

Trade and Integration Monitor 2015

Double-Dip

Latin America and the Caribbean
Facing the Contraction of World Trade

Coordinated by
Paolo Giordano

Integration and Trade Sector

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The Trade and Integration Monitor is an annual report that tracks the state of Latin American and Caribbean integration into the global trading system. It draws on publicly available data from INTrade, the Inter-American Development Bank (IDB) Trade and Integration Information System (www.intradebid.org).

The Monitor is the result of a collaborative research effort undertaken within the Inter-American Development Bank by the Integration and Trade Sector (INT) and its Institute for the Integration of Latin America and the Caribbean (INTAL), carried out under the general supervision of Antoni Estevadeordal, Sector Manager.

This edition was coordinated by Paolo Giordano, Principal Economist (INT), and written in collaboration with Alejandro Ramos, Senior Economist (INTAL). Kathia Michalczewsky participated extensively in the research and provided invaluable support in the preparation of the document.

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Prologue

In recent months, the risks of instability of the world economy have become more pronounced. Low growth in Latin America and the Caribbean's principal trading partners, marked deceleration of economic activity in developing countries, contraction and volatility of commodity prices, and exchange rate fluctuations are affecting the economic panorama. These factors contribute to a trend reversal in world trade, impacting the exports of the majority of countries in the region.

The *Trade and Integration Monitor 2015* analyzes different aspects of the global trade downturn and its effects on the region. This is the most recent edition of the series of reports elaborated by the Integration and Trade Sector of the Inter-American Development Bank that study the evolution of Latin America and the Caribbean's insertion into the global trading system, making use of data available in INTrade, the IDB's information system on integration and trade.

This report analyzes the weak growth of the region's export volume of goods and services and the strong impact of the correction in commodity prices since the middle of 2014. The report emphasizes the consequences of the realignment of exchange rates for the value of trade flows and the price-competitiveness of the export supply of the region.

The report also provides the rationale for the diversification of regional exports, a critical element at this juncture for reducing the vulnerability of the external sector. In particular, the set of indicators used not only highlights the well-known concentration of exports in commodities that occurred during the boom period and post-crisis recovery, but it also underscores a less evident trend of product and market diversification. Likewise, the report characterizes export baskets as a function of their competitive position in global markets and analyzes the export dynamics based on the intensive and extensive growth margins.

Given the magnitude of the challenges and the fragility of the global economic situation, we hope that this edition of the Trade and Integration Monitor provides the countries of the region with useful information for the design and implementation of policies that facilitate the diversification of exports and that contribute to a return to the path of growth with greater competitive integration in the world economy.

Antoni Estevadeordal
Manager, Integration and Trade Sector

List of Abbreviations

BEA	US Bureau of Economic Analysis
CARICOM	Caribbean Community
CPB	Netherlands Bureau for Economic Policy Analysis
ECLAC	Economic Commission for Latin America and the Caribbean
EU	European Union
FAO	Food and Agriculture Organization for the United Nations
FOB	Free on Board
GDP	Gross Domestic Product
HHI	Hirschman-Herfindahl index
HS	Harmonized Commodity Description and Coding System
IDB	Inter-American Development Bank
IMF	International Monetary Fund
KIS	Knowledge-Intensive Services
LA	Latin America
LAC	Latin America and the Caribbean
MERCOSUR	Common Market of the South
OECD	Organisation for Economic Co-operation and Development
p.p.	Percentage points
PPP	Purchasing Power Parity
ROW	Rest of the World
SIEPAC	Central American Electrical Interconnection System (by its Spanish acronym)
STR	Special Trade Regimes
U.S.	United States
US\$	United States Dollar
USITC	U.S. International Trade Commission
WITS	World Integrated Trade Solution
WTO	World Trade Organization



Executive Summary

In the first few months of 2015, the trend in global trade—which had already reversed since mid-2014—worsened, sharply affecting the trade performance of Latin American and Caribbean countries. The change in the pattern of global growth, notably the slowdown in China and developing countries, has cooled real demand for regional products. In addition, the rapid deterioration of commodity prices—mainly oil and gas and metals—has depressed the value of trade and caused a severe contraction in regional aggregate exports in the first half of 2015, after the decline suffered the previous year. In most countries, imbalances in the current account of the balance of payments have been exacerbated, in an international environment characterized by increasing currency volatility and foreseeable stiffer conditions on access to international finance. In this context, the need to adopt policies to support the diversification of exports is heightened.

The *Trade and Integration Monitor 2015* analyzes these trends with the view to contributing to the design of policies that will address the weak elements in the external sector of Latin America and the Caribbean (LAC). Indicators related to trade and the stock of trade agreements in the region, compiled by the Integration and Trade Sector of the Inter-American Development Bank (IDB) and publicly available in INTrade (www.intradebid.org), are used to reveal the following findings:

Regional exports have entered a phase of contraction caused by the deceleration of growth in developing countries and the end of the expansionary phase of the commodity price cycle.

In mid-2014, the phase of substantial stagnation of international trade, which had persisted since the brief post-crisis recovery in 2010, ended. On the one hand, the slowdown in growth in emerging countries—notably China, but also in LAC—was not offset by an incipient dynamism of the U.S. economy and the uneven recovery in European countries. On the other, weak global real demand in conjunction with a sustained nominal appreciation of the dollar explain the depression in commodity prices that has mainly affected regional commodity exporters. Low and declining rates

of growth in export volumes have been matched by volatility and sharp corrections in export prices. In 2014, in an environment characterized by expectations of further restrictions on access to international finance, these factors led to the biggest contraction of regional trade since its collapse in 2009 and to current account deficits in the balance of payments of most countries. At the same time, major exchange rate realignments asymmetrically affected the price-competitiveness of exports from various countries and created risks associated with the implementation of restrictive trade policy responses.

The contraction of regional goods exports deepened and broadened while services exports stagnated.

In 2014, regional goods exports reached US\$ 1.06 trillion, contracting 2.8% over the previous year. This aggregate figure was the result of strong growth in Mexico (4.6%) and Central America (2.3%), which benefited from the greater dynamism of the U.S. economy, offset by setbacks in exports from South America (-7.4%) and the Caribbean (-5.5%) which were strongly impacted by the downturn in the international environment. As compared to the previous year, the evolution of goods exports in the first six months of 2015 points to a further erosion of regional exports. South American countries (-17.7%) are the most affected due to the acute specialization of their export baskets in commodities. However, the positive trend was also reversed in exports of Mexico (-2.2%) and Central America (-3.4%), which are mainly comprised of manufactures. Services exports, which had been more dynamic in recent years than those of goods, entered a stagnation phase, growing just 1.8% in 2014. In spite of the fact that the aggregate impact is strongly determined by deflationary trends in global commodities trade, it is important to emphasize the role of trade in manufactures of Mexico and Central America and, to a lesser extent, Brazil, Chile, Peru and the Caribbean with the United States that offset the collapse of total external sales. In the other countries of the region, exports of industrial products, concentrated on the intra-regional market, showed signs of contraction in line with the recessionary trend present in several economies.

At this juncture, the need to adopt policy frameworks that promote export diversification, of both products and of markets, is urgent.

The fragility of the situation that emerges from this analysis highlights the need to prioritize an ambitious policy agenda aimed at promoting trade diversification. Although at first glance regional trade performance appears strongly conditioned by an excessive dependence on commodities trade, a detailed analysis of the last decade reveals

some encouraging aspects that can serve as a basis for relaunching the export sector. Though there is a high concentration of regional exports in commodities, the addition of new products and new markets to the export supply of the region, particularly in countries that have been actively promoting trade and negotiating trade agreements, should not be overlooked. It is urgent to strengthen the negotiating agenda in countries that have remained on the sidelines and to adopt complementary measures that promote and facilitate trade in those that need to preserve their preference margins. On the other hand, given that in this adverse context a substantial proportion of trade growth has been through the export of existing products to new markets, there is a need to support and encourage the internationalization of companies with active policies that allow them to make the most of their potential.

Introduction

In mid-2014 the exports of Latin America and the Caribbean (LAC) entered into a recessive phase that became more wide-spread in the early months of 2015. Although with differences across subregions and countries, the panorama is one of variations around a trend that differs markedly both from the boom period that preceded the crisis (2003–2008) and from the stagnation (2012–2014) that characterized the years after the brief recovery of 2010–2011.

This report provides a detailed analysis of the principal characteristics of LAC goods and services exports in the recent period. The weak performance of the export sector is the result of the combination of multiple variables that have had adverse consequences in this period and whose impact could deepen in the coming months. The situation calls to attention the region's need to advance a relaunching of exports that includes a diversification of the export supply based on improvements in productivity and innovative capacity, and that broadens and takes advantage of the network of existing trade agreements. This is particularly urgent given that the determinants of the region's trade performance seem to be undergoing transformations that are not transitory and thus require substantial changes, particularly in the policy space of support for the internationalization of businesses.

In the first section, the report examines the principal features of the change in trend of world and regional trade since the middle of 2014. In the second, it offers a panorama of the region's trade performance from 2014 through the first half of 2015, and the dynamics present in the value and composition of the regional export basket, highlighting the singularities of each region and country. Additionally, it analyzes the evolution of the terms of trade, revealing strong deterioration in the past year for the regional aggregate, as well as the relative roles that price and quantity changes have played in the export trajectories of individual countries. The third and last section investigates the concentration of the regional export basket in the medium term, emphasizing the successful diversification trends—both of products and of markets—with the objective of deriving policy recommendations that may allow the region to take greater advantage of its export potential.

The Trend Reversal in World Trade

1

In mid-2014, after three years of stagnation, the value of world trade in goods began to display a recessionary trend that deepened in the first half of 2015. Likewise, the situation halted the momentum of trade in services that had been growing at sustained rates since the crisis. The contraction was derived from the slowdown in China and other developing countries and the weak and unstable recovery of activity in developed economies, phenomena which significantly weakened external demand for the region's exports. Added to this was the persistent appreciation of the dollar which caused a sharp reduction in the value of internationally traded goods, particularly commodities. This accentuated the external vulnerability of the region, which has been offset by sufficient reserves and favorable conditions in international financial markets.

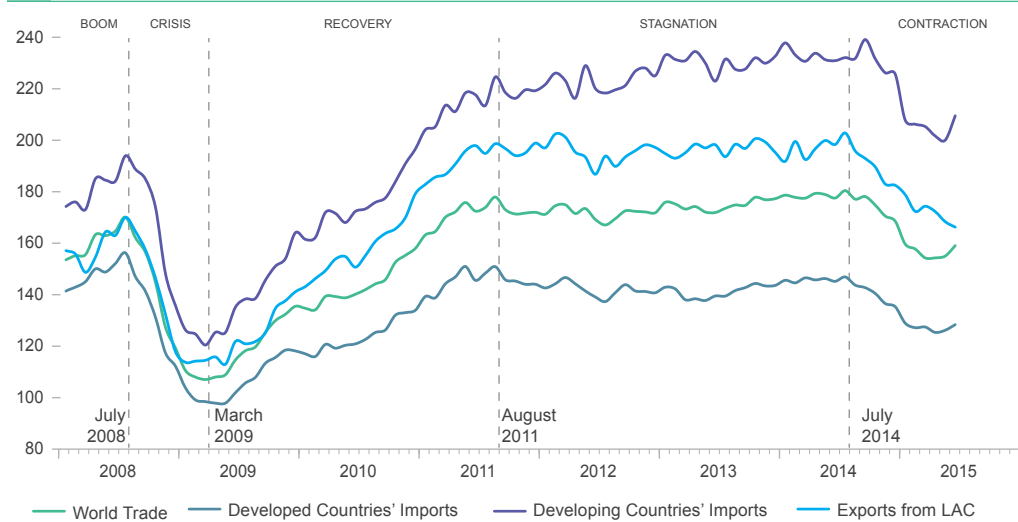
Receding Trade Flows

For much of the post-financial crisis period, world trade has remained essentially stagnant. Following a rapid recovery, the flow of goods has slowed since August 2011 due to a combination of real and monetary factors (Figures 1 and 2). From then until July 2014, the total value of international trade has stabilized, with an average annual growth equivalent to just 0.5% per year, with few fluctuations. This picture of global stagnation was due to a reduction of 0.9% annually in imports originating in developed countries and meager growth of 1.4% in foreign purchases of developing countries. During this period, the stronger relative growth of developing countries has not been enough to offset weak demand in developed countries. LAC exports have mirrored the stagnation of global trade.

The post-crisis recovery of world trade was brief and weak.

In the second half of 2014, the value of traded goods entered a contractionary phase, extending into the first months of 2015. Between July 2014 and June 2015, the value of global trade declined 11.8%, a fall roughly equivalent to one third of the trade collapse of 2008-2009. The re-adjustment of the value of both developed and developing

FIGURE 1 • VALUE OF WORLD TRADE IN GOODS
(Index, 2005=100, 2008-2015)



Source: IDB Integration and Trade Sector with data from the Netherlands Bureau of Economic Policy Analysis (CPB).
Note: The value of world trade is calculated as the average of world exports and imports.

By mid-2014,
the value of
global trade in
goods began to
contract.

countries' imports markedly affected LAC exports, which fell 18%.¹ As described in more detail below, this downturn in world trade and its strong impact on the region are the most obvious manifestation of the LAC's vulnerability to the change in the pattern of global growth: a loss of momentum experienced in developing countries and a barely incipient acceleration of activity in developed countries, especially in the United States, which did not allow a reversal of the general trend.

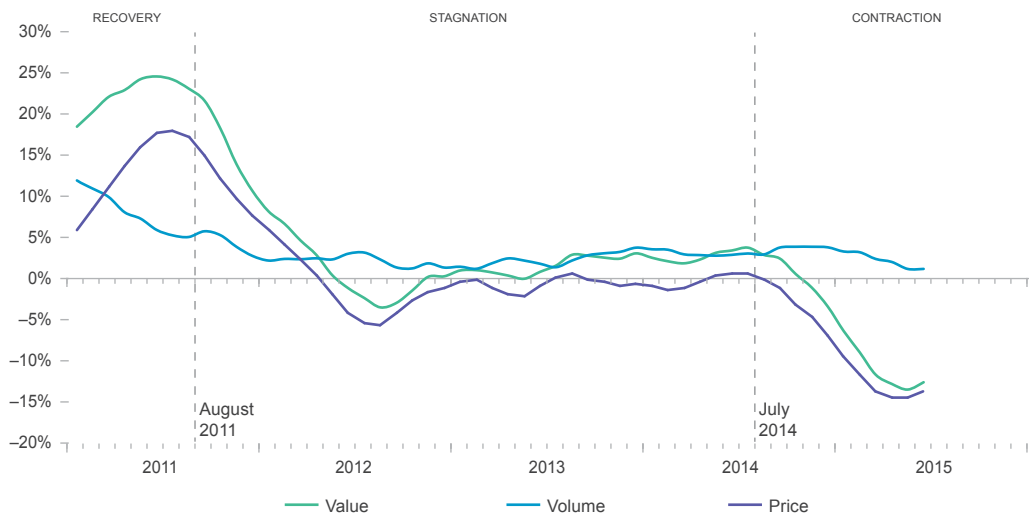
During the post-crisis stagnation, the sluggishness of the value of world trade was a combination of very slight increases in volumes traded with growing weakness in prices (Figure 2). Since mid-2014, deflationary trends have deepened and growth in volumes has deteriorated further (Figure 3). Between July 2014 and June 2015, the value of world trade fell as a result of a contraction in prices by 13.2% and a slight increase in volumes of 0.5%, calculated as equivalent annual growth rates. In this new scenario, the volume imported by developed countries grew

Weak trade
volumes were
combined with
deflationary
trends.

¹ The estimates provided in this report show a progressive deterioration of the business conditions for the region, which could involve a contraction in exports in 2015 greater than the 7.0% forecast by the Economic Commission for Latin America and the Caribbean, ECLAC (2015) and an increase in the volumes smaller than that predicted by the World Trade Organization, WTO (2015).

FIGURE 2 • GROWTH OF WORLD TRADE IN GOODS

(Quarterly moving average of year on year growth rate, percentage, 2011-2015)



Source: IDB Integration and Trade Sector with data from CPB.

Note: The value of world trade is calculated as the average of world exports and imports.

3.1%, while that of developing countries decreased at an annual rate of 1.1%. In the case of LAC, the impact of falling prices is more acute on the region's trade than on the global average.²

Global trade in services has followed a similar pattern to that of trade in goods. The post-crisis expansion phase peaked in mid-2011, followed by a slowdown and stabilization with low growth rates compared to the previous boom (Figure 4).

Between 2002 and 2008, global trade in services grew 13.5% per year while in 2011-2014 this growth rate fell to 4.1%. In the same period, LAC services exports increased at an average annual rate of 3.5%. Thus the shift in world trade in mid-2014 was also reflected in trade in services, with year-end growth rates flat in all subregions. Note that the slowdown in demand from developing countries also affected imports of services which had been the most dynamic component of this trade for the better part of 2013.

Trade in services was still expanding, but at a slower pace.

Cooling External Demand

The weak performance of world trade resulted in fragile demand for imports originating in LAC. Between 2011 and 2014, the demand from the region's primary trading

² Chapter 2 presents the decomposition in prices and volumes of LAC country exports in 2014 with annual disaggregated primary data from INTrade/DataINTAL. The CPB estimates use secondary information from high frequency samples.

