

Latin America: Recent Performance and main challenges

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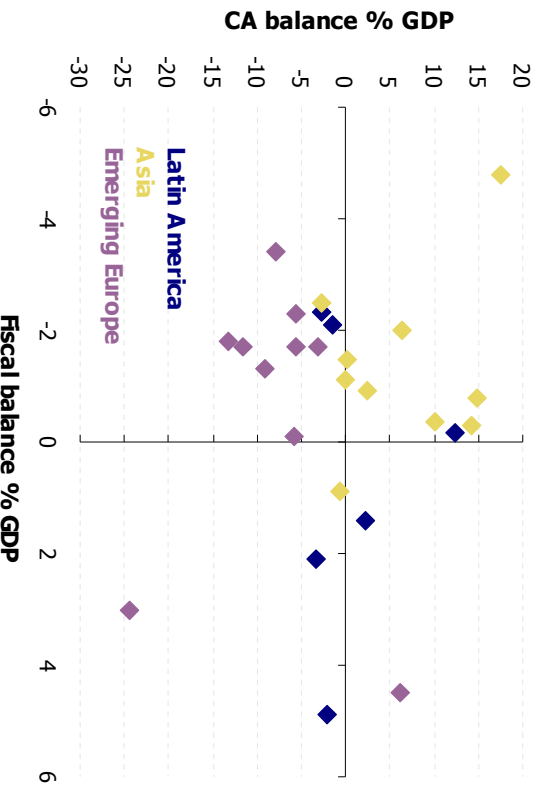
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Main messages

- The economic performance of LATAM during the Global Recession is a clear break from the past, reflects the structural changes of economic reforms and will have long lasting effects on country risks
- Better initial conditions – due to a good management of previous bonanza – allowed for effective counter - cyclical policies and a quick return to economic growth
- Sound financial systems and effective responses by monetary authorities helped the region to resist the liquidity squeeze and there has been no bank bailouts.
- Looking forward we expect the region to resume growth, but it will have to switch from labor intensive growth to one more intensive in capital accumulation and productivity enhancement
- Notwithstanding the previous improvements, the region still faces substantial institutional shortcomings: education, low financial development and the business environment are among the most important.

- Recent Economic Performance: a break from the past
- The Crisis: better initial conditions
- The Financial Sector: a break from the past
- Better fundamentals allowed for better policy reactions
- Exchange flexibility and price stability
- The recovery is underway

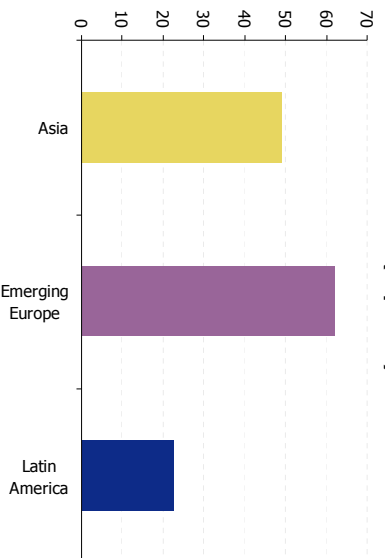
Fiscal and CA Balance % GDP (2008)



Source: WEO

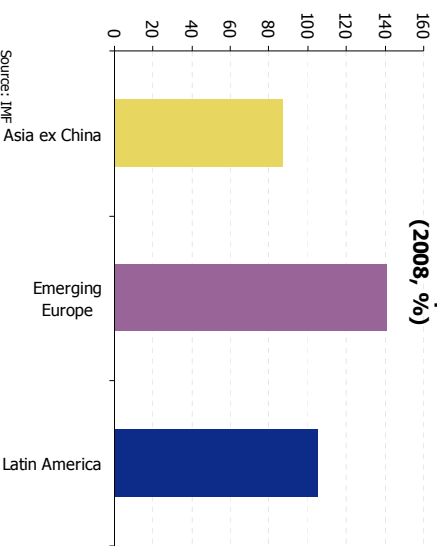
- Greater concern over macroeconomic orthodoxy led the region to show low fiscal and current account deficits prior to the crisis.
- This was a source of differentiation not only with the past, but from other emerging countries as well.

**Total Foreign Liabilities as % of GDP
(Sep. 2008)**



Source: BIS (Consolidated claims of reporting banks-immediate borrower basis) and BBVA.

**Loans to Deposits
(2008, %)**

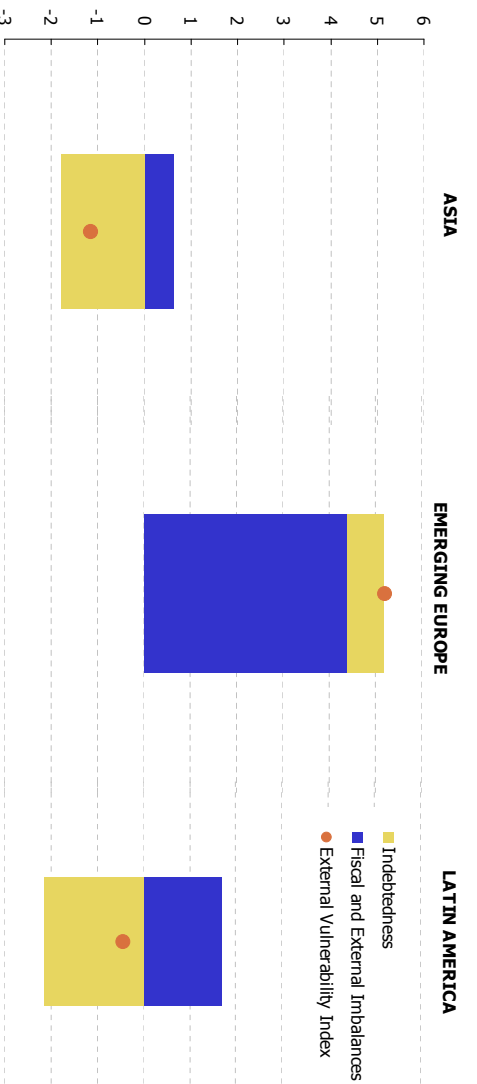


Source: IMF

- Improvements reached external indebtedness patterns: most countries took advantage of the commodity prices windfall to increase reserves and reduce foreign liabilities, in a clear departure from previous practices.

