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Latin America and the Caribbean: economic situation and outlook, 2009-2010

Summary

After six years of uninterrupted growth, the gross domestic product (GDP) of the Latin American and Caribbean region fell by 1.9 per cent and per capita GDP by 3.0 per cent in 2009. The fall-off in growth hurt the labour market and the unemployment rate in the region is estimated to have risen to around 8.3 per cent.

The effects of the crisis were channelled mainly through the real sector of the Latin American and Caribbean economies. Exports, remittances and tourism activity all declined, and foreign direct investment (FDI) contracted. Commodity prices and terms of trade also suffered negative impacts.

Domestic activity levels also dropped in some countries as a result of the tighter credit conditions in the private banking sector. These factors combined with a downturn in economic expectations, which led to a fall in investment and private consumption.

The positive stimulus of fiscal policy action was one of the distinctive features of economic management in 2009, since many of the region's countries implemented countercyclical policies. These packages, together with the gradual return to normalcy in the financial markets, created the conditions for an upturn in activity and an improvement in labour-market indicators in the region starting in the second quarter of 2009. In addition, renewed access to international credit for some countries and the recovery of the stock markets allowed the private sector to restructure its assets and helped normalize lending.

In light of these developments, growth is projected at 4.1 per cent for 2010 and is expected to be somewhat higher in the countries of South America than in the rest of the region, given their larger domestic markets and greater export-market diversification. On the other hand, growth is expected to be slower in some of the more open economies that have a less diversified portfolio of trading partners and a heavier dependence on manufacturing. The same can be said of the Caribbean economies, some of which are facing complex financial and exchange-rate situations.

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I. General trends and the financial crisis

1. The impact of the international crisis, the deepest in 60 years, was felt heavily in late 2008 and early 2009, albeit in different ways, in all the countries of the region. As a result, after six years of economic growth, the gross domestic product (GDP) of the Latin American and Caribbean region shrank by 1.9 per cent in 2009, which translates into a contraction of around 3.0 per cent in per capita GDP.

2. The heaviest contractions in economic activity occurred in Mexico and some of the Central American and Caribbean countries. South America registered positive growth rates although, in all cases, they fell far short of the rates posted between 2004 and 2008, and for 2009.

Table 1
Latin America and the Caribbean: gross domestic product
(Annual growth rates, 2005-2010)

Country	*2005*	*2006*	*2007*	*2008*	*2009*[a]	*2010*[b]
Argentina	9.2	8.5	8.7	6.8	0.9	4.0
Bolivia (Plurinational State of)	4.4	4.8	4.6	6.1	3.5	4.5
Brazil	3.2	4.0	5.7	5.1	-0.2	5.5
Chile	5.6	4.6	4.7	3.2	-1.5	4.5
Colombia	5.7	6.9	7.5	2.4	0.4	2.5
Costa Rica	5.9	8.8	7.8	2.6	-1.1	3.5
Cuba	11.2	12.1	7.3	4.1	1.4	3.0
Ecuador	6.0	3.9	2.5	6.5	0.4	3.0
El Salvador	3.1	4.2	4.7	2.5	-3.5	2.0
Guatemala	3.3	5.4	6.3	4.0	0.6	2.0
Haiti	1.8	2.3	3.4	1.3	2.9	2.0
Honduras	6.1	6.6	6.3	4.0	-2.1	1.5
Mexico	3.3	5.0	3.4	1.3	-6.5	3.5
Nicaragua	4.3	4.2	3.1	2.8	-1.5	2.0
Panama	7.2	8.5	12.1	10.7	2.4	4.5
Paraguay	2.9	4.3	6.8	5.8	-3.5	3.0
Peru	6.8	7.7	8.9	9.8	0.9	5.0
Dominican Republic	9.3	10.7	8.5	5.3	3.5	3.5
Uruguay	6.6	7.0	7.6	8.9	2.9	5.0
Venezuela (Bolivarian Republic of)	10.3	9.9	8.2	4.8	-3.3	2.0
Latin America	**5.0**	**5.8**	**5.8**	**4.2**	**-1.9**	**4.1**
The Caribbean	**4.0**	**7.5**	**3.1**	**0.8**	**-2.1**	**0.9**
Latin America and the Caribbean	**5.0**	**5.8**	**5.8**	**4.1**	**-1.9**	**4.1**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures expressed in constant 2000 dollars.
[a] Preliminary figures.
[b] Projections.

3. The economic slowdown cut into labour demand and the unemployment rate rose to around 8.3 per cent for the region overall. The improvements under way in recent years in job quality stopped as the creation of wage jobs in the private sector and of formal employment in general slowed considerably in many countries. Conversely, real wages rose in most of the countries because of lower inflation.

4. The inflation rate dropped sharply from 8.3 per cent in 2008 to around 4.3 per cent in 2009, as a result of falling international prices for some of the commodities included in household consumption baskets, in addition to the effect of currency appreciation and the impact of slacker activity levels on demand.

5. Some positive signals emerged in the second half of 2009, even though financial markets continued to exhibit some volatility and the situation of the global economy still posed some risks. Beyond the short term, however, a number of questions arise as to whether this rapid recovery will develop into sustained growth at the world level and in Latin America and the Caribbean.

6. Given the magnitude of the crisis, it reached every part of the world and the Latin American and Caribbean region was no exception. Yet this crisis differed from those the region had experienced in the past. Not only because the epicentre of the crisis lay in the developed countries, although this plays no small part in accounting for recent economic trends, but, above all, because of the juncture at which the crisis broke out in the region and how the region was affected.

7. First, the combination of highly favourable external conditions and more prudent management of macroeconomic policy had enabled the region to reduce its outstanding debt and to renegotiate it on advantageous terms, while also building up international reserves. The Latin American economies thus went into the crisis with unprecedented liquidity and solvency, which explains why, unlike on past occasions, the countries' financial systems did not deteriorate and there was no flight from local currency, which helped to maintain calm in the region's currency markets. Some of the Caribbean countries, however, had high levels of external borrowing and faced rather more difficult exchange-rate situations.

8. The broadened macroeconomic policy space in many of the region's countries gave them substantial capacity for anti-crisis policymaking. In general, the public policy space was greater in some South American countries. The improved net financial position also afforded renewed access to international financial markets fairly promptly, which further boosted capacity to implement public policies. As a result, even though the downturn in real variables was very sharp, the recovery now looks fairly solid.

9. Although poverty levels in the region remained high, despite the gains made in recent years, and the impact of the crisis on social variables was predictably negative, the deterioration was not as great as had initially been projected, owing to a number of factors. On the one hand, the drop in activity levels and its impact on the labour market were both smaller than expected, so the unemployment rate did not rise as much as the initial contraction had led analysts to fear it would. On the other, international commodity prices, combined with currency appreciation, helped to significantly lower the rate of inflation and limit the erosion of real income, thereby at least partially offsetting the downturn in labour indicators.

10. The rise in social spending in the last few years and the increase in the number and effectiveness of social programmes also played an important role in containing the social costs of the crisis. Learning the lessons from previous crises, the countries sought to maintain — and even expand — the coverage of these programmes, even in the context of a gradually tightening fiscal space.

