

Latin America worries about U.S. economy

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The fiscal debate in the United States has become a recurrent issue that keeps the world, and Latin America and Caribbean economies in particular, in suspense. The agreement reached a few days ago offers breathing room, by preventing the United States economy from being figuratively dragged over the edge by its fiscal imbalance. The bad news is that this solution does not permanently solve the pending problems.

Our region has closely followed discussions on the “fiscal cliff,” because of the serious implications generated by the uncertain U.S. fiscal situation. Uncertainty poses significant risks to our economies.

It introduces greater market volatility that complicates monetary, foreign-exchange and financial policy management. Uncertainty also destabilizes consumption, production and investment decisions, which have a negative effect on economic growth for the United States and the world.

This will reduce international trade flows, which in turn will have adverse effects on our region’s growth prospects.

Latin America and the Caribbean, and particularly Mexico, Central America and the Caribbean, are closely linked to the U.S. economy, and are especially sensitive to the direction of its fiscal policy. South American countries are not protected from any potential negative effects either, as slower economic activity in the United States and greater global uncertainty could depress commodity prices for their exports, while also hampering access to international financial markets.

In 2013 and the years to come, the U.S. economy could be said to be entering a series of cliffs that will require increased willingness and ability to reach a consensus if they are to be overcome. Soon, the need to raise the debt ceiling will return to the agenda. The earlier debate on this issue highlighted the complex negotiations between the Executive Branch and Congress and the negative effects that any delay in reaching an agreement could have on the international economy and world finances.

Nobody now doubts the urgency of halting the unsustainable growth of public debt in the United States. The necessary adjustment and its impact on economic activity will partly depend on its magnitude, timing and structure.

It is therefore vital to minimize the distributive bias of this adjustment. It is also important to acknowledge that uncertainty and the lack of political consensus on public spending and revenues will lead to higher economic costs. In any event, given the scale of the fiscal deficit and the difficulty of closing it quickly due to such entrenched opposed positions, the world must consider ways of living with a structural fiscal deficit in the United States that some estimate at between 5-6 percent of GDP.

Funding the deficit will imply the continued increase in the issuance of dollar-denominated financial assets, along with the increased demand for them on the part of emerging economies, including our region's countries, to avoid domestic currency appreciation.

However, this threatens the model of protection based on saving through international reserves, as the growing devaluation of the dollar jeopardizes our region's productive and social efforts. In recent years, the region's governments have built unprecedented levels of international reserves, amounting to over \$800 billion.

At the same time, this level of reserves gives our region greater political weight and more leverage in the current fiscal debate.

It is therefore vital to insist that those involved in the political discussions on fiscal governance in the United States seriously consider the implications for the international economy. We call on them to find common ground and to seek consensus around a predictable medium-term plan that avoids high and irreversible political costs.

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