



THE WORLD BANK

International Flows to Latin America

Rocking the Boat?

Ambassadors' Luncheon
April 8, 2014
Washington, DC

Chief Economist Office
Latin America and the Caribbean Region
The World Bank

Structure of the Presentation

- The ongoing re-configuration of global risks and the short-term economic outlook for LAC
- Financing LAC's external deficits: the role of FDI and remittances
- Policy messages

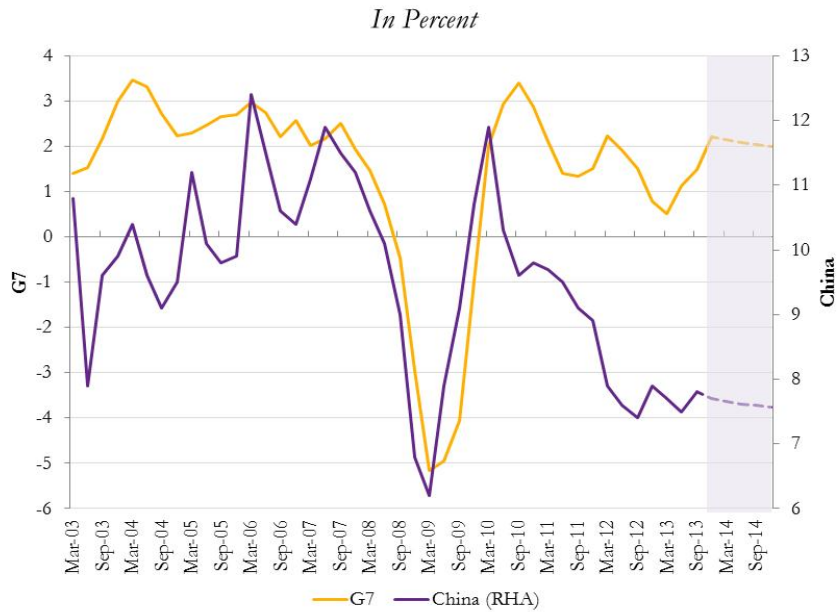


The ongoing re-configuration of global risks and the short-term economic outlook for LAC

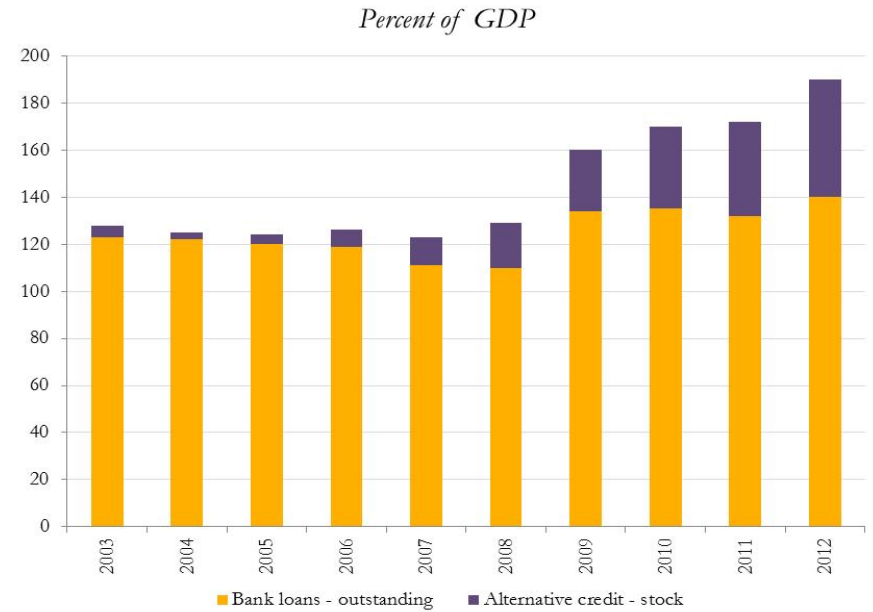


While QE tapering anxiety is part of the story, there is rising concern over China...

G7 and China GDP Growth



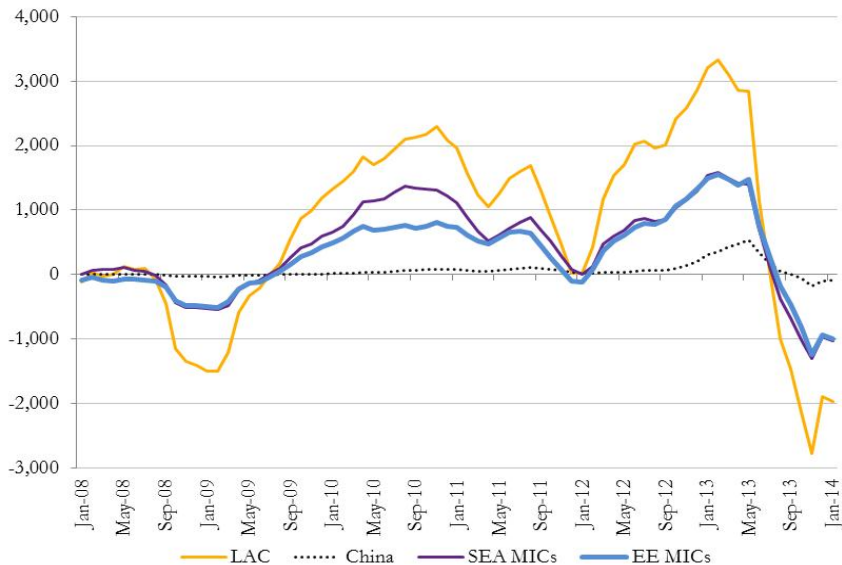
Rapid Credit Growth in China



...leading to a more complex interpretation of “pull” and “push” factors driving capital flows away from EMs ...

