United Nations

E/2013/19

Economic and Social Council

Distr.: General
5 April 2013

Original: English

Substantive session of 2013
Geneva, 1 July-25 July 2013
Regional cooperation

Latin America and the Caribbean: economic situation and outlook, 2012-2013

Summary

The deterioration in the global economy in 2012 was transmitted to Latin America and the Caribbean mainly through the trade channel. Growth in export values tailed off sharply for the region overall, from 23.9 per cent in 2011 to an estimated 1.6 per cent in 2012. It is estimated that the Latin American countries posted a balance-of-payments current account deficit equivalent to 1.6 per cent of regional gross domestic product (GDP) in 2012, slightly wider than the 1.3 per cent in 2011.

Amid global financial instability, net financial inflows into Latin America and the Caribbean were down heavily. Combined with a larger current account deficit, this led to reserve accumulation of just 50 per cent of the figure for 2011. Net foreign direct investment also shrank, but still remained well above 2010 levels, reflecting the region's attractiveness as an investment destination.

Economic activity in 2012 showed some resilience to external shocks. In particular, the region's rate of GDP growth (3 per cent) exceeded global growth (2.2 per cent).

Consumption remained the leading component of growth in 2012, with investment making a smaller contribution than in 2011.

Employment and wages rose, with unemployment falling more among women than among men, but there are signs that growth in "quality" employment has slowed in some countries. For the region overall the urban unemployment rate declined from 6.7 per cent in 2011 to 6.4 per cent — representing around 15 million people — in 2012.

In most of the countries, monetary policy was geared towards offsetting the negative impact of shrinking external demand on economic activity. Generally speaking, the countries avoided policies, such as interest rate hikes or other types of measure aimed at controlling monetary aggregates, that could choke credit growth

and domestic demand. Upward pressure on the currencies eased, but exchange rates became more volatile in some countries.

The fiscal position deteriorated in most of the countries, but fiscal policies remained predominantly prudent. With only a few exceptions, the gap between income and expenditure rose in most of the countries, and the spending growth helped to buoy domestic demand.

It is estimated that GDP growth in Latin America and the Caribbean could pick up to around 3.8 per cent in 2013, thanks to brighter prospects in the United States of America and China, higher growth in Argentina and Brazil, and still fairly buoyant domestic demand in several of the region's economies.

In Latin America and the Caribbean, however, the challenge remains of increasing and stabilizing investment growth (rather than relying solely on consumption) to drive structural change, absorb technical progress and achieve suitable growth. In this connection, tapping the regional market within an open regionalism approach could help to offset the weak rendering of external demand in the past few years.

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I. Introduction

1. The global economy slowed significantly in 2012, amid recession in Europe caused by financial, fiscal and competitiveness imbalances, especially in the euro zone, as well as the slowdown in China and moderate growth in the United States of America. Growth rates for output and global trade fell and capital flows to developing countries shrank and became more volatile.

2. The global downturn was transmitted to Latin America and the Caribbean mainly through the trade channel. Growth in export values tailed off sharply for the region overall, from 23.9 per cent in 2011 to an estimated 1.6 per cent in 2012. Falling prices for a large group of export products eroded the value exported and, by contrast with previous years, volume growth was the factor driving the modest increase in the value of exports.

3. Chiefly as a consequence of the deteriorating trade balance, it is estimated that the Latin American countries posted a balance-of-payments current account deficit equivalent to 1.6 per cent of regional gross domestic product (GDP) in 2012, a slight deterioration from the 1.3 per cent in 2011. The deficit on the income account narrowed slightly (from 2.5 per cent to 2.3 per cent of GDP) and current transfers remained stable (at 1.1 per cent of GDP), but this was not enough to prevent the deterioration in the current account position.

4. Amid global financial instability, in 2012 short-term net capital inflows into Latin America and the Caribbean were down from the preceding year. Net financial flows fell heavily with respect to 2011 and this, combined with a larger current account deficit, led to reserve accumulation of just 50 per cent of the figure for 2011. Net foreign direct investment also shrank, but still remained well above 2010 levels, reflecting the region’s attractiveness as an investment destination.

5. Economic activity in Latin America and the Caribbean in 2012 showed some resilience to external shocks. In particular, the region’s rate of GDP growth (3 per cent) exceeded global growth (2.2 per cent). Consumption remained the leading component of growth in 2012, with investment making a smaller contribution than in 2011, owing chiefly to the contraction in Argentina and Brazil, which both weigh heavily in the regional average.

6. Employment and wages rose, with unemployment falling more among women than among men, but there are signs that growth in “quality” employment has slowed in some countries. For the region overall the urban unemployment rate declined from 6.7 per cent in 2011 to 6.4 per cent — representing around 15 million people — in 2012. Wage employment continued to grow faster than own-account work (3.1 per cent versus 1.3 per cent).

7. In most of the countries, monetary policy was geared towards offsetting the negative impact of shrinking external demand on economic activity. Generally speaking, the countries avoided policies, such as interest rate hikes or other types of measure aimed at controlling monetary aggregates, that could choke credit growth and domestic demand, despite an uptick in inflation caused in part by the rise in food prices starting in September 2012.

8. The pressure for currency appreciation eased but exchange-rate volatility increased in some countries. The deteriorating current account position and smaller capital inflows into the region meant that the reserves build-up was slower than it

had been in 2011, both as a share of GDP and in absolute terms. Although the exchange rates of countries that are more deeply integrated into international financial markets had followed much the same path in 2011 amid the various shocks that year, the degree of correlation between their movements began to diminish in early 2012.

9. The fiscal position deteriorated in most of the countries, but fiscal policies have remained predominantly prudent. With only a few exceptions, the gap between revenue and expenditure rose in most of the countries as spending rose faster (0.7 percentage points of GDP, on average) than income (0.2 percentage points). This spending growth helped to buoy domestic demand, especially consumption, since in 2012 current spending climbed by 0.4 percentage points of GDP and capital spending by 0.3 percentage points of GDP.

10. The economic outlook for Latin America and the Caribbean depends heavily on how the global economy evolves in 2013. The most likely scenario is very low or flat growth in Europe, some momentum in the United States, and continued growth in China. Taking this as the baseline scenario, it is estimated that GDP growth in Latin America and the Caribbean could pick up to around 3.8 per cent, owing to two effects in particular. First, higher growth in Argentina and Brazil and, second, reasonably buoyant domestic demand in some of the region’s economies, thanks to better labour indicators, a rise in bank lending to the private sector and no further significant falls in commodity prices.

11. However, in Latin America and the Caribbean, the challenge also remains of increasing and stabilizing investment growth (rather than relying solely on consumption) to drive structural change, absorb technical progress and achieve suitable growth. In this connection, tapping the regional market within an open regionalism approach could help to offset the weak rendering of external demand in the past few years.

