

REGIONAL ECONOMIC OUTLOOK

WESTERN HEMISPHERE



WESTERN HEMISPHERE
DEPARTMENT

Navigating Tighter Global Financial Conditions

NOVEMBER 2, 2022

This presentation reflects developments and staff projections through September 26, 2022.

ROADMAP

I. Recent Developments

II. Outlook: Shifting Global Winds

III. Risks

IV. Policy Priorities

V. Capacity Development

Key Messages

- While US/Canada slowed in 2022H1, LAC's recovery continued at a firm pace.
- Broad-based inflationary pressures continued across the Western Hemisphere.
- *Global winds are shifting with tightening of global financial conditions* (the 3rd shock, after the pandemic and Russia's invasion of Ukraine)
 - Capital flow reversals, falling commodity prices and lower global growth
 - Outlook for LAC: *Weaker growth and persistent inflation.*
- Risks are tilted to the downside, with main risks stemming from tighter-than-anticipated financial conditions, slower global growth, more entrenched inflation, lower commodity prices, and the possibility of social unrest.
- Policy challenges:
 - *Near-term:* restoring price stability, maintaining fiscal responsibility while protecting social cohesion (inclusive consolidation).
 - *Medium term:* rebuilding fiscal policy space and boosting potential growth

Recent Developments

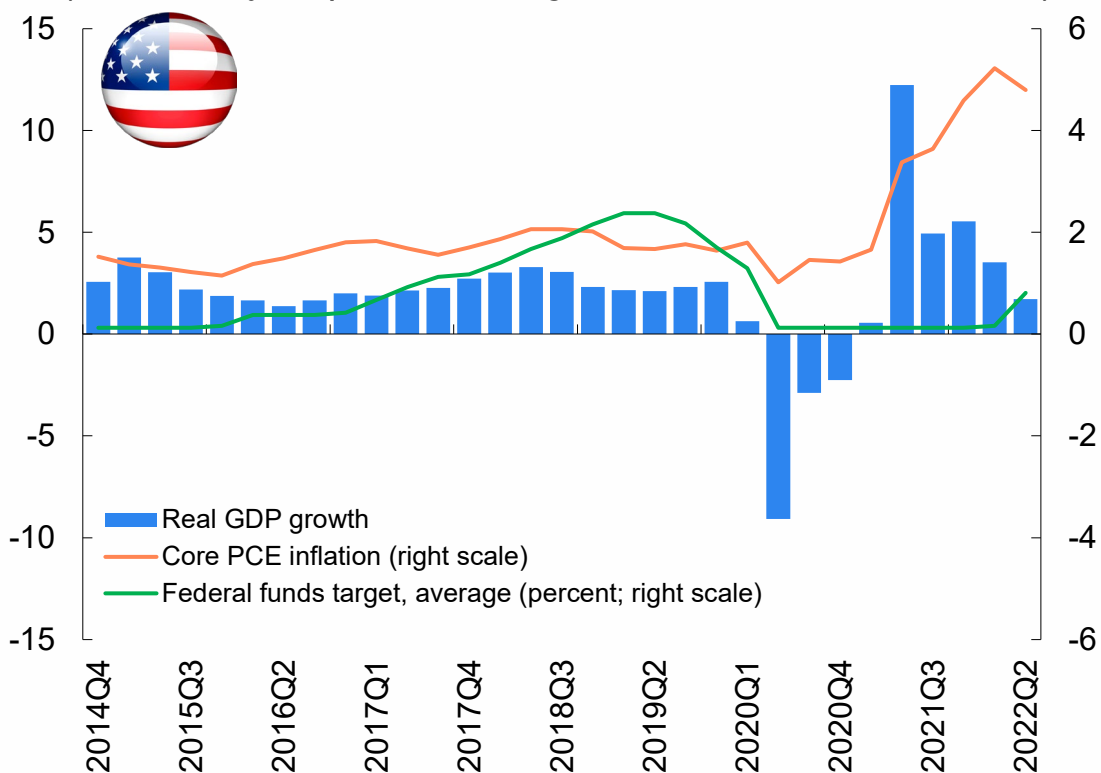
US & Canada: monetary tightening amid high inflation

Strong inflationary pressures in the US and monetary tightening

Canada continue recovering in 2022. But monetary policy tightened as inflation continued to rise rapidly

United States: Real GDP Growth, Core PCE Inflation, and Fed Funds Target Rate

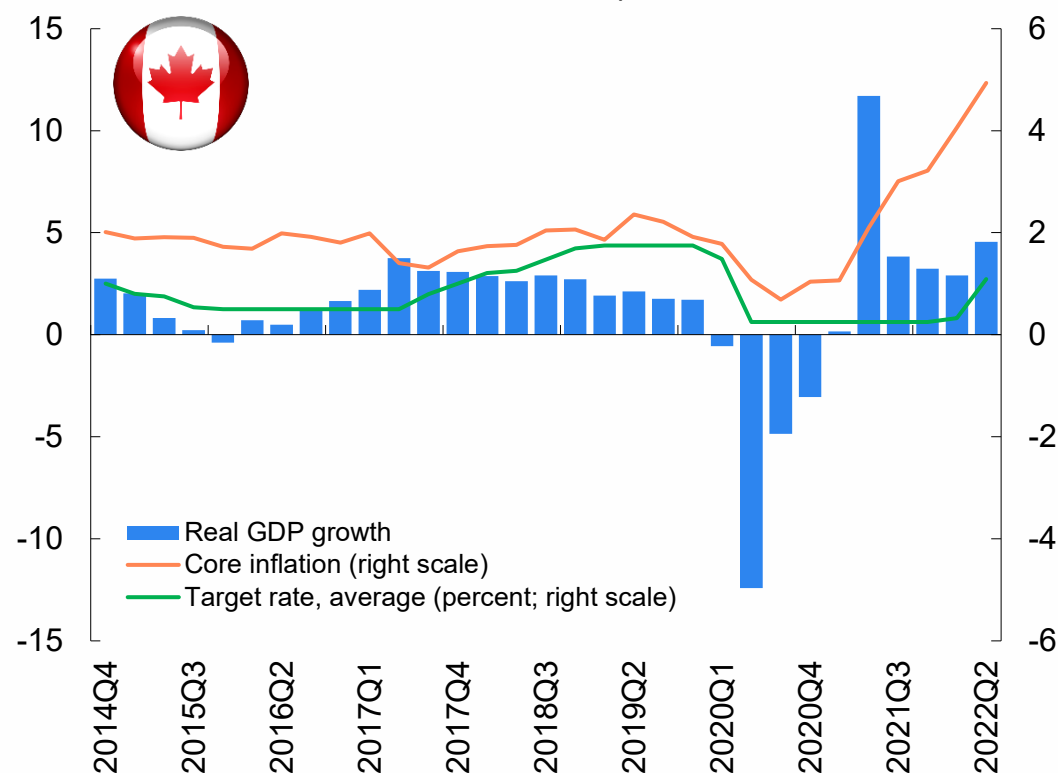
(Year-over-year percent change, unless otherwise indicated)



Sources: IMF, World Economic Outlook database; US Federal Reserve; and IMF staff calculations. Note: PCE = personal consumption expenditure.

Canada: Real GDP Growth, Inflation, and Target Rate

(Year-over-year percent change, unless otherwise indicated)



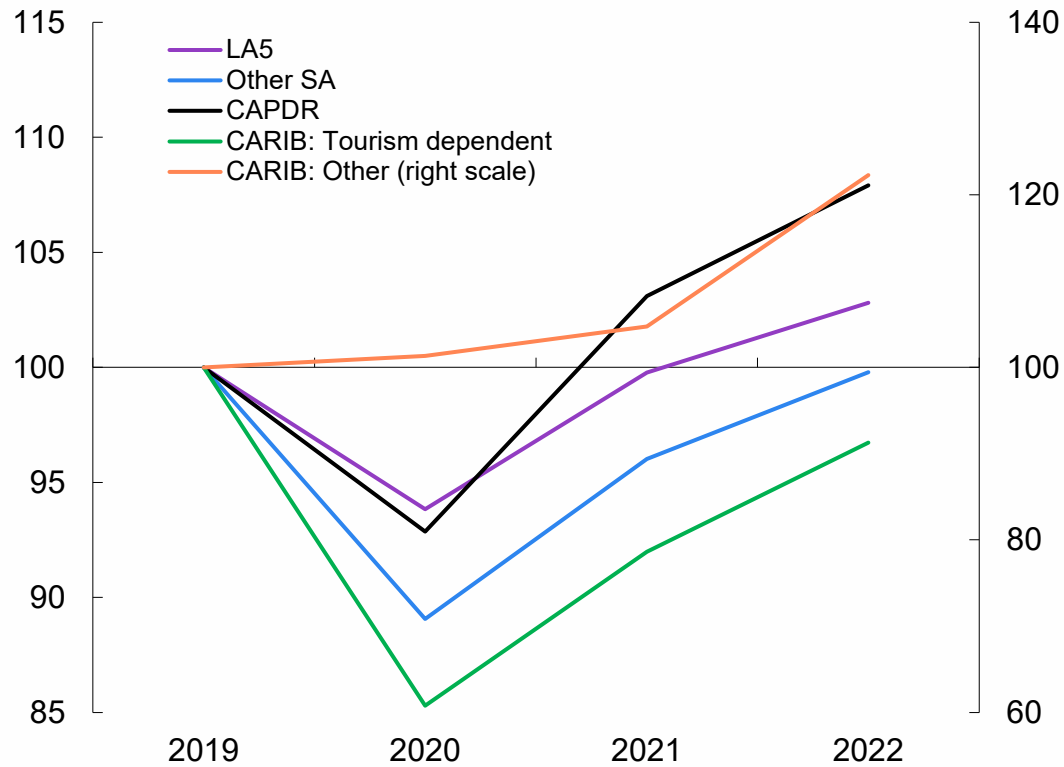
Sources: Bank of Canada; Haver Analytics; IMF, World Economic Outlook database; and IMF staff calculations.

LAC: firm but multi-speed recovery in 2022H1...

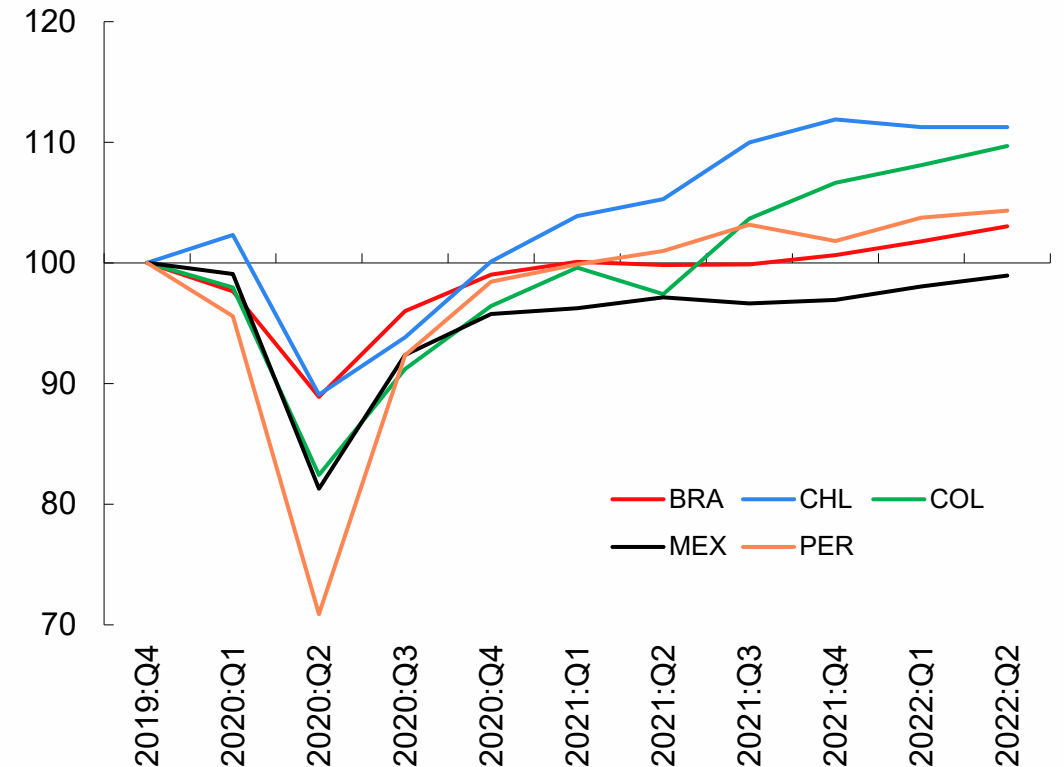
The recovery has been solid but uneven across LAC's subregions...

... with output in LA5 economies comfortably surpassing pre-pandemic levels, except in Mexico

LAC. Real GDP Level
(Index: 2019 = 100)



LA5: Real GDP Level
(Index: 2019Q4 = 100)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: Aggregates are purchasing-power-parity GDP-weighted averages.

Sources: IMF, World Economic Outlook database; and IMF staff calculations.

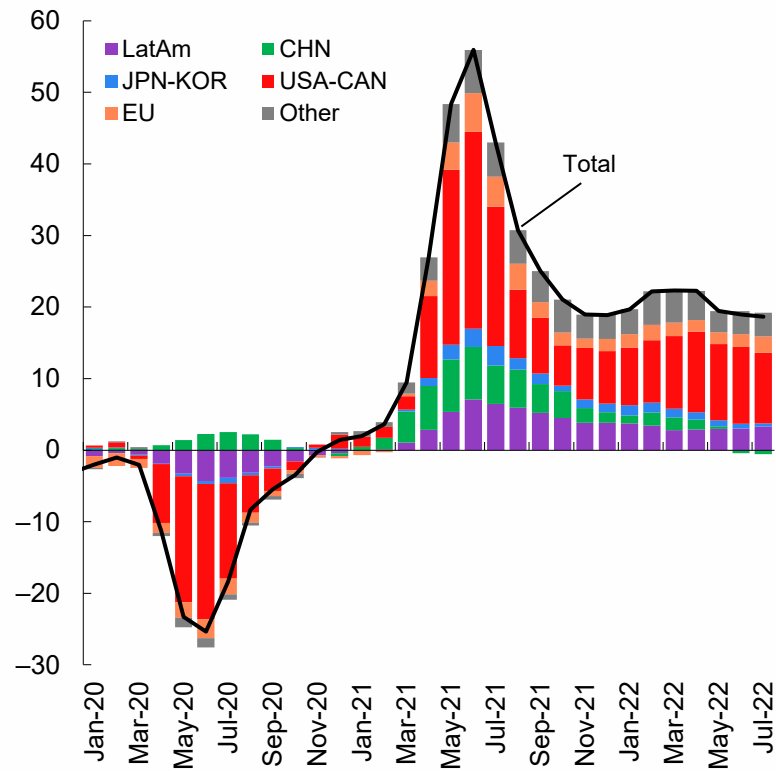
... supported by mostly favorable external conditions ...

