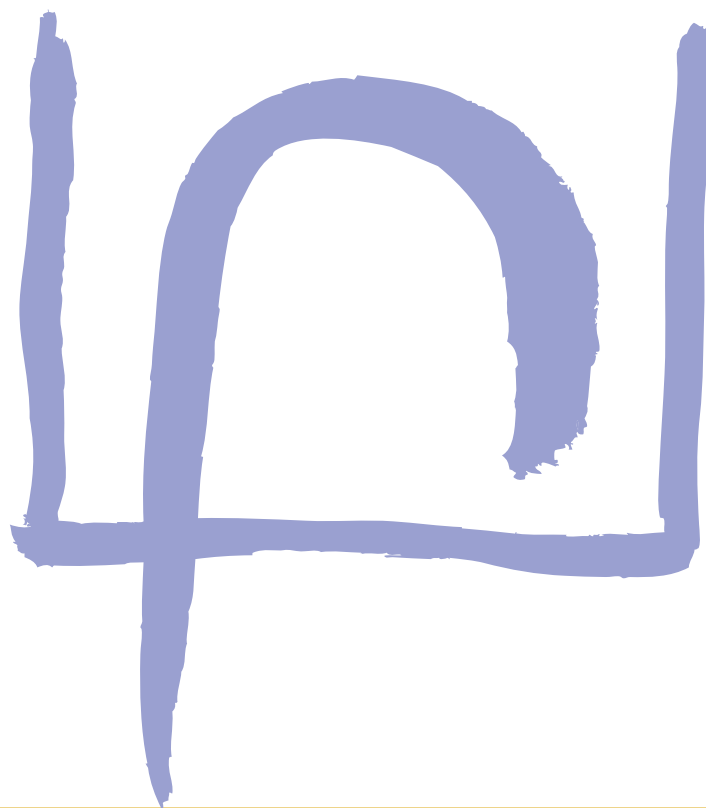


2009

Briefing paper



Preliminary Overview of the Economies of Latin America and the Caribbean



UNITED NATIONS

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The *Preliminary Overview of the Economies of Latin America and the Caribbean* is an annual publication prepared by the Economic Development Division of the Economic Commission for Latin America and the Caribbean (ECLAC). This 2009 edition was prepared under the supervision of Osvaldo Kacef, Director of the Division; Jürgen Weller was responsible for its overall coordination.

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SUMMARY

After six years of uninterrupted growth, the GDP of Latin America and the Caribbean is expected to fall by 1.8% and per capita GDP by close to 2.9% in 2009. The international crisis hit the region hard at the end of 2008 and in early 2009, taking a toll on all of its countries. However, a recovery began to take shape in the second quarter and became more widespread in the second half of the year.

The economic slowdown cut into labour demand, and the unemployment rate is expected to rise to about 8.3% for the region overall, while the new jobs that have been created are of poorer quality.

The effects of the crisis were channelled through the real sector of the economies, damaging what had been the main engines of regional growth. Exports plunged, while the contraction of economic activity worldwide, together with the drop in international trade flows, lowered commodity prices, which hurt the region's terms of trade. At the same time, income from remittances and tourism fell, with Mexico and countries of Central America and the Caribbean suffering the most, and foreign direct investment plummeted by 37%.

Domestic activity also declined in some countries as a result of the tighter credit conditions in the private banking sector which stepped-up public sector lending failed to offset.

This convergence of factors, combined with deteriorating expectations, triggered a slump in private consumption and investment. In fact, public sector consumption was the only component of demand that grew during the first semester, thanks to the countercyclical policies implemented by many of the countries in the region, which accelerated the recovery in the second half of the year.

The positive stimulus of fiscal policy action was one of the distinctive features of economic management in 2009. The region's primary balance fell from a surplus equivalent to 1.4% of GDP in 2008 to an estimated primary deficit of 1% of GDP in 2009. Fiscal revenues have been substantially curtailed, owing to lower levels of activity and falling commodity prices. Also, up to the third quarter of 2009, current expenditures increased significantly, as did capital expenditures, though to a lesser extent.

The region's central banks lowered monetary policy rates and adopted measures aimed at ensuring liquidity in financial markets. In many cases, the public sector banks played a strategic countercyclical role by offsetting the tight credit stance of private banks. In order to defend the real level of the exchange rate to some extent and to sustain domestic liquidity, many central banks intervened in the exchange market, which in some cases enabled them to replenish international reserves.

During the second half of the year, positive signs began to emerge in the economies of the region. Manufacturing and exports picked up, while renewed global activity and expanding international trade volumes spurred demand for commodities, raising prices and improving terms of trade.

The fiscal stimulus packages introduced to boost domestic demand, together with the factors mentioned above and the gradual return to normalcy in the financial markets, often with help from central banks, created the conditions for the resumption of economic activity and the improvement of labour-market indicators. In addition, renewed access to international credit for some countries and the recovery of the stock markets furthered the process. This allowed the private sector to restructure its assets and helped normalize lending which, together with improved labour market indicators and recovery of private-sector confidence, should boost domestic demand.

Growth is projected at 4.1% for 2010 and is expected to be somewhat higher in the countries of South America than in the rest of the region, given their larger domestic markets in some cases, greater export-market diversification and closer trade ties with China. On the other hand, growth is expected to be slower in some of the more open economies that have a less diversified portfolio of trading partners and a heavier dependence on manufacturing. The same can be said of the Caribbean economies, some of which are facing complex financial and exchange-rate situations.

However, it remains to be seen whether or not the developed economies will be able to sustain growth once the copious stimulus packages implemented by the United States and Europe are withdrawn. This, together with increasing unemployment and the still-volatile international financial market, raises questions about the strength of the recovery that began in 2009.

The emergence from this crisis has been quicker than was expected, largely thanks to the ramparts that the countries of the region had built through sounder macroeconomic policy management. Upturns in several of the factors that drove demand in the years prior to the crisis, added in many cases to strong impetus from public policies, should enable a rapid recovery in the context of substantial idle capacity. But how can that recovery be transformed into a process of sustained growth beyond 2010?

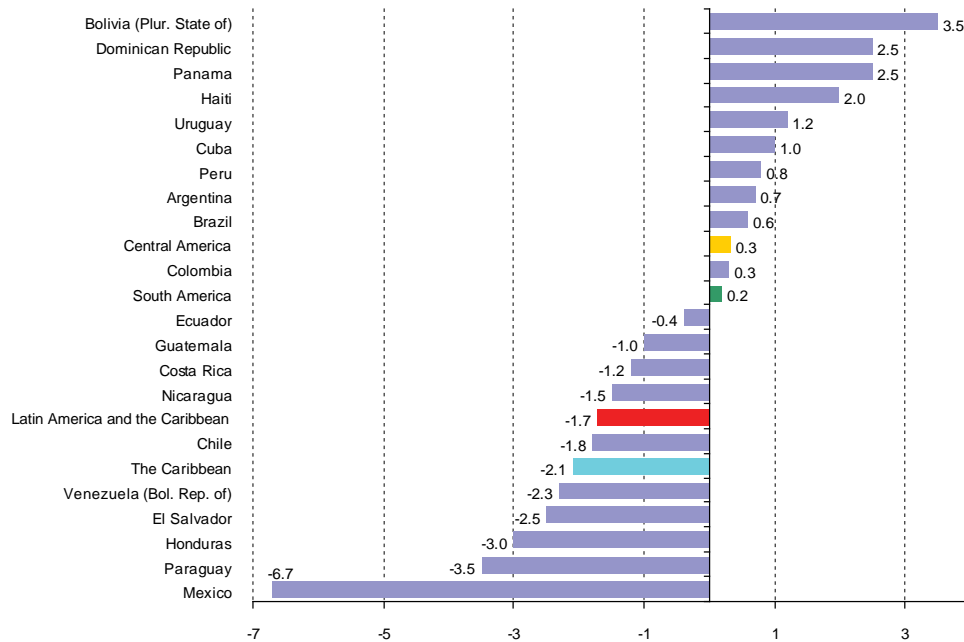
In the short term, the countries of the region responded to the crisis to the best of their capacities - in the process revealing major differences among them. But the objective of regaining sustained growth poses fresh and more complex challenges. Accordingly, the Latin American and Caribbean countries now face the fundamental task of generating and expanding policy space. To do this, they must increase resources, create instruments and strengthen institutions, particularly those involved in coordination.

Chapter I

INTRODUCTION

After six years of economic growth, the GDP of the Latin American and Caribbean region will shrink by an estimated 1.8% in 2009, which translates into a contraction of around 2.9% in per capita GDP. The impact of the international crisis was felt heavily in late 2008 and early 2009, albeit in different ways, in all the countries of the region. A recovery began to take shape in the second quarter, however, and became more widespread in the second half of the year. The heaviest contractions in economic activity occurred in Mexico and some of the Central American and Caribbean countries. Generally speaking, positive growth rates are projected for South America although, in all cases, they fall far short of the rates posted between 2004 and 2008.

Figure I.1
LATIN AMERICA AND THE CARIBBEAN: GROWTH RATES, 2009
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

In-press update: For Brazil read 0.3%. For Latin America and the Caribbean read -1.8%.

The economic slowdown, predictably, cut into labour demand and the unemployment rate is expected to rise to around 8.3% for the region overall and new jobs created are likely to be of poorer quality. The inflation rate dropped sharply from 8.3% in 2008 to around 4.5% in 2009, as a result of falling international prices for some of the commodities included in household consumption baskets, in addition to the effect of currency appreciation and the impact of slacker activity levels on demand.

The emergence of some positive signals in the second half of 2009 has supported a gradual shift in economic prospects and lent weight to the hypothesis that the worst of the crisis may be over, even though financial markets continue to exhibit some volatility and the situation of the global economy is not risk-free.¹ Beyond the short term, however, a number of questions arise as to whether this rapid recovery will develop into sustained growth at the world level and in Latin America and the Caribbean.

Given the magnitude of the crisis, it reached every part of the world and the Latin American and Caribbean region was no exception. Yet it is increasingly evident that this crisis differs from those the region has experienced in the past. Not only because the epicentre of the crisis lay in the developed countries, although this plays no small part in accounting for recent economic trends, but, above all, because of the juncture at which the crisis broke out in the region and how the region was affected.

First, the combination of highly favourable external conditions and more prudent management of macroeconomic policy has enabled the region to reduce its outstanding debt and to renegotiate it on advantageous terms, while also building up international reserves. The Latin American economies thus went into the crisis with unprecedented liquidity and solvency, at least by comparison with their position during previous episodes since the 1980s, because, unlike on those occasions, the countries' financial systems have not deteriorated and there has been no flight from local currency, which has helped to maintain calm in the region's currency markets.² As discussed in detail in *Economic Survey of Latin America and the Caribbean 2008-2009*, a number of Caribbean countries are carrying hefty external debts and facing rather more complex exchange-rate situations.³

Also unlike the situation during previous crises, the broadened macroeconomic policy space in many of the region's countries gave them substantial capacity for anti-crisis policymaking. In general, as will be discussed later, the public policy space is greater in some South American countries. The improved net financial position also afforded renewed access to international financial markets fairly promptly, which further boosted capacity to implement public policies. As a result, even though the downturn in real variables was very sharp, the recovery looks fairly solid.

Although poverty levels in the region remained high, despite the gains made in recent years, and the impact of the crisis on social variables was predictably negative, the deterioration was not as great as had initially been projected, owing to a number of factors. On the one hand, the drop in activity levels and its impact on the labour market were both smaller than expected, so the unemployment rate did not rise as much as the initial contraction led analysts to fear it would. On the other, international commodity prices, combined with currency appreciation, helped to significantly lower the rate of inflation and limit the erosion of real income, thereby at least partially offsetting the downturn in labour indicators.

The rise in social spending in the last few years and the increase in the number and effectiveness of social programmes played an important role in containing the social costs of the crisis. Learning the lessons from previous crises, the countries have sought to maintain—and even expand—the coverage of these programmes, even in the context of a gradually tightening fiscal space.

¹ For example, the events that occurred in the real-estate and financial markets of Dubai (United Arab Emirates) in late 2009 and their immediate repercussions on other markets, given the high levels of exposure of a number of European banks.

² There were some stress in the region's foreign-exchange markets in the last quarter of 2008 which resulted in heavy currency depreciations in some countries. This episode was quickly neutralized, however, and had no major repercussions.

³ See box I.2 in *Economic Survey of Latin America and the Caribbean 2008-2009*.

This chapter looks at the hallmark of the current situation and considers the scenarios the region will face in 2010 and beyond. Section B below briefly examines the current international conditions. Section C reviews the main features of recent economic performance and examines the channels through which the crisis affected the economies of the region and the impacts of the crisis on labour and social indicators. Section D is devoted to an analysis of the macroeconomic policies implemented as the crisis deepened in late 2008 and section E lays out the evidence available on the signs of recovery in the region's economies, especially as of the second half of 2009. The last section discusses the short-term outlook and the risks that could threaten the fledging recovery and the main challenges for Latin America and the Caribbean beyond the crisis.

