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Latin America and the Caribbean: economic situation and outlook, 2006-2007

Summary

With an economic growth rate in 2006 of 5.6 per cent, the Latin American and Caribbean region marked up its third consecutive year of growth at rates of over 4 per cent. The international environment remained favourable, and the volume of goods and services exports was up by 8.4 per cent for the region as a whole. In addition, higher prices for the region's main export products translated into an improvement in its terms-of-trade equivalent to over 7 per cent. As a result of these gains in earnings, together with increased remittances from abroad, the rise in national income (7.3 per cent) again exceeded gross domestic product (GDP) growth.

These regional averages, however, mask stark differences between countries and subregions. Faster worldwide growth boosted external demand for exporters of natural resources, especially in South America, and for petroleum-exporting countries. Economic expansion is expected to slow slightly in 2007, with the regional GDP growth rate projected at 4.8 per cent. If those projections are borne out, the region's per capita GDP will show an increase of about 15 per cent for 2003-2007, which is equivalent to 3.6 per cent per year.

* E/2007/100.

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I. Introduction

1. The Latin American and Caribbean region posted a gross domestic product (GDP) growth rate of 5.6 per cent in 2006, equal to a 4.1 per cent rise in per capita GDP. Thus, 2006 was the fourth consecutive year of positive growth and the third at over 4 per cent, after the average annual rate of 2.2 per cent recorded from 1980 to 2002. The figure would have been even higher had it not been for sluggish growth in the past few years in the region's two largest economies, Brazil and Mexico, which together represent 60 per cent of the region's GDP. Economic expansion is expected to slow slightly in 2007, with the regional GDP growth rate projected at 4.8 per cent. If the projections are borne out, the region's per capita GDP will show an increase of about 15 per cent for 2003-2007, which is equivalent to 3.6 per cent per year (see table).

Rates of variation in gross domestic product

(Millions of United States dollars at constant 2000 prices)

Country	*2004*	*2005*	*2006*
Argentina	9.0	9.2	8.5
Bolivia	3.9	4.1	4.6
Brazil	5.7	2.9	3.7
Chile	6.0	5.7	4.0
Colombia	4.9	5.2	6.8
Costa Rica	4.1	5.9	7.9
Cuba[a]	4.5	11.8	12.5
Dominican Republic	2.7	9.2	10.7
Ecuador	7.9	4.7	4.1
El Salvador	1.8	2.8	4.2
Guatemala	2.7	3.2	4.6
Haiti	-3.5	1.8	2.3
Honduras	5.0	4.1	5.6
Mexico	4.2	3.0	4.8
Nicaragua	5.1	4.0	3.7
Panama	7.5	6.9	8.1
Paraguay	4.1	2.9	4.0
Peru	5.2	6.4	8.0
Uruguay	11.8	6.6	7.0
Venezuela (Bolivarian Republic of)	17.9	9.3	10.3
Latin America[b]	**6.2**	**4.6**	**5.5**
Caribbean	**3.8**	**4.9**	**7.0**
Latin America and the Caribbean[b]	**6.2**	**4.6**	**5.6**

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

[a] Data supplied by the National Statistical Office of Cuba.

[b] Excluding Cuba.

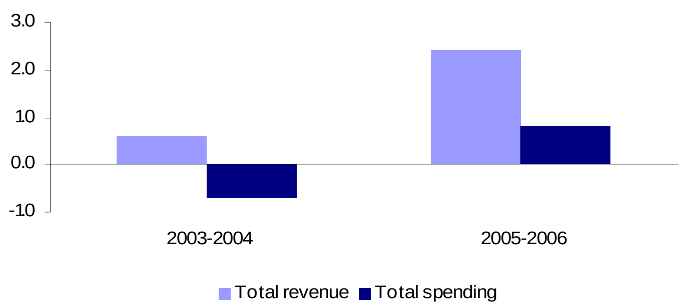
2. The performance of the economies of Latin America and the Caribbean has not come about in isolation, but is rather part of a picture of widespread growth throughout the world economy. Although the region's growth rates are high from a recent historical standpoint, they fall short of the rates being attained by other parts of the developing world (with the exception of sub-Saharan Africa).

3. It is important to note that, thanks to favourable external conditions and the implementation of macroeconomically sustainable domestic policies, the region's economic growth has been accompanied by a rising current-account surplus and a gradual strengthening of public accounts. Although these developments are reducing the region's vulnerability to external shocks, the situation varies substantially from one country to another, as will be discussed below.

II. Economic policy

4. The countries of the region continued to consolidate their fiscal positions in 2006, as they had been doing over the previous few years. Although much of that growth was due to positive developments in the international economy, fiscal management in a number of countries reflects an interest in pursuing a more solvent macroeconomic policy, as evidenced in the management of budget surpluses and public debt.

Figure I
Latin America and the Caribbean: variations in central Government revenues and spending
(Percentage of GDP)

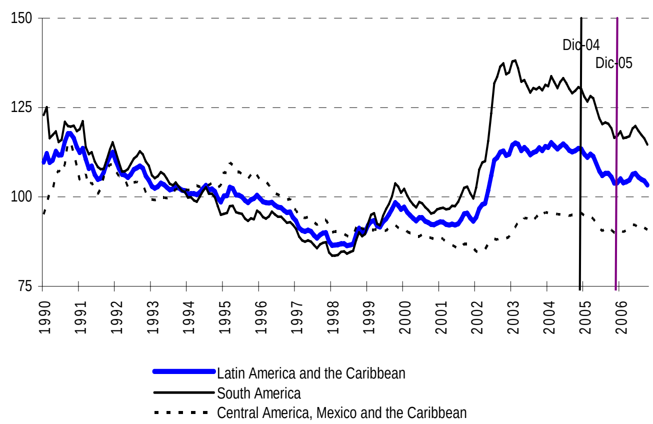


Source: ECLAC, on the basis of official figures.

