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Briefing paper



# Preliminary Overview of the Economies of Latin America and the Caribbean



SIXTY YEARS WITH LATIN AMERICA AND THE CARIBBEAN

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The *Preliminary Overview of the Economies of Latin America and the Caribbean* is an annual publication prepared by the Economic Development Division in collaboration with the Statistics and Economic Projections Division, the Latin American and Caribbean Institute for Economic and Social Planning (ILPES), the ECLAC subregional headquarters in Mexico and Trinidad and Tobago, and the Commission's country offices in Bogota, Brasilia, Buenos Aires, Montevideo and Washington, D.C.

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The national accounts data presented in this edition of the *Overview* are based on the official figures issued by the countries covered in this report; for purposes of comparison between countries, however, these statistics are expressed in constant 2000 dollars. Thus, in some cases, there may be apparent discrepancies with the information issued by individual countries.

### **Explanatory notes**

The following symbols are used in tables in this edition of the *Preliminary Overview*:

Three dots (...) indicate that data are not available or are not separately reported.

A dash (–) indicates that the amount is nil or negligible.

A point (.) is used to indicate decimals.

Use of a hyphen (-) between years (e.g., 2001-2006) indicates reference to the complete period considered, including the beginning and end years.

The word "tons" means metric tons and the word "dollars" means United States dollars, unless otherwise specified.

References to annual rates of growth or variation signify compound annual rates, unless otherwise specified.

Individual figures and percentages in tables do not necessarily add up to the corresponding totals because of rounding.

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## SUMMARY

With annual economic growth for Latin America and the Caribbean being projected at 4.6%, 2008 will mark both the sixth consecutive year of growth and the end of a period which has very few precedents in the economic history of the region. Between 2003 and 2008, regional GDP growth averaged nearly 5% per year, with per capita GDP increasing by over 3% per annum. This growth was coupled with improvements in labour-market indicators and a reduction in poverty in the region. One of the most outstanding features of this period has been the fact that, in most of the countries, policymakers have placed priority on maintaining macroeconomic balances, which has helped generate surpluses in both their external and their fiscal accounts. The highly favourable external economic environment of the last few years has been another contributing factor.

These results will not be repeated in 2009, however. Growth projections for next year are much lower than for the period that is now coming to a close. In view of this situation, the governments of the region should make every effort to deploy countercyclical policies in order to ward off an even sharper economic decline. The growth rate for Latin America and the Caribbean is projected to be 1.9% in 2009 based on a relatively optimistic scenario with regard to the path that the present crisis will take in the future.

Again in contrast to the period 2003-2008, growth projections for the region suggest that the regional unemployment rate will rise from an estimated 7.5% in 2008 to between 7.8% and 8.1% in 2009, depending on the changes that occur in the labour force participation rate, while the informal sector of the economy also expands. The behaviour of international food and fuel prices, on the other hand, indicate that inflation will subside from 8.5% in 2008 to around 6% in 2009.

In just slightly more than a year's time, what had started out as a problem in the subprime mortgage market in mid-2007 turned into a systemic crisis that crippled the credit markets of the developed countries. This will undoubtedly have an extremely negative impact on the real economy, although, as of the end of 2008, it is still too soon to accurately gauge the full impact of the crisis.

The depth and duration of the recession will depend on the effectiveness of steps taken to stimulate demand and offset the slump in private spending, as well as on the normalization of credit markets. It is to be hoped that the array of measures implemented by the United States Federal Reserve and other central banks will succeed in containing systemic risk and that, in conjunction with the recovery of their financial systems as well as fiscal policy measures, the developed economies will begin to emerge from the depths of the crisis in the second half of 2009. This is the fairly optimistic scenario on which the growth projections for the region for 2009 are based.

Although the region is better prepared than before to handle a crisis, there are a number of channels through which its effects are likely to be transmitted to the economies of Latin America and the Caribbean. First, the global slowdown will drive down export volumes and prices, remittances, foreign direct investment and the demand for tourism services. In addition, external financing will be more expensive and will be more difficult to obtain for the countries of the region.

Growth in 2009 is projected to be 1.9%. This estimate is built on a scenario in which the global economy, in general, and the regional economy, in particular, will gradually begin to make a recovery during the second half of the year. This projection is based on a comparison of average levels for 2008 and 2009 which points to a sharp slowdown, with the growth rate largely reflecting a statistical effect. A

more pessimistic scenario of continuing and even deepening recession and tight credit conditions cannot be ruled out, however. In this case, obviously, the problems discussed here would worsen and the growth rate could be lower than the current projection.

The deterioration of labour-market indicators and the decline in remittances will have a negative impact on income distribution in the region. Under current circumstances, this means that public policymakers will face the double challenge of implementing countercyclical measures to stabilize economic growth and of developing instruments to shield the most vulnerable sectors of the population from the effects of the crisis. The fiscal resources available to each country for use in financing these types of policy actions differ considerably, although public finances in general will come under greater pressure, given the expected decrease in fiscal revenues.

## I. INTRODUCTION

The economic growth rate for Latin America and the Caribbean is projected to be 4.6% for 2008. This will mark the sixth consecutive year of growth, as well as the end of a period which has very few precedents in the economic history of the region. Between 2003 and 2008, the region's economy grew by an average of almost 5% per year, with per capita GDP increasing by over 3% per year. This growth was coupled with improvements in labour-market indicators and a reduction in poverty in the region. One of the most outstanding features of this period has been the fact that, in most of the countries, policymakers have placed priority on maintaining macroeconomic balances, which has helped generate surpluses in both their external and their fiscal accounts. The region has also benefited from the highly favourable external economic environment of the last few years.

These results will not be repeated in 2009, however. Growth projections for next year are significantly lower than for the period that is now coming to a close. In view of this situation, the governments of the region should make every effort to deploy countercyclical policies in order to ward off an even sharper economic decline. The growth rate for Latin America and the Caribbean is projected to be 1.9% in 2009 based on a relatively optimistic scenario in which the existing crisis situation gives way to a gradual improvement in the second half of that year.

Again in contrast to the period 2003-2008, growth projections for the region suggest that the regional unemployment rate will rise from an estimated 7.5% in 2008 to between 7.8% and 8.1% in 2009, depending on the changes that occur in the labour force participation rate in a context of increasing informality. The behaviour of international food and fuel prices, on the other hand, indicates that inflation will subside from 8.5% in 2008 to around 6% in 2009.

What started out as a problem in the subprime mortgage market in mid-2007 became, just over a year later, a systemic crisis that crippled the credit markets of the developed countries. This will undoubtedly have an extremely negative impact on the real economy, although, as of the end of 2008, it is still too soon to accurately gauge the full impact of the crisis.

In 2008, the world economy underwent a sharp slowdown as growth dropped to 3.7% from 5.0% in 2007.

Measured on the basis of exports, world trade expanded by 4.7% in 2008, which was far less than the 7.1% rate recorded the year before. Global economic activity began to cool as a consequence of the financial crisis, which, with the developed countries as its epicentre, erupted in mid-2007 and continued to deepen throughout 2008 despite the determined efforts made by authorities in numerous countries to contain it. The developed economies as a group grew by 1.4% this year, compared with 2.6% in 2007, and a contraction of 0.5% in the major advanced economies is expected in 2009. Developing countries also experienced a slowdown in 2008, but still managed to post a robust growth rate of 5.9% and are expected to grow by 4.6% next year.

Table I.1  
**LATIN AMERICA AND THE CARIBBEAN: GROSS DOMESTIC PRODUCT**  
*(Annual growth rates 2006-2009)*

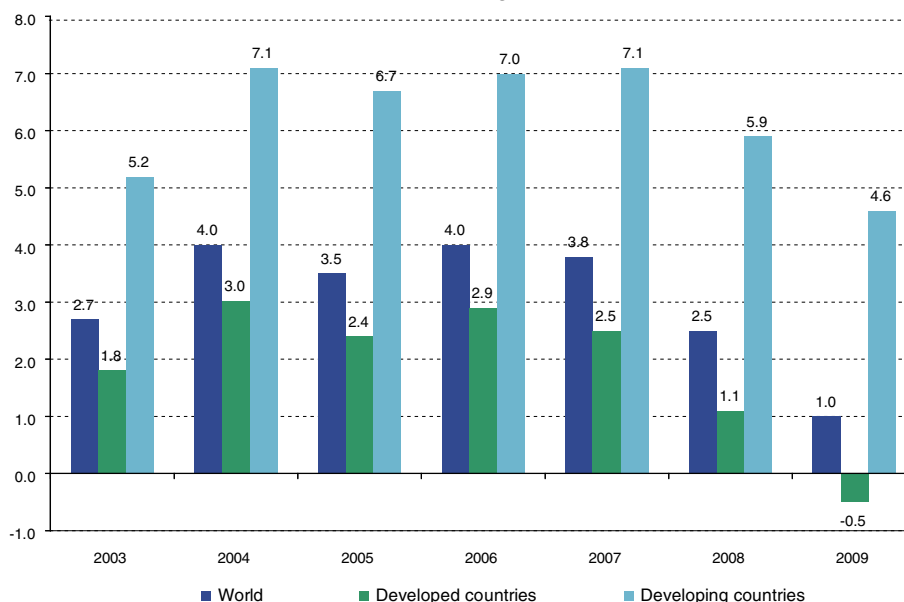
Country	2006	2007	2008 <sup>a</sup>	2009 <sup>b</sup>
Argentina	8.5	8.7	6.8	2.6
Bolivia	4.8	4.6	5.8	3.0
Brazil	4.0	5.7	5.9	2.1
Chile	4.3	5.1	3.8	2.0
Colombia	6.8	7.7	3.0	2.0
Costa Rica	8.8	7.3	3.3	1.0
Cuba	12.1	7.3	4.3	4.0
Ecuador	3.9	2.5	6.5	2.0
El Salvador	4.2	4.7	3.0	1.0
Guatemala	5.3	5.7	3.3	2.0
Haiti	2.3	3.2	1.5	1.5
Honduras	6.3	6.3	3.8	2.0
Mexico	4.8	3.2	1.8	0.5
Nicaragua	3.9	3.8	3.0	2.0
Panama	8.5	11.5	9.2	4.5
Paraguay	4.3	6.8	5.0	2.0
Peru	7.6	8.9	9.4	5.0
Dominican Republic	10.7	8.5	4.5	1.5
Uruguay	7.0	7.4	11.5	4.0
Venezuela (Bol. Rep. of)	10.3	8.4	4.8	3.0
<b>Subtotal Latin America</b>	<b>5.8</b>	<b>5.8</b>	<b>4.6</b>	<b>1.9</b>
Bahamas	4.6	2.8	1.5	0.5
Barbados	3.3	3.2	1.5	0.5
Belize	4.7	1.2	6.0	3.0
Guyana	5.1	5.4	4.8	2.5
Jamaica	2.5	1.2	0.0	0.5
Suriname	5.8	5.3	5.0	3.0
Trinidad and Tobago	12.0	5.5	3.5	2.0
ECMU	6.3	5.3	3.1	1.5
<b>The Caribbean</b>	<b>6.9</b>	<b>3.8</b>	<b>2.4</b>	<b>1.4</b>
<b>Latin America and the Caribbean</b>	<b>5.8</b>	<b>5.7</b>	<b>4.6</b>	<b>1.9</b>

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures expressed in constant 2000 dollars.

