
LAC Weathering the Global Storm: Green Shoots?

May 27, 2009

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



Outline

- The dynamics of the global storm
 - Have we moved away from a catastrophic meltdown?
- Evolving transmission channels to LAC
- LAC is comparatively less vulnerable
- LAC is likely to avert a systemic financial crisis, but will inevitably endure a recession
- LAC is relatively more vulnerably in the social arena
- How much room for countercyclical policy?
- Final thoughts

The dynamics of the global storm

The dynamics of the storm

- The eye of the storm has been in the center
- ... it spread rapidly across markets and countries
- ... leading to the deepest, broadest and most complex *global* recession since the 1930s
- Big factor: toxic assets in systemically important institutions...
 - Interconnected but highly opaque network of exposures
 - Toxic assets hard to spot, price, dump, and restructure
- ... which explains why the Lehman event (Sep 15, 2008) triggered massive panic, runs, and a free fall
 - Investors were gripped by uncertainty and fear of a full system meltdown
- Financial crisis hit real economy, exacerbating financial decay

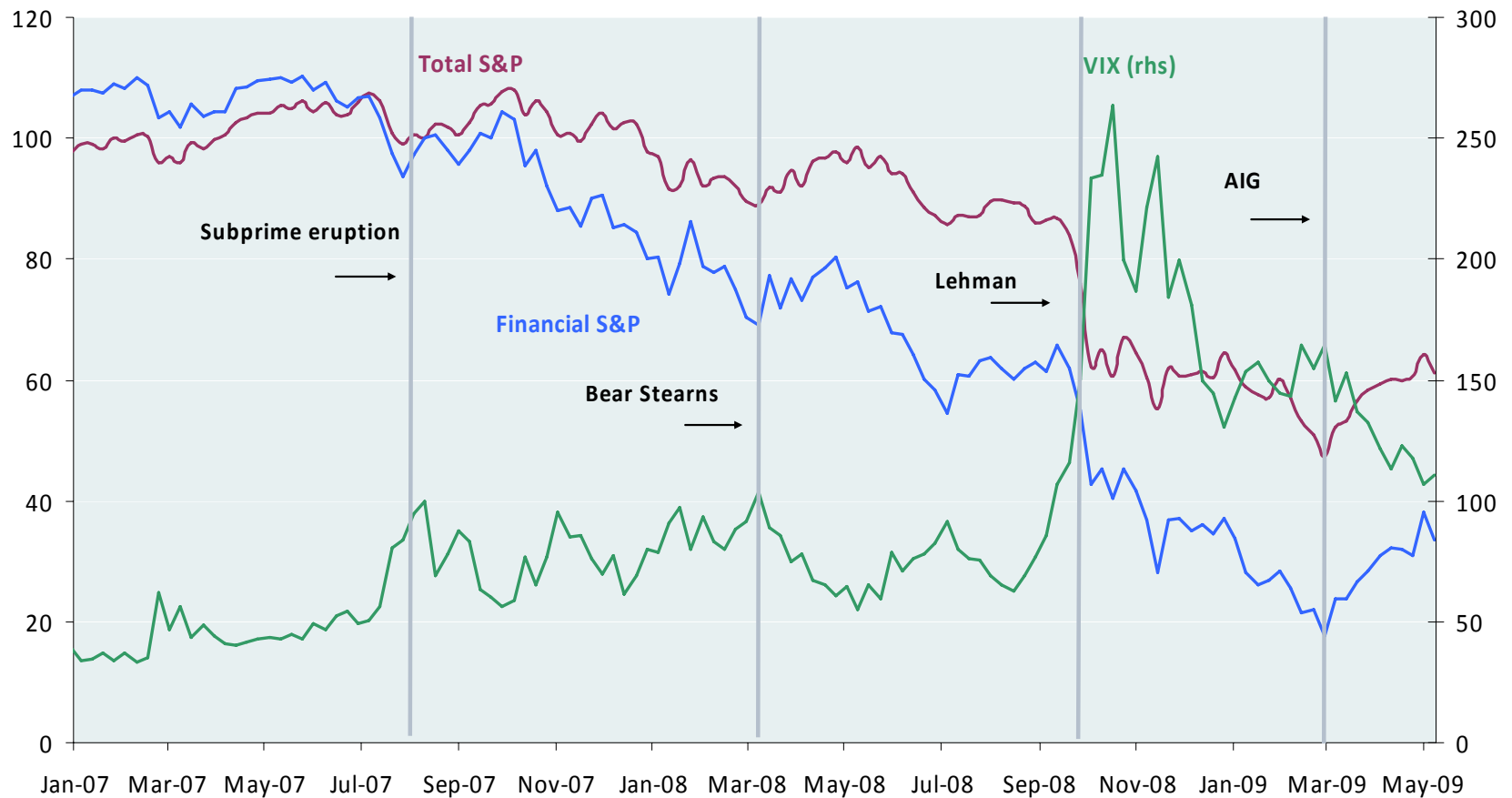
The dynamics of the storm

- Storm reached darkest and most ominous point in late 2008
 - 2008Q4 was the “quarter from hell”
 - All world’s growth engines shut down
 - All transmission channels to LAC fully activated
- LAC idiosyncratic strengths paled as meltdown fears rose
- By April 2009, however, specter of catastrophic meltdown in the center seems to have been exorcised
 - Thanks to the Fed!
 - “Green shoots” suggest a different dynamic
- LAC idiosyncratic strengths gain in importance as catastrophe in the center is averted

The dynamics of the storm

Standard & Pools (Financial and Total) and VIX

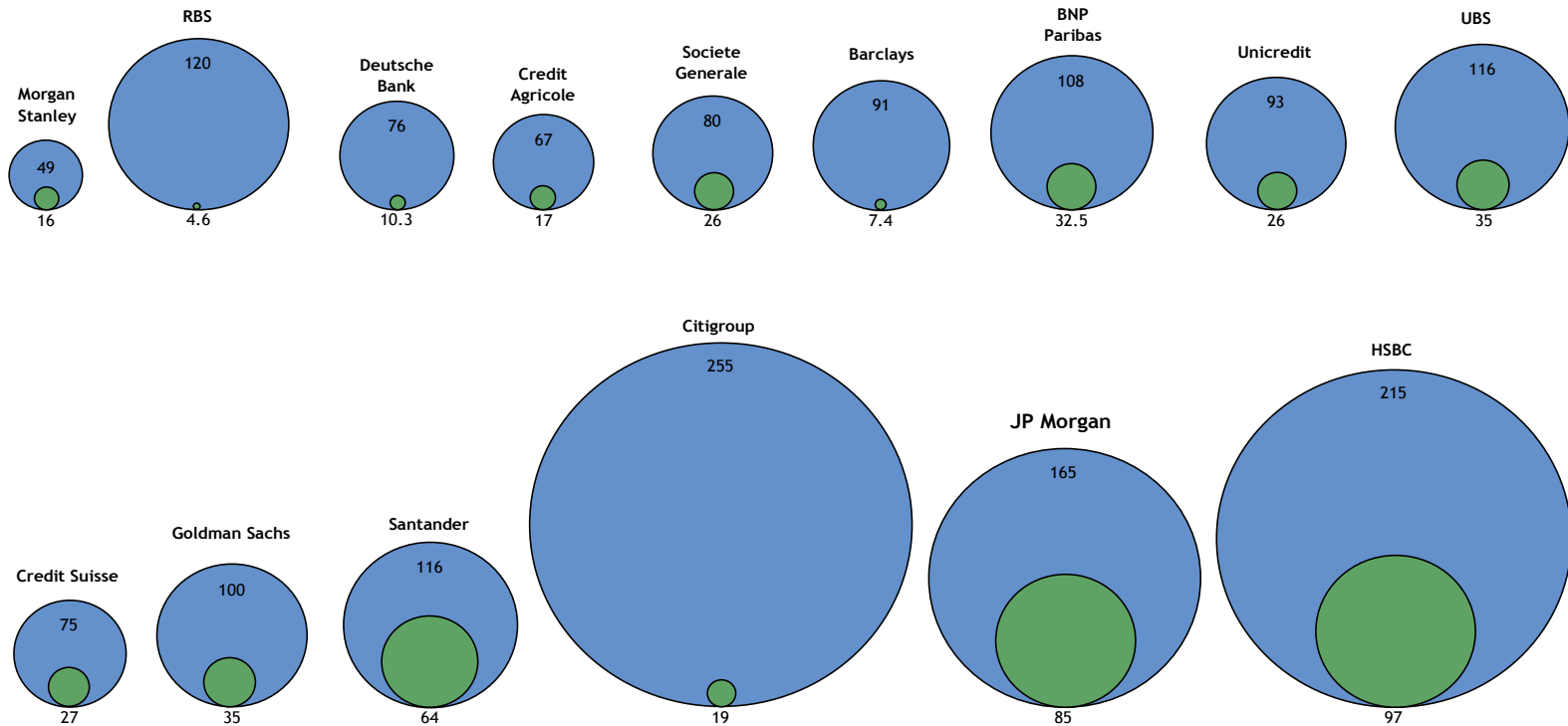
index number Aug 15 /2007 =100



Unprecedented destruction of banks' net worth ...

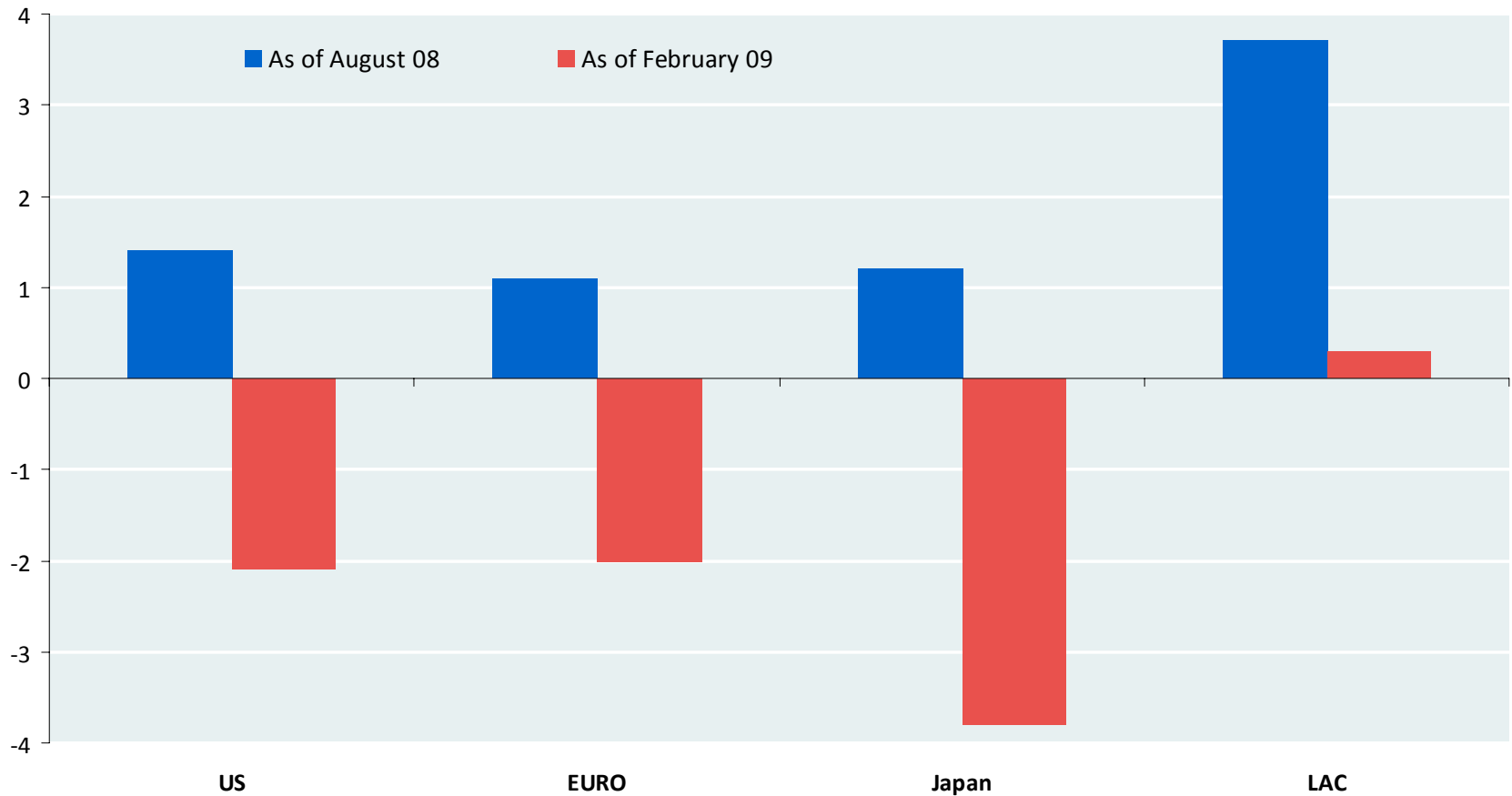
Banks: Market Cap

- Market Value as of January 20th 2009, \$Bn
- Market Value as of Q2 2007, \$Bn

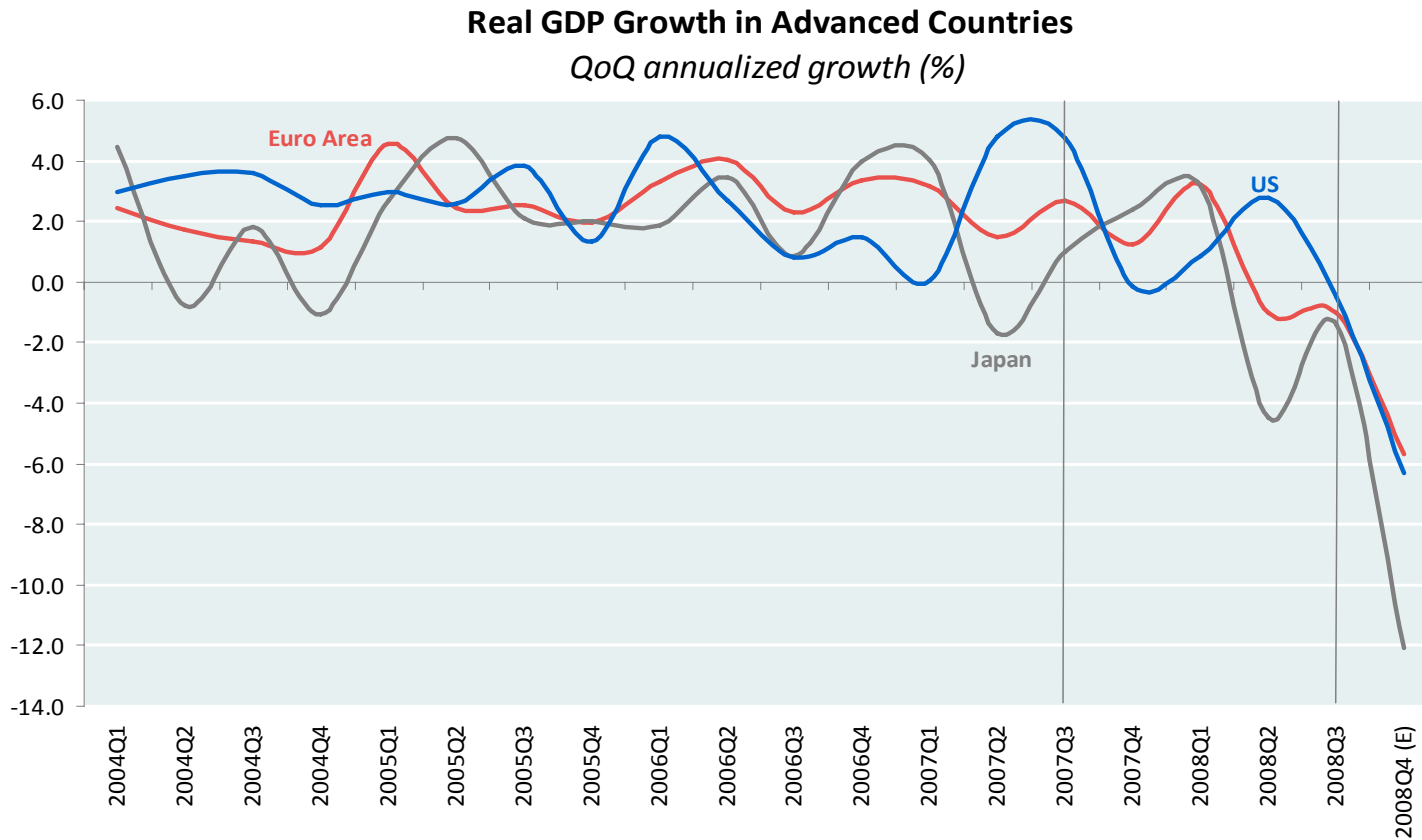


What a difference a few months can make!