5. At the level of central Governments, the region's fiscal performance yielded a primary surplus of 2.1 per cent of GDP (measured as a simple average) by the close of 2006, as compared with a surplus of 1.4 per cent in 2005, while the overall deficit (including interest on the public debt) narrowed from 1.1 per cent to 0.3 per cent of GDP (see figure I). This increase in fiscal revenue in countries throughout the region, with resources increasing by over 1 per cent of GDP in 2006 for the second year running (which was unprecedented in the period 1990-2004), was mainly driven by higher revenues in some of the countries that specialize in non-renewable commodities.

6. The increase in fiscal resources in those countries was the result not just of higher prices for commodities but also of the introduction of new tax-raising measures. Bolivia, Chile and Venezuela (Bolivarian Republic of) created new taxes to draw higher revenues from their non-renewable resources. As a result of the reforms and positive price movements, tax systems have come to depend more on resources derived from the exploitation of non-renewable commodities. Meanwhile, the entry into force of the Dominican Republic-Central America-United States Free Trade Agreement had adverse effects on the tax revenues of participating countries. To offset that loss, El Salvador, Guatemala and Panama implemented tax reforms, which led to higher revenues in 2006.

Figure II
Extraregional real effective exchange rate
(Index base period January 1990-December 1999 = 100)



Source: ECLAC, on the basis of official figures.

7. As regards exchange rate policy, in 2006, the extraregional real effective exchange rate of Latin America and the Caribbean, excluding trade with other countries in the region, appreciated on average by 3.3 per cent, with effective appreciation in 15 countries during the period (see figure II). Taken together, the countries of South America recorded an appreciation of 4.8 per cent, while in Central America, Mexico and the Caribbean there was an effective extraregional appreciation of 1 per cent.

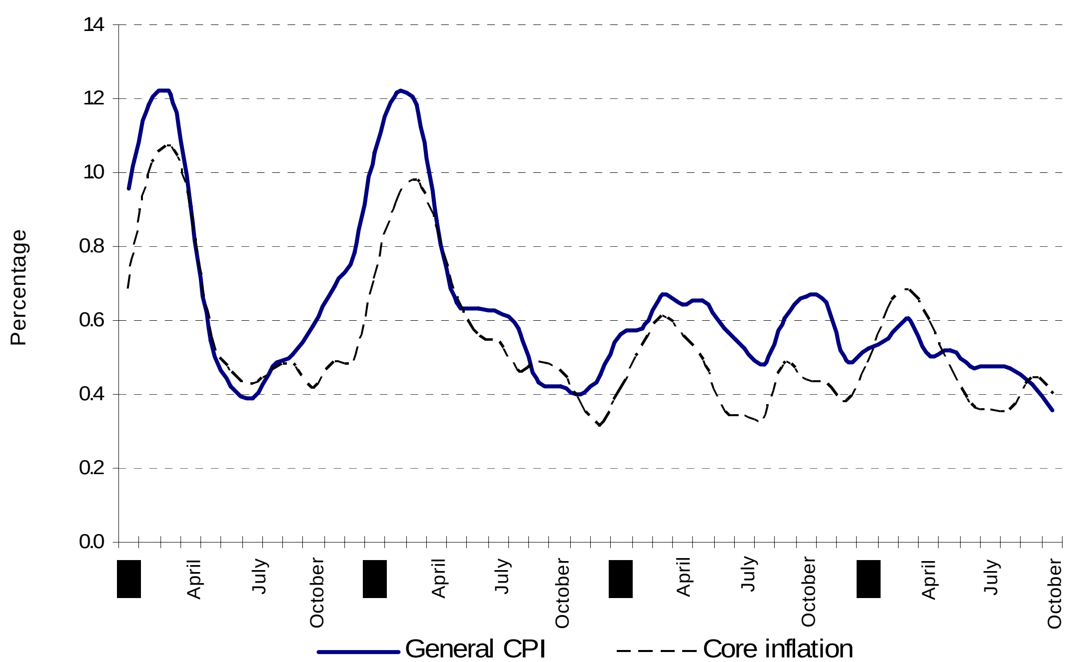
8. It should be noted that, in 2006, as in recent years, the central banks of Latin America concentrated their efforts on inflation control. Regarding monetary policy, the countries of Latin America can be divided into three groups: those that follow an explicit inflation targeting regime or are currently adopting one; those whose monetary policy is guided by other objectives, whether they set targets for international reserves and domestic credit or seek to control some other variable, such as the exchange rate or interest rates; and those that have no monetary policy of their own because their economies are dollarized.

9. The first group comprises Brazil, Chile, Colombia, Mexico, Paraguay and Peru, which use an inflation targeting regime, and Costa Rica, Guatemala and Honduras, which have a target range for inflation and may in future adopt an

inflation targeting regime. The second category includes countries that have agreements with the International Monetary Fund (IMF), such as the Dominican Republic and Nicaragua, and others that have no formal understanding with the Fund, such as Argentina and Bolivia. The last group includes Ecuador, El Salvador and Panama, which have no monetary policy as such because their economies are dollarized and their interest rates consequently vary with international rates. In recent years, inflation in the region has, by historical standards, been subdued (see figure III). In 2006, Latin America and the Caribbean posted an inflation rate, in weighted terms, of 4.8 per cent (6.1 per cent in 2005). This indicator has fallen for the fourth consecutive year from the 2002 level of 12.2 per cent.[1] The behaviour of the consumer price index reflected changes in a number of factors. The appreciation of some national currencies in relation to both the United States dollar and the currencies of other trading partners made imported goods cheaper than domestic products (in the case of manufactures) and reduced the impact of higher international commodity prices on domestic prices.

Figure III
Latin America and the Caribbean: monthly variations in the consumer price index and the core inflation index

(Unweighted three-month moving average)



Source: ECLAC, on the basis of official figures.

[1] A major factor in this result was the fall in the inflation rate of Brazil (3.1 per cent compared with 5.7 per cent in 2005). Other countries that succeeded in lowering their inflation rates include Argentina (from 12.3 to 8.8 per cent), Chile (from 3.7 to 2.5 per cent), Costa Rica (from 14.1 to 9.1 per cent), the Dominican Republic (from 7.4 to 5 per cent), Guatemala (from 8.6 to 5.4 per cent), Haiti (from 14.8 to 10.2 per cent), Honduras (from 7.7 to 5.3 per cent) and Panama (from 3.4 to 2.2 per cent).

