ECONOMIC SURVEY OF LATIN AMERICA AND THE CARIBBEAN 2004-2005

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Executive Secretary
Economic Commission for Latin America and the Caribbean

Santiago, 3 August 2005
1. The year 2004
2. The outlook for 2005-2006
3. Characteristics of the cycle
4. The dynamics of growth
5. Risks and challenges
1. The year 2004
In 2004, the region grew by almost 6%, the highest rate in the past 25 years.
GROWTH WAS WIDESPREAD IN 2004
ALTHOUGH THIS GROWTH OCCURRED IN A VERY FAVOURABLE EXTERNAL CLIMATE
THE REGION WAS NOT IN STEP WITH THE GLOBAL ECONOMY

GROWTH RATE (Ten-year moving averages)

- **Latin America and the Caribbean**
- **Other developing countries**
- **World**
1. The year 2004

2. The outlook for 2005-2006
GROWTH IN THE REGION WILL EXCEED 4% IN 2005

PER CAPITA GDP WILL GROW BY AROUND 10% BETWEEN 2004 AND 2006
IN 2005 THERE WILL BE GROWTH THROUGHOUT THE REGION
AND THE CARIBBEAN COUNTRIES WILL GROW BY ABOUT 4%
THERE WILL BE GROWTH OF NEARLY 4% IN 2006
1. The year 2004
2. The outlook for 2005-2006
3. Characteristics of the cycle
GROWTH HAS BEEN ACCOMPANIED BY A POSITIVE CURRENT ACCOUNT BALANCE
DRIVEN BY THE RISE IN EXPORTS

THE EXPORT GROWTH RATE IS INCREASING
ASIA’S GROWING SHARE OF GLOBAL TRADE HAS BOOSTED THE REGION’S TERMS OF TRADE

Terms of trade for goods
(Base 2000=100)

TERMS OF TRADE EXPECTED TO REMAIN BUOYANT IN THE MEDIUM TERM
RESOURCES FROM MIGRANTS’ TRANSFERS HAVE REACHED 2.1% OF GDP

RESULTING IN INCREASED STABILITY OF FINANCIAL FLOWS
THE REGION NOW HAS MORE FLEXIBLE EXCHANGE RATES

RESULTING IN INCREASED REAL COMPETITIVENESS
COUNTRY RISK IS APPROACHING RECORD LOWS

Sovereign bond spreads (EMBI+)

2001 2002 2003 2004 2005

Latin America, Brazil, Mexico, Peru, Uruguay, Venezuela, Argentina
COUNTRY RISK IS APPROACHING RECORD LOWS (II)

Sovereign bond spreads (EMBI+)

- Brazil
- Mexico
- Peru
- Uruguay
- Venezuela (Bol. Rep. of)
1. The year 2004
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EXPORTS AND INVESTMENT ARE LEADING THIS VIRTUOUS CIRCLE

(Base 2000=100)

- Private consumption
- Public consumption
- Exports of goods and services
- Gross domestic investment
- GDP
**EXPORT GROWTH IS NOT LIMITED TO RAW MATERIALS**

Cumulative annual year-on-year growth rates for exports, to the end of each month, 2005

<table>
<thead>
<tr>
<th></th>
<th><strong>Total exports</strong></th>
<th></th>
<th><strong>Industrial exports</strong></th>
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</thead>
<tbody>
<tr>
<td></td>
<td>jan</td>
<td>feb</td>
<td>mar</td>
</tr>
<tr>
<td>Argentina</td>
<td>17,6</td>
<td>17,2</td>
<td>16,5</td>
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<tr>
<td>Brazil</td>
<td>32,5</td>
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<td>Chile</td>
<td>50,2</td>
<td>47,4</td>
<td>42,2</td>
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<td>25,7</td>
<td>30,2</td>
<td>32,6</td>
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<tr>
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<td>3,2</td>
<td>3,6</td>
<td>2,9</td>
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<tr>
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<td>26,5</td>
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<td>31,8</td>
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<tr>
<td>El Salvador</td>
<td>5,3</td>
<td>5,4</td>
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<tr>
<td>Guatemala</td>
<td>14,0</td>
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<td>13,1</td>
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<td>Honduras</td>
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<td>23,2</td>
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<tr>
<td>Peru</td>
<td>42,1</td>
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<tr>
<td>Uruguay</td>
<td>30,7</td>
<td>31,1</td>
<td>29,1</td>
</tr>
</tbody>
</table>
THE GOVERNMENTS ARE TAKING ADVANTAGE OF THIS FAVOURABLE SITUATION

