



The Current Economic Crisis and its Impact on Latin America

George Washington University

March 26, 2009

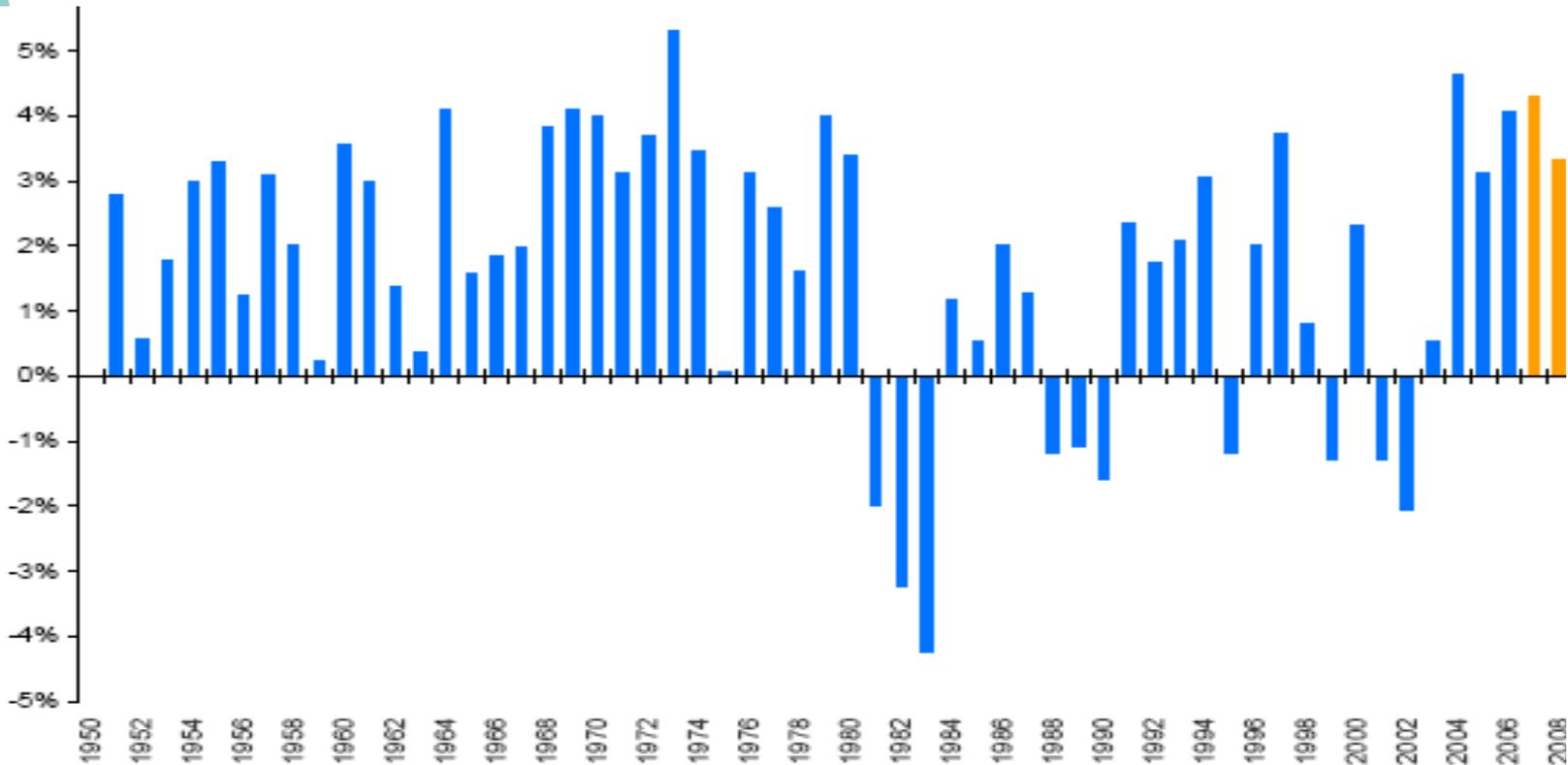
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- 1. What was the economic performance of the region before the financial crisis?**
 - 2. What were the expectations and what happened?**
 - 3. Where does Latin America stand today and where is it headed?**
 - 4. How will the crisis affect living standards?**

1. Economic Growth in LA Before the Crisis was Robust: 5.3 % a yr. 2002-07 (Source: CEPAL)



Economic Growth in LA Before the Crisis was Robust

	2000	2001	2002	2003	2004	2005	2006	2007	2008 ^a
América Latina y el Caribe	4,0	0,4	-0,4	2,2	6,1	4,9	5,8	5,7	4,6
Argentina	-0,8	-4,4	-10,9	8,8	9,0	9,2	8,5	8,7	6,8
Bolivia	2,5	1,7	2,5	2,7	4,2	4,4	4,8	4,6	5,8
Brasil	4,3	1,3	2,7	1,1	5,7	3,2	4,0	5,7	5,9
Chile	4,5	3,4	2,2	3,9	6,0	5,6	4,3	5,1	3,8
Colombia	2,9	2,2	2,5	4,6	4,7	5,7	6,8	7,7	3,0
Costa Rica	1,8	1,1	2,9	6,4	4,3	5,9	8,8	7,3	3,3
Ecuador	2,8	5,3	4,2	3,6	8,0	6,0	3,9	2,5	6,5
El Salvador	2,2	1,7	2,3	2,3	1,9	3,1	4,2	4,7	3,0
Guatemala	3,6	2,3	3,9	2,5	3,2	3,3	5,3	5,7	3,3
Honduras	5,7	2,7	3,8	4,5	6,2	6,1	6,3	6,3	3,8
Jamaica	0,7	1,5	1,1	2,3	1,0	1,4	2,5	1,2	0,0
México	6,6	-0,0	0,8	1,4	4,0	3,2	4,8	3,2	1,8
Nicaragua	4,1	3,0	0,8	2,5	5,3	4,3	3,9	3,8	3,0
Panamá	2,7	0,6	2,2	4,2	7,5	7,2	8,5	11,5	9,2
Paraguay	-3,3	2,1	-0,0	3,8	4,1	2,9	4,3	6,8	5,0
Perú	3,0	0,2	5,0	4,0	5,1	6,7	7,6	8,9	9,4
Uruguay	-1,4	-3,4	-11,0	2,2	11,8	6,6	7,0	7,4	11,5
Venezuela (Rep. Bol. de)	3,7	3,4	-8,9	-7,8	18,3	10,3	10,3	8,4	4,8



2. What were the expectations and what happened?

○ Two Phases of Financial Crisis (Izquierdo and Talvi, 2008)

- First Phase: mid-2007 until mid-2008
- Second Phase: mid-2008 until



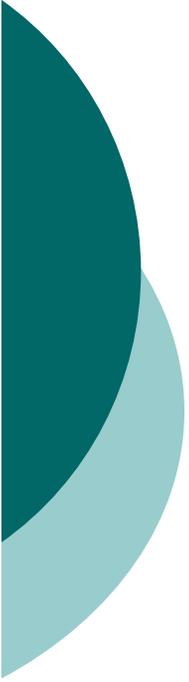
Phase 1: mid-2007 through mid-2008

Expectations:

- Mild recession in advanced countries
- Decoupling (China would continue to grow at high rates; developing countries would continue to expand)
- US monetary policy would lead to a weakening of the dollar

● As a result:

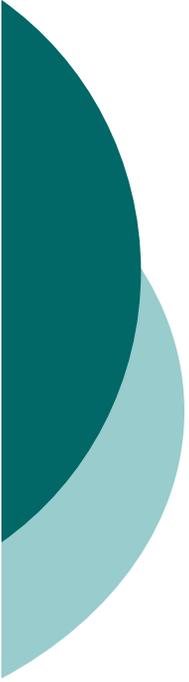
- Capital moved into emerging markets stocks and bonds, foreign currencies, commodities
 - => commodities prices, foreign currencies, foreign stock markets rose simultaneously
 - => dollar depreciated



Phase 1 (cont.)

○Biggest fears:

- **Inflationary pressures => governments implement restrictive monetary and/or fiscal policies or refused to ease (European Central Bank)**
- **Adverse external shocks for oil and food importing economies: Central America and the Caribbean**



Phase 1 (cont.)

- Conventional wisdom in early 2008:
 - Latin America is in a much better position to withstand the external shock: prudent fiscal policy, sound banking system, low indebtedness and large amounts of international reserves.
- Problem:
 - Growth was highly linked to the boom in commodity prices and part of this boom was the result of the policies pursued to tackle with the financial crisis. In particular, with lower interest rates in the US.



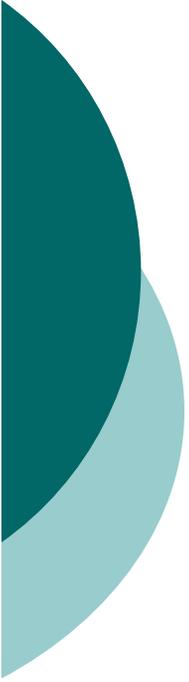
Phase 2: From mid-2008 Onwards

○ Realization that:

- Financial system in advanced countries facing solvency issues
- Advanced countries in deeper recession than anticipated
- Emerging economies would face growth slow down. No decoupling
- Post-Lehman collapse led to global credit market freeze

○ As a result:

- Massive redemptions
- Flight to quality
- Demand for dollar/US Treasuries sky-rocket
 - => commodity price, foreign currencies, foreign stock markets simultaneously fell
 - => dollar appreciated



Phase 2: From mid-2008 onwards:

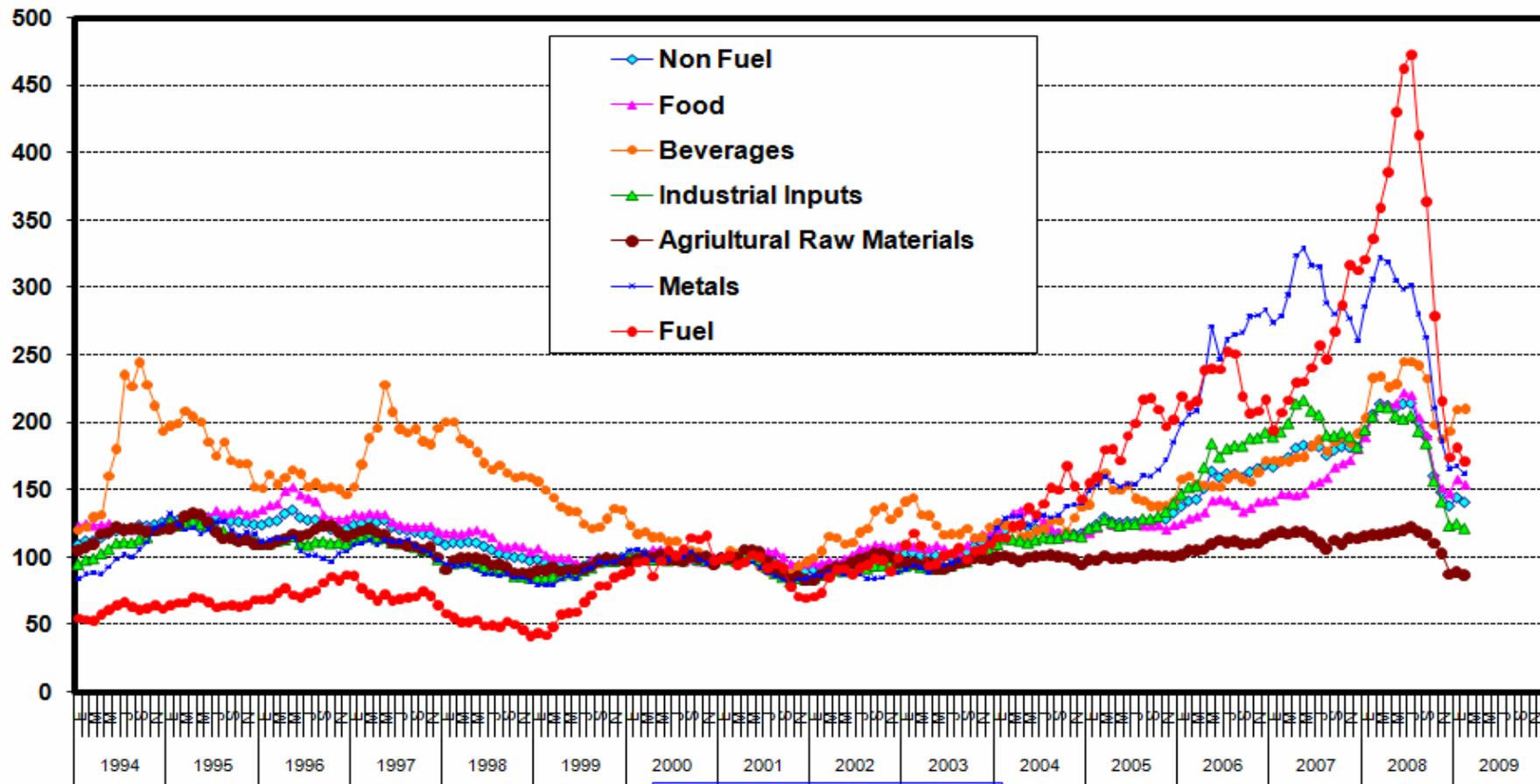
Biggest fears:

- **Deep and protracted global recession**
- **Deflation**
- **For LAC: Adverse external shocks for commodity exporters but also for economies relying on exports to US, remittances, tourism and external capital flows**

(Sources: IMF; Izquierdo and Talvi, Nov. 2008)

