
LAC and the Global Crisis: The Worst is Behind, But What Lies Ahead?

Brookings Institution
4 March 2010

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Latin America and the Caribbean Region
The World Bank*



Structure of presentation

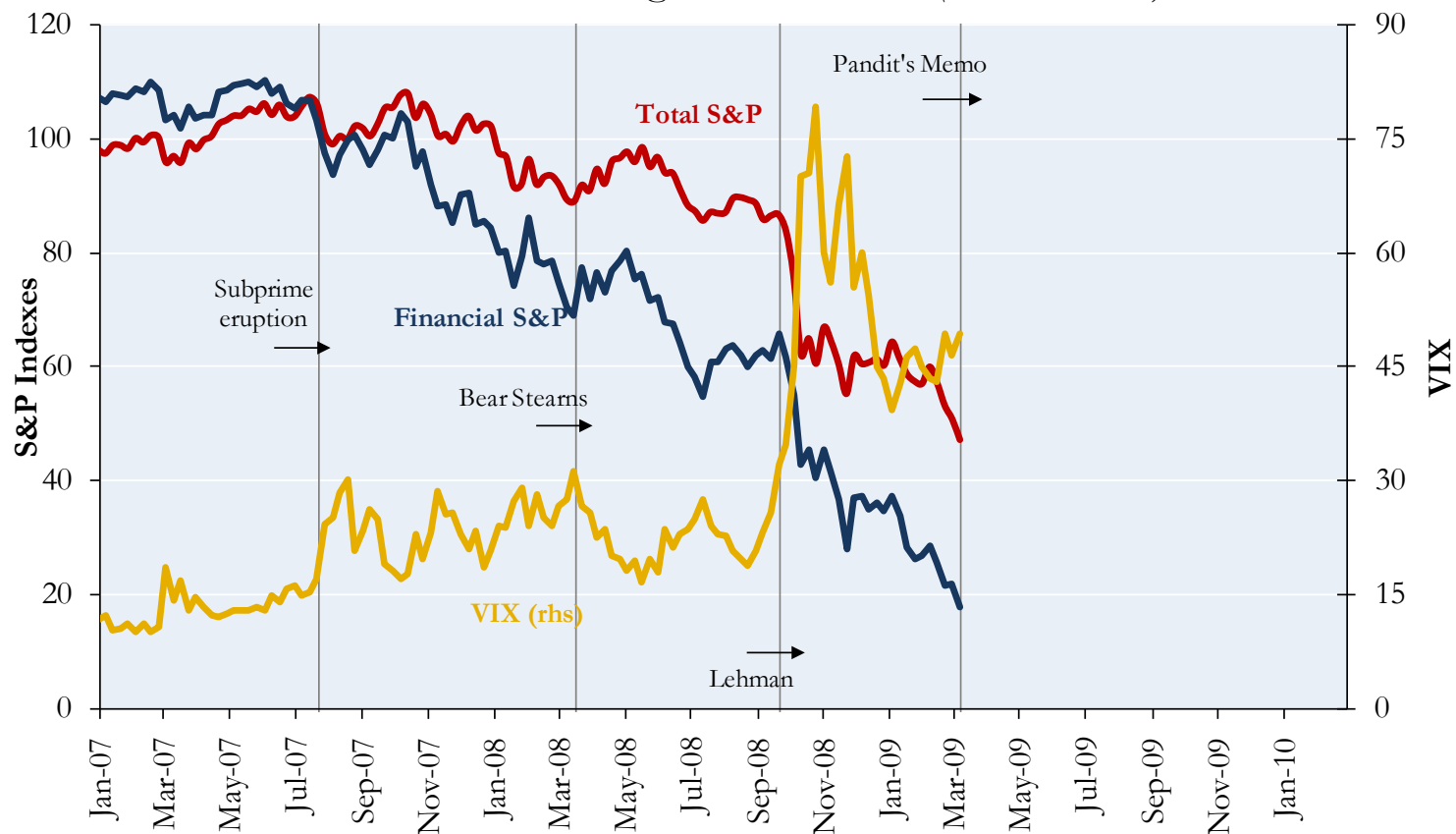
- A broad-based but fragile recovery is under way
- How did LAC respond to the global financial crisis?
 - Bruised but without systemic damage
 - Hence, well positioned for recovery
- What next?
 - Global prospects are clouded by risks
 - LAC-specific challenges

Fragile global recovery

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

Standard & Poor's (Financial and Total Indexes) and VIX

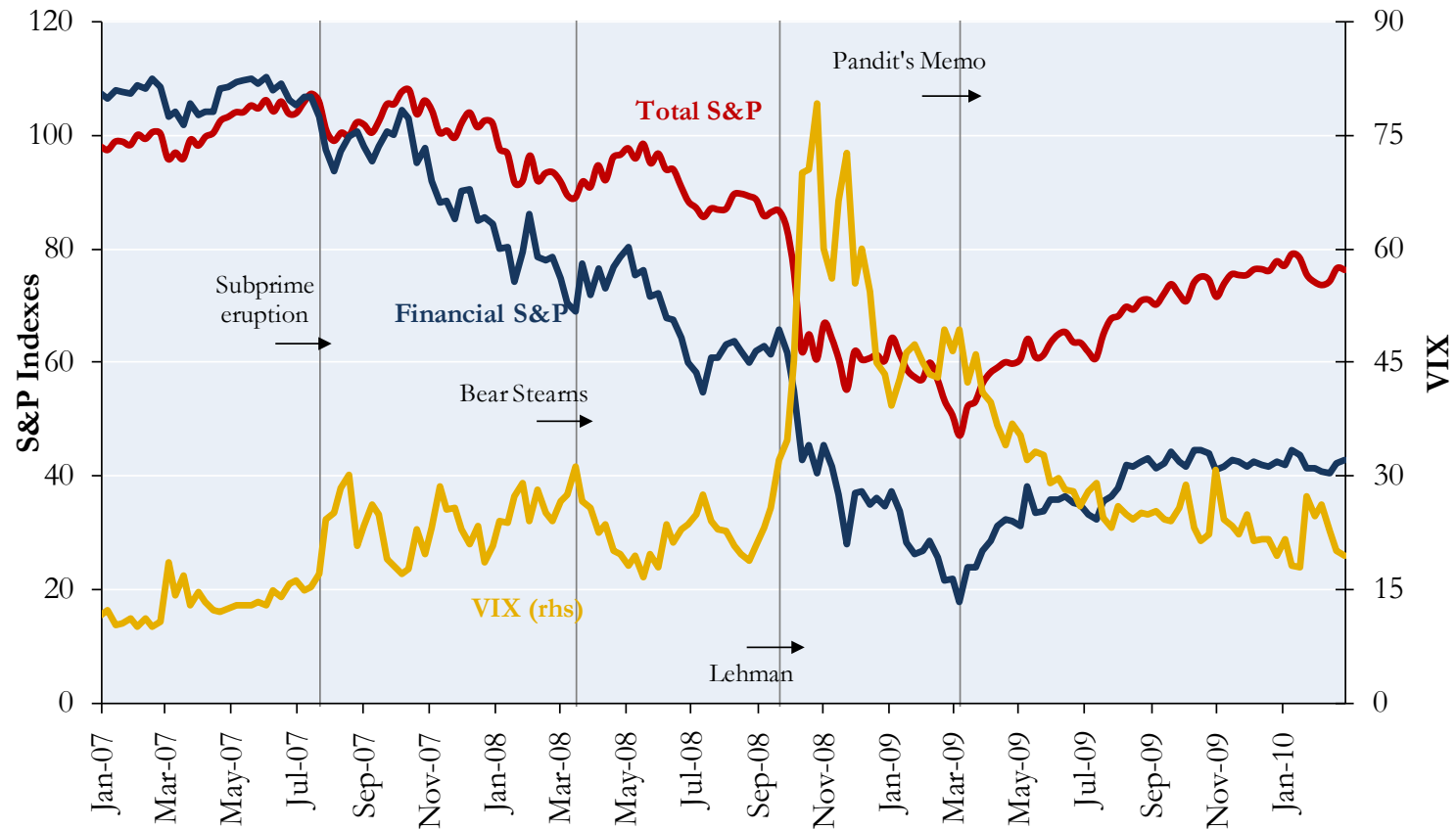
Index number Aug-15-2007 = 100 (S&P indexes)



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

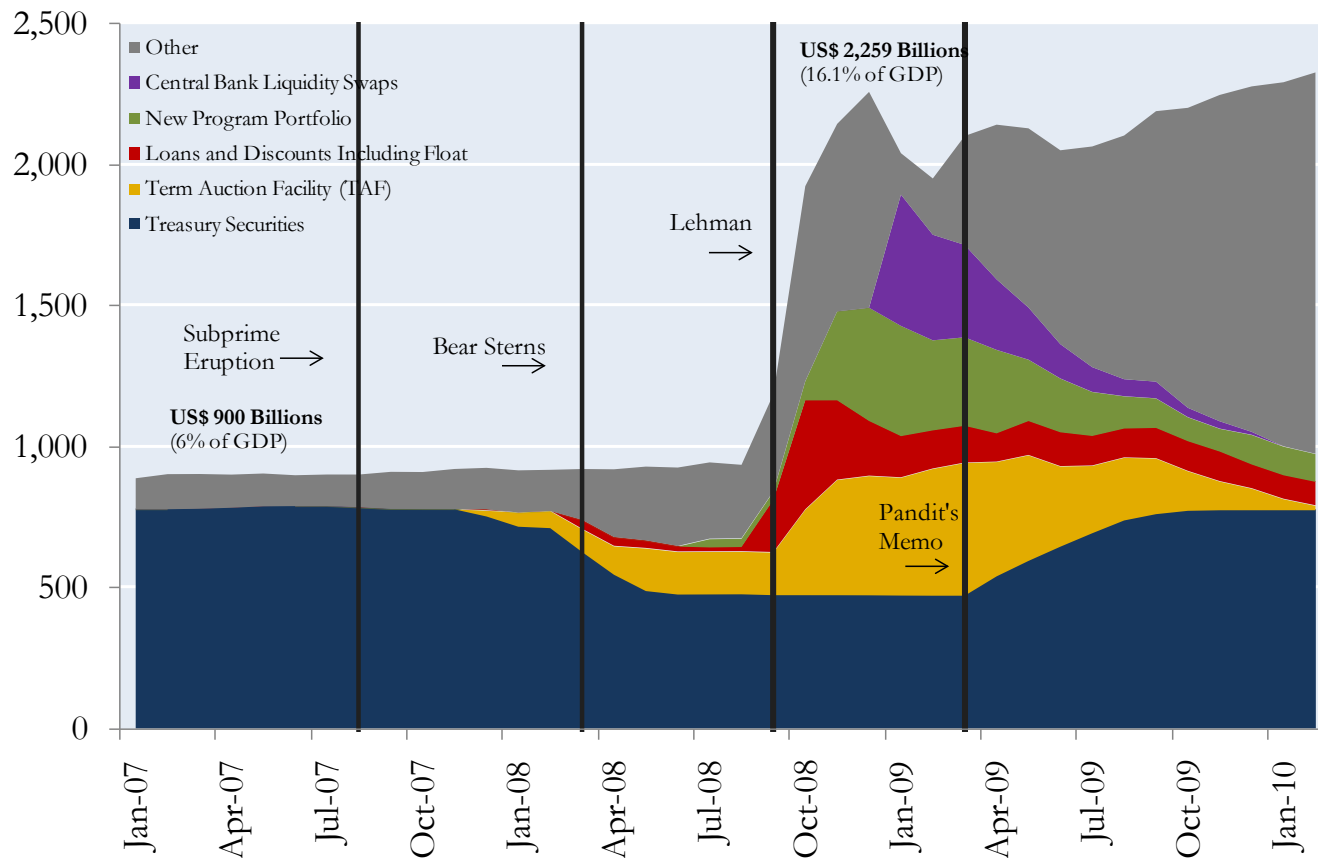
Standard & Poor's (Financial and Total Indexes) and VIX

Index number Aug-15-2007 = 100 (S&P indexes)



... thanks to colossal and unprecedented risk absorption and stimulus policies, led by the U.S. Fed ...

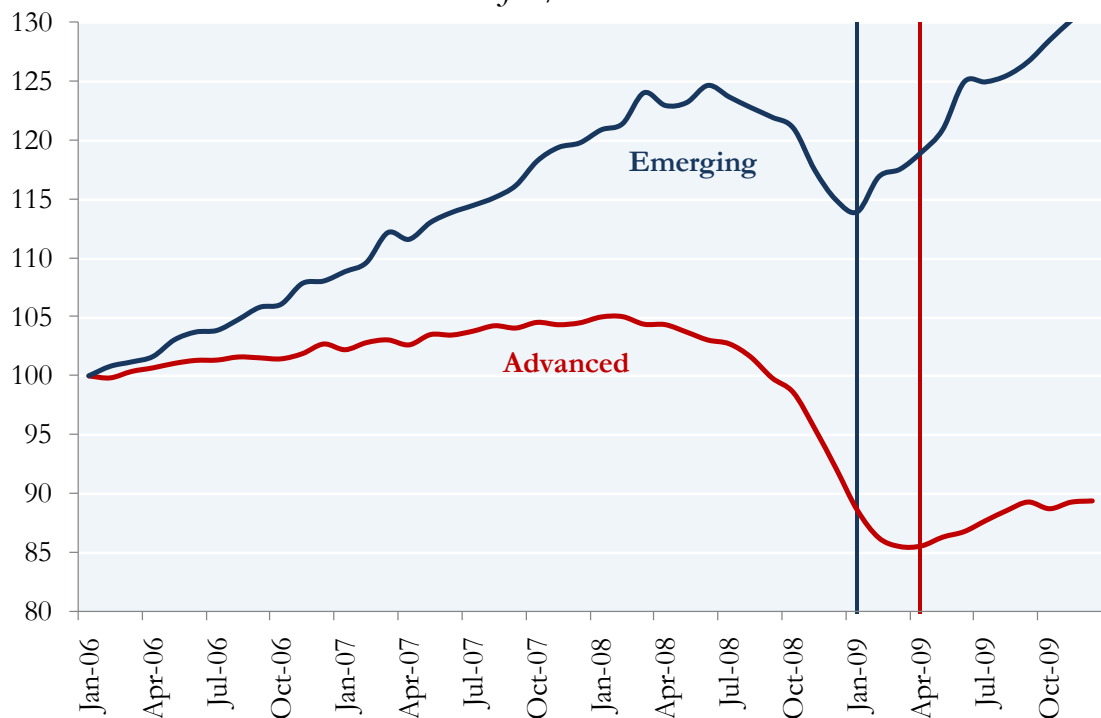
FED's Balance Sheet - Assets Side
Factors Affecting Reserve Balances, US\$ Billion



A global economic recovery process, which started with the large emerging economies, is now under-way

World Industrial Production

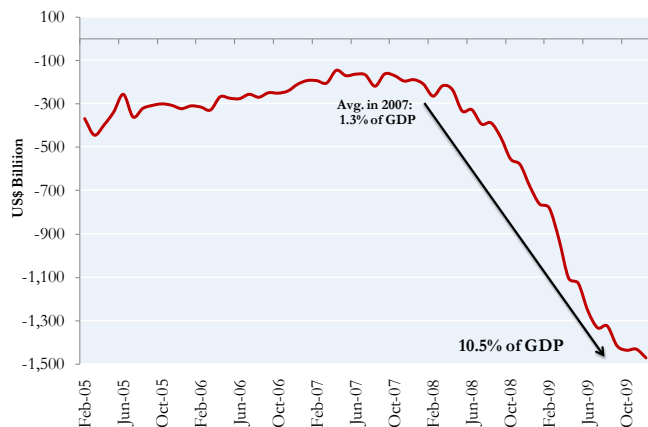
Index Jan/2006=100



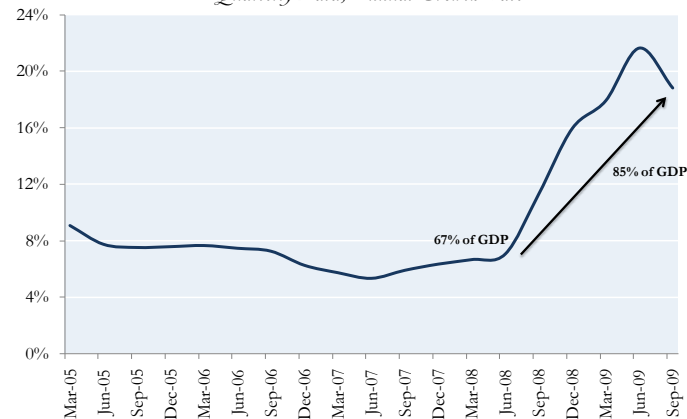
- *The emerging economies with strongest recoveries include Brazil, China, India, Korea, Malaysia, Philippines and Thailand*
- *They represent 52% of emerging economies' GDP*
- *Industrial production for this group increased by 11% from January to October 2009*

However, stimulus policies are a big part of the story so far behind the recovery, especially in the U.S.

