Argentina

March 27th 2020

A pandemic-induced recession bears down on Latin America

- **The coronavirus (Covid-19) pandemic is bringing a sudden halt to economic activity in Latin America and the Caribbean (LAC) and across the world. The disruption is generating a global downturn that will, in the view of The Economist Intelligence Unit, prove even steeper than the global financial crisis of 2008-09.**
- **We are in the process of revising down our forecasts to account for our increasingly pessimistic view of the global economy. We now expect a contraction in global GDP of 2.1% in 2020. Downward revisions to our forecasts for Latin America and the Caribbean mean that the region will again be one of the worst performers in the global economy, with regional average GDP contracting by 4.8% this year.**
- **Bearing in mind that there is an unusually high degree of uncertainty attached to these forecasts, this article is intended not just to set out our forecasts, but also to highlight some of the key indicators that our analysts are tracking. We believe that these indicators will be crucial in determining the severity of the near-term downturn—as well as the strength of the post-Covid recovery—for major LAC economies.**

Although there are a huge number of factors that will ultimately determine the impact of the coronavirus on Latin America's economic performance this year, we are (broadly speaking) monitoring three main areas: healthcare-related factors including health system capacity and government containment policy; the economic policy response including fiscal and monetary policy; and structural factors that will either help or hinder economic recovery.

Some basic trends (laid out in the heat map below) are already evident. First, Latin American economies are extremely vulnerable, relying heavily on the external sector, commodities, services and a large—and largely unprotected— informal sector. Second, the containment response has, on the whole, been rapid and robust, reflecting health system weaknesses that would amplify the effects of an unchecked escalation of the virus. Third, the economic policy response, although not quite "whatever it takes", is likely in many cases—but not universally—to be firm, notwithstanding already high debt burdens and the likelihood of a long-term debt hangover for the region that could further complicate the longer-term prospects for LAC economies.

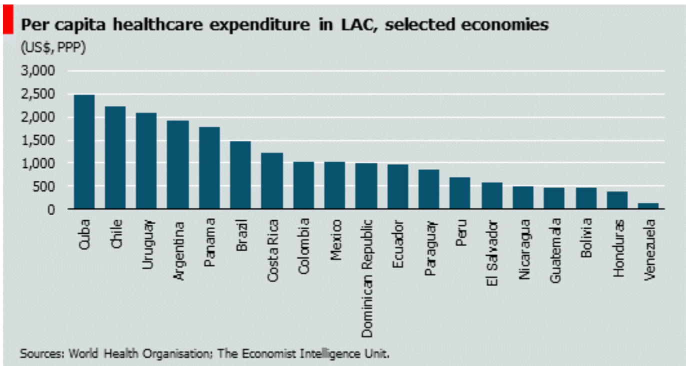
Coronavirus Heat Map

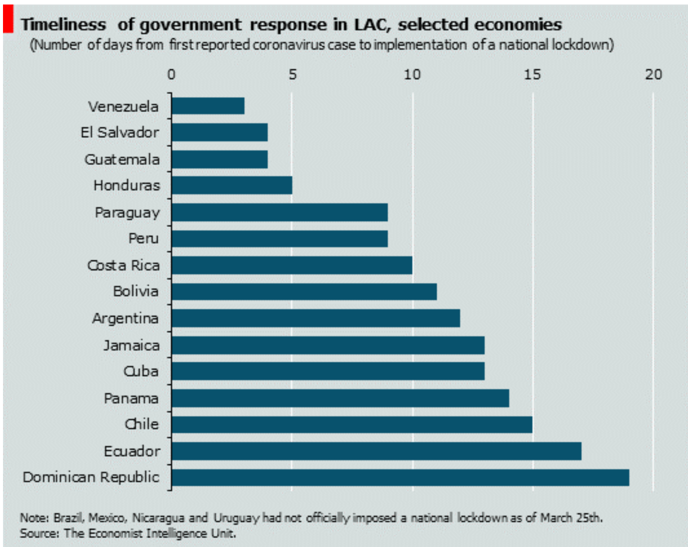
Country	Containment response	Health security	Disruption to domestic activity	Commodity dependence	Informality	Forecast fiscal stimulus	Public indebtedness
Argentina	2	3	4	3	4	2	5
Bolivia	2	4	3	5	5	5	4
Brazil	4	3	5	3	3	3	5
Chile	1	3	4	5	2	1	2
Colombia	2	4	4	4	4	3	4
Costa Rica	2	4	5	3	3	4	5
Cuba	2	4	5	1	1	4	4
Dominican Republic	2	4	4	3	4	4	4
Ecuador	2	4	4	4	5	5	4
El Salvador	2	4	5	3	5	2	5
Guatemala	2	4	5	4	5	5	3
Honduras	2	5	4	4	5	5	4
Jamaica	2	5	4	4	3	2	5
Mexico	4	3	5	3	5	2	4
Nicaragua	5	4	4	5	5	5	4
Panama	3	4	5	3	4	4	4
Paraguay	2	4	3	5	5	4	2
Peru	1	4	4	4	4	2	2
Uruguay	3	4	5	4	2	3	5
Venezuela	3	5	4	5	5	5	5

