
Globalized, Resilient, Dynamic: The New Face of LAC

IMF-WB Annual Meetings Presentation

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



opportunities for all

LAC: Globalized, Resilient, Dynamic

1. Breaking with the Past: Better-than-Expected Outcomes
2. Resilience: Benchmarking LAC Through the Cycle
3. Driving Forces of Resilience and Performance
4. Financial Re-Coupling, Real De-Coupling
5. Policy Challenges and Tensions Ahead

LAC: Globalized, Resilient, Dynamic

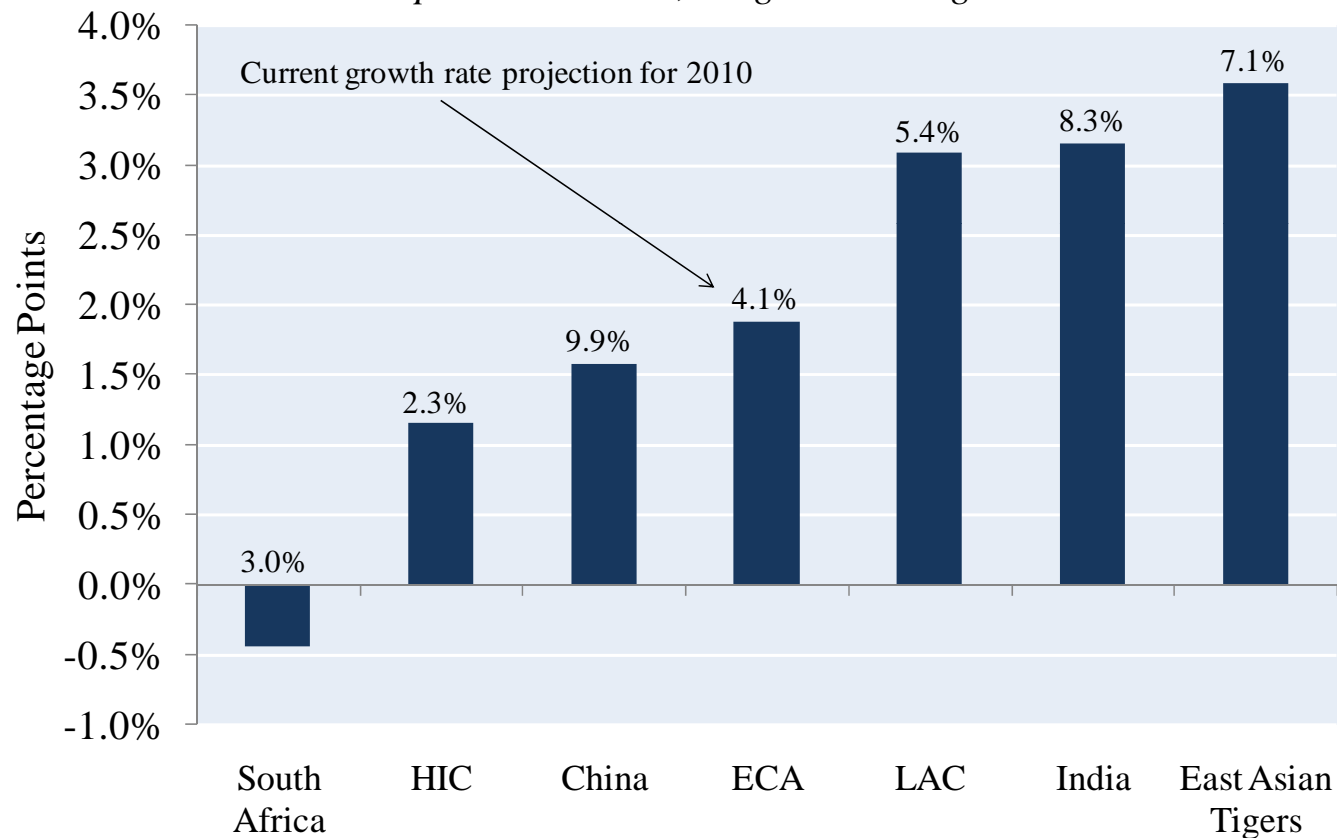
1. **Breaking with the Past: Better-than-Expected Outcomes**
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LAC: globalized *yet* resilient this time around

- LAC is highly integrated to international financial markets
 - LAC-7 much more so than others in the region
- LAC has been crisis-prone
 - Low growth and high volatility in the 1990s
- Debate on the merits of financial globalization
 - Amplification effects and perils of financial globalization if:
 - Currency mismatches
 - Deficient regulatory frameworks
 - Undeveloped markets for local currency-denominated debts
- LAC's performance in this crisis invites revisiting this debate

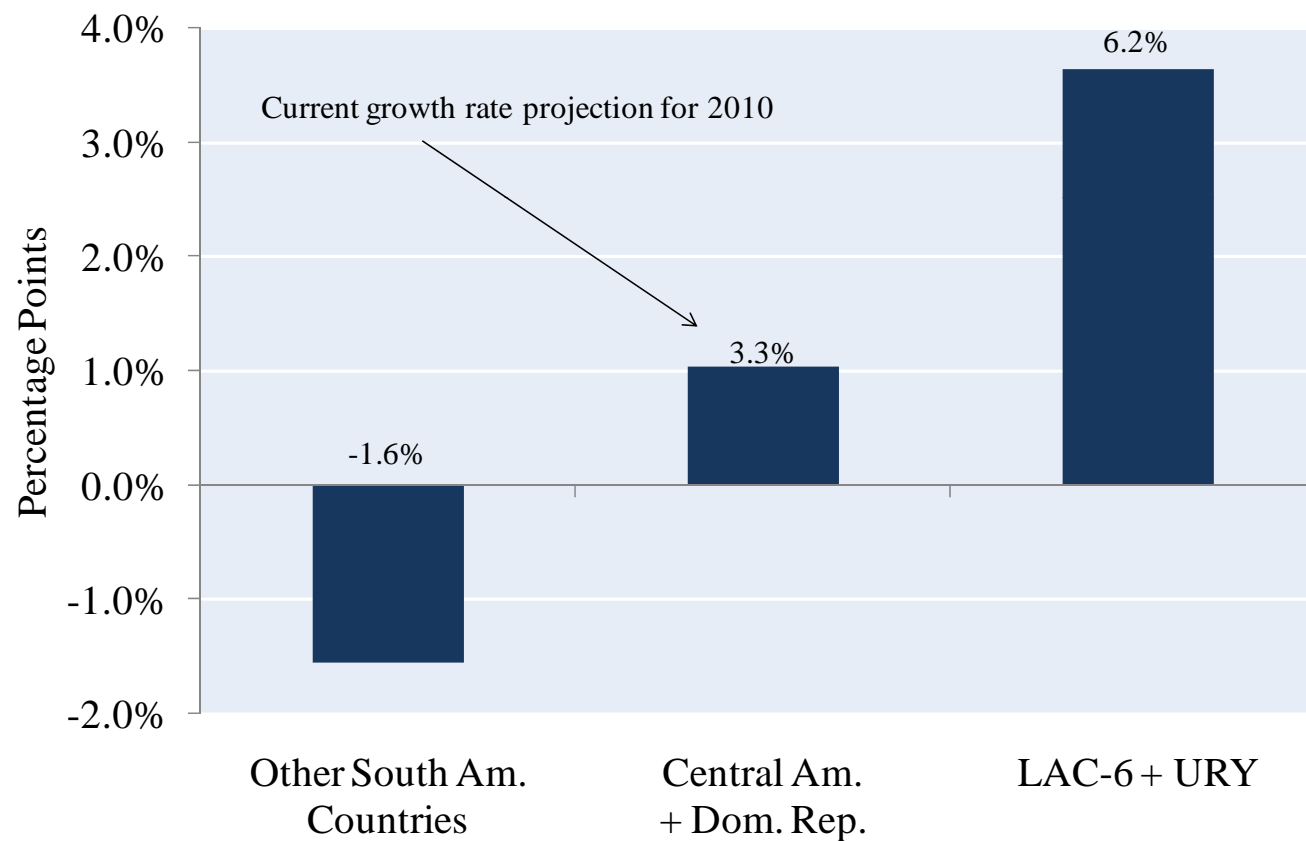
LAC: 2010 growth recovery is vastly exceeding expectations...

Difference in 2010 Growth Projections
Sep-10 vs. Mar-09, Weighted Averages



... especially among the most financially globalized LAC countries

Difference in 2010 Growth Projections
Sep-10 vs. Mar-09, Weighted Averages



LAC: poverty and unemployment responses to the 2009 downturn were *much* milder than initially anticipated

■ Poverty

- *One year ago*: 10 million people were expected to enter moderate poverty in 2009 (estimates based on historical coefficients)
- *Now*: 2.1 million people actually joined the ranks of the poor in 2009 (actual data)

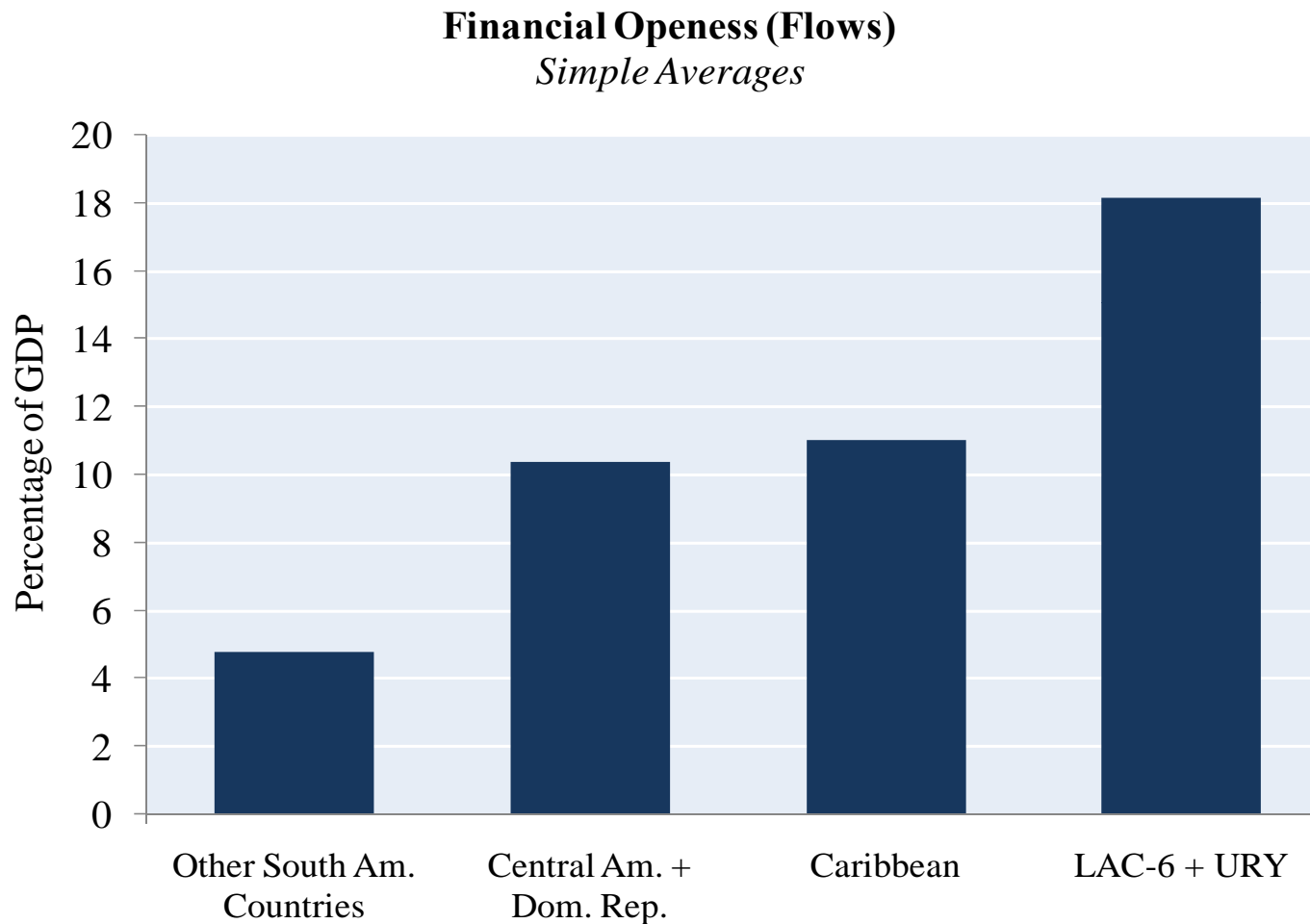
■ Unemployment

- *One year ago*: 3.5 million people were predicted to join the unemployed in 2009
- *Now*: the number of unemployed is estimated to have increased by about 2 million in 2009

