LATIN AMERICA: Waning growth may raise protest risks

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Abstract

The declining outlook for regional growth.

In updated forecasts released on April 29, the UN Economic Commission for Latin America and the Caribbean (ECLAC) anticipates that, despite the expected upturn in the international economy, the region's growth will not increase significantly this year.

Full text

SUBJECT:The declining outlook for regional growth.

SIGNIFICANCE:In updated forecasts released on April 29, the UN Economic Commission for Latin America and the Caribbean (ECLAC) anticipates that, despite the expected upturn in the international economy, the region's growth will not increase significantly this year.

ANALYSIS: Impacts.

External factors will make a lesser contribution to LAC's growth in 2014 than initially hoped.

Seven of ten South American countries analysed will probably see a drop in growth this year.

Improved growth in industrialised countries may benefit the Caribbean, heavily dependent on tourism.

In December, ECLAC anticipated that GDP growth in Latin America and the Caribbean (LAC) would accelerate to 3.2% this year, up from 2.5% in 2013 (see LATIN AMERICA: Modest growth on the cards next year - December 16, 2013). However, in its new report, it forecasts an expansion of only 2.7%, with the reduction reflecting both external factors and, for varying reasons, a downgrade in the outlook for the region's largest economies.

External context.

ECLAC expects global growth to pick up this year, led by the industrialised countries which, according to the IMF, will expand by 2.2%, up from 1.3% last year. Nonetheless, ECLAC attributes the reduction in its forecast for LAC's growth partly to external factors:

China.According to ECLAC, China is the single most important risk factor for LAC's growth this year. The report warns that further insolvency in China's financial system or a deceleration of growth to below 7.0%, down from 7.7% in 2013, would hit South American commodity exporters particularly hard.

Financing conditions.The expected ongoing tapering of monetary stimulus by the US Federal Reserve and improved economic performance of industrialised economies would, as already seen in 2013, mean a shift in capital flows away from emerging economies, including LAC. Countries with a high foreign debt/GDP ratio, principally in Central America and the Caribbean, would be most vulnerable to tighter external financing conditions.

Country downgrades.

	2011	2012	2013	2014*	2014**
Argentina	8.9	1.9	3.0	2.6	1.0
Bolivia	5.2	5.2	6.8	5.5	5.5
Brazil	2.7	1.0	2.3	2.6	2.3
Chile	5.9	5.6	4.1	4.0	3.7
Colombia	6.6	4.2	4.3	4.5	4.5
Ecuador	7.8	5.1	4.5	4.5	5.0
Paraguay	4.3	-1.2	13.6	4.5	4.5
Peru	6.9	6.3	5.6	5.5	5.5
Uruguay	6.5	3.9	4.4	3.5	3.5
Venezuela	4.2	5.6	1.3	1.0	-0.5
Mexico	3.9	3.9	1.1	3.5	3.0
Caribbean	0.5	1.2	1.2	2.1	2.1
LAC	4.3	3.1	2.5	3.2	2.7

GDP growth in selected Latin American countries (%)
*Forecast December 2013, **Forecast April 2014
Source: ECLAC

However, much of the reduction in ECLAC's forecast can be attributed to the region's three largest economies:

Argentina.In the largest single reduction, ECLAC cut its forecast for Argentina, LAC's third largest economy, from 2.6% to 1.0%. This would represent a sharp deceleration from 3.0% in 2013 (a figure itself widely questioned as an under-estimate, designed to avoid making payments on GDP-linked coupons triggered when growth exceeds 3.22%). However, it also reflects devaluation of the peso and an increase in interest rates in a bid to stem higher inflation expectations (see ARGENTINA: Policy shifts compound economic uncertainty - January 27, 2014).

Brazil.ECLAC now expects LAC's largest economy to expand by 2.3% this year, down from an earlier forecast of 2.6% (but still well above the IMF's forecast of 1.8%). This would be the fourth consecutive year in which Brazil has grown below the regional average. Unlike some countries, such as Chile, which have eased monetary policy in response to slower growth, Brazil has raised interest rates in a bid to rein in inflation which, boosted by currency depreciation, remains close to the upper limit of the Central Bank's 2.5-6.5% target range. Brazil's export mix also renders it vulnerable to China's performance.

