The repercussions of the crisis on the countries of Latin America and the Caribbean

Second Meeting of Ministers of Finance of the Americas and the Caribbean

Viña del Mar (Chile), 3 July 2009

UNITED NATIONS

ECLAC

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2009-430

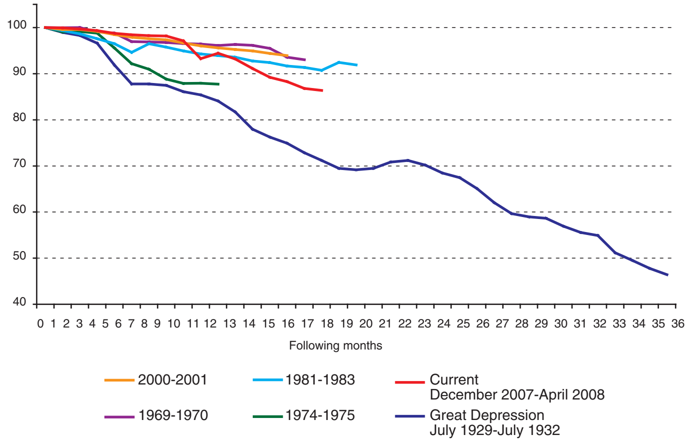
1. The world is facing the most severe international crisis in recent economic history

- In depth and scope, the crisis is comparable only to the crisis of the 1930s.

■ **Figure 1** ■

United States of America: monthly variation in industrial output, recent economic downturns

(At t=0, the month prior to the beginning of the decline, the indicator is set at 100)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the International Monetary Fund.

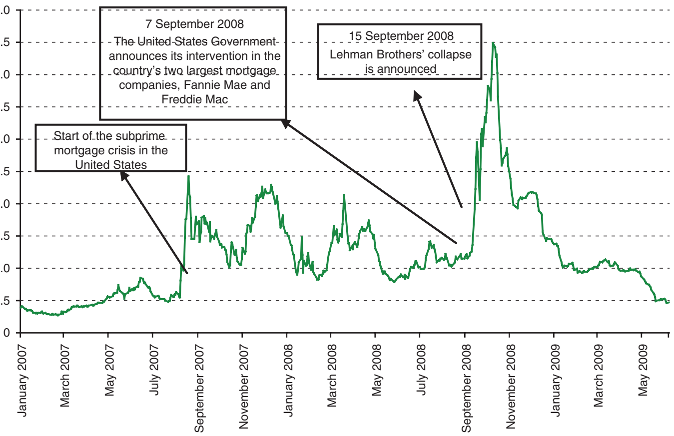
2. Despite the bleak outlook, some features of the current situation allow for cautious optimism

- Interbank market rates have fallen.

■ **Figure 2** ■

Interbank market rates, 2007-2008

(TED spread)

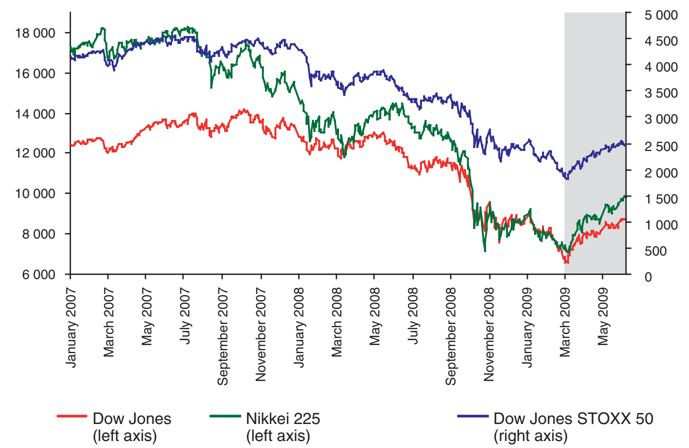


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from Bloomberg.

- Stock markets are bouncing back.

