Latin America is put to the test

Minimal growth and inflationary pressures test the credibility of the policies and institutions of Latin American countries.

Solange Monteiro

WITH THE PRICES OF COMMODITIES exported by Latin American economies not expected to recover any time soon, the growth outlook for the region is pessimistic. According to International Monetary Fund (IMF) estimates, in 2015 Latin American GDP is expected to shrink by 0.3%. Excluding 2009, when the effects of the global financial crisis were deeply felt, that will be the first decline in growth since 1983. "The situation is more serious now, because we are no longer talking about something global but a regional problem," said Marcello Estevão, deputy division chief of regional studies in the IMF Western Hemisphere Department. The commodity price shock has also reduced potential growth in the region, which the IMF now projects at 2.9%, the lowest since the early 2000s.

On October 23 in Rio, IMF representatives and researchers of the Brazilian Institute of Economics (IBRE) met to discuss the IMF Latin American economic outlook presented at the World Bank and IMF Annual Meetings in Lima, Peru. The IMF economists pointed out the need for structural adjustments in most countries in the region, particularly Argentina, Brazil, Ecuador, and Venezuela. These countries are causing concern in financial markets. "Under the more difficult conditions, the credibility of policies and government institutions will be tested," Estevão said.

The decline in commodity prices has been reflected to varying degrees in changes in the terms of trade, incomes, and external current account balances of exporting countries. Copper exporters Peru and Chile have been adjusting their economies since metals prices began to fall in 2011. "In the case of Peru, [this has gone] a little more slowly, as the economy is to some extent dollarized and it is consequently more difficult to adjust the exchange rate," Estevão said. At the other extreme are the oil-exporting economies,

For countries that export agricultural products, such as Brazil and Argentina, the impact of lower commodity prices has been relatively small; domestic factors have weighed on growth more.

where the free fall of oil prices has been more recent, since mid-2014. "In Venezuela, the reduction in the price of exported commodities was equivalent to 21% of GDP. As a result, the country's import revenues declined dramatically, generating a large fiscal deficit that was financed by printing money," he said. "Ecuador, in turn, lost almost 10% of GDP," he added, noting that, as Ecuador's economy is also dollarized, the price shock generated a loss of competitiveness and a sudden downturn in the whole economy.

For countries that export agricultural products, such as Brazil and Argentina, the impact of lower commodity prices has been relatively small; domestic factors have weighed on growth more. In Argentina, the focus is on monetization of large fiscal deficits and a decline in international reserves, which call for traditional adjustment policies. For Brazil, where the fiscal situation is worsening and the political crisis is deep, the IMF sees no possibility of a short-term economic recovery, acknowledging that the crisis was deeper than expected. "The concern now is to find a solution to resolve the structural problems of the economy," Estevão said. The IMF projection for 2015 is that Brazil's output will fall by 3%, second only to Venezuela's drop of 10%. For 2016, the IMF estimates that Brazil's output will again decline, this time by 1%.

Low growth, high inflation

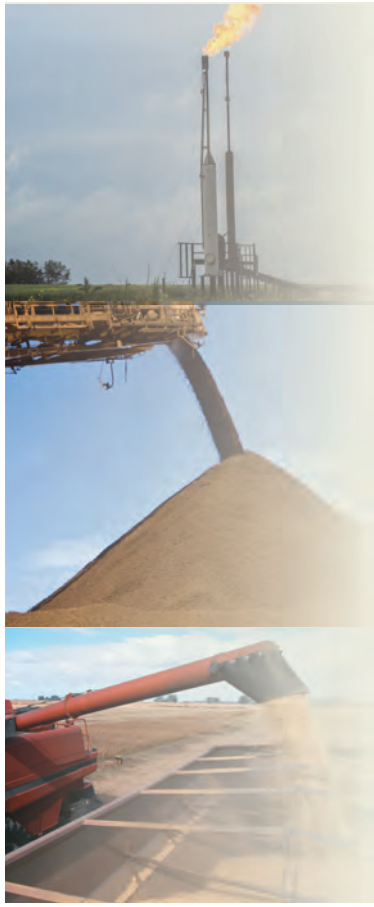
One challenge common to Brazil and other Latin American countries is sluggish growth, if any, compounded by inflationary pressures, even as much of the world is trying to manage disinflation and even deflation. This year, in addition to Brazil, the IMF estimates that Colombia, Chile, Peru, and Uruguay will record

