Recovering from the Global Crisis: Can LAC Shift to a High Growth Path?

Panama: It's Happening Now

Panama City, 24 March 2010

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

World Bank
Latin America and the Caribbean Region

Structure of presentation

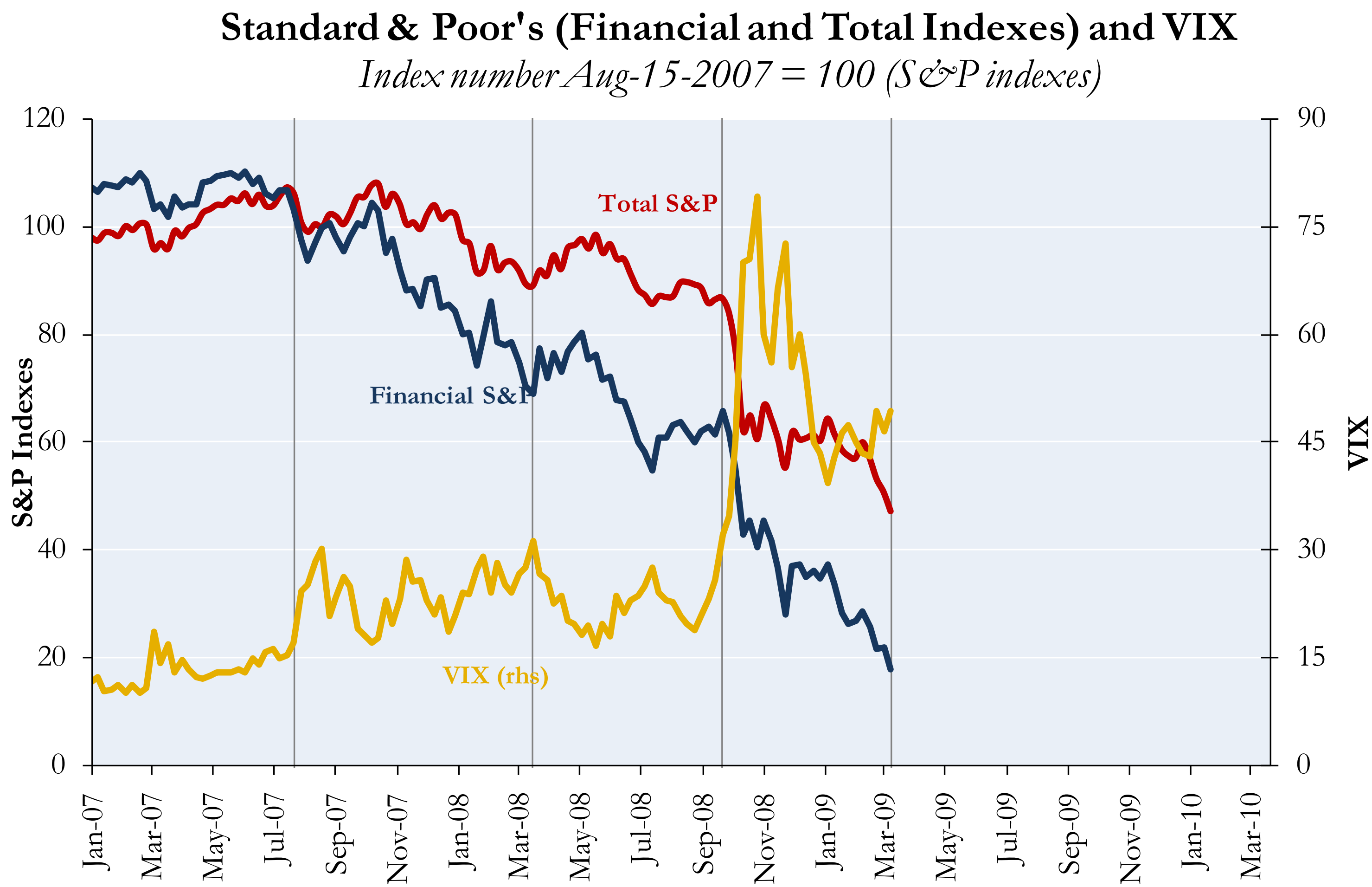
- The worse is behind …

- LAC after the global crisis
  - Bruised but without systemic damage
  - Well positioned for recovery

- What next?
  - Global reconfiguration towards multi-polarity – a rocky road
  - Whither LAC?
    - Short-run tensions
    - Long-run

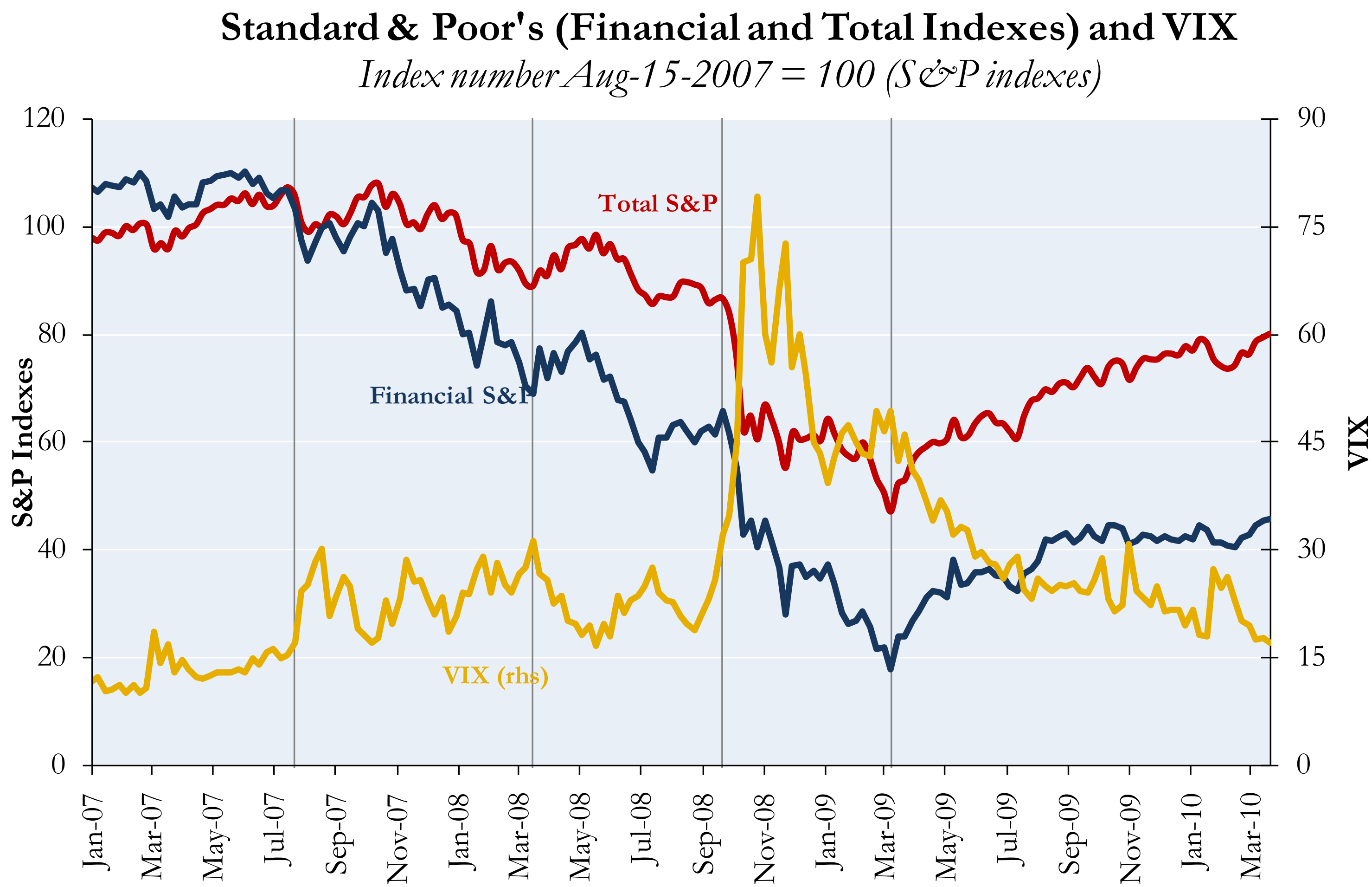
The Worse is Behind

The catastrophic scenario that was feared at the beginning of 2009…



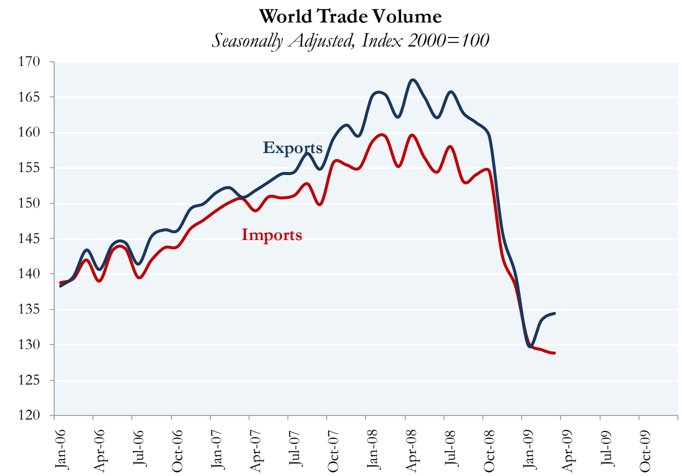
Source: Bloomberg.

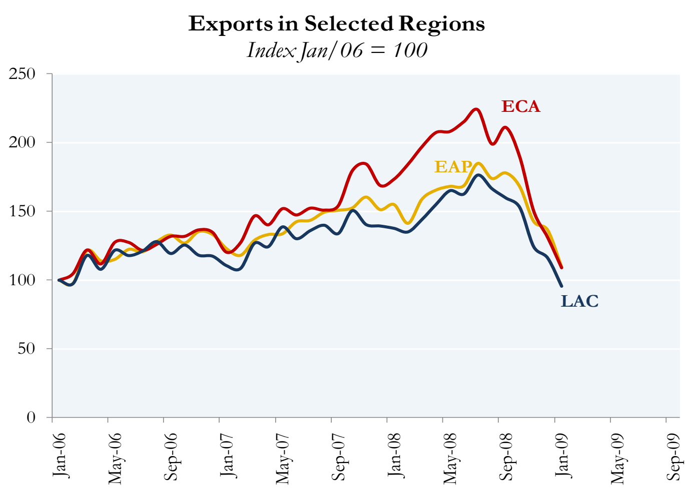
…was averted, and things started turning around in the rich countries around March 2009 …

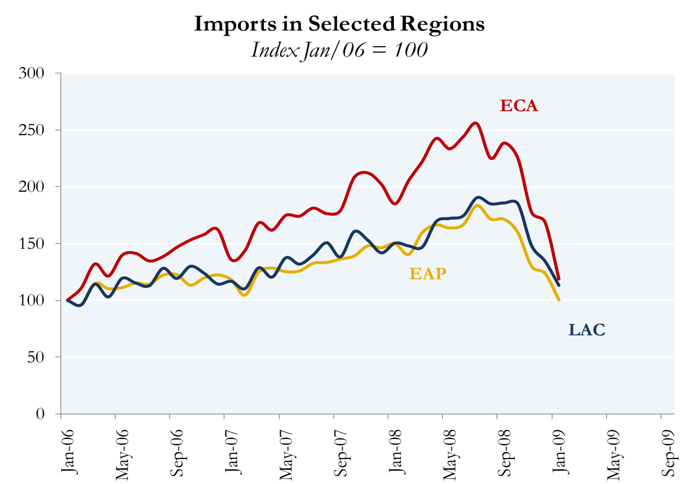


Source: Bloomberg

For LAC, 2009 started with very grim prospects: World demand had taken a nose dive…

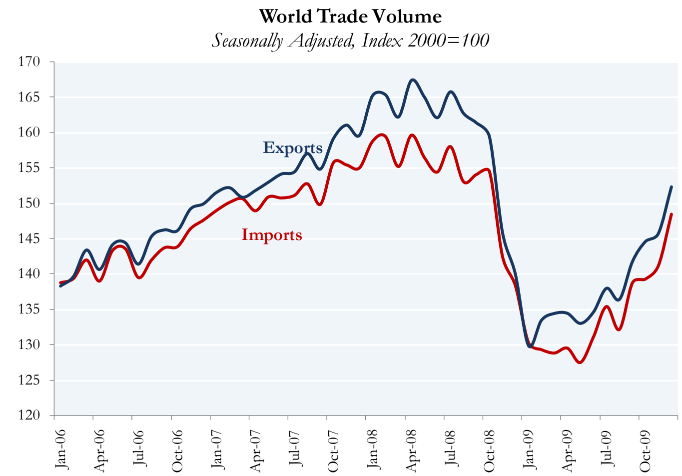


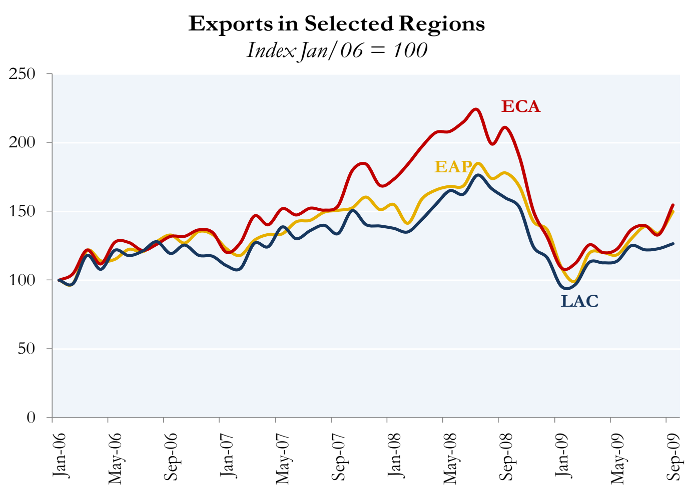


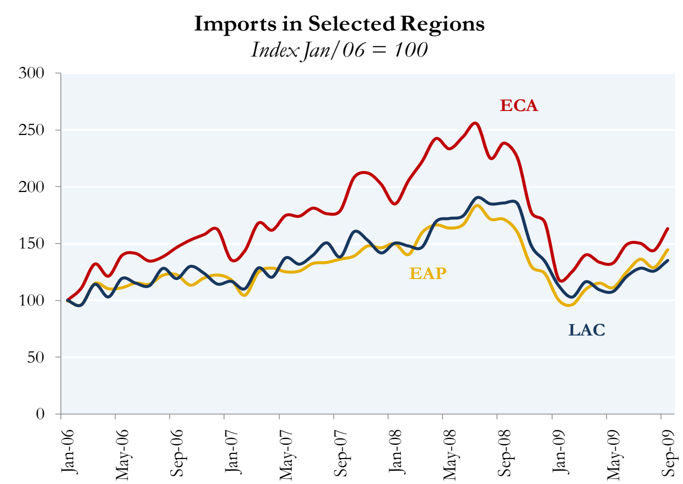


Source: CPB for world trade, and IFS for exports and imports.

…before entering into a modest rebound…

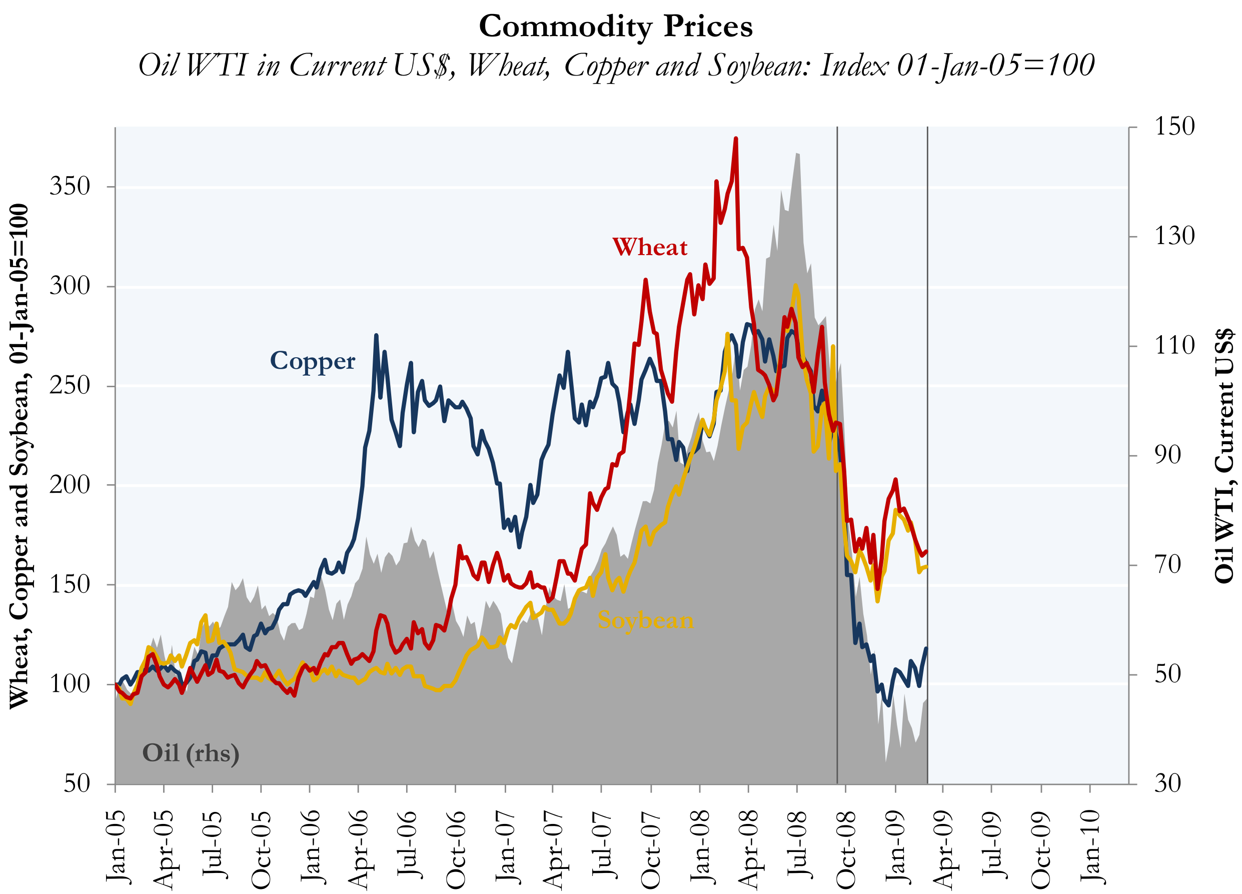






Source: CPB for world trade, and IFS for exports and imports.

