Latin America and the Caribbean

Recent developments

GDP growth in Latin America and the Caribbean came in at 5.7 percent in 2007, up from 5.6 percent in 2006. The current growth spell marks the first time in nearly three decades that growth has exceeded 5 percent for two consecutive years, and the first time since the early 1970s that GDP gains have eclipsed 4 percent for four consecutive years. In 2007 the large regional economies, Argentina, Brazil, and Chile, achieved growth rates well above the 5 percent mark (8.7 percent, 5.4 percent, and 5.1 percent, respectively), while Mexican GDP expanded at a 3.3 percent pace. Smaller economies in Central America and the Caribbean also performed well during the year (table A.7).

This strong performance underscores the view that growth in the region has become more resilient and is better positioned to weather the unfolding slowdown in the United States. Although a favorable external environment has played a role in the improved regional performance, stronger domestic fundamentals have been just as important. Indeed, as figure A.7 highlights, capital formation has made a stronger contribution to growth during the most recent growth spell than during the two previous episodes in the mid-1980s and early 1990s. Higher investment activity has been underpinned by a number of factors, including improved macroeconomic stability. A major factor has been improved effectiveness of central banks in controlling inflation and in anchoring expectations to a stable, low level of inflation. In some countries, this development has been recently translated into lower real interest rates. In turn, the continued strong pace of new investments bodes well for future growth, mainly through faster improvements in productivity.

In fact, this positive spillover to productivity can already be detected in recent data: for a group of countries including Brazil, Chile, Colombia,

Table A.7 Latin America and the Caribbean forecast summary

annual percentage change unless indicated otherwise

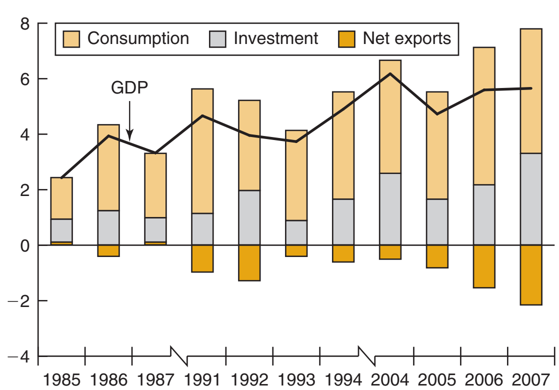
					Forecast		
Indicator	1991–2000[a]	2005	2006	2007	2008	2009	2010
GDP at market prices (2000 $)[b]	3.4	4.7	5.6	5.7	4.5	4.3	4.2
GDP per capita (units in $)	1.7	3.4	4.2	4.3	3.2	3.0	2.9
PPP GDP[c]	4.3	4.6	5.5	5.7	4.5	4.3	4.3
Private consumption	3.4	6.7	6.2	6.1	5.2	4.7	4.5
Public consumption	1.5	2.9	3.4	3.9	2.9	2.9	2.8
Fixed investment	4.7	10.9	10.7	15.3	9.3	6.7	6.3
Exports, GNFS[d]	8.1	8.1	7.8	5.3	2.9	5.4	5.8
Imports, GNFS[d]	10.7	12.0	14.1	13.2	7.9	8.1	7.3
Net exports, contribution to growth	−0.3	−0.8	−1.5	−2.1	−1.5	−1.0	−0.8
Current account bal/GDP (%)	−2.9	1.5	1.7	0.5	0.3	−0.3	−0.7
GDP deflator (median, LCU)	10.8	5.7	10.2	9.3	8.8	4.1	3.8
Fiscal balance/GDP (%)	—	1.1	1.5	1.5	0.9	0.6	0.2
Memorandum items: GDP							
LAC excluding Argentina	3.2	4.0	5.1	5.2	4.1	4.1	4.2
Central America	3.6	3.0	5.0	3.7	2.8	3.6	3.7
Caribbean	3.6	6.5	8.8	6.0	4.7	4.6	4.9
Brazil	2.7	3.2	3.8	5.4	4.6	4.4	4.5
Mexico	3.5	2.8	4.8	3.3	2.7	3.5	3.6
Argentina	4.5	9.2	8.5	8.7	6.9	5.0	4.5

Source: World Bank.
— Not available.
a. Growth rates over intervals are compound averages; growth contributions, ratios, and the GDP deflator are averages.
b. GDP is measured in constant 2000 $.
c. GDP is measured at PPP exchange rates.
d. Exports and imports of goods and nonfactor services.

