

EU-Latam relations

Jorge Sicilia

Fundación FAES
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01

EU-Latam relationship and their structural challenges

Europe and Latam are key partners that would benefit from stronger ties

- Slow per-capita growth in EU & Latam. Need private investment to increase productivity growth
- Several “points of contact” EU-Latam that could increase the likelihood of these goals:



TRADE

- Deficient intra-regional trade in Latam
- Europe is a sizable market and already a key trade partner for high-value-added exports, especially for South America.
- Latam has resources to offer to Europe, including for climate change. Strategic Autonomy
- **Is there really appetite for trade deals?**



INVESTMENT

- EU is the main investor. Even more weight of Europe in FDI to Latam
- FDI from Latam starting to go to Europe

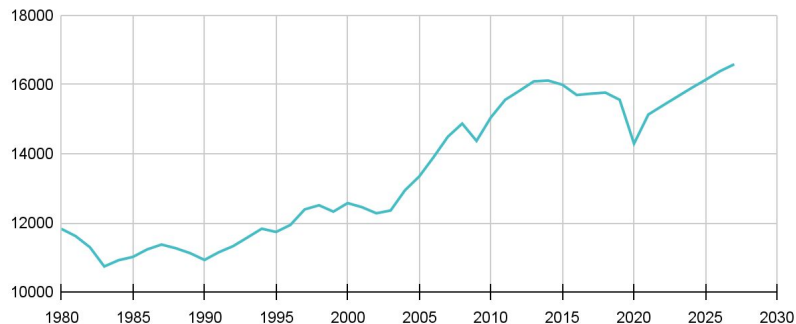


PEOPLE

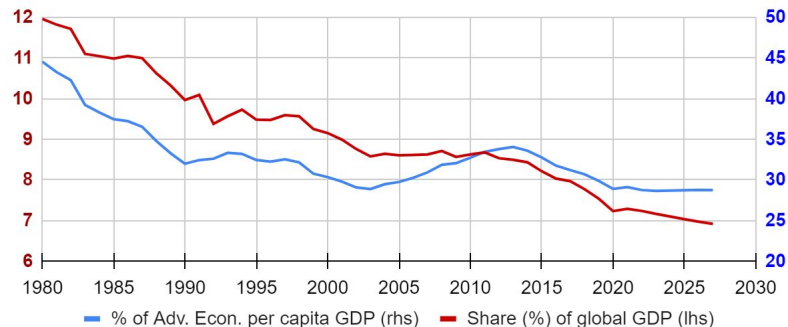
- Strong migration to EU (especially from South America)
- Tourism flows also greatly engage EU and Latam (especially South America)
- Latam needs higher human capital. Europe “exports” education that could fill positions with different skill sets (for which there is strong demand in Europe)

Latam: dealing with the fourth negative shock in short succession

LATAM GDP PER CAPITA - CONSTANT USD PPP



LATAM GDP GAPS - IN PPP



Source: IMF and BBVA Research.

- Four Shocks to the region since 2014
 - End of commodity supercycle (2014).
 - COVID (2019).
 - War in Ukraine (2022-).
 - Tightening global financial conditions.
 - GDP per capita not likely to recover until 2025 (A missed decade? But not like the 80s!).

- Latam's share of Global GDP continues to decline.
 - This is not just the rise of Asia: the gap of GDP per capita between Latam and Advanced Economies remains at historical highs.

- Need to revamp productivity growth. How?

Europe: evolving geopolitics, technology and climate change realities pose new challenges and call for new policies and shifts of economic models

NEW AND OLD STRUCTURAL CHALLENGES IN EUROPE

CAN LATAM HELP?

■ Geopolitics:

- Ukraine war and lack of confidence of Russia.
- Position in the face of increased US-China rivalry.
- Evolving role of international forums (G7, G20, WTO).



■ Trade:

- US increased protectionism: tariffs, IRA.
- Economic dependency on China vs geopolitical pressure.



■ Climate change:

- Increased awareness of climate challenges.
- Lack of some key metals and energy sources.



■ AI and digital:

- Very much behind the US and China in some technologies (AI, chips, batteries).



■ Ageing and migration:

- Ageing and diminishing labour force.
- Diminishing pools of immigrants in the future.