Containment response: A qualitative assessment by EIU analysts of the strictness of social distancing protocols, enforcement of border controls and measures taken to increase the testing rate.
Health security: Considers countries' capabilities to respond to epidemics and pandemics, as measured by the Global Health Security Index.
Disruption to domestic activity: Uses the contribution of services to GDP to assess the extent to which quarantine measures affect aggregate output.
Informality: Uses proportion of informal employment to assess labour market vulnerability to economic shocks.
Forecast fiscal stimulus: Considers the magnitude of fiscal stimulus, as a percentage of GDP, deployed to minimise economic damage.
Public indebtedness: Uses the public debt/GDP ratio as a proxy for available fiscal space.
Commodity dependence: Uses the commodity exports/GDP ratio to assess countries' exposure to external demand shocks.

Healthcare considerations: rapid response

Governments across the region, with a few notable exceptions, have been quick to respond to the coronavirus outbreak. For the median LAC country, there have been just nine days between the confirmation of the first coronavirus case locally and the complete lockdown of the country. Some of the poorest countries—including El Salvador, Guatemala, Honduras and Venezuela—were among the quickest to respond, most likely in recognition of the extremely limited capacity of their healthcare systems to deal with a protracted public health crisis. By contrast, governments in Mexico and Brazil, countries which boast significantly better healthcare systems, have been dragging their feet on implementing even the most basic non-pharmaceutical interventions.





In countries where social distancing measures have not been implemented, the federal government appears to have calculated that the near-term economic cost of shutting down non-essential activity in the country is extremely steep and should be avoided for as long as possible. In some cases, local governments have stepped in to make the difficult decisions. For instance, in late March, the governors of two of Brazil's most populous states, São Paulo and Rio de Janeiro, unilaterally imposed state-wide lockdowns. Similarly, in Mexico, mayors and governors across the country have been imposing restrictions on economic activity and mandating quarantine periods. However, these ad hoc measures will not act as a substitute for centralised policymaking at the national level, leaving vast swathes of the population vulnerable to the pandemic.

Social distancing is just the first step

It is all but a foregone conclusion that the implementation of strict social isolation measures will generate a sharp decline in activity throughout the region in the near term, with LAC economies gearing up for a deep recession in the first half of the year. This contraction will be unavoidable, given that services alone account for three-fifths of the region's GDP. However, in our view (and in that of the majority of regional policymakers), governments will necessarily have to sacrifice GDP growth in the near term if they are to avert a much more calamitous public health—and economic—crisis later on.

Some countries, such as Argentina, Colombia, Paraguay and Peru, have already indicated that national quarantine measures will last until mid-April or beyond; others are likely to follow suit in the coming days. The severity and duration of social distancing measures will ultimately depend on the steps taken by individual countries to increase testing and to trace and isolate infected individuals. Within LAC, Peru has been at the forefront of pursuing an aggressive testing strategy. The Peruvian administration has purchased 1.6m coronavirus test kits from China, with the first batch of 330,000 tests arriving on March 27th. A similar number of tests will be imported in each of the following weeks until the purchase order has been completed. At the same time the Peruvian government is working with the private sector to expand laboratory capacity significantly, with the aim of increasing the testing rate from about 500/day to 5,000/day in the coming weeks. Countries like Chile, Colombia and Ecuador are starting to take similar measures. However, in most of the region, the rate of testing remains inadequate, which could prolong ongoing quarantine periods and cause even more economic pain.

Policy stimulus: cushioning the blow

During this period of crisis, governments will need to use the levers of fiscal policy, not only to minimise economic damage during the sudden stop, but also to give momentum to a recovery when one eventually materialises. Stimulus measures are already being rolled out, to varying degrees, across the region. Plans to support consumption include direct cash transfers, increased social insurance benefits, higher pension payouts and payroll cost subsidies. On the investment side, governments have increased budgets for public works (particularly in health infrastructure), provided tax relief or tax deferrals for businesses and instituted low-cost credit lines to help small and medium-sized enterprises (SMEs) to stay afloat.

