

## **LATIN AMERICA ECONOMIC OUTLOOK 2016-2017**

**Pilar L'Hotellerie-Fallois**  
***AG Director International Affairs***

**GIC Central Banking Series: “Life after Brexit”**

**Fundación Rafael del Pino**

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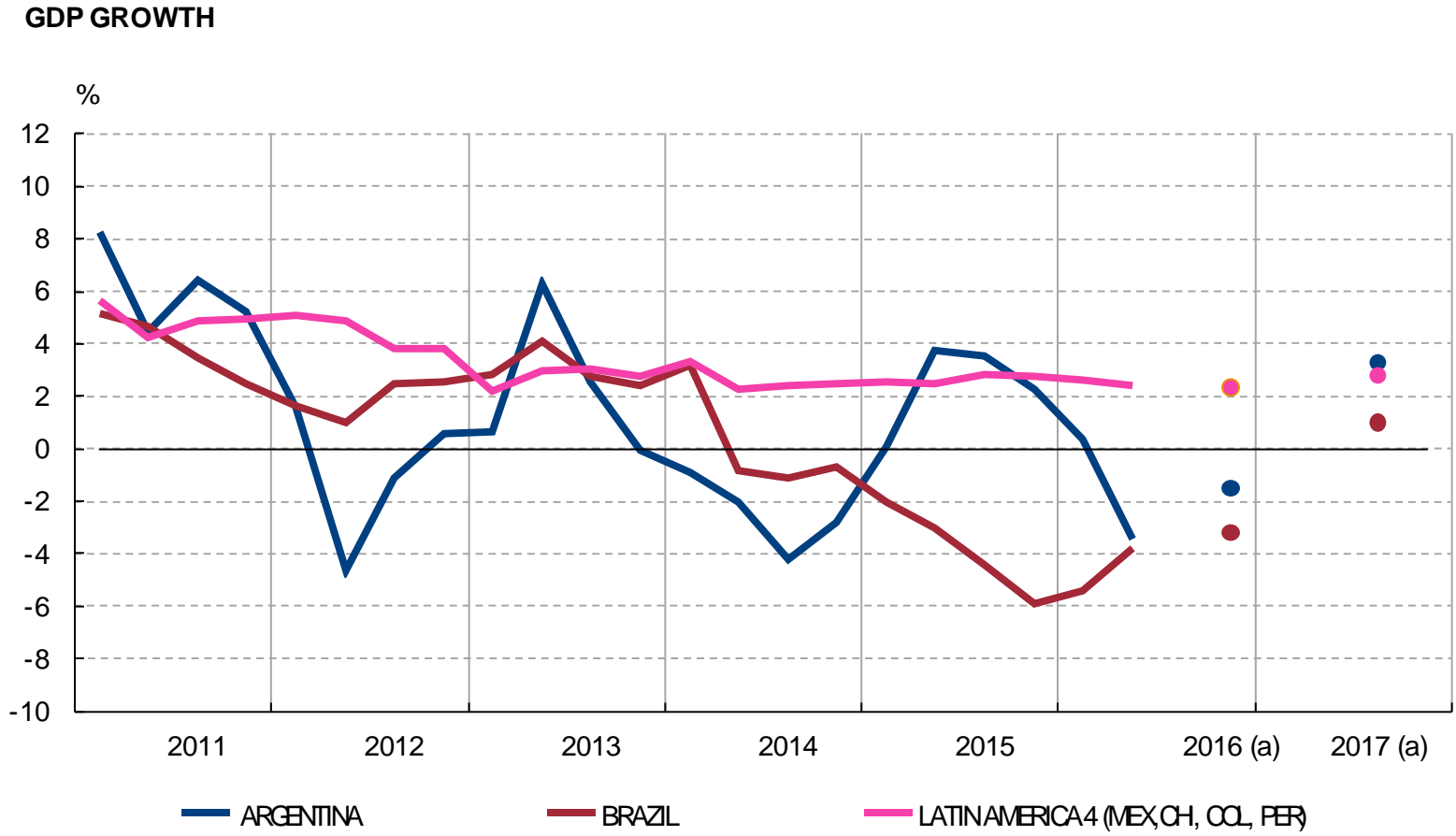


- **A turning point for economic growth in the region?**
- **A focus on Brazil**
- **The long term: what explains TFP performance in Latin America?**

# After a disappointing first half in 2016, will growth return to a positive rate in 2017?



- LA-6: large divergences by country
- Forecasts anticipate a turning point for the region that will depend heavily on Brazil
- Improved growth projections rely in part on a favorable external context for EMEs