10. In both 2005 and 2006, as is shown by the reports of the monetary authorities of Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, Paraguay and Uruguay, higher oil prices in the international market caused prices to rise by more than some central banks had forecast, especially in the region's countries that are net hydrocarbon importers. Given that this rise is the result of a supply factor and may be temporary, before withdrawing monetary stimulus it would be advisable to review economic activity indicators to avert any negative effect on GDP. It should be stressed that the monetary policy of the countries most affected by the oil price rise did not respond to this negative shock.

11. With regard to interbank interest rates, the regional average in December 2006 was 6.5 per cent or, if Brazil is excluded from the sample, 5.9 per cent.[2] This might have been due to a number of factors, especially distortions in financial markets resulting from large reserve requirements, along with the inefficiency of the region's banking sector. Bank lending is more important in Latin America than in economies with deep capital markets. The lending recovery that had begun in 2003 continued in 2006.

III. Domestic performance

12. All the countries posted positive growth rates, in most cases higher than or similar to those of 2005. Chile was the exception, with GDP expansion of 4 per cent over the year (down from 5.7 per cent in 2005). The highest rates were posted in Venezuela (Bolivarian Republic of) (10.3 per cent), the Dominican Republic (10.7 per cent) and Argentina (8.5 per cent). Costa Rica, Panama and Peru grew at rates of about 8 per cent, Uruguay at 7 per cent and Colombia at 6.8 per cent. The lowest figures were for Haiti (2.5 per cent) and Brazil (3.7 per cent). In the rest of the region, GDP growth rates were between 3.5 and 5 per cent.[3] The English- and Dutch-speaking Caribbean countries as a group posted a growth rate of 7 per cent.

13. International economic trends and, in particular, the monetary policy stance of the United States of America, where interest rates rose less than financial markets had forecast at the beginning of the year, together with increased economic activity in the European Union and Japan and the continuing rapid growth of the Asian economies, produced a more favourable situation throughout 2006 than had been forecast at the end of 2005. Thanks to sustained external demand for the region's export commodities, the international prices for them (especially for metals, minerals and hydrocarbons) remained high or even increased further, thus generating higher earnings for the region's countries, especially in South America. The strong expansion of private credit, together with continuing low interest rates in the countries of the region and improved labour-market indicators, boosted domestic demand.

14. In regional terms, in 2006, the volume of goods and services exports expanded (8.4 per cent) at a higher rate than that of GDP, as in 2004 and 2005. Sustained external demand for the countries' export commodities, together with higher levels

[2] The sample includes Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, Honduras, Mexico, Peru, Uruguay and Venezuela (Bolivarian Republic of).

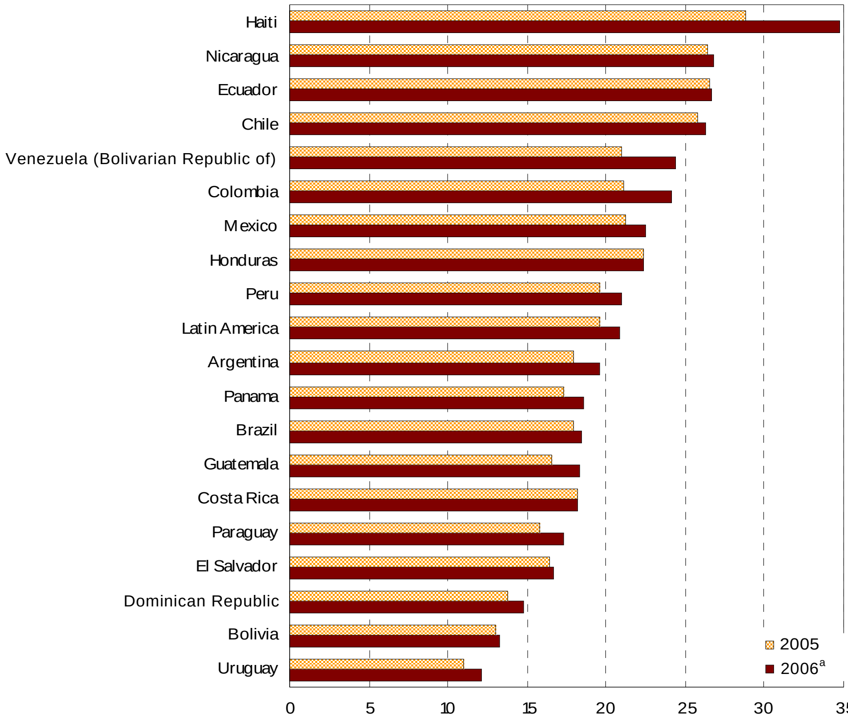
[3] The simple average of GDP growth rates in the Latin American countries was 5.9 per cent and the median was 4.9 per cent (5.1 per cent and 4.7 per cent, respectively, in 2005).

of economic activity and domestic demand for commodities, fuelled intraregional trade in manufactures. The real effective exchange rate has continued to favour exporters in most of the countries, despite the appreciation of some national currencies over the year.

15. In 2006, domestic demand continued its strong performance of 2004 and 2005, posting an increase of 7 per cent (6.2 per cent and 5.5 per cent in 2004 and 2005, respectively), which was driven by a steady rise in gross domestic investment (10.5 per cent) and faster growth in consumption (6 per cent). Some of the factors contributing to the rapid growth in both private consumption and investment were the significant expansion of bank credit to the private sector, thanks to higher domestic-market liquidity, and the maintenance of low lending rates. Although interest rates rose in some countries in 2006, in most they were lower than in 2005, which was a positive factor for both consumption and investment decisions. The appreciation of a number of countries' currencies against the United States dollar in 2005 and 2006 helped to reduce the cost of imported goods, which contributed to the increase in domestic demand. Other factors in the expansion of private consumption (6.3 per cent) were improved labour-market indicators and higher real wages in most countries.

