
BROOKINGS LATIN- AMERICA ECONOMIC PERSPECTIVES

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Outline

1. Assessing the Recovery
2. Common Threads
3. Country Vignettes
 - Brazil: Growing tensions
 - Argentina: Exhausting margins
 - Venezuela: Recession or implosion?
4. Class Rankings



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Assessing the recovery: Where are we now?

PCA analysis based on 8 variables

(all monthly, yoy growth, 2000:01-2010:07)

Employment

Import volume

Industrial production volume

GDP (quarterly)

Equity prices

Emerging market bond spreads (bp)

Business confidence surveys (balances)

Consumer confidence surveys (balances)

Real Index

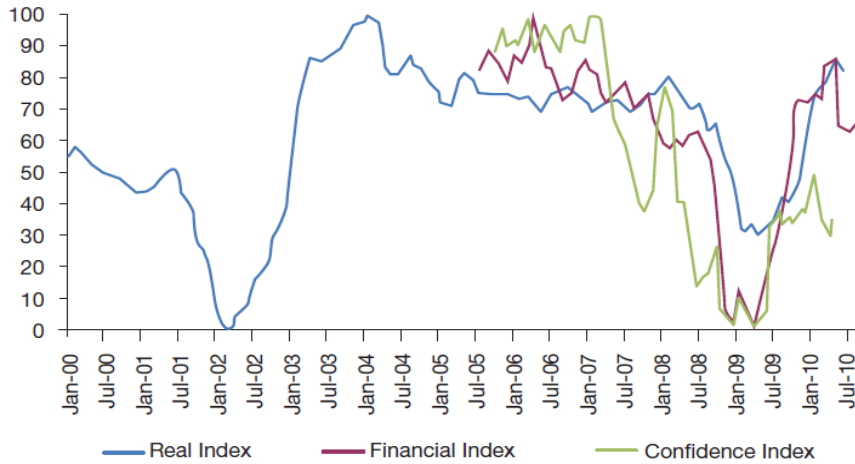
Financial Index

Confidence Index