Boom and Bust of Commodity Prices

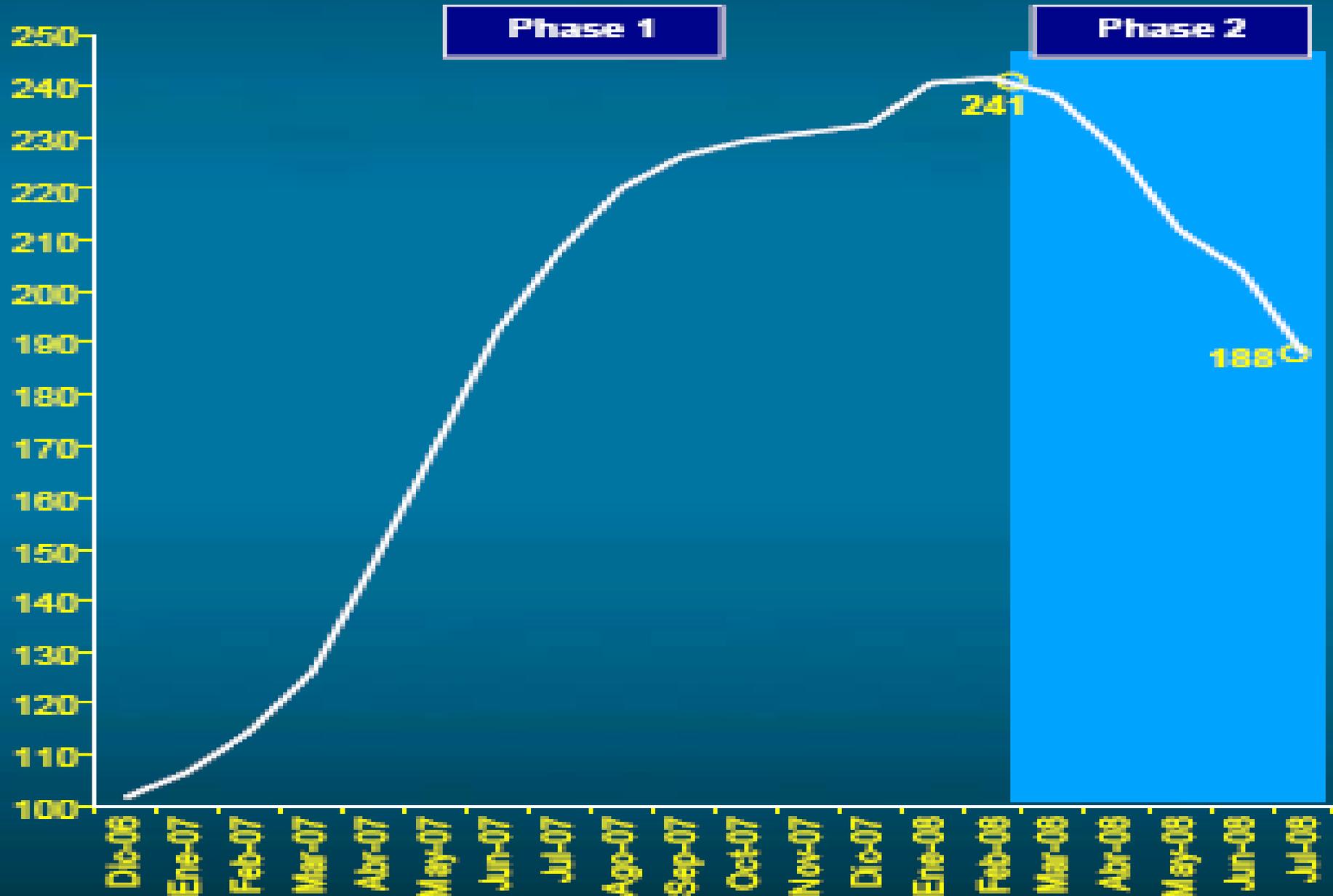
Commodity Price Indexes 1994-2009
(January 2001=100)

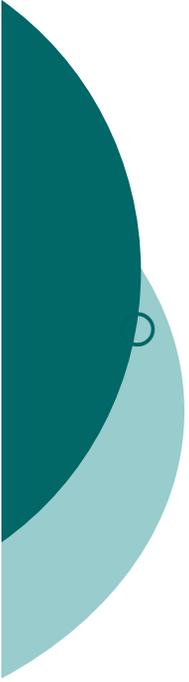


Source: IMFF

Capital Inflows*

(LAC-7; last 12 months, billions of US dollars of 2007)





Latin America and the Caribbean: Transmission Channels

○ Financial:

- Exchange rate volatility, private sector debt and risky financial investments (Brazil, México)
- Lower access to international credit markets
- Capital outflows

○ Real economy:

- Lower exports, remittances and tourism
- Lower commodity prices: bad news for Mexico and South America; good news for CA and Caribbean, but insufficient to compensate for other negative factors



3. Where does Latin America stand today and where is it headed?

- **Growth for 2009 has been adjusted downward continuously: the most pessimistic scenario in November 2008 is now unattainable**
- **Several countries will be in outright recession**
- **Poverty and unemployment will rise in many of the countries; unclear what will happen to inequality**

Latin America and the Caribbean GDP Growth Forecasts

Country forecasts as of March 05, 2009

(annual percent change)

	2009 GDP Growth Forecasts										
	ECLAC		The World Bank		IMF		J.P. Morgan			Barclays Capital	
	Dec 2008 1/	Update	Nov 2008 2/	Update	Oct 2008 3/	Jan 2009 4/	Apr-08	Dec-08	Mar-09	Jan-09	Feb-09
Antigua and Barbuda	0.5	..	1.2	..	4.0	..	..	..	..	..	..
Argentina	2.6	..	1.5	..	3.6	0.0	5.0	-1.0	-1.5	0.6	-0.3
Belize	3.0	..	2.1	..	2.5	2.0	..	..	..	..	..
Bolivia	3.0	..	3.6	..	5.0	4.0	..	..	..	..	..
Brazil	2.1	..	2.8	..	3.5	1.8	4.0	2.0	0.8	1.4	-0.5
Chile	2.0	..	3.4	..	3.8	2.2	5.0	2.5	-1.5	1	0.0
Colombia	2.0	..	2.6	..	3.5	2.0	5.0	2.5	0.5	1	-1.0
Costa Rica	1.0	..	3.9	..	3.5	1.0	..	..	..	..	..
Cuba	4.0	..	..	..	..	..	..	..	..	..	..
Dominican Republic	1.5	..	2.6	..	2.8	1.8	..	..	..	..	..
Ecuador	2.0	..	0.8	..	3.0	1.0	2.5	2.0	0.0	-0.7	..
El Salvador	1.0	..	2.6	..	2.6	2.5	..	..	..	..	..
Guatemala	2.0	..	3.1	..	4.0	3.0	..	..	..	..	..
Guyana	2.5	..	4.0	..	4.5	4.5	..	..	..	..	..
Haiti	1.5	..	3.8	..	4.0	2.5	..	..	..	..	..
Honduras	2.0	..	4.0	..	4.0	2.0	..	..	..	..	..
Jamaica	0.5	..	0.8	..	0.9	-1.0	..	..	..	..	..
Mexico	0.5	..	1.1	..	1.8	-0.3	4.5	-0.6	-4.0	-0.8	-3.9
Nicaragua	2.0	..	1.5	..	3.5	1.5	..	..	..	..	..
Panama	4.5	..	3.3	..	7.8	7.8	..	..	..	..	..
Paraguay	2.0	..	3.0	..	4.2	2.0	..	..	..	..	..
Peru	5.0	..	5.2	..	7.0	6.0	6.0	5.3	3.5	3.4	3.4
Trinidad and Tobago	2.0	..	6.6	..	4.5	4.5	..	..	..	..	..
Uruguay	4.0	..	2.8	..	5.5	2.5	..	..	..	..	..
Venezuela, RB	3.0	..	1.0	..	2.0	-2.0	3.5	1.5	0.0	-2.6	-2.6
Latin America and the Caribbean	1.9	..	2.1	..	3.2	1.1	4.4	0.9	-1.3	0.4	-3.0