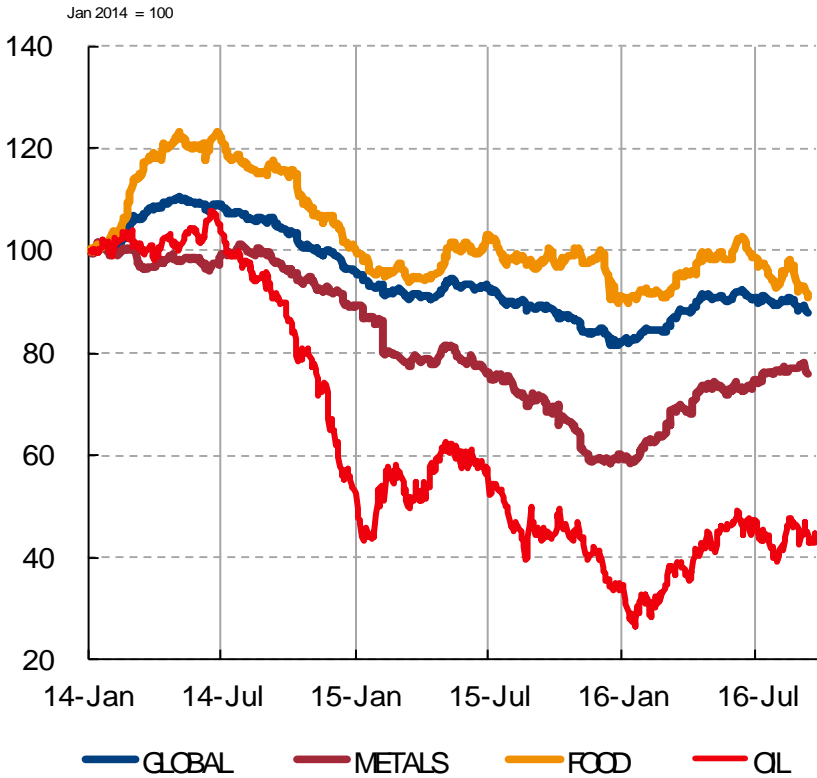


# External drivers: an improved global environment

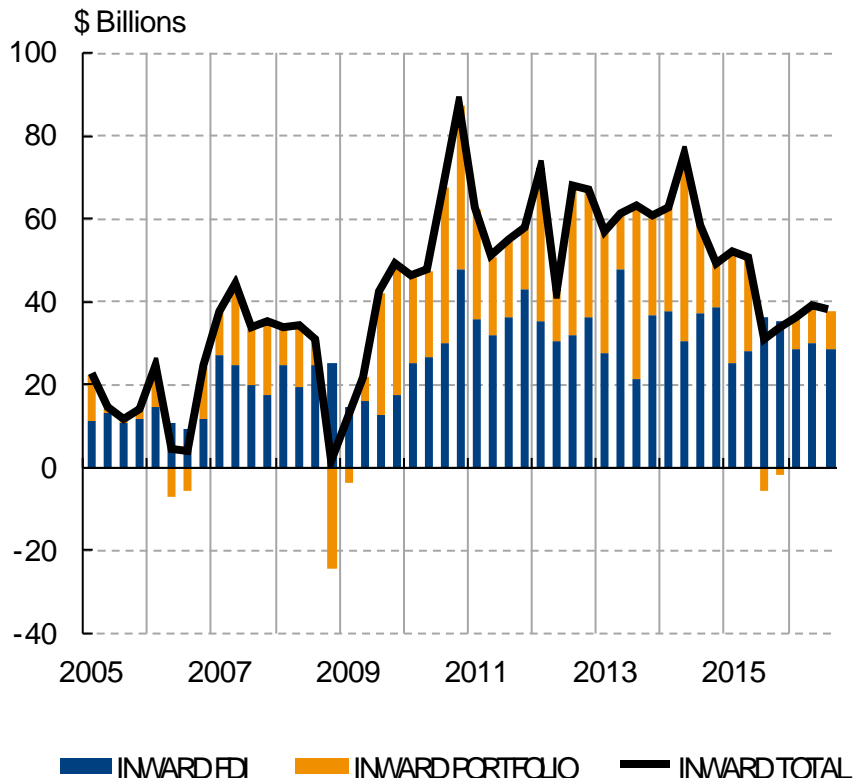


- In parallel to economic stabilization in China, commodity prices have levelled off
- A general Improvement in EM external financial conditions, including a rebound in capital inflows (especially after Brexit), after a sharp fall in 2014-15,
- Monetary policies in AEs remain key: risks of reversal if/when Fed rises oficial rates

