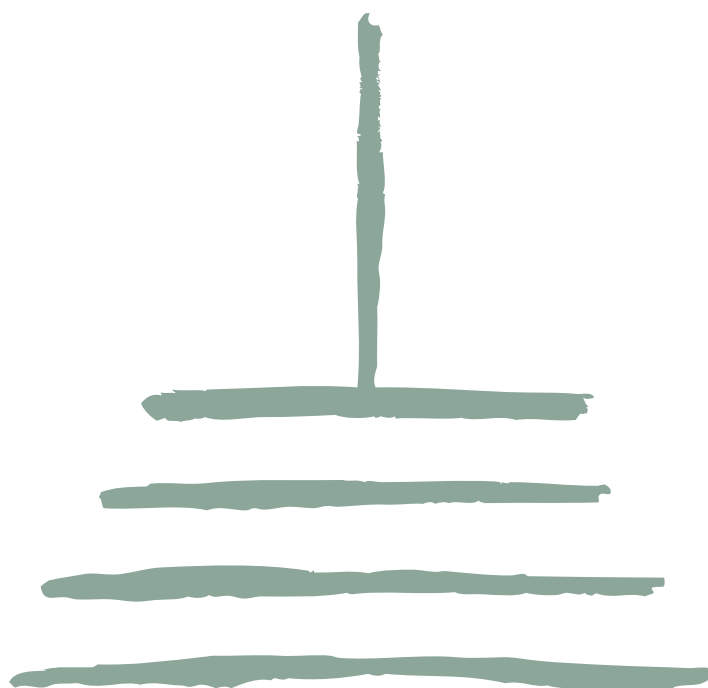


2010-2011

Briefing paper



Economic Survey
of Latin America and the Caribbean



UNITED NATIONS

ECLAC

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Notes

The following symbols have been used in the tables shown in the Survey:
Three dots (...) indicate that data are not available or are not separately reported.
A dash (-) indicates that the amount is nil or negligible.
A full stop (.) is used to indicate decimals.
The word “dollars” refers to United States dollars unless otherwise specified.

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FOREWORD

The sixty-third edition of the *Economic Survey of Latin America and the Caribbean* covers 2010 and the first half of 2011. During this period the economies of Latin America and the Caribbean continued to recover from the global financial and economic crisis whose fallout spread across the region in the second half of 2008 and in 2009. The upturn that began late in 2009 and gained unexpected momentum in 2010 was sustained by a recovery whose characteristics were without precedent in the world economy and by the macroeconomic policies implemented by the countries themselves. The recovery carried over into 2011, albeit with economic growth easing back in response to both external and domestic factors.

The first part of this edition of the *Economic Survey* looks at the nature of the recovery and the factors underlying its initial momentum and later slackening. The differences between countries and subregions are examined along with the challenges now being faced in a setting defined by a highly liquid international economy and surging commodity prices. The outcome of the recovery is analysed in terms of economic activity, labour markets and the external sector, taking account of how macroeconomic policies have been adapted to the challenges arising in the post-crisis world. Detailed consideration is afforded to the uncertainty currently prevailing in the global economy, the resulting risks for growth and the internal factors pointing to a further, albeit gentle, slowdown in growth in 2012. This part of the *Economic Survey* is complemented by an extensive statistical annex.

The second part of this *Economic Survey* delves into the challenges posed by highly liquid conditions in international financial markets combined with high prices for the region's key commodities. The contrasting situations these external conditions represent for the countries of the region are reviewed in detail, taking account of the very different patterns of trade and engagement with international financial markets and the varying depth of domestic financial systems. Consideration is given, as well, to the macroeconomic tools available to policymakers in the current circumstances and the advantages and drawbacks of each, both for rising to short-term challenges and in the interests of longer-term, sustained development.

The *Economic Survey* closes with an analysis of the situation in the countries of Latin America and the Caribbean during 2010 and the first half of 2011. The individual country notes are accompanied by tables showing the evolution of the main economic indicators. These notes, like the specific statistical annexes for each country, are published on the CD-ROM included with the print version and on the ECLAC website (www.eclac.org). The tables in the statistical annex can be used to obtain a rapid overview of the information for the last few years and to create spreadsheets. The disk also contains the first and second parts in electronic format. The cut-off date for the statistical information in this publication was 30 June 2011.

EXECUTIVE SUMMARY

After contracting in 2009, GDP expanded by 5.9% in Latin America and the Caribbean in 2010, albeit with the region's hallmark differences in performance from one country to another. The expansion in output was driven by strong domestic demand in the forms of both consumption and investment, and by buoyant external demand. On the domestic demand side, private consumption (up 5.9%) was sustained by an upturn in employment and wages, brightening economic expectations, an expansion in lending to the private sector and, in some countries, an upswing in remittances from emigrant workers. Public consumption rose at a more modest rate of 3.9% and investment jumped by 14.5%, with strong growth in the machinery and equipment segments in particular. On the external demand side, exports of goods and services were especially buoyant—rising by over 10%—in the Southern Common Market (MERCOSUR) countries, the Dominican Republic, El Salvador, Mexico and Nicaragua. Meanwhile, imports of goods and services increased by more than 10% at constant prices on the back of robust domestic demand within the region, which rose 7.5%.

For 2011, the Economic Commission for Latin America and the Caribbean (ECLAC) projects regional GDP growth of 4.7%, or 3.6% in per capita GDP, as the recovery that began in the Latin American and Caribbean economies in the second half of 2009 firms up. The slippage in this rate compared with 2010 may be attributed to loss of momentum in the international economy and, in some cases, the gradual withdrawal of public policy stimulus implemented to deal with the fallout from the crisis. For 2012, regional growth is projected at 4.1%, equivalent to a rise of 3.0% in per capita GDP, notwithstanding the downturn in external conditions and, on the domestic front, complex policy challenges arising from dilemmas over the direction of certain macroeconomic variables.

In the near term, activity levels in the economies of Latin America and the Caribbean are being sustained largely by private consumption, thanks to an improvement in labour indicators and an expansion in lending. At the same time, expectations of buoyant domestic demand and the depletion of idle production capacity, combined with more readily available credit, are fuelling investment.

The unemployment rate is projected to fall again in 2011, to between 6.7% and 7.0%—below pre-crisis levels—as continued growth boosts the employment generation capacity of the region's economies. Indicators show formal wage employment rising as a proportion of total employment in several countries, suggesting that the new jobs being created are of better quality. This setting of economic growth and jobs rising in both numbers and quality could herald fresh gains in poverty reduction.

Amid burgeoning domestic demand, rising prices for commodities, especially food and fuels, are exerting upward pressure on the inflation rate. The region's central banks are once again facing a dilemma in this respect. On the one hand, they need to maintain price stability. On the other, they must try to keep their export sectors (or those producing import-substitution goods) competitive amid heavy upward pressure on the region's exchange rates. Currency appreciation is being driven by a combination of highly liquid external conditions, the solidity of some Latin American economies and, in several cases, massive inflows of foreign exchange resulting from high export commodity prices and foreign investors' renewed appetite for emerging country assets.

These circumstances present a number of risks and difficulties, both in the short term and in the medium and longer terms. First, the increase in financial inflows makes the region more vulnerable to speculative capital movements, a further risk being that the sheer magnitude of the resources involved

could exceed the capacity of the financial systems to manage them and lead to financial asset or real-estate bubbles. Over a longer period, real exchange-rate appreciation could erode the external component of demand for goods, especially if world trade loses momentum, as it may if growth in the developed countries slackens as mid-2011 projections suggest it will. The combination of real exchange-rate appreciation and rising commodity prices could push the region further towards intensive specialization in the production and export of primary goods, thus leaving its economies more open to external shocks and possibly fuelling macroeconomic volatility. This would certainly hurt the economies' capacity to grow, generate productive employment and reduce inequality.

These risks may not be imminent, yet there are grounds for caution. Advantage should be taken of the current favourable conditions to strengthen the region's external position and generate public sector savings in order to recover the policy space used up during the crisis. Measures such as short-term capital controls could also help to limit vulnerability. These recommendations are, moreover, compatible with efforts to contain currency appreciation. Recouping fiscal space is therefore vital for the countries of the region. It would help them to face not only the classic public policy challenges (the need for greater investment in physical and social capital) but also those arising from developments on the international front. More substantial public sector savings would allow governments to steer clearer of contractionary monetary policy and would help to reduce the tension between strategies to counter inflation and those to contain currency appreciation.

The second part of this report looks at the challenges thrown up in the context of high commodity prices and abundant liquidity flowing towards Latin American assets. The Latin American and Caribbean countries in this situation have the opportunity to use these resources to foster long-term growth, but must at the same time deal with greater inflationary pressures, loss of competitiveness through currency appreciation and the threat of "reprimarization" —a shift back towards primary production— of their productive apparatus.

Although the governments of the region may draw upon a range of tools to contain the negative implications of this international setting, these all have a cost, are not guaranteed to work and may cause unwanted side effects. The challenge for policymakers, then, is to craft the right mix of tools for each country's specific pattern of trade and financial engagement and to create an enabling environment for investment, employment and the greater well-being of the population at large.

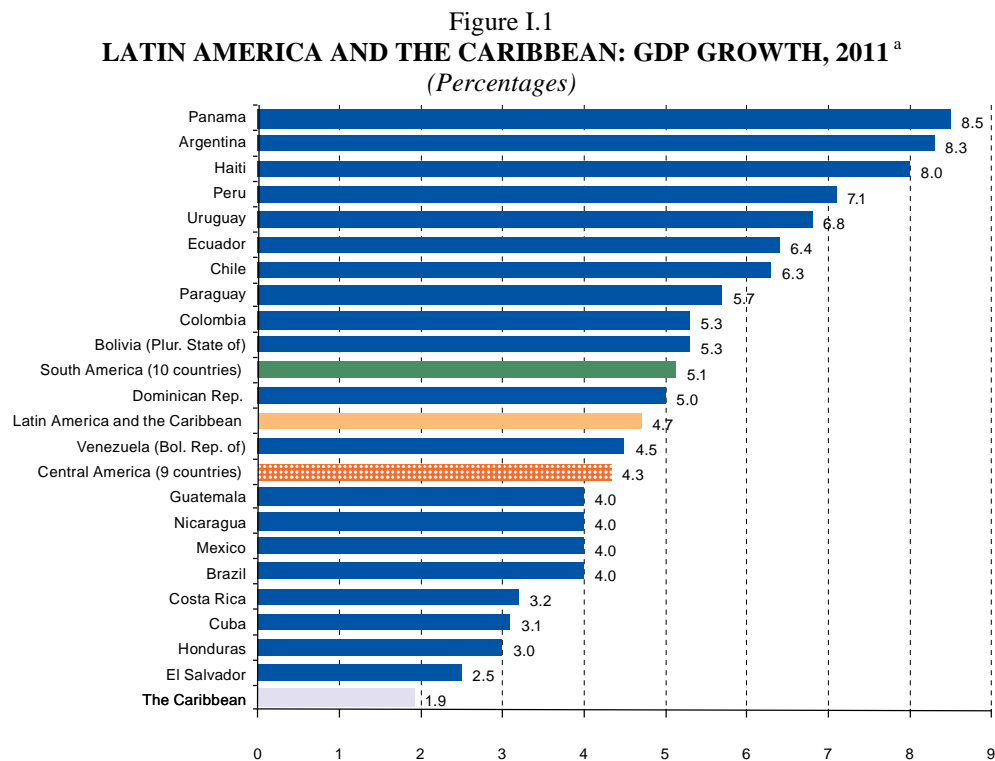
Chapter I

REGIONAL OVERVIEW

A. INTRODUCTION

ECLAC projects growth of 4.7% for the region in 2011, which represents a rise of 3.6% in per capita GDP. Growth will be driven by the ongoing recovery that began in the economies late in 2009, although slackening in the global economy, coupled with the gradual withdrawal of the crisis-response policies implemented by the region's governments, are acting as a drag on the rate. As will be explored below, economic expansion should continue in the region, even with global conditions turning less favourable and the performance of certain macroeconomic variables raising complex policy dilemmas for economic authorities in the region. As a result, regional growth is expected to ease back to around 4.1%, equivalent to a rise of 3% in per capita output, in 2012.

Figure I.1 shows that, consistently with the pattern of the last few years, the highest rates of growth have been in South America, whose combined estimated growth rate for 2011 is 5.1%. Central America as a whole, driven in particular by sustained growth of the Panamanian economy, is expected to register growth of 4.3% and the Caribbean economies, 1.9%.



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

^a Preliminary data.

The growth of the region's economies in 2011 is being sustained to a large extent by private consumption, thanks to improving labour indicators and an expansion in credit. Meanwhile, as idle production capacity has been depleted by sustained domestic demand fuelled by looser credit conditions, investment is on the rise and is regaining pre-crisis levels.

Sustained economic growth is also enhancing the economies' employment-generating capacities and the unemployment rate is expected to come down again in 2011, to between 6.7% and 7% —below pre-crisis levels. What is more, indicators for the first part of 2011 show formal wage employment rising as a proportion of total employment in several countries, suggesting that the new jobs being created are of better quality. Continued economic growth and jobs rising in both numbers and quality should usher in fresh gains in poverty reduction.

Amid burgeoning domestic demand, rising prices for commodities, especially food and fuels, are exerting upward pressure on the inflation rate. Accordingly, several of the region's countries have tightened their monetary policy stances, which is broadening spreads between domestic and international interest rates and this, amid highly liquid external conditions, is pushing up exchange rates in the region. Although the countries are continuing to accumulate international reserves, they are doing so not so much through the current account (which is in fact running a widening deficit in most of the countries) but increasingly through the financial account, particularly by way of relatively short-term operations.

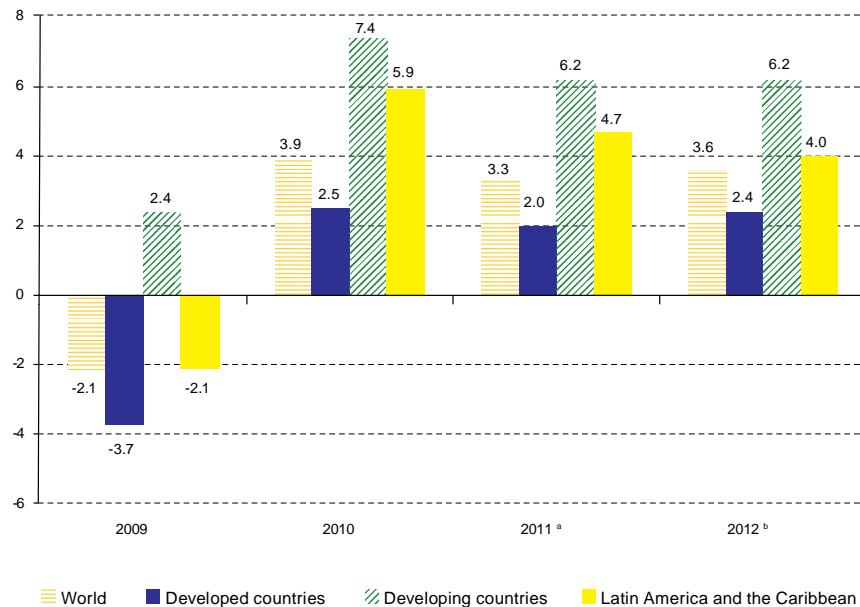
These developments are all extremely important for short-term macroeconomic policy management, resource allocation and strategic decisions on production specialization. The analytical chapters of this issue of *Economic Survey* look at macroeconomic policy and, in particular, its implications for the exchange rate in view of the very different ways in which the countries of the region participate in the global economy. The rest of this chapter is structured as follows. Section B looks at the current conditions in the international economy. Section C examines the behaviour of the main domestic and external macroeconomic aggregates; and section D discusses macroeconomic policies and the policy challenges facing the region and considers the outlook for economic growth.

B. THE INTERNATIONAL ECONOMY

Estimates for global economic activity have been revised downwards following slower-than-expected recovery in global output from the impact of the global financial crisis: the current projections for 2011 and 2012 are 3.3% and 3.6%, respectively (see figure I.2).¹ Sluggish growth in the world economy and particularly in the developed countries is undoubtedly a function of continuing difficulties in those countries' financial markets associated, among other factors, with household deleveraging, weaknesses in real estate markets and the sovereign debt problems of some European countries. At the same time, mounting concern over the sustainability of public debt in those economies is also lending an increasingly austere slant to their public finances, which represents a further drag on growth prospects.

¹ See United Nations, *World Economic Situation and Prospects. Monthly Briefing*, No. 32, New York, Department of Economic and Social Affairs (DESA), June 2011.

Figure I.2
WORLD ECONOMIC GROWTH, 2009-2012
 (Percentages)



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

^a Preliminary data.

^b Projections.

The developed economies are projected to yield a combined growth rate of 2% for 2011, perhaps rising to 2.4% in 2012. For the reasons noted earlier, economic recovery is likely to be fragile in the United States, with growth projected at 2.6% in 2011 (2.8% in 2012). Japan's economy, reeling from the combined effects of the earthquake, tsunami and problems associated with nuclear power generation, will recover very slowly, by an estimated 0.7% in 2011 (2.8% in 2012). In Europe, the outlook is very mixed. Although overall the European region is projected to return to economic growth of 1.85% in 2011 and 1.9% in 2012, Germany and the Nordic countries are expected to expand at above-average rates, while the countries grappling with the worst sovereign debt and fiscal problems will continue to register low growth or remain in recession.

Developing economies will lead global growth, with a rate of 6.2% projected in both 2011 and 2012. Within this context of across-the-board growth rates above the global average, the strongest performers will be China (9.1% in 2011 and 8.9% in 2012) and India (8.1% in 2011 and 8.2% in 2012).

1. International financial conditions and their impact on economies in the region

The problems of a set of countries (Greece, Ireland, Italy, Portugal and Spain) grew steadily worse throughout 2010. These countries' economies have been characterized by structural fiscal deficits and very low levels of private savings, translating into steadily rising public debt and a sustained current account deficit.² This combination led to a series of critical episodes in Greece, Iceland and Ireland,

² The worst case was Greece, which is facing high levels of public debt, a structural fiscal deficit of 12.5% of GDP and an external deficit of almost 14% of GDP. For measures of the structural fiscal and current account position of these countries, see International Monetary Fund (IMF), World Economic Outlook Database, April 2010.

whose bailouts required the creation of a special institution —the European Financial Stability Fund (EFSF)— and involved the International Monetary Fund (IMF), the European Central Bank (ECB) and the governments of countries on a sounder financial footing. Other, smaller countries in the euro area (those sometimes referred to as the peripheral countries) and European countries outside the euro area were also caught up in the turmoil.

Meanwhile, in the United States monetary measures were taken to allow an ordered winding down of low-quality credit exposure and, in general, heal the financial system after the recession that followed the financial crisis. As a result, some signs of an economic upturn began to emerge in the United States in 2010. The slow pace of the recovery persuaded the Federal Reserve to keep the monetary policy rate at historically low levels, however. Japan, whose economy has been at a standstill for a number of years, continued in 2010 to direct monetary policy towards promoting economic recovery, with very low rates of interest.

In contrast with this picture, the emerging economies recovered quickly from the crisis, many of them keeping public debt low and their financial system solvent as they did so (see table I.1). As a result, they have gained a stronger position relative to the developed economies, as is apparent from the region's sovereign risk ratings, which are lower than those of some developed economies previously considered more solid.

Table I.1
**LATIN AMERICA: RISK PREMIUMS ON FIVE-YEAR CREDIT
 DEFAULT SWAP CONTRACTS, 2007-2011^a**
(Basis points)

	Argentina	Brazil	Chile	Colombia	Mexico	Panama	Peru	Venezuela (Bolivarian Republic of)
First semester 2007	208.1	81.0	15.0	94.9	37.6	72.7	78.3	190.1
Second semester 2007	429.3	100.2	24.1	133.1	58.9	112.0	109.2	410.6
First semester 2008	574.6	130.0	60.3	170.7	106.4	154.6	128.9	576.7
Second semester 2008	2 454.1	231.0	146.2	247.5	215.7	245.1	231.4	1 575.9
First semester 2009	3 001.1	285.4	188.8	329.1	320.8	331.8	307.1	1 956.1
Second semester 2009	1 230.2	131.2	76.0	160.1	158.2	151.8	138.0	1 149.3
2010								
January	1 027.4	144.0	76.7	168.2	150.3	155.6	145.4	1 020.1
February	1 150.6	130.2	74.2	157.0	126.8	141.9	131.6	1 026.9
March	902.8	130.5	82.9	150.1	116.2	126.6	127.8	927.9
April	850.4	123.7	84.2	146.2	115.1	115.6	121.5	899.7
May	1 212.3	135.8	103.4	163.4	133.6	129.4	135.2	1 431.0
June	986.9	139.9	104.5	152.2	137.5	135.0	136.5	1 367.6
July	793.6	116.9	77.9	123.8	116.9	108.5	109.3	1 040.3
August	945.7	131.5	77.9	137.8	143.8	114.1	116.3	1 267.8
September	750.5	115.9	73.9	117.8	122.0	112.2	120.5	1 133.0
October	625.1	99.8	67.9	100.3	105.8	94.1	107.3	1 073.5
November	735.0	123.4	93.6	125.7	125.8	115.6	131.8	1 268.8
December	601.9	111.3	84.4	112.7	113.6	98.7	113.0	1 015.9
2011								
January	625.0	118.9	82.2	120.0	122.0	107.2	112.7	1 045.1
February	658.0	118.0	78.4	119.9	114.5	104.2	113.3	1 122.3
March	591.8	111.2	61.3	108.5	105.4	90.8	137.8	1 015.3
April	586.8	105.4	59.4	100.2	98.5	84.2	154.5	1 023.1
May	602.8	104.1	67.9	100.5	102.9	84.3	132.9	1 110.4

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

^a Data for 2011 refer to first five months only.

As a result of all these factors, global liquidity has expanded sharply and the main reserve currencies, especially the dollar, have lost value.³ As a corollary, financial flows into the region, including foreign direct investment, have surged and, in some cases, local currencies have appreciated in both nominal and real terms.