■ **Figure 3** ■

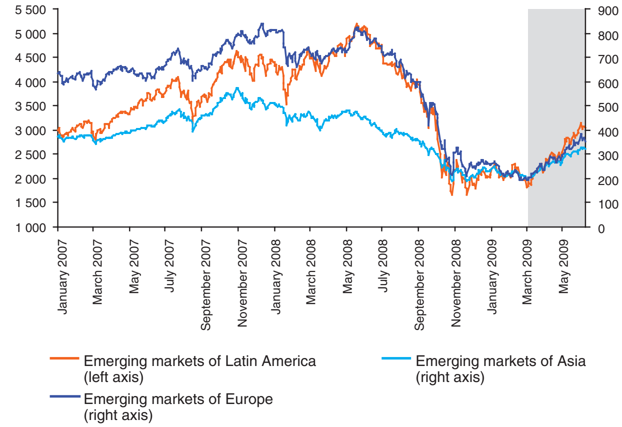
Industrialized countries: stock market indices



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from Bloomberg.

Figure 4

Emerging economies: stock market indices



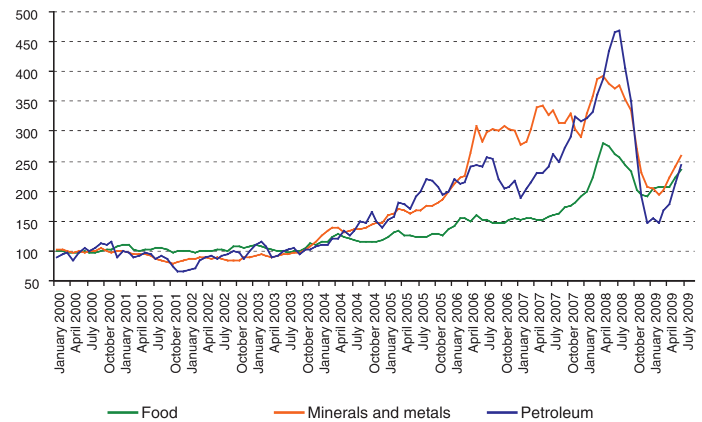
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from Bloomberg.

- Commodity prices are recovering.

Figure 5

Commodity price index, monthly averages

(Index 2000=100)



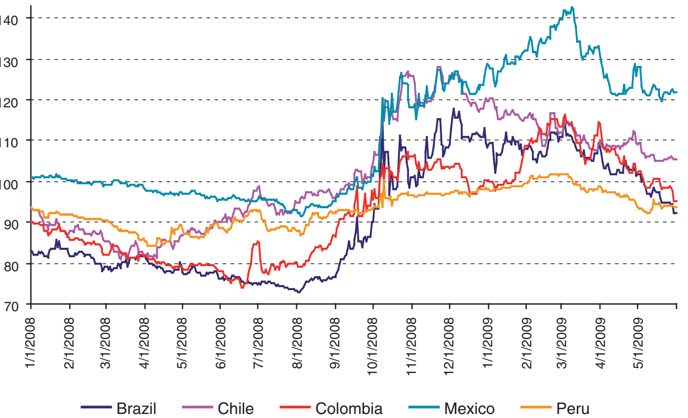
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from Bloomberg and the United Nations Conference on Trade and Development (UNCTAD).

- Pressure on the currency markets has eased.

Figure 6

Selected countries: nominal exchange rate

(January 2007=100)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

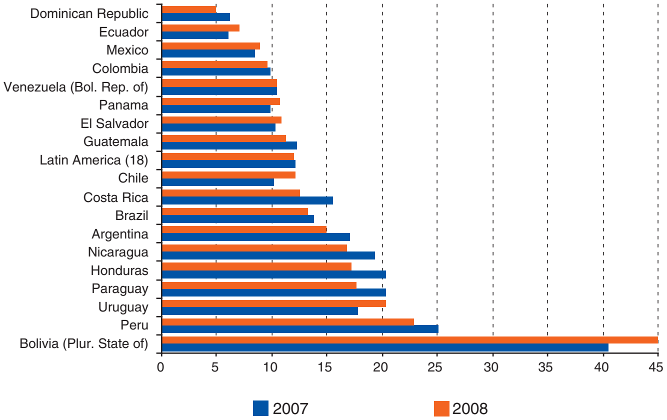
3. Recovery will be slow and gradual, however, given that the negative impact on wealth persists (because property prices have still not recovered from their slump), and it will take some time for the financial systems and credit flows to return to normal

4. For Latin America and the Caribbean the most notable aspect of this crisis is that it differs in both origin and impact from the other crises that the region has been through in the last 30 years

- The current crisis originated in the developed countries, and the countries of Latin America and the Caribbean are in a stronger position to withstand it thanks to major achievements on the macroeconomic policy front.
- Debt levels have been reduced, better loan conditions have been negotiated, and international reserves have been built up. Therefore, unlike on other occasions, in most of the region's countries, the financial sector was neither the first to be hit nor the most affected by the crisis.