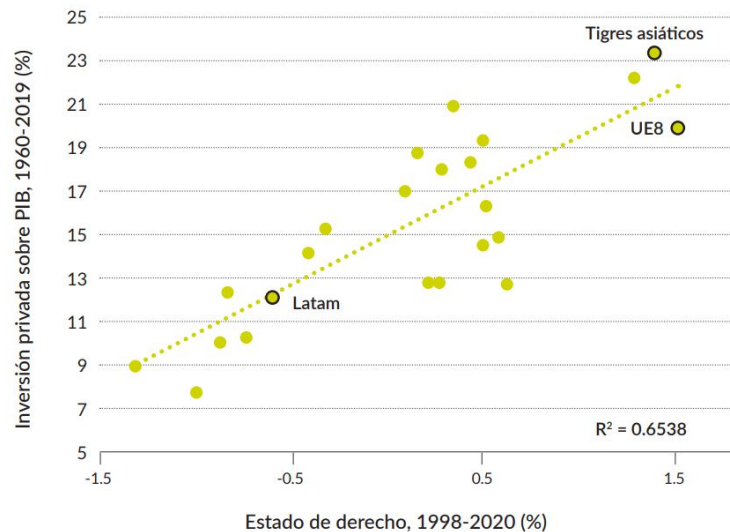


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Levers for productivity growth

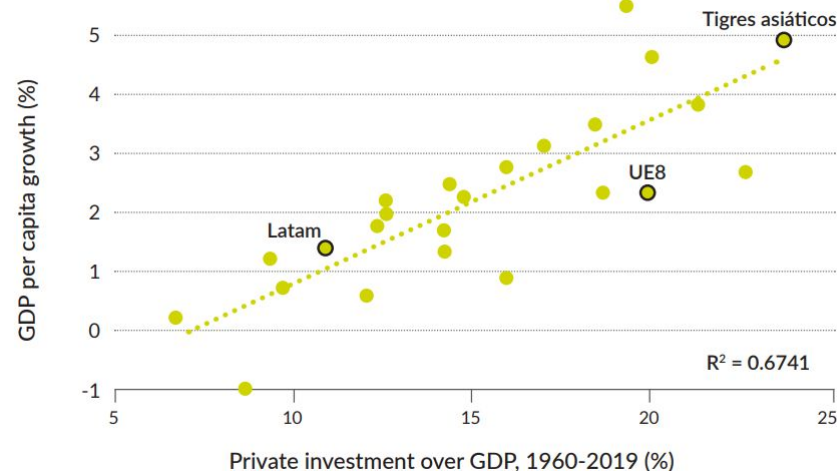
Latam and Europe need to increase per-capita growth: the role of private investment and institutions is key

PRIVATE INVESTMENT AND RULE OF LAW



Source: IMF, World Governance Indicators and BBVA Research.

PRIVATE INVESTMENT AND GROWTH



Source: IMF, Penn World Tables and BBVA Research.

Countries with better institutions and better rule of law correlate with higher investment
Higher private investment translates into higher per-capita growth and faster convergence.

Lever 1: Trade. Increasing trade is a win-win for Latam and EU

LATAM

- Difficult **intraregional trade**: deficient infrastructure, atomized trade deals.
- **Nearshoring**: an opportunity for Mexico. (South America is much farther away; never took advantage of rise of value chains).
- China: important destination for commodities, but not for high-value-added exports.
- US: Low appetite for new trade deals.

What is the EU's appetite to advance trade deals?

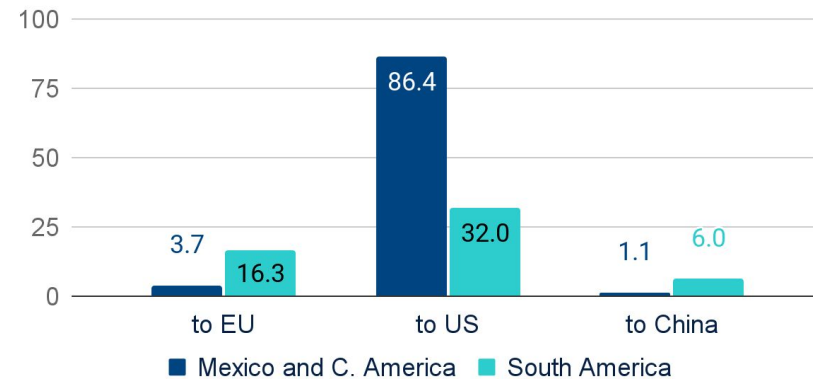
Agreements with Latam in the pipeline:

Mercosur (ratification);
Chile (modernization);
Mexico (modernization)

EU

- Open up new markets.
- Access to commodities and key resources for climate-friendly growth and new industries (commodities, rare earths).
- Strategic autonomy with requires stronger links and investment.

