2013

Economic Survey
of Latin America and the Caribbean

Three decades of uneven and unstable growth

UNITED NATIONS

ECLAC

Contents

I. **Economic situation of Latin America and the Caribbean and prospects for 2013**
   - **Short term risks: a negative external context**

II. **Medium and long term risks: limited economic and productivity growth due to insufficient and inadequate investment**

III. **Policy responses**

Latin America and the Caribbean face serious short and long term risks

- **Short term risks and weaknesses:**
  - High export dependency on Europe and China
  - Growing current account deficit
  - Serious fiscal restrictions in the Caribbean (also in Central America and Mexico), and fiscal vulnerability (arising from a dependence on natural resources) in South America
- **Medium and long term risks and weaknesses:**
  - Economic growth highly dependent on consumption and not on investment or (net) exports
  - Investment highly susceptible (procyclical) to the volatility of economic growth
  - Insufficient investment directed to diversify tradable sectors (structural change)
  - Insufficient public investment and inadequate infrastructure
  - Inadequate labor force training
- **Challenge:** boost investment and productivity through a Social Covenant for Investment

I. Economic situation of Latin America and the Caribbean and prospects for 2013

Economic situation of Latin America and the Caribbean and prospects for 2013

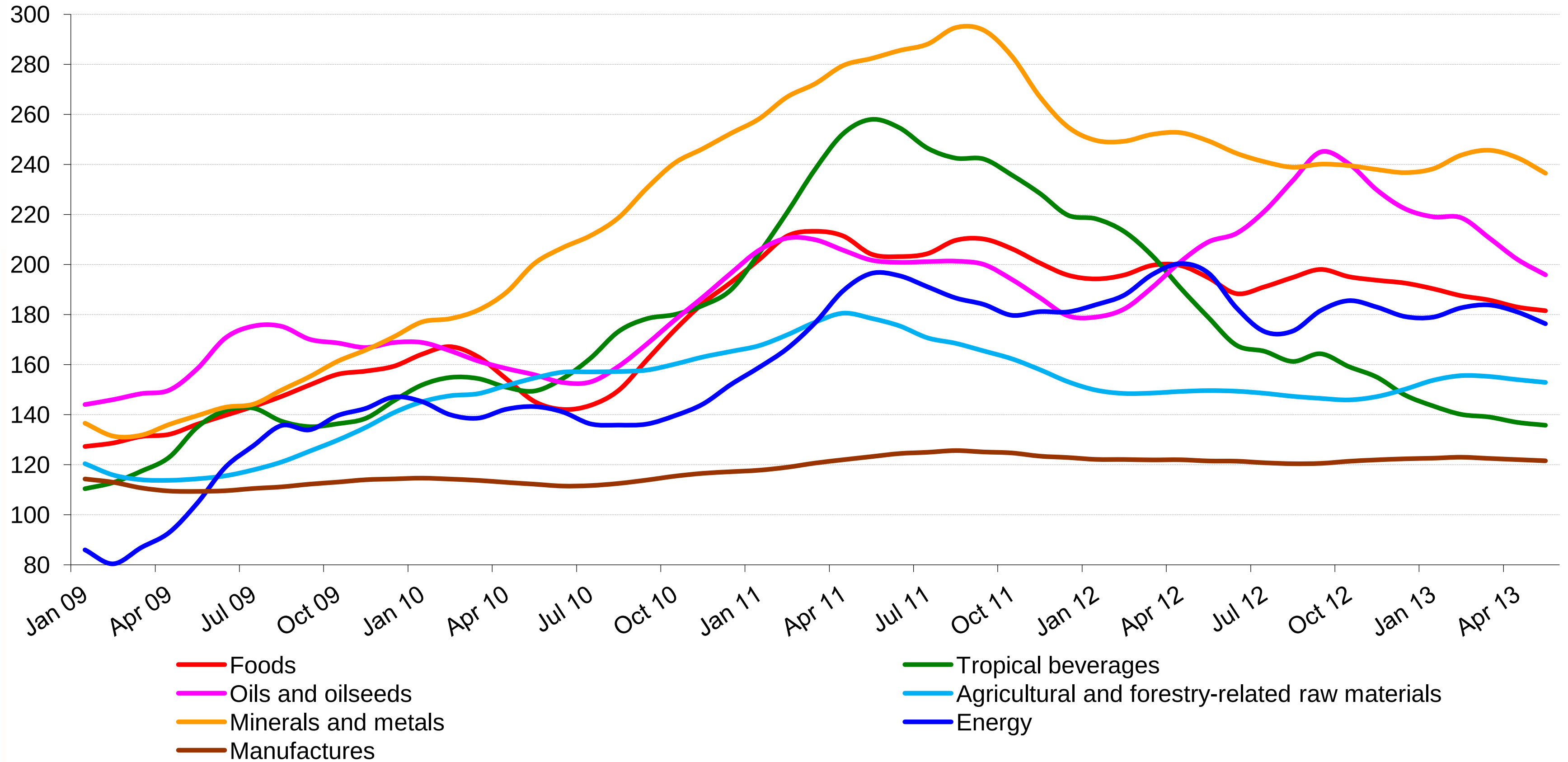
- **Recession in the Eurozone and a deceleration in China lowers the dynamism of exports from Latin America and the Caribbean**
  - Economic growth in the Eurozone is estimated to be -0.4% in 2013, with differences between countries and the perception of risks remains high (Greece, Italy, Portugal, Spain)
  - Deceleration in China, from 9.2% in 2011 to 7.7% in 2012 with a similar or lower growth rate in 2013
- **Monetary policy in the United States becomes a new factor of uncertainty**
  - Low growth in the United States (less than 2% in 2013), but lower unemployment signals the end of monetary stimulus (mid 2014)
  - Recovery (partial) boosts imports originating in Latin America and the Caribbean, especially from México and Central America
  - Announcement of the end of stimulus promotes financial instability, and prospects of interest rate increases in the United States
  - **Positive**: favors the depreciation of Latin America currencies which had previously appreciated
  - **Negative**: inflation pressures could be stimulated by depreciations and a rise in the financing costs to cover (growing) current account deficits

The surge in the prices of the region's export commodities has halted

During the first half of 2013 various export prices declined

Latin America: price indices of export commodities and manufactures, three month moving average, January 2009 to April 2013 [a]

(2000=100)

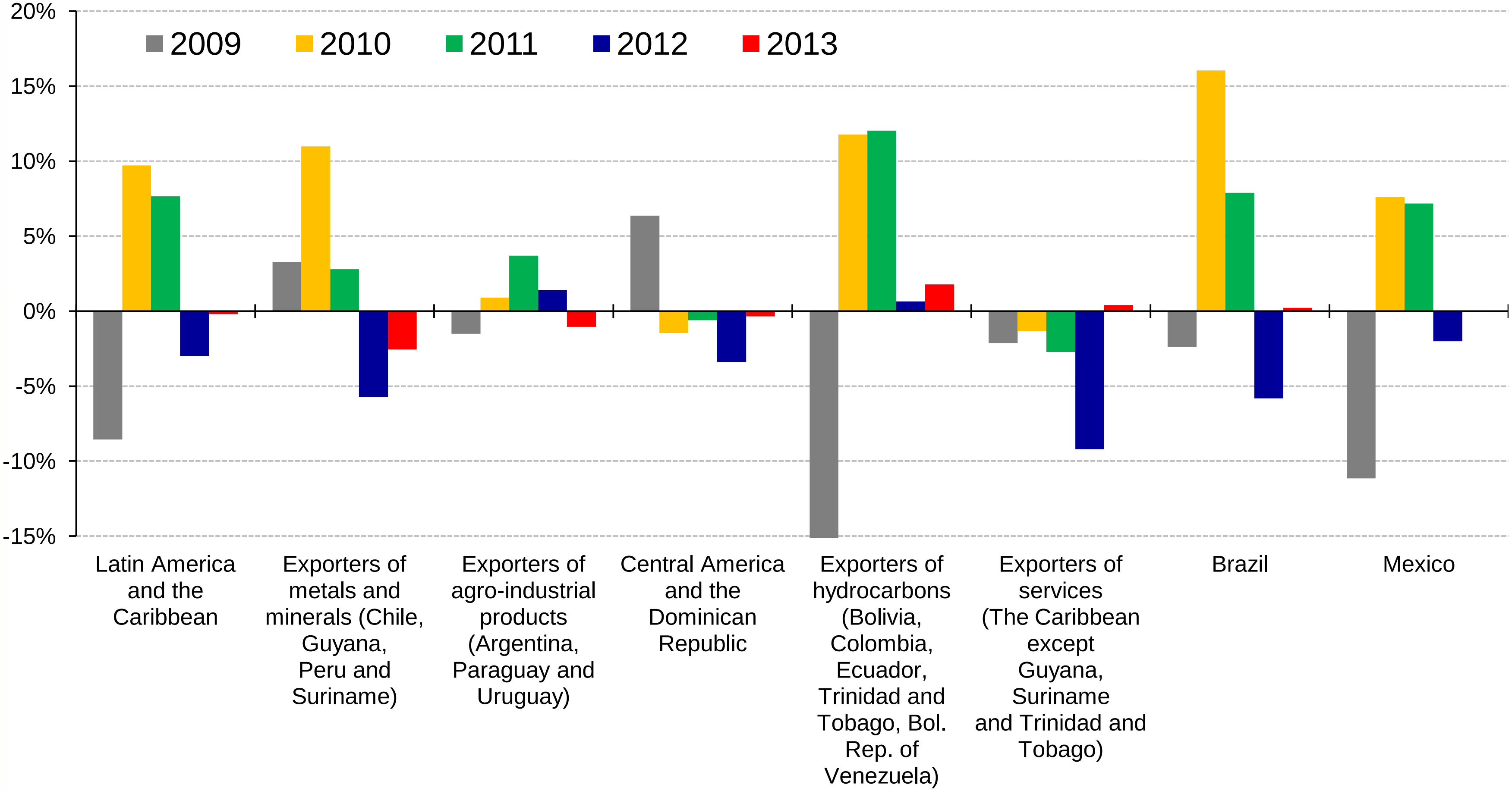


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the United Nations Conference on Trade and Development (UNCTAD) and the Netherlands Bureau for Economic Analysis (CPB).

[a] The weighting of the groups of export commodities are calculated according to their share in the exports of Latin America.

