Latin America and the Caribbean: Still Losing Speed

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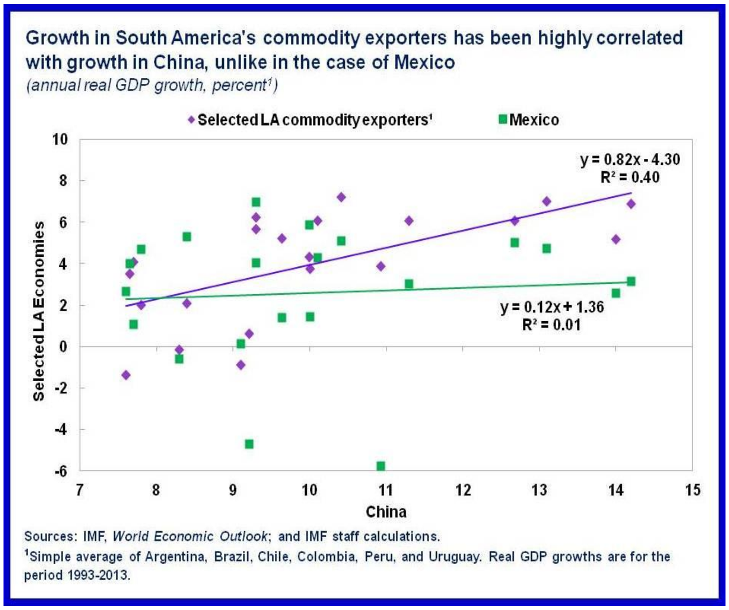
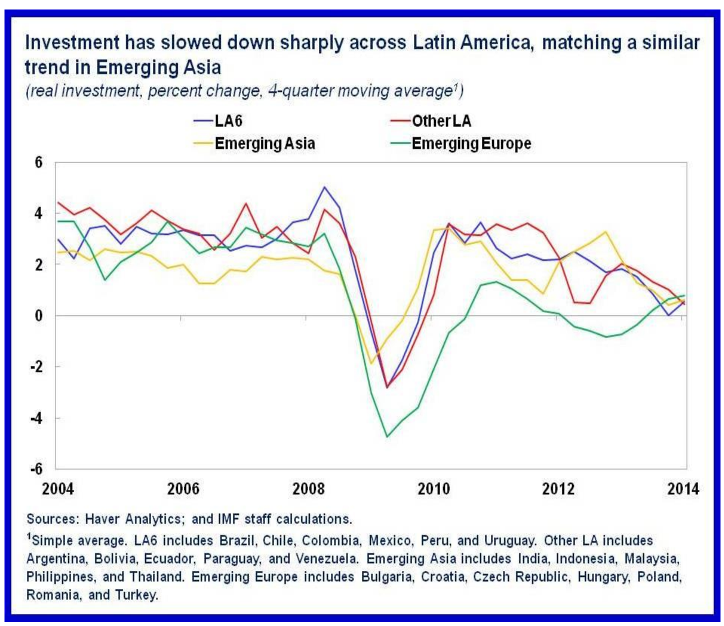
Following nearly a decade of rapid growth between 2003–11, Latin America and the Caribbean has decelerated over the past three years. The slowdown has intensified further in recent months, as growth in several economies came to an effective standstill in the first half of this year. Why has this happened? And what is needed to get the region up to speed again?



The upcoming Annual Meetings of the IMF and World Bank will provide an opportunity to discuss these issues in detail. Today's blog foreshadows some of the key themes I will be talking about during my press conference on Friday, October 10 when we release our latest *Regional Economic Outlook for the Western Hemisphere*. Hope you tune in to the webcast at imf.org.

Brakes on growth

The brakes that have held back activity in the region appear to be partly external (as favorable tailwinds have turned into headwinds) and partly domestic (as the engines of growth have started to sputter).

