Latin America: Financial decoupling, real concerns

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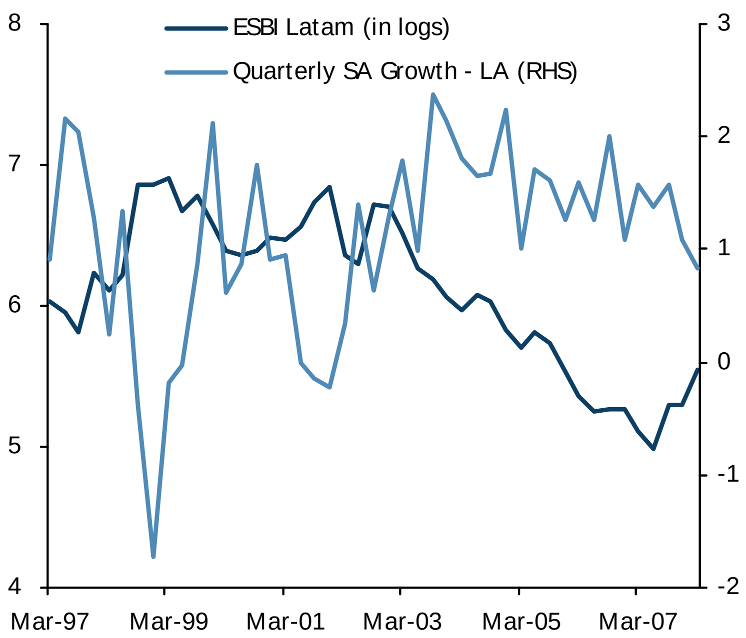
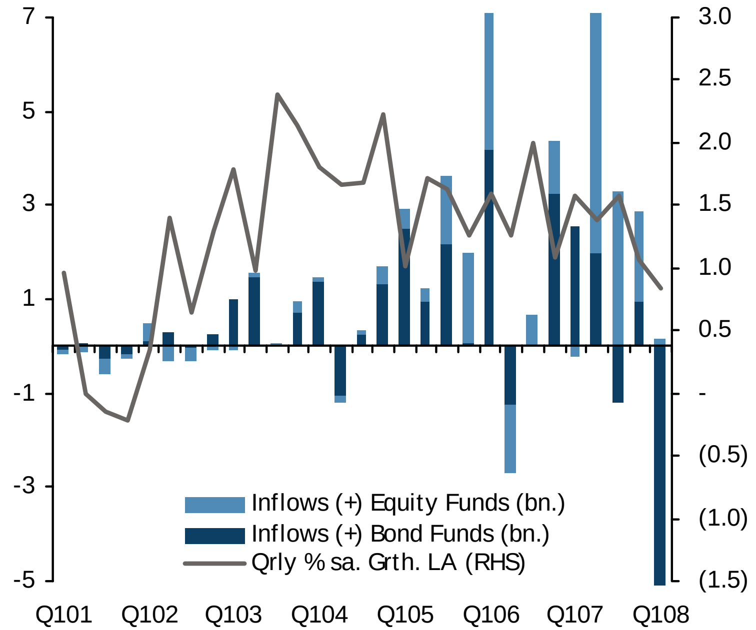
The real/financial channel: Decoupled…

- The decoupling of the real economy from financial shocks is a key structural change in EM in the 2000s…