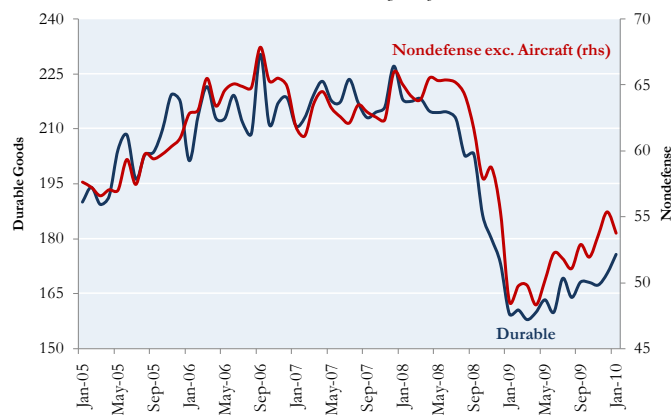
Budget Balance of Central Government
Accumulated in 12 Months



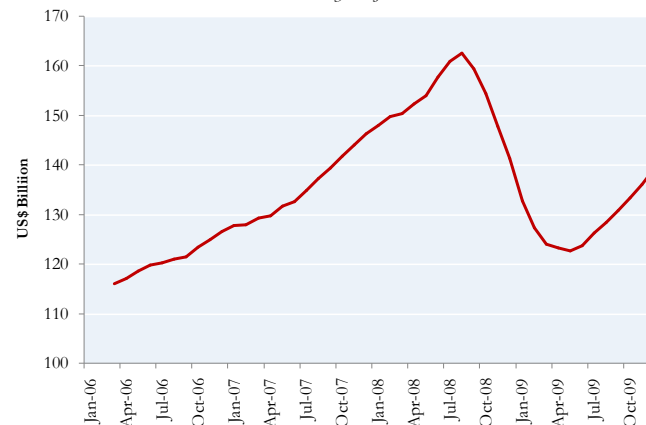
Gross Nominal Public Debt
Quarterly Data, Annual Growth Rate



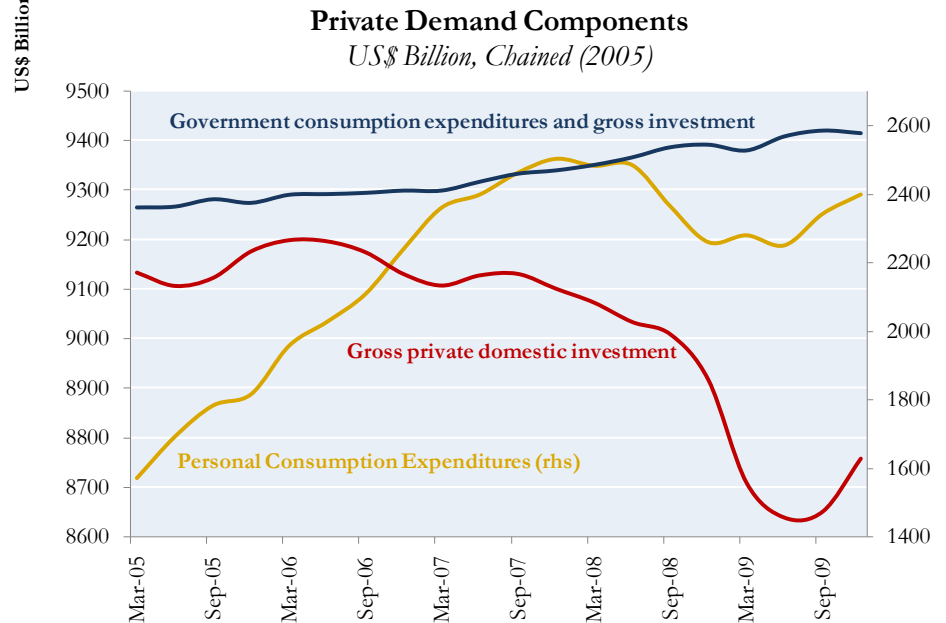
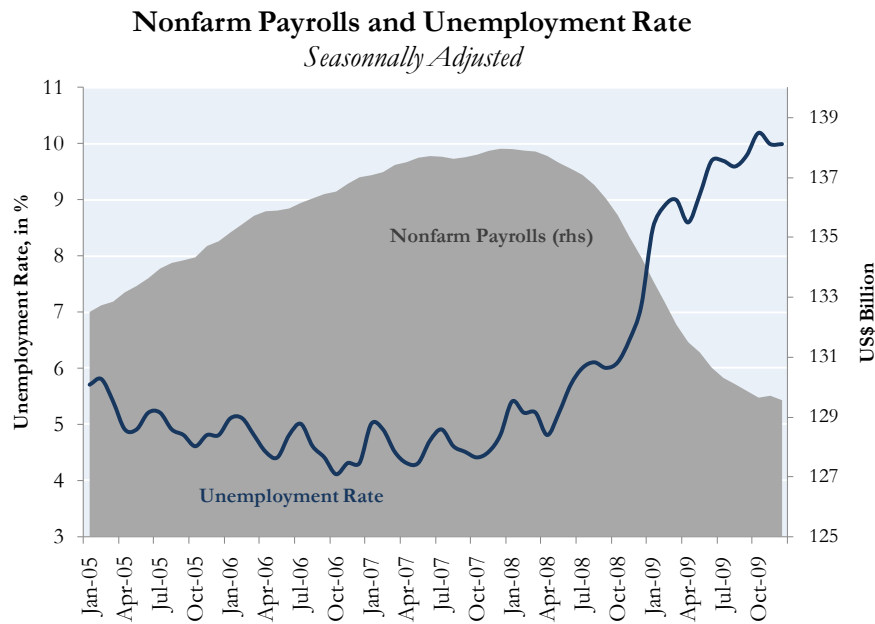
Manufacturers' New Orders
US\$ Billion, Seasonally Adjusted



Exports of Goods and Services, BOP Basis
Seasonally Adjusted



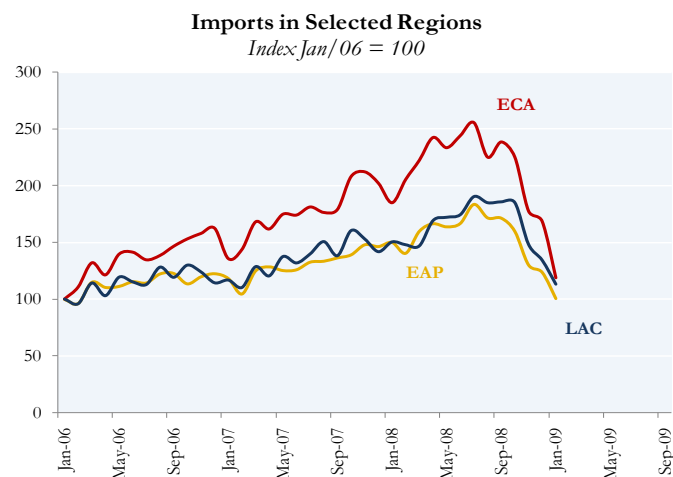
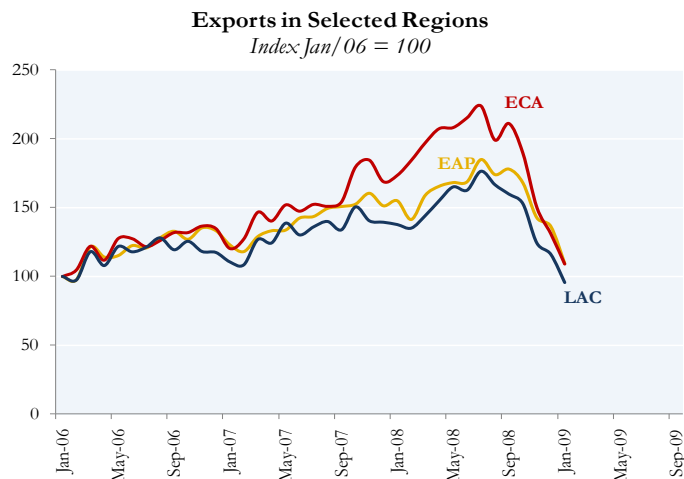
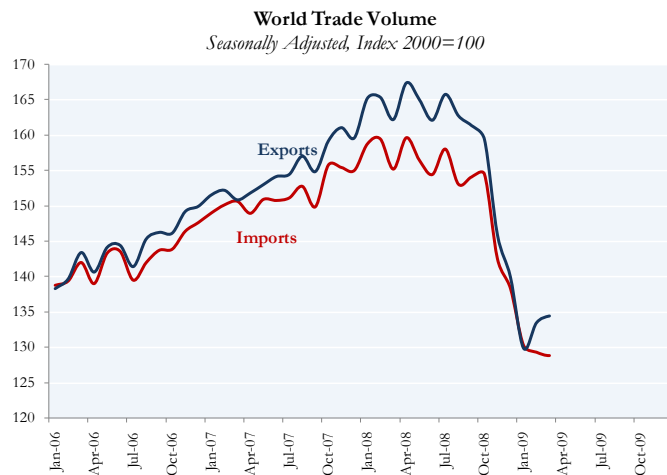
The recovery process in the U.S. and other rich countries is fragile and incomplete



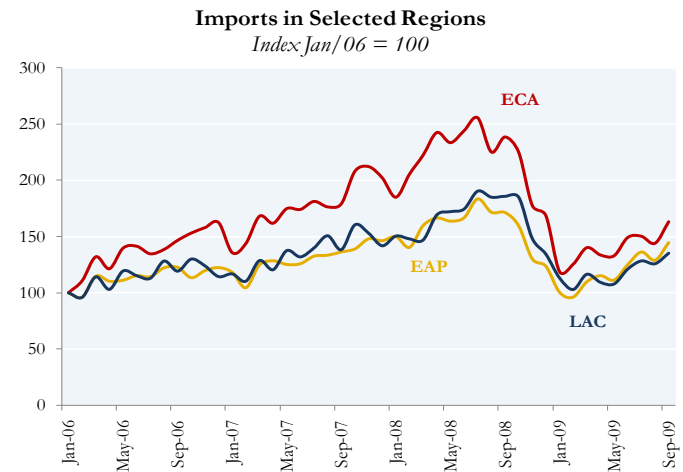
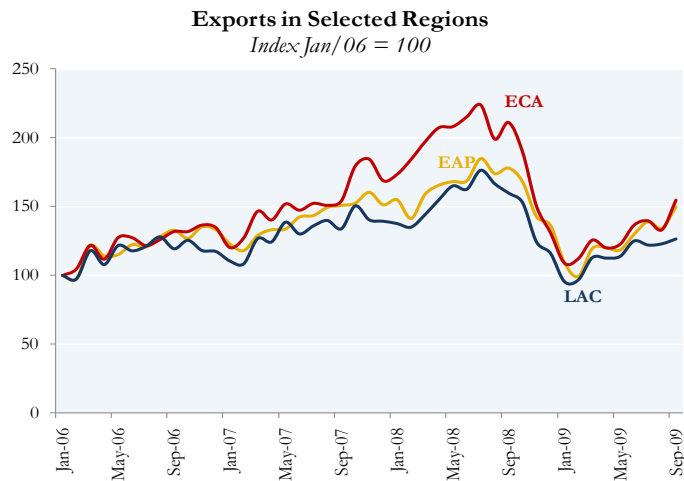
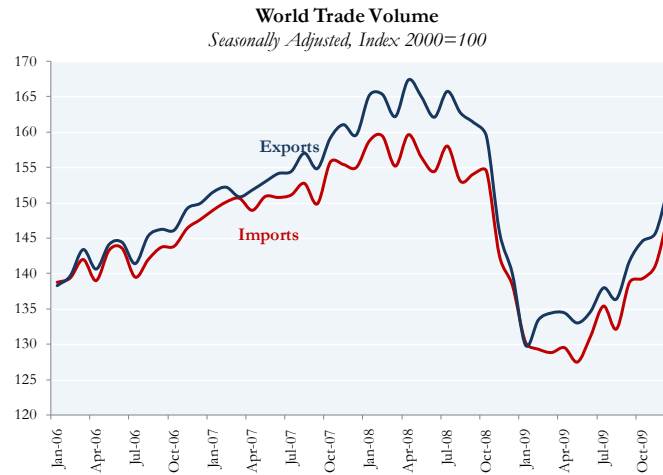
How did LAC fare in 2009?

Bruised but without systemic damage

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



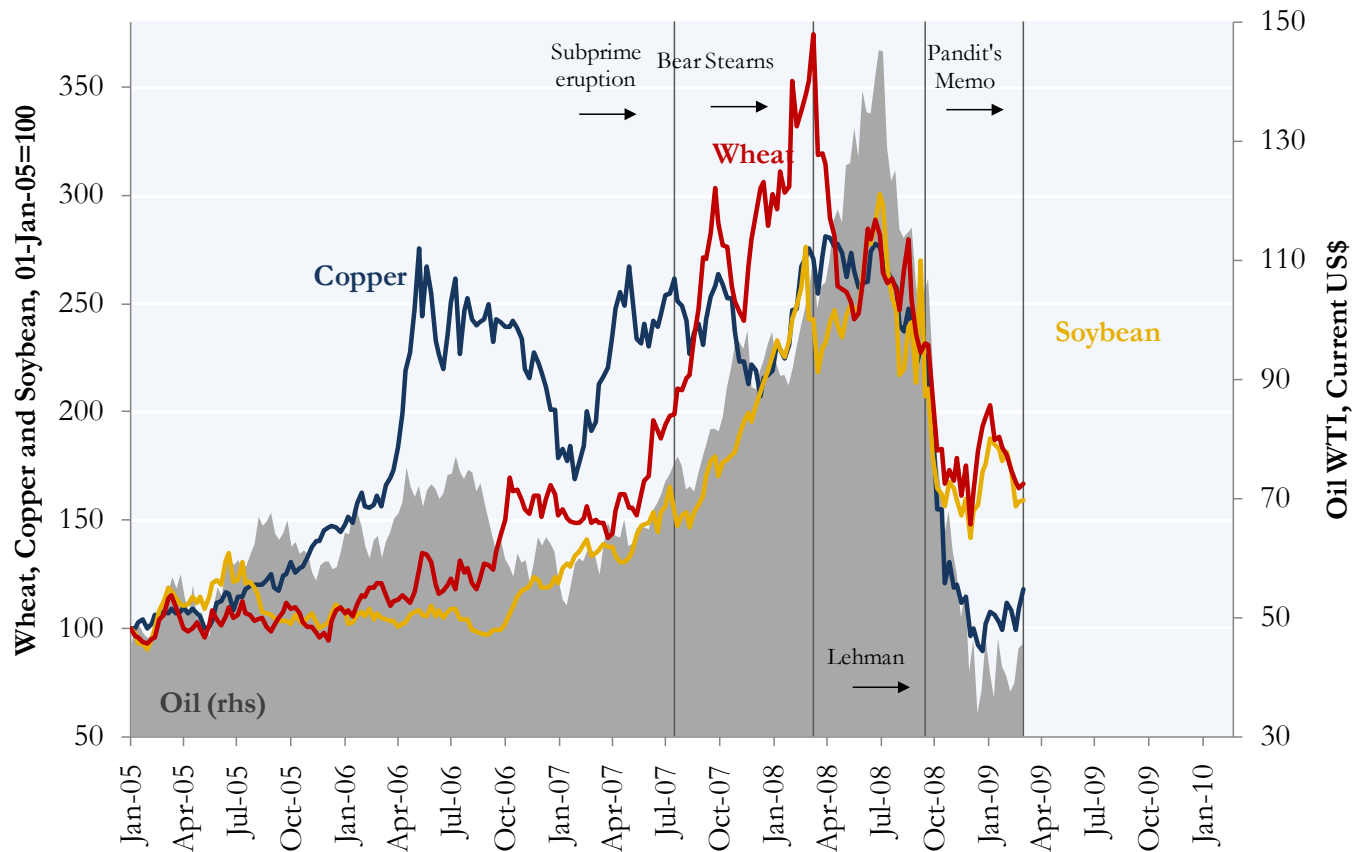
...before entering into a modest rebound...