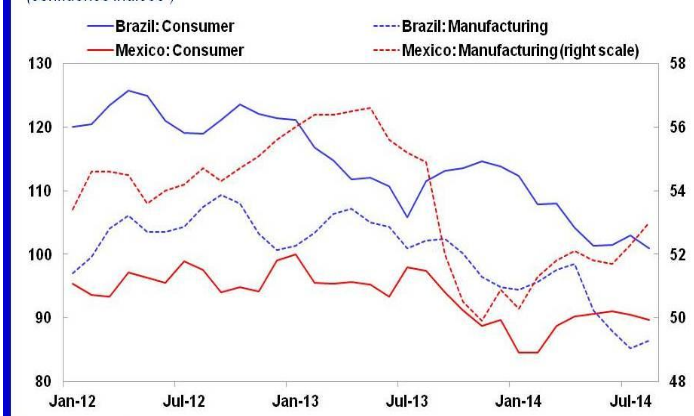


On the external side, important trading partners have not been growing as fast as before—and indeed less than previously projected. In particular, slowing demand from China, along with a rise in global supply, has caused an eight-year boom in commodity prices to taper off since mid-2011. For South America's commodity-exporting economies, the end of the boom has removed an important positive impulse (as analyzed in Chapter 4 of the *April 2014 Regional Economic Outlook for the Western Hemisphere*). The result has been a marked downturn in investment and growth across the region.

Meanwhile, the recovery in the U.S. economy has taken longer than expected to materialize, delaying positive spillovers to Mexico and other economies with close U.S. ties. The latest data suggest that solid U.S. growth is finally becoming entrenched, but this has not been sufficient—and most likely will not be sufficient going forward—to outweigh the weakness in much of South America, which is less closely linked to the U.S. economy.

Beyond external headwinds, domestic factors have also acted as a brake on growth. For one thing, many economies in Latin America reached their productive capacity limits in recent years, as strong growth during the boom years had driven unemployment to historic lows and exposed serious bottlenecks in infrastructure and human capital. Without improvements to productivity and the capital stock, it will be difficult to rekindle strong growth going forward. What's more, economic policy in some economies has recently contributed to uncertainty in the private sector, creating a wait-and-see attitude among investors. In some cases, like Mexico, the apparent source of uncertainty is a set of ambitious reform proposals that is very likely to pay off over the medium term. Thus, the short-term cost—in terms of subdued private spending while the reforms were being fleshed out—was well worth paying. In other cases, however, structural reform efforts have come to a halt, and policy appears to lack a clear sense of prioritizing sustainable growth, weighing on private sector confidence.

Private sector confidence remains very weak in Brazil, though it has recently ticked up in Mexico
(confidence indices¹)



Source: Haver Analytics.
¹Consumer confidence index for Brazil is a fixed base indicator with base year of 2001. For Mexico, base is January 2003. Manufacturing confidence for Brazil is positive (i.e., higher than the 1996-2005 historical average), if data is greater than 100.

The road ahead: uphill, with risks of slippery conditions

The outlook is likely to remain challenging. For example, if China were to decelerate more than currently projected, demand for Latin America's commodity exports would weaken further. Financial markets could also create slippery road conditions once again. For instance, volatility could spike and capital outflow pressures emerge if U.S. interest rates were to rise more abruptly than expected. Clearly, policymakers will need to keep their eyes closely on the road ahead and make sure the car is prepared for rougher terrain.

Tuning up the engines of growth

What else should countries do? External conditions are what they are and need to be taken as given.

What policymakers *can* influence is their economy's preparedness and capacity for sustained future growth. Improving the performance of education systems is one important priority in most countries in the region. Higher investment in infrastructure—within tight budgetary envelopes—will also be needed. In this context, improving the business environment is an important precondition for raising private investment, creating jobs, and boosting growth. Meanwhile, policymakers need to maintain the hard-won macroeconomic stability of the past decade, by ensuring sufficient fiscal buffers, preserving credible monetary frameworks, and containing risks in the financial system. With those conditions in place, the region will be able to ensure a smooth ride even on a more challenging road ahead.