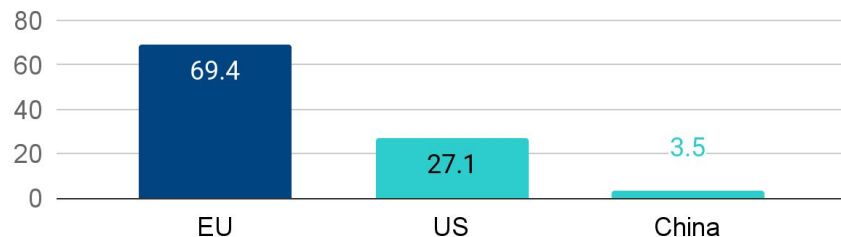
EXPORTS OF MEDIUM- AND HIGH-TECHNOLOGY % OF TOTAL EXPORTS OF ITS KIND



Lever 2: Keep up and increase FDI from Europe in key sectors (in a world where the US and China are trying to catch up)

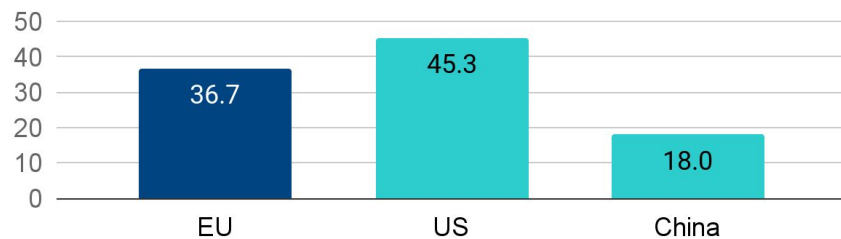
DI STOCK IN LATAM, 2021

(% OF SUM EU+US+CHINA)



CUMULATIVE FDI FLOWS TO LATAM, 2010-20

(% OF SUM EU+US+CHINA)



A big win for Latam

- Key component of transfer of know-how.
- Institutional anchor.
- EU and US still dominant in Latam
 - Stock of EU+US FDI is 20 times bigger than China's;
 - 5 times bigger flows than China during 2010-2020

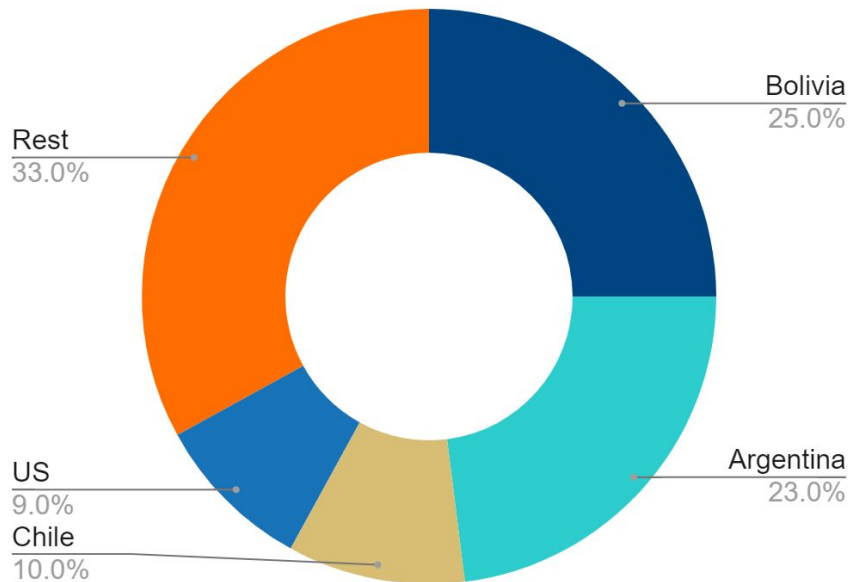
A big win for Latam

- Access to key resources.
- Access to local markets.
- Export platforms (eg USMCA).

