LATIN AMERICA'S ECONOMIC BOOM: THE U.S. PERSPECTIVE
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I was afraid that the morning speakers would have already said everything there is to be said about Latin America--and it seems they almost have. By necessity, though, their comments have been somewhat retrospective in nature, to cover all the tremendous changes that have taken place in Latin American countries over the past decade or so. My plan is to spend time looking forward, first, in terms of the economic outlook of particular Latin American countries and, second, in terms of what the transformation of Latin America will mean to the United States over time. Finally, I would like to address a few of my concerns about other changes I think ought to be made in Latin American countries to ensure that they can continue to pursue their market-oriented reforms.

Economic Outlook for Latin American Countries

It probably goes without saying that it is much harder to be certain about an economic outlook for Latin America since the depreciation of the Mexican peso. The current situation in Mexico has clouded the short-term economic outlook for that country and possibly for some others in Latin America. In fact, my outlook for Latin America in 1995 is based on the assumption that the Mexican situation stabilizes fairly quickly. In any event, I must emphasize that the longer-term outlook remains positive for the region as a whole. I am hopeful that the reform plan formulated by the Mexican government, along with the international initiative to provide financial assistance, will quell the crisis of confidence and enable Mexico to resume its growth and continue the transition to a market-oriented--and more prosperous--economy. I will return to the Mexican situation at the end of my remarks.

Now let me give a brief overview of the outlook for most of the countries in Latin America. In **Argentina**, growth will likely slow to around 3 percent this year after a growth rate of 6 percent in 1994. Continued growth depends largely on Argentina's ability to continue to attract foreign capital. The Mexican crisis may have a negative effect in this regard, at least in the short-term, since many overseas investors have become more hesitant to invest further in emerging markets at this time. Consumer inflation was just under 4 percent last year--the lowest in more than 50 years and the lowest in South America in 1994. Continued fiscal discipline should keep this rate near 4 percent this year. I would also like to comment on the elections to be held in May. Often, approaching elections are viewed as a potential destabilizing force in the economies of developing countries. I view the Argentinean elections in a different light. To me, they represent the positive result of political reforms. Democratization and liberal market reform have gone hand in hand in most of Latin America, and 1995 should showcase the benefits of these reforms in Argentina.

Brazil, the economic giant of the region, should see real economic growth rise to nearly 5 percent this year from just over 4 percent in 1994. For years, the inflation rate in Brazil has been truly astronomical--at more than 1,000 percent. Thanks to the "Plano Real," the inflation rate should fall below 100 percent this year. Continued success on the economic front depends largely on political reform, namely constitutional reforms that will help restrain fiscal spending.

Brazil set out on this path by electing a pro-reform president last year. I am hopeful that Brazil will remain on track in 1995. An economically and politically mature Brazil is essential for the long-term progress of Latin America.

Chile, the next member-elect of an expanded North American Free Trade Agreement, continues to be the shining star of Latin America. Growth should be in the 5 percent range in 1995, up from nearly 4 percent last year. Chile's prudent economic policies have enabled the country to post positive rates of growth averaging 5 percent over the last decade. Inflation in Chile could fall to 8 percent this year from nearly 9 percent in 1994. Chile has a high domestic savings rate and a financial system that is less susceptible to destabilizing outflows of capital. Both of these attributes should help it through the fallout from the Mexican peso depreciation. Overall, Chile is an example of a country benefiting from the kind of economic and political stability other Latin American nations are striving toward.

Venezuela is now struggling after having had such a promising outlook before the bankruptcy of its second-largest bank, Banco Latino, and the subsequent de facto nationalization of its banking system in 1994. The Venezuelan economy contracted more than 3 percent last year and is not likely to post positive growth in 1995. Consumer prices jumped by 70 percent last year, and this performance should improve only slightly in 1995.

In **Bolivia**, real economic growth should remain between 4 percent and 5 percent in 1995. Investment and export growth are expected to lead the way in boosting Bolivia's economy this year. Prudent fiscal and monetary policies should push the inflation rate to below 7 percent from the 8-1/2 percent rate of last year.

In **Colombia**, the economy will probably grow near last year's 5 percent level. Higher social spending should continue to spur growth, but these programs are likely to limit progress on inflation. Consumer prices should rise around 20 percent in 1995, down only slightly from 1994.