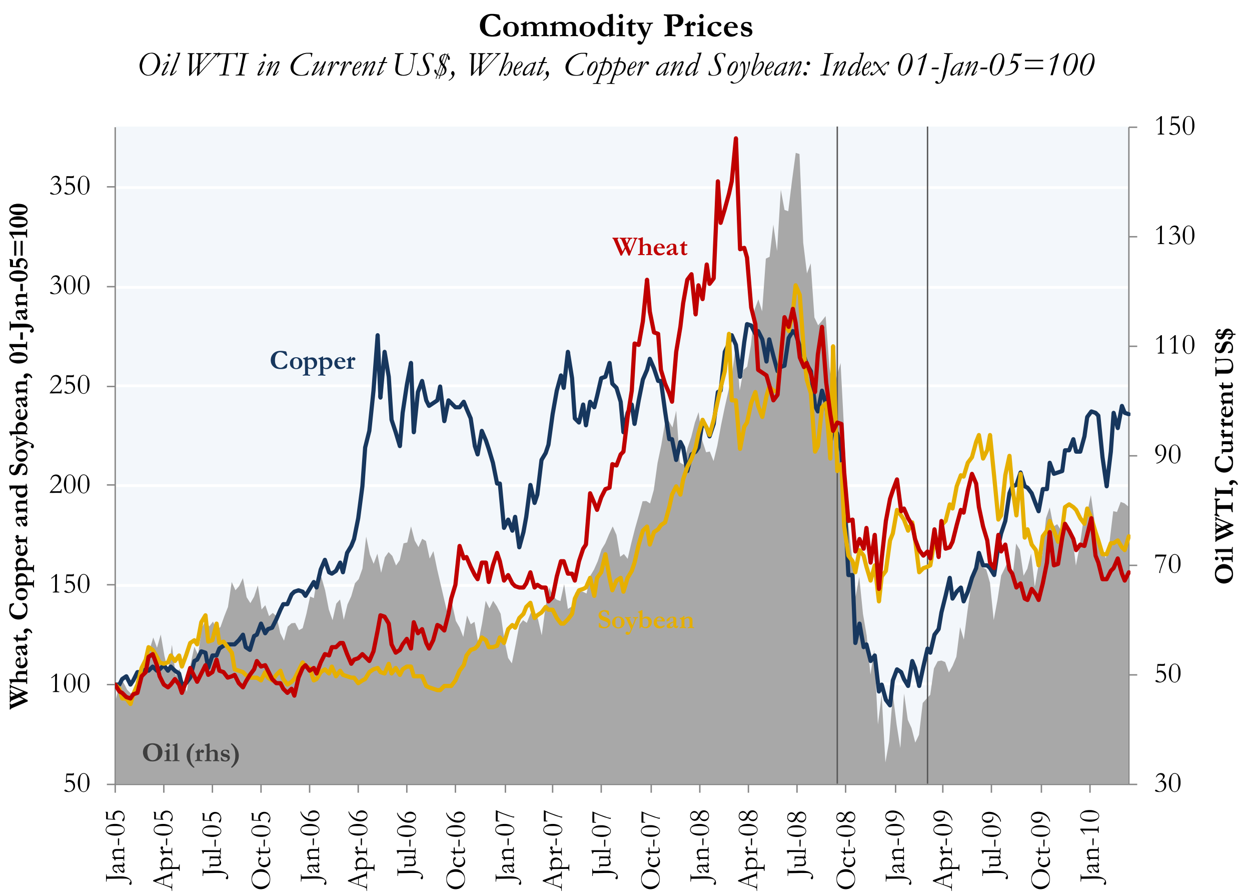
…commodity prices had collapsed…



- *About 95% of LAC's GDP and 90% 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*

Source: Bloomberg

… before staging a strong rebound…



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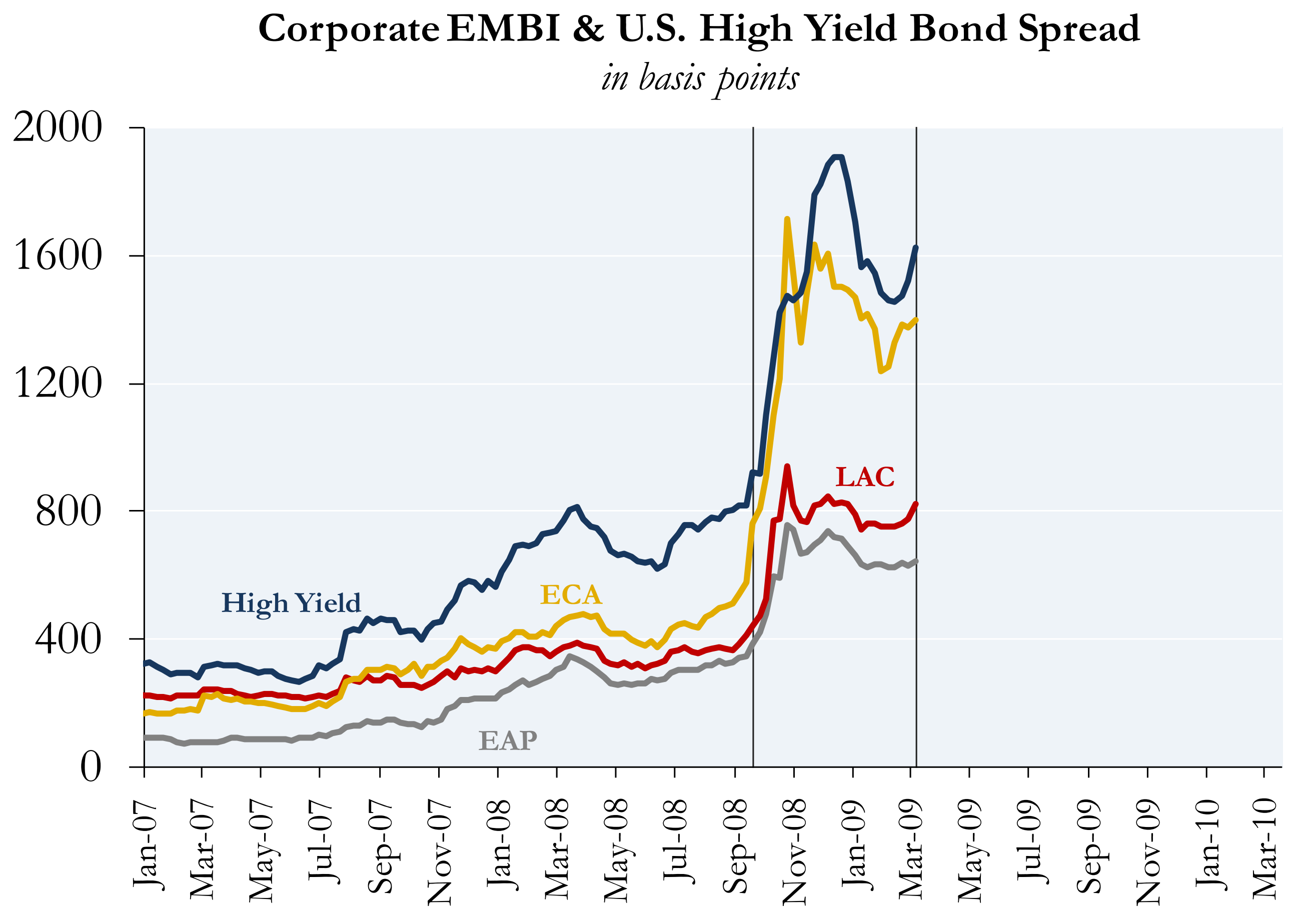
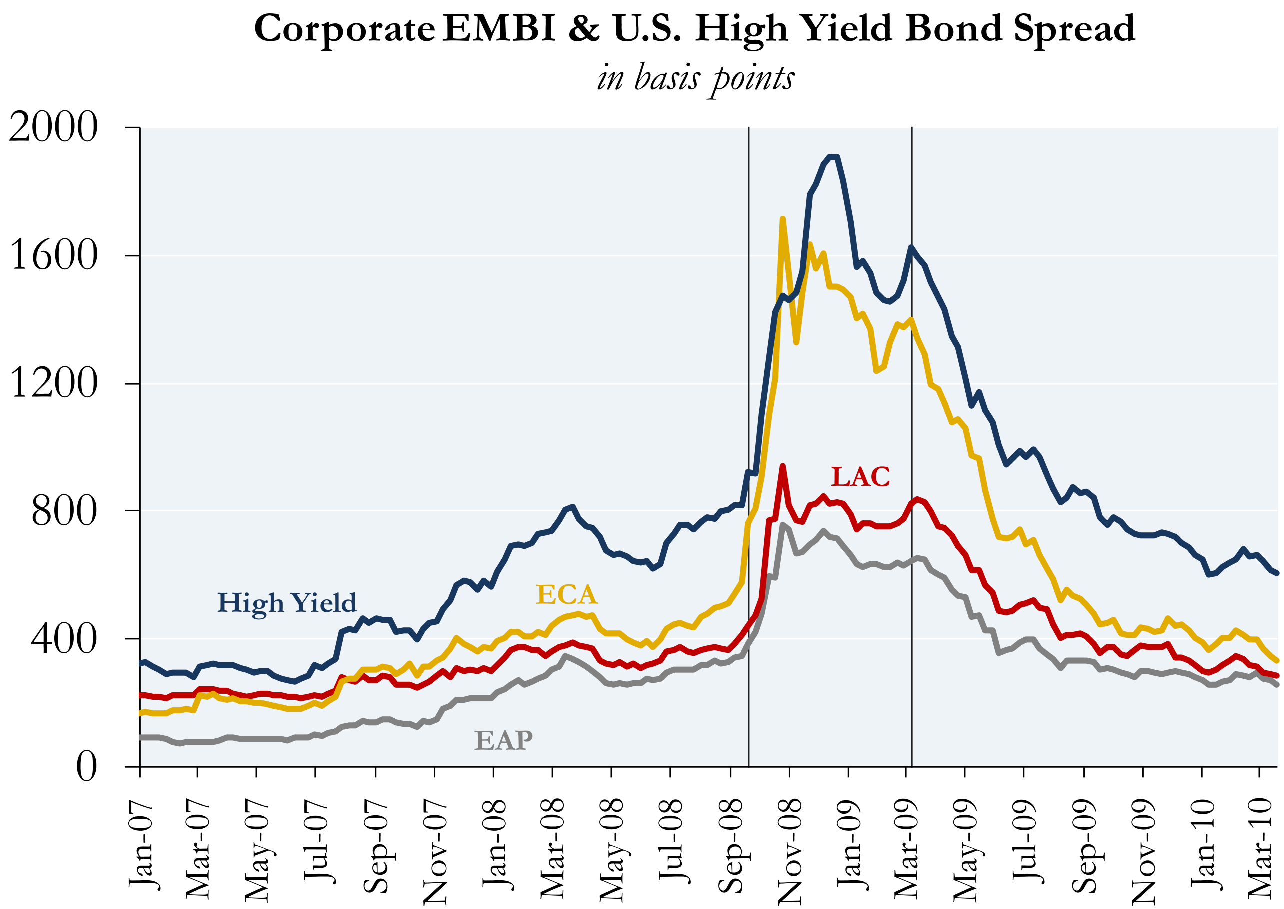
Source: Bloomberg