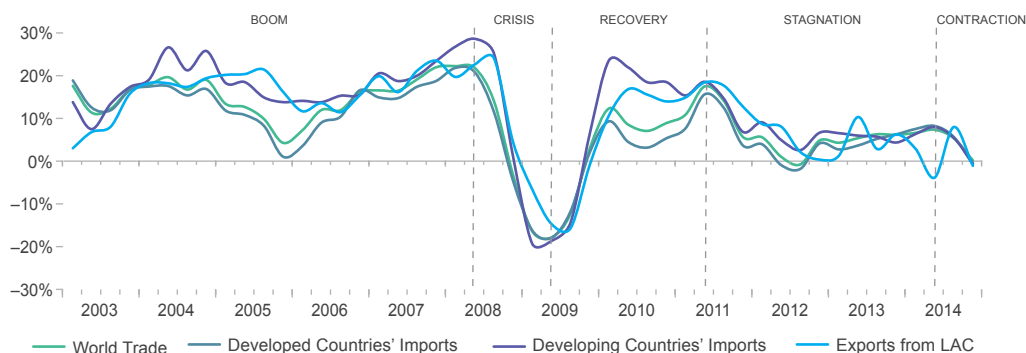
FIGURE 3 • GROWTH IN VOLUMES AND PRICES OF WORLD TRADE IN GOODS
(Equivalent annual growth rate, percentage, July 2014–June 2015)



Source: IDB Integration and Trade Sector with data from CPB.

Note: The value of world trade is calculated as the average of world exports and imports. Growth is calculated as the geometric average annual percentage growth during the interval August 2014–June 2015, July 2014 being the reference period.

FIGURE 4 • GROWTH OF WORLD TRADE IN SERVICES
(Annual growth rate, percentage, 2003–2014)



Source: IDB Integration and Trade Sector with data from the International Monetary Fund (IMF) and the World Trade Organization (WTO).

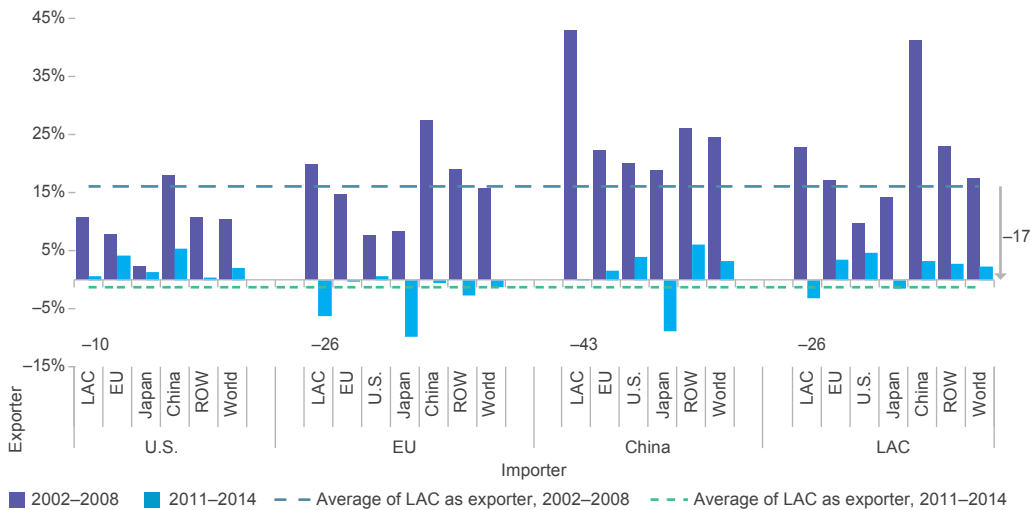
Note: World trade is calculated as the average of exports and imports. The components of the services account of the balance of payments are included, except construction services and government services for the entire series, and manufacturing services, maintenance and repair of goods in 2005–2014.

Demand for imports originating in Latin America and the Caribbean declined.

partners contracted 1.4% annually on average, translating to a reduction of 17 percentage points (p.p.) compared to the period 2002–2008 when it grew at rates of 16% annually (Figure 5). The region was met with a marked cooling of foreign markets once the brief effect of the post-crisis recovery wore off. In the last period considered LAC faced reduced demand due to declines in purchases from the European Union (EU) (–6.2%)

FIGURE 5 • TOTAL IMPORTS OF SELECTED ECONOMIES

(Average annual growth rate, percentage, 2002–2008 and 2011–2014)



Source: IDB Integration and Trade Sector with data from official sources.

Note: The graph illustrates imports of four major partners (U.S., EU, China and the region itself) depending on the country of origin of those purchases. ROW corresponds to the rest of the world. The values reported in each quadrant (below the bars corresponding to LAC as a point of origin of imports) refer to the reduction of the rate of change in percentage points, for the periods indicated. Growth corresponds to the geometric mean of the indicated intervals, being the respective 2002 and 2011 reference years. Where LAC is the origin of exports, the average is weighted by imports.

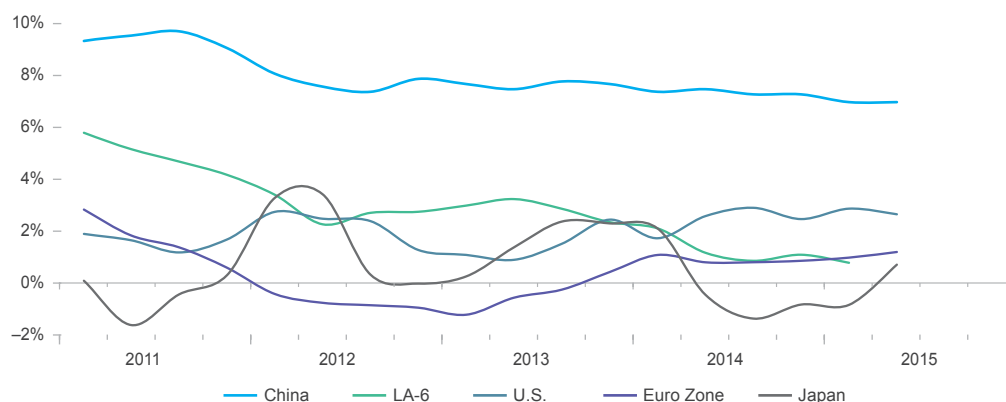
and the region itself (-3.2%), to zero growth in imports from China, and to an increase of U.S. imports of just 0.6% annually. The outlook for the region was part of a weakening of global imports that was pervasive and involved almost all trading partners.

The lower demand stimulus is explained by continued weak and asynchronous growth of the global economy (Figure 6). In 2014, global gross domestic product (GDP) expanded 3.4%, identical to the rate of the previous two years, although there was a small acceleration in activity in developed economies (from 1.4% in 2013 to 1.8% in 2014) and a slight decrease in developing countries' GDP growth to 4.6% (5.0% the previous year).³ In 2014, the U.S. economy expanded 2.4% and the Euro zone emerged from a recession, although growing just 0.9%. In the first half of 2015, the year on year variation of GDP in these two economies slightly accelerated, to 2.8% and 1.1%, respectively. In the U.S., a bitterly cold winter and a strike at the ports weakened growth in the first months of the year though recovery is forecast in the coming quarters. In Europe, activity

Weak and asynchronous global activity depressed trade flows.

³ The IMF's forecasts from July 2015 expect these trends to continue, predicting growth of 3.3% for the world economy, with acceleration in developed countries (2.1%) and less momentum in developing countries (4.2%) compared with the previous year, IMF (2015). However it is probable that these forecasts will be revised downwards, given the impact of the global turmoil that has spread in world markets since August.

FIGURE 6 • GDP GROWTH IN SELECTED ECONOMIES
(Annual growth rate, percentage, 2011–2015)



Source: IDB Integration and Trade Sector with data from the IMF, BEA, the Organization for Economic Cooperation and Development (OECD), the Institute of Social and Economic Research of Japan, and other official sources.

Note: LA-6 is the weighted average of the percentage changes in GDP of Argentina, Brazil, Chile, Colombia, Mexico and Peru. Weights are based on GDP in terms of purchasing power parity.

Trade was progressively less sensitive to the pace of activity.

strengthened only marginally and a significant acceleration is unlikely. The Japanese economy suffered a contraction of 0.1% in 2014 which is reiterated in the year on year figures for January to June 2015. Finally, China's activity expanded at the slowest pace in nearly 30 years, with a year on year growth rate of 7.0% in the first half of 2015. This is likely to be lower in the second half of the year following the devaluation of the renminbi and recent market instability. In addition, in 2014 and early 2015, economic activity slowed noticeably in LAC, which depressed the demand for intraregional trade.

The general cooling of global growth and the asynchronous rhythms of activity among major economies had a direct and cumulative impact on international trade. If a country with expanding activity has a demand effect on its partners that is not reciprocal, then global trade does not enter into a phase of sustained and cumulative growth. In this sense, some measurements show a reduction in world import elasticity with respect to world GDP growth in the post-crisis.⁴ This points to potentially adverse conditions for significant growth in export volumes in the region.

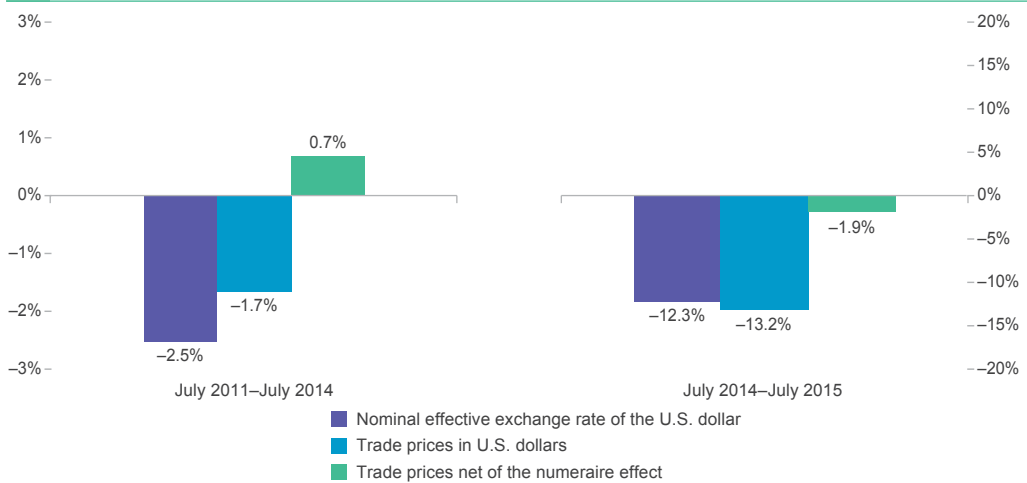
Deterioration of Regional Terms of Trade

By mid-2014, in addition to weak global economic activity, the accelerating nominal appreciation of the dollar was a key factor in the

Dollar appreciation accelerated in mid-2014.

⁴ Constantinescu *et al.* (2015) and WTO (2015).

FIGURE 7 • DECOMPOSITION OF WORLD TRADE PRICES
(Equivalent annual growth rate, percentage, 2011–2015)



Source: IDB Integration and Trade Sector with data from the CPB (prices) and the United States Federal Reserve (exchange rate).

Note: Growth is calculated as the geometric average annual percentage growth in the ranges indicated, with reference periods, respectively, July 2011 and July 2014. The nominal effective exchange rate of the dollar is the average of a broad basket of currencies. A negative/positive rate indicates appreciation/depreciation of the dollar. Prices, net of numeraire effect, are estimated using a constant dollar exchange rate (2005 = 100); see Methodological Annex 1 and IMF (2008).

reduction in the value of trade.⁵ In fact, since the middle of 2011, the dollar has appreciated due to increased preference for assets denominated in this currency. The expectations of tighter U.S. monetary policy, reaffirmed by relatively better economic performance, have strengthened the dollar's role as a global reserve currency. In addition, the strengthening of the dollar reflected the great uncertainty in the post-crisis particularly motivated by the continuing difficulties of the Euro area and the more recent slowdown in China. This financial phenomenon influenced in an autonomous manner the nominal level of world trade—denominated in dollars—by exerting downward pressure on its value (see Methodological Annex 1 and IMF (2008)).

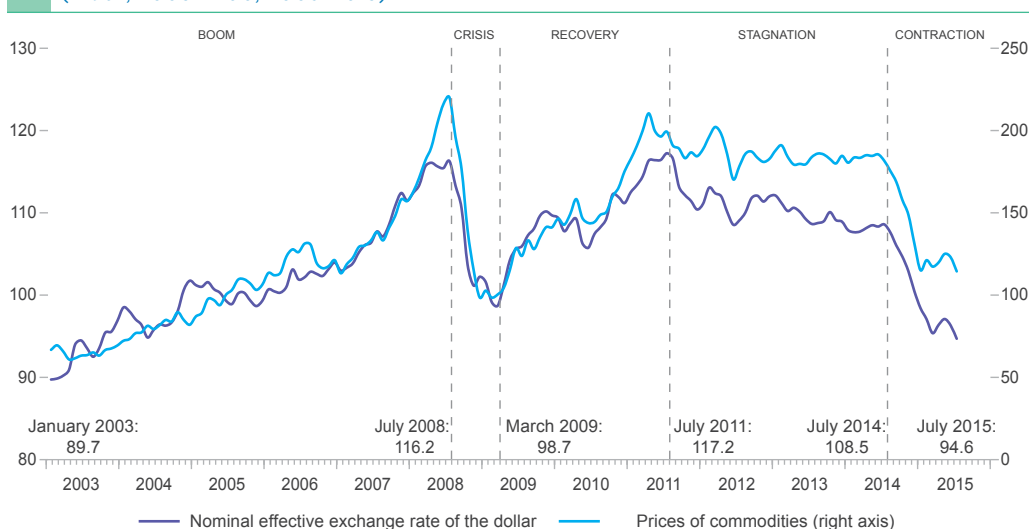
Since mid-2011, the dollar's appreciation has been reflected in a reduction in the level of average world trade prices. That is, the contraction of trade values is explained in part by a “numeraire effect” that can be isolated by valuing trade flows using a constant dollar exchange rate (Figure 7). There are two distinct periods, separated by a turning point in July 2014. In the first period, if the numeraire effect is excluded, the residual variation in prices is still positive, although very small (0.7%). In

The appreciation of the dollar was combined with real deflationary trends.

⁵ The convention of expressing the exchange rate of the dollar as the amount of that currency per unit of foreign currencies is adopted in the following analysis. Dollar appreciations are reflected by negative rates of change.

FIGURE 8 • NOMINAL EFFECTIVE EXCHANGE RATE OF THE U.S. DOLLAR AND PRICES OF COMMODITIES

(Index, 2005 = 100, 2003–2015)



Source: IDB Integration and Trade Sector with data from the U.S. Federal Reserve and the IMF.

Note: Exchange rate versus a broad basket of currencies. A negative/positive slope indicates an appreciation/depreciation of the dollar.

The stronger dollar dragged down commodity prices.

the second, price levels shrank faster than the pace of dollar appreciation so the change net of the numeraire effect becomes negative (-1.9 %). This denotes weaker markets for goods traded, beyond the measure of the dollar prices themselves.

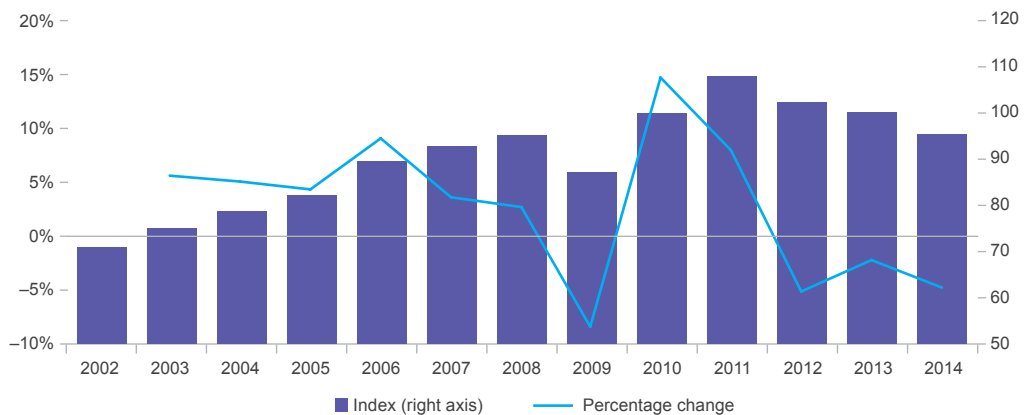
The value of the dollar also particularly influenced the price of commodities, which account for a significant fraction of the LAC export basket. Since the markets for these products operate in dollars, changes in the value of the dollar directly affected prices. Consequently, the acceleration of the dollar's appreciation that occurred in mid-2014 strongly dragged down the average price level of a broad basket of commodities (Figure 8). Within this general trend, substantial price reductions occurred in key markets, with impacts on regional exports.

By July 2015, average commodity prices had plummeted 37.1% with respect to July 2014 levels. This sharp decline is comparable to that experienced during the international financial crisis: the drop between July 2008 and December 2009 levels was 55.3%. From a longer-term perspective, by July 2015, the index was still 75% higher than in 2003, the start of the cycle, but already 48% below its peak in 2008. When the index is broken down into commodity groups, the largest year on year reductions were observed in oil prices

Prices fell quickly and remained depressed.

FIGURE 9 • TERMS OF TRADE

(Index, 2010 = 100 and annual growth rate, percentage, 2002–2014)



Source: IDB Integration and Trade Sector with data from INTrade/DataINTAL.

Note: The countries included are Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Paraguay, Peru, Uruguay and Venezuela.

The terms of trade continued to erode in the region.

(-46.3%) and metals (-27.1%), with more moderate declines in food and beverages (-15.0%).