Defining and measuring *resilience*

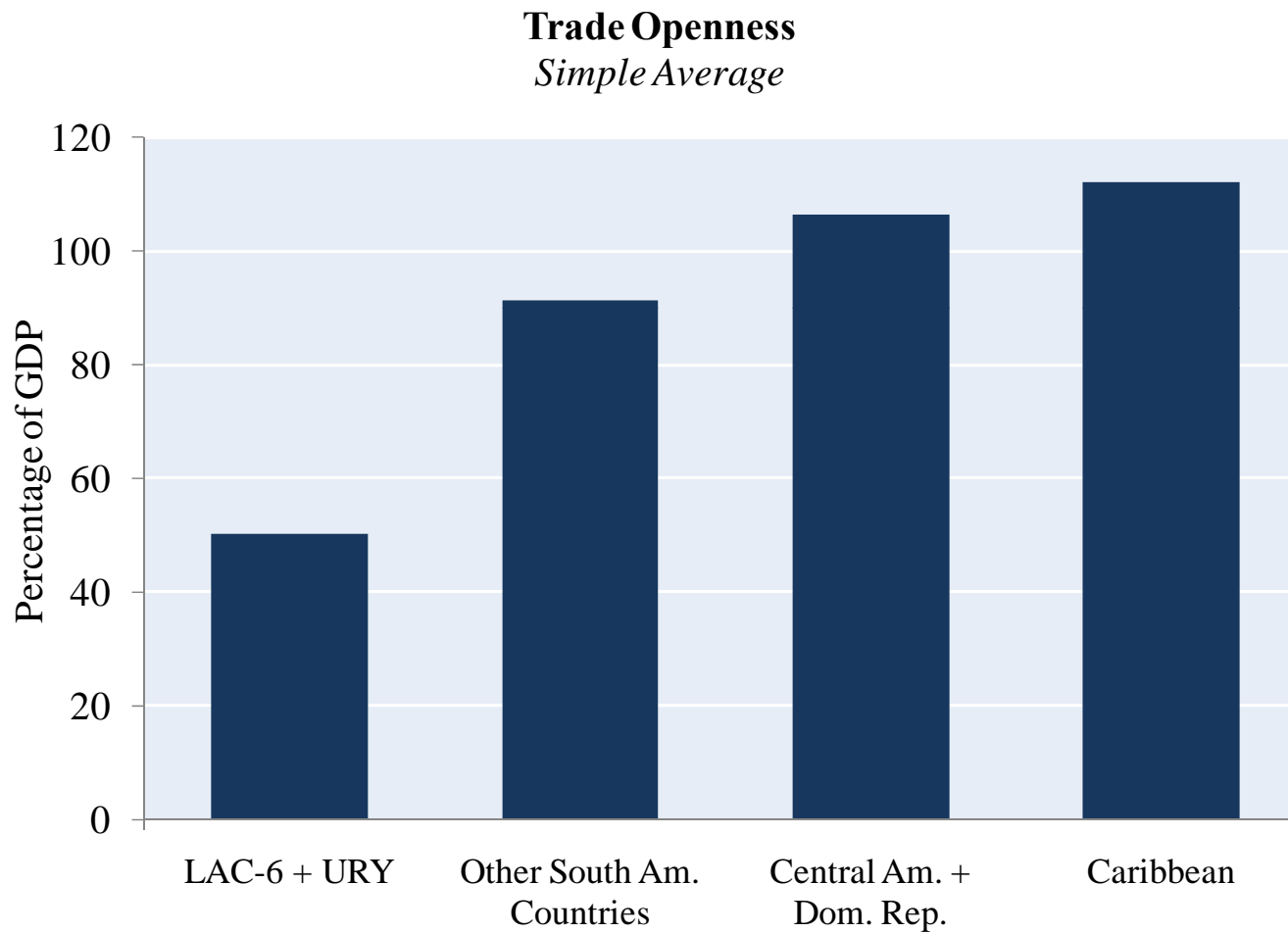
- *Definition* – resilience is the ability to:
 - Withstand the initial external shock
 - Engineer a fast and strong recovery
 - Conduct counter-cyclical policies in good and bad times
- *Measurement* – indirectly, through an outcome variable (GDP) that actually reflects a combination of factors ...
 - Size of the shock
 - Degree of exposure to the shock
 - Extent of resilience *per se* (“*relative*” resilience)
- ... which we sort out through econometric techniques and using appropriate comparators

Exposure to the shock: degree of financial globalization



Note: Financial openness is the amount of inflows and outflows of capital as a percentage of GDP. In this graph, Central America excludes Panama (an outlier due to its condition as offshore financial center). Source: IMF's BOP

Exposure to the shock: degree of trade openness



Note: Trade openness is the sum of exports and imports as a percentage of GDP. Source: IMF's WDI

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Resilience: benchmarking LAC through the cycle

Resilience in the downturn: synchronized growth deceleration

- LAC was not immune, but its *growth collapse* was comparable to that of the East Asian Tigers and significantly smaller than that of ECA
 - Larger growth collapses in financially globalized LAC countries (LAC-7, Caribbean)

Resilience in the upturn: faster and stronger growth recovery

- LAC's *recessionary phase* was shorter compared to previous crisis episodes and to the MIC average
 - Brazil led the LAC pack: industrial production started to recover in 3 months!
- Strong *recovery*: like other non-ECA MICs, LAC's GDP in 2010 will be above its 2008 level (ECA: 1.7% below; HICs: 0.2% below)
 - LAC's GDP will be closer to its potential level than that of the East Asian Tigers, reflecting LAC's lower trend growth rate
 - Brazil, Peru, Argentina, Uruguay, Panama, and Dominican Republic lead the LAC pack

Resilience: benchmarking LAC through the cycle (2)

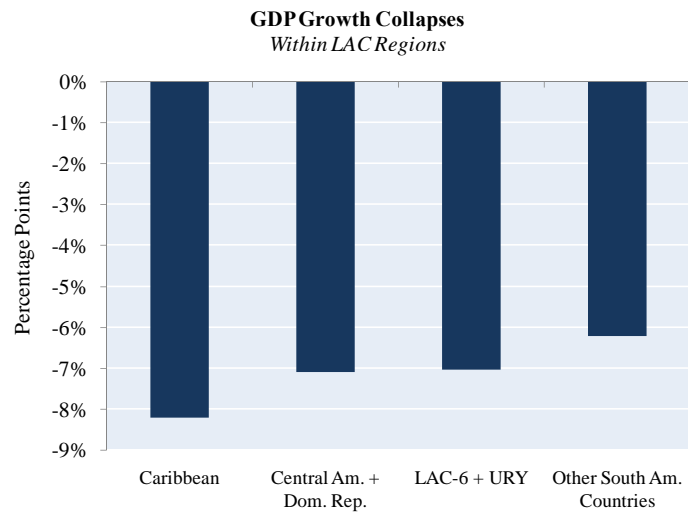
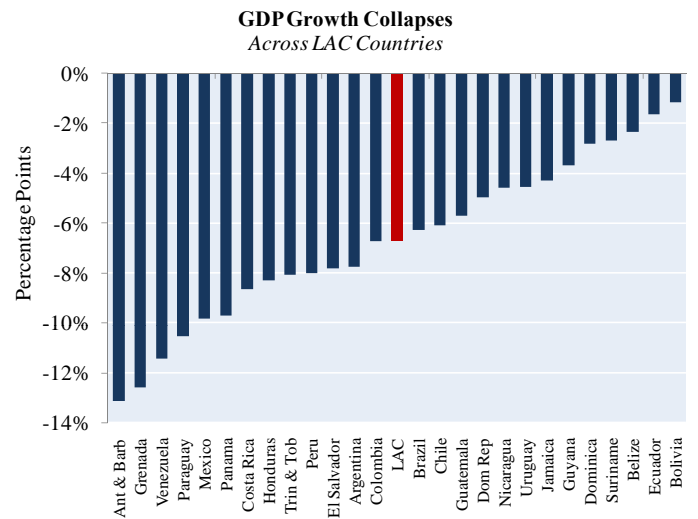
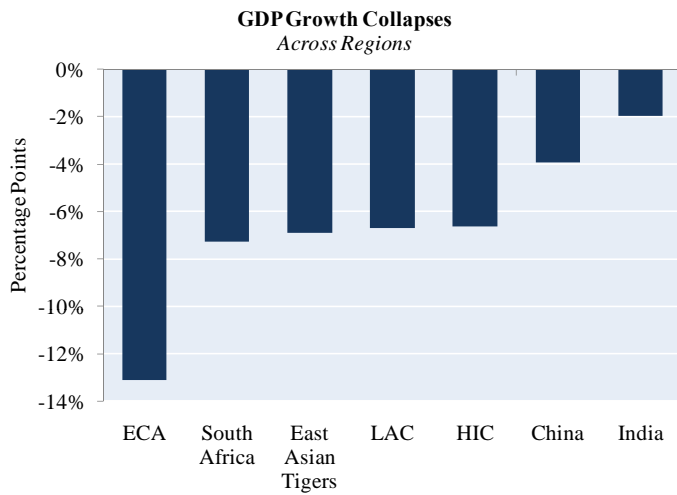
Shielding the poor

- The poverty response to the 2009 downturn was milder than in past downturns and smaller than the response to the 2000-2007 upturn
 - Poverty increased mainly in Mexico and some Central American Countries; it actually continued to decline (at a lower rate) in Brazil, Peru, Uruguay
- If poverty reduction is as elastic to growth as it was during the 2000-2007 expansion, 7 million Latinos will climb out of moderate poverty in 2010

Unexpectedly strong labor market performance

- During 2009, the LAC unemployment rate increased much less than in ECA and slightly more than in the East Asian Tigers ...
- ... the increase in unemployment *given* the decline in GDP was much milder than in previous crises
- ... the trend towards labor market formalization was not reversed ...
- ... and all this despite constant or increasing real average wages

