

2010-2011



Economic survey
of Latin America and the Caribbean

International markets and
macroeconomic policy challenges



UNITED NATIONS

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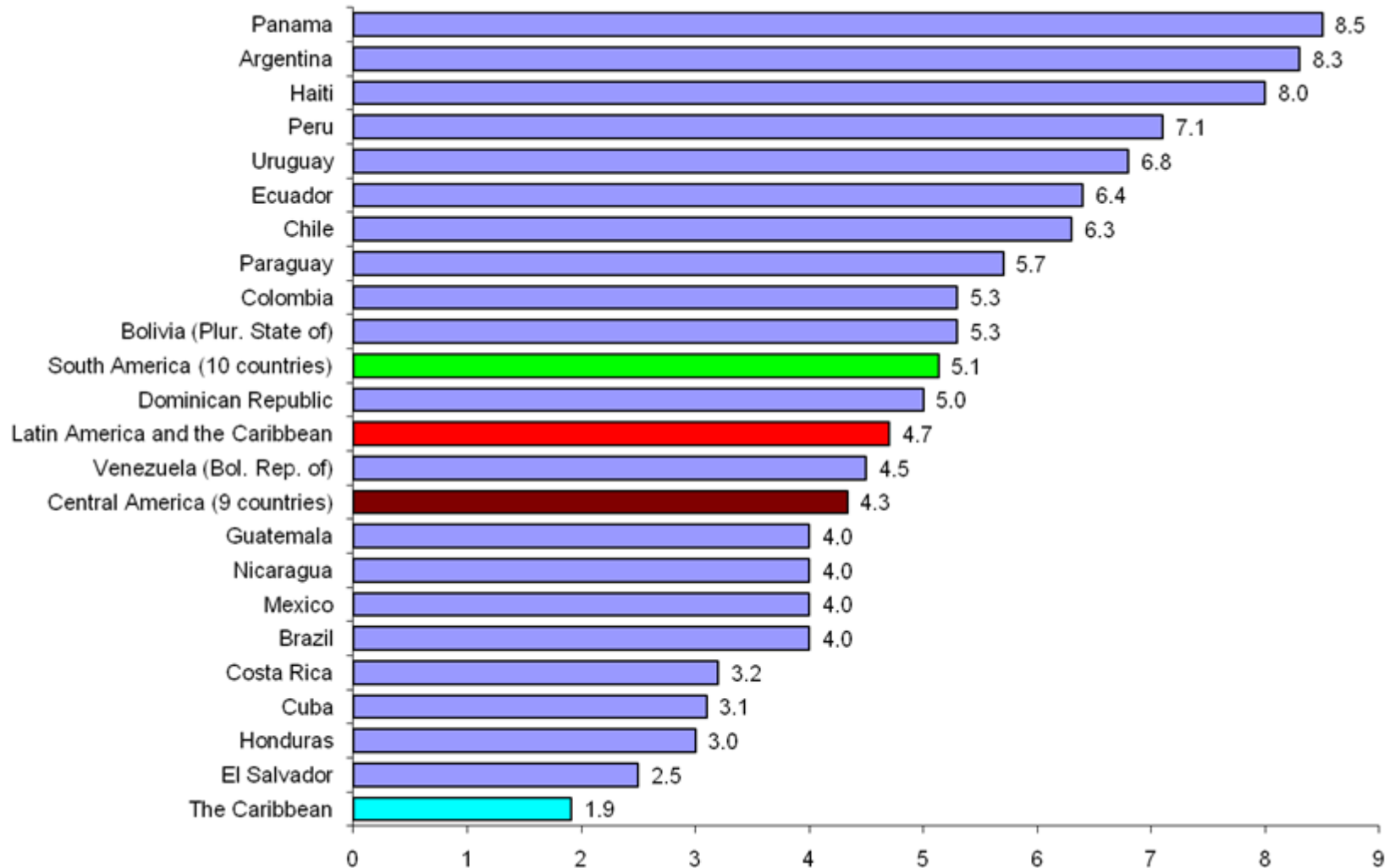
The region grows, but faces major macroeconomic policy challenges

- Growth is projected at 4,7%, based on three different underlying patterns
- Three problem areas :
 - Inflation is picking up
 - Real exchanges rates are falling
 - Current account is deteriorating
- The current situation is posing a series of risks and difficulties, both in the short-term and from a growth perspective



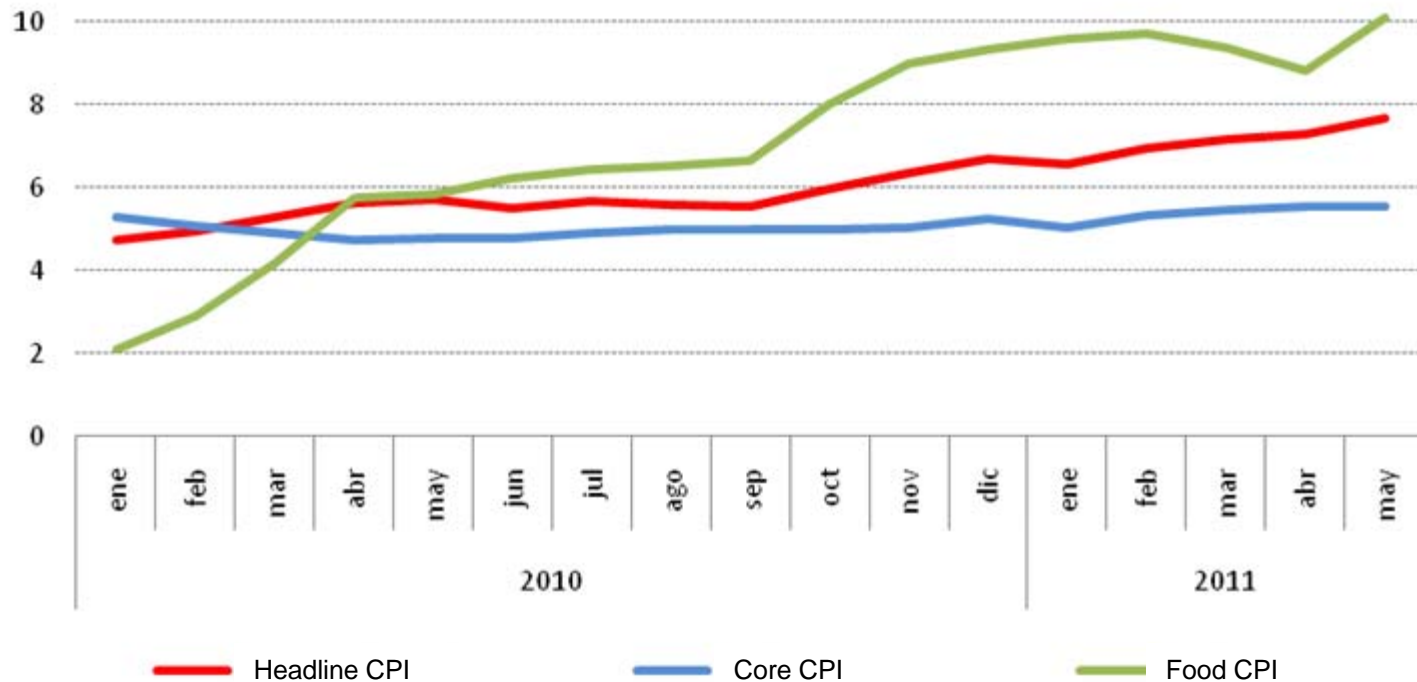
Growth is projected at 4.7%, although at 3 different speeds

GDP growth rates (%)



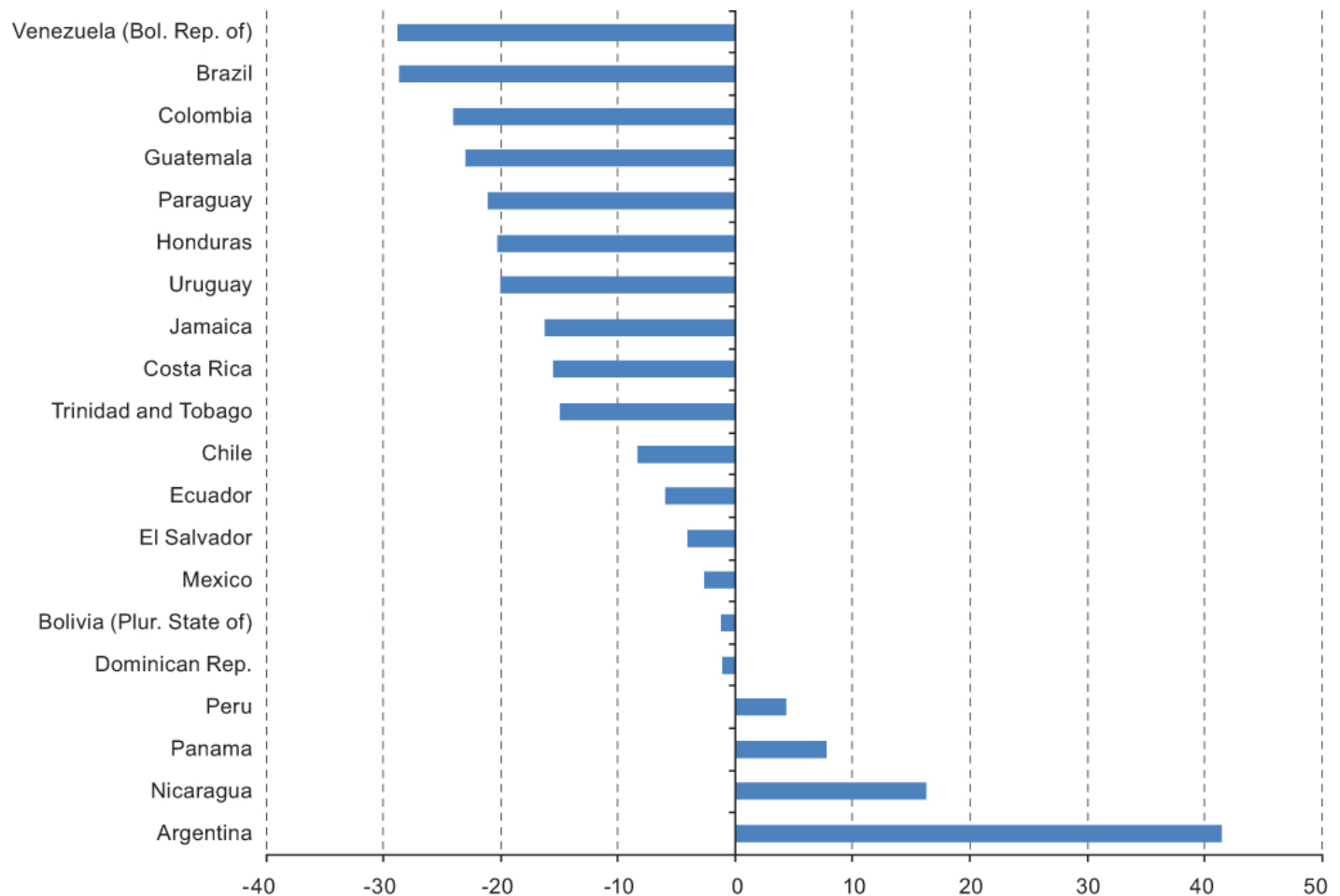
The increase in food and fuel prices in a context of strong growth of internal demand is putting pressure on the inflation rate

