ANALYTICAL ARTICLES

Economic Bulletin

BANCO DE **ESPAÑA**

Eurosistema

REPORT ON THE LATIN AMERICAN ECONOMY.

FIRST HALF OF 2020

2/2020

ABSTRACT

This article analyses the recent performance of the main Latin American economies (Brazil, Mexico, Argentina, Colombia, Chile and Peru). Economic developments in the region have progressively been influenced by the global spread of the coronavirus COVID-19 pandemic. Although it has reached Latin America with some delay compared to Europe and the United States, it shows a similar pattern of dissemination. Moreover, the region faces this pandemic in an economic situation which had already beforehand shown signs of weakness owing to various idiosyncratic reasons, related in part to the bouts of social tension in the final stretch of last year. Some factors, such as high labour market informality and the improvable quality of some institutions, may act as amplifiers of the impact of the health crisis. From the economic standpoint, the pandemic is affecting the region through various key channels, namely the trade, commodities, tourism, financial and domestic demand channels. The national containment measures, the impact of the pandemic on the population, the global nature of the shock and the differential effects on the region are seeing analysts revise their GDP forecasts for 2020 notably downwards, with a balance of risks tilted to the downside. The monetary and fiscal authorities have responded, swiftly adopting measures. Although the region has in recent years consolidated progressively more robust monetary and fiscal policy arrangements, it has less monetary and fiscal space than at the start of the 2008-2009 crisis. Moreover, the Latin American economies, with the exception of Peru, have notably increased their external debt since 2008, though they have more international reserves than in the previous global crisis. Against this background, the resolute response by national policies should ideally be supported by a coordinated global response, led by the main multilateral agencies and geared to minimising the possible long-term adverse effects on the region's economies.

Three boxes accompany this report. The first considers the causes and potential effects of the social tensions in some of the region's countries in the closing months of 2019. The second examines the process of integration of Latin America into global trade and its results, analysing the challenges outstanding if the region is to fully reap the benefits of greater trade integration. The third sets out some simulations made on the basis of a global macroeconometric model to illustrate the potential adverse effects of COVID-19 on economic activity in the main Latin American economies.

Keywords: COVID-19, pandemic, informality, containment measures, monetary and fiscal space, uncertainty over politics and over economic policies, trade integration, simulation.

JEL classification: F01, F13, F21, F30, F41.

Introduction

Economic developments in Latin America have been progressively influenced since the start of the year by the global spread of the coronavirus COVID-19 pandemic. Against a backdrop of weakness, the indicators of economic activity in early 2020 in the main Latin American economies (Brazil, Mexico, Argentina, Colombia, Chile and Peru)[1] showed mixed signs. On one hand, there were muted positive signs derived from an incipient global recovery, linked to some extent to the lessening of the trade tensions between the United States and China in the final stretch of 2019. On the other, these signs progressively worsened markedly from late January, owing to the effects of the adverse external demand shock prompted by the heightening of the health crisis in China and other Asian countries. The spread of the pandemic to Europe as from late February, first, and then across the board - including to Latin America - from late March, has entailed a drastic downturn in the economic growth outlook for the region.

The starting point for the Latin American economy, moreover, taken as a whole, was more delicate than for the other emerging and advanced economies. The main economies in the region continued to evidence weak growth in the second half of 2019, far below that of the other emerging economies and down on projections, mainly as a result of flatter domestic demand (see Chart 1.1). In fact, in 2019 Q4 the quarter-on-quarter rate of change of GDP was negative for the aggregate of these economies (see Chart 1.2), as a result of the contractions posted in Mexico, Argentina and, above all, Chile, after the slowdown and indeed halt in activity in some sectors owing to social tensions (see Box 1). In 2019 as a whole, GDP growth in the group of the six biggest economies in the region was scarcely 0.7% (see Table 1), down from 1.5% in 2018 and averaging 0.9% for the past six years (see Chart 1.3), following the end of the cycle of favourable commodities prices. In terms of GDP per capita, growth in these countries was zero or negative. With the exception of Colombia, all the countries slowed in 2019. Particular mention may be made of the slightly negative growth in Mexico and a further contraction in Argentina, whose GDP has fallen by 6.6% since it went into recession in 2018 Q2.

To contain the expansion of the epidemic, the Latin American countries' authorities have adopted extraordinary measures restricting people's movements and closing down a substantial portion of productive activity. As in other economies, including the advanced countries, these measures are bearing down negatively on activity in

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1   This report focuses on the sub-group of economies with the highest GDP in the region, known as LATAM-6 and comprising Brazil, Mexico, Argentina, Colombia, Chile and Peru.

Chart 1

ECONOMIC ACTIVITY IN LATIN AMERICA

The Latin American economies are departing from a more delicate situation than the other emerging and advanced economies when it comes to facing the COVID-19 pandemic. In the second half of 2019, growth in the region remained very weak, and even negative in quarter-on-quarter terms in Q4, as a result chiefly of the flatness of domestic demand. The widespread diffusion of the pandemic, including to Latin America, has entailed a sharp downturn in economic growth prospects for the region.
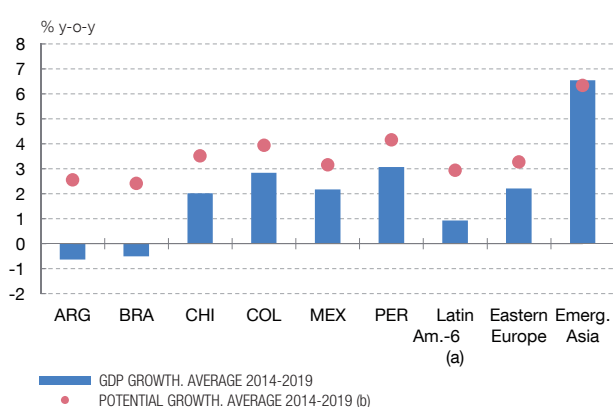
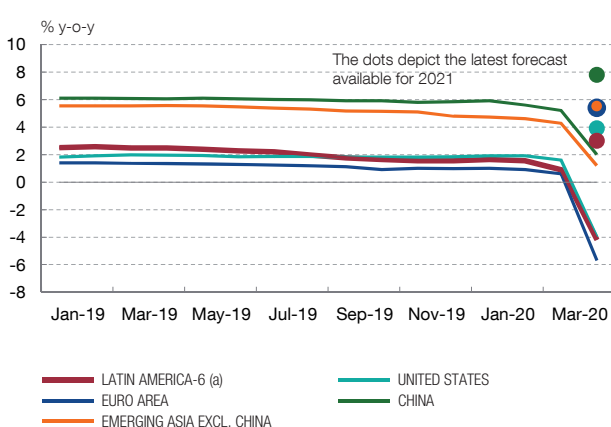1 CONTRIBUTIONS TO GDP GROWTH. LATIN AMERICA-6 (a)
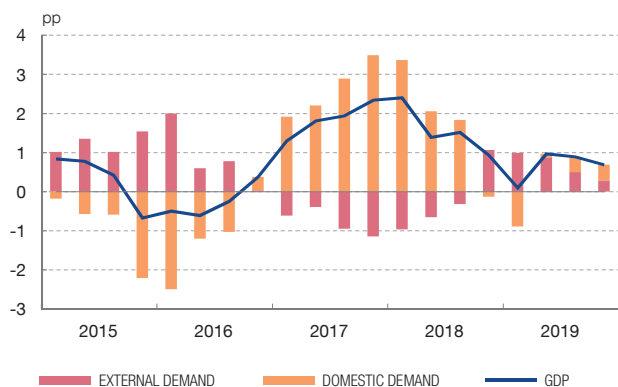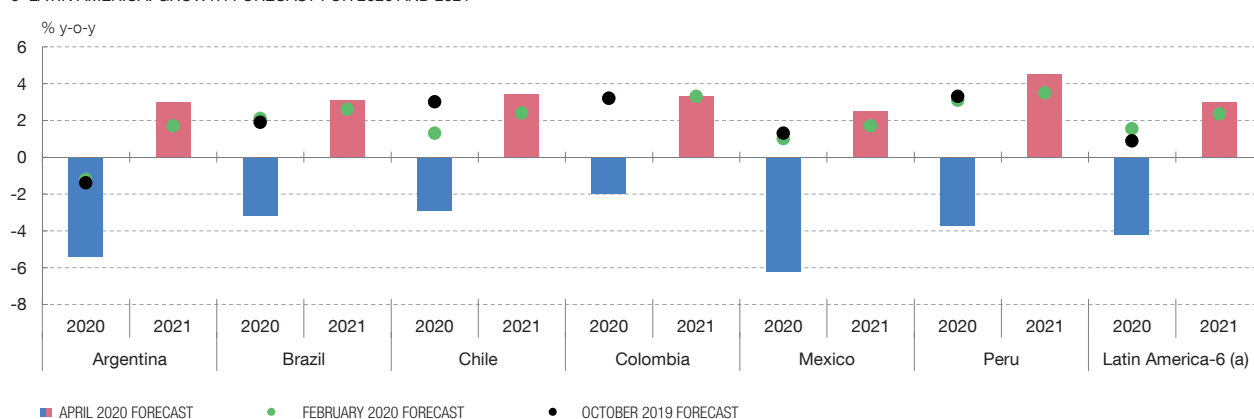
2 GROSS DOMESTIC PRODUCT. RECENT QUARTERS
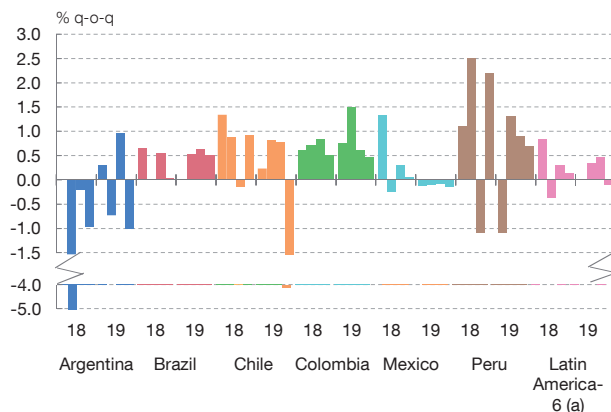
3 GDP GROWTH AND POTENTIAL GROWTH

4 GROWTH FORECAST FOR 2020

5 LATIN AMERICA: GROWTH FORECAST FOR 2020 AND 2021

SOURCES: IMF, Consensus Forecasts and Thomson Reuters.

a Latin America-6: Argentina, Brazil, Chile, Colombia, Mexico and Peru. Weighted by the purchasing power parity method.
b For the estimate of potential growth, the IMF's longest-dated forecast available at that time (five years) is taken for each year.

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Table 1

LATIN AMERICA: MAIN ECONOMIC INDICATORS

	2007-2018 Average	2019	2018		2019				IMF Projections (WEO April 2020)	
			Q3	Q4	Q1	Q2	Q3	Q4	2020	2021
GDP (year-on-year rate)										
Latin America 6 (a)(b)	2.4	0.7	1.5	0.9	0.1	1.0	0.9	0.7	-5.4	3.4
Argentina	1.9	-2.2	-3.7	-6.1	-5.8	0.0	-1.7	-1.1	-5.7	4.4
Brazil	1.9	1.1	1.5	1.2	0.6	1.1	1.2	1.7	-5.3	2.9
Mexico (c)	2.1	-0.1	2.6	1.5	0.0	0.1	-0.3	-0.5	-6.6	3.0
Chile	3.3	1.1	2.8	3.3	1.4	1.8	3.4	-2.1	-4.5	5.3
Colombia (c)	3.8	3.3	2.7	2.7	2.8	3.6	3.4	3.4	-2.4	3.7
Peru	5.1	2.2	2.5	4.6	2.4	1.2	3.2	1.8	-4.5	5.2
CPI (year-on-year rate)										
Latin America 5 (d)	4.8	3.5	4.2	4.1	3.7	3.9	3.2	3.1	3.1	3.0
Brazil	5.7	3.7	4.4	4.1	4.1	4.3	3.2	3.4	3.6	3.3
Mexico	4.2	3.6	4.9	4.8	4.1	4.2	3.3	2.9	2.7	2.8
Chile	3.4	2.3	3.1	2.9	1.8	2.2	2.2	2.8	3.4	2.9
Colombia	4.2	3.5	3.1	3.3	3.1	3.3	3.8	3.8	3.5	3.2
Peru	3.0	2.1	1.3	2.1	2.1	2.5	2.0	1.9	1.7	1.8
Budget balance (% of GDP) (e)										
Latin America 6 (a) (b)	-3.1	-3.8	-4.7	-4.4	-4.2	-3.8	-3.9	-3.8		
Argentina	-2.1	-3.8	-4.9	-5.0	-4.7	-4.3	-4.1	-3.8	n/d	n/d
Brazil	-4.8	-5.9	-7.2	-7.1	-7.0	-6.5	-6.3	-5.9	-9.3	-6.1
Mexico	-2.3	-2.1	-2.5	-2.1	-1.7	-1.6	-2.0	-2.1	-4.2	-2.2
Chile	-0.1	-2.8	-2.1	-1.7	-1.8	-1.8	-2.2	-2.8	-6.3	-3.5
Colombia	-2.8	-2.2	-4.1	-3.1	-2.6	-1.8	-1.1	-2.2	-2.5	-1.3
Peru	-0.4	-2.1	-2.0	-2.0	-1.9	-2.0	-2.1	-2.1	-7.1	-2.6
Public debt (% of GDP)										
Latin America 6 (a) (b)	46.3	—	60.0	59.1	60.2	58.9	60.6	—		
Argentina	47.9	85.9	83.8	73.9	80.3	66.6	80.6	76.3		
Brazil	60.3	75.9	77.0	76.5	78.1	78.0	78.0	75.8		
Mexico	37.8	47.1	46.5	46.9	46.6	46.6	47.3	47.1		
Chile	13.4	30.8	25.0	25.6	26.1	28.0	28.6	30.5		
Colombia	37.4	—	45.7	46.6	47.2	47.1	47.2	—		
Peru	23.8	26.8	23.9	25.8	25.3	25.8	25.7	26.8		
Current account balance (% of GDP) (e)										
Latin America 6 (a) (b)	-2.0	-1.9	-2.5	-2.6	-2.6	-2.3	-2.1	-1.9		
Argentina	-1.3	-3.4	-6.0	-5.1	-4.3	-3.2	-1.8	-3.4	n/d	n/d
Brazil	-2.2	-2.7	-1.9	-2.2	-2.3	-2.4	-2.5	-2.7	-1.8	-2.3
Mexico	-1.6	-0.2	-1.8	-1.9	-1.8	-1.2	-0.6	-0.2	-0.3	-0.4
Chile	-1.2	-3.9	-2.5	-3.6	-4.0	-4.3	-4.4	-3.9	-0.9	-1.8
Colombia	-3.6	-4.3	-3.3	-3.9	-4.1	-4.1	-4.3	-4.3	-4.7	-4.2
Peru	-2.6	-1.5	-1.9	-1.7	-1.8	-1.8	-1.6	-1.5	-0.9	-1.0
External debt (% of GDP)										
Latin America 6 (a) (b)	27.5	39.1	34.7	36.6	37.9	39.4	38.6	39.1		
Argentina	36.1	61.5	44.3	51.6	55.6	60.7	60.3	61.5		
Brazil	26.3	36.7	33.0	35.2	36.9	38.2	36.4	36.7		
Mexico	20.8	28.2	27.9	28.0	28.0	28.2	28.0	28.2		
Chile	49.9	70.1	60.0	61.8	63.5	67.0	67.6	70.1		
Colombia	28.5	42.7	38.3	39.6	40.2	41.3	42.1	42.7		
Peru	32.4	34.7	33.3	34.5	35.8	36.7	35.8	34.7		
MEMORANDUM ITEMS: Aggregate of Latin America and the Caribbean (International Monetary Fund)										
GDP (year-on-year rate)	2.3	0.1								
CPI (year-on-year rate)	5.2	7.1								
Budget balance (% of GDP)	-3.7	-4.0								
Public debt (% of GDP)	51.4									
Current account balance (% of GDP)	-1.8	-1.7								
External debt (% of GDP)	34.1									
Weight in world GDP, in PPP (%)	8.4	7.2								