Real channel: Not what it used to be…



Growth less dependent on inflows



Source: Markit, Barclays Capital

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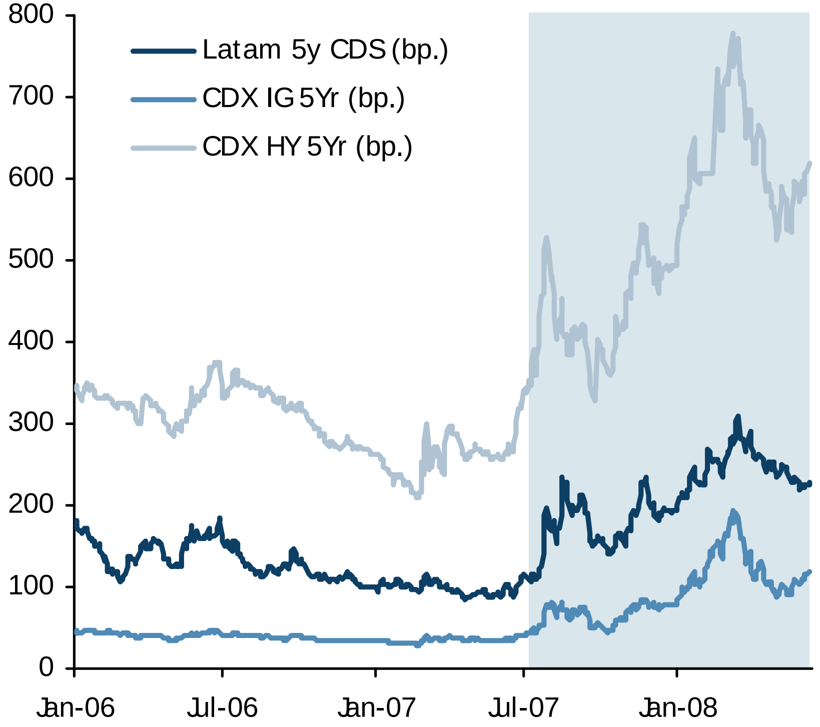
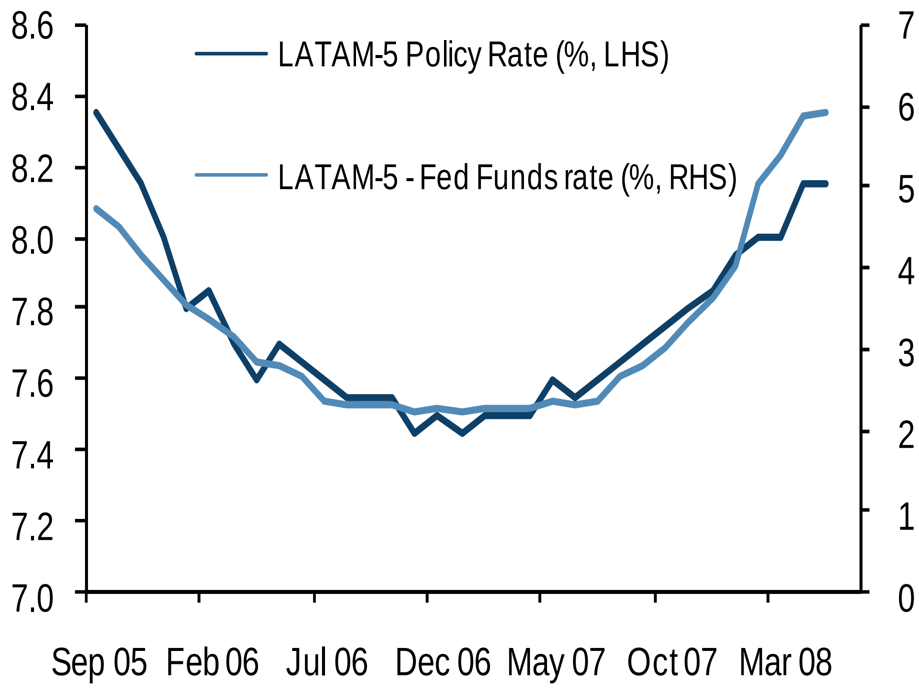
…and already permeating the financial channel

- …that is already permeating into valuations.

EM Trying on investment grade shoes...