16. Investment growth in 2006 was largely a reflection of the sustained rise in gross fixed capital formation, which has been the fastest-growing component of demand since 2004, expanding at rates of over 10 per cent (see figure IV). In 2006, it was up by 12.2 per cent (13 per cent and 10.7 per cent in 2004 and 2005, respectively), with a cumulative growth of 39.6 per cent in 2004-2006 in relation to values in 2003. The fastest-growing component of gross fixed capital formation was investment in (mostly imported) machinery and equipment, which was up by 14 per cent in 2006, accumulating a 52.8 per cent rise over the period 2004-2006. Investment in construction also continued to expand in 2006, although at more moderate rates of about 9 per cent. Although a part of these increases reflects a return to the investment levels of previous years, the rapid growth seen in 2005 and 2006 was more than enough to exceed previous highs. The volume of goods and services imports grew by 15.1 per cent in 2006, and net exports consequently had an increasingly negative impact on growth for the third consecutive year. The performance of import volumes in 2006 was consistent with the upward trend that this aggregate has shown since 2002.

Figure IV
Latin America: gross fixed capital formation, 2005-2006
(Percentage of GDP, calculated on the basis of constant 2000 United States dollars)



Source: ECLAC, on the basis of official figures.
[a] Estimates.

17. The positive regional performance of the components of demand was reflected in the expansion of various branches of economic activity. Rapid growth in the construction sector was largely responsible for the rise in gross fixed capital formation in countries such as Argentina, Colombia, the Dominican Republic, Mexico, Panama, Peru, Uruguay and Venezuela (Bolivarian Republic of). In the Caribbean countries, the construction sector also showed a notable increase in activity in 2006 owing to the organization of the Cricket World Cup, which included work on stadium renovation and rebuilding, as well as extension and enhancement of tourist infrastructure. Mining and hydrocarbon production grew more slowly than in 2005, except in Bolivia. Higher domestic demand also boosted industry, partly thanks to higher returns in goods-producing sectors as a result of the devaluations of 2002-2003 in Argentina and Uruguay. The depreciation of the United States dollar in relation to other currencies helped to enhance the competitiveness of manufacturing exports in countries whose currencies are anchored to the dollar (Ecuador, El Salvador and Panama). Growth in the agricultural sector, although positive in all countries except Costa Rica and the Dominican Republic, was less than the increase in overall GDP. The transport sector was boosted by the higher level of domestic activity in the countries, and the buoyant international economy also had a positive impact on tourism-related activities. Increased disposable income in a number of Latin American countries, together with the higher overall level of economic

activity, fuelled an increase in both recreational and business travel. In 2006, the number of tourist arrivals was up by 6.1 per cent in Central America, 7.2 per cent in South America and 3.2 per cent in the Caribbean countries.[4]

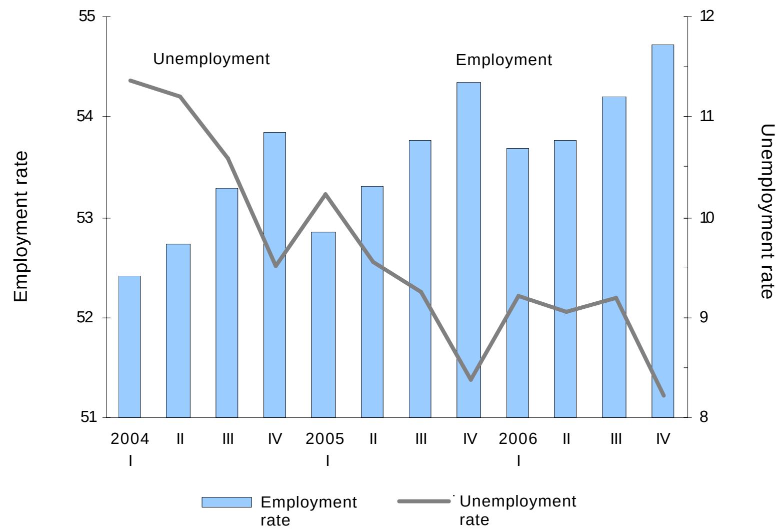
18. One of the characteristics of the current period of economic growth in Latin America is the significant increase in gross national disposable income, which expanded by 7.3 per cent measured in constant 2000 dollars in 2006 (5.9 per cent and 7.1 per cent in 2005 and 2004, respectively).[5] To a large extent, the increase in this aggregate was due to the impact of the trading gains resulting from the terms-of-trade variation recorded in 2006. For the region as a whole, these gains represented about 3.6 per cent of GDP, a higher figure than in 2004 and 2005 (0.4 per cent and 1.7 per cent, respectively). Net factor payments to the rest of the world remained at about 3 per cent of GDP, reflecting the combined effect of lower interest payments on external debt, owing to the decrease in the region's indebtedness to the rest of the world, and the increase in profit and dividend payments to the rest of the world by non-resident enterprises operating in the region. Lastly, the increase in gross national disposable income also reflects rising levels of net current transfers, which were equivalent to 2.2 per cent of GDP in 2006.

19. Together with the considerable increase in gross national disposable income in Latin America, national saving showed significant growth, reaching 23.6 per cent of GDP at current prices, the highest figure since 1990. As has been the case since 2003, in 2006 external saving was increasingly negative, reaching a level equivalent to 1.8 per cent of GDP. Also, as in previous years, in 2006 regional investment was financed entirely from national saving, while the surplus (negative external saving) went to reduce the region's net indebtedness and accumulate reserves and to asset formation abroad by residents. Regional investment as a percentage of GDP stood at 21.7 per cent in 2006; although this is higher than in 2005, it is still below the 1997 value (22.7 per cent), which is the maximum recorded since 1990.

[4] World Tourism Organization, *UNWTO World Tourism Barometer*, vol. 5, No. 1 (January 2007).

[5] The methodology for calculating national disposable income at constant prices developed by ECLAC is described in the *Economic Survey of Latin America and the Caribbean, 2005-2006* (United Nations publication, Sales No. 06.II.G.2).