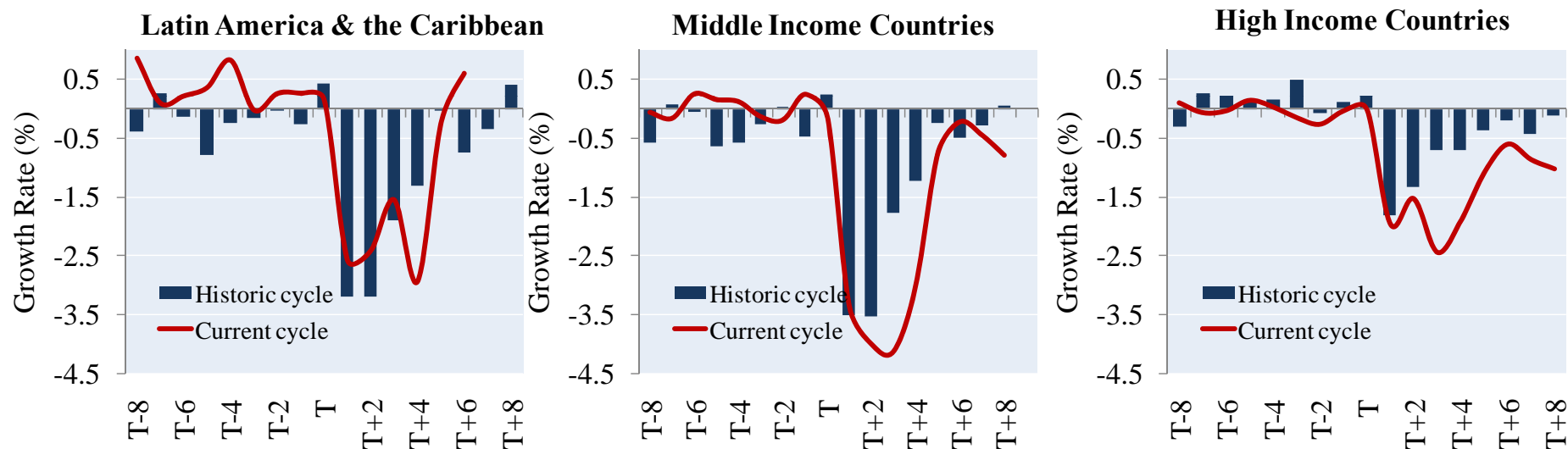
2009 growth collapse: LAC no worse than the East Asian Tigers



Notes: Growth collapses are defined as growth in 2009 minus growth in 2007. Source: IMF's WEO (April 2010).

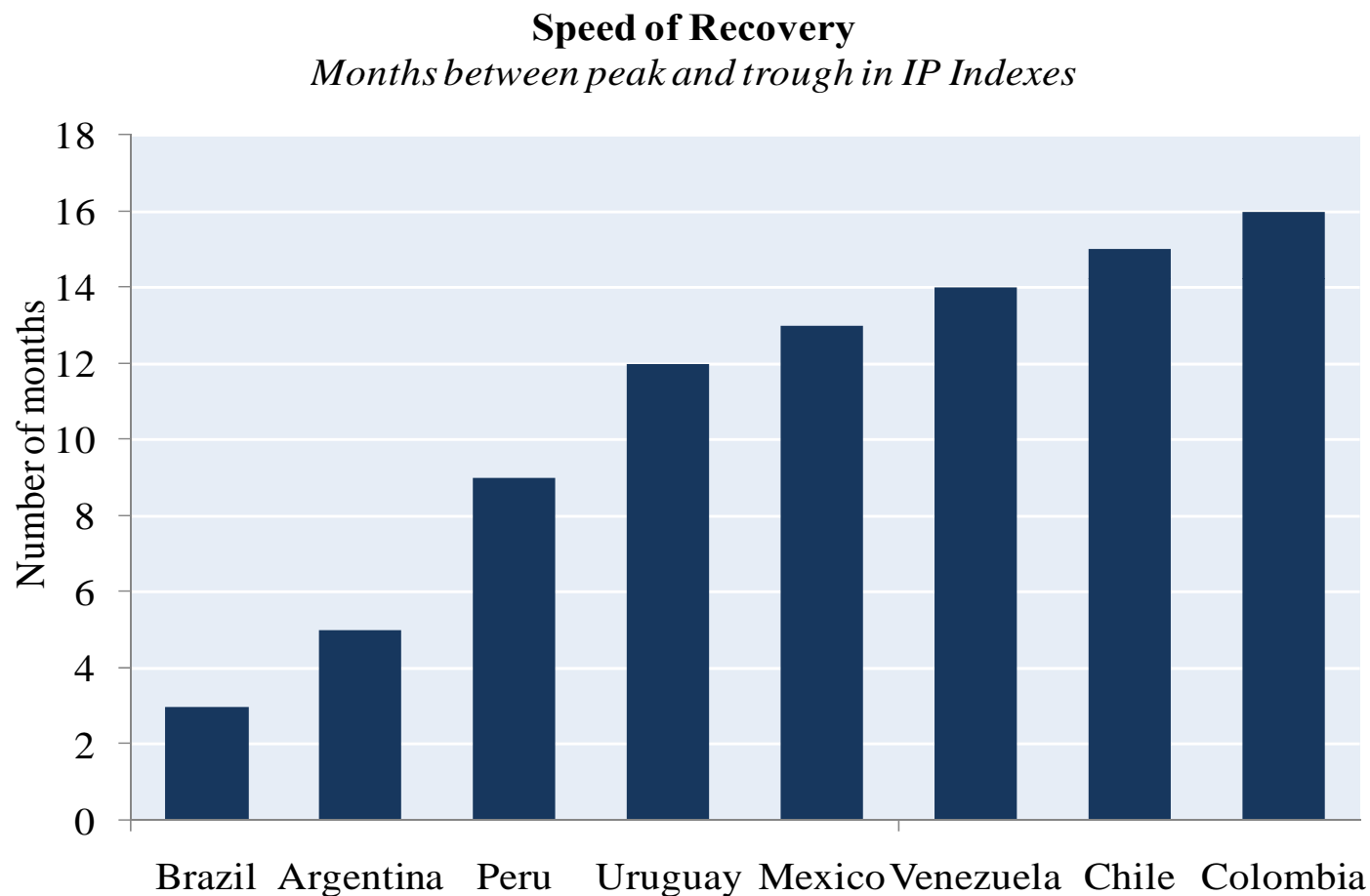
Size and duration of downturn: LAC better than its past and ahead of the MIC average

Cyclical Growth Dynamics in a Comparative Setting

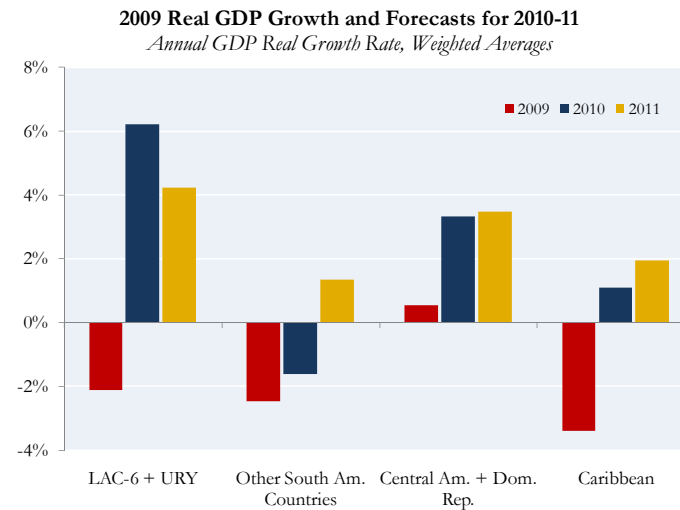
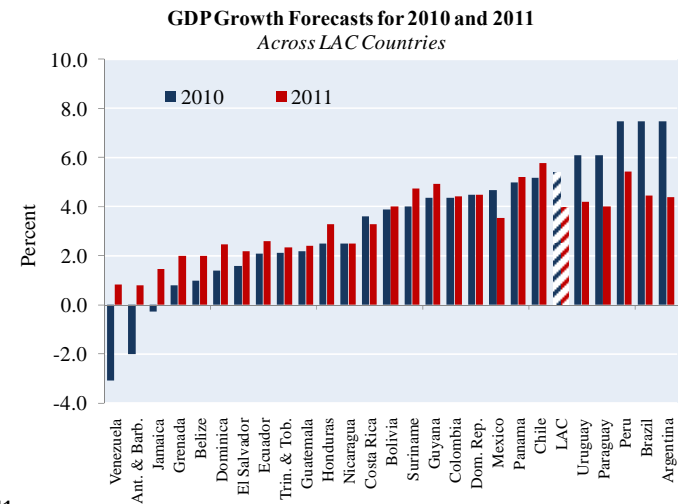
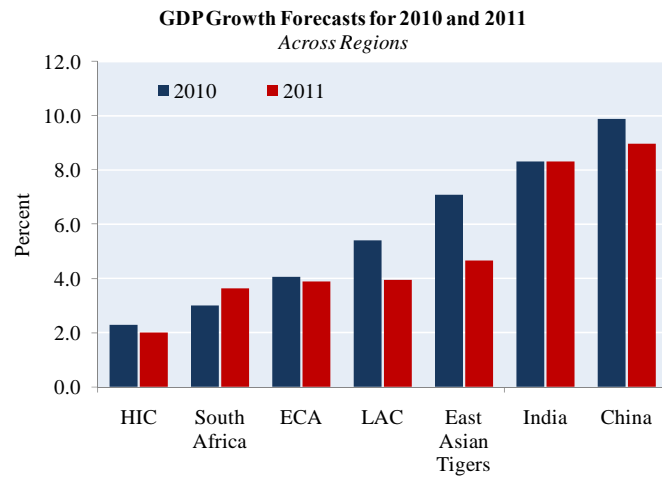


Notes: In the figures, period T stands for the Peak year in GDP business cycles. The sample of LAC countries includes: Argentina, Brazil, Chile, Colombia, Costa Rica, Ecuador, Mexico, Peru, and Venezuela. Sources: Calderón and Servén (2010), EIU, Haver Analytics, LAC Central Banks and Statistical Offices.