COMMODITY PRICES



CAPITAL FLOWS INTO BRAZIL, MEXICO AND CHILE

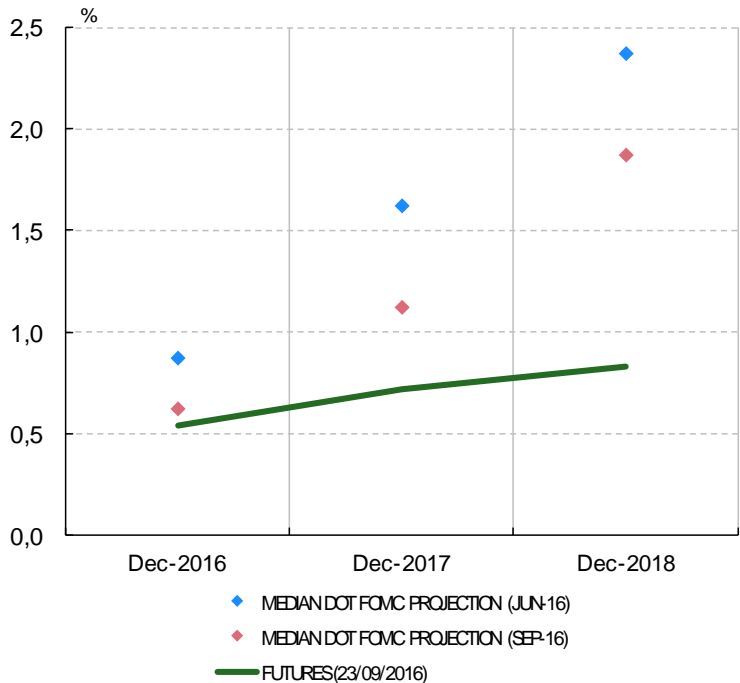


# Sensitivity to US monetary policy and growth outlook



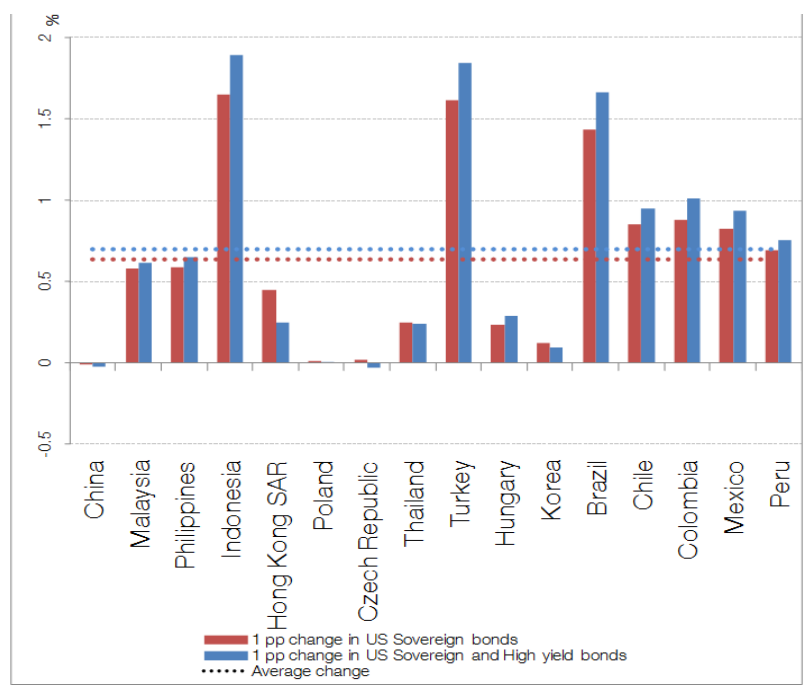
- Divergence between market and FOMC expectations on policy rates generates potential risk-off episodes
- LA economies are particularly sensitive to US MP: dollarization of assets and liabilities; financial and commercial links with the US; main exports (commodities) traded in dollars
- Mexico is especially affected by the pace of economic recovery in the US

