



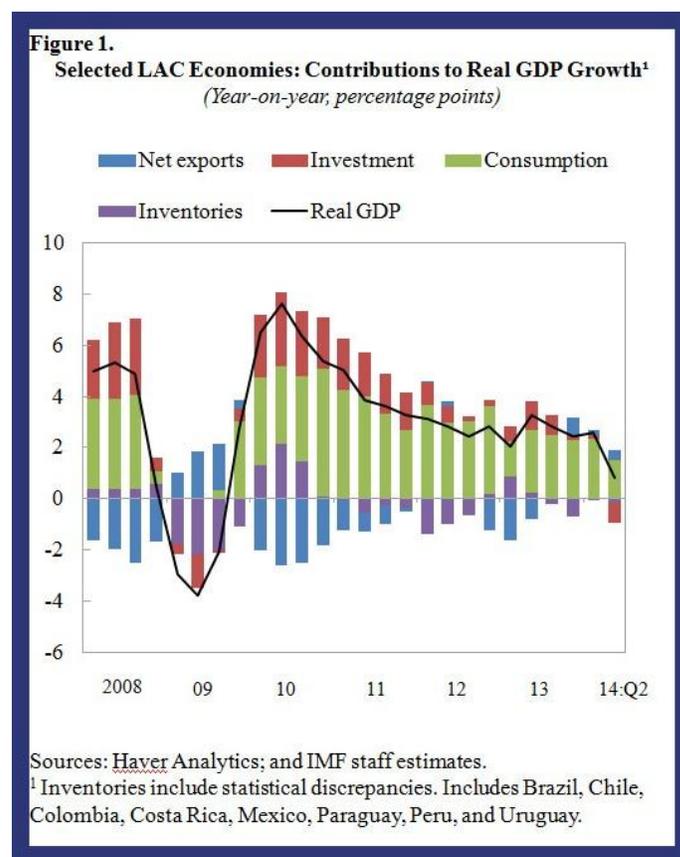
## Coping with Challenging Times—Outlook for Latin America and the Caribbean

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Economic activity in Latin America and the Caribbean has been losing steam ever since the peak of the commodity-led boom in 2011. The end of the bonanza in itself has not been unexpected—many observers sensed that regional growth of above 5 percent, as observed in 2010–11, could not possibly last. However, the extent of the slowdown over the past three years has caught almost everyone by surprise—and even more so during the first half of this year, when activity stagnated or even contracted in several large economies (Chart 1).

Our latest projections bear out the sobering news. Regional growth this year is now forecast at just 1.3 percent—the lowest rate in 12 years, with the exception of 2009, when the global financial crisis hit. For next year, we anticipate growth to rebound to 2.2 percent, but even this is only about half the average growth rate observed during 2003–11. How did the region's fortunes fade so fast? And what can be done to brighten the outlook again? These are two of the questions we address in our latest [Regional Economic Outlook Update](#), which was released today.



### Some recovery up North, broad weakness down South

The differentiated dynamics within the region provide some clues as to the sources of the slowdown. South America has decelerated the most in recent quarters; growth in Central America and the Caribbean is relatively steady; and Mexico is finally picking up pace. This pattern reflects opposing influences, both external and domestic:

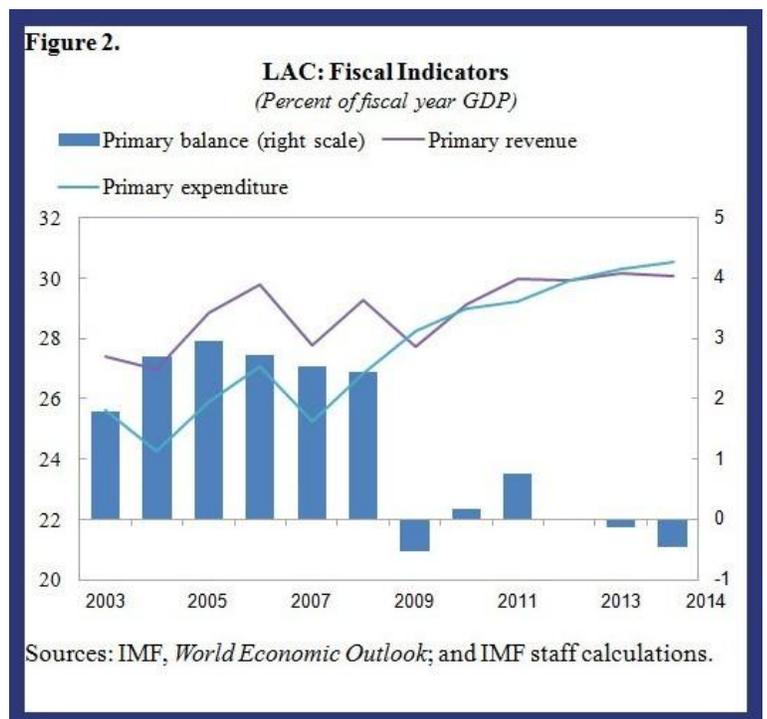
- The weakness in global commodity markets has clouded the outlook especially for South America, which depends significantly on commodity exports. Many economies that had grown particularly fast during the bonanza have recently flagged, amid disappointing investment and exports.