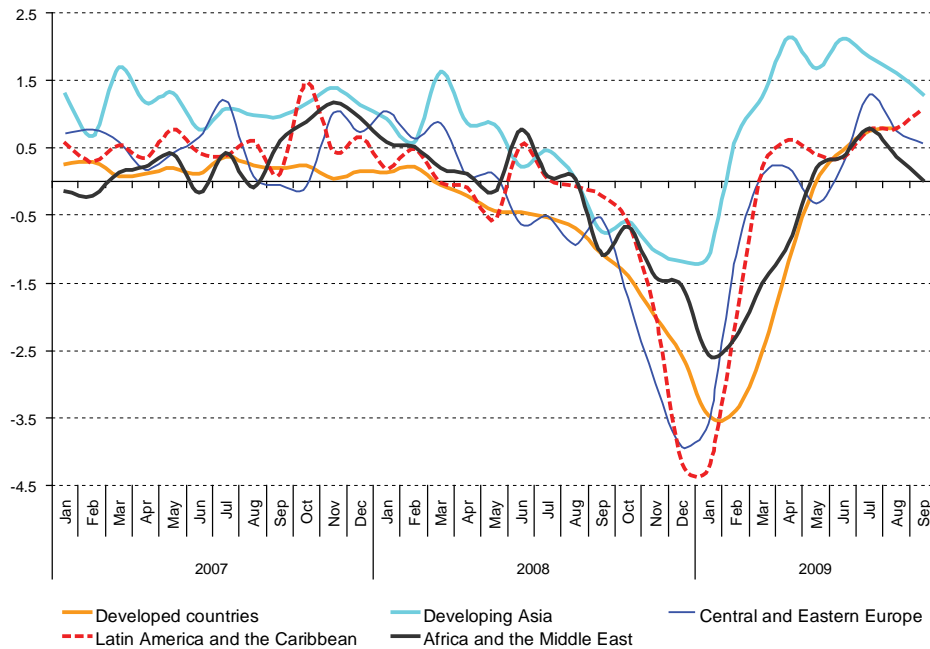
A. THE INTERNATIONAL CONTEXT

The global economy is recovering from the deepest recession the world has seen in the last 60 years. The international financial crisis, which originated in the United States and other developed countries, spread rapidly to the rest of the world's economies, and its effects were soon being felt in the real sector. From mid-2008 to the first quarter of 2009, industrial activity worldwide fell by 11.6% and in the developed countries by 16.4%. International trade volumes meanwhile shrank by 19%. Given that the impact of the crisis was still strong in the first semester of 2009, world GDP is projected to fall by 2.2% over the year.

Nevertheless economic activity and international trade started to show some signs of recovery in the middle of the year. The rapid recuperation from the worst moment of the crisis was largely the result of the expansionary monetary policy response coordinated by the worlds' main central banks, which was subsequently replicated by monetary authorities in the developing world. Copious amounts of liquidity were injected into the markets, and these, together with the fiscal stimulus packages that governments implemented, have been driving the incipient recovery now under way. Also, the relatively strong performance of the developing Asian economies, especially China, prevented an even greater slump in global demand. Initial fears of a long drawn-out depression thus dissipated, and the first signs of a synchronized emergence from the recession began to appear in the second quarter of 2009.

Manufacturing activity has been picking up in general in the different regions of the world since the middle of the year (see figure I.2). In this regard, the industrial output of the developing Asian economies not only contracted less than that of other regions, it was also the first to pick up again at the beginning of 2009.

Figure I.2
SEASONALLY ADJUSTED INDEX OF INDUSTRIAL OUTPUT, BY REGION^a
 (Percentages)



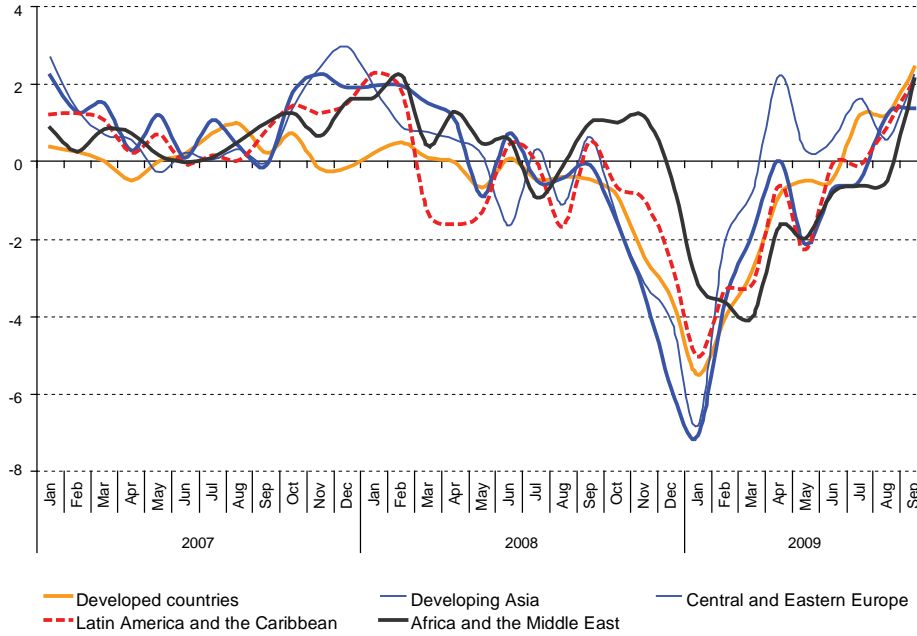
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of data from Centraal Planbureau (CPB), Netherlands Bureau for Economic Policy Analysis.

^a Three-month moving averages compared with the previous quarter.

The volume of international trade began to grow again towards the second half of the year (see figure I.3), largely driven by activity in the developing Asian economies. Their openness to foreign trade and their external orientation meant that most of them were hit hard by the decline in world trade, but, as is analysed below, this did not have a significant impact on economic activity levels thanks to the expansionary policies implemented by the authorities in those countries.

The larger economies in the world began to show signs of recovery as of the second half of 2009. In the United States, seasonally adjusted and annualized GDP grew by 2.8% in the third quarter of the year compared with the previous quarter, after falling for four consecutive quarters since mid-2008 and falling by 5.4% and 6.4% in the last quarter of 2008 and the first quarter of 2009, respectively. All the components of demand posted positive growth in the third quarter of 2009, with the rise in imports and exports heralding the recovery of world trade. At the same time, household consumption, a key indicator in the United States economy (see figure I.4a), began to climb again thanks to growing consumer confidence and increased spending on durables, such as cars and household appliances.

Figure I.3
VOLUME OF TRADE (AVERAGE VOLUME OF IMPORTS PLUS EXPORTS), BY REGION ^a
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of data from Centraal Planbureau (CPB), Netherlands Bureau for Economic Policy Analysis.

^a Three-month moving averages compared with the previous quarter.

Figure I.4
GROWTH IN GDP AND THE COMPONENTS OF DEMAND ^a
(Percentages)

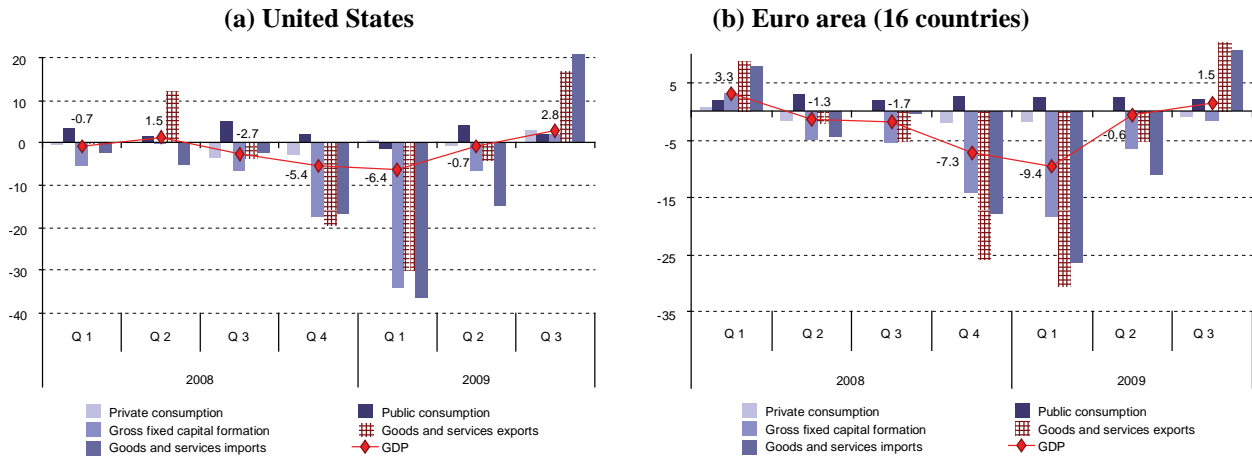
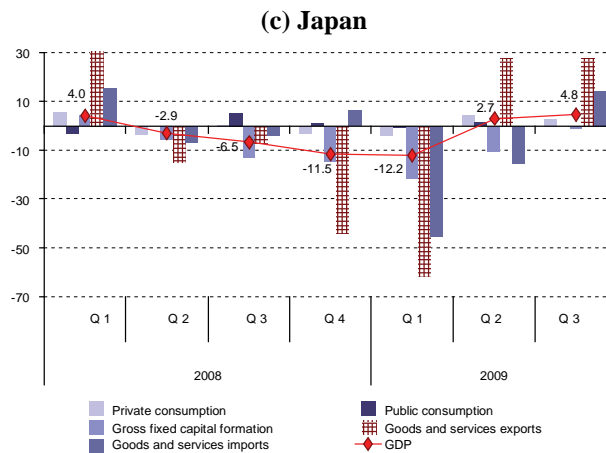


Figure I.4 (concluded)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Seasonally adjusted figures. Annualized variation from the previous quarter.

It should be noted that public-sector consumption is the only component of demand that continued to grow in three of the four quarters of the United States recession, a clear reflection of the fiscal effort put into counteracting the effects of the crisis. The United States economy is projected to grow at the same rate in the fourth quarter as it did in the third, closing out 2009 with a downslide of 2.5%. Inventory shedding is down and its negative influence waning. The need to replenish stocks is expected to help push GDP growth in the United States up to around 2.0% in 2010. However, rising unemployment, which has already hit double-digit levels (10.2%), and the difficulties still affecting the financial markets at a time when both the public- and private-sectors are heavily burdened with debt, are warning signs of the possible future course of the United States economy.

The economies of the euro 16 area also began to recover in the third quarter of 2009, after five quarters of negative growth, thanks to the significant countercyclical role played by public consumption (see figure I.4b). After shrinking by 4.0% in 2009, aggregate GDP for the area is expected to recover slowly and gradually, growing by less than 1% in 2010.

The Japanese economy came out of recession in the second quarter of 2009 after two quarters of year-on-year drops in GDP of over 10% (see figure I.4c). After this sharp contraction, the economy grew again at an annualized rate of 2.7% in the second quarter of the year (compared with the previous quarter) and even more robustly in the third quarter (by 4.8%). This recovery was driven by strong export growth and the fiscal stimulus package implemented by the Japanese authorities, as well as by the rise in transfers to the private sector which encouraged household consumption, albeit at the cost of further debilitating an already weak fiscal position. Despite the recovery recorded in the second semester, the heavy contraction of the economy at the beginning of 2009 (-12.2% annualized in relation to the previous quarter) means that GDP growth for 2009 overall is expected to be -5.9%. GDP growth for 2010 is projected at 1.1%.

As noted earlier, the developing Asian economies were the first to reverse the negative effects of the crisis, and some countries, such as China, India and Indonesia, suffered slowdowns but never actually went into recession. This superior performance was largely achieved through the use of major fiscal and monetary stimuli.

The Chinese economy was back on its path of robust growth towards the second quarter of 2009 thanks to the expansive policies deployed on both the fiscal and monetary fronts. The Government took advantage of the enormous fiscal space it had built up (after years of surpluses in public accounts and thanks to its position as the net creditor of the rest of the world) to launch an ambitious public programme that included an increase in infrastructure spending, tax cuts and the introduction of a new social security system. Also, unlike in other financial markets, lending in China soared, especially credit financing for infrastructure projects. These two factors fuelled domestic demand and contributed to a recovery in imports, which in turn stimulated regional and global trade.

