

Economic Watch

Latam

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Enestor Dos Santos
enestor.dossantos@bbva.com
+34 639827211

Pablo Urbiola
pablo.urbiola@bbva.com
+34 918072457

Deterioration in Latin America's manufacturing competitiveness

The recent worsening follows the relatively positive trend between 2002 and 2007

- **Deterioration has been worse in Brazil and Colombia, affected by the exchange rate appreciation and pressures on labour costs, as well as insufficient progress in productivity**

These three factors have been the key determinants in the changes in manufacturing competitiveness in Latin America throughout the last decade.

- **Mexico is the main exception to regional trends, since competitiveness gains continued beyond 2007**

The exchange rate remained more depreciated and both labour costs and working productivity performed more favourably than in South American countries. However, from 2011 onwards, the reversal in these trends is making it difficult to gain competitiveness in the Mexican manufacturing sector.

- **Gradual return to growth in the developed markets and tapering could put an end to the exchange rate appreciations and loss of manufacturing competitiveness**

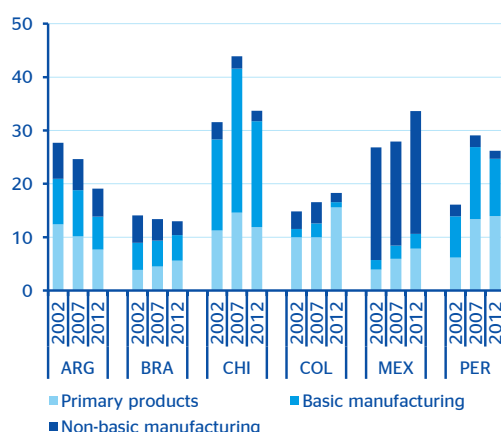
In this environment, a better institutional framework, better infrastructure and more of it, an appropriate tax burden and an upskilled workforce could help to create margins for a new period of greater industrial competitiveness. In this regard, Chile and Peru behaved better in the decade under analysis because they improved their bureaucracy and reduced, or kept under control, logistics and energy costs.

The impetus in exports came mainly from raw materials¹

Economic growth in Latin America in the last decade (Avg. 3.7% YoY), significant in historical terms and in comparison with other regions, has been accompanied in many countries in the region by an appreciation in real exchange rates, rises in wages and, in some cases, a rise in the level of taxation. This has led to a growing concern about a possible loss of manufacturing competitiveness in the region's economies, even though, on the whole, countries have also introduced reforms to improve the institutional environment and increase productivity.

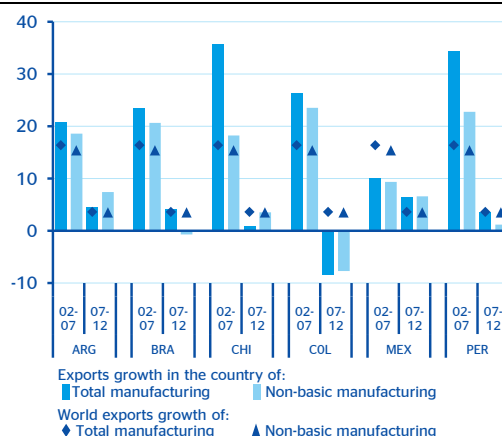
International trade data show that the weight of primary product exports in GDP increased in practically all countries between 2002 and 2012, to a large degree because of historically high raw material prices. However, the weight of non-basic manufacturing has fallen (those which are less primary-resource intensive), with the sole exception of Mexico, which is the only country in the region in which these more advanced exports predominate (see Chart B.2.1). When it comes to basic manufacturing exports, more intensive in primary resources, their weight in GDP has gone down in some countries (Argentina, Brazil and Colombia) and increased in others (Chile, Mexico and Peru), although in all cases they have gone up in absolute terms at high rates in the last 10 years.

Chart 1
Total exports (as % of GDP)



Source: WITS and BBVA Research

Chart 2
Annual growth (%) of manufactured exports:
Latam vs. world



Source: WITS and BBVA Research

Increasing comparative disadvantage in non-basic manufactures

A standard competitiveness indicator based on trade data is the Revealed Comparative Advantage index. The RCA is calculated as the coefficient between the share of a sector in a country's exports and the share of this same sector in world exports. In this way an RCA over 1.0 indicates that the country has a comparative advantage in that sector, since the weight of the sector in the country is greater than the world average.

