XVIII Regional Conference on Central America, Panama, and the Dominican Republic: Latam7 Near-Term Outlook and Challenges

Carlos Giraldo
Chief Economist, Latin American Reserve Fund (FLAR)

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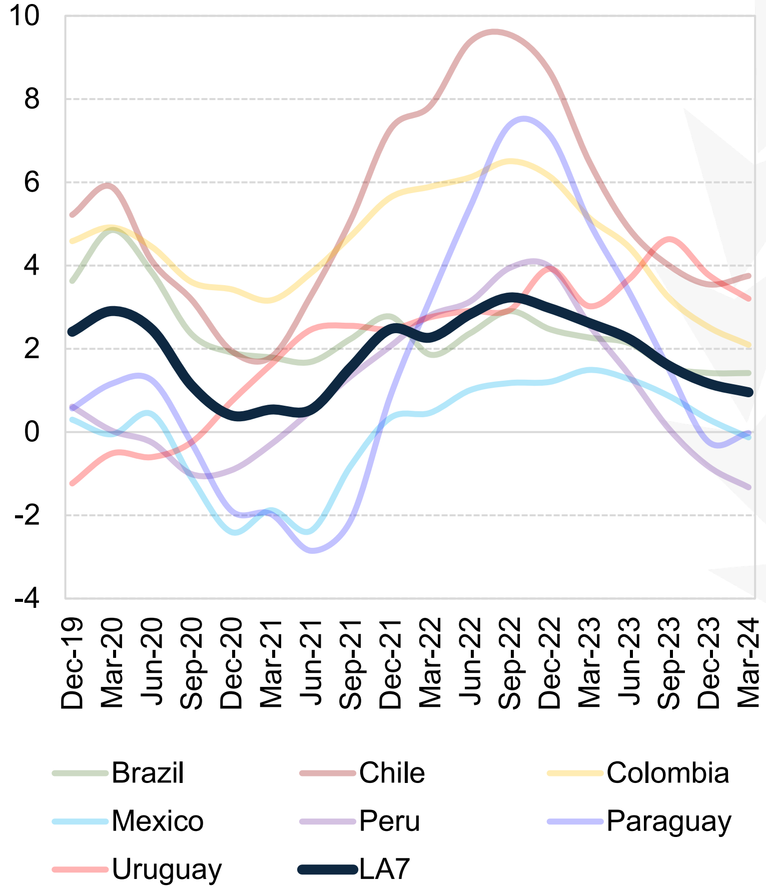
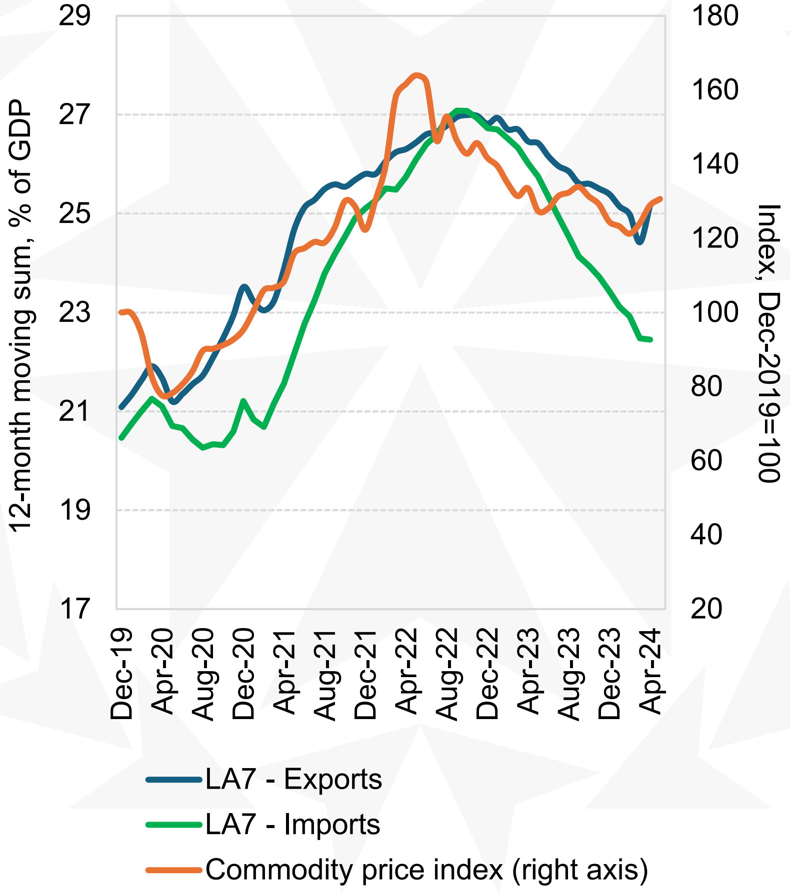
Recent Developments

Current account deficits declined led by imports reduction and recent exports recovery

