

Latin America: Is Solid Growth Sustainable?

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Part 1

- 2004 was a spectacular year for Latin America with the best growth since 1980. Overall inflation was low and the balance of payments in overall surplus.
- The region benefited from a combination of high commodity prices, good macro policies in Mexico, Brazil, Chile and Colombia, a bounce back in growth in Venezuela along with the benefit of a low exchange rate in Argentina.
- FDI flows picked up especially in Mexico and Brazil.
- The expectation is that while growth will slow down in 2005 and 2006 it will still be around 3½% to 4% with low inflation with the region benefiting from continued high commodity prices.

Part 2

- Good news is that for Mexico, Brazil, Chile and Colombia there will be a continuation of successful macro policies.
- So long as the United States and China expand solidly, commodity prices are likely to remain high if not quite as high as in 2004.
- Capital flows are expected to stay high but largely concentrated on Mexico and Brazil.
- Except for Venezuela, exchange rates are floating so helping to avoid the risk of a balance of payment crisis even if commodity prices were unexpectedly to fall. In fact, many currencies have been rising against the dollar (See Appendix 2).

Part 3

- Bad news is that productivity growth remains low and savings remain much less than investment. This means that the risk remains that continued rapid growth leads to a worsening in the balance of payments outlook.
- World economic outlook may turn out to be less benign than generally forecast. The U.S. dollar could fall sharply and this would put upward pressure on U.S. interest rates.
- Spreads and margins for Mexico and Brazil are very low and a change in the world growth and inflation outlook could lead to an upward adjustment in spreads and an inability to raise new money in the international capital markets.
- Commodity prices could fall if there happened to be a significant slow down in the U.S. which would negatively impact on Chinese growth.

Part 4

- There is a question mark about the rise of populism in Latin America. President Chavez has adopted a populist approach to economics in Venezuela with strong central direction to the economy including exchange controls. This is not likely to change during his term of office.
- President Kirchner is refusing to allow tariffs to adjust properly in some important sectors of the Argentine economy. Inflation is rising and the Government is not likely to act to reverse this trend. The Government's action in demanding a 70% haircut on international debt can (and should) sour future access to the international capital market.
- There are ten presidential elections across the region by the end of 2006 and the big question is whether populism will spread. Already Bolivia and Ecuador are suffering serious political instability.
- A major point is whether President Lula will maintain existing orthodox economic policies if he wins a second term – or will he begin to change?

Conclusion

Latin America is traditionally a highly volatile region for economic growth. There is definitely an opportunity to build upon the recent economic success assuming continued high commodity prices. And, if Mexico and Brazil keep to orthodox economic policies which seems likely, this will tend to isolate those countries which shift to the left while allowing the region as a whole to keep growing although largely concentrated on the countries with anti-inflation policies.

Overall, 2005 and 2006 are likely to be more testing years than the majority of economists are now expecting. Above all, the region needs careful monitoring and individual countries must be assessed on their own merits more than at any time in the last decade and a half.

Appendix 1 – Economic Indicators

Appendix 2 – Currency Indicators



Table 1

<u>Key statistics in Latin America</u>	<u>2003</u>	<u>2004^f</u>	<u>2005^f</u>	<u>2006^f</u>
GDP (YoY as %)	1,2	6,0	4,1	3,8
Inflation (YoY as %)	7,0	6,7	6,0	5,6
Current Account (as % of GDP)	0,8 ■	1,2	0,2	-0,4
External Debt (as % of Exports)	155,1	130,8	118,1	111,6
External Debt (as % of GDP)	42,9	38,9	33,7	31,5
Public Deficit (% of GDP)	-1,9	-1,1	-1,3	-1,3
Fiscal Revenues (as % of GDP)	24,8	25,4	25,3	25,2
Unemployment Rate (as % of ec.act.pop.)	9,1	8,1	7,4	7,2

Table 2

<u>GDP growth (YoY as %)</u>	<u>2003</u>	<u>2004^p</u>	<u>2005^p</u>	<u>2006^p</u>
Argentina	8,7	9	7,0	3,8
Brazil	-0,2	5,2	3,6	3,6
Chile	3,3 ■	5,8	5,7	5,2
Colombia	4	4	3,6	3,6
Mexico	1,3	4,4	3,6	3,5
Peru	4	5,1	4,3	4,2
Uruguay	0,2	12,3	5,5	4
Venezuela	-9,2	17,3	5	5