Evolution of headline inflation, core inflation, and food price inflation (%)



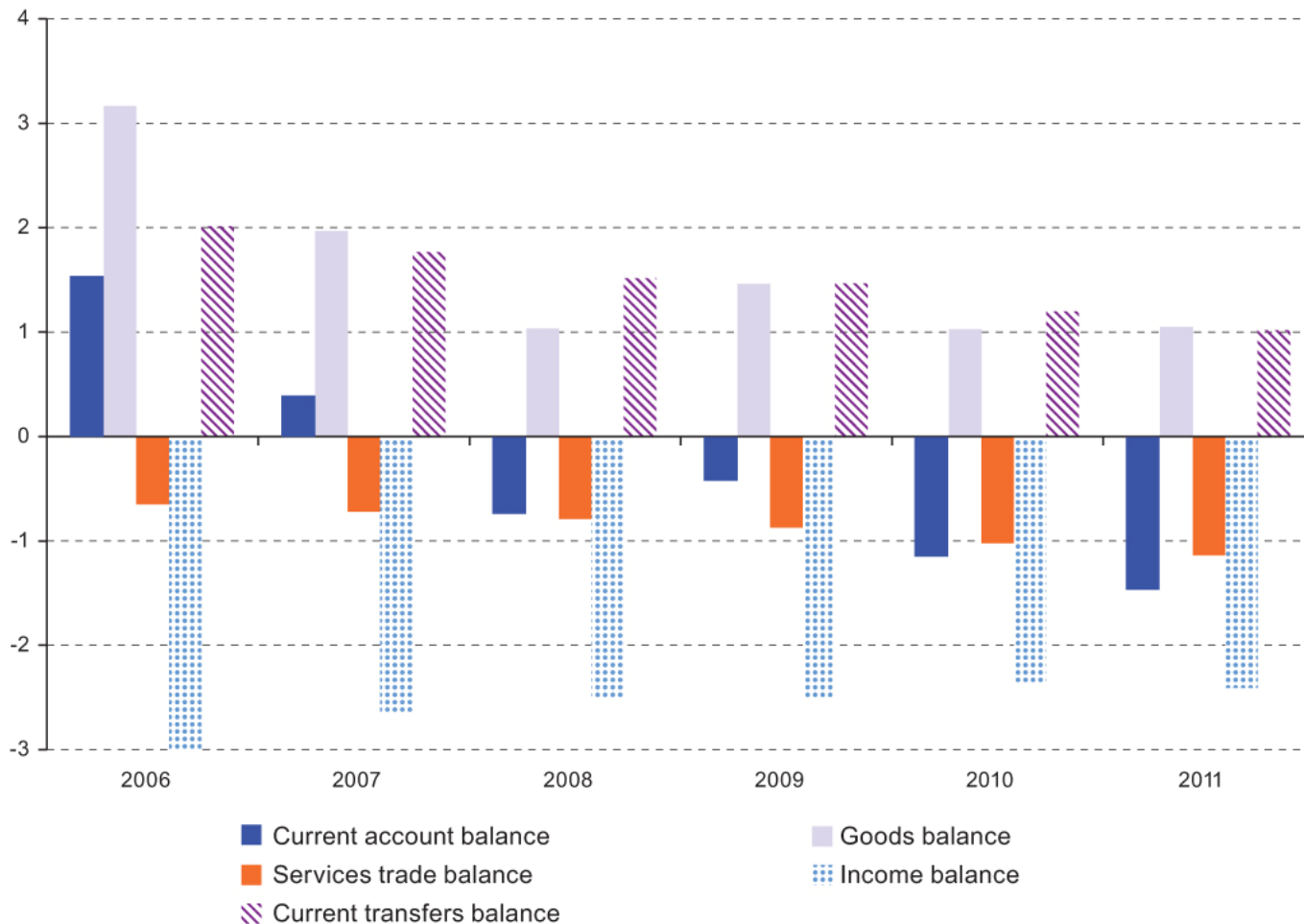
In some countries the real exchange rate has appreciated significantly

Level of the real effective exchange rate, May 2011 vs. average of 1990-2009



The current account is deteriorating

Evolution of the components of the current account (%)



Risks and challenges beyond the short-term

- The region has become vulnerable to speculative capital flows in search of short-term profits.
- Bubbles in financial asset prices and in housing markets could emerge.
- The fall in the real exchange rate helps explain the deterioration of the current account balance in spite of an improvement in the terms of trade.
- This is not a pressing problem given the region's current financial solidity and the composition of the current account.
- However, the elevated international liquidity puts downward pressure on the real exchange rates while at the same time increasing commodity prices.
- This creates incentives for a specialization in the production and exportation of commodities.

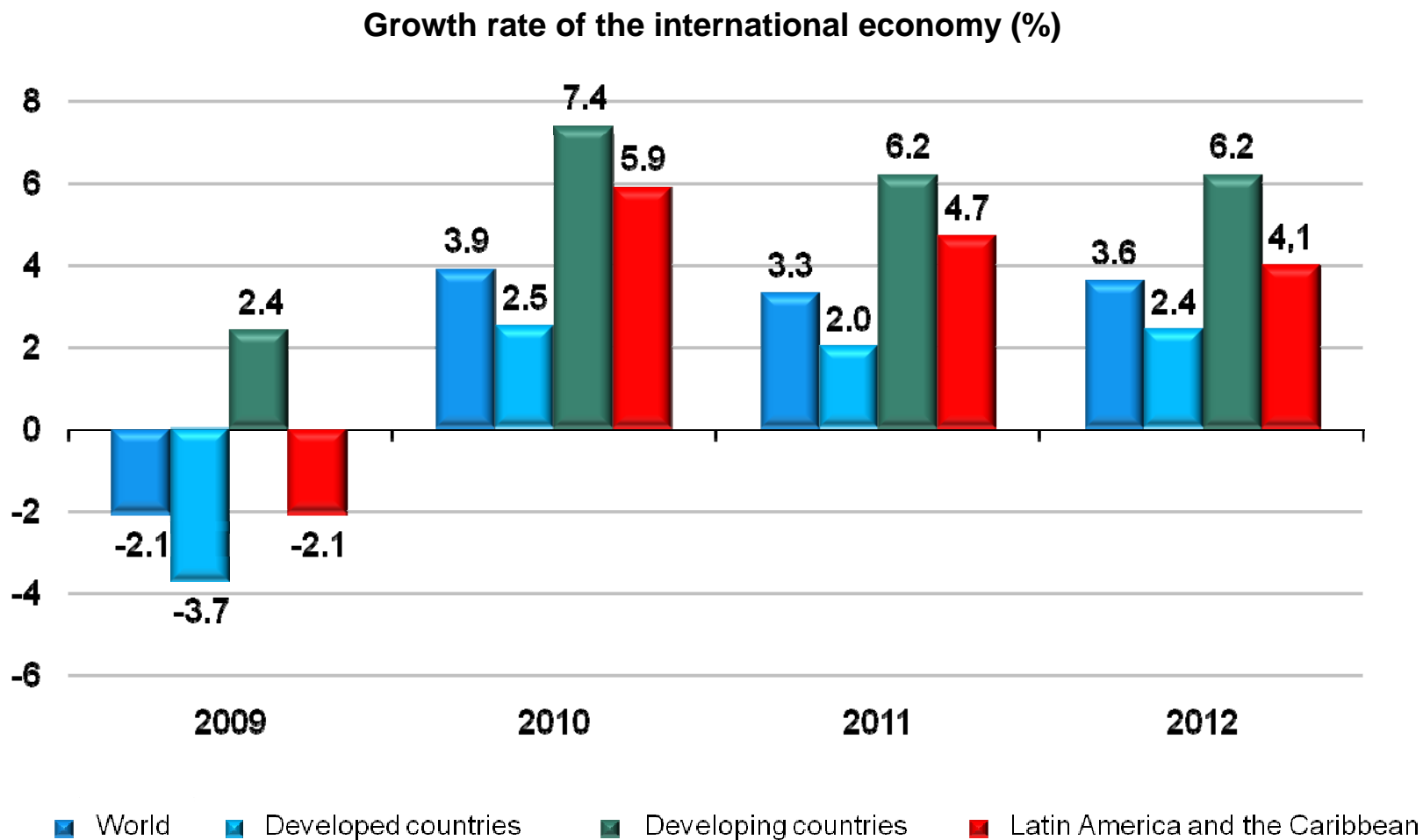


Latin America and the Caribbean continues to grow

- Global context characterized by two-speed recovery
- Internal demand drives regional growth, supported by better employment indicators and an increase in credit
- Global context causes diverging trends in external demand
- External account structure differs significantly from pre-crisis period
- Macroeconomic policy dilemmas are deepening