...commodity prices had collapsed...

Commodity Prices

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

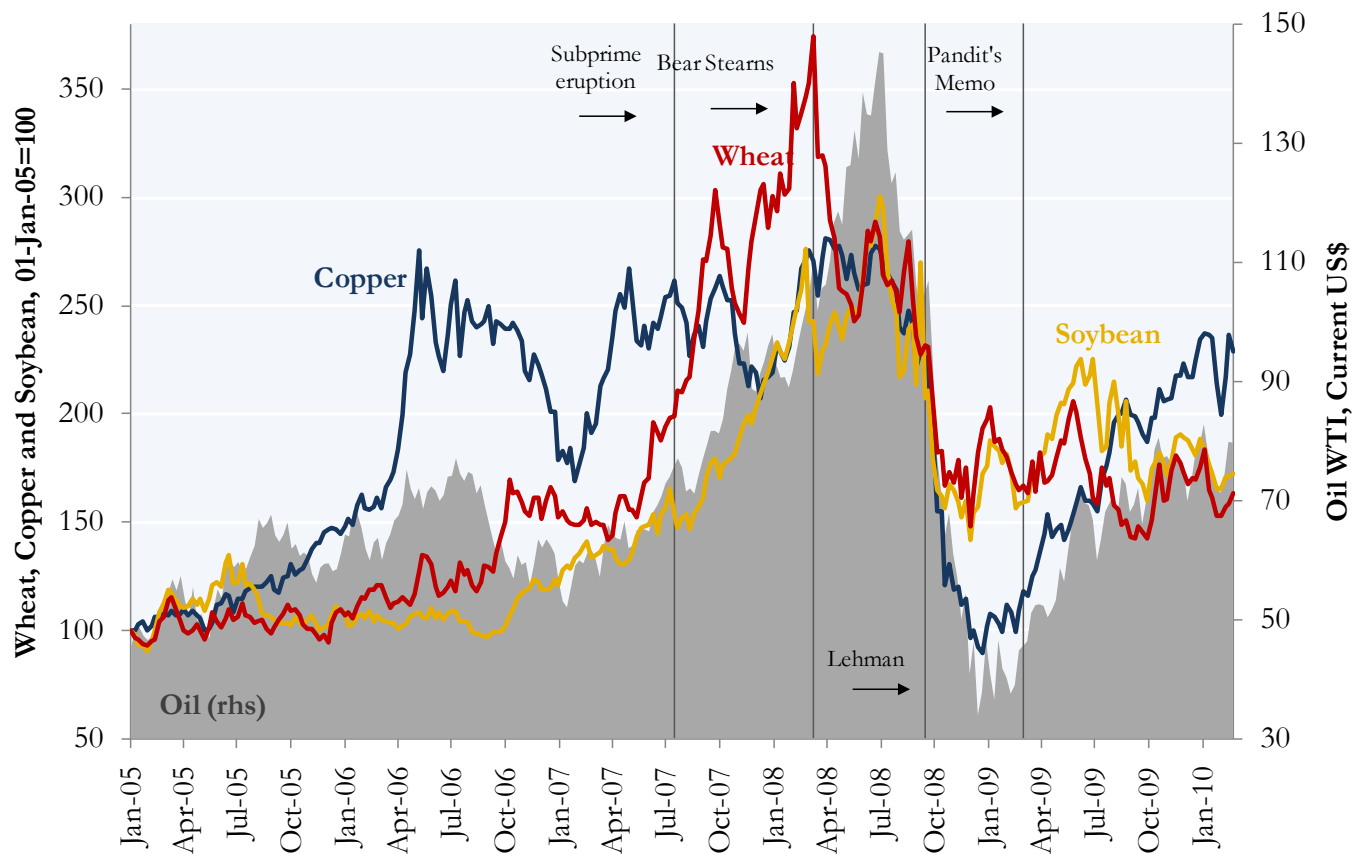


- *About 95% of LAC's GDP and 90% of LAC's population reside in countries that are net commodity exporters*
- *About half the number of countries in LAC are net commodity importers and are mainly located in Central America and the Caribbean*

... before staging a strong rebound...

Commodity Prices

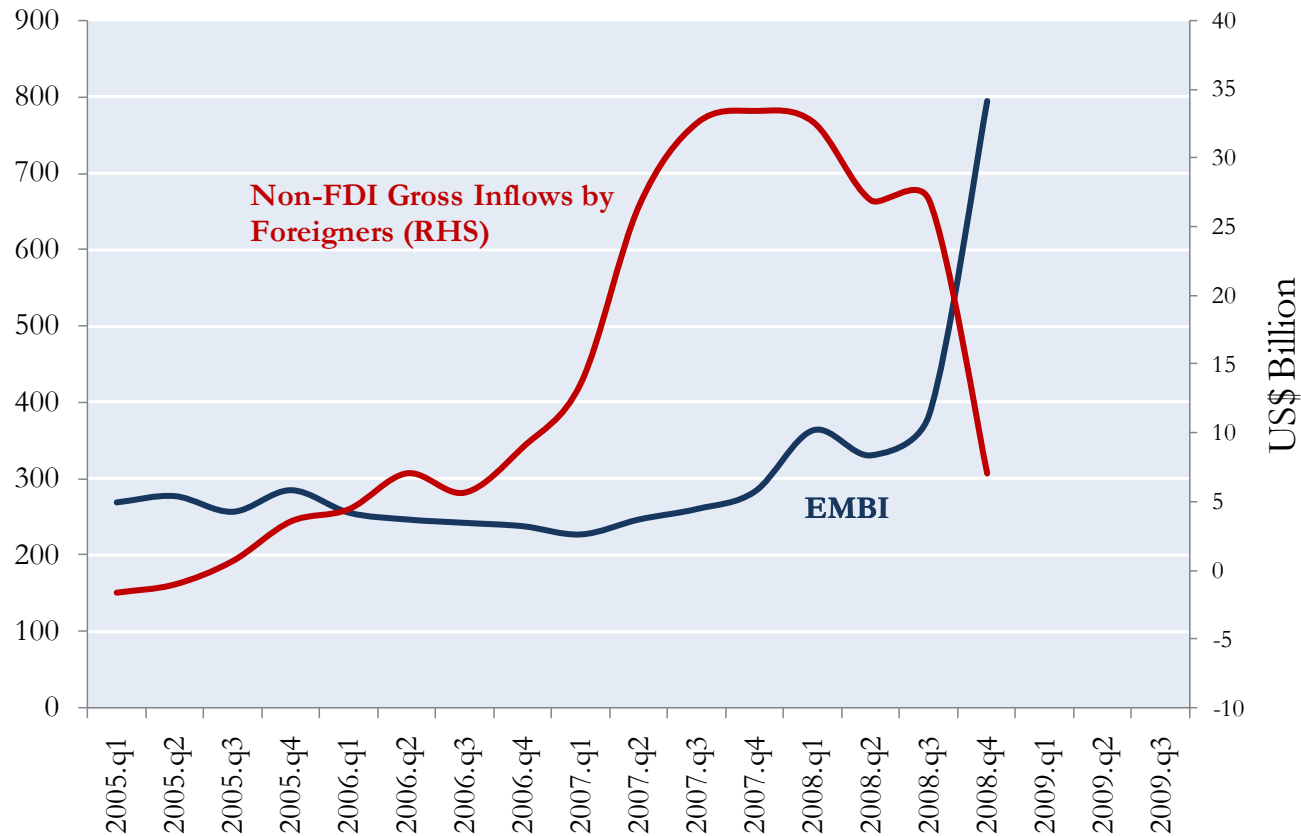
Oil WTI in Current US\$, Wheat, Copper and Soybean: Index 01-Jan-05=100



- 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

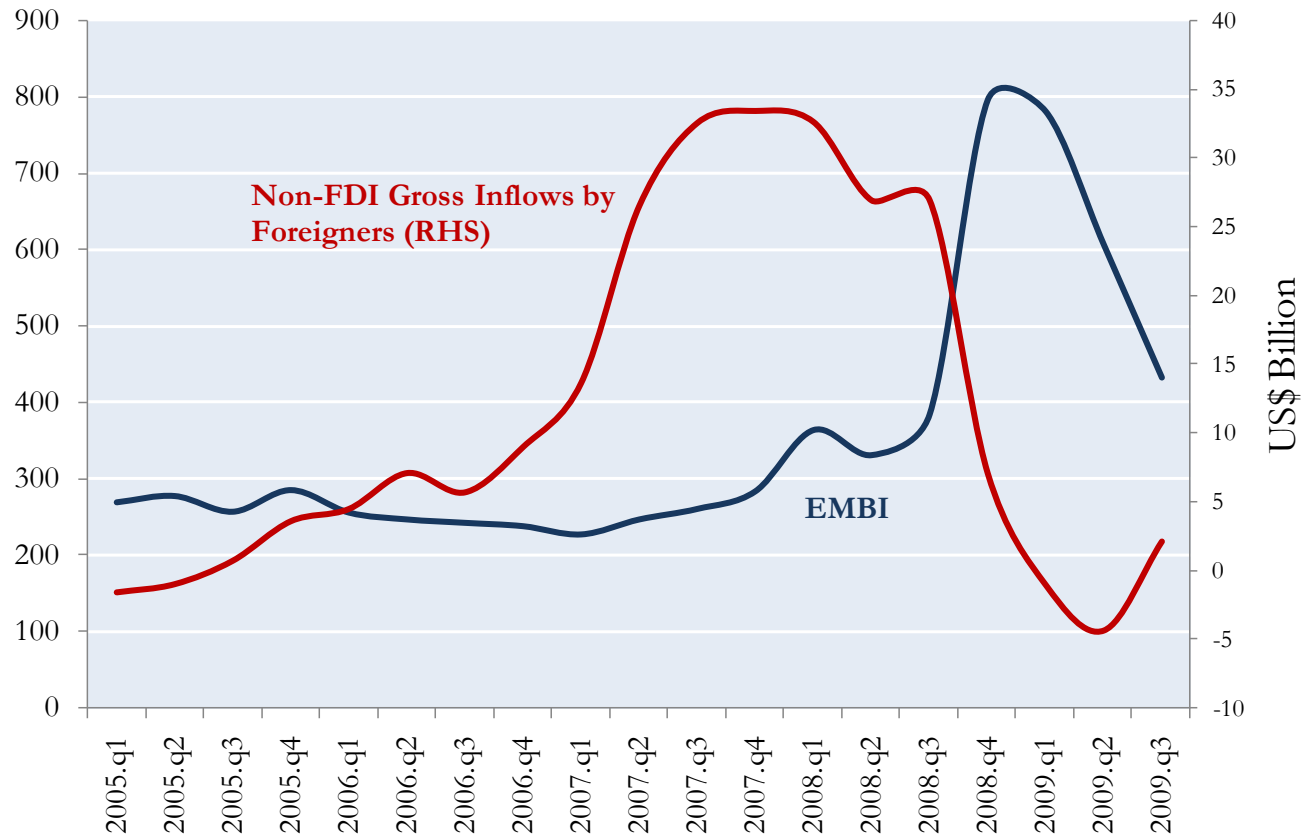
After the Lehman debacle, non-FDI inflows fell sharply as the cost of external rose steeply...

LAC: Capital Flows and EMBI



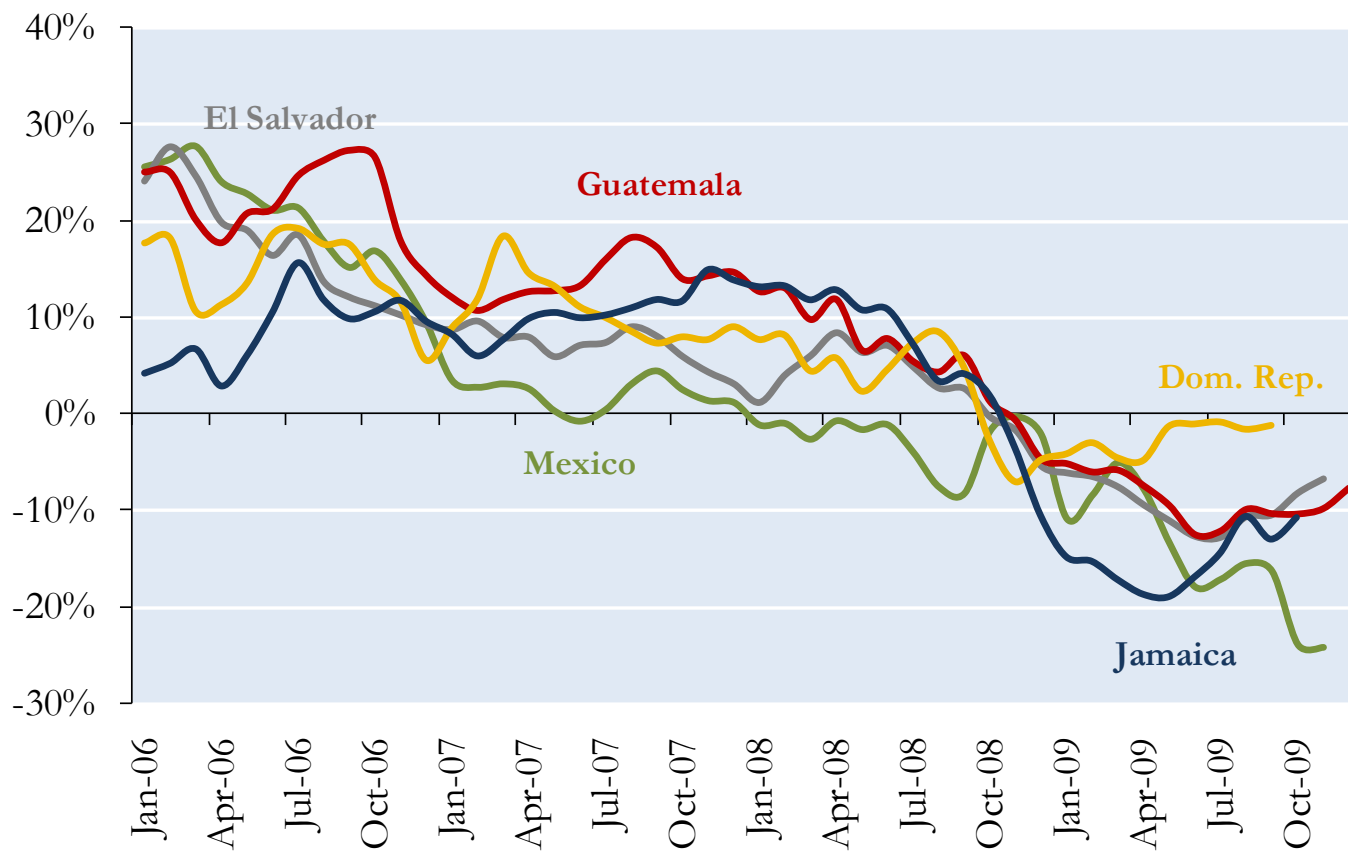
...but spreads started to come down in Q2 and non-FDI inflows began to recover in Q3