- The banking system had suffered in previous crisis in the 80s and 90s, and they had been reformed and supervision was strengthened.
- Domestic credit growth in the “good years” was financed mostly through expansion in bank deposits.

BBVA EXTERNAL VULNERABILITY INDEX



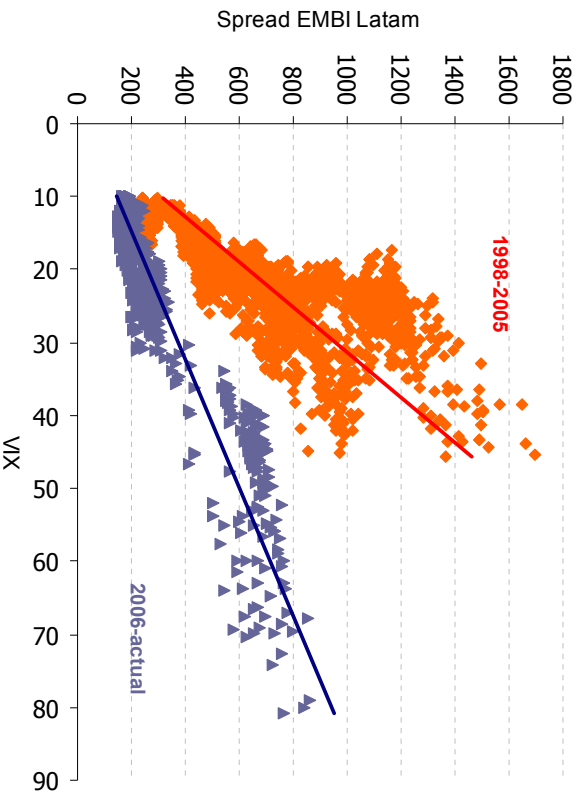
External Vulnerability Index of BBVA includes (1) **Indebtedness** (2) Debt as % of GDP (b) Growth in debt and (c) Short Term Debt as % of reserves and (2) **Fiscal and External Imbalances** (a) Current Account as % of GDP (b) Fiscal Balance as % of GDP and (c) Growth Export. Update: Dec. 2008.

The index ranges from -10 to 10, with greater values reflecting greater vulnerability.

- In all, Latin America arrived to the crisis with a reduced degree of external vulnerability, particularly from a much better indebtedness profile.

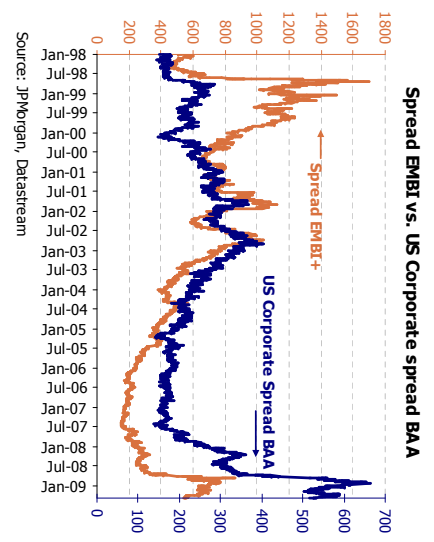
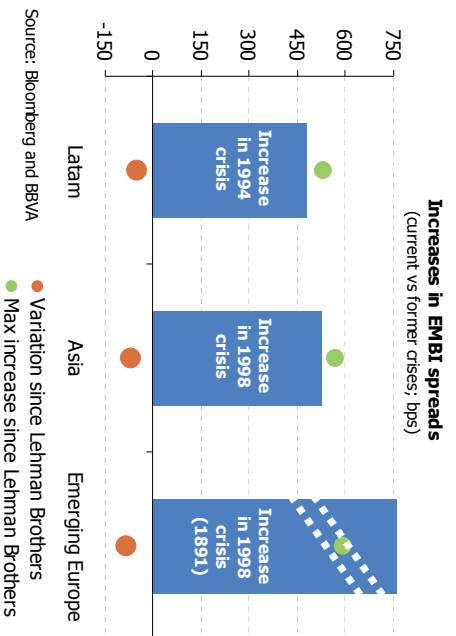
- Financial markets have recognized this new reality in Latin America

Global Risk Aversion and EMBI+



- This time, the impact of volatility in global markets on Risk Premiums for LATAM was far more limited than in previous events.

- Financial markets have recognized this new reality in Latin America

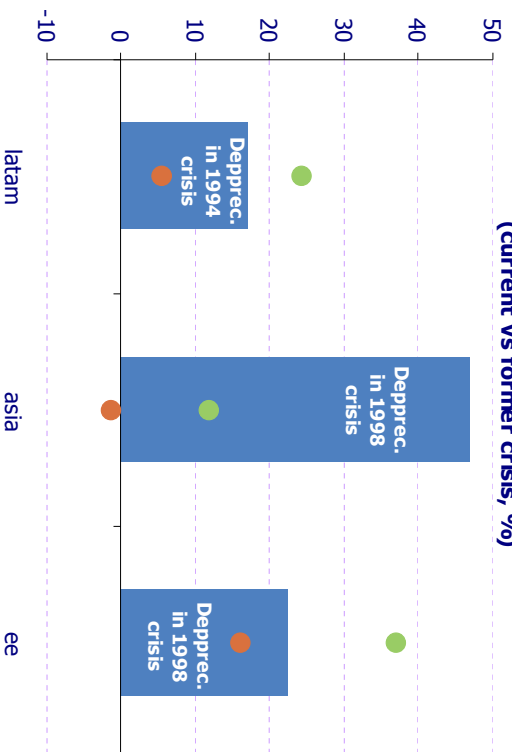


Source: JP Morgan, Datastream

- EMBI spreads rose during the crisis, but far less than in previous episodes
- This time, the changes were similar to those in Emerging Asia, and far more limited than in Emerging Europe.

