The Good, the Bad and the Ugly
An economic overview of Latin America

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Milan, 14th June 2018
1. The Political Super-cycle

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THE POLITICAL SUPER-CYCLE

Changing tides: toward a new regional order?
14 Presidential Elections in 3 years, 2018 is the start of a new political super-cycle
- Corruption scandals undermine public trust in democratic institutions. **Trust in democracy:** 2015: 66.4% - 2017: 57.8%
- The outcome of this political super-cycle defines the regional political direction in the international arena

In 2017 80% of Latin Americans claimed that the government was corrupt

Just the 25% of Latin Americans trust national government in 2017 vs. 45% in 2010

In 2015 52% of Latin Americans were willing to evade taxes
- There is an increasing social demand for more transparent and accountable government
- The anti-establishment and anti-corruption tide is gaining consensus in all countries
- Reading this electoral cycle as a left-right swing would be a simplification (and a mistake)
• Much more than opposition-government dynamics: the emergence of new actors characterize the new cycle
• Increasing national sources of uncertainty (criminality, security, drug-traffic, social unrest)

• The international scenario (International agreements, migration, China economic-cycle) adds uncertainty to the sustainability of regional growth
• Regional Integration Process

• 2017 elected new government with strong position on fiscal equilibrium, growth, migration and security
• Emergence of new social and political movements that gained significant social consensus

• National peace and national security main concerns of political debate
• First round defeated political incumbent party, second round polarization between right and left

• After the populist wave, 2015 elected market oriented government. Elections in 2019
• Fragile economic scenario and increasing informality. High political risk linked to IMF financing

• Unstable political scenario: the president resigned after corruption scandals
• Fragile economic scenario: infrastructure gap and labour informality hamper growth

• 5 consecutive years of low growth, concerns with security and the stability of democracy fuel the debate
• No clear political scenario for end-of-year election. Main parties candidates still not defined

• Sluggish economic growth, poverty and national security are the core of political debate
• Favourite candidate from the opposition with previous government experience and special social sensibility
• NAFTA renegotiations add uncertainty to the political context
During the last year Latin American economies have shown a small uptick in growth. Recent growth dynamics are however weaker than the pre-crisis momentum (2.4% versus 5.6% average). The rate of growth is far from the average of other emerging economies (average 4.8%). The observed growth is not sufficient to give dynamism to labor markets and tackle social challenges.

GDP growth of Latin American main economies
(Simple average of the inter annual variation)

- 6.1%
- 5.6%
- 6.5%
- 2.4%
- 3.9%
- 2.8%


(*)
GDP growth driven by the increasing dynamism of the internal demand, and in particular by private consumption.

External demand regains momentum, mainly because of lower prices in primary goods.

Investments – after more than two years of negative performance, particularly in Brazil and Mexico – show a significant uptick.

The external context and the regional political-cycle add uncertainty to the sustainability of growth.
A more dynamic external demand favored exports dynamics, exports are growing after 4 years of negative performance.

Higher commodities prices and the rebound in economic growth have increased the dynamism of imports.

Projections for 2018: exports +11% (8% price effect), imports 8% (4% price effect)
Current account deficit had been negative since 2009.

The observed reduction started in 2015 is mainly due to improvements in trade balance.

The reduction of the deficit is mainly explained by one percentage point reduction in Brazil (thanks to the high growth in its exports).
The increase in commodities prices will mostly benefit oil and metal exporters.

**Main export by country**

- Argentina: soya beans
- Brazil: iron and soya beans
- Chile: copper
- Colombia: Oil
- Mexico: Automotive
- Ecuador: Oil
- Peru: Copper and gold
Falling investment rate since 2013

In 2017 accounting only for the 20.8% of GDP versus the 23.6% of 2013

This is the result of the low (and insufficient) growth rate of the last five years

Investment rate as % of GD, 2012-2017
Latin American main economies

Fuente: en base a FMI (WEO).
In line with the low growth scenario of the last few years the fiscal deficit has been negative. The negative tendency has shown an uptick since 2016 mainly due to public expenditure reduction policies. However the result is still at -4.1%. Despite the efforts in public expenditure reduction, governments face serious constraints in reducing expenditure in a period of slow economic growth and in economies with serious structural gaps.
External Debt Composition
Latin American main economies (2012-2016)

- **Short run perspective**: better economic conditions and the reduction of the fiscal deficit resulted in a slowdown of the public debt growth rate.
- **Long run perspective**: the dynamics of external debt have been in line with the deterioration of the current account balance and the fiscal deficit.
- Bond emission by private actors has increased with respect to government.
- This reflects a significant change in the evolution of public debt, which has risen around 10 points of GDP between 2011 and 2017.
Monetary policy has been expansionary in most countries due to lower inflation and exchange rate stability even if the internal demand is still weak (important exceptions are Mexico and Argentina).