Growth in LAC has benefited from robust demand for exports from the US and CAN...

... favorable commodity prices (for the largest economies in the region),...

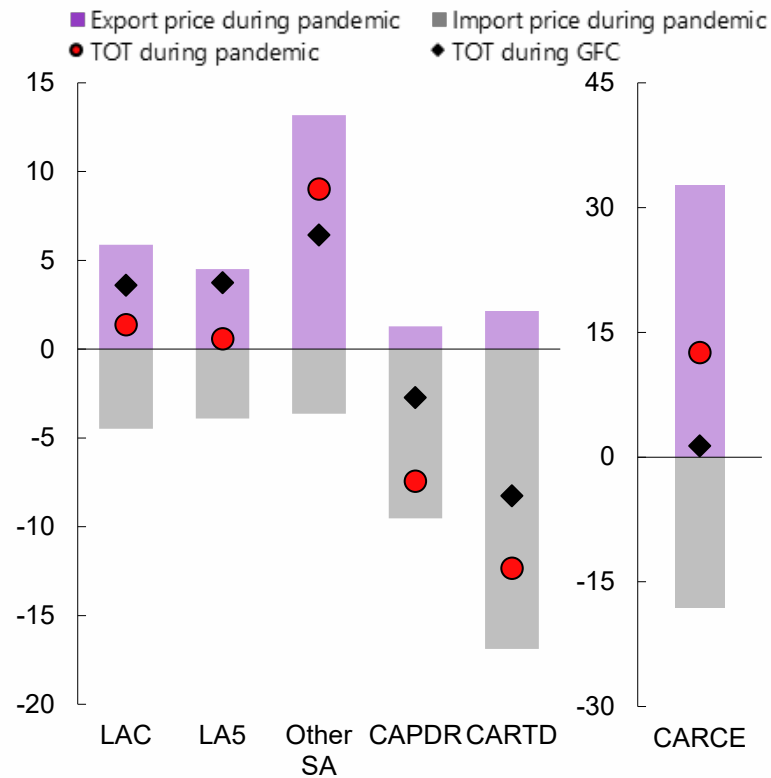
... strong remittances and a robust recovery in tourism

Contributions to Merchandise Exports Growth
(3m-moving sum; year-over-year percent change)



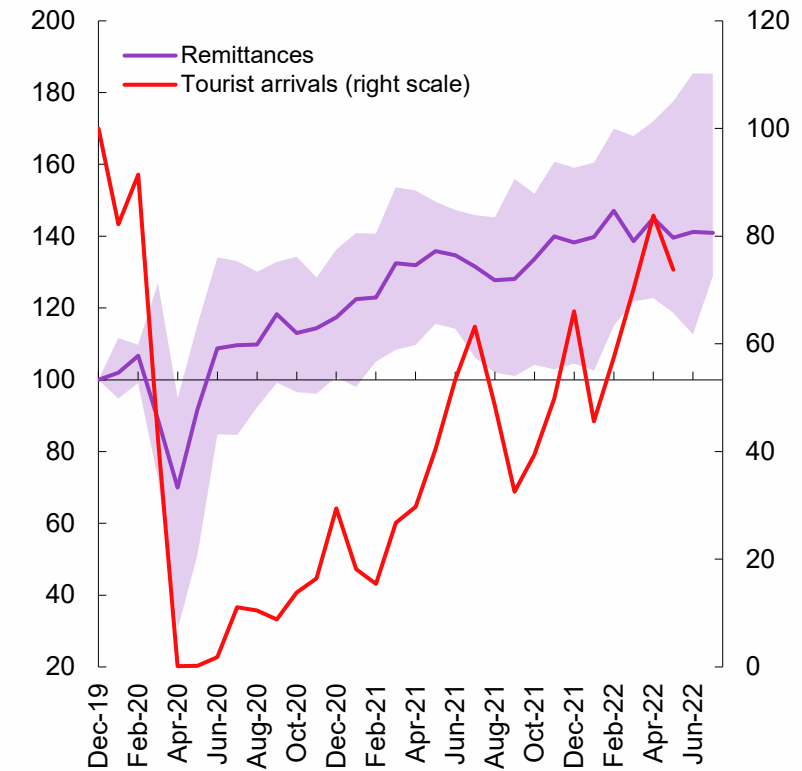
Sources: Haver Analytics; national authorities; and IMF staff calculations.
Note: Includes Argentina, Brazil, Chile, Colombia, Mexico, and Uruguay.

Commodity Terms of Trade
(Percent change; index weighted by GDP)



Sources: IMF Commodity Terms of Trade database; and IMF staff calculations.
Note: Regional aggregates are purchasing-power-parity GDP-weighted averages. CARCE = Caribbean: Commodity exporters; CARTD = Caribbean: Tourism dependent; LA5 = Brazil, Chile, Colombia, Mexico, Peru; SA = South America; TOT = terms of trade.

Remittances and Tourist Arrivals
(Index: December 2019 = 100)



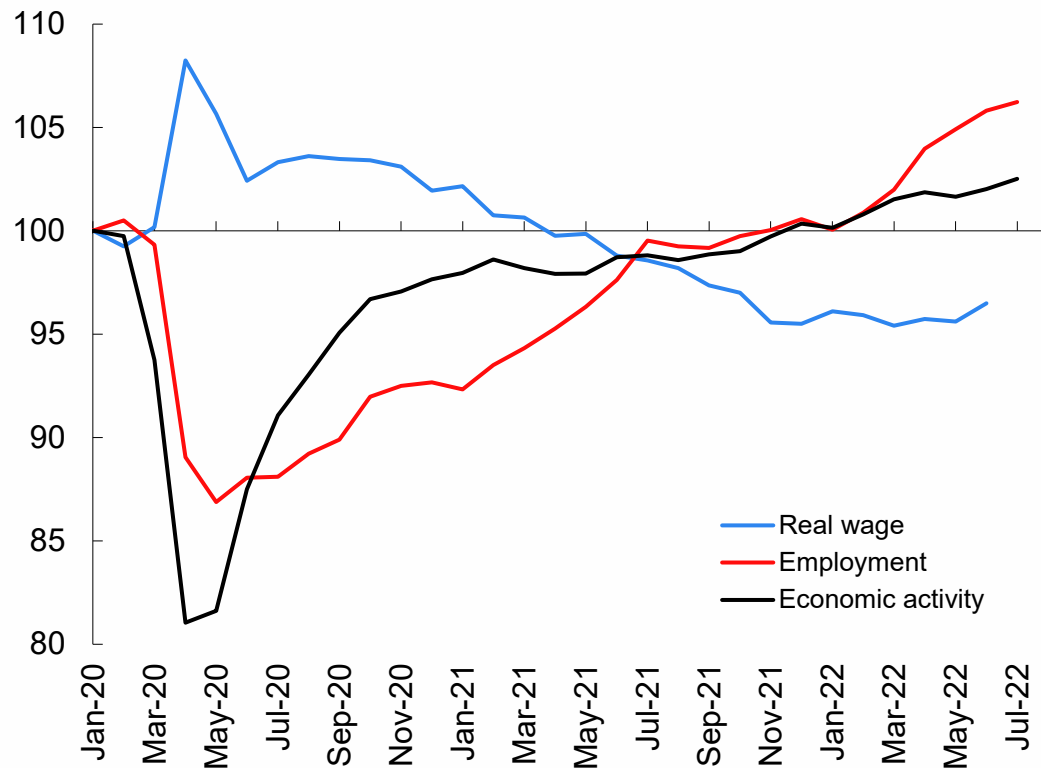
Sources: Caribbean Tourism Organization; Haver Analytics; national authorities; and IMF staff calculations.
Note: Remittances, deflated by US CPI, include COL, DOM, SLV, GTM, HND, JAM, MEX, and NIC). Shaded area is min-max range. Tourist arrivals to Caribbean countries is reported.

... and domestic factors

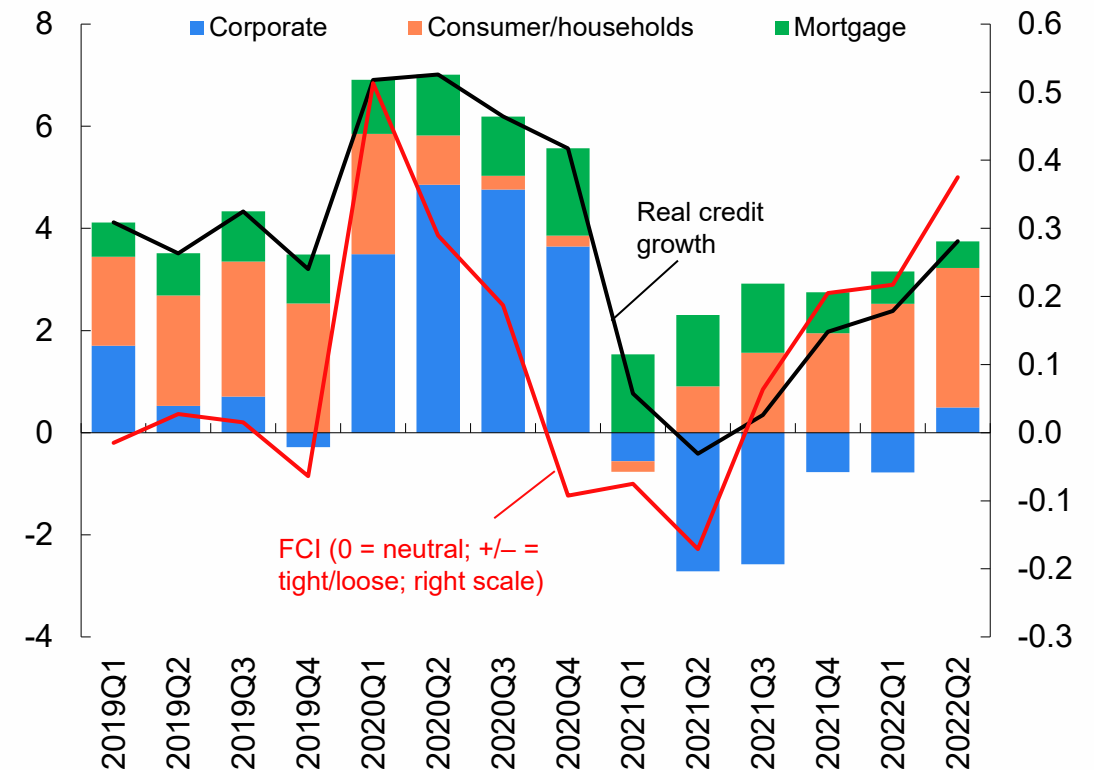
The rebound in activity in LA5 was supported by a strong recovery in employment, despite stagnant real wages, ...

... and the resumption of credit, especially to households

LA5: Real Wage, Employment, and Activity
(Index: January 2020 = 100)



LA5: Real Credit Growth and Financial Conditions Index
(Year-over-year percent change)



Sources: Haver Analytics; national authorities; and IMF staff calculations.
Note: Seasonally adjusted series. Real wage and employment are labor force-weighted averages. Economic activity is purchasing-power-parity GDP-weighted average. LA5 = Brazil, Chile, Colombia, Mexico, Peru.

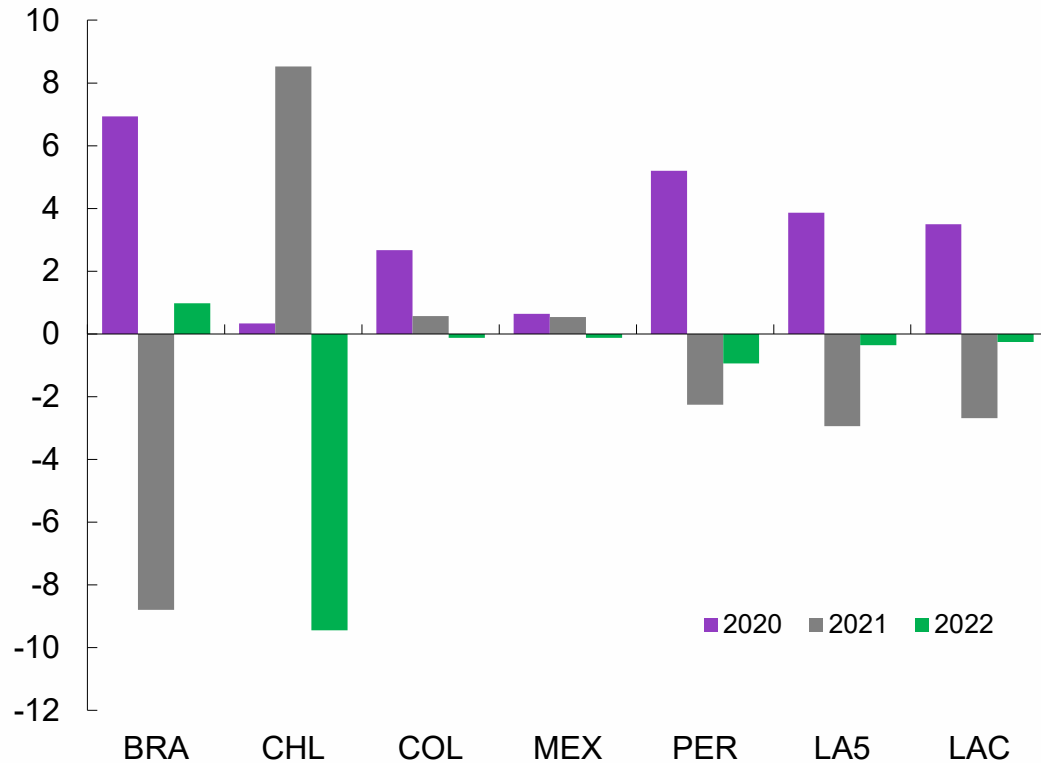
Sources: Haver Analytics; national authorities; and IMF staff calculations.
Note: Purchasing-power-parity GDP-weighted averages. For methodology of FCI (financial conditions index), see online annex of the October 2018 Global Financial Stability Report.

Fiscal policy remained mostly neutral...