1: This Economic Watch is a summarised version of BBVA Research's Working Paper 14/10: "Competitiveness in the manufacturing sector in Latin America: trends and determinants".

All countries, with the sole exception of Mexico, reveal a comparative disadvantage in the exports of non-basic manufactured goods and, furthermore, the RCA of this group of products – considered as a whole – has fallen over the last decade, except in Argentina thanks to a large degree to the sale of transport equipment to Brazil (see Table B.2.1). Mexico, for its part, has a comparative advantage in non-basic manufactured goods and has gained competitiveness in most sub-sectors. In the remaining countries, those non-basic manufacturing sectors which have performed positively (with increases in RCA) are: transport equipment in Peru and Colombia, footwear and hats in Peru and chemicals and textiles in Brazil. In basic manufacturing we can see a more varied performance: four countries have a comparative advantage (Chile, Peru, Brazil and Argentina), while Colombia and Mexico reveal a relative disadvantage. Over the period analysed, some countries have gained competitiveness in these products (Chile, Brazil and Mexico), others have experienced losses (Peru and Colombia) and Argentina, for its part, is showing a marginal increase. RCA indicator data show in general a poorer performance in the second five-year period of the decade analysed.

Table 1

Indicator of revealed comparative advantage (RCA) by sector and aggregate products

	Argentina			Brazil			Chile			Colombia			Mexico			Peru		
	2002	2007	2012	2002	2007	2012	2002	2007	2012	2002	2007	2012	2002	2007	2012	2002	2007	2012
Animals and animal products	3.4	4.1	3.4	2.7	3.5	2.7	4.9	3.7	4.2	0.6	1.1	0.2	0.3	0.4	0.5	1.3	1.1	1.1
Vegetable products	9.6	12.2	9.6	4.2	4.2	5.0	5.8	3.0	3.2	8.1	6.2	3.5	0.9	1.1	1.0	4.4	3.0	3.6
Food products	5.0	6.4	6.7	4.3	3.9	4.2	2.9	1.9	1.8	1.4	1.5	0.7	0.7	0.9	0.9	5.7	3.0	2.9
Mineral products	2.4	1.8	1.6	10.3	9.6	10.5	15.6	17.5	13.8	1.1	0.5	0.1	0.5	0.6	0.8	24.6	25.8	19.2
Fuels	2.0	0.9	0.5	0.4	0.5	0.6	0.2	0.1	0.0	4.3	2.7	3.5	1.0	1.1	0.7	0.7	0.6	0.6
Chemical products	0.6	0.6	0.9	0.5	0.6	0.6	0.7	0.4	0.6	0.7	0.6	0.2	0.3	0.3	0.3	0.3	0.2	0.2
Plastics and rubber	0.8	0.6	0.6	0.6	0.7	0.5	0.3	0.2	0.3	0.8	1.0	0.5	0.4	0.5	0.5	0.3	0.3	0.3
Hides and skins	4.0	3.4	2.4	2.1	2.3	1.4	0.2	0.1	0.1	1.4	1.4	0.6	0.2	0.2	0.2	0.3	0.2	0.2
Wood and wood products	0.5	0.6	0.5	2.1	2.1	1.8	3.7	2.8	3.2	0.7	1.0	0.2	0.2	0.3	0.3	0.7	0.5	0.4
Textiles	0.3	0.3	0.2	0.3	0.3	0.4	0.1	0.1	0.0	1.0	1.2	0.3	1.1	0.7	0.5	1.8	1.4	1.0
Footwear and headgear	0.1	0.1	0.1	2.8	1.7	0.7	0.1	0.2	0.0	0.2	0.5	0.0	0.2	0.2	0.3	0.1	0.1	0.1
Stone and glass	0.2	0.2	0.8	0.8	0.6	0.3	0.4	0.5	0.5	1.3	1.5	1.9	0.6	0.7	1.1	2.7	3.1	3.5
Metals	1.0	0.5	0.5	1.6	1.2	1.0	4.3	4.5	5.3	0.6	1.0	0.4	0.6	0.6	0.6	2.9	2.0	1.5
Machinery and electrical equipment	0.1	0.1	0.1	0.4	0.4	0.3	0.0	0.0	0.0	0.1	0.1	0.0	1.3	1.4	1.4	0.0	0.0	0.0
Transport equipment	0.5	0.9	1.6	0.9	1.0	0.8	0.1	0.1	0.0	0.2	0.3	0.3	1.6	1.7	2.4	0.0	0.0	0.0
Miscellaneous	0.2	0.1	0.1	0.3	0.2	0.2	0.1	0.0	0.0	0.1	0.2	0.1	1.3	1.2	1.3	0.1	0.1	0.0
Primary products	2.7	1.9	1.5	1.7	1.7	1.8	2.3	1.9	1.6	3.8	2.7	2.9	0.8	1.0	0.8	2.7	2.9	2.5
Basic manufacturing	2.4	2.4	2.4	2.9	2.7	3.2	4.6	5.0	5.4	0.8	1.0	0.4	0.5	0.6	0.6	4.3	4.1	4.0
Non-basic manufacturing	0.4	0.4	0.5	0.6	0.6	0.4	0.2	0.1	0.1	0.3	0.4	0.2	1.1	1.1	1.2	0.2	0.2	0.1