Heterogeneity across LAC countries: Length of recession based on IP indexes

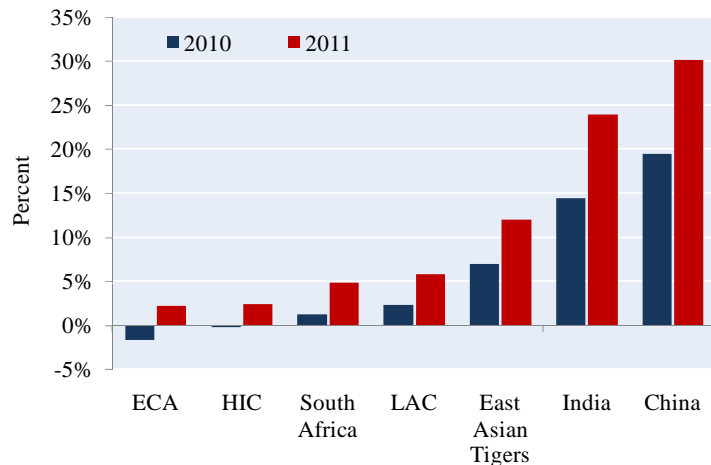


Strength of the recovery: LAC trailing the East Asian Tigers in growth rates

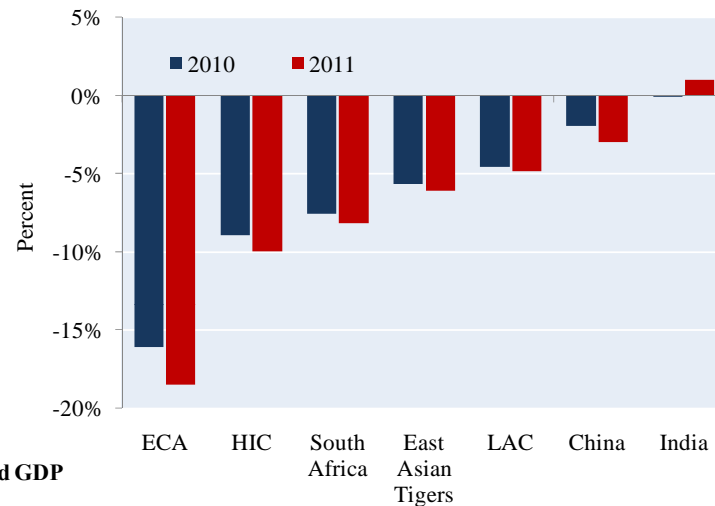


Strength of the recovery: LAC recovering potential output faster than the Tigers

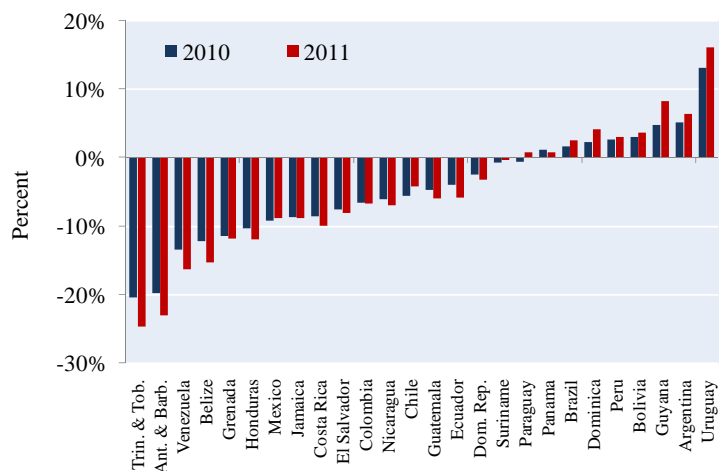
Expected GDP Levels in 2010 and 2011
Relative to GDP in 2008



Expected GDP Levels Relative to Trend GDP

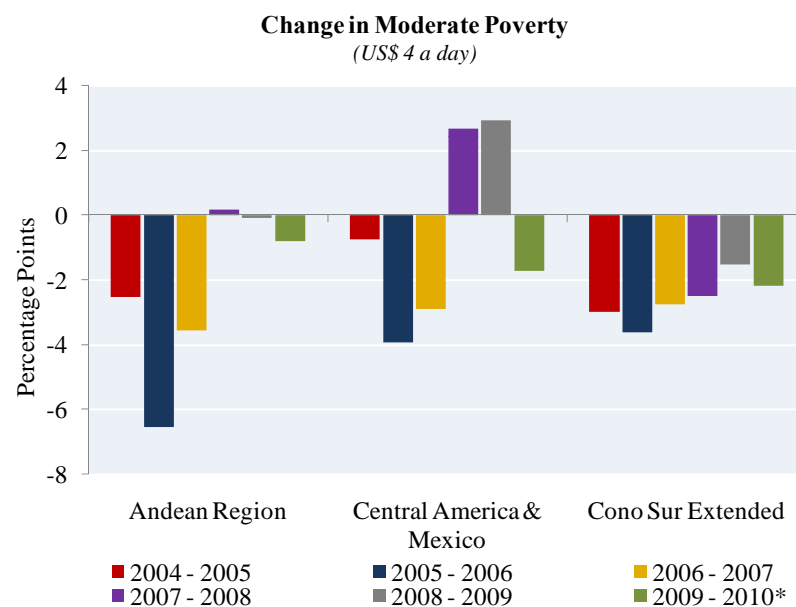
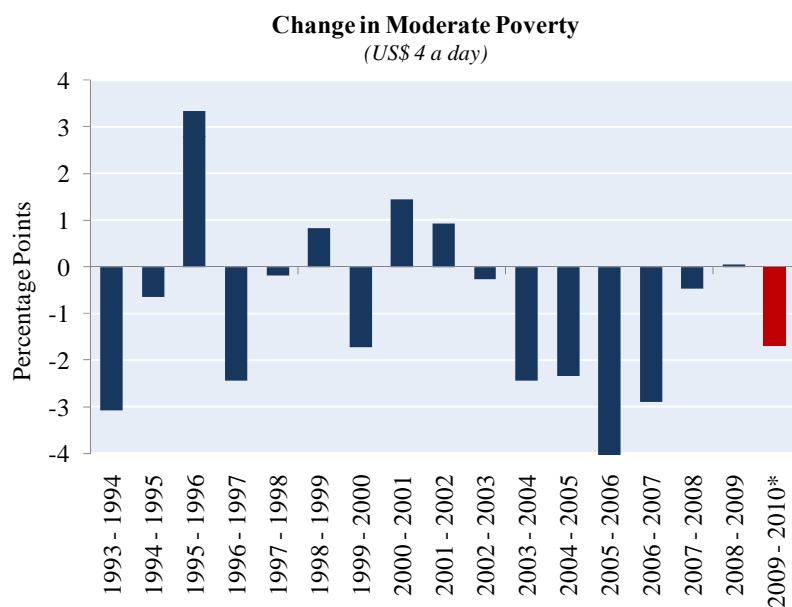


Expected GDP Levels Relative to Trend GDP
LAC Countries

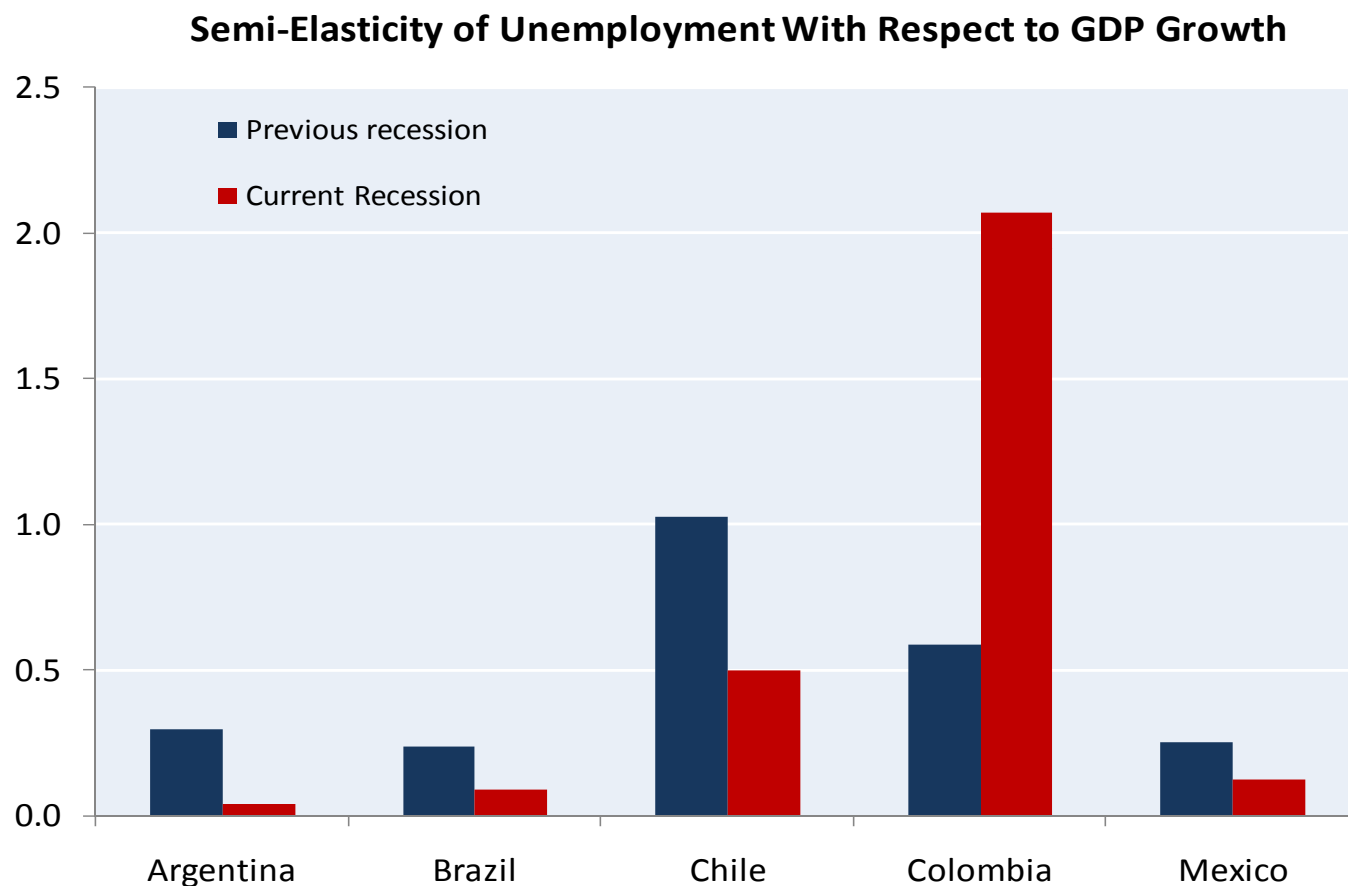


Notes: Trend GDP, used in Panels B and C, is defined as the GDP that each country would have attained if it had grown between 2008 and 2010 at the same pace as in between 2000 and 2007. Sources: Didier, Hevia, and Schmukler (2010).

Shielding the Poor: Milder increase in poverty compared to the past and heterogeneous effects within the region



Labor market performance: Unemployment less responsive to economic activity than in previous downturns, except in Colombia



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.

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The driving factors: Policy-Driven

Silent revolution in macro-financial frameworks

- In a break with history, this enabled counter-cyclical policies, particularly in monetary policy and to a lesser extent in fiscal policy
- Amplifiers turned cushions: currency, banking system, fiscal process
- No financial crises at home this time around

Shift to a safer form of international financial integration

- The region became a net creditor in debt and a net debtor in equity

The China connection

- Increased trade and other economic linkages with China

The driving factors: Exogenous factors

Rebound in commodity prices and surge in capital inflows

- Commodity prices started rebounding in Jan 09 and are at their 2007 level
- Asymmetric effects on the region (South America vs. Central America)

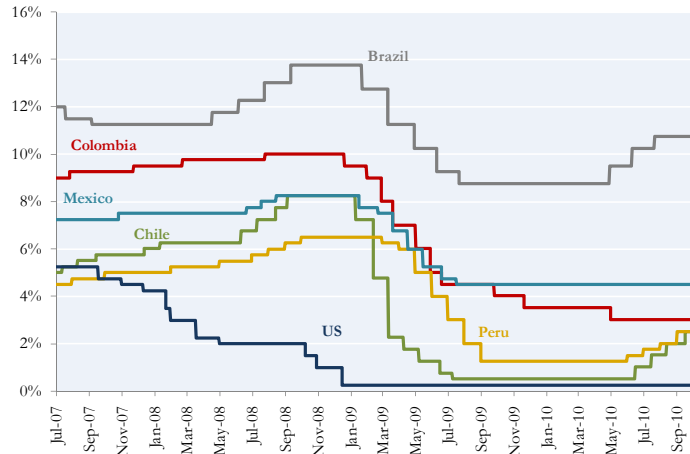
Pronounced move towards risk appetite

- The comeback of risk appetite has contributed to strong capital inflows to LAC, and intensified the strength of the recovery
- Capital inflows to the region in 2010 are already higher than those observed in 2007.

