SPEECHES

The U.S. Economic Outlook and Implications for Latin America

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Key points

- Federal Reserve Bank of Atlanta President Dennis Lockhart says that in the 1980s, during the so-called "lost decade" in Latin America, many countries experienced economic turmoil, with low growth, high inflation, and financial crises. The region's real GDP growth averaged about 2 percent.
- After this lost decade, most Latin American policymakers began to pursue more prudent macroeconomic and fiscal policies, opening their economies to global markets and trade. Lockhart says this policy transformation has strengthened the economic ties between the United States and Latin America.
- Latin American countries showed impressive resilience during and since the financial crisis of 2008, coming through this period without severe downside effects. However, Lockhart notes that several Latin American countries have experienced sizeable capital flows that have uniquely challenged their economies.
- Lockhart says that the recovery in the United States has seen weak growth and high unemployment—attributable, at least partly, to fundamental imbalances that have not yet been corrected. There is a risk to monetary policy being employed too aggressively and without effect to address economic problems that can be resolved only by fiscal reforms.

Thanks to the Latin American Chamber of Commerce and the World Affairs Council of Atlanta for the opportunity to speak about the state of economic relations between the United States and Latin America. Thanks also to Georgia Power for providing this outstanding venue.

Let me begin by saying that the Atlanta Fed has a strong connection to Latin America. Our supervision and regulation team oversees branches and subsidiaries of a number of Latin American banks in our district, particularly in Miami.

Our research department monitors the economic performance of the economies of the region, and our economists interact with colleagues including central bank officials in Latin America. Last October, for instance, our chief economist and I attended a conference sponsored by the Banco Central de Chile and later visited the central bank of Brazil. I will relate impressions from that trip in a moment.

The Atlanta Fed leads the retail payments operations of the Federal Reserve System. Our FedGlobal ACH service executes small ticket money transfers from U.S. banks to banks in some 35 countries, including 12 in Latin America. Our first international partner was the central bank of Mexico. Through our Directo a México program, we help Mexican authorities reach underserved and unbanked consumer markets. In addition, our community and economic development team does outreach work here with immigrants from Latin America.

Finally, and very significantly, our international cash operation in Miami sends and receives U.S. dollar banknotes working with Latin American central banks and commercial banks in the region. More later on this, too.

All of these programs are under the umbrella of our Americas Center initiative, headed by Stephen Kay. I also have a deep personal interest in the region, where I had many business ties in my previous career.

The title of this speech is "The U.S. Economic Outlook and Implications for Latin America," but I would like to expand the idea of my talk to include the experience of Latin America and implications for the United States. I think the world can learn much from the path taken by many Latin American countries since the 1980s.

There has been great progress economically in recent years in Latin America. As these economies have stabilized and matured, the economic ties between the United States and Latin America have grown. It is my view that the policy reforms and the resulting transformations we've seen in the economies of the region contain important lessons for the rest of the world.

Latin America, 1980s and now
I'll begin by looking back at the 1980s, the so-called "lost decade" in Latin America, and contrast the region's economies then to today. The 1980s was a time of economic turmoil, with low growth, high inflation, and financial crises—more specifically, sovereign debt crises. It's quite a different picture today. The region is now far more stable. Most countries of the region now pursue economic policies resulting in higher growth and price stability. Democratic governance is the norm.

In the 1980s, Latin America's real GDP growth averaged around 2 percent. From 2004 through 2011, annual GDP growth averaged 4.5 percent. And during the recent global financial crisis, the region's economies proved resilient, with a relatively shallow decline followed by a rapid recovery.

By the 1980s, many countries had spent years pursuing protectionist import-substitution industrial policies that essentially closed their countries to global markets. Today, we see far more open economies, with countries reaping the gains from trading in global markets.

You may recall that during the '80s, inflation was endemic in the region. Inflation got to 132 percent in Mexico in 1987 and more than 3,000 percent in Argentina in 1989. We can contrast that to the relative price stability that we see today, with a region-wide consumer price inflation averaging 5.5 percent a year over the past five years. Inflation targeting is a common practice, and many of the region's central banks have achieved a high degree of credibility.

