
LAC's Decade: Ending or Beginning?

LAC RLT Retreat

Washington, DC
13 September 2011

Chief Economist Office
Latin America and the Caribbean
The World Bank

World
Bank  **LAC**
opportunities for all

Structure of the presentation

- LAC's successful past decade
- The maturing recovery cycle
- Rising global uncertainty and risks
- Whither LAC's growth in the short and long run?

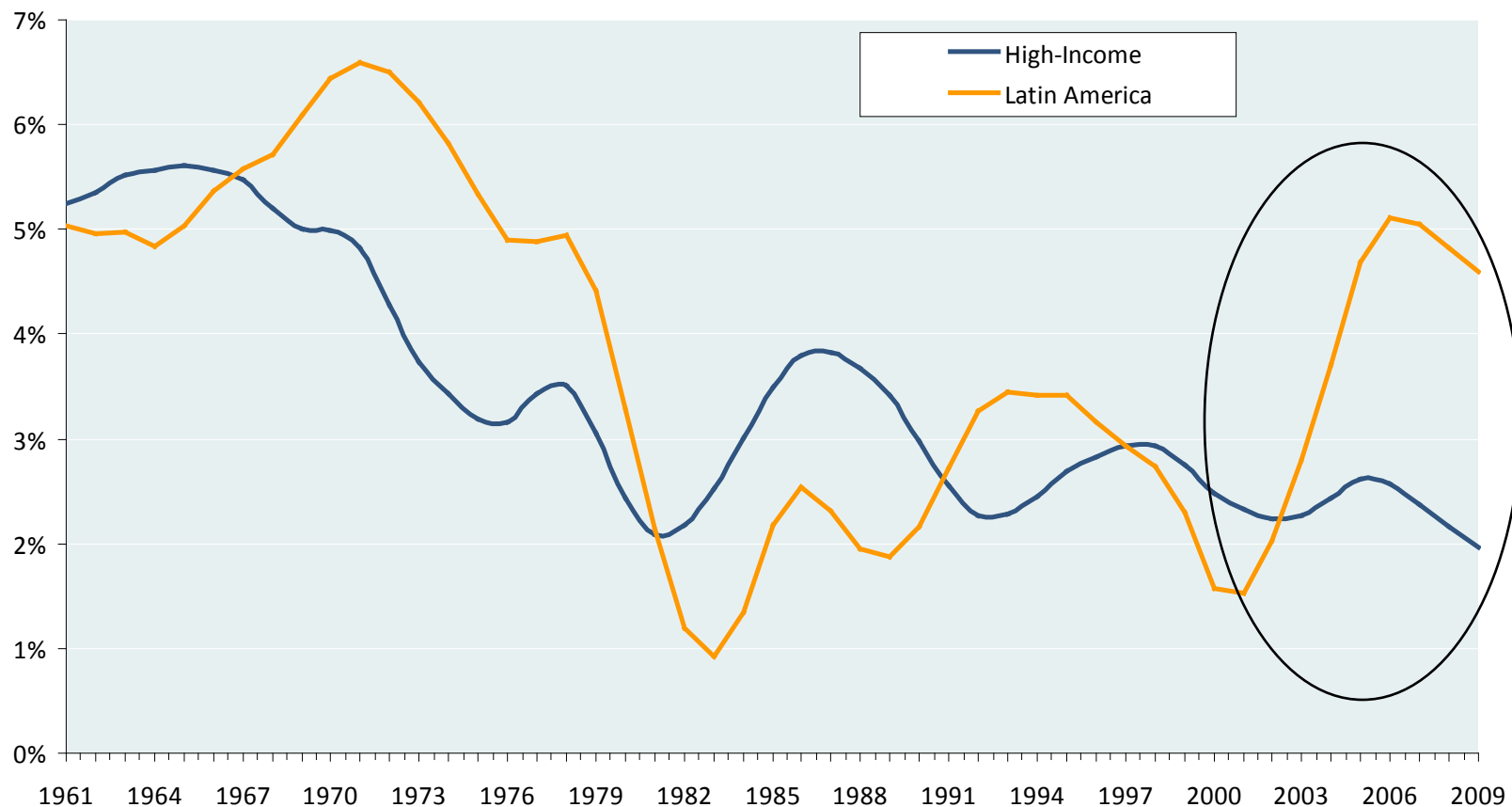
LAC's Successful Decade and the Maturing Recovery Cycle

LAC's success

Non-inflationary growth decoupling from rich countries

Cyclical-adjusted Growth in Latin America and High-Income Countries

Trend growth computed using the band-pass filter

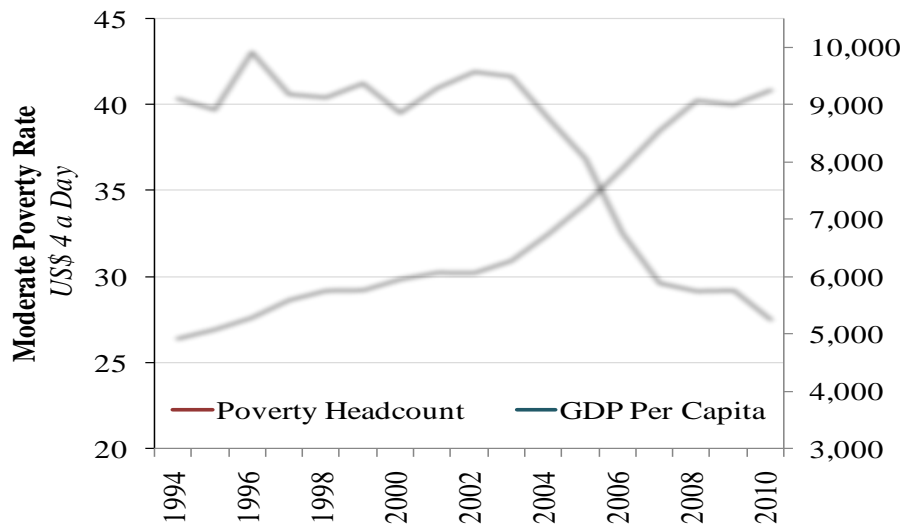


The trend growth of real GDP growth is computed using the band-pass filter (Baxter and King, 1999). LCRCE staff calculations. Source: WDI – World Bank; National Authorities.

