Capital and Trade flows in Latin America and the Caribbean since the 2008 global crisis

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Structure of the presentation

- Dynamics of capital and trade flows since the 2008 global crisis
- Issues and Challenges for Latin America and the Caribbean
International financial flows to the region experienced a significant reduction as a consequence of the 2008 global crisis…

• Some of the factors that explained the behavior of financial flows since the 2008 global crisis never changed and others are back again:

  – deleveraging process of international investors, and financial institutions.

  – Changes in global risk aversion by investors increases volatility in financial flows
    • home bias and their demand for “safe” assets (“flight to quality”)
    • Appetite for regional assets.

  – Higher financial needs of the developed economies (fiscal deficits).

  – Higher uncertainty about future economic conditions of the global economy and of the region.
The reduction in capital flows to Latin America took place in both FDI and portfolio flows … Portfolio flows dropped in 2008 (net outflows) and recovered in 2009 and 2010.

Source: Division of Financing for Development on the basis of data from ECLAC
FDI dropped in 2009 and recovered in 2010…

Source: Division of Financing for Development on the basis of data from ECLAC
In 2010 FDI and Portfolio flows each stood at around the same level: 2.3% of GDP...

Capital flows to Latin American countries
(percent of GDP)

FDI and portfolio flows together add up to 4.6% of GDP

Source: Division of Financing for Development on the basis of data from ECLAC
In 2011 capital inflows to Latin America have shown resilience…

• Global appetite for regional assets has remained relatively robust despite renewed concerns over the global economy and heightened risk aversion.

• The Institute of International Finance (IIF) estimates that net private capital inflows to the region in 2011 remained broadly unchanged from 2010 levels.
BUT… the recent deterioration in the outlook in developed economies (particularly Europe) will impact capital flows to LAC through multiple channels…

Factors that may slow down flows into emerging markets

• A spike in global risk aversion increases investors’ home bias and their demand for “safe” assets.

• This has a direct and sharp negative impact on capital flows to emerging economies.

  √ “flight to quality” leads to precipitated withdrawals of equity and bond inflows from emerging markets.
BUT… the recent deterioration in developed economies (particularly Europe) will impact capital flows into LAC through multiple channels…

Factors that may increase flows into emerging markets

• Wider interest rate differentials in favor of emerging markets
  ➢ weaker-than-expected growth outlook in the mature economies will likely imply delays in monetary tightening cycle and/or reversal in policy hikes already implemented

• Likelihood that the recent trends toward risk rating upgrades in emerging economies and rating downgrades in developed economies will continue (according to IIF)
  ➢ underlying fundamentals of the variables driving sovereign ratings are liable to deteriorate more quickly in mature economies than in emerging economies

On balance, for 2012 capital flows into LAC probably smaller than in 2011 but how much smaller? Hard to
Remittances to the region had started declining before the crisis and intensified the fall…they have not still recovered… In 2010 they stood at 1.2% of GDP

Remittances received in Latin America and the Caribbean (in percent of GDP)

Source: Division of Financing for Development on the basis of data from WDI World Bank.
Official Development Assistance (ODA) flows to the region did not decline as a result of the crisis and in 2009 they stood at 0.24% of GNI. However when looking at the bigger picture ODA is far lower than in the 90’s.

Source: Division of Financing for Development on the basis of data from OECD
Also, as a share of total ODA to developing countries, the region’s share is now lower than in the 90’s.

Source: Division of Financing for Development on the basis of data from OECD
Trade flows in the region also collapsed in 2009 as a result of the crisis...and later recovered vigorously...

**Latin America and the Caribbean: Evolution of trade flows, 2009-2011**

*(yearly growth rates in percentage)*

Source: Based on Panorama de la Inserción Internacional de América Latina y el Caribe
In many cases (notably in Andean countries that are commodity exporters) export price growth explains a large part of the dynamics in export value…

**Latin America and the Caribbean: Breakdown of the growth in export value, 2011**

*(growth rates decomposition in percentage)*

Source: Based on Panorama de la Inserción Internacional de América Latina y el Caribe
Issues and Challenges for Latin America and the Caribbean

- Global uncertainty has increased over the last months and this has increased downside risks:
  - In the case of LAC, *Consensus Forecasts* for growth in 2011 were lowered by 0.3 percentage points between the July and November reports (from 4.5% to 4.2%).
  - In turn, the forecasts for 2012 growth were lowered by 0.5 percentage points from 4.2% to 3.7%.
  - Expectations are still adjusting and forecasts may be further reviewed

- Inflation is less of an issue: pressures in the region have somewhat receded and inflation forecasts were also lowered (by around 1 percentage point from the July to the November Consensus Forecast report)

- Real appreciation pressures are still a problem

- Volatility has increased and has become generalized...
Volatility of the real exchange rate increases during periods of increased global uncertainty…

Volatility of the Real Exchange Rate in Latin America and the Caribbean
GARCH(1,1) variance series of RER monthly variation

Source: Division of Financing for Development on the basis of data from ECLAC
Volatility of total private capital flows has increased...mainly due to an increase in volatility of private portfolio flows...

Volatility of Capital Flows in Latin America and the Caribbean
(10 years rolling Standard Deviation of Capital Flows)

Source: Division of Financing for Development on the basis of data from WEO
Volatility of Terms of Trade has increased…

Volatility of Terms of Trade of Latin America and the Caribbean
10 year rolling standard deviation of ToT

Source: Division of Financing for Development on the basis of data from WEO
The increase in nominal volatility is not innocuous…
It translates into real volatility…

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Summing Up…

- As a result of the 2008 global crisis the region experienced a decline in capital flows (FDI and Portfolio).
- These flows recovered later (portfolio flows increased in 2009 and 2010 while FDI increased in 2010)
  - In 2011 capital flows have shown resilience and for 2012 it is probable that they will be positive and lower than 2011 but subject to conditions not changing too drastically from current ones.
- Remittances have been decreasing as a share of the region’s GDP since 2005 and in 2010 stood at 2.2% of GDP.
- ODA flows as a percent of the region’s GDP have been exhibiting a declining trend in the last decades and they now stand at 0.22%, almost 0.3 percentage points lower than in 1990.
Summing Up (cont.)

• Trade flows fell substantially in 2009 (exports fell by 22.6% and imports by 25%) as a result of the global crisis and then recovered vigorously in 2010 and 2011.
  ➢ The future performance of trade for the region will be determined by what is the final outcome for the situation of developed economies and also on the level of external demand for commodities by China.

• Global uncertainty has increased over the last months and this has increased downside risks: growth prospects all around are being revised downwards (including in LAC)…

• Inflation is less of an issue but appreciation pressures are still a problem in some cases

• Volatility has increased and has become generalized…\textsuperscript{22}