WESTERN HEMISPHERE DEPARTMENT

Covid-19: From Crisis to Economic Transformation

JUNE 30, 2020

Alejandro Werner
Director

Presentation Outline

I. COVID-19 Developments and Re-opening

II. Financial Conditions and Capital Flows

III. Economic Developments

IV. Risks

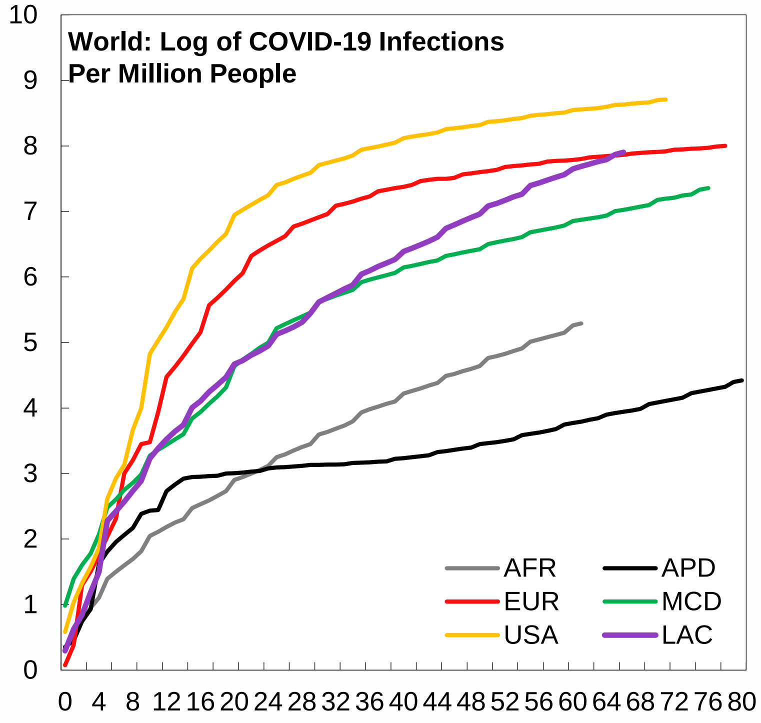
V. Policies and Fund Support

VI. Paraguay

COVID-19 Developments and Re-opening

The pandemic continues to intensify in most LAC countries despite social distancing measures

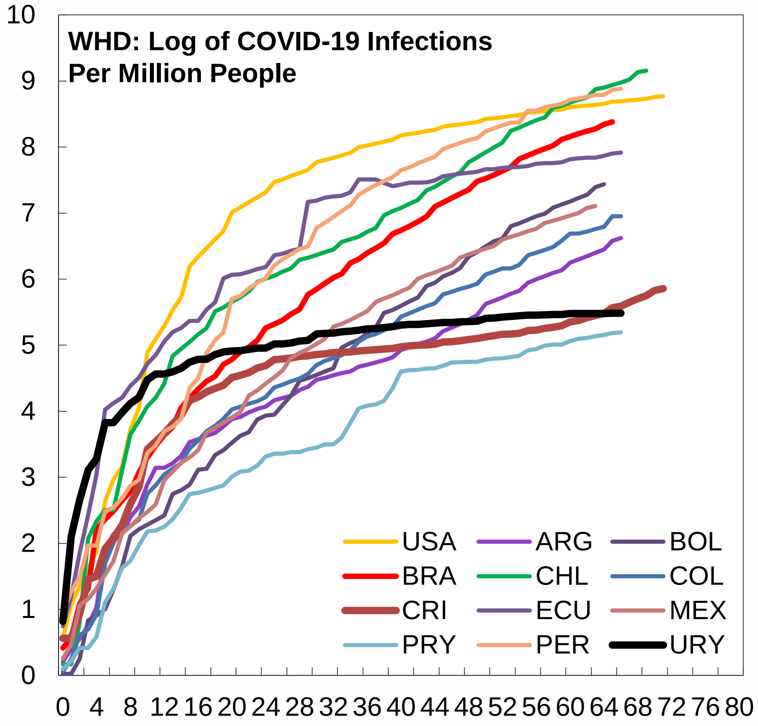
Infections continue to rise in LAC…



Working days since cases reached one per million population

Sources: Johns Hopkins University; and IMF staff calculations.
Note: t = 0 is the 1st day in which infections per million people ≥ 1.
Data as of June 18, 2020.

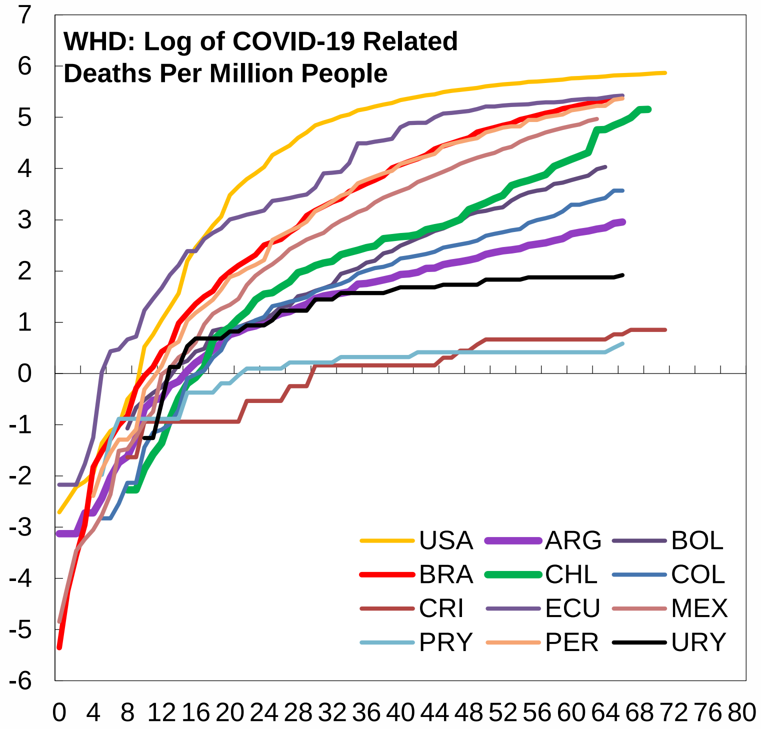
… with infections still accelerating in some countries



Working days since cases reached one per million population

Sources: Johns Hopkins University; and IMF staff calculations.
Note: t = 0 is the 1st day in which infections per million people ≥ 1.
Data as of June 18, 2020.

The death rate in some countries is converging to that of the US



Working days since cases reached one per million population

Sources: Johns Hopkins University; and IMF staff calculations.
Note: t = 0 is the 1st day in which infections per million people ≥ 1.
Data as of June 18, 2020.

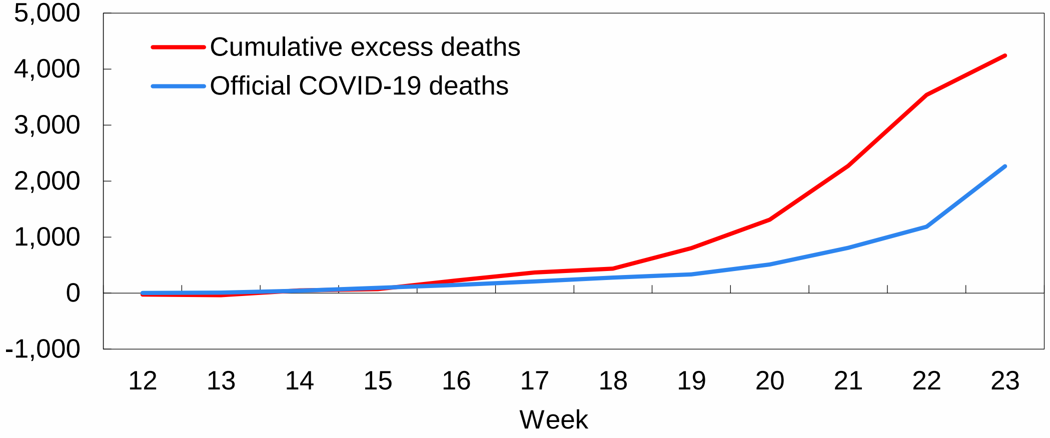
Excess mortality is significantly larger than official COVID-19 deaths for many countries in the region

COVID-19 Deaths and Excess Mortality

Country or Region	Period	Official COVID-19 Deaths	Excess Mortality	COVID-19 Deaths to Excess Mortality
Germany	3/22–4/4	1,280	1,320	97
Spain	3/11–4/21	21,250	29,800	71
United Kingdom	3/14–4/24	22,780	42,140	54
Chile	3/4–6/8	2,264	4,242	53
Ecuador	3/4–5/27	3,203	15,549	20
Mexico City	4/1–5/20	1,832	7,359	25
Peru	3/4–6/6	5,571	19,228	29

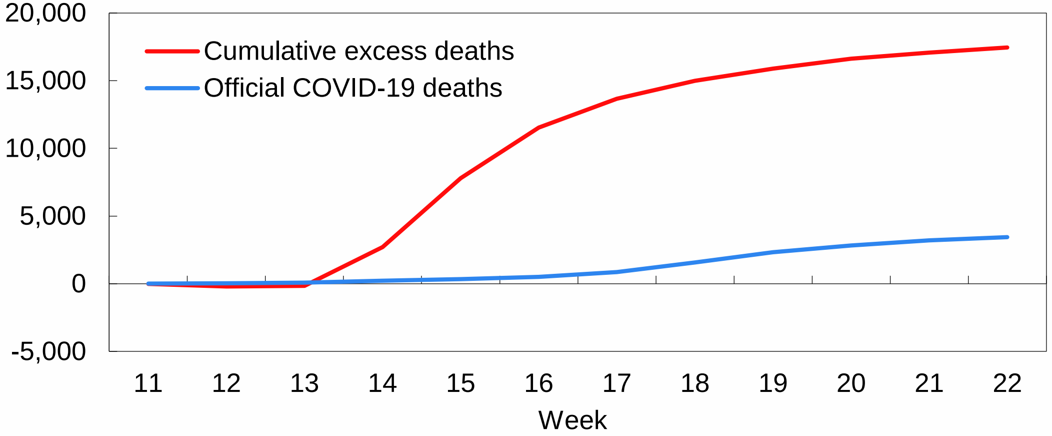
Chile: Total Cases versus Cumulative Excess Deaths

(Number of people)



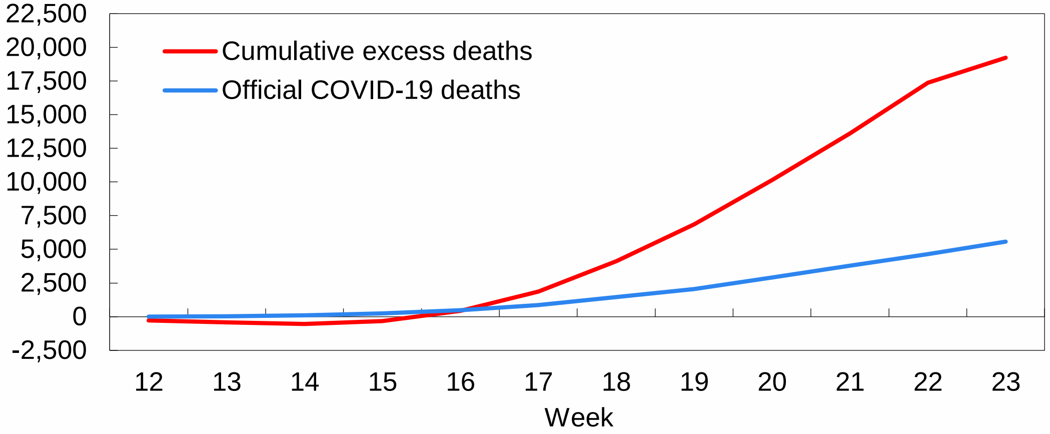
Ecuador: Total Cases versus Cumulative Excess Deaths

(Number of people)



Peru: Total Cases versus Cumulative Excess Deaths

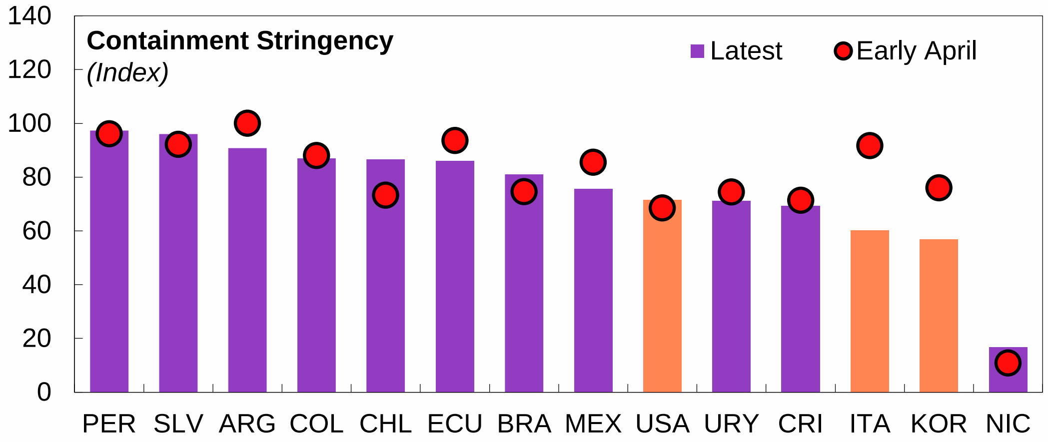
(Number of people)



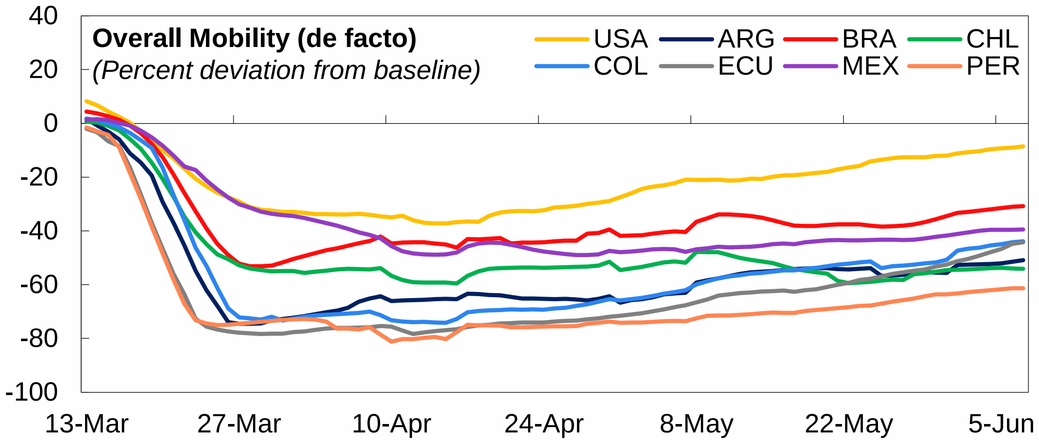
Sources:Ministerio de Ciencia, Tecnología, Conocimiento e Innovación de Chile (http://www.minciencia.gob.cl/COVID19); Mexico Ministry of Health; national authorities; Registro Civil; Our World in Data database; SINAFED ; and The Economist.