The region's terms of trade varied little or they deteriorated

Latin America: growth rate of terms of trade, 2009-2013 [a]
(*In percentages*)

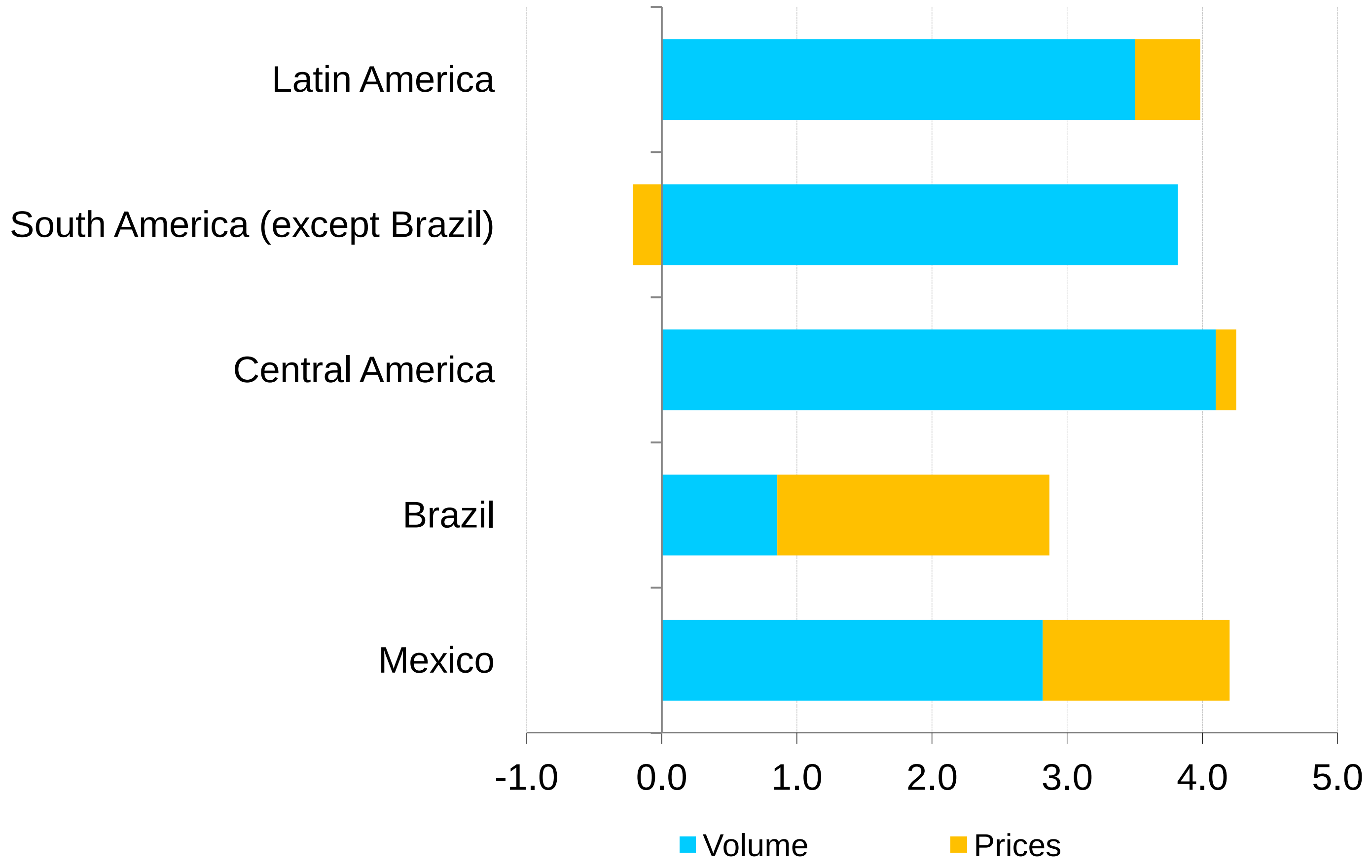


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Figures for 2013 correspond to estimations.

The value of exports is forecasted to increase in 2013 due principally to an increase in volume, with minor variations in prices, in contrast with 2003-2008

Latin America: growth rate of export values by volume and price, 2013

(*In percentages*)

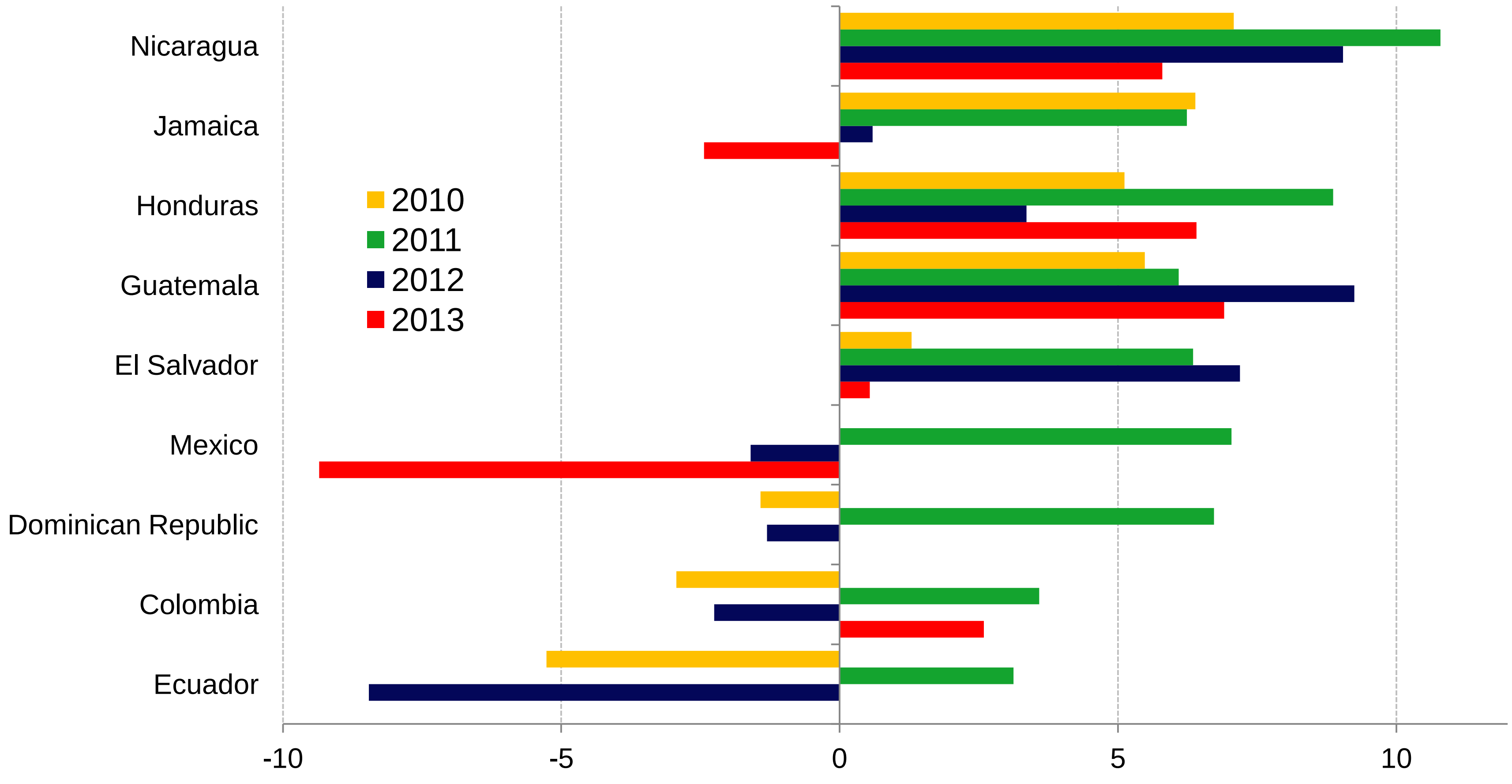


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

The employment situation in Europe is negatively affecting the flow of remittances

Latin America and the Caribbean (selected countries): growth rate of remittances from emigrant workers, 2010-2013 [a]

(*In percentages*)

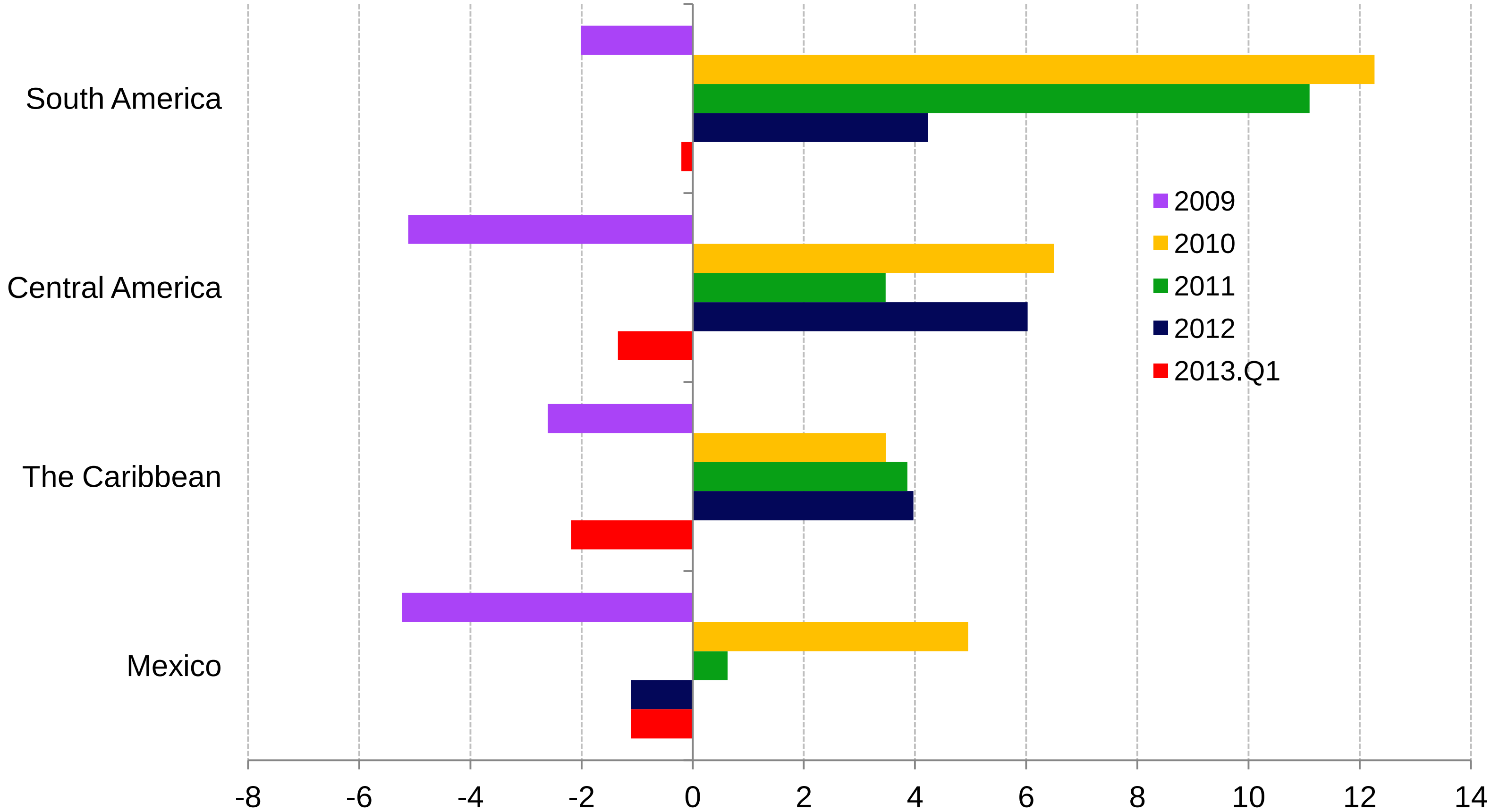


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Data for 2013 refer to the first quarter for Jamaica and Nicaragua; to the period January-April for Colombia, Honduras, and Mexico; and to the period January-May for El Salvador and Guatemala. Data for the 2013 for the Dominican Republic and Ecuador are not available.

