

# LatAm—2003-07 Extraordinary External Adjustment Major Source of Macro Resilience

**Alberto M. Ramos**

Senior LatAm Economist  
Goldman Sachs Economic Research

BCRP-WB Conference “*The Global Rise in Food Prices and the  
US Slowdown: Issues and Challenges in Monetary Policy*”

Lima, Peru: June 16-17, 2008

**2003-07: Major Reduction in External Vulnerabilities ... but Amid Subpar Growth/Inv. Performance.**

**→ Accumulated Resilience to Deal With External Shocks (e.g. Increase in Risk Aversion; Decline in Commodity Prices; Lower Global Growth)**

**Going Forward: Broad Financial/Macro Stability. Unique Opportunity to Push Forward With Needed Reforms and Elevate Growth Potential.**

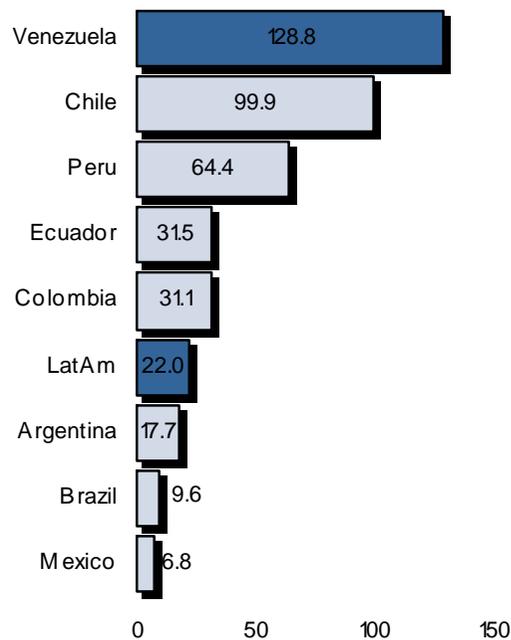
## LatAm: Benefited From Extraordinarily Supportive External Backdrop During 2003-1H2007

- Since 2003 LatAm has benefited from rarely seen constellation of uniquely and concurrently favorable external factors → Allowed region to post above-trend growth rates, considerably strengthen the external accounts, improve fiscal balances and debt ratios, accumulate a significant amount of foreign reserves, and therefore, visibly reduce the perennial vulnerability to external shocks and excessive dependence on international capital flows.
- Such favorable external tail winds contributed decisively to strengthen most regional currencies, improve the balance sheet of both sovereigns and corporates, and reduce hard currency debt spreads to new lows. The significant reduction in external vulnerabilities was recognized by rating agencies through a host of sovereign rating upgrades.
- The onus is now on the regional policy makers to capitalize on this unique opportunity to leave decisively behind the lost decade of the 1980s and the sub-par performance of the 1990s.

# Significant Terms of Trade Gains Since 2003

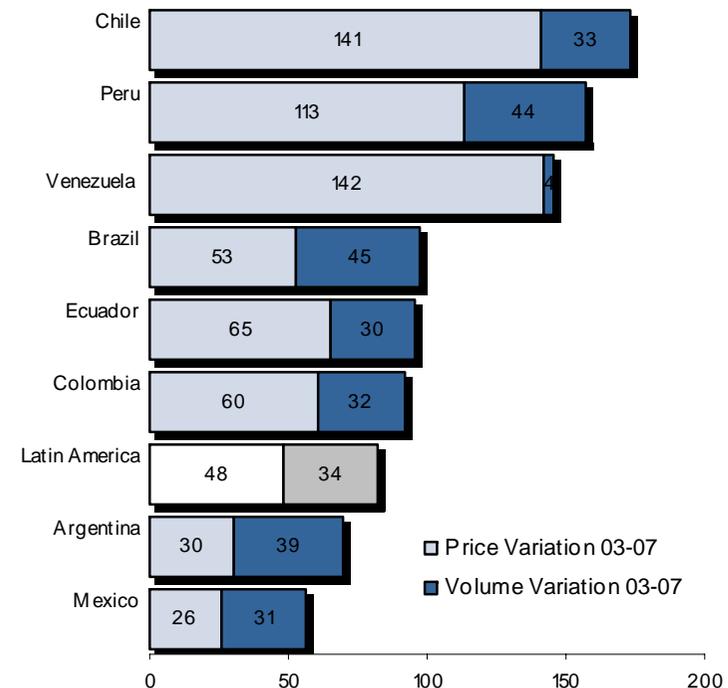
- The external adjustment initiated in 2003 took place on the back of a major rally in commodity prices.
- However, beyond the favorable price developments there was also robust export volume growth.

Variation in Terms of Trade from 2003 to 2007



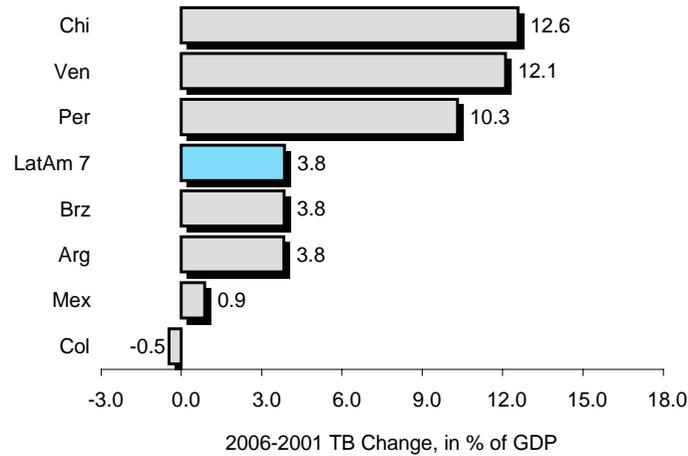
Export Growth 2003-07

(Price and Volume Decomposition)