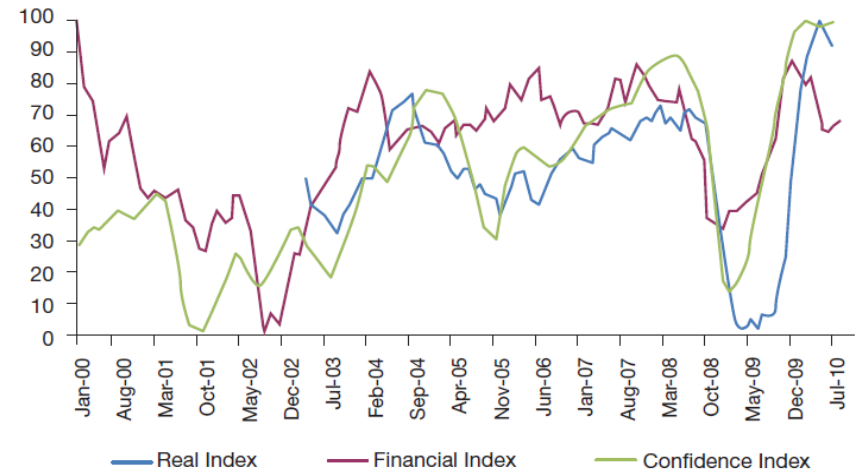


Unsustainable trends

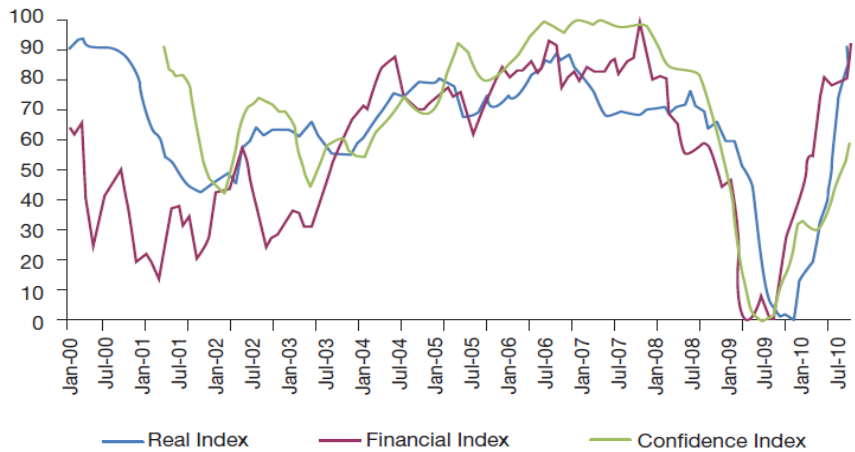
Argentina



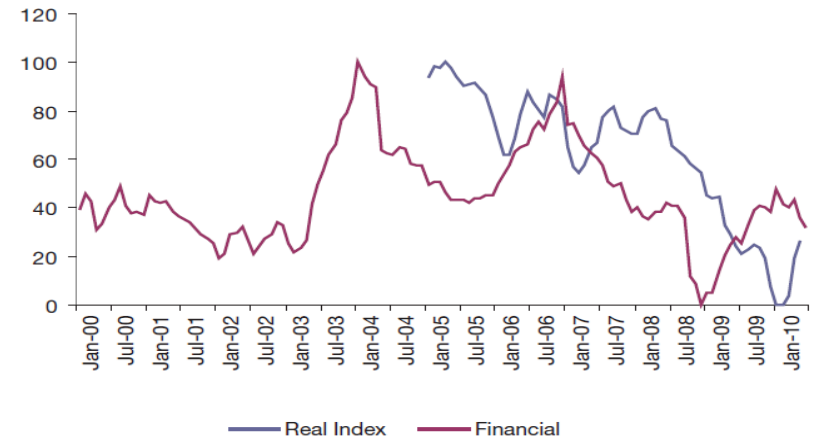
Brazil



Mexico

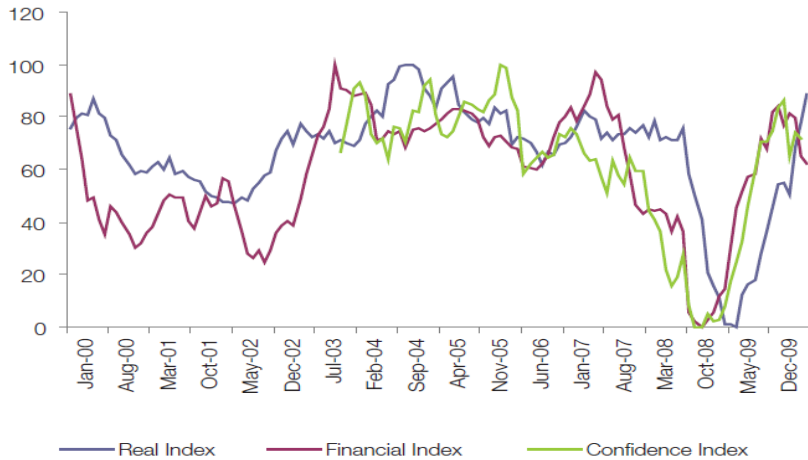


Venezuela

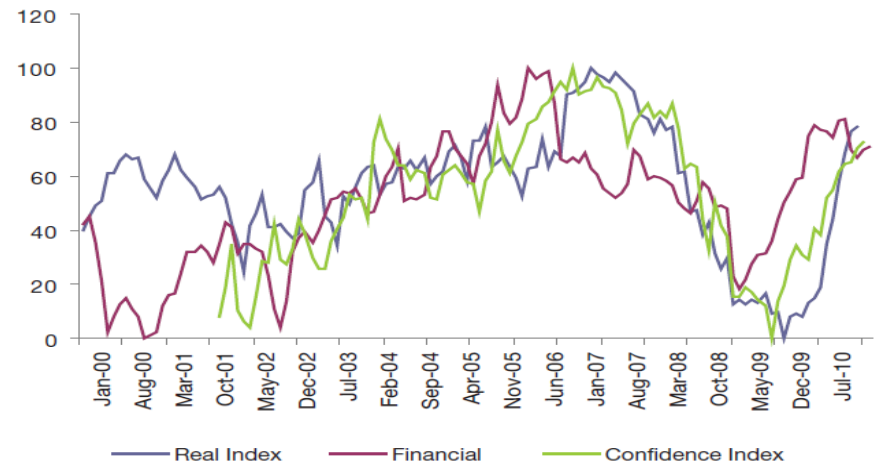


Consistency without exuberance

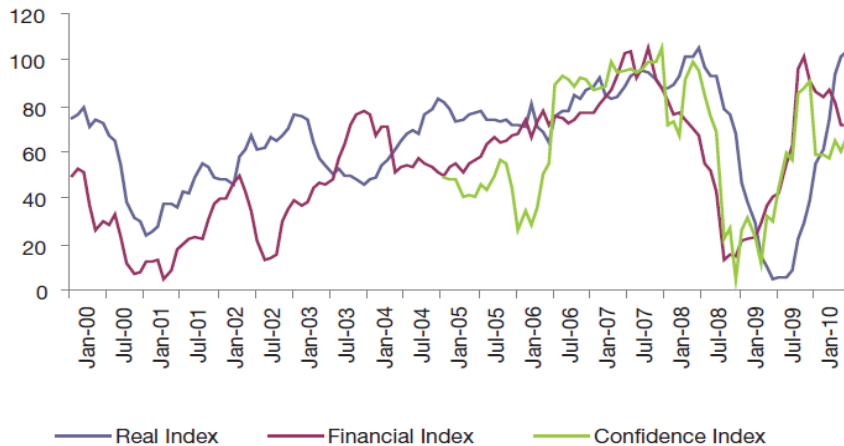
Chile



Colombia



Peru

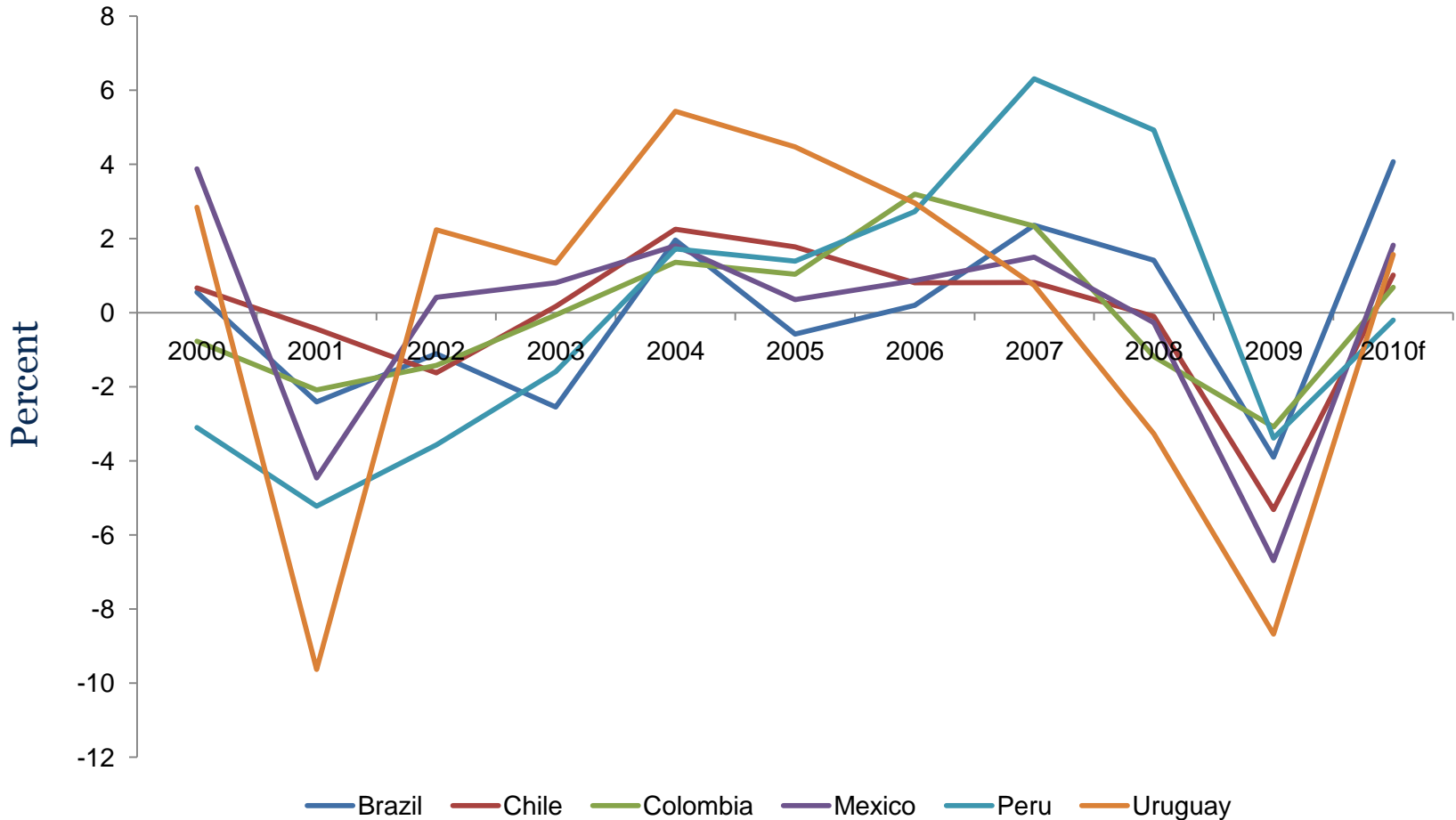


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Rapidly narrowing output gaps



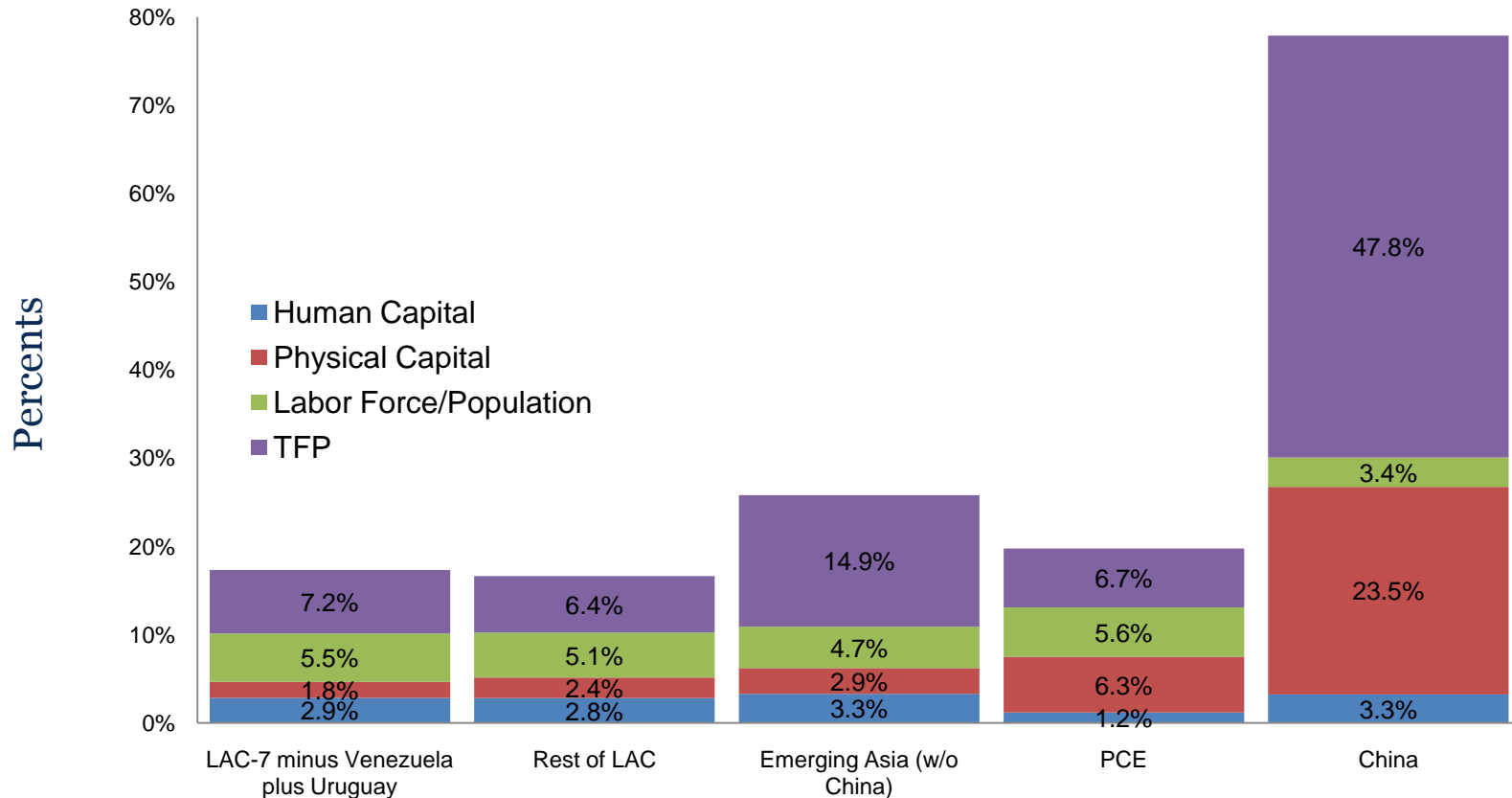
Note: Cyclical output based on the log-linear de-trending. Source: Own construction based on Central Bank bulletins and the Economist Intelligence Unit.



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Reflect limits to non-inflationary growth