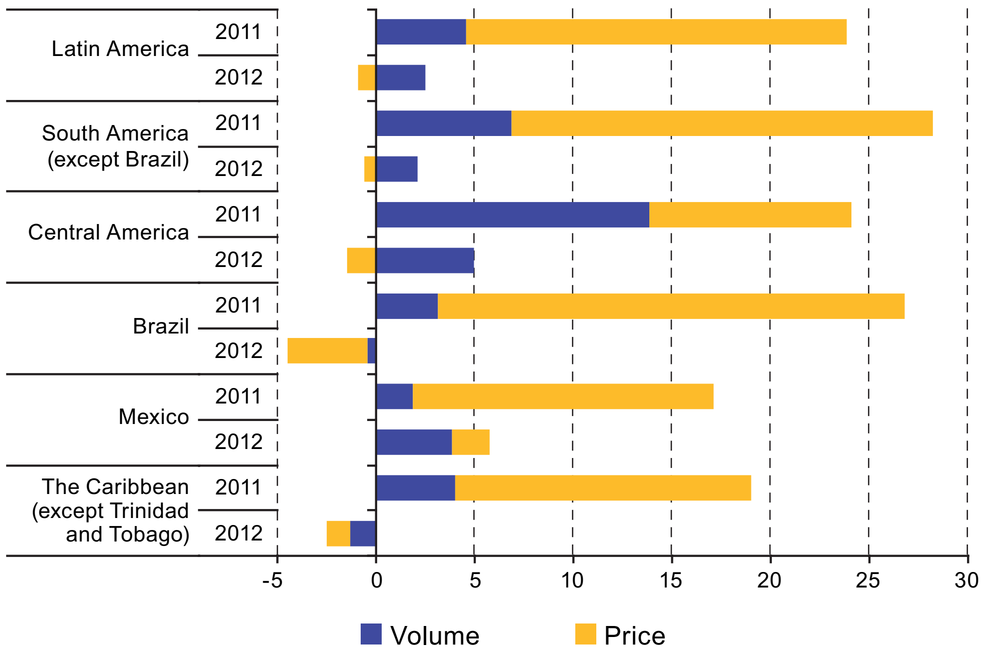
II. External context and its impact on Latin America and the Caribbean

12. Lower growth in the global economy resulted in contraction or lower growth for the region’s goods and services exports. The global economy slowed significantly in 2012, amid recession in Europe caused by financial, fiscal and competitiveness imbalances, especially in the euro zone, as well as the slowdown in China and moderate growth in the United States. Growth rates for output and global trade fell and capital flows to developing countries shrank and became more volatile.

13. This deterioration was transmitted to Latin America and the Caribbean mainly through the trade channel. With the European Union in recession and China’s economy slowing in 2012, the region’s exports to the European Union shrank by 4.9 per cent in value terms and those to China, by 1.7 per cent according to preliminary data. By contrast, exports to the United States increased by 4.8 per cent, thanks to modest growth in that economy, and intraregional exports climbed 1.4 per cent. Growth in export values tailed off sharply for Latin America and the Caribbean overall, from 23.9 per cent in 2011 to an estimated 1.6 per cent in 2012. Falling prices for a large group of goods heavily eroded export values and, in contrast to the

situation in earlier years, higher volumes drove the modest rise in overall export values (see figure I).

Figure I
Latin America: estimated growth in export values, with contribution of volumes and prices, 2011-2012
(Percentages)



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

14. The impact was differentiated within the region. Hydrocarbon-exporting countries, together with Mexico and the Central American and Caribbean countries, much of whose goods and services exports go to the United States, felt a smaller impact since many of them increased their exports to that economy and, in some cases, to Europe and China as well. Other South American countries, which ship a larger share of their exports, especially of natural resources, to China and the European Union, suffered a heavier impact, with exports to both destinations falling sharply for some of them.

15. Import prices were less variable than export prices. Volume growth appears to have been much the same for imports as for exports, but generally positive changes in the unit value of imports meant that their total value increased by more than that of exports in 2012. As a result, the surplus on the merchandise trade balance for the region overall narrowed from 1.3 per cent of regional GDP in 2011 to 0.9 per cent in 2012.

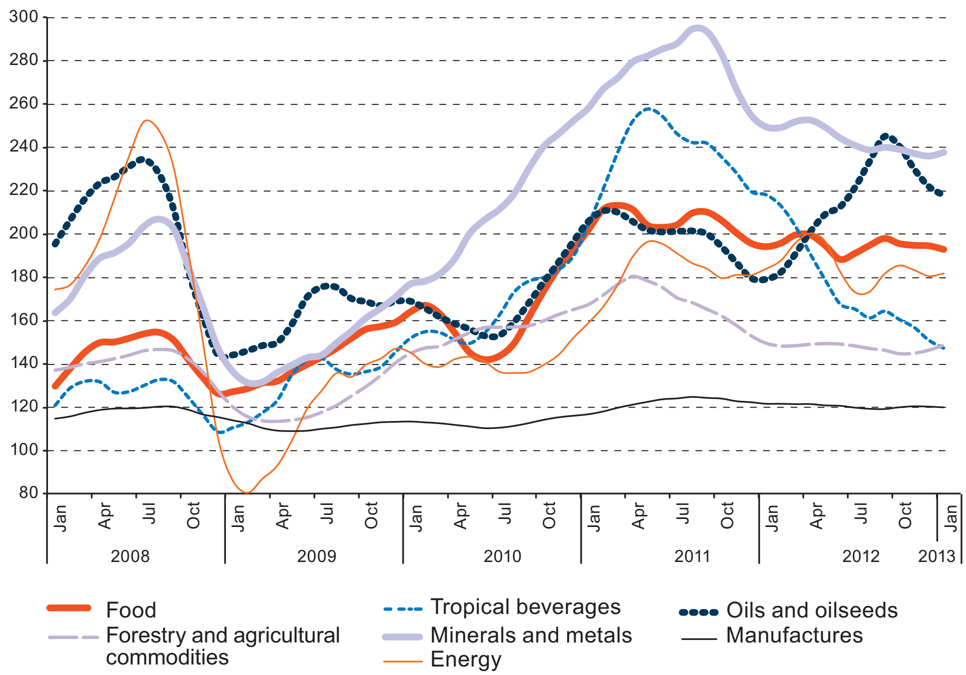
16. The services balance also continued to deteriorate in 2012. One of the main reasons appears to have been the increased cost of freight, insurance and other services associated with goods imports (whose volume continued to increase, as noted above). The most negative outcome was in South America. By contrast, the

services balance held steady as a share of GDP in the Central American countries and Mexico.

17. Weaker external demand resulted in a slight worsening of the terms of trade. As a result of lower global economic growth, especially in Europe and, to a lesser degree, in Asia, prices for some commodities that account for a large share of the region's export basket trended downward in 2012 (see figure II). In particular, lower demand from emerging and developing economies, particularly in Asia, led to a drop in metal and mineral prices. By contrast, food prices were a partial exception to this trend, as they did not decline but rather fluctuated as a consequence of climatic factors.

Figure II
Latin America: price indices for export commodities and manufactures, January 2008 to January 2013[a]

(Index: 2000=100, three-month moving average)



Source: ECLAC, on the basis of figures from the United Nations Conference on Trade and Development (UNCTAD) and the Netherlands Bureau for Economic Policy Analysis.

[a] The export commodity groups are weighted by their share of Latin American exports.

18. After remaining high in the early months of 2012, the oil price fell back in the second quarter. This tendency was reversed in the third quarter, however, and at year end was very close to its 2011 level. The limited movement of the oil price reflects both a rise in global production (particularly in the Middle East) and a slackening of demand, especially in the euro zone.