The flow of tourists to the region is decreasing

Latin America and the Caribbean: year-on-year growth rate of international tourist arrivals, 2009-2013 [a]

(*In percentages*)

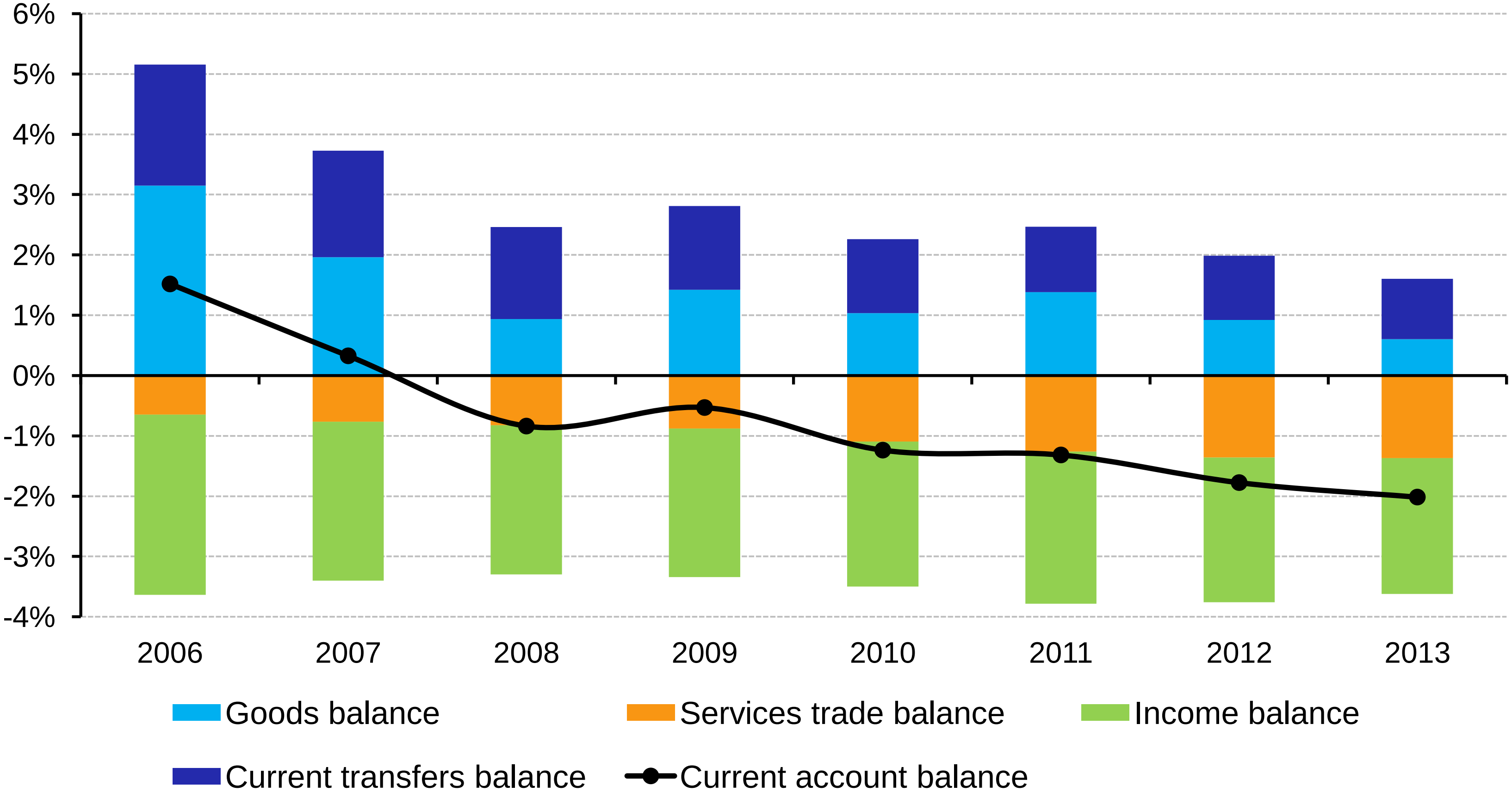


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the World Tourism Organization (UNWTO).
[a] Data for 2013 refer to the first quarter.

The current account deficit of the balance of payments will expand from 1.8% of GDP in 2012 to 2% in 2013

Latin America: structure of the current account, 2006-2013 [a]

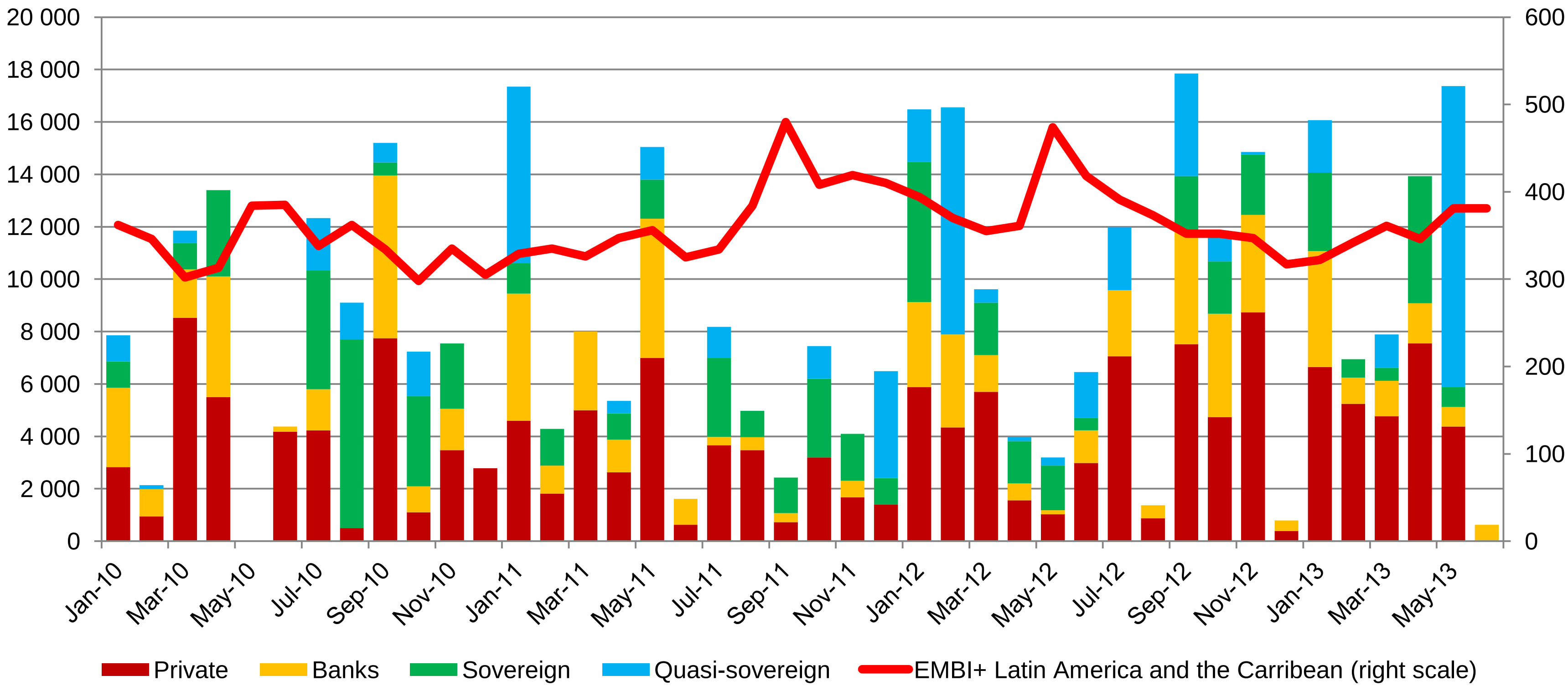
(*In percentages of GDP*)



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

Despite financial instability, the region maintains access to international financial markets

Latin America and the Caribbean (19 countries): external bond issues in international markets and risk according to EMBI+, January 2010 to June 2013
(*In millions of dollars and basis points)*

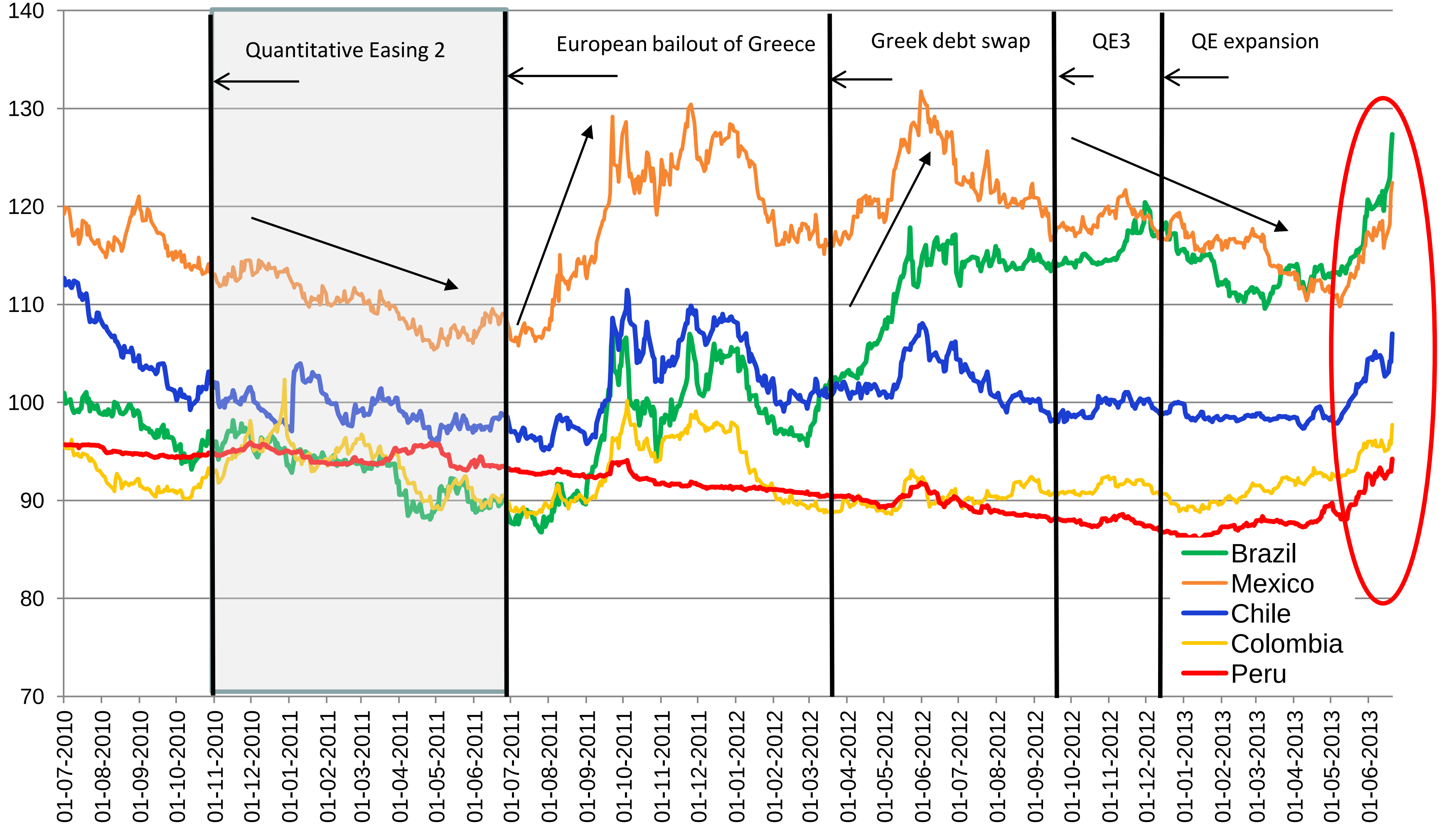


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from Latin Finance Bonds Database, JP Morgan and Merrill Lynch.

