

# The economic outlook for Latin America in a world full of risks

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# Outline of presentation

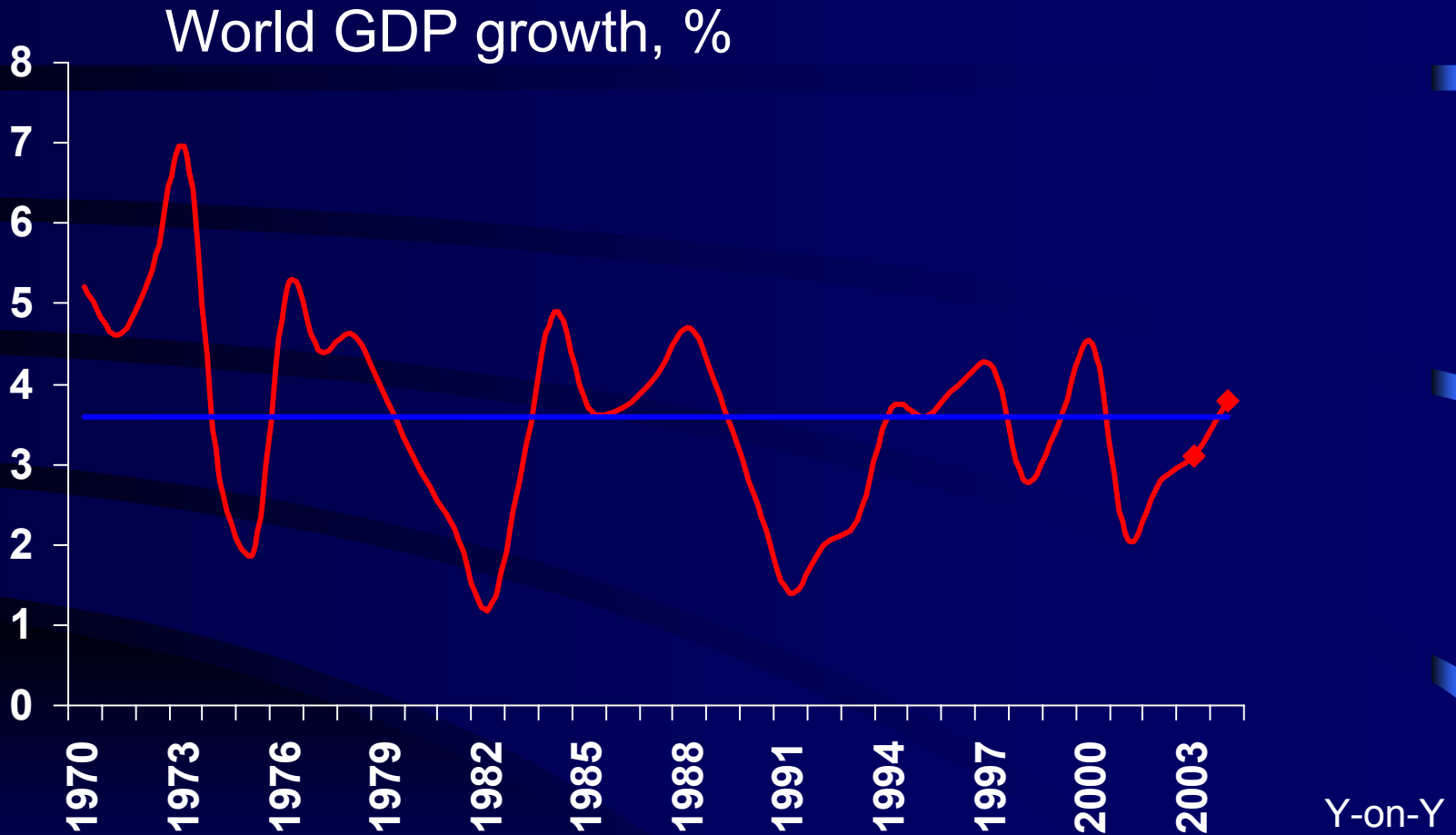
- International context
- Regional context
- Outlook for Dominican Republic
- Risks
- Opportunities: the FTAA

# International context

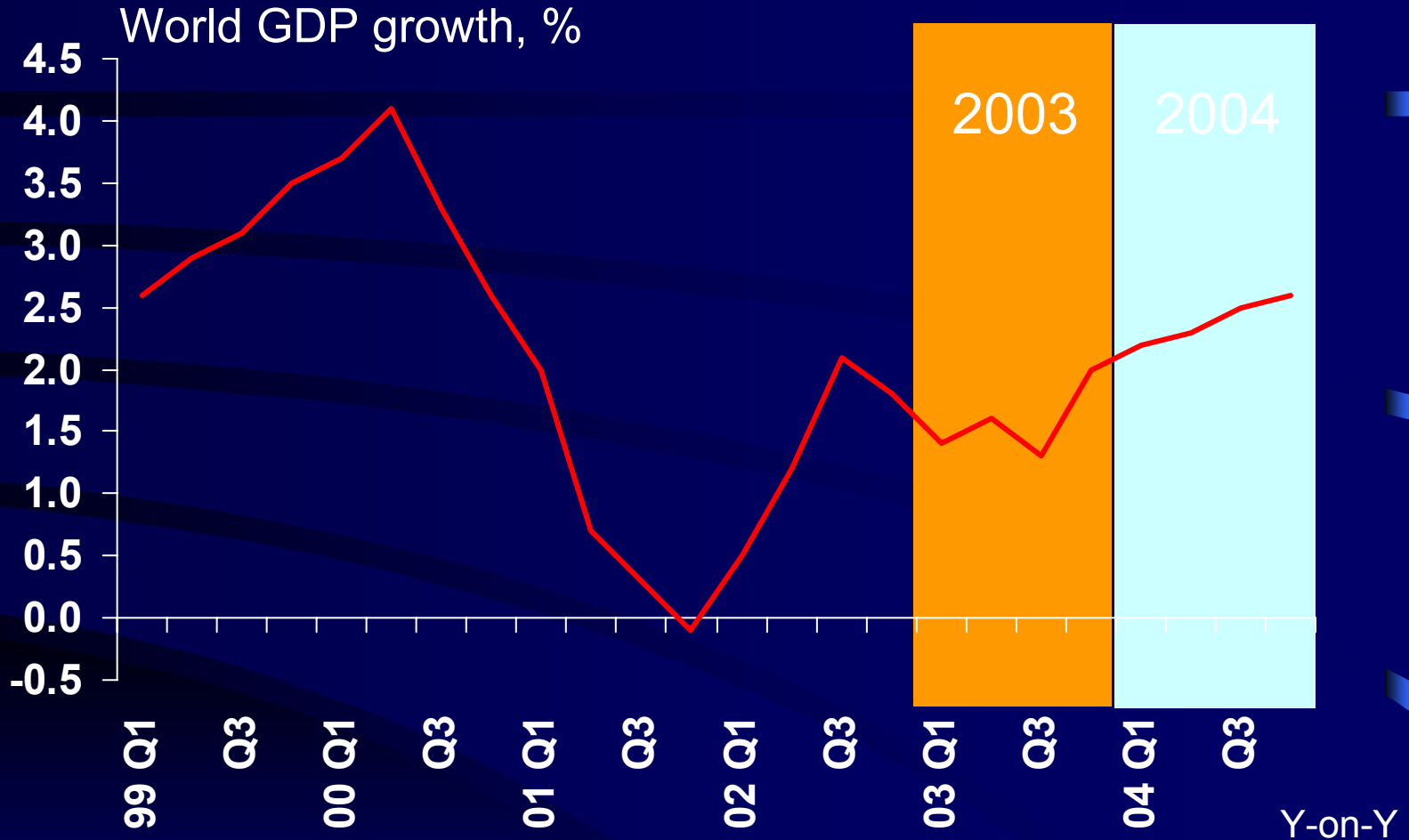
# Key points

- Global economy currently very weak
- Expect only a gradual return to 'normal' pace of growth in OECD
- Emerging markets will be sluggish as a result
- 2004 will be better, but no dramatic rebound

# EIU forecast in a long run context....



# Zooming in.....



# Global themes in 2003-04

- Business sector suffers from over capacity, poor access to capital
- Personal sector reluctant to spend
- These things work out over time
- Policy can provide an offset
  - fiscal policy is the key
- Lower oil prices will help
- **But balance sheet issues will dominate**

# Key risk: War with Iraq

- Assumed in the global forecast
  - short and contained war
  - brief oil price spike, followed by significant fall
  - economic impact has already occurred
- Assessing the risks
  - oil supply
  - oil distribution
  - prolonged and dispersed war would be damaging

# Non-US risks

- North Korea
- Brazil
- Turkey
- Deflation in Germany
- Israel / Palestinian violence
- Chinese slowdown
- India/ Pakistan
- Japanese meltdown / capital controls

# Regional context

# Non-war risks

## ➤ US domestic imbalances

- excessive personal debt / low savings rate
- corporate debt and capacity overhang
- policy response?

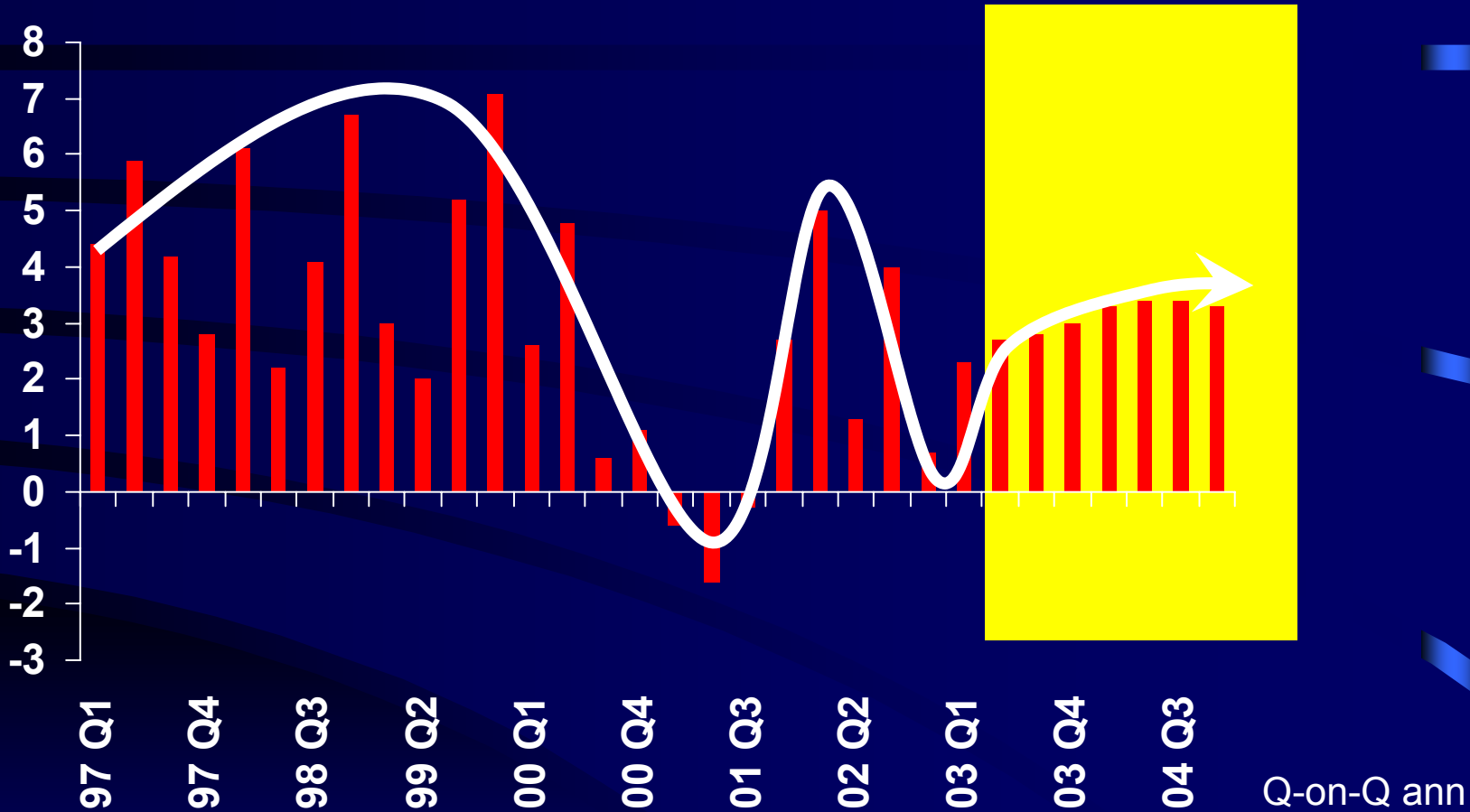
## ➤ US external imbalances

- dollar collapse
- could damage Europe and Japan more than America
- depends on policy response