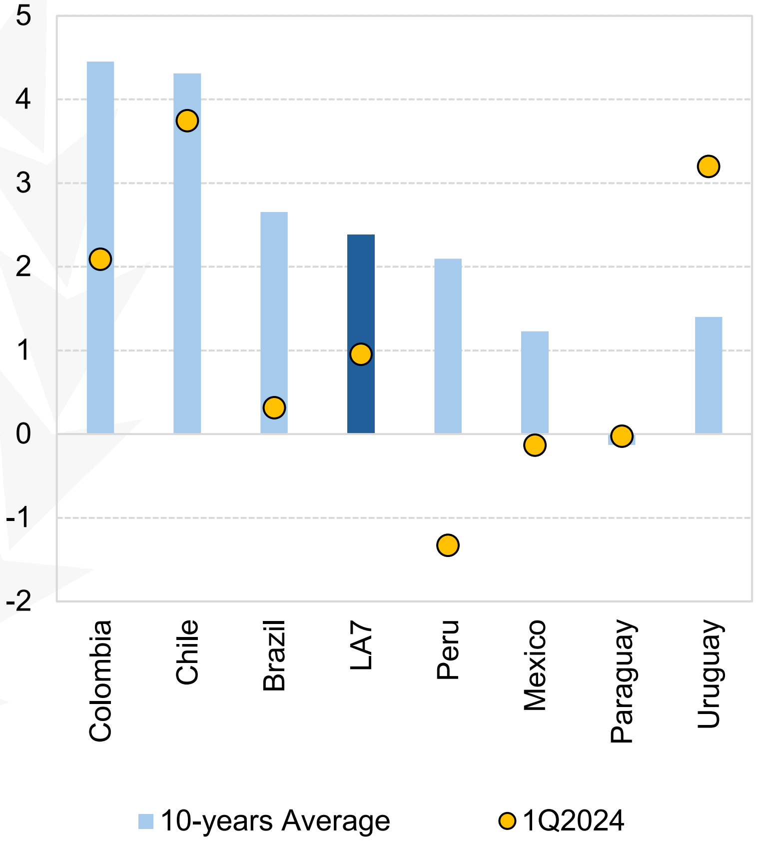
Current account deficit by countries (BoP)[1/]
(12-month moving sum, % of GDP)



LA7 exports and imports (goods) and commodity prices [1/]