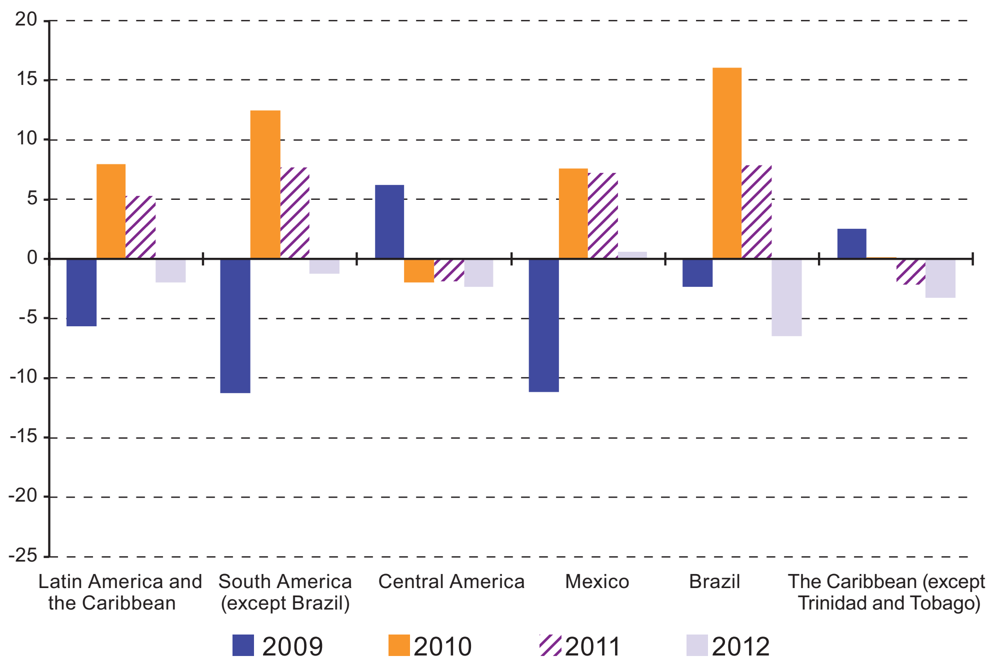
19. Given these developments, the region's terms of trade are estimated to have fallen by 2.2 per cent in 2012 (see figure III). For South America, however, a 3.5 per cent decline is estimated, with exporters of mining and metal products (Chile, Peru

and Brazil) suffering the largest downturn, while the other countries in the region, especially those which export agro-industrial products or hydrocarbons, saw modest terms-of-trade gains.

20. Terms of trade are estimated to have declined by 1.7 per cent for the Central American countries and 3.2 per cent for the Caribbean countries in 2012. The deterioration is attributable to the fall in the prices of the main products exported by these subregions (sugar, coffee and metals). In the case of Mexico, terms of trade improved slightly owing to the fact that its main exports are manufactures.

21. The balance-of-payments current account is estimated to have worsened in most of the countries of the region. Chiefly as a consequence of the deteriorating trade balance, it is estimated that the Latin American countries posted a balance-of-payments current account deficit equivalent to 1.6 per cent of regional GDP in 2012, a slight deterioration from the 1.3 per cent in 2011 (see table). Because of the cooling world economy, the value of exports is estimated to have grown by less (1.6 per cent) than that of imports (4 per cent), with the trade balance thus deteriorating from a surplus of 0.1 per cent of GDP in 2011 to a deficit of 0.4 per cent in 2012.

Figure III
Latin America: estimated variation in the terms of trade, 2009-2012[a]
(Percentages)



Source: ECLAC, on the basis of official figures.
[a] The data for 2012 are estimates.

Table
Latin America: breakdown of the current account, by subregion, 2011-2012[a]
(Percentages of GDP)

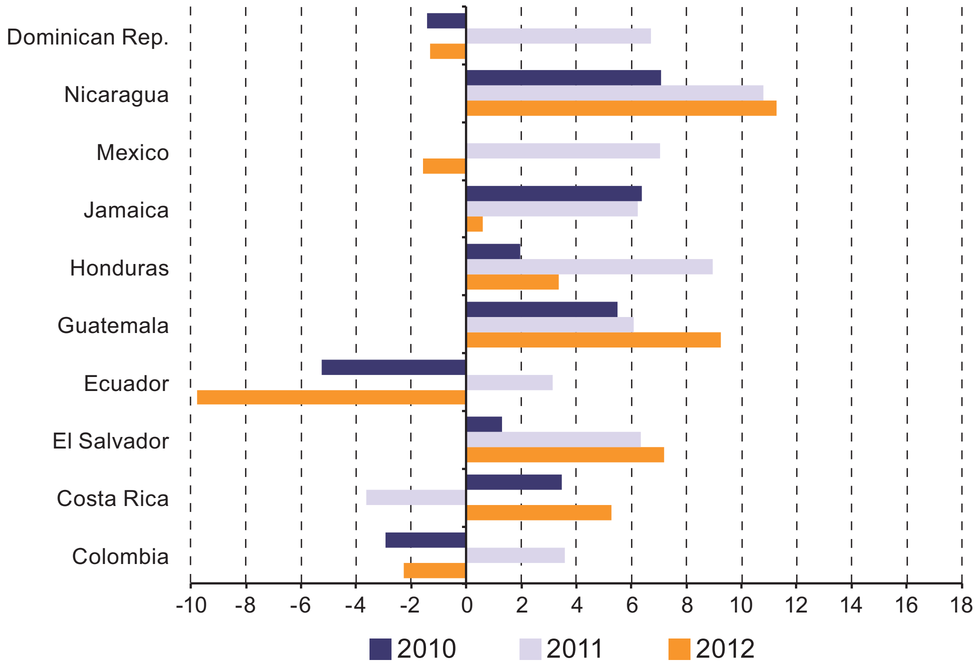
	Goods balance		*Services balance*		*Income balance*		*Transfers balance*		*Current account*	
	2011	*2012*	*2011*	*2012*	*2011*	*2012*	*2011*	*2012*	*2011*	*2012*
Latin America	1.3	0.9	-1.2	-1.3	-2.5	-2.3	1.1	1.1	-1.3	-1.6
South America	2.7	2.2	-1.5	-1.6	-2.7	-2.5	0.4	0.4	-1.1	-1.5
Central America	-16.1	-15.5	3.7	3.8	-3.4	-3.6	8.7	8.3	-7.1	-7.0
Mexico	-0.1	0.0	-1.2	-1.2	-1.5	-1.4	2.0	1.9	-0.8	-0.7

Source: ECLAC, on the basis of official figures.
[a] Data for 2012 are estimates.

22. The main reason for the current account deterioration was a decline in the goods surplus resulting from lower demand for commodities and a terms-of-trade deterioration, particularly for the countries exporting most to the euro zone and China. There were large differences between the region's countries in this respect, however. Chile and Peru appear to have seen a considerably smaller goods trade surplus because of declining exports to Asia and Europe. Brazil's trade deficit rose, as exports fell heavily. By contrast, goods balances appear to have improved in Ecuador and the Plurinational State of Bolivia, owing to higher hydrocarbon prices and an increase in export volumes. Mexico's trade balance appears to have held fairly steady as a proportion of GDP, although its current account deficit narrowed as a result of lower factor income outflows. Central America's current account deficit also appears to have remained fairly unchanged at about 7 per cent of GDP.