Peru has had a sparkling economic performance over the past few years. Its economy grew by more than 12 percent in 1994 and should grow nearly 8 percent this year. But this performance has been tainted by the armed conflict with **Ecuador** over the disputed border region. I am no expert on the history of this long-running dispute nor am I affixing blame to either party, but it seems to me that with so much to gain through cooperation and integration, conflicts such as these have no place in Latin America. Ecuador's economy should grow from 2-1/2 percent in 1994 to nearly 3 percent this year, and inflation in both countries should fall slightly to between 15 percent and 20 percent, assuming the border conflict is resolved quickly and peacefully.

In sum then, conditions in Argentina and Brazil are fundamentally sound, with Brazil having made a remarkable policy turnaround over the past year or so that has helped to bring inflation down. Chile, Colombia, and Peru are likely to outpace the other countries, with GDP gains of between 5 percent and 8 percent. Meanwhile, Venezuela, which had been so promising, has taken a large step backward. The current situation there is an example of the effects that unsound banking supervision and incomplete market reforms can have on a developing economy. Inflation for Latin American countries should decline further in 1995 as long as sound fiscal and monetary policies are pursued.

What Is the U.S. Perspective on Latin America's Growth?

Now let me discuss briefly what this overall growth in Latin America means to the United States. So far today, you have heard a lot about the reforms and trends going on in Latin America. Obviously, it is encouraging to see the great strides made toward market economies, since the resulting stronger economies also create more opportunities for trade. It almost goes without saying that Latin America is a natural trading partner for the United States. Logically, if our neighbors to the south are doing better, so will we. But what exactly do I mean by "doing better"? At the most fundamental level, it means more jobs--jobs in the United States and jobs in Latin America, all tied to increased trade. According to the Commerce Department, U.S. manufacturing exports to the world increased by 95 percent in the period between 1987 and 1993, whereas they increased by 138 percent to Latin America and the Caribbean. Argentina, Chile, Colombia, and Mexico saw the greatest increases in manufacturing exports from the United States during that period. Unlike the vicious cycle of retaliation that protectionism leads to, free trade creates jobs in a virtuous cycle, making all countries better off. In addition, people in countries that trade freely with one another are able to purchase goods and services that would not otherwise be available to them.

However, with all the positive things I have said about the Latin American transformation and what it means to the United States, I wouldn't be worth my salt as a central banker if I did not have some warnings and sober thoughts to add. My main concerns have to do with financial systems in Latin America. Many countries in Latin America have taken a significant first step in the process of ensuring long-term, sustainable growth by converting their previously protected economies into market economies. Yet there is much work to be done by some Latin American countries to become full members in the community of advanced economies, particularly in the area of banking reform.

From my point of view as a central banker, the key to continued long-term, stable growth in Latin America depends on having a strong financial system in place in each country. Why are such structures so critical to the future of Latin America? History has taught us that financial intermediation is a keystone in the foundation of any advanced economy. And, as we have seen in Eastern Europe, true and lasting market reform is difficult to achieve when rationalizing the banking system lags behind other reforms.

Because the world is driven increasingly by technology that links countries more closely, unsound banking practices pose threats to more than the home country. For instance, the failure of Banco Latino in Venezuela and its affiliates in the United States and Curaçao did not affect the U.S. system. Yet it did raise serious concerns about possible problems that may arise when proper supervisory and regulatory controls are not in place. The collapse of BCCI is another obvious example of unsafe banking practices that have the potential to disrupt banking systems and their customers around the globe. In order to ensure the security of the international banking system, it is important that all countries have an independent supervisory authority and that all financial institutions be subject to comprehensive and consolidated supervision. Personally, I believe that the central bank should perform these roles. The reason is that central banks take the larger view and tend to focus on the safety and soundness of the whole banking system. Also, there has been a necessary move toward making these institutions independent, and my main point is that the entity responsible for bank supervision must not be vulnerable to politicization.

