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# Current global economic scenario and its implications for Latin America and the Caribbean

## I. LATEST FORECASTS ON THE PERFORMANCE OF THE GLOBAL ECONOMY

The international economic environment remains weak and is fraught with uncertainties. Despite some positive news on the performance of the U.S. economy in recent months, the growing tensions resulting from the public sector debt crisis, the worrisome decline in the growth rate of world production and the lingering doubts about the future of integration in the European Union – and its direct implications for the euro – could have a significant impact on global economic activity for the rest of this year.

According to the latest report by the International Monetary Fund (IMF), and in spite of the robust growth foreseen for most developing economies – with many of them operating at rates close to full potential – global production is estimated to increase at an average rate of 3.5% this year, down 0.5% compared to the projection made by the IMF in late September 2011.[1]

As a matter of fact, global downside risks continue to dominate. Renewed bouts of financial market volatility in the euro area could accelerate bank deleveraging, disrupt markets, and hit economic activity both in Europe and the rest of the world. Over the medium term, persistent fiscal imbalances in the U.S. and Japan could unsettle financial markets, while a hard landing of the Chinese economy could seriously destabilize global growth and significantly reduce commodities prices in international markets.

The pattern of global growth will remain ”unbalanced” as it will be led by emerging and developing economies. Industrialized economies are projected to grow only 1.4% in 2012, after reaching an average rate of 1.6% in 2011, because weak financial balances, the public sector debt and household distress will continue to restrict an increase in demand in those nations.[2]

All European countries are expected to experience a recession, and since their situation remains extremely fragile, recent shocks on confidence could impact investors in a much more negative way, further accelerating banking deleveraging with very adverse effects on real economic activity. This negative scenario for the European Union – not only in economic and financial terms but also in institutional terms – could trigger very adverse effects on the global economy.

In turn, the U.S. economy is estimated to grow by slightly over 2% annually on average between 2012 and 2013. In Canada, economic growth slowed down to 2.5% in 2011, and will further decelerate to 2.1%, partly as a result of the gradual withdrawal of fiscal incentives and the continued reduction in net exports. After a strong recovery from the crisis of 2008-2009, the labour market is beginning to weaken and real wages have stagnated.[3]

Meanwhile, developing economies in general are expected to grow between 5.7% and 6% in the next two years, spurred by a still robust growth in emerging Asia.

With respect to international commodity markets, the latest IMF estimates indicate that prices will remain high during the period 2012-2013, but would tend to slow down and even drop in 2013. In 2012, energy prices will remain above the levels recorded in the

[1] IMF (2012a). *World Economic Outlook*. Washington, April.

[2] Ibid.

