

Latin America and the Caribbean: Managing Transitions



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With the [global economy](#) still struggling, many countries in Latin America and the Caribbean are facing a harsher world than they did just a few years ago. The growth outlook is weaker in advanced and emerging economies alike, while the gradual slowdown and rebalancing of economic activity in China is likely to keep commodity prices lower for longer. Meanwhile, favorable external financial conditions over the past several years have become more volatile, and risks of a sudden tightening are on the rise.

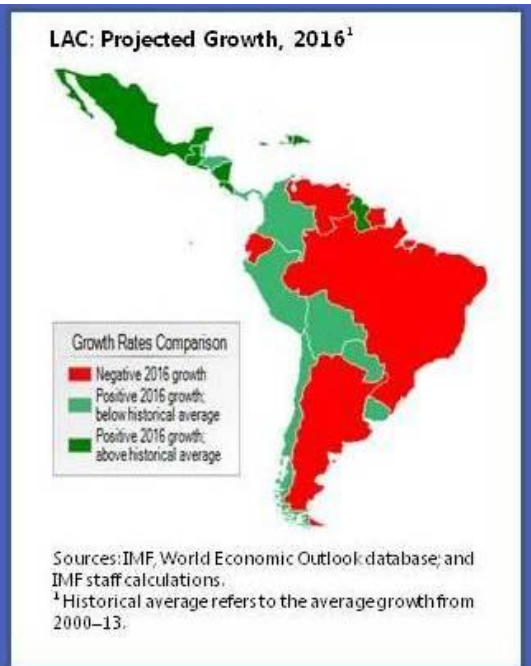
Against this backdrop, economic activity in Latin America and the Caribbean has been revised downward, compared with our [January update](#) and is likely to contract for a second consecutive year in 2016. But the growth outlook varies substantially within the region. While external conditions have placed a large drag on all commodity exporters, countries expected to post negative growth will do so mainly because of domestic imbalances and rigidities at home, and, in certain cases, temporary impact of policies designed to transition away from earlier distortions.

But the news isn't all bad. In the rest of the region—and particularly where policy frameworks have been strengthened over the past two decades—a relatively smooth adjustment continues. Given these broad contours, growth stories vary between the south and north.

Latin America and the Caribbean: Real GDP Growth¹
(Percent change)

	Projections		
	2015	2016	2017
Latin America and the Caribbean	-0.1	-0.5	1.5
South America ²	-1.4	-2.0	0.8
Excluding Argentina, Brazil, Ecuador, Venezuela	2.9	2.6	3.0
Central America	4.1	4.3	4.3
Caribbean	4.0	3.5	3.6
Latin America			
Argentina	1.2	-1.0	2.8
Brazil	-3.8	-3.8	0.0
Chile	2.1	1.5	2.1
Colombia	3.1	2.5	3.0
Mexico	2.5	2.4	2.6
Peru	3.3	3.7	4.1
Venezuela	-5.7	-8.0	-4.5

Sources: IMF, World Economic Outlook database; and IMF staff calculations.
¹ Regional aggregates are purchasing-power-parity GDP-weighted averages.
² Includes Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Paraguay, Peru, Uruguay, and Venezuela.



South America: Facing a harsher world

Most economies in South America are managing the transition to lower commodity prices in an orderly manner, with a policy mix that is supporting high employment and modest growth.

Chile's and *Peru's* macroeconomic frameworks allowed for countercyclical policies over 2014–15, and their economies are expected to continue to grow in 2016, at a slightly slower rate for Chile and a faster rate for Peru relative to 2015. Similarly, *Colombia* continues to grow at a modest rate, partly as a result of needed policy tightening. With this tightening, the current account deficit is expected to gradually reach a sustainable level.

Yet some countries are contracting, mostly on account of domestic factors.

In *Argentina*, the new government has embarked on an ambitious, much-needed transition to remove domestic imbalances and distortions and correct relative prices: foreign exchange controls were scaled back, several constraints on international trade have been removed, export taxes on agriculture products have been eliminated or reduced, utilities tariffs have been raised, and an agreement has been reached with hold-out creditors. These measures have improved growth prospects in the medium-term: although activity is projected to slow in 2016, an important recovery is expected for 2017.

Macroeconomic rigidities have prevented a smooth adjustment in *Ecuador*, and the economy is expected to contract this year, amid continued decline in oil prices, real exchange rate appreciation, and tight financing conditions, which would likely require further fiscal tightening.

