

# Latin America: Breaking out of the trap?

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China, March 2011.

# Main messages

- **The world has changed:** Emerging economies are moving from the periphery to the core of the global economy.
- **Latin America not a mere observer:** participating fully in this process.
- **How has Latin American managed?**
  - **Breakthrough with the past politically and economically**
    - Not only on the surface (the macro) but deeper (structural reforms)
  - **Also some tailwings: commodities no longer a curse but a treasury**
    - Growing ties with China and much better terms of trade
- **Still, major challenges remain**
  - **Demanding middle class but still low education and aging**
  - **Potential growth needs to be increased with additional reforms:**
    - **Investment in infra-structure and education are key**

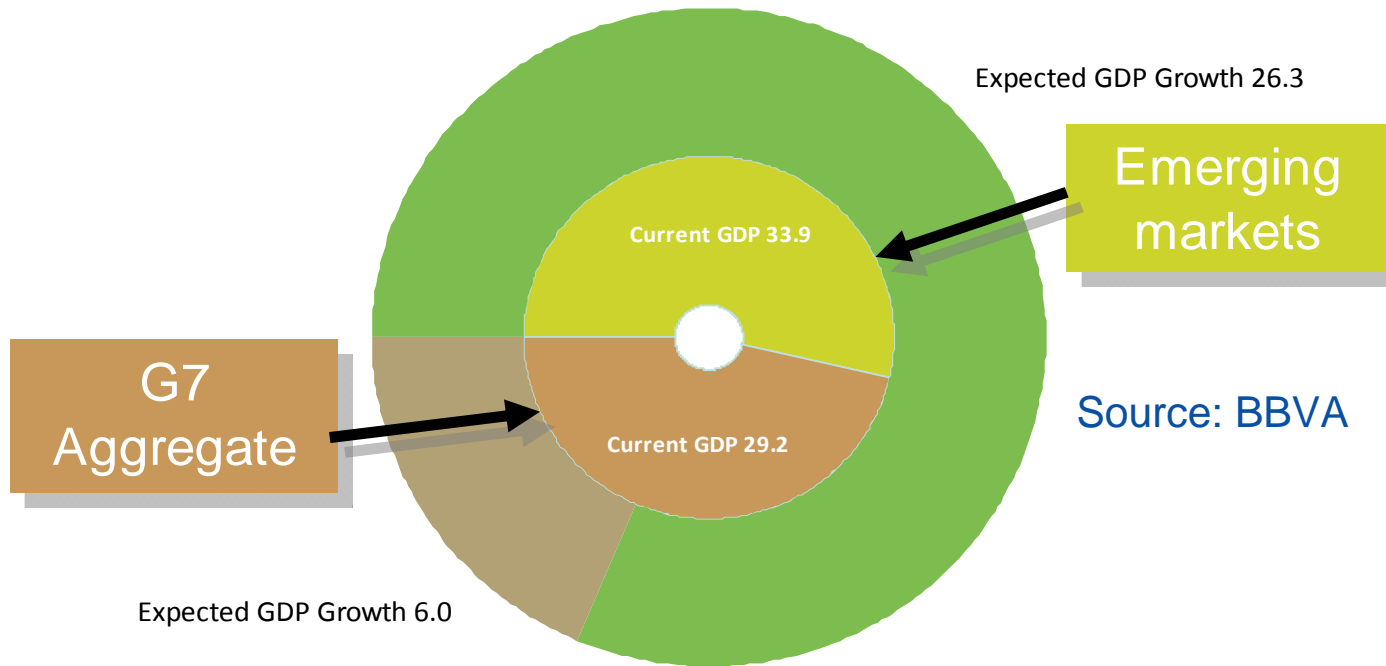
1. Latin America from the periphery to the core...  
together with other emerging economies
2. Latin America breaks with the past
3. Tailwings from commodities: China and commodities
4. Challenges ahead: what about the middle class?
5. Conclusions

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From the  
periphery to  
the core

# From the periphery to the core

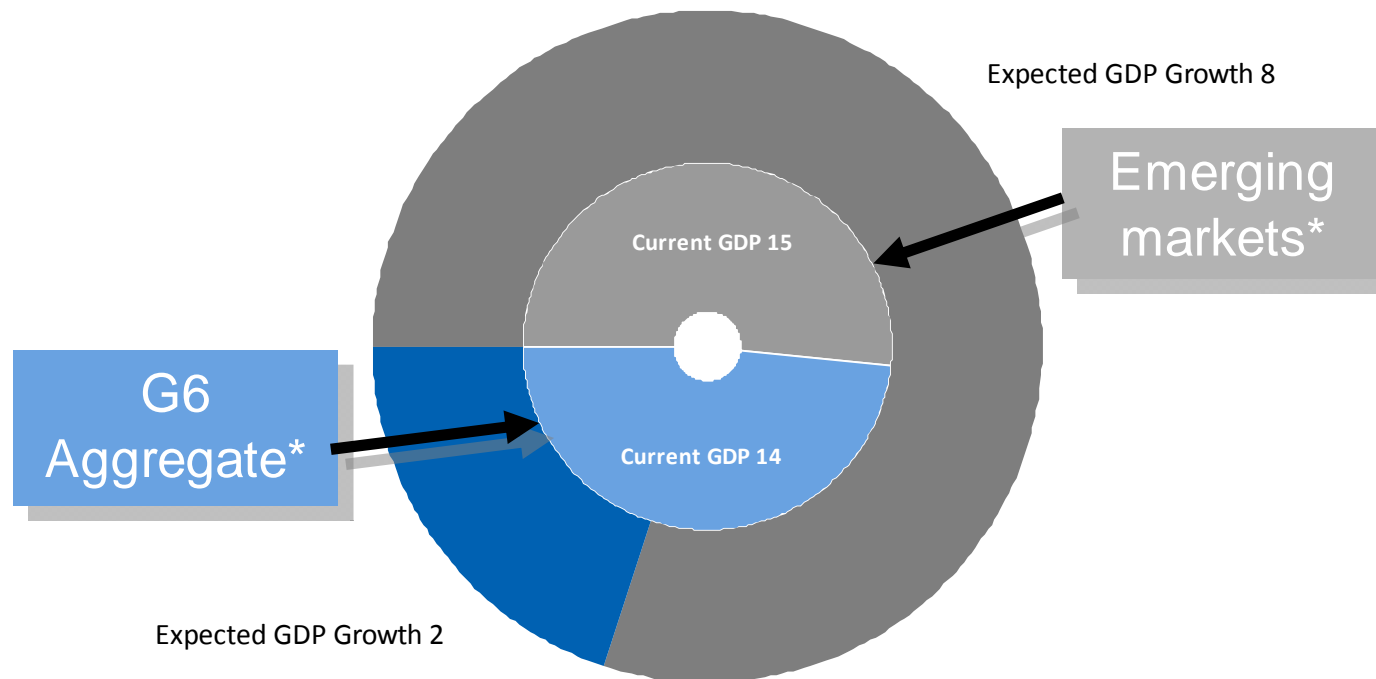
The emerging world is **already** bigger and will also contribute **4 times more** to global growth in next 10 years



Current size (inside) and contribution to global growth in the next 10 years (outside) in trillion USD

# Life does not end in the BRICs

If we compare rest of emerging countries (excluding BRICs) and 6 largest developed economies (ex US), the former are **already bigger** and will contribute **over 3 times** more to global growth in the next 10 years



Current size (inside) and contribution to global growth in the next 10 years (outside) in trillion USD. Emerging markets\* = 45 emerging economies excluding BRIC

# Moving beyond BRICs: EAGLEs

## BRICs (GS)



Based on absolute size

- Bigger does not necessarily determine market potential



Static concept

- Allows no anticipation: too much inertia
- Too long horizon: at least 20-25 years
- Why four countries? Subjective



No clear cut-off

## BBVA EAGLEs definition



Based on absolute growth

- Large enough size plus...
- Fast enough growth



Dynamic concept

- Anticipation: dynamic concept
- Shorter horizon: next 10 years
- Flexible number of countries: "Club admission" depends on performance