Growth decomposition 2000--2007

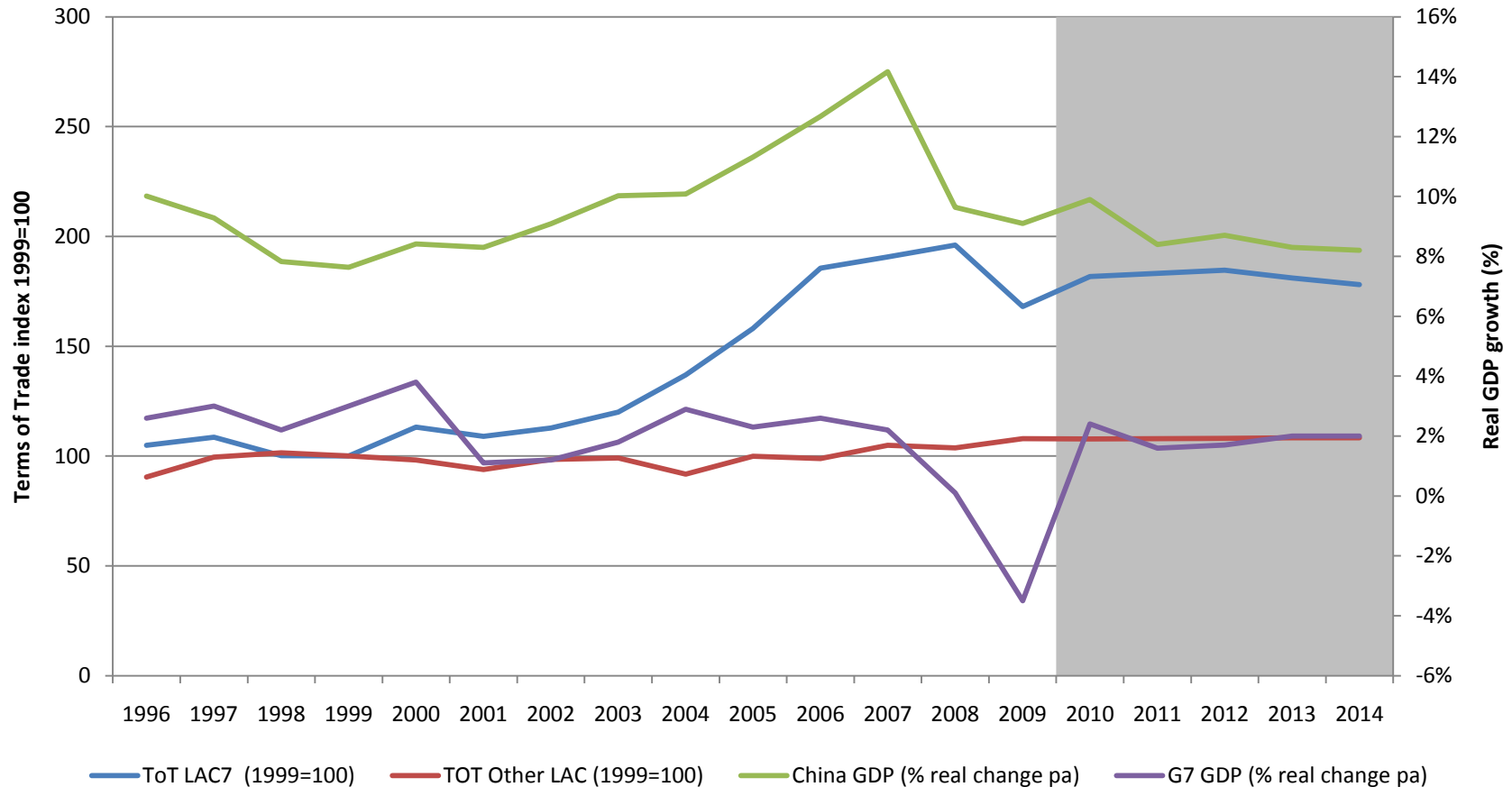


Notes: PCE: Peripheral core economies (Australia, Canada, New Zealand, Norway, Sweden).

Source: own calculations based on data from Blyde, Daude and Fernández-Arias (2009).



Global Growth: Reduced Speed Ahead

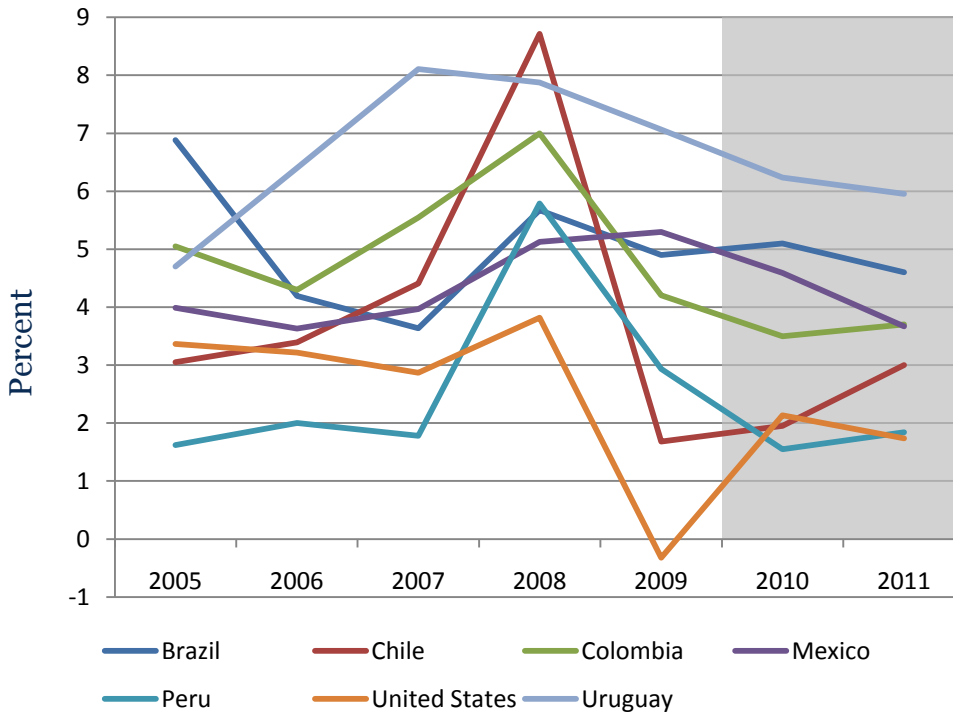


Note: LAC-7: Argentina, Brazil, Chile, Colombia, Mexico, Peru, and Venezuela.
 Other LAC: Costa Rica, Dominican Republic, Ecuador and El Salvador.
 Source: Own calculation based on data from the Economist Intelligence Unit.

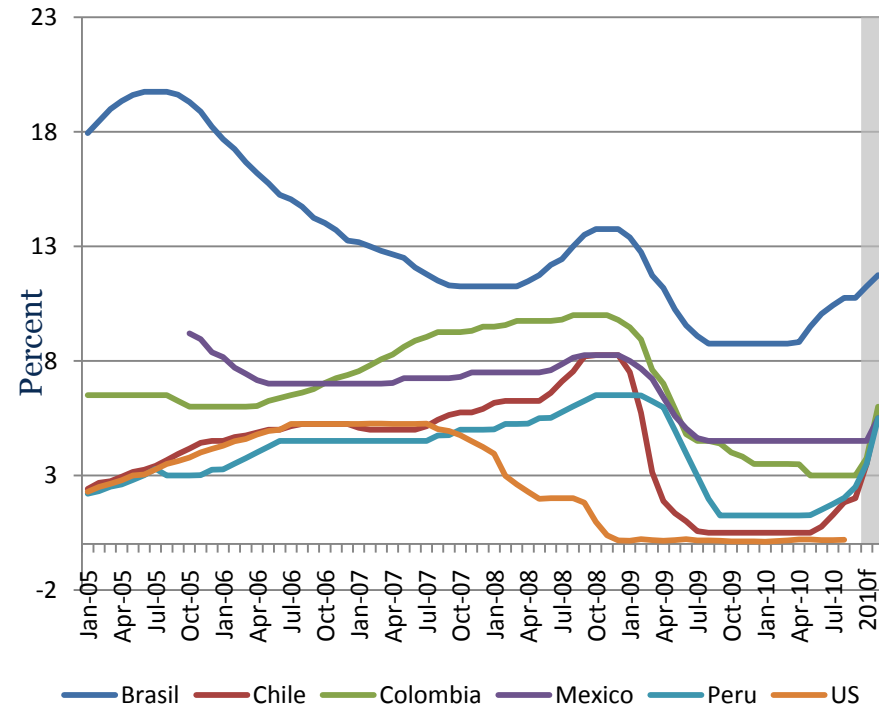


Cautious monetary unwinding is underway...

Inflation (%)



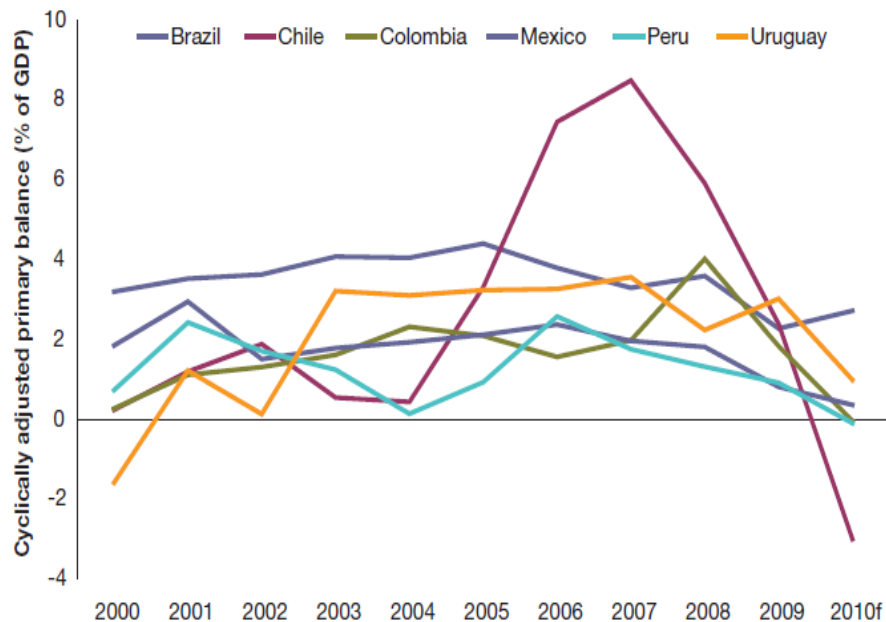
Monetary policy interest rate (%)



