



What Does a Slowdown in China Mean for Latin America and the Caribbean?

Growth in Latin America and the Caribbean (LAC) has become increasingly dependent on activity in China, partly as a result of heavy reliance on commodity exports. A 1 percentage point deceleration of growth in China has been associated with a 0.6 percentage point slowing of growth in the LAC region.

Growth in Latin America and the Caribbean (LAC) received a substantial boost from China in the first decade of the 2000s through growing trade, investment, and commodity market linkages. As linkages between China and LAC have strengthened, their business cycles have also become more correlated. During the same period, global commodity prices and activity have also become more closely aligned with Chinese growth dynamics. The carefully managed slowdown in China expected over the near term, however, may dampen growth and pose policy challenges for the LAC region.

This box briefly documents the growing linkages between LAC and China and analyzes the implications for the region of the slowdown in China.

Linkages between LAC and China

There are two main channels through which China's growth performance has spurred activity in LAC: (i) directly, as trade, and to some extent, foreign direct investment (FDI) from China to several LAC countries have increased; and (ii) indirectly, as the economic expansion in China has contributed to higher global commodity prices, raising receipts for many LAC commodity exporters not only from exports to China, but also to the rest of the world.

China's rapid growth has coincided with a sharp increase in its trade with LAC. The share of the region's exports going to China increased by tenfold between 2000 and 2013 (Figure B2.2.2). China's impact on the export profile of Argentina, Brazil, Colombia, and Peru has been particularly large, although there is some distinction in the types of products China imports from these countries. Argentina, Uruguay, and Paraguay export predominantly agricultural products to China, whereas Chile and Peru export mostly metals and Colombia and República Bolivariana de Venezuela export mainly oil. Brazil exports a large share of both its agricultural and mineral production to China. While the region's trade linkages with the United States have weakened over time, they remain quite strong. Although FDI from China to the LAC region has risen, it remains relatively small.

Since the early 2000s, rapid expansion of the Chinese economy has played an important role in the steady growth of global commodity prices (World Bank, 2014e). China's imports of some commodities have risen significantly, and many of these are produced in LAC. A slowdown in China could reduce demand for commodities and soften their prices, especially of metals that are heavily used in industrial production. This could weaken growth in commodity-exporting countries, including those in LAC.

Near-term effects of slowdown in China

To better understand the possible short- and medium-term effects that a slowdown in China could have on the LAC region, a simple structural vector auto regression (SVAR) model is estimated using data over 1992Q2–2014Q2 with the following

variables: rest of world's gross domestic product (GDP) growth, world interest rate (proxied by the U.S. federal funds rate), China's GDP growth, LAC's GDP growth; world trade; and commodity prices (proxied by an index of metal prices).

A slowdown in China is indeed associated with slower growth in the LAC region, which experiences a 0.6 percentage point reduction in GDP over a horizon of two years in response to a 1 percentage point reduction in China's growth. A slowdown in China, by reducing demand for commodities, also adversely affects commodity prices: they decline by as much as 5 percentage points over two years when growth in China slows by 1 percentage point. The findings related to commodities suggest that commodity markets are an important channel for the transmission of a slowdown in China to the region.

Additional models are estimated to analyze the impact of a slowdown in China on select Latin American economies: Argentina, Brazil, Colombia, Mexico, and Peru. The results indicate that a 1 percentage point decline in China's GDP tends to have a strong, statistically significant impact on Argentina, Brazil, and Peru whereas the impact on Colombia and Mexico is much weaker and not statistically significant. These results point to a complementary economic relationship between some of the largest Latin American commodity exporters and China and a potentially competitive relationship between Mexico and China for export markets, especially for manufactured goods going to the United States (Hanson, 2012).

Long term challenges and opportunities

Growth in China has slowed since 2010 and this trend is expected to continue in the long term as a rebalancing away from credit-fuelled investment toward consumption and services proceeds (World Bank, 2014f; Eichengreen et. al. 2012). Over a longer time horizon than that considered in the models here, the projected rebalancing of China's economy towards consumption and services is also likely to lower the growth of global demand for some commodities, such as copper, lead, tin and aluminum (Roache, 2012; Ahuja and Nabar, 2012; Baffes and Savescu, 2014) proportionately more than for others, such as soybeans, corn and meat (Westcott and Trostle, 2014). As a result, countries that are heavily dependent on metal exports will likely experience sharper growth headwinds than those that rely more on agricultural exports.

At the same time, structural changes underway in China's economy may provide opportunities for the region, regarding commodities, manufacturing, tradable services, and FDI (World Bank, 2014f). These include the potential increase in food prices if growing per capita incomes in China raises food demand, a potential increase in demand for services as China's population ages, improving relative competitiveness of LAC countries as Chinese labor cost rise, and possibly rising FDI from China.

Conclusions

With the slowing of China's economy likely to have negative effects on LAC economies in the short and medium term, pushing forward with reforms aimed at increasing productivity and ensuring sustainable growth, as well as raising the odds that countries in the region benefit from new opportunities that may come with structural changes in China, becomes more urgent (World Bank, 2011a). First, it is critical to consolidate the improvements in macroeconomic management achieved in the last two decades. Second, supply-side measures are needed to increase savings and enable greater investment in infrastructure (World Bank, 2014g). Third, although LAC countries have made significant advances over the last few decades in raising access to education, as measured by years of schooling, the region needs to address lags in the quality of education (Barro and Lee, 2010; Programme for International Student Assessment, 2012). Ensuring continued improvements in human capital will be critical to seizing opportunities related to trade in services. Finally, there is substantial potential to improve the business environment as LAC economies still exhibit among the longest times needed to comply with tax obligations, obtain construction permits, and start a new business (World Bank, 2014h).

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