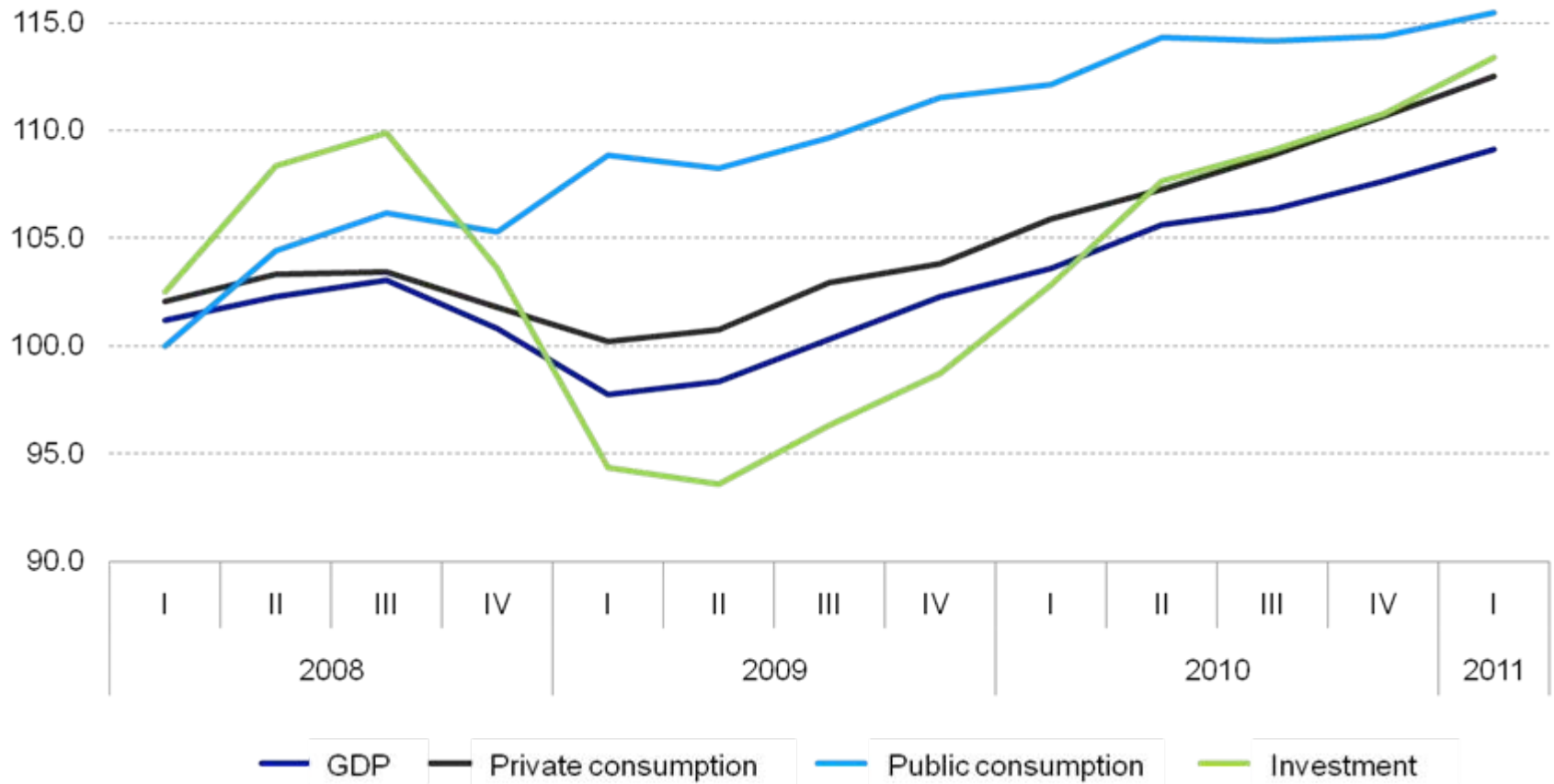


Emerging economies are decoupling from the developed world



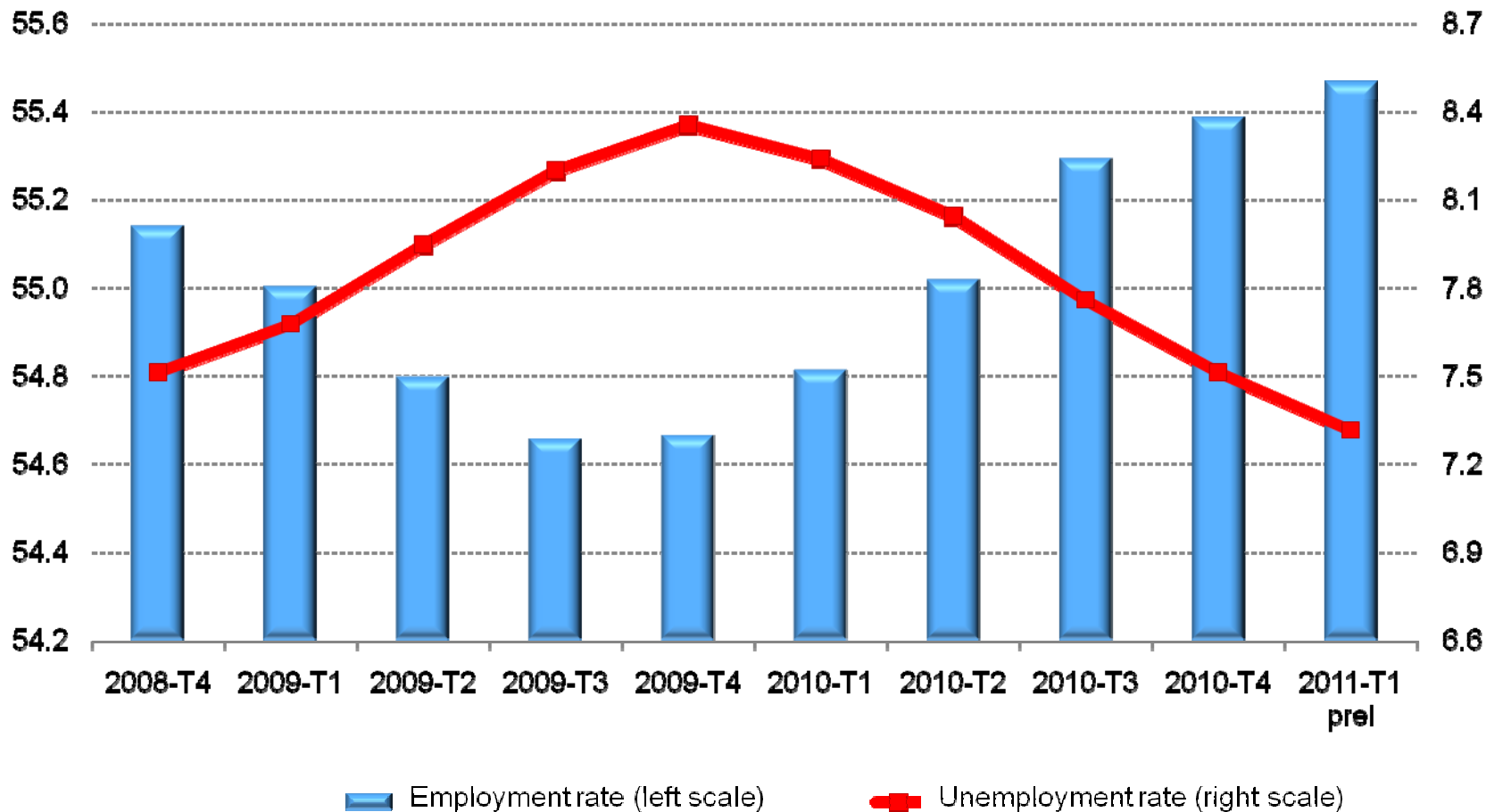
Strong growth in private sector demand

Evolution of GDP, public and private consumption, and investment;
(seasonally adjusted; indexed 2007=100)



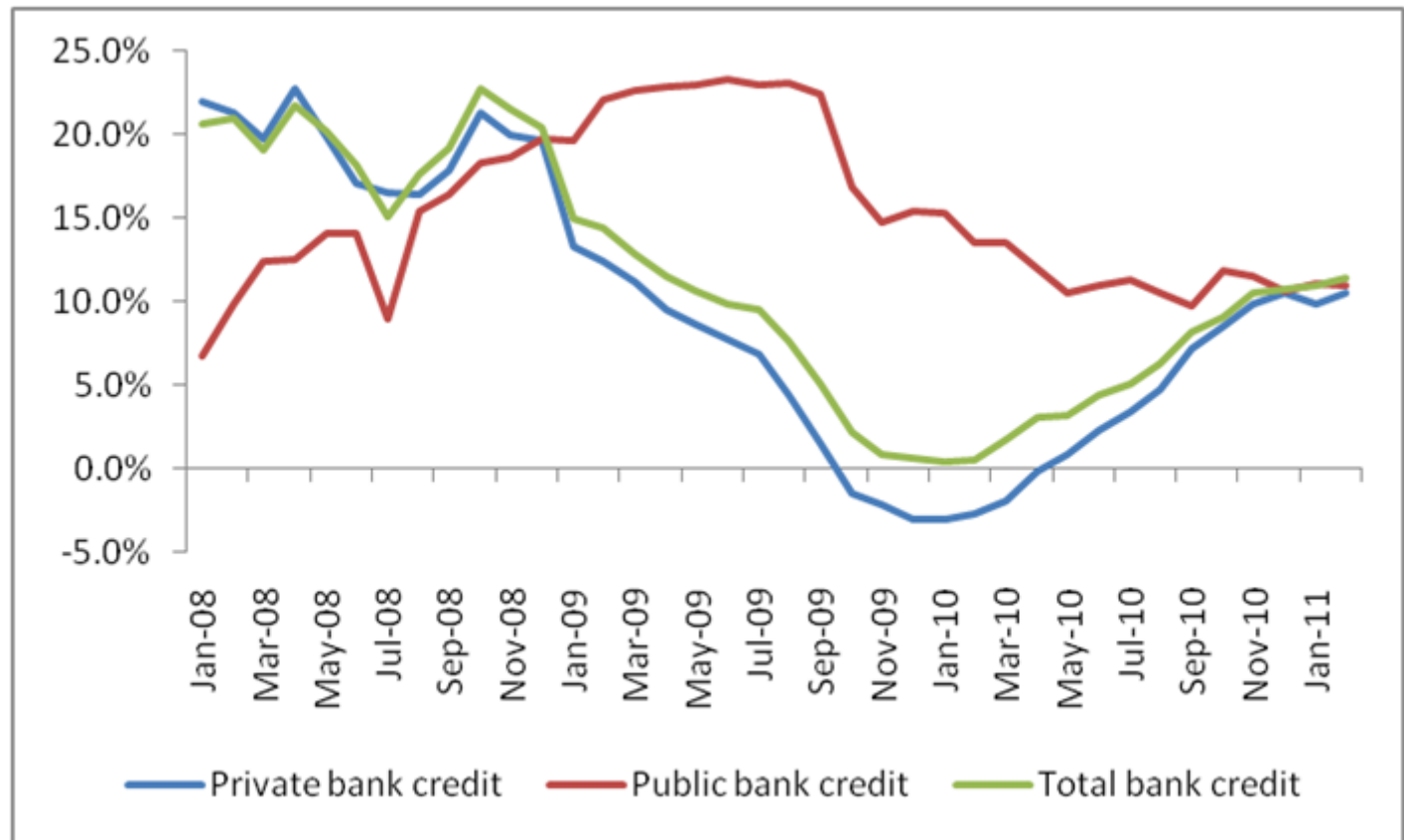
Improvement in labour market indicators is driving consumption

Evolution of employment and unemployment rates (%)
(Four-quarter moving average, ending with the indicated quarter)



Increase in credit helps explain the evolution of demand for durable goods and investment

Latin America. Average rate of change of real credit
(Annual rate of change with respect to the same month of the previous year)