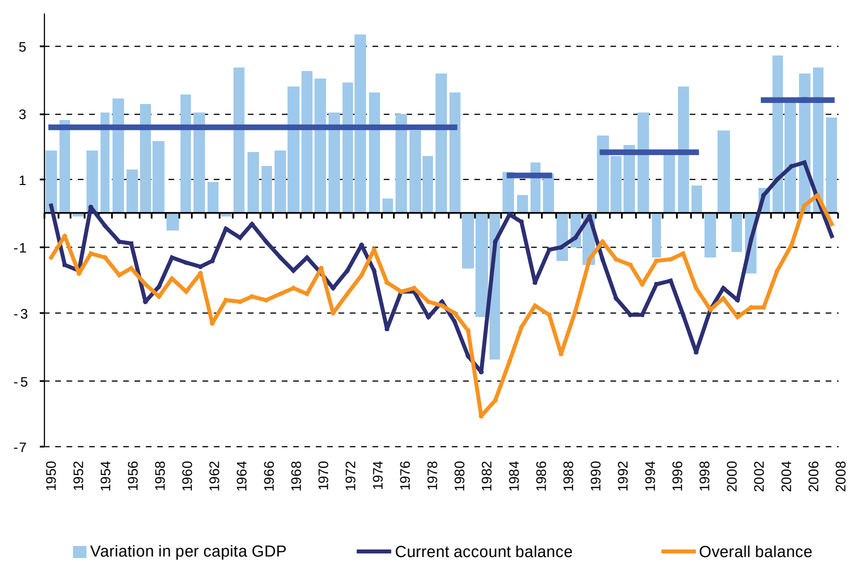
II. Recent trends in the Latin American and Caribbean economies

11. In order to understand why the impact of this crisis on Latin America and the Caribbean was different from that of previous ones, it is important to understand the situation in which the region found itself when the crisis struck. First of all, the global economic crisis brought to a sudden end the longest and most intense phase of economic growth that the region had seen in a very long while. A similar period of steady per capita GDP growth of over 3 per cent per year (as recorded in 2004-2008) had not been seen for 40 years, since the boom that lasted from the end of the 1960s to the oil shock at the beginning of the 1970s, during which the region posted comparable growth rates for seven consecutive years.

12. As shown in figure I, steady growth was accompanied by quantitative and qualitative improvements in macroeconomic fundamentals, making 2004-2008 a period of expansion unprecedented in the region's recent history. On the one hand, the region enjoyed a current account surplus (largely generated by improvement in the terms of trade, especially in South America) as well as increasing remittance flows from migrant workers (mainly in Mexico and, above all, Central America). Meanwhile, ever-larger primary surpluses were being posted on the public accounts and the region's overall deficit was drastically reduced (even turning into a surplus in 2006-2007).

13. At a time of abundant liquidity in international financial markets, the current account surplus allowed countries to reduce their external debt burdens and to renegotiate more advantageous terms, as well as to accumulate reserves. Greater fiscal slack, meanwhile, made it possible to slash public debt.

Figure I
Latin America and the Caribbean: variation in per capita GDP, current account balance and overall balance
(Percentages of GDP)



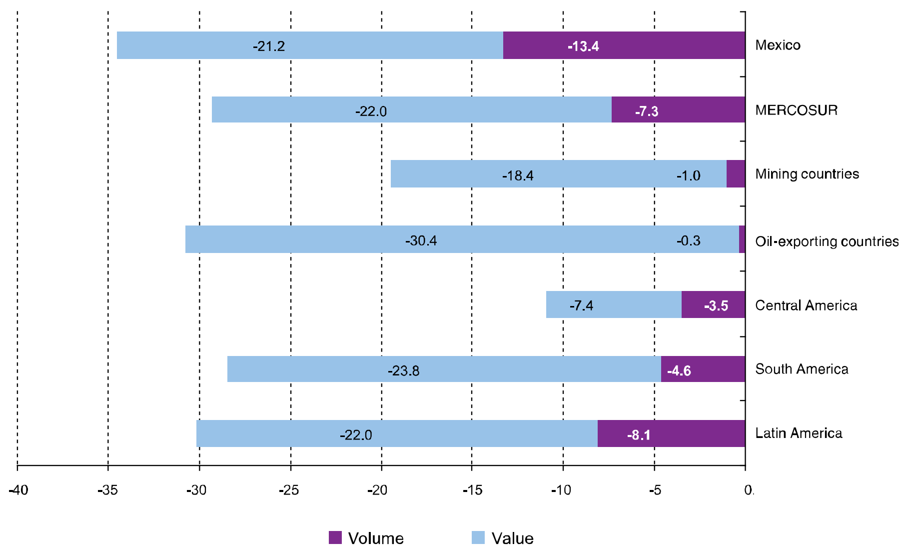
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

14. Although the crisis imposed heavy constraints on macroeconomic policy as it plunged the economies back into deficit positions on their external and public accounts, their favourable situation in terms of financial stocks (more assets, fewer and better liabilities) meant that in 2009, they did not have to contend with problems in the domestic financial systems, runs against domestic currencies or difficulties meeting their external obligations. All this helps to explain why this time around the strongest effects of the crisis were channelled not through the financial sector but through the real economy.

A. Channels of transmission of the crisis

15. As noted above, the repercussions of the crisis on Latin America and the Caribbean were channelled through the real sector, damaging what had been in recent times one of the main engines of regional growth.

Figure II
Variation in goods exports, free on board (FOB), by volume and value, 2009
(Percentages)



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

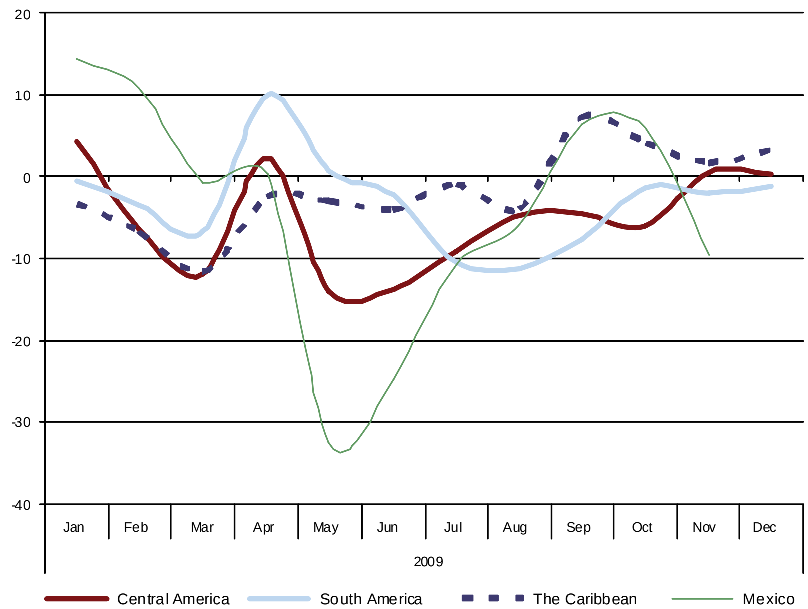
16. Exports plummeted as of the second semester of 2008, both in volume and value terms. Even though the fall slowed in the second half of the year, Latin American export volumes fell by an estimated 8.1 per cent in 2009. As had been expected, Mexico's exports suffered the most, sliding by about 13.4 per cent in real terms. Export volumes are estimated to have dropped by about 3.5 per cent and 4.6 per cent in Central America and South America, respectively, as shown in Figure II.

17. The slowdown in economic activity worldwide, together with the drop in international trade flows, had a negative impact on commodity prices, which hurt the region's terms of trade. Although the downtrend in international commodity prices bottomed out at the beginning of 2009, average price levels for the year were far lower than in 2008, which suggests that the terms of trade for the region as a whole worsened by an estimated 6.0 per cent. This had implications mainly for

South America, and for the oil, hydrocarbon and metal producers in particular, as well as, albeit to a lesser extent, for countries that specialize in food production. In Central America, however, which imports those commodities, terms of trade improved, although not enough to fully offset the worsening experienced in previous years.

