LatAm Macro Outlook – Weathering the global cycle

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US economic cycle has surprised in resilience and duration

The mystery of ‘long and variable lags’

- Post-covid growth trajectory has been uneven as economy digests significant shifts in macroeconomic policy (w/ lags)
- Recession? what recession?
- Consumer spending, household balance sheets continue to provide strong momentum

‘Up the elevator, down the escalator’

- Wage pressures are decelerating, but the pace is slow – think ‘up the elevator, down the escalator’ ...

Turning the corner, finally

- Atlanta Fed Wage Tracker
- PCE core

Recession? what recession?

- Demand rotation towards services sustains positive momentum, though manufacturing cycle typically leads others

Sources: Santander, Bloomberg, Atlanta Fed
US yields – Are we there yet?

Term structure of interest rates at inflection point …

… with term premia repricing leading the adjustment

Economic/policy uncertainties correcting low term premia

US rates vol adding to stresses of tightening liquidity

Sources: BEA, NY Fed, Bloomberg, Santander
USD could defy structural deficiencies a little longer

Long term structural vulnerabilities are papered over … by short term cyclical incentives

Sources: Bloomberg, BIS, Santander
The Dollar Smile Theory – It’s all relative

A broad framework for visualising USD dynamics

Source: Bloomberg, Federal Reserve, National Sources | Twitter: @VPateFX

Note: Growth differentials based on US GDP minus weighted GDP of 25 major economies used in the Federal Reserve (H:10) Broad $ index
Global cyclical indicators suggest demand/supply (and risk pricing) dynamics yet to bottom

**Global macro indicators flashing red**

Copper/Oil ratio warns of weakening global backdrop

- Copper peaked a year ahead of GFC ...
- ... and again during European debt crisis
- Russia invades Ukraine
- And pre-COVID slowdown

Sources: Bloomberg, Santander

**Industrial commodities imply caution too**

While other precious/base metals trends also suggest caution

Copper/gold price ratio as an indicator of global economic sentiment/uncertainties
LatAm Outlook: Cyclical pressures recede but structural challenges remain

Macro forecasts 2021-2025

- Growth challenges (cyclical and structural) remain top of mind after a difficult and “uneven” 2023, as the adjustment process from domestic disinflation, reduced fiscal impulse, high historical real rates and a difficult external environment, continue to run its course.

- Big question marks remain on the quality of the recovery
  Economic ‘scarring’ (hysteresis) is still inadequately understood – the problems of longer term unemployment, wealth and savings destruction on m/t growth, business response to formal hiring / investment plans, how public debt loads can be managed. FDI has been an encouraging counter narrative though.

- Wildcards for LatAm outlook represented by global commodity price adjustments (regional terms of trade), international rates volatility and the evolution of Chinese growth dynamics.

- Despite political uncertainties, on balance, core LatAm’s institutional framework and credibility has proven durable and underscore the effectiveness of regional “checks and balances” alongside orthodox economic anchors.
Regional FX resilience reflects confidence, with a lot of help from high carry

Shock absorbers remain in good shape

LatAm nominal exchange rates (NEER), Jan '20 = 100

External buffers, % GDP

Foreign reserves/ARA ratio

Ratio of 1.0-1.5 considered adequate

Sources: Bloomberg, IMF, Santander
Cost of inflation fight to be borne on growth risks in 2024

LatAm’s inflation fight is not over; the cost to local investment/growth risks will be felt in 2024

Sources: National govts, Santander
China’s maturation poses longer term questions for some regional economies

China’s malaise remains a risk for LatAm prospects (and global/EM more generally)

Sources: National govt.s, Santander
Dollarization can be a double-edged sword

- The dollarization project will be incredibly challenging considering that the net stock of foreign reserves is negative for c. USD 5-10bn
- In practical terms, an estimated USD 40bn (maybe more) required to dollarize (covering monetary base and central liabilities for starters).
- Post-dollarization impact on inflation trends have been encouraging when looking to other economies with similar regime shifts. But maintenance requires stricter fiscal discipline and coherent macro-policy balance (and credibility!).
- Loss of external competitiveness and flexibility could be key longer-term policy risk, especially with major trading partners that maintain more flexible currency regimes, e.g. Brazil.
- Otherwise, without monetary/FX flexibility to withstand domestic and/or external economic shocks, the real economy is the mechanism of transmission, with inherent social-political risks.
Dollarization can be a double-edged sword

**Ecuador**

- Ecuador’s dollarization in 2000, and its efficacy, remains a continued source of debate.

- Low inflation but also low FDI, low trend GDP growth, higher structural fiscal deficit, high immigration, high labor informality and successive debt defaults.

- Giving up local currency puts higher demands on prudent fiscal management and makes economy more susceptible to external shocks (competitiveness, terms of trade, real economy adjustments).

**El Salvador**

- El Salvador dollarized from a position of strength in 2001 after a long period of fixed peg and investment grade status. Relative macro stability, averaging growth of 2% p.a., 2% nominal fiscal deficits.

- However, consistent nominal fiscal deficits and periodic shocks led to consistent debt accumulation and subsequent rating downgrades. Dollarization requires more adept policy management to external shocks and consistent fiscal discipline absent positive shocks to growth and low FDI.

Sources: Santander
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