Latin America and the Caribbean regional prospects

Recent developments

Economic activity in Latin America and the Caribbean picked up during the course of 2006 and for the region as a whole GDP is expected to increase by 5 percent (table A.5). The faster growth reflects favorable international conditions, with low interest rates, high commodity prices and strong import demand, and a relaxation of monetary policy in Brazil and Mexico, two of the region's largest economies. Despite tensions building up in some countries, notably Argentina and República Bolivariana de Venezuela, the overall picture is a healthy one, with strong growth in historical perspective, average inflation in single digits, and, on average, modest fiscal and current account surpluses.

In Mexico, GDP was up 5.1 percent (year-over-year) in the first half of 2006 as lower interest rates boosted domestic demand and construction activity. Stronger exports of cars to the United States and oil exports also contributed. For the year as a whole 4.5 percent growth is expected, 1.5 percentage points higher than in 2005. Lower interest rates also supported a 3.5 percent increase in Brazilian GDP during the first half of the year, which is also expected to be the growth outcome for the year as a whole, implying a 1.2 percentage point acceleration. Nevertheless, growth in Brazil is being held back by real interest rates that remain in excess of 10 percent and the resulting strong currency, which keeps export growth restrained.

Growth has slowed but remains extremely high in both Argentina and República Bolivariana de Venezuela, where GDP is expected to increase by an unsustainable 7.7 and 8.5 percent, propelled by 8.3 and 12.3 percent increases in domestic demand, respectively. Notwithstanding the deep recessions each country experienced in 2002–03, output gaps

Table A.5 Latin America and the Caribbean forecast summary

Annual percent change (unless otherwise indicated)

					Estimate	Forecast	
	1991–2000[a]	2003	2004	2005	2006	2007	2008
GDP at market prices (2000 US$)[b]	2.9	2.0	6.0	4.5	5.0	4.2	4.0
GDP per capita (units in US$)	1.4	0.5	4.5	3.1	3.7	2.8	2.7
PPP GDP[c]	3.5	2.1	5.6	4.3	4.9	4.1	4.0
Private consumption	2.5	2.5	5.3	4.7	5.0	3.8	3.6
Public consumption	1.5	5.9	0.9	3.4	3.3	1.9	1.1
Fixed investment	5.2	−3.2	14.6	7.7	9.0	8.1	6.9
Exports, GNFS[d]	7.4	2.7	12.4	7.8	6.2	5.7	6.8
Imports, GNFS[d]	8.9	2.0	14.4	11.3	9.0	7.6	7.2
Net exports, contribution to growth	−0.6	1.6	1.3	0.6	−0.1	−0.6	−0.7
Current account balance/GDP (%)	−2.8	0.5	1.0	1.6	1.9	1.4	1.0
GDP deflator (median, LCU)	10.1	7.2	8.3	9.1	7.3	6.1	6.1
Fiscal balance/GDP (%)		−0.1	0.2	0.2	0.7	0.1	−0.4
Memo items: GDP							
Latin Amer. & the Carib., excluding Argentina	2.8	1.0	5.5	3.8	4.6	3.9	4.0
Caribbean	3.1	3.2	2.5	6.5	7.6	5.0	4.8
Central America	3.1	1.6	4.3	3.2	4.5	3.6	3.6
Argentina	3.3	8.8	9.0	9.2	7.7	5.6	4.0
Brazil	2.6	0.5	4.9	2.3	3.5	3.4	3.8
Mexico	3.0	1.4	4.4	3.0	4.5	3.5	3.5

Source: World Bank.

a. Growth rates over intervals are compound averages; growth contributions, ratios, and the GDP deflator are averages.
b. GDP is measured in constant 2000 U.S. dollars.
c. GDP is measured at PPP exchange rates.
d. Exports and imports of goods and nonfactor services.

have been eliminated and demand is estimated to exceed domestic supply by some 3.3 and 1.9 percent, respectively. Reflecting this imbalance between domestic demand and supply, current account balances in both countries have deteriorated, although they are expected to remain in surplus (2.2 and 17.1 percent of GDP, respectively) in 2006.

In these conditions, inflation has picked up and exceeds 10 percent in each country. In the case of Argentina, this surge has occurred despite price freezes in a number of sectors that have had negative consequences for sectoral investment and supply. In República Bolivariana de Venezuela, supply-side constraints have been magnified because reductions in investment by the state-owned oil company and by private oil firms (discouraged by the government's antibusiness posturing, high taxes, and royalties) have contributed to a decline in oil production.

