



# Whither Latin America?

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Fundação Getúlio Vargas  
Rio de Janeiro, Brazil

## It's a great question...

- **A fascinating conjuncture**
- **Risks remain grave**
  - Is Europe waiting for Godot?
- **LAC did well in the previous crisis**
- **We have more tools**
- **But structural reforms have lagged**
- **Growth, yes, but how?**

# Grave global risks

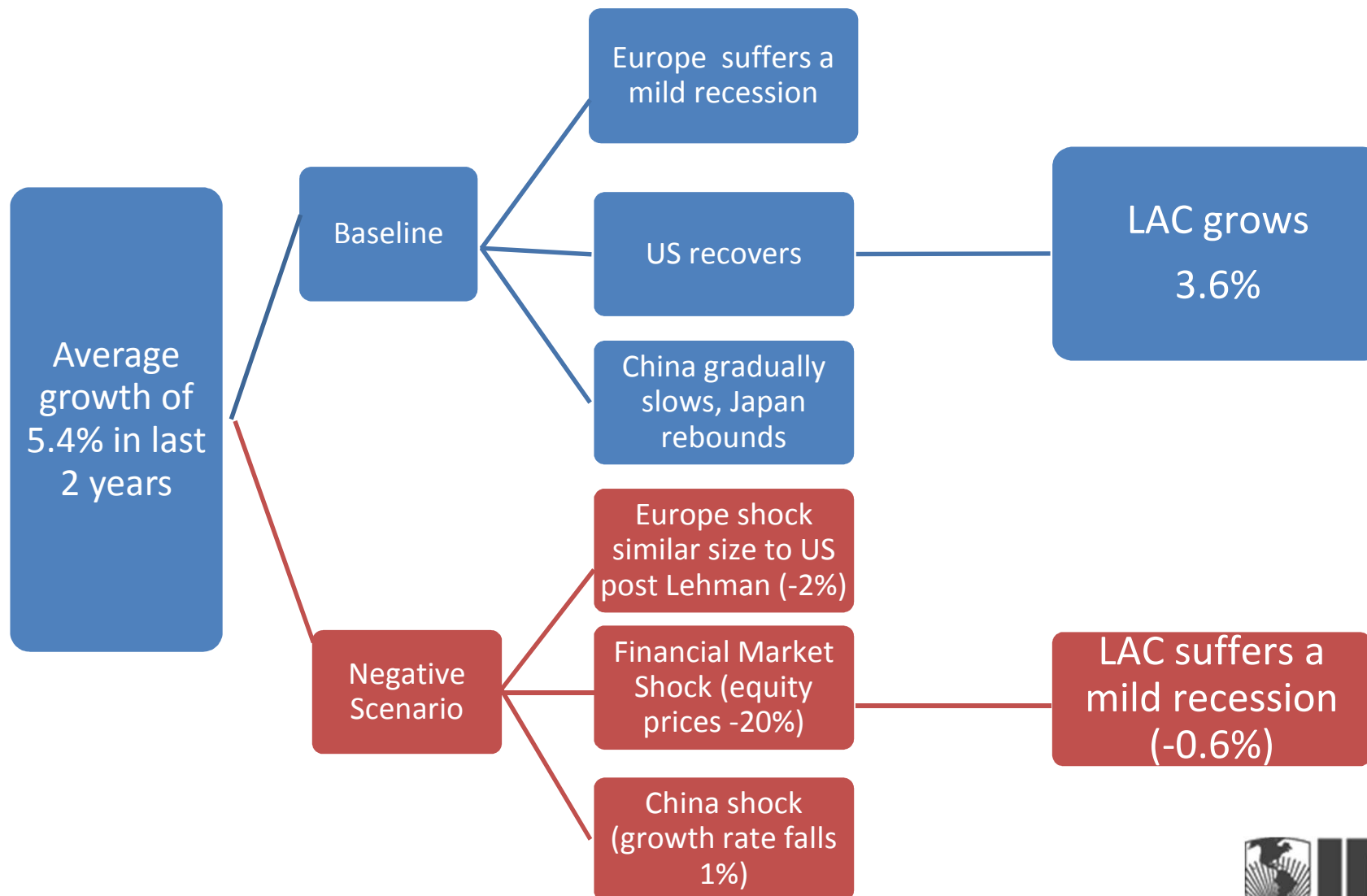


Latin American and Caribbean  
Macroeconomic Report 2012

# **The World of Forking Paths: Latin America and the Caribbean Facing Global Risks**

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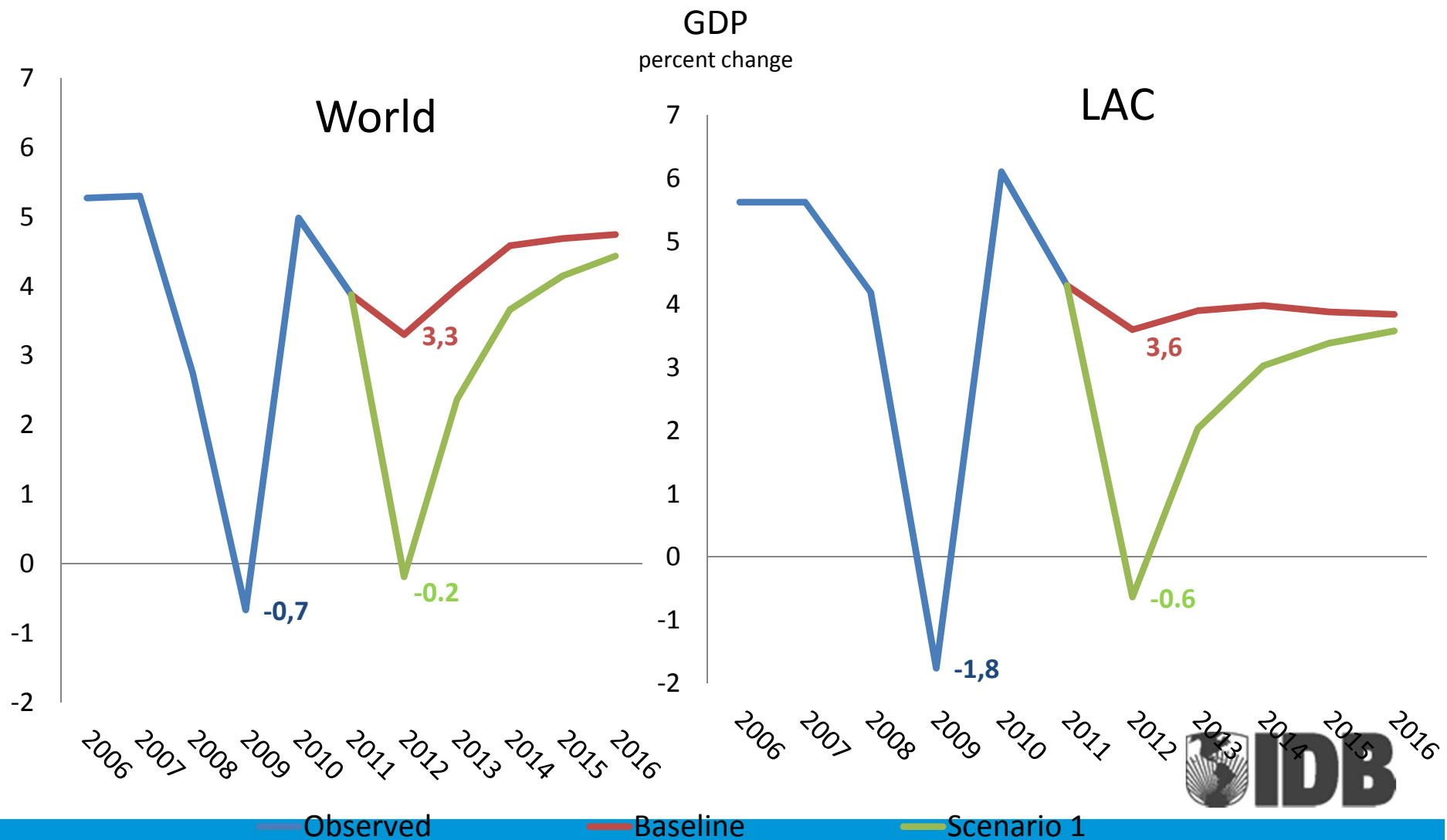
## Our view in March: (using a Global VAR approach)



Source: The World of Forking Paths: Latin America and the Caribbean Facing Global Economic Risks