Table 3

<u>Inflation (YoY as %)</u>	<u>2003</u>	<u>2004</u>	<u>2005^p</u>	<u>2006^p</u>
Argentina	3,7	6,1	10,0	8,0
Brazil	9,3	7,6	5,9	5,2
Chile	1,1 ■	2,4	2,7	2,8
Colombia	6,5	5,5	5,4	5
Mexico	4	5,2	3,9	4,0
Peru	2,5	3,5	2,5	2,6
Uruguay	10,2	7,6	6,9	6,4
Venezuela	27,1	19,2	19	19

Table 4

<u>Latin America: External Financing</u>				
<u>(billions of U.S. dollars)</u>	<u>2002</u>	<u>2003</u>	<u>2004^e</u>	<u>2005^f</u>
Current account balance	<u>-9.3</u>	<u>10.5</u>	<u>23.9</u>	<u>4.8</u>
External financing, net:				
Private flows, net	<u>22.6</u>	<u>23.9</u>	<u>29.9</u>	<u>42.9</u>
Equity investment, net	35.0	21.7	35.1	35.4
Direct investment, net	37.3	27.6	42.0	39.3
Portfolio investment, net	-2.3	-6.0	-7.0	-4.0
Private creditors, net	<u>12.4</u>	2.3	-5.1	7.5
Commercial banks, net	-7.0	-9.7	-15.0	-4.2
Nonbanks, net	-5.3	12.0	9.9	11.7
Official flows, net	<u>6.1</u>	<u>0.5</u>	<u>-9.2</u>	<u>-11.4</u>
IFIs	11.1	5.1	-9.7	-8.7
Bilateral creditors	-4.9	-4.6	0.5	-2.7
Resident lending/other, net ¹	<u>-16.7</u>	<u>-1.6</u>	<u>-23.8</u>	<u>-15.7</u>
Reserves (-= increase)	<u>-2.8</u>	<u>33.4</u>	<u>-20.8</u>	<u>-20.5</u>

Table 5: Argentinean Peso Spot

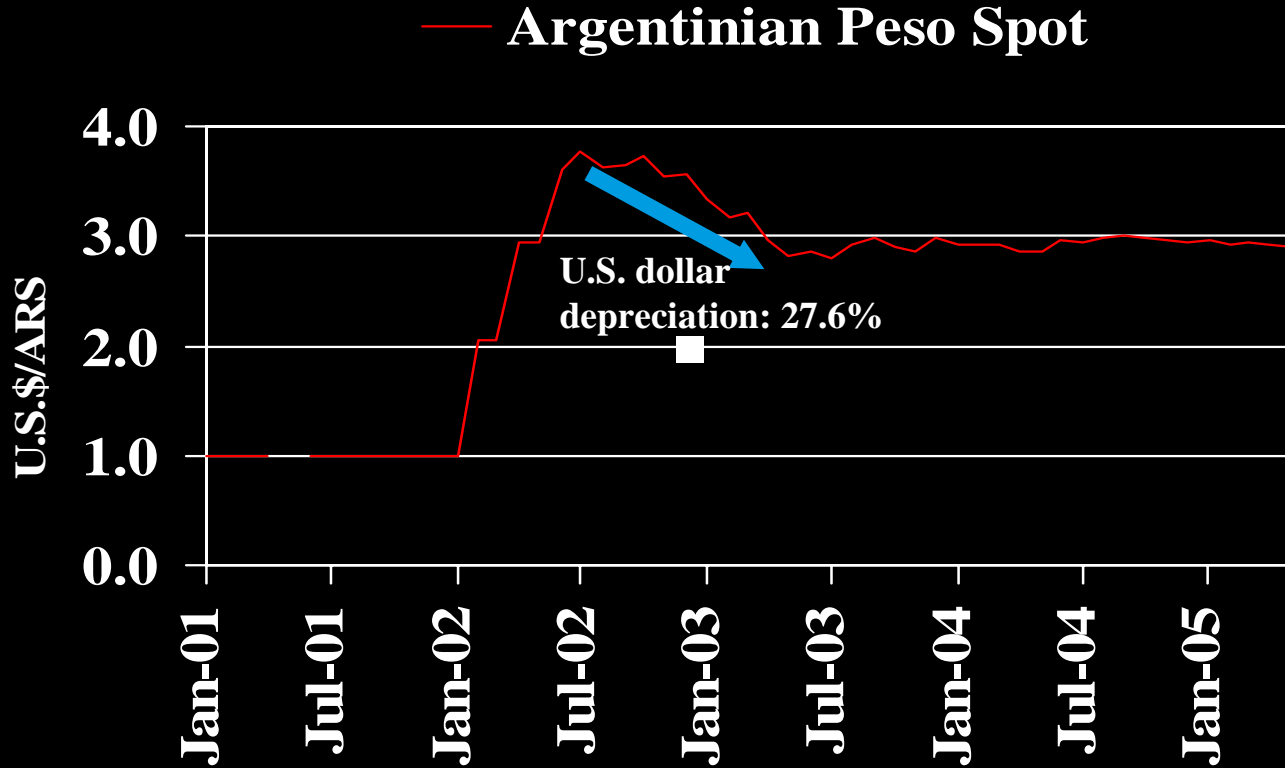


Table 6: Brazilian Real Spot

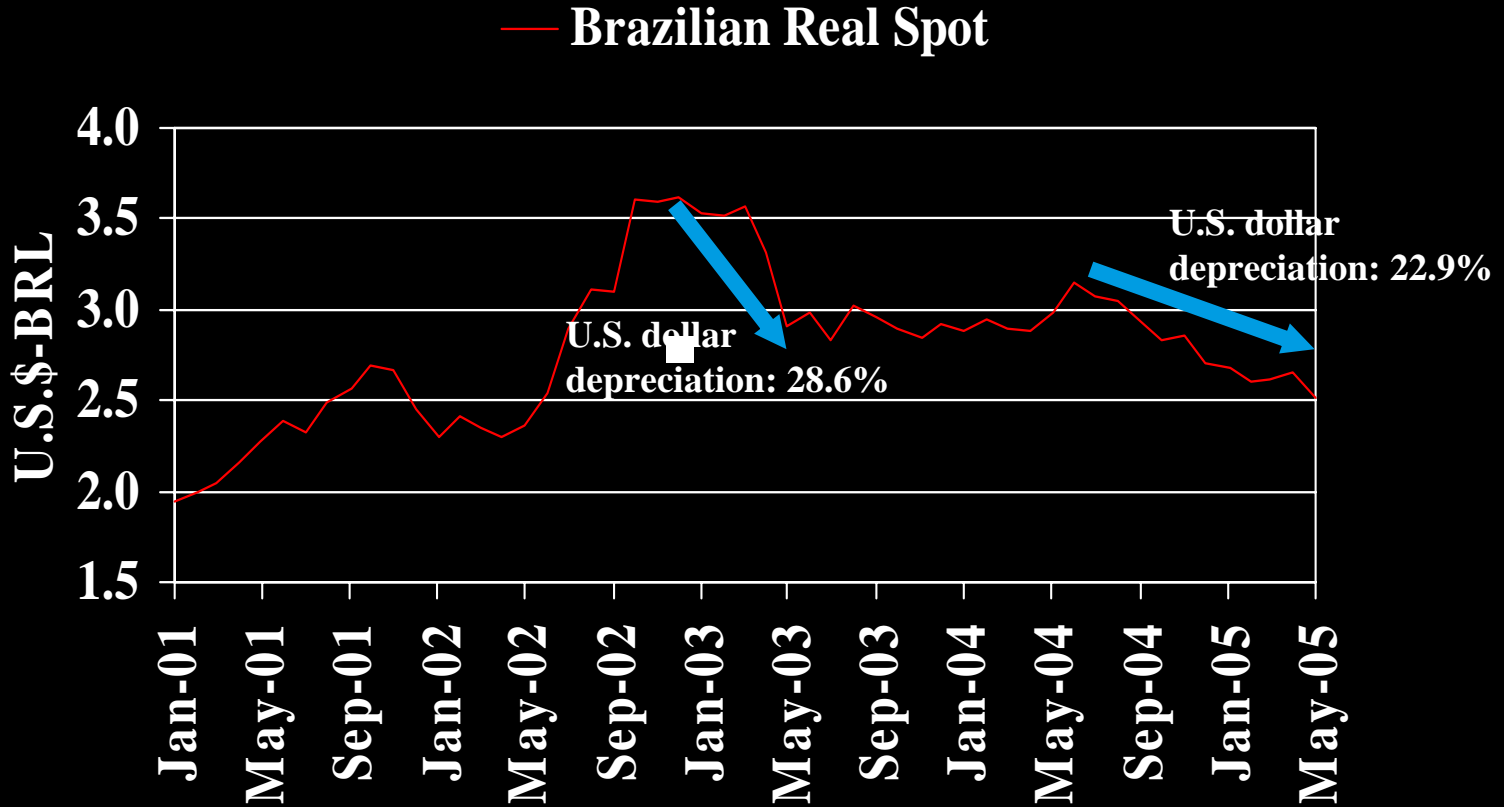