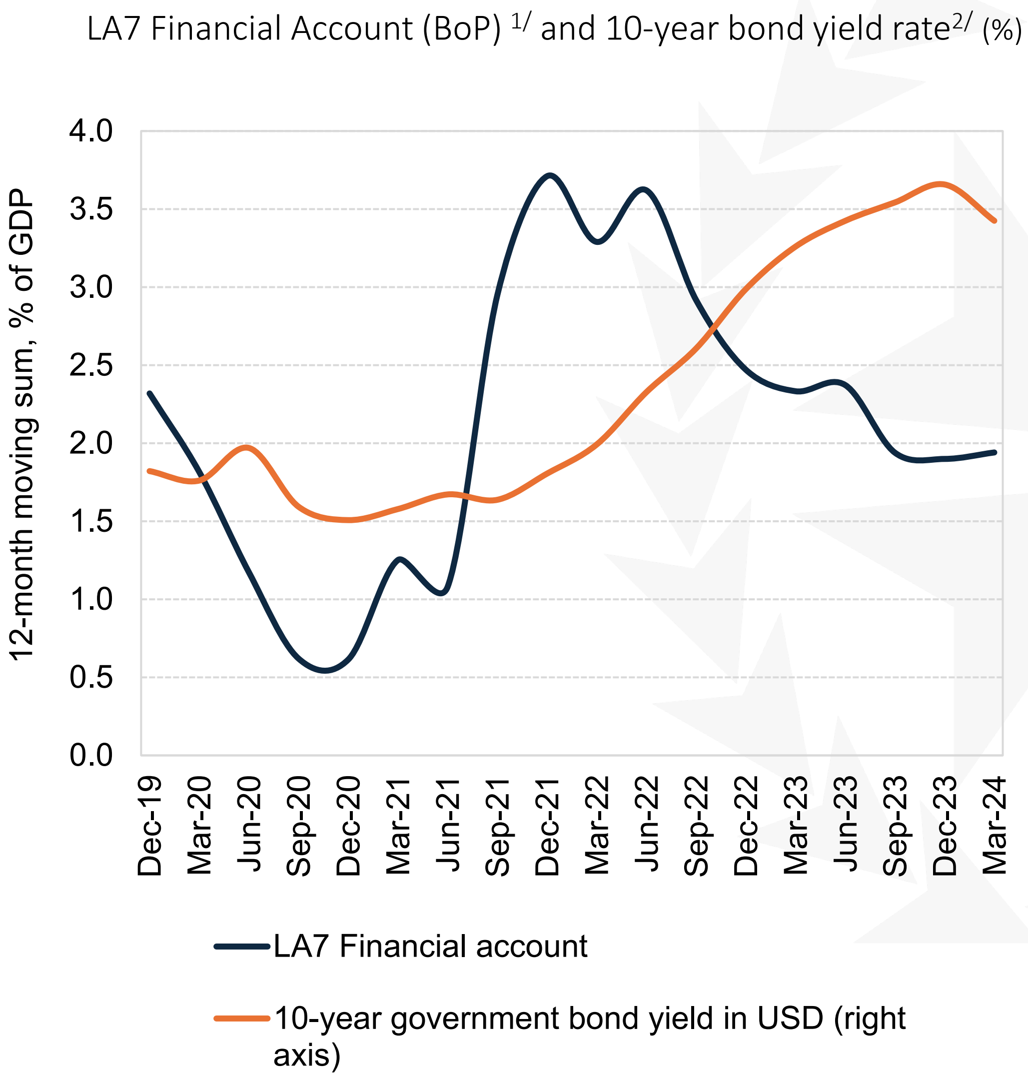


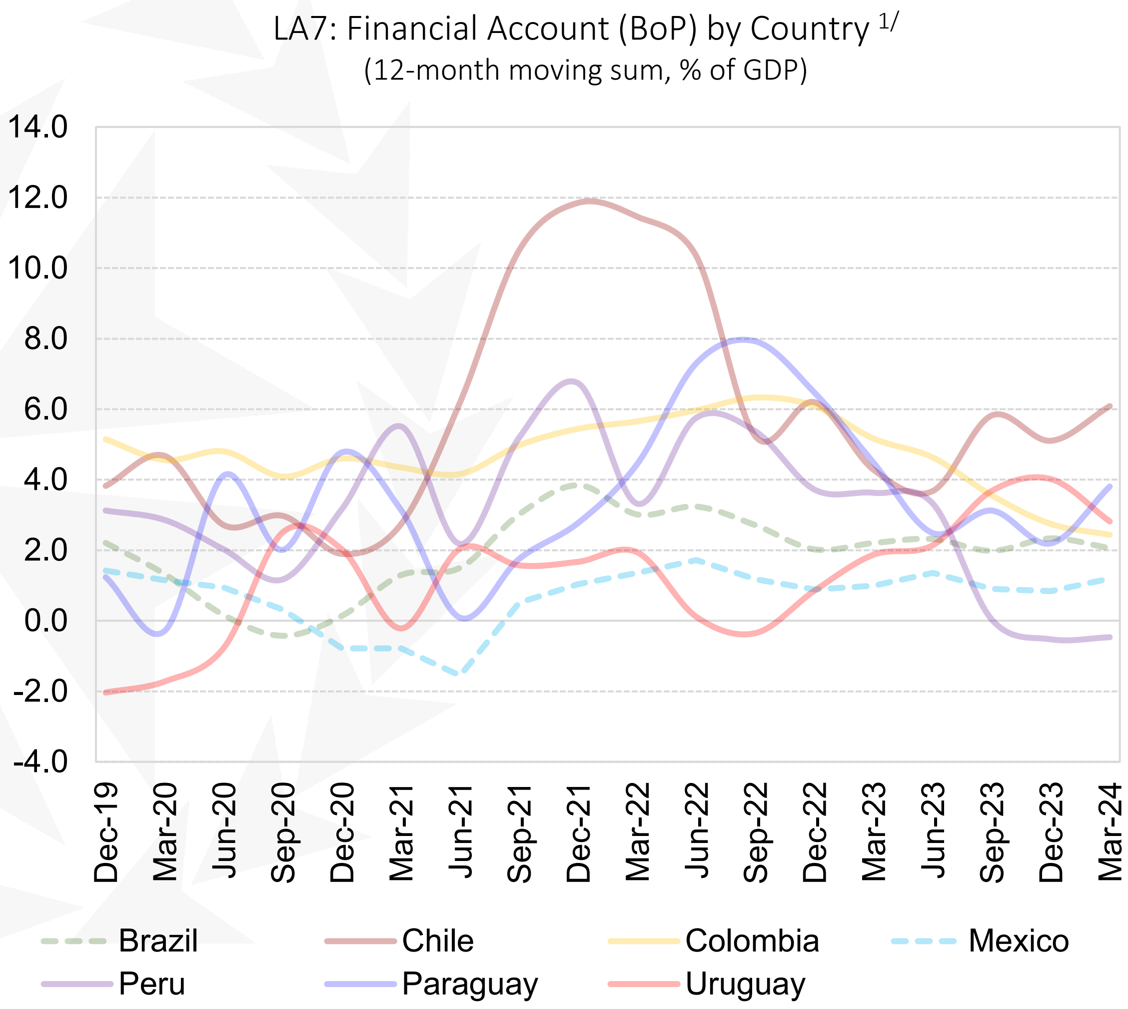
Current account deficit Vs 10-year average (BoP)[1/]
(12-month moving sum, % of GDP)



[1/] LA7 considers Brazil, Chile, Colombia, Mexico, Peru, Paraguay and Uruguay.
Source: central banks, Bloomberg and FLAR staff calculations.

