

2022

FROM RECOVERY TO RENAISSANCE TURNING CRISIS INTO OPPORTUNITY **2022 Latin American and Caribbean Macroeconomic Report**

Mercredi de Réflexion,
Presentation in Haiti,
June 22nd, 2022



Outline

Growth and poverty

External accounts and the war

Monetary policy: putting the genie back in the bottle

Fiscal policy and labor markets: towards a new architecture

Conclusions

GLOBAL AND LATIN AMERICAN AND CARIBBEAN OUTLOOK

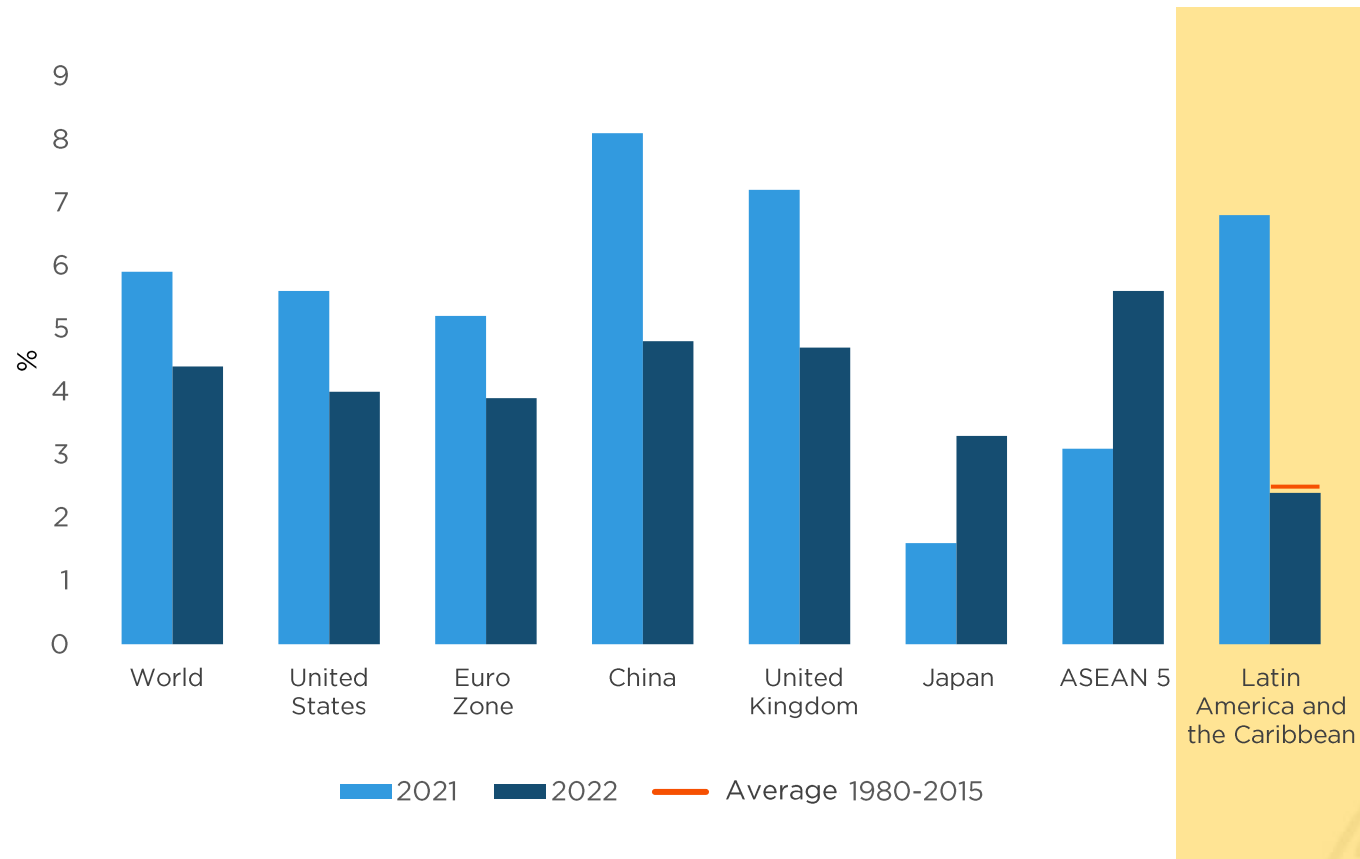


PREWAR GROWTH PROJECTIONS

LAC bounced back in 2021.

The expectation was to converge swiftly to long-run growth.

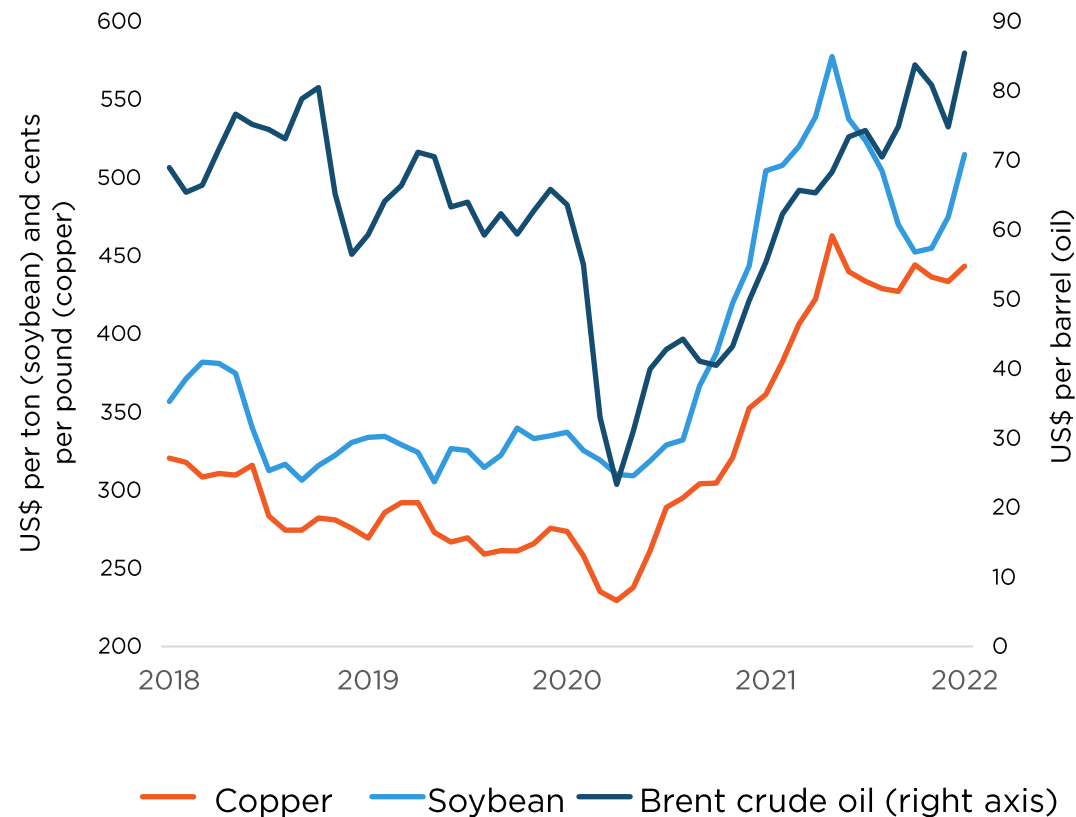
That longer-term growth is lower than in other regions.



Source: IDB staff calculations based on IMF World Economic Outlook January 2022 .

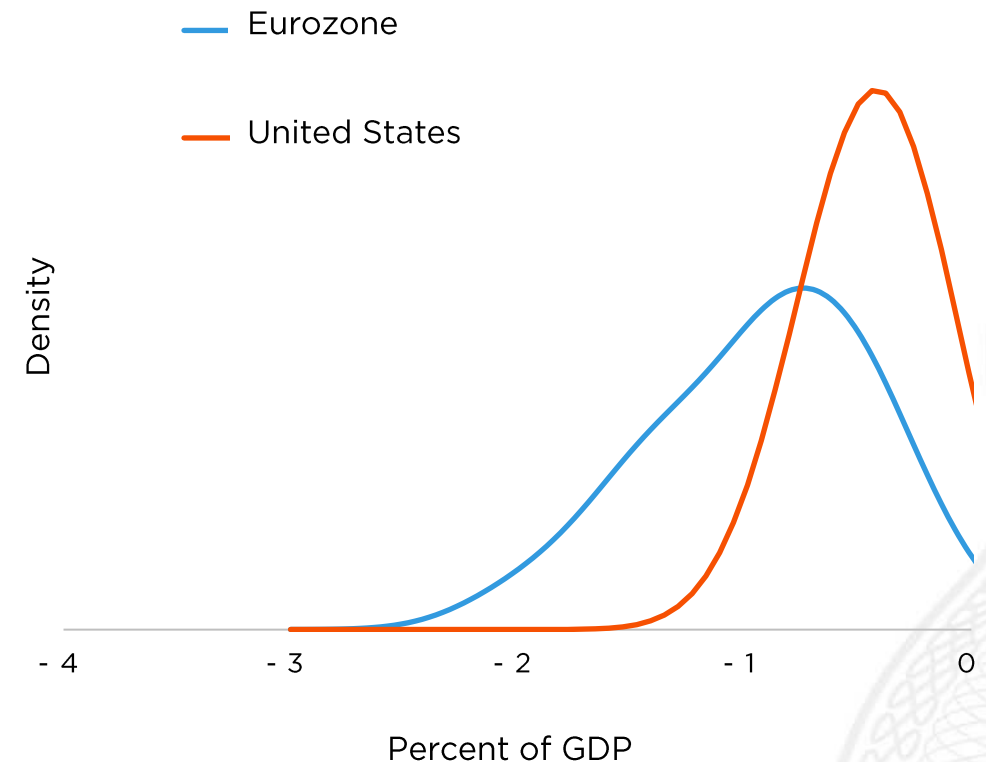
THE WAR: COMMODITY PRICES UP, GLOBAL GROWTH DOWN

COMMODITY PRICES UP



Source: IDB staff calculations, International Commodity Exchange (for Brent crude oil futures), London Metal Exchange “official prices” (for copper futures) and Chicago Mercantile Exchange (for soybean futures).