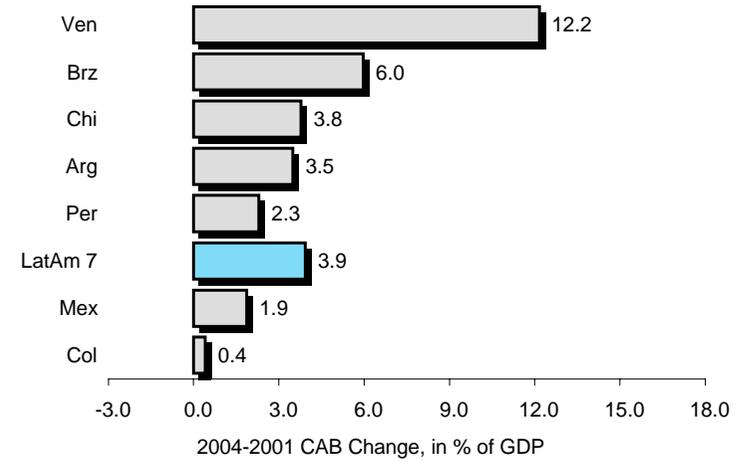
# Oil and Metal Exporters the Main Beneficiaries

**Trade Balance Improved Across The Region**



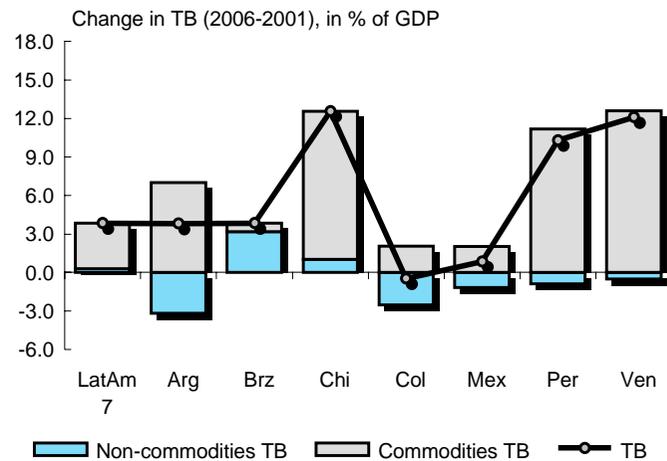
Source: Goldman Sachs estimates.

**Current Account Balance Improved Almost Everywhere**



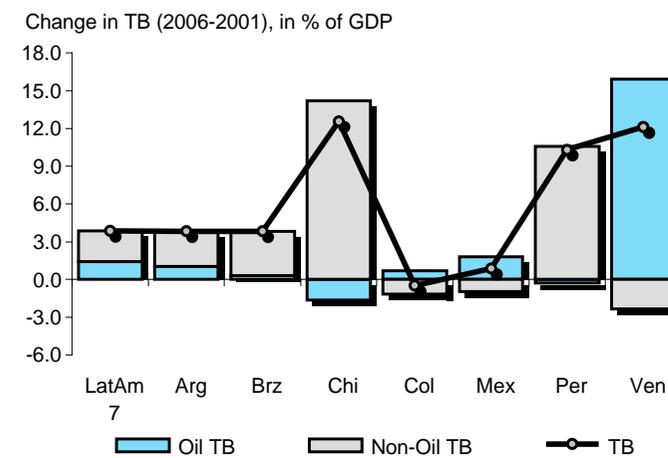
Source: Goldman Sachs estimates.

**Primary Goods Exports Explain 98% of TB Shift**



Source: Goldman Sachs estimates.

**Oil Explains 42% of Trade Balance Shift**

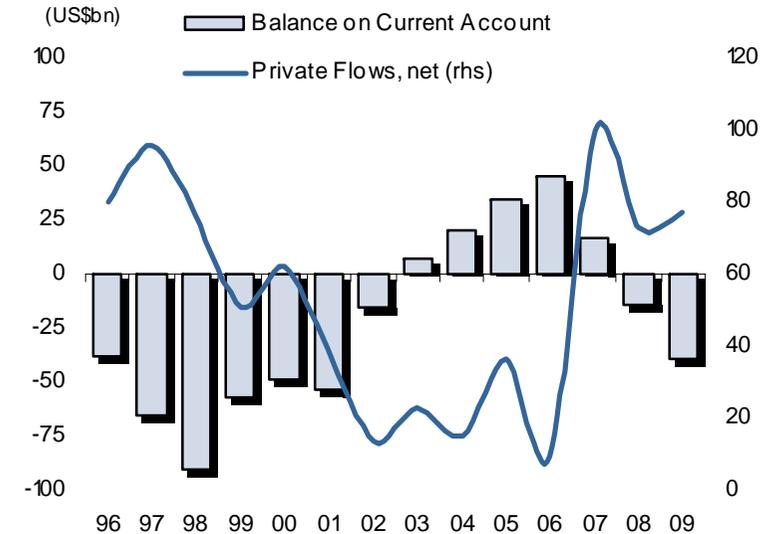


Source: Goldman Sachs estimates.