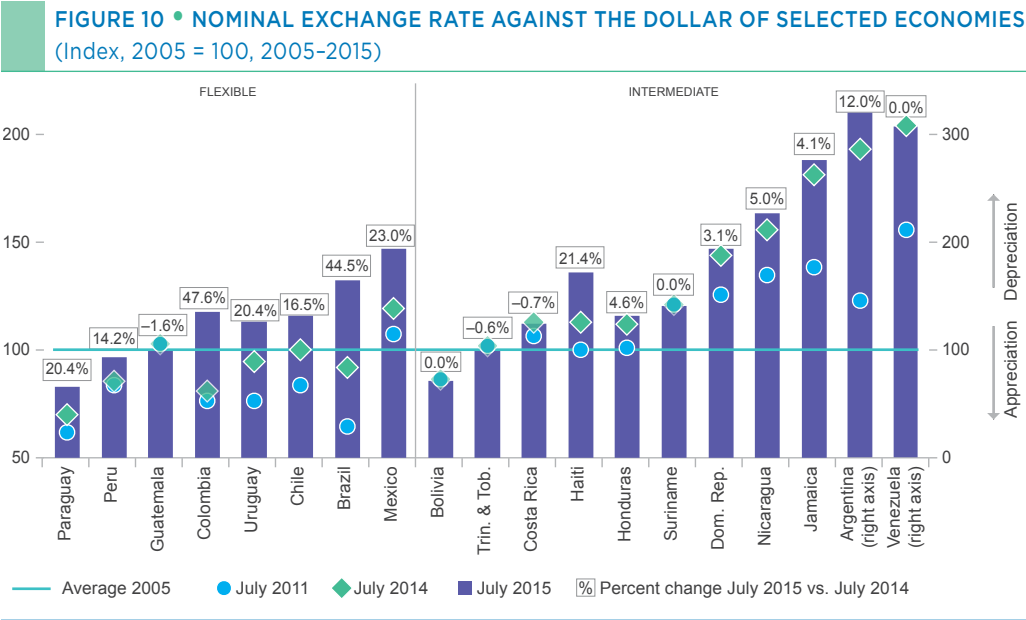
Because of this, the region recorded declining terms of trade in 2014 for the third consecutive year (Figure 9). The annual change was -4.7%, which was a cumulative decline of -11.7% since its peak in 2011. By year-end, gains achieved between 2010 and 2011—the post-international financial crisis period which produced a strong recovery in export prices—were fully absorbed. Subsequent deteriorations would further damage the ratio to below the level reached before the crisis of 2008 and create greater restrictions and vulnerabilities in the external sector.

New Exchange Rate Scenarios

In addition to the aforementioned effect on commodity prices, the significant appreciation of the dollar between July 2014 and July 2015 (-12.8%) was reflected, in an uneven way, in nominal exchange rates of LAC countries depending on their different exchange rate regimes (Figure 10). In seven out of eight countries with flexible regimes,⁶ depreciation against the dollar reached

Strong exchange rate corrections materialized.

⁶ This substantially follows the classification set out in Powell (2015) for LAC exchange rate regimes. Flexible exchange rates: Brazil, Chile, Colombia, Guatemala, Mexico, Paraguay, Peru and Uruguay; intermediate regimes: Argentina, Bolivia, Costa Rica, Dominican Republic, Haiti, Honduras, Nicaragua, Jamaica, Suriname, Trinidad and Tobago and Venezuela; the rest of LAC countries use a fixed exchange rate regime.



Source: IDB Integration and Trade Sector with data from the IMF.
Note: Countries are grouped by *flexible* or *intermediate* exchange rate regime. Excluded from the Figure are those countries with fixed exchange rates. Bars indicate the level of the nominal exchange rate in July 2015, the diamonds in July 2014, and the circles in July 2011. The percentage change reported above the bars corresponds to the movement of the exchange rate between July 2014 (diamond) and July 2015 (bar). A positive/negative rate indicates depreciation/appreciation.

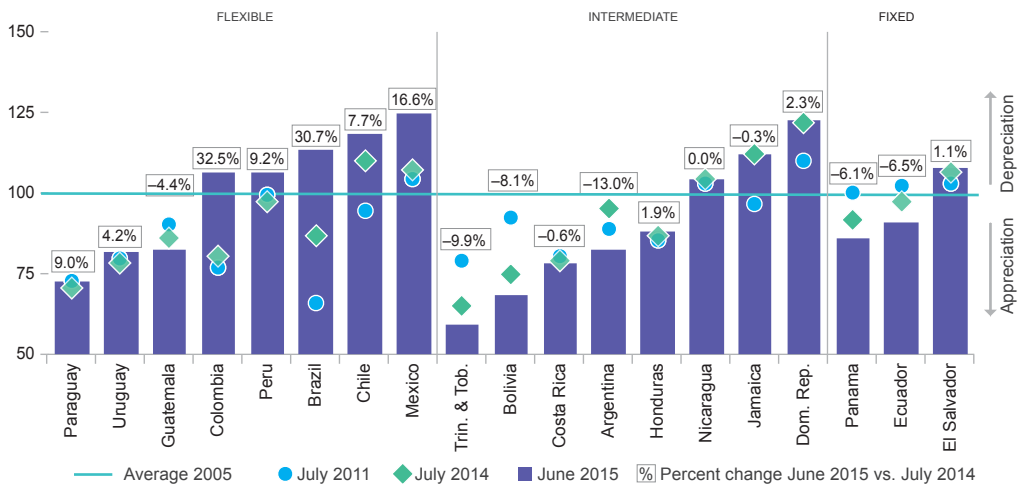
a simple average of 26.7% in the annual interval mentioned above. Of particular note are the exchange rate corrections in Colombia (47.6%), Brazil (44.5%) and Mexico (23.0%). On the other hand, of the eleven countries with intermediate exchange rate regimes, six recorded nominal depreciations of 8.4% on average, while the rest of the currencies appreciated or remained stable against the dollar. In this group, the most significant depreciations were in Haiti (21.4%) and Argentina (12.0%) while the currencies of Costa Rica (-0.7%) and Trinidad and Tobago (-0.6%) appreciated marginally.

Real exchange rate depreciations were generally lower than nominal ones.

The combination of the movements of the nominal exchange rate and the relative inflation dynamics in each country and its trading partners determine the variation of the real effective exchange rate, a measure of the price-competitiveness of exports (Figure 11).⁷ Between July 2014 and June 2015, with the exception of Guatemala, countries with flexible exchange rate regimes recorded real currency depreciations. The real

⁷ The real effective exchange rate measures the international value of the currency of a country with respect to currencies of its main partners, taking into account the relative changes in domestic prices. Accordingly, it is considered an indicator of price-competitiveness of domestic exports in its main target markets.

FIGURE 11 • REAL EXCHANGE RATE OF SELECTED ECONOMIES
(Index, 2005 = 100, 2005–2015)



Source: IDB Integration and Trade Sector with data from INTrade/DataINTAL, the IMF and official national sources.

Note: Countries are grouped by *flexible*, *intermediate* or *fixed* exchange rate regime. Bars indicate the level of the real effective exchange rate in June 2015, the diamonds in July 2014, and the circles in July 2011. The percentage change reported above the bars corresponds to the movement of the exchange rate between July 2014 (diamond) and June 2015 (bar). A positive/negative rate indicates depreciation/appreciation. For Jamaica, Panama and Trinidad and Tobago, the most recent data included in the comparisons is March 2015. The consumer price index is used as the price indicator, except in Argentina where the monthly implicit GDP deflator is used. The weighing uses trade data of the 50 main partners that represent at least 80% of the total flows.

exchange rate corrections of Colombia (32.5%), Brazil (30.7%) and Mexico (16.6%) were significant, though less than the nominal depreciations against the dollar. This indicates the presence of inflationary dynamics undermining the potential benefits in terms of competitiveness. In contrast, for countries with intermediate exchange rate regimes, real appreciations dominated in six of the eight economies considered, with only two experiencing real depreciations. Of the three countries with fixed exchange rates, two realized minor real appreciations, while El Salvador recorded a marginal real depreciation.

This context of strong exchange rate volatility, in conjunction with the devaluation of the Chinese renminbi in mid-2015, created uncertainty about the future prospects of the region's exports. While depreciation may help stimulate the diversification of exports through increased manufacturing competitiveness, the effect depends on the countries' capacity to contain imported inflationary pressures. Recent empirical evidence is not encouraging in this

Volatility of export price-competitiveness grew.

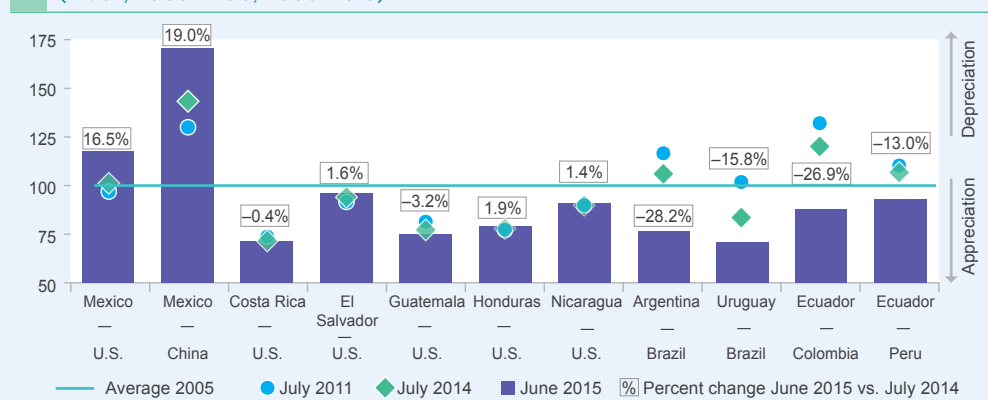
⁸ Ahmed *et al.* (2015) conclude that the elasticity of manufacturing exports to the real exchange rate has decreased over time as a result of the formation of global value chains and the higher content of imported inputs in exports.

BOX 1: REALIGNMENT OF BILATERAL REAL EXCHANGE RATES IN THE REGION

The new exchange rate scenario has caused changes in key bilateral exchange rates for trade between some countries. It is significant that between July 2014 and June 2015, Mexico registered a real depreciation of 16.5% against the currency of its main partner, the U.S., and 19.0% against the currency of China, one of its main competitors in the manufacturing sector. In contrast, the currencies of the Central American countries are experiencing much lower real depreciations against the U.S. dollar (1.6 % on average for El Salvador, Honduras and Nicaragua), or real appreciations (-1.8 % on average for Costa Rica and Guatemala).

BILATERAL REAL EXCHANGE RATES BETWEEN SELECTED ECONOMIES

(Index, 2005 = 100, 2005-2015)



Source: IDB Integration and Trade Sector, with data from the IMF and official national sources.

Note: For each pair of countries, the exchange rate corresponds to the currency of the first relative to the second. Bars indicate the level of the bilateral real exchange rate in June 2015, the diamonds in July 2014, and the circles in July 2011. The percentage change reported above the bars corresponds to the movement of the exchange rate between July 2014 (diamond) and June 2015 (bar). A positive/negative rate indicates depreciation/appreciation. The consumer price index is used as the price indicator, except in Argentina where the monthly implicit GDP deflator is used.

The global exchange rate disruptions have therefore had different results in terms of their potential for stimulating exports. In South America, the real appreciation of the Argentine peso (-28.2%) as well as the Uruguayan currency (-15.8 %) in comparison to that of Brazil, is notable. Brazil is the largest trading partner in both cases and the most important market for manufactured exports from both countries. Lastly, the Ecuadoran economy, dollarized since 2000, recorded a strong appreciation against its neighbors, Colombia (-26.9%) and Peru (-13.0%).

regard.⁸ Moreover, global currency volatility has also had side effects on key bilateral real exchange rates between some countries in the region (Box 1). Important in this regard were the movements in the exchange rates between Mexico and the U.S. and China as well as Brazil with Argentina and Uruguay, and of Ecuador with Colombia and Peru. These realignments created risks of policy responses such as compensatory safeguards, which would have the effect of further depressing international trade flows, particularly intraregional ones.

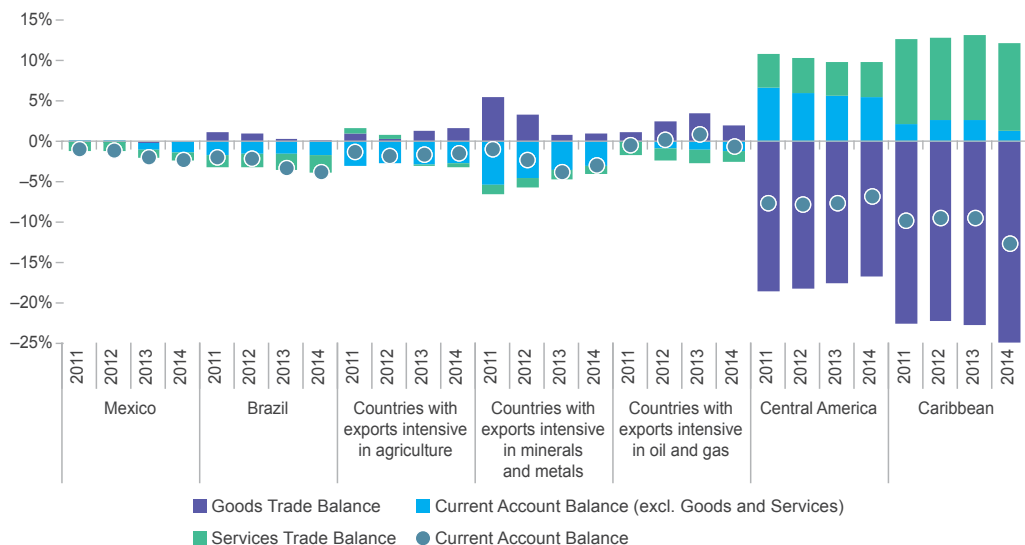
Increasing Vulnerability of the Balance of Payments

Weakening global demand, strong appreciation of the dollar, and falling commodity prices are all factors that together affected the LAC external sector. However, their specific effects were determined according to the respective characteristics of the economies in the region. Classifying these according to their scale and export specialization demonstrates that, in 2014, the current account balance for all groups was negative (Figure 12). In addition, deteriorations in relation to the previous year were seen in the larger economies of Brazil and Mexico, the Caribbean, and countries with exports intensive in oil and gas. These latter countries went from surpluses to deficits in the current account of their balance of payments resulting from the sharp fall in oil prices starting in mid-2014. Brazil and Mexico accumulated current account deficits equivalent to 3.9% and 2.4% of GDP respectively in 2014 and, in the case of the Caribbean countries for which information is available, this figure is equivalent to 12.7% of GDP.

Current account deficits were recorded in the balance of payments of the entire region.

FIGURE 12 • CURRENT ACCOUNT BALANCE

(Balance as a percentage of GDP, 2011-2014)



Source: IDB Integration and Trade Sector with data from Latin Macro Watch and national sources.

Note: The values of the subregions are an average of the balances of the countries in the group as a percentage of GDP, which in turn indicates the degree of external soundness, regardless of the differing economic weights of the balances of the countries involved. The classification separates out the largest economies, Brazil and Mexico, and other groups as follows: countries with exports intensive in agriculture (Argentina, Paraguay and Uruguay); countries with exports intensive in minerals and metals (Chile and Peru); countries with exports intensive in oil and gas (Bolivia, Colombia and Ecuador); Central America (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, Panama and Dominican Republic); and the Caribbean (The Bahamas, Belize and Jamaica, for which appropriate information was available).

Lower imports
reduced
deficits
in some
economies.

Although countries specializing in mining and agricultural exports recorded smaller current account deficits than in 2013 (3.1% vs. 4.0% in the first case and 1.5% vs. 1.8% in the second), these negative balances were significant, especially if one considers the performance of these economies during the boom period before the crisis. Central America also recorded an improvement in its current account balance though it remains at a very high level (6.9 % vs. 7.8%). An important determinant

of the improvements seen in these three groups is a slowdown or contraction in imports in 2014 that led to a marginal increase in goods balances, due to lower levels of activity in several countries.

In summary, by mid-2015 a downturn in the global trading system had created greater vulnerability in the external sector of Latin America and the Caribbean. However, this was compensated by the persistence of favorable external financing and the availability of reserves in most countries. This strength could still be challenged by the imminent normalization of monetary policy in the United States or in the event of a worsening of the global economic outlook as a result of the financial turmoil triggered by the recent adjustment of the exchange rate regime in China. The following section outlines the export trends of the regional countries, taking into consideration the particularities of each country and subregion.

The Contraction of Regional Exports

2

The reversal of the trend of world trade has strongly affected the exports of Latin America and the Caribbean in late 2014 and early 2015. In 2014 exports of goods fell for the second consecutive year while exports of services slowed markedly. The primary reason for this contraction was the drop in commodity prices, in combination with weak growth in export volumes in the majority of countries of the region. Mexico and Central America registered above-average performance due to links with the United States, while South American countries suffered the full effects of the deterioration of the terms of trade, the deceleration of the Chinese economy, and the intraregional market contraction.

Drop in Aggregate Regional Exports

Exports of goods from Latin America and the Caribbean fell 2.8% in 2014. For the subgroup of Latin American countries (LA), the contraction was 2.7% while for the Caribbean it was 5.5%. This was the second consecutive year that the region's foreign sales have showed negative growth: in 2013, there was a slight contraction (-0.2%) that deepened the deceleration suffered in 2012, when growth registered a mere 1.5%. Thus, the change in trend of world trade that began in the middle of 2014 has strongly accelerated the contraction of regional exports, which in the last quarter of the year fell 9.4% with respect to the same period of the previous year.

Exports
of goods
contracted in
2014.