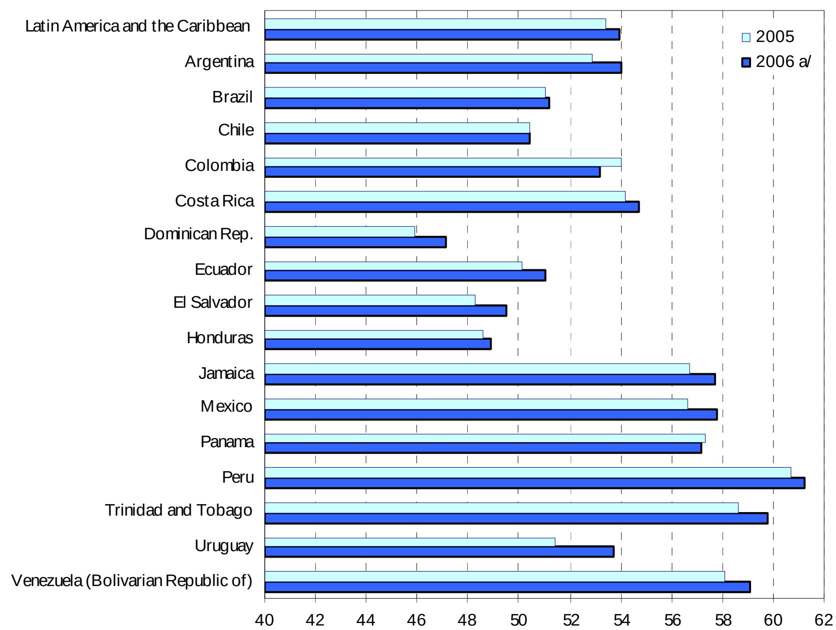
Figure V
Quarterly employment and unemployment rates in nine Latin American countries
(Percentage)



20. The creation of sufficient good-quality jobs remains one of the main concerns in the region. A third consecutive year of relatively strong economic growth improved the main labour-market indicators (see figure V). Boosted by strong labour demand, the employment rate rose again, by half a percentage point, to 54 per cent of the working-age population, the highest rate in 15 years. In contrast with 2005, the labour-force participation rate resumed its long-term upward trend and rose by 0.2 percentage points to 59.3 per cent of the working-age population, thereby making up for the previous fall. Thanks to robust job creation, open unemployment declined for the third year running (by 0.4 percentage points), although by less than the previous year because of the rise in labour-force participation, and the regional unemployment rate stood at 8.7 per cent of the economically active population. In 17 of 19 countries for which data are available, the unemployment rate fell, and in 11 countries there was an improvement of one percentage point or more. Only Brazil saw a rise in unemployment.

21. The employment rate again rose virtually across the region and, of 16 countries, only Colombia and Panama posted decreases in this indicator, in both cases because of a sharp contraction in own-account work (see figure VI). It is noteworthy that a large proportion of recent job creation has been in waged employment. In the relatively high economic growth years of 2004 and 2005, the output elasticity of employment was about 0.55 at the regional level, while waged employment elasticity with respect to output was approximately 0.8. For 2006, similar elasticities are estimated.

Figure VI
Latin America and the Caribbean: employment rates, 2005-2006



Source: ECLAC, on the basis of official figures.
[a] Estimates.

22. The fact that growth in most of the countries was fuelled increasingly by domestic demand, while the external component tended to decline, was reflected in the structure of job creation by branch of economic activity. In practically all the countries for which data are available, employment rates in the construction sector were higher than the equivalent rates for the economy as a whole. Employment in services also expanded rapidly. By contrast, employment in manufacturing increased at below-average rates, in a context of growing international competition. In countries such as the Dominican Republic and El Salvador, jobs were lost owing to a contraction in the maquila textiles sector. Countries with a more diversified maquila industry performed better: in Mexico maquila employment rose by 3.5 per cent and accounted for 1.2 million people, although that was still 7 per cent less than in 2000.

23. Developments in job quality have been a widespread concern. Although there are no comparable indicators for the region's countries in 2006, the scattered information available can be used to draw some conclusions. First, the visible underemployment rate dropped in all the countries for which data are available (Argentina, Colombia, Costa Rica, Ecuador, Honduras, Mexico, Peru and Uruguay), except Brazil and Chile. Second, income indicators suggest that many of the new jobs were low-paying.

24. After a number of years during which economic recovery and rising employment in most countries of the region had no effect on wages, in 2006 formal-sector wages in the region showed the first real increase of over 2 per cent since 1997 (2.6 per cent as a median, 3.3 per cent for the weighted average). Together

with strong job creation, the increase contributed to the upswing in household purchasing power and was one of the main engines of economic growth in 2006.

25. To conclude, the analysis of employment quality shows uneven results, while in terms of quantity, job creation has reacted rapidly to economic growth, with a notable increase in formal employment. In many countries, however, the urban formal sector accounts for only a minority of the workforce. Accordingly, even when that sector has posted high rates of job creation, the increase in formal employment has often been limited in absolute terms and in relation to the population's needs. Additional measures are thus needed to boost the creation of productive jobs.

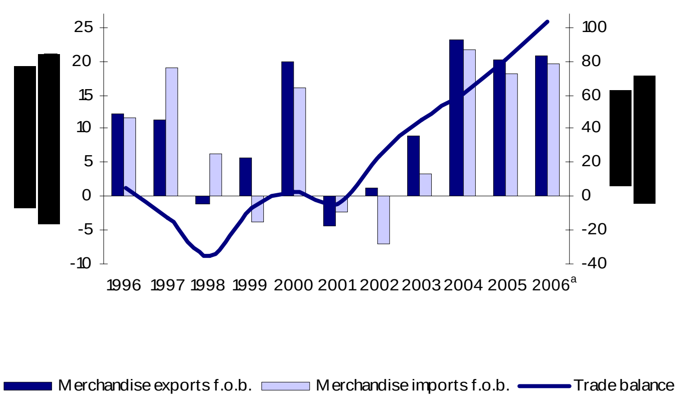
IV. External performance

26. The region's economic growth pattern has been buoyed by a very favourable external environment marked not only by the sustained expansion of the world economy and the growing preponderance of China, India and other Asian economies as the driving force of global demand, but also by highly liquid international capital markets.

