Executive Summary

Global growth remained modest and uneven last year—amid further downgrades in medium-term growth forecasts and a sharp decline in the price of oil—and is projected to strengthen only gradually over the period ahead. Prospects for advanced economies have improved somewhat, as the U.S. economy is projected to maintain robust growth, while cheaper oil and weaker currencies should support recovery in the euro area and Japan. By contrast, growth is expected to ease in oil exporters and several major emerging market economies, including China. Risks around this global outlook have become more balanced, but key downside risks remain—including renewed geopolitical tensions, possible abrupt shifts in financial markets, and stagnation and low inflation risks in advanced economies.

In this global setting, Latin America and the Caribbean face a particularly challenging outlook, notwithstanding intraregional divergences broadly along north-south lines. Overall, growth is projected to decline for a fifth consecutive year in 2015, dipping just below 1 percent before staging a moderate recovery in 2016. Economic weakness is concentrated among South America’s commodity exporters, where falling global commodity prices have compounded country-specific challenges. Thus, output is set to contract this year in three of the largest economies in the south (Argentina, Brazil, and Venezuela), while only Chile and Peru are projected to see a pickup in growth. By contrast, most of Central America, the Caribbean, and Mexico are projected to experience steady or stronger growth, supported by lower oil bills for importers and robust economic recovery in the United States.

Despite the continued regional slowdown, economic slack remains limited, while medium-term growth expectations have continued to decline. Moreover, fiscal positions have weakened in most countries, cautioning against further fiscal expansion to boost growth. Flexible exchange rates can play a critical role in facilitating adjustment to more difficult external conditions. Importantly, policymakers will need to (1) ensure sound public finances, especially since downside risks to growth remain prominent; (2) keep financial sector vulnerabilities in check given that weaker earnings, tighter funding conditions, and a stronger U.S. dollar are testing borrowers’ resilience; and (3) tackle long-standing structural problems to raise investment and productivity.

• These broad policy priorities also apply to the financially integrated economies, although country circumstances require a tailored approach. Brazil is undergoing its most serious downturn in more than two decades but will need to persevere with recent policy efforts to contain the rise in public debt and rebuild trust in the macroeconomic policy framework. In Mexico, a moderate recovery is finally in prospect, which should facilitate the authorities’ plan to gradually reduce the budget deficit. Stronger initial fiscal positions will allow Chile, Colombia, and Peru to smooth the necessary adjustment of their economies to a weaker terms-of-trade environment.

• The collapse in oil prices has hit several of South America’s other commodity exporters hard, heightening the need for fiscal restraint, greater exchange rate flexibility, and broad improvements in governance and the business environment. Major policy changes are indispensable to arrest the economic crisis in Venezuela. In Argentina, foreign exchange pressures have eased recently, but economic distortions and imbalances call for policy adjustments to restore growth and stability.

• Central America’s economies should take advantage of the relief provided by cheaper energy imports to reduce fiscal vulnerabilities and strengthen the credibility of inflation-targeting regimes. Structural reforms remain indispensable to address supply bottlenecks and enhance the prospects for sustained and inclusive growth.
Similarly, the apparent recovery in the tourism-dependent Caribbean provides an opportunity to make headway toward strengthening competitiveness, reducing still-high external and fiscal deficits, and restoring stability to fragile financial systems.

This issue of the Regional Economic Outlook features three analytical chapters that examine core challenges surrounding the current downturn and growth outlook. Specifically, the analysis assesses the impact of lower commodity prices on fiscal and external positions in the region, the drivers of a marked slowdown in investment, and the role of economic diversification and complexity in shaping longer-term growth prospects. Key findings are:

- Given the prospects of persistently lower global commodity prices, several commodity exporters in Latin America are likely to experience a significant and durable drop in fiscal revenues, requiring some deliberate effort to reduce budgetary deficits. The deterioration in trade balances is likely to be relatively moderate and short lived. However, external adjustment typically does not appear to be driven by higher noncommodity exports, but rather by import compression, especially in countries with more rigid exchange rate regimes and low export diversification.

- Real investment across the region has slowed markedly since 2011, though developments to date have been consistent with historical patterns. Based on firm-level data, the sharp decline in commodity export prices stands out as the main driver of the investment slowdown in Latin America, although other standard determinants also play a role. Prospects for a stronger recovery will depend on policymakers making decisive progress in improving conditions for private investment.

- Economic diversification and complexity—relating to the range of products that a country produces and how sophisticated these products are—matter for long-term growth. However, Latin America and the Caribbean scores relatively low in both dimensions, with little progress made over the last decade. The key to improving longer-term growth prospects is to prioritize structural reforms and harness knowledge spillovers through greater openness, while preserving sound macroeconomic frameworks.