Access to international financial markets halted…



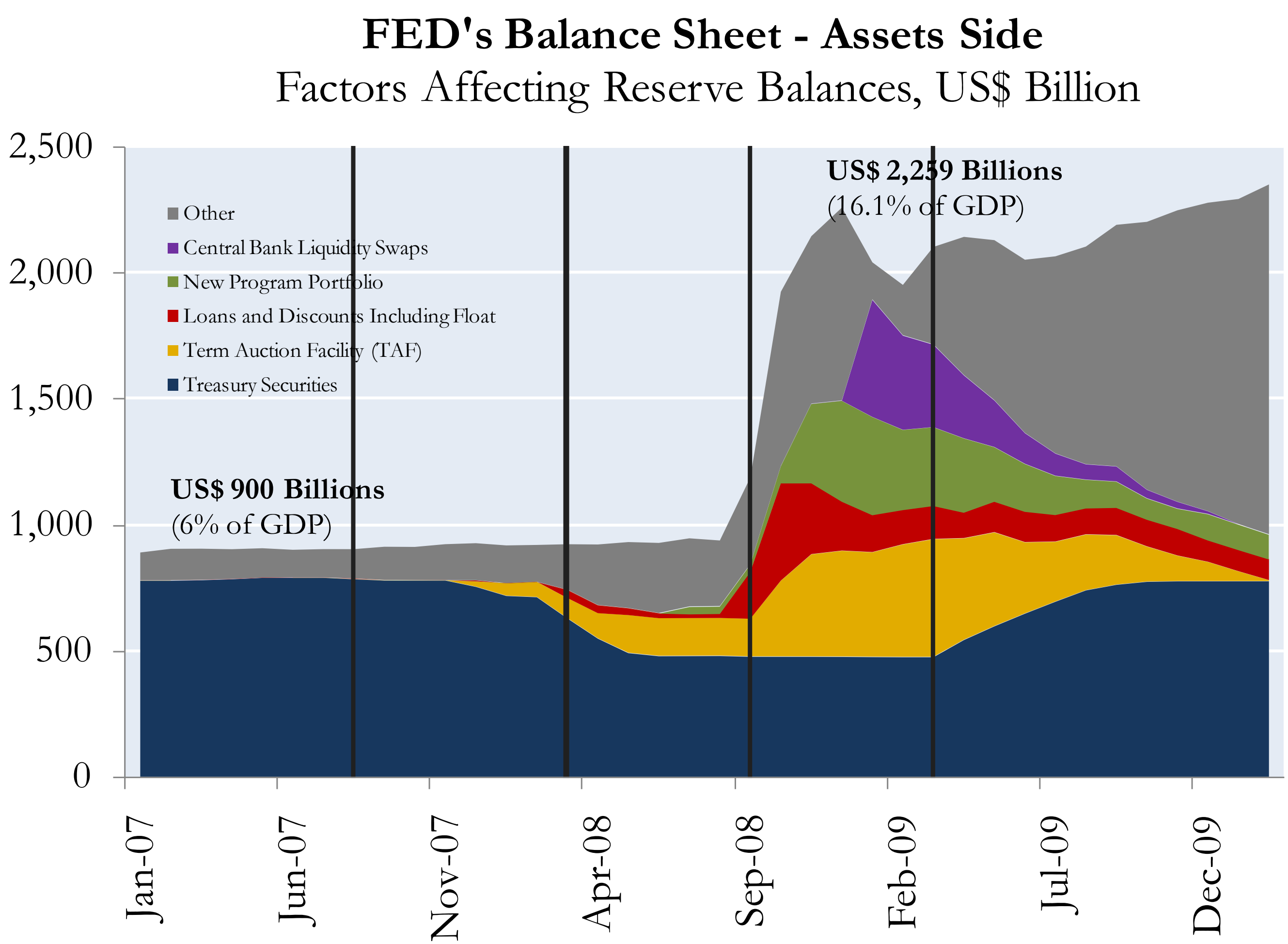
Source: Bloomberg

… but then entered a normalization path

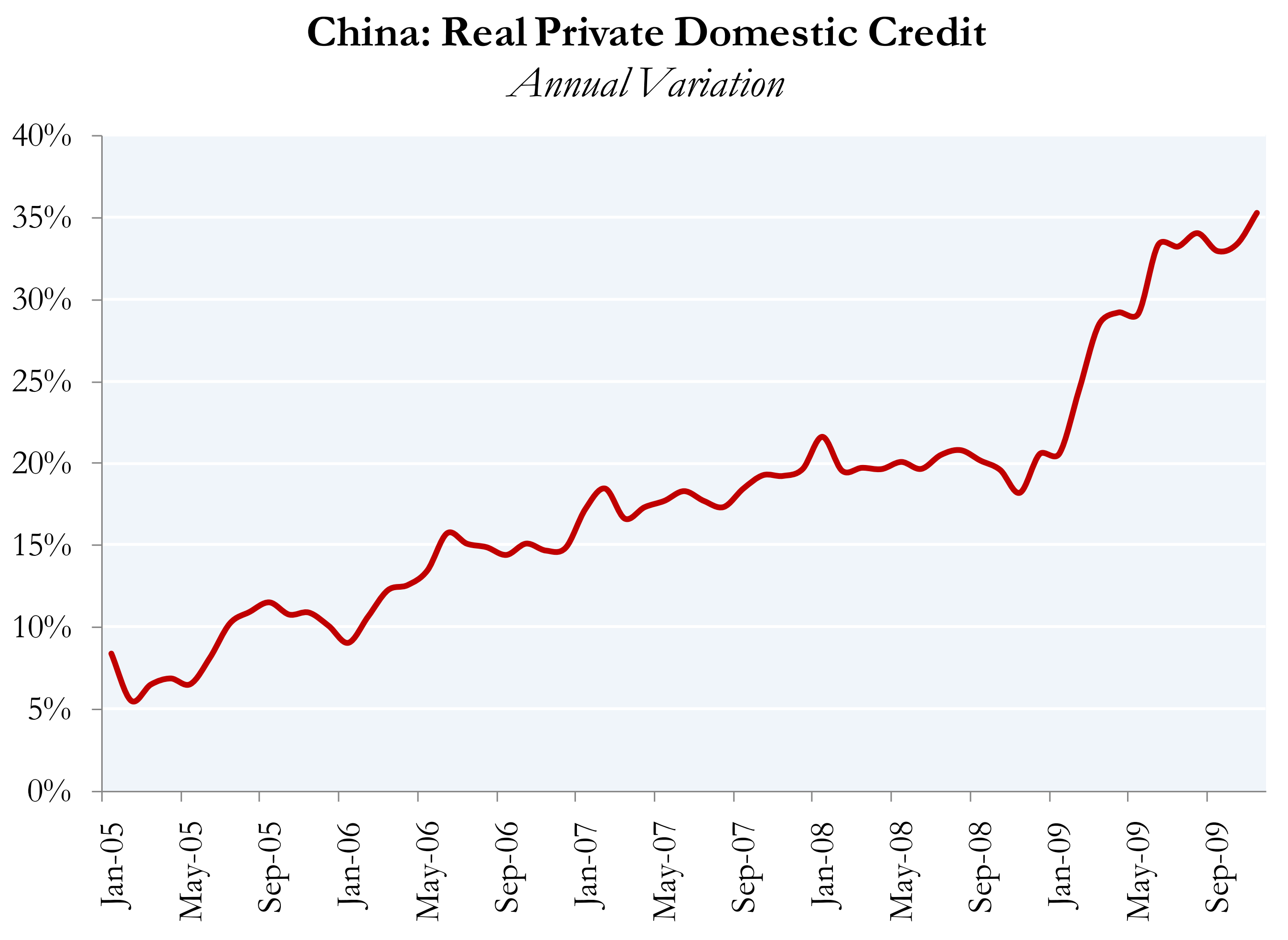


Source: Bloomberg

Disaster was averted thanks to unprecedented risk absorption and stimulus policies, led by the U.S. Fed …



And aggressive investment-focused stimulus in China

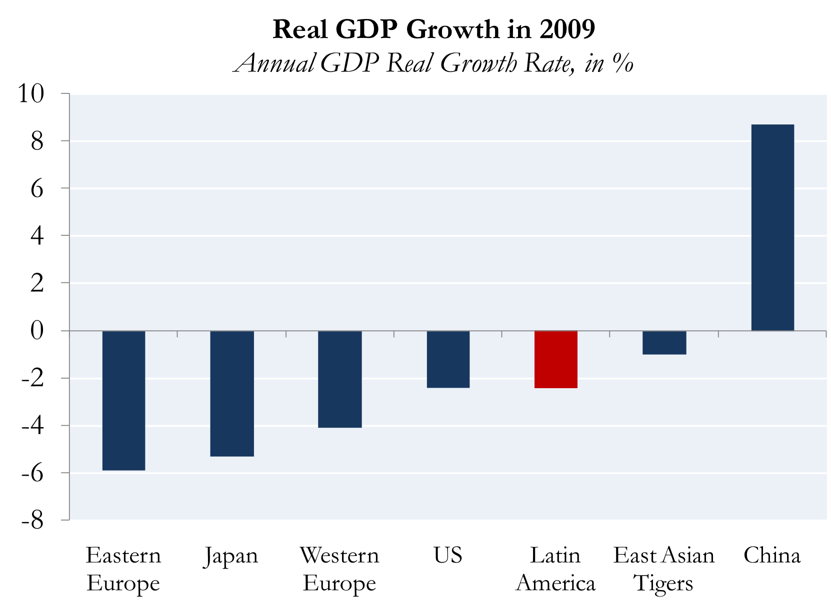


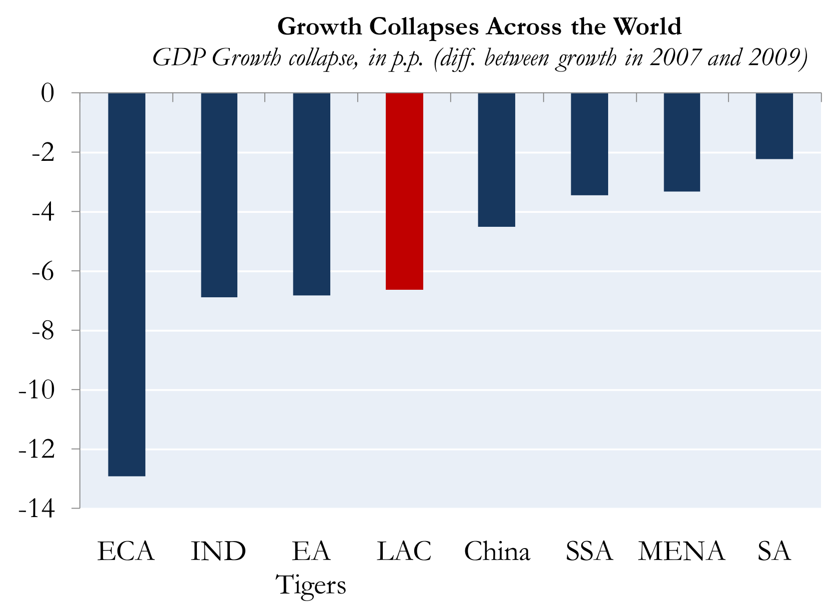
Source: IFS

How did LAC fare in 2009?

Bruised but without systemic damage

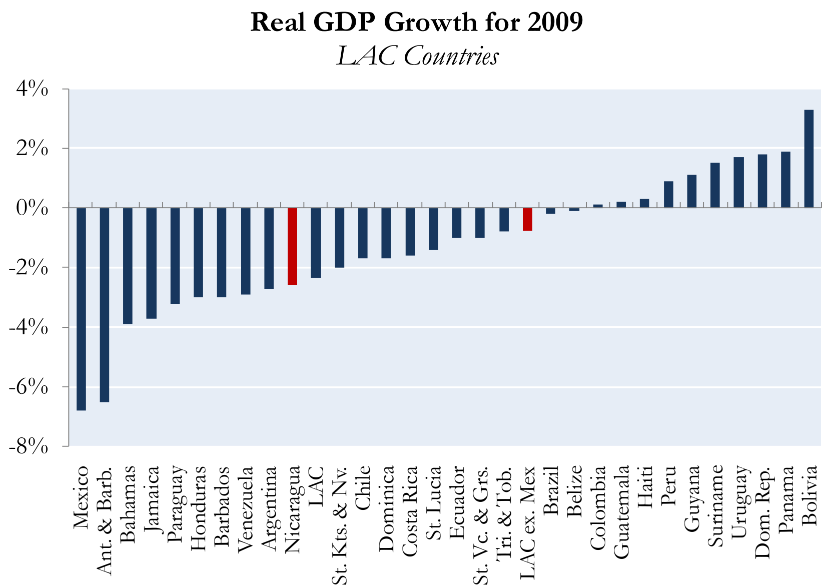
LAC's recession in 2009 was less pronounced than in other areas of the world

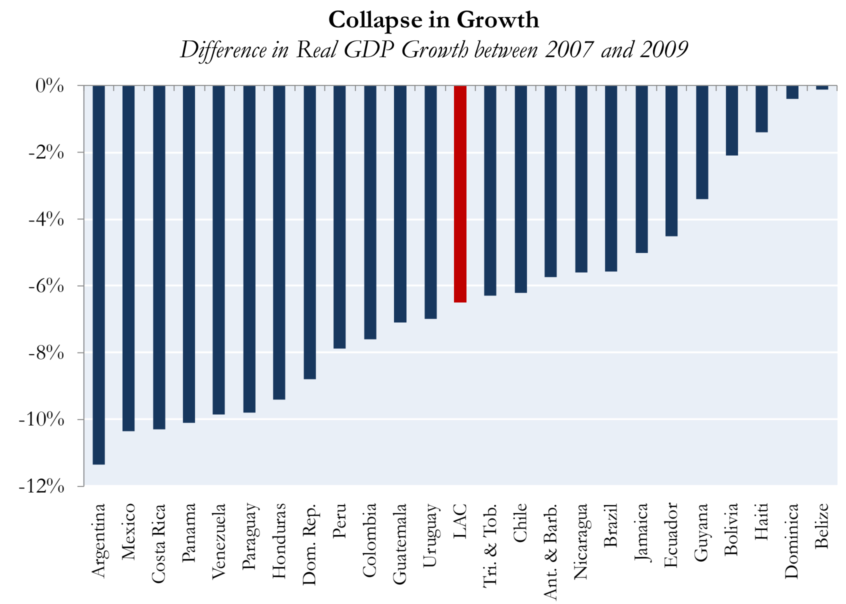




Source: Bloomberg. We used Consensus Forecast as of Dec. 2009 for the countries that didn't published the 2009 growth yet (the latest 2009 forecast for Consensus).

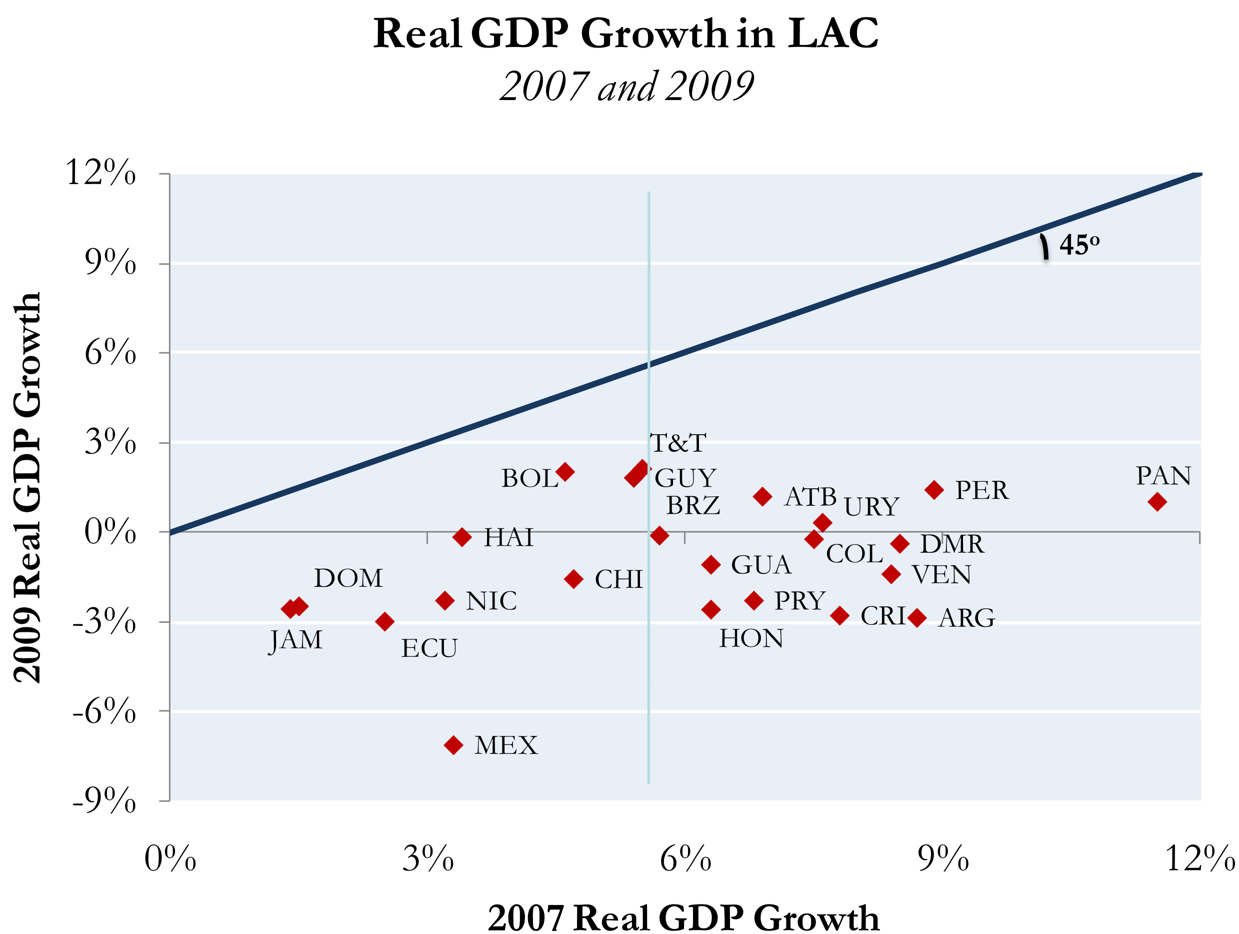
The size of the economic recession and the collapse in growth varied significantly across Latin American countries





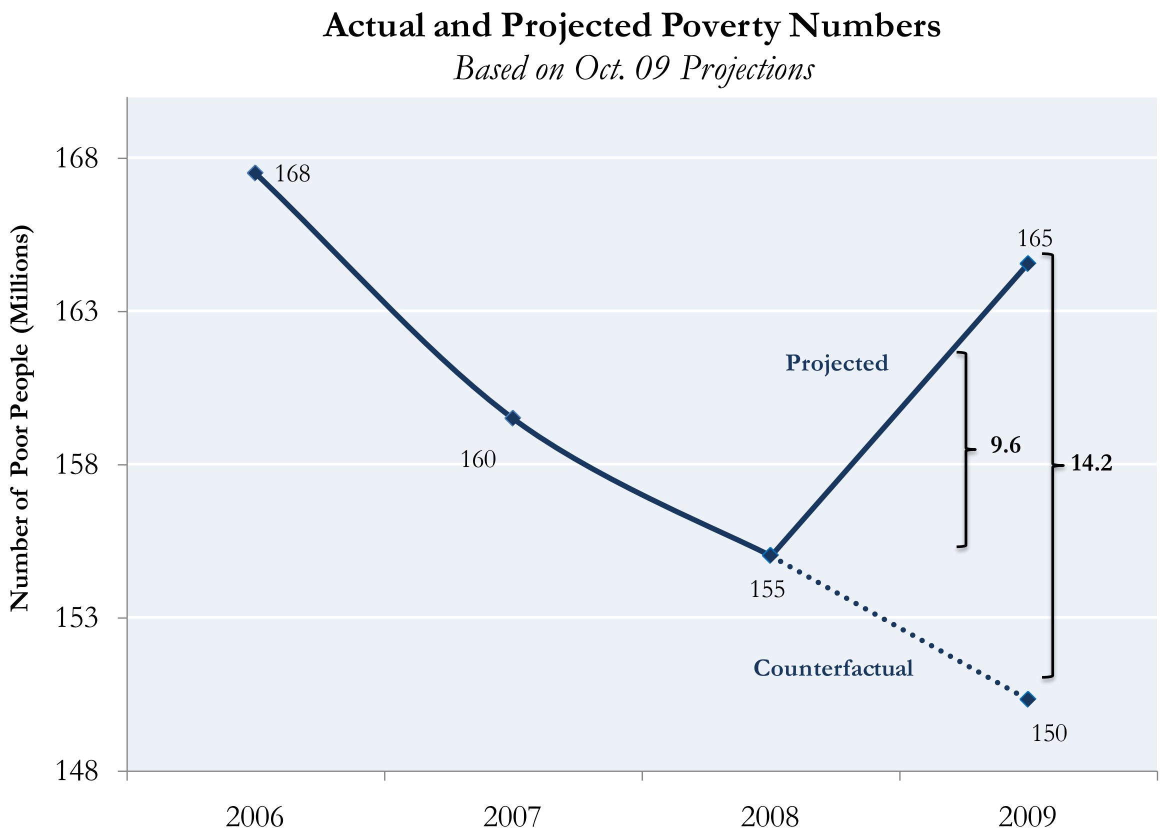
Source: Bloomberg. We used Consensus Forecast as of Dec. 2009 for the countries that didn't published the 2009 growth yet (the latest 2009 forecast for Consensus).