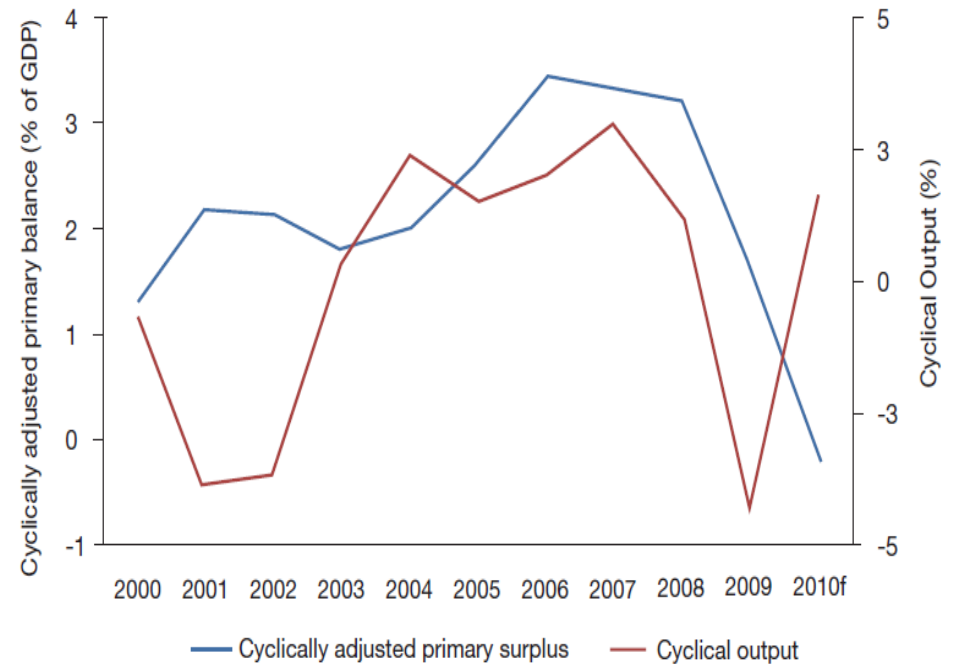
Source: International Monetary Fund, World Economic Outlook; Central Bank bulletins and Economist Intelligence Unit.

...while fiscal stimulus is still on

The cyclically-adjusted fiscal primary surplus



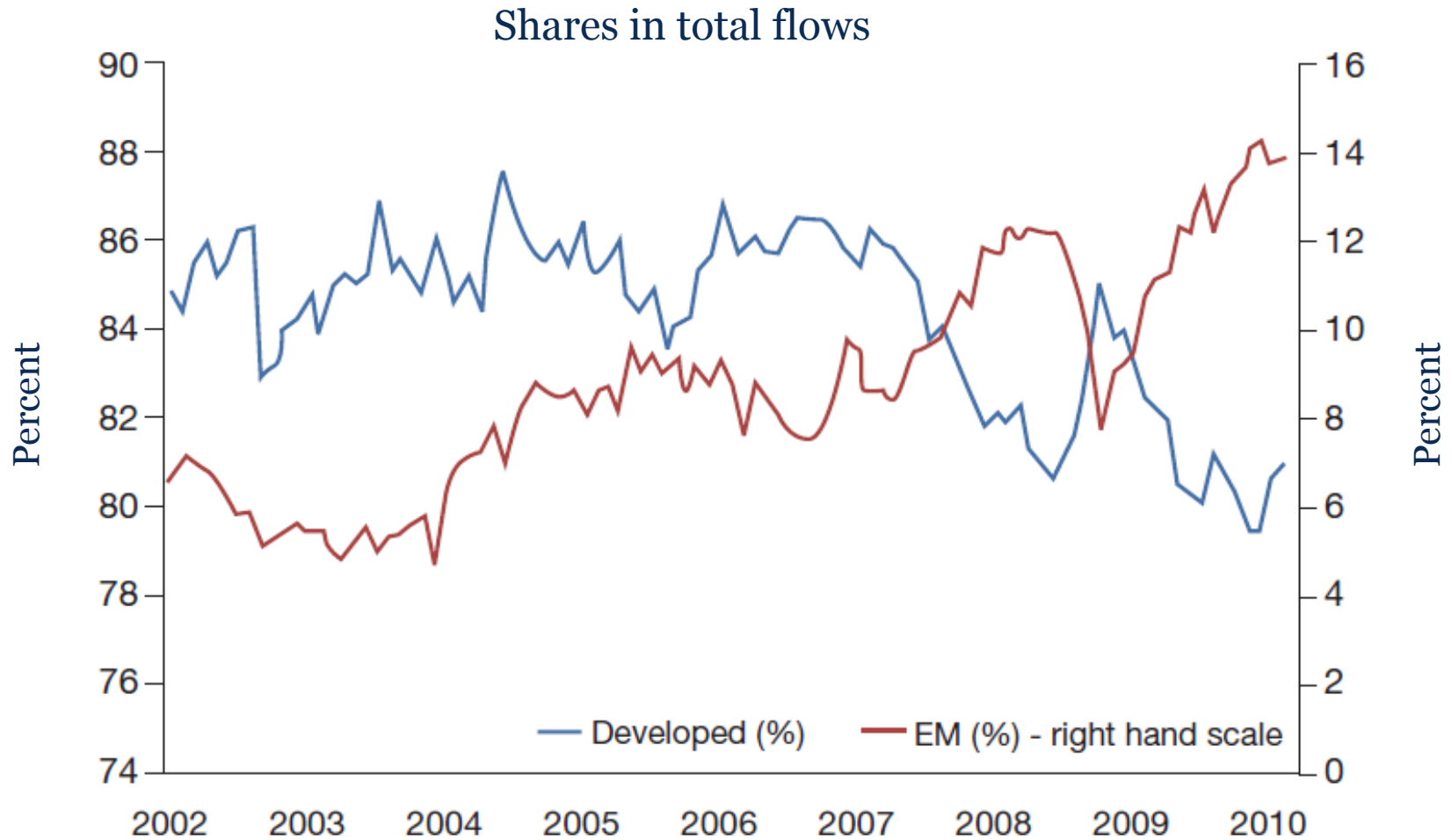
LAC cyclically-adjusted fiscal surplus and cyclical output



Note: Estimated as the intercept from a regression of the primary surplus on cyclical output, where the latter is obtained from the log-linear de-trending of real GDP. Countries include Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela. Source: Own construction based on Economist Intelligence Unit.



Hello, global equity funds

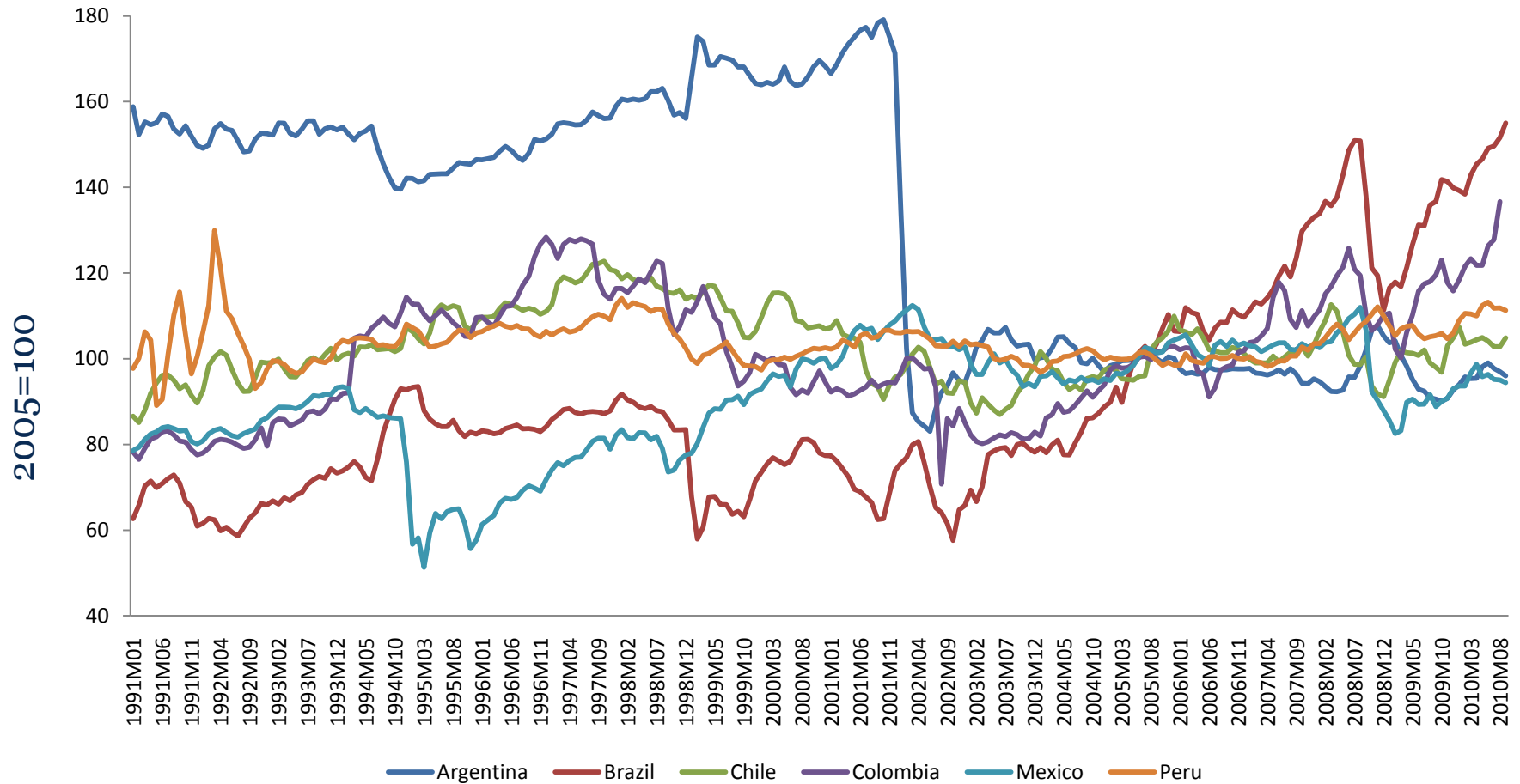


Source: own calculations based on EPFR.



