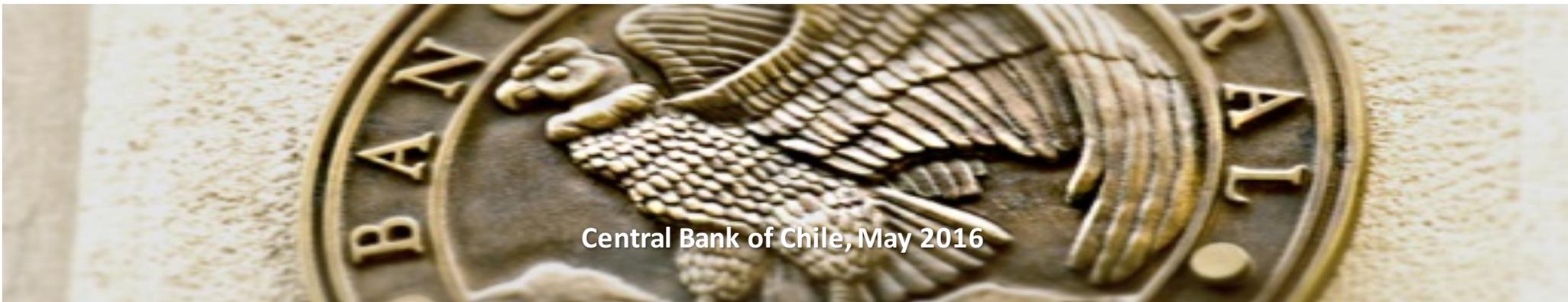




Latin America: Facing the risks in the external scenario

Rodrigo Vergara
Governor



Central Bank of Chile, May 2016

Introduction

Latin America is facing a more challenging external environment.

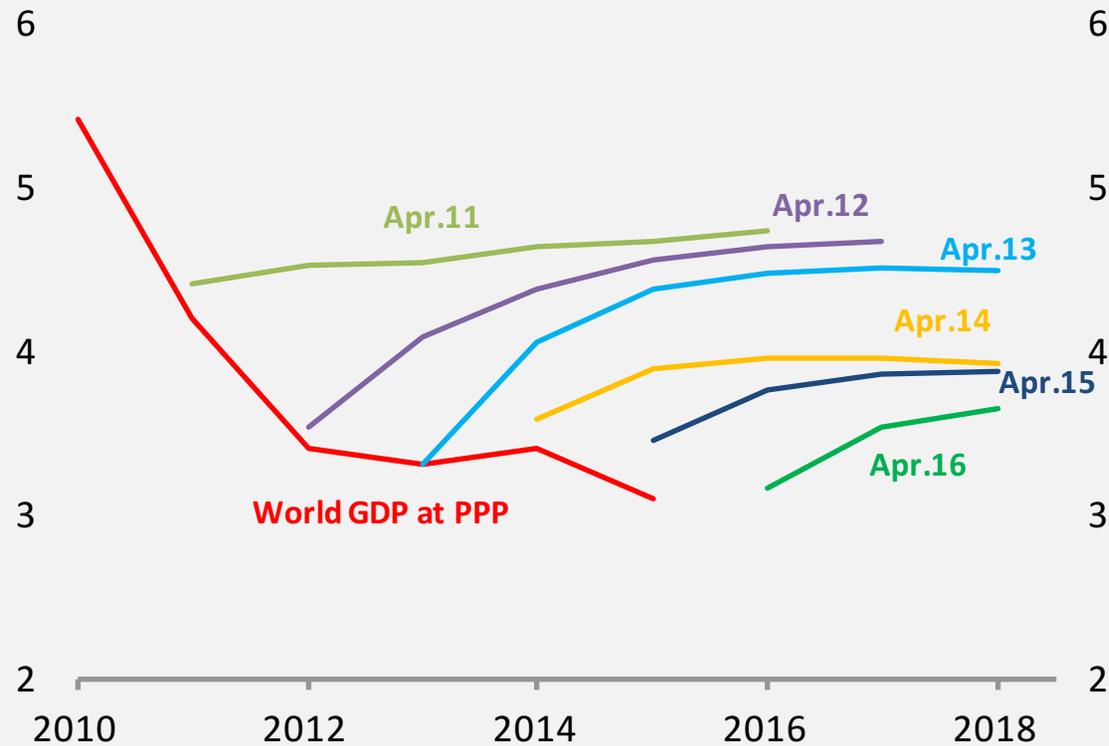
Global demand has weakened, commodity prices have fallen and international financial conditions are no longer as favorable as they were in recent years.

In many cases, this couples with complex situations at home.

However, in the past few decades the region has made progress in improving its policy frameworks. This puts it on a better stand to deal with the challenges ahead, compared with earlier episodes.

World growth is going through a steeper- and longer-than-expected slowdown cycle.

Actual and projected world growth (*)
(annual change, percent)

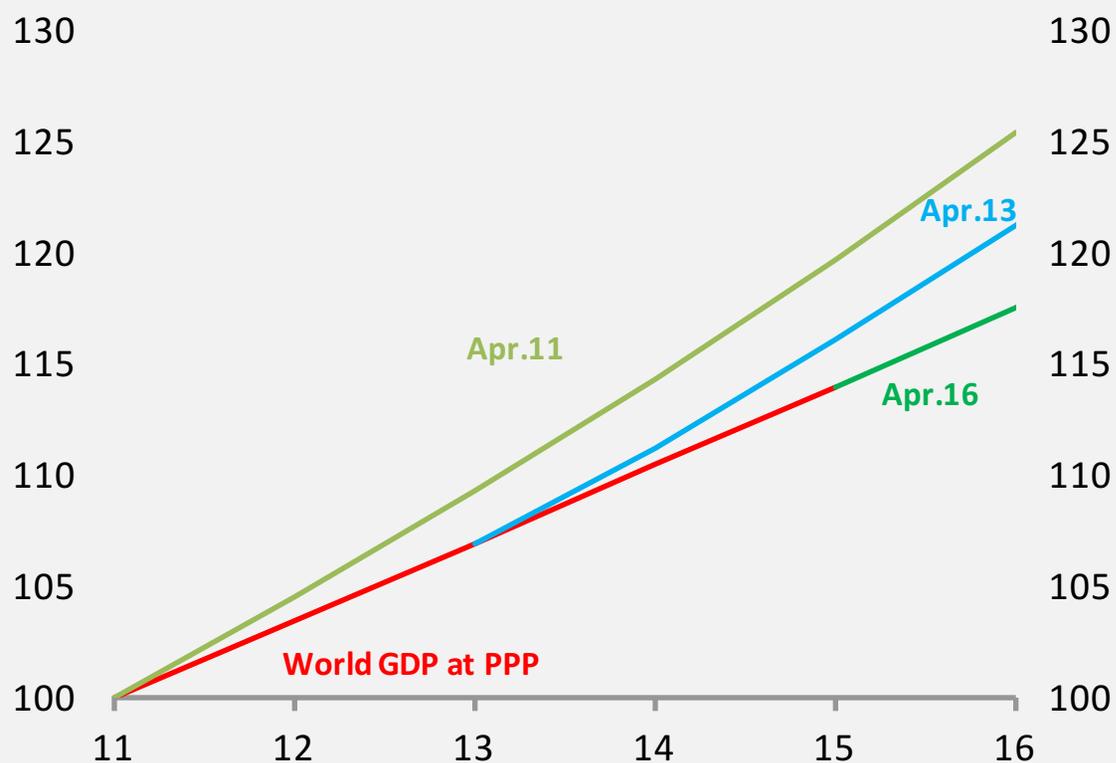


(*) Projections included in the IMF's WEO.
Source: World Economic Outlook, IMF.