Panama, and Peru, growth rates in total factor productivity during 2001–06 ranged from 1.25 to 2.25 percent a year, well above historic averages. In another group of countries, however, including the Dominican Republic, El Salvador, Honduras, and Mexico, productivity growth has been sluggish or even negative.

Figure A.7 Contributions to GDP growth in Latin America and Caribbean, 1985 – 2007

Percentage points

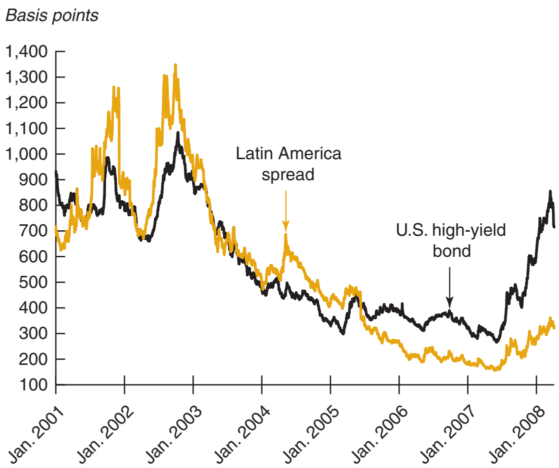


Source: World Bank.

Financial stability has played a key role in supporting growth in recent years and is likely to help mitigate a portion of the contagion effects of the U.S. slowdown in 2008–09. In contrast with previous episodes of financial market instability in high-income countries, increases in sovereign bond spreads for Latin American countries have been fairly muted during the current credit squeeze (figure A.8). This regional performance masks divergent behavior of two groups of countries. A first group, comprised of Argentina, Bolivia, the Dominican Republic, Ecuador, and República Bolivariana de Venezuela, has experienced a sharper rise in the spread, showing a convergence toward the junk bond market. A second group, including Colombia, El Salvador, Panama, Peru, and Uruguay, has shown reduced spread movements and seems to be joining the solid investment-grade group of Brazil, Chile, and Mexico.

Additionally, capital inflows have not reversed but remained buoyant, suggesting the region's financial markets may be providing diversification benefits for investors. Moreover, stocks of international

Figure A.8 Spreads in Latin America and the Caribbean little affected, contrasted with U.S. high-yield bonds



Source: Thomson/Datastream.

reserves are large, and foreign debt continues to decline, limiting the region's vulnerability to terms-of-trade shocks and to a sudden stop in capital flows.

In contrast with this positive backdrop, a number of concerns are emerging. The surge in domestic demand has reduced excess capacity in many of the region's economies and, together with rising food and energy prices, has resulted in increasing inflation. Central banks have responded promptly in several countries: Brazil has suspended the easing of its monetary policy; Chile, Colombia, and Peru have raised their policy rates; and Mexico is holding its rates at a high level. Elsewhere, inflation problems have caused social and political unrest, as in the case of Haiti, or have been addressed with the use of unorthodox policy measures, such as widespread price controls in Argentina and República Bolivariana de Venezuela.

Between 2006 and 2007, the region's current account surplus decreased from 1.7 percent of GDP to 0.5 percent. Surpluses have narrowed in Argentina, Brazil, Peru, and República Bolivariana de Venezuela, while deficits have widened in Colombia and Mexico. Part of the narrowing of the region's current account surplus is tied to shrinking goods surpluses, a consequence of imports growing at a markedly faster rate than exports. But lower growth in remittance inflows also contributed. Declining activity in the U.S. construction sector, where a large share of migrant workers is employed, explains the slowing of remittance incomes.