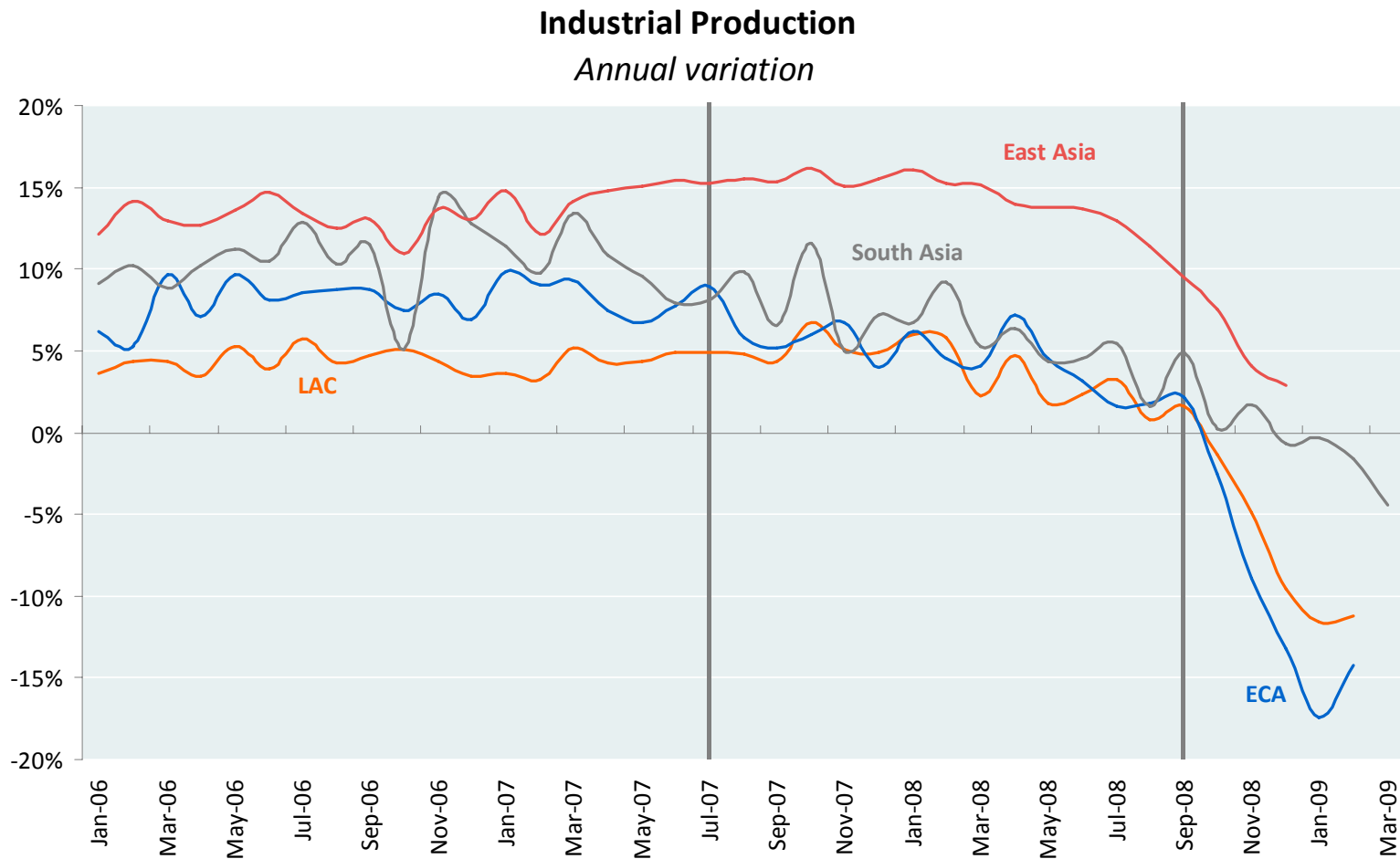
Growth Forecasts for 2009
annual GDP real growth rate, in %



2008Q4 – a quarter from hell for the center...

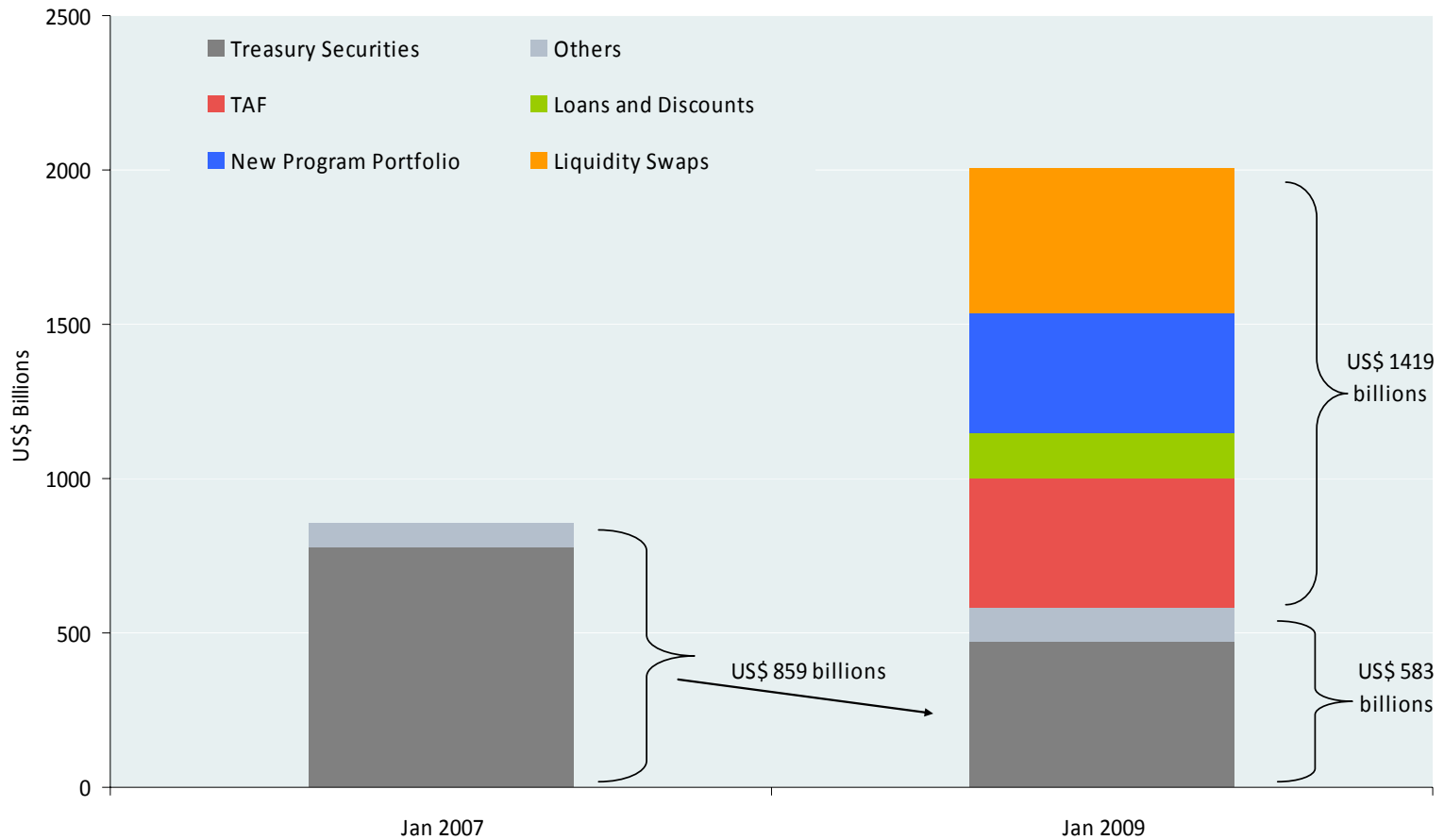


... and for the periphery of emerging economies



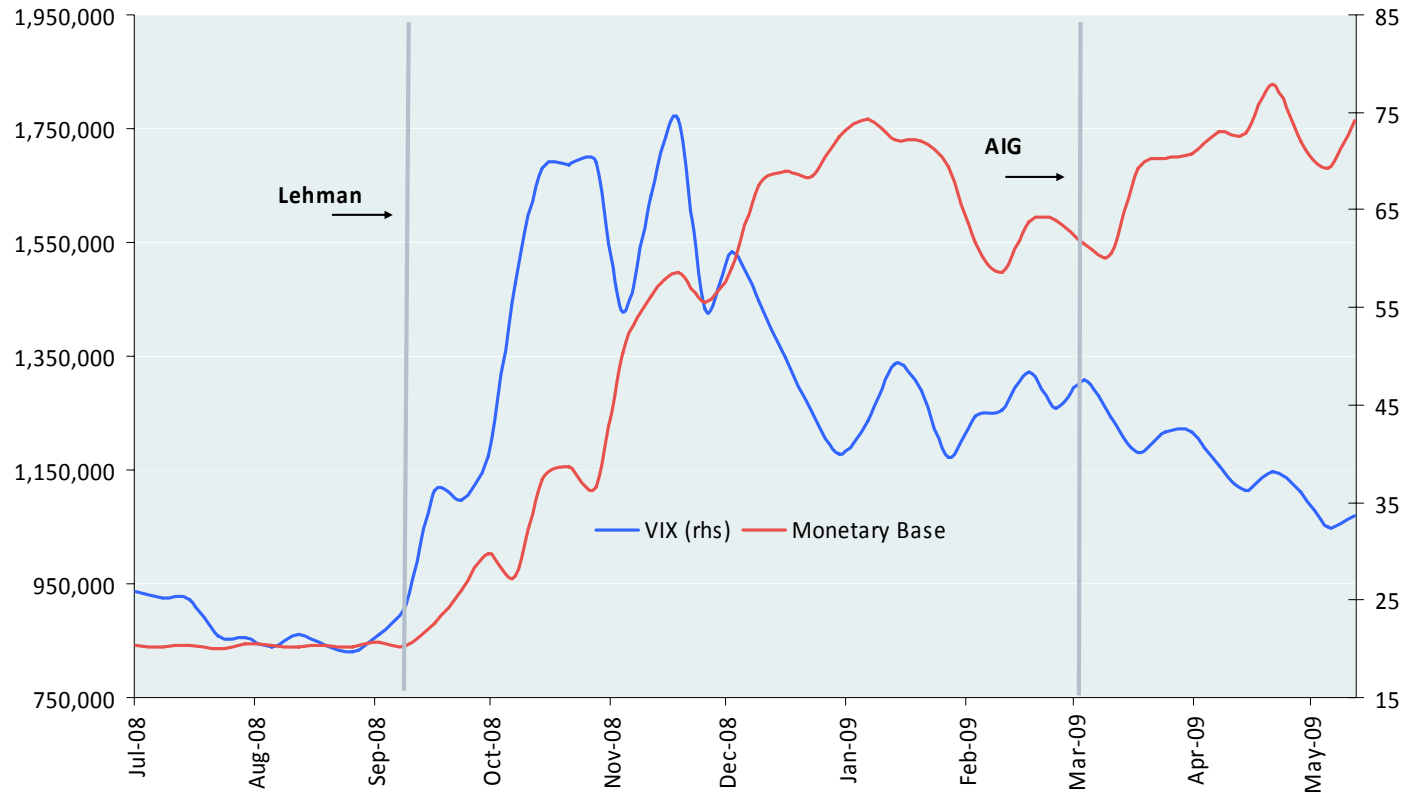
Enter the U.S. FED – risk absorber of last resort

FED's Balance Sheet: Total Assets



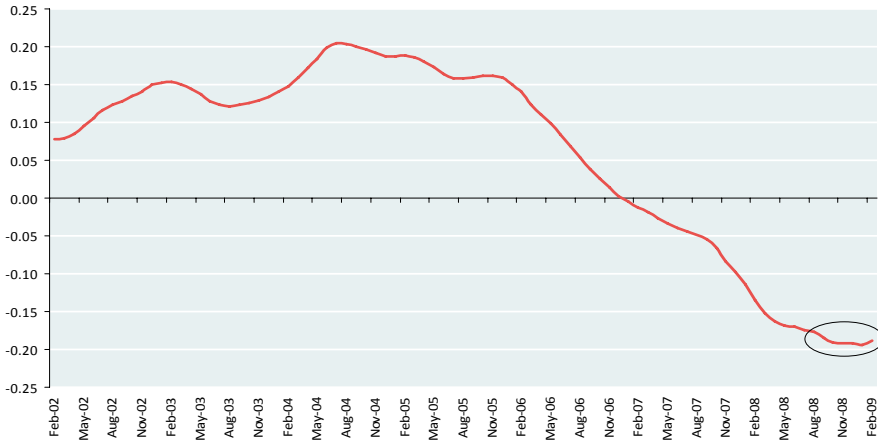
U.S. Fed emergency actions and risk aversion

