Latin America’s Economic Outlook and Policy Challenges

Alejandro Werner
Pedro Casas Alatriste

March 18, 2022
In 2021 Latin America’s economic growth of 6.8% was comparable to the average growth of the emerging and developing countries. However, given that the economic contraction experienced in 2020 was much deeper (-7.4% vs -2.4%), this region still exhibits a significant poor cumulative economic performance among emerging and developing economies since the onset of the pandemic. Nonetheless, at the beginning of 2021, analysts expected the Latin American economy to perform much worse. Therefore, Latin America was the region that exhibited the largest growth surprise (observed growth in 2021 compared to what was expected at the beginning of the year) in the world during 2021.

This better-than-expected performance was generalized throughout the region, only escaping the hardest hit countries of the Caribbean. However, according to most analysts, this positive surprise does not significantly affect their growth projections for 2022 and beyond. For 2022 most growth projections signal that the region will have the lowest growth rate in the world. Putting these numbers together implies that Latin America will end up exhibiting significant GDP losses and will also suffer very deep scarring effects due to the pandemic.
Several factors explain why in 2021 Latin America had an economic performance significantly better than expected at the beginning of the year. On the external side, the better-than-expected performance of the world economy, commodity prices and remittances played a major role. Domestically, a slower-than-expected fiscal stimulus withdrawal and a faster than originally anticipated vaccination campaign contributed to significant growth in domestic demand and in the reopening of the service sector.

### Commodity Prices

<table>
<thead>
<tr>
<th>Commodity Prices</th>
<th>Est. 2021¹</th>
<th>2021²</th>
<th>Percent Diff. (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Soybean oil ($/mt)</td>
<td>828</td>
<td>1,375</td>
<td>66.1</td>
</tr>
<tr>
<td>Crude oil (average) ($/bbl)</td>
<td>44</td>
<td>70</td>
<td>59.1</td>
</tr>
<tr>
<td>Iron ore (cfr-spot) ($/dmtu)</td>
<td>105</td>
<td>165</td>
<td>57.1</td>
</tr>
<tr>
<td>Copper ($/mt)</td>
<td>6,300</td>
<td>9,300</td>
<td>47.6</td>
</tr>
<tr>
<td>Soybeans ($/mt)</td>
<td>400</td>
<td>580</td>
<td>45.0</td>
</tr>
<tr>
<td>Sugar ($/kg)</td>
<td>0.29</td>
<td>0.39</td>
<td>34.5</td>
</tr>
<tr>
<td>Wheat (US-SRW) ($/mt)</td>
<td>207</td>
<td>255</td>
<td>23.2</td>
</tr>
</tbody>
</table>

Source: The World Bank

¹ Commodity Markets Outlook (Oct.20)
² Commodity Markets Outlook (Oct.21)

### Primary Fiscal Deficit 2021 (Estimated vs. Observed)

![Primary Fiscal Deficit 2021 Graph]

Source: IMF

### Personal Remittances Received in Latin America (million dollars)

![Personal Remittances Received in Latin America Graph]

Source: The World Bank

### People Fully Vaccinated (%)

![People Fully Vaccinated Graph]

Source: Our World in Data
This positive economic surprise in 2021 is being interpreted as a one-off by professional analysts following the region. For 2022, although the world economy is expected to slow down by approximately 1 percentage point and commodity prices are likely to remain at historically high levels, they anticipate a larger than 4 percentage points deceleration in Latin America. This assumes that fiscal consolidation will take effect, the pandemic induced bounce back is complete, and unresolved political tensions and electoral uncertainty will take a toll on economic performance. According to most observers, average GDP in Latin America is already back to its new trend level, so the average expected growth rate for the next 5 years is the lackluster medium-term potential growth rate of 2.4%.