LAC breaking with history: countercyclical macro policy

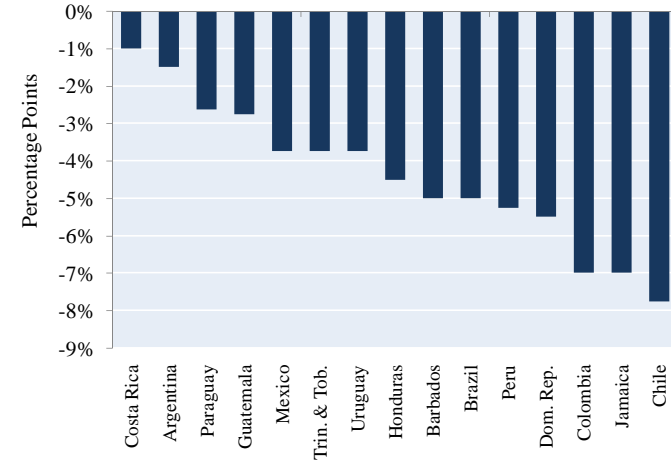
Monetary Policy Rates

Inflation-Targeting LAC Countries, in %

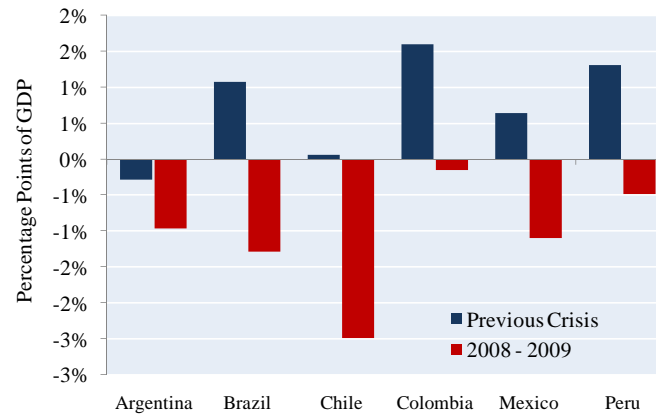


Monetary Policy

Changes in Monetary Policy Rates

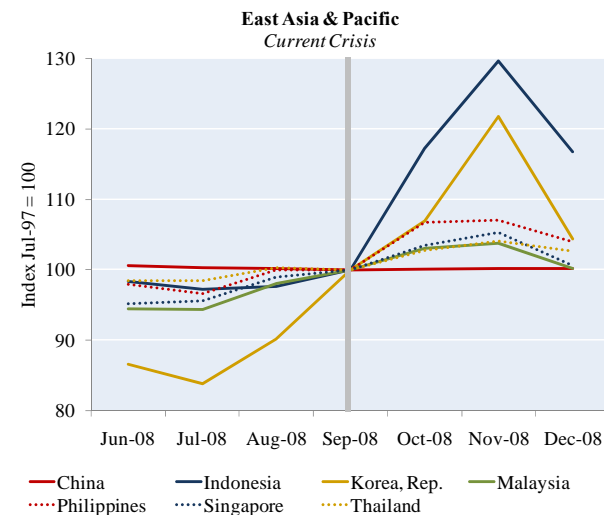
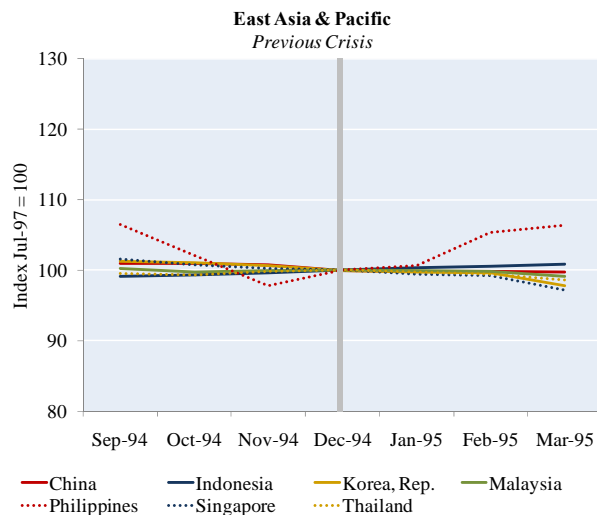
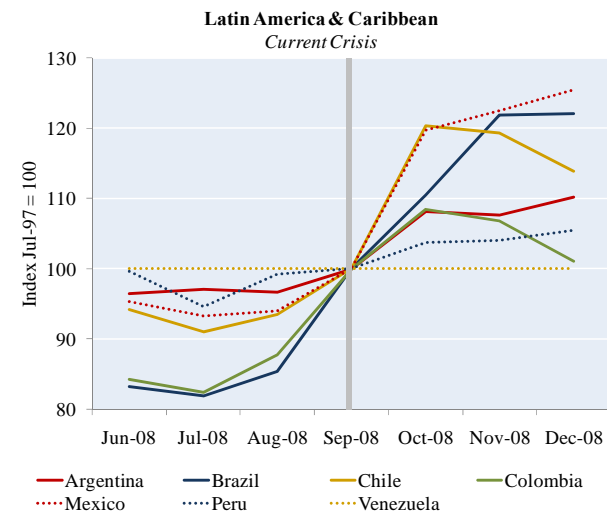
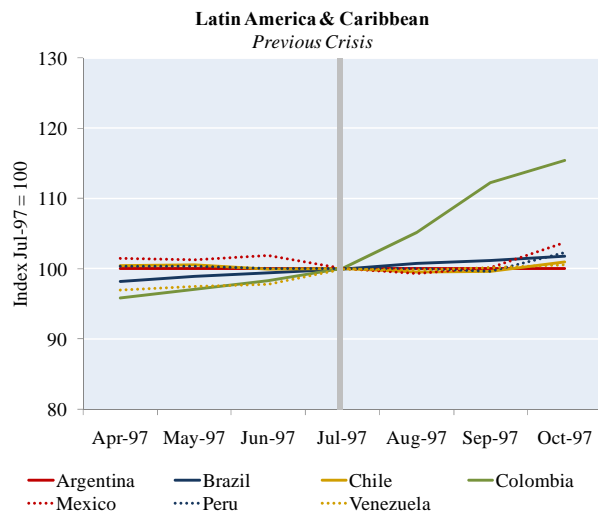


Variation in the Cyclically Adjusted Primary Surplus across LAC Countries



Notes: Panel C reports the average quarterly variation (in percentage points of GDP) of the cyclically-adjusted primary balance of LAC-6 countries during the global downturn associated to the 2008 - 2009 financial crisis and during previous crisis. Negative (positive) values indicate an expansion (contraction) in discretionary fiscal policy. Sources: IMF's "Fiscal Monitor: Navigating the Fiscal Challenges Ahead" (May 2010), ECLAC, and Bloomberg for Panels A and B; and LCRCE staff calculations based on Haver Analytics, Datastream in Panel C.

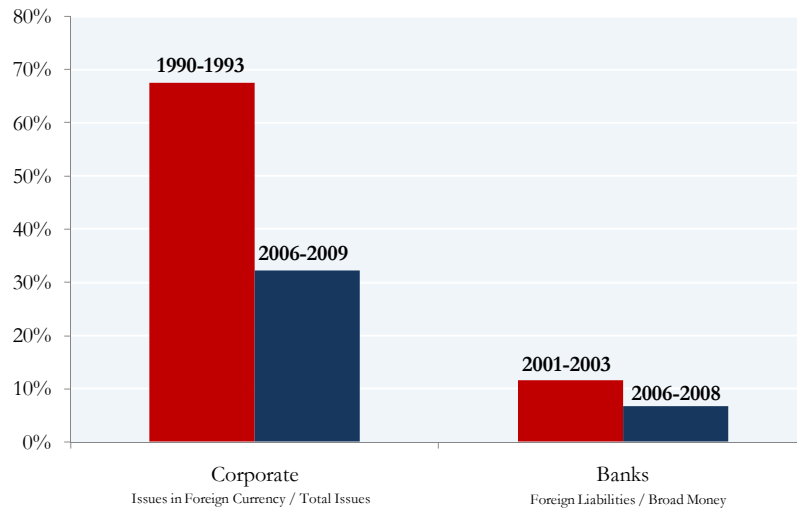
LAC and the East Asian Tigers: Flexible exchange rates cushioned the shock this time...



Notes: This figure depicts the behavior of the nominal exchange rate around crises episodes of external origin to the region in question. Sources: Didier, Hevia, and Schmukler (2010).

... not least because reduced currency mismatches helped dispel the “fear of floating” in most of LAC

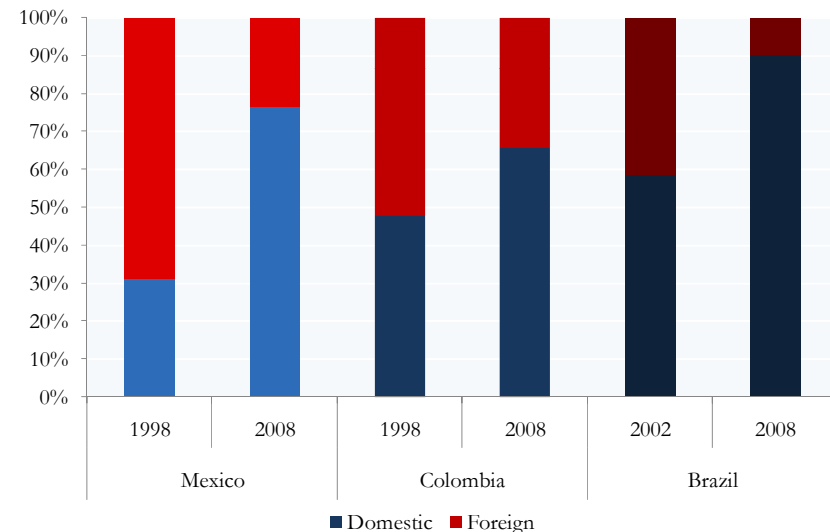
Corporate and Banks' Dedollarization in LAC



Note: GDP-weighted averages of the periods noted.

Source: Gozzi et al. (2009), IFS

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



■ Domestic ■ Foreign

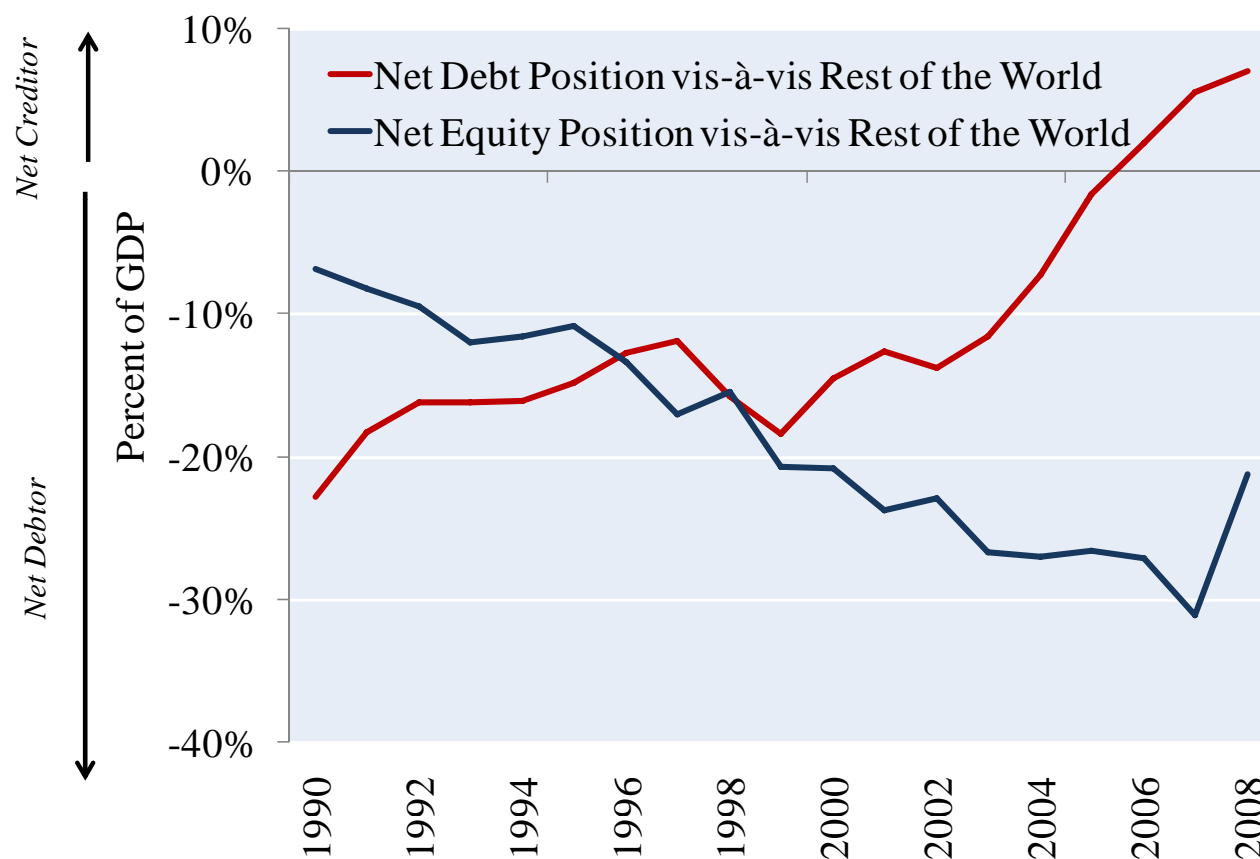
LAC breaking with history: no systemic damage at home