Lever 3: EU-Latam and the scope for cooperation on climate change

LITHIUM RESERVES

(% OF GLOBAL)



Source: IADB and BBVA Research.

Latam: leveraging Climate action for growth?

- Latam has a larger share of **key resources** (copper, lithium) than its share of global GDP
- Latam is also prone for **clean energy export** (hydrogen) to EU or receive **energy-intensive industries**, part of GVCs.
- LatAm also needs to unlock the **potential of natural capital**, to combat the loss of biodiversity
- But it needs the right investment and regulatory framework as **private investment is key**

EU: securing green transformation

- Secure supply chains for climate action, including clean energy.

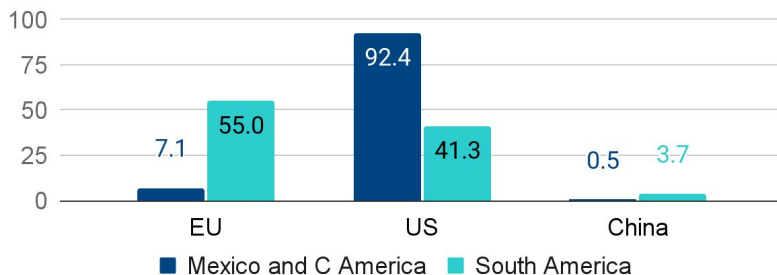
EU investment in clean Value Chains in Latam?

- Work toward EU emissions goals.
- Part of the value added to remain in Latam.
- Help improve Latam environmental standards.

Lever 4: Developing EU-Latam human ties

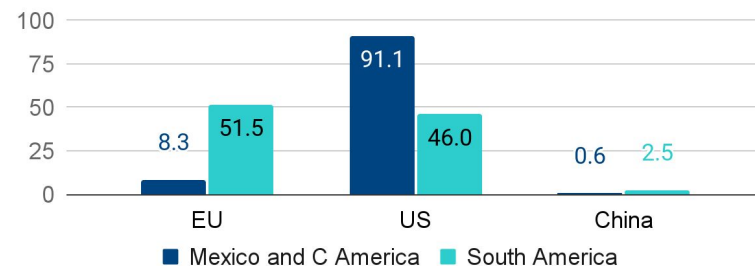
ORIGIN OF TOURISTS TO LATAM, 2019

(% OF SUM EUROPE+US+CHINA)



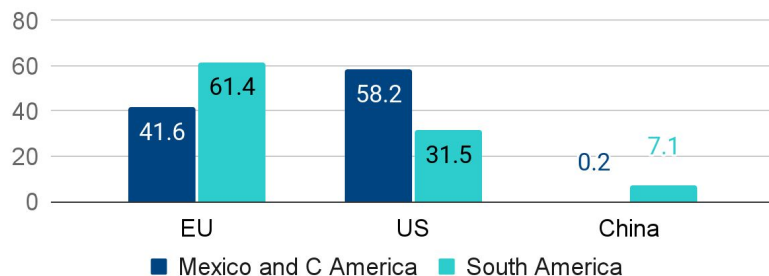
DESTINATION OF LATAM TOURISTS, 2019

(% OF SUM EUROPE+US+CHINA)



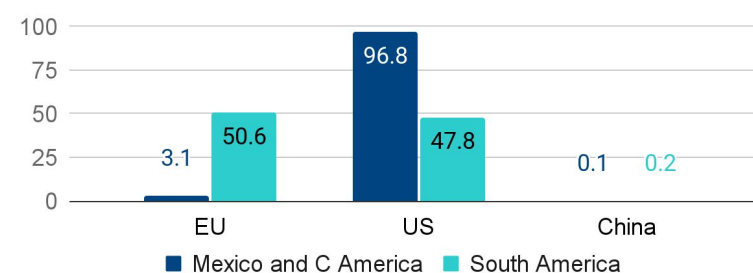
DESTINATION OF LATAM STUDENTS, 2019

(% OF SUM EUROPE+US+CHINA)