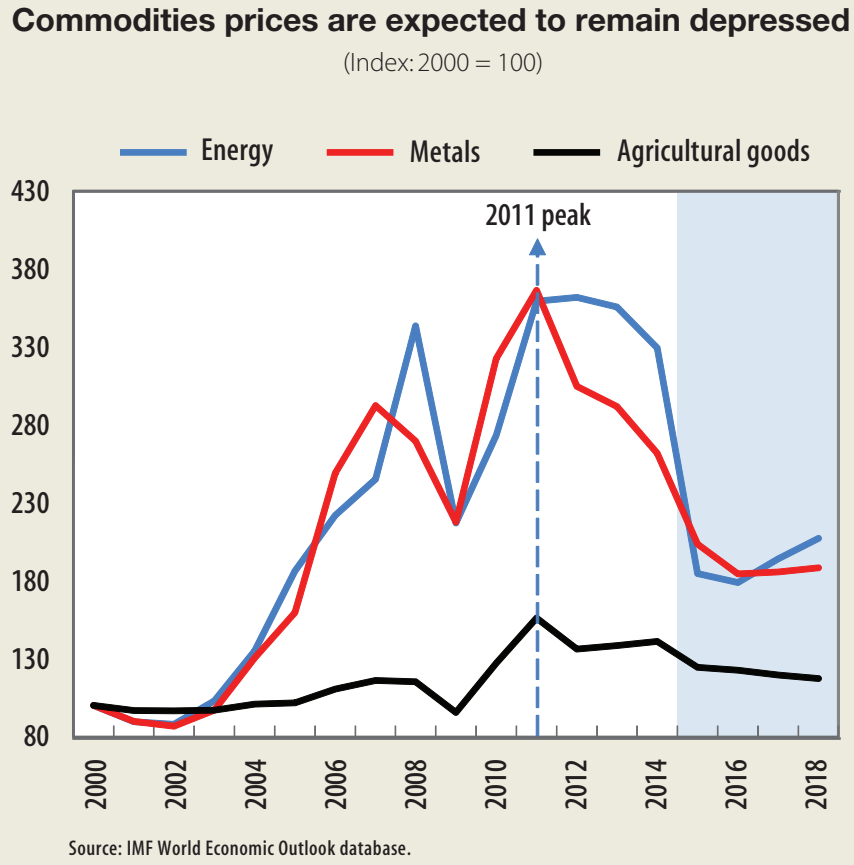
Latin America slows down

GDP growth in %

	2014	2015*
Latin America and the Caribbean	1.3	-0.3
Brazil	0.1	-3.0
Chile	1.9	2.3
Colombia	4.6	2.5
Mexico	2.1	2.3
Peru	2.4	2.4
Uruguay	3.5	2.5
Argentina	0.5	0.4
Bolivia	5.5	4.1
Ecuador	3.8	-0.6
Paraguay	4.4	3.0
Venezuela	-4.0	-10.0

Source: IMF Economic Outlook October 2015.
*** Estimate.**





inflation that is more than 1 percentage point above the center of their targets.

However, the IMF sees monetary policy in the region as a whole as being on track and urges continued efforts to fight inflation. Brazil, however, will not see relief in 2016. IBRE researchers pointed out several factors that are likely to keep inflation above the target ceiling of 6.5%. The first is that the recession has delayed most of the effects of foreign exchange devaluation on industrial input prices for 2016. For controlled prices, IBRE economists Salomão Quadros and André Braz estimate that prices for the items

While in recent years China was able to buy commodities from Brazil's neighboring countries and expand market share for its products in Latin America, Brazil failed to create the same dynamic with trading partners in the region and also failed to gain traction in rich economies.

For Brazil, where the fiscal situation is worsening and the political crisis is deep, the IMF sees no possibility of a short-term economic recovery, acknowledging that the crisis was deeper than expected.

that weigh more heavily in the price index will go up: electricity by 9.5%, bus fares by 9%, and gasoline by 8%. Prices for services are expected to increase in line with the expected 10% increase in minimum wage. José Julio Senna, head of the IBRE Monetary Studies Center, highlighted the difficulty of keeping monetary policy efficacious without a clear fiscal policy, noting that the large imbalance in public finances and the low confidence in corrective measures heighten the perception of risk and boost exchange rate devaluation, which in turn puts more pressure on inflation.

Adding to the deterioration of the confidence of both businesses and consumers in fiscal and political institutions is the fall in the value of financial assets and investments, which could be accentuated if the rating of Brazilian investments is downgraded further. Against this backdrop of business uncertainty, Estevão said, it would help to protect public investment as a positive externality for the private sector. He pointed out that normalization of U.S. monetary policy will give an incentive for capital to flow from emerging countries to the U.S.

Another risk factor the IMF staff pointed out is the quantity of corporate debt, which can also compromise productive investment plans in Brazil; they estimate that the debt-to-net assets ratio of Brazil corporations has reached 65%. IBRE researchers Silvia Matos and Vinícius Botelho emphasized the situation of net debtor companies in terms of U.S. dollars. They expect that at least until 2016 the impact of currency devaluation on the balance sheets of these companies should be greater than the profitability of exports.

Boost to export

So far the exchange rate devaluation has not yet boosted Brazilian exports significantly. Lia Valls Pereira, also an IBRE researcher, pointed out that the devaluation has had a more negative effect on imports. She said that "the real effective exchange rate adjusted by inflation depreciated 47% between September 2014 and 2015," which could help make Brazilian manufactured goods more attractive internationally. However, foreign sales of manufactured goods continued to decline in the first nine months of 2015, except for U.S. demand for aircraft and parts, which contributed to increase shipments to the U.S. by 3.7% in the first nine months of 2015

compared with same period a year earlier. Fabiano Rodrigues Bastos, an IMF economist who studies trade integration in Latin America and the Caribbean, pointed out that increasing the share of exports of higher-value-added products is a challenge for the whole region. He noted that within the region Brazil imports less relative to its potential—population size and proximity to relevant markets—and that it is imperative for the country to boost sales to advanced markets. While in recent years China was able to buy commodities from Brazil's neighboring countries and expand market share for its products in Latin America, he said, Brazil failed to create the same dynamic with trading partners in the region and also failed to gain traction in rich economies.

To raise the added value of Brazilian exports, Bastos argued for greater integration in value chains, but said it is necessary to have realistic expectations about the results of this strategy: "It's a first step, but does not guarantee an increase in value added or productivity growth." To increase competitiveness Bastos also advocated for the removal of domestic barriers to reallocation of resources, and for monitoring major trade agreements such as the Trans-Pacific Agreement. "Agreements like this can be good or bad, but one must watch them so that the country is not left out of a more integrated trade landscape," he said.

One challenge common to Brazil and other Latin American countries is sluggish growth, if any, compounded by inflationary pressures, even as much of the world is trying to manage disinflation and even deflation.

In the short term, however, the main determinant of Latin America's exports continues to be China because of the impact of slower China growth on both demand for and prices of commodities exported by Latin American countries. The IMF estimates that on average every 1 percentage point of lower growth in China reduces growth in Latin America by 0.5 percentage point.