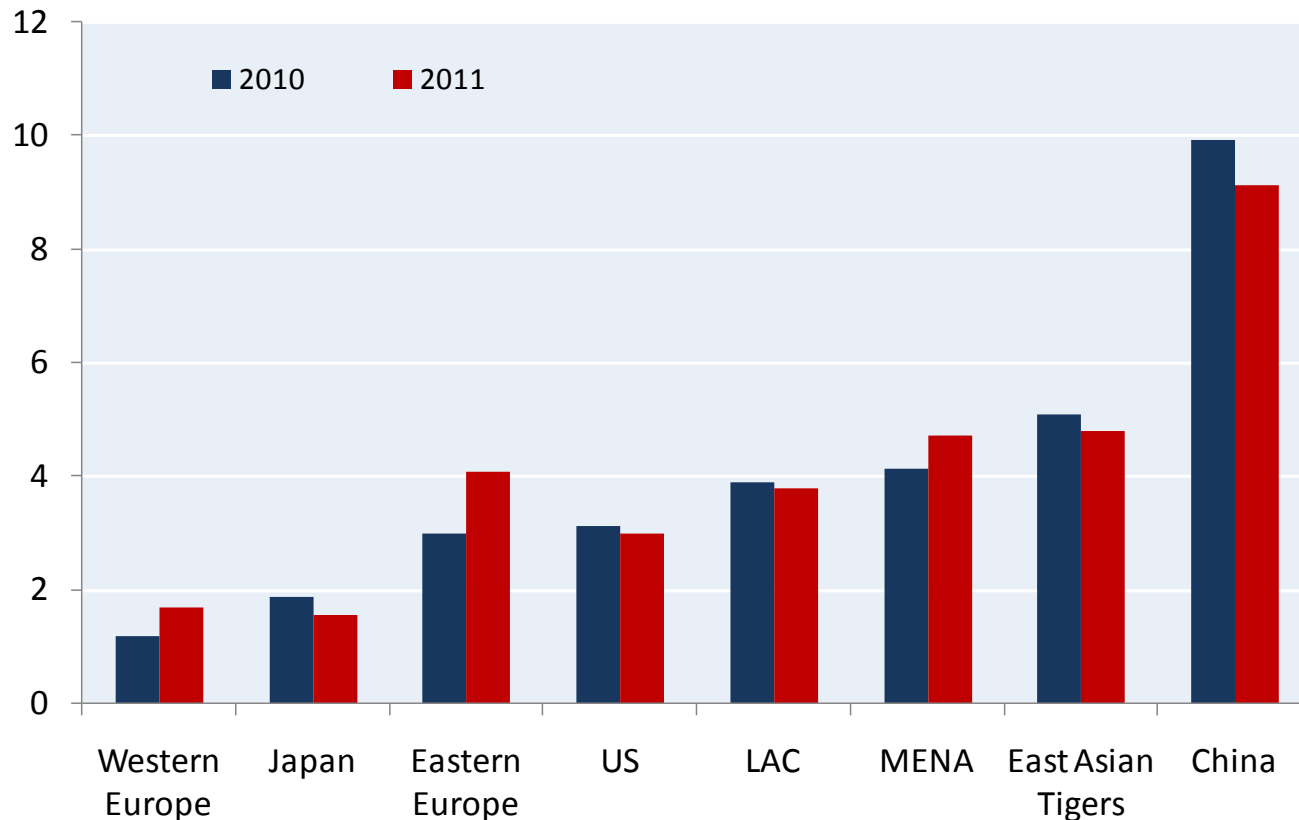
But recovery patterns contrast sharply between the rich countries and the dynamic EMs



- *Emerging economies with strongest recoveries include Brazil, China, India, Korea, Malaysia, Philippines and Thailand*
- *They represent 52% of emerging economies' GDP*