Reopening the LAC economies at this stage is very risky given low preparedness to manage large outbreaks

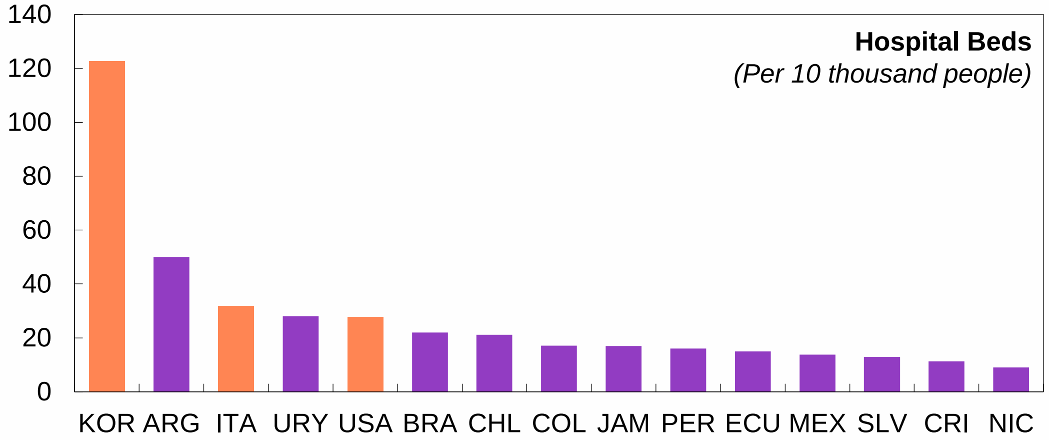
The stringency of de-jure containment measures varies across countries…



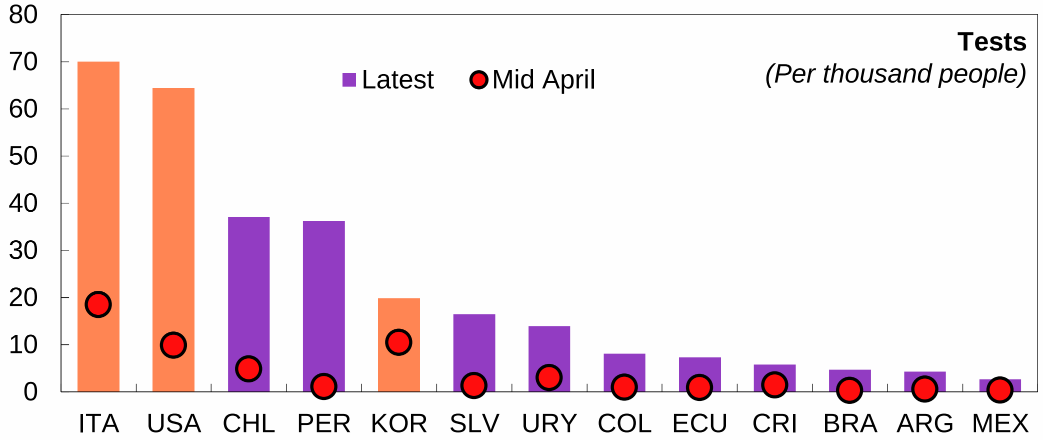
… and is correlated, but somewhat different to, de-facto measures



A low number of hospital beds increase the risks of reopening…



… as does low testing capacity



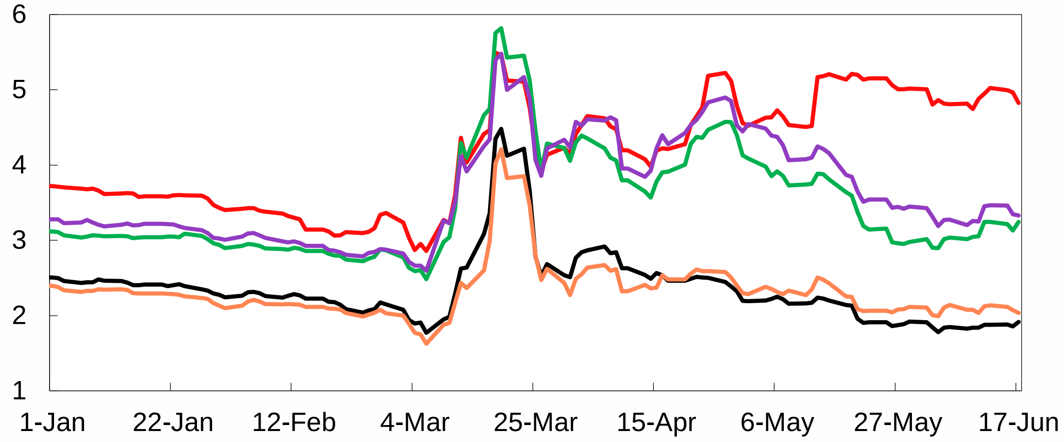
Sources: Google Mobility; Hale, Thomas, Sam Webster, Anna Petherick, Toby Phillips, and Beatriz Kira (2020). Oxford COVID-19 Government Response Tracker, Blavatnik School of Government; Our World in Data database; and Worldometers database.

Financial Conditions and Capital Flows

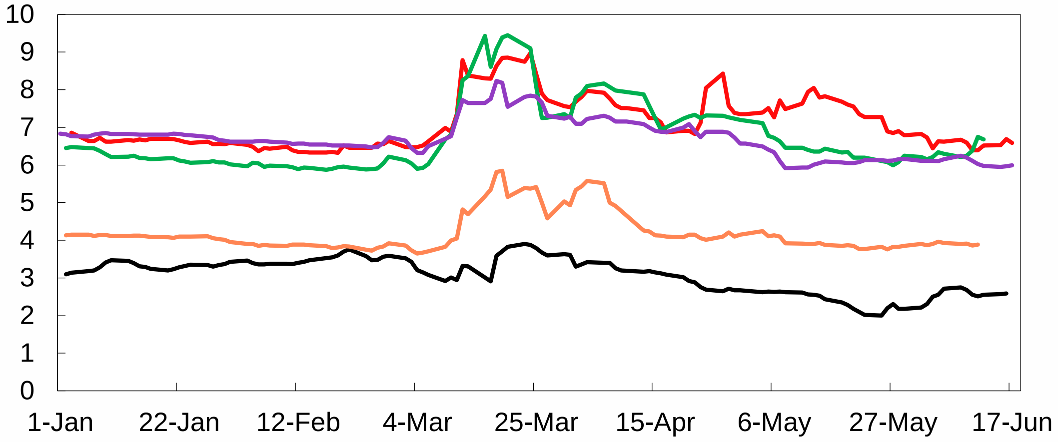
External financial conditions have eased for many LAC countries since late March, …

BRA CHL COL MEX PER

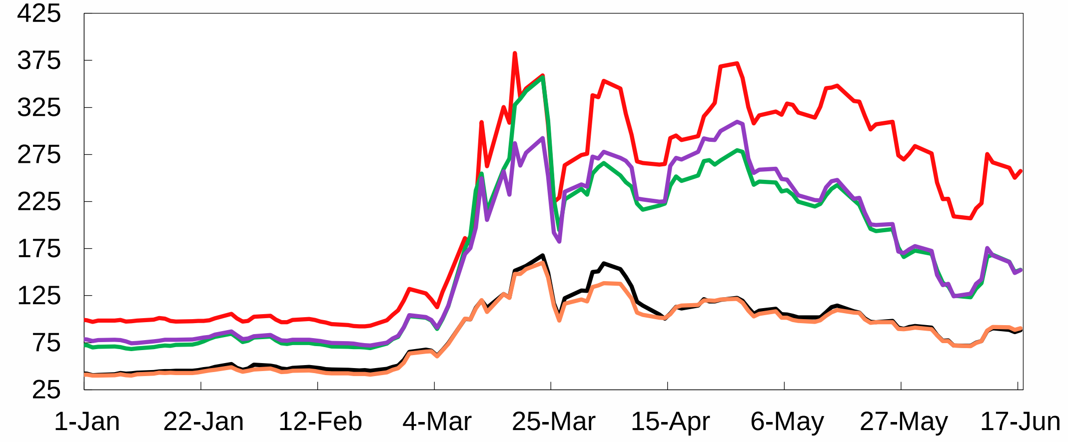
10-Year Government Bond Yield
(Percent; US dollar denominated)



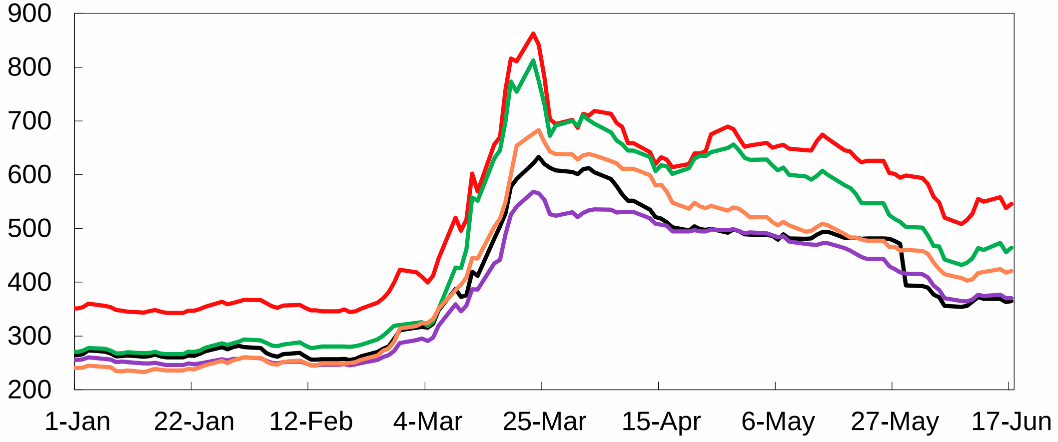
10-Year Government Bond Yield
(Percent; local currency denominated)



CDS Spreads
(5-year; basis points)



Corporate Spreads
(CEMBI; basis points)

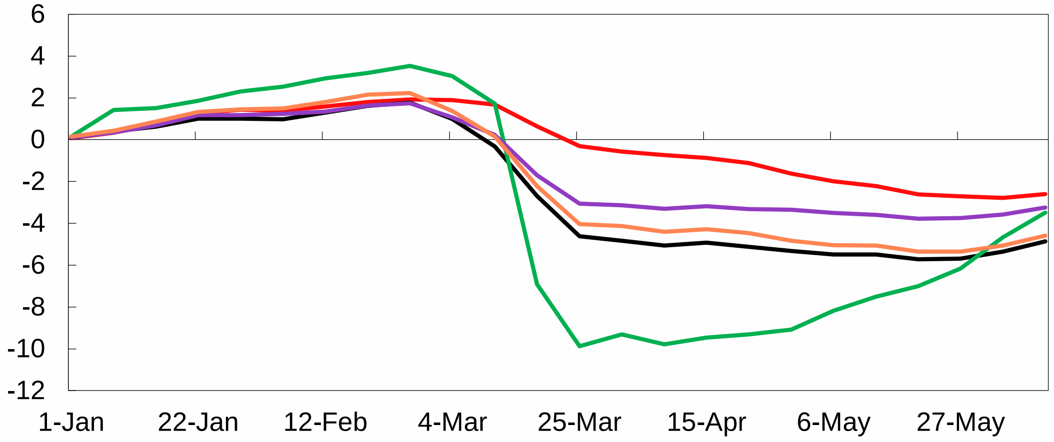


Sources: Bloomberg Finance L.P.; and IMF staff calculations.

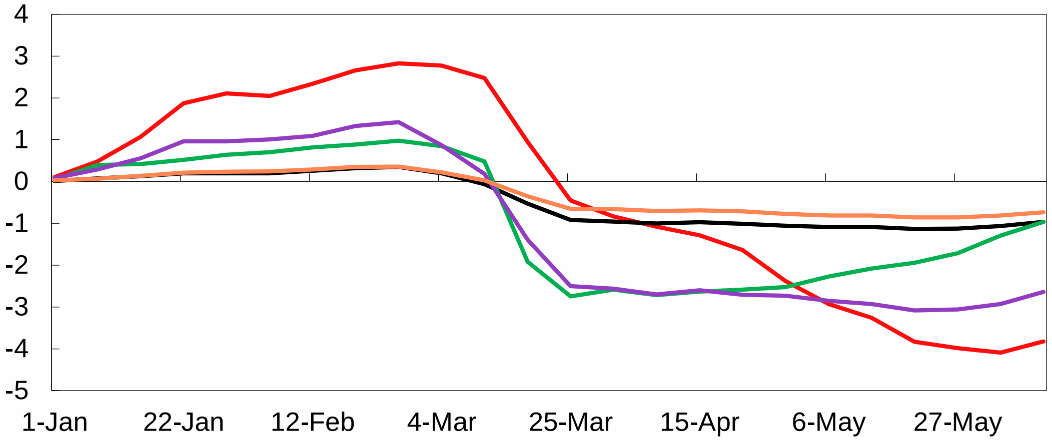
… while capital flows and exchange rates have stabilized, …

BRA CHL COL MEX PER

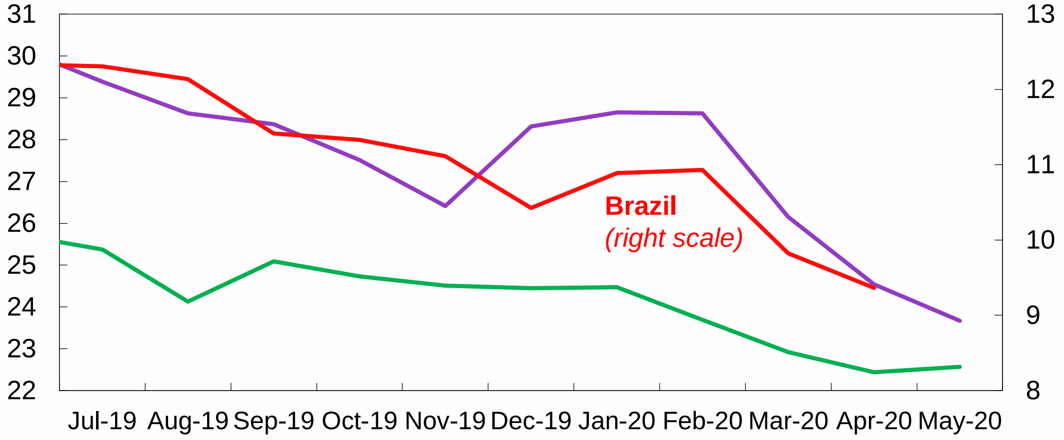
Cumulative EPFR Total Flows, 2020
(Percent of end-2019 allocation)



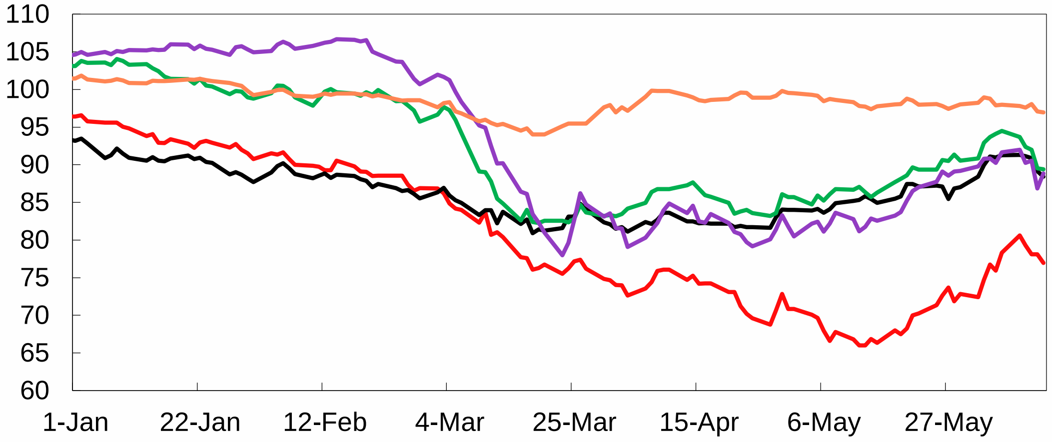
Cumulative EPFR Total Flows, 2020
(Billions of US dollars)



Foreign Participation in Local Government Bond Markets
(Percent of total)



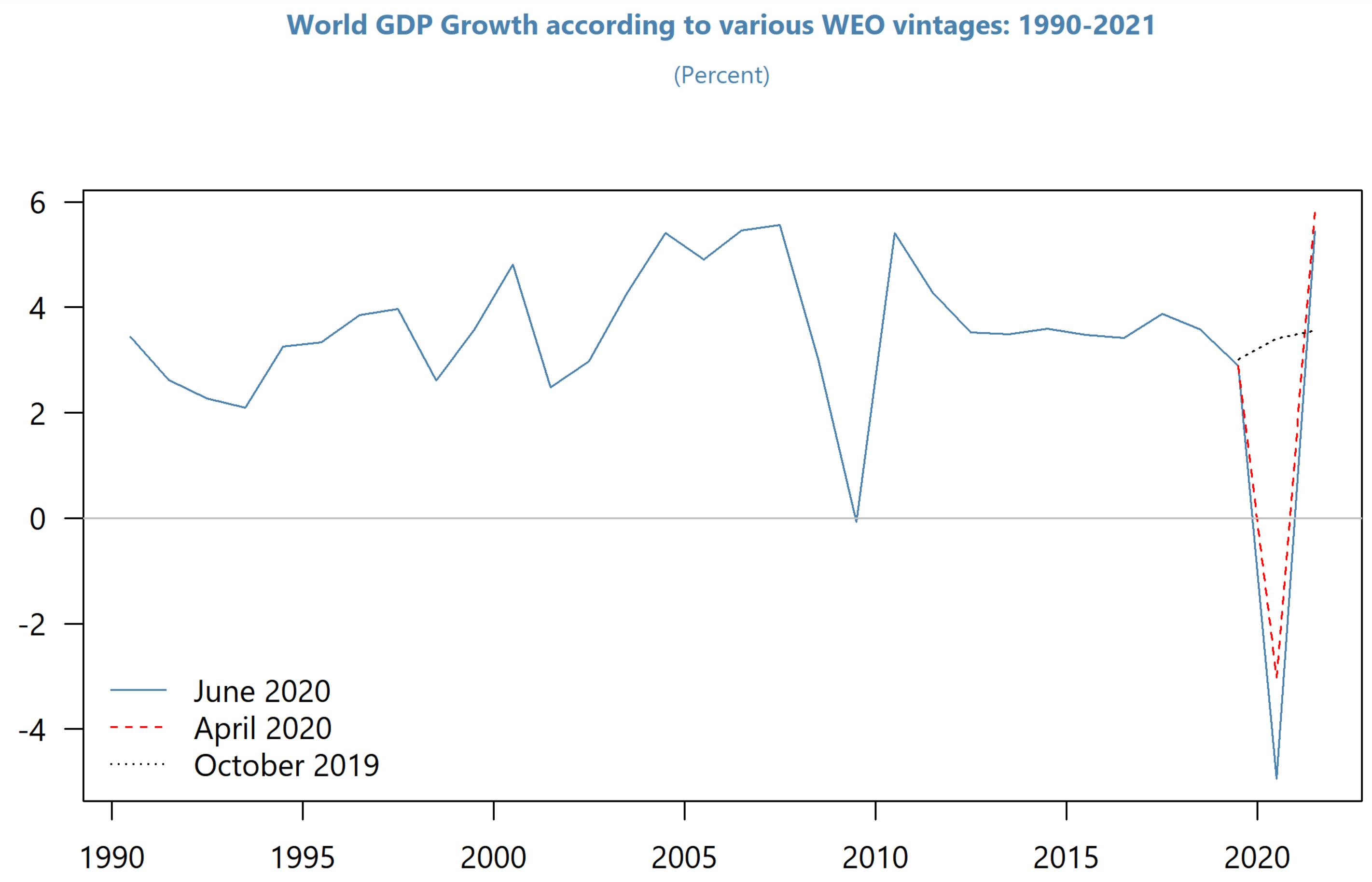
Exchange Rates Against the US dollar
(Index: 6/3/2019 = 100; increase = appreciation)



Sources: Bloomberg Finance L.P.; Emerging Portfolio Fund Research (EPFR) database; Haver Analytics; national authorities; and IMF staff calculations.