This was not the only external shock to affect the region, however. Rapid growth in emerging economies has created vigorous demand for commodities, pushing up prices of metals, hydrocarbons and foods, and these price rises have been exacerbated by the value slippage of the main reserve currencies. The currencies of net commodity exporters have thus been pushed towards appreciation, which has worsened inflationary pressure in these countries.

This complex external scenario has carried over into 2011 and shows some signs of becoming worse. In the United States, the priority continues to be to foster the recovery of output and employment levels, which are also viewed as necessary conditions for restoring the financial system to health. With inflationary expectations low, the Federal Reserve has indicated that monetary stimulus will not be withdrawn in the immediate term—at least up to mid-2012.⁴ The fiscal authorities are engaged in lengthy negotiations over the reduction of the deficit, but sharp adjustments such as those made in Europe are not anticipated. The highly liquid global conditions originating in the United States may therefore be expected to persist in the second half of 2011. In Europe, and in the euro area in particular, the focus of macroeconomic policy thus far has been very different. Unlike the situation in the United States, the monetary effects of measures implemented in response to the crisis have been largely sterilized. In addition, ECB began raising interest rates in April 2011 as inflationary expectations mounted. Projections show inflation running at around 3%, above the ECB yearly target of 2%, so the Bank is unlikely to change its policy stance in the short term.

Fiscal policy in the euro area has focused on restoring solvency as a basic condition for economic recovery, even if these budget adjustments have a short-term recessionary impact. Growing doubts over debt sustainability in some countries prompted drastic spending cuts on the basis that, in the medium term, confidence in public sector stability and solvency would stimulate investment and employment. The debt sustainability issues of the worst compromised countries have yet to be resolved, however.

In particular, Greece has again become a source of uncertainty, on the expectation that the measures taken to meet the fiscal targets agreed upon with IMF, ECB and EFSF will fail to reduce the country's deficit as much as it had been hoped and this has jeopardized the disbursement of the next tranche of funding. According to both the Government of Greece and experts on international finance, Greece's debt must be restructured (that is, its present value reduced), in order to ease the burden of debt servicing, increase the probability of payment and avoid the vicious cycle of near-term recessionary fiscal contraction, which would worsen the domestic deficit. The difficulties such a proposal implies for the assets of ECB (one of the bailout creditors), as well as fears of contagion spreading to other over-indebted countries have delayed the implementation of a solution of this sort.

For the time being, although the monetary policy put in place by the ECB could strengthen the euro, the lack of a resolution for Europe's sovereign debt problems is casting a heavy pall of uncertainty

³ Authorities in the euro area have afforded greater priority to improving the liquidity position of bank assets than to stimulating demand and have sterilized the monetary impacts of their interventions. As a result, the euro has not been so weak as the dollar.

⁴ The need to maintain monetary stimulus until the economy shows more solid signs of recovery was set forth starkly by Paul Krugman in his article "Inflation and economic Hooliganism", *New York Times*, 11 May 2011.

over the future of the euro area and this will continue to drive flows of financial resources towards other, safer and more profitable areas of the world financial market. The downgrading of some of these countries' sovereign debt in the second quarter of 2011 may add to the flight of financial resources from Europe.

In the case of Japan, sovereign debt quality has suffered as a result of the impacts of natural disasters on economic activity and public spending. Nonetheless, as the authorities maintain their objective of avoiding currency appreciation and stimulating recovery, monetary policy will continue to be directed towards expanding liquidity.

The overall picture at the global level is therefore one of strongly contrasting macroeconomic policies adopted in key financial and economic centres. Financial flows may therefore be expected to continue flowing into emerging countries, bringing about pressures towards real currency appreciation, high commodity prices and mounting inflation. Uncertainties abound, however, in particular with respect to the sustainability of public debt in some highly indebted European countries and the point at which economic recovery in the United States will achieve sufficient momentum to prompt a monetary policy shift.

Box I.1

POTENTIAL IMPACT OF THE 2011 JAPANESE EARTHQUAKE AND TSUNAMI ON LATIN AMERICA AND THE CARIBBEAN

Like previous natural disasters, the earthquake and tsunami that struck Japan on 11 March 2011 will have deep, long-lasting repercussions on the local economy but a much shorter-lived impact on the global economy. Even so, although the areas hit by the catastrophe account for less than 4% of Japan's economic activity, the destruction of part of the country's electricity-generating capacity has had a ripple effect across the entire national economy.

Following the Kobe earthquake of 1995, Japan demonstrated its capacity for rapid economic recovery. Although productivity levels plummeted in the short term, the reconstruction effort brought about a speedy recovery and it was not long before devastated infrastructure and housing had been rebuilt. However, the 2011 earthquake was much more severe than the 1995 one; so, although economic activity is expected to pick up again after a period of contraction, the destruction caused by the tsunami and the damage to the country's nuclear power plants threaten to stall further recovery and could have a broader impact on production. In fact, the impaired power-generating capacity—not only at plants directly affected but also at others shut down as a preventive measure given the risk of aftershocks—has taken a toll on the rest of the country's industry, in particular the automotive, vehicle parts, electronics and semiconductor sectors. In many instances the supply of raw materials has been temporarily cut off, affecting production both in Japan and in other countries that are part of the global production chains in which Japan is a key link. According to projections, output could contract by between 1% and 3% before returning to slightly positive levels in 2012. Global economic growth in 2011 is thus expected to slip by half a percentage point.

As was the case following previous external crises, the impact will make itself felt in Latin America and the Caribbean through trade and financial channels.

In the near term, the interruption of normal transport and distribution operations and the contraction of domestic economic activity in Japan will very likely lead to a drop in imports. However, as the reconstruction effort gets under way in the medium term, imports of raw materials and fuel should rise again. In 2008 and 2009, only 3.6% and 3.8% of total exports from Latin America and the Caribbean went to Japan. Inasmuch as exports to Japan from Chile, Peru and the Plurinational State of Bolivia exceed the regional average, the buoyant global demand for those exports—minerals and hydrocarbons—means that they can be diverted to other markets in order to offset the decline in demand from Japan. In absolute terms, Brazil and Chile are the region's main exporters to Japan, followed by Peru, Mexico and Argentina. In the services sector, the region exports very little to Japan, and Japanese tourism accounts for a very small share of the tourism service exports of Caribbean countries.

Japan accounted for 3% of total foreign direct investment in the region in 2010, and has recently been taking on greater significance in Brazil (5% of the total) and, in previous years, in Chile and Peru.^a That investment has historically

targeted mining resources in Brazil, Chile and Peru and, more recently, financial services in Brazil. The earthquake in Japan is not expected to trigger any radical changes in the long-term direction of this category of investment.

Box I.1 (concluded)

As for the earthquake's impact on portfolio investment and other financial flows into the region, analysts think existing trends may intensify because of uncertainty about the future of the public debt of Japan and the United States. Investors are expected to demand higher returns (implicit interest rates) on financial investments, which would bump up the cost of financing for the region.

Japan's public debt has been following a steady upward path driven by persistent deficits and weak or zero economic growth, which has meant only marginal increases in tax revenue. Gross public debt is approaching 225% of GDP, although discounting debt held by government agencies brings that level down to 100% of GDP, comparable with other developed countries. In contrast with other countries, however, most of Japan's public debt is in the hands of its own residents. Even so, signs are that there will be further deterioration in the short term as the projected drop in activity will yield even less tax revenue and public spending will be stepped up to fund reconstruction. In the medium to long term, the country's ageing population will make for a heavier burden in pensions and health spending. All these factors have prompted credit-rating agencies to downgrade the quality of Japan's sovereign debt.

Japan is —after China— the main holder of United States debt. As it was initially thought that private creditors would sell off some of those debt holdings to finance reconstruction and cover insurance payouts by insurance companies holding those bonds, the weeks following the earthquake saw an appreciation of the yen that was halted only after intervention by the central banks of the Group of Seven. As it happens, the insurance companies appear to have sufficient current revenue from premiums to cover earthquake-related payouts, thus allaying initial fears of a mass rush to liquidate financial assets. In the medium term, the ageing of Japan's population points to a trend towards dissaving and a subsequent reduction in demand for financial assets, including United States treasury bonds, thus pushing up the financial cost of debt at the global level. Ultimately, the outcome will hinge on a series of factors relating to global public finances, which will continue to suffer in the short and medium terms, especially in developed countries, as a result of the measures adopted to weather the recent global financial crisis.

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

^a See ECLAC, *Foreign Direct Investment in Latin America and the Caribbean, 2010*, Santiago, Chile, 2011.

C. RECENT MAJOR DEVELOPMENTS IN THE LATIN AMERICAN AND CARIBBEAN ECONOMIES

1. Macroeconomic aggregates

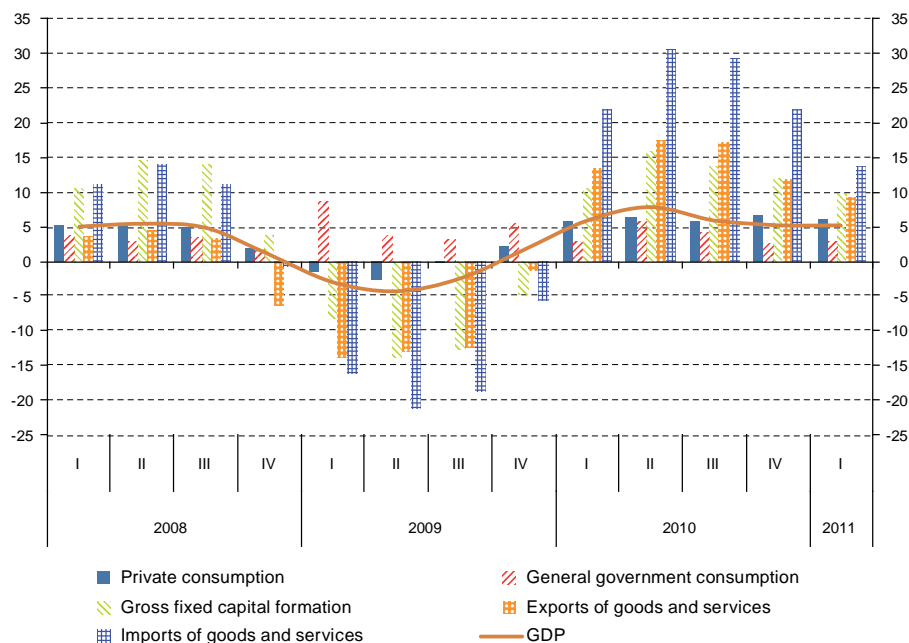
The region's GDP expanded by 5.9% on average in 2010, although the performance was very uneven from one country to another. The countries posting the highest growth rates were the members of MERCOSUR —Argentina (9.2%), Brazil (7.5%), Paraguay (15.0%) and Uruguay (8.5%)— and Panama (7.5%), the Dominican Republic (7.8%) and Peru (8.8%). By contrast, output contracted in the Bolivarian Republic of Venezuela and Haiti, by 1.4% and 5.1%, respectively. In the latter case, the downturn was attributable to the earthquake of January 2010, which struck a severe blow to economic activity. The GDP contraction in the Bolivarian Republic of Venezuela reflected a slump in domestic demand as a result of declining government revenues from oil exports and drought-induced electric power rationing in the first semester.

South America registered growth of 6.4% and Central America,⁵ 4%. The Caribbean countries together expanded by 0.4%. The three economies that account for roughly 70% of this subregion's GDP—Jamaica, Barbados and Trinidad and Tobago—experienced a contraction in output (-1.3%), stagnation (0.3%) and lacklustre growth (1%), respectively.

GDP growth was driven by strong domestic demand in the form of both consumption and investment and by buoyant external demand. On the domestic demand side, private consumption growth (up 6.0%) was due to an upturn in employment and wages, brightening economic expectations, an expansion in lending to the private sector and, in some countries, an upswing in remittances from emigrant workers. Public consumption rose at a more modest rate of 3.9%. Investment jumped by 14.3%, with strong growth in the machinery and equipment segment in particular. Gross fixed capital formation rose from 20.3% in 2009 to 21.4% in 2010, though this falls short of the 22.1% posted in 2008.

Exports of goods and services yielded high growth rates—over 10%—in the member countries of MERCOSUR, the Dominican Republic, El Salvador, Mexico and Nicaragua. Meanwhile, imports of goods and services increased by more than 10% at constant prices on the back of robust domestic demand within the region (7.5%), with capital goods and consumer durables, especially automobiles, standing out in particular. (See figures I.3 and I.4.)

Figure I.3
LATIN AMERICA: YEAR-ON-YEAR QUARTERLY VARIATION IN COMPONENTS OF SPENDING, 2008-2011^a
(Percentages and constant dollars at 2005 prices)



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

^a Figures for 2011 refer to first quarter only.

⁵ Calculation includes Costa Rica, Cuba, the Dominican Republic, El Salvador, Guatemala, Haiti, Honduras, Nicaragua and Panama.

Figure I.4
LATIN AMERICA: YEARLY VARIATION IN GROSS FIXED CAPITAL FORMATION, 2004-2010
(Constant dollars at 2005 prices)



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

By sector of economic activity, commerce, financial and business services and the transport and communications sector expanded across the board. The performance of the goods-producing sectors, however, including mining, manufacturing and agriculture, varied across the region. The agricultural sector enjoyed strong expansion in the MERCOSUR countries, thanks to good harvests as weather conditions returned to normal. Mining output rose in Brazil and Colombia (in both cases owing to increased petroleum production) and in the Plurinational State of Bolivia (with higher natural gas production). Manufacturing activity expanded at above-average rates in Argentina, Brazil, Colombia, Mexico and Peru.

Disposable gross national income in the region was up by 7.6%, reflecting an average gain in terms of trade⁶ and an upturn in inflows of emigrant remittances.

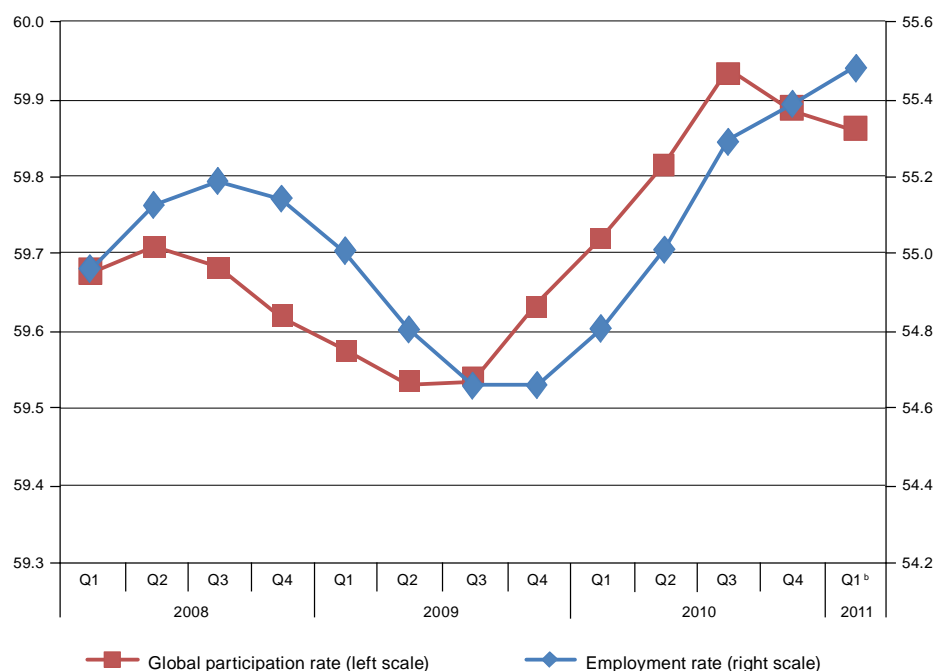
Investment, measured in current dollars as a percentage of GDP, rose from 19.8% in 2009 to 21.6% in 2010. Notwithstanding the expansion in private consumption, national saving was also up in GDP terms (from 19.5% in 2009 to 20.5% in 2010), and external saving climbed to 1.2% of GDP. Data available for the first half of 2011 indicate that economic growth has held steady, with first-quarter growth rates in several countries similar to those recorded throughout 2010. ECLAC projects the regional GDP growth rate at 4.7% for the year overall.

⁶ The terms-of-trade gain was around 3.4% of GDP on average in 2010. Exporters of oil, minerals and metals gained the most, while practically all the Central American countries (Costa Rica, Dominican Republic, El Salvador, Honduras and Panama) suffered terms-of-trade losses.

2. Wages and the labour market

The economic upswing in 2010 helped to nudge the employment rate up to a new high of 54.9%, a rise of 0.6 percentage points.⁷ As figure I.5 shows, the employment rate began to recover strongly in the first quarter of 2010, although this was not the case in all the countries. In 18 countries with comparable data, only 8 showed a rise in employment: Argentina, Brazil, Colombia, Dominican Republic, Nicaragua, Peru, Plurinational State of Bolivia and Uruguay.

Figure I.5
LATIN AMERICA (9 COUNTRIES): GLOBAL PARTICIPATION RATE AND EMPLOYMENT RATE, FIRST QUARTER OF 2008 TO FIRST QUARTER OF 2011^a
(Four-quarter moving average, in percentages)



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

^a The data for each quarter represent the average value for the rolling year (four quarters) ending that quarter.

^b Data for 2011 are preliminary.

The participation rate also changed in 2010, with a rise of 0.3 percentage points. Given that the labour supply behaves procyclically in many countries, this may be interpreted as indicating that the economic upturn improved people's perceptions of their employment options. As figure I.5 shows, the uptrend in the participation rate became apparent in the fourth quarter of 2009 and continued until the

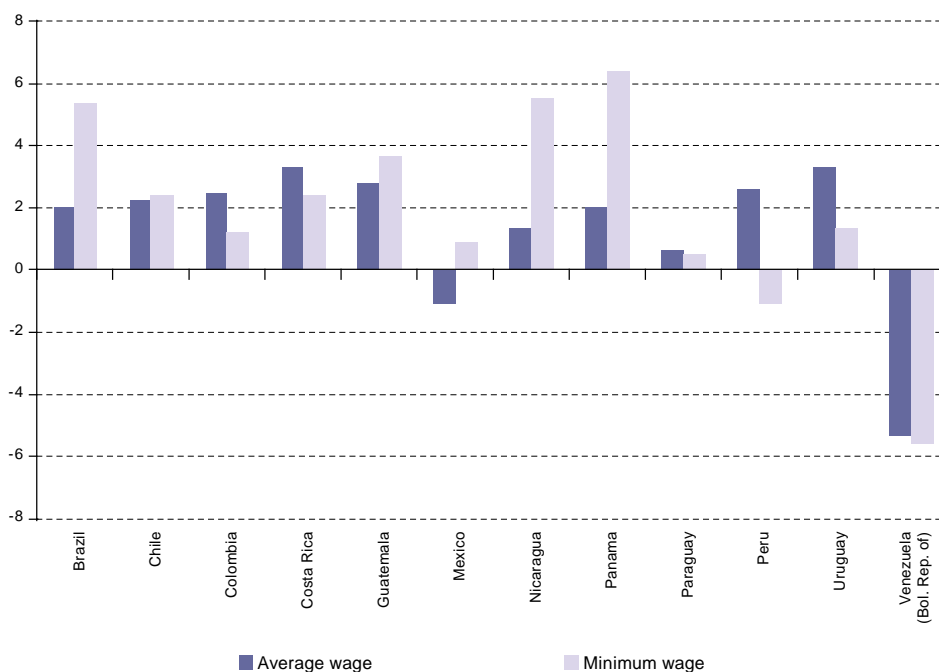
⁷ Unlike the series published previously, this regional rate is calculated using nationwide employment data wherever available.

fourth quarter of 2010, before falling back slightly early in 2011, which could reflect a labour supply contraction among young people.⁸

In 2010, the faster rate of labour supply growth lessened the impact of higher employment levels on the urban unemployment rate, which nevertheless eased back from 8.1% to 7.3% and thus returned to the level of 2008, which had been a 20-year low. In absolute terms, the number of employed in the region's urban areas rose by 6.4 million in 2010, while the urban unemployed decreased by 1 million to stand at 17.1 million. The stronger labour demand reflected in the higher employment rate also helped to lower underemployment rates.

With the economic upturn in 2010, real wages continued to rise, albeit at lower rates than in 2009, given the uptick in inflation (see figure I.6).⁹ Taking the number of employed to have risen by 2.8% and average real labour income by an estimated 2.6% (weighted average), the wage mass increased by around 5.5%¹⁰ and this has acted as a strong driver of domestic demand.

Figure I.6
**LATIN AMERICA (SELECTED COUNTRIES): VARIATION IN REAL AVERAGE WAGE
 AND REAL MINIMUM WAGE IN THE FORMAL SECTOR, 2009-2010**
(Percentages)



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

⁸ In 2010, youth labour force participation fell more or rose less than that of more mature adults in several countries (including Argentina, the Bolivarian Republic of Venezuela, Brazil and Colombia). This may be attributable to a long-term trend whereby young people are spending longer in the education system.

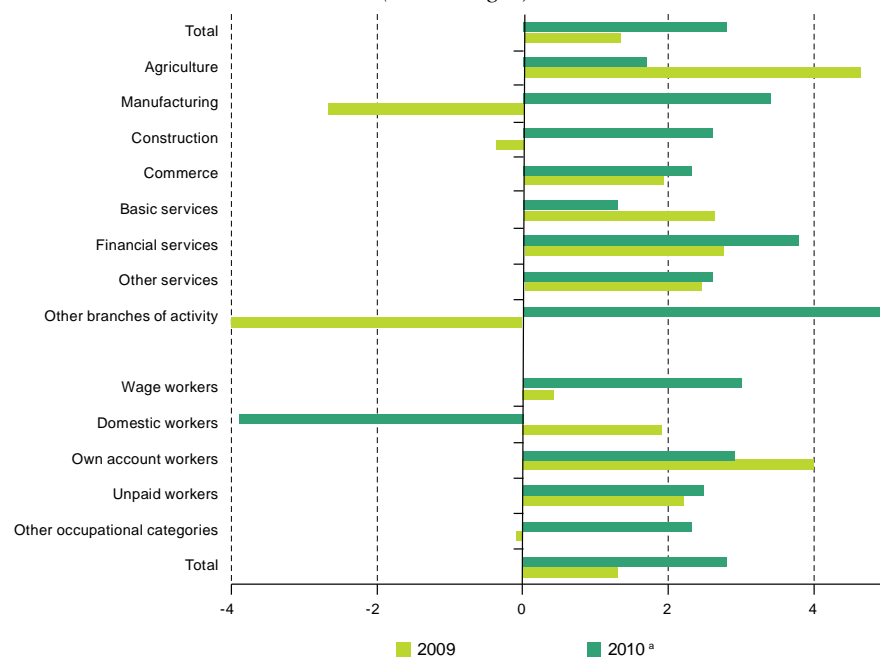
⁹ Minimum wages rose by just under 2% in real terms, measuring by the median variation of 19 countries, after a significant jump in 2009 (see table A-26). In 2010 the variation showed greater dispersion, however, which reflects differences in wage policy in the countries.