US Monetary Base and Investors' Risk Aversion

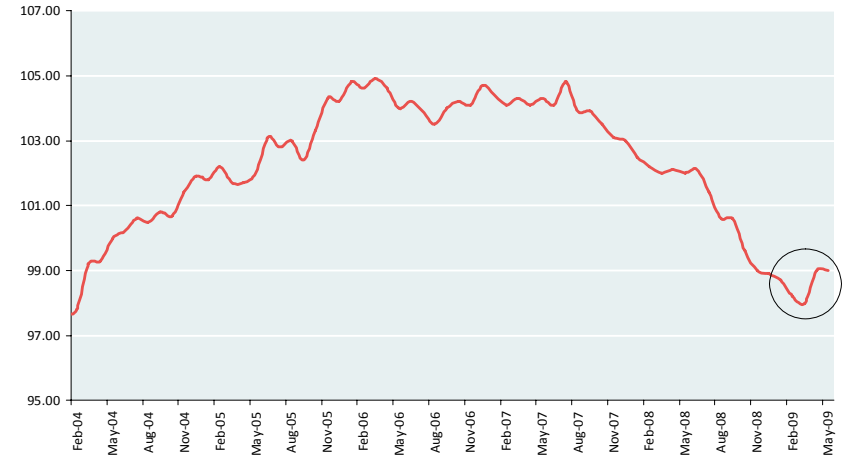


“Green shoots” in U.S. – recession loosening force

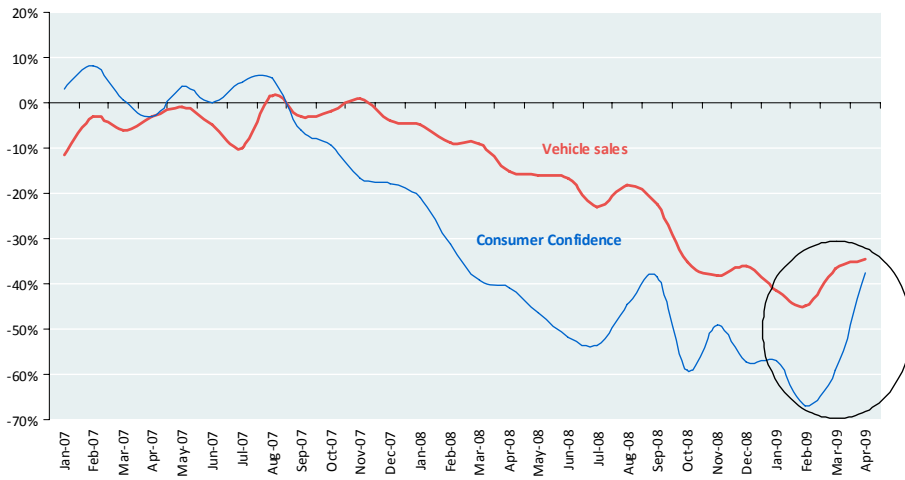
US House Prices
S&P/ Case-Shiller Index - Annual variation



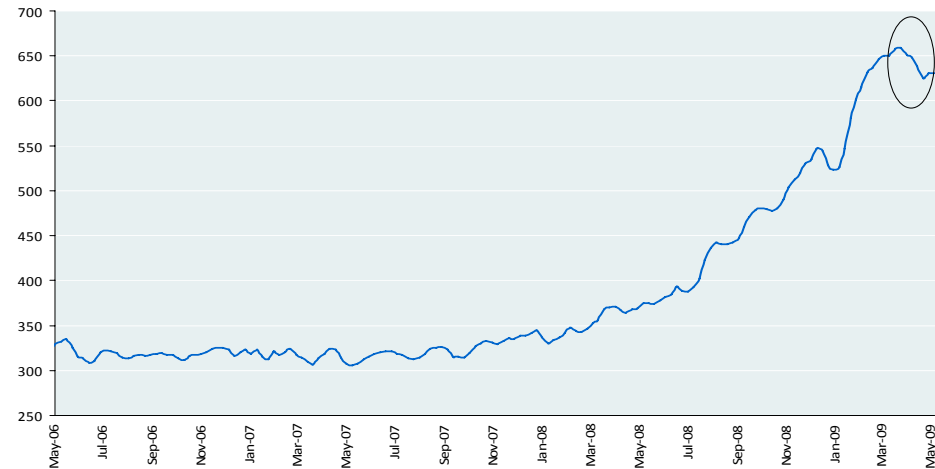
U.S. Conference Board Leading Indicator
Index 2004 =100



U.S. Economic Indicators
Consumer Confidence and Vehicle Sales - Annual variation

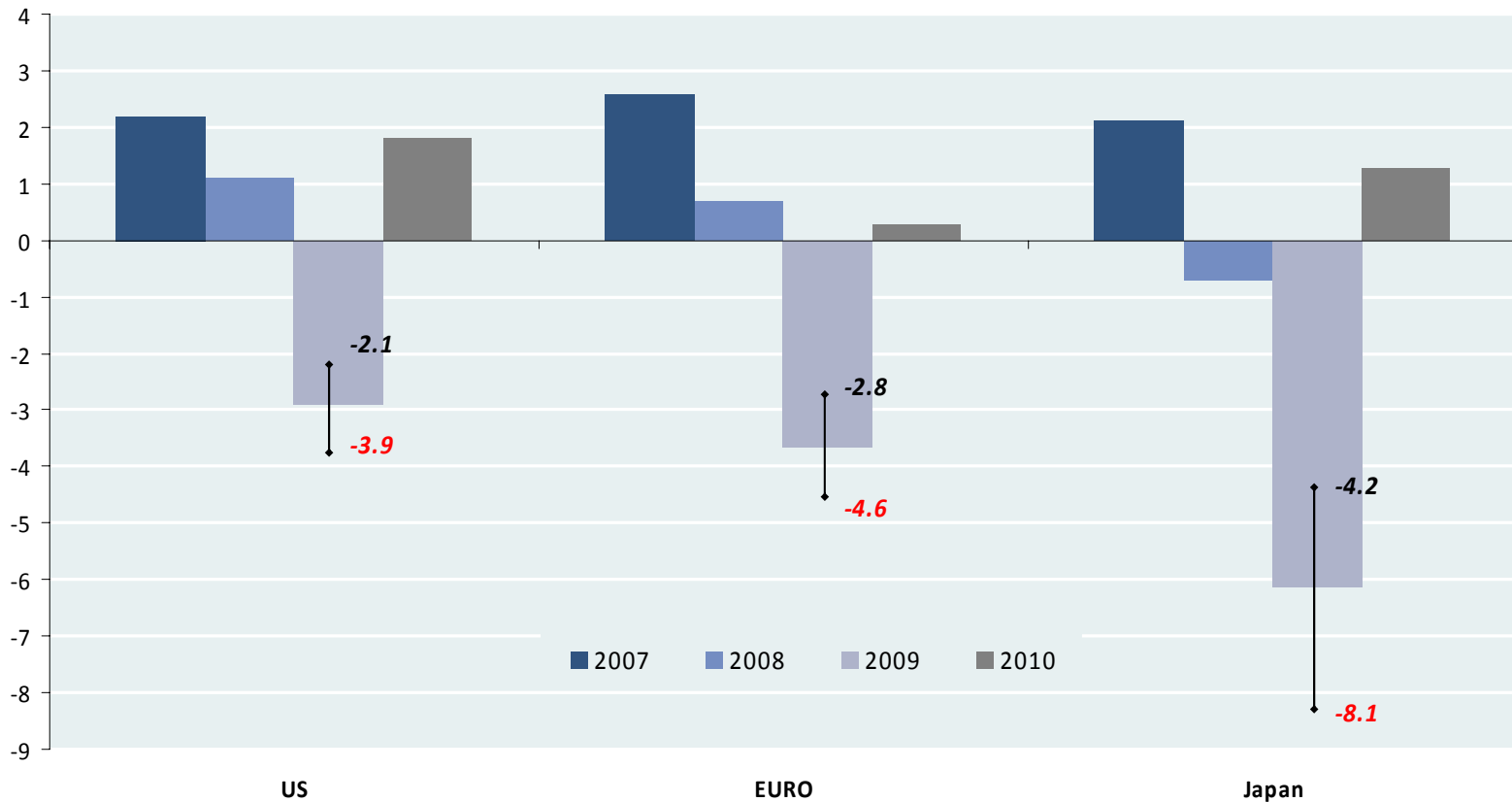


United States: Initial Jobless Claims
In thousand of people, 4-Week MA, SA



Despite removal of catastrophic scenario and green shoots, recession can still be L- or W-shaped

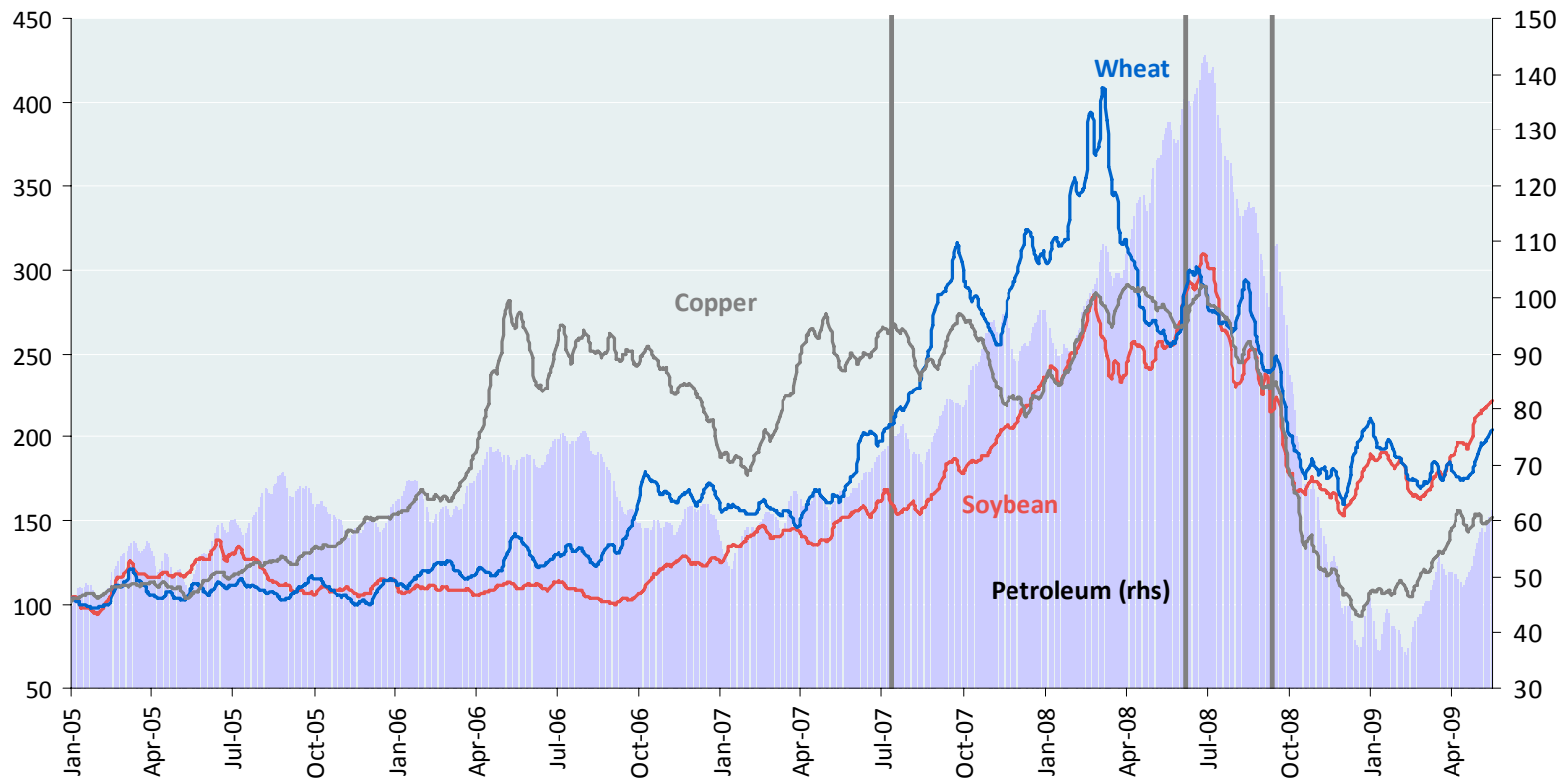
Recent Growth and Forecasts for 2009-10
annual GDP real growth rate, in %



Evolving transmission channels to LAC

Commodity prices ...

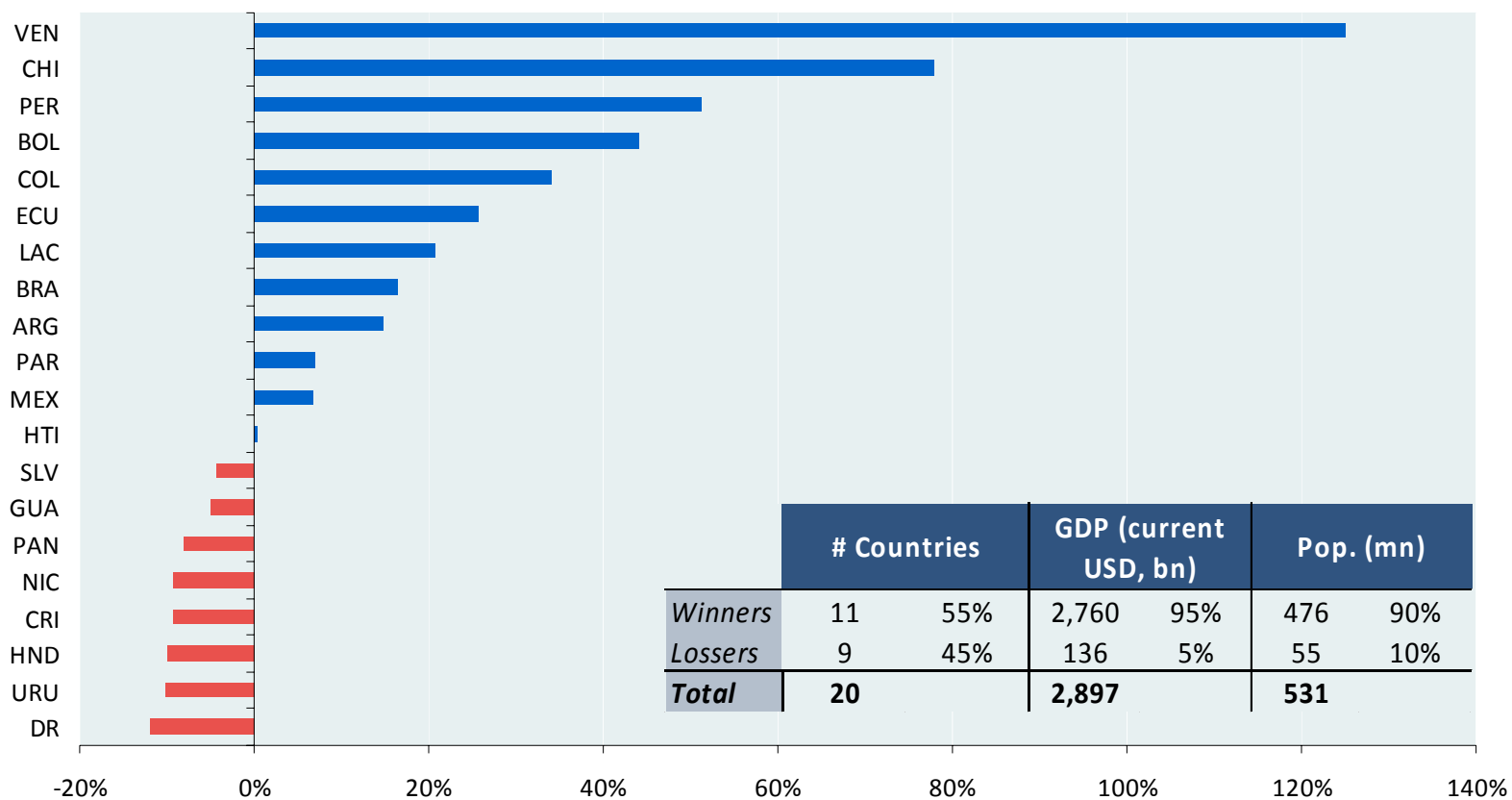
Commodity Prices (5-day Moving Average)
*Oil WTI in current US\$, Wheat,
Copper and Soybean are Index numbers: 1/01/05=100*



