The Global Crisis and Latin America: Can the Region Sustain its Strong Growth Recovery?

Presentation

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Chief Economist Office for Latin America
The World Bank
Agenda

- LAC among the leaders in the global recovery, so far
- Explaining LAC’s relatively strong performance
- LAC’s policy challenges in the short-run
- Threats to continued growth in LAC
  - Global dark clouds and the limits to multi-polarity
  - The region’s own structural constraints
- Summing up
Recovery patterns contrast sharply between the rich countries and the dynamic EMs...

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

**World Industrial Production**

*Index Apr-08 = 100*

![Graph showing world industrial production with developing and emerging economies highlighted.](image)

**Note:** The group of developed countries refers to OECD countries excluding Turkey, Mexico, Republic of Korea, and Central European countries. Source: CPB (Netherlands Bureau for Economic Policy Analysis), June 2010.
... and Latin America is second in IP recovery strength among emerging regions

![Graph showing Industrial Production in Emerging Regions](source)

*Source: CPB (Netherlands Bureau for Economic Policy Analysis), June 2010.*
... and second to emerging Asia in GDP growth forecast for 2010, with Brazil and Peru ahead of the pack.

Real GDP Growth Forecasts for 2010-2011
Annual GDP Real Growth Rate, in %

Real GDP Growth Forecasts for 2010
LAC countries

Real GDP Growth Forecasts for 2011
LAC countries

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

Note: Caricom includes Dominican Republic. Source: WEO (Apr-10) and Consensus Forecast (Aug-10)
Explaining LAC’s relatively strong performance

*Reason 1: improved macro-financial “immune system”*
*Reason 2: safer international financial integration*
*Reason 3: timely multilateral and bilateral response*
*Reason 4: the China connection*
More robust monetary policy frameworks, virtuously interacting with reduced currency mismatches

Sources: Gozzi et al (2009), Reinhart, Rogoff and Savastano (2003), IFS.
In a major break with the past, monetary policy in LAC was strongly countercyclical.

**Monetary Policy Rates**
*Inflation-Targeting LAC Countries, in %*

- **Brazil**
- **Colombia**
- **Mexico**
- **Chile**
- **US**
- **Peru**

*Source: Bloomberg*
While far from perfect, fiscal processes have become more viable on average, even if still pro-cyclical (excepting Chile)

Fiscal Policy Reaction Function: Model with 2003 break in output gap and government debt

Method: Instrumental Variables

<table>
<thead>
<tr>
<th>Dependent variable: Fiscal indicator as % of GDP (FI)</th>
<th>Actual</th>
<th>Cyclically-adjusted</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Balance</td>
<td>Revenues</td>
</tr>
<tr>
<td>I. All LAC Countries (17)</td>
<td></td>
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<tr>
<td>Output gap, 1990-2003</td>
<td>-0.109486</td>
<td>-0.066482</td>
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<tr>
<td>Output gap, 2003-2008</td>
<td>-0.10535</td>
<td>-0.060685</td>
</tr>
<tr>
<td>Govt Debt, 1990-2003</td>
<td>0.006994</td>
<td>-0.005468</td>
</tr>
<tr>
<td>Govt Debt, 2003-2008</td>
<td>0.020370***</td>
<td>0.002222</td>
</tr>
<tr>
<td>No. Countries</td>
<td>17</td>
<td>17</td>
</tr>
<tr>
<td>No. Observations</td>
<td>272</td>
<td>272</td>
</tr>
</tbody>
</table>

Standard errors in brackets

***p<0.01, **p<0.05, *p<0.1

Note: We define the fiscal primary surplus as the general government receipts (including grants received and loan repayments) less non-interest expenditures, as a percentage of GDP. For Mexico, we use the Budgetary Public Sector. Source: EIU
At least in the LAC-6, fiscal policy was countercyclical

**Variation in the cyclically-adjusted primary surplus**
*(in percentage points of GDP)*

- Argentina
- Brazil
- Chile
- Colombia
- Mexico
- Peru

Note: This figure 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 current financial crisis and during the previous two recessionary periods associated to previous crises. Negative (positive) values indicate an expansion (contraction) in discretionary fiscal policy. Source: Haver Analytics, Datastream. Elaboration: LCRCE Staff Calculations
Following a history of crises, banking systems in LAC have become sounder and more resilient.

**Deposit to Loan Ratios**

*Emerging Countries, 2007 Data*

Emerging countries were defined as lower middle income and upper middle income, World Bank Classification. Source: Beck, Demirgüc-Kunt and Levine (2009): Financial Structure Database.
LAC has migrated towards a safer form of integration into international financial markets.

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 provision of liquidity and budget support financing from the official community was flexible and timely.