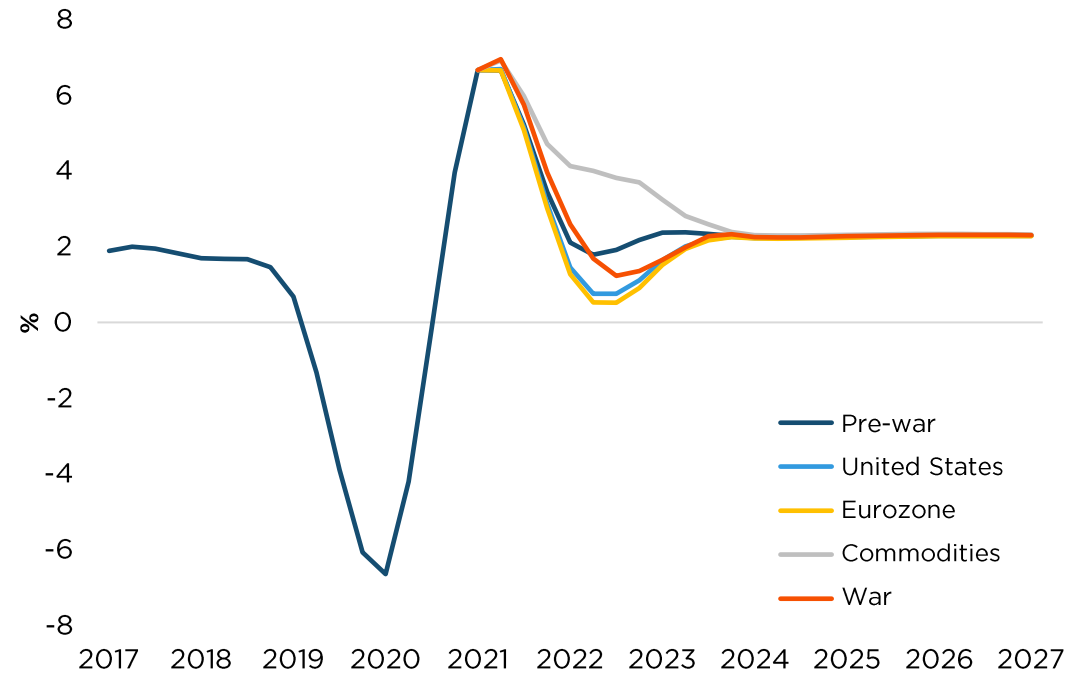
FALL IN GROWTH PROJECTIONS DISTRIBUTION FROM BLOOMBERG SURVEY



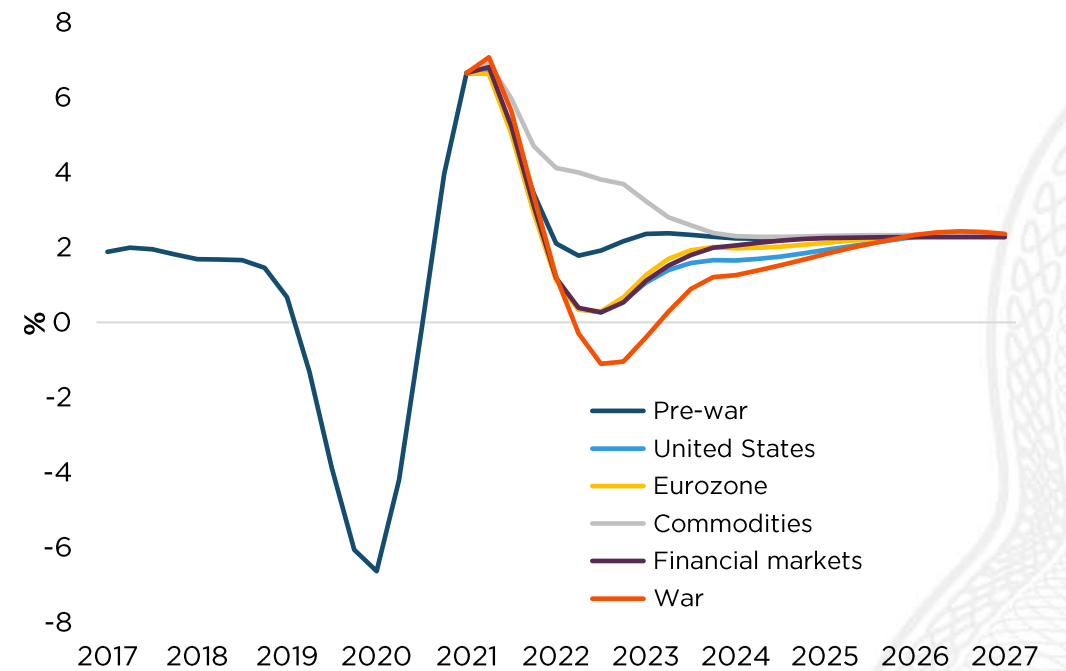
Source: IDB staff calculations and Bloomberg.

A WAR AND A POLICY NORMALIZATION GROWTH SCENARIO FOR LATIN AMERICA AND THE CARIBBEAN

SCENARIO WITH RUSSIA-UKRAINE WAR



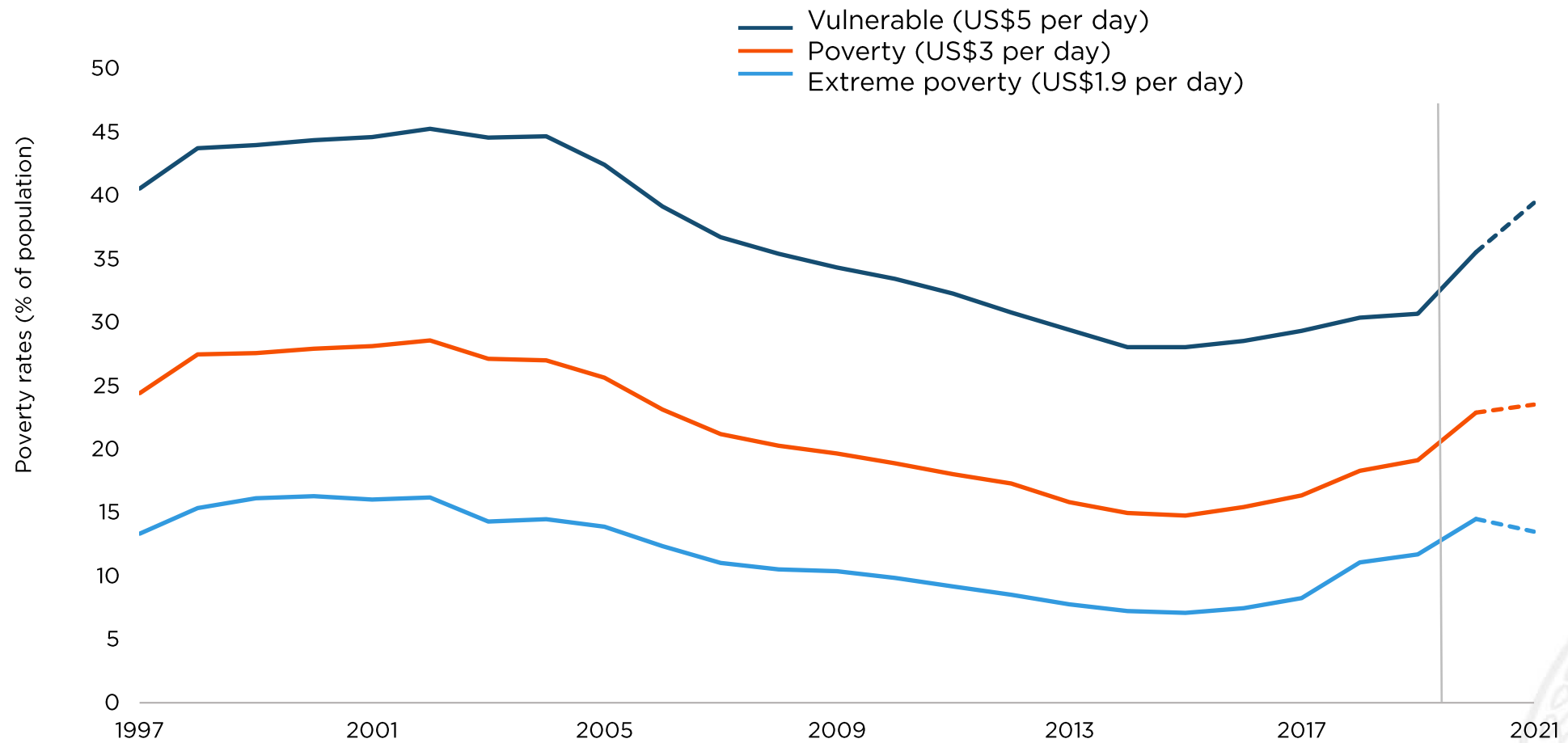
SCENARIO WITH WAR AND POLICY NORMALIZATION



Source: IDB staff calculations, pre-war scenario based on IMF January WEO update and Goldfajn, Ivanova, and Roldos (2022).

POVERTY INCREASED DUE TO THE PANDEMIC

OPPOSING FORCES COULD ALTER THE TRAJECTORY BUT A RESUMPTION OF THE 2003 – 2013 TREND SEEMS UNLIKELY



Source: IDB staff calculations based on Stampini et al. (2021).

THE EXTERNAL SECTOR CURRENT ACCOUNT AND CAPITAL FLOWS



CURRENT ACCOUNT DEFICITS RETURNING

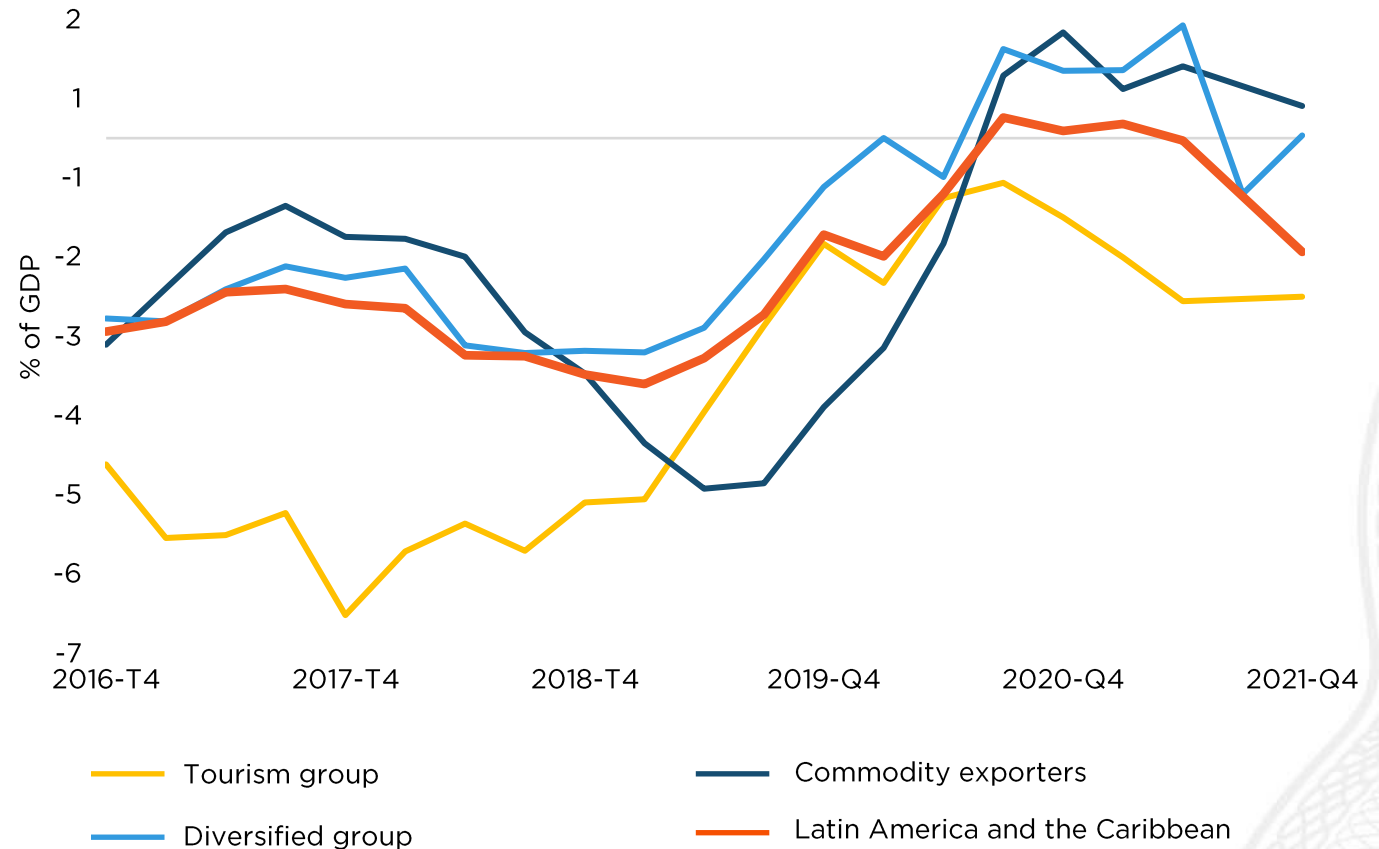
COVID was an atypical crisis.

Exports fell, but imports fell more.

Capital flows were resilient, reserves rose!

Public savings fell, as did investment, private savings rose, current accounts improved.