Therefore, accumulated world growth differs significantly from initial projections.

Projections for the level of world GDP at PPP(*) (index, 2011=100)

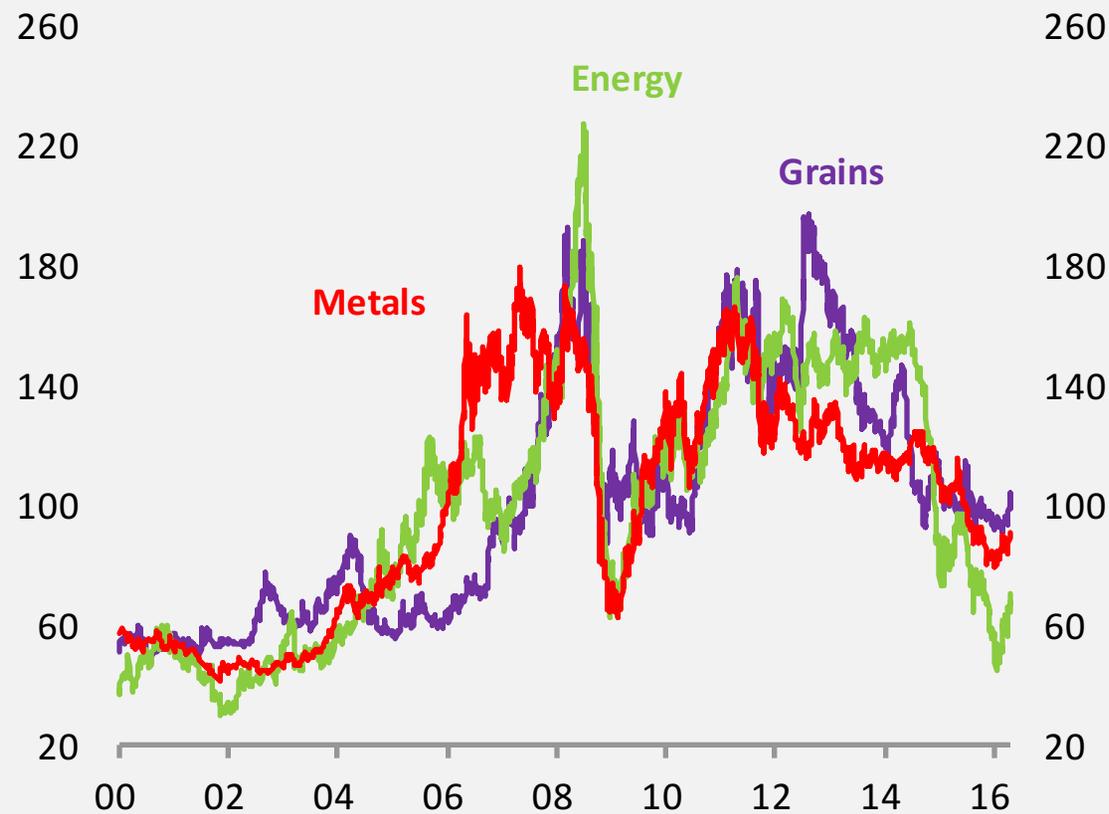


(*) Projections included in the IMF's WEO of respective months.
Source: World Economic Outlook, IMF.



Lately, the lower world growth and especially China's slowdown have resulted in substantial drops in commodity prices.

Commodity prices (*)
(index, 2000-2016=100)



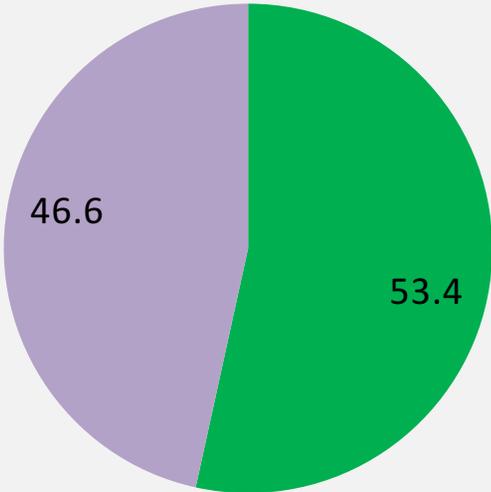
(*) Goldman Sachs aggregate index.
Source: Bloomberg.



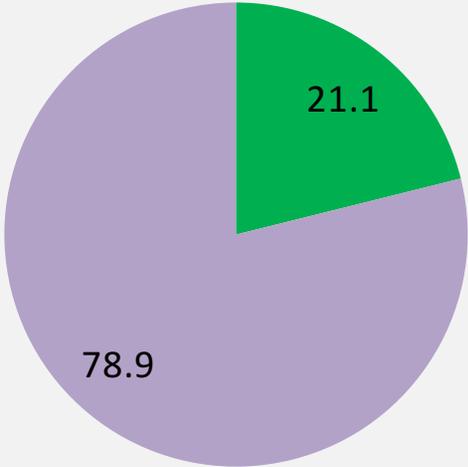
Commodities account for a large share of the region's exports.

Exports structure(*)
(percentage of total)

Latin America



Asia



— Commodities

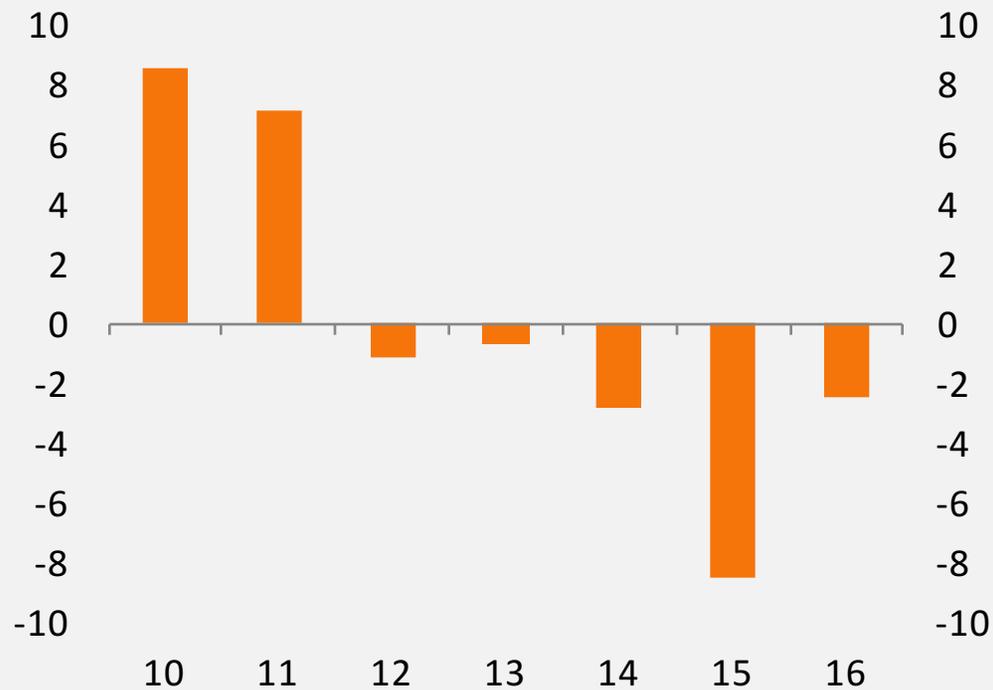
— Other

(*) Considers emerging economies in each region.
Source: United Nations Conference on Trade and Development