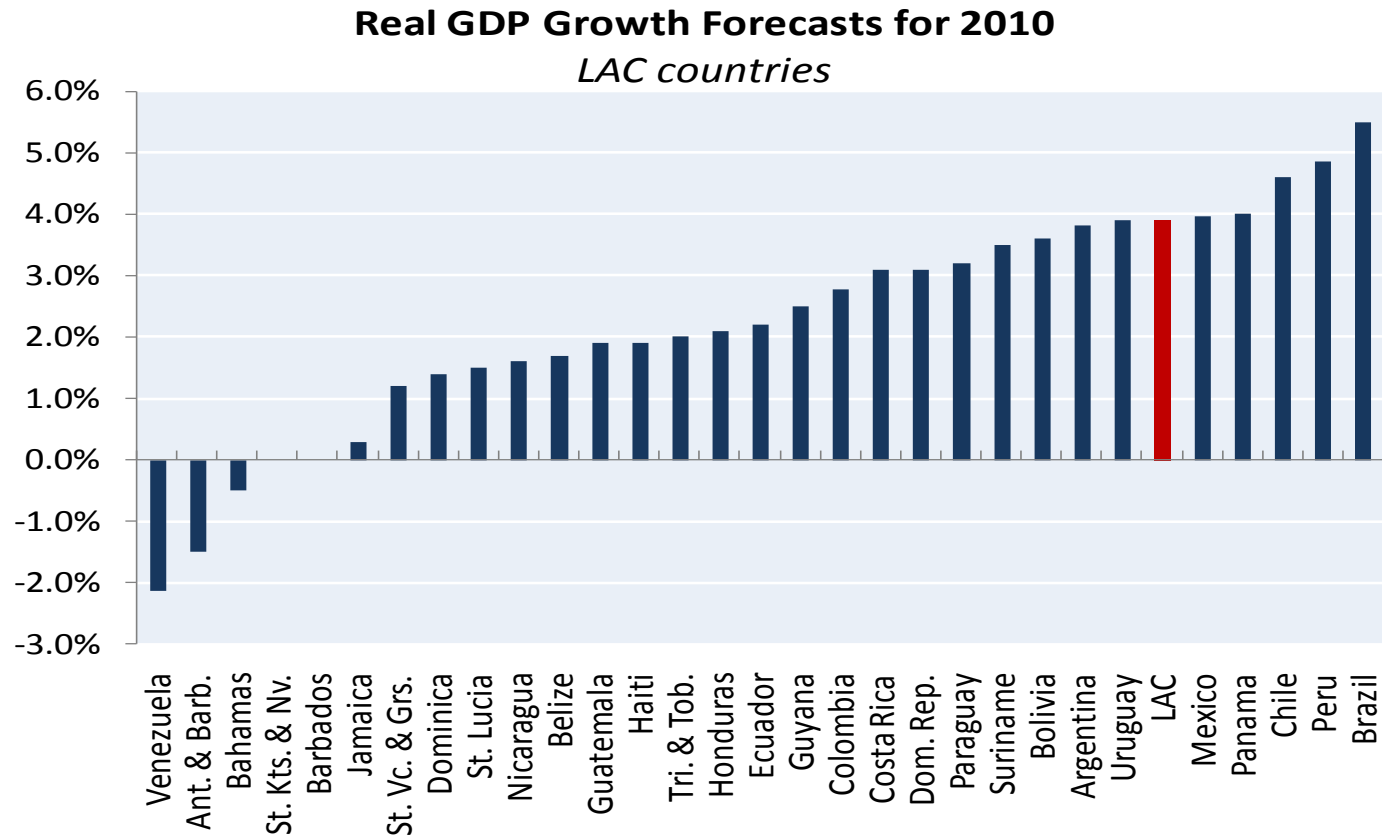
Growth forecasts for LAC in 2010-2011 are robust, but less so than for the East Asian Tigers

