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Economic growth is expected to slow markedly throughout Latin America this year as a result of the Asian financial crisis, although some countries will suffer much more than others, particularly Argentina, Brazil, Chile, and Peru. Nevertheless, most economies are expected to rebound fairly quickly, given that local governments have maintained strict fiscal and monetary discipline to weather the Asian storm, and foreign investors remain confident in the region's basic economic health.

Since 1995, when many Latin American nations slipped into crisis as a result of the Mexican financial debacle, the regional economy has steadily regained its strength. Mexico's decision to devalue its currency in late 1994 resulted in widespread capital flight from the region, sending Latin American stock markets into a tailspin as foreign investors began frantically selling their holdings in fear that the crisis would spread to other countries. That, in turn, forced most South American governments to impose harsh austerity programs to stabilize their economies and restore investor confidence (see NotiSur, 01/12/95, 02/02/95, 02/23/95, 03/16/95, 05/25/95).

The stabilization programs paved the way for steady economic recovery. In 1995, average regional growth had plummeted to 0.2%, down from 5% growth the year before. But in 1996, the economy rebounded with a 3.5% growth rate, matching the average rate of expansion attained in the 1990-1994 period, prior to the Mexican crisis. And 1997 saw the region's best economic performance in nearly 25 years.

Hefty exports, foreign investment fuel robust growth in 1997

"Our preliminary estimates for 1997 show that this was one of the best years since the beginning of the 1970s, measured by high growth rates combined with low inflation," said Gert Rosenthal, head of the UN's Economic Commission for Latin America and the Caribbean (ECLAC), which released its preliminary report on the region in late December. The regional economy grew by an average of 5.5% in 1997, while per capital GDP increased by 3.6%, reaching a level 13% higher than at the beginning of the decade. Argentina and Mexico reported particularly robust growth last year of 8% and 7%, respectively, a complete reversal from 1995, when those economies contracted by 2.5% and 7%, respectively.

Six other countries including Chile, Peru, and Venezuela reported growth rates above 5%, and most other nations achieved moderate but healthy growth of between 3% and 4.5%. No countries experienced negative growth last year. In addition, average regional inflation fell to 11% last year its lowest level in 50 years down from 335% in 1994. And, 13 countries posted single-digit inflation, while Argentina reported a 0.1% drop in prices during the year.

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Last year's growth was largely fueled by a hefty jump in export income of about 12%, plus a huge rise in foreign investment. The region received an unprecedented US$73.5 billion in foreign capital in 1997, up from an average of about US$50 billion per year in the 1990-1994 period, and just US$25 billion in 1995, when the Mexican crisis scared off investors. In September, the UN Conference on Trade and Development (UNCTAD) reported that Latin America and the Caribbean now receive more than 30% of the annual foreign investment in developing countries. Moreover, in sharp contrast to previous years when most investments were in stocks and bonds, last year direct foreign investment accounted for about US$44 billion, or 60% of the capital that entered the region.

And, although privatization of state enterprises still attracted a significant share of direct investment last year, the majority was in new productive endeavors. Among other sectors, foreign automotive manufacturers are making significant investment in the region, especially in Mexico, Argentina, and Brazil. Annual demand for motor vehicles in the Southern Cone Common Market (MERCOSUR) is expected to grow to about 2.5 million units by the year 2000, encouraging most large manufacturers to set up factories in the Southern Cone. Since 1995, Chrysler has invested about US$1 billion in South America. General Motors has either already invested, or plans to invest before the year 2000, about US$1.1 billion in Argentina. And, in November, Ford announced that its investments in Mexico would total more than US$2 billion in the 1997-2000 period (see SourceMex, 12/10/97).

Argentina, Brazil, Chile, Peru suffer most from Asian crisis

Despite last year's glowing performance, the Asian financial crisis is expected to take a heavy toll on some of the large economies this year, dragging regional growth down in 1998. Although estimates among private financial firms vary widely, the International Monetary Fund (IMF) predicts that average regional growth will slow by about two percentage points this year, to between 3% and 3.5%. Some private firms, such as Goldman Sachs and J.P. Morgan, say growth will slow even more, to about 2.5%.

The "dragon effect" will vary widely from country to country, since some nations are more susceptible to fallout from Asia than others. Brazil is by far the weakest link in the chain because it has been slower to carry out needed stabilization measures than most other large economies in the region. When stock markets around the world plummeted in late October, Brazil took a particularly heavy beating because investors feared that a currency devaluation was imminent. In a two-week period, the Sao Paulo Stock Market, Latin America's largest, fell 30%, forcing the government to slam the breaks on the economy in defense of the real. The government doubled interest rates to 43% and imposed stringent austerity measures to slash state spending by about US$20 billion (see NotiSur, 11/14/97 and 11/21/97).