Decline in external financing for LA7 led by tightening of global financial conditions

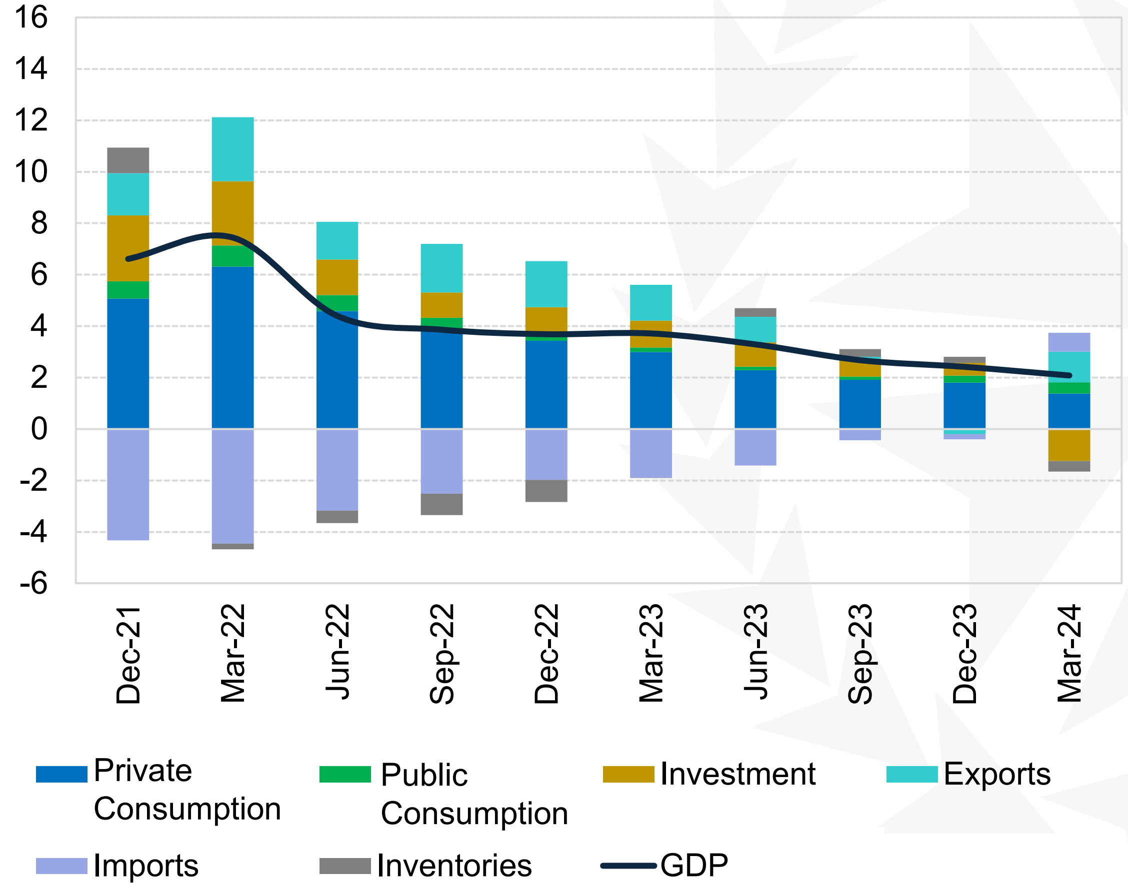




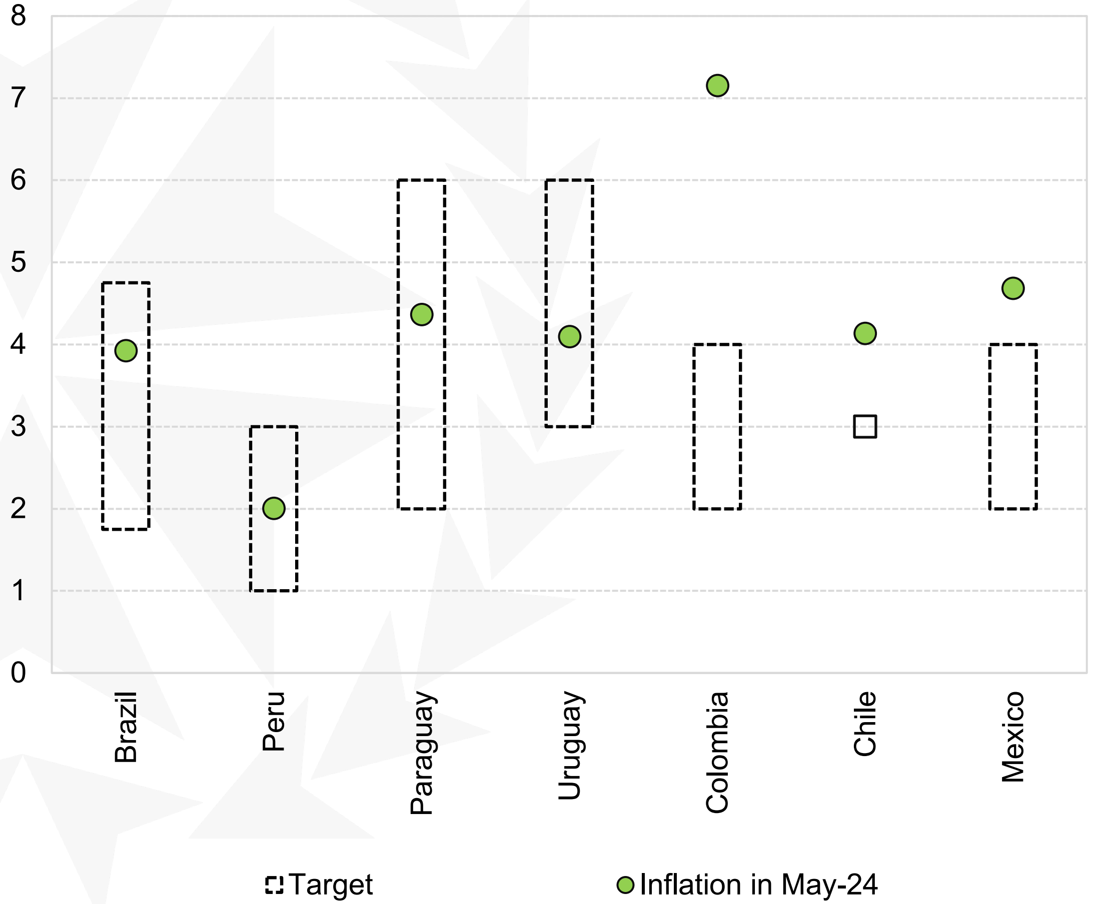
[1/] LA7: Brazil, Chile, Colombia, Mexico, Peru, Paraguay, and Uruguay. Financial Account without Reserve Assets.
[2/] Considers 10-year government bond yields in USD of Brazil, Chile, Colombia, Mexico and Peru.