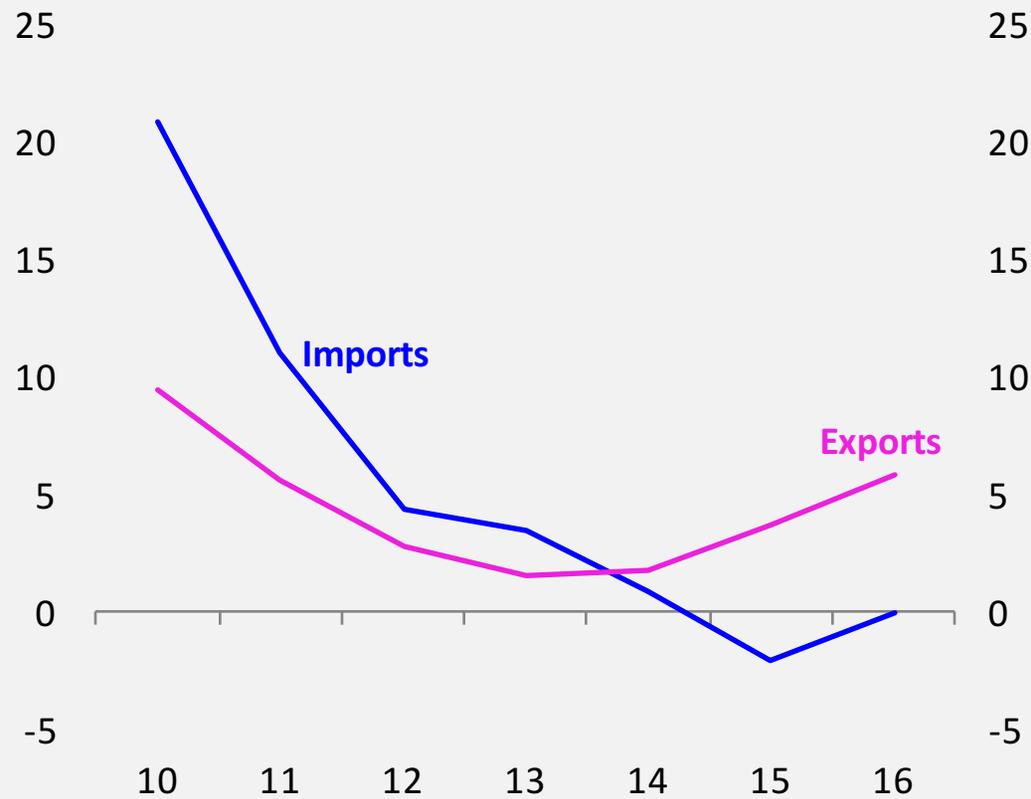
Accordingly, the region's terms of trade have fallen significantly...

Terms of trade in Latin America
(annual change, percent)



...and trade flows have decelerated.

Foreign trade in Latin America (*)
(annual change, percent)

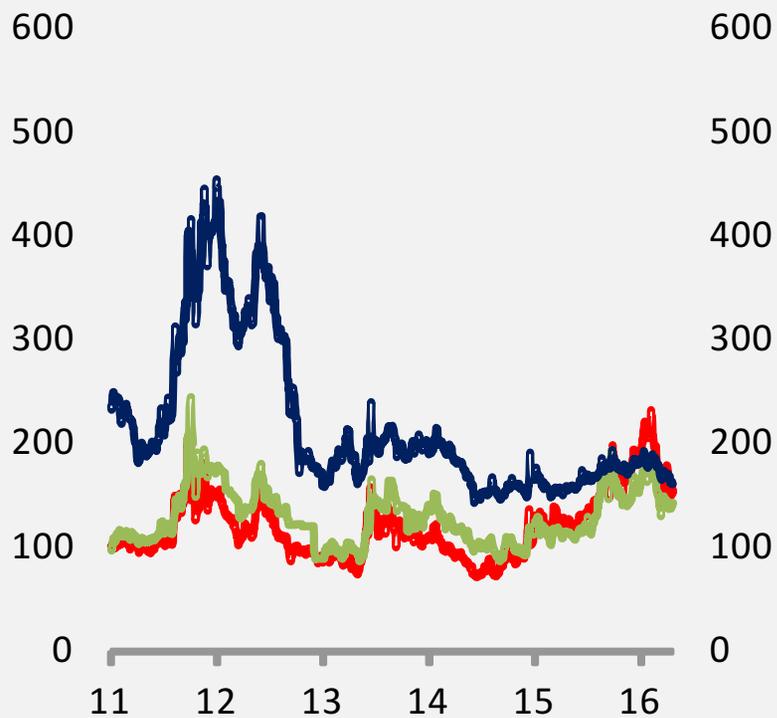


(*) Volume imports and exports of goods and services.
Source: World Economic Outlook, IMF.



Financial conditions have worsened. Volatility has increased due to perceived higher risks associated to, among other factors, the Chinese economy and the Fed's decisions, but also due to idiosyncratic issues within the region.

Sovereign risk premiums(*)
(basis points)



Stock exchanges in dollars
(basis points)



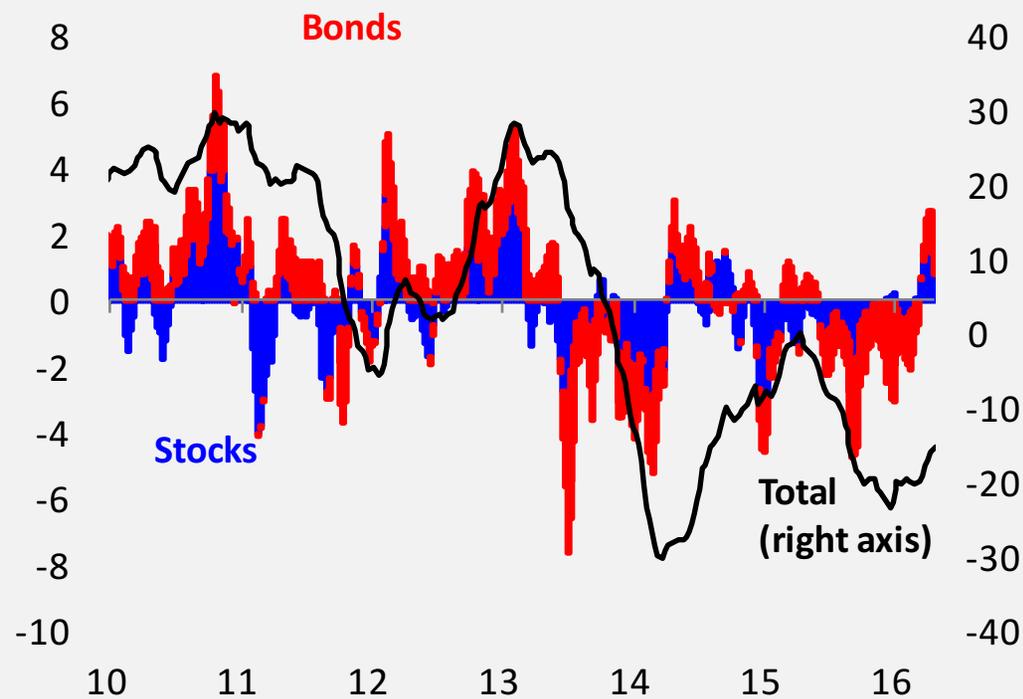
— Latin America — Emerging Asia — Emerging Europe — Developed markets

(*) Risk premiums measured using 5-yr CDS.
Source: Bloomberg.