Defined Cut-off: the G6

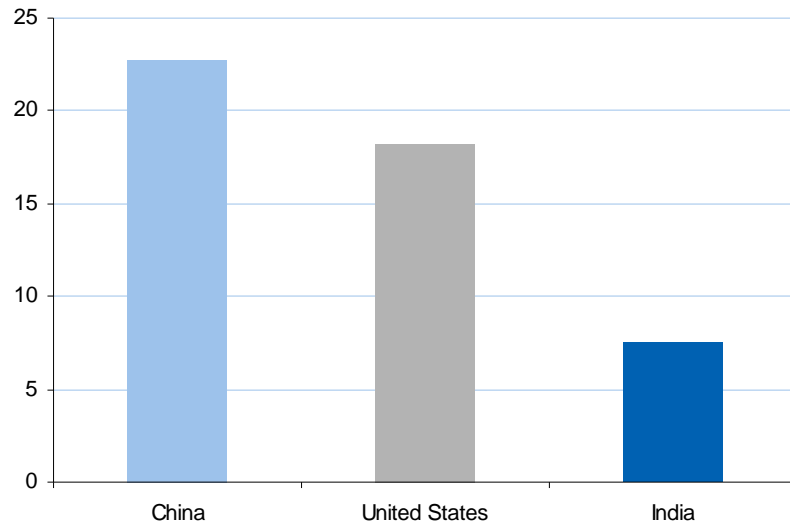
**BBVA EAGLEs is the set of economies whose contribution to world GDP growth is expected to be larger than that of the average G6 economy**

# Who are the giants?

China will be a giant Eagle, followed in the distance by India

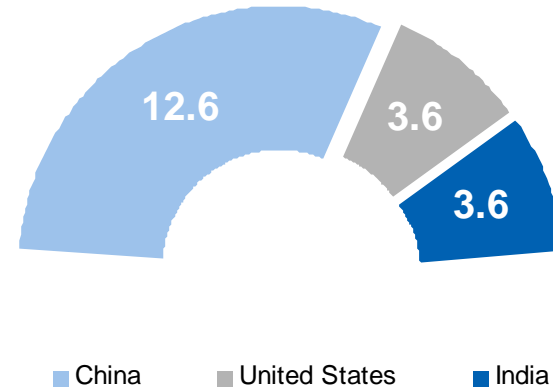
**GDP adjusted by PPP: level in 2020 (trillions)**

Source: BBVA Research and IMF



**GDP adjusted by PPP: change in 2010-2020 (trillions)**

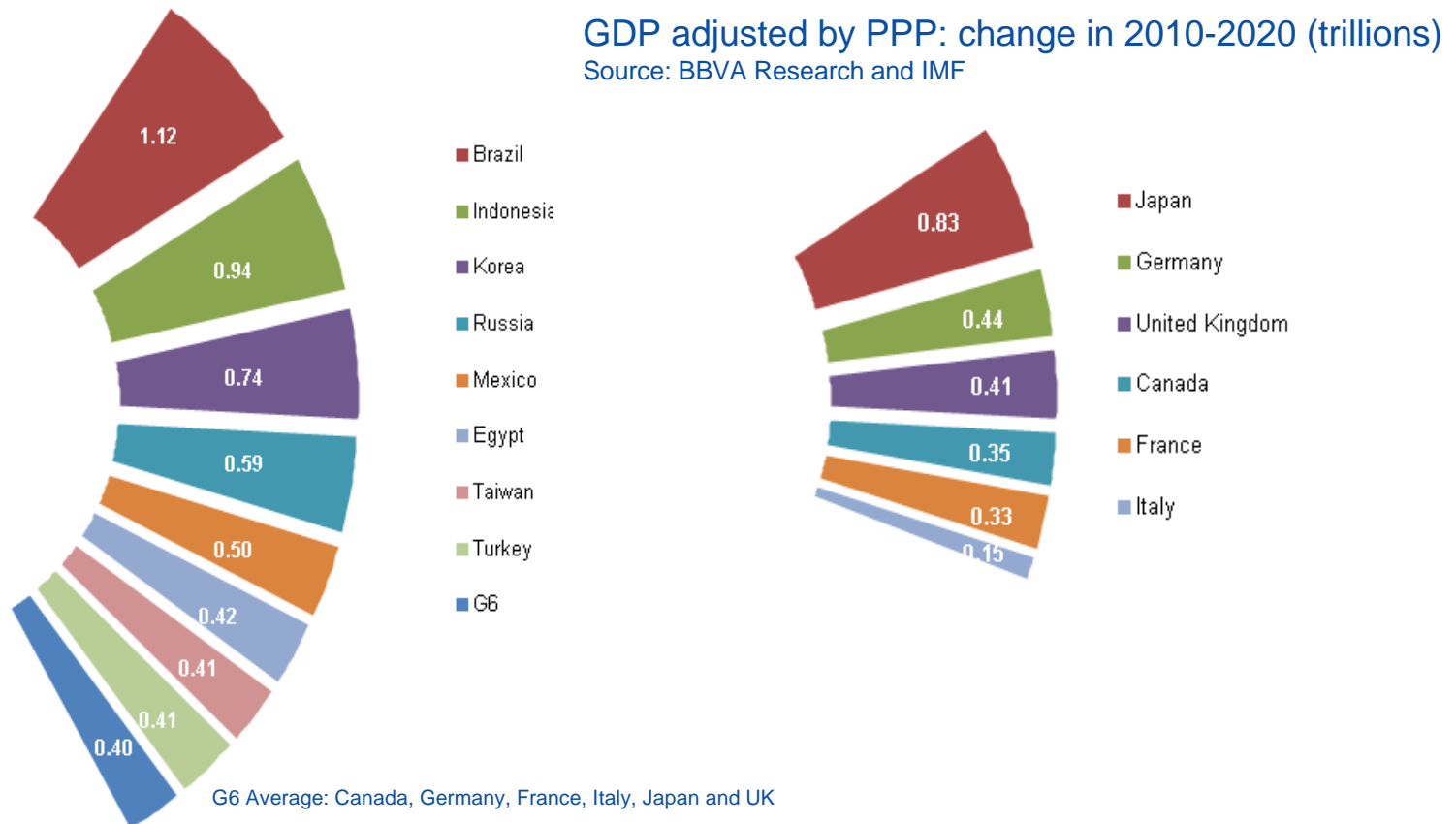
Source: BBVA Research and IMF





# 8 more Eagles contributing more than average G6

- 3 more Asian (Korea, Indonesia and Taiwan):also 1 more Latin American: Mexico
- 3 Pacific leaders in LATAM (Chile, Colombia and Peru) together 1 more EAGLE

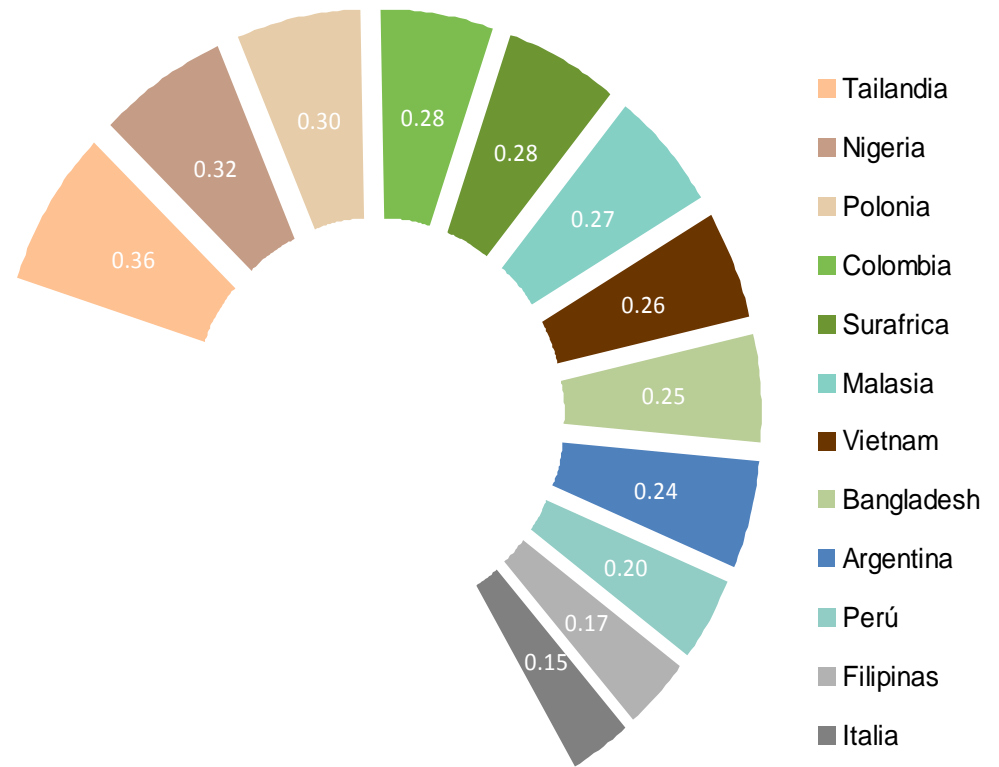


# The EAGLE nest

GDP adjusted by PPP: change in 2010-2020 (trillions)