LAC: Capital Flows and EMBI

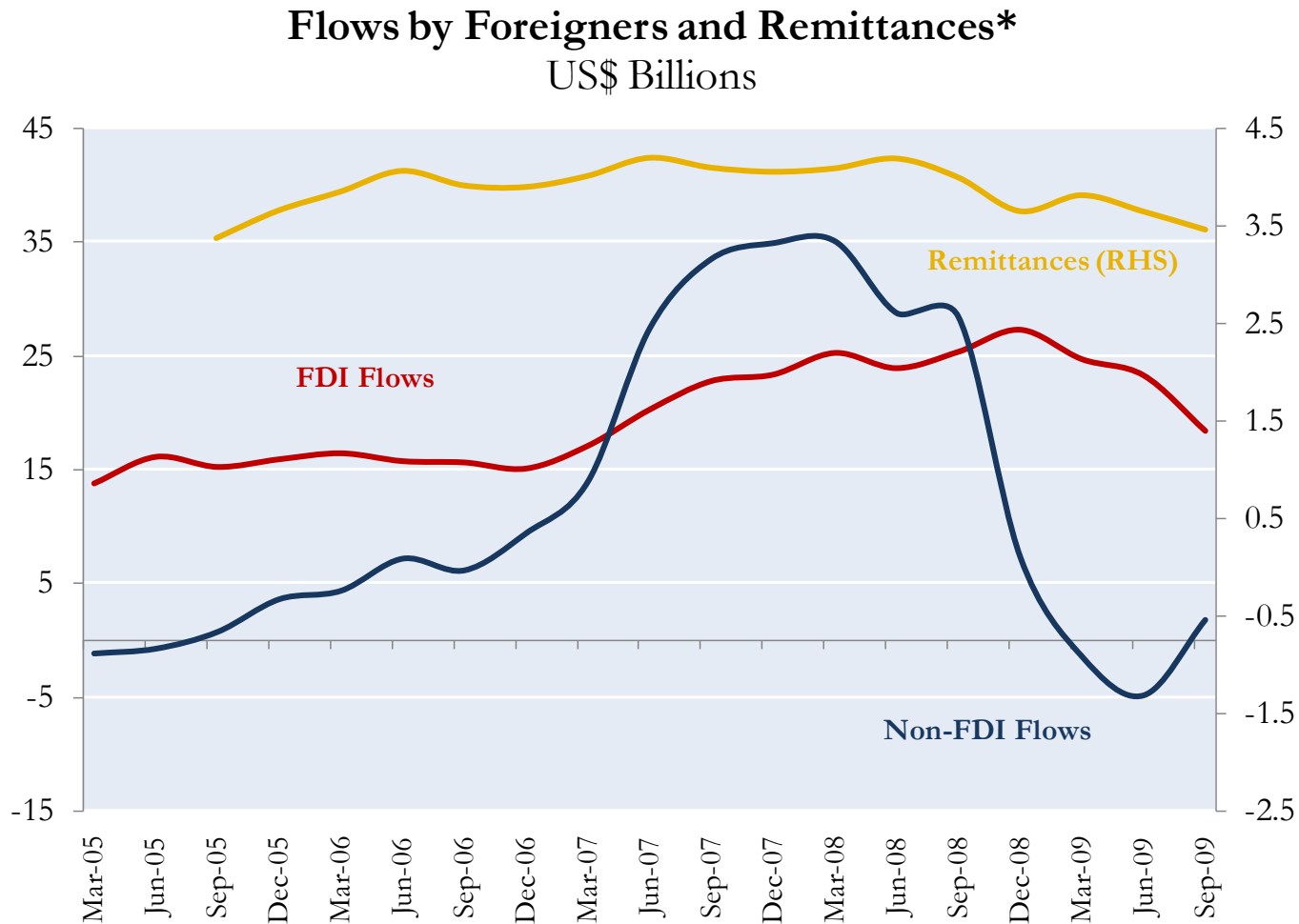


Remittances had started to contract, for the first time in decades...

Remittances Inflows to Latin America
Annual Growth, 3 Months Moving Average



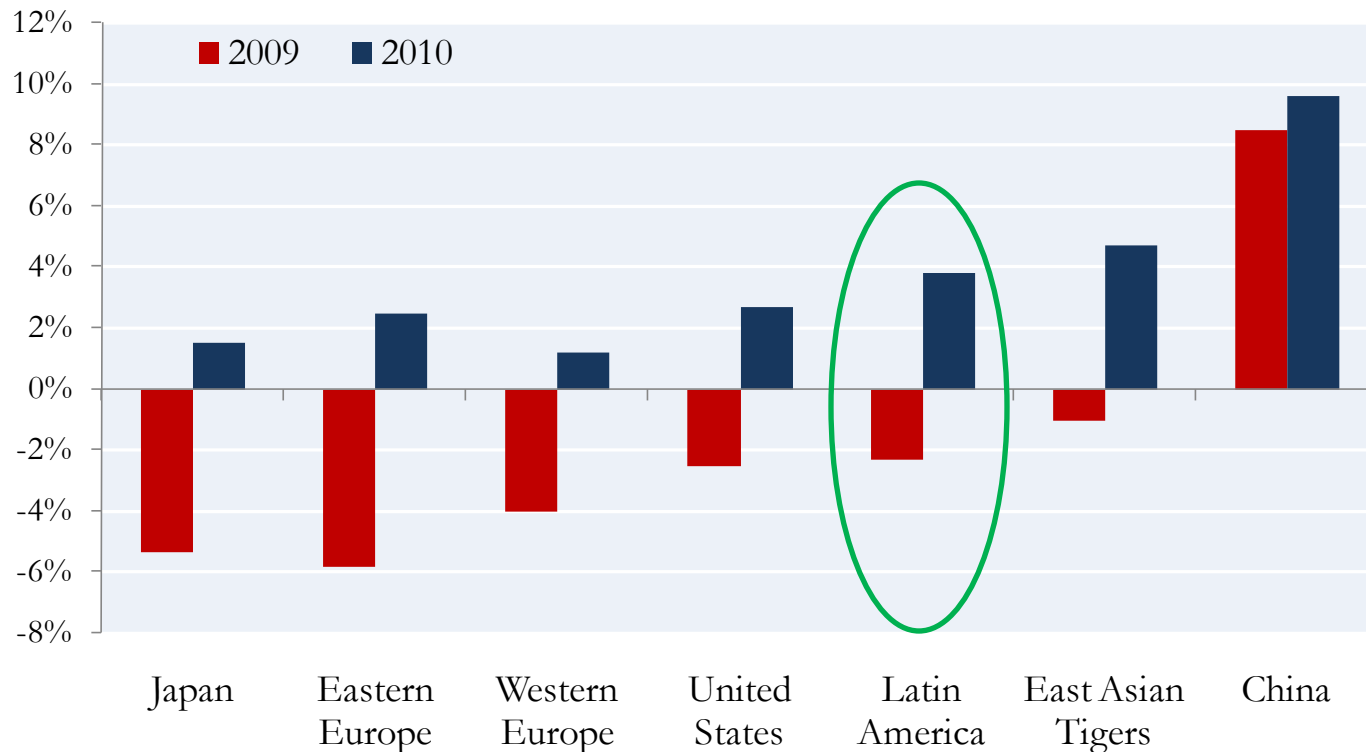
... and have continued to decline, although remittances and FDI have shown resiliency relative to other inflows



In all, LAC fell into a recession in 2009, but it was less pronounced than in other areas of the world

Recent Real GDP Growth and Forecasts for 2009-2010

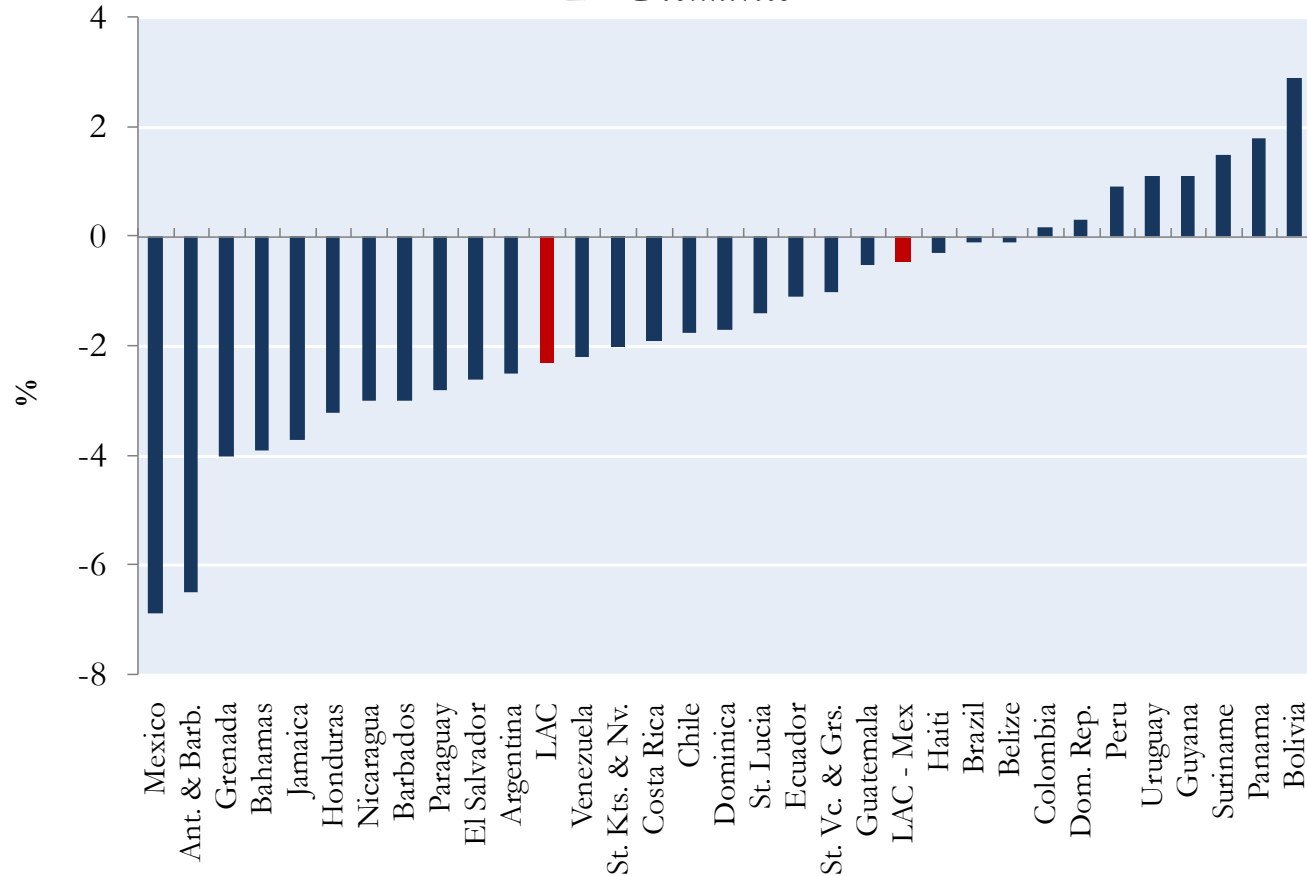
Annual GDP Real Growth Rate,



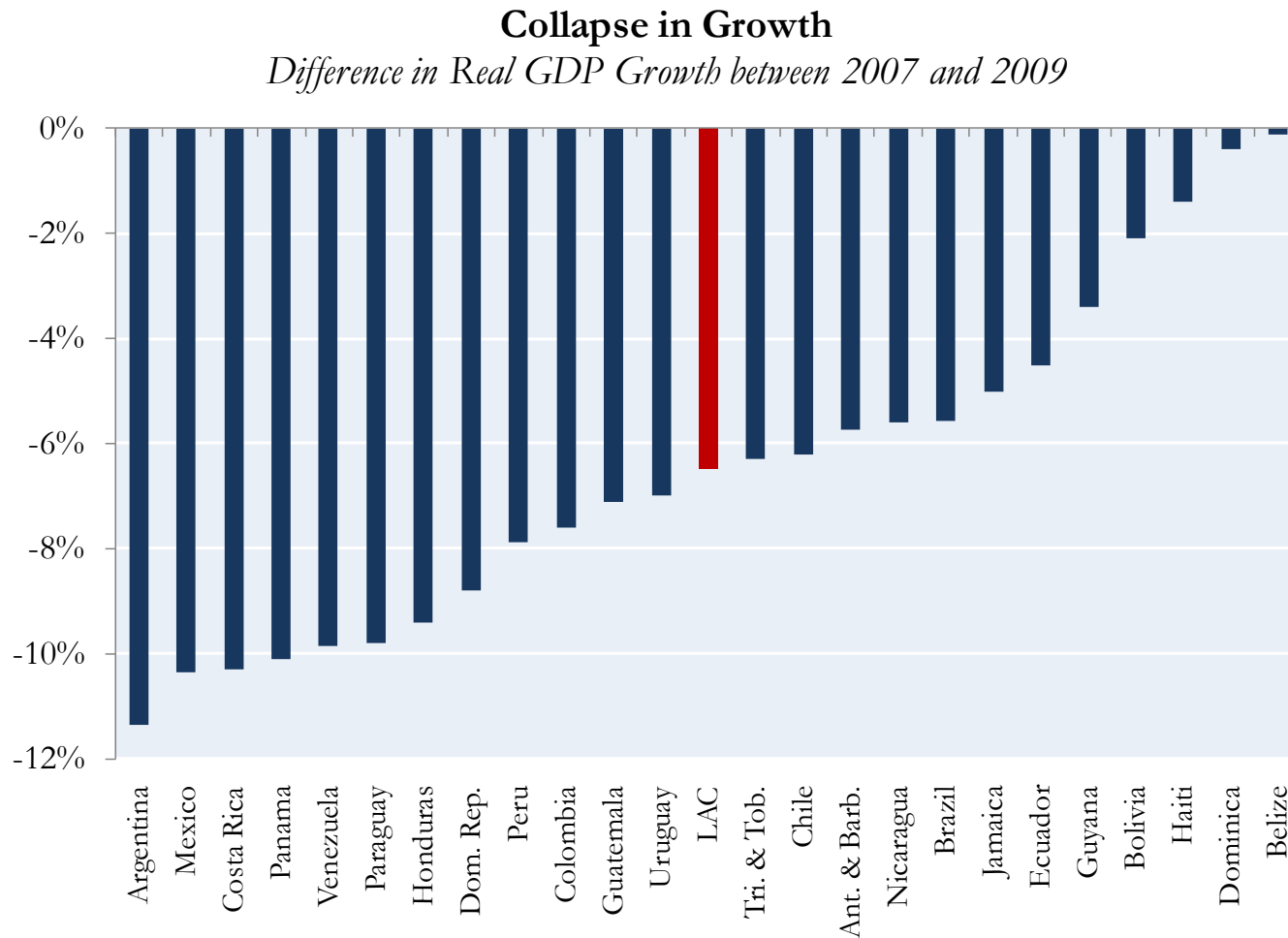
Excluding Mexico, LAC's GDP would have hardly contracted in 2009 and some countries continued to grow

