Latin American Economies Roundtable
Tuesday, July 30th 2013
5:00 – 7:00 pm
Inter-American Dialogue

-- *Summary Report* --

The eighteenth meeting of the Latin American Economies Roundtable addressed growing pessimism about the global economic outlook and its implications for Latin America. More moderate growth is forecasted for emerging markets, including China, while recovery in the U.S. and Europe remains gradual. As credit tightens and demand for Latin American exports falls, macroeconomic reforms will be needed in order to reposition the economies of countries like Brazil and Argentina.

I. Global outlook dreary as developing country growth slows and European recovery stalls

Growth in emerging markets is expected to be moderate both this year and next by developing countries' standards. As commodity prices stabilize and credit tightens, participants agreed that it is unrealistic to expect the very high rates of growth experienced by many emerging economies over the past decade. One presenter suggested that 5 or 5.5 percent might be reasonable in countries with solid economic fundamentals.

China faces a particularly difficult transition in the coming decade. An increasing wage level indicates that the massive movement of people from rural to urban areas over the past decade has eroded the country's agricultural labor surplus. Although its economy will continue to grow at a rate of 6 or 7 percent, China must now undertake a difficult rebalancing of consumption and investment.

Sustained competitive adjustment in the Eurozone periphery countries continues to proceed slowly and painfully. With export growth remaining at a modest 2 to 3 percent, the collapse of demand and falling imports have reduced current account deficits and initiated a gradual reorientation of the economy from non-traded to traded goods and services. And although Europe faces a lengthy recovery, its unwavering commitment to austerity programs has restored investor confidence in the stability of the Euro.

II. Positive signs for U.S. recovery, though monetary and fiscal challenges remain

Participants agreed that the worst risks to U.S. recovery have passed and that the country has successfully exited its fiscal stimulus. A speaker observed that the Federal Reserve is also reaching the limits of monetary policy, noting that a retreat from quantitative easing may be necessary in the near future. He also expressed optimism about this process, given the gradual and transparent path taken by the Federal Reserve thus far.

Fiscal retrenchment had reduced growth by 1 percent in the first quarter of 2013, and the ongoing sequester is expected to further curb growth in the next six months. With decreasing expenditures and increasing revenues, the national deficit is down from 8.7 percent of GDP in 2011 to 4.7 percent this year and a positive primary balance is possible by 2019. However, growth in the next year will not be sufficient to significantly reduce unemployment. The extent of change over the next decade will be largely determined by the pace chosen for retrenchment.

Participants reflected on the unanticipated exploitation of cheap natural gas in the U.S., which could be a boon for domestic manufacturing and consumption. There was little consensus, however, on the implications of this shock for Latin America. Several participants worried that it would create a wedge in energy prices that favors the United States. Others noted that Mexico and Argentina might also develop competitive shale gas industries that could minimize this impact. Finally, the crowding out effect of natural gas on non-renewable and renewable energy sources was briefly discussed.

III. Latin America must revise expectations downward given the slowdown of the global economy

Given the current global climate, Latin America can no longer count on high capital flows and strong demand from Asia to propel its growth to very high levels. A speaker estimated that the region's total production would expand about 2.5 percent this year.

Participants noted that negotiations for the Transatlantic Trade and Investment Partnership (TTIP) are moving forward at a rapid pace, and optimistic reports estimate that most issues will be covered by October. One participant worried that the rapid speed of negotiations does not allow Latin American countries who are eager to participate enough time to evaluate and deliberate the content of the agreement. Regardless of the speed with which the TTIP is ratified, however, another shared that the agreement will have a nearly imperceptible impact for Latin American economies.

A. Mexico undertakes promising reforms

Despite a slowdown in Mexico's economy after the election of President Peña Nieto, the country has experienced a rapid recovery. Growth of 3 to 3.5 percent is expected for next year, and the manufacturing sector has rebounded more competitive than ever.

This year's structural reforms of telecommunications and education were both successful. However, Peña Nieto's planned revisions to the energy sector and public finance promise to be more complicated, politically charged and controversial. One participant was optimistic about energy sector reform, which will most likely open up gas and offshore oil exploration and production to private companies. He noted that, without a strong opposition leader, the current administration faces a much more agreeable political situation than did former President Calderón.

B. Brazil faces difficult macroeconomic outlook

Brazil's economy boomed between 2001 and 2011 thanks to extremely favorable terms of trade, and its government used the opportunity to increase primary expenditures. More recently, however, the slowdown of China's economy means that it and other South American countries will need to significantly readjust expectations. One participant worried that Brazil is not sufficiently concerned about its fiscal largess.

Another observed that Brazil shows all the textbook signs of an overheated economy. The country's investment remains low and stagnant, partly given the country's management of the pre-salt offshore oil fields. Increasing primary expenditures, rising inflation, flat industrial production, and low TFP growth all add to Brazil's list of economic woes. The country's combination of domestic debt, inflation risk, high interest rates and an overvalued exchange rate have severely constrained President Dilma Rousseff's policy options, and it remains unclear how Brazil might rebalance its economy.

Brazil's position is increasingly vulnerable, since around 80% its lending occurs through public sector banks. Yet one participant argued that the Brazilian government will be more worried about combating the specter of inflation than reducing its sovereign debt. Given a lack of central bank independence and Dilma's political vulnerability in the wake of widespread protests, another shared her suspicion that the Rousseff administration will engage in loose spending and creative accounting ahead of the next presidential election. Although participants ruled out a crisis of 1985 proportions, they agreed that trouble lies ahead if there Brazil does not enact some major changes in macroeconomic policy.

C. A potential crisis looming in Argentina's future?

President Cristina Fernández de Kirchner has resorted to increasingly extreme interventions into Argentina's economy in order to prop up an overvalued exchange rate, clamp down on dollar outflows and create an artificial current account surplus. Despite the administration's efforts, the country's reserves have decreased by more than thirty percent in 18 months by official statistics. Moreover, flat soybean prices will most likely not provide enough of a boost to support Argentina's floundering export sector.

Argentina's government made much of its recent Vaca Muerta deal with Chevron (for more information on the deal, click here). However, a participant pointed out that the agreement will only secure around 1 billion of the estimated 40+ billion dollars that the country needs to adequately develop its energy resources. Although Argentina remains sufficiently isolated from capital markets to avoid a financial crisis, the roundtable speculated about the risks of a traditional balance of payments crisis as external conditions grow less favorable.

D. Increasing vulnerabilities undermine growth in Central America

Central America's progress over the past three decades has been largely disappointing despite growth in Costa Rica and Panama. The region has struggled to recover from a crisis caused by rising food prices in 2006, and countries' efforts are complicated by rising crime, declines in tourism and low investment. Several participants noted the detrimental effects of climate change, which has increased Central America's vulnerability to natural disasters and fungus outbreaks that threaten coffee crops.

One participant concluded that Central America's fundamentals continue to undermine the region's economic outlook. Issues of political economy are particularly worrying; even relatively stable Costa Rica faces an uphill battle to undertake fiscal reforms and reduce rising inequality.