18. As shown in figure III, tourism, which is of major importance to the economies of the Caribbean and Central America, declined sharply. The contraction was particularly notable in Mexico in the second quarter of the year due to the outbreak of influenza A (H1N1). Overall, the downturn in tourism was estimated at between 3 per cent and 6 per cent in 2009.

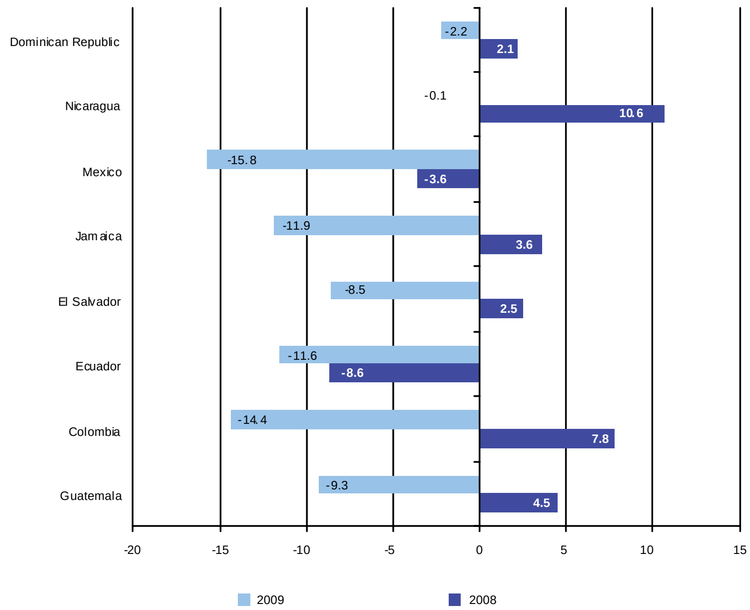
Figure III
Latin America and the Caribbean: year-on-year variation in international tourist arrivals, 2009
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from World Tourism Organization (UNWTO).

19. Given that the main destinations of most Latin American and Caribbean emigrants are the United States and Spain, two of the countries worst hit by the crisis, remittances to the region plummeted. Annual falls of close to 10 per cent in remittances were recorded in some Central American countries, such as El Salvador and Guatemala, and even larger drops in Colombia, Ecuador, Jamaica and Mexico. The Dominican Republic and Nicaragua experienced smaller declines.

Figure IV
Latin America and the Caribbean: year-on-year variation in remittances from migrant workers, 2008 and 2009
(Percentages)



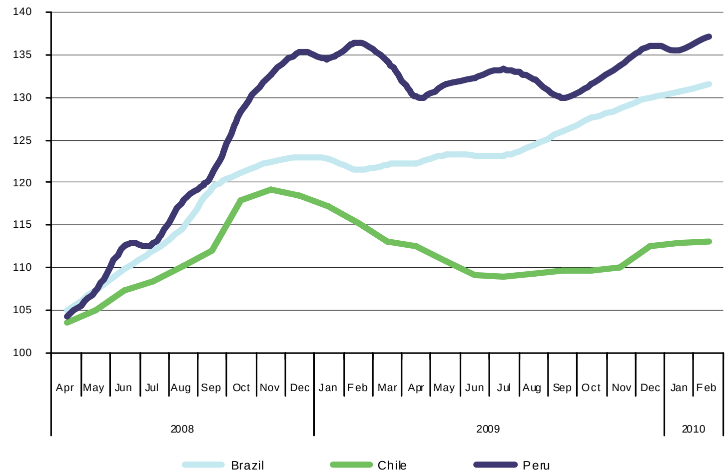
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

20. Meanwhile, FDI in the region fell by an estimated 39.1 per cent, by far the largest drop for at least 30 years. Between 1999 and 2003, FDI flows fell by about 47 per cent, but then the drop was concentrated in only two countries (Argentina and Brazil), while this time around, the downturn was spread across the region, although diminished flows to Brazil accounted for a significant proportion of the total decline.

21. Although the impacts of the international crisis were felt mainly through the channel of the real economy, in some cases there were impacts on financial systems that may have had significant repercussions on activity levels. Having said that the turbulences in the region were mostly related to trade rather than reversals of capital inflows, there were three major exceptions: Brazil, Chile and Peru, whose financial systems were more exposed than those of the rest of the region in late 2008.

22. As shown in figure V, the manifestation of this situation in these countries' financial systems was a major contraction in private bank credit in real terms. The public banks then played an active role in many countries as part of countercyclical strategy although, with the exception of Brazil (where public banks account for a large proportion of total credit), the capacity to offset the contraction in private bank credit was fairly small.

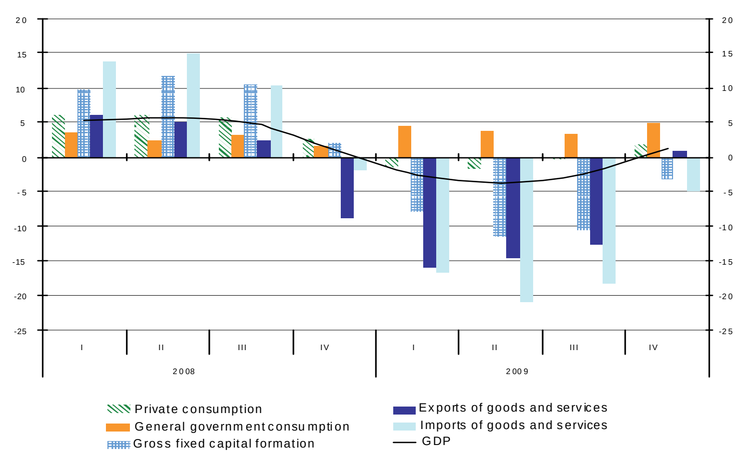
Figure V
Brazil, Chile and Peru: private bank lending 2008, 2009 and 2010
(Index: first quarter 2008=100)



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

23. The expectations of consumers and businesspeople alike worsened, especially towards the end of 2008 and at the beginning of 2009, which translated into lower levels of both private consumption and investment. In fact, as shown in figure VI, public consumption was the only type of consumption to increase in the first part of the year when many countries in the region had at least some room to implement countercyclical policies. These policies partially offset the negative performance posted by the other components of domestic demand and helped speed up the recovery in the second part of the year.

Figure VI
Latin America and the Caribbean: breakdown of total supply and demand, 2008 and 2009
(Percentages)



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

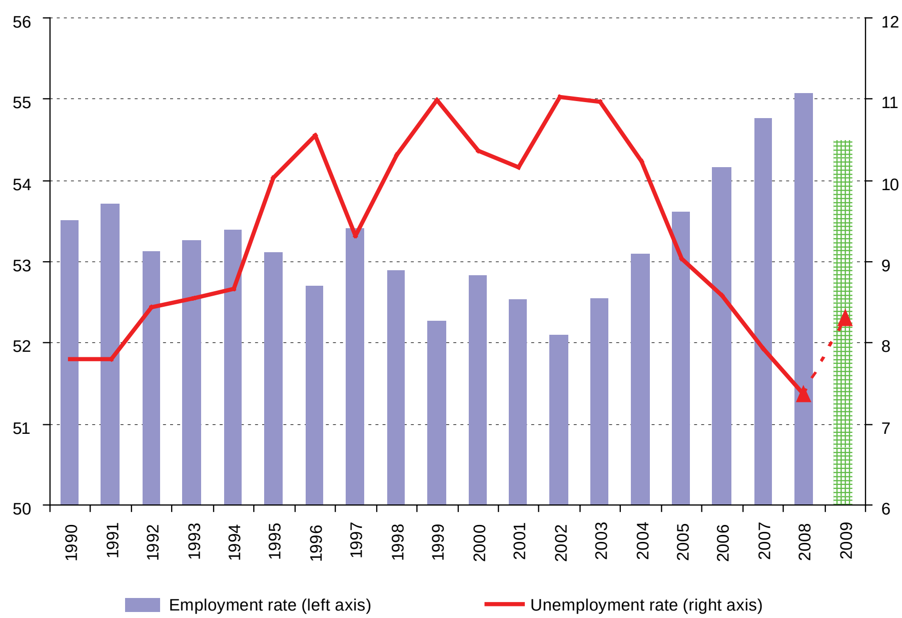
B. The social effects of the crisis

24. The sudden slowdown in economic growth had a negative impact on the labour market: the employment rate fell for the first time in six years. Unemployment rose by around one percentage point from 7.4 per cent to 8.3 per cent (see figure VII). The slack labour supply, as indicated by the participation rate, averted a larger rise in unemployment.