- Another dimension of this more contained increase in Latam risk is through the comparison with corporate US spreads. This is a major departure from the Asian Crisis.

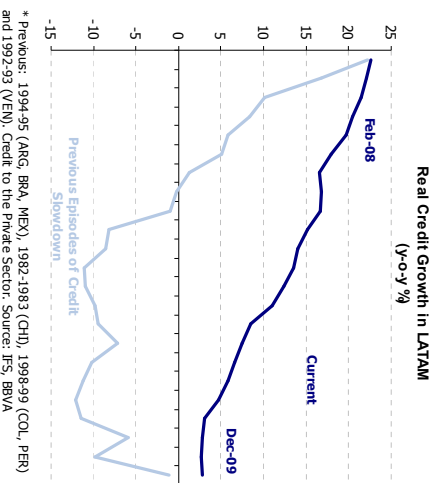
Exchange Rate Variations (current vs former crisis, %)



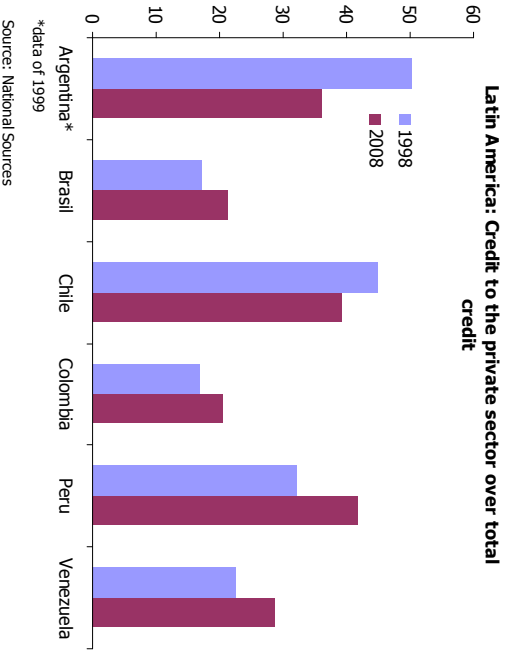
Source: Bloomberg and BBVA

- Variation since Lehman Brothers
- Max. Depreciation since Lehman Brothers

- Just as in the case of risk proxies, LATAM Currencies soon reverted their post-Lehman maximum depreciation, to from previous crisis.
- This was a temporary phenomenon, and a little bit after a year, currencies were back to pre-crisis levels in LATAM.

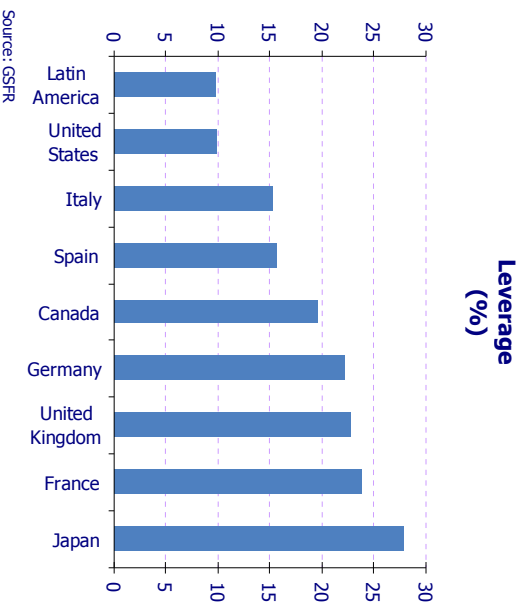


* Previous: 1994-95 (ARG, BQA, MEX), 1982-1983 (CHI), 1998-99 (COL, PER) and 1992-93 (VEN). Credit to the Private Sector. Source: IFS, BBVA

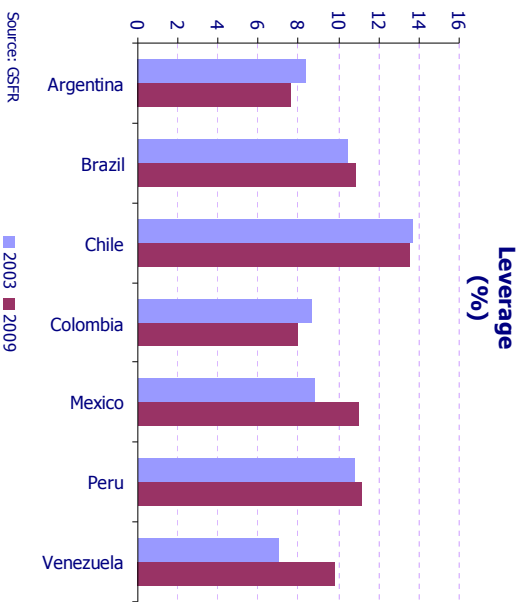


*data of 1999
Source: National Sources

The banking sector has also been more resilient: Loans to the private sector, for example, declined but much less than in other crisis episodes. Credit to the private sector expanded significantly in the years before the crisis.