27. In 2006, total Latin American merchandise exports plus imports are estimated to have amounted to US$ 1.2 trillion, or the equivalent of 45 per cent of regional GDP, while total trade increased by 20 per cent over the year. In real terms, merchandise exports were up by 7.5 per cent and merchandise imports by 14.8 per cent. For the fifth consecutive year, the region showed a positive trade balance ($103 billion in 2006, or 3.7 per cent of the region's GDP); only seven countries (Argentina, Bolivia, Brazil, Chile, Ecuador, Peru and Venezuela (Bolivarian Republic of)) posted a surplus on their merchandise balance, two fewer than in 2005 (when the list included Colombia and Uruguay) (see figure VII). The countries with the fastest-growing external sales are exporters of extractive industry products, which performed well on international markets, owing to strong increases in the prices of oil, natural gas and copper.

Figure VII
Latin America and the Caribbean: external trade, 1996-2006

(Annual rates of variation for exports and imports; trade balance in billions of dollars)



Source: ECLAC, on the basis of official figures.
[a] Preliminary figures.

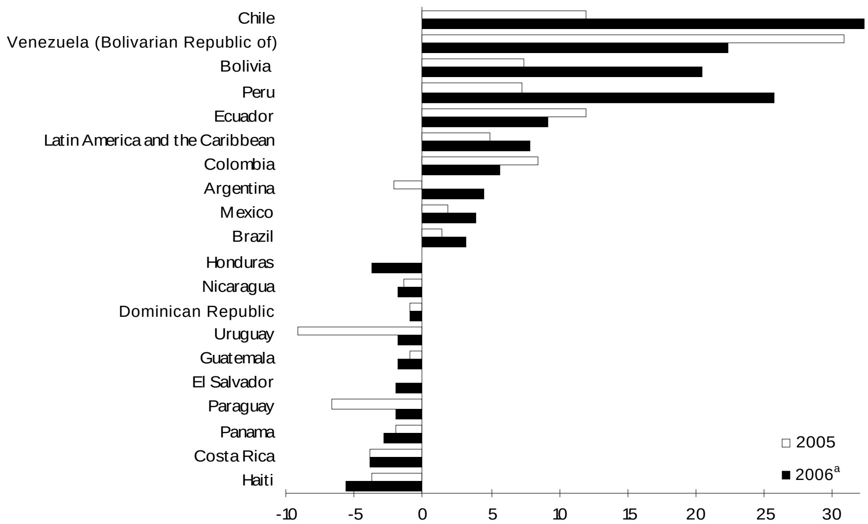
28. A more detailed examination of the exports of South America's two largest economies shows those of Argentina with a 15.1 per cent increase between 2005 and 2006, owing to growth in exports of industrial manufactures (24 per cent) and agricultural manufactures (16.1 per cent). Commodity exports, on the other hand, grew by 10.8 per cent (it will be recalled that soybean prices fell in 2006). Brazil's exports were up 16.2 per cent over the same period, with semi-manufactures climbing by 22.3 per cent and manufactured goods by 14.7 per cent, while exports of commodities expanded by 16 per cent.

29. As in the case of exports, the South American countries saw more dynamic import growth (up 24 per cent in 2006) than the Central American economies (up 14 per cent). In 2006, Latin American imports rose for the fourth consecutive year. For the period 2002-2006, Latin America's import figures showed a 78 per cent increase.

30. Total exports plus imports of services stood at $173 billion, or 6.2 per cent of regional GDP, representing an expansion of close to $17.5 billion over 2005. Services exports are estimated to have increased by 10.4 per cent, while imports grew by 12.1 per cent. The services balance showed a deficit of $21.3 billion (equivalent to 0.8 per cent of GDP), representing a deterioration of $3.3 billion compared with 2005.

31. From 2001 to 2006, Latin America's terms of trade showed a cumulative improvement of 22.1 per cent (see figure VIII). Preliminary figures for 2006 indicate a rise of 7.8 per cent. This amelioration is attributable to a 12.4 per cent increase in the price of exports, while import prices rose by 4.2 per cent. As in 2005, the price increase was concentrated in the petroleum-, mineral- and metal-exporting countries, with Chile, Peru and Venezuela (Bolivarian Republic of) recording the largest terms-of-trade gains, at 33.7, 25.7 and 22.3 per cent, respectively. Meanwhile, net importers of energy products suffered a further downturn, albeit a smaller one than in 2005.

Figure VIII
Latin America and the Caribbean: terms of trade
(Percentage variation, 2005 and 2006)

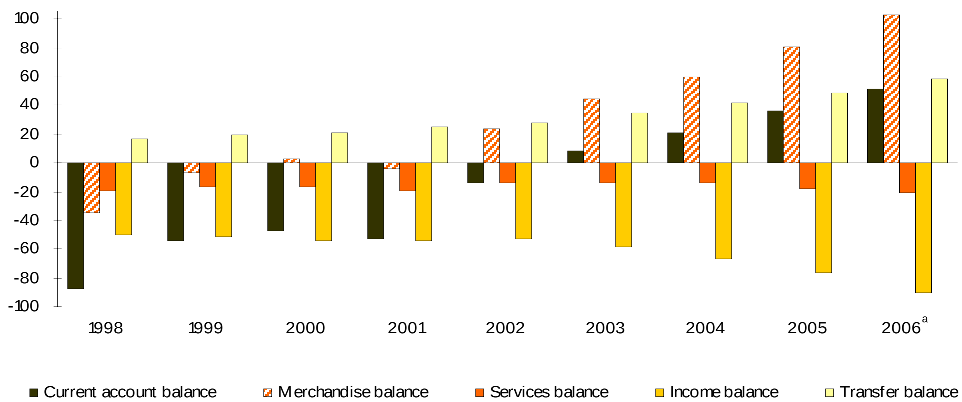


Source: ECLAC, on the basis of official figures.
[a] Preliminary figures.