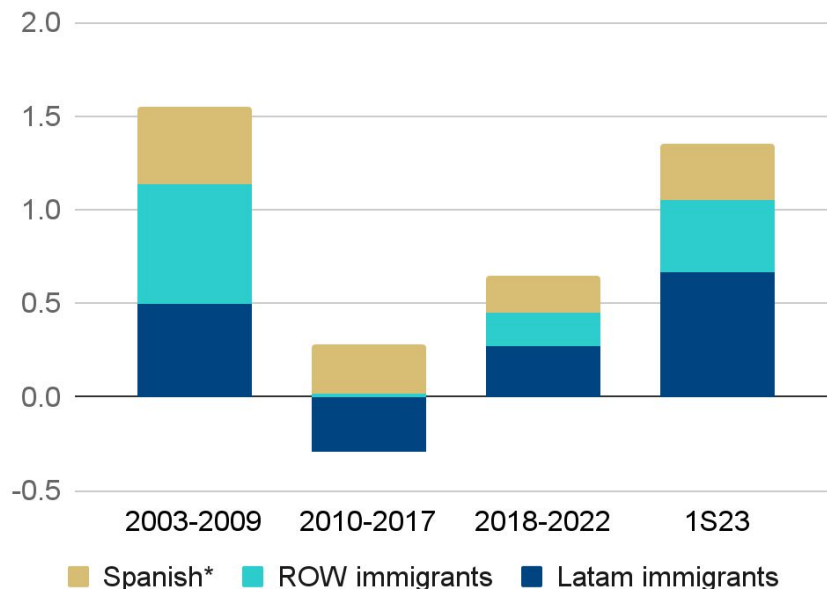
DESTINATION OF LATAM MIGRANTS, 2019

(% OF SUM EUROPE+US+CHINA)



Lever 4: EU-Latam: Taking advantage of demographic trends and strong human ties in migration and education

SPAIN: CONTRIBUTION TO Y-O-Y GROWTH OF THE WORKING-AGE POPULATION (PERCENTAGE POINTS)



- Ageing and diminishing labour force in EU

- Diminishing pools of immigrants in the future.
- Scope for more organized migration from Latam. Qualified immigration.

- Opportunities for EU-Latam cooperation on education

- Further attraction of Latam university graduates for further higher education.
- Brain gain in Latam from higher education opportunities in Europe.

- Baldwin's (2020) third great unbundling and opportunities for trade in services EU-Latam

- Latam: Massive increase in tertiary education cannot always find jobs locally.
- Demand for services (personal and professional) is on the rise in advanced economies.

03

Takeaways

Concluding remarks

- Cyclical slowdown in Latam, but structural challenges as well: need private investment for growth.
- Europe also needs to increase per-capita growth: investment, deregulation, innovation.
- Several points of contact EU-Latam towards these goals:
 - Trade agreements: not the panacea, but significant benefits.
 - For both: new markets; increase productivity and GDP per capita.
 - For EU: secure supply chains, including key resources for climate action.
 - For Latam: institutional anchoring.
 - Investment
 - For both: increase productivity; investment-for-climate-action.
 - For EU: investment opportunities; access to key resources, to local markets; export platforms
 - For Latam: know-how, technology transfer; institutional anchor.
 - Human dimension: migration; service exports; higher education opportunities for Latam in Europe.
- Keeping Latam in the “western” camp and supporting democratic values, avoid authoritarianism that hinders investment.

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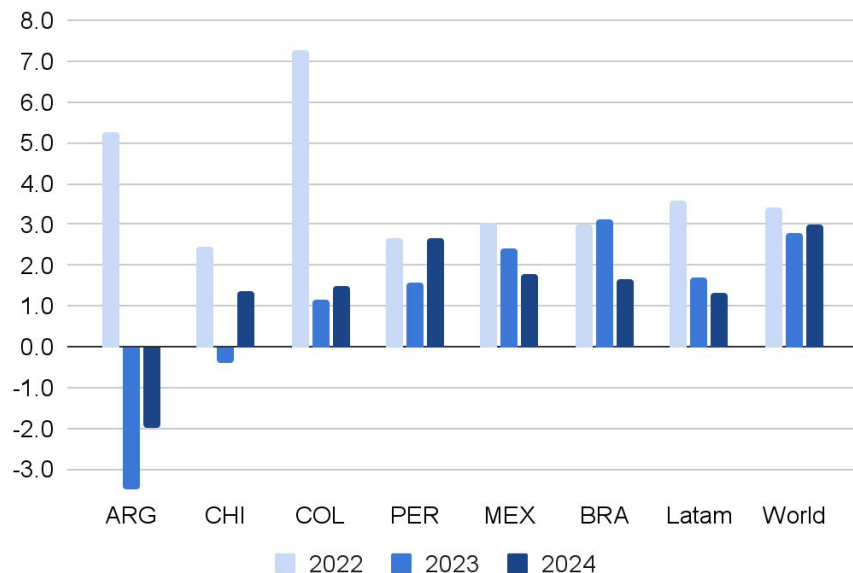
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Annex

