Preliminary Overview of the Economies of Latin America and the Caribbean - 2006

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Our view of the economic situation of Latin America could be summarized in two words: ‘Cautious Optimism’

- **Optimism** because the region is growing faster and better than in the past
- **But, cautious** because of:
  - Increasing uncertainty regarding the international economic context
  - Concerns over the sustainability of the current rates of economic growth
GDP growth reached approximately 5.3%
Forecast for 2007

Latin America and the Caribbean: GDP growth, 2007 (annual growth rates)

- Argentina: 5.4%
- Venezuela: 5.4%
- Dominican Republic: 5.1%
- Panama: 5.1%
- Uruguay: 4.7%
- Peru: 4.7%
- Chile: 4.7%
- Caribbean: 4.7%
- South America: 4.7%
- Honduras: 4.1%
- Guatemala: 4.1%
- Costa Rica: 4.1%
- Colombia: 4.1%
- Latin America and the Caribbean: 4.1%
- Central America and Mexico: 4.1%
- Nicaragua: 4.1%
- El Salvador: 4.1%
- Ecuador: 4.1%
- Bolivia: 4.1%
- Mexico: 4.1%
- Paraguay: 4.1%
- Brazil: 4.1%
- Haiti: 4.1%
A longer-term view: per capita GDP increases after a period of stagnation

Growth 2002-2007: 16%
But less than in many other developing countries

Per capita GDP growth rate by sub-region

- WORLD
- Developed Economies
- Latin America and the Caribbean
- Developing Economies
- Developing Economies (excluding China)

- 2004
- 2005
- 2006
Unemployment drops

Latin America and the Caribbean: growth of economically active population and employment, unemployment rate

Good news in the short run but over the long run faster productivity growth is needed
The percentage of poor and indigent persons has fallen sharply since 2004; trend is expected to continue. But it has taken 25 years to reduce poverty below the 1980 level.

**Latin America: trends in poverty and indigence, 1990 – 2006 (percentage of individuals)**

- **1980**: 40.5% (18.6% indigent, 22.5% non-indigent poor)
- **1990**: 48.3% (22.5% indigent, 25.8% non-indigent poor)
- **1997**: 43.5% (19% indigent, 24.5% non-indigent poor)
- **1999**: 43.8% (18.5% indigent, 25.3% non-indigent poor)
- **2002**: 44.0% (19.4% indigent, 24.6% non-indigent poor)
- **2004**: 42.0% (16.9% indigent, 25.1% non-indigent poor)
- **2005**: 39.8% (15.4% indigent, 24.4% non-indigent poor)
- **2006**: 38.5% (14.7% indigent, 23.8% non-indigent poor)
A large group of countries saw reductions in their poverty and indigence rates, compared with both 2000/2002 and 1998/1999.

Trends in poverty and indigence

- Uruguay b/
- Dominican Rep.
- Bolivia
- Costa Rica
- Paraguay
- Panama
- Brazil
- El Salvador
- Chile
- Honduras
- Peru
- Ecuador b/
- Mexico
- Colombia
- Venezuela
- Argentina b/

- Uruguay a/
- Bolivia
- Peru
- Argentina a/
- Costa Rica
- Dominican Rep.
- Paraguay
- Brazil
- Panama a/
- El Salvador
- Chile
- Honduras
- Mexico
- Colombia
- Venezuela
- Ecuador a/

Percentage points

Poverty

Indigence
Extreme poverty projections for 2006 show that the region is once again moving towards meeting the first target of the MDGs; progress is slightly better than expected.

Progress in reducing extreme poverty between 1990 and 2006 (percentages)
Countries would have a better chance of meeting the poverty target if they reduced inequality in income distribution, especially those lagging furthest behind.

Per capita GDP growth rates needed to halve the 1990 extreme poverty figure by 2015

- **Growth needed without a distributive change**
- **Growth needed with a 10% reduction in the Gini coefficient**
- **Per capita GDP growth 1990-2006**
External conditions have boosted regional growth

- World growth
- Liquidity
- Improvements in terms of trade
Better terms of trade…
but with differences among sub-regions

Variation in terms of trade between the 1990s and 2006

LATIN AMERICA AND THE CARIBBEAN: 31.2%
SOUTH AMERICA: 47.3%
SOUTH AMERICA (excluding Chile and Venezuela): 17.1%
CENTRAL AMERICA (incl. Haiti and Dom.Rep): -13.4%
MEXICO: 25.5%
External conditions have boosted regional growth

- World growth
- Liquidity
- Improvements in Terms of trade
- High level of remittances
Remittances are by far the main source of external financing in Central America.