In the first half of 2013 the region issued US$ 62.207 million of bonds, more than half of that issued in all of 2012

Nevertheless, exchange rates have reflected the effects of uncertainty in international financial markets as well as domestic factors

Brazil, Chile, Colombia, Mexico and Peru: nominal exchange rate movements and external financial conditions, July 2010 to June 2013
(*Index, January 2008=100*)

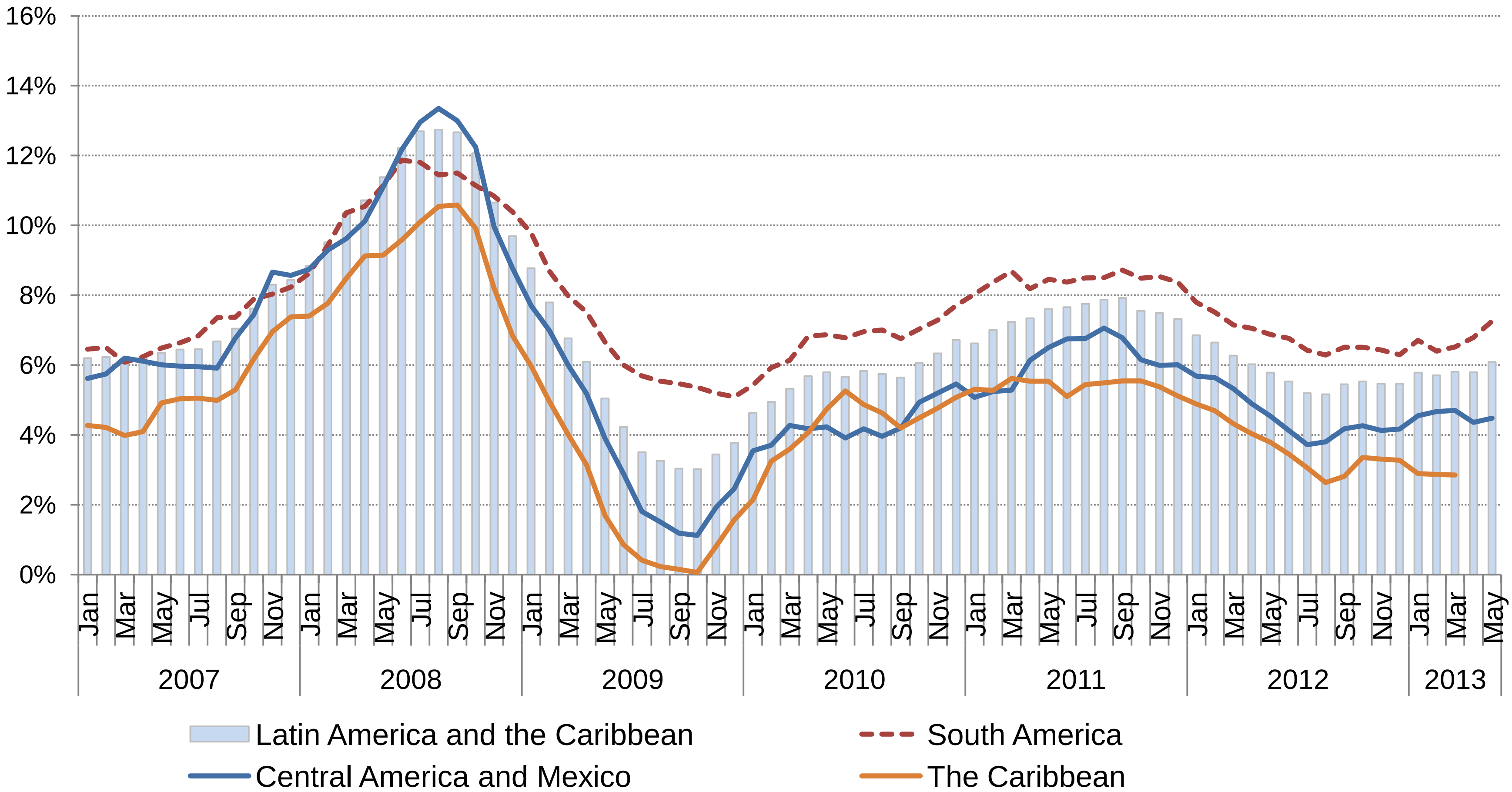


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Inflationary pressures are slightly higher, although with important differences between countries and subregions

Latin America and the Caribbean: 12-month growth rate in consumer price index, simple averages, January 2007 to May 2013

(*In percentages*)

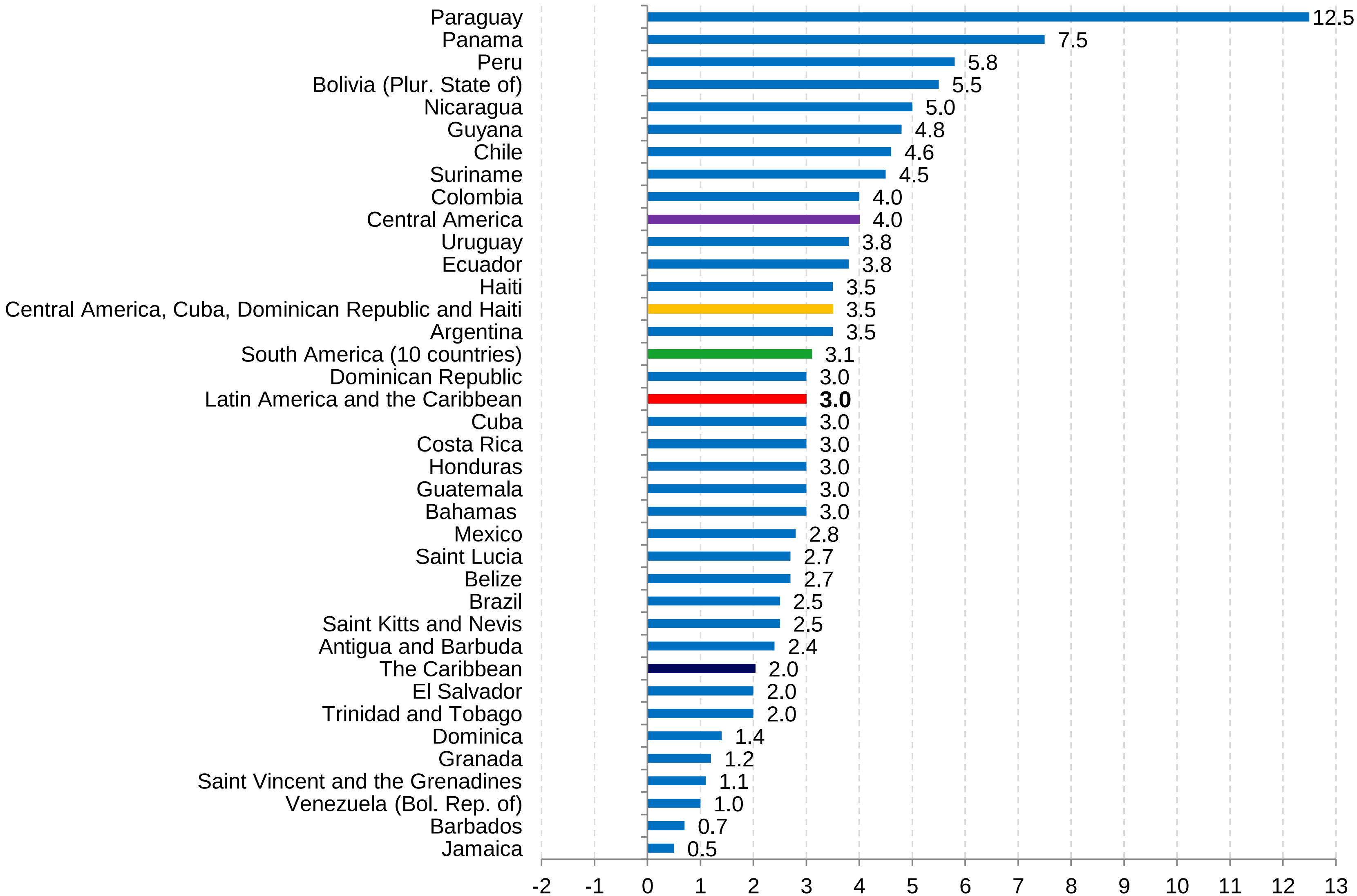


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Latin America and the Caribbean will grow 3% in 2013

Latin America and the Caribbean: GDP growth, 2013

(*In percentages*)



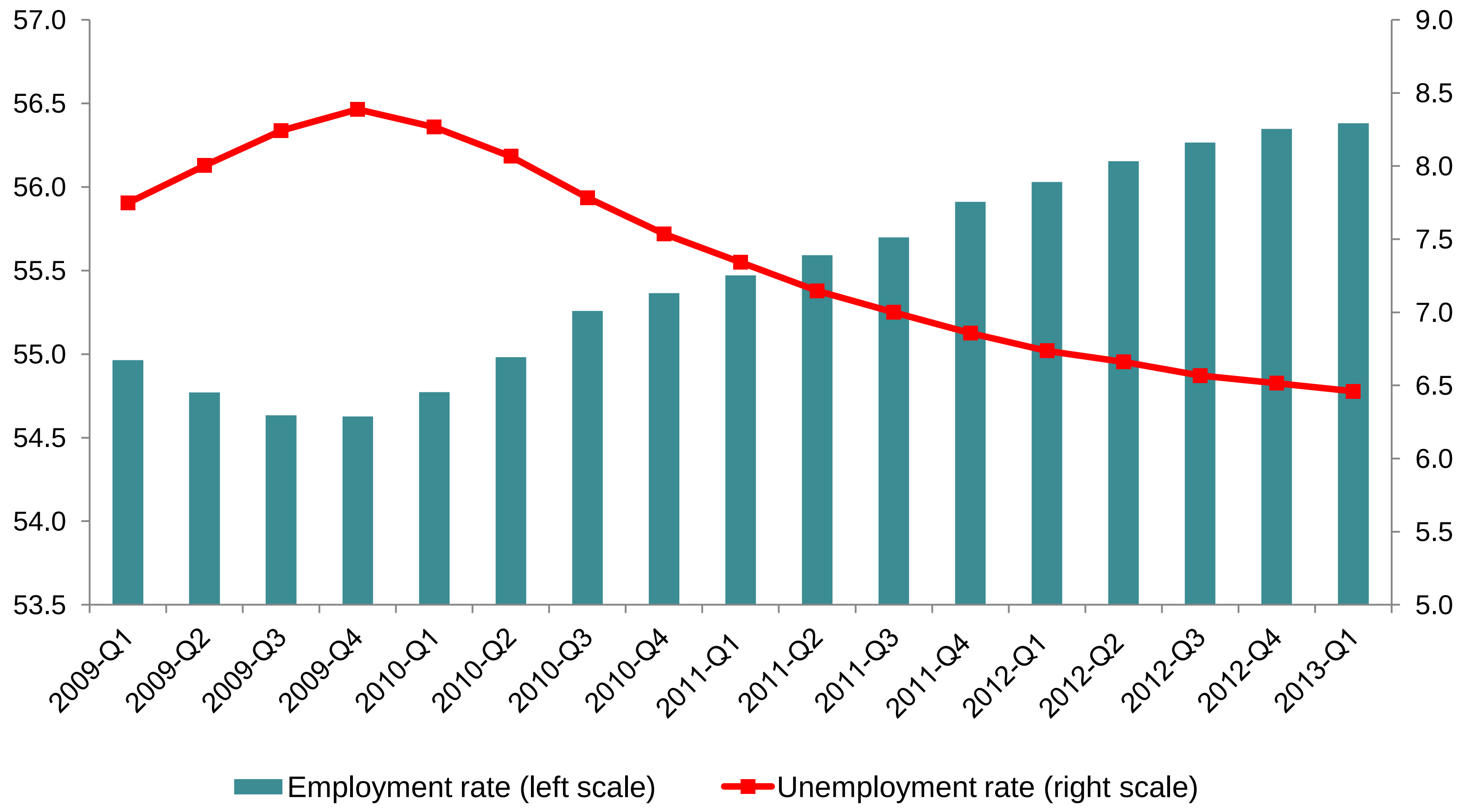
Source: Economic Commission for Latin America and the Caribbean (ECLAC).

