P R E S S   R E L E A S E

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Latin America: Why are manufacturing exports still lackluster?

- **Latin America's exports were previously boosted by China's vast appetite for raw materials and the hike in their international prices**
- **Manufacturing exports recorded overall weak performance over the two last decades**
- **High labour costs, poor infrastructure and limited trade agreements were factors undermining performance in six analysed countries: Argentina, Brazil, Mexico, Colombia, Chile and Peru**
- **A strong rebound in manufacturing exports is unlikely in the near future**

Foreign trade is unlikely to be a main contributor to the growth of Latin American economies over the next few years

Up until 2014, Latin America's exports were boosted by China's vast appetite for raw materials and the hike in their international prices. The region's abundant natural resources brought economic gains during the prosperous period for commodities. However, this trend also resulted in appreciation pressures on exchanges rates for many countries in the region, reducing the competitiveness of manufacturing.

Overall, countries failed to take advantage of the past commodity bonanza to implement the reforms they needed. Serious challenges now remain, but government revenues have shrunk. The following issues will hamper performance in the short and medium term:

- There will not be great improvements in price competitiveness, due to recent appreciations in exchange rates and no reductions in labour costs;
- Global activity is not expected to report vigorous growth in the near future;
- Overcoming bottlenecks in infrastructures will be difficult, in the light of corruption scandals and the absence of a well-defined regulatory framework;
- Protectionism is increasing globally and the development of trade agreements with important trade zones seems unlikely.

Manufacturing sector: weak performance over the two last decades, with predominance of unsophisticated goods

The evolution of manufacturing exports, for all six countries analysed, shows an increase in value terms. As a whole, the evolution of primary exports was more important than that of manufactured goods. The predominance of raw material exports in some countries is mainly due the increase in the price of raw materials (seen until mid-2014) that was accompanied by appreciations in real exchange rates, wage increases and, in some cases, further taxes. All of these have affected the competitiveness of manufacturing over the last decade.

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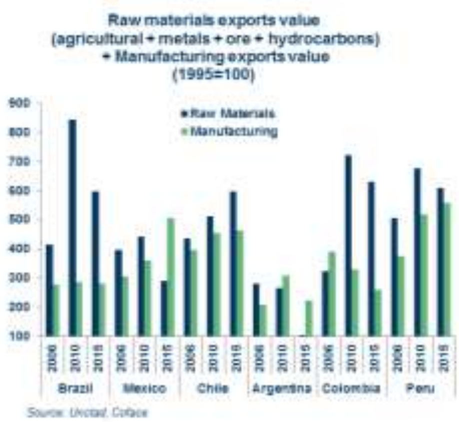

Manufacturing exports have not seen significant increases in terms of ratio to GDP. The contribution of manufacturing exports to GDP has increased in nearly all six countries, even if this trend seems to have reversed in 2015. In Mexico, the only country in the region where manufacturing exports are predominant, they rose to 27% of GDP in 2015, up from 19% in 2005. In the other economies, manufacturing exports represented less than 5% GDP in 2015.

The evolution of manufacturing exports is relatively unaffected by exchange rate movements. Countries in the region are heavily reliant on commodity exports, while the representativeness of commodities to total imports is usually not very high in these economies. The sharp contraction in the international prices of primary goods, which began in 2014, was followed by depreciation pressures on exchange rates.

What is causing lackluster exports?

- **Labour costs**: Real wages play a major role in determining the competitiveness of products, as labour generally weighs heavily on companies' cost structures. In Brazil and Argentina, minimum wages have systematically increased above productivity.

- **Poor infrastructure**: Latin America's poor infrastructure is a well-known issue, but unfortunately little was done during the commodity bonanza period to improve its quality. This aspect is one of the factors that could be preventing a rebound in exports. The complexity of export bureaucracy is also hampering the region's manufacturing activities.

- **Limited trade agreements**: Over the past decade, Mercosur has only successfully negotiated two trade agreements - both with countries of lower importance, in terms of trade volumes. Even the Pacific Alliance countries, which have been more efficient in establishing alliances, have failed to achieve brighter manufacturing exports.

Manufacturing exports: positive performance not expected in the near future

Price competitiveness is unlikely to improve significantly, due to recent exchange rate appreciations and the lack of reductions in labour costs. There is no clear evidence that episodes of strong depreciation in the region's exchange rates are followed by increases in manufacturing exports.

Another aspect is that global activity is not expected to report vigorous growth in the near future, limiting international demand for manufactured products. Coface estimates that GDP in advanced economies will increase by 1.6% in both 2016 and 2017 (down from 1.9% in 2015). In emerging markets, GDP is expected to grow by 3.7% this year and by 4.2% in 2017, up from 3.4% in 2015. In China, activity is expected to continue its gradual deceleration.

The resolution of the region's infrastructural problems is crucial to boosting the productivity of goods, in order to reduce freight costs. Public-private partnerships are being highly encouraged by local governments – although investors remain cautious, due to the deteriorated situation of the business environment.

The global political and economic environment is less favourable to open trade than before and rising protectionism will hamper growth in exports.

"*Overall, countries failed to take the advantage of the past commodity bonanza in order to implement the reforms they needed. Serious challenges now remain, but government revenues have shrunk",* commented Patricia Krause, Latin America economist at Coface.

In summary, Coface expects manufacturing exports to remain weak in the near future. Even in 2017, a strong recovery is unlikely, although a gradual increase in world demand and commodity prices could result in a slight improvement.

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