And though contagion from the U.S. credit freeze-up has not sharply affected bond spreads in the region, broader financial markets have shown some weakness. Equity markets have recorded losses during the first quarter of 2008.

Capital flows. Net debt flows to the region rebounded to $59.1 billion in 2007 after plummeting in 2006. Though gross bank lending increased only slightly to $27 billion from $19 billion in 2006, the proportion of bank lending to the region denominated in domestic currency increased dramatically, led by Brazil and Mexico, where the rise reflected a single transaction in each case. Net bond flows recovered from negative levels in 2006 to $8 billion in 2007, while principal repayments declined by $20 billion in 2007, following record-high repayments in 2006 resulting from sovereign debt buybacks by Brazil, Colombia, Mexico, and República Bolivariana de Venezuela totaling almost $30 billion. Short-term debt flows to the region—debt instruments with original maturity of less than one year (mostly bank loans and trade credit)—rebounded from −$3.3 billion to $29.4 billion (table A.8).

Similarly, the net equity flows (FDI and portfolio equity) surged to $135 billion in 2007, from $81.9 billion in 2006, partially reversing a longer-term trend. Net FDI inflows to the region, in particular, increased by $37 billion in 2007, raising the region's share of total FDI flows to developing countries from 19 percent in 2006 to 24 percent; strong gains came in Brazil ($16 billion), Chile ($6 billion), and Mexico ($5 billion). Despite the rebound, the region's share in total FDI to developing countries is still only half of what it was in the late 1990s. The more recent pickup in inflows to Latin America stems from investment in the manufacturing sector and higher overall retained earnings, whereas in 2000 the bulk of FDI inflows entailed privatization in the service sector.

Medium-term outlook

On the heels of very strong growth in the past four years, the pace of economic activity in Latin America and the Caribbean is likely to be less brisk over the coming years. Regional growth is expected to ease from 5.7 percent in 2007 to

Table A.8 Net capital flows to Latin America and the Caribbean
$ billions

Indicator	1999	2000	2001	2002	2003	2004	2005	2006	2007p
Current account balance	−55.8	−48.0	−53.3	−15.8	7.9	20.1	35.8	46.4	15.8
as % of GDP	−3.2	−3.2	−2.8	−0.9	0.4	1.0	1.5	1.7	0.5
Net equity flows	84.3	78.9	74.6	54.5	45.6	64.0	82.9	81.9	135.3
Net FDI inflows	87.9	79.5	72.1	53.0	42.3	64.6	70.4	70.5	107.2
Net portfolio equity inflows	−3.6	−0.6	2.5	1.4	3.3	−0.6	12.5	11.4	28.1
Net debt flows	11.5	−5.1	12.6	−6.3	16.2	−2.5	−2.0	−23.4	59.1
Official creditors	1.6	−11.1	20.4	12.5	4.9	−10.1	−31.0	−20.0	−4.8
World Bank	2.1	2.0	1.3	−0.6	−0.4	−1.0	−0.7	−3.4	−0.7
IMF	−0.9	−10.7	15.6	11.9	5.6	−6.3	−27.6	−12.1	−0.2
Other official	0.4	−2.3	3.6	1.2	−0.3	−2.8	−2.7	−4.5	−3.9
Private creditors	9.9	6.0	−7.9	−18.7	11.3	7.5	29.0	−3.3	63.9
Net M-L term debt flows	15.1	6.9	6.8	−8.5	9.0	0.6	14.5	−0.1	34.5
Bonds	15.7	7.1	2.8	−0.8	11.0	−0.3	16.0	−19.0	8.1
Banks	−1.4	0.6	5.6	−6.0	−1.4	0.8	−1.4	19.6	27.0
Other private	0.8	−0.8	−1.7	−1.7	−0.6	0.0	−0.1	−0.6	−0.6
Net short-term debt flows	−5.2	−0.9	−14.6	−10.3	2.3	7.0	14.5	−3.3	29.4
Balancing item[a]	−47.8	−23.5	−31.9	−31.6	−36.9	−57.3	−86.4	−47.4	−81.6
Change in reserves (− = increase)	7.7	−2.4	−2.0	−0.8	−32.7	−24.3	−30.2	−57.6	−128.6
Memorandum item									
Worker's remittances	17.6	20.0	24.2	27.9	35.2	41.5	48.3	56.9	59.9

Source: World Bank.
Note: p = projected.
a. Combination of errors and omissions and net acquisition of foreign assets (including FDI) by developing countries.