Other countries in the region are also growing rapidly. GDP growth in Chile, Colombia, and Peru has slowed but is estimated to have remained robust at 5 percent this year. In Central America, high prices for the region's export crops and strong remittances inflows have partly offset the income effects of high energy prices. This, plus increased foreign and domestic investment inflows following the passage of free trade agreements with the United States, underpinned the estimated 4.5 percent increase of GDP in Honduras during 2006, and the 4.1 percent expansion in Guatemala. Strong growth and higher oil prices have been associated with deteriorations in current account balances, which exceed 4 percent of GDP in Costa Rica, Guatemala, and Panama. Although public debt levels remain high in many Central American countries and debt-servicing charges remain a burden on the government accounts, increased multilateral aid, debt relief, and growing flows of remittances have boosted international reserves and reduced the risk of currency instability.

Growth among Caribbean countries has benefited from strong FDI inflows into the tourism and mining sectors, a recovery of nontraditional exports, and a much less destructive hurricane season compared with 2005. Growth in Jamaica is expected to be about 3 percent, a marked improvement from results in the 1990s. Output in the Dominican Republic is estimated to have increased by 8.5 percent as the economy rebounds from the 2003 currency crisis. Reflecting this strong growth and despite tighter monetary policy, inflation is on a rising trend, which, together with an electricity crisis, is hurting the country's competitiveness and has contributed to an estimated 2.8 percent of GDP deterioration in its current account balance in 2006. Trinidad and Tobago has enjoyed strong growth in recent years owing to high energy prices and rapidly rising investment levels. Growth is estimated to have accelerated further to 12 percent in 2006, but price pressures are emerging and inflation is expected to reach 7.9 percent.

Uncertainty from elections and the future path of U.S. interest rate policy contributed to financial market volatility in the spring of 2006. The currencies of a number of countries depreciated, following earlier appreciations in some cases (Brazil and Colombia). Stock markets also underwent a major correction. However, the improved fiscal stance and reduced indebtedness of countries meant that the region was not particularly affected by this episode—and risk premia, after rising somewhat, have once again declined and are currently just 20 points above their historical minima (see figure A.5).

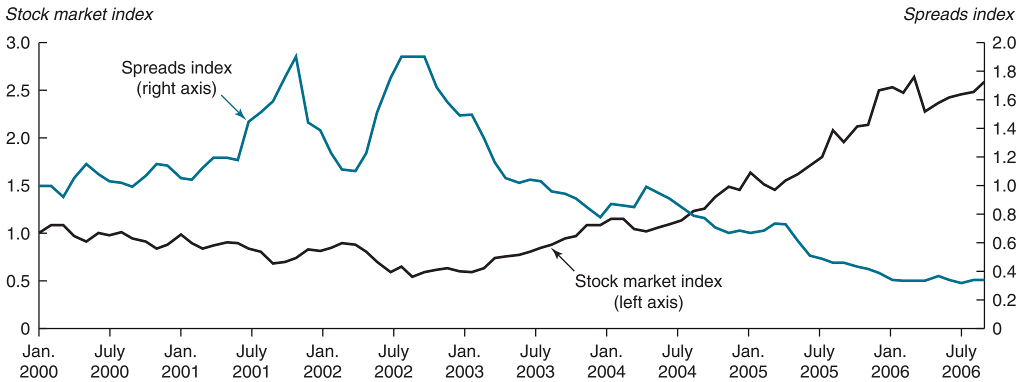
Outlook

An end to the rising trend and even a decline in the prices of the region's main commodity exports, slower import demand from the United States, capacity constraints, and a return to more sustainable growth rates in some of the region's fastest-growing economies are projected to cause regional growth to decline to about 4 percent by 2008.

Most of the deceleration reflects slower growth in Argentina and República Bolivariana de Venezuela. When those two countries are excluded, the expansion in the rest of the

Figure A.5 Spring financial market turbulence was temporary

Financial markets in Latin America



Source: Datastream.