Figure 7

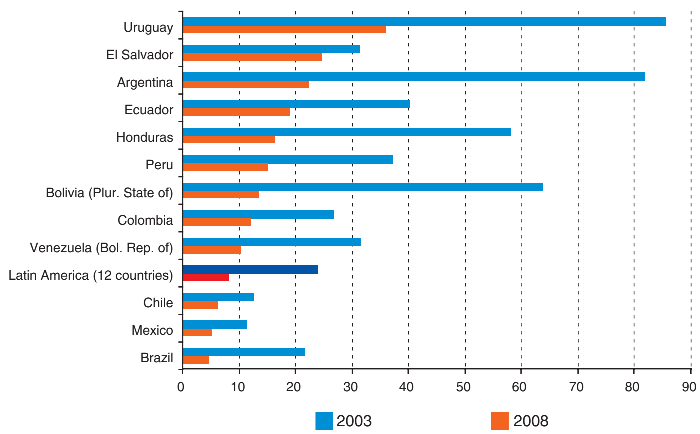
Latin America (18 countries): international reserves, 2007 and 2008
(Percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of offical figures.

Figure 8

Latin America (12 countries): public external debt, 2003 and 2008
(Percentages of GDP)



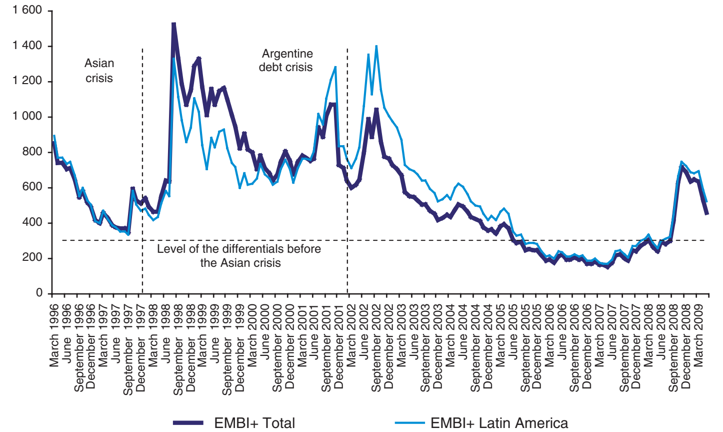
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

- Even when the crisis was at it worst (September-October 2008), the increase in country risk premiums was lower than during other crises. These have since trended sharply downwards, similarly to those of the emerging economies of Asia and much more than those of the emerging economies of Europe.

Figure 9

Emerging market bond index: EMBI+ and EMBI+ Latin America

(Basis points)



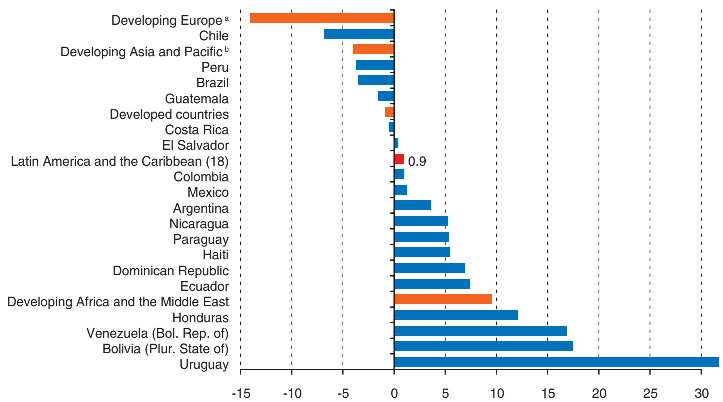
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from JP Morgan.

- The external exposure of the region's financial systems is relatively low, and maintaining domestic credit supply is not, therefore, a major challenge, especially in comparison with other emerging regions, such as Asia and Eastern Europe.

Figure 10

Net external position of the financial system, December 2008

(Percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

[a] Does not include the Russian Federation.

[b] Does not include China.