<sup>a</sup> Preliminary figures.

<sup>b</sup> Projections.

Figure I.1  
**WORLD GDP GROWTH**  
*(Percentages)*



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of International Monetary Fund, World Economic Outlook [database] April 2008.

## A. THE FINANCIAL CRISIS

Plunging real estate values in the United States were the initial destabilizing factor leading up to the international financial crisis. The upswing in property prices began to slow in 2006 (when monetary policy tightened), and prices actually began to come down in early 2007. By August 2008, one representative housing price index was 17.7% lower than it had been in August 2007. This deflationary process exerted strong pressure on mortgage owners and financial institutions alike. Refinancing schemes were hampered by rising default rates and the devaluation of the assets backing the loans, which produced a sudden swell in the relative burden of liabilities. The evidence emerging in mid-2007 of a decapitalization of investment vehicles belonging to major international financial institutions made it impossible for them to borrow on the short-term or interbank markets. Potential lenders became extremely reticent to part with liquidity, and this ultimately triggered a severe credit crunch.

The depreciation of stock market assets that began to accompany this process added another deflationary factor to the crisis: the Dow Jones industrial average was 35.4% lower in mid-November 2008 than in (pre-crisis) July 2007. During the first stage, the flows of private capital that were financing the United States current account deficit, though still positive, decreased notably. Between 2003 and the third quarter of 2007, these flows represented, on average, 2.6% of GDP, while from the last quarter of 2007 to the second quarter of 2008, they accounted for barely 0.6% of GDP, leaving the financing of the current external deficit in the United States mainly to official flows, which covered about 90% of the total balance (the equivalent of 5.0% of GDP).

With Japan and the euro zone moving towards a recession and the dollar appreciating from mid-2008 onward, a third deflationary factor emerged in the form of falling commodity prices. This trend was fuelled by the strong downturn in the United States economy in the second half of 2008.

One incident, in particular, marked a turning point in the development of the crisis: the collapse of Lehman Brothers. The repercussions of this event, far from being confined to the shareholders of that financial institution or, as next in line, investment banking in general, brought negative expectations to a head and culminated in widespread panic. Credit markets were virtually paralysed, and demand for liquidity soared. This situation was clearly reflected in interbank markets, which further undermined the already fragile balances of some banks and threatened the very survival of large financial institutions, in addition to fuelling fears of a systemic failure of global financial markets.

From the viewpoint of Latin America and the Caribbean, these events signalled the start of the contagion of financial markets in emerging economies. The effect on corporate financing was also extremely negative, and this hurt the equity position of large corporations, some of which have large subsidiaries in Latin America and the Caribbean while others are headquartered in the region itself.

The response from the world's monetary authorities came in several stages. First, starting in mid-2007, a number of developed countries injected huge doses of liquidity into the system. In the United States, the Federal Reserve lowered the benchmark interest rate, and the government introduced a fiscal stimulus package equivalent to approximately 1.1% of GDP. The next stage was shaped, in March 2008, by a specific bailout operation: the sale of Bear Stearns, which was brokered by the Federal Reserve. The third stage involved the restructuring of key actors in the mortgage market, such as Fannie Mae and Freddie Mac, and the overhaul of the entire investment banking sector in the United States. This required congressional approval in early October for a system-wide plan involving a sum equivalent to about 5% of GDP to bail out the country's decapitalized financial institutions. The inadequacy of this approach, which was made apparent by the stock market crash of October 2008 and the weakness of the credit market, led the government to allow investors to buy shares in financial institutions, a recapitalization measure that had already been introduced in the United Kingdom. In late October, the United States Federal Reserve lowered its interest rates to 1%, and in mid-December it cut them to between 0% and 0.25%.

With the bailout of Citigroup in late November, the approach being taken to financial rescue operations was altered to incorporate guarantees for the toxic assets held by banks. This means that these assets remain in bank portfolios, and the Treasury only needs to deal with any losses that occur in the future. This scheme is designed to generate confidence in the financial system without requiring, at least initially, any large outlays of funds.

## **B. THE TRANSMISSION OF THE CRISIS TO LATIN AMERICA AND THE CARIBBEAN**

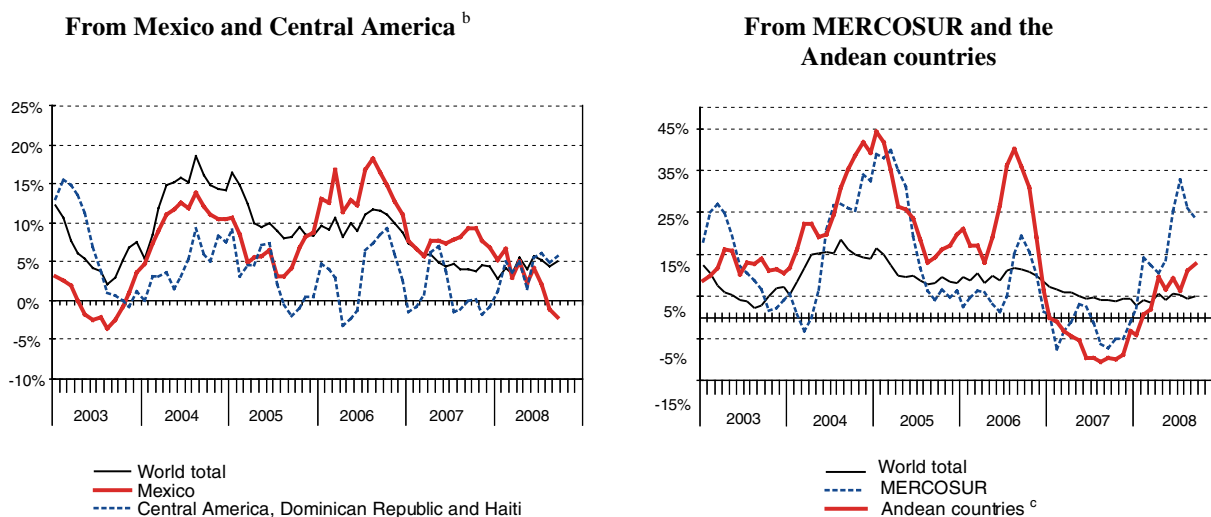
Within the framework of this generally bleak outlook, in which the factors driving growth in Latin America and the Caribbean in the past few years have all but disappeared, the international crisis is being transmitted through various channels that are, in turn, having different effects on each one of the countries of the region.

## 1. The drop in world demand

The looming recession in developed economies and the significant slowdown in the emerging ones will reduce demand for exports from Latin America and the Caribbean. The trend in the region's exports to the United States and China illustrates how the international financial crisis has been affecting the region's economies through trade. The United States' total non-oil imports have grown relatively steadily since mid-2007, when the financial crisis erupted.

This implies that, on average, the effect of rising prices for imported commodities was more or less counterbalanced by the decrease in import volumes. The situation regarding imports by the United States from Latin America and the Caribbean has varied considerably from country to country. Non-oil imports from Mexico began to slow in mid-2007 and continued to fall to the point where they registered a year-on-year contraction of 2.4% in the third quarter of 2008. Imports from the Central American countries have, on the other hand, behaved similarly to imports worldwide. This is because, although there is evidence of a slowdown and even of a contraction in Central American manufactures destined for the United States market, this decline has been offset by the higher prices obtained for commodity exports. United States imports from the Andean countries and MERCOSUR, a large proportion of which consist of commodities, rose in step with commodity prices from mid-2007 until the third quarter of 2008, when they began to level off. China's imports from Latin America and the Caribbean, which are most significant in the case of the Andean countries and MERCOSUR, followed a similar pattern, but peaked towards the end of 2007 in the case of the Andean countries and in the first quarter of 2008 in the case of MERCOSUR. The data for November 2008, however, show a 2% drop in exports and an 18% drop in imports in the region (compared with November 2007), a decline that has not been seen since 2001.

Figure I.2  
**UNITED STATES: NON-OIL IMPORTS, JANUARY 2000-SEPTEMBER 2008**  
*(Variation compared with the same month in the previous year)<sup>a</sup>*



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the United States International Trade Commission.

<sup>a</sup> Based on the three-month moving average of the relevant seasonally adjusted series.

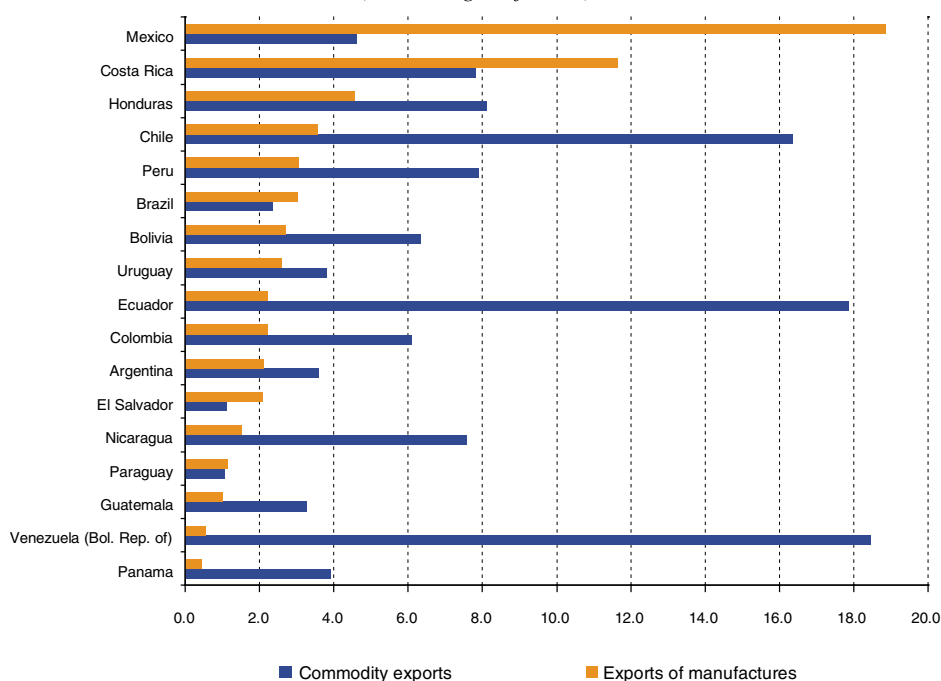
<sup>b</sup> Costa Rica, Dominican Republic, El Salvador, Guatemala, Haiti, Honduras, Nicaragua and Panama.

<sup>c</sup> Bolivarian Republic of Venezuela, Bolivia, Chile, Colombia, Ecuador and Peru.

The decrease in merchandise exports can be expected to have a greater impact on growth in the more open economies, in those that trade more with developed countries and, in particular, in those that sell a larger proportion of manufactured goods to developed markets, as it will be more difficult to find alternative markets for such goods quickly. As shown in figure, in Mexico, Ecuador, Chile, Costa Rica, Bolivarian Republic of Venezuela and Honduras, trade with developed countries accounts for over 10% of GDP. An examination of manufacturing exports alone, however, reveals that such exports account for over 10% of GDP only in Mexico and Costa Rica, and close to 5% in Honduras.