…and monetary autonomy



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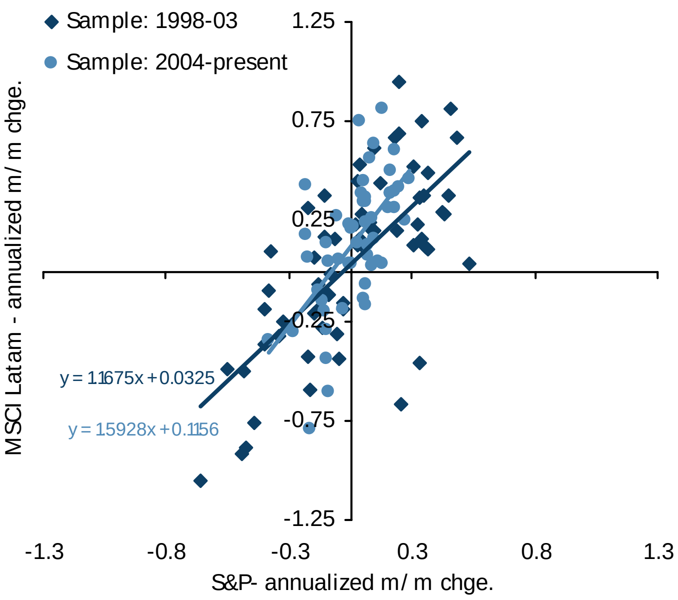
Source: Market, Barclays Capital

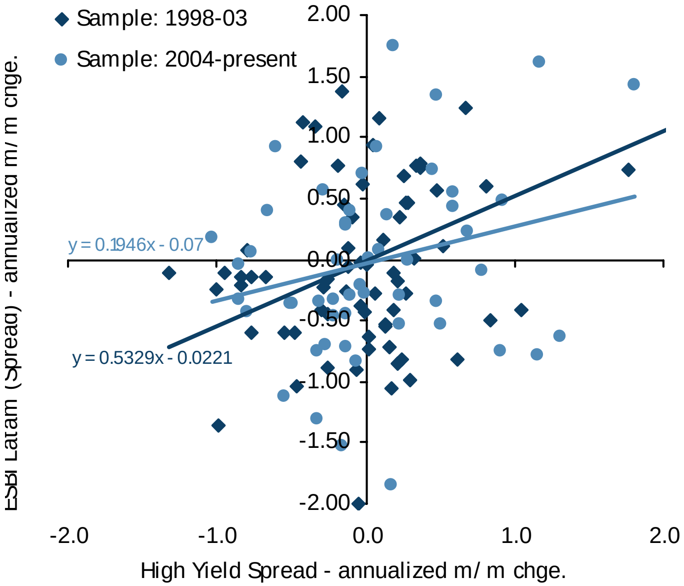
The financial channel: Still there?

- EM Equity remains very responsive to S&P sell offs (high betas), but credit and FX have been less responsive to core markets than in the 1990's (low betas)

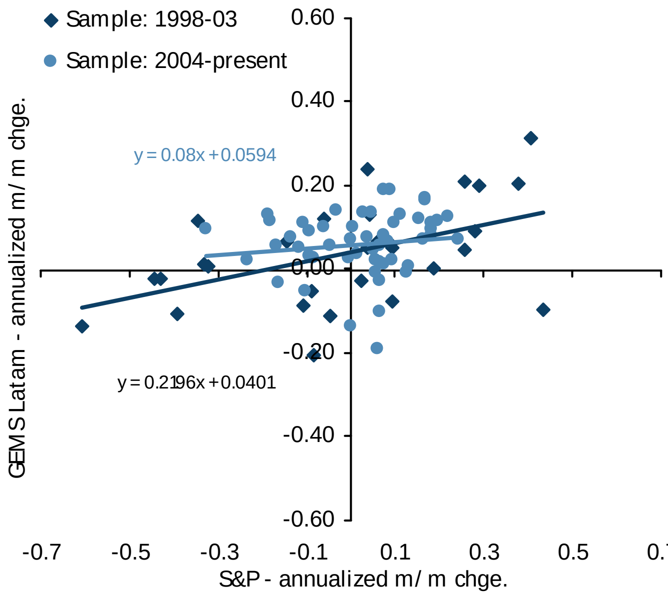
Financial channel: still strong in equities…



…less so in credit…



…and FX.



