

The U.S. Economic Slowdown
is
Bad News for Latin America

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Until last week, Latin America's economic prospects looked very promising. Indeed, most forecasters had predicted that during 2001 the region's rate of economic growth would accelerate to 4.5%, from a mere 3% in 2000. This would have meant more jobs, higher wages, and a better standard of living for millions of people. These rosy forecasts, however, depended on a strong world economy, where the advanced countries, and in particular the United States, continued to buy goods produced in Latin America.

Recent news that the U.S. economy is slowing down, has led a number of experts to revise their forecasts for Latin America downward. For example, the venerable New York investment house Goldman-Sachs just cut its economic growth forecast for the region to 3.7% for 2001.

With a weaker U.S. economy the demand for Latin America's exports will decline. This means lower sales of automobiles produced in Mexico, computer parts manufactured in Costa Rica, wine and salmon from Chile, and garments produced in maquiladoras throughout Central America. What makes these prospects particularly worrisome is that the export sector has become the engine of growth in many of the Latin American nations. When the global demand for exports slows down, people employed in these industries stop spending. This reverberates through the rest of the economy, hurting businesses like grocery stores and restaurants seemingly far removed from the global arena.

Government budgets will also be affected. A decline in spending by the export sector will reduce tax collection and make Latin America's perennial fiscal problems even worse. With lower tax revenues, the region's governments will have to cut expenditures in all areas, including social programs.

A weaker U.S. economy also means that commodity prices -- copper from Peru and Chile, agricultural products from Argentina, and coffee from Colombia and Central America -- are unlikely to recover any time soon from their recent low levels. According to the latest forecasts, even oil, a key export product in Mexico, Ecuador, Venezuela, Colombia and Argentina, will experience a price decline during 2001.

But this is not all. With the exception of Brazil, the leaders of every country in Latin America have stated that the creation of a Free Trade Area of the Americas (FTAA) is one of their highest priorities. Implementing such a trading area would give Latin American nations greater access to the huge U.S. market, creating numerous new business opportunities and well-paid jobs. During the last few years, in spite of NAFTA's success, the United States Congress has been reluctant to move towards freer trade.

Indeed, in 1997 Congress denied President Clinton "Fast Track" authority to negotiate new trade agreements effectively and quickly. A turndown in the U.S. economy may increase concerns over jobs in the U.S., and is likely to reduce the political appetite for further trade agreements with Latin America.

With the U.S. economy moving into a lower gear, it is likely that the Federal Reserve will cut interest rates during the first half of 2001. Lower interest rates in the U.S. will benefit Latin American nations with a strong credit rating, such as Chile and Mexico. Unfortunately, countries that urgently need reducing their international borrowing cost -- Argentina, Colombia, Ecuador and Venezuela, for example -- are unlikely to be significantly helped. Their borrowing costs in international markets are primarily determined by their own policies, and by how risky international lenders perceive these policies to be. In the case of Argentina, the US\$ 40 billion dollar rescue package recently signed by the De la Rúa Administration with the International Monetary Fund is an encouraging first step towards solving that country's economic problems.

The slowing down of the U.S. economy will come with a weakening of the U.S. dollar in international currency markets. During the next 12 months or so, the dollar is likely to depreciate relative to the Euro. This is good news for countries that have rigidly linked their currencies to the U.S. dollar, such as Argentina, Ecuador and El Salvador. These countries' currencies, which move with the dollar, will become more competitive and this, in turn, will make their exports more attractive.

The slowing world economy is bad news for Latin America. Not every country will be equally affected, however. Nations that have diversified their exports and have made social reforms will fare better than those that have lagged behind. Indeed, the downturn should remind us that, what matters most is not the external environment but the effectiveness of domestic policies. Countries that have a competitive private sector and are well integrated to the global economy will fare relatively well in troubled times.

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