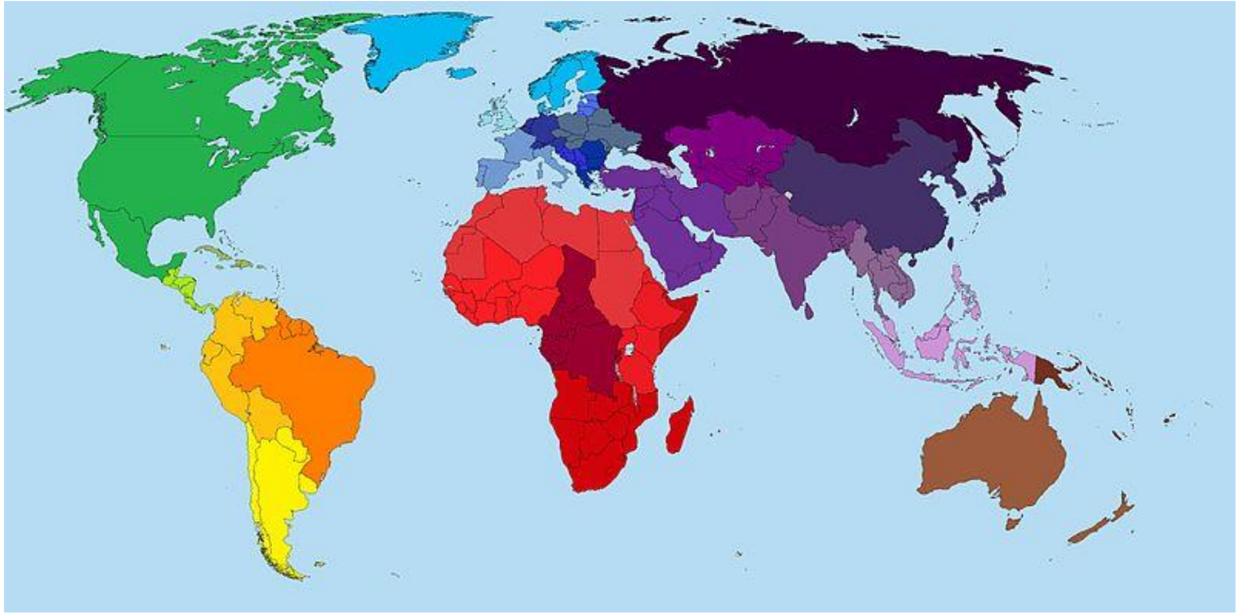
Emerging nations: growth in the post post-crisis



Andrés Velasco / September 2013

The post-crisis

- For advanced economies, the post crisis involved
  - Slow recovery
  - Gradually healing financial systems
  - Crisis in Europe
- For emerging economies, the post crisis involved "the best of all possible worlds" (Leibnitz)
  - High commodity prices
  - Rock bottom world interest rates
  - Abundant international liquidity

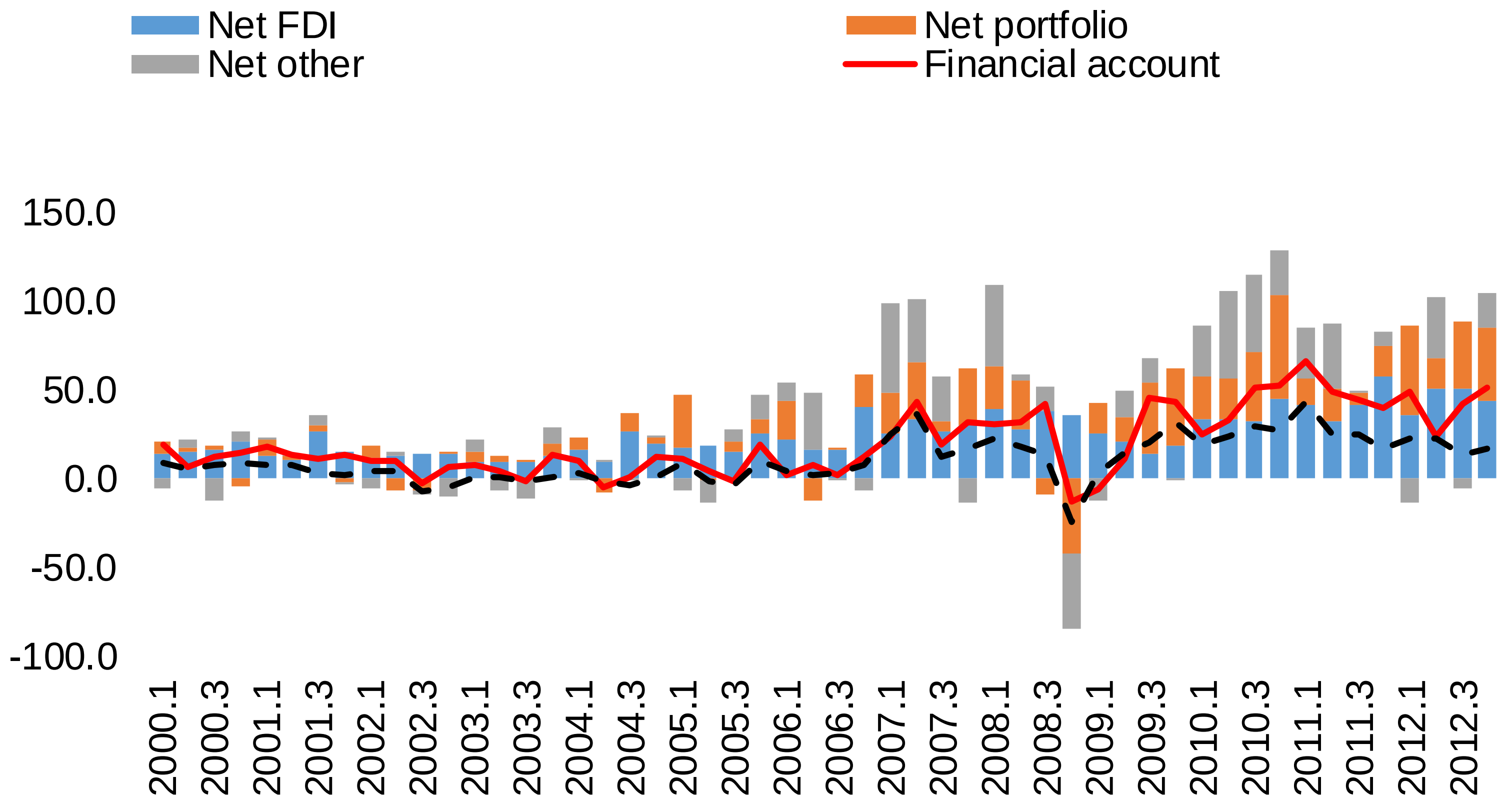
One example: Latin America

Latin growth was strong since the crisis

- Was it good policies?
- Or was it good luck?

Tremendous capital inflows

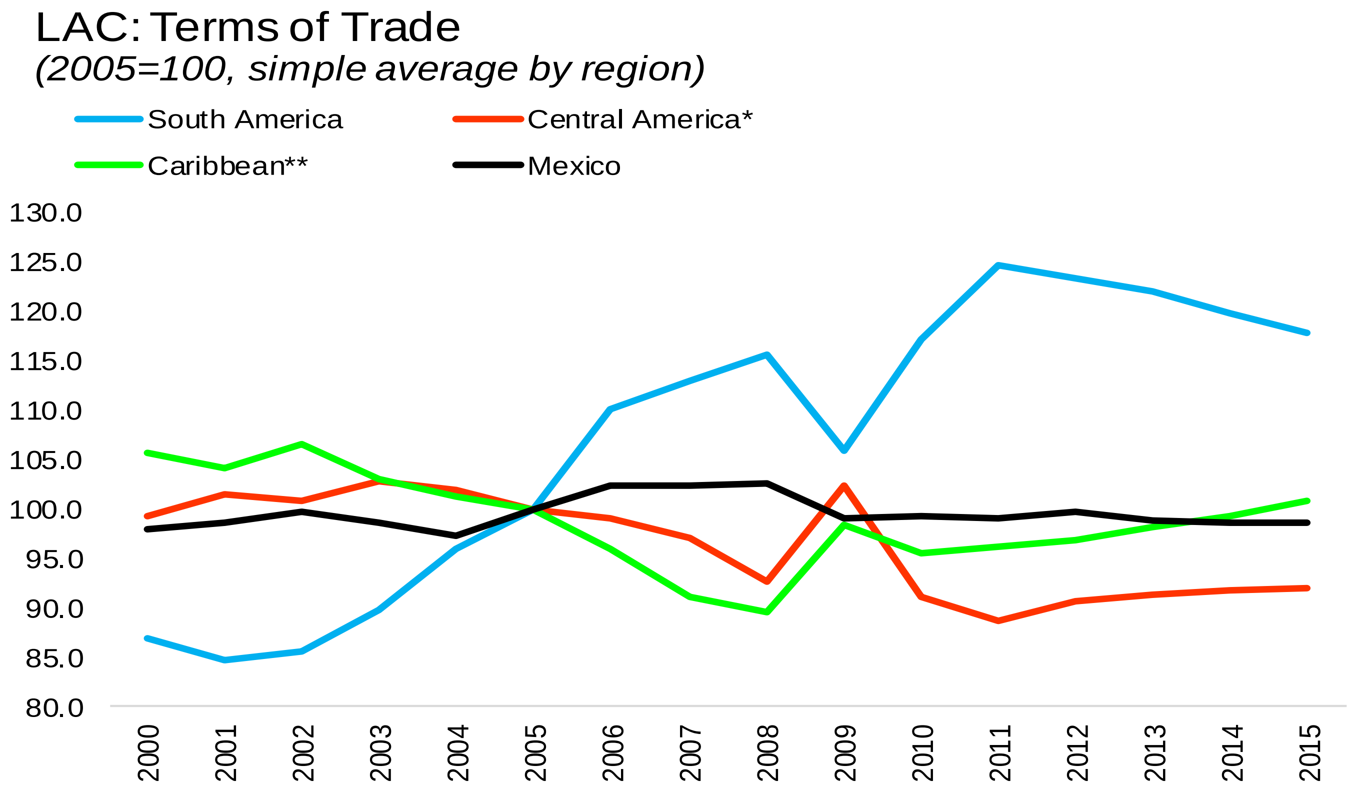
FI South America: Financial Account*
(US$ billions)



Source: Cepal

* Includes Brazil, Chile, Colombia, Mexico and Peru

And strong terms of trade (for some)

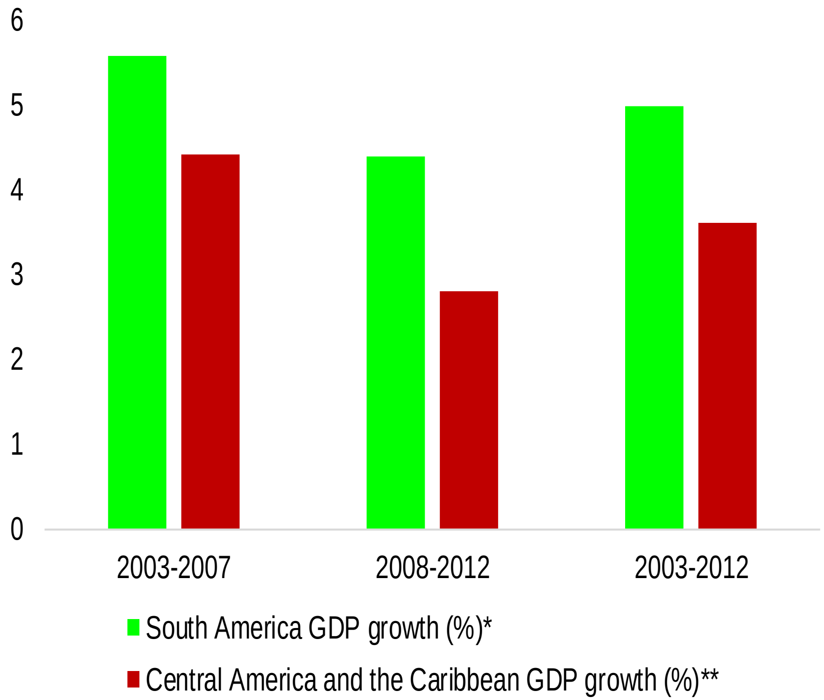


Source: Global Economic Prospects, World Bank

* Includes the Dominican Republic and Panama

** Includes Bahamas, Barbados, Belize, Jamaica, Antigua and Barbuda, Dominica, St. Lucia and St. Vincent and the Grenadines

Growth: north versus south



Source: WEO, IMF

* Includes Bolivia, Brazil, Chile, Colombia, Ecuador, Paraguay, Peru, Uruguay and Venezuela

** Includes Belize, Costa Rica, Dominican Republic, EL Salvador, Guatemala, Haiti, Honduras, Jamaica, Mexico, Nicaragua and Panama

Those countries that got the capital and the favorable terms of trade….

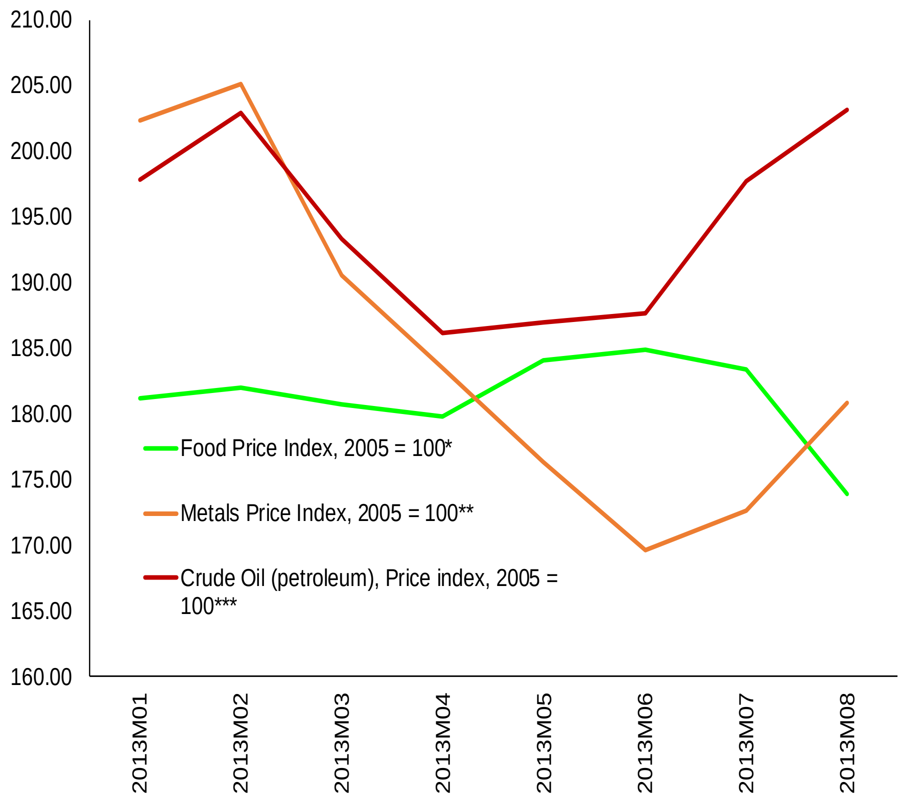
…Also got the growth

The end of the party?

The international environment is changing… and fast

What are the implications for EM growth?

End of the commodity super-cycle?



Source: Primary Commodity Prices, IMF

* Includes Cereal, Vegetable Oils, Meat, Seafood, Sugar, Bananas, and Oranges Price Indices

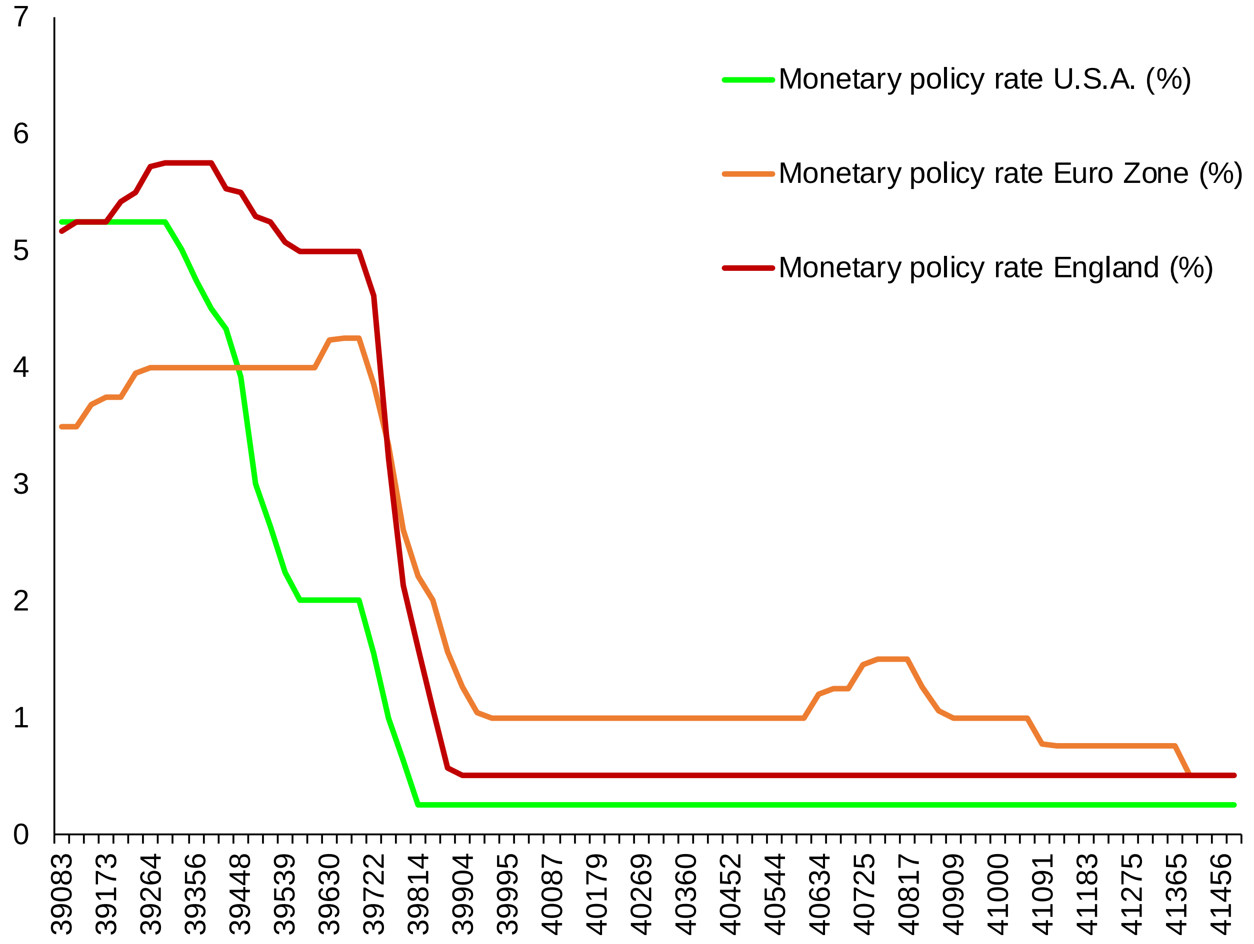
** Includes Copper, Aluminum, Iron Ore, Tin, Nickel, Zinc, Lead, and Uranium Price Indices