4.5 percent in 2008 with further moderation to 4.3 percent in 2009 and 4.2 percent by 2010. A large portion of the slowdown in growth is attributable to an expected deceleration in Argentina—from 8.7 percent in 2007 to 4.5 percent by 2010—and an even sharper easing in República Bolivariana de Venezuela—from 8.4 percent in 2007 to 3 percent. Excluding these countries, the regional slowdown is much less pronounced: growth is likely to moderate from 4.9 percent in 2007 to 4.3 percent in 2010, with a dip to 4 percent in 2008 resulting from weakness in the United States. On balance, despite slower growth in the coming three years, and the contraction in regional output in 2002, real GDP for the decade is on track to be the second-strongest in the last forty years.

With gradual moderation in regional GDP growth and easing of commodity price gains from current record rates by late 2008, the region's current account surplus of the last five years is expected to diminish further in 2008. Looking further ahead, the surplus is likely to shift to a deficit from 0.3 percent of GDP in 2008 to −0.3 percent by 2010. The widening of the aggregate deficit position obscures a great deal of country heterogeneity, with current account improvements in many smaller countries being offset by deterioration among large commodity exporters.

There are several subregional themes to the overall picture of strong but moderating economic growth performance (see tables A.7 and A.8).[2] Growth among energy exporters is likely to slow considerably in 2008—to 4.4 percent from 5.8 percent in 2007—and to moderate further to 3.9 percent by 2010. The main drivers of this slowdown are declining oil prices beginning in late 2008 and signs of potential overheating—manifested in accelerating inflation—that are likely to lead to a deterioration in current account balances and thus a curtailment of spending. In the case of Argentina and República Bolivariana de Venezuela, which account for 38 percent of regional energy exporters' GDP, these factors will be compounded by mounting capacity constraints and even sharper reductions in public spending. Excluding these countries, the moderation in growth is much less pronounced: the pace of output expansion is likely to decline from 4.1 percent in 2007 to 3.8 percent in 2010.

Metal exporters are likely to experience a similar falloff in growth, easing from 5.7 percent in 2007 to 4.7 percent by 2010. Most of the reduction in the pace of economic activity is anticipated to take place in 2008, when growth slows to 4.8 percent. And growth among agriculture exporters (excluding Argentina) is also likely to slow, from 6 percent in 2007 to 4 percent in 2008, with further deceleration to 3.9 percent by 2010. If Argentina is included in the group, the slowdown is much more pronounced: growth falls from 8.1 percent in 2007 to 4.4 percent in 2010.

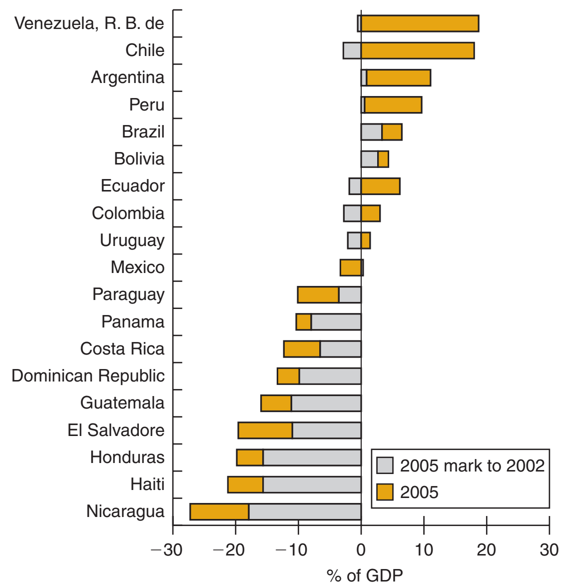
Growth among small energy importers (excluding Brazil and Chile) is likely to fall off significantly, from 7.4 percent in 2007 to 5.1 percent in 2008, and then ease further to 4.8 percent by 2010. This slowing is largely due to a return to more sustainable growth rates in the Dominican Republic, Panama, Peru, and Uruguay, all of which have enjoyed record or near-record growth during 2007. Despite the slowing of overall growth, the negative contribution of net exports to GDP will ease, reflecting expected moderation in oil prices.