For many LAC countries, the collapse in growth was from relatively high rates



Source: Consensus Forecasts (Dec. 2009) , Bloomberg, and IMF Regional Economic Outlook for Oct 2009.

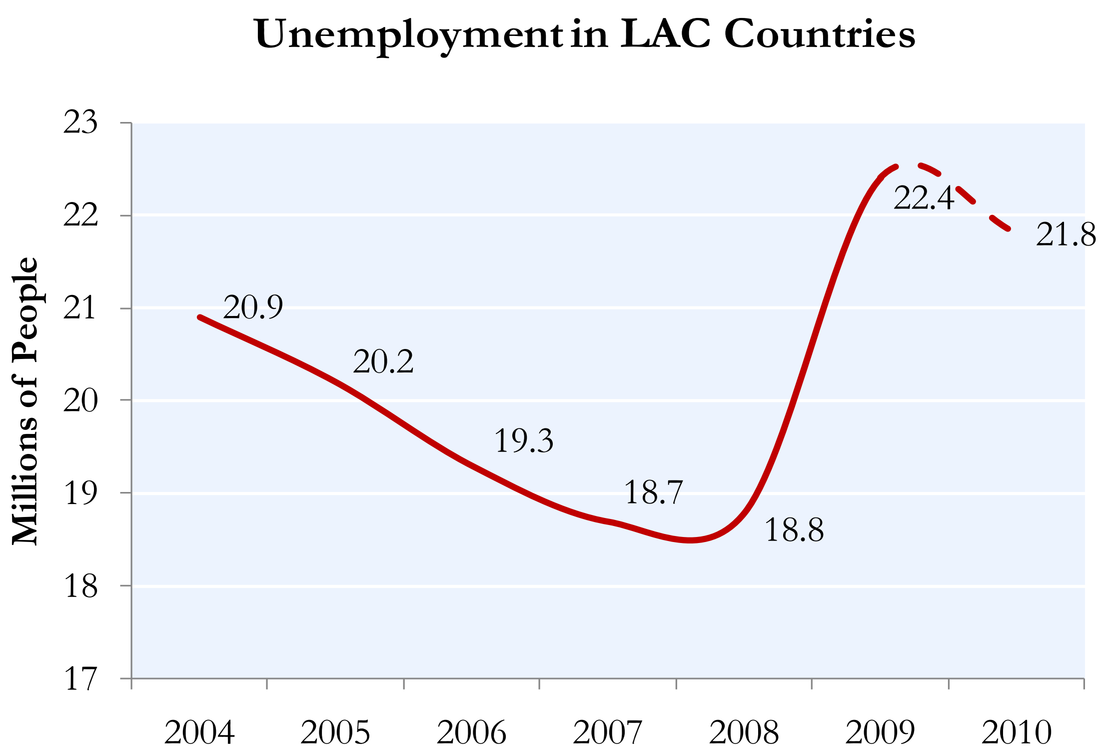
LAC’s 2009 recession added about 10 million to the poor, partly reversing the achievements of pre-crisis years, …



Between 2002 and 2008, almost 60 million people in LAC moved out of poverty

Poverty for LAC is measured at PPP-adjusted US$4 a day. Source: Based on Azevedo, Molina, Rubiano, and Saavedra (2009).

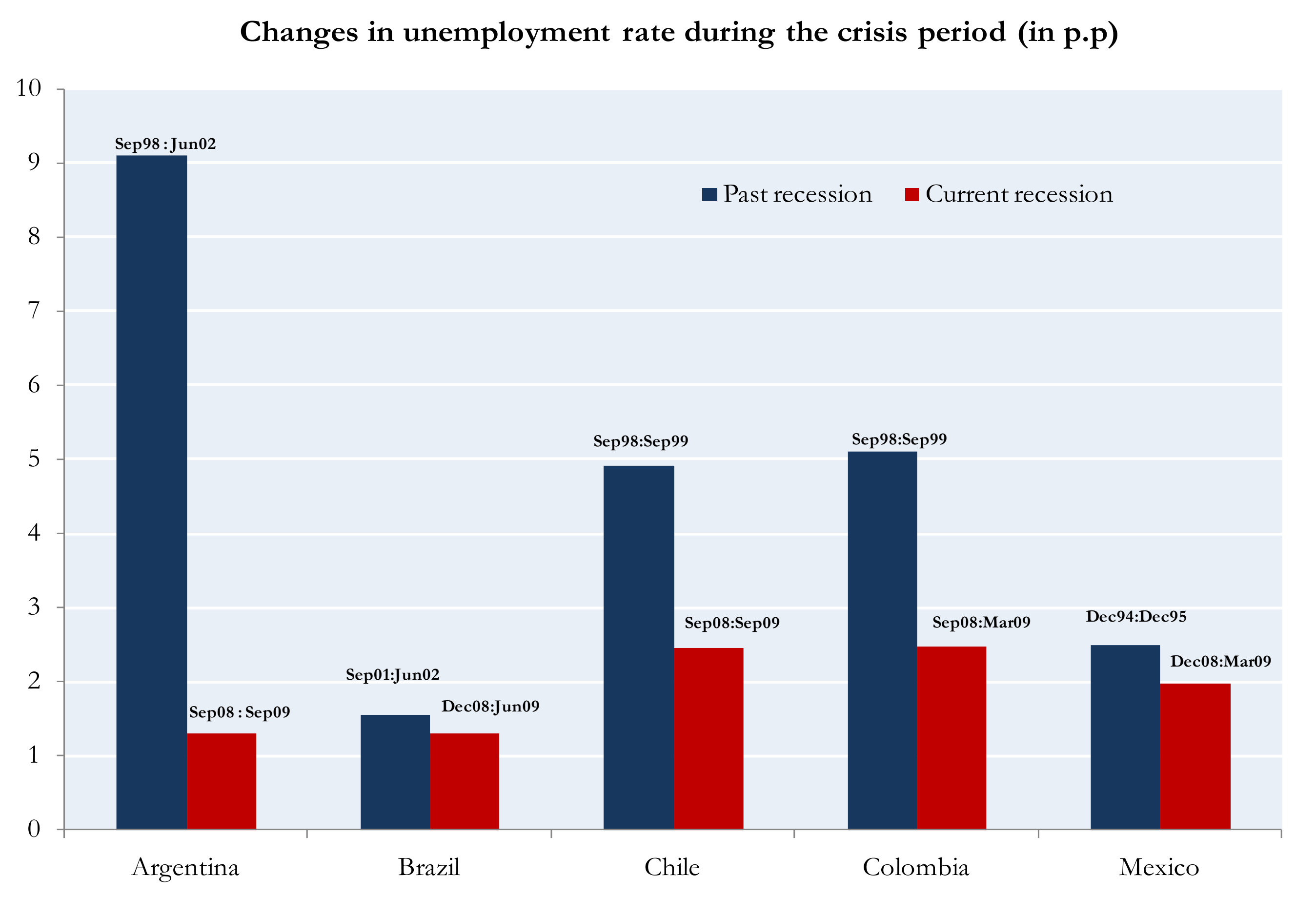
… and it added 3.5 million to the ranks of the unemployed



- *Colombia, Chile, Mexico were hardest hit*
- *Unemployment increased more among men than women*
- *Unemployment tended to concentrate in workers with secondary education and in manufacturing and construction sectors*

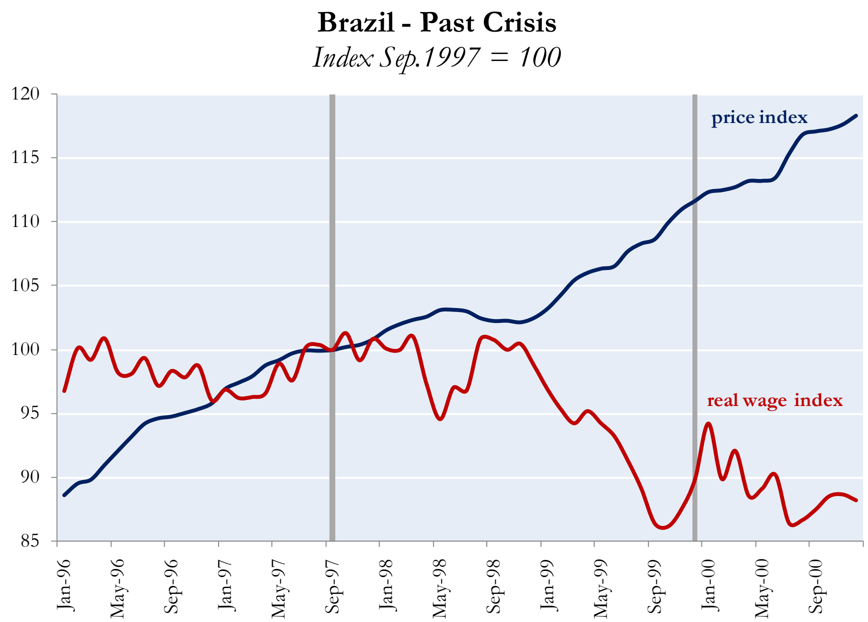
Source: ILO

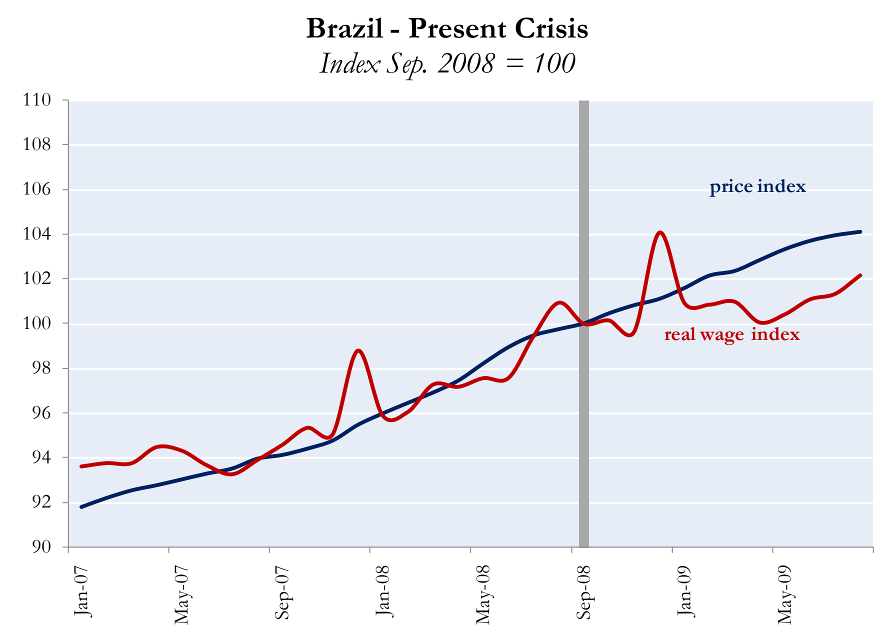
Yet, the impact of the crisis on LAC employment was modest overall, relative to past crises



Source: ILO

Brazil:
Real wage adjustment no longer via inflation





Note: median wages in the industrial sector. Source: IPEA, IFS

LAC comes out of this crisis without significant systemic damage – the dog that did not bark

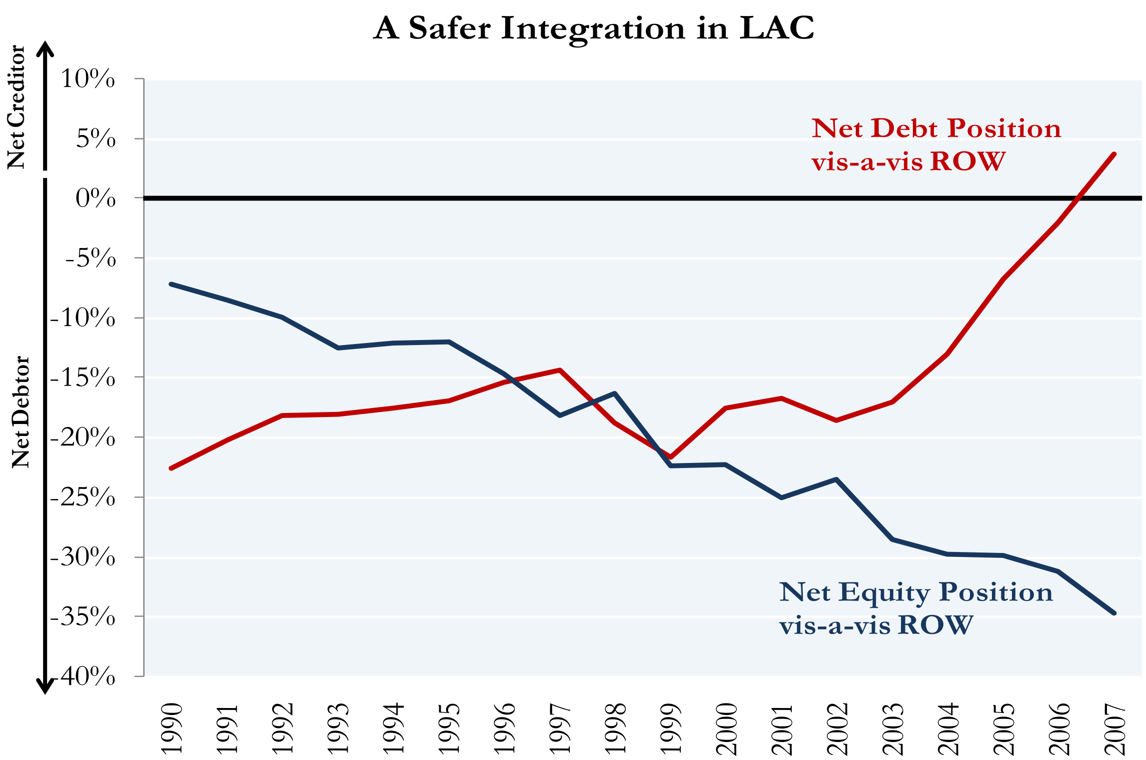
Banking Crises in LAC Countries

1980-1985		1995-2000		2008-2009
		Mexico	1995	No financial crises
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	

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

The table shows the start year of banking crises . Source: Laeven and Valencia (2008) and Reinhart and Rogoff (2008)

LAC's international financial integration has grown safer

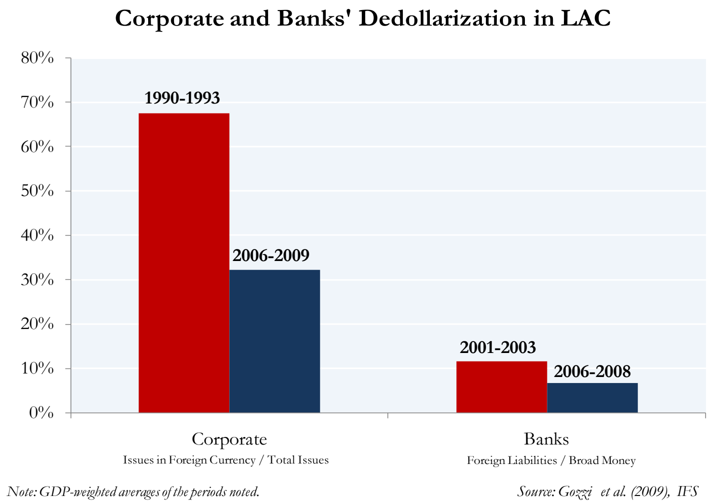


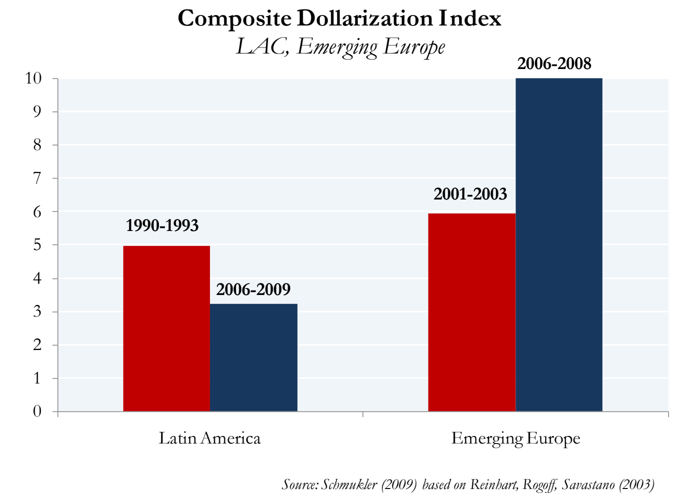
LAC has become a net creditor to the ROW in the debt side

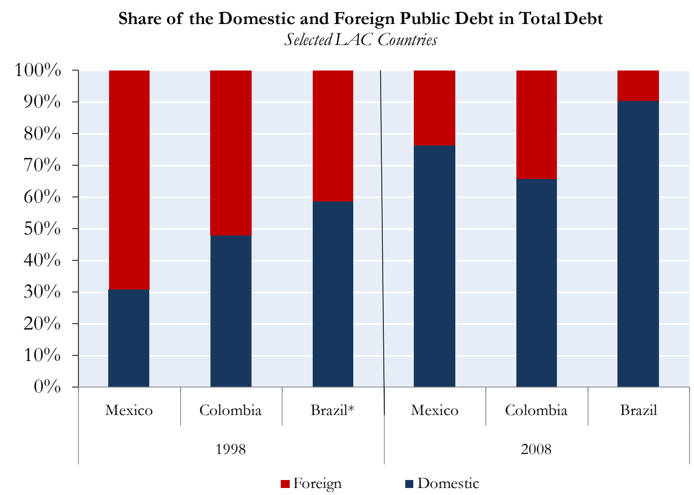
The ROW has become a net claimant on LAC in the equity side, where systemic vulnerabilities are less likely to emerge

Note: Net positions expressed as % of LAC's GDP. LAC: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay, Venezuela. Source: Lane, Milesi-Ferretti (2007)

Currency mismatches in LAC have declined significantly...