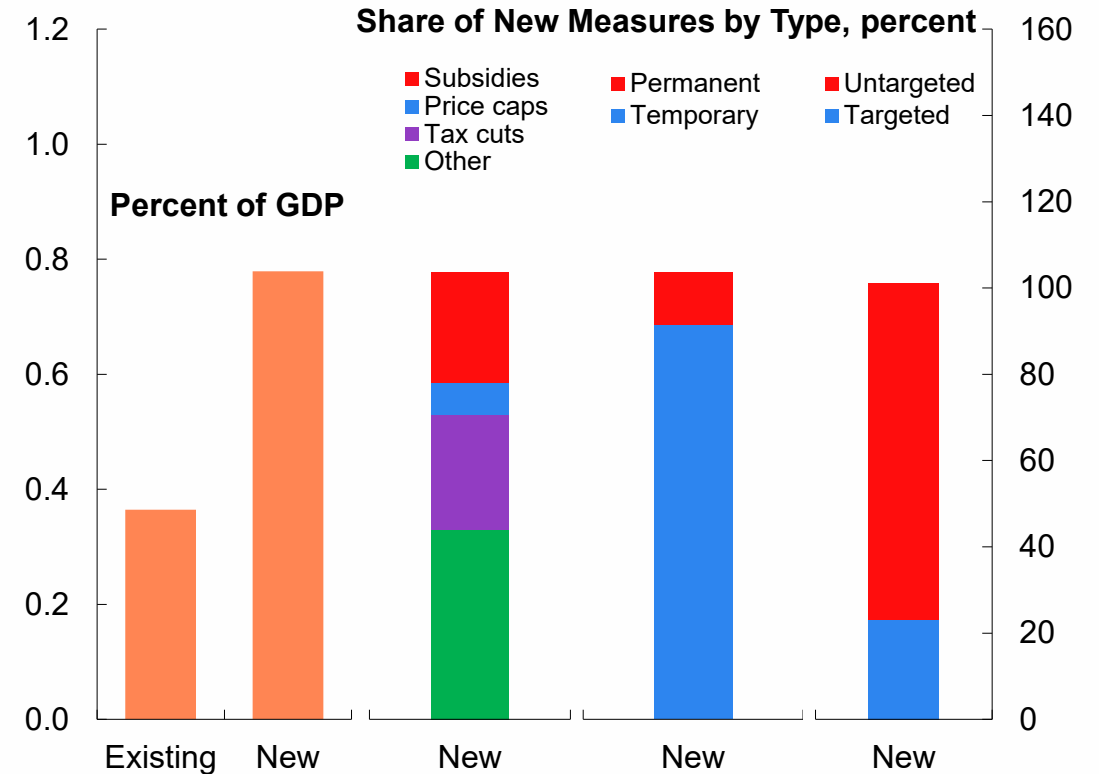
Fiscal policy remained broadly neutral in 2022...

... despite fiscal measures to mitigate the impact of high energy and food prices

General Government Fiscal Impulse
(Percentage points of GDP; +/- = loosening/tightening)



LAC: Existing Energy Subsidies in 2022 and New Announced Measures since January 2022



Sources: IMF, World Economic Outlook database; and IMF staff calculations.

Note: Change in fiscal year structural primary deficit is reported. Aggregates are US dollar nominal GDP-weighted averages. For Chile, values refer to the change in structural non-mining primary deficit. For Colombia, change in consolidated public sector structural non-oil primary deficit is reported. LA5 = Brazil, Chile, Colombia, Mexico, Peru.

Source: IMF staff calculations.

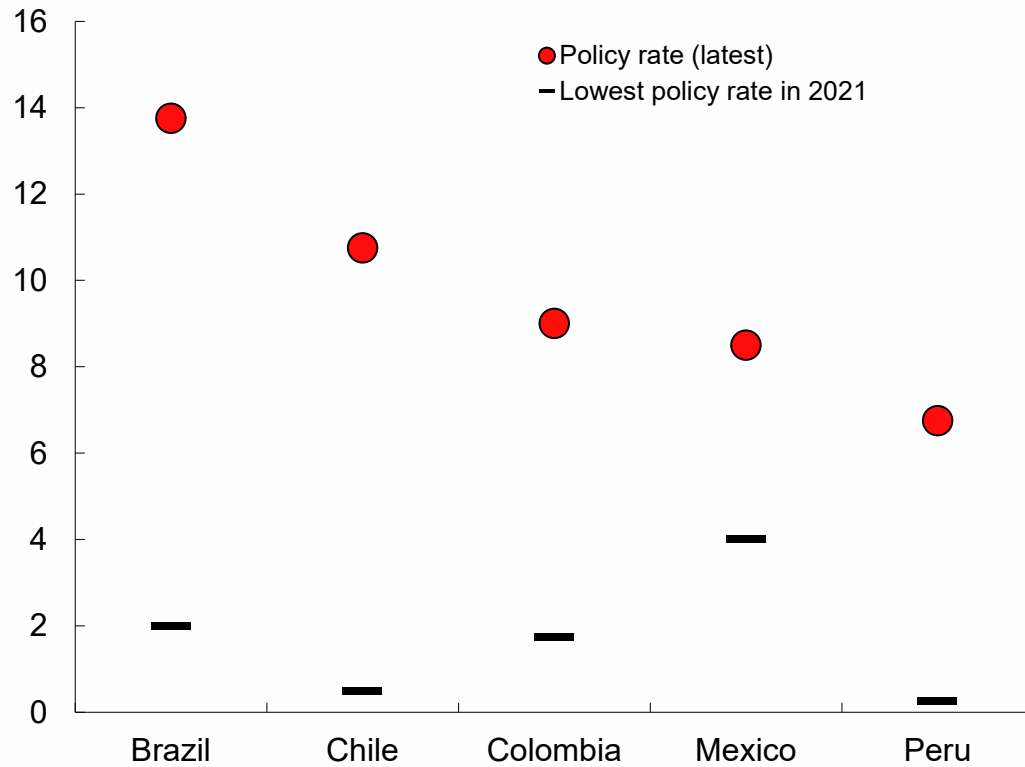
Note: Existing measures (2022) based on IMF staff calculations covering energy subsidies. New measures (2022) include measures to compensate for higher energy and food prices announced since January 2022 based on country desks surveys ran up to June 2022. Measures are considered targeted if announced as benefiting only some specific segments of the population, and permanent if there is no explicit end date. Tax cuts include exemptions.

... while monetary policy tightened...

Central banks in LA5 increased policy rates decisively...

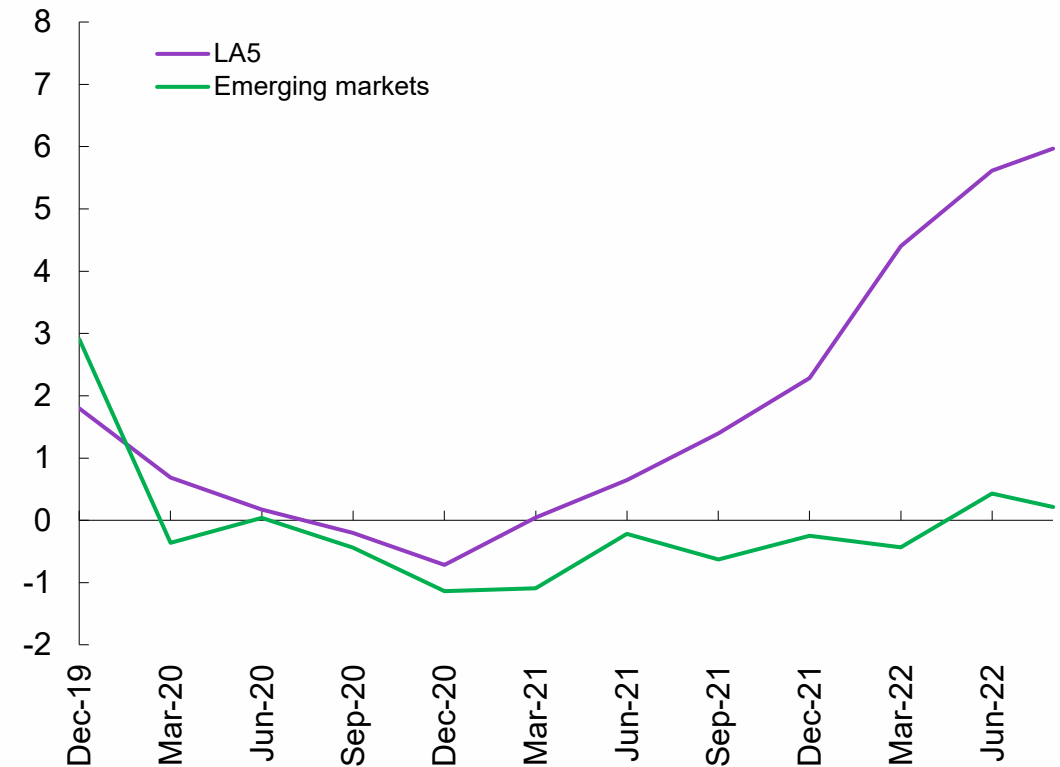
... ahead of other EMs and AEs

**Policy Rates
(Percent)**



Sources: Haver Analytics; national authorities; and IMF staff calculations.
Note: Latest data are as of September 26, 2022.

**Ex-Ante Real Monetary Policy Rates
(Percent)**

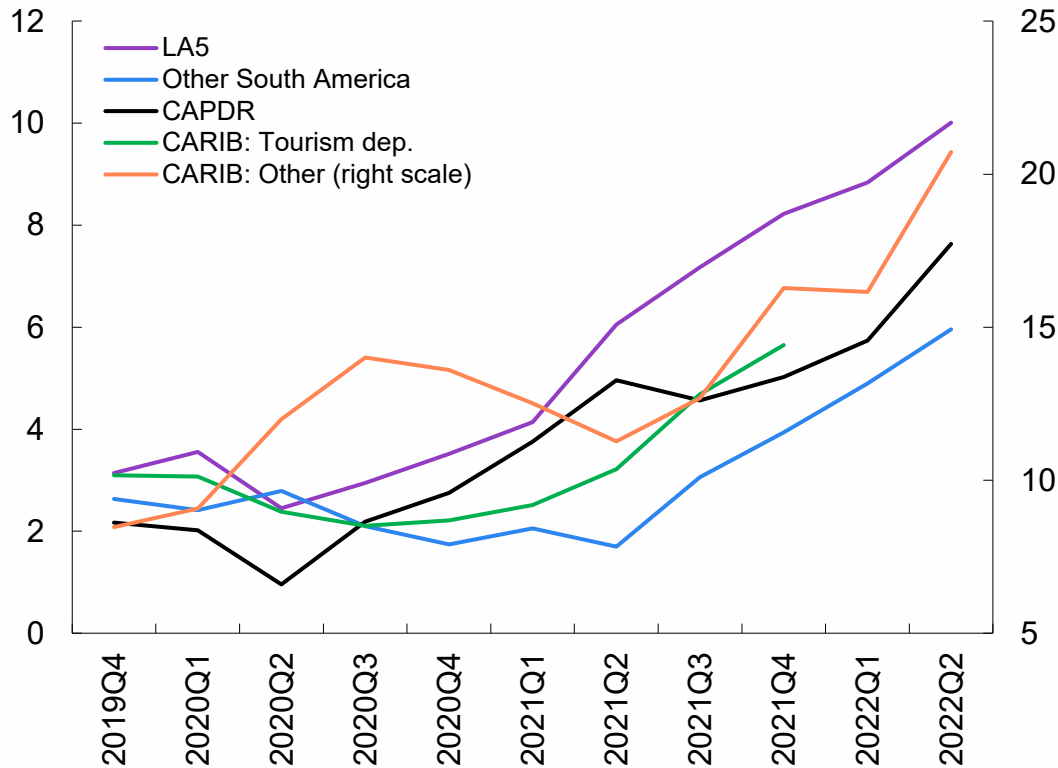


Sources: Consensus Economics; Haver Analytics; and IMF staff calculations.
Note: Ex ante real policy rate is the difference between nominal policy rate and one-year-ahead inflation expectations. Aggregates are purchasing-power-parity GDP-weighted averages.

... to contain inflationary pressures ...

Inflation rose across all LAC subregions...

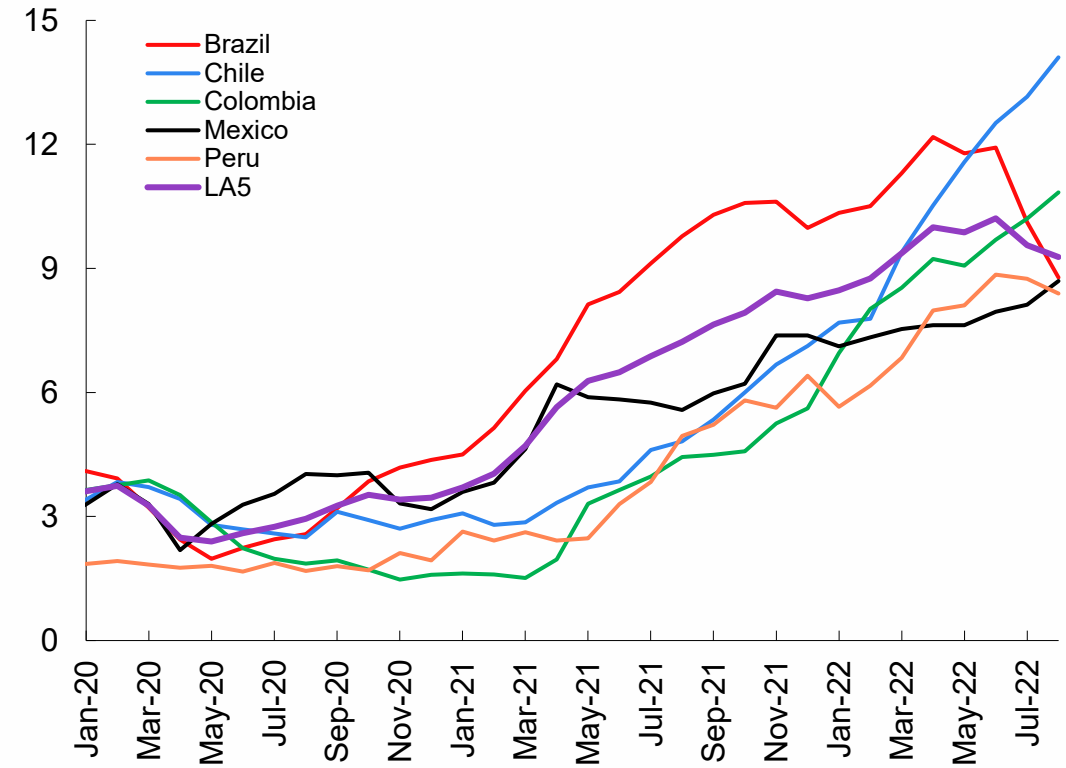
LAC: Headline Consumer Price Inflation
(Quarterly average; year-over-year percent change)



Sources: IMF, International Financial Statistics; IMF, World Economic Outlook database; and IMF staff calculations. Note: Aggregates are purchasing-power-parity GDP-weighted averages. Other South America excludes Argentina and Venezuela.