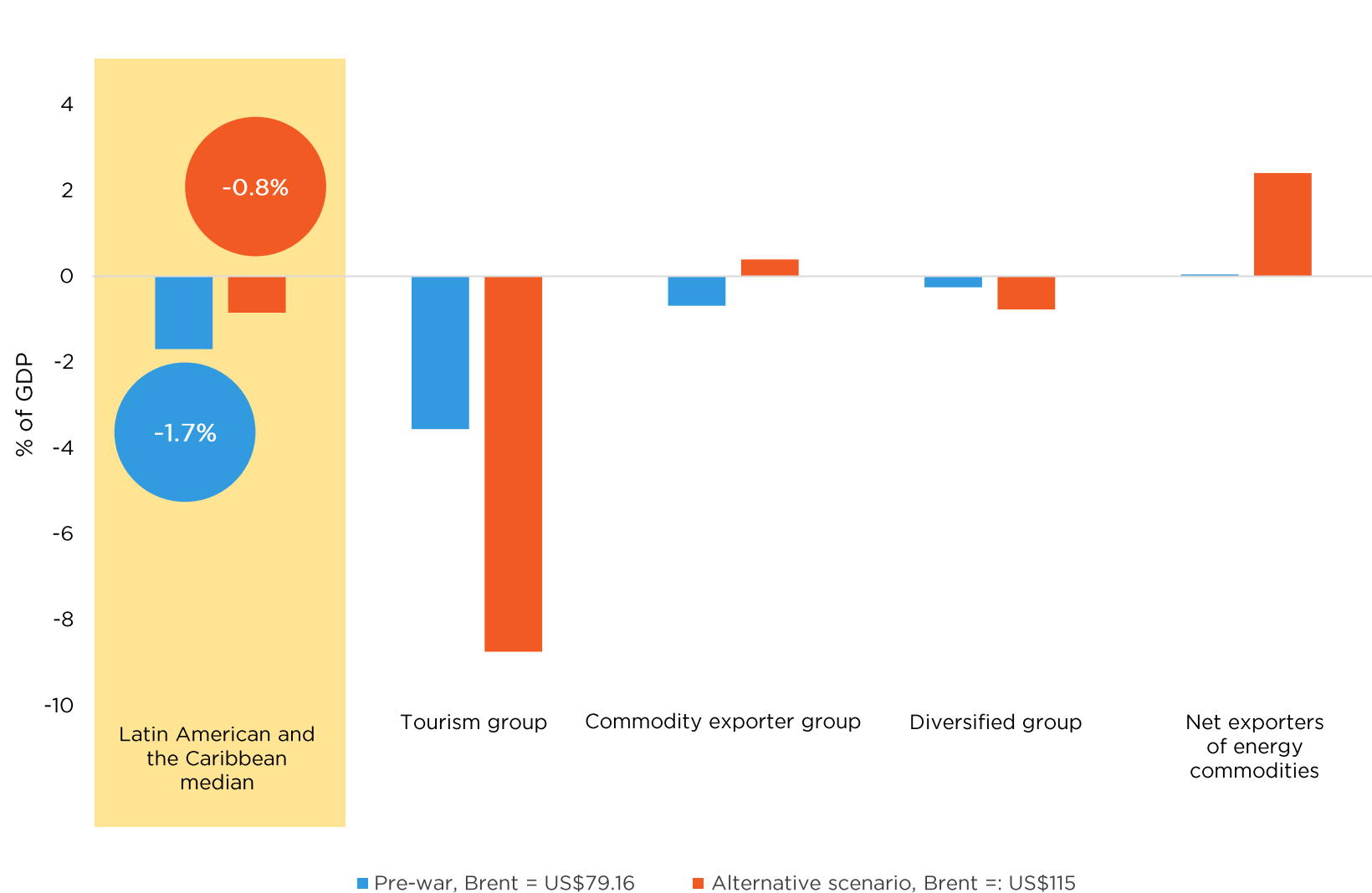
Now these trends are reversing.



Source: IDB staff calculations based on data from the IMF data

HIGH OIL PRICES BENEFITING EXPORTERS, PAIN FOR IMPORTERS

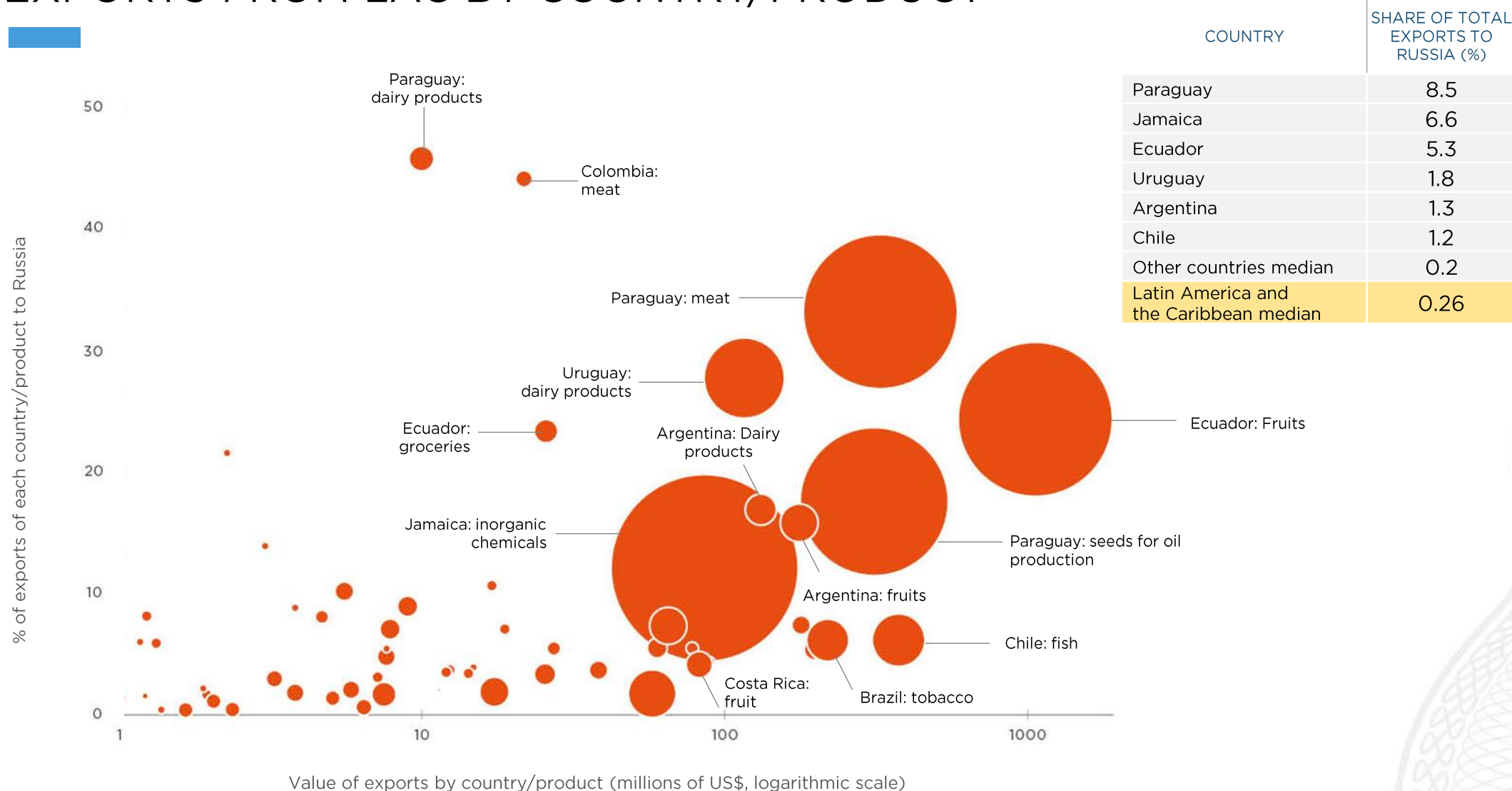
CURRENT ACCOUNTS SIMULATIONS



Source: IDB staff calculations using IMF balance of payments data.

DIRECT TRADE WITH RUSSIA SMALL BUT SOME SPECIFIC IMPACTS

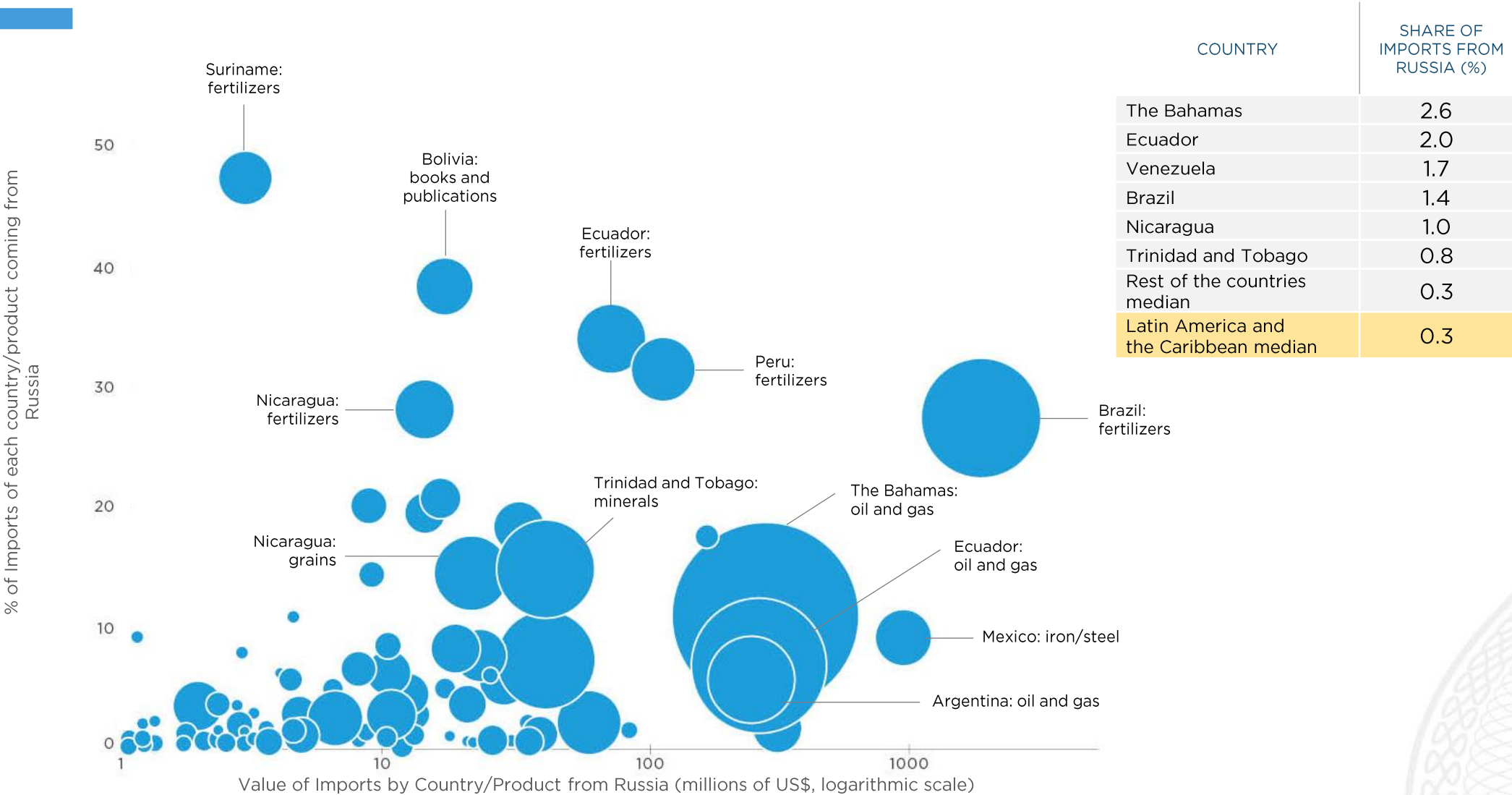
EXPORTS FROM LAC BY COUNTRY/PRODUCT



Source: IDB calculations based on UN Comtrade.