Source: BBVA Research and IMF

- Additional 11 economies are expected to add to global growth somewhere between the G6 average and that of Italy
- 3 Latin American economies:
  - Colombia
  - Argentina
  - Perú



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Latin  
America  
breaks with  
the past

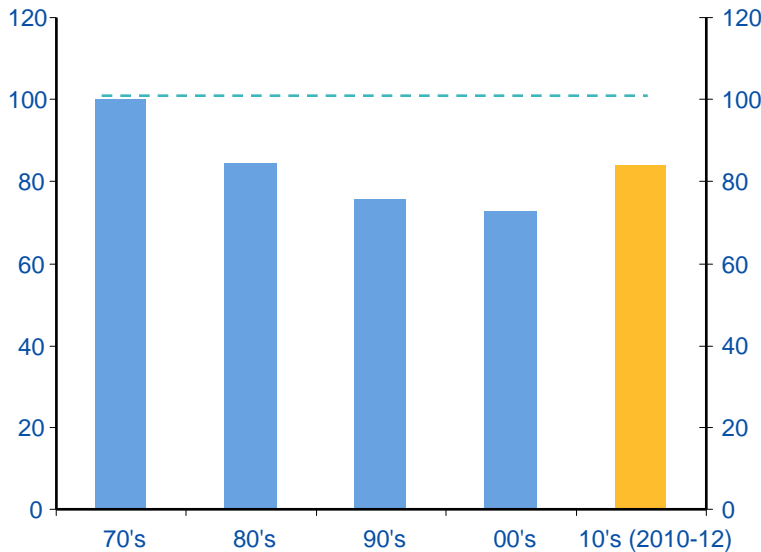
Section II

# Latin America breaks with the past

- Latam is beginning to close the Income Gap after decades of disappointment
- The financial crisis has not stopped the convergence process as in the past

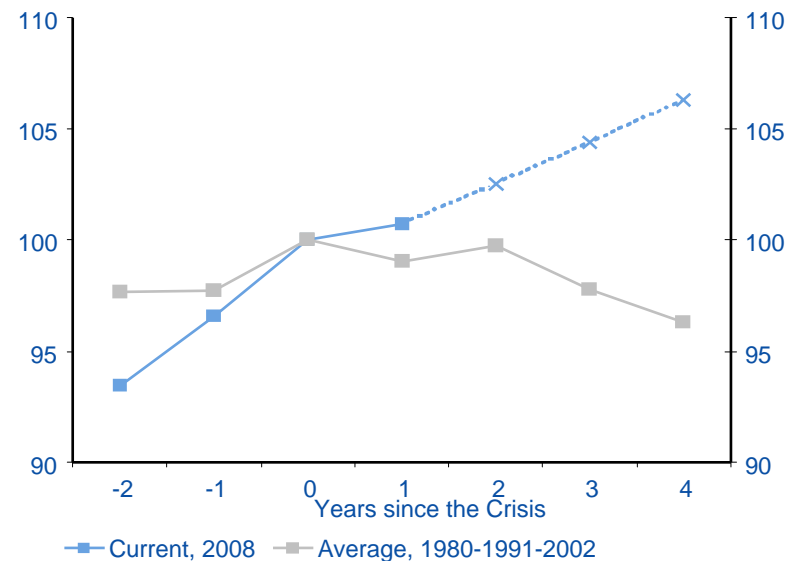
LatAm, GDP per capita, relative performance to US, decade average. 70's=100

Source: BBVA Research



LatAm, GDP per capita, relative performance to US, crisis(\*) comparison. (\*) US recession in terms of GDP pc.

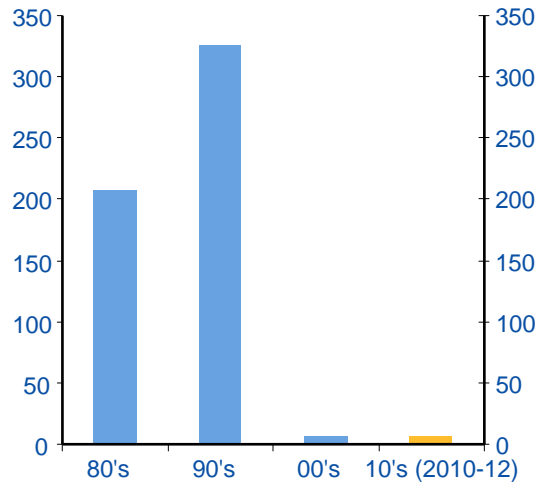
Source: BBVA Research



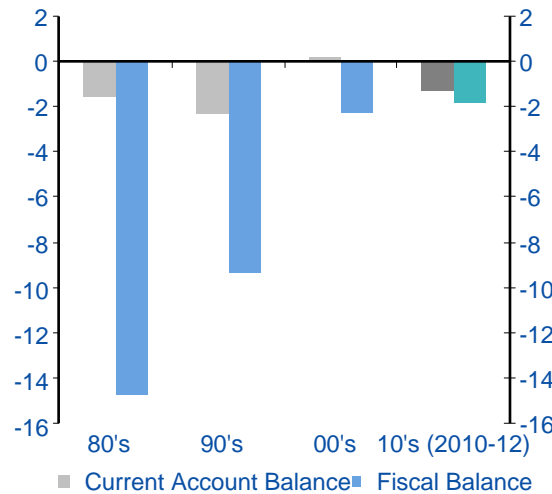
# Macroeconomic stabilization key for breaking with the past...

Inflation tamed first in 90s and then sustained progress in external and public solvency

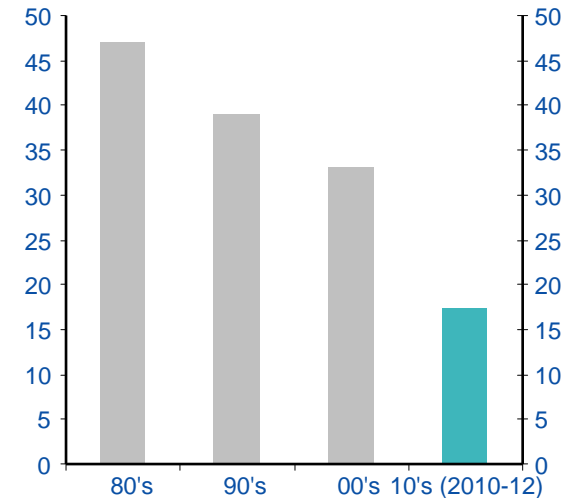
LatAm, Inflation  
(CPI, % yearly average)  
Source: BBVA Research