Table I.1
ANNUAL VARIATIONS IN WORLD GROWTH
(Percentages)

	2003	2004	2005	2006	2007	2008	2009 ^a	2010 ^b
World	2.7	4.1	3.5	3.9	3.8	1.7	-2.2	2.5
Developed countries	1.8	3.0	2.5	2.7	2.5	0.4	-3.6	1.4
United States	2.5	3.6	3.1	2.7	2.1	0.4	-2.5	2.0
Euro area (16 countries)	0.8	2.1	1.7	3.0	2.7	0.6	-4.0	0.7
Rest of Europe (11+3)	2.4	3.5	2.7	3.6	3.1	1.1	-4.1	0.7
Japan	1.4	2.7	1.9	2.0	2.3	-0.7	-5.9	1.1
Developing countries	5.2	7.4	6.6	7.3	7.5	5.2	1.7	5.3
Africa	5.5	9.2	5.5	6.2	6.1	6.0	1.9	4.3
Latin America and the Caribbean	2.2	6.1	5.0	5.8	5.8	4.1	-1.7	4.3
China	10.0	10.1	10.4	11.6	13.0	9.0	8.4	8.7
India	6.9	7.9	9.2	9.8	9.3	7.3	5.9	6.5
Recently industrialized countries	3.1	6.0	4.8	5.6	5.7	1.5	-2.4	3.6
Rest of Asia	6.1	6.8	6.3	5.9	5.8	4.4	-0.1	3.8
Transition economies	7.5	8.0	6.7	8.3	8.7	5.7	-5.9	1.9
Developing countries (excluding China and India)	3.9	6.6	5.4	5.9	5.8	3.9	-0.9	4.0

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

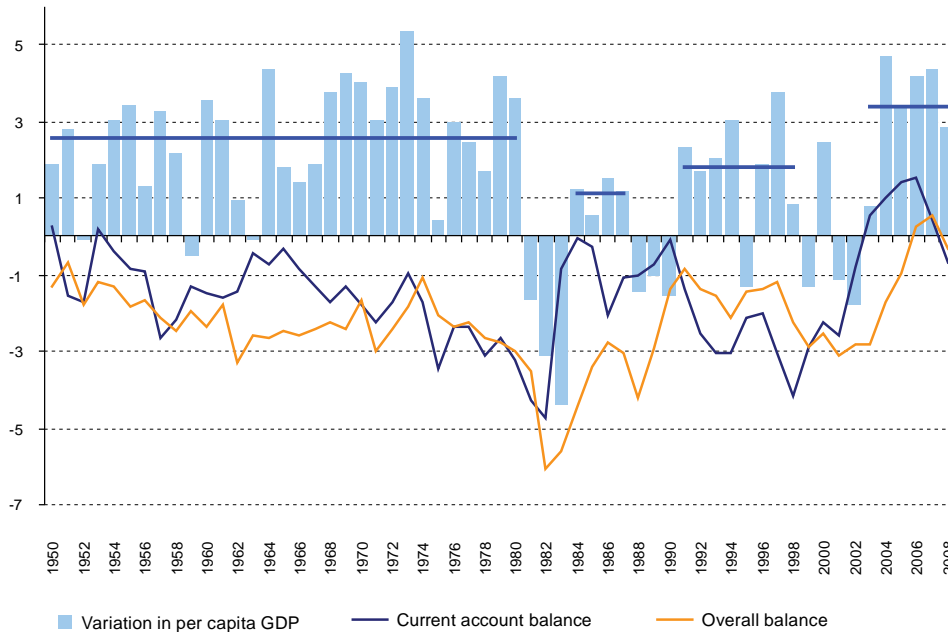
^a Estimates.

^b Projections.

B. RECENT TRENDS IN THE LATIN AMERICAN AND CARIBBEAN ECONOMIES

As noted in the introduction, in order to understand why the impact of this crisis on Latin America and the Caribbean was different from that of previous ones, it is important to understand the situation in which the region found itself when the crisis struck. First of all, the global economic crisis brought to a sudden end the longest and most intense phase of economic growth that the region had seen in a very long while. To find another period of steady per capita GDP growth of over 3% per year (as recorded in 2004-2008), we would have to go back 40 years to the boom that lasted from the end of the 1960s to the oil shock at the beginning of the 1970s, during which the region posted comparable growth rates for seven consecutive years.

Figure I.5
LATIN AMERICA AND THE CARIBBEAN: VARIATION IN PER CAPITA GDP, CURRENT ACCOUNT BALANCE AND OVERALL BALANCE
(Percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

As shown in figure I.5, steady growth was accompanied by quantitative and qualitative improvements in fundamental macroeconomic variables, making 2004-2008 a period of unprecedented expansion in the region's recent history. On the one hand, the region enjoyed a current account surplus (largely generated by improvement in the terms of trade, especially in South America) as well as increasing remittance flows from migrant workers (mainly in Mexico and, above all, Central America). Meanwhile in public accounts, ever-larger primary surpluses were being posted, and the region's overall deficit was drastically reduced (even turning into a surplus in 2006/2007).

At a time of abundant liquidity in international financial markets, the current account surplus allowed countries to reduce their external debt burdens and to renegotiate more advantageous terms, as well as to accumulate reserves.⁴ Greater fiscal slack, meanwhile, made it possible to slash public debt.

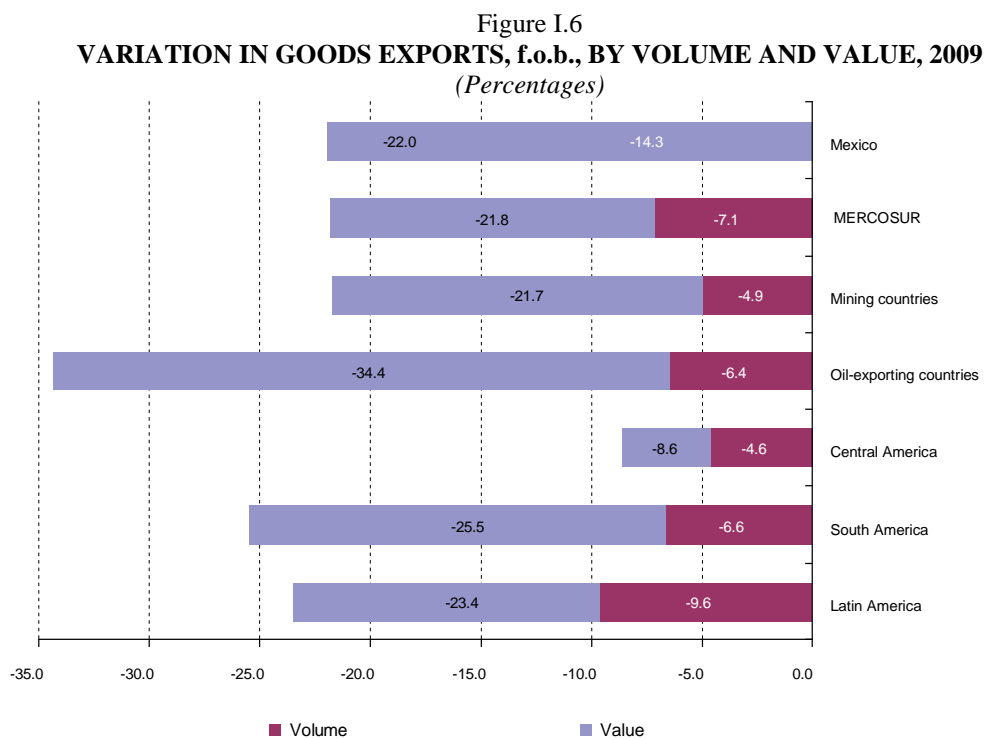
Therefore, although the crisis imposed heavy constraints on macroeconomic policy as it plunged the economies back into deficit positions on their external and public accounts, their favourable situation in terms of financial stocks (more assets, fewer and better liabilities) meant that, unlike in previous crises, in 2009, they did not have to contend with problems in the domestic financial systems, runs against domestic currencies or difficulties meeting their external obligations. This explains why this time around, with a few exceptions which will be discussed later, the strongest effects of the crisis were channelled not through the financial sector but through the real economy.

⁴ As noted earlier, the situation is rather different in some Caribbean economies.

1. Channels of transmission of the crisis

As noted above, the repercussions of the crisis on Latin America and the Caribbean were channelled through the real sector, damaging what had been in recent times one of the main engines of regional growth.

Exports plummeted as of the second semester of 2008, both in volume and value terms. Even though the fall has slowed in the second half of 2009, Latin American export volumes are projected to fall by slightly over 9.5% by the end of the year. Mexico's exports have suffered the most, and will slide by about 14% in real terms. Drops of about 5% and 6.5% in export volumes are estimated for Central America and South America, respectively.

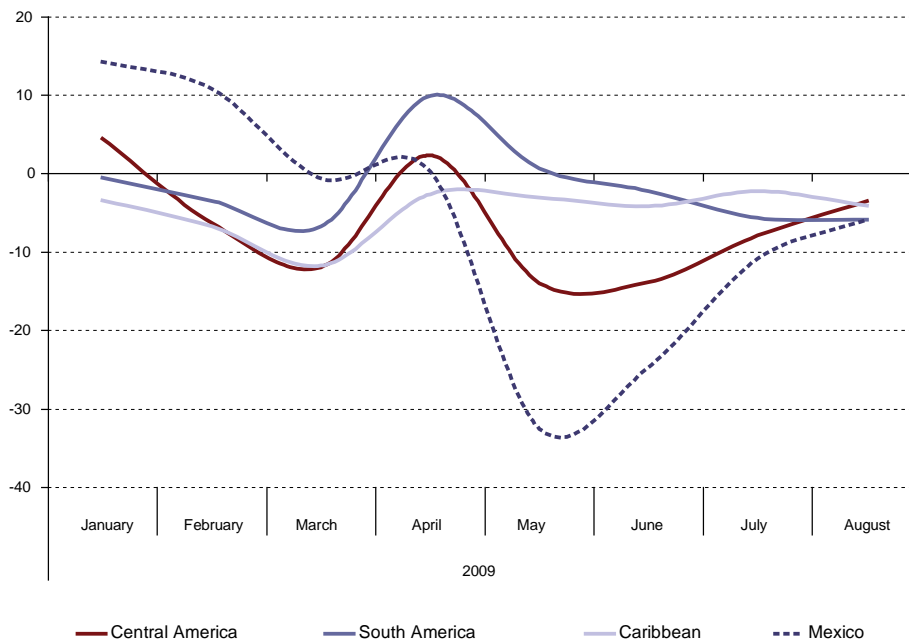


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

The slowdown in economic activity worldwide, together with the drop in international trade flows, had a negative impact on commodity prices, which hurt the region's terms of trade. Prices had soared in the first half of 2008, but the crisis hit the international goods markets hard, especially after the collapse of Lehman Brothers in September that year. Although the downtrend in international commodity prices bottomed out at the beginning of 2009, average price levels for the year are far lower than in 2008, which suggests that the terms of trade for the region as a whole worsened by an estimated 6.1%. This has implications mainly for South America, and for the oil and hydrocarbon and metal producers in particular, as well as, albeit to a lesser extent, for countries that specialize in food production. The terms of trade of Central America, which imports those commodities, on the other hand, can be expected to improve. This will only partially offset the worsening of the terms experienced in previous years, however.

Tourism, which is of major importance to the economies of the Caribbean and Central America, declined sharply in the first part of 2009 as shown in figure I.7. The contraction was particularly notable in Mexico in the second quarter of the year due to the outbreak of the AH1N1 influenza virus. Overall, tourism is expected to fall by 5%-10% in 2009, even though the latest available data reveal a slight upturn.

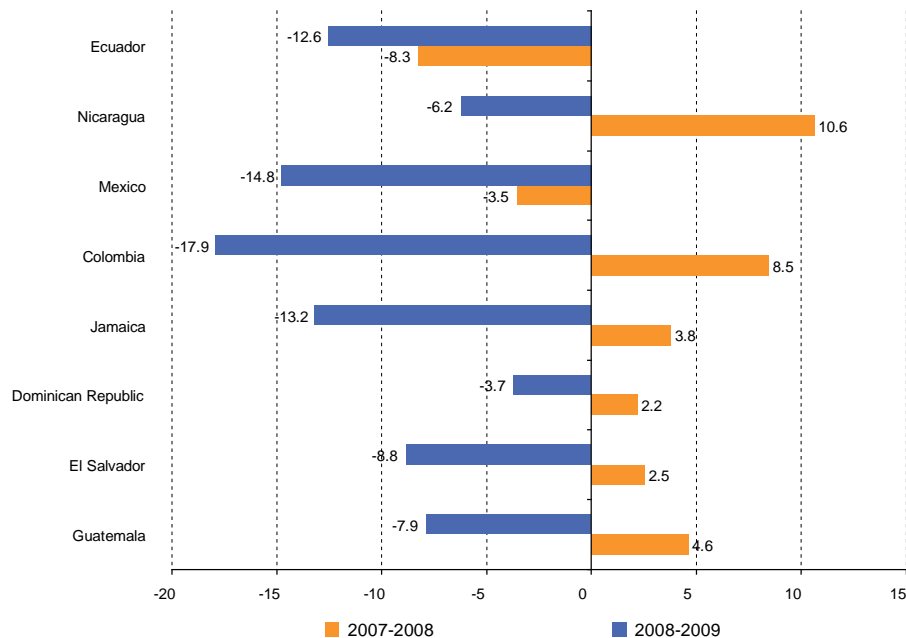
Figure I.7
LATIN AMERICA AND THE CARIBBEAN: YEAR-ON-YEAR VARIATION IN INTERNATIONAL TOURIST ARRIVALS, 2009
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of the World Tourism Organization (UNWTO).

Given that the main destinations of most Latin American and Caribbean emigrants are the United States and Spain, two of the countries worst hit by the crisis, it is not surprising that remittances to the region have plummeted. The latest available data suggest that this trend might be being reversed, but even then, annual falls in remittances of close to 10% have been recorded in some Central American countries, such as El Salvador and Guatemala, and even larger drops in countries such as Colombia, Ecuador, Jamaica and Mexico. Smaller declines have been estimated for the Dominican Republic and Nicaragua.

Figure I.8
**LATIN AMERICA AND THE CARIBBEAN: YEAR-ON-YEAR VARIATION IN REMITTANCES FROM
 MIGRANT WORKERS, SEASONALLY ADJUSTED^a**
 (Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Projections for 2009.