Growth in Brazil is likely to slow in 2008 to 4.6 percent, losing another tenth of a percentage point by 2010. Increasing inflation pressures—the growth in consumer prices is expected to be above 4 percent per year in the forecast period—have caused the central bank to hike the SELIC policy rate in April 2008 and are likely to give pause to future easing of the monetary stance. Furthermore, reduction in global demand will moderate export growth. In Mexico growth is likely to rebound from a relatively weak 2.7 percent in 2008 to 3.5 percent in 2009 and to 3.6 percent in 2010. The deceleration of 2008 is largely the result of a sharp contraction in export growth caused by slowing demand in the United States, already evident in a decline in the monthly manufacturing index compiled by the Mexican Institute of Financial Executives. At the same time, and despite an expected slowing of the inflow of workers' remittances, domestic demand is likely to fall off only slightly, as evidenced by recent increases in the Mexican consumer confidence index (table A.9).

Risks and uncertainties

Despite strong recent performance and improved resilience, there are a number of risks to sustained future growth. Many countries in the region have been riding a wave of high commodity prices, which has buttressed current account surplus positions—and in the case of Chile, has turned a potential deficit into a surplus of 18 percent of GDP (figure A.9). As commodity prices weaken, the surpluses of oil, metal, and agriculture exporters are likely to diminish substantially. In the near to medium term, the combination of falling international interest rates

Figure A.9 Commodity price surge has carried quite different effects across Latin America and the Caribbean



Source: World Bank.

and high food and energy prices also poses a challenge to monetary policy, which has to cope simultaneously with inflationary pressures and appreciating currency. Finally, high food prices create distributive tensions within countries; these are particularly acute for many energy and food importers in Central America and the Caribbean. Resorting to unorthodox measures to mitigate the impacts of the high prices on the consumers presents yet another risk. A preferred mechanism, although not available to all countries, would be to expand the existing cash transfer systems to compensate the most vulnerable.

While many exporters in the region have capitalized on the benefits of high commodity prices, the region has been less successful in exploiting the opportunities of the changing global trade landscape. As shown in figure A.10, the region has not taken advantage of China's rising share in global imports, a factor that is likely to be particularly important in the next several years as import demand in the high-income countries wanes and global trade growth comes to slow substantially. This observation highlights one of the region's remaining vulnerabilities, namely, its low level of integration with the rest of the developing world. This is especially significant for countries such as Mexico whose trade dependency on the United