AND THERE IS ROOM FOR IMPORT SUBSTITUTION

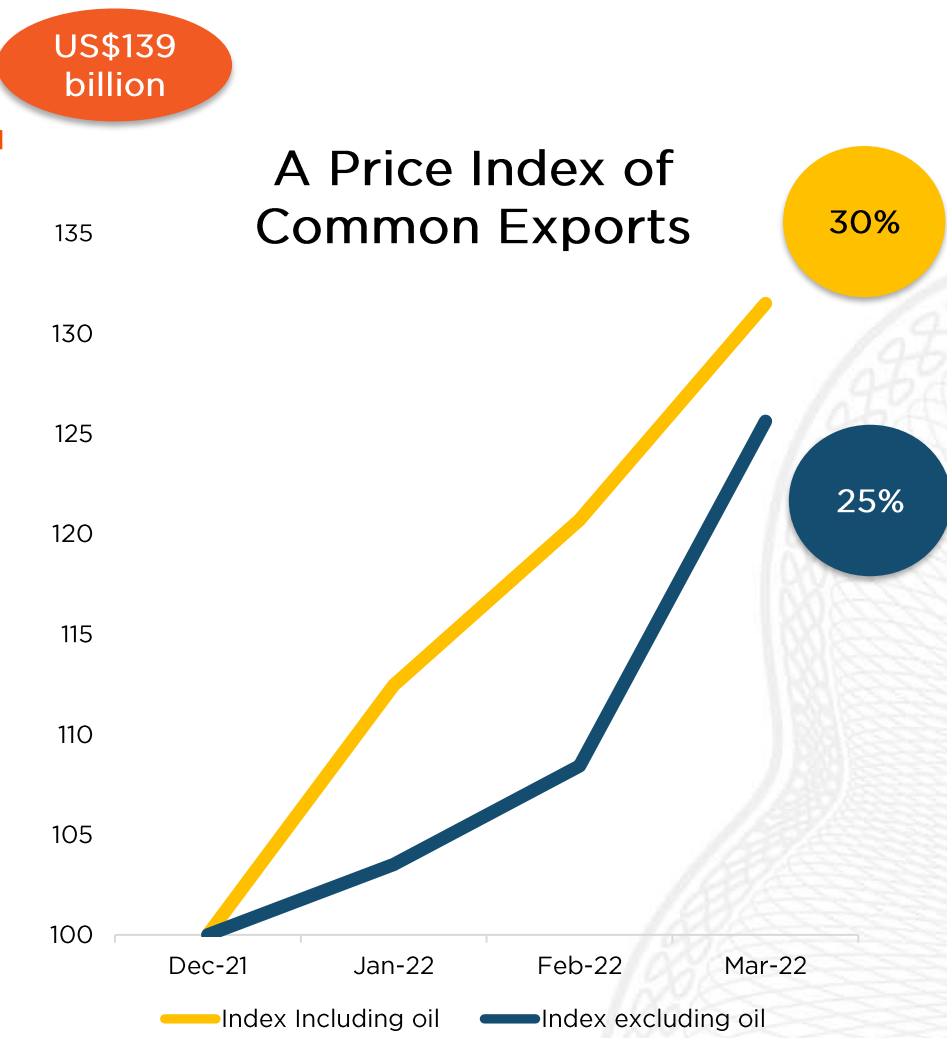
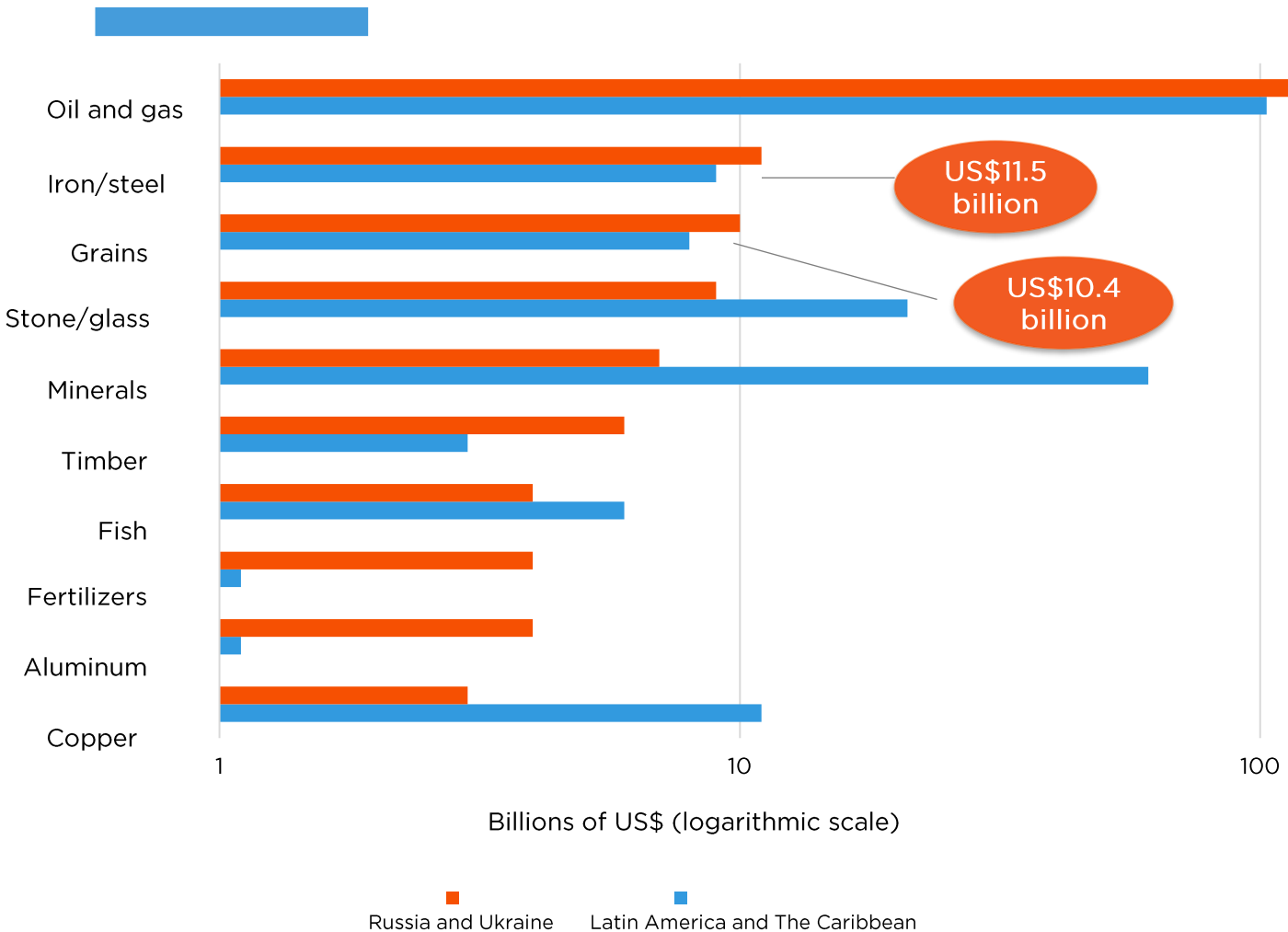
IMPORTS FROM RUSSIA BY COUNTRY/PRODUCT



Source: IDB staff calculations based on UN Comtrade database and the United Nations.

THE REGION COULD ASSIST THE WORLD IN SEVERAL KEY MARKETS

EXPORTS FROM RUSSIA AND UKRAINE AND LATIN AMERICA AND THE CARIBBEAN

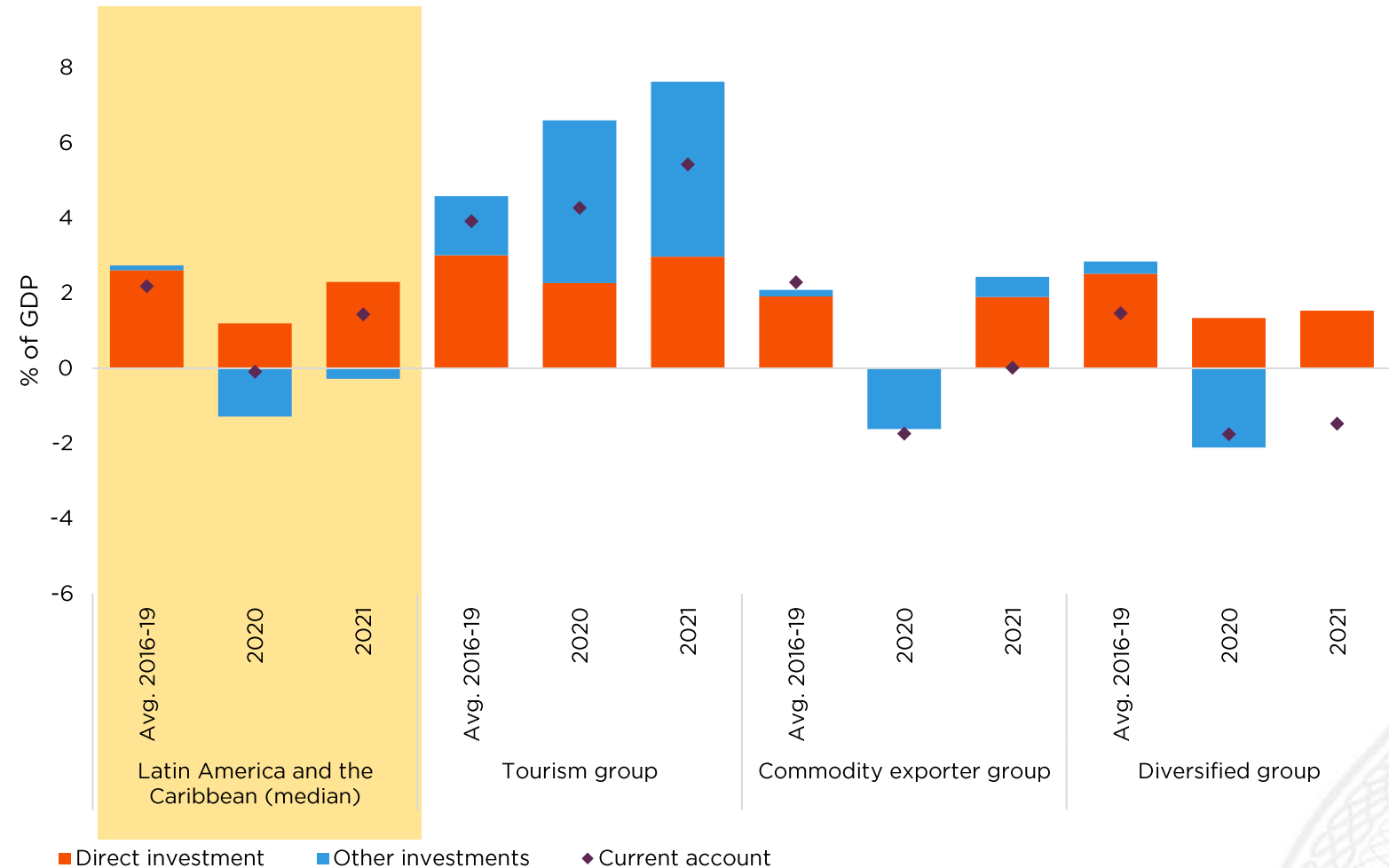


EXTERNAL FINANCING SOURCES HAVE BEEN RESILIENT

During the crisis, many sovereigns and corporates issued and borrowed from official sources to offset outflows