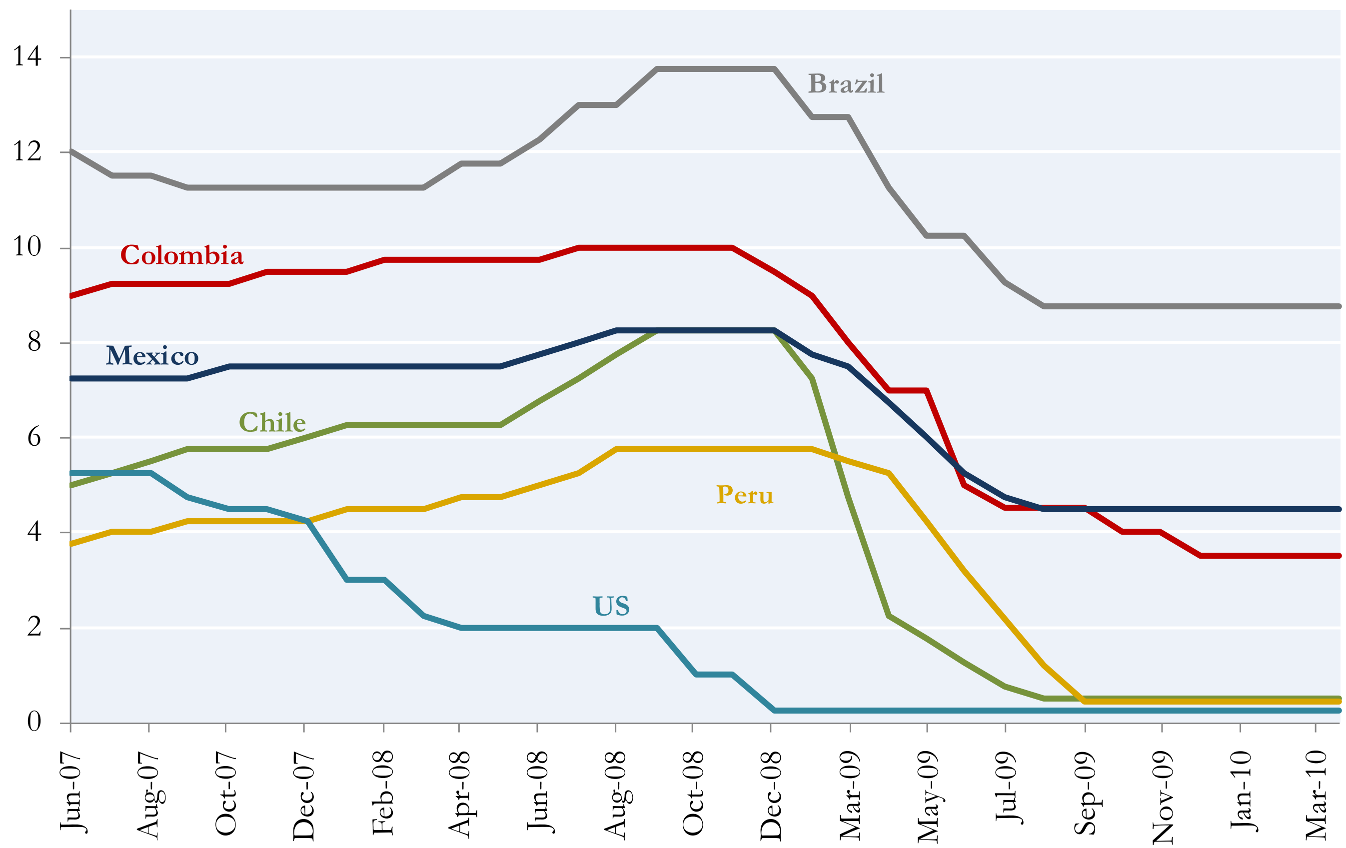




Improved monetary policy frameworks and reduced currency mismatches have enabled countercyclical policy

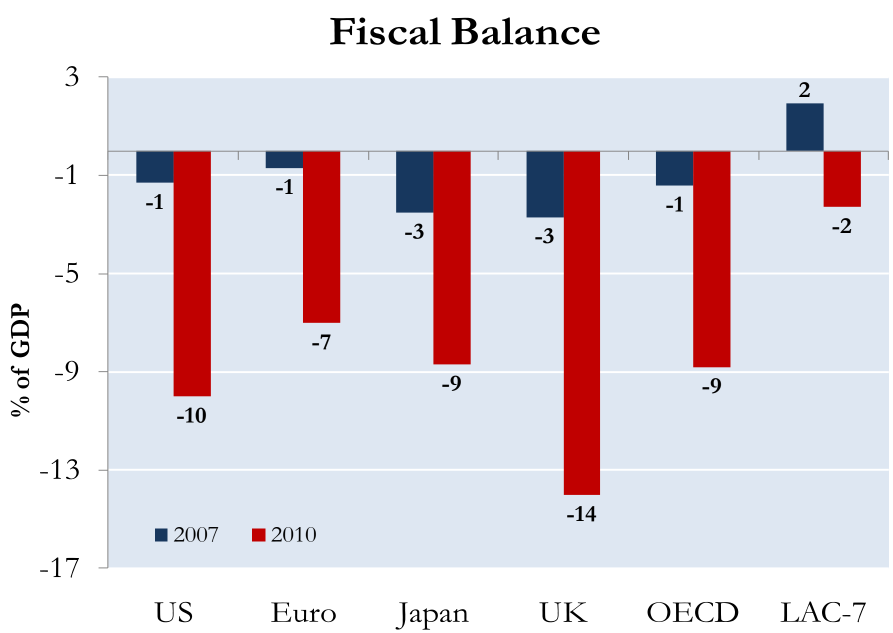
Monetary Policy Rates

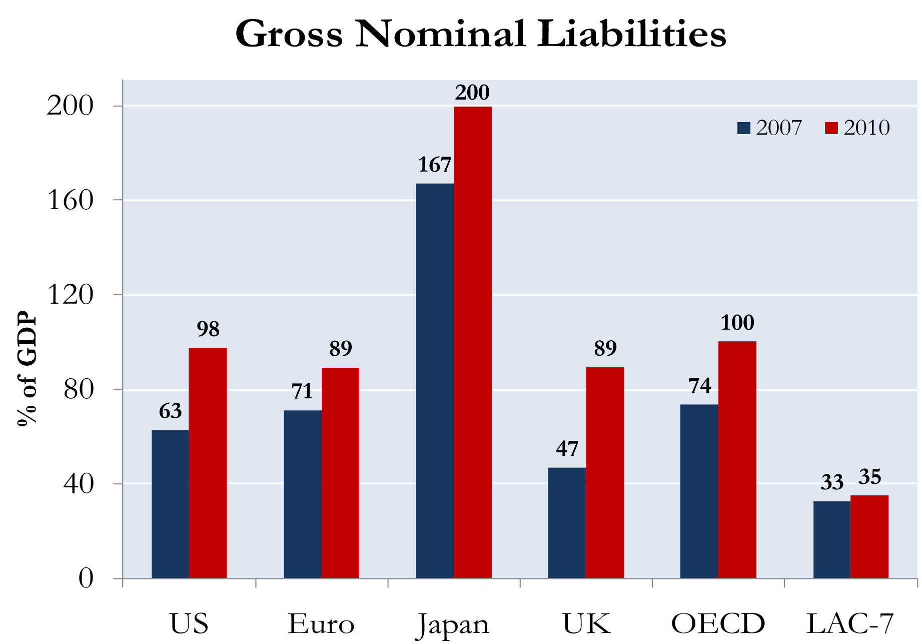
Inflation-Targeting Latin American Countries, in %



Source: Bloomberg

While far from perfect, fiscal and public debt processes in most of LAC have become more viable



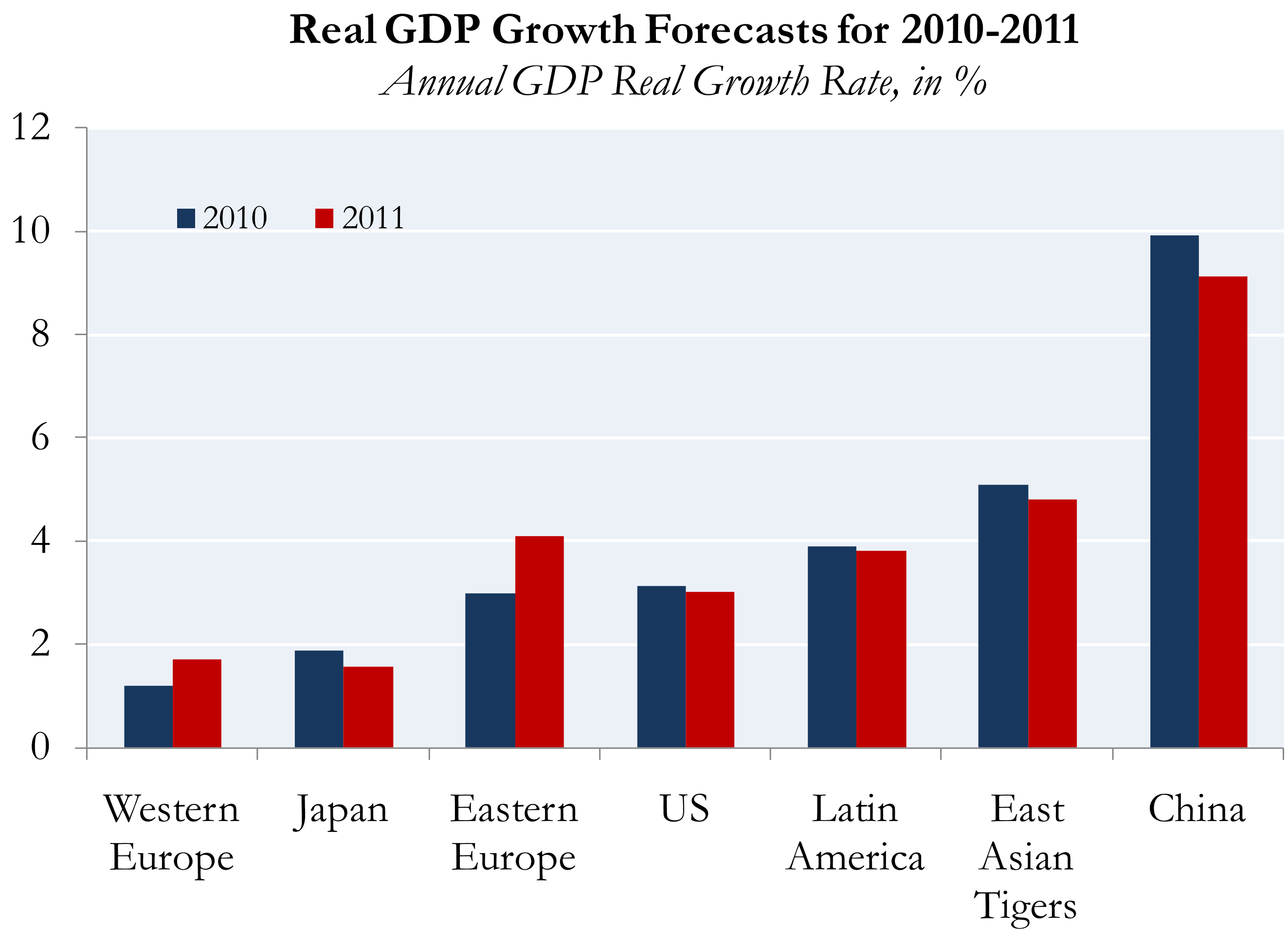


Source: Economist Intelligence Unit (EIU) and Consensus Forecast (Sep. 2009)

What next?

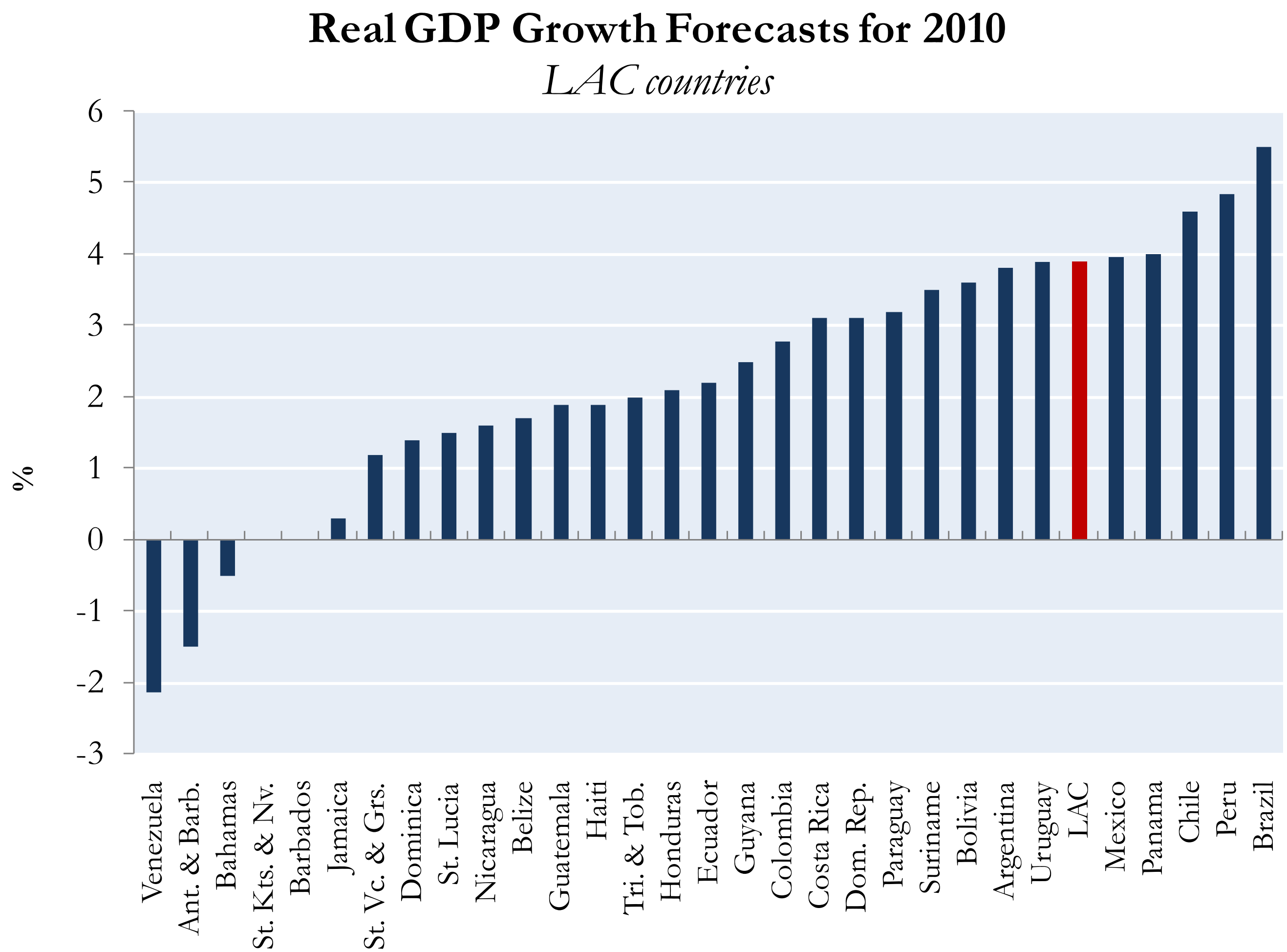
Short-term challenges

A generalized economic recovery is underway but with considerable regional variation