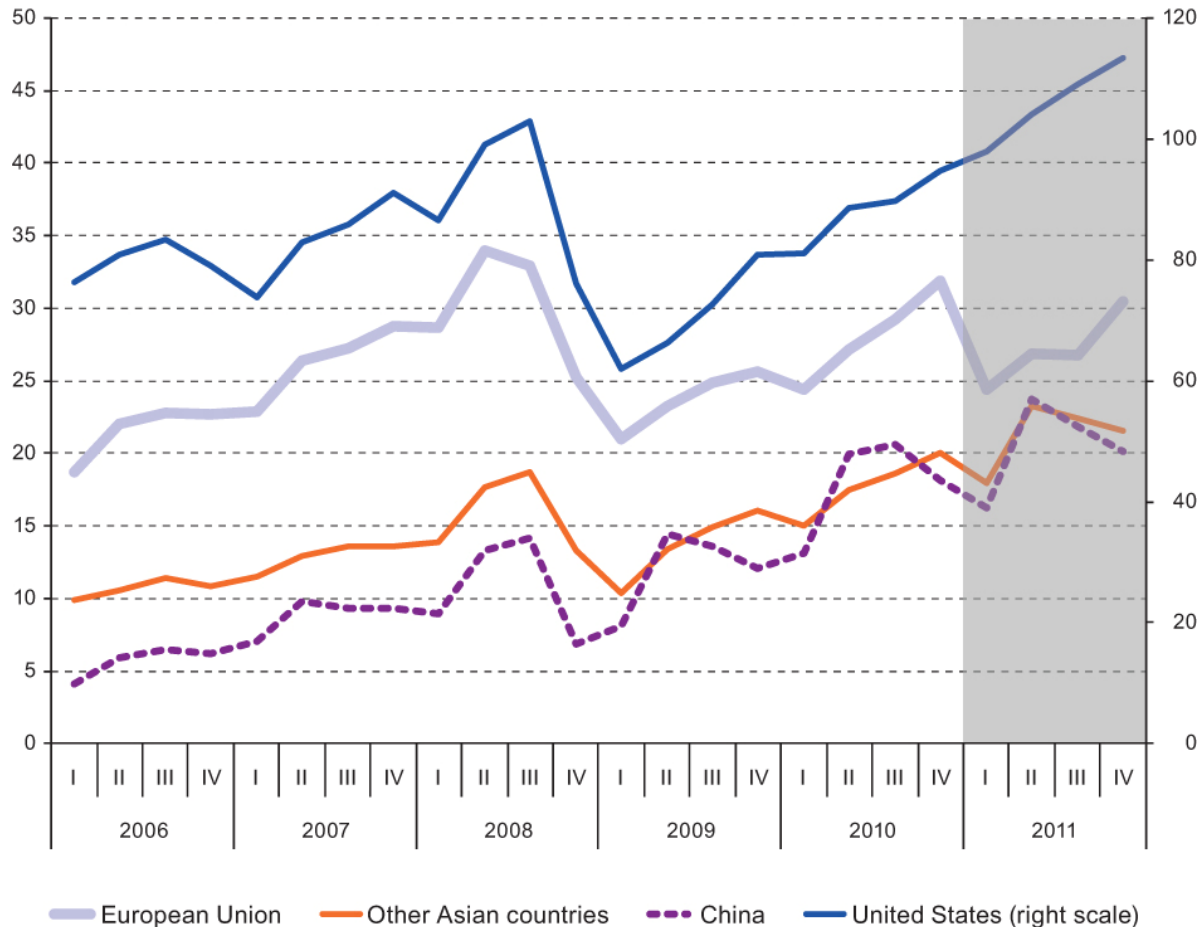


Included countries: Argentina, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Paraguay, Peru and Uruguay



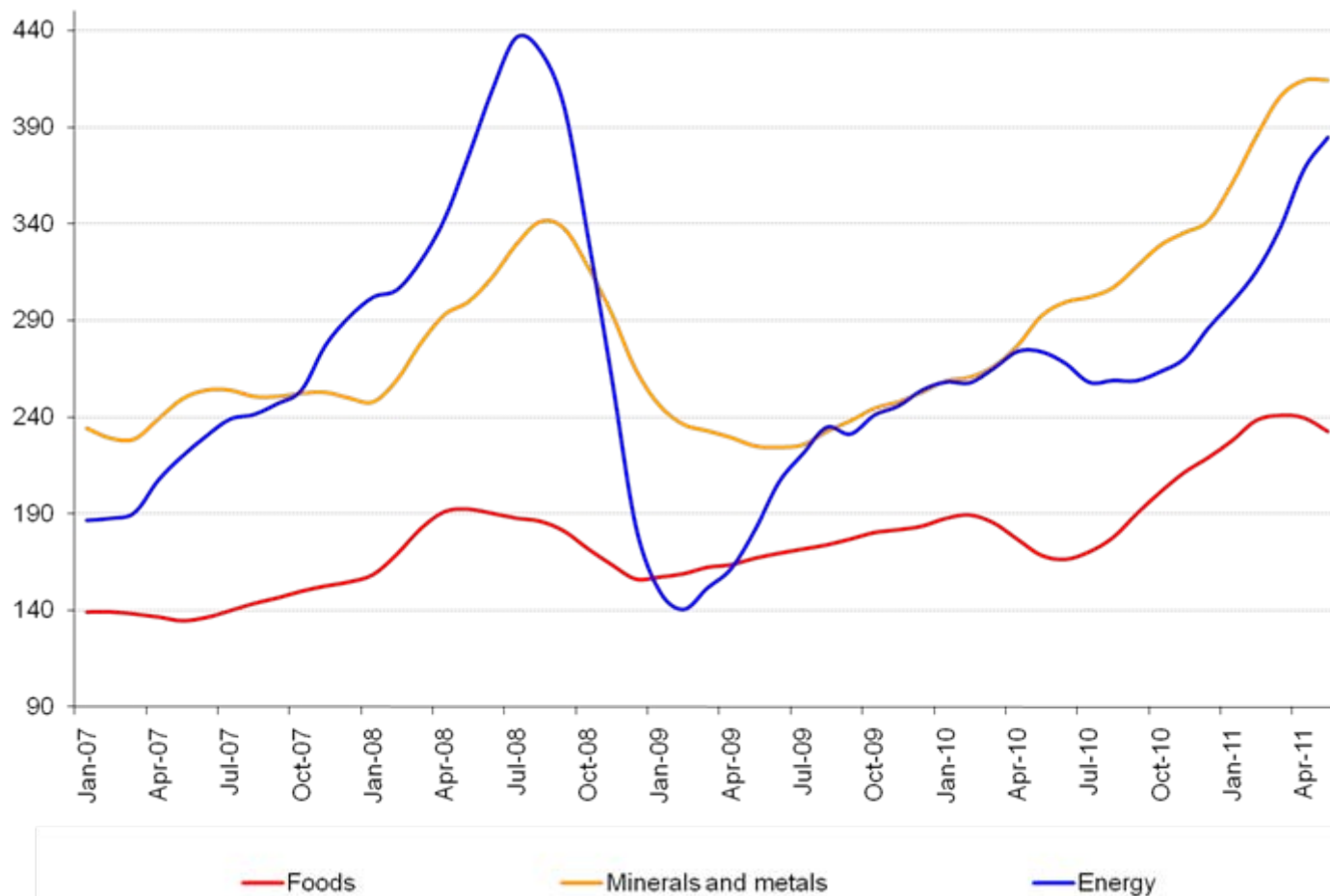
Uneven evolution of exports to principal trade partners

Evolution of exports
(billions of USD)



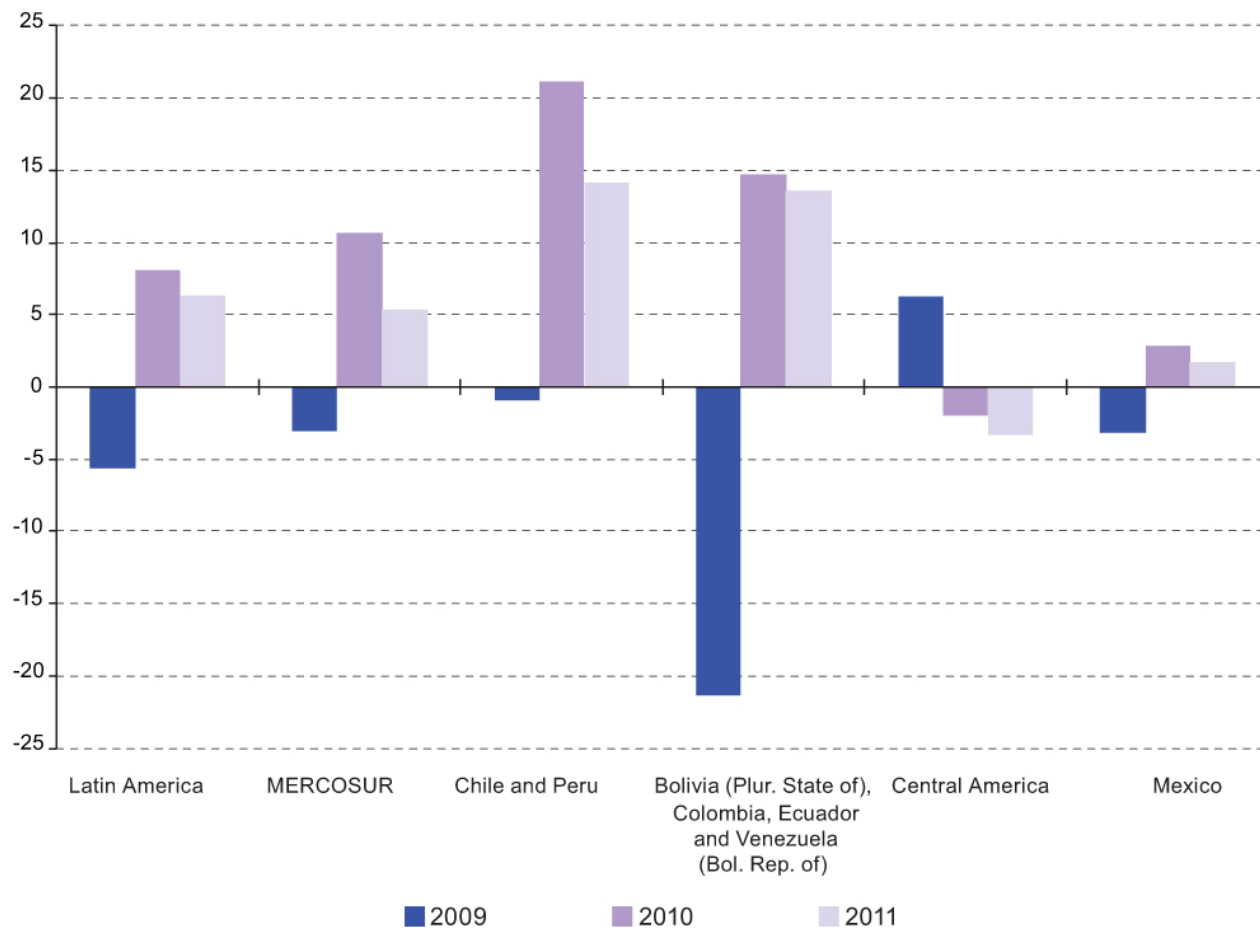
International prices of primary products are increasing