FDI resilient and grew in 2021

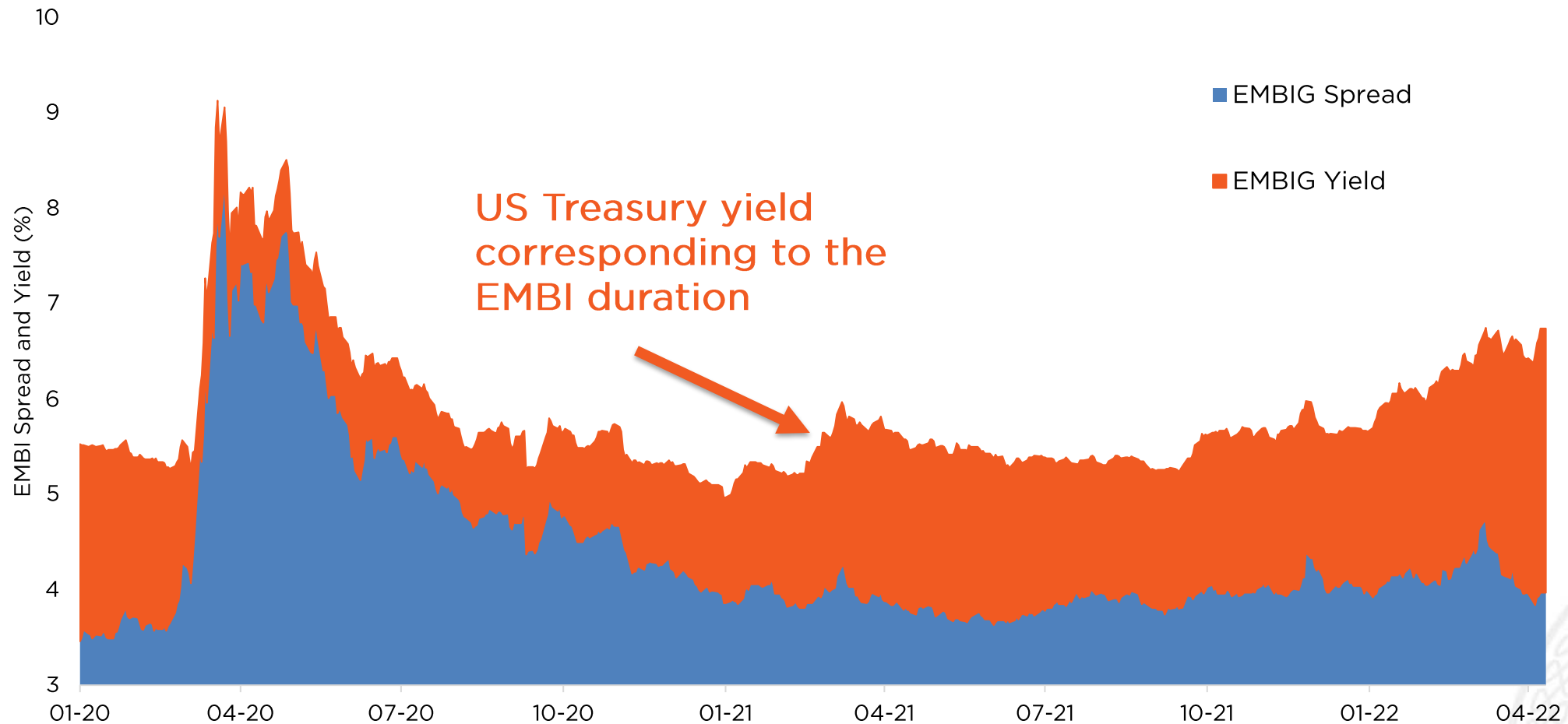
Many sovereigns and firms issued compensating outflows



Source: IDB staff calculations based on the IMF's Balance of Payments Statistics (BOPS) database and IMF (2021c).

FINANCING COSTS HAVE RISEN, NOT BECAUSE OF SPREADS

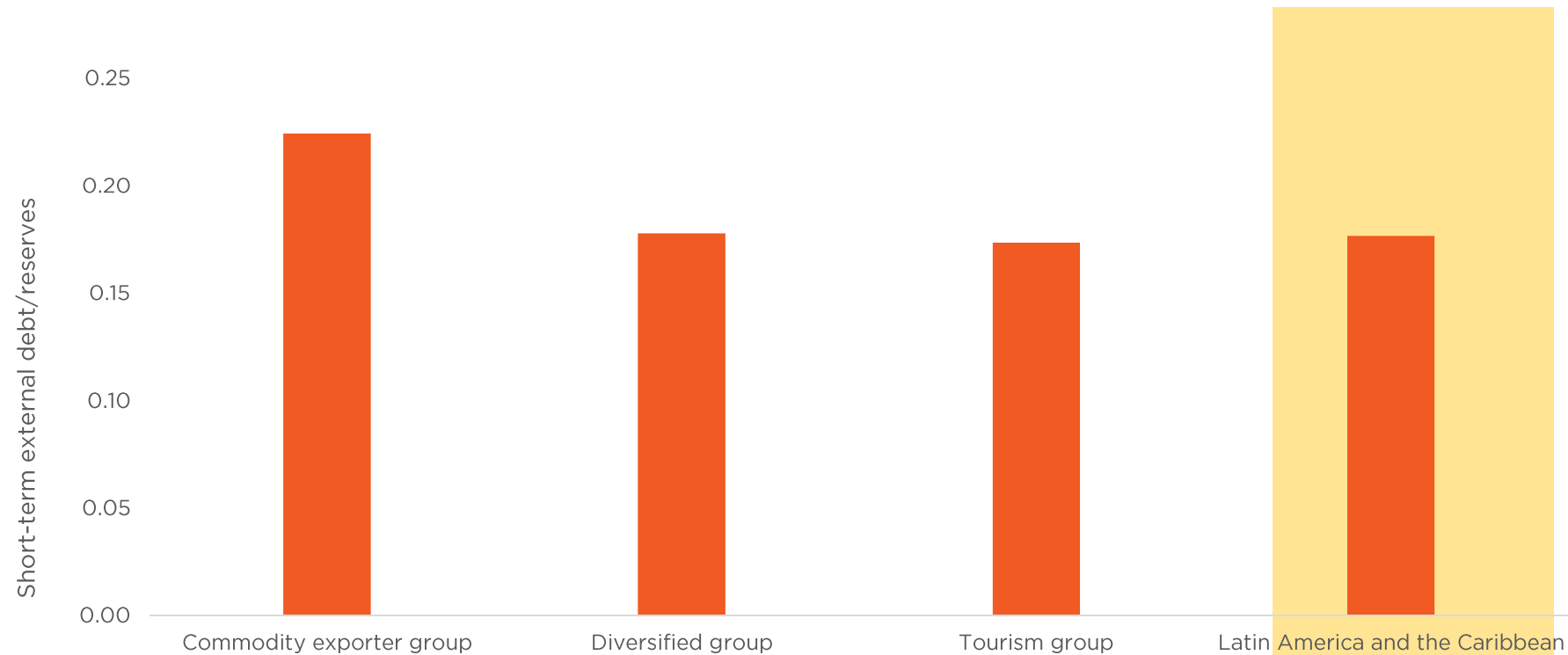
DUE ALMOST ENTIRELY TO THE RISE IN U.S. RATES (IN CONTRAST TO 2020)



Source: IDB staff calculations based on Bloomberg.

THE REGION HAS A STRONG EXTERNAL LIQUIDITY POSITION

DEBT DUE IN THE NEXT 12 MONTHS/RESERVES



THE RISE IN RESERVES MAY HELP CONTAIN “SUDDEN STOP” RISKS

KEY MACRO SUDDEN STOP DETERMINANTS

(% OF GDP)	FISCAL BALANCE			CURRENT ACCOUNT BALANCE			DOLLARIZATION OF LIABILITIES*			INTERNATIONAL RESERVES		
	2007	2019	2021	2007	2019	2021	2007	2019	2021	2007	2019	2021
Tourism group	0.7	-2.7	-4.3	1.8	-0.7	-0.6	27.9	22.9	27.9	13.5	15.1	21.1
Commodities group	-0.8	-3.5	-6.4	-2.9	-2.1	-2.8	20.0	18.1	21.3	12.9	16.4	20.7
Diversified group	0.8	-2.7	-4.5	-5.1	-1.3	-1.6	16.3	19.8	22.0	14.1	14.6	19.3
Latin America and the Caribbean	-0.2	-2.8	-5.4	-3.5	-1.3	-1.6	19.7	19.0	21.6	13.8	15.7	20.7

A deterioration in fiscal buffers increases risks of a sudden stop but is compensated partially by the rise in reserves.

EXTERNAL ACCOUNT PROSPECTS



- Economic recovery boosted imports and current account deficits returned
- Commodity prices will limit deficits for exporters but widen them for oil importers
- Remittances and capital flows have been resilient, spreads relatively stable
- But commodity futures are in backwardation and lockdowns in China a risk as well as continuing risks from viruses and the war and from US monetary normalization
- The region is more vulnerable due to higher fiscal deficits and debt, but reserve levels help to contain the risks

MONETARY POLICY

PUTTING THE GENIE BACK IN THE BOTTLE

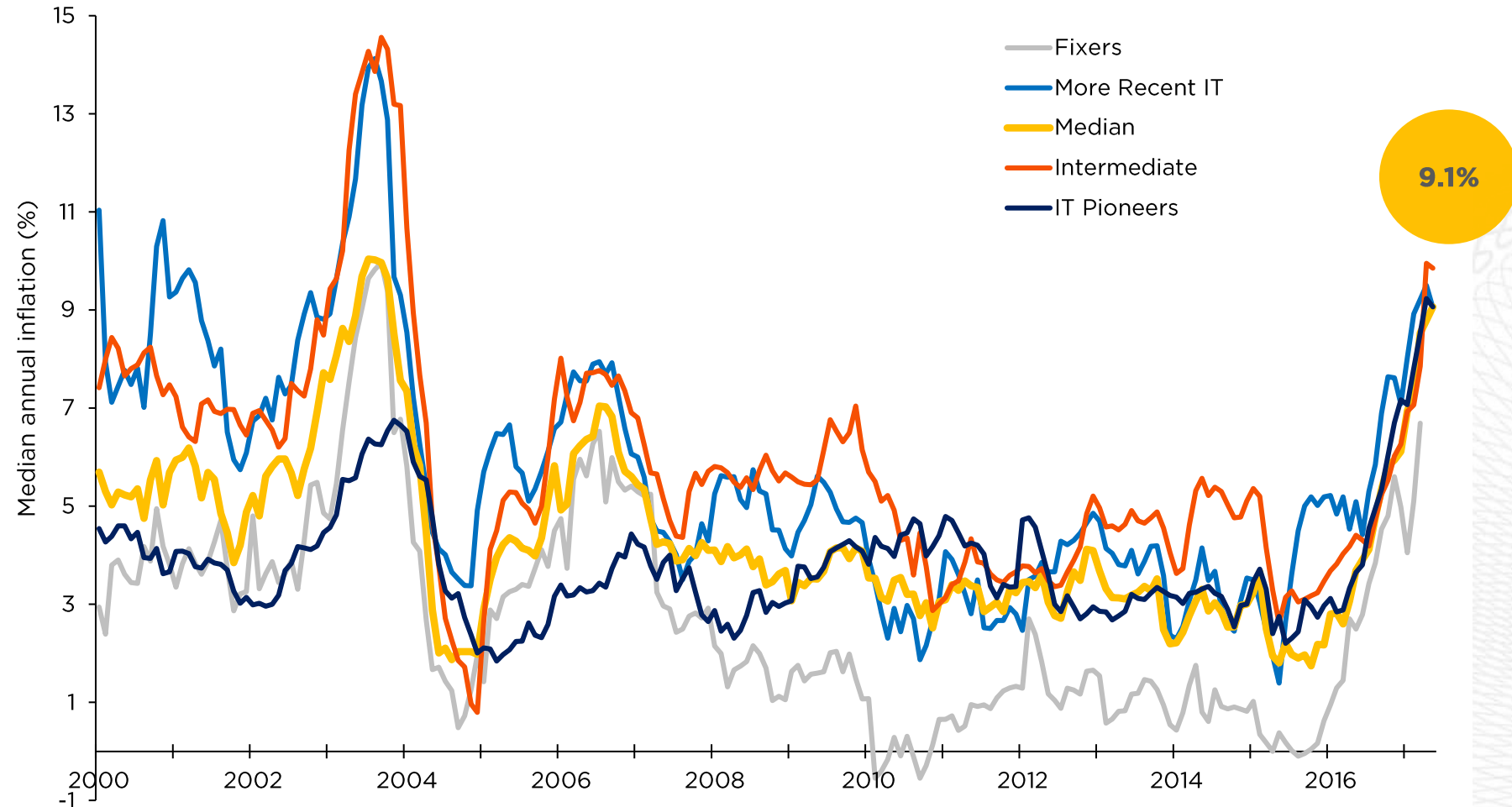


HEADLINE INFLATION ON THE RISE ACROSS MONETARY REGIMES

Median inflation increased from **2.4% in 2020 to 4.6% in 2021.**

Driven by real factors.