Financial Crises Around the World

	Systemic Banking Crises		Foreign Currency Debt		Currency Crises	
	2007-2008	1994-1998	2007-2008	1994-1998	2007-2008	1994-1998
No. Of Crises-Hit Countries						
High Income	19	6	0	0	4	2
OECD only	18	4	0	0	4	1
Middle East & N. Africa	0	1	0	0	0	2
South Asia	0	0	0	1	0	0
Sub-Saharan Africa	0	9	1	1	6	31
East Asia & Pacific	1	6	0	2	0	7
Europe & Central Asia	3	9	0	3	3	17
Latin America & Caribbean	0	11	0	1	0	3
Total	23	42	1	8	13	62
As a Percentage of All Crises Countries						
High Income	83%	14%	0%	0%	31%	3%
Developing Countries	17%	86%	100%	100%	69%	97%
Middle Income	17%	67%	100%	75%	62%	58%
Low Income	0%	19%	0%	25%	8%	39%
LAC Countries						
	Systemic Banking Crises		Foreign Currency Debt		Currency Crises	
	1994 - 1998		2007-2008	1994-1998	2007-2008	1994-1998
Argentina (95)		Haiti (94)		Antigua and Barbuda (96)		Mexico (94)
Bolivia (94)		Jamaica (96)				Suriname (94)
Brazil (94)		Mexico (94)				Venezuela (94)
Colombia (98)		Paraguay (95)				
Costa Rica (94)		Venezuela (94)				
Ecuador (98)						

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

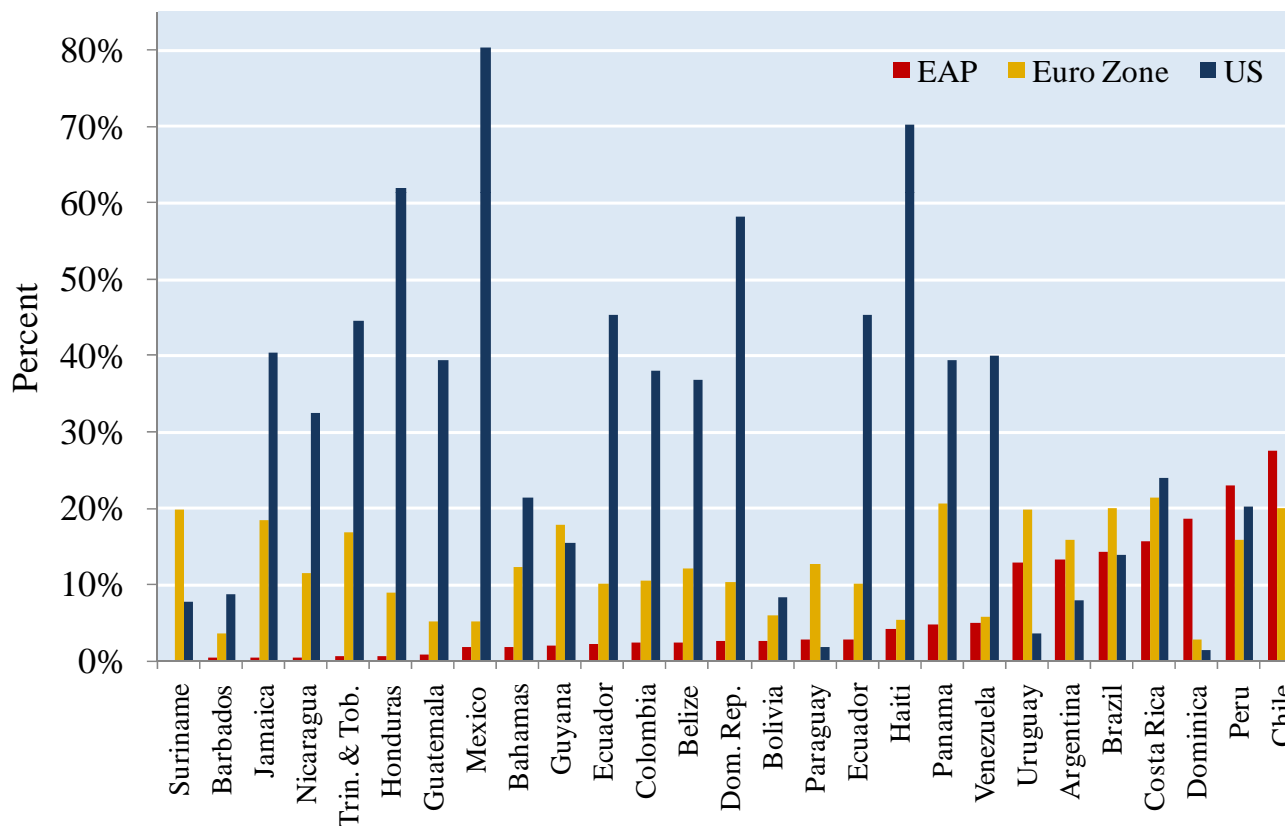
A Safer Integration in LAC *Finance*



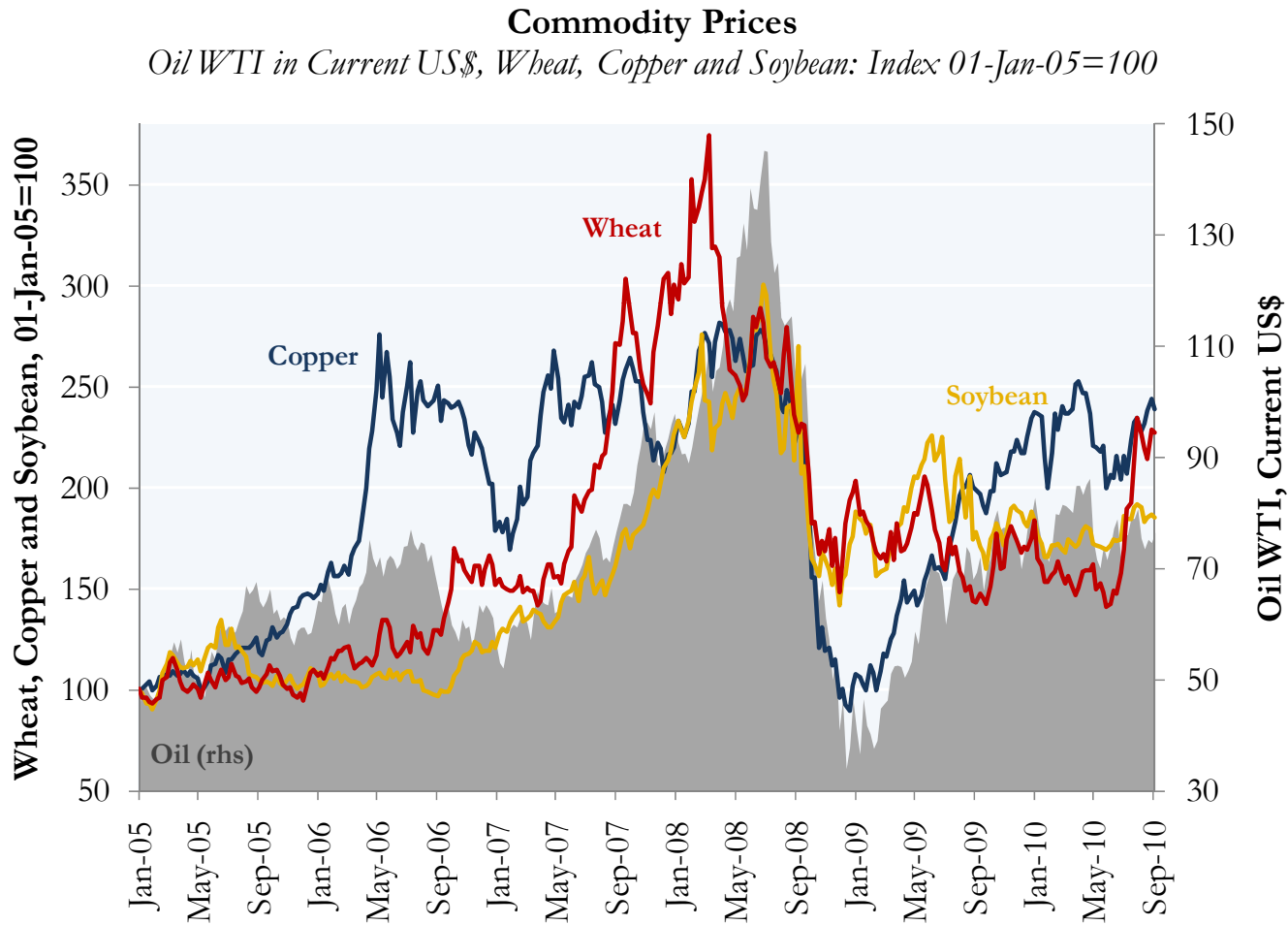
Note: The net debt position (vis-à-vis ROW) is the sum of debt assets and reserves minus debt liabilities. In turn, the net equity position (vis-à-vis ROW) is the sum of net FDI assets and net portfolio equity assets. The sample ranges from 1990 to 2008. Source: Lane and Milesi-Ferretti (2007).