Source: central banks and FLAR staff calculations.

GDP growth is slowing down because of private consumption and investment behaviors

LA7: Contributions to Real GDP growth[1/]
(Year-over-year percent change, year-to-date)



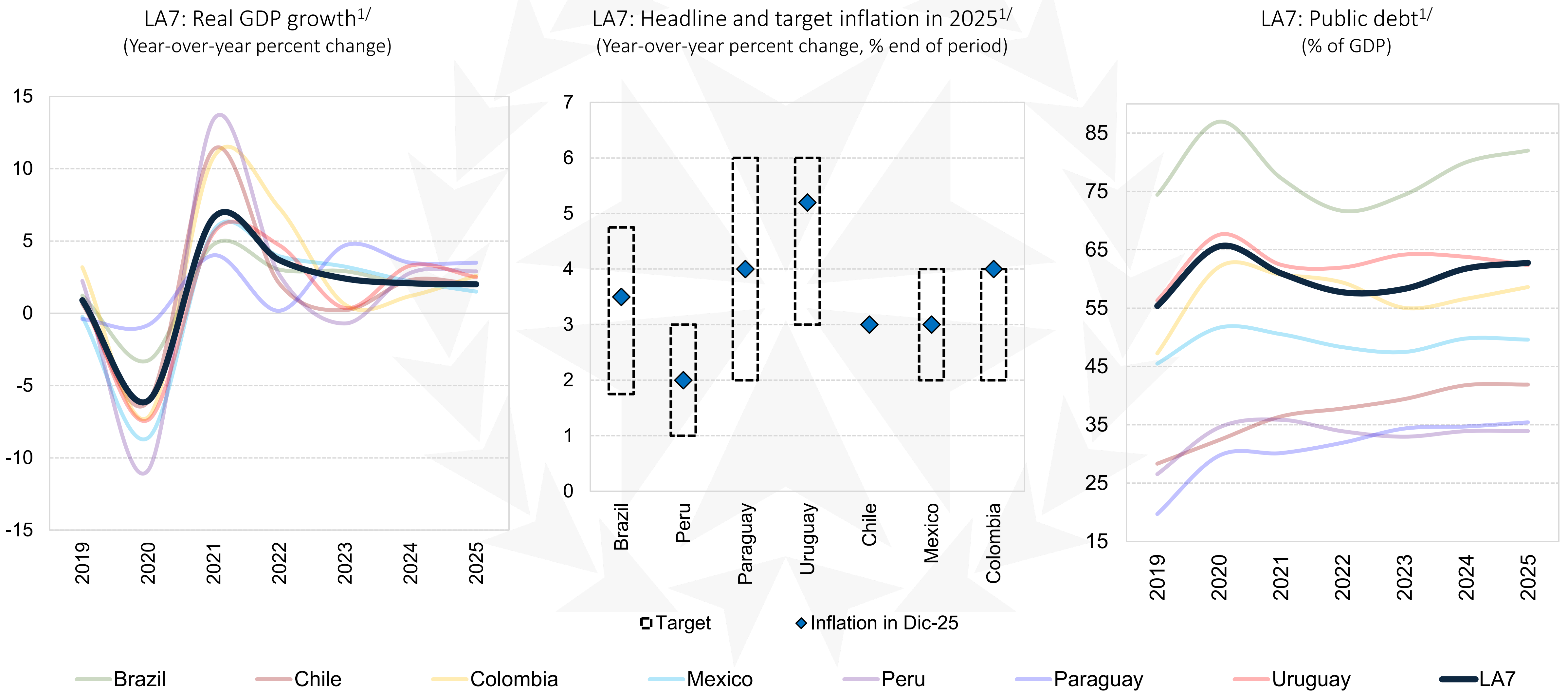
LA7: Headline and target inflation[1/]
(Year-over-year percent change, %)