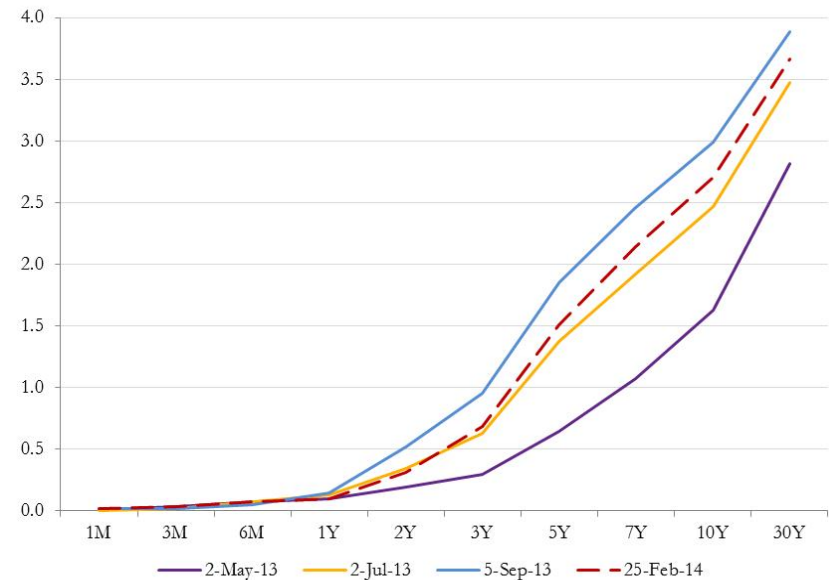
Bond Flows to Emerging Regions

Millions of USD - Six Months Moving Average



U.S. Yield Curve

In Percent



- LAC being hit particularly hard in bond flows

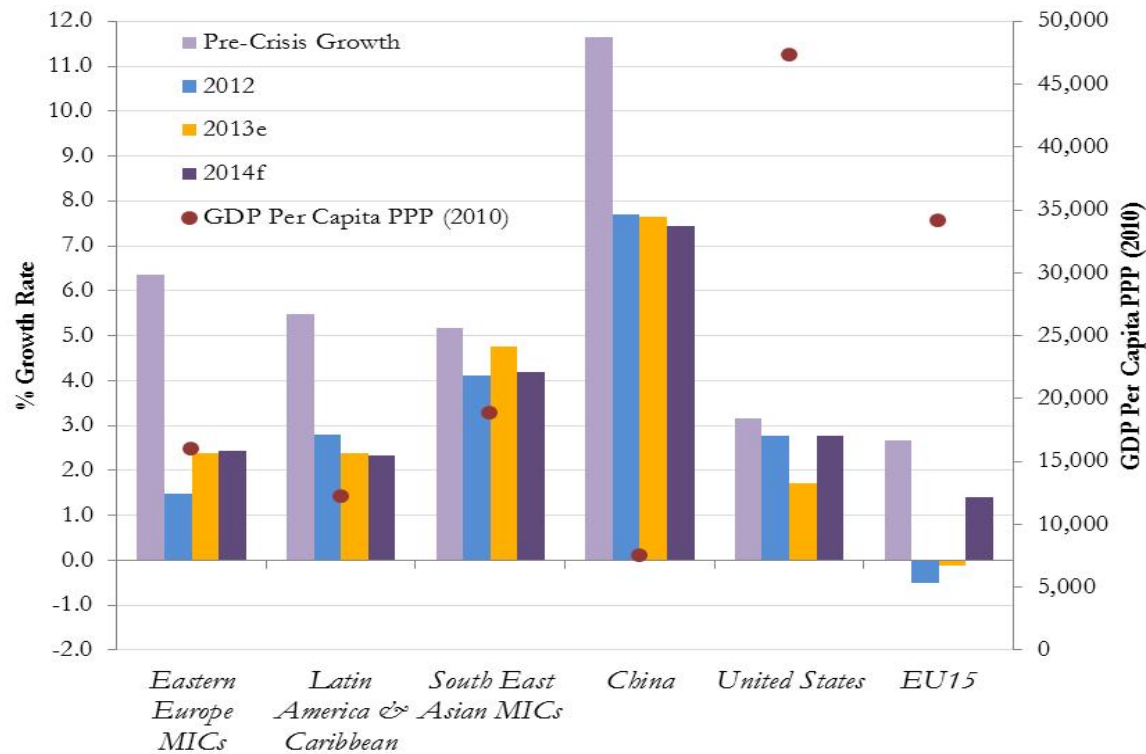
- Push factors may help explain the flattening of the US yield curve



...all of which is taking a toll on MIC growth – a “great deceleration” of 3-4 percentage points

Real GDP Growth Rates, Forecasts, and Per Capita Income

Annual Real GDP Percentage Change, Weighted Average



Is LAC entering a low growth phase? Stuck below 2.5%?