A key risk is the **de-anchoring of inflation expectations** and a loss in credibility and efficacy of monetary policy.



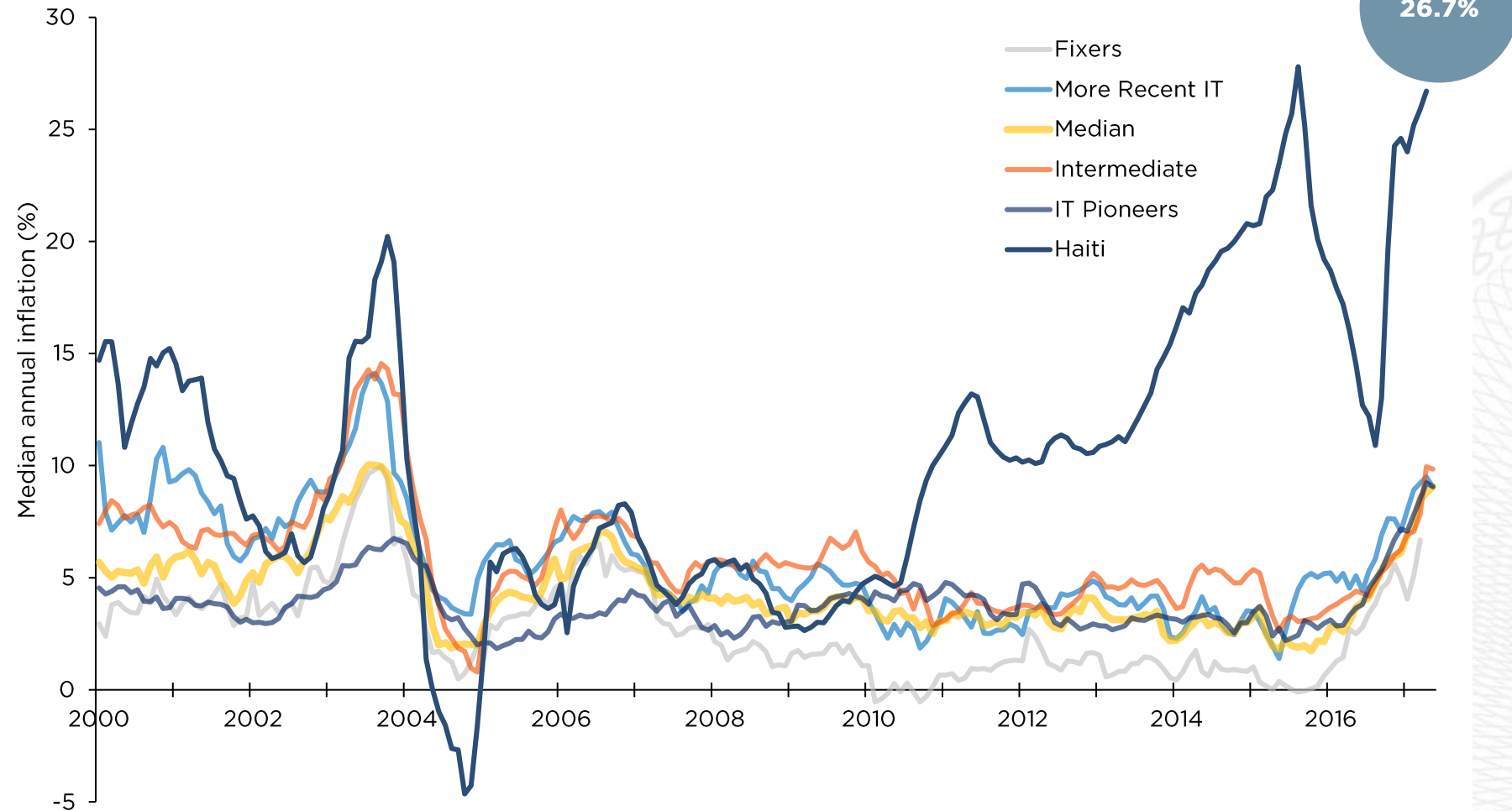
Source: IDB staff calculations based on central bank data and Haver Analytics.

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FOOD PRICE INDEX VS. CONSUMER PRICE INDEX

The rise in **food inflation** will have a **larger impact on the poorer households.**

The food-consumer price index gap has been widening.



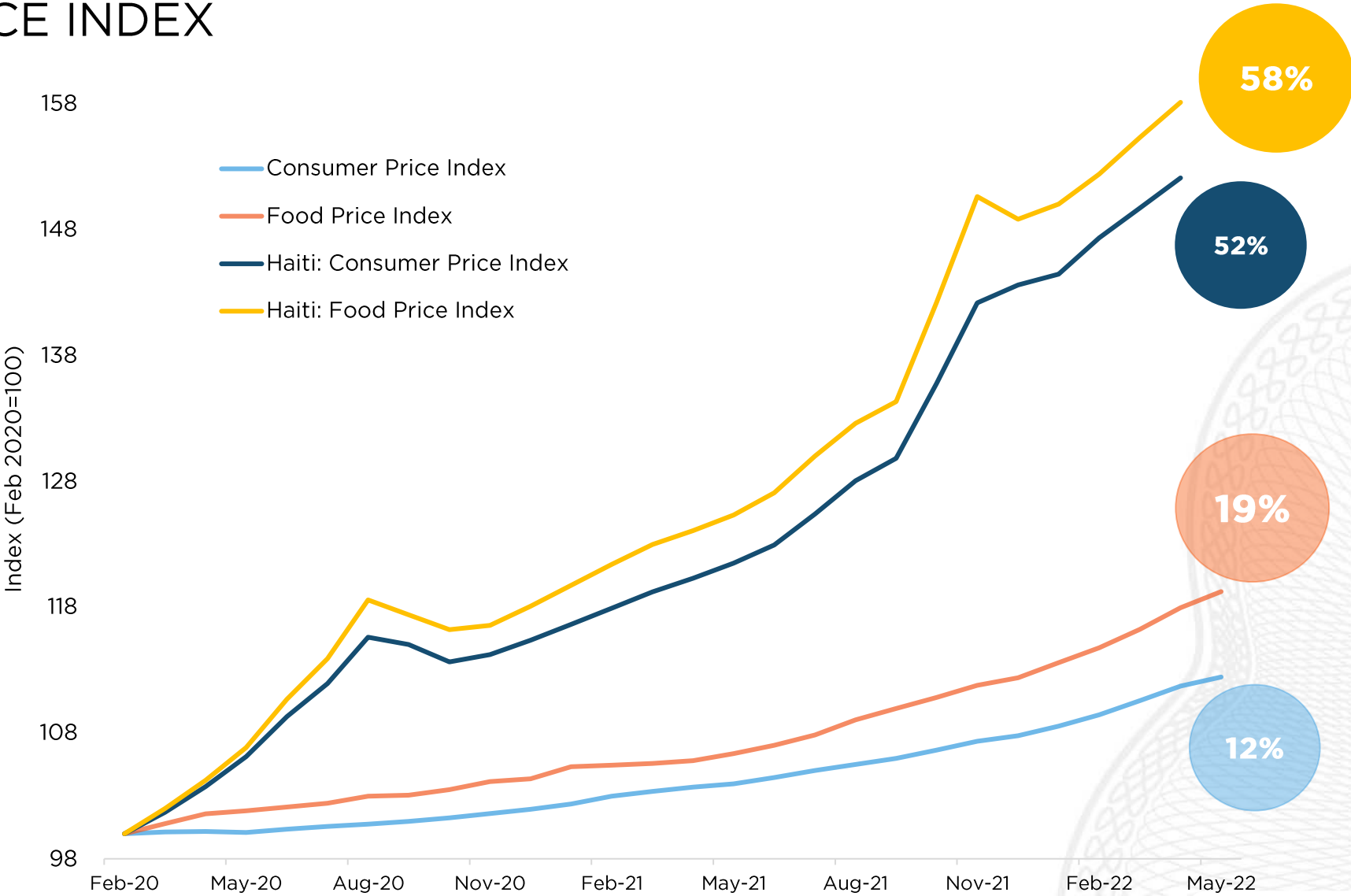
Source: IDB staff calculations based on central bank data and Haver Analytics.

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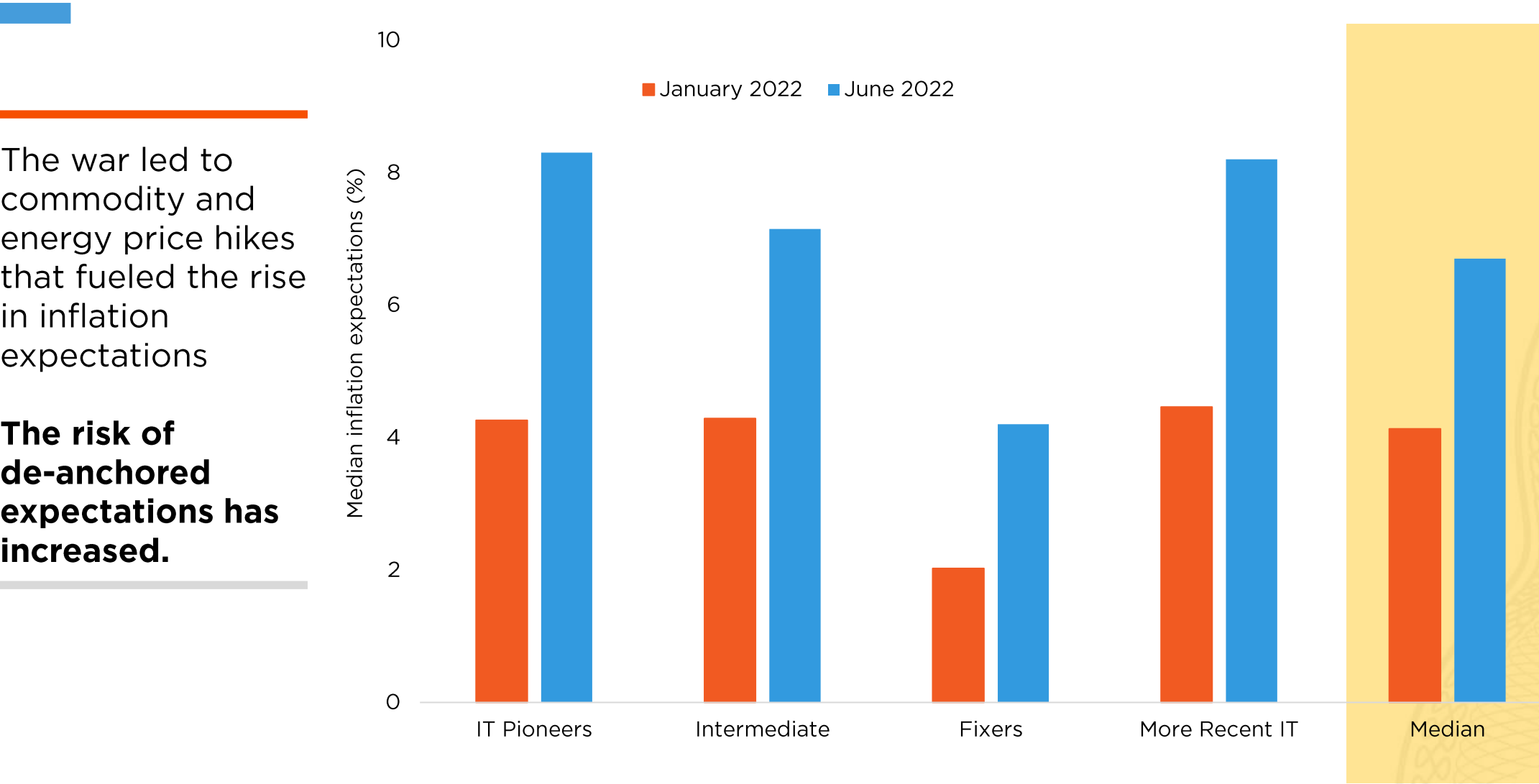
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INFLATION EXPECTATIONS FOR YEAR-END 2022 HAVE RISEN