25. The improvements under way in recent years in job quality stopped as the creation of wage jobs in the private sector and of formal employment in general slowed considerably.

26. At the same time, the Latin American and Caribbean countries took steps to implement social measures. Regionwide, 26 countries have announced measures to support poor families and 18 to subsidize consumption. Accordingly, the portfolio leans slightly towards support for poor families (57 per cent). A breakdown of the measures by subregion, however, shows a major difference in portfolio composition. In South America and Mexico, three quarters of the measures announced involve support for poor families, while in Central America and the Caribbean countries the distribution is fairly balanced.

Figure VII
Latin America and the Caribbean: rates of employment and unemployment
(Percentages)



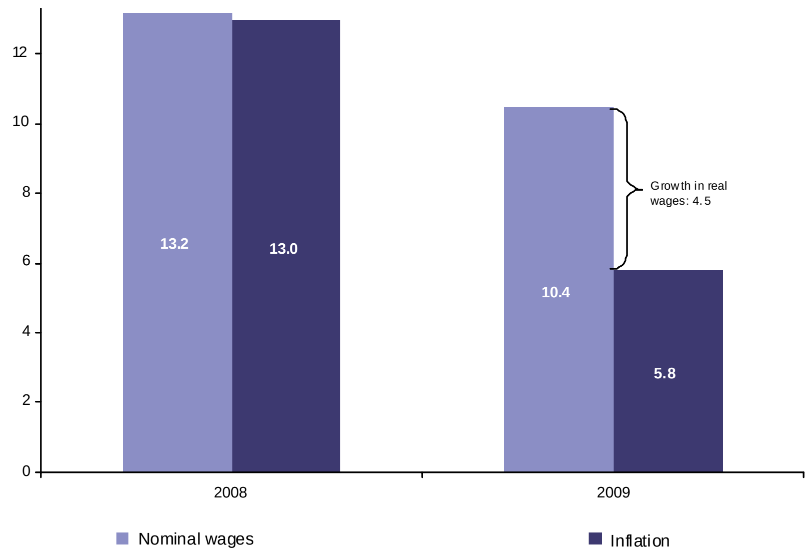
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

27. The crisis contributed to the lowering of regional inflation from 8.3 per cent in 2008 to 4.3 per cent in 2009. This was the result of the dual impact of the global recession and the decline in trade on food and energy prices, on the one hand, and of the widening of the gap between real and potential GDP brought about by the regionwide drop in demand, on the other.

28. Lower inflation staved off a fall in real wages, which partly explains why the negative impact on poverty was more moderate than initially projected, as shown in figure VIII.

29. The smaller-than-expected increase in poverty can also be attributed to the social spending policies implemented by most of the countries of the region, especially to those deployed by the larger countries that have a more tightly woven institutional fabric, which enables them to implement strategies that, by being more targeted, tend to be more effective during crises than the general subsidies on consumption of certain goods and services. Generalized subsidies tend to be the instruments most commonly used in some Central American and Caribbean countries whose institutional framework is weaker.

Figure VIII
Latin America: variation in nominal wages, inflation and real wages[a]
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Simple average for 10 countries.

III. Macroeconomic policy

30. Many countries in the region were able to implement countercyclical policies that allowed them not only to at least partially offset the negative evolution of most of the components of domestic demand, but also to speed up the recovery process, which took hold in some countries as of the second quarter and in nearly all by the third quarter of 2009.

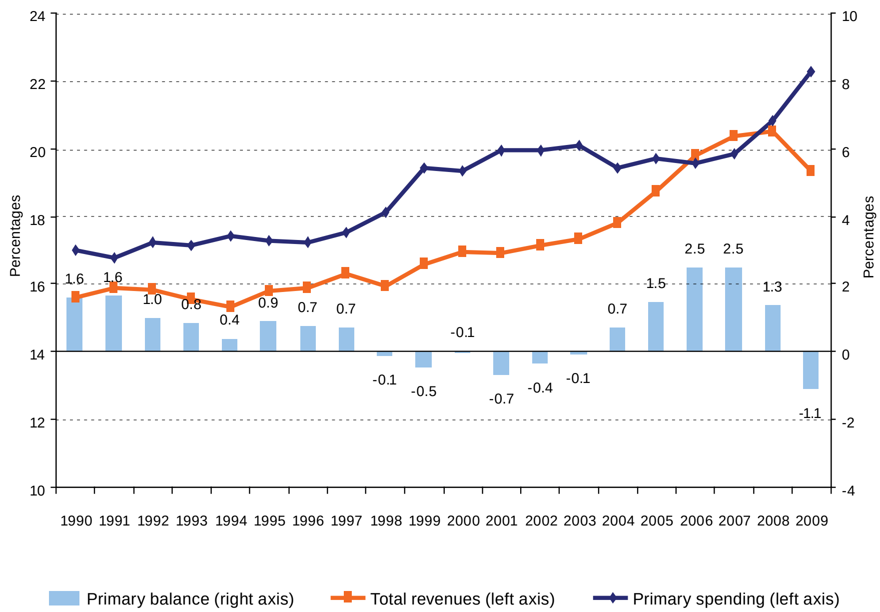
31. One characteristic feature of the crisis has been the capacity shown (by some countries more than others) to implement macroeconomic and sectoral policies to mitigate the negative effects of the crisis on economic activity and employment. To varying degrees, according to the type of problem faced and, above all, according to each country's capacity (in not only financial, but also institutional terms) to deploy

public policies, the Governments of the region have introduced a wide array of initiatives which can broadly be grouped into the following categories: fiscal measures; monetary, financial and exchange measures; and social and employment measures.

A. Fiscal policy

32. The positive stimulus of fiscal policy action was one of the distinctive features of economic management in 2009. The region's primary balance fell from a surplus equivalent to 1.4 per cent of GDP in 2008 to an estimated deficit of 1.1 per cent of GDP in 2009. This drop of more than two GDP points, which is a measure of the size of the fiscal stimulus, reflects both the decline in public revenues and the increase in public expenditures, including both current and capital spending (see figure 9).

Figure IX
Latin America: revenue, primary spending and primary balance, 1990-2009
(Simple average, percentages of GDP)



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

33. Revenues have been conditioned by economic growth (which in turn has influenced tax receipts) and by the fall in the prices of the commodities that the region exports and that in some countries account for a high proportion of public revenues.

34. In addition to these exogenous factors, in many cases, policy measures taken in association with anti-crisis strategies to stimulate domestic demand have reduced tax receipts. Income tax rebates and other tax benefits for both companies and private individuals are among the most widely used instruments, having been introduced in 12 of the 19 countries of Latin America.