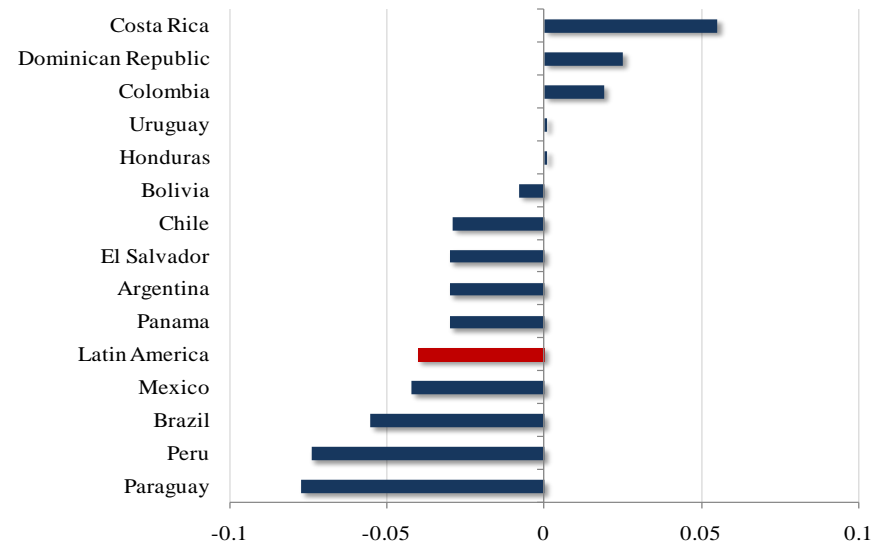
LAC's success

Reduction in poverty and income inequality

Per Capita GDP Growth and Poverty
LAC Countries

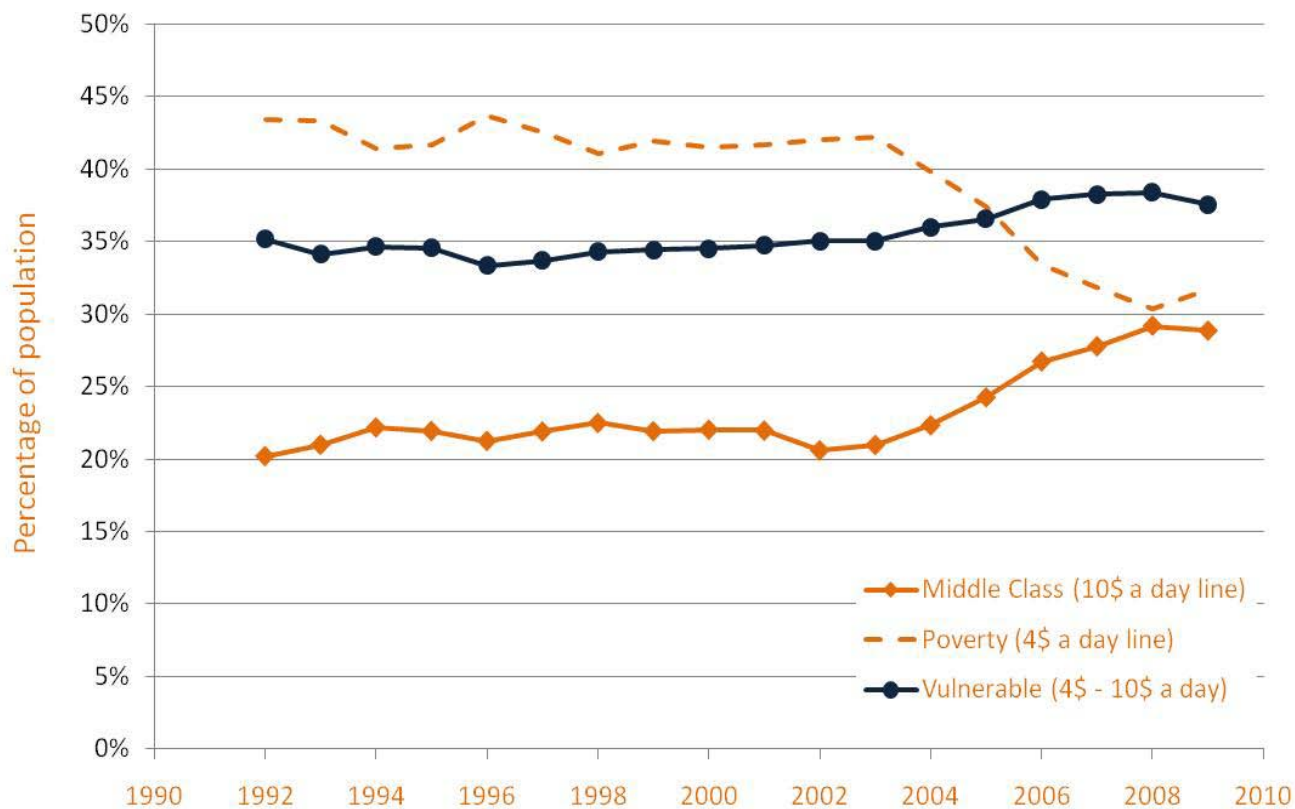


Gini Coefficient Cumulative Change
From 2009 to 1995



LAC's success

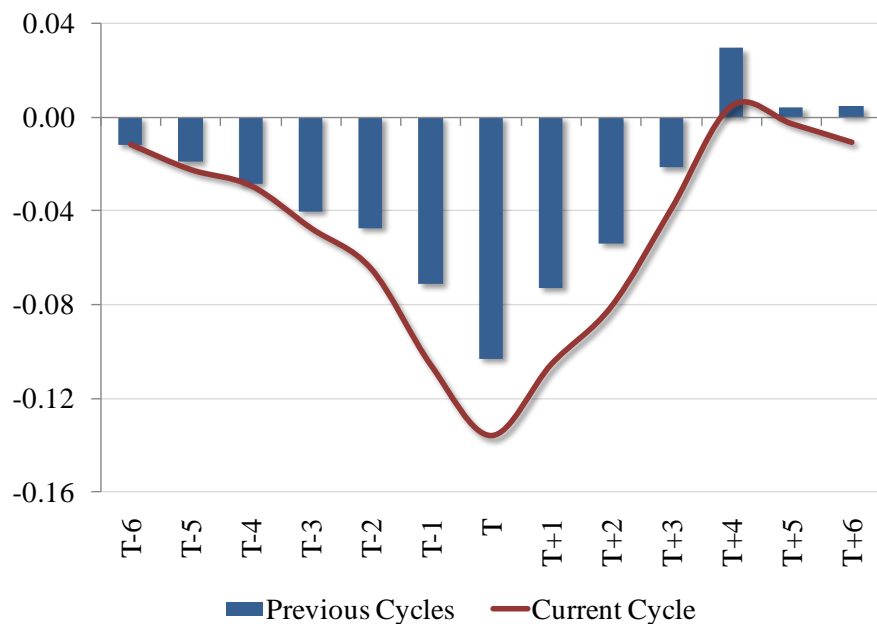
An expanding middle class



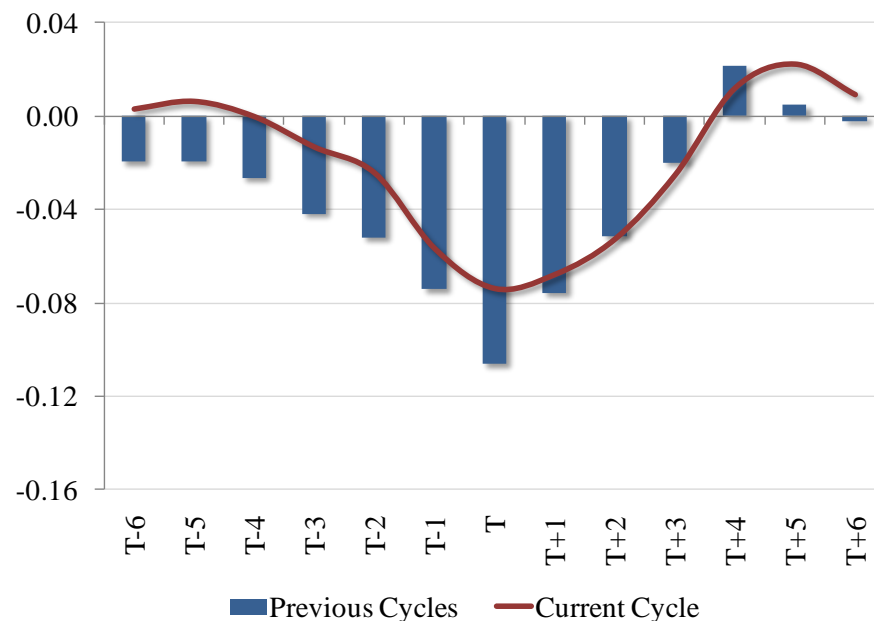
LAC's success

Stellar performance during the 2009 global downturn

Growth in Real GDP
Middle Income Countries



Growth in Real GDP
Latin America and the Caribbean



LAC came out of the global crisis without balance sheet damage

LAC's success

Region comes out of the crisis without systemic damage

Financial Crises Around the World

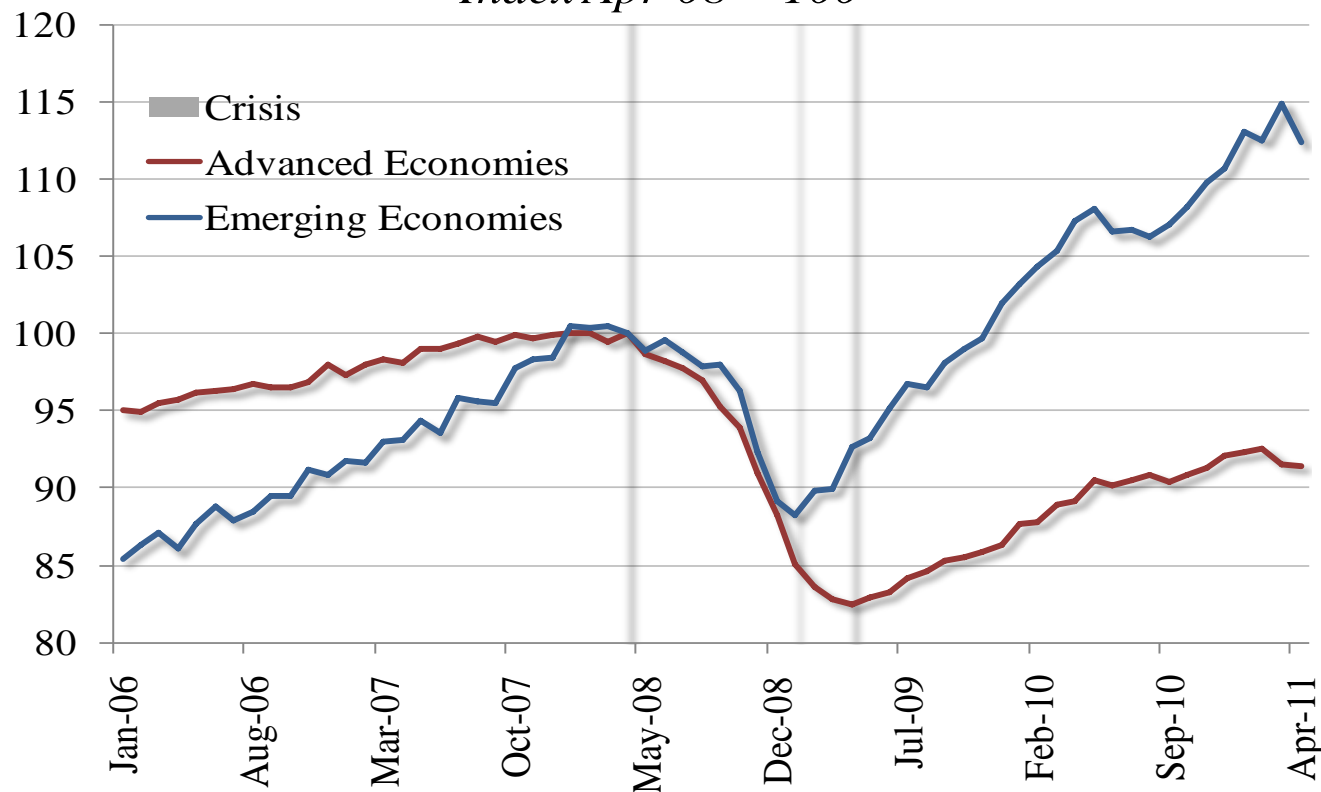
	Systemic Banking Crises		Foreign Currency Debt		Currency Crises	
	2007-2008	1994-1998	2007-2008	1994-1998	2007-2008	1994-1998
No. Of Crises-Hit Countries						
High Income	19	6	0	0	4	2
OECD only	18	4	0	0	4	1
Middle East & N. Africa	0	1	0	0	0	2
South Asia	0	0	0	1	0	0
Sub-Saharan Africa	0	9	1	1	6	31
East 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's success

Joining the dynamic EMs in the recovery phase

World Industrial Production

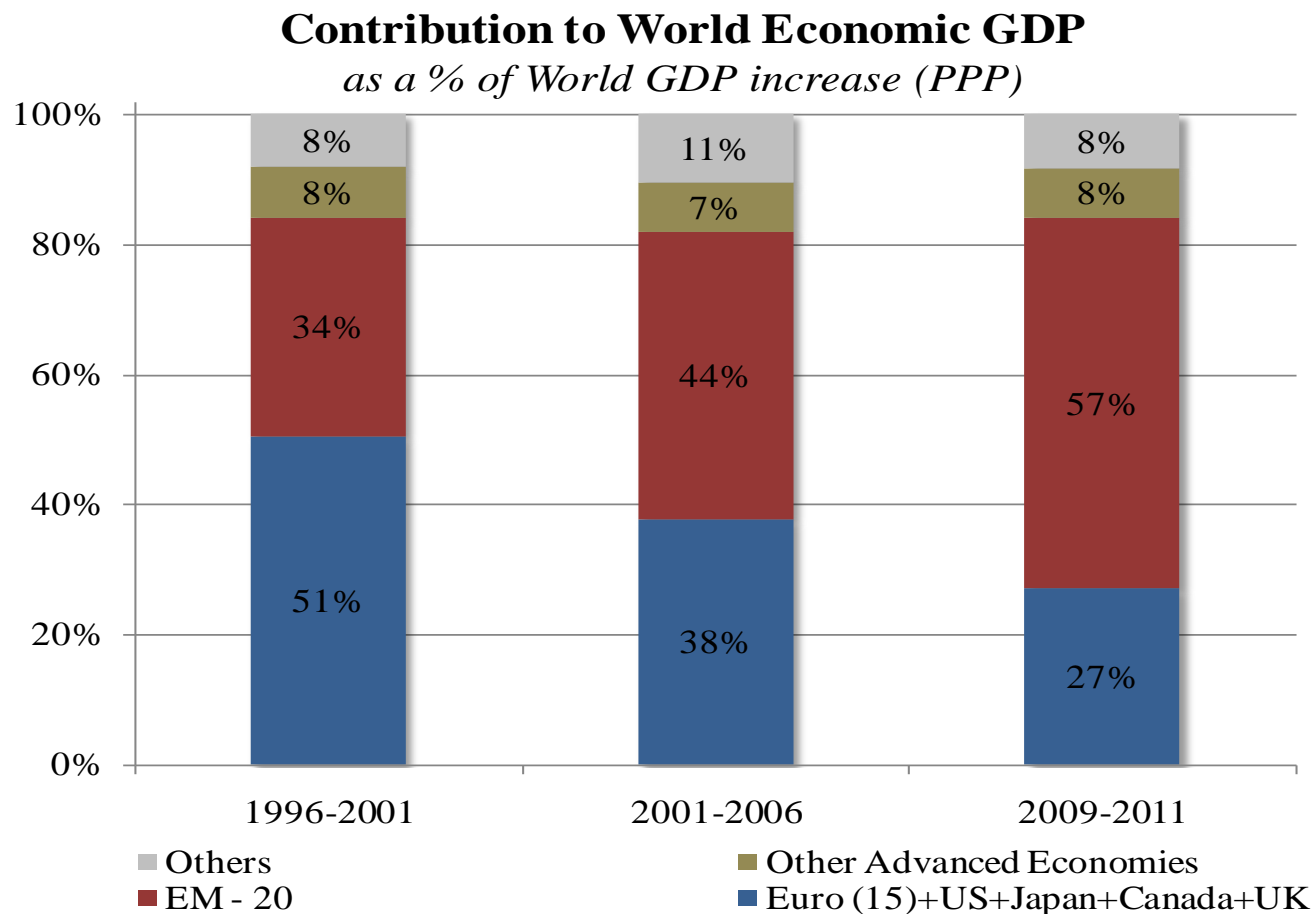
Index Apr-08 = 100



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

LAC's success

Joining the EM family in the recovery phase

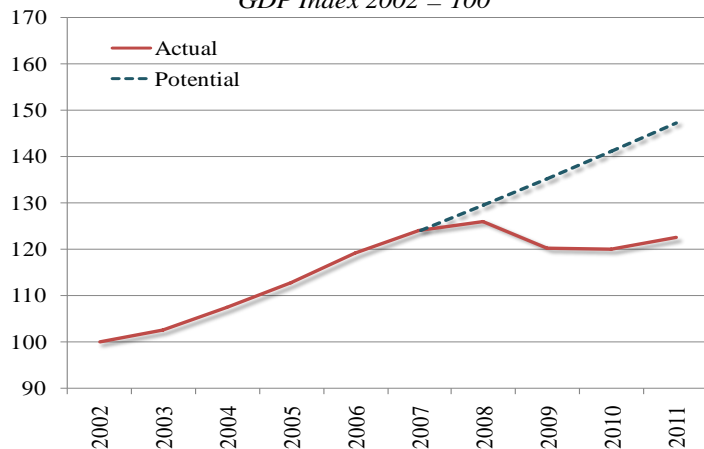


Note: The EM-20 economies are the 20 Emerging Economies with higher GDP PPP in 2011 within the Emerging Economies. They explain 81.9% of the Emerging Economies total GDP. The 20 economies are: China, India, Russia, Brazil, Mexico, Indonesia, Turkey, Iran, Poland, Argentina, Saudi Arabia, Thailand, South Africa, Egypt, Pakistan, Colombia, Malaysia, Nigeria, Philippines and Venezuela.