Real GDP Growth Forecasts for 2009

LAC countries

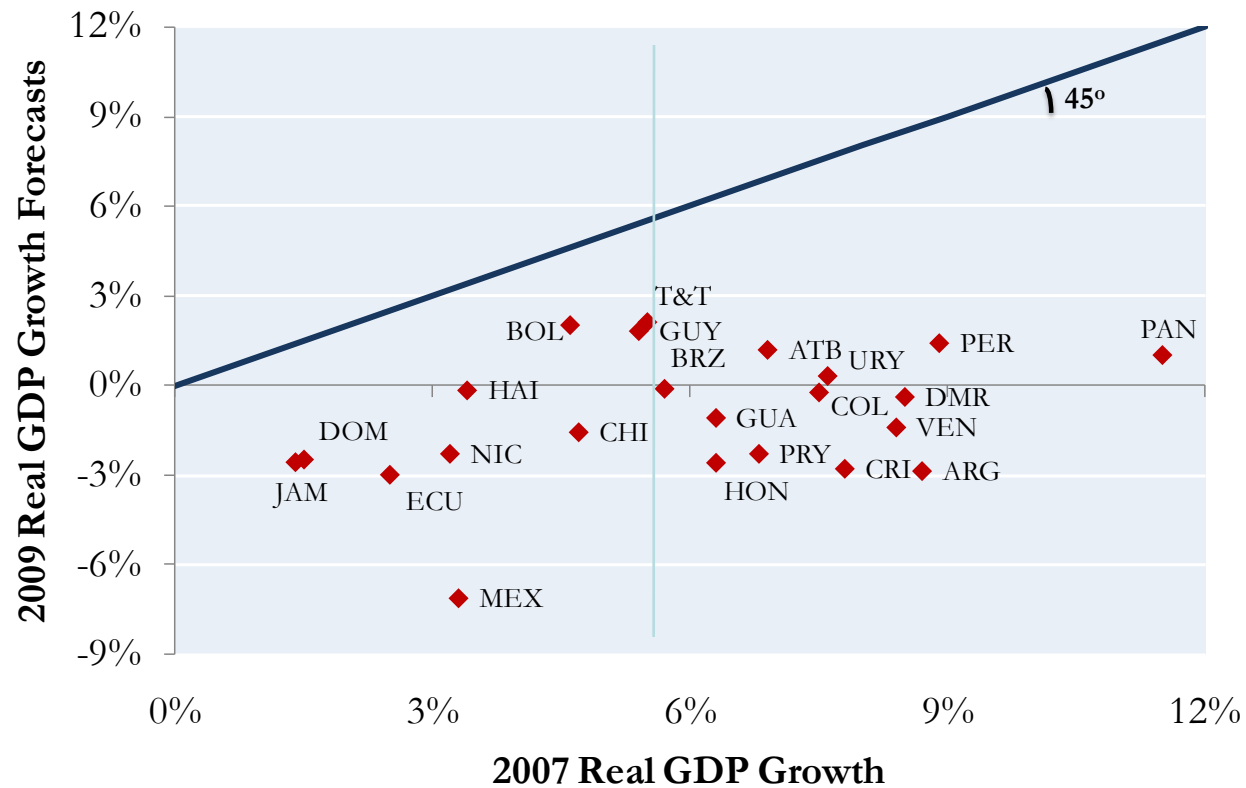


The 2009 *growth collapse* in LAC was significant on average, but cross-country variation was nontrivial



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

Real GDP Growth in LAC
2007 and 2009 Forecasts



More importantly, LAC is coming out of this crisis without significant systemic damage – *no financial crisis...*

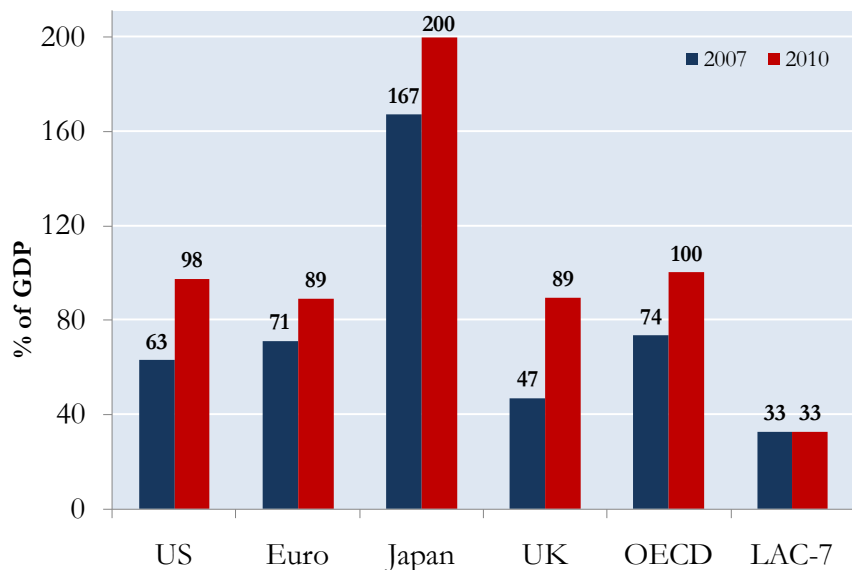
Banking Crises in LAC Countries

1980-1985		1995-2000		2008-2009
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	

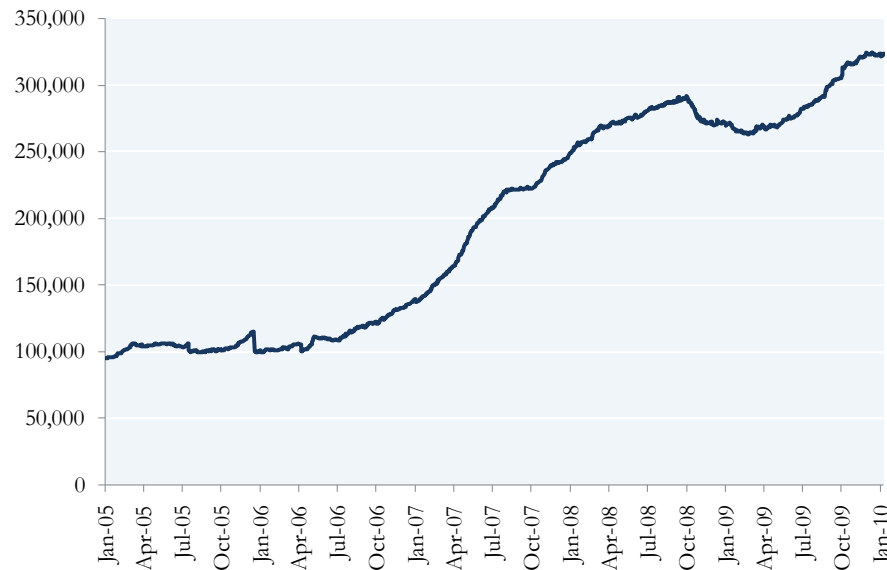
***The global crisis bruised LAC’s “income statement”
but it did not impair it’s “balance sheet”***

...and comfortable public debt positions and international reserve cushions...

Gross Nominal Liabilities



LAC - International Reserves
US\$ Millions



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

How did LAC fare in 2009?

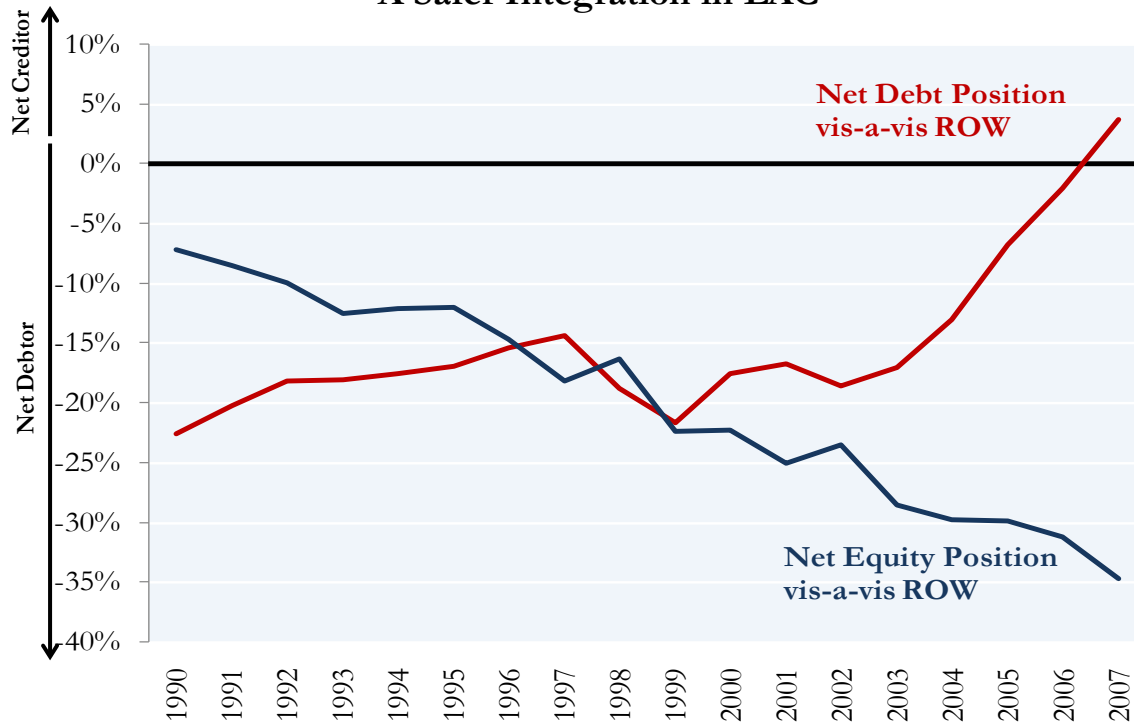
The region is well positioned for recovery

LAC is, thus, well-positioned for recovery

- LAC's improved *macro-financial immune system* passed a tough test, demonstrating that the region has become fundamentally less vulnerable
 - Local conditions/policies did not magnify, but cushioned, the external shock
- What is behind the reduction in LAC's macro-financial vulnerability?
 - Safer form of international financial integration
 - Sounder and better supervised/regulated financial systems
 - Improved monetary policy frameworks – exchange rate flexibility *and* reduced currency mismatches enabled shock-absorbing (countercyclical) policy
 - More viable fiscal/public debt dynamics and improved social assistance policies
- As a result, *on average*, LAC is emerging out of this crisis as better asset class, a relatively more attractive destination for investment

LAC's international financial integration has grown safer

A Safer Integration in LAC

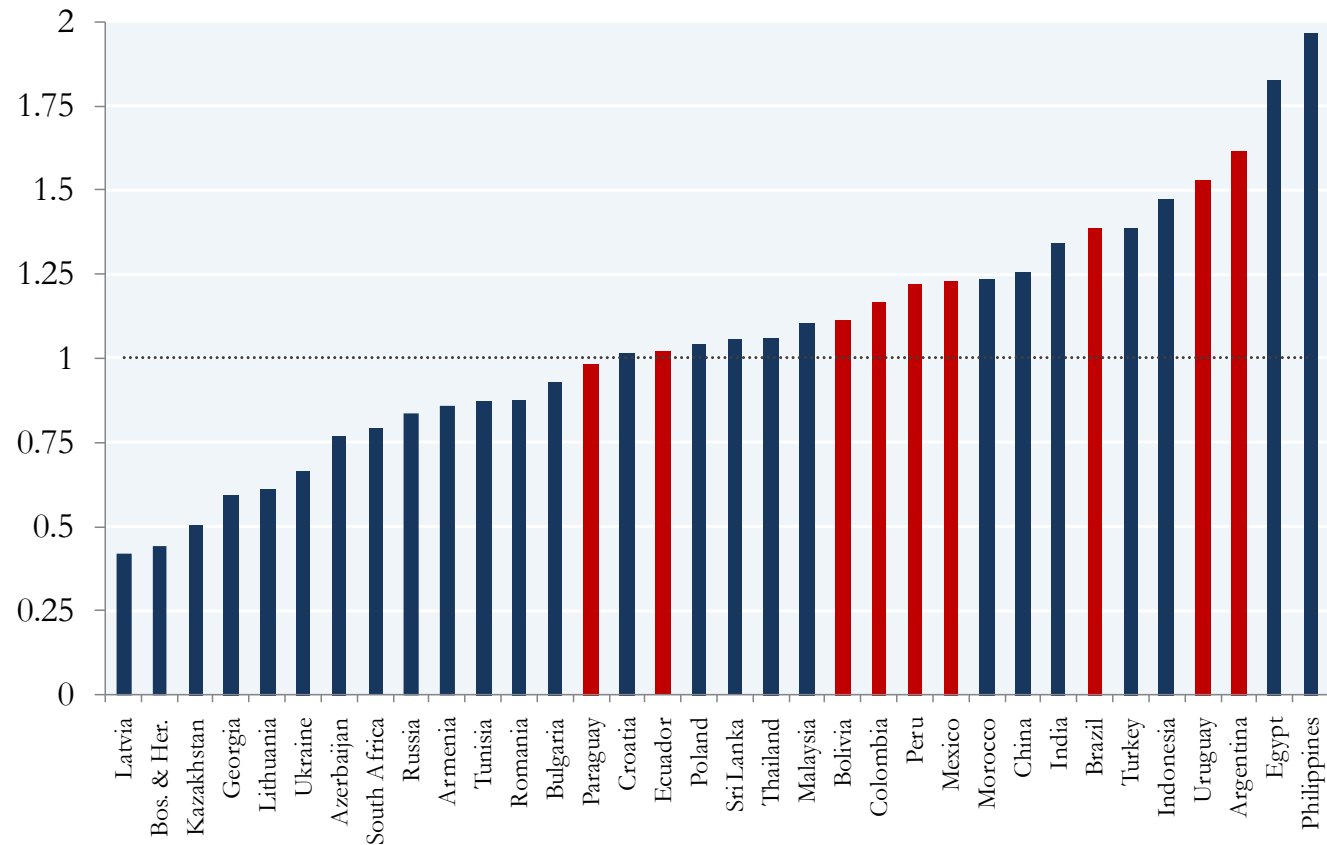


LAC has become a net creditor to the ROW in the debt side

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

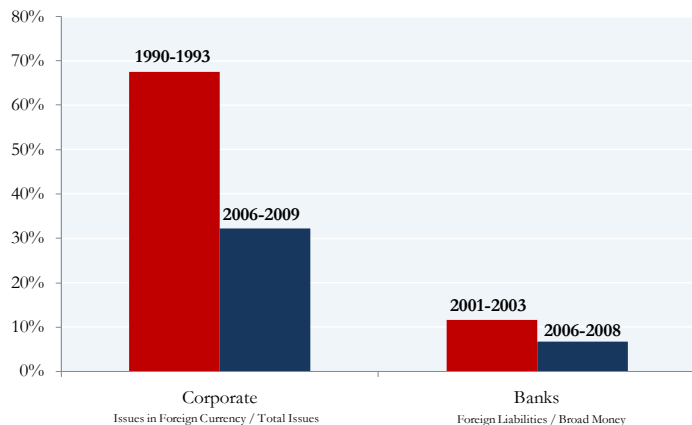
LAC's banking systems have become sounder

Deposit to Loan Ratios
Emerging Countries, 2007 Data



Currency mismatches in LAC have declined significantly...

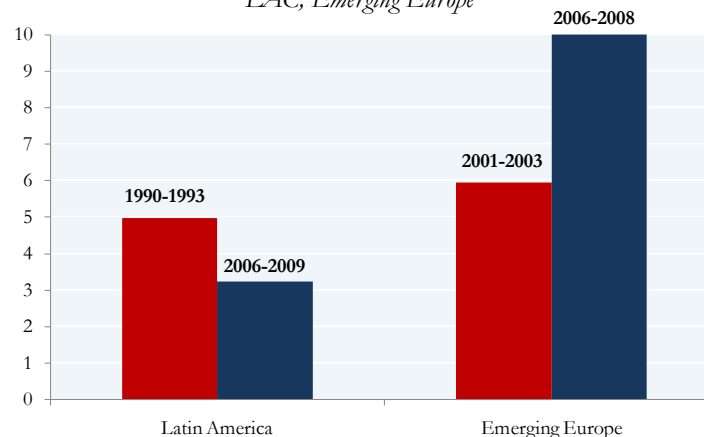
Corporate and Banks' Dedollarization in LAC



Note: GDP-weighted averages of the periods noted.