... with asymmetric effects across LAC countries

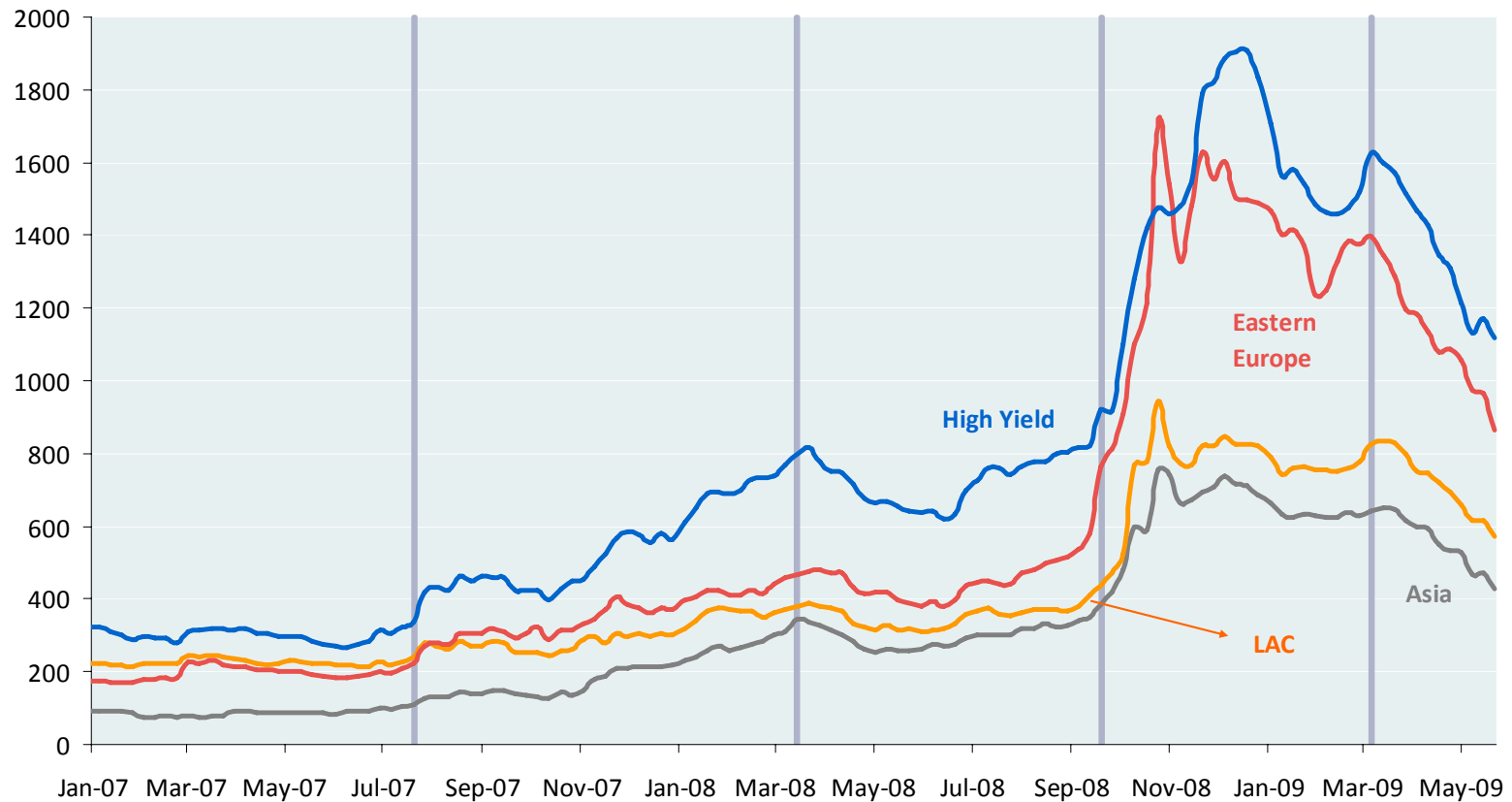
Terms of Trade

cumulative percent change from 2002 to 2007



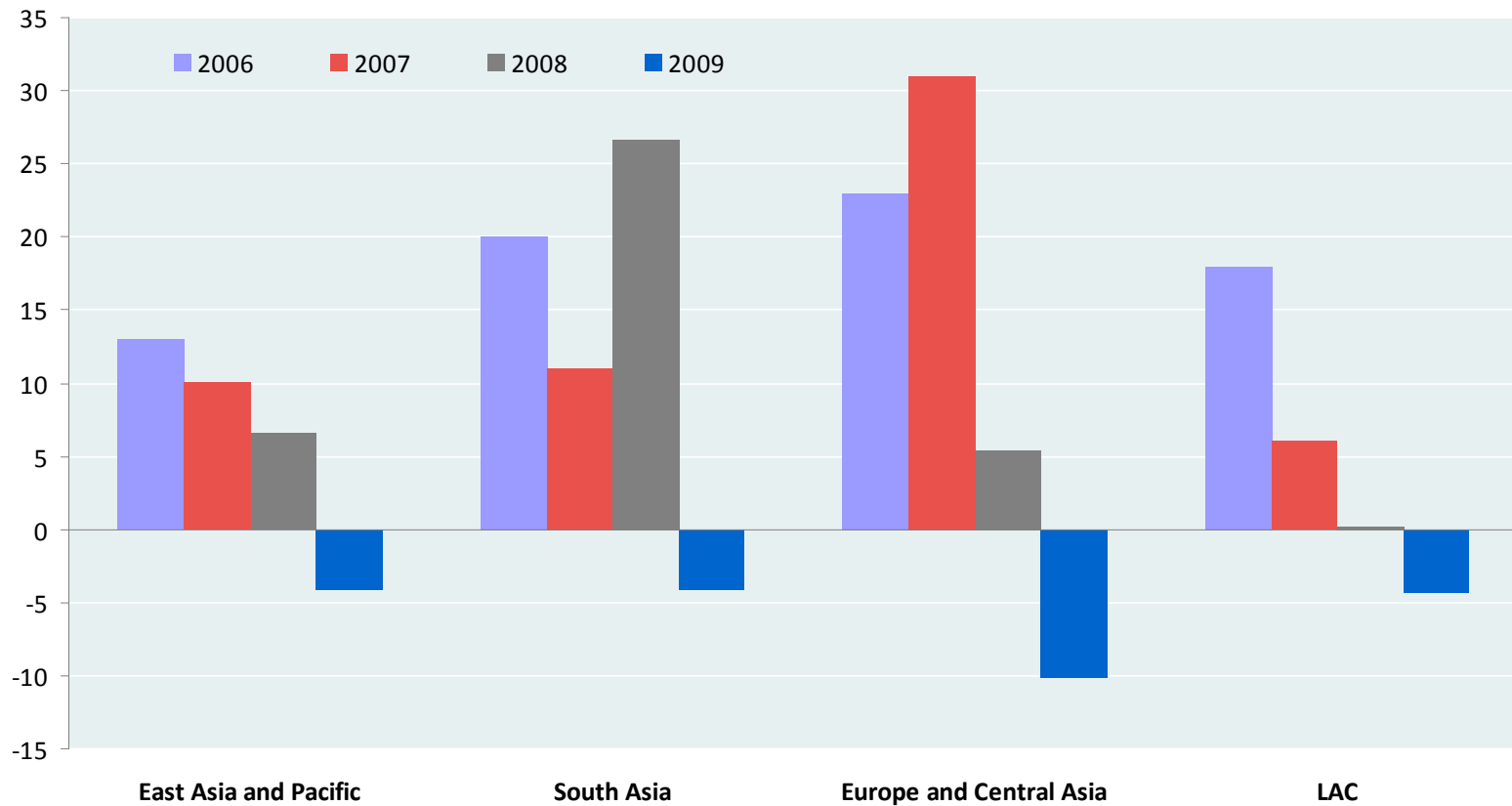
FX borrowing costs

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

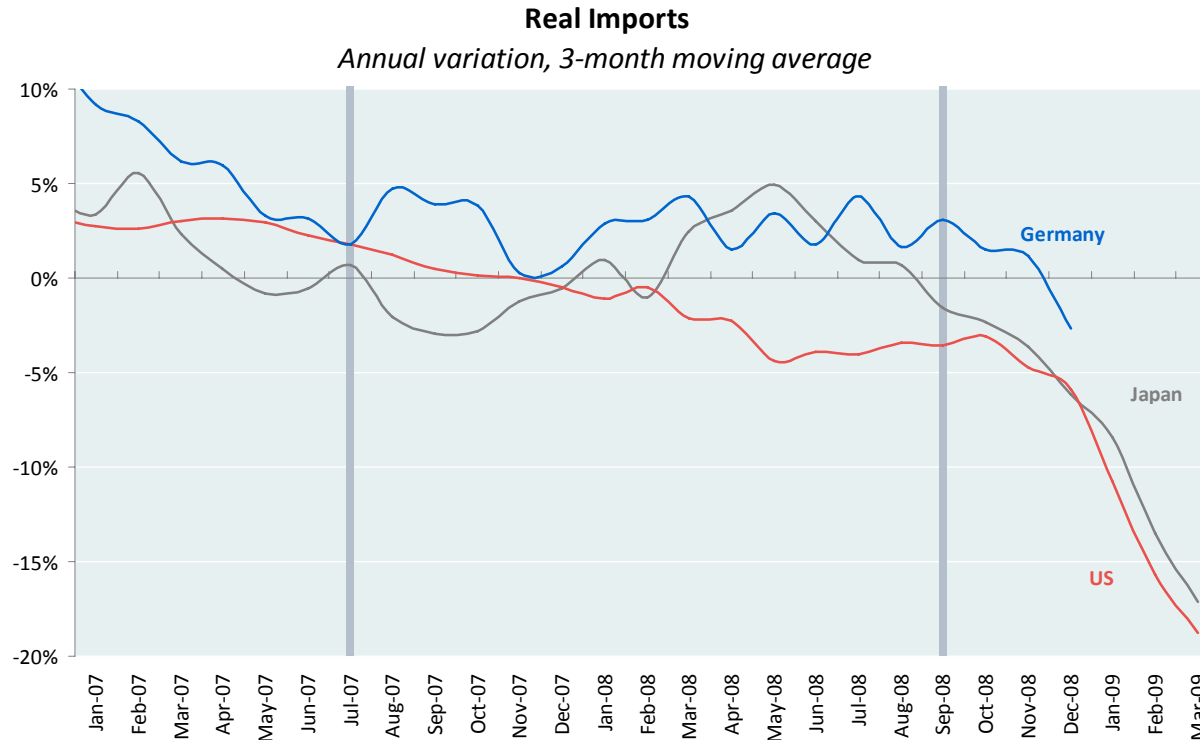


Remittances

Remittance flow to developing countries
Annual variation (in %)



External demand



- **Global trade is declining for the first time in 25 years**
- **ILO: world unemployment could rise to 38 million workers, from 14 million in 2008**

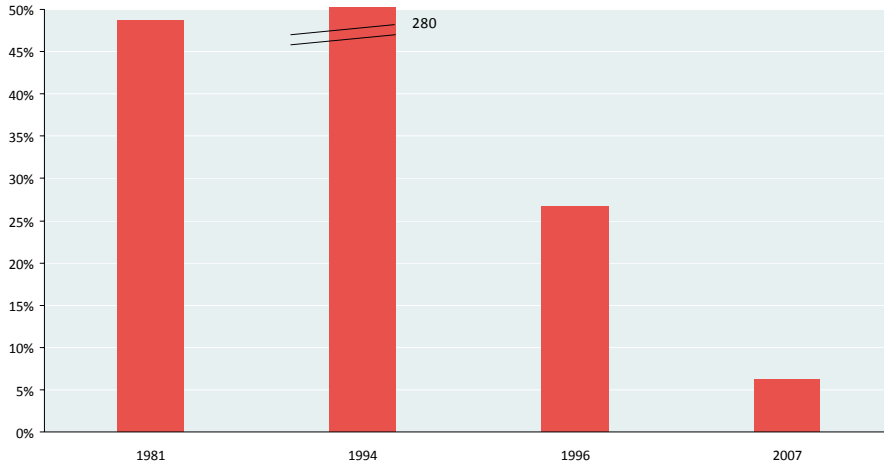
Desirable policy responses are restricted in practice

- *In principle*, the situation calls for timely responses:
 - Countercyclical macroeconomic policy
 - Scaling up of social protection and basis infrastructure
 - Significant real exchange rate depreciations
- *In practice*, impact and response capacity depends on:
 - Extent of pre-existing macro-financial weaknesses
 - Structural factors: openness, sectoral allocation of labor
 - Extent of poverty, inequality and social conflict

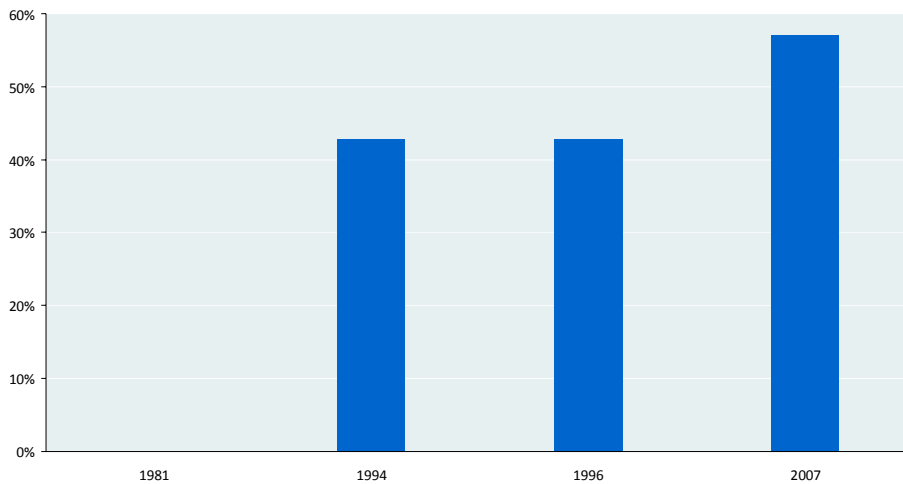
*LAC is comparatively less vulnerable:
no longer catching pneumonia*

