



*Regional Economic Outlook:  
Western Hemisphere  
April 2017*

# **Tale of Two Adjustments**

*The Outlook for  
Latin America and the Caribbean*

Port of Spain, Trinidad and Tobago | June 14, 2017



# Presentation Outline

- Outlook and Risks
- Tale of Two Adjustments
  - *Act I*      Fiscal
  - *Act II*     External
- Policies

## **Outlook and Risks**



# A more favorable global growth environment

*(Output growth rate projections)*



**World      Advanced economies      USA      United Kingdom      Japan      Euro Area      EMDE      China      India      Brazil      Russia**

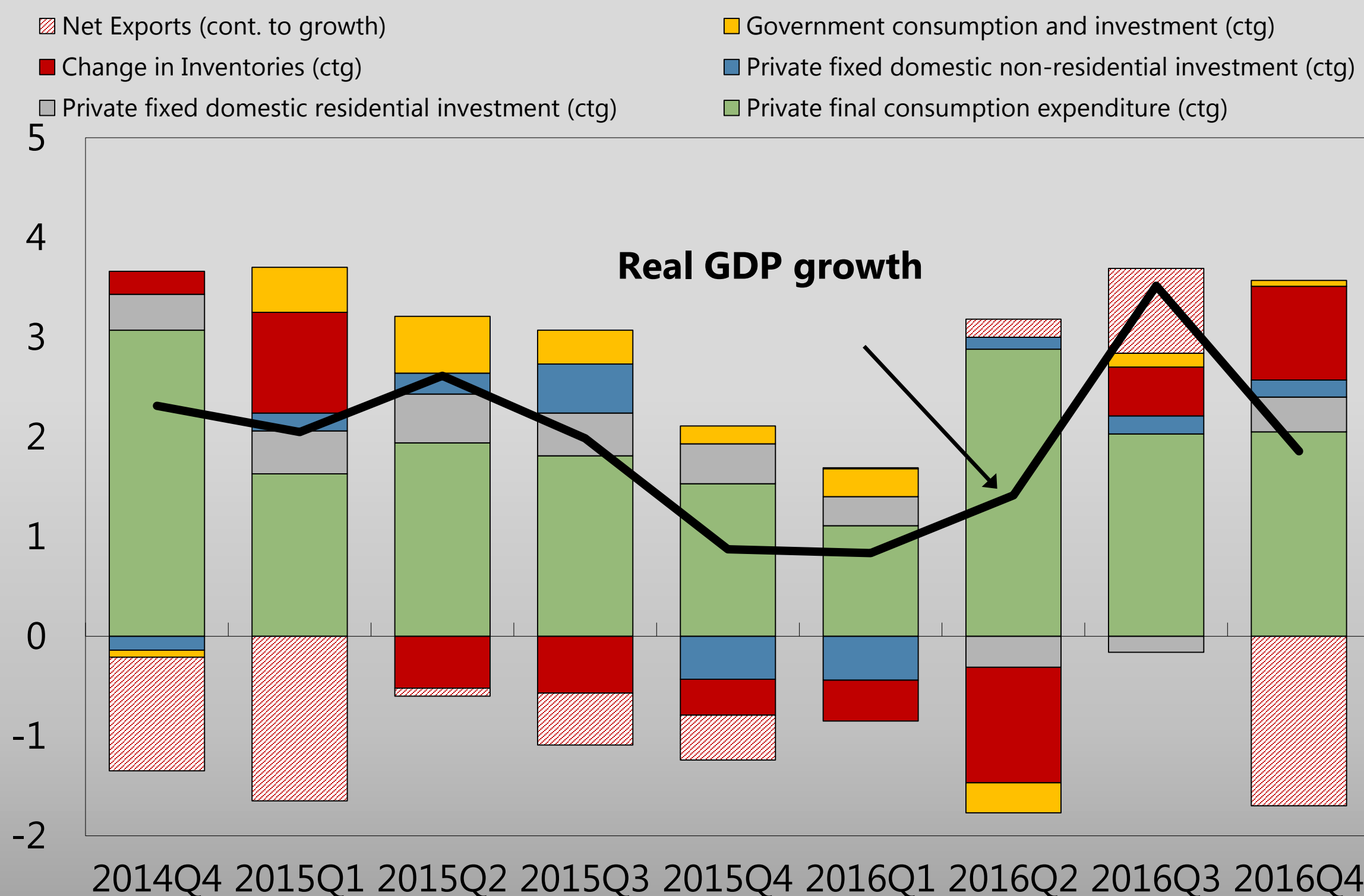
<b>2003–07</b>	<b>5.1</b>	<b>2.7</b>	<b>2.9</b>	<b>2.8</b>	<b>1.7</b>	<b>2.2</b>	<b>7.7</b>	<b>11.7</b>	<b>8.8</b>	<b>4.0</b>	<b>7.5</b>
<b>2010</b>	<b>5.4</b>	<b>3.1</b>	<b>2.5</b>	<b>1.9</b>	<b>4.2</b>	<b>2.1</b>	<b>7.5</b>	<b>10.6</b>	<b>10.3</b>	<b>7.5</b>	<b>4.5</b>
<b>2016</b>	<b>3.1</b>	<b>1.7</b>	<b>1.6</b>	<b>1.8</b>	<b>1.0</b>	<b>1.7</b>	<b>4.1</b>	<b>6.7</b>	<b>6.8</b>	<b>-3.6</b>	<b>-0.2</b>
<b>2017</b>	<b>3.5</b>	<b>2.0</b>	<b>2.3</b>	<b>1.5</b>	<b>1.2</b>	<b>1.7</b>	<b>4.5</b>	<b>6.6</b>	<b>7.2</b>	<b>0.2</b>	<b>1.4</b>
<b>2018</b>	<b>3.6</b>	<b>2.0</b>	<b>2.5</b>	<b>1.4</b>	<b>0.6</b>	<b>1.6</b>	<b>4.8</b>	<b>6.2</b>	<b>7.7</b>	<b>1.7</b>	<b>1.4</b>

Source: IMF, *World Economic Outlook* April 2017.



# United States: Following a few quarters of weak growth, the economy has started to recover

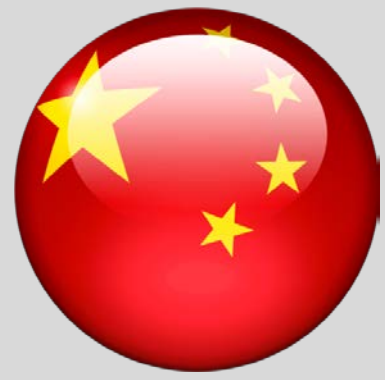
**Contributions to GDP growth**  
(Annual percentage change)



**Selected Economic Indicators**

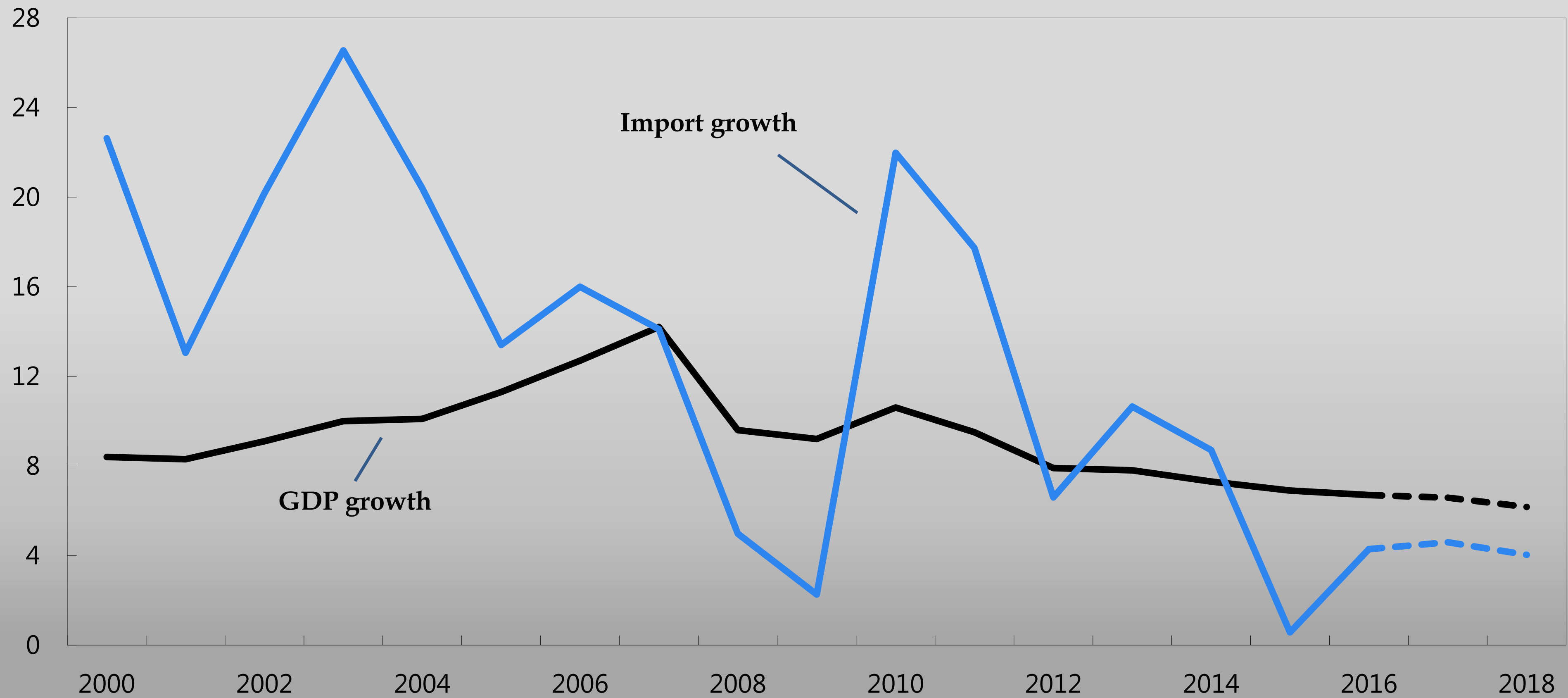
	2016	Proy. 2017	Proy. 2018
<b>April 2017</b>			
GDP growth (annual percentage change)	1.6	2.3	2.5
Current account (percent of GDP)	-2.6	-2.7	-3.3
Core inflation (Annualized, percent)	1.7	1.8	2.1
<b>October 2016</b>			
GDP growth (annual percentage change)	1.6	2.2	2.1
Current account (percent of GDP)	-2.5	-2.7	-2.8
Core inflation (Annualized, percent)	1.8	2.1	2.2

Sources: U.S. Bureau of Economic Analysis; IMF staff estimates.



# China: More vigorous growth in the short term

**Growth of Output and Imports**  
*(annual percentage change)*



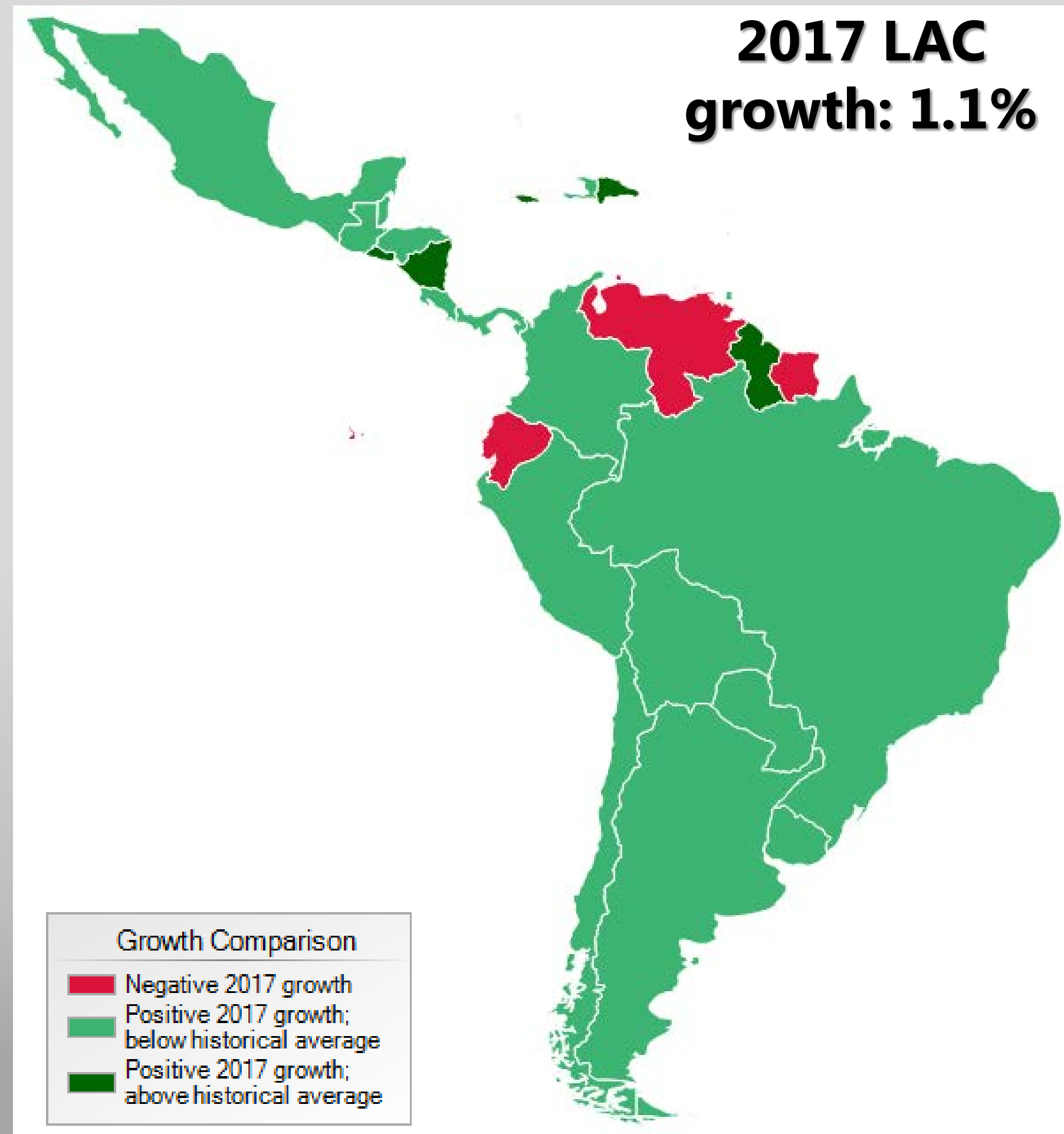
Sources: Haver Analytics; IMF *World Economic Outlook*, April 2017.



# LAC is slowly emerging from recession

Growth is positive in most countries ...

... but is weaker than previously projected.



	2010	2015	2016	Proyecciones	
				2017	2018
<b>LAC</b>	<b>6.1</b>	<b>0.1</b>	<b>-1.0</b>	<b>1.1</b>	<b>2.0</b>
South America	6.6	-1.3	-2.3	0.8	1.8
Central America	4.9	5.1	4.5	4,3	4.3
Caribbean	4.4	3.9	3.7	3.9	4.0
Trinidad & Tobago	3.3	-0.6	-5.1	0.3	3.4
Brazil	7.5	-3.8	-3.6	0.2	1.7
Mexico	5.1	2.6	2.3	1.7	2.0

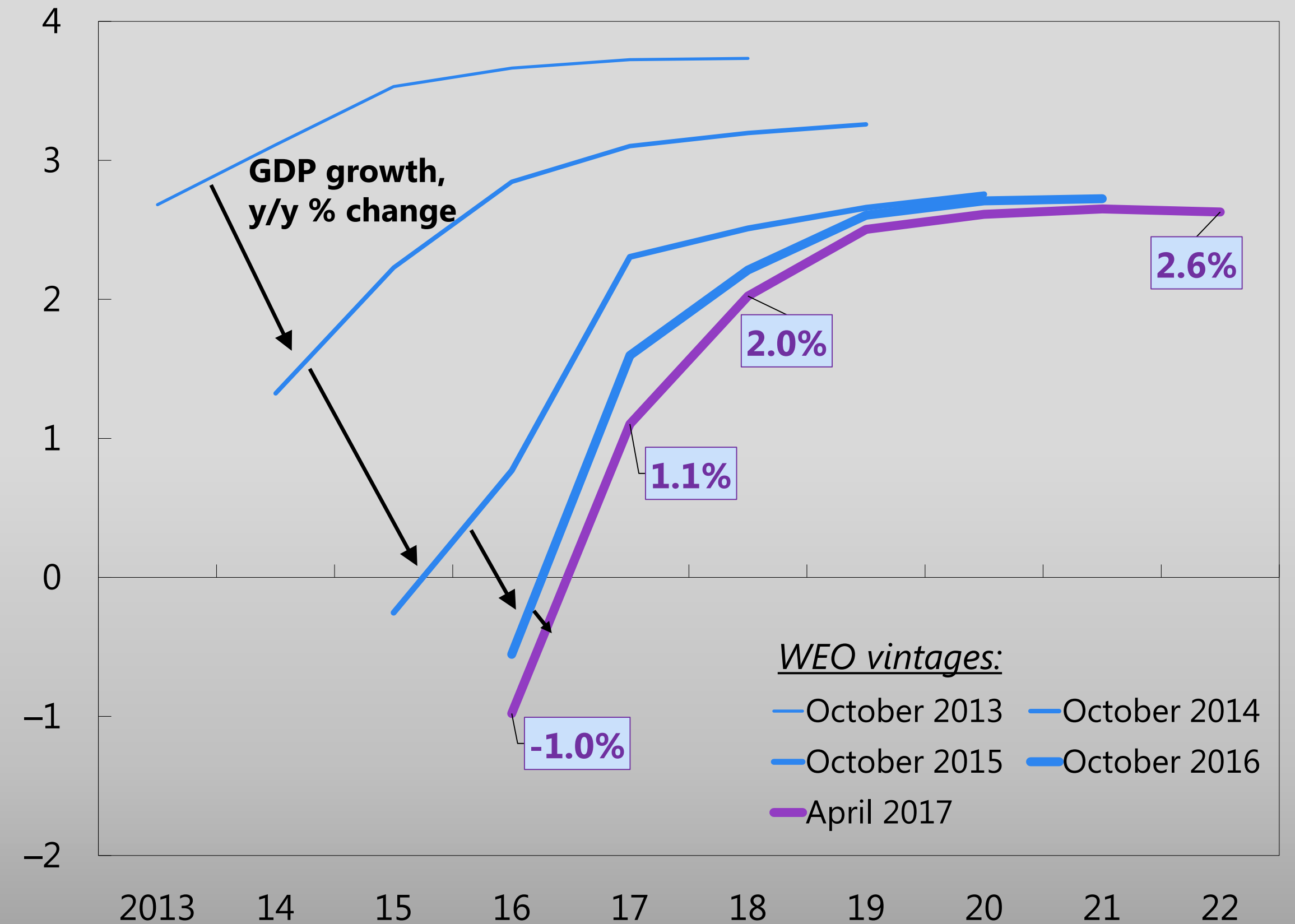
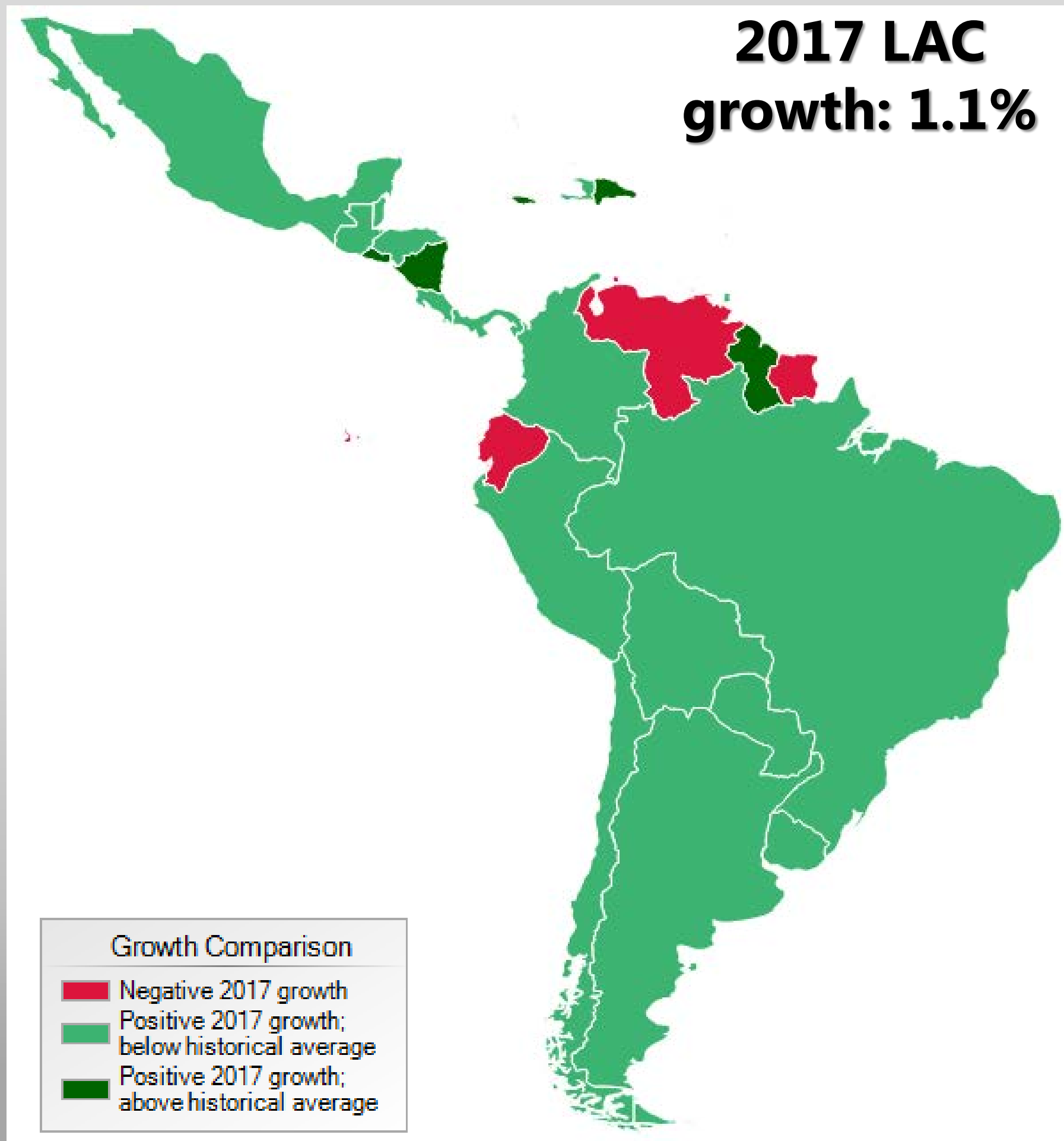
Sources: IMF, World Economic Outlook database; and IMF staff calculations.  
Note: Historical average refers to the average growth from 2000–13.