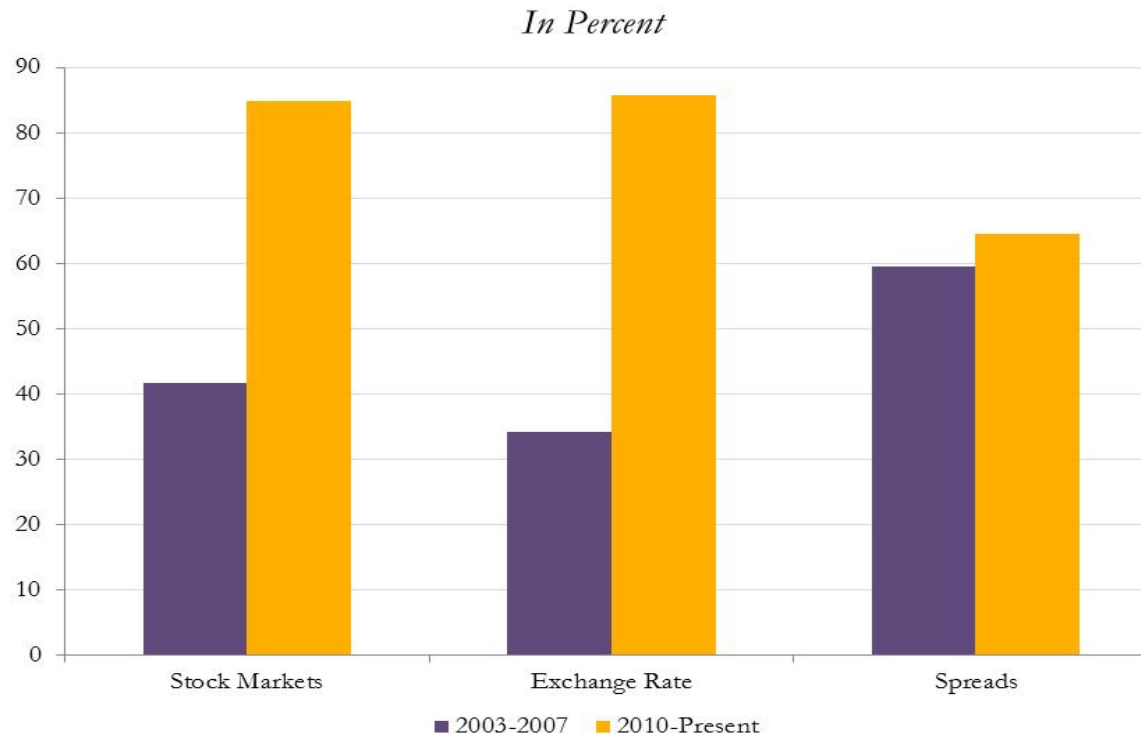
Real GDP Growth Rates and Forecasts for LAC Countries

Annual Real GDP Percentage Change



Global factors—beyond the control of domestic policy—are rising in importance for LAC...

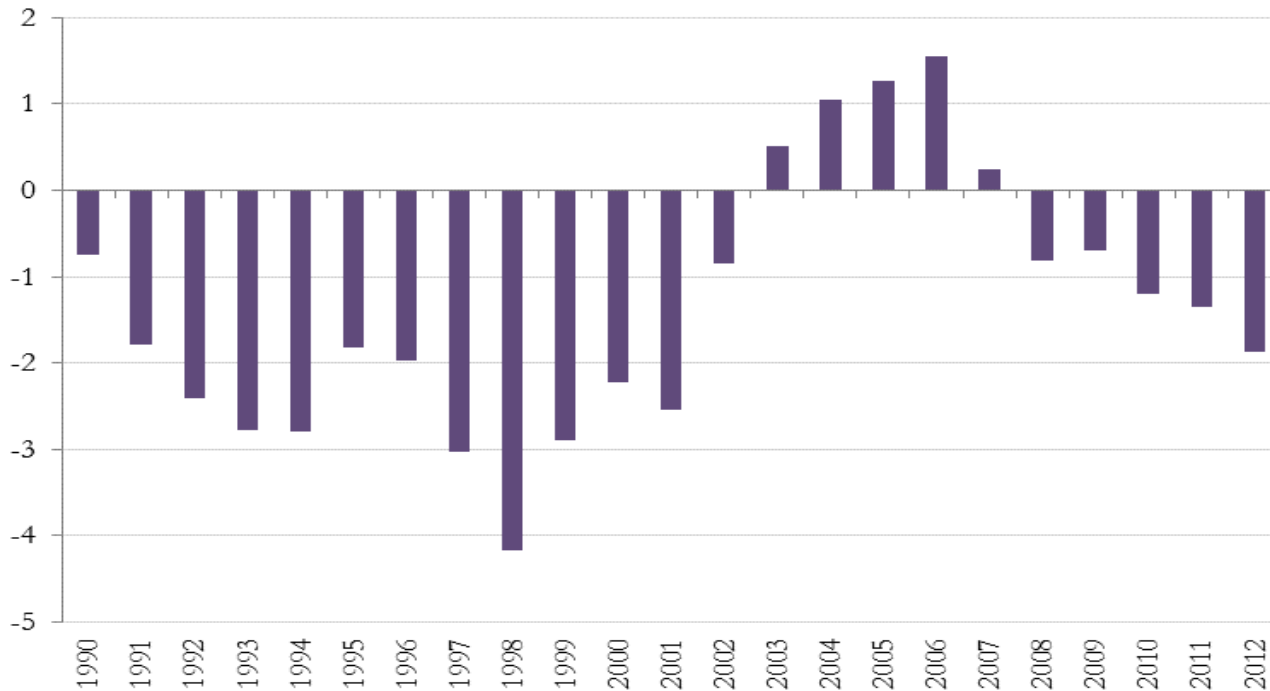
Contribution of Global Factors in LAC Asset Price Changes