35. Countries responded to the crisis with a broad range of measures that sought mainly to strengthen aggregate demand and offset the regressive social effects on the more vulnerable sectors of either the crisis itself or the adjustment measures that may have been taken. The fiscal measures adopted vary widely, given the different capacities each country has to manage and execute them, and depending on the availability of resources. The measures announced may be grouped into two categories of instruments: (i) measures involving tax systems and (ii) measures involving fiscal spending. Table 2, below, provides a schematic view of the wide range of government measures. On the income side, these run the gamut from changes to the income tax structure, through adjustments to the tax base (deductions, exemptions or accelerated depreciation systems) or to nominal tax rates, to reform of taxes on goods and services (VAT, specific taxes or tariffs). On the spending side, the measures sought mainly to boost investment in infrastructure, housing, programmes to support small and medium-sized enterprises (SMEs) and small farmers, or financed a variety of social programmes.

Table 2
Latin America (19 countries): main fiscal measures announced to combat the effects of the crisis

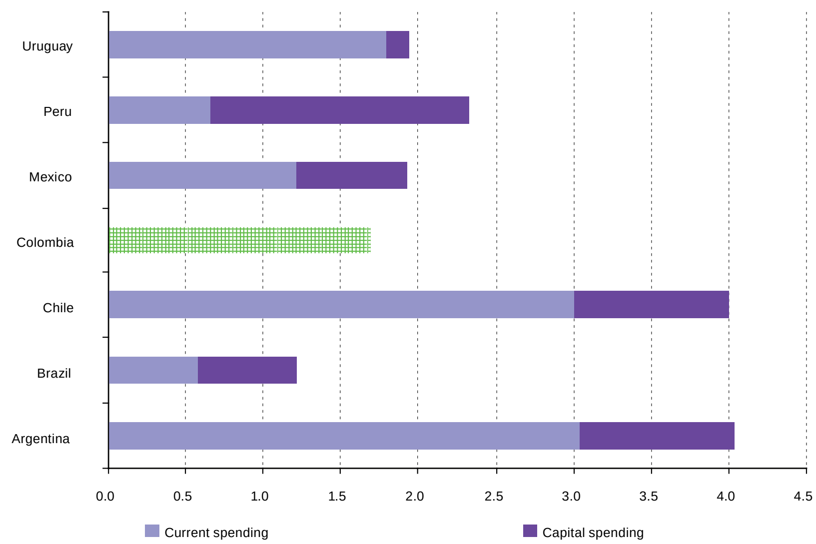
	Argentina	Bolivia (Plurinational State of)	Brazil	Chile	Colombia	Costa Rica	Ecuador	El Salvador	Guatemala	Haiti	Honduras	Mexico	Nicaragua	Panama	Paraguay	Peru	Dominican Republic	Uruguay	Venezuela (Bolivarian Republic of)
Tax system																			
Corporate income tax (cuts/depreciation)			X	T	X	T	X		X			T	X				X	T	
Personal income tax (cuts)	X		X	T	X		X		X		X	T	X	X			X		
Foreign trade taxes	X	X	T				X					X	T		T		X	X	
Taxes on goods and services			T			X	X					X						X	X
Social contributions	X											T							
Others			X	T	X		T						X			T	X	X	
Public spending																			
Investment in infrastructure	X	X	X	X	X	X	X		X		X	X	X		X	X	X	X	
Housing	X	X	X	T		X	X	X	X		X	X	X		X	X	X	X	
Support for SMEs or agricultural producers		X	X	X	X	X	X	X	X	X	X	X		X	X	X	X	X	X
Support for strategic sectors	T	X	X	X	X				X		X	X				X		X	
Direct transfers to families	T	X		T		X		X			X	X	X	X	X				
Other social programmes	X		X	X	X	X		X	X	X	X	X	X	X	X	X	X	X	
Other spending			X		X									X					

Source: Economic Commission for Latin America and the Caribbean (ECLAC), *The reactions of the Governments of the Americas to the international crisis: an overview of policy measures up to 31 December 2009* (LC/L.3025/Rev.5), Santiago, Chile, 31 January 2010.
Note: T= Temporary measures.

36. However, falling fiscal revenue, tight credit conditions and limited capacity in some countries to execute investment projects have delayed implementation of many of these measures.

37. The Governments in the region also announced fairly ambitious spending plans. As far as their implementation is concerned, in most of the countries for which information on actual spending is available for up to the third quarter of the year, current expenditures (which can generally be stepped up more quickly) increased significantly in the first half of the year, while capital expenditures (which are usually slower to materialize) did so to a lesser extent. The drop in commodity prices reduced the fiscal space available in some of the countries that are highly specialized in commodities, however, which prevented them from implementing countercyclical measures. This occurred in the Bolivarian Republic of Venezuela, where the drop in fiscal revenues compelled the authorities to take steps to contain public spending, which gave fiscal policy a procyclical start.

Figure X
Latin America (selected countries): variation in public expenditure, 2008-2009
(Percentages of GDP)



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

B. Monetary and exchange-rate policies

38. As soon as the crisis broke out, the central banks of the region adopted a series of wide-ranging measures aimed at procuring either recovery or the liquidity of local financial markets, or both. The widespread fall in inflation freed up monetary policy both in countries that run inflation-targeting schemes and those that use other targets, such as certain monetary aggregates.

39. The substantial lowering of monetary policy rates by most of the region's monetary authorities occurred most quickly in the countries with inflation-targeting

schemes. In many cases, however, although interest rates plummeted, inflation rates fell even faster, cancelling out in real terms the effect pursued by policy action.

40. Also, the central banks' efforts to inject more liquidity into the financial system failed to translate into an increase in credit in the private banking sector. As noted earlier, in response to this situation, public banks in many countries of the region were engaged in government countercyclical strategies and stepped up public lending to compensate, in some cases partially, in others totally, for the tighter stances of private banks. The impact of this instrument depends on the magnitude of the official banking sector in the financial system. Hence, it has been very significant in Brazil, where public bank lending represents around 35 per cent of total credit.

41. As far as exchange rates are concerned, once the strain experienced at the end of 2008 (which in some cases lasted into the beginning of 2009) was over, the general trend in South America was a return to the appreciation of local currencies under way prior to the crisis. The search for higher returns during a time of abundant liquidity in the international market, together with the relatively robust performance of many of the region's economies, resulted in large inflows of capital that pushed down the exchange rate in most of South America. The notable exception has been Mexico, where the exchange rate is 22 per cent higher in real terms than it was before September 2008 when the international crisis unfolded.