Source: IMF, World Economic Outlook database.

# LAC is slowly emerging from recession

Growth is positive in most countries ...

... but is weaker than previously projected.



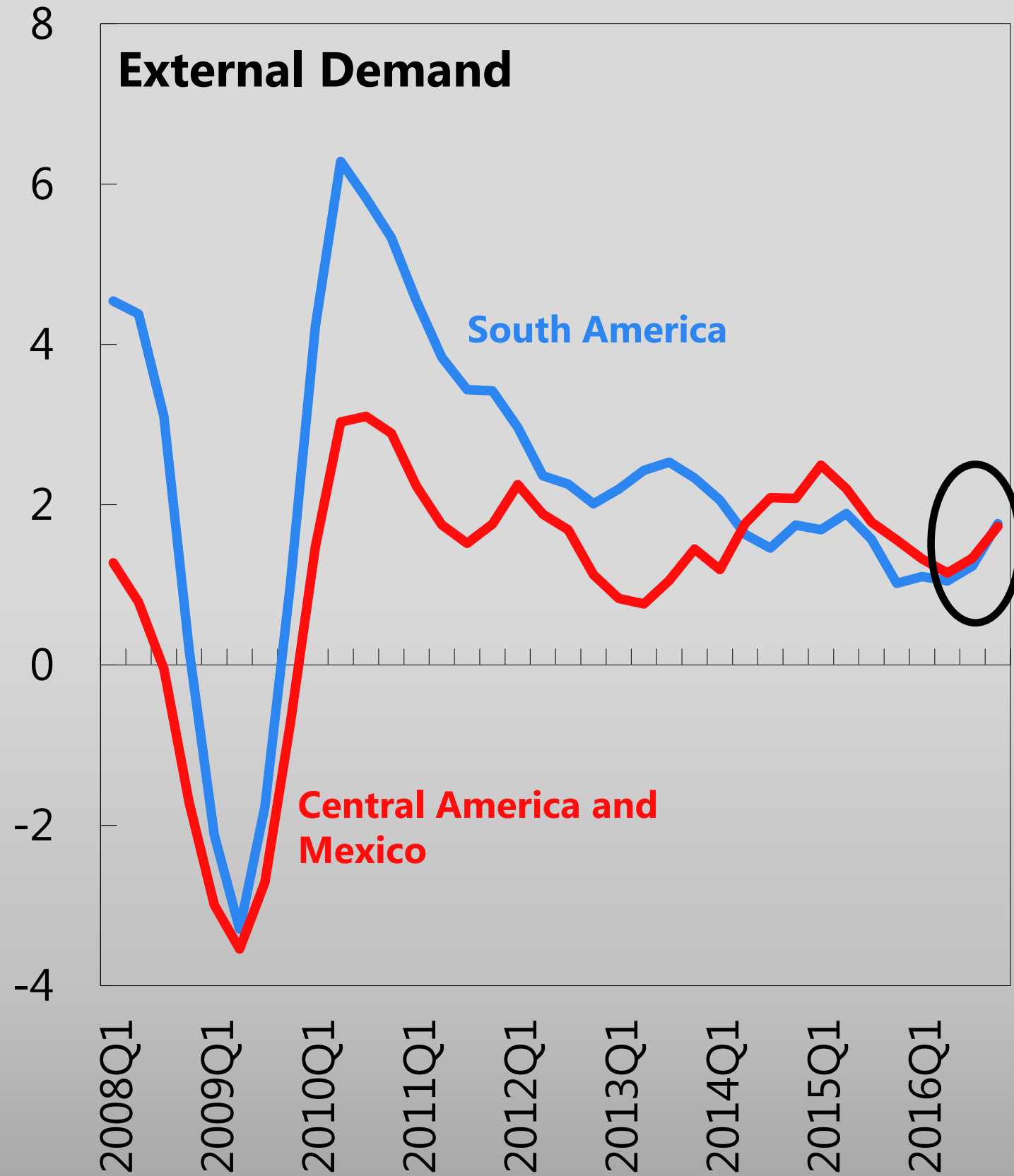
Sources: IMF, World Economic Outlook database; and IMF staff calculations.  
Note: Historical average refers to the average growth from 2000–13.

Source: IMF, World Economic Outlook database.



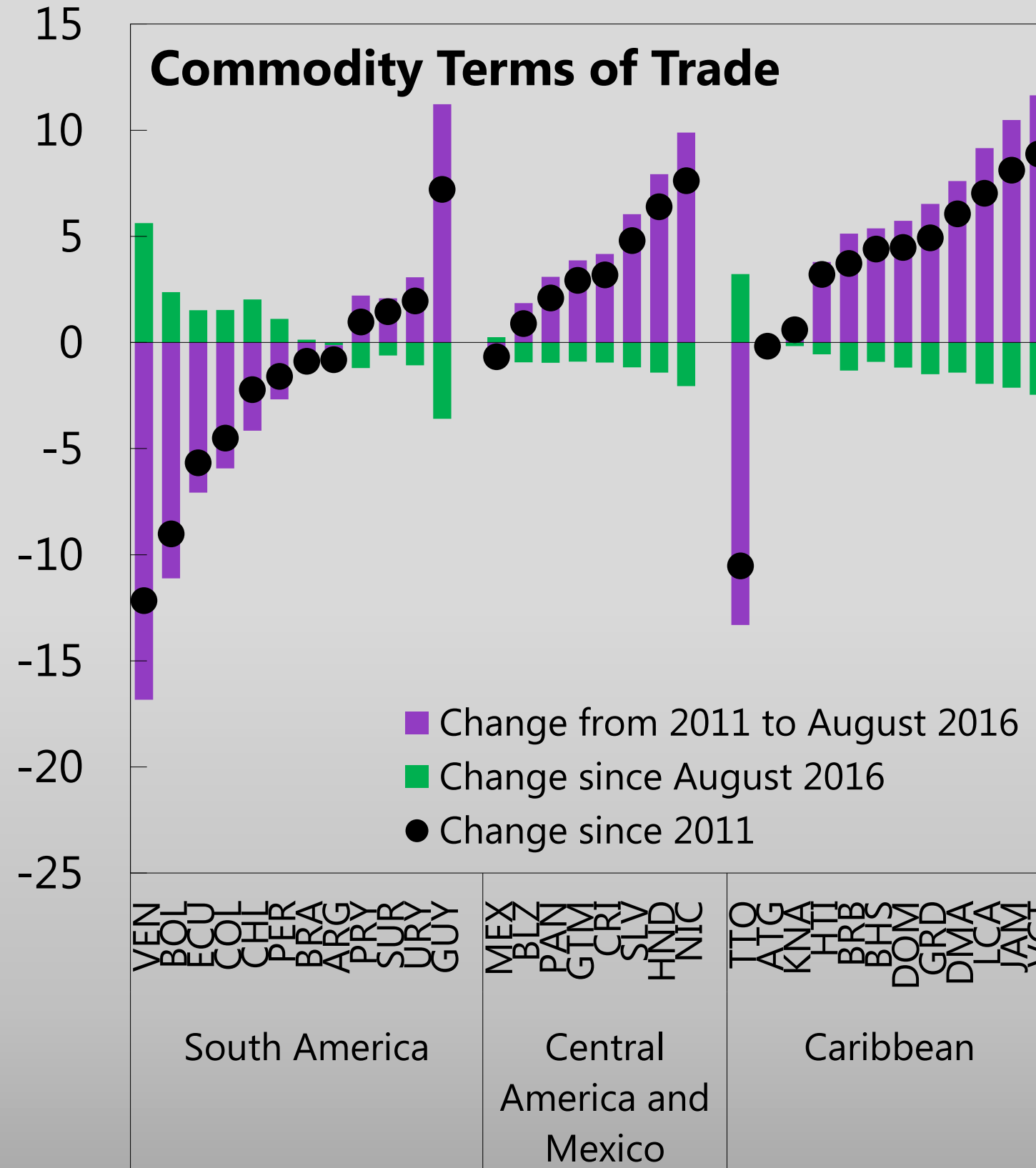
# Tailwinds: Easing external conditions

Some improvement in external demand.



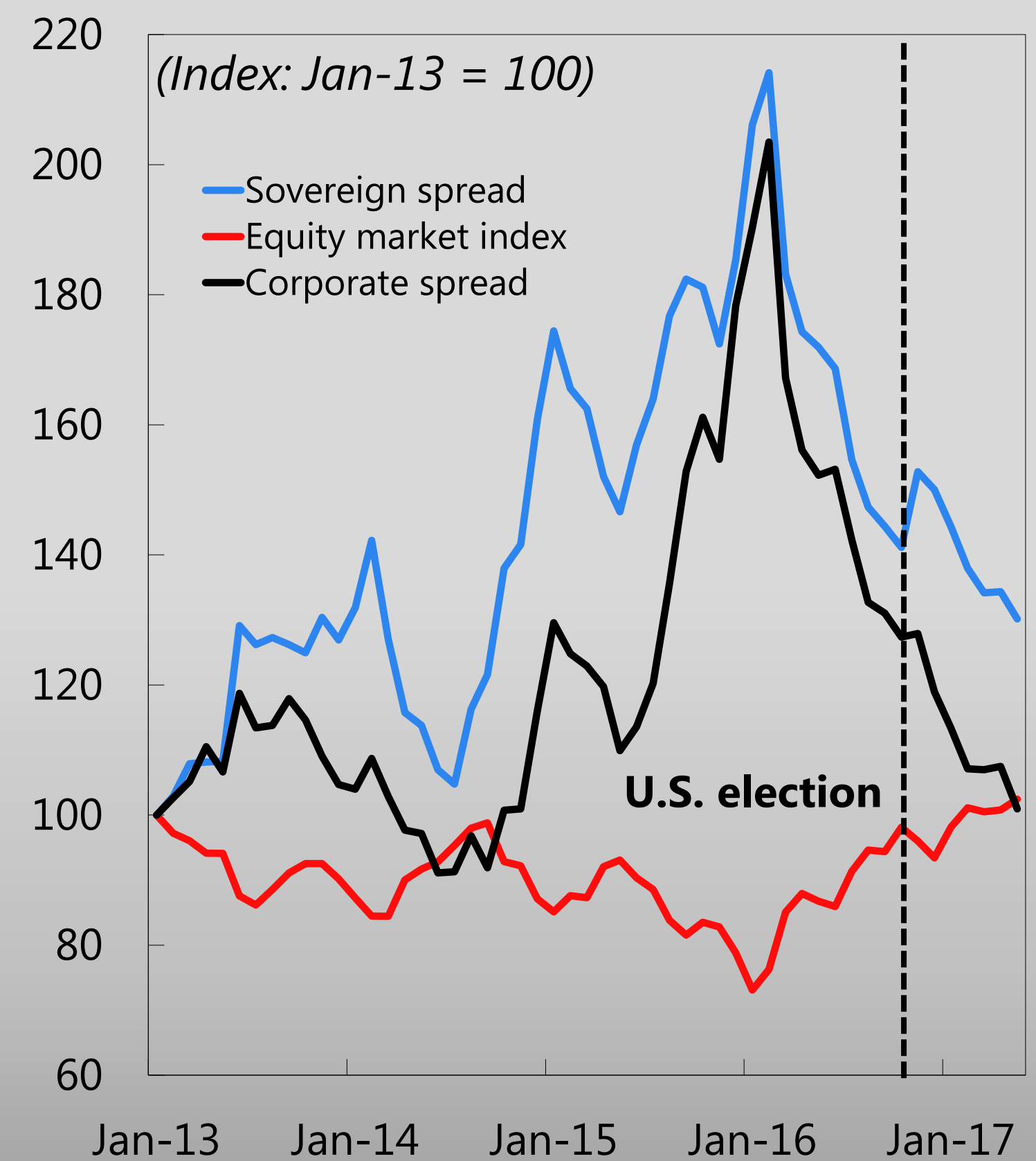
Sources: Haver Analytics; and IMF staff calculations.  
 Note: Quarter-over-quarter real final domestic demand growth of trading partners, weighted by the share of each trading partner in total exports. Percent change; 4-quarter moving average.

Modest recovery in commodity prices.



Sources: Gruss (2014); and IMF staff calculations.  
 Note: Percent change; index weighted by GDP.