**MARKET EXPECTATIONS (FUTURES) VS FOMC PROJECTIONS FOR THE FEDERAL FUNDS RATE**



SOURCE: FEDERAL RESERVE AND DATASTREAM

**MODEL RESPONSE TO AN INCREASE IN US SOVEREIGN YIELD AND US HIGH YIELD SPREAD (DECEMBER 2014)**

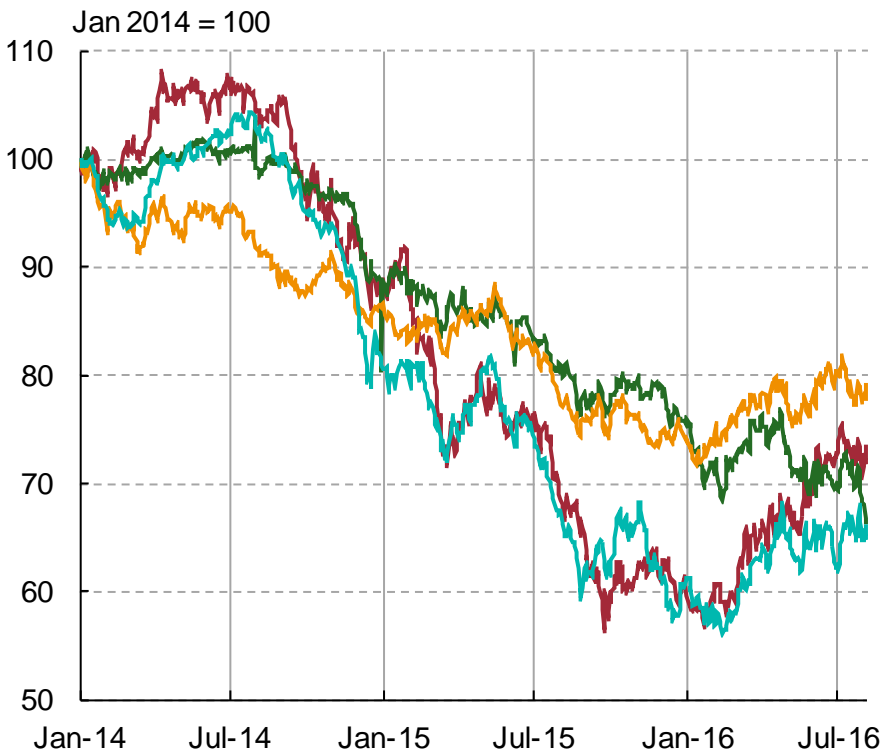


# From external to domestic drivers: external balance

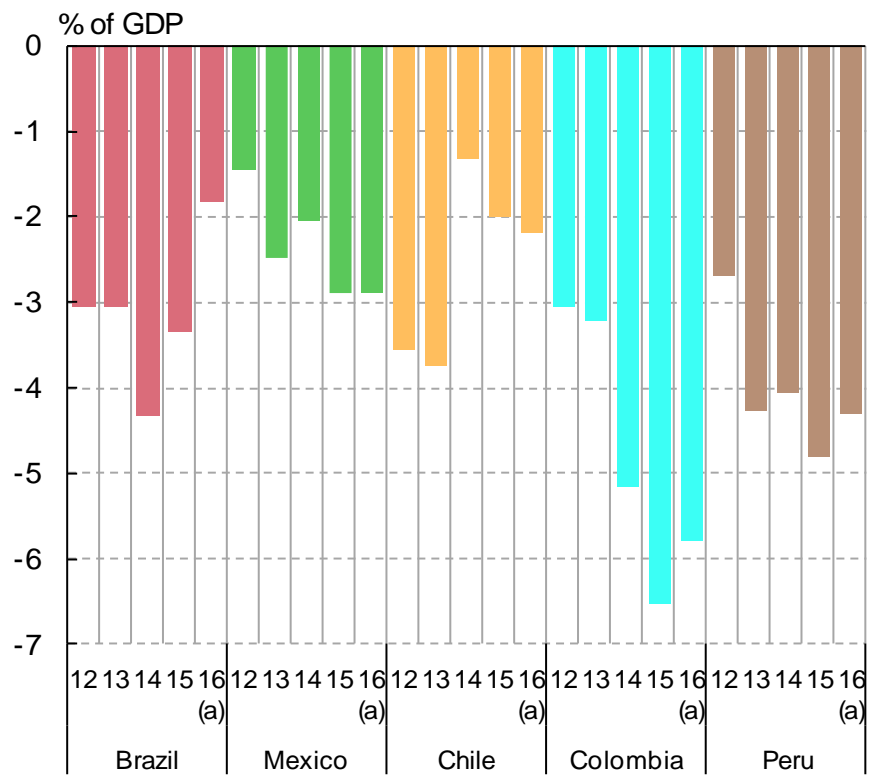


- ER flexibility has provided a cushion. After strong depreciation ER are stabilizing
- Current account adjustment has proceeded swiftly in some countries (Brazil), but external imbalances remain high
- FDI inflows and foreign currency reserves also provide some comfort