# United States: economic outlook

- Next six months will be sluggish
- Gradual acceleration in second half of 2003
  - positive factors start to impact
    - oil, fiscal policy, gradual easing of corporate capacity and debt constraints
- Growth to rise slightly above trend during 2004

# US GDP growth, %

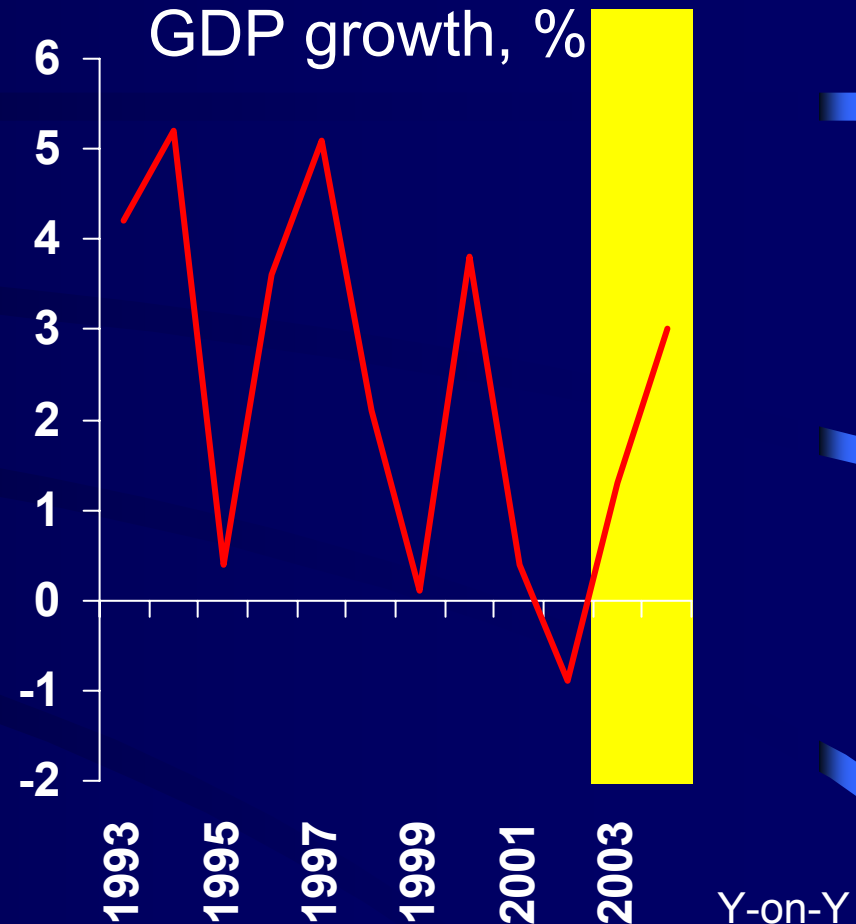


# Latin America: political outlook

- Employment and growth will be political issues
  - social tensions, strikes, possible violence
- Fiscal adjustment will generate tension
  - neo-liberal model will be questioned
- Little room for economic stimulus
  - public and social investment to suffer
- US distracted, less room for negotiation

# Latin America: economic outlook

- Better than 2001-02
  - but still appalling
    - worst performing region
- Little benefit from OECD pick-up
  - unlikely to see much lending or investment into region
- Venezuela shrinks dramatically
- Brazil's solvency still cause for concern



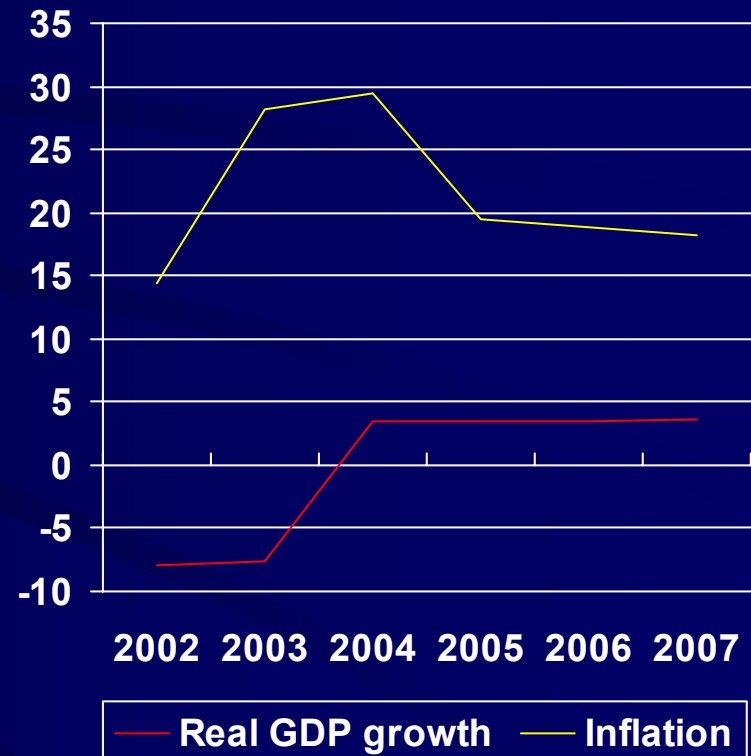
# Venezuela: political outlook

- Divided society
  - Politics is polarised along class lines
  - Government: inefficient and unrealistic
  - Opposition: fragmented and lacking credibility
- Chavez is still the most popular figure
  - Probably he would win fresh elections
  - Constitution would give him an advantage in a referendum
  - Another coup attempt appears unlikely
- Most likely scenario is that Chavez stays
  - Implication: prolonged political crisis
  - Alternative scenario: if Chavez is overthrown, he may form a guerrilla movement

# Venezuela: economic outlook

- Deep recession
- Exchange and price controls create distortions
- Risk of another maxi-devaluation in 2004

## Economic panorama



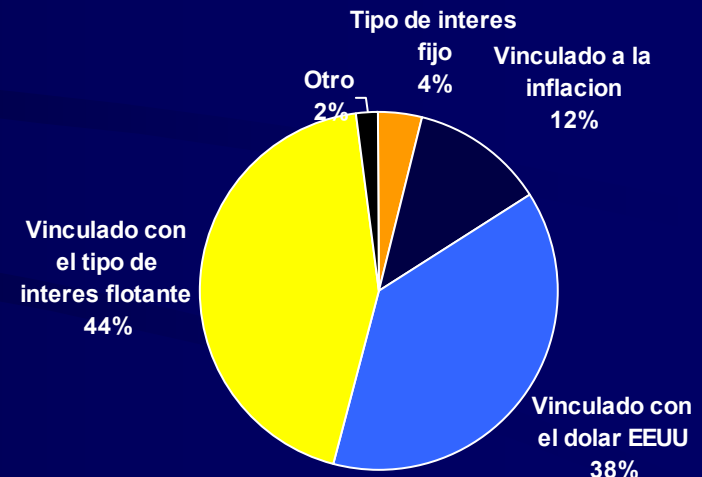
# Brazil: political outlook

- Lula and the PT have enjoyed a good start
  - Hysteria in mid-2002 turned to euphoria at the end of the year
  - Economic programme is prudent and innovative
  - Almost enjoys a majority in Congress
- The honeymoon is coming to an end
  - Vested interests will hamper structural reform
  - It will be difficult to balance fiscal austerity with social spending: could lose support rapidly
  - Administrative inexperience could leave him at the risk of taking wrong decisions

# Brazil: economic outlook

- Huge external and internal debts
- Vicious circle in the internal debt structure
- Debt service takes almost 50% of budget spending
- Fiscal austerity and monetary tightening will impeded economic recovery
- Sentiment key to solvency

Perfil de la deuda interna brasileno



# Outlook for Dominican Republic

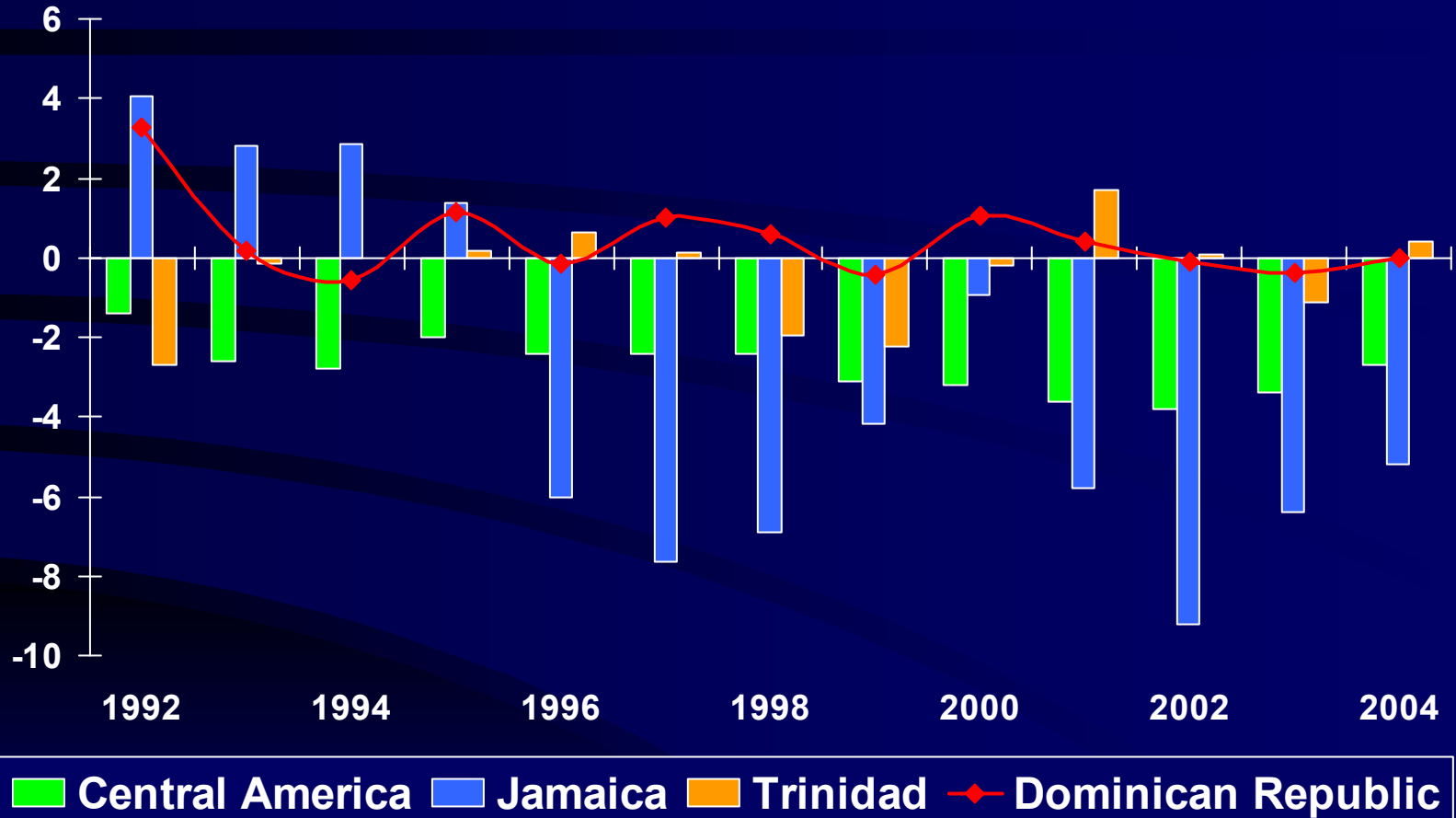
# Domestic politics: governability assured but tense relations with opposition and public

