Growth Prospects for Latin America

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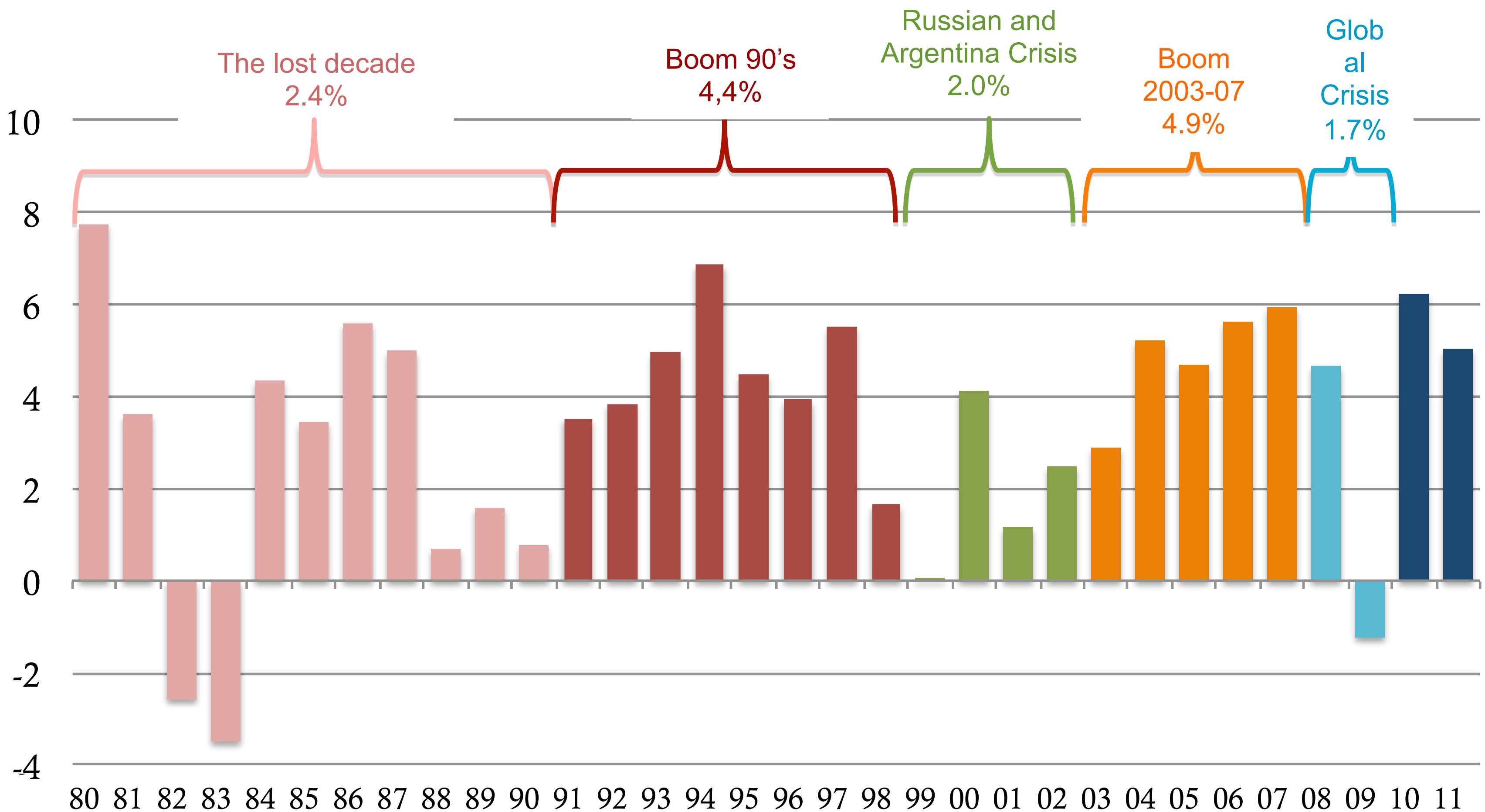
- In the period 2003-2011 Latin America enjoyed the benefits of the super cycle of commodity prices and more favorable external financial conditions.
- The improvement in external conditions had a positive effect on aggregate demand (income effect of terms of trade gain) and on the level of actual and potential output (investment boom)
- The countries that progressed the most were the ones that had introduced reforms to strengthen the macro fundamentals and the policy environment for investment and growth.
  - Some of these countries saved part of the windfall gains with explicit or implicit fiscal rules.

