

## **Regional Summary: Latin America and Caribbean**

### **Overview**

Following several years of above average growth, GDP in Latin America and the Caribbean is expected to decelerate to 3.6 percent in 2012, from an estimated 4.2 percent in 2011, before picking up once again to 4.2 percent in 2013. Policy tightening, increased risk aversion, tighter external financing conditions are slowing domestic demand, while softer global growth (particularly weaker demand from high-income countries and China), is cutting into the region's exports.

Policy tightening and a weak external sector slowed GDP growth in Brazil, the region's largest economy, to a halt in the third quarter. Overall, GDP in Brazil is estimated to have grown 2.9 percent in 2011, down sharply from the 7.5 percent growth recorded in 2010. Growth is forecast to accelerate modestly to 3.4 percent in 2012. In Mexico, the region's second largest economy, growth is estimated to have slowed to 4 percent in 2011, from 5.5 percent in 2010, and is forecast to remain subdued in 2012, at 3.2 percent, in line with modest growth in the United States. More generally, industrial production in the region declined 2 percent and 1.8 percent in the second and the third quarter after a robust 9.2 percent expansion in the first quarter. Export growth decelerated to 1.4 percent in the third quarter, from 14 percent in the second quarter.

Weak tourism and remittances flows have dampened growth in Central America and the Caribbean. Incomes in many countries (notably Venezuela, Ecuador, Bolivia, and Argentina) have benefitted from high commodity prices, although future prospects would be vulnerable to the kinds of significant declines that might accompany a sharp weakening in global growth.

Despite the recent moderation in domestic demand, inflation remains elevated in several economies where output remains above potential. Marked currency depreciations have also started to fuel inflation due to higher import prices.

### **Risks and Vulnerabilities**

The region enters the current global downturn with relatively strong fundamentals. However, should conditions in Europe deteriorate sharply countries in the region could be adversely affected, potentially exposing vulnerabilities that have so far remained latent.

**Commodity prices.** More than other regions, Latin America and the Caribbean would be vulnerable to the kind of sharp decline in commodity prices that might accompany a major credit event in high-income Europe. A sharp deterioration in commodity prices would reduce incomes and fiscal space in commodity exporting countries and, at the same time, place their current account and external financing needs under stress. Countries heavily reliant on commodity exports would be hit hardest, while commodity importing countries would see modest gains.

**Trade.** The region is also exposed to a deterioration in the global climate through trade linkages. Although the high-spread Euro Area economies account for only a small share (4.2 percent) of regional exports, the larger Euro Area – which could become embroiled in a crisis if conditions worsen – accounts for 14.8 percent of total exports from the region (nearly 20 percent of total exports in Brazil and Chile, and almost 15 percent in Argentina and Peru).

**Finance.** In general, although foreign banks have large equity stakes in the banking sectors of several countries in the region, the sector is not dependent on foreign capital flows (most loans are funded by domestic deposits) and as a result should be robust to a deterioration of conditions in high-income countries. However, if parent banks were forced to liquidate their assets in Latin America, this could depress equity prices in the region. Foreign bank ownership in the Caribbean is also high and banks there could be vulnerable, especially given some banks' specialization in high-risk and relatively weakly regulated hedging and derivatives activities. Additionally, should global financial conditions deteriorate markedly, countries with relatively high external financing needs are more vulnerable to sudden reversal

in capital flows, a drying up in credit or substantially higher interest rates.

**Remittances.** Although expected to remain more stable relative to other flows, remittances could also suffer if macroeconomic conditions deteriorate further in Europe and the US –putting pressure on current account positions in countries that rely heavily on remittances (El Salvador, Jamaica, Honduras, Guyana, Nicaragua, Haiti, Guatemala).

### **Policy Recommendations**

Countries in the region should evaluate their vulnerabilities and prepare contingencies to deal with both the immediate and longer-term effects of an economic downturn.