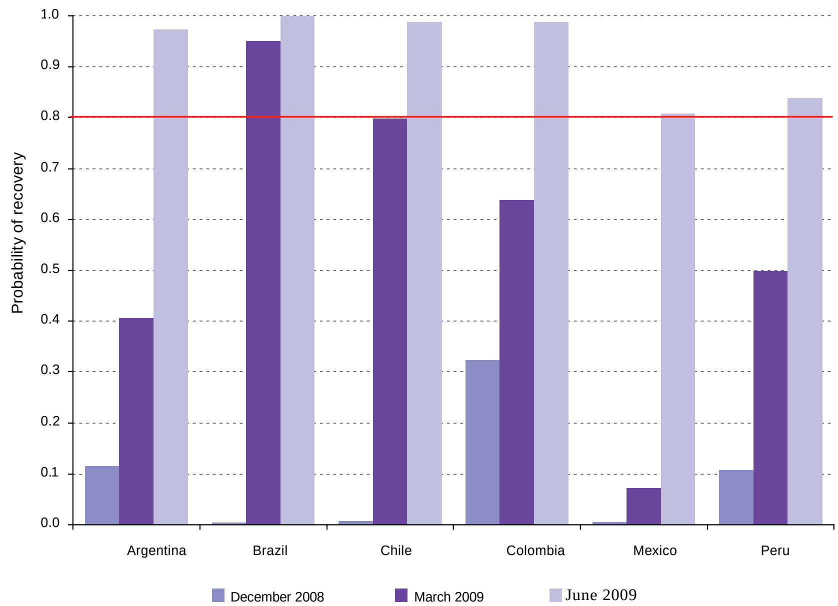
42. In order to defend the real exchange rate to some extent and to sustain domestic liquidity levels, many central banks intervened in the exchange market, which in some cases enabled them to restore international reserve levels to those seen prior to the last quarter of 2008. One notable example is Brazil, where international reserves rose by 23.1 per cent to over US$ 44.737 billion and the real exchange rate fell by 25.9 per cent between December 2008 and December 2009.

43. The changes observed in the countries' international reserve positions over 2009 are particularly interesting. Brazil recorded a larger increase than that posted by Latin America and the Caribbean as a whole, which masked an uneven situation across the region: in some countries, the increases in reserves were enough to offset the losses observed at the end of 2008, while in others, such as Argentina and Mexico, the increments had a minimal impact on the total regional rise. It should be noted that in some cases, especially in the smaller economies, such as those of the Caribbean, the expansion of reserves was mainly the result of the recent allocation of Special Drawing Rights by the International Monetary Fund.

IV. The recovery of the Latin American and Caribbean economies in the second half of 2009

44. According to the leading indicators calculated by ECLAC using the methodology presented in ECLAC (2009a), six of the largest economies of the region, Argentina, Brazil, Chile, Colombia, Mexico and Peru, which together account for about 90 per cent of regional GDP, were on the road to economic recovery in the third quarter of 2009 (see figure XI).

Figure XI
Latin America (selected countries): leading indicators
(Probability of recovery)



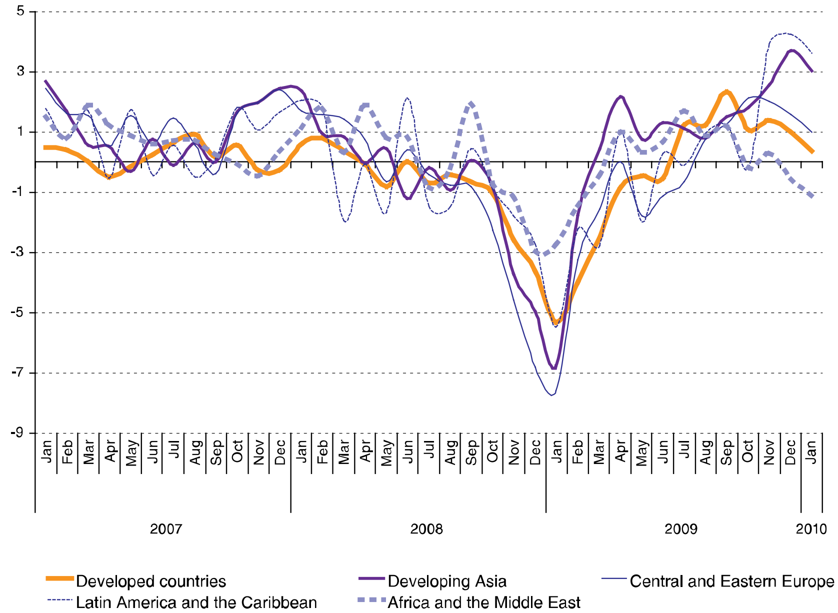
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

45. Expectations that the downturn witnessed in economic activity between the fourth quarter of 2008 and the second quarter of 2009 would be reversed were consistent with the improvements detected in the analysis of the latest information on most of the variables for the real economy.

46. Export volumes began to expand again as of the third quarter of 2009 (see figure XII), while the increase in global economic activity and international trade is having a positive effect on demand for commodities and has been pushing up commodity prices since the second quarter of 2009. This is, in turn, reversing the worsening of the region's terms of trade, which are expected to improve by 4.1 per cent in 2010 for the region as a whole, and by even more in the hydrocarbon- and metal-exporting countries of South America and in Mexico. The terms of trade of Central America, in contrast, are projected to worsen (see figure XIII).

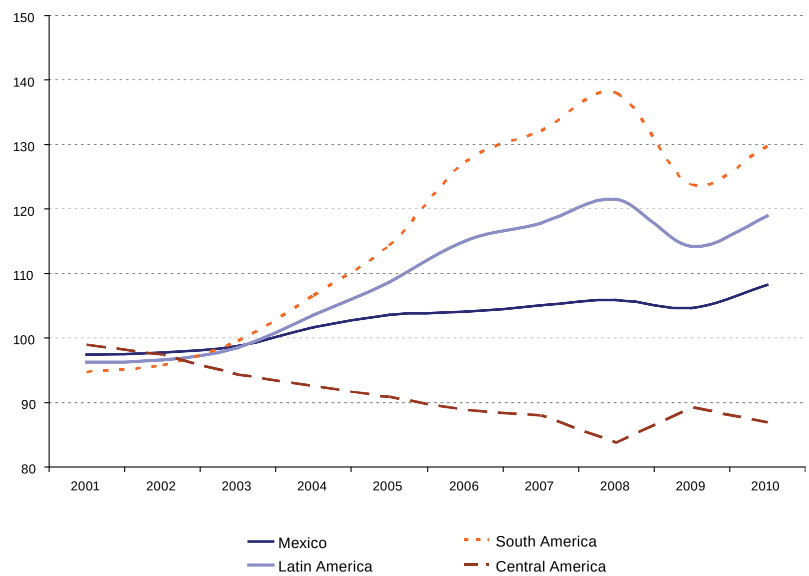
47. With regard to remittance flows, the onset of economic recovery in the United States of America and Spain, the two main destinations for Latin American and Caribbean emigrants, adds weight to expectations of a recovery in that category of foreign-exchange inflows to the region.

Figure XII
Variation in trade volume (average volume of imports plus exports), by region[a]
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of the Centraal Planbureau (CPB), Netherlands Bureau for Economic Policy Analysis.
[a] Three-month moving average compared with the previous quarter.

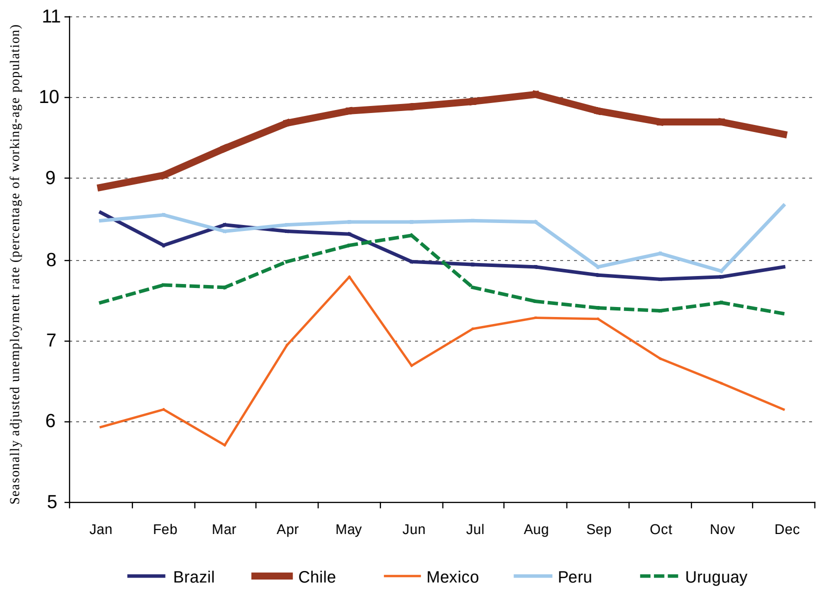
Figure XIII
Latin America: terms of trade, 2001-2010
(Index 2000=100)



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

48. In some countries, domestic demand continued to receive fiscal stimulus in the second half of 2009 which, along with the factors mentioned earlier and as a result of a gradual return to normalcy in financial markets, often with the additional support of official banks, led to a recovery — at fairly rapid rates, in some cases — which was reflected in the gradual improvement in labour-market indicators for the region (see figure 14).

