USAID
Economic Analysis
and Data Services

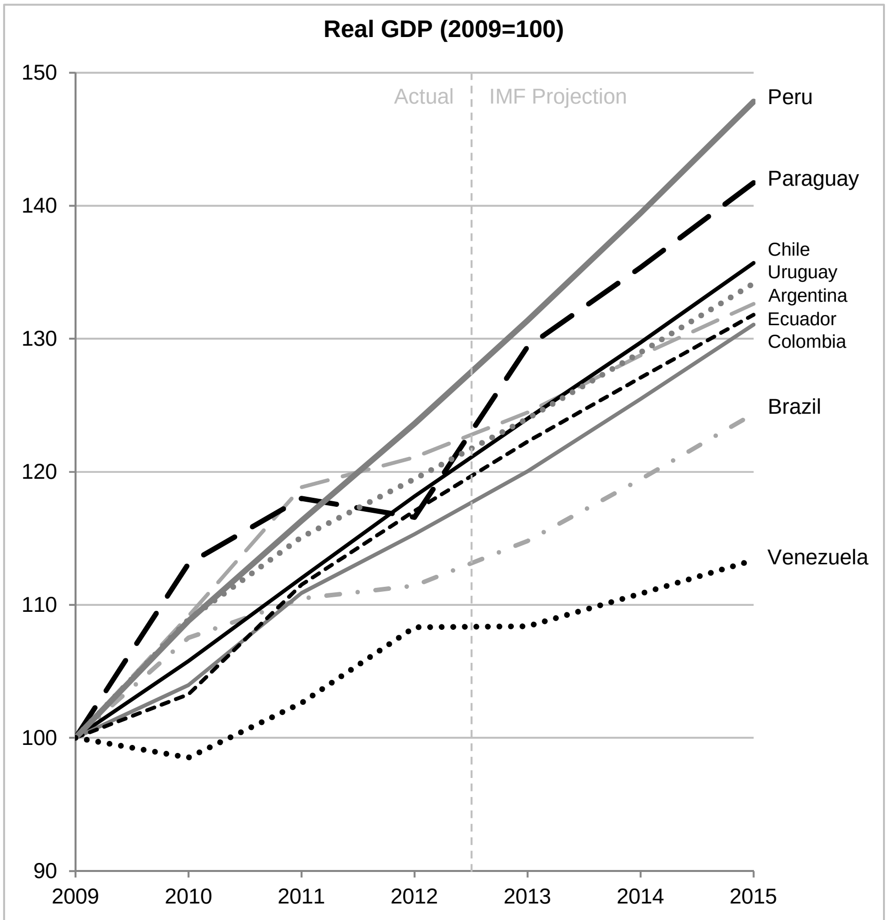
EADS Economic Trends Report

South America

May 2013

Economic Overview

South America's GDP is expected to grow 4.6 percent in 2013, the fastest in the Latin America and Caribbean (LAC) region. However, South America is a commodity-exporting region which is easily impacted by global demand. As a result, the region remains vulnerable to a weak external environment, contraction in domestic demand, and to country-specific factors.



SOURCE: IMF, *World Economic Outlook*, April 2013.

In Paraguay, GDP contracted in 2012 by 1.2 percent, a result of drought and diseases in the agricultural sector. Additionally, political risk because of the impeachment of President Fernando Lugo on the grounds of "poor performance of functions," decreased investor confidence in the country. However, GDP is forecast to increase by 11.0 percent in 2013 mainly due to a surge in soy and beef exports and improvement in foreign investment caused by a stable political climate after the election of the new president.

Argentina's real GDP growth has decreased tremendously to 1.9 percent in 2012 from 8.9 percent in 2011, and is forecast to stay low at an average of 3.0 percent through 2018. A stronger than expected grain harvest would boost the Argentine economy in the short term. Nonetheless, the country needs to undergo a series of economic reforms to regain its economic health. Argentina has great economic potential primarily due to its wealth in natural resources, high agricultural commodity exports, and educated workforce. However, the Argentinian government has long mismanaged the economy and needs to address many issues to increase economic growth. Some of these issues are: highly overvalued exchange rate, a potential for technical default on restructured debt, shaky foreign investor confidence especially after the inaccuracies in government reported data, high inflation, and a weak business environment.

Countries covered in this report include Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Guyana, Paraguay, Peru, Suriname, Uruguay, and Venezuela. Due to data limitations and space constraints, not all countries are represented in every graph or analytical section.

