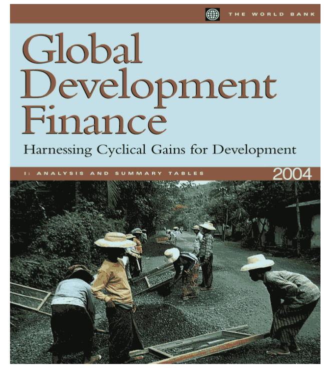
Lat.Am. & Caribbean



GDF 2004 Summary

Global Themes

- The global economic environment affecting capital flows to developing countries improved in 2003. Global growth gained momentum in the second half of the year as the locus of economic activity shifted towards business investment spending. Renewed confidence in international financial markets led to a considerable decline in risk spreads in bond markets and fueled a strong rally in equity prices. Worldwide, GDP growth increased from 1.8 percent in 2002 to 2.6 percent during 2003; it is projected to rise to 3.7 percent in 2004. But the global economy is emerging from the pervasive slowdown of recent years facing major macroeconomic challenges – including large fiscal deficits in many advanced economies and a large current-account deficit in the United States - which could have a critical bearing on the outlook for developing countries and the availability of external capital to finance their development.

- Developing countries as a group are markedly outperforming the high-income countries. Developing countries' GDP grew 4.8 percent in 2003, compared to a 2.1 percent advance in the high-income countries. The low-and middle-income countries are on track this year to match, or even surpass, the record 5.2 percent growth achieved in 2000, before the global slowdown. Since 2000, the developing world has been a net exporter of capital to the advanced economies. For developing countries as a whole, foreign-exchange reserves rose about $276 billion in 2003, bringing total reserves to $1,227 billion—equivalent to nearly four times their short-term external debt. This buildup reflects a precautionary reaction to the costly crises of the 1990s, as well as broader factors related to trade and exchange rates. It underlines the strong financial interdependence between developed and developing countries.

- Official development assistance is still an important source of external finance for many countries. But, as private capital flows have grown, official aid flows have risen only slightly, and remain below the levels needed to achieve the Millennium Development Goals (MDGs). Political developments and changes in attitudes are dramatically altering the landscape for official flows. Net official development assistance did increase to $58 billion in 2002, but half of the $6 billion rise reflects debt relief donor agencies, rather than increased resources provided directly to developing countries. Moreover, the increase represents little progress toward meeting the commitments for higher aid made at the 2002 Monterrey conference.

- From 1992 to 2003, total international investment in developing countries' infrastructure is estimated to have been $622 billion—an average of $52 billion a year or 3.8 percent of total gross domestic investment in the developing world. Infrastructure needs in developing countries remain largely unmet—1.1 billion people lack access to safe drinking water, 2.4 billion are affected by inadequate sanitation, 1.4 billion have no power, and telecommunication links are five times less dense than in the developed world. Worldwide, future demand for infrastructure is likely to come mainly from the developing world. The bottlenecks in assuring a healthy flow of capital from international markets to developing-country infrastructure are related to policies, institutions, and regulation. Multilaterals can play a crucial role in providing risk-mitigation instruments (including guarantees and political risk insurance) and promoting the development of local capital markets. Efforts also need to be taken to develop a strong institutional framework for the protection of creditors' rights, effective covenants, and reliable avenues of legal enforcement and remedy. No single solution will fit all sectors and all countries.

- Developing countries' international trade is equivalent to about one-half of their gross national income. Trade finance supplies the liquidity needed to conduct trade, and governments can support it by ensuring a sound and efficient financial system. Finance linked to trade transactions may hold up better during crises than other forms of foreign borrowing for several reasons - lenders can rely on security arrangements linked to traded goods; supplier's information on their borrowers may limit contagion; suppliers have an incentive to support their customers during cyclical downturns; and, in some cases, governments have provided preferential treatment to trade finance in the context of rescheduling agreements. Trade credit from suppliers and customers appears to have held up better during crises than bank lending.

- The development community should view remittances as a welcome source of external finance and strive to improve the financial infrastructure supporting them. Workers' remittances have become a major source of finance for many developing countries. On an aggregate basis, they increased by more than 20 percent during 2001–03, reaching an estimated $93 billion in 2003, with more remittances being diverted to formal channels from alternatives—a result of efforts to curb money laundering. The increased focus on remittances resulted in better reporting of data in many developing countries.

Regional themes

- Growth in Latin America advanced by 1.1 percent in 2003, following a contraction of 0.6 percent in 2002. This was helped by the bottoming out of decline investments, which contracted only 1 percent in 2003, compared to 7 percent in 2002, as well as a jump in export growth to 15.2 percent from 0.1 percent over the same period. Growth in countries recovering from crises was strong, followed by those in the Andean region. However, growth in other major countries, such as Brazil and Mexico, gained traction only in late 2003.