SOURCES: IMF, Thomson Reuters and national statistics.

a The six economies shown represent 85.2% of the total of Latin America and the Caribbean (IMF).
b GDP of Latin America 6 weighted using the purchasing power parity method. The weightings for 2019 are: Brazil, 39.7%; Mexico, 29.8%; Argentina, 10.4%; Colombia, 9.0%; Chile, 5.6%, and Peru, 5.4%.
c Seasonally adjusted.
d Latin America 5: Brazil, Chile, Colombia, Mexico and Peru. Argentina is not included because its central bank does not have inflation targets.
e Four-quarter moving average.

the region, with high uncertainty over the persistence of the pandemic and growing risks for the world economy. Little and only partial evidence is available as yet on these effects. But many analysts project the decline in GDP in the region in 2020 to be even greater than that in 2009, during the financial crisis (see Chart 1.5).

The rest of the report describes recent developments in, and the outlook for, the main economies in the region. It analyses the various dissemination channels of the shock arising from the pandemic, and the economic policy measures adopted by the authorities to tackle its effects. Three boxes accompany the report. The first considers the causes and potential effects of the social tensions in some of the region's countries in recent months. The second examines Latin America's process of integration into global trade and the attendant results, and analyses the challenges outstanding if the region is to fully reap the benefits of greater trade integration. The third shows simulations made on the basis of a global macroeconometric model to illustrate the potential adverse effects of COVID-19 on economic activity in the main Latin American economies, depending on the duration of the confinement period and the speed at which domestic and external demand recover.

Spread of the pandemic and containment measures

In Latin America the pandemic arrived with a lag of a couple of weeks relative to most of the European countries and the United States, but its propagation dynamics are proving similar. As Chart 2 shows, the trajectory (numbers infected and deaths) does not differ greatly from what is being recorded in other countries, with Brazil at the head of the number of cases and deaths, at the cut-off date for this Report. The containment measures have also been similar, including closures of borders, schools, the partial shutdown of economic activity and other social distancing[2] measures (see Chart 3.2). The health impact of the crisis is related, *ex ante,* to the preparedness of the region's health systems for withstanding an episode of these characteristics. According to the Global Health Security Index (GHSI)[3], there is some heterogeneity within the region given that the GHSI has some countries (Brazil and Chile) evidencing levels on a par with the advanced countries, while others are in a less favourable position, albeit one above the global average (Peru, Mexico and Argentina), or close to it (Colombia) (see Chart 4.1). One possible mitigating factor regarding the health consequences of the spread of the virus in the region may be

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2 The measures are summarised in Chart 3.1, for most economies, with an index tracking their severity devised by Oxford University: "Oxford Covid-19 government response tracker".
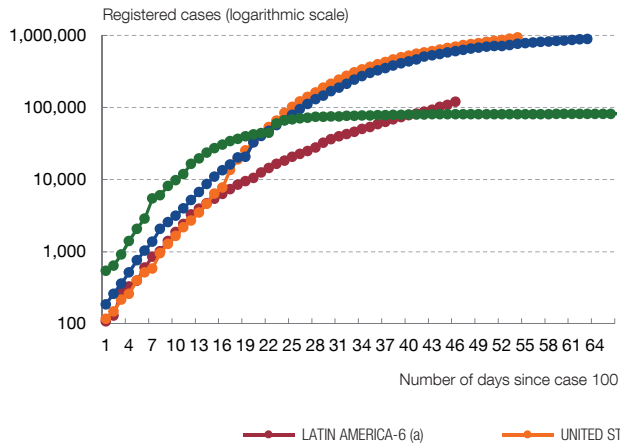
3 The Global Health Security Index is compiled by the Center for Health Security (Johns Hopkins University) and The Economist Intelligence Unit. It provides an internationally comparable measure for 195 countries of the robustness of their health systems and other capabilities for preventing, detecting, responding to and rapidly alleviating public health emergencies. The various characteristics assessed are grouped into six categories: prevention, detection and reporting, speed of response, health system, compliance with international standards and environmental risks. The figures cited in this Report refer specifically to the category "Rapid response to and mitigation of the spread of an epidemic".
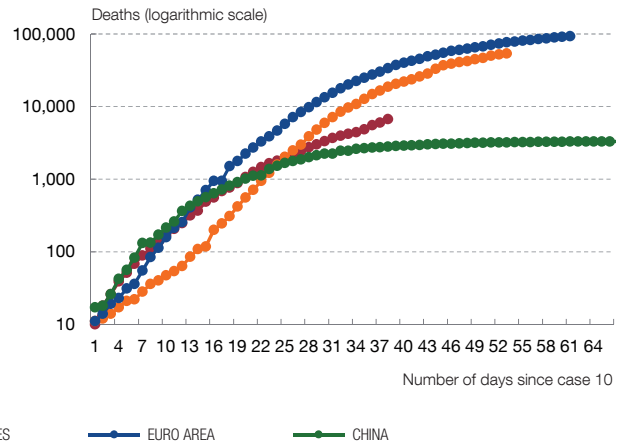
Chart 2
PATH OF THE COVID-19 PANDEMIC

The pandemic reached Latin America with two weeks' delay compared to the European countries and the United States. On the data available, developments in the six economies monitored in this Report can be seen to be similar to those in the other regions mentioned. Brazil is the country with the highest number of infections and deaths so far.
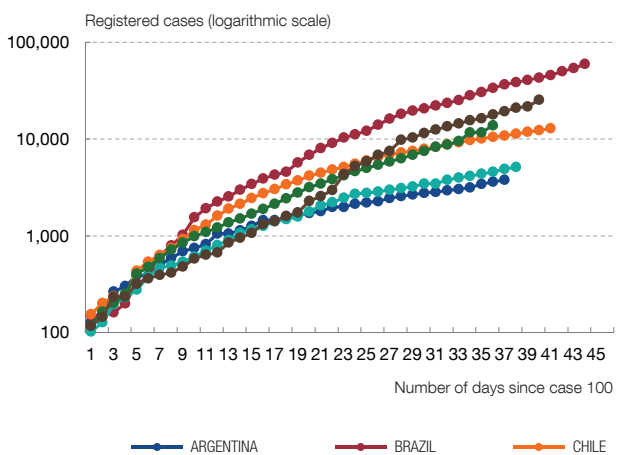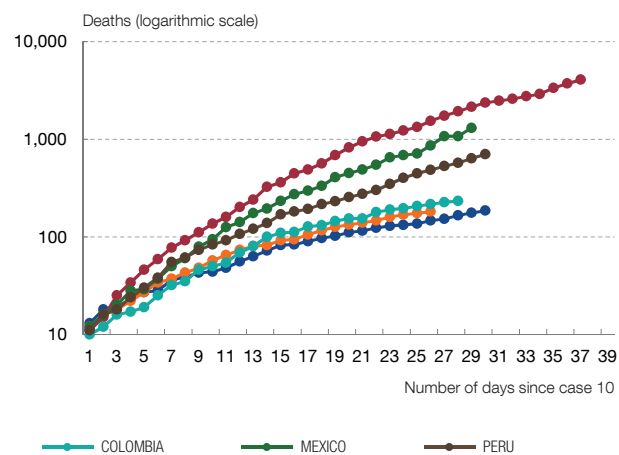
1 NUMBERS INFECTED

Registered cases (logarithmic scale)

2 NUMBER OF DEATHS

Deaths (logarithmic scale)

Number of days since case 100

Number of days since case 10

LATIN AMERICA-6 (a)   UNITED STATES   EURO AREA   CHINA

3 NUMBERS INFECTED IN LATIN AMERICA

Registered cases (logarithmic scale)

4 NUMBER OF DEATHS IN LATIN AMERICA

Deaths (logarithmic scale)

Number of days since case 100

Number of days since case 10

ARGENTINA   BRAZIL   CHILE   COLOMBIA   MEXICO   PERU

SOURCE: Johns Hopkins.

a Latin America-6: Argentina, Brazil, Chile, Colombia, Mexico and Peru.

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the fact that it has a younger population structure than that of other emerging economies and that of the advanced countries[4], given that the virus appears to have more adverse effects on the elderly population cohorts.

However, other factors may amplify the economic impact of the pandemic on the region. One specific factor is high labour market informality. While heterogeneous

4   See the analytical article "The end of the demographic dividend in Latin America: challenges for economic and social policies", *Economic Bulletin 1/2020,* Banco de España.

Chart 3
MEASURES TAKEN BY THE AUTHORITIES TO HALT THE SPREAD OF THE CORONAVIRUS

Social distancing measures in the region's main economies have been very similar to those observed in Europe and the United States, albeit with some differences from country to country.

1 STRINGENCY INDEX (a)

| ARGENTINA | BRAZIL | CHILE | COLOMBIA | MEXICO | PERU |
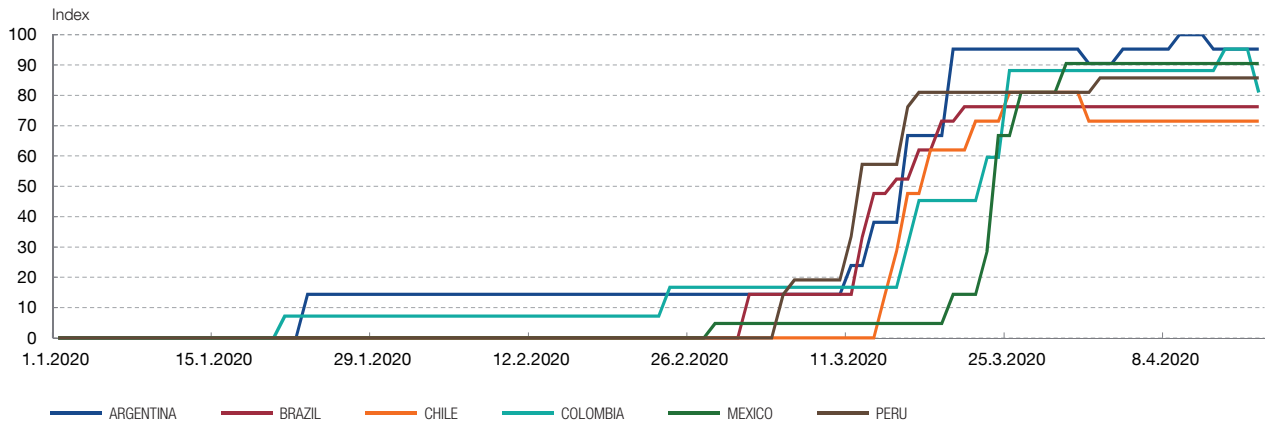
2 MEASURES TAKEN BY LATIN AMERICAN AUTHORITIES

Country/Measures (b)	Closedown of educational activity	Ban on large gatherings	Restricted domestic travel	Shutdown of commercial and industrial activity	Population isolation decree	Border closures
Argentina	16.3.2020	20.3.2020	20.3.2020	20.3.2020	20.3.2020	20.3.2020
Brazil	15.4.2020	23.3.2020	15.4.2020	26.3.2020	14.3.2020	21.3.2020
Chile	15.3.2020	15.3.2020	20.3.2020	20.3.2020	20.3.2020	15.3.2020
Colombia	17.3.2020	17.3.2020	25.3.2020	25.3.2020	25.3.2020	17.3.2020
Mexico	24.3.2020	24.3.2020	30.3.2020	30.3.2020	30.3.2020	20.3.2020
Peru	14.3.2020	14.3.2020	20.3.2020	20.3.2020	20.3.2020	14.3.2020

SOURCES: Oxford University and own calculations.

a Synthetic index prepared by the Oxford University. It assesses the degree of severity of the confinement measures adopted by each country in response to the COVID-19 pandemic.
b Red: full application of the measure; yellow: partial application (by State, night curfew, instead of total confinement, opening of some commercial establishments). The date for each cell is when the measures began to be implemented.