LatAm, External and Fiscal Balance.  
(As % of the GDP)  
Source: BBVA Research



LatAm, External Debt  
(As % of the GDP)  
Source: BBVA Research

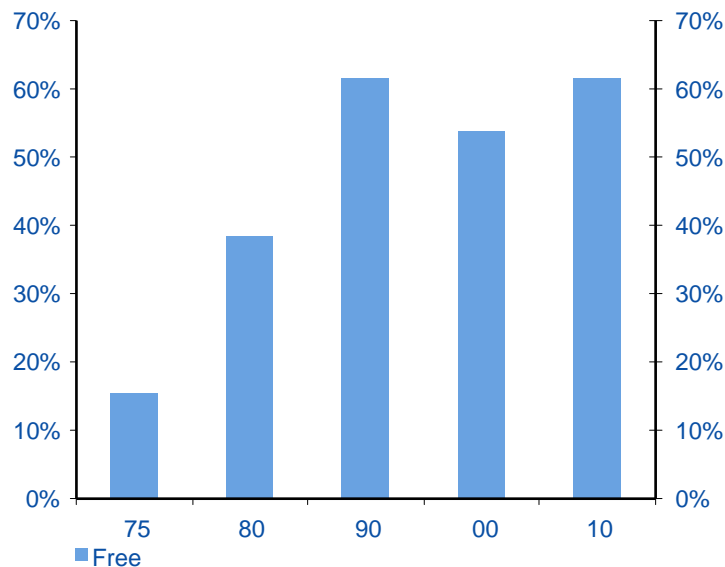


# But structural and institutional reforms have also taken place

## LatAm, Political Freedom

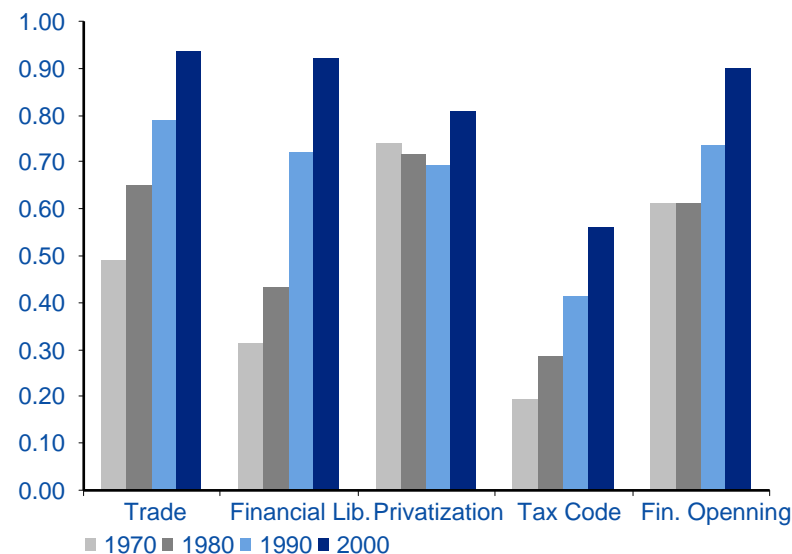
### Freedom House Index, % of free countries

Source: BBVA Research with Freedom House data



## LatAm, Economic reforms

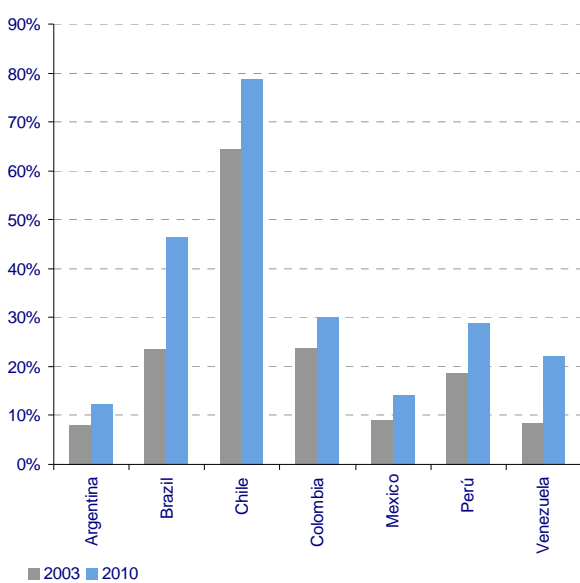
Source: BBVA Research based on IADB and ECLAC data



# Bank reform has been key

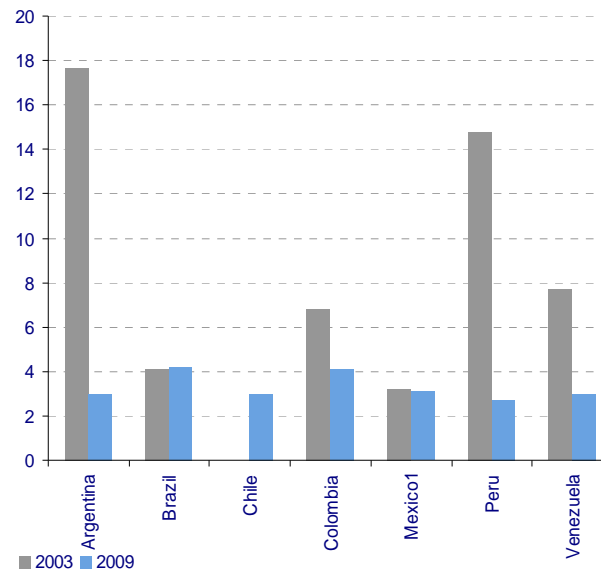
## LatAm, Credit (As % of the GDP)