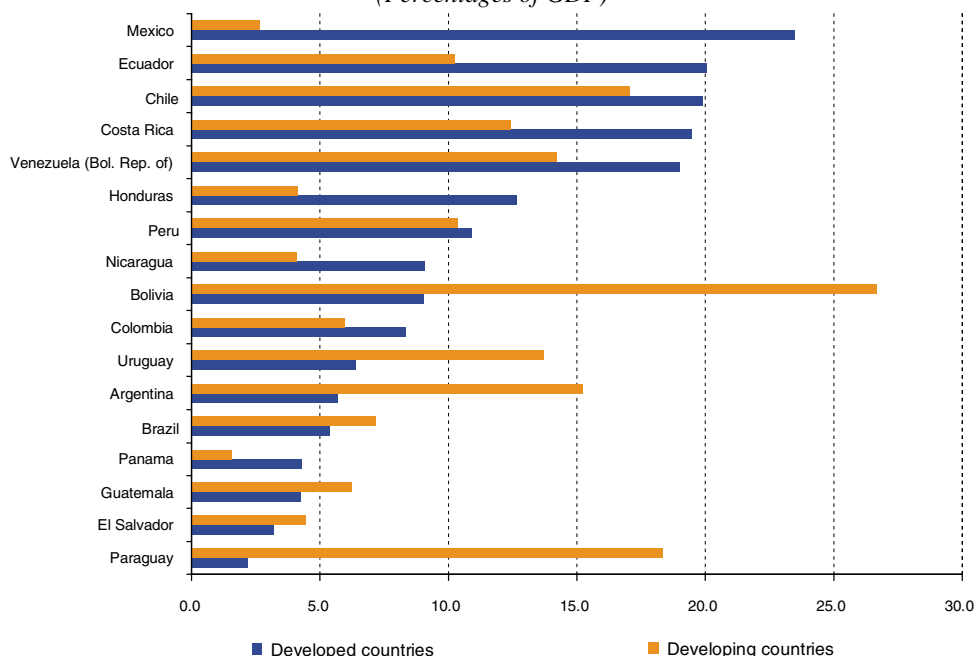
In some of the region's countries, part of the negative impact on growth will be the result of lower demand for services —particularly tourism, for which demand is extremely income-elastic. Although this issue is explored in greater depth in the accompanying box I.1, the following figure shows that Caribbean countries and some Central American economies may be among the most severely affected. In the Caribbean, exports of tourism-related services represent around 20% of GDP, compared with an average of 5% in Central America (although the figure is just under 10% for the Dominican Republic, Costa Rica and Panama).

Figure I.3  
**LATIN AMERICA (17 COUNTRIES): MERCHANDISE EXPORTS TO DEVELOPED COUNTRIES, 2006**  
*(Percentages of GDP)*



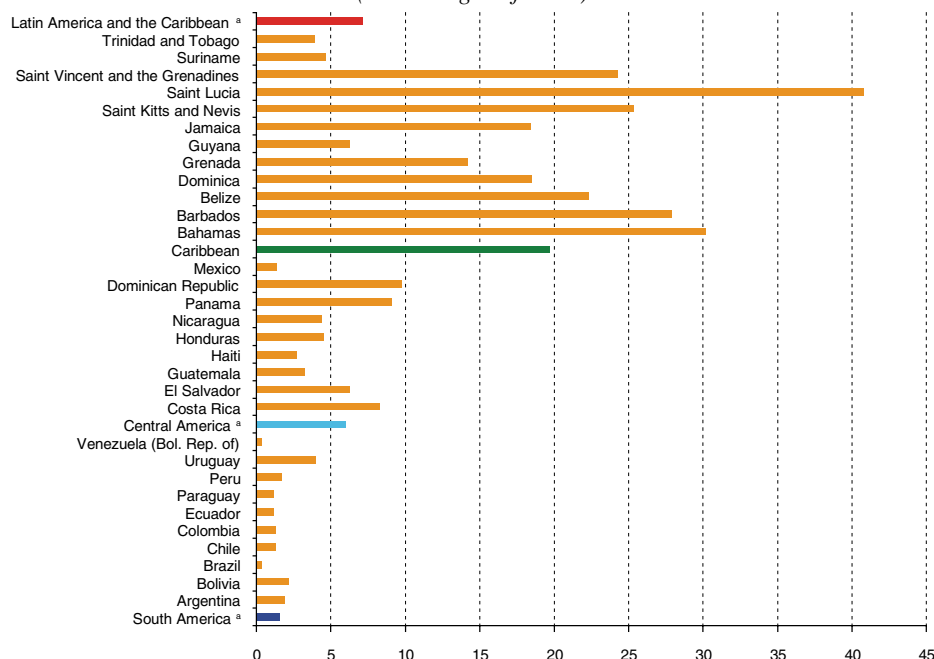
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Figure I.4  
**LATIN AMERICA (17 COUNTRIES): MERCHANDISE EXPORTS, BY DESTINATION, 2006**  
*(Percentages of GDP)*



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

Figure I.5  
**LATIN AMERICA AND THE CARIBBEAN: TOURISM**  
*(Percentages of GDP)*



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

<sup>a</sup> Unweighted average.

## Box I.1

**TRENDS IN THE TOURISM SECTOR AND THE INTERNATIONAL CRISIS**

The tourism sector in Latin America and the Caribbean is one of the areas that has enjoyed the most rapid development in recent years, as evidenced by its role in generating greater value added and foreign exchange earnings. Inbound tourism consumption<sup>a</sup> in the English-speaking Caribbean countries—except Guyana, Suriname and Trinidad and Tobago—ranges from 15% to 41% of GDP;<sup>b</sup> as a percentage of exports of goods and services, it is even higher, as tourism is the main foreign-exchange earner and a major engine of growth for the economies.

The World Tourism Organization (UNWTO) estimates total growth in this activity at between 2% and 3% in 2008 (compared with 6.6% in 2007). World tourism activity started to slow significantly between June and August 2008, owing to the continuing deterioration in real incomes and consumer expectations, the volatility of exchange rates and the squeeze on consumer credit resulting from the financial crisis.

In the first eight months of 2008, tourist arrivals in Central America and South America were still buoyant with growth rates of 9.4% and 7.2%, respectively; the Caribbean countries recorded growth of just 3%, with flat growth between June and August,<sup>c</sup> owing to a decline in arrivals in the Bahamas, Barbados, Bermuda and Puerto Rico, four destinations which receive visitors mostly from the United States and Europe.<sup>d</sup> Arrivals in Mexico were up by 4.8% during the same period, but slowdowns and even falls occurred in some segments and destinations towards the end of the period.<sup>e</sup>

**LATIN AMERICA: INBOUND TOURISM CONSUMPTION**

	Inbound tourism consumption as a percentage of GDP <sup>a</sup>	Inbound tourism consumption as a percentage of exports of goods and services <sup>b</sup>
<b>South America<sup>c</sup></b>	<b>1.6</b>	<b>5.2</b>
Argentina	1.9	7.5
Bolivia	2.2	5.9
Brazil	0.4	2.9
Chile	1.3	2.8
Colombia	1.3	6.6
Ecuador	1.2	3.5
Paraguay	1.2	2.0
Peru	1.7	6.0
Uruguay	4.0	13.6
Venezuela (Bol. Rep. of)	0.4	1.3
<b>Central America<sup>c</sup></b>	<b>6.1</b>	<b>17.8</b>
Costa Rica	8.3	16.9
El Salvador	6.3	23.2
Guatemala	3.3	13.6
Haiti	2.7	19.4
Honduras	4.5	12.9
Nicaragua	4.4	9.7
Panama	9.1	12.6
Dominican Republic	9.8	33.7
<b>Mexico<sup>c</sup></b>	<b>1.4</b>	<b>5.0</b>
<b>Caribbean</b>	<b>19.7</b>	<b>41.3</b>
Bahamas	30.2	62.5
Barbados	27.9	51.7
Belize	22.3	33.8
Dominica	18.5	43.9
Grenada	14.2	47.8
Guyana	6.3	23.2
Jamaica	18.4	44.6
Saint Kitts and Nevis	25.4	53.3
Santa Lucia	40.8	72.2
San Vincent and the Grenadines	24.3	51.9
Suriname	4.7	5.6
Trinidad y Tobago	3.9	5.6
<b>Latin America and the Caribbean<sup>c</sup></b>	<b>7.2</b>	<b>17.3</b>

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures and data from the World Tourism Organization, Yearbook of Tourism Statistics.

<sup>a</sup> Corresponds to the income from travel and transport of passengers entered in the balance of payments, as a percentage of GDP in current dollars.

<sup>b</sup> Corresponds to income from travel and transport of passengers as a percentage of exports of goods and services in current dollars, entered in the balance of payments.

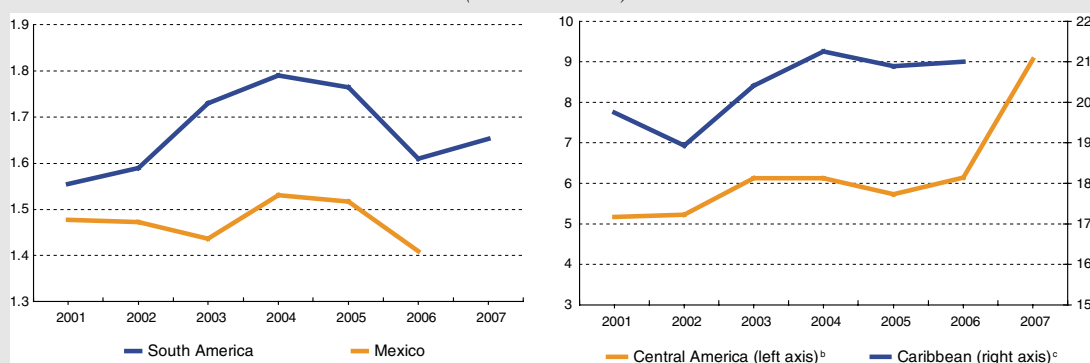
<sup>c</sup> Unweighted average.

## Box I.1 (concluded)

Tourism in Central America benefited from the relative novelty of this destination, from the projects that were maturing and from the increase in the frequency of flights at a time when high fuel costs were forcing most airlines to cut back on flights. In turn, in this subregion as well as in Mexico, the depreciation of the dollar against the euro early in the year boosted arrivals of European tourists as well as United States tourist who opted for trips to more competitive destinations rather than Europe on account of the high cost of airfares. Mexico also benefited from intraregional flows from countries whose currencies had appreciated against the peso. In South America, intraregional tourism helped to mitigate the impact of the crisis in the developed countries, with most of the inflows coming from countries whose currencies had appreciated.

The tourism sector has three characteristics that are of especial importance for many countries in the region: (a) it is an activity which has the potential to generate positive externalities on GDP and employment, since it can be structured as a network involving different providers of services and products which offers scope for small and medium-sized enterprises; (b) it is a sector that generates surpluses in the services balance in the smaller economies and compensates for pressures from other balance-of-payments categories thanks to the use of natural resources which, unlike mineral resources, can be exploited—subject to appropriate public policies—without the risk of depletion; and (c) it is an activity that proved to be particularly responsive to stimulation from the sound external context that prevailed during the period 2003-2007. The ratio of inbound tourism consumption to GDP may be used as an indicator to show the growing importance of this activity in Central America and South America during this period, when it increased by 1.5% and 0.2% of GDP, respectively, compared with the period 1997-2001 (see figure 1). In South America, tourism has acted as one of the engines of post-crisis recovery, particularly in 2003-2004, and maintained a historically high level in subsequent years. In Central America, positive growth in the sector stems from the consolidation of the industry in some countries (Costa Rica and Dominican Republic) and from the emergence of newcomers to the market (El Salvador and Nicaragua). The Caribbean countries also performed well during the growth years.