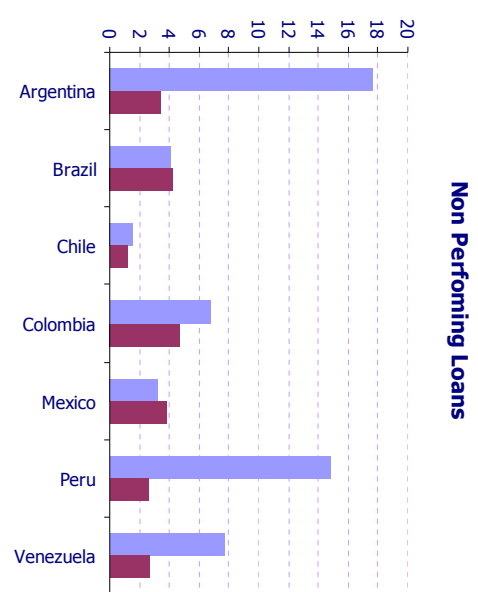


Source: GSFR



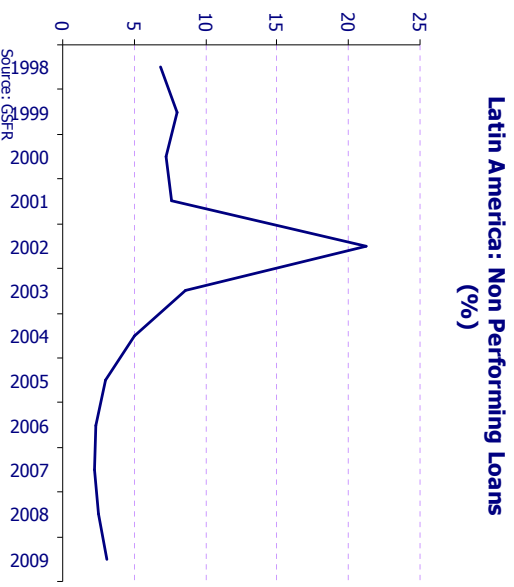
Source: GSFR

Leverage levels, which were one of the main problems in developed countries, remained under control in Latin America. In many Latin American countries, leverage ratios declined in the last expansive cycle despite the solid credit expansion.



Source: GSFR

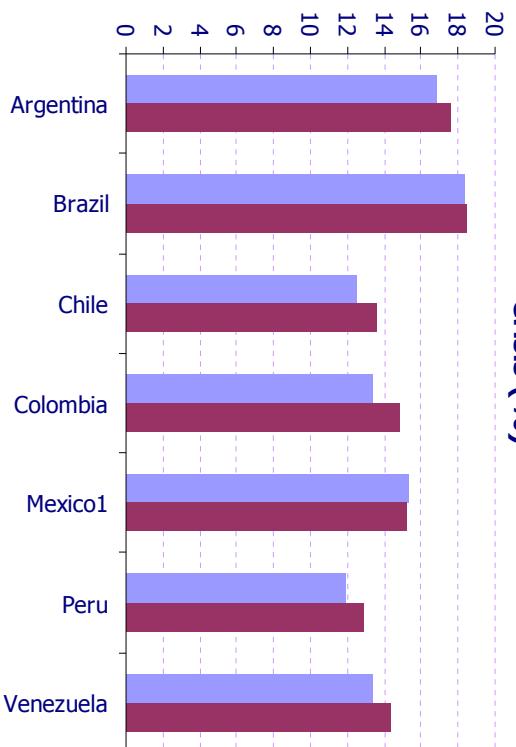
■ 2003 ■ 2009



Source: GSFR

Another sign of stability: in all countries in the region, Non-performing loans (NPLs) are now lower than in the past.

Capitalization: Before and After the Crisis (%)

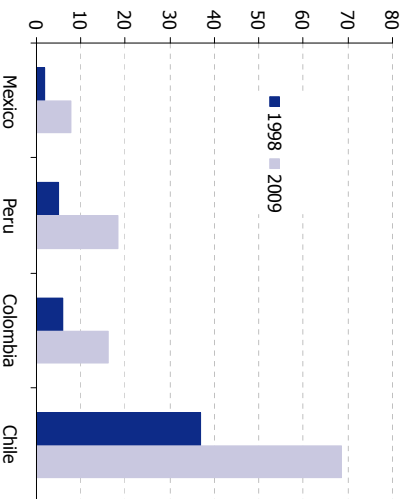


- All of the above in the context of banking sectors characterized by well-capitalized institutions (risk-adjusted ratios far higher than international standards), higher provisions, better risk management, and stricter regulation and supervision.
- There have not been major bank failures or rescue operations involving public money in the region.

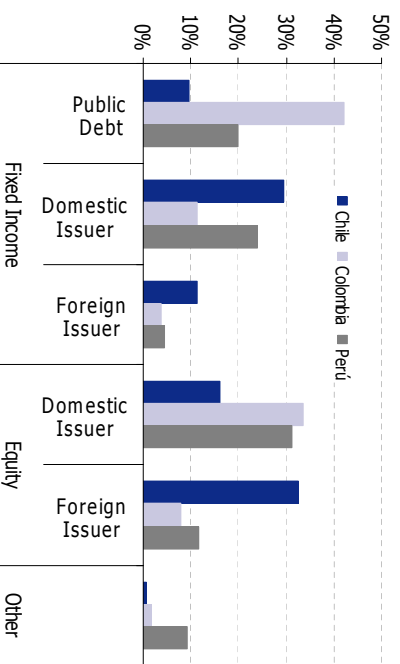
Source: GSFR

■ 2008 ■ 2009

Pensions Funds Value: 1998 y 2009 (percentage of GDP)



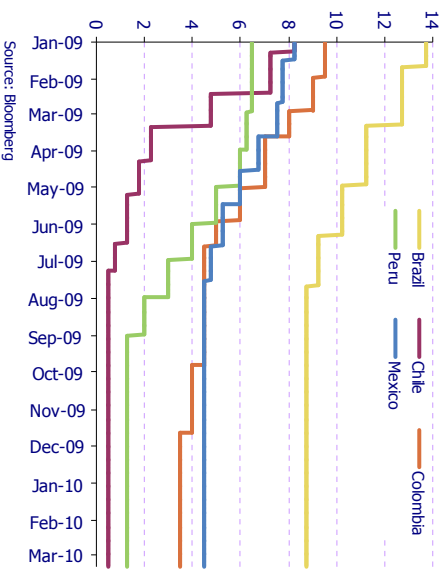
Colombia, Chile and Peru: Pensions Funds Investments



Source: Superintendencia Financiera de Colombia y Superintendencia de pensiones de Chile

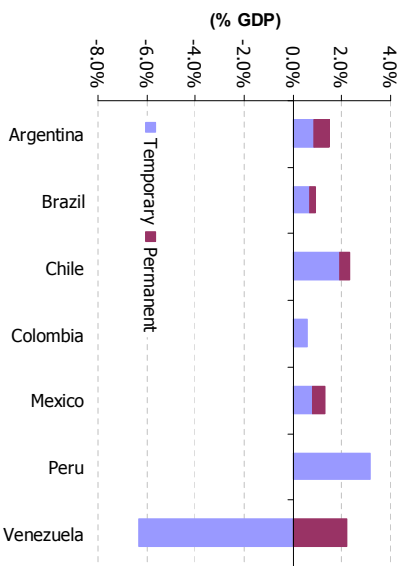
- Reformed pension funds have accumulated large financial assets.
- Even though some of them show an excessive concentration in public debt, several of them providing significant long and medium term funding in local currency to banks and corporations.
- During 2009 bond purchases by Pension Funds helped replace lost short-term funding from banks.