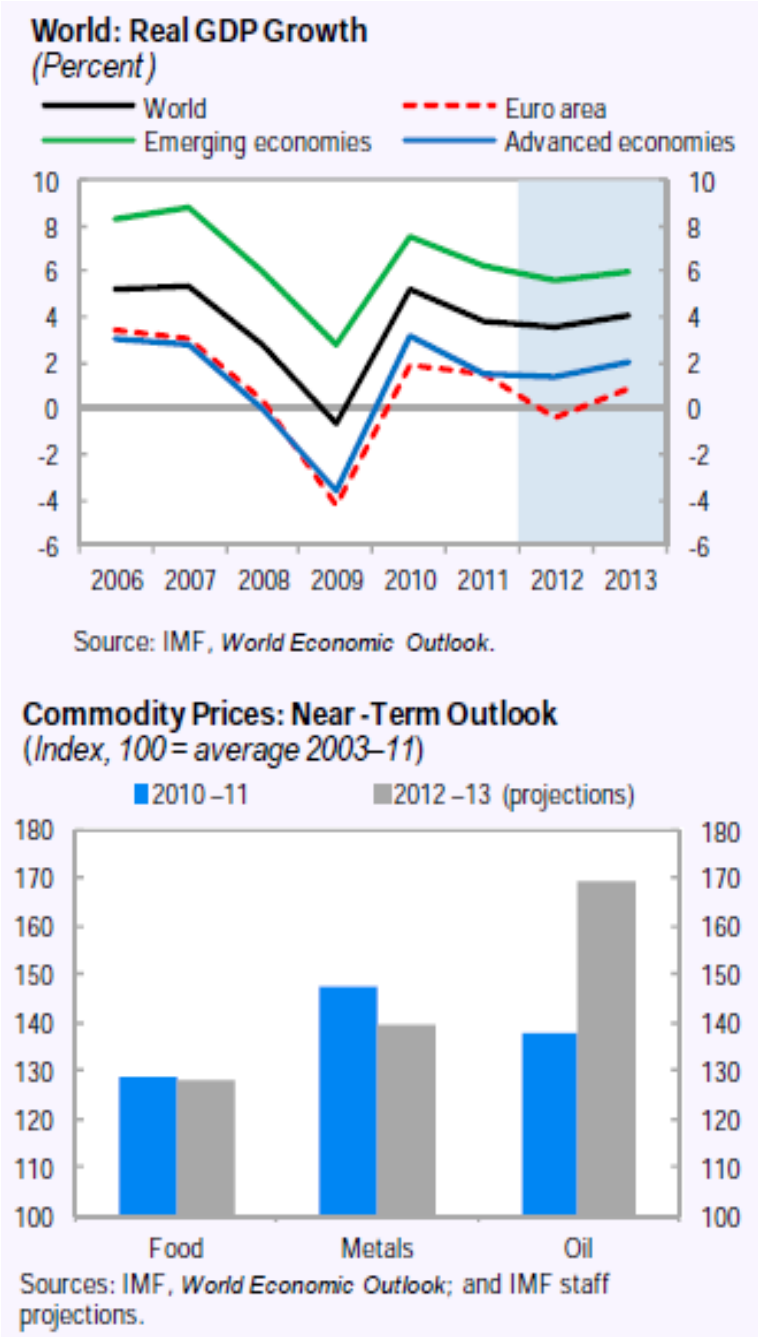
[3] Ibid.