*** Simple average of three spot prices; Dated Brent, West Texas Intermediate, and the Dubai Fateh

Oil still high –partly for geopolitical reasons

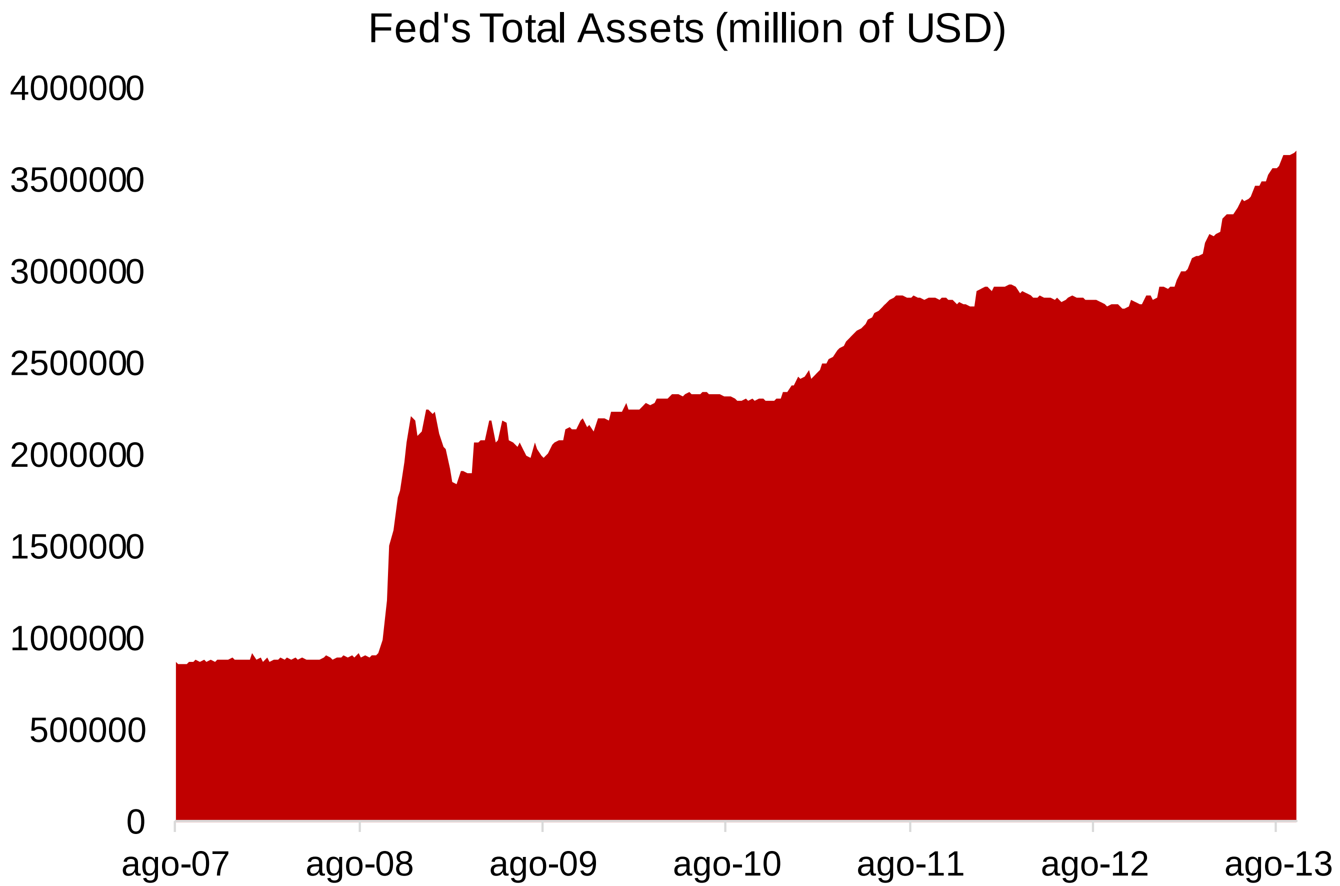
Other commodity prices weakening – reflecting expectations of lower world growth- USA, China, elsewhere…

Policy rates: still rock bottom



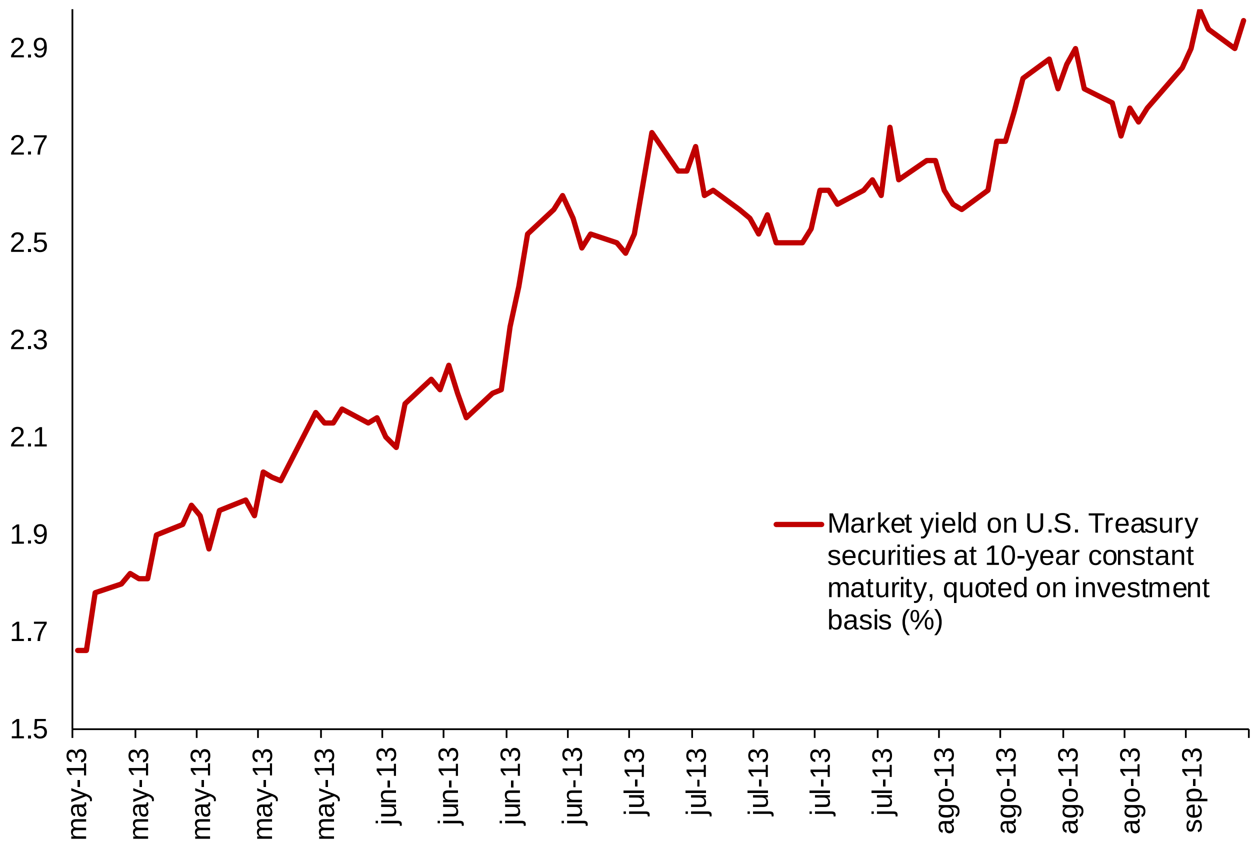
Source: Central Bank of Chile for U.S.A. and Euro Zone and Bank of England for England