Latin America: Interest Rate (%)



Source: Bloomberg

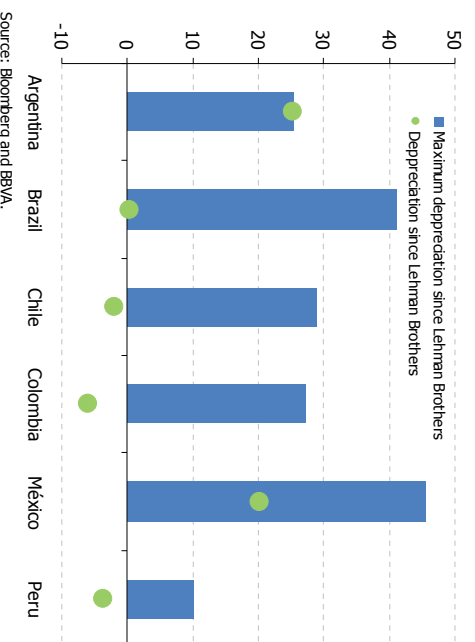
Latin America: Composition of the 2009 fiscal stimulus



Source: BBVA

- Central Banks following inflation targets have gained a lot of credibility
- This allowed them to cut interest rates fast and deep.
- Interest rates stand now at record low levels, and they are expected to remain low one or two additional quarters.

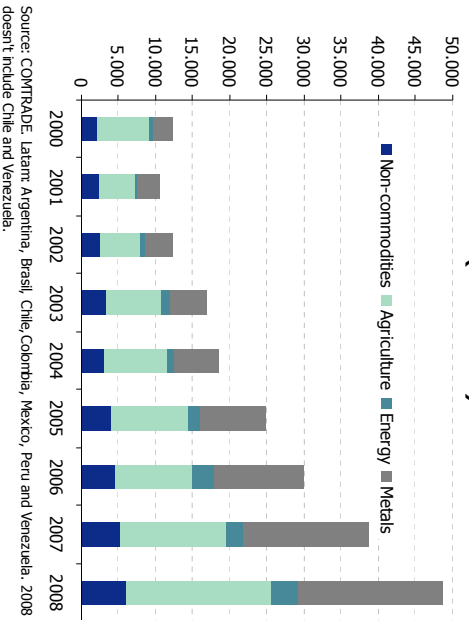
Exchange Rate (% variation since Lehman Brothers)



Source: Bloomberg and BBVA.

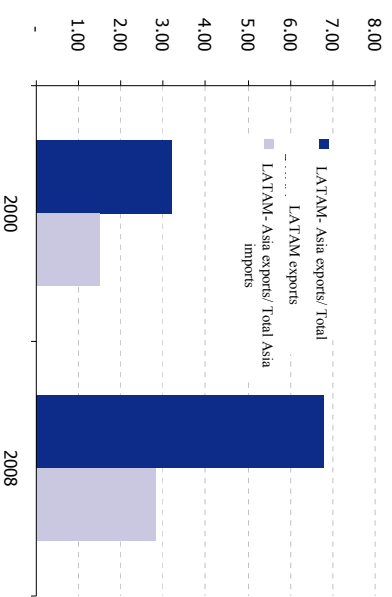
- during previous crises, Central Banks were committed to defend a fixed or quasi-fixed parity to keep inflation under control. This time they were not limited by this commitment and allowed currencies to float.
- After the initial depreciations, currencies were back to pre-crisis levels, while inflation moved down in response to the new environment.

Total Exports from Latam to Asia*
(USD billions)



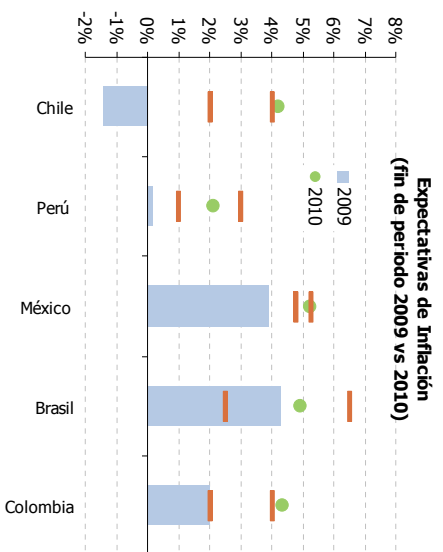
Source: COMTRADE. Latam: Argentina, Brasil, Chile, Colombia, Mexico, Peru and Venezuela. 2008 doesn't include Chile and Venezuela.

Latin America and Asia: Exports weight

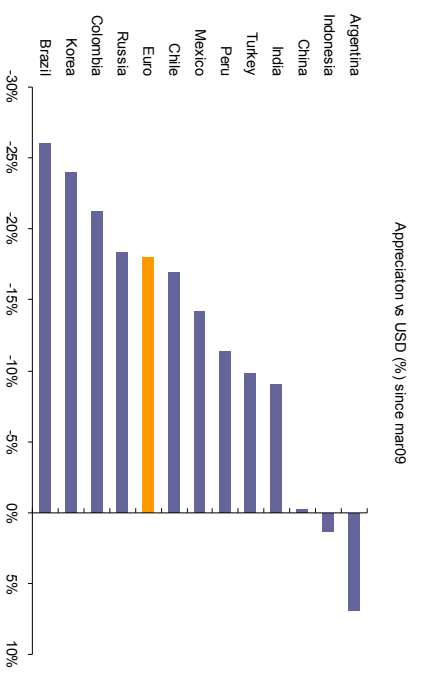


Source: BBVA ERD based on COMTRADE data

In addition to benefiting from high commodity prices, the region has also benefited from the complementarity of its trade with Asia