- The much-anticipated recovery in the U.S. economy appears to be finally taking hold but its positive impulse is mostly concentrated on Mexico and a few other close trading partners in Central America and the Caribbean. Meanwhile, the expected rise in U.S. policy rates is likely to bring higher external funding costs and greater volatility in financial markets for the region at large.
- These external influences are compounded by domestic factors, notably uncertainty about the direction and impact of economic policies. Mexico's broad reform package initially generated uncertainty but is very likely to boost growth over the medium term. This contrasts favorably with the outlook for countries where reform momentum has stalled, or where misguided policies have ratcheted up distortions and macroeconomic imbalances, Venezuela being among the most alarming examples.

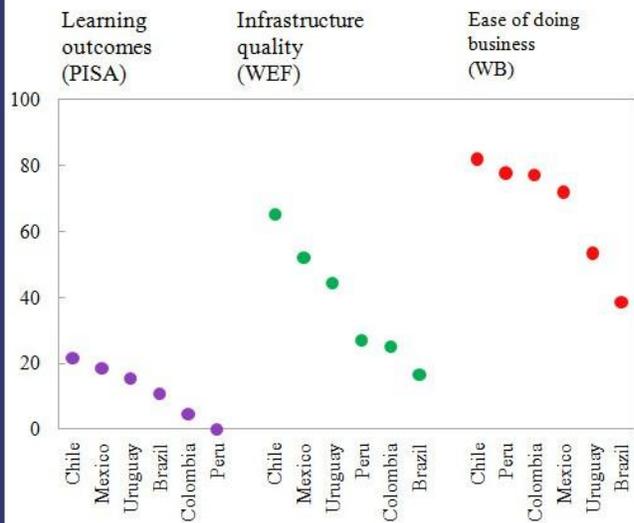
### Rising to the challenges

Where does this leave policymakers? Clearly, the overwhelming priority is to enable strong and sustainable growth without jeopardizing macroeconomic stability. In most of the region, supply-side bottlenecks (including deficient infrastructure and low human capital) are prominent and economic slack is limited, as witnessed by still-tight labor markets, above-target inflation, and persistent deficits in the external current account. This constellation calls for a clear and urgent focus on reforms to boost productivity and the capital stock:

- Most countries in the region need to address a long-standing problem of 'low saving, low investment, low productivity' that was masked by the commodity-related boom but has re-emerged as a serious brake on growth. The principal challenges include improving the region's deficient physical infrastructure, creating a better and more competitive environment for businesses to invest, and enhancing the performance of education systems so the gains from human capital are more widely spread (Chart 2).



- Demand-side policies, in turn, should remain anchored in a commitment to sound public finances, low inflation, and macroeconomic stability. This cautions against using fiscal stimulus where output is close to potential or fiscal buffers have already eroded significantly in recent years (Chart 3). Flexible exchange rates and—where inflation targets are credible—monetary policy are best suited to deal with adverse shocks. In countries with persistent macroeconomic imbalances, notably in the Caribbean but also in parts of Latin America, strict policy discipline is necessary to avoid disorderly dynamics.

**Figure 3.**
**LA6: Structural Performance Indicators<sup>4</sup>**  
*(Percentile ranks)*


Sources: OECD, *PISA (2012)*; World Bank, *Ease of Doing Business database (2013)*; World Economic Forum, *Global Competitiveness Report (2014–15)*; and IMF staff calculations.

<sup>4</sup> The scale reflects the percentile distribution in all countries for each respective survey; higher scores reflect higher performance; PISA: Program for International Student Assessment; WB: World Bank; WEF: World Economic Forum.

In sum, the bonanza has given way to challenging times, as policymakers need to confront slower growth amid still-tight supply constraints, weaker fiscal balances, and less favorable external conditions. These challenges underscore the need for much greater domestic policy efforts to restore strong and sustainable growth than were needed during the “good years.” With the right focus on structural reforms to boost productivity and investment, the region will be able to rise to the challenge.