Economic Developments

Growth projection for the world revised to -4.9 percent



Projections are gloomier than they were in April

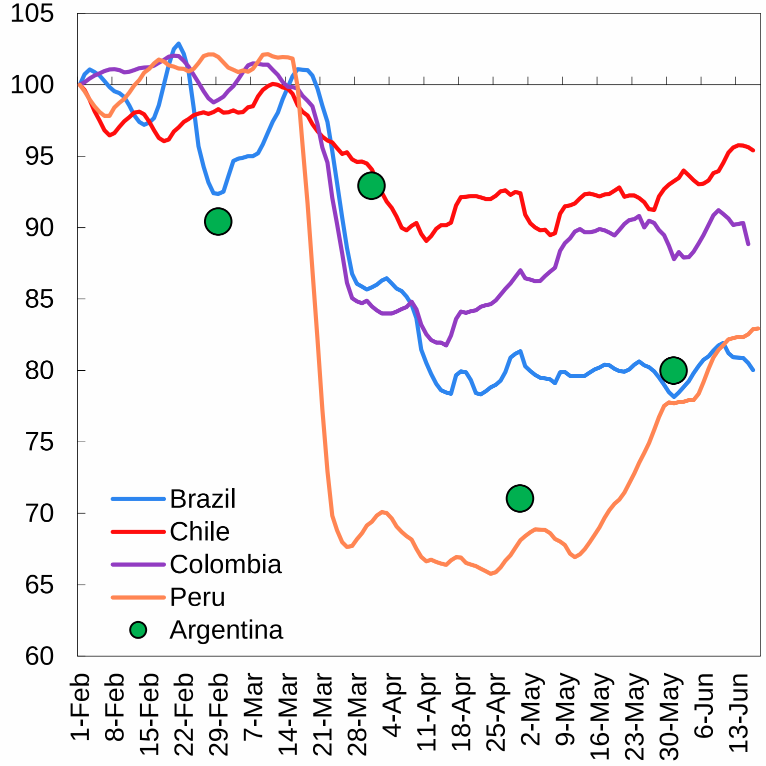
Recession in 2020 deeper and recovery in 2021 slower than earlier projected

We project a cumulative loss to the global economy of over $12 trillion over two years (2020-21)

10 percent of this total loss (about $1.2 trillion) stems from Latin America

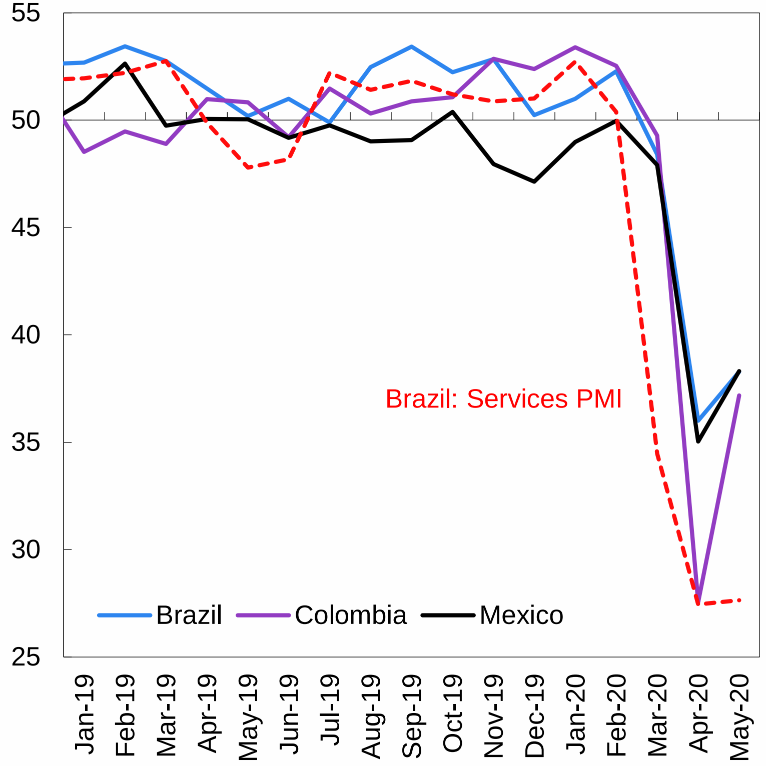
High frequency indicators pointing to a deeper contraction in the second quarter…

Electricity Consumption
(Index: 2/1/2020 = 100)



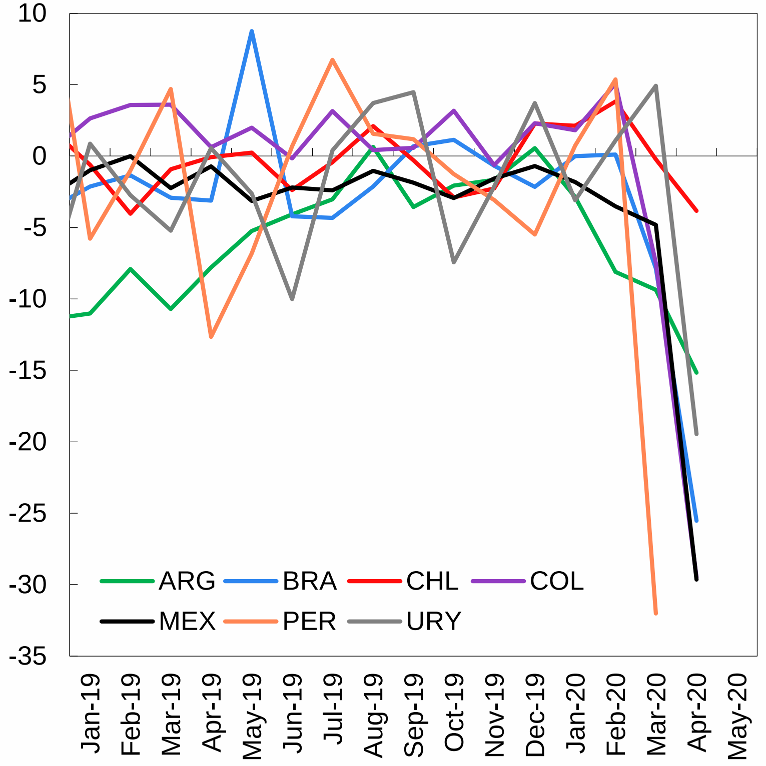
Sources: National authorities; and IMF staff calculations.
Note: Indices are based on the 7-day moving average of the raw data, except for Argentina where data is only available on a monthly frequency. Chile refers to electricity generation.

Manufacturing PMI: Overall
(Seasonally adjusted; 50+ = expansion)



Sources: Haver Analytics; and IHS Markit.

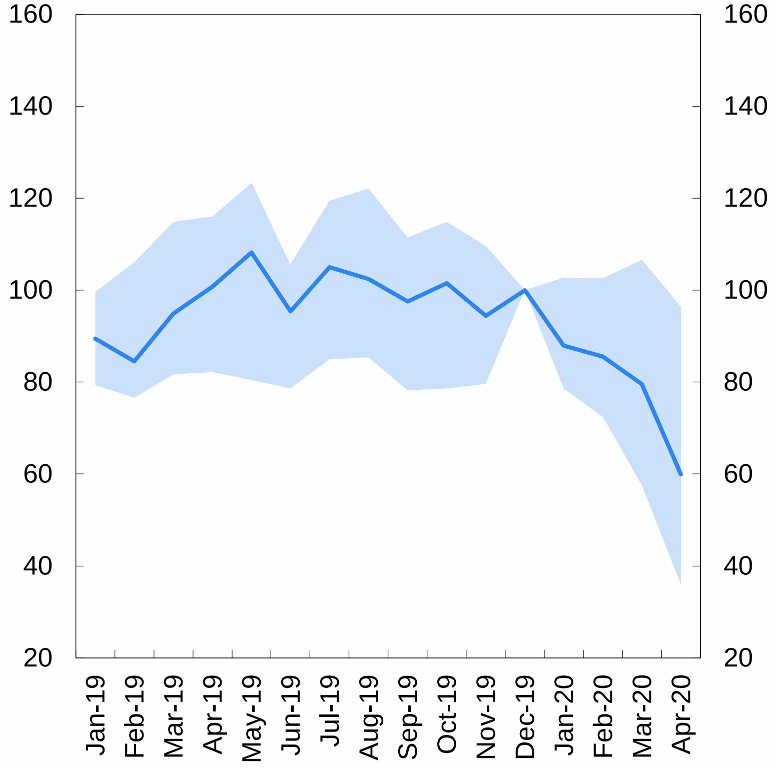
Industrial Production
(Year-over-year percent change)



Sources: Haver Analytics; and national authorities.

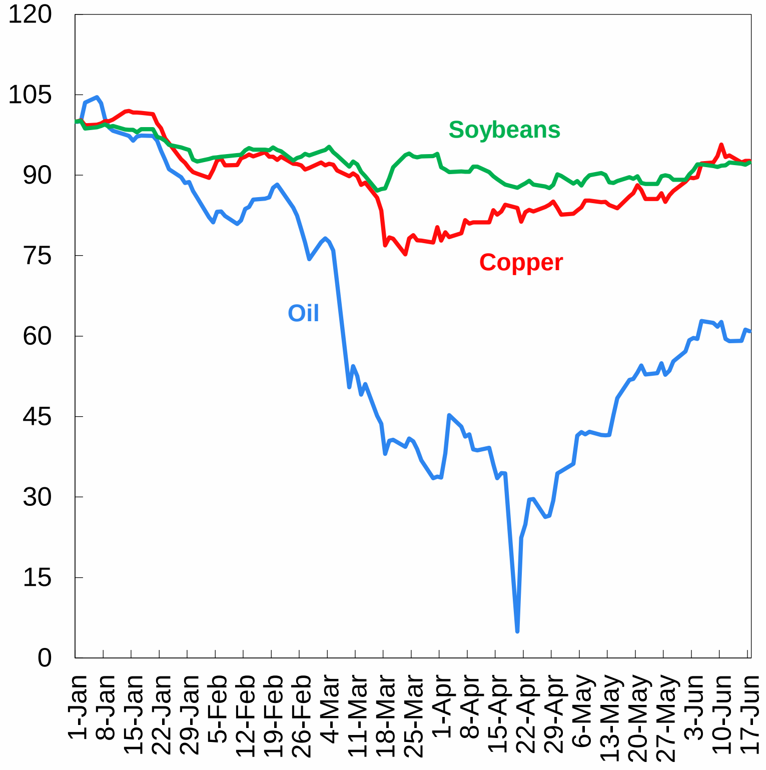
Trade, commodity prices, and tourism activity have also suffered with the pandemic

South America and Mexico: Goods Exports
(Median; index: December 2019 = 100)



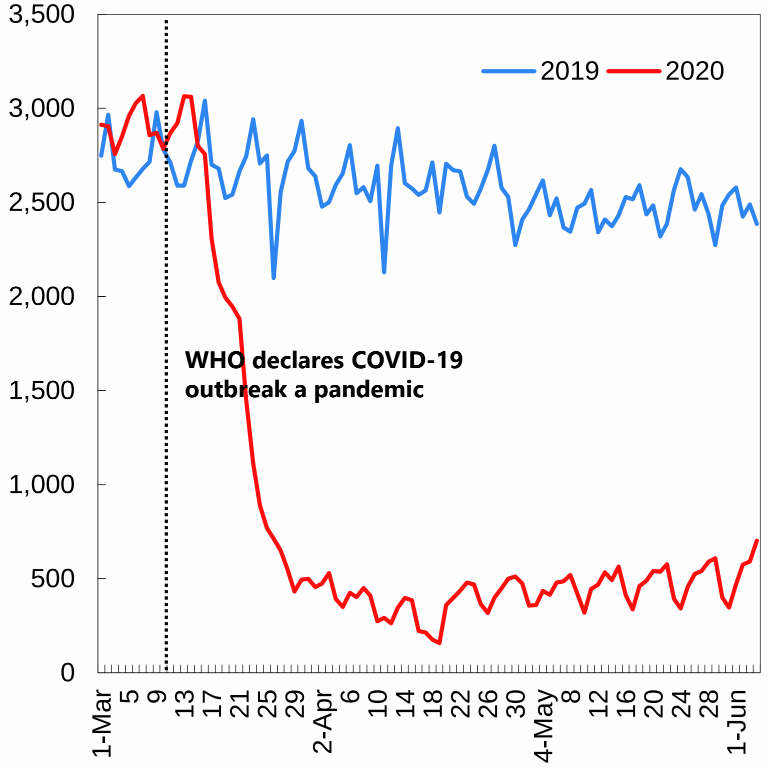
Sources: Haver Analytics; national authorities; and IMF staff calculations.

Global Commodity Prices
(Index: December 31, 2019 = 100)



Sources: Bloomberg Finance L.P.; and IMF staff calculations.
Note: Oil refers to the average petroleum spot price (APSP).

Latin America and the Caribbean: International Arrivals
(Number of flights)



Sources: FlightRadar24; and IMF staff calculations.

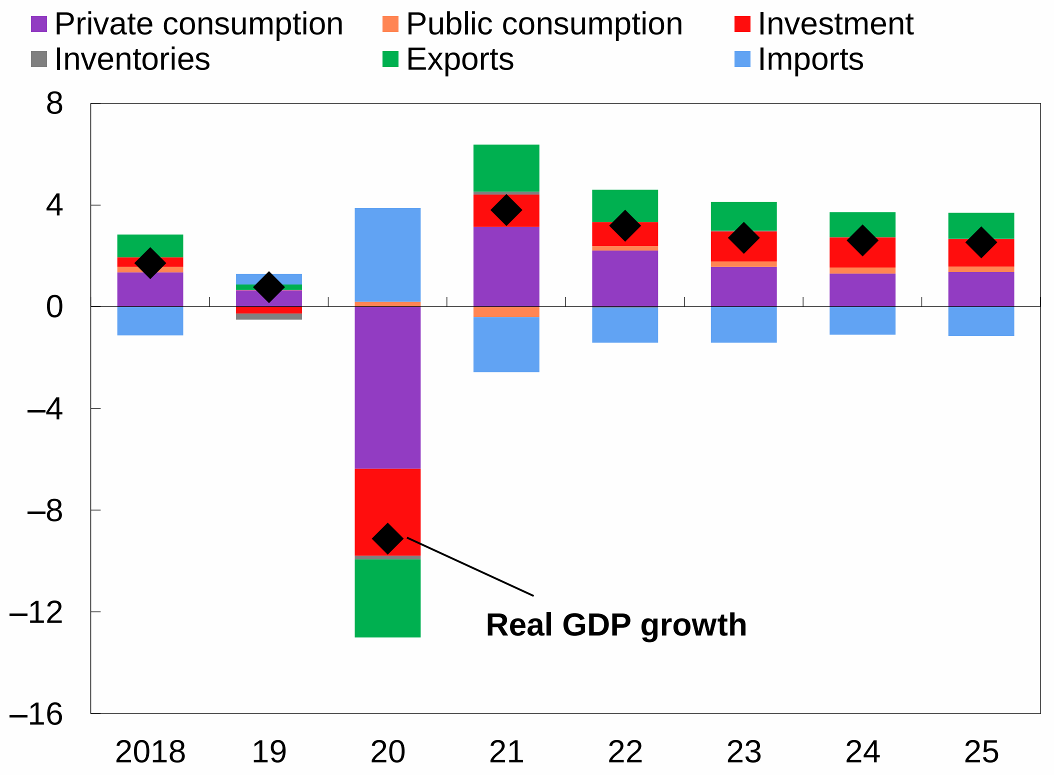
The outlook has worsened sharply, with a gradual recovery in GDP expected from 2021

Latin America and the Caribbean: Real GDP Growth
(Year-over-year percent change)