Sounder money

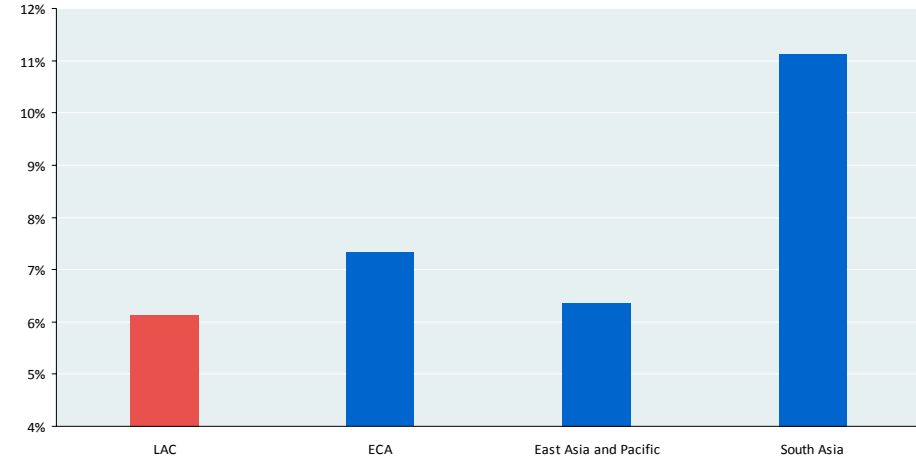
Inflation in LAC
annual variation



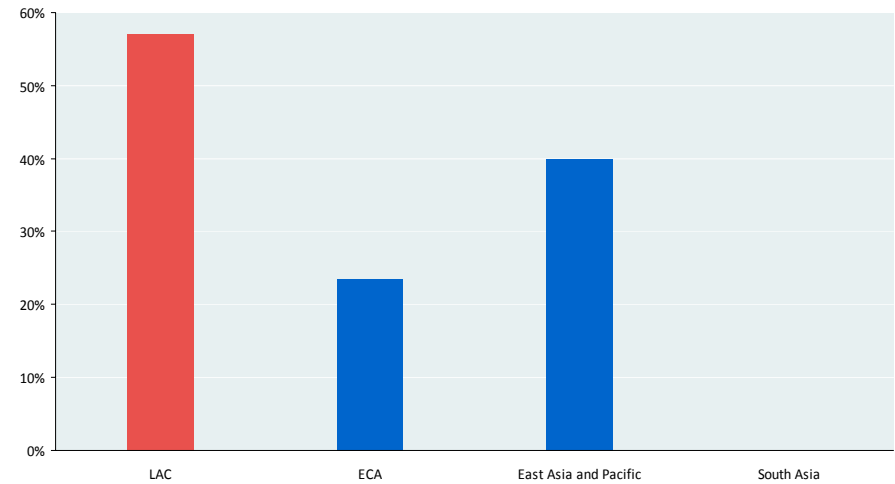
LAC countries with exchange rate flexibility
as % of the sample



Inflation in selected regions
annual variation

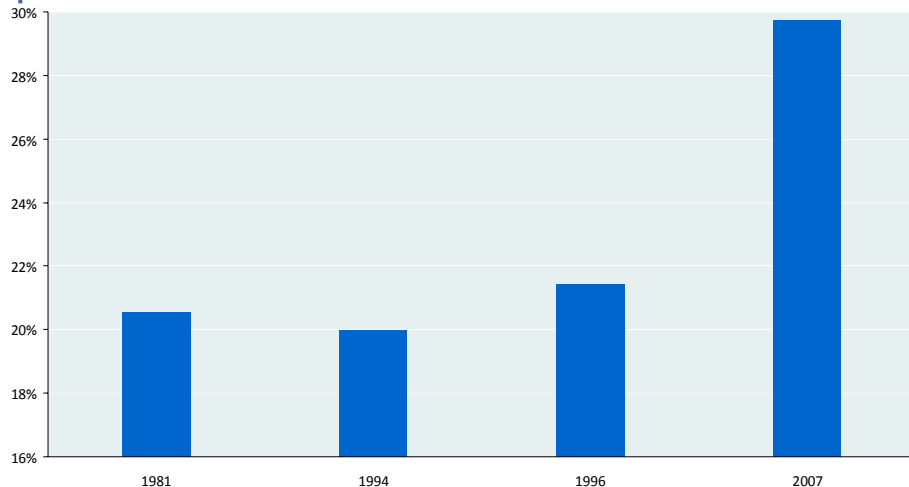


Countries with exchange rate flexibility in selected regions
as % of the sample

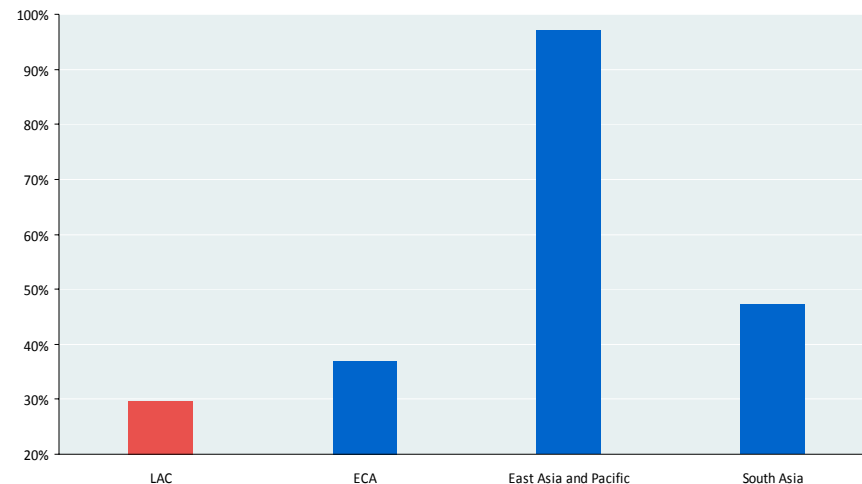


More resilient financial systems

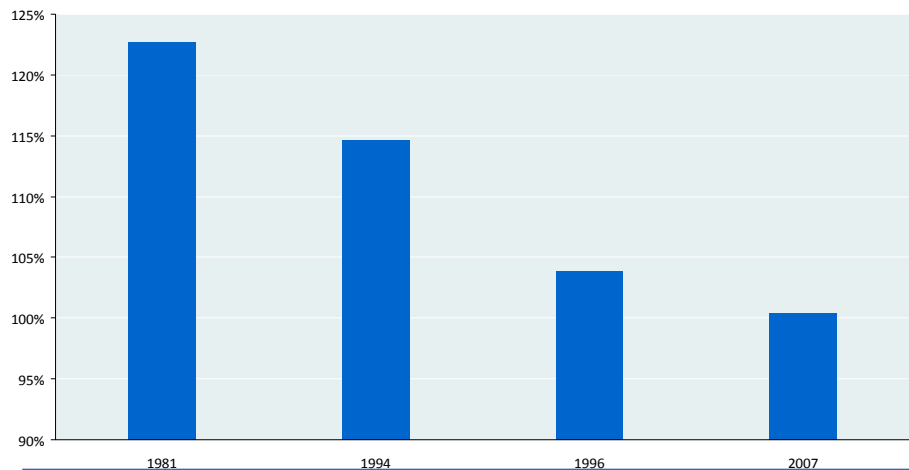
Bank Deposits in LAC
as % of GDP



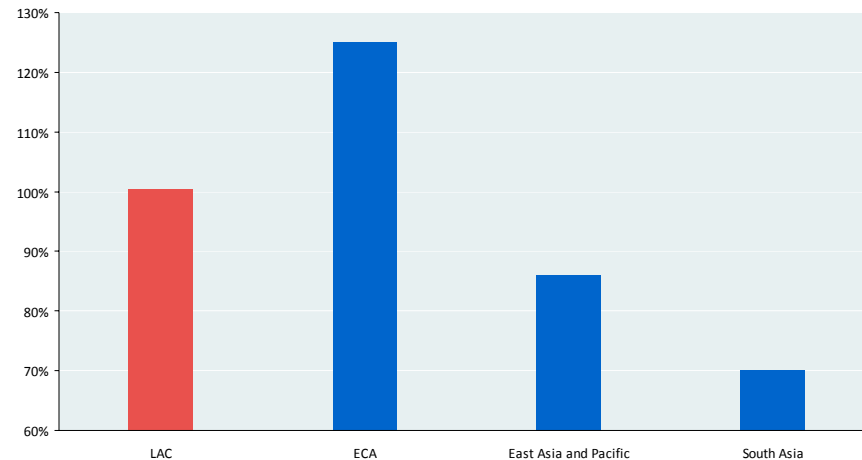
Bank Deposits in selected regions
as % of GDP



Loan to Deposit Ratio in LAC
in %

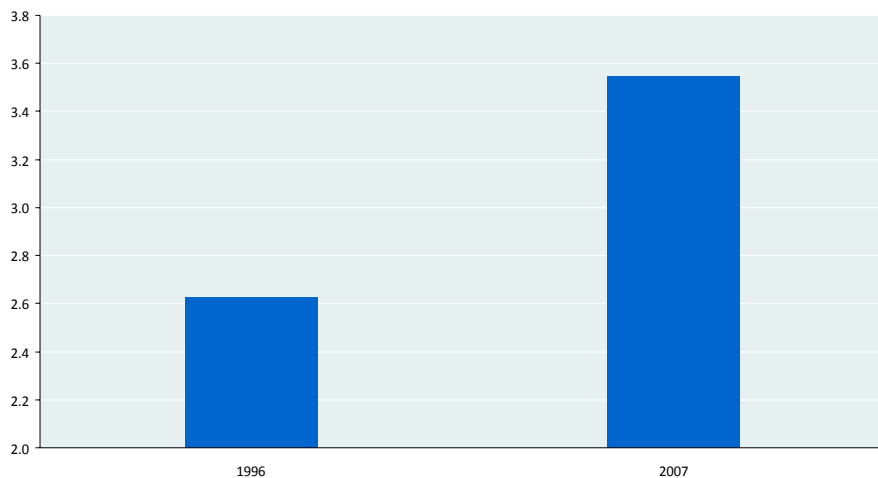


Loan to deposit ratio in selected regions
in %

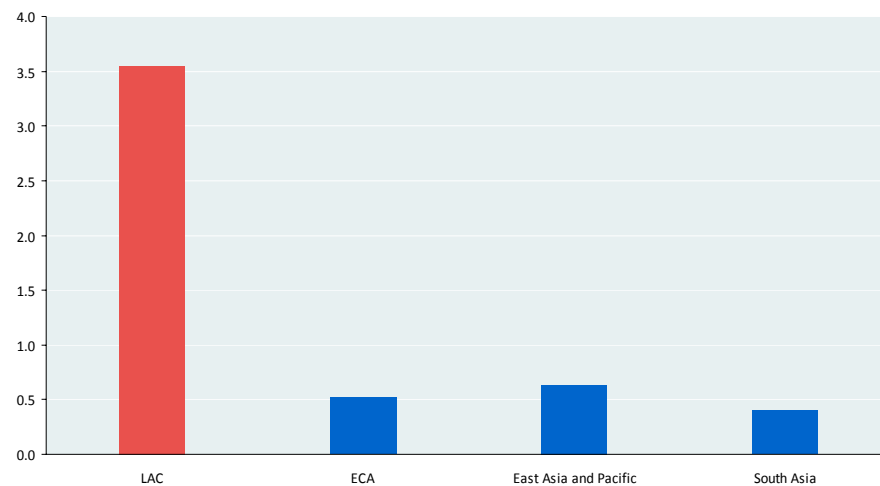


More viable public finances

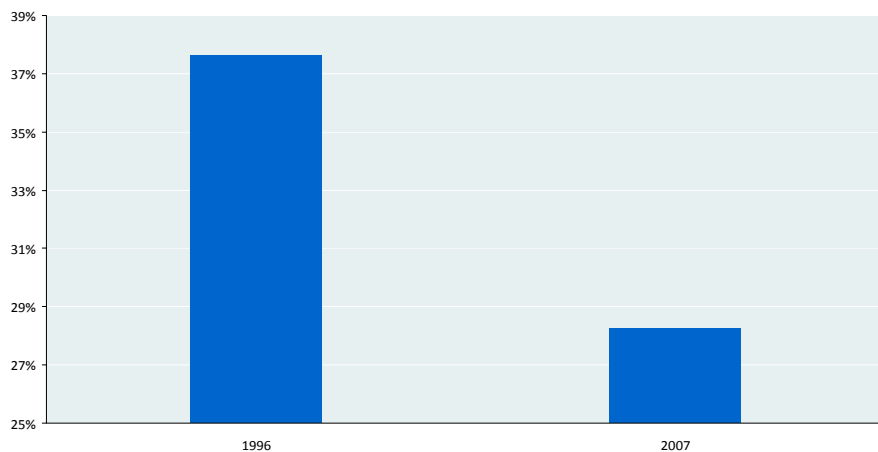
Primary Balance in LAC
as % of GDP



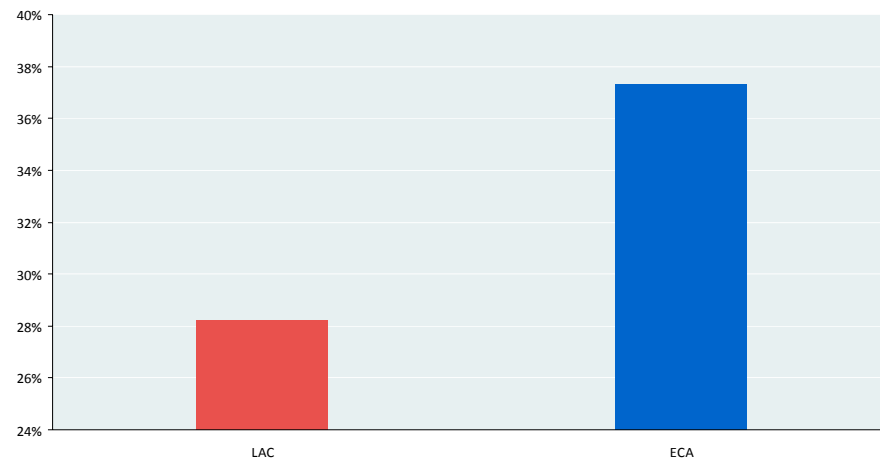
Primary Balance in selected regions
as % of GDP



Total Public Debt in LAC
as % of GDP



Public debt in selected regions
as % of GDP

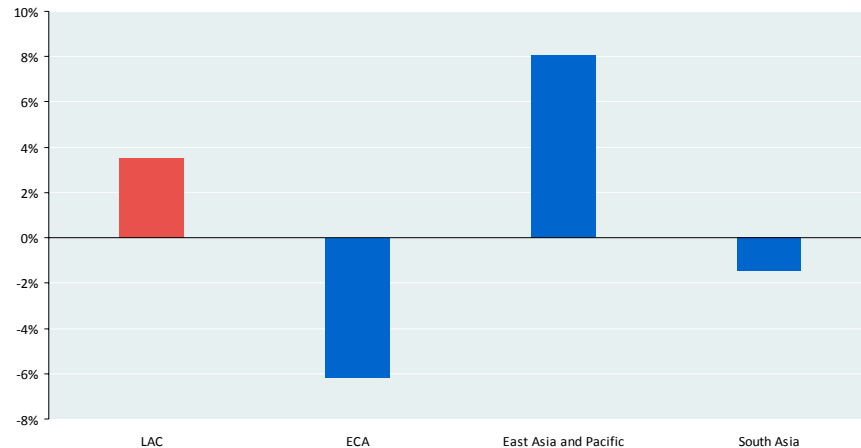


Strong external position

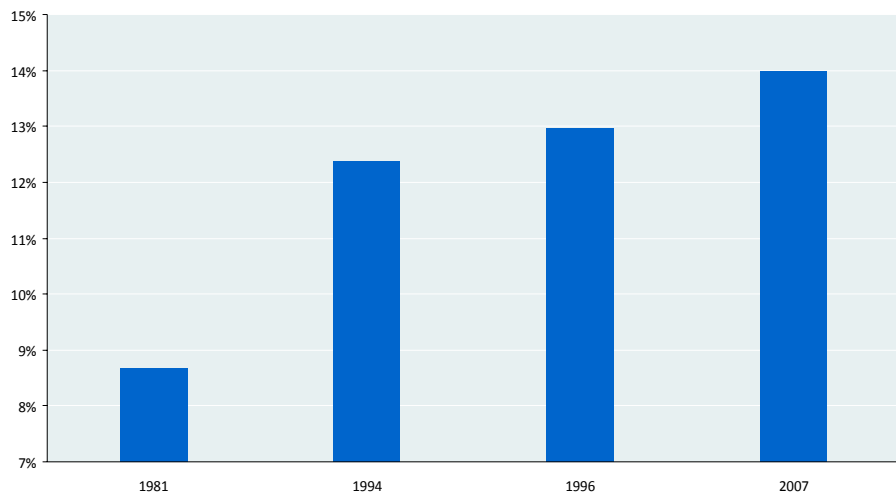
Current account balance in LAC
as % of GDP