... and LA5 economies, with some signs of deceleration in Brazil and Peru more recently

LA5: Headline Consumer Price Inflation
(Year-over-year percent change)



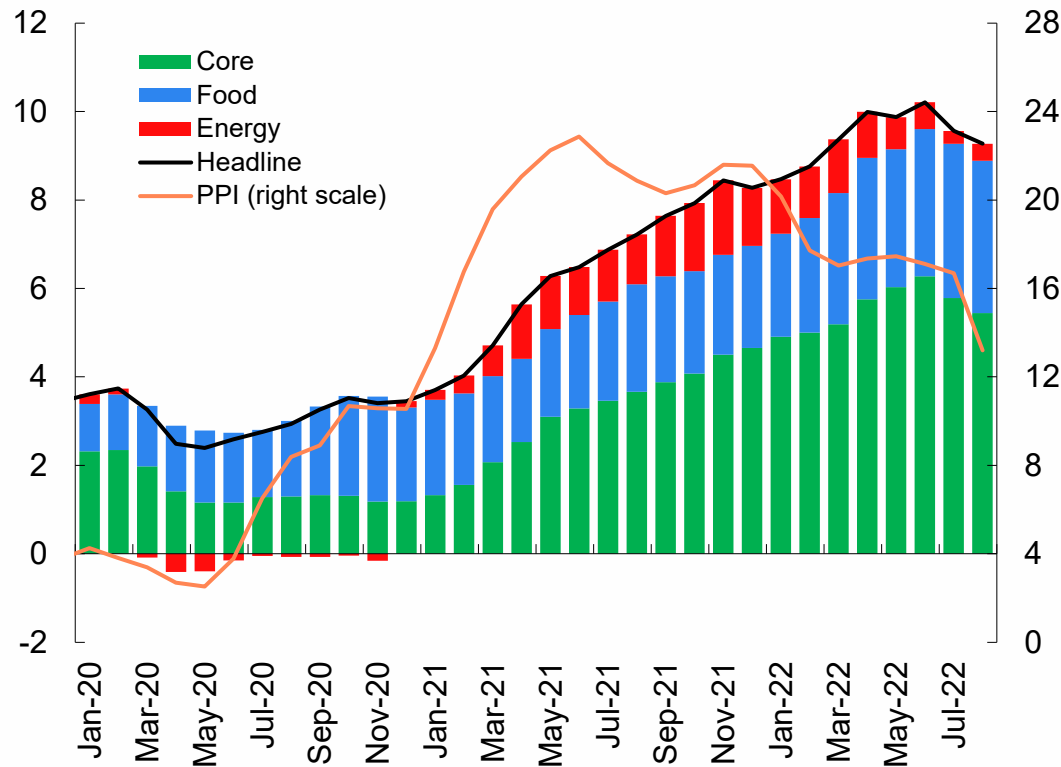
Sources: Haver Analytics; national authorities; and IMF staff calculations. Note: For Peru, Lima's CPI inflation is used.

... that became broad-based

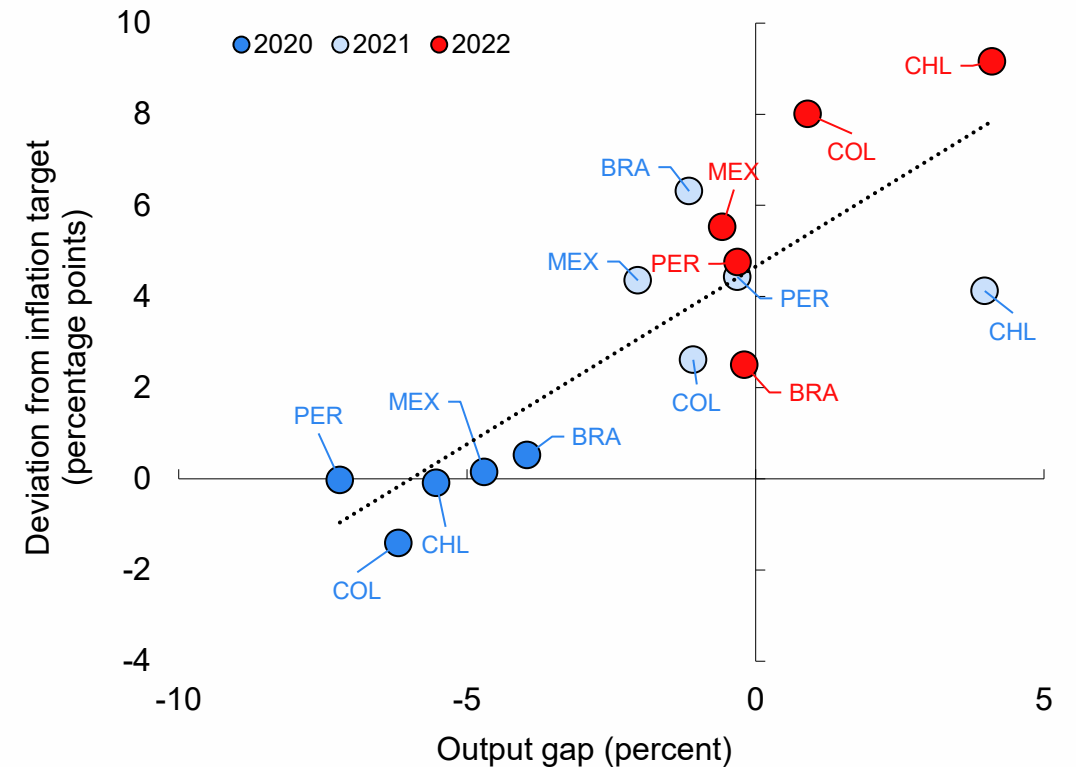
Inflation was initially driven by food and energy prices, but increasingly also by the core, ...

... reflecting, in part, closing output gaps

LA5: Contributions to Headline Inflation and Producer Price Inflation
(Year-over-year percent change)



LA5: Output Gap and Deviation of Inflation from the Target



Sources: Haver Analytics; national authorities; and IMF staff calculations.
Note: Purchasing-power-parity GDP-weighted average of LA5 countries (Brazil, Chile, Colombia, Mexico, Peru). Core inflation is defined as headline inflation less food and energy. For Peru, Lima is reported.

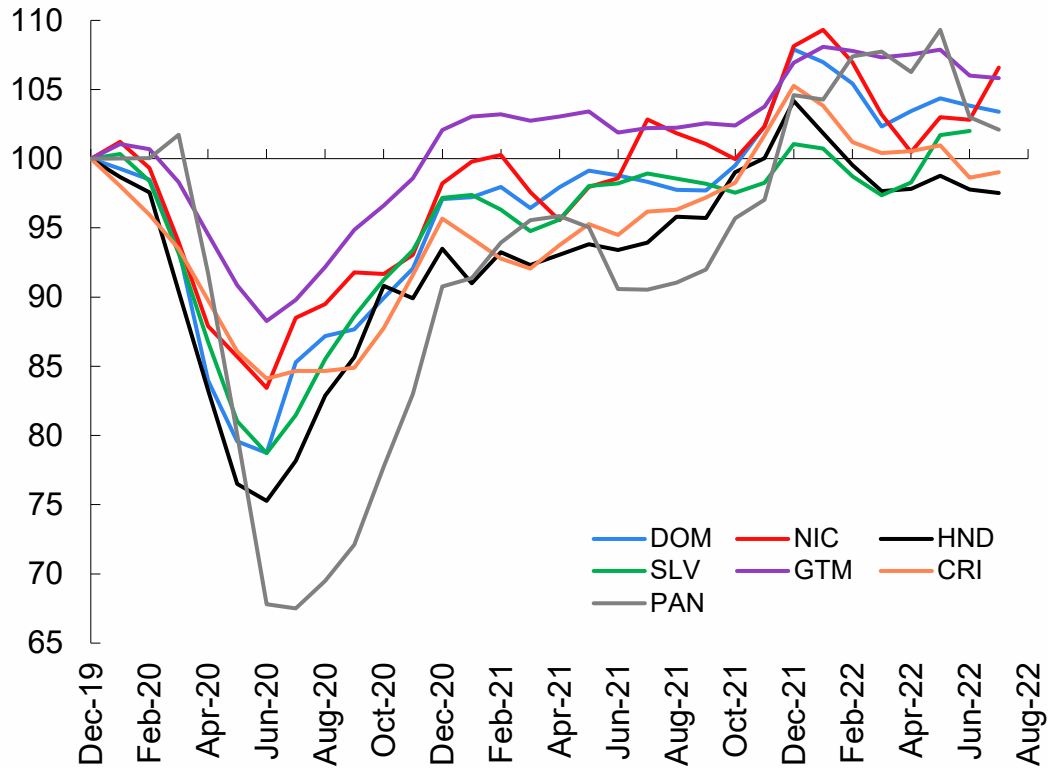
Sources: Haver Analytics; IMF, World Economic Outlook database; national authorities; and IMF staff calculations.
Note: Deviation from inflation target is the difference between end-of-period inflation and midpoint inflation target.

CAPDR: Strong growth in 2022H1 amid rising inflation

The rebound in 2021 and the slowdown in early 2022 have been largely synchronized across CAPDR economies ...

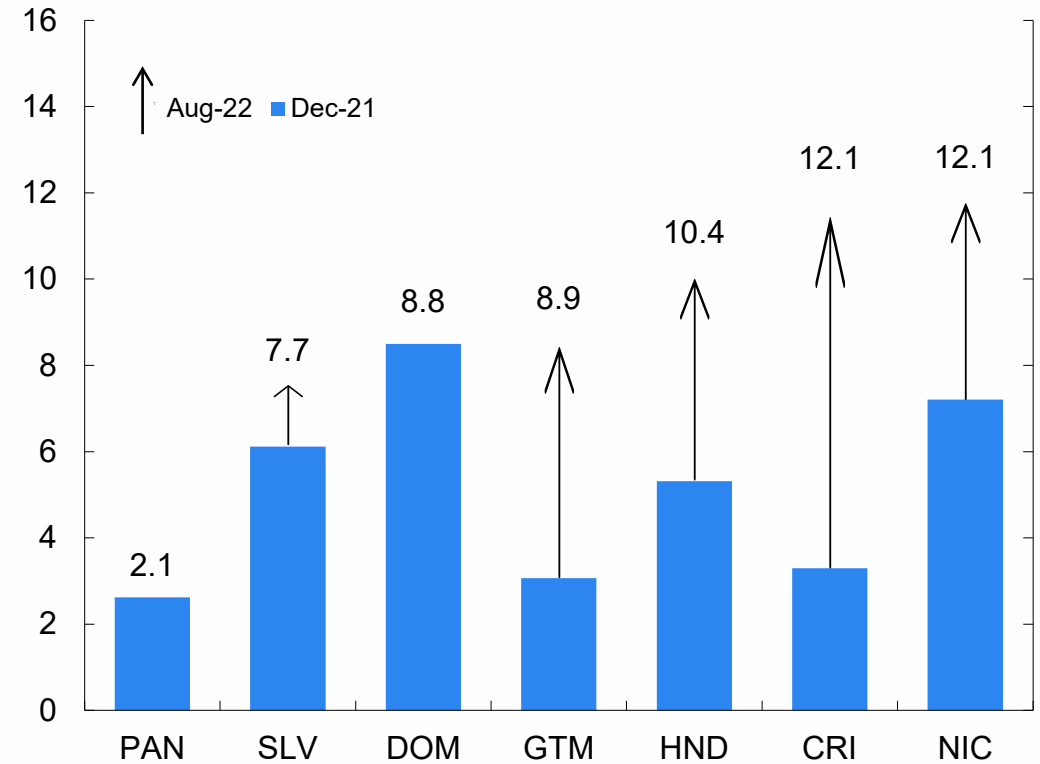
... and so have been inflationary pressures

Economic Activity Index
(Three-month moving average; index: December 2019 = 100)



Sources: Haver Analytics; national authorities; and IMF staff calculations.

CPI Inflation Rates
(Year-over-year percent change)

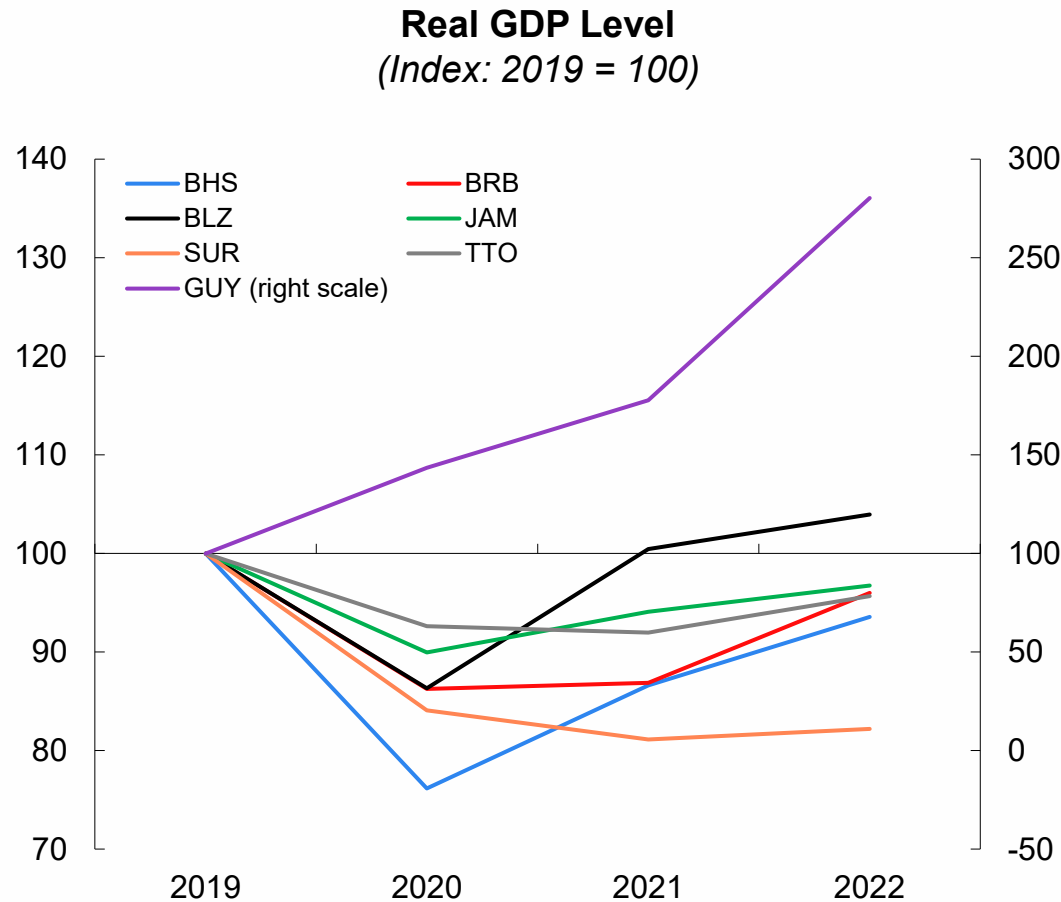


Sources: IMF staff calculations.