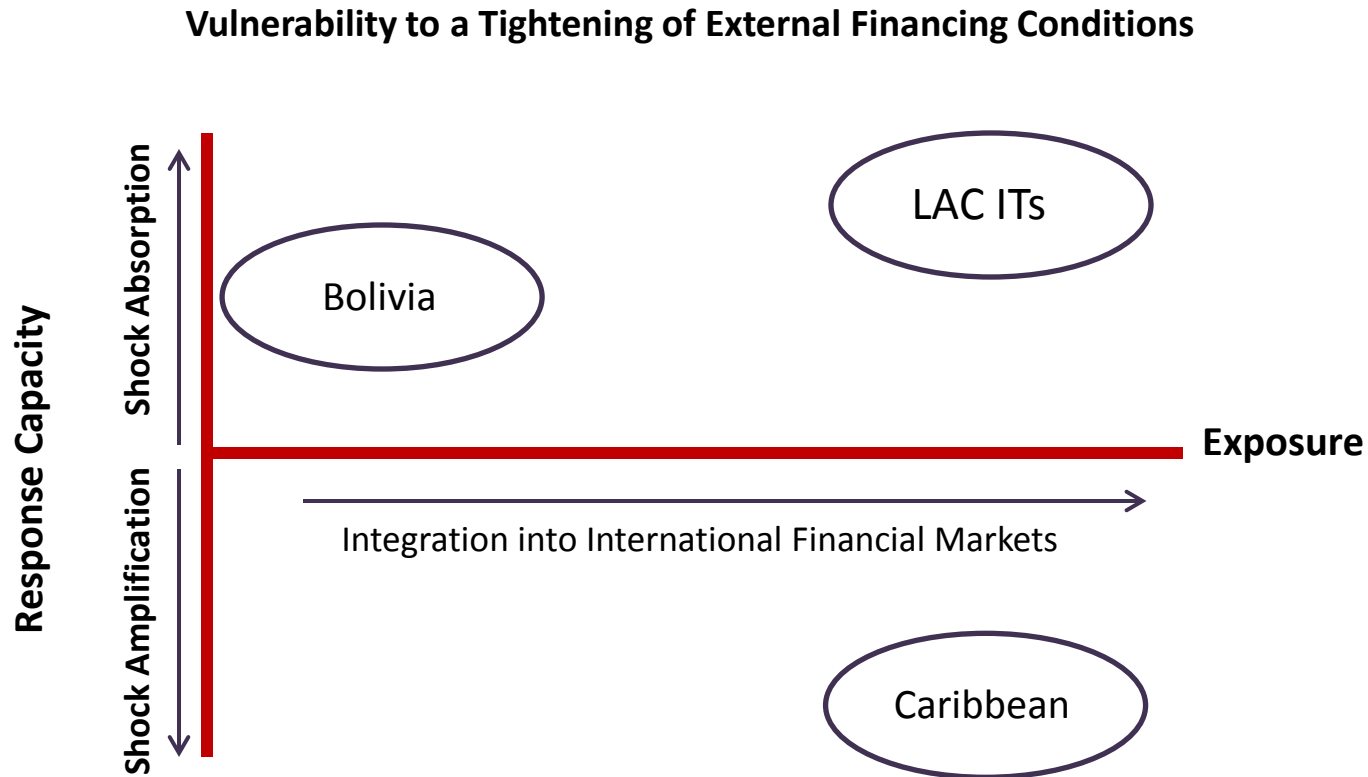
... which, coupled with low saving, leave LAC exposed to external financing and commodity price shocks

LAC: Current Account Balance

Percent of GDP



But exposure is not the same as vulnerability – a country's policy response capacity mediates between the two