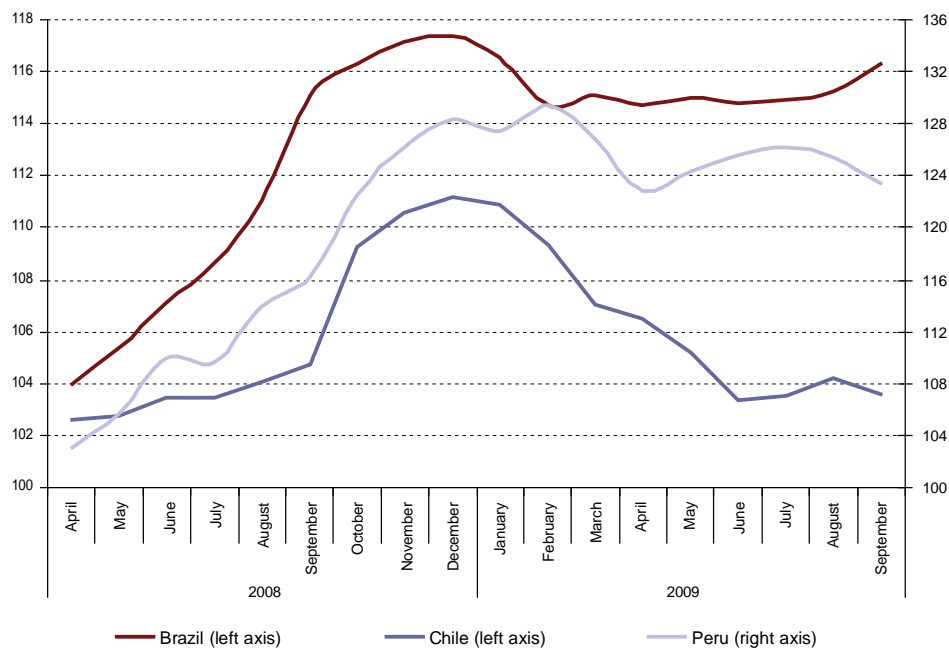
Meanwhile, foreign direct investment (FDI) in the region as a whole is expected to fall by 37%, by far the largest drop for at least 30 years. Between 1999 and 2003, FDI flows fell by about 47%, but then the drop was concentrated in only two countries (Argentina and Brazil), while this time around, the reduction is spread across the region, although diminished flows to Brazil account for a significant proportion of the total decline.

Although, generally speaking, the impacts of the international crisis were felt mainly through the channel of the real economy, in some cases there were impacts on financial systems that may have had significant repercussions on activity levels. Although the turbulences in the region were mostly related to trade rather than reversals of capital inflows, there were three major exceptions: Brazil, Chile and Peru, whose financial systems were more exposed than those of the rest of the region in late 2008.⁵

⁵ See *Economic Survey of Latin America and the Caribbean 2008-2009*, in which box I.1 gives an analysis of the consequences of the shocks experienced by the region after the crisis deepened in late 2008. Figure I.4 of that publication shows the net external position of the financial systems of the Latin American countries and discusses certain aggregates in developed countries and emerging economies. These data are based on information from the Bank for International Settlements.

As shown in figure I.9, the manifestation of this situation in these countries' financial systems was a major contraction in private bank credit in real terms. The public banks then played an active role in many countries as part of countercyclical strategy although, with the exception of Brazil (where public banks account for a large proportion of total credit), the capacity to offset the contraction in private bank credit was fairly small.

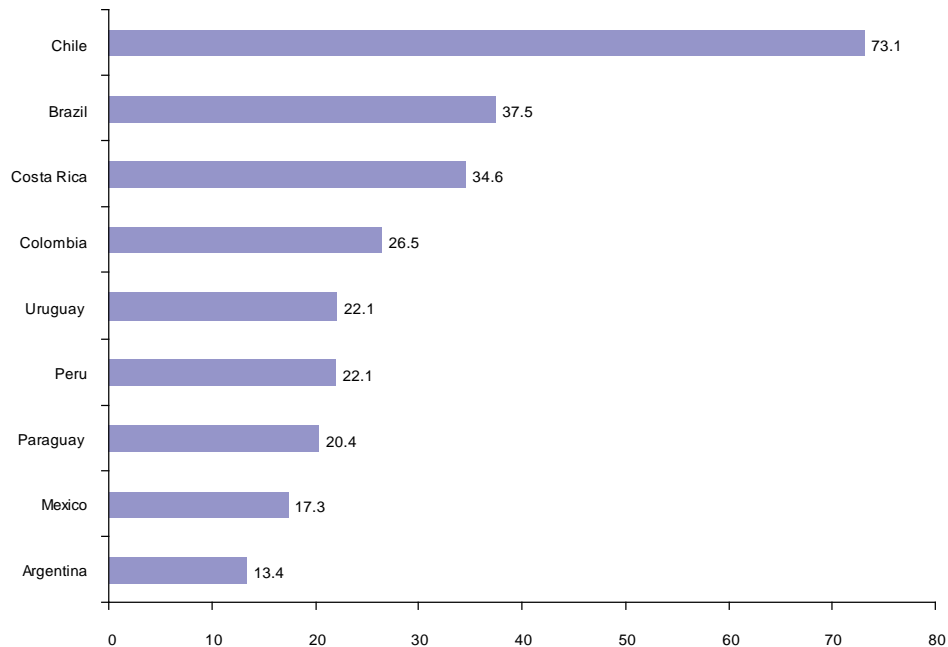
Figure I.9
BRAZIL, CHILE AND PERU: PRIVATE BANK LENDING
(Index: first quarter 2008=100)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

This factor been crucial in explaining the relative weakness of the Chilean economy between late 2008 and the third quarter of 2009, despite its sound macroeconomic fundamentals and the active intervention of the State through countercyclical policies. The evidence shown in figure I.10 regarding the magnitude of credit as a proportion of GDP speaks for itself as regards the impact on activity levels of shrinking private bank credit in the Chilean economy, compared with the Brazilian and Peruvian economies and, in general, the rest of the region.

Figure I.10
LATIN AMERICA (SELECTED COUNTRIES): PRIVATE BANK LENDING, 2008
(Percentages of GDP)

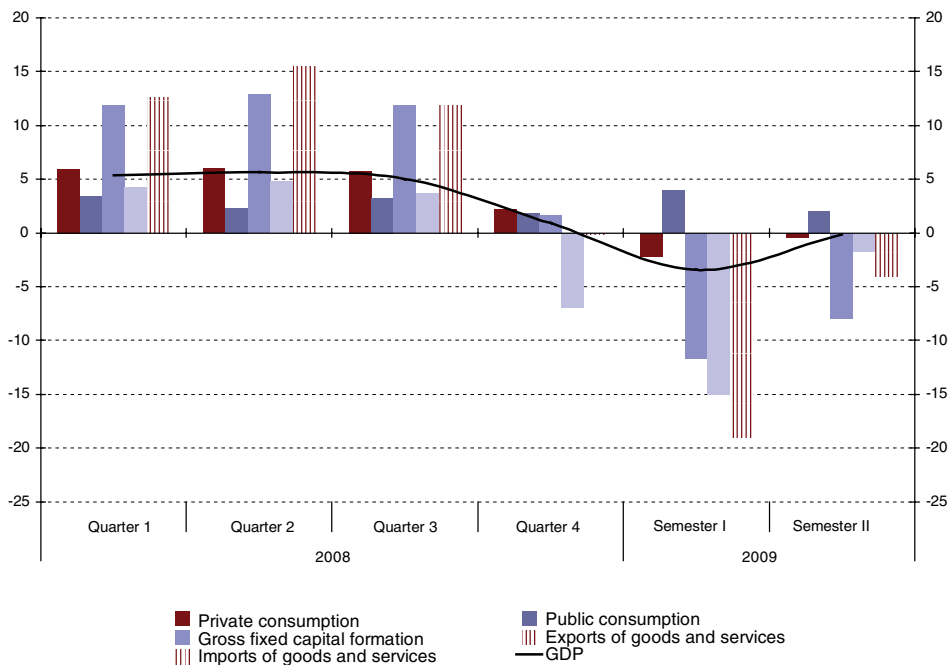


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Generally-speaking, the expectations of consumers and businesspeople alike worsened towards the end of 2008 and at the beginning of 2009, which translated into lower levels of both private consumption and investment. In fact, as shown in figure I.11, public consumption was the only type of consumption to increase in the first part of the year when many countries in the region had at least some room to implement countercyclical policies that partially offset the negative performance posted by the other components of domestic demand and helped speed up the recovery in the second part of the year as discussed below.⁶

⁶ As no disaggregate data is available on investment, no distinctions could be made between public investment which, as commented below, increased over the year, and private investment, which contracted sharply and whose weight is far greater, masking the compensatory effect of public investment.

Figure I.11
LATIN AMERICA AND THE CARIBBEAN: BREAKDOWN OF TOTAL SUPPLY AND DEMAND
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

2. The social effects of the crisis

The sudden slowdown in economic growth had a negative impact on the labour market: the employment rate fell for the first time in six years, as shown in section III.C. Unemployment rose by almost one percentage point from 7.4% to 8.3%. The slack labour supply, as indicated by the participation rate, averted a larger rise in unemployment.⁷ Governments implemented a series of measures (see box I.1) whose impact is impossible to gauge on the basis of the information available to date, but which probably helped stem the rise in unemployment.

The improvements under way in recent years in job quality, however, stopped as the creation of wage jobs in the private sector and of formal employment in general slowed considerably.

⁷ The projected rise in the unemployment rate is smaller than mid-year forecasts. For example, in “Crisis and the labour market”, *ECLAC/ILO Bulletin The employment situation in Latin America and the Caribbean*, No. 1, June 2009, it is estimated that unemployment could come close to 9% for the year overall.

Box I.1
SOCIAL MEASURES IN LATIN AMERICA AND THE CARIBBEAN

The Latin American and Caribbean countries have announced social measures that may be classified under consumption subsidies, on the one hand, and support for poor families, on the other. The consumption subsidies consist of subsidies for fuel, food and other items, transport and electric power. Support for poor families has encompassed mainly help with housing, health care and education for vulnerable groups. Of the 33 countries and 2 dependent territories in the region, 27 have information on these measures (9 of 11 in South America, 8 of 9 in Central America and 10 of 15 in the Caribbean).

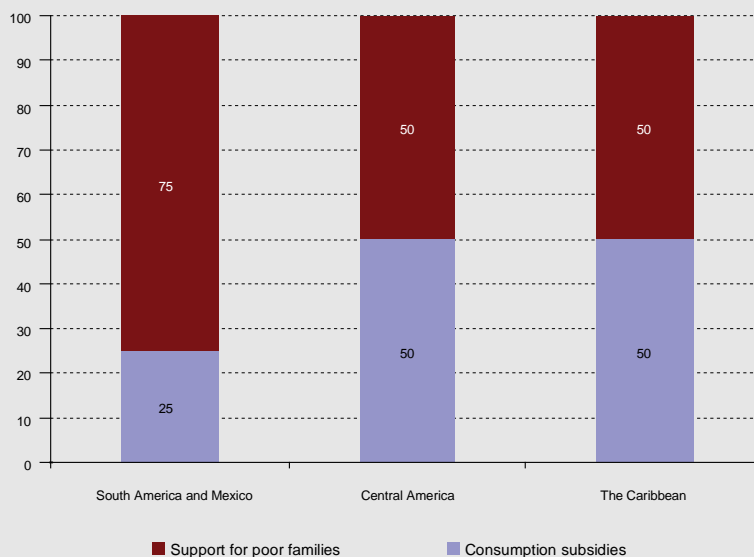
Regionwide, a total of 45 measures were registered. Of the 33 countries and 2 dependent territories, 24 have announced measures to support poor families and 21 to subsidize consumption. Accordingly, the portfolio leans slightly towards support for poor families (53%).

A breakdown of the measures by subregion, however, shows a major difference in portfolio composition. In South America and Mexico two thirds of the measures announced involve support for poor families (64%), while in Central America and the Caribbean countries the distribution is fairly balanced, with close to half of the measures announced corresponding to consumption subsidies and the other half to family support.

Apart from the different ways in which the crisis may have affected the different subregions, these divergences may also have to do with disparities in institutional capabilities for carrying out social policies. Targeted policies tend to be more effective during crises, since they reach those who need them directly, but they make greater demands on institutions. By contrast, consumption subsidies are relatively simpler to implement, but less effective because they are spread across the entire population and may even be regressive insofar as their benefits may accrue excessively to those who consume most.