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across the different countries, it stands at around 50% of total employment for the region as a whole, similar to other emerging regions (see Chart 4.2). It hampers the success of certain fiscal policy responses focused on individuals and firms, such as unemployment benefits or tax relief, and it makes it more difficult to sustain policies temporarily reducing or halting activity or confinement policies, owing to the adverse effects on a considerable number of households' income. Moreover, the lower institutional quality of some countries in specific facets, in accordance with the habitual indicators (such as "government effectiveness" indices and "rule of law")[5],
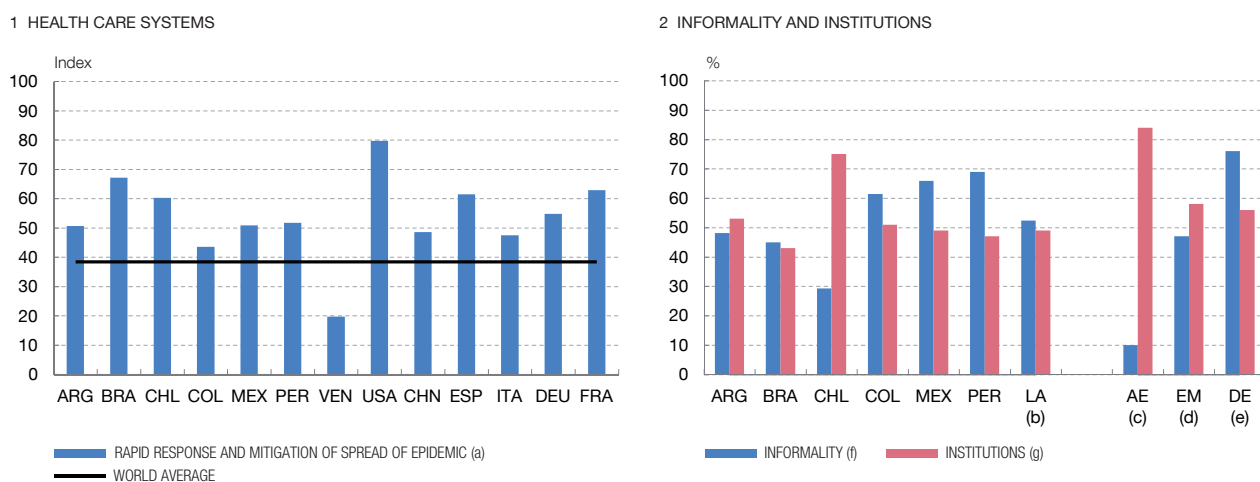
5 Kaufmann, D., K, Aart and M, Massimo, The Worldwide Governance Indicators: Methodology and Analytical Issues (2010). World Bank Policy Research Working Paper No. 5430.

Chart 4

RELEVANT EX ANTE FACTORS IN CONTROLLING THE PANDEMIC

In tackling the pandemic, the region's economies depart from an uneven situation as regards their health systems. Brazil and Chile have similar health systems to those of the advanced countries to respond to the spread of the pandemic and mitigate it. Argentina, Mexico, Peru and, in particular, Colombia have a somewhat less favourable starting position. Further, these countries' high informality and lower institutional quality compared with the advanced economies may be factors that amplify the economic impact of the pandemic.

1 HEALTH CARE SYSTEMS

2 INFORMALITY AND INSTITUTIONS

RAPID RESPONSE AND MITIGATION OF SPREAD OF EPIDEMIC (a)
WORLD AVERAGE

INFORMALITY (f)   INSTITUTIONS (g)

SOURCES: GHS Index, ILO, IMF and World Bank.

a Composite index (0-100), 2019.
b Latin America-6: Argentina, Brazil, Chile, Colombia, Mexico and Peru.
c AE: Advanced economies.
d EM: Emerging economies.
e DE: Developing economies.
f Informality: informal unemployment rate, latest year available (between 2011 and 2017).
g Institutions: government effectiveness, governance indicator, indicator re-scaled between 0 (minimum, worst institutions) and 100 (maximum, best institutions), 2018.

might affect the capacity and scope of the containment measures detailed in Chart 3.2.

Transmission channels and economic outlook

From the economic standpoint, the pandemic affects the region through several channels. First, the reduction in global economic activity, and in that of the main trading partners in particular, entails a fall in export volumes, the scale of which will depend on the intensity of the decline and speed of recovery in the different world economies. The degree of openness and, therefore, of exposure via the trade channel (see Box 2) is less in the region compared with other emerging areas, although cross-country heterogeneity is high, in particular regarding the ties with China (which are greater for Chile and Peru) and with the United States (above all for Mexico) (see Chart 5.1). In addition to direct exposure, a further factor is the countries' degree of integration into global value chains, especially for Mexico, closely linked to US industry, and Chile, in relation to China and other Asian economies (see Chart 5.3).
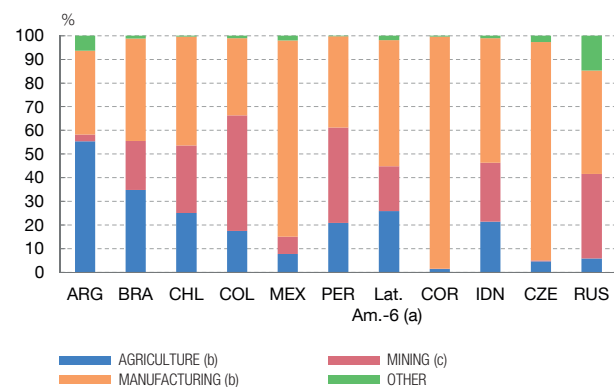
Chart 5

LATIN AMERICA: PANDEMIC TRANSMISSION CHANNELS

Although the degree of trade openness Is lower in the region compared with other emerging areas, some countries have close links with specific economies (Chile and Peru with China, and Mexico with United States), in respect of both final goods exports and participation in global value chains. Commodities prices, with a high weight in the region's exports, have fallen sharply since the outbreak of the pandemic, although they were already starting from levels below their historical average. The economy most affected by the fall in oil prices is Mexico, despite not being a net oil exporter, owing to the position of the State-owned company PEMEX. Lastly, another relevant transmission channel is tourism, whose weight in GDP is higher than that of other emerging areas.
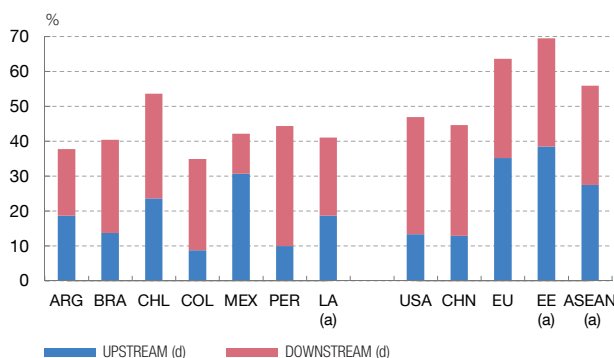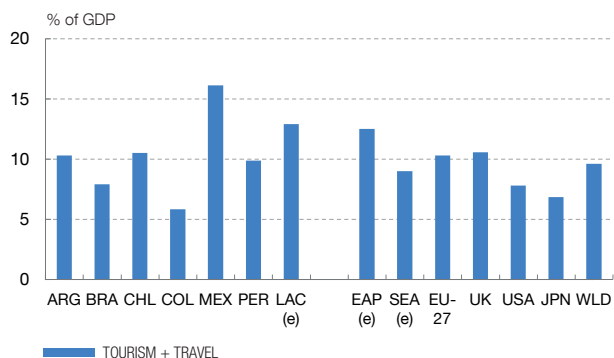
1 TRADE OPENNESS

Goods exports as a % of GDP

UNITED STATES
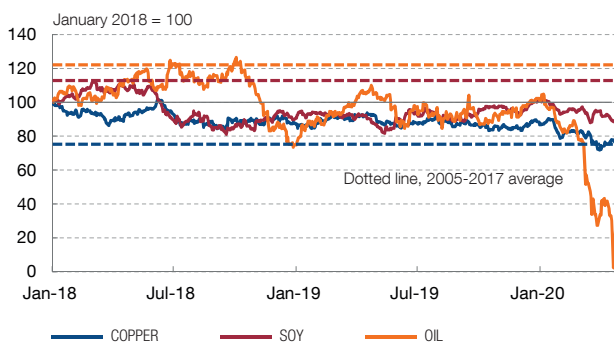EU
CHINA
REST OF THE WORLD
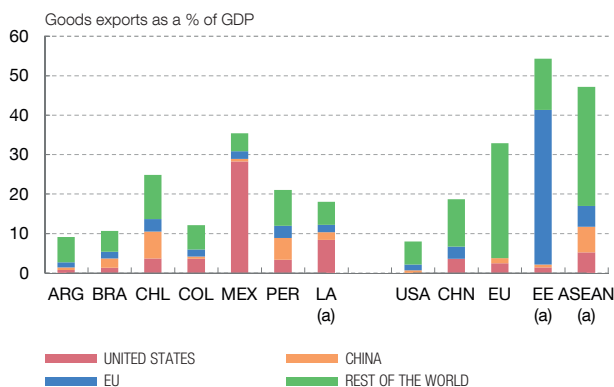
2 BREAKDOWN OF EXPORTS BY TYPE OF PRODUCT

%

AGRICULTURE (b)
MANUFACTURING (b)
MINING (c)
OTHER

3 PARTICIPATION RATE IN GLOBAL VALUE CHAINS

%

UPSTREAM (d)
DOWNSTREAM (d)

4 TOTAL CONTRIBUTION OF TOURISM TO GDP

% of GDP

TOURISM + TRAVEL

5 COMMODITIES PRICES

January 2018 = 100

Dotted line, 2005-2017 average

COPPER
SOY
OIL

6 RISK PREMIUM ON MEXICAN GOVERNMENT AND PEMEX DEBT, AND OIL PRICES

Basis points $ per barrel (reverse)

CDS MEXICAN GOVERNMENT
WTI PRICE (right-hand scale)
CDS PEMEX
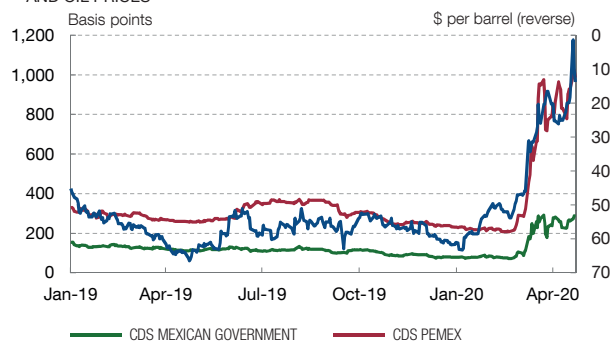
SOURCES: Thomson Reuters, OECD, World Bank, UNCTAD-Eora GVC Database and WTO.

a LA: Aggregate of Argentina, Brazil, Chile, Colombia, Mexico and Peru; EE: Eastern Europe (EU-13); ASEAN: Association of Southeast Asian Nations.
b The food, beverages and tobacco heading is inlcuded under the agricultural aggregate, not under manufacturing, unlike in the original source (OECD).
c "Mining" includes oil extraction.
d Upstream: proportion of exports used as an input by industries in other countries that produce goods and services intended for export to third countries (indirect exports of added value). Downstream: proportion of exports made up by the value added of foreign goods and services used as inputs to produce goods and services for export.
e LAC: Latin America and Caribbean; EAP: East Asia and Pacific; SEA: South-East Asia.

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As a result of the pandemic and of the measures to tackle it, global value chains are being significantly disrupted and bearing down negatively in particular on activity in Mexico.

The weight of commodities in the region's exports is high, with the exception of Mexico (see Chart 5.2). Accordingly, developments in not only the demand for but also the prices of these products and, by extension, the terms of trade are essential for these economies. In this respect, the decline in commodities prices since the start of the year owing to the contraction in Chinese demand has gradually steepened with the spread of the epidemic to other areas in the world. And this in a setting in which the starting point for prices of these products before the health crisis was below its historical average (see Chart 5.5). The decline was particularly sharp from late February in the case of oil prices. The reason lay not only in the fall-off in demand caused by the pandemic, but also in the lack of agreement between OPEC and Russia to reduce oil supply. In mid-April the two parties did reach an agreement, but this has not provided for a pick-up in oil prices. Among the main Latin American economies analysed in this report, Colombia is the biggest net exporter of oil in terms of GDP (around 3.5%). As a result, a scenario of very low prices may ultimately have significant adverse effects on its trade balance. But the main negative consequences of low oil prices have been witnessed in Mexico[6], despite the fact it is a net oil importer. This is due to the worsening of the position of the State-owned oil company, PEMEX, which has been reflected in the valuation of the company's debt (see Chart 5.6) and in the recent downgrade both of Pemex and the Mexican government by one or more rating agencies.

Another key transmission channel for the pandemic is through the impact on tourism. The weight of this sector in the GDP of the main Latin American economies is greater than in other emerging areas (averaging around 12%, similar only to the emerging East Asian and Pacific economies). It is particularly important in Mexico (see Chart 5.4), with a high weight for tourism from outside the region. Consequently, the containment measures (including the ban on travel) adopted by the national authorities and in other countries have led to a drastic reduction in demand in this sector. One further factor of particular importance is the dynamics of emigrants' remittances, which are particularly significant in the case of Mexicans resident in the United States. The amount of these remittances peaked in 2019 ($36 billion, 2.8% of GDP), and how they evolve in the short term will depend on the extent to which the sectors in which these workers are employed are affected.[7]

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6 The adverse consequences are also significant in Argentina, where the non-conventional exploitation of the Vaca Muerta gas and oil field was considered to be one of the main sources of growth for the coming years, and, with the lower oil prices, many of the projects expected to be pursued have seen their profitability fall.

7 By way of a reference, owing to the 2008/2009 global financial crisis, the flow of remittances from the United States to Mexico fell by 21% from 2008 Q1 to 2010 Q1, and only in 2016 did remittances manage to recoup their 2007 level.

The financial markets have reacted significantly to the health crisis. Since the expansion of the epidemic beyond China's borders, risk aversion on international financial markets has increased markedly, with shifts in investors' holdings towards safe-haven assets. As Charts 6.1, 6.2 and 6.3 show, the emerging economies' financial markets worsened notably, with declines on stock markets most pronounced in the Latin American indices. There were also increases in sovereign yields and exchange-rate depreciations. As a result, the financial stress indicators (which summarise the aggregate downturn on markets) increased substantially in Latin America, to around their end-2008 highs (See Chart 6.4). Meantime, the financial conditions indicators, which shows the greater or lesser ease with which agents can finance themselves in each economy, tightened substantially. They exceeded historical average conditions and attained peak levels of tightening as from early 2016 (see Chart 6.5). Some of these adverse developments have eased in part subsequently, following the global response of the main central banks to the pandemic. In terms of capital flows, debt and equity portfolio outflows were, from end-February to end-March, on a much greater scale than that observed in the 2008-2009 financial crisis and at other times of turbulence in the past decade (see Chart 6.6).[8] At the same time, issuance on international markets, which had reached a new high in 2019, was seen to come practically to a halt. However, there were renewed issues by some governments in the region in April.

Finally, domestic demand in the region's countries is being acutely affected by the influence of the restrictions associated with the containment measures set in train by the authorities. These measures are also exerting an impact on the supply side. The intensity of this channel will depend on the duration of these measures and on the responsiveness of offsetting demand-side policies, which will be discussed in the following section. The forgone income of workers who cannot perform their tasks normally is affecting consumer spending. The reduction in firms' cash-flow, along with increased uncertainty, entails a fall in investment. Domestic demand in the economies is thus expected to contract considerably, having already looked notably sluggish in 2019. The health crisis, moreover, exerts adverse effects on the supply side of the economy; the public health measures entail the total or partial shutdown of firms, and the cancellation of activities and events, impacting especially the aviation and tourism industries, and retail trade services. Further, the direct influence of the virus on the workforce also has the potential to create adverse effects on the supply side.