The Peruvian GDP growth rate is forecast to decrease slightly and stay around 6.0 percent in 2013–2018. The decrease is caused by a slowdown in Peru's metal exports to China. Private consumption and fixed investment will be the primary drivers of Peruvian growth in the future. The Peruvian government is fighting poverty and income inequality, which will increase the middle class and boost consumerism. Moreover, investment in the infrastructure, energy, and mining sectors is projected to surge in the next five years. However, the Peruvian economy remains reliant on foreign capital and Chinese economic growth in the short term.

Fixed investment underperformance and government pressure on the banking sector negatively affected Brazilian economic activity in 2012, which grew by only 0.9 percent. Fixed investment was hit because of high construction costs, a complex tax system, high tariffs, investors' lack of access to heavy industry, and complicated legal and capital structures. In addition, the banking sector had a low profit in 2012 because of government pressure on commercial banks to decrease lending rates. On the other hand, Brazil's GDP is forecast to slightly recuperate in 2013 and grow by 3.0 percent. The recovery is caused by a forecasted increase in private consumption, a boost in activity in the consumer and manufacturing sectors, and a backlog of infrastructure projects for the 2014 FIFA World Cup and 2016 Olympic Games.

The slight decrease in the Colombian GDP growth rate in 2012 was caused by a slowdown in private consumption, tighter credit conditions, and slow domestic capital investment. However, GDP is forecast to increase at an average above 4.0 percent in 2013 through 2018. The solid political environment, improved security situation, and optimistic economic outlook by the IMF and rating agencies will elevate foreign investment inflows. Still, Colombia is overly dependent on U.S. trade and high oil prices. An unexpected slowdown in global growth could negatively impact Columbian growth by decreasing demand for Colombian exports, reducing foreign direct investment, and lowering energy prices.

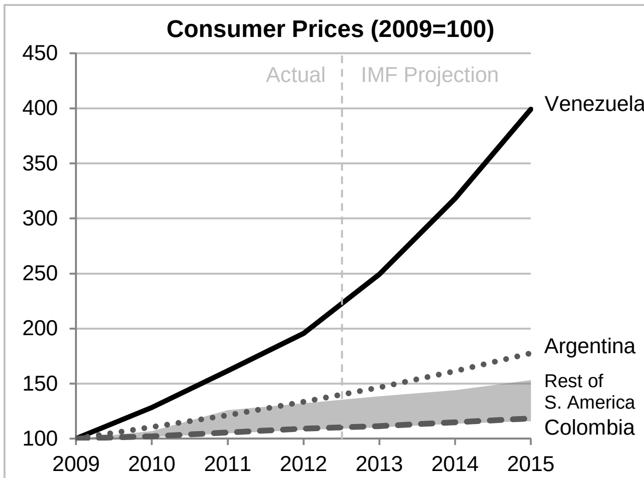
In Venezuela, GDP growth is forecast to decline to 0.1 percent in 2013 from 5.5 percent in 2012 mainly due to currency devaluation, decreases in private consumption and gross fixed investment, and political and social tensions. These tensions, along with deteriorating consumer and business confidence, will negatively affect prospective international investment.

Ecuadorian GDP growth has decreased to 5.0 percent in 2012 from 8.0 percent in 2011, and it is forecast to decline further to 4.4 percent in 2013 and 3.9 percent in 2014. The sluggish GDP growth is caused by a decline in private consumption, slowdown in the oil sector and infrastructure spending, and reduction in investment. Business-friendly policies could improve investor confidence in the economy and increase investment, especially in the infrastructure, and oil and mining sectors. According to the World Bank's Doing Business 2013 report, Ecuador ranked 139th out of 185 countries in ease of doing business. The report cites Ecuador's difficulties in starting new businesses, trading across borders, protecting investors, and resolving insolvency—all of which hinder investment.

Real GDP Growth, 2013 (IMF Projections)	South America 4.6%	Central America 4.0%	Mexico 3.4%	Caribbean 1.8%

Inflation

Governments in several South American countries are concerned with preventing overheating economies and rising inflation related to substantial capital inflows and high global food and fuel prices. South America has the highest projected inflation rate for 2013 compared to other sub-regions in LAC. However, this average is skewed by the exceedingly high expected inflation rates for one country: Venezuela. The majority of South American countries have implemented effective policies designed to maintain inflation within targeted ranges. Venezuela and Argentina are still the exceptions.



SOURCE: IMF, *World Economic Outlook*, April 2013.