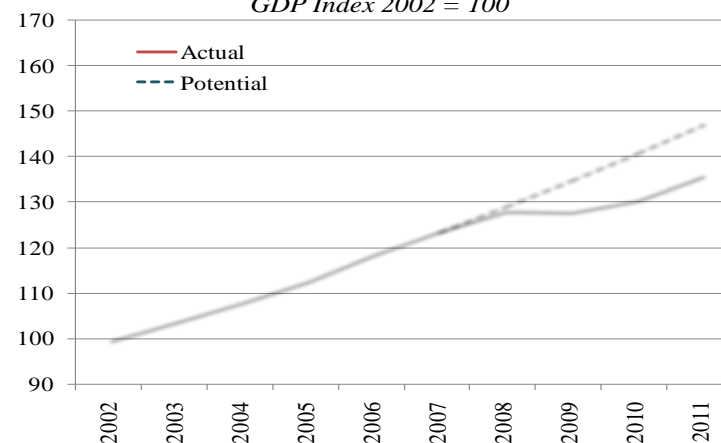
LAC's uneven success

Mutating regional heterogeneity

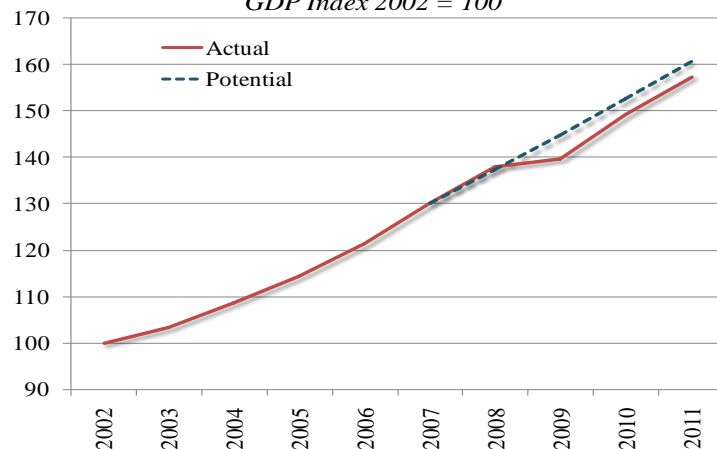
Slow-Growth Countries within LAC
GDP Index 2002 = 100



Medium-Growth Countries within LAC
GDP Index 2002 = 100



High-Growth Countries within LAC
GDP Index 2002 = 100



Sources: Potential GDP is computed as the average rate of growth between 2007 and 2003. Simple averages are used to construct the composite. The categorization of each group is as follow: Slow-growth are those countries that showed a less than 3.5% in their 2011-2008 GDP real growth rate; Medium-growth are those between 3.5% and 10%; High-growth are those with 10% or more. For 2011 we used the last available forecast (Consensus Forecast June-2011). Sources: Consensus Forecast (June – 2011); WEO (April – 2011).

LAC's uneven success

Where you are matters less than to whom you are connected

	Number of countries	Mean growth 2003-2007*	Mean Growth 2003-2011	Mean Growth 2008-2011**	Cumulative	
					Max. 2008-2011	Min. 2008-2011
<i>Low growth</i>	13	4.4%	2.3%	-0.3%	3.3%	-12.3%
<i>Medium growth</i>	7	4.4%	3.5%	2.4%	7.9%	4.1%
<i>High growth</i>	12	5.4%	5.2%	4.9%	18.8%	10.0%
Total	32	4.8%	3.7%	2.2%	18.8%	-12.3%

* This is the measure used to construct the "Potential GDP"

** This is the measure used to define the classification as "Low", "Medium" and "High".

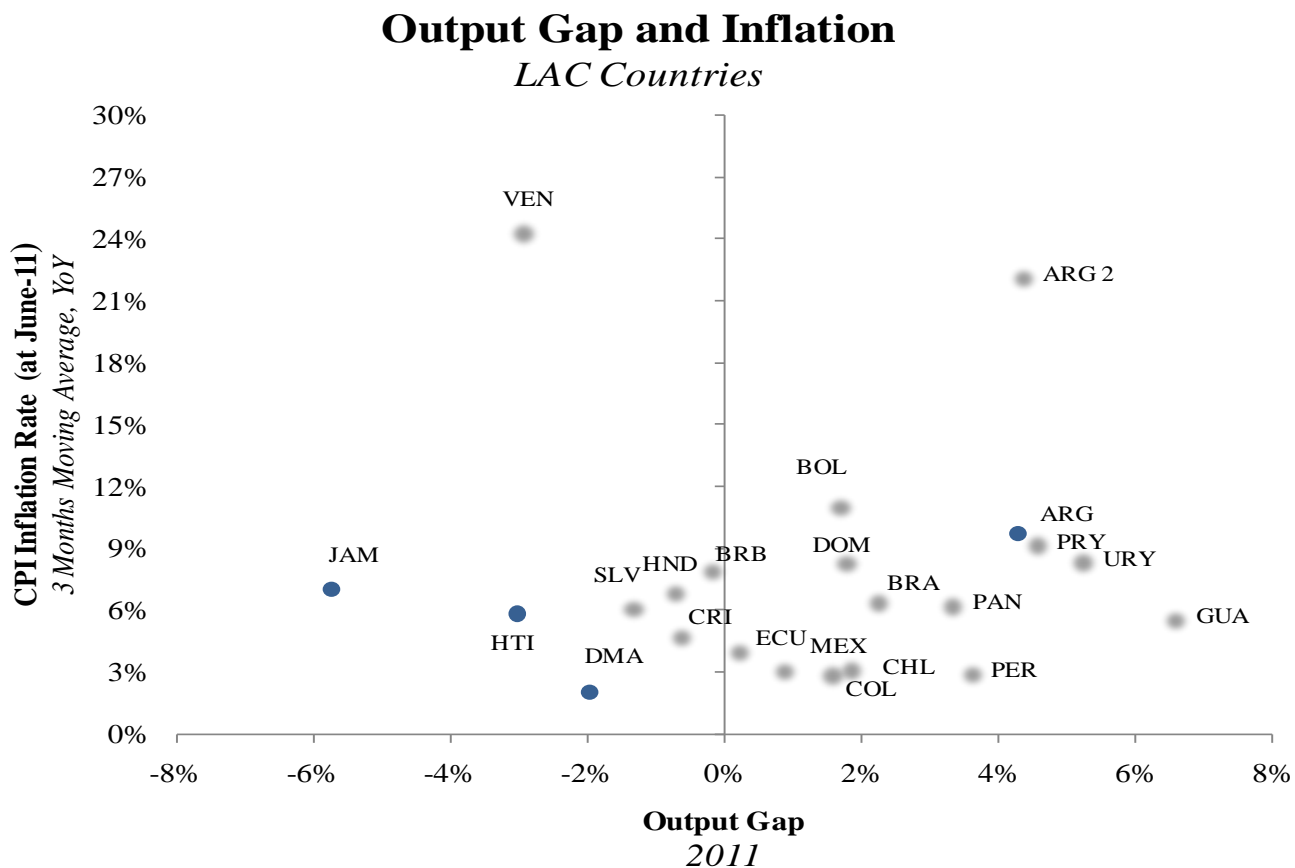
Low growth (<4%): St. Kitts and Nevis, Antigua and Barbuda, Grenada, Barbados, *Jamaica*, Bahamas, *Venezuela*, *Trinidad and Tobago*, St. Vincent and the Grenadines, El Salvador, St. Lucia, Dominica and *Mexico*

Medium growth (4%-10%): Honduras, Belize, Haiti, Nicaragua, Guatemala, Costa Rica and *Ecuador*

High growth (>10%): Chile, *Colombia*, Brazil, Guyana, *Bolivia*, Suriname, Paraguay, *Dominican Republic*, Peru, Argentina, Uruguay and *Panama*

LAC's maturing cyclical recovery

Overheating and *endogenous* inflationary pressures



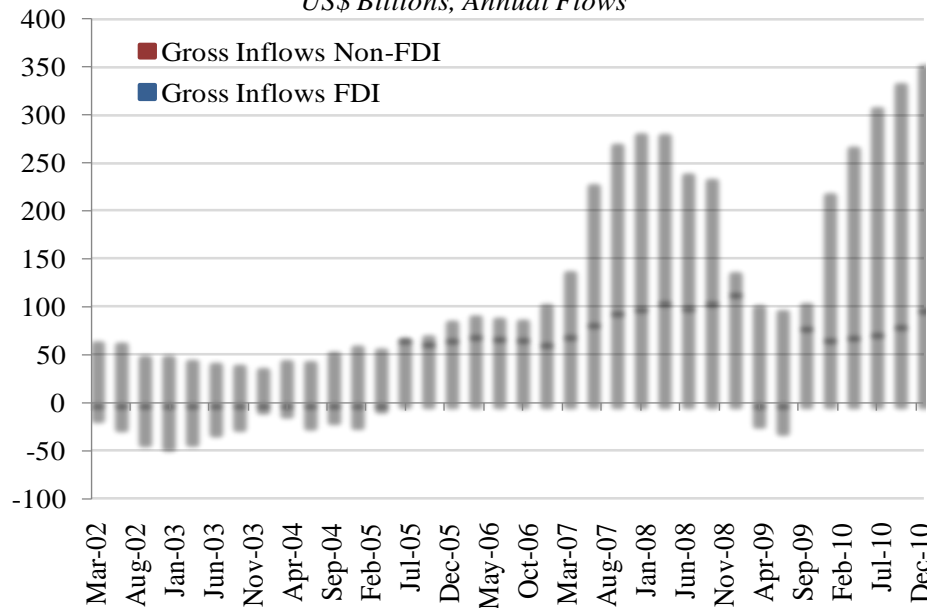
Notes: The area inside the box represents the range between the lowest and highest midpoints among inflation targeting countries. Sources: National Statistical Institutes and Central Banks, Haver Analytics.