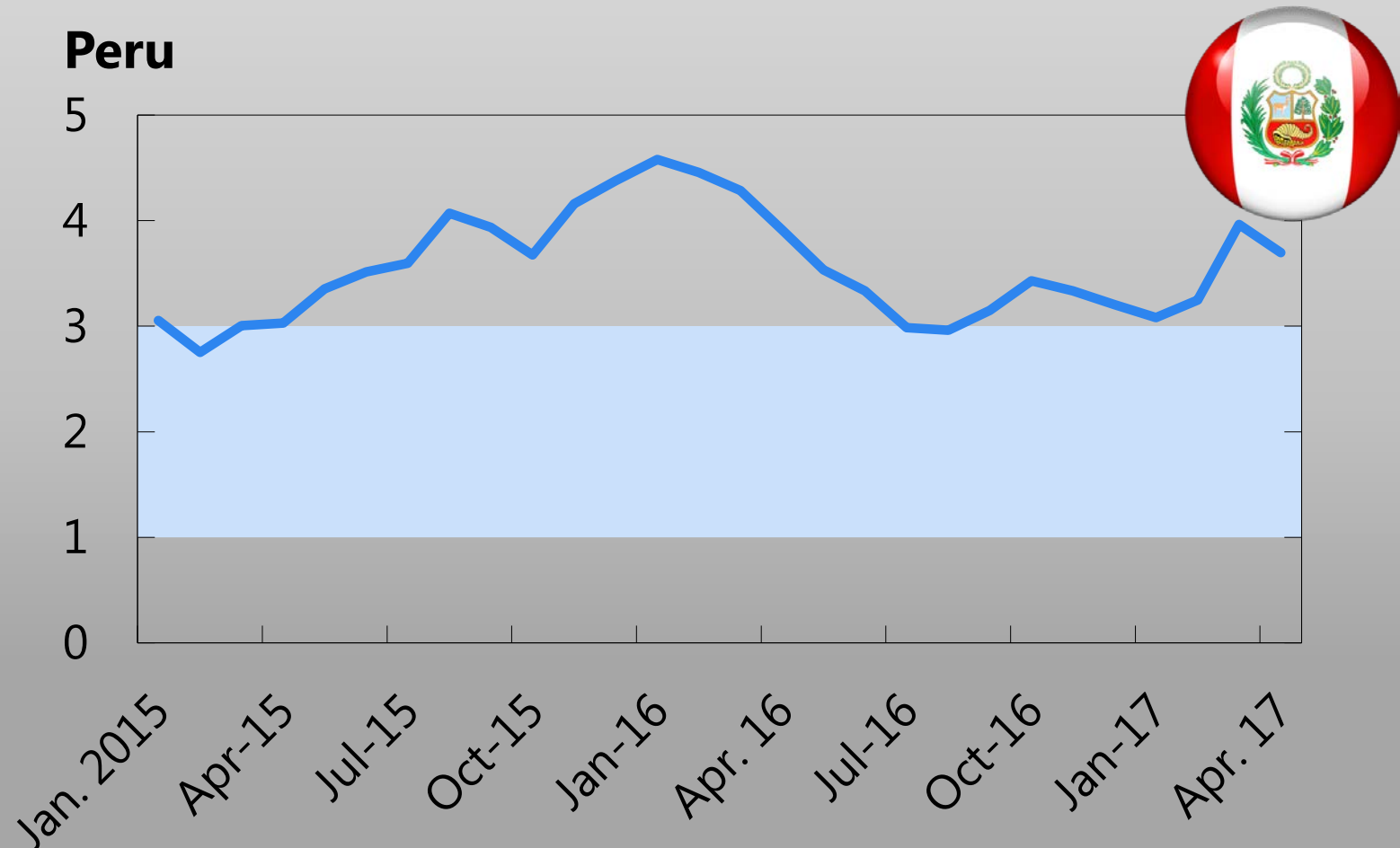
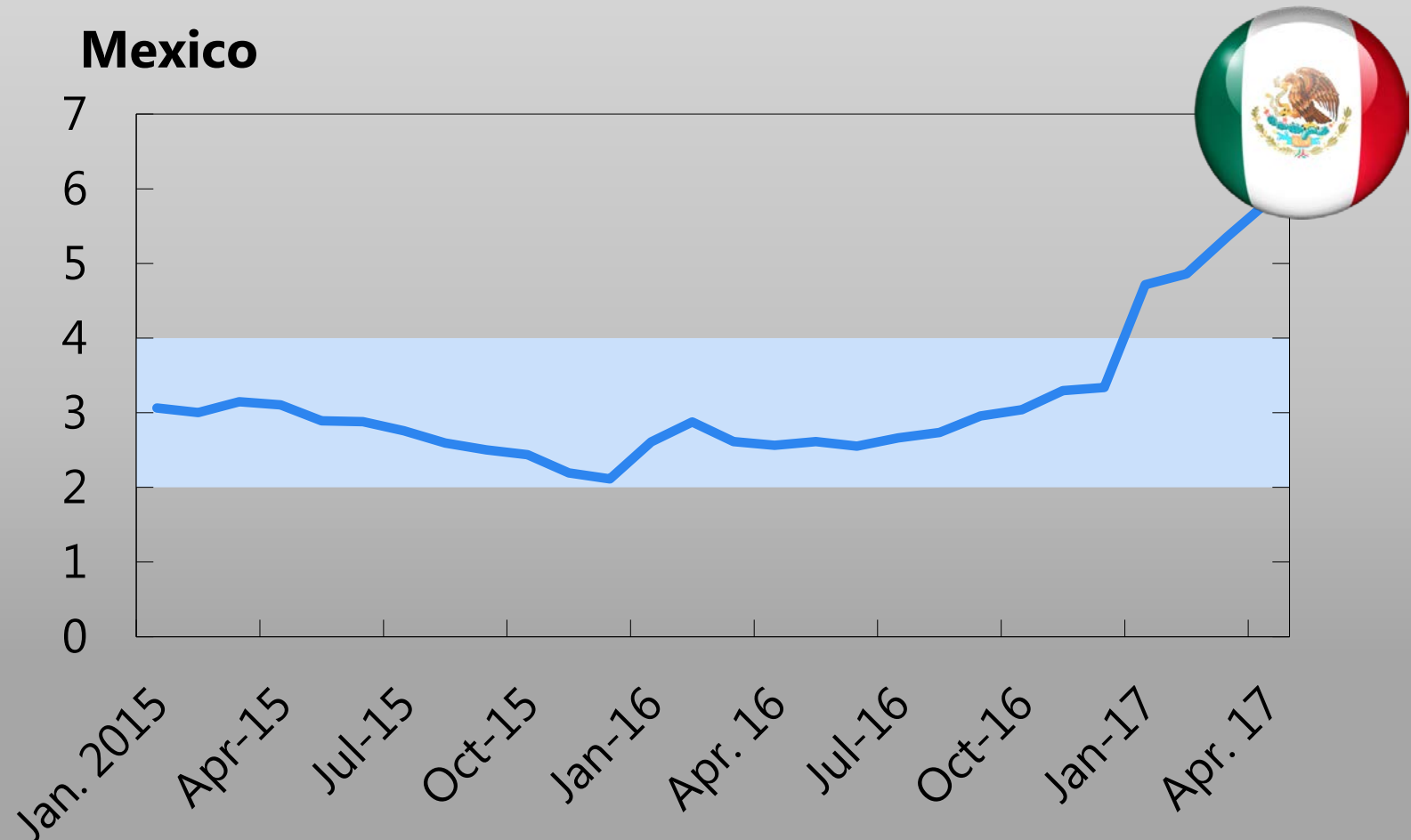
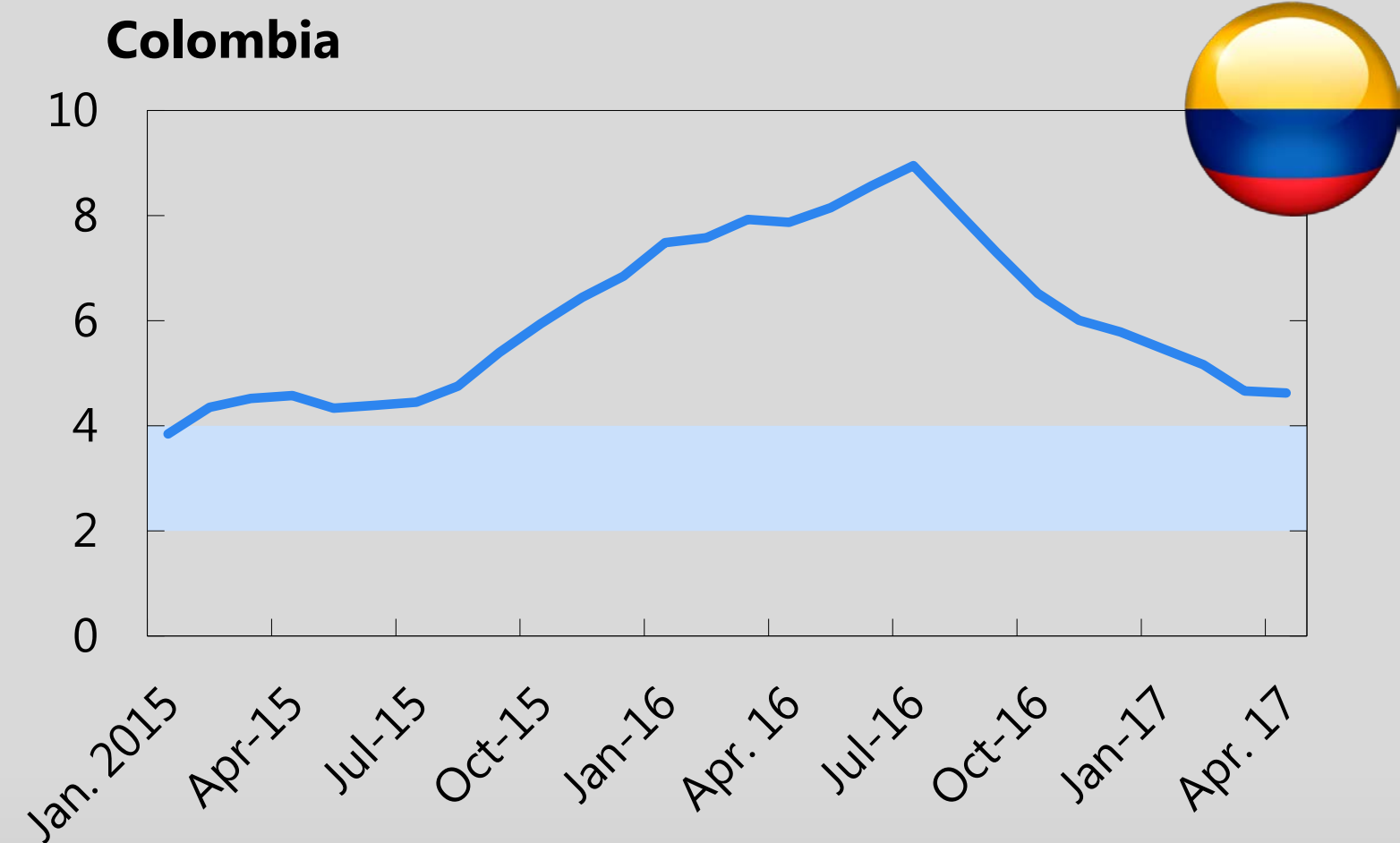
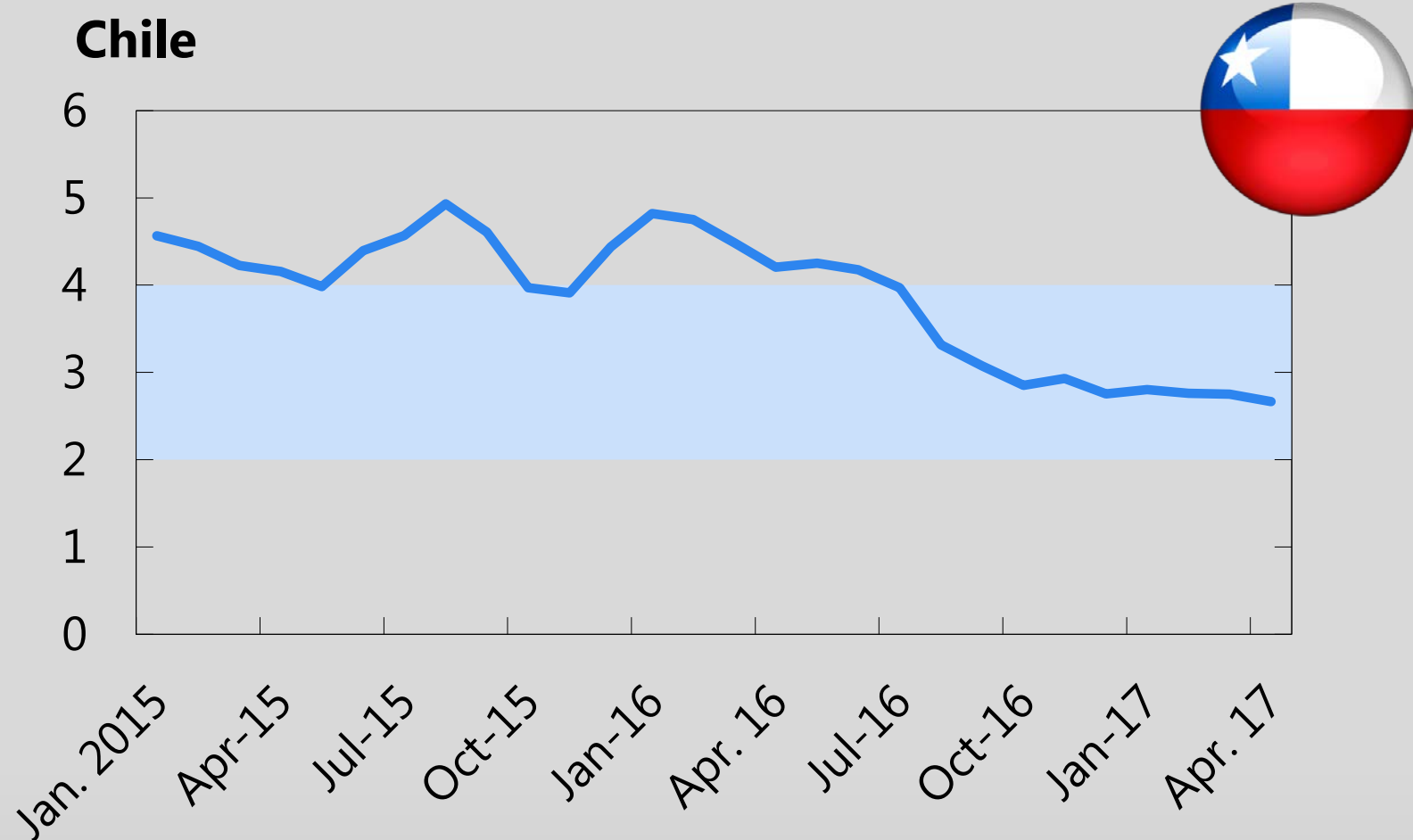
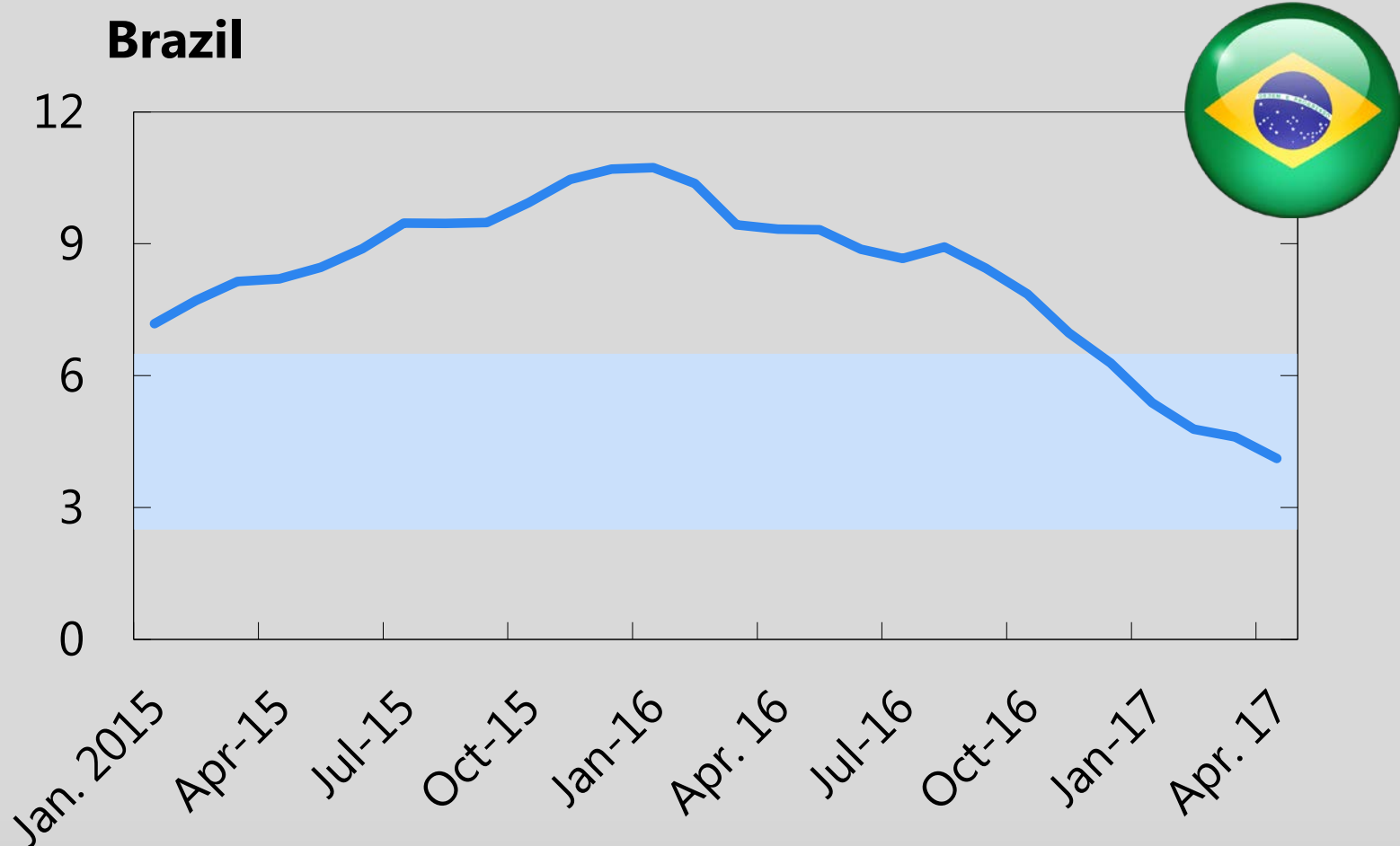
Relatively accommodative financial conditions.



Sources: Bloomberg L.P.; and IMF staff calculations.  
 Note: Sovereign spread refers to J.P. Morgan Emerging Market Bond Index Global; equity refers to Morgan Stanley Capital International (MSCI) local currency index; and corporate spread refers to J.P. Morgan Corporate Emerging Markets Bond Index Broad Diversified.

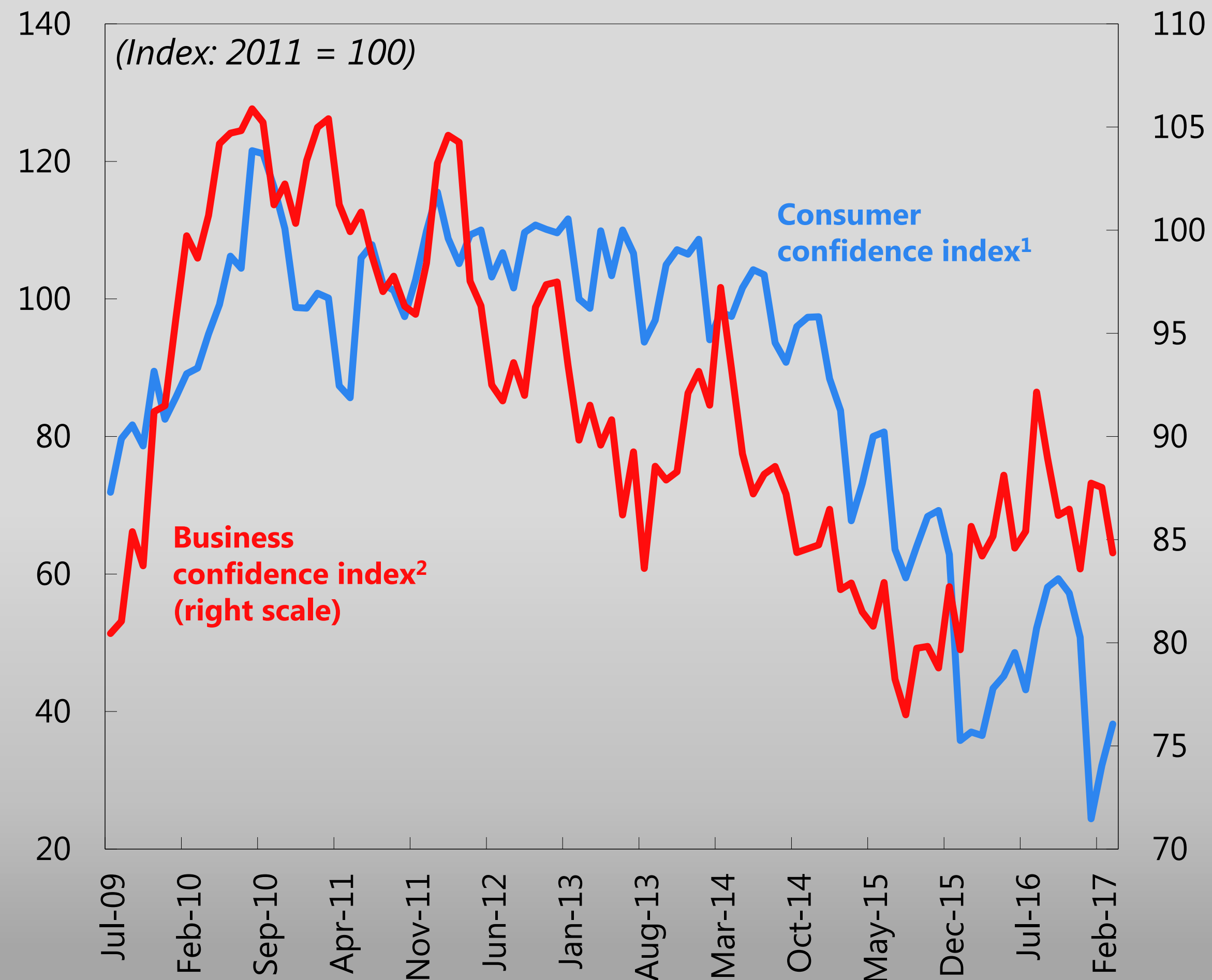
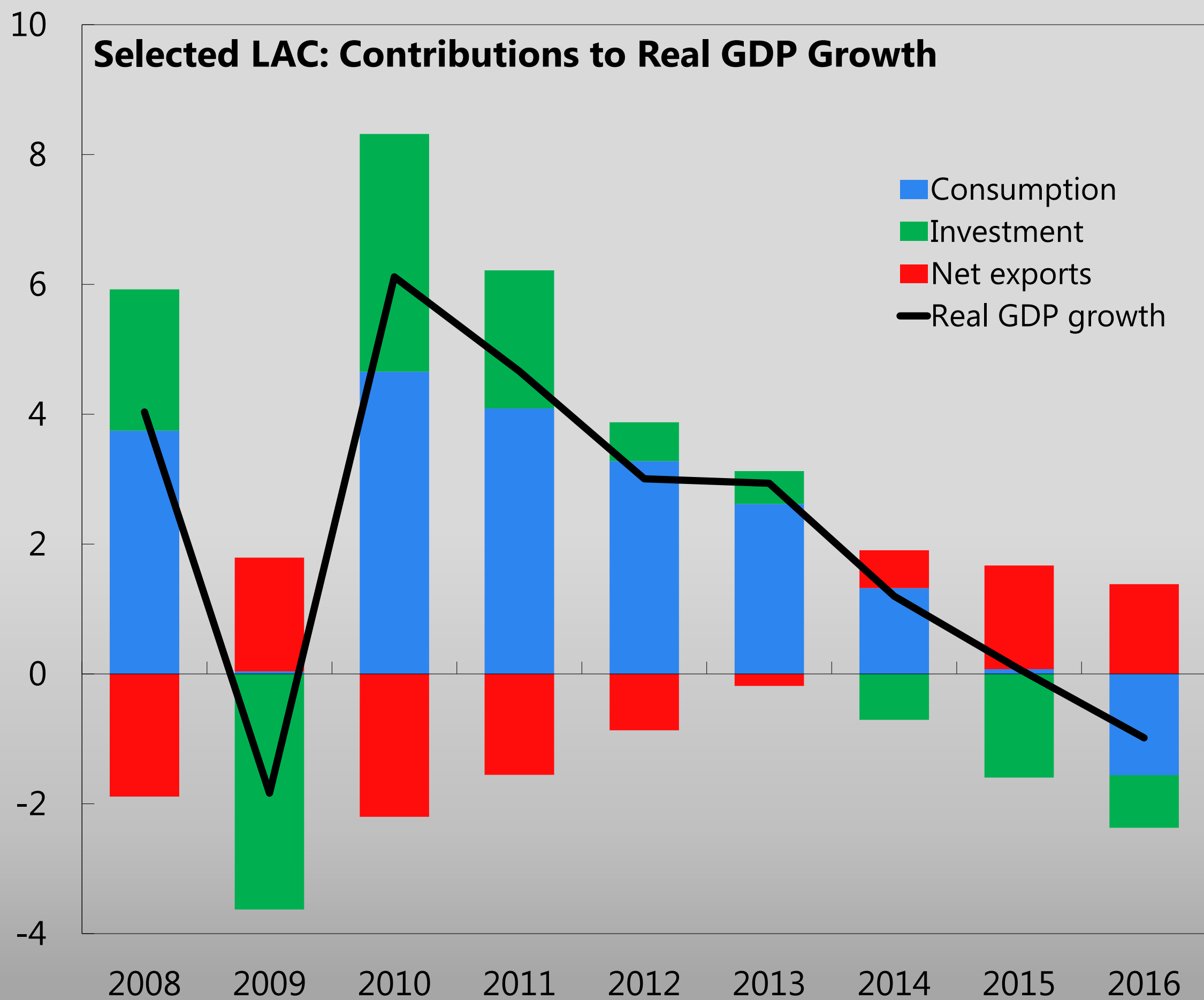
# As inflation declines, more space for cuts in policy rates

## Inflation (Percent)



Sources: Bloomberg L.P.; Global Data Source; Haver Analytics; national authorities; and IMF staff calculations.  
Note: Shaded area refers to the target range.