High inflation in Venezuela is mainly caused by an expansionary monetary policy and devaluation of the Venezuelan bolivar. The increase in inflation is likely to have a negative effect on the private sector by reducing profit margins and social stability since Venezuelans heavily rely on imported goods. To protect consumers from rising prices, the government subsidizes goods, enforces price controls, and has lifted minimum wages. However, these policies do not address the causes of inflation and are contributing to an unsustainable situation, especially if oil prices begin to decline and the government is no longer able to finance its subsidy programs. A solution to the high inflation would be to increase private investment to elevate productivity. However, that might be a challenge since Venezuela was ranked among the worst countries globally for ease of doing business, at 180th out of 185 countries in the *Doing Business 2013* report.

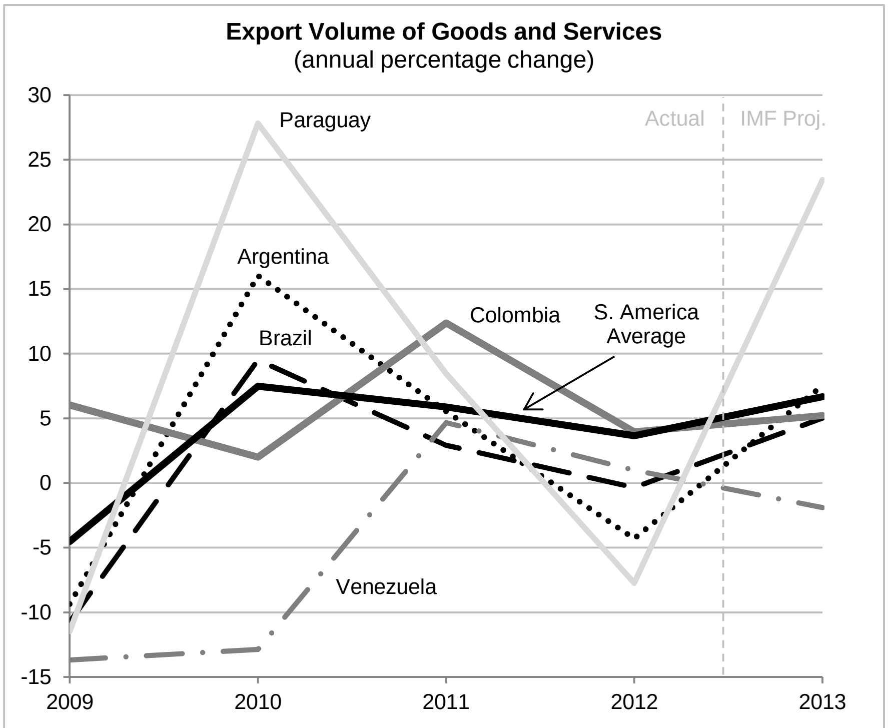
In Argentina, elevated inflation remains the major economic problem in the country. In 2012, inflation was in the double digits and expected to stay steady at around 10.0 percent through 2018. The high inflation is primarily caused by the current expansionary monetary and fiscal policy to support economic growth. Of further concern is the poor quality of official inflation data from Argentine authorities. This uncertainty in the data is likely to cause additional damage to business investments and may pose a major threat to the stability and resilience of the country's financial system. Furthermore, high inflation may cause Argentine consumers and businesses to use their savings to fund purchases. In addition, high inflation may cause the peso to overvalue in real terms and make imported goods cheaper in comparison to domestic ones. Argentina experienced hyperinflation in 2002, which forced it to abandon its fixed exchange rate regime with the U.S. dollar and caused major social turbulence.

Last year, Colombia reached its lowest level of inflation since 1955, mainly because of weak domestic demand. It is forecast to stay low because of strong currency and consumer tax reform for many goods. Low inflation represents price stability and encourages planning and investment. However, the strong currency in Colombia has weighed heavily on export growth and negatively affected agricultural producers.

CPI Inflation, 2013 (IMF Projections)	Mexico 3.7%	Caribbean 4.0%	Central America 4.3%	South America 6.2%

Trade

South American exports are expected to grow 6.7 percent in 2013, the fastest growth in the LAC region. The strength of South American exports has been in oil, iron, and copper commodities, but for the last decade the region has been investing in diversification of its export sectors. A rise in the manufacturing sector is expected, particularly in the transport sector such as motor vehicles (Brazil and Argentina) and ships (Venezuela). According to the *Latin American Economic Outlook 2013* by OECD/ECLAC, when a country's exports are more diversified, it is more flexible and better able to stand up to external shocks.