Source: WITS and BBVA Research

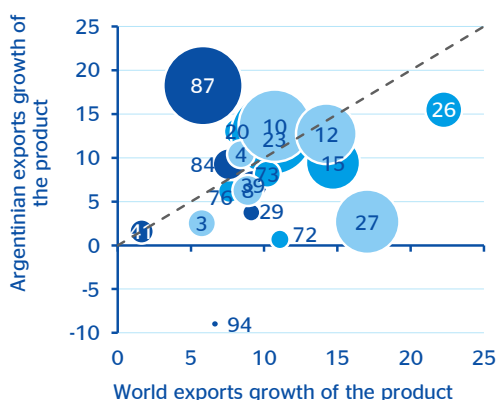
Recent drops in market share after having risen between 2002 and 2007

Another competitiveness indicator is the gain or loss of world share a country has undergone in terms of the various products it exports. If we analyse manufacturing (basic and non-basic) as a whole, most countries had growth rates above the world average in the first half of the decade and below or practically the same as in the second half, which suggests competitiveness gains in the first years followed by a worsening (see Chart B.2.2). Mexico is an important exception to this general behaviour, since its manufacturing exports grew less than world exports up to 2007 and more in the last few years, as it started to recover competitiveness and share in the export market to the US, after the displacement it suffered at the beginning of the decade

because of Chinese exports. Among those which followed the general pattern, Chile and Peru had the best performance in the first five years, and Colombia fell the most in the second. If we limit the comparison to non-basic manufacturing (less intensive in natural resources) we also see in most countries growth rates above the world average in the first period and lower, or similar, between 2007 and 2012. Charts 3 to 8 show countries' world share losses or gains by their most important export products.

Chart 3

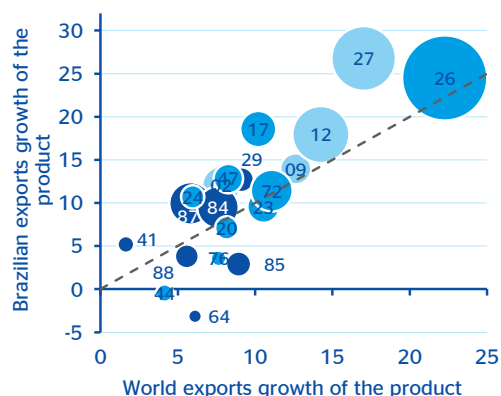
Argentina: YoY growth (%) in exported products 2002-2012*



Source: WITS and BBVA Research

Chart 4

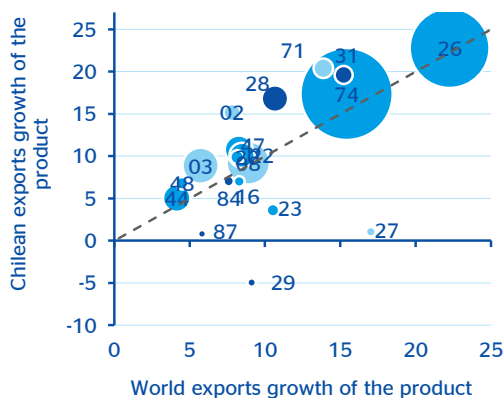
Brazil: YoY growth (%) in exported products 2002-2012*



