LATIN AMERICA'S ECONOMIC BOOM: THE U.S. PERSPECTIVE

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Good afternoon! It is a great pleasure for me to address the Florida International Bankers Association, an organization with truly global interests. Today I will try to give you an update of the economic situation in Latin America. First, I will share my views on the status of Mexico in the wake of the devaluation of the peso in December. Next I will review the revised outlooks for several Latin American countries. Then, I will discuss what the reforms that have taken place in Latin America in recent years will mean to the United States over time. And, finally, I would like to address a few other changes I think ought to be made in Latin American countries to ensure that they can continue to pursue their market-oriented reforms. That is a lot to cover, so let me begin.

The Mexican Situation

I do not need to chronicle the events of peso devaluation since they are still fresh in our collective memory. However, a few words on the resolution of that situation are in order. Mexico avoided a more severe crisis, largely because of the economic assistance effort led by the United States, the International Monetary Fund, and the Bank for International Settlements. Loans to Mexico have helped retire debt and build reserves, as well as build confidence in our southern neighbor. As you know, the assistance effort received some negative reactions. But I remain in favor of the moves made to help Mexico for three reasons.

First, the loans kept the financial crisis from severely damaging other emerging markets. Without the assistance provided to Mexico, financial markets and economies throughout the region would surely be worse off.

Second, an extended recession in Mexico would have an adverse, long-term effect on U.S. exports -- not only to Mexico, but to the entire region. Mexico is our third largest export market, and scores of jobs in the United States are linked to shipments of U.S. goods across the Rio Grande. It was in our own best interest to help Mexico.

Finally, leading the effort to assist Mexico was simply the right thing to do. When a family member is in need, the natural reaction is to do whatever is possible to help ensure that similar problems do not resurface. Mexico joined the NAFTA family last year, making the relationship between our two countries closer than it has ever been. Turning our backs on Mexico was not, in my judgment, an option in this new relationship.

The questions that remain concern where Mexico is headed. The financial situation in Mexico appears to have stabilized. The exchange rate has settled just above 6 pesos per U.S. dollar. The stock market has recovered, interest rates have fallen, and inflation seems to be decelerating. The country's current account deficit has been erased, and Mexico now has a trade surplus. Mexico also ran a fiscal surplus of $2.5 billion in the first half of the year, which could give the government some room to stimulate growth in the second half.

However, economic activity has fallen off sharply -- over 10 percent in the second quarter from a year ago. Although the contraction in Mexico's economy was greater than expected, it is possible that growth could resume earlier than previously thought. Still, unemployment has increased, the banking system has had some rumblings, and incomes have been significantly affected by the events earlier this year. The official unemployment rate has more than doubled from 3.2 percent in December to 6.6 percent in June. The official figure, which considers anyone who works more than one hour a week as employed, underestimates the true picture. Private estimates of the un- and under-employed have reached as high as 50 percent of the work force.

Recession and high interest rates have led to a huge jump in the number of non-performing loans. The loan restructuring program announced by the government last month should help decrease the burden on banks, but many banks are still weak and some consolidation is probable. While, on balance, I am optimistic about economic prospects for Mexico, the outcome will depend on how well it sticks with the reform program it has laid out.

Economic Outlook for Latin American Countries

It certainly is harder to forecast the economic outlook for the rest of Latin America since the depreciation of the Mexican peso. But my outlook is based on the assumption that Mexico will continue to stabilize and that the worst effects of the peso's devaluation on the region have passed. I would emphasize that the longer-term outlook remains positive for the region as a whole.

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. Argentina's economy should slow considerably this year because of the Mexican peso crisis, but could well turn around in 1996. 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.

Let's look at some of the countries individually.

In **Argentina**, the country most affected by the spillover from the Mexican situation, economic activity has decelerated and unemployment has risen. Economic growth this year could slow to near 1 percent after reaching nearly 7-1/2 percent in 1994. The recovery of the Argentine economy depends largely on the willingness of the government to stick to its reform program. The inflation rate in Argentina should remain among the lowest in the region at around 3 percent this year and next.

Brazil, the economic giant of the region, should see real economic growth remain in the 5 percent to 6 percent range this year and next. 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 to near 30 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. 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 6 percent range in 1995 and 1996, up a couple of percentage points over last year. In fact, some reputable sources expect even faster growth. Chile's prudent economic policies have enabled the country to post positive rates of growth averaging 6-1/2 percent over the last decade. Inflation in Chile could drop slightly to a rate below 8 percent this year although higher than expected growth, along with increased taxes, strong exports, and an expanding money supply could mute this progress. Nonetheless, 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 1996. Consumer prices jumped by 70 percent last year, and this performance should improve only slightly over the next year and a half.

In **Bolivia**, real economic growth should remain between 4 percent and 5 percent in 1995 and 1996. Investment and export growth are expected to lead the way in boosting Bolivia's economy this year. The inflation rate will also remain near 7 percent, somewhat below last year's rate.

In **Colombia**, the economy will probably continue to grow between 5 and 6 percent this year and next. 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 and 1996, down only slightly from 1994.

Peru has had a sparkling economic performance over the past few years. Its economy grew nearly 13 percent in 1994. Growth should slow to the single digit range and settle next year between 5 and 6 percent. Inflation in Peru should remain in the 10 to 15 percent range this year and next.