# A very negative global scenario, a relatively mild recession in LAC

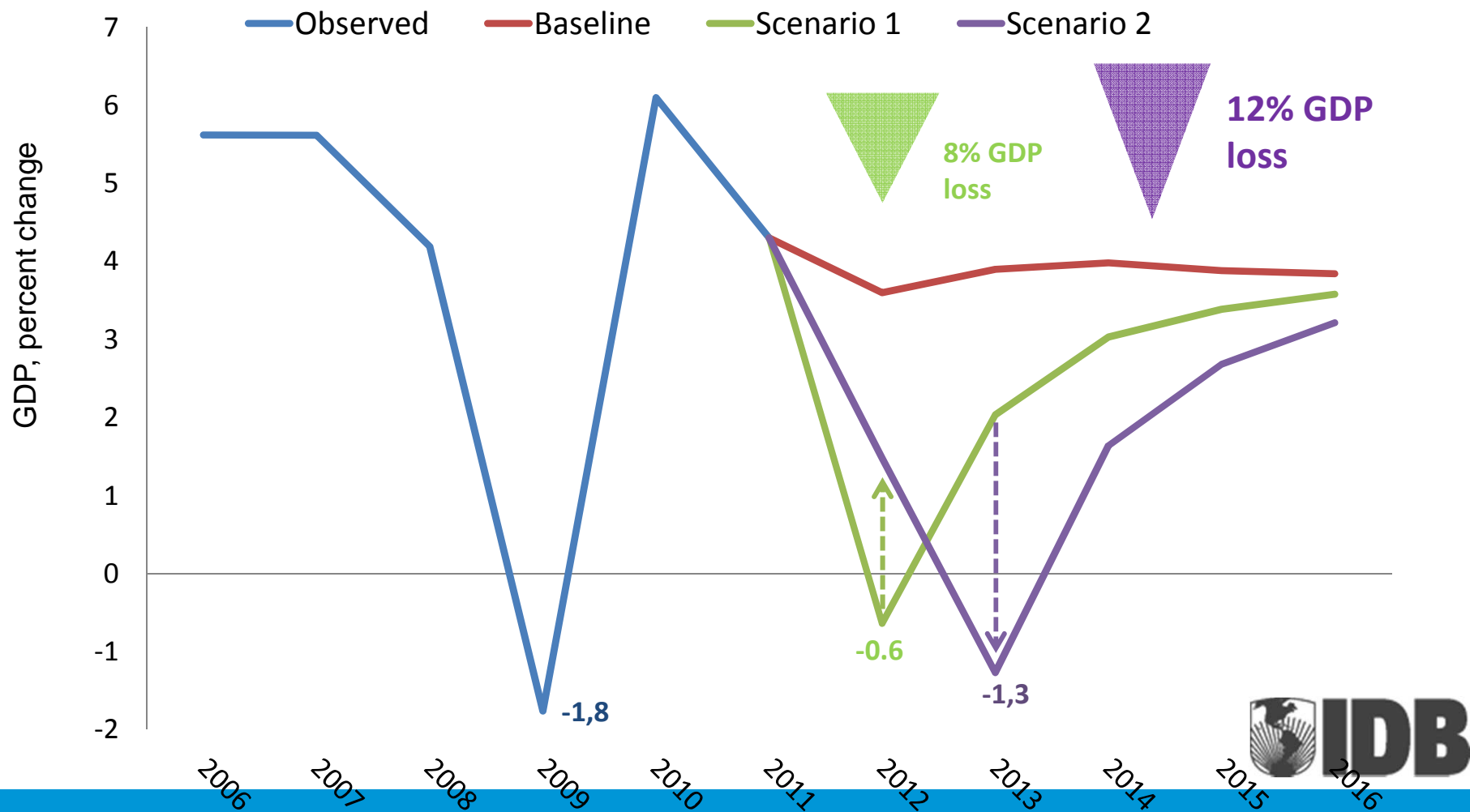


# The current conjuncture..

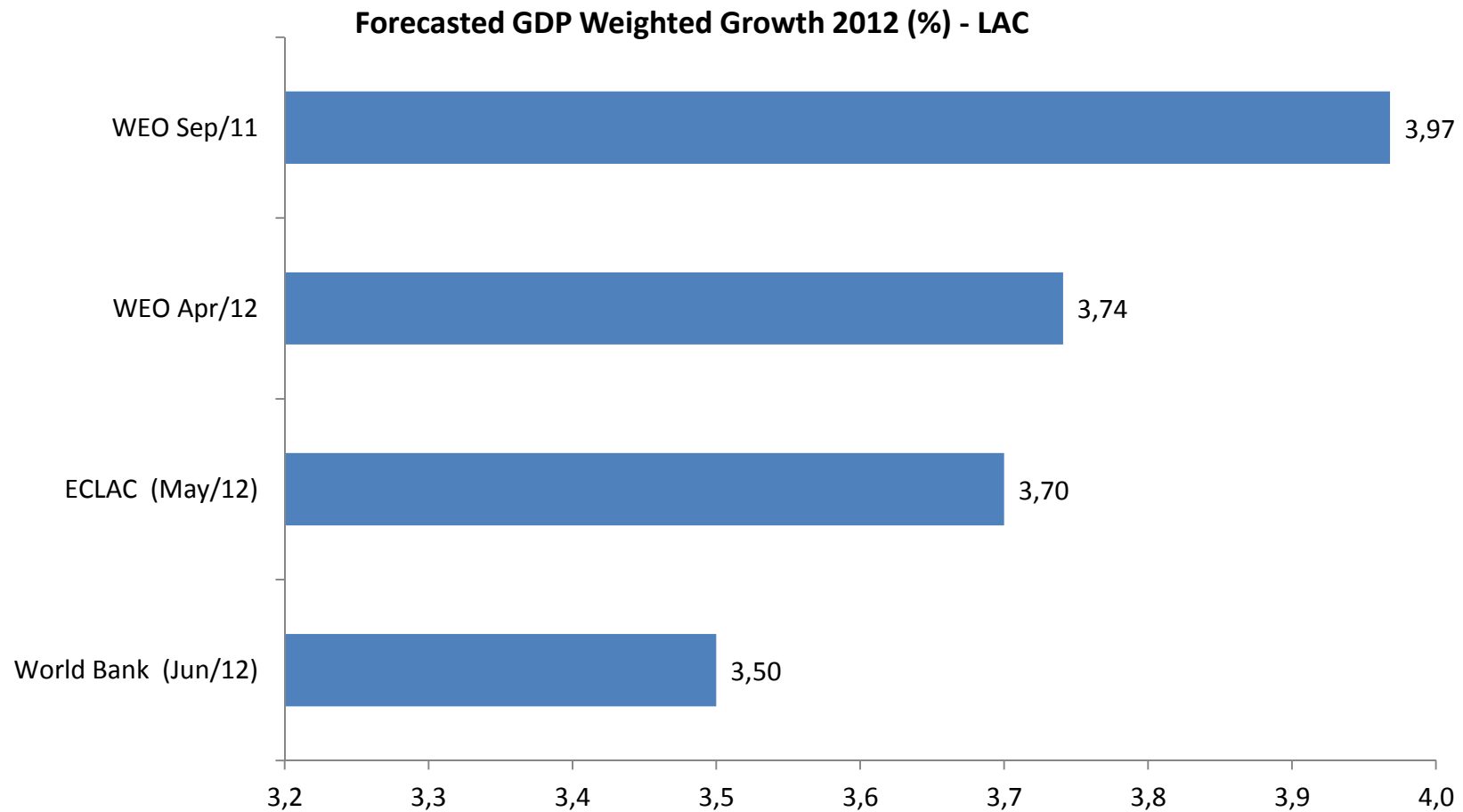
- **While our first bad scenario has thankfully not happened**
  - Europe has not suffered a fully fledged crisis to date
  - But there has been fall out in financial markets
  - China has slowed
  - US risks remain finely balanced
- **The current conjuncture is more akin to our second, more persistent negative scenario...**

# Second bad scenario: weak global growth in 2012 and then a European crisis...

LAC Growth Scenarios Compared



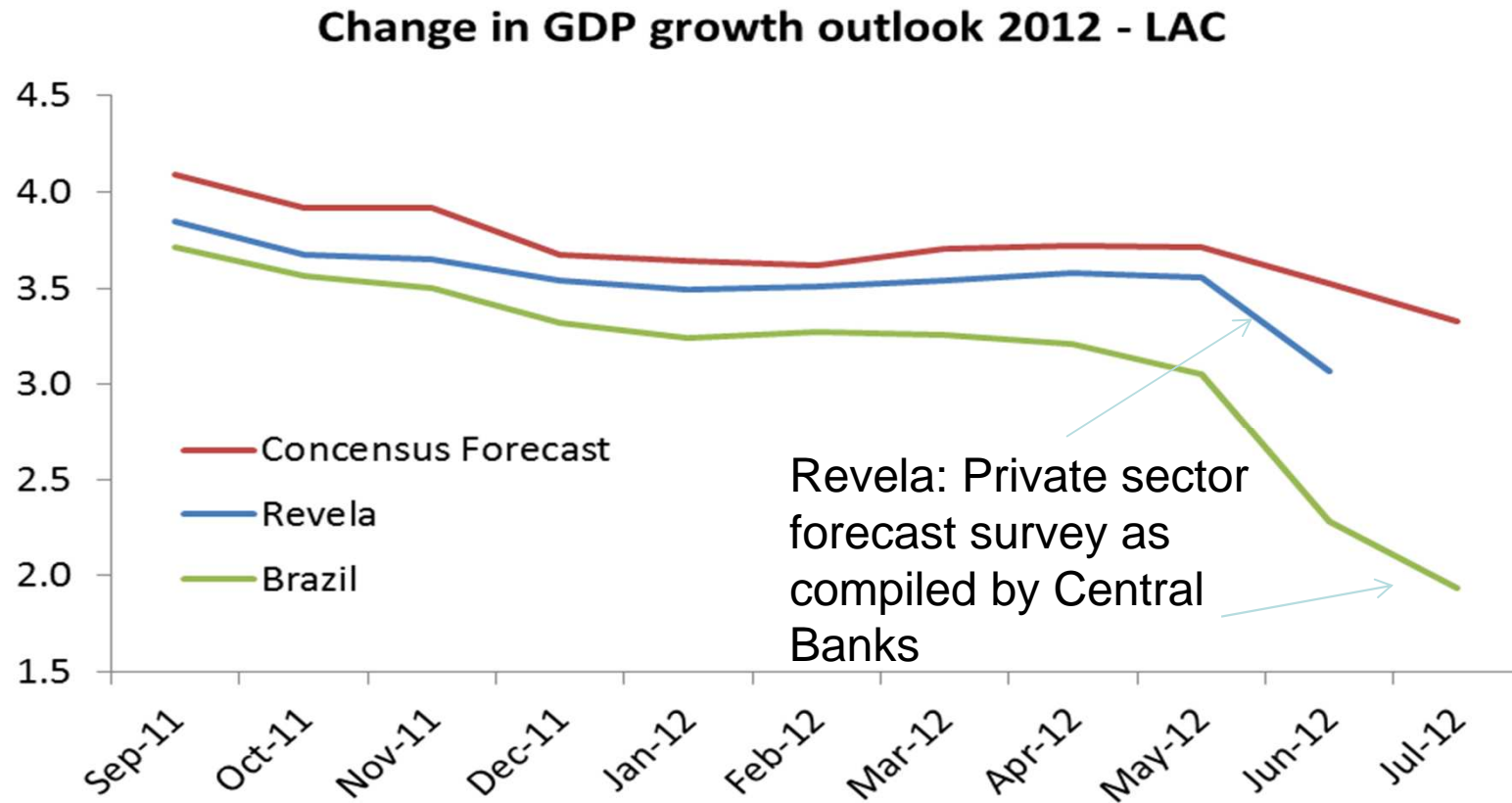
# Growth has slowed...