- The government has reinforced its grip on power
  - in mid-term elections in May 2002
  - dominates most organs of state
  - overturned ban on consecutive presidential re-election
- Still likely to face a difficult second part of its term
  - corruption scandals
  - recurrent blackouts
  - economic slowdown
  - strained relations with the opposition
- Political climate will become tense in run-up to 2004 polls

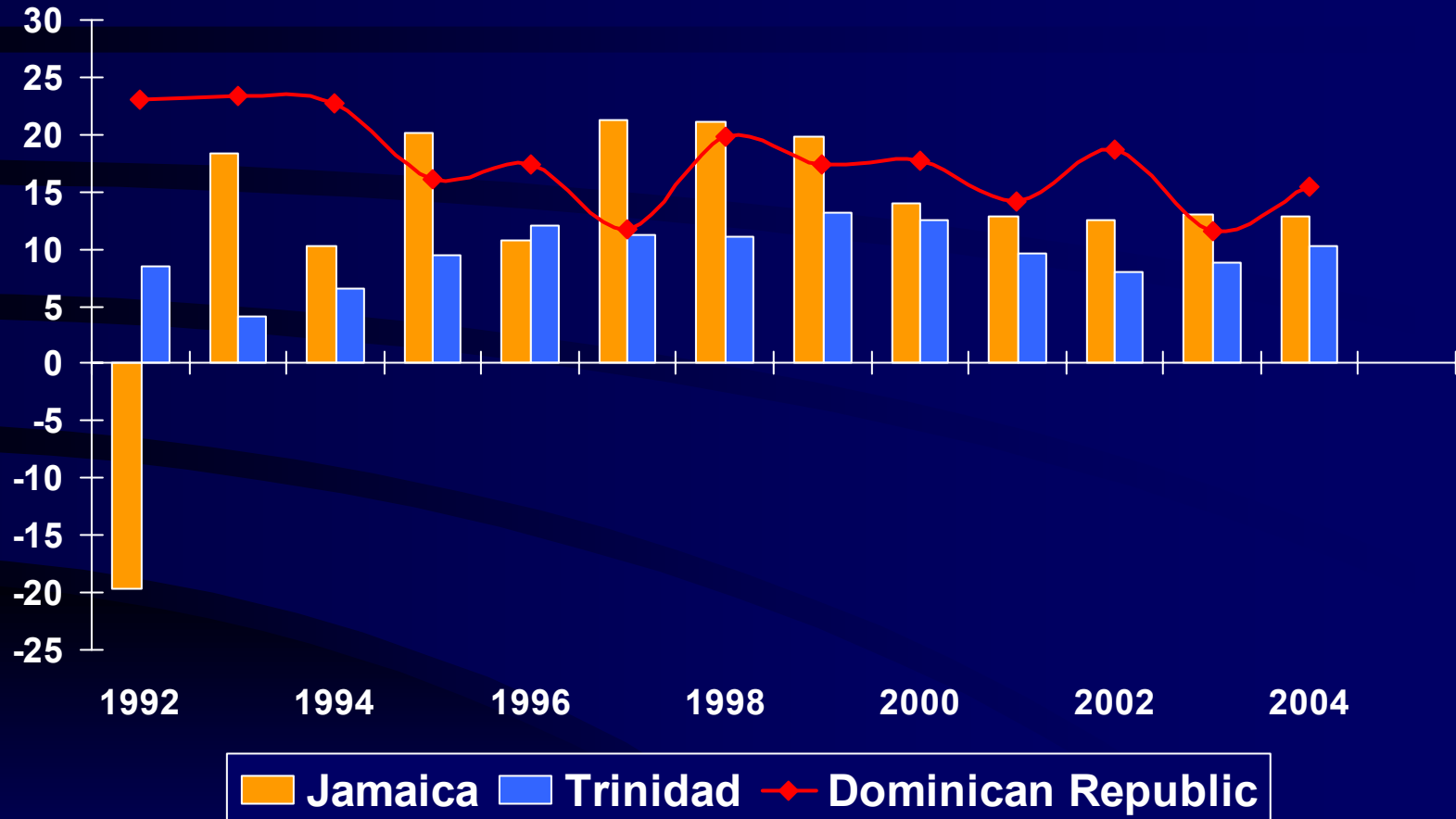
# Election watch: could uncertainty about 2004 destabilise the peso further?

- Will Hipolito Meijia stand again, despite his insistence that he will not run?
- Will any of the candidates be able to decisive lead in the campaign?
- If not, could Dom Rep suffer in 2004 the type of financial market instability that has affected other Latin countries in election years?
- If the final result of the elections is close, will the losing side accept defeat?

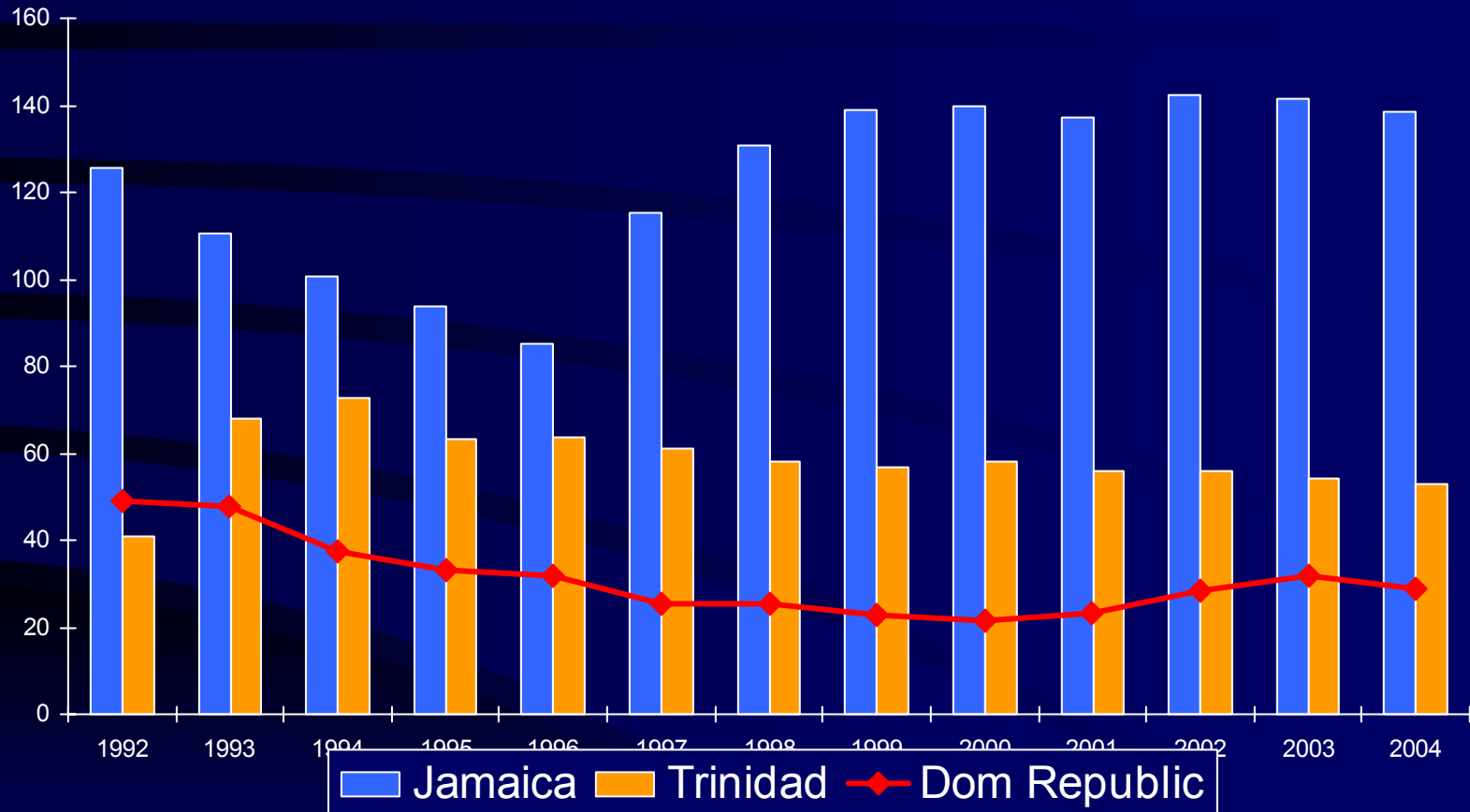
# Public finances: central government finances are in good shape compared to Central America and Jamaica.



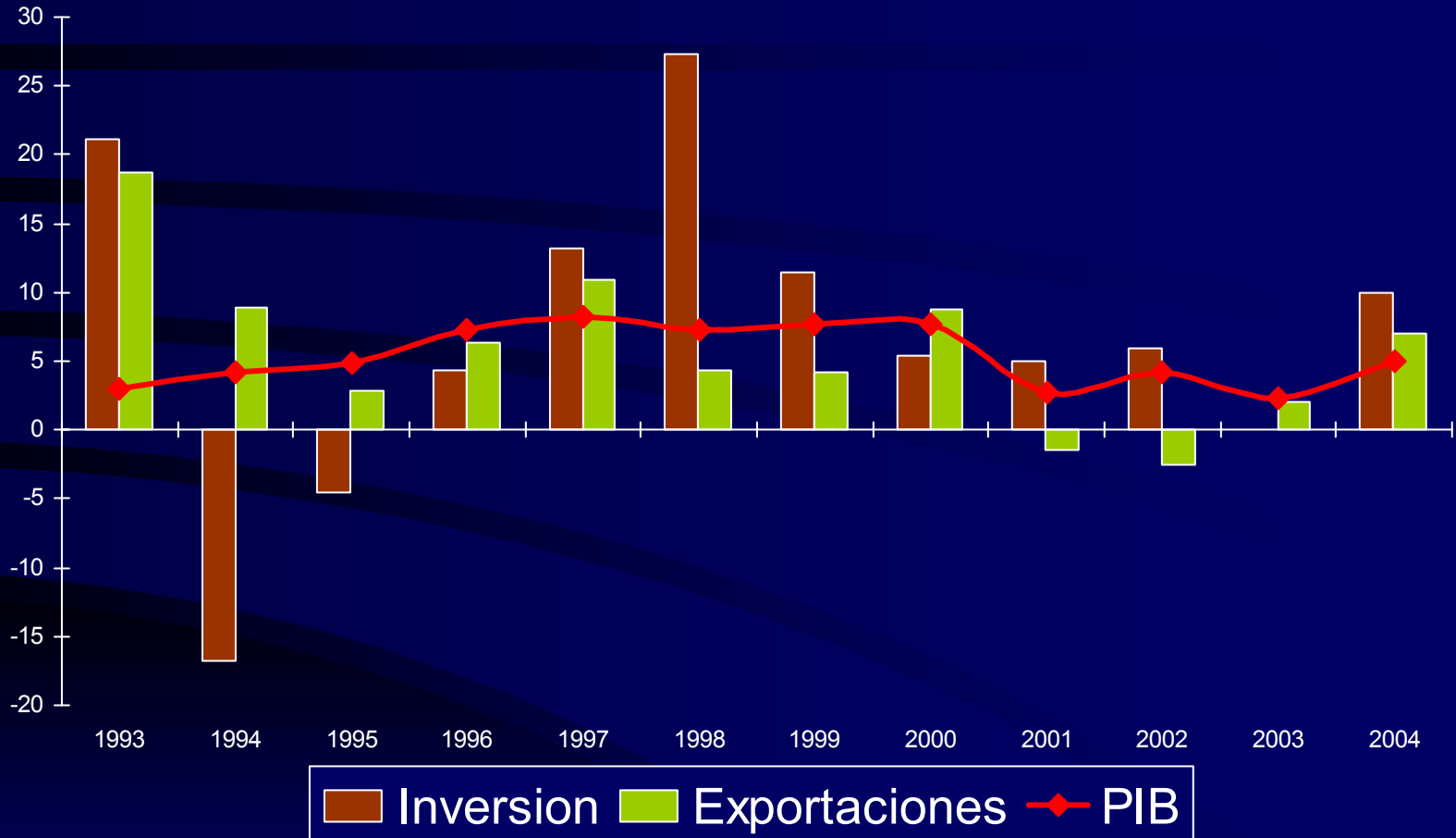
# Cost of capital: higher in real terms than its subregional competitors even though Dom Rep has grown faster.