23. Current transfers, consisting mainly of remittances from workers abroad, rose slightly. Their share of GDP held steady at 1.1 per cent in 2012, albeit with large variations from country to country (see figure IV). The significant increases in El Salvador and Guatemala were owing to a relative upturn in economic activity and labour market prospects in the United States, while the rise in Nicaragua was chiefly owing to the work of the country's migrants in Costa Rica. The declines in remittance flows to Colombia and Ecuador, meanwhile, reflected the difficult employment situation in Spain, the main destination for Colombian and Ecuadorian migrants, where unemployment stood at around 25 per cent.

Figure IV
Latin America and the Caribbean (10 countries): year-on-year change in emigrant workers' remittances, 2010-2012[a]
(Percentages)



Source: ECLAC, on the basis of official figures.
[a] The rates for 2012 for Costa Rica and Ecuador are up to the third quarter.

24. The deficit on the income account is estimated to have improved slightly in nominal terms, from 2.5 per cent to 2.3 per cent of regional GDP, reversing the downtrend of recent years. This development is linked to the decline in a number of export commodity prices in 2012, resulting in lower earnings for foreign firms operating or investing in the region, with the consequent decline in profit remittances.

25. Amid global financial instability, short-term net capital inflows into Latin America and the Caribbean were down in 2012. Financial flows into the region continued to exceed the current account deficit and refinancing needs, so that international reserves tended to continue to build up, but there were changes from 2011. Net financial inflows were significantly down on the previous year and this, in combination with a larger current account deficit, meant that the reserves build-up was only 50 per cent of that seen in 2011.

26. The drop in net inflows was mainly accounted for by increased outflows in the other net investment liabilities category, which includes the most volatile and shortest-dated components of external financing, and whose evolution partly reflected increased uncertainty in global financial markets. The greatest outflows were from Argentina, the Bolivarian Republic of Venezuela and Mexico, but those from Chile, Colombia, Costa Rica, Guatemala and Uruguay were also substantial.

27. While net foreign direct investment diminished slightly, it remained substantially above 2010 levels, reflecting the region's attractiveness as an investment destination. Lastly, net portfolio investment showed a slight increase over 2011, especially in Mexico. Generally speaking, private-sector bond issues abroad were highly dynamic in 2012, exceeding sovereign issues (which fell in the case of countries such as the Bolivarian Republic of Venezuela, El Salvador, the Dominican Republic and Mexico), despite a small increase in risk in the region.

III. Economic growth, employment and wages

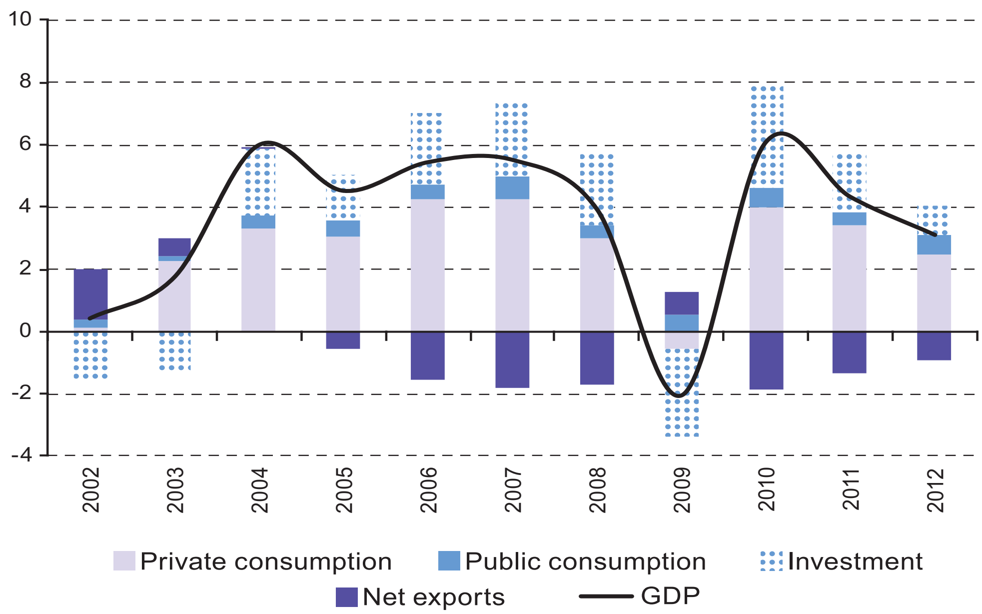
28. Growth was slower in Latin America and the Caribbean in 2012, although several economies maintained their momentum. The economic activity arising from the interaction between global economic deterioration, the regional pattern of specialization and the policy mix implemented by the Governments suggested that Latin America and the Caribbean has continued to show some resilience to external shocks. In particular, the regional rate of GDP growth (3 per cent) exceeded global growth (2.2 per cent), unemployment eased down from 6.9 per cent in 2011 to 6.4 per cent in 2012, and real wages rose. Most of the English- and Dutch-speaking Caribbean countries, which have taken longer to rebound from the global financial crisis of 2008-2009, returned growth rates in 2012 that were still low, but nevertheless positive and slightly up on 2011 (1.1 per cent versus 0.4 per cent).

29. The regional performance was heavily weighted by slower growth in two of the largest economies, Argentina (2 per cent in 2012 compared with 8.9 per cent in 2011) and Brazil (0.9 per cent in 2012 compared with 2.7 per cent in 2011). Not including these two countries, the regional GDP rose by 4.4 per cent, which was not far from the rate without those countries in 2011 (4.5 per cent). The economy of Mexico expanded 3.9 per cent and several countries posted rates of 5 per cent or more, including the Bolivarian Republic of Venezuela and Chile (both 5.6 per cent), Costa Rica (5 per cent), Peru (6.3 per cent) and the Plurinational State of Bolivia (5.2 per cent). Panama was again the region's fastest-growing economy (10.7 per cent). The other economies in Latin America and the Caribbean expanded by between 1 per cent and 5 per cent, except for Paraguay, Saint Kitts and Nevis and Jamaica, which registered negative growth. Central America overall achieved growth of 4.2 per cent, South America 2.5 per cent and the Caribbean 1.1 per cent.

30. In aggregate regional terms, economic activity in the region reflected two opposing trends in 2012: the slowdown observed in 2011 continued into the first half of 2012, albeit not with the same intensity in all countries; in the third quarter, however, the regional economy started to pick up, owing in large part to the tenuous recovery in the Brazilian economy.

31. Consumption remained the leading component of growth. With external demand weakening, growth in the region was driven by domestic demand, fuelled partly by monetary or fiscal policy measures in most of the countries (see figure V). The rise in demand was chiefly a reflection of consumption, with public consumption making a larger contribution than in 2011, consistently with the expansion of public spending in many countries. Robust domestic demand partly offset the more sluggish performance of the external sector, whose negative impact was felt more strongly in several South American countries.

Figure V
Latin America: GDP growth and contribution to growth by the components of aggregate demand, 2002-2012[a]
(Percentages based on United States dollars at constant 2005 prices)



Source: ECLAC, on the basis of official figures.
[a] The data for 2012 are estimates.

32. The performance of domestic demand was matched by a rise in domestic economic activity, especially in the services sectors (commerce, restaurants and hotels, and financial and business services) and in construction. Services activities expanded strongly across the board, with all countries recording positive growth. The construction sector recorded double-digit expansion in the Bolivarian Republic of Venezuela, Ecuador, Panama, Peru and Uruguay, unlike the situation in Argentina and Paraguay, where it contracted.