Source: WEO April 2012 and WEO September 2012 – IMFI; CEPAL and World Bank



# Particularly in Brazil...



Source: Revela: private sector surveys of forecasters in LAC countries conducted by central banks in the Region and Consensus Forecast



**The global risks remain, particularly those  
stemming from Europe**

# The European crisis: waiting for Godot?

- Two characters waiting for “Godot”
- ....but he never arrives
- Turns out they hardly know him anyway, many interpretations
- Perhaps whoever Godot is, we actually don’t need him to appear...



Vladimir and Estragon wait for Godot....



Samuel Beckett:  
the Irish Nobel  
laureate

“a play in which nothing happens,  
that yet keeps audiences glued to  
their seats. What's more, since the  
second act is a subtly different...he  
has written a play in which nothing  
happens, twice”

Vivien Mercier



# The European problems drag on...

- **The Troika must decide on the state of the Greek program**
- **Germany must decide on constitutionality issues**
- **Spain inching towards a package**
- **But the challenges remain huge,**
  - Is “fiscal union” politically feasible?
  - Banking union: the devil is in the details
  - And the fundamental competitiveness issues?
- **... there are still serious concerns about the “end game”**
- **Higher interest rates, an admission of potential convertibility risks, contracts that contemplate break up all tend to undo the benefits of the monetary union**
- **What will be the game-changer?**

# In the face of such risks, LAC has better defenses and more tools...

- Fiscal
- Monetary
- Micro and Macro-Prudential Policies

# Effective counter cyclical fiscal stimulus

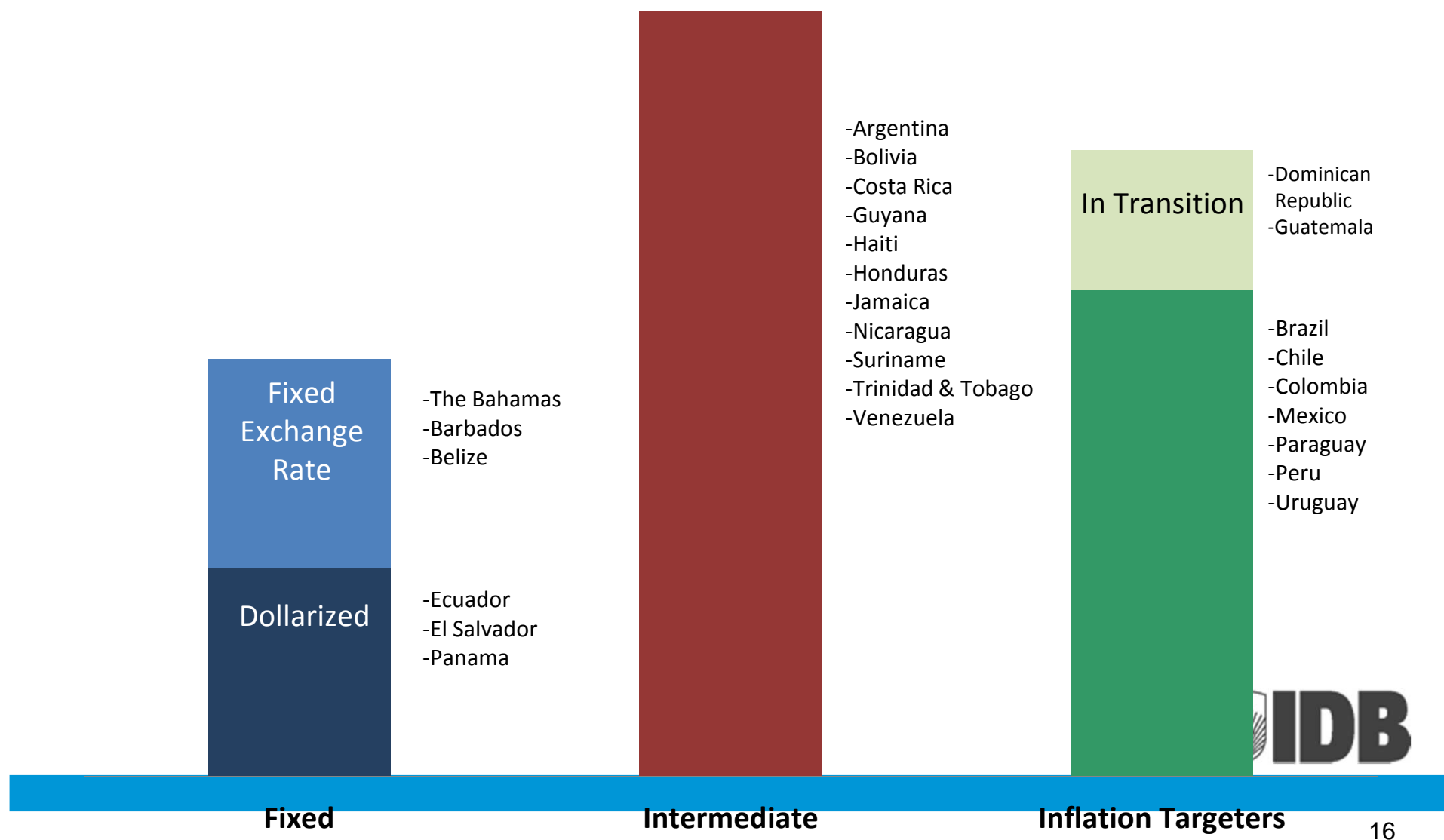
Counter cyclical response to 2008/09 Great Recession (% of GDP)		
Strong	Medium	Small
greater than 2% reduction in structural balance	between 1% and 2% reduction in structural balance	smaller than 1% reduction in structural balance
Bolivia Chile Colombia Costa Rica Dominican Republic Ecuador El Salvador Honduras Mexico Nicaragua Panama Paraguay Peru Uruguay Venezuela	Argentina Belize Brazil Guatemala Jamaica	The Bahamas Haiti

Perhaps, for the first time, the majority of LAC countries responded to an external shock with counter cyclical fiscal policy.

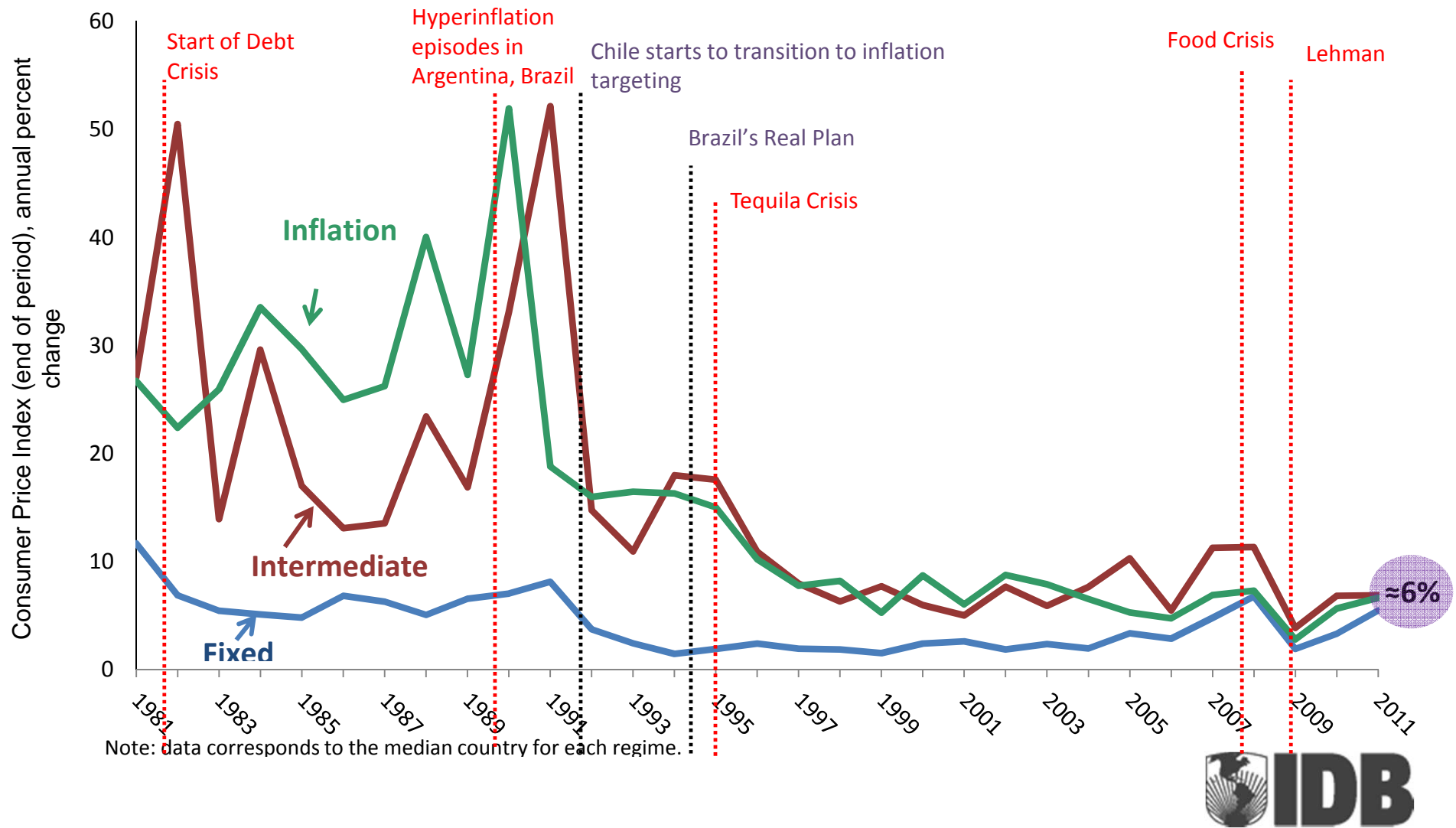


Note: the change in structural balance is measured over the period that delivered the maximum fiscal impulse and using constant commodity prices.