Mexico.Despite expected spillover from stronger US growth, ECLAC has reduced its forecast for Mexico's growth this year from 3.5% to 3.0% (still an important recovery from 1.1% in 2013). This follows a contraction of investment last year. However, structural reforms, principally in energy and telecommunications, should strengthen growth in the medium term (see MEXICO: Growth will be tepid until reforms are passed - May 2, 2014).

Other reductions in forecasts include the following:

Venezuela.With a cut in its growth forecast from 1.0% to -0.5%, Venezuela is the only country for which ECLAC anticipates a contraction. This reflects a complex situation including high inflation (which reached an annualised

59% in March), shortages of foreign exchange and basic consumer goods, a large gap between the official and market exchange rates and lack of confidence in the government's economic management (see VENEZUELA: Economic plans will not halt deterioration - April 25, 2014).

Chile. In line with a sharp downturn in investment and extreme dependence on commodity exports to China (see CHILE/PERU: Copper price exposure creates risks - April 2, 2014), ECLAC reduced its forecast for Chile's growth this year from 4.0% to 3.7%; local private-sector forecasts currently suggest a rate closer to 3.0%.

Trade variables.

Given that international growth will be driven principally by industrialised countries which are less intensive in demand for primary products, most commodity prices are likely to decline further in 2014. As a result, ECLAC anticipates that, on average, the region's terms of trade will worsen by around 1.0%, after dropping by 1.8% last year. However, there would be important differences between countries, with South America hardest hit while Mexico, with its higher proportion of manufactured exports, would see little change and Central American and Caribbean countries, as net food importers, would see a small gain.

ECLAC expects that the region's exports will stagnate for a second consecutive year, with a slight increase in volume offsetting the impact of lower commodity prices (but with important variations between China-geared economies and Mexico and Central America, with their greater US focus). As a result, it anticipates that LAC's current account deficit (2.6% of GDP in 2013, up from 1.8% in 2012) will continue to widen. A number of factors, including tighter global liquidity and lower commodity prices, also suggest a reduction of foreign direct investment which, in recent years, has been key in financing the region's current account deficits.

Domestic effects.

A pick-up of growth in industrialised countries, particularly the United States, and the latter's ongoing withdrawal of monetary stimulus suggest that, in a trend which began last year, many LAC currencies will continue to depreciate against the dollar. Currency depreciation would, in turn, create inflationary pressures and ECLAC notes that, as of February, regional twelve-monthly inflation was running at 7.6%, up from 7.3% in December (and 5.6% in December 2012). However, in many countries, these pressures will be contained by slower growth.

Fiscal accounts .

In 2013, LAC's fiscal deficit held steady at 2.5% of GDP but ECLAC anticipates that pressure on fiscal accounts will increase this year, particularly for South American commodity exporters. Given mounting demand for better-quality public services, this suggests that tax increases -- as currently being debated in Chile (see CHILE: Tax reform makes swift progress - April 24, 2014) -- may figure on the political agenda.

Employment .

Job creation lost momentum last year and, with GDP growth virtually stagnating, this trend is likely to persist. Moreover, higher inflation would dent real wage growth; household consumption, although remaining a key driver of GDP growth, would thus also continue to lose dynamism.

CONCLUSION: This year monetary authorities in many countries will be walking a tightrope between slower growth and currency depreciation, with the consequent risk of higher inflation. However, their governments will face the broader challenge -- likely to be a key political issue -- of balancing a slowdown in fiscal revenues against mounting public demand for better-quality government services and growing impatience with high income inequality.

Details

Subject	Economic conditions; Agriculture; Employment; Foreign exchange rates; Fiscal policy; Foreign investment; International trade; Economic growth; Mining industry; Public policy; Prices; Commodities
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