End of QE: much uncertainty



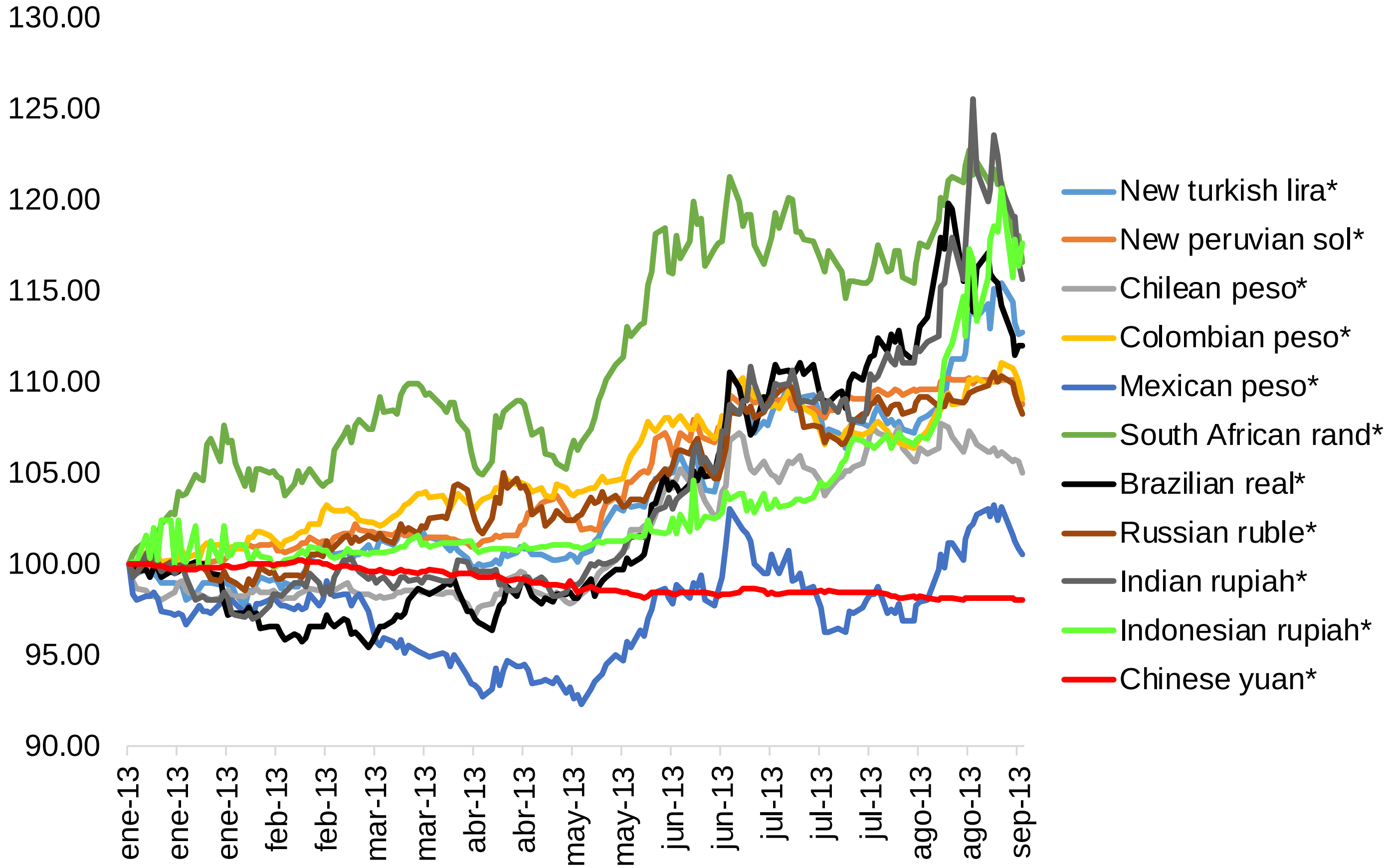
Source: Fed

But market rates did rise in the US



Source: Federal Reserve

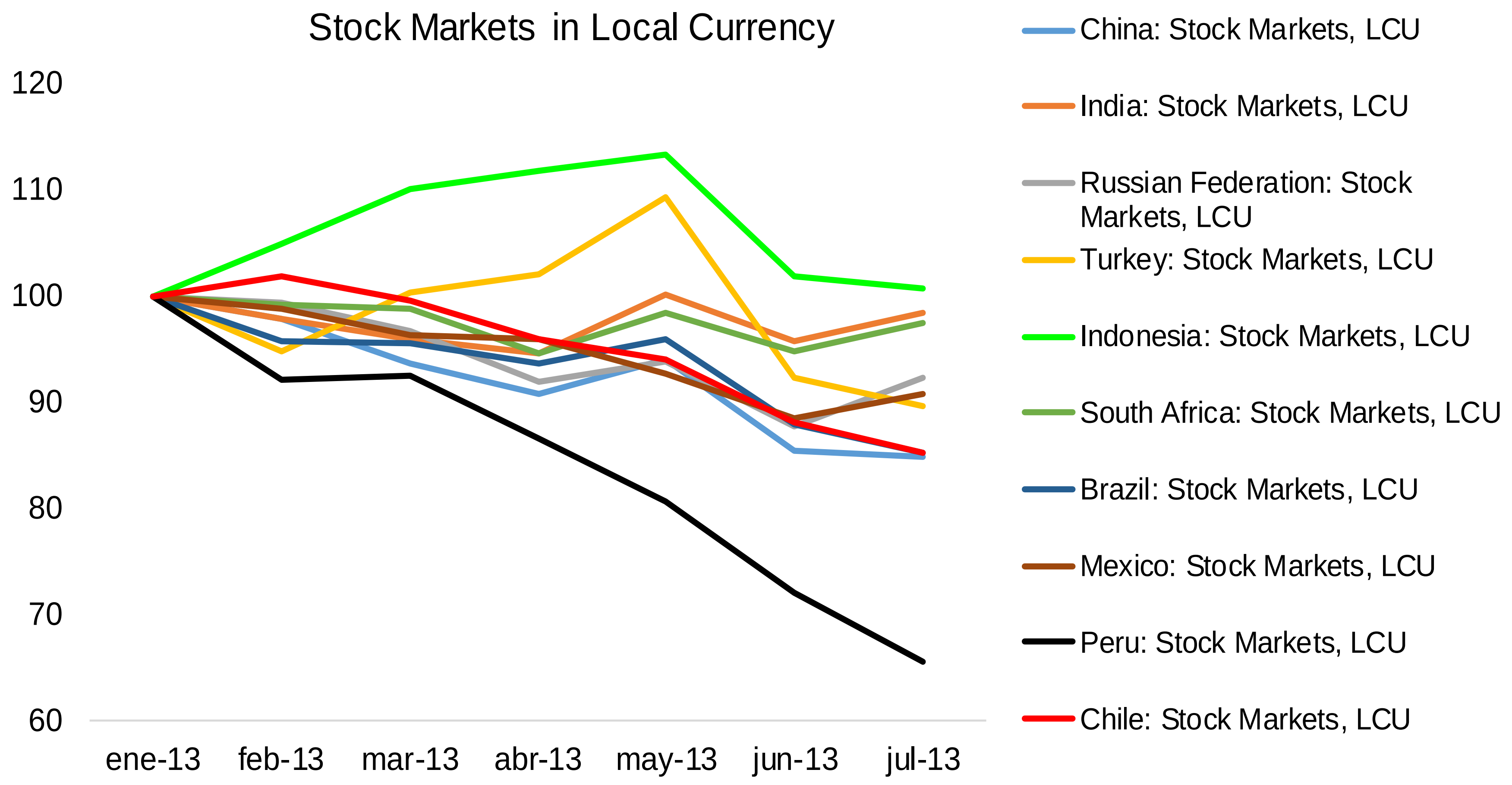
Causing instability in EM currencies



Source: Central Bank of Chile

* Local currency per USD, index, 02-01-2013=100

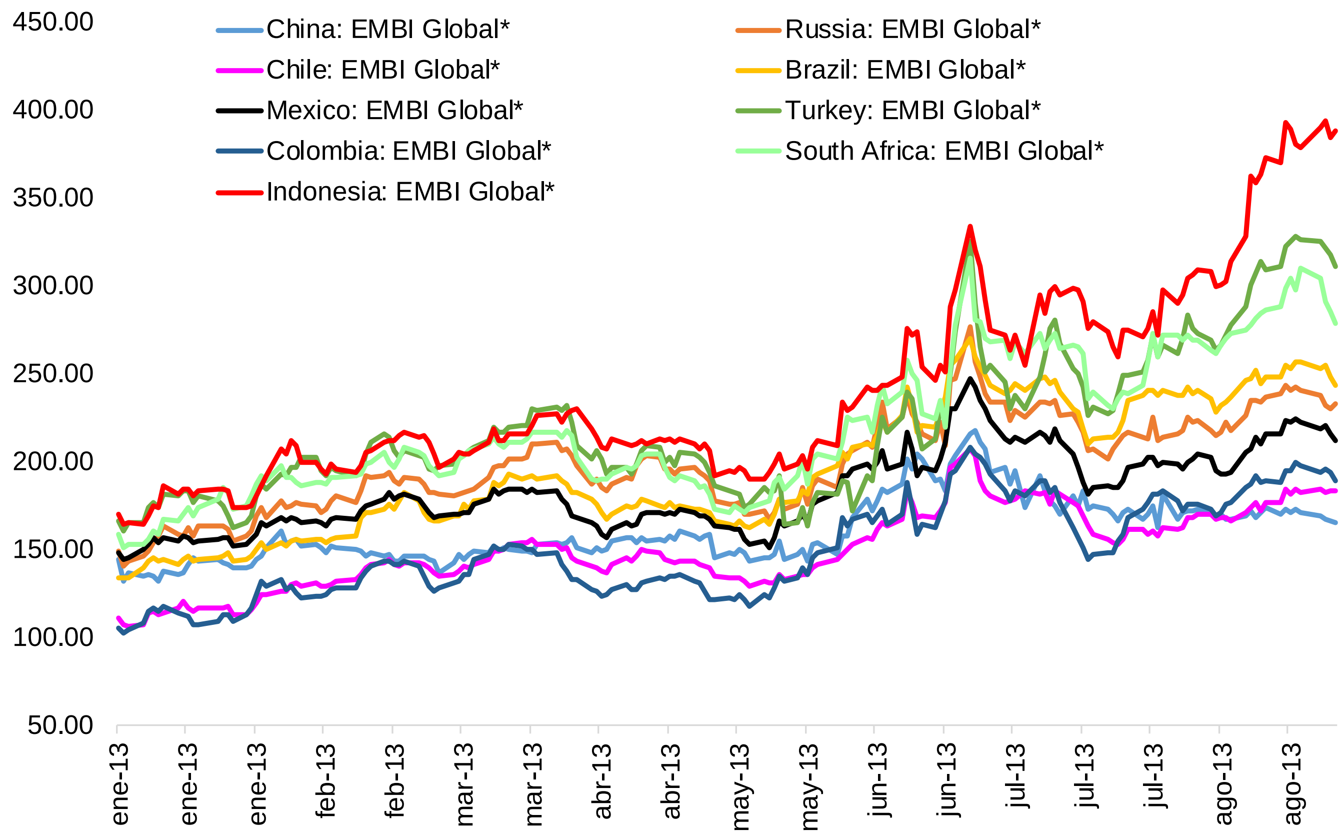
...and stock prices



Source: Global Economic Monitor, World Bank

*Index, January 2013=100

…and sovereign spreads



Source: Central Bank of Chile

* Base points

One big question

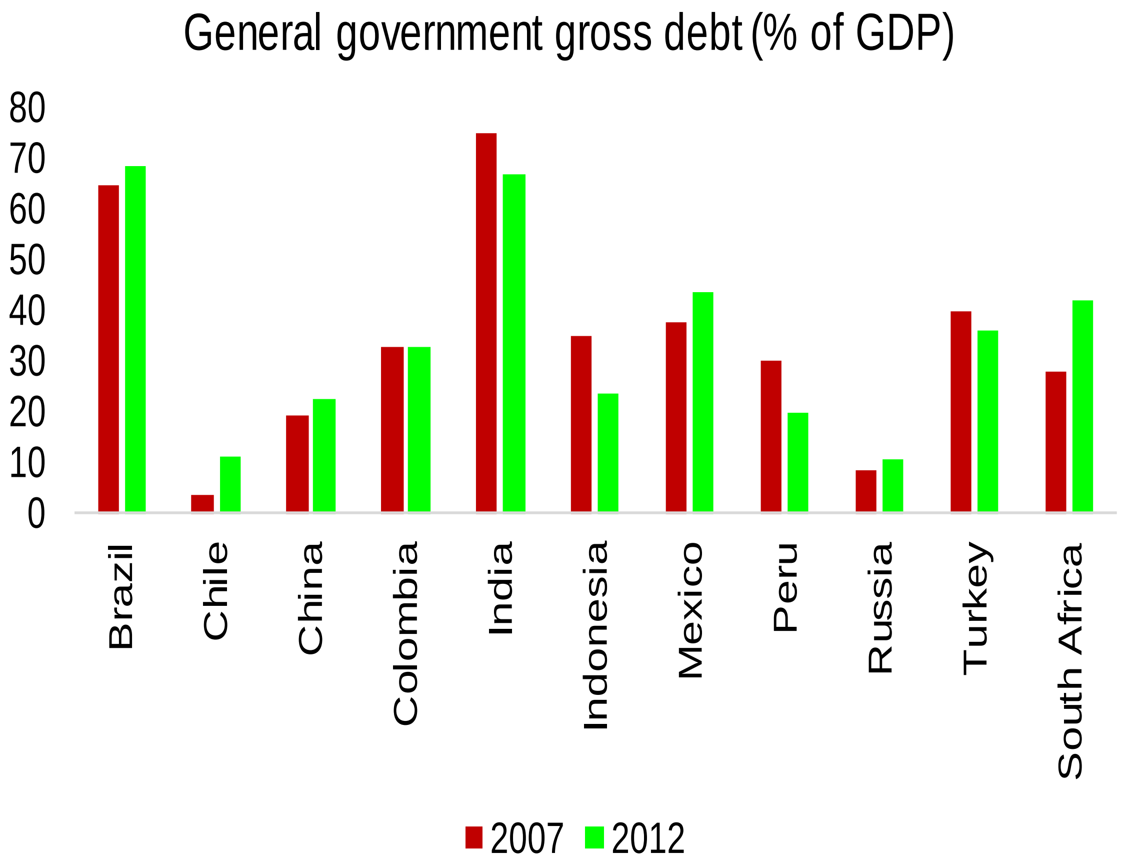
How large is the risk of financial instability in EMs?

Not huge

Fiscal policy: this time was different

- In previous cycles, commodity producers spent the windfall and also borrowed against it
- That is, fiscal policy was procyclical, while theory suggests it should be countercyclical
- Céspedes & Velasco (2013): this time was different –commodity producers followed more cautious fiscal policies in response to the commodity boom

So public debt is relatively low

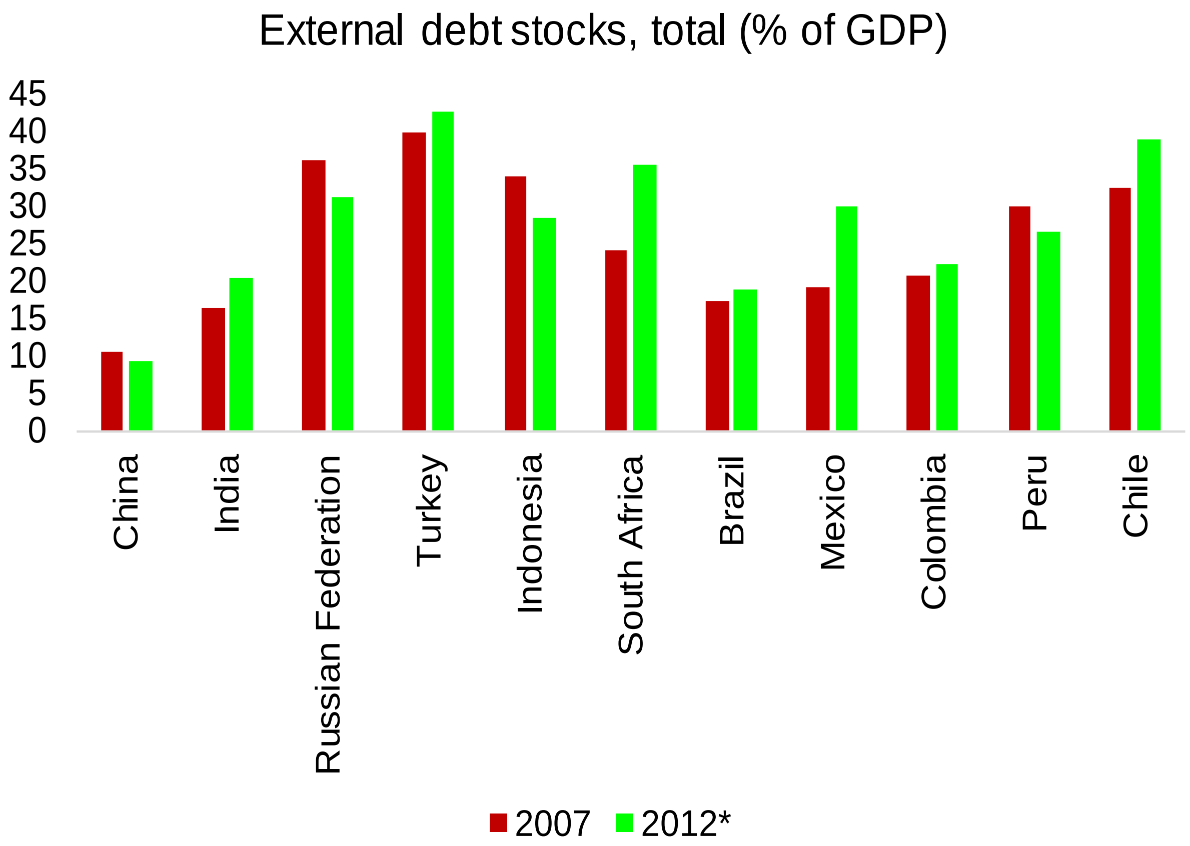


But notice: room for counter-cyclical fiscal policy is a bit less than in 2007…

…Mostly as a result of the anti-crisis fiscal packages

Source: WEO, IMF

And external debt levels are also moderate



…though higher than in 2007…

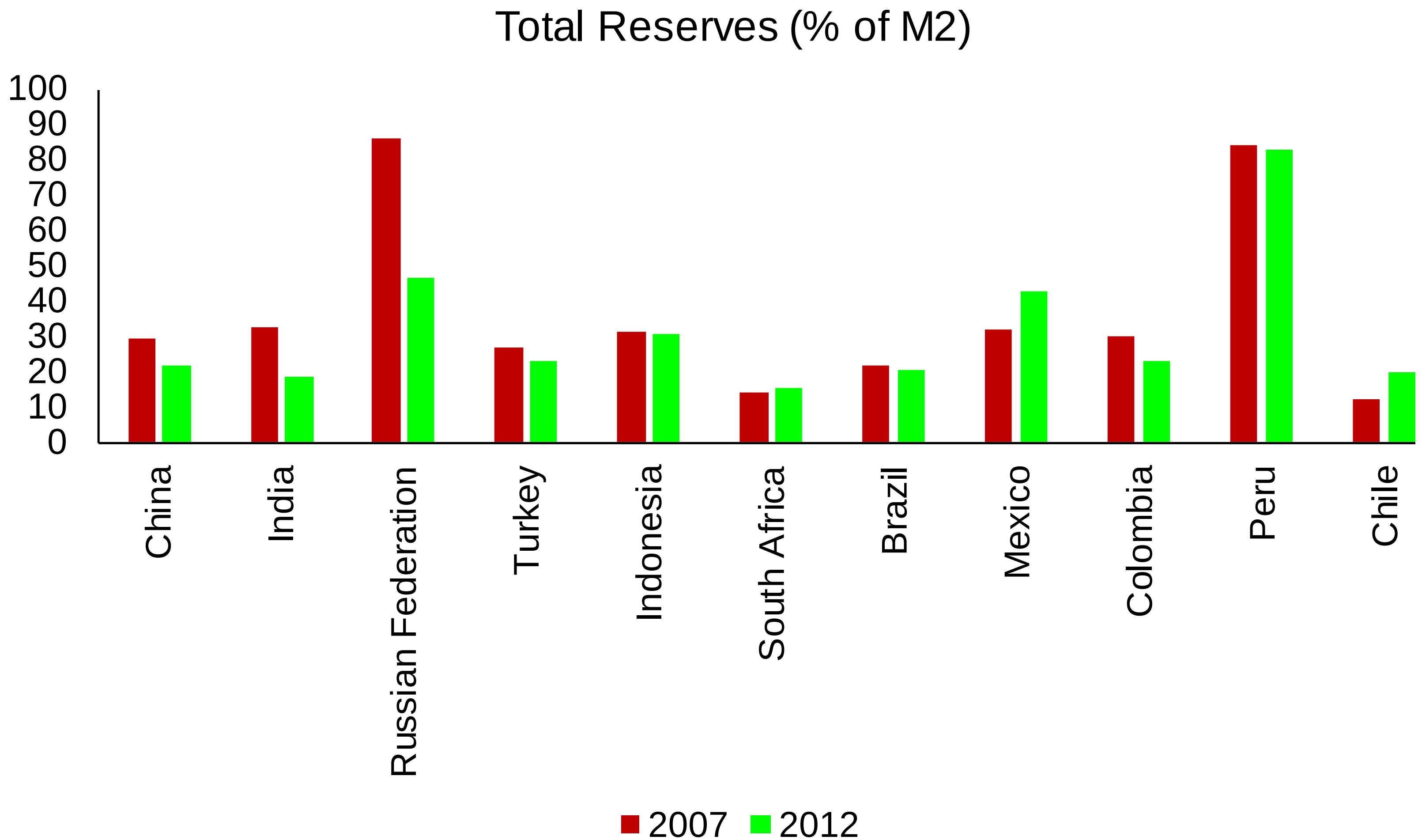
…but more heavily denominated in domestic currency…

…which lowers balance sheet risk

Source: WDI for 2007 and CIA World Factbook for 2012

*Forecasts

And large (ish) international reserves



Source: WDI, World Bank

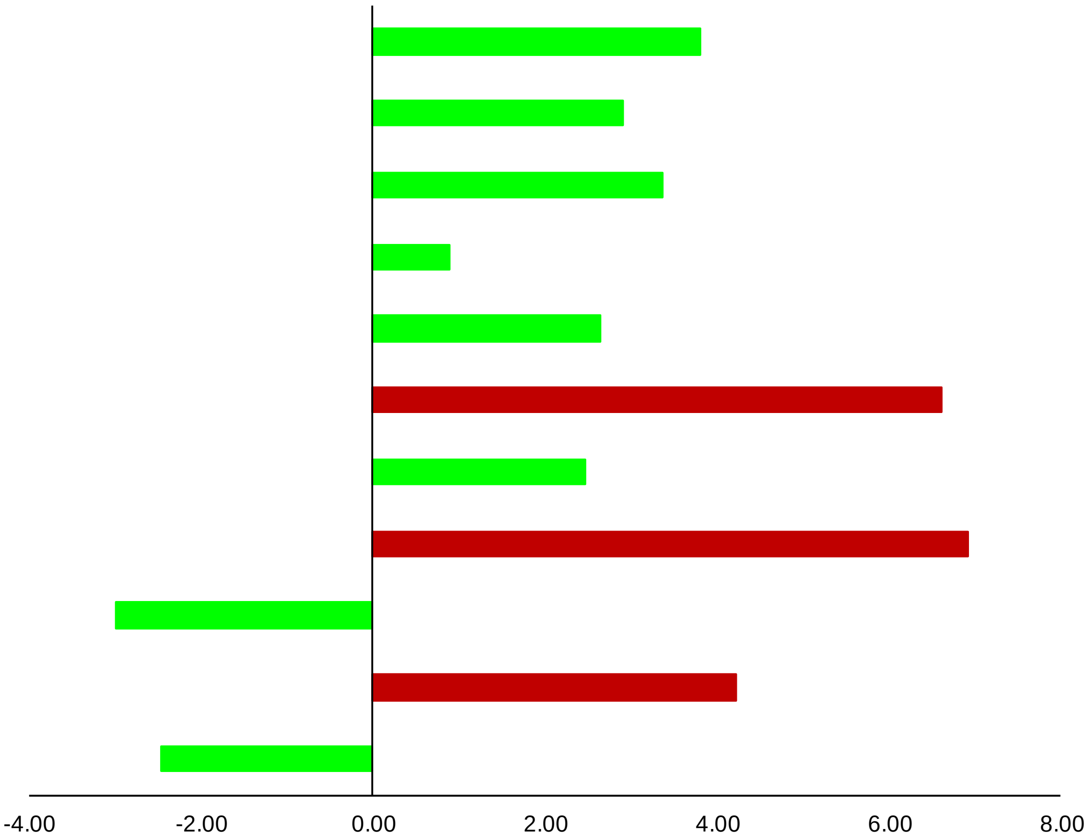
So….

- Where are the vulnerabilities?
- And in which countries?