33. Investment made a smaller contribution to growth in 2012 than it had in 2011, owing mainly to the investment contraction in Argentina and Brazil, which both weigh heavily in the regional average. Investment growth was slack, too, in some Central American countries, and in Cuba and the Dominican Republic, with very low investment ratios of around 15 per cent of GDP or less in 2012, although remittances helped to drive expansion of domestic demand. Investment was strongly up in other countries of the region, however, and Latin America and the Caribbean overall achieved an average ratio investment of 22.9 per cent of GDP in 2012, the highest value recorded since 1981. Evidence of stronger growth in construction and commerce suggests that investment went mainly to those sectors and less to procurement of machinery and equipment.

34. At the regional level, loss of momentum in domestic demand meant that real imports of goods and services were less brisk at 4.7 per cent, reflecting more moderate growth in consumption and investment across the region as a whole. Meanwhile, real exports of goods and services expanded by 3.7 per cent. With real

regional imports slowing even more sharply in comparison with 2011, net exports again contributed negatively to growth but less so than in 2011.

35. Employment and wages rose, with unemployment falling more among women than among men, but there are signs that growth in “quality” employment has slowed in some countries. For the region overall, urban unemployment eased down from 6.7 per cent in 2011 to 6.4 per cent in 2012, which was no small achievement in the context of a slowing global economy, but a smaller gain than in recent years: unemployment rates were 8.1 per cent in 2009 and 7.3 per cent in 2010. This represented a reduction of 400,000 in the absolute number of urban unemployed in the region overall, to about 15 million. The drops in unemployment and rises in employment in the past few years have been larger in the South American countries and have been occurring more recently in Mexico. Mexico and Central America have yet to regain pre-2009 employment levels and the Caribbean has not achieved a significant reduction in unemployment since 2009.

36. Based on the simple average of 15 countries for which sex-disaggregated, labour-market information is available, the rise in employment levels occurred mainly among women: the female employment rate rose by 0.4 percentage points, while the rate for men remained unchanged. The long-term upward trend in the female participation rate continued (0.3 percentage points), while the male participation rate diminished in many countries, giving a 0.1 percentage-point reduction on average. Consequently, the unemployment rate among women fell slightly more (by 0.2 percentage points) than the rate for men (0.1 percentage points). Notwithstanding recent advances, disparities between men and women in terms of participation, employment and unemployment continue to be heavily skewed against women.[1]

37. Higher public current spending helped to boost public sector employment in many countries in 2012. Other indicators suggest that improvements are still taking place in the labour market, but at a slower rate than before. Growth in formal wage employment remained strong in several countries, but slowed in Argentina and Brazil in particular, in keeping with slackening economic growth. Growth in wage employment (3.1 per cent) continued to outstrip growth in own-account employment (1.3 per cent). Only in Argentina, the reverse occurred with brisker growth in own-account employment. In most of the countries with data available (7 of 10), the services sector expanded its share in total employment, which reflects slower growth in tradable sectors, such as agriculture and industry, which are harder hit by sluggish external demand.

38. Generally speaking, real wages rose, which helped to bolster domestic demand, particularly consumption. Higher minimum wages in many countries contributed to the rise in real wages at the regional level. In addition, a number of countries made changes to their labour legislation, including measures to give domestic workers stronger rights and better income (Nicaragua, Uruguay and Ecuador), to broaden breastfeeding rights (Bolivarian Republic of Venezuela, Ecuador and Mexico), and to restructure social security contributions to favour labour-intensive activities (Brazil). In Mexico broader legislative changes were made, including the introduction of new types of contract and the regulation of subcontracting.

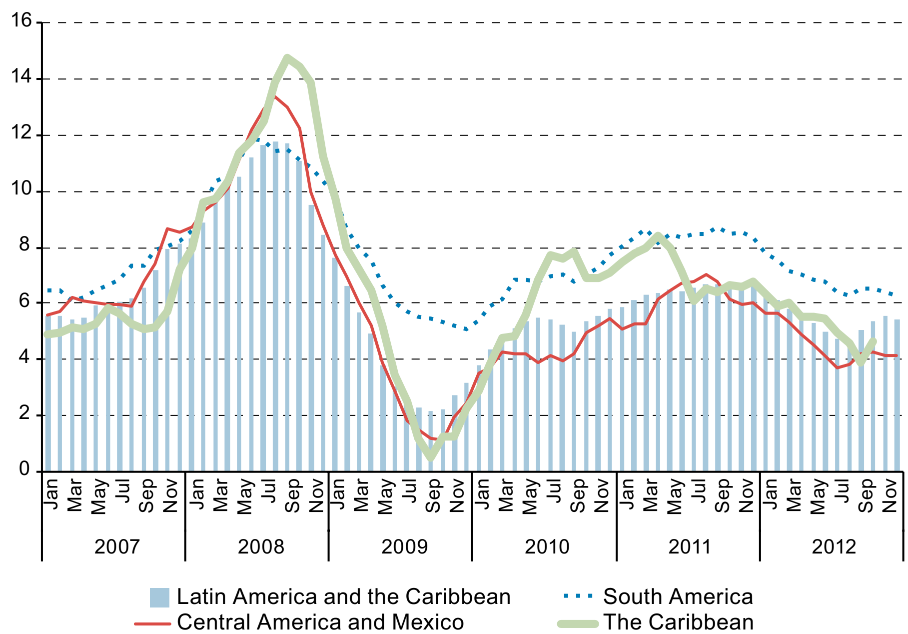
[1] In 2011, the open urban unemployment rate, based on the simple average for 19 Latin American and Caribbean countries, was 6.6 per cent for men and 8.8 per cent for women.

Substantial changes were made in the Bolivarian Republic of Venezuela, as well, with the elimination of outsourcing, a shorter working day and a higher severance pay.

IV. Economic policy responses in Latin America and the Caribbean

39. In most of the countries monetary policy was geared towards offsetting the negative impact of shrinking external demand on economic activity. Generally speaking, the countries avoided policies, such as interest rate hikes or other types of measure aimed at controlling monetary aggregates, that could choke credit growth and domestic demand, despite an uptick in inflation in part by the rise in food prices starting in September 2012. Inflation did temporarily breach the upper limit of the band in countries that run inflation-targeting schemes, such as Mexico and Peru, but the region's unweighted average inflation rate in the 12 months to December 2012 was down to 5.6 per cent, from 6.7 per cent in December 2011 (see figure VI). By subregion, as in 2011, South America posted the highest rate of inflation, and Central America and the Caribbean saw the steepest drops.

Figure VI
Latin America and the Caribbean: 12-month inflation, January 2007 to December 2012
(Percentages)



Source: ECLAC, on the basis of official figures.