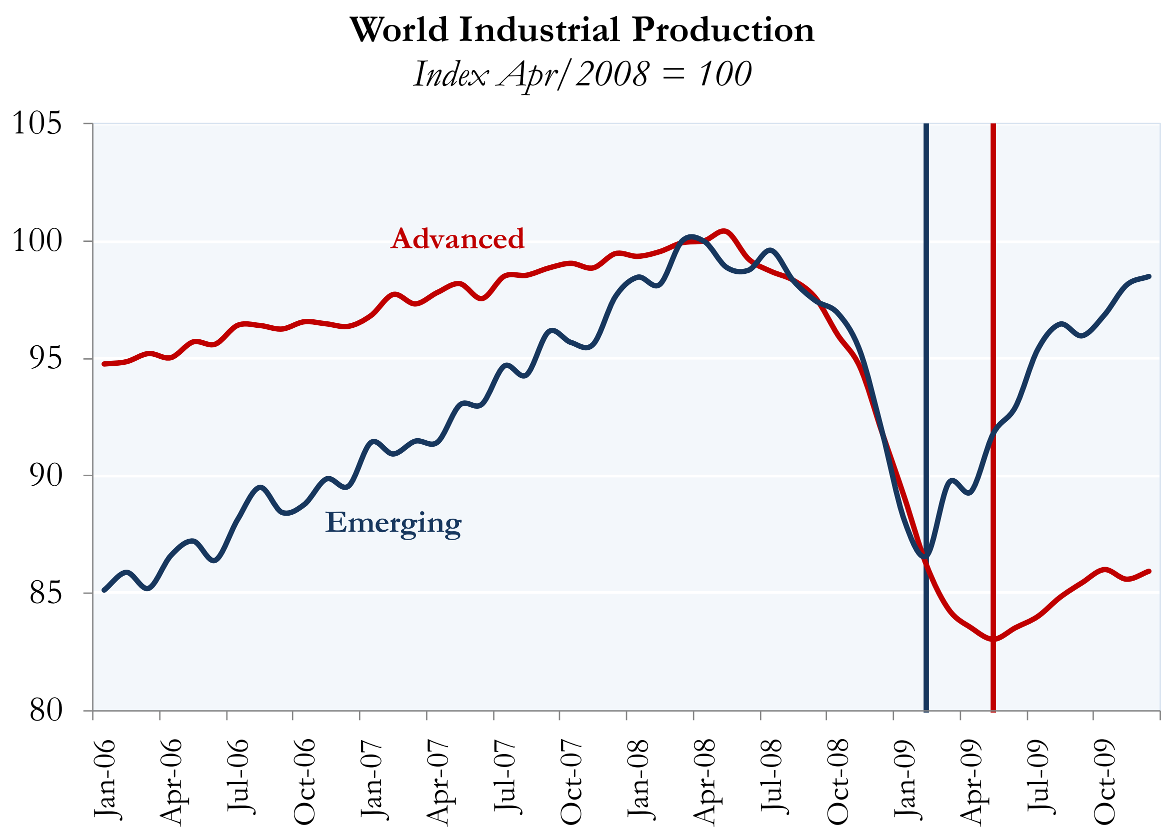
Source: Consensus Forecasts (Mar. 2010 and Dec. 2009), and Bloomberg

The economic recovery expected for LAC in 2010 is not uniform but it is fairly generalized and relatively strong



Source: Consensus Forecasts as of Mar. 2010, World Bank's GEP Jan. 2010 and IMF Regional Economic Outlook from Oct 2009.

But … sharply contrasting growth dynamics in advanced versus emerging economies

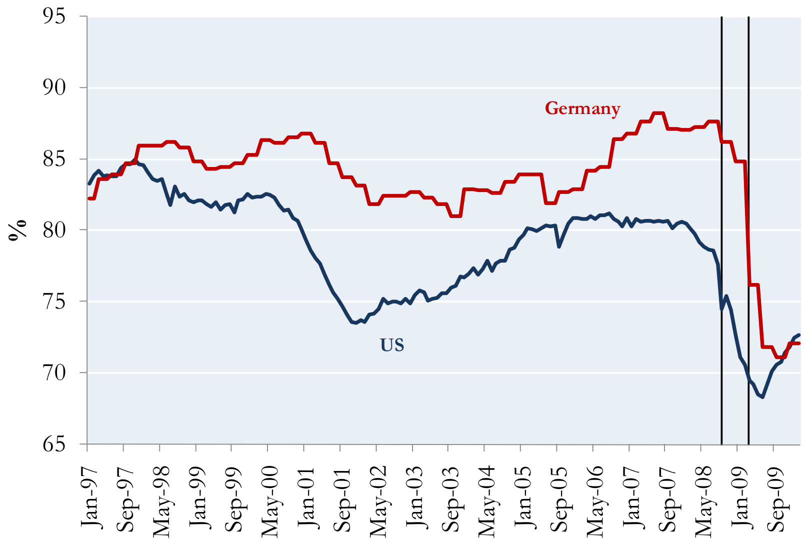


- *Emerging economies with strongest recoveries include Brazil, China, India, Korea, Malaysia, Philippines and Thailand*
- *They represent 52% of emerging economies' GDP*

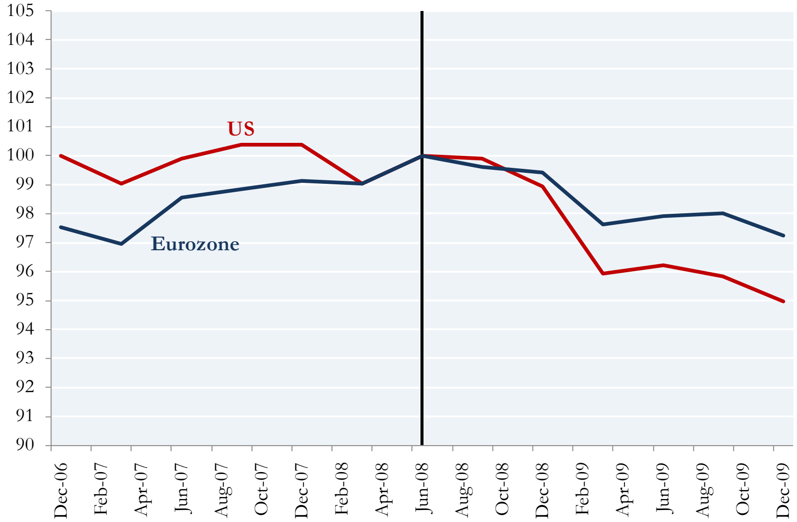
Source: CPB (Netherlands Bureau for Economic Policy Analysis)

While capacity utilization and employment is at a very low point in rich countries (keeping interest rates low)…

Capacity Utilization

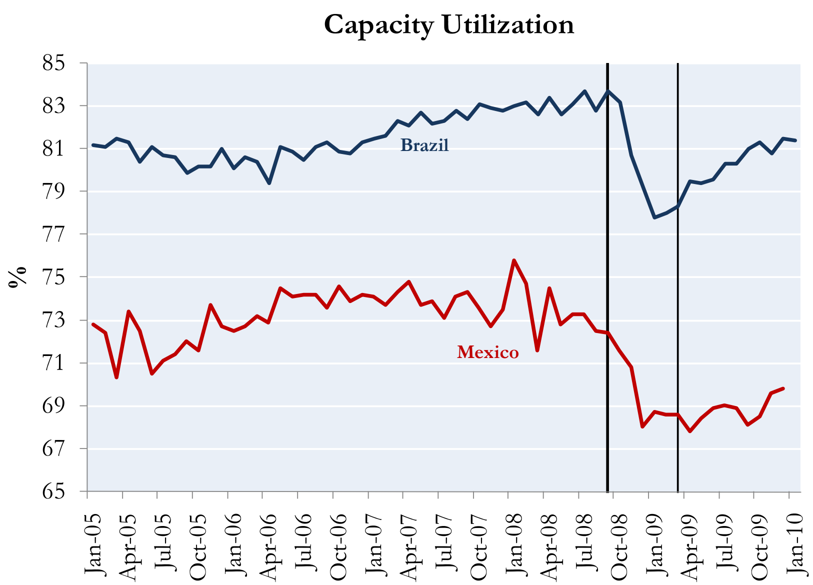


Civilian Employment
Index Jun/08 = 100



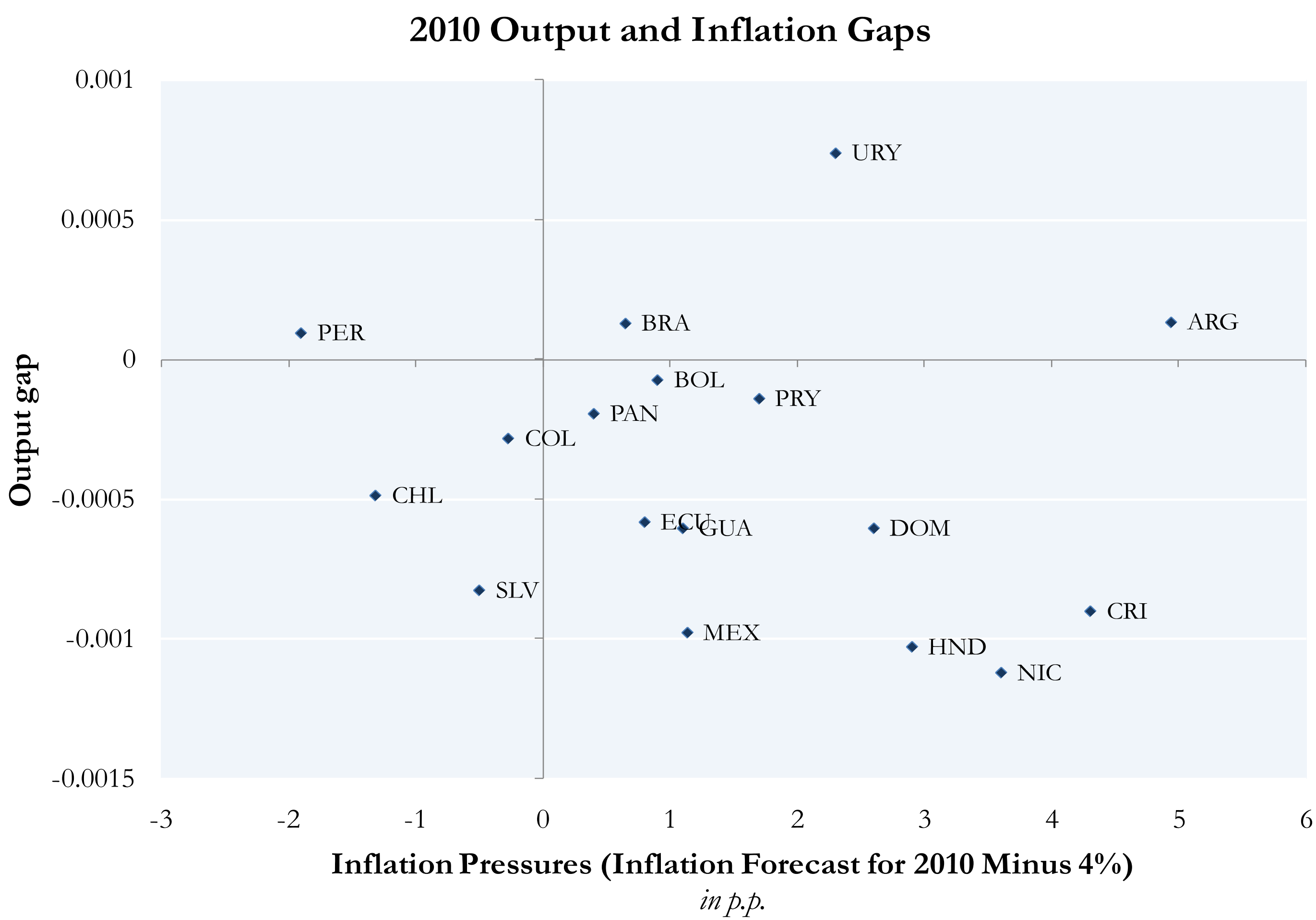
Source: Bloomberg and OECD

… it is getting back to normal levels in EMs (pointing towards monetary normalization/tightening)



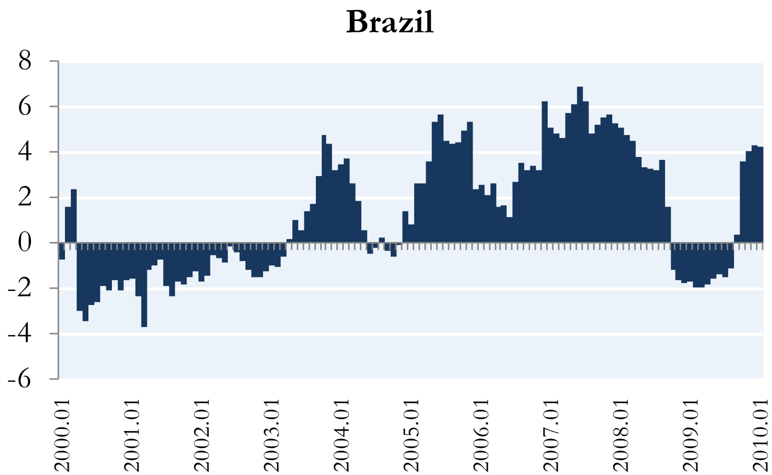
Source: Bloomberg and OECD

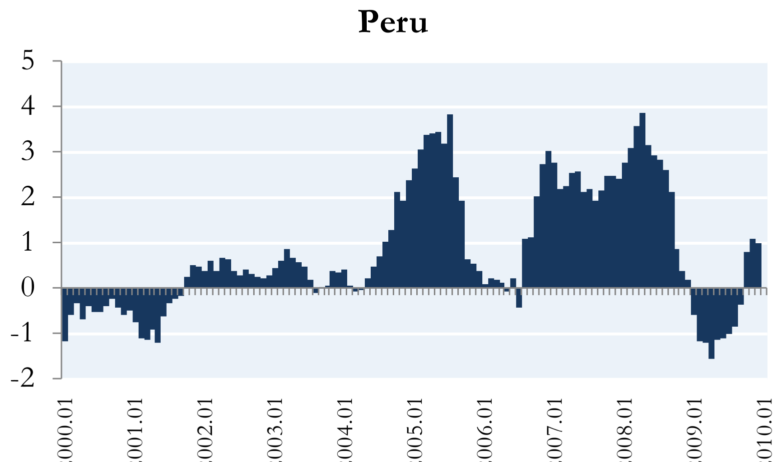
Some Latin countries may be hit capacity constraints soon and be compelled to tighten monetary policy …

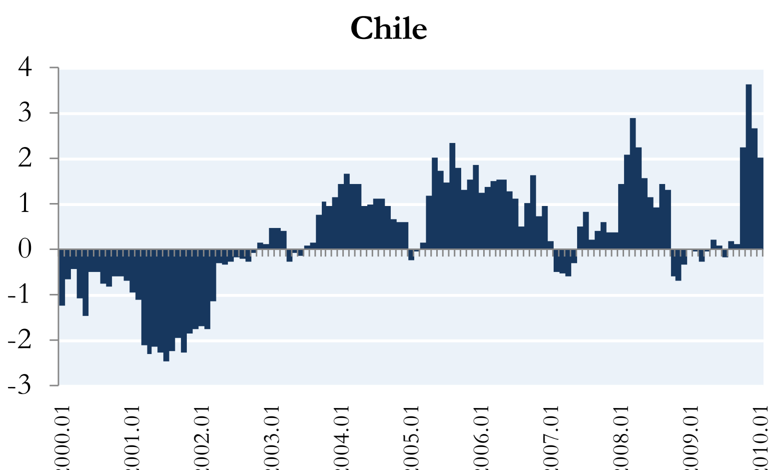


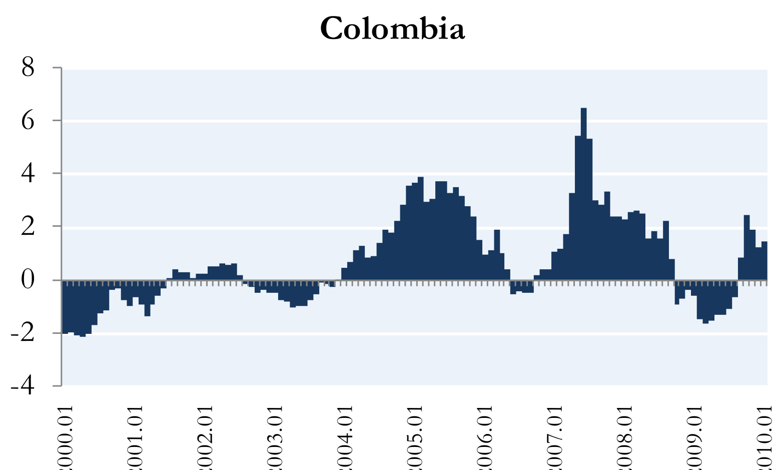
Source: Consensus Forecasts (Mar. 2010) - LCRCE Staff Calculations

… which will exacerbate the already strong currency appreciation pressures in some Latin countries