Source: BBVA Research, GSFR. 2010 Forecast



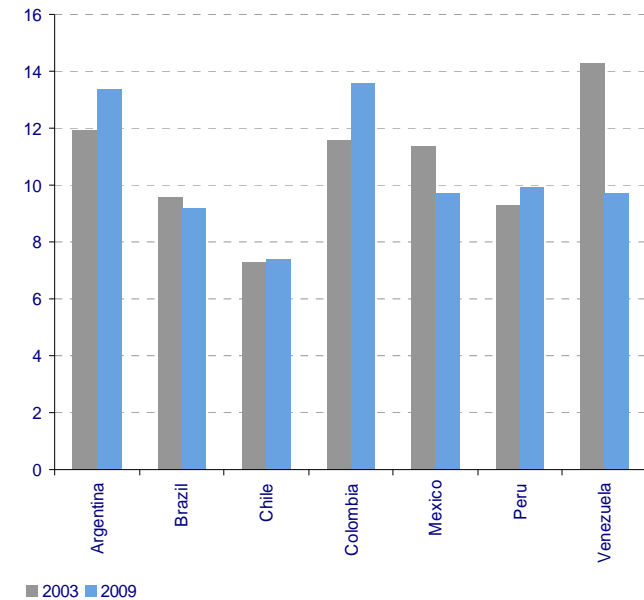
## LatAm, NPL %

Source: BBVA Research, GSFR



## LatAm, Bank Capital to Assets %

Source: BBVA Research, GSFR

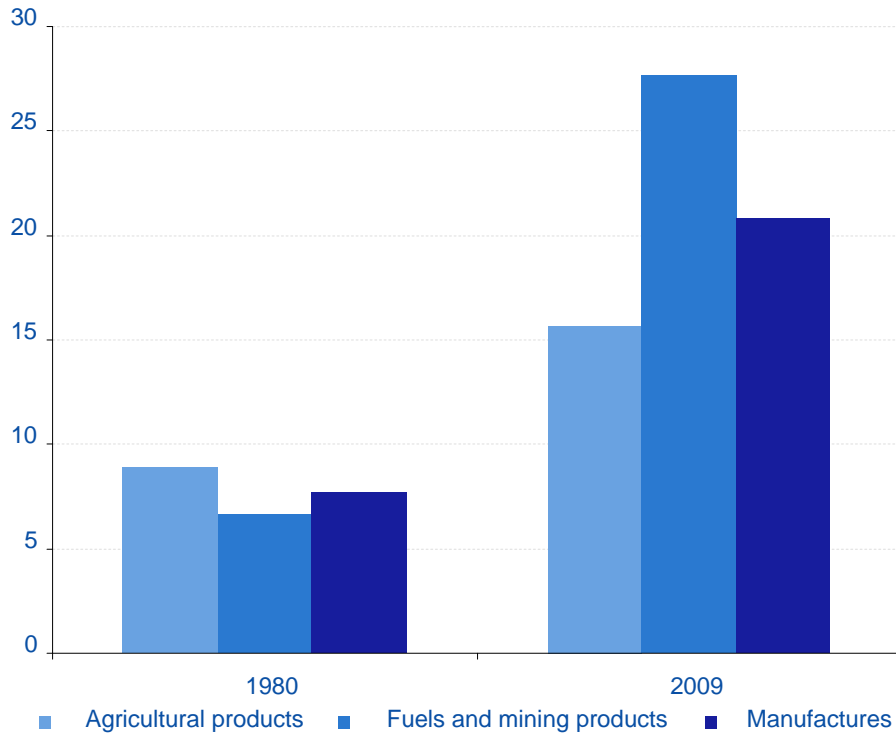


# 4 Tailwings from comomodities

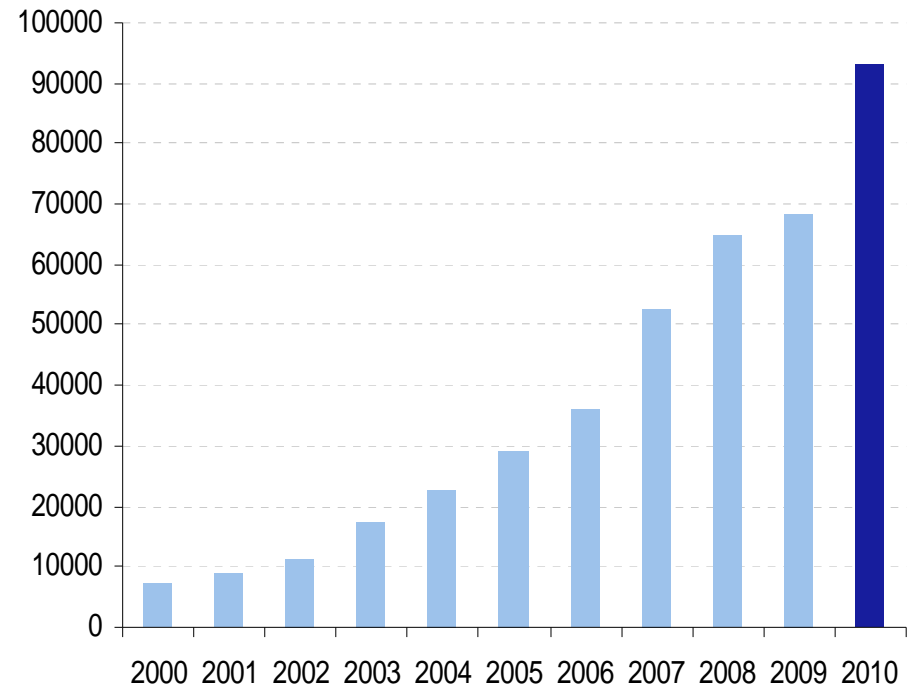


# Opening up the economy has helped Latam benefit from Asia

Emerging Asia: share in world imports (%)  
Source: BBVA Research



Latin America Exports's to Asia (US\$ M)  
Source: BBVA Research.

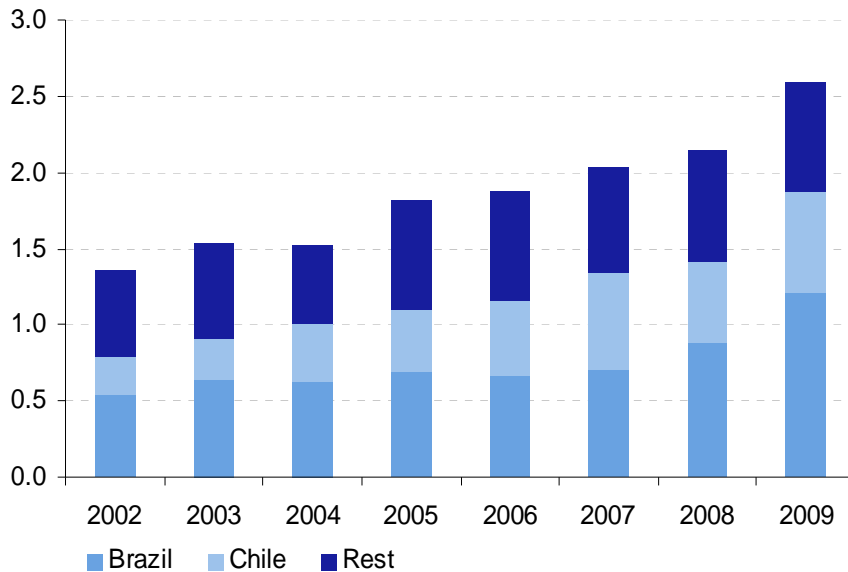


# More trade integration with Asia but exports concentrated on commodities

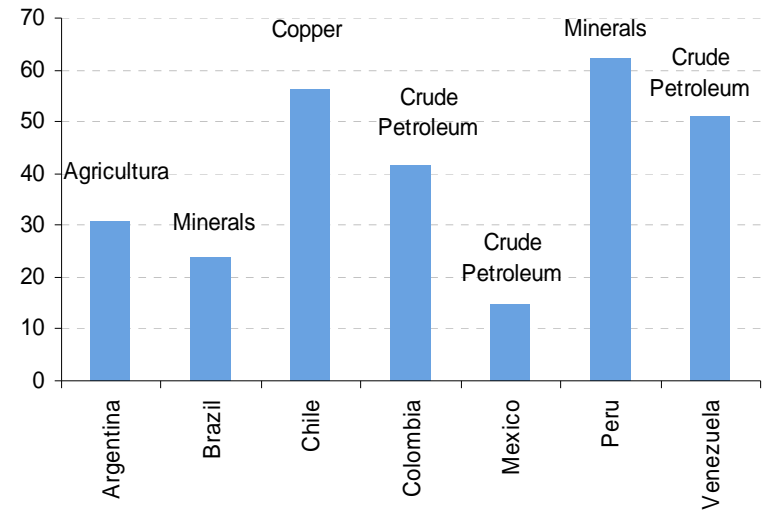
**Mainly at the expense of traditional trade partners (US but also Europe)**

**Commodity exports are benefitting from high prices**

Asian imports from Latam (% over total Asian imports)  
Source: IMF and BBVA Research



Concentration of exports to Asia from Latin America (% over total exports in each country).  
Source: BBVA Research



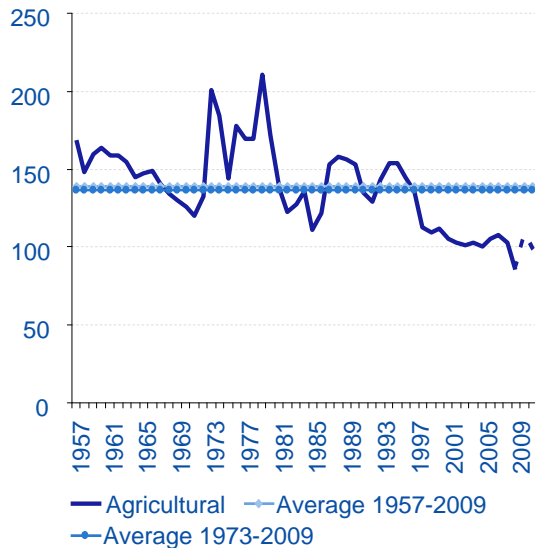
# High commodity prices to be maintained by Asia industrialization

It is not only China. India is just at the beginning of a similar process, followed by other large countries (Indonesia, etc)

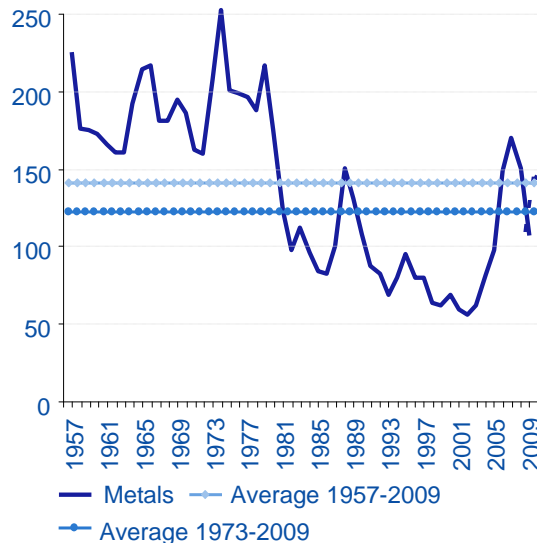
Commodity prices have been resilient to the financial crisis. A new cycle of high prices have started