Real GDP Growth Forecasts for 2010-2011
Annual Real GDP Growth Rate



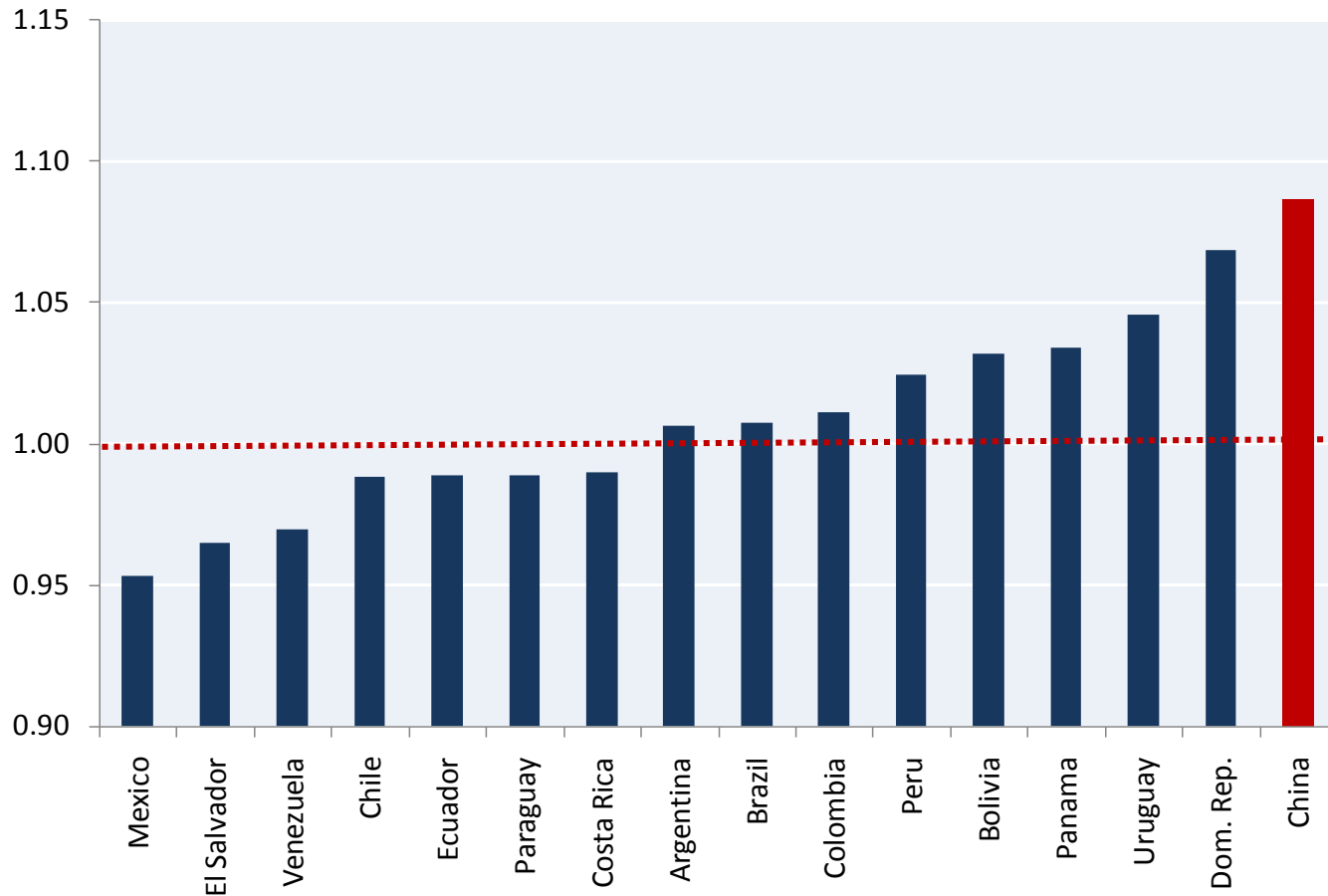
Note: Western Europe comprises Euro Zone countries, Denmark, Sweden, UK, Norway, and Switzerland. Source: Consensus Forecasts (December 2009 and March 2010), and Bloomberg.

... with Brazil, Peru, Chile and Panama leading the pack;
and Colombia behind the regional average