# Headwinds: Weak domestic demand and confidence



Sources: IMF, World Economic Outlook database; and IMF staff calculations.  
 Note: LAC excludes Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines due to data limitations. Inventories include statistical discrepancies. PPP GDP-weighted average; year-over-year percent change.

Sources: Haver Analytics; and IMF staff calculations.  
<sup>1</sup>Simple average of Brazil, Chile, Colombia, and Mexico.  
<sup>2</sup>Simple average of Brazil, Chile, Colombia, Mexico, and Peru.

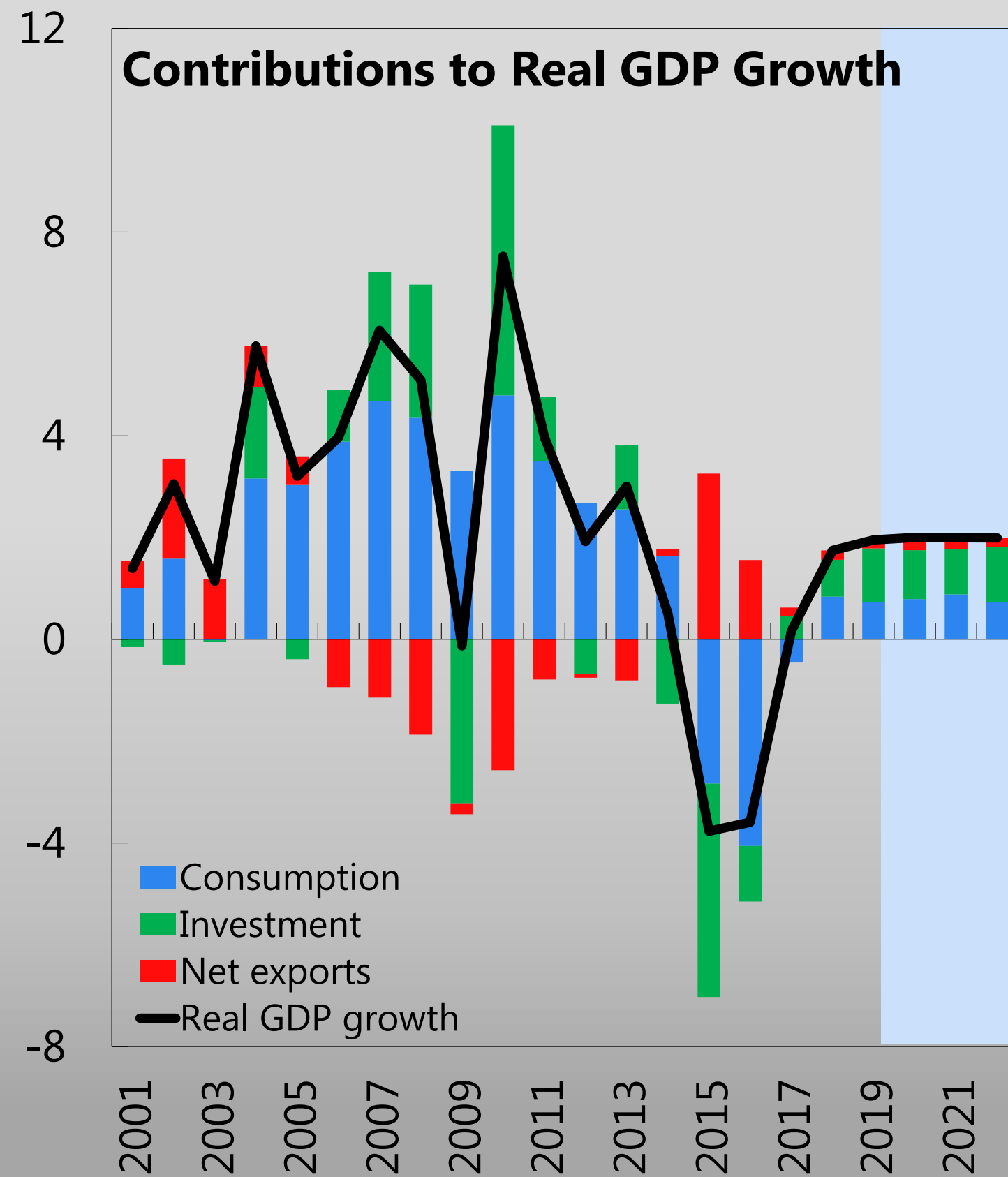


# Country Focus

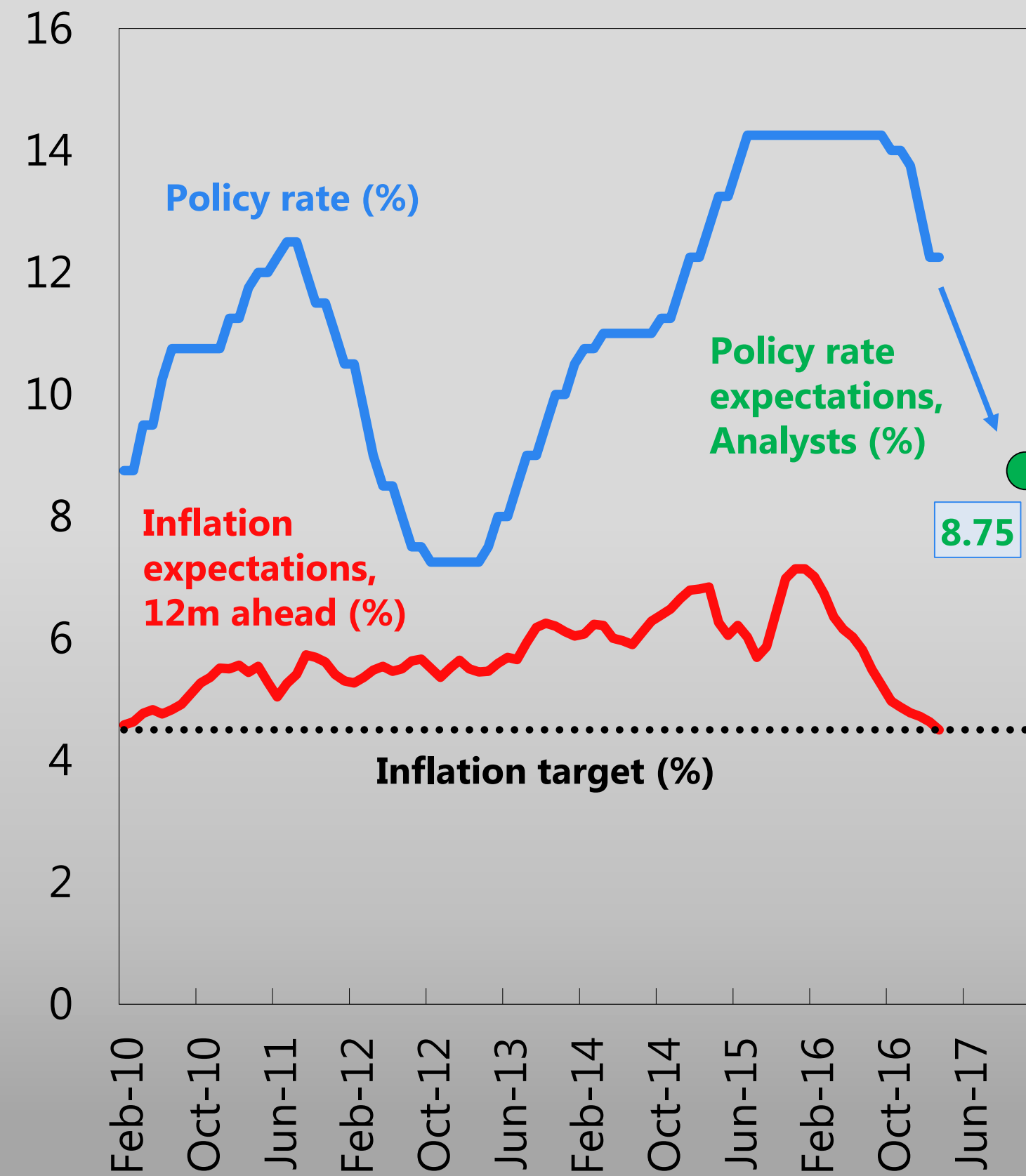


# Brazil: Recession nearing end, disinflation accelerating, but fiscal sustainability remains a concern

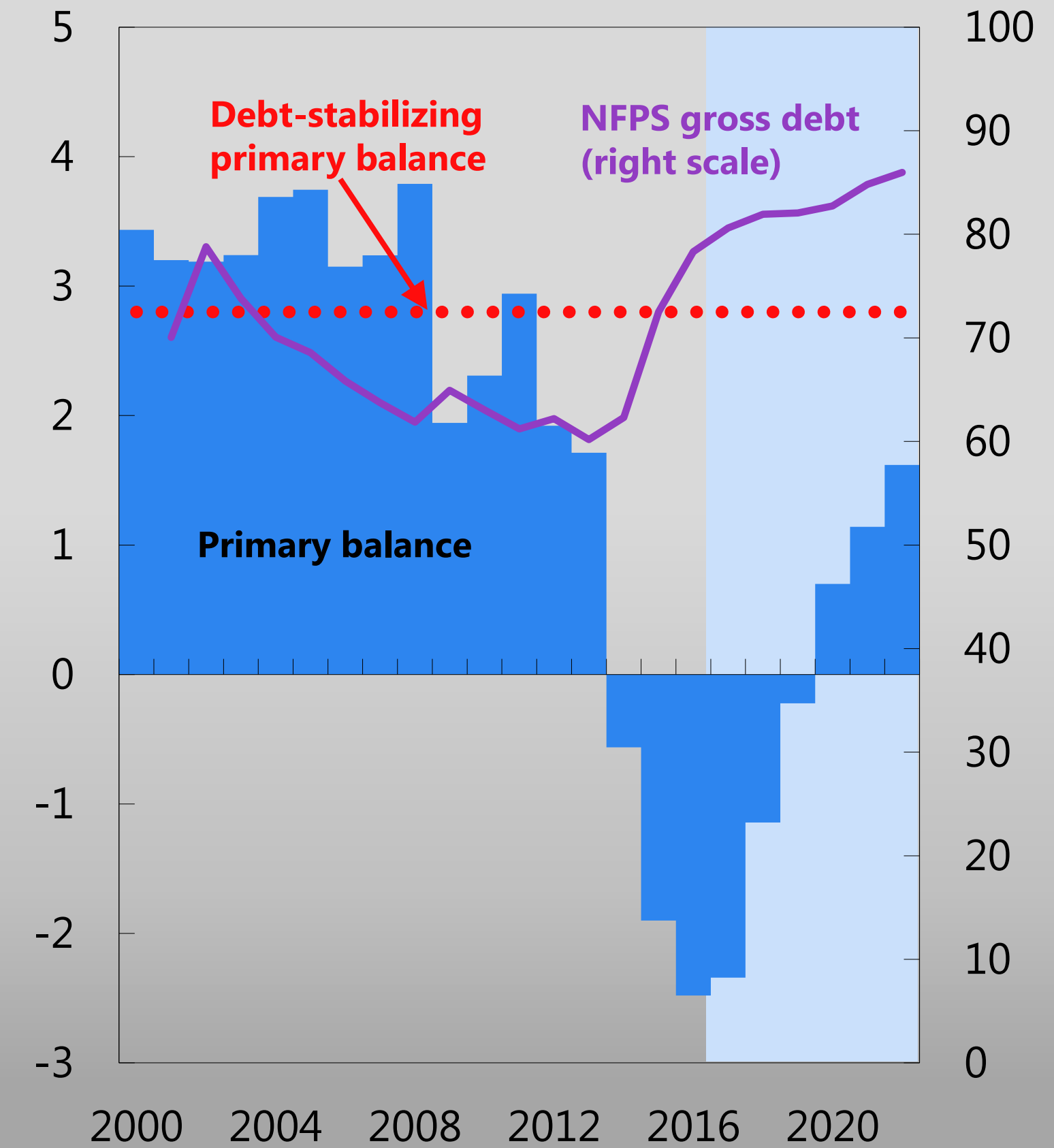
Deep recession could be nearing its end.



Faster-than-expected disinflation is providing more policy space.



Fiscal sustainability is still a concern, with backloaded adjustment.



Sources: IMF, World Economic Outlook database; and IMF staff calculations.  
Note: Year-over-year percent change.

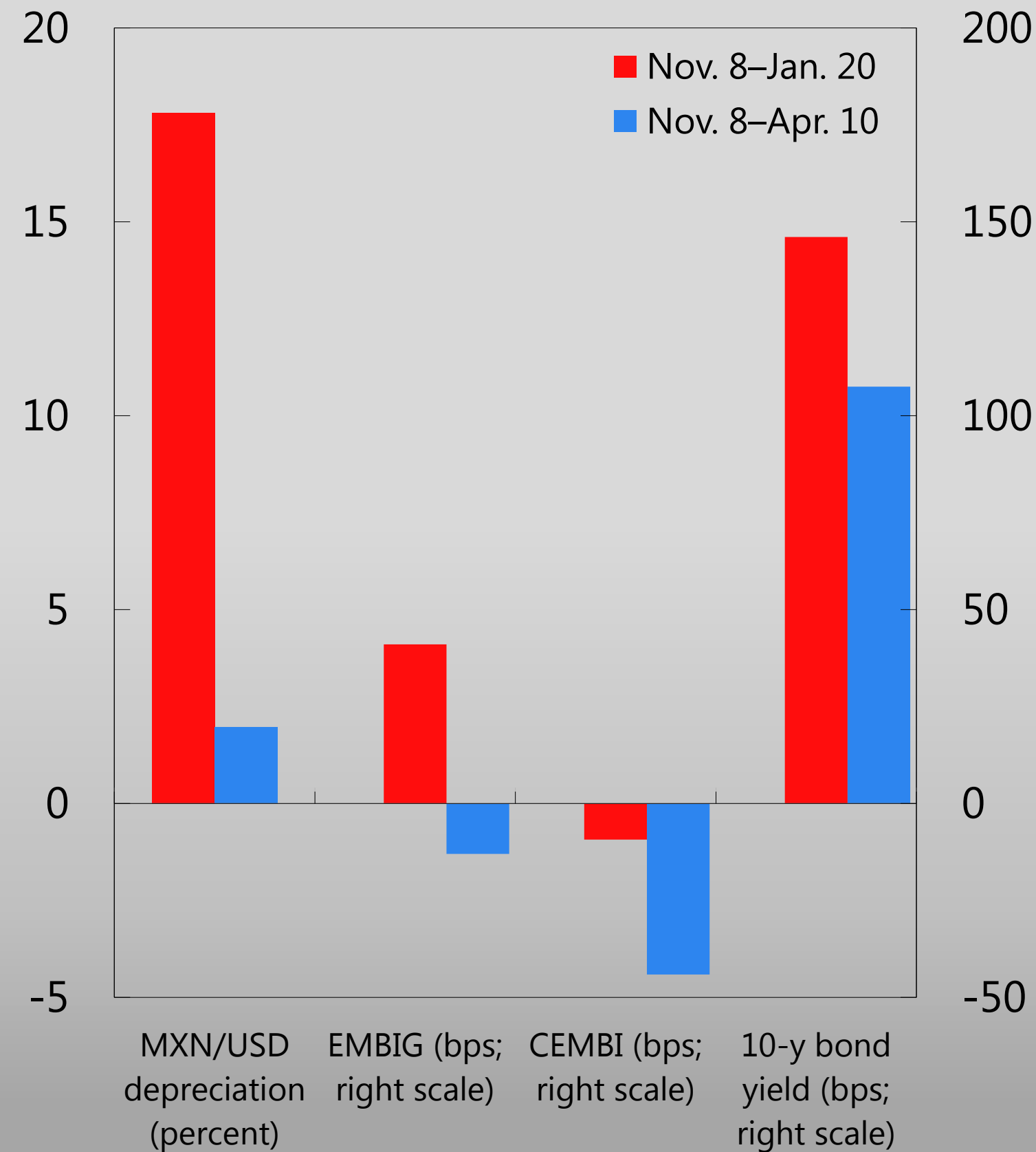
Note: Analysts' policy rate expectations from Central Bank's Weekly Focus Survey.

Note: Debt-stabilizing primary balance excludes interest. Percent of GDP.