32. In 2006, Latin America recorded a surplus on its balance-of-payments current account for the fourth consecutive year, an unprecedented achievement for the region. That surplus is estimated at $51 billion or 1.8 per cent of regional GDP, an increase of 43 per cent over 2005 and of 147 per cent with respect to 2004. Seven countries recorded a positive balance on this account: Argentina, Bolivia, Brazil, Chile, Ecuador, Peru and Venezuela (Bolivarian Republic of).

33. In 2006, the merchandise trade balance exceeded the 2005 figure by $22.4 billion, while the current transfers balance was up by $9.4 billion (see figures IX and X). The latter balance reflects an increase in remittances from workers abroad, which have represented significant flows into the region in recent years, the most important beneficiaries being Mexico (which receives more than 40 per cent of incoming transfers), Ecuador and Central America. Such inflows have helped those countries to strengthen their external accounts.

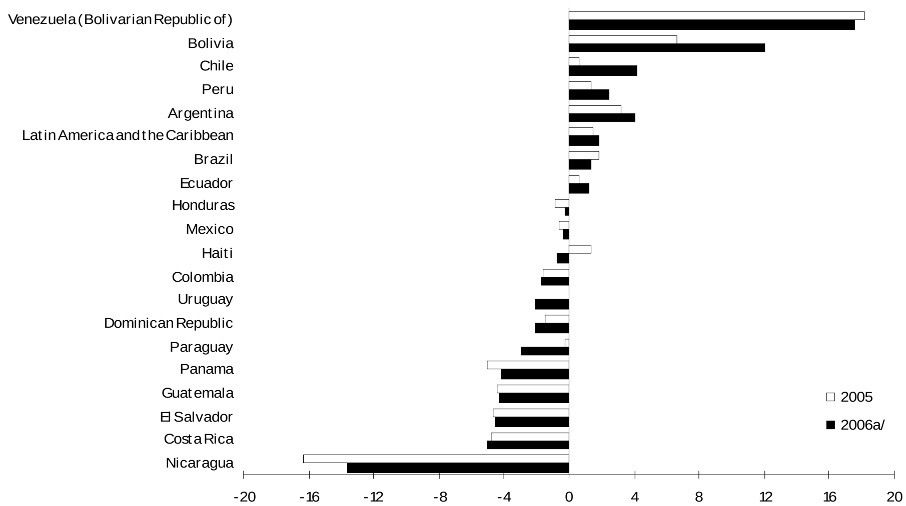
Figure IX
Latin America and the Caribbean: structure of the current account balance, 1998-2006
(Billions of United States dollars)



Source: ECLAC, on the basis of official figures.
[a] Preliminary figures.

34. The services and income balances have both continued to show deficits, which have widened by $3.3 billion and $13 billion, respectively. With respect to the services balance, the non-factor services deficit has widened significantly since 2005, principally as a result of rising maritime freight rates (following the hike in oil prices) and mounting demand for vessels for trade with China. The wider deficit on the income balance is attributable to increased repatriation of profits and dividends. Chile offers an example: in the first half of 2006, outward remittances of profits and interest were 90 per cent higher than in the same period in 2005. Conversely, Argentina improved its interest balance with respect to 2005 thanks to its debt swap operations.

Figure X
Latin America and the Caribbean: current account
(Percentages of GDP in current United States dollars)

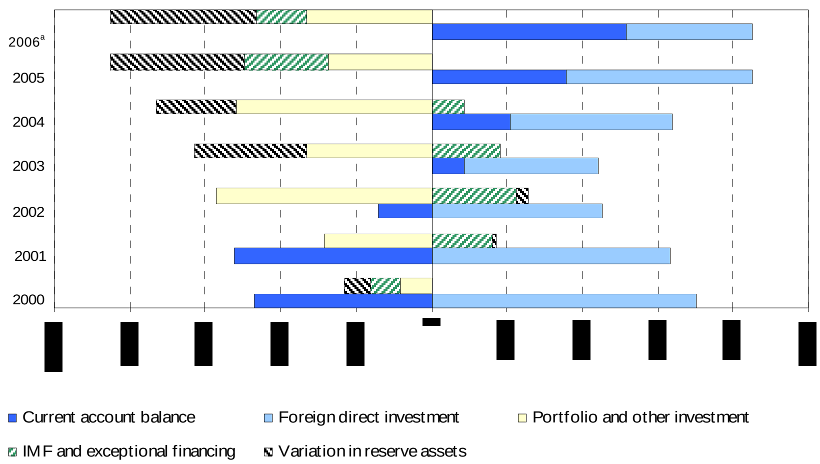


Source: ECLAC, on the basis of official figures.
[a] Preliminary figures

35. In 2006, the capital and financial account[6] of the Latin American and Caribbean region was close to equilibrium, with net flows of financial capital[7] showing a larger negative balance than the previous year, at 1.3 per cent of GDP (see figure XI). Net foreign direct investment (FDI) was lower than in 2005, representing 1.2 per cent of GDP. Financial capital flows reflected bond issuance, debt restructuring and external asset formation by the public sector, as well as private-sector financing and investment strategies. Despite rising interest rates in the United States in the first half of the year, international market liquidity continued to drive the positive take-up of financial securities issued by the countries of the region in international markets. Foreign investors in Latin American and Caribbean markets, on the other hand, benefited from the deeper development and increased openness of domestic markets, the prevalence of high real interest rates (in Brazil, for instance) and the nominal appreciation of local currencies.

[6] Including errors and omissions.
[7] Financial capital flows are defined as the capital and financial balances (including errors and omissions) minus the net flow of foreign direct investment.

Figure XI
Latin America and the Caribbean: breakdown of basic balance, 2000-2006



Source: ECLAC, on the basis of official figures.
Note: Negative variation indicates an increase in reserve assets.
[a] Estimates.