Table A.6 Main Latin America and the Caribbean region stock market index returns

Percent changes

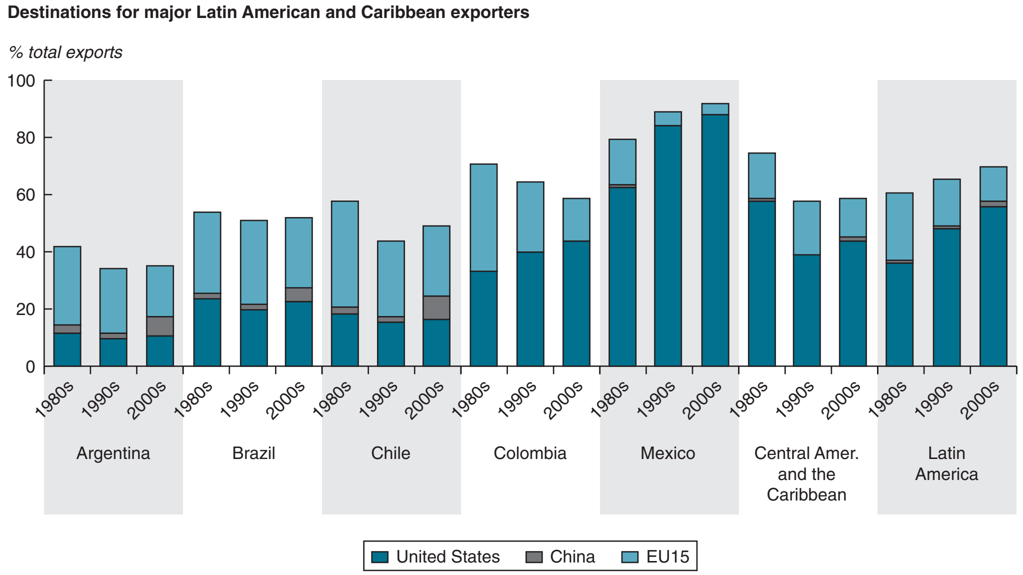
Country	January–July 2006	May 2006
Argentina	4.4	−13.5
Brazil	4.2	−9.5
Chile	3.8	−2.1
Mexico	3.6	−9.6
Peru	80.7	1.0
Venezuela, R. B. de	55.3	−3.0

Source: World Bank; DataStream.

region is projected to moderate by only 0.7 percentage points. In Argentina, tighter monetary policy, increased leakages, and slowing investment demand as high domestic costs squeeze profits are expected to contribute to a slowing of growth to about 4 percent by 2008, which is nevertheless well above that country's trend growth rate. Growth in República Bolivariana de Venezuela is projected to ease to about 5.5 percent by 2008, partly because the contribution of government spending to increased demand will fall, both because falling oil prices and stagnant production will reduce revenues and because to make the same contribution, spending would have to continue to increase by about 14 percent annually as it has over the past several years. In addition, as in Argentina, strong domestic inflation, rapidly rising wages, domestic capacity constraints and rising leakages are projected to slow the pace of production and contribute to a 9.5 percent of GDP reduction in República Bolivariana de Venezuela's current account surplus.

The slowdown is expected to be less marked elsewhere in the region. Weaker import demand in the United States in 2007 will affect many economies in the region (see figure A.6), notably Mexico where growth is projected to fall to 3.5 percent. The outlook for Brazil is slightly brighter, partly because the external economy is less closely tied to U.S. imports. While export growth is projected to slow, it will remain relatively robust thanks to continued strong demand from emerging Asian economies. At the same time, lower domestic interest rates should contribute to a pickup in investment in 2007. Similar factors, including the recent implementation of a free trade agreement with China, will support continued robust growth in Chile. Output in a number of Caribbean countries (including Dominica and St. Vincent and the Grenadines) is projected to weaken in line with reduced sugar and banana production following disappointing outcomes from negotiations

Figure A.6 Among Latin American and Caribbean countries, Mexico is the most dependent on U.S. imports



Source: World Bank.

with the European Union over the Economic Partnership Agreement. In other countries, these effects may be countered by further improvements in the mining and financial service sectors (Barbados, Trinidad and Tobago) or tourism (St. Kitts and Nevis, St. Lucia). With the recent swearing in of a new democratically elected legislature and the prospects of consolidating the improvements in the political and security situation, Haiti should experience a mild economic recovery with GDP growth of 2.7 percent in 2007.

Overall, weaker commodity prices and strong domestic demand are expected to contribute to a deterioration in the region's current account balance from a surplus of 1.9 percent of GDP in 2006 to about 1 percent by 2008.

Risks and policy challenges

The outlook is subject to a number of uncertainties. On the upside, the relatively gradual slowdown projected for Argentina and República Bolivariana de Venezuela may not materialize. Should domestic demand continue to expand at excessive rates, inflationary pressures would likely build and current account positions would deteriorate even more quickly than projected. Such a scenario would increase the likelihood of a hard landing, including much higher interest rates and the possibility, in the case of Argentina, of a significant further currency depreciation.