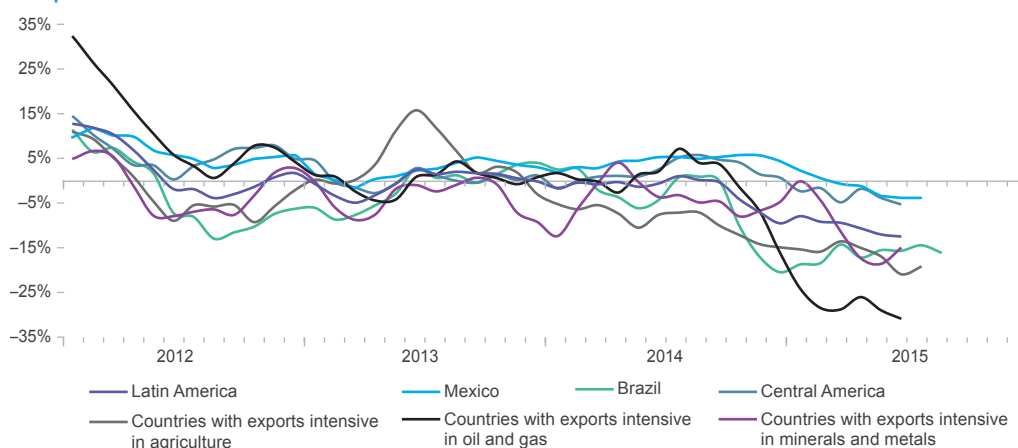
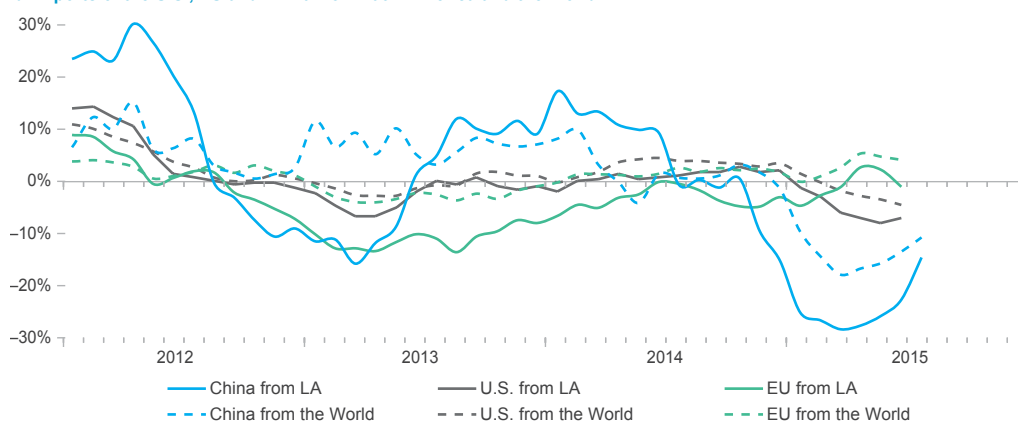
The decline
deepened and
broadened in
2015.

Negative export performance continued in early 2015, with an accumulated year on year contraction through June of 10.8% (Figure 13a). In the first part of the year, exports of all subregions fell, with the most affected countries being those with exports intensive in oil and gas. At the same time, in early 2015 the positive trend that had been observed in Mexican and Central American exports during 2014 was reversed.⁹

⁹ In the analysis of export performance of this section the largest economies, Brazil and Mexico, are treated separately, and the rest are grouped in the following way: Central America (Costa Rica, El Salvador, Guatemala,

FIGURE 13 • TRADE FLOWS OF SELECTED ECONOMIES

(Quarterly moving average of the annual growth rate, percentage, 2012–2015)

a. Exports from Latin America**b. Imports of the U.S., EU and China from Latin America and the World**

Source: IDB Integration and Trade Sector, with data from the U.S. International Trade Commission (USITC), EuroStat, China Customs, and national sources.

Note: Regarding exports, LA corresponds to the 18 countries mentioned in footnote 9. Figures do not include Venezuela as of January 2015 and the Dominican Republic as of April 2015. Imports are estimated based on the Latin America definitions of the reporting countries.

The behavior of regional exports was tightly linked with the change in the pattern of world growth, characterized by incipient signs of recovery observed in the advanced economies that has not compensated the marked deceleration of the developing

Honduras, Nicaragua, Panama, and the Dominican Republic); countries with exports intensive in agricultural goods (Argentina, Paraguay, and Uruguay); countries with exports intensive in oil and gas (Bolivia, Colombia, Ecuador, and Venezuela); and countries with exports intensive in minerals and metals (Chile and Peru). High frequency data was not available for the Caribbean or Venezuela for 2015.

economies. Although probably due to transitory factors, the U.S. economy slowed in the first quarter of 2015 and as a consequence U.S. imports from LA, which had shown moderate recovery in the previous year, entered negative territory (Figure 13b). Though the EU grew in April 2015 at a rate not seen since the second half of 2012, this growth was still insufficient to produce a positive annual average. Moreover, exports of South American countries were the most affected by the reduction of imports in China, which stagnated in mid-2014 and suffered a strong reduction beginning in November. In July of 2015 the quarterly moving average of the growth rate of Chinese imports from the region registered a contraction of 14.6% after reaching a minimum of -28.4% in March, one of the worst levels in recent records. These three economies' imports from LA showed a steeper contraction than their total imports, which revealed the severity of the global downturn's impact on the region.

Demand from principal trading partners fell.

Prices of main exports collapsed.

Considering that 60% of the region's foreign sales are composed of commodities (77% if Mexico is excluded) and in particular almost 20% corresponds to oil and gas, the drop in commodity prices, especially oil, has strongly affected the value of regional exports. These prices have experienced a sequence of drops since mid-2014: in July of 2015 the average price index of these products had fallen 37.1% year on year, with oil dropping almost by half (Figure 14).

The largest reduction was seen in the price of oil.

Besides the general factors driving commodity prices mentioned in Chapter 1, there are also important supply side issues in the case of oil. The high prices that characterized the past decade made profitable the production of non-traditional deposits with elevated unit production costs. Given the weak state of global demand, once the subsequent wave of technological innovation and investment in the sector had matured, the increase in crude oil production capacity put downward pressure on prices. In the U.S., the notable growth of domestic production since 2005 started a process of import substitution that eroded the net demand of an actor with singular weight in the global market.¹⁰ The drop in the price of oil by 48.2% year on year to July 2015¹¹ is one of the most salient features of the recent commodity market weakening, with an impact on producers in LAC (Box 2).

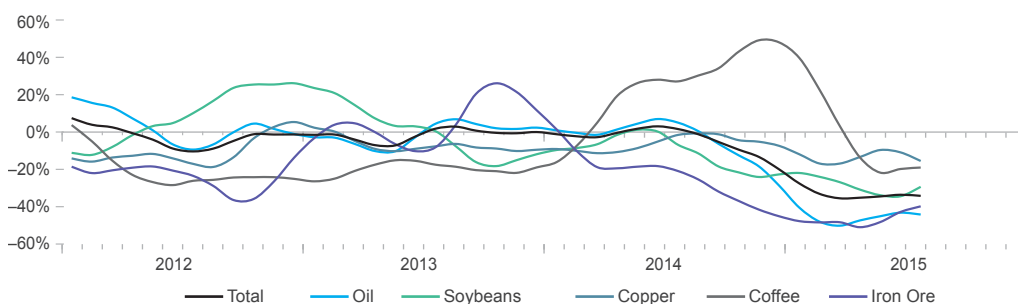
Minerals, metals and agricultural products have followed the downward trend.

¹⁰ See Espinasa and Sucre (2015) and Giordano (2014).

¹¹ Average of the prices of *Dated Brent*, *West Texas Intermediate* and *Dubai Fateh* reported by the IMF.

FIGURE 14 • PRICES OF THE MAIN EXPORT PRODUCTS OF LATIN AMERICA AND THE CARIBBEAN

(Quarterly moving average of the annual growth rate, percentage, 2012-2015)



Source: IDB Integration and Trade Sector with data from IMF.

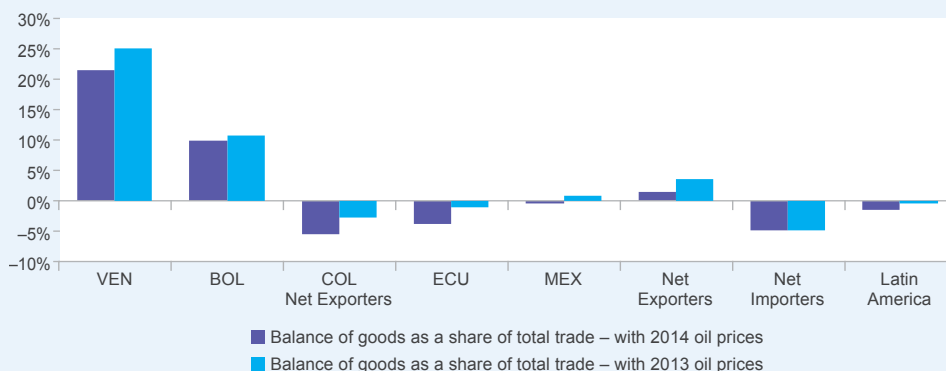
Note: The total corresponds to the weighted average of the commodity price indices included in the IMF estimation.

BOX 2: THE FALL IN OIL AND GAS PRICES

Exports of oil and gas feature strongly in the external supply of the region. In 2014, these products represented 18.2% of total regional exports. The principal suppliers of oil are Colombia, Ecuador, Mexico, and Venezuela, while Bolivia is an important exporter of gas. If the 2014 volume of oil and gas exports were valued at 2013 customs unit values, total exports of Latin America would have been US\$1.065 trillion. All else being equal, this would have implied a contraction with respect to the previous year of only 0.5% instead of 2.7%. The difference of 2.2 p.p. is equivalent to US\$25 billion, which represents 1% of total regional trade in 2014. With respect to the trade balance, the principal beneficiary would have been Venezuela, although Mexico would have had a small positive balance. On the other hand, net oil and gas importers would have only registered a marginal deterioration in their trade deficits.

IMPACT OF THE FALL IN OIL AND GAS PRICES

(Balance of goods trade as a share of total trade, percentage, 2014)



Source: IDB Integration and Trade Sector with data from INTrade/DataINTAL, PEMEX, IEA and the Central Bank of Venezuela.

Note: Net exporters are those with a positive balance in oil and gas in 2014. Exports from Bolivia include gas. Current figures were not available for the Caribbean. The estimation does not account for the potential use of hedging instruments.

Among minerals and metals, iron and copper prices also fell sharply. The price of iron has fallen since early 2014, a trend that accelerated mid-year: in July 2015 this price had an accumulated contraction of 46.3% year on year. In the same period, the downward trend in the price of copper deepened (-22.3%) and, in agricultural commodities, noteworthy declines are observed in the prices of soybeans (-19.6%) and coffee (-19.6%), whose strong recovery in 2014 suffered a sharp reversal in November.

Export Performance by Subregion and Country

The aggregate fall of 2.8% in goods exports from LAC in 2014 took the nominal total to US\$1.06 trillion. This total obscures differences among subregions and countries. Growth was observed in Mexico (4.6%) and Central America (2.3%), with improved performance over 2013, and more intense contractions than the previous year in South America¹² (-7.4%) and the Caribbean (-5.5%). Of the 26 economies included in Table 1, exports fell in half of them in 2014. The countries with the highest growth rates were Nicaragua (9.7%), Guyana (8.8%), Guatemala (7.8%), Bolivia (5.6%), Honduras (4.7%), The Bahamas (4.6%), and Mexico (4.6%).¹³ The steepest declines were seen in Venezuela (-16.8%), Belize (-13.6%), Argentina (-11.9%), Suriname (-10.4%), Peru (-7.8%), Trinidad and Tobago (-7.5%), Brazil (-7.0%), Colombia (-6.9%), El Salvador (-4.0%), and Jamaica (-1.8%).

Divergent performance across subregions was recorded in 2014.

In early 2015 the export contraction broadened.

The year on year performance of goods exports in the first half of 2015 shows an additional erosion of regional exports. For 24 of the LAC countries for which data is available, 20 registered negative growth rates, with the most affected region being South America (-17.7%).¹⁴ The exceptions to the general deterioration of exports are El Salvador (6.0%), Honduras (4.4%), Guatemala (3.1%), and Belize (2.4%). For the three Central American countries contributing factors include the fact that for much of the period coffee prices had not yet fallen, as well as flows from new electricity trade made possible by the Central American Electrical Interconnection System (SIEPAC by its Spanish acronym).

Given the collapse in the price of oil, naturally, the greatest impact in the year on year data through June 2015 is observed in the countries with an important component

¹² This grouping includes all countries of the continent, except Guyana and Suriname which are classified as Caribbean.

¹³ Due to the lack of information the figures corresponding to Honduras and Nicaragua do not include trade under Special Trade Regimes (STR).

¹⁴ This estimate does not include Venezuela due to a lack of current data.

TABLE 1 • GOODS EXPORTS OF LATIN AMERICA AND THE CARIBBEAN

(Annual growth rate and billions of US\$, selected periods)

	US\$ Billion			Growth Rates (%)			Acum. June 2015
	2012	2013	2014	2002–2008	2013	2014	
LATIN AMERICA AND THE CARIBBEAN	1092.3	1090.5	1060.0	16.7	–0.2	–2.8	–10.9
LATIN AMERICA	1071.5	1070.2	1040.9	16.6	–0.1	–2.7	–10.8
MESOAMERICA	414.4	423.9	442.4	10.2	2.3	4.4	–2.3
Mexico	370.8	380.0	397.5	10.4	2.5	4.6	–2.2
Central America	43.7	43.8	44.8	9.0	0.4	2.3	–3.4
Costa Rica	11.4	11.6	11.3	10.3	1.5	–2.6	–16.0
El Salvador	5.3	5.5	5.3	7.6	2.8	–4.0	6.0
Guatemala	10.0	10.0	10.8	10.9	0.5	7.8	3.1
Honduras	4.3	3.9	4.1	13.6	–10.4	4.7	4.4
Nicaragua	2.7	2.4	2.6	17.5	–10.3	9.7	–2.6
Panama	0.8	0.8	0.8	7.3	2.7	–3.0	–14.8
Dominican Republic	9.1	9.6	9.9	4.1	5.5	3.6	–16.3
SOUTH AMERICA	657.1	646.4	598.5	22.1	–1.6	–7.4	–17.7
Argentina	80.2	81.7	71.9	18.2	1.8	–11.9	–17.9
Bolivia	11.8	12.2	12.9	31.7	3.3	5.6	–30.3
Brazil	242.6	242.0	225.1	21.9	–0.2	–7.0	–14.7
Chile	77.8	76.5	75.7	23.5	–1.7	–1.0	–12.2
Colombia	60.1	58.8	54.8	21.1	–2.2	–6.8	–31.2
Ecuador	23.8	24.8	25.7	24.6	4.6	3.6	–26.8
Paraguay	7.3	9.4	9.7	18.4	29.5	2.4	–17.6
Peru	47.4	42.9	39.5	26.1	–9.6	–7.8	–15.8
Uruguay	8.7	9.1	9.2	21.3	4.1	1.0	–15.1
Venezuela	97.3	89.0	74.0	23.5	–8.6	–16.8	n.a.
CARIBBEAN	20.8	20.3	19.1	24.3	–2.7	–5.5	–14.9
The Bahamas	0.8	0.8	0.8	10.3	–2.0	4.6	–34.6
Barbados	0.6	0.5	0.5	13.2	–18.7	1.4	–7.5
Belize	0.4	0.4	0.4	10.6	2.2	–13.6	2.4
Guyana	1.1	1.1	1.1	7.0	0.0	8.8	–0.8
Haiti	0.8	0.9	0.9	11.8	13.9	3.8	n.a.
Jamaica	1.6	1.5	1.5	13.8	–9.9	–1.8	–12.6
Suriname	2.6	2.4	2.1	29.5	–6.6	–10.4	–8.8
Trinidad and Tobago	13.0	12.8	11.8	29.9	–1.6	–7.5	–18.3

Source: IDB Integration and Trade Sector, with data from INTrade/DataINTAL and national sources.

Notes: n.a. means that data is not available. See Methodological Annex 2 for definitions.

of this commodity in exports, namely Colombia (-31.2%), Bolivia (-30.3), and Ecuador (-26.8%). Likewise, other commodity exporters (mining or agricultural) have appreciable reductions in their exports: Peru (-15.8%), Paraguay (-17.6%), Chile (-12.2%), and Uruguay (-15.1%). In Argentina (-17.9%) and Brazil (-14.7%), whose export baskets hold both commodities and manufactures, the poor performance in extraregional markets was compounded by the weakening of intraregional demand due to slowing or negative growth. Mexican exports (-2.2%) reflect the sluggish growth in the U.S. in the first quarter and lower oil prices. Costa Rican exports (-16.0%) were down sharply due to the cessation of manufacturing operations of INTEL.

The largest drops were seen in oil exporters.

Services exports lost dynamism.

The unfavorable external context also affected regional exports of services (Table 2). Though in 2014 services exports expanded in contrast to those of goods, growth registered only 1.8% for a total of US\$ 142 billion. That is, a deceleration of 2.9 p.p. compared to the previous year (4.7%). Thus, just as with

the foreign sales of goods, exports of services performed poorly in the post-crisis compared to the years prior to the global financial collapse: between 2002 and 2008 the average annual growth rate of these flows was 14.0%.