[1/] LA7 considers Brazil, Chile, Colombia, Mexico, Peru, Paraguay and Uruguay.
Source: central banks and FLAR staff calculations.

Near-Term Outlook

Growth will remain stable in most economies, inflation will reach its target, while public debt will stabilize above pre-pandemic levels



[1/] LA7 considers Brazil, Chile, Colombia, Mexico, Peru, Paraguay and Uruguay. Aggregates are PPP GDP-weighted averages.
Source: central banks and FLAR staff calculations.

Summary

- Cyclical adjustment continues at heterogenous paces in the region in the short term

- Macroeconomic policy frameworks have been tested during the last large shocks:

  - Combination of central bank independence, inflation targeting, fiscal rules with escape clauses, and strong financial regulatory and supervision has worked well

- Improvement of policy frameworks has helped to mitigate external pressures

  - Magnitude of the U.S. yield term spillovers to Latam economies (Brazil, Chile, Colombia, Peru, and Mexico) has decreased during the pandemic (Giraldo et al, 2024) and post-pandemic (Adrian et al, 2024)

- However, key risk factors persist ….

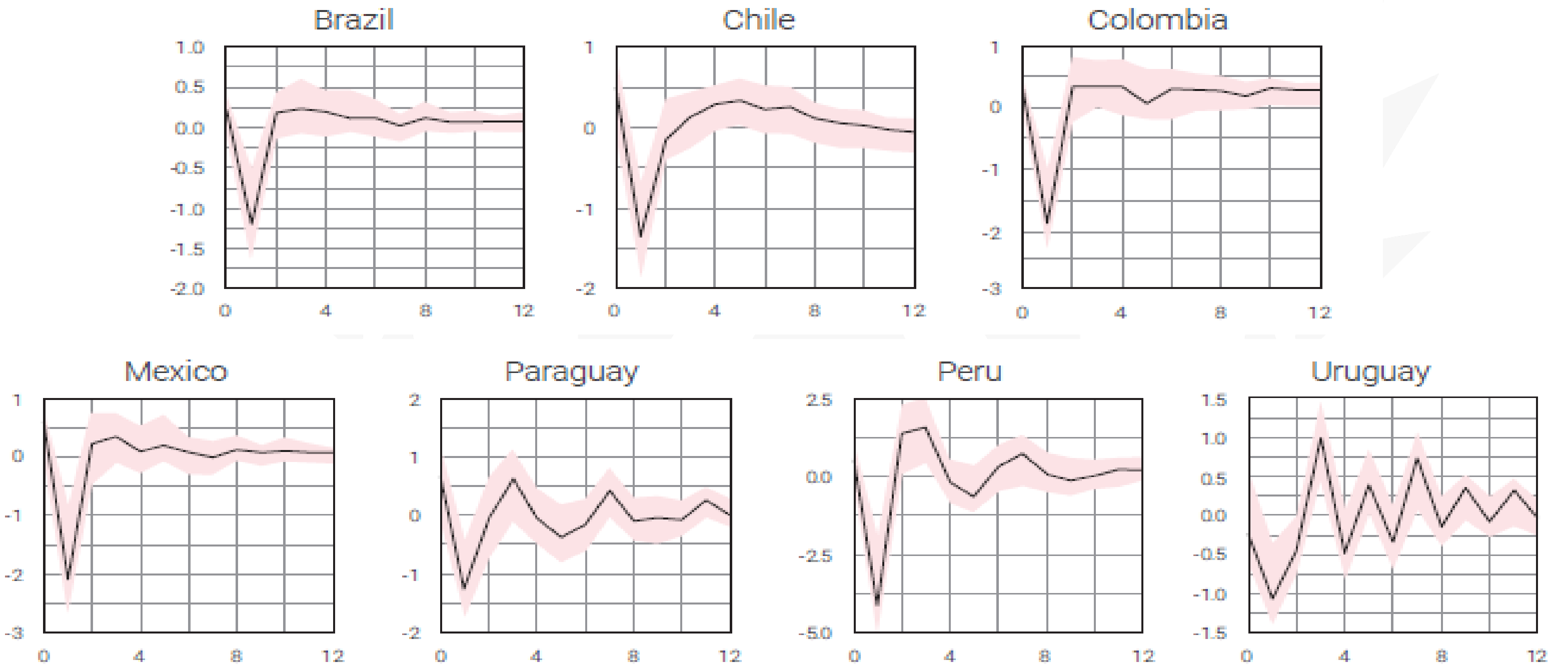
Some Risk Factors and Challenges

