LATIN AMERICA: Trade obstacles cut growth prospects

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Abstract

The UN Economic Commission for Latin America and the Caribbean (ECLAC) released its annual report on regional trade on October 9.

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Full Text

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SIGNIFICANCE:According to ECLAC, 2014 will be the third consecutive year in which the region's foreign trade stagnates. As well as lower commodity prices and slack demand in the EU, this reflects a sharp decline in already weak intra-regional trade.

ANALYSIS: Impacts.

In the first half of this year, LAC ran an estimated deficit on trade in goods of 8.5 billion dollars.

South America's trade performance this year will be pulled down principally by Argentina and Brazil.

Mexico and Brazil source only 7% and 4%, respectively, of their imports of parts and components from within LAC.

In its new report, Latin America and the Caribbean in the World Economy 2014, ECLAC warns that both the exports and imports of Latin America and the Caribbean (LAC) will perform poorly this year:

Exports. It estimates that the value of LAC's exports of goods dropped by 0.3% in the first half and will increase by only 0.8% over the whole year, despite an important depreciation of most regional currencies. This follows a 0.2% contraction last year to 1,122 billion dollars and just 1.6% growth in 2012, after an increase of 23.5% in 2011 (see LATIN AMERICA: Trade challenges reduce growth outlook - September 25, 2013).

Imports. ECLAC estimates that goods imports were down by 0.6% in the first half and will also contract by 0.6% full-year. This follows only 3.0% growth in both 2012 and 2013 (when they reached 1,108 billion dollars) down from a 21.7% expansion in 2011.

External factors.

Global trade is also expected to remain weak this year, with the WTO forecasting that, in volume, it will grow by just 3.1% (albeit an improvement from 2.3% in 2012 and 2.1% last year). In this context, two external factors have dampened LAC's exports:

Commodity prices.

The 0.3% first-half contraction of exports was the net result of a 5.5% reduction in prices and a 5.2% increase in volume. This, in turn, reflected lower prices for many of LAC's commodity exports, particularly mining products. As a result, ECLAC anticipates a 2.2% decrease in the value of the region's mining and oil exports over the whole year (although its total exports to China would still increase by 5.4%).

LAC's food exports would, however, show a 3.4% increase in value, despite a general drop in prices including soya. Driven by increased demand in Asia, including India as well as China, and boosted by Russian import restrictions, this would benefit particularly Paraguay and Uruguay -- which would lead export growth this year, with increases of 14.1% and 13.6%, respectively -- as well as Brazil and Argentina (where ECLAC forecasts that exports will, nonetheless, contract by 3.0% and 5.2%, respectively).

EU .

ECLAC anticipates that, in 2014, LAC's exports to the EU will contract by 0.7% as compared to the 5.4% expansion of exports to China and a 3.2% increase in sales to the United States. An estimated 0.5% drop in regional exports to the EU in the first half affected particularly El Salvador (down 20.9%), Peru (15.0%) and Paraguay (14.5%) as well as the Caribbean (6.6%). Hit also by lower mineral prices, Peru would, indeed, be the country with the largest export contraction this year (a drop of 10.6%).

Mexico and Central America.

Despite these adverse factors, Mexico and Central America would see the value of their exports rise by 5.0% and 3.9%, respectively, in 2014. This is in line with their close trading ties with the United States, with its strengthening economy, and their lesser dependence on commodity exports. Mexico's successful penetration of international markets for manufactures is illustrated by ECLAC's estimate that 23% of LAC's manufactured exports are sold within the region but, if Mexico is excluded, the figure rises to 59%.

Internal factors.

With Argentina and Brazil in or close to recession and growth slipping in most other major LAC countries (see LATIN AMERICA: Gloom deepens as ECLAC cuts outlook - August 11, 2014), lower demand within the region will, however, be the single most important factor in its lacklustre trade performance this year:

Imports from other LAC countries. According to ECLAC, these dropped by 5.2% in the first half and it anticipates a 4.8% reduction over the whole year, led by Argentina and Brazil where, in the first half, they were down by 18.8% and 10.1%, respectively. Important drops were also seen in Chile (down 8.4%) and Colombia (6.0%).

Intra-regional exports. Mirroring this, intra-regional exports would drop by 4.9% this year, affecting principally South America where the drop reached 7.4% in the first half while Central America and the Caribbean saw increases of 4.8% and 8.8%, respectively.

Structural factors.

However, according to ECLAC, two long-term features of the pattern of LAC's and, principally, South America's foreign trade render the region particularly vulnerable to cyclical swings:

Low intra-regional trade.

This accounts for only around a fifth of LAC's total exports (but closer to 30% if Mexico is excluded) as compared to around half for NAFTA (Canada, Mexico and the United States) and Asia and 60% for the EU. This, in turn, reflects the limited development of intra-regional supply chains.

ECLAC notes that intra-regional trade is more intensive than extra-regional trade in manufactured products but these correspond principally to finished products rather than intermediate goods. It estimates that the latter account for only 10% of total trade within LAC as compared to over 30% in Asia and almost 20% in NAFTA.

Limited insertion into international supply chains.

Partly as a result of this lack of regional integration, LAC's participation in international supply chains is, except for Mexico, also very low. Raw materials with little or no processing not only predominate in its exports to Asia but also in those to industrialised markets. In the case of the EU, for example, they accounted for almost 60% of total exports in 2012.

Policy recommendations.

Addressing these structural drawbacks is, according to ECLAC, crucial not only for the growth of LAC's trade but also its quality in terms of job creation, productivity, wages and, ultimately, income distribution. In this context, it urges policy measures that include increased investment in infrastructure and improved access to financing for small and mid-sized enterprises (SMEs). It also suggests that LAC multinationals or mutilatinas -- albeit still small in number -- could be harnessed to the development of intra-regional production linkages.

In South America, however, the very different trade policies of the Mercosur block and the Pacific Alliance pose an important obstacle to increased integration. ECLAC is currently preparing a study of the two groups' input-output matrices so as to identify synergies of which they could take advantage.

CONCLUSION: Many countries are increasingly looking to industrial policy -- for example, development of clusters and selective attraction of foreign direct investment -- as a means to mitigate dependence on commodity exports. The extent to which this leads to the development of intra-regional supply chains as a stepping stone towards greater integration into extra-regional chains will, however, depend on overcoming obstacles including infrastructure deficits and important differences in trade policy, particularly in South America.

Details

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