1/ ECLAC Preliminary Overview of the Economies of Latin America and the Caribbean (December 2008)

2/ Global Economic Prospects 2009 (forecasts made by end-November 2008).

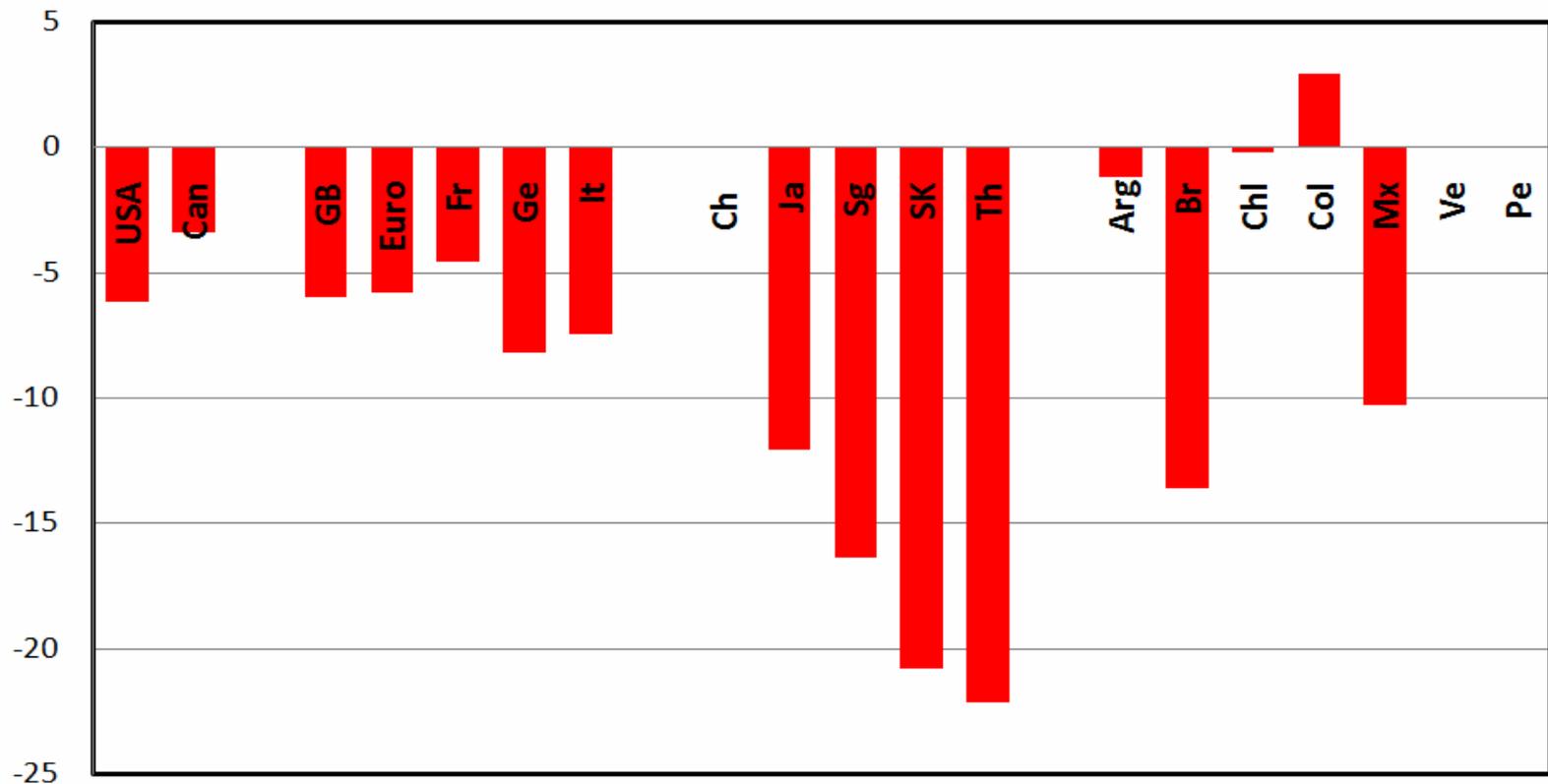
3/ International Monetary Fund, World Economic Outlook Database, October 2008

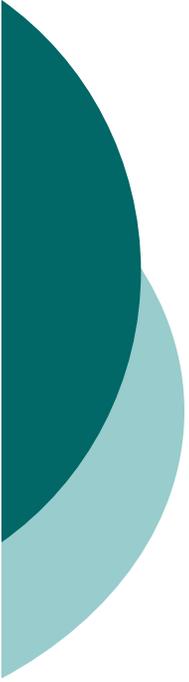
4/ IMF updated projections reported in January 2009

Sharp Contraction of Economic Activity in 4th Quarter of 2008

(Source: Esquivel, Mar 09)

GDP Growth in Selected Countries in 4th Qr. 2008
(annualized percentage change with respect 3rd. quarter of 2008)