Table 7: Mexican Peso Spot

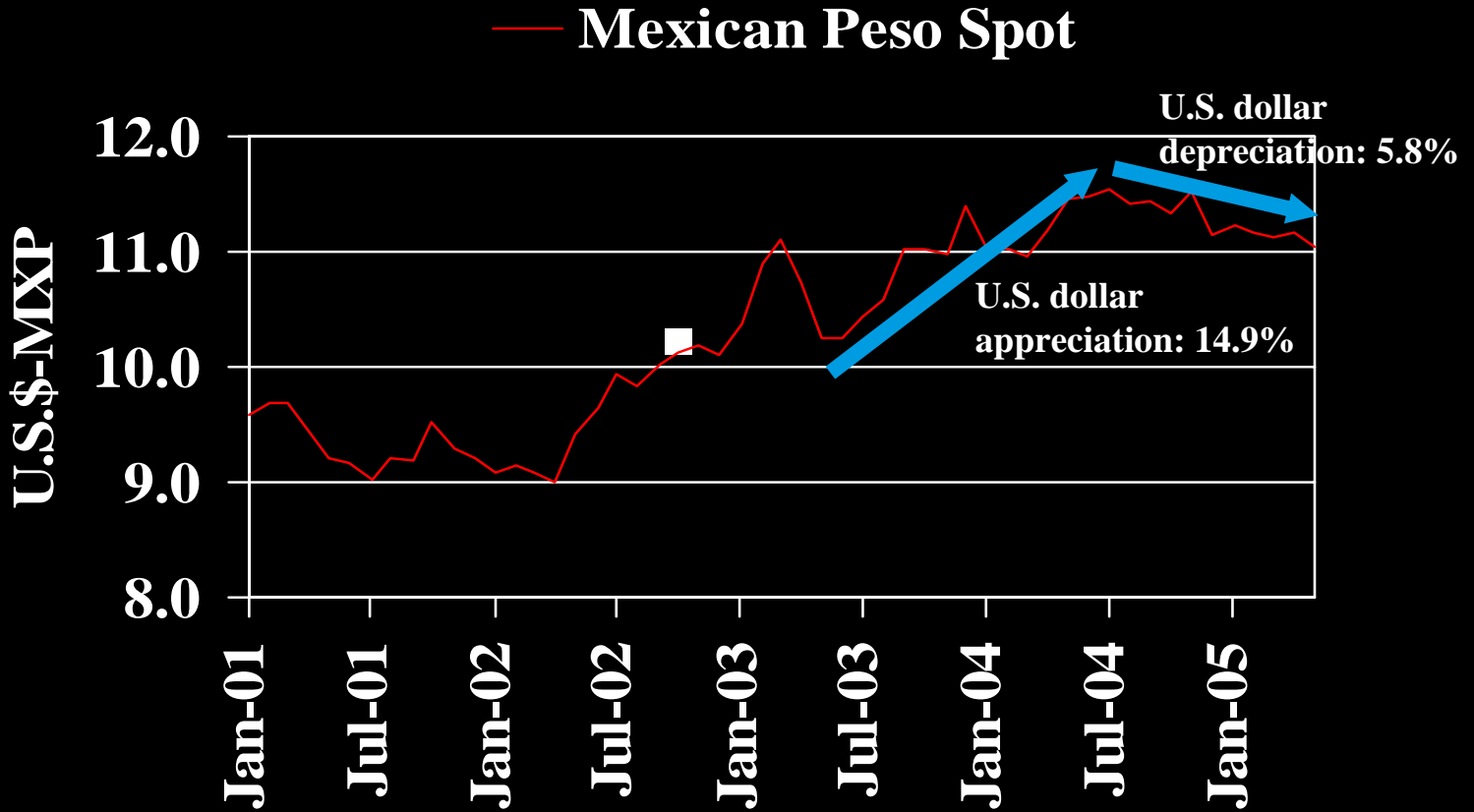


Table 8: Venezuelan Bolivar Spot