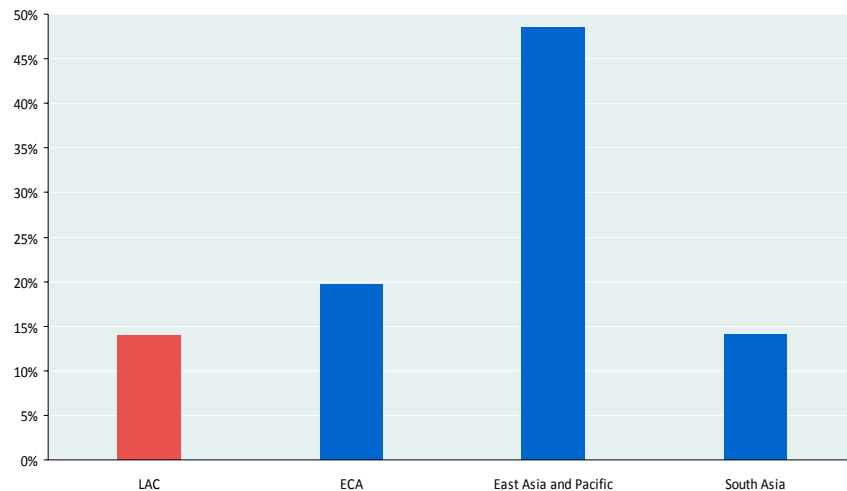
Current account balance in selected regions
as % of GDP



International Reserves in LAC
as % of GDP



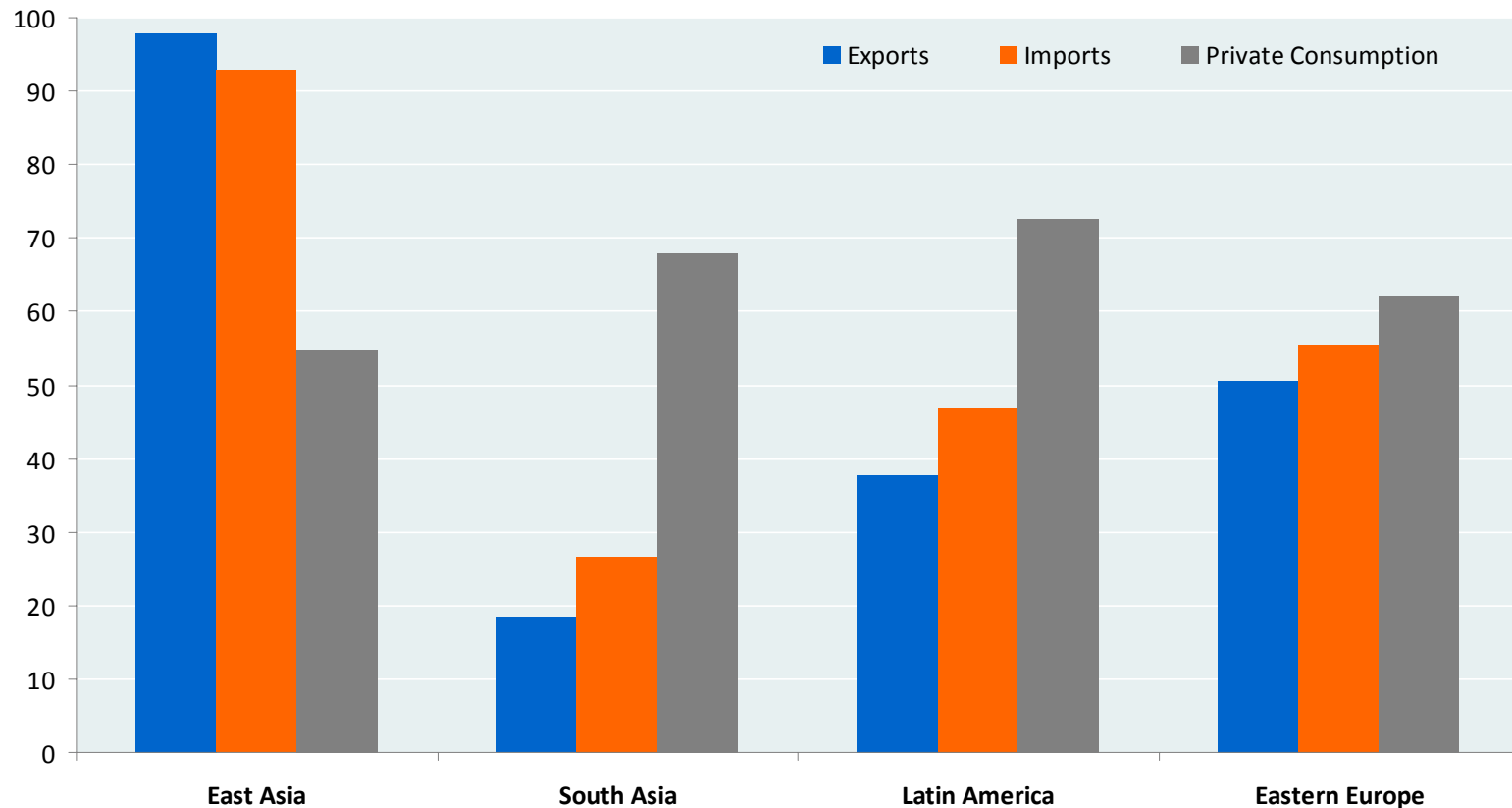
International Reserves in selected regions
as % of GDP



Hence, LAC is likely to avert systemic financial crises, but will inevitably endure a recession

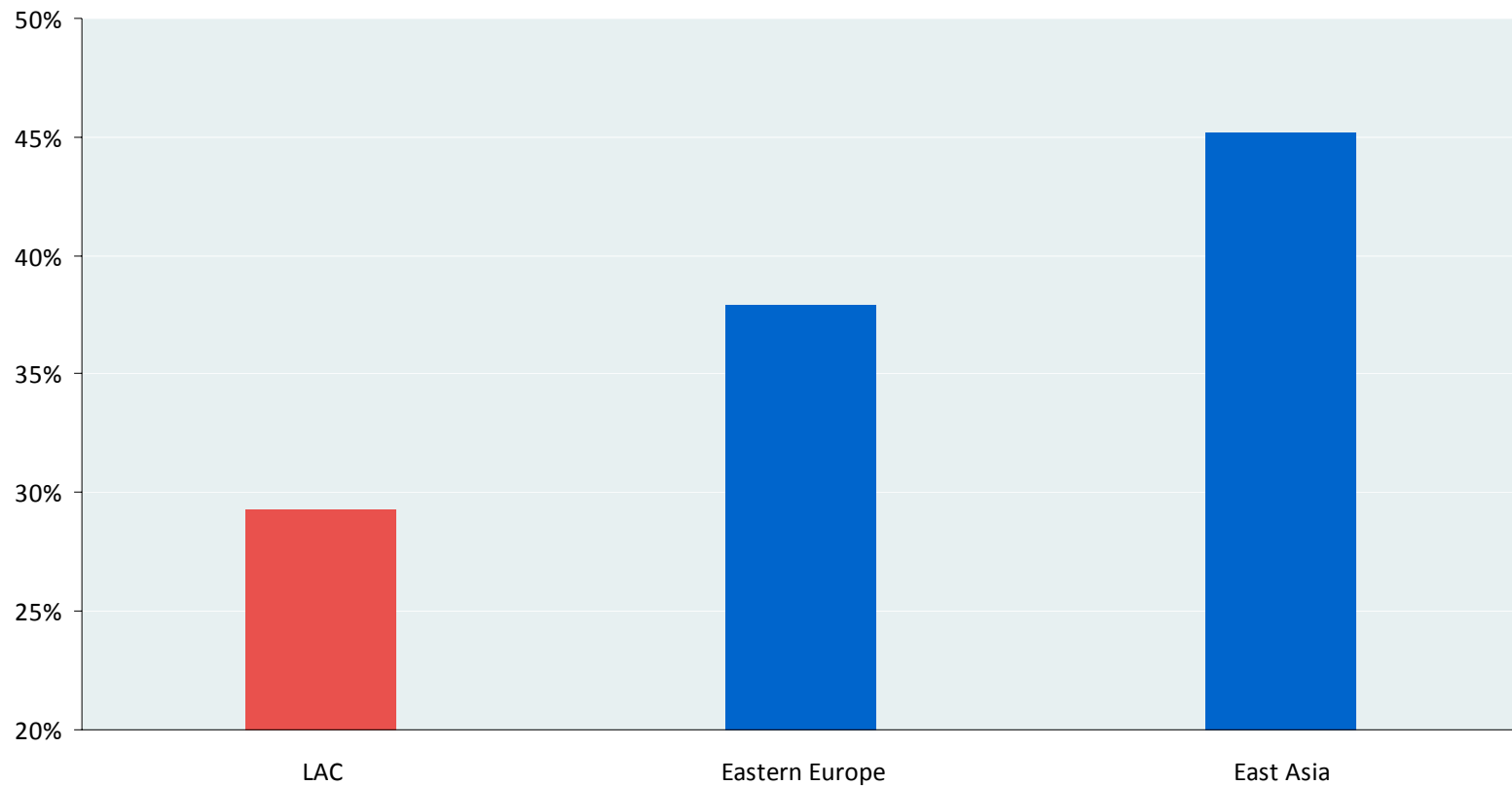
Structural factors can help: our vice – low relative openness – helps us now...

Structure of GDP
as % of GDP



... and can dampen the first-round impact on employment

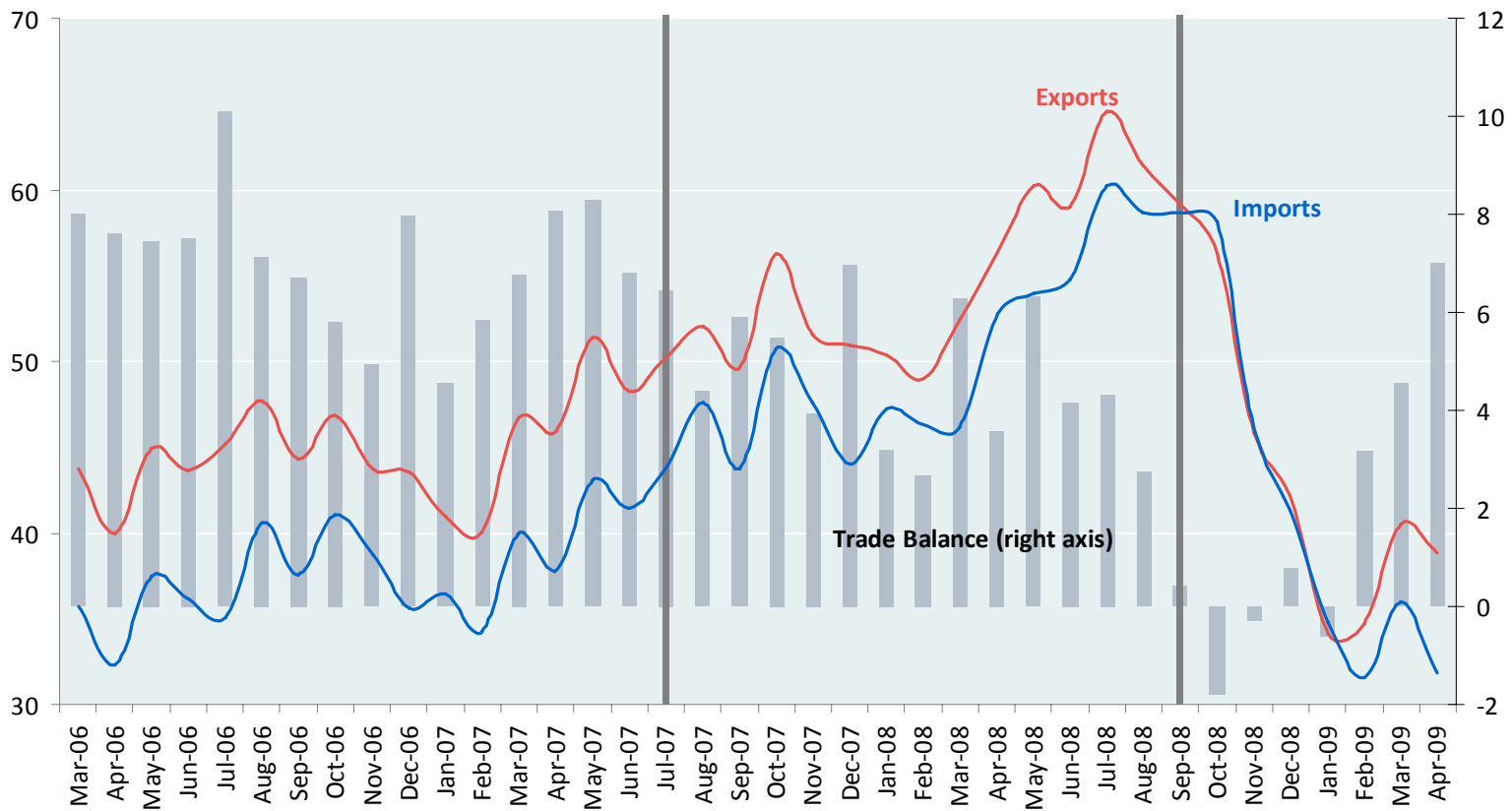
Labor Force in the tradable sector in selected Regions
as % of total labor force - as of 2006



But major external adjustments are already taking place...