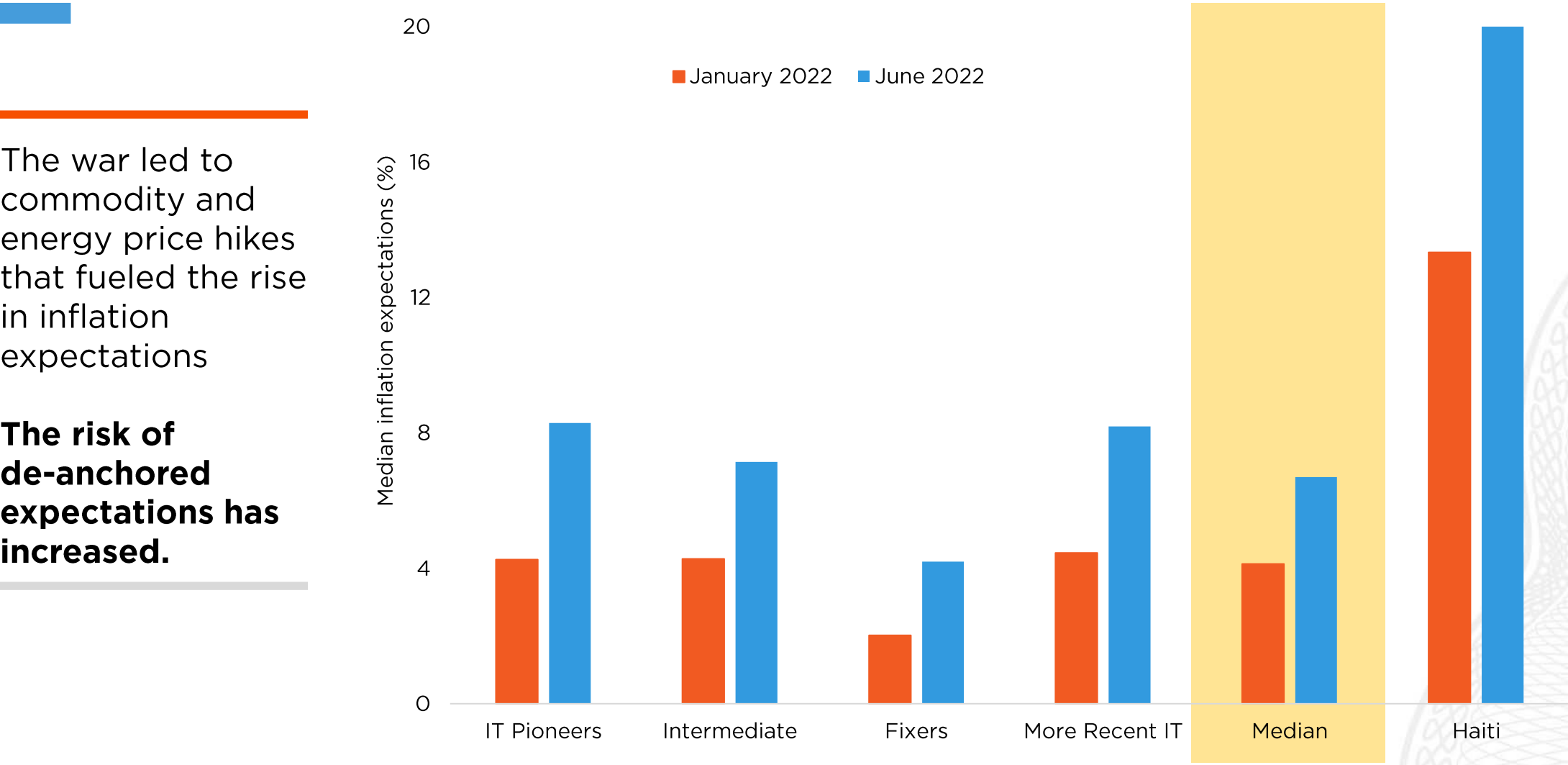


The war led to commodity and energy price hikes that fueled the rise in inflation expectations

The risk of de-anchored expectations has increased.

Source: IDB staff calculations based on Focus Economics (2022).

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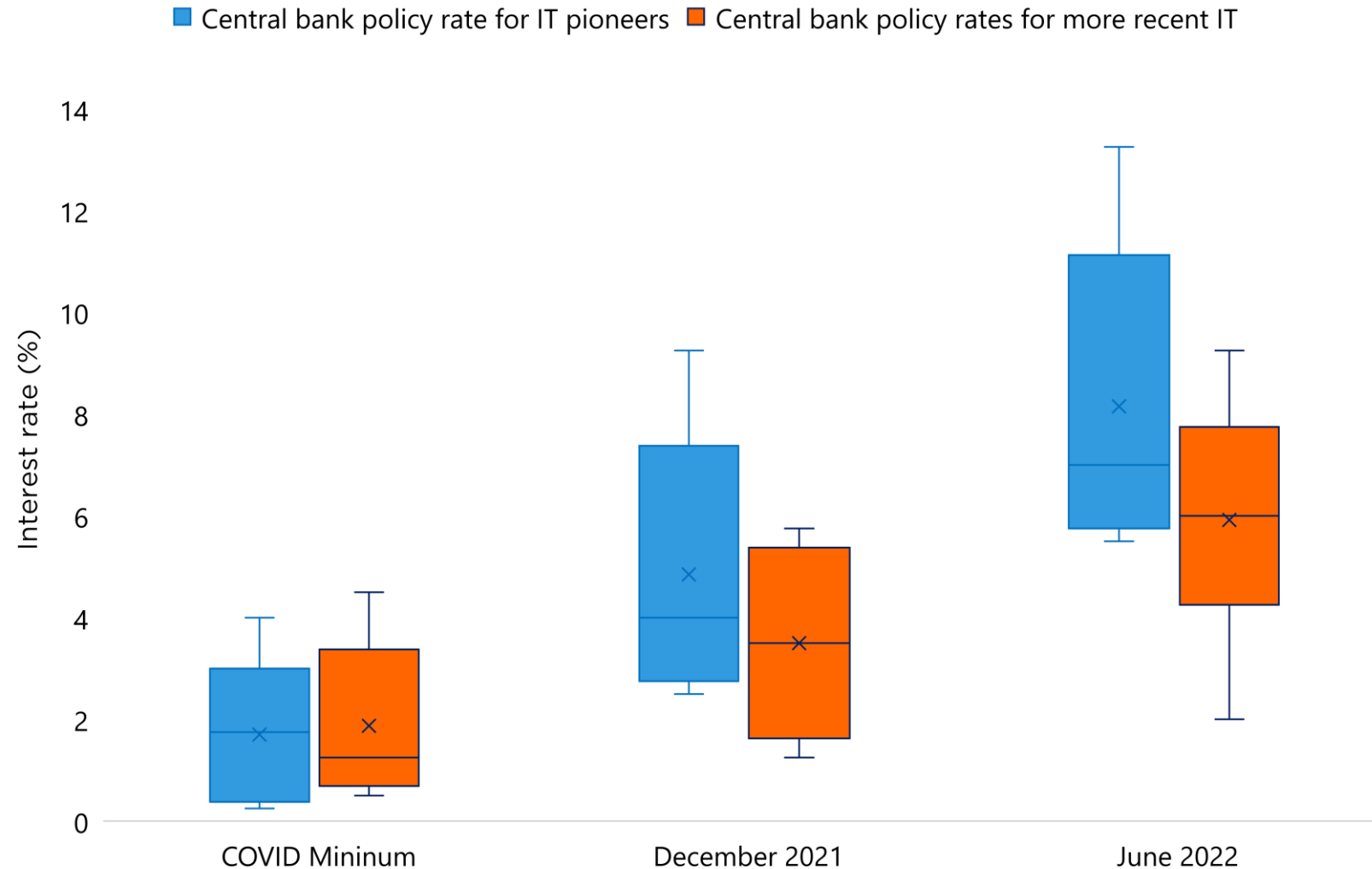


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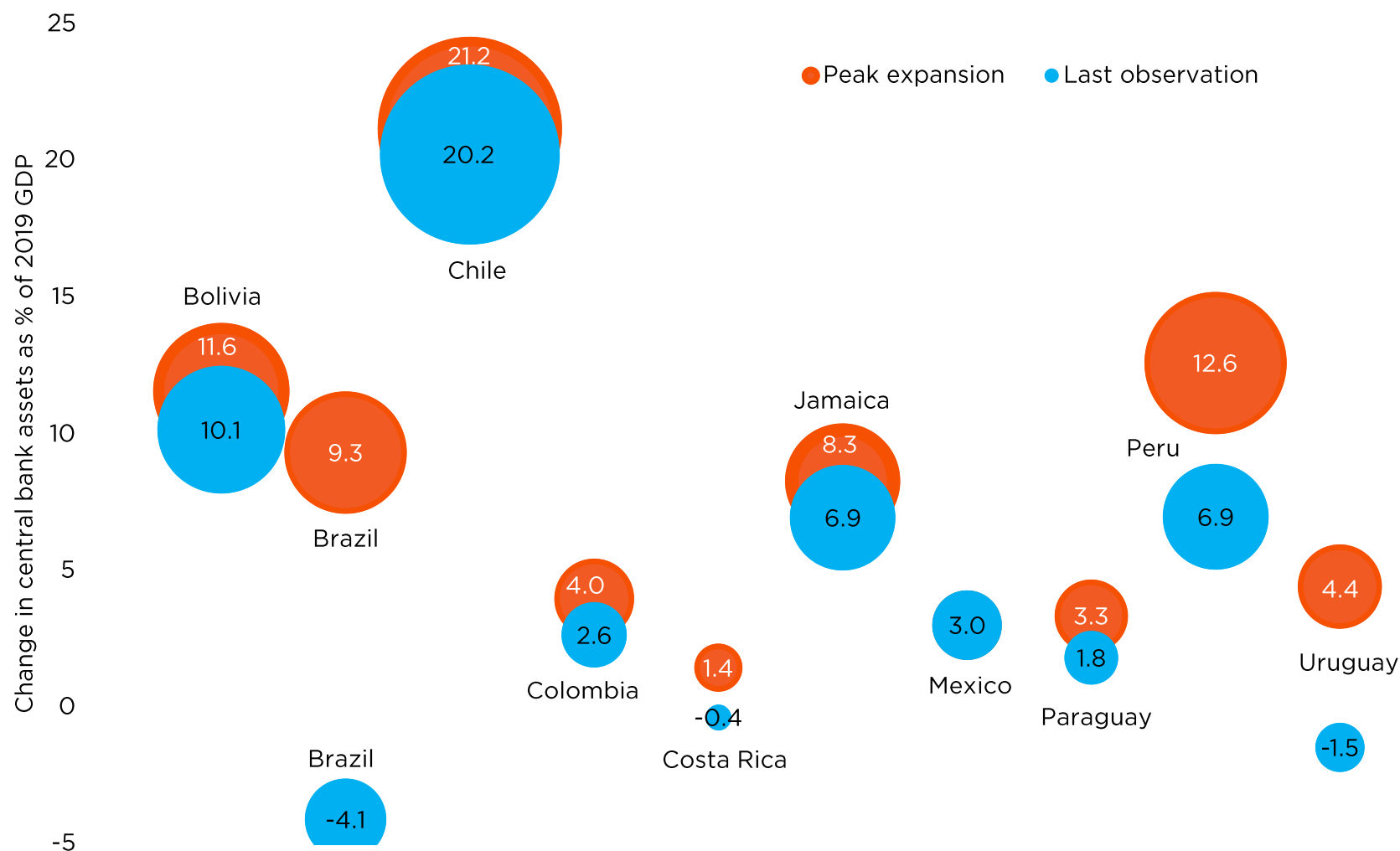
MONETARY POLICY INTEREST RATES SHARPLY RAISED



Central banks reacted swiftly to higher inflation to keep inflation expectations anchored.