				Projections		
	2017	2018	2019	2020	2021	Avg. 2022–25
LAC	**1.3**	**1.1**	**0.1**	**–9.4**	**3.7**	**2.8**
LAC excl. Venezuela	2.0	1.8	0.8	–9.2	3.9	2.8
South America	0.7	0.4	–0.1	–9.5	3.9	2.8
Argentina	2.7	–2.5	–2.2	–9.9	3.9	2.5
Brazil	1.3	1.3	1.1	–9.1	3.6	2.6
Chile	1.2	3.9	1.1	–7.5	5.0	2.9
Colombia	1.4	2.5	3.3	–7.8	4.0	3.8
Peru	2.5	4.0	2.2	–13.9	6.5	4.5
Mexico	2.1	2.2	–0.3	–10.5	3.3	2.2
CAPDR	4.2	3.9	3.2	–5.9	3.2	4.1
Caribbean						
Tourism dependent	0.9	1.9	1.2	–10.3	4.8	2.9
Commodity exporters	–1.2	0.7	0.9	3.5	3.2	5.0

Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: PPP GDP-weighted average. South America excludes Guyana and Suriname. Green/red denotes upward/downward revision compared with the April 2020 *World Economic Outlook* forecasts. **(June 19, 2020)**

Selected LAC: Contributions to Real GDP Growth
(Year-over-year percent change; excludes Venezuela)

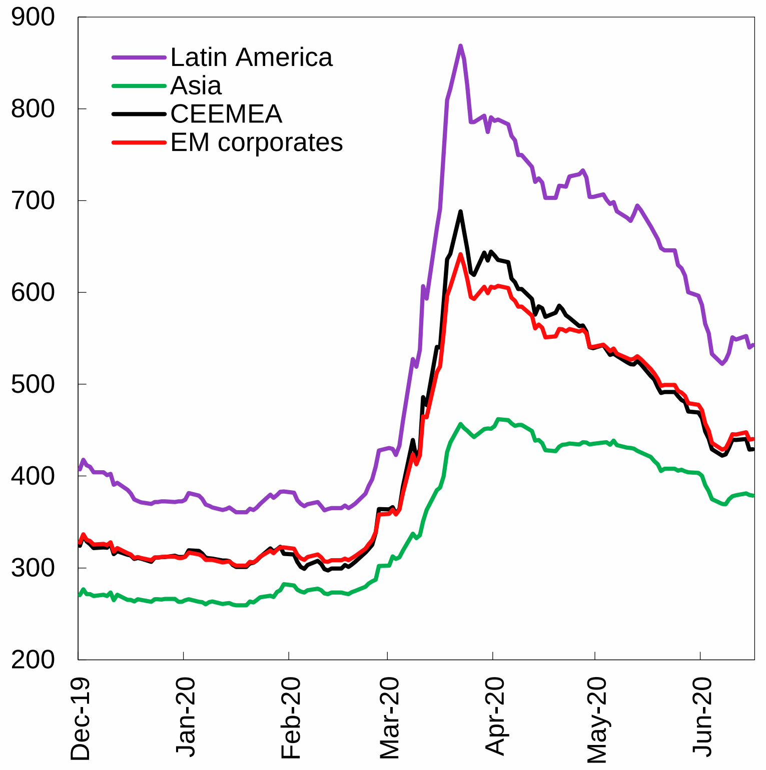


Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: Purchasing-power-parity GDP-weighted average. Also excludes Aruba, Barbados, Dominica, Grenada, Guyana, Jamaica, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname, and Trinidad and Tobago due to data limitations. Inventories include statistical discrepancies.

Risks

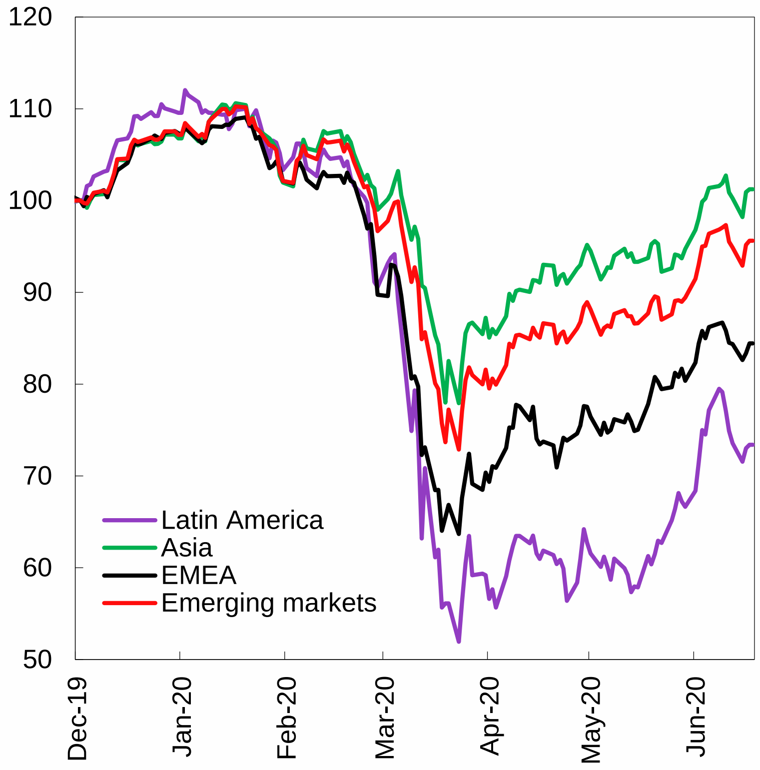
Elevated spreads and the sharp fall in stock prices highlight ***financial stress*** in the corporate sector…

Corporate Spreads in Emerging Markets
(Basis points)



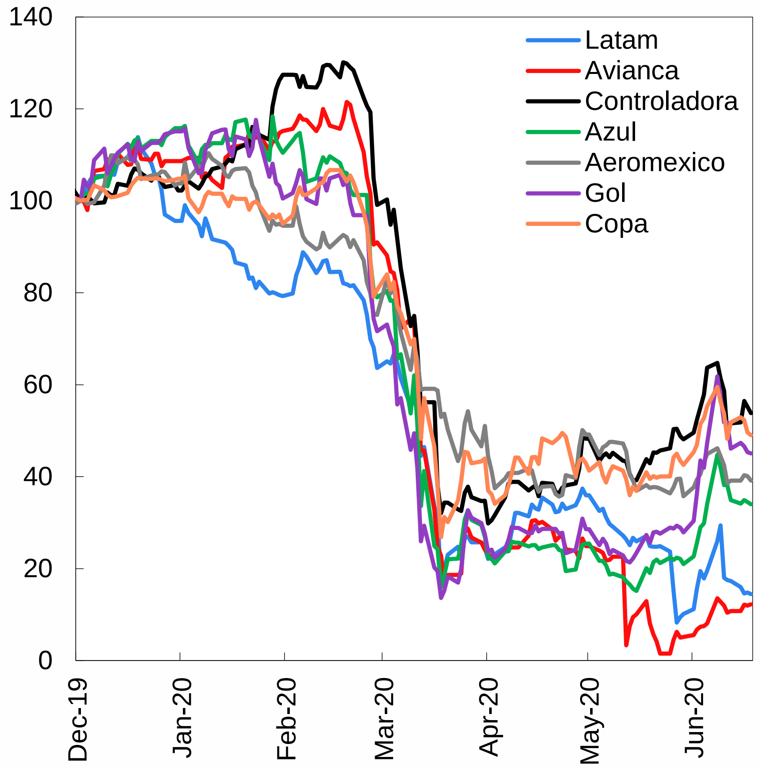
Source: Bloomberg Finance L.P.
Note: CEEMEA = Central and Eastern Europe, Middle East, and Africa.

MSCI Emerging Markets
(US$; index: 12/2/2019 = 100)



Sources: Bloomberg Finance L.P.; and IMF staff calculations.
Note: EMEA = Europe, Middle East, and Africa.

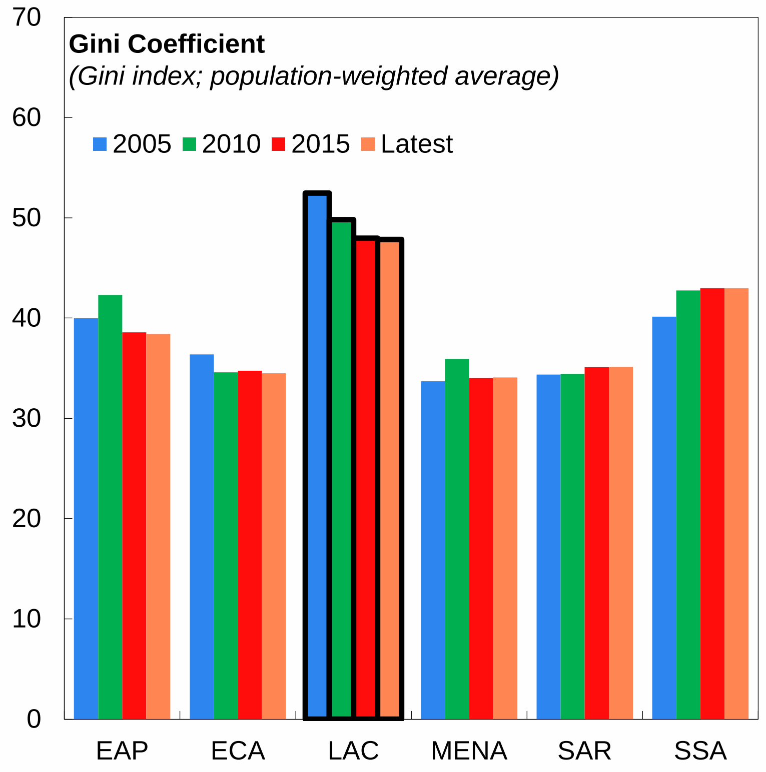
Airlines: Equity Prices
(Index: 12/2/2019 = 100)



Sources: Bloomberg Finance L.P.; and IMF staff calculations.

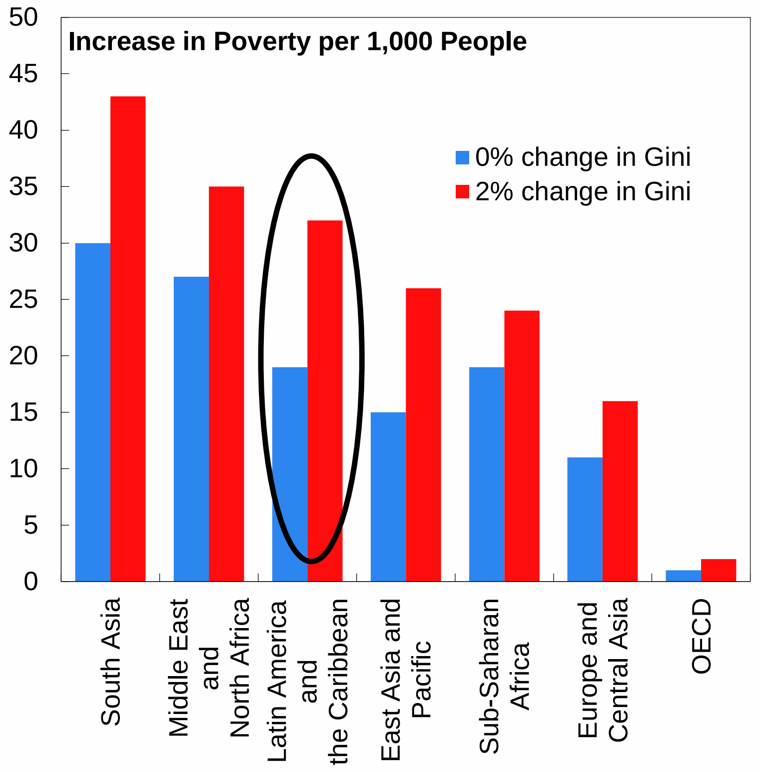
The collapse in activity could reverse the narrowing of *inequality and poverty*, and renew *social tensions*

Inequality narrowed until 2015 when commodity prices were rising…



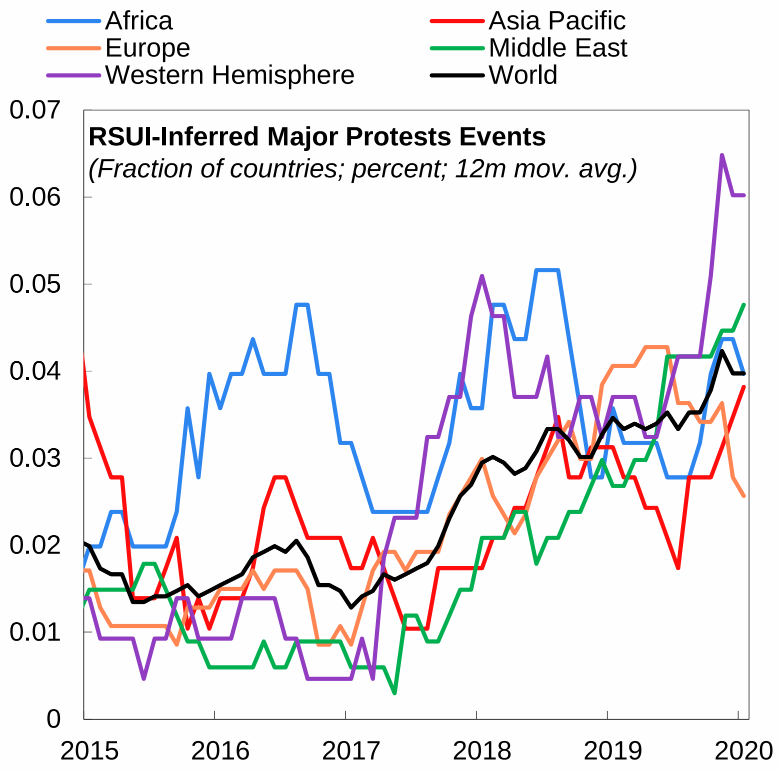
Sources: IMF, World Economic Outlook database; World Bank, World Development Indicators database; and IMF staff calculations.
Note: EAP = East Asia Pacific; ECA = Europe and Central Asia; LAC = Latin America and the Caribbean; MENA = Middle East and North Africa; SAR = South Asia; SSA = sub-Saharan Africa.

… together with poverty, but risk of reversal as commodity prices are likely to remain low…



Sources: Prepared by Loayza abd Shaharuddin based on data provided by Christoph Lakner and Daniel Gerszon Mahgler from PovcalNet (World Bank 2020d); IMF 2020a; and Lakner et al. 2019.

… and could lead to new outbreak in social tensions (as in the last quarter of 2019)

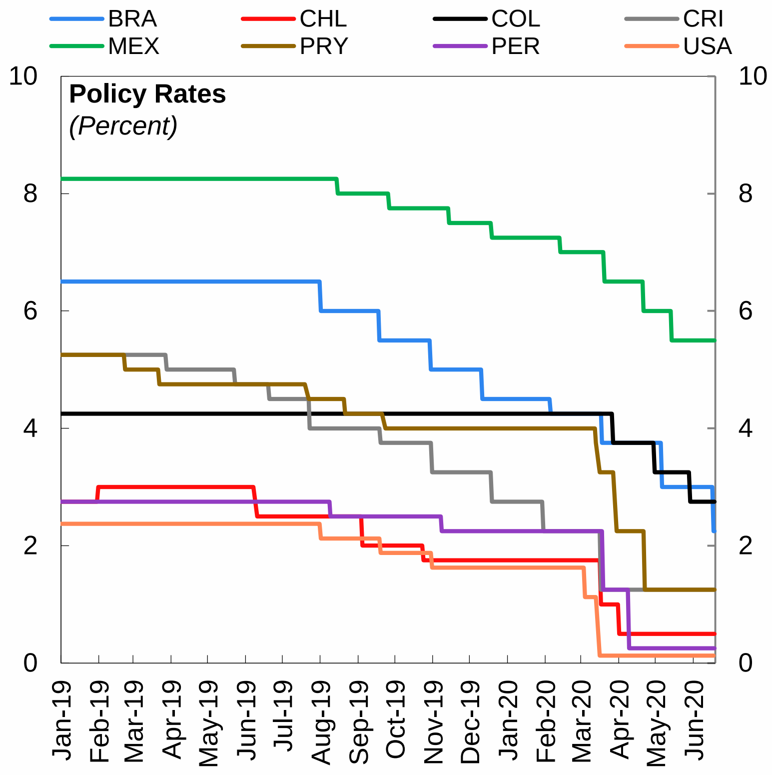


Sources: Factiva; and IMF staff calculations.