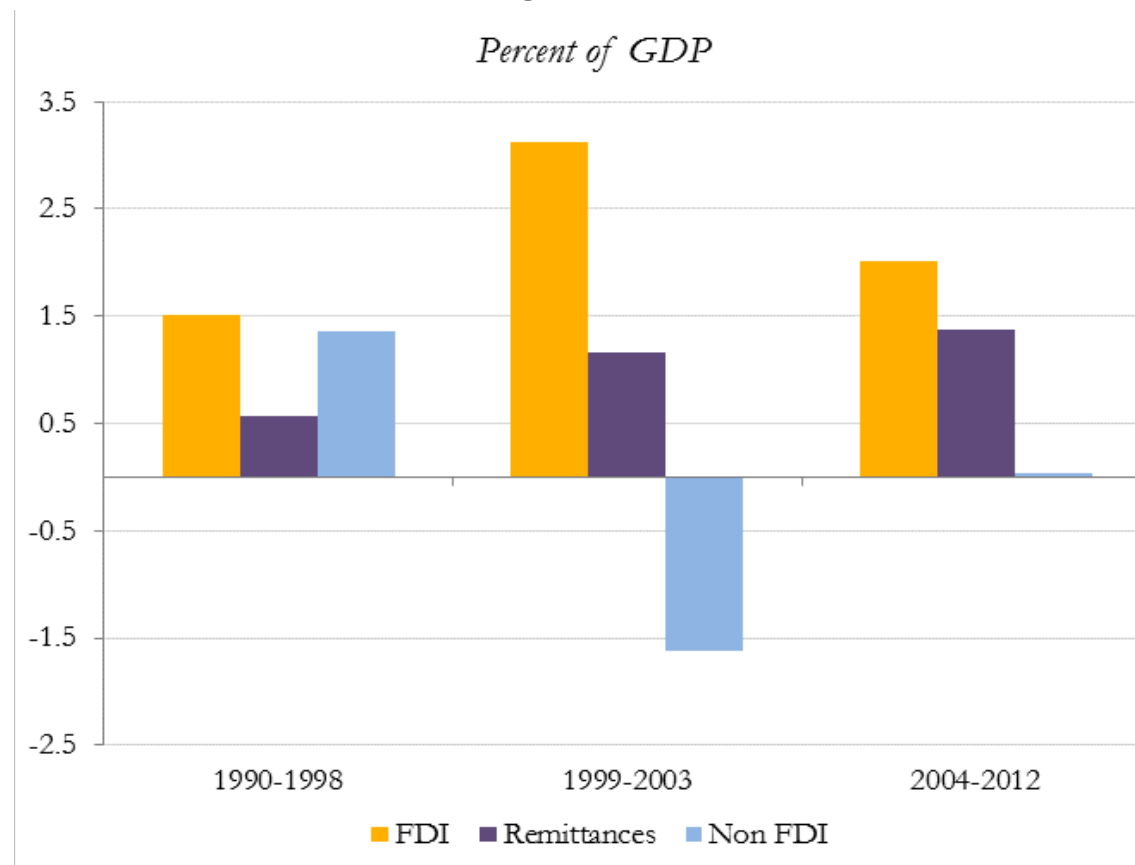
- Unfortunately, some of LAC's buffers, especially fiscal, are weaker across the region today than in September 2008

Financing LAC's external deficits: *The role of FDI and remittances*



In a structural break with history LAC changed its sources of financing towards FDI and remittances...

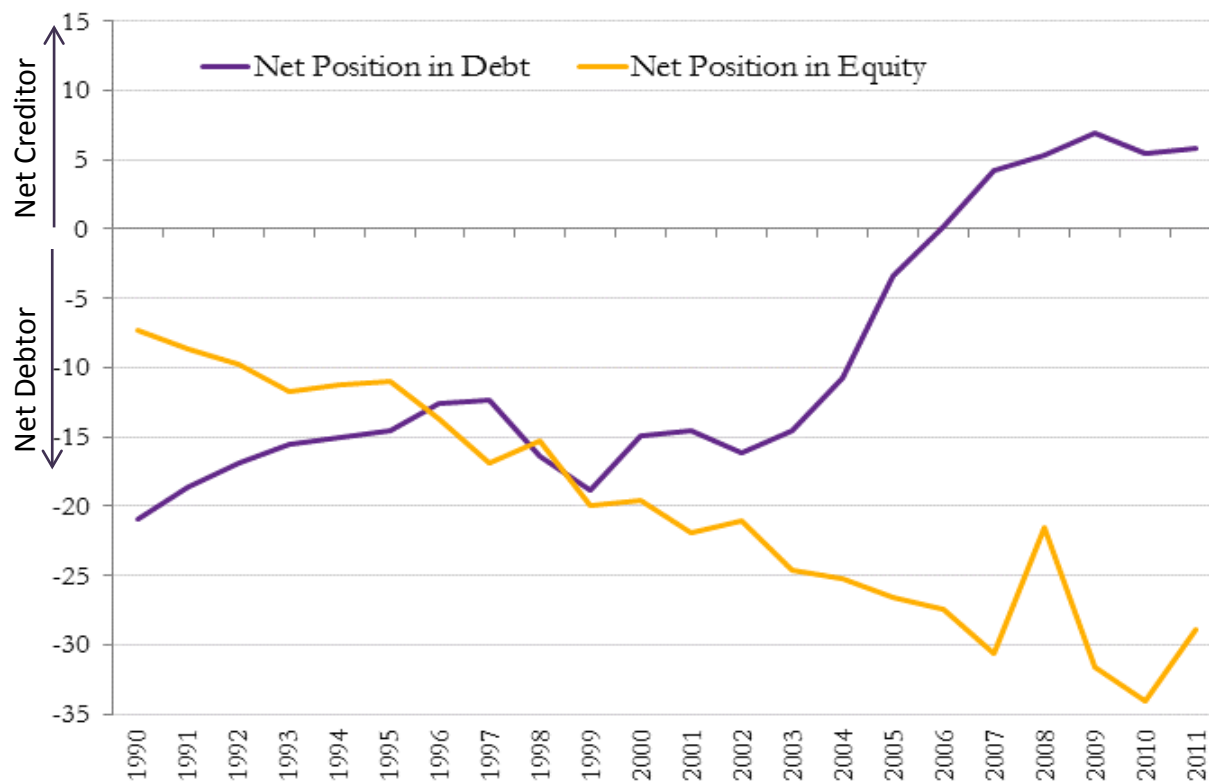
Sources of Financing of LAC's External Deficits