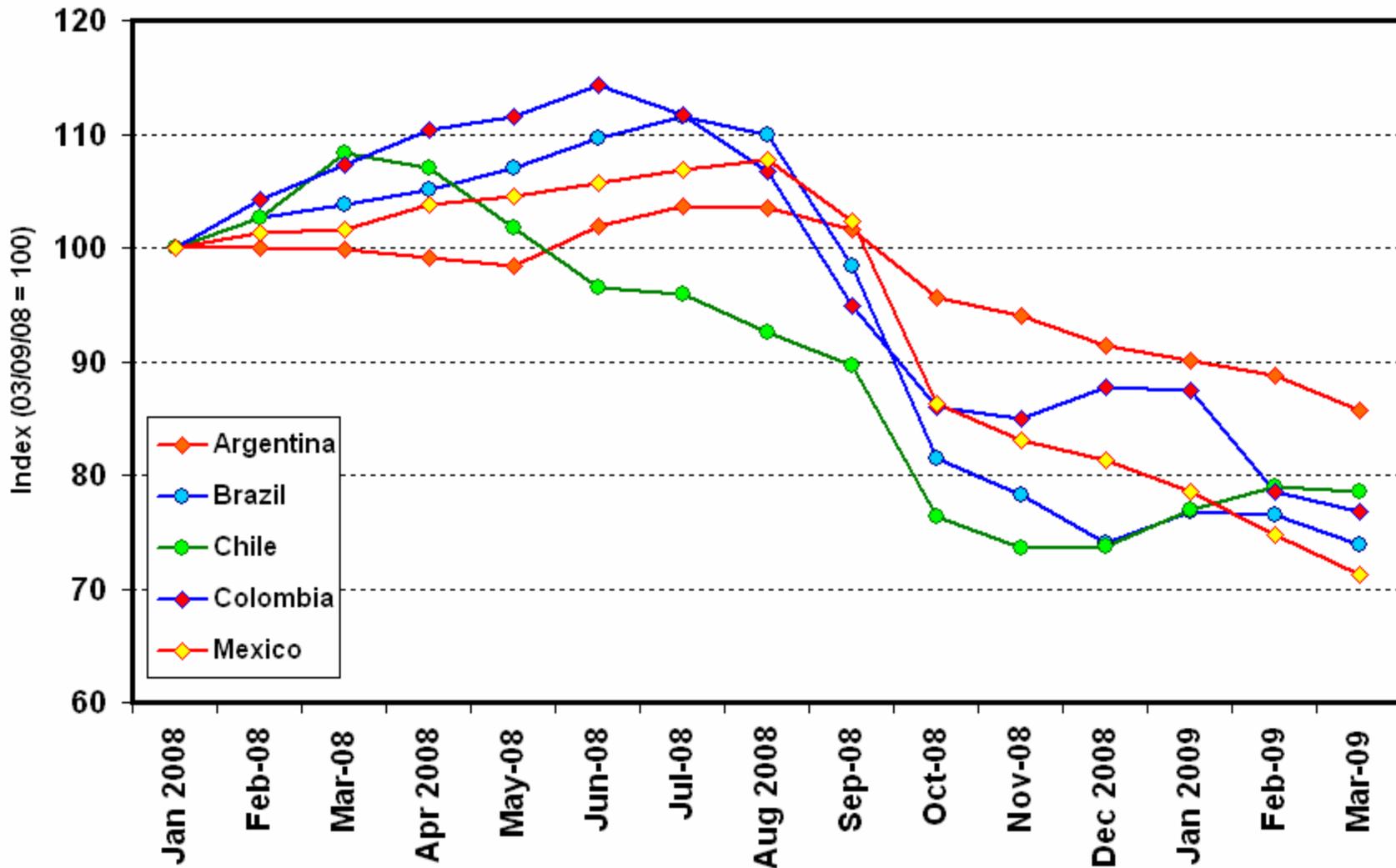


Within Latin America...

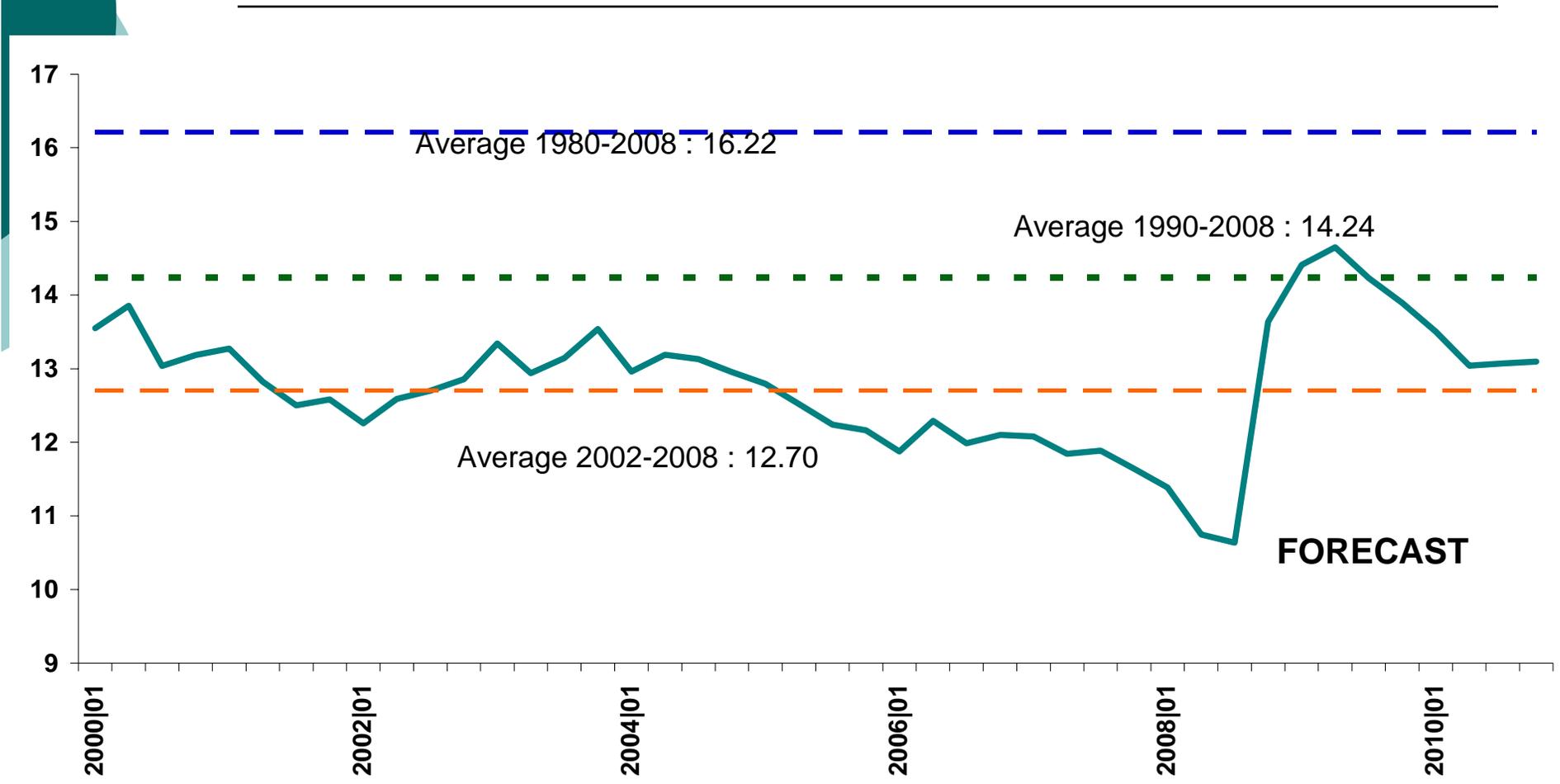
- Countries most affected not necessarily those people were expecting
- Argentina and Venezuela have been holding their ground while...
- ...Mexico has been hit hard because of its close ties with US economy through exports and capital flows.