COMPOSITION OF PORTFOLIO OF SOCIAL PROGRAMMES IN SOUTH AMERICA AND MEXICO, CENTRAL AMERICA AND THE CARIBBEAN

(Percentages)

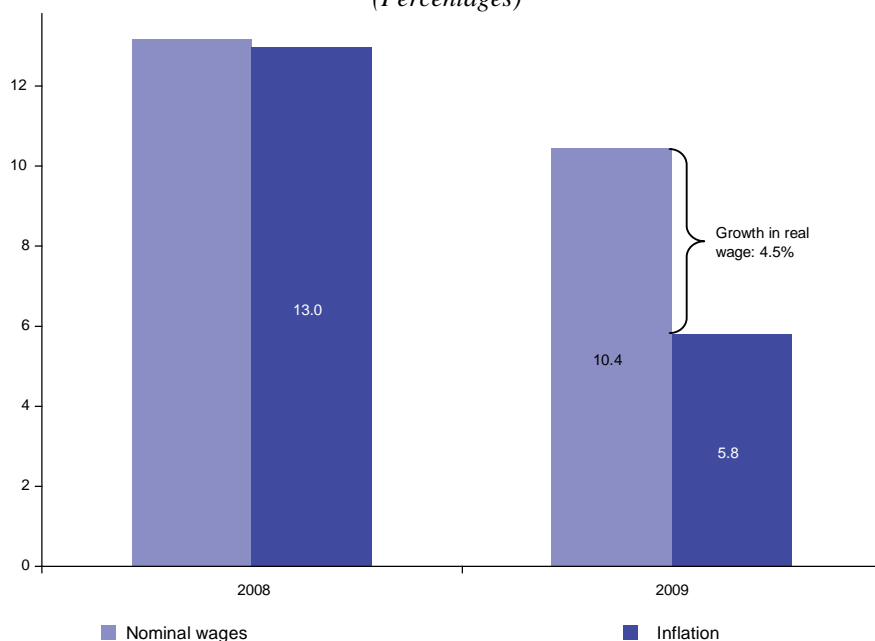


Source: Economic Commission for Latin America and the Caribbean (ECLAC), *The reactions of the Governments of the Americas to the international crisis: an overview of policy measures up to 30 September 2009* (LC/L.3025/Rev.5), Santiago, Chile, October 2009.

On the other hand, the crisis contributed to the lowering of regional inflation from 8.3% in 2008 to 4.5% in 2009. This was the result of the dual impact of the global recession and the decline in trade on food and energy prices, on the one hand, and of the widening of the gap between observed and potential GDP brought about by the regionwide drop in demand, on the other (see box I.3).

Lower inflation staved off a fall in real wages, which accounts in part for why the negative impact on poverty was more moderate than initially projected.⁸

Figure I.12
LATIN AMERICA: VARIATION IN NOMINAL WAGES, INFLATION AND REAL WAGES^a
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Simple average (10 countries).

The smaller-than-expected increase in poverty can also be attributed to the social spending policies implemented by most of the countries of the region, especially to those deployed by the larger countries that have a more tightly woven institutional fabric, which enables them to implement strategies that, by being more targeted, tend to be more effective during crises than the general subsidies on consumption of certain goods and services. As shown in box I.1, general subsidies tend to be the instruments most commonly used in some Central America and Caribbean countries whose institutional framework is weaker.

⁸ As noted in *Social Panorama of Latin America*, launched by ECLAC in November 2009.

C. MACROECONOMIC POLICY

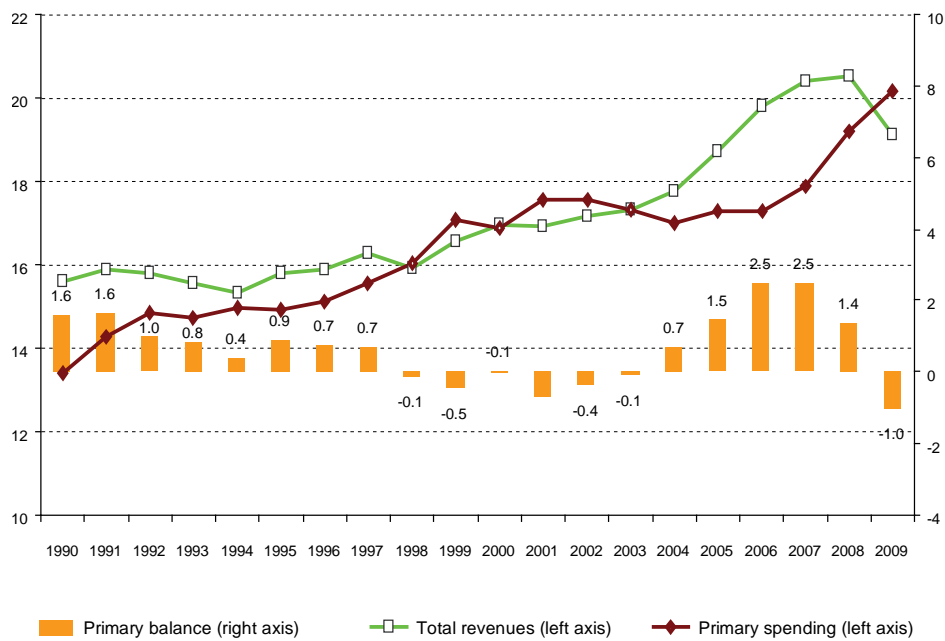
Many countries in the region had some room to implement countercyclical policies that not only allowed them to at least partially offset the negative evolution of most of the components of domestic demand, but also to speed up the recovery process, which took hold in some countries as of the second quarter and in nearly all by the third quarter of 2009, as discussed below.

One characteristic feature of the crisis has been the capacity shown (by some countries more than others) to implement macroeconomic and sectoral policies to mitigate the negative effects of the crisis on economic activity and employment. To different extents, according to the type of problem faced and, above all, according to each country's capacity (in not only financial, but also institutional terms) to put into practice public policies, the governments of the region have introduced a wide array of initiatives which can broadly be grouped into the following categories: fiscal measures; monetary, financial and exchange measures; and social and employment measures.

1. Fiscal policy

The positive stimulus of fiscal policy action was one of the distinctive features of economic management in 2009. The region's primary balance fell from a surplus equivalent to 1.4% of GDP in 2008 to an estimated deficit of 1% of GDP in 2009. This drop of more than two percentage points, which is a measure of the size of the fiscal stimulus, reflects both the decline in public revenues and the increase in public expenditures (including both current and capital expenditures), as shown in figure I.13.

Figure I.13
LATIN AMERICA: REVENUE, PRIMARY SPENDING AND PRIMARY BALANCE
(Simple average, percentages of GDP)



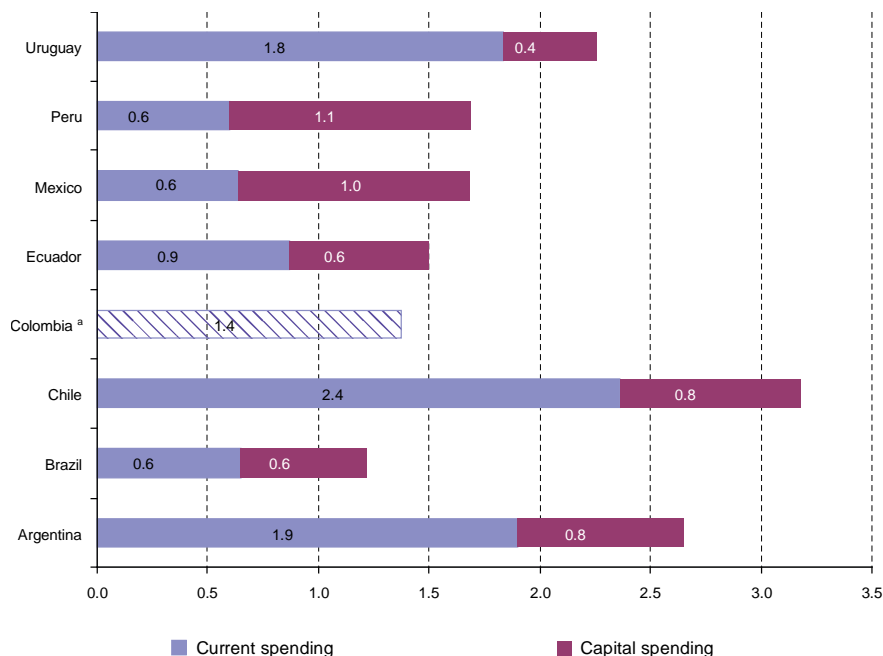
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Revenues, which are examined in detail in the corresponding chapter, have been conditioned by economic growth (which in turn has determined tax receipts) and by the fall in the prices of the commodities that the region exports and that in some countries account for a high proportion of public income.

In addition to these factors, in many cases, policy measures taken in association with anti-crisis strategies to stimulate domestic demand have reduced tax receipts. Income tax rebates and other tax benefits for both companies and private individuals are among the most widely used instruments, having been introduced in 12 of the 19 countries of Latin America.

The governments in the region also announced fairly ambitious spending plans. As far as their implementation is concerned, in most of the countries for which information on actual spending is available for up to the third quarter of the year, current expenditures (which can generally be stepped up more quickly) increased significantly in the first half of the year, while capital expenditures (which are usually slower to materialize) did so to a lesser extent. The drop in commodity prices reduced the fiscal space available in some of the countries that are highly specialized in commodities, however, which prevented them from implementing countercyclical measures.⁹

Figure I.14
LATIN AMERICA (SELECTED COUNTRIES): VARIATION IN PUBLIC EXPENDITURE, NINE MONTHS OF 2008 COMPARED WITH NINE MONTHS OF 2009
(Percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Variation in total spending.

⁹ See the definition in chapter II.A.

2. Monetary and exchange-rate policy

As soon as the crisis broke out, the central banks of the region prioritized a series of wide-ranging measures aimed at guaranteeing either recovery or the liquidity of local financial markets, or both. The widespread fall in inflation freed up monetary policy both in countries that run inflation targeting schemes and those that use other targets, such as certain monetary aggregates.

As shown in chapter II, the substantial lowering of monetary policy rates by most of the region's monetary authorities occurred most quickly in the case of the inflation-targeting countries. In many cases, however, although interest rates plummeted, inflation rates fell even faster, cancelling out in real terms the effect pursued by policy action.

Box I.2

MONETARY POLICY OBJECTIVES IN LATIN AMERICA

The principal mandate of central banks in countries that run inflation-targeting schemes is to keep prices rises under control. In such a system the credibility of the monetary authority is crucial because it is expected to act to ensure that inflation targets are met. However, goods prices are not the only macroeconomic variable that fluctuates in an economy. Variations in real exchange rate and in GDP can, at particular times, also cause concern for central banks. For example, in their monetary policy and inflation reports, the central banks of those countries have noted that the reduction in monetary policy reference rates since the first semester of 2009 has also been intended to help revive domestic demand amid slack economic activity. Sharp fluctuations in the nominal exchange rate, which are also passed through to the real exchange rate, have also prompted central banks to intervene in the foreign-exchange markets.^a In Chile, for example, in response to the nominal appreciation of the peso, the central bank announced and implemented a series of interventions aimed at strengthening the international reserve position.

All this goes to show that, under certain circumstances, monetary authorities may respond to variables other than price movements. In order to evaluate these observations empirically, a modified Taylor rule was estimated using autoregressive vectors and including the cyclical components of GDP and the real exchange rate for Brazil, Chile, Colombia, Mexico and Peru.^b As will be recalled, the dependent variable for this rule is the monetary policy reference rate. In other words, the idea is to estimate how a central bank will respond to deviations from trend in these variables.

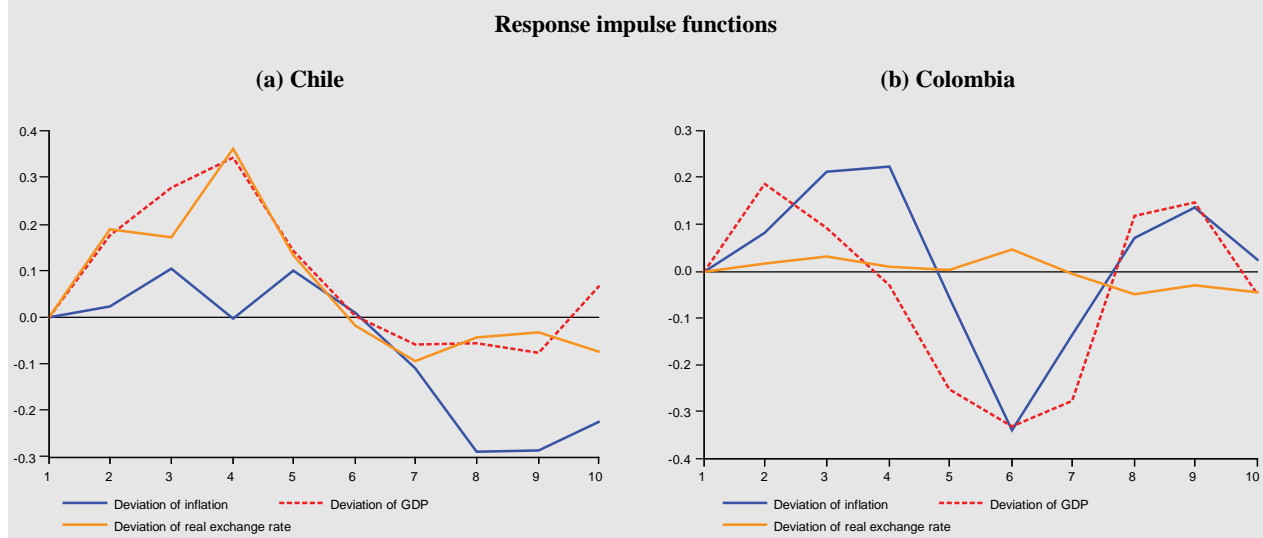
The following equation was estimated:

$$(1) \quad TRPM_t = \beta_0 + \beta_1 * i_t^E + \beta_2 * (\pi_t - \pi_t^{obj}) + \beta_3 * (PIB_t - PIB_t^{Ten}) + \beta_4 * (TCR_t - TCR_t^{Ten}) + \epsilon_t$$

where i_t^E is the equilibrium rate of interest, $\pi_t - \pi_t^{obj}$ represents the deviation of effective inflation from target inflation, $\pi_t - \pi_t^{obj}$ is the deviation of effective GDP from trend, estimated using using a Hodrick-Prescott filter, and $TCR_t - TCR_t^{Ten}$ is the deviation of the real exchange rate, whose trend was estimated using the aforementioned methodology for quarterly data, given that these countries have an inflation-targeting scheme.