Elsewhere in the region, downside risks predominate. Given the relative importance of the United States as a destination for regional exports, the region would be particularly sensitive to a more serious-than-projected downturn in the United States, such as might follow a sharp decline in housing prices. Such a scenario would likely have both direct impacts in the form of reduced export demand and significant indirect impacts as slower U.S. and global growth would likely also cause commodity prices to ease more quickly than projected, reducing regional incomes and current account balances by more than would have been expected otherwise. For oil-importing countries the impact of lower oil prices might offset the reduced export prices, but for oil exporters and other commodity-rich countries the overall negative impact could be large.

A second persistent risk for the region stems from the possibility of a disorderly resolution of global imbalances. This could have effects similar to a housing-price-induced slowdown, but would likely be combined with higher interest rates and rising risk premia, raising the costs for highly indebted countries in the region. While improved fundamentals, including reduced debt exposure and relatively liquid positions following the prefinancing of 2007 debt requirements, should insulate many countries in the region from the most severe potential consequences of a sharp reversal in interest rate trends, such an outturn could have serious consequences for countries where debt ratios remain high (Argentina, Chile, Colombia, Jamaica, Panama, Paraguay, Peru, and Uruguay).

Table A.7 Latin America and the Caribbean country forecasts

Annual percent change (unless otherwise indicated)

					Estimate	Forecast	
	1991–2000[a]	2003	2004	2005	2006	2007	2008
Antigua and Barbuda							
GDP at market prices (2000 US$)[b]	3.1	4.9	5.2	5.0	7.1	3.9	4.1
Current account balance/GDP (%)	−5.3	−10.1	−18.7	−15.9	−20.4	−18.4	−16.7
Argentina							
GDP at market prices (2000 US$)[b]	3.3	8.8	9.0	9.2	7.7	5.6	4.0
Current account balance/GDP (%)	−3.1	6.2	1.9	2.7	2.2	1.4	0.9
Belize							
GDP at market prices (2000 US$)[b]	4.8	9.4	4.6	3.1	2.6	2.6	3.3
Current account balance/GDP (%)	−7.2	−20.3	−17.6	−18.5	−18.8	−24.9	−24.9
Bolivia							
GDP at market prices (2000 US$)[b]	3.2	2.8	3.6	4.1	3.1	3.1	3.2
Current account balance/GDP (%)	−6.1	0.8	3.5	5.2	5.3	4.0	3.9
Brazil							
GDP at market prices (2000 US$)[b]	2.6	0.5	4.9	2.3	3.5	3.4	3.8
Current account balance/GDP (%)	−2.1	0.8	2.0	1.9	1.4	1.1	0.8
Chile							
GDP at market prices (2000 US$)[b]	5.6	3.7	6.1	6.3	5.0	5.3	5.3
Current account balance/GDP (%)	−2.8	−1.5	1.7	0.6	3.5	2.7	2.0
Colombia							
GDP at market prices (2000 US$)[b]	2.3	4.1	4.8	5.1	4.7	4.2	4.0
Current account balance/GDP (%)	−1.9	−1.2	−1.0	−1.9	−2.3	−3.0	−3.7
Costa Rica							
GDP at market prices (2000 US$)[b]	5.0	6.5	4.1	5.9	5.0	4.6	4.1
Current account balance/GDP (%)	−3.6	−5.3	−4.6	−4.9	−5.7	−4.1	−4.4
Dominica							
GDP at market prices (2000 US$)[b]	1.8	0.0	3.6	2.4	3.0	3.0	3.0
Current account balance/GDP (%)	−16.3	−19.5	−23.0	−23.2	−24.2	−24.5	−24.0
Dominican Republic							
GDP at market prices (2000 US$)[b]	5.9	−0.4	2.0	9.3	8.5	5.5	5.0
Current account balance/GDP (%)	−3.2	6.3	5.3	−0.4	−3.2	−4.1	−3.6
Ecuador							
GDP at market prices (2000 US$)[b]	1.3	2.7	7.9	4.7	3.5	3.0	3.0
Current account balance/GDP (%)	−2.3	−1.7	−0.9	−0.3	0.7	−1.1	−2.7
El Salvador							
GDP at market prices (2000 US$)[b]	4.2	1.8	1.5	2.8	3.2	3.1	3.1
Current account balance/GDP (%)	−2.0	−5.1	−3.9	−4.4	−5.7	−4.7	−4.3