Vulnerability: current account deficits

Country	Currency depreciation 2013 (%)*
Chile	4.99
Peru	8.78
Colombia	9.11
Mexico	0.55
Brazil	12.03
South Africa	16.64
Indonesia	17.66
Turkey	12.78
Russian Federation	8.24
India	15.67
China	-1.97

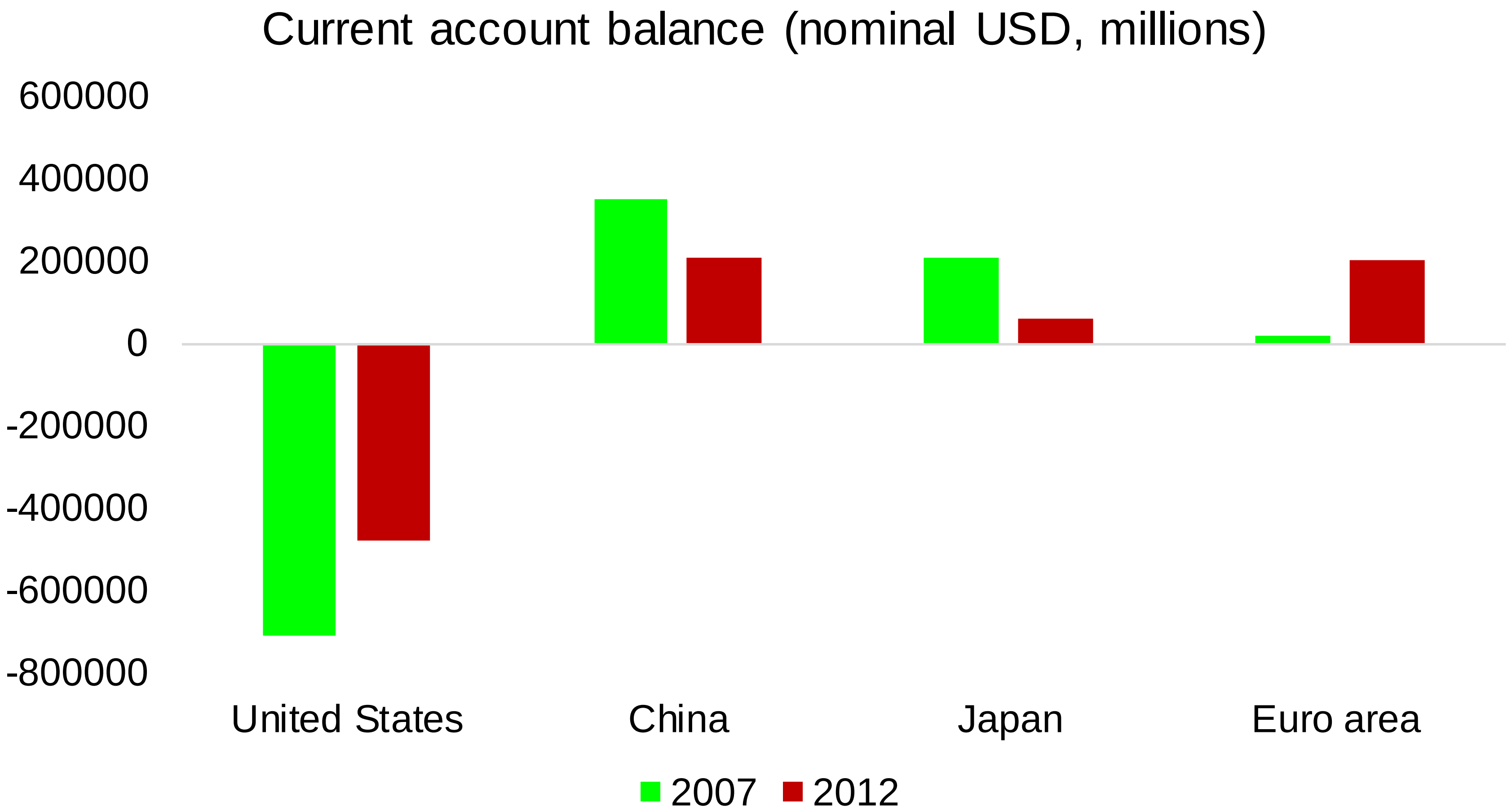
Current account deficit 2013 (% of GDP)**



Source: Global Economic Prospects, World Bank for current account deficit and Central Bank of Chile for currency depreciation

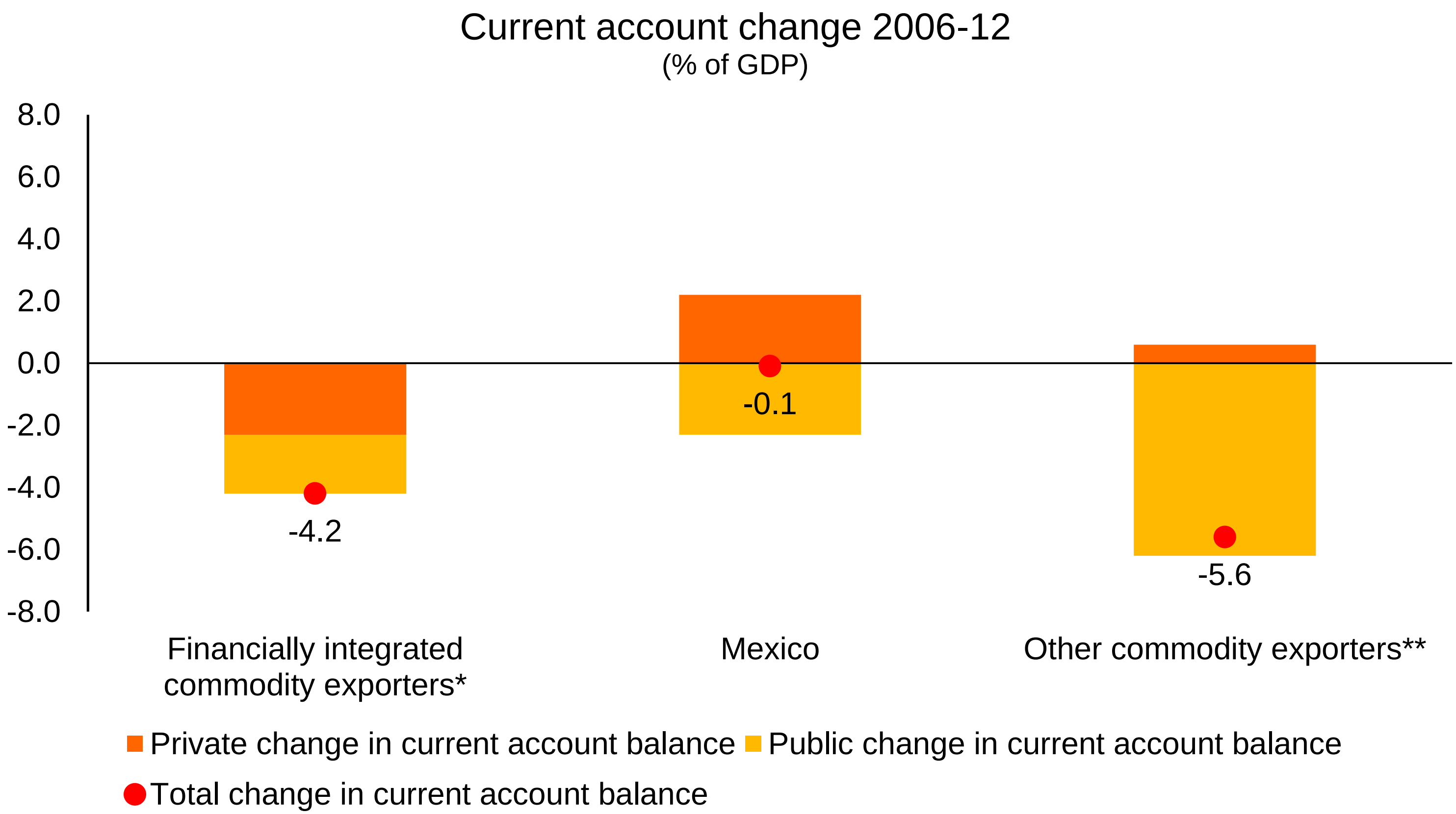
* From January 1st 2013 to September 12th 2013

Which are the counterpart of adjustment (or lack thereof) in the ROW



Source: Global Economic Prospects, World Bank

Latam: souces of CA change



Dealing with those deficits

- May call for an adjustment…
- Which in turn may affect growth

Declining growth in Latin America

País	Crecimiento estimado 2013* **(1)**	Crecimiento estimado 2014* **(2)**	Crecimiento estimado 2013*** **(5)**	Crecimiento estimado 2014*** **(6)**	Diferencia entre **(5)** y **(1)**	Diferencia entre **(6)** y **(2)**
Argentina	2.8	3.5				
Brasil	3.0	4.0	2.5	3.1	**-0.6**	**-0.9**
Chile	4.9	4.6	4.3	4.5	**-0.6**	**-0.1**
Colombia	4.1	4.5	3.8	4.1	**-0.3**	**-0.4**
México	3.4	3.4	1.8	3.7	**-1.6**	0.3
Perú	6.3	6.1	5.7	6.0	**-0.6**	**-0.1**
Uruguay	3.8	4.0	3.5	3.3	**-0.3**	**-0.7**
Venezuela	0.1	2.3				

* WEO, Abril 2013

*** Para Brasil los datos corresponden a las expectativas de crecimiento contenidas en el Quarterly Inflation Report de Junio de 2013.

Para Chile los datos corresponden a las expectativas de crecimiento de la Encuesta de Expectativas Económicas de Agosto de 2013.

Para Colombia los datos corresponden al promedio crecimiento esperado en la Encuesta de Expectativas Económicas de Julio de 2013.

Para México los datos corresponden al crecimiento esperado en la Encuesta sobre las Expectativas de los Especialistas en Económia del Sector Privado de Agosto de 2013.

Para Perú los datos corresponden al crecimiento esperado por los analistas económicos en la Encuesta de Expectativas Macroeconómicas de Julio de 2013.

Para Uruguay los datos corresponden al promedio del crecimiento esperado en la Encuesta de Expectativas Económicas de Septiembre de 2013.

Growth dilemmas

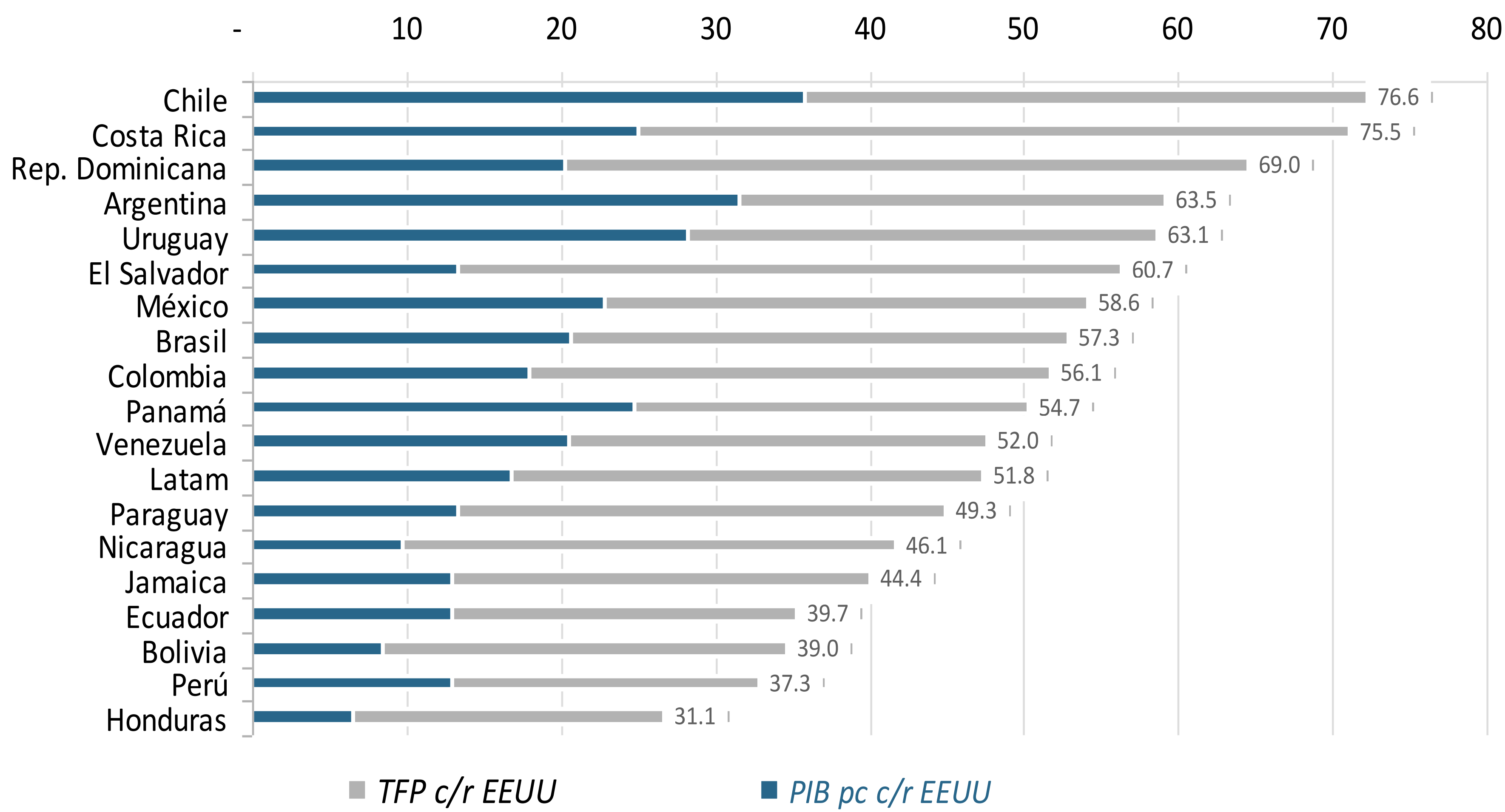
- Growth after the commodity boom
- The productivity conundrum

Latin American EMs:

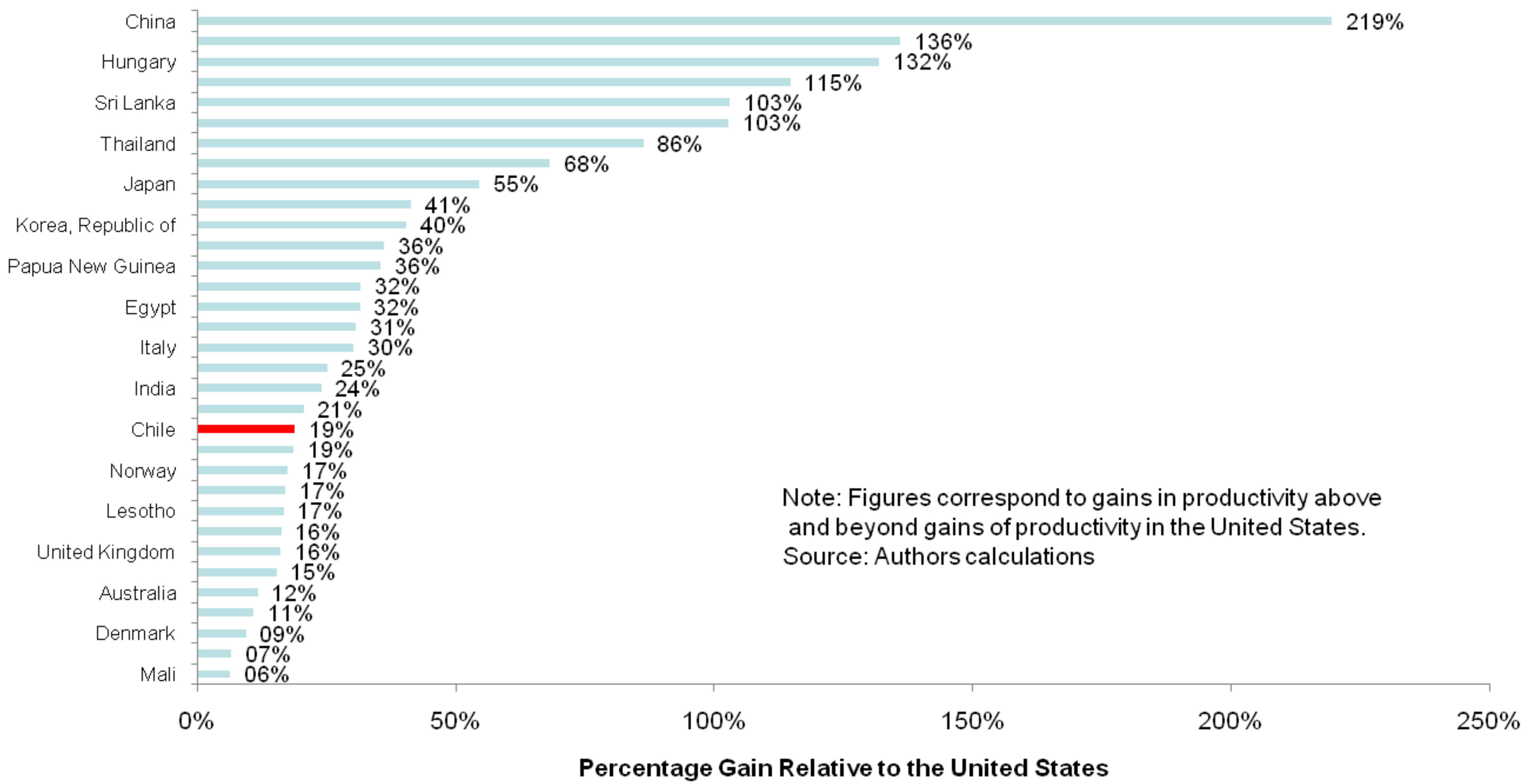
A long run productivity crisis

Far away from the frontier

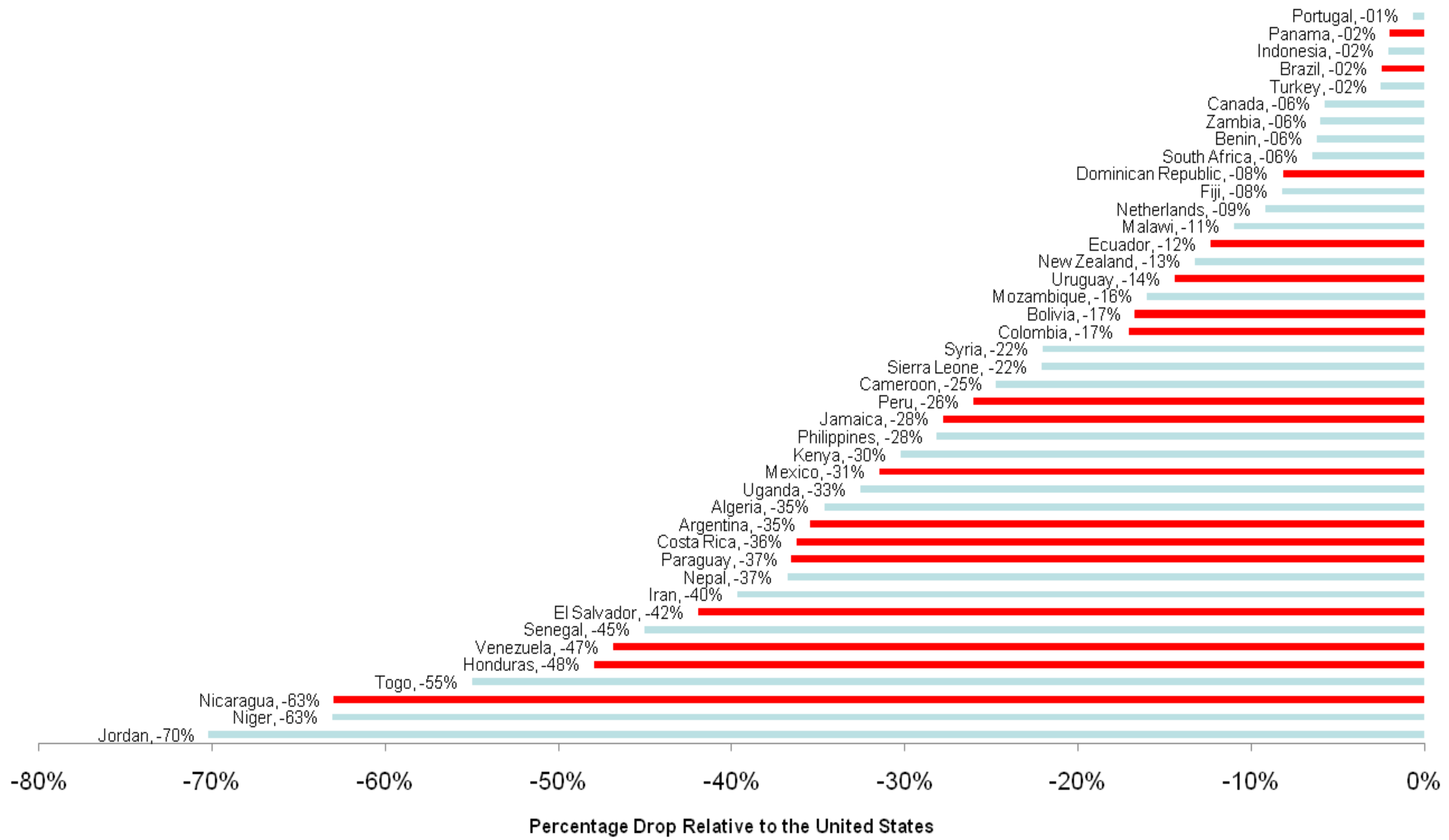
(2006 GDP pc and TFP as % of US)