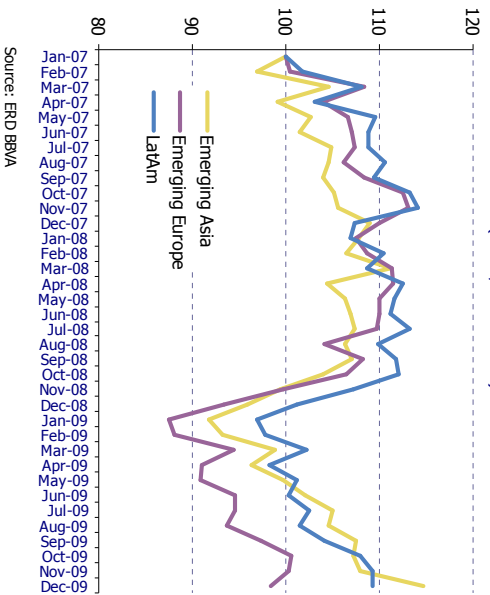
Fuente: BBVA. Las líneas rojas definen los objetivos del Banco Central para 2010



- Despite exchange rate fluctuations, inflation has remained for the most part under control in “Inflation Targeting” Countries, allowing for the continuation of the monetary stimulus.
- As growth accelerates, price pressure will mount, although it will remain within CB objectives. This will also lead to the gradual withdrawal of the monetary stimulus.
- A new challenge concerning economic competitiveness emerges: exchange rates will be under pressure and governments and business will have to look for other sources of competitiveness.

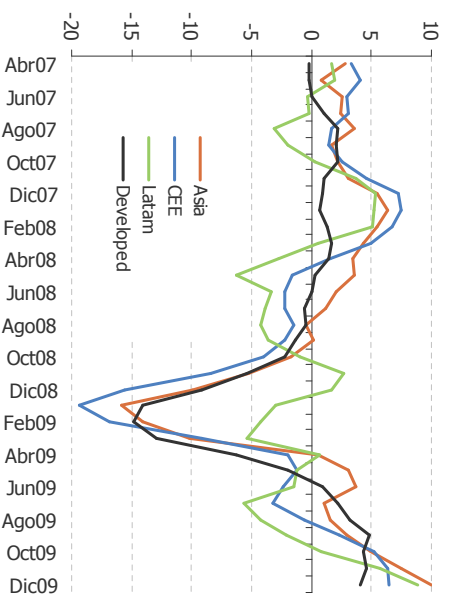
Emerging Economies: Industrial Production

(Index: Jan-07=100)



Source: ERD BBVA

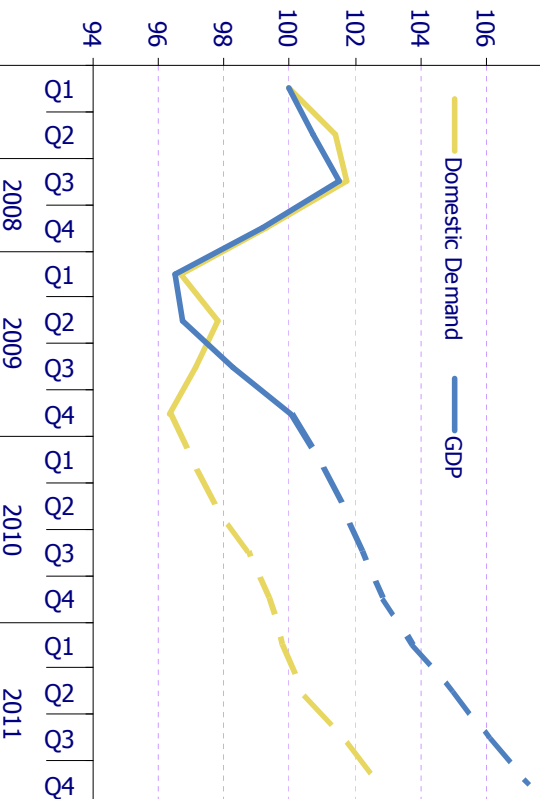
Export volume (% q/q change over 3-month avg.)



•As confidence came back – helped for an early recovery in commodity prices – industrial production and domestic demand reacted.

•The “Chinese connection” has been very important both for the recovery of the volume and value of exports.

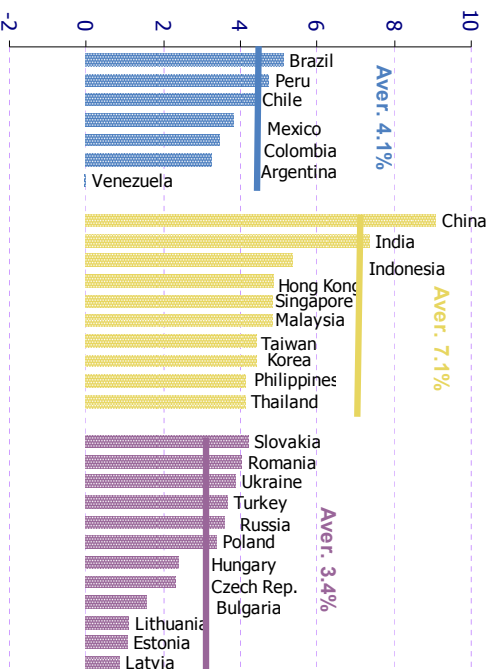
Latin America: Evolution of GDP and Domestic Demand (S.a.) (qoq, Q12008=100)



Source: ERD BBVA

•The initial expansion in domestic demand has been heavily dependent on fiscal stimulus, but as confidence returns and employment recovers, there are good reasons to expect that private demand will take the lead in the coming months.