Long-term trends in commodity prices (US cents 2009/pound)  
 Source: IADB (2010) and BBVA Research

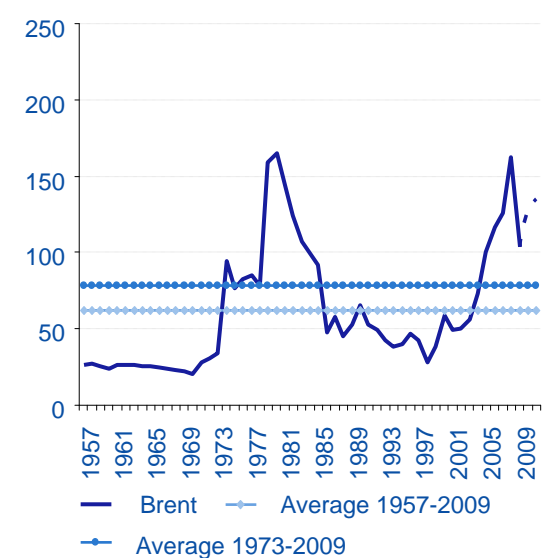
## Agricultural



## Metals



## Brent

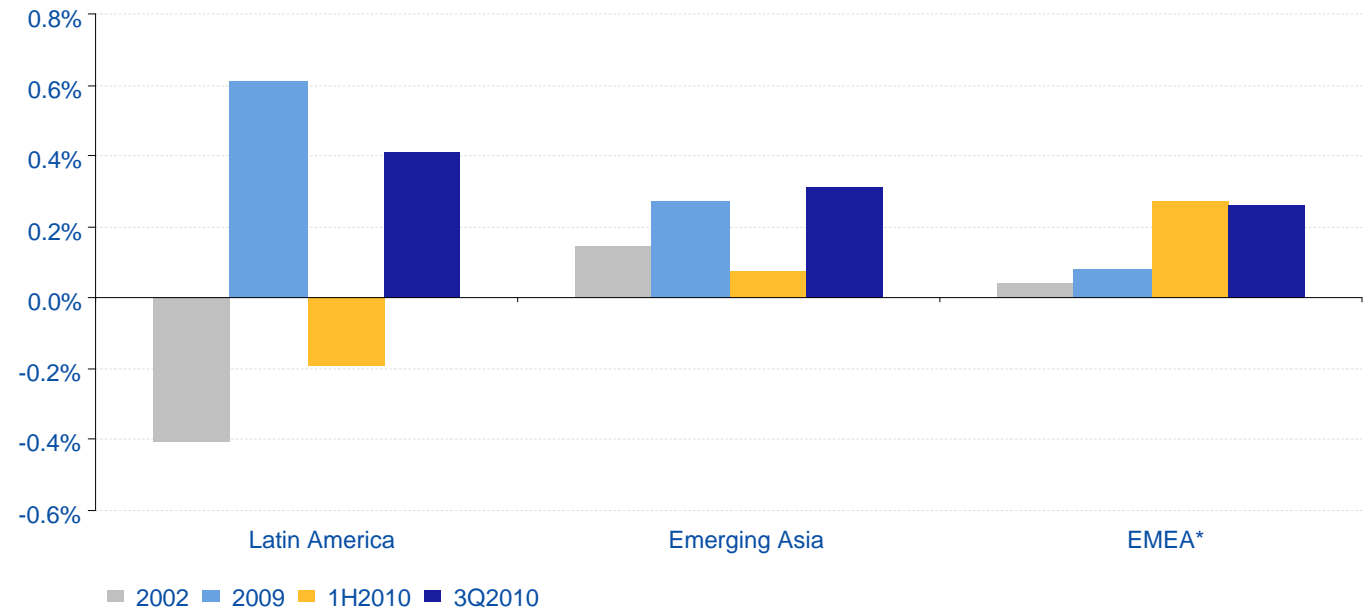


# Latin America's bright future, coupled with financial openness, brings capital

**Strong growth, (relative) high yields and (relative) low risk is prompting capital inflows in the region**

**Emerging Markets Net Equity Inflows**  
(Yearly Flows as % of Total Regional Assets)

Source: EPFR and BBVA Research. \*EMEA: Emerging Europe, Middle East and Africa

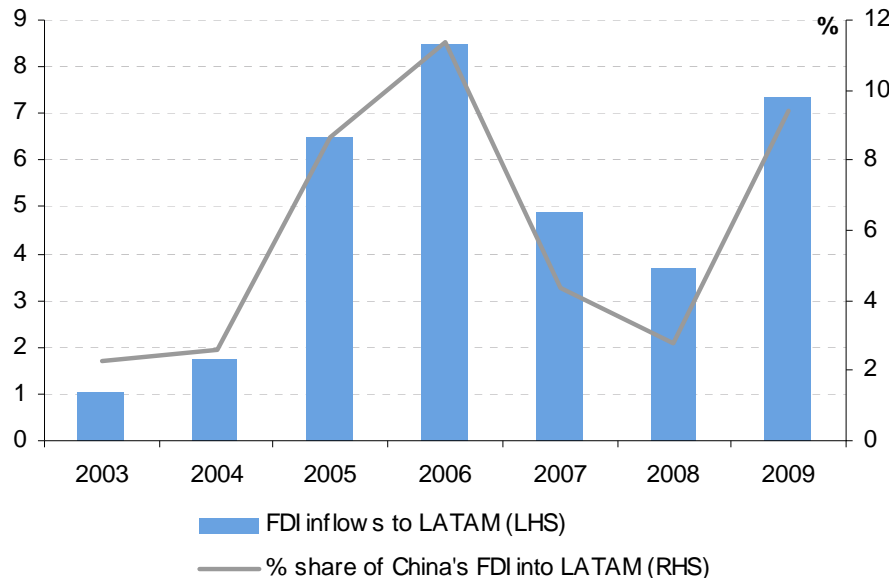


Section IV

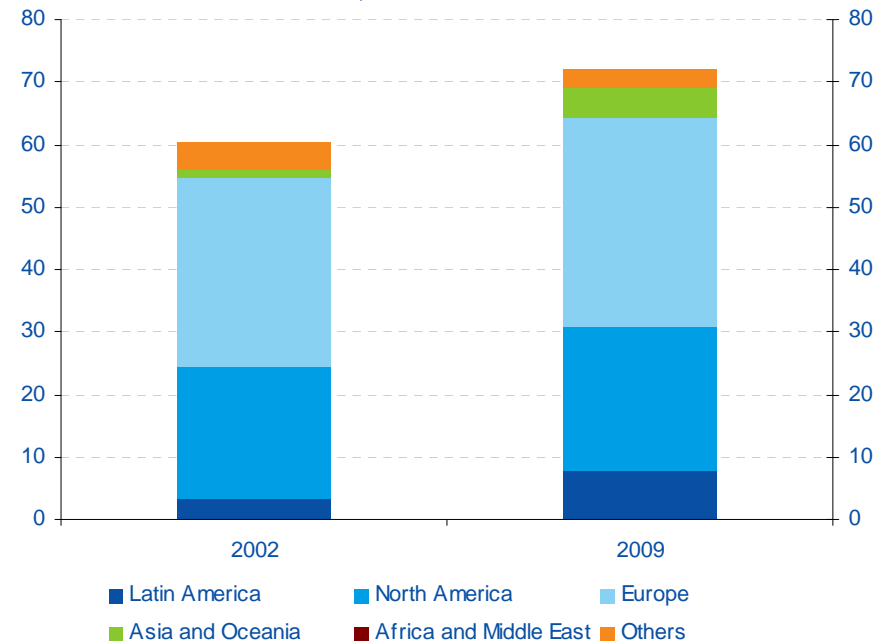
# A bright future, if the right road is taken

- China's FDI flows on LATAM have gained importance in recent years mainly oriented towards oil and other commodity projects.