Getting closer to the frontier



Falling further behind

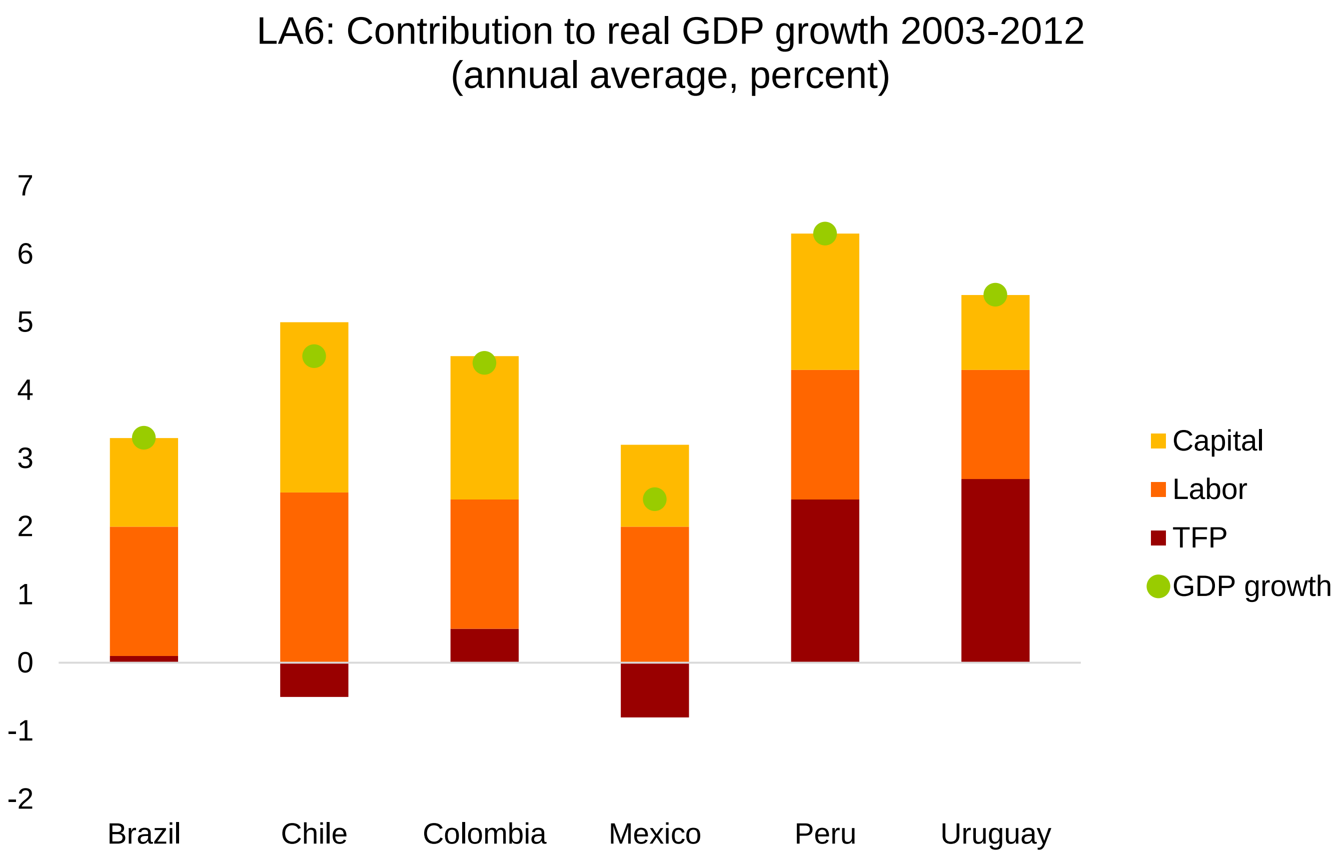


Source: Authors' calculations based on Heston, Summers and Aten (2006), World Bank (2008) and Barro and Lee (2000).

Yet...

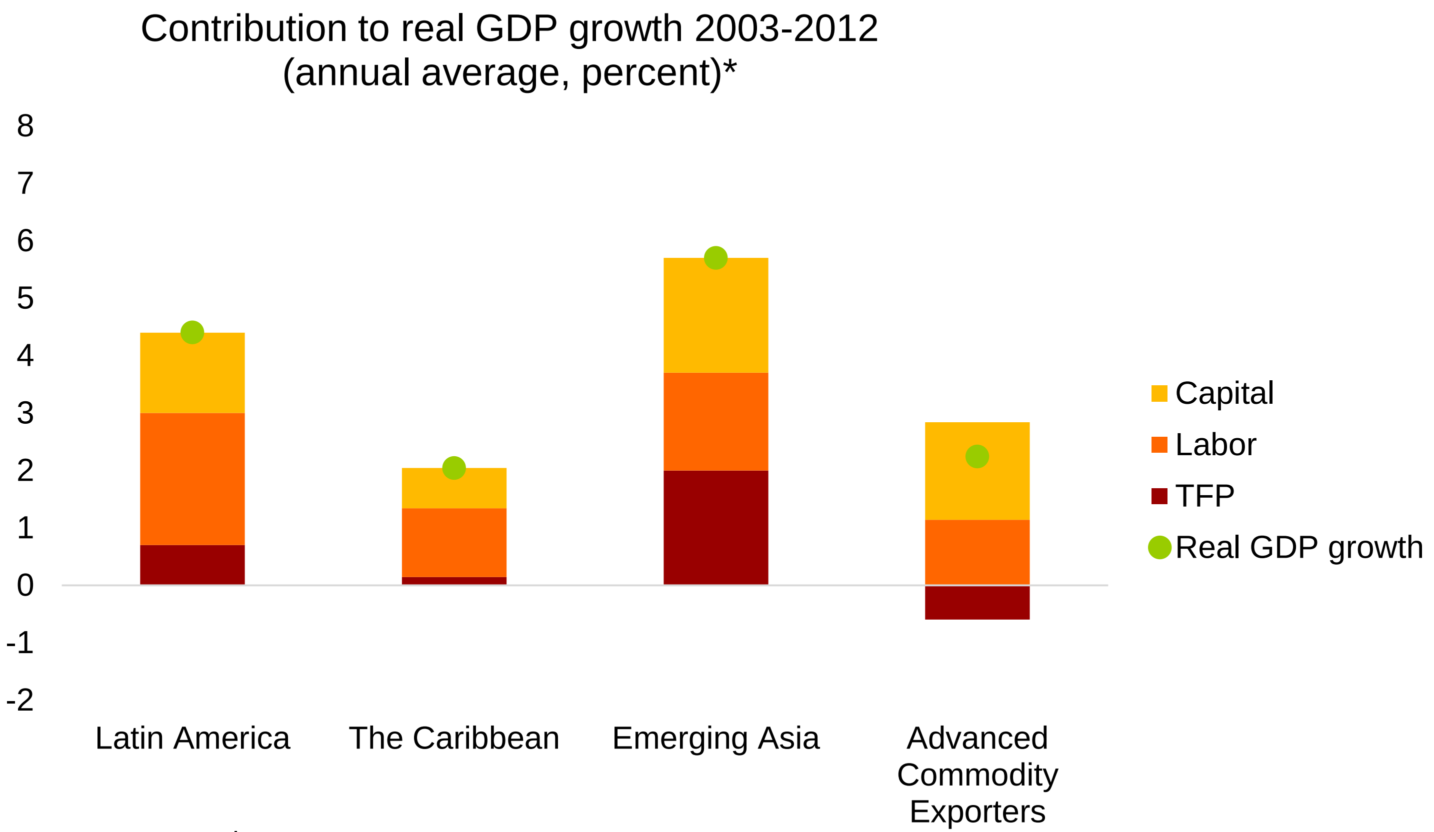
- Latin America grew recently...
- What were the sources of that growth?
- And what hapenned to productivity?

LAC: sources of growth



Uneven TFP performance, better than before, but nothing to write home about

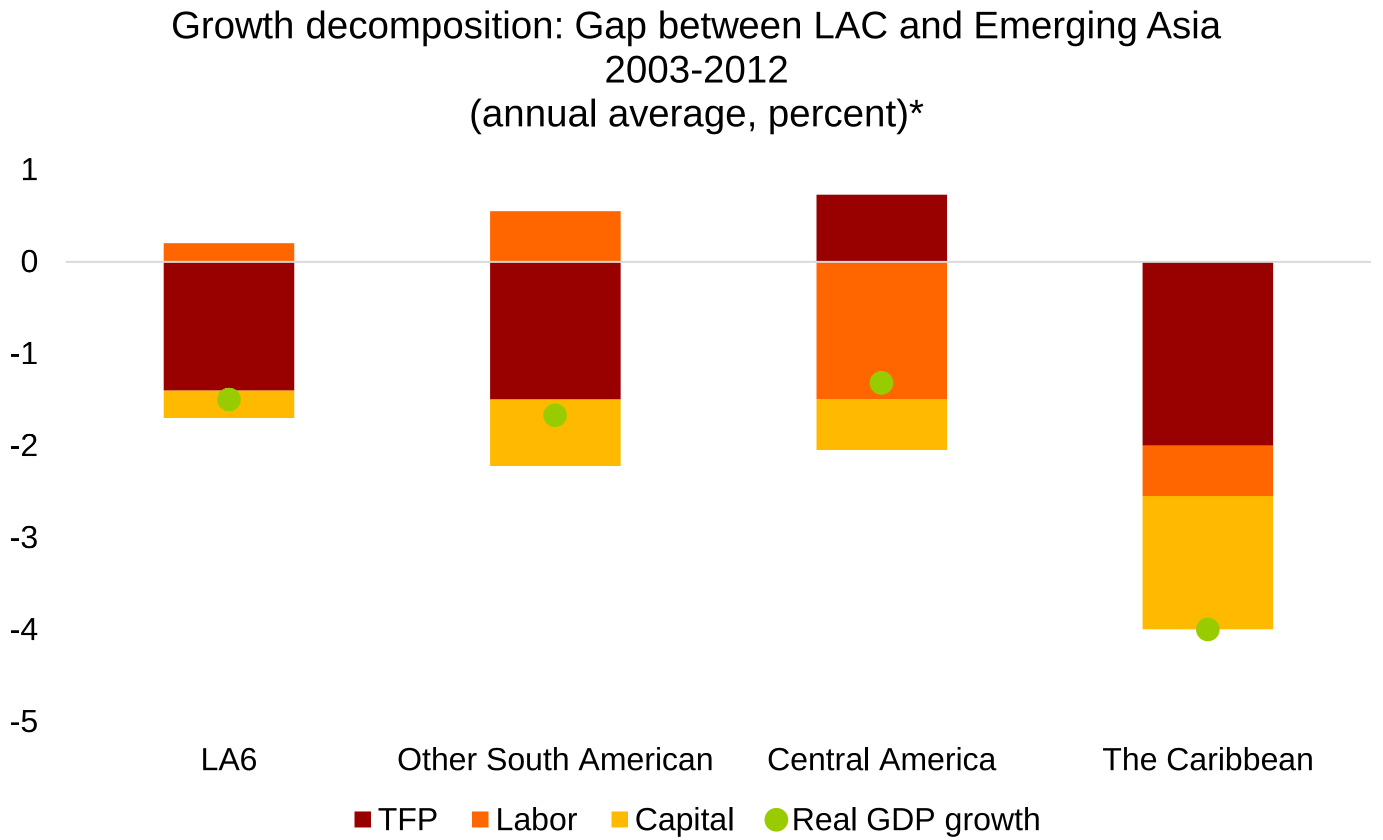
Sources of growth: different from ROW



Source: Sosa er al. (2013)

* Simple average of countries within each group. Latin America includes all Latin American countries in our sample. Emerging Asia includes Indonesia, Malaysia, Philippines, Thailand and China. Advanced commodity exporters includes Australia, Canada, New Zealand and Norway. The Caribbean includes Barbados, Jamaica and Trinidad and Tobago.

Latin America v. Asia: sources of growth



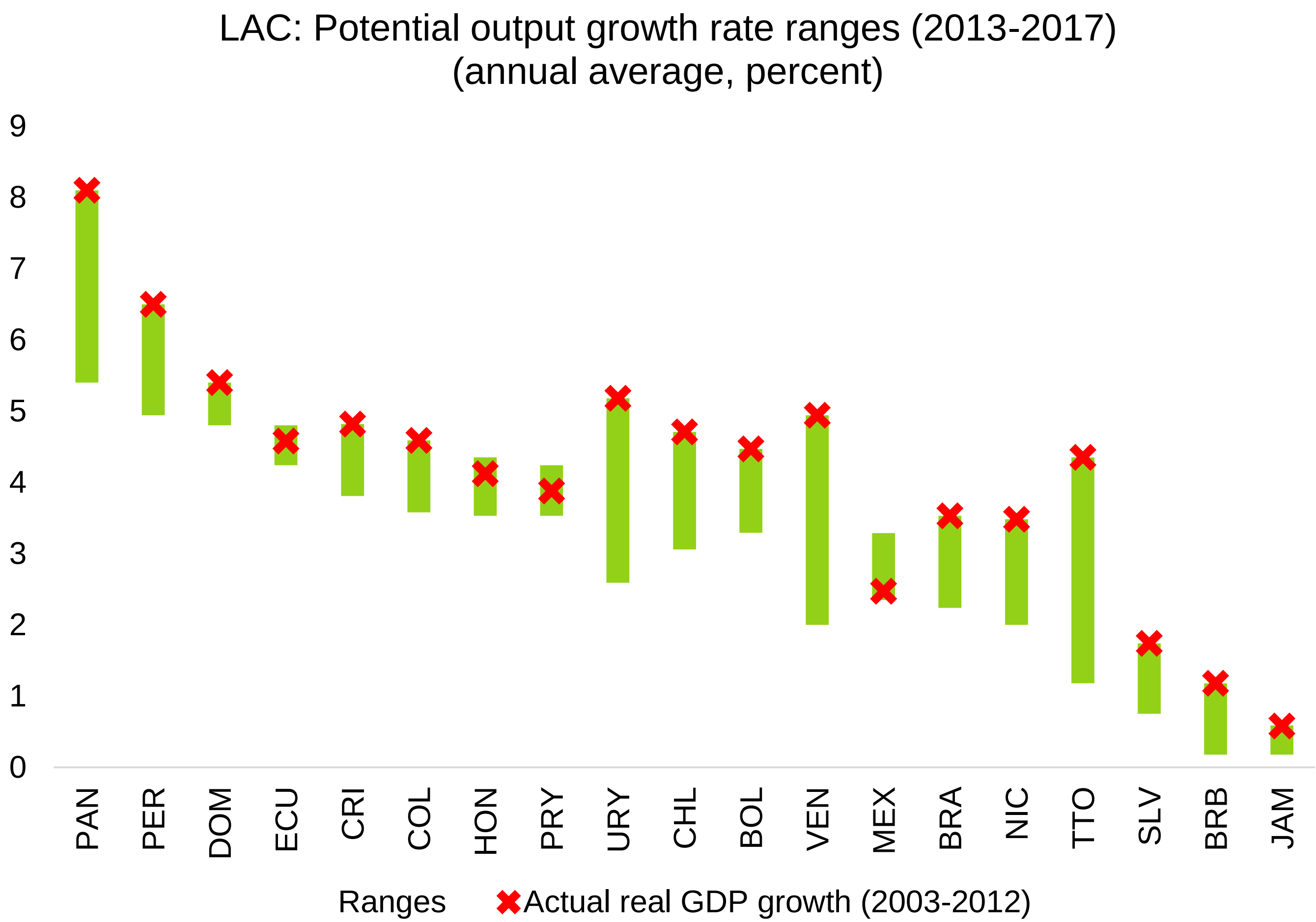
Source: Sosa et al. (2013)

*Simple average of countries in each group. LA6 includes Brazil, Chile, Colombia, Mexico, Peru and Uruguay. Other South American includes Bolivia, Ecuador, Paraguay and Venezuela. Central America includes Costa Rica, Dominican Republic, El Salvador, Honduras, Nicaragua and Panama. The Caribbean includes Barbados, Jamaica and Trinidad and Tobago.