GDP 2010-2012 average forecast (% y/y)



Source: WB, IMF, Bloomberg and BBVA

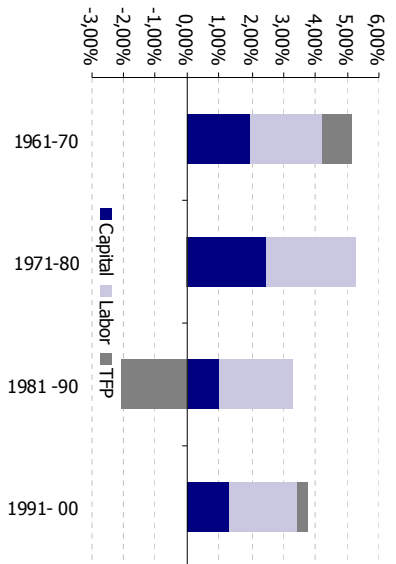
- One major challenge for the region will be to improve past performance and accelerate growth to close the gap with the Developed Countries.
- Economic links with Asia will help, but there is a danger that it might make the region more dependent on natural resources.

- Recent Economic Performance: a break from the past
 - The Crisis: better initial conditions
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• Main Challenges for the future

- Labor – intensive growth
- Demographics and the labor market
- Informality and growth
- Investment must rise
- Pension Reform and Capital Investment

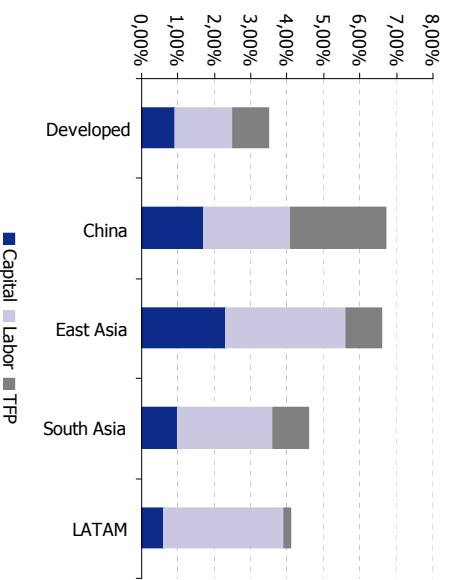
Sources of Growth for Latin America



Source: Catterton, Loayza and Fajnzylber

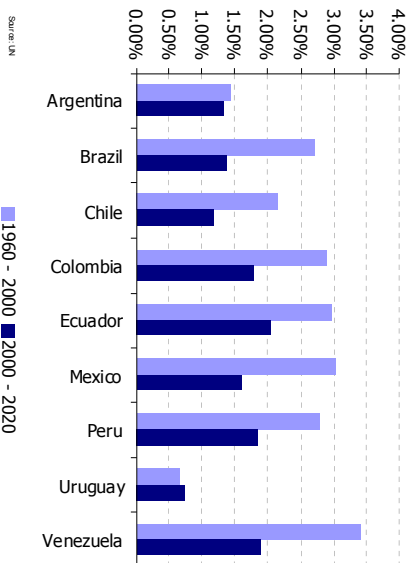
- Over the last 50 years, the growth of labor input has been the main contributor to GDP growth in LATAM
- Productivity contribution has been low and volatile.

Sources of GDP growth 1960-2000



- When comparing to other regions, LATAM has relied too much on labor input.
- The contribution of Productivity has been the lowest among the regions compared.
- The same is true for the contribution of capital.

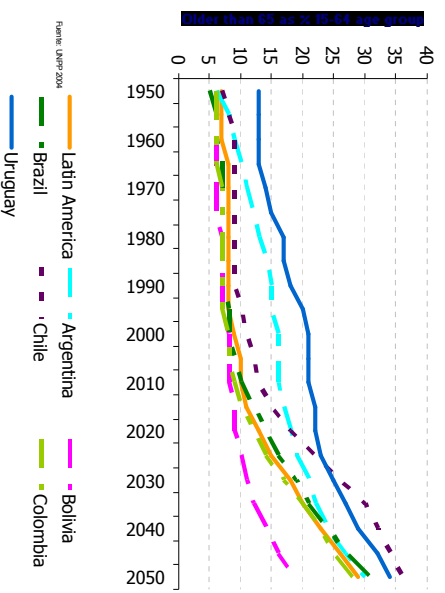
Annual growth rates of Working Age Population



Source: IZA

- The slowdown in population growth means that labor input will not grow as fast in the future as in the recent past.
- In order to keep high rates of growth, more investment, innovation and efficiency gains will be needed.

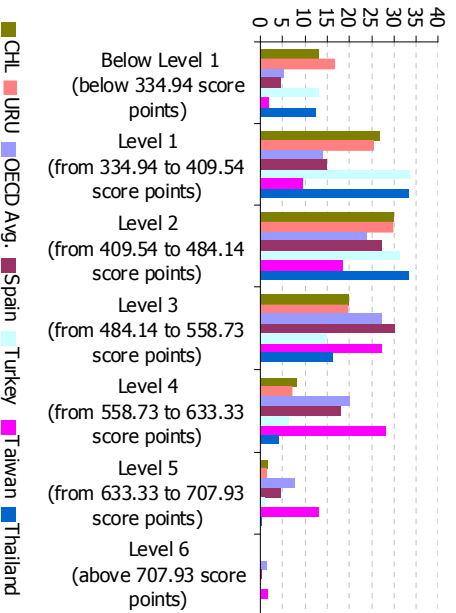
Old Age Dependency Ratios



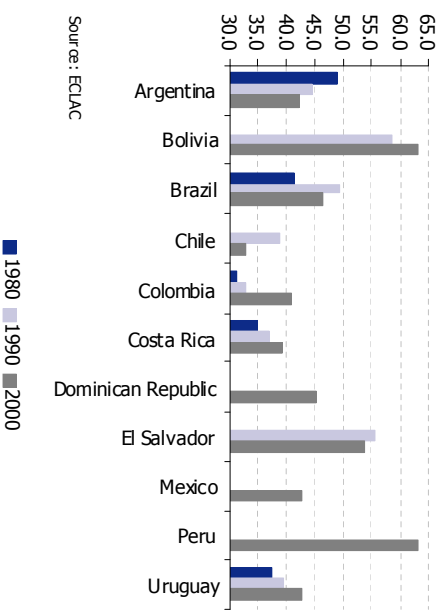
Source: IZA/IFSA 2010

- Ageing populations will also pose major challenges for these countries.
- Lower labor force growth
- Rising demand for social protection for the elderly (health and pensions)
- Informality erodes coverage of the Social Security System