The China connection: LAC countries has been sharply intensifying trade and FDI links to Asia

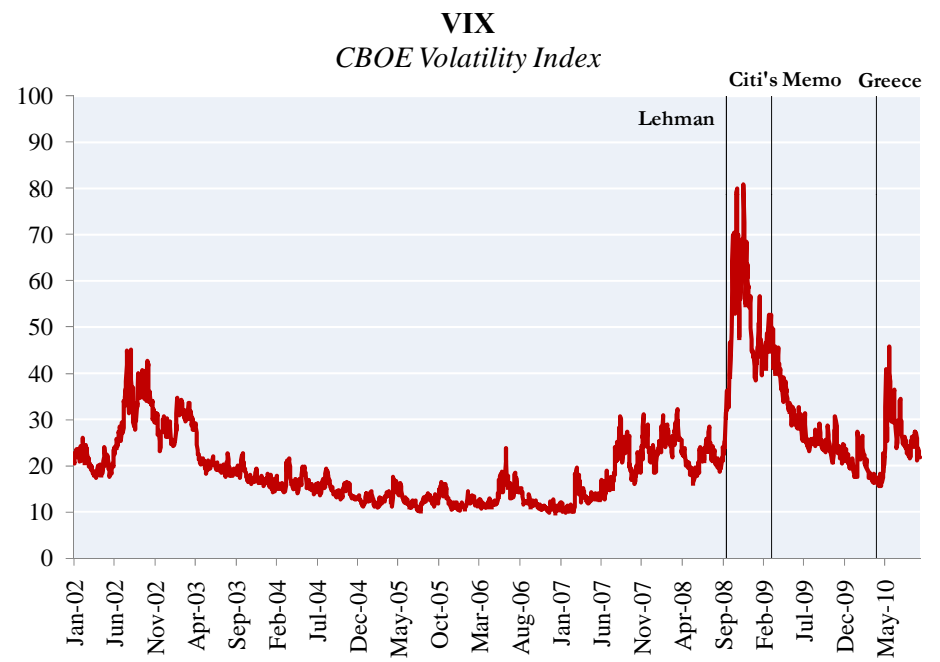
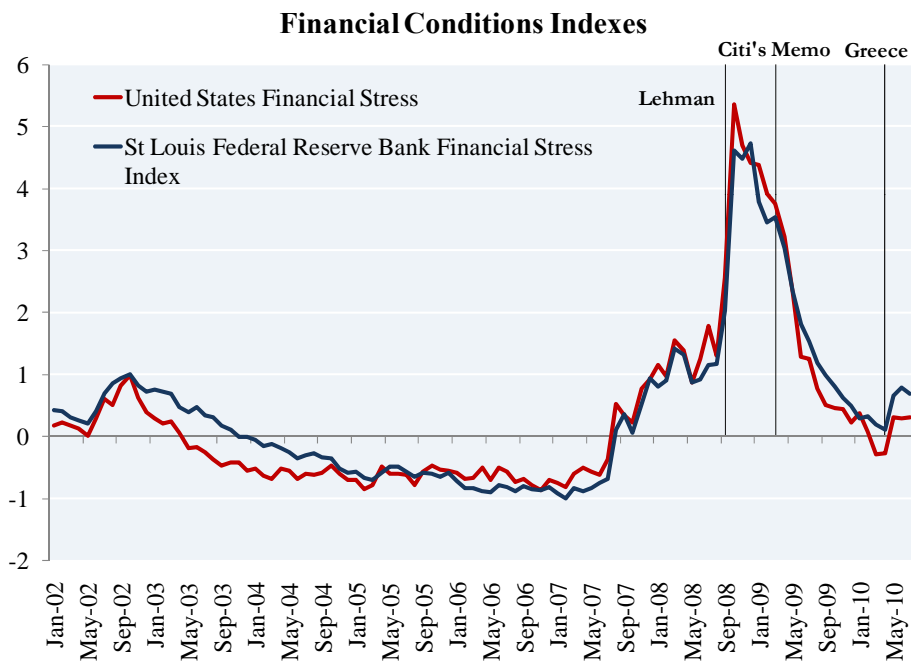
LAC Exports to Selected Regions
as % of total exports, 2008 data



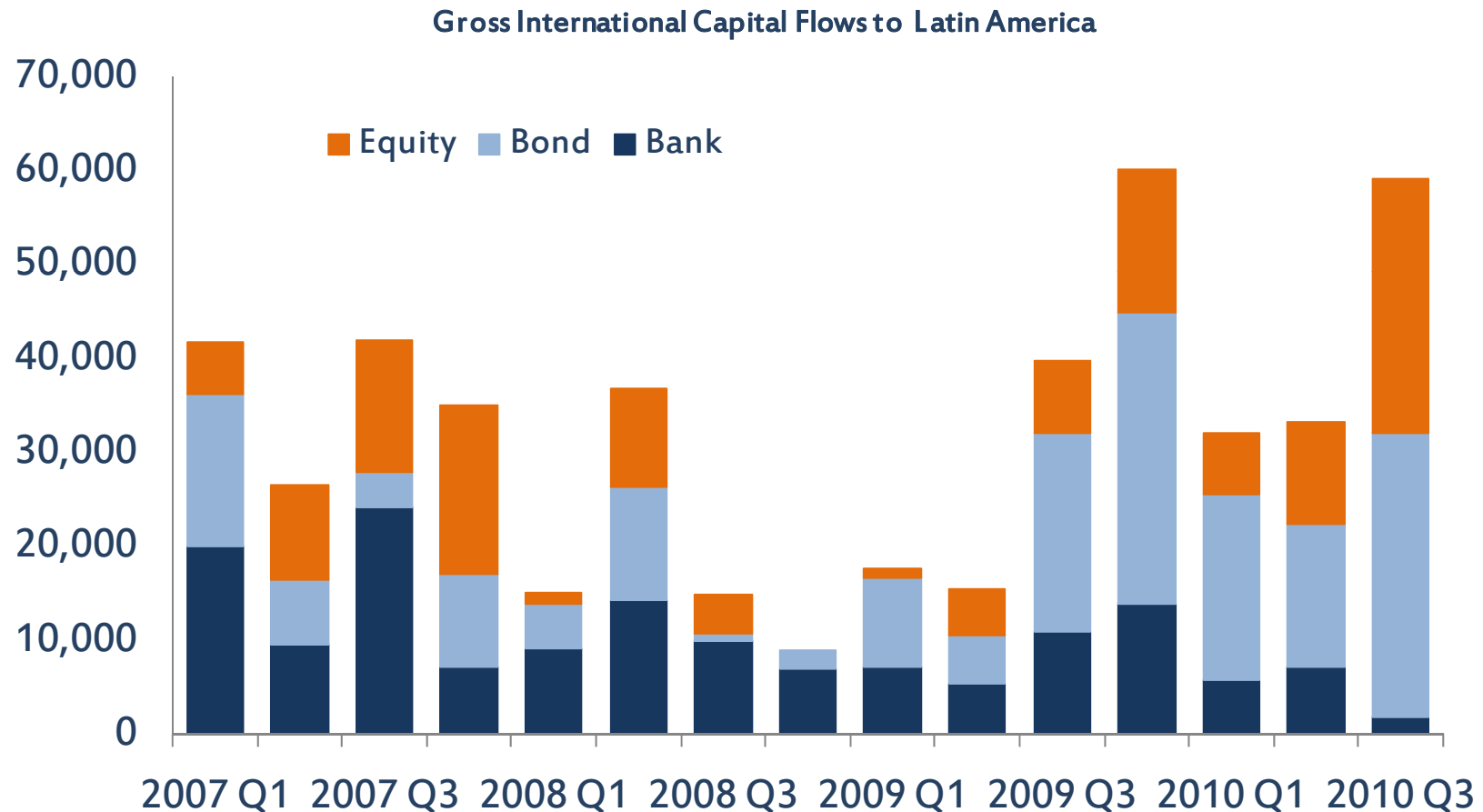
Commodity prices rebounded quickly to 2007 levels



A swing from risk aversion to risk appetite is boosting capital flows to EMs



Capital flows to LAC have surged in 2010 to levels significantly higher than those observed in 2007



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Re-coupling, de-coupling

Real de-coupling from HICs and increased coupling with China

- Over time, economic activity in EMs has become less sensitive to economic activity in HICs, and more sensitive to economic activity in China

Financial re-coupling

- While EM policy fundamentals boost economic resilience, they are not the main drivers of financial asset performance
- EM asset returns have become more sensitive to common factors than to differences in EM fundamentals
- The co-movement of asset returns across the world has increased over time, reducing the gains of international portfolio diversification

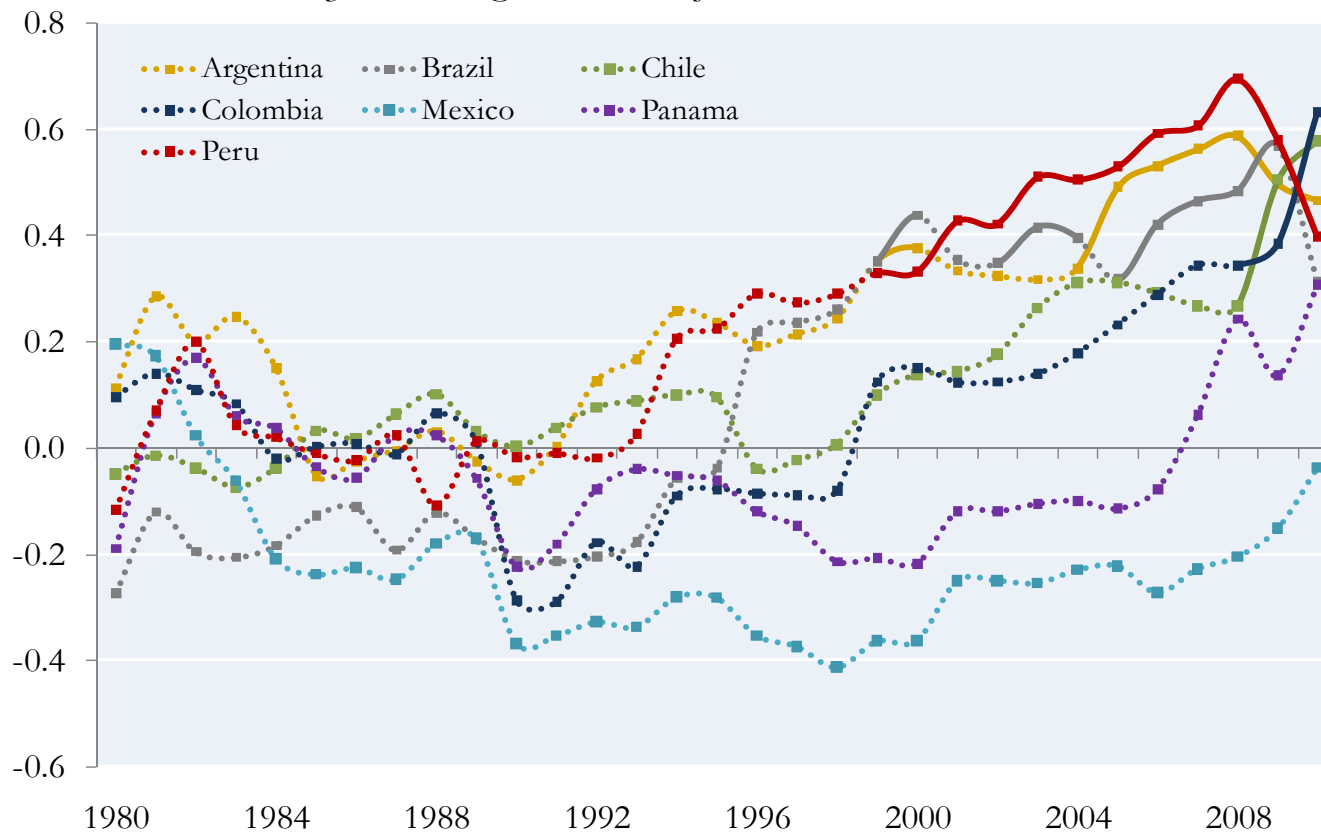
Real de-coupling: growth in EMs has become more sensitive to China and less sensitive to the G-7