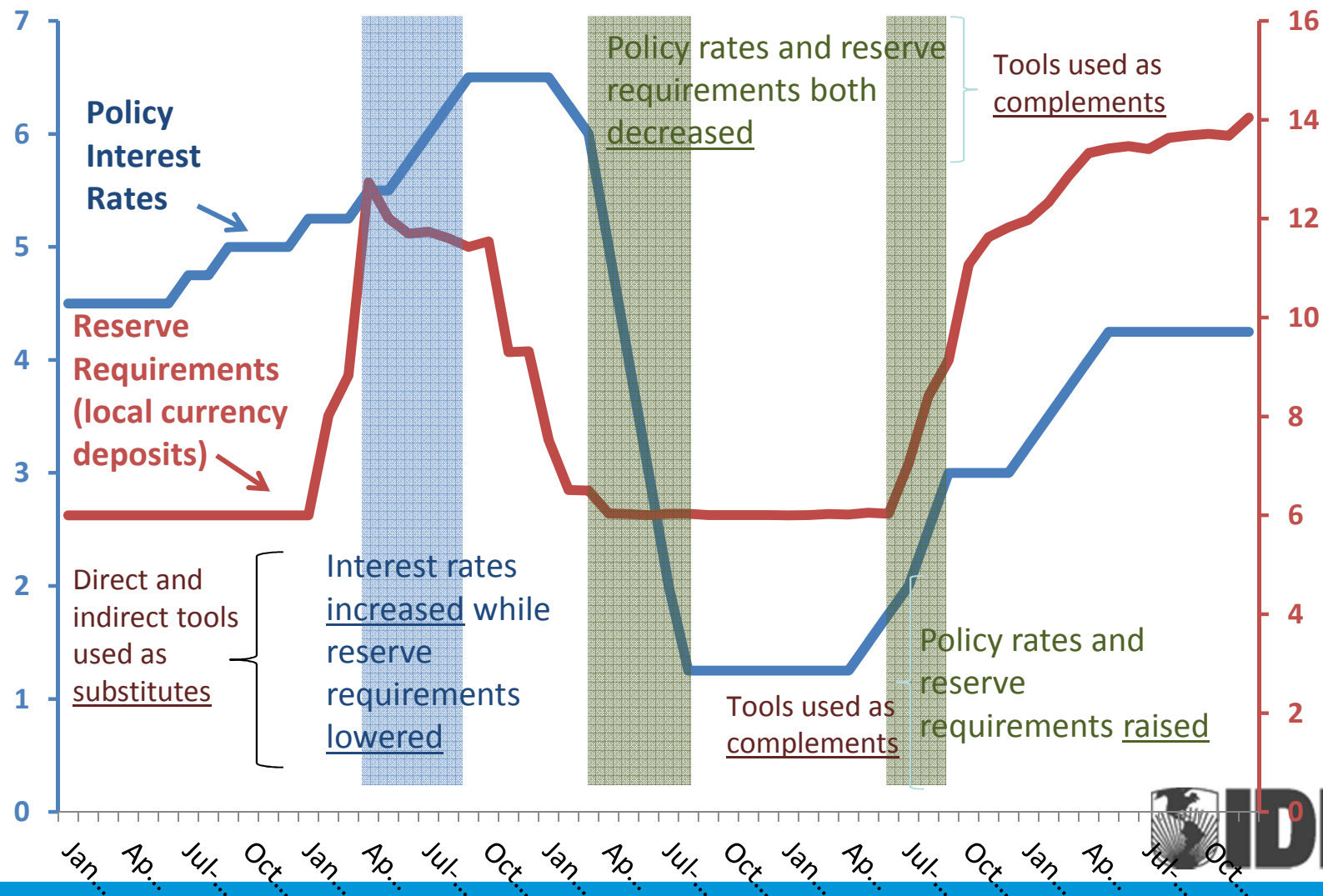
# A variety of exchange rate regimes



# Regardless, stable prices have been achieved



# The case of Peruvian Inflation Targeting

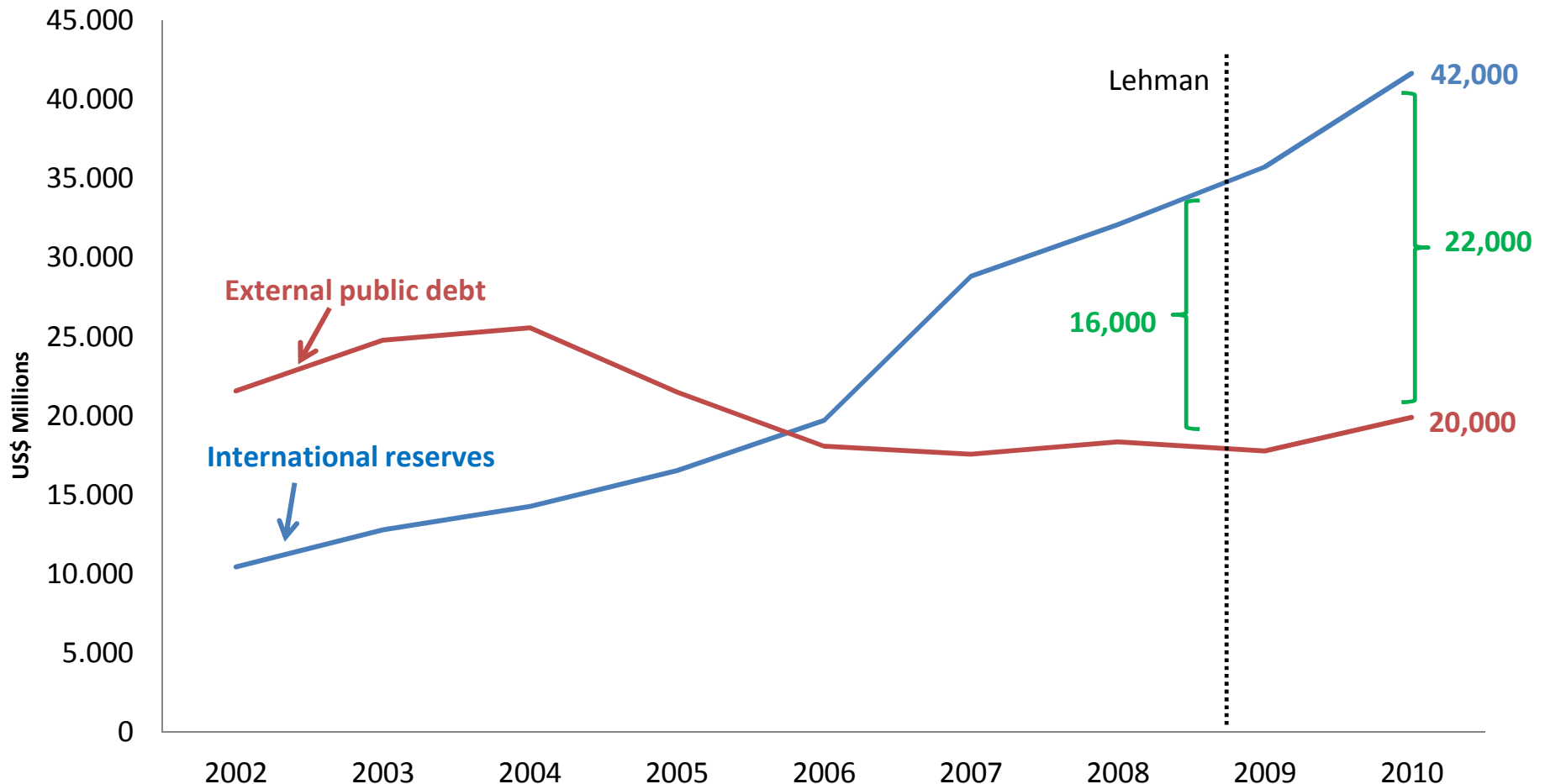


# Micro and macro prudential tools

- **High bank capital** (average required capital ratio of 11% and actual ratio of 16% vs. Basel II's 8% and Basel III's 13% - latter includes the full amount of the capital conservation and cyclical buffers).
- **Dynamic provisions** (Eg: Uruguay, Colombia, Bolivia).
- **Bank reserve/liquidity requirements** (Eg: Peru, Argentina).
- **Taxes/liquidity requirements on capital inflows** (Eg: Brazil, Colombia).
- **Foreign exchange mismatch limits on banks** (virtually all).
- **Tougher rules on complexity** – banks generally have to seek authorizations to use new instruments

# Better defenses (including improved public balance sheets) allows for better tools...

typical LAC country (simple average across countries)