In 2014, services exports represented 11.8% of total LAC exports. However, their relative weight as well as their sectoral composition varies greatly by country, particularly in reference to knowledge-intensive services (KIS), which are especially dynamic at the global level (Box 3). In Mexico services represented a mere 5.0% of total exports, while in Central America and in South America they reached 39.7% and 12.4%, respectively. Performance in 2014 was also unequal. Central American exports of services were relatively dynamic, increasing by 8.3% to US\$30 billion, while in South America services exports fell by 1.2% to US\$85 billion. In 2014, Mexico exported services worth US\$21 billion, 4.6% above the previous year. Brazil, representing 45.6% of South American sales, registered an increase in this category (3.0%) while in Argentina services exports fell 5.9%. With the exception of Chile, whose services exports fell 11.9%, the rest of the Andean countries were characterized by good performance, particularly Bolivia with growth of 12.6%.

Performance of services exports is unequal.

Caribbean performance was above the regional average.

In the Caribbean countries for which 2014 data is available, significant growth in services exports was registered: Suriname (19.3%), Belize (10.4%), Haiti (7.5%), Jamaica (6.8%), and The Bahamas (1.5%). For some of these economies, tourism constitutes one of the more important parts of the external sector as services exports related to these activities represented close to one third of total goods

TABLE 2 • SERVICES EXPORTS OF LATIN AMERICA AND THE CARIBBEAN

(Annual growth rate and billions of US\$, selected periods)

	US\$ Billion			Growth Rates (%)		
	2012	2013	2014	2002–2008	2013	2014
LATIN AMERICA AND THE CARIBBEAN	133,3	139,5	142,0	14,0	4,7	1,8
LATIN AMERICA	126,6	132,9	135,1	14,8	5,0	1,6
MESOAMERICA	41,6	47,4	50,5	8,8	14,0	6,7
Mexico	16,1	20,1	21,0	6,2	24,6	4,6
Central America	25,4	27,2	29,5	12,0	7,2	8,3
Costa Rica	5,4	6,0	6,3	14,0	10,9	4,5
El Salvador	1,3	1,4	1,7	5,4	14,1	15,8
Guatemala	2,3	2,4	2,6	9,1	3,1	8,1
Honduras	1,0	1,1	1,2	8,9	6,5	7,9
Nicaragua	0,6	0,6	0,7	15,4	0,5	5,3
Panama	9,1	9,7	10,5	17,9	5,8	8,9
Dominican Republic	5,6	6,0	6,6	8,5	7,0	9,7
SOUTH AMERICA	85,1	85,6	84,5	19,4	0,6	–1,2
Argentina	14,8	14,4	13,5	23,3	–3,2	–5,9
Bolivia	1,0	1,1	1,2	12,5	10,2	12,6
Brazil	38,1	37,4	38,5	21,9	–1,8	3,0
Chile	12,4	12,5	11,0	16,4	0,5	–11,9
Colombia	6,3	6,7	6,8	14,6	6,8	1,9
Ecuador	1,7	1,9	2,1	8,7	12,8	11,1
Paraguay	0,6	0,7	0,7	12,3	15,0	4,7
Peru	4,8	5,7	5,7	17,3	18,8	0,9
Uruguay	3,6	3,4	3,3	20,9	–3,3	–4,6
Venezuela	1,9	1,8	1,6	14,1	–1,1	–12,1
CARIBBEAN	6,6	6,6	6,8	7,2	–0,3	2,7
The Bahamas	2,6	2,6	2,7	3,4	–0,6	1,5
Barbados	n.a.	n.a.	n.a.	11,4	n.a.	n.a.
Belize	0,4	0,4	0,5	14,0	13,6	10,4
Guyana	0,3	0,2	n.a.	4,2	–44,7	n.a.
Haiti	0,5	0,6	0,6	14,8	20,8	7,5
Jamaica	2,7	2,6	2,8	6,6	–1,0	6,8
Suriname	0,2	0,2	0,2	37,0	4,4	19,3
Trinidad and Tobago	n.a.	n.a.	n.a.	7,4	n.a.	n.a.

Source: IDB Integration and Trade Sector, with data from the IMF, WTO, and national sources.

Notes: n.a. means that data is not available. See Methodological Annex 2 for definitions.

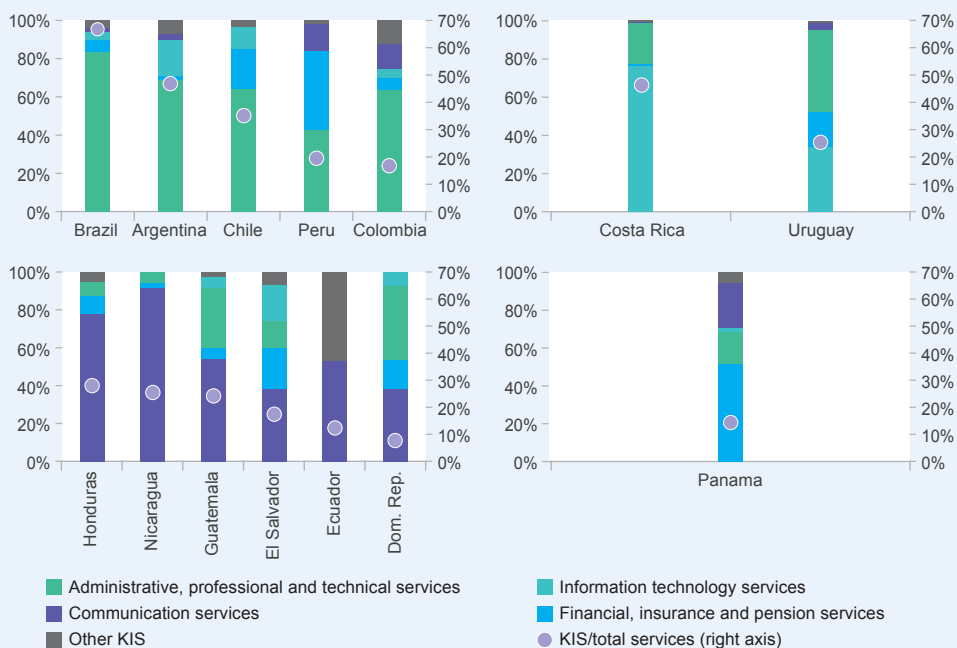
BOX 3: KNOWLEDGE-INTENSIVE SERVICES EXPORTS

Trade in knowledge-intensive services (KIS) is in a phase of rapid expansion as the progress of new communication technologies has allowed greater cross-border flows. In 2013, estimates put the total value of services exports at 5.7% of global GDP and those of KIS equivalent to 2.4%. The corresponding proportions highlight a gap for LAC countries: total services exports were 2.3% of GDP, and exports of KIS represented only 0.7% of regional output.

A disaggregated analysis of KIS exports for the countries of the region where data are available shows a heterogeneous panorama. In the larger countries—Brazil, Argentina, Chile, Peru, and Colombia—the share of KIS exports in total services exports is relatively high, above 35% on average in this group. These countries have a significant presence of professional and administrative services and services related to design, engineering, etc. in their export baskets. A second group of smaller countries, Costa Rica and Uruguay, have specialized in the provision of information technology services, software, and similar activities. For this group, KIS exports represent around 35% of total services exports.

In smaller countries the share of KIS is on average below 30%. In these cases, specialization is focused in communication and business services, such as the operation of call centers and similar activities. Finally, in Panama the supply of financial services dominates, and is important in absolute terms, though the participation of KIS in the total is only 14% due to the importance of transport and storage activities related to the Canal.

EXPORTS OF KNOWLEDGE-INTENSIVE SERVICES (Percentage, 2013)



Source: IDB Integration and Trade Sector, with data from the IMF and WTO.

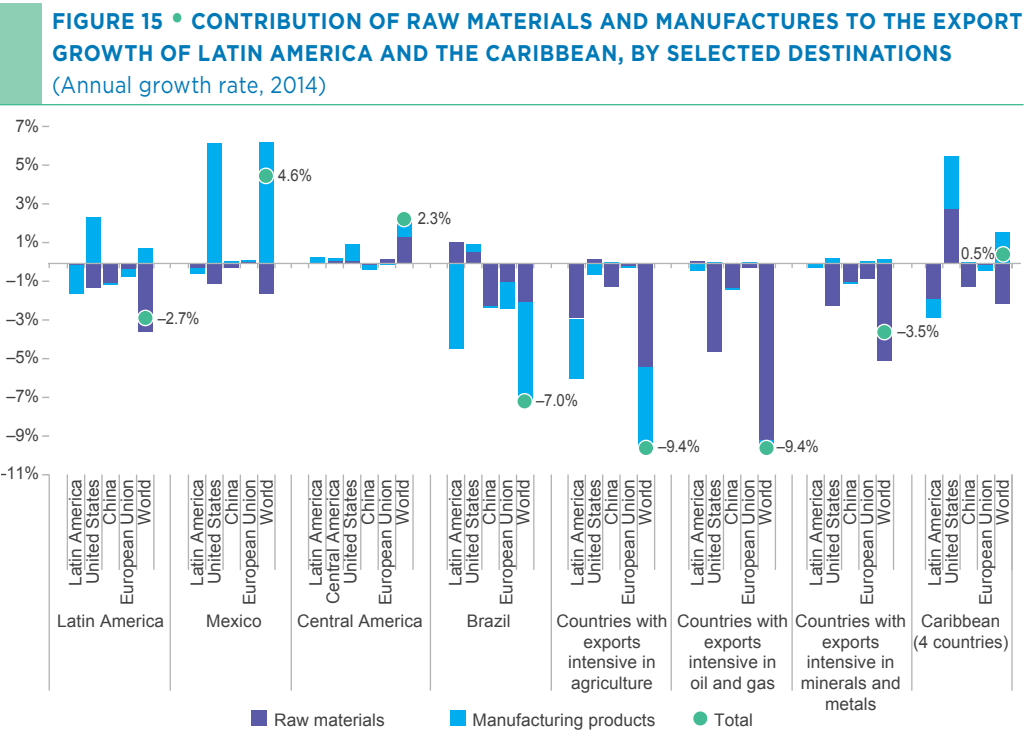
Note: Exports exclude government and manufacturing services. Countries are included in the analysis only if comparable disaggregated data is available, and if they have a share of services exports in total exports (goods and services) greater than 10%. Financial, insurance, and pension services are included within exports of KIS.

and services exports. The available indicators of tourism flows give a generally positive outlook, though with some caveats. The Bahamas and Jamaica recorded average annual growth rates of tourism arrivals of 3.0% and 6.1%, respectively, between 2010 and 2015. On the other hand, Belize and Haiti, from a lower starting point, are rapidly developing tourism industries with growth rates of 6.2% and 29.8% in the same period. In contrast, Barbados, Trinidad and Tobago, and Suriname have seen these flows stagnate.

Export Dynamics by Product and Destination

Commodities explain most of the export contraction.

The fall in regional exports of goods in 2014 can be broken down by type of product and by destination market (Figure 15). For the Latin American total, the contraction of 2.7% resulted from a reduction of 3.5 p.p. corresponding to commodities, partially compensated by an expansion of manufactures equivalent to



Source: IDB Integration and Trade Sector, with data from INTrade/DataINTAL.
Note: Growth rates are decomposed according to the share that the principal partners and the type of products contribute to the total rate of change of exports in 2014. The Figure does not include all partners and, therefore, the sum of the contributions may not equal the total. Raw materials includes manufactures based on natural resources. The classification of countries is defined in footnote 9. The Caribbean includes Barbados, Belize, Guyana, and Jamaica, the only ones for which current disaggregated data were available, and so the growth rate is different from that reported in Table 1.

0.8 p.p.. The weak performance of commodity markets affected most of the region, with the exception of Central America, whose commodity exports expanded in most markets, except China. On the other hand, the global economy markedly affected those countries with exports intensive in oil and gas and minerals and metals in nearly all markets, and accounted for the bulk of the decline in their exports. Raw materials sales from Mexico to the U.S., mainly composed of oil and its derivatives, were also affected and subtracted 1.5 p.p. from the growth of total exports. Similarly, raw materials exports from the Caribbean (4 countries) subtracted 2.0 p.p. from total export growth, despite expansion of these exports to the U.S. by 2.8 p.p.. In Brazil, this factor explained 2.0 p.p. of the total 7.0% contraction, driven principally by the Chinese and European market dynamics. However, it was the collapse of intraregional exports, in particular within the Common Market of the South (MERCOSUR) that was the principal determinant of the poor export performance.

While foreign sales of commodities to the main destinations considered above contracted, exports of manufactures to the U.S. expanded, partially compensating for the decline in intraregional flows of these products. The increase in shipments from Mexico, the Caribbean (4 countries), and, to a lesser extent, Central America, Brazil, Chile, and Peru to the

Exports of manufactures expanded, especially to the United States.

South America faced a significant deterioration of the market for manufactures.

U.S. explains the growth of manufacturing in 2014.

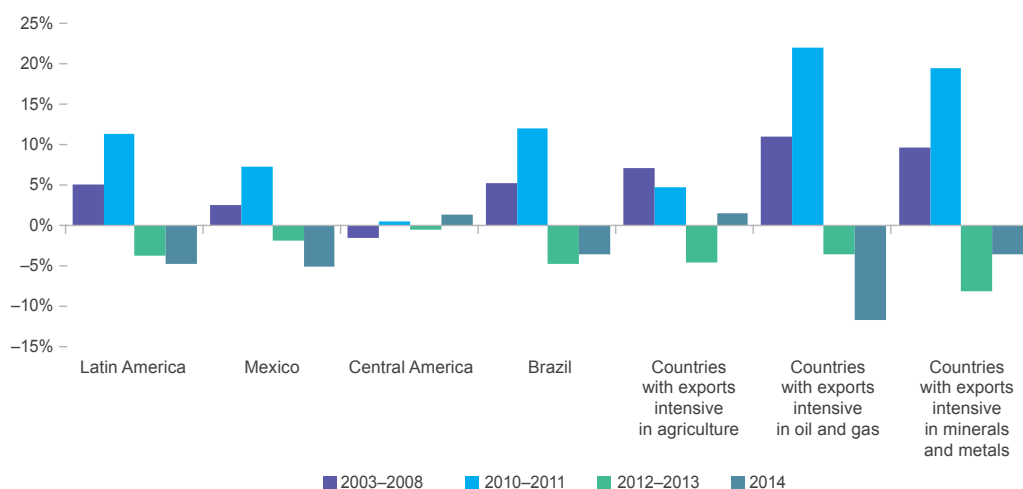
The performance of the countries of South America, and particularly those with exports intensive in agriculture, was consistent with that observed in Brazil. The change in total exports of this group (-9.4%) combines close to 5.3 p.p. attributable to the reduction of commodity exports, and 4.1 p.p. explained by the fall in manufactures sales in the Latin American market. As on other occasions, the deterioration of the extraregional market for Brazil and the countries with exports intensive in agriculture dampened intraregional trade flows where industrial goods are more relevant. Thus, in 2014 the most relevant positive factor driving total regional exports was the sales of manufactures to the U.S. by Mexico and Central America.

Terms of Trade, Prices, and Export Volumes

As expected, the magnitude of the price movements affecting the commodity markets caused large swings in the prices of regional exports and imports. The net result for the regional aggregate for 2014 was a fall, for the third consecutive year, in the

Terms of trade fell for a third consecutive year.

FIGURE 16 • TERMS OF TRADE OF LATIN AMERICA
(Average annual change, percentage, selected periods)



Source: IDB Integration and Trade Sector, with data from INTrade/DataINTAL, Banco de México and Banco Central de Venezuela.

Note: The classification of countries is defined in footnote 9. Central America does not include Panama and the Dominican Republic. Data was not available for the Caribbean. The growth rate is calculated as the annual equivalent of the average geometric growth rate over the intervals indicated, with the reference years being, respectively, 2002, 2009, and 2011.

terms of trade, which declined 4.7% after an average reduction of 3.7% in 2012–2013 (Figure 16).¹⁵ It is thus evident that the period of export stagnation was characterized by terms of trade dynamics that were the opposite of those experienced by the region during the 2003–2008 boom and the 2010–2011 recovery. Nonetheless, it is worth noting that the impact of the drop in terms of trade in 2014 had heterogeneous effects across groups of countries.

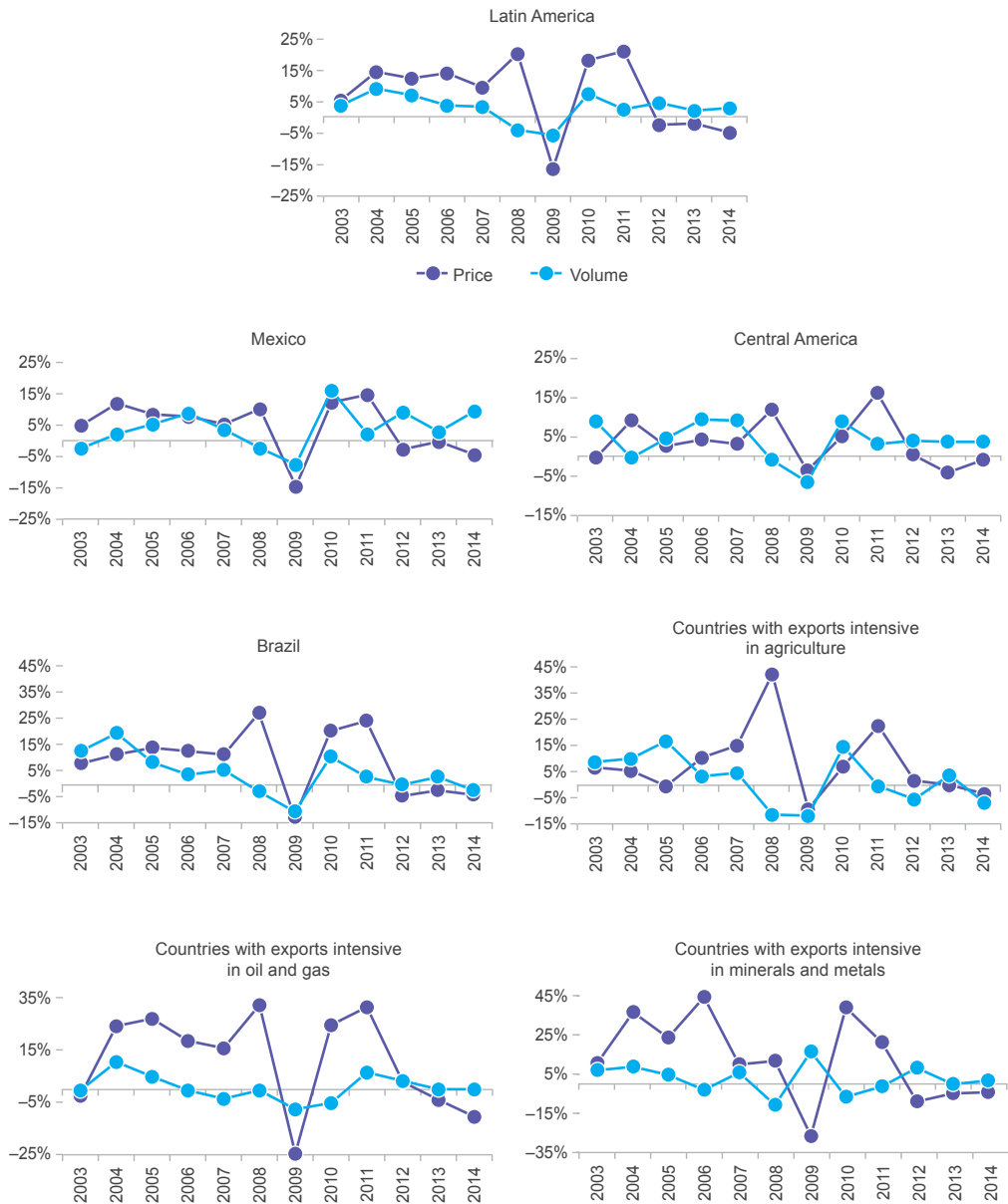
The collapse of oil prices dominated the movement of the terms of trade.

Although the global outlook was characterized by a decline in most commodity prices, this movement was particularly dramatic for oil. The deterioration of the terms of trade for the regional aggregate is explained for the most part by a reduction of the price ratio in the countries with exports intensive in oil and gas (Bolivia, Colombia, Ecuador, and Venezuela) where the drop in terms of trade (–11.6%) far exceeded the regional average. Likewise, in Mexico the relative price of exports in terms

of imports fell 5.0% due both to the oil component of the export basket (nearly 12% of the 2014 total) and to downward pressure on the prices of some manufactures.

¹⁵ Methodological Annex 3 describes the methodology used to derive the price, quantity, and terms of trade indices for the countries of Latin America, which were estimated from disaggregated data from INTrade/DataINTAL and national sources.

FIGURE 17 • EVOLUTION OF THE PRICE AND VOLUME OF LATIN AMERICAN EXPORTS
(Annual rate of change, percentage, 2003-2014)



Source: IDB Integration and Trade Sector, with data from INTrade/DataINTAL, Banco de México and Banco Central de Venezuela.

Note: The classification of countries is defined in footnote 9. Central America does not include Panama and the Dominican Republic. Data was not available for the Caribbean.

On the other hand, the terms of trade for the countries of Central America, net oil and gas importers, benefitted with a gain of 1.4% with respect to the previous year. Countries with exports intensive in agriculture also saw their terms of trade improve by 1.4%, after a negative performance (-4.8%) in the preceding year.

Oil importers marginally improved their position.

Although the mineral and metal intensive exporters and Brazil registered terms of trade declines in 2014, -3.6% and -3.5% respectively, these were substantially smaller than those of the 2012-2013 period (-8.1% and -4.8%). The result for countries with exports intensive in agriculture, as well as for those where minerals and metals dominate, was influenced precisely by the drop in oil prices, an input that represented a significant portion of their import baskets. Additionally, on the export side, the fall in world prices of some key products such as copper and soybeans was less dramatic than the fall in oil prices, which made for a net positive contribution to the terms of trade.

Export volumes grew modestly and unevenly.

While the main factor determining the contraction of the value of exports was the 5.0% drop in prices, it is notable that the volume of exports only grew by 2.6% (Figure 17). This modest increment was similar to those recorded in the previous four years, when the average growth of quantities exported between 2011 and 2014 was 2.8%. Additionally, the increase in export volumes in 2014 was concentrated in the foreign sales of Mexico (9.3%) and Central America (3.8%), while in the other cases export volumes diminished (in countries with exports intensive in agriculture -6.6% and in Brazil -2.9%), or grew only slightly (oil and gas exporters: 0.3%; mineral and metal exporters: 1.6%).

In this context of low export volume growth in the majority of countries, the drop in prices had a decisive impact on the value of exports. In 2014, the largest fall in average export prices was in countries with exports intensive in oil and gas (10.1%), followed by those intensive in minerals and metals (-4.1%), in agriculture (-3.1%), and Brazil (-4.2%). Likewise, those economies with real growth of their exports were affected by the deflationary trend in international trade, as the export prices of Mexico and Central America fell 4.3% and 0.8%, respectively.

Export prices fell in all subregions.

In conclusion, the change in trend of international trade in 2014 strongly affected the region, resulting in a substantial contraction of goods exports and a deceleration of the growth of services exports. In general, the small and uneven increases in export volumes did not compensate for the sharp reduction in the prices of the principal export products. While in 2014 Mexico and Central America performed better than the regional average as the U.S. economy gained traction, momentum was lost in the first part of 2015. Elsewhere, the countries of South America suffered a sharp

deterioration in their terms of trade driven by a significant fall in commodity prices, the deceleration of the Chinese economy, and the contraction of the intraregional market. In this context, it is urgent that the policy response contribute to a diversification of the regional export basket, as discussed in the next section.

The Challenge of Export Diversification

3

The adverse trade outlook for Latin America and the Caribbean elevates the need to further diversify exports, while the new exchange rate scenario offers incentives to non-traditional export sectors. The analysis of the diversification dynamics in the past decade indicates that, although the surge in commodity prices increased the level of concentration of the export baskets, there were nonetheless success stories of new product exports and access to new markets. Several small and medium-sized economies of the region managed to establish competitive positions in world markets even during the recent stagnation of global trade. However, the growth of exports was accomplished principally by selling existing products in new markets while the introduction of new products in new markets has been limited. Overall, most countries of the region have had modest success in diversifying their export supply, indicating a need for policies that facilitate and promote diversification.

The preceding sections described the increasingly adverse environment that LAC exports are facing due to the contraction of external demand and the collapse of commodity prices. At the same time, the recent exchange rate depreciations in several economies have created opportunities to correct the processes of strong appreciation that had previously been obstacles to greater export diversification. This chapter considers several aspects of export supply diversification witnessed in the past decade, given that any policy response oriented to relaunching foreign sales should consider export diversification among its objectives.¹⁶ The first section characterizes

¹⁶ The effects of export diversification have been the subject of extensive theoretical and empirical literature. Notable contributions are as old as Prebisch (1950) and as recent as those that followed Imbs and Wacziarg (2003), and have given rise to countless policy-oriented analyses, among which those of Newfarmer *et al.* (2009) and Sabel *et al.* (2012) stand out. Given that all of the arguments highlight the vulnerability of foreign earnings to broad fluctuations in prices, this chapter provides a descriptive analysis of regional export diversification with the objective of identifying guidelines for a policy response geared towards the promotion of exports. Of course this is only one partial aspect of the agenda for the insertion of regional countries into international markets, and cannot be disassociated from other actions oriented towards increasing market access, productivity, innovation, and the efficient use of factor endowments that would result in a greater variety of the export basket.

the concentration of regional exports using indicators based on the number of products exported and markets reached. The second section looks at the competitive position of regional exports in global markets. Lastly, the third section analyzes the relative weight of the diversification of partners and products in export growth. Throughout the chapter, the export boom of 2003–2008 is compared to the period beginning in 2011 dominated by stagnation and, more recently, contraction of exports.

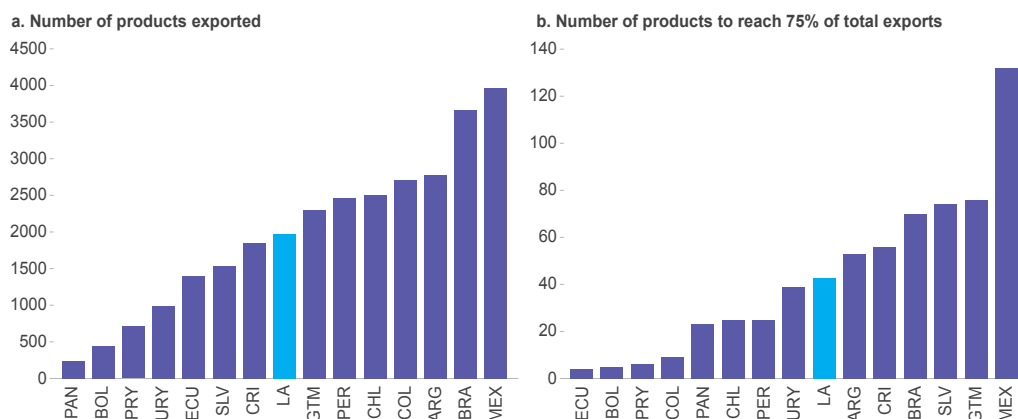
Concentration of the Export Basket

The exports of most countries are highly concentrated.

The concentration of exports is a salient characteristic of most LAC countries' external supply. However, there are important differences with regards to the size of the export basket and its degree of concentration (Figure 18).¹⁷ At the extremes, in 2014 Panama exported close to 250 products while Mexico registered exports of almost 4,000; in Ecuador 4 products account for 75% of total exports, while in Mexico 132 products yield the same proportion. For the region, the simple average is 1,970 products exported, with 43 of them providing 75% of the value. Factors in these differences include asymmetries in the scale of the economies (Box 4) and their pattern of specialization. In Bolivia, Colombia, Ecuador, and Paraguay less than 10 products represent 75% of exports. Panama, Chile, and Peru are at the upper end of the scale, with an average of 23, followed by Uruguay with 39. The first group consists of countries with a broader array of commodities that also include some manufactures. Above the regional average are Argentina, Brazil, and some Central American countries (Costa Rica, El Salvador, and Guatemala), with an average of 66 products to reach 75%. Although the Central American countries are relatively small, their export supply includes a significant

¹⁷ Both the breadth and degree of concentration of the basket are relevant measures to characterize export diversification as they reflect different dimensions of the degree of productive development and the complexity of international insertion. Apart from the intuitive measurement offered by the number of products exported, there are different indicators of concentration. The indicator used here (number of products that represent 75% of the value exported) is sensitive both to the size of the basket and to inequality of the structure of foreign sales. In this report, the concept of a product corresponds to the 6-digit subheading of the Harmonized System (HS), considering only those with exports greater than US\$10 thousand. Given the sample and the periods studied, the selected threshold (75%) is adequate to balance two objectives: explaining the variability of the number of products exported, and exclusion of goods of scant economic importance. The normalized Hirschman-Herfindahl index (HHI) is not used because it is much more sensitive to a lower dispersion of the relative weights of the products than to the number of products included in the basket. For example, a country with a very broad basket (in this sense, diversified) and a certain disparity in the structure of the shares of the products can have a HHI much higher than a country with a much smaller basket (less diversified) but with a more balanced structure. In the sample only 14 countries are considered due to a lack of comparable historical data for the rest.

FIGURE 18 • SIZE OF THE BASKET AND CONCENTRATION OF EXPORTS
(Number of products, 2014)



Source: IDB Integration and Trade Sector with data from INTrade/DataINTAL.

Notes: Products are counted at the 6-digit HS level, considering only those with exports exceeding US\$10 thousand.

contingent of manufactures.¹⁸ Mexico's export basket has the most products and is the least concentrated in the region.

Given the high degree of export supply concentration and the associated risks in the current global economy, a retrospective examination of export diversification by product and by destination market is useful. Taking a medium-term perspective, Figure 19 analyzes the diversification dynamics, considering the trajectories of the individual countries in terms of the scope and breadth of the basket (partners and products exported) and their concentration (partners or products which represent 75% of the total). To identify the impact of the boom of commodity prices, the analysis by products is modified to exclude these goods from the total. In general, the analysis supports the conclusion that, although at first sight the exports of regional countries with abundant natural resources became more concentrated as the prices rose, this is only a partial view of the region's international insertion pattern during this period. On the contrary, during the boom there are examples of diversification trajectories, and in the more recent phase these trends have stagnated, which is worth examination.

For the regional total, during the boom period, the number of export markets grew at an average rate of 2.7% per year and,

During the boom, market concentration lessened and the number of exported products increased.

¹⁸ However, the presence of many textile and apparel products in the export baskets of these countries influences the low relative indices of concentration as the HS with which products are classified distinguishes a wide variety of goods in this sector, and the indicator is therefore biased upwards.

BOX 4: SCALE AND EXPORT DIVERSIFICATION

Economic literature has commonly investigated the link between the level of development, represented by income per capita, and export diversification. However for the purposes of this report, establishing the relationship that links this variable with the absolute scale of the economy is more appropriate. A larger population, more resources, or a larger output, in principle, would allow a broader variety of exports. Certainly, the dimension of the export supply also depends on other variables such as factor endowments, capacity for innovation, infrastructure, proximity to foreign markets, and trade policy. To isolate the effect of scale, the graph orders countries according to the share of their GDP (measured at PPP on the vertical axis) and the number of products exported (on the horizontal axis) with respect to the maximum levels observed (China, in both cases). The relationship shows that, in effect, scale is an important factor in diversification in addition to other variables. It is useful to distinguish two groups of economies separated by a line corresponding to 10% of the Chinese GDP. Regarding to the dimension of the export supply, three ranges are distinguished: small baskets, with less than 25% of the products exported by the reference economy; medium baskets, with between 25% and 60% of those products; and large baskets, with more than 60%.

In the case of LAC, the first range includes the economies of the Caribbean and Central America, the smallest of South America (Bolivia, Ecuador, Paraguay, and Uruguay) and Venezuela. In the subgroup with GDP below 2% of China's (see inset graph), there is a broad range of export supplies. The Caribbean countries (except Trinidad and Tobago) have baskets with less than 5% (and GDP less than 0.2%); the baskets of Costa Rica and Guatemala reach nearly 20% of the reference level, which has them well positioned relative to their scale. Venezuela (similar, for example, to Nigeria, Algeria, and Qatar) has a small basket relative to total output, due to its high degree of specialization in oil and gas. Based on the size of their export basket, Argentina, Colombia, Chile, and Peru fall into the second group. In these countries their larger scale is accompanied by a larger export supply. However, these four countries still have GDP less than 10% of the Chinese level, which makes them comparable with Korea, and part of a group where there

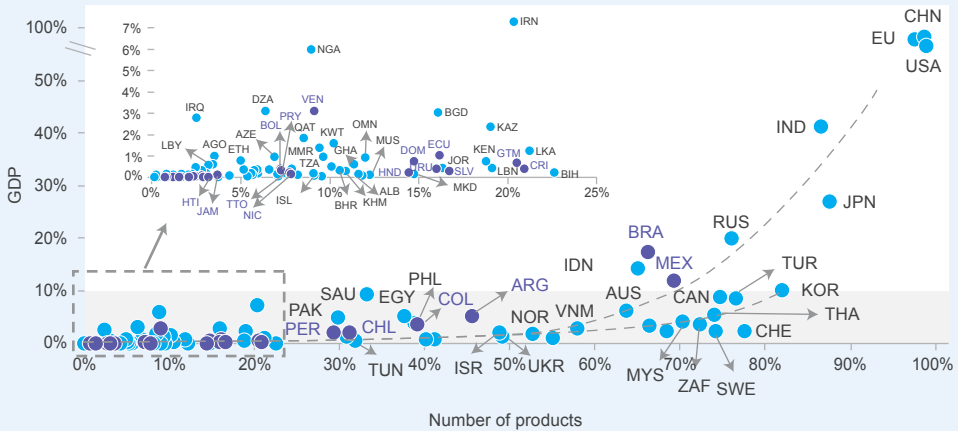
except for Bolivia, all countries increased their number of destinations (Figure 19, left panel). At the same time, the region reduced its market concentration as the number of destinations accounting for 75% of exports grew at an annual rate of 2.9%. This trend occurred in most of the economies with the exception of Ecuador and Uruguay. Likewise, the number of products included in the total export basket grew 2.3% per year. In this respect, it was slightly below the rest of the world (3.5%, not

reported in the Figure) but it is a signal of a response in terms of the introduction of new products that was present in most countries other than Mexico, Panama, and Bolivia. With some exceptions, there are notable diversification processes of both markets and products in those countries that have actively negotiated trade agreements.

However, during this period, at the same time that the number of products exported was rising, there was also an increase

Product concentration increased as an effect of high commodity prices.

SCALE AND EXPORT DIVERSIFICATION (Shares, percentage, 2013)



Source: IDB Integration and Trade Sector with data from INTrade/DataINTAL, WITS, and IMF.

Notes: Vertical axis: GDP of each country measured at PPP as a proportion of China's GDP; horizontal axis: Number of products exported as a proportion of the number of products exported by China, defined at the 6-digit HS level.

are several countries with much more diversified exports (as high as 60% of the Chinese level) than the Latin America countries: for example, Israel, Ukraine, Norway, Australia, Malaysia, South Africa, and Thailand, some with abundant natural resources similar to South American countries. Lastly in the third range, those with baskets above 60% of the reference level are Mexico and Brazil which also have GDP above 10% of the Chinese level. In relation to their scale, these large LAC economies have a relatively low degree of diversification.