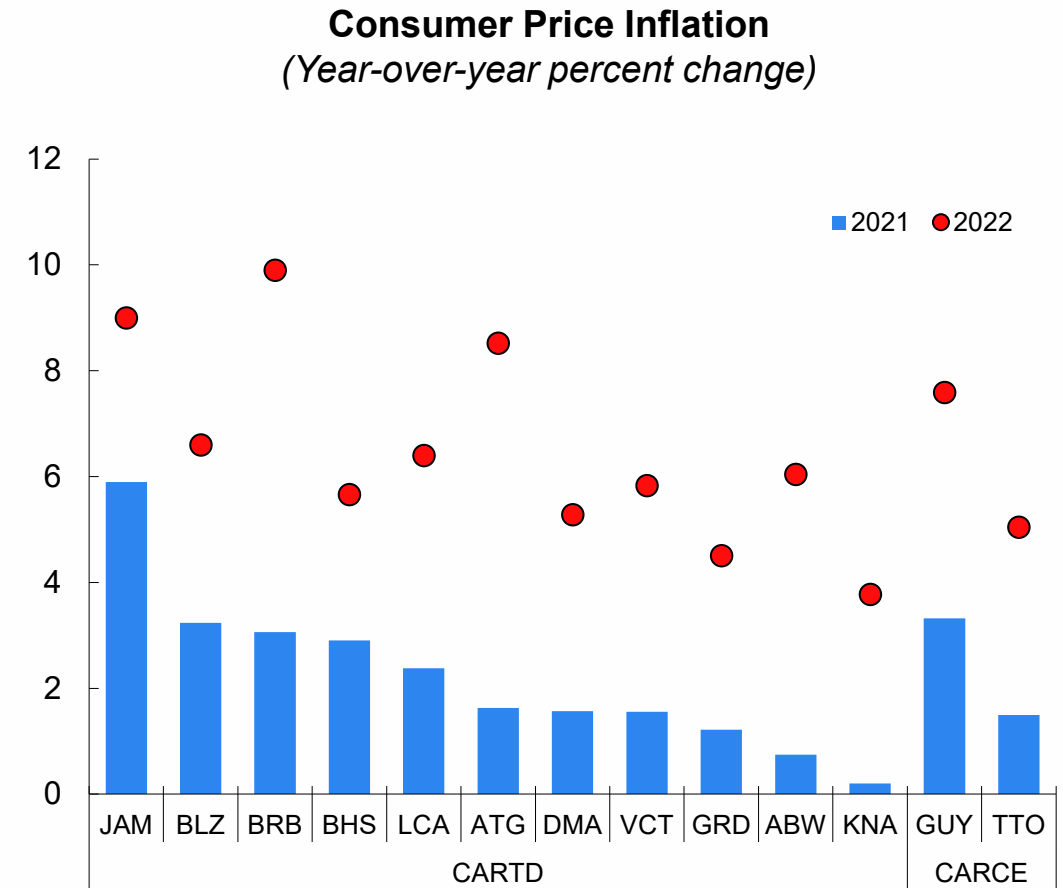
The Caribbean: Uneven recovery and rising inflation

Commodity exporters have grown rapidly, while tourism-dependent economies are yet to reach their pre-pandemic GDP levels...

... while inflationary pressures have affected all



Sources: IMF, World Economic Outlook database; and IMF staff calculations.



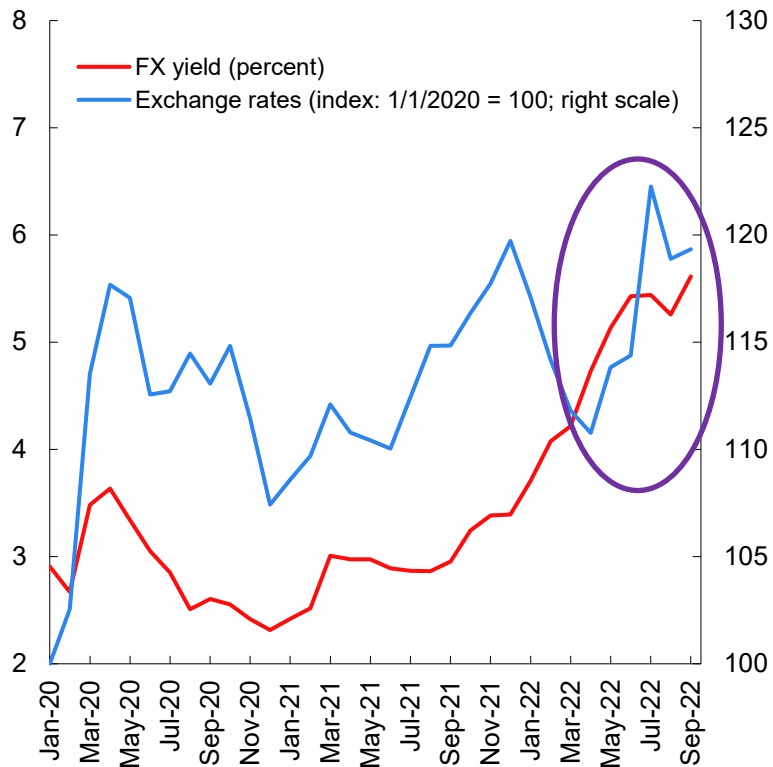
Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: CARCE = Caribbean; Commodity exporters; CARTD = Caribbean: Tourism dependent.

Outlook: Shifting Global Winds

Tightening global financial conditions (the 3rd Shock)...

External financing costs are rising, and domestic currencies are weakening ...

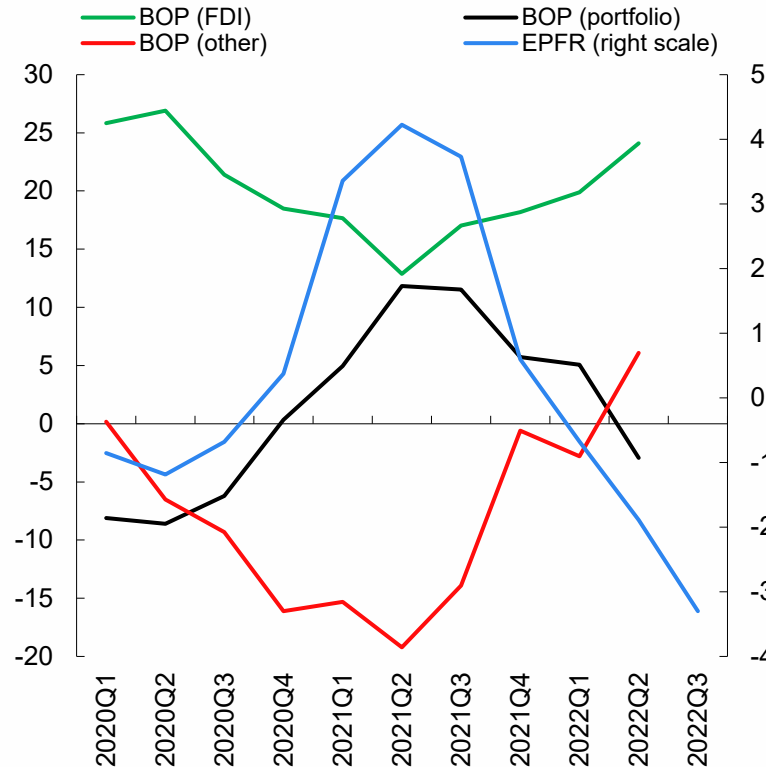
LA5: Ten-Year Bond Yields and Exchange Rates
(For exchange rates: increase = depreciation)



Sources: Bloomberg Finance L.P.; and IMF staff calculations.
Note: Simple averages are reported. For exchange rates, increase denotes depreciation of local currency. LA5 = Brazil, Chile, Colombia, Mexico, Peru.

... amid portfolio outflows...

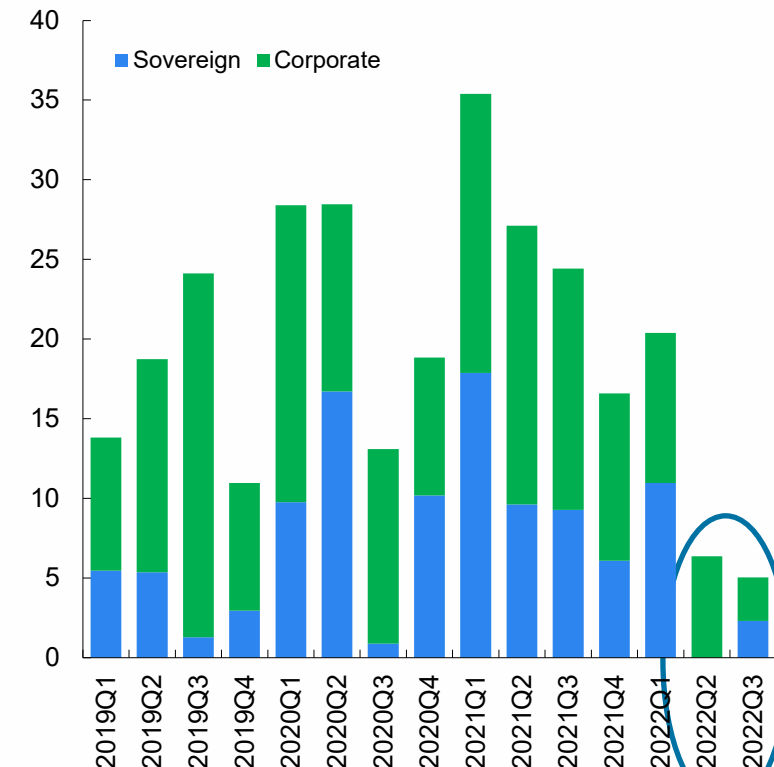
LA5: Balance of Payments and EPFR Net Flows
(Billions of US dollars; four-quarter moving average)



Sources: Emerging Portfolio Fund Research (EPFR) database; IMF, Balance of Payments (BOP) Statistics database; and IMF staff calculations.
Note: Balance of payments flows exclude special drawing rights allocations.

... and subdued activity in primary bonds markets

LA5: Sovereign and Corporate Eurobond Issuance
(Billions of US dollars)



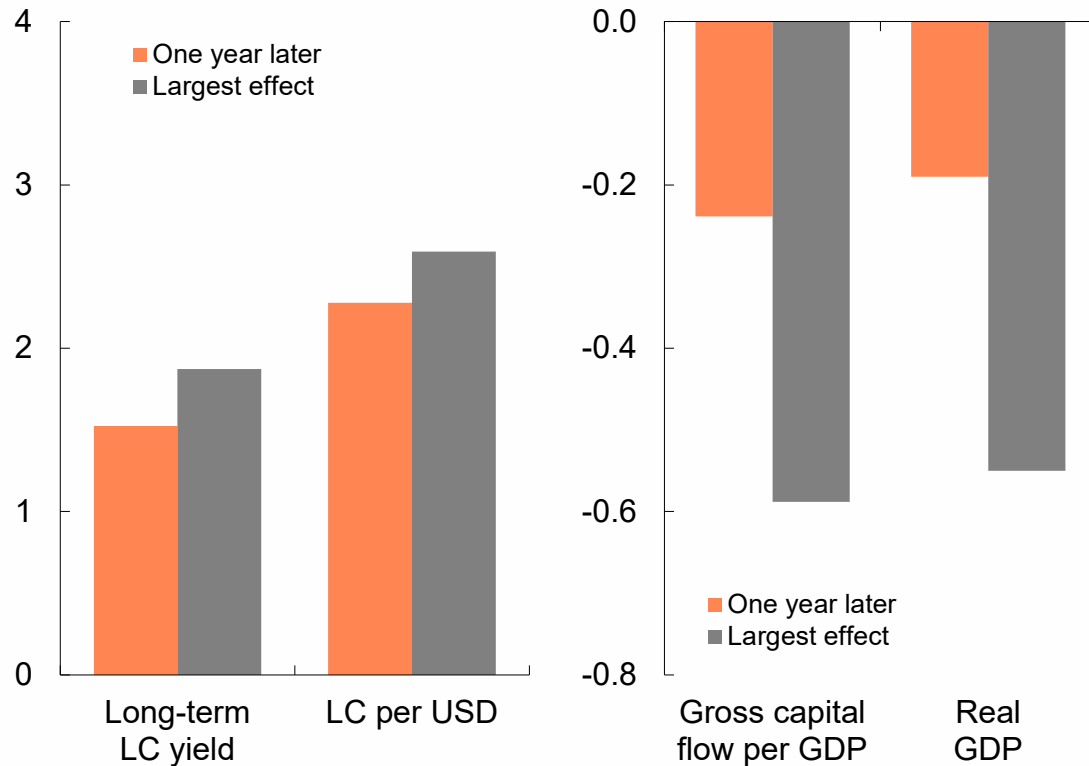
Sources: Bond Radar database; and IMF staff calculations.
Note: Data for 2022Q3 is until September 26, 2022. LA5 = Brazil, Chile, Colombia, Mexico, Peru.

... will constrain growth in LA5...

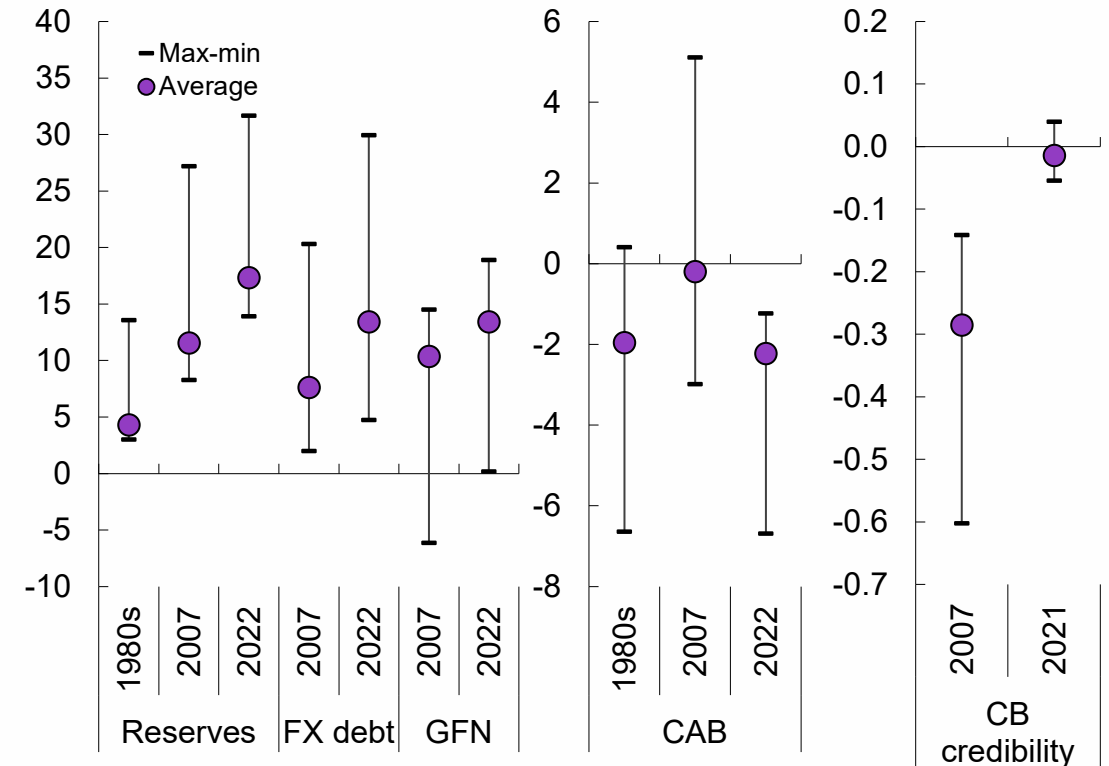
Global financial conditions tightening could considerably impact LA5 domestic financial markets and growth, ...

