Recovery from the Pandemic in LAC: Balancing Short-term and Long-term Concerns

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Summary

- LAC entered the pandemic with multiple preexisting problems, including low productivity, political polarization and social problems.

- And now it is suffering of a “Triple Sudden Stop” as a result of the pandemic with an extreme economic impact.

- Today LAC is the global epicenter of the crisis both in the health and economic spheres.

- And LAC does not have the resources of its own to face the crisis. Both debt and its costs will rise sharply.

- Reforms will be necessary for macroeconomic sustainability.

- The role of multilateralists will be key to supporting the recovery.
Pre-existing Problems
LAC went into this crisis with pre-existing conditions

Per Capita Income Relative to the US (%)

- Latin America and the Caribbean:
  - 1960: 30.6
  - 1980: 27
  - 2000: 18.8
  - 2019: 22.4

- Emerging Asia:
  - 1960: 8.9
  - 1980: 22.3
  - 2000: 33.9
  - 2019: 50.9
Growth in the region has decelerated over the last decade

Growth 2007 vs 2013-9, LAC average

<table>
<thead>
<tr>
<th>Year</th>
<th>Average</th>
<th>Median</th>
<th>Weighted Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>5.2</td>
<td>5.3</td>
<td>5.6</td>
</tr>
<tr>
<td>2013</td>
<td>3.3</td>
<td>3.2</td>
<td>2.9</td>
</tr>
<tr>
<td>2014</td>
<td>2.4</td>
<td>2.9</td>
<td>1.3</td>
</tr>
<tr>
<td>2015</td>
<td>2.1</td>
<td>2.8</td>
<td>0.3</td>
</tr>
<tr>
<td>2016</td>
<td>1.0</td>
<td>2.3</td>
<td>-0.6</td>
</tr>
<tr>
<td>2017</td>
<td>1.7</td>
<td>2.2</td>
<td>1.3</td>
</tr>
<tr>
<td>2018</td>
<td>1.3</td>
<td>2.3</td>
<td>1.1</td>
</tr>
<tr>
<td>2019</td>
<td>-0.1</td>
<td>1.1</td>
<td>0.1</td>
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</tbody>
</table>
The lack of productivity growth is holding LAC back

Per capita GDP growth and contributions to growth - 1990-2019

-1% 0% 1% 1% 2% 2% 3% 3% 4% 4% 5%

Advanced Economies
-0.05% 0.64% 0.75% 0.33%

Emerging Asia
-1.73% 0.43% 1.52% 0.44%

Latin America and the Caribbean
-0.10% 0.21% 0.71% 0.97%

Productivity Capitl Education Labor
The Triple Sudden Stop
The region has been affected through several transmission channels

- Triple Sudden Stop
- Human mobility (lockdowns, travel restrictions)
- Trade (volumes, prices)
- Financial flows (portfolio investments, remittances)

https://www.project-syndicate.org/commentary/latin-america-triple-sudden-stop-lockdowns-by-eric-parrado-2020-08
LAC suffers both in the management of public health and the economy

Source: Johns Hopkins University and WEO October 2020, IMF
Containment measures have proved effective at reducing mobility

Daily % difference in traffic congestion with respect to the first week of March

Source: Waze and IDB
The fall in human mobility is also evident in air passengers data

Source: Latin American & Caribbean Air Transport Association
The “sudden stop” resulting from the covid-19 crisis in LAC

Cumulative net bond flows since the beginning of the pandemic

Source: IDB staff calculations based on data from EPFR Fund Flows and Haver Analytics. Note: “Others” refers to the sum of net flows from: Bolivia, Costa Rica, Republica Dominicana, Ecuador, El Salvador, Honduras, Jamaica, Panamá, Paraguay y Uruguay.
We anticipate significant falls in remittances to the region

<table>
<thead>
<tr>
<th></th>
<th>Remesas en % del PIB en 2019</th>
<th>Cambio % año acumulado a agosto</th>
<th>Proyecciones de cambio en 2020</th>
<th>Escenario optimista</th>
<th>Escenario Base</th>
<th>Escenario pesimista</th>
</tr>
</thead>
<tbody>
<tr>
<td>Haiti</td>
<td>37.10%</td>
<td>N/A</td>
<td></td>
<td>4.58%</td>
<td>-0.28%</td>
<td>-8.88%</td>
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<tr>
<td>Honduras</td>
<td>22.00%</td>
<td>-1.77%</td>
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<td>2.06%</td>
<td>-1.99%</td>
<td>-13.05%</td>
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<td>El Salvador</td>
<td>21.00%</td>
<td>-1.69%</td>
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<td>-3.09%</td>
<td>-6.49%</td>
<td>-16.73%</td>
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<tr>
<td>Jamaica</td>
<td>16.40%</td>
<td>N/A</td>
<td></td>
<td>2.24%</td>
<td>-1.01%</td>
<td>-9.53%</td>
</tr>
<tr>
<td>Nicaragua</td>
<td>13.20%</td>
<td>8.98%</td>
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<td>-5.37%</td>
<td>-8.68%</td>
<td>-16.94%</td>
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<tr>
<td>Guatemala</td>
<td>13.10%</td>
<td>2.24%</td>
<td></td>
<td>6.73%</td>
<td>3.18%</td>
<td>-15.49%</td>
</tr>
<tr>
<td>Mexico</td>
<td>3.0%</td>
<td>9.35%</td>
<td></td>
<td>9.9%</td>
<td>7.1%</td>
<td>-6.7%</td>
</tr>
<tr>
<td>LAC</td>
<td></td>
<td></td>
<td></td>
<td>-2.0%</td>
<td>-4.9%</td>
<td>-15.3%</td>
</tr>
</tbody>
</table>