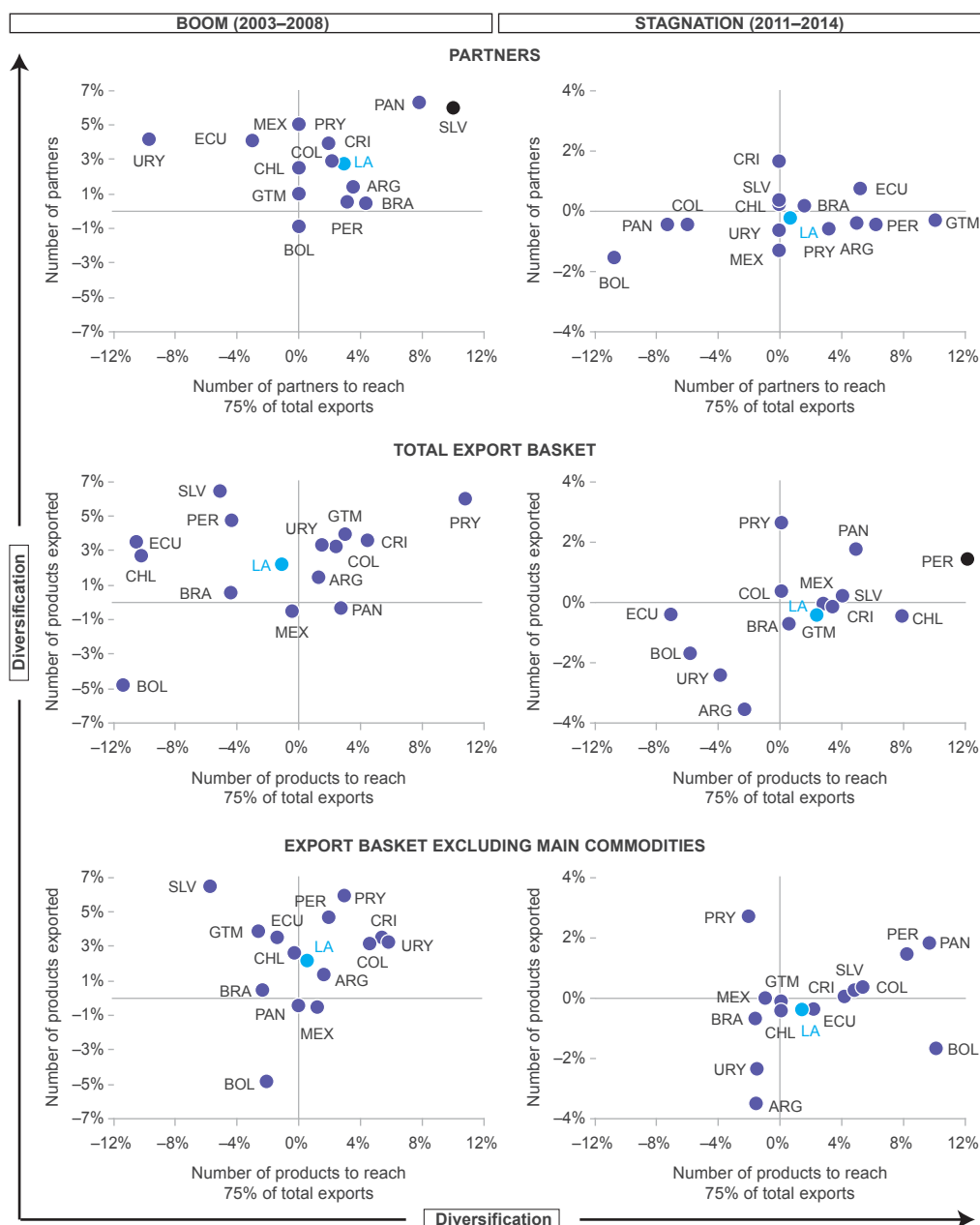
in concentration. For the regional average, the number of products that represented 75% of exports fell at an annual rate of 1.1%. This result depended strongly on the presence of commodities in the export basket. Countries with the most concentrated baskets are those that intensively produced and exported commodities whose prices soared in that period: Bolivia, Chile, and Ecuador. Also notable are the success stories of commodity exporters, such as Paraguay, that managed to diversify their foreign sales as investments in new commodity export sectors matured.

The effect of commodity prices on concentration is even clearer when considering a basket that excludes the main commodities.¹⁹ In this case, the number of products

¹⁹ Primary goods and manufactures based on natural resources representing at least 3% of total exports in the final year of the respective period were excluded from these baskets. For example, in 2014 an average of 5 products per country was excluded. The share of the remaining basket in total exports varies across countries: in Mexico and Central America (except Panama), it exceeded 70% of exports; while in the oil and gas exporters it was less than 30% of the total.

FIGURE 19 • DYNAMICS OF EXPORT DIVERSIFICATION

(Average annual rate of change, percentage, 2003–2008 and 2011–2014)



Source: IDB Integration and Trade Sector with data from INTrade/DataINTAL.

Notes: The sample includes 14 countries for which comparable historical data is available. Products are counted at the 6-digit HS level, considering only those with exports greater than US\$ 10 thousand. The rates of change are annual geometric averages over the intervals indicated, with 2003 and 2011 as reference years, respectively. The "main commodities" are those primary goods and goods based on natural resources that represent at least 3% of total exports in the last year of the respective period. The highlighted countries (PER and SLV) are outliers of the variable on the horizontal axis, respectively 18.6% and 28.5%, that were replaced with lower values to allow the graphs to have comparable scales, without affecting the averages.

representing 75% of aggregate regional exports fell at an annual rate of 0.5% from 2003–2008. Using this measure, the concentration trend weakened in most countries. The most notable cases were Mexico and Peru, where the number of products to reach 75% of exports increased. In Argentina, Costa Rica, and Uruguay, the increase in concentration was less intense.

The adverse economic situation halted the diversification process.

Excluding commodities, the trend towards concentration has eased.

Since 2011, during the stagnation period there have been several changes in the diversification dynamics of LAC countries (Figure 19, right panel).²⁰ First, in terms of partners, in the context of weakening foreign demand and with diminishing new market access via trade agreements, the growth in the regional average of the number of new partners slowed slightly and diversification halted. Second, in terms of products, the fall in commodity prices led to most countries

experiencing lower levels of concentration, but this movement was also accompanied by a moderate reduction in the number of products exported. Finally, in contrast to the boom period when some countries displayed diversification through industrial products, in the more recent phase the exports of manufactures ceased to contribute to diversification. This is notable for example when comparing the baskets with and without main commodities in countries with agriculture-intensive exports. For example in Argentina and Uruguay the export supply without main commodities is lower and is more concentrated due to the weakness of the subregional market, which is the main destination of their manufactures.

Competitive Position in Foreign Markets

Apart from considering the dynamics of diversification, it is useful to analyze the competitive position of regional exports in global markets. This positioning is determined by the relative weight of regional products in global supply (the “market share”), and the “relative dynamism” of the export basket measured by the weight of those products in world trade. If, at the end of a period, a country’s exports have gained ground in their respective markets, and these products increased their share in world trade, the country will have improved its competitive position in both dimensions. The different possible combinations are represented in a diagram with four

²⁰ The period under review excludes 2009–2010 because they are anomalous years: in 2009, world trade collapsed due to the financial crisis and in 2010, it rebounded strongly only to slow down in 2011.

Only a few small and medium-sized countries gained market share in the boom period.

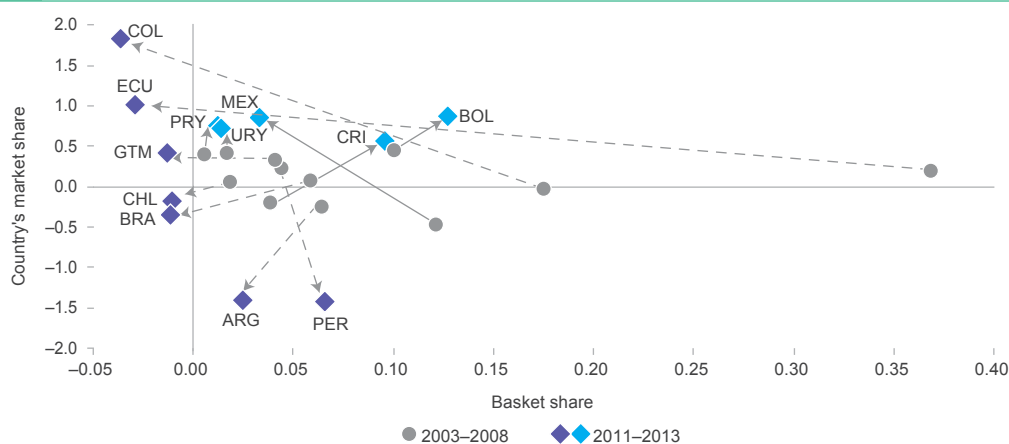
sectors (Figure 20), where countries' competitive positions are indicated in the boom (circle) and stagnation (diamond) periods, respectively.

During the boom period, all countries considered had dynamic export baskets, composed of products that were gaining weight in global trade (towards the right side of the graph). But in that favorable environment, only a few economies managed to significantly increase their market share: Bolivia, Ecuador, Guatemala, Paraguay, Peru, and Uruguay.

Countries such as Brazil, Chile, and Colombia maintained stable shares, while Argentina, Costa Rica, and Mexico did not take advantage of the favorable environment and suffered losses. However, some countries already occupied lead positions as global exporters in their key export products (for example, Chile in copper and Argentina in soybean cakes and oil), and thus had little margin to increase their shares. The outcome, though, is that the growing demand between 2003 and 2008 was leveraged mostly by some small and medium-sized economies, while the larger countries only maintained or lost ground.

In the more recent period of stagnation, the deterioration of commodity prices was reflected in the lack of dynamism of the products that comprise the export

FIGURE 20 • MARKET SHARES AND DYNAMISM OF EXPORT PRODUCTS
(Shares, 2003–2008 and 2011–2013)



Source: IDB Integration and Trade Sector with data from INTrade/DataINTAL and COMTRADE.

Notes: The vertical axis presents a measure of the change in the average market share of the goods exported by each country. The horizontal axis reports a measure of the country's export basket dynamism in world markets. The reference years are 2003 and 2011, respectively. The circles and the diamonds indicate the position of the country in the first and second interval, respectively. The countries that improve their competitive position between these two periods are marked with solid arrows and a blue diamond. Products are measured at the 4-digit HS 2002 level, considering only those with exports greater than US\$ 10 thousand. The sample includes 12 countries with comparable historic information available. See Methodological Annex 4.

baskets of several countries in the region, evidenced by a general displacement towards the left of the figure. This effect is particularly pronounced in countries like Ecuador and Colombia that, nonetheless, gained market share, and in Guatemala that maintained a stable share. On the other hand, the baskets of Costa Rica²¹ and Bolivia increased their dynamism, those of Paraguay and Uruguay remained stable, and all of these countries managed to increase their market shares. The countries most affected by the current downturn were Argentina, Brazil, Chile, and Peru. All four saw their participation substantially eroded and, with the exception of Peru, they also experienced a reduction of the dynamism of their baskets. Finally, although Mexico's export supply became less dynamic, its market share strongly increased.

Most baskets lost dynamism during the period of stagnation.

Intensive and Extensive Margins of Export Growth

Having evaluated the dimension and concentration of the export baskets, by products and markets, and their competitive position in global trade, this section analyzes the decomposition of export growth into “intensive” (existing links) and “extensive” (new links)²² margins²³ with the objective of characterizing the relative contribution of both growth modalities in the boom and stagnation periods. This indicator allows an assessment of the degree to which the capacity to diversify the export supply has contributed to the growth of exports. From the public policy point of view, it offers a useful perspective to focus promotion initiatives, oriented to relaunching trade performance in the current environment of slowing trade.

Between 2003 and 2008 regional exports grew 17.8% on average per year.²⁴ Of this significant growth, 15.5 p.p. corresponded to the intensive margin, that is, existing products in the export basket to existing partner

The intensive margin predominated during the boom.

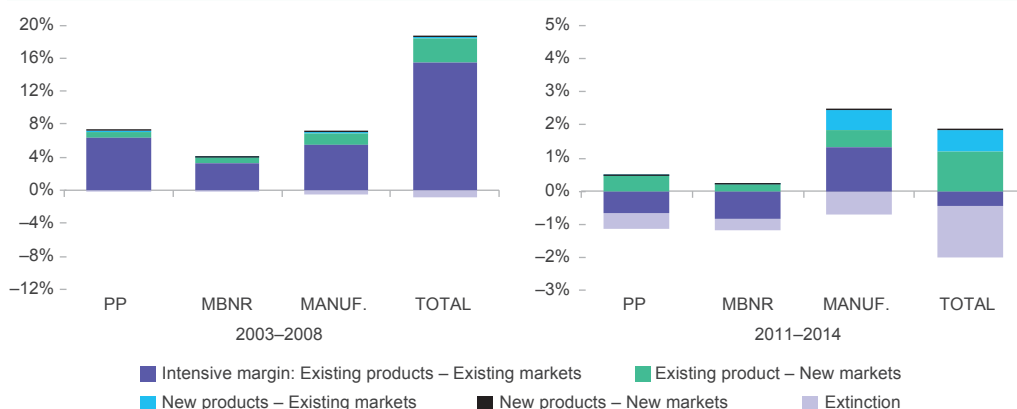
²¹ The positive performance of Costa Rica depends in good part on the growth of their integrated circuits market share during those years and does not reflect the end of INTEL's manufacturing operations at the end of 2014.

²² The extensive margin has three variants: exports of new products to existing partners (product diversification), exports of existing products to new partners (market diversification), or exports of new products to new partners (diversification in both senses). Extinction refers to the cessation of exports of given products to certain partners.

²³ For a discussion of these indices' properties and their measurement and interpretation, see Evenett and Venables (2003), Hummels and Klenow (2005), Helpmann *et al.* (2008), and Besedeš and Prusa (2011). This report adopts a perspective similar to that of Agosin and Chancí (2015), the most recent contribution with greatest coverage of Latin America, but extends the time frame of the sample and analyzes national data at a higher level of disaggregation.

²⁴ This rate of change takes 2003 as a reference and corresponds to the sample studied; it is therefore different from the figure reported in Table 1.

FIGURE 21 • INTENSIVE AND EXTENSIVE MARGINS, BY PRODUCT TYPES
(Decomposition of the cumulative annual rate, percentage, 2003–2008 and 2011–2014)



Source: IDB Integration and Trade Sector with data from INTrade/DataINTAL.

Notes: PP: Primary Products; MBNR: Manufactures Based on Natural Resources; MANUF.: Manufactures (following Lall (2000)). Products correspond to 6-digit HS 2002 subheadings, considering only those with exports greater than US\$10 thousand, and excluding those classified in special codes without an equivalent in the HS. The reference years for the cumulative annual growth rate are 2003 and 2011, respectively.

countries (Figure 21).²⁵ Of this figure, 9.6 p.p. are explained by commodities and manufactures based on natural resources, and the rest (5.9 p.p.) by the increase of manufactures exports.

Only the extensive margin of markets was relevant during the boom.

Considering that in the exceptional economic environment of 2003–2008, product extinction only deducted 0.9 p.p. from growth, it turns out that 3.1 p.p. of the expansion is attributable, by this indicator, to diversification. Further, diversification occurred primarily by selling existing products to new partners, which explains 2.8 p.p. of the expansion, and was linked with the relative dynamism of the market access negotiations mentioned in the first section. The other two

forms of extensive margin expansion—through new products to existing partners or to new partners—contributed practically nothing to the growth of export values. This does not mean that these channels are not relevant for increasing the scope and complexity of export supply, but it does indicate the low innovation capacity of the region.

More recently, the near zero export growth since 2011 is characterized by a strong and growing negative contribution

The extensive margin limited the drop in exports in 2011–2014.

²⁵ The contribution of each margin corresponds to the result net of the respective increases and decreases. The sample includes 13 countries with comparable historical information available: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Mexico, Panama, Paraguay, and Uruguay.

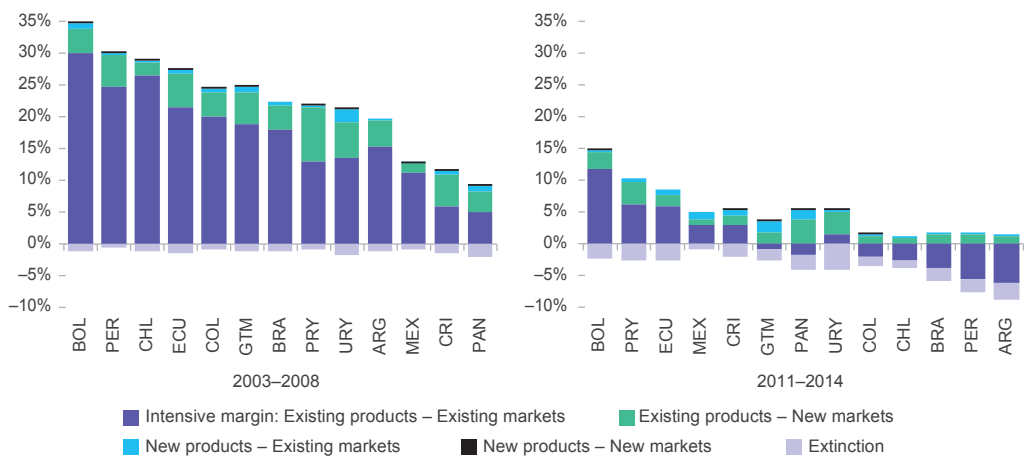
of extinct products (–1.5 p.p.)—goods that were no longer exported to certain partners—and a reduction of the intensive margin (–0.5 p.p.). These two contracting factors were balanced by two components of the extensive margin: sales of existing products in new markets (1.2 p.p.) and sales of new products in existing markets (0.7 p.p.). Deflationary pressures impacting commodity markets led to the collapse of the intensive margin for these products, partly offset by the growth of manufactures on this same margin. The extinction of products responded mostly to the disappearance of trade flows to traditional partners within and outside the region, including the U.S., Argentina and Venezuela. The greatest contribution of new products to existing markets came essentially from the addition of new manufactures to the export basket of Mexico in its trade with the U.S.