And notice…

- Productivity growth tends to be very procyclical
- And low interest rates were very favorable for capital accumulation
- In next few years, both could decline
- In that case, growth momentum not sustainable

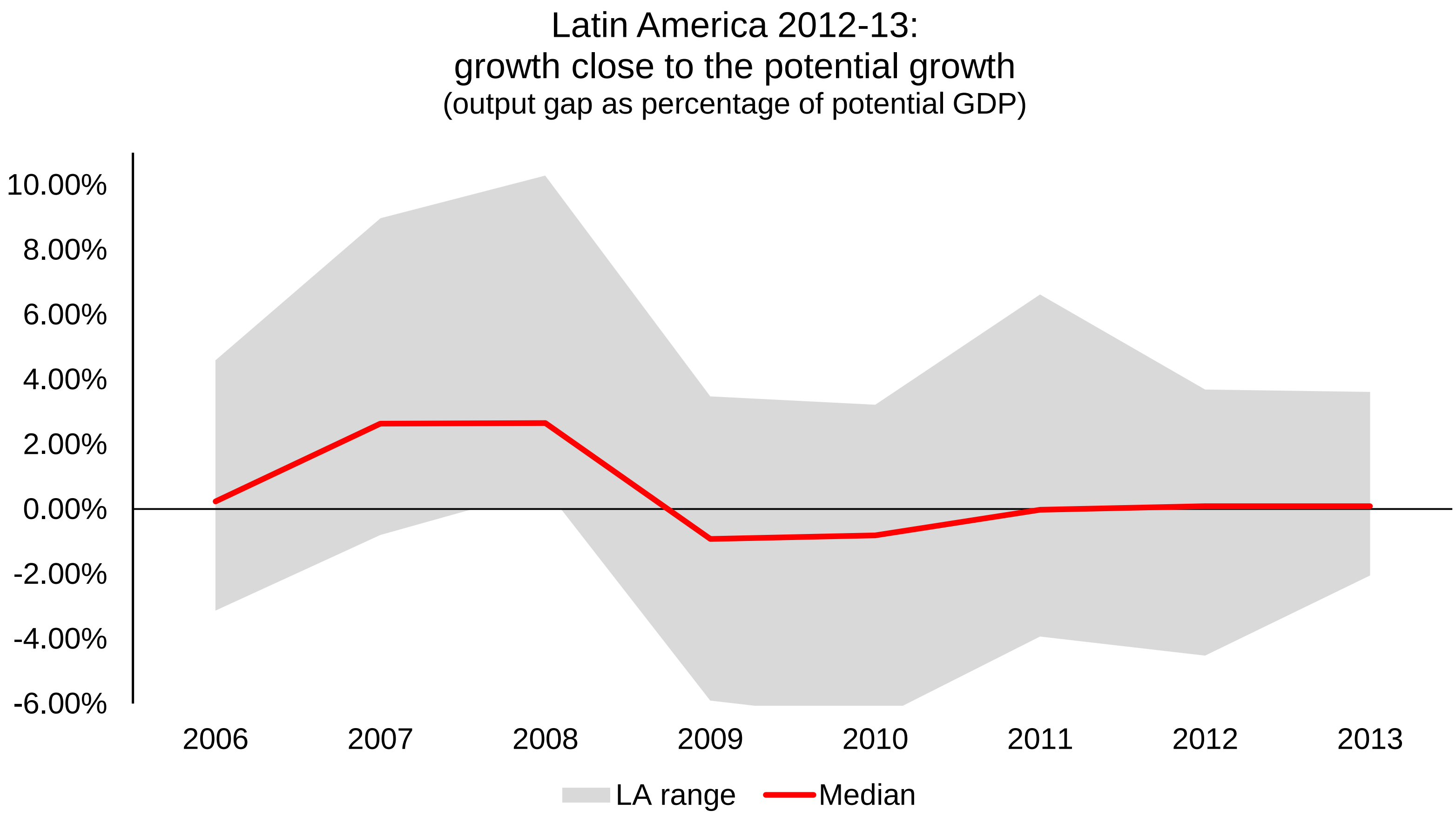
LAC countries: growth unsustainable?



This is what would happen if capital and TFP returned to their 2000-12 path or worse

Source: Sosa et al. (2013)

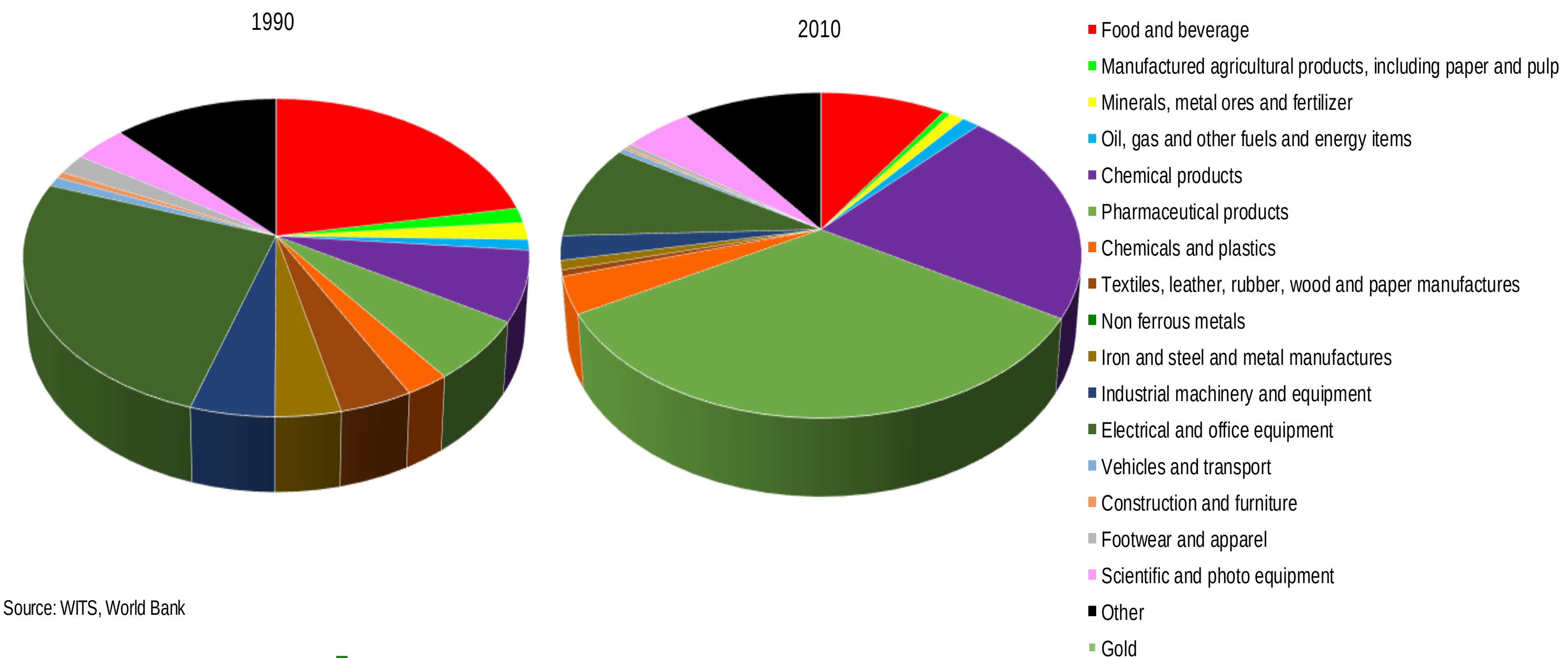
Output gap nearly zero



Why has TFP performance been mediocre?

One possible answer for Latin America: lack of productive diversification

Composition of exports: Ireland



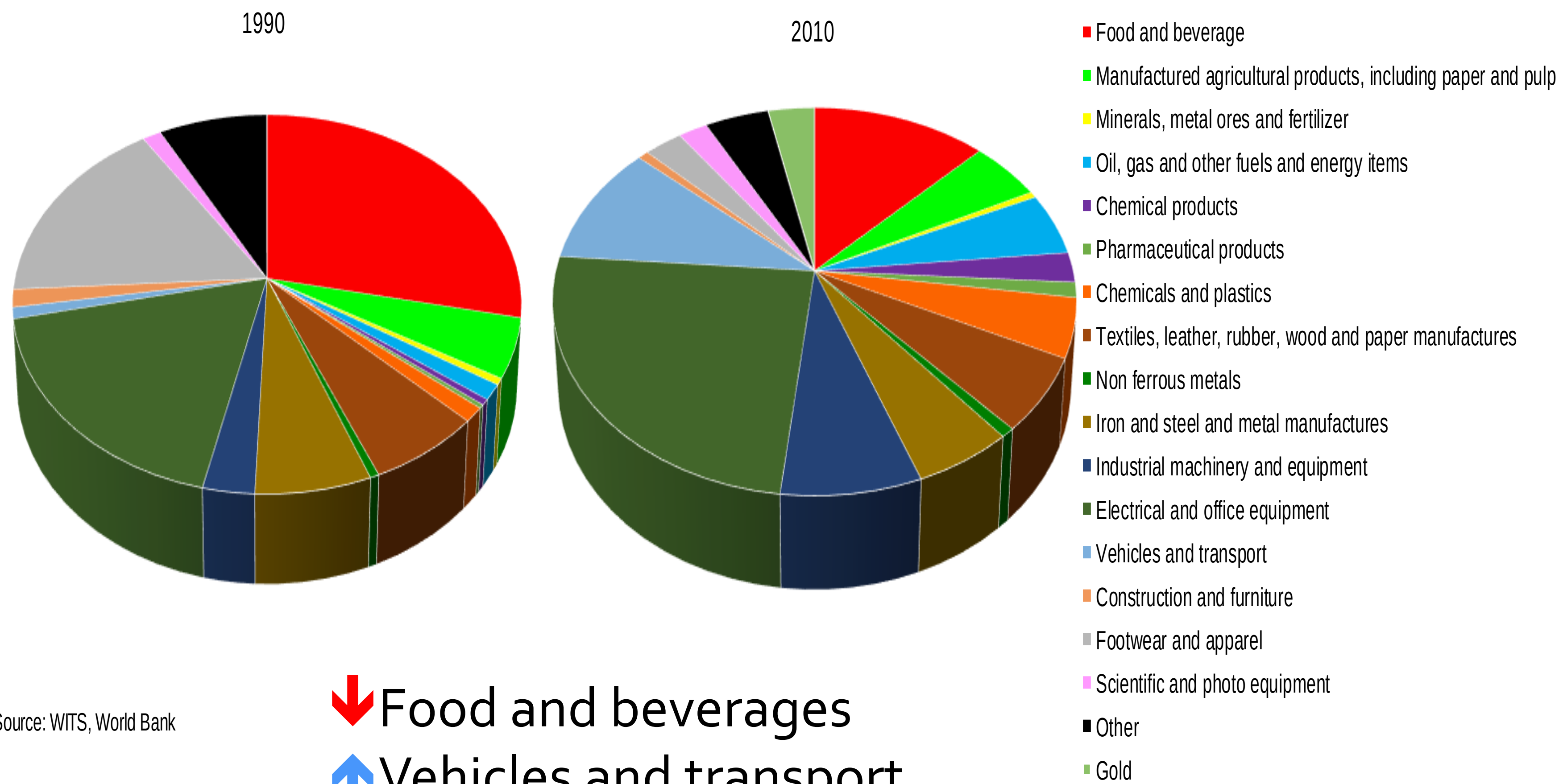
Source: WITS, World Bank

↓ Electrical equipment

↑ Pharmaceutical products

↑ Chemicals and plastics

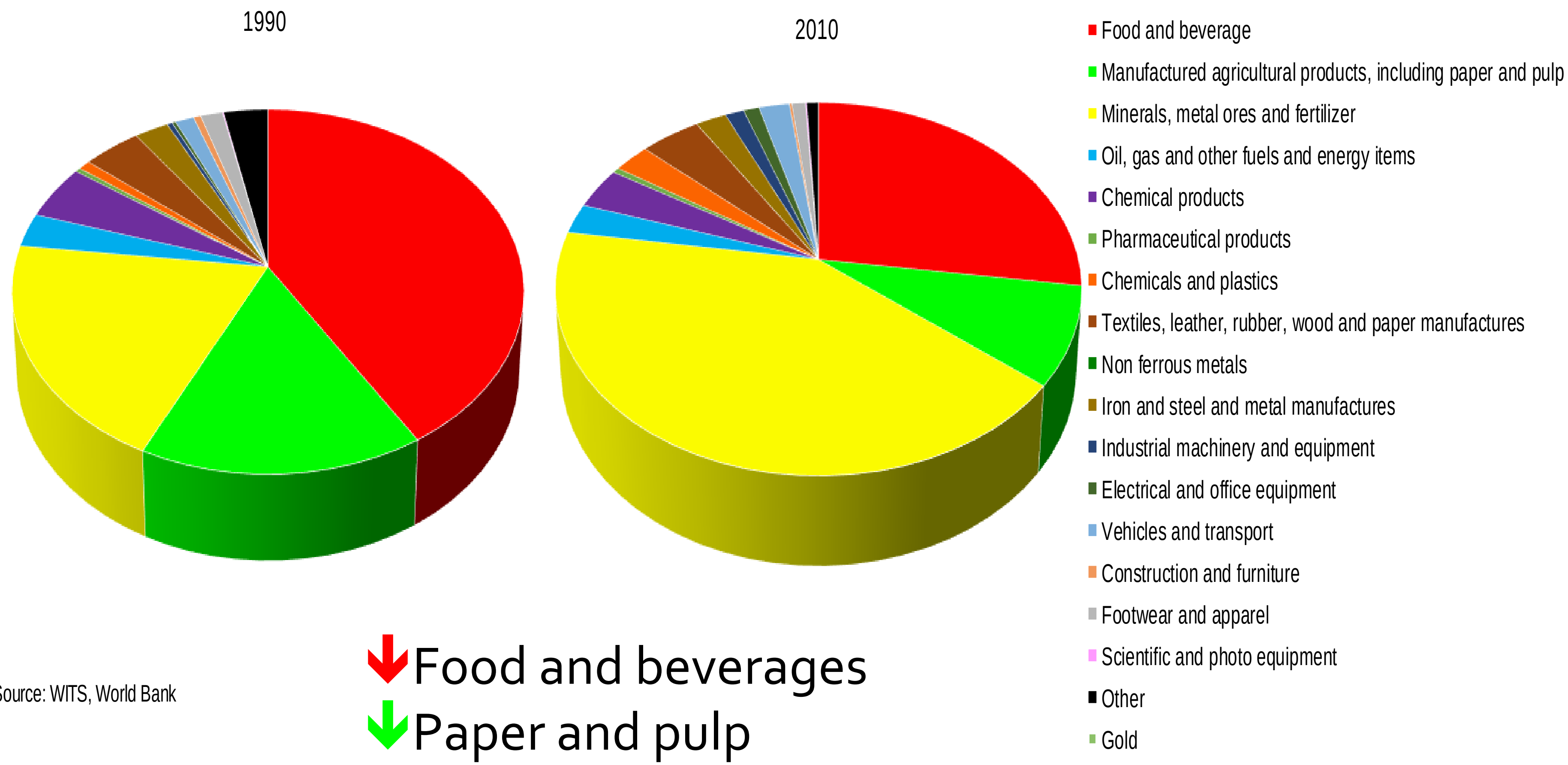
Composition of exports: Thailand



Source: WITS, World Bank

- ↓ Food and beverages
- ↑ Vehicles and transport
- ↑ Electrical equipment

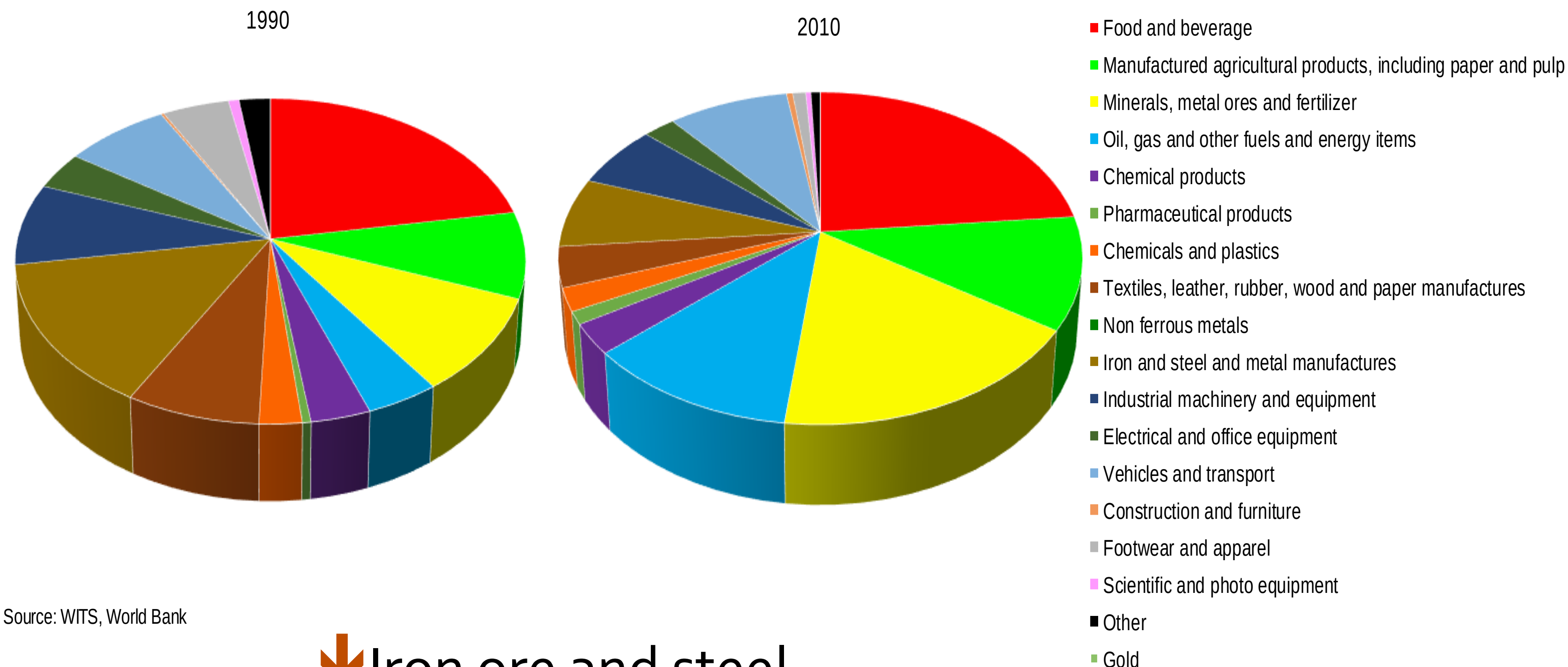
Composition of exports: Chile



Source: WITS, World Bank

↓ Food and beverages
↓ Paper and pulp
↑ Minerals (copper)