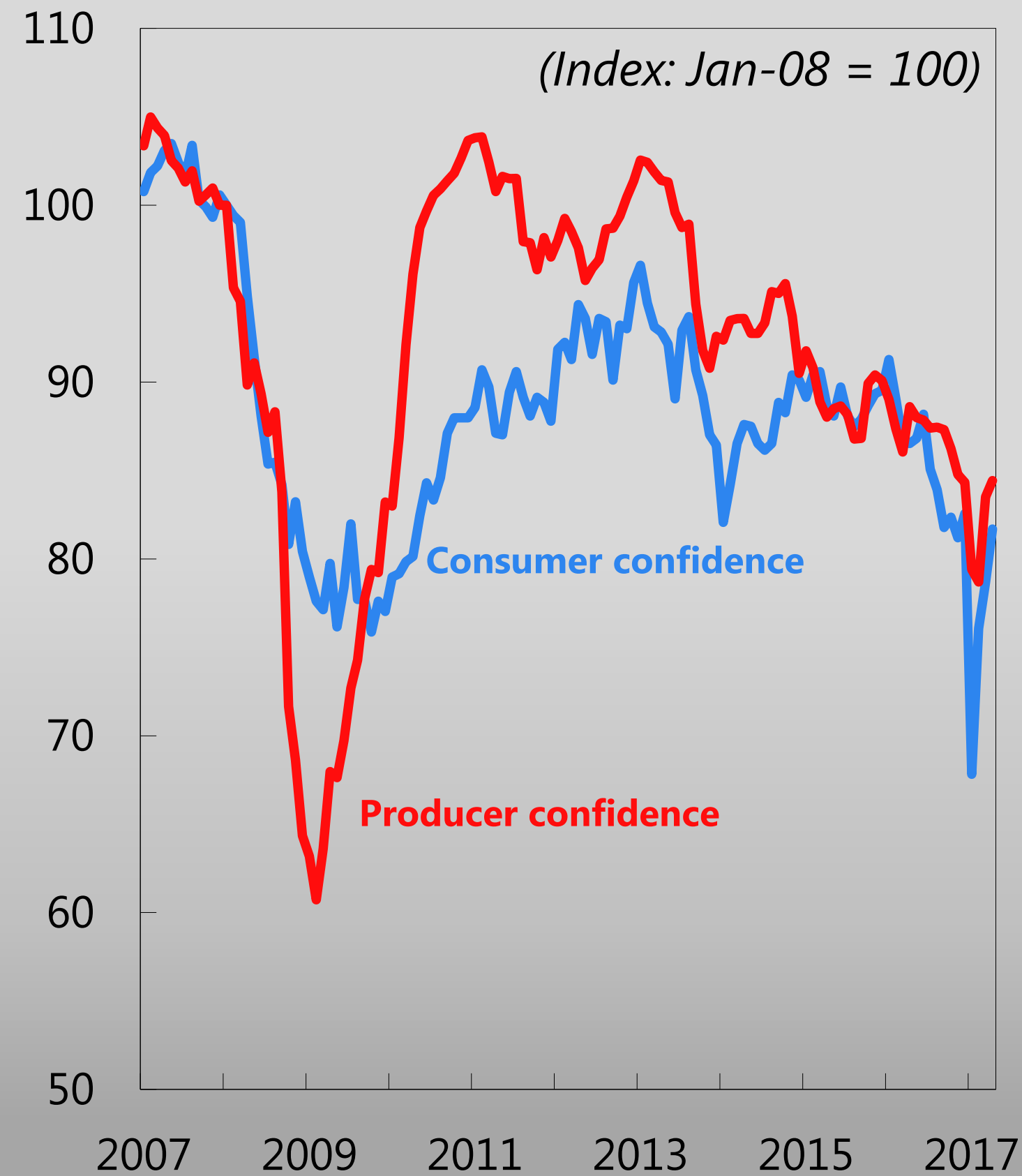
# Mexico: Growth is expected to decelerate amid elevated uncertainty

Financial conditions have eased after the tightening in the aftermath of the U.S. election.



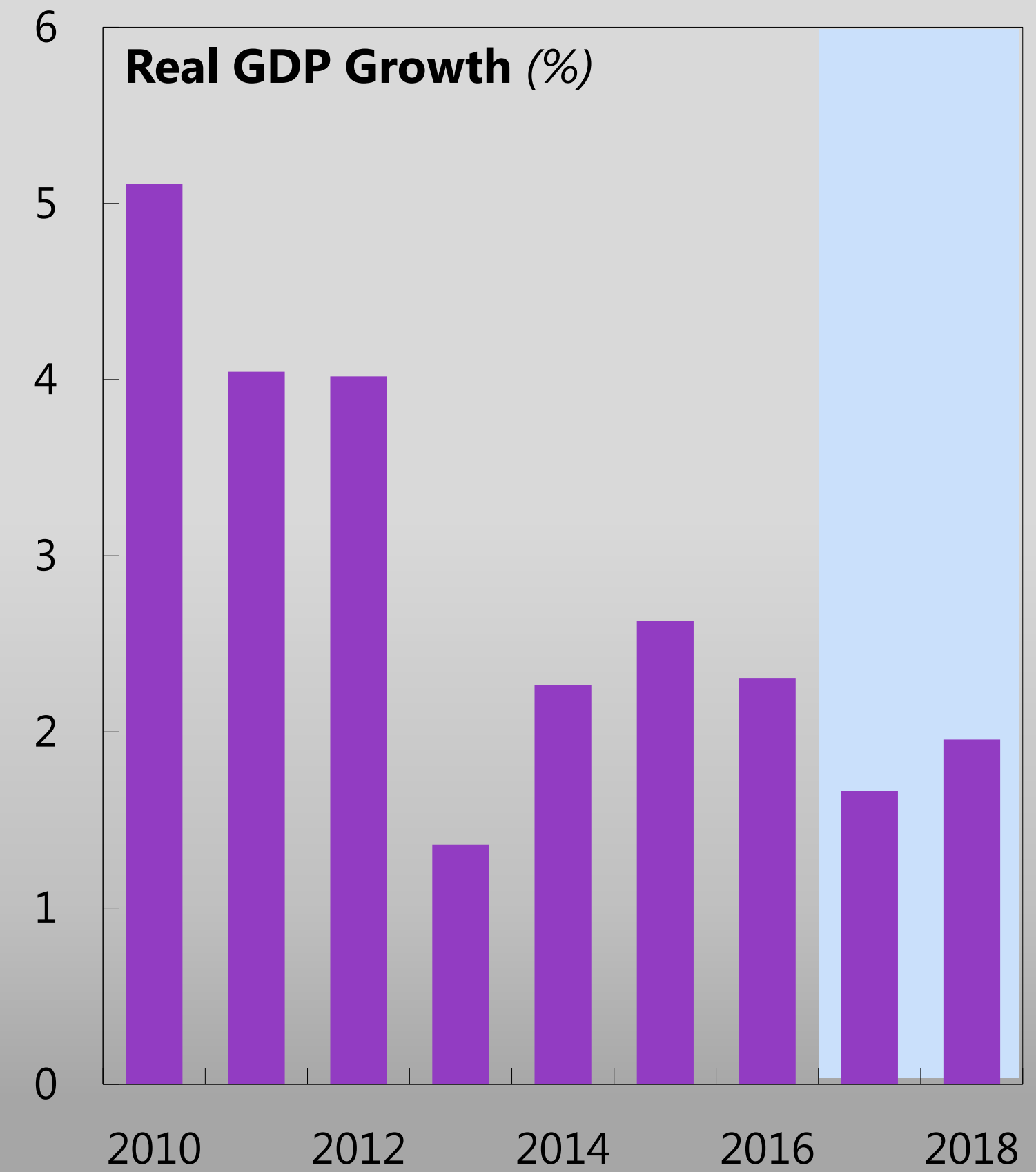
Sources: Bloomberg L.P.; and IMF staff calculations.

But elevated uncertainty and subdued confidence...



Sources: Haver Analytics; and IMF staff calculations.

... are expected to weigh on growth.



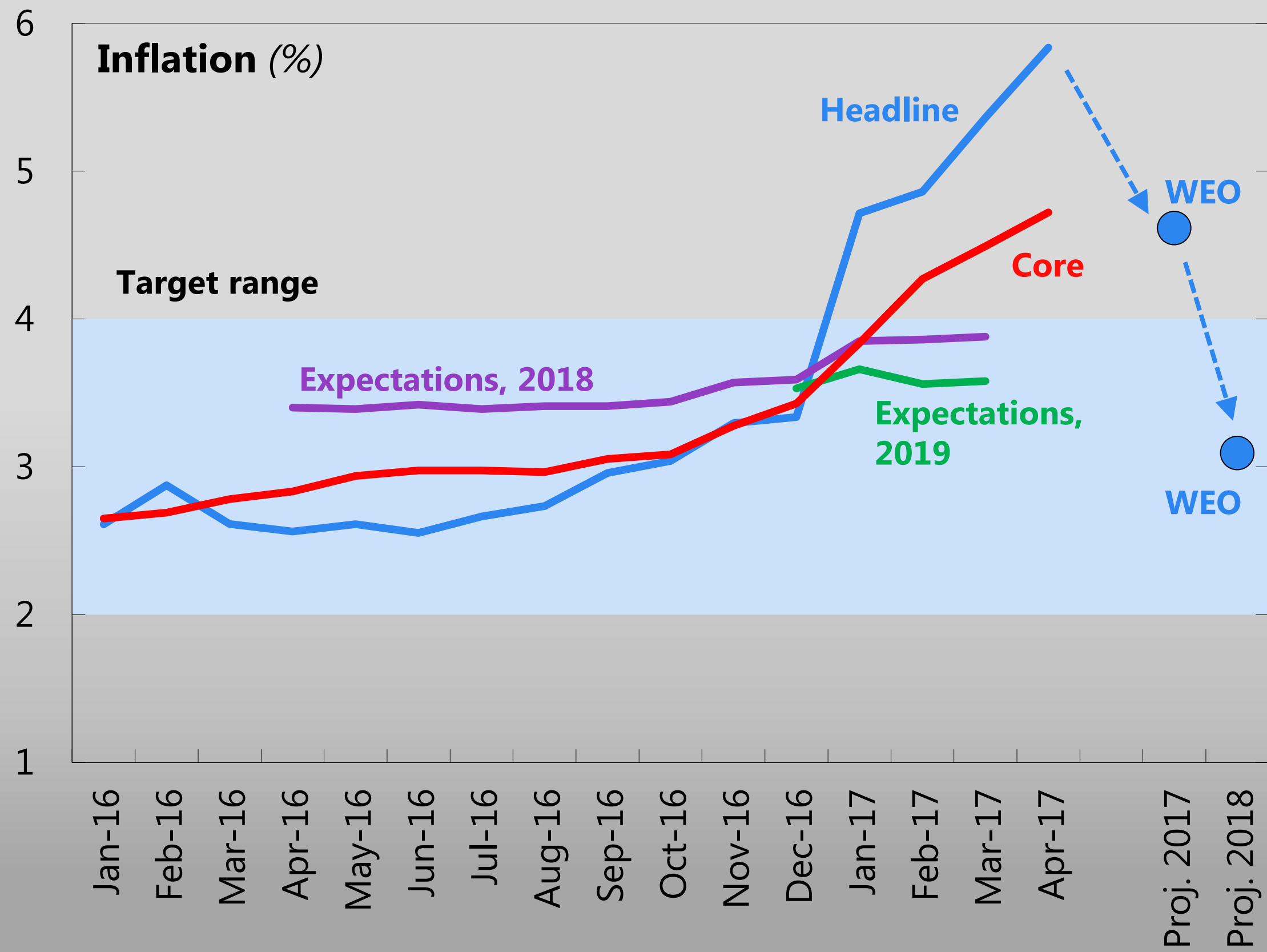
Source: IMF, World Economic Outlook database.



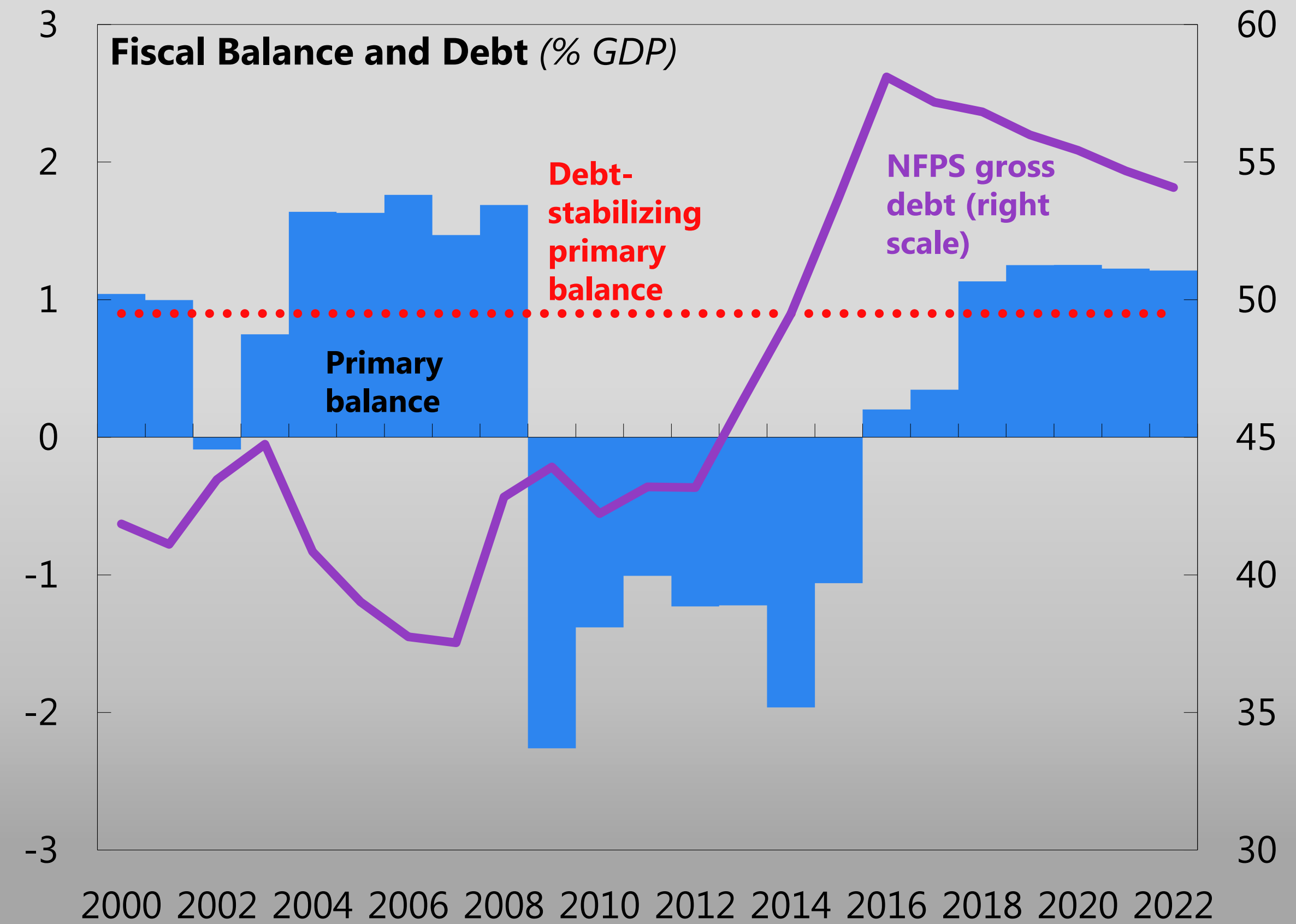


# Mexico: Maintaining macroeconomic stability and strengthening fiscal framework

*Inflation is above target, reflecting mainly the liberalization of gasoline prices, compounded by the pass-through of depreciation, but expected to decline rapidly.*



*Strengthening the fiscal framework will help bolster credibility and reduce public debt*



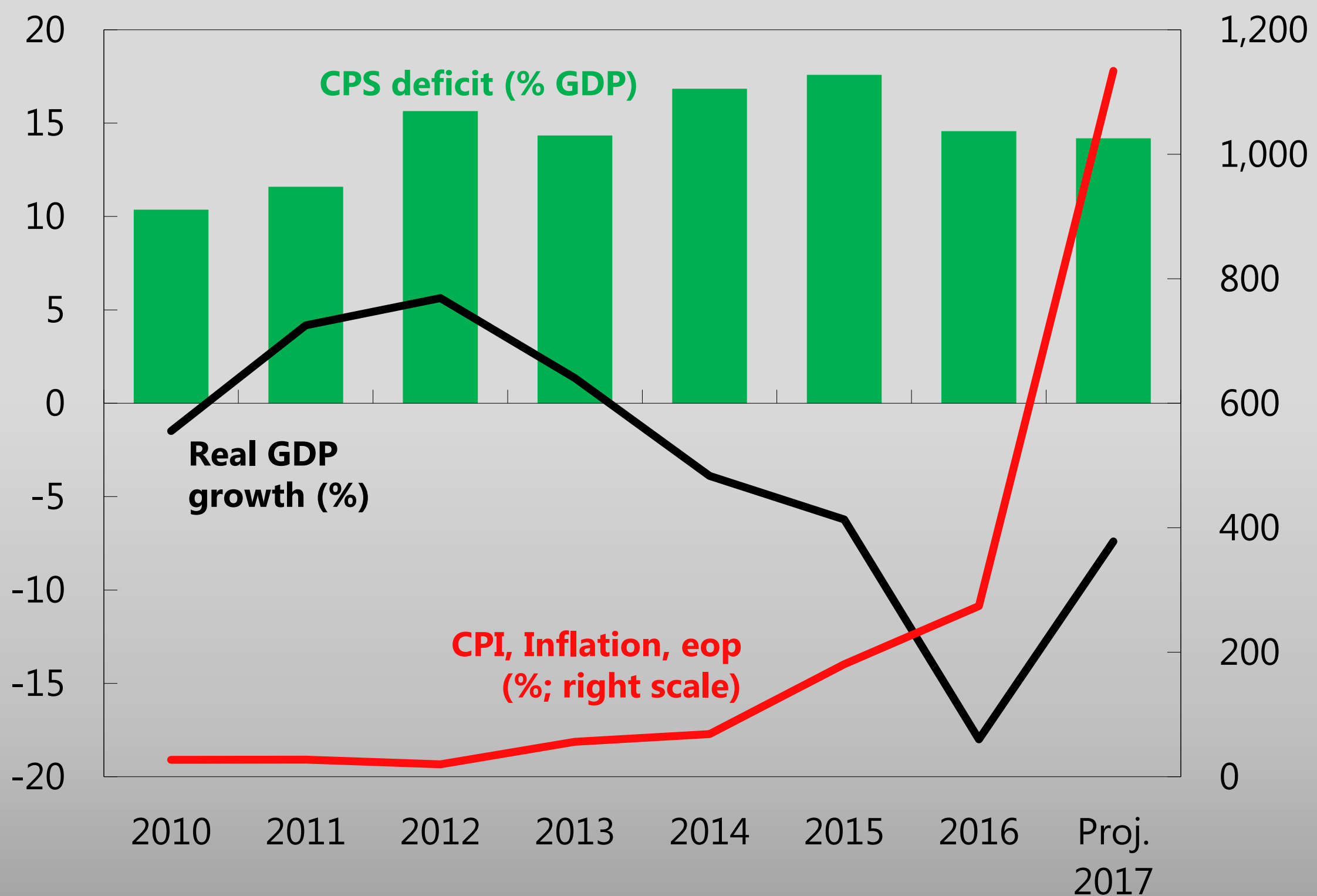
Sources: Haver Analytics; and IMF, World Economic Outlook database.

Sources: IMF, World Economic Outlook database; and IMF staff calculations.



# Venezuela: Rising economic costs and unfolding humanitarian crisis

Deepening economic crisis, accelerating inflation, and large fiscal deficits



Unfolding humanitarian crisis

- Worsening poverty:  
82% (33% in 2012)
- Collapse of the health system:  
scarcity of medicine, 76% of hospitals (55% in 2014)
- Security concerns:  
homicide rate 92 murders per 100,000 (20 in 1998)
- Rising number of refugees:  
around 100,000 annually to Brazil and Colombia each.

Sources: IMF, World Economic Outlook database; national authorities; and IMF staff estimates and projections.

Note: Projecting the economic outlook in Venezuela, including assessing past and current economic developments as the basis for the projections, is complicated by the lack of discussions with the authorities (the last Article IV consultation took place in 2004), long intervals in receiving data with information gaps, incomplete provision of information, and difficulties in interpreting certain reported economic indicators in line with economic developments. The fiscal accounts include the budgetary central government and Petróleos de Venezuela, S.A. (PDVSA). Revenue includes the IMF staff's estimated foreign exchange profits transferred from the central bank to the government (buying U.S. dollars at the most appreciated rate and selling at more depreciated rates in a multitier exchange rate system) and excludes the staff's estimated revenue from PDVSA's sale of PetroCaribe assets to the central bank.