In theory, the magnitude of the stimulus in a given country should be proportional to its available fiscal space. We expect countries like Chile and Peru to implement substantial countercyclical policy, which will be financed easily, given their low debt levels and solid macroeconomic fundamentals. Nevertheless, many regional governments are expected to dole out sizeable fiscal packages despite having already high levels of indebtedness. In Argentina, for instance, a significant part of new public spending will be financed through money printing. In Brazil, Chile and Colombia, governments can be expected to borrow more, at higher interest rates, from domestic debt markets. However, many of the smaller economies in the region have shallow domestic capital markets, making their financing constraints more binding. For these countries, the government's ability to spend will depend significantly on the extent to which they can access increased bilateral and multilateral credit.

Latam's glaring structural weaknesses return to the spotlight

Even governments that pull out all the stops on the fiscal front have numerous challenges ahead. Many regional governments face large administrative costs, low technical capacity and high levels of corruption, all of which constrain the effectiveness of fiscal policy in stimulating demand. Implementing targeted fiscal policy is complicated even further by high levels of informality. In the median LAC country, over half of the workforce is informally employed, effectively leaving a large share of labourers outside the ambit of traditional safety nets.

Although some countries have policies in place aimed specifically at protecting informal workers, there are numerous implementation problems arising from a lack of financial inclusion. According to the World Bank's Global Financial Inclusion Database, only 39% of adults in LAC have an account with a formal financial institution. This is below the comparable level for Central Asia (45%), East Asia and the Pacific (55%), and developing economies more broadly (41%).

Another major structural vulnerability, which fiscal policy can do little to address, is the region's dependence on the external sector. Many LAC countries continue to rely on remittances from abroad to support private consumption. As the global economy struggles, this flow of income will decline considerably, further dampening economic prospects. Central America and the Caribbean will be the hardest hit, given that remittances account for close to 10% of GDP in these two sub-regions.

However, a more important channel of transmission from external demand to domestic activity will arguably be the dramatic fall in LAC exports. Having made only moderate progress on economic diversification in recent decades, many regional economies still rely heavily on commodity exports to drive economic growth. The region's commodity exporters are now faced with the double whammy of collapsing commodity prices (which reduce economic rents) and lower export volumes. Our forecasts continue to be underpinned by the assumption of a recovery in the global economy starting in the second half of 2020. However, risks to this assumption are high, and a protracted global recession would weigh all the more on the prospects for economic recovery in LAC.

Finally, going beyond structural economic deficiencies, we also recognise that a number of idiosyncratic factors are at play in countries across the region, which will undoubtedly influence how they emerge from 2020. Argentina finds itself in the middle of extremely difficult debt restructuring negotiations, and a disorderly default in the current context would be devastating for the economy. The situation in both Bolivia and Chile is marred by low levels of social cohesion and public trust in the aftermath of political crises in 2019, which will complicate governability and policy implementation. In Nicaragua and Venezuela, the ruling authoritarian regimes will struggle to keep their patronage systems afloat, raising the risk of a perfect storm of political and economic instability. Bearing all of this in mind, we view the balance of risks to our economic outlook for LAC as being heavily skewed to the downside.

The outlook

Looking (for example) at monthly data from China and the US, which give us an early indication of the impact of coronavirus containment measures, and at non-conventional high-frequency data, such as online restaurant bookings, it has become clear that the blow to the global economy will be much more severe than we thought just weeks ago. In this environment, sharp downward revisions to our forecasts are taking place. We now project a contraction in LAC GDP of 4.8%, a recession that will outpace that of all regions of the world apart from the euro zone.

Among Latin America's big six economies (LAC6), we are projecting contractions ranging from about 2.5% for Peru (which was growing moderately before the crisis, has space for fiscal stimulus and has enacted strong containment measures that will bolster confidence in government and support demand in the second half of 2020 and into 2021), to 6.7% for Argentina (which is confronting the coronavirus crisis amid already recessionary conditions and a brewing debt crisis). For these countries, and for the entire region, we recognise a high level of uncertainty surrounding our forecasts, but we will continue to take major considerations around health policy response, stimulus measures, structural conditions and starting points into account in our GDP forecasts. We believe that such considerations will be vital to determining which countries emerge most quickly—and most sustainably—from this year's recession.

Real GDP growth forecasts, 2020, Latin America and the Caribbean

	January 2020 forecast	Current forecast
Brazil	2.4	-5.5
Mexico	0.9	-6.3
Argentina	-1.4	-6.7
Colombia	3.0	-3.0
Chile	1.2	-4.8
Peru	3.2	-2.5
LAC	0.9	-4.8

Source: The Economist Intelligence Unit.