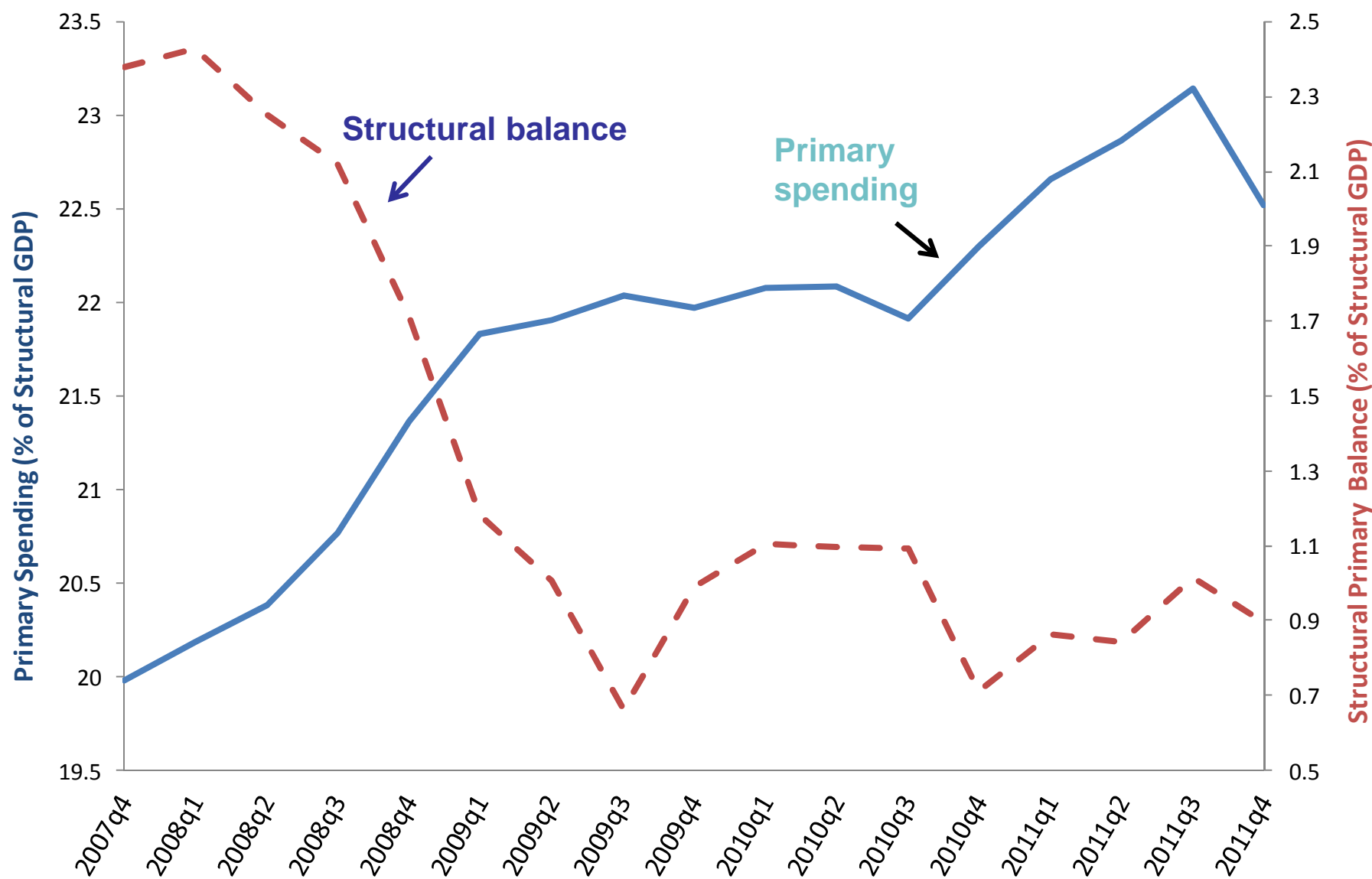
The international reserves of the typical LAC country are double its external public debt.



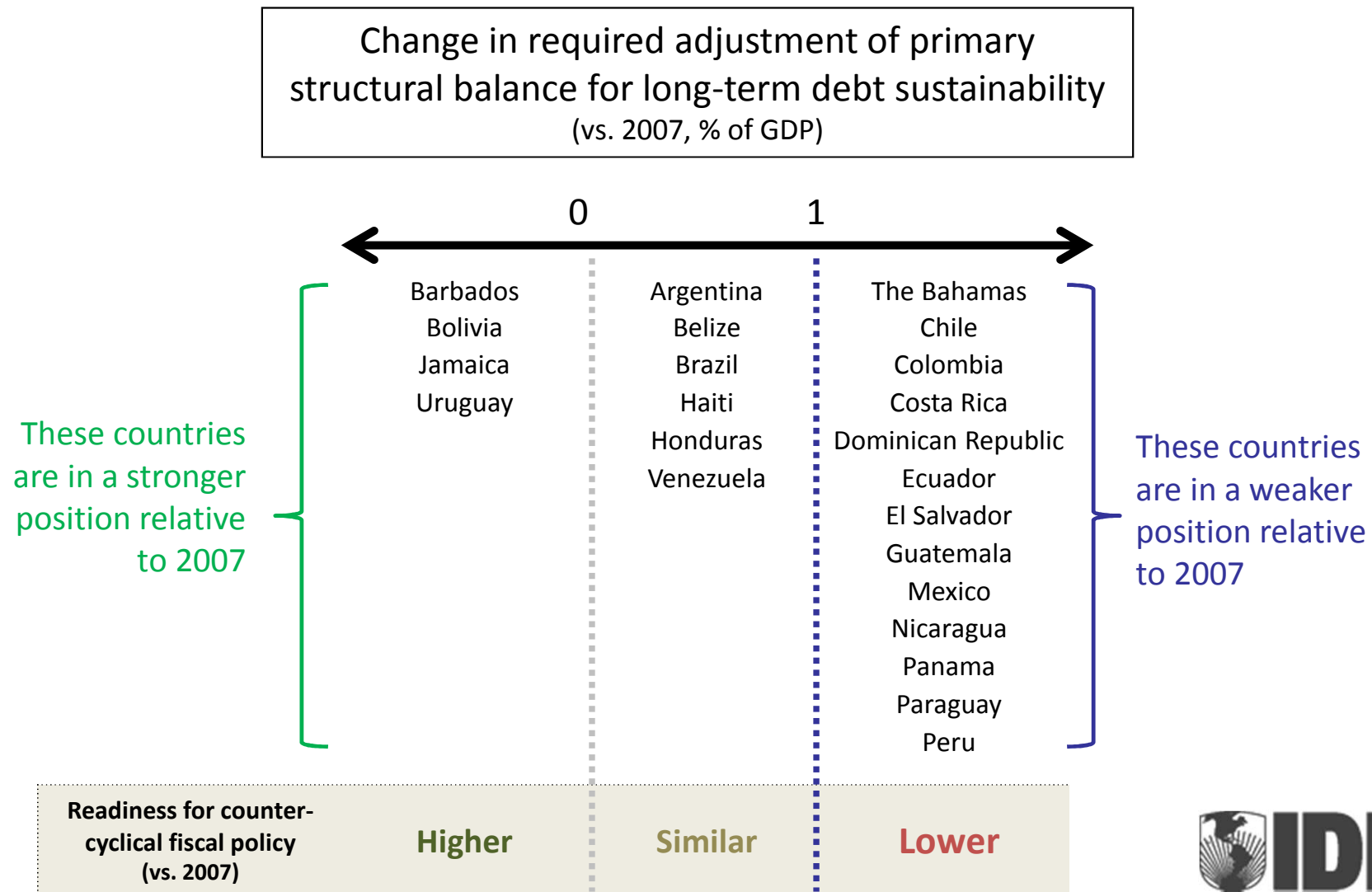
**But tools can always be sharpened...**