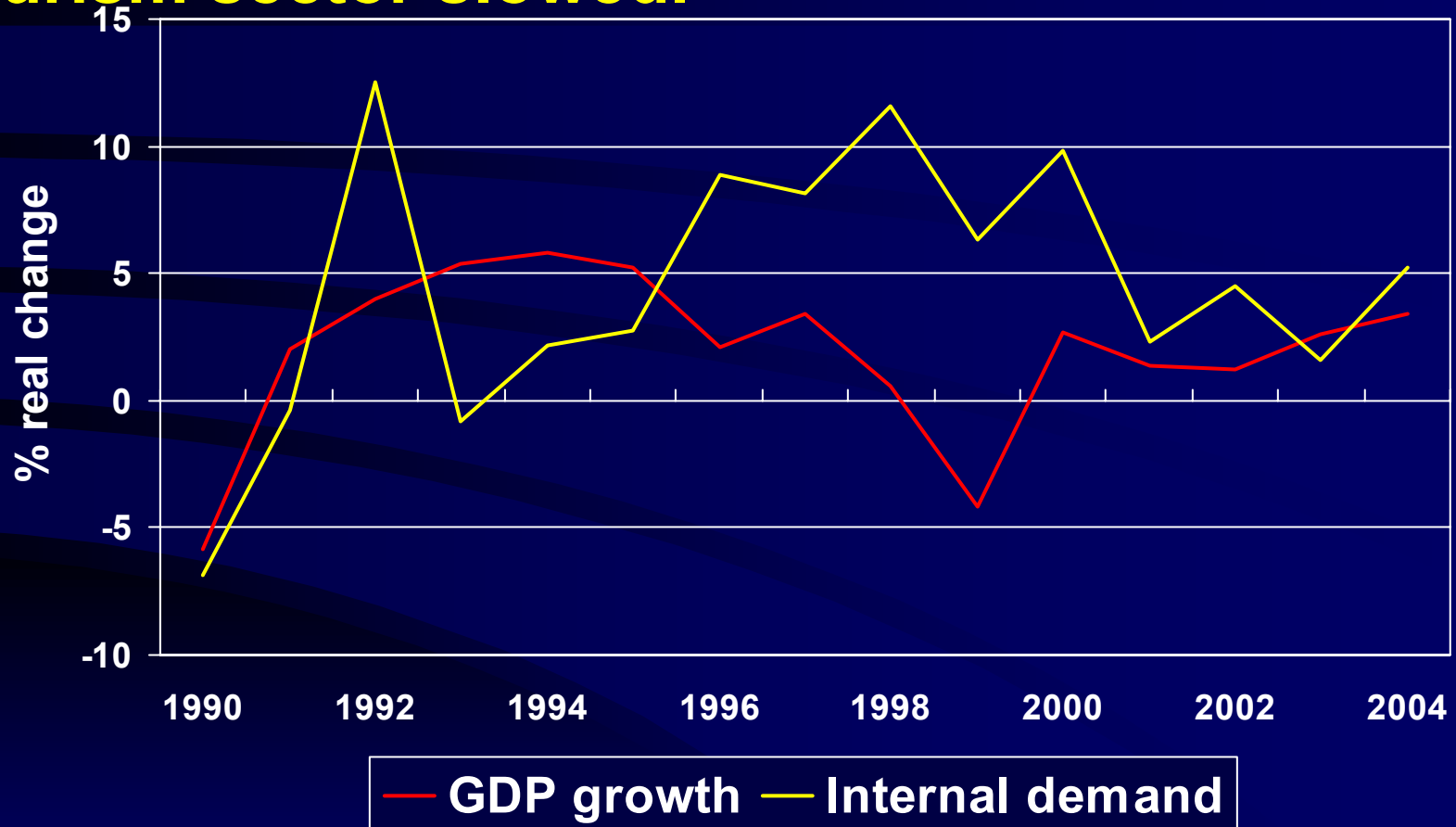
# Public debt: much less of a burden in the Dom Rep, although it has been on an upward trend since 2000.



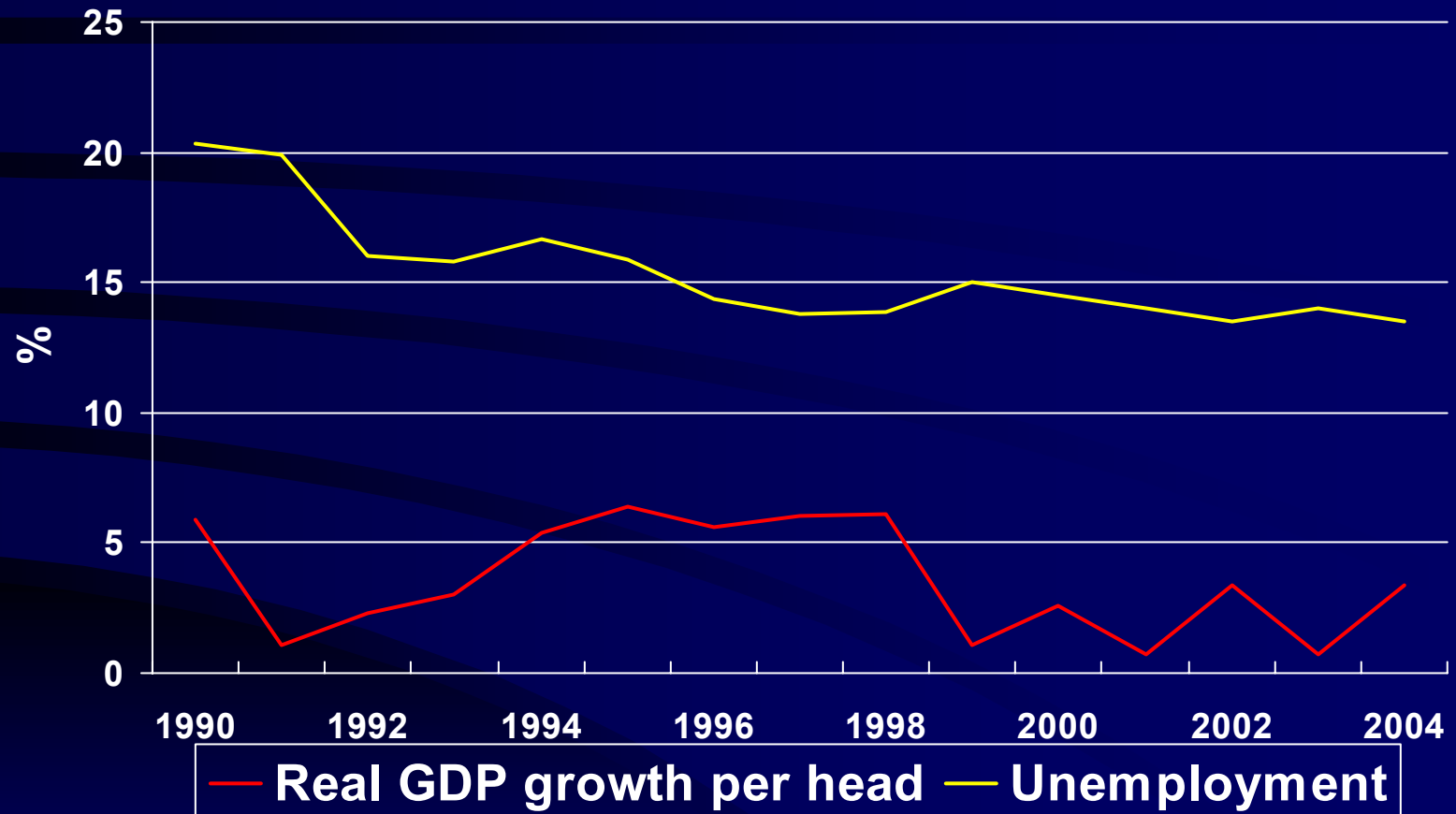
# Economic activity: both investment and exports (including tourism) have disappointed in recent years.



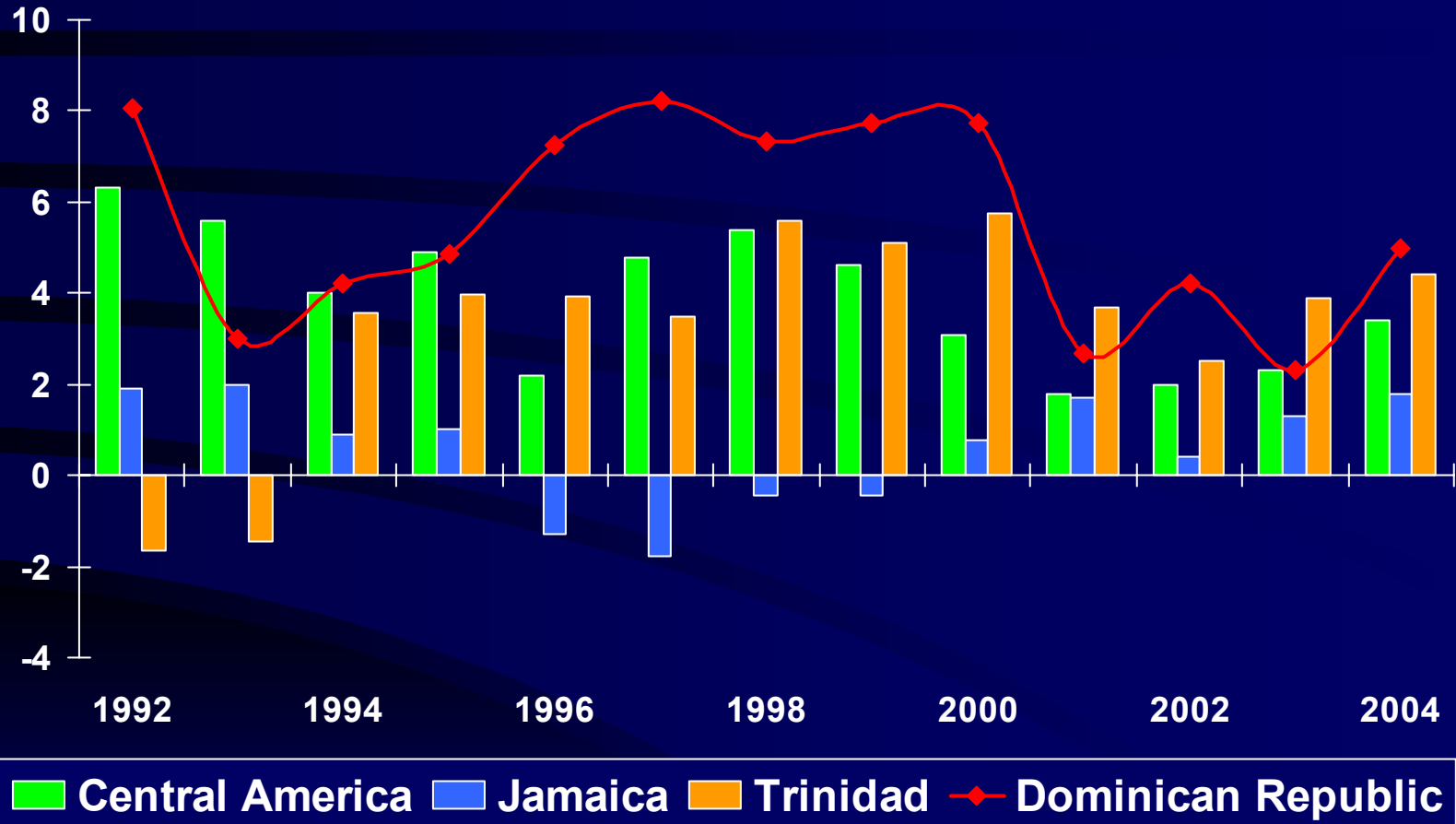
**Economic activity: domestic demand was running well above GDP growth in the mid-1990s. An adjustment was required when the tourism sector slowed.**