Source: IDB staff calculations based on data from the World Bank, the UN and the BEA, and growth and unemployment projections from the IDB and the IMF.
The unprecedented US fiscal policy expansion has had a positive spillover effect on LAC

YoY Change of GDP and Disposable Income in the US

Source: Bureau of Economic Analysis
International Trade has suffered significant contractions, but the region shows a recovery

Export Volume Index (January 2015 = 100)

Source: CPB – Netherlands Bureau of Economic Policy Analysis
The impact of the crisis was made evident by the Q2 growth figures

Source: Refinitiv
Growth scenarios, from June 2020...

- LAC could have a recession of between -8% y -10% this year.
- The first and second wave scenarios use the OECD’s projections for the global economy.
- Our model suggests a U rather than a V-shaped recovery.
- The good news is that more recent data (especially on Brazil) suggest regional growth perhaps more in the -6% to -7% range.
- Still, this is a very serious recession for many countries.

Source: IDB staff estimates. The baseline is close to the IMF’s April WEO and the scenarios are generated employing a G-VAR model of the global economy – see Powell (2012, 2020) and Cesa Bianchi et al. (2012).
The measures to control the pandemic have implied a record loss in employment, some 24 million jobs

Source: Observatorio Laboral Covid-19, IDB
Job losses have particularly affected poorer households

% of households impacted by job losses by income relative to the minimum wage

New developments in the labor market risk leaving behind the poorer households

% of households where at least one member worked from home over the last two weeks of March, by income relative to the minimum wage

It will take 3 or 4 years to get back to pre crisis income per capita, the region needs to find ways to boost growth from the pre crisis trend.

Post-GFC growth has averaged just 1.6% per annum.

Source: World Economic Outlook, June 2020, IMF
Fiscal Space
Debt levels were already higher as this crisis hit

- On average debt to GDP was about 57% in 2019, excluding Venezuela.
- This figure will rise very sharply given Covid related fiscal packages and the fall in revenues.

Source: IDB Staff calculations based on the IMF’s World Economic Outlook
Debt ratios will be rising for the following years depending critically on growth

Gross Public Debt (% del PIB)

Source: IDB staff estimates.
The Pandemic Tunnel Dilemma

The dilemma LAC is facing: transiting the pandemic tunnel... while tackling problems the region was already facing

Uncertainties:
- How long is the tunnel?
- What will the World look like when exiting the tunnel?

Certainties. The region will become:
- More indebted
- Poorer
- More unequal
- Going back to pre-crisis policies will not be enough
Transiting the Pandemic Tunnel: Strategy

- Limit losses (preservation)
- Reforms for higher inclusive growth

Learning to live with Covid-19/Vaccine
- Remediation policies
- Reforms for higher inclusive growth

Positive Feedback Loop

Higher Growth than before the crisis
A Virtuous Cycle: Medium-Term Reforms for Better Access & Better Preservation Today

Sanitary and preservation measures

Sustainable reforms for inclusive growth

Access to credit markets
Priorities

• Preservation policies:
  • Health preservation inside the tunnel
  • Economic preservation
    • Help households who have lost their income
    • Help firms so that they can keep their workforce (formal firms)
    • Help the financial system through liquidity
    • Fiscal stability

• Preservation measures, on their own, will not be enough
Priorities

• Reforms for growth: a new social contract with a long-term view:
  
  • More opportunity:
    • Once the pandemic is under control, focus first on infrastructure and new job creation
    • Do away with the regulation and tax policies that hinder productive job creation and productive firm growth
    • Efficient public spending, geared towards growth and inclusion
    • Generate incentives for sustainable activities (ESG)

  • More equity in public policy:
    • Transfers that reach vulnerable populations
    • Insurance against cyclical shocks (unemployment insurance)
    • More and better services (health, education) for low income groups
Public expenditure reallocation will be key

Agility for Reallocation
- Ability to massively reallocate fiscal expenditure (allocation and expenditure quality agencies)
- towards health and loss limitation policies inside the tunnel
- towards stimulus and equitable growth outside the tunnel

Efficiency for Fiscal Space
- Ability to generate fiscal space for inclusive growth policies
- Inefficiencies in public expenditure in the order of 4.4% of GDP (transfers, wages, procurement)
- Full digital adoption
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