LAC's maturing cyclical recovery

Double tail spin push: commodity prices & capital inflows

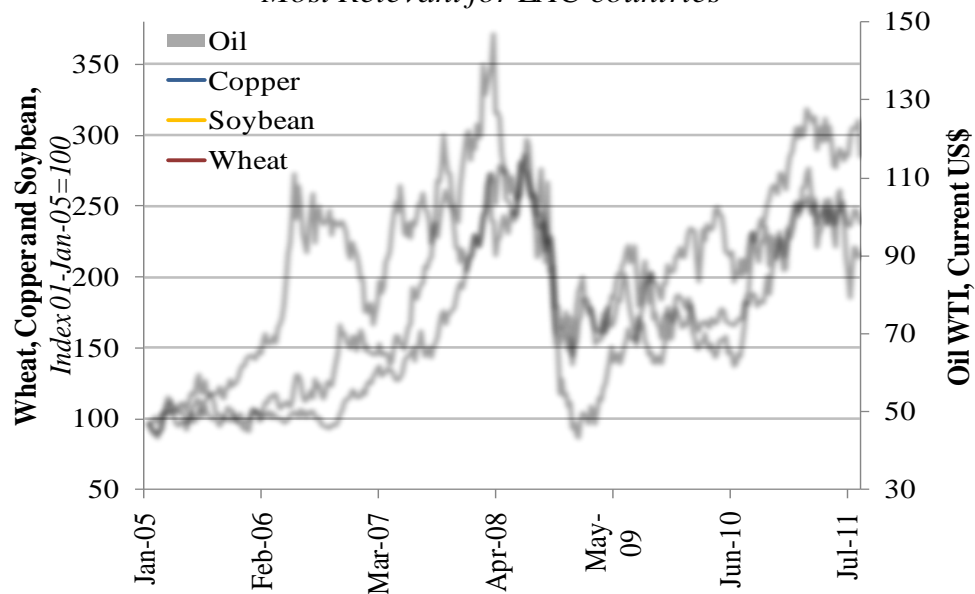
Gross Capital Inflows to LAC-7 Countries

US\$ Billions, Annual Flows



Commodity Prices

Most Relevant for LAC countries

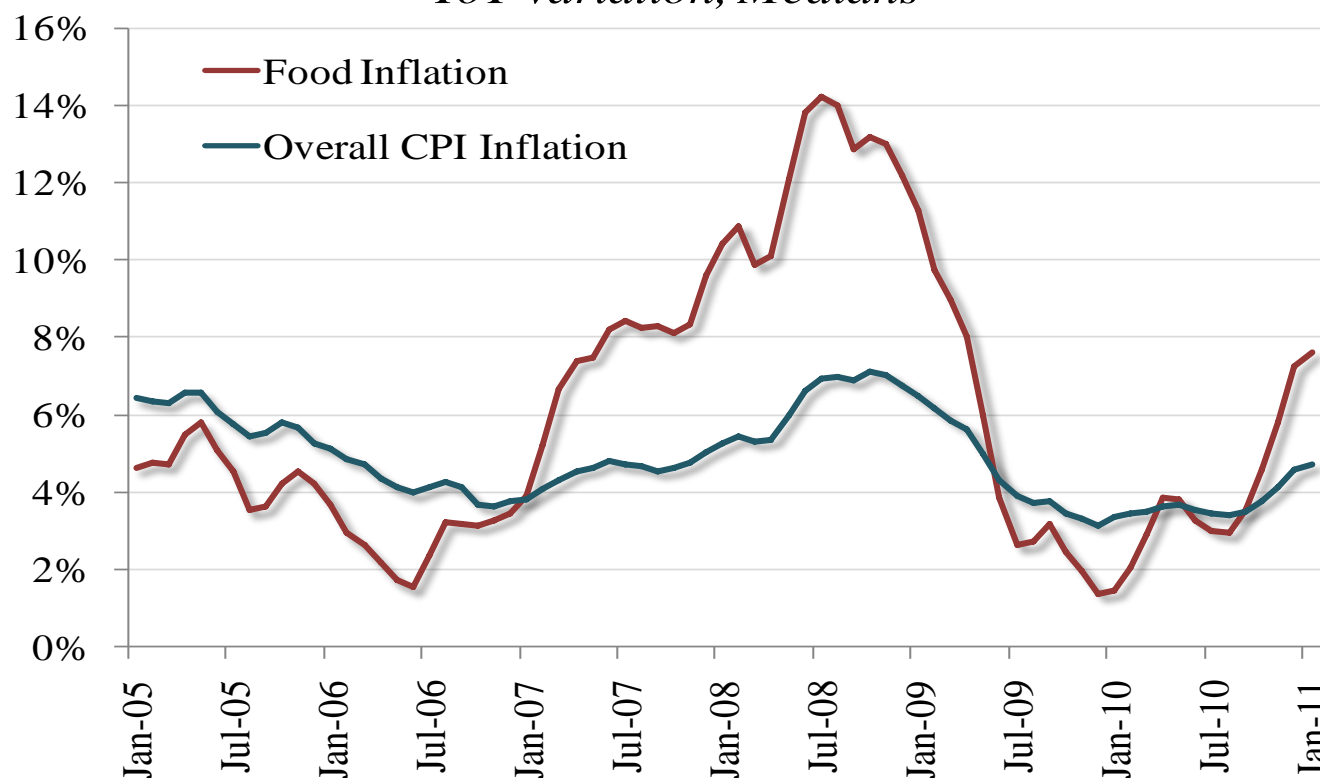


Notes: Annualized capital inflows to LAC-7. Sources: IMF's Balance of Payments Statistics, National Statistical Institutes, and Central Banks.

Demands on domestic macro-financial policy

Maintain inflation expectations well anchored

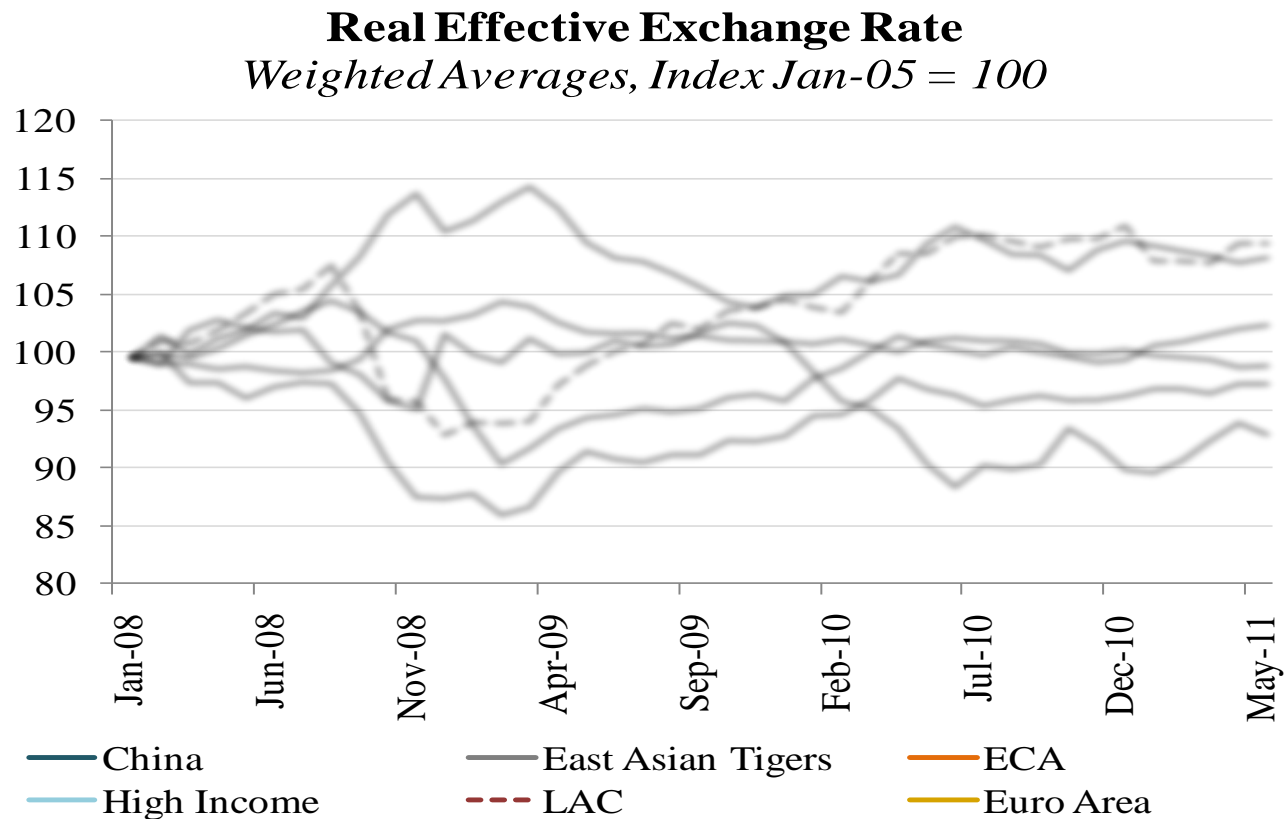
Food and Overall CPI Inflation : LAC-7 + URY
YoY Variation, Medians



Notes: There is a change in the methodology of calculation for both food and overall PCI index for Chile since January 2009. For the figure on the right, we used the latest available figure for each country. Weighted averages (2007 Nominal GDP in USD Billions) were used in the case of the regional numbers. Sources: Bloomberg, Instituto Nacional de Estadísticas de Chile – INE, and Food and Agriculture Organization – FAO (2010) and IMF's World Economic Outlook – WEO (October 2010).

Demands on domestic macro-financial policy

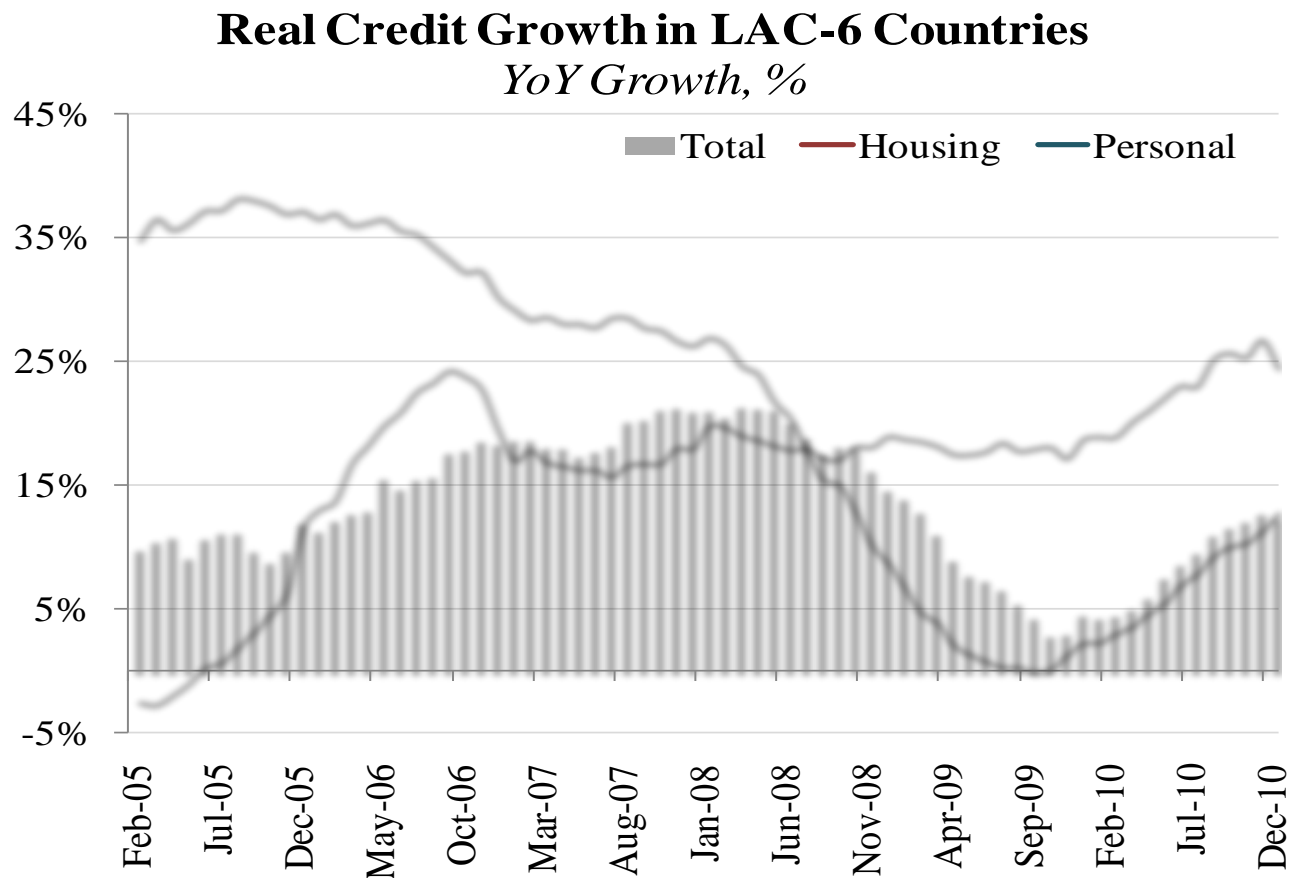
Avoid “excessive” currency appreciation



Notes: Weighted averages were calculated using the 2007 nominal GDP in USD Billions. An increase means an appreciation of the REER. Sources: IMF's International Financial Statistics – IFS and IMF's World Economic Outlook – WEO (April 2011).