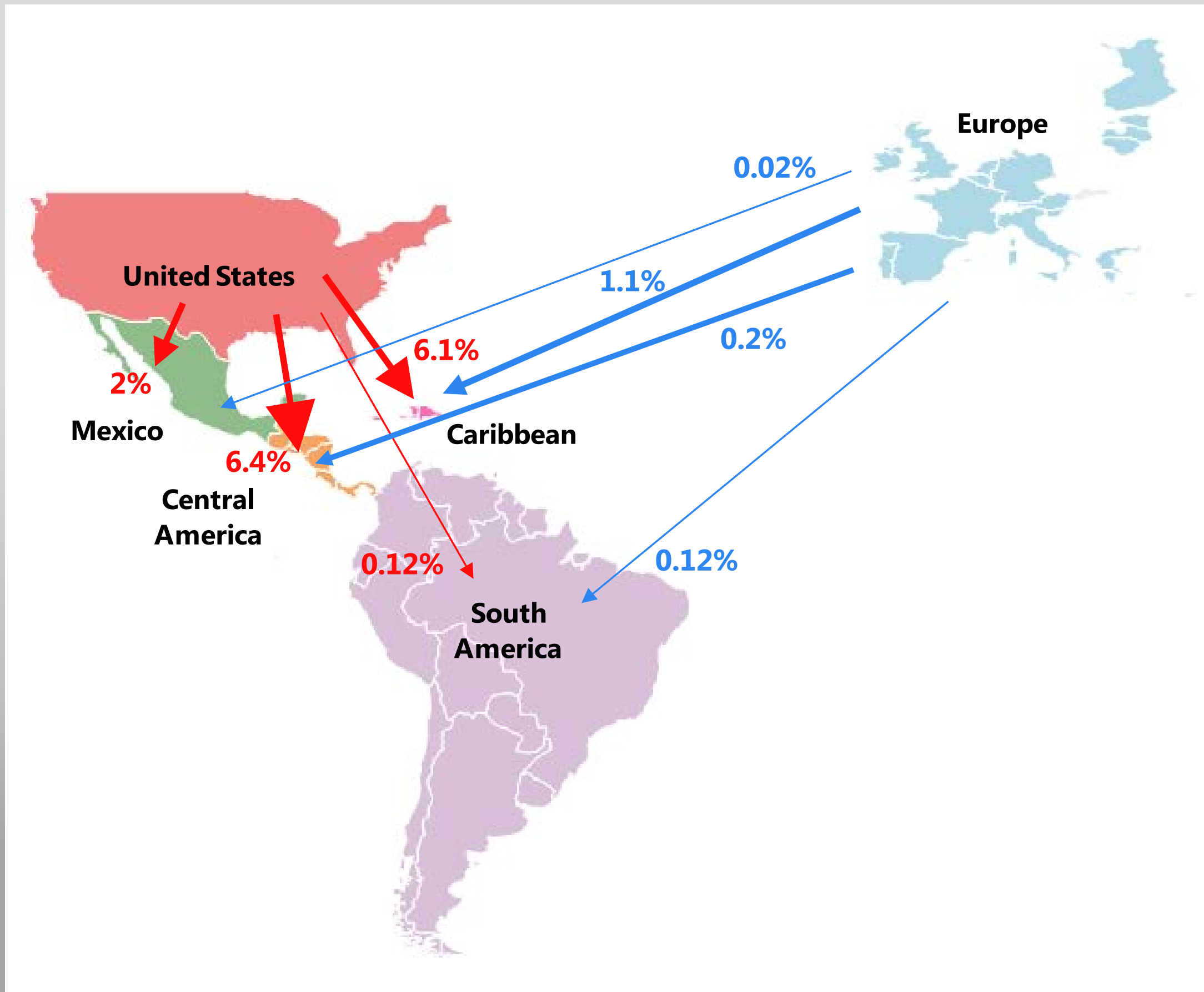
# Risks to the LAC outlook are tilted to the downside

- **An escalation of global policy uncertainty and a rising tide of economic nationalism**
- **A tightening of global financial conditions**
- **A hard landing in China and renewed decline in commodity prices**

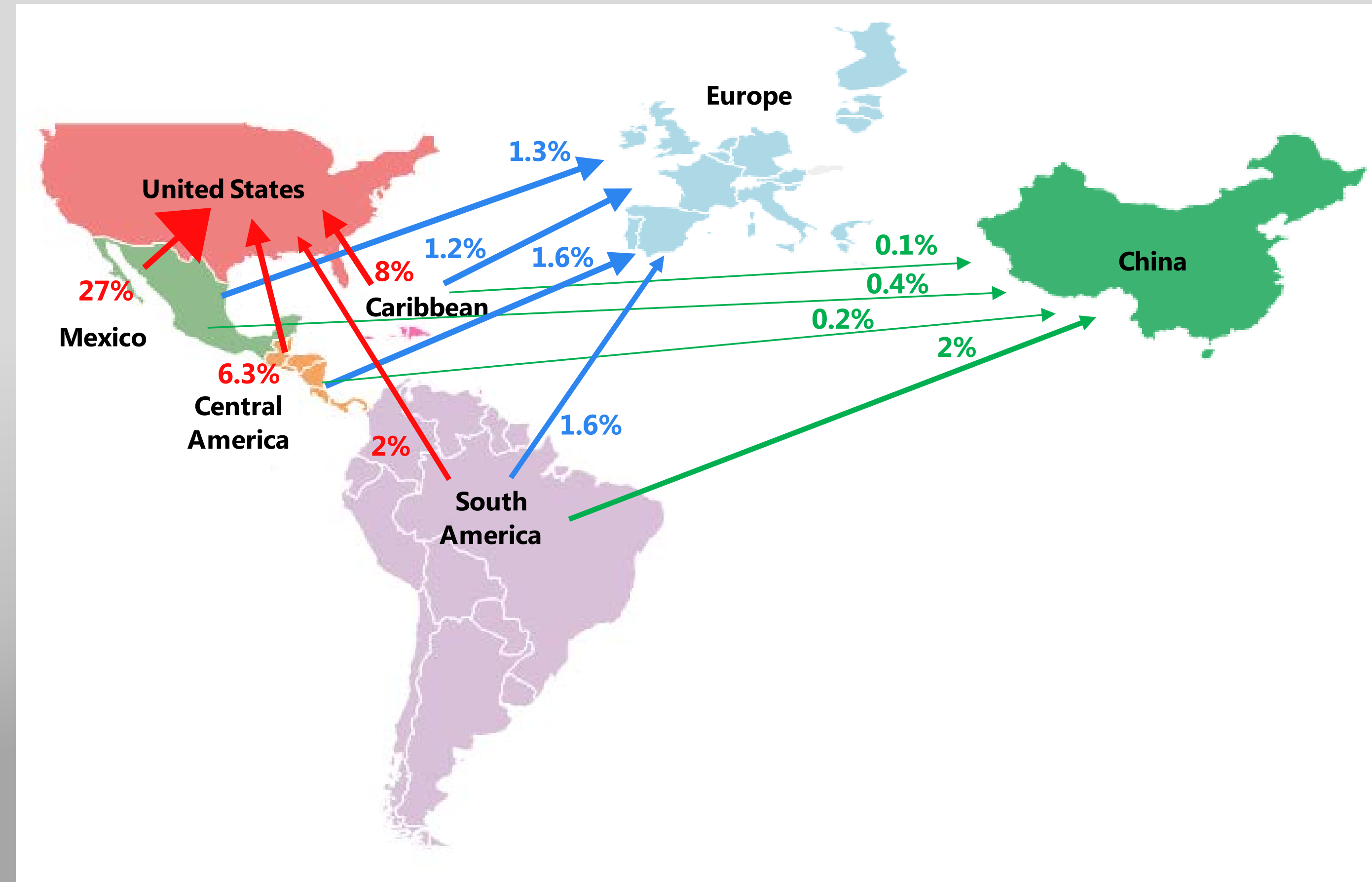


# Spread of economic nationalism and policy uncertainty— LAC trade flows and remittances subject to US influence...

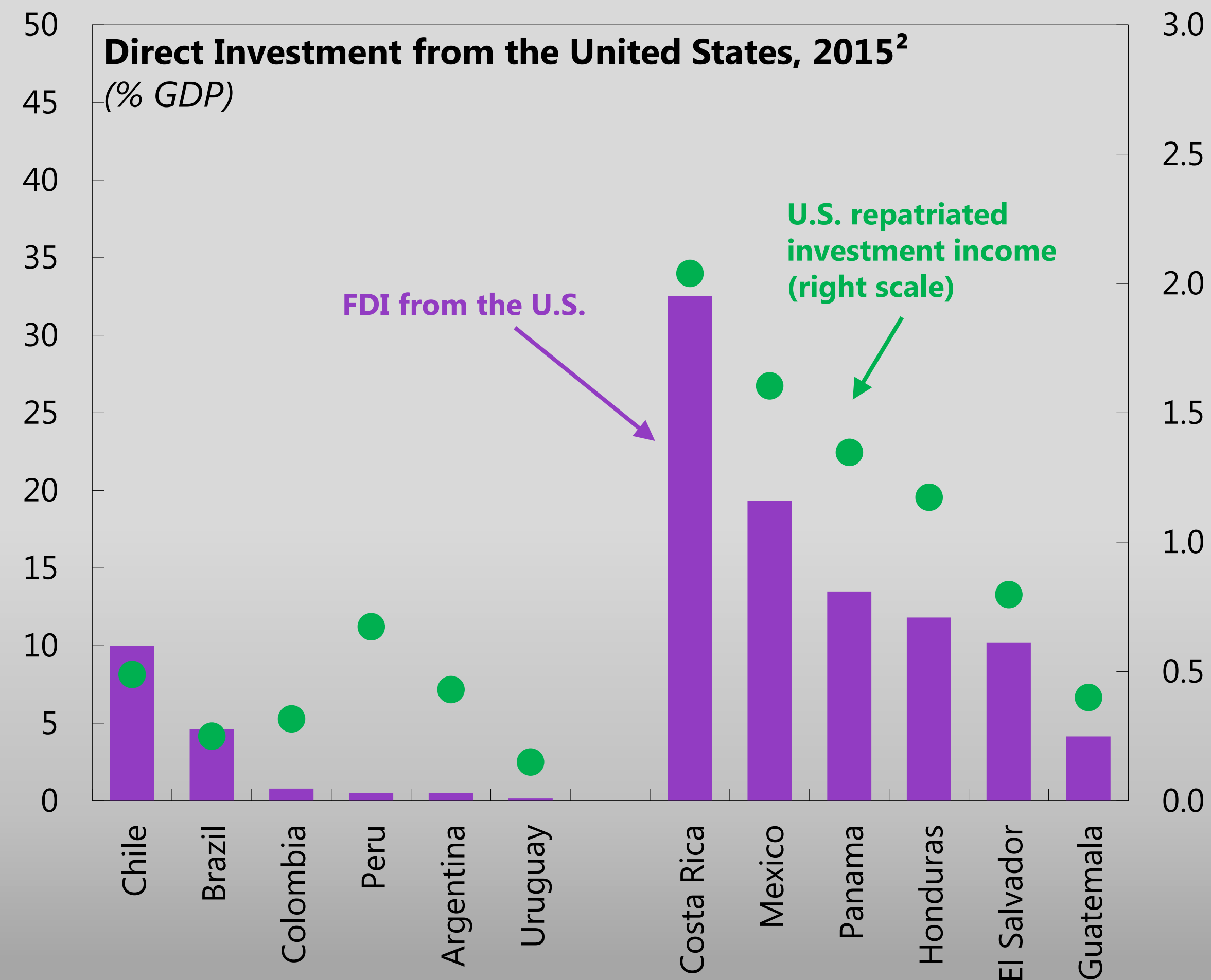
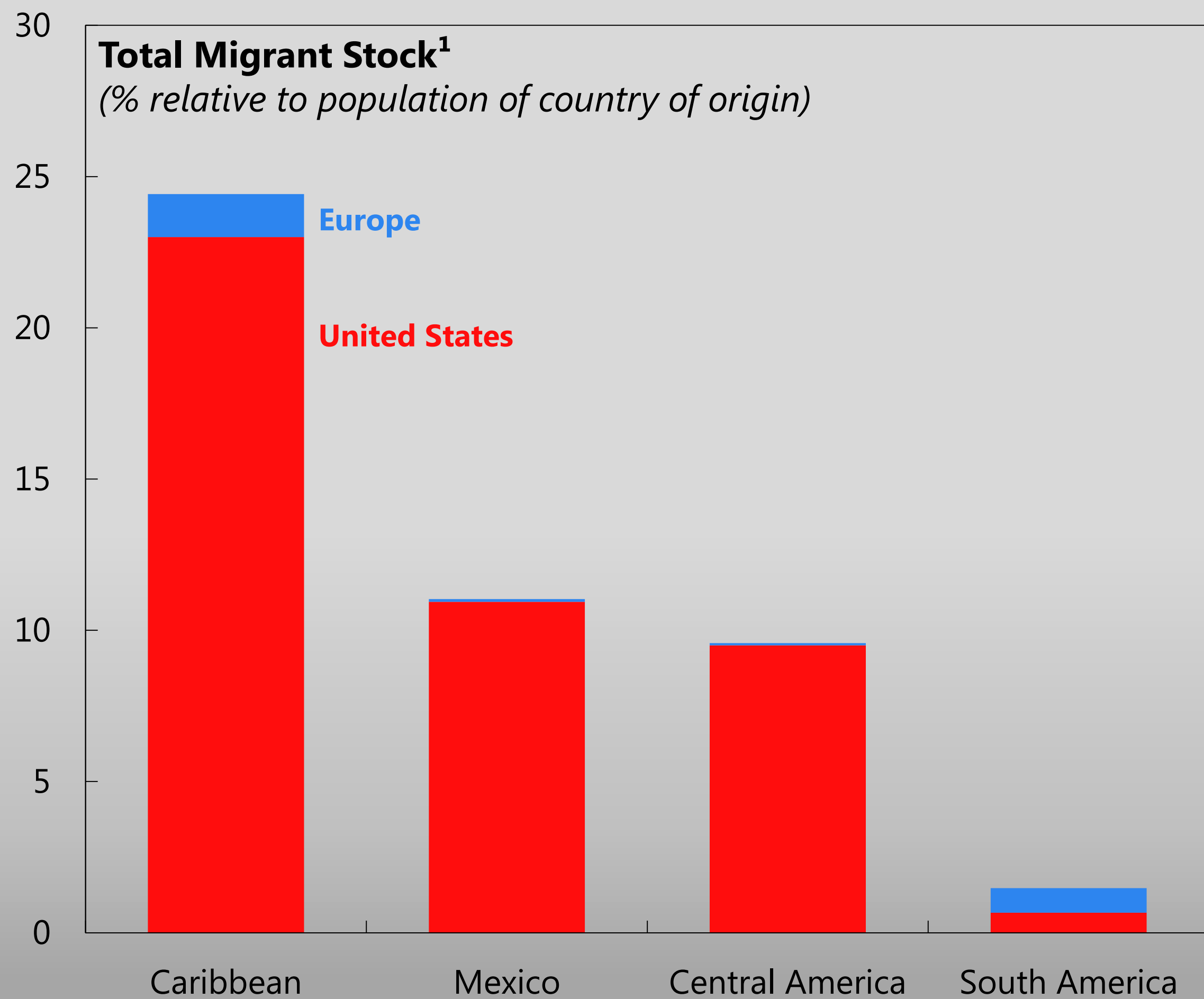
**Remittance Flows from the United States and Europe**  
*(% of recipient country's GDP)*



**Exports of Goods to Select Destinations**  
*(% of exporting country's GDP)*



# ... and so is the stock of migrants and FDI.



Sources: UN Department of Economics and Social Affairs 2015 and Coordinated Direct Investment Survey; IMF, World Economic Outlook database; and IMF staff calculations.

<sup>1</sup> The aggregate measure can mask significant exposures across the region's members.

<sup>2</sup> FDI income repatriation is based on the 2015 income from FDI (flow) and the share of U.S. FDI in total FDI stock.

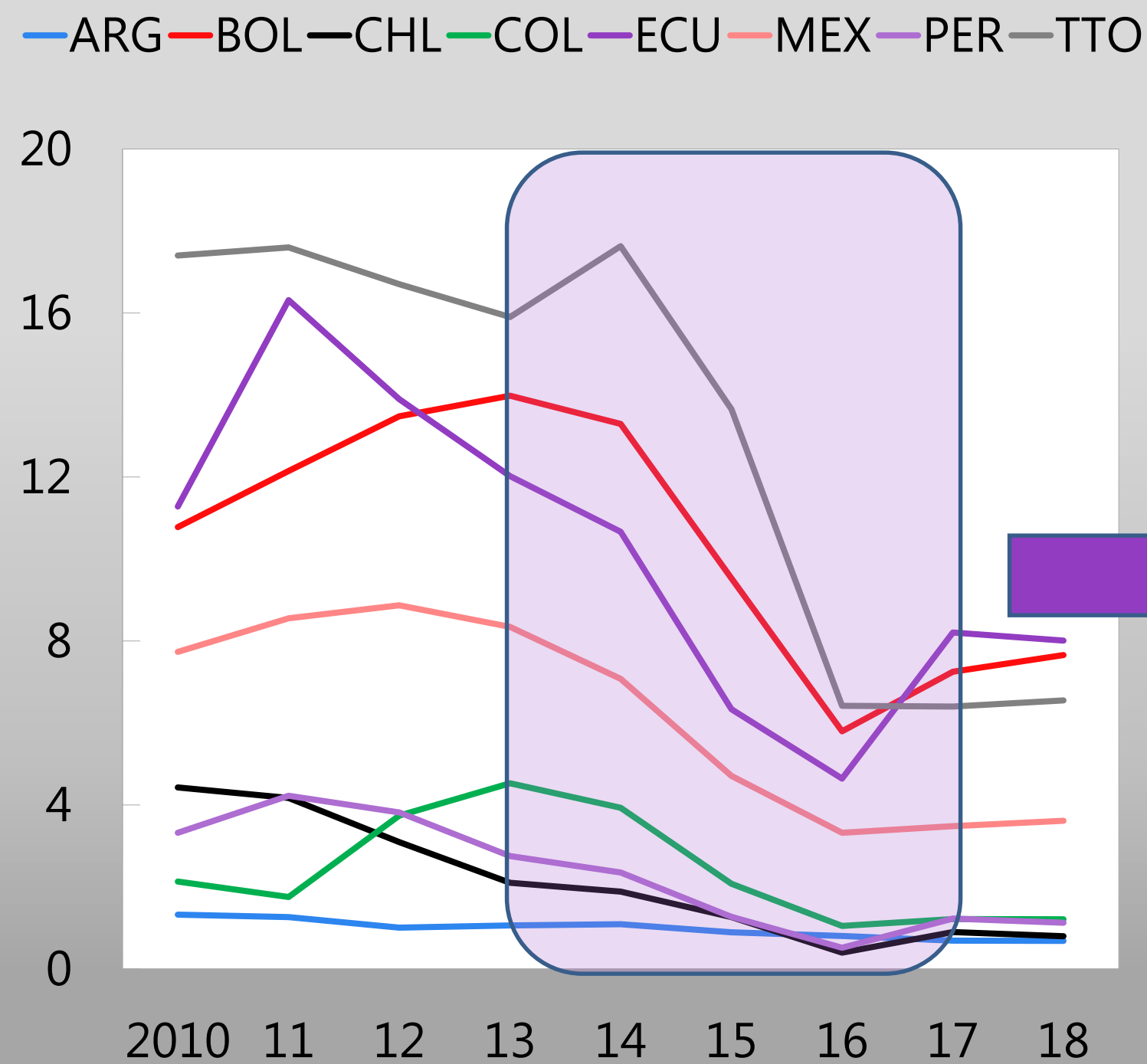
**Tale of Two Adjustments**  
*Act I: Fiscal*