LAC Currencies: Appreciation Followed by Sharp Depreciation

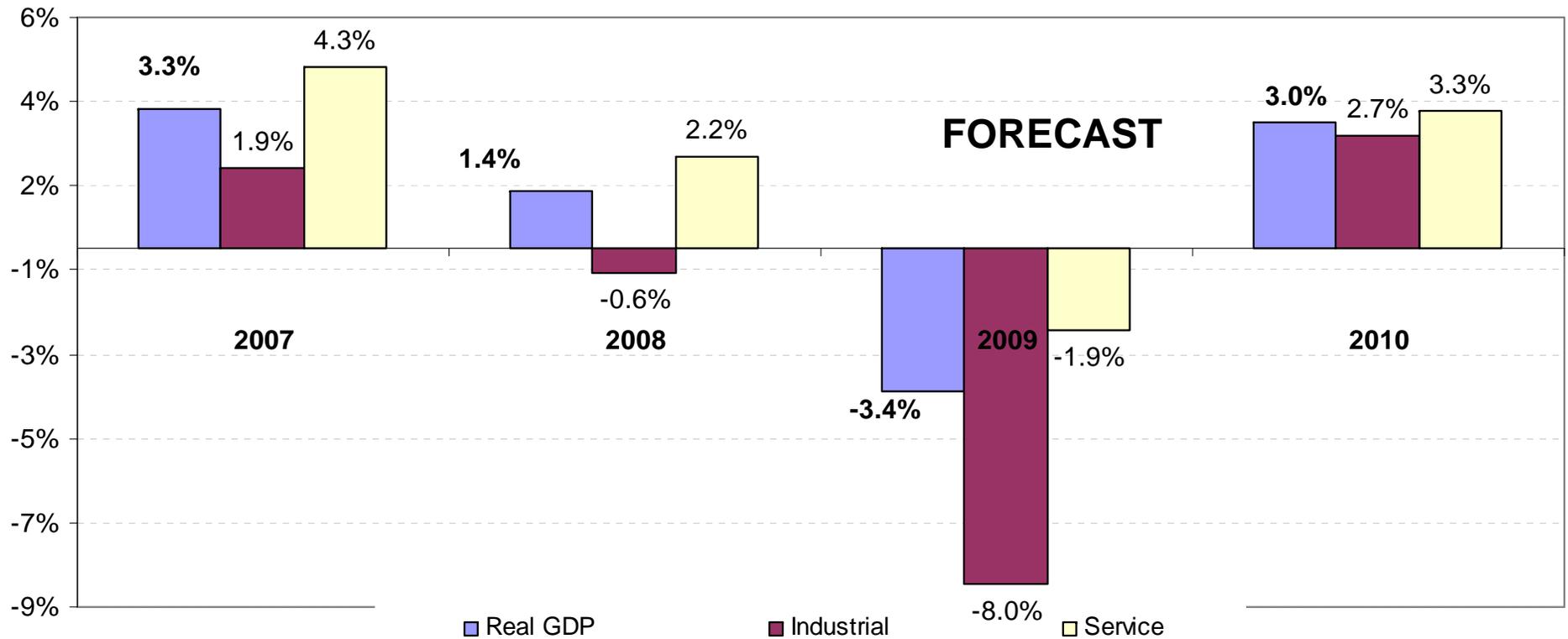
LAC: Monthly Exchange Rates Relative to U.S. Dollar
(January 2008 - March 2009)



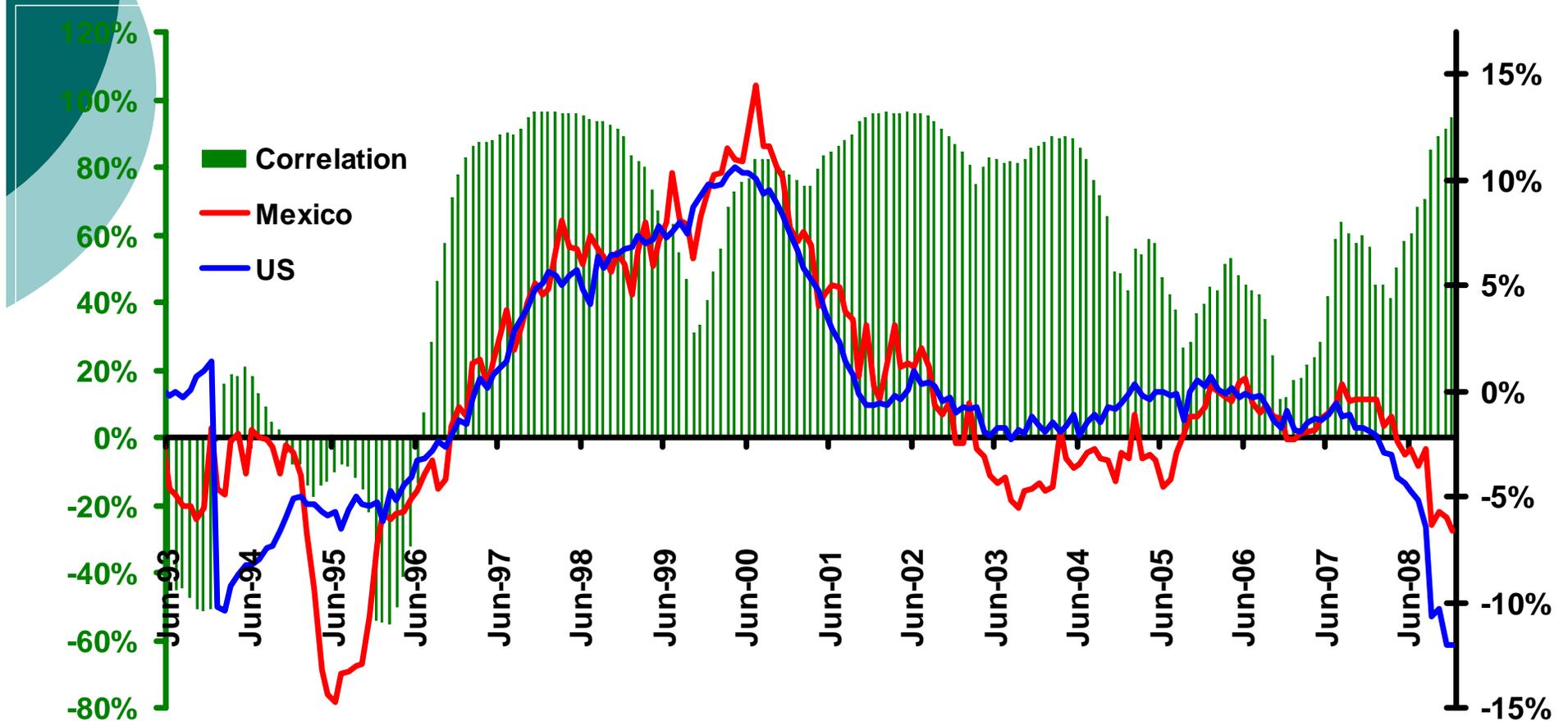
Mexico: Real Exchange Rate (1st Q 2009=100)