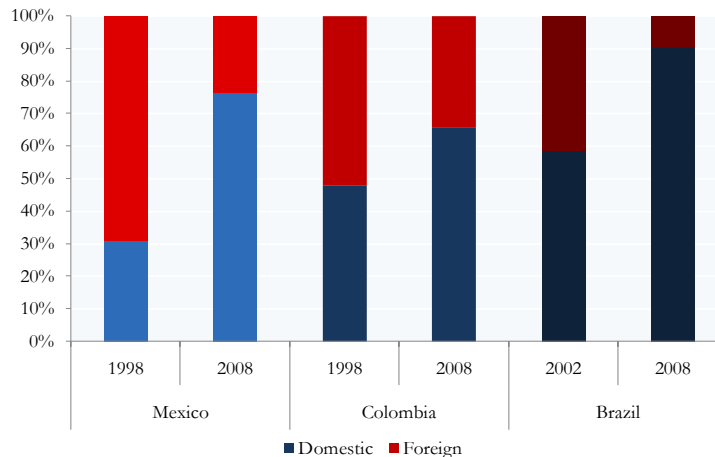
Source: Gozzi et al. (2009), IFS

Composite Dollarization Index
LAC, Emerging Europe



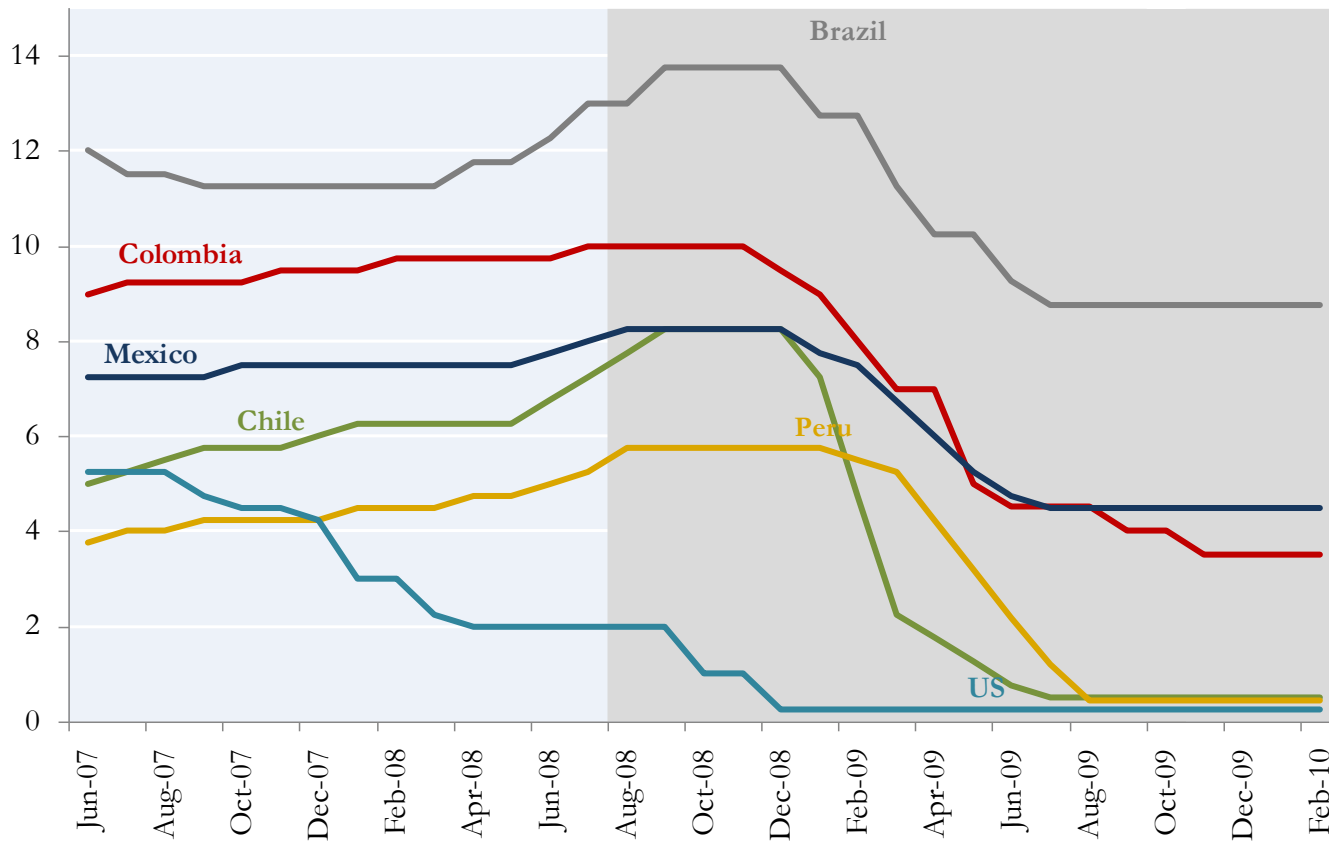
Source: Schmukler (2009) based on Reinhart, Rogoff, Savastano (2003)

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



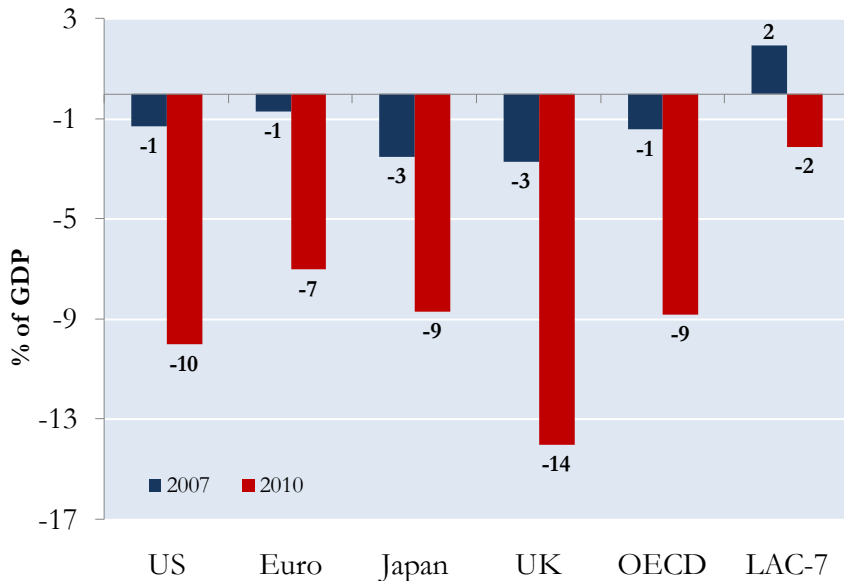
Improved monetary policy frameworks and reduced currency mismatches have enabled countercyclical policy

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

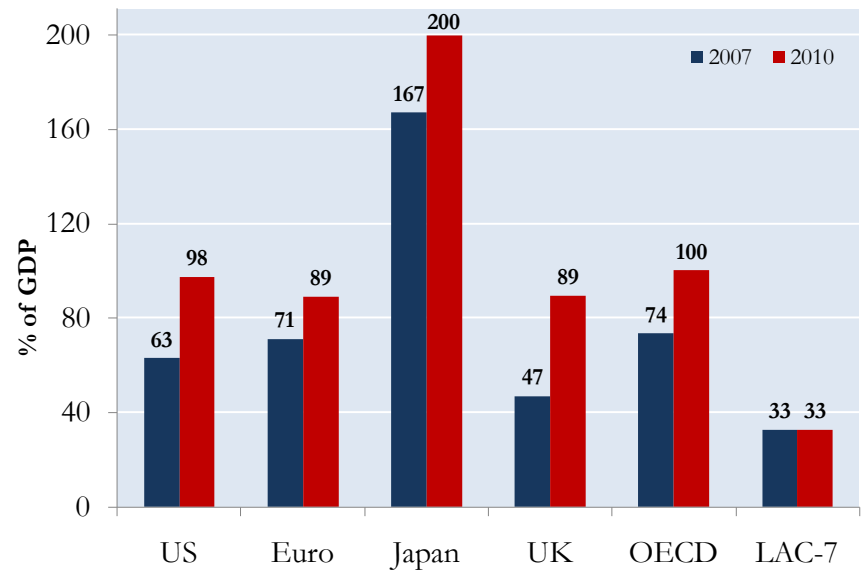


While far from perfect, fiscal and public debt processes in most of LAC have become more viable

Fiscal Balance

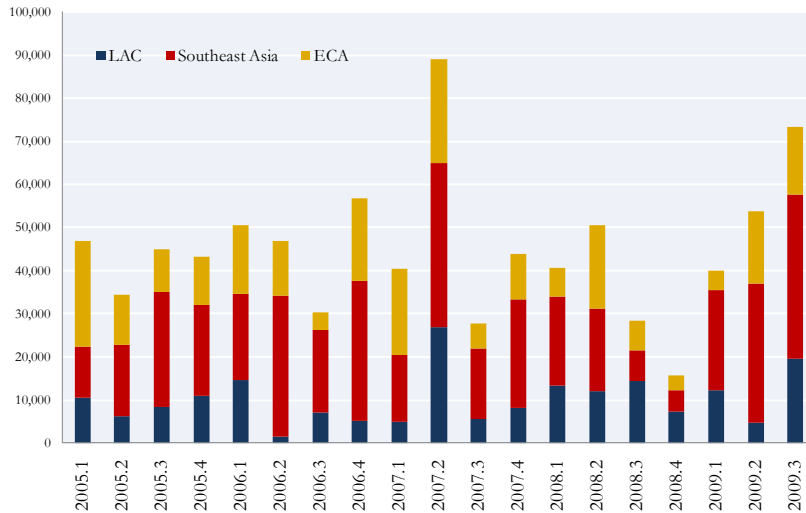


Gross Nominal Liabilities

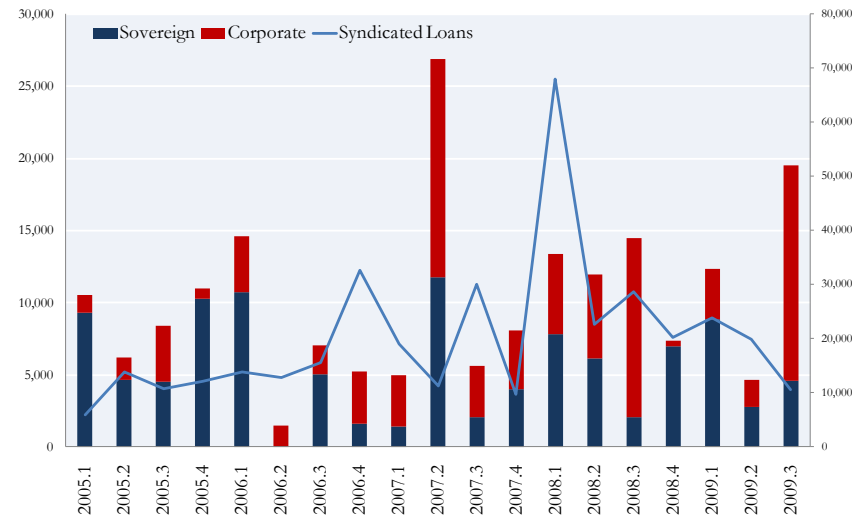


As a result, the larger LAC countries are regaining access to international bond and equity markets

New Capital Raisings Abroad
Equity + Bonds, US\$ Millions



LAC: New capital raisings in international markets
Equity + Bonds and Syndicated Loans, US\$ Millions

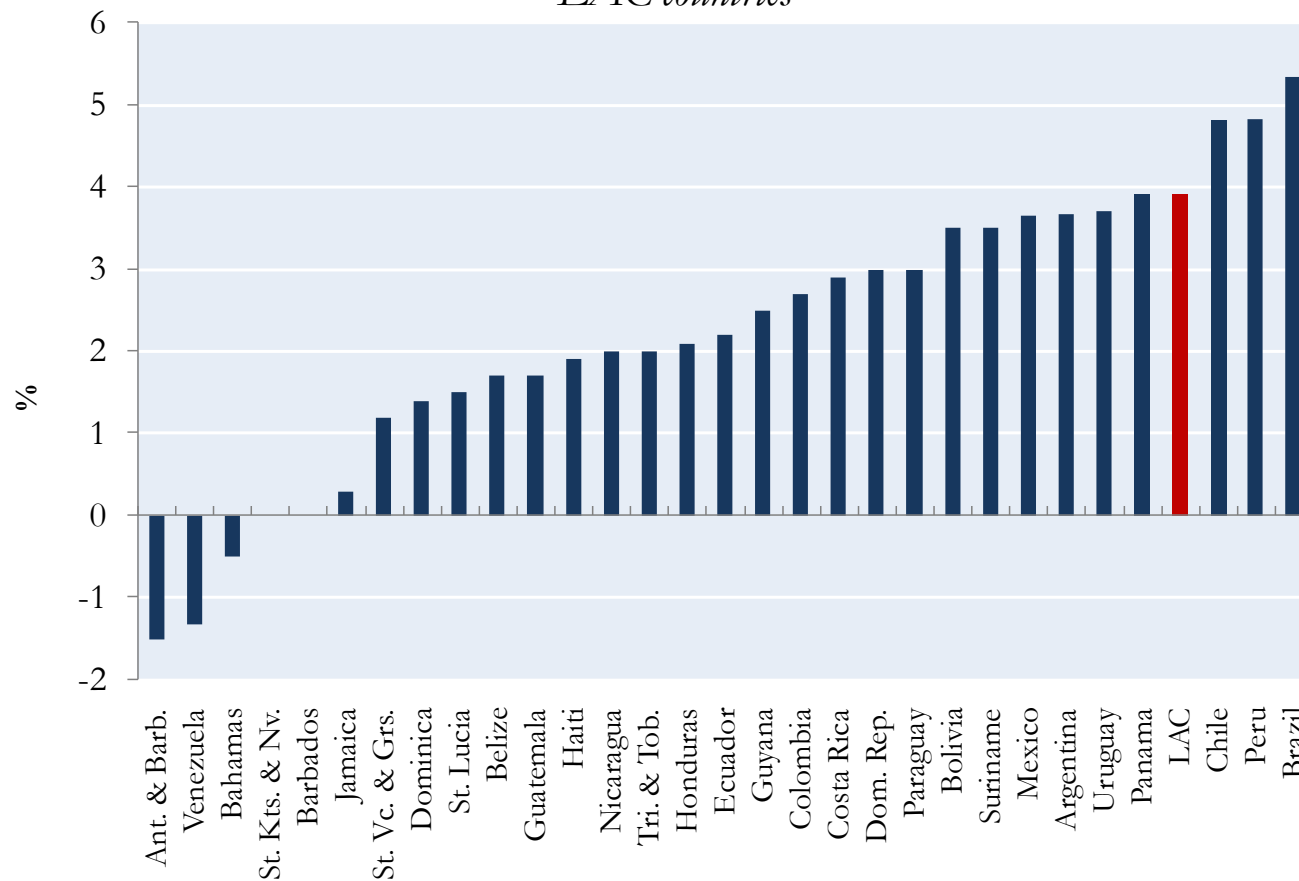


Note: Corporate sector includes state-owned firms

...and a broad-based growth recovery is expected for LAC countries in 2010...

Real GDP Growth Forecasts for 2010

LAC countries



What next?