Preliminary results show that central banks react to variables other than deviations from the inflation target. The figure below shows response impulse functions for Chile and Colombia. The response variable is the monetary policy reference rate, while the impulses are provided by standard deviations in inflation, GDP and the real exchange rate. The longitude of the response graphed in the figure is 10 periods. In the case of Chile, the monetary policy reference rate reacts basically to changes in the deviation of inflation and output and, to a lesser extent, to real exchange rate variations. In Colombia, the monetary policy reference rate reacts to all three variables. This evidence is consistent with that found in other regions, in Asia for example, for countries that maintain an inflation-targeting system.

Box I.2 (concluded)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of J.B. Taylor, “Discretion versus policy rules in practice”, *Carnegie – Rochester Conference Series on Public Policy*, N° 39, 1993; y F. Neumann y S. Yi Kim S., “What do they target? A profile of Asian central banks”, *Macro Asian Economics*, HSBC Global Research, 2009.

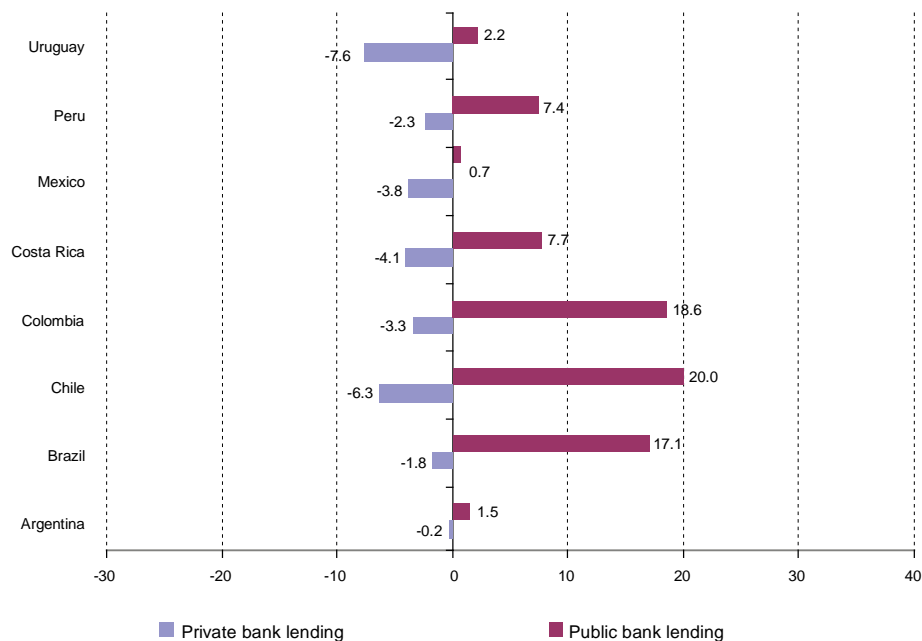
^a See section on exchange-rate policy in this publication.

^b Since the study is at a preliminary stage, only the results for Chile and Colombia are presented.

Also, the central banks’ efforts to inject more liquidity into the financial system failed to translate into an increase in credit in the private banking sector (see figure I.13). As noted earlier, in response to this situation, many governments of the region had the public banking sector play a role in their countercyclical strategies and stepped up public lending to compensate, in some cases partially, in others totally, the tighter stances of private banks. Naturally, the impact of this instrument depends on the magnitude of the official banking sector in the financial system. Hence, it has been very important in Brazil, where public bank lending represents around 35% of total credit.

As far as exchange rates are concerned, once the strain experienced at the end of 2008 (which in some cases lasted into the beginning of 2009) was over, the general trend in South America was a return to the appreciation of local currencies under way prior to the crisis. The search for higher returns during a time of abundant liquidity in the international market, together with the relatively robust performance of many of the region’s economies, resulted in large inflows of capital that pushed down the exchange rate in most of South America. The notable exception has been Mexico, where the exchange rate is 22% higher in real terms than it was before September 2008 when the international crisis unfolded.

Figure I.15
LATIN AMERICA (SELECTED COUNTRIES): VARIATION IN PUBLIC AND PRIVATE BANK LENDING BETWEEN DECEMBER 2008 AND SEPTEMBER 2009
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

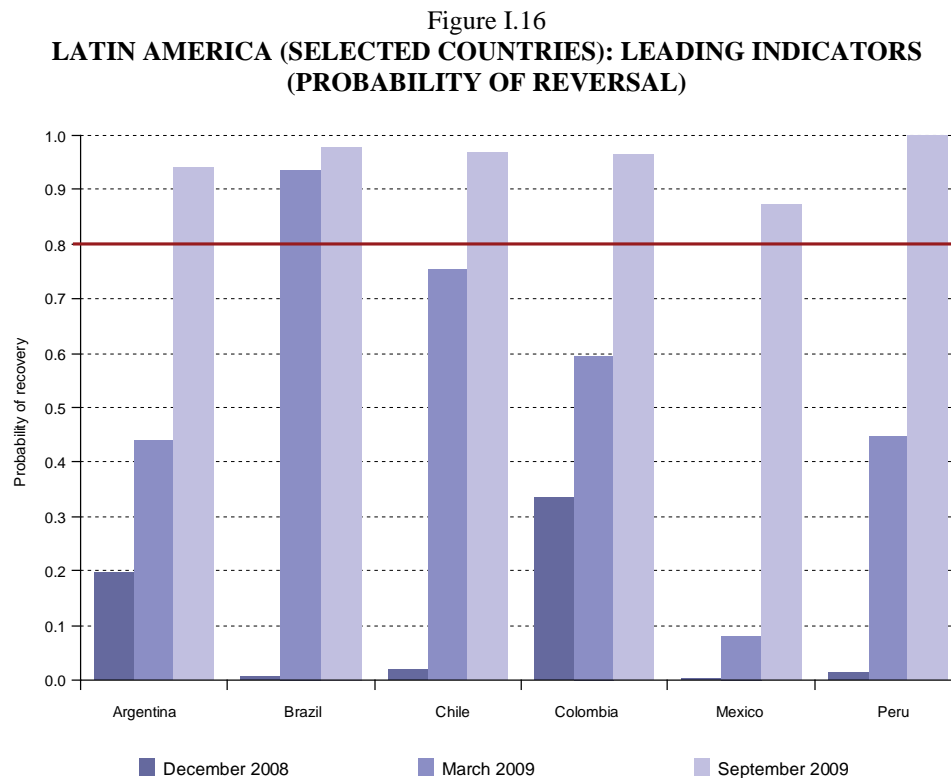
In order to defend the real exchange rate to some extent and to sustain domestic liquidity levels, many central banks intervened in the exchange market, which in some cases enabled them to restore international reserve levels to those seen prior to the last quarter of 2008.¹⁰ One notable example is Brazil, where international reserves rose by 19% to over US\$ 37 billion and the real exchange rate fell by 26% between December 2008 and October 2009.

The changes observed in the countries' international reserves over 2009 are particularly interesting. The increase recorded by Brazil was larger than that posted by Latin America and the Caribbean as a whole. The situation varied across the region, with the increases in reserves in some countries managing to offset the losses observed at the end of 2008, while in others, such as Argentina and Mexico, the increments were minimal in terms of their impact on the total regional rise. It should be noted that in some cases, especially in the smaller economies, such as those of the Caribbean, the expansion of reserves was mainly the result of the recent allocation of Special Drawing Rights by the International Monetary Fund.

¹⁰ The collapse of Lehman Brothers produced some jitters in the financial and exchange markets of the region, which led central banks, among other things, to step in to prevent an even greater depreciation of local currencies than that seen in the last quarter of 2008. This sapped about US\$ billion of the region's international reserves, approximately 10% of total holdings.

D. THE RECOVERY OF THE ECONOMIES OF LATIN AMERICA AND THE CARIBBEAN IN THE SECOND HALF OF 2009

According to the indicators calculated by ECLAC using the methodology presented in *Economic Survey of Latin America and the Caribbean 2008-2009*, six of the largest economies of the region, Argentina, Brazil, Chile, Colombia, Mexico and Peru, which together account for about 90% of regional GDP, were on the road to economic recovery in the third quarter of 2009 (see figure I.16).¹¹



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

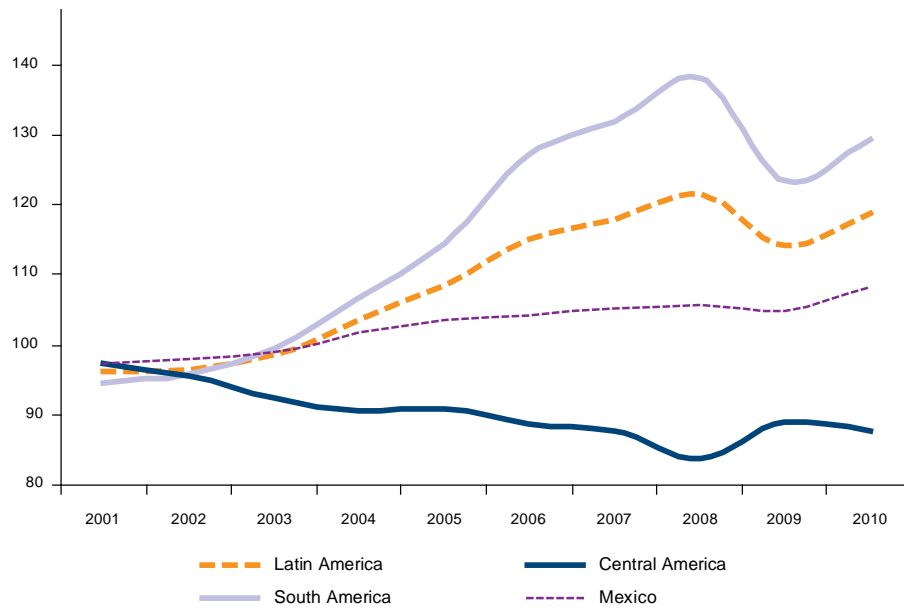
Expectations that the downturn witnessed in economic activity between the fourth quarter of 2008 and the second quarter of 2009 will be reversed are in keeping with the improvements detected in the analysis of the latest information on most of the variables for the real economy referred to in section C.

Export volumes began to expand again as of the third quarter of 2009 (see figure I.3), as shown in chapter IV.A, while the increase in global economic activity and international trade is having a positive effect on demand for commodities and has been pushing up commodity prices since the second quarter of 2009. This is in turn reversing the worsening of the region's terms of trade, which are expected to improve by 3.8% in 2010 for the region as a whole, and by even more in the hydrocarbon- and metal-

¹¹ F. Cantú, A. Acevedo and O. Bello, "Indicadores adelantados para América Latina", Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2009, unpublished.

exporting countries of South America and in Mexico. The terms of trade of Central America, in contrast, are projected to worsen.