**LATIN AMERICA AND THE CARIBBEAN: INBOUND TOURISM CONSUMPTION AS A PERCENTAGE OF GDP**  
(In current dollars)<sup>a</sup>



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

<sup>a</sup> Corresponds to income from travel and transport of passengers entered in the balance of payments, simple average of national figures.

<sup>b</sup> Central America includes the following countries: Costa Rica, Dominican Republic, El Salvador, Guatemala, Haiti, Honduras, Nicaragua, Panama.

<sup>c</sup> The Caribbean includes the following countries: Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname and Trinidad and Tobago.

UNWTO projects that world tourism will expand by between 0% and 2% in 2009. The recession in the developed economies, which are home to approximately 75% of all tourists travelling to the English-speaking Caribbean and over 40% of those travelling to Central America (for Cuba and the Dominican Republic, the percentage is 75%), will have an impact on per capita disposable income and hence on tourism spending. Business travel may be particularly hard hit. Nevertheless, an easing of inflationary pressures and currency depreciation in several countries in the region could compensate in part for these effects and tourist destinations closest to the place of residence could benefit. Price competitiveness and the exchange-rate situation between the different tourist destinations will prove to be much more important for sustaining this activity. Lastly, several countries where significant investments have taken place in recent years will be better placed to compete for the declining demand that seems to be in the offing.

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC).

<sup>a</sup> Income from passenger travel and transport recorded in the balance of payments.

<sup>b</sup> Figures relate to 2007.

<sup>c</sup> Figures from the World Tourism Organization (UNWTO) *World Tourism Barometer*, Vol. 6, No.3, October 2008.

<sup>d</sup> Caribbean Tourism Organization, *Latest statistics* 2008, November 2008.

<sup>e</sup> Secretariat of Tourism of Mexico, *Boletín cuatrimestral de turismo*, No. 23, May-August 2008.

## 2. Expected trend in remittances

The weaker job market in developed economies will have an adverse effect on the remittances that emigrant workers send back to their families in their home country. Remittances have been an extremely important source of external revenues in Latin America and the Caribbean, where they have helped to increase the well-being of low-income families. Any reduction in remittances will therefore have a negative impact on the situation of this socio-economic group, as is discussed in box I.2. Thus, the major challenge facing the region is to prevent poverty indicators from increasing.

### Box I.2

#### CONSIDERATIONS ON THE DISTRIBUTIVE IMPACT OF SLOWER GROWTH

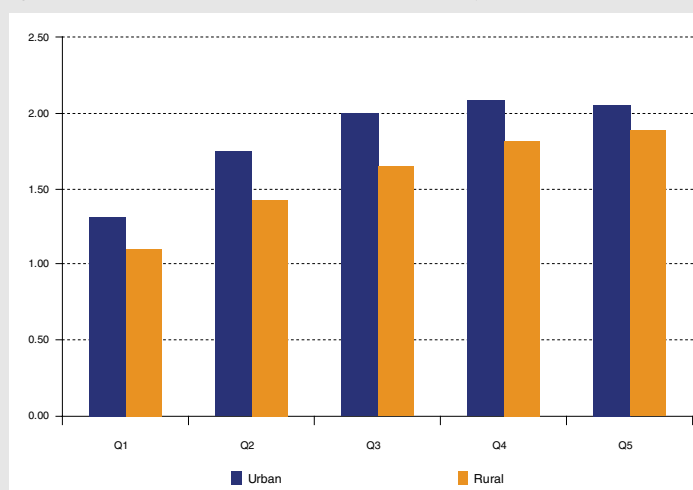
A very significant factor in a region with levels of inequality as high as they are in Latin America and the Caribbean is that not all households are equally affected by slower growth. For the great majority of the region's households, labour market shifts are the main transmitters of this impact. In 2008-2009 the well-being of lower-income households is also being eroded by trends in remittances and domestic prices.

In the current circumstances, therefore, public policies have to deal with the challenges not only of stabilizing economic growth through countercyclical measures but also of developing ways to protect the most vulnerable sectors of the population from those negative distributive effects. Clearly, the scope for action in that direction varies widely among the countries of the region.

#### Impact on the labour market

It is expected that in 2009, the employment rate will fall and unemployment will rise. The impact of job loss is differentiated by household traits. Figure 1 shows that lower-income households tend to have fewer breadwinners; indeed, that is one of the reasons for their low incomes. Consequently, job loss has a greater effect on low-income households, since it means, at least initially, the loss of a higher proportion of the household's already low income. Urban households in the three highest income quintiles average two breadwinners, so even if one job is lost, one full income is retained. The situation is very different in urban households belonging to the lowest quintile, where, on average, only a third of one wage is retained.

#### LATIN AMERICA (EIGHT COUNTRIES): NUMBER OF BREADWINNERS BY HOUSEHOLD INCOME QUINTILE AND URBAN OR RURAL AREA, SIMPLE AVERAGE, 2006-2007

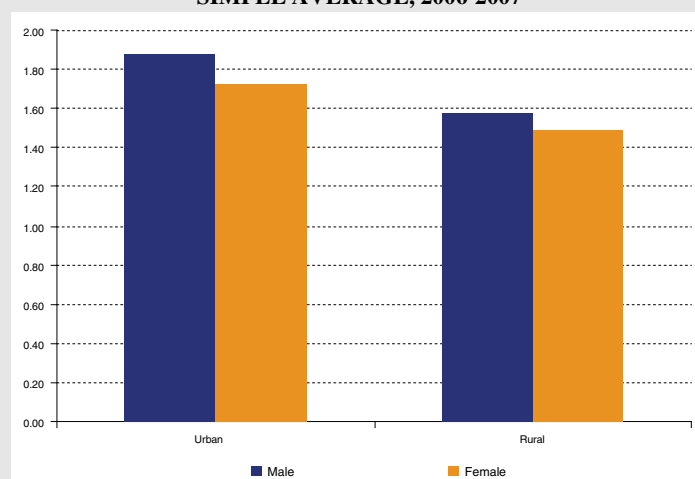


**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of special processing of data from household surveys conducted in the respective countries.

The situation is worse in rural areas, where households in the poorest quintile have, on average, only one breadwinner. In both urban and rural areas, female heads of household are especially vulnerable, since their households average a lower number of breadwinners (see figure below).

Box I.2 (concluded)

**LATIN AMERICA (EIGHT COUNTRIES): NUMBER OF BREADWINNERS PER HOUSEHOLD,  
BY SEX OF HEAD OF HOUSEHOLD AND URBAN OR RURAL AREA,  
SIMPLE AVERAGE, 2006-2007**



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of special processing of data from household surveys conducted in the respective countries.

Furthermore, the members of the poorest households tend to work in the informal sector, so that when they lose their jobs they enjoy none of the protection mechanisms that, at least in some countries and occupations, are available to workers in the formal sector.

The members of the poorest households tend to work in different job categories and branches of activity from those of wealthier households. For example, in urban areas, employees in the first and second quintiles make up 12.8% and 16.8% of all employed persons, respectively, but 17.2% and 22.2%, respectively, of construction workers. Since in many countries the economic slowdown is impacting heavily on that sector, many households which already have low incomes are likely to suffer major losses in well-being.

In terms of employment category, low-income quintiles tend to be over-represented in domestic work, own-account work (other than professional or technical activities) and unpaid work. Crisis situations often jeopardize domestic employment, since many medium-income households employing domestic workers will dismiss them in the event of income loss or the possibility of a household member losing his or her job. Also, own-account—and unpaid—workers tend to increase in number during low-growth periods because such work is perceived as the only means of generating income or, in the case of unpaid work, of helping to generate it. This often results in a fall in the average incomes of such workers, because the supply of specific goods and services increases while demand stands still or falls.

### Impact on remittances

As many studies have emphasized, cross-border migrants do not generally come from the poorest households. Yet the remittances they send home tend to have a positive impact on distribution, since they favour low- and medium-low-income households and stimulate their consumption and investment. Falls in remittances following the cooling of host country economies, together with stricter migration control policies, clearly have a negative impact on the well-being of such households.

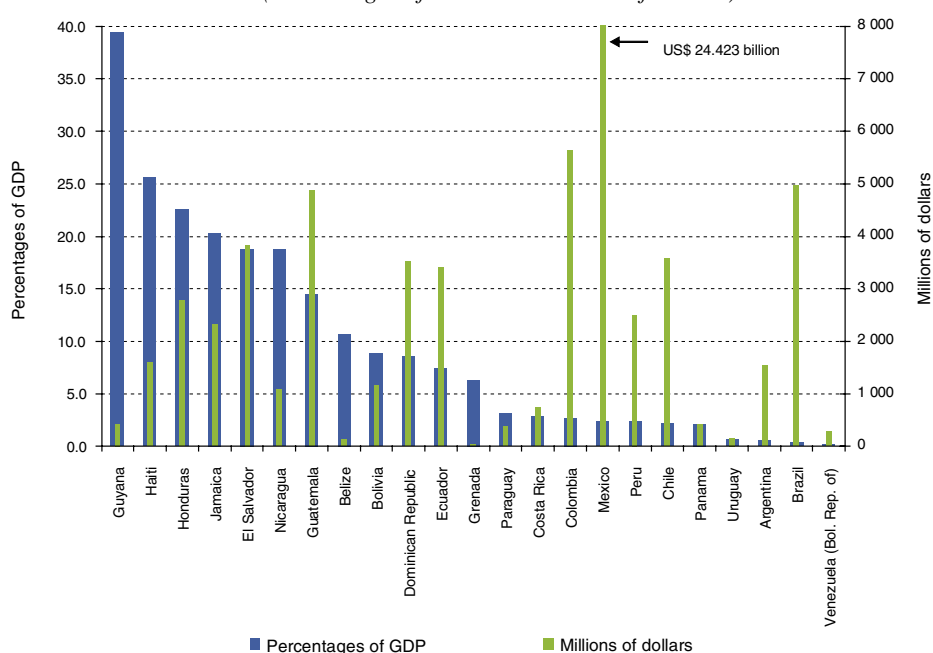
### Impact on prices

The sharp price rises seen in many countries in 2008 also had a specific distributive impact, since much of the inflationary upsurge was due to spikes in food prices, which have a higher relative weight in consumption baskets at the lowest income levels. Thus, the soaring food prices have had a greater impact on that segment of the population. In those countries in the region which publish such information, the consumer price index (CPI) for the lowest income levels systematically rose more than for the highest levels: in Mexico, in the 12 months to October 2008 the index for the lowest stratum rose by 7.0%, compared with 5.4% for the highest level; in the Dominican Republic the corresponding figures were 18.0% and 10.5%; and in the Bolivarian Republic of Venezuela, 39.5% and 33.9%.

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC).