Financial tensions that took place in the first months of 2018, and other factors of an internal nature, had a significant impact in Argentina, Brazil and Uruguay were risk premium and nominal exchange rate increased more than expected.

All the other countries face more stable situation with slow convergence to inflation targets.
The current rate of growth barely makes it possible to absorb the increase in the active population. The employment rate does not fall, but it is far from what is necessary to reduce the existing gaps with the developed countries and to reduce inequalities.
Income distribution has significantly improved after the commodities boom, all the countries reduced extreme poverty and inequalities.

However, income distribution indicators have plateaued since 2012 and Latin America remains the most unequal region in the world.
In 2015, 34.5% of the population could be considered middle class. This new middle class has higher aspirations and social demands. The emergence of middle classes poses challenges in terms of public expenditure sustainability.

There is still a large vulnerable class, around 40% of the population in 2015 living with the uncertainty of falling back into poverty. Structural reforms are necessary to guarantee sounded market integration to this emerging class.
REGIONAL STRUCTURAL PROBLEMS
Do you remember the commodities boom?
The productivity gap between Latin America and US has been constantly increasing for more than two decades, even during the periods of relative high prices and economic growth.

From a global perspective, the region has lost the opportunity to leapfrog in production chains, increasing its productivity gap with Asian developing giants.
In LA, the industrial structure was – and still is - biased towards natural resources and traditional industrial sectors. The evident lack of structural change is at the root of the immobility and slowdown of productivity.

Most of the world regions succeeded in promoting structural changes. In Latin America, excluding the exception of Mexico, the productive structure has remained immanent and poorly diversified.
- With the exception of Mexico, Latin American countries have remained at the lowest level of global value chains
- The international competition on prices has fostered premature deindustrialization
- Countries have increased their specialization in commodities, resource-based manufactures and low productivity services
Despite the significant difference in fiscal and social policies, the decline of manufacturing and industrial production has been insensible to the political cycle.

All the countries have missed the opportunity to impulse structural reforms during the commodities boom.
Breaking the vicious circle: Social Expenditure, Productivity and Inequalities (2000-2015)
The “bonanza” quinquennium: 2003-08
- The expansion of the external sector
- The increased weight of manufacturing sectors

A “cold shower”: the “bonanza” is over and a global crisis knocks at the door
- The flip side of rising commodity prices
- Chronically underdeveloped technological capabilities
- Trade imbalances
- Industrial production within the Global Value Chain
- Structural change and productivity

The post-crisis: ten years of low growth
- Low productivity, low growth and reduced fiscal space
- The lack of anticyclical policies depressed internal demand
- Inequality and poverty reduction plateaued
Strength and Weaknesses of the last economic cycle

- Commodities boom and the missed opportunities
  - A common failure in pushing structural reforms and boost productivity growth
  - Poverty and inequality reduction: the missing link between social and market integration

Uptick in growth and improved economic conditions are not enough to ensure stability in the labor market and sound economic growth

- The region needs higher economic growth to generate quality job, prop up investments and improve income distribution
- A higher rate of growth faces the limit imposed by the current account balance, whose determinants are structural (low complexity and reduced productive diversification, high external debt and strong exposure to financial and commodity cycles)
- Productive diversification remains the *conditio sine qua non* for regional development
GLOBAL SCENARIO
Challenges And Opportunities
CHINA

1. The normalization of economic growth could depress external demand

GEOPOLITICS

2. Renegotiation of international mega-agreements and global value chains restructuring could impact on economic stability

External sources of uncertainty...

MONETARY POLICY

3. The slow-down of expansionary monetary policies in USA and EU could affect interest rate and inflation targeting

PROTECTIONISM

4. The escalation of protectionist measures and the future evolution in the international scenario are likely to impact on regional economies
A Changing World: Does LAC understand It?

Estimated worldwide annual supply of industrial robots - 2016 ('000 of units)

- China
- Japan
- Germany
- Italy
- France
- Thailand
- Singapore
- Czech Republic
- Asia/Australia
- Europe
- America

WIDENING OUR WORLD
• Automation of the production, digitalization and the incorporation of intangible assets are redefining the determinants of competitiveness
• Countries are responding to this new revolution rediscovering industrial and technological policies
• Latin America is lagging behind in terms of incorporation of new technologies but also in implementing structural policies
Digitalization and automation of the production threaten a significant number of jobs all over the region and adds further pressure to social protection systems.

Reskilling the labor force should be a priority for all the countries in the region.
The backwardness of the manufacturing sector and the low knowledge intensity of the Latin American productive structure require coordinated and long-minded efforts in policy design to have a place in the future productive scenario.
Based on the following sources: