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FEATURED Q&A

Does Inflation Risk Threaten Recovery in Latin America?

Latin American countries may be facing serious inflation risks. Venezuelan refugees in Bogotá are pictured selling crafts made of virtually worthless Venezuelan currency. // Photo: Reg Natarajan via Creative Commons.

Q **A rising level of inflation "is no longer a risk but a tangible reality in a number of emerging markets," including the main economies of Latin America, Alberto Ramos, the head of Latin America economic research at Goldman Sachs, said in a note on April 13. Inflation "will likely get worse before it gets better," he added. What are the major factors putting pressure on inflation in Latin America? How much do rising consumer prices in the region threaten economic recovery from the Covid-19 pandemic-led recession? Which countries of the region will see the highest levels of inflation this year, and how much room do their central banks have to raise interest rates and take other corrective action?**

A **Alfredo Coutiño, director for Latin America at Moody's Analytics:** "Inflation is a serious risk in Latin America for the short and longer terms as it could threaten the region's economic recovery. The upward inflation trend is caused not only by transitory factors but also has a monetary root. A common component in the region's rising inflation is rising commodity prices, particularly prices of energy and food, which constitutes an imported inflation. A second set of components comes from domestic factors; on the one hand, there are still some supply shortages and disruptions caused by the virus outbreak and resurgence, which are more of a transitory nature. On the other hand, inflation has a monetary root caused by the prolonged money expansion that central banks have implemented. The region's monetary stance is either expansionary or ultra-expansionary, as evidenced by the significant excess liquidity still circulating in economies. In most

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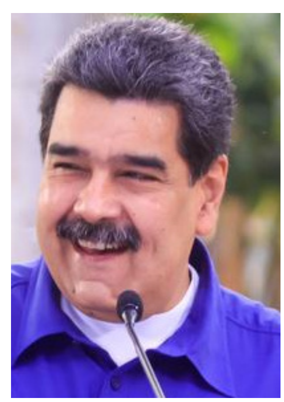

Maduro // File Photo: @NicolasMaduro via Twitter.

POLITICAL NEWS

Leaders Call for More Equitable Vaccine Access at Summit

Representatives of 22 Latin American and European countries gathered on Wednesday for the mostly virtual Iberoamerican Summit, at which they called for more equitable access to Covid-19 vaccines, the Associated Press reported. At the summit, hosted by the tiny nation of Andorra, leaders also called for flexible funding for their countries' economic recovery from the pandemic. At the gathering, Bolivian President Luis Arce called for a suspension on vaccine and drug patents and a reordering of "international standards that protect the hegemonic pharmaceutical industry at the expense of billions of human beings," the AP reported. Argentine President Alberto Fernández said patents should be protected, but he also expressed support for granting temporary licenses to increase the production of vaccines. At the summit, U.N. Secretary General António Guterres expressed alarm about the unequal distribution of vaccines. "If this dangerous trend of vaccine nationalism and parallel deals continues, vaccination in developing countries could take years, delaying, even more, the world's recovery," he said. "The vaccination campaign is the main moral challenge of our times." Spanish Prime Minister Pedro Sánchez, one of the few leaders who attended the gathering in person, announced that his government would donate at least 7.5 million doses of Covid-19 vaccines for use in Latin American and Caribbean countries through the U.N.-sponsored Covax initiative. He added that the donation would occur after Spain vaccinates at least half of its population against Covid-19. At the current pace, the country would reach that mark in July. The final declaration at the summit did not make reference to vaccine patents, but leaders did urge the international community and pharmaceutical companies to "face the pandemic in a more equitable way and with solidarity" and also to provide "universal access at affordable costs" to Covid-19 vaccines and treatments, the AP reported. Also on Wednesday, authorities in Mexico said fake Covid-19 vaccines represent "a risk to health," a statement that came after counterfeit doses of the Pfizer-BioNTech vaccine were found in Mexico and Poland. Authorities in the Mexican state of Nuevo León said they discovered three empty vials of fake vaccine in February, which suggested that 15 to 18 people had been injected with it. Mexico's government urged people not to attempt to get vaccine doses through the Internet or from private sellers, saying that the government is distributing all real doses of the vaccine in Mexico. Elsewhere in the region, Argentina's health minister said Wednesday that the country is experiencing its "worst moment" of the pandemic as it faces another wave of infections and the recorded number of Covid-19 deaths surpassed 60,000, Reuters reported. Infections are "growing exponentially in most of the country," said Health Minister Carla Vizzotti. Argentina's health system is at risk, especially around Buenos Aires, where authorities have suspended indoor activities and restricted movement in efforts to curb infections.

ECONOMIC NEWS

Venezuela's Maduro Vows to Resolve Diesel Shortages

Venezuelan President Nicolás Maduro on Wednesday vowed to resolve widespread diesel shortages that farmers say are complicating the planting and harvesting of crops, Reuters reported. Maduro also called on the country's oil minister to increase domestic production of fuel, blaming U.S. sanctions on state oil company PDVSA for the shortages. The administration of former U.S. President Donald Trump last year declined to renew an exemption from sanctions for diesel supplied to Venezuela by non-U.S. companies, a measure that had been in place on humanitarian grounds. There had been some speculation that the diesel exemption from sanctions could be reinstated

NEWS BRIEFS

U.S. Begins Two-Day Virtual Climate Summit

U.S. President Joe Biden this morning kicked off a virtual climate summit with the attendance of 40 world leaders, CNN reported. Biden began the two-day summit by announcing that the United States would commit to reducing greenhouse gas emissions by between 50 and 52 percent below 2005 levels by 2030. Among the world leaders attending the summit is Brazilian President Jair Bolsonaro, whose environment minister said last week that Brazil needs $10 billion annually in foreign aid to achieve net-zero carbon emissions by 2050, Reuters reported.

U.S. Vice President to Meet Virtually With Guatemalan President on Monday

U.S. Vice President Kamala Harris will hold virtual meetings with Guatemalan President Alejandro Giammattei on Monday and will travel to Central America's Northern Triangle in June, an unnamed White House official told The Hill on Wednesday. Harris is also set to join a virtual roundtable on addressing the root causes of migration with representatives from Guatemalan community-based organizations next week, the official said.

Guatemalan Authorities Seek to Prosecute Former President Morales

Guatemalan prosecutors on Wednesday requested to strip former President Jimmy Morales of his immunity so he can be prosecuted for alleged violations of the mandate of the U.N.-supported anti-corruption mission, known as CICIG, when it worked in the country, the Associated Press reported. Morales has immunity because he is now a representative to Guatemala's parliament. A Supreme Court judge will now decide whether there is sufficient evidence to lift Morales' immunity.

under U.S. President Joe Biden, but his administration so far has signaled continuity of all sanctions against the Andean nation. "We must regularize the issue of diesel with national production," Maduro said, urging Oil Minister Tareck El Aissami to resume normal supply within 60 days. "If we could import, we would be buoyant. We will be buoyant in the production of oil products," he added. In addition to U.S. sanctions, years of mismanagement and lack of funding have hit the country's oil sector. Venezuela's Paraguaná refining complex has been operating below capacity for years. "Many crops will be lost this year due to a lack of diesel, which is also expected to affect the transportation of medicines, food, cooking gas and gasoline," Antero Alvarado, managing partner and Venezuela director at Gas Energy Latin America, told the weekly Energy Advisor in a **Q&A** published March 26. "This could make daily life much more complex for those of us living in Venezuela," he added.

BUSINESS NEWS

China's Ant Group Agrees to Buy Stake in Brazil-Based Dotz

China's Ant Group has reached a deal to buy a 5 percent stake in Brazilian loyalty program Dotz, according to a securities filing on Wednesday, Reuters reported. Ant Group, Chinese giant retailer Alibaba's payment affiliate, and Dotz have also signed a business cooperation agreement to explore new opportunities for digital financial services in the South American country. Dotz recently launched an initial public offering of roughly 815 million reais ($146.35 million) and is planning to start trading on the São Paulo stock exchange on May 13, Reuters reported. The deal with Ant Group is subject to the conclusion of the IPO, Dotz said. The company could be valued at as much as 3 billion reais. Dotz, a loyalty program as well as a marketplace and financial start-up, has 20 million active users, according to the report.

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countries, the real quantity of money is still growing at a speed much superior than that of the quantity of goods and services produced. This root is more a longer-lasting event as the economic recovery is still weak and heavily relies on the support of the monetary crutch. Moreover, given the single anti-inflationary monetary mandate, the inflation persistence could force central banks to start tightening monetary conditions sooner rather than later, thus limiting the strength of the recovery. Inflation is out of the target's upper range in Brazil and Mexico, and above the central target in Peru, while it shows an increasing trend in Chile. All these countries still persist in the use of monetary stimulus to support the economy, even though growth is not part of their respective mandates. Given the inflation risk, policymakers face the challenge of starting to normalize monetary conditions soon. Unfortunately, central banks have become victims of their own single monetary mandate."

A **Daniel M. Schydlowsky, visiting professor at the Hebrew University of Jerusalem and former Peruvian superintendent of banking, insurance and private pension fund administrators:** "In the context of the pandemic, measuring inflation is a daunting task. What consumption basket is relevant when some 20-30 percent of the normal expenditures are prohibited? And should services such as delivery of groceries become part of the product's recorded cost, or should they become part of the decimated service-sector percentage of the price index? And how should housing services be assessed when moving is severely curtailed? Reaching for the underlying determinants of inflation can perhaps provide a more useful guide for price developments during and after the pandemic. If an inflationary spiral already exists, it is likely to continue, depending on its strength. Regarding the aggregate supply-demand balance, with a government-induced recession, there can be no generalized excess demand, hence no demand-pull inflation. Indeed, there will be excess supply of products, such as food, resulting from the shutdown of tourism, restaurants and the entertainment industry. These prices are likely to fall. With gross government interventions, there will inevitably be 'local' imbalances. These will be aggravated by supply-line disruptions coming from abroad, many of them from China. Hence there is likely to be imported inflation for selected products. Where there are insufficient international reserves and exports fall, devaluation may ensue and initiate or continue an inflationary spiral. The fraction of normal expenditure now not allowed (20-30 percent of the total) may find its way partially into other expenditures (for example, computers to be used at home, televisions and home improvement products) and force prices up in these sectors of the economy. Normally, government subsidies raise aggregate demand; under Covid-19 conditions, they only partially replace lost income. As Covid-19 dissipates, forced savings will decline along with government subsidies. However, some net increase in precautionary savings will remain. In summary, there is little reason to think that Covid-19 has generated or exacerbated inflation, or that its aftermath will do so. Indeed, existing measures of inflation need to be examined carefully for their suitability to the current conditions."

A **Allison Fedirka, director of analysis at Geopolitical Futures:** "Inflation risks and levels vary widely across Latin America. The fear of inflation in the region is driven by how quickly it can get out of control and persist in an economy. Current inflation concerns center around Mexico and Brazil, the region's two largest economies and ones where inflation has been under control in recent years. Central banks in the region have a variety of tools they can use to address the problem, including raising interest

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rates. Bear in mind, however, that while Latin American economists largely follow U.S. economic school of thought, their economies face fundamentally different realities, and therefore corrective actions will not necessarily follow standard, U.S. prescription. Inflation becomes particularly problematic in the region when it affects energy and food prices, which is applicable to the current situation. Inflation presents a greater threat post-pandemic as larger portions of the region's population are more vulnerable to price increases. Unemployment has increased, many people have fallen back into poverty, and informal labor has gained ground. None of these countries can count on domestic consumer demand for recovery, nor was it ever really a viable option beforehand. Instead, these countries must look to external sources of economic activity, such as trade and investment. A weaker economy coupled with inflation does, however, present a large threat to any semblance of political stability in a given country. People will demand the government meet their needs, and many governments will be hard pressed to respond effectively."

A **Gary Hufbauer, senior fellow at the Peterson Institute for International Economics:** "The most startling feature about the inflation experience in Latin America is its diversity. At one end of the scale, Venezuelan President Nicolás Maduro has engulfed Venezuela in hyperinflation—more than 2,000 percent per year. At the other end, Caribbean islands linked to the U.S. dollar experience practically zero inflation. In between, Argentina's inflation is way too high, around 40 percent, while Chile's inflation is less than 3 percent. Mexico is around 5 percent, and Brazil around 6 percent. The pandemic has struck all of Latin America. Modest national differences in infection and death rates cannot explain wide differences in inflation rates. Nor are distinct commodity cycles responsible for the diverse inflation experience. The explanation, as Milton Friedman would have said, lies in political control of central banks. Those beholden to national leaders are often forced—as in Venezuela, Suriname, Argentina and Haiti—to print money to finance large budget deficits. It is Modern Monetary Theory with a vengeance. Independent central banks, and those tied to the U.S. dollar, are considerably more prudent. Strong recovery during the second half of 2021—in the United States, a few other advanced countries, along with China and much of Asia—will put upward pressure on global prices, especially for services and goods in short supply (for example, semiconductors). These forces will bring marginally higher inflation to Latin America. But the big inflation story for the region will in fact be a series of separate stories, each determined by national policies."

"The explanation, as Milton Friedman would have said, lies in political control of central banks."

— Gary Hufbauer

The Advisor welcomes comments on its Q&A section. Readers can write editor Gene Kuleta at **gkuleta@thedialogue.org**.

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