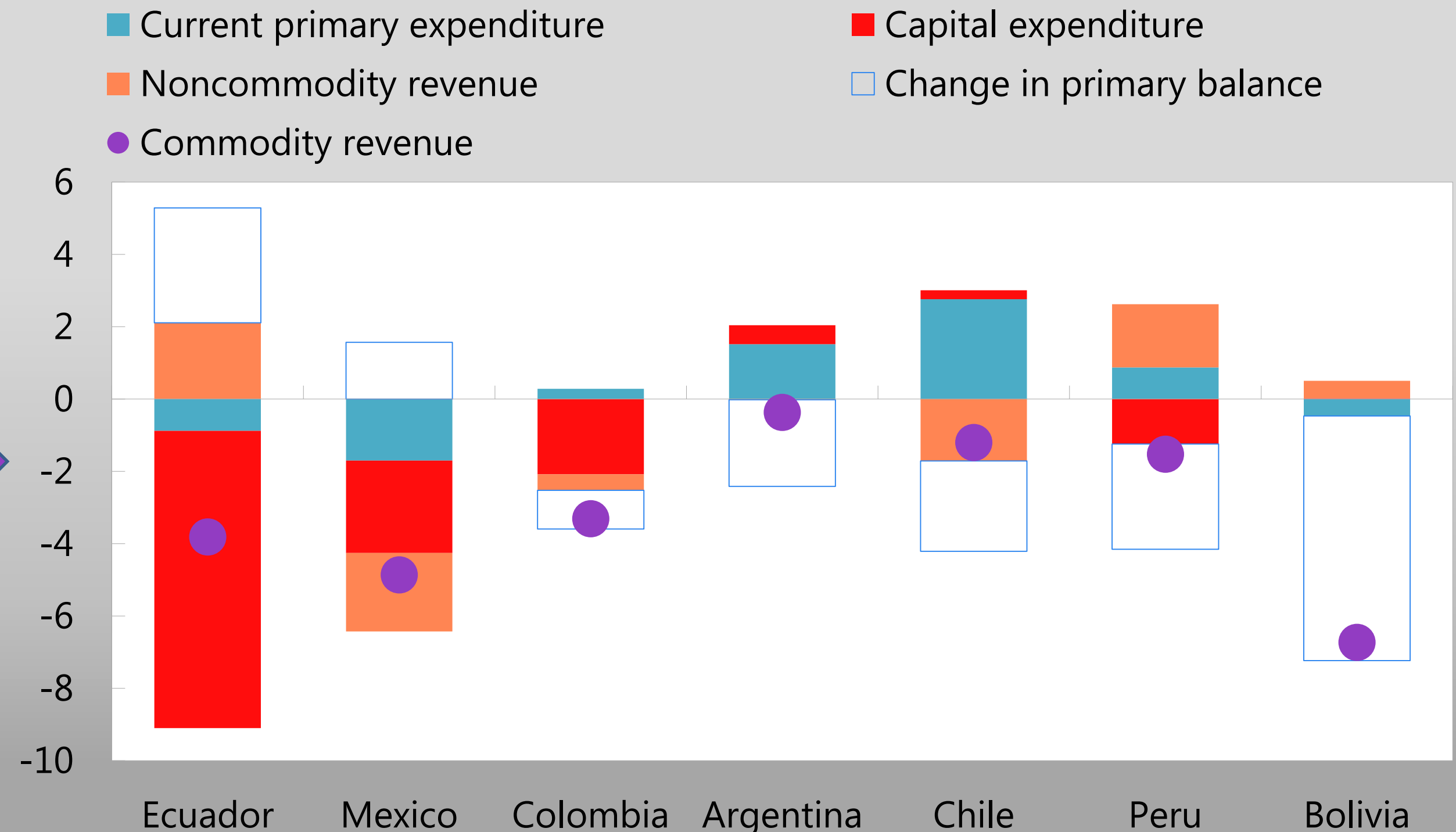
# Falling commodity revenue and rising deficits in most cases

*Fiscal revenues from commodities have fallen steeply. To fill the gap, different fiscal strategies have been deployed across the region.*

**General Government Commodity Revenues**  
(Percent of fiscal year GDP)



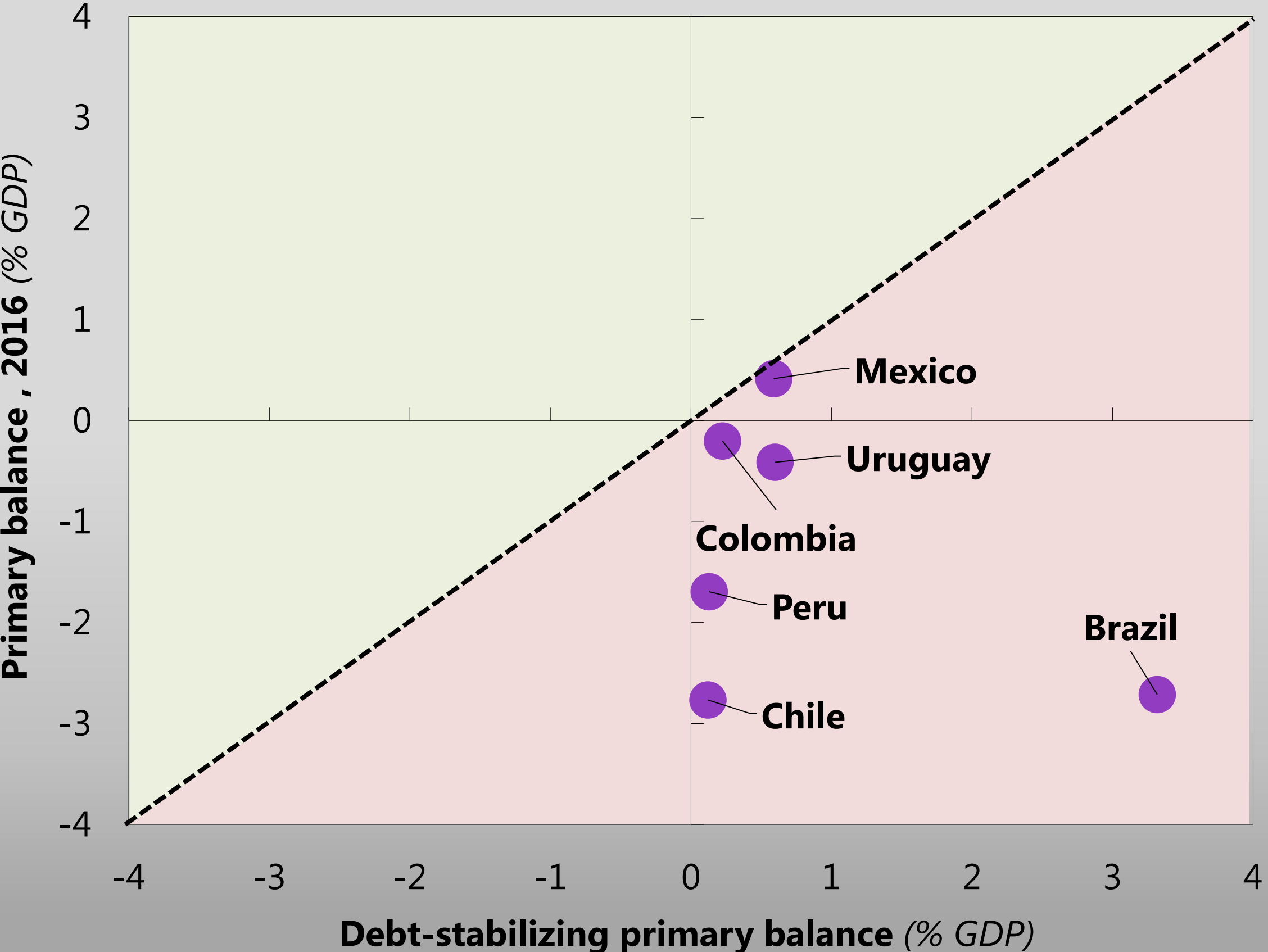
**Making Up for Lost Commodity Revenue, 2013–17**  
(Budget components; percent of fiscal year GDP)



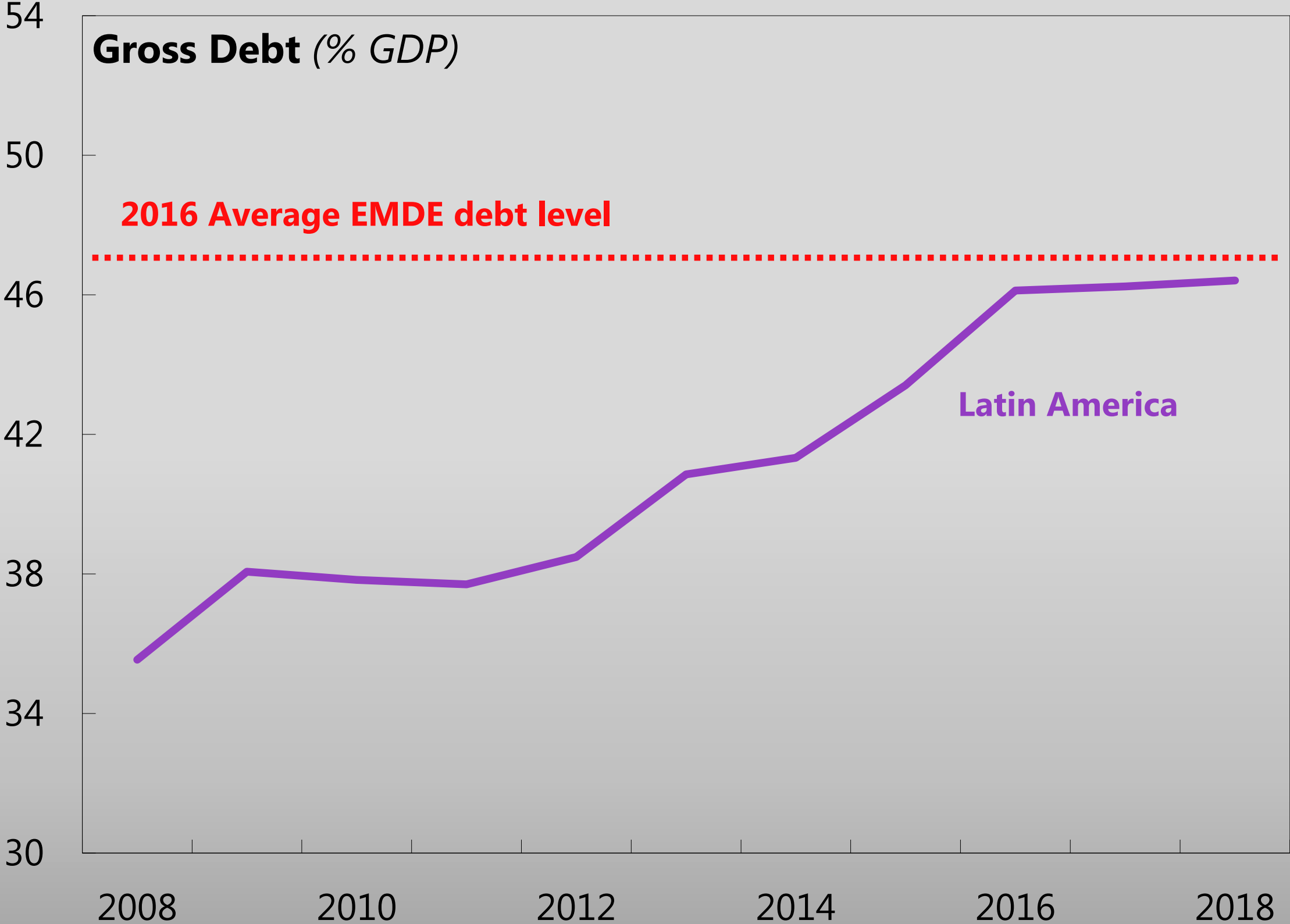
Sources: IMF, World Economic Outlook database; and IMF staff calculations.

# Further fiscal adjustment required to stabilize debt

Primary deficits currently exceed debt-stabilizing levels...



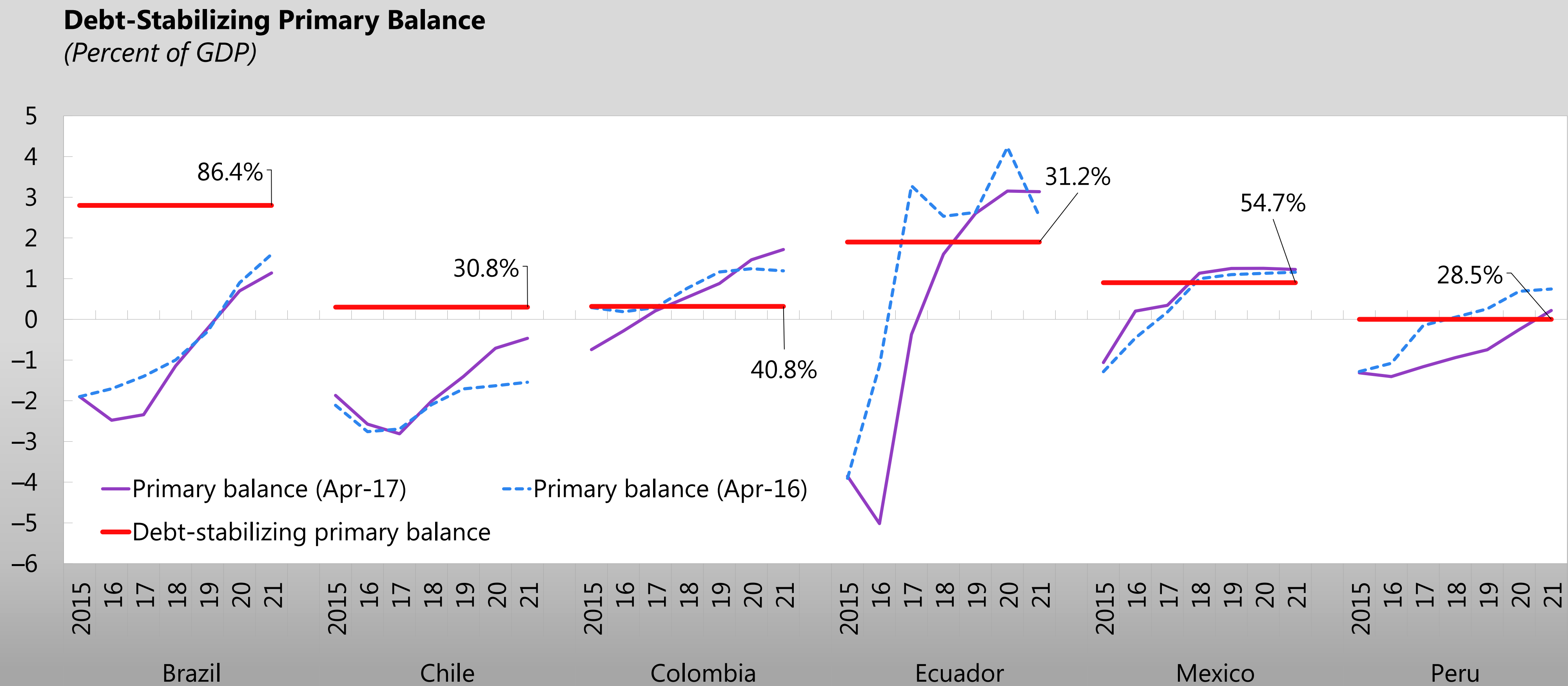
... causing rising public debt and eroding fiscal space.



Sources: IMF, World Economic Outlook database; and IMF staff calculations.

Sources: IMF, World Economic Outlook database; and IMF staff calculations.

# Pace of consolidation has been slowed in some cases



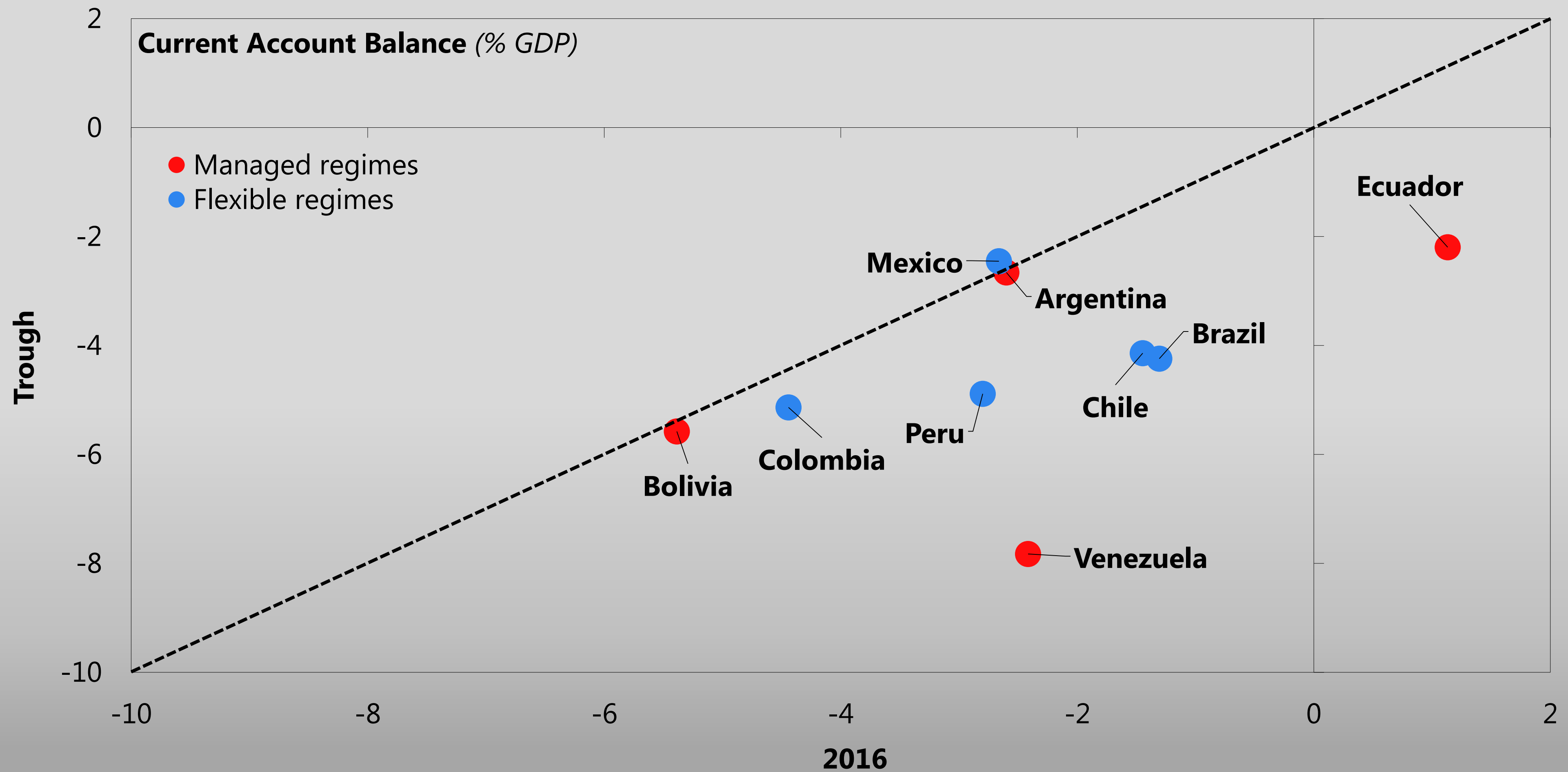
Sources: IMF, World Economic Outlook database; and IMF staff estimates.

Note: Number next to the red line refers to the 2021 debt-to-GDP ratio. For Brazil, debt-stabilizing primary balance excludes interest.

**Tale of Two Adjustments**  
*Act II: External*



# Current accounts have been adjusting...



Source: IMF, World Economic Outlook database.

Note: Trough year for Argentina, Bolivia, Ecuador, Peru, and Venezuela was 2015; Brazil and Colombia was 2014; and Chile and Mexico was 2013.