Latam: after COVID growth rebound, slowdown is expected in 2023-24, on external and domestic headwinds

GDP GROWTH

(%)

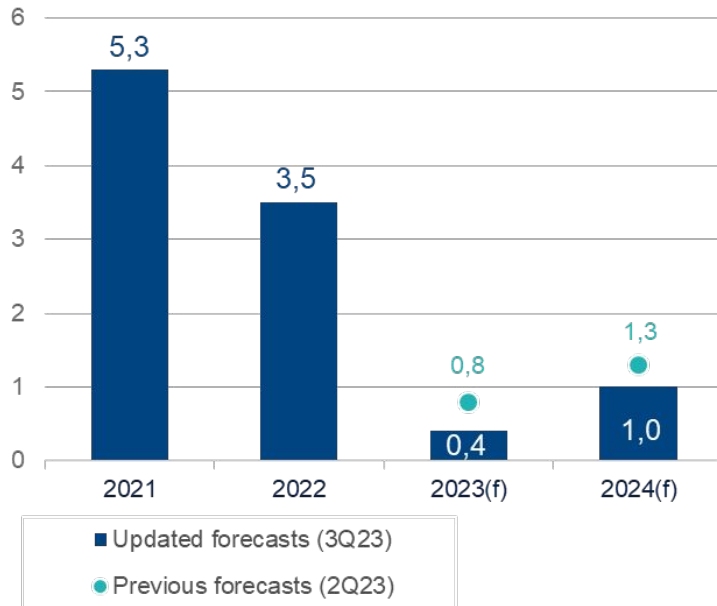


- Growth will slow down significantly in 2023-24, to around 1.5%
- Inflation in Latam has moderated significantly due to early and fast monetary tightening
- First rate cuts are starting in some countries. They will spread before year-end. But the road to neutral monetary policy is long.
- Fiscal policy in Latam is broadly neutral but it could probably help more to reduce price pressures going forward.

EU: After the sharp exit from Covid, GDP growth has been affected by the Ukraine war, higher interest rates and, more recently, China's sub-par growth

EUROZONE: GDP GROWTH PRELIMINARY FORECASTS

(%)



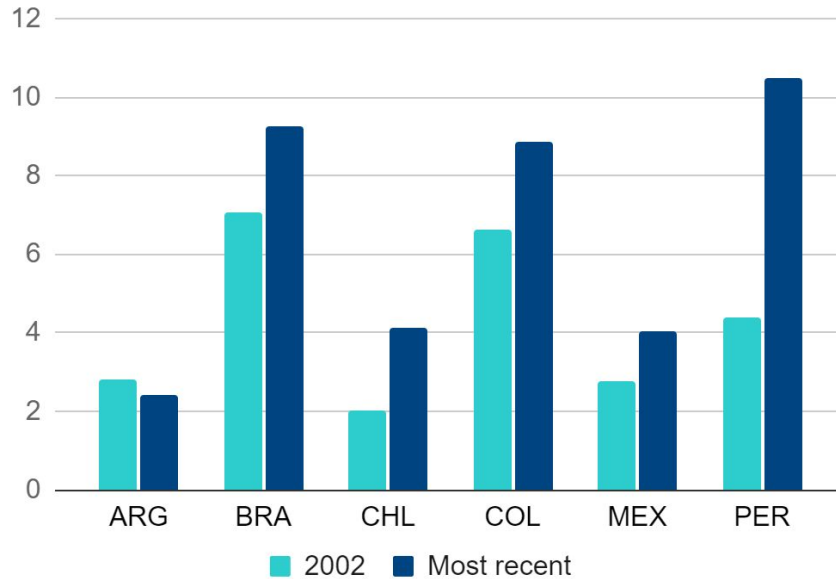
- **Growth:** Bias to lower growth, mostly due to lower than expected performance in China and
- **Fiscal policy is still supportive**, but will likely become more targeted and less expansionary onwards. It is pending on an agreement on fiscal rules to be applied in 2024
- **Inflation remains relatively high.** It has started to flex down thanks to lower commodity prices, base effects and higher rates, but remains far from target
- **ECB:** Very close to maximum rates expect another hike this year and no rate cuts for a long period of time
- **Risks** include the war, higher energy prices (negative competitiveness shock), China's deceleration, more persistent inflation, collapse of the current growth model, especially in Germany (and impact of China US industrial policies)

What does Europe need to increase per-capita growth?