CENTRAL GOVERNMENT (Percentages of GDP)

- Total revenues
- Total expenditure
- Primary expenditure
AND REDUCING THEIR DEBT LEVELS

PUBLIC DEBT – Central Government
(Percentages of GDP)

(*) Estimate

Simple average
Weighted average
(*) Estimate
EXTERNAL DEBT RATIOS ARE SHRINKING

Latin America: Net external debt as a percentage of exports of goods and services (simple averages)

EXCEPT IN CARIBBEAN COUNTRIES
SHORT TERM EXTERNAL DEBT AS A PERCENTAGE OF TOTAL DEBT IS ALSO SHRINKING
THE REGION BUILT UP ITS RESERVES AT AN ANNUAL RATE EQUIVALENT TO 1.5% OF GDP
1. The year 2004
2. The outlook for 2005-2006
3. Characteristics of the cycle
4. The dynamics of growth
5. Risks and challenges
Risks (I): the international context

- The traumatic adjustment of macroeconomic imbalances may lead to a drastic downturn in global GDP and heighten uncertainty.
- The deepening of imbalances may generate an increase in protectionism.
- The high levels of political conflict that persist in various parts of the world may impair the operation of the economy.
- The main strategy in the region and in other parts of the world is to accumulate reserve assets to hedge against possible financial turbulence.
- This strategy is costly in terms of resources and inefficient compared with other mechanisms that could be developed by international financial agencies.
Risks (II): exchange-rate policy

- The favourable international context results in better terms of trade and lower country risk premiums.
- This exerts downward pressure on real equilibrium exchange rates.
- Many countries in the region are trying to sustain real exchange rates by intervening in the exchange market.
- This creates tension with monetary policy which can generate inflationary pressures.
- Or an increase in the quasi-fiscal deficit.

<table>
<thead>
<tr>
<th>Country</th>
<th>Real exchange rate (Variation: Jan-May 2005/Jan-May 2004)</th>
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<tbody>
<tr>
<td>Paraguay</td>
<td></td>
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<tr>
<td>Ecuador</td>
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<td>Panama</td>
<td></td>
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<tr>
<td>Barbados</td>
<td></td>
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<tr>
<td>Trinidad and Tobago</td>
<td></td>
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<tr>
<td>Argentina</td>
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<tr>
<td>Mexico</td>
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<td>Chile</td>
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<td>Jamaica</td>
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<td>Bolivia</td>
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This creates tension with monetary policy which can generate inflationary pressures.

Or an increase in the quasi-fiscal deficit.
Risks (III): The growth of imports

- Imports are growing at very high rates, especially in South America (13% total – 22% in South America).
- The high income elasticity of imports may be a short-term phenomenon, as the economies are growing again after a long period of stagnation.
- But some aspects may be more permanent as a result of the disappearance of part of the industrial fabric in the 1990s or changes in consumption habits.
- In order to counteract these trends, the countries in the region should combine a more aggressive export promotion strategy with policies aimed at increasing saving.
- In this context, it is important to make progress in implementing countercyclical fiscal policies.
Challenges (I): grow more

- Three consecutive years of growth (2004-2006) at an average rate of around 4.7% is a very promising achievement.
- Nevertheless, this rate is insufficient as there is a need to correct the imbalances that have been affecting the region’s labour markets for over a decade.
- If the economically active population grows at an annual rate of almost 2.5% and productivity rises, an increase in GDP of 4.7% does not leave much room for reducing the unemployment rate.
Challenges (II): invest more

- Investment is not sufficient to sustain high growth rates

*Latin America and the Caribbean: investment as a percentage of GDP (in 2000 dollars)*
Challenges (III): take advantage of this opportunity to add value

- What are the issues?
- Unsuitable domestic policies
  - Insufficient investment in education and in R&D
  - Lack of incentives and targeted strategies
  - Absence of strategies for attracting “quality” FDI (technology, products, processes)
  - Variability in the rules of the game
  - GDP volatility
  - Exchange-rate volatility
- Tariff escalation in developed countries
- Exchange-rate appreciation (Dutch disease)

Better terms of trade do not guarantee a high and sustained growth rate
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