Table A.9 Latin America and the Caribbean country forecasts

annual percentage change unless indicated otherwise

					Forecast		
Country/indicator	1991–2000[a]	2005	2006	2007	2008	2009	2010
Argentina							
GDP at market prices (2000 $)[b]	4.5	9.2	8.5	8.7	6.9	5.0	4.5
Current account bal/GDP (%)	−3.1	2.8	3.5	2.8	2.2	1.2	0.6
Antigua and Barbuda							
GDP at market prices (2000 $)[b]	3.3	5.3	11.5	7.0	5.3	5.4	5.6
Current account bal/GDP (%)	−6.0	−8.8	−15.2	−15.1	−16.5	−16.4	−14.9
Belize							
GDP at market prices (2000 $)[b]	5.9	3.1	5.6	3.0	2.8	2.8	2.9
Current account bal/GDP (%)	−7.3	−14.5	−1.9	−3.3	−3.1	−5.3	−5.8
Bolivia							
GDP at market prices (2000 $)[b]	3.8	4.1	4.5	4.2	4.1	4.1	4.2
Current account bal/GDP (%)	−6.1	6.6	11.4	10.6	15.2	12.7	11.0
Brazil							
GDP at market prices (2000 $)[b]	2.7	3.2	3.8	5.4	4.6	4.4	4.5
Current account bal/GDP (%)	−2.1	1.8	1.5	0.3	−0.4	−1.0	−0.6
Chile							
GDP at market prices (2000 $)[b]	6.4	5.7	4.0	5.1	4.6	5.0	5.2
Current account bal/GDP (%)	−2.7	1.2	5.5	4.3	2.8	1.8	0.9
Colombia							
GDP at market prices (2000 $)[b]	2.5	4.7	6.8	7.5	5.4	5.0	4.8
Current account bal/GDP (%)	−1.9	0.7	−2.3	−3.1	−1.4	−1.4	−3.1
Costa Rica							
GDP at market prices (2000 $)[b]	5.2	5.9	8.2	6.7	4.0	4.8	5.0
Current account bal/GDP (%)	−3.6	−4.8	−4.8	−5.5	−6.6	−6.4	−5.3
Dominica							
GDP at market prices (2000 $)[b]	1.8	3.1	4.1	3.2	3.1	3.0	6.5
Current account bal/GDP (%)	−14.6	−32.6	−23.1	−20.7	−26.1	−29.1	−23.1
Dominican Republic							
GDP at market prices (2000 $)[b]	6.0	9.3	10.7	8.5	5.2	4.5	4.8
Current account bal/GDP (%)	−3.2	−1.9	−2.5	−3.8	−6.8	−5.5	−4.9
Ecuador							
GDP at market prices (2000 $)[b]	1.8	4.7	4.1	1.9	2.5	2.6	2.5
Current account bal/GDP (%)	−2.3	0.8	3.6	2.2	6.1	5.0	3.6
El Salvador							
GDP at market prices (2000 $)[b]	4.6	2.8	4.2	4.2	2.0	2.5	2.8
Current account bal/GDP (%)	−2.0	−5.4	−4.7	−6.0	−8.4	−7.5	−7.3
Guatemala							
GDP at market prices (2000 $)[b]	4.1	3.2	5.0	5.7	2.8	3.5	3.4
Current account bal/GDP (%)	−4.6	−4.5	−4.4	−5.2	−7.7	−7.1	−6.3
Guyana							
GDP at market prices (2000 $)[b]	4.9	−1.9	4.7	5.5	3.7	3.5	3.4
Current account bal/GDP (%)	−15.1	−12.0	−11.2	−4.9	−5.5	−2.0	−1.9
Honduras							
GDP at market prices (2000 $)[b]	3.3	6.1	6.3	6.3	3.1	4.4	4.7
Current account bal/GDP (%)	−7.7	−1.6	−5.2	−10.9	−15.5	−12.8	−12.0
Haiti							
GDP at market prices (2000 $)[b]	−1.3	1.8	2.3	3.5	3.8	4.0	4.0
Current account bal/GDP (%)	−1.7	−6.4	−7.6	−1.8	−11.3	−12.4	−13.1
Jamaica							
GDP at market prices (2000 $)[b]	1.9	1.8	2.5	1.2	1.4	2.4	2.6
Current account bal/GDP (%)	−2.7	−11.4	−10.9	−11.7	−14.0	−16.0	−15.7
Mexico							
GDP at market prices (2000 $)[b]	3.5	2.8	4.8	3.3	2.7	3.5	3.6
Current account bal/GDP (%)	−3.7	−0.7	−0.3	−0.8	−0.8	−1.0	−1.3
Nicaragua							
GDP at market prices (2000 $)[b]	3.4	3.1	3.7	3.5	2.2	2.7	3.0
Current account bal/GDP (%)	−28.7	−15.8	−16.4	−17.7	−20.5	−20.5	−17.7