Figure I.17
LATIN AMERICA: TERMS OF TRADE
(Index 2000=100)

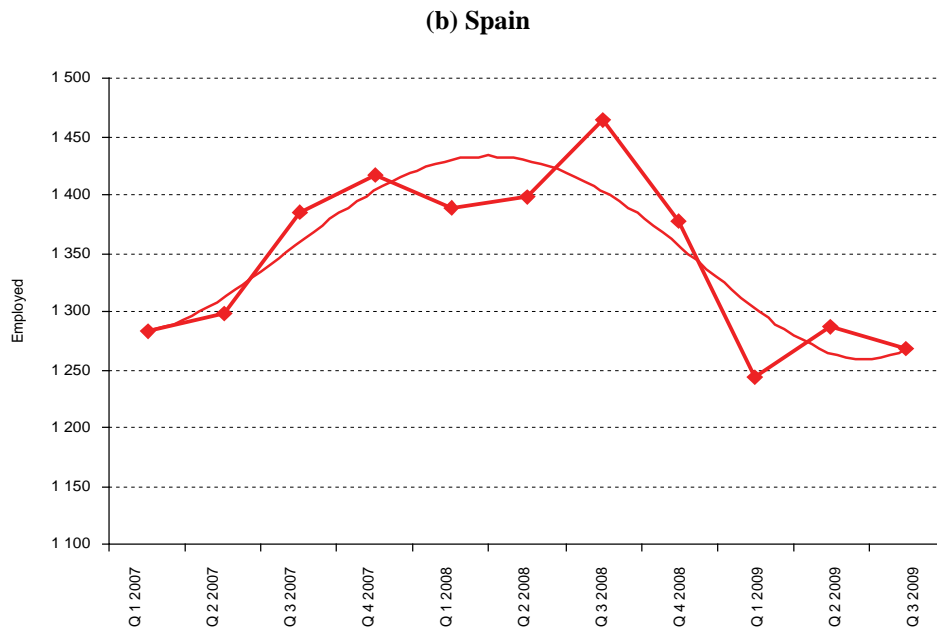
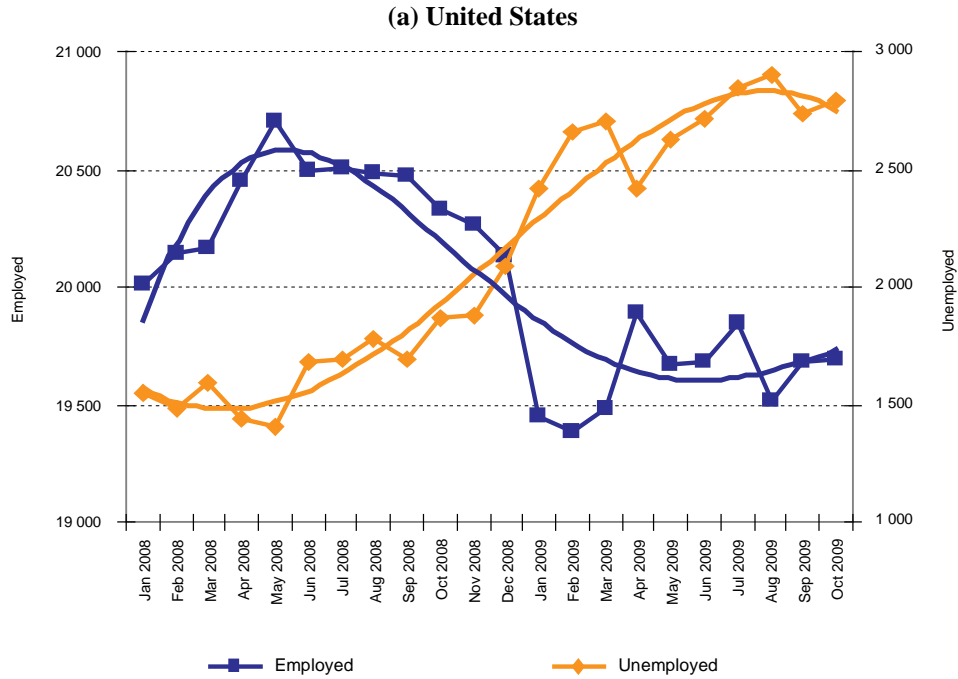


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Remittance flows, which were one of the other engines of growth in 2003-2008, are beginning to pick up again. Moreover, the onset of economic recovery in the United States and Spain, the two main destinations for Latin American and Caribbean emigrants, adds weight to expectations of a recovery in foreign-exchange inflows to the region in the form of remittances. Indicators for the Latin American labour markets meanwhile show that both the downturn in employment and the rise in unemployment halted in the third quarter of the year.¹²

¹² See Dilip Ratha, Sanket Mohapatra and Ani Silwal (2009), "Migration and Development Brief", World Bank, November.

Figure I.18
EMPLOYMENT STATUS OF LATIN AMERICAN CITIZENS IN THE UNITED STATES AND SPAIN
(Thousands of persons)

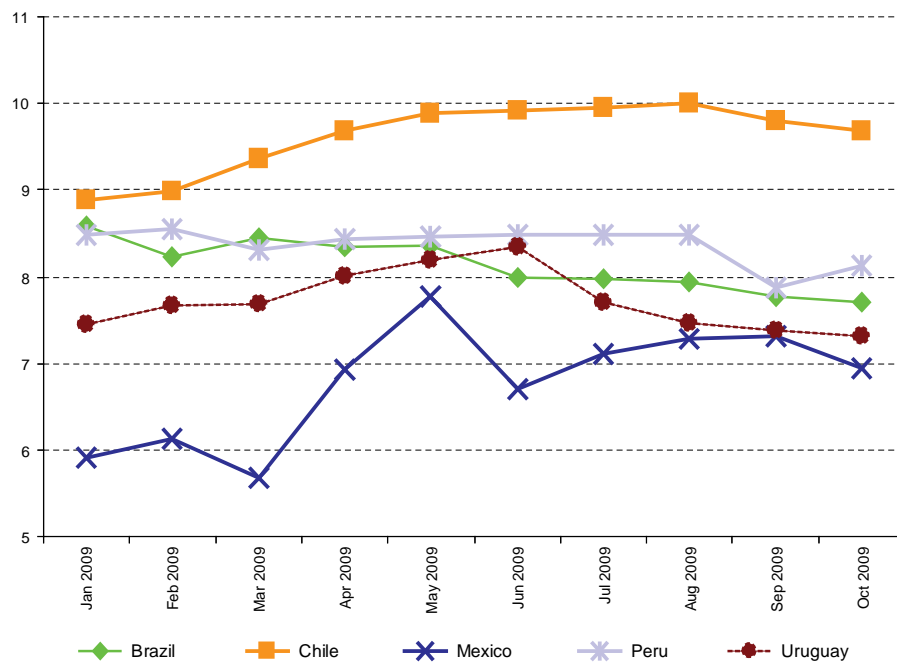


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

As noted in the preceding section, domestic demand is continuing to receive fiscal stimulus in the second half of 2009 which, along with the factors referenced earlier and as a result of a gradual return to normalcy in financial markets, in many cases with the additional support of official banks, is leading to a recovery—at fairly rapid rates, in some cases—which is reflected in the gradual improvement in labour-market indicators for the region (see figure I.16).

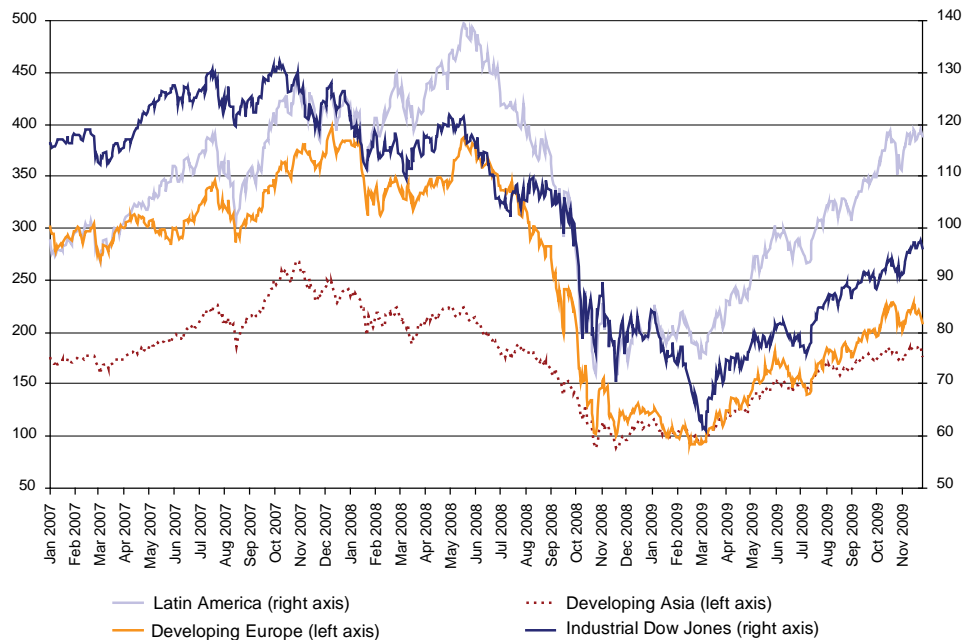
At the same time, the increased tolerance for risk in a context of high liquidity in international financial markets—along with a positive perception of prospects for several of the economies in the region—is resulting, as noted in the previous section, in a number of countries regaining access to international credit. This is having a positive effect on stock markets, which are returning to levels seen prior to the worsening of the crisis. In turn, the private sector should be able to restructure assets and lending activity should return to normal which, together with the gradual improvement in labour market indicators and the renewed confidence within the private sector, as indicated by surveys of business and consumer expectations, domestic demand for both consumer and capital goods should start to climb.

Figure I.19
LATIN AMERICA (SELECTED COUNTRIES): SEASONALLY ADJUSTED MONTHLY UNEMPLOYMENT RATES
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Figure I.20
STOCK MARKET INDICATORS: DOW JONES AND EMERGING MARKETS
(Index 2000=100)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures of Bloomberg.

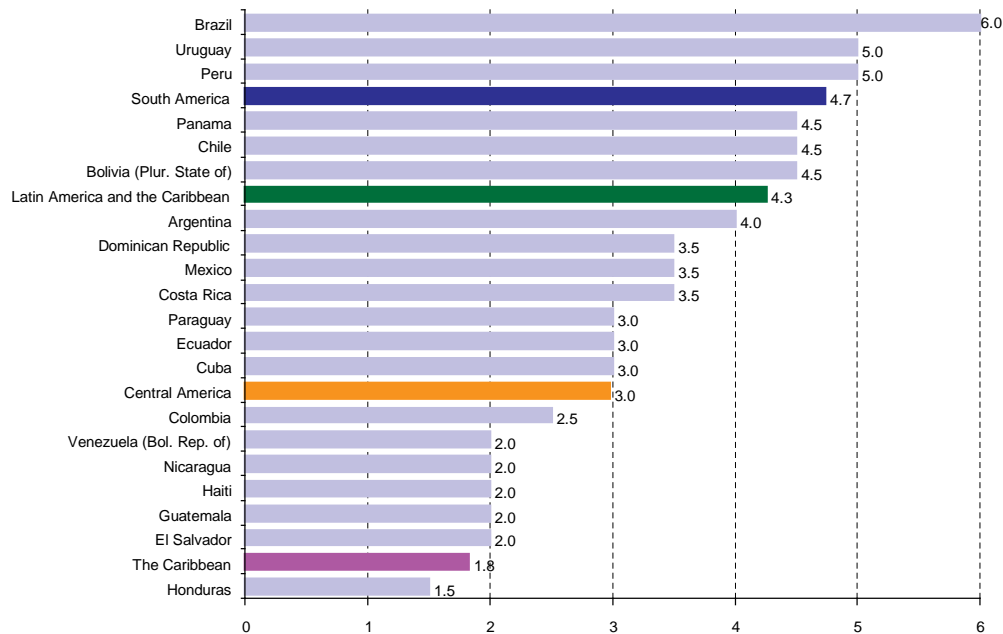
E. PROSPECTS, RISKS AND CHALLENGES FACING THE REGION

1. Anticipated developments in the economies of Latin America and the Caribbean in 2010

Given the speed of the recovery that became evident in the second quarter of 2009, in 2010 the region could return to rates that, in some cases, will come close to matching those seen prior to the crisis. While this is the most likely scenario, it is not without risks. Moreover, there is considerable scepticism as to whether this recovery will lead to sustained growth.

The projected growth rate for 2010 is 4.1%, with expectations of stronger growth in South America than in the other subregions, given the larger size of the domestic markets in some of the countries (particularly Brazil and, to a lesser extent, Argentina and Colombia), the diversification of export markets, and the greater role played by Asia, China, in particular, as export markets for a number of countries (Argentina, Brazil, Chile and Peru). By contrast, slower growth is expected in more open economies that have a less diversified portfolio of trading partners and are more heavily reliant on manufacturing trade, such as Mexico and the Central American economies. The Caribbean economies may be similarly placed and many face additional difficulties arising from a complex financial and exchange-rate situation.

Figure I.21
LATIN AMERICA AND THE CARIBBEAN: GROWTH RATES, 2010
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

In-press update: For Brazil read 5.5%. For Latin America and the Caribbean read 4.1%.

In this context of increased growth and higher prices for a number of commodities in which the region specializes, there is reason to expect a rise in public revenues and, to the extent that private sector demand increases, a gradual decline in government consumption throughout the year.¹³ However, in countries that specialize more heavily in natural-resource-intensive processed goods, higher fiscal revenues will boost the governments' capacities to inject impetus into domestic activity. Capital expenditures, responding more slowly, will continue to increase as a result of various projects initiated in 2009. This should not prevent an improvement in the fiscal balance, however.

To the extent that growth takes hold and approaches potential growth rates, inflation could begin to edge up, which could lead to a tightening of monetary policy, perhaps towards the end of the year. Here, however, central banks will again face the choice between maintaining price stability and limiting currency appreciation, in an environment in which exchange rates will very probably be subject to downward pressure (currency appreciation) owing to a surplus of hard currency resulting from abundant international market liquidity.

While there is reason to expect a deterioration in the balance-of-payments current account compared to 2009, mostly as a result of an upturn in imports, the availability of external financing, together with increased FDI inflows, will probably suffice not only to cover this larger deficit, but even to continue restoring international reserve levels.

¹³ Some countries have already begun, in 2009, to reduce current spending, while others, such as Mexico, have announced fiscal reform programs that would involve a major increase in tax collections.

Economic growth should help to increase rates (and, probably, the quality) of employment, although it will likely mean a corresponding increase in the participation rate, which will partially offset the impact on unemployment. All in all, it is estimated that unemployment could fall to around 8%, settling mid-way between pre- and post-crisis levels. This, in turn, would have a positive effect on poverty indicators.

Box I.3
ESTIMATING POTENTIAL GDP

An economy's growth potential ¹—how much it would grow if production resources were fully employed—is an important concept for economic analysis and, in particular, for economic policymaking. This growth potential is not something that can be observed however, but must be estimated.