Demands on domestic macro-financial policy

Curb systemic risk buildup (financial excesses)

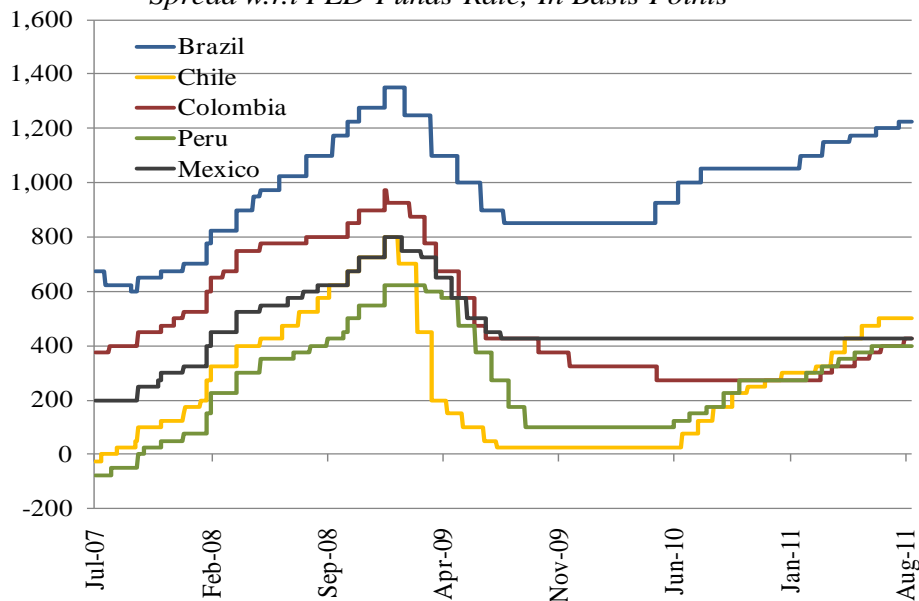


Notes: The figure depicts the (PPP-GDP) weighted average of the growth rates of (total, personal and housing) credit to the private sector for the six largest LAC countries (Argentina, Brazil, Chile, Colombia, Mexico, and Peru). Sources: National Statistical Institutes, Central Banks, and Superintendence of Banking.

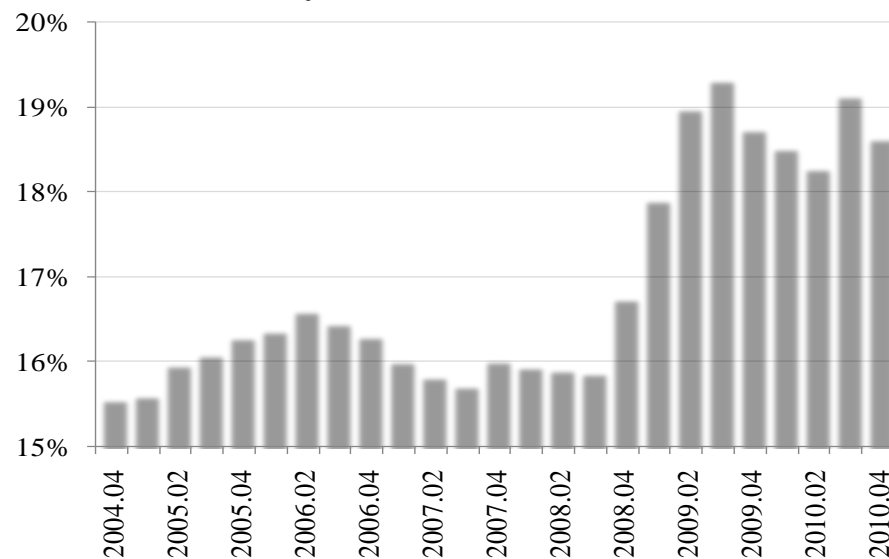
Adjusting the macro-financial policy response

Monetary-fiscal policy mix and macro-prudential policies

Monetary Policy Interest Rate Differential
Spread w.r.t FED Funds Rate, In Basis Points



Primary Expenditure
% of GDP, LAC-6 Countries

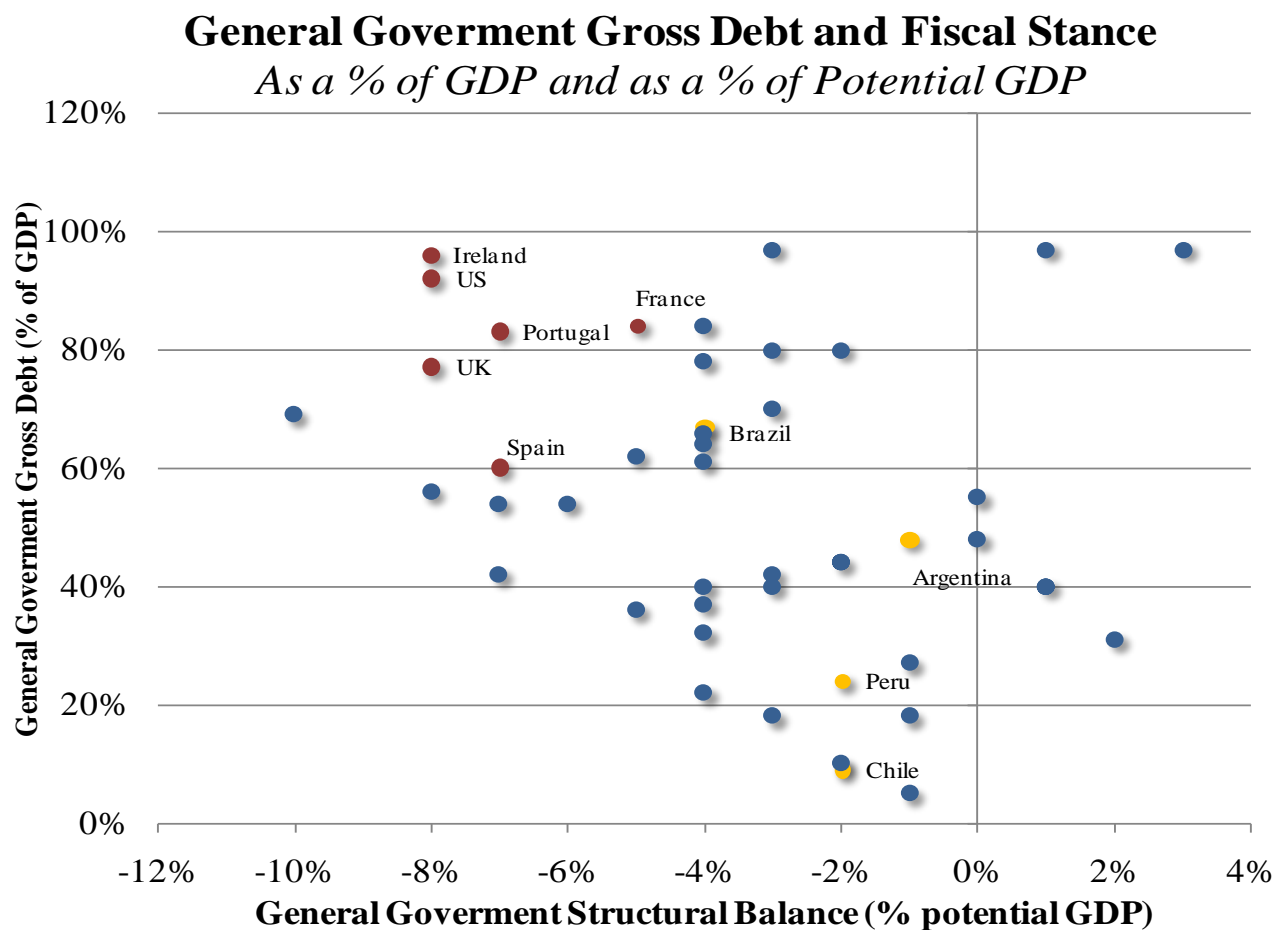


Notes: The figures in Panels B is the cyclically-adjusted primary expenditure and primary balance for the major six LAC countries (Argentina, Brazil, Chile, Colombia, Mexico, and Peru). Sources: Bloomberg, Haver Analytics, National Statistical Institutes, and Central Banks.

Rising Global Uncertainty and Risks

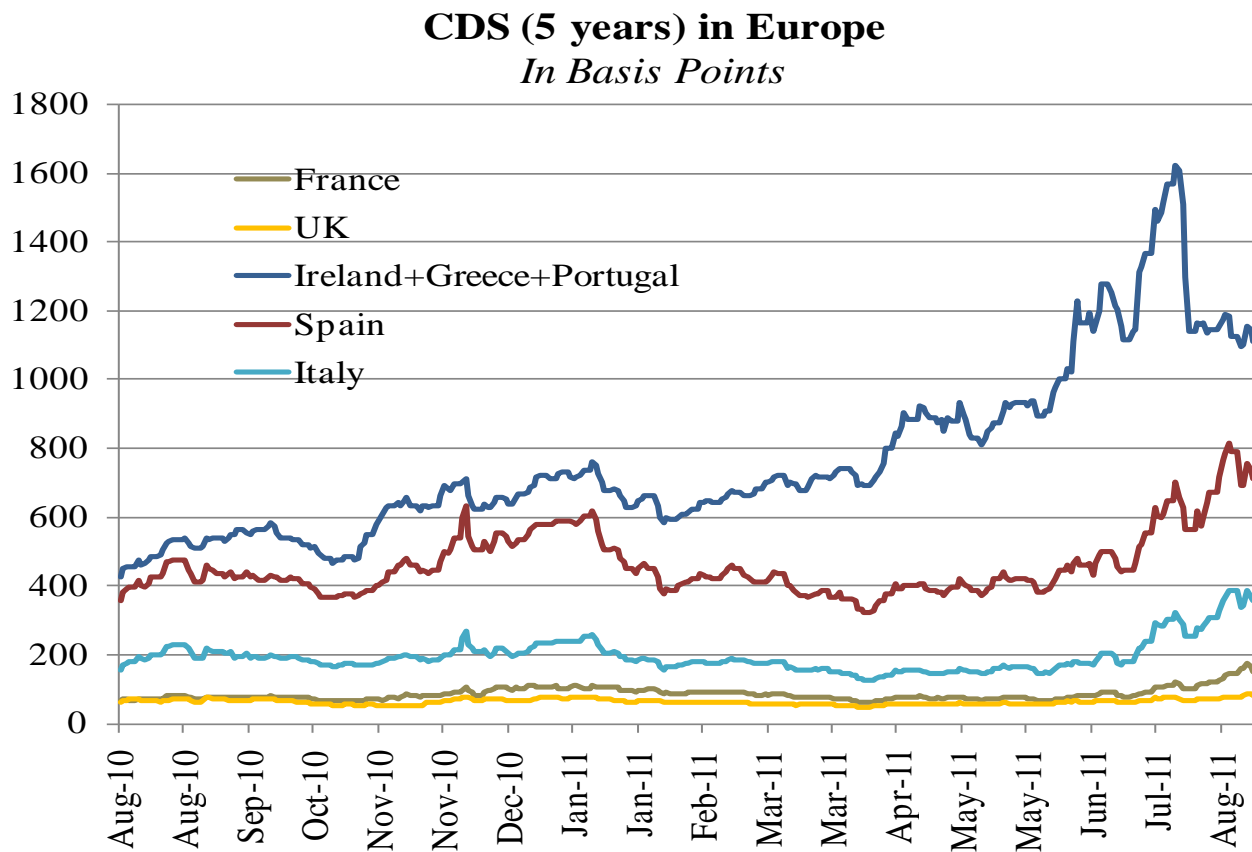
The European Epicenter

Deeper and broader concerns about debt viability



The European Epicenter

From drama to trauma

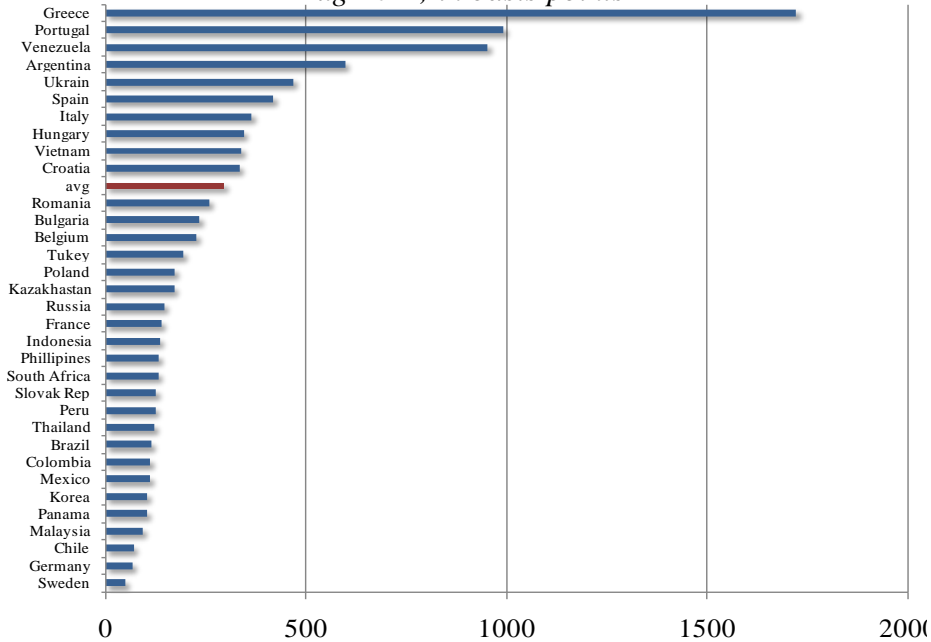


Note: The average CDS is computed for Ireland, Greece and Portugal. Source: Bloomberg