**NOMINAL EXCHANGE RATE AGAINST US DOLLAR**



**CURRENT ACCOUNT BALANCE**



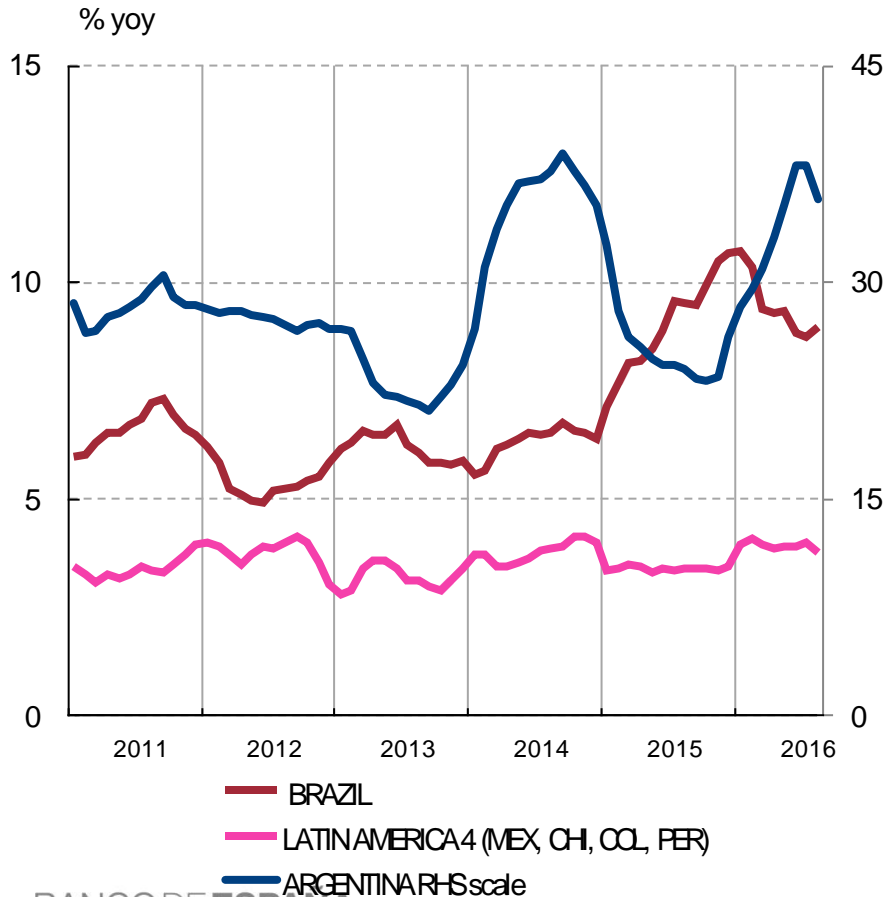
a) Four quarters sum, latest data 1Q2016

# Domestic drivers: inflation and monetary policy

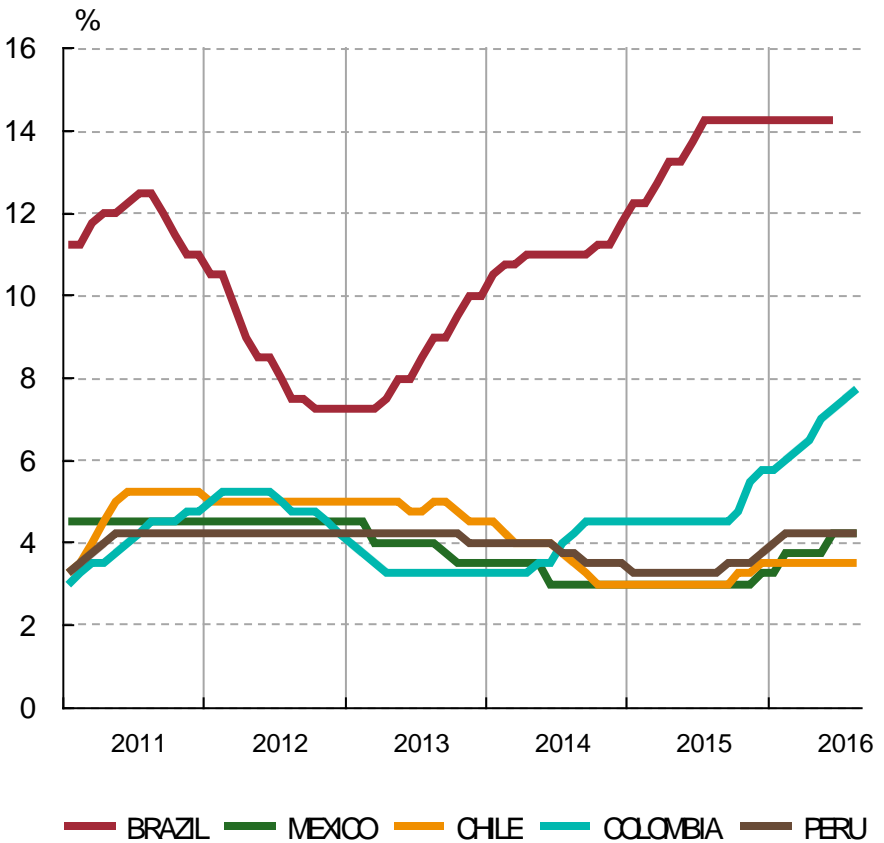


- After sharp inflationary processes (BR, ARG) consumer prices are converging to targets
- This opens some space for monetary accomodation (but Fed tightening could be a constrain)
- Mexico is a somewhat different case due to stronger links to US