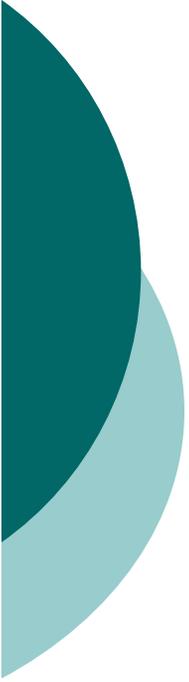


Mexico: GDP Growth, yearly average



US-Mexico correlation of business cycle in manufacturing sector

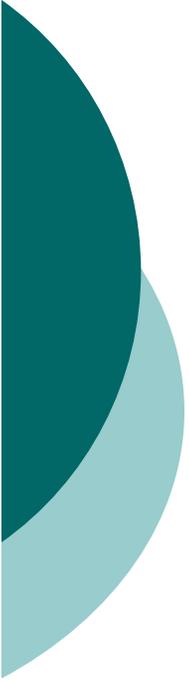


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- For the first time in decades, most Latin American economies will do badly mainly due to adverse external shocks and not because of poor domestic macroeconomic policies.
 - Adverse external shocks are also an impediment to implement counter-cyclical fiscal policies.
 - => Adjustment costs can be significant



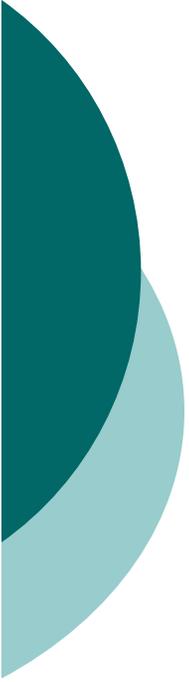
4. How will/is the crisis affect/affecting living standards?

- Real wages will fall or remain stagnant
- Unemployment will rise
- Private transfers, particularly from family members living abroad, will shrink
- Public spending, including social spending might have to be cut
- Poverty is likely to rise
- Progress in the nutrition, health and education fronts will slow-down and in some cases it might be reversed



IDB sees remittances to Latin America and the Caribbean declining in 2009

- In 2008 Latin American and Caribbean expatriates transferred some \$69.2 billion to their homelands, 0.9 percent more than in 2007
- Fourth quarter of 2008 registers first decline in nearly a decade. In the fourth quarter remittances dropped to \$17 billion, 2 percent less than in the same period of 2007.
- For the countries that have reported data for January, totals were down by as much as 13 percent.



Poverty and Social Indicators

- Poverty-growth elasticity is between one and two, but has been found to be higher (around 3) when growth is negative
- Next two tables show impact of previous crises on poverty and social indicators

(Source: Lustig, N. “Crises and the Poor: Socially Responsible Macroeconomics,” *Economia, The Journal of the Latin American and Caribbean Economic Association*, 1(1), 1-45, Fall 2000.)

Country	Year of Crisis	Before the Crisis		Year of Crisis			After the Crisis			After Crisis GDP per Cap-ita	
		Year	Value	Year	Value	Change	Year	Value	Change	vs. yr. of the Crisis	vs. yr. before Crisis
Argentina ^a (Greater Buenos Aires)	1985	10.1	(1980)	20.6	+	25.2	(1987)	+	+	-	
Argentina ^a (Greater Buenos Aires)	1989	25.2	(1987)	34.6	+	35.0	(1990)	+	+	-	
Argentina ^a (Greater Buenos Aires)	1995	16.9	(1993)	24.8	+	26.3	(1997)	+	+	+	
Brazil ^b (All metropolitan areas)	1990	27.9	(1989)	28.9	+						
Chile ^c (Metropolitan areas) §/	1982	40.3	(1980)			48.60	(1987)	+	+	-	
Costa Rica ^d */	1982	29.6	(1981)	32.3	+	29.7	(1983)	+	+	-	
Dominican Republic ^d */	1985	37.3	(1984)			38.2	(1986)	+	+	+	
Dominican Republic ^d */	1990	35.7	(1989)			39.5	(1992)	+	+	-	
Guatemala ^e §/	1982	65.0	(1980)			68.0	(1986)	+	-	-	
Mexico ^f	1986	28.5	(1984)			32.6	(1989)	+	+	+	
Mexico ^g §/	1995	36.0	(1994)			43.0	(1996)	+	+	-	
Panama ^d */	1983	40.6	(1980)			44.0	(1986)	+	-	-	
Panama ^d */	1988	44.0	(1986)			50.0	(1989)	+	-	-	
Peru ^h §/	1983	46.0	(1979)			52.0	(1986)	+	+	-	
Peru ⁱ (Urban) */	1988	32.2	(1985)			50.0	(1991)	+	-	-	
Uruguay ^e §/	1982	11.0	(1981)			15.0	(1986)	+	-	-	
Venezuela ^j §/	1983	25.7	(1982)	32.7	+	34.8	(1985)	+	-	-	
Venezuela ^j §/	1989	40.0	(1988)	44.4	+	41.5	(1990)	+	+	-	
Venezuela ^j §/	1994	41.4	(1993)	53.6	+	48.2	(1996)	+	-	-	

Table 3: Social Impact of Economic Crises

	Argentina (1995)	Dominican Republic (1990)	Jamaica (1985)
Main crisis indicators¹¹	-In 1995 GDP per capita fell 4.2% and private per capita consumption fell 6.4%.	-In 1990 GDP per capita fell 7.6% and private per capita consumption fell 13.9%.	-In 1985 GDP per capita fell 6.2%.
Poverty and inequality	-Urban income based gini index rose from 0.36 in 1994 to 0.38 in 1996 ²¹ . -Moderate poverty headcount rose from 16.9% in 1993 to 24.8% in 1995 ²¹ .	-National income based gini index rose from 0.51 in 1989 to 0.52 in 1992 ³¹ . -Poverty headcount rose from 36% in 1989 to 40% in 1992 ⁴¹ .	-Moderate poverty rose from 29.1% in 1980 to 29.6% in 1988 ⁵¹ .
Labor markets⁶¹	-In 1995 the average real wage fell 1.1%. -The urban open unemployment rate rose from 11.5% in 1994 to 17.5% in 1995.	-Minimum urban real wages fell 3% in 1991 ⁵¹ .	-The open unemployment rate decreased from 25.5% in 1984 to 23.6% in 1986.
Social spending¹⁰¹	-Social spending as a share of total expenditure rose from 65.2% in 1994 to 66.8% in 1995, as percentage of GDP it increased from 18.1% to 18.6% in the same period. -Education spending as percentage of GDP rose from 3.7% in 1994 to 4.0% in 1995; meanwhile the health spending as percentage of GDP rose from 1.9% to 2.0% in the same period.	- Social spending as percentage of total expenditure decreased from 39.6% in 1989 to 36.6% in 1990 and as a percentage of GDP decreased from 6.6% to 4.7% in the same period. -Spending on education as percentage of GDP decreased from 1.5% to 1.2% Spending on health as percentage of GDP decreased from 1.2% to 1.1% in the same period.	-Spending on education as percentage of GDP decreased from 7.2% in 1982 to 0.6% in 1985. In 1986 it rose to 1.2%. -Health spending as percentage of GDP decreased from 10.6% in 1982 to 6.1% in 1985.
Health and Nutrition^{12/131}	-The per capita daily protein grams intake decreased 3.8% in 1995, in 1996 it increased 1.9%. -In 1995 deaths from pneumonia and influenza rose nearly 6%.	-The number of infants aged 6-11 months suffering from chronic malnutrition rose from 9.6% in 1986 to 17% in 1991. -Per capita daily protein grams intake decreased 6.8% in 1990. The next year it increased 4.6%	-The per capita daily protein grams intake decreased 5.9% in 1985 then increased 4.9% in 1986.
Educational¹⁴¹	-Total primary enrollment ^{c1} growth declined from 2.2% in 1993 to 0.62% in 1996.	-Total primary enrollment ^{c1} declined from 97.1% in 1988 to 96.6% in 1990.	-Total primary enrollment ^{c1} rose slowly between 1985 to 1987, from 100.0 to 100.8.