¹⁰ For some countries this estimate uses broader measurements than those shown in figure I.6 and table A-25, which refer to wages in the formal sector.

At the subregional level, the varying rates of economic growth in 2010 led to very different rates of job creation. For the South American countries as a group, the employment rate rose 0.4 percentage points (simple average for seven countries with comparable data). In Mexico and Central America the rate dropped by 0.2 percentage points (average for six countries) and in the Caribbean it fell by 1.3 percentage points (average for three countries).

Generation of wage employment rose much more quickly in 2010 than in 2009, whereas self-employed work showed a smaller rate of increase (see figure I.7). Wage employment increased relative to total employment in Argentina, Brazil, Costa Rica, Ecuador and Panama, and formal wage employment rose rapidly in Brazil, Chile, Nicaragua and Uruguay. By sector of employment, the number of employed in tertiary activities and agriculture continued to rise in 2010, but the distinctive feature of the year was the recovery of employment in manufacturing and construction.

Figure I.7
LATIN AMERICA AND THE CARIBBEAN: YEAR-ON-YEAR VARIATION IN EMPLOYMENT RATE, BY BRANCH OF ACTIVITY AND OCCUPATIONAL CATEGORY, 2009 AND 2010
(Percentages)



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

^a Preliminary data.

The output elasticity of wage employment was 0.56 for an average of eight countries with data available, implying that job creation was accompanied by a significant jump in average labour productivity (see table I.2). The output elasticity of formal employment was even higher, at 0.83 for an average of 10 countries.

Table I.2
**LATIN AMERICA (SELECTED COUNTRIES): OUTPUT ELASTICITY OF WAGE EMPLOYMENT
 AND FORMAL WAGE EMPLOYMENT, 2010**

	Output elasticity of wage employment	Output elasticity of formal wage employment
Brazil	0.57	0.81
Chile	...	1.17
Colombia	0.60	1.03
Costa Rica	0.88	0.78
Dominican Republic	0.50	...
Ecuador	0.86	1.34
Guatemala	...	0.65
Mexico	0.34	0.72
Panama	0.47	0.64
Peru	0.25	0.48
Uruguay	...	0.66

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

In early 2011 the region overall continued to create employment and reduce unemployment rapidly. For a weighted average of nine countries, the employment rate has continued to rise significantly, by 0.4 percentage points year-on-year. Although this rate is lower than during the post-crisis upswing, given that the participation rate fell slightly, it has risen enough to have a strong impact on the unemployment rate: for the countries with information available, unemployment came down by 0.7%. Importantly, the expansion in employment continues to be associated with formal job creation. For the year overall, the regional urban unemployment rate is projected to drop again, from 7.3% to somewhere between 6.7% and 7.0%.

Although higher food and fuel prices have pushed up inflation, real wages continued to rise in the early part of 2011 at rates similar to those of 2010 thanks to strong labour demand, falling unemployment rates, a shortage of workers with specific skills and gains in labour productivity.

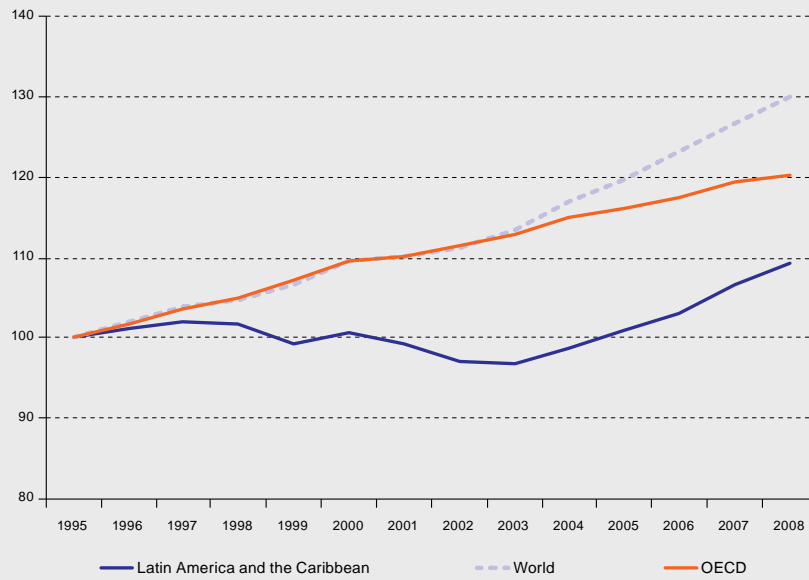
Box I.2
LABOUR PRODUCTIVITY

One characteristic of economic development in Latin America in the 1980s and 1990s was the lack of progress in closing the wide labour productivity gap between the region and more developed countries. The gap even began to widen again at the start of the twenty-first century, on comparing the region with the member countries of the Organization for Economic Cooperation and Development (OECD) and with the international average (see figure 1). The year 2004 marked a trend change, as average labour productivity in the region began to grow at similar rates to the rest of the world and faster than OECD countries.

Leaving aside the differing labour productivity levels among the countries of the region, it is apparent that the upturn in labour productivity was widespread but uneven. Early in the decade, labour productivity stagnated in most countries while falling sharply in others. From 2004 (earlier, in some instances) there was a general upswing in productivity, despite disparities in the rate of growth. The impact of the 2009 crisis on average productivity varied again; for example, it declined more steeply in the Bolivarian Republic of Venezuela, Colombia and Mexico than elsewhere. The 2010 economic recovery had a positive —although mixed— impact on productivity. While Brazil and Peru were able to surpass pre-crisis levels, recovery in other countries was slower or has yet to materialize.

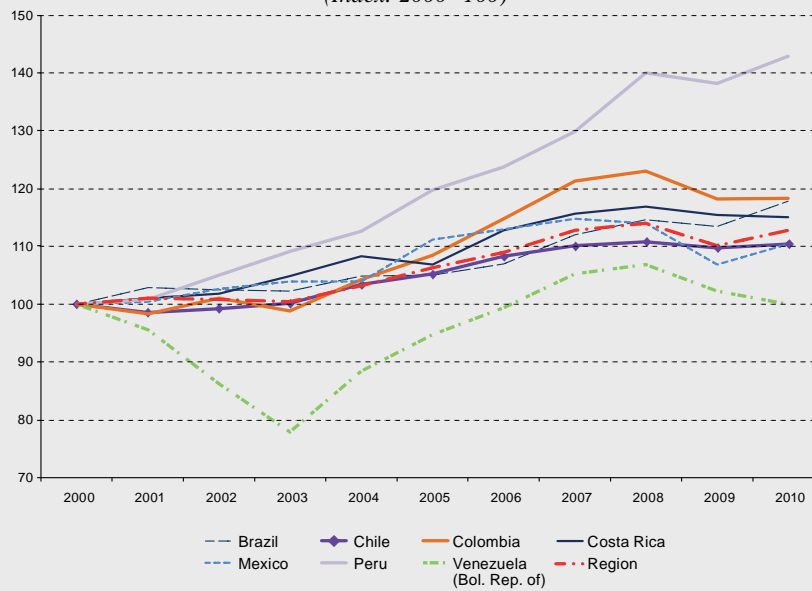
Box I.2 (continued)

Figure 1
LATIN AMERICA AND THE CARIBBEAN, WORLD AND OECD COUNTRIES:
LABOUR PRODUCTIVITY, 1995-2008
(Index: 1995=100)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of International Labour Organization (ILO), Key Indicators of the Labour Market (KILM) and World Bank GDP series.

Figure 2
LATIN AMERICA (7 COUNTRIES): LABOUR PRODUCTIVITY, 2000-2010
(Index: 2000=100)



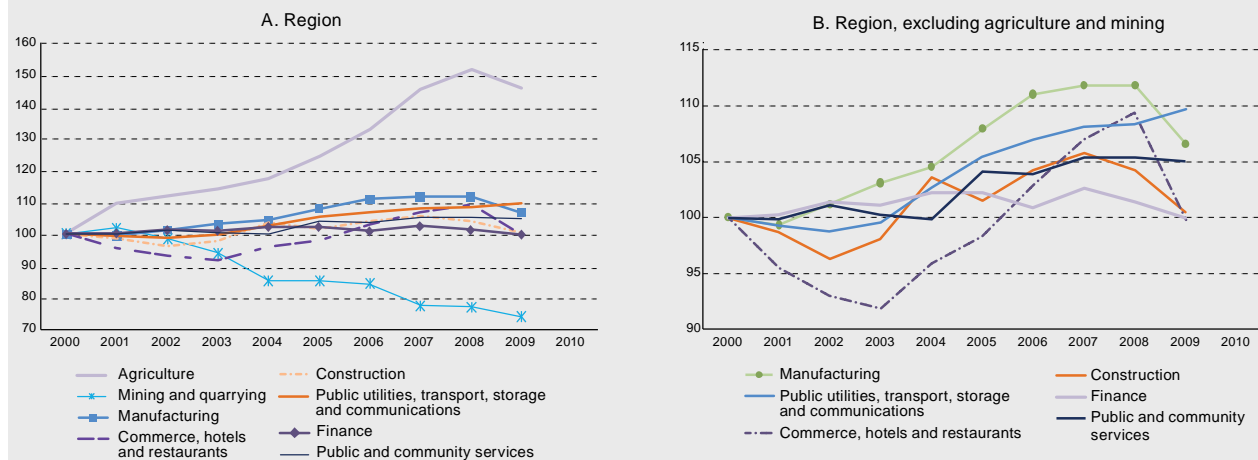
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data.

Box I.2 (continued)

Examining labour productivity by industry, it is clear that the two primary sector industries (agriculture, forestry and fishing, and mining and quarrying), which have traditionally recorded the lowest and highest labour productivity, respectively, also reflect the two extremes in terms of recent variations. Agriculture, forestry and fishing experienced a surge, and mining and quarrying a marked decline in average productivity. As far as agriculture is concerned, this is part of a long-term trend attributable to the expansion of commercial agriculture (which is not labour-intensive) and the decreasing share in employment of low-productivity small farming. Declining labour productivity in mining may have to do with low-yield deposits being brought into production in response to high prices for many minerals.

The highest productivity gains were made in manufacturing, but were interrupted (as in other industries) by the 2009 crisis. Within the tertiary sector, commerce shows particularly volatile productivity, reflecting its role as an “employer of last resort” during a crisis, owing to the low entry requirements. Accordingly, at the beginning of the last decade when economic growth was sluggish, average labour productivity in commerce plummeted. During the subsequent period of higher growth, the buoyancy of domestic demand generated a boom in the industry, cut short once again by a sharp contraction in 2009.

Figure 3
LATIN AMERICA (7 COUNTRIES): LABOUR PRODUCTIVITY BY INDUSTRY, 2000-2010
(Index: 2000=100)



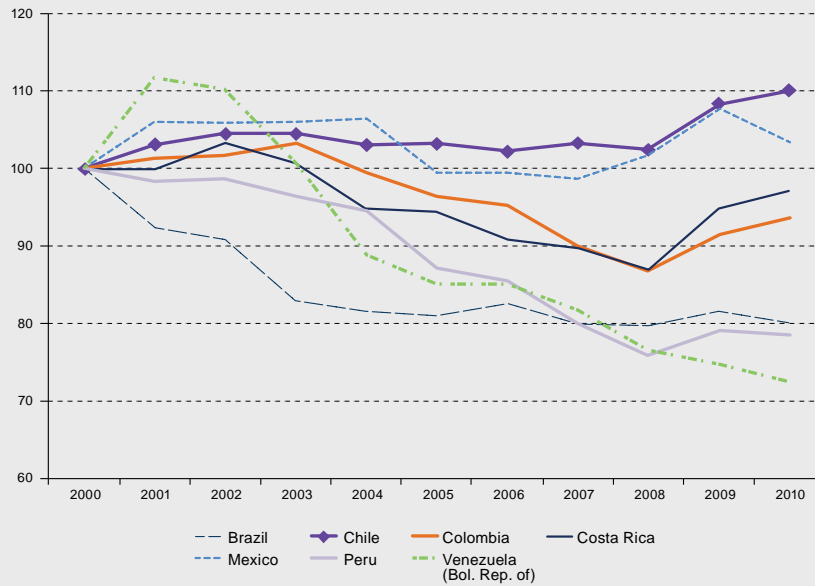
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data.

Notably, the upturn in labour productivity from 2004 on did not translate into a comparable rise in real wages in the formal sector, which grew at a slower pace in most countries. This appears to have been a factor in deteriorating functional income distribution and a fall in unit labour costs.

In many countries, lower local labour costs were offset by currency appreciation, which increased labour costs as measured in other currencies. Brazil, Colombia and Costa Rica all experienced a drop in unit labour costs in local currency, but a rise in those costs in dollars.

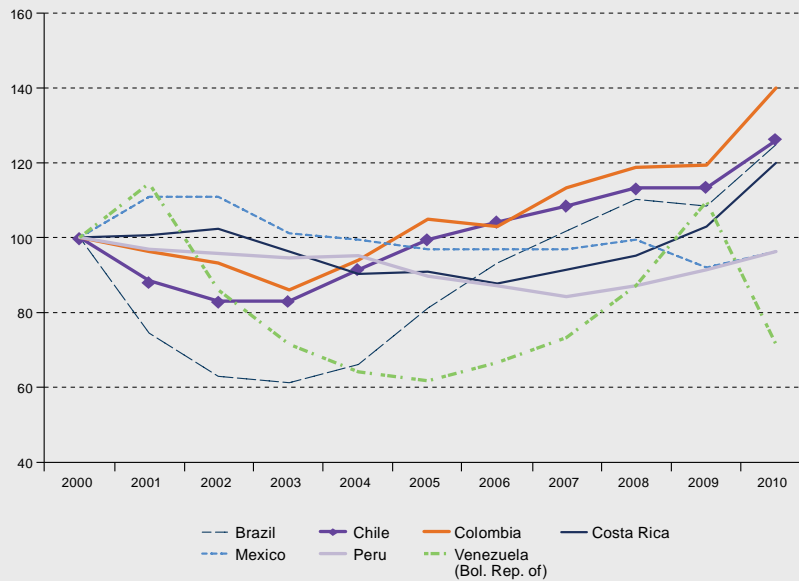
Box I.2 (concluded)

Figure 4
LATIN AMERICA (7 COUNTRIES): RATIO OF THE AVERAGE REAL FORMAL SECTOR WAGE INDEX TO THE LABOUR PRODUCTIVITY INDEX, 2000-2010
(Index 2000=100)



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

Figure 5
LATIN AMERICA (7 COUNTRIES): RATIO OF THE AVERAGE REAL FORMAL SECTOR WAGE INDEX TO THE LABOUR PRODUCTIVITY INDEX, ADJUSTED BY DOLLAR EXCHANGE RATE, 2000-2010
(Index: 2000=100)

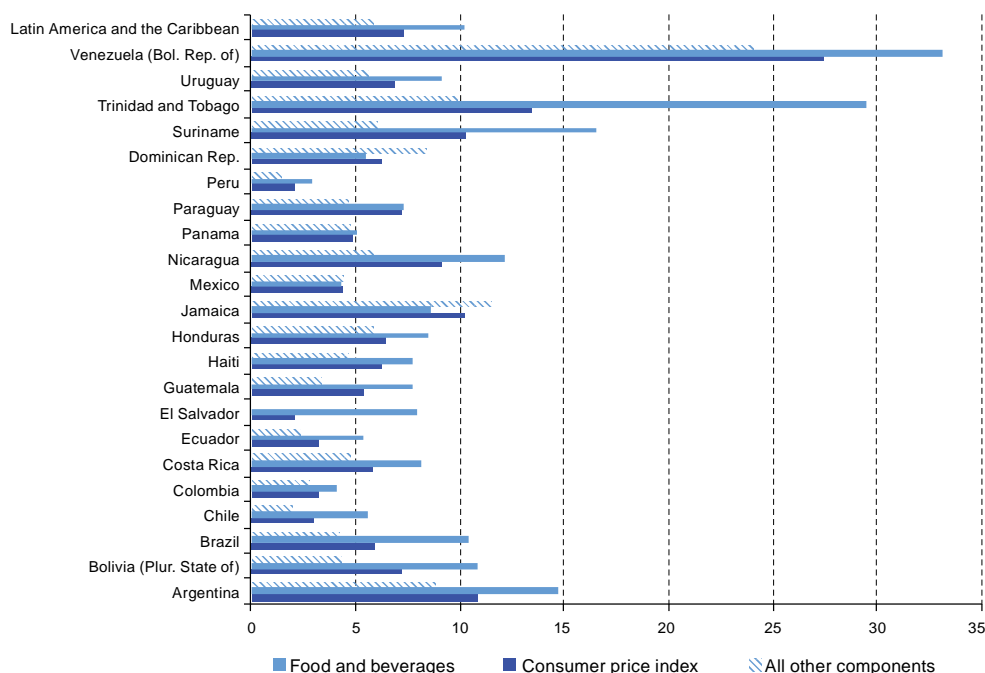


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data.

3. Inflation

Measured by the consumer price index (CPI), regional inflation stood at 6.6% in 2010 as a weighted average. Inflation ran at over 10% in Argentina, Jamaica and Trinidad and Tobago, as well as in the Bolivarian Republic of Venezuela, which recorded the region's highest rate of 27.4%. All the countries except Ecuador registered a higher rate than in 2009, owing largely to higher prices for foods and beverages practically across the board (see figure I.8).

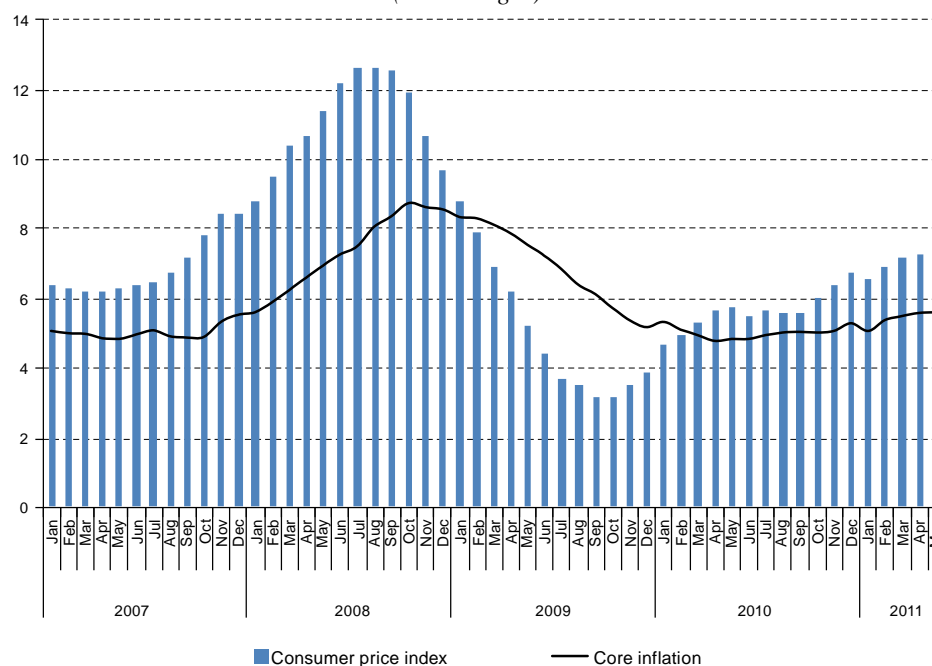
Figure I.8
LATIN AMERICA AND THE CARIBBEAN: 12-MONTH VARIATION IN CONSUMER PRICE INDEX, FULL INDEX, FOOD AND BEVERAGES ONLY AND ALL OTHER COMPONENTS, DECEMBER 2009-DECEMBER 2010



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

The inflation rate continued to rise in 2011, driven basically by food and beverage prices, although fuels and transport services and, in some cases, housing, have risen in price as well. Core inflation has also begun to climb amid rapid growth in domestic demand. In May 2011, 12-month core inflation stood at 5.6% after sitting just above 5% throughout 2010 (see figure I.9). Producer prices, too, have seen a fairly widespread increase. In fact, they have risen much faster than consumer prices in all countries except the Bolivarian Republic of Venezuela.

Figure I.9
**LATIN AMERICA: 12-MONTH VARIATION IN CONSUMER PRICE INDEX
 AND CORE INFLATION, 2007-2011^a**
 (Percentages)



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

^a Data for 2011 refer to first five months only.