Medium-term global prospects clouded by risks

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

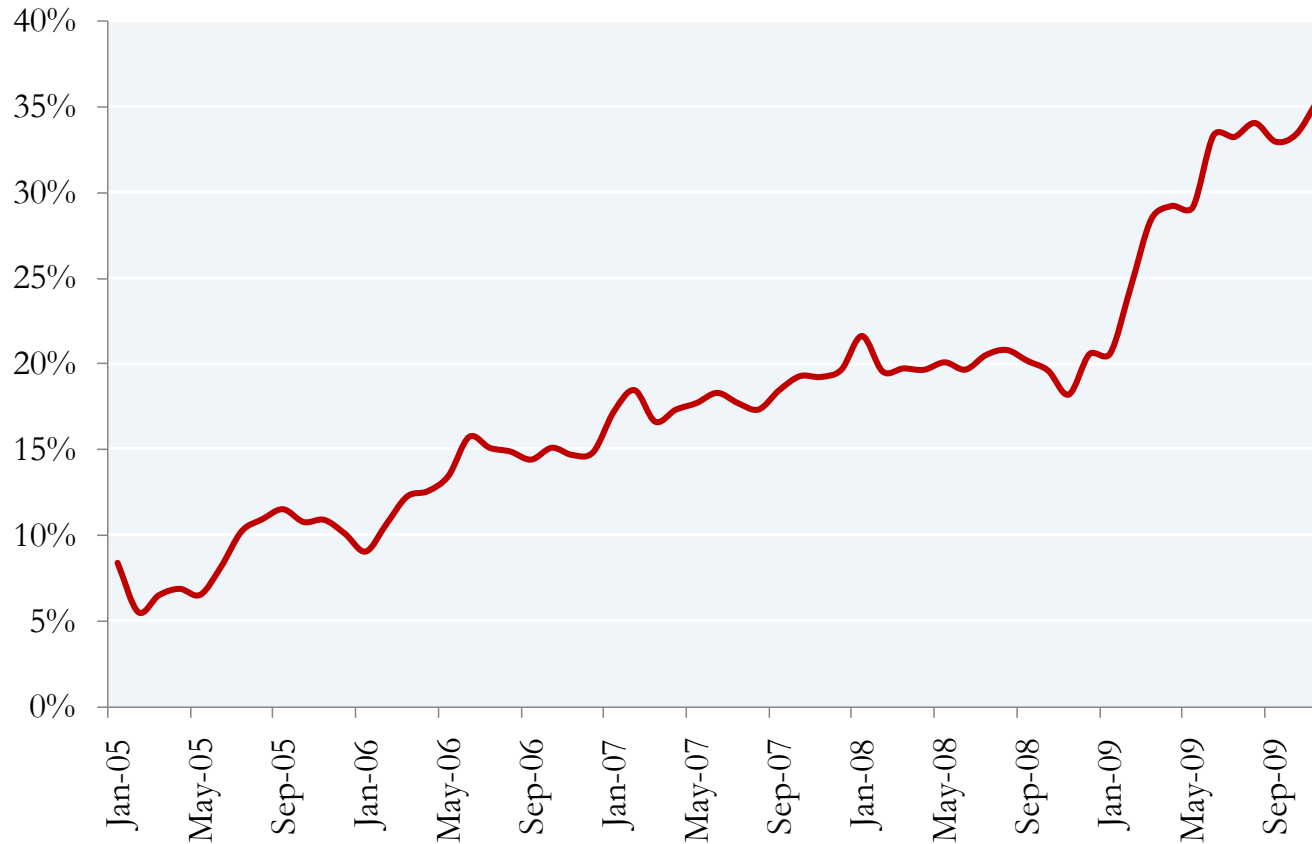
- Will private sector demand in rich countries be strong enough when the effects of stimulus policies and inventory restocking fizzle away?
 - Private investment, employment, and credit remain depressed
- Will exit from stimulus policies be well-timed and orderly?
 - Premature retreat can kill the recovery; delayed retreat can rise inflation specter
 - Ambiguity regarding exit strategies and additional stimuli may be under way due to concerns with high unemployment
- Will fiscal/debt dynamics in rich countries be restored to viability?
 - Specter of future inflation or higher interest rates – if “growing out of debt” and/or higher taxes/major spending cuts are not feasible
- Will problems in Club Med Europe be contained?

LAC prospects depend on the global environment, where haziness and risks exist (2)

- Will private sector balance sheets (financial intermediaries, households, firms) in rich countries be adequately repaired?
 - The process of de-leveraging and asset rebuilding is just beginning
- Will regulatory uncertainty in rich countries be adequately dispelled?
 - Regulatory reform pending in finance, health, environment
- Will China avoid the materialization of downside risks?
 - Bubbles in stock and real estate markets, spurred by the credit surge
 - Rise in NPLs, especially of local governments and state enterprises
 - Excess capacity in the face of weak global demand (88% of growth in first half of 2009 came from investment)
- Will external current account positions be globally rebalanced?
 - A revaluation of the Renminbi is arguably essential for rebalancing

Fast credit growth has been at the core of the stimulus policies in China

China: Real Private Domestic Credit
Annual Variation



The world is likely to enter into a slow-growth path

- While in the very short-run the recovery is looking a lot like a V, reconstructing robust world growth in the medium-term will not be easy
- The crisis may have a permanent effects on *potential* growth in rich countries
 - Household wealth shock and debt overhang → lower consumption
 - Financial system deleveraging and balance sheet cleanup → lower credit
 - Underutilization of labor can weaken skills → lower productivity
 - Fear of inflation or higher taxes → lower investment
 - Regulatory reform → less innovation
 - Transfer of debt to public sector → more risk
- The transition path to potential growth may be protracted and bumpy, not least because of rebalancing-related problems and adjustment costs

What Next?

LAC-specific challenges

LAC challenges

- If the current global scenario continues, the larger LAC countries will face
 - Exchange rate appreciation pressures and risk of asset price exuberance
 - ER dilemmas dampened by the absence of inflationary threats in most of LAC
 - And by the depreciation of the dollar
- But the current global scenario can take a bad turn down the line
 - Inflation in high-income countries prompting an increase in interest rates
 - Materialization of downside risks in China, leading to global stagnation and low commodity prices
- In any case, we are set for a period of low world growth
 - Will LAC be able to grow faster than the world average, while maintaining its improved macro-financial immune system and enhancing its social policies?

***The quest for the “virtuous development triad” (resiliency, productivity, equity)
but with a premium on growth***

In the larger LAC countries, exchange rates have been appreciating....

Brazil: Exchange Rate

Market Rate, End of Period, LCU/US\$



Chile: Exchange Rate

Market Rate, End of Period, LCU/US\$



Colombia: Exchange Rate

Market Rate, End of Period, LCU/US\$



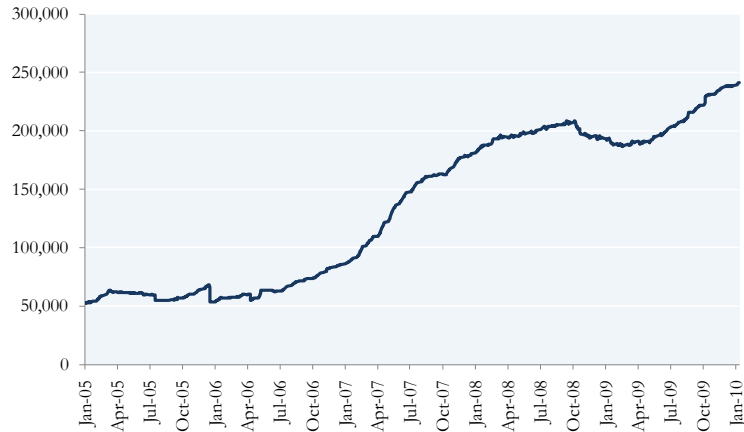
Peru: Exchange Rate

Market Rate, End of Period, LCU/US\$



... and int'l reserves have continued to accumulate, reflecting competitiveness and self-protection motives

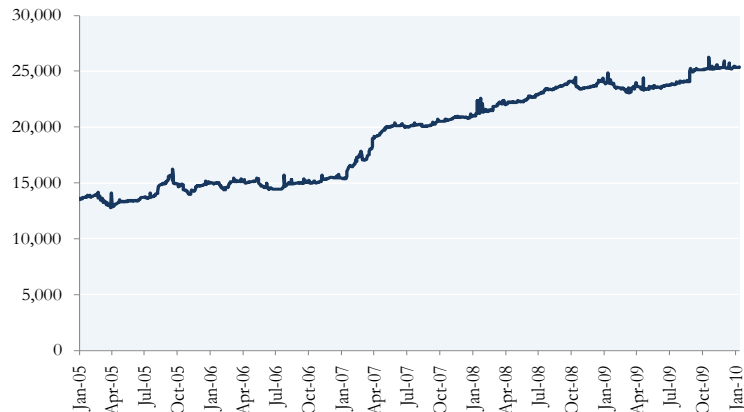
Brazil: International Reserves
US\$ Millions



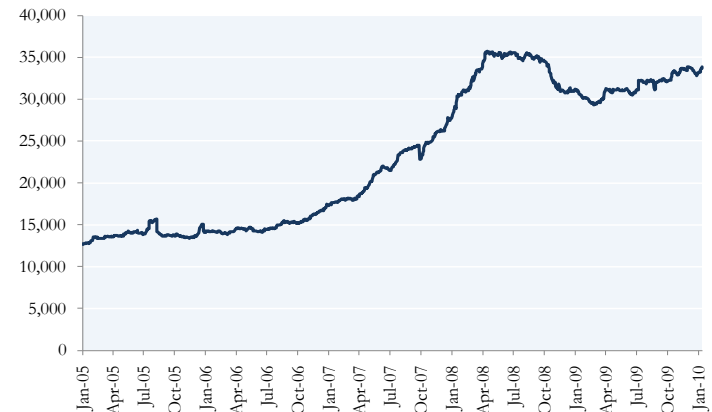
Chile: International Reserves
US\$ Millions



Colombia: International Reserves
US\$ Millions

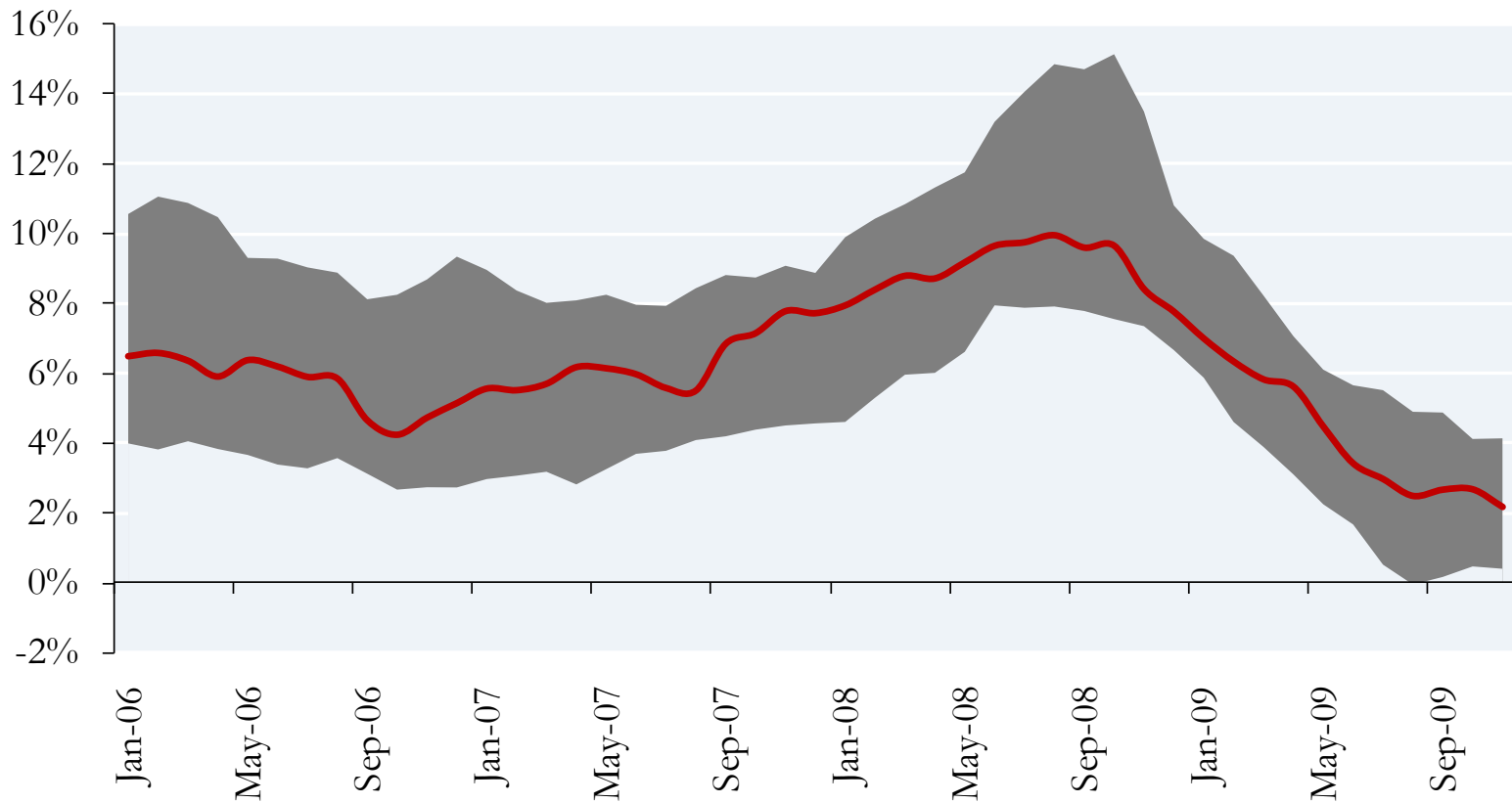


Peru: International Reserves
US\$ Millions

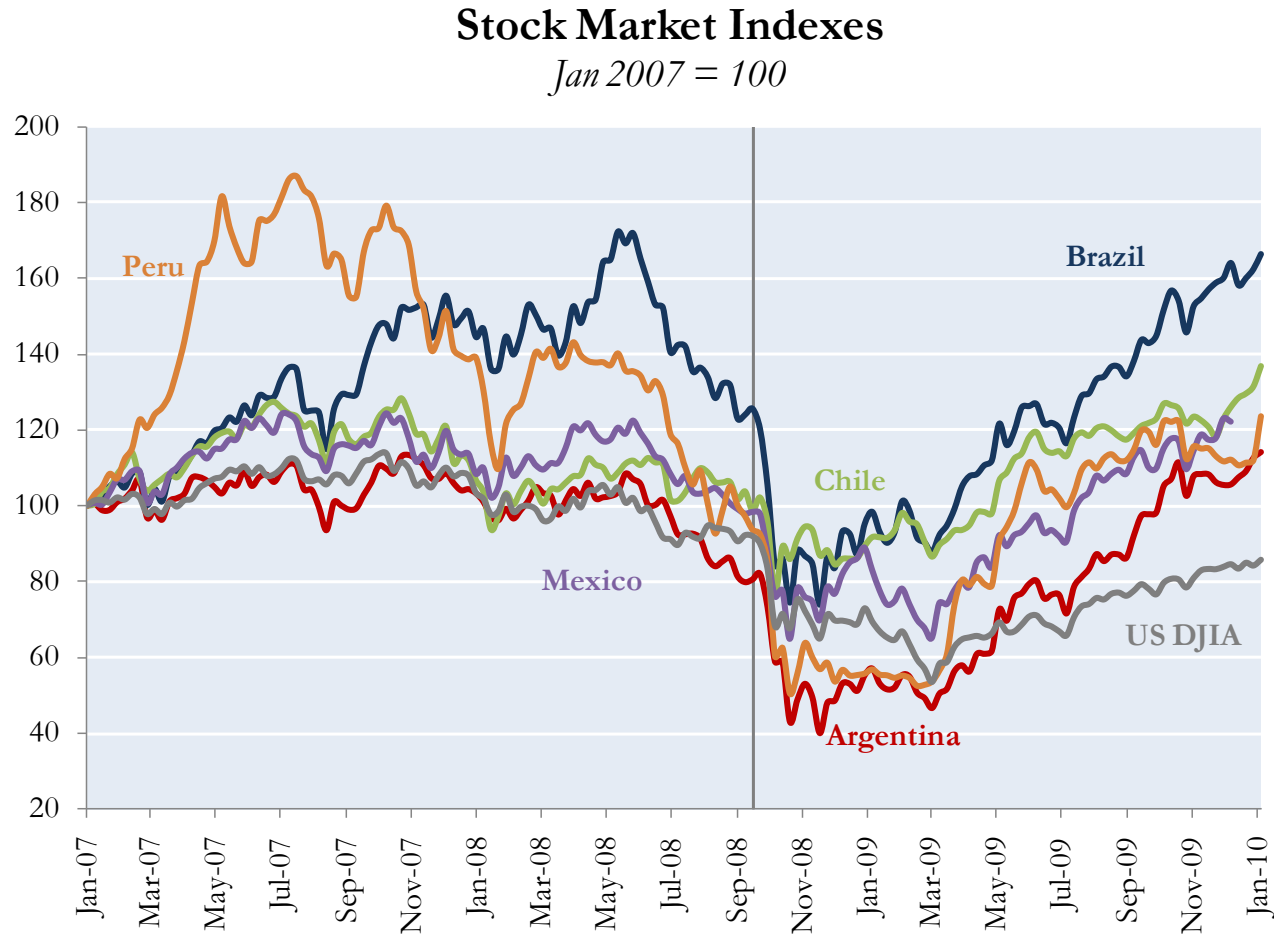


Low inflation in most of LAC has helped deal with currency appreciation through low interest rates, for the time being