36. Outward direct investment on the part of the region's countries has increased significantly over the past two years (see figure XII). In 2006, the strong upswing in outward direct investment on the part of the region's countries, largely attributable to the acquisition by a Brazilian firm of a Canadian metals company, combined with a slight drop in FDI received,[8] resulted in a fall in net FDI (from 2.1 per cent of GDP in 2005 to 1.1 per cent in 2006).

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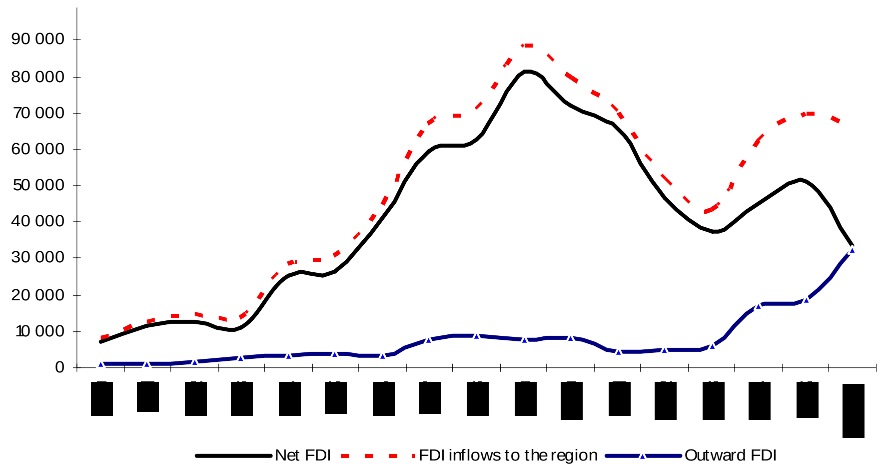
[8] FDI inflows reflected several sales of assets by foreign companies to national companies and the appreciation of the exchange rate.

Figure XII
Latin America and the Caribbean: foreign direct investment
(Millions of United States dollars)



Source: ECLAC, on the basis of official figures.
[a] Estimates.

37. As a consequence of capital movements throughout the year, the balance on the regional capital and financial account was close to equilibrium. This, combined with the current-account surplus, once again generated a large build-up of reserves in most of the region's countries (estimated at 1.4 per cent of GDP). The external debt outcome resulted from debt-restructuring operations (redeeming more expensive bonds with shorter maturities and swapping external debt securities for local currency-denominated bonds), but also from debt-relief measures and early payments to international bodies. The Multilateral Debt Relief Initiative was approved by IMF in January 2006 and by the World Bank in March, and has benefited Bolivia, Guyana, Honduras and Nicaragua. In November, the Inter-American Development Bank (IADB), the region's largest multilateral creditor, announced the creation of a debt-forgiveness framework for those same countries and Haiti, which was approved in March 2007.[9] Argentina and Brazil settled all their debts with IMF in 2005,[10] and, in 2006, Uruguay followed suit and paid off its entire debt to the Fund (some $2.4 billion) ahead of time. Uruguay also undertook early payments of its debt to the World Bank and IADB ($420 million), while Mexico paid off $9 billion to the same institutions. Brazil settled its debt with the Paris Club ($2.6 billion) in the form of several payments made during the first half of the year.

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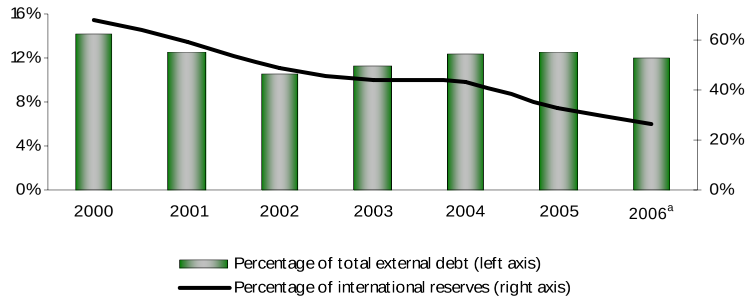
[9] Haiti reached the decision point under the Heavily Indebted Poor Countries (HIPC) Initiative in November, which qualified it for debt relief under that scheme.

[10] Argentina's payment was made effective in January 2006.

Figure XIII
Latin America and the Caribbean: short-term external debt
(Percentage)



Source: ECLAC, on the basis of official figures and information from the World Bank.
[a] Estimates.

38. As a result of these developments, the level of external debt fell again, to 24 per cent of GDP in 2006. In addition to reducing the amount of external debt, the countries of the region have made efforts to change their debt structures by diversifying the currencies of denomination (often by swapping external for domestic debt), increasing the proportion of fixed-rate debt and cutting short-term external debt (see figure XIII). With respect to this last point, in 2006, public sector debt accounted for a small portion in most of the countries, which means that most of the total is short-term private external debt. This strategy has helped to reduce the region's external vulnerability.

V. Current situation and outlook for 2007

39. International conditions should remain positive for the region in 2007, although less so than in 2006, as global growth is forecast to slow. The expansion that began four years ago is expected to continue in 2007, although at a somewhat slower rate than in 2006. Regional economic activity is expected to expand by about 4.8 per cent, which will translate into an increase of over 3 per cent in per capita GDP.

40. Regional GDP is expected to continue to expand despite the global economic slowdown, thanks to a healthy internal macroeconomic situation and the impact of continuing growth on domestic demand. This is a highly auspicious set of conditions for the Latin American and Caribbean region, which has been afflicted more seriously than any other by an extreme degree of macroeconomic volatility that has, in the past, inhibited investment and undermined the ability of the countries in the region to achieve sustained growth. Meanwhile, current-account trends indicate that the region will maintain relatively high growth rates, with no strong external sector tensions on the horizon.

41. Nevertheless, many factors bear careful watching both from the standpoint of short-term macroeconomic policy and in view of the need for a more clearly delineated development strategy. In particular, beyond reaping the benefits of current international market conditions, the region needs mechanisms to sustain its

external competitiveness and to consolidate efforts by countries to develop policies and instruments that can keep fiscal accounts sustainable and strengthen their potential to counteract business cycle fluctuations.