... which is part of a transformation of LAC's asset-liability position vis-à-vis the rest of the world

LAC's Net Foreign Asset Position in Debt and Equity

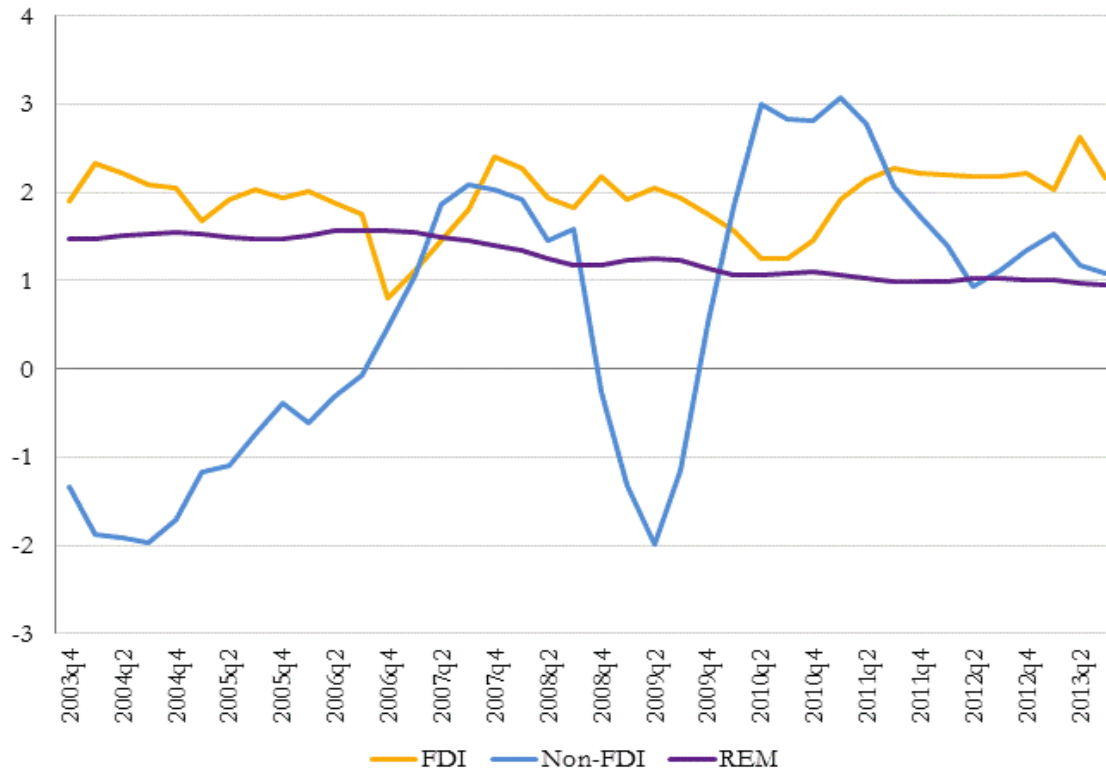
Percent of GDP



By reducing rollover, currency, and interest rate risks, this shift provides more stable financing...