Consumer Price Inflation in Latin America *Annual Variation*

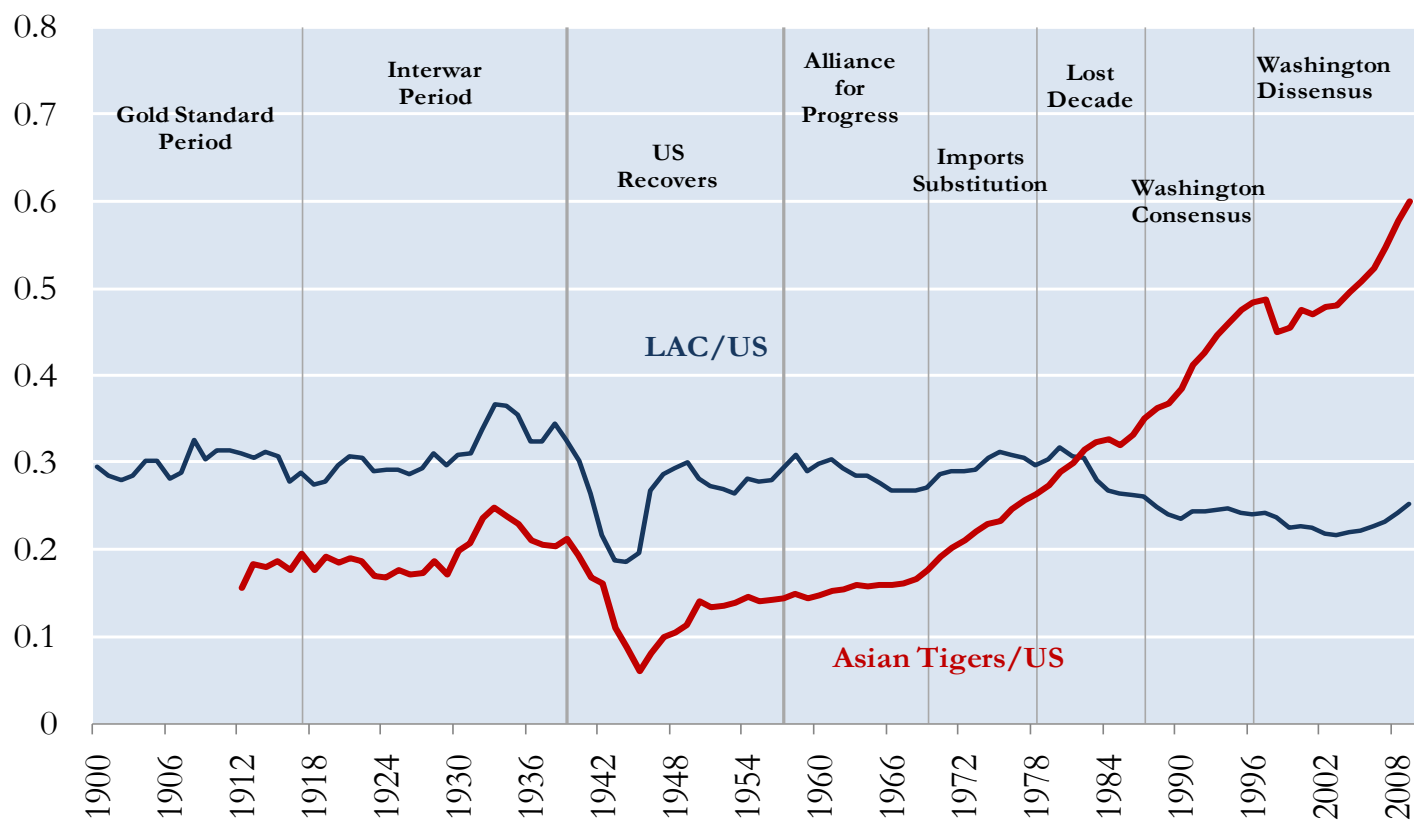


Can the current scenario of capital reflows, low interest rates, and strong commodity prices lead to a bubble?



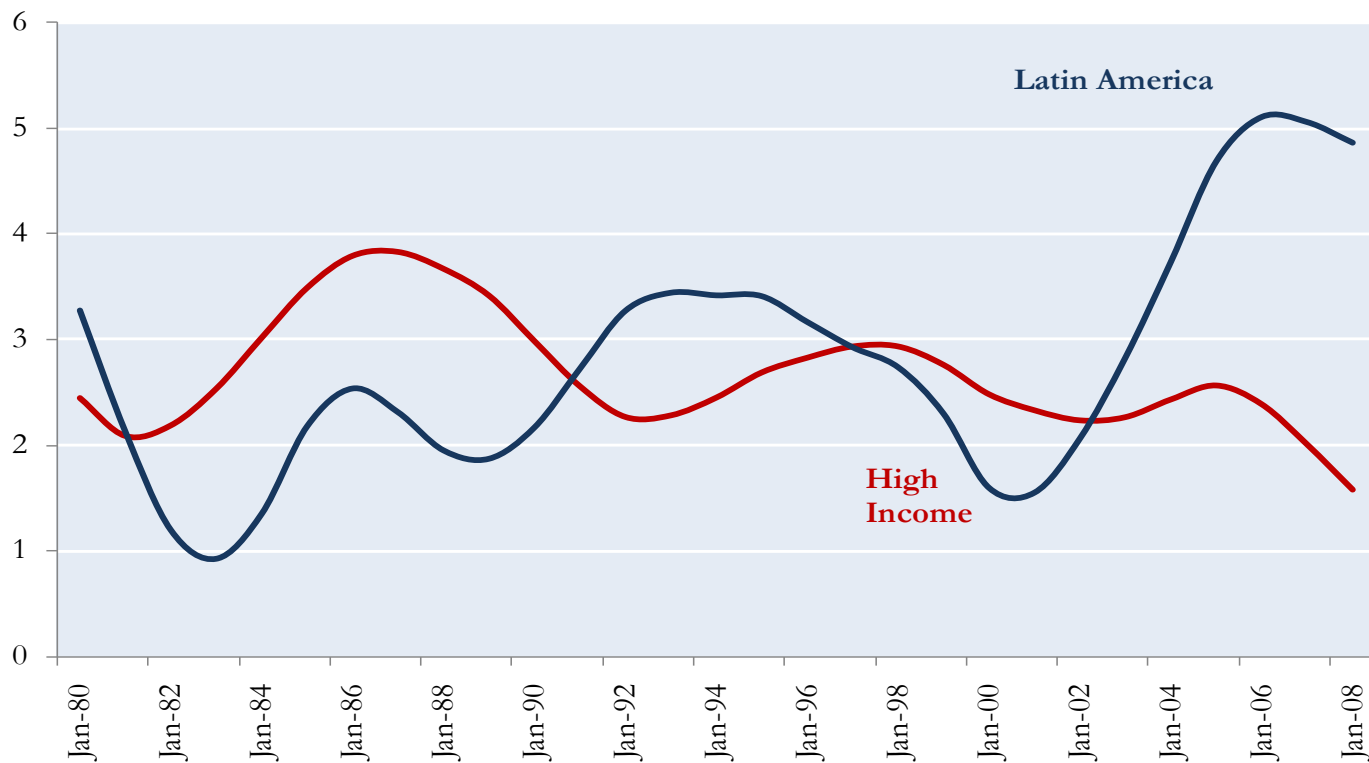
For more than a century, in contrast with the Asian Tigers, LAC has been unable to grow faster than rich countries...

GDP Per Capita of Selected Regions / US GDP per Capita



Did such dire record start changing this millennium? Or was it simply a mirage due to favorable external conditions?

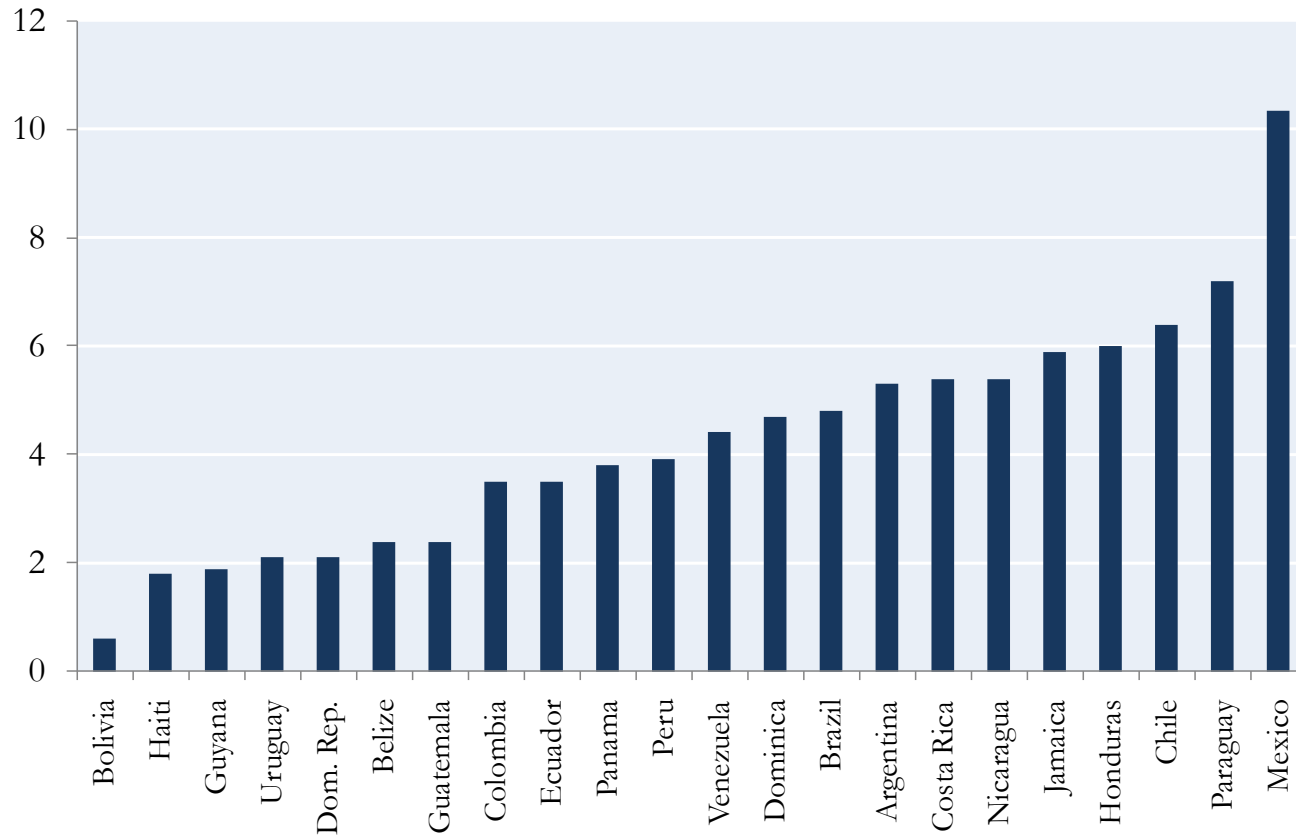
Trend GDP growth in LAC and High Income Countries
Stock Market Indexes, Jan 2007 = 100



Thank you

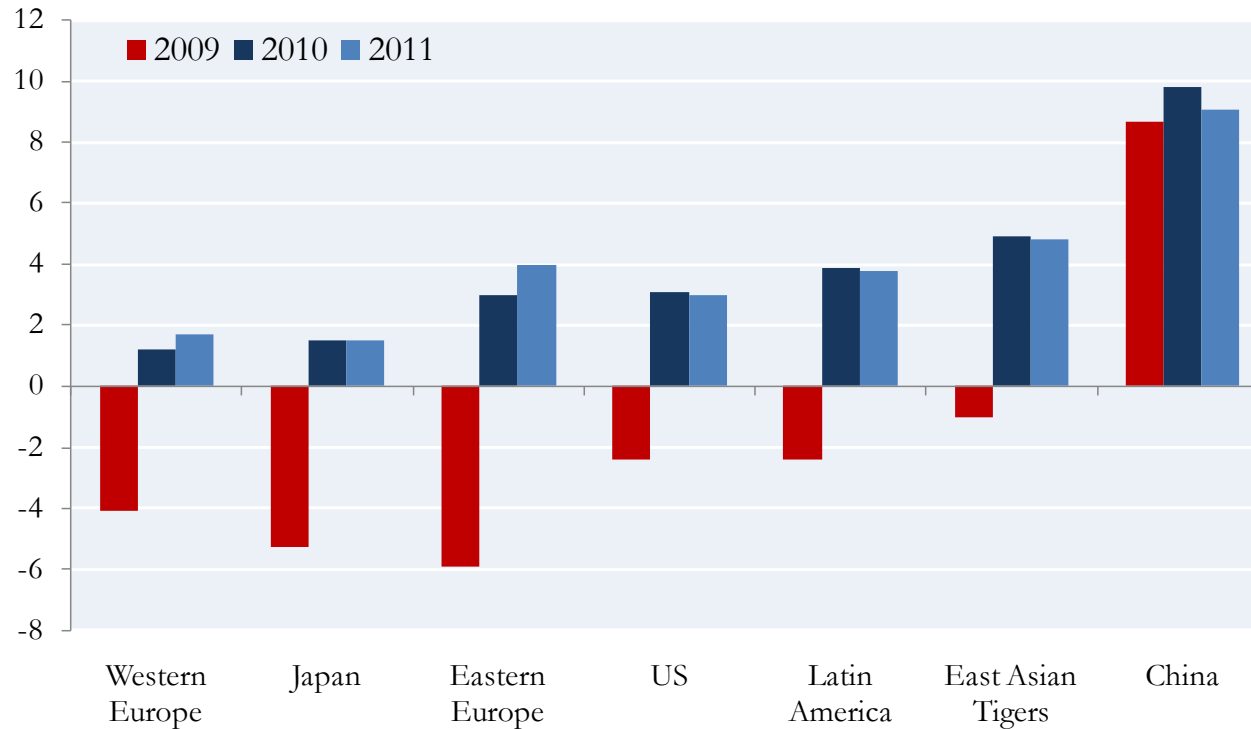
Recovery in Growth

Recovery in Growth
Difference in Real GDP Growth between 2009 and 2011



Recent Real GDP Growth Forecasts

Recent Real GDP Growth and Forecasts for 2009-2011
Annual GDP Real Growth Rate



Real GDP growth Forecast for 2011

Real GDP Growth Forecasts for 2011

LAC countries