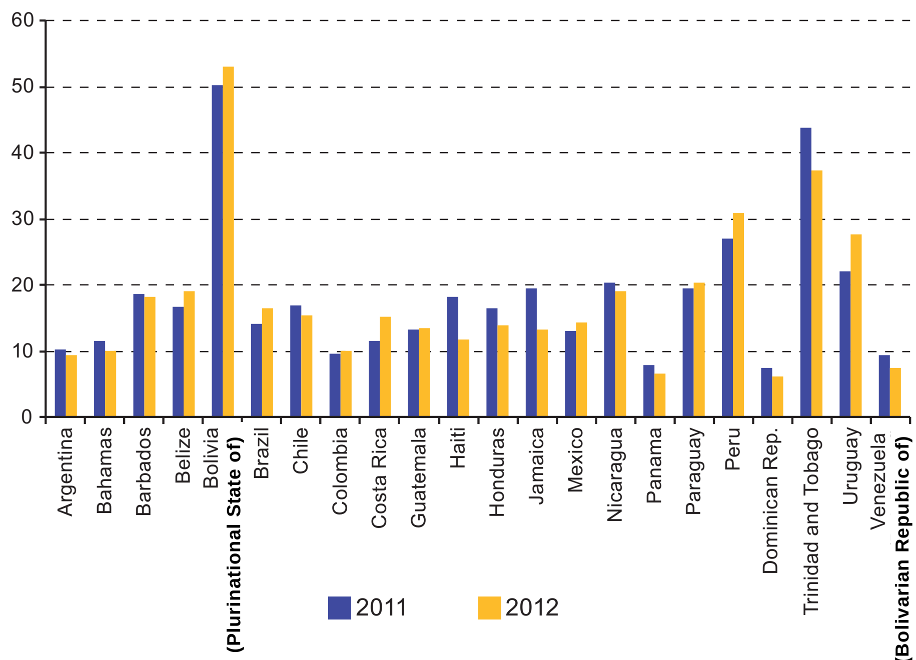
40. Liquidity injections by the monetary authorities, as measured by changes in the monetary base, continued to be substantial in 2012, with double-digit growth rates in 17 of the 25 countries for which information is available. Argentina, the

Bolivarian Republic of Venezuela, Peru and Suriname stand out, with annualized growth in the monetary base exceeding 30 per cent. Similarly, the broader monetary aggregates (MI and M2) expanded in most of the region's countries albeit, as with the monetary base, mostly by less than in 2011.

41. Another reflection of the authorities' intentions was the substantial increase in domestic lending during 2012, particularly to the private sector, with growth rates that exceeded 10 per cent in 20 of the 31 countries for which information is available and approached or exceeded 30 per cent in Argentina, the Bolivarian Republic of Venezuela, Guatemala, Haiti and Nicaragua. As regards the sectoral allocation of lending, consumer credit growth was particularly strong at 17 per cent, followed by lending to commerce (13 per cent) and industry (10 per cent).

42. The pressure for currency appreciation eased but exchange-rate volatility increased in Brazil and Mexico. As already noted, the deteriorating current account and smaller capital inflows into the region meant that the reserves build-up was slower than it had been in 2011, both as a share of GDP and in absolute terms. This was heavily influenced by the reduced build-up of reserves in Brazil from the first quarter of 2012. Nevertheless, reserves represented over 25 per cent of GDP in some countries, such as Peru and Uruguay, and over 50 per cent of GDP in the Plurinational State of Bolivia (see figure VII).

Figure VII
Latin America and the Caribbean (selected countries): change in international reserves, December 2011 to December 2012
(Percentages of GDP)



Source: ECLAC, on the basis of official figures.

43. A number of central banks, particularly those of Argentina, Colombia, Costa Rica, Peru and Uruguay, intervened actively in the currency markets. Meanwhile, although Brazil intervened in the currency market and built up reserves only until May 2012, the central bank intervened indirectly in August, September and October by using currency swaps[2] to influence the path of the exchange rate.

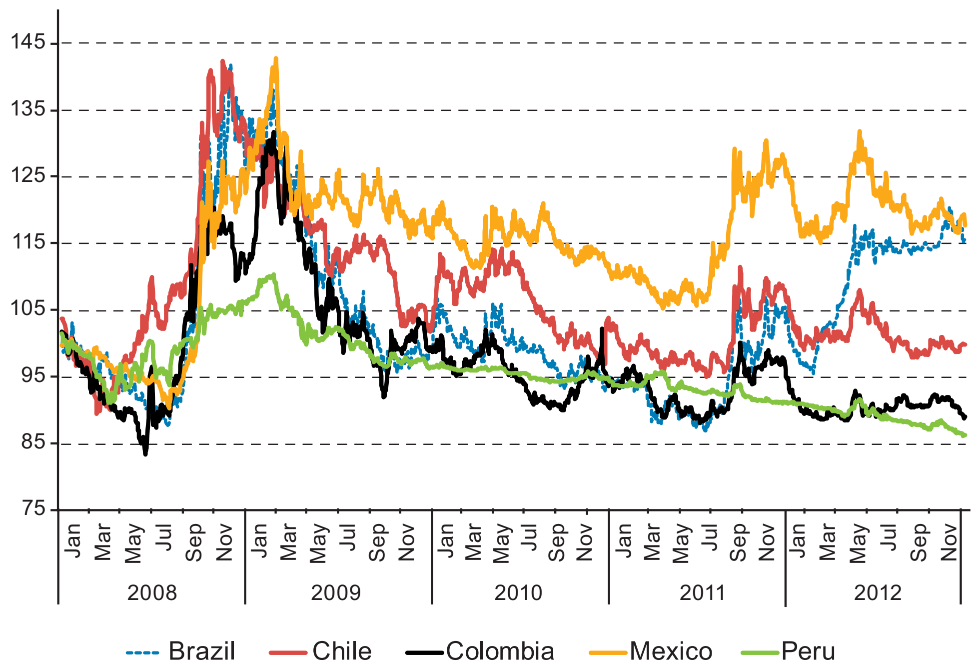
44. In Brazil and Mexico, global financial instability exacerbated exchange-rate volatility. Although the exchange rates of countries that are more deeply integrated into international financial markets had followed much the same path in 2011 amid the various shocks that year, the degree of correlation between their movements began to diminish in early 2012 (see figure VIII).

45. The domestic currencies in Brazil and Mexico depreciated in nominal terms against the United States dollar, particularly as expectations about the future path of the European economy deteriorated during the third quarter of 2012.

Figure VIII

Latin America (selected countries): nominal exchange rates against the United States dollar, January 2008 to December 2012

(Index: January 2008=100)



Source: ECLAC, on the basis of official figures.

46. Nominal exchange-rate trends plus the dynamic of inflation in Latin America and the Caribbean led to the region's real effective extraregional exchange rate falling (currency appreciation) by an average of 2.8 per cent during the first 10 months of 2012 as compared to the same period in 2011. The currency

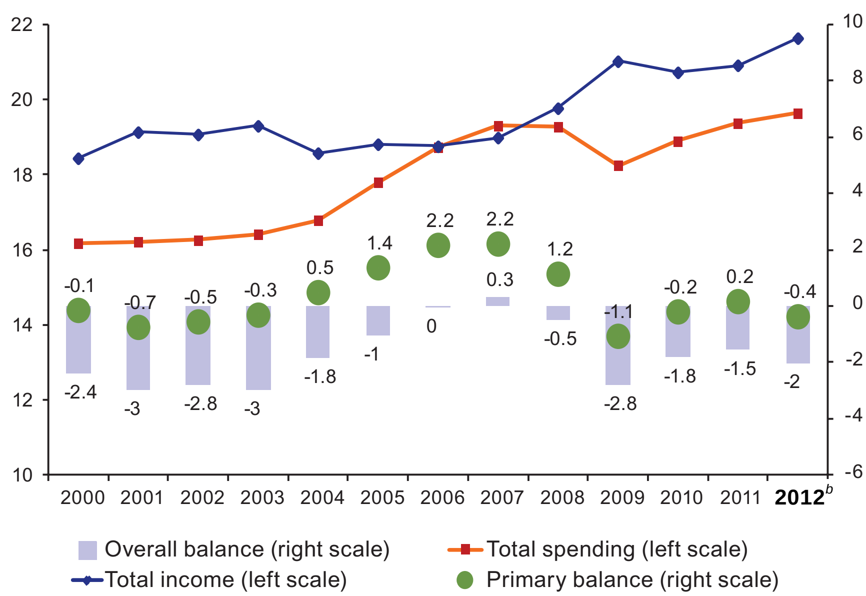
[2] Swaps are a type of financial derivative whereby two parties undertake to swap currencies for a set period of time and at a certain price, with an undertaking to repurchase them at the end of the period. In October 2012, outstanding swap operations were worth $4.9 billion.

appreciation was greater in South America (4.9 per cent, excluding Brazil) than in Central America (2 per cent), being influenced particularly by falling real effective exchange rates in the Bolivarian Republic of Venezuela, owing to its high inflation and fixed exchange rate. The Caribbean subregion's real effective extraregional exchange rate fell by about as much as that of South America, with the main influence being the currency appreciation in Trinidad and Tobago.