- **Increase labour force (immigration) and labour use** (higher participation of older and female workers).
- **More investment**, especially in sectors that address new needs (clean energy, EVs).
- **More trade openness** to third countries.
- **Focus on effective innovation** (AI and digital, clean energies), less regulatory burden.
- **Autonomous payment systems** (which may benefit third countries) that do not depend on the US.

What does Latam need to increase per capita growth? More investment. What prevents it?: Lack of political consensus for micro reforms

NUMBER OF EFFECTIVE* PARTIES IN CONGRESS



* The number of effective parties is computed as the inverse of the Herfindahl concentration index for party seats in Congress.

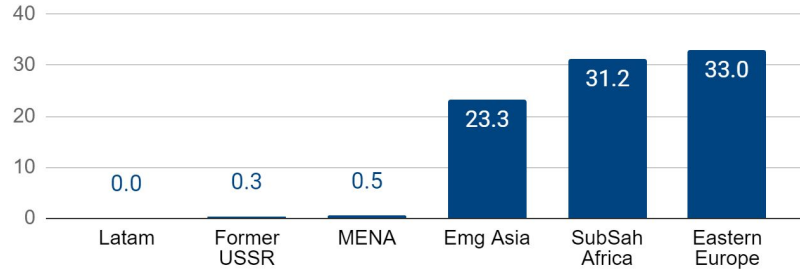
Source: National Congresses and BBVA Research.

- 2022-24 is the latest election cycle in Latam (CRC, COL, BRA, ARG, PRY, GTM, MEX, ELS, VEN, URU)
- Pink Wave (PER, COL, BRA, CHI) cannot be generalized: see ARG, ECU, CRC.
- Since 2018, opposition has won 76% of elections in Latam. No ruling party has won the presidency.
- “Punishment vote” started around 2015, with the growth slowdown. “Punishment vote” reduces the length of mandates, relative to long mandates in the high-growth decade (2003-13)
- Winning coalitions since 2015 usually united in protest.
- Polarization and fragmentation have become the norm. Elected Presidents on average got 37% of vote in first-round in 2018-22 (48% in 2009-13).
- Difficult governability. Difficult to pass reforms.

Environment: Geostrategic US-China rivalry and the Latam-EU relationship

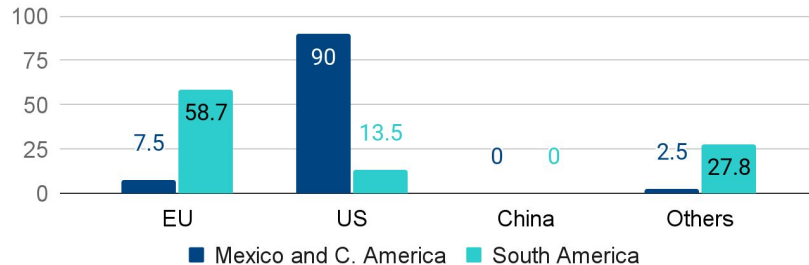
WEAPONS IMPORTS FROM CHINA 2021-22

(% OF WEAPONS IMPORTS OF EACH REGION)



ORIGIN OF WEAPONS IMPORTS IN LATAM 2021-22

(% OF TOTAL WEAPONS IMPORTS)



- It does not seem that the US and EU have abandoned Latam to China when looking at
 1. Destination of high-technology exports from Latam (mostly US and EU);
 2. FDI stocks and flows;
 3. Financial flows;
 4. Human links (tourism, students, migration)
 5. Military links with the US (see graph)

- But the EU and US need to rekindle a closer relationship held in the past. And dealing with countries that demand a stronger voice (their own voice) in foreign affairs. Europe could be the first to understand it and build on that

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