Table I.3
**LATIN AMERICA AND THE CARIBBEAN: 12-MONTH VARIATION IN CONSUMER
 PRICE INDEX, FULL INDEX, FOOD AND BEVERAGES ONLY AND ALL
 OTHER COMPONENTS, MAY 2010 AND MAY 2011**
 (Percentages)

	12-month variation (May 2010)				12-month variation (May 2011)		
	CPI	CPI for food	CPI for all other products		CPI	CPI for food	CPI for all other products
Argentina	9.9	15.1	8.1	Argentina	9.7	8.0	10.7
Bolivia (Plurinational State of)	1.4	1.7	1.1	Bolivia (Plurinational State of)	11.3	16.9	6.9
Brazil	5.2	6.8	4.4	Brazil	6.6	8.2	5.4
Chile	1.5	1.7	1.2	Chile	3.3	5.3	1.8
Colombia	2.1	1.0	2.5	Colombia	3.0	3.6	2.8
Costa Rica	6.2	4.9	6.9	Costa Rica	4.8	6.0	4.2
Dominican Republic	7.9	5.8	8.7	Dominican Republic	8.0	7.4	8.3
Ecuador	3.2	4.0	2.9	Ecuador	4.2	6.4	3.2
El Salvador	-0.1	-2.2	1.6	El Salvador	6.7	9.9	5.2
Guatemala	3.5	1.7	4.4	Guatemala	6.4	11.0	4.2
Haiti (January)	6.1	3.7	8.8	Haiti (January)	3.7	4.9	2.5
Honduras (April)	4.2	-0.4	6.4	Honduras (April)	7.3	7.1	7.4
Jamaica	9.5	14.2	6.2	Jamaica	14.1	10.0	17.2

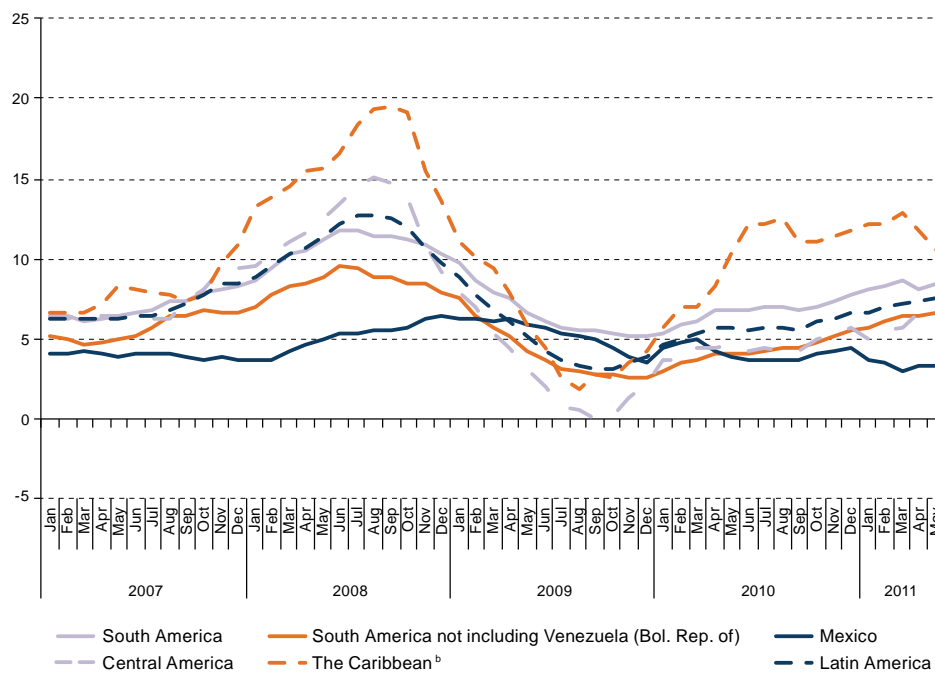
Table I.3 (concluded)

	12-month variation (May 2010)				12-month variation (May 2011)		
	CPI	CPI for food	CPI for all other products		CPI	CPI for food	CPI for all other products
Mexico	3.9	1.8	4.3	Mexico	3.2	5.2	2.5
Nicaragua	5.4	2.2	6.6	Nicaragua	8.7	8.2	8.9
Panama	3.2	2.7	3.4	Panama	6.4	6.1	6.6
Paraguay	4.5	2.3	1.8	Paraguay	10.2	18.1	6.5
Peru	1.0	1.7	0.8	Peru	3.1	4.6	2.1
Suriname	7.4	9.2	6.0	Suriname	20.3	20.0	20.5
Trinidad and Tobago	9.6	19.4	7.4	Trinidad and Tobago	3.9	8.2	3.0
Uruguay	7.1	6.0	6.9	Uruguay	8.5	11.1	6.7
Venezuela (Bolivarian Republic of)	32.0	44.7	26.8	Venezuela (Bolivarian Republic of)	24.8	22.1	26.0
Latin America (simple average)	6.1	6.7	5.7	Latin America (simple average)	8.1	9.5	7.4

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

The Caribbean countries with data available show relatively high rates of inflation, whereas the Central American economies are running rates below the regional average, as is Mexico where inflation has been slowing since late 2010 (see figure I.10). An inflation rate of 7.5% is projected for the region overall in 2011.

Figure I.10
**LATIN AMERICA AND THE CARIBBEAN: 12-MONTH VARIATION IN CONSUMER PRICE INDEX,
SIMPLE AVERAGES, 2007-2011^a**
(Percentages)



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

^a Data for 2011 refer to the first five months.

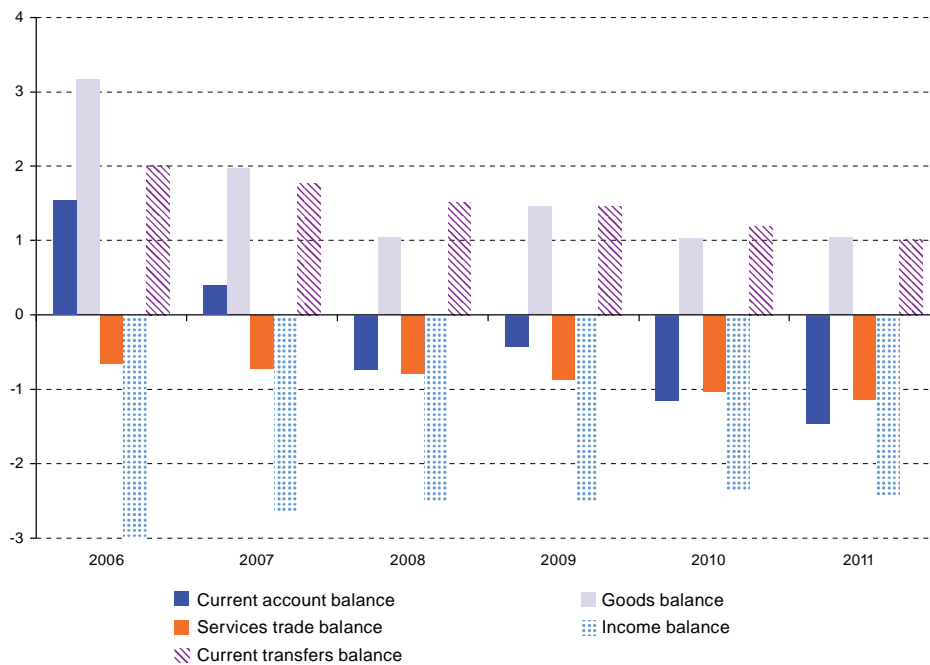
^b Data for the Caribbean refer to Jamaica, Suriname and Trinidad and Tobago.

4. The external accounts

(a) The balance-of-payments current account

In 2010, Latin America recorded a current account deficit equivalent to 1.2% of regional GDP, somewhat larger than the deficit of 0.4% in 2009 (see figure I.11). While the income and services accounts remained stable, the relative decline in the transfers balance and, above all, the narrowing of the trade surplus (from 1.5% of GDP in 2009 to 1.0% in 2010) caused a deterioration in the region's external accounts. More robust growth in imports than in exports was attributable to the upturn in domestic demand and the currency appreciations that took place in most of the countries of the region.

Figure I.11
LATIN AMERICA: CURRENT ACCOUNT STRUCTURE, 2006-2011^a
(Percentages of GDP)



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

^a Does not include data for Cuba. Data for 2011 are projections.

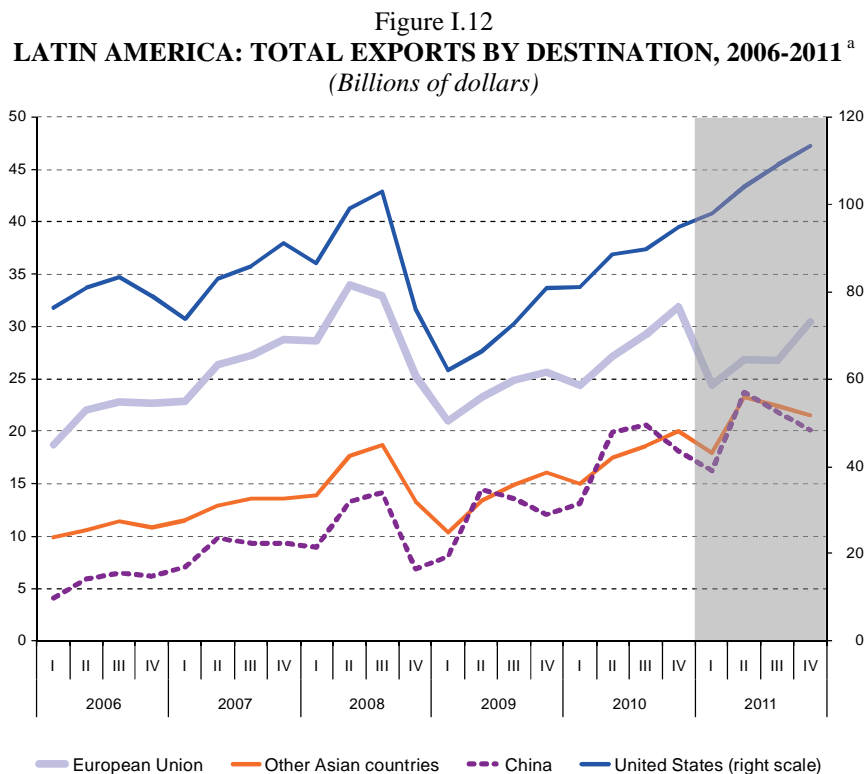
The heftier overall current account deficit reflected a considerably larger deficit in the MERCOSUR and Central American countries and a reduction in the surplus of the mineral exporting countries (Chile and Peru). By contrast, the Caribbean recorded a better external balance, since higher oil prices contributed to a more substantial surplus in Trinidad and Tobago and stronger metal prices had a similar result in Suriname, while Jamaica's deficit diminished.

The current account deficit of Latin America is projected to widen slightly in 2011 to 1.5% of GDP. The trade surplus should continue to hold at around 1% of regional GDP owing to higher prices for the main exports combined with a slower rise in imports. What will widen the current account deficit,

however, will be a larger negative balance on the services account and a smaller transfers surplus. This downturn will be fairly widespread except in the hydrocarbon-exporting countries. The Caribbean, on the other hand, is projecting a larger current account surplus overall, associated with the increase in international commodity prices and the sustained rebound in remittances and tourism inflows, although the average balance masks the fact that almost all the countries in this subregion are running a deficit on their external accounts.

(i) *The balance of goods and services*

As shown in figure I.12, external demand for goods produced in the region started to pick up steadily in the second quarter of 2009, although without regaining pre-crisis levels in the case of the United States and the European Union. On the other hand, exports to China and the rest of Asia at the end of 2010 were 12% and 28% higher, respectively, than in mid-2008. Exports to the United States are estimated to have pulled even with their pre-crisis level in the second quarter of 2011, whereas those to the European Union are not expected to do so until early 2012.



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

^a Does not include data for Cuba. Data for 2011 are projections.

In view of the growth rate in external demand, Latin American exports are expected to expand by 26.9% in 2011, thanks to a 16.6% rise in prices and an 8.8% increase in volume. Once again, mining and petroleum products will grow the fastest, by as much as 39.3%, a slightly higher rate than in 2010. Meanwhile, exports of agricultural products and manufactures will expand by 18.9% and 21.8%, respectively (see table I.4).

Table I.4
**LATIN AMERICA: YEAR-ON-YEAR VARIATION IN INTERNATIONAL TRADE BY
 MAIN PRODUCT CATEGORIES, 2008-2011^a**
(Percentages)

A. Exports	2008	2009	2010	2011
Agricultural products	20.5	-9.1	21.3	18.9
Mining and petroleum	23.9	-28.7	37.3	39.3
Manufactures	10.8	-20.6	23.1	21.8
Total exports	15.8	-21.9	27.0	26.9
B. Imports				
Capital goods	21.3	-17.9	23.5	21.2
Intermediate goods	16.7	-24.1	29.9	25.6
Consumer goods	20.4	-21.1	32.3	29.5
Fuels	47.3	-40.9	44.8	44.2
Total imports	21.4	-24.7	30.7	27.6

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

^a Does not include data for Cuba. Data for 2011 are projections.

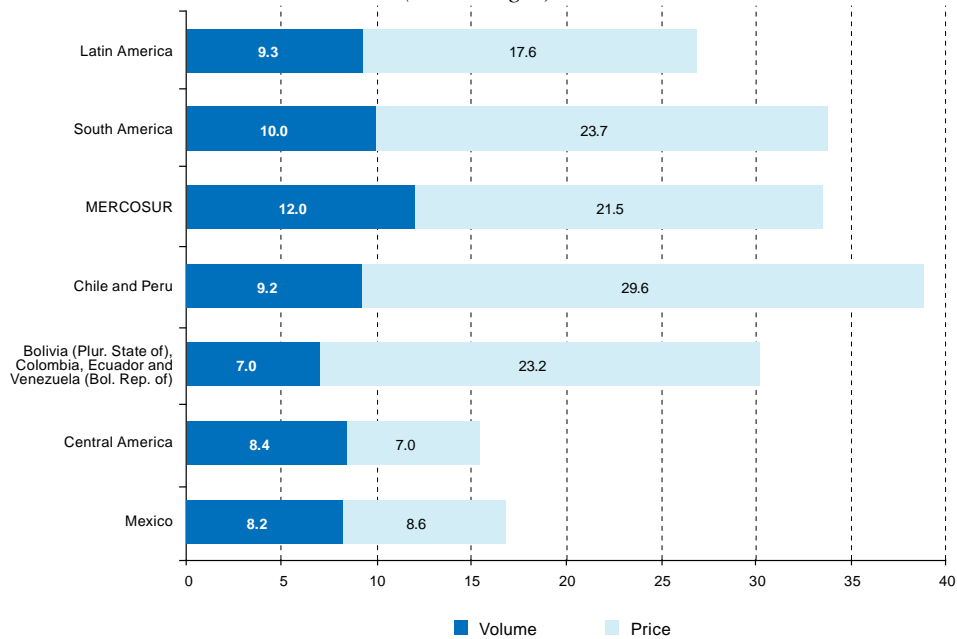
Imports are projected to grow at a similar pace as exports in 2011, by an estimated 27.6%, almost three percentage points below the 2010 rate. Imports of fuels and consumer goods will continue to trend strongly upward, by 44.2% and 29.5%, respectively. In 2010, when imports surged faster than exports, Latin America's trade surplus narrowed by 13% to stand at approximately US\$ 50 billion. In 2011, however, as imports and exports grow at similar rates, the trade surplus will move back up to some US\$ 57.5 billion.

In 2010, export growth over 2009 was strongest in the mineral-exporting countries (31.7%), Mexico (29.9%) and the members of MERCOSUR (29.8%). In the hydrocarbon-exporting countries, the gain was 18%; meanwhile, Central America and the countries of the Caribbean recorded rises of 12.3% and 11.1%, respectively. In the case of Mexico and Central America, the expansion was due mainly to higher export volumes, and in the other countries to higher prices.

Figures I.13 and I.14 show projections of international trade by subregion. Both exports and imports are seen to have staged a full recovery in all countries. Price variation will be the main driver of the trade upsurge in the mineral- and hydrocarbon-exporting countries and to a lesser extent in MERCOSUR. In Mexico and the Central American countries, which trade mainly in manufactures and essentially with the developed markets, export values will move up more slowly and the effects of price and volume will be more evenly divided. Since manufactures account for a substantial percentage of imports, their growth is strongly associated with increased volumes and more homogenous across the subregions than exports.

The upturn in regional trade in 2010 brought an expansion in transport-based services; accordingly, the larger increase in goods imports in relation to exports had a parallel effect in the services balance. Travel services too, grew much more rapidly on the import side than the export side on the strength of economic growth and currency appreciation, particularly in the case of Brazil. As a result, in 2010, the deficit on the services balance jumped by 45% with respect to 2009 for the region as a whole and stood at approximately US\$ 50 billion.

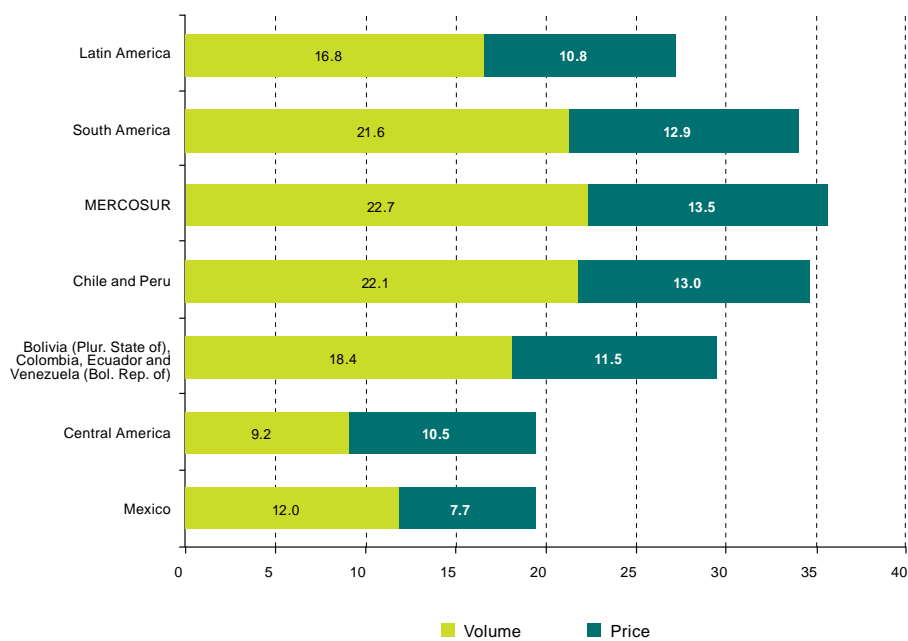
Figure I.13
LATIN AMERICA: PROJECTED VARIATION IN EXPORT VALUES BY VOLUME AND PRICE, 2011^a
(Percentages)



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

^a Does not include data for Cuba.

Figure I.14
LATIN AMERICA: PROJECTED VARIATION IN IMPORT VALUES BY VOLUME AND PRICE, 2011^a
(Percentages)

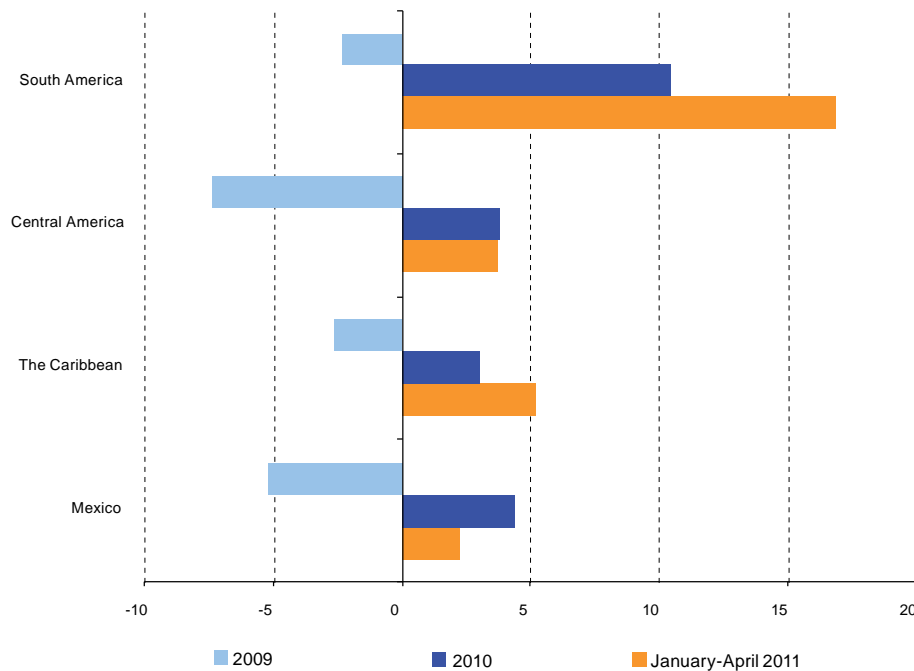


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Does not include data for Cuba.

Figure I.15 shows trends in international tourist arrivals, with a significant rebound in 2010 in all subregions following the slump in 2009. All countries benefited from the upturn in tourist arrivals, in particular the South American economies, where the numbers rose by 10.4% even though the international crisis in 2009 damaged this subregion's tourism industry less than others. Mexico, the region's leading tourist destination, received approximately 22 million visitors (4.4% more than in 2009), only 1 million fewer than were recorded for all the South America countries and 2 million more than in the Caribbean. A number of factors augur well for continued growth in this sector: the region's efforts to improve tourism-related accessibility and infrastructure; improvements in tourist security in some countries; the vigorous promotion of some destinations in international markets; and the brightening prospects for the global economy. The data to April 2011 attest to this positive outlook (see figure I.15).

Figure I.15
LATIN AMERICA AND THE CARIBBEAN: YEAR-ON-YEAR VARIATION IN INTERNATIONAL TOURIST ARRIVALS, 2009-2011^a
(Percentages)



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

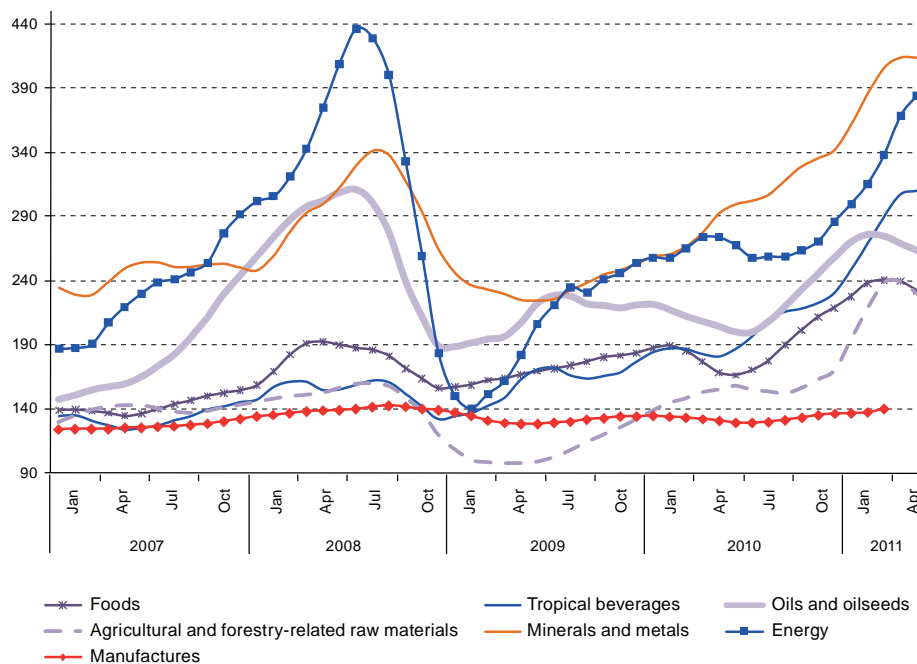
^a Figures for 2011 refer to first two months only.