- **Oct-08**
  - US Fed opens US$ 120 bn swap lines with BRA, MEX, KOR, and SGP
  - IMF creates short-term liquidity facility

- **Apr-09**
  - IMF launches FCL
  - FCL agreement with Mexico (US$ 47 bn)

- **May-09**
  - FCL agreement with Colombia (US$ 10.4 bn)

Note: 2010 numbers projected based on submissions to OPCS. Source: IBRD
An increasing number of LAC countries has been sharply intensifying trade and FDI links to Asia

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

Source: IMF’s Direction of Trade Statistics (DOTS).
...the co-movement of growth between LAC countries and China has been 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.`
China’s commodity-intensive growth is a boon to Latin commodity exporters

**Cumulative Change in Terms of Trade**

<table>
<thead>
<tr>
<th>Country</th>
<th>2001q4 - 2008q2</th>
<th>2008q4 - 2009q4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bolivia</td>
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<td>Ecuador</td>
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<td>Chile</td>
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<td>Paraguay</td>
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<td>Trin. and Tob.</td>
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<td>Colombia</td>
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<td>Peru</td>
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<tr>
<td>Argentina</td>
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<td>Mexico</td>
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<td>Uruguay</td>
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<tr>
<td>Brazil</td>
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<td>Panama</td>
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<td>Guatemala</td>
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<td>Costa Rica</td>
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<td>Nicaragua</td>
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<tr>
<td>Dominica</td>
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<td>Honduras</td>
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</table>

**Note:** The cumulative variation in the terms of trade index is calculated using quarterly data. The blue bars represent the cumulative percentage change during the recent commodity price boom up to the peak in 2008q2. The red bars capture the cumulative percentage change in terms of trade from its trough in 2008q4 to the most recently available quarter (2009q4). Source: WDI, DECPG, and Haver Analytics.

- About 97% of LAC’s GDP and 93% 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.
And commodity prices have rebounded to 2007 levels since their early-2009 lows.

Commodity Prices

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

Source: Bloomberg.
LAC’s cyclical recovery and ST policy challenges

*It is mostly about coping with the currency implications of success*
The price of success: currency appreciation pressures already felt and bound to intensify in the short-run...

Note: The Exchange Market Pressure Index is the weighted average of year-on-year percentage changes in: (a) the nominal exchange rate of the local 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 index signals appreciation pressures and/or accumulation of reserves. Source: LCRCE Staff calculations based on IMF’s IFS.
... reflecting strong capital inflows and relatively high commodity prices

Gross Capital Inflows to LAC-7 Countries
Annualized Inflow in US$ Billions

Source: National Authorities
Fast-closing output gaps and inflation risks ...

2010 Output Gap and Inflationary Pressures

Note: Inflation pressures are calculated as the difference between the 2010 inflation rate forecast and an estimated target of 4% (assumed to be the target for most countries in the region, except for Chile, whose target is 3%). The output gap calculated as the difference between the (log of) actual and potential GDP, with the latter being calculated using the Hodrick-Prescott filter. Source: LCRCE Staff calculations based on Consensus Forecasts as of June 2010 and WDI (April 2010)
... are compelling LAC central banks to raise interest rates well in advance of deflation-threatened rich countries

**Monetary Policy Rates**

*Inflation-Targeting LAC Countries, in %*

[Graph showing interest rates for Brazil, Colombia, Mexico, Chile, US, and Peru from July 2007 to September 2010.]

*Source: Bloomberg*
Threats to continued growth in LAC:
Dark clouds from peripheral Europe

*Turbulence in peripheral Europe threatens to spread to the core, risking a double dip into a major global downturn*
Investors unsettled: peripheral Europe, and rich countries, at currency-growth-debt (CGD) bind
Stock market sell-off is global...

Stock Prices in Emerging and Developed Markets

Index Mar-10 = 100

Source: Bloomberg
... while investors shy away from the Euro...

**Exchange Rates**

*LCU per US$, Jul-08 = 100*

Source: Bloomberg
... and seek refuge from uncertainty in assets perceived to be safe
But financial contagion to LAC is not significant, so far

Note: LAC-7 is the simple average between BR, AR, CH, CO, MX, PE and VZ. For the BRIC countries average we used Brazil, Russia and China. Source: Bloomberg
Threats to continued growth in LAC:
The limits to multi-polarity

*The sustainability of growth recovery in advanced emerging economies remains tied to economic activity in high-income countries*
Multi-polarity – Exhibit 1
Trend growth divergence ... need not imply autarkic growth

Trend GDP growth in LAC and High Income Countries

Source: LCRCE Staff Calculations
Multi-polarity – Exhibit 2
Rising South-South trade ... but linked to South-North?