**INFLATION RATE**



**OFFICIAL INTEREST RATES**

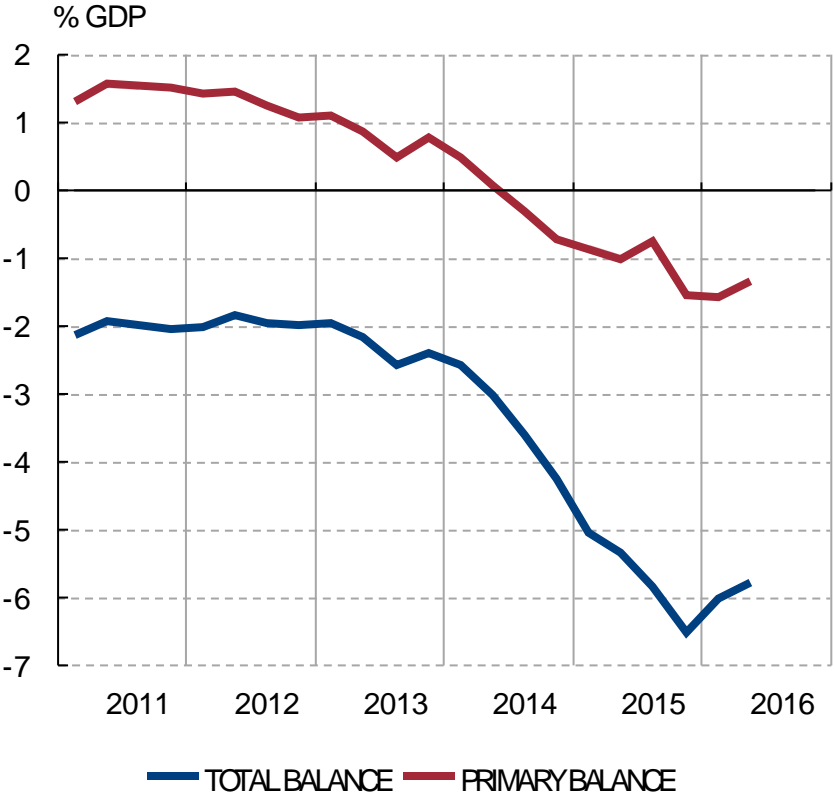


# Domestic drivers: fiscal policy



- A general need to adjust fiscal accounts to a low-commodity price environment
- The private sector is deleveraging, with some exceptions
- Currency mismatches not worrisome