# Major Turnaround in the External Accounts

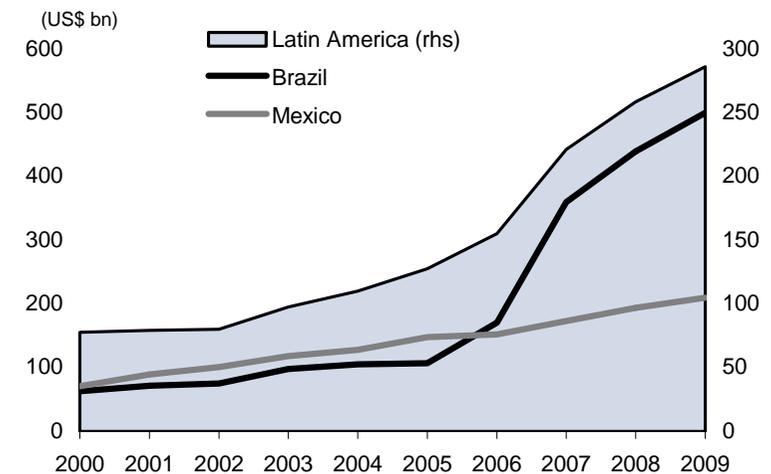
- The current account shifted into a small surplus in 2003—the first in over 35 years—and continued to improve every year until 2006.
- The swing in the current account was driven by a shift in the trade balance to a surplus of close to US\$100bn in 2006, up from a US\$10bn deficit in 2001. In addition, the volume of labor remittances increased from US\$26 billion in 2001 to US\$55 billion in 2006.

LatAm Exporting Savings (Curr Acc Surplus)



Source: IMF WEO.

Significant Accumulation of International Reserves

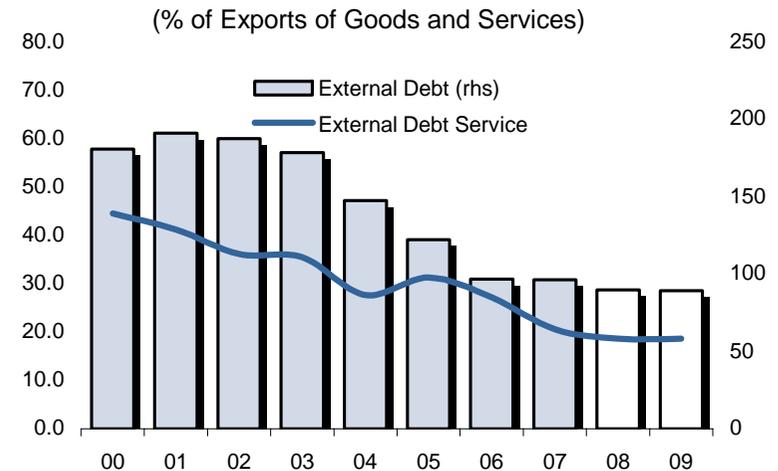


Source: IMF WEO.

# External Debt Service Capacity Improving and Inflation Under Control

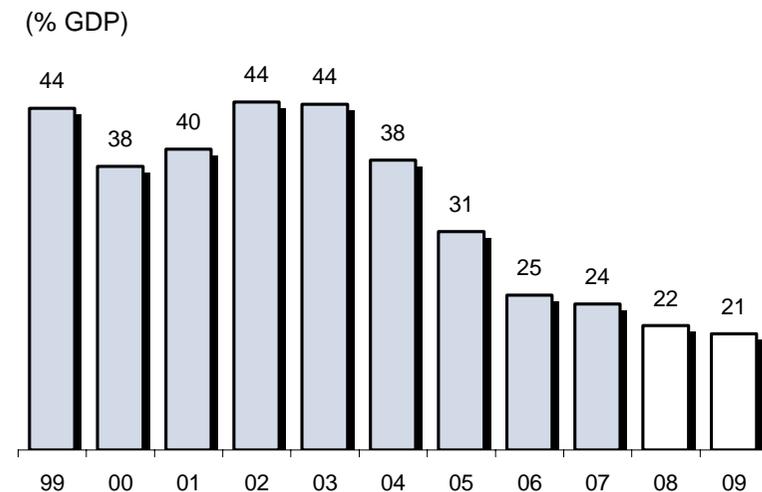
- The external debt servicing capacity indicators of the region have improved markedly.
- This reflects the boom in exports, higher international reserve levels and, smoother debt servicing profiles achieved through liability management.

## External Debt Service Capacity Improving



Source: IMF WEO.

## Total External Debt Declining



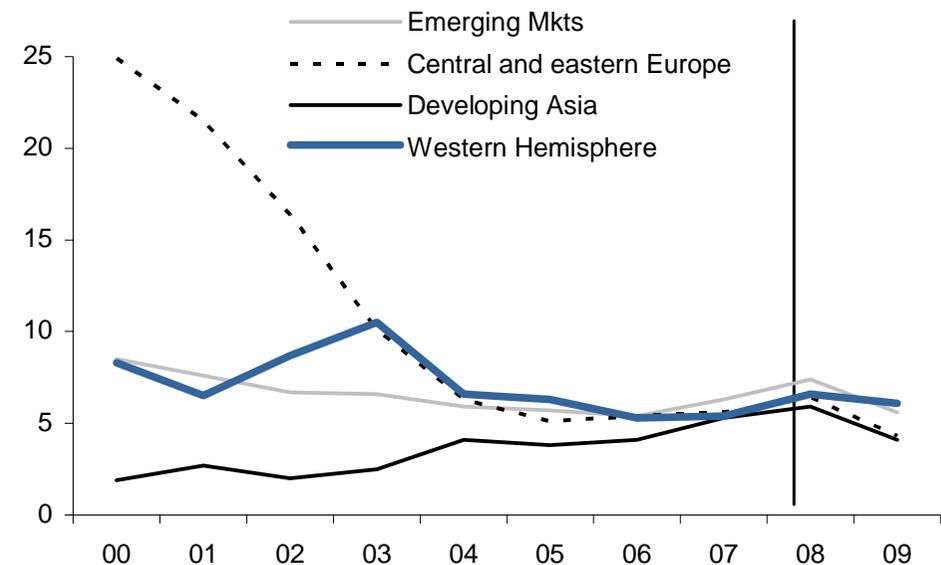
Source: IMF, WEO.

# Inflation Turning into Main Macro Policy Challenge

**2003-2006:** (1) Inflation inertia conquered, and (2) the happy combination of declining inflation and growth revival was reflected in the buoyant performance of local markets (equities and fixed income).

**2007-08:** since 2H2007 inflation has accelerated almost across the board driven in part by food-fuel supply price shocks but also with a few exceptions accommodative monetary conditions amid solid domestic demand growth also played a key role.

**Inflation Dynamics Under Control**

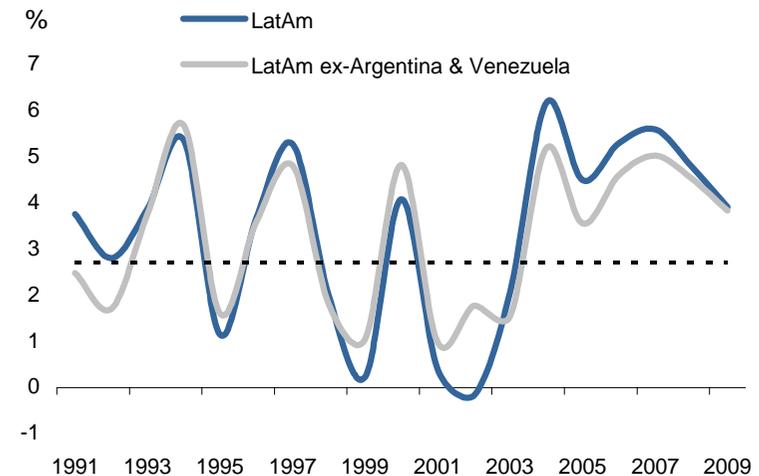


Source: IMF WEO.

# LatAm: Above-Par Real GDP Growth During 2004-06

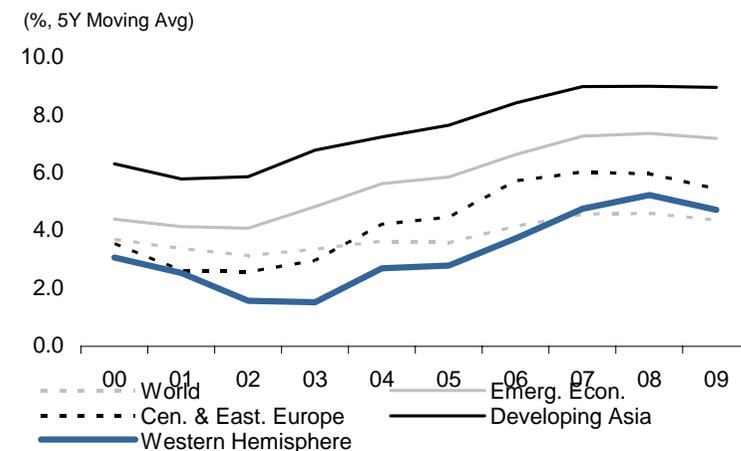
- The economic history of LatAm is populated by boom-bust cycles amid mediocre growth on average.
- The growth performance during 2004-06 (4.9% average) was higher than 2.7% average of the past two decades, but it was unfortunately still considerably below the average of emerging market economies (7.5%) and pales when compared against the performance posted by Emerging Asia (8.8%).

Above-Par Real GDP Growth During 2004-07



Source: Goldman Sachs

Disappointing Real GDP Growth Performance

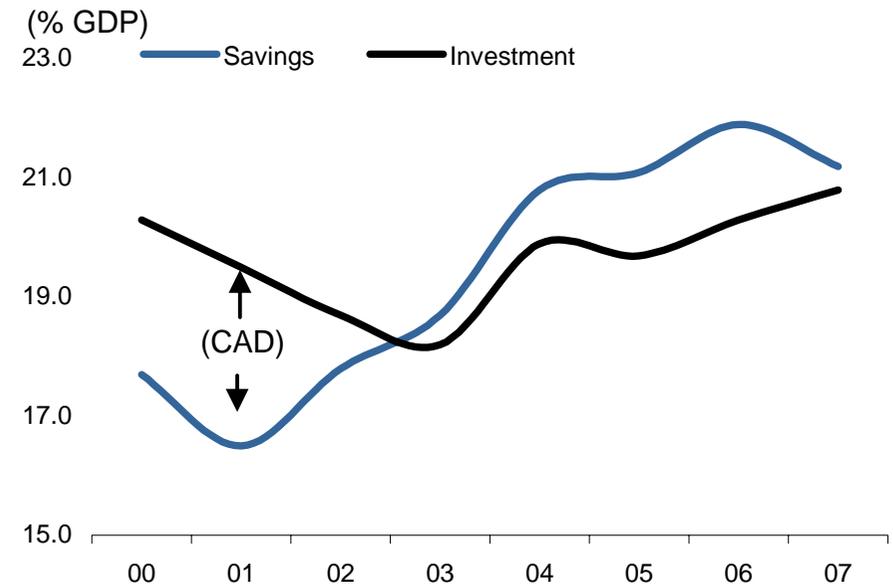


Source: IMF WEO.

# Investment Ratio Lagging Increase in Savings

- The significant wealth transfer observed via terms of trade gains led to an increase in the domestic savings ratio by 4.9 percentage points of GDP since 2001.
- However, increase in savings led to only minor increase in the investment to GDP ratio (up 1.0% of GDP) with the rest being channeled abroad (i.e. exporting national savings as the current account moved into a surplus).

## Latin America Savings and Investment

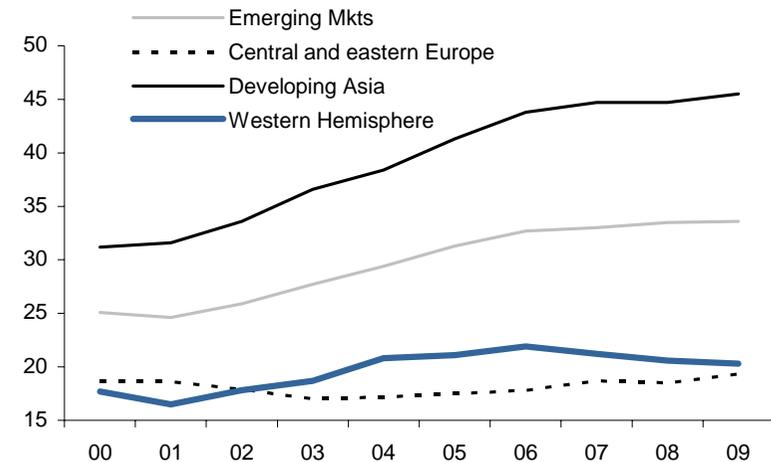


Source: IMF WEO.

# Very Low Investment and Savings Ratios

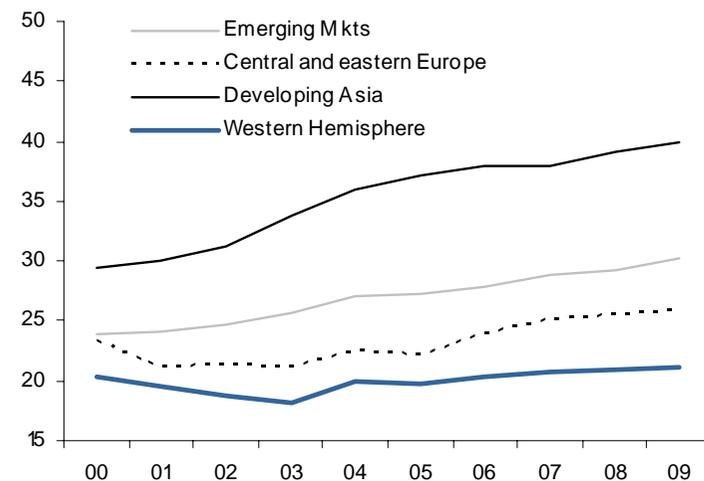
- Unfortunately, 21% of GDP investment ratio is still the lowest of any region, particularly when compared with other emerging markets (e.g. Asia at 36% of GDP, and emerging Europe at 25% of GDP).
- Hence, no surprise that despite the recent acceleration, economic growth in the region continues to lag that of other more dynamic regions in the globe.

**Very Low Domestic Savings Ratio**



Source: IMF WEO.

**Very Low Investment Ratio**

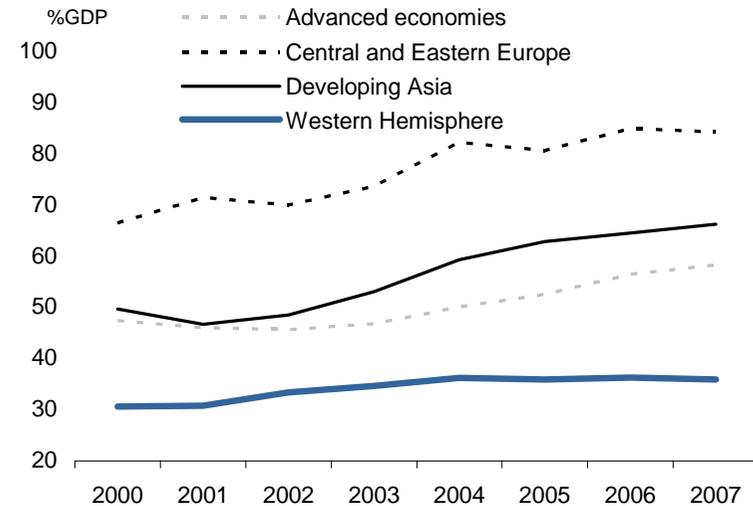


Source: IMF WEO.

# LatAm Still Very Closed to Trade

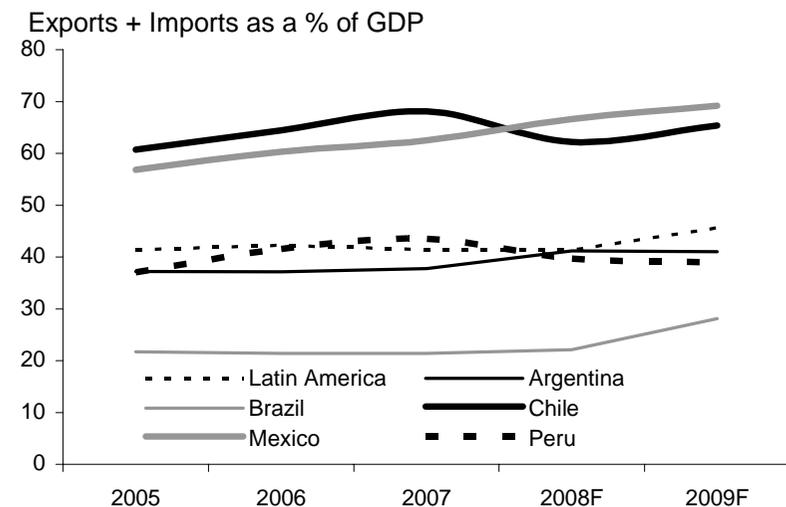
- Opening to trade, by reducing still high levels of protection within clearly inefficient regional trade arrangements, would also contribute to give a technological/productivity shock to economies that need to elevate investment levels and attract foreign capital to leverage their development.
- Imperative to continue to invest in education to enhance the level of human capital and create knowledge based societies.
- A more educated population also less susceptible to populist proposals and experimental-heterodox policy platforms (that have and continue to hinder the development of the region)

## LatAm Still Very Closed to Trade



Source: IMF WEO.

## Brazil Exceptionally Closed to Trade



Source: Goldman Sachs estimates.

# LatAm Navigated Quite Well Recent International Market Jitters

## ***How did Latin America react to the sub-prime crisis?***

Quite well (even Mexico) due to the massive reduction in external vulnerabilities observed during 2003-07. Many sovereigns are now net external creditors. Growth remains solid and many central banks are implementing monetary policy counter-cyclically versus the US.

## ***How would a slowdown in U.S. and global economic activity affect the region?***

It affects the region but given how close these economies are and the small share of non-commodity exports the spillovers from the downshift in activity in the US and globally via the trade balance are quite limited (except for Mexico). As long as commodity prices hold the region should do well.

## ***Is the commodity-driven expansion in LAC a source of fragility?***

Yes and No. Yes, since commodities represent a large share of exports and a major source of fiscal income and current account receipts... but not necessarily a source of fragility if govt's implement counter-cyclical savings funds (e.g. Chile, Norway) and save part of the revenue windfall (i.e. smooth inter-temporally the commodity revenue windfall).

# Real Rather Than Financial Shocks Will Dominate the Future

## ***What are other sources of real/financial fragility in the region?***

With a few exceptions there are no main financial fragilities but on the real side the quest is still to diversify the sources of growth and create conditions to increase investment and elevate potential growth. I.e. structural productivity enhancing reforms still a must to elevate TFP.

## ***Will real shocks matter more than financial shocks in the future?***

Probably real shocks will turn more relevant as the financial vulnerabilities that used to magnify/amplify financial shocks have been to a great extent addressed.

# Going Forward Sizeable Opportunities but Also Significant Policy Challenges

## ***What are the main challenges that LAC policymakers face in the current environment?***

Strengthen the policy mix. Now that we have reduce perennial vulnerabilities we need to increase the efficiency in public spending, invest more, improve human capital levels, reduce poverty, and embrace trade.

## ***What are the challenges they are like to face when monetary conditions tighten in the US?***

Not a big deal. The challenges ahead will not be that different from the challenges these govt's face today. They still need to pursue investment/market friendly policies to attract needed foreign capital and encourage local capital to stay engaged domestically.

## Selected Commodity Prices

	Units	Current Price	2008 YTD	Spot Price Changes (in %)				Forecasts		
				Past Performance				3-Mth	6-Mth	12-Mth
				1-Wk	1-Mth	3-Mth	12-Mth	3-Mth	6-Mth	12-Mth
<b>Energy</b>										
WTI Crude Oil	\$/bbl.	136.7	43.1	7.5	10.9	26.3	102.1	138.0	149.0	145.0
<b>Industrial Metals</b>										
Aluminum	\$/lb.	1.32	23.1	2.2	-1.9	-4.6	8.3	1.3	1.3	1.3
Copper	\$/lb.	3.62	18.1	0.0	-5.4	-6.2	5.8	3.7	3.9	4.2
<b>Precious Metals</b>										
Gold	\$/oz.	869.2	4.1	-0.4	-1.4	-13.2	33.4	860	840	800
<b>Agricultural</b>										
CBT Wheat	¢/bu.	851.0	-1.9	10.5	12.5	-27.2	40.3	900	900	900
Soybeans	¢/bu.	1536.5	24.6	4.2	12.2	11.8	85.7	1400	1530	1420

Source: Goldman Sachs Commodities Group.

**Consolidated Latin America Aggregate Selected Economic Indicators**

	2005	2006	2007F	2008F	2009F
<b>I. Economic Activity and Prices</b>					
Nominal GDP (US\$bn)	2396	2794	3260	4002	4227
Real GDP growth (% yoy) 1/	4.4	5.3	5.6	4.7	3.8
CPI Inflation (% yoy)	5.6	4.8	6.1	7.5	5.7
<b>II. External Sector</b>					
Current Account (US\$bn)	39.8	52.1	22.9	-17.7	-56.7
Trade Balance (US\$bn)	95.2	112.8	89.2	62.8	33.7
Gross International Reserves (US\$bn)	235.3	283.8	416.2	462.8	487.0
Change in Reserves (US\$bn)	51.5	48.5	132.5	46.6	24.2
<b>III. Public Finance and Indebtness</b>					
Overall Fiscal Balance (%GDP)	-0.8	-0.5	-0.2	-0.1	-0.6
Total External Debt (%GDP)	27.4	22.3	20.9	17.4	16.6

1/ Calculated using nominal GDP weights

Source: National Authorities and Goldman Sachs estimates and forecasts.

## Global Macroeconomic Framework

	2006F	2007F	2008F	2009F	07Q1	07Q2	07Q3F	07Q4F	08Q1F	08Q2F	08Q3F	08Q4F
<b>Real GDP Growth (% , yoy)</b>												
United States	2.9	2.2	1.5	1.1	1.5	1.9	2.8	2.5	2.5	1.6	0.9	1.0
Euroland	2.9	2.6	1.7	1.6	3.2	2.5	2.7	2.2	2.2	1.9	1.4	1.4
Japan	2.4	2.1	1.4	1.5	3.2	1.8	1.7	1.7	1.0	1.7	1.6	1.2
World Economy	5.0	4.8	3.9	3.7	4.7	4.8	5.0	4.8	4.4	3.9	3.5	3.5
<b>CPI Inflation (% , yoy)</b>												
United States	3.2	2.9	4.1	3.2	2.4	2.6	2.4	4.0	4.2	3.9	4.5	4.0
Euroland	2.2	2.1	3.5	2.4	1.9	1.9	1.9	2.9	3.4	3.5	3.7	3.4
Japan	0.1	0.0	1.6	1.0	-0.1	-0.1	-0.1	0.4	1.0	1.4	1.8	1.9
<b>Interest rates (% , e.o.p)</b>												
Fed Funds	5.25	4.25	2.00	2.00	5.25	5.25	4.75	4.25	2.25	2.00	2.00	2.00
UST 10-Year	4.71	4.03	3.91	4.20	4.65	5.03	4.58	4.03	3.43	3.70	3.80	3.90
Euro yield 10-year	3.95	4.33	4.12	4.30	4.07	4.57	4.32	4.33	3.90	4.00	4.00	3.90
<b>Exchange Rates (e.o.p)</b>												
US\$/EUR	1.27	1.38	1.51	1.40	1.32	1.34	1.39	1.46	1.55	1.51	1.51	1.45
JPY/US\$	117	117	103	110	117	123	115	112	101	102	102	106

Source: Goldman Sachs Economic Research Group.

# GS vs. Consensus

## GDP Growth: GS vs Consensus

% yoy	2006	2007	2008		2009	
			GS	Consensus*	GS	Consensus*
US	2.9	2.2	<b>1.5</b>	1.5	<b>1.1</b>	1.7
Japan	2.4	2.1	<b>1.4</b>	1.3	<b>1.5</b>	1.5
Euroland	2.9	2.6	<b>1.7</b>	1.5	<b>1.6</b>	1.6
UK	2.9	3.0	<b>1.6</b>	1.7	<b>1.6</b>	1.3
Europe	3.2	2.9	<b>2.0</b>	1.9	<b>1.8</b>	1.8
Switzerland	3.2	3.1	<b>2.2</b>	2.1	<b>1.5</b>	1.5
China	11.6	11.9	<b>10.5</b>	10.1	<b>10.0</b>	9.4
India	9.6	9.0	<b>7.8</b>	7.6	<b>8.2</b>	8.1
<b>BRICs</b>	10.0	10.3	<b>9.1</b>	8.8	<b>8.7</b>	8.4
<b>Advanced Economies</b>	3.1	2.7	<b>1.9</b>	1.8	<b>1.7</b>	1.9
<b>World</b>	5.0	4.8	<b>3.9</b>	3.8	<b>3.7</b>	3.7

\* Consensus Economics May 2007

## Inflation: GS vs Consensus

% yoy	2006	2007	2008		2009	
			GS	Consensus*	GS	Consensus*
US	3.2	2.9	<b>4.1</b>	4.0	<b>3.2</b>	2.5
Japan	0.1	0.0	<b>1.6</b>	1.1	<b>1.0</b>	0.8
Euroland	2.2	2.1	<b>3.5</b>	3.1	<b>2.4</b>	2.1
UK	2.3	2.3	<b>3.2</b>	3.1	<b>1.8</b>	2.4
Europe	2.2	2.2	<b>3.6</b>	3.0	<b>2.5</b>	2.2
Switzerland	1.1	0.7	<b>2.2</b>	2.3	<b>1.6</b>	1.4
China	1.5	4.8	<b>6.8</b>	7.0	<b>3.0</b>	4.5
India	5.5	4.5	<b>7.0</b>	7.1	<b>4.7</b>	5.9
<b>BRICs</b>	3.6	5.0	<b>6.8</b>	7.3	<b>4.6</b>	5.3
<b>Advanced Economies</b>	2.3	2.2	<b>3.5</b>	3.3	<b>2.6</b>	2.2
<b>World</b>	3.3	3.4	<b>5.0</b>	4.8	<b>3.7</b>	3.5

\* Consensus Economics May 2007

---

Goldman, Sachs & Co.

One New York Plaza | 45th Floor | New York, NY 10004

 212.357.5768 |  212.346.4402

 [alberto.ramos@gs.com](mailto:alberto.ramos@gs.com)

**Alberto M. Ramos**

Vice President | Senior Economist

**Goldman  
Sachs**

---

Disclosures applicable to research with respect to issuers, if any, mentioned herein are available through your Goldman Sachs representative or at <http://www.gs.com/research/hedge.html>.

Copyright 2006 The Goldman Sachs Group, Inc. All rights reserved.

This material should not be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. We are not soliciting any action based on this material. It is for the general information of clients of The Goldman Sachs Group, Inc. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Before acting on any advice or recommendation in this material, clients should consider whether it is suitable for their particular circumstances and, if necessary, seek professional advice. The price and value of the investments referred to in this material and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide to future performance. Future returns are not guaranteed, and a loss of original capital may occur. The Goldman Sachs Group, Inc. does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding any potential investment. Certain transactions - including those involving futures, options, and other derivatives as well as non-investment-grade securities - give rise to substantial risk and are not suitable for all investors. The material is based on information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied on as such. Opinions expressed are our current opinions as of the date appearing on this material only.

We endeavor to update on a reasonable basis the information discussed in this material, but regulatory, compliance, or other reasons may prevent us from doing so. We and our affiliates, officers, directors, and employees, including persons involved in the preparation or issuance of this material, may from time to time have "long" or "short" positions in, act as principal in, and buy or sell the securities or derivatives (including options) thereof of companies mentioned herein. For purposes of calculating whether The Goldman Sachs Group, Inc. beneficially owns or controls, including having the right to vote for directors, 1% of more of a class of the common equity security of the subject issuer of a research report, The Goldman Sachs Group, Inc. includes all derivatives that, by their terms, give a right to acquire the common equity security within 60 days through the conversion or exercise of a warrant, option, or other right but does not aggregate accounts managed by Goldman Sachs Asset Management. No part of this material may be (i) copied, photocopied, or duplicated in any form by any means or (ii) redistributed without The Goldman Sachs Group, Inc.'s prior written consent.

The Global Investment Research Division of Goldman Sachs produces and distributes research products for clients of Goldman Sachs, and pursuant to certain contractual arrangements, on a global basis. Analysts based in Goldman Sachs offices around the world produce equity research on industries and companies, and research on macroeconomics, currencies, commodities and portfolio strategy.

This research is disseminated in Australia by Goldman Sachs JBWere Pty Ltd (ABN 21 006 797 897) on behalf of Goldman Sachs; in Canada by Goldman Sachs Canada Inc. regarding Canadian equities and by Goldman Sachs & Co. (all other research); in Germany by Goldman Sachs & Co. oHG; in Hong Kong by Goldman Sachs (Asia) L.L.C.; in India by Goldman Sachs (India) Securities Private Ltd.; in Japan by Goldman Sachs Japan Co., Ltd, in the Republic of Korea by Goldman Sachs (Asia) L.L.C., Seoul Branch; in New Zealand by Goldman Sachs JBWere (NZ) Limited on behalf of Goldman Sachs; in Singapore by Goldman Sachs (Singapore) Pte. (Company Number: 198602165W); and in the United States of America by Goldman, Sachs & Co. Goldman Sachs International has approved this research in connection with its distribution in the United Kingdom and European Union. This material has been issued by The Goldman Sachs Group, Inc. and/or one of its affiliates and has been approved for the purposes of section 21 of the Financial Services and Markets Act 2000 by Goldman Sachs International, which is regulated by the Financial Services Authority, in connection with its distribution in the United Kingdom, and by Goldman Sachs Canada, in connection with its distribution in Canada. Goldman Sachs International and its non-US affiliates may, to the extent permitted under applicable law, have acted on or used this research, to the extent that it relates to non-US issuers, prior to or immediately following its publication. Foreign-currency-denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of, or income derived from, the investment. In addition, investors in securities such as ADRs, the values of which are influenced by foreign currencies, effectively assume currency risk. In addition, options involve risk and are not suitable for all investors. Please ensure that you have read and understood the current options disclosure document before entering into any options transactions.

Further information on any of the securities mentioned in this material may be obtained on request, and for this purpose, persons in Italy should contact Goldman Sachs S.I.M. S.p.A. in Milan or its London branch office at 133 Fleet Street; persons in Hong Kong should contact Goldman Sachs (Asia) L.L.C. at 2 Queen's Road Central; persons in Australia should contact Goldman Sachs JBWere Pty Ltd. (ABN 21 006 797 897), and persons in New Zealand should contact Goldman Sachs JBWere (NZ) Ltd. Persons who would be categorized as private customers in the United Kingdom, as such term is defined in the rules of the Financial Services Authority, should read this material in conjunction with the last published reports on the companies mentioned herein and should refer to the risk warnings that have been sent to them by Goldman Sachs International. A copy of these risk warnings is available from the offices of Goldman Sachs International on request. A glossary of certain of the financial terms used in this material is also available on request. Derivatives research is not suitable for private customers. Unless governing law permits otherwise, you must contact a Goldman Sachs entity in your home jurisdiction if you want to use our services in effecting a transaction in the securities mentioned in this material.

# LatAm—2003-07 Extraordinary External Adjustment Major Source of Macro Resilience

**Alberto M. Ramos**

Senior LatAm Economist  
Goldman Sachs Economic Research

BCRP-WB Conference “*The Global Rise in Food Prices and the  
US Slowdown: Issues and Challenges in Monetary Policy*”

Lima, Peru: June 16-17, 2008