Risk factor: High uncertainty around the world, including the U.S. economy

According to our recent research, the most important transmission channel of uncertainty shocks in the U.S. to Latam economies is the real channel (trade and investment)

GDP Response to a US Real Uncertainty Shock

LA7



Note: The figure shows the response of GDP in Latin American countries to US real uncertainty. The shadowed area corresponds to 95% confidence intervals constructed by bootstrapping.
Source: Giraldo *et* al (2023).

Risk factor: Sustained tightening of international interest rates

- Capital flows are sensitive to external and internal factors. Risk of reversals or sudden stops of capital flows is always present in emerging market economies

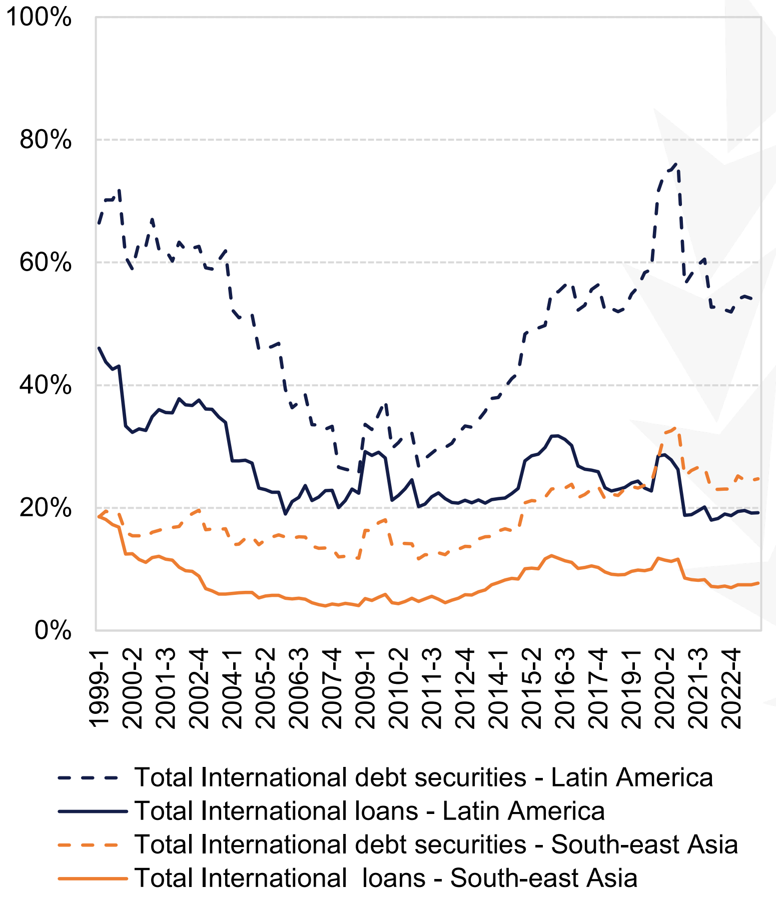
- In a financially dollarized and open economy, the ease of substituting between domestic currency and USD-denominated assets creates a spillover channel, influenced by the relationship between international and domestic interest rates

- Our recent research shows evidence[1/] of an international bank lending channel extending from the U.S. to Brazil, Chile, Colombia, Mexico, and Peru. The impact is even clear in countries where the presence of U.S. banks is minimal