Economic Survey of Latin America and the Caribbean

Employment and unemployment rates are flattening

Latin America and the Caribbean (10 countries): employment rate and urban unemployment rate, 2009 to first quarter of 2013

(Four-quarter moving average, in percentages)

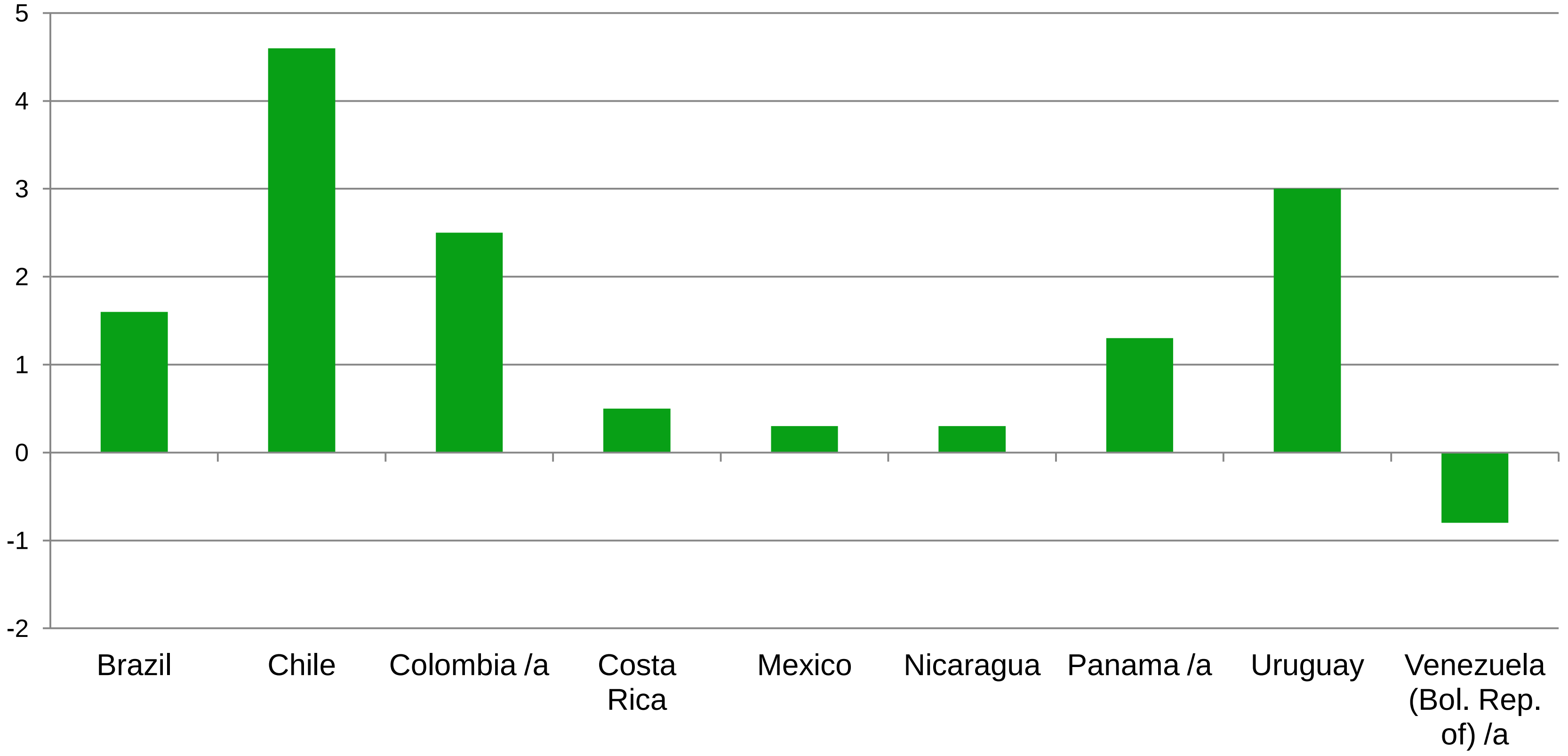


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Wage growth has moderated

Latin America (selected countries): year-on-year growth in formal-sector real wages, January-April 2013/January-April 2012

(*In percentages*)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
a/ January-March 2013 / January-March 2012.

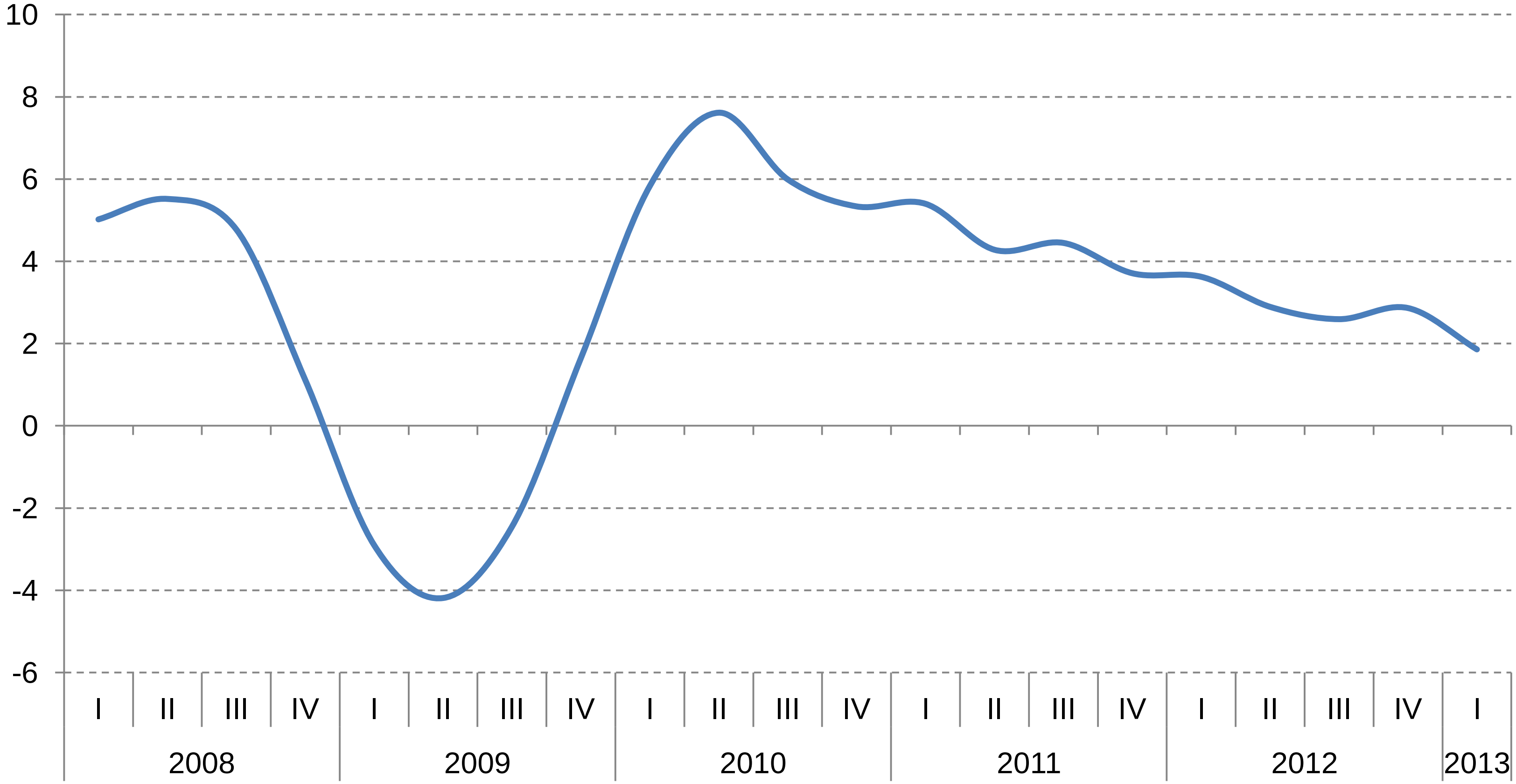
II. Medium and long term risks:

Insufficient and inadequate investment hinders increases in

- productivity; and
- economic growth

Economic growth has decelerated in the region

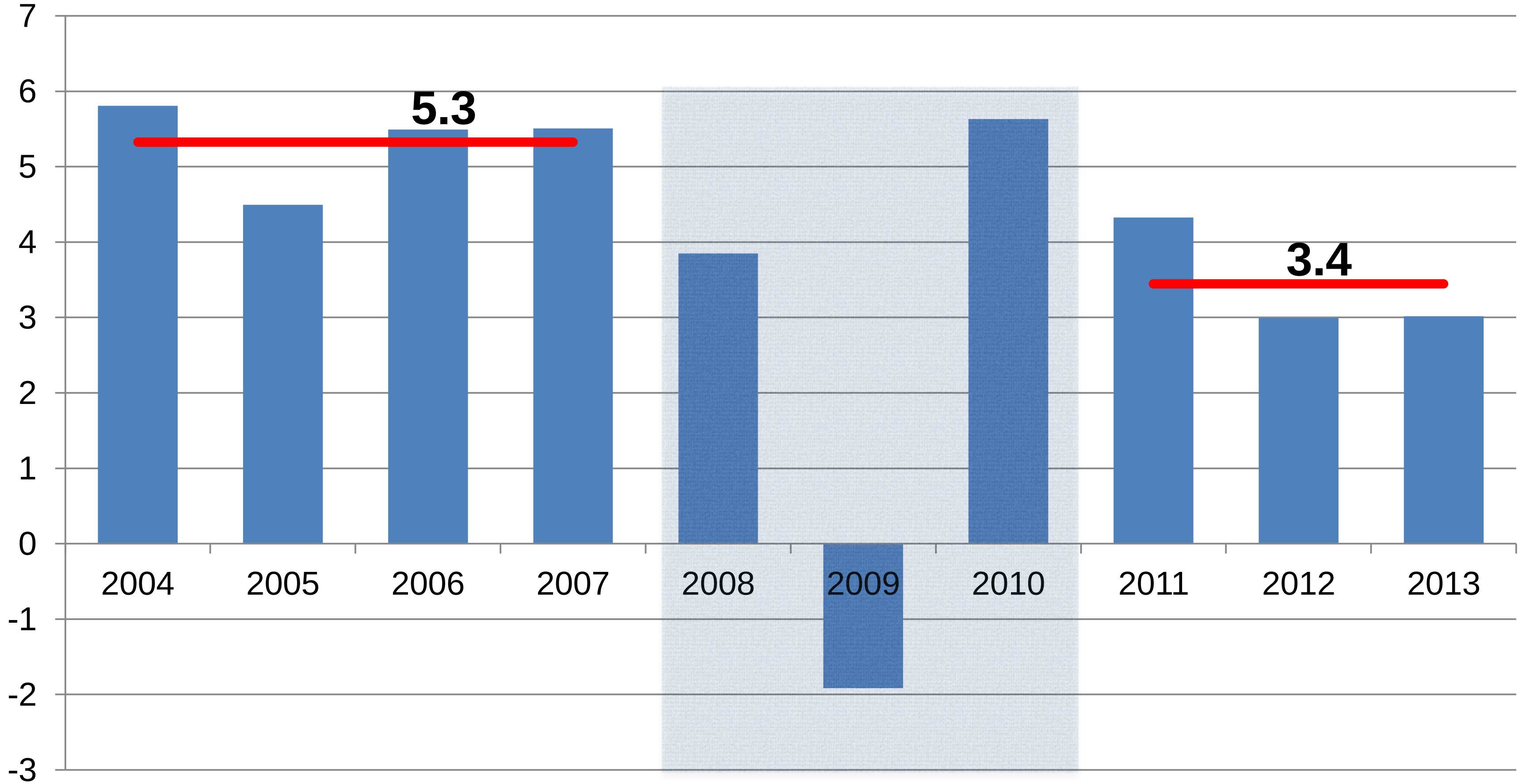
Latin America: year-on-year quarterly growth rate of GDP, weighted average, January 2008 to March 2013
(In percentages on the basis of constant dollars at 2005 prices)