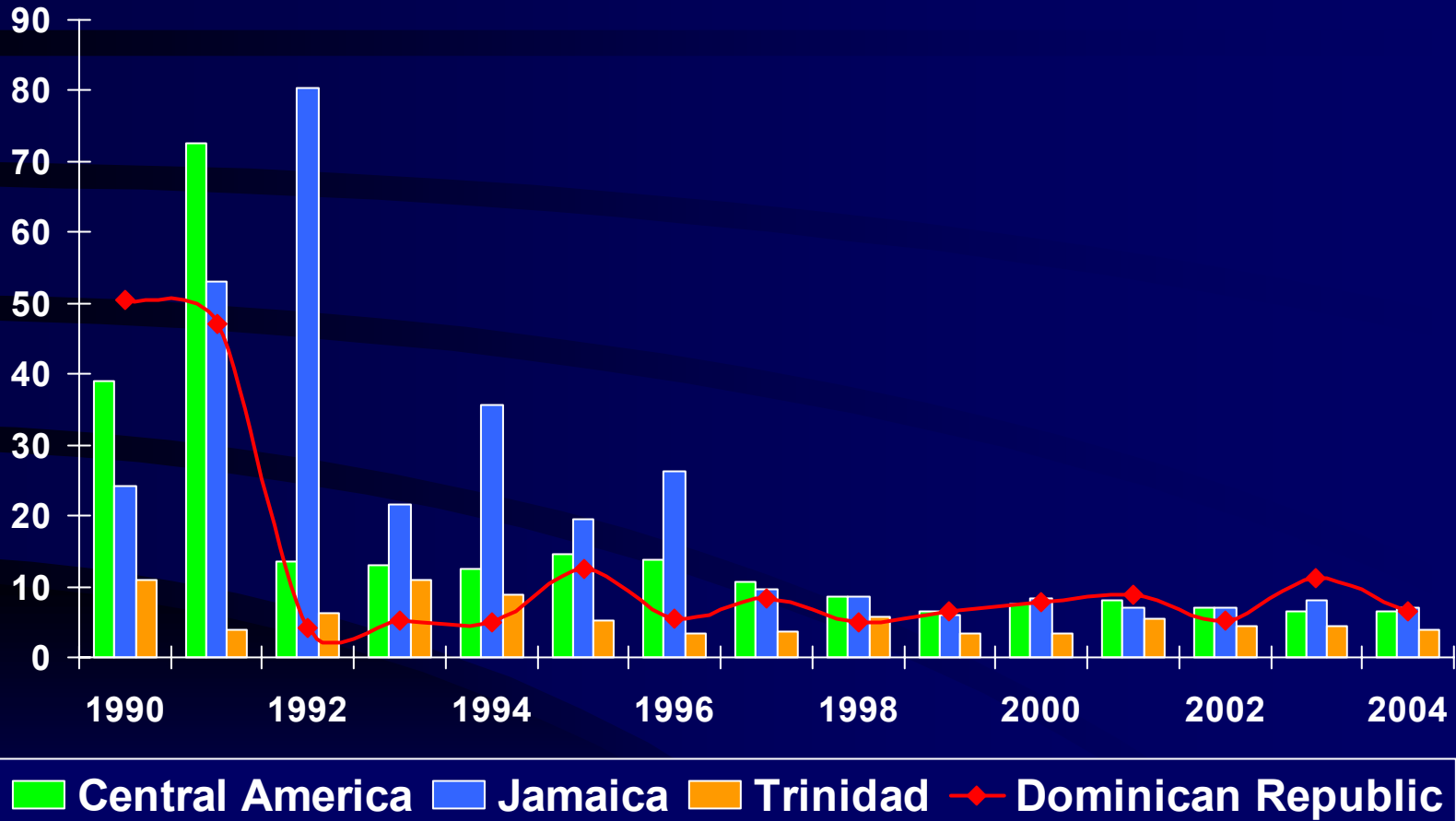
**Economic activity: unemployment has fallen over the decade but remains high. Real income growth has slowed sharply since 1999.**



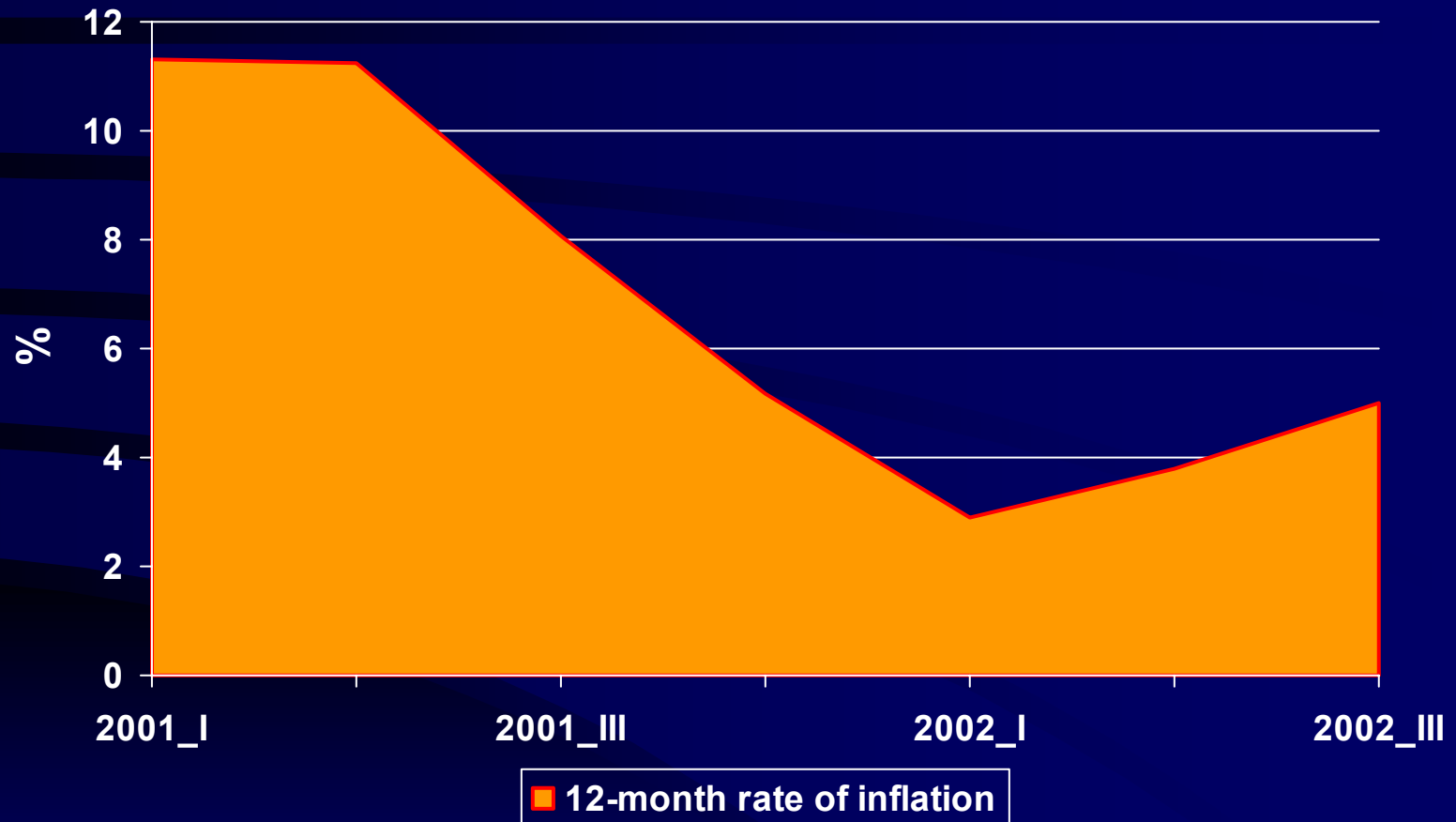
# Economic activity: the Dominican Republic has outperformed its CBI competitors in all but two years in the past decade.



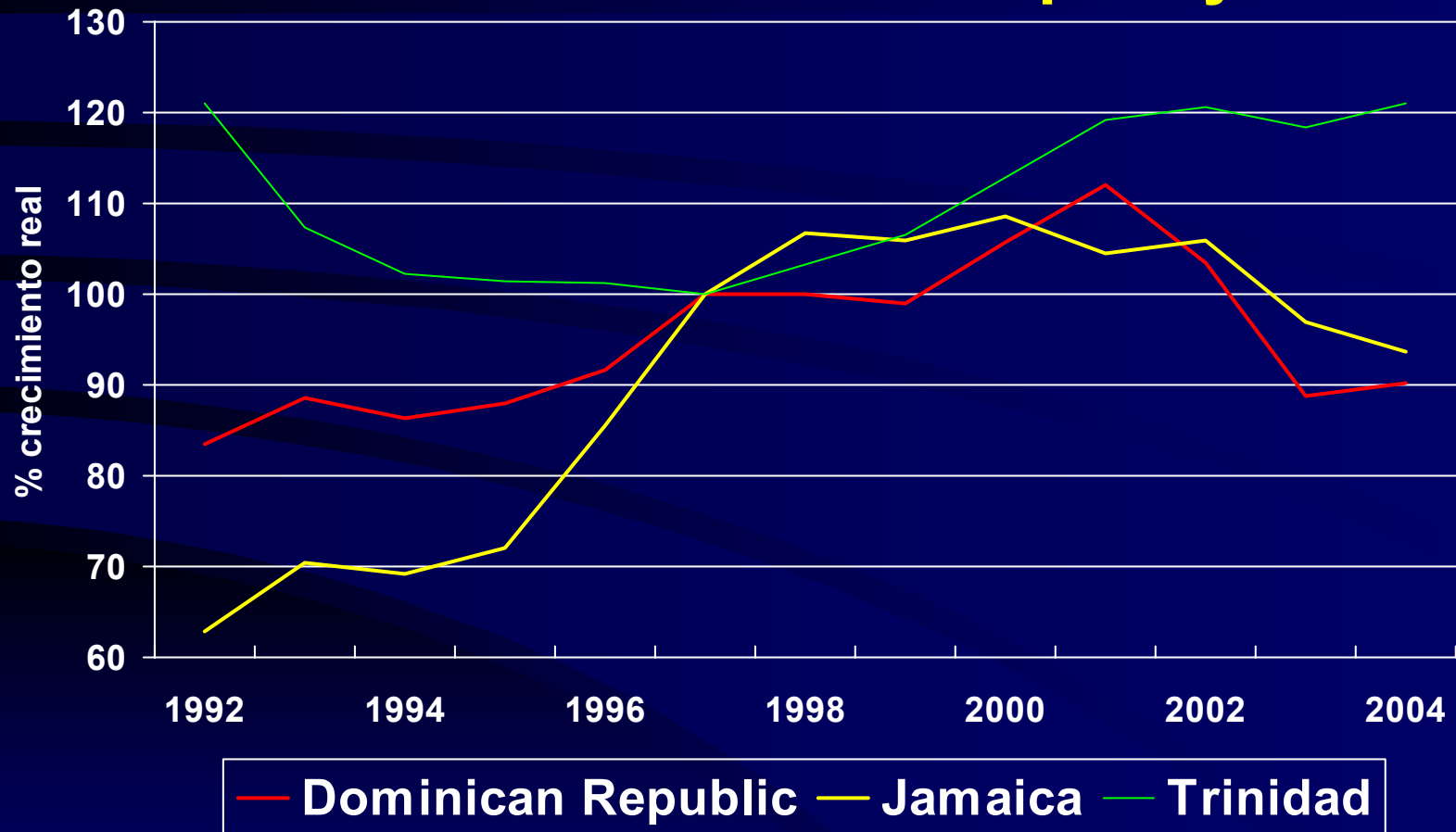
**Inflation: has stabilised rapidly since early 1990s, but still remains slightly high for the sub-region and pressures have recent reappeared.**