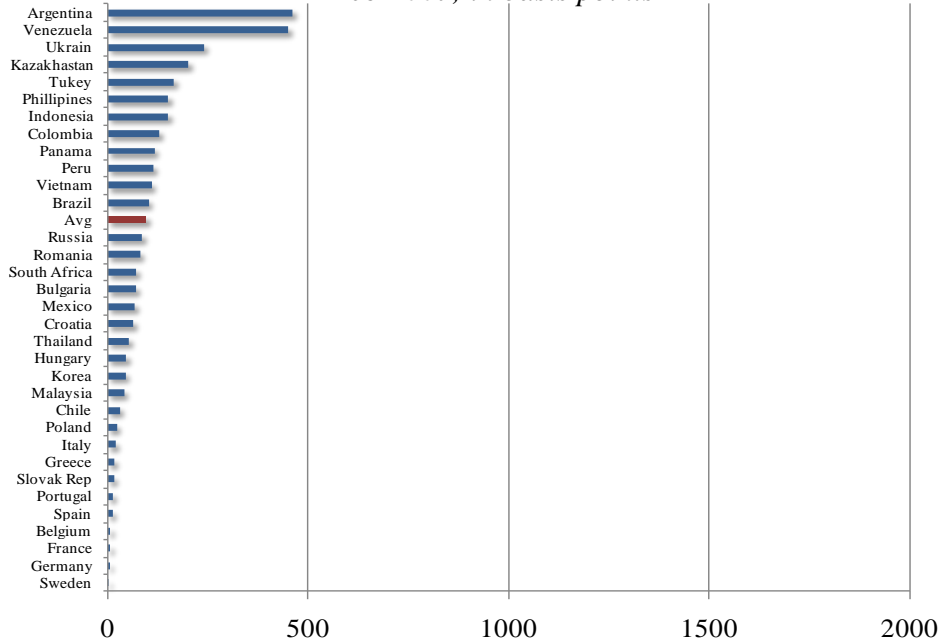
The European Epicenter

Reversal of fortune!

Global Sovereign CDS
Aug-2011, in basis points

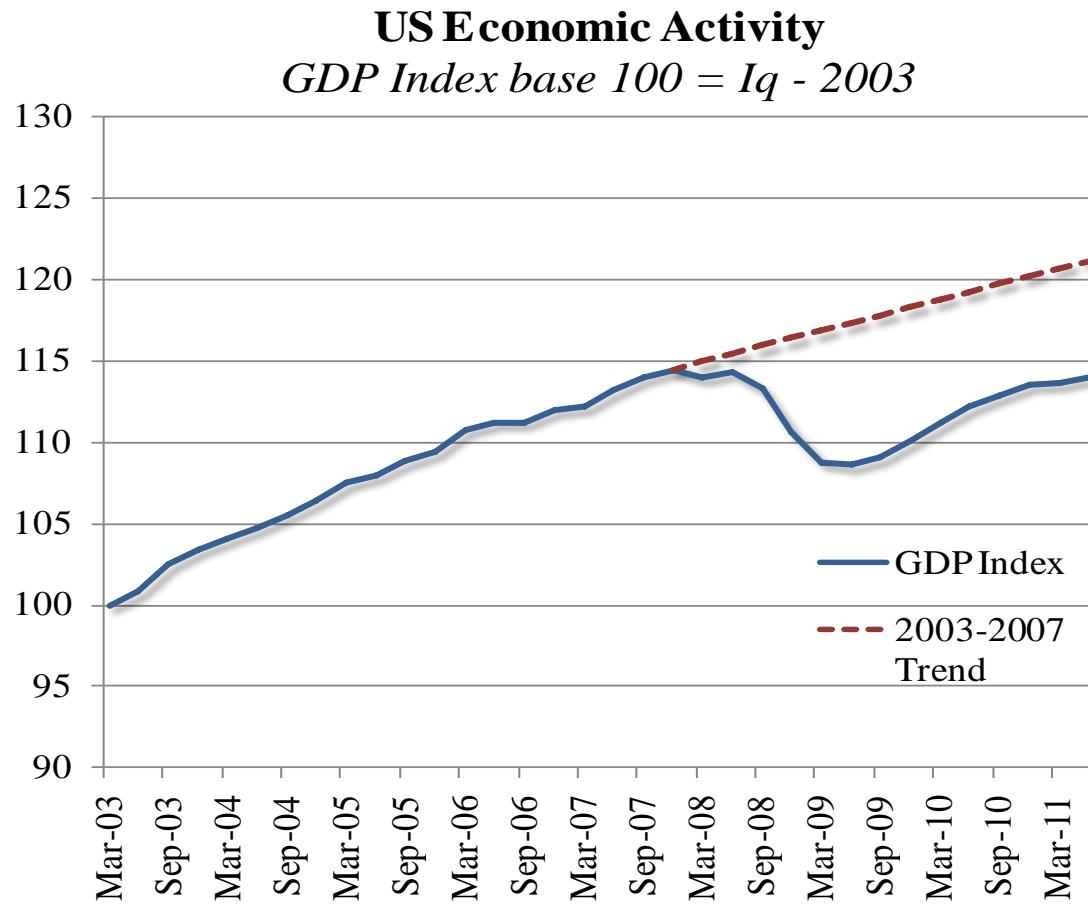


Global Sovereign CDS
Dec-2007, in basis points



The U.S. Epicenter

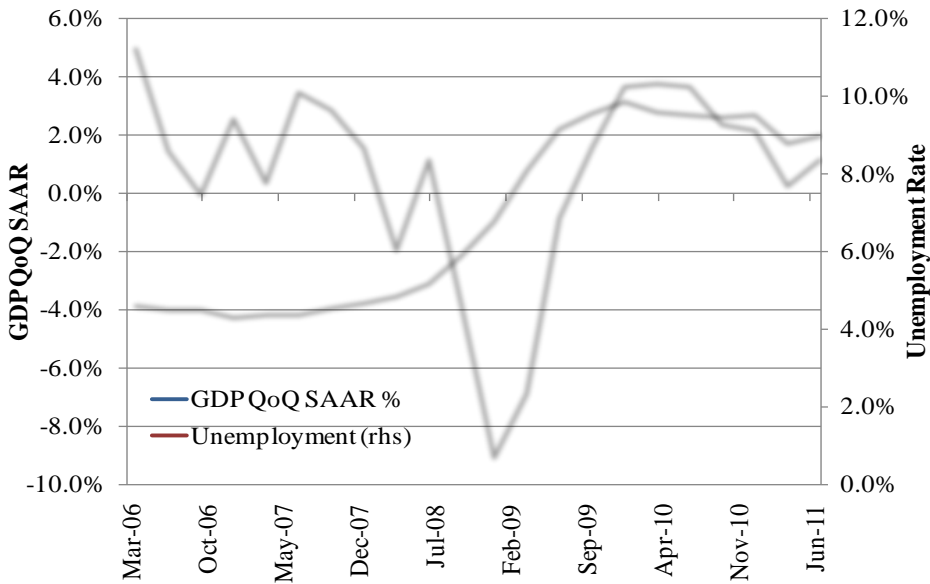
Still well below potential and a risk of a double dip



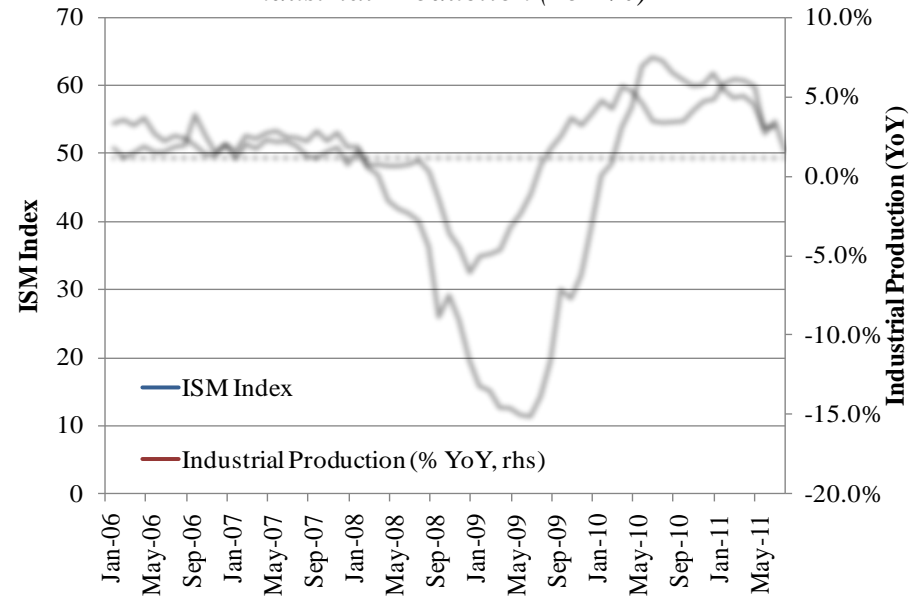
The U.S. Epicenter

A threat of a double dip? Keynes or Fischer?