Source: Bloomberg, Barclays Capital

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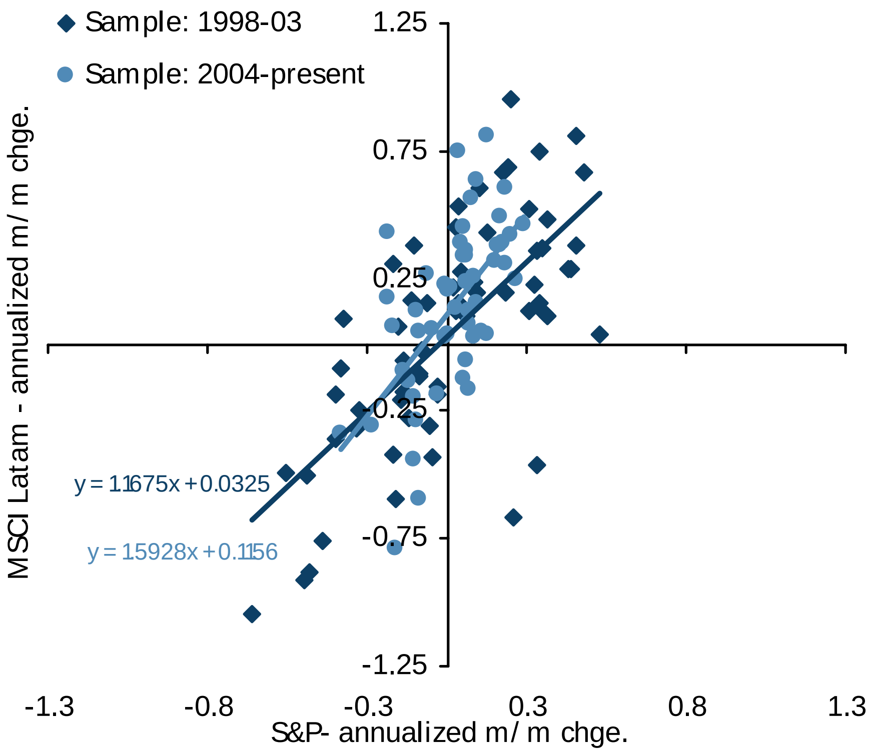
Still there? LatAm's slow divergence

- What do talk about when we talk about betas?

High-frequency correlation…



…low-frequency divergence

Source: Markit, Barclays Capital

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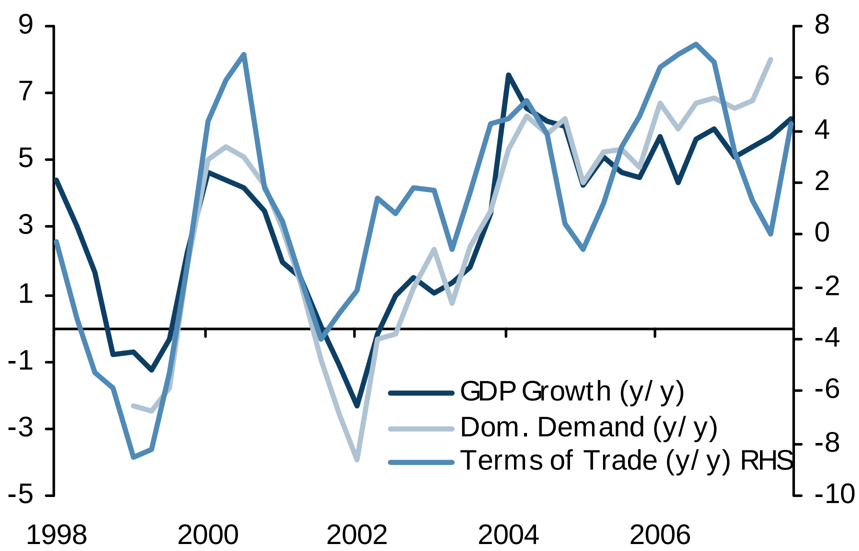
The real channel: Buying external slack…

- ...which could be wiped out by an (unlikely) decline in commodity prices

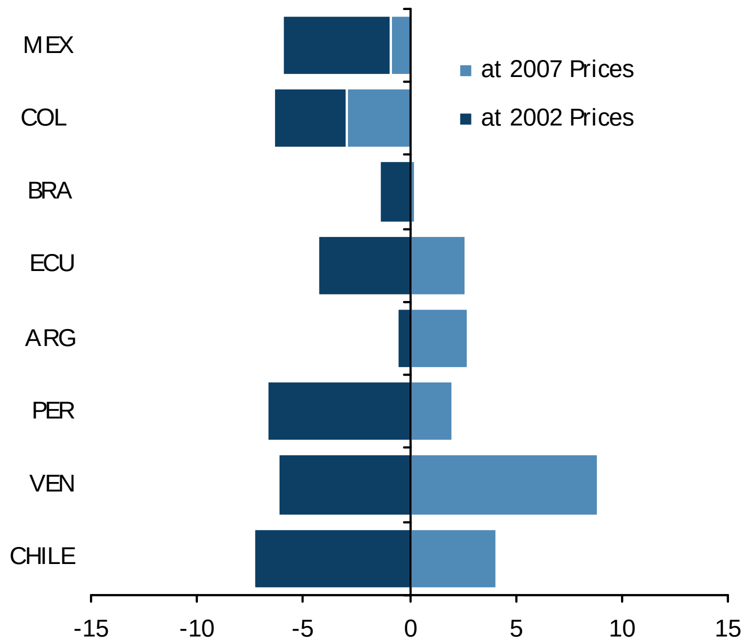
Growth and Terms of Trade



Note: PPP weighted.

Source: Haver Analytics, Barclays Capital

The Impact of Terms of Trade on the Current Account



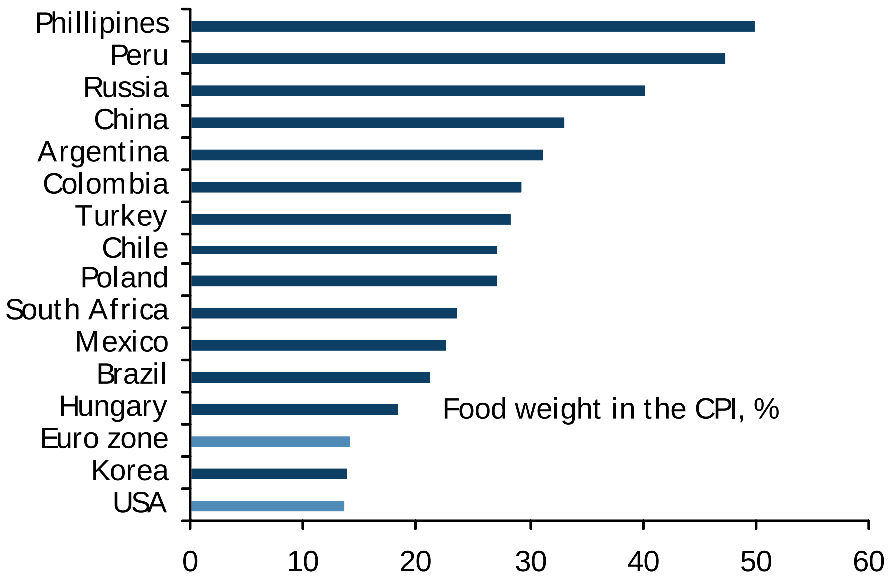
Source: Barclays Capital

The curse of inflation targeters

Food inflation: The talk of the town

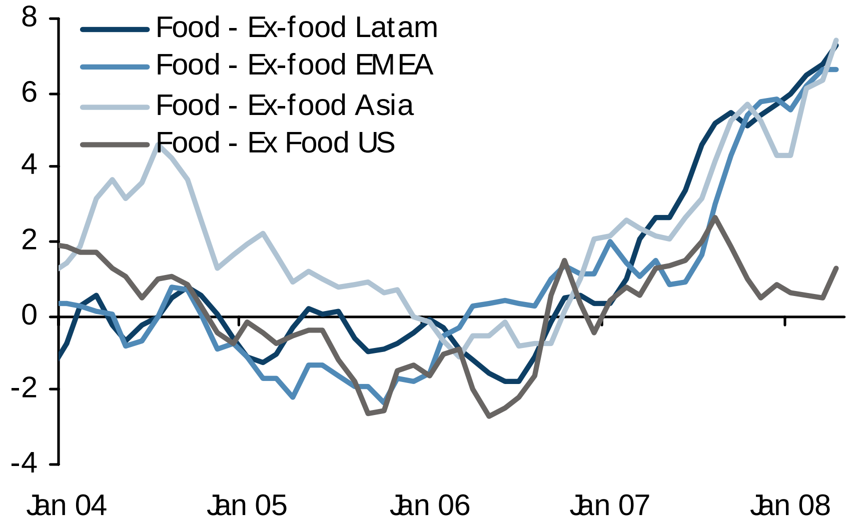
- The surge agricultural commodity prices affected EM disproportionately.
- Food has a higher weight in EM CPIs, and food prices increased relatively more in EM.

Food Is More Important for EM …



Source: National authorities, CEIC, Barclays Capital

… and Increased Proportionately More



Source: Haver Analytics, Barclays Capital

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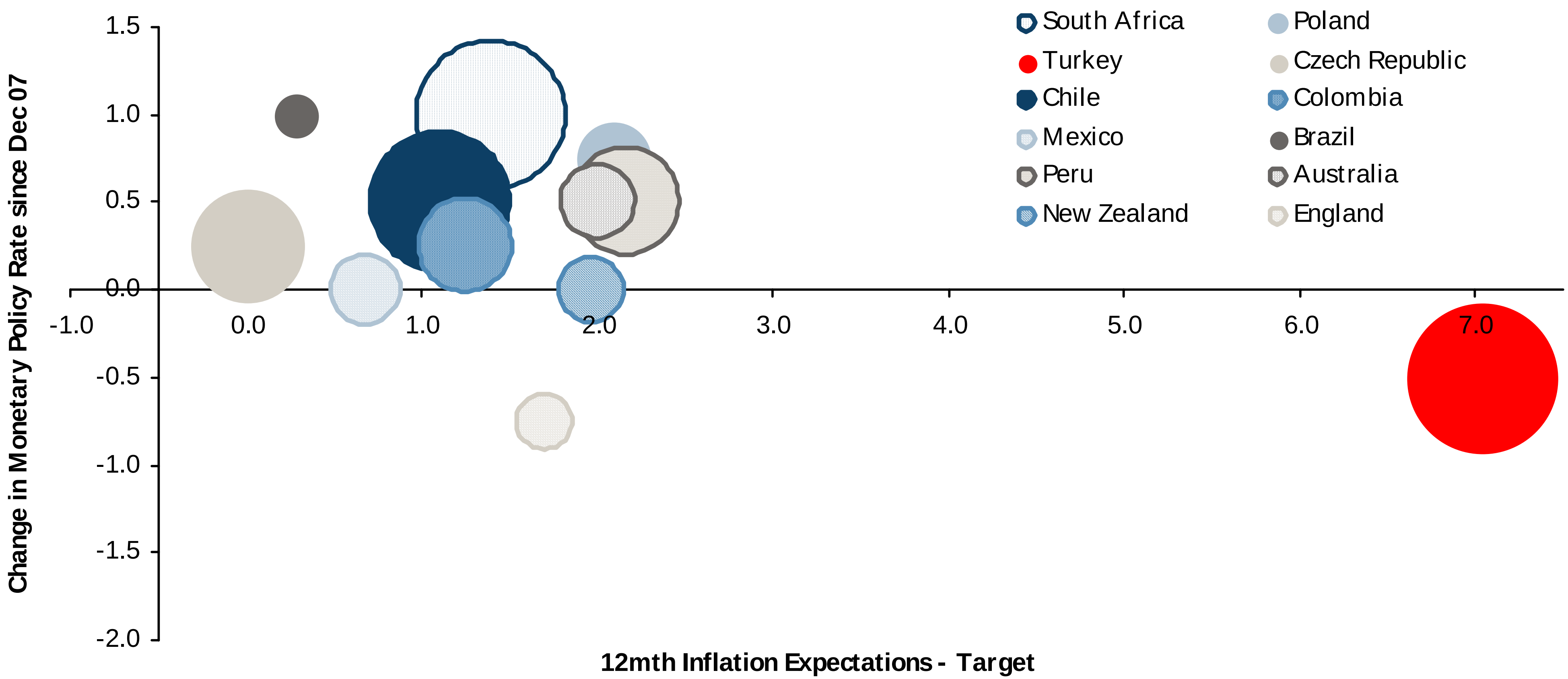
Hawks, Doves & Turkeys

- Central banks have responded to the problem in different ways (December 07 through June 5, 2008)…



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Hawks, Doves & Turkeys

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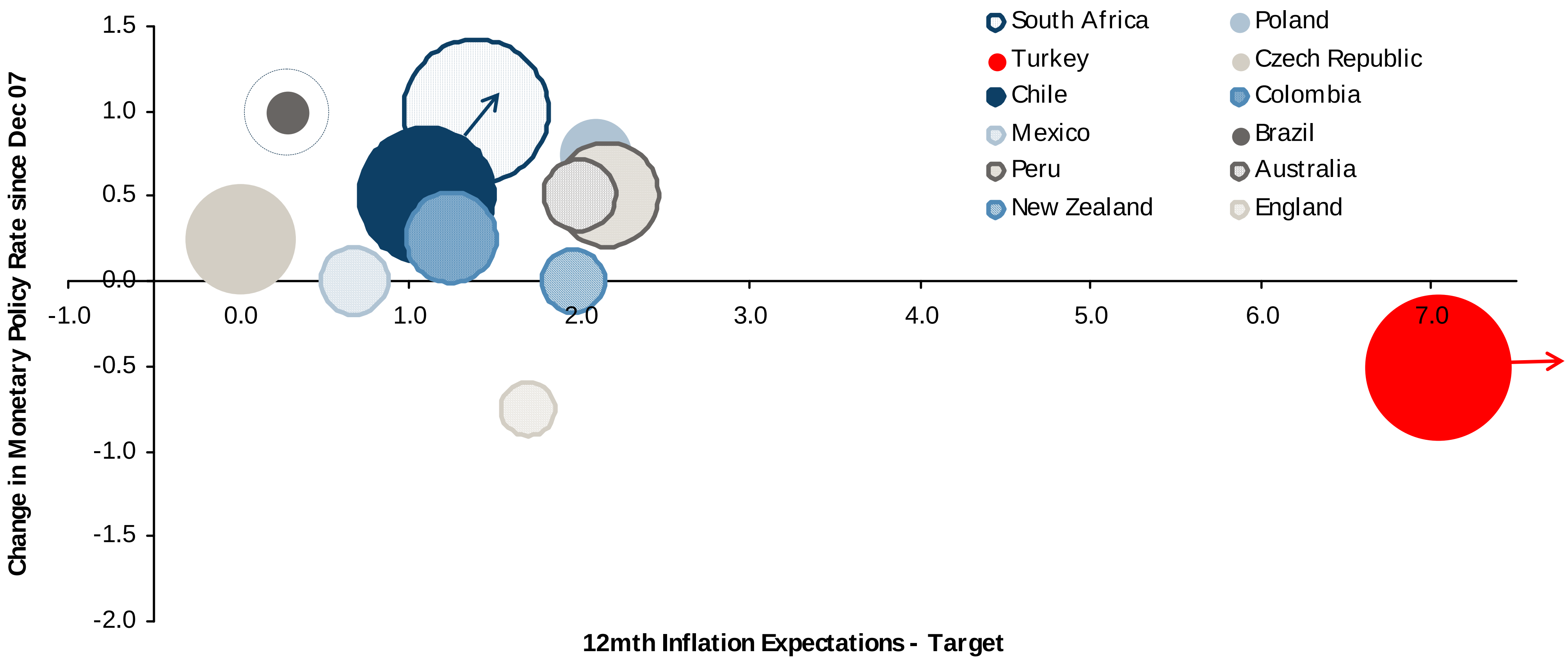