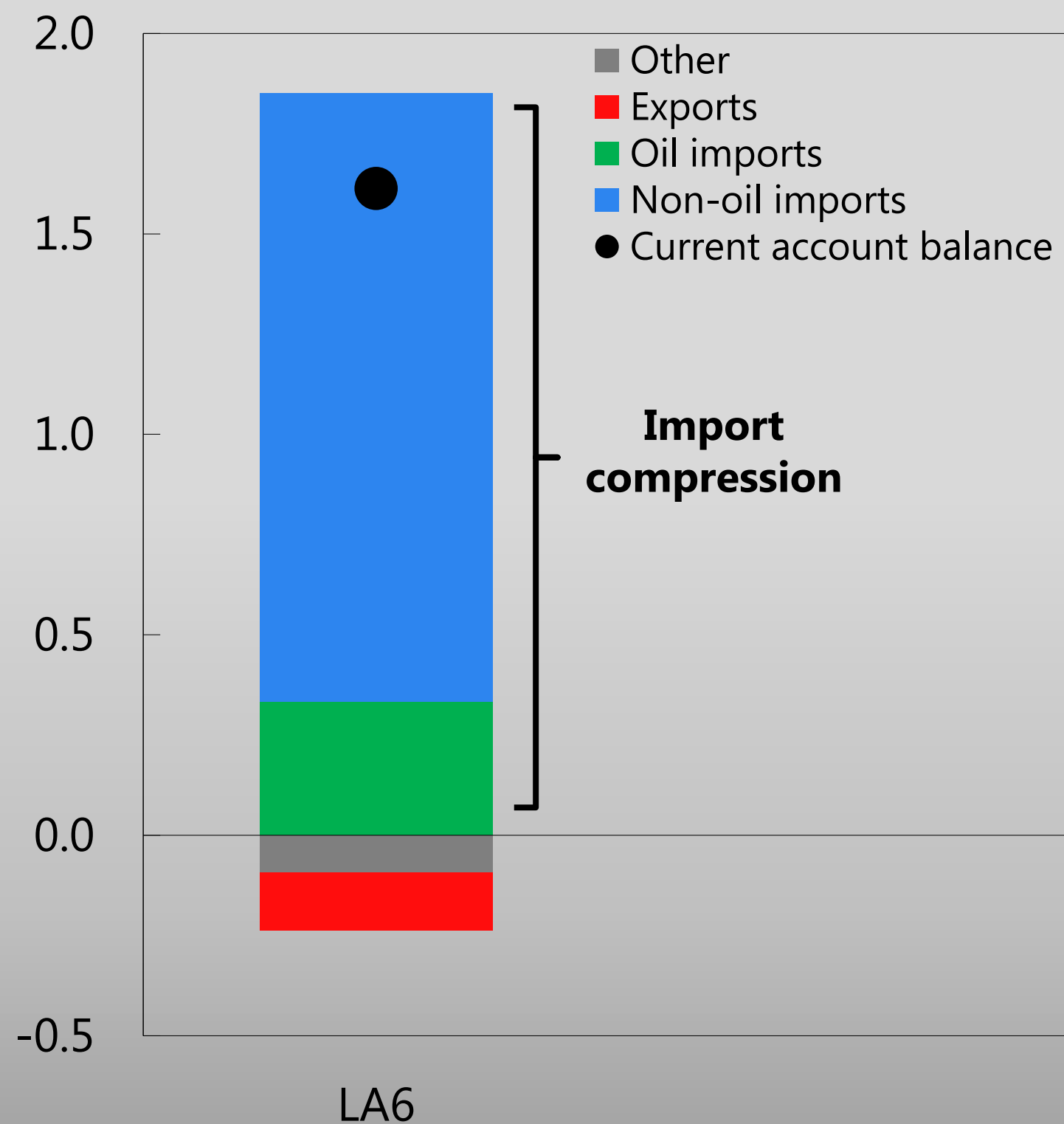
# ... and placed smaller drag on growth for flexible regimes

Current account adjustment through import compression...

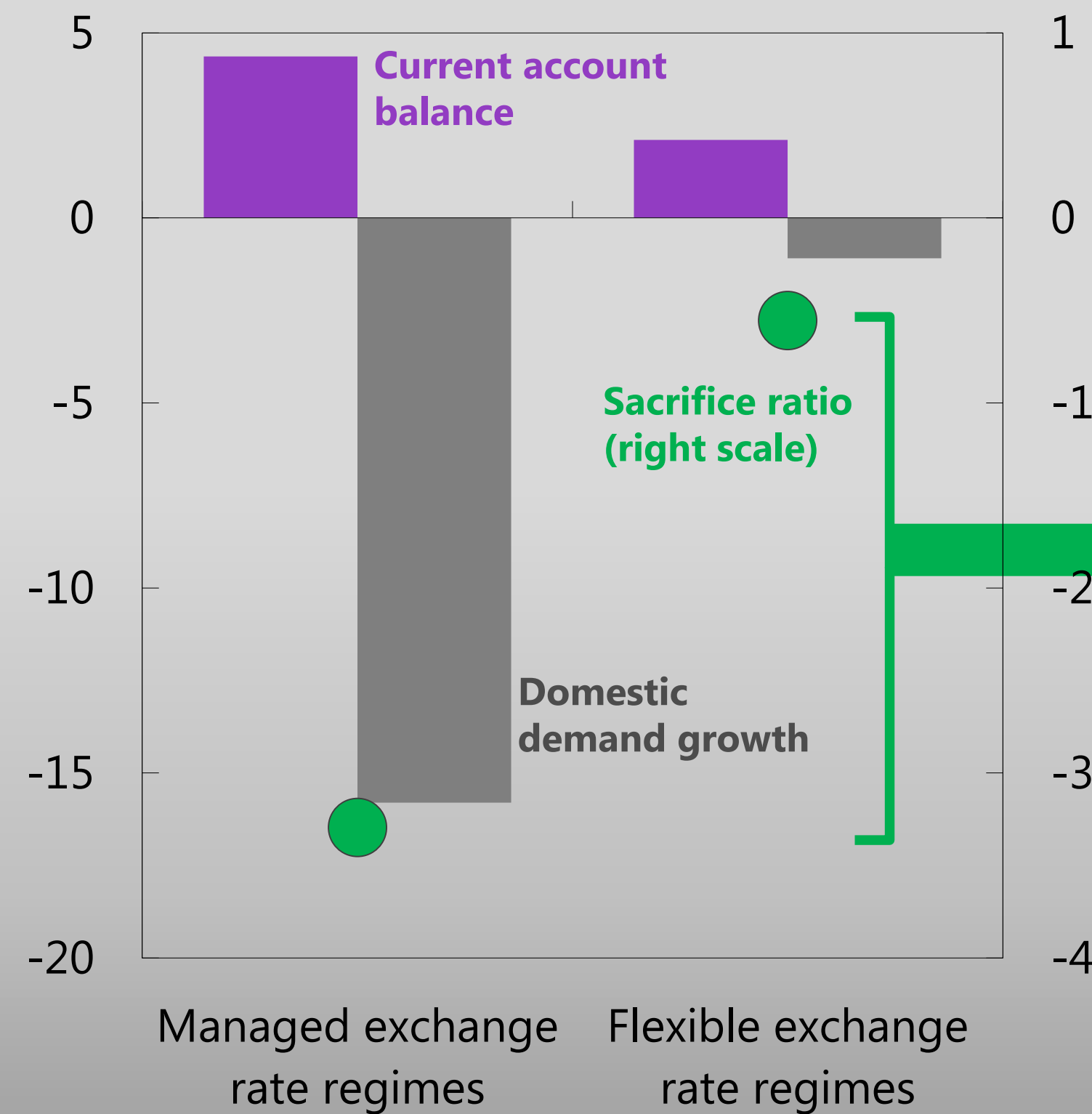
... but domestic demand more resilient in economies with flexible ER regimes...

... with large depreciations lowering the hardship of current account adjustment (lower sacrifice ratio).

(% GDP change; peak to trough)



(Percentage point change from peak current account deficit)



**Lower sacrifice ratio for countries with flexible exchange rate regime is due to:**

**60% Import expenditure switching**

**40% Export expenditure switching**

Sources: IMF, World Economic Outlook database; and IMF staff calculations. Note: Peak to trough is: Brazil (2014–16), Chile (2013–14), Colombia (2014–16), Mexico (2013–14), Peru (2015–16), and Uruguay (2015–16) for the period 2012–16.

Note: Sacrifice ratio of external adjustments is defined as how much domestic demand must compress in order for the current account balance to improve by one percentage point of GDP.

Source: IMF staff estimates based on a counterfactual exercise in a PVAR model that includes 38 countries at quarterly frequency from 2000–16.

*Policies*

# Policy Priorities

Insuring against downside risks and targeting strong, sustainable, and inclusive growth

- **Maintaining exchange rate flexibility**
- **Continuing with fiscal adjustment**
- **Easing monetary policy where inflation is declining and credibility is strong**

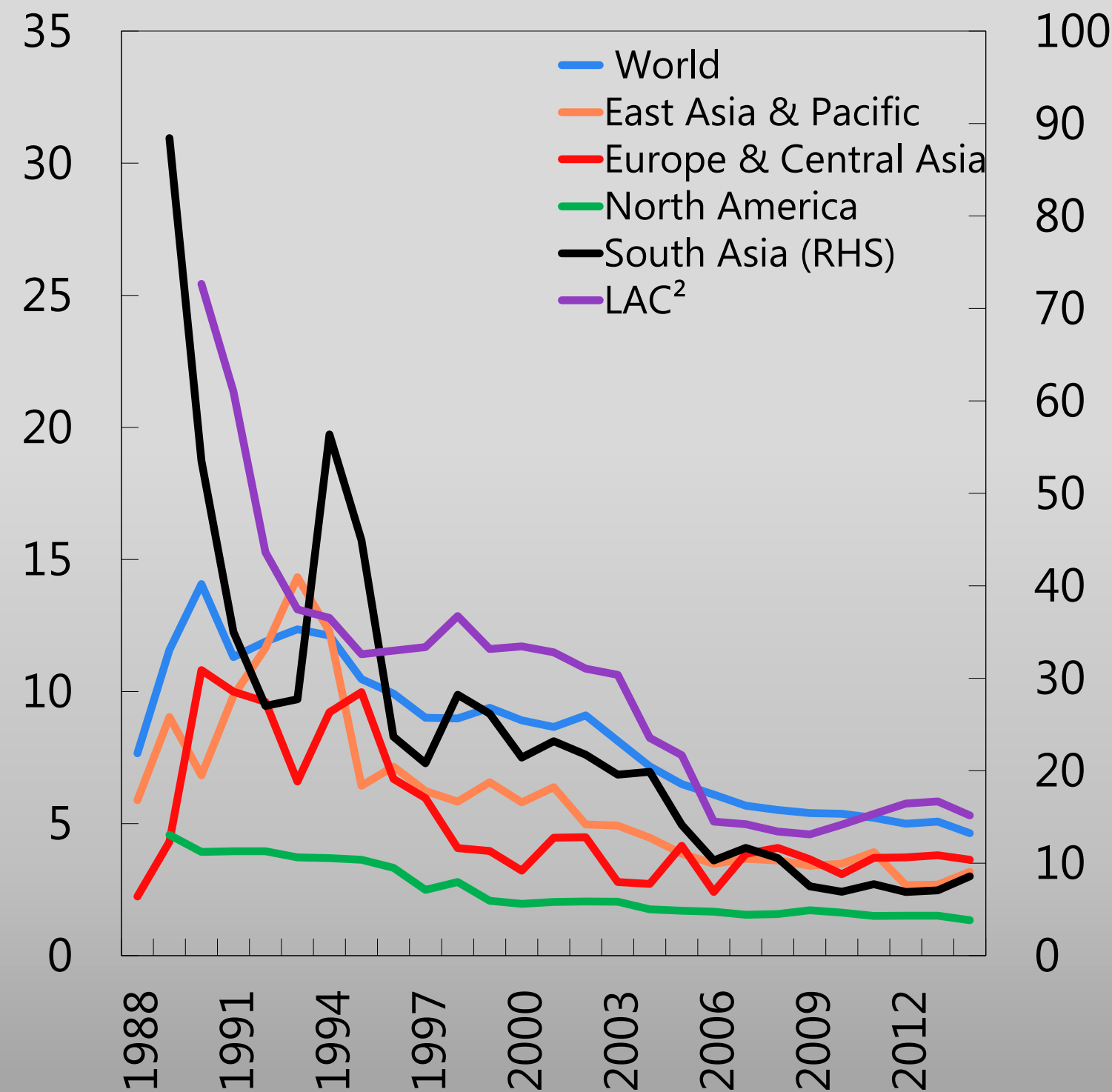
- **Securing strong and sustainable medium-term growth**
  - **Prioritizing capital and human capital spending**
  - **Improving institutions and governance**
  - **Furthering trade integration**
  - **Encouraging female labor participation where gaps exist**



# Strengthening medium-term growth— Room to increase trade integration

*Despite improvements, effective tariff rates remain higher than in other regions.*

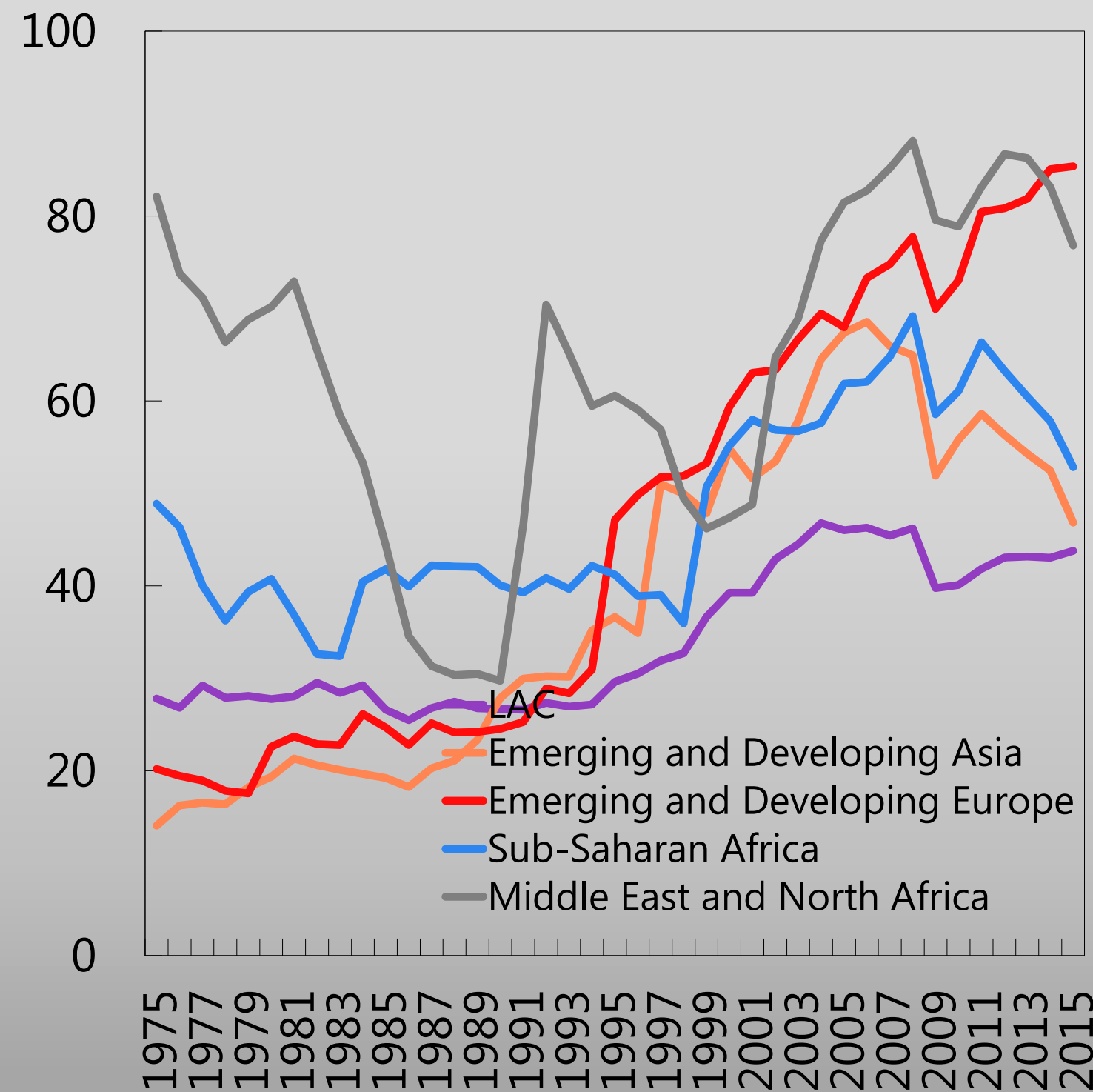
**Weighted Average Tariff<sup>1</sup>**



Sources: World Bank, WITS database; and IMF staff calculations.  
<sup>1</sup>Effectively applied weighted average tariff (%): The average of tariffs weighted by their corresponding trade value figures.  
<sup>2</sup>Refers to 3-month moving average.

*Weakly integrated into global trade*

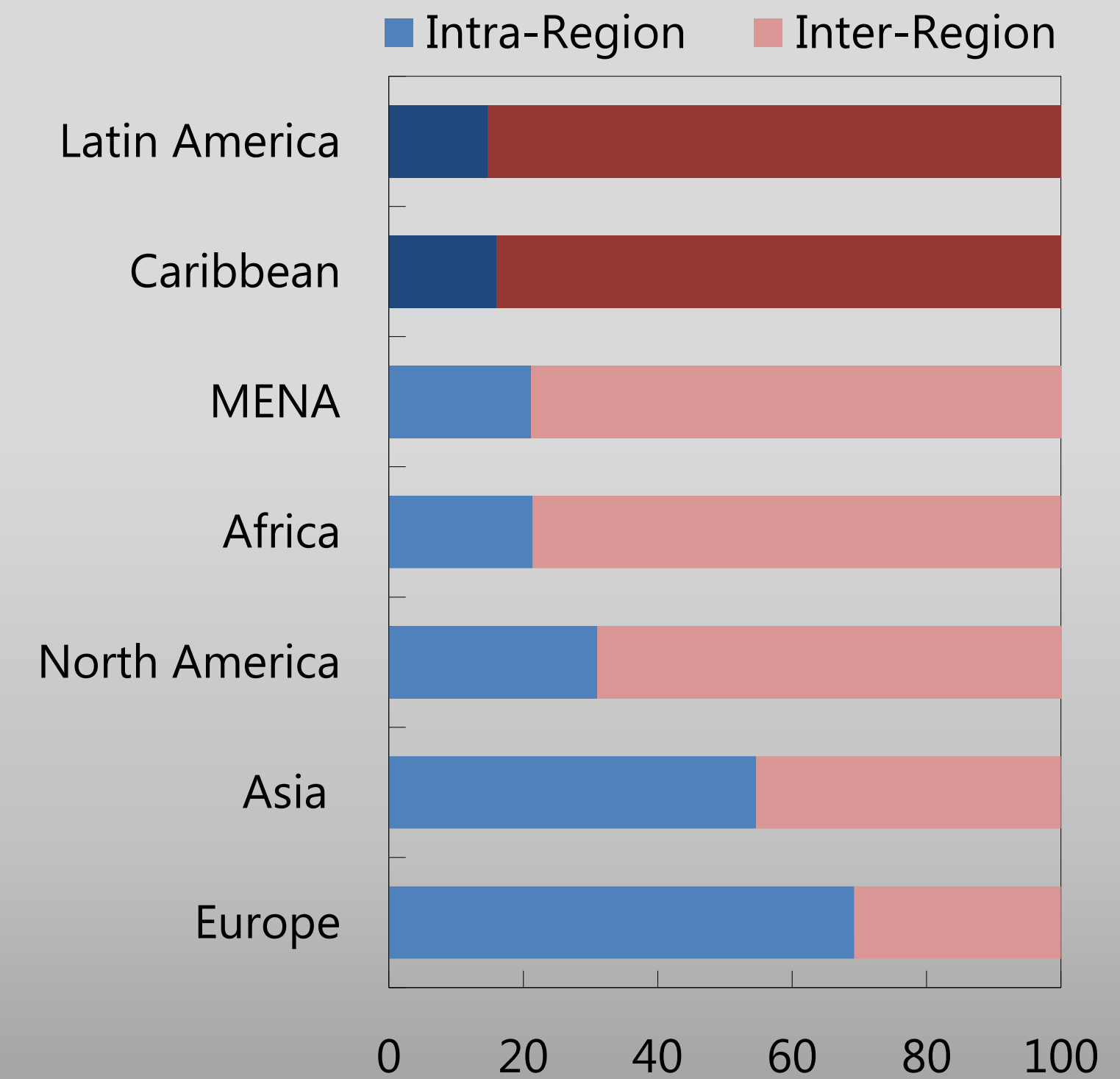
**Trade Openness**



Sources: IMF, World Economic Outlook database; and IMF staff calculations.  
 Note: Exports and imports in percent of GDP.

*Low regional integration*

**Regional Export Shares, 2015**



Sources: IMF, Direction of Trade Statistics database; and IMF staff calculations.  
 Note: Percent of total exports.



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