Evolution of selected commodity prices
(Indexed 2000=100)



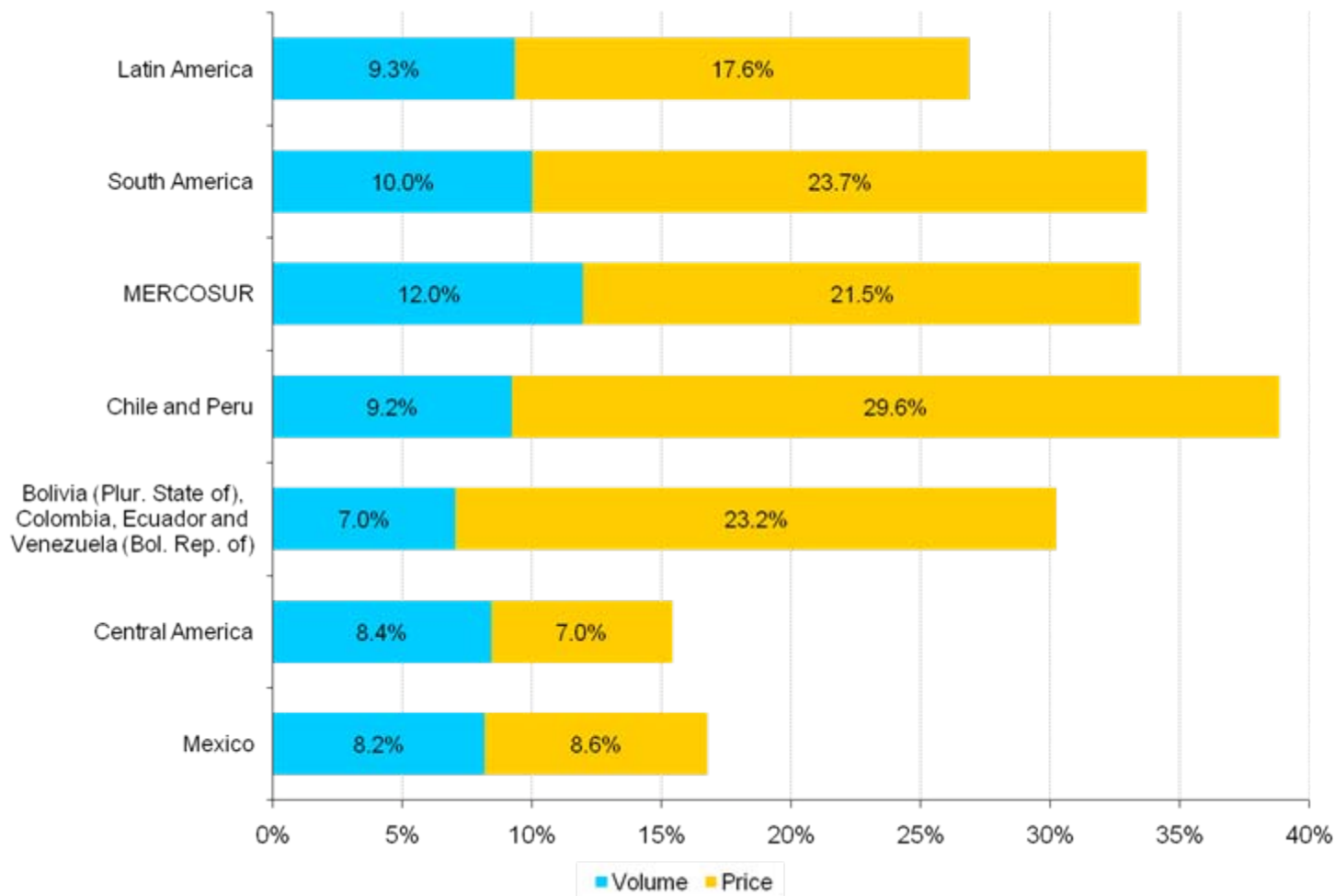
Terms of trade are improving, but not for all countries

Rate of change of terms of trade (%)



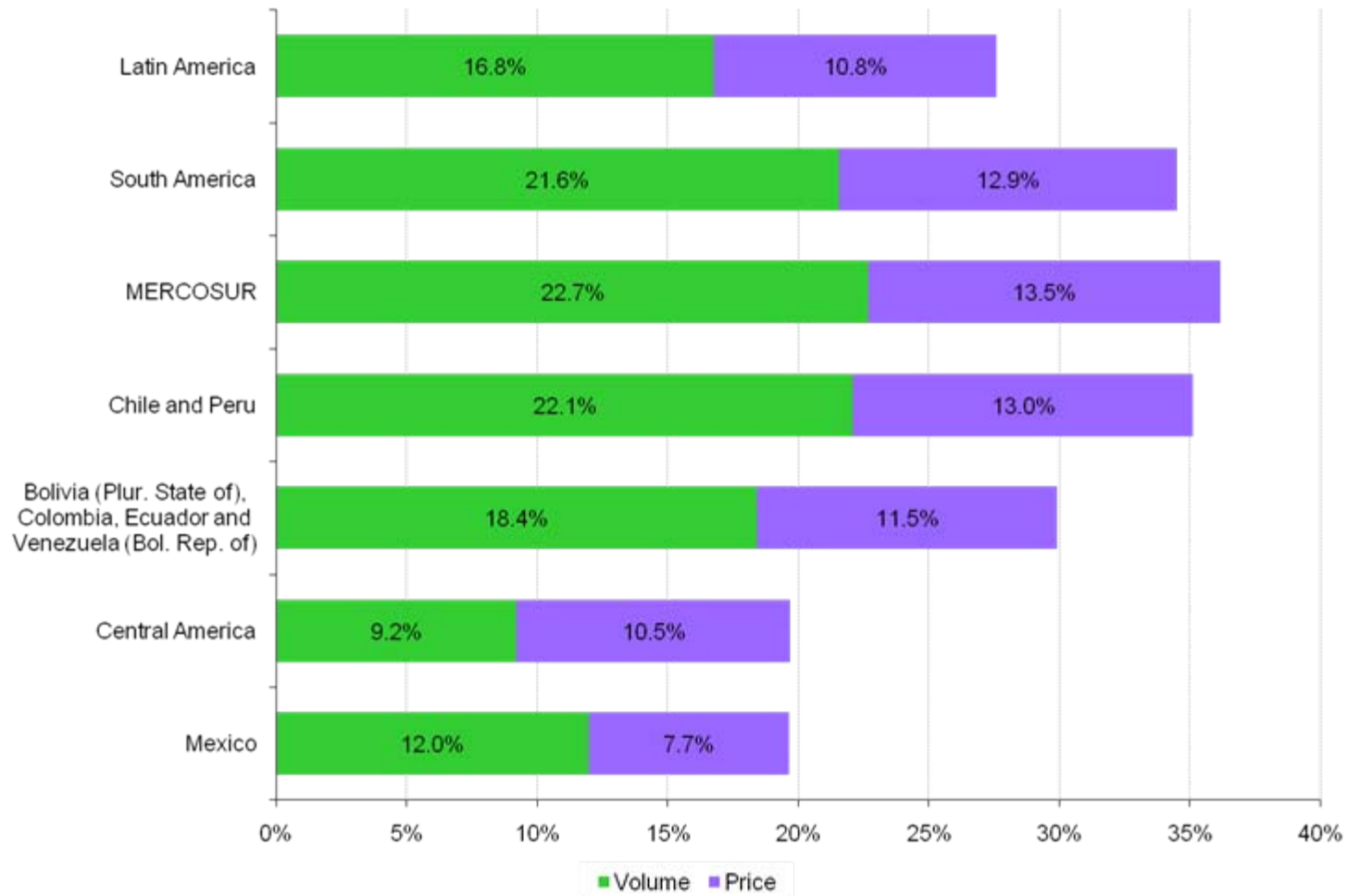
Price increases explain most of the increase in export values

Breakdown of the projected increase of the exported value between volume and price, 2011 (%)



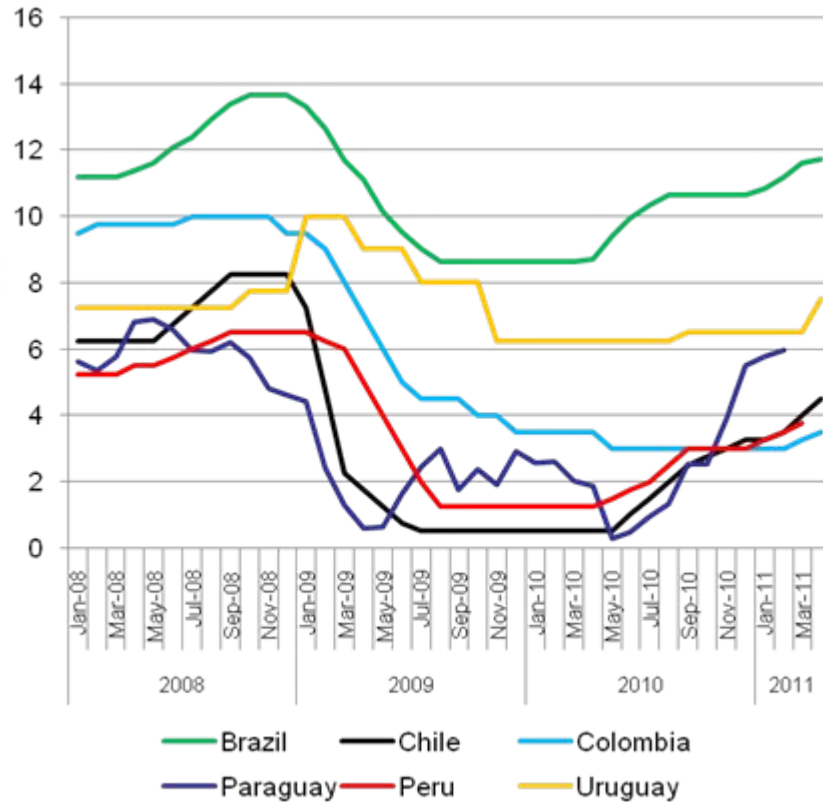
GDP growth explains the increase in the volume of imports

Breakdown of the projected increase in the value imported between volume and price, 2011 (%)

