Latin America and the US shock

Juan Ruiz

Revista G de Gestión (Peru)

There is still much uncertainty about the new economic policies that will eventually be implemented in the US, with three dimensions particularly relevant for Latin America: changes in policies on trade, immigration and remittances.

However, this uncertainty does not affect all of Latin America equally. Mexico is the most affected in view of the close links with the US, with sharp losses in Mexican asset prices and significant depreciation of its currency, which pushes up inflation, and slowing investment. Moreover, household and business confidence indicators have plummeted to all-time lows.

In the South America the panorama is very different. The financial centres have now more than recovered the post-election losses, doubtless helped by the increase in commodity prices. Also, confidence has started to recover, although in general it is still at pessimistic levels, except in Peru, where optimism has returned.

This differing response to uncertainty about US policies will mark the divergence in the growth dynamic of the two regions. Both South America and Mexico will grow by 1% in 2017, but in South America this represents a turning point after three years of slowdown and GDP contraction of 1.4% in 2016. In Mexico, the negative impact on investment, combined with a more restrictive monetary policy, will lead to a slowdown in economic activity in 2017, from a growth rate of around 2.3% over the past three years. This will be a temporary dip, since we anticipate that both regions will grow by around 1.7% in 2018, which is still weak compared with their potential, which is closer to 3%.

And in Peru? The growth driver will swing between mining and investment in infrastructure from this year on. In any case, this year and next it will continue to post the highest growth rates (3.5% and 3.6%) of the major Latin American countries.

Thus there will be a marked difference in dynamism between the north and the south of the region: recovery in South America in 2017, but slowdown in Mexico. All the same, the risks surrounding this regional forecast are still tilted downwards. As well as the risks associated with future US policies and the rate of slowdown in China, on the domestic front we have the political noise (amplified by ongoing investigations of corruption in several countries) and the long-term risk of failure to re-launch the process of reforms to boost productivity.

Even so, it is important to highlight the fact that, as in the case of the global crisis of 2008-9, the region now has two cushions that are working well against external shocks. The first is the exchange rate: currencies will continue to weaken against the dollar without causing significant harm to households' or businesses' assets. The second one is a solid, well capitalised and regulated financial system, which rather than multiplying the impact of the external shock, will soften it. In both cases, a very different situation from what we witnessed in the crises that affected the region in the 1980s.