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Stronger currencies, for now...



Source: World Bank's Global Economic Monitor.



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What to do?

- Avoid over-appreciation as part of the counter-cyclical response...
 - ...as opposed to undervaluation as a development tool.
- Arguments for smoothing-out exchange rates:
 - Portfolio capital has never applied for permanent residence
 - QE2 in developed countries is not sustainable in the medium term
 - Current accounts are expected to deteriorate in LAC
- Ultimately, reasonably priced currencies and limited external deficits are the best protection against procyclical flows



What to do?

- Save for the rainy days
 - The region saved in the early 2000s to gain reputation, and spend during the crisis: Will it unwind now that reputation has been built?
- Reserves as a form of countercyclical saving
 - Sterilized interventions generate quasi fiscal losses...but the reversion of the exchange rate during a dollar squeeze recoups valuation losses...
 - ...and lower spreads and investment of reserves in longer-term, higher yielding instruments should reduce carrying costs.



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Brazil's policy imperatives

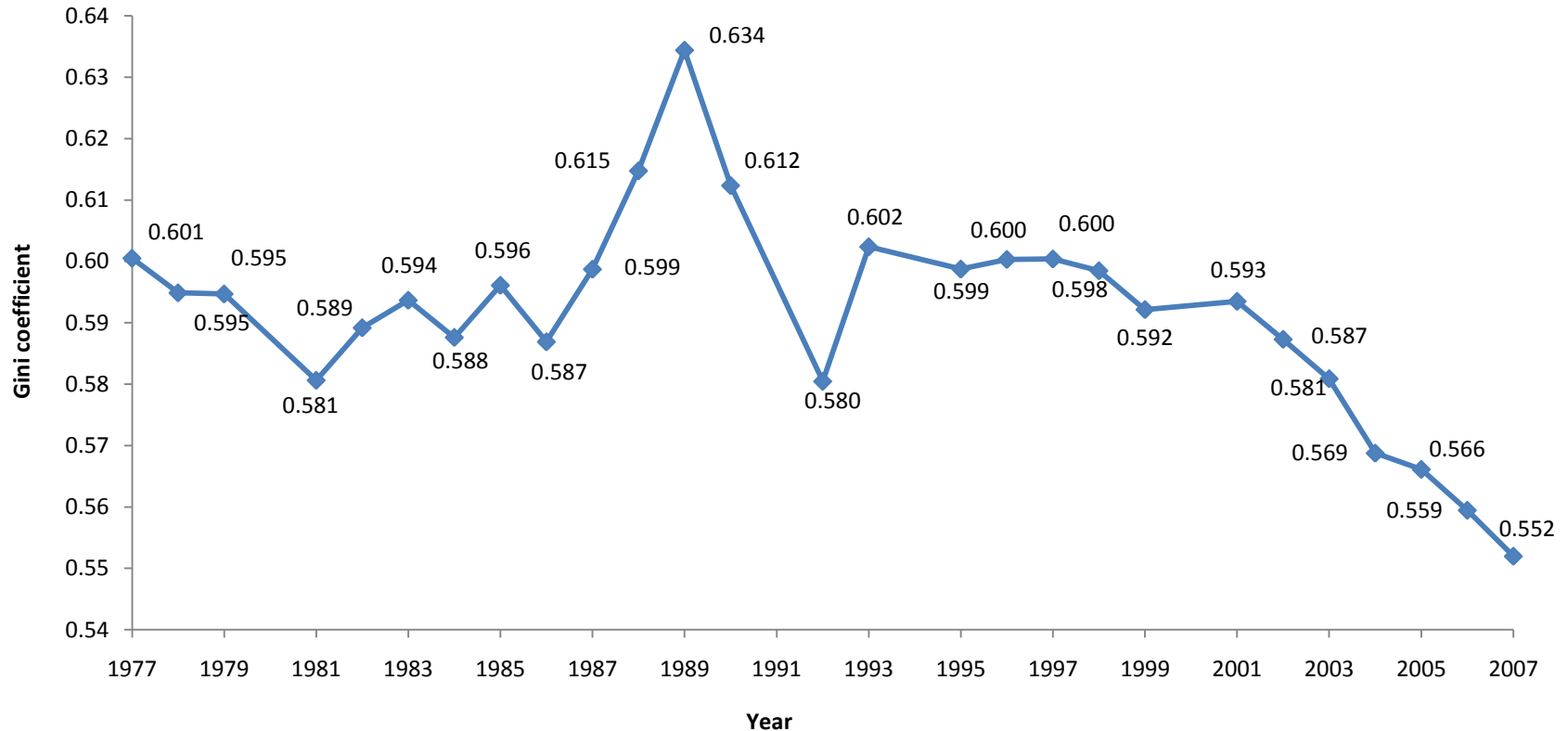
1. Macroeconomic stability
2. Social progress (expansion of the middle class)
3. Active industrial policies (e.g., BNDES)

Is this sustainable?

- Taxes are already high
- Low hanging social fruit already collected
- Development banks will begin to deal with NPLs
- Public investment is extremely low



Brazil: reduction in inequality is noteworthy....

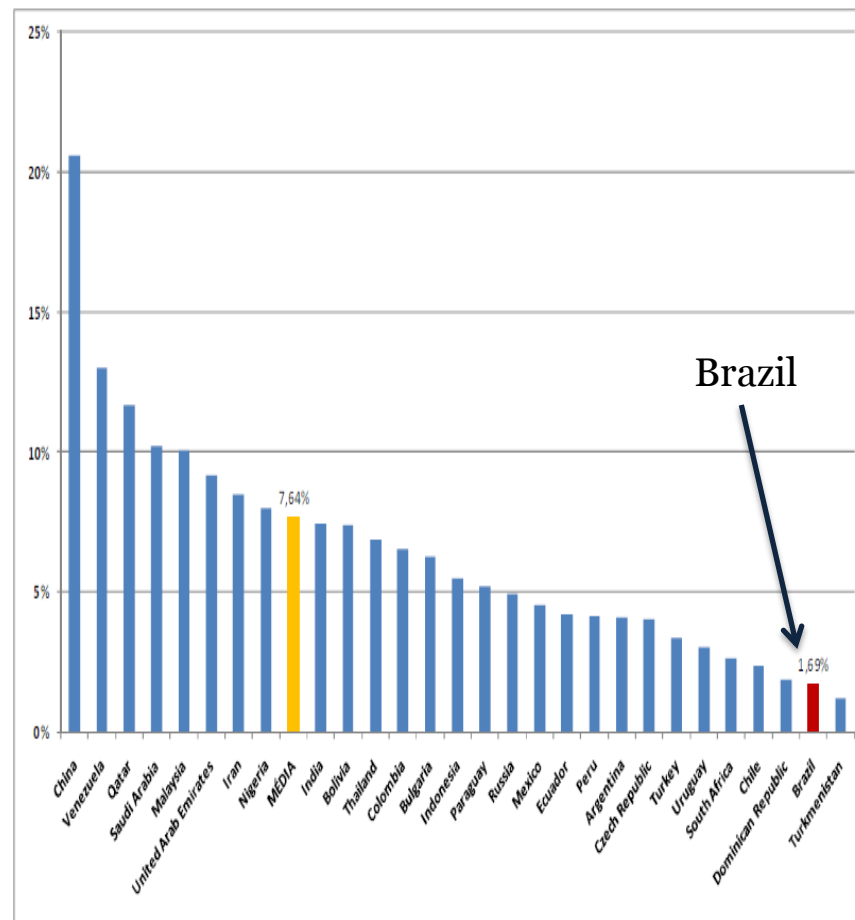
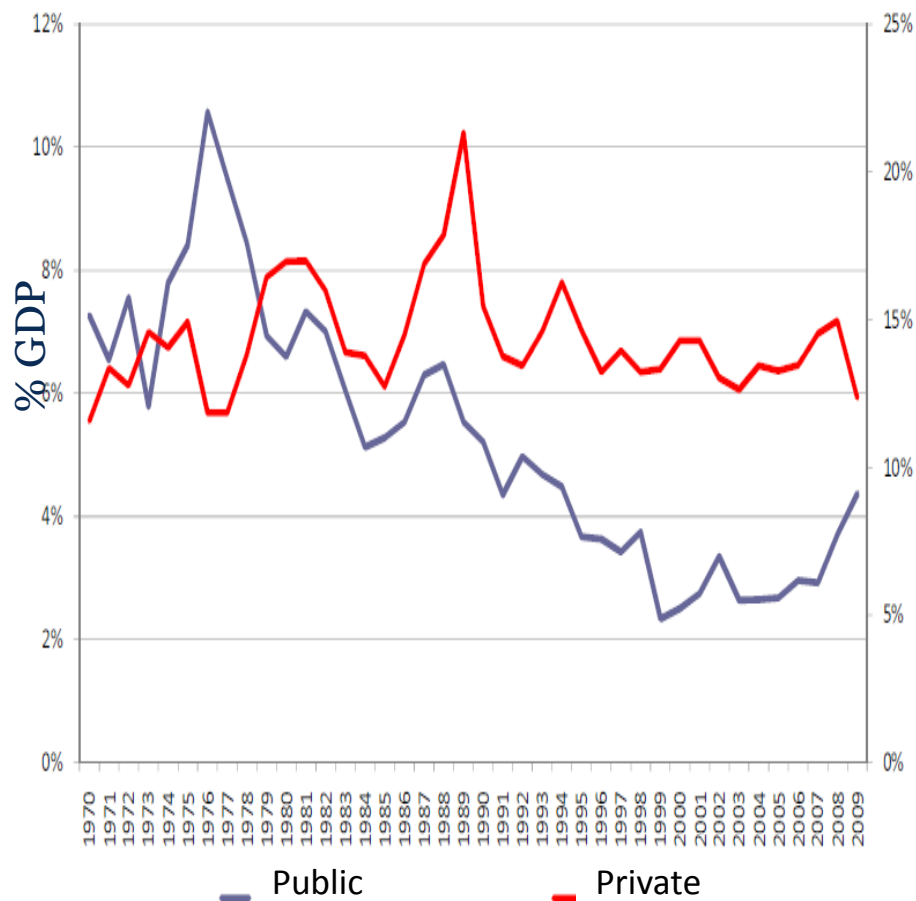


Source: Barros, R., de Carvalho, M., Franco, S., and Mendonça, R. (2010).