... especially in countries with weak current account balances, low reserves and public debt vulnerabilities

Impact of US Monetary Policy Shock (Percent unless otherwise indicated)



Macroeconomic Fundamentals that Amplify/Mitigate Financial Spillovers (Percent of GDP, unless otherwise stated)



Source: IMF staff calculations.

Note: Impulse response one year later and largest impact within the first three years, based on local projection estimation for LA5. Size of the shock is one percentage point increase in US 2-year bond yield. In case of long-term local-currency yields, impact computed within 6 months. Changes in gross capital flow to GDP ratio is measured in percent of GDP; LA5 = Brazil, Chile, Colombia, Mexico, and Peru.

Sources: IMF, World Economic Outlook database; and IMF staff calculations.

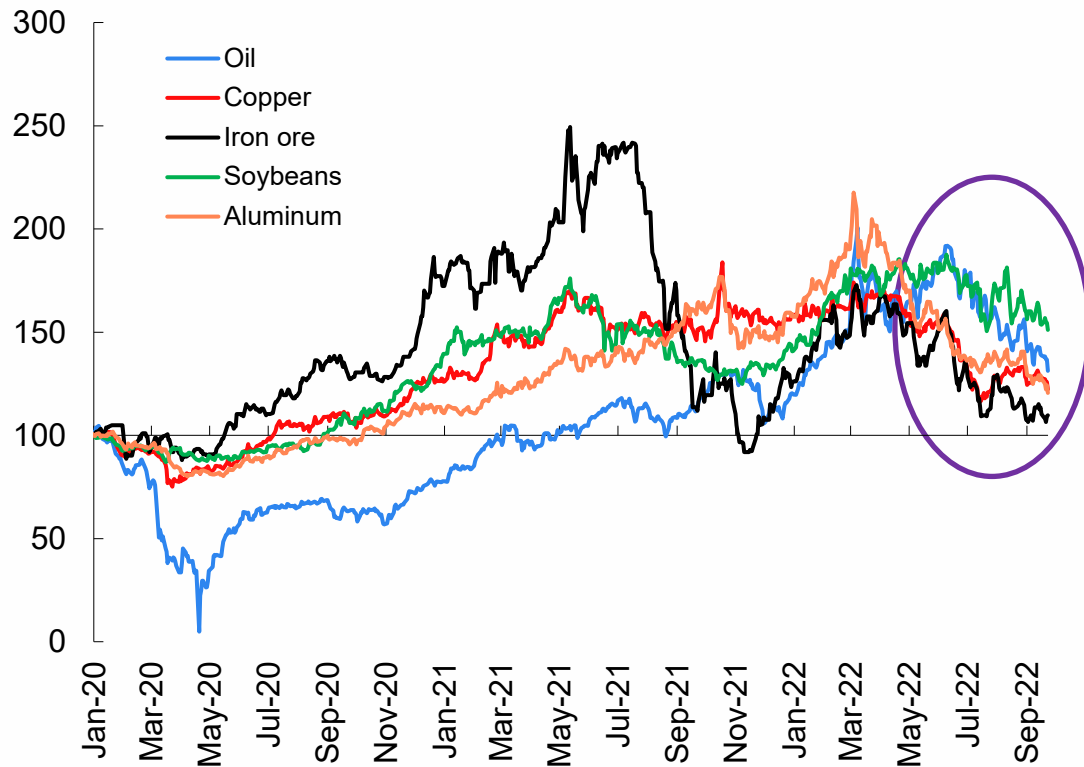
Note: Average is purchasing-power-parity GDP-weighted. Central bank credibility is measured as inverse of sensitivity of LT inflation forecasts to inflation surprises. CAB = current account balance. GFN = public sector gross financing needs.; LA5 = Brazil, Chile, Colombia, Mexico, Peru.

... as commodity prices and global growth weaken

Commodity prices that are relevant for the region have fallen and are expected to soften further...

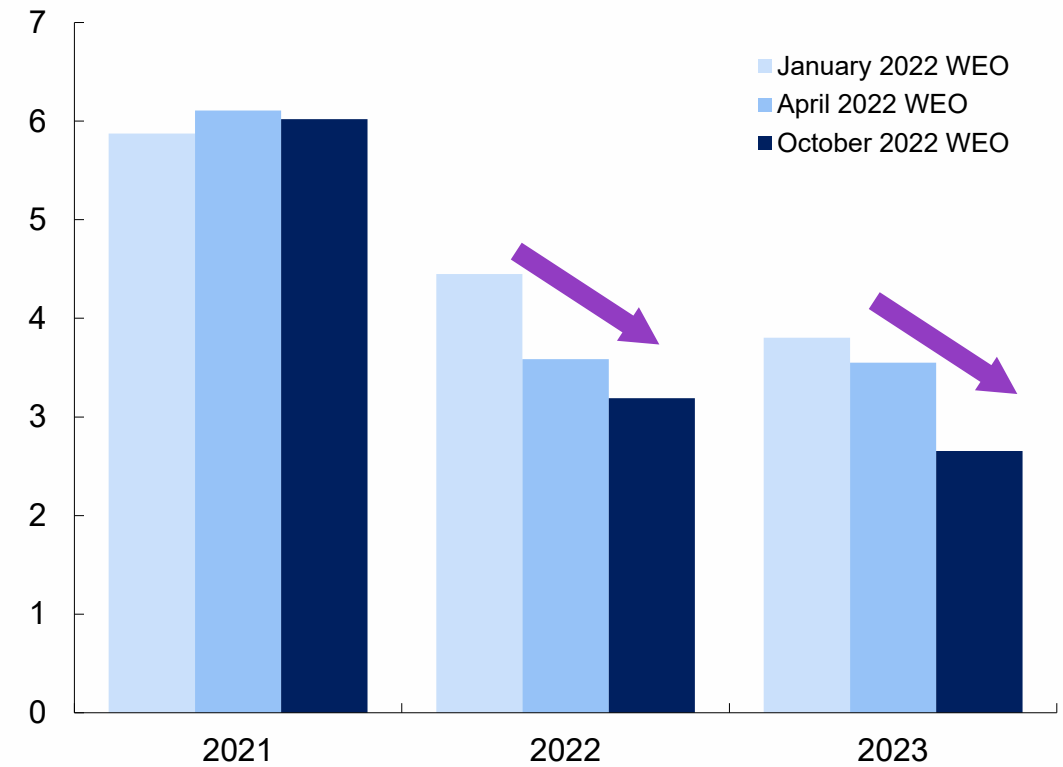
... amid slower global growth

Commodity Prices
(Index: January 1, 2020 = 100)



Sources: Bloomberg Finance L.P.; and national authorities.

Global Real GDP Growth
(Year-over-year percent change)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.

Throughout the region—slower growth and high inflation

Western Hemisphere: Real GDP Growth and Inflation
(Year-over-year percent change)

	Real GDP Growth				Inflation, end of period			
	2020	2021	Projections		2020	2021	Projections	
			2022	2023			2022	2023
United States	-3.4	5.7	1.6	1.0	1.5	7.4	6.4	2.3
Canada	-5.2	4.5	3.3	1.5	0.7	4.7	6.9	3.2
Latin America and the Caribbean (LAC)	-7.0	6.9	3.5	1.7	6.3	11.6	14.6	9.5
LAC excluding Venezuela	-6.6	7.0	3.4	1.7
South America	-6.6	7.3	3.6	1.6	8.0	14.1	18.0	12.1
CAPDR	-7.1	11.0	4.7	3.6	2.8	5.1	7.8	4.4
Caribbean								
Tourism Dependent	-14.7	7.8	5.2	3.6	2.5	5.4	8.3	4.3
Other	1.3	3.4	16.7	9.3	14.4	11.7	16.8	9.0
<i>Of which: Commodity Exporters</i>	4.0	6.1	24.6	12.8	8.6	11.0	10.8	6.8
Memorandum items:								
LA5	-6.2	6.3	3.0	1.2	3.5	8.3	7.8	4.9
Brazil	-3.9	4.6	2.8	1.0	4.5	10.1	6.0	4.7
Mexico	-8.1	4.8	2.1	1.2	3.2	7.4	8.5	4.8

Sources: IMF, World Economic Outlook database; and IMF staff calculations.

Note: PPP GDP-weighted average. Green/red denotes upward/downward revision compared with the April 2022 World Economic Outlook forecasts. WEO data as of September 26, 2022. CAPR includes Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, and Panama. Caribbean Commodity Exporters include Guyana, Suriname, and Trinidad and Tobago. Caribbean Tourism Dependent encompasses the rest of the Caribbean countries not included in the Commodity Exporters group, except for Haiti, which is included in Other Caribbean group. LA5 includes Brazil, Chile, Colombia, Mexico, and Peru.

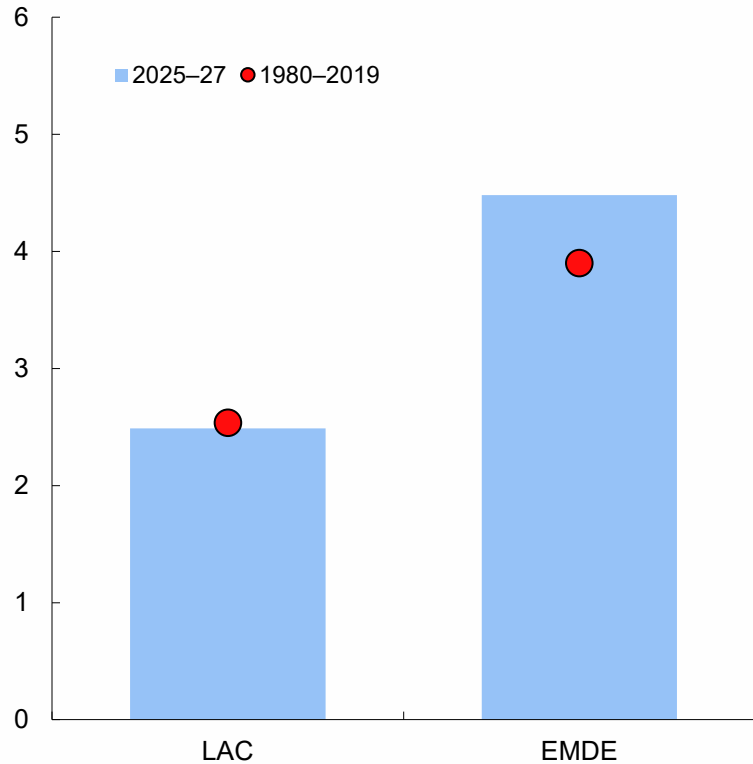
The pandemic will leave medium term scars

LAC's growth is expected to return to its (low) pre-pandemic rates ...

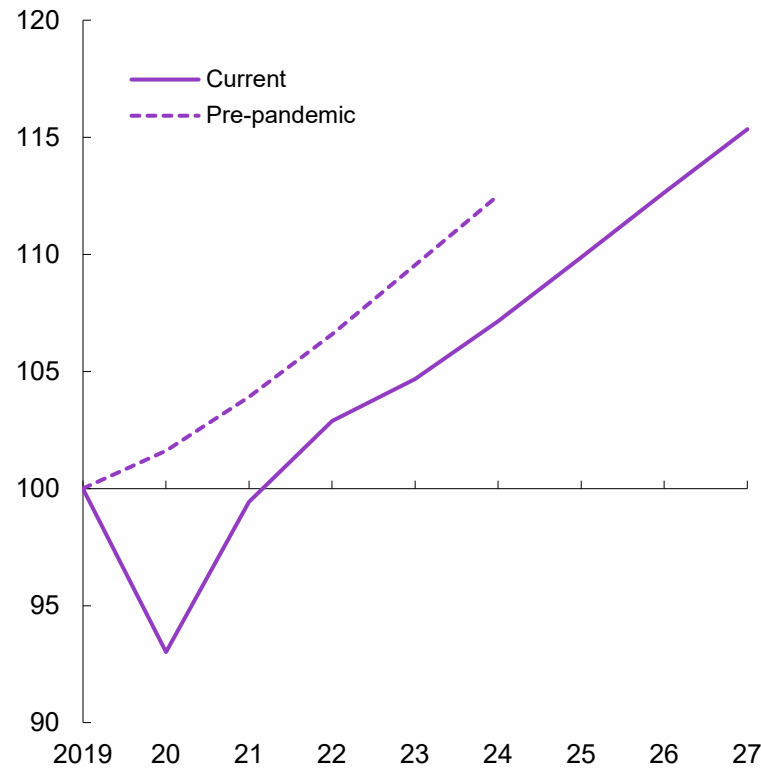
... while output levels remain below pre-pandemic trend ...