Policies and Fund Support

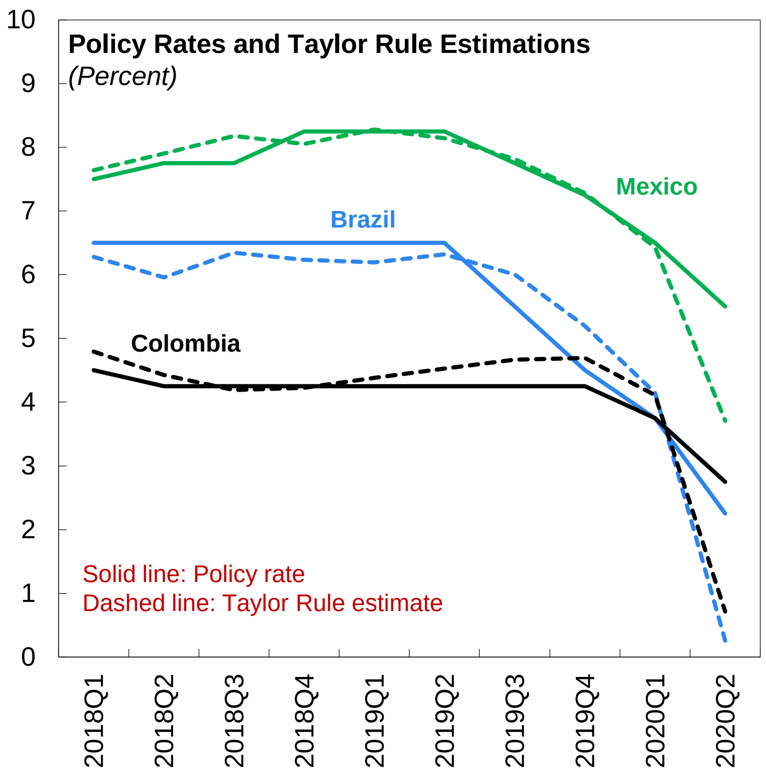
Central Banks have reduced rates and increased liquidity and funding support

Policy rates were reduced in line with the Fed…



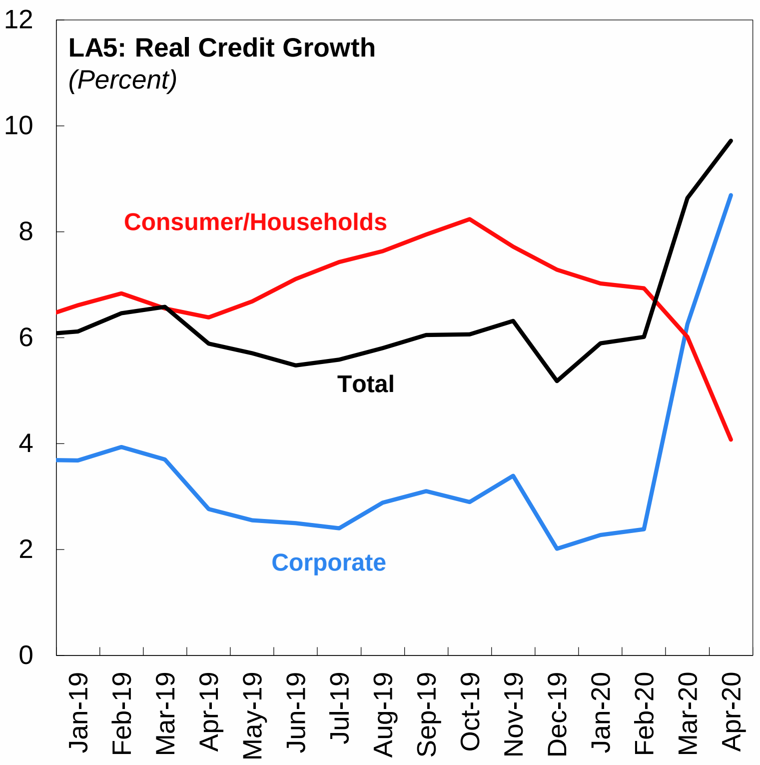
Sources: Haver Analytics; and national authorities.

… and Taylor Rules suggest some countries have room to cut policy rates further…



Sources: Haver Analytics; national authorities; and IMF staff calculations.
Note: Interest rates are end of period.

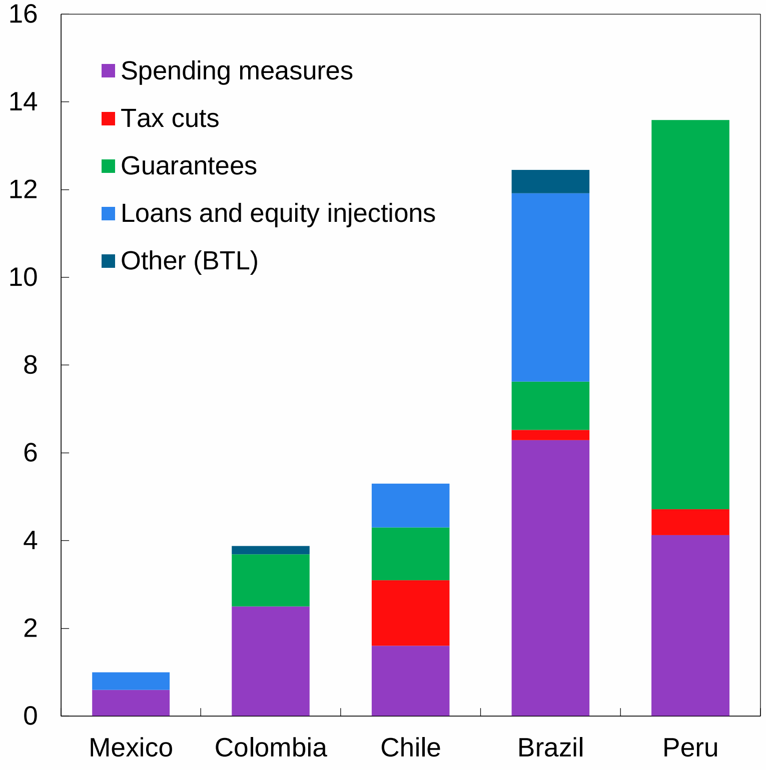
... as corporate credit responds to liquidity provision policies



Sources: Haver Analytics; national authorities; and IMF staff calculations.
Note: LA5 is the simple average of Brazil, Chile, Colombia, Mexico, and Peru.

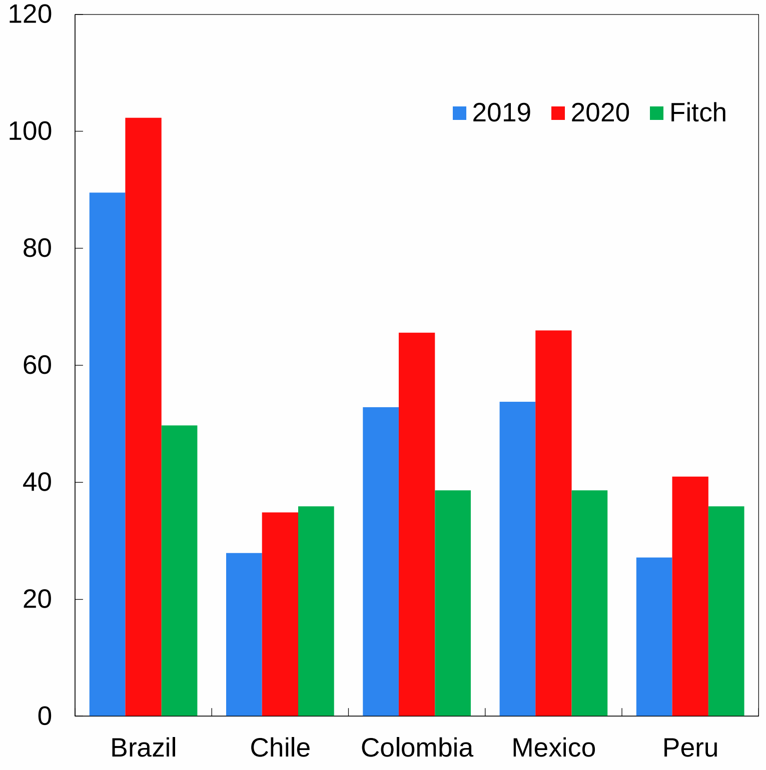
While some countries have provided large fiscal support, they risk intensifying debt sustainability concerns

Fiscal Support Measures, 2020
(Percent of GDP)



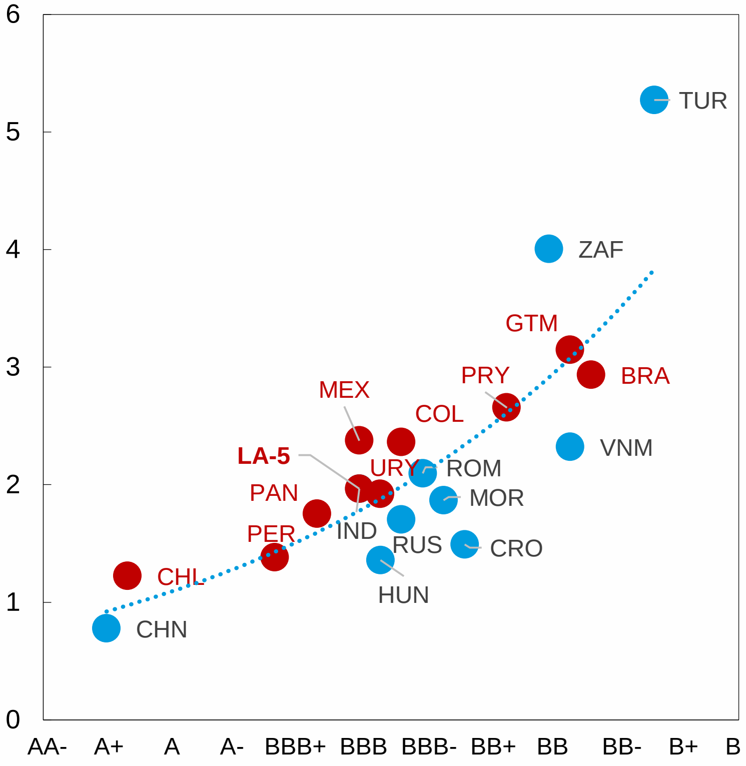
Sources: National authorities; and IMF staff calculations.
Note: Excludes temporary tax deferrals and anticipation of spending as typically they will not have a significant impact on the annual budget deficit. Guarantees refer to committed amounts, except for the case of Peru where the total size of the loans program is reported. BTL = below the line.

Gross Debt
(Percent of GDP)



Sources: Fitch Ratings; and IMF, World Economic Outlook database.
Note: Fitch refers to the median based on three-year centered averages of the countries with a similar or lower credit rating.

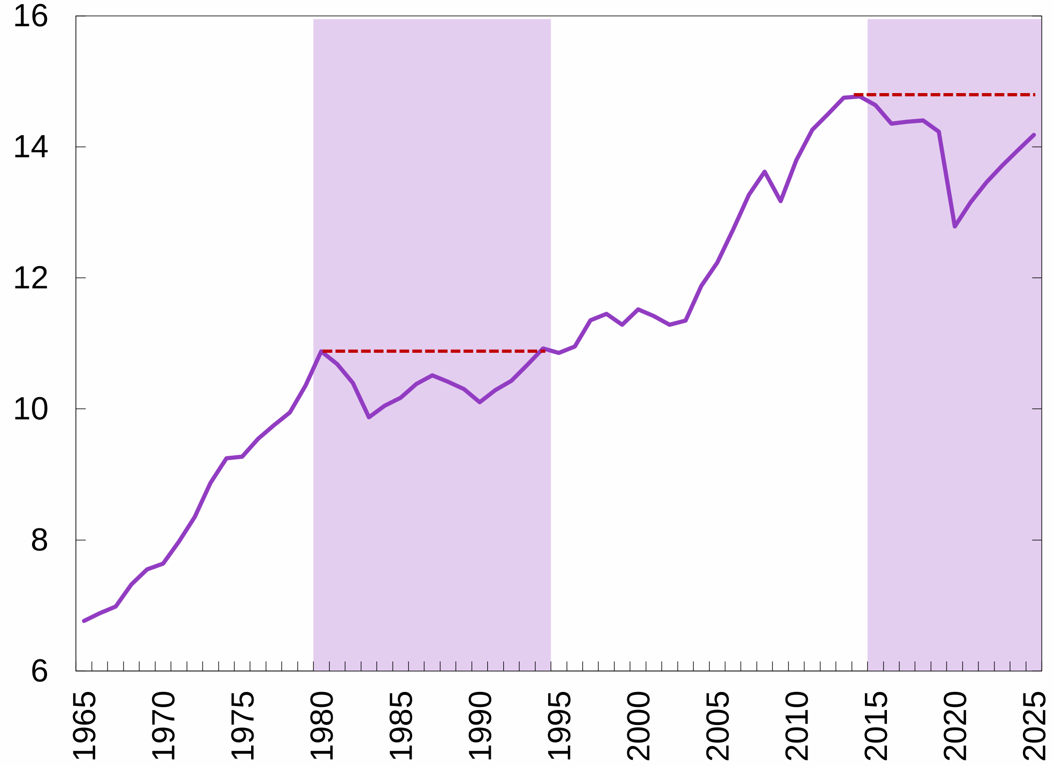
Emerging Markets: USD Sovereign Spreads and Credit Risk Ratings
(Percentage points)



Source: Bloomberg Finance L.P.
Note: Credit ratings are calculated as the average rating across Fitch, Moody's, and S&P. LA5 is the average of Brazil, Chile, Colombia, Mexico, and Peru.

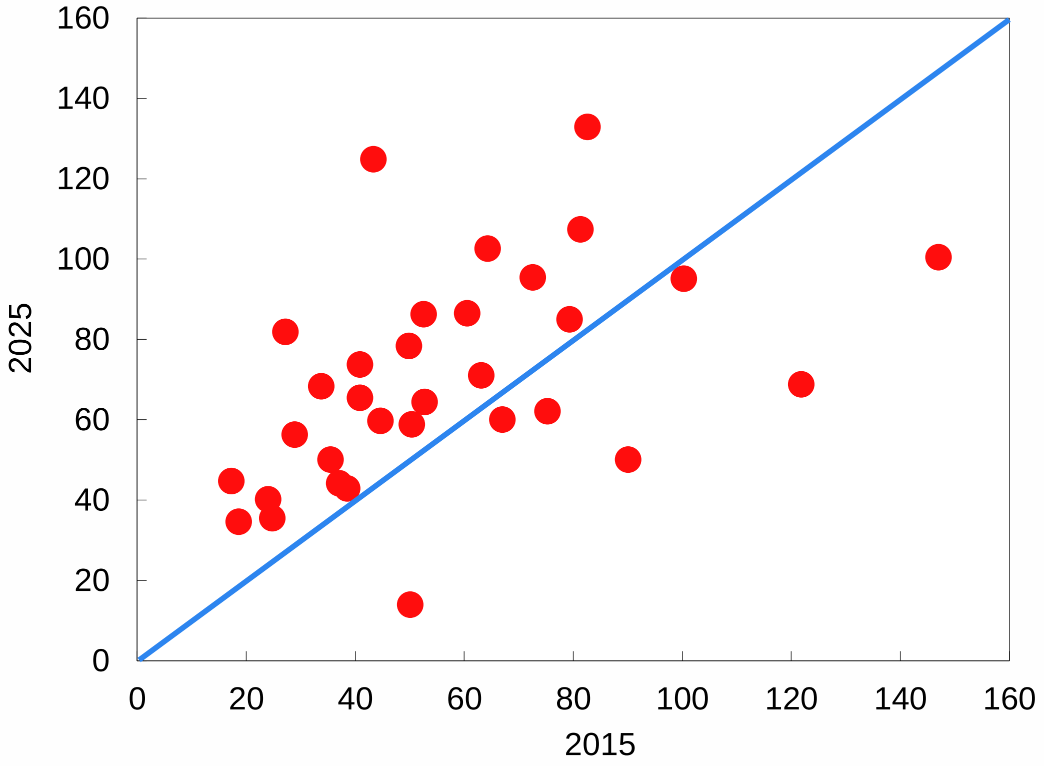
A decade lost? Activity has stagnated and poverty is on the rise, while rising public debt will limit policy space

LAC: Real GDP per Capita
(Thousands of PPP 2011 international dollars)



Source: IMF, World Economic Outlook database.

LAC: Public Debt, 2015 vs. 2025
(Percent of GDP)



Source: IMF, World Economic Outlook database.

Emergency and Precautionary Arrangements
(As of June 15, 2020)

	Number	Amount (US$ mln)	Caribbean	CAPDR	Other
Total	**20**	**50,774**	**8**	**6**	**6**
RFI	10	4667	2	5	3
RCF	5	193	5	0	0
Augmentation/Rephasing	2	314	1	1	0
FCL	3	45,600	0	0	3

Note: Two of the FCL cases (Chile and Peru) are new approvals, while Colombia FCL is a renewal of an existing arrangement.

Paraguay got an RFI

Instrument: Rapid Financing Instrument (RFI).

Amount: SDR 201.4 million (US$ 274 million, 100 percent of quota)

Approval date: April 21, 2020

Usage: to help meet the urgent balance of payment needs from the COVID-19 pandemic, preserve resources for COVID-19-related health expenditure and social safety net spending, and catalyze multilateral donor support.