GDP and Unemployment in the US
GDP QpQ SAAR %, Unemployment as a % of



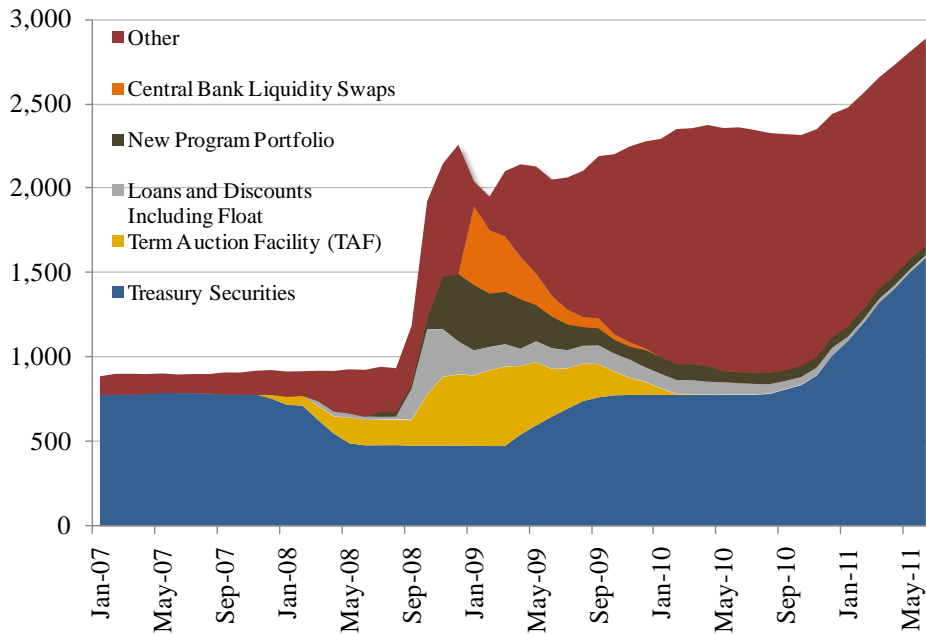
Industrial Production and ISM Index
Industrial Production (YoY %)



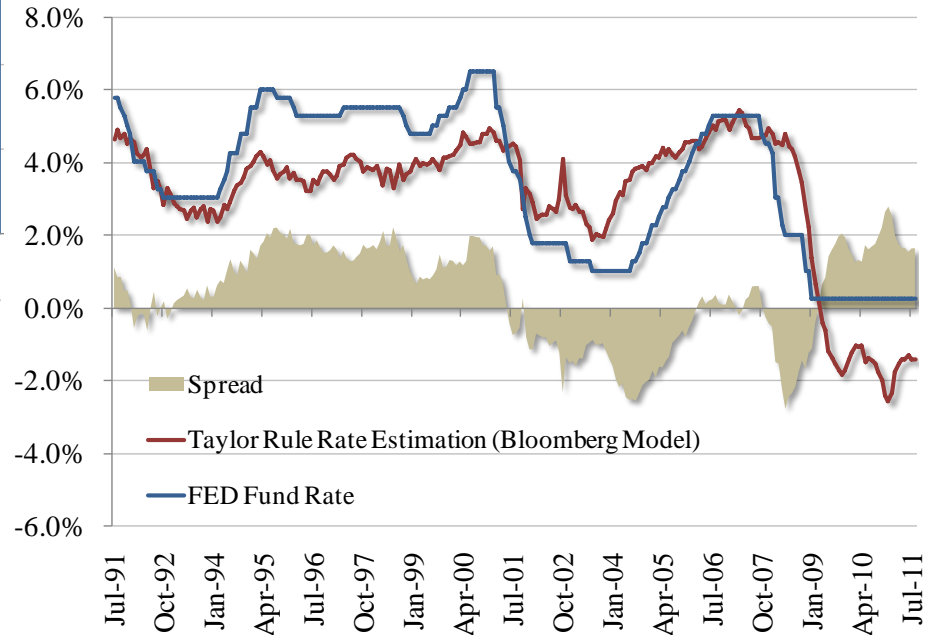
The U.S. Epicenter

Narrowing room for policy maneuvering

The FED Balance Sheet - Assets Side
Factors Affecting Reserve Balances, US\$ Billion



FED Funds Rate and Taylor Rule Estimation

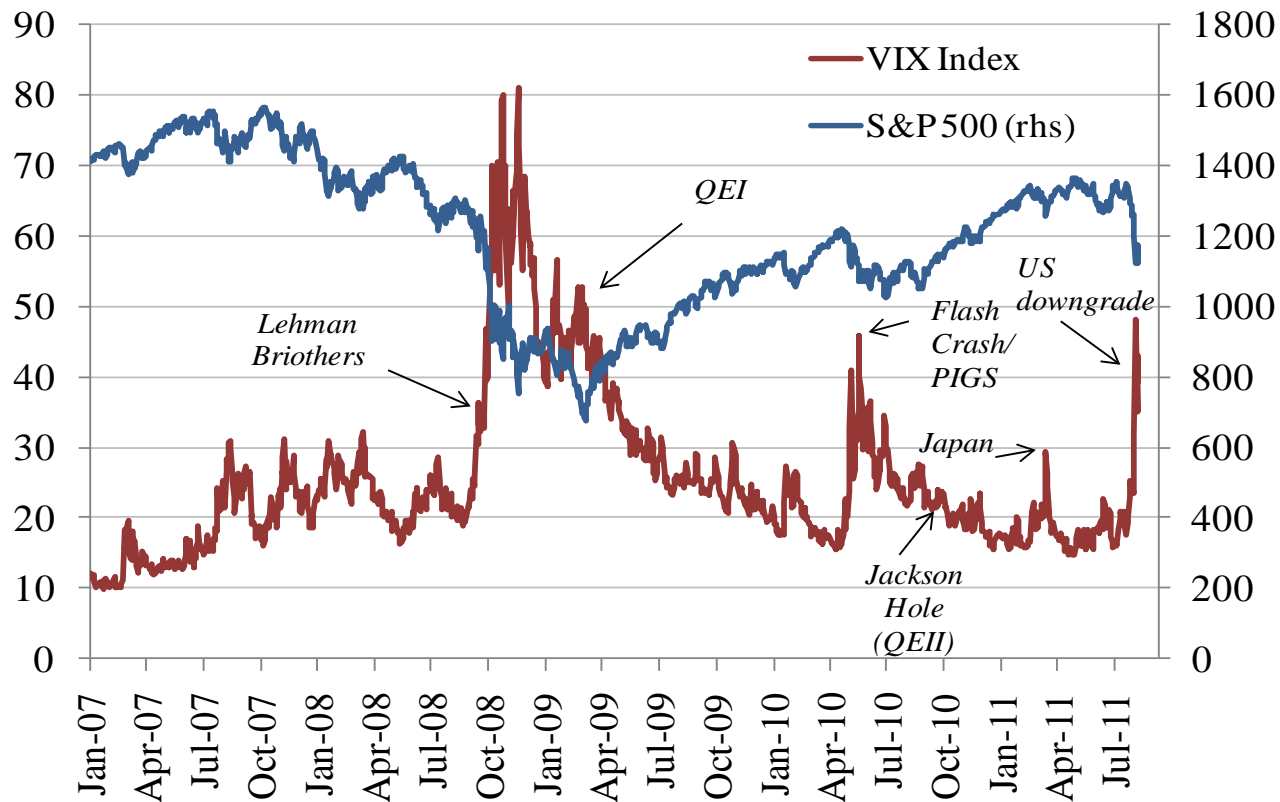


The U.S. Epicenter

The downgrade and the swing in market sentiment

Market Trends and Volatility

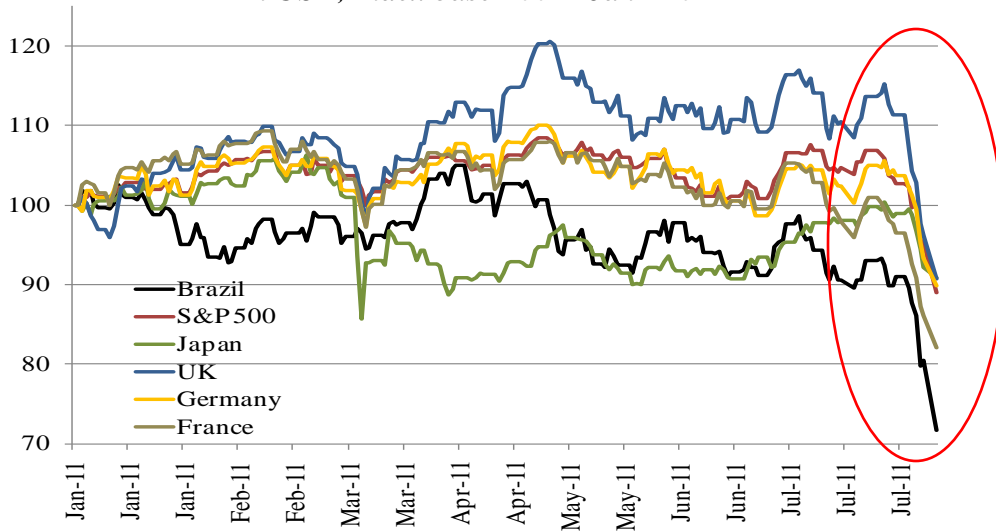
VIX Index and S&P 500



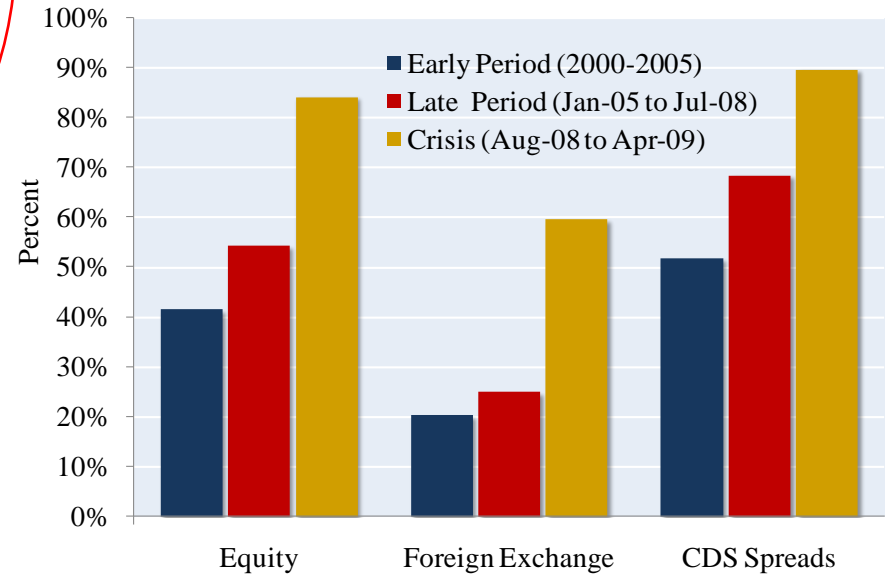
The U.S. Epicenter

The downgrade and global financial coupling

Stock Markets: 2011
In USD, Index base 100 = Jan - 2011



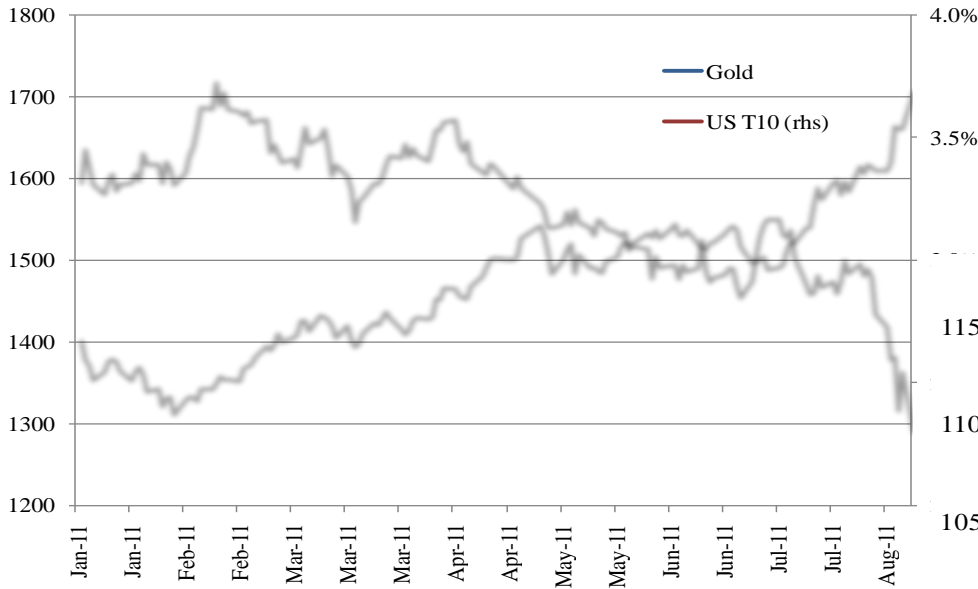
Emerging Market Asset Returns and Common Factors
Average R-Squared from Country Regressions



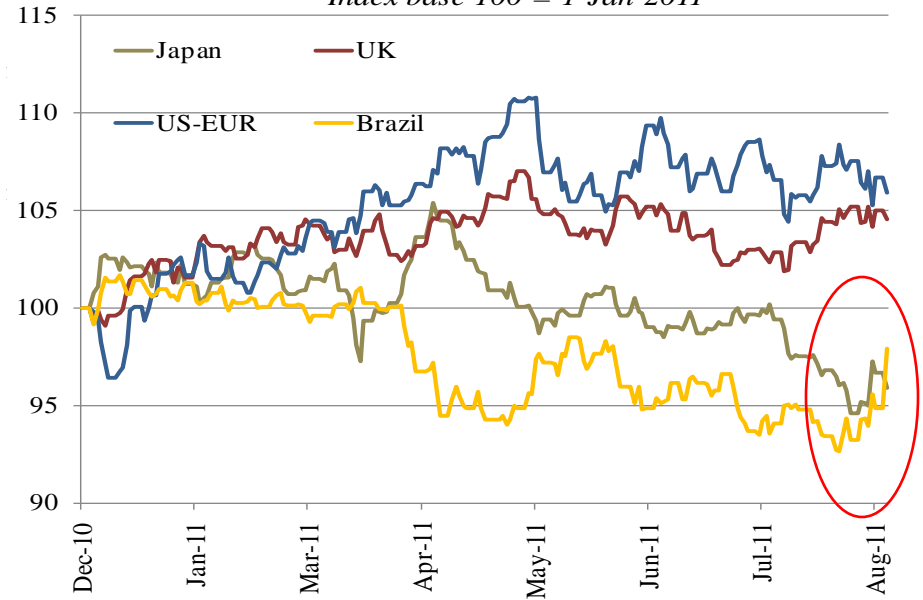
The U.S. Epicenter

Downgraded but still the safe haven

Gold and US T10
2011



Currencies: 2011
Index base 100 = 1-Jan-2011



Whither LAC?