Since 2011, the composition of countries' export baskets has been influenced by varying performance at the country level (Figure 22). Mexico and the Central American economies maintained their exports through the expansion of the extensive margin, in terms of both destinations and products. In the intensive margin, Mexico and Costa Rica contributed mainly in the area of manufacturing. In Guatemala and Panama, shipments grew only thanks to the extensive margin in commodities and manufactures based on natural resources. In South America, only smaller economies (Bolivia, Ecuador, Paraguay and Uruguay) managed to increase their exports, expanding through existing links

Countries' performance was highly heterogeneous.

FIGURE 22 • INTENSIVE AND EXTENSIVE MARGINS OF EXPORTS

(Decomposition of the cumulative annual rate, 2003–2008 and 2011–2014)



Source: IDB Integration and Trade Sector with data from INTrade/DataINTAL.

Note: The products correspond to the 6-digit HS 2002 level, include only exports greater than US\$ 10 thousand, and exclude those classified with special country codes without equivalent in the HS. Annual reference years for the cumulative annual rate are 2003 and 2011 respectively.

In South America, goods based on natural resources are finding new markets.

and by the creation of new ones. In Argentina, Brazil, Chile, Colombia and Peru the intensive margin contributed negatively, in large part due to the drop in commodities and their derivatives. In Argentina and Brazil, the negative contribution of manufacturing also weighed significantly.

In terms of diversification, only the extensive margin related to new destinations for existing products has contributed to export growth in South American economies. Usually these sales have been closely tied to the comparative advantage the countries have in natural resources: Argentina, Bolivia, Colombia, Ecuador, Paraguay, Peru and Uruguay began exporting to new markets, primary products and manufactures based on natural resources which had a strong presence in their export baskets. Meanwhile, Brazil and Chile, diversified not only their traditional export destinations, but they also exported some manufactured goods.

In conclusion, although a major component of the 2003-2008 export boom was attributable to growth on the intensive margin for primary and resource-based products, there was also a meaningful component related to the extension of sales of existing products to new markets. That is, the concentration of exports observed during this period in the total export basket was a reflection of the strong increase in traditional export products, primarily to existing partners, and to a lesser extent to new destinations. Moreover, the near zero growth rate of exports in the most recent period was the result of both the contraction on the intensive margin of exports of primary products and manufactures based on natural resources, and of the extinction of trade links across product categories. A moderate increase in the extensive margin, especially in manufacturing, as well as in some primary and resource-based products, was a positive factor for trade performance in the region.

Conclusions

The downturn in global trade in mid-2014 that negatively affected the exports of goods and services of Latin America and the Caribbean worsened in the early months of 2015. While the deterioration affected all countries, those in South America were most hurt by the sharp decline in prices of commodities which are key to their export supply. Mexico and Central America experienced a reversal of prior export growth due partly to sluggish demand in the United States. Changes in the international economy, that do not appear to be transitory, point to the need to strengthen the export sector by enhancing diversification efforts in terms of partners and products exported.

The largest contraction to occur since the collapse of 2009 marked the end of the phase of substantial stagnation that has characterized post-crisis global trade. Real and monetary factors come together in this relapse. In the real economy, weak and unstable growth in the developed economies, which has persisted since 2011, was joined by a sharp slowdown in activity in developing countries, particularly China, but also in countries of the region. This factor was not offset by modest growth in the U.S. or by the uneven recovery of European economies. In monetary terms, weak growth in real global demand was accompanied by a sustained nominal appreciation of the dollar which generated downward pressure on the prices of commodities exported by the region. These real and monetary trends created an external scenario that will require adjustments by the region both in the short and medium term, and on which there is a wide margin of uncertainty.

In the short term, weak export performance creates vulnerability in the balance of payments at a moment when current account deficits are becoming more widespread and a tightening of external financing conditions is expected. In concert, these forces may induce real exchange rate realignments in countries with flexible regimes or adjustments in relative prices in those with more rigid systems, which could effectively help to improve price-competitiveness and promote the growth of non-traditional exports. Such developments may help to mitigate the elements of Dutch disease witnessed by some countries during the commodity boom. However, to take advantage of this situation, containing inflationary pressures and ensuring the sustainability of competitive real exchange rates is essential. Further, since differences

in exchange rate policies of LAC countries also induce significant changes in the intraregional bilateral exchange rates, restrictive trade measures that would stifle trade flows and growth should be avoided.

From a medium-term perspective, the importance of promoting trade diversification is critical. The analysis of the last decade reveals some encouraging features which countries in the region could leverage to revive exports. First, the effective presence in new markets and the addition of new products to the export basket of the region, particularly in countries that have been active in trade promotion policies and the negotiation of trade agreements, must not be overlooked. This phenomenon has been generally obliterated by the effects of the boom of commodity prices on export concentration. It is necessary to prioritize the negotiating agenda in countries that have not participated in these dynamics and to adopt complementary measures for promoting and facilitating trade in those countries that need to preserve and expand their margins of preference. Moreover, given that in the most recent period most of the growth in trade has been the result of exporting existing products to new markets, support for the internationalization of companies is essential to leverage their potential. These are some of the issues that must be prioritized in any ambitious policy agenda in order to address the current adverse outlook of the external sector of Latin America and the Caribbean.

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Methodological Annex 1

Estimation of the prices of world trade with a constant dollar exchange rate

The growth of the total value of world trade expressed in dollars (that is, in the accounting unit used globally to measure these flows) is composed of the variations in volumes and in prices of the goods exchanged.²⁶ This latter growth can be separated into two components: the variation in the prices of goods expressed in the exporters' currencies, and the variation of the average dollar exchange rate with respect to the different national currencies.²⁷ This last factor generates a "numeraire effect" that can be isolated constructing a series of prices with a dollar exchange rate held constant at the level of a given base year. In this way, the change in prices is obtained, net of the exchange rate variations.

Procedure

(1) From the monthly series of world trade in current dollars (average of exports and imports) subtract the value of U.S. exports, as the variations in the exchange rate of the dollar affect the value of the foreign sales of all countries except the U.S., which are already expressed in that currency.²⁸ (2) Calculate the year on year (logarithmic) growth rates of this series and of the series for the nominal effective exchange rate of the dollar. (3) For each month, subtract the growth of the exchange rate series from the growth of the trade series. (4) Convert the resulting rates of change (net of the exchange rate effect) into growth factors applying the exponential function. (5) Using the figures of 2005 as a base year, apply the growth factors to generate a series for the value of trade in dollars at a constant exchange rate (of course, for 2005 the values of the series with current exchange rates and with constant exchange rates are

²⁶ The standard source for the value, price, and volume of world trade data is CPB.

²⁷ This average can be estimated by the nominal effective exchange rate of the dollar calculated by the U.S. Federal Reserve with respect to a broad basket of currencies, expressed as dollars per unit of the selected currencies.

²⁸ The exchange rate of the dollar with respect to itself is equal to 1. This is valid also for exports of those countries that use the dollar as their official currency. However, given their small relative weight, these flows are not separated in the estimation.

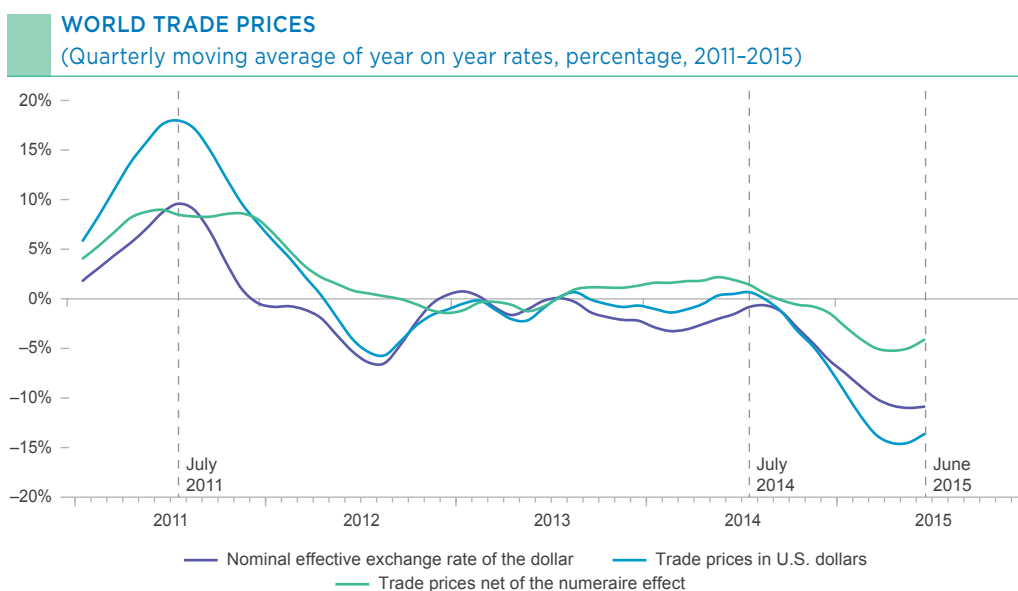
equal). (6) Add the U.S. exports, which are not affected by the exchange rate variations, back into the new series. (7) Subtract the (logarithmic) growth of the volume of world trade from the growth of the series derived in the previous point. (8) To the previous result, apply the exponential function to obtain the corresponding discrete rates of change. The result is a series with the changes in prices of world trade with the exchange rate effect removed, that is, of the prices expressed in dollars with a constant exchange rate (2005 = 100).

Sources

1. Monthly indices of the value, volume, and prices of world trade and the nominal value of trade in 2005 dollars: CPB
2. Monthly value of U.S. Exports in dollars: USITC
3. Monthly level of the nominal effective exchange rate of the dollar: U.S. Federal Reserve

Results

The estimation of the numeraire effect indicates that the appreciation of the dollar has a relevant weight in the downward trend of the world trade prices (Figure).



Source: IDB Integration and Trade Sector with data from CBP and the U.S. Federal Reserve.

Note: The appreciation/depreciation of the dollar is represented with a negative/positive rate.

Although since the second quarter of 2012 the trend in world trade prices expressed in current dollars is negative, when the effect of the dollar appreciation is removed, the remaining trajectory is in general positive, though very close to stagnation. This situation changed in mid-2014 when the change in the prices of world trade measured at a constant exchange rate turned negative. After the inflection point in July this trend deepened. In June 2015, the quarterly moving average of this variable showed a contraction of 4.1% while the drop in prices measured in current dollars reached -13.6%, and that of the dollar exchange rate -10.8%. Although the appreciation of the dollar continues to be an important factor in the contraction of the world trade prices, since mid-2014 other factors than the numeraire effect begin to operate, most related to the evolution of the markets for the products exchanged.

Methodological Annex 2

Geographic, Temporal and Conceptual Coverage of Goods and Services Exports

The rates for 2002–2008 of Tables 1 and 2 correspond to the geometric growth over the interval, with 2002 as the reference year. Figures for 2013 and 2014 are preliminary and subject to change by the national authorities.

Table 1

Exports of goods are expressed in free on board (FOB) values. Data for goods exports from Argentina and Peru correspond to official figures and may differ from the microdata. Figures for the Caribbean correspond to official sources and CARICOM. For Venezuela, the total was estimated based on official sources. The goods exports data for Costa Rica, El Salvador, Guatemala, and the Dominican Republic include Special Trade Regimes (STR). The information for Honduras and Nicaragua excludes trade under STR and was taken from sources other than INTrade/DataINTAL. The data for Panama refers only to national exports and imports.

The growth of goods exports through June 2015 is an estimate of the year on year growth based on monthly data through that month, except for Guyana (May), and The Bahamas, Barbados, Belize, Jamaica, the Dominican Republic, Suriname, and Trinidad and Tobago (March). The estimates for the aggregates of Central America, South America, and the Caribbean do not include, respectively, the Dominican Republic, Venezuela, and Haiti.

Table 2

The definition of services exports for 2002–2008 corresponds to the fifth Manual of Balance of Payments and for 2012–2014 to the sixth. In the full series construction services and government services are excluded, and in the period 2012–2014 manufacturing, maintenance, and repair of goods are excluded as well. The services data for Guyana, Haiti, Honduras, the Dominican Republic, Ecuador, Peru, Paraguay, and

Venezuela in 2014 are estimated based on figures from the WTO. The value of services exports from the Caribbean and for Latin America and the Caribbean for the period 2012-2014 is an estimation that excludes some Caribbean countries for which data were not available at the time of publication.

Methodological Annex 3

Price and Volume Indices and Terms of Trade

This Annex summarizes the methodology used to decompose the current values of goods exports and imports in terms of variations in their prices and volumes. This information provides a measure of the evolution of trade flows at constant prices (that is, in terms of volume, or “real” trade flows), and at the same time allows an analysis of the impact of changes in international prices on the values of aggregate trade flows. The result of applying this methodology is a set of annual price and volume indices of exports and imports for a group of countries in Latin America.

The export and import price indices are used to calculate the terms of trade evolution over time, a ratio that measures the changes in the average purchasing power that a country’s exports provide in terms of the goods they import, or equivalently, it represents the variations in the relative prices that countries face in their foreign trade.

The principal criteria followed in the calculation of the indices are:

- The indices are calculated at the Heading level of the Harmonized System (4 digits).
- All items with a value of less than US\$ 1 million are excluded.
- Items without available data on quantity are excluded.
- The series begins in 2002 and uses 2010 as a base year.

The calculations include information from 16 Latin American countries. For 14 countries,²⁹ the export and import price and volume indices were elaborated from data based on trade flows at the maximum level of disaggregation (“microdata”), both for current values and physical volumes.

This data was reported by official sources to INTrade/DataINTAL as of March 2015. The calculations were made according to the formulas presented below at the 4-digit HS level, and aggregated to the total national level. In the case of Mexico, aggregate indices obtained from the Central Bank (Banco de México) are used due to the fact that, as of the closing date of the estimates, no reliable disaggregated data

²⁹ Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Nicaragua, Paraguay, Peru and Uruguay.

on physical volumes was available for several years. For Venezuela, no microdata were available, and estimations are based on official figures published in the National Accounts. Sufficient data was also not available for any country of the Caribbean. Data for the last two years are subject to revisions by the respective sources and do not necessarily coincide with figures updated later and published by these sources at the aggregate level. The estimates must therefore be considered preliminary.

Indicators for the groups of countries presented in Figures 9, 16 and 17 were obtained from weighted averages of the national price and volume indices of the trade flows corresponding to each country. The relative weights of exports or imports of the countries in each group were used as weights in each year.

Price Indices

Laspeyres price indices were estimated separately for imports and exports:

$$P_t = \frac{\sum_i p_t^i * q_0^i}{\sum_i p_0^i * q_0^i}$$

Where $p_t^i = \frac{v_t^i}{q_t^i}$, the unit values of item i in period t ,

- Value v_t^i , (thousands of US\$)
- Volume, q_t^i , (kilograms)

The Laspeyres price index compares the value of a basket of goods corresponding to the base year at the prices in period t with the value of the same basket at prices of the base year.

When $P_t = 1$, the basket in t costs the same as in the base year.

Volume Indices

Paasche volume indices were estimated separately for imports and exports:

$$Q_t = \frac{\sum_i p_t^i * q_t^i}{\sum_i p_t^i * q_0^i}$$

Where $p_t^i = \frac{v_t^i}{q_t^i}$, the unit value of item i in period t ,

- Value, v_t^i , (thousands of US\$)
- Volume, q_t^i , (kilograms)

The Paasche volume index compares the value of a basket of products in period t to the prices of that same period with the value of the basket in the base year valued at the prices of period t . When $Q_t = 1$, the current basket is composed of the same quantities as in the base year.

Terms of Trade

The terms of trade ratio is defined as:

$$TT_t = \frac{P_{x,t}}{P_{m,t}} * 100$$

Where $P_{x,t}$ and $P_{m,t}$ correspond, respectively, to the price indices of exports and imports of country in period t .

Methodological Annex 4

Indicators of Competitive Position

Figure 20 presents two indicators of the evolution of the competitive position: average market share of the country and dynamism of the exported products. For each country, the Figure shows the values of both indicators corresponding to the intervals 2003-2008 and 2011-2014, connected by a line to indicate the change in position between the two periods.

(a) Market share of the country (vertical axis). For each product in the export basket of the country (at the 4-digit HS level), the market gain (or loss) is defined for the interval between $t = 0$ (2003 or 2011) and $t = 1$ (2008 or 2014) as the difference between the value exported in $t = 1$ and the amount that would have been exported if the market share had remained constant at the level of $t = 0$. The sum of the values of these absolute changes for each country is a measure of the average variation corresponding to the market share of all of their exported products. The (annualized) indicator expresses this average variation aggregated for each country as a proportion of the absolute value of its total exports between the two years.

(b) Product dynamism (horizontal axis). For each product in the country's export basket, the change in world imports was calculated between the years $t = 0$ (2003 or 2011) and $t = 1$ (2008 or 2014). The sum of these variations, weighted by the share of the respective products in the country's export basket, is a measure of the "dynamism" of the export basket in question in the global market. The (annualized) indicator expresses this net aggregate variation as a share of the absolute value of the variation of world imports.