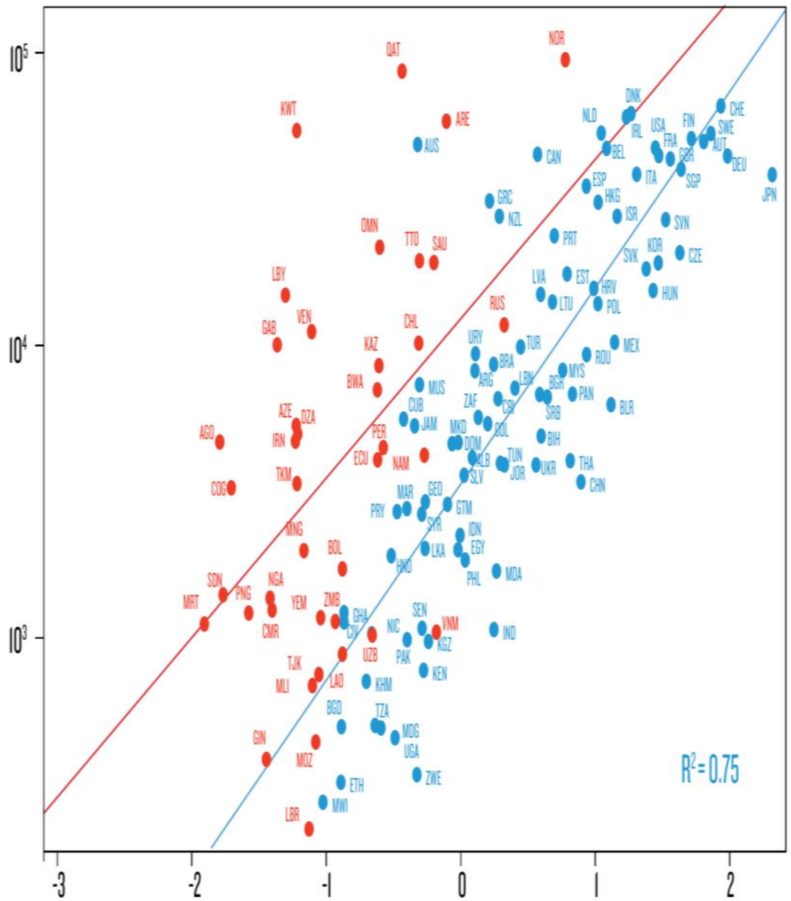
Composition of exports: Brasil



Source: WITS, World Bank

- ↓ Iron ore and steel
- ↑ Minerals
- ↑ Oil and gas

Export diversification and GDP



Ingreso per cápita

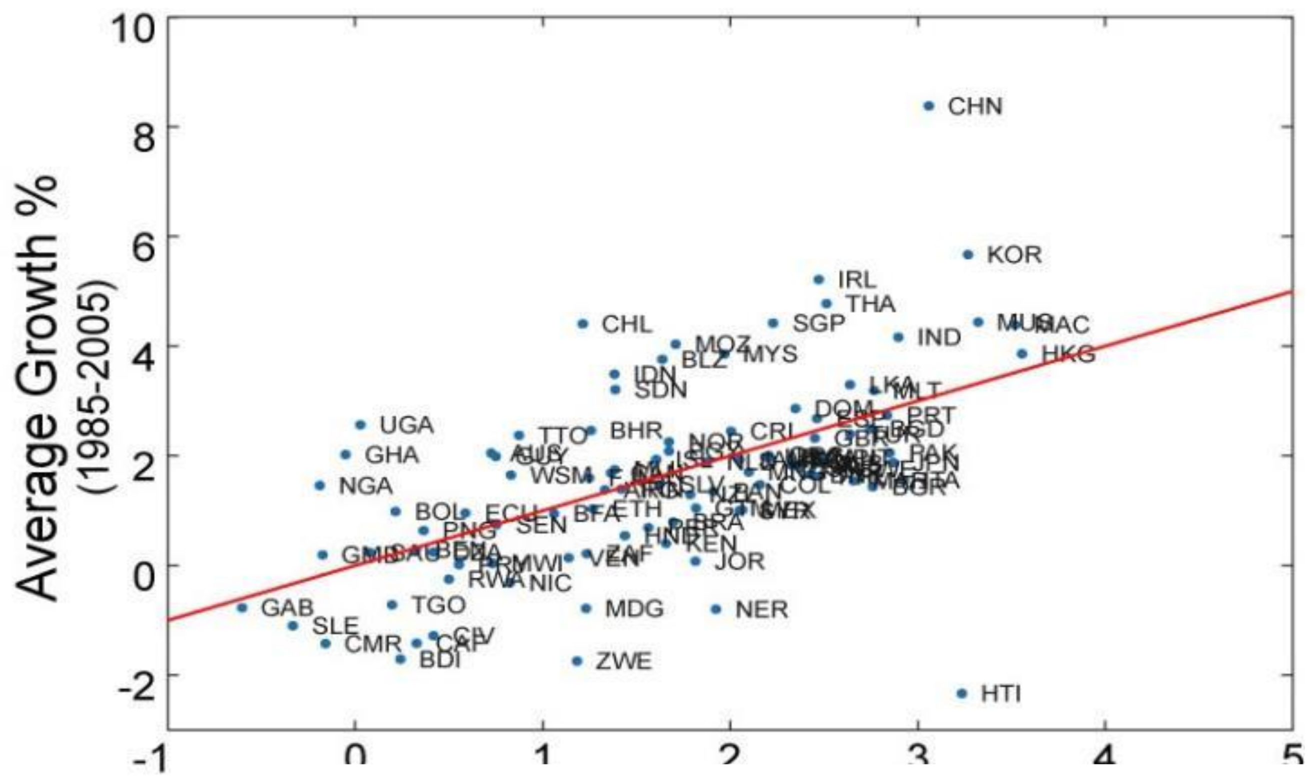
Diversificación Económica

Hausmann and coauthors:

- Export diversification is positively correlated with per capita GDP
- That is true for countries with few natural resources (blue) and for countries rich in natural resources (red)

And it is not only correlation…

Export Diversity Predicts Future GDPpc Growth

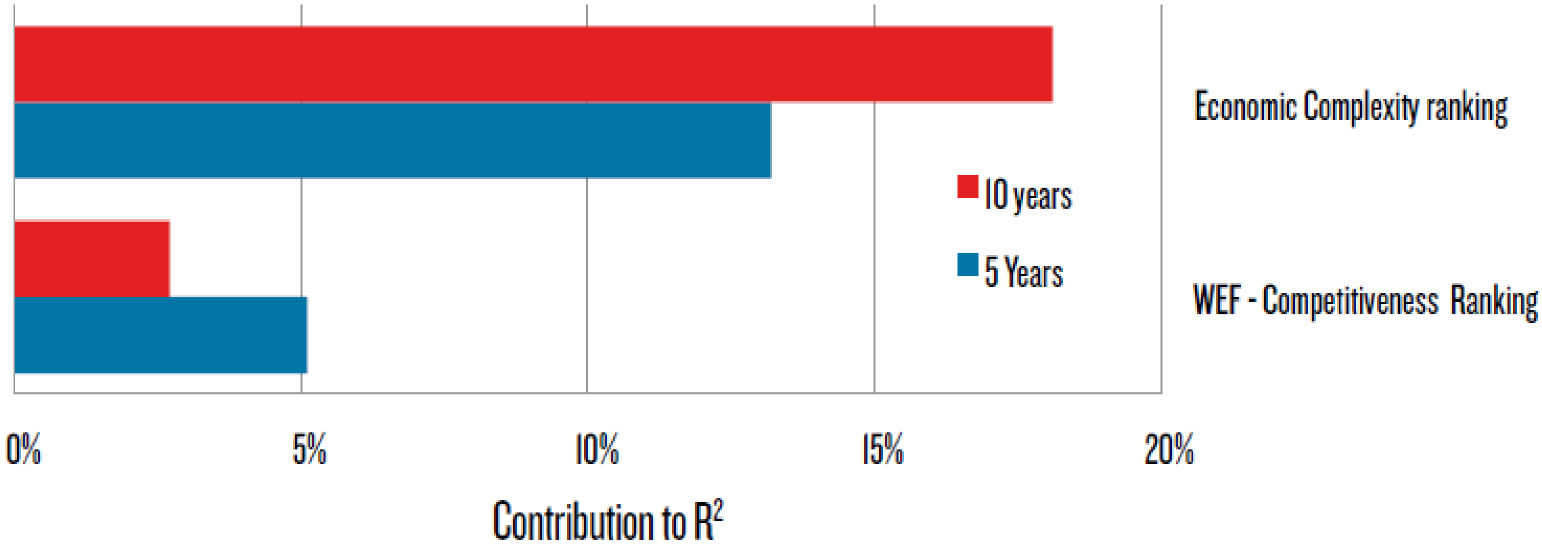


Complexity in 1985 (Controlling for GDP per capita at ppp)

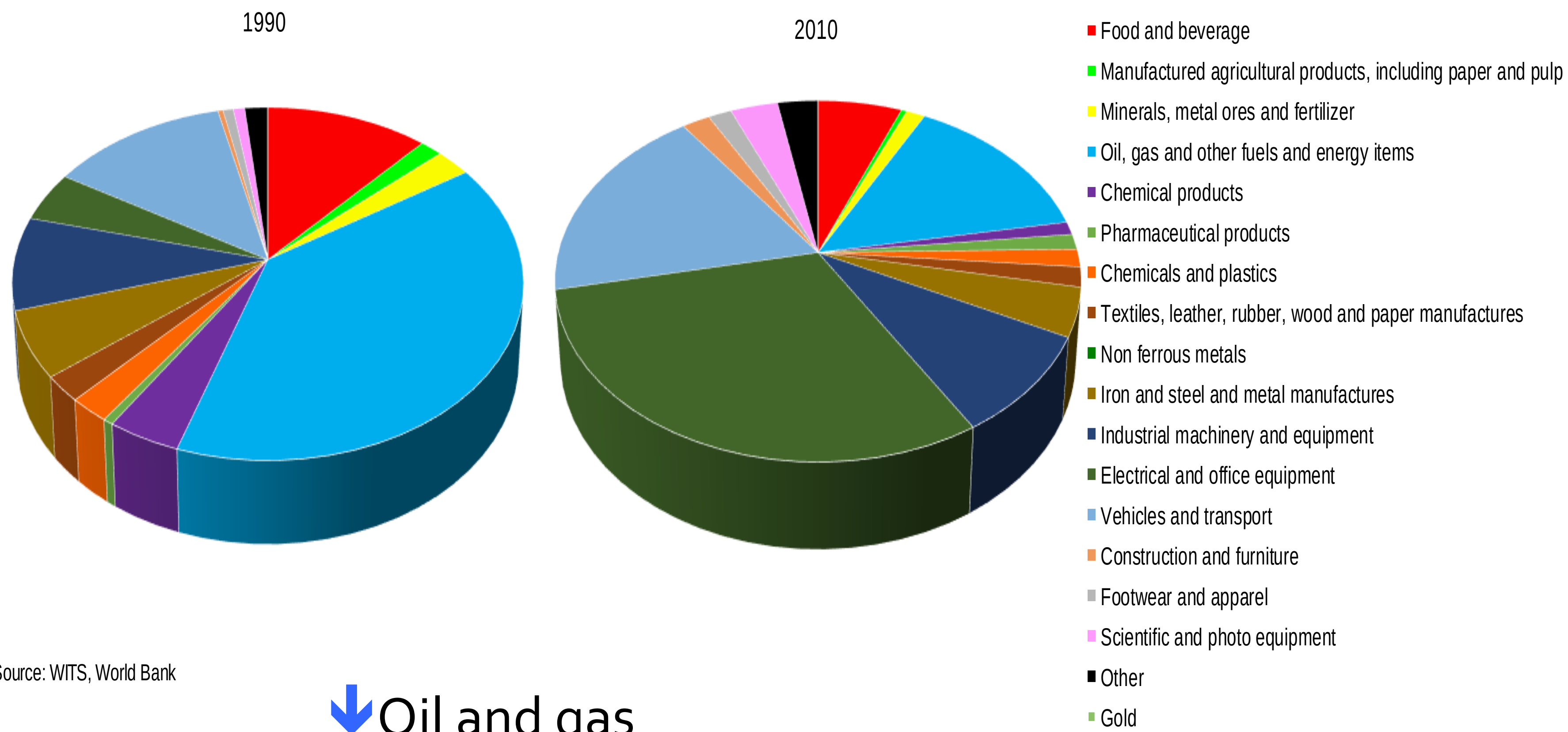
Hidalgo, Hausmann (2009) *PNAS*

Complexity is a better predictor of future p.c. growth than other standard factors

Hausmann, Hidalgo et al (2011) show that the contribution of the Economic Complexity Index (ECI) to predict future economic growth is 500% to 2000% larger than current measures of governance (World Bank), Education, and Competitiveness (WEF)



The exception that confirms the rule: Mexico



Source: WITS, World Bank

- ↓Oil and gas
- ↑Vehicles and transport
- ↑Electrical equipment

But note…

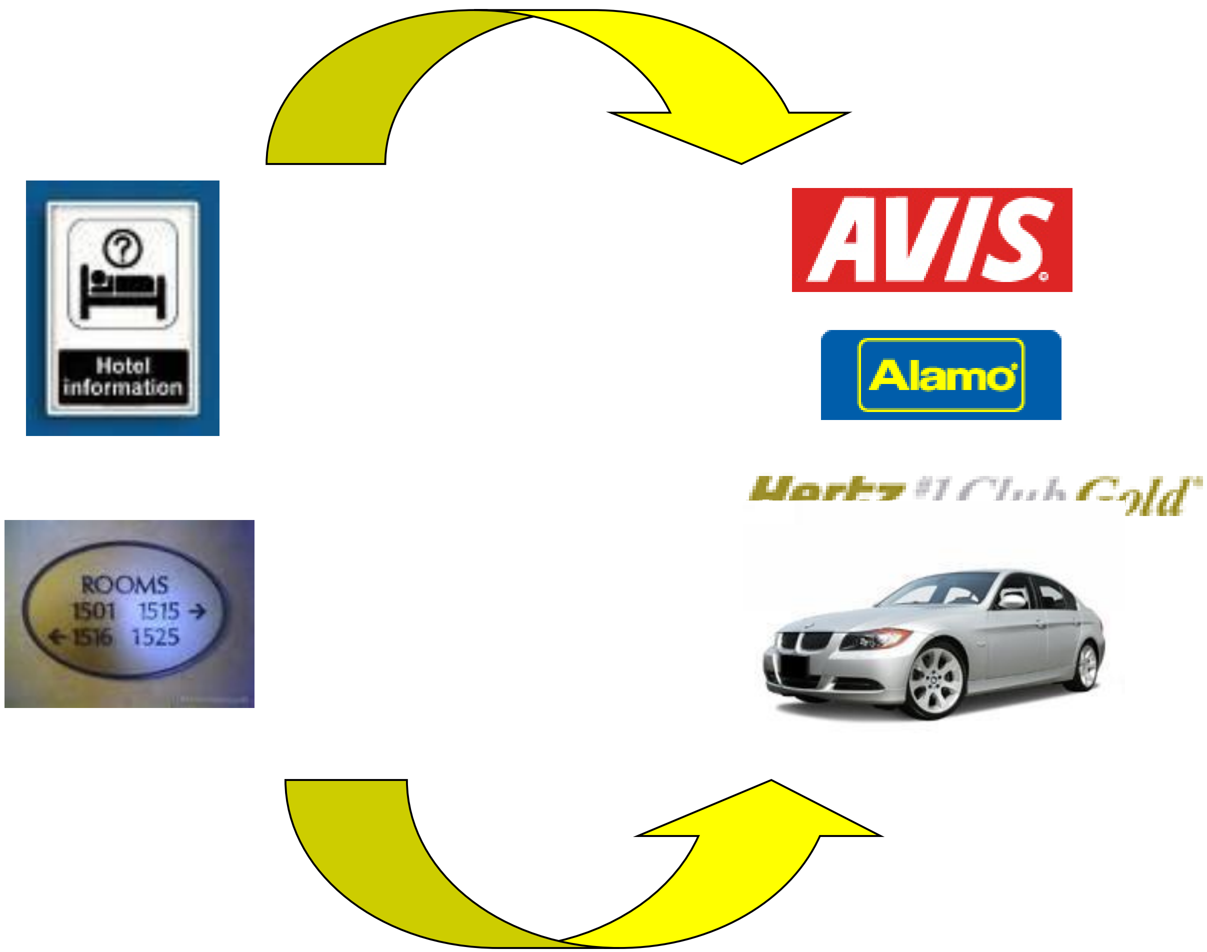
- Regressions show that effect of diversification on growth is not immediate
- Can operate with substantial lags
- Reason to be optimistic about TFP in Mexico?
- Of course, there are a number of other issues to worry about

An obvious question

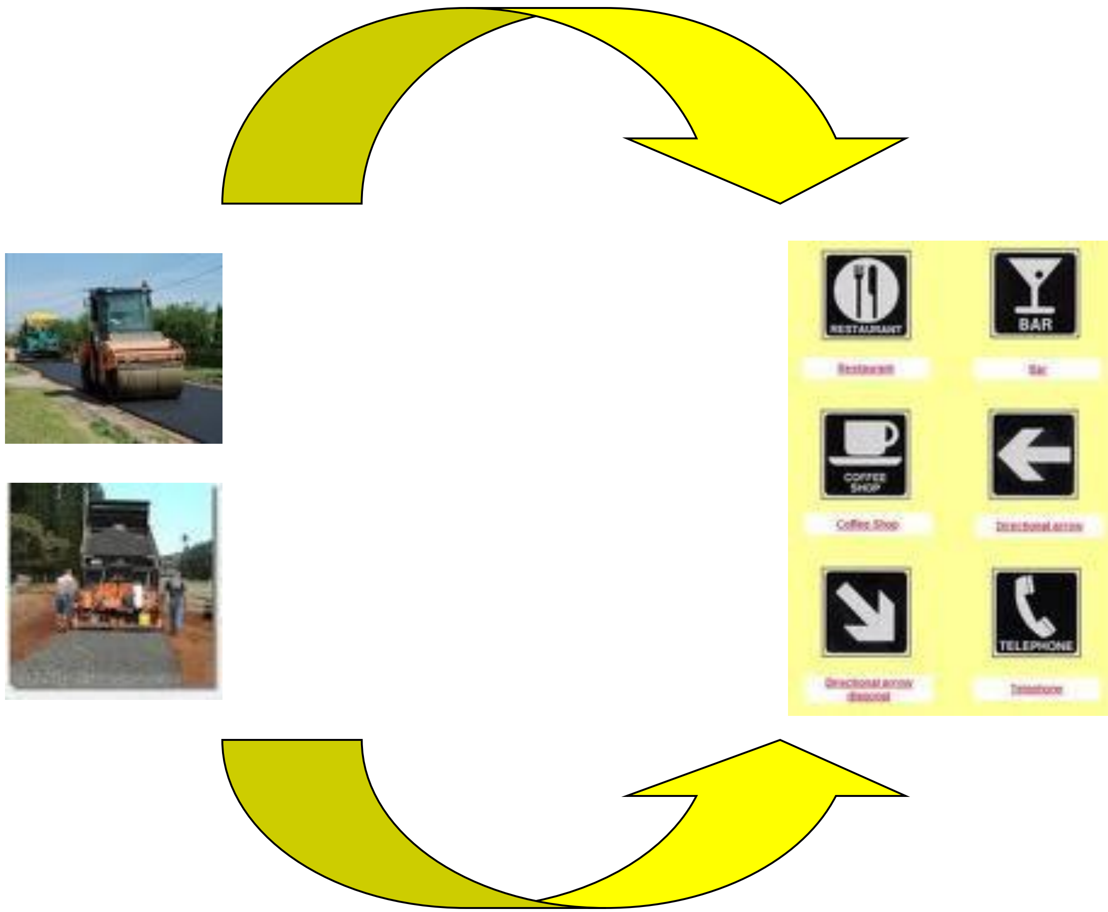
Why so little diversification?