No doubt, the issue of foreign banking supervision has become more intense for us in the United States since Congress passed the Foreign Bank Supervision Enhancement Act in 1991. This law governs whether an international bank can establish offices and do business in the United States, based largely on whether the bank is subject to comprehensive supervision and regulation on a consolidated basis in its home country. Now, as we at the Atlanta Fed are considering more bank applications from Latin America, we must also be certain that home countries have in place the comprehensive and consolidated supervision that the law requires. Legal requirements call for detailed information, and we cannot process applications unless the applicant institutions and their home countries provide this information. This process has proved to be time-consuming. The challenges for expediting this process rest not only with the Fed but also with the applicant institutions themselves and with their governments.

Another major challenge pertains to policymakers in Latin American countries who should consider many legal reforms. Among the evolving economic and political reforms taking place in many countries, one area that has not yet become firmly implanted is private property and contract law. In the industrialized world, such laws are taken for granted. However, in countries where nationalization has been a recurring theme, the concept of private property exists on shaky grounds.

Setting up an enduring legal system as a foundation for newly privatized companies and property is a daunting challenge, but one that should, in my opinion, be met. Otherwise, private and corporate citizens, as well as foreign investors, will continue to operate as though the government could take their property at a moment's notice. It is in fact this very real fear of enforced nationalization that caused the extremely complex pattern of offshore holdings that developed in many Latin American countries. In this regard, although many Latin American countries have reasonably good bank supervision within their borders, generally the same attention has not been paid to offshore operations. It is fair to say that the fear of nationalization has created these complicated offshore business organizations in order to protect assets from being seized by the government. Obviously, such a situation prevents consolidated, comprehensive supervision and regulation of banks.

The Mexican Situation

Finally, it would not be cricket for me to talk about the future of Latin America without touching on how the situation in Mexico may affect it. Since December 20, the peso has fallen by roughly 35 percent against the dollar. The depreciation of the peso caused a financial crisis in Mexico and possibly in other emerging countries. The stock market in Mexico has declined nearly 10 percent in peso terms since December 20, and stock markets in Argentina, Brazil, Chile, and Peru have also declined.

But these negatives must be viewed in perspective, that is, by comparing Mexico's response to recent difficulties with the way it handled the debt crisis of the early 1980s. During the debt crisis a decade ago, Mexico nationalized banks, reneged on liabilities denominated in dollars by converting them to pesos on the spot, and imposed tighter controls on foreign investors. The reaction by the Mexican government to current developments is quite different. Provisions for foreign ownership, investment, and trade remain intact. Trade barriers have not been reinstated, and privatization continues to be a priority for the Mexican government. In addition, the government has pledged fiscal discipline.

There are many views of what led to this situation, and economists will be debating for a long time both the long-term and proximate causes of the financial crisis. Some analysts are pointing to the lack of independence of the central bank as a reason; others believe that pegging the peso to the U.S. dollar was misguided. I do not doubt that there was more than one reason, but it is not possible for me to go into all of them, nor is it possible for us to understand the real reasons for the difficulties while we are still so close to them. However, I do have a few thoughts on the subject that I would like to leave with you.

First, it seems clear to me that the fundamentals in Mexico remain positive. This emerging country is basically sound, and I believe it will persevere through its latest economic problems. However, in the short term, strong backing from the United States, which is Mexico's largest trading partner, is absolutely necessary in order to restore confidence in the ability of the Mexican government to handle the financial situation.

Second, I believe it is critical to recognize that financial difficulties of this sort can be expected from time to time in a world that is more tied together through the globalization of finance. While many countries have benefited from the increase of capital flows around the world, it is also true that capital is not fixed. It can just as easily flow out as well as flow into a country. Mexico has felt both sides of this force, as have other countries, including several in Europe in recent years. The point is that isolation is not a better alternative. The benefits of worldwide trade and financial linkages far outweigh the costs associated with these occasional setbacks.

Conclusion

In conclusion, the transformation of Latin America over the past decade or so has created a new emerging market in the world economy. From the U.S. perspective, we could not be more pleased because economic growth in Latin America will have a positive effect on the United States. As economic growth leads to increased incomes in Latin America, it will, in turn, lead to more trade that increases the incomes of U.S. citizens through job creation.

While I have raised a number of significant challenges that must be met by Latin American countries in order to translate their tremendous potential for growth into full membership in the community of advanced economies, I also firmly believe that this emerging region is fundamentally sound. With a view toward the long term, I am optimistic that Latin America will continue on the road of market-based reforms it has set out upon and that the region's success will only serve to enhance the economic prospects of the United States.