The dissemination of the negative effects of the pandemic through these channels has notably worsened the short-term outlook for Latin American economic activity. Analysts have progressively revised their growth projections for the region, auguring
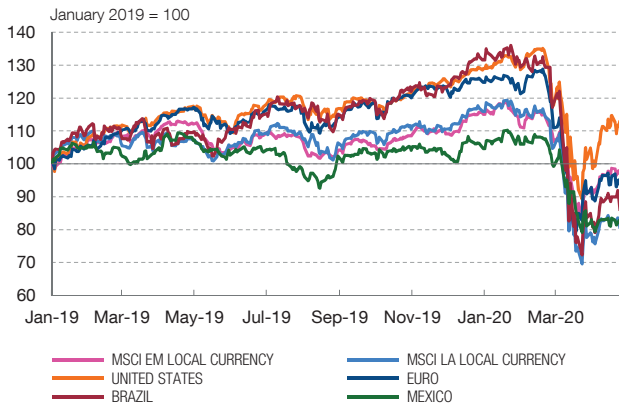
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8 The daily data on portfolio capital flows provided by the Institute of International Finance (IIF) cover only Brazilian and Colombian equity flows and Mexican and Colombian bonds. Accordingly, what are involved are partial data on the portfolio capital flows of the six countries considered in this Report.
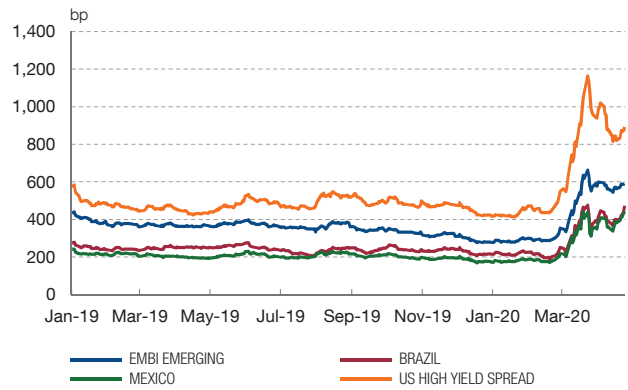
Chart 6

MARKED DETERIORATION IN LATIN AMERICAN FINANCIAL MARKETS

Emerging markets, which performed favourably until late 2019, were impacted by the spread of the epidemic outside China as from February and by the subsequent increase in global risk-aversion. Stock markets fell, sovereign yields rose and exchange rates depreciated substantially. Moreover, there were unprecedented capital outflows. Of particular note in Latin America was the heavy depreciation of the Mexican peso, weighed down by the fall in oil prices. In the final days of March, the markets stabilised following the expansionary measures announced by the advanced and emerging economies' authorities.
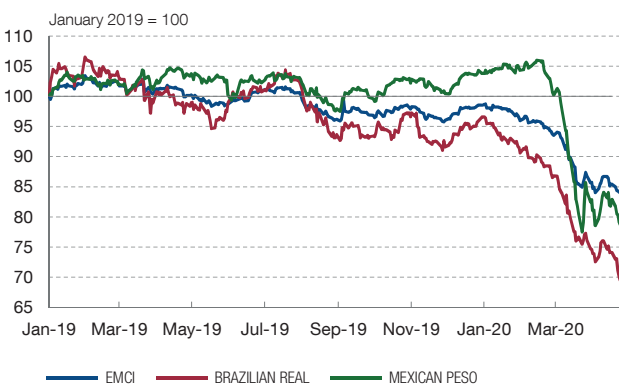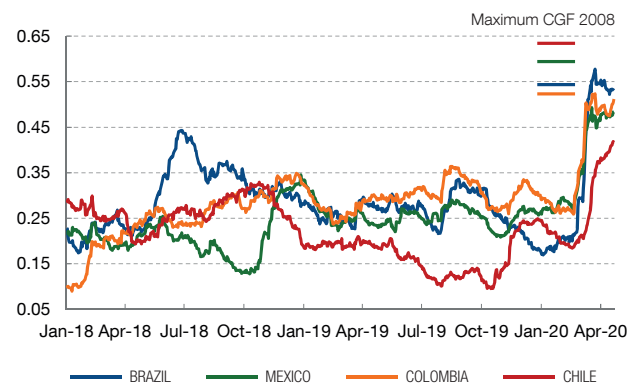
1 STOCK EXCHANGE INDICES

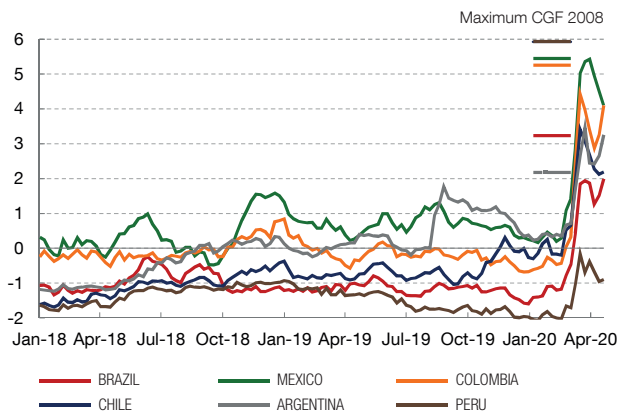January 2019 = 100

Legend:
- MSCI EM LOCAL CURRENCY
- MSCI LA LOCAL CURRENCY
- UNITED STATES
- EURO
- BRAZIL
- MEXICO

2 SPREADS

bp

Legend:
- EMBI EMERGING
- BRAZIL
- MEXICO
- US HIGH YIELD SPREAD

3 EXCHANGE RATE AGAINST THE DOLLAR

January 2019 = 100

Legend:
- EMCI
- BRAZILIAN REAL
- MEXICAN PESO

4 FINANCIAL STRESS INDEX

Maximum CGF 2008

Legend:
- BRAZIL
- MEXICO
- COLOMBIA
- CHILE

5 FINANCIAL CONDITIONS INDICES (a)

Maximum CGF 2008

Legend:
- BRAZIL
- MEXICO
- COLOMBIA
- CHILE
- ARGENTINA
- PERU

6 CAPITAL FLOWS TO EMERGING MARKETS ($bn)

Base t = 0 at the beginning of each event

Legend:
- LEHMAN BROTHERS BANKRUPTCY (15.9.2008)
- TAPER TANTRUM (22.5.2013)
- CHINESE STOCK MARKET CRASH, 2015 (18.8.2015)
- COVID-19 (20.1.2020)
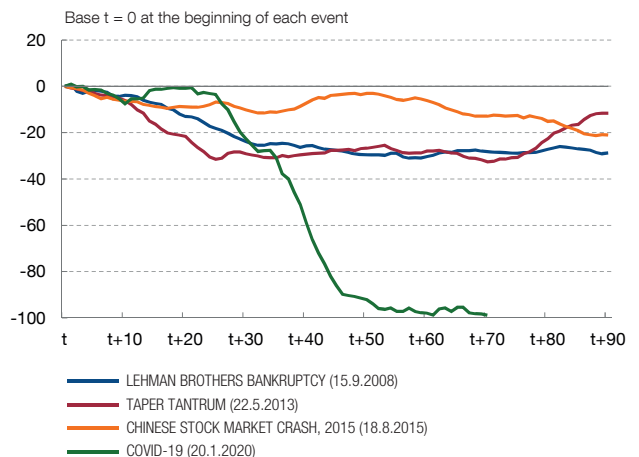
SOURCES: Thomson Reuters, Institute of International Finance and JP Morgan.

a An increase denotes a contraction in financial conditions.

negative rates for 2020 as a whole for most of the region's countries (see Chart 1.5). It thus cannot be ruled out that GDP may contract more than in the 2008-2009 financial crisis. Most analysts anticipate that the effect of this shock will be transitory, and global. That means that the Latin American economies, like those in the rest of the world, will recover as from the second half of this year, posting a rate of 3% in 2021 (for the Latam-6 aggregate). The expected rebound in activity for the main Latin American economies, however, will be less than for other areas. This possibly reflects the greater structural weakness in the region and the fact that the Latin American economies usually take longer to recover from strong shocks than other world regions.[9] The factors at play here include less fiscal space to slacken the shock; the bigger decline in income for a large number of households in the informal sector; the weight in the economy of certain sectors where recovery will be lagging; and a greater proportion of SMEs that have a greater probability of failing. However, these estimates are at present shrouded in uncertainty, particularly regarding the duration and intensity of the containment measures and the health crisis (see Box 3), globally. The resilience of the economy, in these scenarios, hinges crucially on the economic policies applied and their success in lessening the persistence of the adverse effects of the shock once the health situation normalises.

Economic policy responses

The Latin American authorities have reacted swiftly, adopting economic policy measures to alleviate the economic effects of the pandemic. As regards monetary stimuli, the region's central banks have resorted across the board to policy interest rate cuts (see Chart 7.1). Since the start of the epidemic there have been rate cuts in Brazil (50 bp), Chile (125 bp), Colombia (50 bp), Mexico (100 bp) and Peru (200 bp), occasionally outside the regular decision-making schedule. Some central banks have also adopted measures involving asset purchases, credit backing, and the provision of dollar- and local currency-denominated liquidity to domestic financial markets (see Table 2). To counter the notable depreciation of the region's currencies, central banks have also adopted measures aimed at stabilising the exchange rate. To this end, Argentina and Brazil intervened directly on the foreign exchange markets, while Chile, Colombia, Mexico and Peru extended their current programmes geared to preventing sharp fluctuations in their exchange rates.

However, conventional monetary policy has less room for manoeuvre than during the 2008-2009 global financial crisis. Comparing the pre-crisis situations, the official interest rates of the Latin American countries with inflation targets were already at relatively low levels at the start of the current crisis. Indeed, in Chile, interest rates following the cuts are at the lows attained in the financial crisis, while in Peru they are

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9 See, for example, the IDB 2020 Latin American and Caribbean Macroeconomic Report "Policies to combat the pandemic".

Chart 7

ROOM FOR MANOEUVRE OF CONVENTIONAL MONETARY POLICY

Across the board, central banks have responded with significant policy interest rate cuts and other monetary and foreign exchange measures. However, the initial starting point is worse than in the 2008/2009 global financial crisis: policy interest rates are at similar levels to the lows for that period (except in Mexico, which has greater room for manoeuvre), and even far below, as is the case in Brazil; there is a risk of pass-through to inflation from the depreciation of their currencies (albeit offset by deflationary pressures resulting from the decline in activity and lower energy prices); and real effective exchange rates are more depreciated, except in Peru, than in the previous crisis.
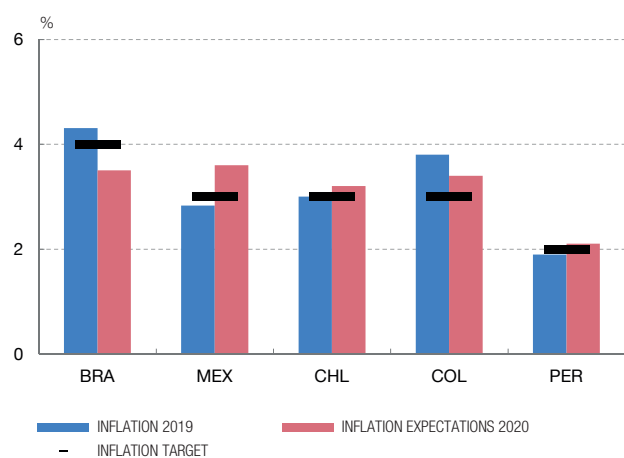
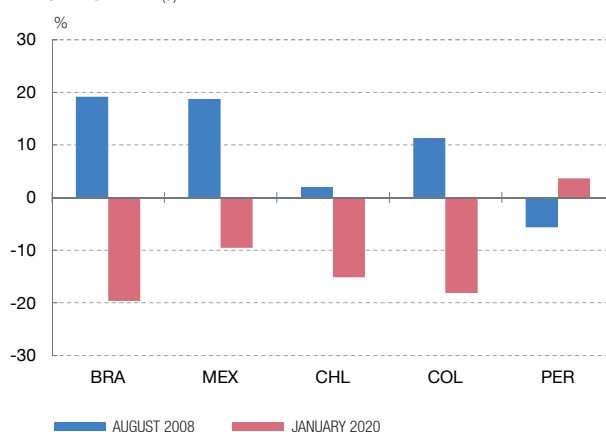1 POLICY INTEREST RATES IN THE MAIN LATIN AMERICAN ECONOMIES
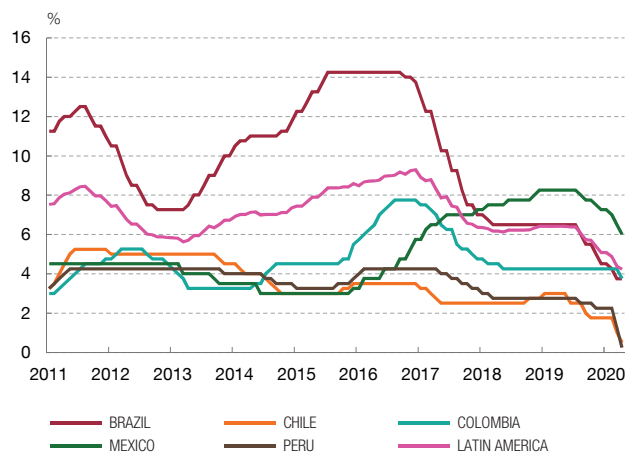
2 POLICY INTEREST RATES
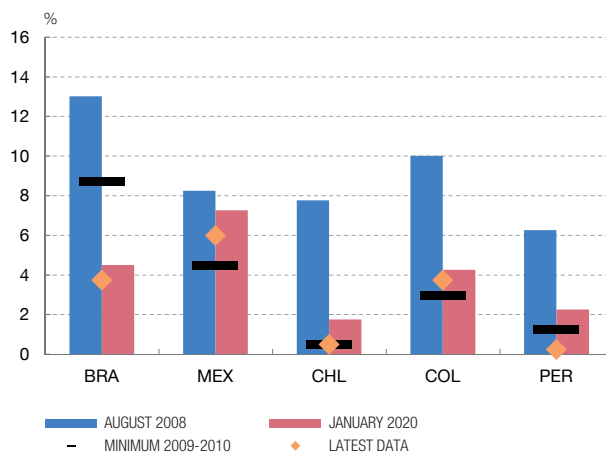
3 INFLATION

4 APPRECIATION (+)/ DEPRECIATION (–) OF THE REAL EFFECTIVE EXCHANGE RATE (a)

SOURCE: Thomson Reuters.

a The real effective exchange rate at the two points in time - August 2008 and January 2020 - is expressed as a percentage difference relative to the average since 2005.