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

Growth rates are lower than before the crisis of 2008-2009

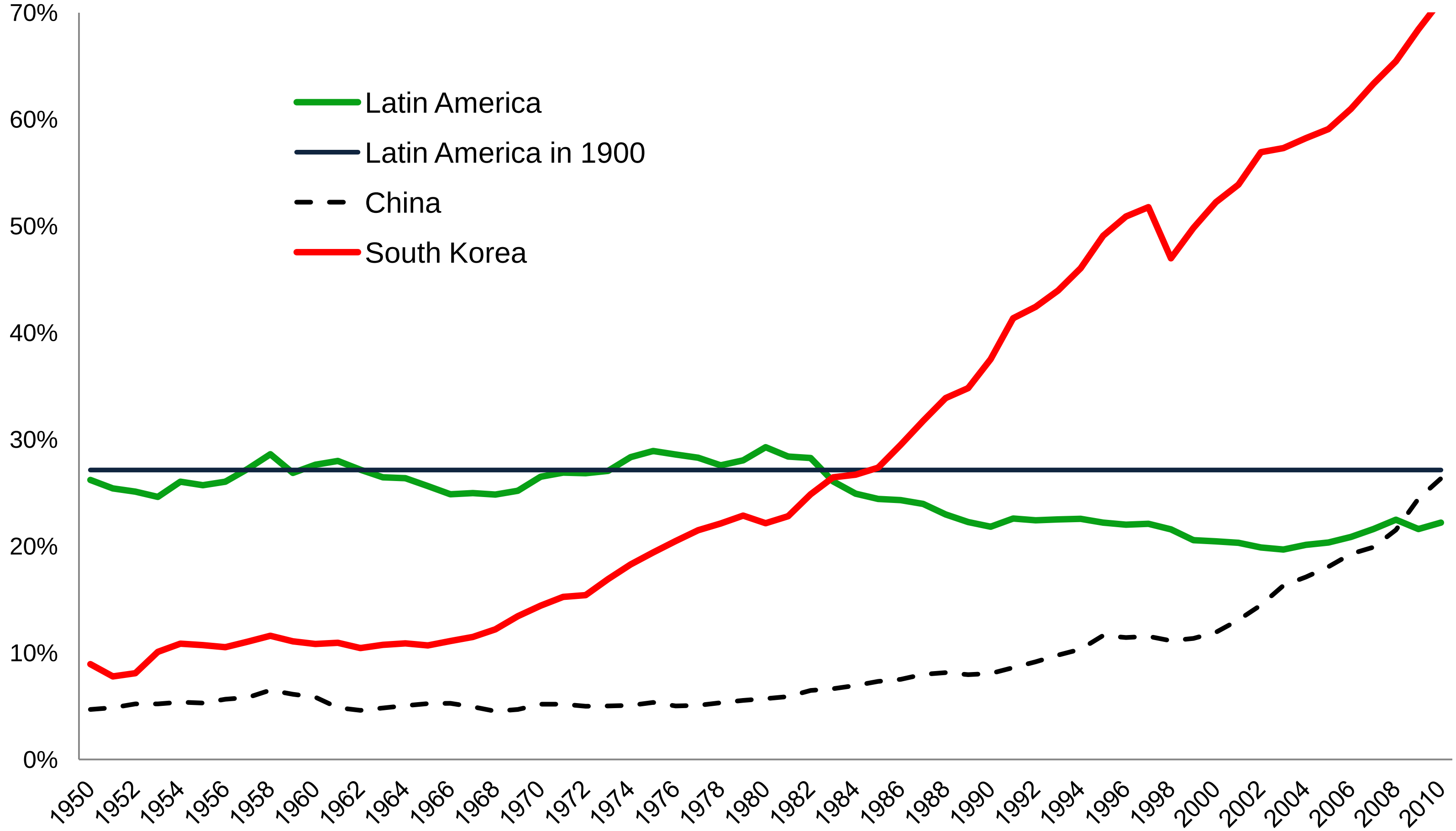
Latin America and the Caribbean: GDP growth, 2004-2013
(In percentages)



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

Despite growing in 2003-2008, the real GDP per capita of the region could not keep pace with that of the United States

Latin America, South Korea and China: GDP per capita relative to the United States
(In percentages of GDP per capita of the United States, based in 1990 Int. GK$)

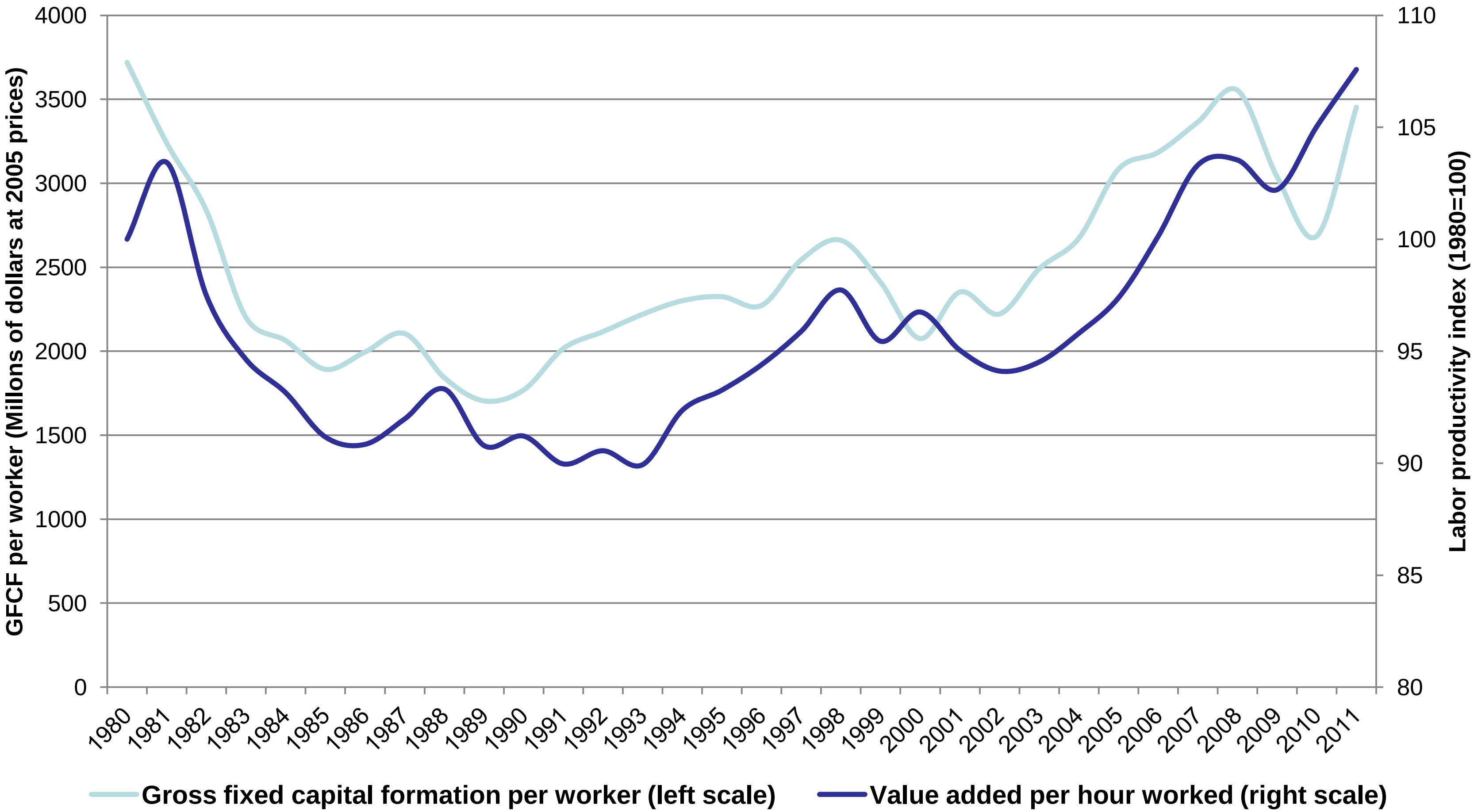


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of updated data from Angus Maddison (Bolt y Van Zanden, 2013).

Labor productivity (insufficient) has depended mainly on investment

Latin America and the Caribbean (19 countries): gross fixed capital formation per worker vs. value added per hour worked

(In millions of dollars at constant 2005 prices and index: 1980=100)