Most countries in the region have less fiscal space available for counter-cyclical policies to cope with a sharp deterioration in global conditions as compared with 2008/09. In such an eventuality, where fiscal space exists, governments could use countercyclical policy to support growth, by increasing spending on social safety nets that would limit poverty impacts, and on infrastructure projects that would benefit growth. Countries with limited fiscal space could increase the effectiveness of countercyclical fiscal policy, improving the targeting of social safety nets and prioritizing infrastructure programs necessary for longer-term growth. In such a situation, monetary policy could also become more accommodative provided that inflation expectations remain anchored.

Financial oversight should continue to be improved, building on the progress made so far in many countries in the region. The countries could also benefit from further financial deepening, increased maturities of fixed-income debt, and increased local currency debt issuance.

Countries where credit has increased rapidly in recent years should engage in stress testing of their domestic banking sectors. A much weaker external environment could result in sharply lower domestic growth and falling asset prices that could result in a rapid increase in the number of non-performing loans and domestic banking stress.

Countries with large external financing needs should pre-finance these needs to avoid abrupt and sharp cuts in government and private sector spending.

With growth in high-income countries likely to remain subdued for an extended period, countries in the region may need to identify new drivers of growth and to address structural problems that negatively affect competitiveness.

**Latin America and the Caribbean forecast summary**

(annual percent change unless indicated otherwise)

	98-07 <sup>a</sup>	2008	2009	Est. 2010	Forecast 2011	2012	2013
GDP at market prices (2005 US\$) <sup>b</sup>	2.9	4.1	-2.0	6.0	4.2	3.6	4.2
Argentina	2.2	6.8	0.9	9.2	7.5	3.7	4.4
Belize	5.4	3.8	0.0	2.7	2.1	2.3	2.9
Bolivia	2.8	6.1	3.4	4.2	4.8	4.1	3.8
Brazil	2.8	5.2	-0.2	7.5	2.9	3.4	4.4
Chile	3.4	3.7	-1.7	5.2	6.2	4.1	4.4
Colombia	3.1	3.5	1.5	4.3	5.6	4.4	4.2
Costa Rica	4.7	2.6	-1.5	4.2	3.8	3.5	4.5
Dominica	1.6	7.8	-0.7	0.3	0.9	1.6	2.2
Dominican Republic	4.9	5.3	3.5	7.8	4.9	4.4	4.5
Ecuador	3.1	7.2	0.4	3.6	6.1	3.3	3.4
El Salvador	2.5	1.3	-3.1	1.4	1.5	2.0	3.1
Guatemala	3.4	3.3	0.5	2.6	2.8	3.1	3.5
Guyana	0.6	2.0	3.3	4.4	4.6	5.1	5.6
Honduras	4.0	4.0	-1.9	2.6	3.4	3.3	4.0
Haiti	0.6	0.8	2.9	-5.1	6.7	8.0	8.3
Jamaica	1.6	1.7	-2.5	-1.0	1.3	1.8	2.2
Mexico	2.8	1.5	-6.1	5.5	4.0	3.2	3.7
Nicaragua	3.5	2.8	-1.5	4.5	4.1	3.3	4.0
Panama	4.8	10.1	3.2	7.5	8.1	6.1	6.3
Peru	4.1	9.8	0.9	8.8	6.3	5.1	5.6
Paraguay	1.9	5.8	-3.8	15.3	4.8	3.9	4.5
St. Lucia	2.0	5.8	-1.3	4.4	2.7	2.7	3.5
St. Vincent and the Grenadines	4.2	-0.6	-2.3	-1.8	-0.2	1.9	3.3
Uruguay	0.8	7.2	2.9	8.5	5.5	4.0	5.1
Venezuela, RB	2.8	4.8	-3.3	-1.9	3.8	3.1	3.4

Source: World Bank.

World Bank forecasts are frequently updated based on new information.

Barbados, Cuba, Grenada, and Suriname are not forecast owing to data limitations.

a. Growth rates over intervals are compound average; growth contributions, ratios and the GDP deflator are averages.