Peru and Chile got a new FCL; Colombia’s FCL was renewed

Peru: 2-year Flexible Credit Line (FCL) of SDR 8.007 billion (US$11 billion, or 600 percent of Peru’s quota), approved on May 8, 2020

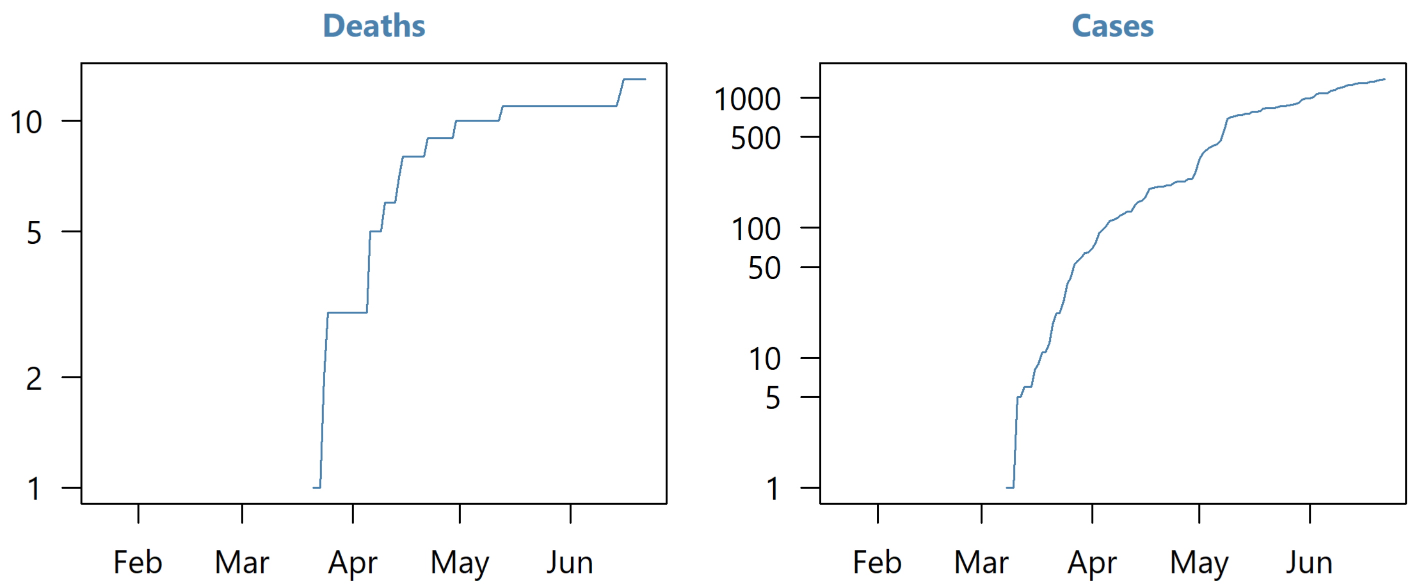
Chile: 2-year FCL of SDR 17.443 billion (US$ 23.93 billion, or 1,000 percent of Chile’s quota), approved on May 29, 2020

Colombia: 2-year FCL of SDR 7.8496 billion (US$10.8 billion, or 384 percent of Colombia’s quota), approved on May 1, 2020

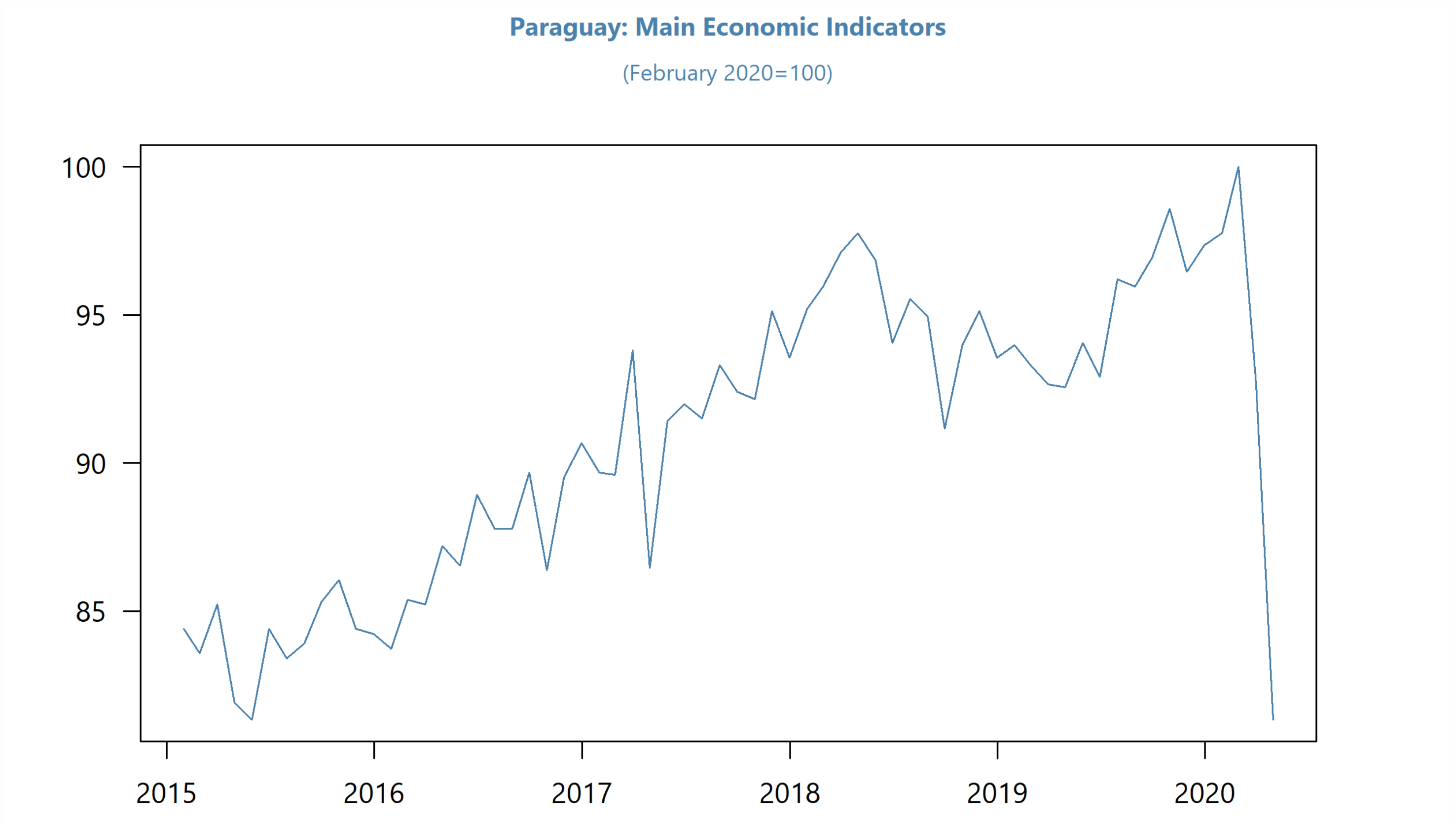
Paraguay

With an early and strict lockdown Paraguay has contained the number of deaths…

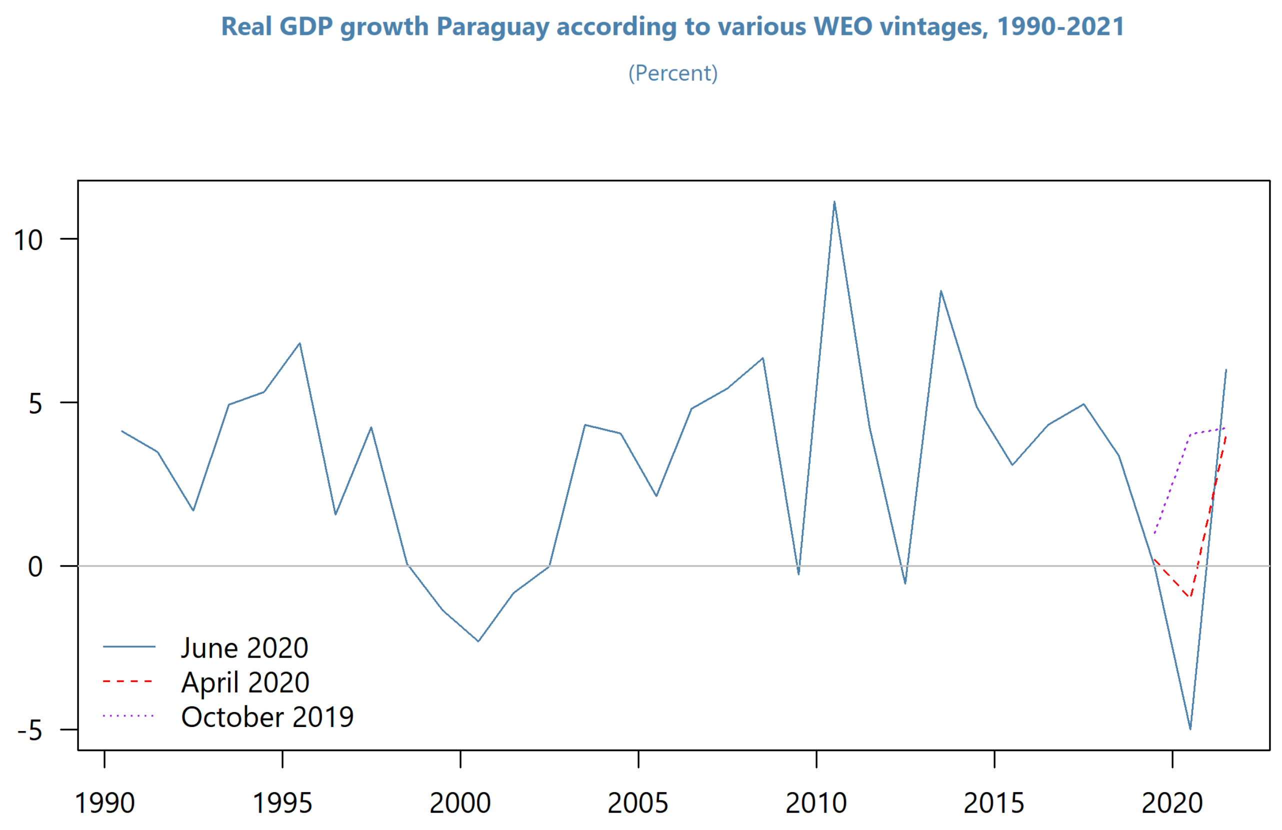
Paraguay: Covid-19 Deaths per Million People



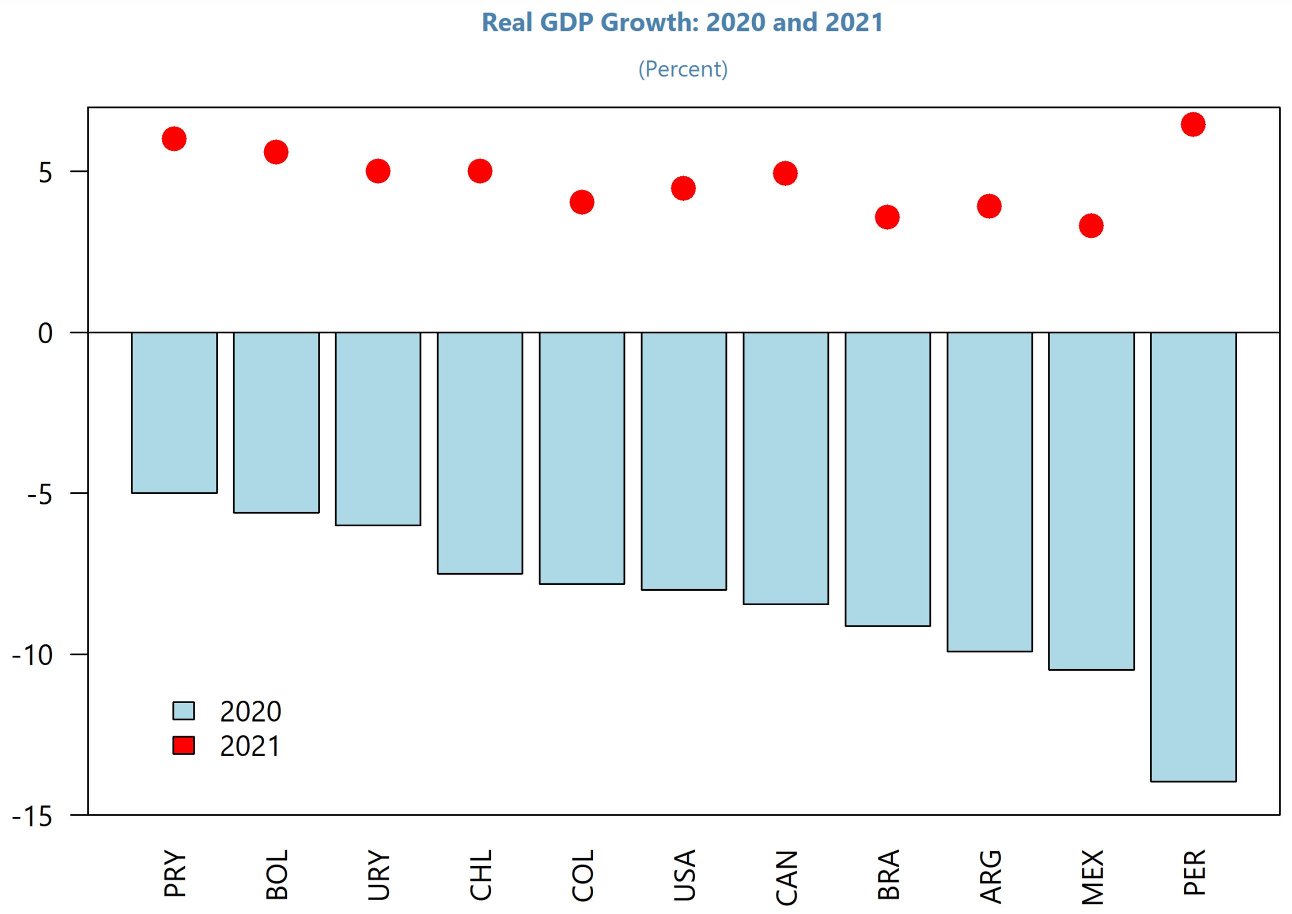
Lockdown has led to a steep drop in activity…



Even if the projected rebound in the second half materializes, GDP in 2020 will decline by 5 percent