This situation has translated into important movements in the region's capital inflows

Capital inflows to Latin America (*) (billions of dollars)

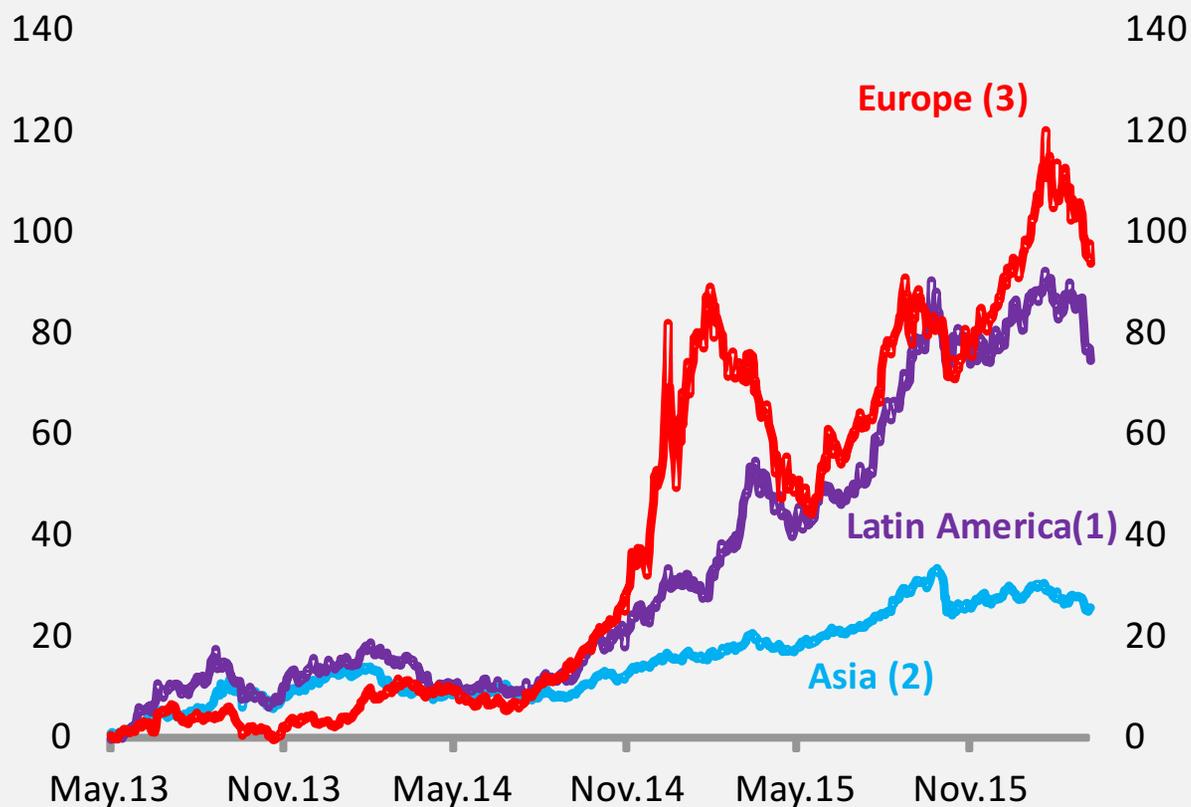


(*) Moving month for stocks and bonds. The Total considers the accumulated moving year.
Source: Emerging Portfolio Fund Research.



Meanwhile, the region's currencies have depreciated significantly.

Nominal exchange rate
(accumulated change since trough of May 2013)

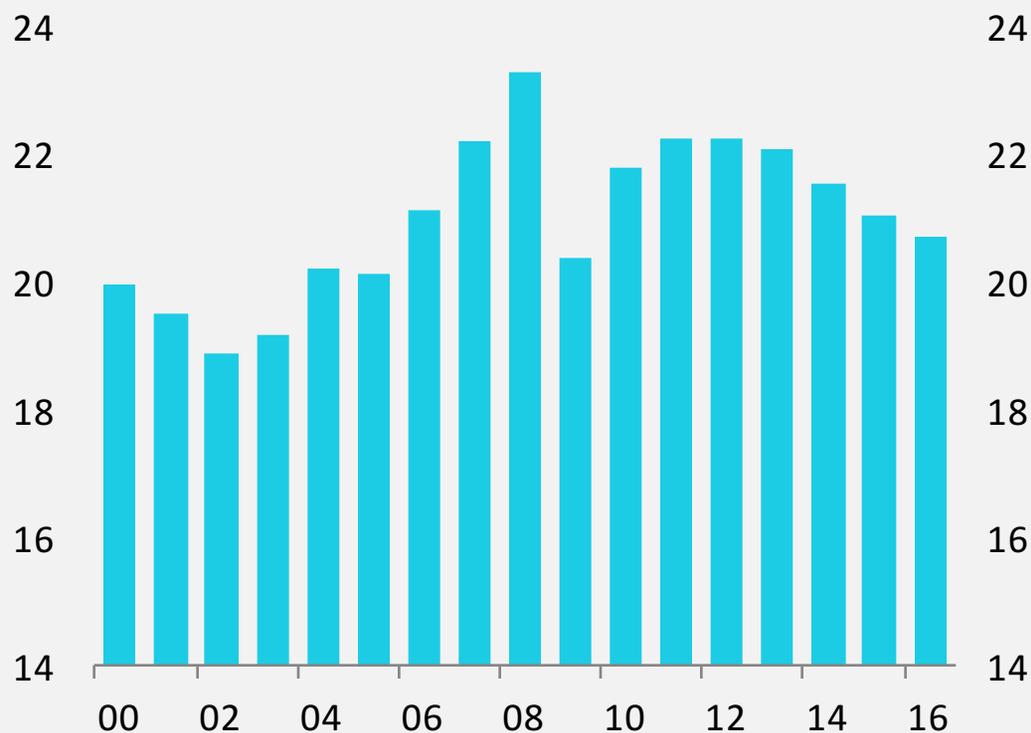


(1) Includes: Brazil, Chile, Colombia and Peru. (2) Korean Rep., Indonesia, Malaysia and Thailand. (3) Czech Rep., Hungary, Poland and Russia. Sources: Bloomberg and IMF's WEO, October 2015.



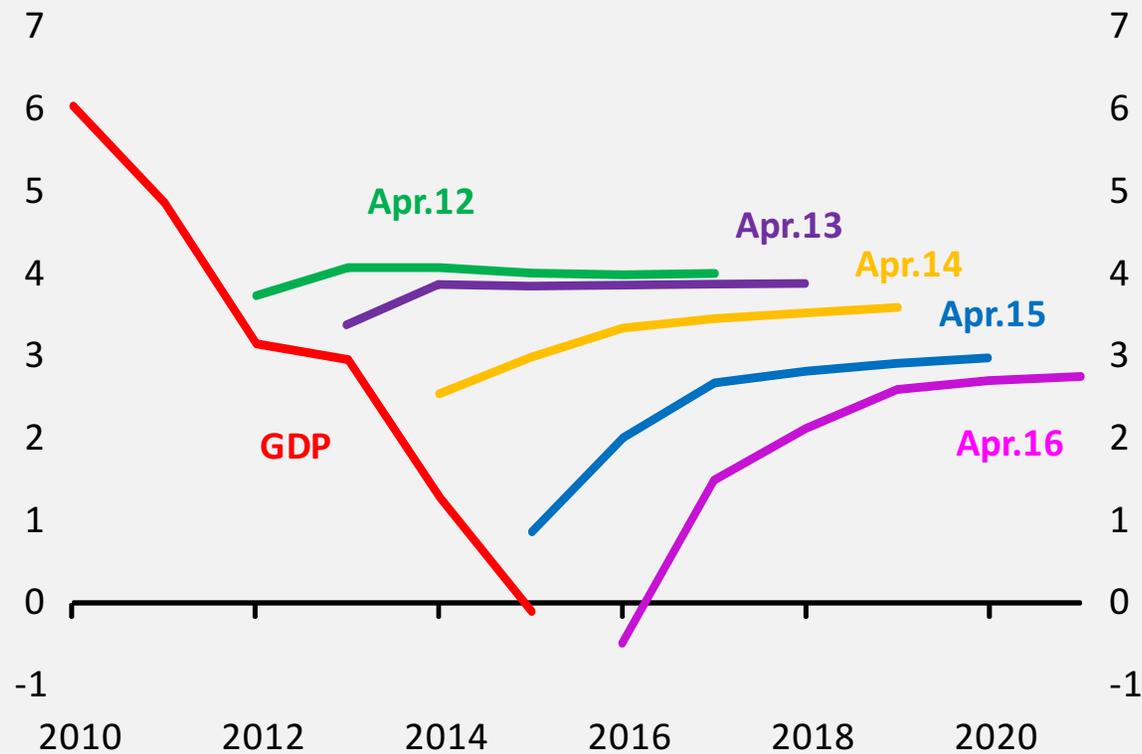
The drop in commodity prices, the deterioration of financial conditions and the reduced external demand, plus local factors, have driven down the region's investment rates.