Here again, certain Central American and Caribbean countries are the most at risk, as in many such economies remittances represent between 15% and just under 40% of GDP. These countries are, in decreasing order, Haiti, Honduras, Jamaica, El Salvador, Nicaragua and Guatemala. Slightly less at risk are countries where remittances account for between 5% and 10% of GDP. This category includes some South American economies, such as Bolivia and Ecuador (as well as Belize, the Dominican Republic and Grenada).

Figure I.6  
**LATIN AMERICA AND THE CARIBBEAN: CURRENT TRANSFERS (CREDIT), 2007**  
*(Percentages of GDP and millions of dollars)*



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

### 3. Commodity prices

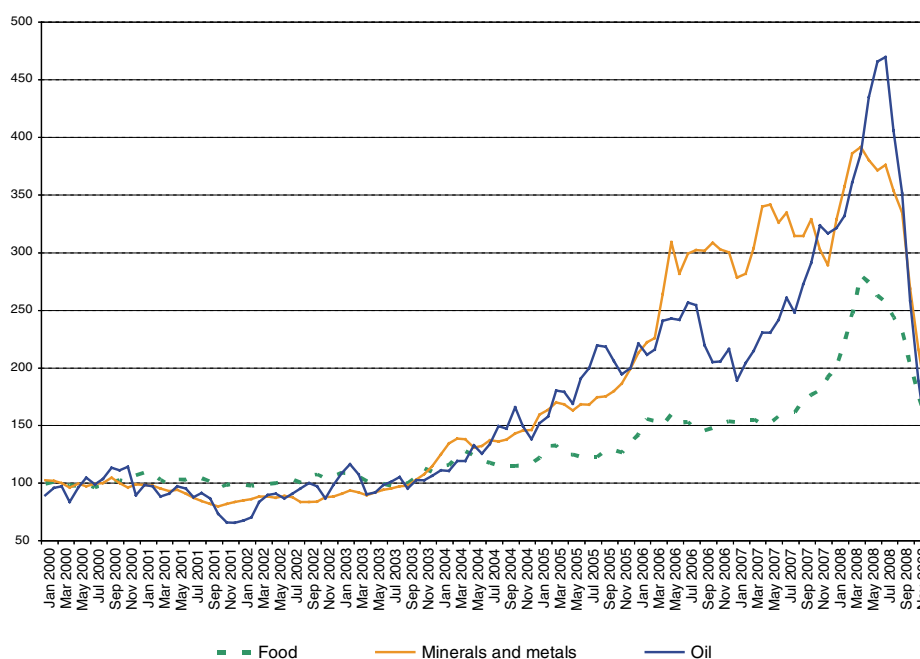
Falling commodity prices in the wake of slower world growth will result in a deterioration in the terms of trade for the region as a whole, although the actual effects will vary from country to country.

The rate of increase in commodity prices rose steadily between mid-2007 and mid-2008. Although there was an across-the-board surge in commodity prices, the increase was particularly striking in the cases of petroleum, certain metals such as copper, and foods such as soybeans, maize and wheat (as part of the global “food-price inflation” experienced at that time).

The index for most of the region’s exports peaked between June and August 2008; the total aggregate (not including petroleum) skyrocketed in July. From then onward, sharp declines ushered in the new recessionary and deflationary phase of the international crisis. In the case of petroleum, prices at the end of November 2008 were similar to those recorded in late 2004, while metal prices were similar to

those observed at the end of 2005. Food prices, which had shown a smaller increase previously, fell less dramatically, with prices in November 2008 being more or less equivalent to those of mid-2007.

Figure I.7  
COMMODITY PRICE INDICES  
(2000=100)



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Conference on Trade and Development (UNCTAD).

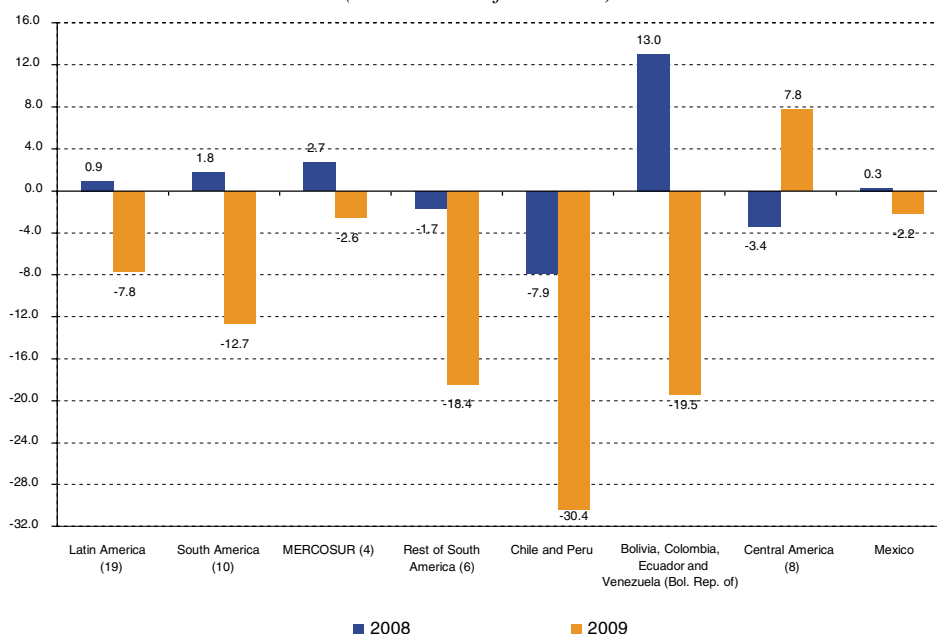
For most of the region's countries, commodities make up a considerable proportion of the export basket and, for many countries, they are a significant source of public funds. For all of these countries (including those in South America and Mexico, which had all benefited from improved terms of trade since 2003), commodity price patterns over the next year (or more) are expected to cause one of the region's recent engines of growth to come to a standstill.

For the region as a whole, it is estimated that the terms of trade will grow by 0.8% in 2008 and fall by 7.8% in 2009. For Chile and Peru, which are both metal exporters, the terms of trade are expected to deteriorate by around 8% in 2008 and 30% in 2009. For countries that export fuel, the terms of trade are expected to rise by 13% in 2008, before falling by almost 20% in 2009. As for MERCOSUR, where food accounts for an extremely significant proportion of exports, the rise in 2008 will be almost completely offset by the decline projected for 2009. In Mexico, the terms of trade are expected to improve very slightly in 2008 and then drop by over 2% in 2009.

In contrast, as Central America and the Caribbean are net importers of commodities, the fall in oil, metal and cereal prices alleviates and partially offsets the consequences of the world economic slowdown and the above-mentioned fall in remittances. In a departure from the figures presented in the

previous paragraph, the terms of trade in Central America are expected to deteriorate by over 3% in 2008, before rising by almost 8% in 2009, which represents over a third of the decline observed in recent years.

Figure I.8  
**LATIN AMERICA (19 COUNTRIES): TERMS OF TRADE, 2008-2009**  
*(Annual rate of variation)*



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

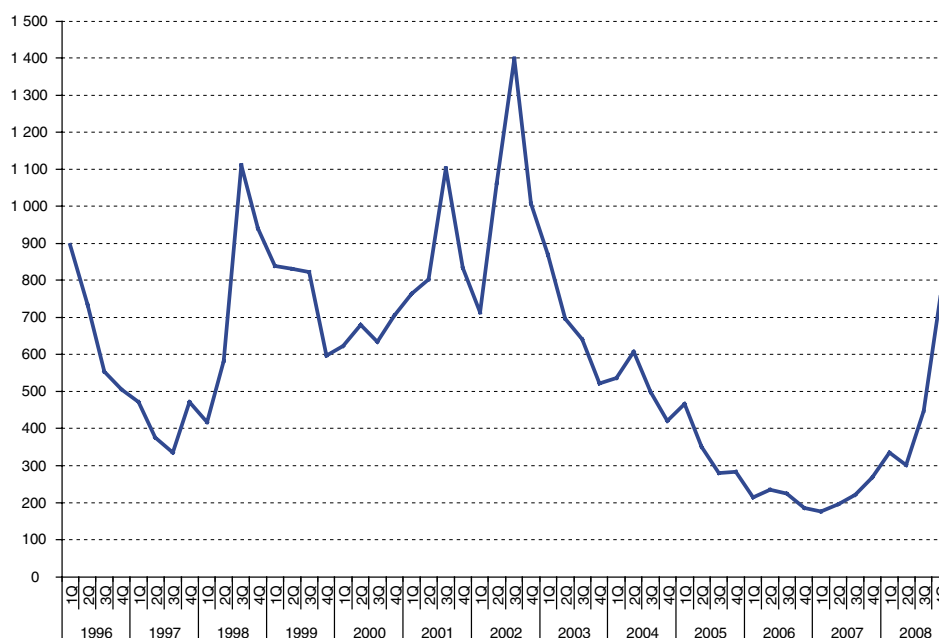
Recent trends in food and energy prices are easing inflationary pressures. Given the rapid devaluation of many currencies, this has yet to be reflected in price indices. However, inflation rates are expected to be lower as a result in 2009.

#### 4. Financial contagion

As stated previously, in the wake of the failure of the Lehman Brothers investment bank, the crisis had an increasing impact on the financial markets of Latin America and the Caribbean. In the final four months of the year, the region has experienced a slowdown then a decline in portfolio flows, huge falls in regional stock markets and drastic depreciations, attributable in part to previous speculative positions based on expectations of appreciation for Latin American currencies.

The cost of international borrowing soared, mainly for businesses but also for sovereign debtors, although the region's experience in this regard is merely a reflection of the widespread increase in risk aversion sparked by increasing global uncertainty and what is occurring with the debts of emerging economies in general. As shown in the following figure, the increase in the sovereign risk premiums of the region is actually smaller than in previous crises, although this varies a great deal across countries.

Figure I.9  
**LATIN AMERICA: INTEREST-RATE SPREADS MEASURED BY EMBI+**  
*(Basis points, end of period)*



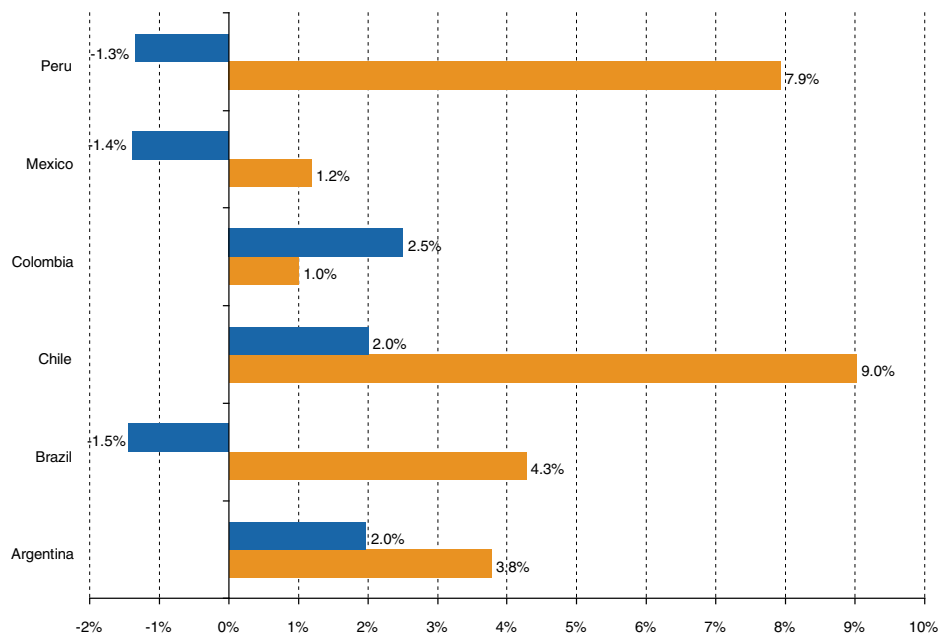
**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of JP Morgan.