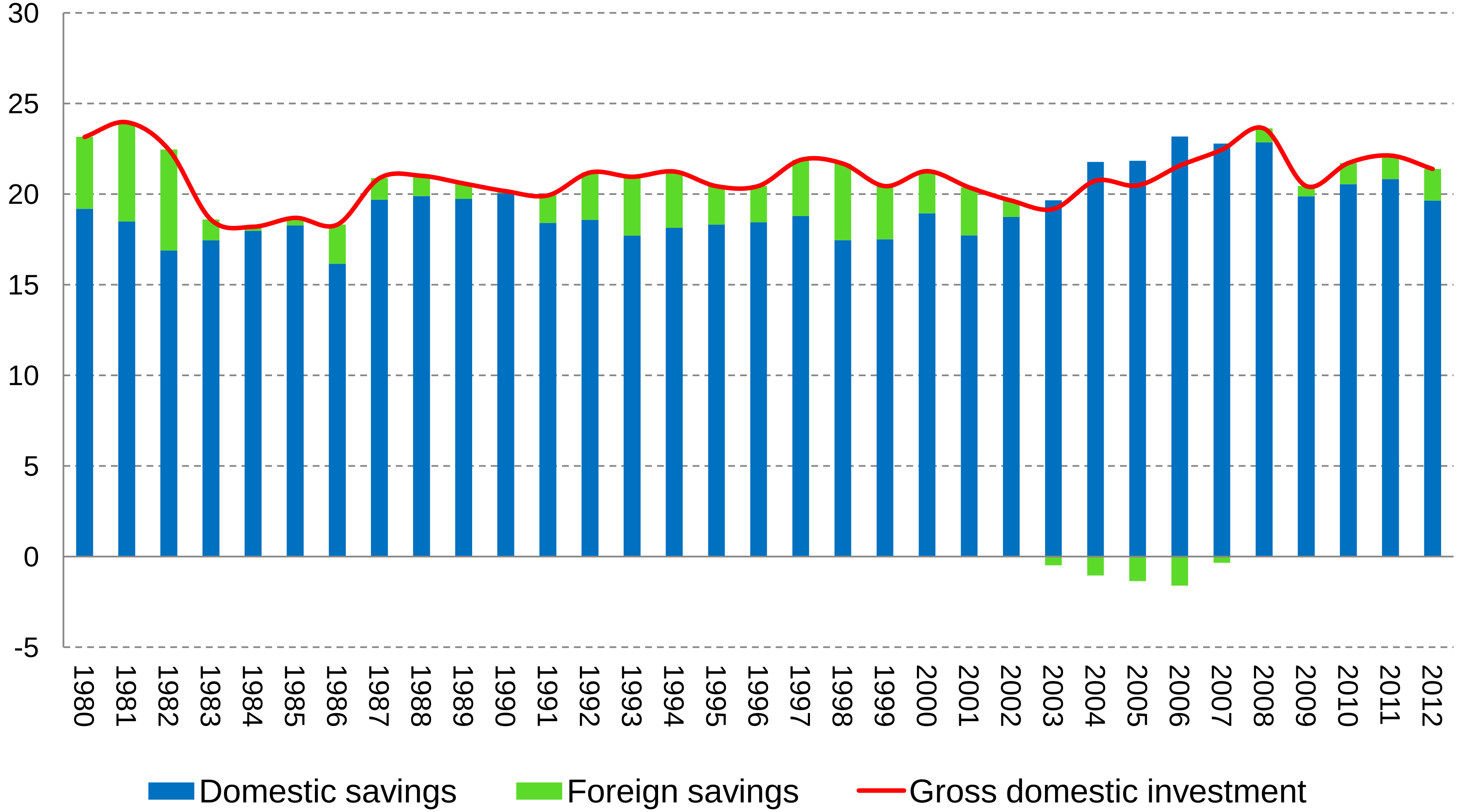
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of its own data and those of the World Bank.

Investment has been affected by:

- **The use of installed capacity**
  - Recessionary adjustments have generated idle capacity, which deters further investment
- **GDP dynamism**
  - Investment has depended on the (past) growth of GDP: investment has been procyclical
- **Available savings**
  - The availability of domestic savings to finance investment have fluctuated due to:
    - Changes in terms of trade
    - Fluctuations in remittances

When domestic savings have increased, investment has been greater

Latin America and the Caribbean: investment financing, 1980-2011
(In percentages of GDP on the basis of current dollars)

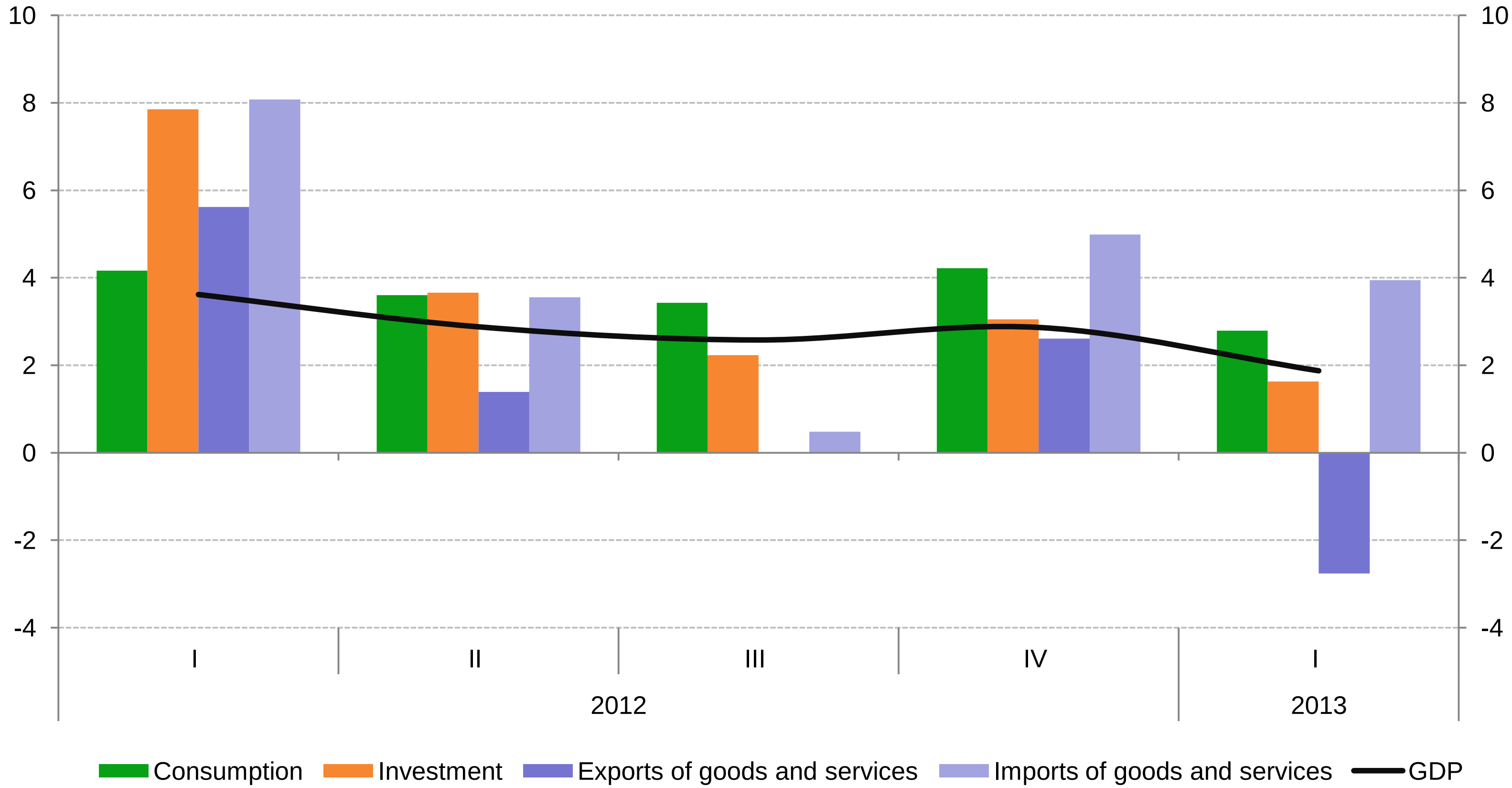


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

In view of the limited contribution of investment (and net exports), GDP growth has depended mainly on the expansion of consumption

Latin America: year-on-year quarterly growth rate of GDP and of the components of aggregate demand, January 2011 to March 2013

(In percentages on the basis of constant dollars at 2005 prices)

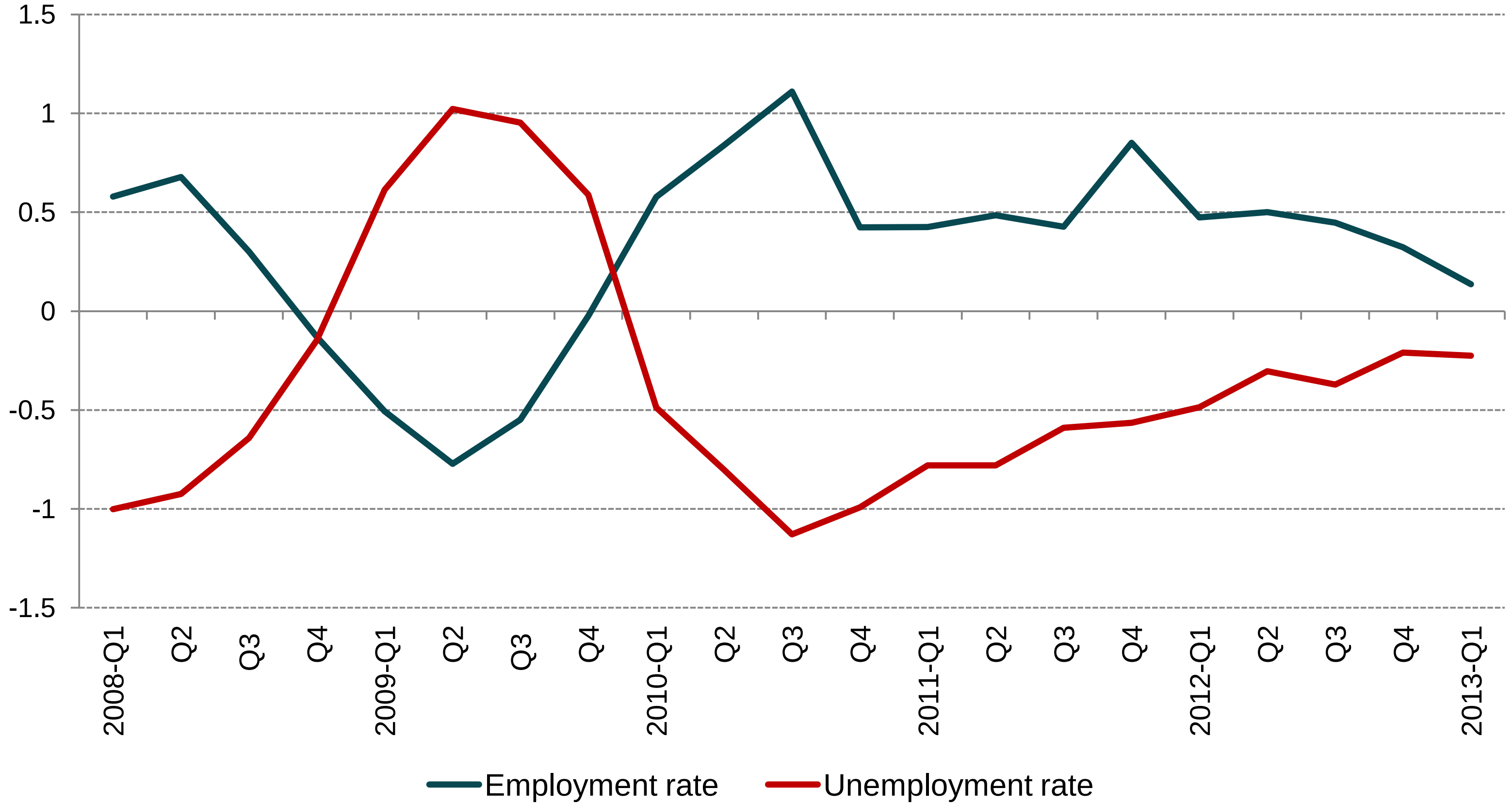


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Consumption growth is slowing due to the deceleration of job creation and real wages

Latin America and the Caribbean (10 countries): year-on-year growth rate in employment and unemployment rates

(In percentages)



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

Job creation and real wages growth have decelerated, but the employment rate will hold steady in 2013

The contribution of investment to productivity has also been limited by its composition and destination

1. **Limited public investment (or insufficient public-private alliances)**
   – Inadequate infrastructure
2. **Greater investment in non-tradable sectors (services, trade, construction) has limited the possibilities to diversify tradable production**
   – Limited growth of productivity and greater external vulnerability due to limited generation of foreign exchange
3. **Greater investment within the same sectors, instead of favoring diversification and investment in other sectors with greater productivity**
   – Fewer increases of productivity by way of structural change