(ii) *International prices and terms of trade*

Export commodity prices surged in 2010 with very few exceptions (such as rice and soybean flour). Among agricultural products, prices rose by 9.9% for foods, 25.4% for tropical beverages (coffee, tea and cacao) and 41.6% for agricultural and forestry-related raw materials. Prices for the subcategory of oils and oilseeds increased by a more moderate 3.5%. Minerals and metals were up by 29.3% in price, and energy products by 27.9%. The uptrend spread to prices of manufactures, which rose especially from late 2010 onwards.

As figure I.16 shows, commodity prices have regained the ground lost during the international crisis. In fact, with the exception of energy products and oils and oilseeds, they have exceeded the highs of 2008: the food price index published by the Food and Agriculture Organization of the United Nations (FAO) reached a new peak in February 2011. Factors relating to both supply and demand underlie these price surges. On the supply side are: (i) poor weather conditions, which hurt coffee production in Central America and South America; (ii) the drought in the Russian Federation, which pushed up prices for wheat and wheat substitutes; (iii) the post-election crisis in Côte d'Ivoire, which drove up cacao prices; and (iv) political instability in the Middle East, which influenced prices for oil and petroleum products. On the demand side was the global economic recovery and strong demand for commodities on the part of China, India and other emerging economies. Commodity prices are expected to continue moving upward during 2011, although less steeply than in 2010 as world economic growth slows, demand eases following completion of stock replenishment and the supply-side response to higher prices and more favourable climate conditions kicks in. This change is already apparent in the slowing of food and agricultural price inflation. These trends have had an uneven impact on the region's terms of trade, as shown in figure I.17. In 2010 exporters of minerals and metals (Chile and Peru) and hydrocarbons (Bolivarian Republic of Venezuela, Colombia and Plurinational State of Bolivia) benefited the most from higher export prices, followed by the member countries of MERCOSUR. Mexico, which exports mainly manufactured goods, saw smaller gains, while the Central American countries, as net food and energy importers, suffered terms-of-trade losses. Overall, Latin America enjoyed an 8.1% gain in its terms of trade in 2010.

Figure I.16
**LATIN AMERICA AND THE CARIBBEAN: PRICE INDEXES FOR COMMODITIES
 AND MANUFACTURES, 2007-2011^a**
(Index: 2000=100, three-month moving average)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures from the United Nations Conference on Trade and Development (UNCTAD) and the Netherlands Bureau for Economic Analysis (CPB).

^a The categories of commodities are weighted by their share in Latin America's exports.

Figure I.17
LATIN AMERICA: VARIATION IN THE TERMS OF TRADE, 2009-2011^a
 (Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures of the United Nations Conference on Trade and Development (UNCTAD), International Monetary Fund (IMF), World Bank and Bloomberg.

^a Does not include data for Cuba. Preliminary data for 2009 and 2010 and projections for 2011.

The region's terms of trade will maintain the current trend in the short term, although the improvements will be smaller than in 2010. The countries standing to gain the most are again the exporters of minerals and hydrocarbons; and again, the opposite will occur in Central America, which will see its terms of trade deteriorate. For Latin America and the Caribbean as a whole, a positive variation of 6.2% is projected for 2011.

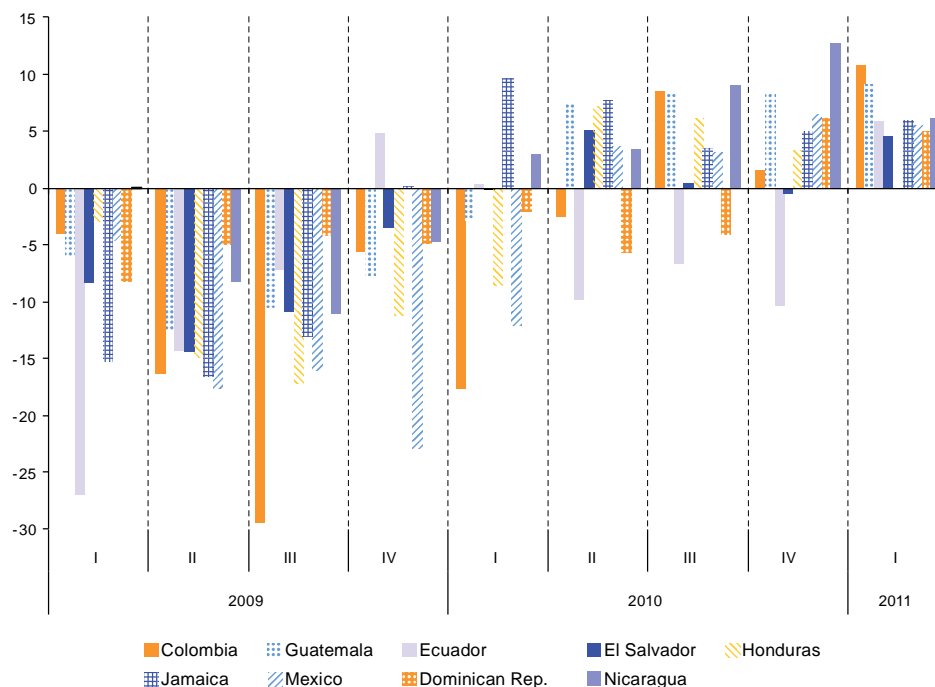
(iii) *The income and transfers balance*

The deficit on the factor income account for Latin America rose from US\$ 98.1 billion in 2009 to US\$ 114.6 billion in 2010 but narrowed in relation to GDP, from -2.5% to -2.4% between the two years, on the strength of regional economic growth. The wider absolute deficit¹¹ chiefly reflected heftier outflows of profits and dividends, given the rise in international commodity prices and more substantial interest payments. In 2011 this deficit is likely to continue widening in absolute terms in view of projections for economic growth and still-rising prices for the region's export commodities, although in relative terms it should hold steady at around 2.4% of regional output.

¹¹ Four countries accounted for 90% of the increase in the deficit: Brazil, Chile, Colombia and Peru; the rest of the countries showed smaller negative variations or even improvements in their income balance.

After plunging in 2009, remittances from migrant workers began to rise again in early 2010, as shown in figure I.18. With the exception of Colombia, the Dominican Republic and Ecuador, all the countries shown in the figure ended the year with a positive variation. However, growth in family remittances has been modest and levels of income from this source still fall far short of the highs observed before the crisis. The prime cause here is a sluggish labour-market recovery in developed countries, particularly Spain and the United States, the main destinations for migrants from Latin America and the Caribbean. Labour market projections for these countries suggest that growth in remittances will be modest in 2011.

Figure I.18
LATIN AMERICA AND THE CARIBBEAN (9 COUNTRIES): QUARTERLY YEAR-ON-YEAR VARIATION IN REMITTANCES FROM EMIGRANT WORKERS, 2009-2011^a
(Percentages)



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

^a Data for 2001 refer to first quarter only.

Like remittances, the transfers account for the region also reflected a rise, of 80% and 118% in incoming transfers for Haiti and Chile, respectively, associated with grants and official assistance extended in the wake of the earthquakes that hit the two countries.¹² The surplus on the transfers balance narrowed from 1.5% of GDP in 2009 to 1.2% in 2010, although it increased in absolute terms. In 2011 the account is projected to yield a surplus equivalent to 1.0% of regional GDP.

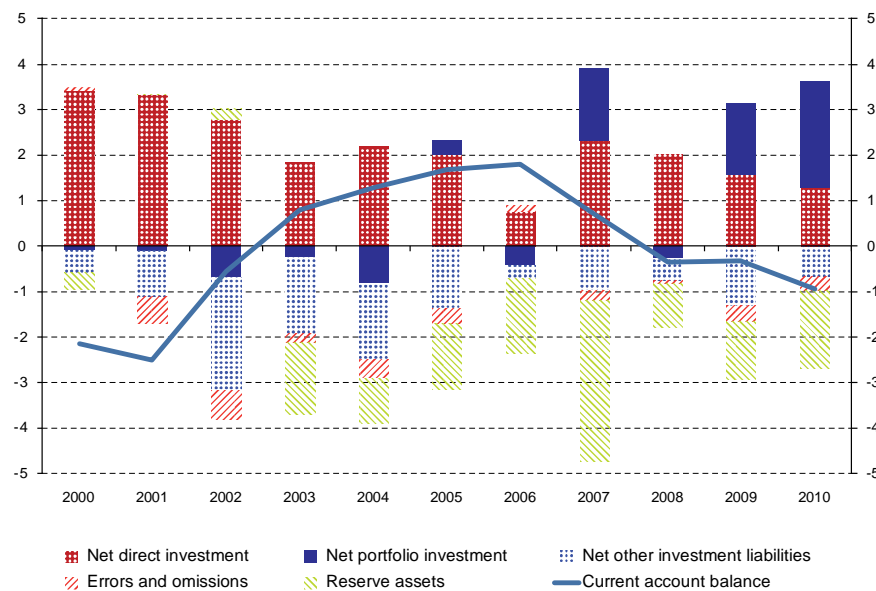
¹² Also reflected in the transfers account is a decrease of 58% on the credit side in Argentina, associated with an allocation of special drawing rights by the International Monetary Fund (IMF) that was registered as a current transfer in the third quarter of 2009 and not repeated in 2010.

(b) The capital and financial account

In 2010, external financial conditions—in the form of abundant global liquidity and stronger net investment inflows—once again led to a positive overall balance in the region's balance of payments, with international reserves climbing to the equivalent of 16% of regional GDP.

This picture disguises somewhat divergent trends, however. As figure I.19 shows, net inflows of foreign direct investment (FDI) and portfolio investment into South America and Mexico have been rising vigorously since 2007, except for a hiatus in 2008 when the global financial crisis broke out. In fact, net portfolio investment flowing into these countries reached US\$ 109.157 billion in 2010, exceeding for the first time—and by quite some way—net FDI, which came in at US\$ 59.995. The figure also reflects the role played by reserves accumulation in absorbing external liquidity, which is associated with the exchange-rate-related objectives of several countries in this group.

Figure I.19
**SOUTH AMERICA AND MEXICO: CURRENT ACCOUNT BALANCE
 AND COMPOSITION OF EXTERNAL FINANCING, 2000-2010**
(Percentages of GDP)

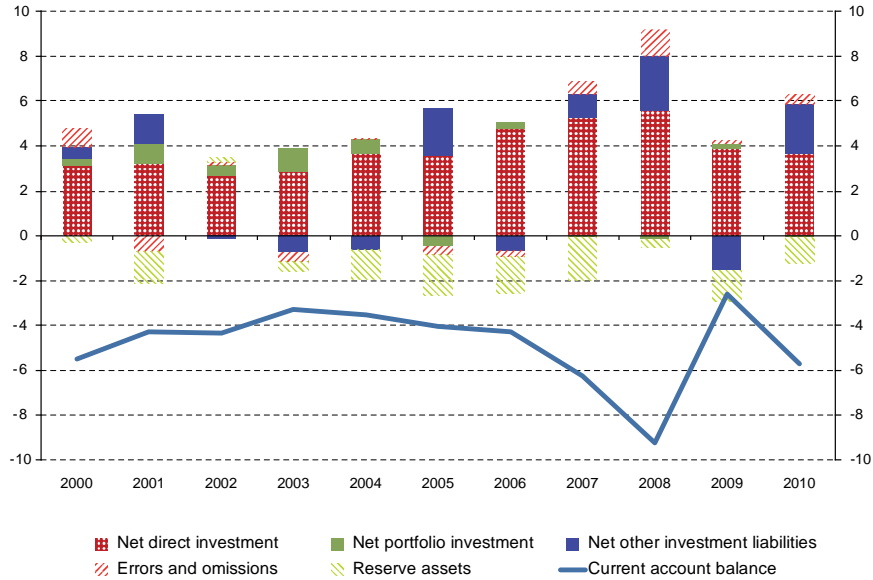


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

A very different situation prevails in the Central American countries, Dominican Republic and Haiti, however (see figure I.20). In this group, net FDI was the main component of positive inflows on the financial account, whereas portfolio investment was virtually insignificant. The next largest positive component was net other investment liabilities, which captures the effects of cross-border flows of bank deposits, loans and debt instruments. The surge in this category of inflows in 2010 was enough, together with the relatively stable net FDI flows, to finance the increase in the current account deficit over the year.

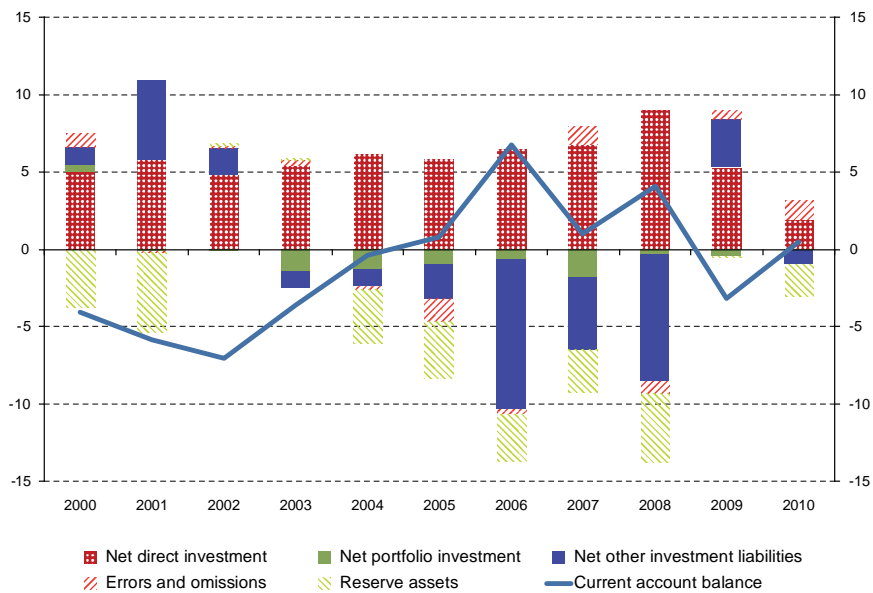
The pattern is even more pronounced in the Caribbean countries, where net FDI was virtually the only positive component of the financial account, while net other investment liabilities—mainly banking flows—were often negative (see figure I.21).

Figure I.20
**CENTRAL AMERICA, DOMINICAN REPUBLIC AND HAITI: CURRENT ACCOUNT BALANCE
 AND COMPOSITION OF EXTERNAL FINANCING, 2000-2010**
(Percentages of GDP)



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

Figure I.21
**THE CARIBBEAN: CURRENT ACCOUNT BALANCE AND COMPOSITION
 OF EXTERNAL FINANCING, 2000-2010^a**
(Percentages of GDP)



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

^a Includes data for the following countries: Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname and Trinidad and Tobago.

Net FDI is thus continuing to follow its long-term, steady upward path and was largely unaffected by the financial crisis of 2008. Recently, and especially in 2010, portfolio investment has accounted for an increasingly larger share of the region's financial account; this has to do with the tremendous surge in global liquidity that resulted from developed countries' responses to the global financial crisis and with the lower relative risk offered by economies in the region, especially Brazil, Colombia, Mexico and Peru (see table I.5). These are the countries that receive the bulk of flows from net FDI, portfolio investment and other investment liabilities, which partly explains their stockpiling of reserves and the efforts many of them have deployed to stave off currency appreciation. Chile stands out among the countries receiving FDI because it had a negative net portfolio investment flow over the period; this was attributable to the outward diversification of its pension funds and the build-up of resources in its sovereign funds on the back of high copper prices.

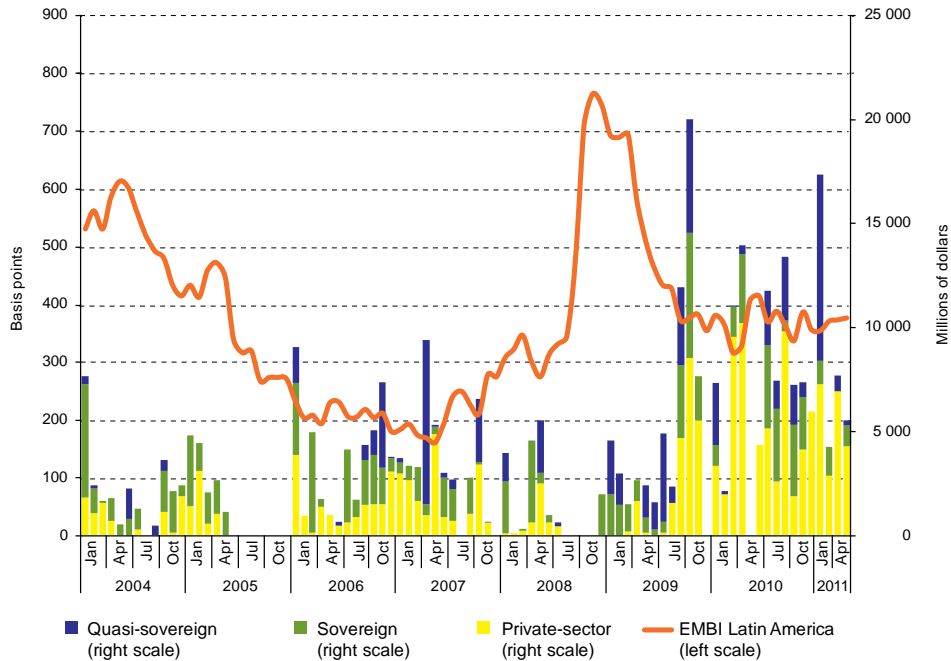
Table I.5
LATIN AMERICA (19 COUNTRIES): EXTERNAL FINANCIAL FLOWS, 2007-2010
(Millions of dollars)

	Net foreign direct investment	Net portfolio investment	Net other investment liabilities	Total
Venezuela (Bolivarian Republic of)	-8 679	17 729	-88 407	-79 357
Haiti	142	0	-178	-35
Paraguay	1 097	0	1 617	2 714
Ecuador	1 683	-3 778	44	-2 051
Bolivia (Plurinational State of)	1 946	-301	-1 278	366
Nicaragua	1 950	0	777	2 727
Guatemala	2 694	-229	2 144	4 609
El Salvador	2 723	651	-1 278	2 096
Honduras	3 255	-8	-202	3 045
Uruguay	5 950	-696	-6	5 248
Costa Rica	6 449	488	841	7 778
Panama	8 230	-1 556	1 214	7 889
Dominican Republic	8 329	649	4 448	13 426
Colombia	20 784	-18	14 179	34 945
Argentina	21 850	4 651	-38 000	-11 498
Peru	23 904	6 690	2 323	32 918
Chile	28 234	-42 921	5 749	-8 939
Mexico	59 384	69 931	-26 575	102 740
Brazil	125 071	162 817	-2 547	285 342
Latin America	314 995	214 101	-125 135	403 961

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

The region has continued enjoying access to international capital markets, and its risk ratings—while higher than before the global financial crisis—are still significantly lower than those of other regions. As can be seen in figure I.22, private entities, especially banks, made voluminous and frequent external bond issues in 2010 and have continued to do so thus far in 2011. Sovereign issues, on the other hand, have declined, reflecting the efforts by the public sector in the region to pare back its foreign debt over the past several years.

Figure I.22
LATIN AMERICA: EXTERNAL BOND ISSUES AND COUNTRY RISK, 2004-2011^a
(Millions of dollars and basis points)

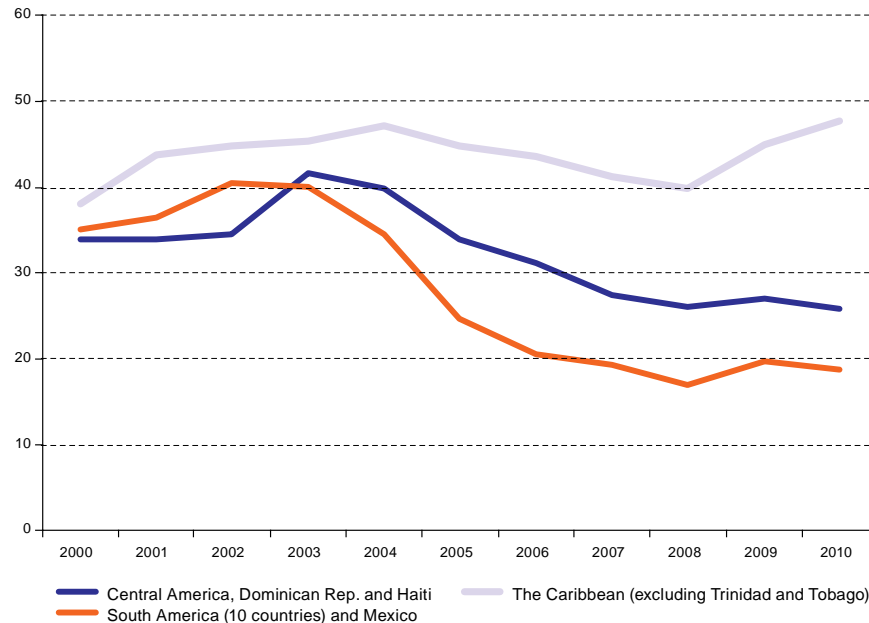


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from LatinFinance, Bonds database; JP Morgan and Merrill Lynch.

^a Does not include data for Cuba. Data for 2011 refer to first four months only.