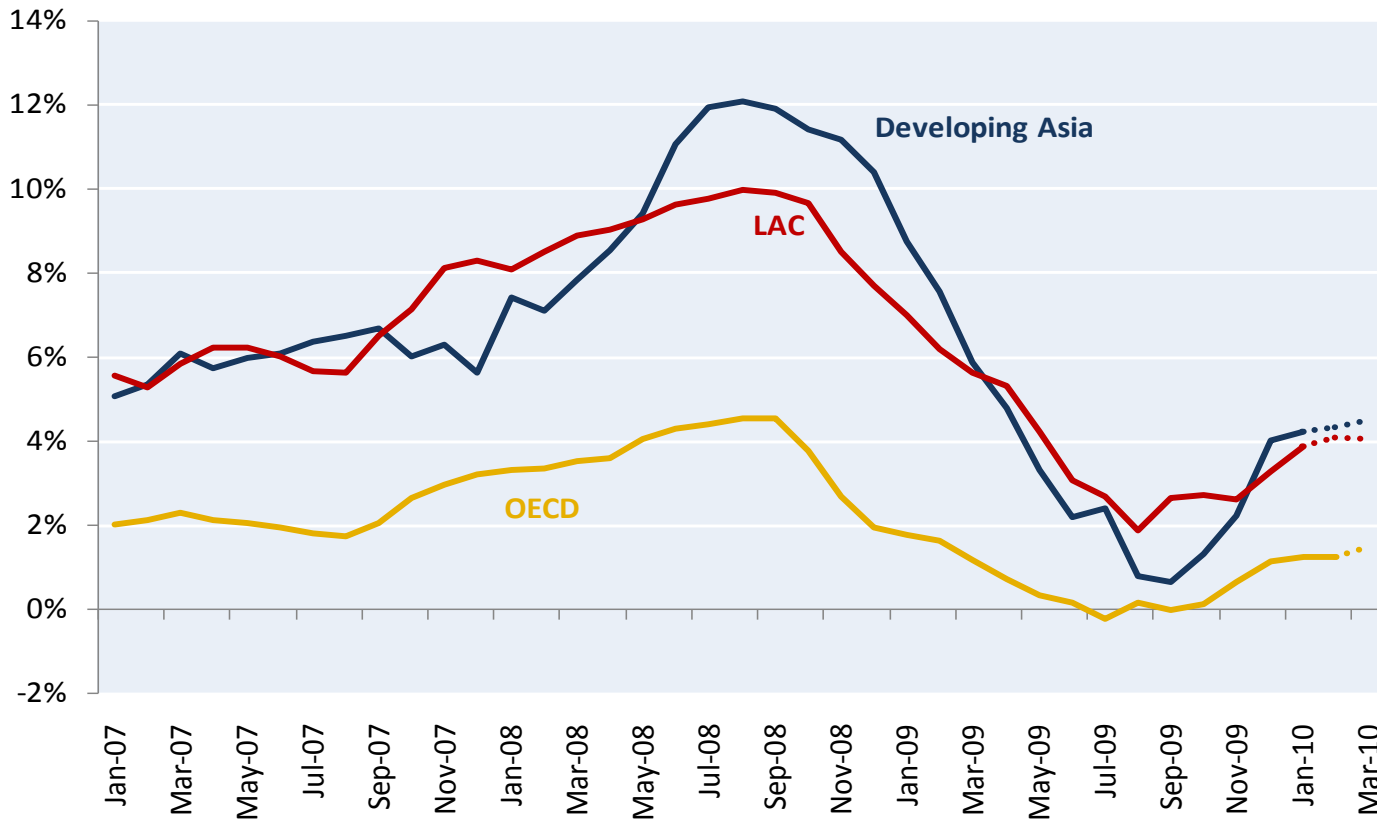
Dynamic EMs, including several LAC countries, are basically back to the pre-crisis peak in economic activity