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under these lows. In both countries, rates are close to zero (see Chart 7.2). In Brazil's case, they stand notably below the level during the crisis. The country that appears to have most latitude is Mexico, although the greater historical exposure of its currency - in the group of the emerging economies - to bouts of depreciation in situations of uncertainty might limit the Mexican monetary authority's capacity. Generally, in all the countries the latest inflation expectations remain close to target

Table 2

MAIN MONETARY POLICY MEASURES ADOPTED BY THE AUTHORITIES DURING COVID-19 CRISIS

Measure / Country	Argentina	Brazil	Chile	Colombia	Mexico	Peru
Cut in benchmark interrest rate (to % level)		−50 bp (3.75%)	−125 bp (0.5%)	−50 bp (3.75%)	−100 bp (6.0%)	−200 bp (0.25%)
Asset purchases		Sovereign bond repos in dollars (10% discount)	Bank bond purchase programme worth $8 billion	Purchases of private debt securities ≤ 3 years for a total amount of $10 billion Purchases of government debt on the secondary market up to $2 billion		
Credit support	Credit at subsidised rates channeled by public and private banks to firms in affected sectors and construction, and for durable goods purchases Reduction in reserve requirements on bank loans to SMEs and households	Easing of Basel criteria (capital and liquidity) Term deposit with special guarantees (DPGE) Reduction in cost of extraordinary liquidity to meet reserve requirement	Financing facility conditional upon increased bank credit (FCIC) Interest rate: policy rate at time of access thereto; effectiveness: 6 months; term: 4 months; initial amount: 3% of the business and consumer credit portfolio Liquidity credit line (LCL)		Reduction in cost and extension of securities and counterparties, for the Central Bank-banks credit line (ordinary additional liquidity facility) Reduction in capital requirements Provision of funds for lending to SMEs and individuals	
Liquidity measures		Temporary liquidity line (LTEL): loans secured by debt or bonds to financial institutions 8 pp reduction (from 25% to 17%) in cash ratio for term deposits	Corporate bonds will be included under eligible collateral for all peso-denominated liquidity opderations in force, including the FCIC	Increase by $6.5 billion in liquidity tenders Extension of repo terms Repo tenders with private debt securities worth 500 billion Reduction in reserve requirement Permanent liquidity in the economy ($9 billion)	Government debt securities swaps Temporary exchange of collateral (up to Peso 100 billion) Credit tenders in dollars ($2 billion) Liquidity provision in peso and at market opening times Creation of new liquidity instrument for firms (corporate security reporting facility)	Overnight repos for daily average of Soles 1.4 billion, 6-month repos for 1.4 billion and 1-year repos for 1.5 billion 2-year repo tender for 400 million More flexible capital requirements in domestic and foreign currency, thereby releasing the equivalent of Soles 2 billion New liquidity instrument for firms: repos with State guarantee for firms
Swap lines		Swap line with the Federal Reserve ($60 billion)			Swap line with the Federal Reserve ($60 billion)	
Use of international reserves	Sale of 2.2% of gross reserves to mitigate currency depreciation	Direct forex market interventions (6% of total reserves)	Extension of currency sale, repos and swaps programme to 2021	Dollar swaps for $800 billion Foreign exchange hedge via tender of financial compliance forward operations for $2 billion at 30 days	Extension of hedge programme by $10 billion up to $30 billion	Sale of swaps: $2 billion

SOURCE: Devised by authors.

(see Chart 7.3); but as in the financial crisis, their future monetary policies might be influenced by the depreciation of their currencies and its pass-through to inflation.[10]

10 Recent empirical evidence indicates that the pass-through of exchange-rate depreciations to inflation is less in Mexico than in the other countries in the region (see Banco de España, "Report on the Latin American economy. First half of 2016"). This pass-through depends on the openness of the economy, the credibility of the central bank, inflation expectations and the sign and size of the output gap.

Nonetheless, for the moment central banks consider that the deflationary pressures from the decline in activity and from lower energy prices are greater than the inflationary pressures from exchange-rate depreciations and from firms' higher financial costs.

Compared with the 2008-2009 global financial crisis, the Latin American countries have generally started from an initial position of more depreciated real exchange rates. As Chart 7.4 shows, with the exception of Peru, real effective exchange rates were notably more depreciated before the start of the pandemic than in the run-up to the global financial crisis at the end of the previous decade. Consequently, the exchange rate may play a less significant role in absorbing economic shocks, increasing the relative demand for goods produced in the region and the local currency-denominated proceeds from commodities exports.

On the other hand, currency depreciations adversely affect external debt service. Once again with the exception of Peru, the Latin American economies have notably raised their external debt since 2008. Chile is a notable case in point, where it has risen by more than 45 pp of GDP (see Chart 8.2). A high proportion of such debt is, moreover, foreign currency-denominated, particularly in the case of the Chilean corporate and Argentine government sectors. From this standpoint, the most vulnerable countries when it comes to meeting external debt obligations are those which most depend on external financing (with a high external debt and current account deficit, see Charts 8.3 and 8.4) and/or those that are experiencing the biggest capital outflows. As a positive factor, however, the international reserves built up by these countries are at a higher level than before the 2008-2009 global financial crisis (see Chart 8.1). In terms of vulnerabilities, the household and business sectors in the Latin American countries have a lower level of debt than other emerging regions, with the exception of Chile. Another positive aspect is the starting point of the financial system, since most institutions have higher solvency, liquidity and profit levels, with no major currency mismatches on their balance sheets. However, the resilience of the financial system may be dented if the health crisis runs for longer and the recovery is slower than expected.

As in the developed economies, the countries in the region have adopted fiscal policy measures to tackle the effects of the pandemic. On one hand, all the countries have approved extraordinary budgetary items to reinforce their health systems. On the other, the Latin American countries have adopted fiscal policy measures to counter the adverse effects on economic activity. In some cases, they have deferred or eliminated the payment of certain taxes and have subsidised the activities or persons affected (see Table 3). But as mentioned earlier, the implementation of these measures may prove complex owing to the region's high labour market informality, especially for those individuals who did not benefit in the past from means-tested income transfer programmes. Moreover, owing to liquidity tensions, practically all the countries have implemented some measure seeking to guarantee credit for

Chart 8
EXTERNAL VULNERABILITIES

Against the background of high capital outflows and currency depreciations, the most vulnerable economies are those with high external debt or greater financing requirements. The Latin American countries have raised their external debt substantially since 2008 (except Peru) and are posting current account deficits. On the positive side, at end-2019 all the countries had a higher volume of international reserves than at the start of the 2008 crisis.
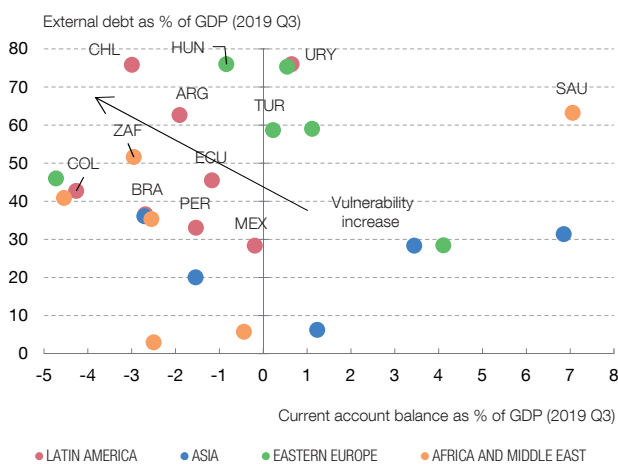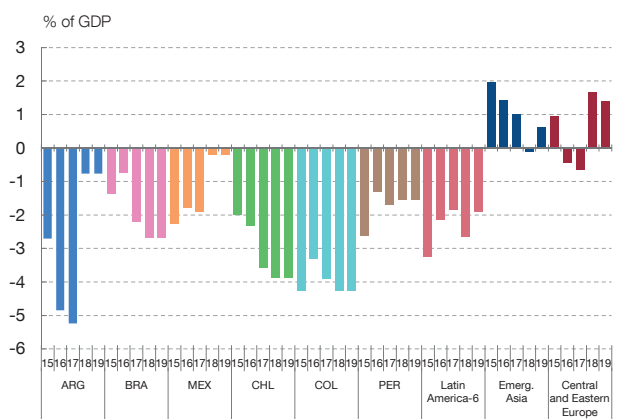
1 INTERNATIONAL RESERVES
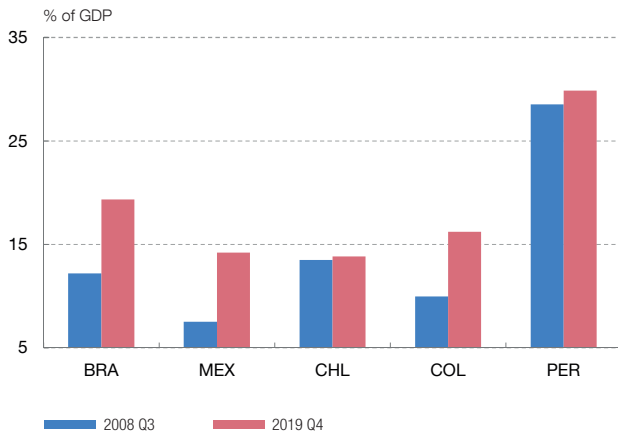
2 EXTERNAL DEBT, AS PERCENTAGE OF GDP
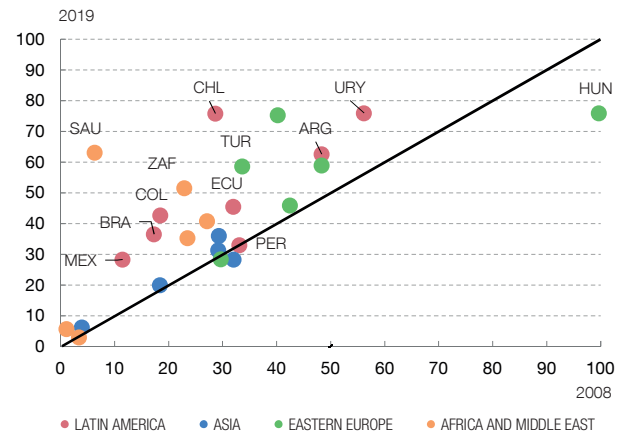
3 VULNERABILITY

4 CURRENT ACCOUNT BALANCE

SOURCES: Thomson Reuters, IMF and national statistics.

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companies. The budgetary impact of these measures varies considerably, with the size of the Chilean and, especially, Peruvian fiscal packages standing out (the latter at over 10% of GDP).

However, the fiscal space of the Latin American countries is also limited, and might curtail the possibility of setting additional measures in train. The countries in the region, with the exception of Peru, face the current crisis with higher public debt levels than those in place at the start of the 2008-2009 financial crisis. Brazil and

Table 3

MAIN FISCAL MEASURES ADOPTED BY THE AUTHORITIES DURING THE COVID-19 CRISIS

| Measure / Country	Argentina	Brazil	Chile	Colombia	Mexico	Peru
Support to health care system	Reallocation of budgetary items to health Extra payment in April to medical staff owing to greater workload Lower tariffs on medical supplies	0.15% of GDP	0.4% of GDP	VAT exemption on medical product imports	Up to 1% of GDP [creation of health emergency and economic crisis fund, potentially (up to 0.7% of GDP), prepayments to states (0.1% of GDP), additional funds to National Welfare Health Institute (0.2% of GDP)]	0.1% of GDP
Deferral or suspension of taxes	Social contributions payment exemption for sectors most affected	Deferral of Social Security contributions Reduction to zero tariff or temporary suspension of payment of financial transactions tax (IOF) Reduction to zero or suspension of payment of tariffs and sales tax on health-related products	0.8% of GDP for 3-month postponement of personal income tax 0.5% of GDP for 3-month deferral of VAT payment 0.2% of GDP for advance refunds of income tax to SMEs 0.2% of GDP for deferral of firms' and individuals' SS contributions	Deferral of tax contributions for tourist sector	Some local governments announce suspension of private sector payments (including certain tax payments) until 20 April	Temporary suspension of contributions to pension schemes (a)
Consumer support	Subsidy to lower-income individuals Subsidised financing for durable goods purchases	Income-support policies (600 reales for 3 months) for the vulnerable Extension of Household Support Allowance	< 0.5% of GDP to a solidarity fund to cover social emergencies < 0.1% of GDP to pay informal unemployment subsidy	VAT refund arrangements brought forward for the most vulnerable	Support for the elderly [e.g. spending on pensions (0.15% of GDP)] brought forward Mortgage and personal loans (0.9% of GDP)	Soles 380 ($107) subsidy for 3.5 million households $57 million for the most vulnerable
Subsidisation of labour and unemployment costs, and support for businesses	"Bolstering" of unemployment insurance	More flexible working conditions (teleworking, bringing forward of holidays, reserve of working hours)	0.6% of GDP to Shutdown Fund to finance wages of workers whose activity has been ceased Wage compensation for shorter working day 0.3% of GDP for prepayment of suppliers	Creation of a guarantee fund to help firms	Accelerated payment from State to firms	Creation of a business support fund with $84.4 million + $171 million to subsidise jobs + $1.2 million from the saving fund for workers whose contract has been terminated
Liquidity provision to firms	Credit at subsidised rates for firms	Loans to SMEs (reales 5 billion from the BNDES + reales 40 billion credit line)	Greater flexibility in repayment by SMEs and individuals of tax debts to the State 0.16% of GDP ($500 million) in new capitalisation to the State Bank to deliver loans to individuals and SMEs Loan guarantees for $3 million	Credit line to the tourist sector (up to $60.6 million) Suspended payment of loan instalments for two months for households and firms	New credit lines for SMEs (0.1% of GDP) Greater liquidity provision by public banks ("development banking") (0.25% of GDP)	Loans to SMEs and microfirms (0.05% of GDP)
Aggregate demand	Loans for homebuilding and reform	Interruption of debt payments to municipalities, states			Public and private investment in the energy sector (1.5% of GDP) and basic infrastructure (0.1% of GDP)	
Budgetary impact (% of GDP)	1.2	2.9	5.2	3.0	up to ≈ 4 % of GDP	12.0

SOURCE: Devised by authors.

a The Government also authorises the withdrawal of up to Soles 2,000 from its pension fund for all fund-members who ceased to contribute in the past six months.

Chart 9
LIMITED FISCAL SPACE

To be able to adopt fiscal stimulus measures to counter the crisis, fiscal space is limited in the Latin American economies. The level of public sector debt is significantly higher than that at the start of the 2008/2009 global financial crisis, except in the case of Peru. Of particular note are Brazil and Argentina, with public debt at over 90% of GDP. Moreover, all the region's economies analysed in this Report, again with the exception of Peru, have a structural budget deficit at the start of this crisis that may limit the space available to pursue countercyclical policies.