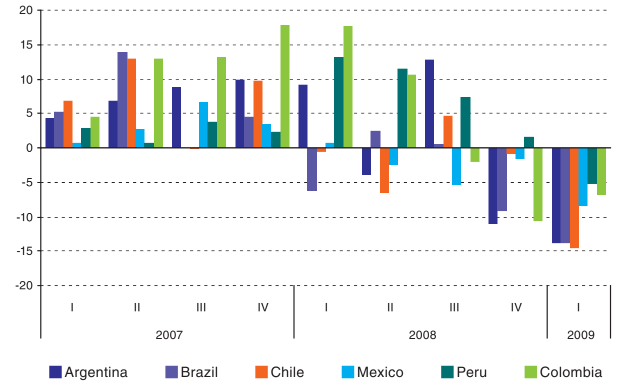
5. Presently, the region's economies are, in several ways, more open and more integrated with the rest of the world, and the impact of external events is passed on increasingly quickly through the real sector

- Exports have slowed considerably. In the first quarter of 2009, year-on-year declines of 10%-15% were seen in Argentina, Brazil, Chile and Mexico, and of 5%-10% in Colombia and Peru.
- Some countries, especially Mexico and the countries of the Caribbean and Central America, will feel the impact of falling tourism revenues, which in many cases have been further eroded by the outbreak of the A(H1N1) virus.
- The global recession and the drop in world trade are having a negative effect on commodity prices, which have plummeted from the highs reached in 2008. The recent reversal of this downward trend and the gradual recovery of prices for some items have not offset the downturn recorded between the end of 2008 and the beginning of 2009.
- In 2009, exports for the region as a whole are expected to shrink by approximately 11% and by more in the hydrocarbon and metal sectors.

Figure 11

Latin America (6 countries): real growth of exports, by quarter, 2007-2009

(Percentage variation on previous year)

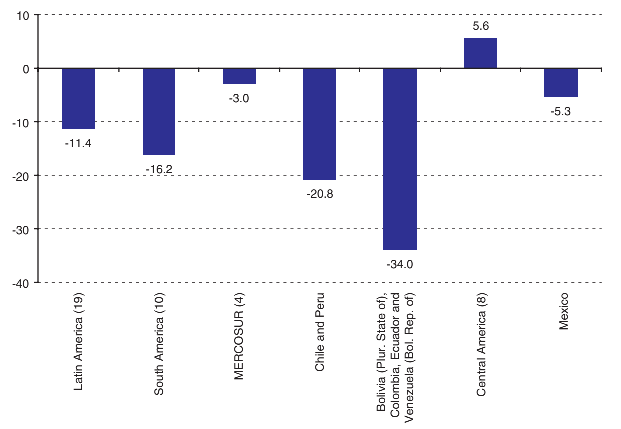


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Figure 12

Latin America (19 countries): estimated year-on-year variation in terms of trade, 2009

(Percentages)



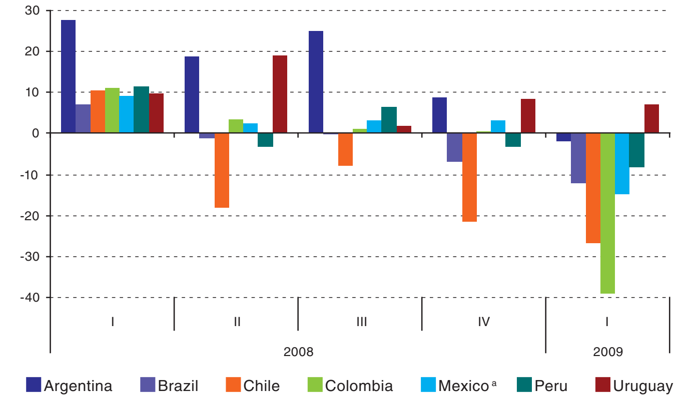
Source: Economic Commission for Latin America and the Caribbean (ECLAC).

- The drop in commodity prices is also having a negative impact on fiscal income in the countries that are largely dependent on primary-product exports, such as Argentina, the Bolivarian Republic of Venezuela, Chile, Colombia and Ecuador, and could limit their ability to mitigate the effects of the crisis. Public revenue in these five countries is projected to shrink by approximately 4 percentage points of GDP.