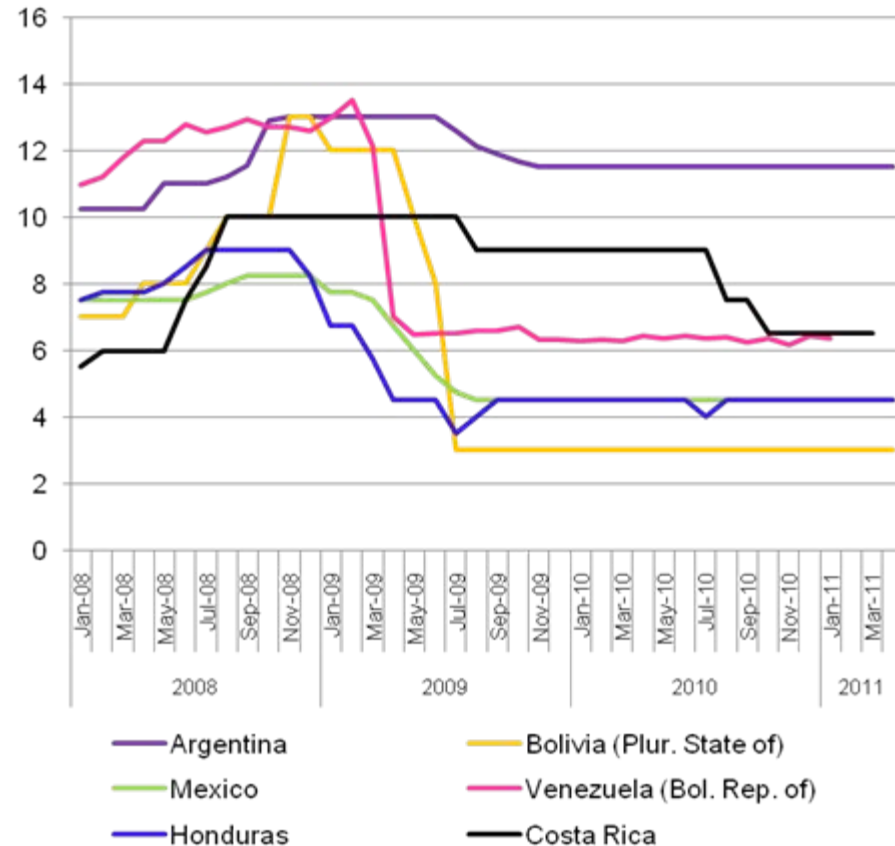


In Latin America, central bank reactions follow diverging trends

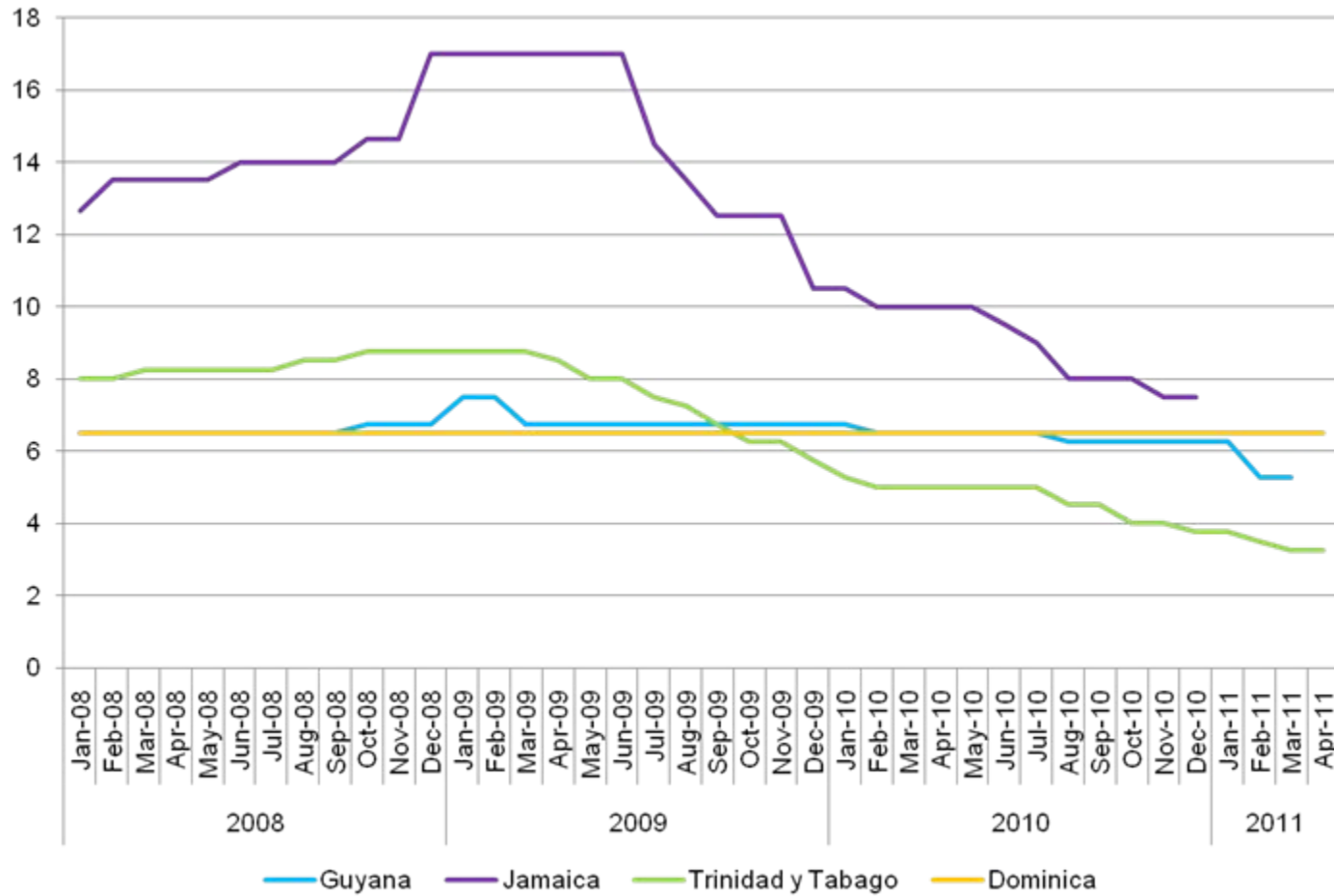
Some countries have begun to raise their policy rate



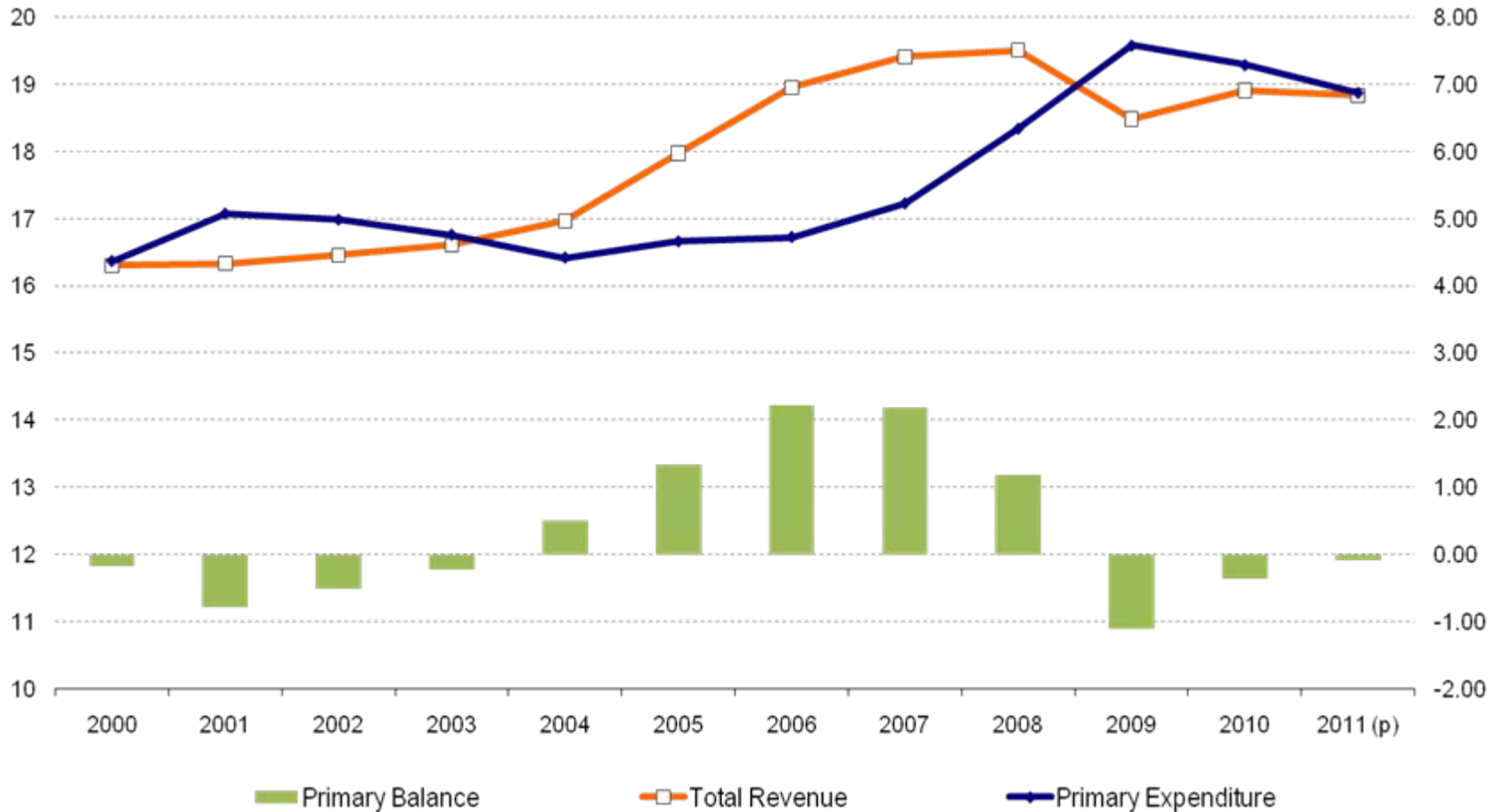
Others have decided to keep interest rates unchanged