Latin America and the Caribbean: resources from migrant workers’ transfers (percentages of current GDP)

- South America: 1.2
- Central America: 11.1
- Mexico: 2.8

*Estimated*
Main features of the current macroeconomic cycle (1)

- More saving, investment and exports than in the previous upswing

Latin America: annual average growth rates

- GDP
- Investment
- Imports of goods and services
- Total Consumption
- Exports of goods and services

INCOME ELASTICITY OF IMPORTS:
- 1991 – 1994: 3.6
- 2003 – 2006p: 2.4

p/ Projected
Latin America’s market share in total world imports increased during the last 15 years.

Latin American and Caribbean exports evolution, 1980-2005
(total LAC exports as a percentage of total world imports)
This is not a function of prices alone: LAC exports are outpacing world exports

GDP and volume of exports, annual growth rates (percentages)

- World GDP
- Global exports
- LAC exports

8.5%
6.1%
e/ Estimated
Main features of the current macroeconomic cycle (2)

- Surplus on the current account
Main features of the current macroeconomic cycle (3)

But with major differences among countries

Current account balance as % of GDP, 2006

-13.6
-10
-5
0
5
10
17.5
12.0
1.8

Venezuela
Bolivia
Chile
Argentina
Peru

LATIN AMERICA AND THE CARIBBEAN
Brazil
Ecuador
Honduras
Mexico
Haiti
Colombia
Uruguay
Dominican Republic
Paraguay
Panama
Guatemala
El Salvador
Costa Rica
Nicaragua
Main features of the current macroeconomic cycle (4)

- More reserves and less external debt

Latin America and the Caribbean: short-term external debt and international reserves

- Short-Term Debt (left axe)
- International Reserves (left axe)
- Ratio Short-Term Debt / International Reserves (right axe)
Main features of the current macroeconomic cycle (5)

- The primary fiscal surplus is high (compared to other periods) and growing

![Chart showing change in principal fiscal indicators for Latin America and the Caribbean, with data for 1991-1994, 1995-1998, and 2003-2006. The chart indicates a trend of increasing primary balance over time, with a notable increase in the later period.]
Main features of the current macroeconomic cycle (6)

Reduction in public debt

Public debt in Latin America, 1993-2006
(percentages of GDP)

Improvement in Structure of debt
(maturity and local currency)
Main features of the current macroeconomic cycle (7)

- Better fiscal conditions

![Graph showing revenues, expenditures, and primary balance over time.]}
Summary: some reasons for optimism...

- External conditions are currently highly favorable
- Latin America and Caribbean is growing faster
- Unemployment is falling
- Extreme poverty has been reduced markedly in recent years
- The region seems to be less vulnerable now to external shocks than in the past...
And some reasons for caution?
Some Caveats

- **External conditions**
  - Uncertainties about the prospects for global growth
Some Caveats

- **External conditions**
- **Economic policy challenges for LAC**
  - Despite the reduction in vulnerability, some countries in the region are still highly indebted and some financial systems are highly dollarized.
  - The rate of investment is still insufficient.
The rate of investment is still insufficient (and differs substantially across countries)

Latin America: gross capital formation as a percentage of GDP (in dollars at constant 2000 prices)
Some Caveats

External Conditions

Economic policy challenges for LAC

• Despite the reduction in vulnerability, some countries in the region are still highly indebted and some financial systems are highly dollarized.
• The rate of investment is still insufficient.
• Increases in public expenditures in some countries should be carefully monitored.
The trend in terms of trade is impacting fiscal revenues and putting pressure on public expenditures.

Latin America: revenues and primary expenditure of the central government, 2003-2006 (as percentage of GDP)
Some Caveats

- **External Conditions**
- **Economic policy challenges for LAC**
  - Despite the reduction in vulnerability, some countries in the region are still highly indebted and some financial systems are highly dollarized.
  - The rate of investment is still insufficient.
  - Increases in public expenditures in some countries should be carefully monitored.
  - Countries must place more emphasis on countercyclical policies and strengthen fiscal institutions.
  - Perhaps there is room for relaxing monetary policy in countries in where inflation seems to be under control.
  - This might help to sustain economic growth and reduce pressure on exchange rates.
Inflation rate has been falling and real interest rates are rising.
Is there any scope for relaxing monetary policy in some countries?

Interest rate of monetary policy $^a/$

Brazil | Colombia | Mexico | Peru | Chile | Argentina

$^a/$ Interest rate of monetary policy deflated by core inflation
There has been real exchange appreciation in some countries

Latin America and the Caribbean: real effective exchange rate (October 2006 compared to October 2003 and for the 1990s)
But the causes of appreciation are beyond the control of monetary policy.
Some Caveats

- External conditions
- Economic policy challenges for LAC
- In order to achieve a sustainable rate of growth, in the medium term it is necessary to:
  - Increase human and physical capital.
  - Strengthen innovation processes (adopt, adapt and create).
  - Diversify the productive structure of the economy (continued dependence on primary exports).
  - Address the challenge of financing the necessary upgrades in “capabilities” (human resources, innovations…) Using the rents generated from natural resources?