Latin America Growth (LAC-5)* (%)

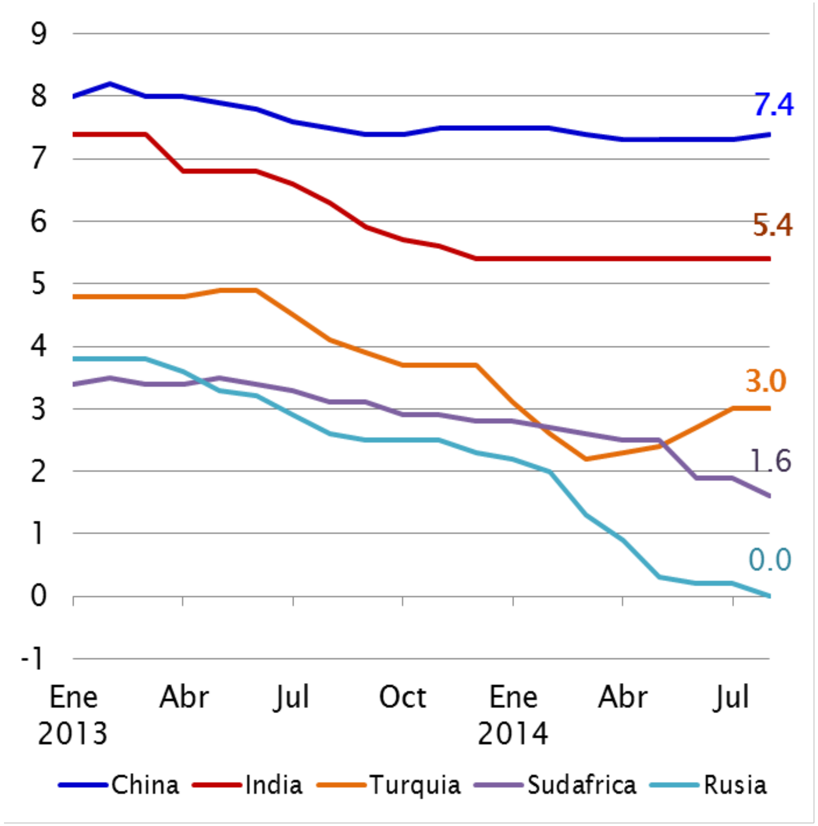


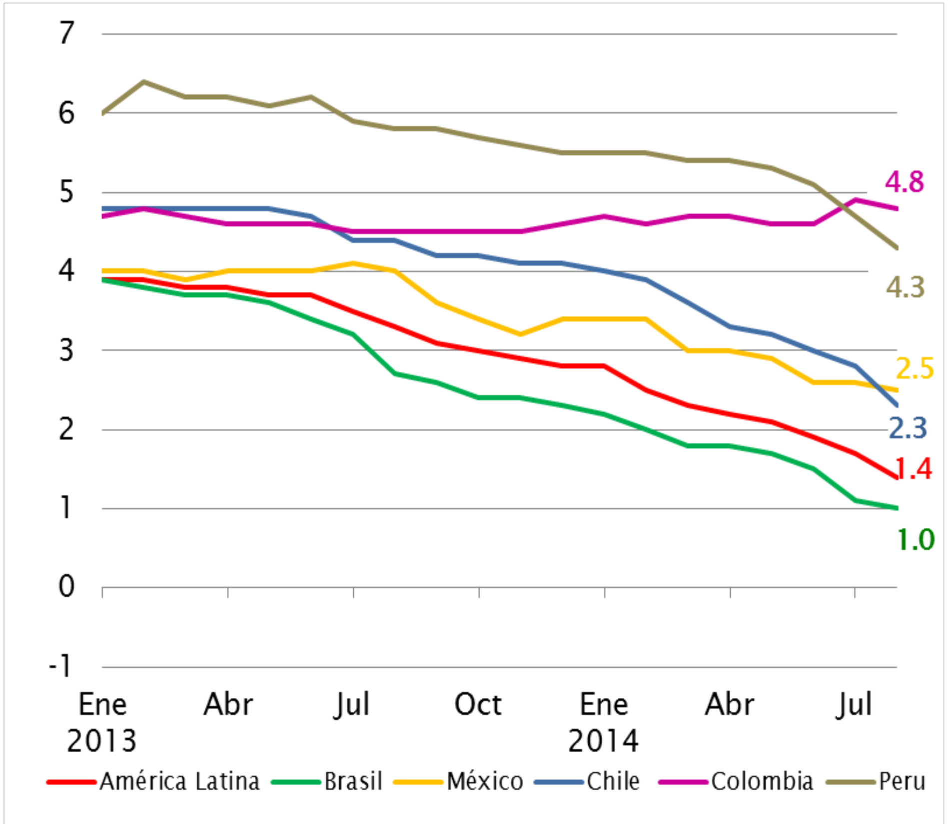
*LAC-5 is the simple average of five main countries of Latin America: Brazil, Chile, Colombia, Mexico, Peru.
Source: IMF, WEO September 2011.

- The supply response to favorable commodity prices, plus the slowdown of the Chinese and the World economies has put an end to the super cycle.
- Now that the super cycle in commodity prices is over, growth has slowed down substantially (2011: 4.6; 2012: 3.1, 2013: 2,7), and is affecting almost all countries.
  - Although commodity prices are higher than the average of the years 2003-2011, just staying constant has a negative effect on growth and their reduction has an even larger negative effect on growth (Talvi and Munyo, 2013 and Gruss, 2014).
  - Furthermore, there is the risk of a further slowdown in China's growth that would exacerbate the deterioration of the terms of trade and the growth prospects for the region.

