Latin America and the Caribbean and Global Economic Trends

José Luis Machinea
Executive Secretary
Economic Commission for Latin America and the Caribbean

Santiago, 25 April 2007
LAC has been growing more and better than in the past

- More: By the end of 2007 per capita GDP will have increased 16% in four years
- Better:
  - Fall in unemployment
  - Fall in poverty and specially extreme poverty
  - Less vulnerability to external shocks
Global growth is expected to decelerate in 2007

In the past few years Latin America has improved its growth performance, although growth has been lower than in other developing countries.
Risks are weighted to the downside

- Further deterioration of the US housing sector will have a strong impact on consumption (wealth effect)
- An increase in financial market volatility and a rise in the spread of risky assets (including in emerging markets)
- An increase in interest rates as a result of:
  - a sharper US dollar devaluation (sudden unwinding of the US current-account imbalance)
  - higher oil prices
Impact on LAC of a worse scenario

- Although there are still important macroeconomic challenges for LAC, the region is better prepared than in the past to face a gradual deterioration of external conditions.
- However, if there is a very sharp slowdown of the US economy and therefore of the world economy, it will have a negative impact on LAC:
  - Lower demand from the US will mainly affect exports from Mexico and Central America.
  - Slowdown in the construction sector will result in less remittances (México and CA).
  - Lower terms of trade will have a greater impact on South America.
If slower global growth dampens commodity prices, the greatest impacts will be felt in South America.

Variation in terms of trade between the 1990s and 2006

LATIN AMERICA AND THE CARIBBEAN: 31.2%
SOUTH AMERICA: 47.3%
SOUTH AMERICA (excl. Chile and Venezuela): 17.1%
CENTRAL AMERICA (incl. Haiti and Dom.Rep): -13.4%
MEXICO: 25.5%
Latin America and the expected evolution of oil prices

- The most likely scenario is one of relative stability
- However, the risks are skewed to the upside
  - Recurrent geopolitical tensions in the Middle East
  - Limited spare capacity, and the possibility that non-OPEC supply may fall below projections
  - Downside risks are limited due to OPEC’s commitment to defend prices through production cutbacks
- Rising demand for biofuels will likely cause the prices of corn and soybean oil to rise further and to move, in the medium term, closely in step with the price of crude oil, as has been the case with sugar
- Latin America is a net exporter of energy, although production is concentrated in a few countries
Production is concentrated in a few countries

Net exports of petroleum, petroleum products + Gas both natural and Manufactured, 2005 (millions of dollars)

- Venezuela: 48,720
- Mexico: 19,941
- Argentina: 68
- Colombia: 48
- Ecuador: 720
- Bolivia: 19,941
- Nicaragua: 68
- Paraguay: 48
- Panama: 48
- Peru: 48
- Uruguay: 48
- Honduras: 48
- Costa Rica: 48
- Guatemala: 48
- Chile: 48
- Brazil: 48
- LA: 68,188
- LA without Ven & Mex: 68,188
An increase in energy prices would have differentiated effects in the region.
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Global imbalances still persist

Current account imbalances (1997-2007p)
(billion dollars)
Has the period of low real interest rates ended..?

Real interest rates – LIBOR 1 year adjusted by US CPI
12-months moving averages
The region is less vulnerable than in the past

- Growth of better quality (more saving, investment and exports than in previous upswings)
- Current-account surplus (with differences across countries)
- More reserves and less external debt.
- Better fiscal performance
- Reduction of public debt and improvement of its structure in terms of maturities and currencies
The slowdown of the US economy is expected to have a greater impact on Mexico and Central America.
But there are still reasons for concern

- Despite the reduction in vulnerability, some countries in the region are still heavily indebted and some financial systems are highly dollarized.
- Increases in public expenditure in some countries should be carefully monitored.
- Countries must place more emphasis on countercyclical policies and strengthen fiscal institutions.
- Appreciation of the real exchange rate.
Latin America and the expected evolution of oil prices

- The most likely scenario is one of relative stability
- The risks are skewed to the upside
- Latin America is a net exporter of energy, although production is concentrated in a few countries
- Sustained economic growth puts pressure on demand and requires strong investments to allow supply to match demand requirements
- The risk is that the region could slip into a net importer position in a context of high energy prices