Independent Variables:	Panel Estimations						Panel Estimations	
	Emerging Markets			LAC-7	CRB	China	Non-Euro Advanced Economies	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
G-7	0.432*** (0.000)	1.636*** (0.000)	0.988*** (0.000)	1.936*** (0.000)	0.960 (0.253)	0.052 (0.592)	0.327* (0.081)	0.169 (0.435)
G-7, Late	0.146** (0.043)	-1.299*** (0.000)	-0.763*** (0.000)	-1.54*** (0.000)			0.492** (0.033)	0.487** (0.039)
China		0.850*** (0.000)	0.557*** (0.000)	0.847*** (0.000)	2.826*** (0.000)		0.121* (0.067)	0.050 (0.511)
China, Late		0.420*** (0.000)	0.174*** (0.006)	0.535*** (0.000)			-0.153*** (0.005)	-0.223*** (0.002)
CRB			0.091*** (0.000)	0.060* (0.058)			0.000 (0.000)	0.028* (0.069)
WTI			0.013*** (0.005)	-0.023** (0.012)			0.000 (0.000)	0.002 (0.611)
α	0.028*** (0.000)	-0.086*** (0.000)	-0.040*** (0.000)	-0.101*** (0.000)	-0.269*** (0.000)	0.097*** (0.000)		
Observations	1357	1357	1357	264	63	64	264	264
R-squared	0.12	0.26	0.30	0.26	0.27	0.00	0.42	0.43
G-7 + G-7, Late	0.578*** (0.000)	0.347*** (0.000)	0.226*** (0.000)	0.397*** (0.000)			0.818*** (0.000)	0.657*** (0.000)
China + China, Late		1.270*** (0.000)	0.731*** (0.000)	1.382*** (0.000)			-0.054 (0.579)	-0.172 (0.123)

Notes: The late period goes from 2000 to 2009. Median sample estimations report the median values from country-by-country regressions. G-7 growth was computed as the average of individual growth rates weighed by the dollar GDP in the previous year. Non-Euro Advanced Economies include Australia, New Zealand, Norway, and Sweden. For panel regressions, ***, ** and * denotes significance at a 1%, 5% and 10% respectively. P-values are reported in parentheses. Sources: IMF's IFS.

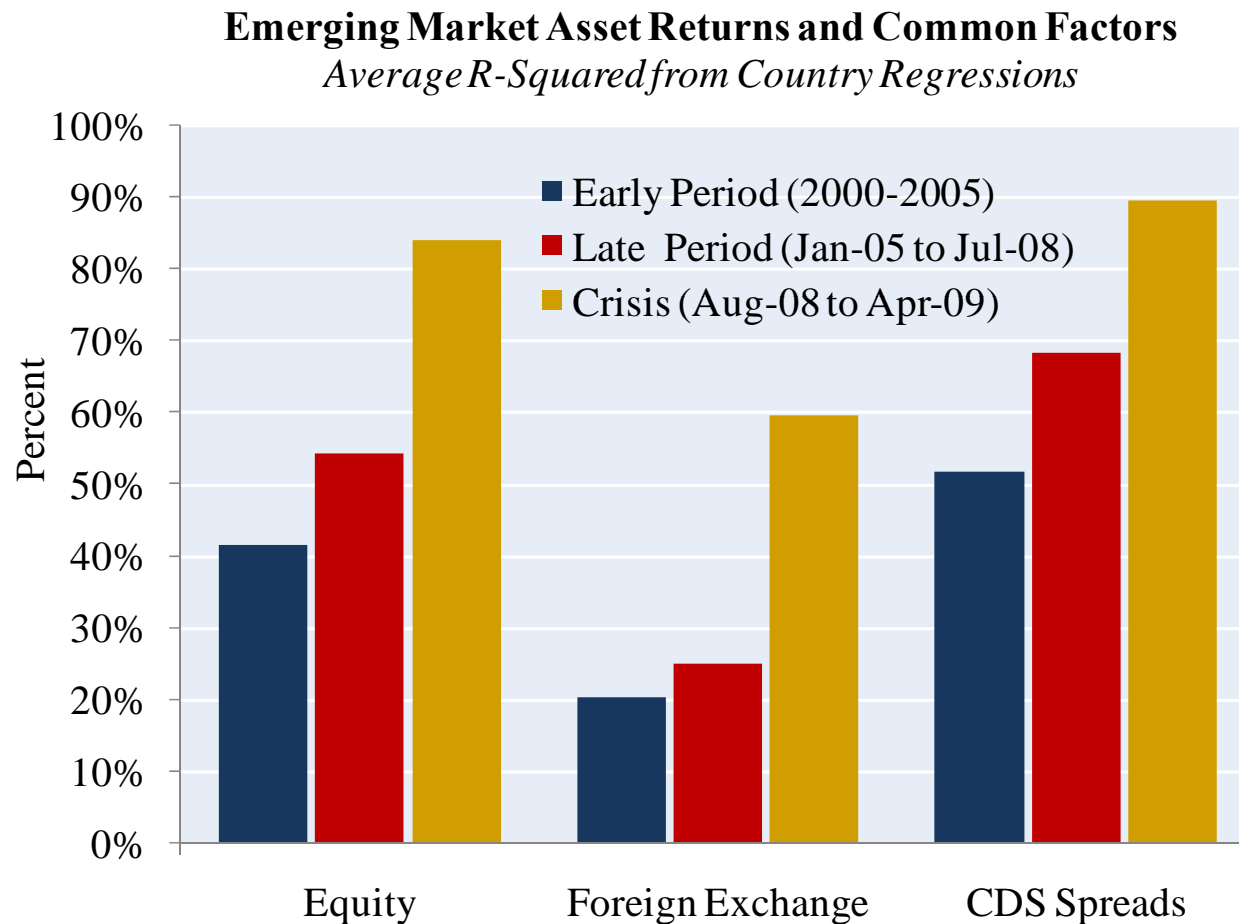
The co-movement of growth between LAC countries and China has been clearly trending upward...

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.

The variance of EM asset return is increasingly explained by common factors



Notes: A principal component is estimated for returns on equities, on foreign exchange spot contracts, and on CDS sovereign spreads. Then, country-specific returns for each asset class are regressed on its associated PC1 in order to get an R-squared. The average R-squared is being reported for countries within each region. See Levy Yeyati (2010) for more details. Sources: Bloomberg.

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Policy challenges and tensions ahead

No time for complacency

- Downside risks stemming from HICs, and Europe in particular, remain
- Continued resiliency not guaranteed and must be cultivated

Over-burdened monetary policy

- Fiscal stance is pro-cyclical throughout most of the region
- Need to rebalance the monetary-fiscal policy mix
- Need for macro-prudential policies to avoid financial excesses in LAC

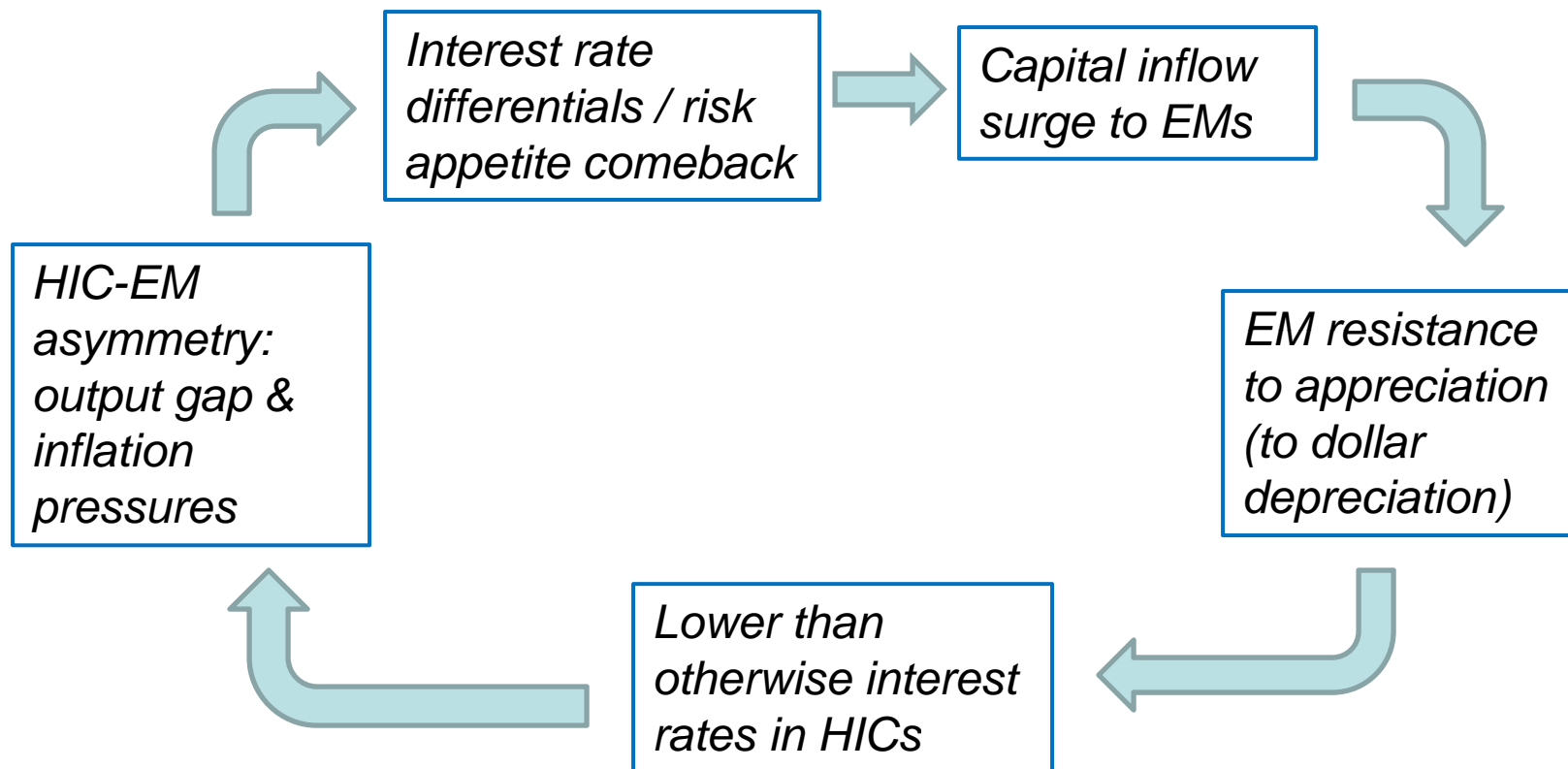
Global coordination failure complicates things for LAC

- Asymmetry in output gaps/inflation pressures & risk appetite fuel capital flows to EMs
- As EMs collectively resist currency appreciation, interest rates in HICs have to be lower than otherwise, further boosting capital flows to EMs

Can the recovery involve higher trend growth and not just cyclical rebound?

- LAC's non-inflationary growth rate is lower than in the East Asian countries
- A premium must be placed on the productivity agenda

Capital inflows surge and global rebalancing



- Global coordination failure
- Could be broken if the Chinese currency appreciates significantly
- LAC: responding to a global distortion or adding to the global distortion?

Over-burdened monetary policy

- Monetary policy focused on pre-empting inflation also dealing with capital inflows surge and natural resource windfalls
 - Withdrawal of fiscal and credit stimulus is taking longer than expected
 - Short-fall of countercyclical policy in good times – fostered by:
 - Easing of financial conditions – mood swing
 - Substantial margin to borrow
 - Demonstration effect from rich-country fiscal and monetary largesse

- Towards a sounded macro-financial policy mix
 - Emphasis on cyclically-adjusted fiscal targets
 - Public saving even more important in countries with commodity bonanza
 - Need for a macro-prudential agenda to avert financial excesses
 - But a significant degree of exchange rate flexibility is needed to ensure prudential policy independence

Thank you