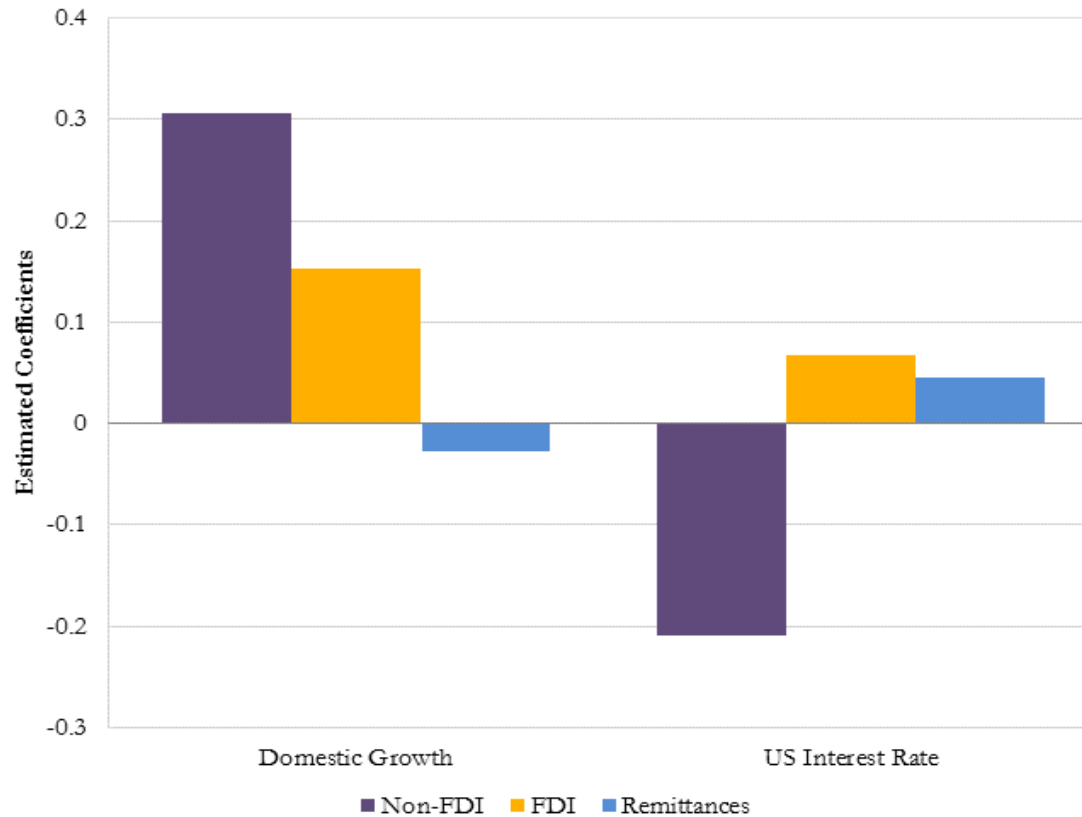
LAC: Capital Flows and Remittances

Net Flows, 1-yr Moving Average



FDI is less pro-cyclical than non-FDI; remittances counter-cyclical, and both increase with US interest rates

Sensitivity to Growth and U.S. Interest Rates
of International Flows to LAC



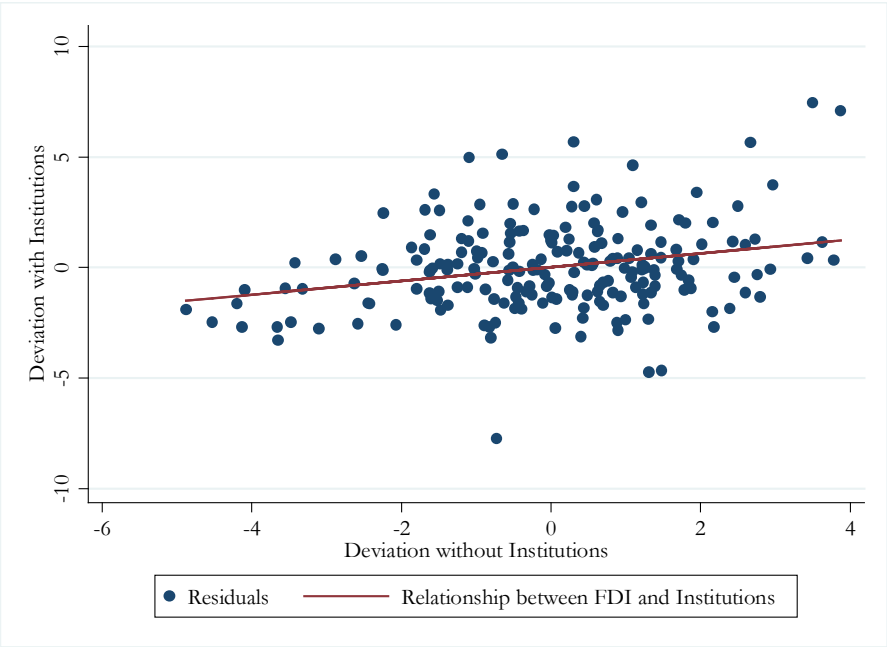
However these flows are not without challenges

- Both flows widen the external deficit
 - FDI through imports of intermediate and capital goods, and net factor payments
 - Remittances through imports of consumption goods
- Both flows reduce external competitiveness (exchange rate appreciation)
- FDI has built-in capacity to raise productivity...
 - New technologies, Learning spillovers
- ... However, the link between FDI and productivity growth is not automatic – in the Caribbean large FDI inflows puzzlingly coexist with low growth
- Remittances protect households from poverty but tend to lack productivity-enhancing features

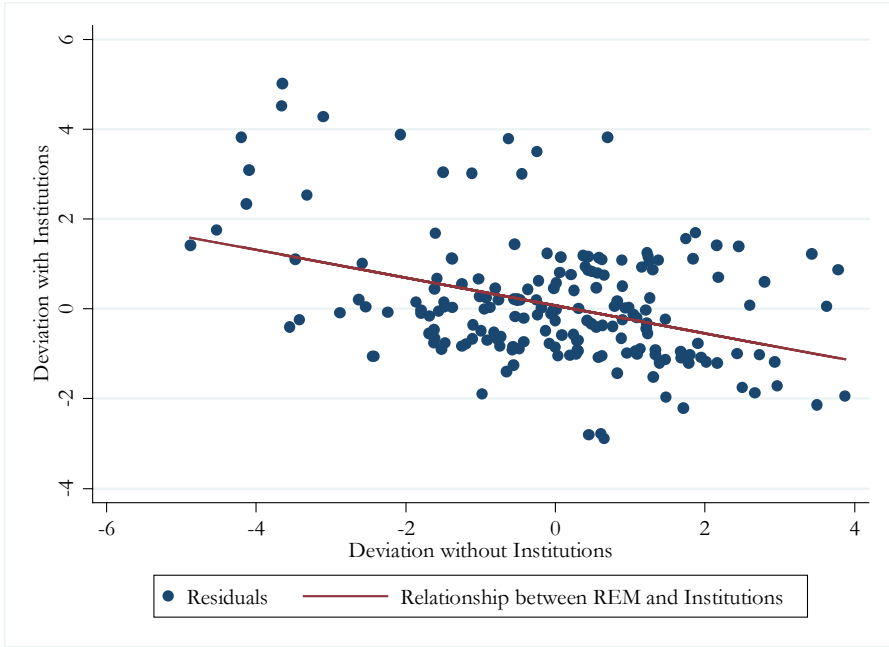


The quality of institutions drives both FDI and remittances, yet in opposite directions ...