Although the region's financial activity has not been exposed to toxic assets, the problems existing on the interbank market and the impact that the tightening of external credit has had on local credit markets are two ways in which turmoil in the financial markets of developed countries can be transferred to the region. The available information (most of which corresponds to the third quarter) is not sufficient to allow the scale of this impact to be calculated, however.

Of particular concern are the conditions of access to credit for a series of large regional enterprises from various countries that usually find financing on international markets. Given the credit crunch and the higher price of credit in global financial markets, it is expected to become more difficult to meet borrowing requirements. The reduced availability of external financing will force the larger private enterprises to turn to the domestic market. This, along with increased uncertainty, will probably make it more difficult for small and medium-sized enterprises to access financial resources. The backdrop to all this is a liquidity squeeze in local credit markets.

In the final part of the year, companies with debt in foreign currency have seen their balances negatively impacted by the devaluations of several of the region's currencies. This is a striking and somewhat unprecedented feature of this cycle as, unlike the situation in previous crises, it is the private sector that is the most exposed to exchange-rate volatility in many countries.

Figure I.10  
**LATIN AMERICA AND THE CARIBBEAN (SELECTED COUNTRIES): EXTERNAL DEBT,  
 2006-JUNE 2008**  
*(Percentages of GDP)*

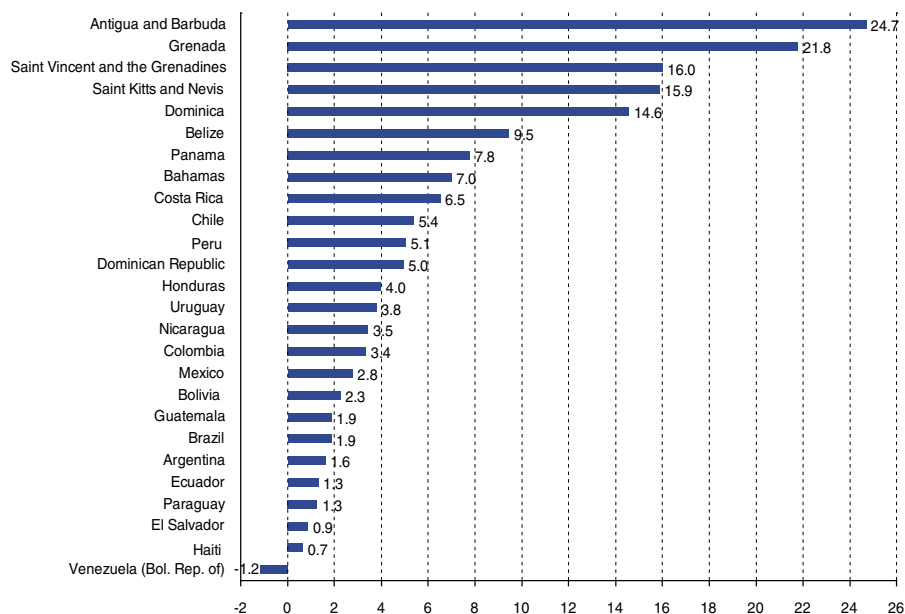


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

### 5. Impact on foreign direct investment (FDI)

It is also likely that the tightening of international financial conditions will have an adverse effect on inflows of foreign direct investment (FDI), which had been such an important source of resources for some countries in recent years. The figure below shows the high inflows of FDI into countries of the Caribbean (related to tourist activity) where they account for between 15% and 25% of GDP, into the Dominican Republic, Costa Rica and Panama (between 6.5% and 8% of GDP) and into Chile and Peru in South America (with FDI accounting for around 5% of GDP in 2008).

Figure I.11  
**LATIN AMERICA AND THE CARIBBEAN: NET FOREIGN DIRECT INVESTMENT**  
*(Percentages of GDP)*



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures from the relevant countries and International Monetary Fund.

### C. LATIN AMERICA AND THE CARIBBEAN IS BETTER PREPARED TO FACE THE CRISIS BUT IS NOT IMMUNE

Over the last six years, the region has made a number of improvements in terms of macroeconomic and financial policy. This has enabled countries to take advantage of the external boom and is now helping the region to face the crisis in a completely different way from in the past. The region has thus been able to continue growing even as the external situation seriously deteriorates. Nevertheless, many of the improvements are beginning to fade and in some cases revert.

Even though the factors described below are clearly different from those observed in past situations, if the crisis deepens and/or its effects become more prolonged, the macroeconomic foundations for the region's recent growth are eventually likely to be weakened. These factors include:

#### 1. The balance-of-payments current account surplus

It is unprecedented in the region's economic history to see growth coincide with a surplus on the external accounts. Initially, this was due to the combined effect of greater export volumes and higher prices for the exports of most of the region's countries. However, as the volume factor became less important, the increase in export values began to be exclusively dependent on international prices (while economic growth was also accompanied by a rise in imports). Therefore, the recent fall in commodity prices and the

expectation that this downward price trend will intensify as a result of slower world growth cast doubt over one of the main strengths of the region in recent years: its independence from external financing. Indeed, in 2008, the above-mentioned factors had already generated a slight current account deficit (0.6%), which is expected to widen in 2009 to a projected deficit of around 2.5% of regional GDP.

## 2. The generation of a surplus in the public accounts

Public accounts improved significantly, largely thanks to higher revenues (on the strength of better export prices and increased economic activity) and (up to 2007) to less expansionary spending patterns than in the past. The improvement in public accounts resulted in a substantial reduction in public debt.

More recently, public spending has been on the rise, and this has curbed the expansion of the primary surplus. The surplus has become exclusively dependent on income levels, and the reduction of public debt has also slowed. As with the current account balance, public revenues are expected to come under greater pressure at times when it may become necessary to increase spending to tackle the slowdown in private demand.

Given the predictions for income from exports of non-renewable resources (analysed separately), a small total deficit is forecast for the public accounts in 2008 (0.3% of GDP), although the primary surplus is expected to be maintained. In 2009, there should still be a primary surplus, albeit a smaller one, and the total deficit will expand to 1.5% of GDP.

The region's twin surpluses (on the current account and the fiscal accounts) in the period 2006-2007 are giving way to twin deficits, which will start off small in 2008 and then widen in 2009. The average for the region also reflects individual country trends, as shown in the figure: only three countries will retain their position in the virtuous quadrant with twin surpluses in 2008, while a growing number of countries will find themselves in the quadrant with deficits on the public and external accounts.

Figure I.12a  
**LATIN AMERICA (19 COUNTRIES): CURRENT ACCOUNT BALANCE  
 AND FISCAL BALANCE, 2006-2007**

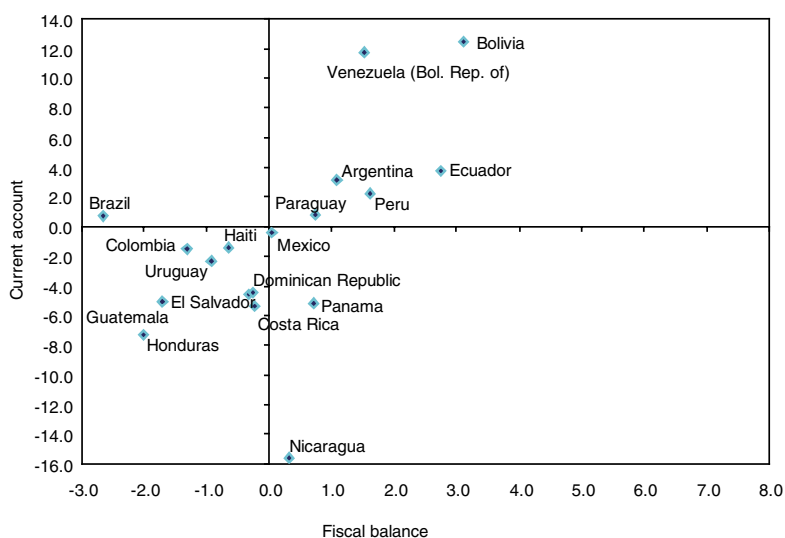
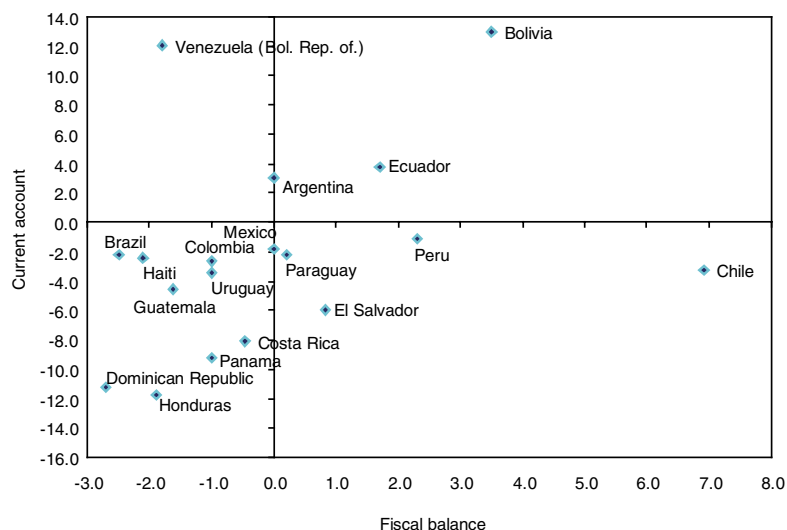


Figure I.12b  
**LATIN AMERICA (18 COUNTRIES): CURRENT ACCOUNT BALANCE  
 AND FISCAL BALANCE, 2008**



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

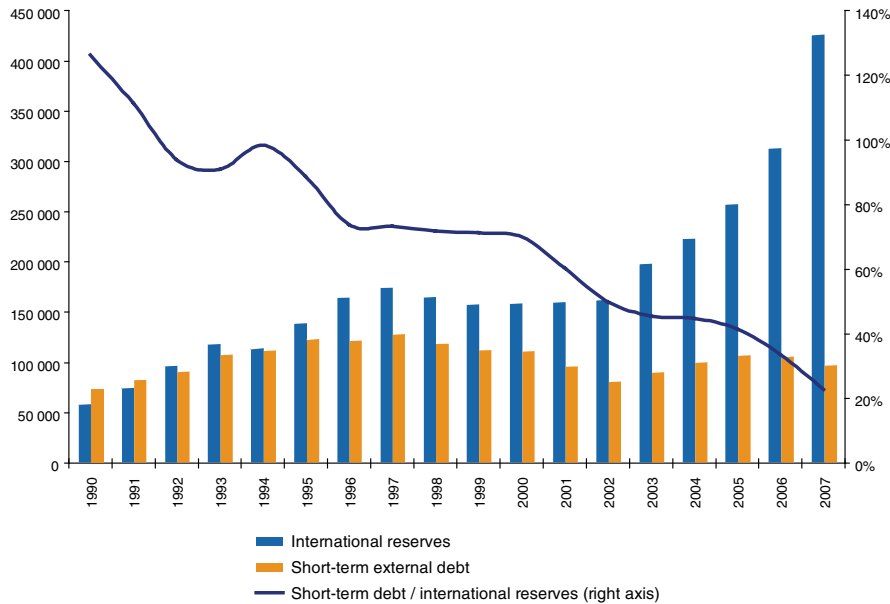
### 3. The external debt and international reserves

Exceptional liquidity conditions on the financial markets in recent years have meant that the reduction in external debt made possible by the twin surpluses went hand in hand with a tendency to renegotiate debt with better conditions in terms of rates, maturities and even currency in some cases. At the same time, some countries experienced strong capital inflows seeking to take advantage of the significant interest-rate spreads as currencies appreciated.