# Structural fiscal balances have deteriorated

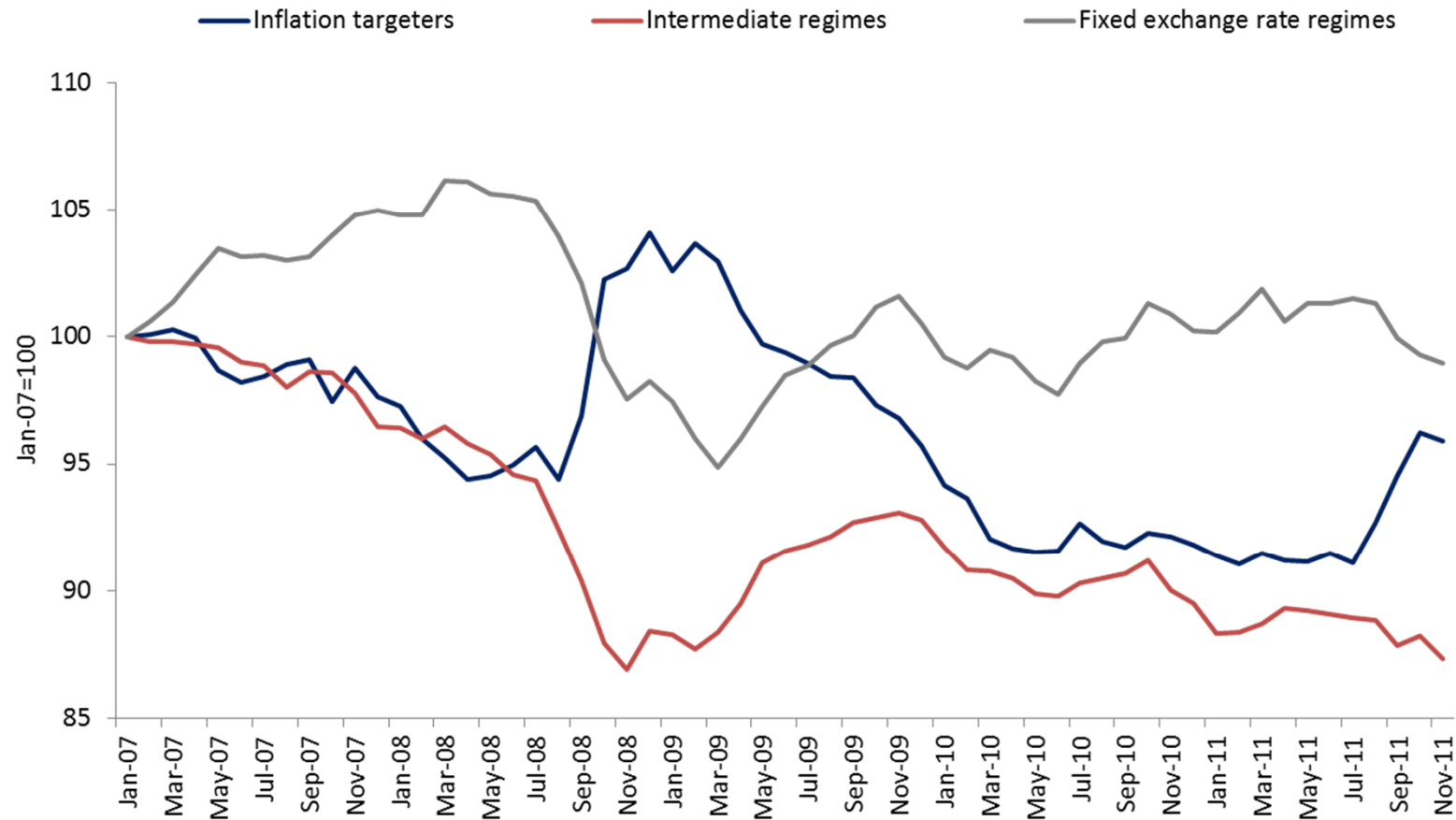


# In general LAC is less ready now for counter-cyclical fiscal policy



# Mixed responses of LAC's monetary regimes

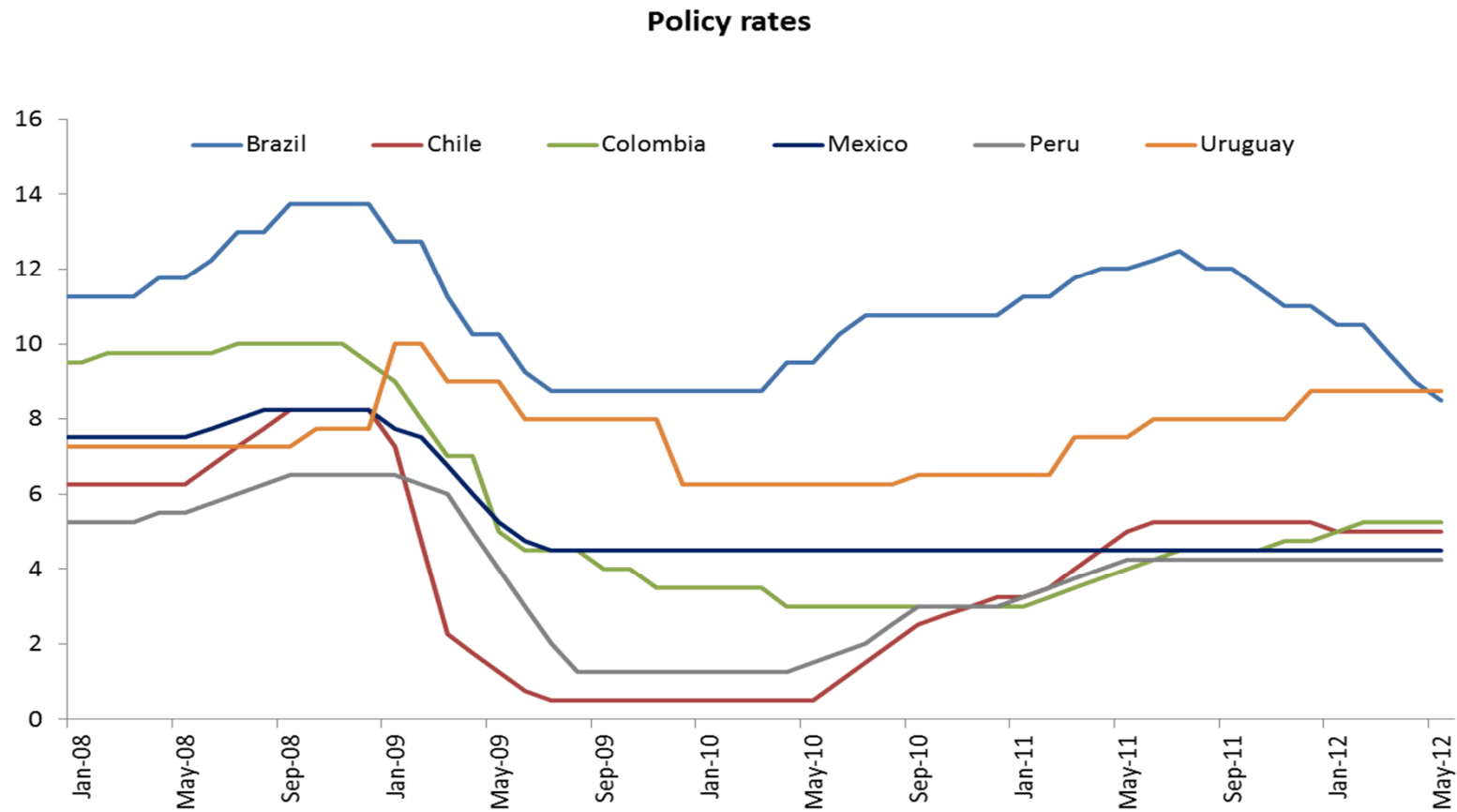
Multilateral real exchange rate



Source: LMW and RES calculations



# Inflation targeters: more thinking required on how to best use interest rate, non-conventional and macro-prudential tools...