Ratio of Real GDP in 2009q4 to Pre-Crisis Peak



If inflation pressures are surfacing, it is in the EMs

Inflation in Selected Regions
Seasonally Adjusted, YoY Growth Median



Challenges for LAC going forward

An uncertain and complex global context

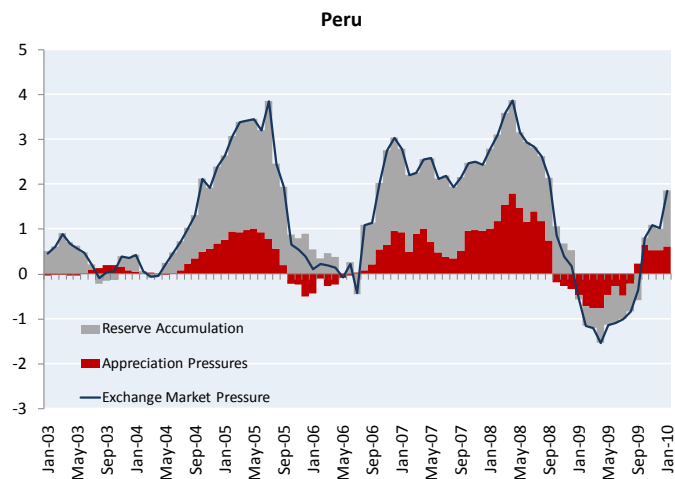
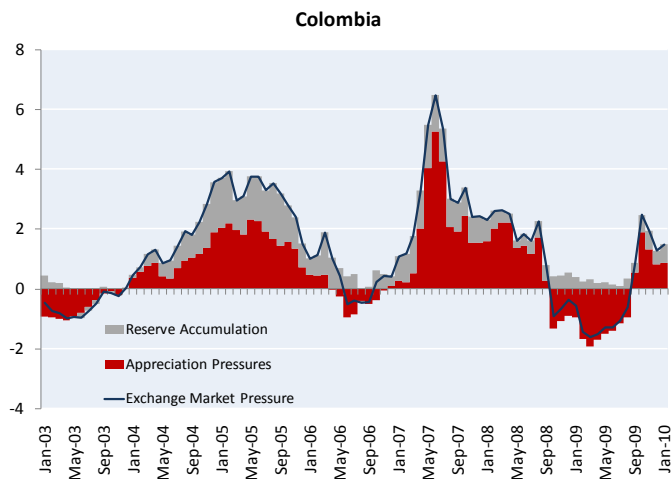
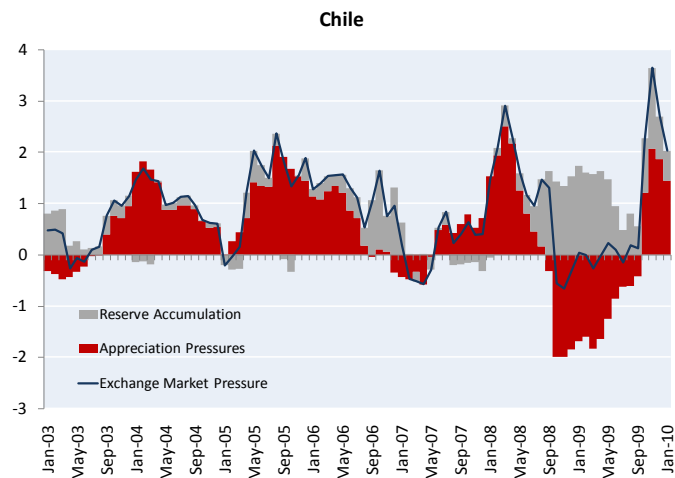
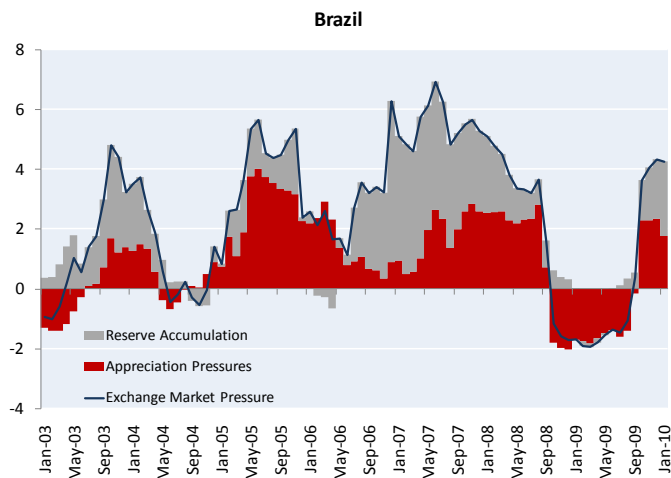
LAC prospects will still depend on the global environment, where much haziness and risks exist

