

The future of Latin America? Still up in the air

The outlook for Latin American countries becomes more problematic as throughout the world economic growth stays low.

Solange Monteiro

In the last decade Latin America experienced an unparalleled economic expansion. The relocation of labor to more productive activities and the boom in commodity prices gave extra breadth to its economies. To a greater or lesser extent, Latin American countries have carried out structural reforms, reduced poverty, and seen a steep rise in domestic consumption.

Today, those economies are slowing along with the major economies of the globe. The International Monetary Fund (IMF) is projecting that average Latin American growth would be 2.9% until 2019–1.2 percentage points lower than average growth between 2003 and 2012. Demand for Latin American commodity exports is down as China's growth slows, and external financing is down as the U.S. economy recovers and international interest rates rise.

The implications of these changes were the topic of a seminar on "Latin America and the

New World Economic Outlook," sponsored by the Brazilian Institute of Economics of Getulio Vargas Foundation on September 19th in Rio de Janeiro. Experts from a number of countries analyzed the current situation and future prospects for five economies—Brazil, Mexico, Colombia, Chile, and Argentina—and for Central America, now that international trade is expected to expand at only half the rate seen in the years preceding the 2008 crisis. "The financial crisis was a watershed for the continent. Now there are doubts about the prospects for trade in goods and services, and the extent to which prices of commodities exported by the region are sustainable," said Regis Bonelli, the IBRE researcher who organized the seminar.

STUNTED ECONOMIC GROWTH?

How much will the world economy really grow in the next few years? The issue divides economists. Staff of the U.S. Federal Reserve Bank have been debating, for instance, whether interest rates are falling for structural or for cyclical reasons. "After six years of crisis, we still see very low market interest rates, even below inflation at some points," said José Julio Senna, head of the IBRE Center for Monetary Studies. U.S. economists Lawrence Summers and Paul Krugman have argued that the rich countries have entered into "secular stagnation," a concept coined in the 1930s to describe insufficient demand for goods and services. Senna noted that "One of the signs of stagnation would be that excess liquidity and credit availability and low interest rates in the pre-crisis period, in both the U.S.A. and Europe, did not overheat the economy. That would indicate that advanced economies are suffering from lack of demand."

Senna saw signs of monetary normalization in the United States. Alejandro Werner, director of the IMF Western Hemisphere Department, said that second quarter activity in the U.S. was better than expected, considering a bad start of the year was combined with a tough winter that saw inventories accumulate and exports fall. "With the improvement of production and manufacturing activity, we estimate that the U.S. could grow about 3% in the next few quarters," Werner said, noting that this figure is above the 2% medium-term growth potential the IMF had calculated for the country. Werner also pointed out that more robust domestic demand will allow U.S. companies, which have used the period of low interest rates to accumulate resources, to undertake investment projects at low financial cost.

One of the main sources of the U.S. recovery is real estate. After having stoked the overheating of the economy before 2008 and having suffered in recent years from a lack of demand for houses, real state is now returning to a normal level of activity.

The bellwether indicator of economic recovery is the job market.

But the bellwether indicator of economic recovery is the job market. Werner pointed out that current U.S. unemployment of 6.1% to 6.5% does not include, for example, people who reduced their workload or who decided to leave the job market to return when the economy is better. "About 40% of this group could return to the labor market in the short term, creating a new floor for unemployment and a new ceiling for wage pressures," he said.

In Europe, Luiz de Mello, deputy chief of staff, Office of the Secretary-General of the OECD, observed, recovery is still short of what could be desired. "Six years after the crisis, we still see



Photo: André Telles.

Regis Bonelli

"There are doubts about the prospects for trade in goods and services."



José Julio Senna

"The monetary normalization in the United States will finally come."

significant restrictions on consumption in European countries, which should be the growth engine of recovery," he said. The IMF revised its growth projection for EU countries to 0.8% in October, down from 1.1% last July, primarily because of the performance of Italy, France, and Germany. The continuing crisis in Ukraine may also influence consumer confidence and further reduce consumption. The IMF also reduced Japan's projected growth to 0.9%, down from 1.6%, partly because of an increase in the value-added tax on consumption.

For Latin America, however, the biggest source of concern is still China. The IMF calculations, which take 2003 as the baseline, show that the correlation of growth in China with higher revenues for exporters of commodities has been very high, particularly for Venezuela, Argentina, and Brazil. Though Werner believes the Asian GDP slowdown from 10% to 7.5% has been smooth and orderly, the IMF is concerned with the sources of stimulus in Asian economies. "Loans in China have almost doubled in recent years, from 129% of GDP in 2009 to the current 212%," he said. He noted that the magnitude of indebtedness is a challenge for China at a time when it is moving to replace investment with domestic consumption and also manage potential crises in the informal financial sector (shadow banking) because of the possibly poor quality of loans in the hands of shadow institutions. "China will need to discipline its financial sector without creating panic," Werner said.

Otaviano Canuto, senior adviser on BRICS to the World Bank, pointed out that China is aware that large investments in the economy and huge trade surpluses at the expense of compressing domestic consumption will not find a favorable external environment from now on. "Western countries' consumption growth fueled by financial bubbles disappeared," he said. He believes that if the new government can carry out the reforms approved by the Communist Party—which include making contracts, patent rights, and ownership more secure—the country will enter a new phase that could make it an even more formidable competitor in manufacturing products.

GROWING FROM THE INSIDE OUT

Given this international outlook, experts are unanimous in predicting that in future Latin America will depend less on external demand and increasingly on internal adjustments that each economy must make to boost growth. Canuto cited a study showing that growth in Latin America in the last decade had relied more on export prices and less on stabilization policies and reforms. From now on, however, there will be no such easy gains. Seminar participants agreed that growth in the region will increasingly depend on reforms that have been pending for 20 years but have now become urgent.

In addition to slowdowns in the economies of trading partners, other elements are affecting Latin American growth: many economies are already close to their growth potential, and the end of the demographic bonus will reduce the contribution of labor to growth. Also, less international liquidity will reduce external financing and make it more difficult to correct structural barriers to competitiveness and growth.

Latin American countries will now have to work diligently to raise productivity, better educate workers, upgrade infrastructure, and enhance the business environment. To avoid compromising productive transformation and the stabilization of the economy, seminar participants also pointed out, government transfers and consumption at the expense of savings and a deterioration of the external current account balance, and wage increases above productivity, will have to be addressed.

"It will also be important to review the countercyclical fiscal policies adopted at the beginning of the 2008 crisis, which in many countries have not been reversed," Werner said. Even if countercyclical polices were adopted at a point where the perception of collapsing economies was greater than the later reality, policies continued to be expansionary well after markets had stabilized and their beneficial effects on the economies had greatly diminished. Canuto noted, though, that "Mexico was an exception. It was one of the few countries that understood how to manage a countercyclical policy and the need to press ahead with structural reforms."



Photo: André Telles.

Luiz de Melo

"Six years after the crisis, we still see significant restrictions on consumption in European countries."



Alejandro Werner

"Countercyclical fiscal policies have not been reversed."