2/3 of emerging Asia exports are ultimately consumed by the G7 countries

Source: DOTS
Multi-polarity – Exhibit 3
AEM’s contribution to world growth is important & rising...

Contribution to World Growth
in percentage points

Allocation of World GDP Expansion in 2010
Based on First Differences

Note: Adv. EM countries are Brazil, China, Czech Republic, Hungary, India, Indonesia, South Korea, Malaysia, Mexico, Philippines, Poland, Russia, South Africa, Taiwan, Thailand. Source: DOTS and LCRCE Staff Calculations
Multi-polarity – Exhibit 4
... but rich countries dominate global consumption demand

Domestic Demand as % of World GDP
2008 Data

Note: “I” includes public and private investment. Advanced EMs comprise Brazil, China, Czech Republic, Hungary, India, Indonesia, South Korea, Malaysia, Mexico, Philippines, Poland, Russia, South Africa, Taiwan, Thailand. Source: IMF’s WEO and IFS.
Multi-polarity – Exhibit 4 (a)

... consumption is small in China; Brazil is relatively closed.

Note: Consumption includes private and government consumption. Source: IMF’s IFS
Threats to continued growth in LAC:
The region’s own structural limitations

*It is mostly about unleashing productivity growth, raising savings, and capitalizing on natural resource wealth*
Having made progress in the stability and fairness agendas, LAC seems ready to embrace growth.
But can LAC do so after 100 years of growth solitude?

Note: The group of East Asian tigers includes Hong Kong (China), Indonesia, Malaysia, Republic of Korea, Singapore, Thailand, and Taiwan (China). Source: LCRCE Staff calculations based on Maddison (2007, 2009), WDI and DECPG
LAC’s relative low saving rate constrains accumulation and transformation of commodity windfalls into prosperity.

LAC and East Asia: Gross Domestic Savings

% of GDP

Note: East Asia is the un-weighted average of Hong Kong, Singapore, South Korea, Taiwan, Indonesia, Thailand and Malaysia, while LAC covers the whole Latin American and Caribbean region. Source: World Development Indicators, World Bank.
The good news is that TPF growth has been picking up...

### Total Factor Productivity Growth in LAC and EAP

**Average Annual Trend-Growth in TFP During 2000-7, in %**

<table>
<thead>
<tr>
<th>Country</th>
<th>Growth in TFP During 2000-7, in %</th>
</tr>
</thead>
<tbody>
<tr>
<td>CH*</td>
<td>0.0</td>
</tr>
<tr>
<td>PAN</td>
<td>0.5</td>
</tr>
<tr>
<td>THA</td>
<td>1.0</td>
</tr>
<tr>
<td>PER</td>
<td>1.5</td>
</tr>
<tr>
<td>DOM</td>
<td>2.0</td>
</tr>
<tr>
<td>IDN</td>
<td>2.5</td>
</tr>
<tr>
<td>BRA</td>
<td>3.0</td>
</tr>
<tr>
<td>ARG</td>
<td>3.5</td>
</tr>
<tr>
<td>BOL</td>
<td>3.0</td>
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<td>CRI</td>
<td>2.5</td>
</tr>
<tr>
<td>COL</td>
<td>2.0</td>
</tr>
<tr>
<td>LAC</td>
<td>1.5</td>
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<tr>
<td>SLV</td>
<td>1.0</td>
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<tr>
<td>URY</td>
<td>0.5</td>
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<tr>
<td>MEX</td>
<td>0.0</td>
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<tr>
<td>CHL</td>
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<tr>
<td>JAM</td>
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<tr>
<td>GTM</td>
<td>1.5</td>
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<tr>
<td>NIC</td>
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<td>PRY</td>
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<tr>
<td>ECU</td>
<td>3.0</td>
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<tr>
<td>HND</td>
<td>3.5</td>
</tr>
</tbody>
</table>

**Source:** LCRCE Staff Calculations
... but to raise 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...

Aggregate Index of Infrastructure Capital

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)
Summing up

- LAC is coming out of the crisis as an attractive destination for investment
  - Stronger macro-financial fundamentals, better international financial integration, connection to China, and commodity price effects

- LAC’s cyclical rebound poses currency appreciation & overheating risks
  - The burden is unduly on monetary policy, which is reacting proactively but needs support from macro-prudential tools and fiscal policy

- LAC’s sustained growth is threatened by global dark clouds
  - Peripheral Europe is the epicenter of a turbulence that can spread to the core, with rich country governments in a “CGD” bind
  - And there are limits to growth multi-polarity

- ... and by it own structural limitations to long-run growth
  - While productivity growth is picking up in some LAC countries, constraints come from low savings (in the face of natural resource wealth) and key gaps
Thank you