Investment in Latin America
(percent of GDP)



Growth forecasts for Latin America have also been revised downward accordingly.

Growth in Latin America and the Caribbean, and evolution of projections (*) (annual change, percent)

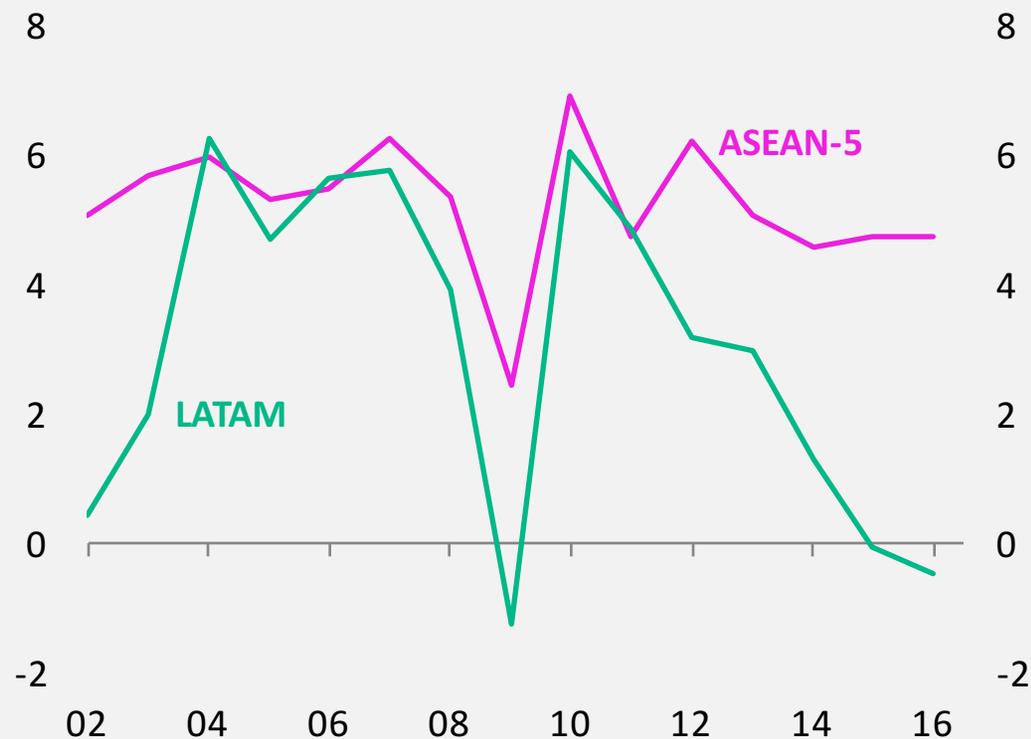


(*) Projections included in WEO.
Source: World Economic Outlook, IMF.



This has distanced our economies' performance from Asia, which has kept higher growth rates.

Growth in Latin America and Asia
(annual change, percent)

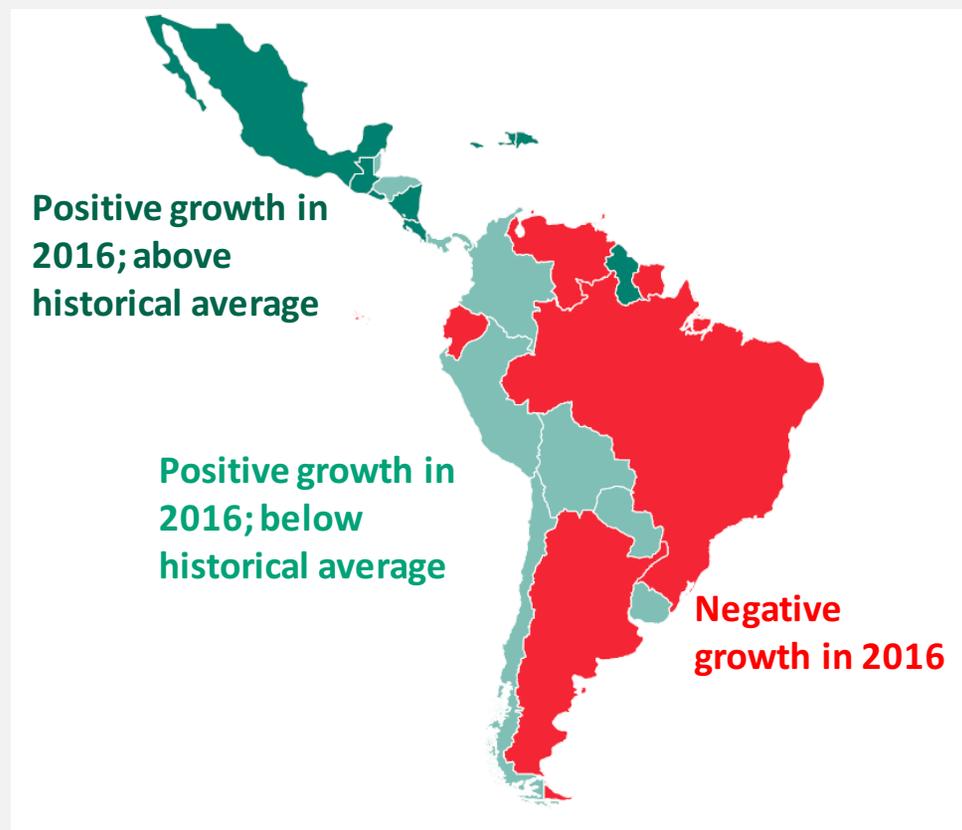


(*) Projections included in WEO. Asean-5: Indonesia, Malaysia, Philippines, Singapore and Thailand
Source: World Economic Outlook, IMF.



Inside the region, however, the outlook is very heterogeneous.

Growth forecast for 2016 (*)



(*) Historic average is defined as 2000-2013 growth.
Source: Regional Economic Outlook, IMF.



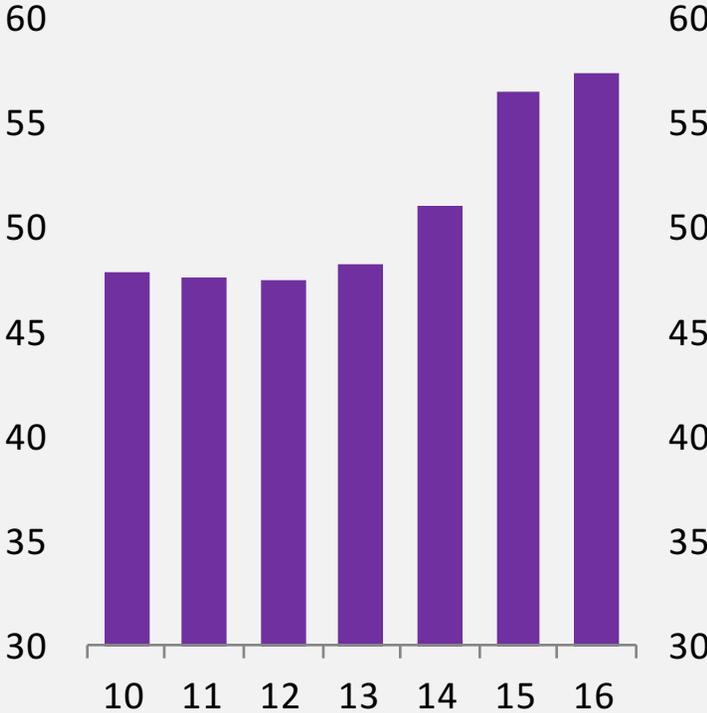
In this adverse scenario facing several of our countries, there are still some adjustments pending.