This box offers a brief explanation of the estimation of Latin America's potential growth for the period 1980-2020,^a measured by means of the production function methodology, whose main advantage is that it is built on a sound theoretical model that is lacking in other, purely statistical, methodologies. Production function methodology calls for the estimates of total factor productivity (TFP), on the one hand, and the valuation of the factors of production (employment and capital) at full potential, on the other.

TFP is obtained from the difference between the variation rates of GDP, employment and capital stock (with this last adjusted using an installed capacity use index).

The capital stock of the different types of production activity under way in the economy is estimated from 1950 onwards using the following formula:

$$K_{t,j}^p = \sum_{\tau=0}^{T_j} I_{j,t-\tau} R_{j,\tau} E_{j,\tau}$$

where $I_{j,t-\tau}$ is the investment of τ age expressed at constant prices, $R_{j,\tau}$ is the retirement function, which determines the proportion of investment made τ periods ago that is currently surviving and $E_{j,\tau}$ represents the age-efficiency profile, which tracks the production efficiency loss of assets as they age.

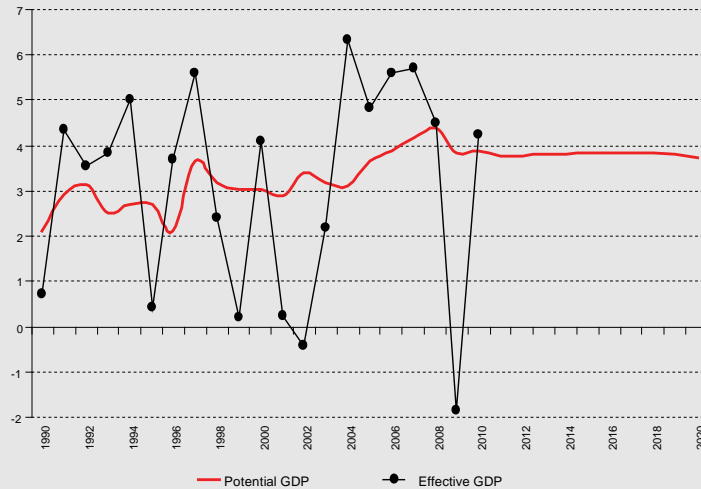
In order to achieve the largest possible geographical and time coverage, the analysis used only two types of production asset: machinery and equipment and construction,^b which are assumed to have average useful lives of 20 and 50 years, respectively.^c

The capital services flow is obtained from the effect of variations in installed capacity use over the business cycle. Since this is a particularly hard variable to measure, variations in installed capacity use are approximated using energy consumption series.

Potential employment is measured by discounting the trend unemployment rate, estimated using a Hodrick-Prescott filter, from the economically active population published by the International Labour Organization (ILO). The results shown in the figure show that Latin America's growth potential has increased steadily in the last two decades, from rates of just over 4% in the early 1990s to over in the last few years. The steady rise over time is mainly the result of increases in productivity and capital. Accordingly, rising investment rates accounted for the jump in growth potential from 2004 to 2008 and drove actual growth above potential. This trend went unbroken until 2009, when GDP growth fell well below potential. Effective growth could return to above-potential rates in 2010, however.

Box I.3 (concluded)

LATIN AMERICA: POTENTIAL OUTPUT GROWTH (Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of C. Aravena, “Estimación del crecimiento potencial de América Latina”, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2009, unpublished.

^a The growth potential of Latin America was calculated on the basis of growth registered by Argentina, the Bolivarian Republic of Venezuela, Brazil, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, the Plurinational State of Bolivia and Uruguay.

^b Based on official fixed gross capital formation figures from each country.

^c A sensitivity analysis conducted for different average lifespans and rate of efficiency losses showed variation of less than 10% in capital variation at the extremes.

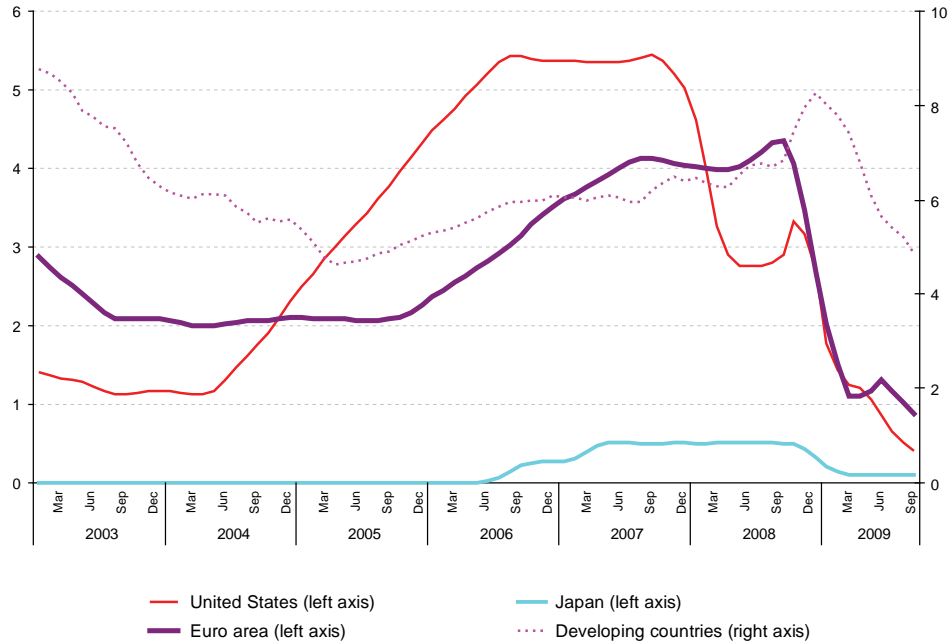
2. Risks resulting from the external scenario

Beyond the problems that persist in some economies of Eastern Europe, it remains to be seen whether the developed economies will be able to grow as they phase out the substantial stimulus initiatives associated with the countercyclical policies implemented in the United States and Europe. Added to the increase in unemployment and the still volatile international financial market, this raises questions about the strength of the recovery that began in 2009.

As mentioned earlier, expansionary monetary policy, led by the world’s principal central banks, with the emerging economies following suit, led to historically low interbank interest rates (see figure I.22). This greater liquidity, however, was not reflected in increased credit to the private sector, which has been slowing in much of the world, and even declining in year-on-year terms in the United States and the euro area.¹⁴

¹⁴ The Latin American and Caribbean region has been no exception to these trends, as discussed in section D.2.

Figure I.22
INTERBANK INTEREST RATES^a
 (Percentages)



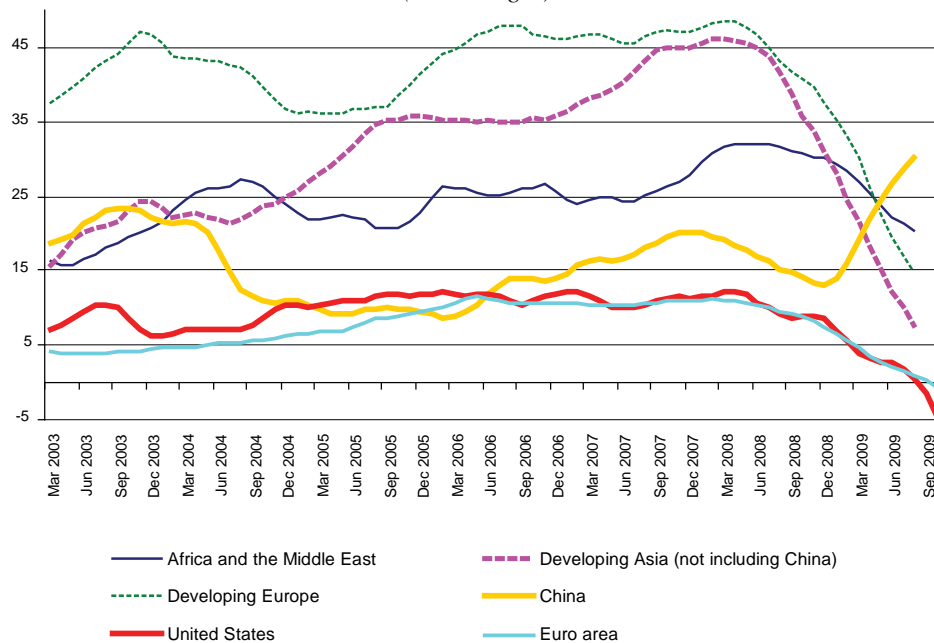
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures and International Monetary Fund (IMF).

^a Three-month moving average.

The credit squeeze is the result of a combination of factors limiting both supply and demand, associated with declining economic activity and the loss of wealth experienced by economic agents most notably towards the end of 2008. Since then, banking institutions have been focusing on shoring up their balance sheets and reducing their exposure, and are maintaining greater liquidity in order to deal with potential problems. Added to the banks' more conservative stance is the reduced solvency of many businesses whose balance sheets—and, thus, their eligibility for credit—were damaged by the crisis.

The challenge facing the global economy is how to leverage credit to speed up the recovery, particularly with regard to financing consumption and SMEs, at a time when the public sectors of many developed countries will have greater need for financing to cover the massive deficits built up by their fiscal stimulus measures.

Figure I.23
BANK LENDING TO THE PRIVATE SECTOR^a
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures and International Monetary Fund (IMF).

^a Year-on-year growth, three-month moving average.

This situation creates a tension between the need to maintain the policy stimulus if private sector demand is slow to pick up, and the increasing problem this creates in terms of availability of credit for businesses and consumers, as well as the burden of financing the enormous deficits accumulated in some countries. All of this must be considered against a backdrop of continued limitations in supply due to uncertainty and the bias toward liquidity that are still evident in financial markets.

The other major risk is that concern over the need to progressively close fiscal gaps will take precedence over other policy objectives, and that this will lead to a premature withdrawal of fiscal and monetary stimulus measures that, at least thus far, have been the principal factors buttressing demand, and the principal (in some cases the only) engine driving the global economic recovery.

3. Challenges beyond the short term

It is highly probable that the crisis will lead to profound changes that will produce a less growth-friendly international environment than the conditions the region experienced between 2003 and 2008. One factor is that the post-crisis world is likely to see slower overall growth, given the drop in aggregate demand in the developed countries, counterbalanced in part by rising overall demand in the developing countries.

As a result, the emerging economies may be expected to play a stronger role in world growth, but within the framework of a slowdown in trade flows. The drop in demand for imports among developed economies will mean that emerging economies will have fewer opportunities to place their products in those markets, which will exacerbate competition and encourage the adoption of domestic-market-

oriented strategies, at least in the larger economies. At the same time, this shows up the need to redefine patterns of production and trade specialization and encourage innovation, the building-in of knowledge and product diversification, on the one hand, and to build up a highly diversified portfolio of destination markets, with many in Asia, on the other.

The global financial crisis has also highlighted the need to reform the international financial architecture and, in particular, the regulatory and oversight systems, in order to ensure greater international financial stability. Though it is clear that the reform impetus is weakening as the global economy recovers, it may be expected that a new, more transparent banking model will be developed, with less incentive for risk taking and lower levels of leveraging. This could lead to a reduction in international financial flows and, therefore, a partial reversal of the pattern of financial integration seen prior to the crisis.

Although it is not yet clear how these factors will affect interest rates in general, there is a risk they will rise, given projections of steadily mounting public debt in some developed countries and the lack of any tax or fiscal reform that might lead to lower demand for resources on the part of the public sector in those countries. Nevertheless, this situation could change, insofar as awareness increases of the risks to growth, those reforms are made and saving rates begin to rise.

Be this as it may, resource flows from the most demanding segments of the international capital markets to higher-risk countries are very likely to decrease, given the greater caution prevailing in the wake of the financial crisis and the possibility of regulatory changes that could limit risk-taking. This could deepen the differences among developing countries in terms of access to the international capital markets, which would oblige less well-endowed or more macroeconomically vulnerable countries to rely more heavily on financing from multilateral agencies or on more expensive, less advantageous financing.

The question then arises as to how the region can make further inroads in a world characterized, on the one hand, by lower growth rates in the developed countries and developing countries playing a larger role in global growth, and, on the other, financial systems that are subject to stricter regulations and oversight, with less dynamic credit markets and higher interest rates? How, moreover, is this to be accomplished in a way that allows for sustained growth at rates that will make it possible to meet social needs, while at the same time providing for more equitable distribution of the benefits of that growth?

The recovery from the crisis seems to have been quicker than expected, largely thanks to the domestic strengths built up by the countries of the region as a result of sounder macroeconomic policies. Upturns in several of the factors that drove demand in the years prior to the crisis, added in many cases to strong impetus from public policies, should enable a rapid recovery in the context of substantial idle capacity. But how can that recovery be transformed into a process of sustained growth beyond 2010?

Answering these questions satisfactorily is well beyond the scope and ability of this publication, which confines itself to offering a brief discussion of the role of public policies in this connection. Aside from differences from country to country, the Latin American and Caribbean economies have certain features in common that underscore the importance of State involvement. In the short term, the countries of the region acted to offset the effects of the crisis to the best of their capacities—in the process revealing major differences in terms of this capacity. But the objective of regaining a sustained growth path poses fresh and more complex challenges. For this reason, the Latin American and Caribbean countries face the unavoidable task of generating and expanding the policy space, for which they must (with few exceptions) increase the resources available for financing policies, create instruments and strengthen their institutions, particularly those involved in coordinating different policy areas.