- The region's current account deficit continued to adjust, falling to $4.4 billion in 2003 from $15.4 billion in 2002, and as compared to $54 billion in 2001. The mirror image, net financial-resource flows dropped sharply from a peak of $138 billion in 1998 (6.9 percent of GDP) to $38 billion in 2002 (2.3 percent of GDP), before stabilizing at $46 billion in 2003.

- After consecutive outflows since 2001, private debt flows (bond and bank) staged a strong rebound, with a net inflow of $9.3 billion in 2003, compared with an outflow of almost $21 billion in 2002. While new bond issues almost doubled over 2002 to $41 billion, bank lending rose only marginally to $22 billion. Led by Brazil, regional spreads compressed sharply from an average of 785 basis points in 2002 to nearly 470 basis points at the end of 2003, before widening to 545 basis points by March 2004. Access to bond financing in the region was widespread, with Brazil and Mexico issuing bonds worth $14 billion and $15 billion respectively.

- The region, however, continues to be the epicenter of the decline in developing country foreign direct investment (FDI) for the third consecutive year. The reasons being the lack of large-scale privatization and weak cross-border merger and acquisitions since 2000, as well as financial crises. Brazil, and to a lesser extent Argentina, suffered most declines in 2003.

- The majority of developing country workers remittances—second largest financial flow after FDI—continued to go to Latin America and the Caribbean. In 2003, remittances to the region increased by another 10 percent to $30 billion (one-third of the developing country total).

Other key regional points to note

- The report emphasizes the need for maintaining prudent fiscal and inflationary policies in the region, given the likelihood of increased imports, as growth picks up to 3.8 percent in 2004. Being a region heavily reliant on external debt and faced with an enticing financing environment, Latin America faces difficult challenges in restoring and maintaining fiscal prudence. This is particularly relevant given the possibility of a turn around in industrial country interest rates and its consequences.

- The handling of Argentine debt restructuring could influence investor risk perceptions—the impact of which on capital flows is discussed in the report. The report underscores the need for prudence in contracting new debt and heeding lessons of recent economic and financial stresses. Additionally, focused discussion related to bank credit in Argentina is presented.

- Since the late 1990s, FDI to the region has shifted from manufacturing to the service sector. This structural shift in great part explains the decline in regional FDI in recent years. Separately, the reasons for the sharp decline in FDI in Brazil are examined.

- Given the importance of the region's trade dynamics in stimulating output gains in 2003, the chapter on "Financing Developing Country Trade" should be particular interest. The chapter highlights the role of trade finance in supplying the liquidity necessary for efficient trade and helping countries grow rapidly out of crises by exporting. Trade finance also helps low-income and less creditworthy countries—especially relevant for Latin America since its average credit quality is amongst the lowest in the developing world—access international credit. The chapter analyzes that even if countries lack reliable access to commercial bank credit they can still access trade finance because the goods provide security for the credit.

- Sound infrastructure facilities are necessary for attracting FDI, expanding trade and achieving long-term investment and growth. However, since 2001, despite the continued need for vast investments in infrastructure international investment in infrastructure has dropped by almost 70 percent in Latin America—historically the second most important destination of such funds. The chapter highlights that the global capital markets have the depth, maturity, size and sophistication to potentially fund viable investments. However, given the susceptibility of such investments to perceived host-country risks, the importance of measures to prevent financial crises and ensure macroeconomic stability are also examined.