Growth Forecast for 2014

Annual rate of growth of GDP (%)

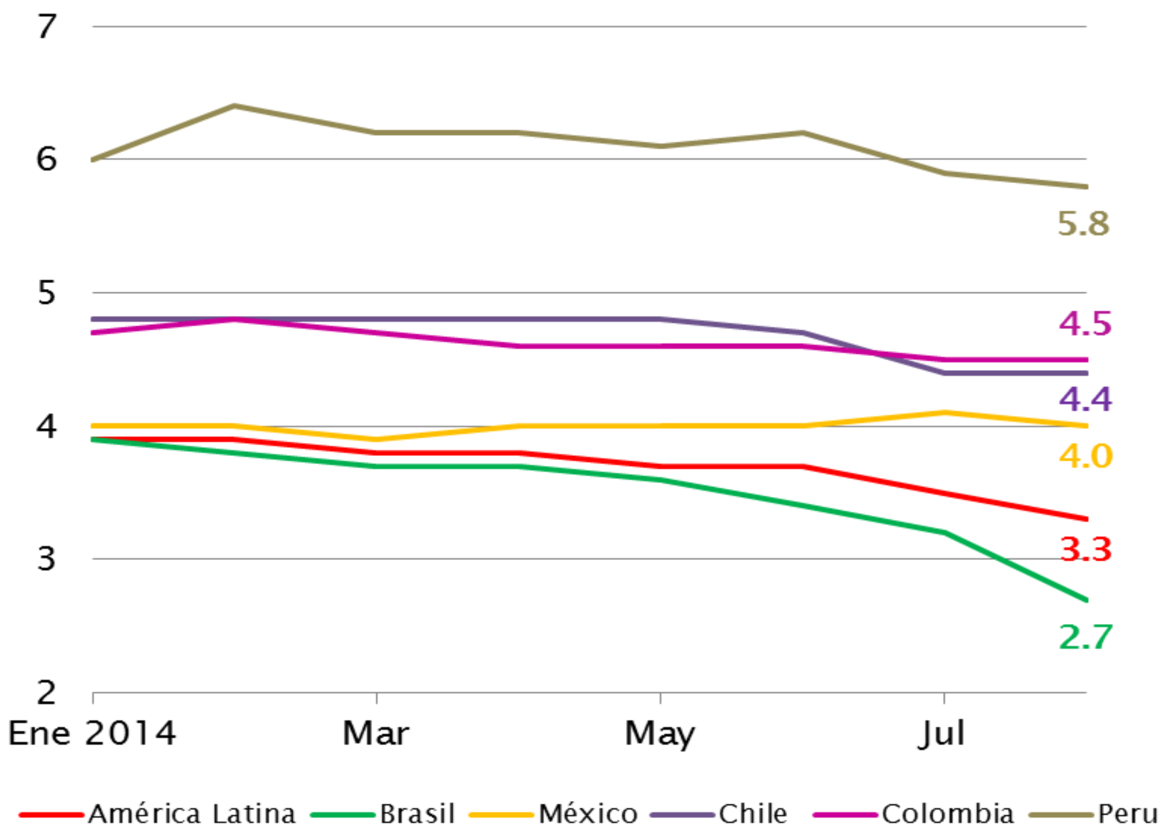




Source: Consensus Forecast of the month indicated

Growth Forecast for 2015

Annual rate of growth of GDP (%)



Source: Consensus Forecast of the month indicated

- To make matters worst, external financial conditions will deteriorate with the beginning of the monetary normalization process in the US.
- The main challenge for Latin America today is to facilitate the adjustment to this less favorable external conditions, and at the same time to remove domestic obstacles to higher growth.
- To ease the adjustment the best defense is to keep a strong macro policy framework (price stability, flexible exchange rates, fiscal sustainability) and to facilitate the mobility of resources.
  - One potential problem here is that for many countries the fiscal situation is less favorable now than in 2008 and others have an important homework ahead to strengthen the macro framework (specially Argentina and Venezuela).

- On policies to raise the rate of growth of potential output there is room to promote capital accumulation and the rate of growth of TFP, the opportunities are many:
  - (1) Fiscal and monetary policies to achieve macro stability;
  - (2) Reducing severe distortions that affect an efficient allocation of resources, and investment growth;
  - (3) Reducing supply bottlenecks in infrastructure (ideally through private sector concessions to provide fiscal room for priority social spending) and energy;
  - (4) Strengthening market competition and creative destruction;
  - (5) Improving the functioning of labor markets (more flexibility in conditions and in working hours, and more security in contracts);
  - (6) Strengthening human capital formation (improvement in the quality of preschool, primary, secondary and technical education);
  - (7) Improving the efficiency of the state.

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