... mostly on the account of losses in productivity

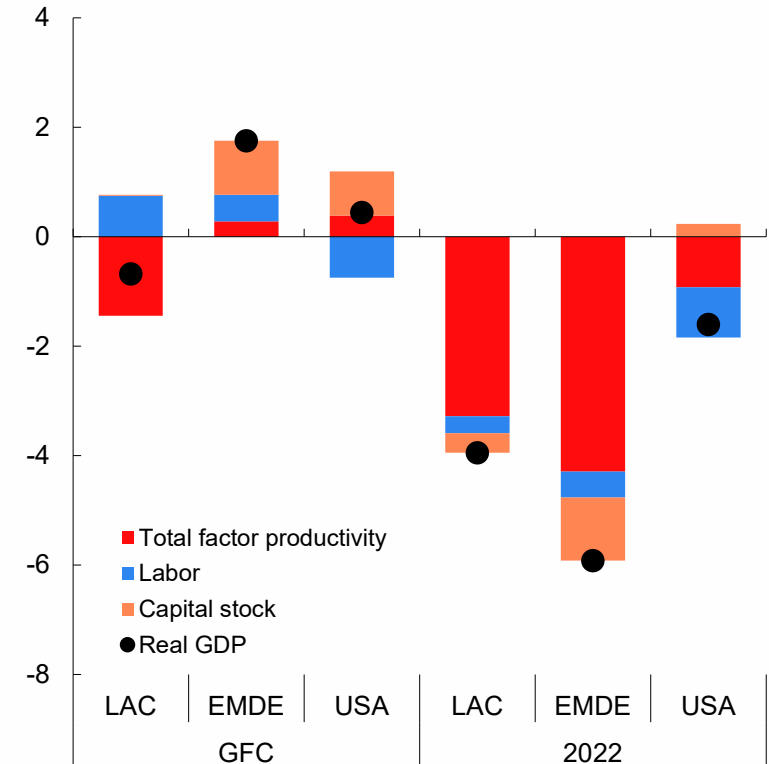
Real GDP Growth
(Year-over-year percent change)



LAC: Real GDP Level
(Index: 2019 = 100)



Decomposition of Output Losses
(Percent of previous projections)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: Purchasing-power-parity GDP-weighted average. EMDE = emerging market and developing economies exc. LAC and China; LAC = Latin America and the Caribbean.

Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: Current refers to the October 2022 WEO; pre-pandemic refers to the January 2020 WEO vintage.

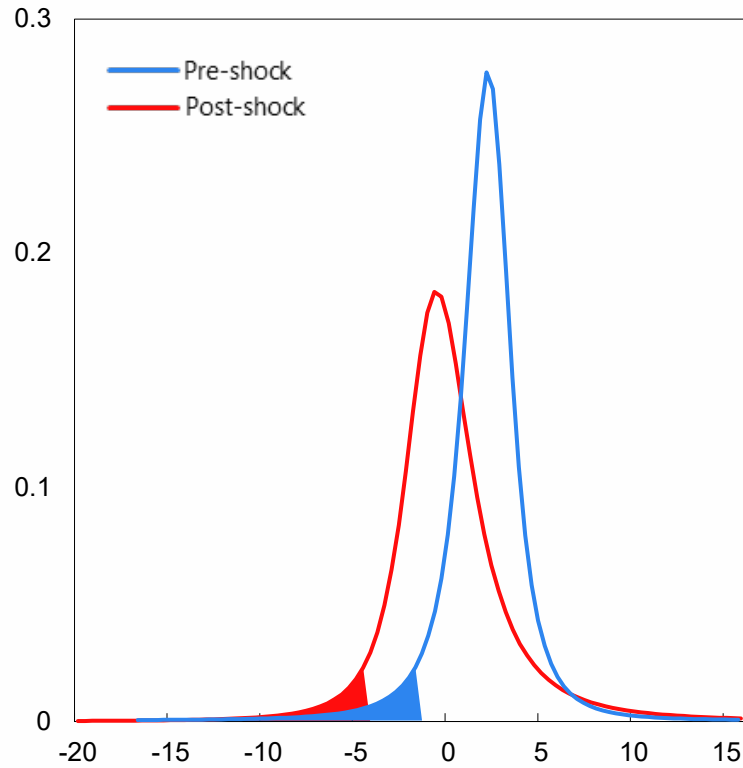
Sources: IMF, World Economic Outlook database; Penn World Tables 10.0; and IMF staff calculations.
Note: For GFC (global financial crisis), comparison of Oct 2009 and Oct 2010 WEO projections for 2010. For 2022, comparison of Jan 2020 and Oct 2022 WEO projections. EMDE excludes LAC and China.

Risks

Risk of tighter global financial conditions

A broader tightening of financial conditions could materially increase the likelihood of severe outcomes...

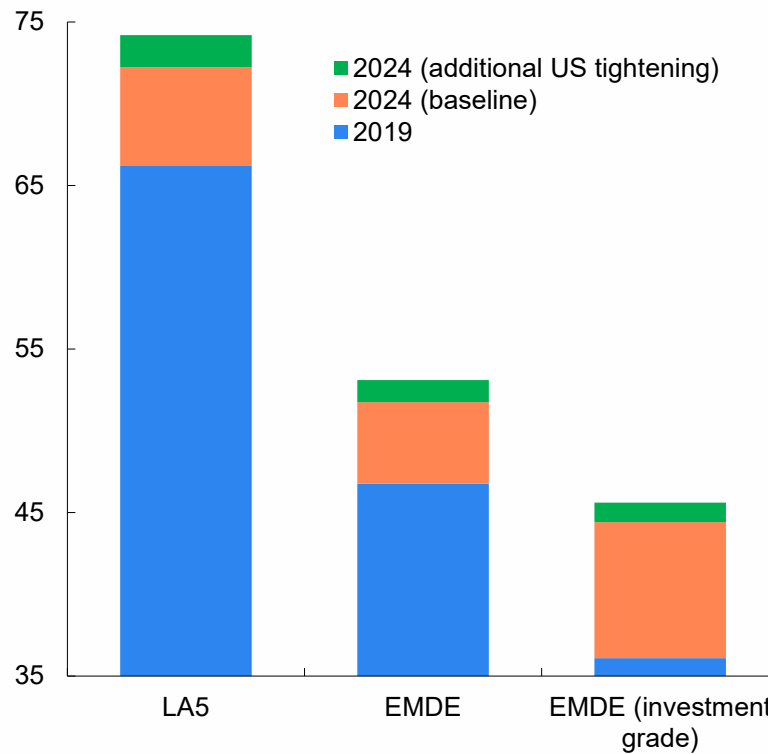
Growth Impact of Tighter US Financial Conditions
(Probability density)



Source: IMF staff calculations.
Note: Distribution of aggregate LA5 growth, based on quantile regression. Shock is one standard deviation tightening in US financial conditions index. The blue line shows the distribution of 3-quarter ahead GDP growth based on historical data. The red line shows the estimated cumulative percent change in GDP from the quarter prior to the shock, up to two quarters after the shock at different deciles of GDP growth's distribution. Shaded areas show tail outcomes with 5 percent probability.

... worsen an already-fragile public debt dynamics in LA5...

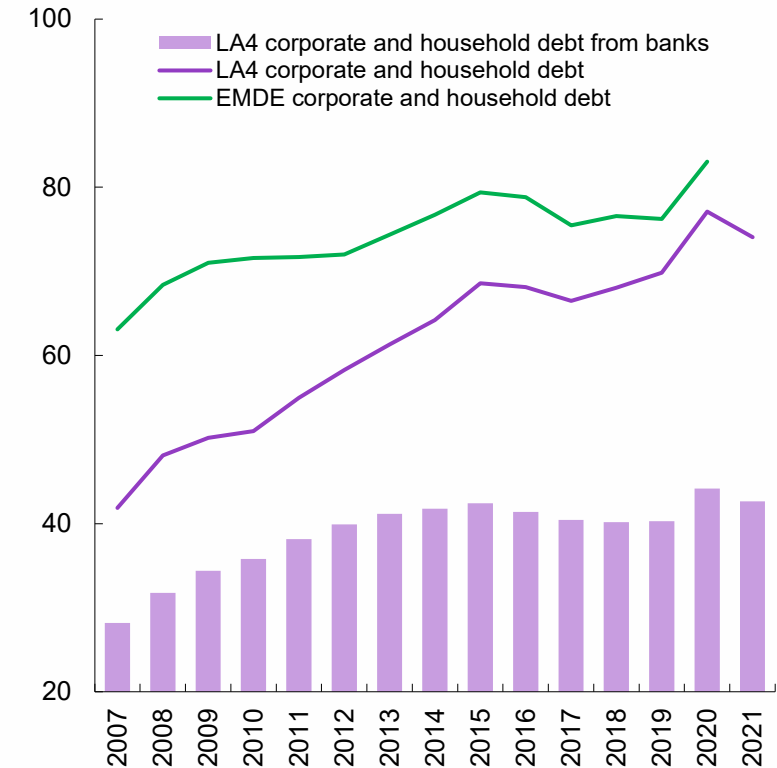
Gross Public Debt
(Percent of GDP)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: In additional US tightening scenario, interest rate for new debt increases by the by the additional Fed tightening of 0.6 and 1.4 percentage points in 2023 and 2024, respectively, plus 50 basis points risk premium in 2023–24. The exercise abstracts from growth and exchange rate effects, which are likely to worsen debt dynamics. LA5 = Brazil, Chile, Colombia, Mexico, Peru; EMDE = emerging and developing economies excluding China.

... and potentially stress some private debt markets

Private Sector Debt
(Percent of GDP)



Sources: Bank for International Settlements database; IMF, Global Debt Database; IMF, World Economic Outlook database; and IMF staff calculations.
Note: Aggregates are US dollar nominal GDP-weighted averages. Corporate and household debt includes debt to banks, non-banks, and market debt issuances. EMDE = emerging market and developing economies (excluding China and LAC); LA4 = Brazil, Chile, Colombia, Mexico.

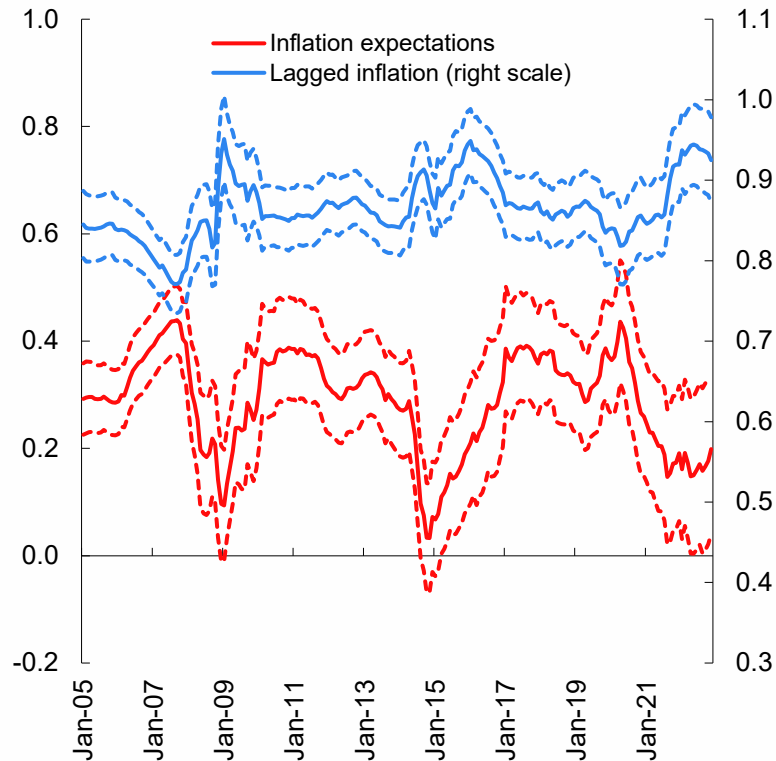
Risk of high inflation becoming entrenched

Inflation dynamics have become more backwards-looking, raising the risk of entrenchment,...

... nominal wages are accelerating,...

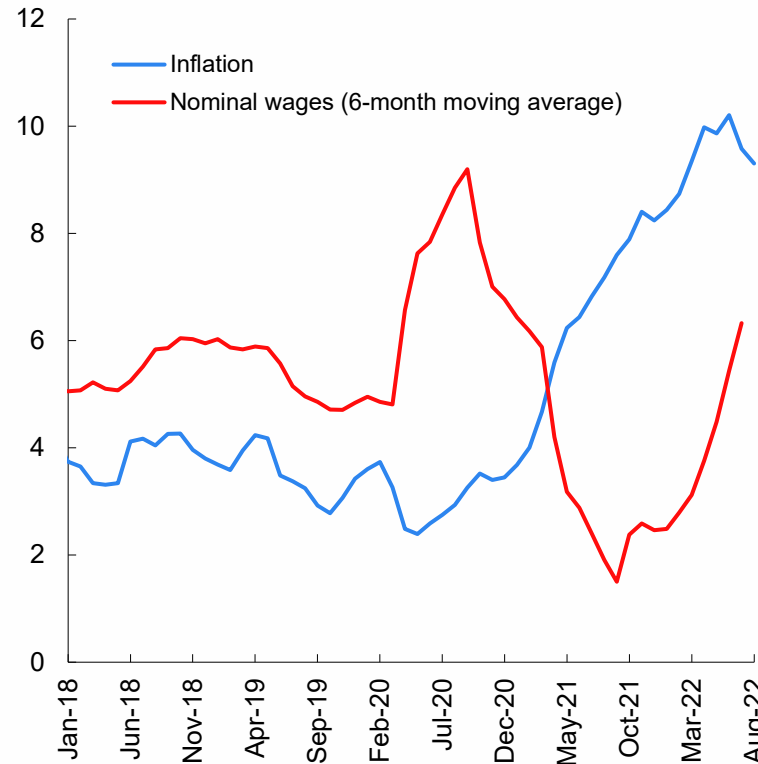
... and the magnitude of the current inflationary shock points to a protracted path back to the target

LA5: Inflation Coefficients from Rolling Phillips Curve Estimates
(Index; dashed lines are confidence intervals)



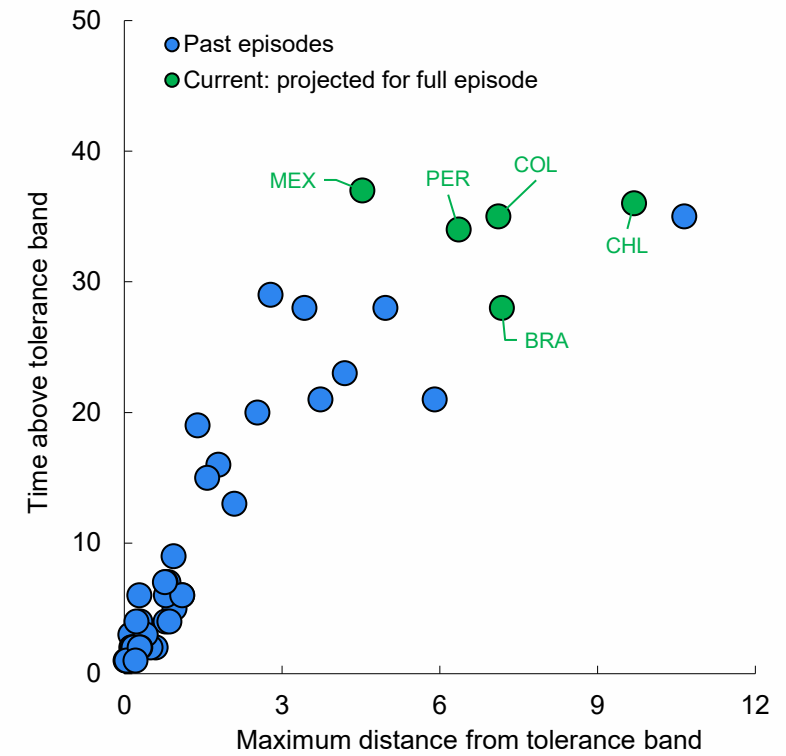
Sources: IMF staff calculations.
Note: LA5 = Brazil, Chile, Colombia, Mexico, Peru.

