Growth projections for Latin America and the Caribbean have been revised down further—to 0.5 percent in 2015—marking the fifth consecutive year in which activity has decelerated.

Our last regional outlook in April 2015 focused on the differences along North–South lines, with strong economic activity in the North partially offset by weak growth in South America. The same forces broadly shape our updated outlook for the region.

However, weaker-than-expected U.S. growth at the beginning of the year has lowered growth prospects in Mexico, Central America, and the Caribbean, while a continued decline in commodity prices has further weakened the external environment for most countries in South America. At the same time, domestic factors have added to external woes, contributing to depressed business and consumer confidence and, thereby, to lower private demand (Charts 1 and 2). And the moderation of commodity prices and high corporate leverage imply that investment is likely to remain subdued for an extended period.
Taken together, these developments suggest a further cooling of economic prospects in the region. In addition to lower growth projections for this year, we expect a weaker rebound in 2016.

**Disappointing growth in the South**

In Brazil, real GDP contracted in the first three months of the year. Preliminary data for the second quarter suggest a further deterioration, including in the labor market, even as inflation remains uncomfortably high. We now expect a stronger contraction in 2015, of about 1½ percent (½ percentage point lower growth rate than in our April projection). This reflects a significant contraction in private investment and a moderate decline in private consumption, owing to declining confidence attributable primarily to domestic factors. The economy is expected to register a modest recovery of around ¾ percent in 2016.

Some other countries in the South are expected to grow more rapidly in 2015 than in 2014, but at a lower rate than previously anticipated. Peru is a case in point, with higher growth in 2015, albeit ½ percentage point lower than in our April forecast. Similarly, in Chile, private demand has remained relatively lackluster despite an impulse from fiscal support, leading to a tempering of our growth projections to 2.5 percent in 2015 and 3.1 percent in 2016. In Colombia, we see a deeper deceleration in economic activity, although the country is still expected to grow by 3 percent in 2015 (about ½ percentage point lower than in our April forecast). On the positive side, well-anchored inflation expectations have allowed these countries room to maintain an accommodative monetary policy stance despite above-target inflation, which has helped to contain a stronger-than-expected deceleration in domestic demand. We expect stronger growth for these countries next year. In Argentina, economic activity is expected to remain flat in 2015 and 2016.
Weak commodity prices are also affecting other commodity exporters in the region. In particular, the impact of the decline in commodity prices has been magnified in Venezuela by years of unsustainable macroeconomic policies and heavy-handed microeconomic intervention. Venezuela continues to experience a deep recession, with GDP projected to contract by 7 percent and inflation to surpass 100 percent in 2015.

**Moderate growth in the North**

In Mexico, we are projecting the economy to grow by around 2½ percent this year. This is about ½ percentage point lower than in our April forecast; a revision that is attributed largely to temporary economic weakness in the United States in the first quarter of 2015 and a drop in oil production. Private consumption and investment have also disappointed so far. This said, the outlook for the Mexican economy remains brighter than in many of its Southern neighbors, since the U.S. recovery is expected to gather momentum going forward.

Similarly, for Central America, we have revised our April projections slightly downward to reflect the slower-than-expected U.S. expansion so far this year and expect the region to grow at about 4 percent in 2015. The Caribbean economy is projected to rebound in 2015-2016, including because of more robust tourism inflows.

**Multiple risks**

The region faces a number of risks. Continued economic slowdown in China and its impact on future commodity prices remains the overarching external risk to the region. At the same time, negotiations on Greece could still have negative implications for Latin America, although spillovers to asset prices (and, thus, economic activity) in the region have so far remained contained. Meanwhile, the United States has signaled the start of an interest rate rising cycle before year-end. This could increase market volatility and exchange rate pressures in Latin America and pose challenges for policymaking in the region. On the upside, however, the boost to trade from robust U.S. growth, which would accompany the Fed’s decision of raising interest rates, should provide a boost to economic activity, notably in Mexico and Central America.

Domestic risks are of equal concern. In particular, high corporate debt in the context of a tightening of external financial conditions could be a bigger drag on investment than is currently assumed. Moreover, from a longer-term perspective, the projected rebound in economic activity in 2016 and beyond would not materialize if business and consumer confidence remain stuck at their current low levels (or even recede further).

**Boosting the region’s resilience**

Going forward, structural reforms—especially deeper trade integration—and focusing government spending on infrastructure would enhance productivity, thus strengthening potential growth. Similarly, improving fiscal balances would ensure long-term debt
sustainability, while contributing to greater fiscal space for countercyclical policies when needed. Fiscal space is also necessary for furthering the social gains achieved in recent years, including a lowering of poverty and inequality.

Exchange rate flexibility continues to be fundamental to absorb external shocks, particularly in a more volatile global environment. And monetary policy frameworks that anchor inflation expectations will help contain excessive short-run fluctuations in economic activity.

Taken together, this set of policies would also bolster confidence in the region and further boost future economic activity.

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Alejandro Werner assumed his current position as Director of the Western Hemisphere Department of the International Monetary Fund in January 2013. A Mexican citizen, Mr. Werner has had distinguished careers in the public and private sectors as well as in academia. Most recently, he served as Undersecretary of Finance and Public Credit of Mexico from December 2006 until August 2010; was Professor of Economics at the Instituto de Empresa in Madrid Spain from August 2010 until July 2011, and Head of Corporate and Investment banking at BBVA-Bancomer from August 2011 until end-2012.

Previously he was Director of Economic Studies at the Bank of Mexico and professor at ITAM. He has published widely. Mr. Werner was named Young Global Leader by the World Economic Forum in 2007. Mr. Werner received his Ph.D. from the Massachusetts Institute of Technology in 1994.