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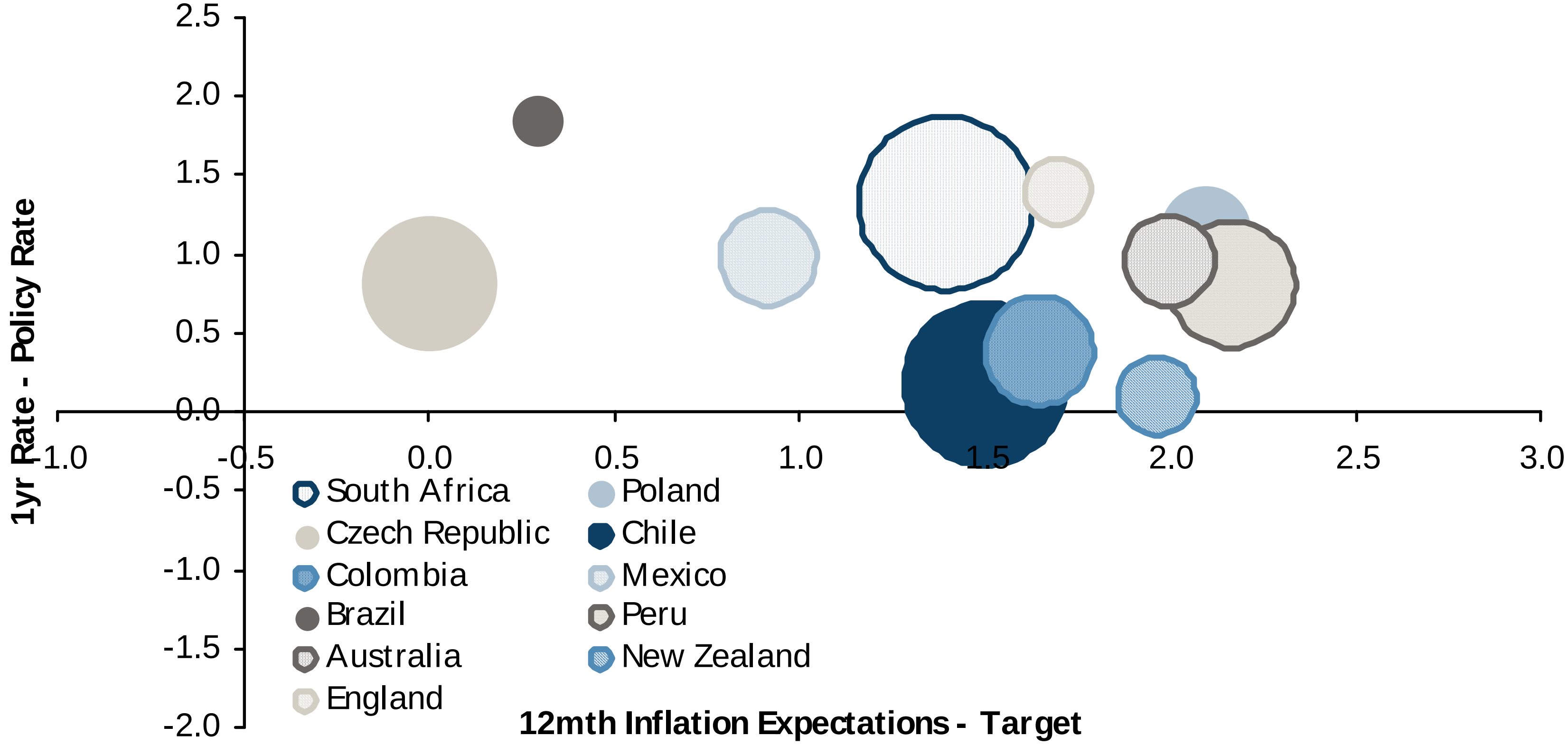
Hawks, Doves & Turkeys

- ...and are perceived accordingly by the market (June 5, 2008)



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Summing up

- Short-term challenge:
  - Monetary policy confronting food inflation again (in some countries, together with cyclical expansions), with risks of de-anchoring. Further tightening expected in Brazil, Chile, Mexico, and Peru, and (until recently) in Colombia.
  - IT prospects in an inflating world: Americanization (benign neglect); fiscalization (Chile) or outright overkill?
- Medium-term challenge: A dollar rebound and its effects on EM ToT and FX...

...a topic for a future talk

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Gracias

Latin America Outlook

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