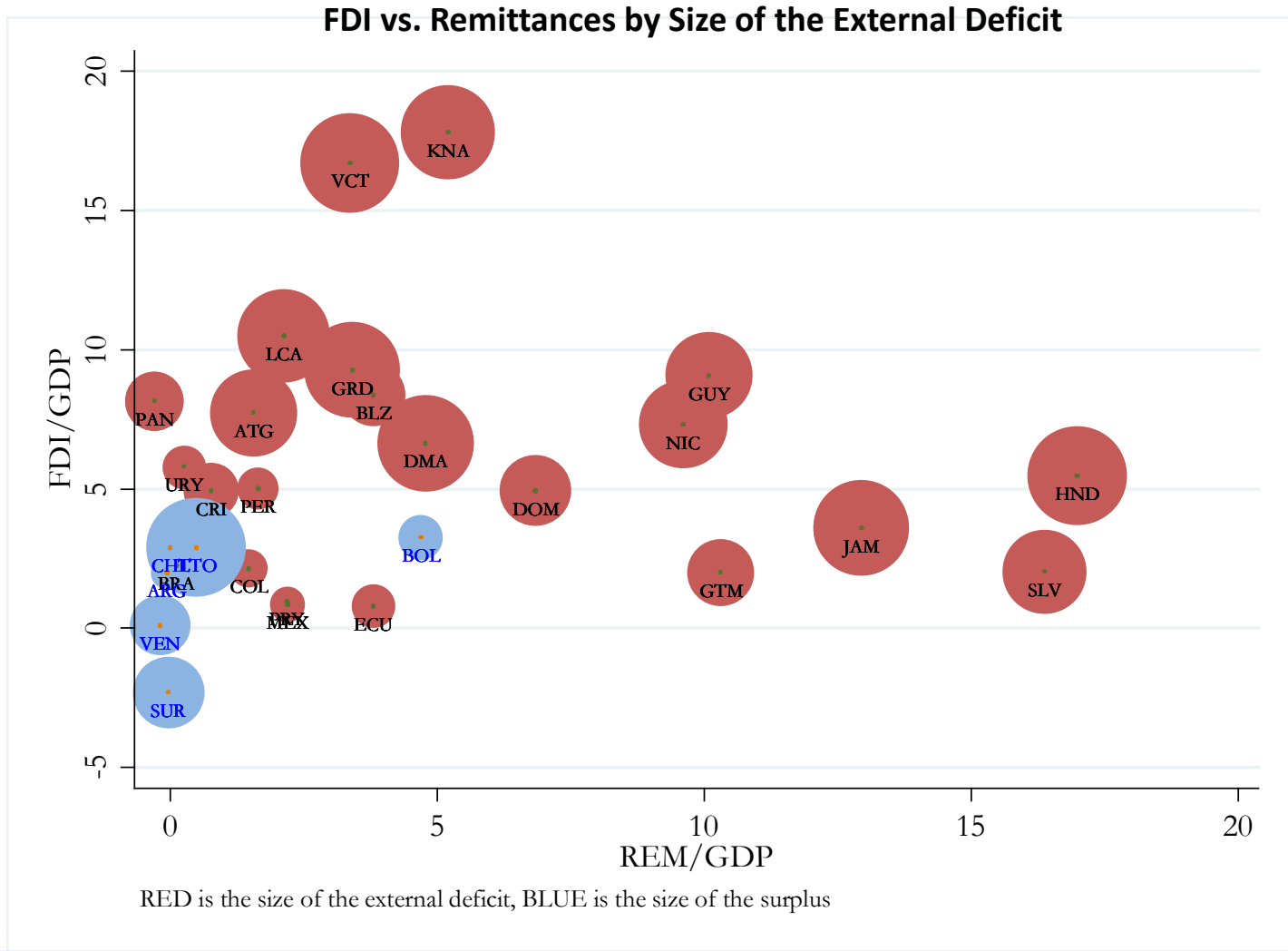
FDI Inflows and Quality of Institutions



Remittances and Quality of Institutions



In some sense, thus, FDI and remittances are substitutes!



Policy messages



Policy messages

- Exposure per se is not a bad thing!
 - It should increase as LAC becomes more integrated
 - The problem not with *Exposure* but with *Vulnerability*
- Now the premium on sound macroeconomic immune systems is higher
 - Being able to absorb shocks and act counter-cyclically is the name of the game
 - There is great heterogeneity in the quality of macro-immune systems in LAC
- Cyclically, the composition of external financing favors the region...
 - A move towards more stable and less pro-cyclical flows
- ... but over the trend it raises major challenges
 - Reliance on remittances is a symptom of a poor enabling environment
 - The region has to learn to maximize FDI-related productivity gains, not least to offset the adverse growth effects of its domestic saving gap
 - For remittance-intensive countries the challenge is much tougher: to attract its own workers and FDI, and then ensure the efficient interaction of the two