LA5: Inflation and Nominal Wages Growth
(Year-over-year percent change)



Sources: Haver Analytics; IMF, World Economic Outlook database; national authorities; and IMF staff calculations.
Note: LA5 is purchasing-power-parity GDP-weighted average of Brazil, Chile, Colombia, Mexico, and Peru.

LA5: Inflationary Episodes
(x-axis: percentage points; y-axis: months)



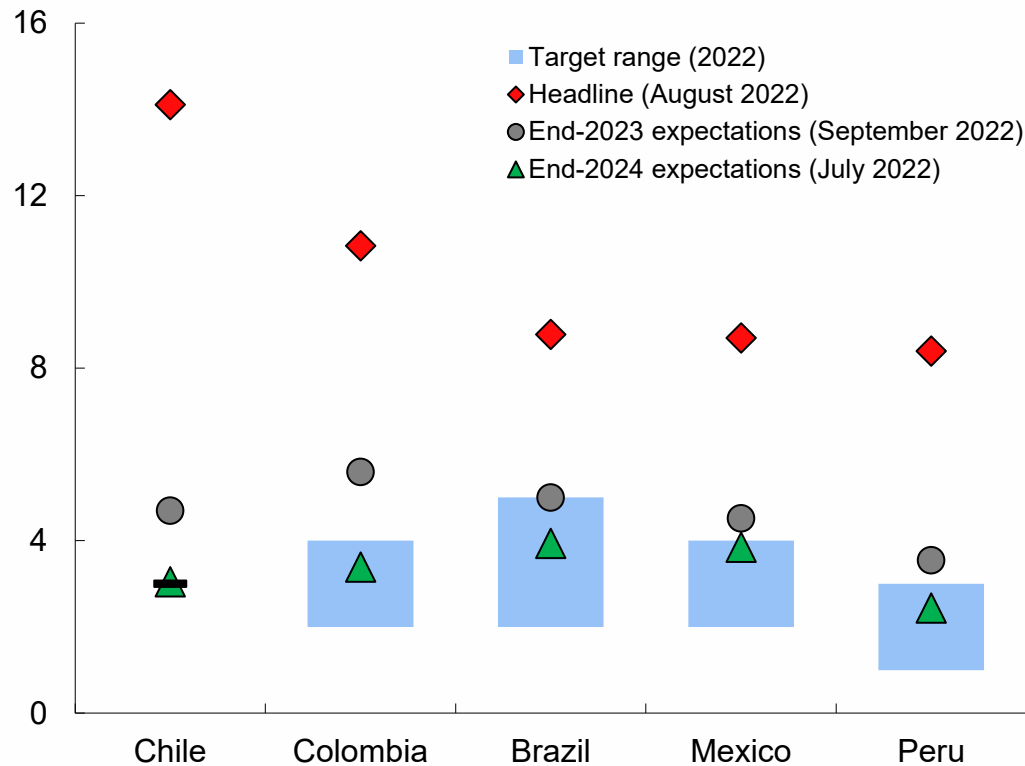
Sources: Haver Analytics; IMF, WEO database; national authorities; and IMF staff calculations.
Note: Episodes identified as periods (in months) with y-o-y inflation above the central banks' tolerance bands—1pp. above target for Chile. Blue dots: completed past episodes since 2000. Green dots: expected for current episode based on October 2022 WEO projections.

Risk of high inflation becoming entrenched (cont.)

Survey-based measures point to well-anchored LT inflation expectations...

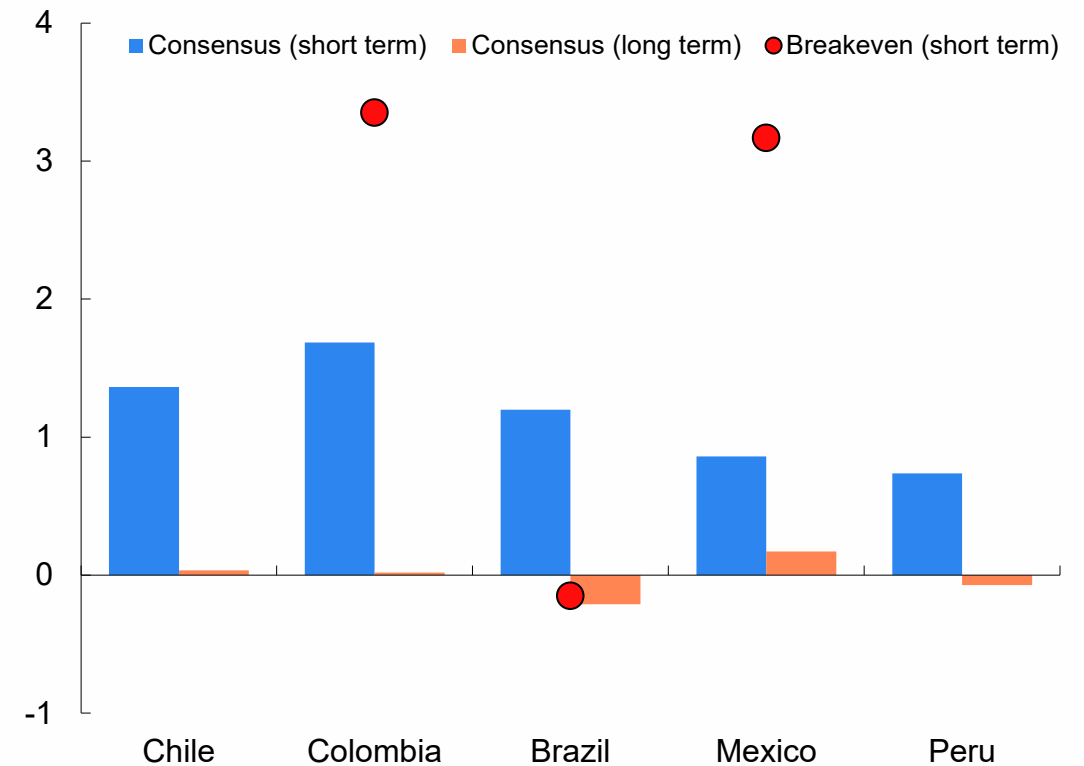
... but ST expectations have risen

Headline and Inflation Expectations (Percent)



Sources: Consensus Economics; Haver Analytics; and national authorities.
Note: Brazil inflation target is set to decline over time from 3.5 percent in 2022 to 3 percent in 2025. Chile does not have tolerance bands; midpoint target is shown.

Revisions in Inflation Expectations, 2022 (Percentage points)



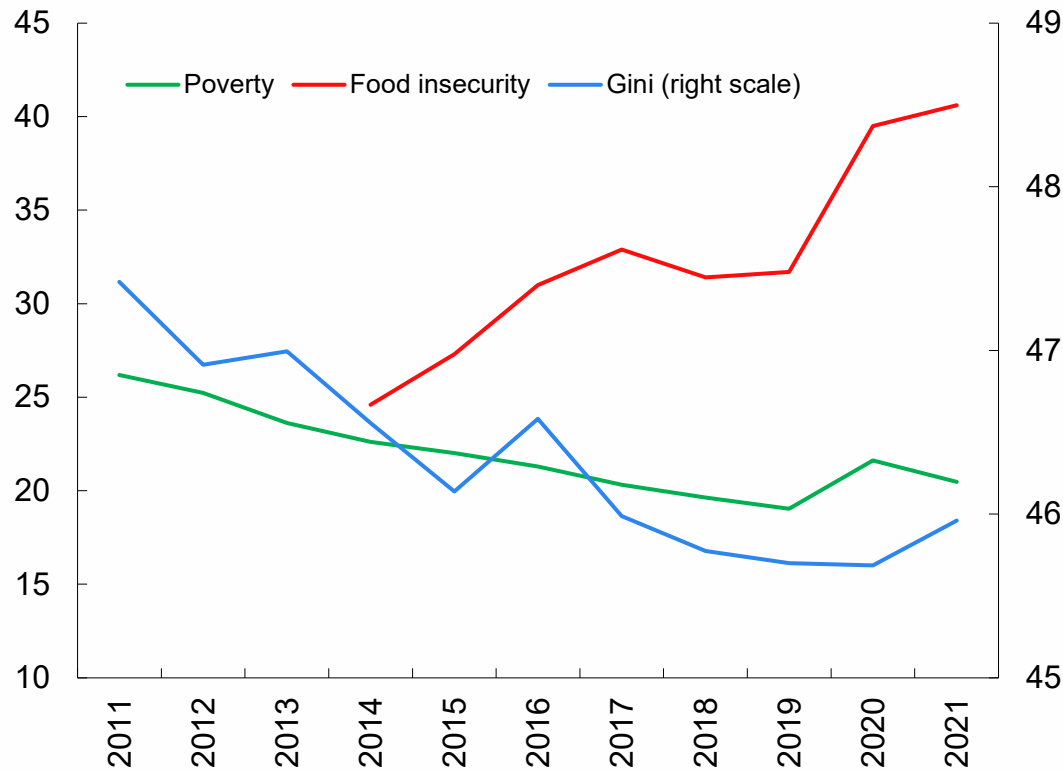
Sources: Bloomberg Finance L.P.; Consensus Economics; Haver Analytics; national authorities; and IMF staff calculations.
Note: Change between latest and January 2022. Breakeven inflation is computed using the difference in yields between regular bonds and inflation-indexed bonds of the same maturity. Short term: Consensus forecasts: one-year ahead; Breakeven: one-year. Long term: Consensus forecasts: five-year ahead.

Risk of social unrest

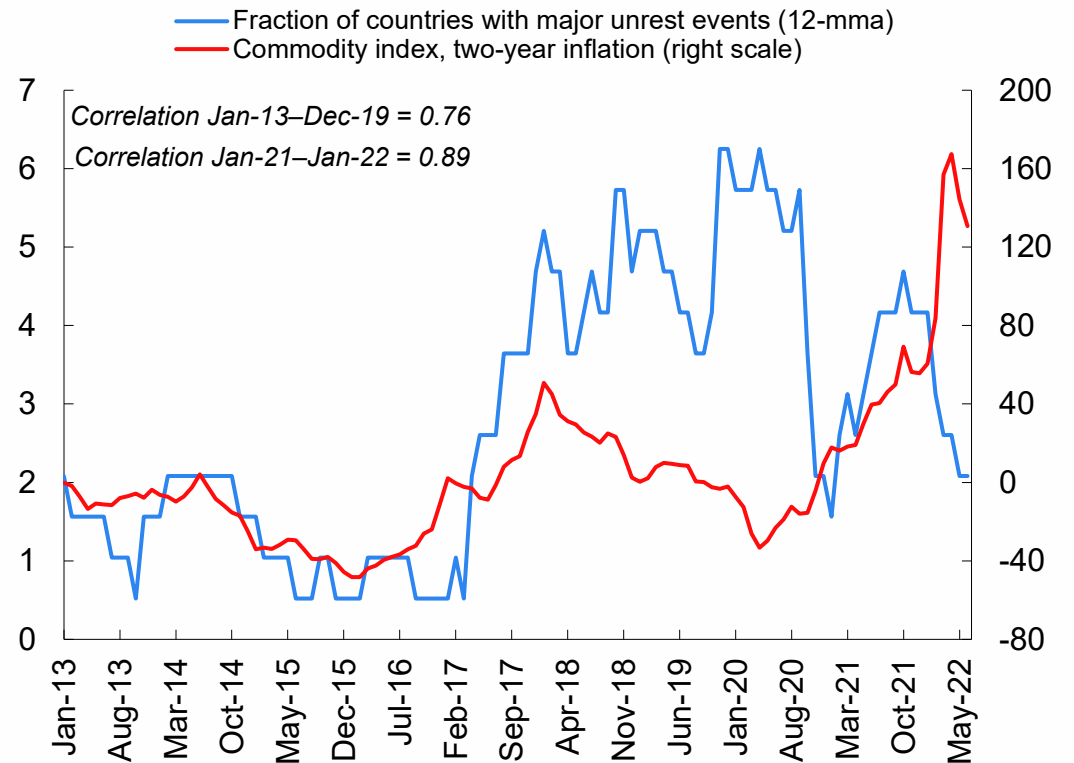
The pandemic and high commodity prices have exacerbated food insecurity, while inequality and poverty remains elevated...

... raising the risk of social unrest, particularly if food and energy costs remain high

LAC: Poverty, Food Insecurity, and Gini
(Left scale: percent of population; Right scale: index)



LAC: Fraction of Countries with Major Unrest Events and Commodity Inflation
(Percent)



Sources: Food and Agriculture Organization of the United Nations database; IMF, WEO database; The Standardized World Income Inequality Database (SWIID); World Bank, World Development Indicators database; and IMF staff calculations. Note: Poverty is based on US\$5.5 threshold. Food insecurity refers to prevalence of moderate or severe. Gini data for 2021 estimated using available LAC countries in SWIID. LAC sample is based on source and data availability.

Sources: IMF, Global Assumptions database for commodity prices; Barret et al (2020) for unrest; and IMF staff calculations. Note: 12-mma = 12-month moving average.

Policy Priorities

Policy priorities

- ❖ **Short term: Restoring price stability while preserving social cohesion**
 - **Monetary policy** – bring inflation back to target range over horizon of monetary policy (do not ease prematurely; communicate policy intentions clearly)
 - Allow ERs to operate as shock absorber against external financial condition shocks, while using FXI to address disorderly market conditions. Where needed, explore boosting reserve buffers.
 - **Financial sector policies** – monitor closely the evolution of NPLs, and balance sheets of non-financial corporates as financial conditions tighten. Strengthen supervision/regulation of non-bank financial corporations.
 - **Fiscal policy** – protect the most vulnerable throughout the period of high inflation & weaker activity, while maintaining a neutral/contractionary fiscal stance to support monetary policy and debt sustainability.
- ❖ **Medium term: rebuilding fiscal policy space and boosting potential growth**
 - **Structural policies** – Remove structural impediments to productivity and investment to boost potential growth.
 - **Fiscal policy** – “Inclusive consolidation” to ensure debt sustainability and social stability.



Thank You