- 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

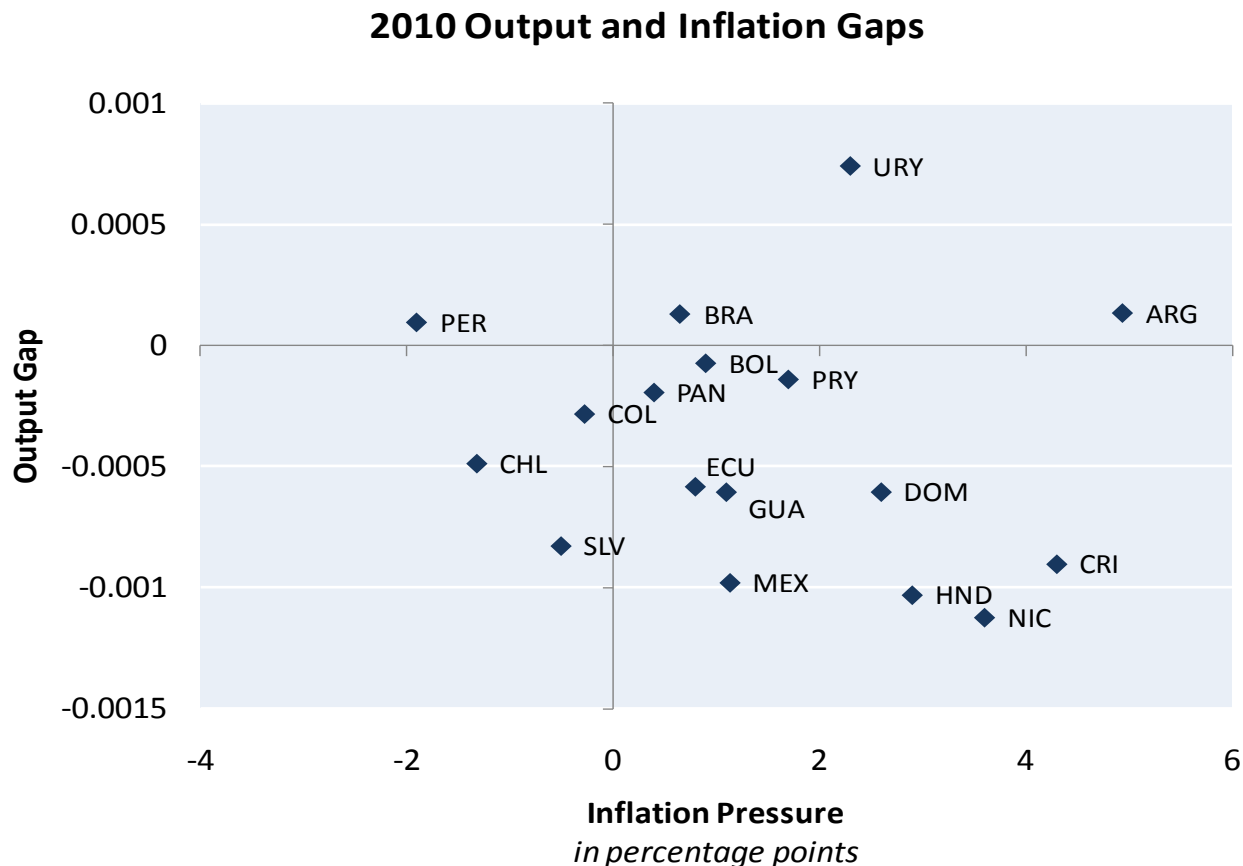
In the short-run: currency appreciation pressures

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...

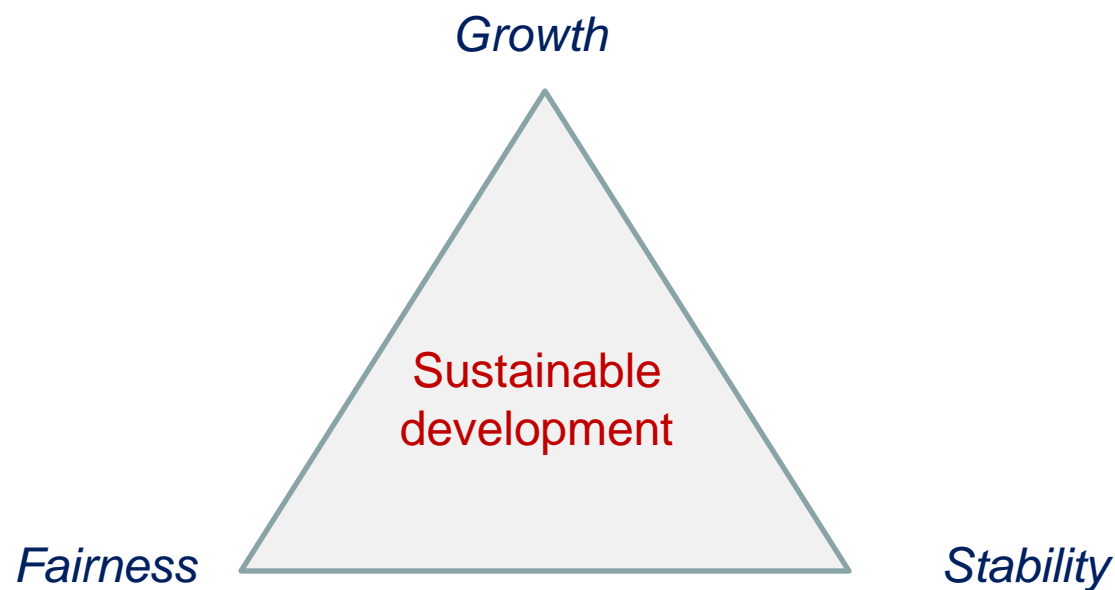


Note: Inflation pressures are calculated as the difference between the 2010 inflation rate forecast and an estimated target of 4% (assumed to be the target for most countries in the region). The output gap calculated as the difference between the (log of) actual and potential GDP, with the latter being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