Figure XIV
Latin America (selected countries): seasonally adjusted monthly unemployment rates, 2009
(Percentages of working-age population)

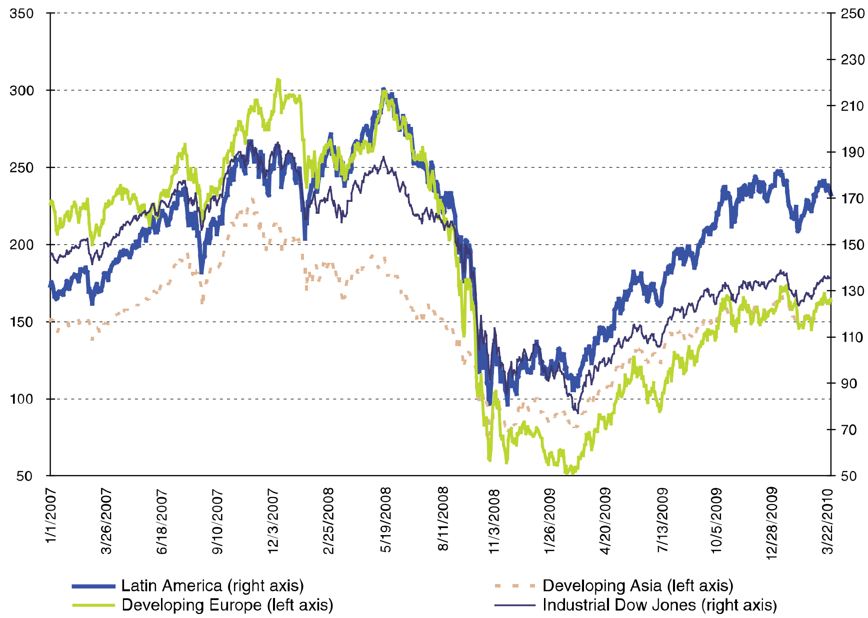


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

49. At the same time, the increased tolerance for risk in a context of high liquidity in international financial markets — along with a positive perception of prospects for several of the economies in the region — resulted in a number of countries regaining access to international credit. This had a positive effect on stock markets (see figure XV) which began to return to levels seen prior to the worsening of the crisis.

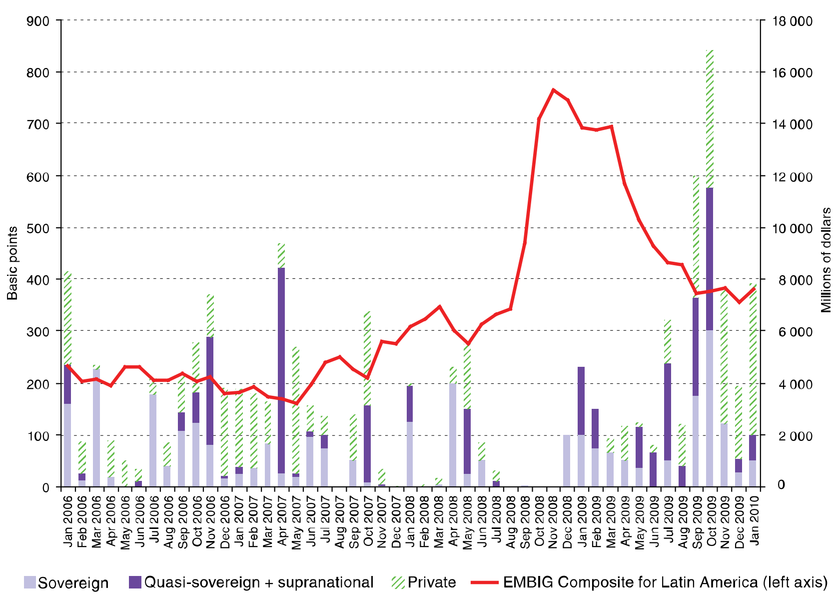
50. By December 2009, a total of US$ 65 billion in sovereign and corporate bonds had been issued by the region on international markets: more than either the total for 2008 (US$ 19 billion) or the average for 2006 and 2007 (US$ 42 billion annually). The surge in corporate bond issues had a strong hand in this high total figure (see figure XVI).

Figure XV
Stock market indicators: Dow Jones and emerging markets
(Index 2000=100)



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

Figure XVI
Latin America and the Caribbean: EMBIG[a] and external bond issues
(Basis points and millions of dollars)



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

[a] Emerging Markets Bond Index Global.

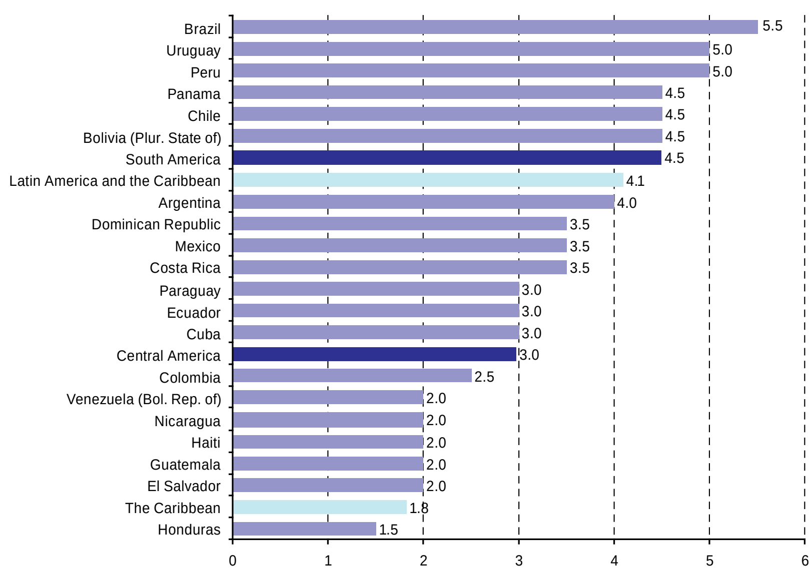
51. In turn, the private sector should be able to restructure assets and lending activity should return to normal which, together with the gradual improvement in labour market indicators and the renewed confidence within the private sector, as indicated by surveys of business and consumer expectations, should sustain a recovery in domestic demand for both consumer and capital goods.

V. Prospects, risks and challenges facing the region

52. Given the speed of the recovery that became evident in the second semester of 2009, in 2010 the region could return to growth rates that, in some cases, will come close to matching those seen prior to the crisis. While this is the most likely scenario, it is not without risks. Moreover, there are doubts as to whether this recovery will lead to sustained growth.