The region's continued financial inflows, access to financial markets and historically high levels of international reserves show that its external financial position remains solid. Some specific developments merit closer examination, though. As shown in figure I.23, external debt has come down considerably as a percentage of GDP in South America and Mexico, thanks to economic growth and the fiscal and external surpluses posted in the years leading up to the global financial crisis (see figure I.23). Central America too has reduced its debt-to-GDP ratio quite significantly, largely owing to debt relief schemes such as the Heavily Indebted Poor Countries (HIPC) Debt Initiative, but by a smaller percentage than South America and Mexico given very difficult financial conditions and the slower pace of growth experienced by this group of countries. On the other hand, in the Caribbean countries —except for Trinidad and Tobago— external borrowing in relative terms has crept upward since the global financial crisis. This reflects the bleak financial conditions in the subregion since the crisis, which resulted in smaller net FDI inflows and lower current account balances (see figure I.21).

Figure I.23
LATIN AMERICA AND THE CARIBBEAN: GROSS EXTERNAL BORROWING, 2000-2010^a
(Percentages of GDP)



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

^a Does not include data for Cuba.

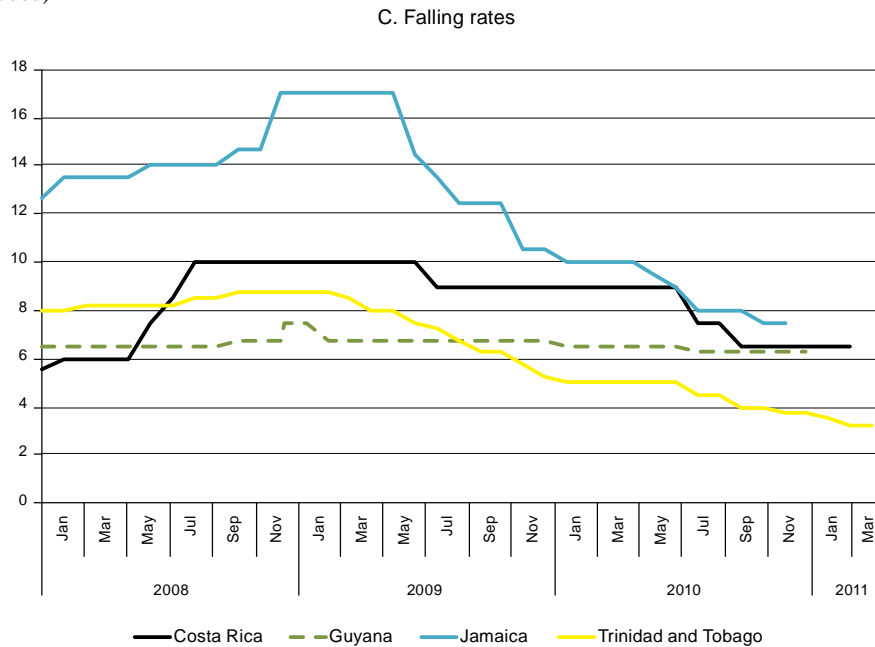
D. MACROECONOMIC POLICIES

1. Monetary and exchange-rate policy

International financial conditions combined with rising commodity prices, in particular for foodstuffs and fuel, to complicate monetary and exchange-rate policy management in the region starting in the second half of 2010. Mounting inflationary pressures and expanding aggregate domestic demand prompted several countries to tighten monetary and credit policies initially created to weather the crisis, the majority of which continue to be in effect. Moreover, abundant liquidity in international financial markets and the resulting capital inflows to the region strengthened local currencies but undermined the competitiveness of the tradable goods sectors.

The region's monetary and exchange-rate policymakers now face the challenge of maintaining price stability while keeping exchange-rate appreciation from diverting resources towards the production of non-tradable goods, as that would hinder diversification in the region's manufacturing sector. The solution will lie in measures such as interest rate management, intervention in the foreign-exchange market—generally coupled with open-market operations designed to sterilize the monetary effect of foreign currency purchases—and the deployment of fiscal, exchange-rate, monetary and financial instruments regarded as unconventional until very recently, in an effort to restrict or discourage capital inflows. Despite the changes in policy rates, monetary policy in 2010 and the first part of 2011 maintained a distinctly expansionary slant. Benchmark interest rates and growth in the main monetary aggregates are fuelling credit expansion in the region, thus boosting aggregate domestic demand. As noted earlier, however, since mid-2010 some central banks in the region have raised monetary policy rates in response to inflationary pressures, especially

Figure I.24 (concluded)



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

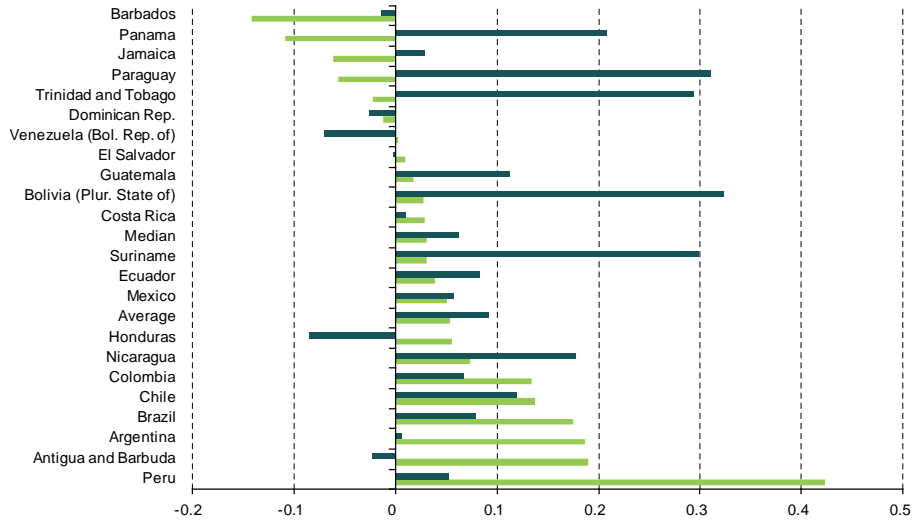
Overall, the management of benchmark interest rates by central banks in Latin America and the Caribbean has resulted in minor adjustments to nominal lending rates and, given the inflation levels expected, this has meant a reduction in lending rates in real terms. Moreover, the behaviour of the main aggregates reflects the expansionary nature of monetary policy and the recent efforts to mitigate its effects on aggregate demand. Thus, in many of the region's countries the monetary base grew in real terms in 2010, albeit at a slower pace than in 2009 in many cases, with M1 and M2 following similar paths. In 2011 thus far, monetary aggregates have continued to grow, but at lower rates than those posted in 2010 (see figure I.25).¹³

Credit expanded significantly in 2010 in real terms. Of the 13 countries with information available, variations in lending were positive in 9 countries and negative in only 4 (see figure I.26). This trend is a reflection, in part, of the steps taken by central banks to boost credit, mitigate the effects of the crisis on the region's economies and create liquidity conditions conducive to stimulating aggregate demand. Public sector lending started to grow in mid-2008 when the crisis began to reverberate in the region and caused lending by private financial institutions, to contract in 2009. With regard to the destination of lending, the growth posted in 2010 was fairly widespread and encompassed the industrial and commercial sectors as well as mortgage lending and consumption in general. In the first quarter of 2011, credit continued to expand vigorously, especially consumer lending, which accounted for a greater share of total lending.

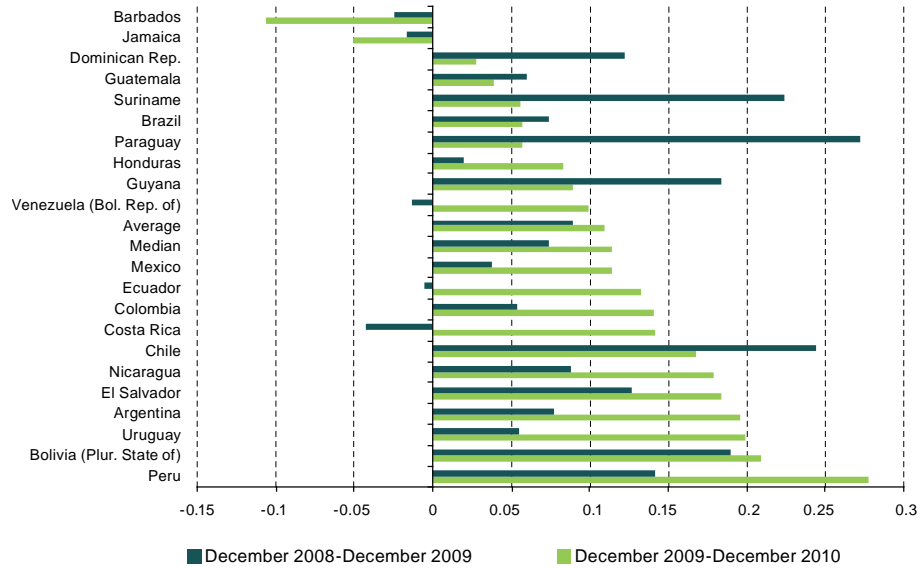
¹³ The monetary base shrank in real terms in only 6 countries and expanded in the other 16 countries, albeit at a slower pace in 6 of them. Of the 21 countries for which information is available in real terms for 2010, the M1 aggregate contracted compared with 2009 in only 2 countries while growth slowed in 7 countries. With regard to real M2, of the 20 countries for which data are available, the aggregate fell in only 2 countries while growth slowed in 6.

Figure I.25
LATIN AMERICA AND THE CARIBBEAN (SELECTED COUNTRIES):
VARIATION IN MONETARY AGGREGATES, 2008-2010
(Percentages)

A. Real-term variation in monetary base

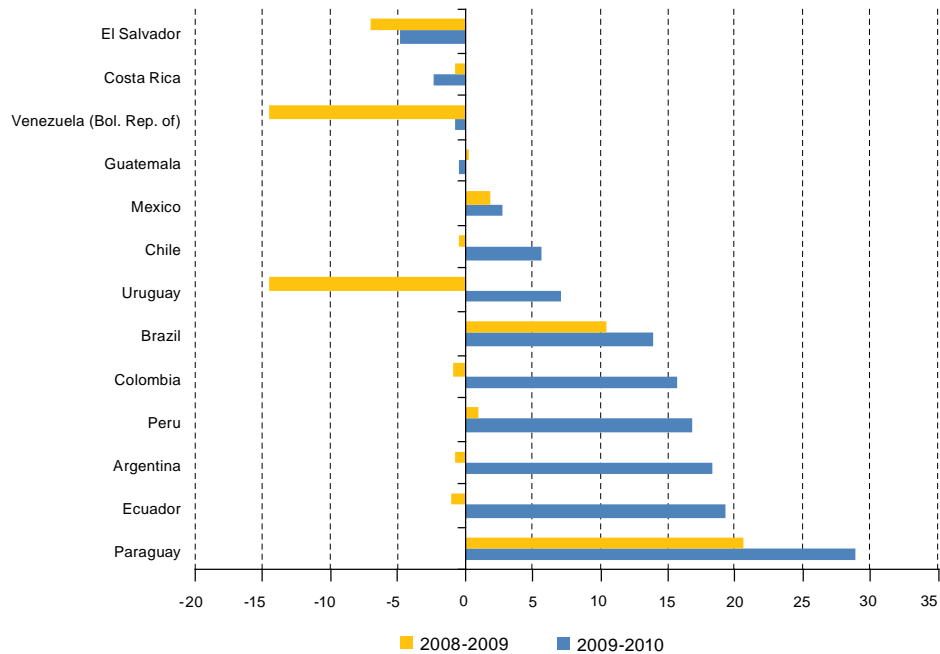


B. Real-term variation in M1



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

Figure I.26
**LATIN AMERICA (SELECTED COUNTRIES): REAL-TERM VARIATION
 IN TOTAL LENDING, 2008-2010**
(Percentages)



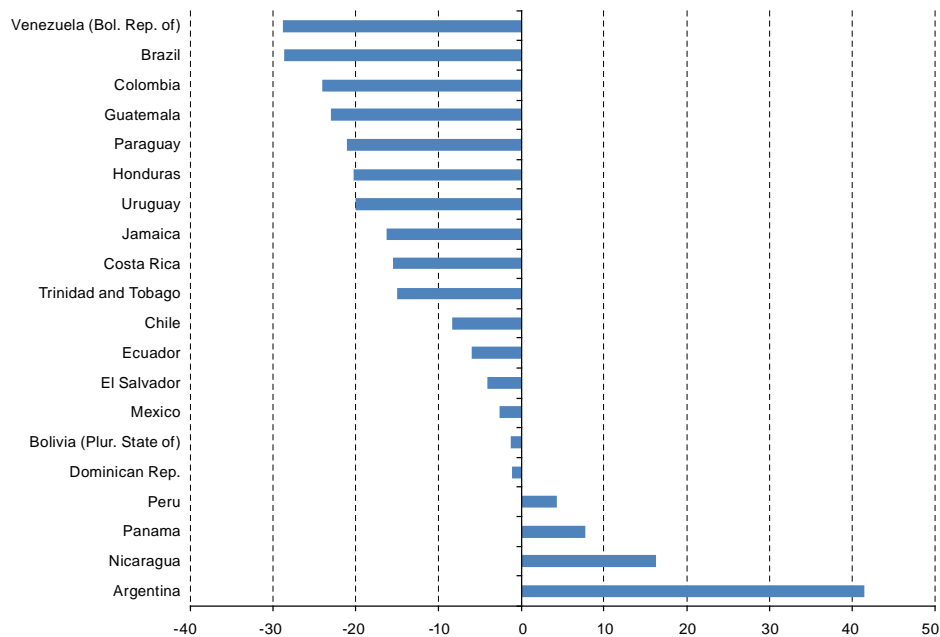
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

As noted earlier, abundant global liquidity and its repercussions on the region's money markets triggered currency appreciation pressures. In an effort to reverse this trend, some countries took steps to restrict capital movements, coupled with other measures such as stockpiling international reserves at central banks, pre-payment of external debt by national treasuries and streamlined arrangements for domestic financial and non-financial agents (such as pension fund operators and public enterprises) to hold some of their international assets abroad.

In 2010, all non-dollarized economies in Latin America and the Caribbean with the exception of the Bolivarian Republic of Venezuela and Uruguay accumulated international reserves, which by the end of 2010 exceeded, as a percentage of GDP, the pre-crisis levels recorded in 2007 in most cases. In the first few months of 2011, the region's central banks continued to build up reserves and in some cases (Brazil, for instance) intervened heavily in the foreign-exchange market. Following the strong appreciation of the Brazilian real in nominal terms and as part of the effort to stem capital inflows, the Central Bank of Brazil acquired US\$ 31.7 billion in reserves in the first four months of 2011, 273% more than the year-earlier period. Argentina, Chile, Colombia and Costa Rica also actively intervened in the foreign-exchange market in early 2011. In March and April 2011, Peru—breaking from its practice for much of 2010—drew down US\$ 1 billion in reserves with an eye to mitigating the nominal exchange rate volatility triggered by its presidential elections.

Despite the efforts deployed, 11 of the region's countries recorded nominal appreciations in 2010 and early 2011, in particular Brazil, Colombia and Uruguay but also, to a lesser extent, Chile, Costa Rica, Mexico and Peru (see figure I.27). Against appreciating nominal exchange rates and increasing inflationary pressures, the extraregional real effective exchange rate of Latin America and the Caribbean fell by 3.5% between 2009 and 2010. The drop in the real exchange rate was widespread: in South America, it fell by an average of 2.6% in the period, or by 7% if the Bolivarian Republic of Venezuela is excluded from the calculation, while in Central America, Mexico and the Caribbean it was down by 4.5%. In the first four months of 2011, the average extraregional effective exchange rate for the region remained virtually unchanged from December 2010, with the average for South America falling by 1.4% and the average for Central America, Mexico and the Caribbean rising by 1%.

Figure I.27
LATIN AMERICA AND THE CARIBBEAN (SELECTED COUNTRIES): VARIATION IN REAL EFFECTIVE EXTRAREGIONAL EXCHANGE RATE, MAY 2011 COMPARED WITH 1990-2009
(Percentages)



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

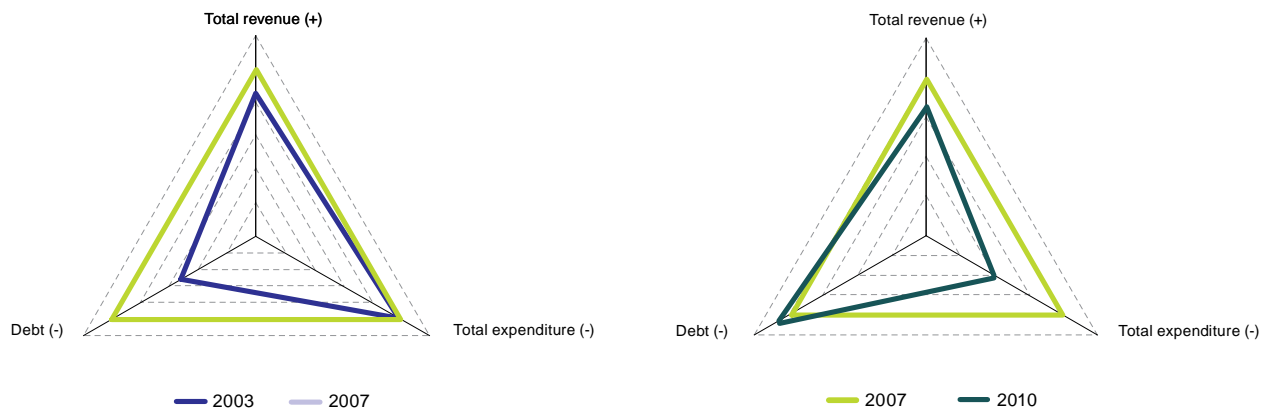
In April 2011, the overall effective real exchange rate stood at more than 20% below (i.e. currency appreciation) the 20-year average in the Bolivarian Republic of Venezuela, Brazil, Colombia, Guatemala, Paraguay and Trinidad and Tobago and at more than 10% below the long-term average in Costa Rica, Honduras, Jamaica and Uruguay. In the Bolivarian Republic of Venezuela, persistent high inflation partly offset the implicit devaluations of January 2010 and January 2011.

2. Fiscal policy

Following the fiscal activism pursued by the countries of the region in 2009, two developments in particular shaped the year-end results for 2010. One was growth in fiscal revenues on the strength of higher economic activity levels and, in countries specializing in the production and export of natural-resource-intensive goods, the rebound in commodity prices. The other was on the spending side, as governments sought to temper the impact of public policy as a driver of demand, although those efforts were not even across all countries. The outcome has been better fiscal performance on the whole, with estimates for 2011 indicating that the region will return to a primary balance near equilibrium (-0.1% of GDP).

However, even with the improved health of public accounts, the fiscal policy space for managing revenue, spending and public debt has been critically diminished by the crisis, as can be seen in figure I.28. While the period 2003-2007 saw a solid expansion of the fiscal space thanks mainly to higher revenue flows and lower debt levels, spending increases and revenue dips during the crisis caused the fiscal space to shrink, and that space was not regained in 2010.

Figure I.28
**LATIN AMERICA (19 COUNTRIES): VARIATION IN FISCAL SPACE
 (REVENUE, EXPENDITURE AND CENTRAL GOVERNMENT DEBT),
 2003-2007 AND 2007-2010^a**



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

^a The triangles represent the fiscal space in direct proportion to disposable income and inverse proportion to expenditure and debt.

At the central government level, the region ran a primary deficit of 0.4% of GDP in 2010 (measured as a simple average), compared with a deficit of 1.1% in 2009; in terms of the overall balance (that is, including debt service payments), the deficit narrowed from 2.9% to 2.0% of GDP. In 2010, half the Latin American countries reviewed ran a primary surplus, while in the period 2003-2008 an average of 15 (nearly 80% of the total) had done so.