Property rights, *self-discovery* and innovation

Coordination failures: private-private



Coordination failures: public-private



Why so little innovation policy?

1. Ideological prejudices and the fear of “picking winners”

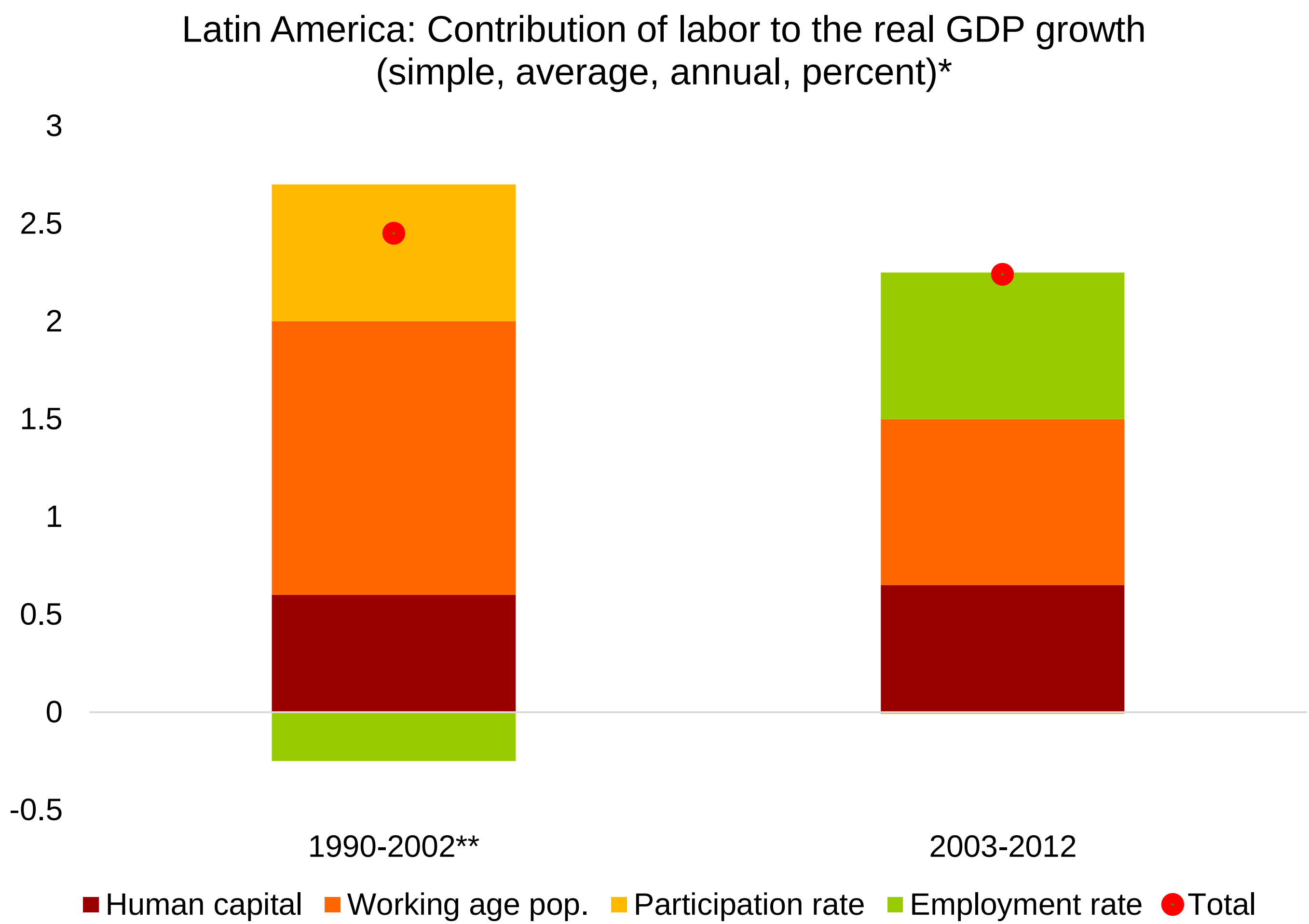
2. Tricky political economy
   - Lots of failures, few successes
   - Weaning failures from support

3. Testy relationship with private sector
   - Lobby versus cooperation
   - Weak state capacities

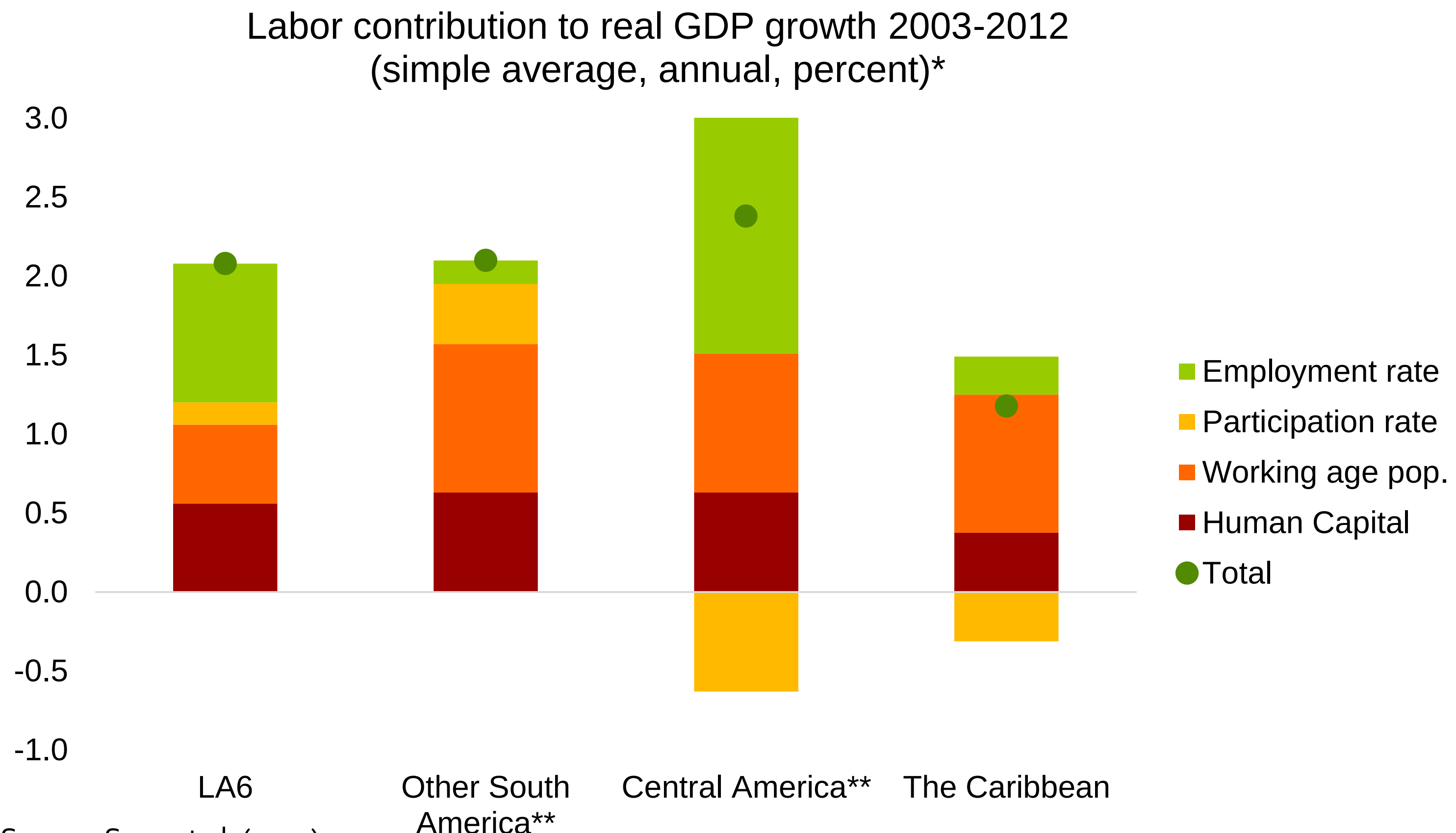
One more issue:

Can labor absorption make a contribution to future growth?

Employment just made a contribution to growth



…in most sub-regions



Source: Sosa et al. (2013)

*Simple average of countries in each group. LA6 includes Brazil, Chile, Colombia, Mexico, Peru and Uruguay. Other South American includes Bolivia, Ecuador, Paraguay and Venezuela. Central America includes Costa Rica, Dominican Republic, El Salvador, Honduras, Nicaragua and Panama. The Caribbean includes Barbados, Jamaica and Trinidad and Tobago.

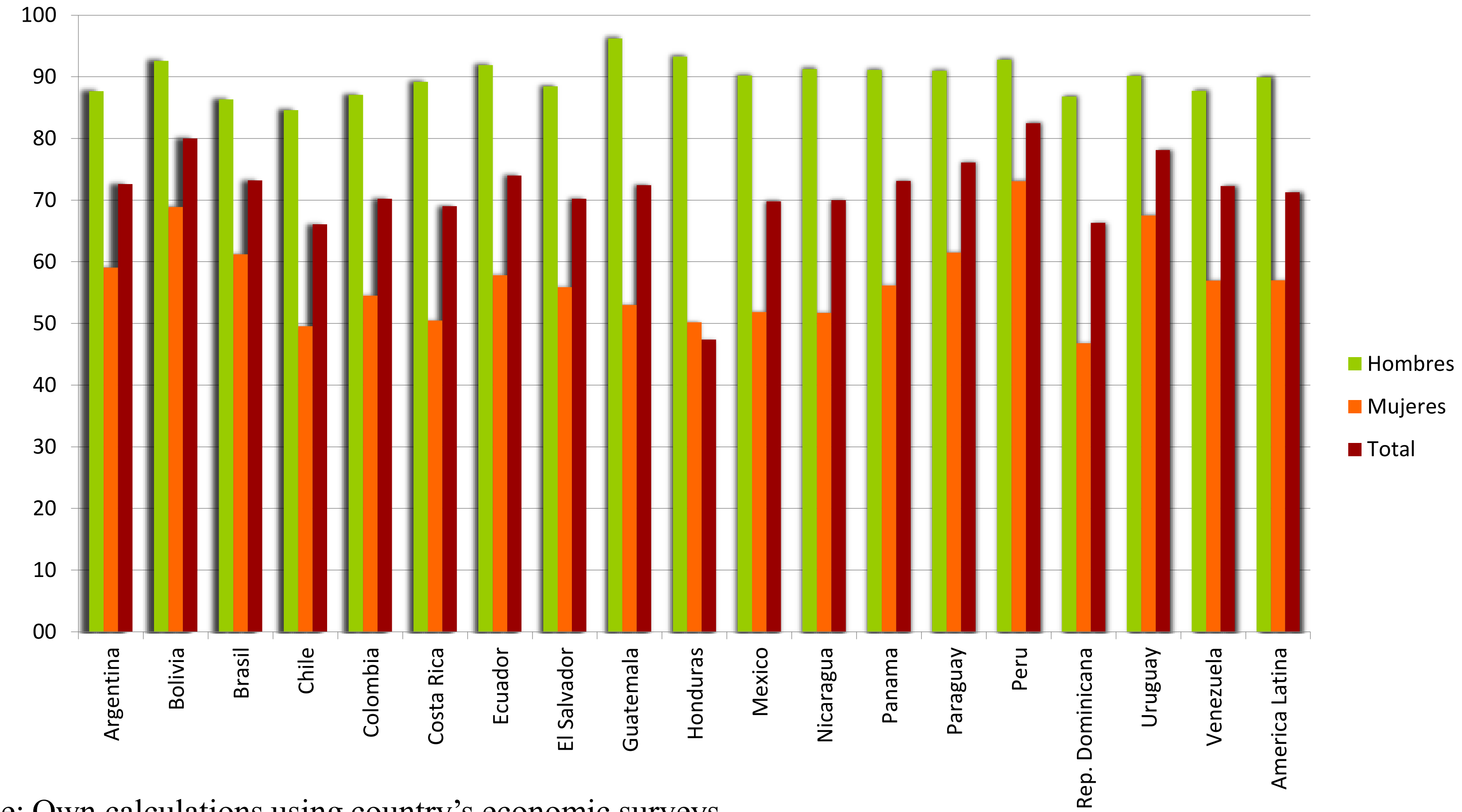
**Excludes Paraguay and Nicarague due to data limitations.

A few more questions

1. Can employment rates keep rising?
2. Can participation rates keep rising?
3. Standard view: pessimistic
   - Employment has risen a lot already
   - End of demographic dividend approaching
4. My view
   - Perhaps yes
   - See next

Employment rates are not that high

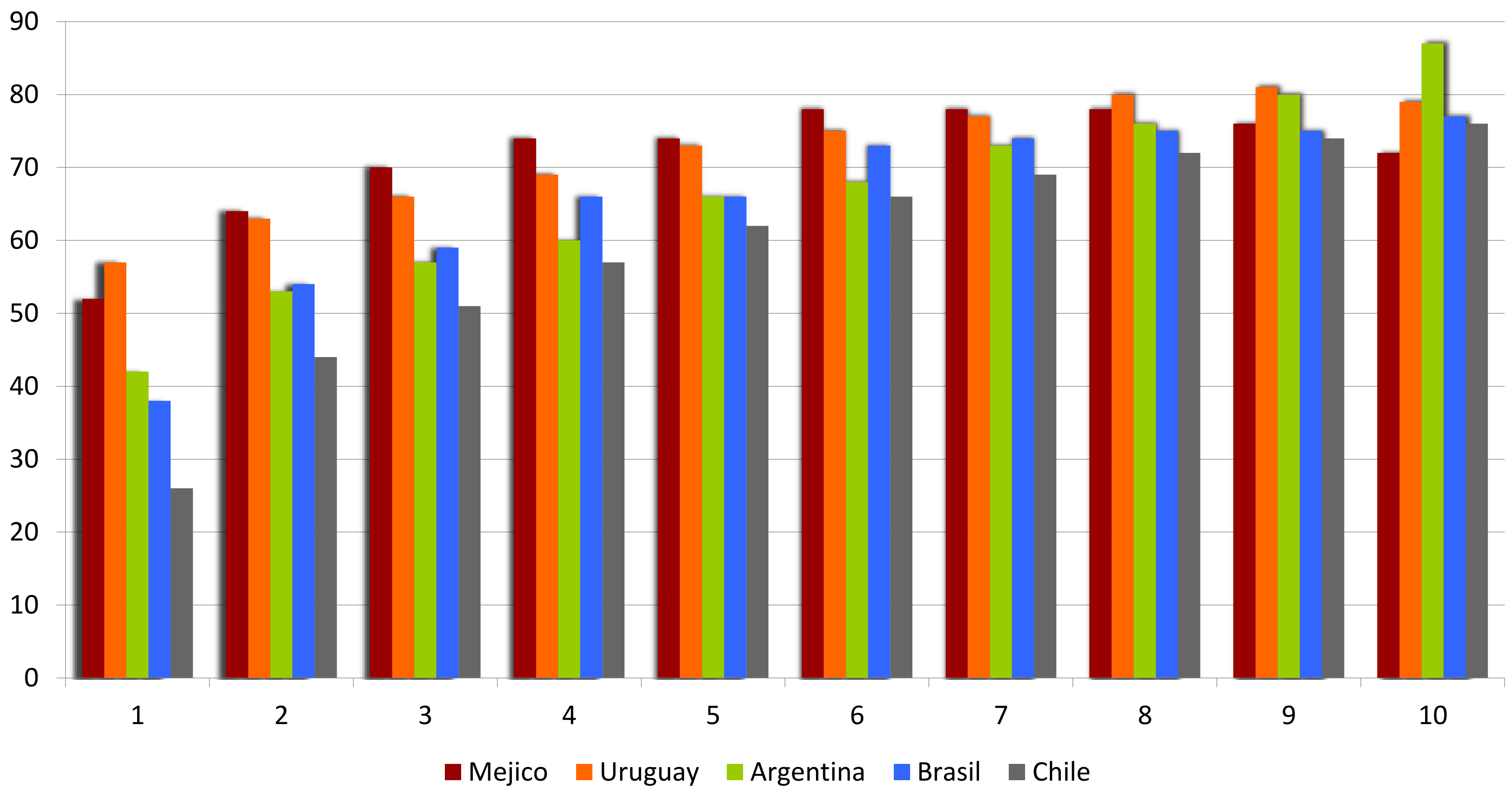
Tasa de empleo 25-64



Source: Own calculations using country's economic surveys

And they are very badly distributed

Employment rates by decile



Source: Own calculations using country's economic surveys

How to increase employment among the poor?

Problem is especially acute among women and the young

1. Change to labor contracts
   - Make part-time work easier
   - Review hiring and firing regimes
   - Eliminate incentives against formal employment
2. Don´t be shy about subsidizing formal work
   - First time entrants? Low-income women?
3. Revamp labor training schemes
   - Today focused on those already employed
   - Focus on the unemployed

Final Summary

- Main impact of current external changes will likely be on growth
- Need to close CA deficits will trigger that impact
- But changes in demand conditions will also reveal sustained supply side problems
- One such problem –at least in the Western Hemisphere– is lagging total factor productivity
- Once plausible cause of that problem is the persistence of market failures that prevent new products or new sectors from being developed
- There is also room for employment to keep making a contribution to growth
- But for that, labor and training rules have to change profoundly

END