	Mexico (1982)	Mexico (1995)	Venezuela (1994)
Main crisis indicators ¹¹	- In 1983 GDP per capita fell 6.3% and private per capita consumption fell 7.4%.	- In 1995 GDP per capita fell 8.1% and private per capita consumption fell 11.5%.	-In 1994 GDP per capita fell 4.6% and private per capita consumption fell 8.3%.
Poverty and inequality	- 1984-1989: National income based gini index rose from 0.43 to 0.47 - Moderate poverty headcount rose from 28.5 to 32.6% , extreme poverty rose from 13.9% to 17.1in 1994 to 43% in 1996.	- Moderate poverty headcount rose from 36% in 1994 to 43% in 1996 ^{6f} .	-National income based gini index rose from 0.45 in 1992 to 0.50 in 1994 ^{7f} . -Moderate poverty headcount rose from 41% in 1993 to 54% in 1994 ^{7f} and the extreme poverty rose from 16.8% to 27.5% during the same period ^{7f} .
Labor markets ⁸	- 1983-1988: The average wages fell by between 36% and 46% depending on the sector. -Urban open unemployment rate rose from 4.2% to 6.3%	-The average real remuneration increased 3.7% in 1994 but decreased 13.5% in 1995 ^{9f 10f} -Urban open unemployment rate rose 2.6 percentage points between 1994 and 1995 (3.7% to 6.3%). In 1997 it fell back to its 1994 level ^{10f} .	-Average real wages ^{6f} fell 15.7% in 1994 and 4.6% in 1995. -Urban open unemployment rate rose from 6.8% in 1993 to 8.9% in 1994.
Social spending ^{10f}	- 1983-1988: Social spending fell 33.1% - 1983-1988: Social spending on education fell 29.6; spending on health fell 23.3%	-Social expenditure as percentage of GDP decreased from 9.0% in 1994 to 6.8% in 1995. -The education spending as percentage of GDP decreased from 3.9% in 1994 to 3.6% in 1996.	-Real per capita social expenditure in 1990-1991 was 9.0% of GDP. In 1996-1997 it fell to 8.4%. -Spending on education as percentage of GDP rose from 3.9% in 1993 to 4.4% in 1995.
Health and Nutrition ^{12/13f}	-Infant mortality continued to decline between 1982 and 1989, but at a slower rate than in the previous decade - Infant and pre-school mortality caused by nutritional deficiencies increased from 1982 after years of decline. The number of infants suffering from slow fetal growth and malnutrition increased from 8.5% of the total diseased children in 1981 to 11.7% in 1984.	-Mortality from anemia increased in children under 1, from 6.3 deaths per 100,000 live births in 1993 to 7.9 in 1995, and in children between the ages of 1 and 4 from 1.7 to 2.2 deaths per 100,000 respectively.	-The per capita daily protein grams intake decreased 4.2% in 1993, 2.9% in 1994 and 0.5% in 1995
Educacion ^{14f}	-The proportion of graduates who entered the subsequent educational level declined after 1982. - In rural zones the dropout rate rose by almost 3 percentage points.	-In 1994 total primary enrollment ^{6f} growth was 0.44% and it fell in the next year to 0.35%	-Total primary enrollment ^{6f} declined from 94.4% in 1993 to 91.7% in 1995.



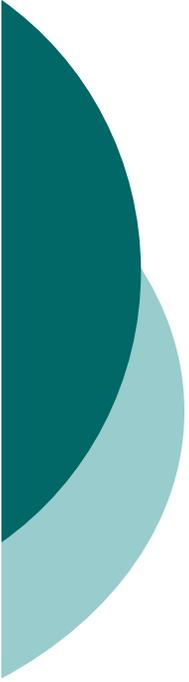
Extreme poverty has been on the rise and will continue to do so...(UNECLAC, 2009)

- During 2008, the percentage of the population living in poverty in Latin America and the Caribbean dropped to 33.2% (182 million people) from the 34.1% (184 million) the previous year.
- However, extreme poverty or indigence rose mildly, from 12.6% in 2007 (68 million people) to an estimated 12.9% (71 million) this year primarily due to food price inflation.



Extreme poverty has been on the rise and will continue to do so...(UNECLAC, 2009)

- Average household incomes will deteriorate, particularly among independent and informal workers whose jobs are most sensitive to movements in economic cycles.**
- Poverty and indigence will most likely increase moderately, continuing the negative trend begun in 2008. WB estimates an increase of 6m.**



Are Countries Ready to Mitigate the Impact on the Poor?

- **Next slide shows that many are not: e.g., Conditional Cash Transfers not yet pervasive**
- **Most countries do not have unemployment insurance or employment guarantee schemes**
- **=> no counter-cyclical safety nets**

Conditional Cash Transfers in LAC

(Source: Inter-American Development Bank, 2008)

Without program	Pilot	Small scale (<25% poor)	Medium & large scale (>25% poor)
Bahamas Barbados Belize Guyana	Haiti Nicaragua Suriname	Guatemala	Costa Rica El Salvador Dominican Rep.
			Honduras
			México
Uruguay	Paraguay		Jamaica Panama
Bolivia Trinidad y Tobago Venezuela		Argentina Perú	Brasil Colombia Chile Ecuador
11	2	5	8



What can the multilateral institutions and the US do?

- Help stabilize macroeconomic conditions (e.g., the swap arrangements by the US Fed last October)
- Increase resources available in the multilaterals so lending for counter-cyclical fiscal policies is made feasible (e.g., pledges to increase IMF resources; support the capital increase of Inter-American Development Bank)
- Avoid protectionist measures
- Avoid anti-immigration measures



THANK YOU