Figure 13

Latin America (7 countries): tax income without social security, by quarter, 2008-2009

(Percentage variation in real terms on the same period the previous year)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

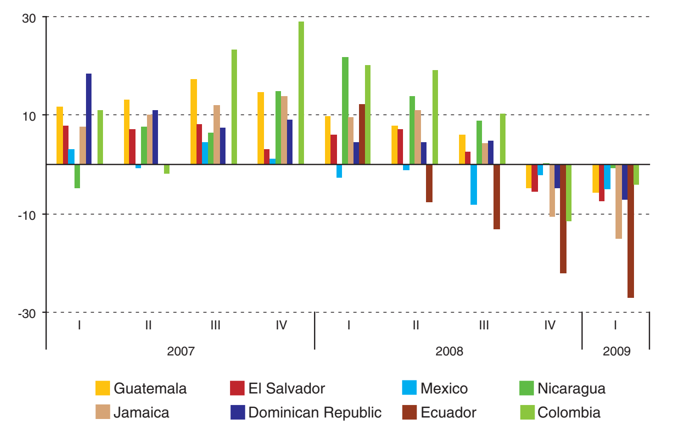
[a] Does not include income from the following taxes: single-rate business taxes, taxes on cash savings, special production and service taxes.

- Remittances have fallen 5%-10% in year-on-year terms. This will have a negative impact on consumption and the social situation will worsen because the recipients of remittances tend to belong to the low-income (but not the poorest) segments of the population.

Figure 14

Latin America and the Caribbean: growth in remittances from emigrants, by quarter, 2007-2009

(Percentage variation on the same period the previous year)



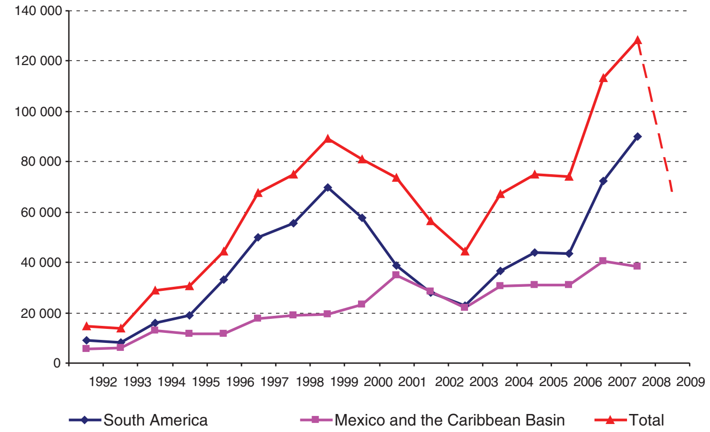
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

- The decline in foreign direct investment (FDI) will dampen demand. This effect has been particularly apparent in the countries of the Caribbean and Central America where FDI flows represent a high proportion of GDP, as well as in some South American economies, such as Chile, Colombia and Peru.

Figure 15

Latin America and the Caribbean: foreign direct investment inflows, 1992-2009

(Billions of dollars)



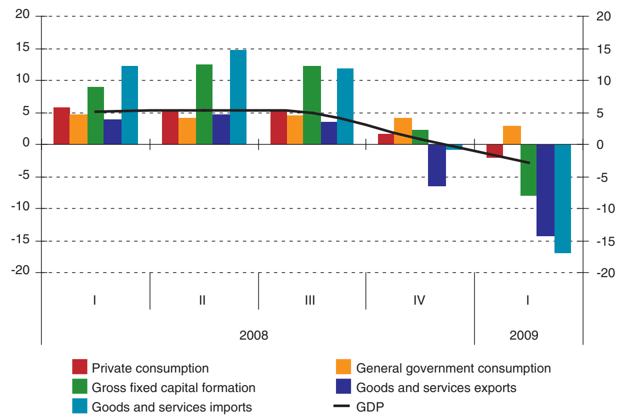
Source: Economic Commission for Latin America and the Caribbean (ECLAC).

- The significant lowering of expectations has meanwhile generated a contraction of both private consumption and investment.

Figure 16

Latin America: estimated year-on-year variation in aggregate demand, 2008-2009

(Constant 2000 dollars)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

6. After posting an accumulated growth of almost 23% in 2003-2008, regional GDP and per capita GDP growth are expected to slow down sharply in 2009