As I said, the 1980s was also a period of debt crises, particularly external debt crises involving obligations to foreign banks. The external imbalances were born of deep fiscal problems. In the 1980s, governments ran large budget deficits, and public debt relative to GDP soared. Governments relied on foreign dollar-denominated financing at a time when governments could not issue debt in their own currencies. International reserves covered less than a fifth of total foreign debt.

Today, it is a different story. Most countries in the region have moved toward fiscal balance, debt levels are far lower, local currency capital markets are deeper, and some governments are able to sell local currency-denominated securities to foreign investors. The ratio of international reserves to total foreign debt rose to about 70 percent last year, approximately five times the average in the 1980s.

Personal recollections
I have personal recollections from the '80s. For calendar year 1987, I was in charge of Citicorp's efforts to organize a debt-for-equity swap program involving a number of "restructuring countries" (as they were called) in Latin America. These countries included Mexico, Chile, Argentina, and Brazil. The idea of a debt-equity swap was that a government would allow and facilitate the exchange of its sovereign or private external debt for shareholdings in domestic firms and assets. In effect, the debt would be the currency with which a lender could buy stock in a local company. After such a transaction, some of the country's external debt would be extinguished.

In some countries of Latin America, this program was politically unpopular. There was resistance to what opponents of the scheme considered handing over the patrimony of the country at a bargain price.

For this brief period—1987—I was immersed in the policy debates and politics of sovereign debt restructuring. Restructuring is the end-of-the-road measure undertaken when a country and its government are severely overextended. I came away from this experience with two broad observations:

First, nations control their destinies by implementing and sustaining good policies. External factors beyond a country's control *can* deliver shocks to an economy, but for the most part, domestic policy decisions determine a country's economic fate.

And second, the world's capital markets "vote," in effect, every day on a country's policies. Sovereignty does not mean a government can dictate terms to the world. Policymakers are compelled to respect the power and opinion of investors.

Ties between the United States and Latin America
In the wake of the lost decade, Latin American policymakers, generally speaking, have pursued more prudent macroeconomic and fiscal policies and opened their economies to global capital markets and trade.

This policy transformation has made possible a considerable strengthening of economic ties between the United States and Latin America.

Trade between the United States and Latin America has grown rapidly. About a fifth of U.S. imports now come from Latin America, up from around 15 percent in the 1980s. And the share of U.S. exports going to Latin America has risen considerably, from an average of 15 percent of all U.S. exports in the '80s to nearly 25 percent.

In the southeastern United States, a significant portion of merchandise exports go to Latin America. Around half of merchandise exports from Florida and Mississippi are bound for Latin America, around a third of exports from Louisiana, and about a fifth of exports from Georgia, Tennessee, and Alabama.

Last year, the flow of U.S. direct investment in Latin America rose to $84.5 billion, and direct investment from Latin America into the United States was $18.4 billion.

I mentioned earlier the movement of U.S. dollar cash we manage in the Atlanta Fed branch in Miami. In 2011, we shipped $1.7 billion in U.S. currency to Brazil, with the primary demand coming from tourists planning to travel to the United States. Spending by Brazilians in Florida has made quite an impression on their hosts. *Florida Trend* magazine named Brazil as "Floridian of the Year" in 2011, acknowledging the 1.5 million Brazilians who visited Florida, second only to the number of Canadian visitors to Florida. Brazilians also represented 12 percent of foreign buyers of real estate in South Florida last year, second only to Venezuelans.

We also see growing cash transactions with Panama, where the canal is being expanded to accommodate ships that are nearly three times larger than current vessels transiting the canal. Rail, port, and distribution facilities throughout the United States are being upgraded to handle larger vessels and more cargo that will result from the canal expansion.

And one more point about how the north-south relationship in our hemisphere has changed: in the 1980s, most Latin American economies were reliant on foreign capital. Today, many countries are capital exporters. Brazil is the fourth largest holder of U.S. Treasury Securities, with more than $200 billion in Treasuries as of June 2012, after China, Japan, and the major oil exporters as a group.

Trade, capital flows, and decoupling
Not long ago it was fashionable to talk of the decoupling of certain emerging market economies from advanced economies. The notion was that major countries like Brazil are sufficiently independent economically to be unaffected by developments in advanced economies—the United States and Europe, for example.