The objective is to act to minimize the growth impact, if inflation expectations de-anchor bringing them down will have much larger costs.

CENTRAL BANK BALANCE SHEETS EXPANSION OVER THE PANDEMIC



Large central bank balance sheet expansions may raise concerns about a monetary overhang provoking potential inflationary pressures.

The **independence and credibility** of the central bank are key to maintain a consistency between monetary and fiscal policies, when returning balance sheet to normal levels.

MONETARY POLICY FOR RECOVERY

PUTTING THE GENIE BACK IN THE BOTTLE



- The region will face higher levels of inflation in the coming months.
- Monetary policy is more effective when it is credible, which requires central bank independence, a transparent framework, and a clear and consistent communication strategy.
- The coordination with fiscal policy will be key.

TOWARDS A NEW FISCAL ARCHITECTURE



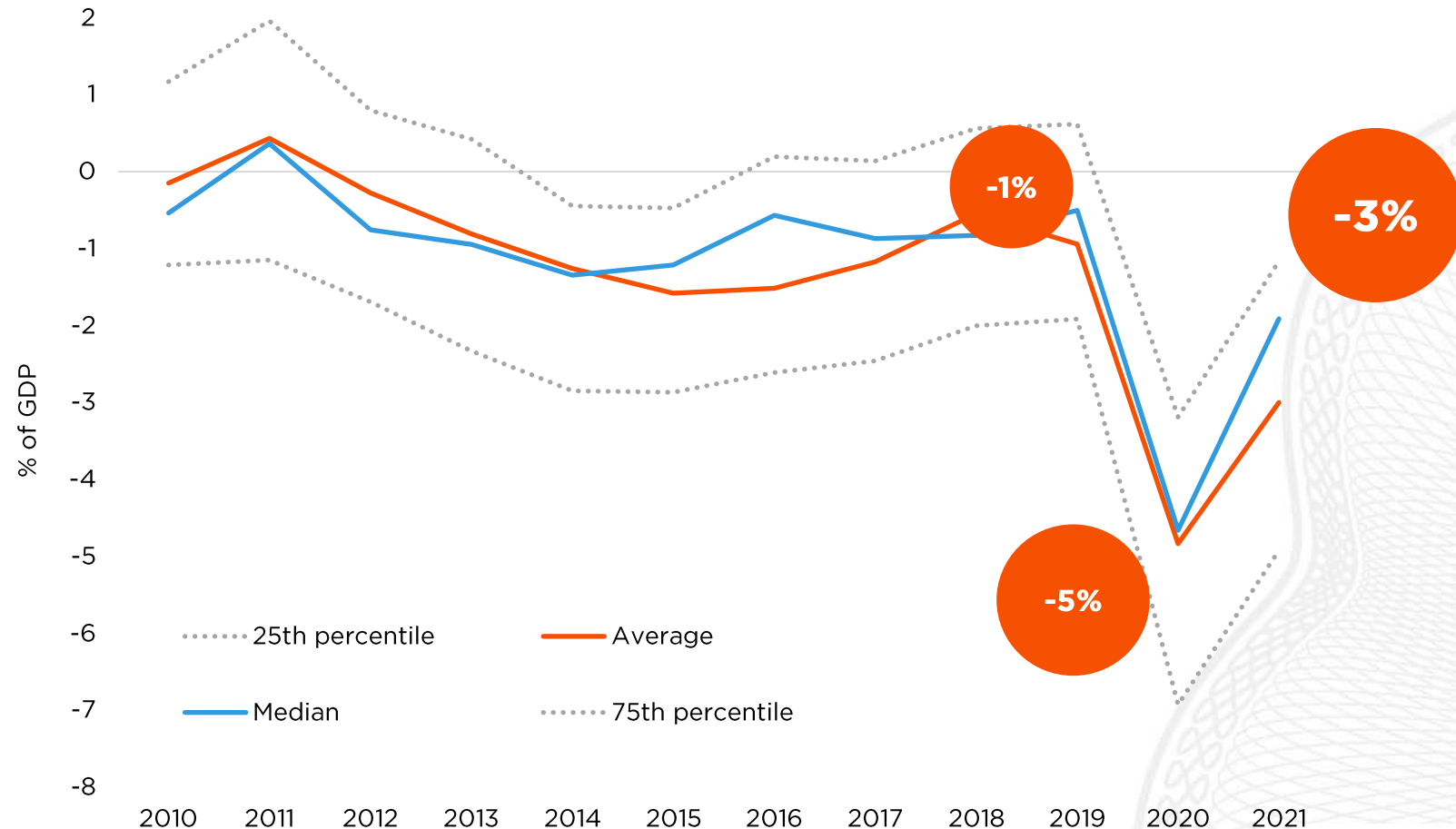
FISCAL BALANCES

A PARTIAL RECOVERY

The average primary fiscal deficit declined from **5% of GDP in 2020 to 3% of GDP in 2021**.

The region's average overall fiscal deficit was **5.8% of GDP, down 1.8 p.p. of GDP compared to 2020**.

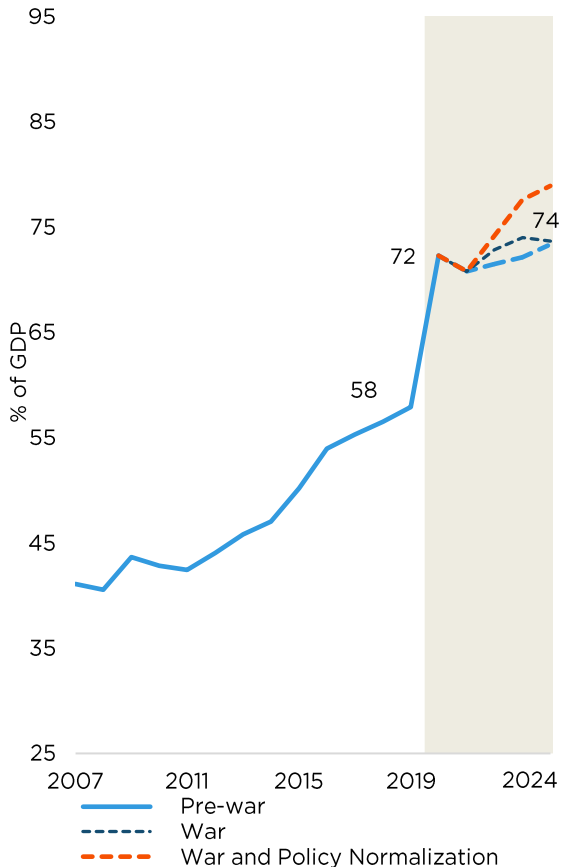
PRIMARY FISCAL BALANCE



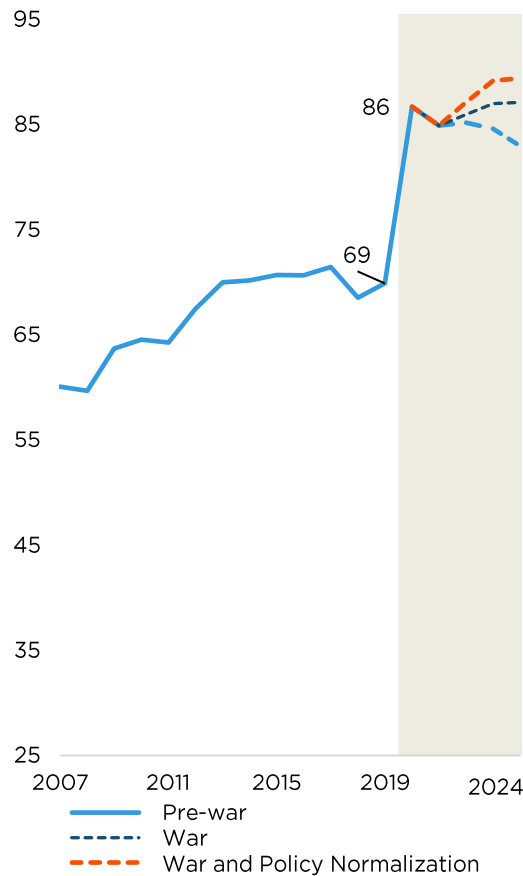
Source: IDB staff calculations based on IMF (2021c) and Focus Economics (2021).

DEBT-TO-GDP RATIOS SCENARIOS

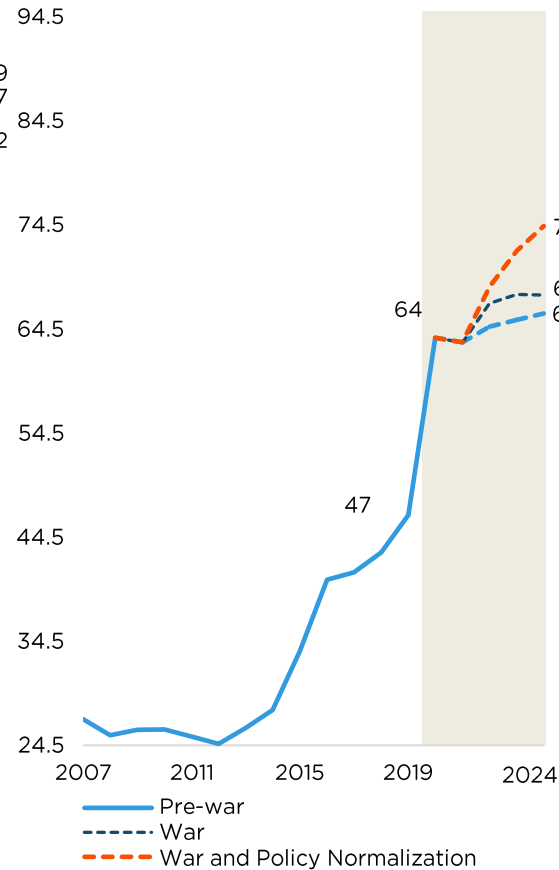
LATIN AMERICA AND THE CARIBBEAN



TOURISM DEPENDENT



COMMODITY DEPENDENT



Despite the fiscal deficits, **debt ratios did not increase in 2021.**

Debt to GDP ratios could be between 73% and 79% by 2024 depending on the scenario

Towards a new fiscal architecture

- Countries face the challenge of fiscal consolidation to ensure debt sustainability. Moreover, expansionary fiscal policy with inflation above target and a central bank raising rates is inefficient.
- Commodity exporters should use temporary gains from higher commodity prices to reduce debt burdens, or to increase savings.
- But the form of that consolidation may be at least as important as the headline deficit reduction. Protecting capital spending (eg: infrastructure) can assist inclusive growth and boost supply.
- More generally the region needs a new fiscal architecture to address informality and expand the tax base: Countries should consider a negative income tax and “personalized VAT” through a system of rebates
- Many opportunities to change the tax system and spending to improve both equity and efficiency

LABOR MARKETS AN OPPORTUNITY FOR A GREAT TRANSFORMATION



LABOR MARKETS

AN OPPORTUNITY FOR A GREAT TRANSFORMATION

- A complementary new architecture for labor market policies would in the region promote formal jobs and reduce informality, to increase productivity and widen the tax base
- A shift away from labor taxes to general taxation and fund transfers (unemployment benefits, social security etc.)
- A renewed emphasis on human capital, education, and training programs
- Policies to encourage automation and digitalization that creates jobs (and does not just replace them) and training for the workers in the digital age
- Policies to close the gender gap

CONCLUSIONS



FROM RECOVERY TO RENAISSANCE

TURNING CRISIS INTO OPPORTUNITY

- The war will have varied effects on the region, higher commodity prices and lower world growth. Complicated policy normalization a serious risk for all.
- The region can play a role in mitigating the impacts of the war on key international markets and global inflation.
- With rising financing costs, debt reduction should be a priority. And with higher inflation and a risk of expectations drifting higher, expansionary fiscal with tight money is inefficient and risks credibility.
- The crisis and the war provide a window of opportunity to reset policy frameworks.
- Fiscal and labor market policies should work together to reduce informality, allow good small firms to grow, expand the tax base, increase productivity and growth.
- Equity can benefit at the same time through higher wages, a fairer tax system and better targeted spending.



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Research Department

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