Latin America and Caribbean outlook in summary, 1981-2004

	1981-90	1991-00	1998	1999	2000	2001	2002	2003e	2004f
Real economy									
(percent change, unless stated)									
Real GDP growth	1.1	3.3	2.0	0.1	3.7	0.3	-0.6	1.3	3.8
Private consumption per capita	-1.0	2.3	-0.1	-1.7	2.2	-0.9	-3.6	-1.6	2.3
GDP per capita	-0.9	1.6	0.4	-1.5	2.1	-1.2	-2.0	-0.1	2.4
Population	2.0	1.7	1.6	1.6	1.6	1.5	1.5	1.5	1.4
Gross Domestic Investment / GDP /a.	20.2	20.0	21.4	19.8	19.7	19.2	18.0	17.5	18.1
Inflation /b.	17.3	11.9	8.2	4.6	7.5	5.6	5.8	4.2	4.0
Central Gvt budget balance / GDP	-9.1	-3.3	-5.2	-4.1	-3.0	-2.9	-3.0	-2.4	-1.4
Export Market Growth /c	4.4	9.8	7.2	5.6	13.0	-1.4	-0.1	4.8	8.6
Export Volume /d.	5.4	8.7	7.9	6.6	10.3	1.1	2.6	5.4	11.2
Terms of Trade / GDP /e.	-0.4	0.0	-0.9	0.3	1.1	-0.6	-0.1	-0.3	0.0
Current Account / GDP	-1.5	-2.9	-4.5	-3.2	-2.4	-2.8	-0.9	-0.3	-0.6
Workers Remittances ($ billion)	--	12.5	15.2	16.9	19.2	22.9	26.8	29.6	--
Memorandum item:									
GDP growth: Central America	1.0	4.6	5.9	4.7	3.2	1.9	2.0	3.1	3.1
Caribbean	2.0	3.9	4.2	6.9	5.8	2.7	3.0	0.5	0.8
External Financing and Debt	1995	1996	1997	1998	1999	2000	2001	2002	2003e
(billions of dollar unless stated)									
Net inward FDI	30.5	44.3	66.7	73.8	88.0	77.0	69.9	44.7	36.6
Net inward portfolio equity flows	4.8	12.2	13.3	-2.2	-3.6	-0.5	2.3	1.5	1.4
Net inward debt flows	61.2	36.5	25.4	38.0	12.1	-9.7	6.3	-7.9	19.5
From public sources	22.0	-10.7	-8.7	10.9	1.5	-11.1	20.4	12.7	10.2
From private sources	39.2	47.2	34.1	27.2	10.6	1.4	-14.1	-20.6	9.3
Gross Market Based Capital Inflows	42.8	84.9	120.6	84.5	75.3	88.4	77.0	43.5	64.3
Total External Debt	612.2	633.7	665.8	748.4	770.2	751.9	729.3	727.9	762.1
Medium and Long Term	488.8	516.7	541.8	632.9	664.0	648.6	639.8	652.2	678.2
Short Term	123.4	116.9	124.0	115.5	106.2	103.4	89.5	75.7	84.0
Owed by Public Sector Borrowers	401.4	399.5	379.3	412.7	419.0	403.7	398.8	423.3	454.8
Owed by Private Sector Borrowers	210.8	234.2	286.5	335.6	351.2	348.2	330.5	304.7	307.3
Owed to Public Sector Creditors	187.3	164.0	145.7	160.8	162.9	149.8	162.6	182.6	200.5
Owed to Private Sector Creditors	424.8	469.7	520.1	587.6	607.3	602.1	566.7	545.3	561.6
Gross Foreign Exchange Reserves	125.1	153.1	166.7	157.5	150.0	152.9	155.9	156.0	188.8

-- Not Available

Note: e = estimate, *f* = forecast.

a. Fixed investment, measured in real terms.

b. Local currency GDP deflator, median.

c. Weighted average growth of import demand in export markets.

d. Goods and non-factor services.

e. Change in terms of trade, measured as a percentage of GDP.

External financing: Latin America and Caribbean, 1997-2003
(billionsof dollars)

	1997	1998	1999	2000	2001	2002	2003e
Current account balance	-66.0	-90.3	-56.6	-46.8	-54.0	-15.4	-4.4
as % GDP	-3.3	-4.5	-3.2	-2.4	-2.8	-0.9	-0.3
Financed by:							
Net equity flows	80.0	71.7	84.4	76.5	72.2	46.2	38.0
Net FDI inflows	66.7	73.8	88.0	77.0	69.9	44.7	36.6
Net portfolio equity inflows	13.3	-2.2	-3.6	-0.5	2.3	1.5	1.4
Net debt flows	25.4	38.0	12.1	-9.7	6.3	-7.9	19.5
Official creditors	-8.7	10.9	1.5	-11.1	20.4	12.7	10.2
World Bank	0.8	2.4	2.1	2.0	1.3	-0.3	-0.5
IMF	-3.9	2.5	-0.9	-10.7	15.6	11.9	11.4
Others	-5.5	5.9	0.3	-2.4	3.5	1.2	-0.7
Private creditors	34.1	27.2	10.6	1.4	-14.1	-20.6	9.3
Net M-L term debt flows	41.7	54.7	18.5	4.0	-0.7	-11.6	6.7
Bonds	10.8	17.3	19.3	5.2	3.6	0.5	13.2
Banks	31.9	39.1	-1.5	-0.3	-2.7	-10.3	-5.8
Others	-1.0	-1.7	0.8	-0.9	-1.7	-1.8	-0.7
Net short-term debt flows	-7.7	-27.6	-7.9	-2.6	-13.4	-9.0	2.6
Balancing item *	-25.9	-28.6	-47.4	-17.1	-21.6	-22.8	-20.2
Change in reserves	-13.5	9.2	7.5	-2.9	-2.9	-0.1	-32.9
(- = increase)							
Memo items:							
Bilateral aid grants	2.7	3.2	2.9	2.5	3.2	2.7	2.9
(excluding technical co-operation grants)							
Net private flows (debt+equity)	114.1	98.8	95.0	78.0	58.1	25.6	47.3
Net official flows (aid+debt)	-6.0	14.0	4.4	-8.7	23.6	15.5	13.1
Workers' remittances	13.8	15.2	16.9	19.2	22.9	26.8	29.6

Note : e = estimate

a. Combination of errors and omissions and net acquisition of foreign assets (including FDI) by developing countries