(*continued*)

Table A.7 (*continued*)

Annual percent change (unless otherwise indicated)

					Estimate	Forecast	
	1991–2000[a]	2003	2004	2005	2006	2007	2008
Guatemala							
GDP at market prices (2000 US$)[b]	3.7	2.1	2.7	3.2	4.1	4.0	4.0
Current account balance/GDP (%)	−4.6	−4.2	−4.3	−4.4	−4.1	−4.0	−3.4
Guyana							
GDP at market prices (2000 US$)[b]	4.3	−0.6	1.6	−3.0	3.5	3.3	3.6
Current account balance/GDP (%)	−19.9	−6.3	−8.9	−19.9	−26.1	−22.3	−15.4
Honduras							
GDP at market prices (2000 US$)[b]	3.0	3.5	4.6	4.2	4.5	4.5	4.0
Current account balance/GDP (%)	−7.7	−4.6	−5.3	−0.5	−1.5	−1.3	−1.2
Haiti							
GDP at market prices (2000 US$)[b]	−1.7	0.4	−3.8	1.5	2.5	2.7	3.0
Current account balance/GDP (%)	−1.6	−0.4	0.4	0.7	−1.2	−1.4	−1.5
Jamaica							
GDP at market prices (2000 US$)[b]	0.7	2.3	0.9	2.0	3.0	3.5	3.0
Current account balance/GDP (%)	−2.7	−9.4	−5.8	−8.8	−10.4	−8.4	−5.0
Mexico							
GDP at market prices (2000 US$)[b]	3.0	1.4	4.4	3.0	4.5	3.5	3.5
Current account balance/GDP (%)	−3.7	−1.4	−1.0	−0.6	0.1	−0.2	0.4
Nicaragua							
GDP at market prices (2000 US$)[b]	3.4	2.3	5.1	4.0	3.7	4.2	4.6
Current account balance/GDP (%)	−28.6	−18.1	−18.7	−18.8	−18.1	−19.4	−19.9
Panama							
GDP at market prices (2000 US$)[b]	4.1	4.3	7.6	6.4	6.3	5.7	5.5
Current account balance/GDP (%)	−4.8	−3.9	−7.8	−5.2	−4.6	−5.0	−6.2
Peru							
GDP at market prices (2000 US$)[b]	3.7	4.0	4.8	6.7	6.6	5.5	5.0
Current account balance/GDP (%)	−5.5	−1.5	0.0	1.4	1.1	0.5	−0.4
Paraguay							
GDP at market prices (2000 US$)[b]	1.7	2.6	4.1	3.0	3.2	3.0	3.1
Current account balance/GDP (%)	−2.0	2.2	0.3	−0.2	−0.3	−0.4	−0.3
St. Kitts and Nevis							
GDP at market prices (2000 US$)[b]	4.1	2.1	6.4	4.9	3.7	4.0	4.1
Current account balance/GDP (%)	−18.8	−51.8	−24.4	−21.6	−21.0	−20.0	−20.0
St. Lucia							
GDP at market prices (2000 US$)[b]	2.4	3.0	4.0	5.4	5.5	3.4	3.3
Current account balance/GDP (%)	−11.3	−18.6	−13.0	−25.2	−15.3	−10.0	−10.0
St. Vincent and the Grenadines							
GDP at market prices (2000 US$)[b]	2.0	4.5	4.3	4.9	4.3	4.1	4.2
Current account balance/GDP (%)	−19.0	−15.5	−19.4	−23.6	−24.3	−25.0	−25.8
Trinidad and Tobago							
GDP at market prices (2000 US$)[b]	2.9	13.2	6.5	7.0	12.0	6.2	6.5
Current account balance/GDP (%)	0.2	9.4	15.4	18.9	23.2	17.2	17.3
Uruguay							
GDP at market prices (2000 US$)[b]	2.7	2.5	12.3	6.6	5.5	4.4	3.8
Current account balance/GDP (%)	−1.5	−0.5	0.3	−0.5	−1.7	−2.2	−2.5
Venezuela, R. B. de							
GDP at market prices (2000 US$)[b]	1.1	−7.7	17.9	9.3	8.5	6.0	5.5
Current account bal/GDP (%)	2.6	13.7	12.6	18.1	17.1	12.6	7.6

Source: World Bank.

Note: Growth and current account figures presented here are World Bank projections and may differ from targets contained in other 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 U.S. dollars.