These capital inflows, combined with current account surpluses in many countries and foreign direct investment, led to significant growth in international reserves. As of mid-2008, that growth averaged about 15% of the region's GDP and was equivalent to almost five times the countries' short-term debt.

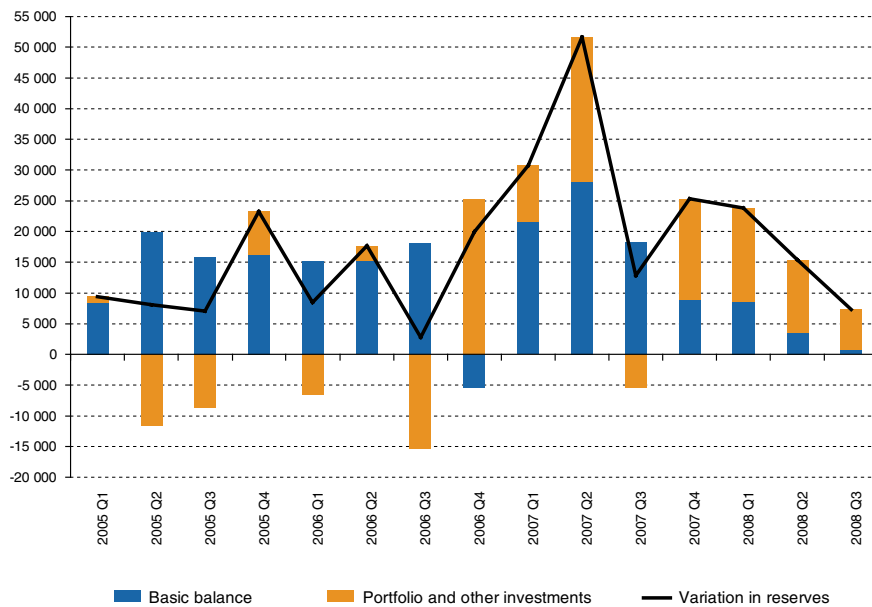
The role of financial capital inflows is increasingly significant in terms of the factors that contribute to the growth of international reserves. This is especially true when compared with the share of the increase in foreign exchange reserves that is accounted for by current account surpluses, which showed a markedly downward trend. This makes the stock of reserves somewhat fragile, particularly in some of the countries of the region, in light of the volatile nature of such resources.

Figure I.13  
**LATIN AMERICA AND THE CARIBBEAN: SHORT-TERM EXTERNAL DEBT AND INTERNATIONAL RESERVES**  
*(Millions of dollars and percentages)*



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bank, Global Development Finance database [online].

Figure I.14  
**LATIN AMERICA (SIX COUNTRIES)<sup>a</sup>: BREAKDOWN OF VARIATION IN RESERVES, 2005-2008**  
*(Millions of dollars)*



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

<sup>a</sup> Includes Argentina, Brazil, Chile, Colombia, Mexico and Peru.

#### 4. The private sector

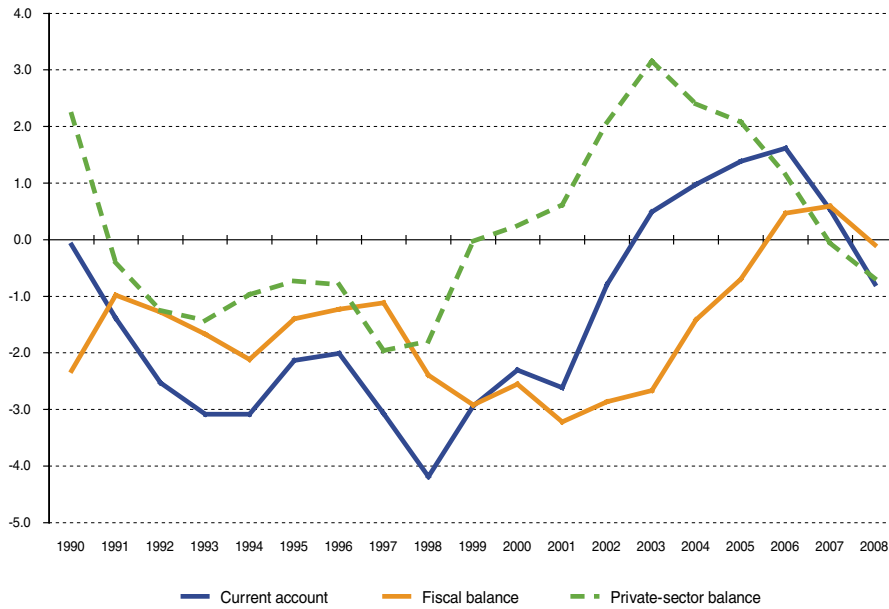
The maintenance of macroeconomic equilibrium requires that the sum of external saving and public saving is equal to the difference between private-sector investment and saving. External saving is equivalent to the balance-of-payments current account balance, but with the sign reversed. From 2003 to 2007 that balance was negative for Latin America and the Caribbean, and this was the counterpart to the aforementioned current account surplus. In 2008, however, the external saving figure is expected to be slightly positive.

When public-sector saving is calculated by means of the overall fiscal balance, the amount by which investment exceeds private saving can be determined; this, in turn, is an approximation of the private surplus (when it is positive) or, inversely, of private-sector overspending (when it is negative). This factor can produce a significant level of external vulnerability, as may be the case in a number of the countries whose private external debts have risen considerably, even if the macroeconomic fundamentals which are followed most closely are solid (as in the case of the twin surpluses seen in the region from 2003 to 2007).

Figure I.15 shows the trends of the current account balance, the surplus on public accounts and the private-sector surplus for the region. The behaviour of these balances in recent years provides a new picture of fundamental economic aggregates in the region. Taking the regional average, the private sector was in surplus from 2003 to 2007, while the public sector cut back its deficit and then achieved a surplus from 2006 onward. Until 2006 the private surplus was very high and easily compensated for the shrinking public-sector deficit, so the region as a whole was in surplus and did not need external saving; the current account balance was positive (i.e., external saving was negative). In 2006 and 2007, negative external saving was mainly a reflection of the public surplus, since the private sector saw its surplus shrink in 2006 and posted a deficit in 2007. From 2008 on, external saving was positive thanks to the combination of a fiscal deficit and excess private spending. In a context of tight international financial markets, this combination of factors is a source of vulnerability.

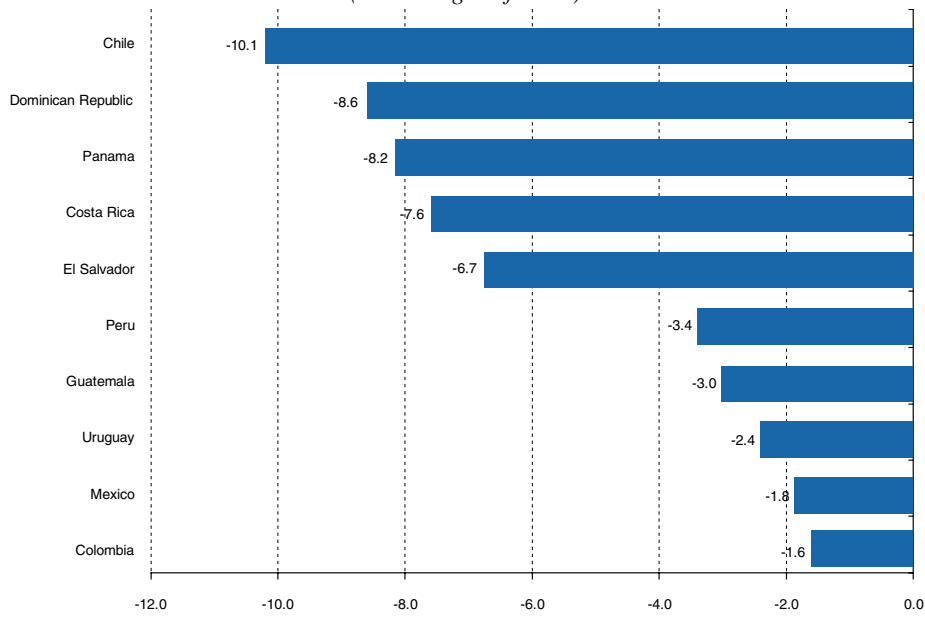
There are considerable differences across countries in this respect. As shown in figure I.16, the private-sector deficit is larger in Chile and some Central American economies and is somewhat smaller in Peru, Uruguay, Mexico and Colombia. It should be noted, however, that in many cases fiscal data correspond to the central government aggregate, and the figures obtained for the private sector as a residual therefore includes public enterprises.

Figure I.15  
**LATIN AMERICA (19 COUNTRIES): CURRENT ACCOUNT, FISCAL AND PRIVATE-SECTOR BALANCES**  
*(Percentages of GDP)*



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

Figure I.16  
**LATIN AMERICA AND THE CARIBBEAN (SELECTED COUNTRIES): PRIVATE-SECTOR OVERSPENDING, 2008**  
*(Percentages of GDP)*



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

#### **D. MEASURES IMPLEMENTED IN THE REGION TO COPE WITH THE ESCALATING CRISIS**

The Latin American and Caribbean countries have adopted a variety of measures in response to the deepening international financial crisis. They are well aware that, although most of them have macroeconomic foundations that are significantly stronger than in the past, the region will not escape the impact of instability in world financial markets and the expected recession in the developed economies.

The range of measures implemented is quite wide, not only because the effects differ from country to country and the instruments needed for countering them therefore also vary, but also because of differences in the countries' capacities, in terms of the availability of resources, to implement such initiatives.

That availability generally depends, on the one hand, on the fiscal room for manoeuvre available for financing the measures, when their implementation entails the use of public funds; and on the other hand, when they involve foreign-currency transactions, on the availability of external assets (basically, foreign reserves) or of access to foreign-currency credit. In the current circumstances, the latter is limited to dealings with international financial bodies.

Beyond these considerations, taking into account the impact that these measures may have on the rest of the economy, a full analysis of the countries' capacities should encompass, in addition to the aforementioned factors, other elements such as the degree of monetization and the depth of the financial market or the balance-of-payments current account balance. It should be remembered that a demand promotion strategy based on increased public spending, aside from its fiscal impact, may widen the external deficit beyond a country's capacity to finance it. In this case, the availability of foreign-currency resources will be an issue even if there is plenty of fiscal room for manoeuvre.