Regional current account
(percent of GDP)

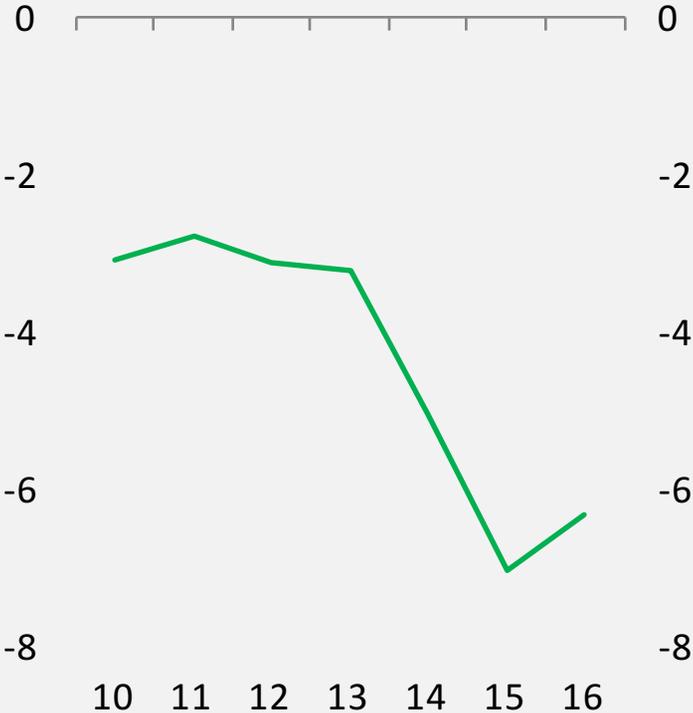


The fall in commodity prices and the economic slowdown have eroded fiscal positions, limiting the space for stimulus policies on the fiscal side.

Public debt (*) (percent of GDP)



Fiscal balance (percent of GDP)

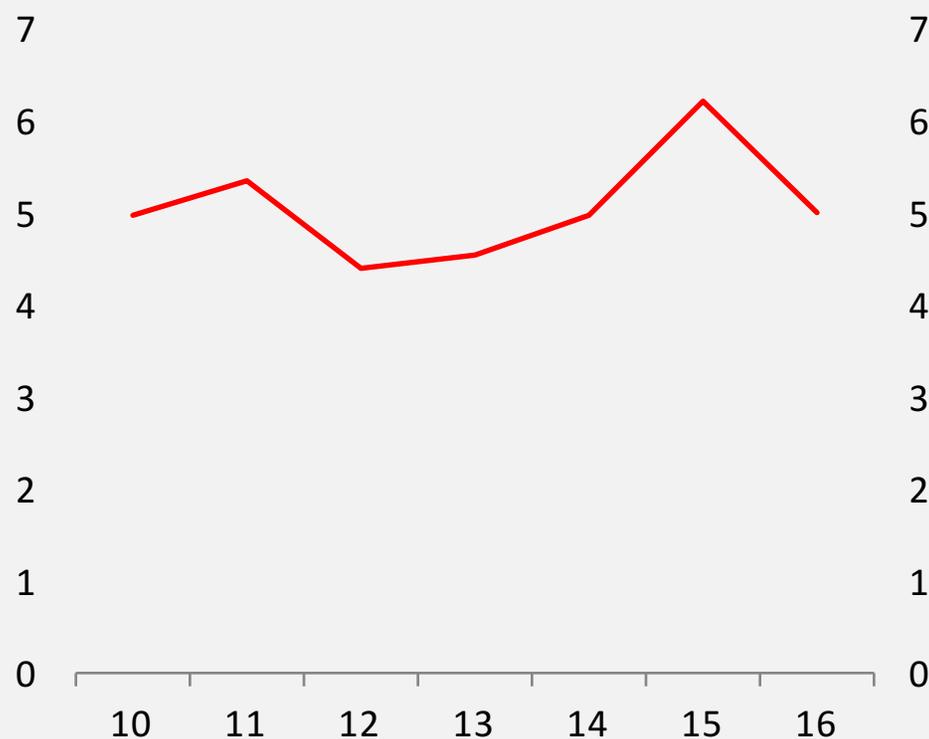


(*) General Government Gross Debt.
Source: IMF.



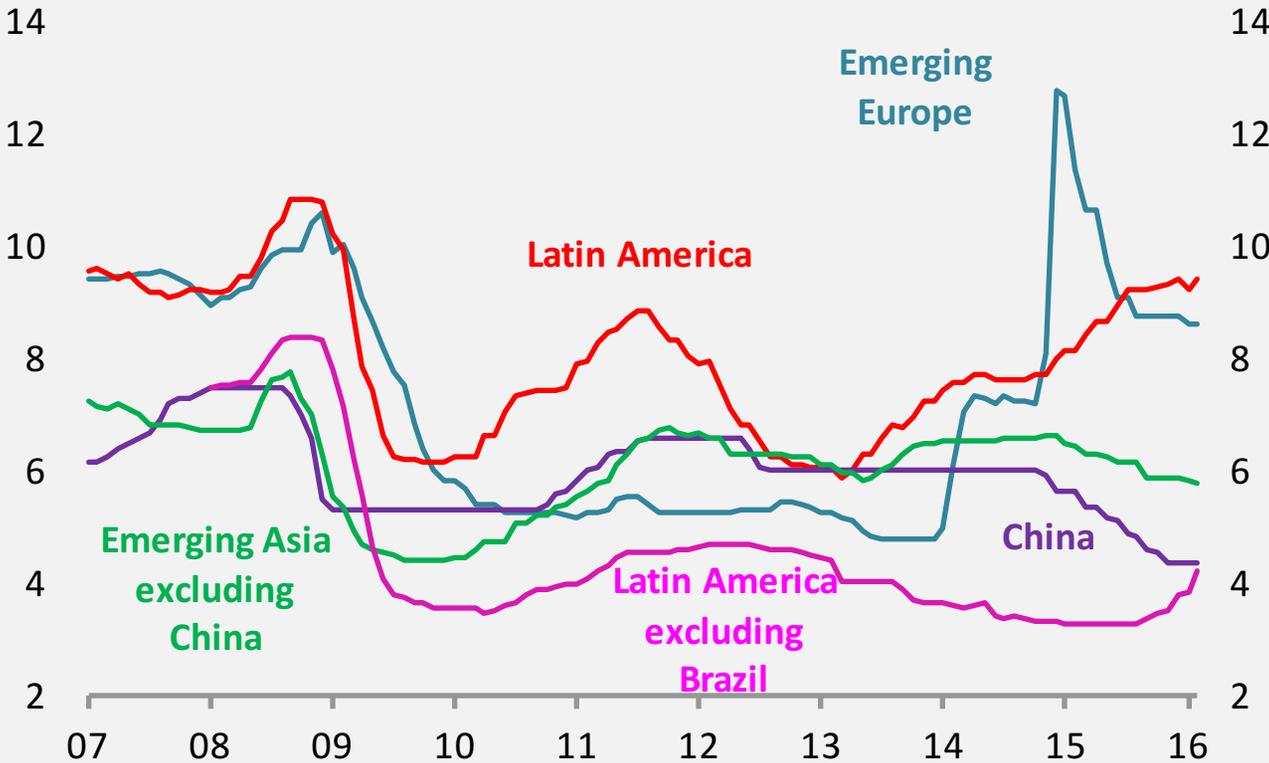
In the region as a whole, inflation has shown a mild increase, but in some countries the currency depreciation has had important effects on headline and expected inflation. This also limits the space for looser monetary policies. For 2016, inflation is expected to decline.