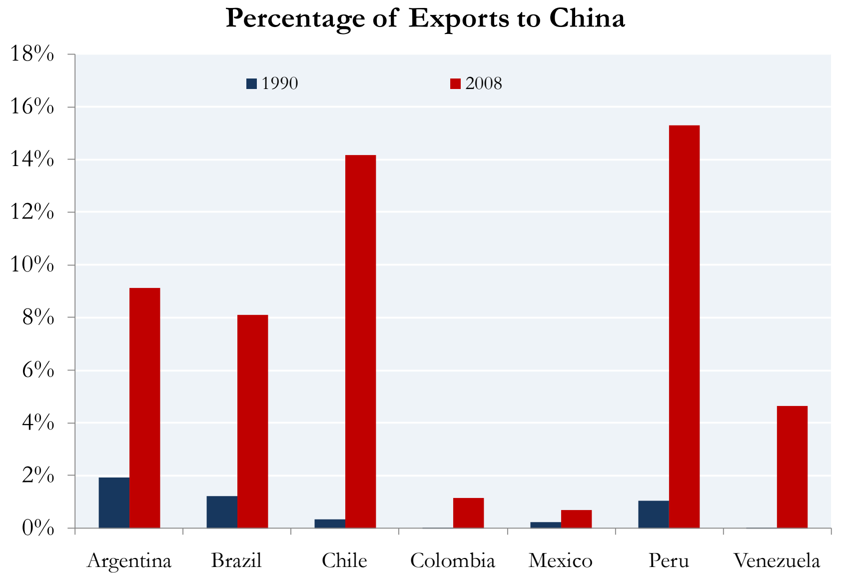


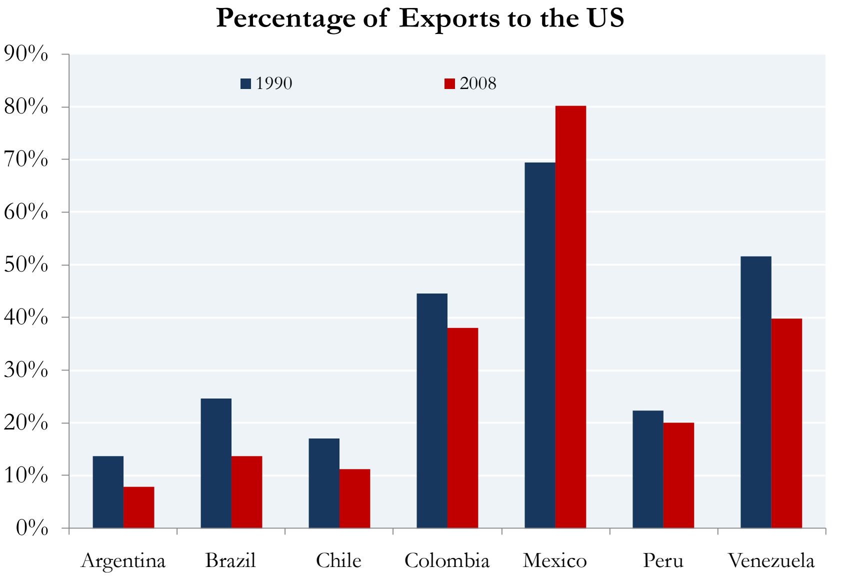




Note: The exchange market pressure is the weighted average of year-on-year percentage changes in: (a) the nominal exchange rate of the LAC-6 country currency vis-à-vis the US dollar (such that an increase represents an appreciation of the LAC currency), and (b) the level of international reserves. The 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 (EMP) index signals appreciation pressures and/or accumulation of reserves.

Economic activity in LAC is increasingly linked to large emerging markets, particularly China



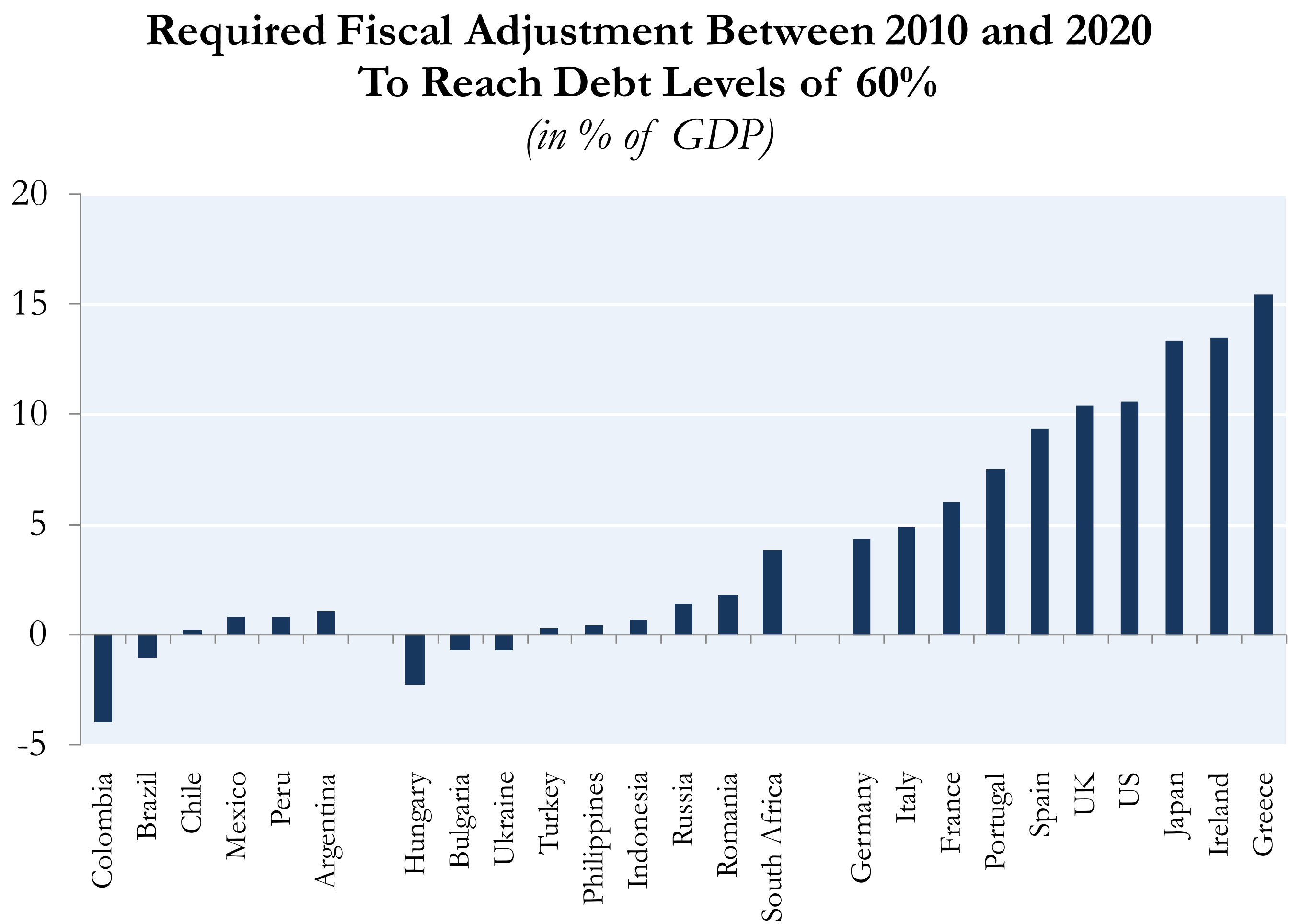


Source: DOTS

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

- Will exit from stimulus policies be well-timed and orderly?
  - Premature retreat can kill the recovery; delayed retreat can rise inflation specter
- Will fiscal/debt dynamics in rich countries be restored to viability?
  - Specter of future inflation or higher interest rates – to the extent that "growing out of debt" and/or higher taxes/major spending cuts are not feasible
- Will problems in Club Med Europe be contained?
- Will regulatory uncertainty in rich countries be adequately dispelled?
- Will external current account positions be globally rebalanced?
  - A revaluation of the Renminbi is arguably essential for rebalancing

In sharp contrast with EMs, rich countries face daunting fiscal and debt challenges

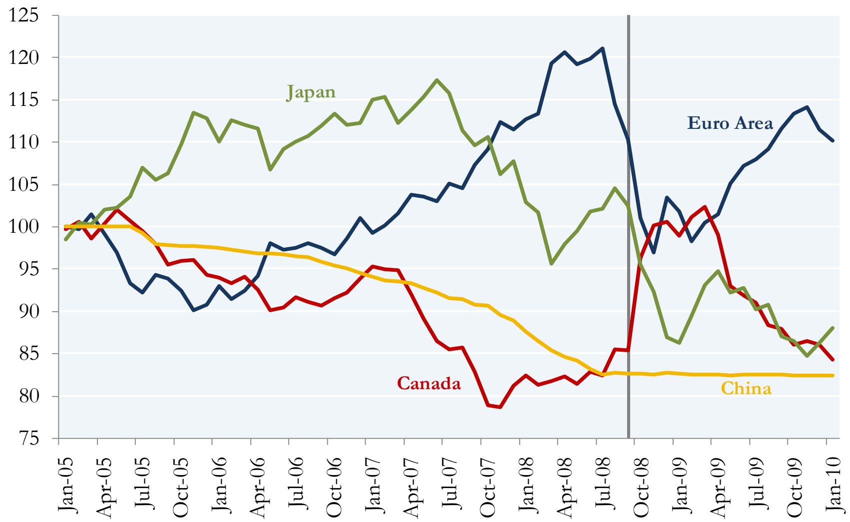


Source: IMF

So far, rebalancing seems incipient and there has been no adjustment in China's currency

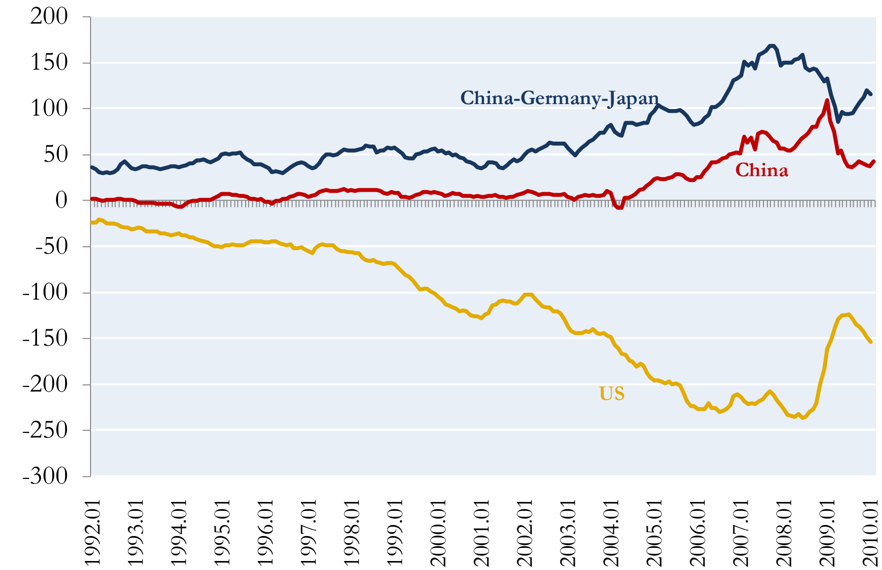
Global Imbalances: Exchange Rates (LCU/US$)

Period average, market rate, index Jan/05=100



Global Imbalances

(Trade balance in goods, US$ millions, SA, 3-month cumulative)

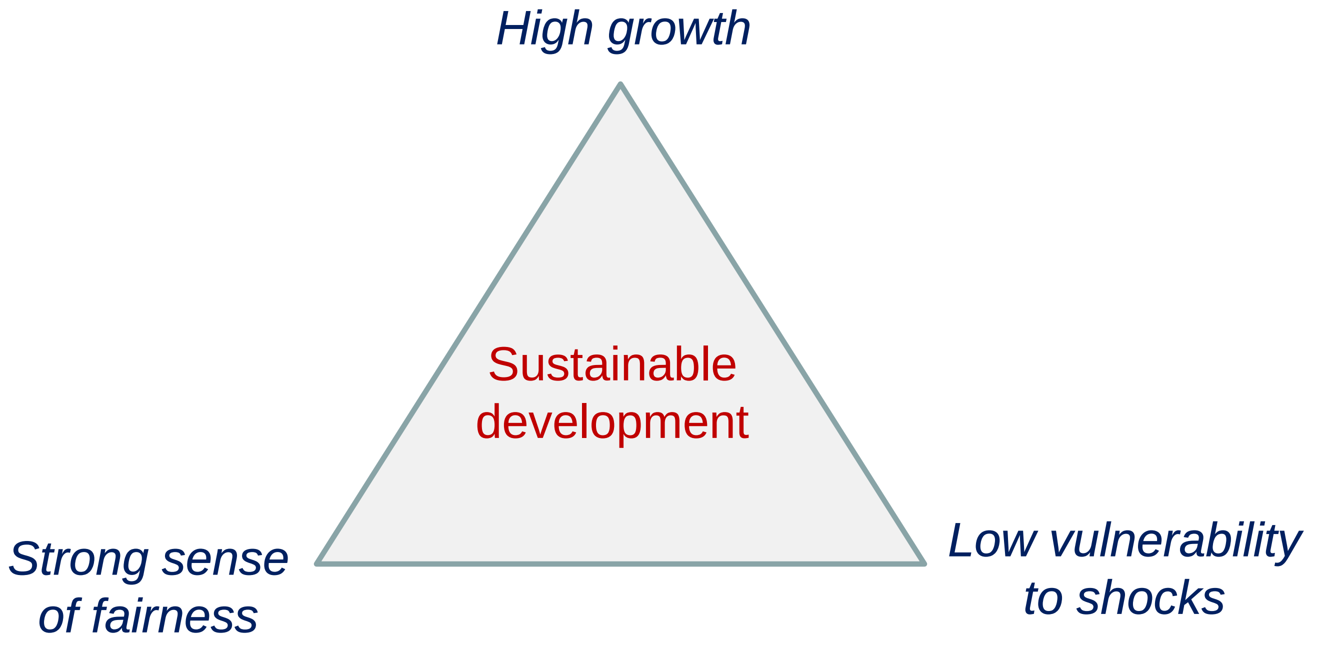


Source: Bloomberg, EIU

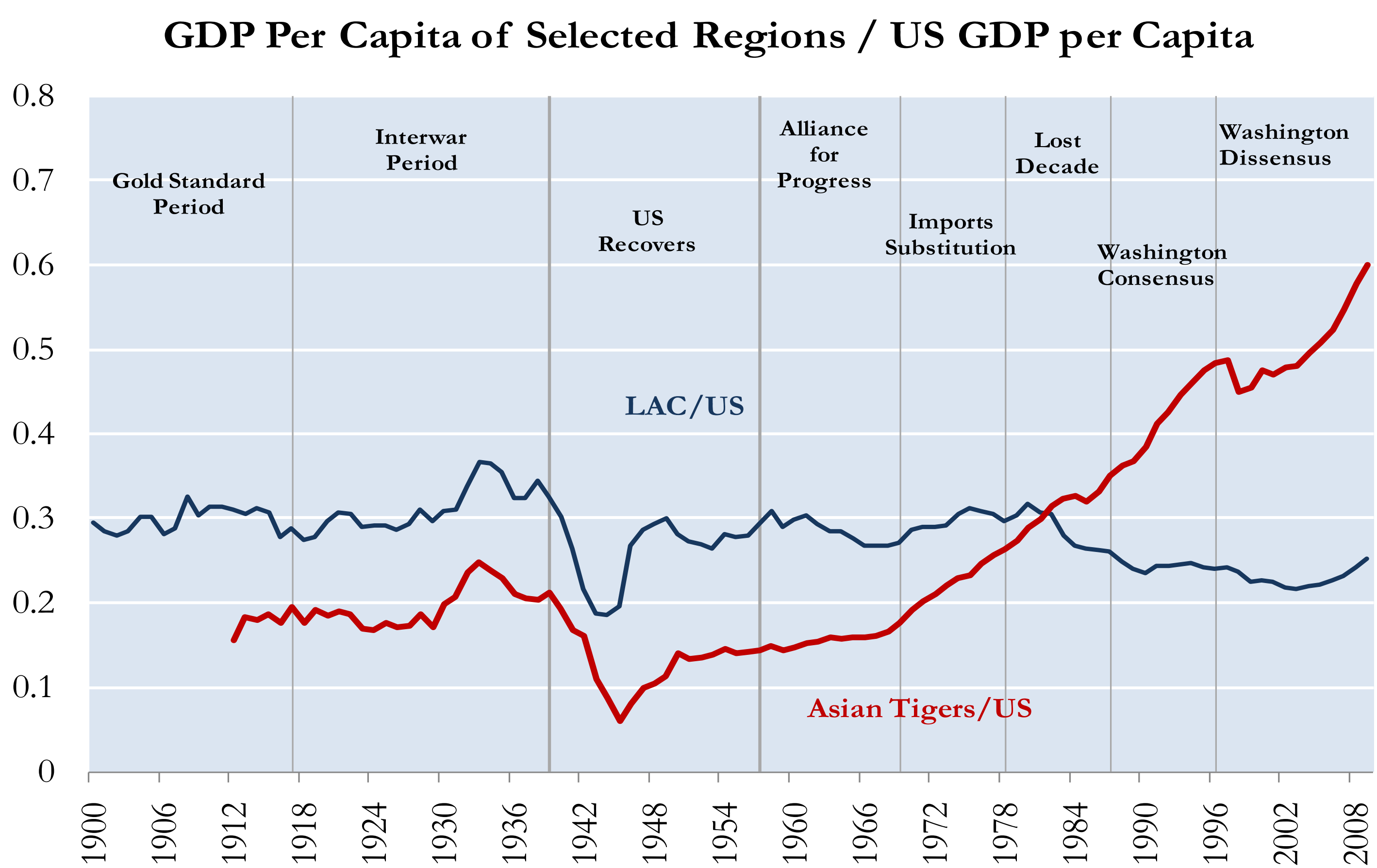
What Next?