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..and so is the very low public investment



Source: J.R. Afonso (2010) "O Nó dos Investimentos Públicos no Brasil" based on data from the IMF's WEO.



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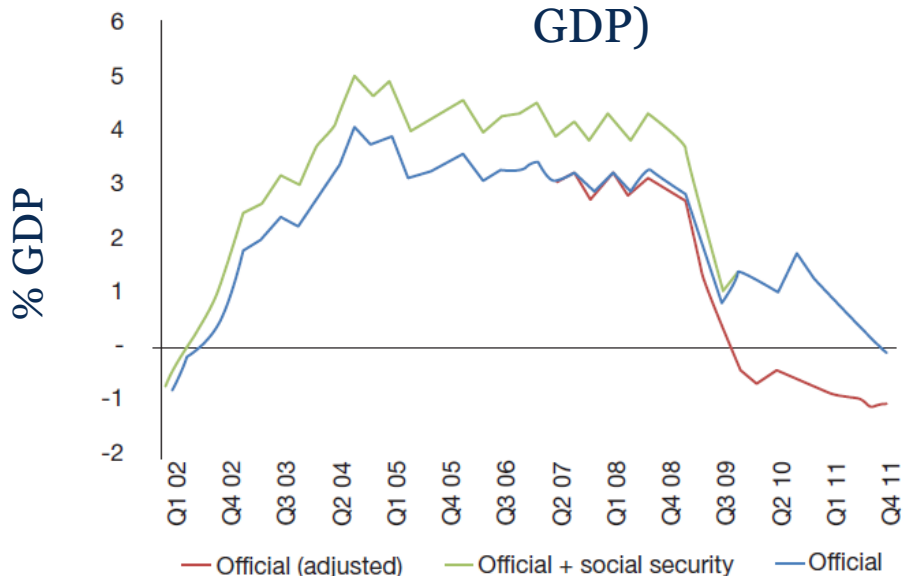
Brazil's low non-inflationary growth: what to do?

- High real interest rates → Subsidies to long-term financing (BNDES) → Weak monetary transmission → High interest rates.
- Low public (and corporate) investment.
- Alternative equilibrium → Redirect BNDES resources to infrastructure → Increase potential growth and create room for lower real interest rates.

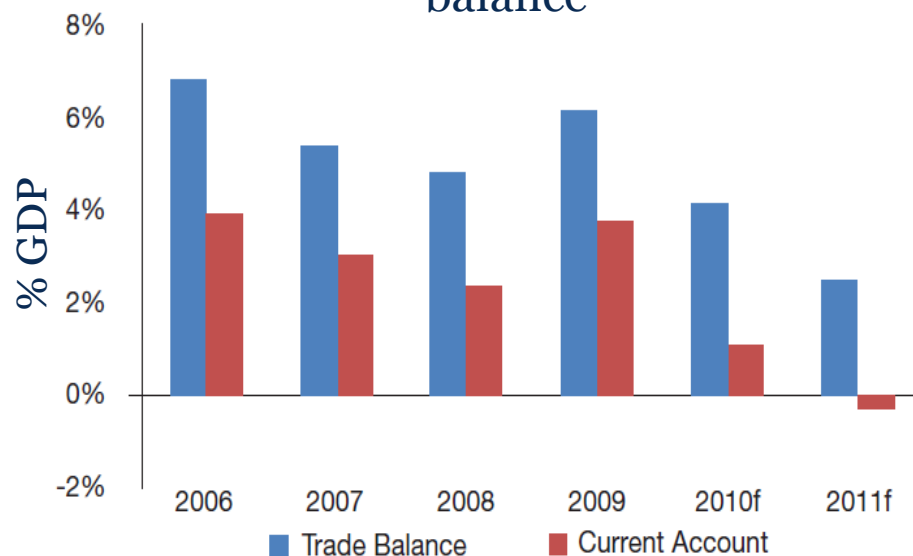


Argentina: Agony of the twin surpluses

Primary fiscal surplus (% GDP)



Current account and trade balance



Note: Adjusted primary surplus excludes from the official figures the central bank's quasi fiscal surplus, FGS profits and SDR issuance. Consolidated adds to the official figures the contributions to the social security system allocated to private pension funds prior to the 2008 renationalization. Source: Ministry of Economics, Central Bank of Argentina and INDEC.

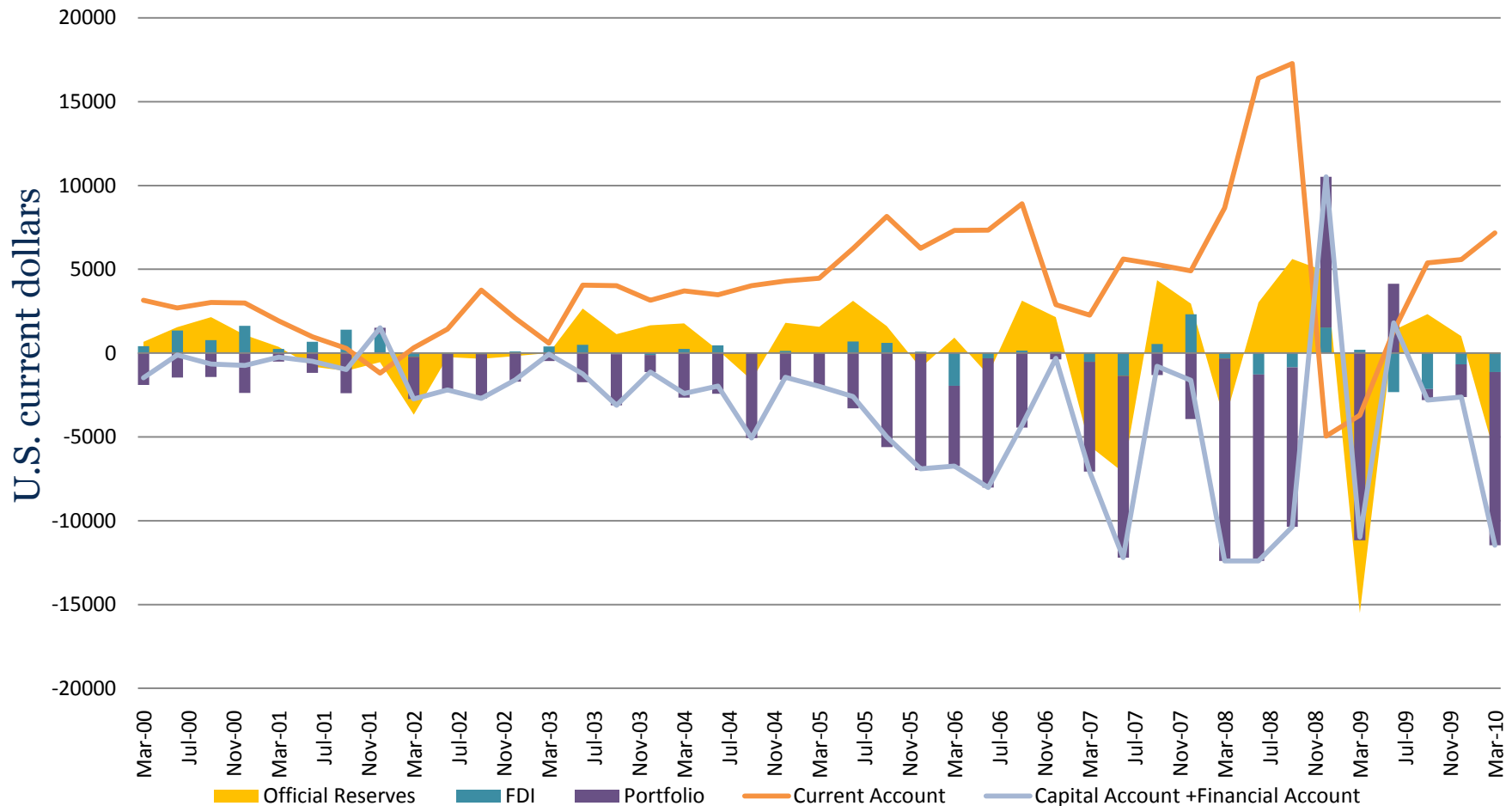


Argentina's inflationary growth: what to expect?