1 PUBLIC DEBT

2 STRUCTURAL FISCAL BALANCE

2008   2019

SOURCE: IMF.

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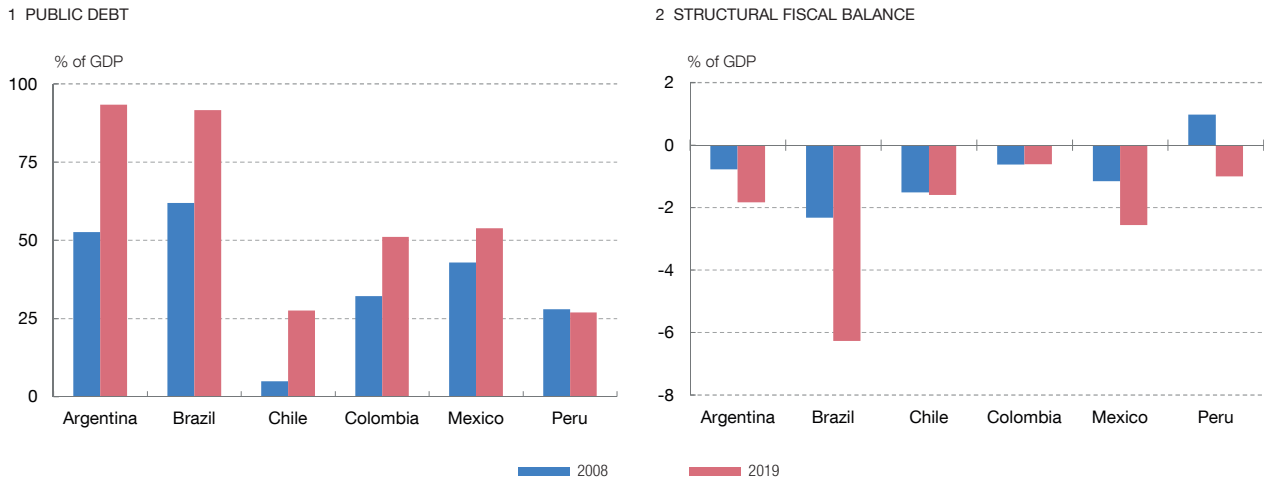
Argentina, whose public debt exceeds 90% of GDP (see Chart 9.1), have particularly high debt levels.[11] In addition to higher debt, the region's main economies start from an initial position of higher structural public debt (see Chart 9.2), which may restrict the space available to pursue countercyclical policies. In addition, the risk premia on public debt have risen and capital flows towards the emerging markets have been reversed, which will bear down on the debt interest burden and hamper the financing of bigger budget deficits. In this respect, it is crucial that financial markets perceive the increase in budget deficits to be due to the adoption of these exceptional measures, and that the measures are temporary and, therefore, reversible. Gradual, medium-term budgetary plans should then be laid, allowing the stock of public debt to move towards lower levels.

Against this background, support from supranational institutions and the international coordination of economic policies is vital. The global nature of the crisis advises harnessing to the full and potentially expanding the international financial architecture and global coordination mechanisms available. First, the definition of globally coordinated actions, such as those under study in the G20, take on particular importance for the most vulnerable economies, which include those in Latin America.

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11 Argentina has been renegotiating its public debt since before the coronavirus crisis. The prospects of a successful conclusion have worsened owing to the greater international financial volatility.

Such actions encompass both those aimed at stimulating global growth and those geared to specific problems, such as debt moratoria, where necessary. Second, the IMF has tools to support the countries in the region, through various financial assistance facilities, which may prove vital for replenishing the stock of international reserves, maintaining access to essential imports and providing budgetary stimulus measures. In this connection, for example, Colombia could apply for the disbursement of the flexible credit line it has with the IMF, while the Peruvian government has requested its inclusion in this arrangement, of which Mexico has also availed itself. Some economies in the region, moreover, are subject to IMF programmes. These involve sizeable loans whose conditions will possibly have to be renegotiated to provide more flexibility to the recipients, given the severity of the crisis. Finally, regarding monetary policy and financial stability, the US Federal Reserve has re-established temporary swap facilities with some of the region's central banks (Brazil and Mexico) and has set in train a new overnight repo facility (FIMA)[12], to provide access to dollars. The facility entails significant liquidity support for alleviating tensions on global financial markets in general, and in Latin America in particular.

Cut-off date: 24.4.2020.
Publication date: 29.4.2020.

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12 The FIMA repo facility allows central banks to sell US Treasuries to the Federal Reserve's System Open Market Account, with these central banks agreeing to buy them back at the maturity of the overnight repurchase agreement, although these operations may be extended. The operations bear an interest rate of 25 bp over IOER (0.10% at present) and will be functioning as from 6 April for a minimum period of six months.

Box 1

THE RECENT SOCIAL TENSIONS IN LATIN AMERICA

Throughout the second half of 2019, there were demonstrations and social protests in numerous Latin American and Caribbean countries, such as Ecuador, Bolivia, Colombia, Puerto Rico, Haiti, Venezuela and Chile, and in other regions, such as Hong Kong, Algeria, Iraq, Lebanon, Iran, India, Malta and France. True, these processes have been eclipsed by the current situation of the global health crisis. But their potential significance for the economic development of the countries affected, in both the short run (owing to the economic impact of the conflicts and their resolution) and the medium term (linked to possible institutional reforms) is unquestionable.

This box offers evidence on the short-term impact of the social protests (essentially, the uncertainty over the economic policies to pursue, and strong tensions on financial markets) for the case of Latin America. It also sets the context in which they have arisen, namely social inequality and growing discontent with the functioning of institutions. It further sets out the policies announced and implemented, in certain cases, in response to these episodes.

The demonstrations and social protests in late 2019 were mainly in Ecuador, Bolivia, Colombia and Chile. In Ecuador, the announcement of an adjustment package that included cuts to certain fuel subsidies sparked the protests; in Bolivia, they arose following the controversy over the October general election results; and in Colombia, following a political corruption case coming to light. Finally, to Chile where, although the trigger may have been the rise in underground transport ticket prices in mid-October, the protests progressively increased in intensity and scale, and were closely linked to the student movement. These episodes were accompanied by an increase in economic uncertainty in the countries in which they arose. This was particularly so in Ecuador and Chile,

for example, where bouts of violence broke out. Indeed, both the indicators of economic policy uncertainty and the financial market stress indices[1] (see Charts 1.1 and 1.2) started to post high values in the final stretch of 2019. They even attained previous highs relating to events as notable as the financial turbulence in August last year[2], or the escalation of China/US trade tensions. In some economies, such as Chile, the ongoing conflict led to the slowdown and even standstill in activity in some sectors, which translated into a contraction in the economy in 2019 Q4.[3]

The dynamics behind the demonstrations and social protests have not been the same in all countries. However, as part of the extensive set of factors that are usually highlighted, there are some broad, common elements. These include most notably the discontent of a good number of citizens with the economic situation and their prospects for progress, in particular among the under-privileged (inequality of income and opportunities; access to public goods and services), and dissatisfaction with the functioning of institutions and the political system.[4] There are internationally comparable indicators that allow an approach to some of these aspects.

As regards inequality, measured by the usual indices (the Gini coefficient of gross income), average levels in the region are higher than in other emerging economies, and higher too than what might be expected given their relative level of per capita income (see Chart 2.1).[5] Here, fiscal policy performs a less decisive distributive function than in other reference emerging countries and in higher-income economies, as inferred by the smaller reductions the Gini coefficient undergoes when applied to disposable income, after tax and transfers (see Chart 2.2).[6] Poverty, for its part, has fallen in the past decade in Latin America as a whole. On the somewhat lagged data available, the

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1   Regarding the economic policy uncertainty indices and the related methodology, see Ghirelli C., J. J. Pérez and A. Urtasun (2019). A new Economic Policy Uncertainty index for Spain, Documentos de Trabajo no. 1906, Banco de España. As to the financial market stress indices for the emerging economies, these are drawn from Berganza J.C., A. Buesa and L. Molina (2020, forthcoming).

2   See Box 1 of the "Report on the Latin American economy. Second half of 2019", Banco de España, October 2019.

3   For a discussion of the transmission channels of social tensions to the Chilean economy, see the Informe de Política Monetaria del Banco Central de Chile de diciembre de 2019.

4   Some of these arguments are set out in, for example, Francisco Ferreira and Marta Schoch (2020), "Inequality and social unrest in Latin America: The Tocqueville Paradox revisited", 24 February 2020, World Bank Blogs. A broader time perspective is offered by, among others, Patricia Justino and Bruno Martorano (2019), "Redistributive Preferences and Protests in Latin America", vol 63 (9), Journal of Conflict Resolution.

5   These calculations might even be underestimated, according to ECLAC: see the publication Panorama Social de América Latina (2019).

6   There are no comparable data for a broader set of emerging economies. In the work "Commitment to Equity Handbook. Estimating the Impact of Fiscal Policy on Inequality and Poverty2 (Lustig, Nora, editor. 2018. Brookings Institution Press and CEQ Institute, Tulane University), Gini coefficients are constructed to measure the effect of public transfers, taking as a basis post-tax income. In any event, inequality in the region remains among the highest in all emerging areas, only below South Africa.

Box 1

THE RECENT SOCIAL TENSIONS IN LATIN AMERICA (cont'd)

number of people in a situation of "extreme poverty" ($1.90 per day) fell from 6.2% to 3.9% of the total, between 2010 and 2015 (around 7 million people less), while the number of people in a situation of "poverty" ($3.20 per day) dipped from 14.2% to 10.6% (17 million less). The enormous effort invested in reducing poverty rates in recent decades has created new middle classes which, however, will be in a position of high vulnerability in the face of a crisis or marked economic slowdown. ECLAC estimates that these vulnerable middle classes total 128 million people which, along with the lower-income (but above the poverty threshold) strata of the population, account for 77% of the region's total population.[7]

Turning to institutional development, the figures of the World Bank's Doing Business index are similar to those for other emerging areas, with some countries posting above-average figures. Nonetheless, some partial indicators show that institutional quality has worsened in several respects in recent years, in particular as regards government effectiveness, the monitoring of corruption and the rule of law. In this connection, government action is perceived with discontent by part of the population, in a setting in which the increase in the weight of the middle classes places upward pressure on the demands for more and better public services, as recent OECD[8] studies show and as the available surveys[9] of Latin American citizens manifest. Specifically, according to the 2018

Chart 1
MEASURES OF UNCERTAINTY OVER ECONOMIC POLICIES (a) AND FINANCIAL MARKETS (b)

In late 2019, uncertainty over the economic policies in the region increased, up to previous highs, as was likewise reflected in the financial markets. In 2020 Q1 there was an even bigger rise, stemming from the spread of the coronavirus epidemic outside China.

1.1 ECONOMIC UNCERTAINTY INDICATOR (a)
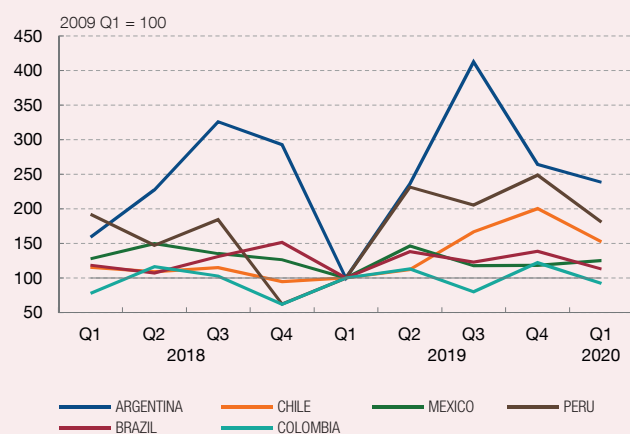
1.2 FINANCIAL STRESS INDEX (b)
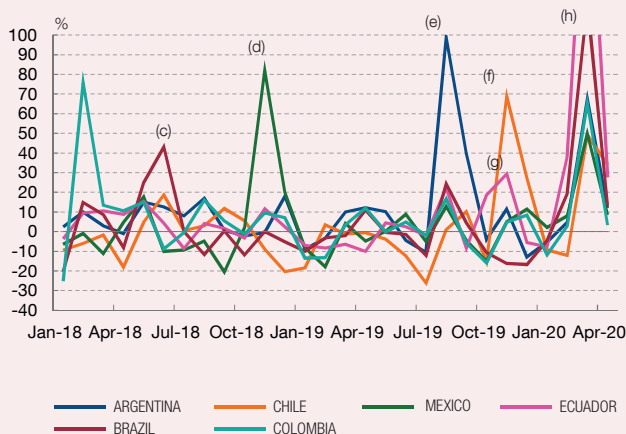
SOURCES: Banco de España, drawing on Ghirelli, Pérez and Urtasun (2020, forthcoming) and on Berganza, Buesa and Molina (2020, forthcoming).

a Quarterly average of the indicator that is constructed on the basis of the number of articles published in the Spanish press that contain a set of words related to the concept of uncertainty over economic policies.
b Monthly change in the financial stress index or equivalent in each country.
c Road haulage strike in Brazil. Bolsonaro running first in polls.
d Referendum rejecting the construction of a new airport in Mexico City.
e Unexpected opposition victory in the Argentine primary elections.
f Social protests heighten in Chile following the rise in public transport prices.
g Social protests in Ecuador following the approved cut to subsidies under the IMF agreement.
h Spread of the coronavirus epidemic outside China.

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7 See ECLAC (2019), op. cit.

8 Risks that matters (OECD, 2018).

9 Latinobarómetro, a public opinion survey conducted annually with around 20,000 interviews in 18 Latin American countries.