Source: WITS and BBVA Research

Chart 5

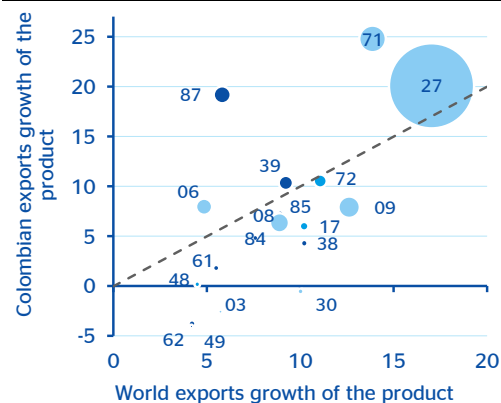
Chile: YoY growth (%) in exported products 2002-2012*



Source: WITS and BBVA Research

Chart 6

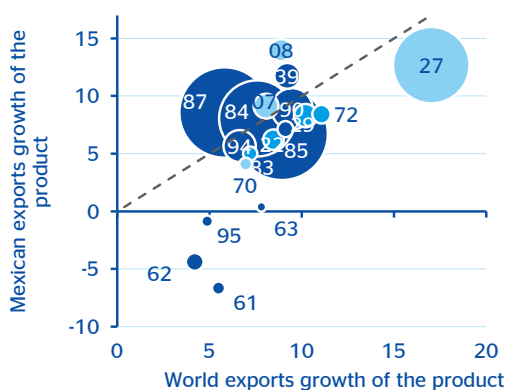
Colombia: YoY growth (%) in exported products 2002-2012*



Source: WITS and BBVA Research

Chart 7

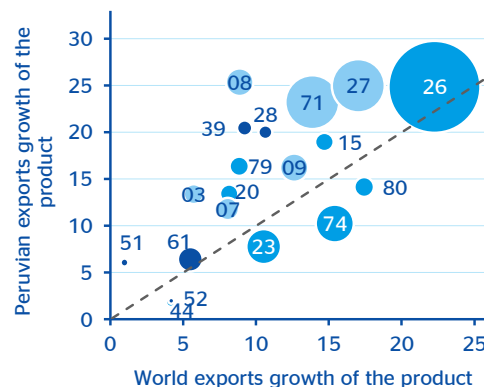
Mexico: YoY growth (%) in exported products
2002-2012*



Source: WITS and BBVA Research

Chart 8

Peru: YoY growth (%) in exported products
2002-2012*



Source: WITS and BBVA Research

Bubble size indicates the product's share in the country's exports and the colours classify the products according to whether they are: ● Primary, ● Basic manufactures ● Non-basic manufactures. Furthermore, each product is identified with its two HS 2002 classification digits. Above the 45° line, product exports have grown more in the country than in the world, and therefore, the country has gained share in global exports.

The region needs to adopt reforms in order to foster a new period of progress in competitiveness

Taken in conjunction with a detailed analysis of national idiosyncrasies, competitiveness indicators based on international trade data allow us to conclude that after a really positive period, the manufacturing sector lost competitiveness in the second half of the decade. This recent deterioration, which was worse in Brazil and Colombia, is linked to currency exchange appreciation, pressures on labour costs and insufficient progress in productivity. The main exception to these regional tendencies is Mexico, where competitiveness gains in the manufacturing sector continued beyond 2007, partly because the exchange rate had gone down more and costs and labour productivity showed more positive performance than in South American countries. However, from 2011 onwards a reversal in these trends has been making it difficult to gain competitiveness in the Mexican manufacturing sector.

Although the exchange rate, costs and labour productivity were the main causal factors in how manufacturing competitiveness performed over the last decade in Latin America, the impact of the remaining variables was not inconsiderable: the results show that competitiveness earnings have been greater and competitiveness losses lower in those countries, such as Chile and Peru, which have succeeded in improving the institutional environment and have reduced or kept under control their logistics and energy costs.

From here onwards, growth recovery in developed countries, although gradual, and the Federal Reserve's tapering may put an end to (or at least slow down) appreciation in the exchange rates of the region's currencies and the loss of competitiveness in manufacturing sectors. In this environment, a better institutional backdrop, more and better infrastructure, appropriate tax burdens and an increase in human capital through improvements in education and health will help to create margins for a new period of expansion in industrial competitiveness.

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