- Low real interest rates (+ lack of investment instruments) → Real estate and durables consumption boom
- Expansionary fiscal spending (+ wage indexation) → Growing (and latent) inflation
- No policy change until the end-2011 election → Political dilemmas
 - Who will switch to a non-inflationary slower growth path?
 - How much time can a renewed access to capital markets buy for a smooth transition to sustainable growth?
- Binomial scenario
 - Reelection: Smooth ride into a slow descent
 - New administration: Near term risks and significant upsides

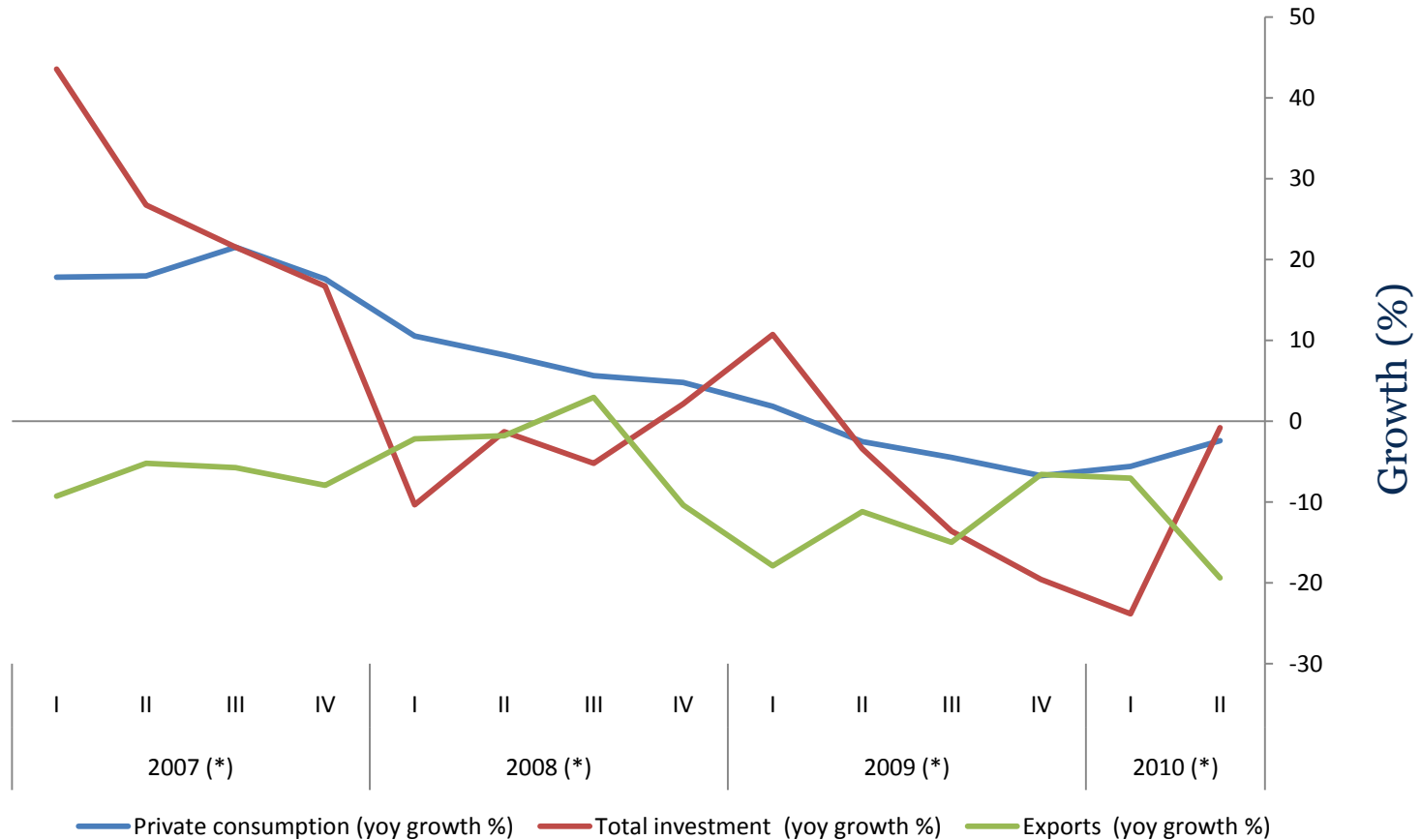


Venezuela: chasing capital out



Source: International Monetary Fund's International Financial Statistics.

Venezuela: Recession or implosion?



What's next in Venezuela?

- Radicalization vs. Moderation: Past experience suggests that Chavez is more dogmatic than pragmatic, so hard-line seems more likely.
- This means more nationalizations (which now are confiscations) and interference in key markets and sectors.
- A currency depreciation seems unavoidable to provide government additional fiscal firepower.
- Private sector will not react positively.
- Optimism regarding 2012 elections, tamed by tumultuous uncertainty in the next two years.



Regional repercussions

- Venezuela's economy will not recover, affecting growth prospects in Colombia.
- Moderate fiscal and monetary unwinding in Colombia, relative to Chile and Peru.
- Additional pressures from the private sector in Colombia for policies that restrain the appreciation of the currency.
- Problems in Venezuela will affect Petrocaribe's support to Central American and Caribbean countries, exacerbating problems in many of them, including Cuba.



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A way to measure progress towards development

Variables used in the rankings:

Real GDP growth

Inflation, average CPI (%)

Cyclically adjusted fiscal balance (%GDP)

Net external debt (%GDP)

Net external financing needs/CAR (%)

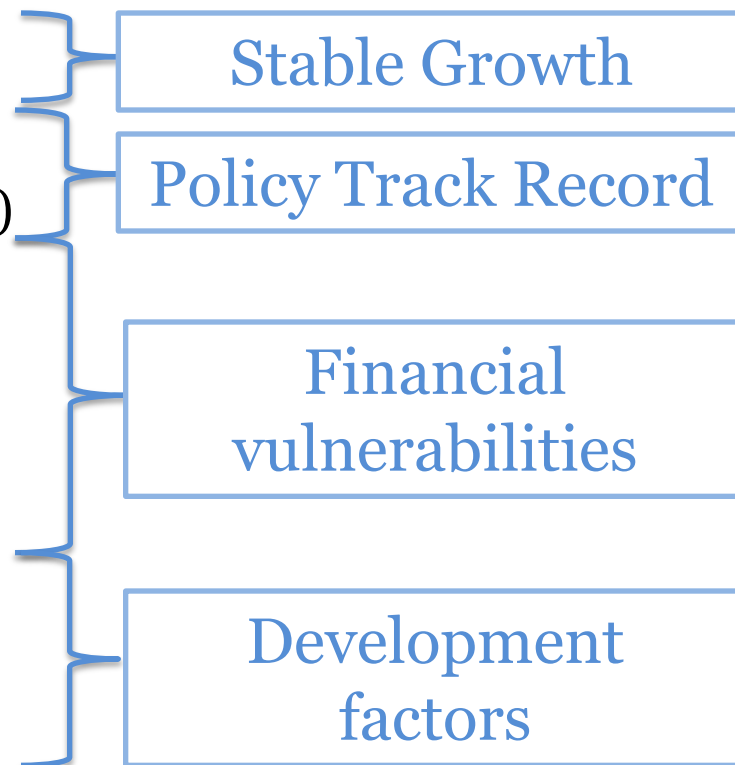
Public sector external debt (%GDP)

Emerging market bond spreads (bp)

Gini coefficient (%)