Nevertheless, speculative attacks on local currency have continued, since many investors believe the real is overvalued by between 15% and 20%. Currently, the Central Bank only allows monthly mini-devaluations of about 0.6%, or 7.5% per year. As a result, the government will be forced to keep interest rates high, which will sharply cut economic growth this year. At best, the economy is expected to expand by about 0.5% in 1998, compared with 3.5% last year. While the downturn in Brazil will affect growth in the entire region, repercussions will be greatest in Argentina. Argentina sells about one-third of its exports to its neighbor, making Brazil its most important trading partner. In November, automobile production in Argentina plunged by 18.4% because of declining demand

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in Brazil, and the major producers have announced thousands of layoffs at plants around the country.

Sales to Brazil of oil, cereal, and food have dropped markedly as well. At the same time, a huge increase in imports from Asian countries, where exports have become much cheaper because of the devaluations, is making it difficult for domestic manufacturers to compete. In July, for example, Argentina imported 340,000 pairs of shoes from Asia, but in August the number climbed to 590,000, and by October and November, to more than 2 million per month. All told, growth in Argentina is expected to slow to about 4% this year. Chile and Peru, meanwhile, are affected by the Asian crisis because their economies are more closely tied to Asia than other Latin American countries. Chile sells about one- third of its exports to Asian nations, while Peru sells about one-fifth of its goods to that region, making them particularly vulnerable to the drop in Asian demand for imports.

Concern about the dragon effect on Chile contributed to a 10% drop in the stock market in January, forcing the Chilean government to raise interest rates by half a point (see NotiSur, 01/16/98). Investor confidence remains strong, buffering "dragon effect" While the Asian crisis poses a heavy burden for some countries, the resilience of other economies in the region particularly Mexico will somewhat offset the economic slowdown. Mexico's economy is by far the best prepared to weather fallout from Asia because of reforms enacted after the 1995 peso crisis. "Mexico has managed its economic policy especially well," said a report in late January by Frankfurt-based Deutsche Morgan Grenfell. "Mexico, which in 1995 was at the center of the 'tequila crisis,' is now in a much better position than most other countries in Latin America to withstand the crisis in Asia."

Like other nations in the region, Mexico will be hard pressed to compete with cheaper Asian imports. In addition, the recent fall in world oil prices will also hurt the economy this year (see SourceMex, 01/21/98). But the GDP is only expected to decline slightly from its robust 7% expansion in 1997, and growth in 1998 will reach about 5%. Moreover, despite the regional slowdown, confidence among foreign investors remains very strong, since most Latin American countries have maintained the tight fiscal and monetary policies they adopted in the aftermath of the Mexican crisis.

Consequently, foreign capital will likely continue to flood the region, aided by extremely favorable ratings from most financial firms. In late January, both Bank of America and Dresdner Kleinwort Benson strongly advised their clients to keep investing in Latin America to offset the losses in Asia and other markets. And, a survey by Price Waterhouse, published in early February, found that among the world's largest corporations, Latin America is now the preferred destination for investments in the emerging markets. "The Latins have just gone through the crisis that the Asians are starting to go through now," said Jose Luis Daza, head of emerging market research at J.P. Morgan. "Asia is not a compelling buy at these valuations, and Latin America is, because there is a fundamental positive trend in terms of credit improvement."

Added Robert Pelosky, senior Latin America research strategist with Morgan Stanley Dean Witter, "We think the silver lining in all of this is the investment in Latin America. That region has not really been given, in our view, the credit it deserves in restructuring its economy, both at the corporate and government levels." [Sources: Journal of Commerce, 11/05/97; Spanish news service EFE,

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10/29/97, 01/10/98, 01/11/98, 01/19/98; Associated Press, 12/17/97, 01/08/98, 01/19/98; Diario Gestion (Peru), 01/23/98; Reuter, 12/14/97, 12/17/97, 12/18/97, 01/28/98, 01/29/98, 02/01/98; Notimex, 12/15/97, 12/18/97, 01/09/98, 01/12/98, 01/13/98, 01/16/98, 01/19/98, 01/20/98, 01/23/98, 01/29/98, 02/02/98; Inter Press Service, 10/08/97, 12/19/97, 12/21/97, 01/01- 03/98, 01/12/98, 01/14/98, 02/08/98; Chinese news service Xinhua, 02/09/98]

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