53. The projected growth rate for 2010 is 4.1 per cent, with expectations of stronger growth in South America than in the other subregions, given the larger size of the domestic markets in some of the countries (particularly Brazil and, to a lesser extent, Argentina and Colombia), the diversification of export markets, and the greater role played by Asia, China, in particular, as export markets for a number of countries (Argentina, Brazil, Chile and Peru). By contrast, slower growth is expected in more open economies that have a less diversified portfolio of trading partners and are more heavily reliant on manufacturing trade, such as Mexico and the Central American economies. The Caribbean economies may be similarly placed and many face additional difficulties arising from a complex financial and exchange-rate situation (see figure XVII).

Figure XVII
Latin America and the Caribbean: growth rates, 2010
(Percentages)



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

54. In this context of increased growth and higher prices for a number of commodities in which the region specializes, there is reason to expect a rise in public revenues and, to the extent that private sector demand increases, a gradual decline in government consumption throughout the year. In countries that specialize more heavily in natural-resource-intensive processed goods, however, higher fiscal revenues will boost the Governments' capacities to inject impetus into domestic activity. Capital expenditures, responding more slowly, will continue to increase as a result of various projects initiated in 2009. This should not prevent an improvement in the fiscal balance, however.

55. To the extent that growth takes hold and approaches potential growth rates, inflation could begin to edge up, which could lead to a tightening of monetary policy, perhaps towards the end of the year. Here, however, central banks will again face the choice between maintaining price stability and limiting currency appreciation, in an environment in which exchange rates will very probably be subject to downward pressure (currency appreciation) owing to a surplus of hard currency resulting from abundant international market liquidity.

56. While there is reason to expect a deterioration in the balance-of-payments current account compared to 2009, mostly as a result of an upturn in imports, the availability of external financing, together with increased FDI inflows, will probably suffice not only to cover this larger deficit, but even to continue restoring international reserve levels.

57. Economic growth should help to increase rates (and, probably, the quality) of employment, although it will likely mean a corresponding increase in the participation rate, which will partially offset the impact on unemployment. All in all, it is estimated that unemployment could fall to around 8 per cent, settling mid-way between pre- and post-crisis levels. This, in turn, would have a positive effect on poverty indicators.

58. Beyond the problems that persist in some economies of Eastern Europe, it remains to be seen whether the developed economies will be able to grow as they phase out the substantial stimulus initiatives associated with the countercyclical policies implemented in the United States and Europe. Together with the increase in unemployment and the still volatile international financial market, this raises questions about the strength of the recovery that began in 2009.

59. As noted earlier, expansionary monetary policy, led by the world's principal central banks, with the emerging economies following suit, led to historically low interbank interest rates. This greater liquidity, however, was not reflected in increased credit to the private sector, which has been slowing in much of the world, and even declining in year-on-year terms in the United States and the euro area.

60. The credit squeeze is the result of a combination of factors limiting both supply and demand, associated with the fall in economic activity and the loss of wealth experienced by economic agents, most notably towards the end of 2008. Since then, banking institutions have been focusing on shoring up their balance sheets and reducing their exposure, and are maintaining greater liquidity in order to deal with potential problems. The banks' more conservative stance is compounded by the reduced solvency of many businesses whose balance sheets — and, thus, their eligibility for credit — were damaged by the crisis.

61. The challenge facing the global economy is how to leverage credit to speed up the recovery, particularly with regard to financing consumption and SMEs, at a time when the public sectors of many developed countries will have greater need for financing to cover the massive deficits built up by their fiscal stimulus measures.

62. This situation creates a tension between the need to maintain the policy stimulus if private sector demand is slow to pick up, and the increasing problem this creates in terms of availability of credit for businesses and consumers, as well as the burden of financing the enormous deficits accumulated in some countries. All of this must be considered against a backdrop of continued supply constraints due to uncertainty and the bias towards liquidity that are still evident in financial markets.

63. The other major risk is that concern over the need to progressively close fiscal gaps will take precedence over other policy objectives, and that this will lead to a premature withdrawal of fiscal and monetary stimulus measures that, at least thus far, have been the principal factors buttressing demand, and the main (in some cases the only) engine driving economic recovery.

64. It is highly probable that the crisis will lead to profound changes that will produce a less growth-friendly international environment than the conditions the region experienced between 2003 and 2008. One factor is that the post-crisis world is likely to see slower overall growth, given the drop in aggregate demand in the developed countries, counterbalanced in part by rising overall demand in the developing countries.

65. As a result, the emerging economies may be expected to play a stronger role in world growth, but within the framework of a slowdown in trade flows. The drop in demand for imports among developed economies will mean that emerging economies will have fewer opportunities to place their products in those markets, which will exacerbate competition and encourage the adoption of domestic-market-oriented strategies, at least in the larger economies. At the same time, this shows up the need to redefine patterns of production and trade specialization and encourage innovation, the building-in of knowledge and product diversification, on the one hand, and to build up a highly diversified portfolio of destination markets, with many in Asia, on the other.

66. The global financial crisis has also highlighted the need to reform the international financial architecture and, in particular, regulatory and oversight systems, in order to ensure greater international financial stability. Though it is clear that the reform impetus is weakening as the global economy recovers, it may be expected that a new, more transparent banking model will be developed, with less incentive for risk-taking and lower levels of leveraging. This could lead to a reduction in international financial flows and, therefore, a partial reversal of the pattern of financial integration seen prior to the crisis.

67. Although it is not yet clear how these factors will affect interest rates in general, there is a risk they will rise, given projections of steadily mounting public debt in some developed countries and the lack of any tax or fiscal reform that might lead to lower demand for resources on the part of those countries' public sectors. Nevertheless, this situation could change, insofar as awareness increases of the risks to growth, fiscal reforms are put in place and saving rates begin to rise.

68. Be this as it may, resource flows from the most demanding segments of the international capital markets to higher-risk countries are very likely to decrease,

given the greater caution prevailing in the wake of the financial crisis and the possibility of regulatory changes that could limit risk-taking. This could deepen the differences among developing countries in terms of access to the international capital markets, which would oblige less well-endowed or more macroeconomically vulnerable countries to rely more heavily on financing from multilateral agencies or on more expensive financing under less advantageous conditions.

69. The question then arises as to how the region can make further inroads in a world characterized, on the one hand, by lower growth rates in the developed countries and developing countries playing a larger role in global growth, and, on the other, financial systems that are subject to stricter regulations and oversight, with less dynamic credit markets and higher interest rates? How, moreover, is this to be accomplished in a way that allows for sustained growth at rates that will make it possible to meet social needs, while at the same time providing for more equitable distribution of the benefits of that growth?

70. The recovery from the crisis seems to have been quicker than expected, largely thanks to the domestic strengths built up by the countries of the region as a result of sounder macroeconomic policies. Upturns in several of the factors that drove demand in the years prior to the crisis, coupled in many cases with strong impetus from public policies, should enable a rapid recovery in the context of substantial idle capacity. But how can that recovery be transformed into a process of sustained growth beyond 2010?

71. Answering these questions satisfactorily is well beyond the scope and ability of this document, which merely offers a brief discussion of the role of public policies in this connection. Aside from differences from country to country, the Latin American and Caribbean economies have certain features in common that underscore the importance of State involvement. In the short term, the countries of the region acted to offset the effects of the crisis to the best of their capacities — in the process revealing major differences in terms of this capacity. But the objective of regaining a sustained growth path poses fresh and more complex challenges. For this reason, the Latin American and Caribbean countries face the unavoidable task of generating and expanding the policy space, for which they must (with few exceptions) increase the resources available for financing policies, create instruments and strengthen their institutions, particularly those involved in coordinating different policy areas.