**TABLE No. 1**
**Overview of the *World Economic Outlook* Projections**
*(Percent change unless noted otherwise)*

| | Year over Year | | | | | |
|---|---|---|---|---|---|---|
| | | | Projections | | Difference from January 2012 WEO Projections | |
| | 2010 | 2011 | 2012 | 2013 | 2012 | 2013 |
| **World Output[1]** | **5.3** | **3.9** | **3.5** | **4.1** | **0.2** | **0.1** |
| **Advanced Economies** | **3.2** | **1.6** | **1.4** | **2.0** | **0.2** | **0.1** |
| United States | 3.0 | 1.7 | 2.1 | 2.4 | 0.3 | 0.2 |
| Euro Area | 1.9 | 1.4 | –0.3 | 0.9 | 0.2 | 0.1 |
| Germany | 3.6 | 3.1 | 0.6 | 1.5 | 0.3 | 0.0 |
| France | 1.4 | 1.7 | 0.5 | 1.0 | 0.3 | 0.0 |
| Italy | 1.8 | 0.4 | –1.9 | –0.3 | 0.2 | 0.3 |
| Spain | –0.1 | 0.7 | –1.8 | 0.1 | –0.2 | 0.4 |
| Japan | 4.4 | –0.7 | 2.0 | 1.7 | 0.4 | 0.1 |
| United Kingdom | 2.1 | 0.7 | 0.8 | 2.0 | 0.2 | 0.0 |
| Canada | 3.2 | 2.5 | 2.1 | 2.2 | 0.3 | 0.2 |
| Other Advanced Economies[2] | 5.8 | 3.2 | 2.6 | 3.5 | 0.0 | 0.1 |
| Newly Industrialized Asian Economies | 8.5 | 4.0 | 3.4 | 4.2 | 0.1 | 0.1 |
| **Emerging and Developing Economies[3]** | **7.5** | **6.2** | **5.7** | **6.0** | **0.2** | **0.1** |
| Central and Eastern Europe | 4.5 | 5.3 | 1.9 | 2.9 | 0.8 | 0.5 |
| Commonwealth of Independent States | 4.8 | 4.9 | 4.2 | 4.1 | 0.5 | 0.3 |
| Russia | 4.3 | 4.3 | 4.0 | 3.9 | 0.7 | 0.4 |
| Excluding Russia | 6.0 | 6.2 | 4.6 | 4.6 | 0.2 | –0.1 |
| Developing Asia | 9.7 | 7.8 | 7.3 | 7.9 | 0.0 | 0.1 |
| China | 10.4 | 9.2 | 8.2 | 8.8 | 0.1 | 0.0 |
| India | 10.6 | 7.2 | 6.9 | 7.3 | –0.1 | 0.0 |
| ASEAN-5[4] | 7.0 | 4.5 | 5.4 | 6.2 | 0.2 | 0.6 |
| Latin America and the Caribbean | 6.2 | 4.5 | 3.7 | 4.1 | 0.2 | 0.1 |
| Brazil | 7.5 | 2.7 | 3.0 | 4.1 | 0.1 | 0.1 |
| Mexico | 5.5 | 4.0 | 3.6 | 3.7 | 0.1 | 0.2 |
| Middle East and North Africa (MENA) | 4.9 | 3.5 | 4.2 | 3.7 | 0.6 | –0.2 |
| Sub-Saharan Africa | 5.3 | 5.1 | 5.4 | 5.3 | –0.1 | 0.0 |
| South Africa | 2.9 | 3.1 | 2.7 | 3.4 | 0.1 | 0.0 |
| *Memorandum* | | | | | | |
| European Union | 2.0 | 1.6 | 0.0 | 1.3 | 0.1 | 0.1 |
| World Growth Based on Market Exchange Rates | 4.2 | 2.8 | 2.7 | 3.3 | 0.3 | 0.1 |
| **World Trade Volume (goods and services)** | **12.9** | **5.8** | **4.0** | **5.6** | **0.2** | **0.2** |
| Imports | | | | | | |
| Advanced Economies | 11.5 | 4.3 | 1.8 | 4.1 | –0.2 | 0.2 |
| Emerging and Developing Economies | 15.3 | 8.8 | 8.4 | 8.1 | 1.3 | 0.4 |
| Exports | | | | | | |
| Advanced Economies | 12.2 | 5.3 | 2.3 | 4.7 | –0.1 | 0.0 |
| Emerging and Developing Economies | 14.7 | 6.7 | 6.6 | 7.2 | 0.5 | 0.2 |
| **Commodity Prices (U.S. dollars)** | | | | | | |
| Oil[5] | 27.9 | 31.6 | 10.3 | –4.1 | 15.2 | –0.5 |
| Nonfuel (average based on world commodity export weights) | 26.3 | 17.8 | –10.3 | –2.1 | 3.7 | –0.4 |

**Source**: IMF. World Economic Outlook, April 2012

**CHART No. 1**
**Real GDP growth and commodity prices**




**Source:** IMF. Regional Economic Outlook. Western Hemisphere. April 2012.

period 2010-2011 because of the geo-political tensions and certain supply constraints. Due to the increased supply – to some extent – and the slightly lower demand from Asia, metal and food prices will fall in 2012 and 2013, but will still remain at acceptable levels for exporters of such commodities.[4]

In the absence of a scenario of dramatic crisis in the case of the European Union, significant downside risks are also likely in the medium and long term. Delays in enacting comprehensive fiscal consolidation plans in the United States (and other advanced economies) could eventually increase U.S. interest rates and the costs of financing at the global level. Meanwhile, difficulties in reorienting demand in China, away from investment and towards consumption, could result in an overinvestment cycle with an adverse impact on actual and potential growth. Weaker growth in Asia

[4] IMF (2012a). *World Economic Outlook*. Washington, April.

would further reduce commodity prices, delivering a blow to commodity exporters.

Overall, a protracted process of adjustment – or balance sheet repair – in advanced economies, although necessary, will very likely hold back global economic growth for an extended period.

In this connection, it should be borne in mind that a large portion of Europe is now halfway into what could become a lost decade, and the U.S. might face many years of slow economic growth, even if it manages to avoid a second recession in the near future. The economic difficulties confronted by developed countries will affect emerging economies.[5]

However, developing nations – in general – are likely to post better growth rates, comparatively.

It should be noted that such economic performance gap among countries in recent years does not necessarily mean that developing or emerging markets have "detached" from developed markets. Experience shows that, in the long term, markets are closely linked – most notably in the case of capital markets. As a result, the prices of financial assets around the world tend to be correlated. Similarly, the growth in trade and global production chains in recent years has probably reinforced the correlation of trends in global trade flows. Therefore, the dominant trends in financial markets and trade flows in developed countries will continue to exert a strong influence on the economies of developing nations in the medium and long term.

## II. Implications of the current international scenario and estimates for Latin American and Caribbean economies

In[5] the short term, overall external conditions are still positive for most of Latin American and Caribbean countries. Thus far, monetary policies in industrialized countries are likely to remain "accommodative" for some time, in view of the sluggish growth, high unemployment rates and the continued erosion of fiscal balances in those nations. This would lead to favourable external financing conditions for the region.

Meanwhile, sustained demand from emerging Asia will support commodity prices, keeping terms of trade favourable for most of South America's commodity exporters. That said, conditions seem to be less favourable for Central American and Caribbean countries, whose external demand is more strongly linked to the markets of advanced economies and which depend more heavily on remittances and income from tourism. Thus, Central American and Caribbean economies will continue to face tough external conditions insofar as economic activity in industrialized countries and U.S. imports remain stagnant.[6]

According to the baseline IMF forecast, growth in the region is projected to slow down to nearly 3.75% in 2012 and to rebound to an average rate of 4% in 2013. Such slowdown is consistent with the projected moderation in global growth of economic activity, as well as further policy tightening to counteract a still-stimulative external environment.

Regional growth is still driven by commodity exporting countries, for which overheating pressures remain relevant as favourable external conditions continue to push domestic demand growth above output growth. Meanwhile, growth has held up reasonably well in Mexico and Central America, in part as a result of the slow but steady recovery in the United States. Real GDP growth in the tourism-intensive countries of the Caribbean is slowly picking up after a deep and protracted recession. Constrained by a still difficult external environment and fiscal consolidation, output is expected to expand by only 1.5% in 2012 (compared with 0.5% last year). Tourist arrivals continue to recover but at different speeds determined in part by variations in the weak employment conditions in the main tourism markets. Vast challenges from high public debt levels and from adverse terms of trade, attributable to high oil prices, continue to weigh on growth.

[5] Standard & Poor's (2012). *Cambiante entorno económico mundial y su impacto en América Latina*. Mexico, 14 March.
[6] IMF (2012). *Regional Economic Outlook. Western Hemisphere*. Washington, April.

**TABLE No. 2.**
**Selected Western Hemisphere Economies:**
**Real GDP, consumer prices and current account balance**
*(Annual percent change unless noted otherwise*

| | Real GDP | | | Consumer Prices[1] | | | Current Account Balance[2] | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Projections | | | Projections | | | Projections | |
| | 2011 | 2012 | 2013 | 2011 | 2012 | 2013 | 2011 | 2012 | 2013 |
| **North America** | **2.0** | **2.2** | **2.5** | **3.1** | **2.3** | **2.0** | **–3.0** | **–3.1** | **–2.9** |
| United States | 1.7 | 2.1 | 2.4 | 3.1 | 2.1 | 1.9 | –3.1 | –3.3 | –3.1 |
| Canada | 2.5 | 2.1 | 2.2 | 2.9 | 2.2 | 2.0 | –2.8 | –2.7 | –2.7 |
| Mexico | 4.0 | 3.6 | 3.7 | 3.4 | 3.9 | 3.0 | –0.8 | –0.8 | –0.9 |
| **South America[4]** | **4.8** | **3.8** | **4.3** | **7.8** | **7.4** | **7.0** | **–1.0** | **–1.9** | **–2.0** |
| Brazil | 2.7 | 3.0 | 4.1 | 6.6 | 5.2 | 5.0 | –2.1 | –3.2 | –3.2 |
| Argentina[5] | 8.9 | 4.2 | 4.0 | 9.8 | 9.9 | 9.9 | –0.5 | –0.7 | –1.1 |
| Colombia | 5.9 | 4.7 | 4.4 | 3.4 | 3.5 | 3.1 | –2.8 | –2.7 | –2.4 |
| Venezuela | 4.2 | 4.7 | 3.2 | 26.1 | 31.6 | 28.8 | 8.6 | 7.4 | 5.6 |
| Peru | 6.9 | 5.5 | 6.0 | 3.4 | 3.3 | 2.6 | –1.3 | –2.0 | –1.9 |
| Chile | 5.9 | 4.3 | 4.5 | 3.3 | 3.8 | 3.0 | –1.3 | –2.4 | –2.4 |
| Ecuador | 7.8 | 4.5 | 3.9 | 4.5 | 5.7 | 4.8 | –0.3 | 0.5 | 0.6 |
| Uruguay | 5.7 | 3.5 | 4.0 | 8.1 | 7.4 | 6.6 | –2.2 | –3.6 | –3.2 |
| Bolivia | 5.1 | 5.0 | 5.0 | 9.9 | 4.9 | 4.5 | 2.2 | 1.6 | 1.1 |
| Paraguay | 3.8 | –1.5 | 8.5 | 6.6 | 5.0 | 5.0 | –1.2 | –3.5 | –1.4 |
| **Central America[6]** | **4.7** | **4.0** | **4.0** | **5.6** | **5.3** | **5.2** | **–6.9** | **–6.9** | **–6.7** |
| **Caribbean[7]** | **2.8** | **3.5** | **3.6** | **7.2** | **5.5** | **5.2** | **–3.5** | **–3.6** | **–3.7** |
| *Memorandum* | | | | | | | | | |
| Latin America and the Caribbean[8] | 4.5 | 3.7 | 4.1 | 6.6 | 6.4 | 5.9 | –1.2 | –1.8 | –2.0 |
| Eastern Caribbean Currency Union[9] | –0.2 | 1.5 | 2.2 | 3.4 | 3.5 | 2.4 | –19.9 | –21.4 | –20.5 |

**Source**: IMF. World Economic Outlook, April 2012.

Prospects are somewhat more favourable for the commodity exporters (Guyana, Suriname, and Trinidad and Tobago), where output is projected to grow by 3.5% on average this year (2.5% in 2011) supported by high commodity prices, particularly for gold and oil. Meanwhile, Haiti is projected to expand by close to 8% in 2012, reflecting increased earthquake reconstruction efforts.[7]

At any rate, countries in our region with strong financial ties to Europe need to remain vigilant. However, the direct impact of a worsening European crisis on Latin America may not be too large. Real linkages (trade and remittances) with Europe are relatively low, except in the Caribbean. Spillovers from European bank deleveraging also are likely to be limited, because most of the subsidiaries of European banks operating in Latin America and the Caribbean seem to be well capitalized and are domestically funded.[8]

Still, global repercussions from a tail event in Europe could have a more significant impact, through its effects on commodity prices, risk aversion, and capital flows.