Table I.2 summarizes the areas of action selected by the governments of the region. In the short term, central banks in several countries have endeavoured to provide liquidity to their financial systems in both domestic and foreign currency in order to enable local credit markets to function normally or to provide funding where those markets cannot do so. Generally, there has been a marked difference between the scope of the policies announced in certain South American countries in comparison with some of the Central American and Caribbean States. This certainly relates to differing capacities to implement countercyclical policies, as referred to above.



## Box I.3

**MEASURES RECENTLY ADOPTED BY EXTERNAL FINANCING AGENCIES****International Monetary Fund**

To complement existing balance-of-payment support programmes, the International Monetary Fund (IMF) has announced the creation of a new Short-Term Liquidity Facility (SLF) for countries with access to international capital markets.

- Purpose: Create a facility to provide large upfront disbursements of short-term financing;
- Terms: Disbursements may be up to five times the country's quota in the Fund, and will have a three-month maturity. Eligible countries may draw on these lines of credit up to three times during a 12-month period;
- Eligibility: Countries with a good track record of sound policies (based on the periodic assessments conducted by the Fund) and sustainable debt burdens may qualify. The credits will be disbursed promptly and will not be subject to the procedures and conditionalities that normally apply to the Fund's other programmes.

**United States Federal Reserve**

The Federal Reserve has established temporary liquidity swap facilities with the central banks of Brazil, Mexico, Republic of Korea and Singapore to provide external liquidity in amounts of up to US\$ 30 billion in each case.

**Inter-American Development Bank**

The Inter-American Development Bank (IDB) announced new quick-disbursing credits to the tune of US\$ 6 billion to help countries to maintain economic growth and employment in the midst of the credit crunch.

The Liquidity Program for Growth Sustainability is designed to provide financing through intermediary banks to firms in the region that are facing transitory difficulties in accessing interbank credit lines or credit from world financial centres.

The countries that receive financing out of the Bank's ordinary financial capital can tap into the Liquidity Program. The loan amounts are determined by IDB on a case-by-case basis.

IDB also intends to speed up approval of its loans to finance projects and strengthen social programmes. The objective is to approve a record US\$ 12 billion in new loans in 2009, up from about US\$ 10 billion in 2008.

If the liquidity facility is fully utilized and the goal for new loan commitments is met, the financing granted in 2009 will amount to about US\$ 18 billion. This would represent an 80% increase on the Bank's current financing in the region.

**Andean Development Corporation**

The Andean Development Corporation (CAF) recently announced the establishment of a contingency line of credit for US\$ 1.5 billion.

The Corporation has also pledged to increase the lines of credit set up for the region's financial system from US\$ 1.5 billion to US\$ 2 billion.

These mechanisms, in conjunction with its traditional loan operations and other financing modalities, will bring total CAF loan commitments to US\$ 16 billion for the period 2008-2009.

**Latin American Reserve Fund**

The Latin American Reserve Fund (LARF) has also offered to make available, with immediate effect, liquidity credit lines totalling US\$ 1.8 billion. The Fund could add another US\$ 2.7 billion in the coming months through its contingency lines for balance-of-payments support, depending on how market conditions evolve.

**The World Bank and its affiliates**

The World Bank is in a position to increase its support to countries with new commitments of up to US\$ 100 billion between 2009 and 2011.

The International Development Association (IDA) can provide US\$ 42 billion to support countries seeking to enter the capital market and to assist countries experiencing difficulties due to falling commodity prices and weaker remittances.

Between 2009 and 2011, the group will provide support to the private sector, through the International Financial Corporation (IFC), for a total of US\$ 30 billion. The initiatives envisaged are as follows:

- Doubling the Global Trade Finance Program (from \$ 1.5 billion to \$3 billion).
- Investing US\$ 1 billion, through IFC, in the global share fund for bank recapitalization. Japan has already pledged US\$ 2 billion, and other investors are expected to invest similar amounts.
- Implementing a credit line for privately funded, financially viable infrastructure projects to support them in the renewal of commitments and recapitalization in case of financial constraints.

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

## E. THE CURRENT SITUATION AND THE OUTLOOK FOR THE FUTURE

### 1. The external situation

As of late 2008, it is not yet possible to arrive at an accurate projection of the impact that the financial crisis will have on the real sector of the economy. With uncertainties spreading worldwide, the balance sheets of financial bodies are weakening owing not only to the loss of value of mortgage guarantees but also, more generally, to the impact of the recession and the severe shortage of liquidity. The uncertainties also extend to the prospects for other major financial-market components such as insurance companies, hedge funds and pension funds, some of which have already been the object of rescue operations.

The recessionary trend is gradually worsening as a result of huge losses of financial and non-financial wealth in the private sector, most of all in the developed countries but also in emerging economies, and the steep fall in credit. The downward trend is also damaging expectations and causing sharp declines in investment and consumption.

As at the fourth quarter of 2008, there are signs that levels of activity and other real variables in the world's principal economies have been weakening considerably, thereby creating a negative feedback loop in financial markets. Macroeconomic aggregates in the United States indicate that, even though levels of economic activity did not worsen initially, growth in the first months of 2008 reflected a combination of a sharp drop in the aggregate formed by consumer durables and residential investment (-6.1%) with a strong upturn in goods and services exports (10.5%), which were stimulated by the real depreciation of the dollar up to mid-2008. This signals a progressive weakening of the domestic market which grew worse towards the end of the year.

Figure I.17  
UNITED STATES: UNEMPLOYMENT RATE, 1997-2008



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures provided by the United States Bureau of Labor Statistics.

The labour market, especially labour demand, has been very sensitive to the effects of the crisis. While in 2006-2007 new jobs created each month averaged about 133,000, between December 2007 and November 2008 nearly 170,000 jobs were lost per month; this trend worsened as the year went by, bringing the unemployment rate to 6.7% in November, its highest level since the early 1990s.

In the other developed economies, not only did the new set of conditions lead to a sharper initial slowdown than in the United States, but the financial problems were passed through to economic activity more rapidly. GDP growth rates in Japan and the euro zone amounted to a meagre 0.7% and 1.4%, respectively, in the first nine months of 2008, compared to 2.0% and 2.6% in 2007. Both recorded a GDP contraction in the second and third quarters of 2008, a clear sign that these economies had moved into recession. This was associated, first, with a downturn in export performance—as a result of real dollar depreciation in the first stage of the crisis, as noted earlier—and weakening capital formation. In a number of countries, such as Japan and Germany, the stretch of export expansion from 2003 onwards had driven a surge of investment in machinery and equipment, which lost momentum in the new conditions. In other countries, such as Ireland and Spain, rising investment in construction was associated with the real estate price boom, which began to be reversed as conditions toughened in the credit market.

The depth and duration of the recession will depend on the effectiveness of steps taken to stimulate demand and offset the slump in private spending, as well as on the normalization of credit markets. It is to be hoped that the array of measures implemented by the United States Federal Reserve and other central banks will be enough to contain systemic risk and that, in conjunction with the recovery of their financial systems and the initiatives launched from fiscal areas, the developed economies will gradually begin to rebound in the second half of 2009. This is the scenario on which the growth projections for the region for 2009 are based.

## **2. Expected performance of the Latin American and Caribbean economies in 2009**

As noted earlier, although the Latin American and Caribbean region is better prepared to face this crisis than previous ones, there are a number of channels through which the economies are likely to be affected.

First, the real channel—the global slowdown—has a number of aspects that do not affect all the countries the same way. Thus, the impact of financial contagion will depend on various factors and the countries of the region are exposed to it in varying degrees.

Growth of 1.9% is projected for the region in 2009. This estimate is built on a scenario in which the worst of the crisis has passed by the second half of 2009 and in which the global economy in general and the region in particular gradually begin to strengthen. This forecast is based on a comparison of average levels for 2008 and 2009 which points to a sharp slowdown and largely reflects a statistical effect.<sup>1</sup> A more pessimistic scenario of continuing and even deepening recession and tight credit

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<sup>1</sup> The reference made here to “the statistical effect” alludes to the fact that GDP figures for any given year are partially a reflection of the growth dynamics of the preceding year. When the economy is growing, as was the case in the Latin American and Caribbean region in 2008, in each quarter the (seasonally adjusted) level of output is higher than it was in the preceding one. As the annual GDP is the sum of the four quarterly GDPs (at constant prices), its growth rate represents, in approximate terms, the change in the level of activity existing midway through the year. However, as the calculations for the next year start from the level “inherited” from the fourth quarter of the previous one, even if there is no growth at all during this second year (i.e., the level of activity stays at the same (seasonally adjusted) level as it was in the fourth quarter of the previous year), the GDP growth rate for that second year will be positive.

conditions cannot be ruled out, however. In this case, obviously, the problems discussed here would worsen and the growth rate could be nil or even negative.

A breakdown by subregion shows smaller differences than those seen in earlier years. Although they all show a strong slowdown, Mexico and Central America continue to post lower growth than South America, and a very sharp downturn is projected in the growth rates of the Caribbean economies.

### **3. Global and regional problems call for a concerted solution**

Apart from the efforts of the region's countries to deal with the crisis and to do as much as possible to contain its impact on their economies and societies, the situation worldwide calls for coordinated solutions to give maximum leverage to whatever strategies are put in place.

In the last few years the global economy has expanded within the framework of excessive consumption in the developed countries, which has been financed by excess saving in the emerging economies. The surplus saving has largely been a result of the emerging economies' efforts to shield themselves from the impact of a potential financial crisis by building up assets. This form of "self-insurance" was an inefficient yet effective means by which many emerging economies could deal with a situation in which they found the resources and instruments made available by international financial institutions were unsatisfactory. This form of behaviour became more marked in the aftermath of the Asian crisis of 1997.

Clearly, the picture has changed substantially in the last year and half. The combination of wealth loss, credit crunch and rising unemployment will depress consumption in the developed economies and darken their performance expectations, feeding the downward spiral. So, in the near future, it will be up to the emerging economies to produce much of the demand needed to compensate for the negative stimuli in terms of world growth coming from the developed world. In this situation, self-insurance strategies are not only insufficient but are actually counterproductive, since they can do nothing to restart global growth. These strategies originated in real failures, however, which must be borne in mind in the design of a new international financial architecture. It is therefore essential that the emerging economies are involved in planning that architecture.

In the light of this, it is obvious that the role of the emerging economies in global economic growth has not only grown in importance, but is likely to increase further. They must therefore be included in forums to discuss strategies for coordinating policies to stimulate global growth and be provided, through international bodies, with the resources to finance the implementation of countercyclical policies.

The need to coordinate policies and resources also has a regional dimension. Macroeconomic policy coordination at the regional level and the strengthening of intraregional trade and integration in the broadest sense offer opportunities to leverage the impacts of the strategies being implemented and to counteract the conditions of low GDP and world trade growth that lie ahead.

Intraregional trade incorporates a higher level of innovation and knowledge, and it can therefore be expected to have a stronger impact on the productive fabric. It is also a form of trade in which small and medium-sized enterprises participate more actively, and it therefore offers greater potential in terms of job creation and, hence, in terms of increased equity. This type of trade is also markedly procyclical, however, and a financial support strategy will therefore be required. This, in turn, means that regional financial institutions will have an important role to play as providers of liquidity to finance these efforts.