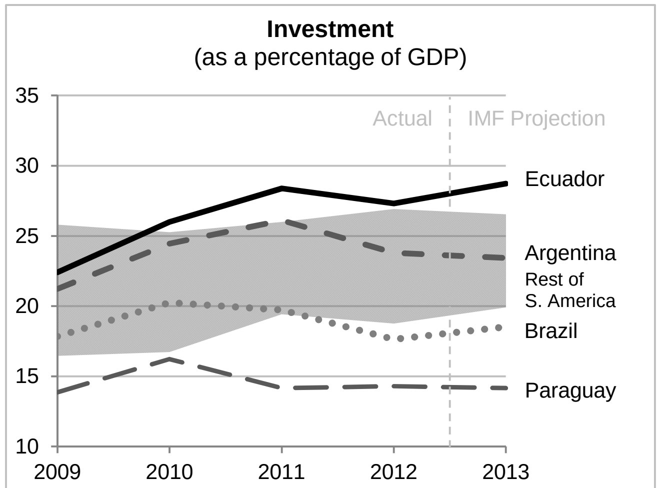
SOURCE: IMF, *World Economic Outlook,* April 2013.

Brazilian exports were hit in 2012 due to the slowdown in China but forecast to grow by 5.0 percent in 2013. The growth is supported by an increase in agricultural production (sugar, coffee, and soybeans) and rising Chinese demand for iron ore and steel. In Paraguay, exports are forecast to increase by 23.5 percent in 2013. Exports are dependent on few commodities (beef and soy) and a few destinations in the Mercosur area (Uruguay, Argentina, and Brazil). The lack of diversification in its export commodities and markets is increasing the vulnerabilities to supply and demand shocks. In 2012, Paraguayan exports decreased by 7.7 percent because of the spread of foot and mouth disease and a drought that hurt the soy harvest.

Venezuelan exports are expected to decline in 2013 by 1.9 percent due to a contraction in oil sector production. This sector accounts for 95 percent of total exports, and the decline in production is caused mainly by underinvestment. On the other hand, Colombia's exports are expected to rise in 2013 by 5.2 percent mainly due to the launching of U.S.-Colombia free trade agreement in 2012, which will give Colombia privileged access to the U.S. market. Furthermore, the Colombian oil sector is forecast to increase its production due to major improvement in its infrastructure that will increase exports. Nonetheless, dependency on U.S. trade and oil prices will expose Colombia to external economic changes.

Export Volume of Goods and Services, 2013 (annual percentage change) (IMF Projections)	South America 6.7%	Caribbean 6.5%	Central America 3.5%	Mexico 2.9%

Investment



SOURCE: IMF, *World Economic Outlook*, April 2013.

Capital inflows and investment in South America have been hit slightly in 2012 by the economic crisis currently affecting several advanced countries. Also, according to the *Latin American Economic Outlook 2013*, investment is limited by the scarce supply of human capital. South America has a shortage of well-trained workers that is generating a barrier for growth in productivity. The limitation is a result of the lack of hard skills (such as knowledge of foreign languages and the use of computer systems) and soft skills (such as critical thinking, teamwork, and responsibility).

Brazil has one of the world's largest economies, one that is rich in agricultural and mining resources. Brazil's investment as a percentage of GDP is expected to increase in 2013 as a result of its recent onshore and offshore oil discoveries and infrastructure investment plans in preparation for the FIFA World Cup and Olympic Games. These discoveries and events could help attract investors and businesses over the long term. In 2012, investment has decreased because of weak economic growth in China which weakened the demand for base metals from Brazil. In addition, Brazil still needs to improve its business environment.

Investment as a percentage of GDP in Argentina is expected to decrease slightly in 2013, primarily because of the uncertain political landscape, elevated corruption, high inflation, and possible devaluation and technical default on restructured debt. However, Argentina has been trying to be investment-friendly especially after the 2001 debt default. For instance, foreign companies are permitted to invest without registration or pre-approval from the government. Also, they are allowed to enter Argentina through mergers, acquisitions, and joint ventures.

Paraguay has the lowest investment as percentage of GDP in the South American region, mainly due to a high level of corruption. Paraguay received 'Highly Corrupt' on the *Corruption Perceptions Index* score by Transparency International. However, the investment environment might change if the newly elected president, Horacio Cartes, will work with the opposition to reduce corruption and ramp up investment in the infrastructure and oil and gas sectors. Ecuador's investment/GDP ratio is forecast to increase in 2013 after a slight decrease in 2012. Despite the expected slight improvement, Ecuador has a weak business environment and limited sources to finance investment. The country ranked 139th out of 185 countries in the World's Bank *Doing Business 2013* report. Unless Ecuador taps international capital markets for funding, its investment forecast will be weak.