PISA Scores, Science, 2006. Best LATAM and reference countries



Urban Informality rates

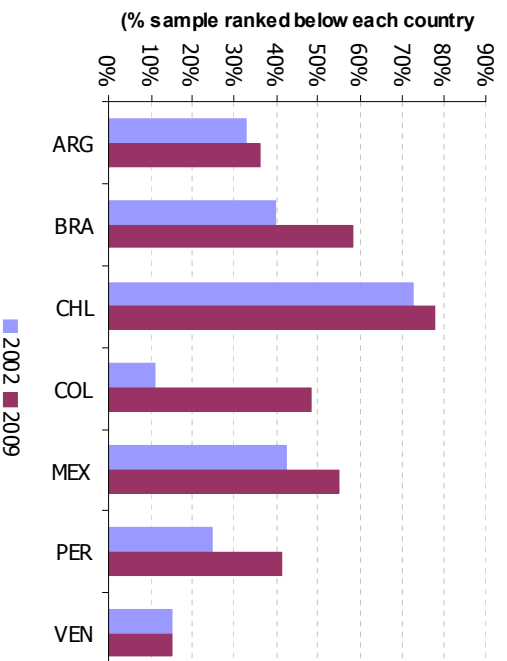


Source: ECLAC

- In order to increase labor productivity, workers need more capital.
- But those workers must be more skilled
- Even though coverage of formal education has risen, the quality is still very poor. The best in LATAM do as bad as the worst in the OECD

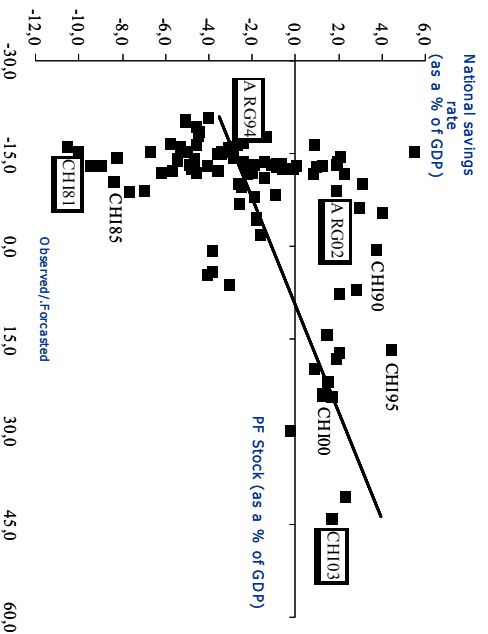
- Labor informality is a major problem
- It is partly due to over-regulation in labor markets
- But it also related to informality in other areas (taxes, etc.)
- Better business climate is critical to reduce informality.

Global Competitiveness Index (WEF)

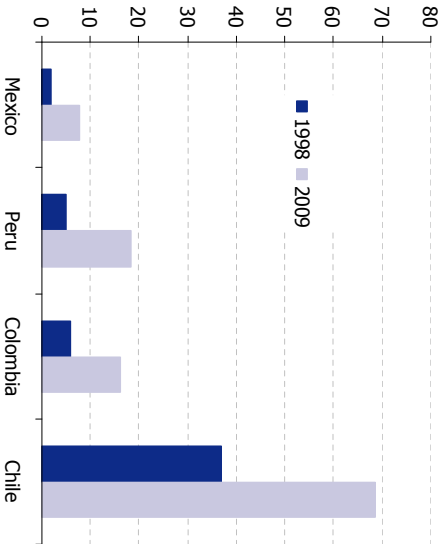


- LATAM has generally performed poorly in these rankings.
- However there has been an improvement in the last decade, largely through improvements on the macroeconomic front, as well as financial development.
- It is less clear in the area of institutional performance, innovation and regulation.

Pension funds and savings ratios



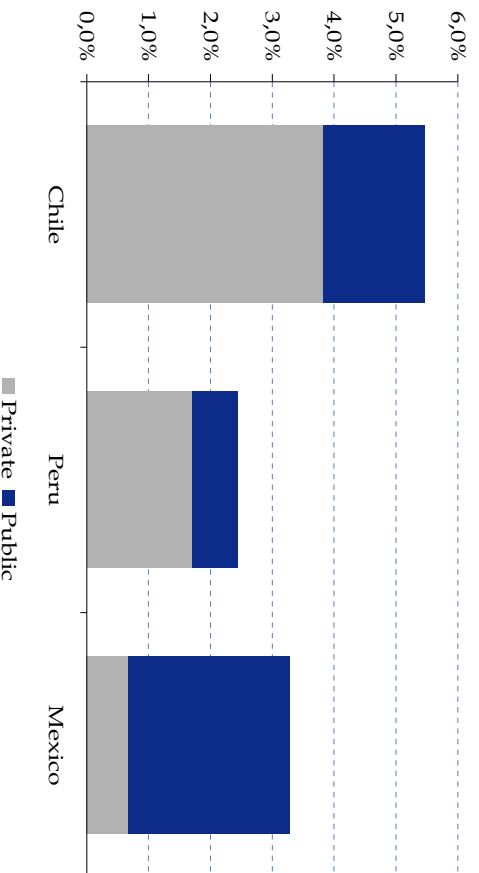
Pensions Funds Value: 1998 y 2009 (porcentaje de GDP)



- Evidence shows that private pension funds have increased savings ratios in LATAM

- They have risen fast and are becoming a major source of long-term finance for local banks, corporations and have also played a key role in financing infrastructure build under private concessions.

Infrastructure investment over GDP in Chile, Mexico and Peru, around 2000



Source: World Bank, official sources and BBVA

- Concessions supported by pension funds financing – as well as other sources – have proven very effective tools to close the gap with other regions, especially in Chile, where the institutional framework was developed earlier.

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