Latin America Adjusting to a New Equilibrium: Macroeconomic and Distributional Challenges

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Promoting Growth through Effective Policy
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LAC’s deceleration: unexpectedly pronounced and magnified relative to the change in external factors...

GDP Growth and Forecasts by Region

Notes: *: ECA excludes Russia. Sources: June 2015 Consensus and IMF’s WEO.
... in large part due to an investment amplification effect at work in commodity exporters

LAC Commodity Exporters and Importers:
GDP Growth and Investment Contribution to Growth

Sources: Author’s calculations from national sources.
The permanence of the reconfiguration of external factors took long time to sink in

**LAC: Changes in Investment, and in Domestic and External Saving**

Sources: IMF’s IFS, IMF’s WEO and national sources.
The macro challenge is not to dampen a cyclical downturn but to manage the adjustment to a new equilibrium
The ongoing pain depends on structural features, degree of exchange rate flexibility, ...

<table>
<thead>
<tr>
<th>Exchange Rate Flexibility</th>
<th>Large Negative Shock</th>
<th>Moderate Negative Shock</th>
<th>Positive Shock</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>Belize, Ecuador, and Bolivia</td>
<td>El Salvador, Guyana, and Panama</td>
<td>OECS Countries</td>
</tr>
<tr>
<td>Intermediate</td>
<td>Argentina, Guatemala, Jamaica, Paraguay, Trinidad &amp; Tobago, and Venezuela</td>
<td>Honduras and Nicaragua</td>
<td>Costa Rica, Dominican Republic, and Haiti</td>
</tr>
<tr>
<td>High</td>
<td>Brazil, Chile, Colombia, Mexico, and Peru</td>
<td>Uruguay</td>
<td></td>
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</table>
... and the extent of “unsustainable” fiscal expansion during the bonanza

Government Consumption Before and After the Commodity Price Boom

**The World**

**Latin America and the Caribbean**

Notes: Figures shown are for the general government’s final consumption expenditure. Sources: IMF’s WEO.
Fixers face tougher transition problems, but floaters face unexpected tensions of their own...

Change in the Terms of Trade and Nominal Exchange Rate

*Percentage Change between January 2011 and May 2015*

The Rise of LAC’s Pass-Through

*Correlation Inflation and Depreciation*

Sources: Author’s elaboration from Bloomberg and World Bank’s GEM.
...which limit the counter-cyclical use of monetary policy...

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**LAC Inflation Targeters**

*Simple Average*

**ECA Inflation Targeters**

*Simple Average*

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Notes: * Inflation for 2015 is the CPI year on year change for May 2015. The target bands in the left panel include Mexico. Sources: National sources.
The absence of “divine coincidence” is a first major test to inflation targeting in the region!

Sources: Authors’ elaboration based on Bloomberg and national sources.
To compound things, fiscal space has shrunk across most of the region.

Primary Balance Sustainability Index

Notes: The primary sustainability index depends on assumptions about the primary balance, growth, debt, and the interest rate. Sources: Author’s calculations from Bloomberg, IDB, and IMF’s WEO.
As the deceleration starts to hit labor markets in commodity exporters, distributional concerns loom large.

LAC: PPP-Adjusted Wage Growth Across Sectors, by Country Groups

Thank you!