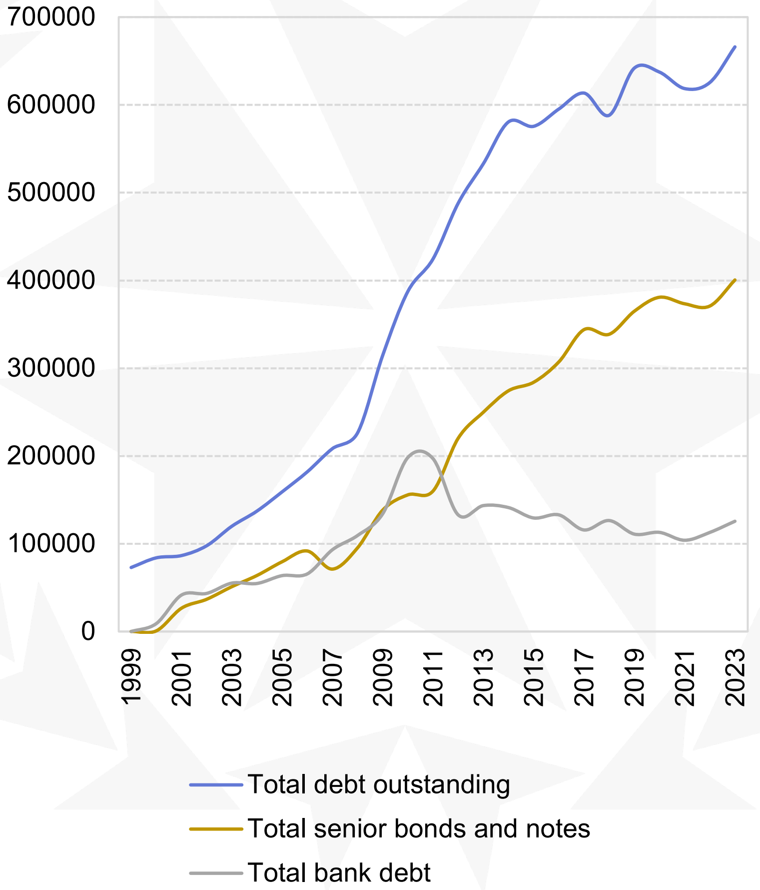
[1/] Giraldo et al. (2023)

Risk factor: International debt of non-financial corporate sector in USD is high, persistent, and characterized by decreasing maturity

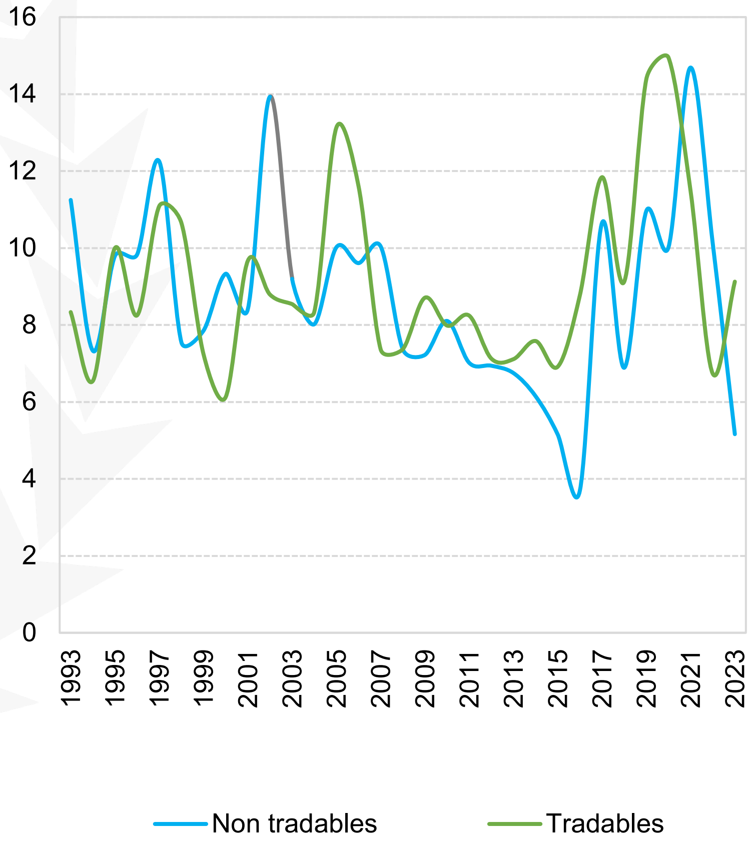
International dollar debt of non-banks
(% exports)



Debt securities vs. Bank loans NFC in LA7
(USD million)



Maturities of average gross issuance of non-financial companies in LA7 (%)



Source: FLAR-DEE calculations and Capital IQ.

Challenge: Successful transition of the monetary policy stance by preserving macroeconomic and financial stability

- Central banks need to consolidate and preserve inflation control, while:
  - Avoiding excessive pressure on private (households and firms) and public balance sheets
  - Avoiding capital reversals or sudden stops:
    - High for longer international interest rates led by U.S. Federal Reserve is a challenging factor

- Better understanding the supply side of the economy, given the complexity of the supply shocks we have seen since the pandemic outbreak

- There is more uncertainty about neutral rate interest (r*), not only in advanced economies but also in emerging and developing economies

Challenge: Advance in Fiscal Consolidation

- The advance in fiscal normalization is clear
- However, more effort is needed:
  - Public debt levels exceed prudent levels (Powell and Valencia, 2023)
  - Current high interest rates are adding pressure on fiscal accounts
- Fiscal authorities need to rebuild fiscal buffers, while:
  - Social demands need to be addressed for the most vulnerable people
  - Facing current effects from climate change
  - Supporting macroeconomic stability
- Fiscal consolidation has significant implications for price stability, and could be key to inflation convergence in several countries (work in progress)

Thanks!

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