Challenges for LAC going forward

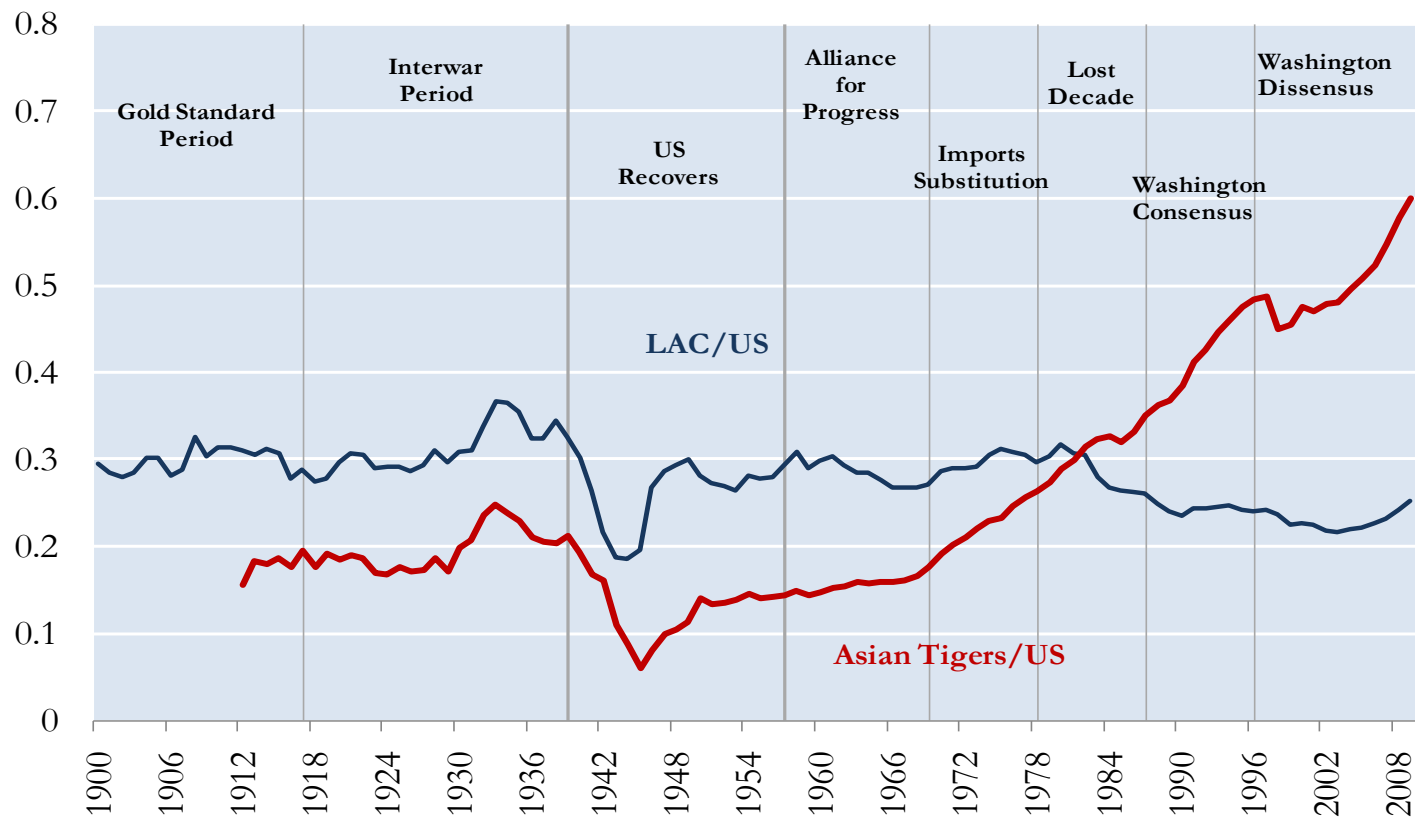
It is mostly about growth and, for most of the LAC economy, growth linked to natural resource wealth

The virtuous development triad



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