Box 1

THE RECENT SOCIAL TENSIONS IN LATIN AMERICA (cont'd)

Latinobarómetro survey and the cited OECD study, over 85% of respondents stated that the government should do more to shore up the economic and social situation; between 70% and 65% said they would have difficulty gaining access to public services were they to need them; and 79% indicated that the country was governed by a select number of powerful groups for their own benefit, with the figure rising to 90% in the odd country. Finally,

Chart 2
THE BACKGROUND AGAINST WHICH TENSIONS ARE ARISING IS GROWING MISTRUST IN INSTITUTIONS AND THE DECLINE IN GROWTH

The lower per capita growth in the region since 2005 (along with a high degree of inequality compared with the other emergingeconomies, the lack of public sector action to redress it and growing political polarisation) has increased people's mistrust of institutions and fuelled social protests.
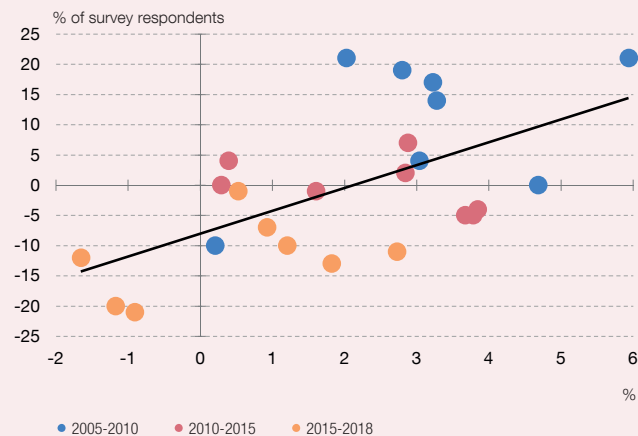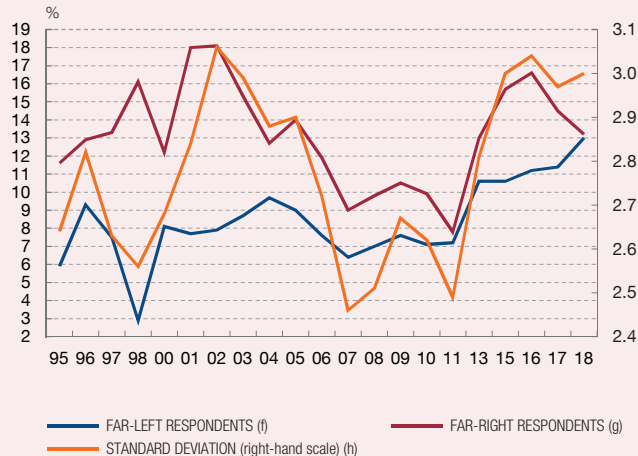
2.1 INCOME PER CAPITA (a) AND INEQUALITY (b)
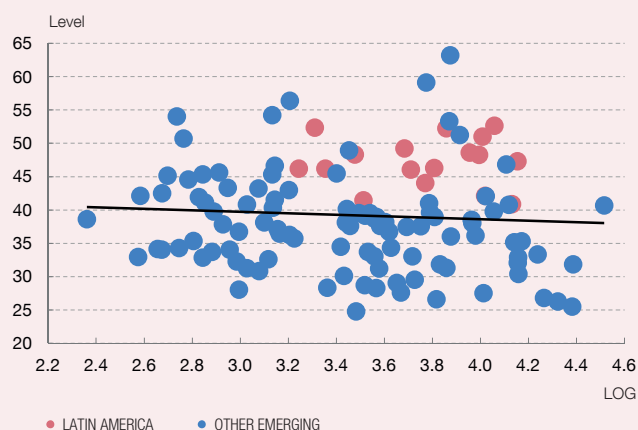
2.2 CORRECTION OF INEQUALITY THROUGH PUBLIC SECTOR ACTION (c)
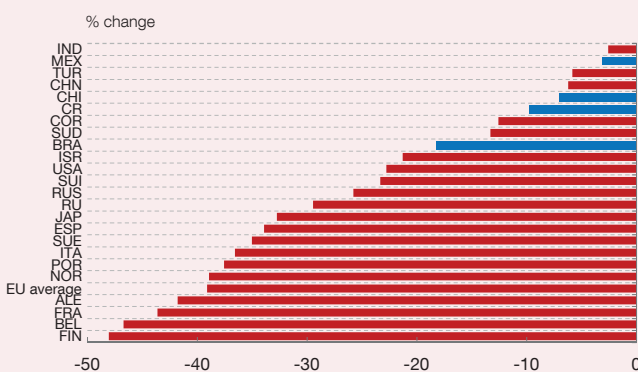
2.3 PER CAPITA GDP GROWTH (d) AND SUPPORT FOR DEMOCRACY (e)

2.4 DEGREE OF POLITICAL POLARISATION

SOURCES: Latinobarómetro, World Bank and OECD.

a Logarithm of per capita GDP in constant dollars
b Level of the Gini coefficient.
c Percentage change in the Gini coefficient after taxes and public transfers.
d Average change over the five-year period of per capita GDP in constant dollars. 8 biggest economies, excluding Venezuela.
e Change, between the dates indicated, of the percentage of respondents who assert that "Democracy is preferable to any other form of government".
f Respondents who place themselves in scales 0 to 1 in the question: "In politics we normally talk about left and right. In a scale where 0 is the left and 10 the right, where would you place yourself?"
g Respondents who place themselves in scales 9 to 10 in the question: "In politics we normally talk about left and right. In a scale where 0 is the left and 10 the right, where would you place yourself?"
h Standard deviation of all the replies obtained in the question on the politics scale.

Box 1

THE RECENT SOCIAL TENSIONS IN LATIN AMERICA (cont'd)

80% of respondents said that the distribution of income was unfair or very unfair. Moreover, the possibilities of progress are perceived as having come to something of a standstill, given that the numbers surveyed who estimated that their children would end up in lower income segments increased between 2013 and 2018. An additional factor that has led to an increase in the negative perception of institutions is the persistence of lower economic growth in the past decade (see Chart 2.3). Lastly, this mistrust of institutions appears to have been fuelled, in turn, by an increase in political polarisation. Both opinion polls (see Chart 2.4) and election results reflect this, with the emergence of extreme political options in some countries.

Governments' response to the social tensions has been very mixed. There have been conjunctural fiscal measures in most countries to strengthen the provision of specific public services, along with more structural actions, which in some cases entailed bringing previous ongoing reforms to a halt. One example in the structural domain was the consensus forged last December in Chile to draft a new Constitution. Stepping up the fight against corruption has been another institutional-improvement aspect launched in most countries to check the dissatisfaction of broad swaths of society with the political system. Some countries, such as Brazil, undertook or announced ambitious processes to reform the role of the State in the economy, bearing on elements of fiscal sustainability and efficiency. Several countries, including Colombia, Chile and Brazil, have launched far-reaching tax reform plans. The objectives range from increasing capacity to fund new demands for public goods to enhancing the efficiency and progressivity of the tax system. Finally, several proposals have been discussed for pension systems: some are linked to improving their sustainability (such as the reform that came into force in Brazil), while others are more geared to re-designing their management in the public and private spheres and to bolstering the benefits of the lower-income strata (certain proposals under discussion in Chile).

In any event, the momentum of these more or less ambitious ongoing reforms has been most significantly curtailed in recent months given the drastic change in economic policy priorities stemming from the current global health crisis situation.

This box describes the process of integration of Latin America into global trade, the results to date and the challenges ahead if the region is to fully reap the benefits of the process.

Overall, Latin America's degree of openness to international trade is less than in other emerging areas (see Chart 1.1). The sum of its exports and imports of goods and services accounts for 45% of GDP, which is far below the figure for Eastern Europe (120%) or Southeast Asia (130%), for example. The pattern is markedly uneven across the different countries: some economies are more closed, such as Argentina, Brazil and Colombia, with a rate of openness of between 30% and 40% of GDP, while others are more open, such as Chile, Peru and Mexico, with rates between 50% and 80% of GDP. The lesser openness of the region as a whole, along with the prevalence of commodities in its exporting sector, is accompanied by less integration into the global value chains (see Chart 1.2). The exceptions here are Chile and Mexico, with the latter a supplier of goods and services used as inputs in other countries' industries (upstream integration), in particular the United States.

However, the Latin American economies have been very active in promoting trade agreements. This has been the case both within and outside the region, in the past two decades, and in particular since the deadlocked Doha round of multilateral negotiations (2001). The number of trade agreements entered into by the Latin American and Caribbean countries has increased fivefold in the past 20 years, totalling 97, whereas globally there has only been a threefold rise over the same period (see Chart 1.3). Of these agreements, 43 are intra-regional, while 54 are extra-regional.[1] Notable among the latter, for their economic importance, is the NAFTA agreement between the United States, Canada and Mexico, recently re-named the USMCA agreements, and that reached last year between the EU and Mercosur[2] (see Chart 1.4).

According to a recent study[3], trade agreements (intra-regional and extra-regional alike) generate an increase in trade among the signatory countries of between 35% and 75%, on average, compared with a situation in which they had not signed. Other papers[4], however, indicate that the beneficial impact of a trade integration drive is limited by the differences in rules and standards present in the dense network of trade agreements of the Latin American economies, both intra-regionally and with other countries. Such regulatory multiplicity would put a brake both on trade growth in the region, despite the signing of new agreements, and on Latin America's capacity for integration into global value chains. These studies also show that the agreements that most promote trade growth, the diversification of economic structures, productivity and growth in the emerging countries are those the latter sign with advanced economies[5] (see Chart 1.5). On this evidence, the companies that benefit from greater integration with these types of signatories (through extra-regional agreements) are not only those that have a direct foreign connection (exporting and importing multinationals), but also with other companies, through links between them and, in particular, through the transfer of technology, of know-how and of improvements in productive processes.

Hence, despite the efforts made by the Latin American countries in recent decades to increase the openness of their economies, significant challenges remain if they are to improve and extend their actual degree of trade integration, both within the region and outside it. In this respect, the region will benefit from the reduced regulatory fragmentation of the existing agreements, e.g. regarding

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1 Intra-regional agreements are those between Latin American economies, while extra-regional agreements are those that include at least one Latin American economy and one non-Latin American economy among their signatories.

2 The agreement is pending signature and ratification, and the European Commission has published the details of the "agreement in principle". For further details see the Analytical Article "The EU-MERCOSUR free trade agreement: main features and economic impact", Jacopo Timini and Francesca Viani, *Economic Bulletin,* 1/2020, Banco de España.

3 See Ayman El-Dahrawy Sánchez-Albornoz and Jacopo Timini (2020), "Trade Agreements and Latin American trade (creation and diversion) and welfare", Documento de Trabajo 2009, Banco de España.

4 See, for example, Cadestin, C., J. Gourdon and P. Kowalski (2016), "Participation in Global Value Chains in Latin America: Implications for Trade and Trade-Related Policy", OECD Trade Policy Papers, No. 192, OECD Publishing, Paris; Mesquita Moreira M. (ed.) (2018), "Conectando los puntos – una hoja de ruta para una mejor integración de américa latina y el caribe", BID: Washington; Banco Mundial (2019) "Trade integration as a pathway to development?", Semiannual report of the Latin America and Caribbean region, October 2019.

5 Specifically, in line with World Bank (2019) estimates, the "economic complexity index" of emerging countries is affected positively by a trade agreement when advanced countries also participate in that agreement. The index measures an economy's knowledge intensity using the composition of its exports and the intensity in knowledge activities of such exports.
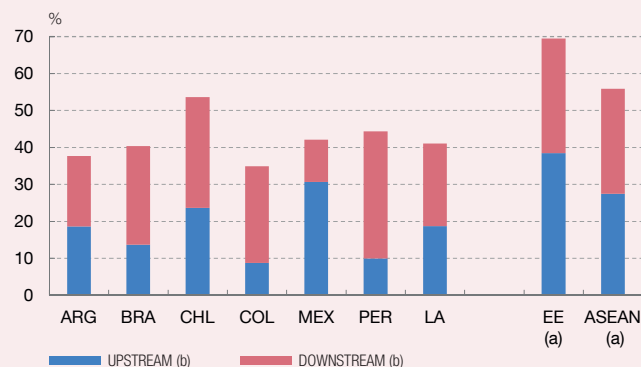
Chart 1
LATIN AMERICA COULD BENEFIT FROM GREATER INTRA-REGIONAL AND GLOBAL ECONOMIC INTEGRATION

Despite the efforts made by the Latin American countries in recent decades, significant challenges remain if greater integration into the world economy is to be achieved. Apart from continuing to increase the number of trade agreements, in order to lower tariff and non-tariff barriers, these economies might be assisted by a reduction in regulatory fragmentation and the modernisation of existing agreements, in particular those with the more advanced countries. That would deepen bilateral relations and, most particularly, promote technological transfer.
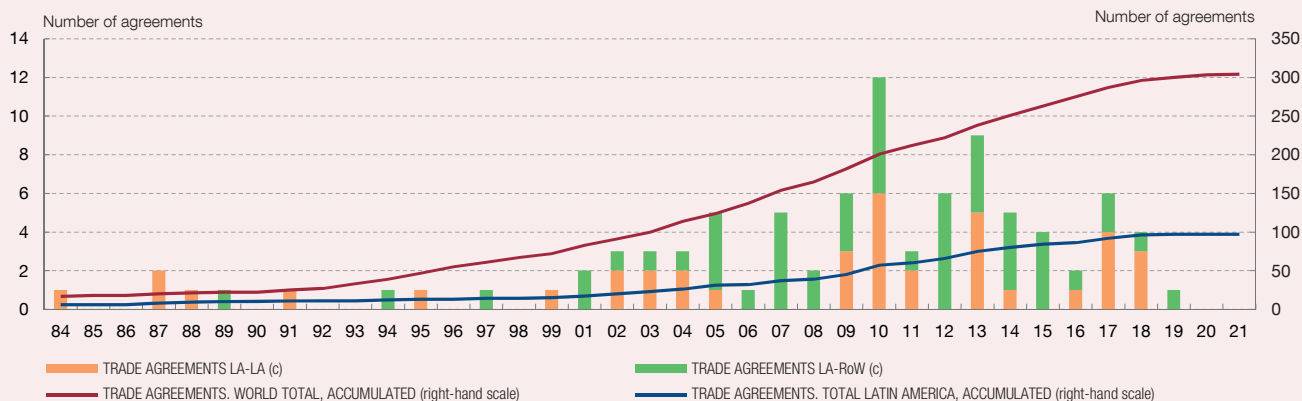
1.1 TRADE OPENNESS

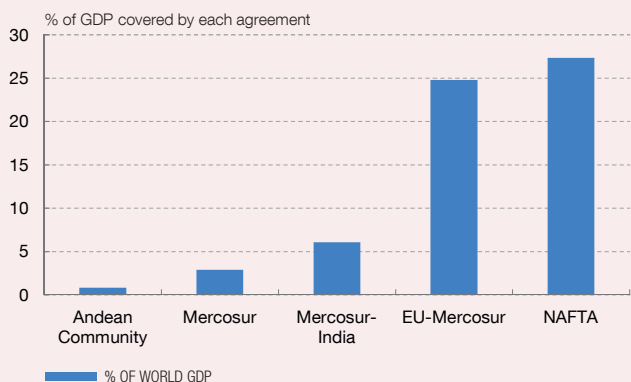Imports + exports (% of PIB)