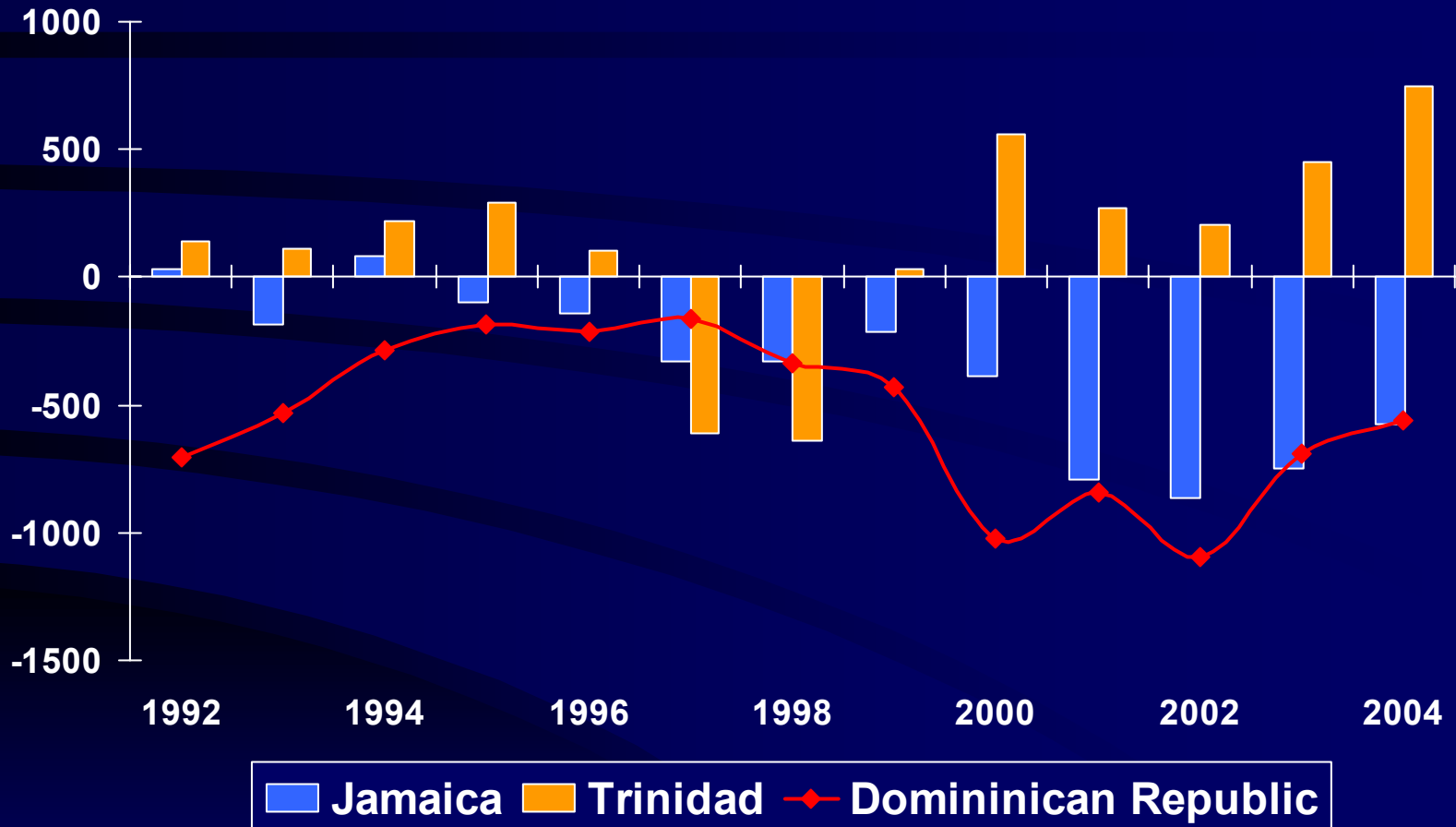
# Inflation: pressures have reappeared recently.



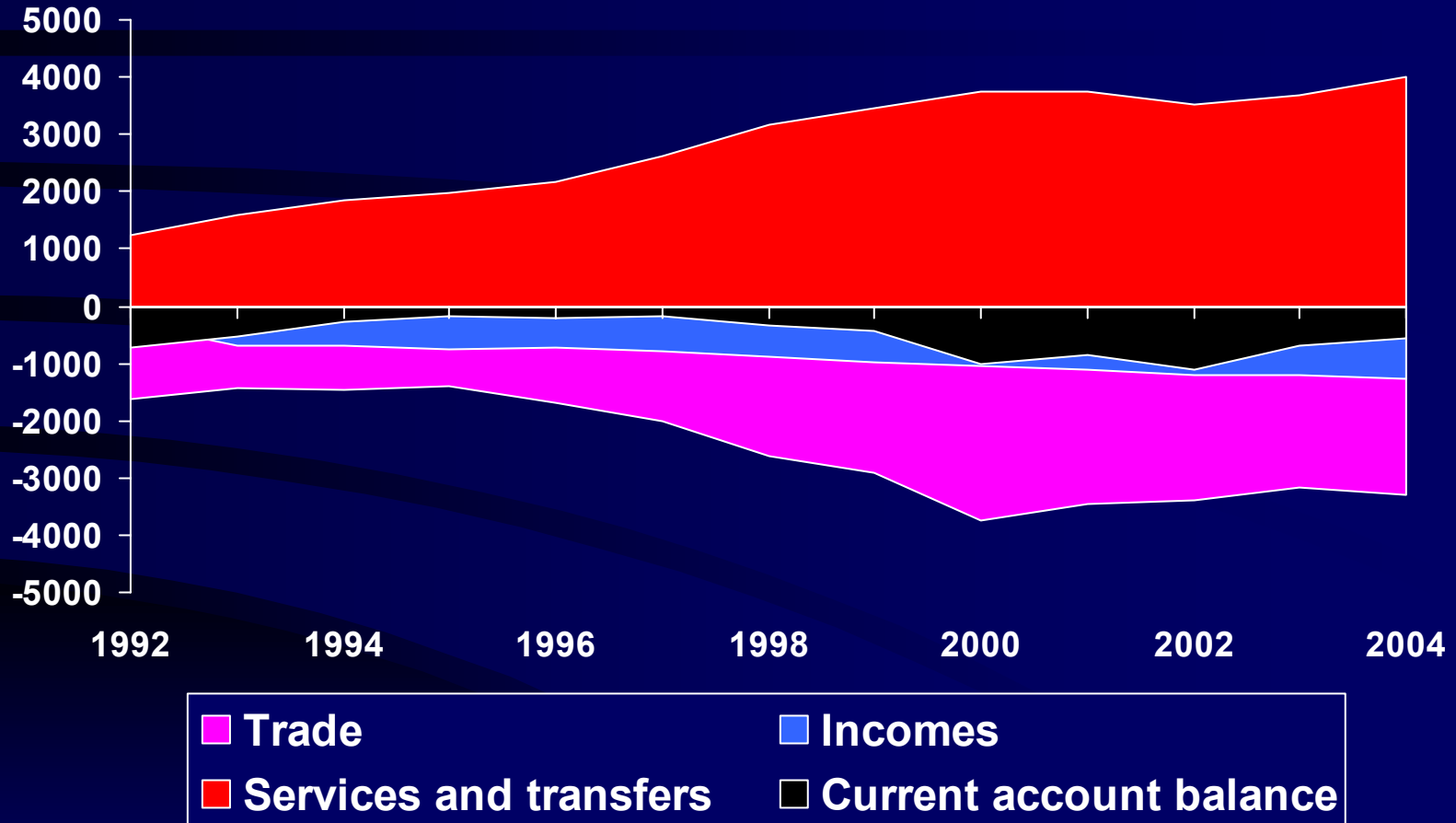
**Exchange rate: in real terms still fairly strong over the decade but undermined by fiscal concerns and low international liquidity.**



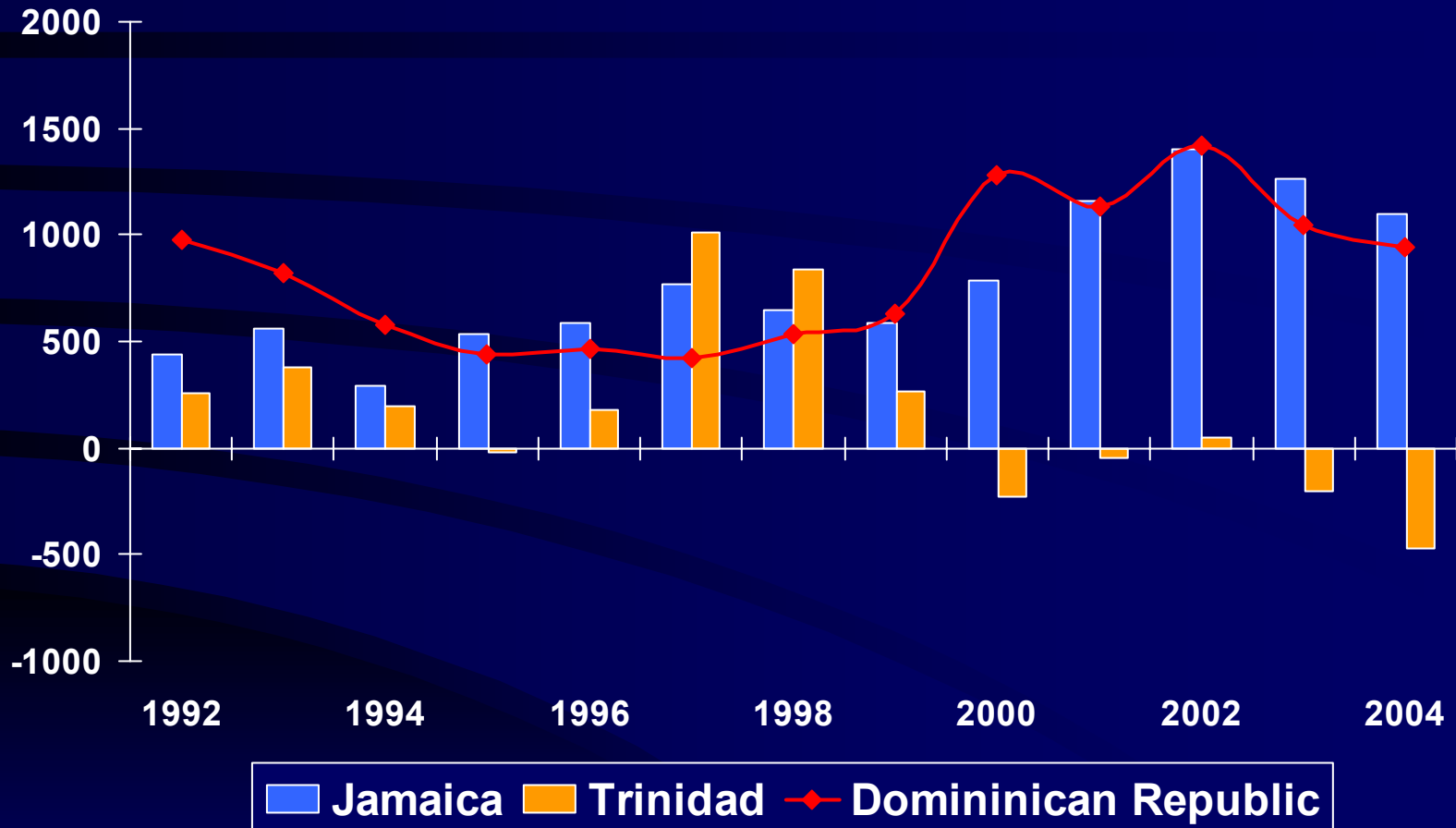
# Current account balance: an area of weakness for the Dominican Republic.