**BUDGET SURPLUS (+) OR DEFICIT (-) IN LATIN AMERICA 5**



**REAL CHANGE IN CREDIT GROWTH TO THE PRIVATE SECTOR**



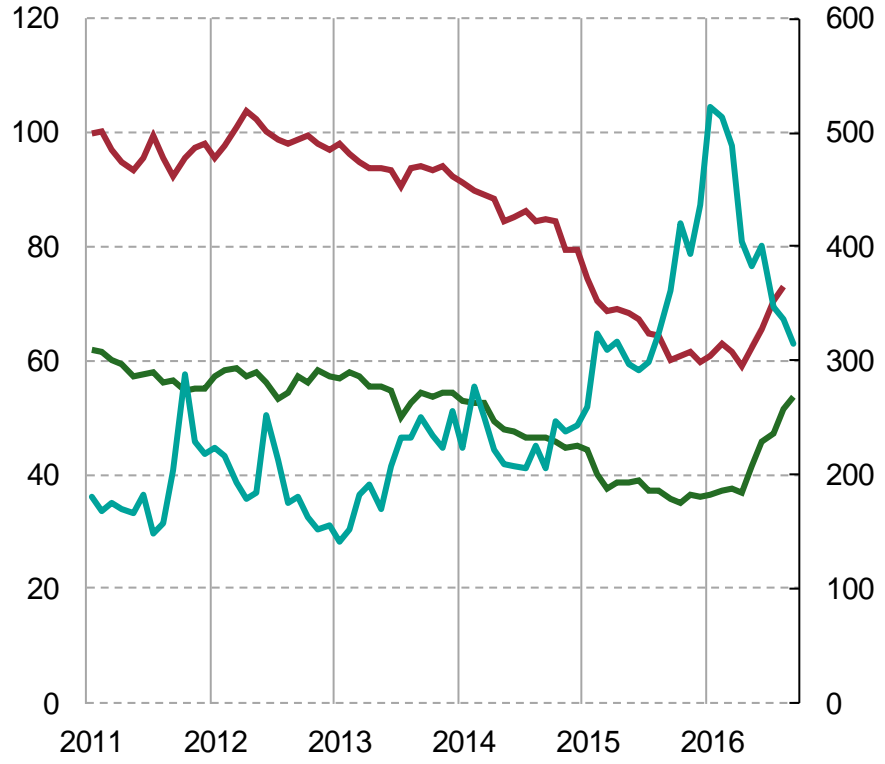


# A focus on Brazil

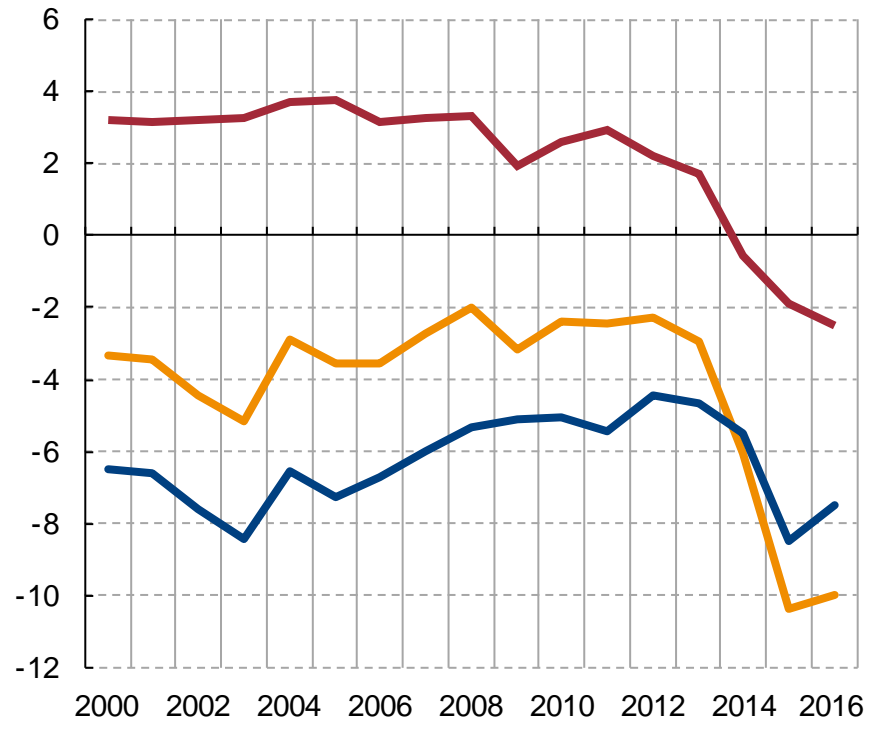


- Expectations have shifted as a result of improved policy credibility...
- ...but economic policies still need to deliver: is a gradual fiscal adjustment enough?

**BRAZIL: BUSINESS AND CONSUMER CONFIDENCE; EMBI**



**BRAZIL: PUBLIC BUDGET**



— BUSINESS CONF. — CONSUMER CONF. — EMBI (RHS scale)

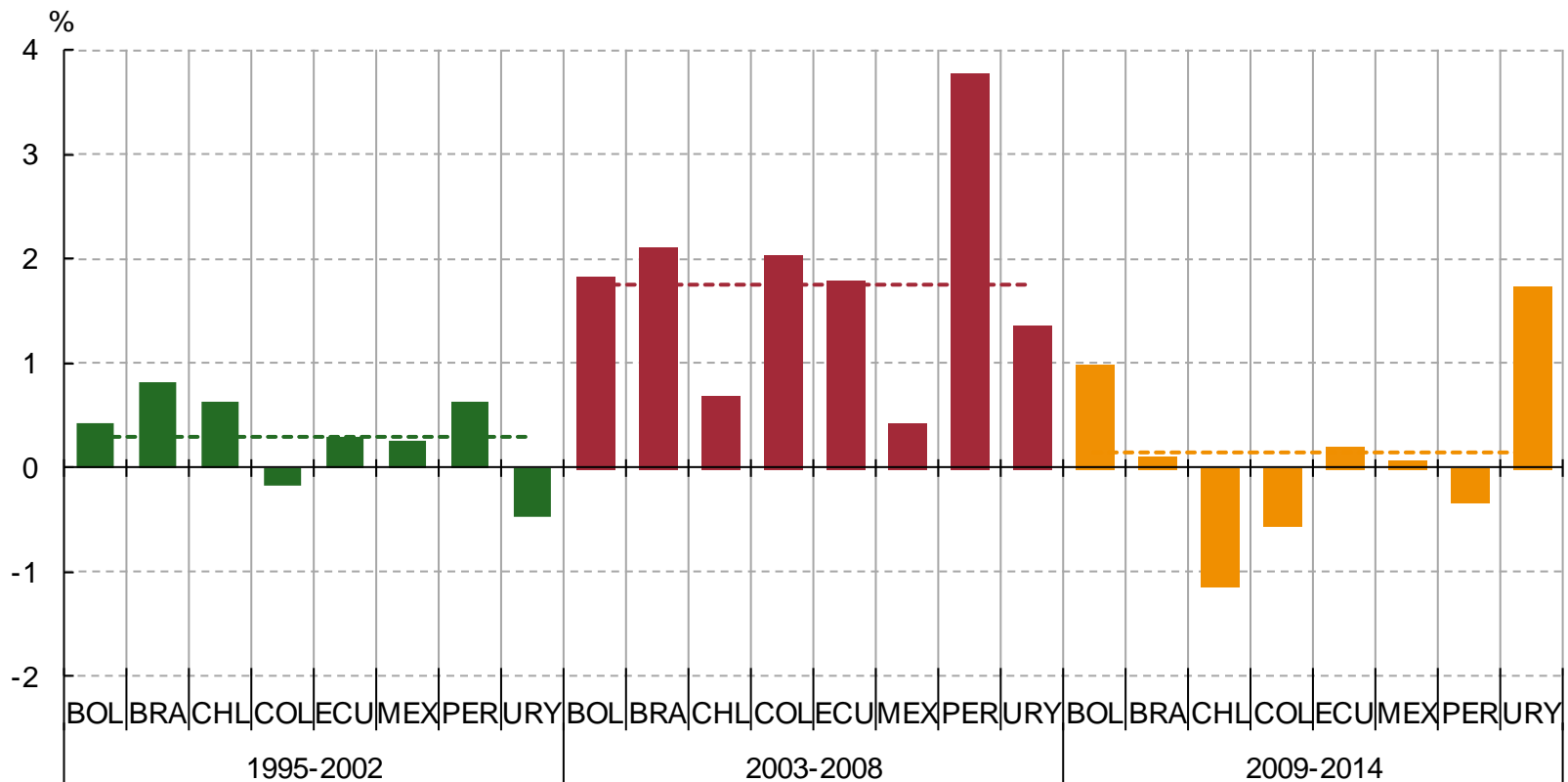
— PRIMARY BALANCE — TOTAL BALANCE — INTEREST PAYMENTS