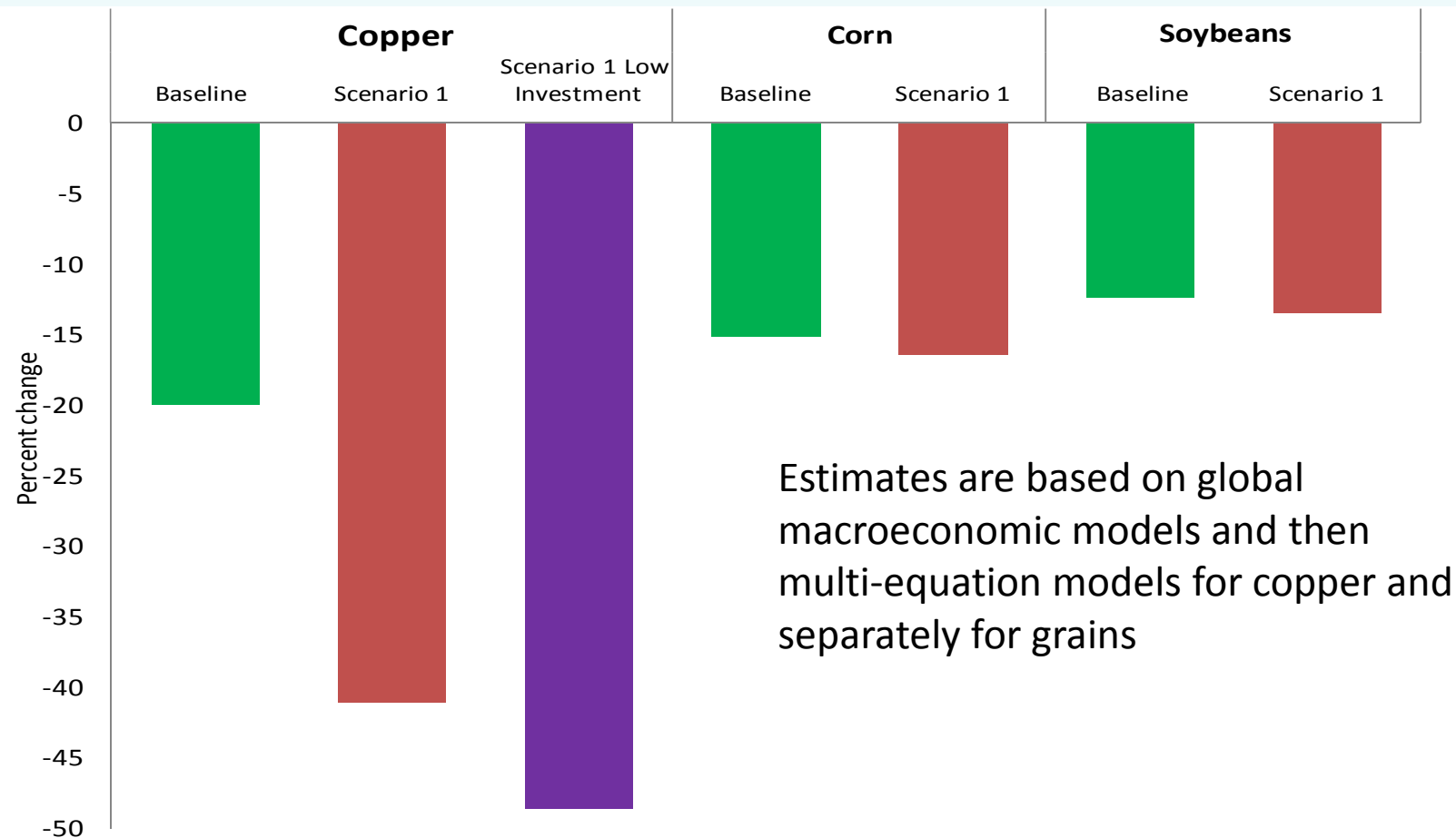


Source: Bloomberg and Central Banks



## Two specific vulnerabilities

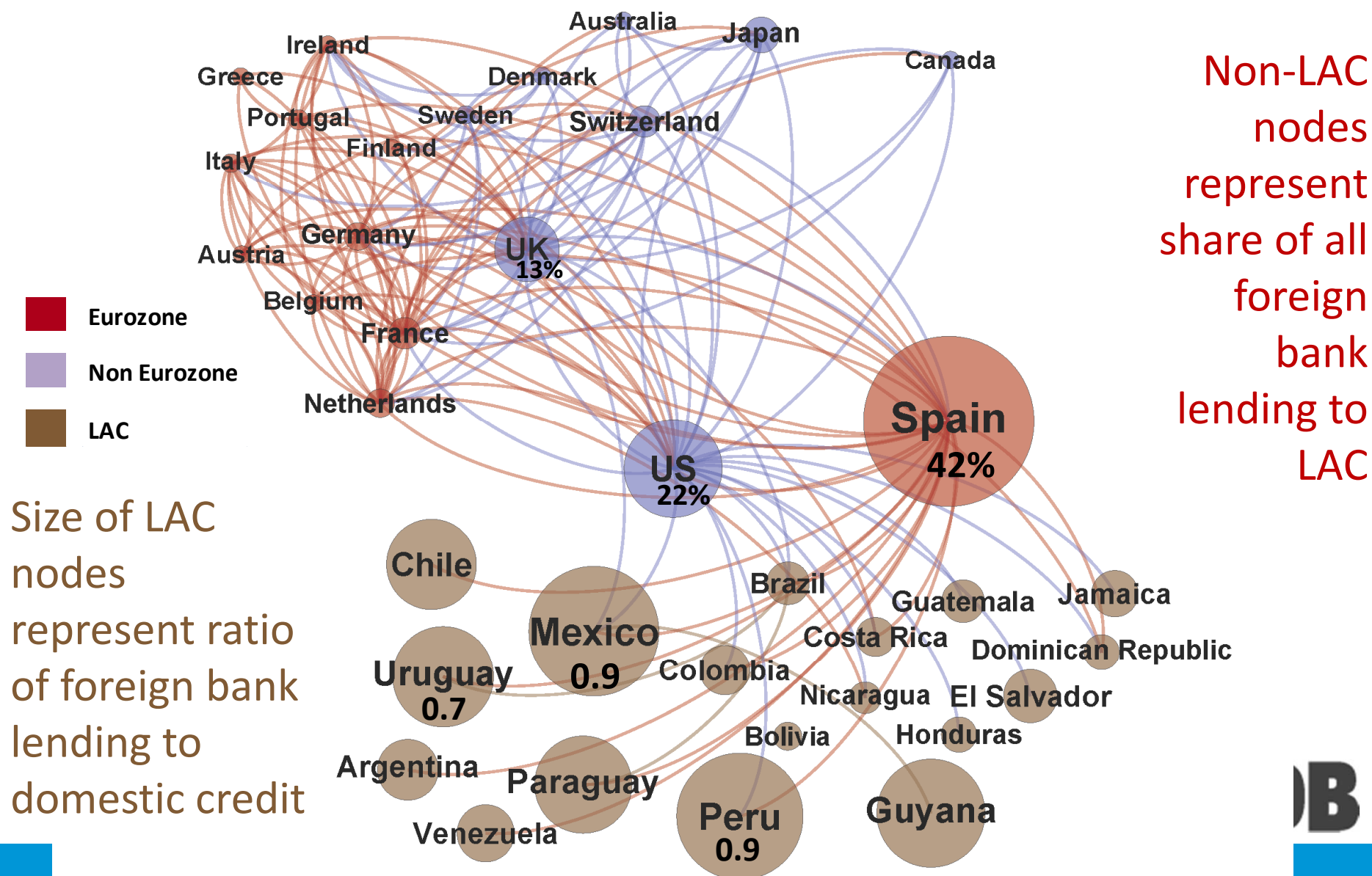
# Commodities: particularly metals are vulnerable to a China slow-down



Scenario 1 assumes that investment in China only falls moderately (from 46% to 41% of GDP by 2016) while the Low Investment scenario assumes a more dramatic change in the composition of GDP (investment falls to 32% of GDP by 2016)