In the Caribbean, monetary policy continues to be expansionary

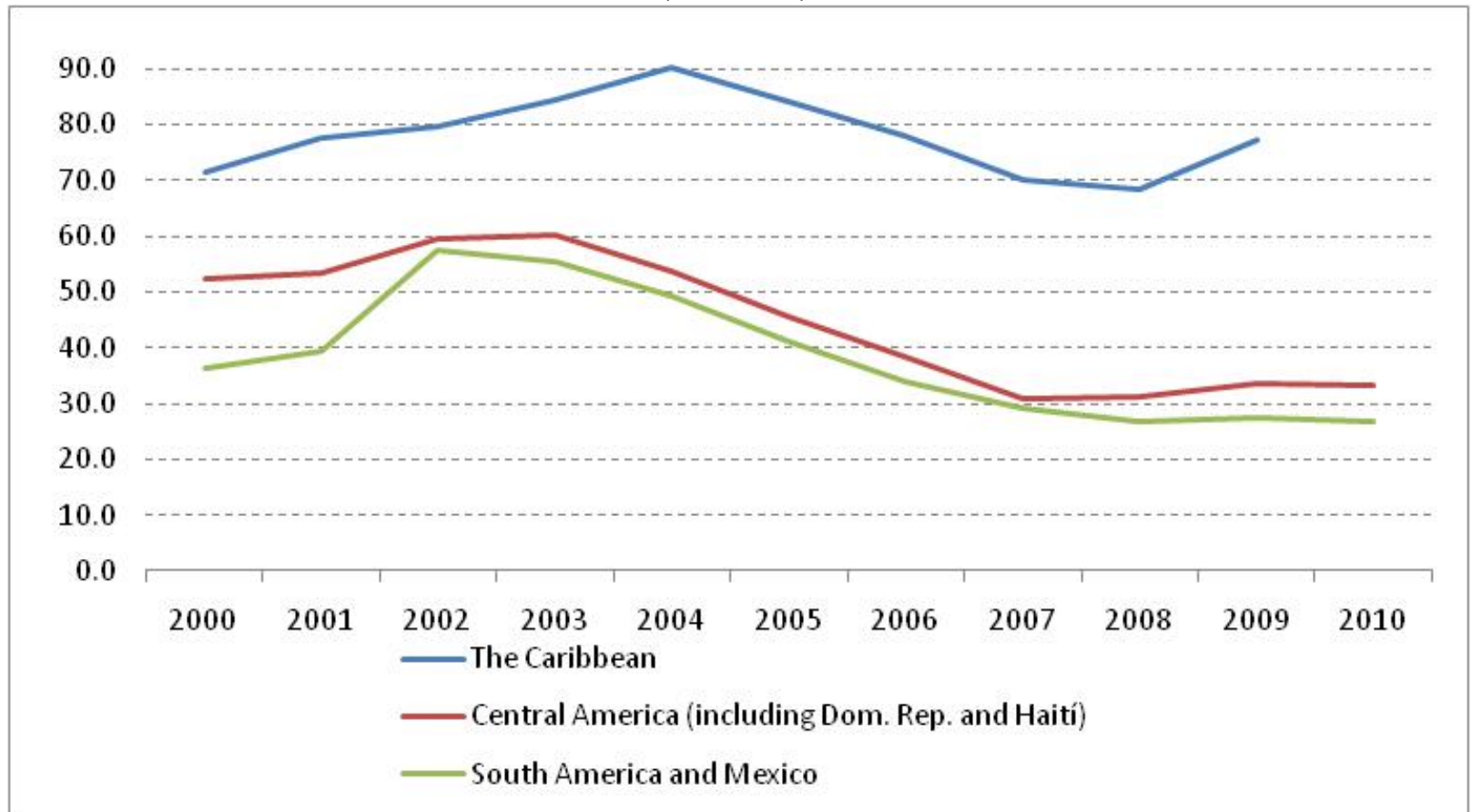


Although the fiscal impulse has been reduced, the public sector is not yet generating savings



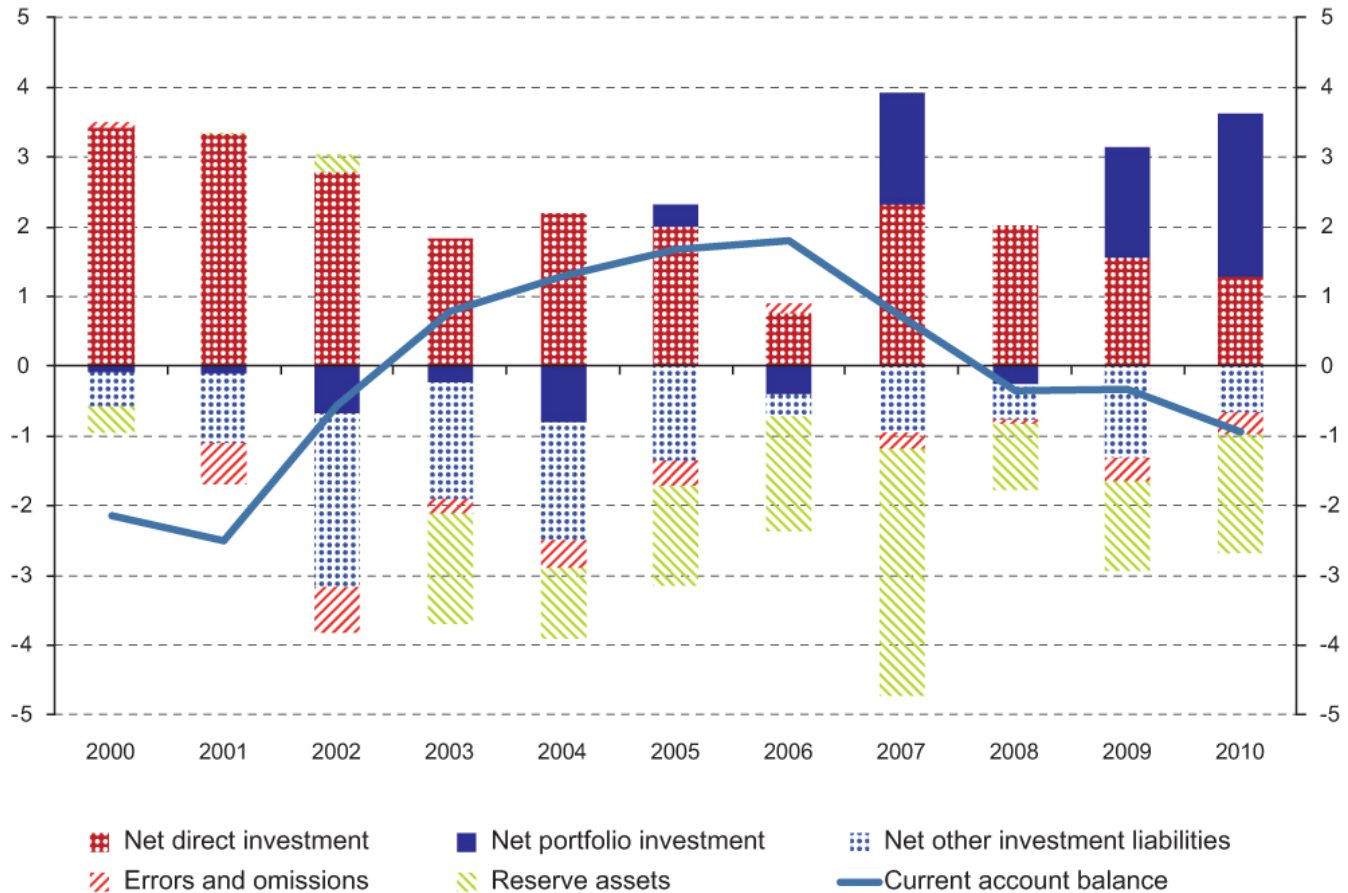
Public debt has ended its downward trend, but it remains at low levels with the exception of certain Caribbean countries

Evolution of public debt
(% of GDP)



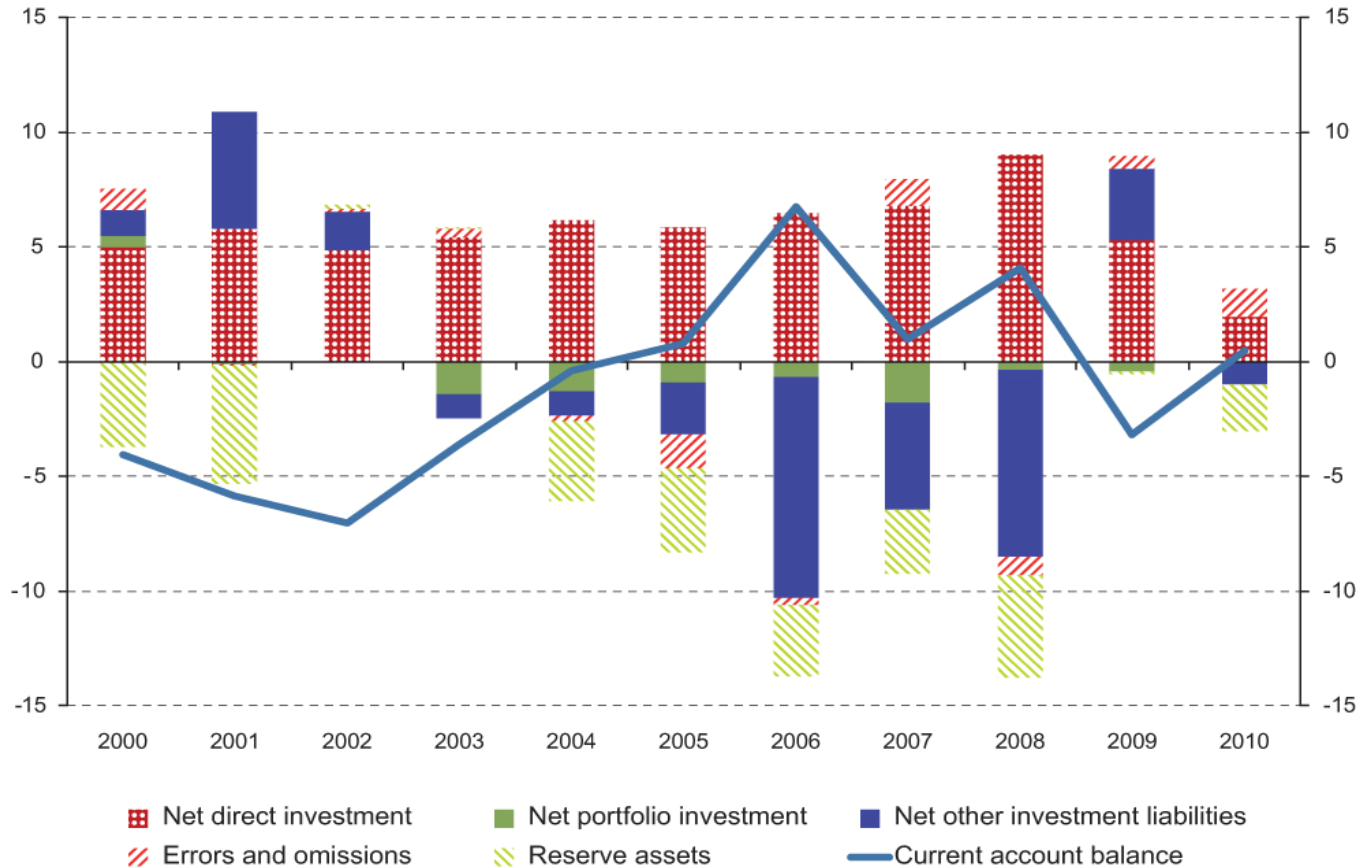
Latin America continues to accumulate reserves, but driven by a changed dynamic

Latin America (19 countries): Current account and the composition of external financing
(as a percentage of GDP)



The situation looks different in the Caribbean

Caribbean: Current account and the composition of external financing
(as a percentage of GDP)