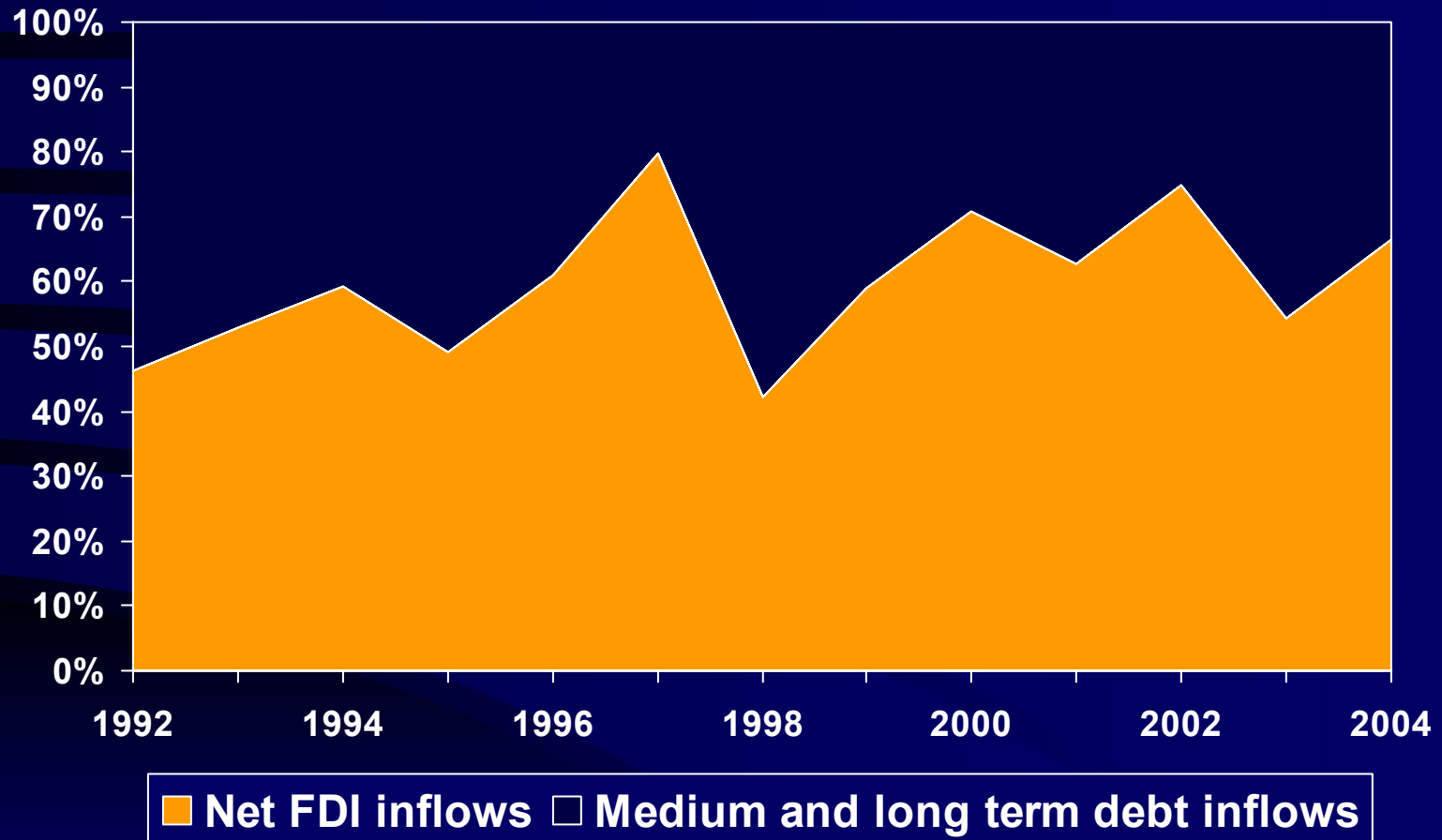
# Current account balance: large services surplus and transfers needed to offset trade imbalance



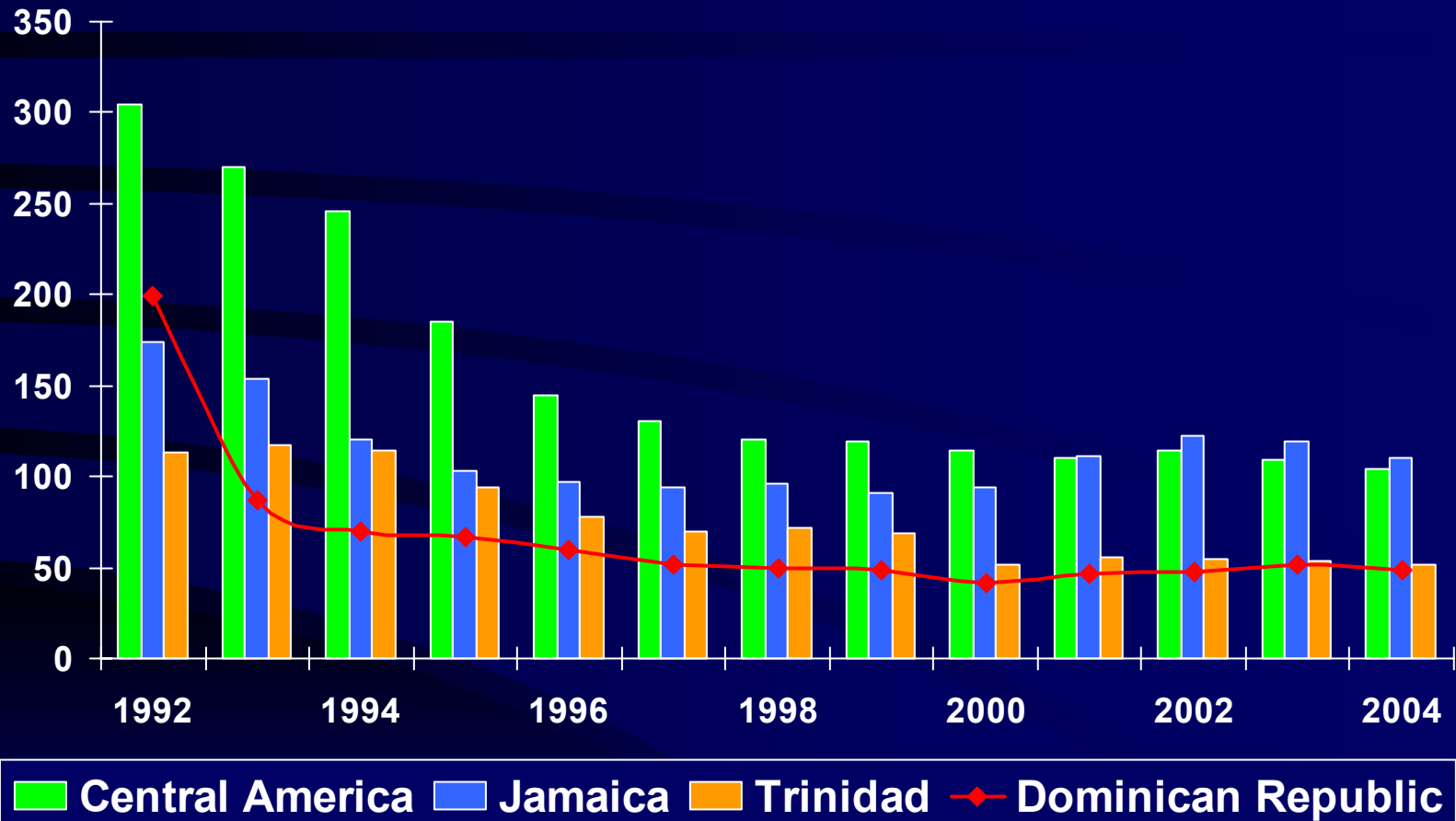
# Financing needs: these are high, despite modest debt indicators.



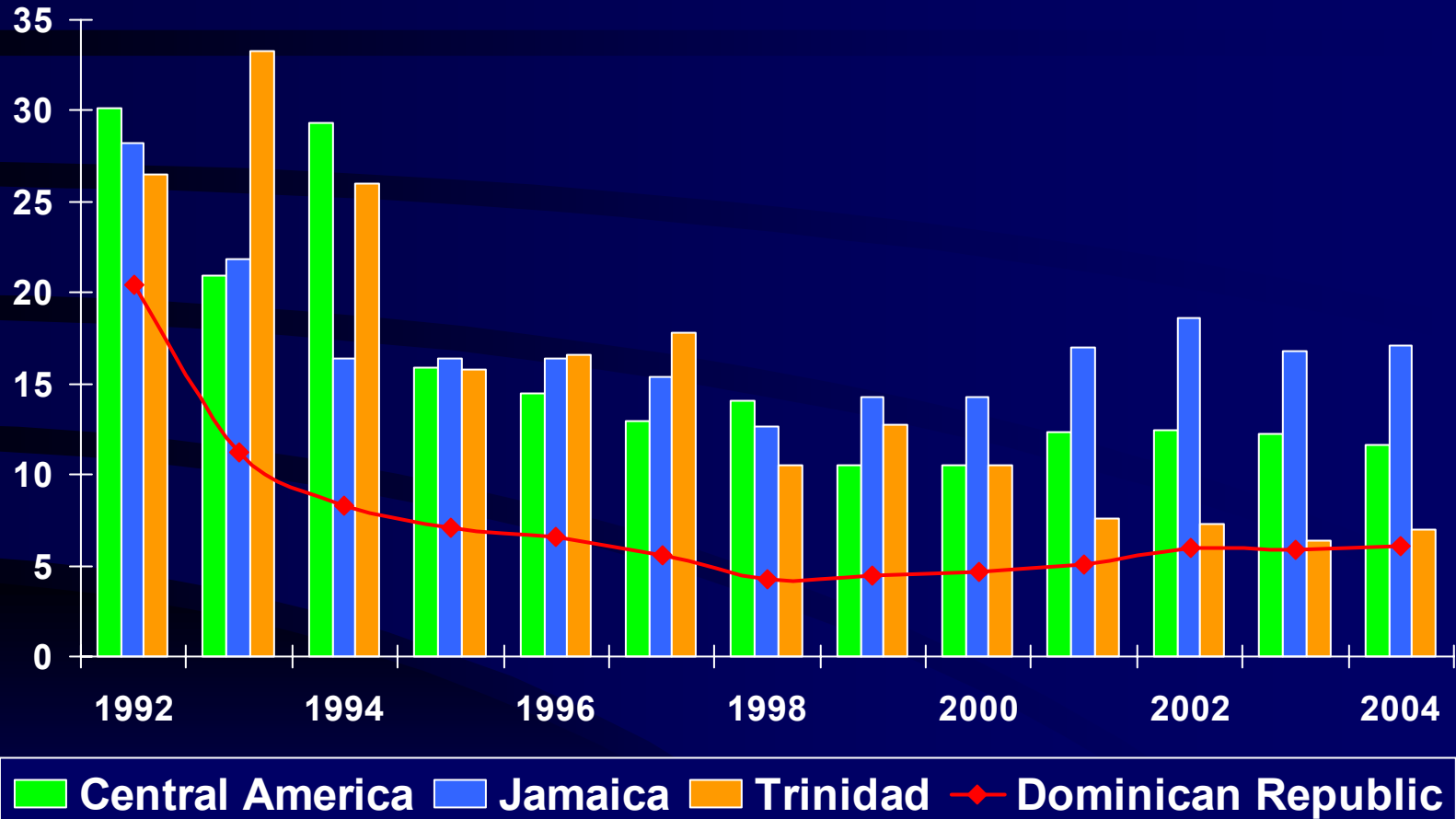
# Financing: dominated by FDI in recent years, though MLT debt inflows are significant