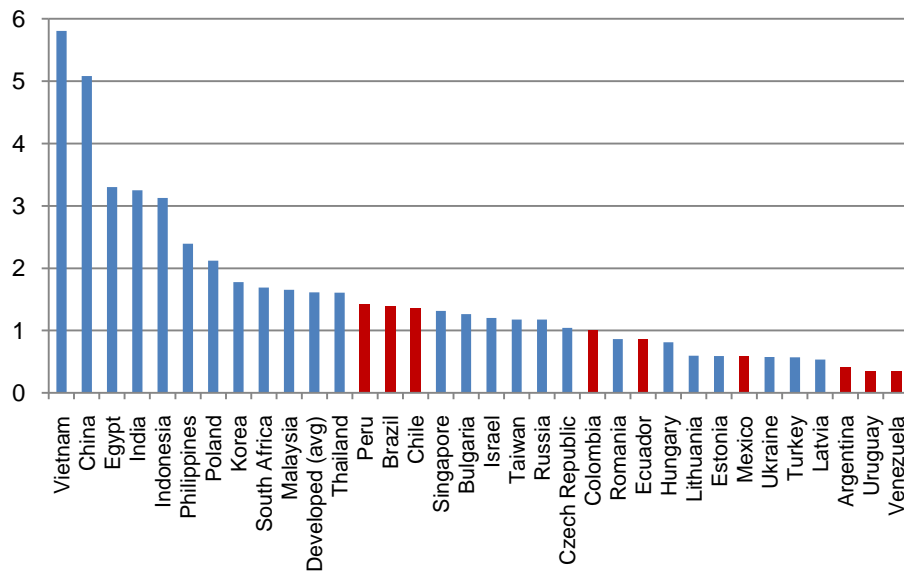
Human development index

Composite world governance indicator

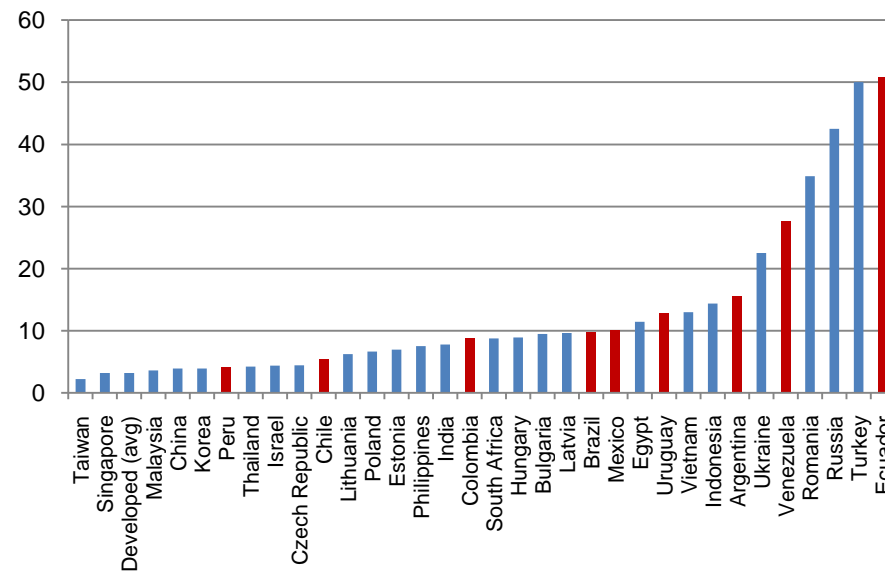


Graduation scorecard: Core program

Risk adjusted GDP



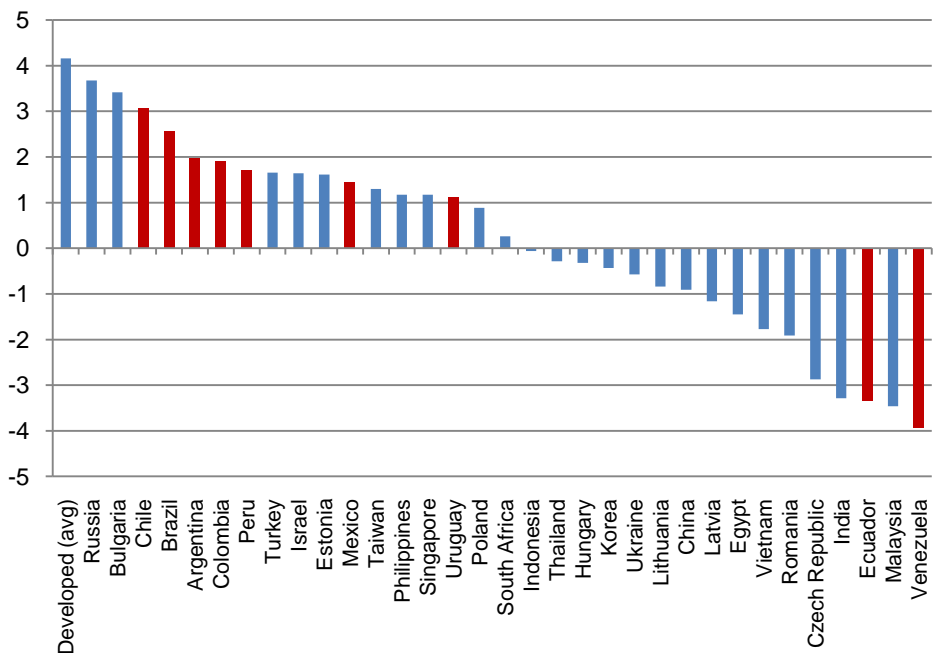
Risk adjusted CPI



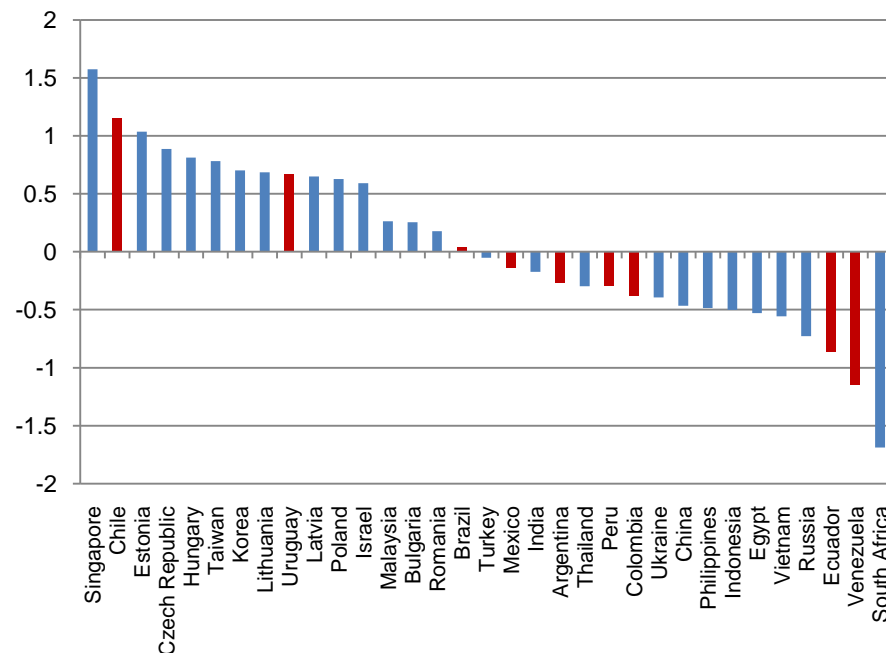
Notes: Risk adjusted GDP is constructed as the mean of the real GDP growth (1999-2009)/standard deviation real GDP growth (1999-2009); Risk adjusted CPI is constructed as the mean of the CPI inflation rate (1999-2009)/standard deviation of the CPI inflation rate (1999-2009)
 Source: The Economist Intelligence Unit and IMF World Economic Outlook Data Base, April 2010.

Graduation scorecard: the hard sciences

Cyclically adjusted fiscal balance (%GDP)



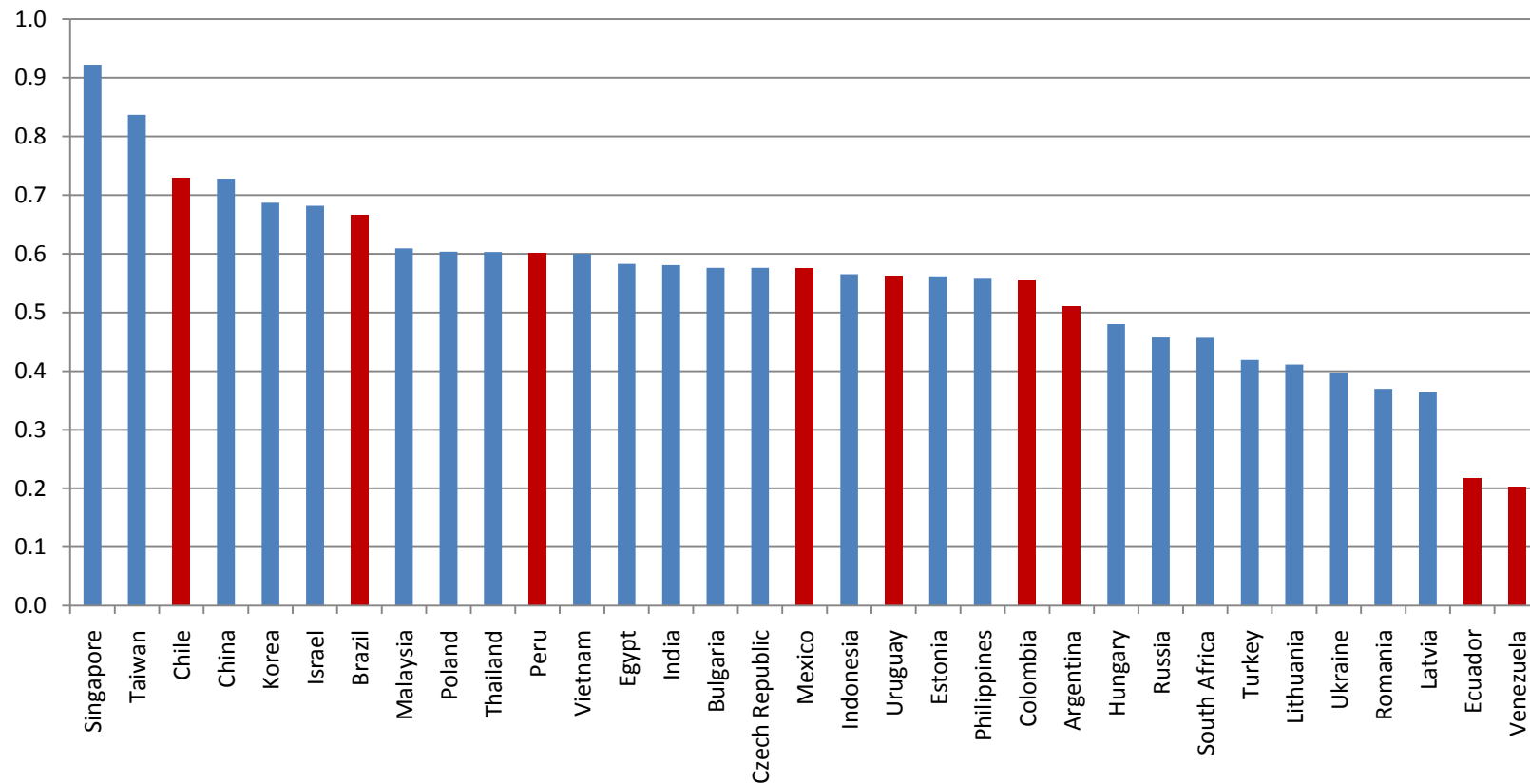
World Governance Indicators



Notes: Cyclically adjusted fiscal balance estimated as the intercept from a regression of the primary surplus on cyclical output, where the latter is obtained from the log-linear de-trending of real GDP. The Economist Intelligence Unit and Kaufmann, Kraay and Mastruzzi (2009). Governance Matters VIII



Graduation scorecard: Final report



Sources: The Economist Intelligence Unit; IMF World Economic Outlook, April 2010; Bank of International Settlements; Moody's; World Bank Global Economic Monitor and World Development Indicators; Human Development Report 2009; Kaufmann, D., Kraay, A., Mastruzzi, M. (2009) Governance Matters VIII.



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