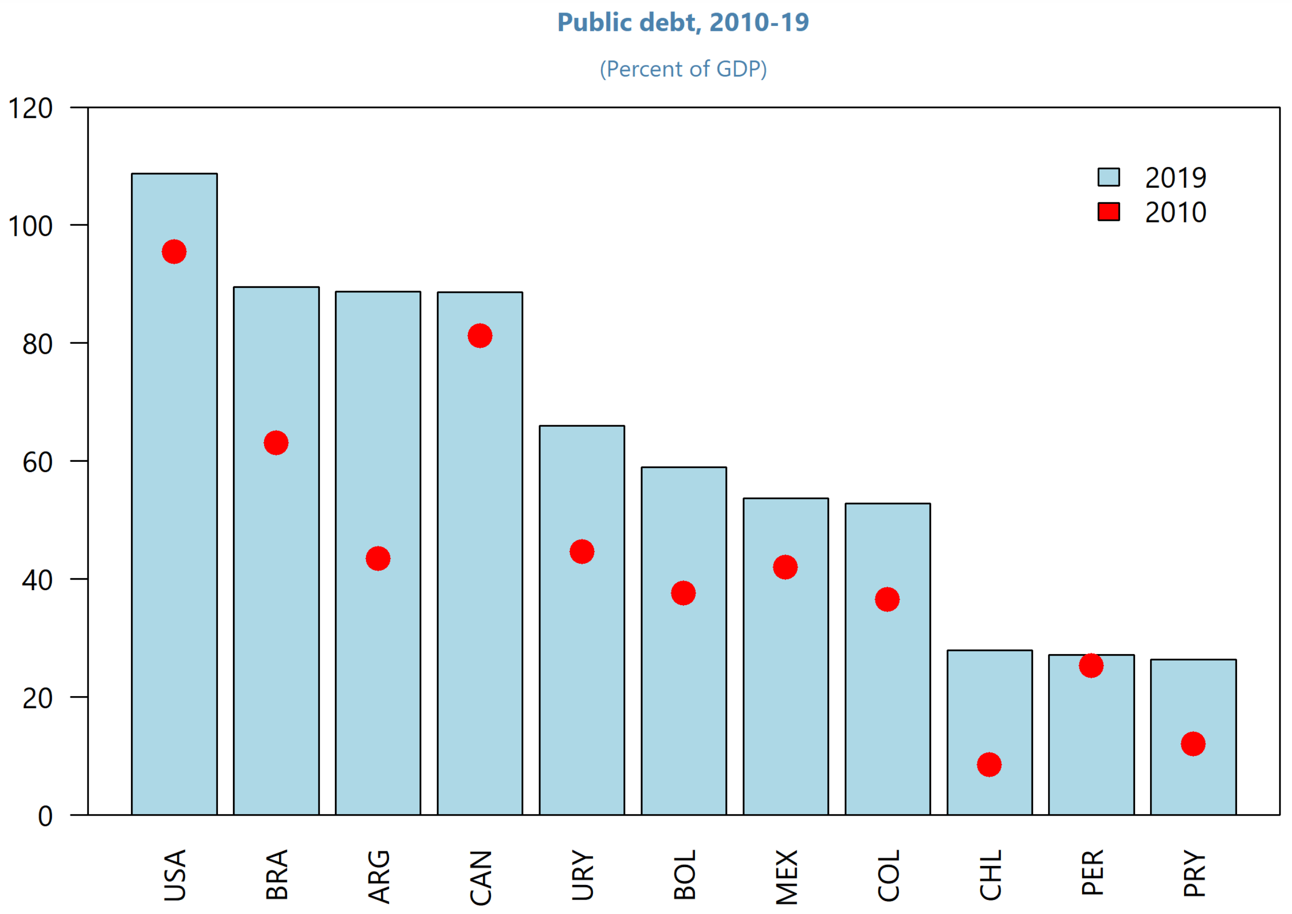


This is a deep recession, but not as deep in other countries in the region

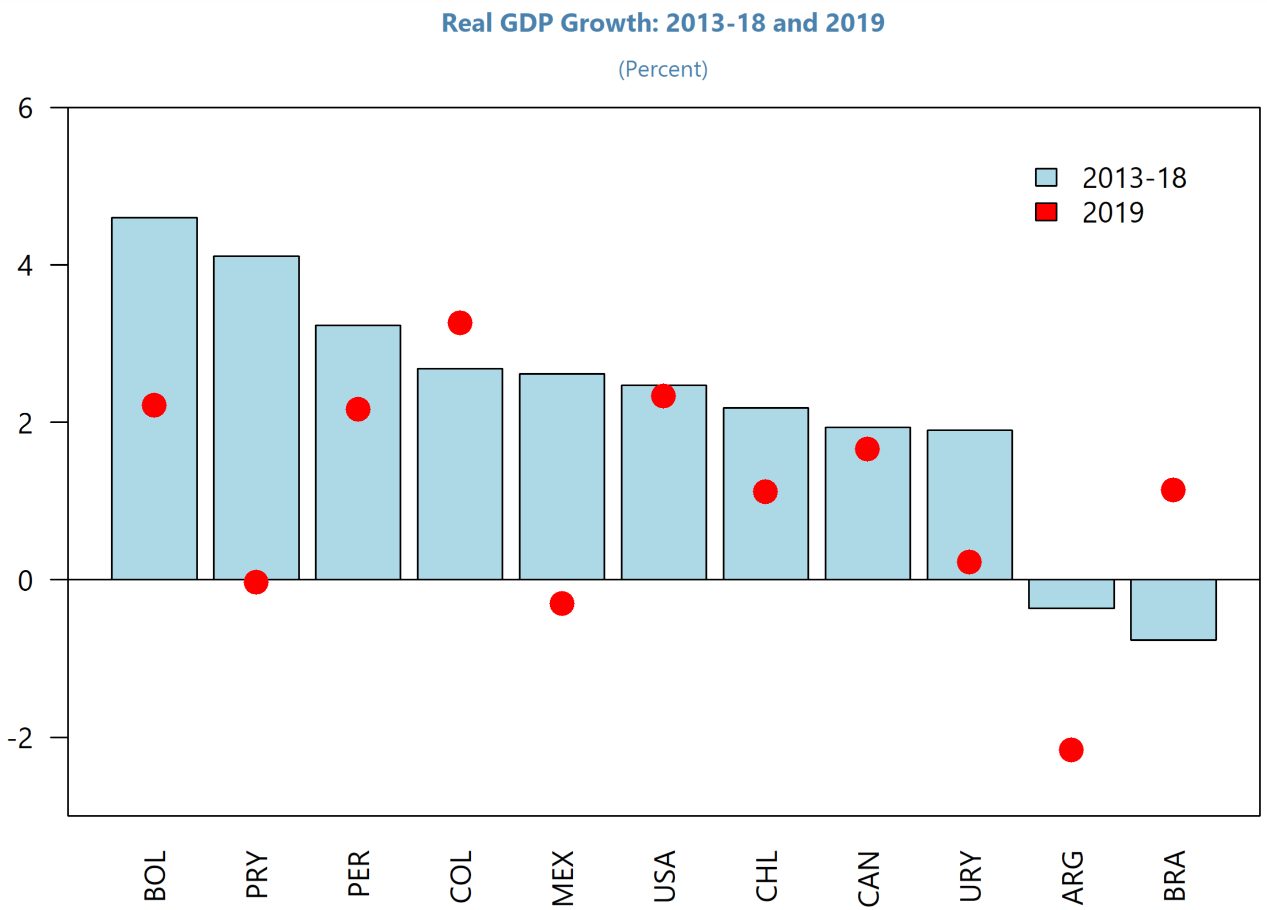


Macro policies

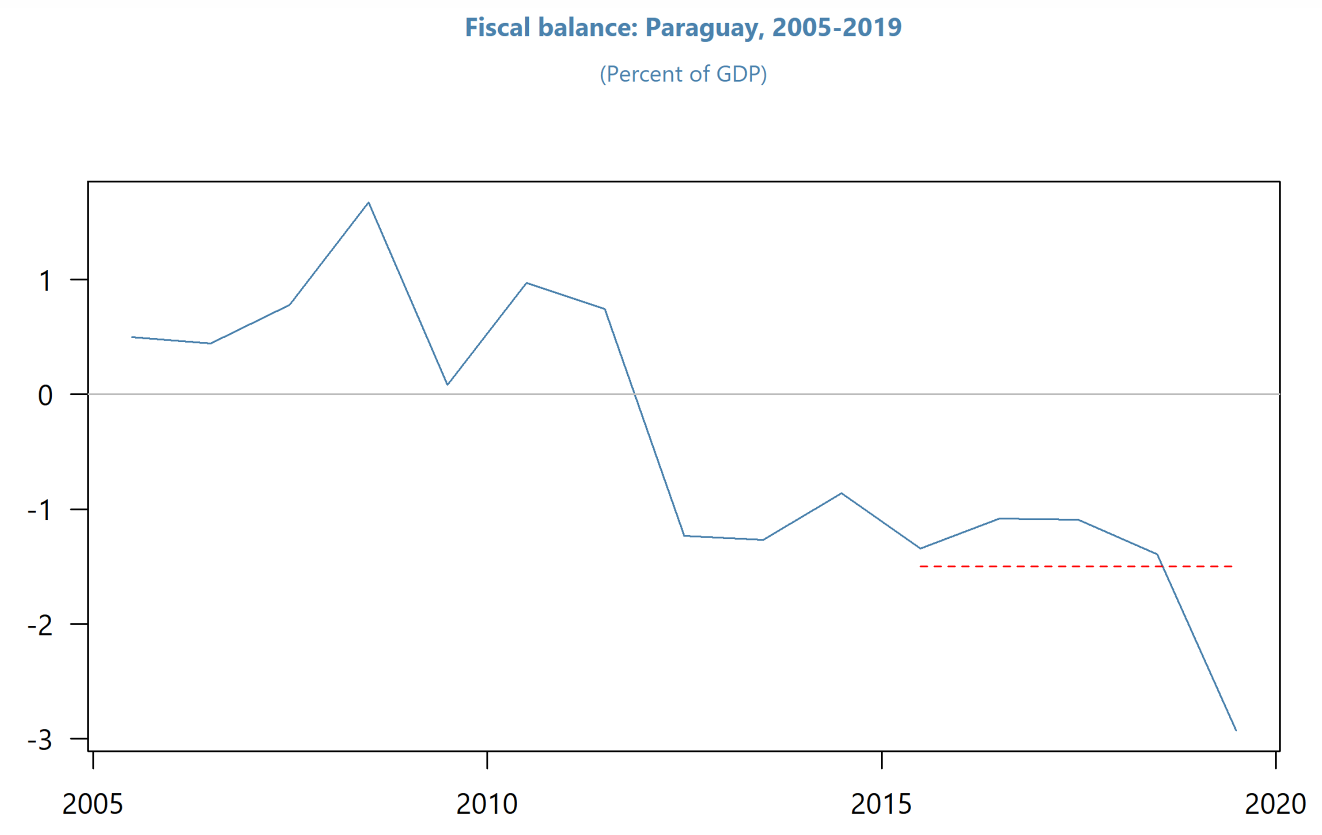
Paruaguay entered the crisis with sound fundamentals, including low public debt



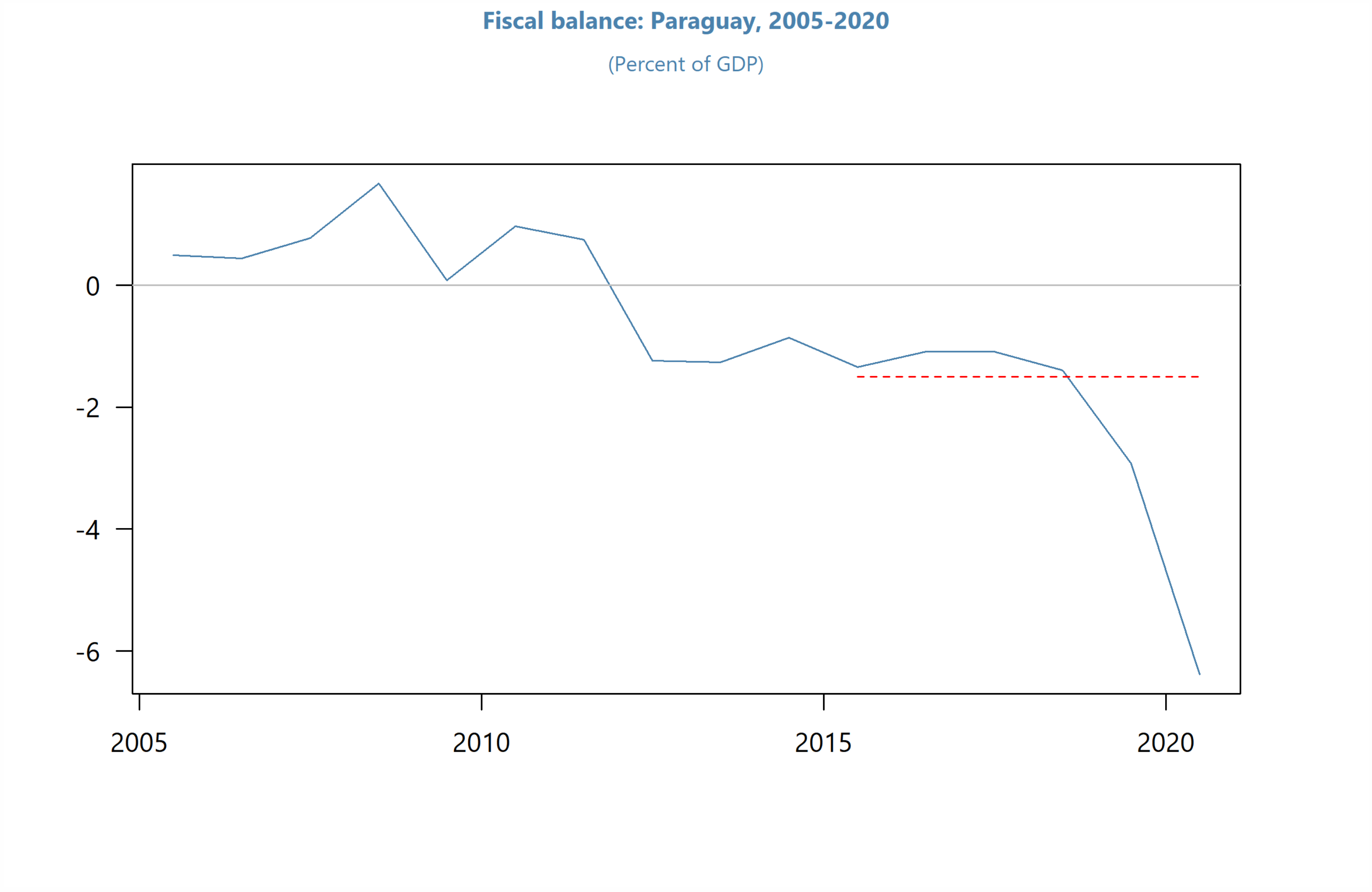
Paraguay's economy, which had been growing rapidly between 2003 and 2018, came to a standstill in 2019 (the result of bad weather and the crisis in Argentina)



The escape clause was called to allow a fiscal deficit higher than the FRL ceiling



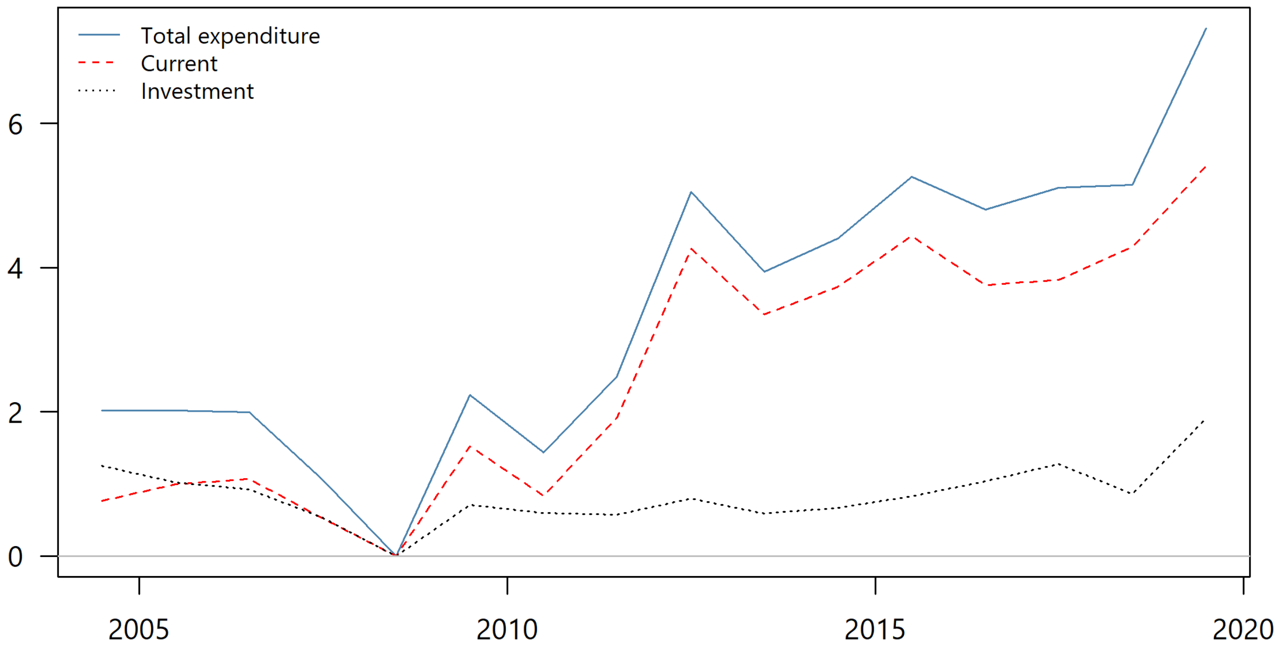
This year, the deficit was going to be reduced, but with the new shock, the deficit will instead increase further



To bring the deficit back to the ceiling, growth of current expenditure will need to be reduced…

Paraguay: change in central government expenditure to GDP ratio, 2004-19

(Change from 2008; in percentage points of GDP)

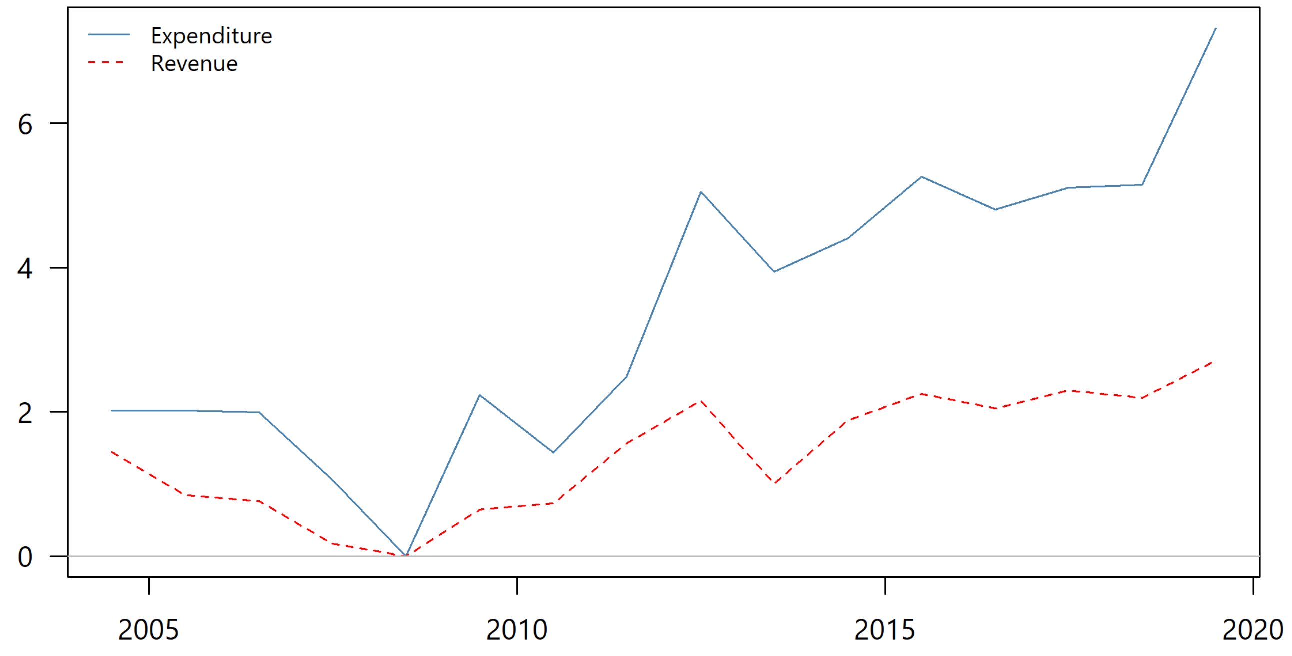


Source: CEIC

Revenue, which has not kept pace with increase in expenditure, will need to rise too.

Paraguay: change in central government revenue and expenditure to GDP ratio

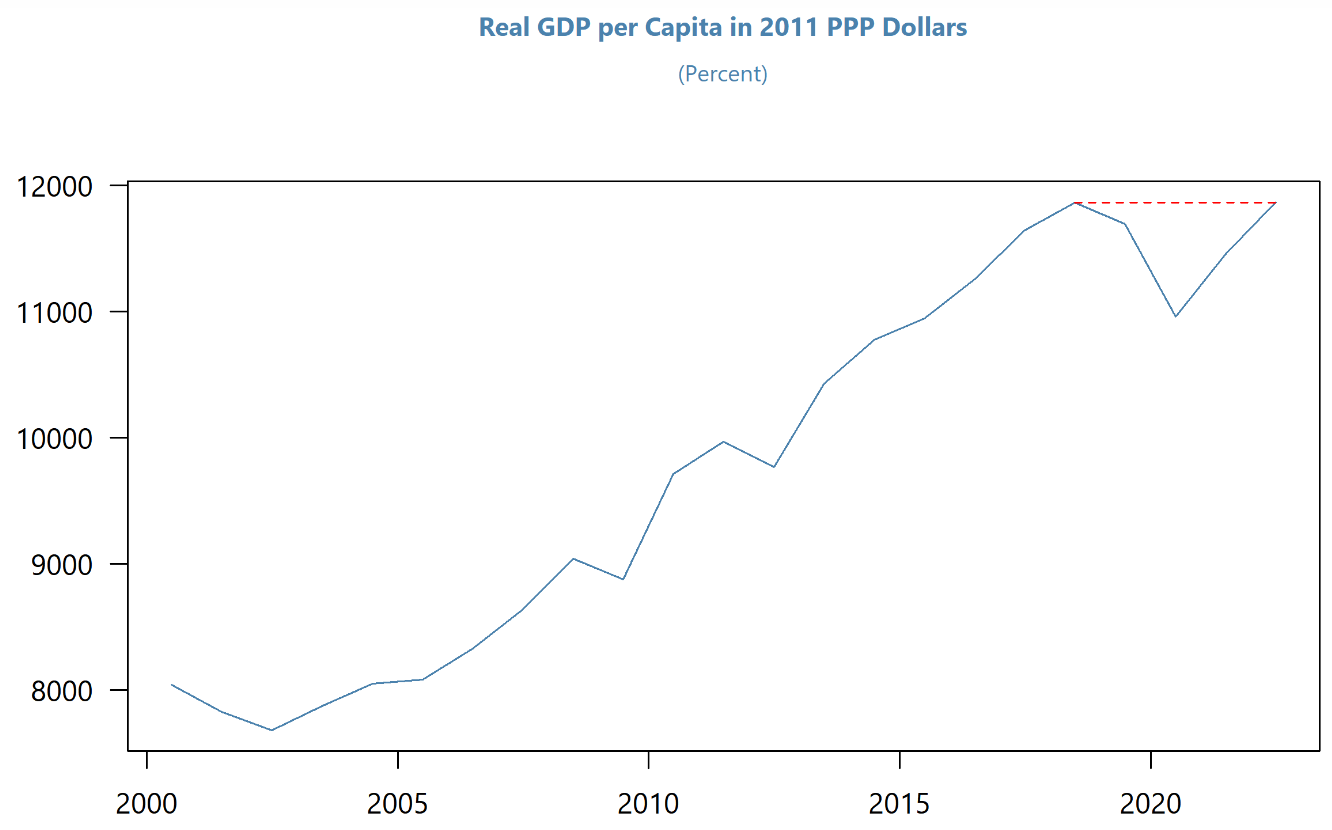
(Change from 2008, in percentage points of GDP)



Source: CEIC

Crisis legacies and Future Growth

2018 GDP per capita level will only be regained in 2022



Rekindling growth is not just *cyclical* issue

Rapid growth in the past decade and a half has been result of

- Sound macro-economic policies, including low deficits and debt, flexible exchange rate, and low inflation
- Agricultural commodity price boom, which has spilled over to rest of economy

It will be important to keep sound macro policies

Agricultural commodity price boom has run its course

- Need diversification

Agricultural commodity price boom has run its course—diversification of economy needed

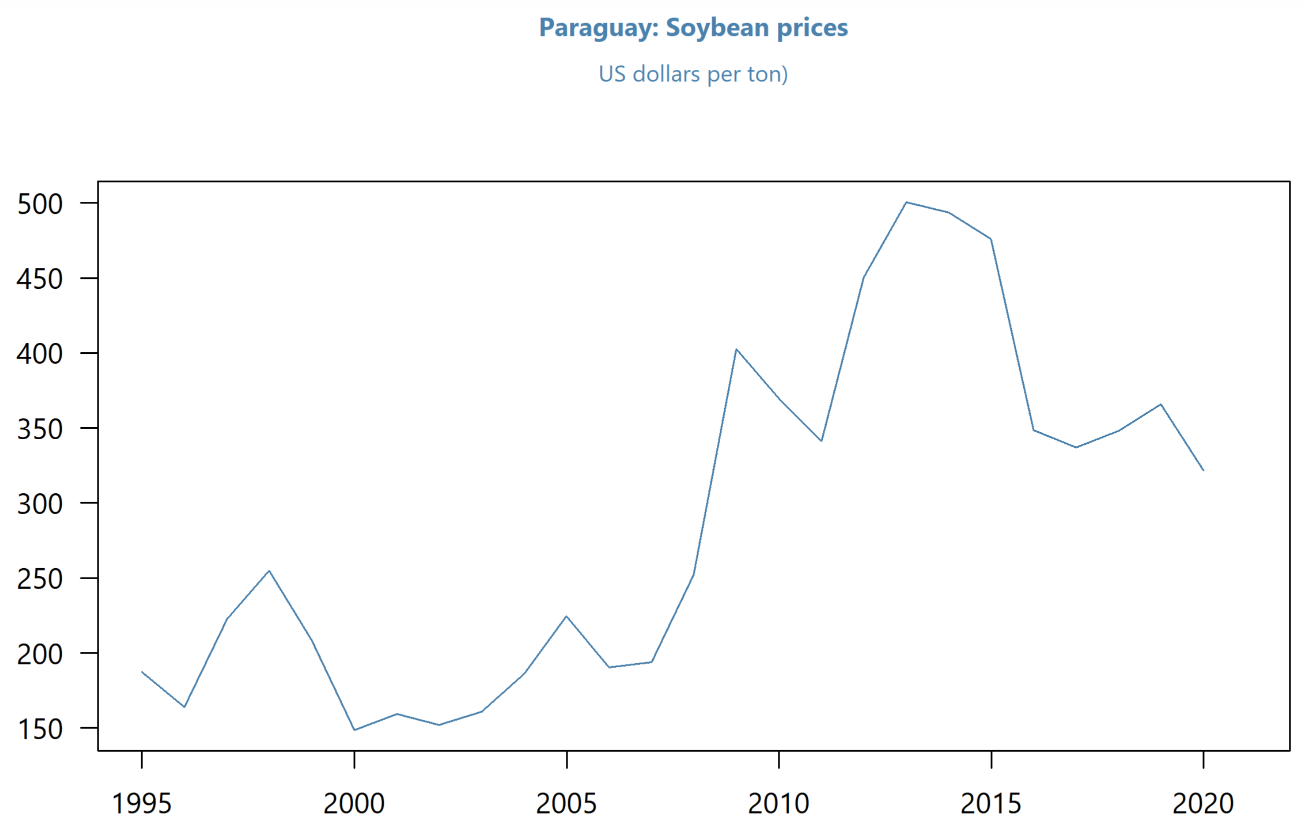
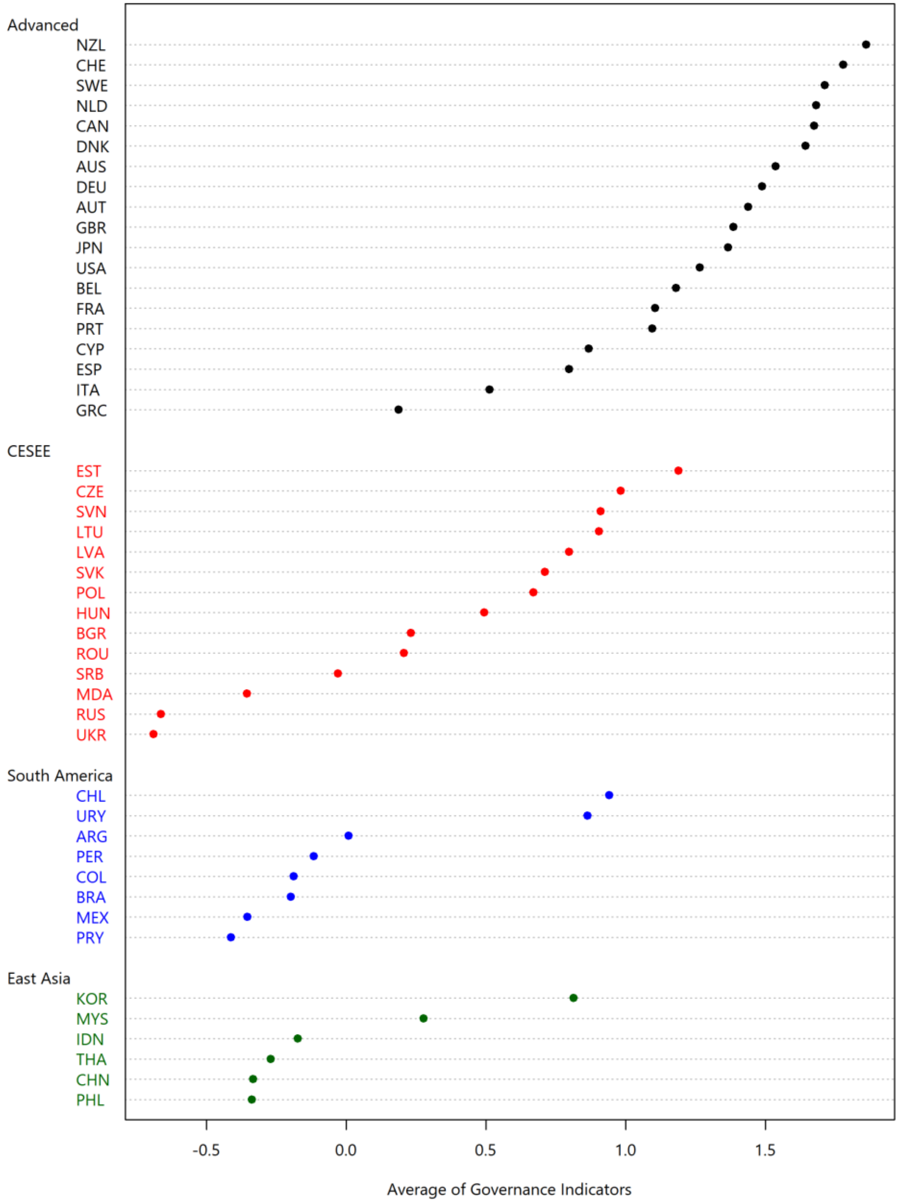


Figure 5.1. World Bank Governance Indicators
(Grouped by region)



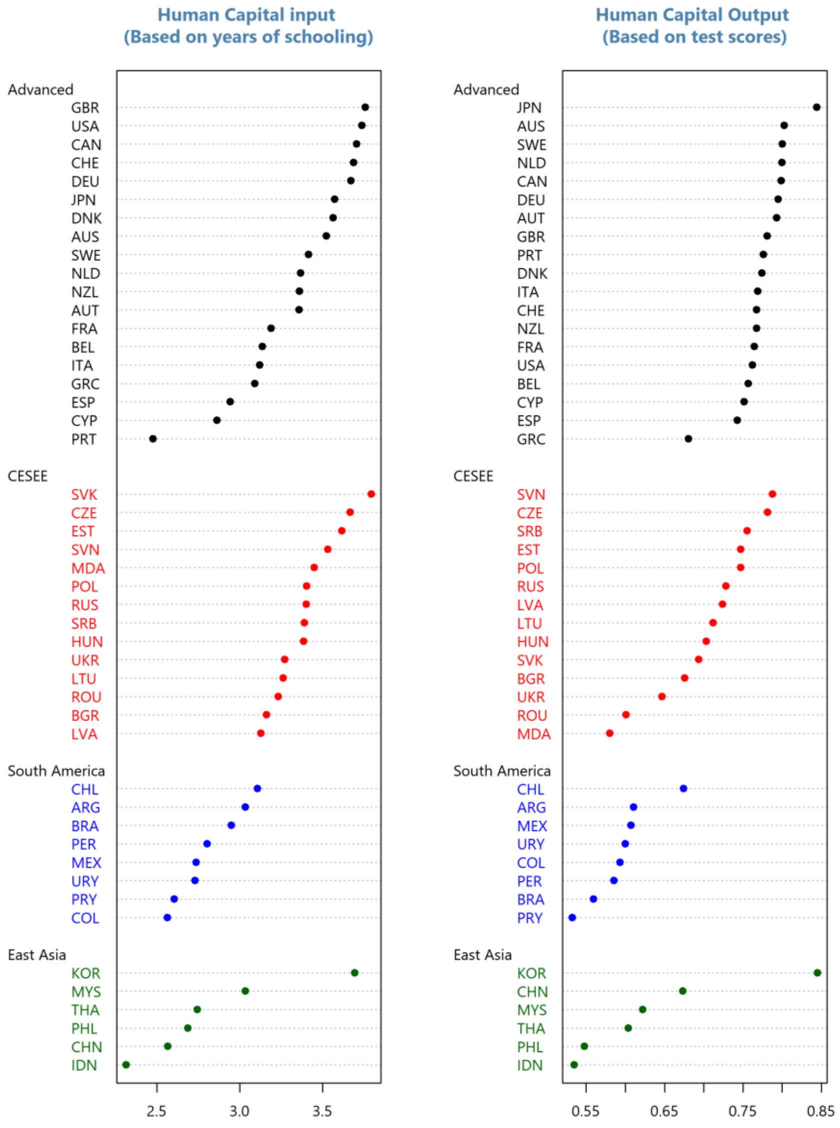
Source: World bank governance indicators, 2019

To boost investment in other sectors, structural problems need to be addressed

Paraguay scores poorly on governance indicators, not just compared with advanced countries, but also with other countries in the region

The same applies for economic competitiveness indicators

Figure 5.7. Human Capital, 2017



Source: Penn World Tables 9.1 and World Bank- Human capital index

Human capital scores are low as well

They are poor both in term of

- Human capital *input* (years of schooling)
- Human capital *output* (how well kids do in international tests

Structural reforms needed

State needs to become more effective and efficient

- Raise the quality of public spending by better and more transparent procurement systems.
- Improve the efficiency of the state by a civil service reform.
- Reform the health and education systems to achieve better outcomes.

Financial sector needs to be upgraded

- Establish financial supervision of pension funds

A recent IMF mission looked into governance and corruption in Paraguay

They found that public sector internal control systems are weak and fragmented and need to be strengthened by legal and administrative reform.

They also identified weaknesses in customs administration, financial supervision, and effective control of money laundering.

Transparency of public sector operations has improved, but more needs to be done.

Paraguay’s new Economic Recovery Plan (ERP) will help address both cyclical and structural issues:

The ERP is comprehensive and a balanced mix of measures to address both cyclical and structural issues:

- It will mitigate the economic recession by focusing on employment-generating public investment (this is also good for medium-term growth).
- It aims to stimulate financing for small and informal enterprises that are currently suffering most and have no access to the traditional credit system.
- It will stabilize income and consumption by extending social transfers to poor households (this will also improve health and education outcomes, once schools are open again).
- It proposes important structural reforms (civil service reform; fiscal responsibility law; state reform; public procurement systems) that will make the public sector more efficient.

THANK YOU