# The long term: what explains TFP performance in Latin America?



- It is well known that productivity growth has been historically low in Latin America
- However, TFP growth rose sharply during the commodity “supercycle”: plausible (not fully convincing) explanations range from lesser financial frictions to complementarity effects

## PRODUCTIVITY

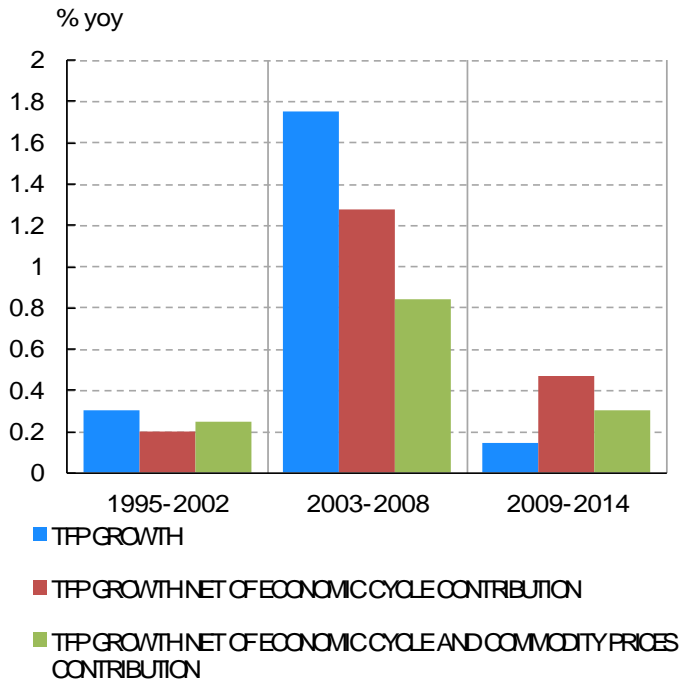


# The long term: what explains TFP performance in Latin America?



- According to model estimates including usual long-term TFP determinants along with short-term determinants (commodity prices and output gap) the later explain over 50% of the TFP increase during the commodity boom
- An improvement of structural determinants (i.e., bringing the levels of secondary education achievement and economic diversification closer to emerging peers) could contribute up to 0.7 pp in annual productivity growth

## TOTAL FACTOR PRODUCTIVITY



## LATIN AMERICA AND ASIA





- **Odds point in the direction of growth picking up in the region in 2017, with three big “ifs” (or three big risks):**
  - If Brazil manages to exit from a bad equilibrium to a good one
  - If Fed tightening is in fact as smooth as anticipated
  - If China continues the transition to lower growth while deleveraging orderly
- **Fiscal consolidation in Brazil is challenging economically as well as politically (parliamentary support not granted) and socially (pensions)**
- **Argentina provides an example of sharp policy adjustment with positive returns up to now**
- **But, in general, important policy risks surround governments having to make substantive reforms without strong social support**
- **Total factor productivity growth is back to standard (low) rates after an exceptional phase**
  - Few alternatives to usual recipees: diversifying the economy and increasing human capital takes time



**Thank you**