Potential shocks in the financial sector which may result from an aggravation of the crisis in Europe – similar to the effects of the collapse of Lehman Brothers in 2008 – could raise the costs and reduce the availability of funding for local borrowers in Latin America and the Caribbean, including governments. Such adverse events abroad could heighten risk aversion among local investors.

[7] Ibid.

[8] Ibid.

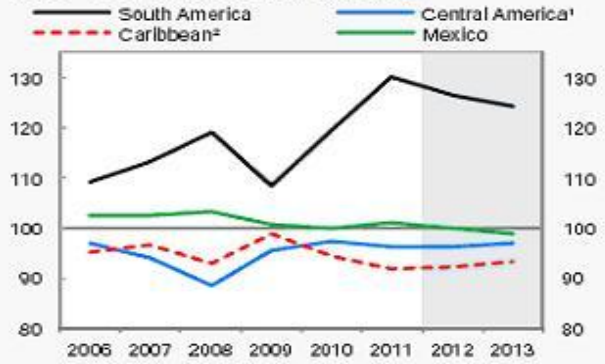
**CHART No. 2**
**LAC: Real GDP, terms of trade and output**

**LAC: Real GDP Growth[1]**
*(Percent)*

| | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|
| | | | Proj. | |
| LAC[2] | **6.2** | **4.5** | **3.7** | **4.1** |
| South America | 6.6 | 5.7 | 3.8 | 4.8 |
| Mexico | 5.5 | 4.0 | 3.6 | 3.7 |
| Central America[3] | 4.0 | 3.7 | 3.5 | 3.7 |
| Caribbean | | | | |
| Tourism intensive[4] | -0.8 | 0.5 | 1.6 | 2.0 |
| Commodity exporters[5] | 3.0 | 2.5 | 3.5 | 4.7 |

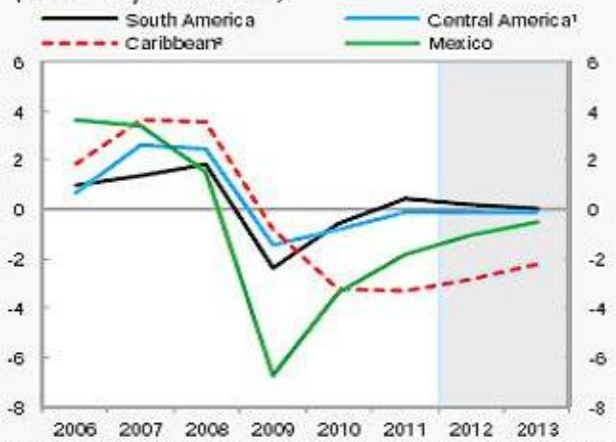
Source: IMF, *World Economic Outlook*.
[1] LAC: Latin America and the Caribbean. Simple average of growth rates within regions unless otherwise noted.
[2] PPP-GDP weighted average.
[3] Includes the Dominican Republic, but excludes Panama.
[4] Includes The Bahamas, Barbados, Belize, Jamaica, and the ECCU member states.
[5] Includes Guyana, Suriname, and Trinidad and Tobago.

**LAC: Terms of Trade**
*(2005 = 100, simple average by region)*




Sources: IMF, *World Economic Outlook*; and IMF staff calculations.
[1] Central America includes the Dominican Republic and Panama.
[2] Includes The Bahamas, Barbados, Belize, Jamaica, and ECCU member states.

**LAC: Output Gaps**
*(Percent of potential GDP)*




Sources: IMF, *World Economic Outlook*; and IMF staff calculations.
[1] Central America includes the Dominican Republic and Panama.
[2] Includes The Bahamas, Barbados, Belize, Jamaica, and the ECCU member states.