As a result of the pandemic, Latam lost 7.4 percentage points of regional GDP in 2020 and 2021 combined, measured by the difference between the GDP level in 2019 and those two years. In addition to this important GDP loss, the deterioration in social indicators, the losses in education and health effects will continue to weigh on development prospects in the region for a long time.
During 2022, Latin America will have to deal with three important macroeconomic challenges: fiscal sustainability, inflation control and tightening international financial conditions. First, having increased debt ratios due to the pandemic, financial markets will pay attention to which countries have the fiscal institutions and political capital to implement a fiscal strategy that contributes to stabilizing debt to GDP in the short run and bringing this ratio to a sustainable level in the medium term. Second, after an important increase in inflation during 2021 associated with a negative supply shock and, in some instances, with faster than expected aggregate demand growth, central banks will need to maintain inflation expectations anchored. Finally, the upcoming monetary policy tightening in advanced economies has already initiated a cycle of hardening of financial conditions, dollar appreciation and retrenching of capital flows that will complicate the implementation of monetary policy.

After 2022, the Covid-19 economic cycle will be complete and growth in Latin America will stabilize at the mediocre potential growth rate of approximately 2.4%. This scenario implies that the pandemic will have permanent effects on the level of GDP in the region.
According to the IMF, regional GDP in the years after 2022 is expected to be permanently 6% below the projection for the same years done in 2019. This scenario also implies that from 2015 to 2025, regional per capita GDP will be almost constant, or even lower than in 2015, bringing another (the first one being the 1980’s) lost decade to Latina America because of the commodity shock of 2014 and the economic effects of the pandemic. During this past decade, the region has also witnessed the worst economic disaster in world history in Venezuela as GDP per capita has dropped by 70%, worse than the loss of output in Germany during the Second World War.

Not all is grim for Latin America, as the external environment presents some positive signs. For the initial phases of the energy transition, the current environment of high oil and metal prices will likely persist since higher financing costs for non-renewable energy projects and high demand for transmission and storage of energy will maintain the current equilibrium in these markets. Additionally, Latin America is far from the current geopolitical tensions, both geographically and politically, so shifting production, services, and other activities to the region will be safer than locating elsewhere.

Aside from the economic analysis, the region was already facing significant social tensions before the pandemic as evidenced by the important demonstrations registered in Brazil in 2014, Chile starting in 2015 and Colombia and Ecuador in 2019.
Though there are some idiosyncratic factors and triggers in each of these events, the disenchantment with the way most economies and democracies are functioning, reveals a profound lack of legitimacy of the socioeconomic and political equilibrium, which is perceived to be beneficial only to a very small share of the population.

The current regional economic, social, and political context is one in which to set the foundations of a new inclusive and fast growth process. There is a need for significant reforms at a time when the political system is fragmenting, society is polarizing, and social tensions may resurface. This environment will call for skillful political leadership to forge broad national agreements that allow for sustainable public finances broadening social risk-sharing and public goods. While a stronger government is needed to provide these public goods, a more predictable and less onerous regulatory environment is needed for the private sector to invest and create jobs. The specific elements of reform vary from country to country, but the level of ambition needed is similar. These changes pose a huge challenge for the political class to guide society towards these broad social agreements and to bring the regional economies back to a strong development path. The absence of reforms will lead to multiple episodes of debt crises, political turbulence, and social unrest.

About the authors:
- Alejandro Werner is the Director of the Georgetown Americas Institute.
- Pedro Casas Alatriste is a graduate student of International Development Policy at Georgetown University and president of the Latin American Policy Association (LAPA).
Bibliography

- International Monetary Fund (IMF)
  - Ilan Goldfajn, Anna Ivanova and Jorge Roldos. "Latin America’s Strong Recovery is Losing Momentum, Underscoring Reform Needs": https://blogs.imf.org/2022/01/31/latin-americas-strong-recovery-is-losing-momentum-underscoring-reform-needs/

- The World Bank Group
  - The World Bank Data. Personal Remittances:
    https://data.worldbank.org/indicator/BX.TRF.PWKR.CD.DT
  - Commodity Markets Outlook, October 2020:
    https://openknowledge.worldbank.org/handle/10986/34621

- Our World in Data: https://ourworldindata.org/covid-vaccinations