China FDI inflows to Latam (US\$ bn) Total Latin America and Caribbean  
Source: China Ministry of Commerce and BBVA Research



Total FDI inflows to Latam 2002 and 2009 (US\$ bn) Bra, Ch, Col, Mex and Per  
Source: BBVA Research,



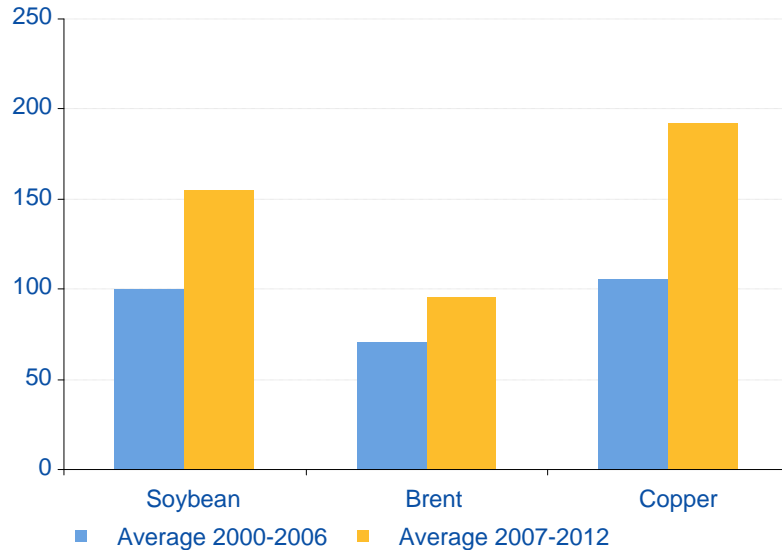
Section IV

# A bright future, if the right road is taken

- Some new policy dilemmas: Stronger fundamentals means more appreciated currencies – in real terms – over the long – run

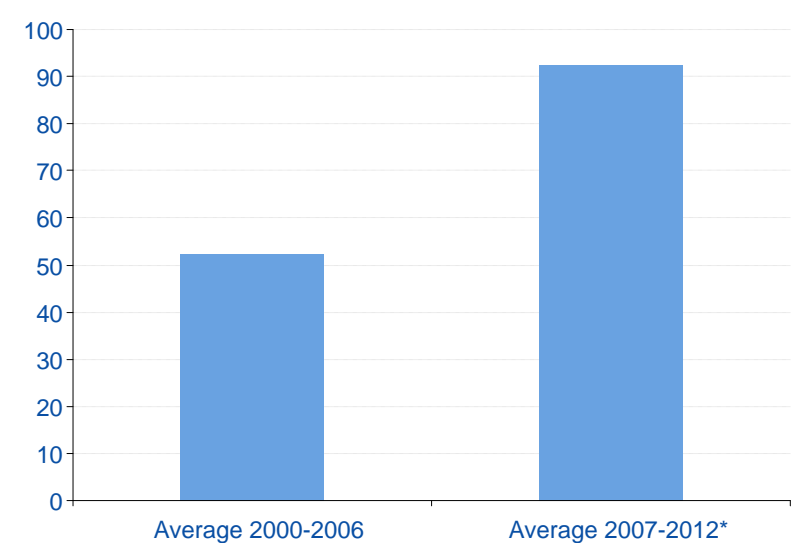
**Real Commodity Prices**  
(Respect US CPI, base 2005=100)

Source: IMF and BBVA Research



**Foreign Direct Investment to the region (US\$ bn)**  
Arg, Bra, Ch, Col, Mex, Per and Ven

Source: BBVA Research. \*Forecast BBVA Research.



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# Challenges ahead

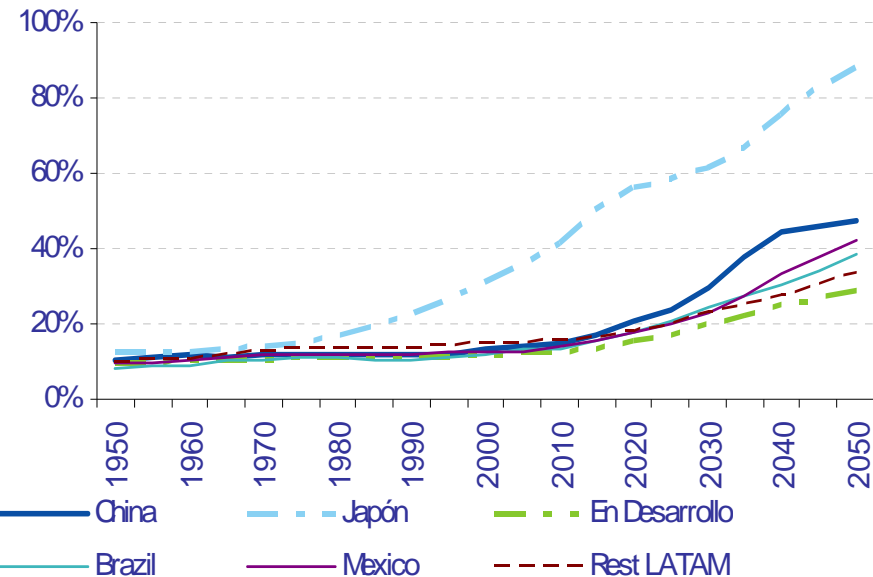
# Demographic transition is basically over

Ageing will have a major impact in the labor market:

the rates of growth of the working age population is already halving

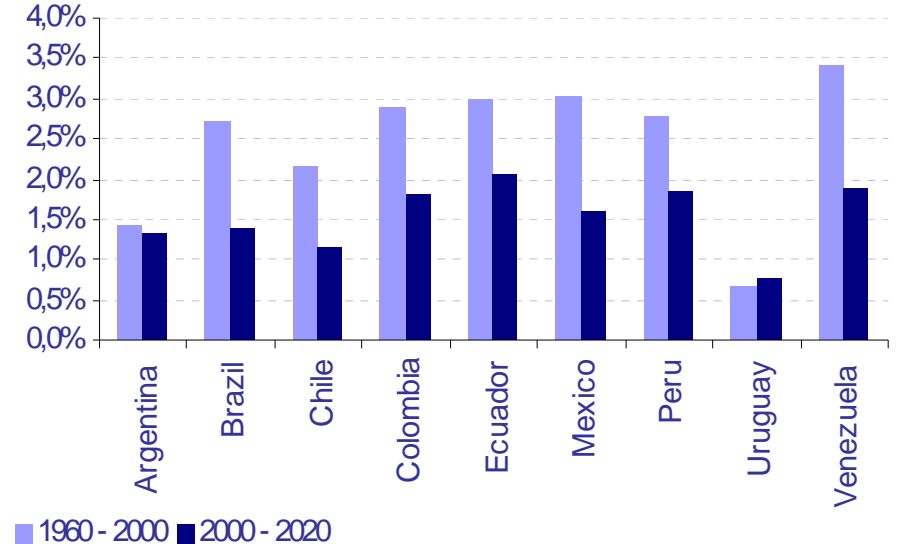
## Old age dependency ratios

Source: United Nations



## Annual growth rates of Working Age Population

Source: UN



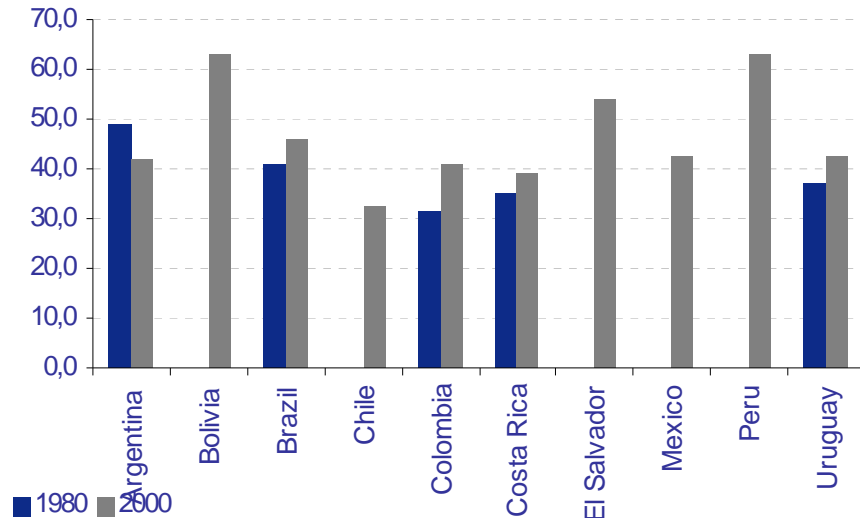


# Aging brings large liabilities

- Exploding demand for social protection in Old Age.
- Several countries reformed their pensions system from defined benefits to defined contributions. This is helping them avoid a fiscal crisis
- Second generations of reforms develop the “Solidarity Pillar” with the defined contribution system due to the low coverage of the formal system.
- Informality and coverage of Social Security are twin problems