Chile, Colombia, and Peru rank in the top 50 for overall ease of doing business. These three countries scored high in the region due to the ease of starting a business and registering property and protecting investor. They stand out because of their strong institutions, good infrastructure, and business-friendly regulatory environments. In contrast, Venezuela, Suriname, and Ecuador rank in the lowest 50 because of challenges in the following areas: starting a business, investor protections, and insolvency resolution.

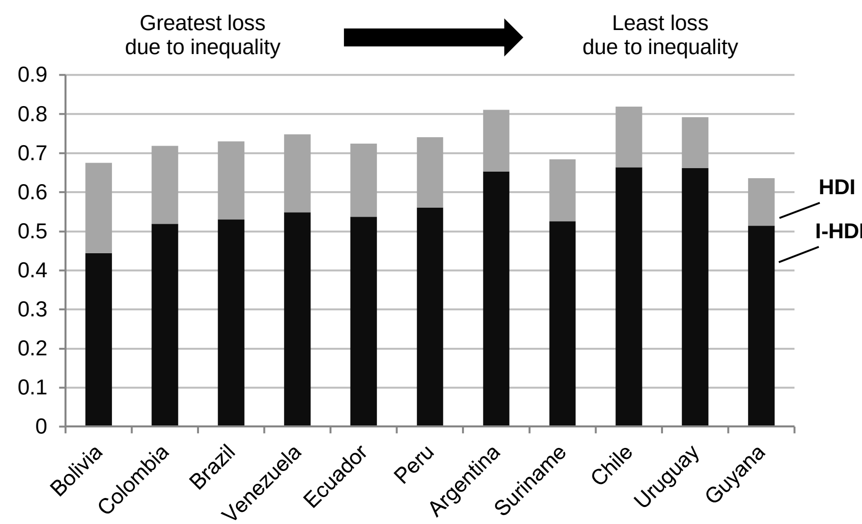
Investment, 2013 (as a percentage of GDP) (IMF Projections)	Caribbean 27.0%	Mexico 24.4%	South America 22.9%	Central America 21.3%

Poverty Reduction and Sustainable Development

According to the UNDP *2013 Human Development Report*, South America has shown a noticeable improvement in the following Human Development Index components: average life expectancy at birth, mean years of schooling, and gross national income. There has been a noticeable improvement in reducing inequality in health and education, especially in Brazil and Chile. These improvements are caused by the success in the following human development drivers:

- state proactivity in development policies,
- greater integration with global markets, and
- innovative social policies.

Inequality Adjusted Human Development Index (I-HDI)



SOURCE: UNDP *Human Development Report 2013*.
NOTE: The I-HDI is the Human Development Index (HDI) value adjusted for inequalities in the three basic dimensions of human development.

However, the region still remains the one with the world's highest levels of income inequality. Economic growth alone does not guarantee a reduction in poverty if there are structural or social factors that cause some groups to be left behind. In Brazil, for example, inequality in earnings is directly related to household circumstances such as race, ethnicity, place of birth, and parent's educational attainment. Studies by the UNDP highlight the following factors that contribute to the persistence of inequality:

- continued gaps in the quality of services and human security,
- institutional and regulatory challenges, and
- lack of opportunity for decent work.

Income inequality in Latin America is the highest in the world despite the decrease since 2000. However, the slight decline in income inequality is the results of cash-transfer programs (Chile's Chile Solidario and Brazil's Bolsa Familia). These programs attempt to reduce short-term poverty by direct cash transfers and to fight long-term poverty by increasing human capital among the poor through conditional cash transfers.

Additional Information

For questions or more information, please contact the author, Georges Fadel, at gfadel@devtechsys.com.

For country-specific data and additional information about the countries covered in this report, please visit the ESDB Country Portal at http://esdb.eads.usaidallnet.gov/query/do?_program=/eads/esdb/countryPortal.

Sources used in compiling this report include the semi-annual *World Economic Outlook* from the International Monetary Fund (http://www.imf.org/), the *Global Economic Prospects* and *Doing Business* reports from the World Bank (http://www.worldbank.org/), the UNDP *Human Development Report 2013* (http://hdr.undp.org/en/reports/global/hdr2013/), and Business Monitor International Business Forecast Reports (http://www.businessmonitor.com/).