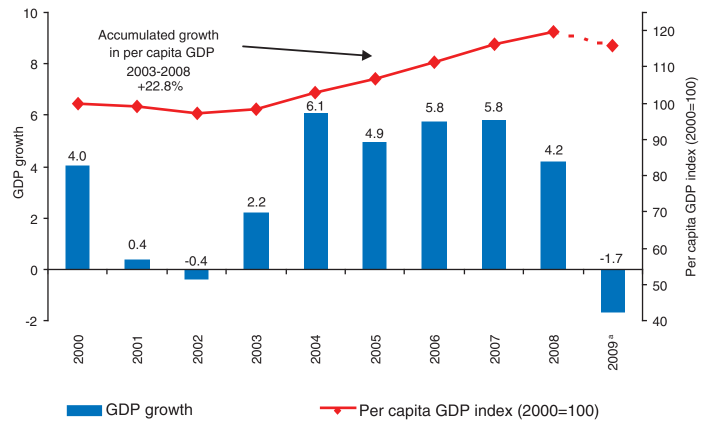
- The worsening of the international crisis in the last quarter of 2008 has had a devastating impact on the region, forcing it to revise downwards its growth estimates for that year. Hence, the point of departure for the estimates for 2009 is much lower as well.

- In addition to the impact of events on the external markets, rising uncertainty at the regional and global level is lowering expectations in the private sector which is having a negative effect on investment and consumption.

Figure 17

Latin America and the Caribbean: GDP and per capita GDP, growth and trends, 2000-2009

(Variation of GDP as a percentage, per capita GDP index 2000=100)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

[a] The figures for 2009 are preliminary estimates.

7. The crisis is having multiple negative effects on the labour market and beginning to reverse the gains made in previous years

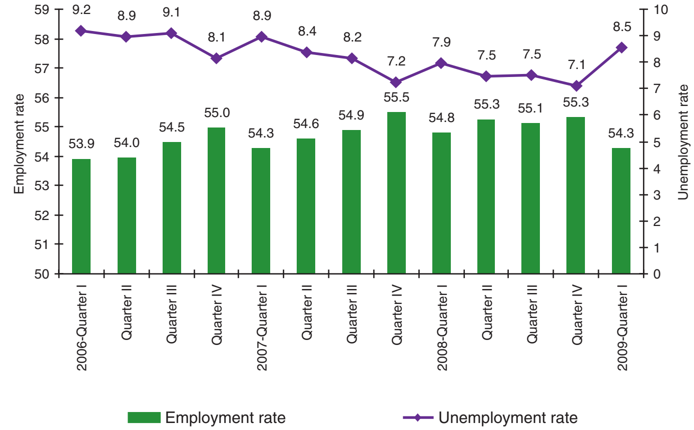
- There has been a steep decline in formal job creation since the second semester of 2008 and into 2009. This threatens to undermine one of the region's previous achievements: the increase in quality jobs.

- The employment rate is falling and the unemployment rate is rising in many countries, most notably in Chile, Colombia, Ecuador and Mexico, where the urban unemployment rate rose by more than one percentage point between the first quarter of 2008 and the first quarter of 2009.

- Between 2004 and 2008, the regional unemployment rate fell from 11% to 7.4%. In 2009, it will probably rise by over one percentage point, which will mean about 3 million more people joining the ranks of the unemployed.

Figure 18

Latin America (9 countries): employment and unemployment rate, first quarter 2006-first quarter 2009
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

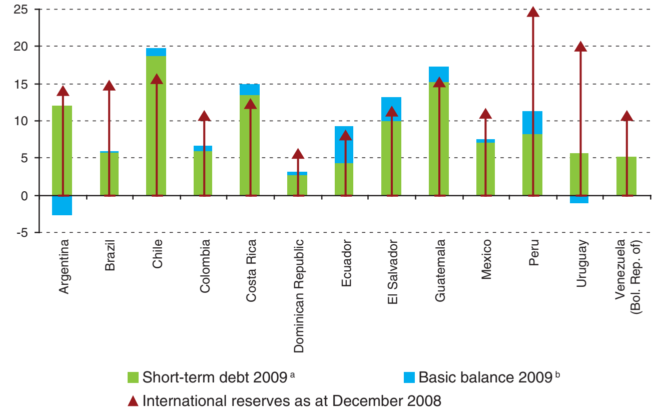
8. The region is better prepared to face this crisis, but there is little space for implementing countercyclical macroeconomic policies

- Financial problems are not likely this year, but could arise in the future if the markets take a long time to return to normal.

Figure 19

Estimates of basic balance, foreign direct investment and external debt obligations for 2009

(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the Bank for International Settlements and the International Monetary Fund.

[a] Preliminary estimate, includes short- and medium-term debt amortizations.