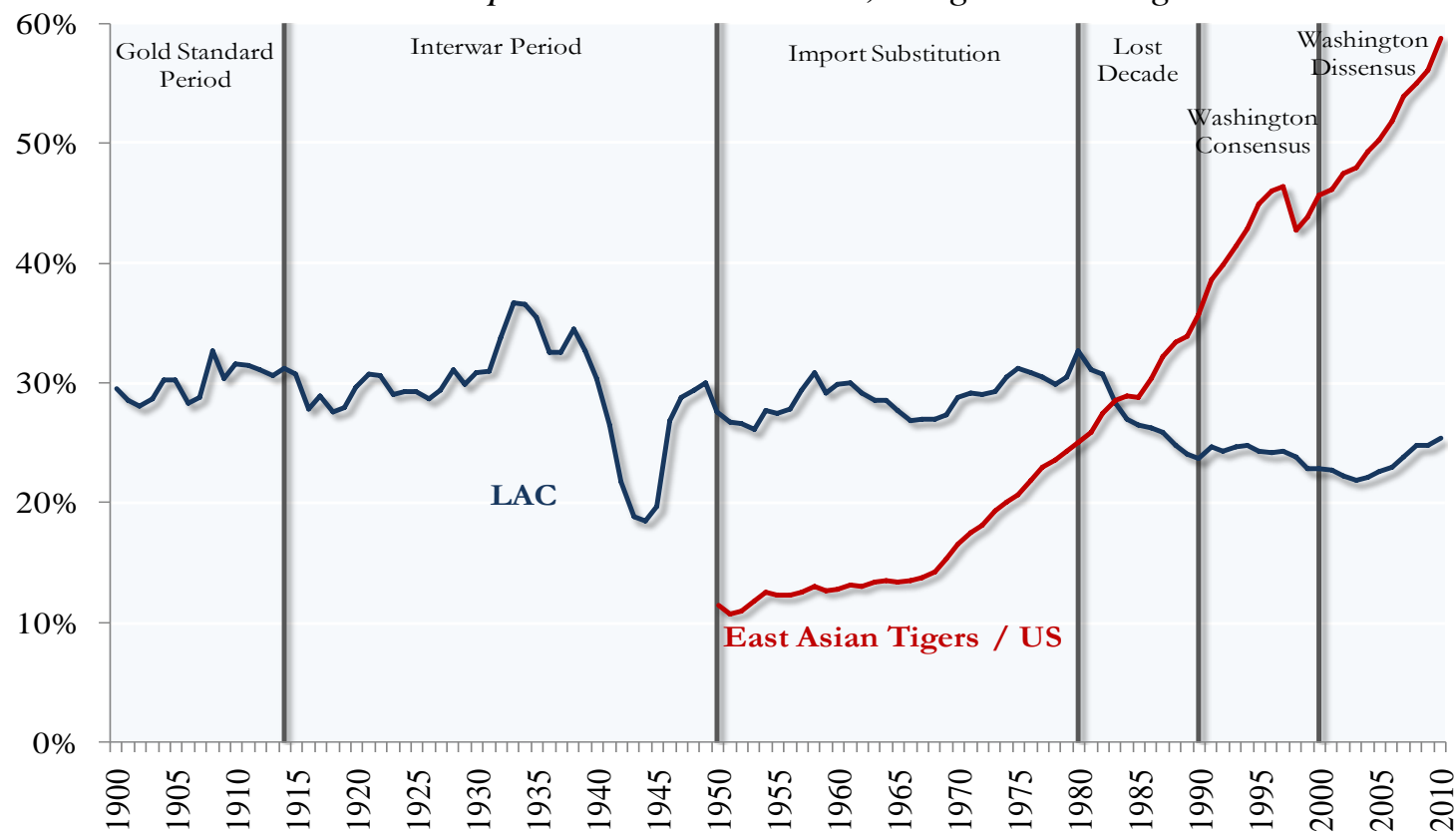
Benign scenario: real decoupling continues

Can LAC turn cyclical recovery into higher trend growth?

- Successful management of the cycle is essential to break free from the historical boom-bust pattern
- LAC bumps against *structural speed limits* at low growth rates
 - Productive capacity in LAC lacks the efficiency and flexibility to accommodate robust long-run growth rates
- Could the region avoid the natural resource curse...
 - The volatility trap
 - The enclave trap
 - The rent seeking trap
- ... and turn natural resources into a blessing?
 - It is all about saving (for stabilization and asset building), diversification, and institutions

LAC has experienced 100 years of growth solitude

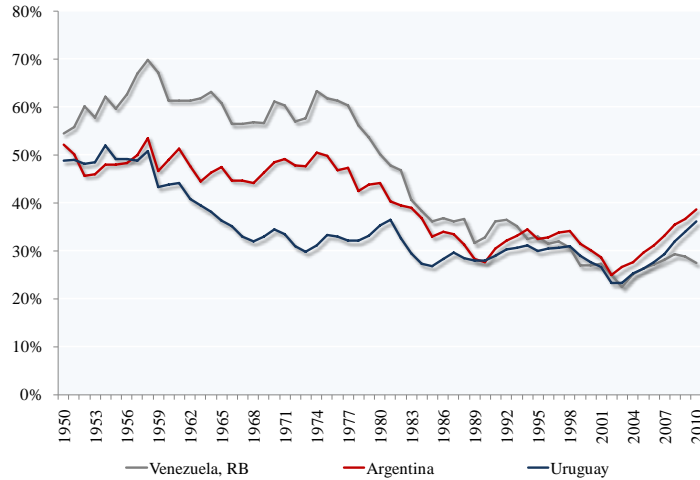
One Hundred Years of Solitude
GDP Per Capita Relative to the US, Weighted Averages



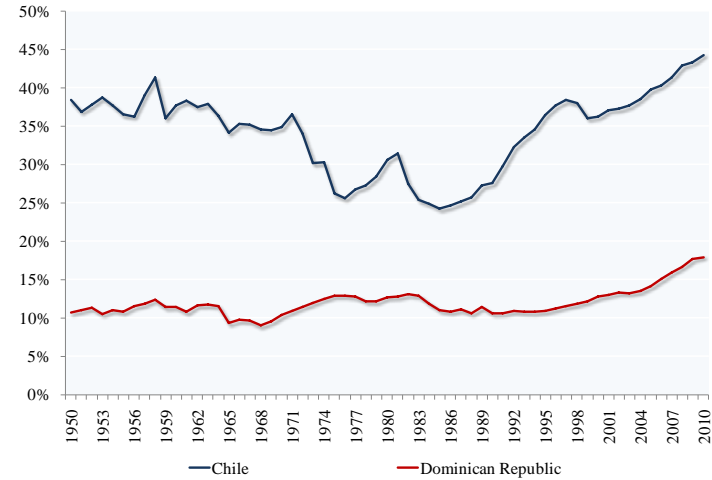
Note: The group of East Asian tigers includes Hong Kong (China), Indonesia, Malaysia, Republic of Korea, Singapore, Thailand, and Taiwan (China). Maddison (2007-2009) was used from 1900 to 2006. We used the Real Per Capita GDP growth from WDI to calculate the levels from 2006 to 2010. Source: LCRCE Staff calculations based on Maddison (2007, 2009) and WDI

Post-WWII growth in LAC, by country groups

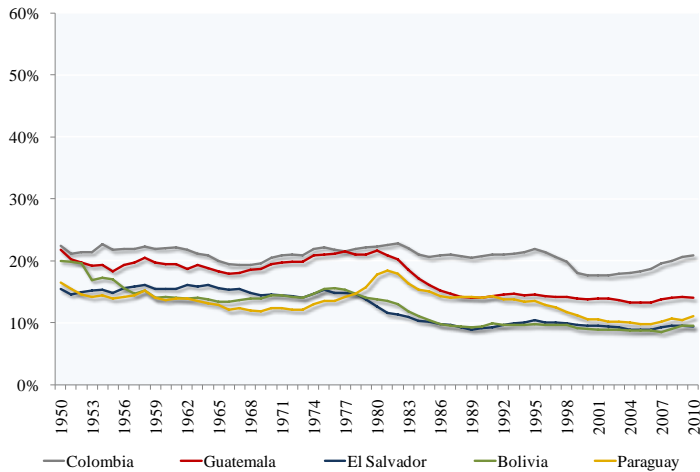
Diverging



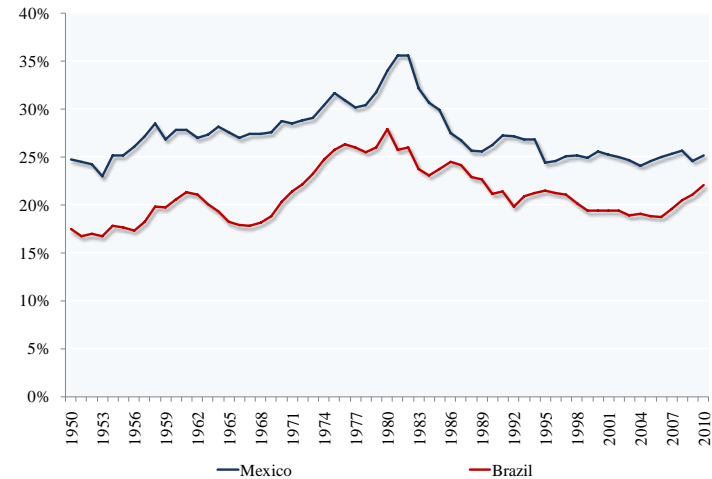
Semi-Converging



Non-Converging



Fluctuating



Note: Maddison (2007-2009) was used from 1900 to 2006. We used the Real Per Capita GDP growth from WDI to calculate the levels from 2006 to 2010. Source: LCRCE Staff calculations based on Maddison (2007, 2009) and WDI

Bad scenario: global downward re-coupling

How much can LAC's new "immune system" resist?

- Robust monetary policy frameworks in LAC, mostly
 - First line of defense in shock absorption: e-rate flexibility and countercyclical monetary policy (LAC has earned it!)
- How good are LAC's fiscal buffers?
 - Comfortable public debt levels but now is the time for more fiscal savings
- How good are LAC's financial system buffers?
 - Strong capital and liquidity positions
 - ... but have systemic risks been brewing in the past year or so?
- How good are LAC's social safety nets?
 - Ability to scale up social assistance programs varies widely in the region
 - Social insurance frameworks are the weak link

Thank you

... constrained by insufficiently redistributive fiscal