Inflation
(percent)



In fact, monetary authorities have raised the policy rates in the region.

Monetary policy interest rates
(percent)

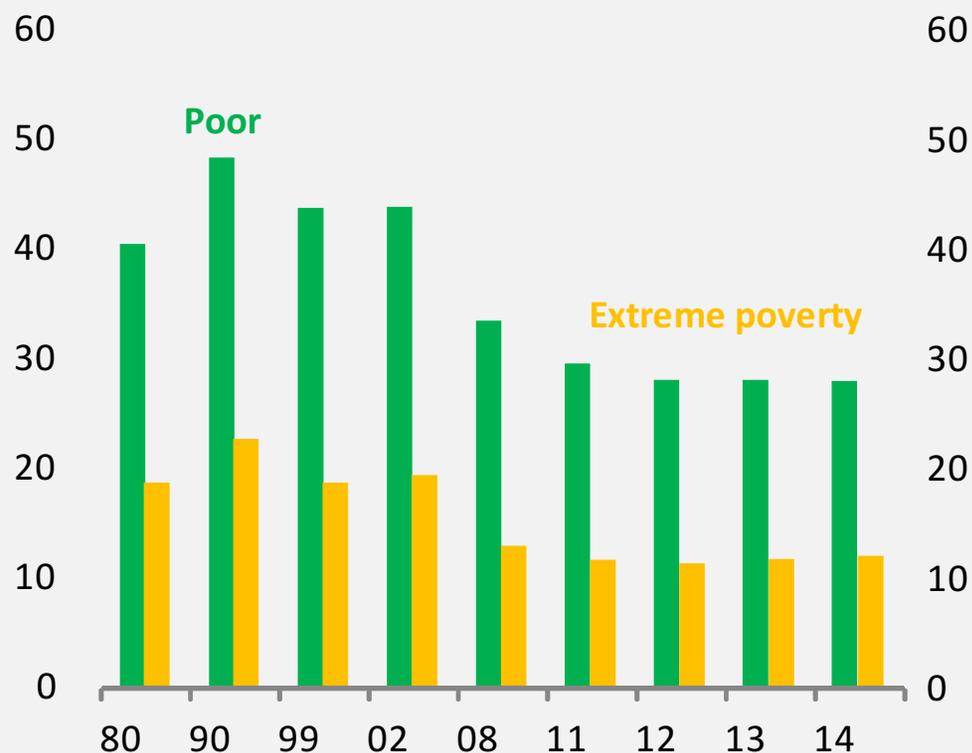


Sources: Bloomberg and World Economic Outlook, IMF.



Overall, for a few decades the region has been making significant progress on a number of areas: poverty has declined along with a increase in per capita income.

Poverty (*)
(percent)

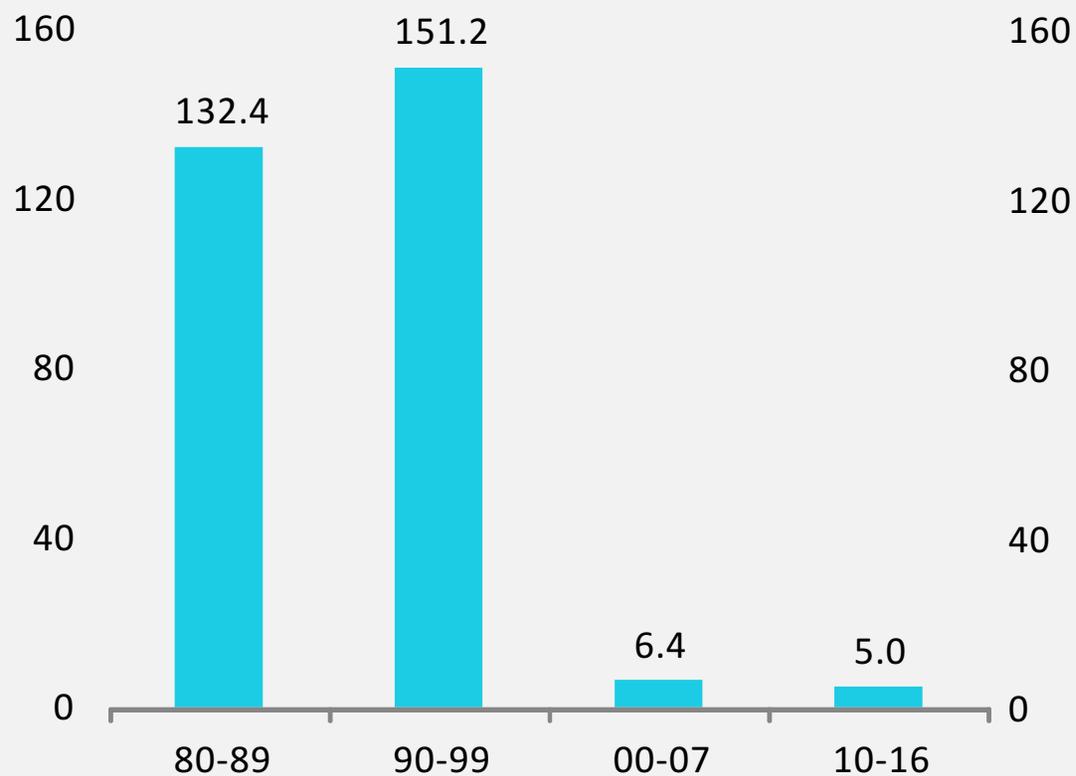


(*) The poor include the extreme poverty.
Sources: ECLAC and IMF.



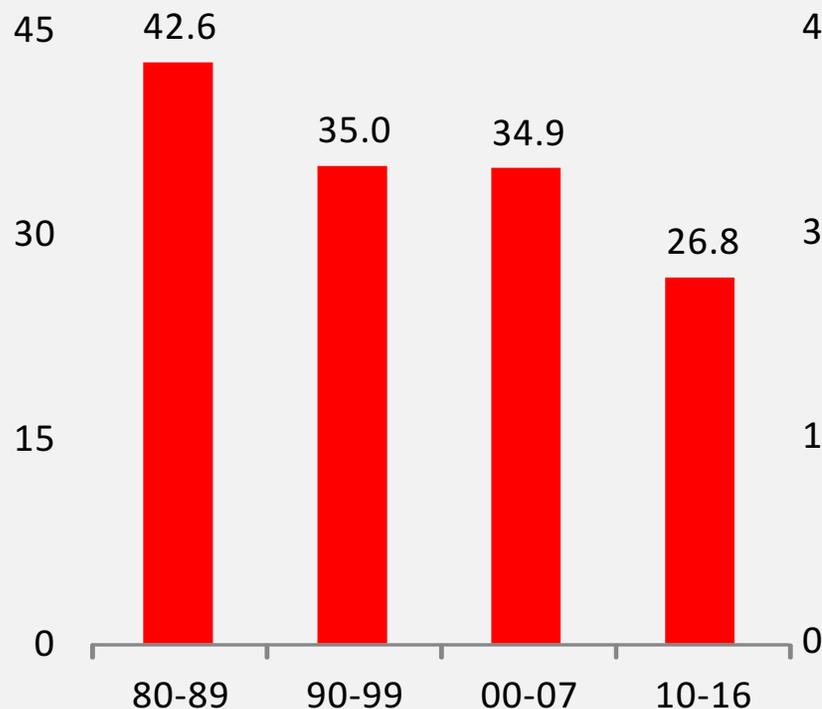
The central banks' credibility has strengthened, as they have been able to achieve important advances in controlling inflation.