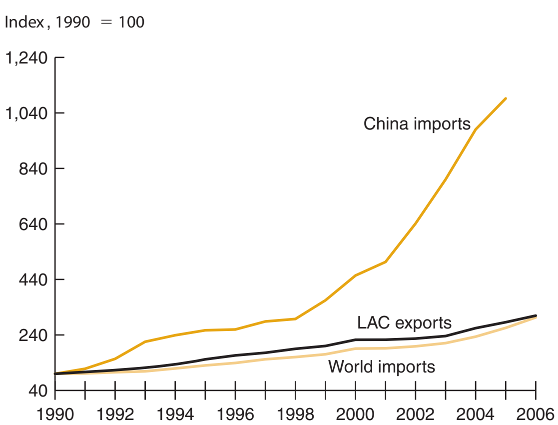
(*Continues*)

Table A.9 (*Continued*)

Country/indicator	1991–2000[a]	2005	2006	2007	2008 (Forecast)	2009 (Forecast)	2010 (Forecast)
Panama							
GDP at market prices (2000 $)[b]	5.1	6.9	8.1	11.2	7.8	6.7	6.5
Current account bal/GDP (%)	−4.8	−4.9	−2.2	−5.4	−6.6	−7.6	−8.3
Peru							
GDP at market prices (2000 $)[b]	4.0	6.7	7.6	9.0	7.0	6.4	5.9
Current account bal/GDP (%)	−5.5	1.6	3.2	1.4	0.7	−0.5	−1.9
Paraguay							
GDP at market prices (2000 $)[b]	1.8	2.7	4.0	6.0	4.2	3.8	3.7
Current account bal/GDP (%)	−2.2	0.5	−1.9	−3.1	−2.9	−2.5	−2.1
St. Lucia							
GDP at market prices (2000 $)[b]	3.1	5.8	5.7	4.0	4.4	4.8	5.0
Current account bal/GDP (%)	−11.4	−22.5	−23.4	−21.4	−22.4	−23.1	−22.9
St. Vincent and the Grenadines							
GDP at market prices (2000 $)[b]	3.1	1.5	4.5	5.5	6.3	5.9	5.8
Current account bal/GDP (%)	−18.8	−24.3	−25.9	−24.8	−25.2	−21.8	−17.3
Uruguay							
GDP at market prices (2000 $)[b]	3.0	6.8	7.0	7.4	4.6	4.1	3.8
Current account bal/GDP (%)	−1.5	0.1	−2.3	−0.7	−1.9	−2.2	−2.3
Venezuela, RB							
GDP at market prices (2000 $)[b]	2.1	10.3	10.3	8.4	5.0	3.4	3.0
Current account bal/GDP (%)	2.6	18.0	14.0	7.5	8.1	6.2	4.3

Source: World Bank.
Notes: Growth and current account figures presented here are World Bank projections and may differ from targets contained in Bank documents. Barbados, Cuba, Grenada, and Suriname are not forecast owing to data limitations.
a. Growth rates over intervals are compound averages; growth contributions, ratios, and the GDP deflator are averages.
b. GDP is measured in constant 2000 $.

Figure A.10 Exporters in Latin America and the Caribbean have not capitalized on growing demand from China



Source: World Bank.

States is very high. Notwithstanding the negative aspects of this lack of market diversification, the region is still benefiting from growth in China through higher foreign investments and terms-of-trade gains.

An additional danger to continued strong growth lies in the signs of potential overheating, which is manifested in rising inflation in many countries in the region. The median GDP deflator for the region, already high at 9.9 percent in 2006, increased to an estimated 10 percent in 2007. Although a significant portion of that inflation has been imported, strong growth, rising remittance inflows, and less restrictive monetary positions (particularly in Argentina and República Bolivariana de Venezuela) have played a large role in building inflationary pressures. Such pressure may undermine the possibility of a countercyclical monetary policy, while constraining the margin for maneuver of fiscal policy. For many countries the structural government balance has not improved in line with the nominal balance. Indeed some governments may find themselves in a difficult situation when revenues from beneficial terms of trade abruptly disappear.