Table I.6

LATIN AMERICA AND THE CARIBBEAN: CENTRAL GOVERNMENT FISCAL INDICATORS, 2007-2010
(Percentages of GDP at current prices)

	Primary balance				Overall balance				Public debt ^a									
									Central government					NFPS ^b				
	2007	2008	2009	2010	2007	2008	2009	2010	2006	2007	2008	2009	2010	2006	2007	2008	2009	2010
Latin America and the Caribbean^c	1.8	1.3	-1.0	...	-0.8	-1.3	-3.4	...	53.7	47.3	46.1	49.1	...	...	...	...	...	...
Latin America^c	2.2	1.2	-1.1	-0.4	0.2	-0.5	-2.9	-2.0	35.9	30.0	28.6	30.0	29.5	40.7	33.6	32.1	33.6	32.8
The Caribbean^c	1.4	2.0	-0.6	...	-2.0	-2.1	-4.0	...	79.7	72.6	71.8	79.3	...	...	...	...	...	...
Argentina	2.7	2.8	1.4	1.5	0.6	0.7	-0.8	-0.1	63.6	55.7	48.5	48.5	45.1	76.3	66.7	57.8	57.7	52.0
Bolivia (Plurinational State of) ^d	3.5	0.8	0.4	1.4	2.3	0.0	-1.1	-0.1	49.6	37.1	34.0	34.5	34.5	52.4	40.0	36.8	37.6	38.1
Brazil	2.2	2.4	1.3	2.2	-1.9	-1.2	-3.5	-1.0	31.0	30.7	24.0	29.3	27.6	47.0	45.1	38.5	42.8	40.7
Chile	8.8	4.8	-4.0	0.1	8.2	4.3	-4.5	-0.4	5.3	4.1	5.2	6.2	9.2	10.6	9.1	12.0	12.9	15.8
Colombia	0.8	0.6	-1.1	-1.1	-2.7	-2.3	-4.1	-3.8	37.5	32.9	33.2	34.7	34.8	47.4	43.8	42.6	44.8	45.9
Costa Rica	3.7	2.4	-1.3	-3.1	0.6	0.2	-3.4	-5.3	33.3	27.6	24.9	27.5	29.6	38.4	31.8	29.9	34.1	36.2
Cuba	-1.8	-5.5	-3.8	-2.1	-3.2	-6.9	-4.8	-3.4	...	...	...	...	...	...	...	...	...	...
Dominican Republic	1.4	-1.9	-1.6	-0.6	0.1	-3.5	-3.5	-2.5	20.4	18.4	24.4	28.0	28.2	...	19.0	25.3	28.6	29.2
Ecuador	1.9	0.3	-4.2	-2.1	-0.1	-1.1	-5.1	-3.0	29.5	27.7	22.9	18.2	22.4	32.0	30.2	25.0	19.6	23.5
El Salvador	2.3	1.8	-1.2	-0.4	-0.2	-0.6	-3.7	-2.7	37.7	34.9	34.4	42.6	43.0	39.9	37.0	36.9	45.2	45.6
Guatemala	0.0	-0.3	-1.7	-1.8	-1.4	-1.6	-3.1	-3.3	21.7	21.3	20.1	23.0	24.2	21.9	21.6	20.4	23.3	23.7
Haiti	-1.3	-1.0	-0.8	-0.1	-1.6	-1.3	-1.3	-0.6	36.2	33.6	42.3	34.4	20.5	38.7	35.9	44.5	35.0	20.9
Honduras	-2.4	-1.9	-5.5	-3.8	-3.1	-2.5	-6.2	-4.8	28.7	17.4	20.1	24.5	30.0	30.0	18.3	19.0	22.9	25.4
Mexico	-0.5	-0.2	-0.5	-1.2	-1.9	-1.6	-2.2	-2.7	20.6	20.9	24.4	28.1	27.5	22.6	22.7	26.9	34.9	34.0
Nicaragua	1.9	0.0	-0.9	0.5	0.4	-1.2	-2.3	-1.0	69.5	42.7	38.2	43.6	44.5	70.0	43.5	39.3	44.8	45.6
Panama	4.6	3.4	1.4	0.1	1.2	0.3	-1.5	-2.7	60.3	52.3	44.8	44.9	46.0	61.0	52.9	45.4	45.6	46.7
Paraguay	1.8	3.1	0.7	1.8	1.0	2.5	0.1	1.4	26.0	18.6	15.9	16.1	15.5	27.6	22.2	19.2	18.8	16.3
Peru	3.4	3.6	-0.4	1.1	1.8	2.2	-1.7	0.0	30.1	26.2	24.1	23.4	21.3	31.3	27.2	24.5	23.8	21.7
Uruguay	2.1	1.7	1.3	1.2	-1.6	-1.1	-1.5	-1.1	57.8	49.0	47.7	43.6	38.7	61.1	52.2	51.1	47.7	42.6
Venezuela (Bolivarian Republic of)	4.5	0.1	-3.7	-2.4	3.0	-1.2	-5.1	-3.7	24.1	19.1	14.2	18.4	18.4	24.1	19.1	14.2	18.4	18.4

Table I.6 (concluded)

	Primary balance				Overall balance				Public debt ^a									
									Central government									
	2007	2008	2009	2010	2007	2008	2009	2010	2006	2007	2008	2009	2010	2006	2007	2008	2009	2010
The Caribbean^e																		
Antigua and Barbuda	-2.7	-3.2	-7.8	1.3	-5.6	-5.9	-10.6	-1.1	90.5	79.7	80.1	92.8	82.6	...	...	...	...	...
Bahamas	0.6	-1.0	-0.9	0.4	-1.2	-2.9	-3.2	-2.8	32.8	35.1	36.6	...	...	...	...	...	...	...
Barbados ^d	2.3	-0.2	-4.0	-2.4	-1.6	-5.1	-9.4	-8.1	79.0	84.0	88.0	101.7	...	...	...	...	...	...
Belize	0.7	5.4	0.8	1.9	-1.2	1.5	-2.9	-1.5	93.5	89.1	83.1	87.2	98.3	...	...	...	...	...
Dominica	1.6	-0.7	-1.0	3.0	-0.9	-2.6	-2.1	1.4	89.4	80.2	71.7	68.6	72.8	...	...	...	...	...
Grenada	-3.7	-3.4	-2.8	0.2	-5.3	-5.0	-5.0	-1.7	87.5	83.4	79.3	91.7	93.0	...	...	...	...	...
Guyana	-2.8	-2.1	5.1	6.5	-4.5	-3.8	-3.7	-3.0	155.3	98.8	103.7	115.2	...	...	...	...	...	...
Jamaica	7.2	4.9	6.2	4.4	-4.2	-7.4	-11.1	-6.0	55.9	53.9	48.7	54.2	64.7	...	...	...	...	...
Saint Kitts and Nevis	4.7	6.5	6.1	3.0	-1.9	-0.3	-0.6	-4.2	149.5	141.5	134.5	145.3	156.3	...	...	...	...	...
Saint Vincent and the Grenadines	0.0	1.8	0.0	-0.8	-2.5	-0.6	-2.6	-3.5	62.3	55.5	58.1	62.2	63.8	...	...	...	...	...
Saint Lucia	0.9	2.6	0.8	2.2	-2.0	0.0	-2.2	-0.6	65.3	66.9	64.8	66.3	71.7	...	...	...	...	...
Suriname	5.7	5.8	8.1	-5.6	8.0	2.3	3.7	-14.7	37.0	28.5	25.2	25.0	21.0	...	...	...	...	...
Trinidad and Tobago	6.9	8.8	-3.2	...	4.9	7.1	-6.0	...	16.8	16.8	14.5	19.0	...	...	...	...	...	...

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

^a At 31 December each year, using the average exchange rate applicable to external debt at the end of the period.

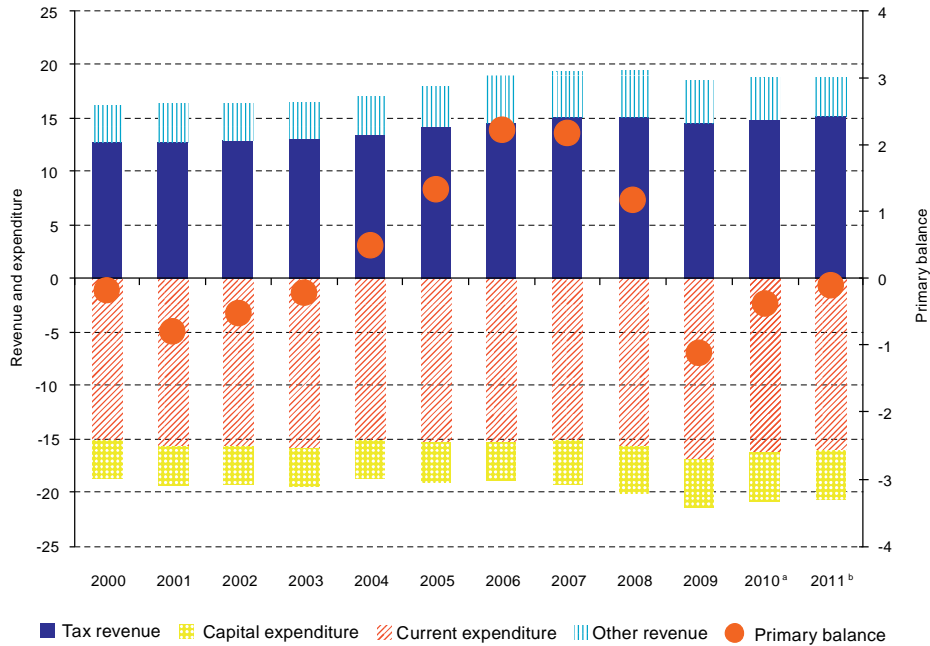
^b Non-financial public sector.

^c Simple average.

^d General government.

^e Fiscal years.

Figure I.29
LATIN AMERICA AND THE CARIBBEAN: THE PUBLIC ACCOUNTS, 2000-2011
(Percentages of GDP)



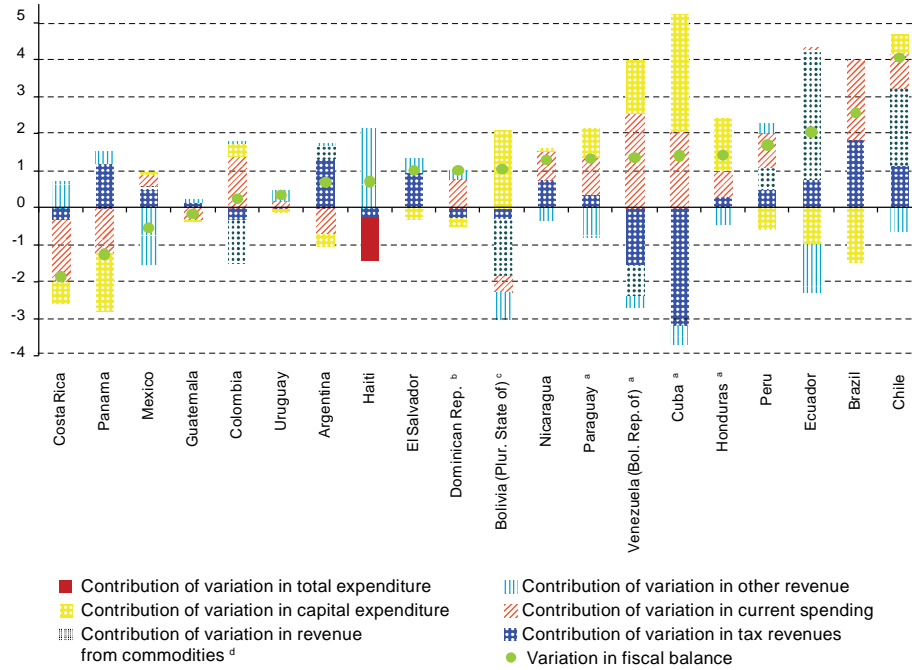
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Estimate.

^b Projection.

Underlying the general performance of the region's public accounts are differing patterns in the countries (see figure I. 30). As indicated earlier, the countries of South America—for the most part commodity exporters that grew above the regional average— posted a significant increase in tax revenue (except for Colombia, the Plurinational State of Bolivia, Uruguay and, especially, the Bolivarian Republic of Venezuela), and that was the main factor behind the improvement in the public accounts. In most cases, higher revenue flows were accompanied by a drop in current spending as a percentage of GDP (Argentina and the Bolivarian Republic of Venezuela being the exceptions). Mexico and the Central American countries saw much weaker fiscal revenue flows; in half of those economies (Costa Rica, Guatemala, Mexico and Panama) the public accounts worsened, while the others witnessed some improvement (Cuba, Dominican Republic, El Salvador, Honduras and Nicaragua) but not on a level comparable to South America and mainly as a result of lower spending.

Figure I.30
LATIN AMERICA (19 COUNTRIES): CONTRIBUTION OF REVENUE AND EXPENDITURE VARIATIONS TO VARIATION IN OVERALL BALANCE, 2009-2010^a
(Percentages of GDP)



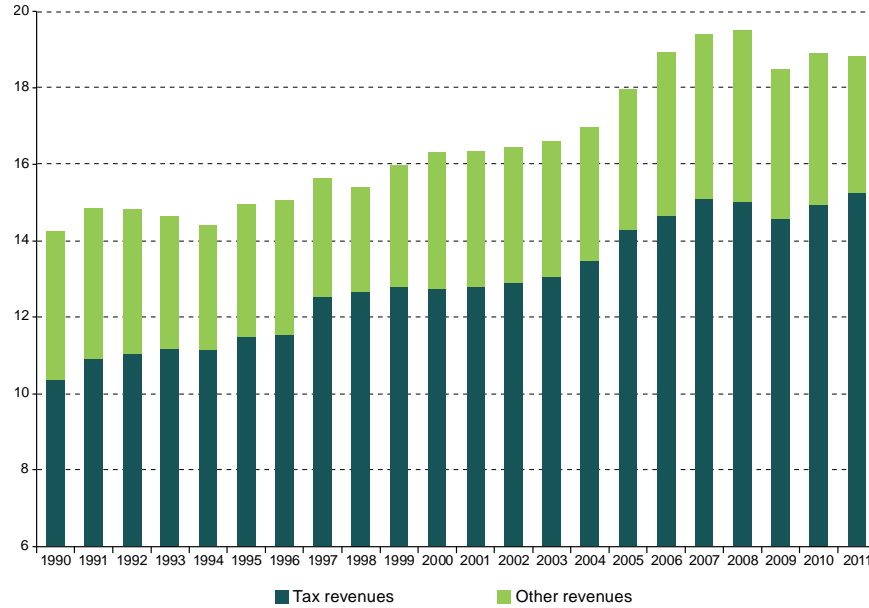
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

- ^a Total expenditure does not include net lending.
^b The overall balance includes statistical discrepancies.
^c General government.
^d Includes both tax and non-tax revenue from commodities.

Renewed economic growth in 2010 enabled the region to bring in an average tax take equivalent to 14.9% of GDP, which was still below the historic high of 15.1% recorded in 2007. Tax collection levels in a full 50% of the countries have already returned to the levels preceding the 2008-2009 crisis, although clear variations in tax revenue trends can be observed in the period 2007-2010.

A look at quarterly performance of tax revenues in some countries of the region over 2009-2011 shows an across-the-board recovery beginning in the fourth quarter of 2009. That recovery gained strength throughout the first three quarters of 2010 but lost steam in the fourth quarter, except in Argentina and Colombia.

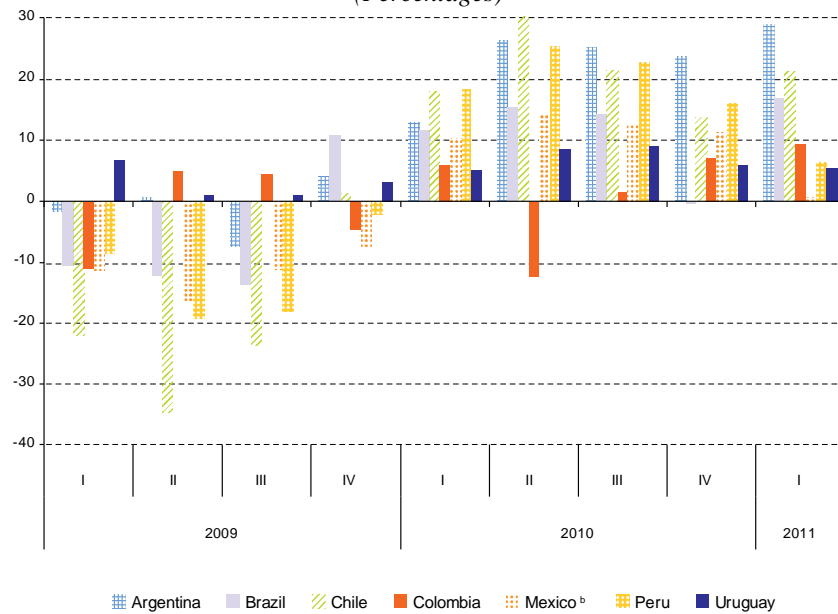
Figure I.31
LATIN AMERICA AND THE CARIBBEAN (19 COUNTRIES): CENTRAL GOVERNMENT REVENUES, 1990-2011^a
(Percentages of GDP)



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

^a Data for 2011 are projections.

Figure I.32
LATIN AMERICA (SELECTED COUNTRIES): REAL-TERM YEAR-ON-YEAR QUARTERLY VARIATION IN TAX REVENUE, EXCLUDING SOCIAL SECURITY, 2009-2011^a
(Percentages)



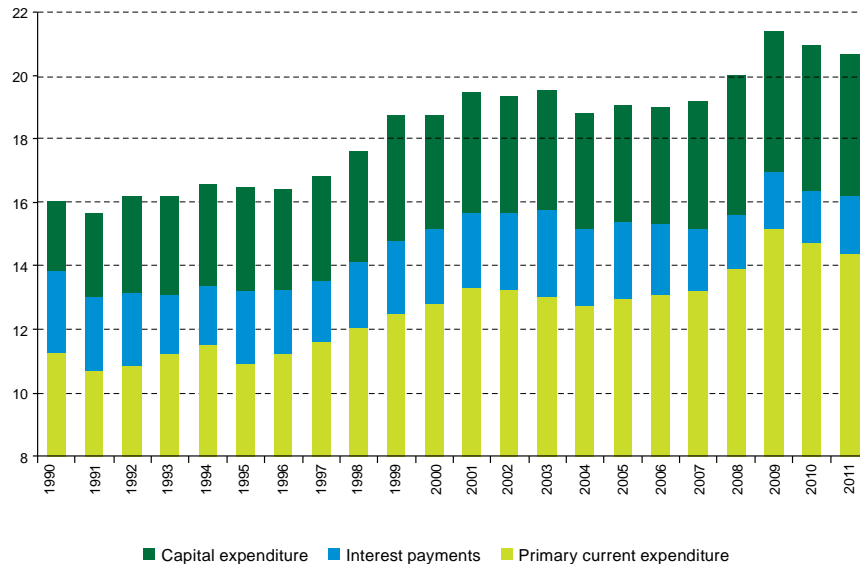
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Data for 2011 refer to first quarter only.

^b Includes non-petroleum tax revenues.

In 2010, fiscal spending was reduced by just under 0.5 percentage points of GDP, with 13 of the 20 countries examined reporting spending cuts. Nearly all countries of the region curtailed their current expenditure, while increasing capital spending. The regional average shows a drop in current spending of 0.6 percentage points of GDP and an uptick in capital expenditure of nearly 0.1 percentage points of GDP. Primary current expenditure was down by approximately 0.4 percentage points of GDP.

Figure I.33
LATIN AMERICA: CENTRAL GOVERNMENT EXPENDITURE, 1990-2011^a
(Percentages of GDP)



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

^a Does not include Cuba. Data for 2011 are projections.

The region's level of public spending at year-end 2010 was 1.8 GDP percentage points above the 2007 level. The increase stemmed from a large rise in primary expenditure (2.1 percentage points of GDP), which offset the drop in interest payment outlays during the period (0.3 percentage points of GDP). Of the 20 countries examined, five reported expenditure 3 percentage points of GDP higher than in 2007. The countries with the largest increases were Ecuador (9.5 percentage points of GDP), Argentina (5.3 points), Costa Rica (4.9 points), Panama (4.8 points) and Chile (4.7 points). The countries in which interest payments dropped the most were Brazil, Costa Rica, Ecuador, Panama and Uruguay, all with reductions of around 1 percentage point of GDP. Conversely, the Plurinational State of Bolivia, Honduras and the Dominican Republic saw interest payment increases of 0.2, 0.3 and 0.6 percentage points of GDP, respectively, during the period. The region's current expenditure rose on average by more than 1 percentage point of GDP but interest payments contracted slightly, so primary current spending was up by around 1.5 percentage points. Capital expenditure rose by 0.5 percentage points of GDP approximately.

In summary, following the deterioration observed in 2009, the countries of the region are slowly recreating their fiscal space through higher fiscal revenue inflows, steady spending levels in GDP terms and lower debt-to-GDP ratios. The strategies for expanding that space will vary from one country to the next: in some countries, the authorities should focus on strengthening a weak tax burden; in others (those having more robust revenue structures), efforts should focus on containing the expansion of current public spending. In some Caribbean countries, the recurring issue of public debt sustainability will need to be addressed.

3. Summary and outlook

Beginning in the second half of 2009, the Latin American and Caribbean region has been recovering steadily from the fallout of the global crisis and —thanks to rising domestic and external demand— it is today growing at rates considered relatively high for its economic history. The region is expected to grow by 4.7% in 2011 and by 4.1% in 2012, but that growth will take place in a setting of mounting uncertainty brought about by the external context, as will be discussed below. World economic growth, especially in developing countries, has resulted in significantly improved terms of trade, especially in the majority of South American economies, in some Caribbean economies similarly specialized in commodity production and export and, to a lesser extent, in Mexico. In Central America and most of the Caribbean economies, however, the opposite effect is observed because of their position as net importers of commodities.

Abundant liquidity in the global economy coupled with low relative risk levels in the region have opened access to international financial markets for both the public and private sectors. This has fuelled credit expansion in the region and spurred domestic demand for consumption and for investment. The clear improvement in labour market indicators driven by the economic recovery is an additional key element that explains in part why private consumption has remained so buoyant.

These developments all evolved within a framework that is still marked in some cases by a strong presence of public policies implemented to mitigate the effects of the crisis, although some governments have announced plans to dismantle these measures. For instance, while it is true that public spending has been gradually declining since 2009 (as a percentage of GDP), the projected levels for 2011 are still above pre-crisis levels.

Higher commodity prices (in particular for foodstuffs and fuel) are combining with robust domestic demand to exert upward pressure on the inflation rate. The region's central banks thus once again face the dilemma of whether to focus on price stability or on attempting to defend the competitiveness of sectors that produce exportable goods and import substitutes, at a time when the mix of available international liquidity, the solidity of some Latin American economies and renewed appetite of foreign investors for assets in emerging countries is translating into strong pressure towards exchange-rate appreciation in the region.

Although, this topic will be examined in greater detail in the second part of this study, it is worth noting here the challenges posed in terms of macroeconomic policy design. First, bearing in mind that the recent price increases were triggered by a supply shock and that the demand for goods such as foodstuffs and fuels is relatively inelastic, monetary policy loses effectiveness as an inflation-fighting instrument, although it achieves the objective of allaying fears of further price hikes. Interest rate hikes, however, tend to widen the spread between domestic rates in the region and the rates prevailing on the financial markets of the developed economies. Capital inflows are thus attracted to the region, with the ensuing pressure towards currency appreciation in the foreign-exchange markets. Currency appreciation has a deflationary effect whose magnitude depends on the share of tradable goods in the household consumption basket, by which it alleviates inflation. In the short term, capital inflows also expand the credit available for sustaining domestic demand and even help to alleviate poverty: as consumption by the poorer strata is food-intensive, the relative price of foodstuffs should normally fall hand in hand with a falling real exchange rate. It is an anti-inflation strategy that appears to have no costs, and that is why economic authorities often cannot resist allowing some measure of appreciation.¹⁴

¹⁴ See ECLAC, *Preliminary Overview of the Economies of Latin America and the Caribbean*, 2010 (LC/G.2480-P), Santiago, Chile, December 2010.

The foregoing notwithstanding, the situation poses a series of risks and issues for the short term as well as with regard to growth prospects. For instance, the region could become vulnerable to speculative capital movements looking for very short-term gains, compounded by the fact that the resources flowing in often exceed financial system capacity and can create bubbles in financial asset prices and real estate markets.¹⁵ At the same time, that capital can leave from one moment to the next, severely disrupting growth; this topic will be addressed in greater depth below.