Inflation
(average annual change, percent)

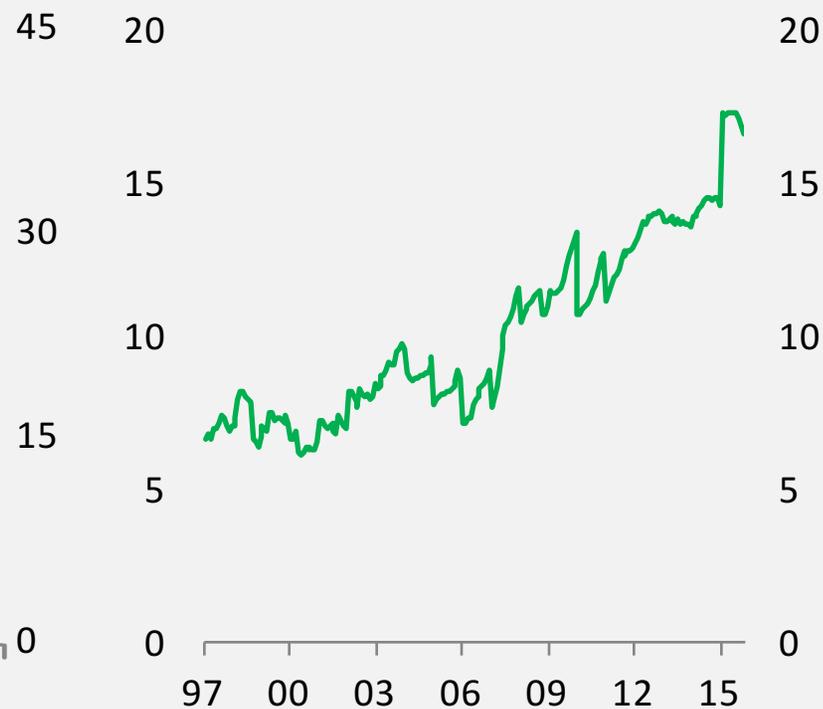


The region managed to benefit from the years of bonanza to bring down its levels of external debt and hoard international reserves.

External debt
(percent of GDP)



International reserves (*)
(percent of GDP)



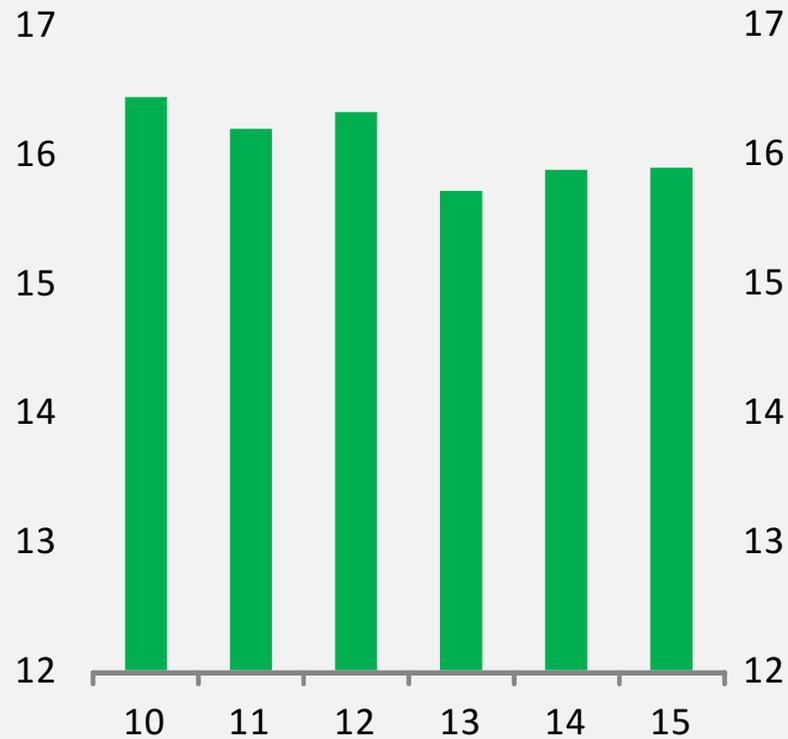
(*) Considers Argentina, Brasil, Chile, Peru and Colombia.
Source: World Economic Outlook, IMF.



Regarding our financial systems, capital adequacy ratios are good, while non performing loans have diminished.

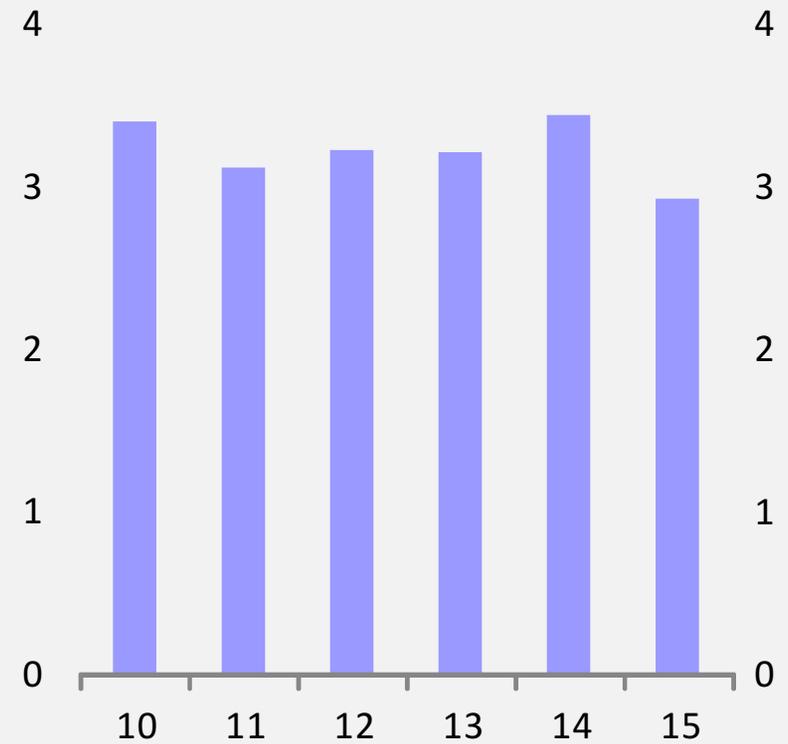
Regulatory Capital (*)

(percentage of risk weighted assets)



NPL (*)

(percentage of total loans)



(*) Shows the region's simple average.
Source: Global Financial Stability Report, IMF.



Taking steps to strengthen institutions is essential

Financial openness has brought benefits to our region, but it also leaves us more exposed to the volatility of the international scenario. This requires making advances in strengthening the regulation and supervision of our financial systems.

Considering the importance of commodities for our economies, reducing the dependence of our fiscal revenues on them is key.

Safeguarding the credibility of our central banks has helped us ensure that, despite the sharp depreciation of our currencies, inflation is still contained.

In recent years, we have made important advances in various fields, especially regarding macroeconomic stability. The current scenario stresses the importance of making further advances in strengthening our economic policies.

Increasing productivity is a key challenge.

A decorative graphic at the bottom of the page consisting of a grid of light gray and white squares, creating a perspective effect that recedes into the distance.



Latin America: Facing the risks in the external scenario

Rodrigo Vergara
Governor



Central Bank of Chile, May 2016