Imports and Exports in selected LAC countries

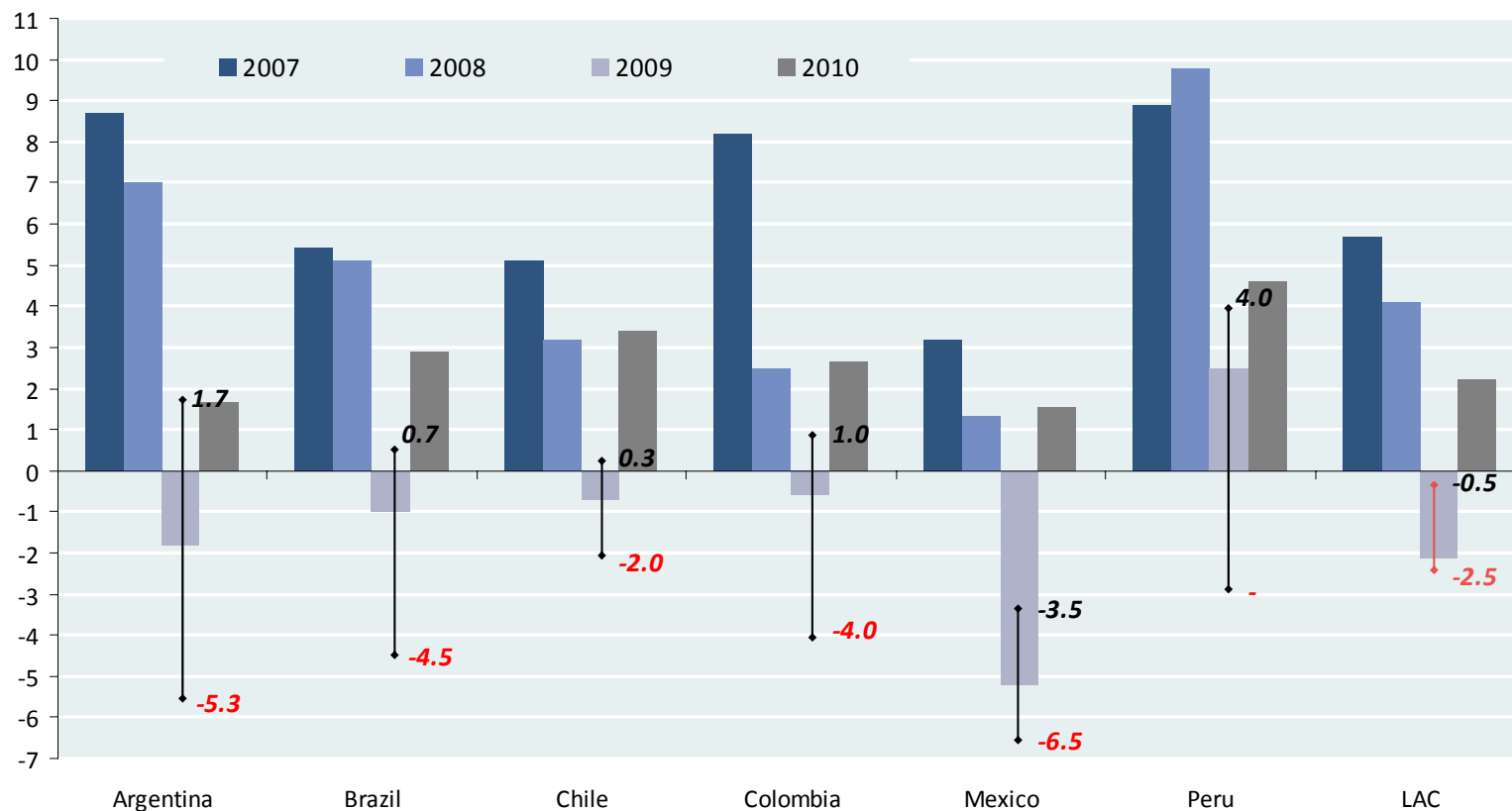
In billions of US\$



No matter what, LAC is in for a recession in 2009

Recent Growth and Forecasts for 2009-10

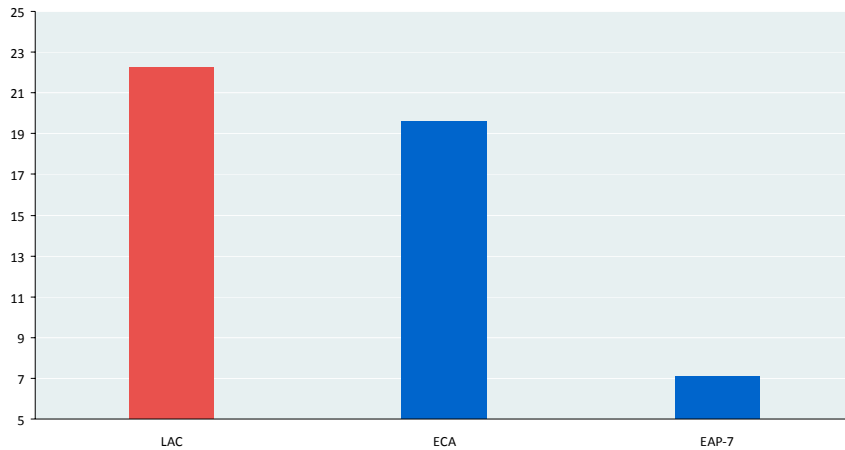
annual GDP real growth rate, in %



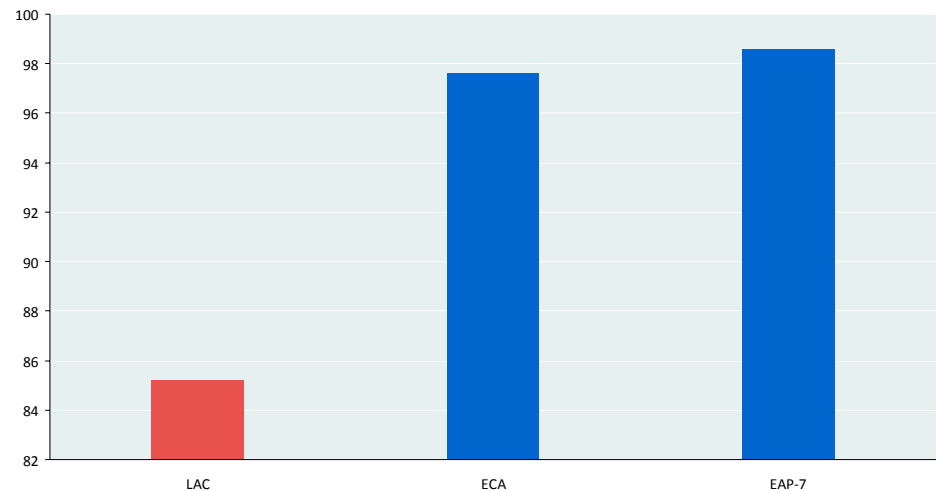
The risk of reversal of social gains can be highly problematic for LAC

LAC lags other emerging regions in social indicators

Mortality rate in selected regions
infant per 1,000 live births

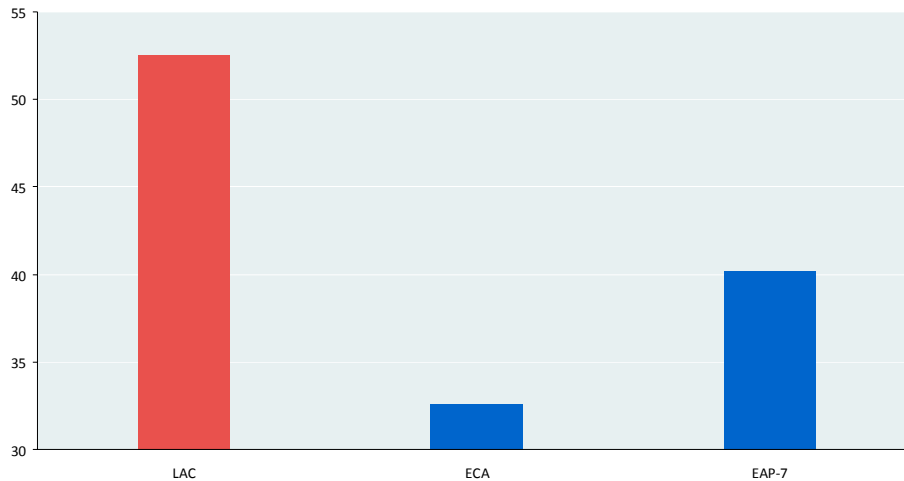


Persistence to last grade of primary in selected regions
total as % of cohort

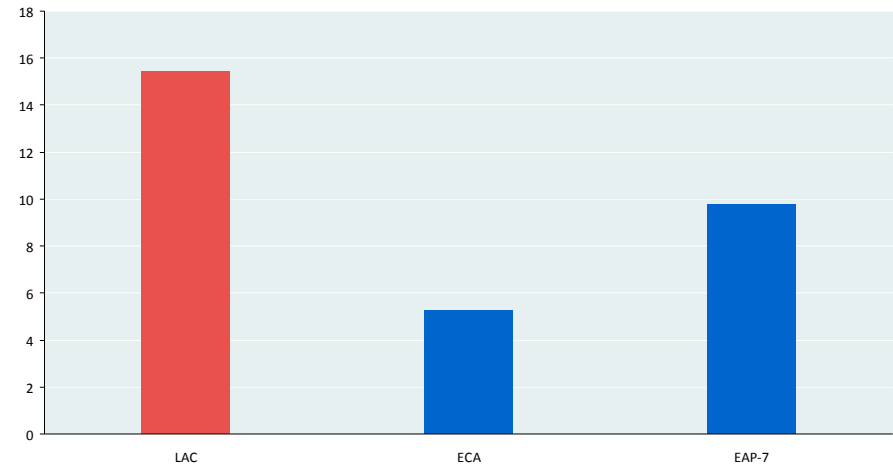


LAC lags other emerging regions in social indicators

Income inequality in selected regions
Gini index



Poverty in selected regions
% of pop. living in households with consumption or income below \$2 a day

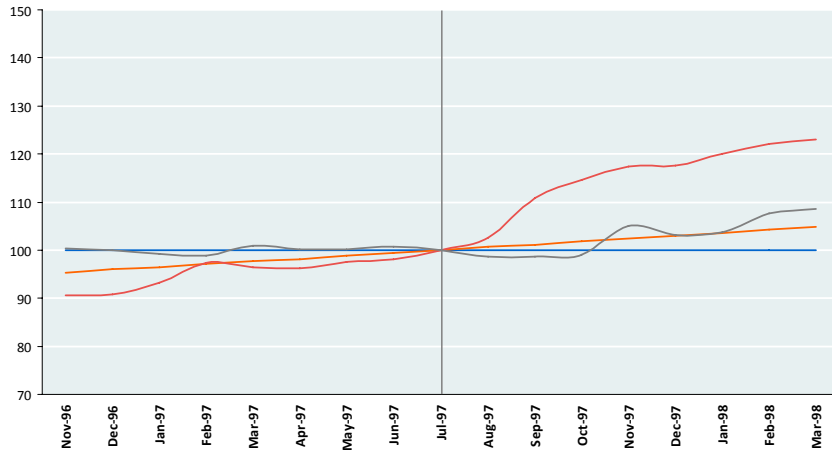


LAC: how much room for policy maneuver?

Flexible exchange rates are shock absorbers now

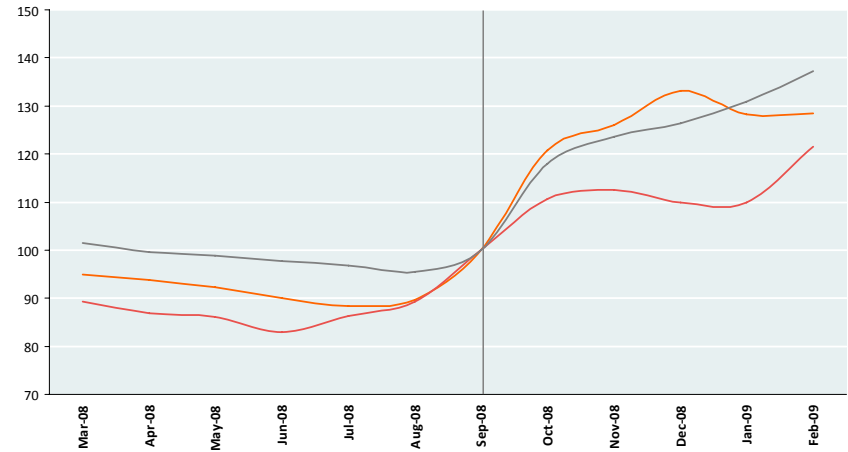
Exchange Rates in selected LAC countries

Jul-97=100



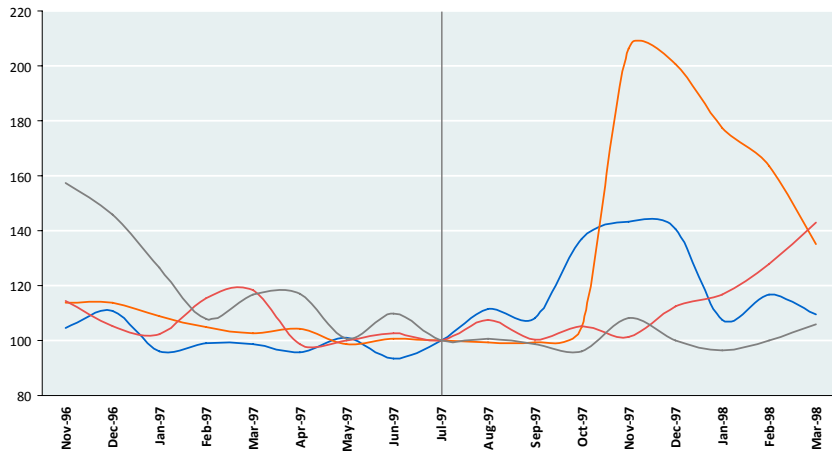
Exchange Rates in selected LAC countries

Sep-08=100



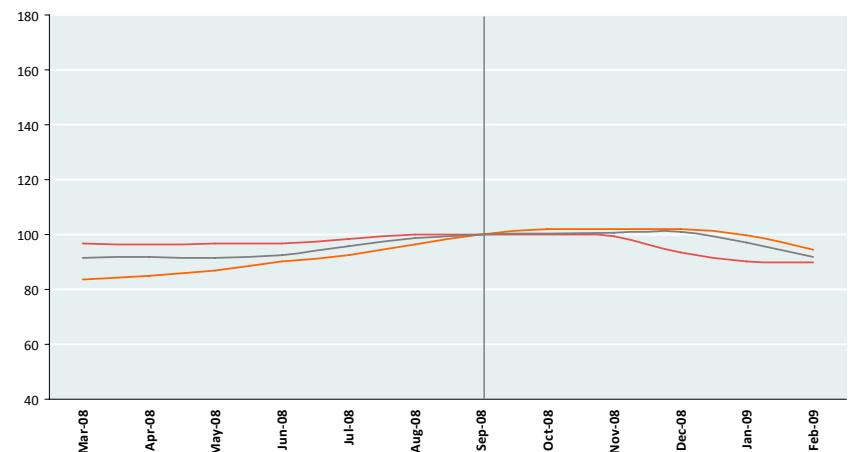
Interest Rates in selected LAC countries

Jul-97=100



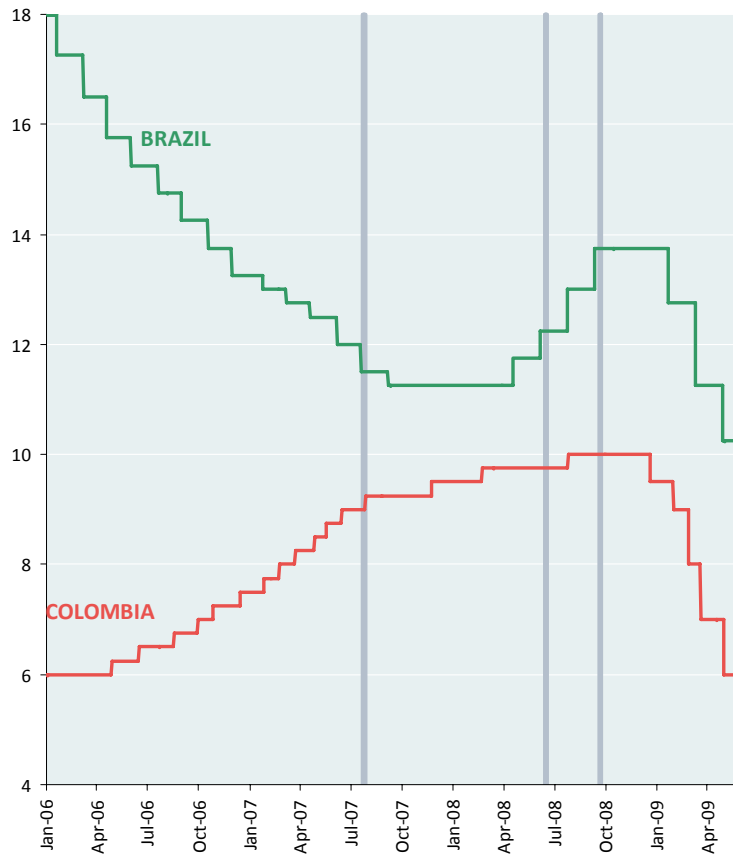
Interest Rates in selected LAC countries