IMPORTS + EXPORTS (% OF GDP)
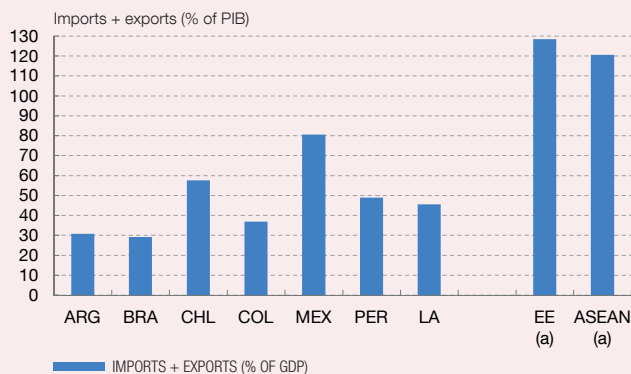
1.2 PARTICIPATION RATE IN GLOBAL VALUE CHAINS

%

UPSTREAM (b)   DOWNSTREAM (b)

1.3 TRADE AGREEMENTS: NUMBER AND TYPE

Number of agreements   Number of agreements

TRADE AGREEMENTS LA-LA (c)
TRADE AGREEMENTS LA-RoW (c)
TRADE AGREEMENTS. WORLD TOTAL, ACCUMULATED (right-hand scale)
TRADE AGREEMENTS. TOTAL LATIN AMERICA, ACCUMULATED (right-hand scale)

1.4 RELEVANCE OF SELECTED TRADE AGREEMENTS

% of GDP covered by each agreement

% OF WORLD GDP

1.5 EFFECT OF DIFFERENT TRADE AGREEMENTS ON ECONOMIC COMPLEXITY (d)

Percentage points
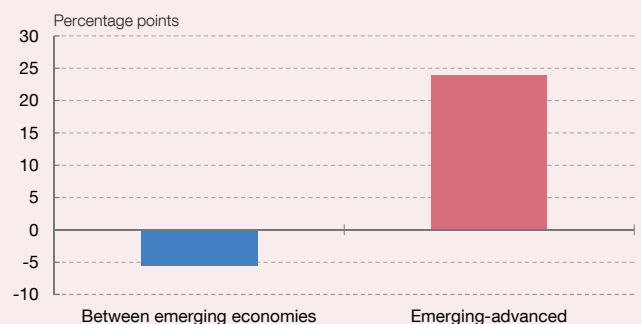
SOURCES: OECD, UNCTAD-Eora GVC database, World Bankl, WTO and Thomson Reuters.

a LA: Aggregate of Argentina, Brazil, Chile, Colombia, Mexico and Peru. EE: Eastern Europe (EU-13). ASEAN: Association of Southeast Asian Nations.
b See Chart 5, note d, in the main text.
c LA-LA: agreements between Latin American countries. LA-RoW: agreements in which at least one signatory is Latin American and at least one other is not (i.e. it belongs to the "rest of the world").
d The columns indicate the estimated effect (in percentage points) of a trade agreement between emerging countries or between emerging and developed countries on the emerging countries' economic complexity index. The economic complexity index measures an economy's knowledge intensity using the composition of its exports and the extent to which these exports are knowledge-intensive. Source of the estimates: World Bank (see reference in note 4 to this Box).

rules of origin[6] and standards (relating to quality, labour and others), among other factors. One means of progress along these lines would, for example, be in connection with the regional dimension, the creation of a platform to promote the uniformity or mutual recognition of national regulations (in line, for instance, with EU internal market practices). As to the extra-regional dimension, improvements might be had if the existing trade agreements between the Latin American countries and the advanced economies were to be modernised, in particular regarding technological transfer, e.g. through greater foreign direct investment. One example of such modernisation is the updating of the "comprehensive agreement" between Mexico and the EU, which came into

force in 2000 and was reformed in 2018. Initially, this agreement focused on lowering tariff and non-tariff barriers on goods (mainly manufactures) and services, although it also included provisions on economic cooperation and policy. In 2018, the EU and Mexico reached a new agreement, one broader than in 2000, which includes agricultural exports and new types of services. It further provides for simpler customs procedures, sets out rules that smooth foreign direct investment and establishes investor safeguard mechanisms. Finally, it includes a series of new chapters on, for instance, government procurement markets, the protection of property rights, sustainable development, the environment and the fight against corruption.

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6   According to the WTO, the rules of origin are the criteria used to determine the place where a product is prepared, and they are important for applying other trade policy measures, including trade preferences (preferential rules of origin), contingent measures, anti-dumping measures and countervailing duties (non-preferential rules of origin).

Box 3

ECONOMIC EFFECTS OF THE HEALTH CRISIS IN LATIN AMERICA

The health crisis and the measures adopted by the authorities to contain its spread are severely disrupting global economic activity, including in Latin America. This box illustrates the potential adverse effects for this latter region.[1] It does so with several simulation exercises which assume, in line with other institutions and analysts, that the direct impact of the health crisis is confined essentially to the first half of this year.[2] This is despite the fact that its effects will persist into the medium term, depending, among other factors, on the duration of the confinement measures needed to limit the expansion of the epidemic and on the policies applied to cushion the recessionary effect of this shock.

The scope of the disruption this episode may ultimately cause is very uncertain at present. Several differing economic shocks of unspecified duration are concurrently in play, impacting activity through several channels.[3] In particular, as argued in the main body of this Report, there are significant effects stemming from: the reduction in trade in goods and services with the external sector; those associated with the adverse performance of financial and commodities markets; the sharp contraction in domestic demand, reflected in lower household consumption and a fall-off in business investment; and the adverse supply-side effects linked to the shutdown imposed on production. Moreover, uncertainty over the economic and health outlook may reduce economic agents' consumption and investment beyond the most immediate horizon. The upshot would be the destruction of firms and jobs, an increase in defaults and the tightening of financing conditions for certain agents, which may feed back into a doom loop and embed the persistence of the crisis.

To illustrate the possible dimensions of the magnitude of the situation on economic activity in Latin America, there follow some simulations conducted on the basis of a global macroeconometric model[4], encompassing the main advanced and emerging economies. The model used has a simplified framework. It captures mainly the channels that operate through domestic demand, tourism, and the effects of financial variables and commodities prices; however, it also incorporates some supply-side effects.[5] Two hypothetical scenarios, dubbed "limited" and "prolonged confinement", are considered. They differ in terms of the assumed duration of the confinement period, the speed at which demand is assumed to recover, and the possibility that there will be a tightening of global financial conditions. In the limited scenario, it is considered that the confinement being applied at present will last eight weeks, while in the case of the prolonged confinement scenario, the most severe containment measures run to 12 weeks (hence the greater decline in domestic demand under this scenario). As regards the speed of recovery, while it is assumed in both scenarios that the adverse effects will be confined to the first half of this year, a swifter path is justified in the limited scenario owing to the rebound in postponed purchases of consumer durables. Meantime, in the other scenario, additional adverse effects on potential output are incorporated, derived from the possibility that the initial decline will be more persistent owing to a possible tightening of financial conditions, which would make some of the adverse effects of the pandemic more durable. The technical assumptions and calibration of the simulations are set out in Table 1.

Should the scenarios materialise, GDP growth in the aggregate of the main Latin American economies is estimated to fall, relative to expectations before the pandemic[6], by more than 8 pp and 13 pp in 2020, in the limited and prolonged confinement scenarios, respectively. GDP growth is therefore expected to post negative figures

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1   Defined as the aggregate of the six biggest economies: Brazil, Mexico, Argentina, Colombia, Chile and Peru.

2   See, in particular, the recent reports by the IMF (WEO, April 2020) and the Inter-American Development Bank (April 2020).

3   See Banco de España (2020). "Reference macroeconomic scenarios for the Spanish economy after Covid-19", Analytical Articles, Economic Bulletin 2/2020.

4   Namely, the National Institute of Economic and Social Research's NiGEM model. The model's documentation is available at https://nimodel.niesr. ac.uk/. The simulation incorporates various assumptions. Specifically, expectations are considered to be adaptive; monetary policy is endogenous in accordance with a "Taylor rule" (and the non-conventional measures offset the negative nominal rates constraint), generally, although in Latin America policy interest rates are tied to the United States Federal Reserve response (to avoid an over-reaction by the rates, given the scale of the shocks simulated, in line with historical evidence); and fiscal policy acts as an automatic stabiliser (maintaining, simultaneously, a medium-term budget balance target).

5   The decomposition of the effects of the different channels is by means of exercises that simulate, one by one, the shocks associated with each of the channels. The supply channel cannot be uncoupled from the domestic demand channels because it affects the cyclical position of the economy and, therefore, the economic policy response. There are composition effects the quantification of which is the difference between the simulation that jointly considers all the shocks and the sum of the effects of each channel, taken independently.

6   The consensus of analysts' January 2020 forecasts is taken as a reference.

of around -6.5% and -11.5%, respectively, in 2020 (see Chart 1.1), entailing a bigger decline than that expected for the world economy.[7] That is partly because the pre-pandemic growth projection was lower in the Latin American economies, and partly because the channel of the contraction in domestic demand, the most significant one, is more pronounced in these economies since they are more closed to trade in goods and services than the global average.

In the scenarios considered, and in the absence of fresh outbreaks of the epidemic further ahead, the economies are expected to begin to recover as from the second half of 2020. As a result, the global economy in general, and the Latin American countries in particular, will pose substantial increases in output in 2021. However, it is estimated the cumulative loss of income for Latin America between 2020 and 2021 will, in both scenarios, be

between 11% and 22%, respectively, of the level augured before the pandemic (see Chart 1.2).

Nonetheless, several factors might mean that the estimated effects differ from those presented. In the negative sense, the macroeconometric model used includes price elasticities for commodities lower than those estimated in the empirical literature which, given Latin America's export specialisation in these products, might lead the reductions in GDP to be greater than those estimated. Moreover, the simulations assume that the declines in stock exchange indices and the increases in risk premia in the Latin American economies are the same as those in the other regions considered. Yet both variables have behaved more negatively in Latin America since the start of the shock to financial markets in late February. Accordingly, the negative effect on GDP derived from the financial channel might be of a greater magnitude

Table 1
CALIBRATION OF SCENARIOS

Shock		Calibration	Scenario 1 Limited			Scenario 2 Prolonged confinement		
			Latin America	Advanced economies	China and the rest of Asia	Latin America	Advanced economies	China and the rest of Asia
Domestic demand		Estimates of Chinese GDP growth in Q1: −10% quarter-on-quarter	−10% over three months; after containment measures imposed, 40% of shock is recovered in the following quarter			−15% over three months; after containment measures imposed, domestic demand picks up slowly		
Supply		Reduction in potential GDP in financial crises + decline in investment + hours worked	The decline in investment and in hours worked affects potential GDP (a)			Potential GDP is additionally affected by a financial crisis (b)		
Tourism		Severe restrictions on people's movements	−100% in 2020 Q2 and gradual recovery up to 2021 Q3					
Financial markets	World Stock markets	Global MSCI Index since the start of the epidemic	−25% in Q2; reverts swiftly to previous levels			−25% in Q2; reverts to previous levels very gradually		
	Investment risk premium	Corporate spread (average of investment grade and *high yield)*	+250 bp in Q2; reverts swiftly to previous levels			+250 bp in Q2; reverts to previous levels very gradually		
Commodities		Oil futures market	Change in Brent per barrel prices implicit in futures curve					

SOURCE: Banco de España.

a This decline exerts persistent effects until end-2021.
b Potential GDP declines, moreover, by 2.5% in the long run, the amount by which it fell in the 2008-2009 global financial crisis, according to OECD calculations.

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7   The estimated declines for the euro area, the United States and China in the "limited" and "prolonged confinement" scenarios are available in Box 2 ("Global economic effects of the health crisis") in the analytical article cited in footnote 2.

than those estimated in the simulations. Conversely, however, a more forceful economic policy response to that assumed in the simulations, both at the global and
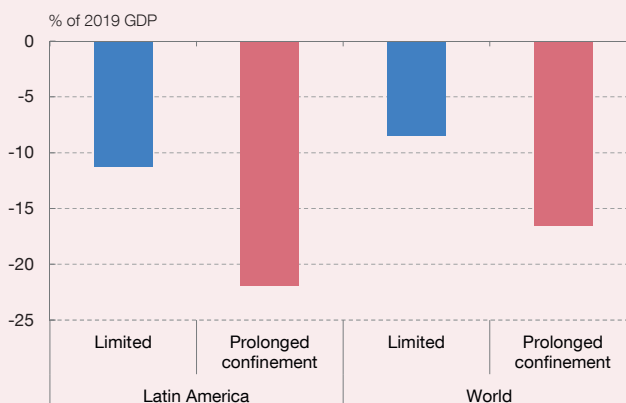
regional levels, would have a positive bearing on the performance of these economies, reducing both the intensity and the duration of the shock.

Chart 1
ECONOMIC EFFECTS OF THE COVID-19 PANDEMIC IN LATIN AMERICA

1.1 GLOBAL IMPACT OF THE HEALTH CRISIS IN 2020
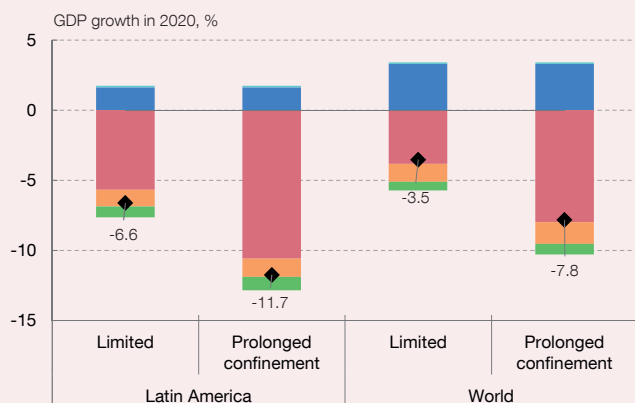
1.2 GDP CUMULATIVE LOSS BETWEEN 2020 Q1 AND 2021 Q4

PRE-COVID-19 ESTIMATED GROWTH (a)
COVID-19 SHOCK: DOMESTIC DEMAND CHANNEL
COVID-19 SHOCK: TOURISM CHANNEL
COVID-19 SHOCK: FINANCIAL CHANNEL
COVID-19 SHOCK: OIL CHANNEL
◆ UPDATED ESTIMATED GROWTH (b)

SOURCES: Banco de España, *Consensus Forecasts,* IMF and Thomson Reuters.

a The pre-COVID-19 forecasts considered are those of the January 2020 *Latin American Consensus Forecasts.*
b Sum of the impact of the channels taken individually plus the composition effect (interaction between the channels).