There is some reality in this claim. During and since the financial crisis of 2008 and the recession in this country that followed, Latin America demonstrated impressive resilience. There was some contagion, but on balance Latin America came through this period without severe downside effects. In percentage terms, real GDP contraction in Latin America in 2009 was less than half of that in advanced economies. And the following year's recovery was much stronger. For many countries in South America, the economic output fell for only two quarters.

At the same time, several countries of Latin America have been on the receiving end of sizeable capital flows that have brought unique challenges. When I visited Chile and Brazil last fall, I heard a lot about the volatility of portfolio investment capital flows that swing with the appetite of global investors for emerging market risk and risk in general.

Economists and central bankers expressed a lot of concern about how to manage their monetary affairs in an environment characterized by strong capital inflows that drive their exchange rate higher and fuel credit expansion that in turn causes a boom in asset prices. Then these forces can come to sudden stops followed by a reversal of capital flows, falling asset prices, and credit contraction because of shrinking collateral for loans. My central bank colleagues from Latin America did not talk of decoupling. Rather, they described their challenge of avoiding a boom-bust cycle as a result of hot money flows in a risk on-risk off world.

The export trade of Latin America is also affected by demand conditions here in the United States and the rest of the world. Beyond direct exports to the United States, we have seen how in recent years South American commodity exports to emerging Asia have soared. Argentina, Brazil, Chile, and Peru are the leading exporters of commodities to emerging Asia, and China is now Brazil's top trading partner. The boom has contributed to strong economic growth in the exporting countries, but as global growth has slowed, so has demand for these commodity exports, and commodity prices have fallen.

Most Latin American countries, through openness to capital flows and trade, are more and more integrated into the global economy. This is, on balance, a good thing, but it brings policy challenges in their pursuit of macroeconomic stability and consistent growth.

Conclusion

Let me recap. The Latin American story—in the simplest terms—goes something like this: Latin America got into trouble in the '80s because of bad policy decisions. The region suffered what some have called a lost decade. Since then, the governments of most Latin countries have pursued sound policies, and as a result these countries have progressed economically and their economies continue to perform rather well.

This history suggests to me there exist certain basic realities—behaving almost like physics—that cannot be long ignored or avoided. Consistent and sustained good economic performance needs a foundation of sound fundamentals. These fundamentals include good fiscal management—especially debt management—and monetary policy that supports growth while delivering control of inflation. Add to these the maintenance of an open economy that accepts and benefits from trade and capital flows from the rest of the world.

It is my sense that the countries of Latin America have mostly learned these lessons.

I don't believe the United States or other mature economies are immune to these realities—these physics, so to speak. The U.S. economy has been in a technical recovery since the summer of 2009. The recovery to date has seen weak growth and persistently high unemployment. By any number of measures, the strength of the recovery has been and remains disappointing.

Some commentators have warned that the United States, along with Europe and Japan, could be experiencing our own lost decade. Just last week, an article in the *Financial Times* argued the world is halfway there. Friday's *New York Times* ran an article referring to Europe's lost decade. I will leave it to economic historians to arrive at a verdict on this question, but certainly our current expansion is not on the track we would wish.

Real personal income (excluding government transfer payments) is still 1.5 percent below what it was before the recession in late 2007.

As of July, there are more than 4½ million fewer payroll jobs than in November of 2007. Most of these job losses were in the private sector. The share of unemployed workers who have been out of a job for more than 27 weeks has fluctuated between 40 and 50 percent over the entire course of the recovery.

I think this condition can be attributed, at least in part, to fundamental imbalances that have not yet been corrected, a situation that presents formidable challenges for monetary policymakers. There is a risk to monetary policy being employed too aggressively and without effect to address economic problems that can be resolved only by fiscal reforms that involve making tough choices about the allocation of public resources. Monetary policy can exert a powerful positive influence on an economy, but as Chairman Bernanke has pointed out, monetary policy is not a panacea.

We should applaud sound policy decisions and effective policy implementation where we see it. Again, I commend many of the governments and central banks of Latin America for having chosen this path.

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