Brazil is experiencing one of the deepest recessions in its history, driven by a combination of policy missteps, macroeconomic fragilities, and political problems. The deteriorating fiscal position and public debt dynamics have played an important role in the collapse in sentiment. The outlook will only start to look more promising when these uncertainties have been resolved and fiscal concerns are addressed.

Venezuela's economic conditions have deteriorated, with policy distortions and fiscal imbalances remaining unaddressed. Economic activity is expected to collapse by an additional 8 percent in 2016, and inflation is expected to exceed 700 percent, fueled by the monetization of the large fiscal deficit, an increase in the parallel market exchange rate, and the scarcity of basic goods.

Mexico, Central America, and the Caribbean: Modest growth

The outlook is brighter in Mexico and much of Central America and the Caribbean, where the gradual recovery in the United States has boosted external demand and lower oil prices have reduced costs, pushing growth above historical averages in many countries.

Mexico is expected to continue to grow at a moderate pace, although the poor performance of U.S. industrial production increases downside risks. With the oil price risk hedged, lower oil prices will have a limited impact on public finances in the near term, but a persistent decline would increase the fiscal consolidation burden in the medium term.

In *Central America*, a favorable outlook has triggered both fiscal and current account adjustment, but further efforts are needed to institutionalize fiscal discipline, build stronger fiscal buffers, and boost potential growth.

While low commodity prices continue to support the *tourism-based countries in the Caribbean*, growth prospects are deteriorating for commodity-based economies. Addressing fiscal

vulnerabilities and strengthening the financial sector remain overarching objectives for most Caribbean countries.

Risks: On the downside

Downside risks continue to weigh on the outlook. The region is vulnerable to a slower than expected recovery in China, further declines in commodity prices, and a further deterioration of the situation in Brazil. Despite sizable depreciations, the corporate sector has shown resilience so far. But bond debt has risen, is largely denominated in foreign currency, and is highly concentrated among a small number of firms. Although upcoming debt payments appear manageable given existing buffers, the recovery in investment could be more challenging given the current state of the world, with persistent depreciations, low profitability, increased financial volatility, and lower commodity prices.

Policies: Tailored to managing transitions

Medium-term growth throughout the region is now projected to be much lower than what was believed not long ago, given that commodity exporters need to reallocate capital and labor out of resource-intensive sectors, and other economies need to replenish their capital stocks. Continued economic development in the region will require policies that are tailored to managing the transition to lower commodity prices, while also reducing poverty and inequality and addressing the bottlenecks that have long hampered investment and productivity in the region, without derailing the important gains in macroeconomic stability that have served the region so well.

Fiscal policy space is constrained by rising public debt and new realities of slower growth and lower revenues, including from commodities. Fiscal adjustment has begun in many countries, but economies should continue to preserve or rebuild buffers. Countries with low debt levels can afford to have a slower pace of adjustments, while those with higher debt levels are facing a harsher reality—reflected in higher financing costs—and will need to adjust sooner.

Monetary policy in the region has prudently supported this transition so far. Many countries with flexible exchange rates have experienced large exchange rate adjustments, and these depreciations have been among the largest and the most persistent in decades. In contrast to the past, however, large currency depreciations have generally not translated into runaway inflation, owing to the decline in exchange rate pass-through reflecting the implementation of more credible monetary policy regimes. Nevertheless, in some countries, inflation has increased beyond the direct effects of depreciations, and in many parts of South America inflation is above the central banks' target range. As a result, central banks in some of these countries have preemptively raised policy interest rates to prevent an increase in medium-term inflation expectations. Given weak growth prospects, countries with well-anchored inflation expectations can still afford to keep monetary policy accommodative.

The policy constraints and the markdown of medium-term growth underscore the importance of structural reforms to address the region's declining productive capacity. Inadequate infrastructure has been widely viewed as one of the principal barriers to growth in Latin America and the Caribbean. The region's infrastructure network has been upgraded over the past decade, but still compares relatively poorly with trade competitors. Increasing the efficiency of public investment would help close the gap. In addition, structural policies aimed at addressing shortcomings in quality of education, increasing export diversity and complexity, and improving financial market development could help boost potential output.

Alejandro Werner assumed his current position as Director of the Western Hemisphere Department of the International Monetary Fund (IMF) 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-July 2011), and was 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.