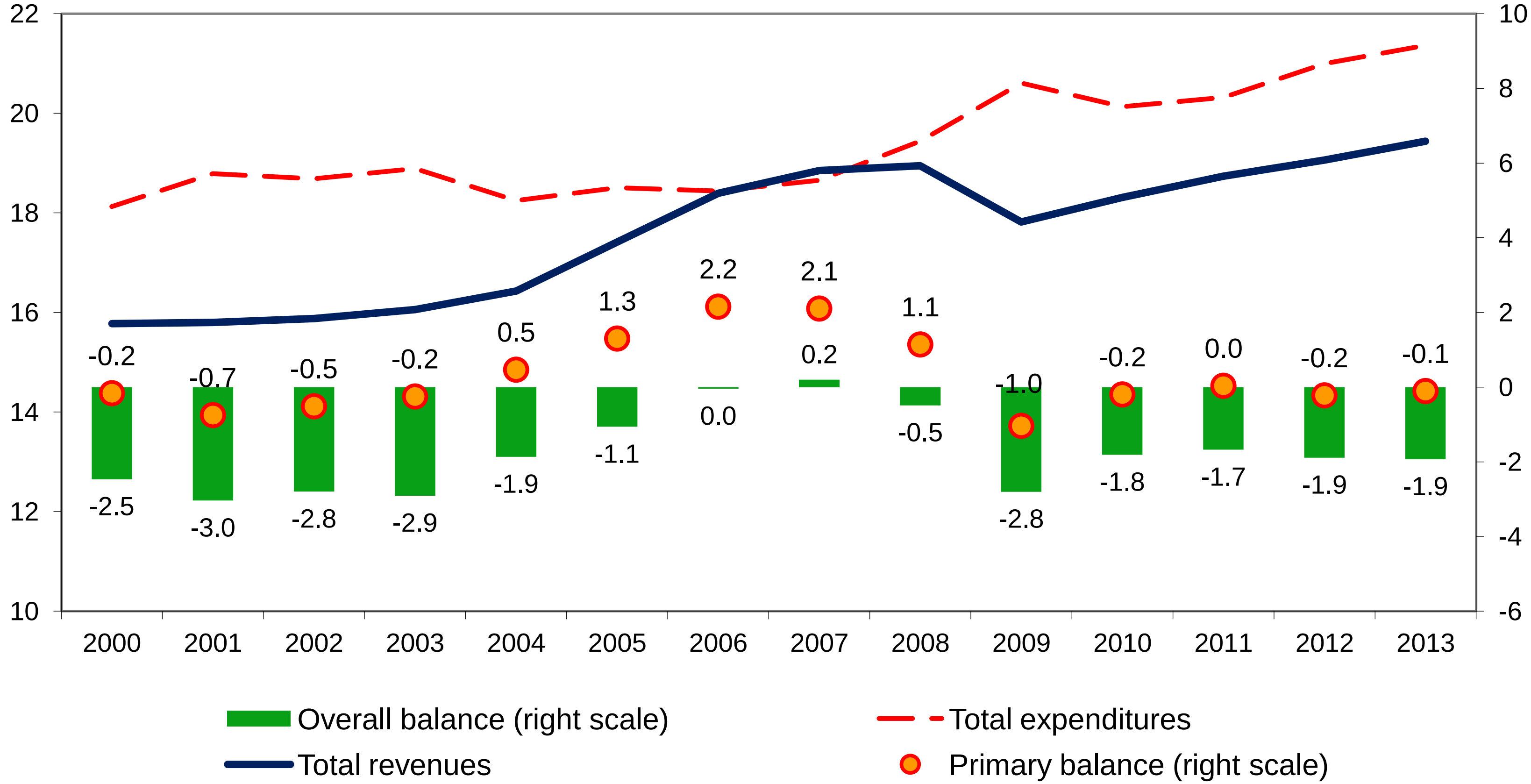
III. Policy responses

Monetary policy responses have been varied

- **Three factors condition the direction of monetary policy**
  - The possible increase of external interest rates (in response to policy changes in the United States), with possible depreciations and capital outflows (limited) and lower international reserves, could induce a monetary authority to increase the monetary policy rate.
  - The deceleration of economic activity due to lower external demand could favor a reduction in the monetary policy rate.
  - Recent inflationary pressures (in some cases) and increases in the current account deficit (in many cases) could suggest an increase in the monetary policy rate to contain consumption.
- **In practice, the use of monetary policy as reflected by modifications of the interest rate, has been diverse in 2013:**
  - Increases: Brazil, Guatemala, Uruguay
  - Reductions: Colombia, Costa Rica, Dominican Republic, Guyana, México

Tax revenues exhibit less dynamism and public expenditures are moderating in some countries

Latin America (19 countries): fiscal indicators of the central government, 2000-2013
(In percentages of GDP)

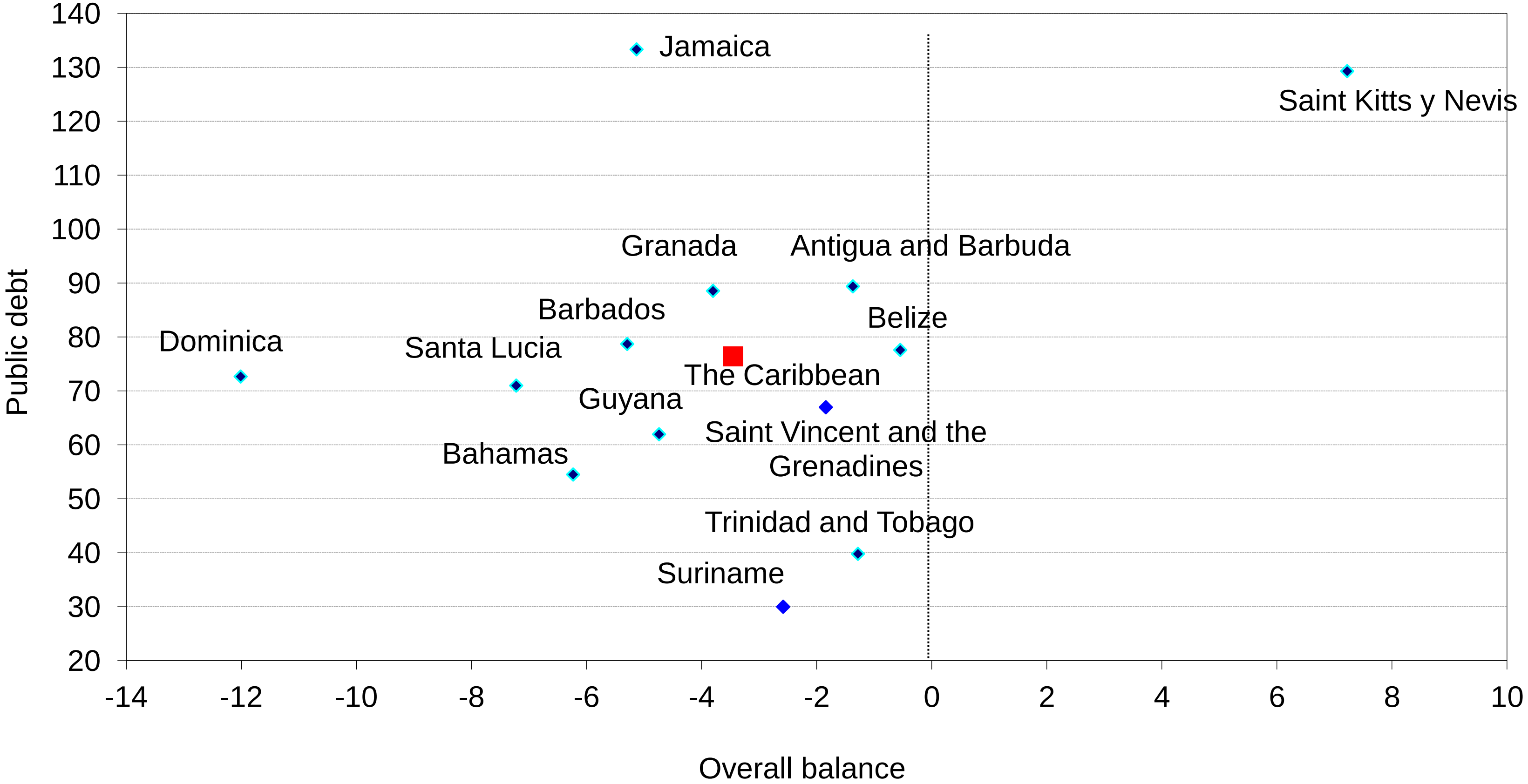


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Commodity exporting Caribbean countries maintain sustainable fiscal deficit and public debt levels. Service exporters, in contrast, have suffered from high fiscal deficits since 2009.

Serious fiscal problems persist in the Caribbean: elevated deficits and debt

The Caribbean (12 countries): overall balance and public debt of the central government, 2012
(In percentages of GDP)



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

A Social Covenant for Investment (and productivity) is justified

1. Likely end of the “boom” in commodity prices counsels a diversification of the production structure and bolstering new sources of growth
2. Current context of uncertainty reinforces the necessity of coordinating investments: public and private; domestic and foreign
3. Investment is key as a means to increase productivity
4. GDP growth has depended excessively on the expansion of consumption and not sufficiently on investment or net-exports
5. Support is required to promote the diversification of investment in tradable sectors to encourage:
   - a more balanced process of structural change, with more linkages,
   - a production of goods and services that, by increasing net exports, could diminish the impact of external financial restrictions on growth

Social Covenants for Investment (and productivity) require 3 dimensions

Institutional framework

Short term policies

Long term policies

Social Covenant for Investment:
1. Institutional framework

Take advantage of or create coordination bodies in order to:

1. Coordinate the entirety of policies directed at promoting investment:
   - Fiscal, monetary, exchange rate, industrial, sectoral, microeconomic, environmental, labor, social
   - Boost dialogue between the State, the business sector (domestic and foreign) and civil society
2. Formulate guidelines, norms, and plans or programs of investment and mechanisms to monitor them

Social Covenant for Investment:
2. Short term policies

1. Avoid the formation of idle capacity through:
   - Nominal stability (inflation and low interest rates)
   - Real exchange rate that is not misaligned
   - Sustainable public finances and external accounts
   - Use of countercyclical policies in moments of boom or contraction, with an emphasis on “second generation” countercyclical fiscal policies

2. Develop countercyclical capabilities (fiscal, monetary, macroprudential, sectoral, wages-employment) in order to counter shocks quickly

3. Prevent domestic crises that result in recessionary periods by maintaining sustainable internal and external balances over time

Social Covenant for Investment
3. Long term policies for structural change

1. Promote investment in the diversification of tradable sectors
   - Real exchange rates that are not misaligned
   - Fiscal and financial policies that compensate for the bias against tradable sectors that results in cases of sustained exchange rate appreciation; direct subsidies instead of exemptions, with greater transparency
2. Investment in infrastructure
3. Labor force training to facilitate structural change
4. Coordination with other policies (industrial, environmental and social) to promote investment that ensures structural change

Macroeconomic risks and challenges for growth in Latin America and the Caribbean

Strengths

- Greater fiscal space than in previous periods
- Low inflation trajectory (with exceptions), flexible exchange rates and ample reserves creates space for countercyclical policies
- Ready access to international financial markets in cases where the sovereign ratings are favorable

Opportunities

- New macroeconomic framework constitutes a solid base to promote structural change for equality
- The promotion of a **Social Covenant for Investment** (and productivity) in each country could bolster structural change through:
  - The coordination of macroeconomic policies with other policies (industrial, sectoral and social)
  - Dialogue between the State and diverse social actors
- Rising jobs and wages, coupled with redistributive policies, have created an internal demand (domestic and regional) that can be a solid base of growth if investment and productivity increase

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