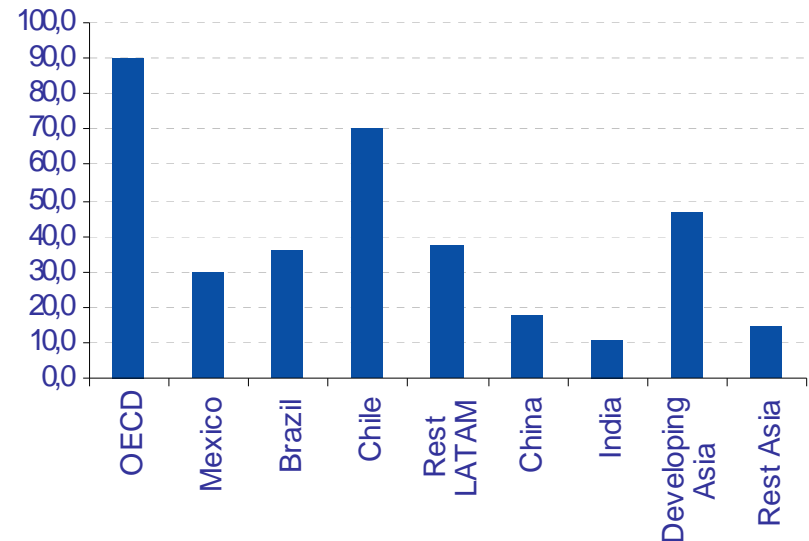
## Urban Informality rates

Source: ECLAC.



## Pensions Coverage

Source: World Bank (early 90s)

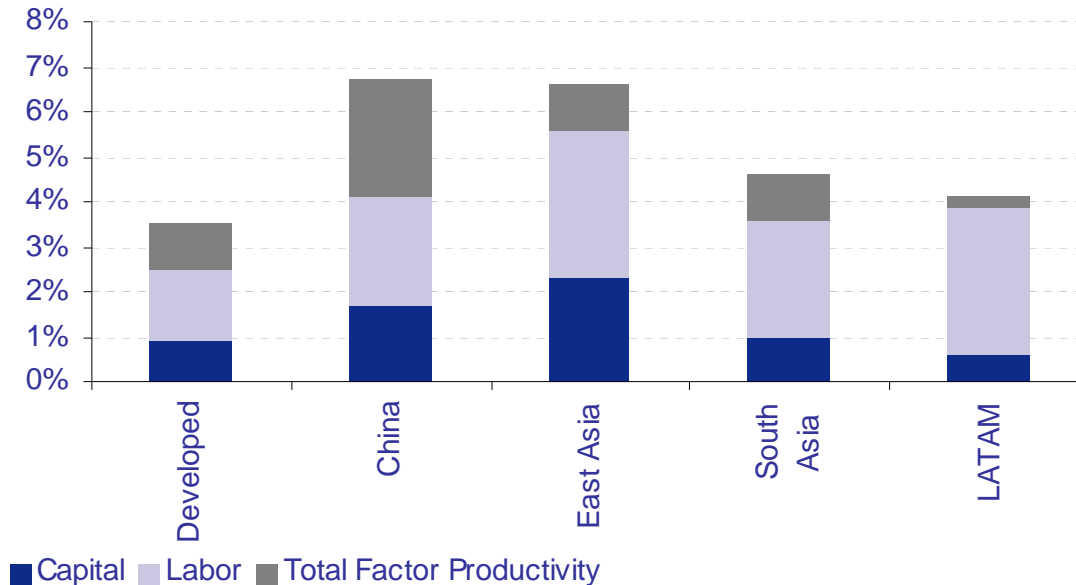


# Labor too important for growth: investment needs to take the lead

- Abundance of labor and natural resources major source of income inequality
- One major challenge: to create an economic climate supportive of business as a precondition to expand investment efficiency gains and innovation.
- Macroeconomic and political stability key but they are not enough.

## Sources of Growth 1960-00

Fuente: Bosthw orth & Collins

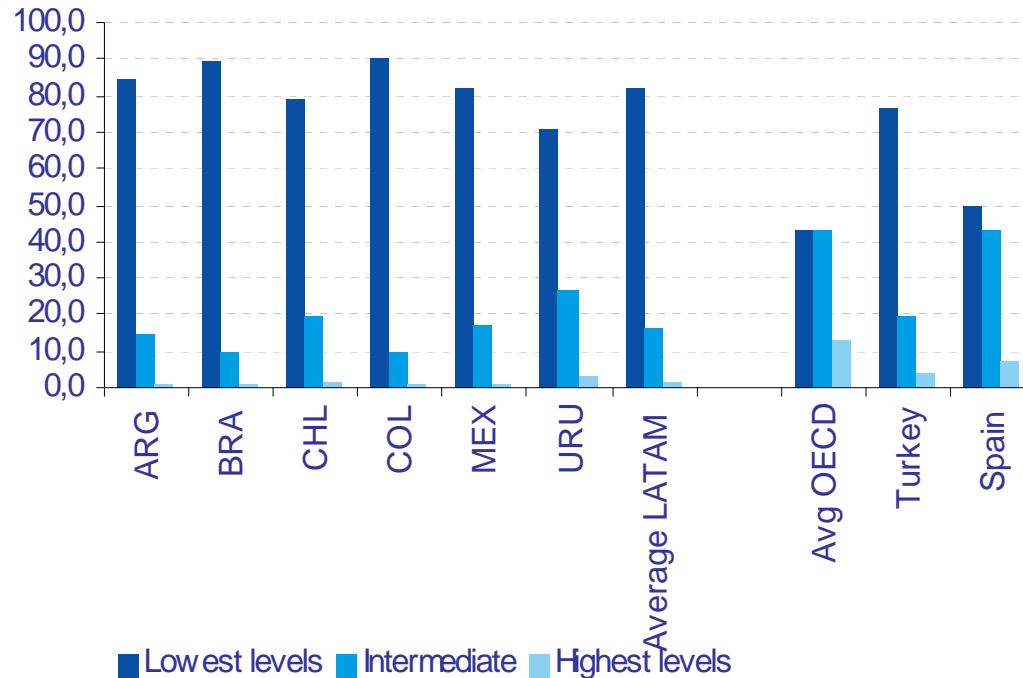


# Education is a major challenge

- There have been major progress in coverage.
- But well behind in quality of education.
- Most stable and progressive countries are making efforts to upgrade education system

## PISA Test Math

Source: OECD.



# 5 Conclusions

# Conclusions

- A good part of Latin America is moving from the periphery to the core thanks to its own efforts but also to Asia and specially China
- Challenges remain but the region has the resources to confront the challenges
- Part of the planning has already been done
  - Pension reform for aging
- But other key challenges remain
  - Specially education reform and relaying more on investment for growth, specially infrastructure
- China should be a natural partner for Latin America given:
  - Its experience in infrastructure
  - Its search for natural resources
  - Central America (Mexico's) geographical position could also be of interest for partnering