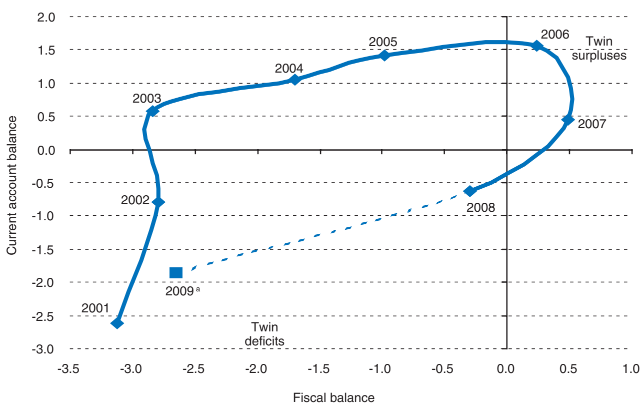
[b] Preliminary estimate. Positive values indicate a deficit on the basic balance.

- Since the onset of the crisis, macroeconomic indicators have steadily worsened. The region's countries went from mostly having twin surpluses (on their public accounts and their external accounts) to the current situation in which, on average, they are estimated to post deficits in both their public and their external accounts equivalent to slightly over 2% of GDP. The situation will vary considerably from country to country, with some, especially those of Central America, recording extremely large domestic and external deficits.

Figure 20

Latin America and the Caribbean (19 countries): variations in current account and fiscal balance, 2000-2009

(Percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

[a] Data for 2009 are preliminary estimates.

9. This reveals the marked difference in the capacity of the region's countries to tackle the crisis and, given the situation of the international financial markets today, underscores the importance of expediting and increasing the lines of credit that the international financial institutions can offer to help countries finance measures to counteract the effects of the crisis

10. Despite these limitations, the countries of the region have reacted swiftly and implemented a broad range of countercyclical policies

Monetary policy

- Almost all the countries have taken action in this area to ensure sufficient liquidity to keep the financial system working. The scope of these policies is limited, however, because:
    - The region's economies are not highly monetized, which curbs the impact of monetary policy.
    - Under the present situation, increasing money supply does not guarantee an increase in credit, which in turn does not guarantee an expansion of demand.

Fiscal policy

- Fiscal policy action is more appropriate in these cases, but more difficult to implement. It also depends on a country's institutional capacity and its macroeconomic policy space.
- Lowering taxes is easier but less effective because the increase in private income does not necessarily translate into an increase in private spending. A large portion usually ends up in savings.
- Increasing spending is more effective, but not every country has projects ready and waiting for rapid implementation.
- Targeted subsidies are highly effective, but the possible beneficiaries of social programmes have not been identified in every country.
- There is a trade-off between the effectiveness and the institutional and administrative complexity of increasing public spending.

Exchange and trade policies

- Only four countries have raised import duties, which is an auspicious sign.
- Greater emphasis has been placed on foreign trade financing.
- A growing number of countries are applying for loans from international agencies, especially to guarantee export financing and to increase the space they have for implementing countercyclical policies.

Sectoral policies

- Housing and building programmes have been carried out given their positive effect on employment and domestic demand, as well as their social impact.
- SME support programmes have been implemented owing to the role SMEs play in job creation.
- Sector-specific support programmes have also been set up, especially for agriculture.
- More attention has been paid to developing social programmes, some of which have targeted specific segments, than to active employment policies.

11. The international financial institutions must provide the resources needed to finance countercyclical policies

- The region has room to increase its borrowings from the international financial institutions.
- The measures announced by the Group of Twenty (G20) to increase the financing capacity of international agencies, and the International Monetary Fund in particular, need to be implemented soon.
- Greater liquidity would broaden the policy space for breaking the vicious circle of recession, expanding poverty, rising social tension and worsening macroeconomic indicators.
- It would also prevent the situation from worsening even more and from generating economic, social and political consequences that could be difficult to reverse. Poverty indicators take almost twice as long to recover as GDP indicators.

12. Beyond the crisis: dilemmas and challenges

- Avoiding old and new forms of protectionism
- A new international financial architecture?
- What combination of public policies is needed for the new, regulated markets?
- Bilateralism versus multilateralism as options for integrating with the global economy
- Uncertain environmental impact
- Reducing unemployment and poverty
- Strengthening democracy and civil society participation
- New risks: security and the illegal economy

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