47. Efforts continued to strengthen macroprudential policies through changes to legal reserve requirements, sometimes to promote the use of national currencies (as in Paraguay, Peru, the Plurinational State of Bolivia and Uruguay) or to prevent overborrowing by households (Colombia). Reforms were also made to financial regulations to improve countercyclical provisioning (Ecuador), reduce interest rate risks (Bahamas, Paraguay and Ecuador) or expand central bank powers (Argentina and, to a lesser degree, Guatemala).

48. The fiscal position deteriorated in most of the countries, but fiscal policies have remained predominantly prudent. With only a few exceptions, the gap between revenue and expenditure rose in most of the countries as spending rose faster (0.7 percentage points of GDP) than income (0.2 percentage points). The primary balance (before interest payments) was in deficit by 0.4 GDP points on average, contrasting with a surplus of 0.2 points in 2011. The overall balance (which includes payments of interest on the public debt) yielded a deficit of 2 percentage points of regional GDP (see figure IX).

Figure IX
Latin America (19 countries): central Government fiscal indicators, 2000-2012[a]
(Percentages of GDP)

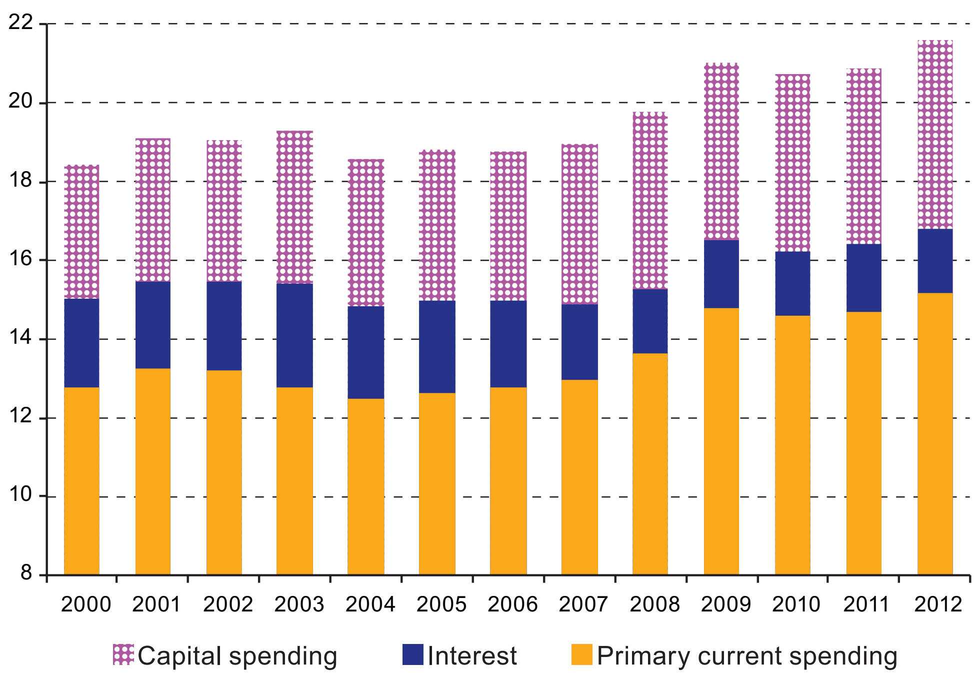


Source: ECLAC, on the basis of official figures.
[a] Simple averages.
[b] The data for 2012 are estimates.

49. The higher spending helped to maintain the momentum of domestic demand, especially consumption, with current spending rising by 0.4 GDP percentage points and capital spending 0.3 GDP points (see figure X). In the case of natural resources exporters, the drop in non-tax income was offset by an equivalent rise in tax income on the strength of buoyant domestic demand but, in countries where revenues increased, the rise was usually quite moderate. Meanwhile, the various tax measures or reforms being pursued in several countries (Chile, Colombia, the Dominican Republic, Ecuador, El Salvador, Guatemala, Panama and Peru) should increase their tax burden in 2013.

50. Debt levels rose only slightly and did not pose a threat to fiscal sustainability in the Latin American countries, where the ratio of central government debt to GDP edged up from 30.5 per cent in 2011 to 31.3 per cent in 2012. The fiscal deterioration was larger in the Caribbean, however, where the overall fiscal deficit widened from 3.6 per cent to 4.0 per cent of GDP. In previous years, raw material-dependent countries, such as Belize, Guyana, Suriname and Trinidad and Tobago, had sustained a better financial and fiscal performance, but this deteriorated sharply in 2012. Service economies such as Antigua and Barbuda, the Bahamas, Barbados and Jamaica have been badly affected by the drop in revenues from tourism and offshore financial services since the start of the international financial crisis and continued to feel these effects in 2012. Thus, public debt in Barbados and Jamaica rose to 106 per cent and 128 per cent, respectively, of GDP in 2012.

Figure X
Latin America (19 countries): central Government expenditure, 2000-2012[a]
(Percentages of GDP)



Source: ECLAC, on the basis of official figures.
[a] The data for 2012 are estimates.

V. Outlook and challenges

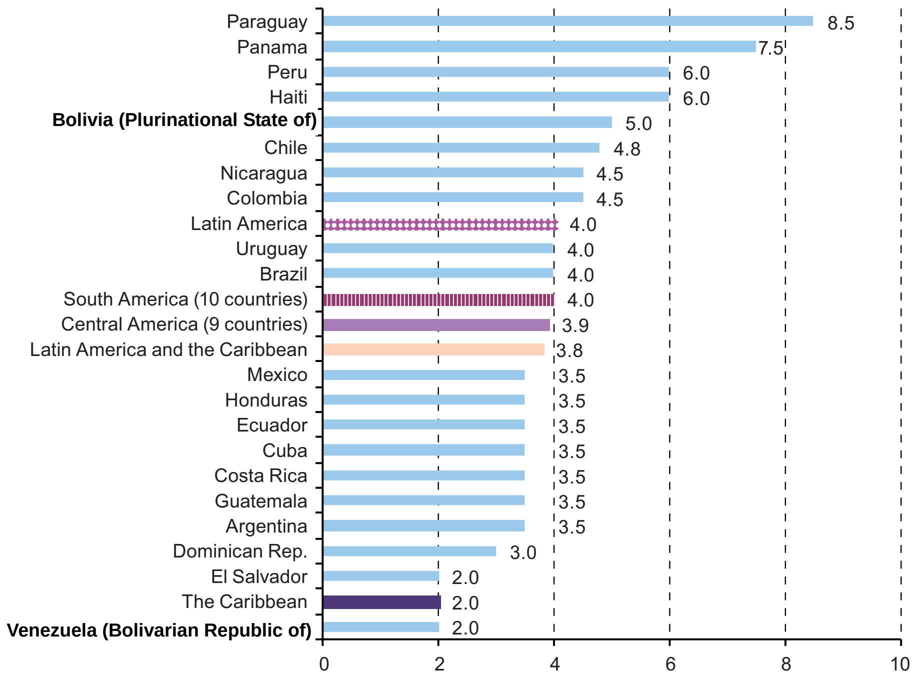
51. The economic outlook for Latin America and the Caribbean depends heavily on how the global economy evolves in 2013. The most likely scenario is continued low growth in Europe and even recession in some European countries. The crisis in the euro zone is still one of the main risk factors for Latin America and for the global economy in general. The situation in Europe has prevented consensus on whether the way out of the crisis lies in fiscal austerity and structural reform, or in policies for kick-starting growth. All the signs are that efforts will be geared towards tackling specific situations, providing the liquidity and financial assistance to help stricken economies through critical episodes and promoting very gradual structural reform (that is, the approach that has been dubbed “muddle-through”).