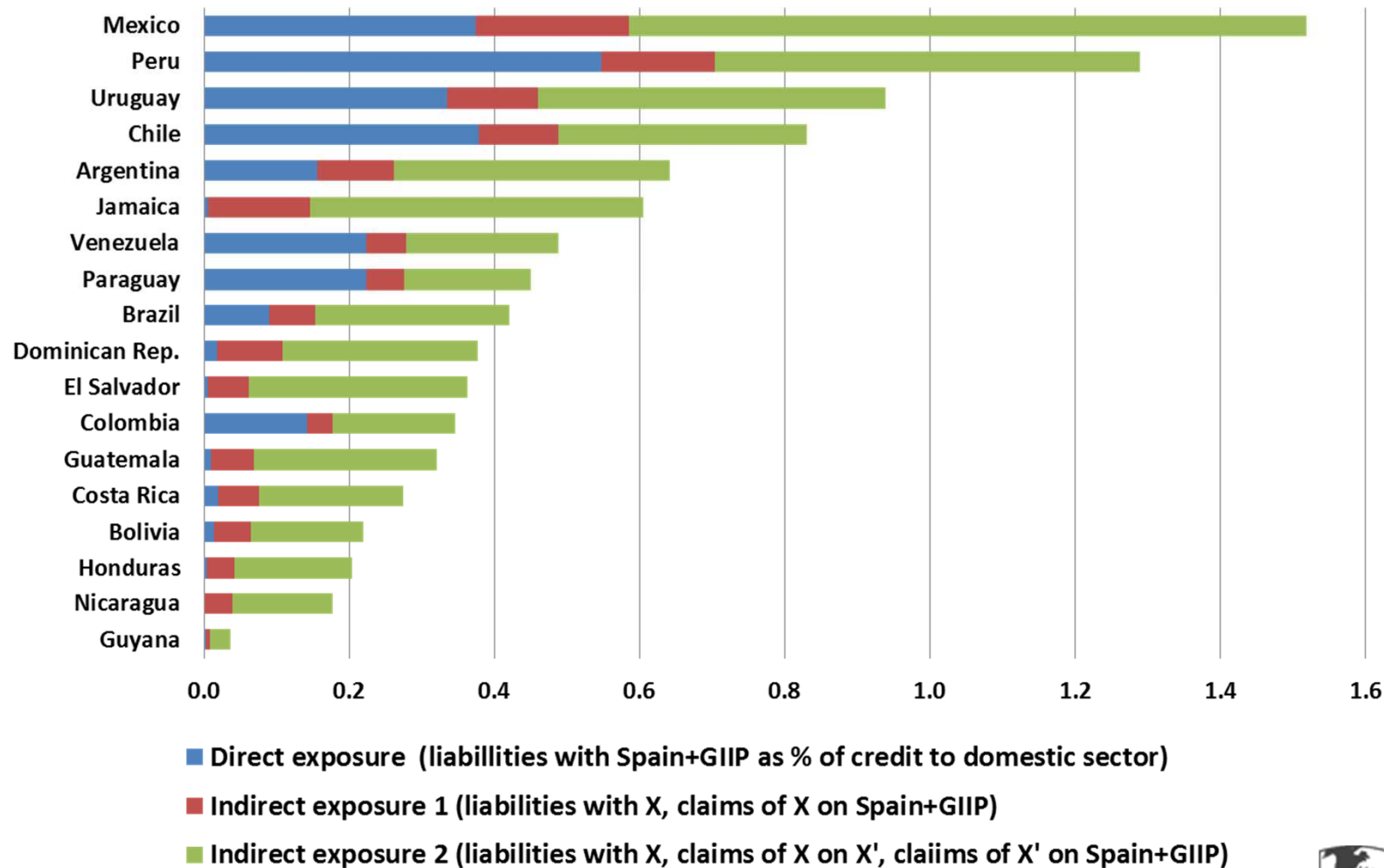


# Global banking connections: direct and indirect connections

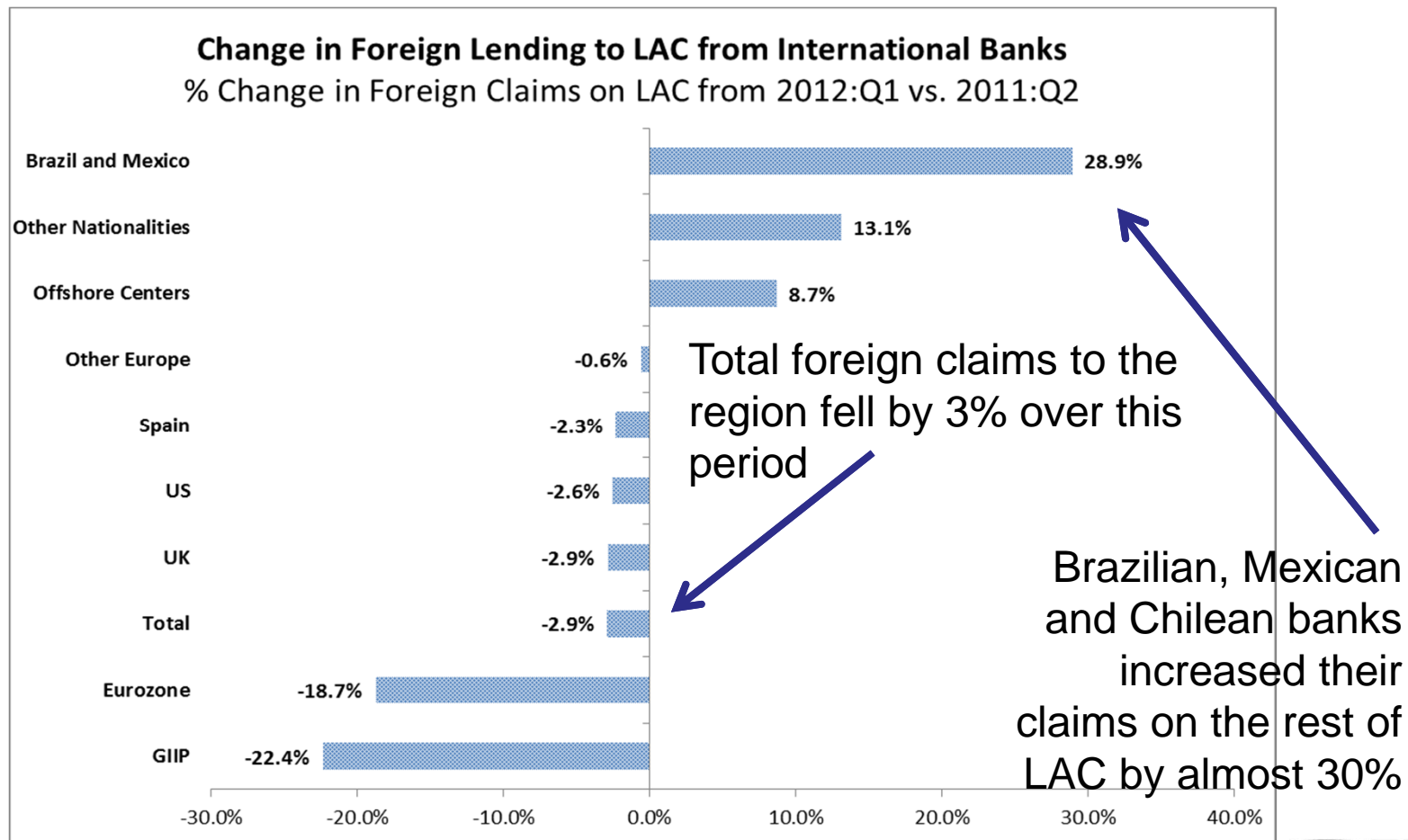


Note: a link to a LAC country shows when lending by foreign banks exceeds 10% of domestic credit

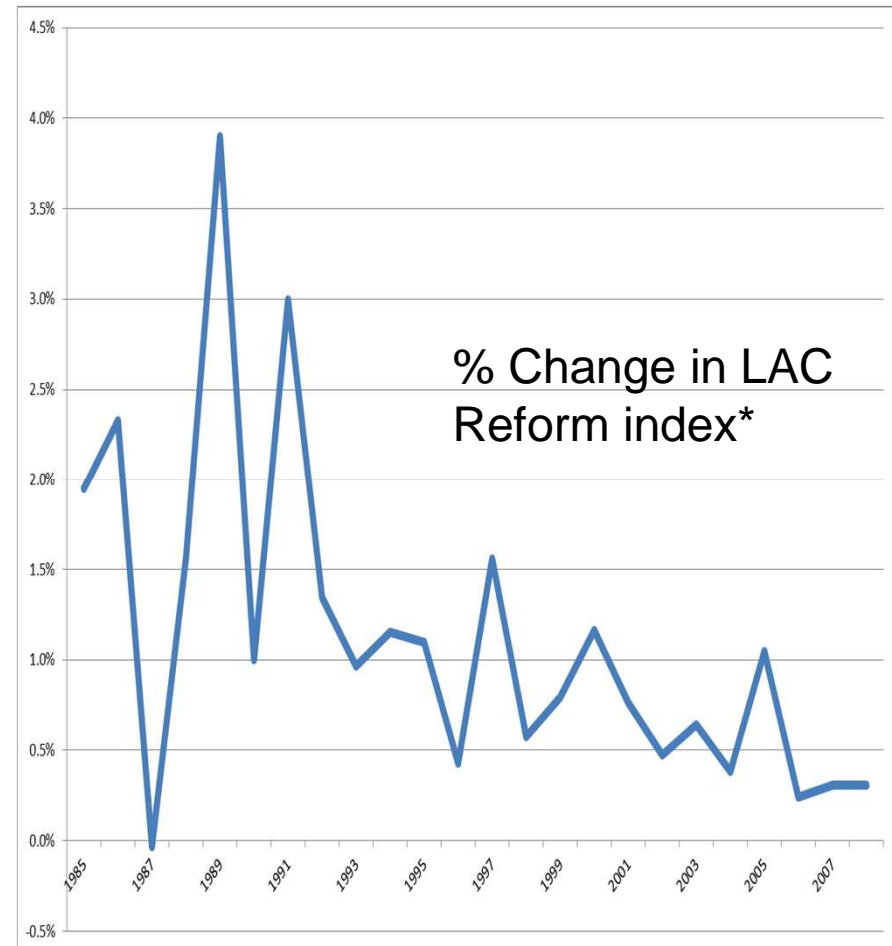
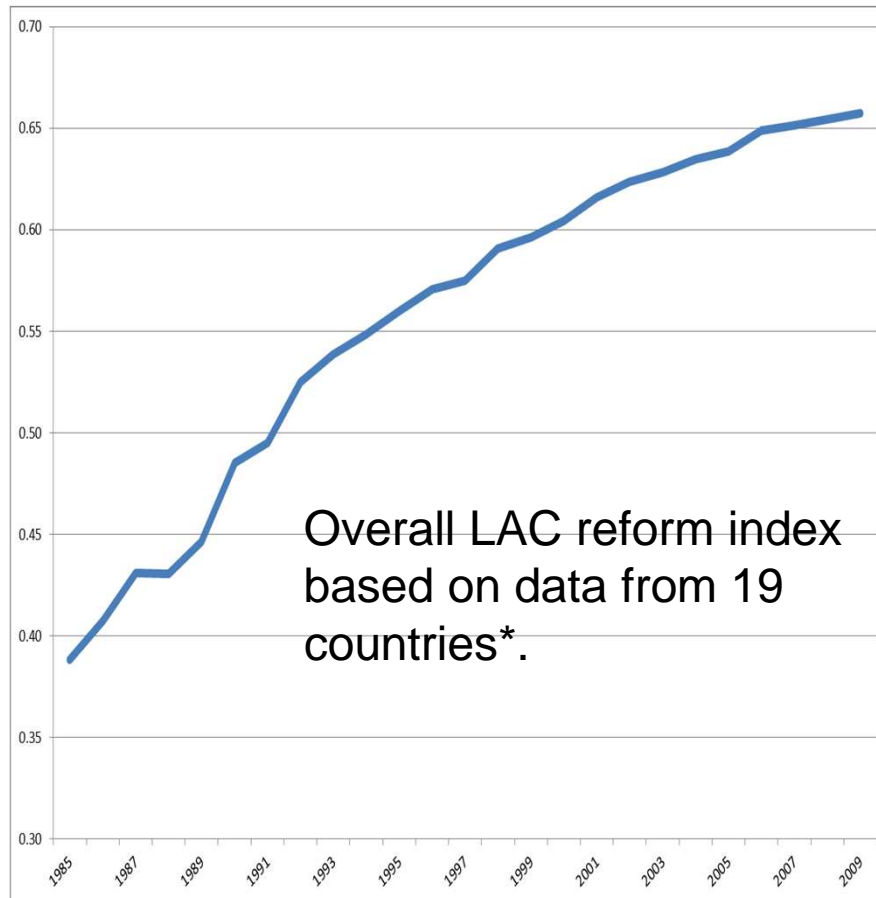
# Indirect exposures may be as important as direct ones...



# But despite strong links to Spanish banks, little evidence of a Europe induced credit crunch to date...



# Having good defenses and counter-cyclical tools is great, but reforms have stagnated...

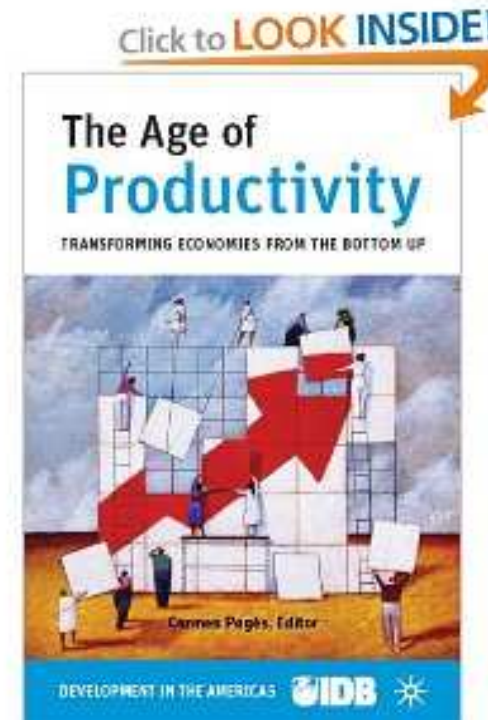


**\*Las reformas estructurales en América Latina: Qué se ha reformado y cómo medirlo (updated version). E. Lora, August 2012, IDB.**



# The Age of Productivity

- In this recent IDB Book, a set of policy actions is reviewed to boost productivity and growth



# More than Revenue: taxation as a development tool

- In this forthcoming IDB book the structure of LAC tax systems is reviewed
- It is argued that tax reform may play a significant role to increase economic efficiency and growth

# Counter-cyclical policies vs. Growth-inducing reforms

- A balance is needed between the two
- Counter cyclical policies respond to temporary downturns and should be designed to be reversed, otherwise they are not counter cyclical policies
- As this downturn may not be so short-lived as the last, LAC may need to put more attention on growth inducing reforms



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