A falling real exchange rate can impact the external component of the demand for goods, especially if world trade were to slow down, as could happen if growth in the developed nations stalls as is forecast for mid-2011. While there is no cause for immediate concern, the region's balance-of-payments current account has been deteriorating systematically since 2006, including during times of very favourable terms of trade for the region. As can be seen in box I.3, the region's current account estimated on the basis of international trend prices yields a higher deficit than the actual one, but financing of that deficit would pose no problem.

At the same time, excess global liquidity is pushing real exchange rates down and commodity prices up, acting as an incentive for intensive specialization in the production and export of primary goods. As indicated earlier,¹⁶ this makes the region's economies more vulnerable to external shocks and generates greater volatility in internal macroeconomic aggregates, such as investment; the overall impact is to stunt economies' ability to grow, create productive employment and reduce inequality.

Economic authorities across the region have tackled these complex macroeconomic policy dilemmas by launching measures that combine, to varying degrees, partially sterilized interventions in foreign-exchange markets and specific controls on capital inflows and financial regulations aimed at boosting demand or curbing the supply of foreign exchange on stock markets, thus alleviating pressure on currency prices. The effectiveness of the measures ultimately adopted, however, will hinge on the immediate macroeconomic policy context. For instance, as will be seen in detail below, these measures will produce greater impact if they are coordinated with fiscal policy measures to spur public sector savings, as that would reduce exchange-rate and inflationary pressure.

The situation described is not without its risks but those risks will not prevent the region from growing throughout 2011 and, it is expected, into 2012. The rate of growth, however, will likely approach a level closer to potential GDP. Much will depend on the progress made in resolving some uncertain situations, in particular in the developed economies. For instance, the United States economy has been recovering more slowly than expected, as reflected not only in data on level of activity but also in labour market indicators and real-estate market performance. Ongoing problems at some banks, households' inability to shake off debt and the overall slow pace of the recovery are all elements that impinge on financial activity and conspire against the strategy of fostering growth through monetary policy; at the same time, budget deficits and high levels of indebtedness undermine the effectiveness of fiscal policy measures.¹⁷

¹⁵ See Nicolas Magud, Carmen Reinhart and Kenneth Rogoff, "Capital controls: myth and reality. A portfolio balance approach", *NBER Working Papers*, No. WP11-7, Peterson Institute for International Economics, 2011.

¹⁶ See R. Frenkel and M. Rapetti, "Fragilidad externa o primarización: ¿cuál es la principal amenaza para América Latina?", Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2011, unpublished.

¹⁷ See James Mason and others, *Central Bank Watch: The Shifting Tides of Global Monetary Policy*, Roubini Global Economics (RGE), June 2011.

Box I.3

LATIN AMERICA'S CURRENT ACCOUNTS AT TREND PRICES

From 2003 to 2007, Latin America experienced an unprecedented current account surplus that averaged 1% of GDP. With the onset of the international financial crisis at the end of 2008, the region's external balance turned negative, averaging a deficit of 0.8% of GDP during 2008-2010, in particular owing to the decline in the trade balance. Since the period under consideration coincided with a steady rise in the price of commodities, which make up a significant portion of the region's exports, it is worth asking how the current account balance would look, if measured at trend prices for commodities.

To this end, a matrix was prepared containing the main commodities exported by Latin American countries^a and their respective international prices. The trend prices were obtained using 10-year moving averages.^b Then, the ratio between the trend price and the actual price is used as the adjustment factor applied to export items.^c For the sake of consistency, the adjustment is applied to both commodity exports and imports, the latter consisting mainly of oil and petroleum products. Given the positive and significant correlation between commodity exports and profit remittances from foreign direct investment (which shows as a debit on the income account), this component of the income account was also adjusted using the same factor.

In addition, given that the adjustment of exports and imports does not produce a symmetrical outcome, the net balance of the trade adjustment will generate an identical movement in GDP. Therefore, the current account balance in relation to GDP should be calculated as a proportion of this "corrected" GDP. Indeed, given that the demand for imports is a component of GDP, GDP must be adjusted to be consistent with adjusted imports, in line with their income elasticity.^d Intuitively, if the region had not benefited from the very high export prices of the last few years, its disposable income would have been decidedly lower, as would its demand for imports^e

Table 1 shows the long-term income elasticity of imports for 10 countries, and for the region overall (average for 19 countries).^f The estimates were calculated using annual data from the period 1980-2010. There is a significant dispersion in the long-term elasticities for each country, which vary from 1.3 to 1.4 in countries such as Chile, Peru and the Plurinational State of Bolivia, to above 3 in Brazil and Mexico. The aggregate for 19 countries in the region was 2.5.

Figure A shows the results of the adjustment for the regional aggregate (19 countries). At the regional level, the external balance is seen to be sustainable, since, measured at trend prices, the region would still have posted a slight current account surplus for 2003-2007 (an average of 0.1% of GDP). The reversal of the external balance during the international financial crisis —i.e. an external deficit at trend prices— peaked at 1.9% of GDP in 2008 and eased back to 1% in 2009; these figures are compatible with the region's capacity to sustain net inflows of capital. In fact, during 2003-2010, the regional capital account averaged a surplus (net inflows) of 1.4% of GDP and, in particular, the net inflow of FDI averaged 1.9% of GDP (net portfolio investment: 0.5%; other net investment: -1%). In 2010, once the crisis was over, Latin America's current account, measured at trend prices, posted a deficit of 1.8% of GDP (an effective deficit of 1.2%), while the capital account ran a surplus of 3.1% of GDP, with FDI making up 1.4% (net portfolio investment: 2.2%; other net investment: -0.5%).^g

Of course, the outcome of this exercise differs at the country level. Figure B shows the specific results for selected countries. Of the four countries that posted an actual surplus on their current account in 2010 —Argentina (1% of GDP), Bolivarian Republic of Venezuela (3.7%), Chile (1.9%) and Plurinational State of Bolivia (4.6%)— all except for the Plurinational State of Bolivia recorded a deficit measured at trend prices (-0.1%, -0.2%, -1.6% and 1.2%, respectively). The countries with the largest gap between their actual and corrected balances are, as may be expected, the exporters of hydrocarbons, particularly those for which this item represents a significant portion of the export basket, such as the Bolivarian Republic of Venezuela, Colombia, Ecuador and the Plurinational State of Bolivia. In Colombia and Ecuador, the actual current account deficit was 3% of GDP in 2010, but measured at trend prices, their deficits were larger: 4.2% and 4.7% of GDP, respectively.

The copper exporters, Chile and Peru, also had a wide gap, especially for 2006-2007, when the real price of the metal hit all-time highs. Brazil and Mexico showed the smallest gap between the actual and corrected current account balance, mainly because their export baskets are much more diversified than those of the other countries analysed. The downward adjustment of exports is offset in large part by the higher estimated income elasticity for both countries.

Box I.3 (continued)

Table 1
LATIN AMERICA AND THE CARIBBEAN (19 COUNTRIES): ESTIMATED INCOME ELASTICITY OF IMPORTS

	Argentina	Bolivia (Plurinational State of)	Brazil	Chile	Colombia	Ecuador	Peru	Uruguay	Venezuela (Bolivarian Republic of)	Mexico	Region
LM(-1)	0.57***		0.78***	1.09***	0.68***		0.45***	0.83***		1.02***	0.97***
LM(-2)										-0.43***	-0.14*
LPIB	3.53***	3.72***	2.49***	3.02***	2.82***	1.76***	1.65***	2.36***	2.91***	3.91***	2.89***
LPIB(-1)	-2.46***	-2.32***	-1.78***	-3.14***	-2.31***			-2.36***		-4.34***	-2.46***
LPIB(-2)							-0.91***	0.35*	-0.77***	1.95**	
LTCR	-0.34***		-0.30***	0.33*	-0.41**	-0.24**	-0.16**	-0.20**	-0.45***		-0.35**
LTCR(-1)		-0.25**		-0.50*				0.15*			0.23*
LTCR(-2)				0.24*	0.38***				-0.27**	-0.64*	
Significant at 1% (***), 5% (**) and 10% (*)											
GDP elasticity	2.5	1.4	3.2	1.3	1.6	1.8	1.4	2.1	2.1	3.7	2.5
Real Exchange-rate elasticity	-0.8	-0.3	-1.4	-0.8	-0.1	-0.2	-0.3	-0.3	-0.7	-1.6	-0.7

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

Note: LM, imports log; LPIB, gross domestic product log; LTCR, real exchange rate log.
 Dependent variable: log (imports). Method: least squares (Newey-West heteroskedasticity and autocorrelation consistent (HAC) standard errors). Sample: 1980-2010.

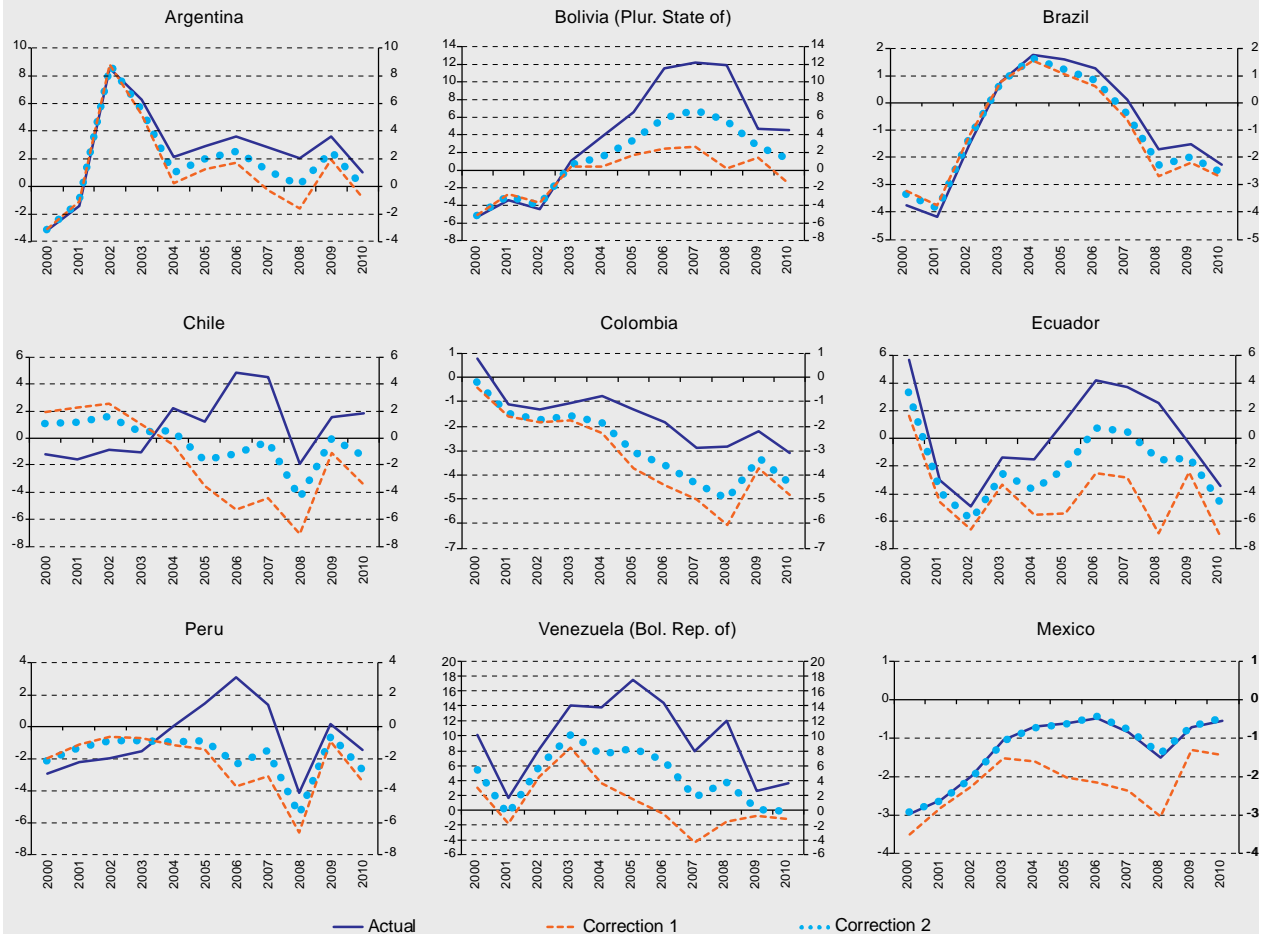
Figure 1
LATIN AMERICA AND THE CARIBBEAN (19 COUNTRIES): CURRENT ACCOUNT AT TREND PRICES, 2000-2010
 (Percentages of GDP)



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

Box I.3 (concluded)

Figure 2
LATIN AMERICA AND THE CARIBBEAN (19 COUNTRIES): CURRENT ACCOUNT
AT TREND PRICES, 2000-2010
(Percentages of GDP)



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

^a These products are wheat, corn, rice, soybean, copper, iron, steel, aluminium, silver, zinc, tin, nickel, lead, oil, coal and natural gas.

^b Similar results are obtained using the Hodrick-Prescott filter for the trend prices.

^c This adjustment reflects corrections in prices, not in volumes.

^d The income elasticity of imports is calculated as follows:

$$\beta = \frac{\partial \log M}{\partial \log PIB}$$

^e Of course, in seeking an overall balance, we could also consider a drop in private consumption and other effects. However, here we are focusing exclusively on correcting the elements that affect the current account.

^f The specification estimated using the ordinary least squares method in each case corresponds to constrained versions of:

$$\log M_t = c + \sum_{i=1}^2 \alpha_i \log M_{t-i} + \sum_{i=0}^2 \gamma_i \log PIB_{t-i} + \sum_{i=0}^2 \delta_i \log TCR_{t-i} + \varepsilon_t \sim N(0, \sigma^2) + \varepsilon_t$$

^g As part of the revenue relating to FDI includes profits that are reinvested, the FDI figure used for calculating the current account balance at trend prices could be lower than the observed figure.

Monetary stimuli will thus likely be maintained until the United States economy takes off again, and that will reinforce the generally gloomy forecast for global growth; it will also exacerbate the economic policy dilemmas facing the economies of the region, as discussed earlier.

Japan, for its part, continues to rebuild in the wake of the March 2011 earthquake (see box I.1) and it will grow very little in 2011 but —given the low basis for comparison— slightly more in 2012. The prolonged stagnation of the Japanese economy began with the crisis that rocked the country's banking system in the 1990s and for which a lasting solution has yet to be found.

This inauspicious outlook for growth in the developed economies is compounded by the situation in Europe, where the focus for the time being is on finding a solution to the Greek debt problem. Latin America's experience, the level of Greece's indebtedness and the severity of the fiscal adjustments needed to return the public debt to sustainable levels all point to the virtual inevitability of an across-the-board restructuring coupled with a hefty write-off. The European authorities have, however, thus far resisted this form of debt reduction, fearful of the possible contagion effect on other economies in difficult circumstances, including not just Ireland and Portugal but also Spain and Italy, despite the relative improvement seen in these countries recently.¹⁸

While that fear is not entirely unfounded, the economic history of Latin America and the Caribbean holds —as noted above— important lessons for what is happening in Europe these days. A write-off is inevitable, but it should be conducted in an orderly fashion rather than left to market pressures and a possible haphazard approach. The contagion effect in the latter case could be devastating and even become systemic.

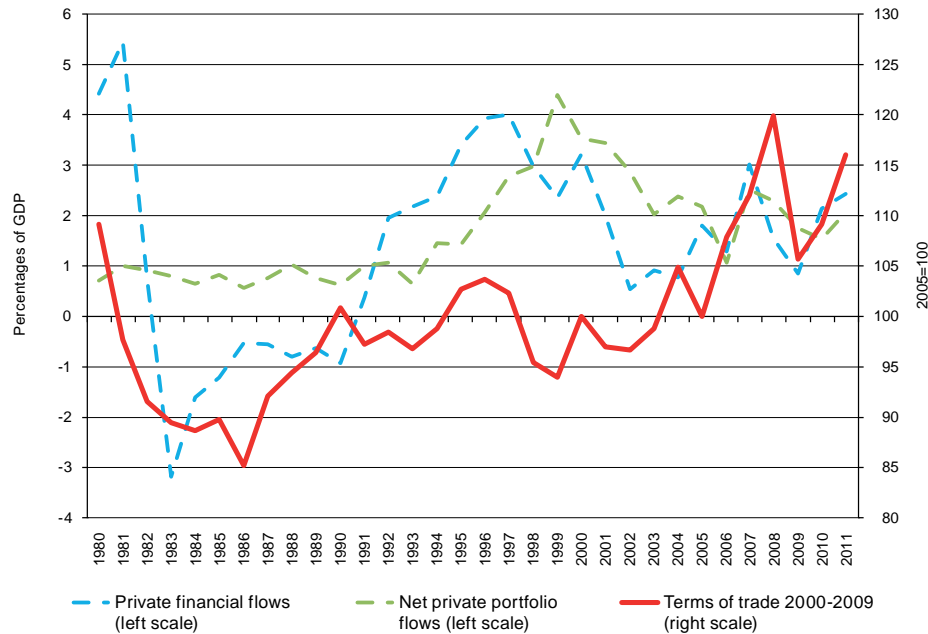
In the emerging economies, the outlook is somewhat brighter but the possibility cannot be ruled out that growing inflationary pressure in countries such as China, India and the Russian Federation, for instance, will lead to tighter monetary policy and, as a result, a slowdown in growth. That, in turn, would hamper the ability of those economies to sustain the growth in demand that is instrumental in correcting global imbalances.

Undoubtedly, there are a myriad of factors at play —slowdown of world economic growth, gradual absorption of available global liquidity and a higher risk component in financial assets, especially (but not only) of some European sovereign debt— that could culminate in a “flight to quality”. That would mean, as borne out in the recent crisis, greater demand for dollar-denominated assets and a sudden reversal in capital flows.

However, such a scenario does not appear imminent, although it could come to pass sooner rather than later depending on how the European debt problem is handled. The bad news is that the economic history of Latin America and the Caribbean clearly shows that reversals in capital flows rarely occur in isolation; rather, they are often accompanied by drops in international commodity prices and, consequently, a deterioration in the region's average terms of trade, as can be seen in figure I.34. In this regard, Mexico and some South American economies are much more vulnerable to such a turn of events than the majority of the economies of Central America and the Caribbean, which are net commodity importers and do not enjoy open access to international financial markets.

¹⁸ See Eduardo Levy Yeyati, “Grecia, entre la negación y la reprogramación inútil”, 20 May 2011 [online] <http://yeyati.blogspot.com/>.

Figure I.34
LATIN AMERICA: CAPITAL FLOWS AND TERMS OF TRADE, 1980-2011
(Percentages of GDP)



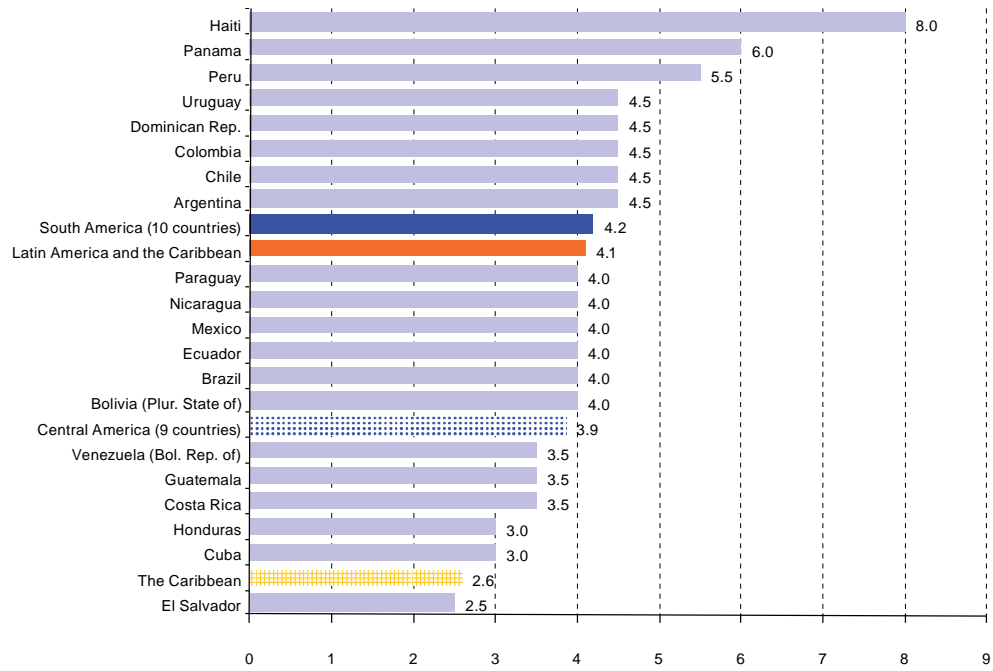
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Inasmuch as net outflows of capital usually occur in parallel with a deterioration in the terms of trade, any further worsening on the international financial markets could create pressure on the region's external accounts, in both its current and the capital components. If, and it is possible this will be the case, the scenario is compounded by a slowdown in growth and, by extension, a dropoff in trade, the most prudent recommendation would be that the region's economies should prepare themselves as best they can to pursue a countercyclical strategy in a context of less abundant foreign exchange.

Again, the risks are not imminent but the situation does need to be taken seriously. That means tapping the current favourable conditions to accumulate international reserves and generate public sector savings in order to reclaim the policy space lost during the crisis. Controls or limits on short-term capital inflows would also help to make economies less vulnerable. These recommendations are compatible with the need to contain the currency appreciation referred to earlier. The instruments available to the region's economic authorities to defend, to the extent possible, levels of competitiveness with longer-term objectives could also promote macroeconomic equilibria and counteract the volatility that has been a chronic feature in Latin America and the Caribbean.

In sum, rebuilding fiscal space is of vital importance to the countries of the region, as it would underpin efforts to meet not only traditional public policy challenges (the need for greater investment in physical and social capital) but also other challenges emerging on the international stage. In addition, with higher levels of public sector savings, monetary policy could be relaxed, thus alleviating the tension between anti-inflationary and exchange-rate strategies.

Figure I.35
LATIN AMERICA AND THE CARIBBEAN: GDP GROWTH, 2012



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

STATISTICAL ANNEX