Ecuador's economy should slow slightly to 3 or 3-1/2 percent growth this year and next, and inflation should fall slightly to 20 percent.

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

Now let me discuss briefly what the overall growth in Latin America means to the United States. 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. exports to the world increased by 98 percent in the period between 1987 and 1994, whereas they increased by 165 percent to Latin America and the Caribbean. 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.

Additional Reforms Advised

However, with all the positive things I have said about the Latin American transformation and what it means to the United States, I would not 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 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. This was recognized many years ago by the supervisory authorities of the G-10 countries, and was the reason for the formation of the Bâsle Committee of the BIS more than 20 years ago. Since the committee's original concordat in 1975, and subsequent positions stated since we have witnessed a slow, but now almost universal, convergence toward the principle that bank supervision must consider an institution's operations in their entirety. While this principle may seem to us only common sense at this point in the evolution of international banking, unfortunately in some countries this convergence has only occurred with regard to the principle, not as yet with the practice.

In December of 1991, as part of a larger legislative initiative directed toward the banking industry, the United States enacted the Foreign Bank Supervision Enhancement Act, or FBSEA (Fib-see-ah) as it has become known. This legislation was controversial even from its introduction because it significantly raised certain standards for entry into or expansion within the American market. Since enactment, only a handful of applications from Latin American banks have been approved, a number have been withdrawn, and I have no doubt that many interested parties have not bothered even to apply after the track record to date.

At a distance of almost four years, I think we may all conclude that there have been banks effectively denied entrance into the U.S. market which, on their own merit, would have gained entry prior to the Foreign Bank Supervision Enhancement Act. However, during this period, pressure has been brought on local supervisors to move toward international standards, and it has been most gratifying to observe the material progress a number of countries have made toward this goal. In the end, we all benefit from supervisory systems that follow all of an institution's activities, not jut those within local borders.

FBSEA was not intended as a dictate that other countries adopt a certain blueprint for their supervisory programs. Proper supervision can be carried out in different ways, and in the end all supervisors gain from diversity of approach. However, no matter the means, the end must be supervision of the whole, often in cooperation with other supervisors, both domestically and abroad. Supervision has become a multilateral responsibility and will benefit from the demand for higher standards for entry among those nations dealing with the global marketplace.

Nonetheless, I believe there may be room for more flexibility on the part of the United States in regard to implementation. The standard of comprehensive, consolidated supervision in the Foreign Bank Supervision Enhancement Act is somewhat stronger than that which currently prevails elsewhere in regard to supervising internationally active banks. Such supervision is not the norm worldwide, particularly in countries with less developed financial systems. In fact, the U.S. standard is stricter than the Bâsle minimum standards, which also emphasize the need to consolidate internationally active banks. Therefore, I favor legal action that would incorporate more flexibility, such as that embodied in the Bâsle minimum standards.

Another major challenge for Latin American policymakers is to consider 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.

Conclusion

I have covered a lot of territory, literally and figuratively. Let me conclude with a recap and a comment. The transformation of Latin America over the past decade or so has created a new emerging market in the world economy. Despite the setback in Mexico and repercussions elsewhere, growth prospects in most of the region are good and the high rates of inflation that have been characteristic of so many countries seem to be moderating. 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.

It is true that I have pointed to some 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. At the same time, I 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.

ECONOMIC FACT SHEET

ARGENTINA

Growth in 1994 -- 7 1/2 percent
Growth in 1995 (projected) -- 1 percent
Growth in 1996 (projected) -- 3 percent

Inflation 1994 -- 4 percent
Inflation 1995(projected) -- 4 percent

BRAZIL

Growth in 1995 (projected) -- 5-6 percent
Growth in 1996 (projected) -- 5-6 percent

Inflation 1995 (projected) -- 30 percent

CHILE

Growth in 1994 -- 4 percent
Growth in 1995 (projected) -- 5-6 percent (7 percent per central bank economists)
Growth in 1996 (projected) -- 5-6 percent

Inflation 1994 -- nearly 9 percent.
Inflation 1995 (projected) -- below 8 percent (above 8 percent per central bank)

VENEZUELA

Growth in 1994 -- 3 percent decrease
Growth in 1995 (projected) -- Negative growth expected.

Inflation in 1994 -- 70 percent
Inflation in 1995 (projected) -- Only slight improvement expected.

BOLIVIA

Growth in 1995 (projected) -- 4-5 percent
Growth in 1996 (projected) -- 4-5 percent

Inflation 1994 -- 8-1/2 percent
Inflation 1995 (projected) -- 7 percent

COLOMBIA

Growth in 1995 (projected) -- 5-6 percent
Growth in 1996 (projected) -- 5-6 percent

Inflation 1995 (projected) -- 20 percent
Inflation 1996 (projected) -- 20 percent

PERU

Growth in 1994 -- 13 percent
Growth in 1995 (projected) -- 7 percent
Growth in 1996 (projected) -- 5-6 percent

Inflation in 1995 (projected) -- 10-15 percent.
Inflation in 1996 (projected) -- 10-15 percent.

ECUADOR

Growth in 1994 -- 4 percent
Growth in 1995 (projected) -- 3 to 3-1/2 percent
Growth in 1996 (projected) -- 3 to 3-1/2 percent

Inflation in 1995 (projected) -- 20 percent, a slight drop form 1994.
Inflation in 1996 (projected) -- 20 percent.