52. Meanwhile, the United States has achieved only a partial fiscal accord and although the cap on public borrowing has been staved off for the moment, the failure to agree on long-term solutions has triggered the automatic spending cuts (the “sequester”) specified in the 2011 budget. These cuts will likely erode growth, but are not large enough to push the economy into recession. If, as appears likely, agreement can be reached in the course of the year to moderate these adjustments, the economy should remain on a positive, albeit shallow, growth track. The Federal Reserve has also confirmed its intention to maintain an expansionary monetary policy stance. With employment and housing indicators favourable as well, growth projections for the United States economy are on the order of 1.7 per cent for 2013. China’s rate of growth may rise — or at least should not fall — in 2013, depending on how much the country can boost domestic consumption while holding down inflation and regaining export growth. However, China may find it hard to boost its exports if a fiscal pact remains elusive in the United States or Europe’s economy performs worse than in 2012. The scenario described also assumes that oil will not become a factor of additional instability for geopolitical reasons.

53. Taking the most likely scenario as the baseline for 2013, it is estimated that GDP growth in Latin America and the Caribbean could pick up to around 3.8 per cent (see figure XI), owing to two effects in particular. First, higher growth in Argentina and Brazil, on the back of recovery in the agricultural sector in Argentina and in manufacturing and investment in Brazil. An upswing in trade between the two countries could also boost their respective economic activity levels. Second, several of the region’s economies are expected to experience strong domestic demand thanks to improvements in labour indicators and an increase in bank lending to the private sector. Slack demand and uncertain conditions in the external sector could lead to falls in raw material prices, although these will remain high by historical standards. With external demand contributing little to economic growth amid sluggish global growth and domestic demand remaining buoyant, the current account deficit will widen somewhat in 2013. This is unlikely to herald external financing difficulties, however, for three reasons. First, most of the region’s countries are holding ample international reserves. Second, public foreign borrowing levels are low, except in a few Caribbean countries. Given also the external assets built up by a number of countries, the region overall appears to be well placed to meet its external obligations with ease. Third, Latin America and the Caribbean is offering a better risk profile than other regions at present and, with just a few exceptions, will continue to be an attractive destination for foreign direct investment. In addition, its

risk ratings will very likely continue to improve in 2013, so steady financial flows in 2013 should be sufficient to cover any external liquidity needs.

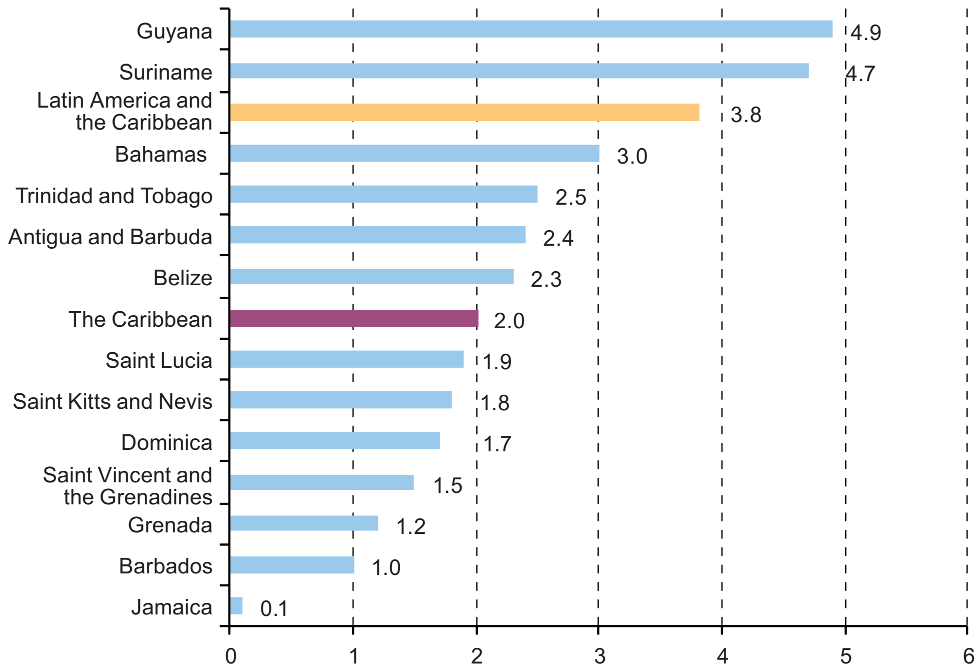
Figure XI
Latin America and the Caribbean: GDP growth forecasts, 2013
(Percentages)



Source: ECLAC, on the basis of official figures.

54. In this scenario, growth rates should be less disparate in 2013, including an uptick in the Caribbean subregion from 1.1 per cent in 2012 to 2.0 per cent (see figure XII). However, the Caribbean countries are still on a fragile fiscal footing and need fiscal reform along with external support to firmly gain sustainable fiscal consolidation paths.

Figure XII
The Caribbean: GDP growth forecasts, 2013
(Percentages)



Source: ECLAC, on the basis of official figures.

55. In Latin America and the Caribbean, the challenge also remains of increasing and stabilizing investment growth (rather than relying solely on consumption) to drive structural change, absorb technical progress and achieve suitable growth. In this connection, tapping the regional market within an open regionalism approach could help to offset the weak rendering of external demand in the past few years.

56. Lastly, although it is less likely than the baseline scenario, a lower growth scenario cannot be ruled out, given the (albeit receding) possibility that external risk factors — the deepening of the crisis in the euro zone, lack of agreement over how to deal with the fiscal situation in the United States, a heavy slowdown in China or oil price hikes fuelled by political tensions in the Middle East — will worsen. In that case, the resilience the Latin American and Caribbean region has shown thus far would be more severely tested and the impact would continue to be uneven in the region, depending on the significance of each of these factors for the economies of the individual countries. A growth slowdown in the United States would affect Mexico, Central America and the Caribbean the most, whereas the South American countries would feel the impacts more heavily if Europe remained in recession or China’s economy cooled. Finally, an oil price hike could have a more or less favourable impact, depending on the countries’ positions as net exporters or importers of fuels.