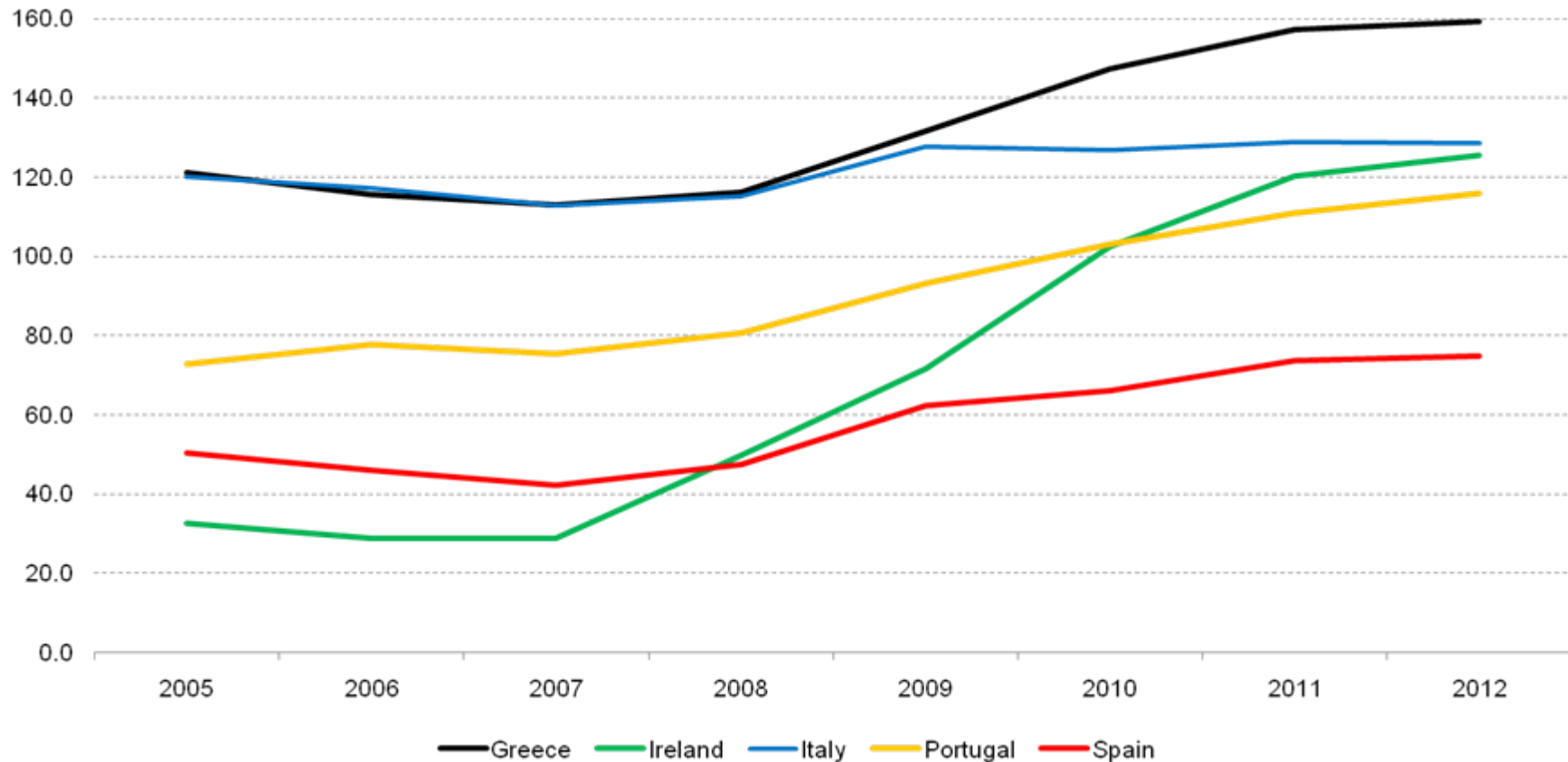
The international environment suggests lower growth in the years to come

- The economic recovery of the United States is slower than anticipated.
- Monetary stimuli are expected to continue as long as the economic take-off of the United States is delayed.
- In Europe, the focus is still on Greece, but a more systemic problem cannot be ruled out.
- From the perspective of emerging economies, a tightening of monetary policy is possible in countries such as China, India and the Russian Federation, owing to increasing inflationary pressures.



In several European economies public debt is at unsustainable levels

Europe (selected countries). Evolution of public debt as a percentage of GDP



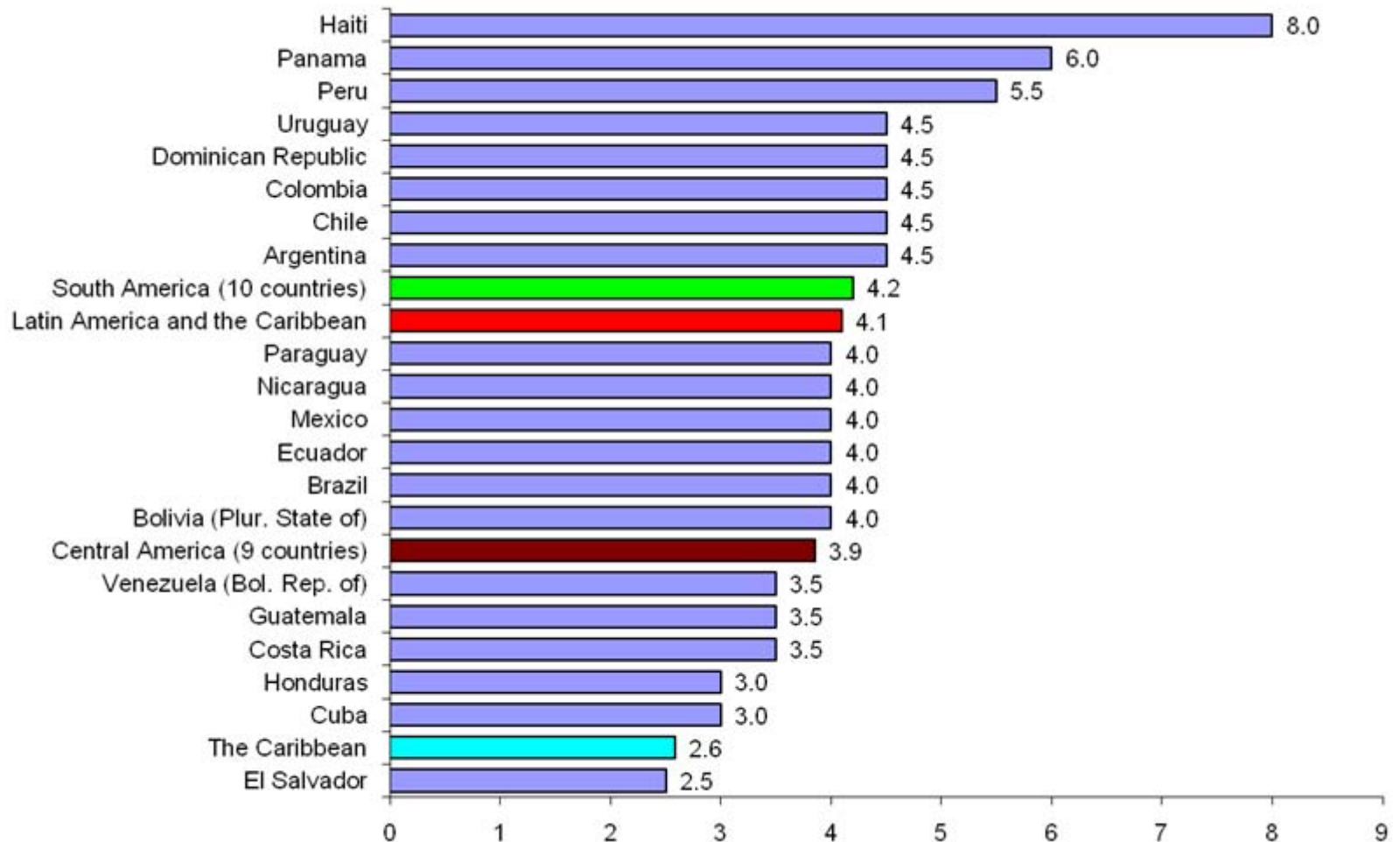
Summing up...

- The region continues to grow, but slowing down from 4.7% in 2011 to 4.1% in 2012
- Three underlying patterns characterize the region: South America, Central America and the Caribbean
- Falling real exchange rates are hampering the development of non-traditional sectors (industry, services, etc) which are the main generators of employment
- While keeping in mind the lessons learned from the past, we must transition to macroeconomic policies for development, taking advantage of the currently favourable situation...



Somewhat lower growth is expected for 2012

GDP growth rates (%)



Rebuilding macroeconomic policy space

- A variety of factors, including the deceleration of international economic growth, the gradual reduction in global liquidity, and the increase in the perceived risk of financial assets could trigger a “flight to quality.”
- A situation like this could doubly affect the region: through the availability of financing and through the evolution of the terms of trade.
- Controls or limits on short-term capital inflows could help reduce the vulnerability of the economies.



Rebuilding macroeconomic policy space (continued)

- These risks are not yet pressing, and countries should take advantage of the current favourable situation to accumulate international reserves and generate public sector savings.
- Further reforms are needed in the regulatory and supervisory frameworks of the financial sector.
- Labour market institutions need strengthening.
- Policy instruments in support of increased long-term economic competitiveness could also contribute to maintaining macroeconomic equilibria and to limiting volatility.



A hierarchy of policy objectives and instruments for:

- Tackle inflationary pressures that are in large part driven by external factors (increases in food and energy prices).
 - Monetary policy alone will not solve the problem
 - Fiscal measures are needed to complement monetary policy
 - ...in order not to jeopardize the recent economic recovery
- How to address falling real exchange rates in a context of improving terms of trade and low international interest rates
 - Capital flow controls
 - Currency market interventions
 - Macroprudential financial regulations
 - ...to move beyond an commodity-based economy
 - ...to overcome the deterioration of the current account



The challenges are even greater for the small economies of Central America and the Caribbean

- In general, these countries are net commodity importers (with the exception of certain Caribbean economies).
- They are more dependent on developed countries as their principal export destination or their principal source of tourism earnings.
- Public debt levels in the Caribbean are close to 80% of GDP on average, and above 100% in some cases.
- Central America is characterized by higher average deficit levels than South America and by lower tax burdens, at 10% to 15% of GDP.
- The average primary deficit of the Caribbean economies is similar to that of Central America, though with larger differences between countries. Owing to the higher debt-service levels, however, the global deficit in the Caribbean is significantly higher, reaching around 5% of GDP in a number of countries.



Macroeconomic policies for development call for...

- The design of a hierarchy of policy objectives for rebuilding macroeconomic policy space
- A gradual transition from macroeconomic policies for stability to macroeconomic policies for development, without neglecting the lessons learned from the past
- Beyond mere inflation control, the design of growth targets and creation of employment, while maintaining macroeconomic equilibria in both fiscal and external accounts
- Increased competitiveness based on productivity improvements, with social inclusion and environmental sustainability



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