Long-term development challenges

The virtuous development triad

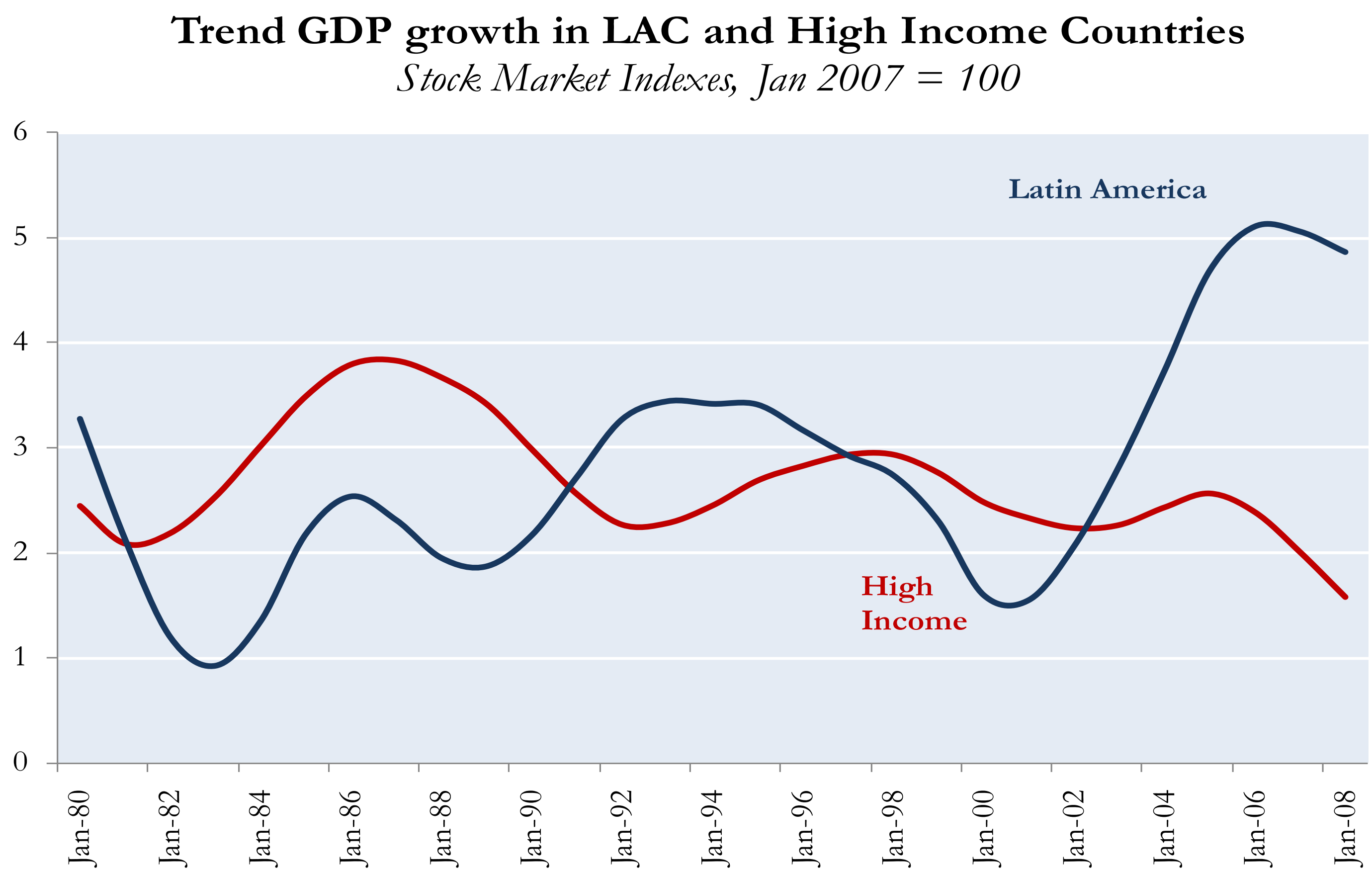


For more than a century, in contrast with the Asian Tigers, LAC has been unable to grow faster than rich countries…



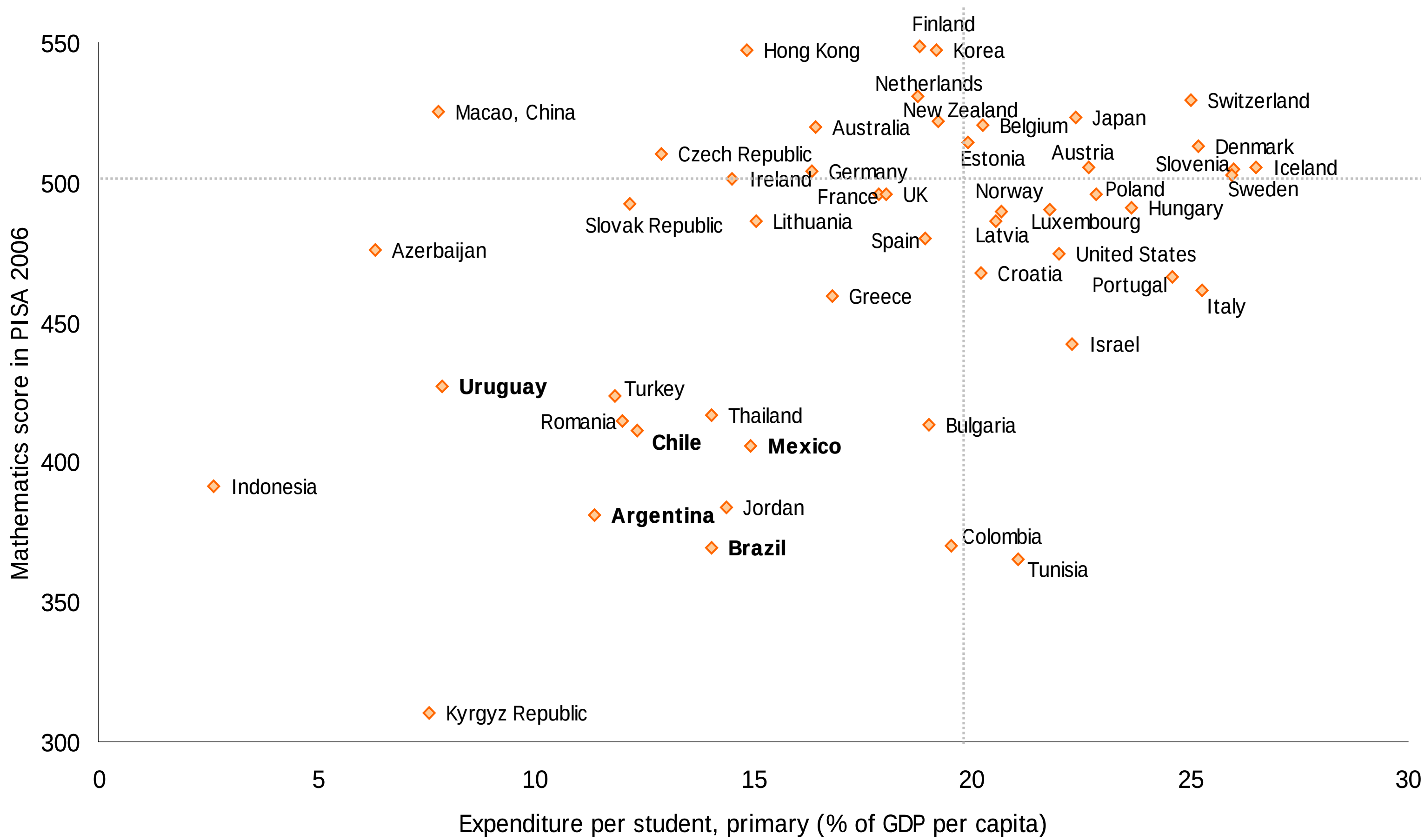
Source: Maddison

Did such dire record start changing this millennium?



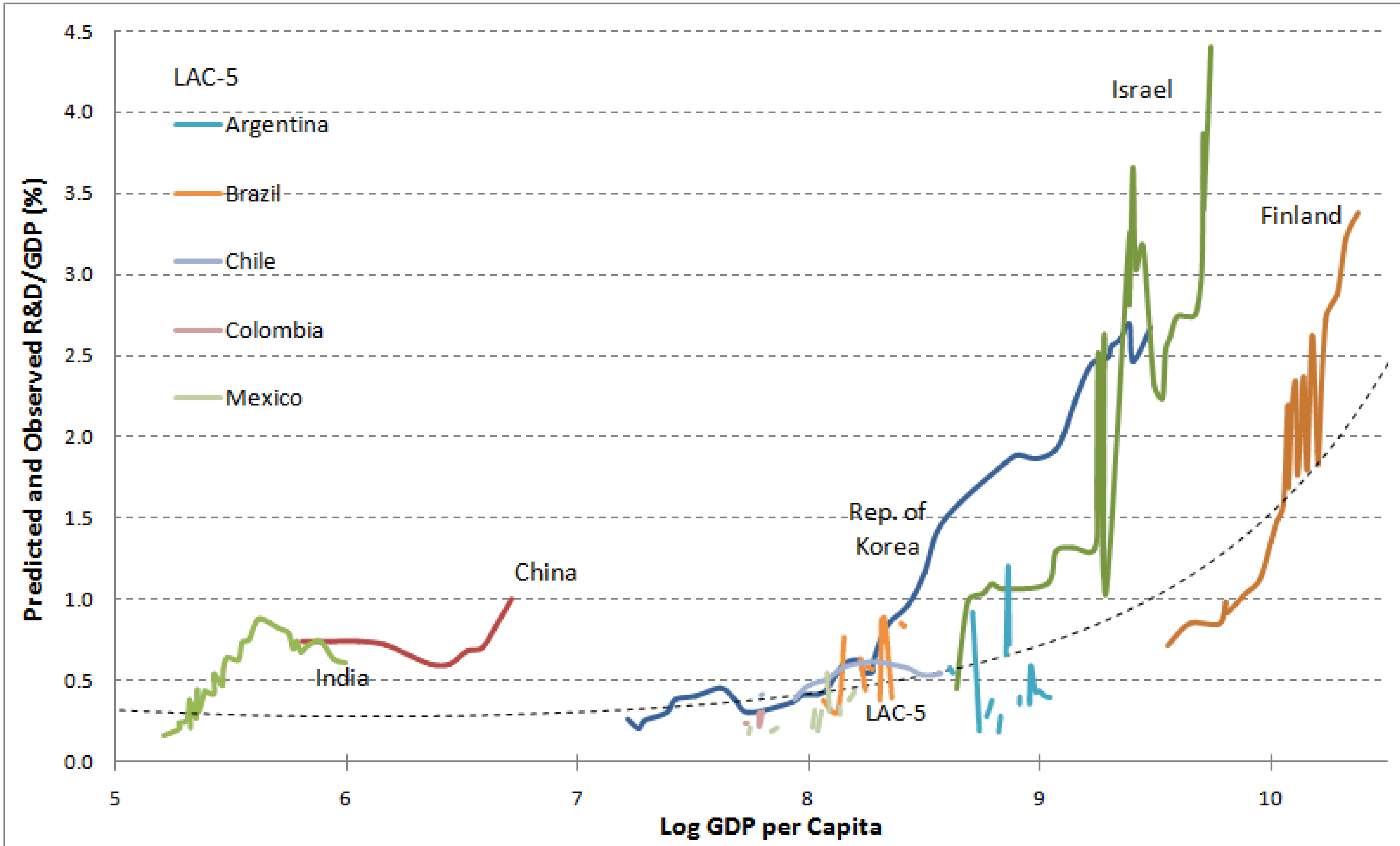
Source: Maddison

To generate trend growth above the world's average, LAC will need to close key gaps: *the education gap…*



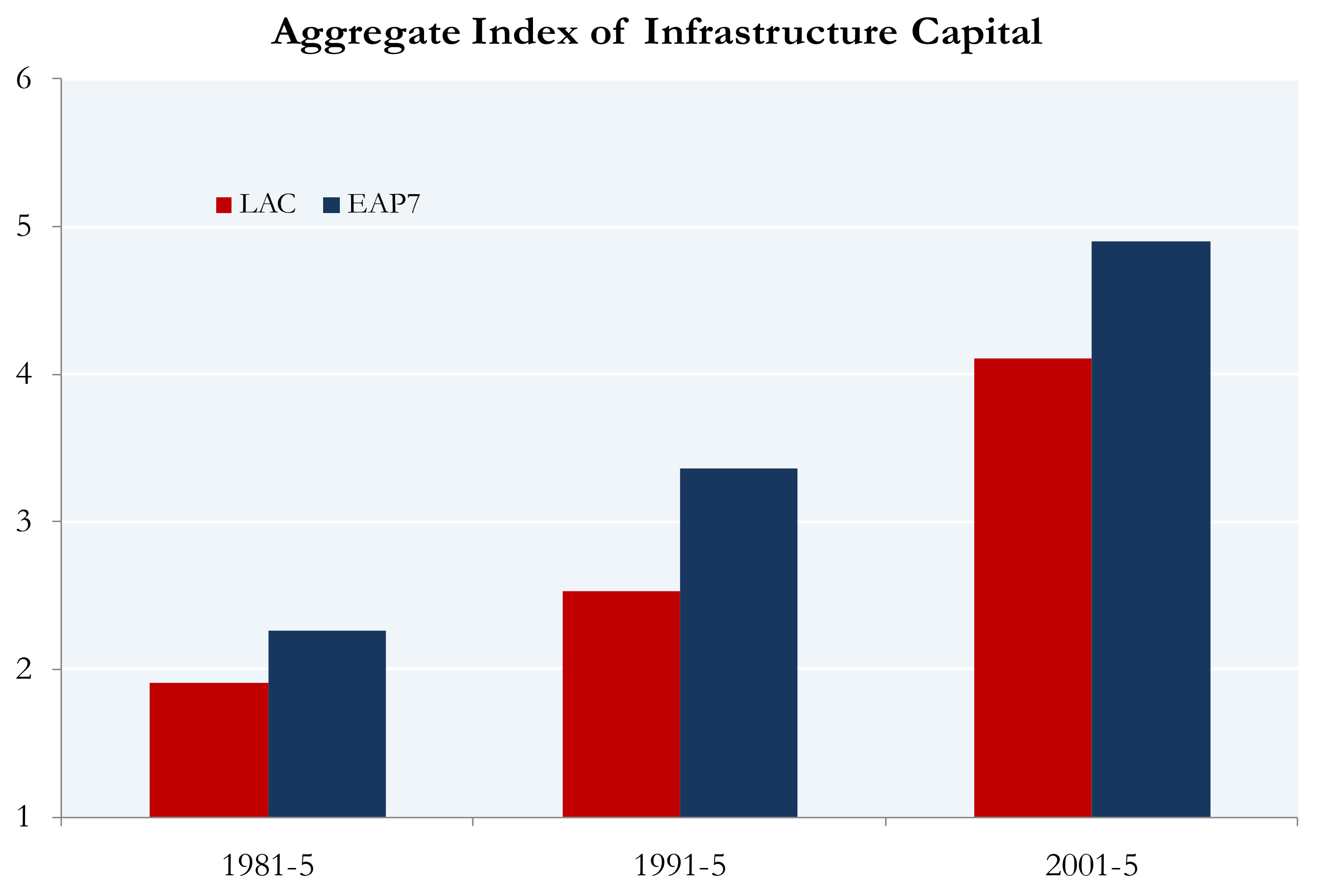
Source: Mathematics score from Pisa (2006). Expenditure per Student, primary (% GDP) is the most recent data available in WDI (2004 for most of the countries). Public expenditure per student is the public current spending on education divided by the total number of students in the primary level.

…the innovation gap…



Source: Lederman & Maloney (2007)

…the physical infrastructure gap…



Note: LAC – Argentina, Brazil, Bolivia, Chile, Colombia, Costa Rica, Dom. Rep., Ecuador, Guatemala, Honduras, Jamaica, Mexico, Nicaragua, Panama, Peru, Paraguay, El Salvador, Uruguay, and Venezuela. EAP - Hong Kong, Indonesia, South Korea, Malaysia, Singapore, Taiwan and Thailand. Aggregate index: First principal component of: (a) main lines and mobile phones (per 1000 inhabitants), (b) electricity installed capacity (in thousands of KW per 1000 inhabitants), (c) total road length (in Km. per 1000 inhabitants). All infrastructure variables are expressed in logs before performing principal components analysis.
Source: Calderón and Servén (2003)

Thank you