Sep-08=100

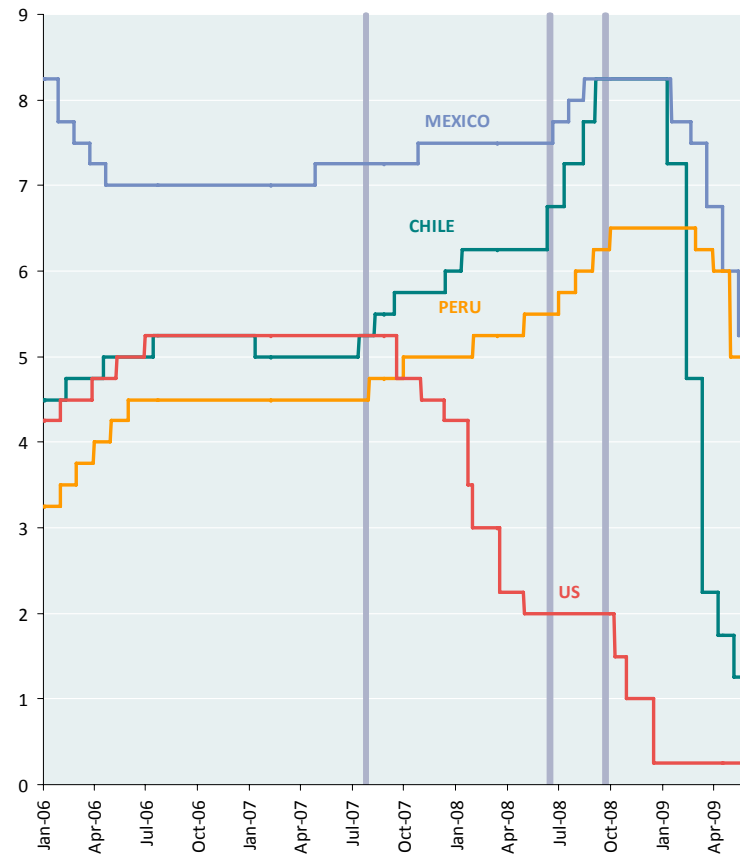


Hence, LAC inflation targeters have (and are using the) room for countercyclical monetary policy

Monetary Policy Rates
in %

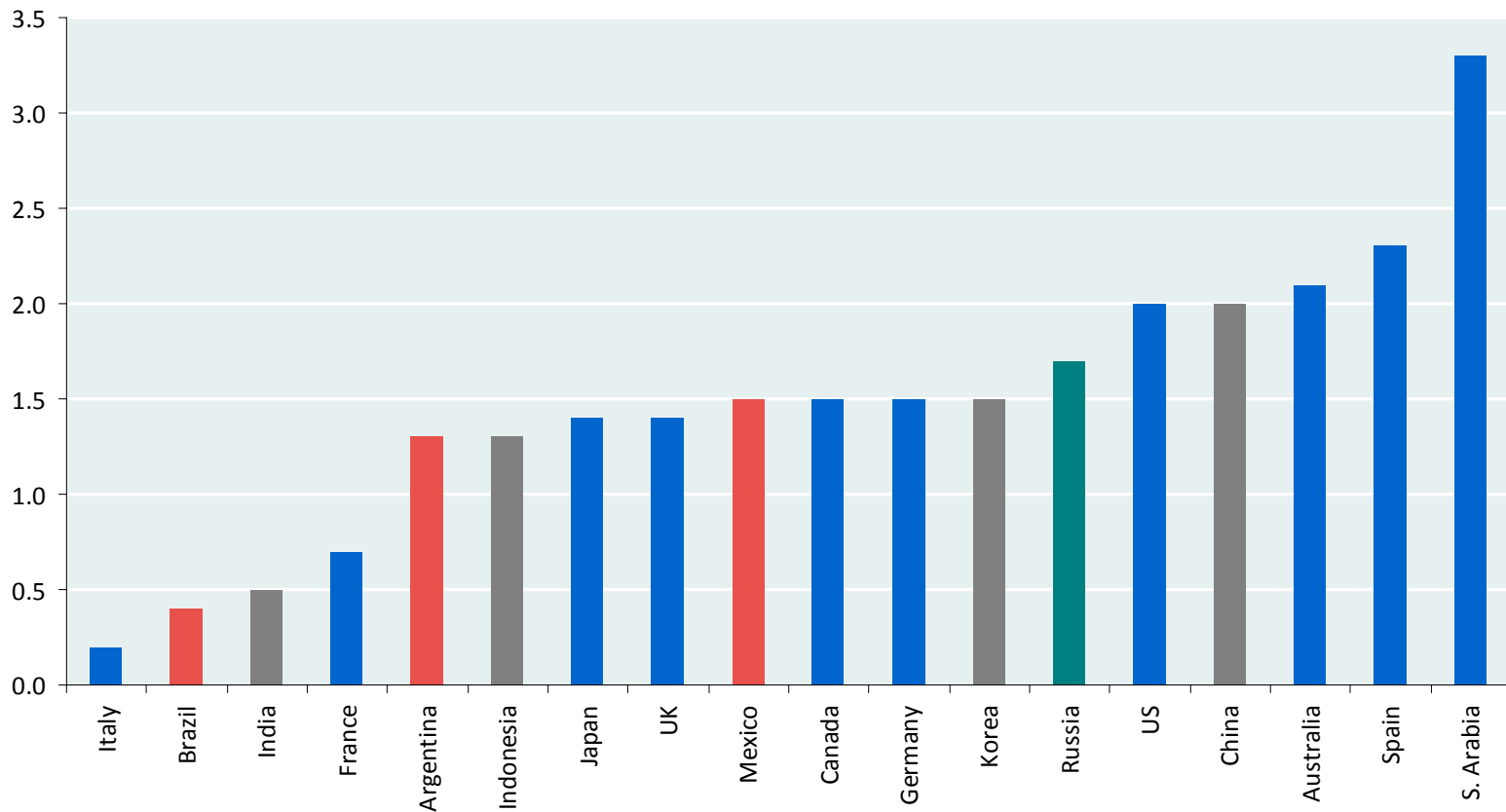


Monetary Policy Rates
in %



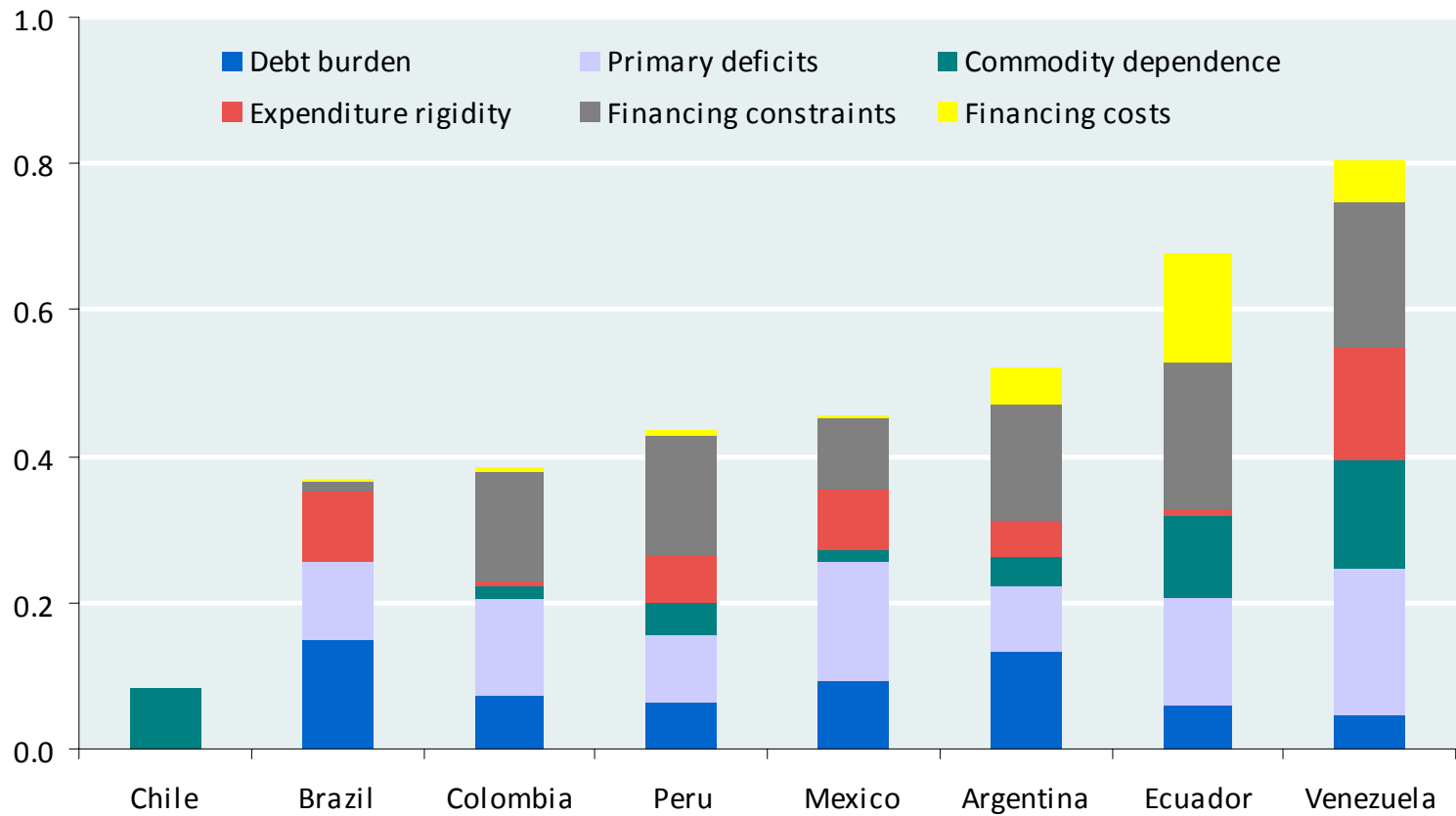
LAC countries are joining governments across the world in designing fiscal stimulus packages

Estimated Cost of Fiscal Discretionary Measures in 2009
as % of GDP



But fiscal maneuvering room varies significantly across LAC countries...

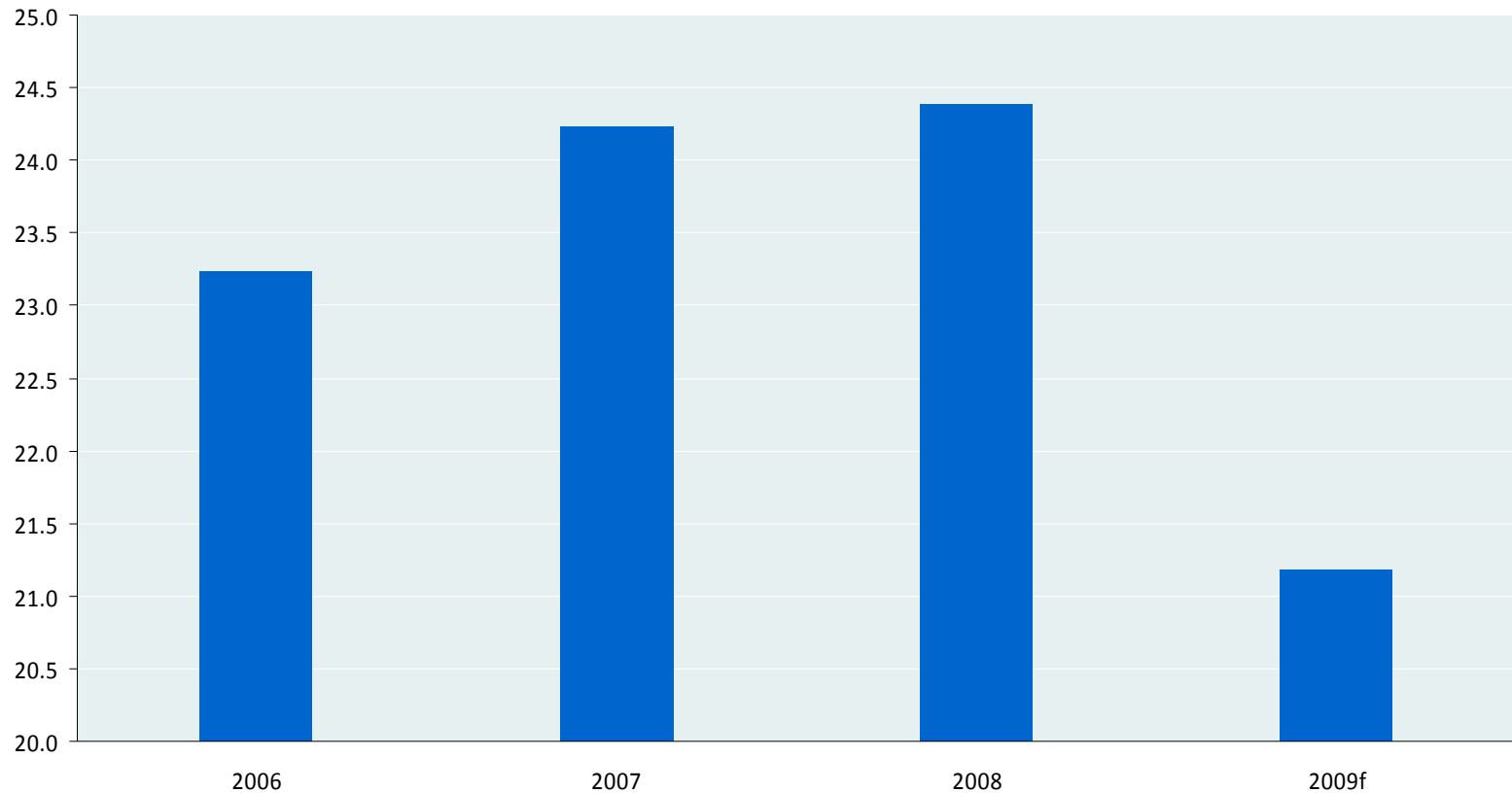
Index of constraints to implement counter-cyclical fiscal police



This index is the weighted average of the relative score of the six different categories. The index as well as each category take values between 0 and 1. Higher values indicate higher constraints to create room for counter-cyclical fiscal police. Source: LCRCE Office calculations based on National Authorities

... which complicates matters given the expected large fall in fiscal revenues across LAC countries

Fiscal Revenues in LAC
as % of GDP



Final thoughts

- As risk of catastrophic scenario subsides the relevance of LAC idiosyncratic features reemerge
- LAC as a whole is comparatively less vulnerable
 - Monetary and fiscal policy frameworks and local financial systems are not—for a change—independent sources of trouble
 - LAC likely to avert systemic financial crises at home
 - LAC's lower integration mitigates the *initial* effect of global slowdown
 - Some room for countercyclical policies, especially in the monetary area
 - But heterogeneity within LAC is significant
- A reversal of social gains can be highly problematic for democratic-but-unequal LAC
- Big questions on reconfiguration of world finance and trade
- Finance and advice from multilaterals can and should help

Thank you