**Source:** IMF. Regional Economic Outlook. Western Hemisphere. April 2012.

As noted by the IMF in its latest report, the impact of global financial shocks on any economy depends primarily on two factors: a) the degree of financial integration of that economy with the rest of the world, which would increase sensitivity to those shocks; and b) the strength of its macroeconomic fundamentals, which would help to mitigate the effects of the shock on the real economy, both by lessening capital outflows and by buffering the economic impact of a given shock on the capital account.[9]

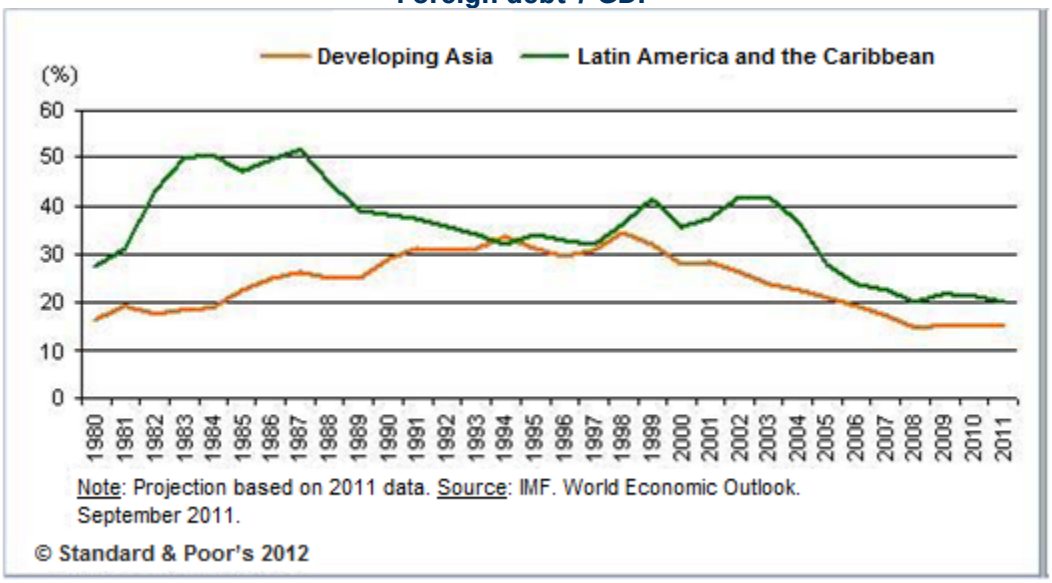
Sustainable external positions and exchange rate flexibility hold the key for emerging markets to lessen the adverse effects of global financial shocks on their economic activity. In Latin America, improved fundamentals have made economies less sensitive to these external shocks in recent years. In this connection, due account should be taken of the increased capacity of many governments in our region to issue debt bonds in local currency with longer maturity structures and fixed nominal interest rates, which has reduced their vulnerability to a sudden loss of external liquidity or a sharp increase in interest rates.

Chart 3 shows the gradual downward trend seen in the average levels of foreign debt in the countries of Asia and Latin America and the Caribbean in recent years. Such improved net external position of many countries in our region is largely due to the growth of their local capital markets as well as the fiscal reforms that have held back increases in public debt. According to the IMF, in 2010, the average maturity of local debt bonds circulating in Latin America and the Caribbean exceeded eight years, compared with an average of four years in 2003. Maturity terms of new sovereign bond issues are now averaging 14 years.[10]

[9] Ibid.

[10] Standard & Poor's (2012). *Cambiante entorno económico mundial y su impacto en América Latina*. Mexico, 14 March.

**CHART No. 3**
**Foreign debt / GDP**




**Source: Standard & Poor's.** *Changing global economic environment and its impact on Latin America*. March 2012.

## III. Policy challenges of the current international environment for the economies of Latin America and the Caribbean

In the current context, Latin American and Caribbean countries should continue to rebuild their "counter-cyclical buffers" in order to regain fiscal space, preserve fiscal credibility and increase monetary policy flexibility. This challenge is especially crucial for South American countries, which have benefitted the most from continued favourable terms of trade and low global interest rates, but with output near or above potential, they also need to guard against overheating. Mexico and Central America, which are more dependent on the U.S. economy, also need to continue rebuilding fiscal buffers, especially Central America, where output is near potential and public debt in some cases is approaching uncomfortable levels. Weak balance sheets and strong tourism dependence will continue to restrain growth in the Caribbean, where fiscal consolidation needs to continue despite the sluggish growth environment. In general, the following issues should be pointed out:

1.- The financially integrated commodity exporters in South America[11] should take advantage of favourable external conditions – which are expected to last for a while, but not forever – to continue reining in public debt, in order to allow due flexibility for monetary policy, and preserve fiscal credibility. Central banks should remain watchful of liquidity conditions, which could be disrupted by further bouts of global financial stress. Meanwhile, exchange rate flexibility should be preserved to buffer shocks, while macroprudential policies can address financial excesses.

2.- A number of other commodity exporters need to end procyclical policies, which could be exacerbating overheating pressures, eroding buffers and weakening the balance of payments.

3.- Countries in Central America, which are operating near their full potential and have debt-to-GDP ratios above pre-crisis levels, should redouble efforts to consolidate their fiscal positions, while strengthening monetary and prudential regulation frameworks.

4.- Most Caribbean countries will have to remain focused on working down fiscal overhangs and addressing financial fragilities, given the threats that they pose to stability.[12]

A key factor for the future of the region will be the capacity of governments to keep inflation rates under control while applying flexible foreign exchange regimes. Several countries have been forced to intervene in foreign exchange markets to buy dollars

[11] Chile, Colombia, Peru and Uruguay.

[12] IMF (2012). *Regional Economic Outlook. Western Hemisphere*. Washington, April.

and relieve pressures resulting from a strong currency appreciation. Such pressures could persist for some time, forcing authorities to allow a sharp currency appreciation or to continue buying dollars, implicitly modifying the performance of exchange rates and monetary policy itself.

In general, Latin American and Caribbean countries have gained economic strength in recent years, with lower inflation rates, less dependence on external funding and greater policy flexibility in responding to external shocks. Healthy credit quality in many countries has been in line with encouraging social trends, which bodes well for the stability of policies in the next few years.

In spite of these encouraging trends, many Latin American and Caribbean countries show a relatively limited capacity to grow on the basis of an autonomous growth engine. Weak growth prospects are due to many factors, including the way in which the region is inserted within the global economy and its comparatively low investment in physical infrastructure and education, which has characterized Latin America and the Caribbean. [13]

These structural obstacles to a faster GDP growth in Latin America and the Caribbean turn out to be more relevant in a scenario where the global economy enters a long period of slow growth. For many Latin American and Caribbean countries, their insertion into the global economy is characterized by a weak presence in both world exports of goods with high technological contents and global sales of knowledge-based services. Total productivity of productive factors in our region, which posted some growth during the first decade of this century, still shows a discouraging long-term trend.

Moreover, poor physical infrastructure in the region and its weak base in terms of skilled labour force also constrain prospects for long-term growth, preventing the development and consolidation of a productive sector with more skilled labour that generates well-paid jobs and that promotes a more sophisticated manufacturing base.[14]

In addition, as pointed out by SELA on previous occasions, in the current scenario, Latin America and the Caribbean need to strengthen capacities to deepen trade and financial ties among the countries of the region. Greater regional integration would increase markets' size, thus compensating for dependence on extra-regional foreign demand, whereas greater financial integration would allow for mitigating the difficulties that might arise in terms of access to financing and for making the process of economic growth in our nations more autonomous.[15]

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[13] IMF (2012). *Regional Economic Outlook. Western Hemisphere*. Washington, April.

[14] See SELA (2010a). *Desarrollos Recientes de la Facilitación del Comercio*, SP/CL/XXXVI.O/Di Nº 20-10, Caracas.

[15] See SELA (2011). *Informe sobre el Proceso de Integración Regional, 2010-2011*, SP/CL/XXXVII.O/Di No. 13 – 11), Caracas, October.