# External debt: moderate level of debt by sub-regional standards.



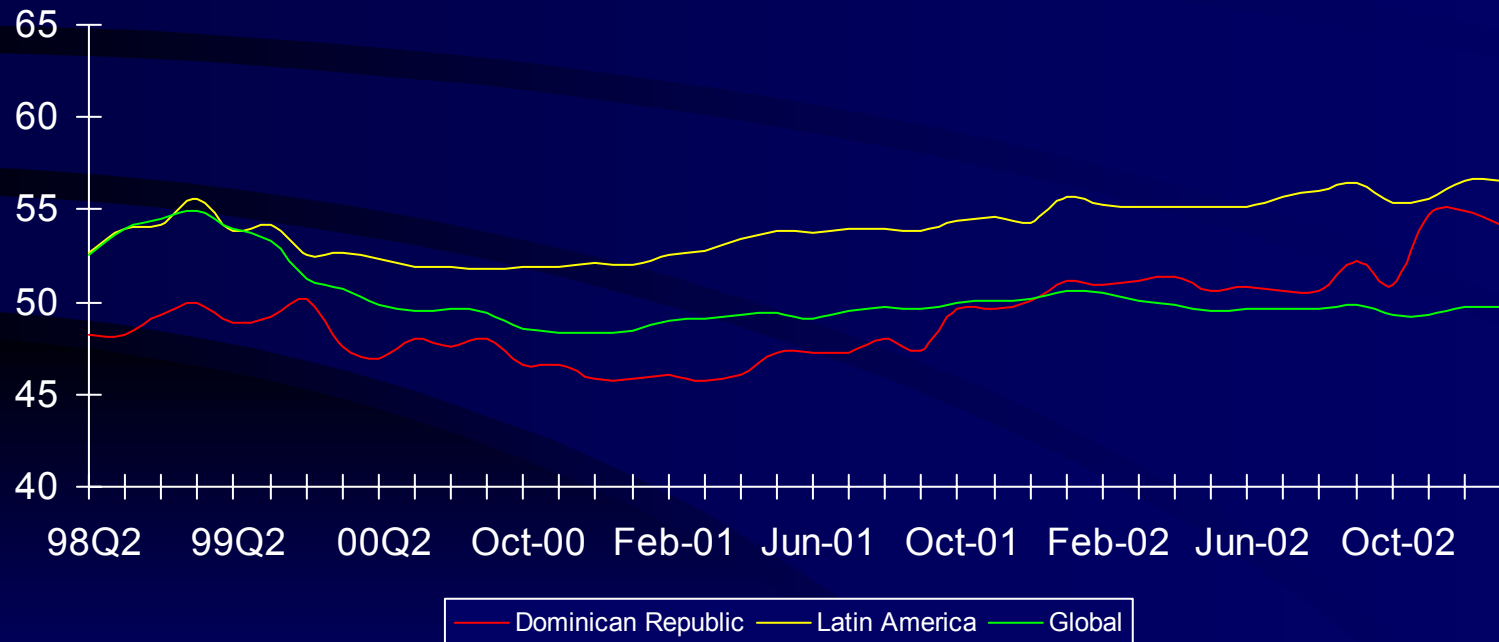
# External debt service: very modest level by emerging markets standards, but has risen slightly since 1998.



# Risks

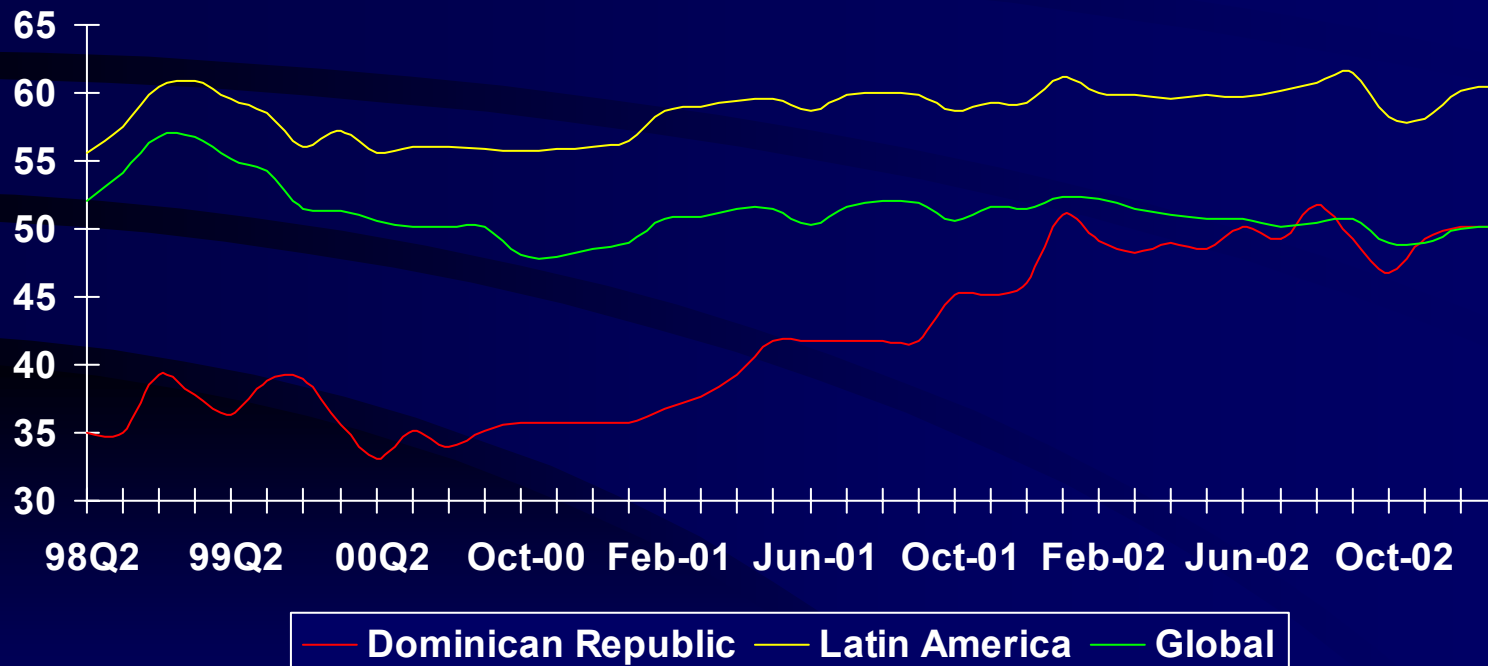
# Overall country credit risk: was running well below Latin American average, but has deteriorated in recent years.

Country credit risk: measure of a country's overall creditworthiness. Scores range from 0 (lowest risk) to 100 (highest risk)



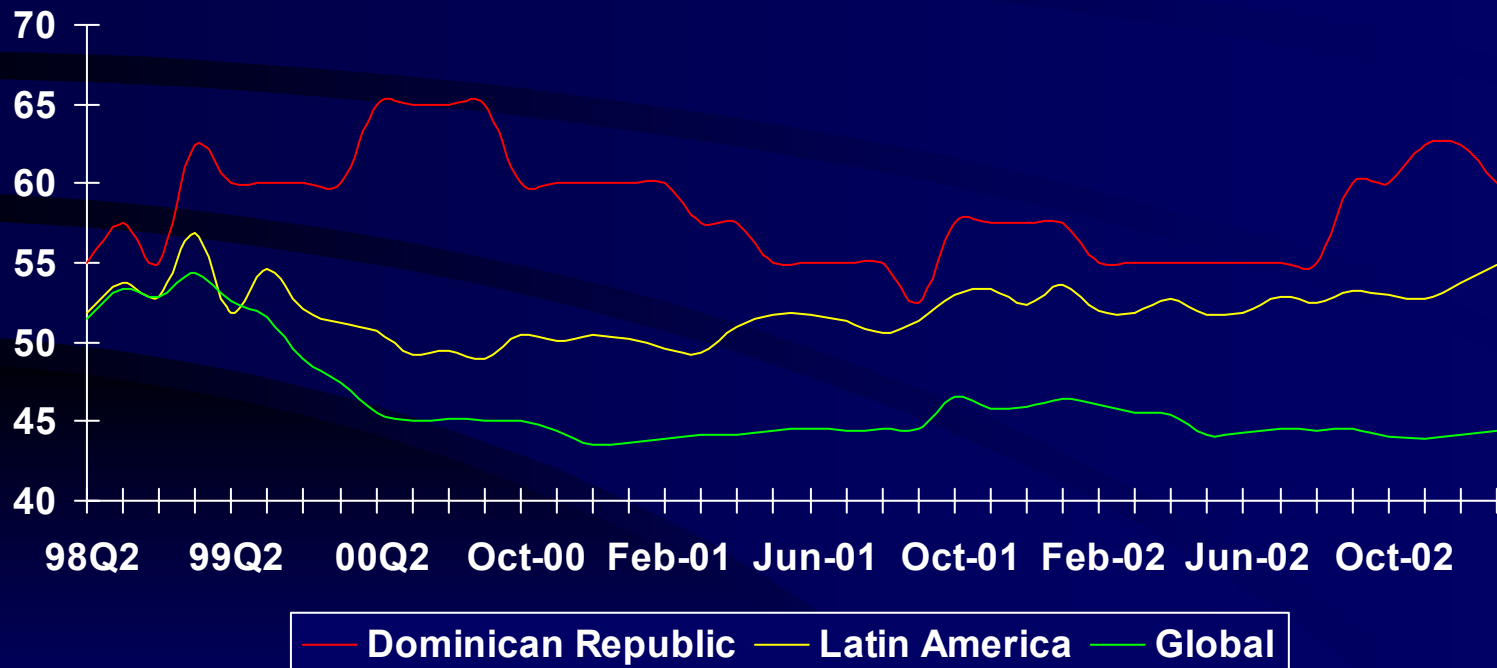
# Solvency risk: still moderate, but large current account deficit, slower growth, and low savings has caused strong deterioration in recent years.

Solvency risk: examines variables central to a country's capacity to meet its obligations in the medium term. Scores range from 0 (lowest risk) to 100 (highest risk).



# Liquidity risk: the worst rated category. Low level of reserves, high import levels, and strong monetary growth leave Dom Rep vulnerable.

Liquidity risk: examines variables that determine a country's capacity to meet its external obligations in the short term. Scores range from 0 (lowest risk) to 100 (highest risk).



# FTAA: fantasy or reality?

# Fantasy?

- A comprehensive accord will not be reached by the start of 2005 as planned
  - little time left, US distracted
- There will be a lot resistance to the liberalisation of sensitive sector
  - lack of will by major players
  - competition will impede consensus
- Bilateral treaties with the US could jeopardise the FTAA integration process

# Reality?

- There will be some type of accord in effect in 2005
  - Some benefits will be shared by all
  - Spurred by the expansion of the EU in 2004
- Member states of the FTAA may surprise us
  - US, Brazil and Mexico are the keys

**The end.**